HERITAGE CAPITAL LLC

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## Stock Market Behavior Models for the Day

As with every Federal Open Market Committee (FOMC) statement day, there is a model for the stock market to follow pre and post announcement. Certain environments have very strong tendencies while others do not. Over the past few meetings, many of the strongest trends were muted.

As with most statement days, the model for the day calls for stocks to return plus or minus 0.50% until 2:00 PM. There is a 90% chance that occurs. If the stock market opens outside of that range, there is a strong trend to see stocks move in the opposite direction until 2:00 PM. For example, if the Dow opens down 1%, the model says to buy at the open and hold until at least 2:00 PM.

With stocks somewhat on the defensive lately, the next model calls for stocks to close higher today and rally after 2:00 PM. That is usually a very strong trend, 80%+, but it would have been stronger in magnitude had Tuesday's early weakness not been overcome. Last meeting, this trend did not work as early strength on Fed day was sold in to and then piled on.

**Rate Hike - One Down, Three to Go**

The Fed is going to take no action today. At best, their commentary will be benign. At worst, Powell and company will upgrade their economic forecast which will also increase the likelihood for three or even four more rate hikes this year. June becomes the "live" meeting where rates should go up by another 1/4%. Then September and December. Back in January, I forecast 3.5 rate hikes this year with the risk to the upside. I am standing by that.

To reiterate what I have said for more than a year but a little more bluntly, the Fed is misguided, arrogant and in desperate need of help. NEVER before have they sold balance sheet holdings in the open market AND raised interest rates. In fact, I don't think it's ever been done in the world before. So why on earth do they believe they will so easily be successful? This grand experiment is going to end poorly and we are all going to suffer at the hands of the next recession which I stabbed in the dark as beginning between mid 2019 and mid 2020.

Yes, with banks holding $2.5 trillion on their balance sheets, the recession should be mild and look nothing like 2007-2009. And yes, this expansion will be more than 10 years old. And yes, there will be some external trigger like 9-11 or the S&L Crisis to push the economy over. But the Fed will have greased the skids sufficiently for the economy to recess.

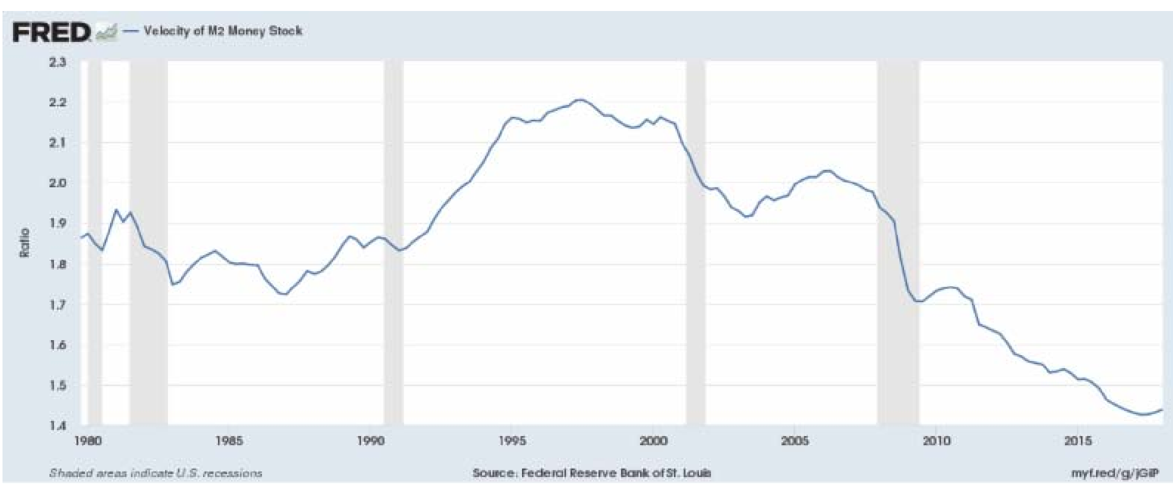
Let's remember that the Fed was asleep at the wheel before the 1987 crash. In fact, Alan Greenspan, one of the worst Fed chairs of all-time, actually raised interest rates just before that fateful day, stepping on the throat of liquidity and turning a routine bull market correction into a 30% bear market and crash. In 1998 before Russia defaulted on her debt and Long Term Capital almost took down the entire financial system, the Fed was raising rates again. Just after the Dotcom Bubble burst in March 2000, ole Alan started hiking rates in May 2000. And let's not even go to 2007 where Ben Bernanke whom I view as one of the greats, proclaimed that there would be no contagion from the sub prime mortgage collapse.

Yes. The Fed needs to stop.

**Velocity of Money Most Important**

Below is a chart I have shown at least quarterly since 2008. With the exception of a brief period from mid 2009 to mid 2010, the velocity of money collapsed. It's still too early to conclude, but it does look like it stopped going down in 2017 and might be just slightly starting to turn up. If 2017 does turn out to be the bottom, this could could eventually lead to the commodity boom I see for the 2020s, especially ex energy.

In the easiest terms, M2V measures how many times one unit of currency is turned over a period of time in the economy. As you can see, it's been in a disastrous bear market since 1998 which just so happens to be the year where the Internet starting becoming a real force in the economy. Although it did uptick during the housing boom as rates went up, it turned out to be just a bounce before the collapse continued right to the present.




This single chart definitely speaks to some structural problems in the financial system. Money is not getting turned over and desperately needs to. The economy has been suffering for many years and will not fully recover and function normally until money velocity rallies. This is one chart the Fed should be focused on all of the time.

It would be interesting to see the impact if the Fed stopped paying banks for keeping reserves with the Fed. That could presumably force money out from the Fed and into loans or other performing assets. It continues to boggle my mind why no one called the Fed out on this and certainly not Yellen at her quarterly press conferences. Hopefully, someone will question Chairman Powell on this next month.

**To Your Financial Success,**

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