POTOMAC WEALTH ADVISORS, LLC

Here's To Your Wealth

Q4 Outlook: Stocks Need A Catalyst To Move Higher

Dear Mark,

The first nine months of this year have produced strong returns and stocks are now trading near their historical norm relative to forward looking earnings projections. In the near term, we may be stuck in a trading range with wide volatility. There is no clear catalyst, other than perhaps a China trade deal, for stocks to move higher. Absent a China trade deal, global economic and political factors will dominate and may negatively impact stock prices. As a result, we suggest investors remain patient and remember that investing is a long-term proposition that needs to be void of emotion.

Below is a summary of a few key points to consider as well as an October 3 clip from Mornings With Maria where I emphasize that while a recession isn't imminent, investors should expect volatility.

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European economies are at a standstill. Central Bank easing has reached the limit of effectiveness. The European Union economy expanded 1.4 percent year-over-year in the second quarter of 2019, easing from a 1.6 percent gain in first quarter. It was the weakest growth rate since the third quarter of 2013 and the trend is downward.

Europe's economies will remain weak. Fiscal policy and regulatory reform would help, but the governments in place seem reticent to embrace capitalism and corporate profits. The irony is their social safety nets and progressive programs rely on strong corporations and profits; yet current policies are restrictive. As a result we have seen a decade of sluggish growth, sky-high youth unemployment, riots in

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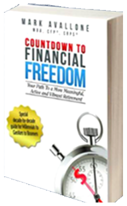

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Paris, annual Italian budget crises, massive layoffs in the financial sector and a near collapse of several major banks.

China is slowing due to the trade war. If the U.S. goal was to inflict economic pain that is working; but if the goal was capitulation they are 100% mistaken.

Xi's National Day comments were a clear directive to the U.S. and Hong Kong and sent a message re: China's objective of global hegemony. They have no intention of being subservient to the U.S. especially in a negotiation with a tweeter who will smack them down and take a victory lap.

Chinese negotiators have signaled they aren't on board with a hard-line strategy and have been urging calm and a 'rational attitude' in the negotiation. The U.S. should pursue a unified, global approach that is more off-the-radar - and that is not happening. The Chinese believe they are at least our economic (and military) peer and are intent on passing us. Thinking that we will 'defeat' them with a punitive trade deal is ludicrous. They do not have elections and they can - and will - wait us out.

At home, policy (and trade) uncertainty needs to be removed. The U.S. manufacturing sector is slowing and the labor market appears to be peaking.

Business spending and capital investments are slowing here and abroad, and it is largely due to the uncertainty around trade. The recent purchasing managers index (PMI) and The Institute for Supply Management (ISM) reports reflect the slowdown.

Recession is unlikely in the next year, but if the economy slows, we may see lower rates. However, at this point lower rates will have muted benefit on the economy. They could create a floor but not a catalyst for stock prices. We need the overseas economies to also get on track which would help earnings which in turn would drive stocks higher. Ultimately, earnings are the number one driver for stock prices.

The next stock correction could be violent since many investors have stretched into equity for yield, return and greed. When losses start, look for a rush to the exit from investors and program selling. Timing this is difficult and in the recent past we have seen several sharp corrections followed by swift recoveries.

Q4 stock performance will look like Q3 - up only slightly with wide volatility. Disappointing earnings and global growth will be the main overhang on stocks and keep them (best case) range bound in the near term.

Short of economic collapse, the Fed will not lower rates in Q4. Stock shouldn't cheer the next Fed cut - any cut will be from a reluctant Fed due to anemic growth. It's better if rates do not go lower. Just look at how very low and negative rates in Europe have not had the desired effect and, in fact, have hurt financials with far reaching implications.

Political uncertainty at home could also drag on the U.S. economy. A near total focus on impeaching President Trump has become a distraction from what might otherwise produce positive legislation for the economy and stocks.

The best hope for stocks is fiscal and regulatory reform in Europe and a (modest) trade deal with China. Short of that, stocks may be stuck in a trading range and investors would be wise to manage their expectations.

Please call us if you have any questions about your unique situation.

Thank You From The Entire Potomac Wealth Advisors, LLC Team.

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