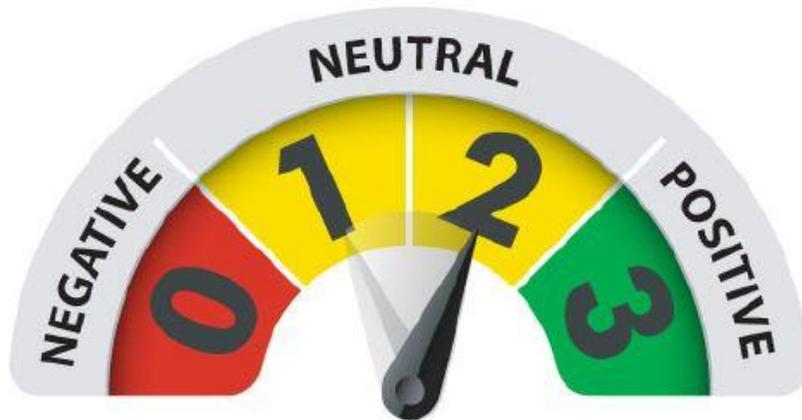


M MIDWEST
F FINANCIAL



Market Condition*
NUMBER OF INDICATORS IN POSITIVE STATUS

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The SITREP for the week ending 04/12/2019

Please NOTE: Changes from last week's SITREP are highlighted.

The very big picture:

The long-term valuation of the market is commonly measured by the Cyclically Adjusted Price to Earnings ratio, or "CAPE", which smooths out shorter-term earnings swings in order to get a longer-term assessment of market valuation. A CAPE level of 30 is considered to be the upper end of the normal range, and the level at which further PE-ratio expansion comes to a halt (meaning that increases in market prices only occur in a general response to earnings increases, instead of rising "just because"). The market is currently at that level.

Of course, a "mania" could come along and drive prices higher – much higher, even – and for some years to come. Manias occur when valuation no longer seems to matter, and caution is thrown completely to the wind as buyers rush in to buy first and ask questions later. Two manias in the last century – the 1920's "Roaring Twenties" and the 1990's "Tech Bubble" – show that the sky is the limit when common sense is overcome by a blind desire to buy. But, of course, the piper must be paid and the following decade or two are spent in Secular Bear Markets, giving most or all of the mania gains back.

See Fig. 1 for the 100-year view of Secular Bulls and Bears. The CAPE is now at 31.28, up from the prior week's 31.13, above the level reached at the pre-crash high in October, 2007. Since 1881, the average annual return for all ten year periods that began with a CAPE around this level have been in the 0% - 3%/yr. range. (see Fig. 2).

In the big picture:

The "big picture" is the months-to-years timeframe – the timeframe in which Cyclical Bulls and Bears operate. The U.S. Bull-Bear Indicator (see Fig. 3) is in Cyclical Bull territory at 65.47, up from the prior week's 63.70.

In the intermediate and Shorter-term picture:

The Shorter-term (weeks to months) Indicator (see Fig. 4) turned **negative** on March 22nd. The indicator ended the week at 33, up from the prior week's 30. Separately, the Intermediate-term Quarterly Trend Indicator - based on domestic and international stock trend status at the start of each quarter – was **positive** entering April, indicating positive prospects for equities in the second quarter of 2019.

Timeframe summary:

In the Secular (years to decades) timeframe (Figs. 1 & 2), the long-term valuation of the market is historically too high to sustain rip-roaring multi-year returns. The Bull-Bear Indicator (months to years) remains positive (Fig. 3), indicating a potential uptrend in the longer timeframe. In the intermediate timeframe, the Quarterly Trend Indicator (months to quarters) is positive for Q2, and the shorter (weeks to months) timeframe (Fig. 4) is negative. Therefore, with two indicators positive and one negative, the U.S. equity markets are rated as **Neutral**.

In the markets:

U.S. Markets: Most of the major U.S. indexes recorded small gains for the week. Trading volumes, however, were notably lower with daily volumes hitting new year-to-date lows on Monday, Wednesday, and Thursday of the week. The narrowly-focused Dow Jones Industrial Average ended the week down 12 points, or -0.05%, to close at

26,412. The technology-heavy NASDAQ Composite gained 0.6% and neared the 8000-level, closing at 7,984. By market cap, the large cap S&P 500 index gained 0.5% for the week (and in the process moved within roughly 1% of its all-time high established in September 2018), while the S&P 400 mid cap index rose 0.9% and the small cap Russell 2000 gained a lesser 0.1%.

International Markets: Canada's TSX rose 0.5%, while the United Kingdom's FTSE retreated -0.13%. On Europe's mainland, France's CAC 40 rose 0.5%, but Germany's DAX retreated -0.08%. Italy's Milan FTSE also gained 0.5%. In Asia, China's Shanghai Composite retreated -1.8% following last week's big 5% surge. Japan's Nikkei tacked on an additional 0.3% to last week's gain. As grouped by Morgan Stanley Capital International, developed markets rose 0.3%, while emerging markets were off -0.1%.

Commodities: Precious metals finished the week down slightly. Gold ticked down \$-0.40 to \$1295.20 an ounce, while Silver dipped -0.8% to \$14.96. Energy continued to rally, now up 6 weeks in a row. West Texas Intermediate crude gained 1.3%, finishing the week at \$63.89 per barrel. The industrial metal copper, viewed by analysts as a barometer of global economic health due to its variety of uses, retraced all of last week's decline and then some by rising 1.8%.

U.S. Economic News: For the first time in 50 years, the number of claims for first-time unemployment benefits fell below 200,000. The Labor Department reported the number of new jobless claims fell by 8,000 to just 196,000 last week. Economists had expected a reading of 210,000. Jobless claims have fallen four weeks in a row, just a few months after hitting a short-term high of 244,000. The monthly average of claims, smoothed to iron out the weekly volatility, declined by 7,000 to 207,000. That number was also near its lowest level since 1969. Continuing claims, which counts the number of people already receiving benefits, fell by 13,000 to 1.71 million.

The amusingly-named JOLTS report (Job Openings and Labor Turnover Survey) showed the number of job openings across the country fell to its lowest level in nearly a year, said the Labor Department. Job openings fell by more than half a million to 7.1 million in February, its lowest level since March 2018. The U.S. added only 33,000 new jobs, the smallest increase in a year and a half. Economists blamed a severe cold spell, the residual effects of the government shutdown and other seasonal disruptions for the unusually small gain. However, even after the significant drop there still remain almost 800,000 more open jobs available than the number of Americans officially classified as unemployed. The closely watched "quits rate" part of the JOLTS report remained at 2.3% for the ninth month in a row. The quits rate gives an underlying view of the strength of the labor market as it is presumed that an employee would most likely only leave a position if he or she had a high confidence in finding another, more lucrative one. The current rate is the second-highest it's been since the government began keeping track in 2000.

Sentiment among the nation's small business owners ticked up in March, remaining at a historically strong level. The National Federation of Independent Business (NFIB) reported its Small Business Optimism Index increased 0.1 point to 101.8. The reading marked the third month in a row remaining at or near its highs. In the details, 23% of business owners surveyed by NFIB said the next three months was a good time to expand, a point higher than last month. In addition, 60% reported hiring or trying to hire new employees, but 54% reported few or no qualified applicants for the positions they were trying to fill. Over 20% cited the difficulty of finding qualified workers as their Single Most Important Business Problem—just 4 points below the record high.

Consumers paid more for gas and rent last month, but broader inflationary pressures remained contained, according to the Bureau of Labor Statistics. The government reported the Consumer Price Index (CPI) jumped 0.4% in March, the biggest increase in over a year. The reading matched economists' forecasts. Over the past year, the cost of living has increased 1.9%, up from 1.5% in February. The majority of the increase in March was due to higher energy prices. Stripping out the volatile food and energy categories, so-called "core" CPI was up just 0.1%. Furthermore, the annual core CPI slipped to 2% from 2.1%. That's the lowest level in a year.

At the producer level, wholesale prices surged due to the higher cost of energy, but overall inflation remained tame. The Bureau of Labor Statistics reported its Producer Price Index (PPI) climbed 0.6% last month. Economists had expected just a 0.3% increase. Almost all of the increase was due to the higher cost of gas. Stripping out food and energy prices, core PPI was flat for the month. The rate of wholesale inflation over the past 12 months rose 0.3% to 2.2% in March, but that remained far below the seven-year high last summer of 3.4%. The reading reinforces the belief that significant inflation isn't on the horizon, at least not yet. Economists Gregory Daco and Jake McRobie of Oxford Economics told clients in a note, "We believe this tame inflationary environment continues to provide the Fed with reason to remain patient as it assesses economic and inflation conditions."

The Federal Reserve's decision last month to cease raising interest rates this year was driven by concerns over the U.S. and global economies and surprisingly tame domestic inflation data, Fed meeting minutes showed. Last month the Fed aborted plans to keep raising key short-term interest rates, with Chairman Jerome Powell stating the Fed would remain "patient". On the Fed's list of worries: sluggish U.S. growth early in the new year, a weaker global economy, the messy attempt by the U.K. to leave the European Union and festering trade tensions between the Trump administration and China. "A majority of participants expected that the evolution of the economic outlook and risks to the outlook would likely warrant leaving the target range unchanged for the remainder of the year," the minutes said. With regards to inflation, the Fed stated, "It was noteworthy that [inflation] had not shown greater signs of firming in response to strong labor market conditions and rising nominal wage growth, as well as to the short-term upward pressure to prices arising from tariff increases."

International Economic News: The International Monetary Fund lowered its expectation of economic growth in Canada to 1.5%, down -0.4% from its previous forecast. The reduction was due to an overall lowering of its forecast for global economic growth. However, an alternative economic outlook projected Canadian growth to be even lower. Management consulting firm Deloitte stated it projects the Canadian economy will grow by a "weak" 1.3% this year, and a slightly better 1.5% in 2020. Deloitte stated, "Growth is unlikely to bounce back substantially in early 2019 as drag from residential investment and cautious households weighs on growth." The Deloitte report said that modest growth leaves the Canadian economy more vulnerable to unexpected negative shocks, though Deloitte didn't quite forecast a recession. Rather than be rattled by potential risk, it suggested companies "adapt, innovate and overcome."

The United Kingdom's Office for National Statistics reported the economy unexpectedly grew by 0.2% in February, but the number didn't necessarily mean the economy was on a sustainable growth path. Analysts were quick to point out that the key driver to the unexpected burst of activity appeared to be stockpiling by manufacturers ahead of Brexit, or Britain's exit from the European Union. The Office of National Statistics reported manufacturers "...changing the timing of their activities..." as a key reason for the increase. Economists in a Reuters poll had expected zero growth. The International Monetary Fund said that Britain would grow 1.2% this year if it can avoid the shock of a no-deal Brexit.

On Europe's mainland, French Finance Minister Bruno Le Maire stated this week that with global growth already slowing down, starting a trade war now between the U.S. and European Union would be both a political and economic mistake. U.S. President Donald Trump had tweeted that the European Union was "a brutal trading partner". The French minister stated, "We have to avoid a trade war. We're facing a slowdown both at the global level and the European level and the reason why there is such an economic slowdown is that there are trade tensions all over the world." Since taking office, Trump has called out major trading partners including the EU, China and Canada for what he deemed unfair practices that adversely affected American workers and companies.

The German government is expected to cut its economic growth forecast for this year in half from 1% to just 0.5%, Der Spiegel reported. The reduction is due to weaker exports experienced by Europe's economic powerhouse in the wake of global trade tensions. For 2020, the government expects gross domestic product to grow by 1.5%, helped in part because of positive calendar effects from four public holidays falling on weekends. Germany's leading economic institutes last week also revised down their 2019 growth forecast to 0.8% from a previous estimate of 1.9%. New data released this week showed that German exports and imports had fallen more than expected in February, seeming to confirm the negative forecasts.

In Asia, the latest trade data out of Beijing showed China's trade surplus last month soared past expectations. Customs data showed that China's exports for the month of March came in much higher than expected, while its imports came in much lower than expected. Dollar-denominated exports rose 14.2% for March from the same time last year, blowing away expectations of just a 7.3% increase. Furthermore, dollar-denominated imports were down 7.6% over the past year in March, falling far more than the expectations for just a 1.3% decline. The numbers suggest domestic demand remained weak. However, analysts noted that the export gains may have been due more to seasonal factors rather than a turnaround in global demand. The long Lunar New Year holidays hit February's business activity particularly hard, causing a jump in shipments in March.

Despite record immigration, Japan's population decline is accelerating, threatening future economic growth. According to the latest figures from the Ministry of Internal Affairs, the native population fell by more than 430,000 people last year—about the size of a mid-size city, and the pace is expected to continue for the foreseeable future. That number was partially offset by a record net inflow of more than 161,000 migrants. However, the overall pace of decline still hit a new high of -0.21% of the population. The latest population figures show 126.4 million people, down from a peak of 128 million in 2010. Akihiko Matsutani, professor emeritus in applied economics at the National Graduate Institute for Policy Studies stated, "The reason Japan's population is now falling so fast is not the low birth rate but rather an increase in the number of deaths." Japan had a baby boom before the Second World War because of military pressure to increase the birth rate, he added. "Those people are now reaching the age of passing away," said Prof Matsutani.

Finally: Filed under "How is this possible?" analysts are at a loss to explain how the stock market continues to rally amid an exodus of investors in U.S. equity funds. U.S. stocks posted their best quarter in nearly a decade at the end of March, but they did so without the help of investors in U.S. stock mutual funds and exchange-traded funds. According to data from Lipper and EPFR Global, those funds have seen sizeable outflows since the beginning of the year. Jared Woodward, investment strategist at Bank of America Merrill Lynch (and the source for the chart below), said although it isn't unprecedented for equity fund flows to be negative while stock prices climbed, the pace and magnitude of the stock market's rise and equity outflows are much greater so far this year. Back in 2016, equity outflows totaled \$93 billion, but the accompanying 5% rise in global stocks was far less

potent than this current period, the analyst said. Woodward and his colleagues theorized that the divergence between outflows and concurrent outside gains can perhaps be explained by corporate buybacks. S&P 500 firms have repurchased \$227 billion of their own stock in the first quarter of 2019, according to FactSet data, up sharply from the already-huge \$143 billion in buybacks in the first quarter of 2018.

Chart 1: Worst start to year for equity flows since 2008



Source: BofA Merrill Lynch Global Investment Strategy, EPFR Global

(sources: all index return data from Yahoo Finance; Reuters, Barron's, Wall St Journal, Bloomberg.com, ft.com, guggenheimpartners.com, zeroedge.com, ritholtz.com, markit.com, financialpost.com, Eurostat, Statistics Canada, Yahoo! Finance, stocksandnews.com, marketwatch.com, wantchinatimes.com, BBC, 361capital.com, pensionpartners.com, cnbc.com, FactSet; Figs 1-5 source W E Sherman & Co, LLC)

The ranking relationship (shown in **Fig. 5**) between the defensive **SHUT** ("S"=Staples [a.k.a. consumer non-cyclical], "H"=Healthcare, "U"=Utilities and "T"=Telecom) and the offensive **DIME** sectors ("D"=Discretionary [a.k.a. Consumer Cyclical], "I"=Industrial, "M"=Materials, "E"=Energy), is one way to gauge institutional investor sentiment in the market. The average ranking of Defensive SHUT sectors **declined to 8.50 from the prior week's 7.25**, and average ranking of the Offensive DIME sectors **rose to 15.25 from the prior week's 16.00**. The Defensive SHUT sectors' **lead over Offensive DIME sectors shrank**. Note: these are "ranks", not "scores", so smaller numbers are higher ranks and larger numbers are lower ranks.

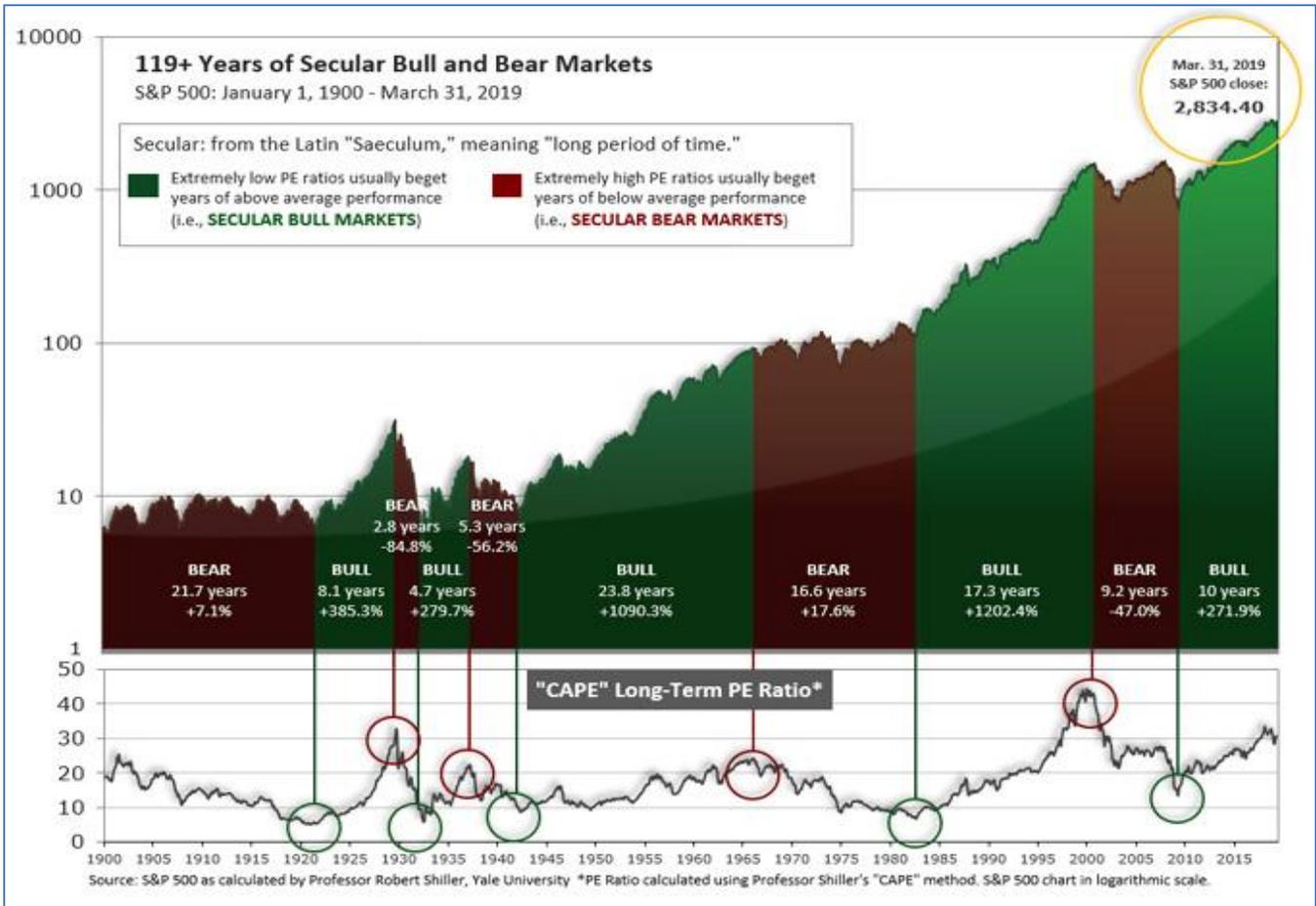


Fig. 1



Fig. 2

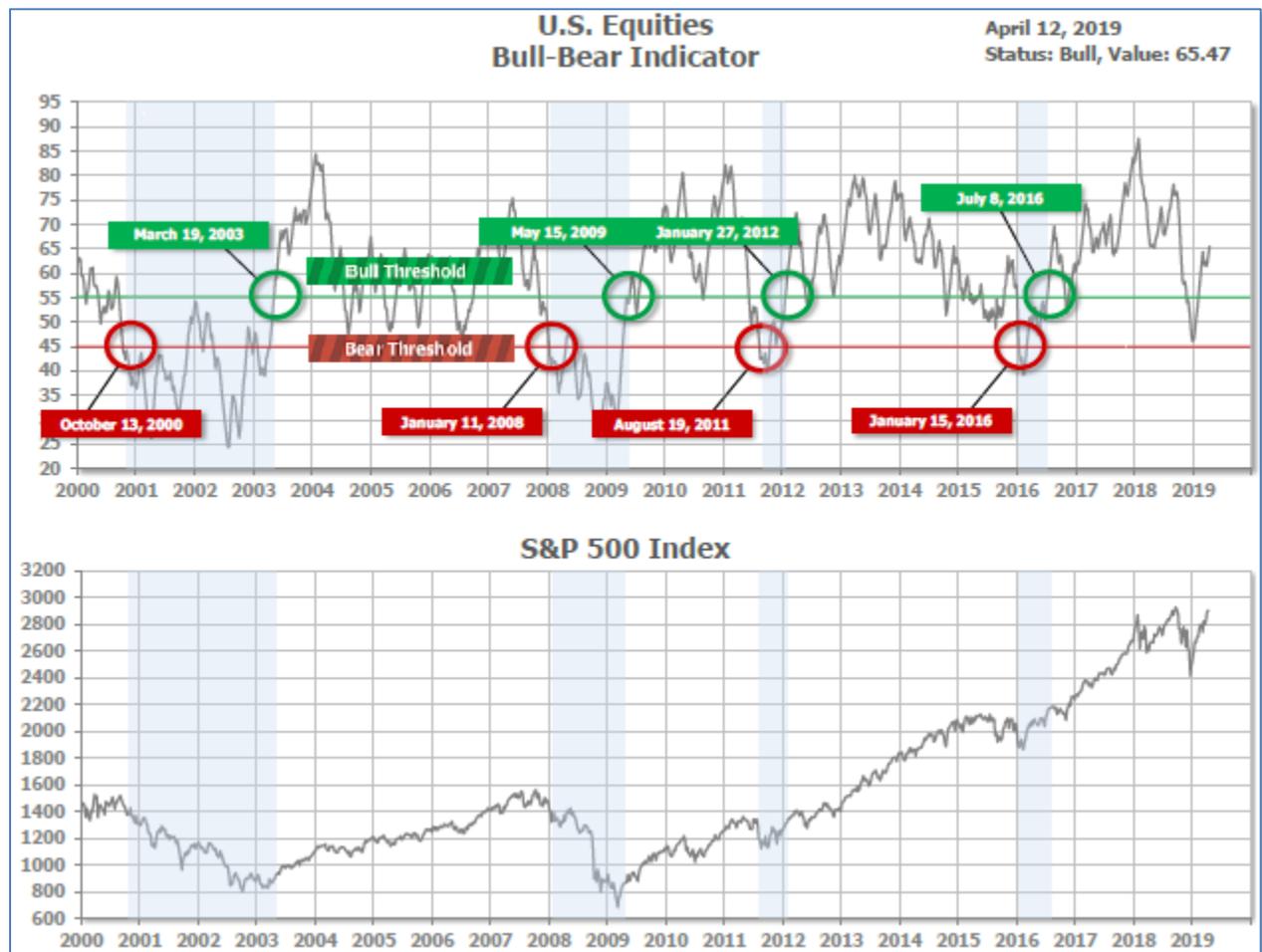


Fig. 3

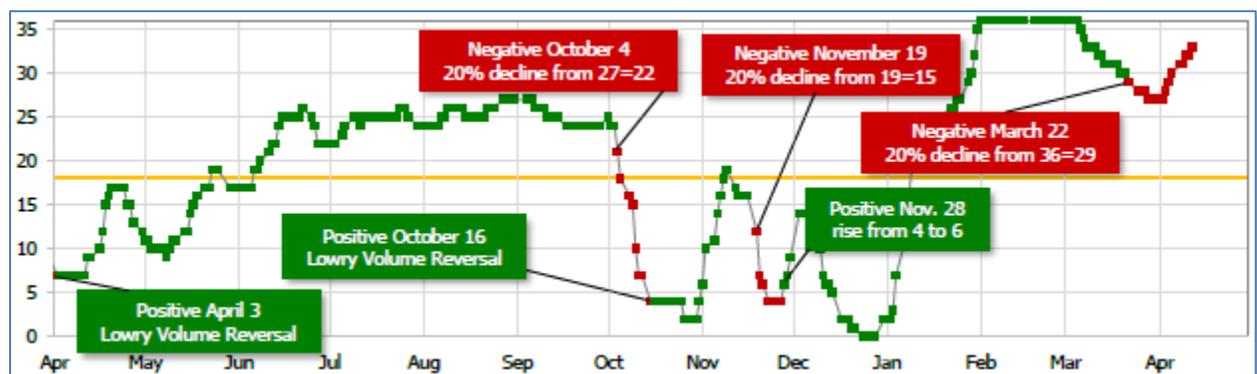


Fig. 4

U.S. Intermediate-Term Asset Class Rankings

Major Asset Classes		Type	Rank	Week Ago Rank
Above Average - best for new positions	Real Estate	283	1	2
	Utilities	3	2	1
	Technology	3	3	3
	Telecom	3	4	4
	Nasdaq 100	1	5	5
	LargeCap Growth	1	6	6
	Industrial	3	7	7
	Consumer Cyclical	3	8	10
	LargeCap Blend	1	9	9
	Dow 30	1	10	8
	Emerging Markets	2	11	14
	LargeCap Value	1	12	12
Above Avg	Consumer Non-Cyclical	3	13	13
US Mkt Avg	Russell 3000 Index		14	15
Below Average	Healthcare	3	15	11
	Financial	3	16	16
	Developed Int'l Markets	2	17	17
	MidCap Growth	1	18	18
	MidCap Blend	1	19	20
	MidCap Value	1	20	19
	Basic Materials	283	21	22
	SmallCap Blend	1	22	21
	SmallCap Growth	1	23	23
	SmallCap Value	1	24	24
	Energy	3	25	25
	CASH (1-3 mo T-Bills)		26	26

Fig. 5

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"Good risk managers are unapologetic about taking actions to avoid or mitigate risk - even if the actions don't always pay off - because they know that in the long run, their investors will survive the trip when other investors are left in smoking ruins at the side of the road to retirement."