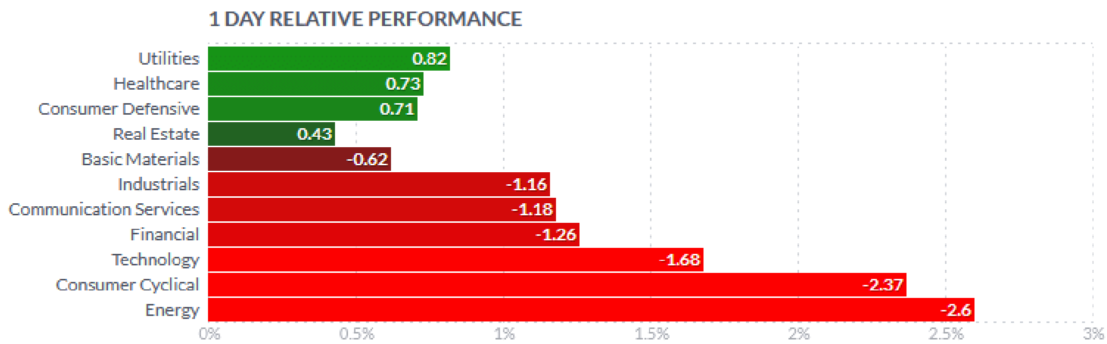
High dividend stocks rose yesterday despite weakness in the major indexes. The weakness in the market was not surprising as we noted in this past weekend's newsletter.

> "**Such also suggests that we will see some additional *?sloppy?* action next week heading into options expiration next Friday.** However, that weakness should provide the base for the year-end rally to commence from."

This morning stocks are opening weaker again as we head into the Fed meeting on Wednesday.

However, yesterday, high dividend stock sectors like Utilities, Healthcare, Consumer Defensive, and Real Estate were strong while the S&P fell almost 1%. Energy and Consumer Cyclicals, which also are high dividend stocks, led the way lower with losses greater than 2%. The recent CPI inflation report was hot at 6.8%, yet inflation expectations are declining. Since mid-November, the implied 5-year breakeven inflation rate has fallen over .40%. As judged by the recent outperformance of the Consumer Defensive, investors are betting the Fed will become more aggressive and win the fight against inflation.



[dmc]

What To Watch Today

Economy

- 6:00 a.m. ET: **NFIB Small Business Optimism**, November (98.4 expected, 98.2 in October)
- 8:30 a.m. ET: **Producer Price Index (PPI)**, month-over-month, November (0.5% expected, 0.6% in October)
- 8:30 a.m. ET: **PPI excluding food and energy,** month-over-month, November (0.4% expected, 0.4% in October)
- 8:30 a.m. ET: **PPI year-over-year,** November (9.2% expected, 8.6% in October)
- 8:30 a.m. ET: **PPI excluding food and energy,** year-over-year, November (7.2% expected, 6.8% in October)

Earnings

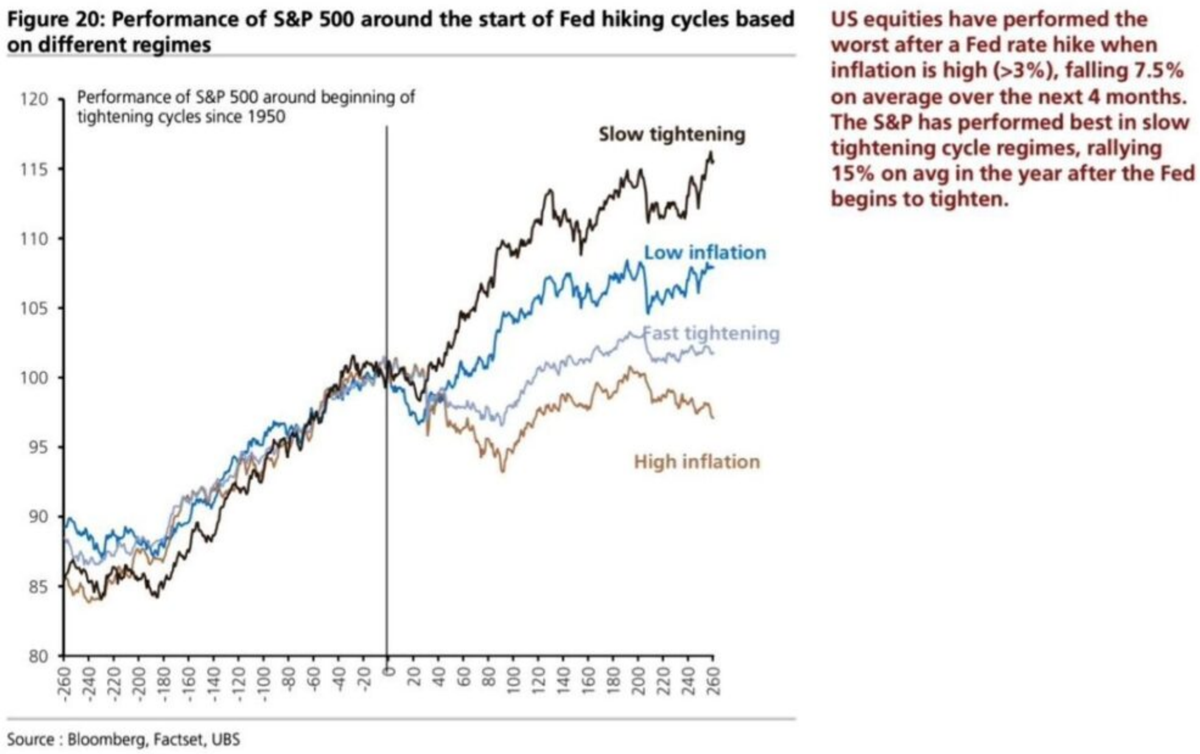
- *No notable reports scheduled for release*

Is Fed Tightening Good or Bad for Stocks?

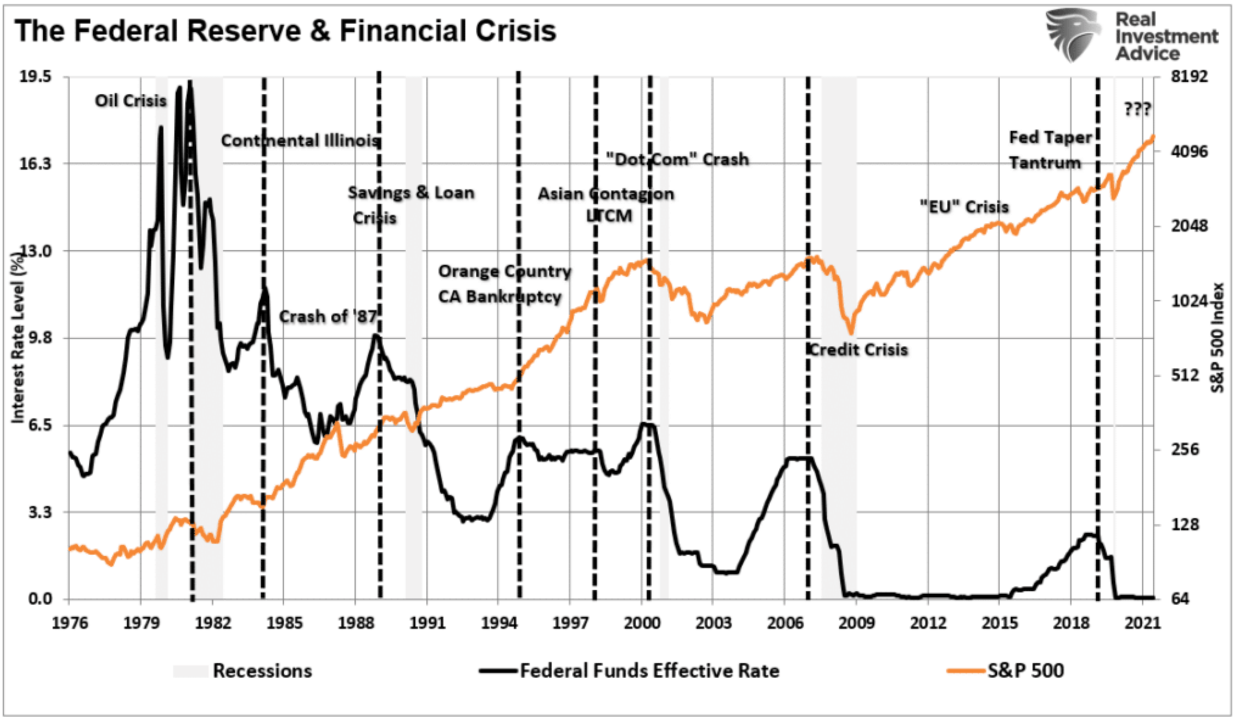
Over the course of the next few months, you are going to see a lot of articles suggesting that initial rate hikes from the Fed don't impact stocks. [Such as this one:]

> ?Historical analyses put together by Evercore ISI?s Ed Hyman and The Sevens Report?s Tom Essaye show that **the S&P 500 typically fares well when the Fed raises rates for the first time in a tightening cycle**.
>
> **For example, the Fed embarked on a rate hike cycle on June 30, 1999, when it raised rates by a quarter-point to 5%. The S&P 500 rose 7% from there to post a gain of 19.5% for the year.? -** Fred Imbert, CNBC

The graph below from UBS makes answering that question difficult. S&P 500 performance is negative when the Fed tightens in a high inflation environment. Today's inflation environment certainly falls into that category. However, before preparing for poor performance, consider that historically slow tightening provides a great outcome.

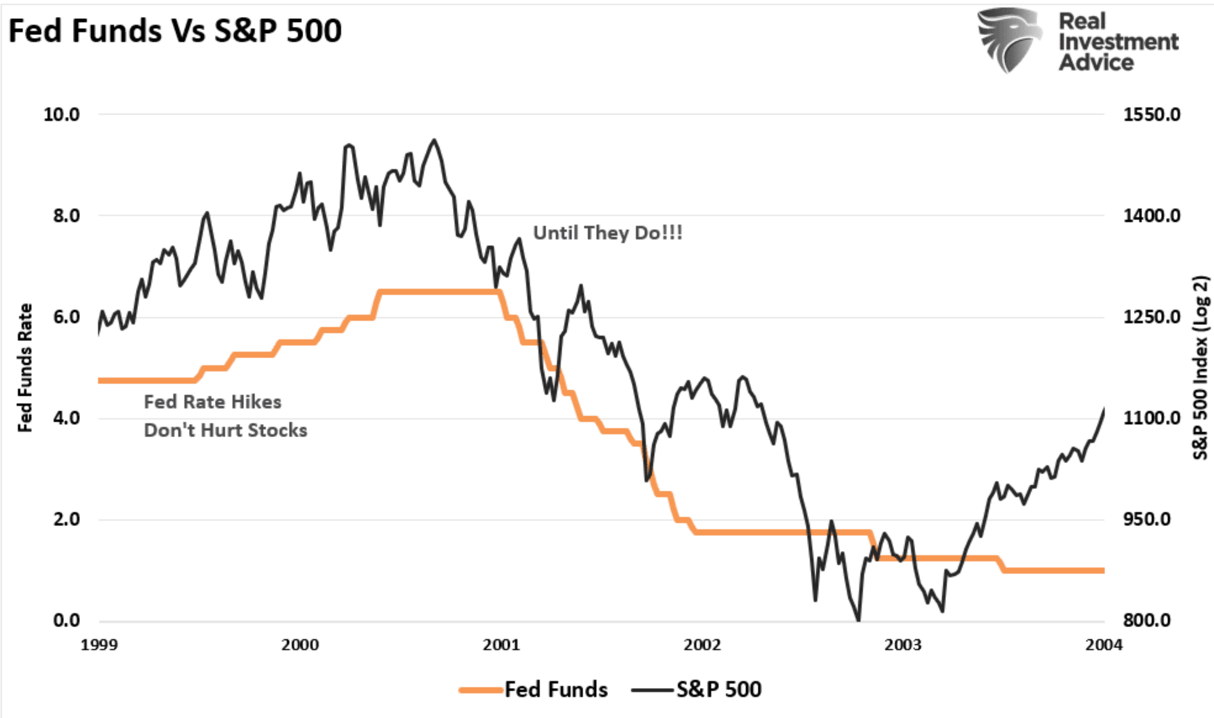


However, when the Fed initially starts hiking rates, it is usually during a strongly trending bull market. Much like a car rolling downhill in neutral, tapping the brakes initially doesn't do much to curb the momentum. However, keep pushing on the brake pedal long enough, and the car will slow to stop. There are two things to take away from the chart below.



For stocks, the risk is not the initial rate hike, or the second, or even the third. It is the point where the increase in rates causes something to break either in the economy, credit markets, or a change in bullish psychology. **Secondly, without exception, rate-hiking campaigns led to a negative outcome. Furthermore, the negative impact occurred at consistently lower levels.**

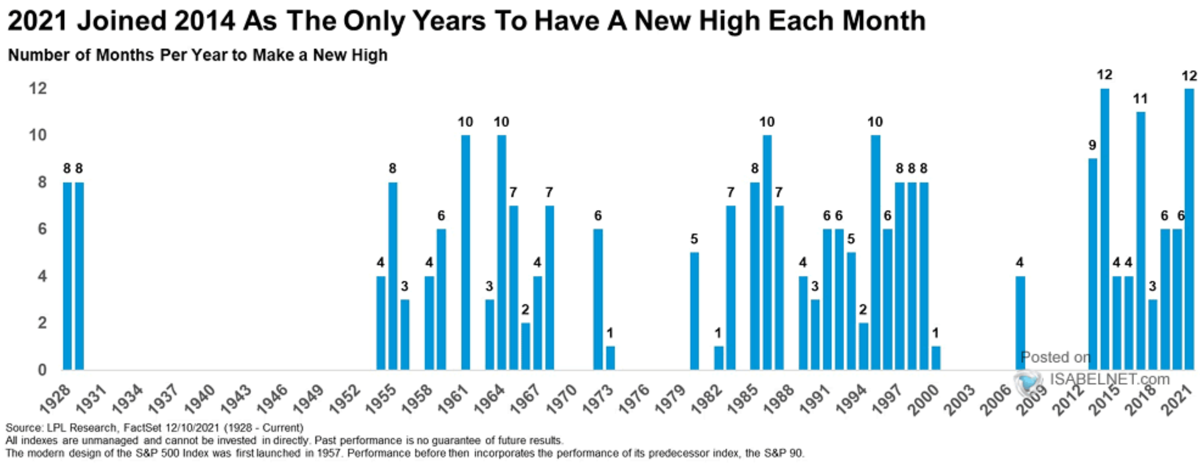
So, while stocks rose 7% in 1999 after the Fed hiked rates, in 2000 when the Fed finished hiking rates, the stock market fell nearly 50% over the next two years.



Are Fed rate hikes dangerous to stocks? Clearly, that answer is yes.

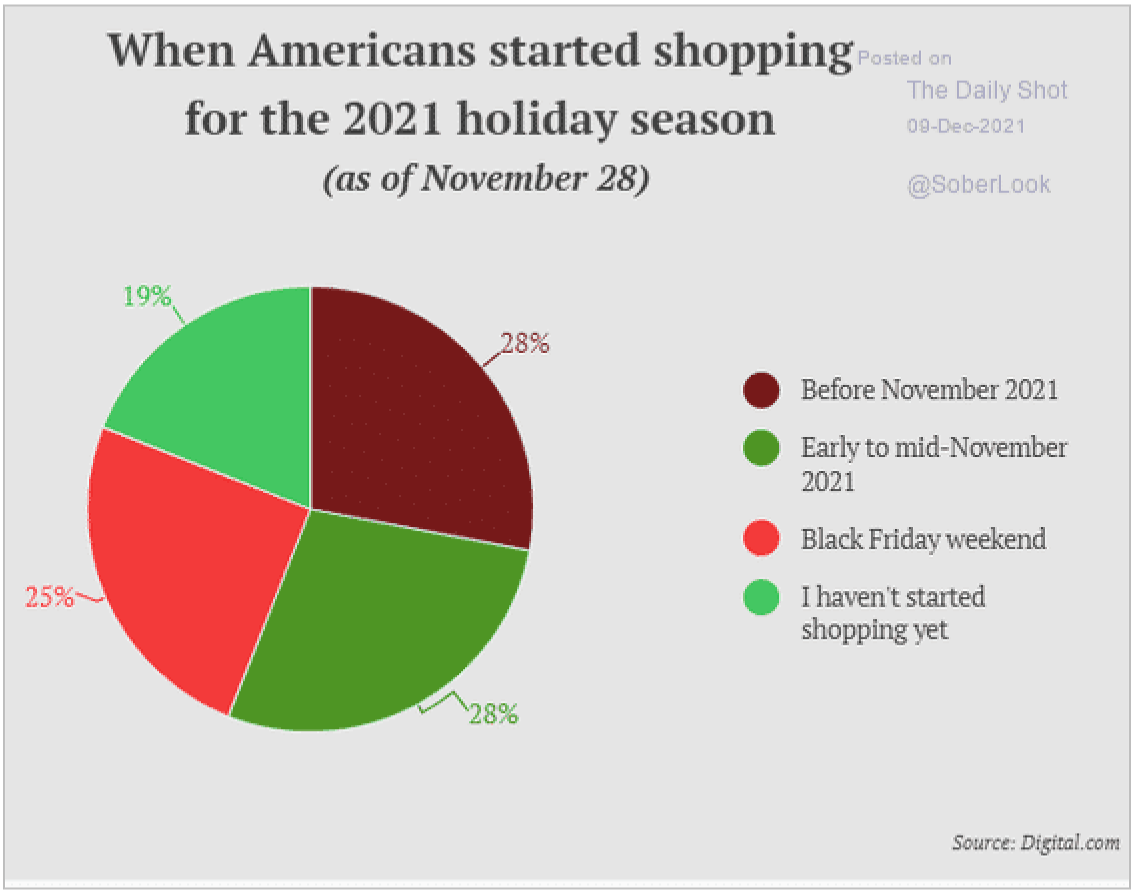
Another Record

The graph below from LPL Research shows that since 1928 there are have only been two years the S&P 500 set a record high every month of a year. The first time it occurred was in 2014. With a record high set last week, the market has done it again. It's worth noting that during the prior valuation peaks of 1998-1999 and 1928-1929, the market could not accomplish the task.



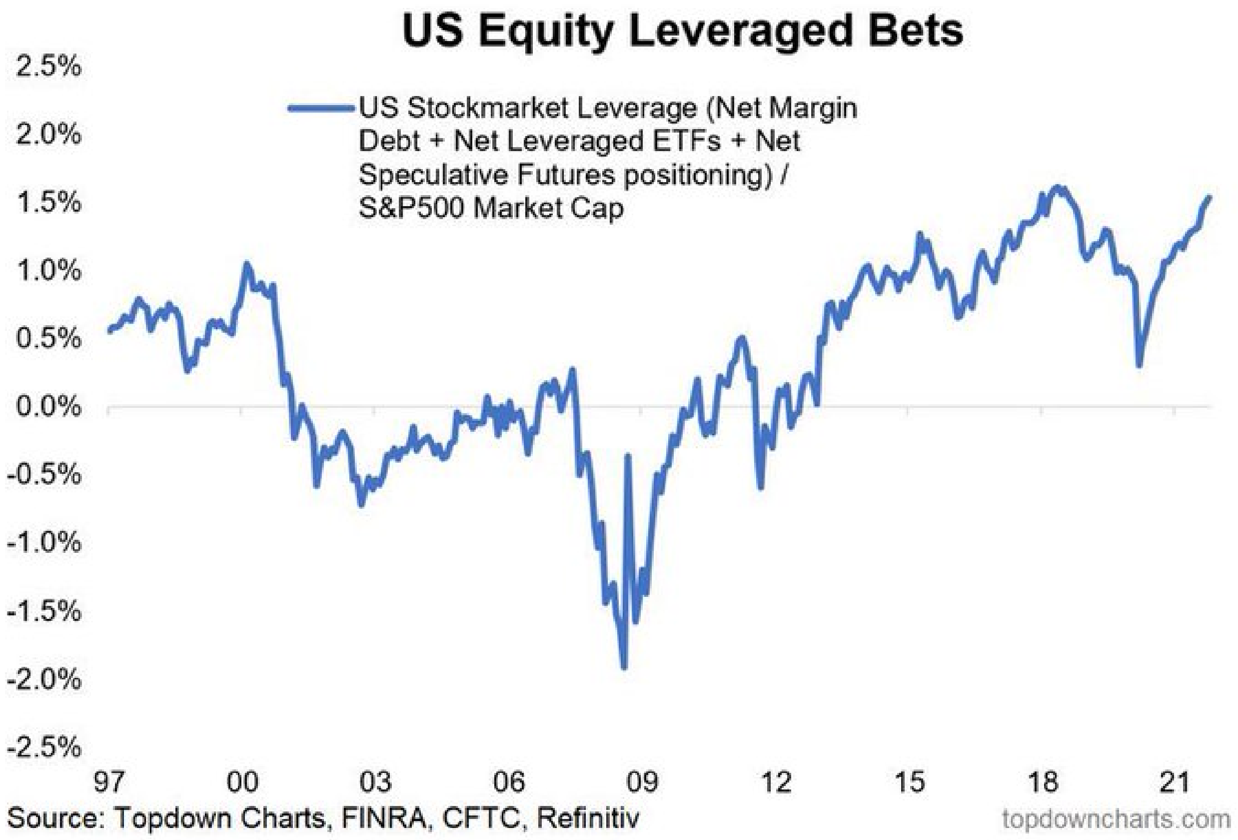
Volatility of Retail Sales

Comparing holiday-related consumer spending this year to prior years will be very difficult as consumers adjust their spending patterns to compensate for shortages of many goods. Some bought presents early, while others plan to take the opposite approach and wait until after the holidays. The graph below provides data on when consumers spent money or plan on spending. It's also worth noting that most government data use seasonal adjustments. The adjustments help us compare activity from month to month, thereby minimizing the quirks and nuances of each month. However, the adjustments may further skew spending patterns this year, making reports like Wednesday's Retail Sales challenging to analyze. We suspect this will be less of a problem for corporate profits as they report on a three-month basis, and in many cases covering the entire holiday shopping season.



Investors Are All In

The graph below, courtesy of TopDown Charts, shows that the amount of leverage as a percentage of its market cap is nearing the highs from late 2017. At that time, the market had a parabolic run into year-end, which continued into January 2018. Despite overwhelming optimism, the rally petered out, and the S&P 500 fell to its 200 dma, registering a 20% correction. At that time, The Fed was embarking on Quantitative Tightening (QT) after running a steady balance sheet for two years. They were also in the process of raising rates from zero to 2.5%. Monetary policy is tightening today, but the Fed is just starting to taper asset purchases and only raising the specter of higher interest rates next year. Might the recent outperformance of high dividend stocks and relatively lower yields signal a change is afoot at the Fed?



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