

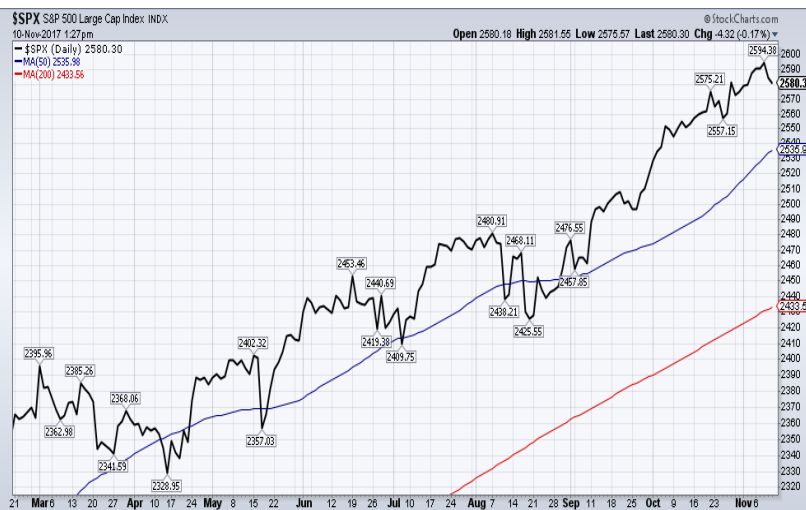
# BILLS ASSET MANAGEMENT

## BAM MARKET NOTE

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The S&P has turned down a little this week but nothing too alarming or disturbing. The longer-term uptrend remains firmly in place and it would take a much deeper correction to even begin to challenge the long-term trend. On the positive side, sell-offs continue to be bought as we saw yesterday with buyers coming into the market after a sharp decline at the market open. On the negative side, see below.



We have written here a number of times how the high-yield bond market often acts like a canary in a coal mine. If that is true this time, then the markets could be set up for more volatility and a deeper decline. HYG has been moving lower over the last 3 weeks and that accelerated this week. Historically, high yields are a good barometer of the market's economic view. Perhaps this is just a blip due to the back and forth on tax reform but regardless of the reason this chart will be important for the near term direction of the market.

## Our Point

Last week we nitpicked a little but the current week raises a few more concerns. While the major indices have not declined much at all, there is underlying weakness that bears watching. After bottoming in August, small caps surged to the upside and logged an impressive 11% gain in 6 weeks. However, since the beginning of October the widely watched Russell 2000 has developed a slow drip downward. The decline accelerated this week and when coupled with the high-yield weakness above, has garnered our attention. At this point, the major indices have not been affected to any material degree but it is unlikely that the market will continue plodding upward without participation from high-yields and small caps. There remains pockets of strength in certain sectors and we have increased allocations to equities modestly over the last week. With an historically very strong market period quickly approaching, we will have to see whether or not those tailwinds can overcome the harbingers mentioned above. At some point, the low volatility upward grind will come to an end and we remain vigilant to protect our portfolios from what will likely be a painful decline. Until then, we wait. Have a good weekend.

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