



Creative Global Investments

Morning Market Commentary

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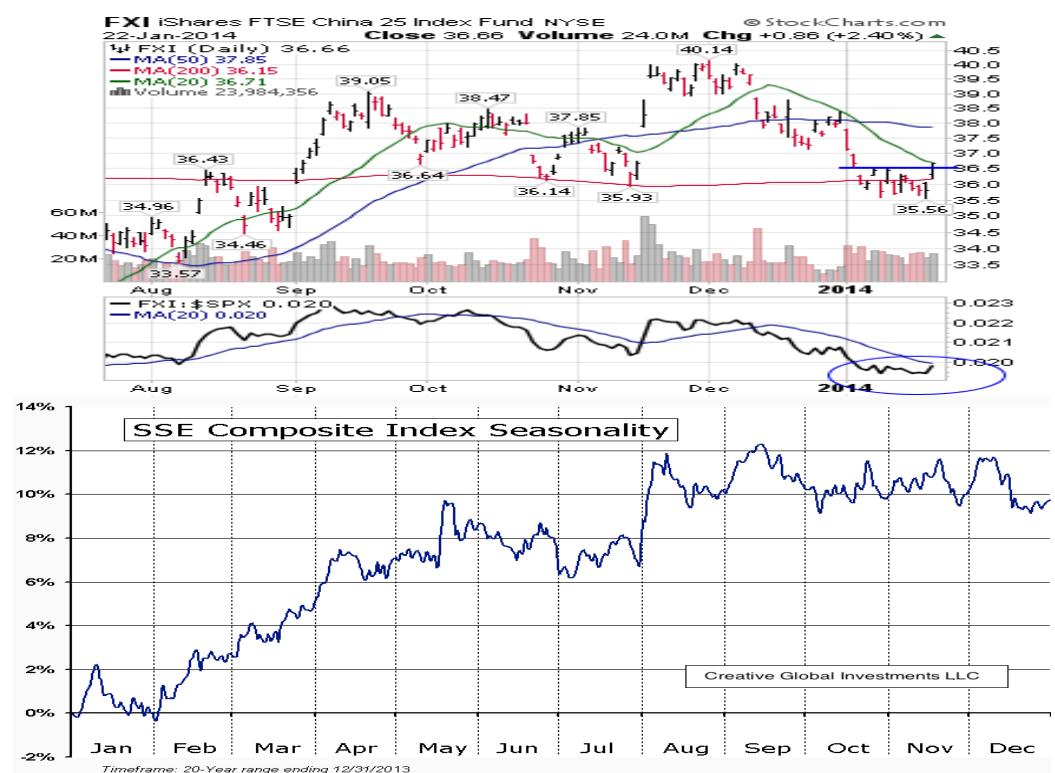
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As we mentioned over the past 4 days, Chinese equities are showing early signs of bottoming. The Shanghai Composite Index moved above its 20 day moving average yesterday and began to show early outperformance relative to the S&P 500 Index. The bottom is occurring just before Chinese New Year (January 31st) Historically, one of the best times during the year to buy Chinese equities is just before the start of Chinese New Year for a seasonal trade lasting until mid-April.



The most actively traded Chinese ETF (FXI) broke above a short-term trading range and also started to outperform the S&P 500 Index.



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Global Macro Commentary

Upcoming macro data:

- Weekly Jobless Claims will be released at 8:30am. The market expects Initial Claims to show 330K versus 326K previous.
- Flash PMI Manufacturing Index for January will be released at 8:58am. The market expects 55.0 versus 54.4 previous.
- Existing Home Sales for December will be released at 10:00am. The market expects 4.90M, consistent with the previous report.
- FHFA House Price Index for November will be released at 10:00am. The market expects a month-over-month increase of 0.4% versus an increase of 0.5% previous.
- Leading Indicators for December will be released at 10:00am. The market expects a month-over-month increase of 0.1% versus an increase of 0.8% previous.
- Weekly Crude Inventories will be released at 11:00am.
- German Flash Manufacturing PMI for January will be released at 3:30am EST. The market expects 54.7 versus 54.2 previous.
- Euro-Zone Flash Manufacturing PMI for January will be released at 4:00am EST. The market expects 53.0 versus 52.7 previous.
- Canadian Retail Sales for November will be released at 8:30am EST. The market expects a month-over-month increase of 0.3% versus a decline of 0.1% previous.
- Euro-Zone Consumer Confidence for January will be released at 10:00am EST. The market expects -12.6 versus -13.6 previous.

Past macro-data review:

Event	Actual	Forecast	Previous
AUD Consumer Prices Index (QoQ)	0.80%	0.40%	1.20%
AUD Consumer Prices Index (YoY)	2.70%	2.40%	2.20%
CNY MNI January Business Indicator	52.2		58.4
JPY All Industry Activity Index (MoM)	0.30%	0.30%	-0.40%
JPY Leading Index	111.1		110.8
JPY Coincident Index	110.7		110.5
GBP Jobless Claims Change	-24.0K	-32.0K	-34.3K
GBP ILO Unemployment Rate (3M)	7.10%	7.30%	7.40%
USD MBA Mortgage Applications	4.70%		11.90%
CAD Bank of Canada Rate Decision	1.00%	1.00%	1.00%

Asian Economies

The unofficial HSBC/Markit flash purchasing managers index (PMI) for Chinese manufacturing showed that the sector unexpectedly contracted in January. The PMI fell from 50.5 to 49.6 this month, disappointing analysts who had expected a smaller decline to 50.4. Chinese manufacturing has dropped to a six-month low.

Robust domestic demand helped South Korea record its fastest annual growth for nearly three years in the last quarter, as an improving global outlook prompted the export-reliant nation's manufacturers to invest in new capacity. The economy grew by 3.9% in the last three months of 2013 from the same period of 2012, broadly in line with economists' forecasts. In a break from the trend of recent years, domestic demand's contribution to growth outstripped that of exports, the Bank of Korea said on Thursday

Euro Economies

The Eurozone's current account surplus rose in November, data from the European Central Bank showed Thursday. The current account balance, a broad measure of an economy's international financial position, increased in **adjusted terms to a surplus of EUR 23.5 bn (\$32.0 billion), following an upwardly-revised EUR 22.2 bn surplus in October**. The bloc's surplus in trade of goods rose to EUR 18.6 billion in November from EUR 16.6 bn in October, likely reflecting some eurozone countries' efforts to rebalance economies toward exports and away from imports demanded by the domestic economy. In November, the surplus for services decreased to EUR 9.5 bn from October's EUR 10.1 bn.

PMI figures from the Eurozone came in ahead of expectations with the manufacturing PMI for January rising from 52.7 to 53.9 and the services PMI rising from 51 to 51.9. This pushed the composite PMI up from 52.1 to 53.2, ahead of the 52.5 forecast.

US Equities Commentary & Charts

US stocks ended generally higher on yesterday, lifting the S&P 500 Index by a subtle 0.06% and adding 0.41% to the NASDAQ Composite.



The Dow Jones Industrial Average, however, was unable to escape the weight of IBM, which plunged over 3% following a disappointing earnings report.

Positive seasonal tendencies for IBM typically conclude around this time of year, leading to a period of underperformance that persists through to April. Technical analysis on the stock, however, doesn't point to a negative outcome. A double bottom pattern was charted last quarter, bringing an end to a trend of lower-lows and lower-highs.

The stock closed around the now broken declining trendline. Double-bottom support can be found around \$172, a test of which could set the stock up for the next seasonal up-leg that begins in April.



Canadian Equity Market Commentary & Charts

The depreciation of the C\$ is expected to “boost exports and, in turn, business confidence and investment,” the impact of which could be inflationary without having to adjust monetary policy. The weak C\$ has already shown signs of fuelling positive relative returns for the TSX Composite, which is outpacing equivalent equity benchmarks in the US.

The TSX outperforming seasonal trend remains typical through to March.

Seasonal tendencies for the C\$ turn positive in April, just as the period of seasonal strength of the TSX relative to the S&P 500 comes to an end.



European Equities Commentary & Charts

European equity benchmarks follow the same seasonal pattern as that of the US, gaining, on average, between October and May; relative performance, however, can seasonally vary from market to market.

All short-term technicals for the DAX 30 are positive. RSI, TSI, MACD and 50day and 200-day MVA's are all rising.

We see the next psychological 10,000 level as a minor resistance point.

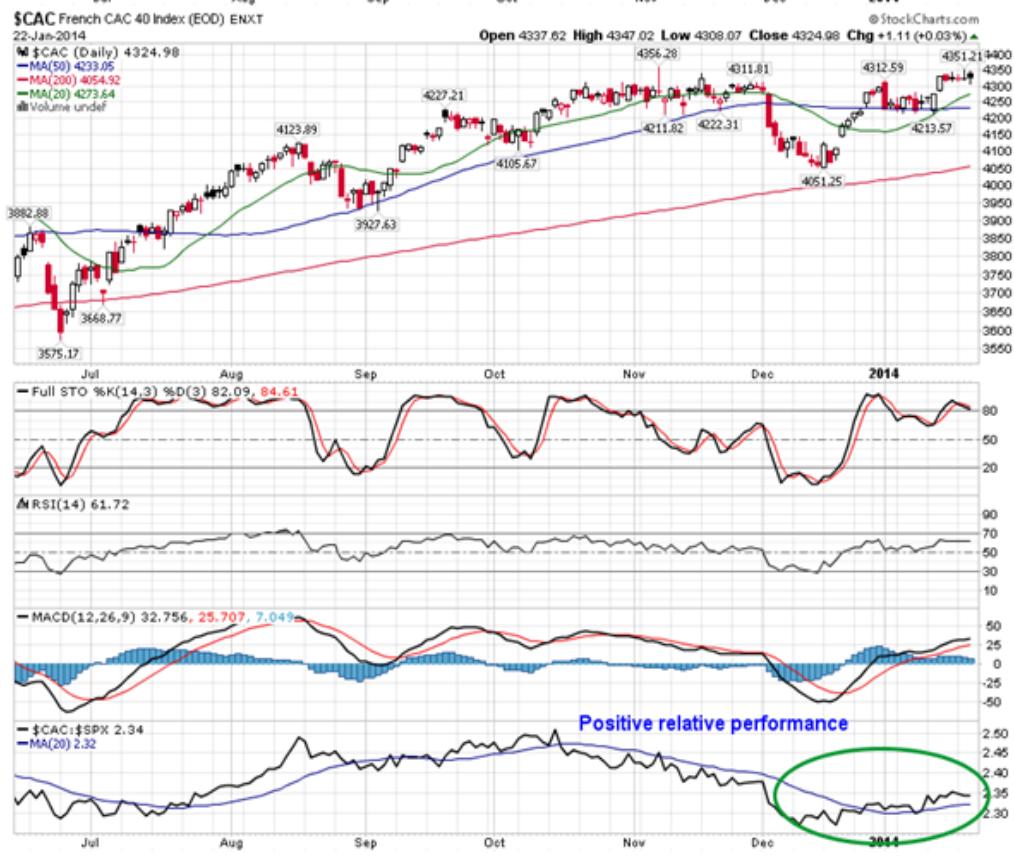
We maintain our 2014 price target of 12,000 for the DAX 30.

All short-term technicals for the CAC 40 are positive. RSI, TSI, MACD and 50day and 200-day MVA's are all rising.

The current resistance level of 4,335 should be broken, and then the CAC could be on its way to 4,500 in the short-term.

We maintain our 2014 price target of 5,000 for the CAC 40.

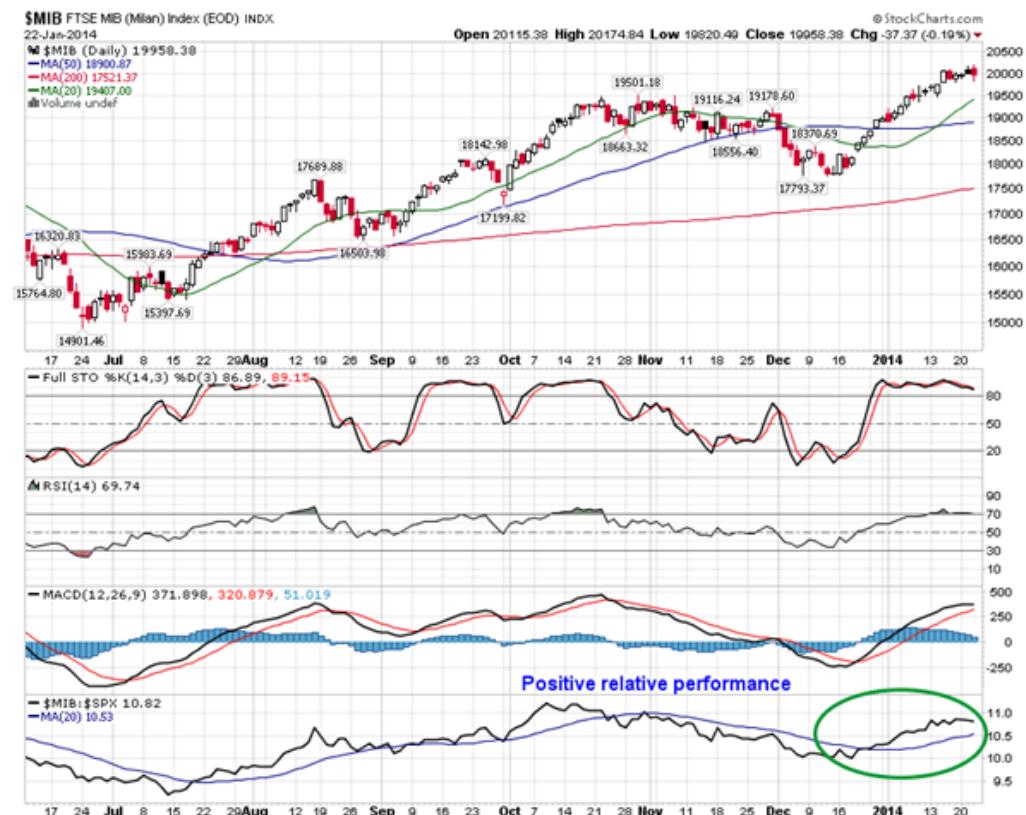
As per other reports we published since the beginning of January, European indices have been showing positive relative performance versus the S&P 500. The trend of equity benchmarks in Germany, France, Italy, and United Kingdom continue to be of higher-highs and higher-lows.



All short-term technicals for the FTSE 100 are positive. RSI, TSI, MACD and 50day and 200-day MVA's are all rising.



Even the technical for the MIB, the benchmark for Italian equities, and our least favorite of the European equity markets are showing positive signs.



Fixed Income Commentary & Charts

Of course, that would still be an interesting technical development, since it would be the largest deviation above the log-channel lower in rates that have been in force for more than thirty years as the chart below shows.

We are expecting for US 10-year rates to climb to between 3.75 and 4% by year-end 2014. We think that to get 10-year rates to approach 4% (a level last touched in 2010 and not seen on a closing basis since before the crisis in 2008) is not a stretch of imagination.

The Fed is in taper mode, and there reportedly remains a pocket of 'negative convexity' that could turn a mild sell-off into a major sell-off if interest rates rise towards 3.25%. It was the 'convexity trade' that helped fuel the move in 10-year notes to 3% last year from 1.65% in May, and another convexity-triggered sell-off could easily cause rates to reach 4% at some point this year.



We do not think that it is inconceivable to start thinking, hypothetically speaking, of 10-year rates at 5% within a year. Five percent 10-year rates seem far away; as we haven't seen them since 2007, but we should recognize that this is roughly a neutral nominal rate. If real growth is expected to be 2.75% on average over time, and inflation is expected to be around 2.25%, then $r + i = 5\%$.

If the Fed would apply a neutral interest rates policy stance, is it really that much of a stretch to envisage "normal market rates"?

We don't see 5% as being outrageous. However, realistically, we would have to say that there would be a lot of volatility and re-allocating between various durations and asset classes between the current 2.85% and there, by which we mean that as interest rates rise, investors will find them increasingly attractive and will rotate from equities to bonds. That would make the case for a 200bps selloff somewhat difficult, however, particularly this year, where we are seeing balanced fund managers re-allocating assets from bonds to equities since January, in the perspective of a massive re-allocation paradigm shift, we do not think that a temporary overshoot towards 5% would be impossible.

Additionally, investors need to envisage the possibility that the Federal Reserve could choose to start selling securities from its portfolio at some point; while the Fed professes to be relying on its reverse repo facility to be able to drain liquidity as needed, that's only plausible if they need to drain relatively small amounts of liquidity (tens or scores of billions). As rates would approach 5%, losses in the Fed's SOMA portfolio would be large enough that it will be technically impossible for it to fully drain all of the reserves they have added.

But we urge our clients to start thinking about tail risks, as long-term investors should be, and for 2014 one should factor in this potentially detrimental scenario. The point is not to try and look for the signals that this particular scenario is unfolding; by the very nature of such a chaotic move, it is very unlikely that we'll correctly guess in advance what will actually cause it.

However, as usual, we like to be on the "other side" of conventional herd-mentality thinking (or the lack thereof) and point out to our clients that the risks of the return to a normal rate environment are rising, and that one should go one step beyond that thought, and envisage the market participants reaction in such a possibility, and start to entertain and develop strategies for hedging against that tail risk.

No matter how the Fed were to choose to account for a mark-to-market losses, it could and would get ugly for long-term bond investors. We are not making any predictions about what the Fed will do or not do when rates start to rise past 4%; we only point out that there will be a lot of zeroes involved and that tends to affect decision-making. A move to 5% isn't completely unthinkable, although we don't think we'll get there in the course of 2014.

Is it unthinkable to get 10-year rates of 8% by year-end?

This is outside the realm of traditional and current forecasting. A 500bps move in a year is roughly a 4-5 standard deviation event. In the post-WWII period the US 10-year treasury never had a 500bps move on a year-end-to-year-end basis. In fact, 10-year rates have so far never yet moved more than 400bps in a 12-month period. So, this is really outside of the range of outcomes one could reasonably expect in a normal world.

However, for investors, we are not any longer in a normal world, because of excessively easy monetary policies of major central banks like the FED, BOE, ECB, BoJ, since the mid 90's, but particularly consequent to the bubbles they created up to the early 2,000's, which demanded even more abnormal monetary policies subsequent to those bubbles bursting, we have come a long way distant to normality.

Or in another way: for rates to rise to 8% in a year would take something really abnormal. So, investors will have it difficult to make "abnormal" predictions, but one can play with entertaining suppositions and we will do that in a moment.

But before we do, we just want to make very clear that guessing how rates would come unglued and get to 8% in 12 months is, since it relies on a chaotic break, probably unknowable in advance. We can, though, test the limits of imagination to see if we can come up with a plausible scenario in which such an outcome would not be impossible. And here is where inflation, and specifically inflation expectations, comes in. The dynamics of nominal interest rates imply that at low levels of nominal rates, movements are caused mostly by changes in real rates (thus the high beta of TIPS at low rates) while at high levels of nominal rates, movements are caused mostly by changes in inflation expectations.

Suppose that inflation expectations can be characterized as "multi-equilibrium," meaning that they are reverting to mean within some ranges but then can jump to a new equilibrium when expectations become "unanchored." Let's hypothesize, that investors and consumers don't encode "2% inflation" or "4% inflation" or "6% inflation," but rather "low inflation," which means anything where inflation doesn't enter into daily consideration, or "medium inflation" (which is where inflation considerations cannot be overlooked), or "high inflation" (which is where inflation considerations are the prime concern). If that describes the way that inflation expectations behave, and we think it is fair to say that, at least, it is the way that financial participants behave, then it's plausible to say that inflation expectations might move very rapidly from a distribution centered around, say, 2% to one centered around 5%. And that, in turn, could trigger a very sharp move in nominal rates. If that happened, it could plausibly be worse than historical precedents if only because the system is far, far more leveraged now than it was in the late 1970s, when we last saw a sharp ramp-up in expectations.

Again, none of the foregoing is a reliable and historically based forecast, however hypothetically possible.

We expect nominal rates will at some point this year (probably in late Q3) as global bonds will run into their period of seasonal weakness, and approach 4%, and we think there's a measurable chance that things could get ugly enough, in an environment where Wall Street dealers are discouraged from providing liquidity by leaning against the flow, to push rates towards 5%. We don't really think that's very likely, though, however the possibilities are rising. We think it's quite unlikely that rates could approach 8% this year, or even next year.

Currencies Commentary & Charts

The C\$ continued its decline on Wednesday as the Bank of Canada kept rates unchanged. The central bank stated that "the path for inflation is now expected to be lower than previously anticipated for most of the projection period," indicating that there is little incentive to raise the cost of borrowing in the near future.

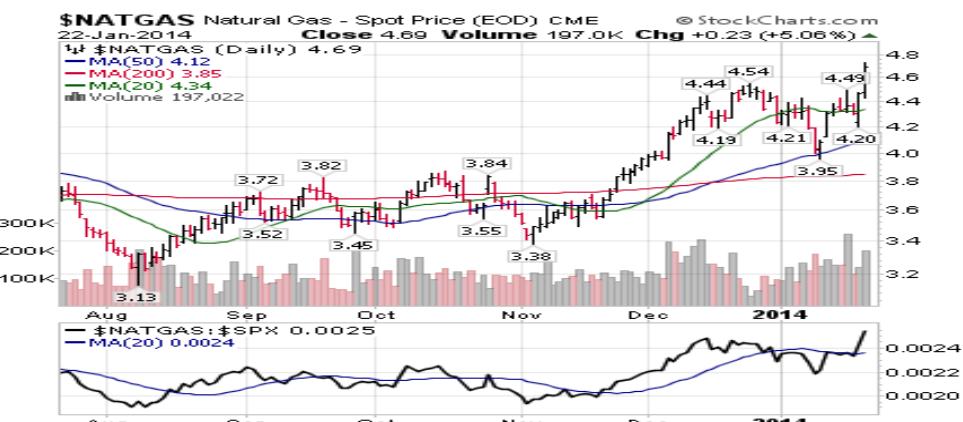
The C\$ is now significantly oversold on the daily chart following the near parabolic move lower; a bounce higher back towards significant moving averages appears probable over the short-term. Similar bounces have been realized over the past three years following the Relative Strength Index (RSI) reaching levels below 30. The long-term trend remains negative, defined by lower-lows and lower-highs, the result of which could finally act as a catalyst for some sort of "catch-up" in Canadian stocks following a few years of lagging US counterparts.

Seasonal tendencies for the C\$ turn positive in April.



Oil & Energy Commentary & Charts

Natural Gas continues to gather momentum.



Oil is showing signs of halting its recent slide, setting up the potential for upside during the period of seasonal strength in energy stocks and commodities ahead.

The price of Crude Oil seasonally gains from mid-February through to May and recent lows may be sufficient to provide the launching point for the trade ahead; Oil has held predominantly above \$91 for the past year, supporting the commodity numerous times at this level.

Technical indicators are currently hinting of improving momentum.

We maintain our \$112 - \$ 115 price target for WTI for 2014.



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