



Creative Global Investments Investment Strategy update

Friday, April 29th, 2016

“Brexit” referendum June 23rd “(should I stay or should I go)”

The words of the 1982-launched song by “the Clash” could not be any more pertinent and descriptive of the current times and the UK’s “Clash with Europe” until the inevitable June 23rd upcoming referendum the citizens of the UK are facing.

Darling, you gotta let me know
Should I stay or should I go?
If you say that you are mine
I'll be there till the end of time
So you gotta let me know
Should I stay or should I go?

It's always tease, tease, tease
You're happy when I'm on my knees
One day is fine and the next is black
So if you want me off your back
Well, come on and let me know
Should I stay or should I go?

<https://www.youtube.com/watch?v=GqH21LEmbfQ>

The significance of “Brexit” and its consequences on financial markets will surely intensify over the next 2 months. We are expecting volatility in all UK and EU asset classes, be it Foreign Exchange, Fixed Income and Equities to rise significantly before June 23rd.

A clear misread by the markets is the fact that we think that the Federal Reserve would not dare to go and “shake” the June 23rd UK EU referendum, that Mr. Obama has so explicitly taken as his #1 mandate, when he seized the opportunity last week and visited the UK and Europe, and made it very clear, that a vote in favor of a “Brexit” would set the UK back into the stone-ages (at least when it comes to trade and trade policy and trade deals with the US and its biggest trade partner namely the EU). He basically told the British to understand that the relationship they thought they had with the US, was second to none, well, maybe not, maybe second to only that one the US has with the EU, as he was very clear that a United Europe including the UK was the only way for economic and political and military success and validity.

So, basically he told the UK to “shut up & put up”, or come in as second (yes, reiterating that “might makes right” in a capitalistic political world).

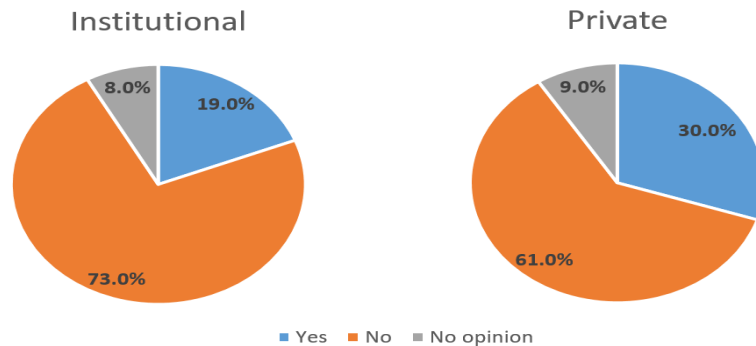
UK politicians, and particularly from the far right of course, are arguing that the “friendly advice” of an exiting US President is not needed, and meaningless, as it is pretty much not supported by consequential action. However, for investors, there is a meaning to this.

We believe that Ms. Yellen and Fed-team did get this message from the President, and hence the likelihood of “another Fed monetary policy change and mistake” on June 14 -15th, ahead of the UK referendum on remaining in the EU, is pretty much zero. No one in their right mind would want to “rock the boat” unnecessary ahead of this critical moment in time for the UK, and less critical for Europe.

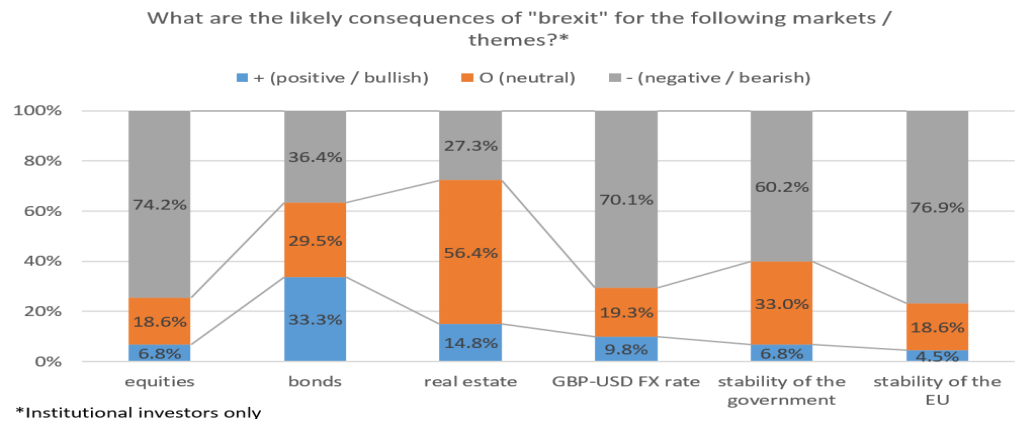
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The **sentix Euro Break-up Index (EBI)** was unchanged at 16,7% for April. Investors see little risks of a "Brexit" and its aftermath to EU trade and business, however, increasingly question the long-term political success perspectives of the "EU-project".

Do you believe a "brexit", the exit of Great Britain from the EU, will happen?



Another **sentix** index, gauging possible contagion due to one country leaving Europe did rise by 2% in April to 26.15%.



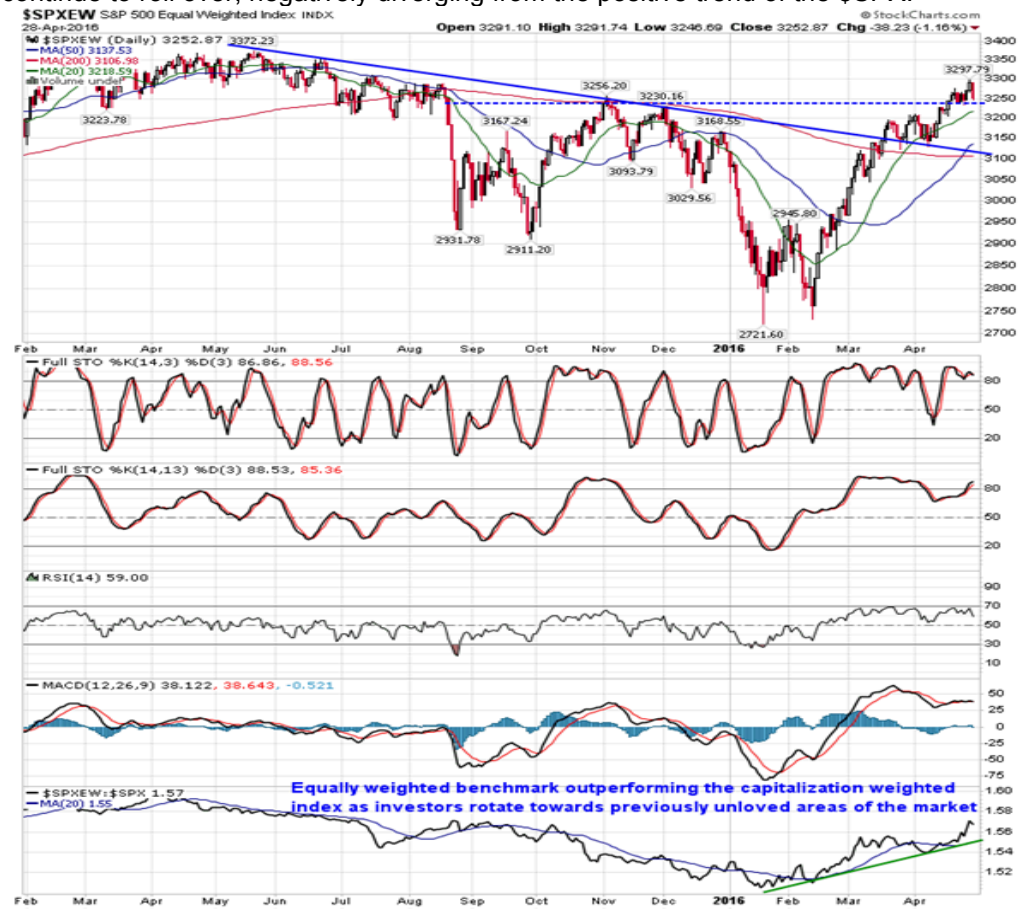
Of more than 1000 institutional investors participating in the survey, only 19% are weighing the risks of a "Brexit" as significant, of which 74,5% believe in such case of a "Brexit" that the short and long term impacts will be negative for equity markets in the UK and Europe. 70,5% of institutional investors see negative impacts on the GBP consequent an eventual "Brexit". 77% of institutional investors surveyed believe that a "Brexit" will have a further likely contagion affect on the EU and possibly other member states leaving.

Approximately 30% of private investors surveyed are seeing a "Brexit" as significant.

From a tactical and short-term strategic aspect, we are advising for investors to reduce exposure towards risky assets, such as European, UK and US equities for the coming 3 – 4 months, as the geo-political risks are rising both in Europe & UK, but also in the US with the current Presidential race Circus taking on new heights in the public limelight.

Global Equities Commentary

With the weight of Apple once again pulling on the broader market, the S&P 500 Index is back testing short-term support at its 20-day moving average. Momentum indicators continue to roll over, negatively diverging from the positive trend of the \$SPX.



Drilling deeper, a short-term head-and-shoulders topping pattern has become evident on the hourly chart of the index. Calculated downside of the bearish setup points down to 2050, which, if realized, would come close to testing a significant level of horizontal support around 2040.



Earnings for US companies are much worse than expected

At the start of April, just ahead of the beginning of Q1 earnings season, as-reported corporate earnings on the S&P 500 Index were expected to come in at \$89.28 per share. This represented a -10.05% decline versus year-ago levels. Looking ahead for the remainder of the year, Q2 earnings were expected to come in at \$94.01 per share, which would be effectively flat versus year-ago levels. Earnings growth was then expected to jump dramatically in 2H of the year with a \$99.88 per share reading in Q3, which would be +10.17% higher than year-ago levels, and an impressive record-breaking \$111.11 per share in Q4, representing a remarkable +28.41% improvement over year-ago levels. Once again, these were expectations just three weeks ago, at the start of April.

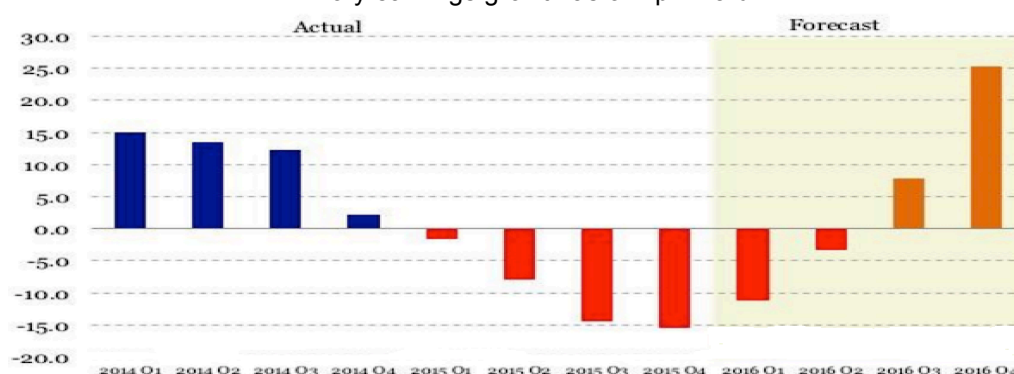
Y-o-y earnings growth as of March 31st



In the three weeks that have passed through April 21, earnings have NOT come in better than expected. They have come in measurably worse than expectations for the first-quarter earnings season so far. With one-quarter of companies already reporting and the remaining three-quarters of companies guiding expectations lower so that they can magically "beat" expectations, Q1 earnings on the S&P 500 Index are now expected to come in at \$88.06 per share, which is -1.37% lower than expectations from three weeks ago and now represents a -11.27% decline versus year-ago levels.

Expectations for the remainder of the year are also lower across the board. Q2 earnings are now expected to come in at \$91.72 per share, which is -2.44% below expectations from just three weeks ago and represents a -3.37% decline versus year-ago levels. Q3 earnings expectations have also been ratcheted back by -2.13% to \$97.75 per share, which no longer represents a double-digit increase, with just a +7.82% improvement over year-ago levels. And even the remarkable Q4, where all suddenly becomes right with the world, is already showing signs of breaking down, as expected earnings have been lowered by -2.46% to \$108.38 per share, which would still set a new record and represents a +25.25% increase over year-ago levels. One should not have their hopes set to high for Q4, however, as it is very likely that earnings growth could end up being negative by the time we get to next January, when Q4 earnings season actually starts.

Y-o-y earnings growth as of April 23rd



The data makes it clear. Corporate earnings for Q1 of 2016 are not coming in better than expected. They are coming in much worse than expected by as much as -3% to -5%. And this is only after 45% of all companies have reported.

With more companies reporting in the next two weeks, it is reasonable to expect that these numbers will continue to be revised lower. We keep our Q1 earnings projection in the \$80 - \$81 per share range by the time reporting season is completed.

The EPS problem in the US is NOT just an energy problem, but it clearly stretches to technology, consumer discretionary, materials, and yes, the banks and financials.

So while the energy and materials sector may have once been the primary detractors to quarterly earnings on the S&P 500 Index, this is no longer the case. And with earnings expectations being revised meaningfully lower across many sectors, it is likely that this pressure is likely to remain more widespread going forward.

In conclusion:

Q1 earnings season is NOT off to a good start. Instead, results are coming in below expectations, and are likely to continue to do so in the coming weeks. As a result, for any further increase in the stock market, it is becoming increasingly more expensive for investors, with the underlying earnings underneath the stock market price continuing to shrink.

Many investors may not care right now about the price they are paying for stocks in the current market environment, but the markets have repeatedly shown throughout history that valuations eventually matter, particularly when prices are climbing, while earnings are shrinking. This is a risk that investors should not overlook when continuing through the remainder of the year.

As we have been highlighting since our 2016 Global Investment Strategy Outlook, non-US based companies and their current and future earnings are benefitting from several aspects from a “strong-US\$” related positive tailwind, and hence why we did prefer foreign equities over US equities, and still do currently.

Positive tendencies for Brazilian, Indian and European equity indices can persist occasionally into the early summer months, however for 2016 we see the typical “May peak” that has become conducive to the well known adage:

“Sell before May and Go Away”

But particularly after May 11th, (which constitutes the zenith of annual dividend pay-outs for German and French equities) we do see history repeat itself, and to become catalyst to most professional money managers, particularly pertinent to balanced fund management styles, to lighten up their portfolio's in US and European & UK equities and to switch for the summer into the historically seasonally stronger performing 10-Year US and European government bonds.

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