



Creative Global Investments

Morning market commentary & charts

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Carlo R. Besenius

Chief Executive Officer
cbesenius@cg-inv.com
+(352) 2625 8640



Creative Global Investments LLC

115 East 57th Street
11th Floor
New York, NY 10022
Tel: 212 939 7256
Mob: 917 301 3734

Creative Global Investments/Europe

5, op der Heed
L-1709 Senningerberg
Tel: +(352) 2625 8640
Mob: +(352) 691 106 969

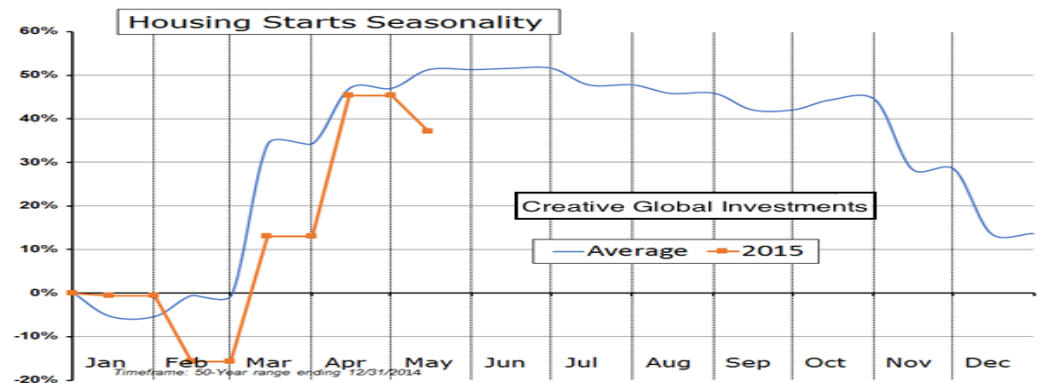
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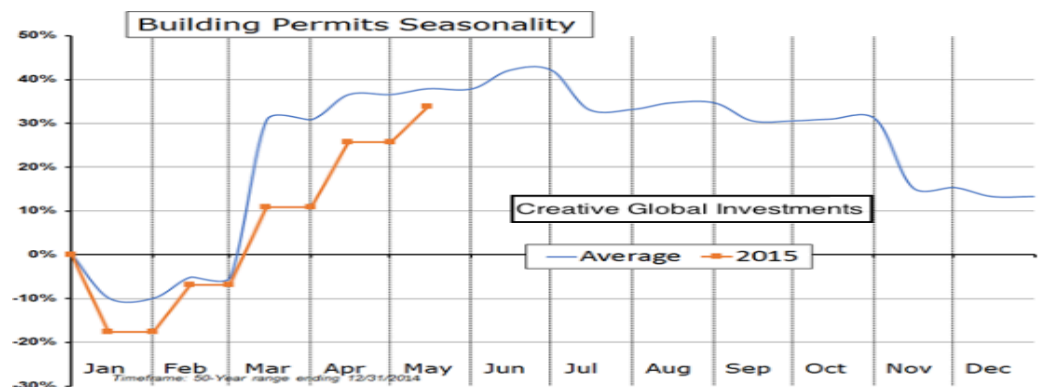
Creativity

US Macro Commentary: Housing picture mixed

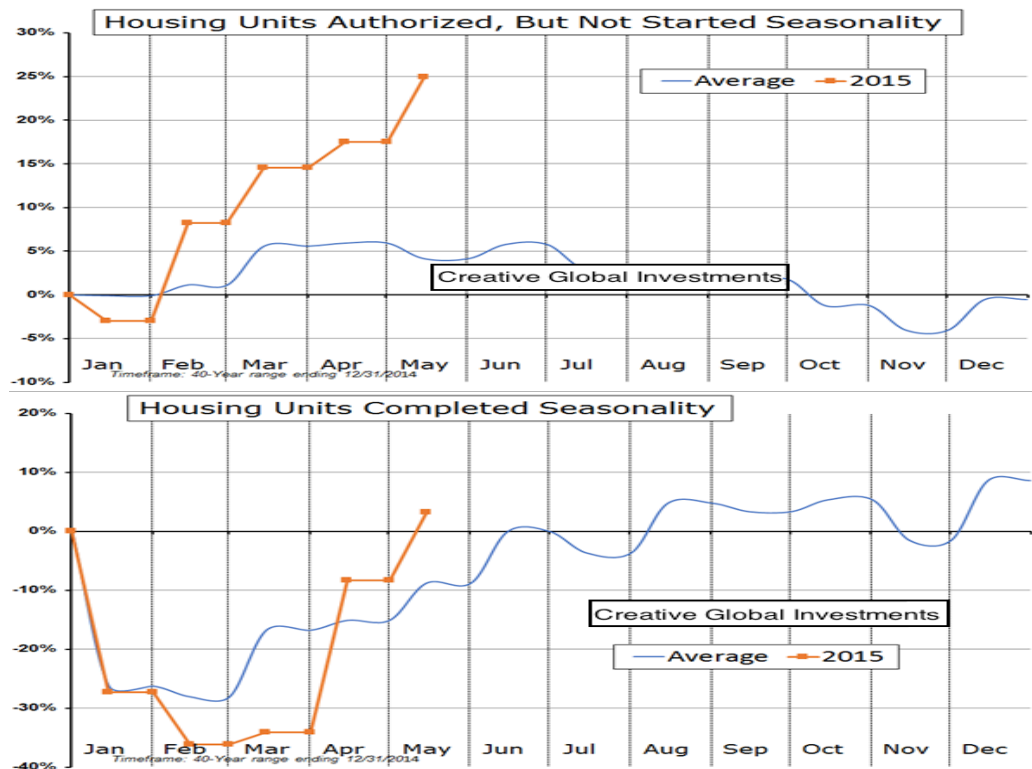
Housing starts for May were reported yesterday at a seasonally adjusted annual rate of 1.036 MN, down over -11% from the previously revised annual rate of 1.165 MN reported in April. Stripping out seasonal adjustments, starts fell by -8.2% last month, well below the 4.3% average gain for the month of May, based on data from the past 50 years. May typically caps the spring building season that sees a steady rise in new construction units ahead of the summer months; month-over-month declines start to become the norm through the back half of the year as the timeframe narrows to complete units before the colder winter weather sets in. As a result of the weak May report, the gap has widened between the 2015 y-t-d change and the average trend, highlighting the struggles the economy is showing during what was supposed to be a robust spring rebound from the Q1 weather woes.



A glimmer of hope is present in the Building Permits competent of the report, perceived as a leading indicator. Permits came in well above expectations at a seasonally adjusted annual rate of 1.275 million, or an increase of 11.8% versus the month prior; stripping out seasonal adjustments, the increase was still a healthy 8.1%, well above the May average increase of 1.3%. Permits typically reach a peak in June, one month following the peak in starts. Whether or not the permits or units authorized materialize into starts during the slower back half of the year is yet to be seen. Concerns pertaining to higher borrowing rates upon completion of construction may be weighing on the industry.



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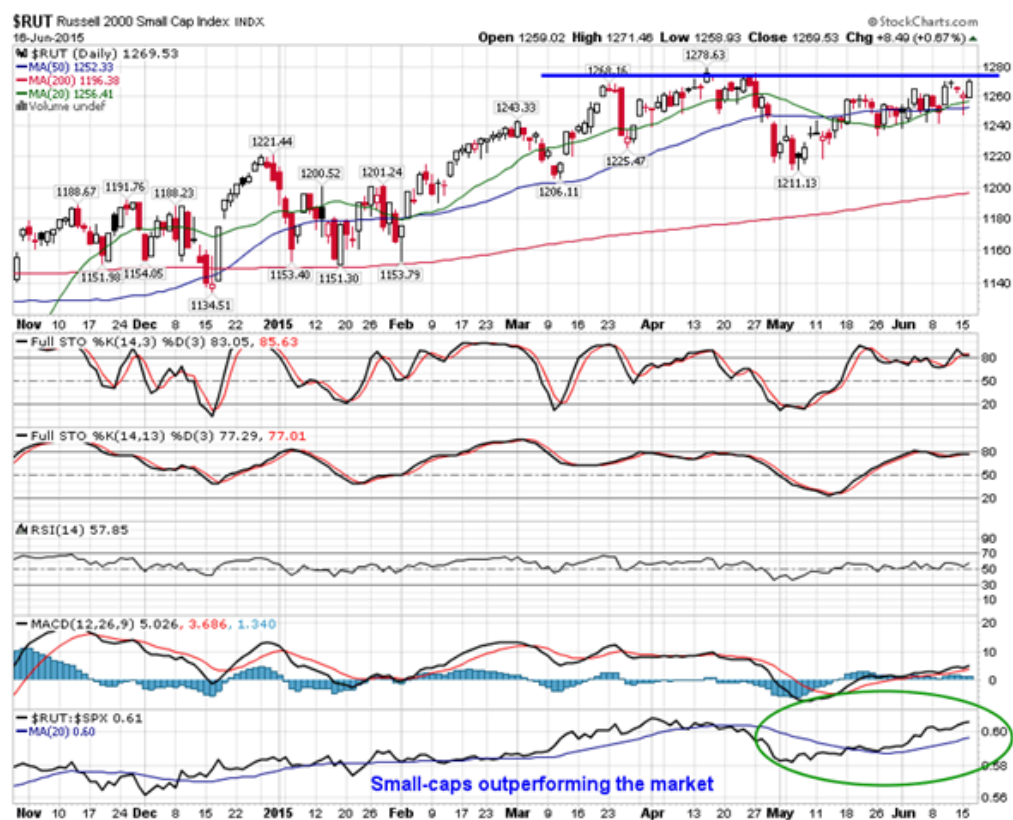
Equity markets commentary & charts

Stocks ticked higher yesterday as investors allocated portfolios ahead of today's FOMC announcement. The S&P 500 Index moved back above its 100-day moving average, albeit on one of the lowest volume sessions of the year; clearly conviction to the uptick in equity prices was lacking. Although volume may be indicating a lack of commitment of investors to this market, risk sentiment is suggesting otherwise.





Since the start of May, the riskier Russell 2000 Small-Cap Index has been outperforming the market; price of the benchmark closed just below the all-time high once yesterday's trade was complete.



Momentum stocks, as gauged by the Momentum ETF (MTUM), have been showing similar outperformance as investors chase the high beta assets. Typically, these areas of the market act as a leading indicator to the direction of stocks as investors adjust portfolios for the underlying systemic risk. Despite the uncertainty, there may be no better alternative to stocks over the longer-term.



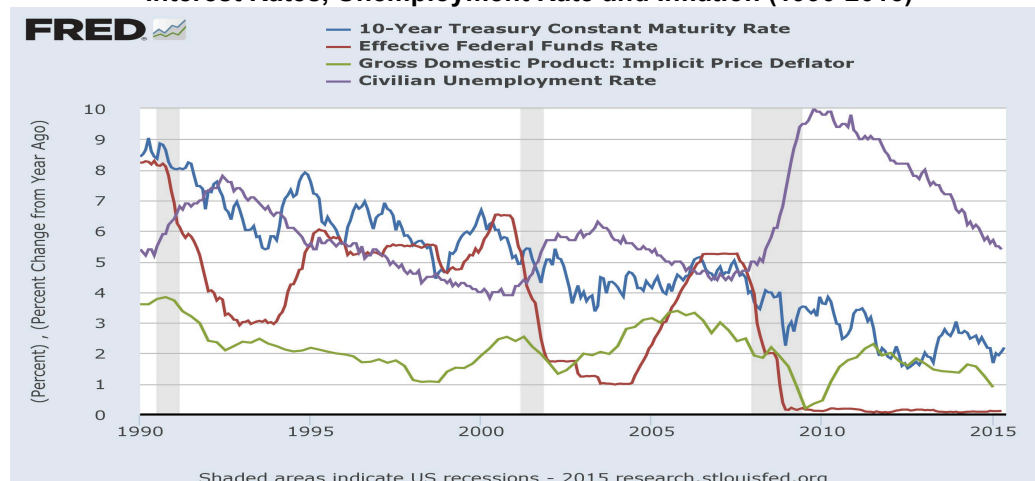
What could investors experience in the eventuality of a rate hike in 2015?

With the rate hike in most investors short term view, we would like to highlight what past experience of rate hikes has shown what might happen to bond portfolios.

The chart plots the interest rates, inflation and unemployment rate since 1990. The rate hikes in 1994 and 2004 both started when the unemployment rate was around 5-6% and kept dropping. The current unemployment rate stands at 5.5%. Even the inflation threat is less of a problem than that in the last two rate hikes, it is totally justified that the Fed starts tightening as the job market continues to improve.

We believe that the past 21 days sell off in US and European 10-year Treasuries is overdone, and that current market prices constitute a clear "buy" signal. We are advising for investors to step up investments into 10-year US and European bonds, which sold off excessively in the past week, on nothing but a bit of improving, but still mixed, and not sustainable macro data from Europe and the US in the past three days.

Interest Rates, Unemployment Rate and Inflation (1990-2015)



In 1994, the Fed raised fed funds rate by +300 basis points over the course of one year. Consequently the 10-Year Treasury yield rose by +200 basis points.

In 2004, the Fed adopted a more orderly and slower approach. It took two years and +25 basis point rate-increase every meeting to raise the Fed funds rate by +425 basis points. Consequent to the Fed's action path in 2004, long-term rates barely moved. After dropping by -30 bps during the first part of rate hike, the 10-year Treasury yield ended up on +60 bps higher than when the rate hike started.

As we have been writing in length, we do not see the Fed to start raising the Fed funds rate in 2015. And even if this were the case, we believe

- **The rate hike will be slow, orderly and data-dependent.** The current GDP deflator, the Fed's favorite measure of inflation, stays at 1%, which is well below the Fed's target of 2%. There is no rush for the Fed to jerk up rates. Globally, just to the contrary, other major central banks are implementing loose monetary policies, which will make the US\$ even stronger, and the strong, and likely in the case of a rate hike, strengthening US\$ would hurt US exports, thus GDP growth.
- **Bonds will have slightly negative returns.** As our baseline projection, the Fed will raise fed funds rate by +175 bps in 24 months. With respect to 10-Year Treasury yield, given its current low level, we expect it will rise by +100 bps, somewhere between the 1994 and 2004 rate hikes.

Bond Market Performance During Rate Hikes

(%)	Fed Funds Rate	Ten-Year Treasury Rate
1994 Rate Hike		
Feb-94	3.00	5.75
Feb-95	6.00	7.8
2004 Rate Hike		
Jul-04	1.00	4.50
Jul-05	3.25	4.20
Jul-06	5.25	5.10

The yield on the 10-year treasury note broke resistance at 2.3%, pushing to the highest level in seven months; broken resistance of an apparent ascending triangle pattern calculates upside potential to around 2.9%, which would test the 2013 highs and potentially confirm the conclusion to the bull market trend for bonds that began in the 1980s.



Long-term trend line resistance stemming from the 2007 highs, just prior to the flurry of buying in the bond market amidst significant equity market declines in 2008/09, hovers around 2.6%, a level that could become the basis of a neckline of a head-and-shoulders bottoming pattern that would suggest significantly more upside as the bond trade unwinds. Some of these outflows may find their way into the equity market, supporting stock prices, but a limit will be reached when investors enticed by the higher yields shift back to the beaten down asset class as fast as they left.



We see no macro fundamental neither technical evidence at this point that the long-term declining trend in yields will suddenly shift to a long-term rising trend; a prolonged range-bound trend, either as part of a bottoming pattern or a stagnant period, is the more probable scenario.



Carlo R Besenius, CEO & Head of Global Strategy

cbesenius@cg-inv.com

office: +(352) 26 25 86 40

mobile: +(352) 691 106 969

Luxembourg/Europe

Sabine CJ Blümel, Head of Global Automotive Research

sblumel@cg-inv.com

office: +44 (7785) 301588

London, UK

Feliks Lukas, Director of Industrial Consulting

flukas@cg-inv.com

office: 212-939-7256

mobile: +385 9848 8951

Kastela, Croatia

Gary Schieneman, Managing Director,
Global Accounting and Finance

gschieneman@cg-inv.com

office: 917-868-6842

New York, NY, USA

Steve Gluckstein, Global Strategist

sgluckstein@cg-inv.com

office: 212 939 7256

mobile: 732 768 8843

New York, NY, USA

Marc Peters, Head of Global Industrial Strategy

mpeters@cg-inv.com

office: +(352) 26 25 86 40

mobile: +352 621 36 44 50

Luxembourg/Europe

Allison M Cimon, Director of Sales & Technology

amcimon@cg-inv.com

office: 646 228 4321

Boston, MA, USA

Jennifer Crisman, COO

jcrisman@cg-inv.com

office: +(352) 26 25 86 40

Luxembourg/Europe

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