



Creative Global Investments

Weekly investment strategy & charts

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Macro economic & political commentary

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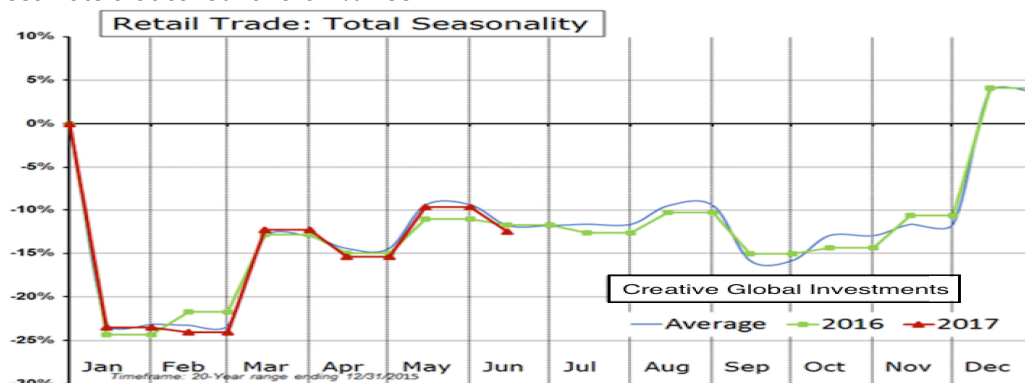
Objectivity

Integrity

Creativity

In Asia, data revealed China's Q2 GDP grew 6.9% y-o-y, unchanged from Q1 but ahead of expectations for 6.8% growth. On a quarterly basis, the Chinese economy grew 1.7% compared to 1.3% in Q1, as expected. Chinese retail sales, industrial production and fixed asset investment data for June were also encouraging.

In the US, retail trade revealed a consumer that is showing signs of slowing. The headline print indicated a 0.2% decline in sales for the month of June, diverging from expectations calling for a 0.1% gain. Excluding the more volatile components of autos and gas, sales were still lower, this time by 0.1%, another miss versus the consensus estimate that called for a 0.4% rise.



Stripping out the seasonal adjustments, sales actually fell by 3.1%, more than the average decline for the month of June of 2.4%. The y-t-d trend is now below the seasonal average by 0.7%. Weakness in auto sales continues to weigh on the aggregate result; retail trade excluding autos continues to show above average growth at this mid-point to the calendar year. Strength centers around purchases for the home, whether it be building materials, electronics, or furniture. These constituents are all trending above average through 1H as consumers look to improve their living conditions given the low cost of borrowing.

But the most telling category of consumer sentiment does not pertain to material goods. Sales at food services/restaurants and drinking places were down by -3.9% in June, firmly below the average decline of -2.5% for the last month in Q2.

The y-t-d change is in negative territory by -1.1%, the first time in the history of the report that restaurant spending has fallen through the 1H. This category is the easiest for consumers to substitute, making it the most discretionary, providing a reasonable gauge as to how willing consumers are to open their wallets. Should consumers further rein in spending, other categories would surely suffer. Bottom line is that the consumer is becoming increasingly selective of their purchases, presenting a threat to sales at retail stores through the remainder of summer. Non-store, or online, retailers are benefiting from this selective shift, but even their activity is only marginally above average as low cost goods continue to be a driver. Consumer spending represents the lion share of GDP and for the sake of declaring a robust economy, greater discretionary spending is obviously desired.

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Misperceptions of the EU's monetary mechanisms

For the past year, there has been a lot of positive news about the Eurozone. The economy is growing, unemployment is declining and even Greece is working itself out of the crisis. Is everything well now in the currency union?

The euro crisis is definitely over and the economy is developing better everywhere than expected. Four former crisis countries can finance themselves autonomously on the markets again and Greece should also be able to manage without an ESM assistance program, provided the government sticks to the agreed reform conditions.

Although some organizations like the OECD predict a meager growth rate of only 1.1% for Greece this year, only about half of what the European Commission is forecasting, one should not forget the deep crisis Greece is emerging from, and that it will take substantial amount of time to correct the irresponsibility's of the former Greek governments. The Greek GDP declined in Q1 of this year, and the OECD has taken that into account in its forecast. But the growth trend for the next decades is more important and the OECD has a much more positive view of that than the European Commission.

Where will that growth come from? Growth comes automatically when a country is internationally competitive. In this regard, Greece has made tremendous progress and that is reflected in growing exports. For example, since its privatization the port of Piraeus has a container volume that is 10 times that of before. Not only tourism are growing, also agriculture and everything that is linked to ship building, from construction to repair services to logistics.

So will Greece not need a fourth rescue program? No, provided the government stays on the reform path. However, there is still a mountain of debt in Greece, and in other areas the state of public finances doesn't match your optimism either. In France and Italy, debt is rising and there is no change in sight.

That is not entirely right. France's new president Macron is determined to get the deficit quota under the EU threshold of 3%. His predecessor Francois Hollande also promised this at the start of his mandate. Why should we believe Macron now?

There are two important differences. Macron has already announced his policy of cutting costs in his election campaign that he will do savings. So he has a voter mandate for that. That was not the case with Hollande. Also, Macron has a clear majority in parliament, Hollande did not.

For years Italy has been the last in terms of growth and on top in terms of public debt, and investors are afraid that the government in Rome will one day knock on the ECB's door and ask for help, as the Italian growth rate has been only half of what it is in the rest of the Eurozone for over two decades. The country now really needs reforms to improve its competitiveness. The Commission has been preaching that for years, something that Rome has consistently ignored. There have been certain reforms on the labor market, but that is not sufficient.

Now, Italy is accumulating more debt in order to fix its banks with billions of state aid. But big creditors are not affected by this. For the big banks, the rules of the banking union apply, for the smaller and medium sized banks, national insolvency law applies. It was Germany that insisted at the time that the smaller banks be exempt from the rules of the EU banking union.

Should senior creditors of big banks are liable for losses but not of small banks?

The finance ministers talked about this on Tuesday. Perhaps the EU state aid rules have to be adapted to the banking union.

The IMF will no longer be present in case of future crises and neither probably will be the ECB. But we will continue to need the European Commission for specific topics such as the energy or labor market policies. Therefore we think that a European Monetary Fund would do that together with the Commission in the future.

The European Commission has this dream of a European treasury. Could the European Monetary Fund take on this task?

Theoretically yes. However, we don't see how there could be a political consensus in the euro area on this in the foreseeable future. That would mean that the euro countries would issue common debt and would be jointly liable for it. That requires a lot of mutual trust that simply is not there at the moment.

Couldn't the new German-French couple Merkel-Macron build this trust? For example at the German-French ministerial council this Thursday?

Generally our view is that the chances of success of the German-French cooperation are as good as they have been in over 10 years.

President Macron is asking for a sort of Eurozone budget, and we believe Merkel will respond favorably, as it has become clear that Europe needs a limited common fiscal capacity in the euro area, in order to be able to help member states in case of a sudden major crisis.

Such a new European "rescue mechanism", to be funded by a budget resulting from 1% to 2% of the euro area's GDP would be largely sufficient to draw into in the case of another financial crisis.

The individual countries could provide the financing of the rainy day fund in advance. The complementary unemployment insurance would be financed through a small fraction of existing contribution from employers and employees. So there is no additional financial burden.

President Macron is asking for an economic government of the Eurozone. The Eurogroup already works like a sort of government, and a permanent chairman for the Eurogroup could be good, especially in order to represent the euro area better in international fora like the G7 or the IMF.

The European Commission has developed another idea for the euro area: It wants to issue bonds of several euro countries in bundles with the alluring name of European Safe Bonds. Such so-called safe assets would in principle be a tremendous step forward. We would get a market in Europe that would be as deep and liquid as the market for US government bonds. But that works only if we partially mutualize government debt in the Eurozone, however, this may take another 5 years to stand a realistic possibility.

For now, we see EU integration will accelerate but the currency union will not have reached its final state. By 2022, the EU will have finished banking union, the European Monetary Fund and the ESM will have created a small fiscal capacity for the Eurozone, and will have a permanent chairman of the Eurogroup.

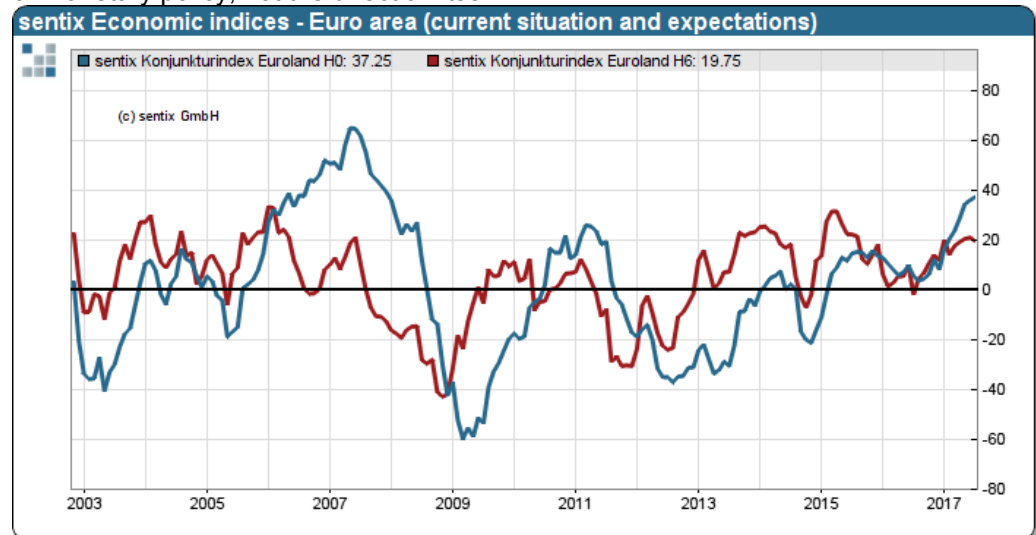
In spite of a lot of Anglo-Saxon criticism and misinformation, we see the EU progress steadily, and slow at times, and continue to emerge as a stable global critical investment area, where investors and citizens are enjoying a single market with all of its benefits.

While Euroland and Eastern Europe stand out due to their better situation indices, the US is still characterized by a slowdown. Overall, it is striking that the economic expectations have weakened only slightly. The economic momentum may thus be a top line. Better, as it indicates the very good situation index values, it will probably not be for the time being.

In the last few days, the fears of investors before a change in interest rate policy in the euro area determined market activity. This discussion is quite understandable against the backdrop of the much-improved economic momentum in the Eurozone. Also in July, nothing changes. Investors' assessment is rising for the seventh time in succession, reaching 37.3 points the highest level since December 2007! The expectations cannot quite keep up. They lag from 21.0 to 19.8 index points, but remain clearly positive. The trend continues to be in the Eurozone, but the momentum should have reached a certain zenith.

For a few months now, it has been clear to investors that the ECB must leave its expansive course. In early times, the interest rate increase path would have long been pursued if the economic indices were similarly strong. This expectation has intensified for investors over the past few weeks. The corresponding sentix topic index clearly drops to -26 points.

However, as the chart below shows, inflation expectations have a rather opposing trend. Against this backdrop, it would not be a surprise if Mario Draghi at the next ECB meeting would rather warn investors not to be certain in their assessment of the speed of monetary policy, not the direction itself.

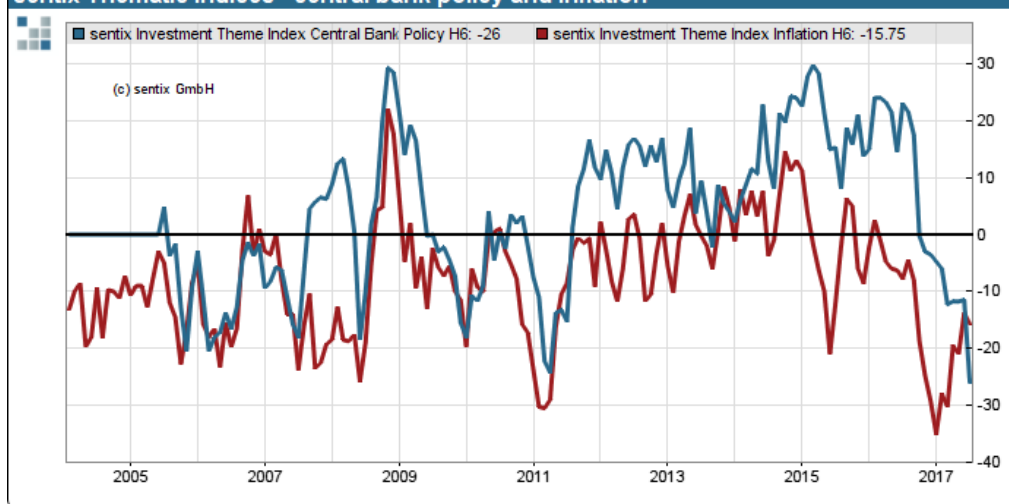


The German economy is doing very well. And yet, the latest sentix data are easy to worry about. Because the second decline in the expectation values in succession nourishes the impression that much better than it currently runs, it will probably no longer be on sight. The zenith seems to be crossed.

In spite of the US economy continuing to cool down, there is still some euphoria left amongst investors, who after the election of US president Trump were joining the "Trump Bump" wagon. And we see increasing financial market risks for a "Trump Dump" to unravel, even though the situation assessment fell to the lowest level since October 2016, ie before the election, and with expectations dropping to the lowest level since March 2016.

With "tweets" alone, it is no longer done for the US president. He must now deliver concrete, if he does not want to risk a serious economic slowdown.

sentix Thematic indices - central bank policy and inflation

**Germany**

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	31.3	34.1	35.3	36.9	39.2	37.5
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Headline Index

- Current situation	53.5	56.8	59.0	61.3	66.8	65.5
- Expectations	11.0	13.5	13.8	14.8	14.5	12.5

USA

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	31.0	33.6	26.7	20.4	16.5	14.8
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Headline Index

- Current situation	45.0	47.8	45.0	36.0	35.5	32.5
- Expectations	17.8	20.3	9.8	5.8	-1.0	-1.5

Switzerland

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	18.1	19.3	28.1	29.0	18.6	29.4
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Austria

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	19.4	20.6	29.2	29.0	39.7	35.4
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Japan

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	13.2	17.0	14.1	15.2	18.6	16.7
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Headline Index

- Current situation	16.0	18.8	19.3	20.0	26.8	23.3
- Expectations	10.5	15.3	9.0	10.5	10.8	10.3

Asia ex Japan

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

Overall Index	19.8	24.6	24.8	22.9	25.4	25.0
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Headline Index

- Current situation	25.8	29.5	31.5	30.5	33.5	33.3
- Expectations	14.0	19.8	18.3	15.5	17.5	17.0

Eastern Europe

Feb 17

Mar 17

Apr 17

May 17

Jun 17

Jul 17

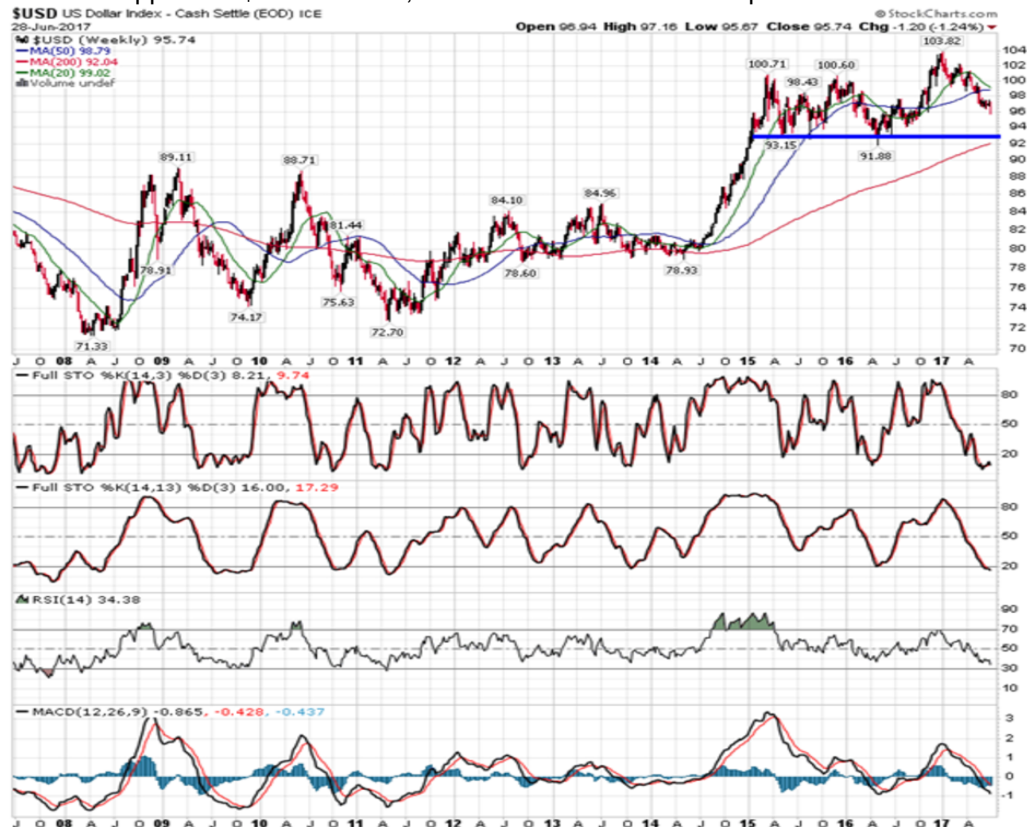
Overall Index	5.1	8.8	7.6	9.5	11.6	12.1
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Latin America	Feb 17	Mar 17	Apr 17	May 17	Jun 17	Jul 17
Overall Index	-0.6	3.2	0.1	-0.7	-2.8	-1.1
Headline Index						
- Current situation	-10.8	-7.5	-9.8	-9.8	-13.5	-9.8
- Expectations	10.0	14.5	10.5	8.8	8.5	8.0
Global Aggregate	Feb 17	Mar 17	Apr 17	May 17	Jun 17	Jul 17
Overall Index	18.9	22.6	20.8	19.3	19.6	19.0
Headline Index						
- Current situation	23.8	27.1	27.8	26.5	28.0	27.5
- Expectations	14.0	18.2	14.0	12.4	11.5	10.8

Currencies Commentary & charts

Last week, the Euro hit our most aggressive EURUSD 1.14 target for end of Q2. That was against a full year EURUSD consensus of 1.04, with 14 out of 27 Bloomberg ranked currency forecasters calling for the Euro to drop under par against the US\$. So far for currency experts and their value added to create alpha.

We continue to see the Euro to stabilize further and continue to rise. Safe heaven currencies like the US\$ and like Gold will reverse course and decline. As per our Q3 Global Investment Outlook & Strategy, the EUR/US\$ is on track to rise to our Q2 end target of 1.18, and our 2017 EUR/USD target of 1.18 – 1.20. Last week, the \$USD continuing a lower trend of lower-highs and lower-lows that has spanned the 1H of 2017. Support for \$USD is at 93, less than 3% below current price.



Just as we were forecasting, the US\$ Index lost -5.6% in 1H of 2017, and just last week -1%, marking the US\$'s largest two-quarter percentage decline since 2011, and hitting both our 1H target prices for the \$USD at 96, and EUR/USD at 1.14. Even the Federal Reserve continuing to raise US interest rates, one of the few positives for the US\$ this year, is no sure thing. Some Fed officials recently have expressed concern about pushing up rates amid weakening inflation. The latest was Federal Reserve Bank of St. Louis President James Bullard, who now is coming into our thought camp and said last Thursday that he doesn't support raising short-term interest rates again this year.

So, with no more rate hikes to come, and with a US economy showing increasing weak spots, where should the US\$ be priced? As we argued for 18 months now, the only country which cannot cope with a strong US\$ is the United States.

So, where do we see the US\$ over the next 6 – 12 months?

- **\$USD at 92, with an increasing likelihood of breaking 90**
- **EUR/USD moving back towards 1.20, with an increasing likelihood of hitting 1.24.**

Over the past 23 years, the US\$ has experienced two 7-year bull markets, and one 7-year bear market. Is history repeating itself, is the current rolling over the start of another 7-year bear market for the greenback?

Trade weighted US\$ until June 27th as per Federal Reserve of St. Louis



Seasonally, the \$USD records a loss between July and the middle of October.



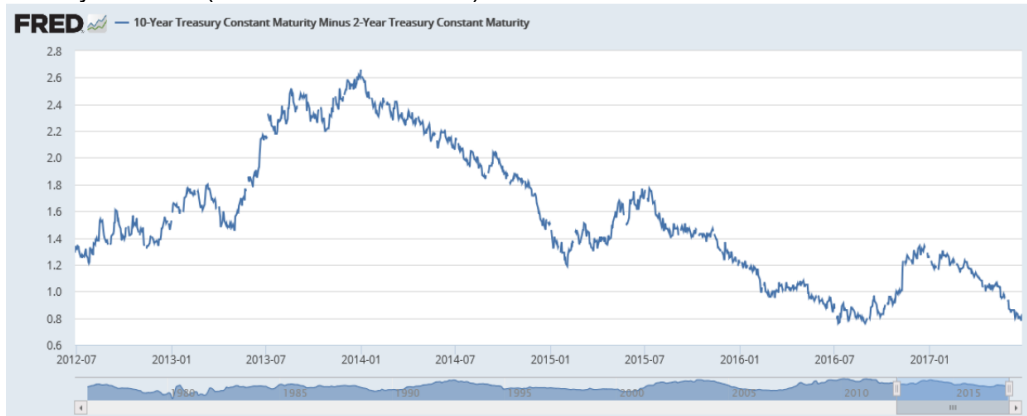
Fixed Income commentary & charts

The spread, between the 10-Year US Treasuries yield and the 2-Year US Treasuries yield. A widening spread denotes bullishness and economic growth expectations, while a declining spread that goes negative (or inverts) signifies slowing economic growth and, even, the likelihood of a recession.

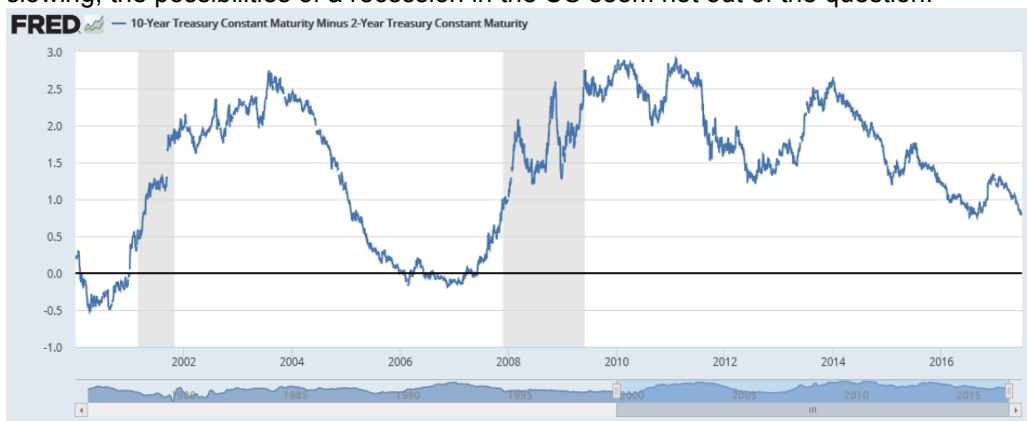
For clarity, a negative or inverted yield curve indicates that long-term debt instruments have a lower yield than short-term debt instruments, given that these debt instruments are of the same or similar credit quality. Historically, inversions of the yield curve have preceded many US recessions. Thus, the yield curve is considered an important barometer for predicting turning points in the business cycle.

The current (June 27) 10-2 yield curve reading is 0.83x, and falling. This is nowhere

near a recessionary reading of 0.00x. However, the trend is distinctly down and it is close to its 5-year low from a year ago and compared to the recent high of 1.34x. Here is a 5-year chart (June 2012-June 2017):



Here is a look at the 10-2 yield curve going back to January 2000. It shows the negative occurrences and the corresponding recessions that soon followed. The 10-2 yield curve is nowhere near the 0.00 level needed to denote a recession. With US economic growth slowing, the possibilities of a recession in the US seem not out of the question.



Equities commentary & charts

Equity markets (except China) remain intermediate overbought and vulnerable to a correction, despite a move by the S&P 500 Index and the Dow Jones Industrial Average to all-time highs on Friday. The S&P 500 Index and TSX Composite Index on average during the past 20 years have reached their seasonal peak on July 17th followed by at least a shallow correction lasting until mid-October.

However, volatility measured by the VIX Index remains relatively mute implying that the seasonal peak this year could be delayed slightly. Investors should be aware of the conclusion of this summer rally period, which also coincides with the start of the most volatile time of year for stocks, which can see significant swings in either direction.



The VIX tends to rise between now and the beginning of October, often benefiting volatility hedges, such as Gold. On Friday the VIX closed at 9.51, the lowest level in more than 20 years and suggestive of investor complacency. From the 9.31 closing low charted on December 22, 1993, the VIX more than doubled in the three months that followed while stocks traded predominantly sideways over the subsequent year.



Political events (most notably in the US) could change the timing quickly. Possibilities include a show down with North Korea, failure by the US Congress to pass meaningful legislation on health care and tax reform, an unexpected increase in interest rates and impending trade wars. The spike in volatility above levels reached two weeks ago will be the most likely sign that the summer correction has started. Meanwhile, holding a robust position in cash in your investment portfolio makes sense. Economic news this week is expected to show a slight slowdown in US economic growth.

The Index to an all-time high surprisingly mixed technical action by individual S&P 500 stocks last week despite a move on Friday.

Sectors showing strongest positive technical action were

- Industrials,
- Technology
- Materials

Sectors showing weakest technical action were

- Consumer Discretionary
- Financials

Number of S&P 500 stocks in an intermediate uptrend was unchanged at 282, number of stocks in a neutral trend increased to 52 from 46 and number of stock in a downtrend dropped to 166 from 172. The up/down ratio increased last week to $(282/166=)$ 1.70 from 1.64

The earnings and sales outlook for S&P 500 stocks remain promising (albeit at a slightly lower level than previous): 6% of companies have reported to date. 80% reported higher than consensus earnings and 83% reported higher than consensus revenues. Accordingly, consensus for blended Q2 earnings on a y-o-y basis for all companies increased to 6.8% from 6.5%. Consensus for blended Q2 revenues remained the same at a 4.8% rate. This week another 68 S&P 500 companies are scheduled to report (including 9 Dow Jones Industrial companies. Beyond the Q2, consensus shows a 7.2% increase in Q3 earnings (down from 7.3% last week) and a 5.0% increase in revenues (down from 5.1%). Consensus for Q3 shows a 12.2% increase in earnings (down from 12.4%) and a 5.0% increase in revenues (down from 5.1%). For 2017, earnings are expected to increase 9.6% (down from 9.8%) and revenues are expected to increase 5.3%.

Response to Q2 reports was "off to a rough start" late last week. High profile companies (JP Morgan, Citigroup, Wells Fargo) reported higher than consensus Q2 profits, but traders took profits on news. A word of caution on US Q2 earnings reports! On one hand, consensus estimates are notorious for under-estimating actual earnings. On the other hand, consensus estimates for Dow Jones Industrial Average companies are significantly lower than consensus estimates for S&P 500 companies (3.0% increase for Dow companies versus a 6.8% increase for S&P 500 companies). The discrepancy implies that a small number of S&P 500 companies (think FANG companies) will report oversized sales and earnings gains while other companies will report less than consensus results. Rotation within sectors could be significant during the next few weeks.

Short-term technical indicators (momentum, above/below 20 day moving average) for most equity markets, commodities and sectors turned higher last week. In most cases they are overbought, but have yet to show signs of peaking. Medium term technical indicators (Percent of stocks trading above their 50 day moving average, Bullish Percent Index) generally moved higher last week, but became more overbought.

Note the downgrade in seasonal ratings indicated below for a wide variety of equity indices and sectors effective July 17th. The S&P 500 Index and TSX Composite Index on average during the past 20 years have reached a seasonal peak on July 17th. This year, technical evidence currently suggests that the S&P 500 Index and Dow Jones Industrial Average probably peaked on June 19th.

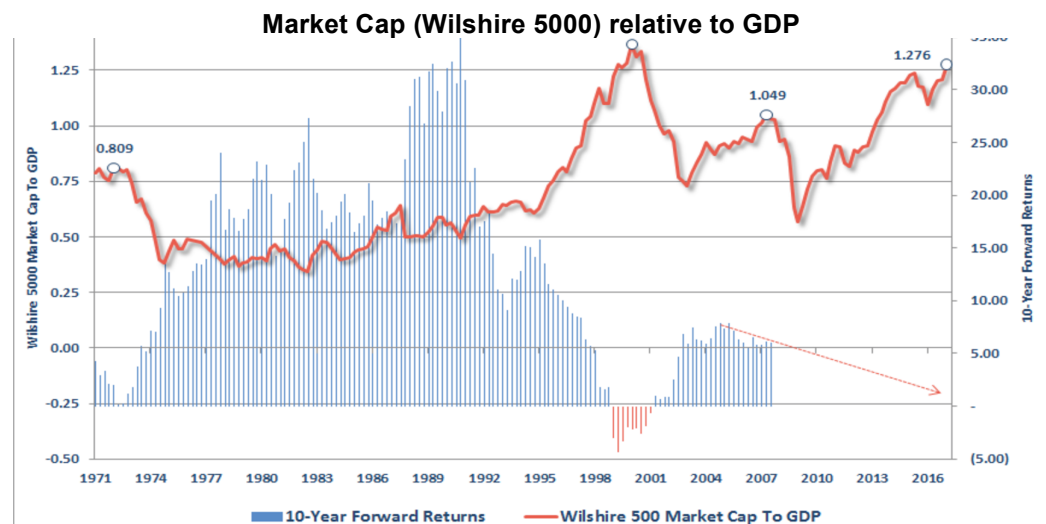


US equity markets have a history of moving lower from mid-June to mid-October in Presidential cycle years after a two term President has been replaced (as indicated this year). See red line in the chart below.



As we have been highlighting since May 13th, US equity valuations are extremely high, and not sustainable at these levels for the long term in our opinion. **Listed and charted below are a few equities' valuation measures, which are at all time highs, and which should be of concern for serious investors:**

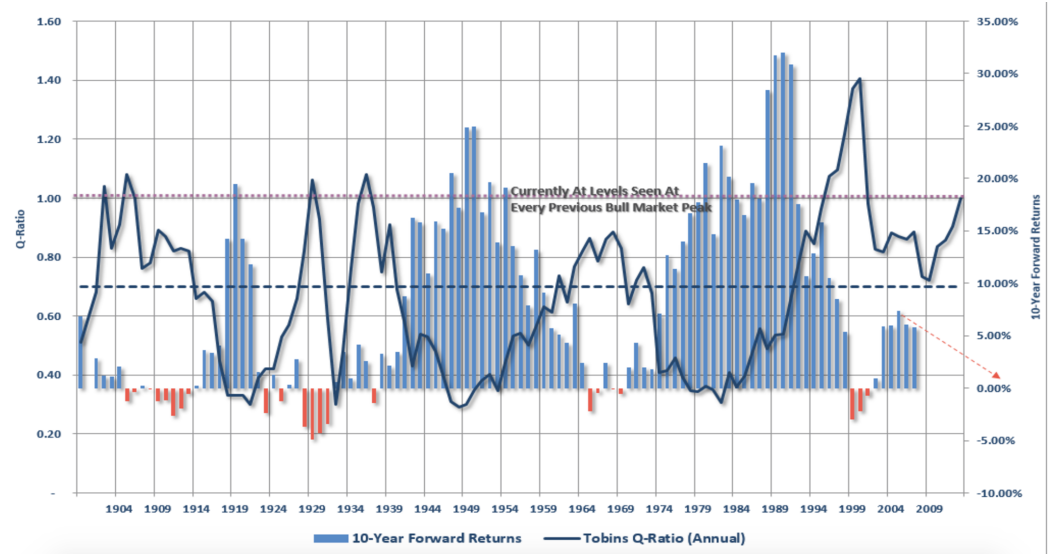
- Market Cap to GDP
- Price to sales
- Tobin's Q
- Earnings yield
- Number of hours for average American to buy 1 share of SPX



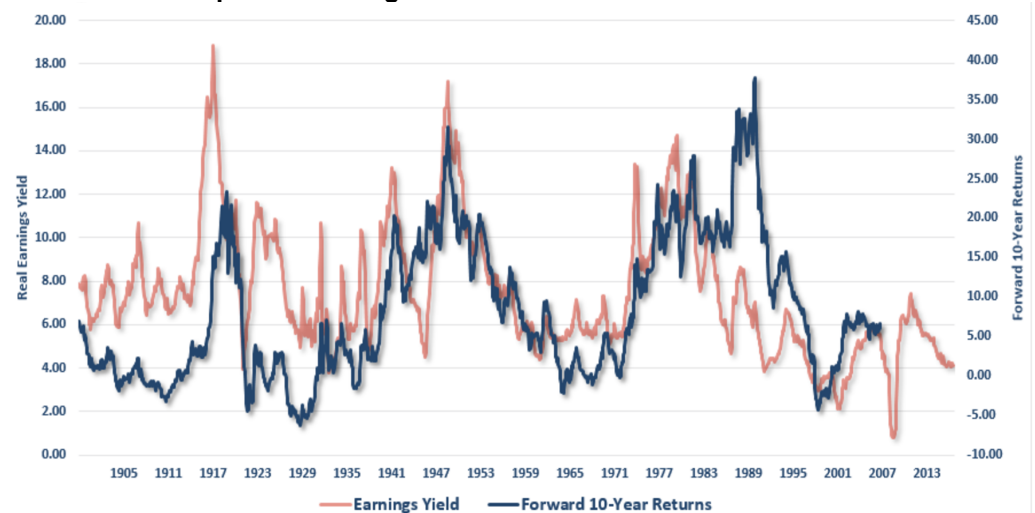
Price to sales valuation is a good long-term indicator of overvaluation, and current price-to-sales is pushing the highest level in history.



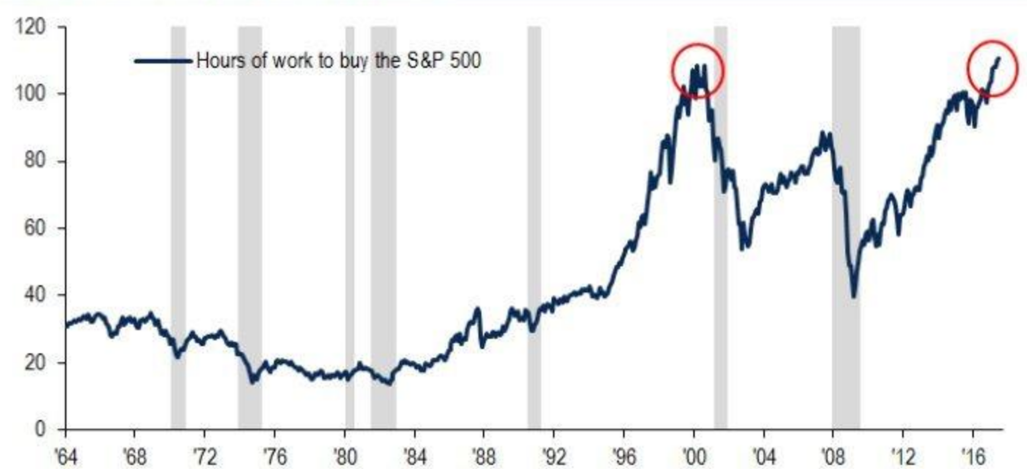
Tobin's Q Ratio vs. 10-Year forward returns



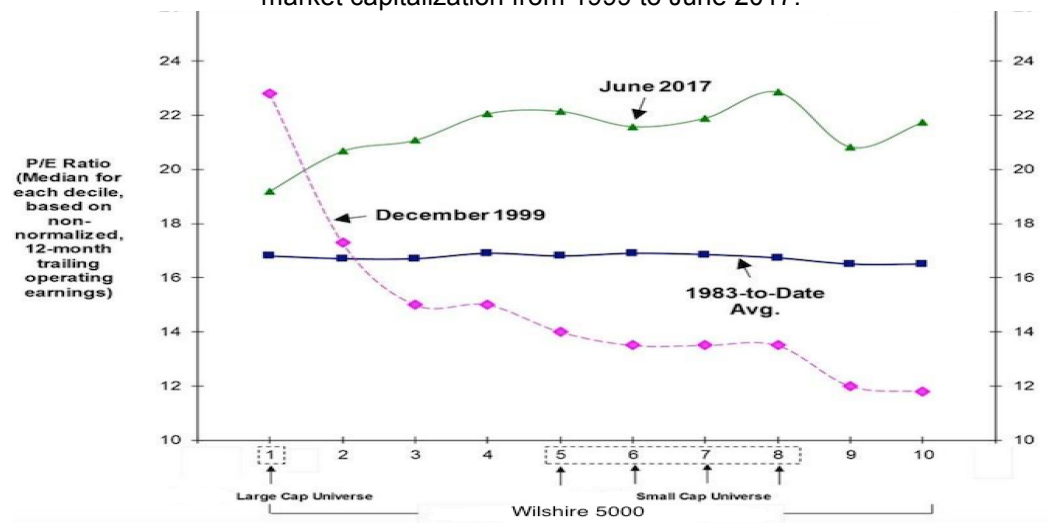
Equities Earnings Yield vs. 10-Year forward returns



And lastly, from a retail investors' perspective, an important valuation metric for stocks is the number of hours of work for the average American to buy the S&P 500, which currently has hit Dot-com bubble highs:

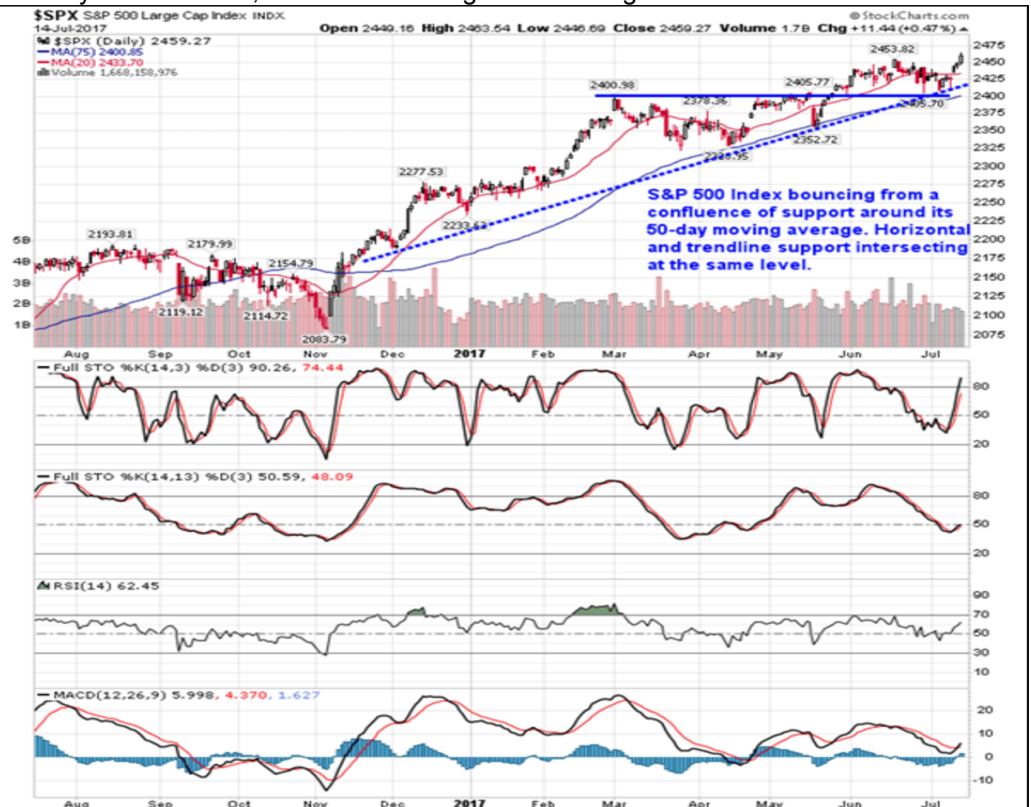


The following chart gives a P/E ratio comparison for US stocks (Wilshire 5000) by market capitalization from 1999 to June 2017.



The S&P 500 Index added almost 0.5%, closing at a new all-time high as the benchmark tacks on further gains to this seasonally positive time of year. Recall, between the close of June 27th and the close of July 17th, the S&P 500 Index has gained an average of 1.11% with positive results realized in two-thirds of the seasonally favorable timeframes over the past 50 years.

As of Friday's close, the \$SPX is higher by 1.65%, helped by the financial and technology sectors, each of which have gained over 3%. Nevertheless, the technicals of the market continue to be positive. Support on the large-cap index continues to hold at the rising 50-day moving average and momentum indicators have just started to curl higher after dipping into the end of the last quarter. While the new highs amongst the major equity indices suggest that the sky is the limit, traders must be mindful that the conclusion of this summer rally period also coincides with the start of the most volatile time of year for stocks, which can see significant swings in either direction.



European equities seemingly took the seasonal lead to roll over, as the Euro Stoxx 600 Index briefly moved below 386.46 completing a double top pattern, and short-term indicators (MACD and RSI) turned negative. Next support is the 200-day MVA at 366, there after the range of support between 340 and 360 should give comfort.



We continue recommending for investors to reduce equity positions in G-10 markets into the last rally before the summer, as we are forecasting for a -12% to -15% decline in European and US stocks to materialize. The spike in volatility above levels reached last week will be the most likely sign that the summer correction has been confirmed. Meanwhile, we continue to recommend holding a robust position in cash in your investment portfolios.

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