



Creative Global Investments

Weekly investment strategy & charts

Tuesday, July 25th, 2017

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Just as a recap, since our June 20th Q3 Global Investment Outlook & Strategy and the performance of our major forecasts which we had correctly predicted for the quarter:

- US\$ has dropped -3.84% since June 20th
- EUR has gained +4.6% since June 20th
- WTI has gained +9.87%
- Global Equities have rolled over, and for the case of EU equities, we correctly did forecast the seasonal peak on May 23rd (EUROSTOXX 600)
- US equity markets are showing same set up now, as EU and Asian equities did in May, and we are expecting the S&P 500 to follow global peer indices down by -12% to -15% by middle of October



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2017 Q3 Global Investment Outlook & Strategy

- Global economy to slow to 2.5% to 2.8% GDP in 2H 2017
- Chinese economy will stay on track for 6.0 to 6.5% GDP growth
- EU economies' GDP growth will continue to surprise on the upside (+1.6% for 2H 2017), albeit less than in 1H 2017
- US economy to decelerate in Q3 (sub 2.0%) consumer-fatigue driven, and partly due to embedded US\$ strength continuing to weigh on productivity, FDI, trade, tourism
- US presidency and government investigations will impact flows to the US negatively
- 10-Year US yields will move lower (\$TNX 2.10% - 1.70%)
- \$USD will continue decline towards below 93 in Q3 2017
- Oil & Commodities will move higher by 12% - 15% in Q3 2017
- Global Equities to correct by -10% to -15% before end of seasonal weakness October 2017
- EAFE (EU equities will continue to outperform US, mainly due to yield premium (DDM) & valuations advantages) and EM continue to outperform US equities in Q3
- Chinese equities will outperform due to MSCI Index inclusion

June 20th, 2017



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Last week's ECB meeting has provided an additional positive to an already rising tide of optimism on the Euro versus the US\$. In the near-term, EUR/USD sentiment readings have reached the high end of their range of the past seven years. However, near-term uncertainties aside, the latest investors' strategic bias are becoming ever more positive.

Recent comments made by the ECB, by EU company executives and recent investor surveys have shown that the majority of financial market participants don't view the currency as overvalued, and see further upside for EUR/USD in the medium-term, which concurs with our Q3 views.

On the next page we would like to reiterate our 2017 Q3 Tactical Asset Allocation Strategy.

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2017 Q3 Tactical Asset Allocation

Assets classes		Recommendation as of June 20 th , 2017							Change since March 28 th , 2016
		+++	++	+	0	-	--	---	
Equity Markets	USA						XX		Reduce weighting
	Europe				X				Reduce weighting
	Japan					X			Reduce weighting
	Asia/Pacific			X					Increase weighting
	Emerging Markets			X					Unchanged
Bond Markets	Developed Markets		XX						Increase weighting
	Emerging Markets		XX						Increase weighting
	Inflation Linked			X					Increase weighting
	Investment Grade			X					Unchanged
	High Yield				X				Unchanged
	Convertibles				X				Unchanged
Private Equity & Real Assets	Listed Private Equity				X				Unchanged
	Commodities	XXX							Increase weighting
Cash		XXX							Increase weighting
Forex	USD						XXX		Reduce weighting
	EUR		X						Unchanged
	Yen						X		Unchanged
	EM & Others	XXX							Unchanged

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Equities commentary & charts

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.

We have highlighted since May 5th that signs of a seasonal peak in European and now also for North American equity markets had arrived. The Euro Stoxx 600, the DAX and the CAC reached their seasonal peaks on May 13th. The Euro Stoxx 600 Index, which moved below 386.46 completing a double top pattern, and short-term indicators (MACD and RSI) turned negative. Now at 378, the next support is the 200-day MVA at 366, there after the range of support between 340 and 360 should give comfort, but risks towards 330 are rising.



European indices recorded sizeable drawdowns amidst the continued rise in the European currency. The DAX, CAC, and IBEX saw losses in excess of -1% with each turning lower from resistance at now declining 50-day moving averages. The summer swoon tends to be much more pronounced amongst these European benchmarks. Both the German DAX and the French CAC have averaged returns that have lagged the S&P 500 Index between now and the end of September. This trend is seemingly already underway. Weakness amongst global benchmarks can often have a feedback effect, whereby declines spill from one market to another.





The NYSE Composite, a gauge of broad market activity based on all common stocks listed on the New York Stock Exchange, has been trading within a narrowing range for the past year and a half, depicting what appears to be a rising wedge. This is typically a bearish setup that is confirmed when price breaks below the lower limit of the pattern, presently around 11,800.

Chart technical theory says that historically a breakdown below the pattern suggests a retracement back to the point at which the pattern started, therefore back to the January 2016 lows, and more importantly, a break of trend would surely send a very important warning signal to the market that the trend of higher-highs and higher-lows amongst a broad constituent of stocks has come to an end and either a flat to negative trend is emerging. The \$NYA has been hugging the lower limit of the pattern for the past few months as investors show their reluctance in pushing the benchmark back to trendline resistance above 12,000. Seasonally, the \$NYA scores a declining trend between now and early October, just like other major global equity indices such as the DAX 30, the CAC 40, the FTSE, the Ibex and the similarly in the US the S&P 500.

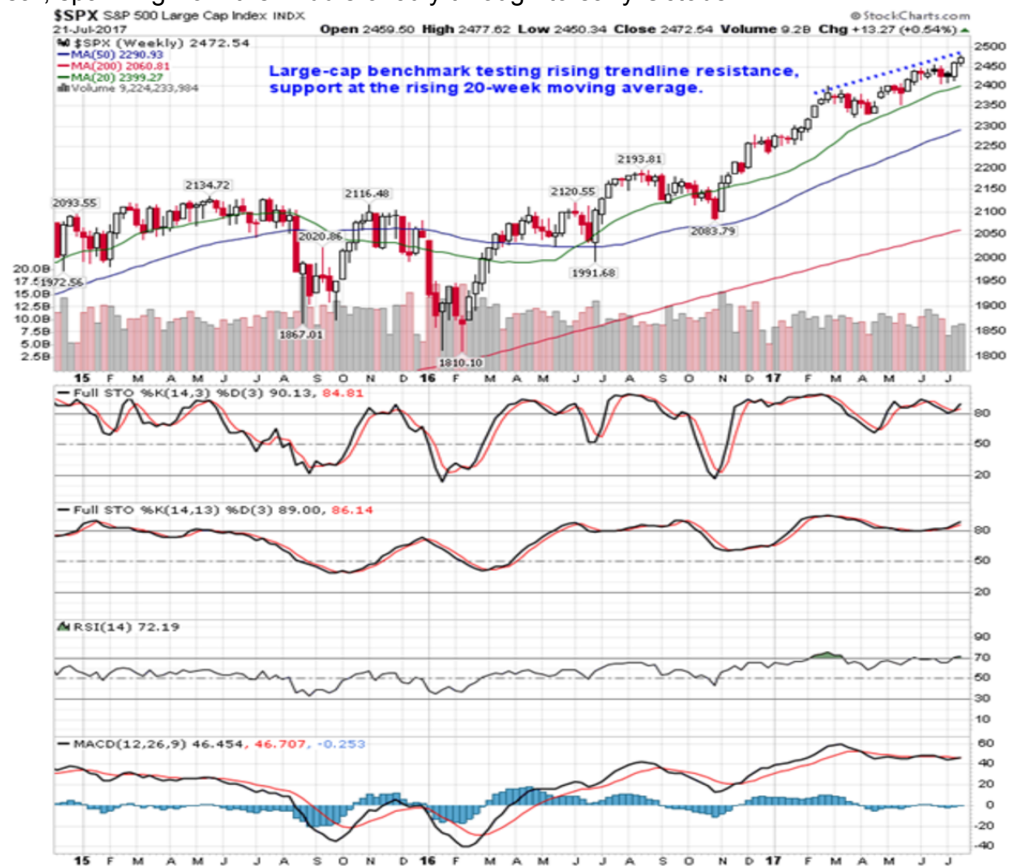


The S&P 500 Index, Dow Jones Transportation Average and TSX Composite Index on average during the past 20 years have reached their seasonal peak on July 17th followed by at least a shallow correction lasting until mid-October. Last week, the TSX Index was virtually unchanged, the S&P 500 Index gained 0.54% (but weakened on Thursday and Friday), the Dow Jones Industrial Average lost 0.27% and the Dow Jones Transportation Average plunged 2.79%. Many S&P 500 stocks came under profit taking pressure last week shortly after reporting strong Q2 earnings. Another 191 S&P 500 companies are scheduled to release Q2 results this week.

However, volatility associated with the summer correction is not there yet. With the VIX Index at a multi-year low on Friday, full force of the summer correction has yet to arrive. Political events (most notably in the US) could change the timing quickly. Possibilities this summer include a show down with North Korea, failure by the US Congress to pass meaningful legislation on health care and tax reform, disruptive news from the investigation on Russia's interference in the US election, an unexpected increase in the Fed Fund Rate and disruptive trade negotiations leading to threat of a trade war.

Equity benchmarks in the US and Canada closed mildly lower on Friday as investors continue to react to earnings that have generally been better than expected. 73% of S&P 500 companies that have reported thus far have beaten EPS estimates, while 77% have beaten revenue estimates. However, despite the generally strong results, investors have been less likely to buy around these all-time high levels, instead leaning more towards the sell button. Stocks that have beaten EPS estimates are only up 0.59% on average [following earnings], while misses have fallen -4.7% and inlines have fallen 2.8%." This has fuelled a bit of a risk-off shift in the most recent week with the utilities, health care, consumer staples sectors outperforming the market return

The S&P 500 Index added 0.54% by Friday's close, remaining overbought according to weekly momentum indicators. Rising trendline resistance on the large-cap benchmark is directly overhead, while variable support remains apparent at the rising 20-week moving average. Seasonally, the benchmark has entered into its weakest period of the year, spanning from the middle of July through to early October

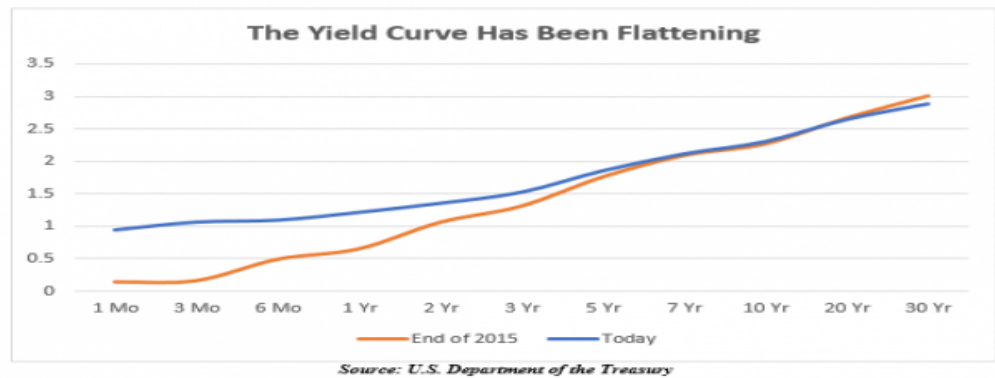


Rotation within sectors could be significant during the next few weeks, with seasonal negatives for the Transports Sector until October.

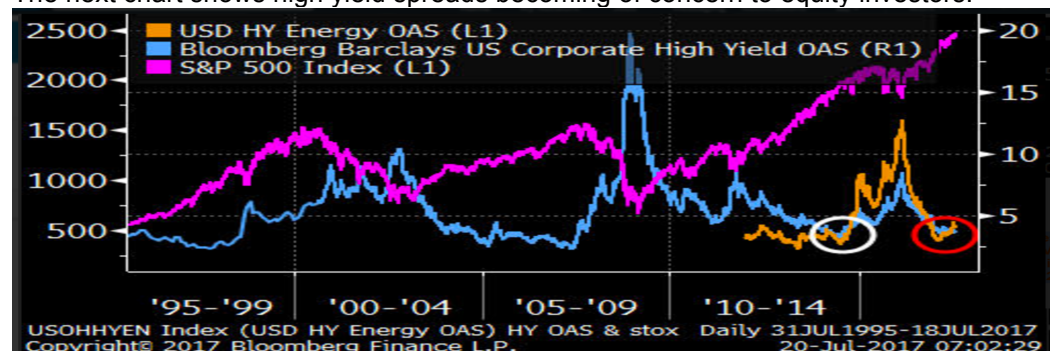


Currently, we see increasing risks for equities in the US:

1. **The yield curve has been flattening over the last few years**, which is a warning sign that a slowdown may be ahead. On average, the yield curve inverts 16 months prior to an economic recession and 13 months before major stock-market corrections. As the chart below shows the blue line (today's yield curve) is notably flatter than the orange line (yield curve at the end of 2015). In the last two cycles, stocks advanced while the yield-curve flattened, but they eventually turned south once it inverted.



The next chart shows high yield spreads becoming of concern to equity investors.



Economic conditions in the US, which include modest but consistent growth, close to full employment, near double digit earnings growth, and steady inflation should allow the Fed's tightening cycle to continue, meaning we can reasonably expect another rate increase this year. That puts upward pressure on the short end of the curve, while global demand for US Treasuries is likely to remain strong putting downward pressure on the long end of the curve. If the short end rises faster than the long end, the yield curve will flatten further and could eventually invert. That would be a significant warning sign and is something investors should monitor closely.

2. The pace of monetary policy tightening. Every recession in the last 50 years has been preceded by a decline in money supply growth (to zero or below), so as the Fed tightens investors should be eyeing how economic conditions, and in particular, corporate earnings, are affected as a result. The Fed has indicated that balance sheet reductions should begin in September. While the rate of balance sheet reductions could be very slow, taking 5+ years to reduce the Fed's balance sheet to \$2.5 TRN, it is still tightening across the board.

3. Credit delinquency rates are on the rise, and it's been fairly broad-based. Auto loans were the delinquency du jour this week, making headlines as analysts took note that subprime auto bonds were exponentially rising. Subprime auto bonds are nothing new, but the sheer increase in circulation is enough to liken it to the subprime mortgage crisis of 2008. A look inside the numbers makes this point clear: in 2009, \$2.5 BN of new subprime auto bonds were sold. In 2016, that number rose to \$26 BN. But, it's not only auto loans that are turning sour. Delinquencies are rising across a variety of sectors, including consumer loans, commercial and industrial loans (many being energy-related), and agriculture. Were not at flashing red warning levels just yet, but it's important to note that rising delinquencies in these areas have historically preceded recessions.

4. In Q2, US and global stocks continued their steady upward march in a low volatility environment. For most investors, the combination of low volatility and relatively strong positive returns is a blessing, and reason to cheer. But to investment managers like us, the combination of low volatility and strong returns amidst a flattening yield curve and rising valuations tends to become a concern. When markets are calm for too long, complacency has a tendency to settle in, and risks can start to build in

pockets of the economy that few people notice. Ignored or unnoticed risks are the very kind that can bubble up and lead to major dislocations, and it can happen fast. The past few bear markets provide evidence of how this can take shape.

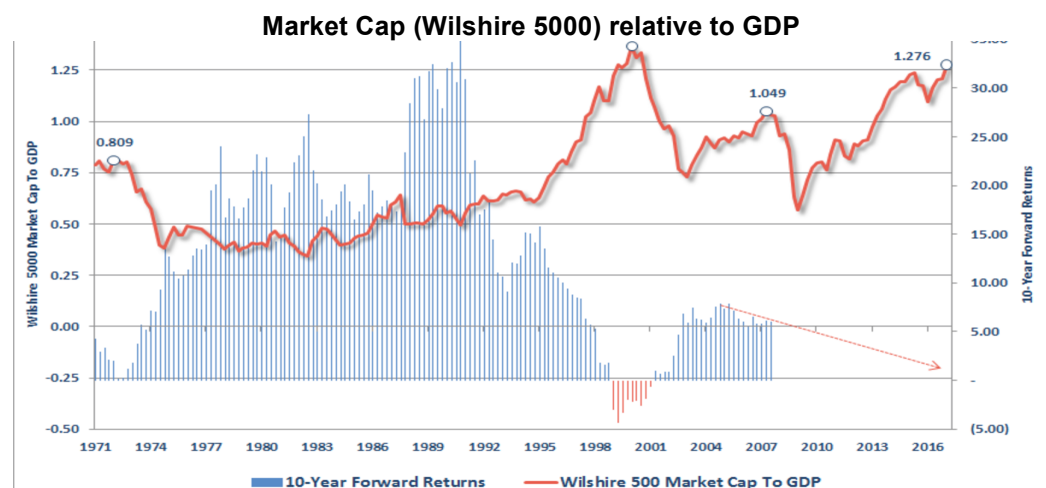
If the market continues to trade in a very low volatility setting, and optimism continues to build on future economic growth and potential stock market gains, it would concern us even more. Now is a time to be extra vigilant, and to make sure your portfolio has adequate diversification and risk-controls should the market take a turn. The last time we saw momentum slowing like this on the weekly chart was in 2015. Shortly thereafter, the S&P 500 dropped from 2135 to 1870 in two months! Perhaps it's a coincidence, but note that the highs were established in July 2015 and the ensuing weakness occurred in August and September - two notoriously bearish summer months that we're now approaching.

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 benefitting 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.



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



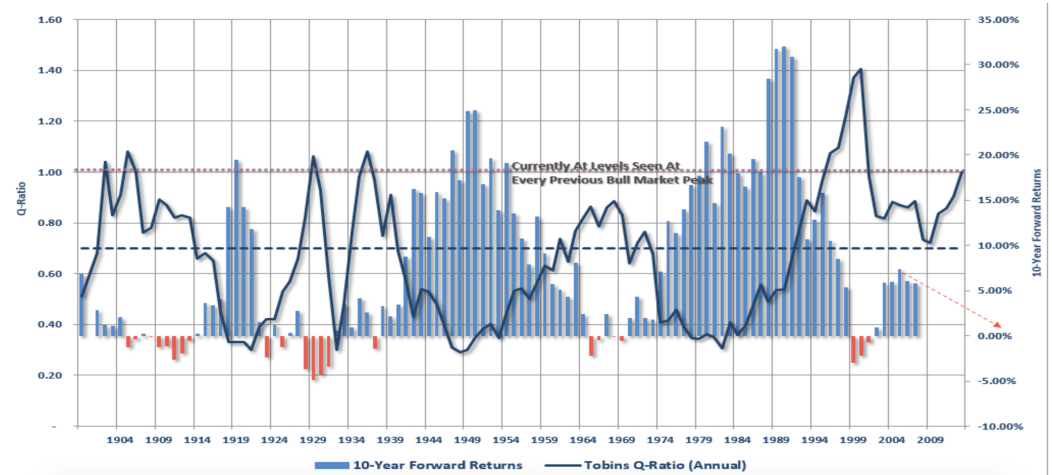
Price to sales valuation is a good long-term indicator of overvaluation, and current

price-to-sales is pushing the highest level in history.

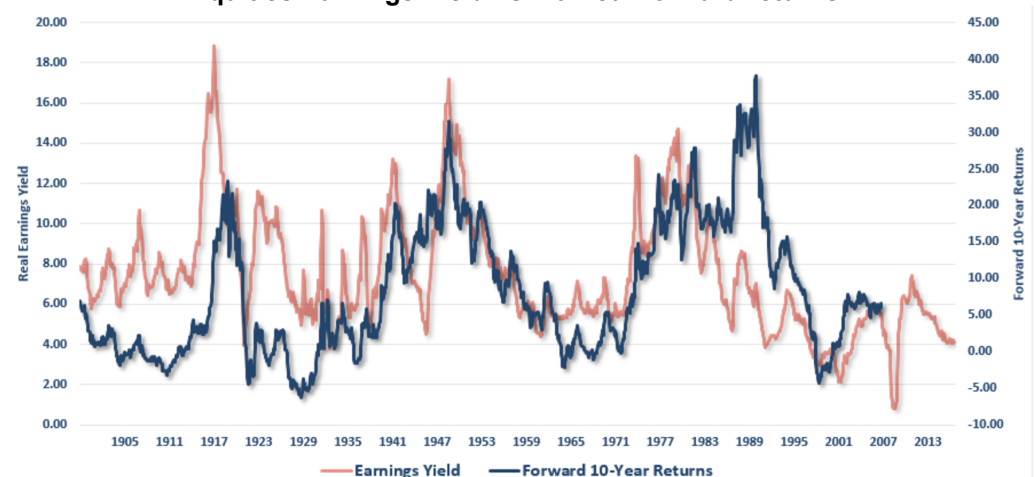
Price to sales vs. 10-year forward returns



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



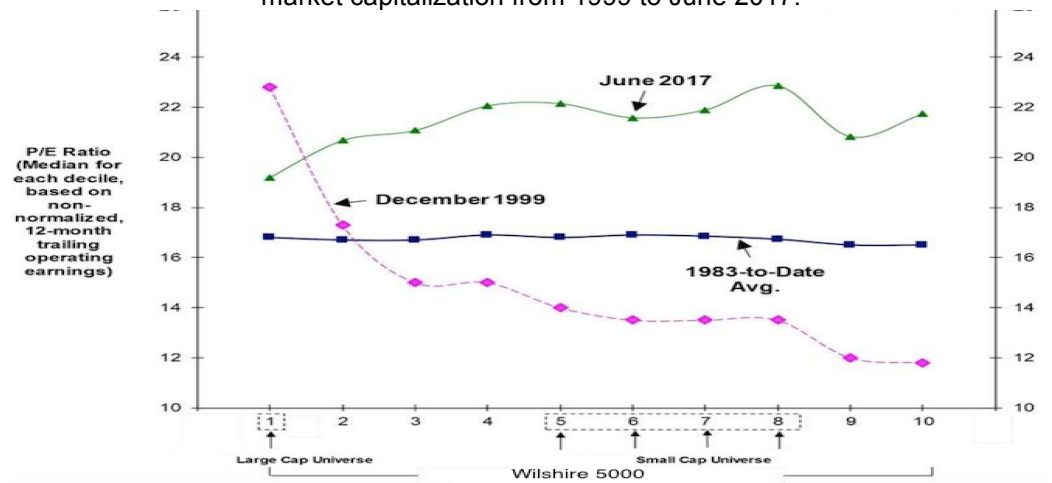
Equities Earnings Yield vs. 10-Year forward returns



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.



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