Creative Global Investments

Weekly investment strategy & charts

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Objectivity

Integrity

Creativity

Macro economic & political Commentary

In Asia, factories across much of Asia posted another month of solid growth in September. China again led the way, with an official manufacturing index expanding at the fastest pace in nearly five years, while factory surveys showed encouraging growth as well in Japan, India and much of emerging Asia. **Macro economic momentum in Asia, as we had forecast correctly for 2017, proves to be much better than consensus expectations, and why we advise for equity investors to allocate more of their funds into Chinese, Indian and Japanese equities from now until year end 2017.**

In Europe, IHS Markit's final manufacturing Purchasing Managers' Index for the Eurozone climbed to 58.1 in September, the highest since February 2011, as an improving global economy boosted export demand in the region's biggest economies.

However, the Catalan Vote rattled financial markets yesterday, and the recent Euro's mini correction continued further, as investors monitored the aftermath of an independence vote in Spain's Catalonia over the weekend, which was marred by violent clashes between voters and national police. The Euro fell as much as 0.8% against the USD to an intraday low of 1.1734 and last stood at 1.1740, down around 0.7% (EUR/USD). Investors shunned Spanish stocks, as the IBEX 35 corrected by -149.50 (-1.44%) to 10,232.00.

Earlier this morning, the pan-European STOXX 600 (STOXX) index was up 0.1% by 0714 GMT, while Madrid's blue chip IBEX (IBEX) also gained 0.1%, recovering from yesterday's 1.2 % fall as Madrid seeks ways to respond to Catalonia secessionist crisis.

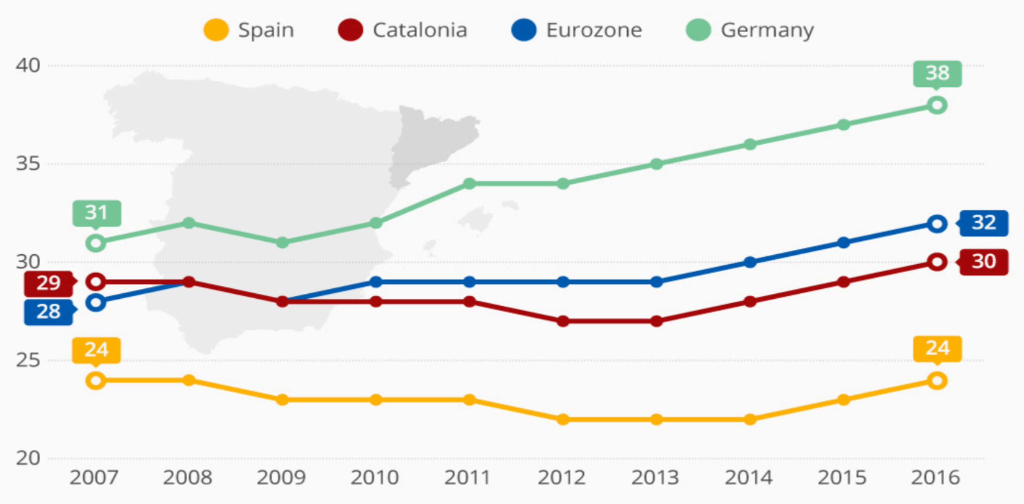
The tensions also had a clear impact in the bond market, with Spanish premiums climbing over comparable German debt. Catalonia's regional leader opened the door to a unilateral declaration of independence from Spain on Sunday after voters defied a violent police crackdown and, according to regional officials, voted with 90% favoring independence. Election results will now be passed along to the Catalan parliament, in which separatists have a majority and a declaration of independence could be declared within days.

As most EU politicians, we also do see virtually no chance of Catalonia to split from Spain, as the macro economic consequences would be devastating for the Catalan economy, as consequent to a split, Germany alone would withdraw and re-position a major part of its investments in factories and businesses from the Catalan economy, and reposition in other, much cheaper parts of Spain, and the economic consequences would be unsustainable for Catalonia. Catalonia, together with its capital Barcelona, has over the past 40 years become one of the economically more powerful parts of Spain. A split would reverse that undoubtedly.

So, whilst socially there is no doubt a strong majority of Catalans who might wish for independence, the economic consequences would be devastating, a bit like the emotional referendum result in the UK with the Brexit vote, and the economic and unintended consequences.

The chart below shows that the gross domestic product (GDP) per capita of Catalonia lies closer to that of the Eurozone than to that of Spain as a whole.

GDP per capita Catalonia, Spain, Germany and the Eurozone



In the Americas, talk of a potentially more hawkish successor to Fed Chair Janet Yellen provided further support. The DXY was up more than 0.5% at 93.45. The USD and US 10-Year Treasury yields moved higher, underpinned by growing expectations of a Federal Reserve rate hike in December. Treasury yields jumped, with the yield on two-year notes reaching a nine-year high of 1.50%, while the 10-Y yield topped 2.37%, the highest since mid-July.

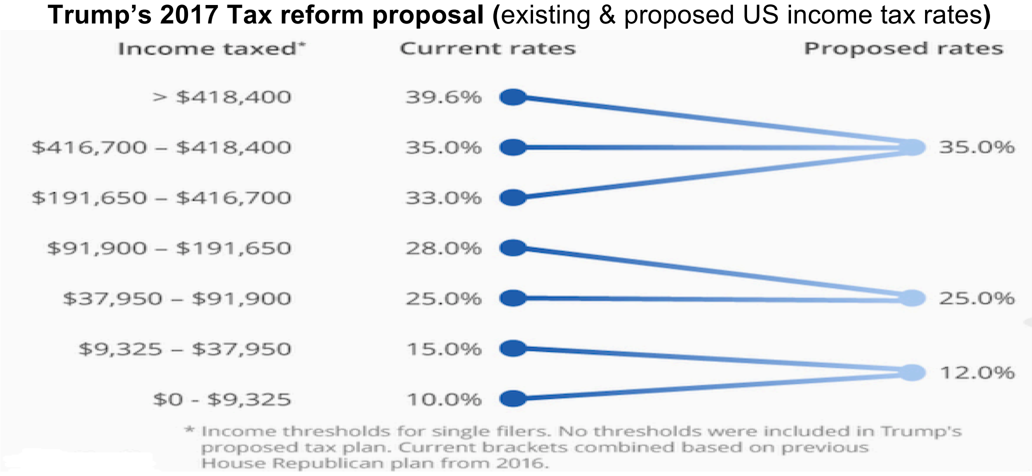
US President Donald Trump held a "cut the red tape" event at the White House yesterday, highlighting the administration's efforts to eliminate what the president sees as burdensome government regulation of private businesses. Trump highlighted the broader initiatives on regulatory reform, but did not announce any new initiatives; merely emphasize what's already being done.

We see Trump's proposed Tax reform being hyped by sell side firms; Trump's tax plan would one-sidedly profit the rich.

Indeed, bringing down the tax ceiling from almost 40 to 35% would profit the biggest earners. In the lower middle-income bracket ($37,950 to $91,900) there wouldn't be any movement (25%).

This, one more time, contradicts Trump's assertion that he would aim for tax cuts for the middle class. Finally, lowest income bracket taxes would hike 2%, and when examining a bit closer, one can see that the expected positive impacts will be minimal at best.

Trump's 2017 Tax reform proposal (existing & proposed US income tax rates)

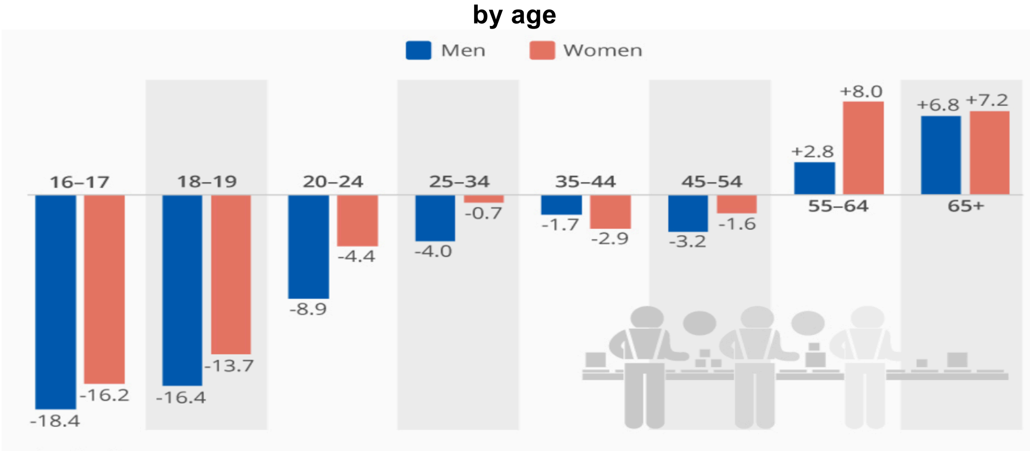


On another obscure macro economic topic of "full employment" in the US, we have researched and mentioned for more than 3 years that the US labor data is misleading to most economists, and needs to be looked at rather from a labor participation aspect, rather than the conventional methodology of labor analysis, measuring the number of people claiming for unemployment.

A study by Alan B. Krueger of Princeton University explores the dramatic fall in labor participation rate in the US from 1997 to 2017. As the next chart shows, over the last 20 years, the rate has fallen the most for the under 20's, with the share of 16 to 17 year olds in work dropping by 18.4% and 16.2% points for men and women, respectively. As the Krueger report shows for 2016, Italy was the only OECD country, which had a lower participation rate of prime age men than the US.

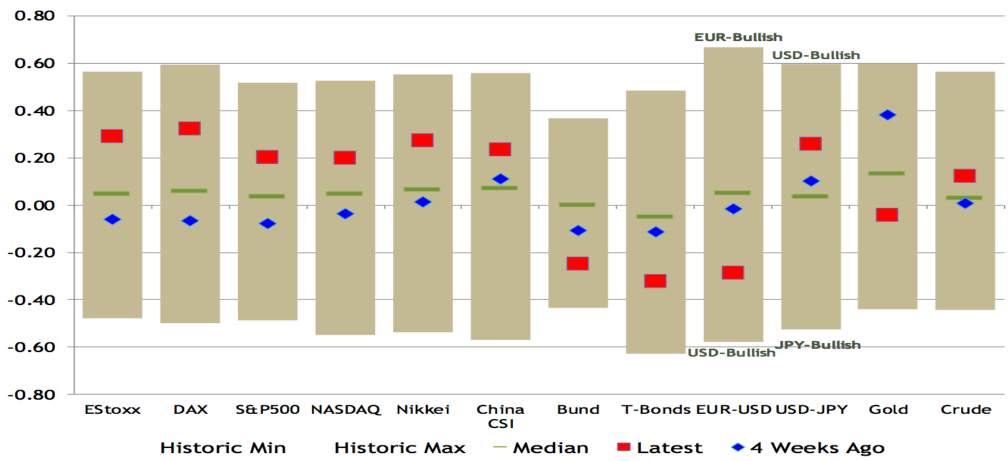
One of the reasons posited by the research is the opioid crisis currently ravaging the country. Labor force participation rates have fallen more in areas where more opioid pain medication is prescribed. According to the Center for Disease Control and Prevention, the amount of opioids prescribed in 2015 was three times higher than it was in 1999.

Percentage point change in US labor force participation rates from 1997 – 2017, by age



Investors' weekly sentiment indicators

Investors increasingly poles apart on Equities versus Bonds The latest ***sentix*** survey indicates that investors remain resolutely upbeat on equities and deeply downbeat on bunds. As a result, the sentiment gap between bunds and Eurozone equities is now large and growing, albeit the gap has yet to reach historic lows.
In the case of equities, investors' increasingly positive medium-term strategic bias on the EuroSTOXX is likely being lent support by growing caution on the Euro, with EUR/USD medium-term strategic bias readings rolling over in recent weeks. The interplay between investor opinion on equities, bonds and the Euro remains notable into the Q4.



Currencies Commentary & Charts

EURO

EUR/USD has dropped 70 points since FX markets opened in New Zealand following the news coming out of Cataluña over the weekend. The civil and political unrest is creating quite a bit of uncertainty in financial markets and it will be interesting to see if the European Union feels obliged to intervene – the Catalan President has already appealed to the EU for support in moving towards a declaration of independence in the coming days. This uncertainty is likely to weigh on the single currency at least through the early part of this week, although this weakness isn't necessarily playing out vs. the pound at the moment with EUR/GBP having traded a narrow 25-point range so far this morning. UK economic data disappointed; Final GDP printed in line with expectations at 0.3% q/q and Current Account data printed weaker than expected, which put GBP on the back foot right from the beginning of the day. Comments from Governor Carney failed to offer the quid any kind of reprise either. He said that the Brexit transition period was in the best interest of the UK and the EU, not drifting to far wide of a very general tone.

US$

The USD strengthened through the day on Friday as month/quarter-end demand kicked in. The greenback was also supported yesterday by the news that President Trump had met with several candidates for the Fed Chair role, including former Fed governor Kevin Warsh, who is said to be keen on bringing reforms to the bank. Economic data released on Friday from the US, including personal income and spending was mixed, but Chicago PMI beat expectations, which gave further support to the USD.

We see the current USD rally as a counter-cyclical one, as the $USD remains well below all of its principal long-term moving averages that define the direction if the primary trend.

It is also important to remember that swings in the USD's do not occur in isolation. They influence a lot of other relationships along the way. The USD's moves affect many markets and relationships but the 4 most important are:

- The ratio between US stocks and the rest of the world
- US bonds versus the rest of the world
- Bond yields
- Commodity prices

Swings in the USD affect commodity prices, which tend to move inversely with the currency. This is not what the current political leadership, and their corporate backers in the US want, as their economic interests with a rising USD are in jeopardy. (Just remember Trumps campaigning views on the USD ("a strong USD is good for America, and shows the strength of the US"), which he reversed totally the week he came into office, when he stated "The US$ is too strong, and is hurting the economy of the US" and "the US trade deficit has got to stop", when he went on his "America 1st" tantrum. Trump did even threaten to "default on government bonds" if the US$ was going to continue to be this strong.

Here is our 35 year old, repeatedly proven "common sense approach" for US economic, monetary and fiscal policies when the GOP is in power goes like this:

"Since early US history, Republicans own the land and what is in it"!

They own businesses related to the land and what is in it (Agriculture, Fishing Companies, Mining (Gold, Silver, Iron Ore), Quarries, Construction businesses, Fishing Companies, Chemical companies, asf. You get the picture).

And in order to exploit these businesses successfully, which are all very capital intensive, long-term big industrial investment businesses, and in order to be able to compete internationally, common sense economic principles apply:

- **They do not want a strong USD (as it raises their overall costs to run their businesses and makes US products globally more expensive and less competitive, and implicitly reduces exports and increases imports)**

- **They do not want a strong USD, as the implications for commodity prices, which tend to be inverse to the USD, and hence making it more expensive to extract and process commodities from the US. Plus, it inversely makes commodities (raw and increasingly so processed {due to additional higher USD-based labor cost impacts & processing & transport costs impacts}**

- **They do not want high interest rates, (i.e. higher cost of capital, which in return lends also support for stronger USD)**

History has shown, with a high, nearly flawless rate of re-occurrence, that is usually safe to assume that when the USD is rising it represents a headwind for both commodities, particularly Oil & Gold.

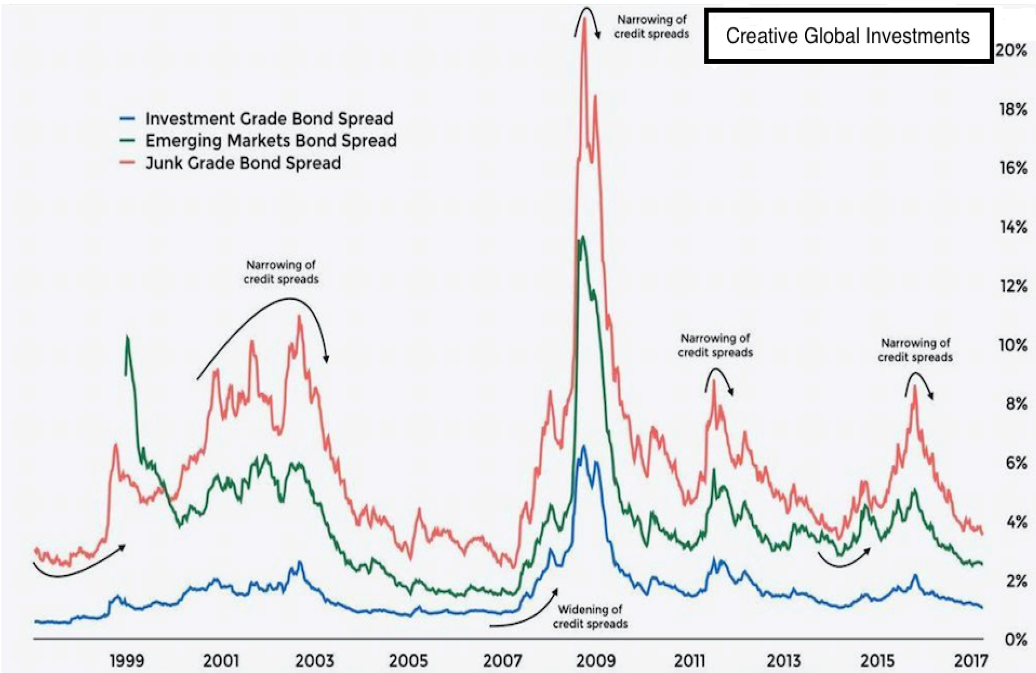
So, just to refresh our memories, "Why would GOP policies now be modified to suddenly tolerate or embrace a stronger US$?

C'mon all strong US$ debaters and currency experts, refresh our minds. We'd like to hear the arguments for "This time it is different". Déjà vu anyone?

Fixed Income Commentary & Charts

Yield spread of Treasury 10s over 2s narrowing, testing lows charted last year.

We see still better value in EM bonds for the remainder of 2017.



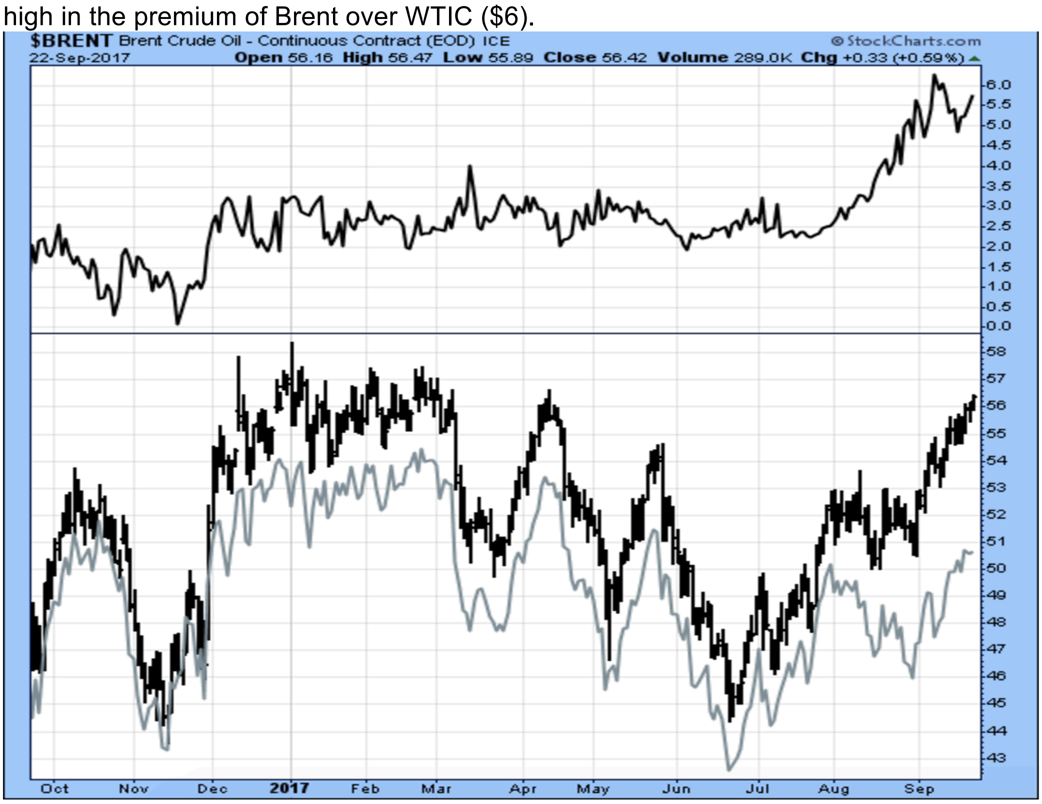
Overall, it has been a reasonably good year so far to be a fixed income investor, as to our original 2017 outlook and forecasts, nearly all fixed income asset classes have delivered a positive return in 2017.

Commodities commentary & charts

As we had been forecasting since June 2017, Commodities' prices are on the rise, as shown in the chart for the $CRB Index below.

The recent upturn in energy prices show the price of Brent Crude Oil ($BRENT) rising to the highest level since April. Since late June, Brent crude has gained 25% (which qualifies as a bull market). Brent being the international benchmark for crude oil. Historically, Brent has given forecasters a truer picture than WTIC Light Crude Oil produce in the states. The gray line shows WTIC lagging behind Brent since August.

That resulted from a drop in WTIC during August resulting from Hurricane Harvey when US refineries were temporarily shut down. The upper box in Chart 5 shows a two-year high in the premium of Brent over WTIC ($6).



Historically, that big a premium has usually resulted in higher prices for WTIC, (as it also has increased demand for cheaper WTIC for export to foreign refiners).

As we had been advising since our Q3 Global Strategy, energy and financials have been market's strongest performers this month, and money has been coming out of the tech sector and is continuing to move into undervalued energy and financial stocks.

Equities commentary & charts

US economic news this week is expected to show mild weakness mainly due to impact of assessment of impact of the two hurricanes affecting the US economy. Other uncertainties are rising such as the Korean "sabre rattling", the failure by Congress to pass crucial legislation (notably tax reform) and increased scrutiny by special council on Russia's influence on the Presidential election.

The outlook for S&P earnings and revenues remains positive (albeit at a lower than previous rate). 75 companies have issued negative Q3 guidance and 43 companies have issued positive guidance.

- Q3 earnings are expected to increase 4.2% (down from 4.5% last week due to Hurricane impacts) on a 5.0% increase in revenues (down from 5.2% last week).
- Q4 earnings are expected to increase 11.1% (down from 11.2% last week) on a 5.7% increase in revenues.
- For FY 2017, earnings are expected to increase 9.6% on a 6.1% increase in revenues.
- Q1 2018 earnings are expected to increase 10.3% on a 6.1% increase in revenues (down from 6.2% last week).
- Q2 2018 earnings are expected to increase 10.1% (down from 10.1% last week) on a 5.9% increase in revenues.

Prospects beyond the Q3 report season are quite promising for US based companies with international exposure. Consensus for S&P 500 earnings on a y-o-y basis are expected to exceed 10% in Q4 of 2017, and Q1 of 2018 and Q2 of 2018. Earnings will benefit significantly from weakness in the USD on a y-o-y basis when revenues and earnings from international operations will benefit from higher valued foreign currencies.

The USD averaged 100 in Q4 of 2016 and 101 in Q1of 2017. If the USD currently near 93 maintains that average in Q4 of 2017, revenues and earnings from international operations will be boosted from currency alone by approximately 5% to 6% in Q4 of 2017 and by 7% to 8% in Q1 of 2018.

What to expect between now and end of October:

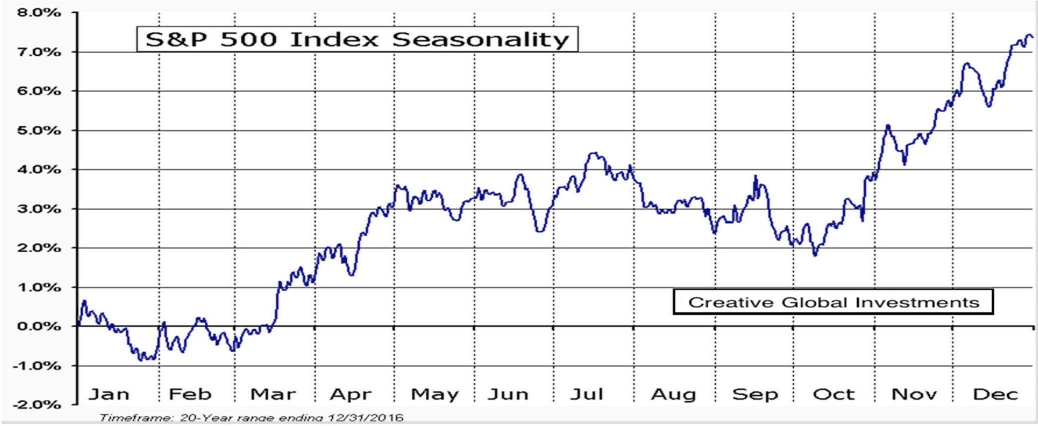
Seasonality on a wide variety of equity indices, commodities and sectors begin to turn to neutral/positive beginning early in October and continue to improve to the end of October. See changes in seasonality ratings below. During the past 20 years, the S&P 500 Index and TSX Composite Index normally bottom in mid-October.

Equity markets have been climbing a "wall of worry". However, expected events during the next 2-3 weeks are mixed and are not fully anticipated by equity markets, and we advise equity investors to be **cautious until at least mid-October.**

- **RISING BOND YIELDS STILL PULLING MONEY OUT OF TECHNOLOGY INTO CHEAPER PARTS OF THE MARKET (APPLE, AMAZON, AND GOOGLE LOSE GROUND)**
- **RISING OIL PRICES MAY CONTRIBUTE TO HIGHER BOND YIELDS**
- **RISING YIELDS ARE BOOSTING SMALL CAPS**

Medium term technical indicators (Percent of stocks trading above their 50 day moving average, Bullish Percent Index) remain at intermediate overbought levels.

Short-term technical indicators (short term momentum, above/below 20 day moving average) mostly moved higher last week to overbought levels, but have yet to show signs of rolling over.



The S&P 500 Index scored a high of almost 2529 yesterday, and came within one point of the 2530 target we suggested 4 weeks ago, representing the upside limit of a short-term head-and-shoulders bottoming pattern observed in August.

With this upside target now fulfilled, overbought readings on the chart of the large-cap index are being flagged, including a reading over 70 on the relative strength index (RSI).

At some point, upside exhaustion has to be expected. Variable support at the 20 and 50-day moving averages at approximately 2495 and 2475, respectively, present the downside risk over the near-term, implying a 2% drawdown should the short-term trend sour. A number of catalysts are ahead including monthly employment reports for September and Q3 earnings, which kick into full gear next week. As well, the Fed's balance sheet unwind, scheduled to begin this month could fuel a response from the bond market.

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