



# Creative Global Investments

## Weekly global equities strategy & charts

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### Geo-political and macro commentary

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Objectivity

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**In Asia**, China's top leaders have started annual meetings to map out economic and reform plans for 2018. The Central Economic Work Conference will focus on implementing agendas laid out by the Communist Party Congress in October, and is watched by investors for clues on policy priorities and key economic targets for 2018 and 2019. China's leaders are maintaining the 2018 growth target of "around 6.5%" in 2018 despite increasing measures to control systemic risks from a rapid build-up of debt.

**China's new home prices rose 5.1% y-o-y in November, down from October's 5.4% increase as the pace of growth slowed in the face of government efforts to engineer a soft landing in the housing market.** Central bank data last week showed household loans, mostly mortgages, rose to Yuan 620.5 Bn (\$93.89 Bn) in November from Yuan 450.1 Bn in October. Property prices in China's tier-2 cities, mostly sizable provincial capitals, recorded the strongest price growth in November, rising 0.5% from a 0.3% increase in October. The smaller tier-3 cities rose 0.4% from a 0.3% gain in October. China's housing market boom was giving the economy a major boost for the past 5 years, but now with fears of a property bubble, the government is taking aggressive measures to curtail speculative buying, particularly focusing on curbing lending for speculation in the housing market in a broad effort to defuse financial risks from a rapid build-up in debt. Average new home prices in China's 70 major cities rose 0.3% in November from the previous month, in line with October's price gains.

**In Japan**, the government plans an initial budget of a record JPY 97.7 Trn (USD 872 Bn) for the 2018/19 fiscal year, however aiming to keep new debt issuance below 2017 levels, mostly due to hefty tax revenue as the economy continues to accelerate. The planned budget spending for the year beginning April 1 marks an increase from this year's JPY 97.5 Trn. Prime Minister Shinzo Abe's cabinet is expected to approve the budget draft on Dec. 22. Tax income for the 2018/19 fiscal year is estimated at JPY 59.1 Trn. Japan's rising tax revenues allow for reductions in new bond issuance to JPY 33.7Trn, (down from JPY 34.4 Trn 2017), eight straight years of reductions. The government will tap non-tax revenue of JPY 4.9 Trn, down from this fiscal year's JPY 5.4 Trn, and reducing debt-servicing costs to JPY 23.3TRN, from this year's JPY 23.5 Trn.

**In Europe**, the five leading EU economies' finance ministers (Germany, France, Spain, Italy and the UK) today have raised concerns in a joint letter to their US counterpart Steven Mnuchin and also the Senate and House of Representatives, that the US tax reform could lead to "international distortions" internationally. The EU warns that the US tax legislation must be in line with the "international obligations" and that the introduction of tax rules that are internationally "less conventional" could lead to significant "distortions" in international trade.

The Federation of German Industries (BDI) had also criticized the reform as "protectionist" and warned of competitive disadvantages for German companies. The EU finance ministers also pointed to the plan to tax corporate financial transfers, and hence risks of double taxation.

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Other important news today is that the ECB today published its semi-annual review of the health of EU banks. The report showed that the ECB's 3-year push to get banks to hold more capital and clean up their balance sheets was bringing the desired positives, and that banks are broadly resistant and stable. The remaining risks centers around profitability and non-performing loan issues. The presentation showed most banks on the ECB's watch held significantly more capital than the minimum 10.6% T-1 capital ratio needed for making payouts to investors and staff. The result was overall very satisfactory, although one unnamed bank fell short of the ECB's requirements and another was barely above it, four banks were asked to hold additional cash to deal with liquidity risk. The review was based on banks' results as of the end of June; meaning banks may have already remedied their shortfalls in the intervening time.

**In the Americas, the New York Federal Reserve on Friday raised its estimate of US GDP growth for Q4 of 2017 closer to 4%,** based on revisions of prior data that the regional central bank's "Nowcast" model calculated the economy was expanding at an annualized pace of 3.98% in Q4, up from the 3.92% rate calculated a week ago. The New York Fed said its latest tracking estimate on GDP growth for Q1 of 2018 was 3.15% compared with 3.12% from last week.

The US Senate approved by a small majority of the tax reform earlier this month. The House of Representatives had approved the reform with a majority of Republicans in mid-November. Both now have to match their versions and vote again. The joint version will then be presented to US President Donald Trump until Christmas. The reform provides for dramatic tax cuts for companies, however individuals are relieved quite differently depending on the income class, with the top earners getting off better in percentage terms. The corporation tax is to be reduced from the current 35% to 20%, below the average of the industrialized countries of 22.5%. **Our major concern of the proposed tax reform is that the bill, if enacted in its current form, will cause a significant increase in public debt, as a recent calculation of the Congressional Budget Office shows an extra USD 1.2 Trn. And, we do not expect, if passed, that this tax reform will actually bring the anticipated affects on "repatriation of US profits held abroad" plus we do not see any meaningful economic "trickle down" benefits.**

## Equities commentary & charts

Major equity markets outside of the US continue to struggle. Most peaked 4-8 weeks ago.

We like to reiterate our positive stance on Japanese equities, combined with partial hedging of the Yen, as the BoJ's continued easing, and the potential to drive it lower against major currencies including the US\$, Euro, and AUD, are fundamentally very attractive, and also will benefit from a seasonal period of strength until end of March (end of fiscal year 2017).

Foreign investors are still tremendously underweight in Japanese equities, both on a trade weighted and an overall GDP-weighted basis, and we think there is room for significant further upward momentum in the short-medium term. We continue advising to use those for long-term asset allocation build-ups to overweight Japanese equities on a relative basis, as we do see more value in Japanese equities still at current valuations than in the US.

Short term investors and hedge funds taking profits before they close their books for the year (western fiscal year end, Dec 31<sup>st</sup>) are offering longer-term investors a great opportunity to build up positions ahead of an expected seasonal rally until the end of fiscal year in Japan (March 31st 2018).

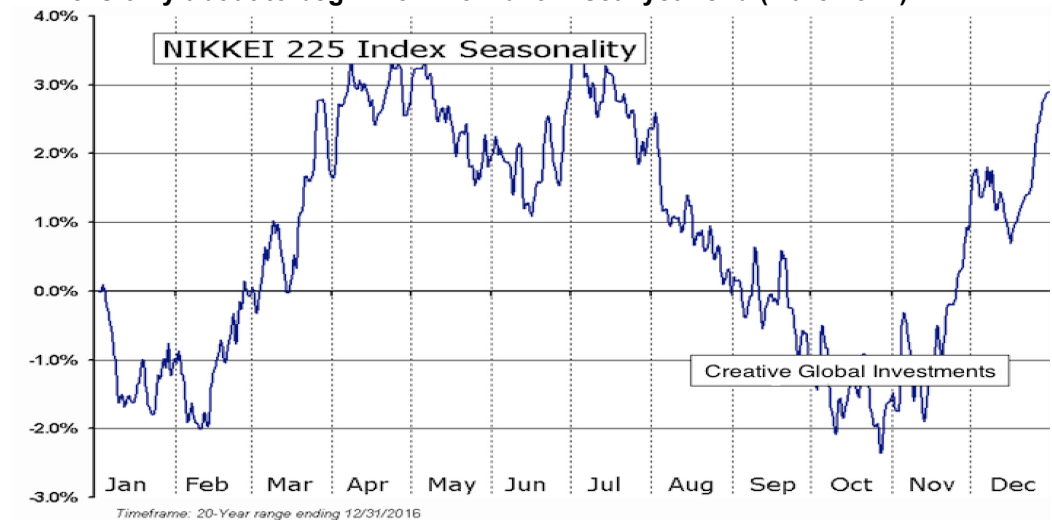
We like to point out again the strong corporate earnings momentum for Japanese companies, mostly driven by managements' focus on profitability (ROE; ROI; ROCE) but also due to strong domestic and export growth momentum.

## Japanese Corporate Profit Margins



Since Abenomics began in late 2012, and since December of 2012 when we have been recommending for investors to “overweight” Japanese equities, the Japanese stock markets have been rising and outperforming the US indices steadily; then the major index the Nikkei-225 stood in 2012 at 8,665.

Today, it trades at a three decade high at 22,901, having surpassed our year-end target of 22,000 already by now, however, the period of seasonal strength for the N-225 is only about to begin from now until fiscal year end (March 31<sup>st</sup>).

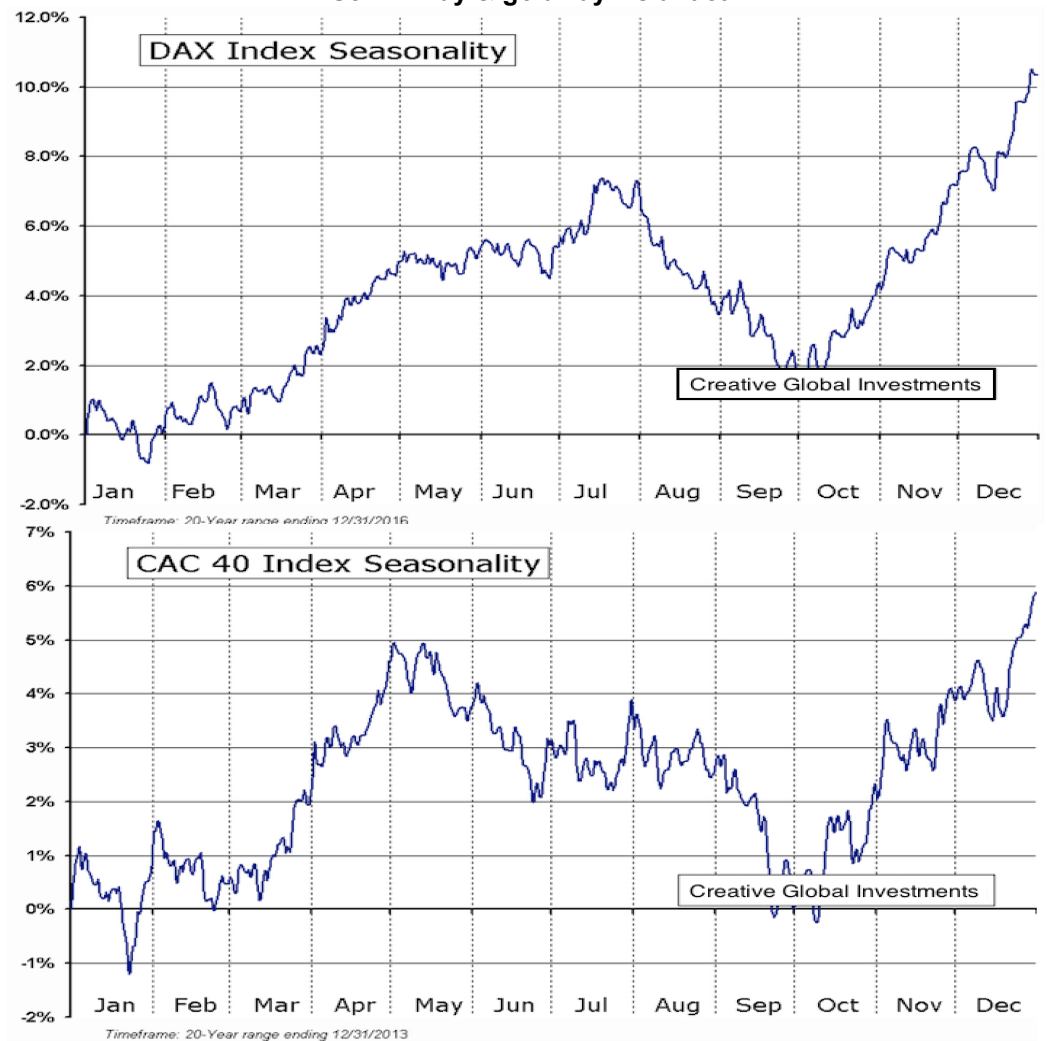


**In Europe**, although a few indices like the DAX 30, the CAC 40 have seemingly peaked about 6 weeks ago, most are still within a few percentage points of all-time highs.

One has to keep in mind that European equity indices have now entered their historic year-end seasonal rally, which gives investors a great entry opportunity to fully load up on financial and industrial stocks, same for utilities, energy and automotive stocks, which are paying above market average dividends in the upcoming 4 months.

European high dividend-yield stocks have historically outperformed over the period of November to May, as fund managers are looking at the upcoming annual dividend pay-out season to own the high yielding stocks. Once post pay-out of the annual dividend, balanced fund managers tend to sell those stocks and “park” their clients money in either government bonds, currencies, or alternatives until October.

Hence, why there is such a seasonal performance disparity in those sectors:  
 “Sell in May & go away” is a fact.



Seasonal influences for most world equity markets turned positive in mid-October and remain positive until the first week in January. Traditional seasonal sensitive sectors (e.g. Consumer Discretionary, Industrials and Financials) are leading the market higher.

The sectors that were under the most downside tax loss selling pressures were the energy, oil services and gold sectors. Selected stocks in the gold and precious metals sectors moved strongly higher late last week implying that seasonal influences may have come sooner than normal this year.

In Europe, like in the US, tax-loss selling pressures in the underperforming energy, oil service and precious metal sectors are expected to continue until the end of this week.

Fund managers subsequently close their books and leave their desks starting this week until the first week of January, leading to a melt up in stocks that has become known as the Santa Claus rally. **We see any weakness provide investors with a buying opportunity for a seasonal trade in these sectors into spring. Energy and oil service stocks began showing technical signs of outperformance late last week, an encouraging technical sign prior to entering their period of seasonal strength.**

**In the US**, economic news this week focuses on passage of the Tax Bill. The market is anticipating passage of the bill. Likely time of the vote by the House is Tuesday. Likely time of the vote by the Senate is Thursday.

A few weekly market developments show a continuation that:

- the technology sector was last weeks strongest sector hitting new highs
- same for the NASDAQ
- the Russell 2000 bounced off 50-dayMVA, as small caps are to benefit from tax cuts
- basic resources sector moved higher lifted by Copper being above 50-dayMVA (Freeport McMoran at 2-year high)

Last week's technical action by individual S&P 500 stocks was mixed. The number of stocks breaking resistance totaled 23 while number of stocks breaking support totaled 15. The number of stocks trading in an uptrend increased to 305 from 304, number of stocks trading in a neutral trend dropped to 55 from 61 and number of stocks in a downtrend increased to 140 from 135. The Up/Down ratio slipped last week to (305/140=) 2.18 from 2.25.

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) for equity indices generally moved higher, but are overbought.

Seasonal influences on a wide variety of equity indices, commodities and sectors began to turn neutral/positive in early October and continue to improve. During the past 20 years, the S&P 500 Index bottom on average on October 10th. Historically, December has been one of the strongest months (the "Santa Claus rally" from December 15th to January 6th is the strongest period in the year for US and Canadian equity indices).

- The outlook for S&P earnings and sales remains positive.
- Q4 earnings are expected to increase 10.6% y-o-y (up from 10.5% last week on a 6.4% increase in sales.
- Q12018 earnings are expected to increase 10.6% on a 6.4% increase in sales.
- Q2 2018 earnings are expected to increase 10.2% (up from 10.1% last week) on a 6.2% increase in revenues (down from 6.3%).
- Q3 earnings are expected to increase 11.6% on a 5.4% increase in revenues.
- Q4 2018 earnings are expected to increase 11.1% (down from 11.2%) on a 4.3% increase in revenues.
- 2018 earnings are expected to increase 11.2% (up from 11.1%) on a 5.4% increase in sales.

Strength in the USD last week triggered weakness in commodity prices across the board (e.g. crude oil, natural gas, gasoline, copper, gold, silver, platinum, palladium, lumber, corn, wheat, coffee, sugar). Strength is related to anticipation of an increase in the Fed Fund rate on Wednesday. Following the increase in the Fed Fund rate, we are expecting commodity prices to recover from deeply oversold levels.

Earnings and revenue prospects beyond Q3 report season are good for US based companies with international exposure. Consensus for S&P 500 earnings on a y-o-y comparison is to exceed 10% in Q4 of 2017 and throughout 2018. US companies' 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.

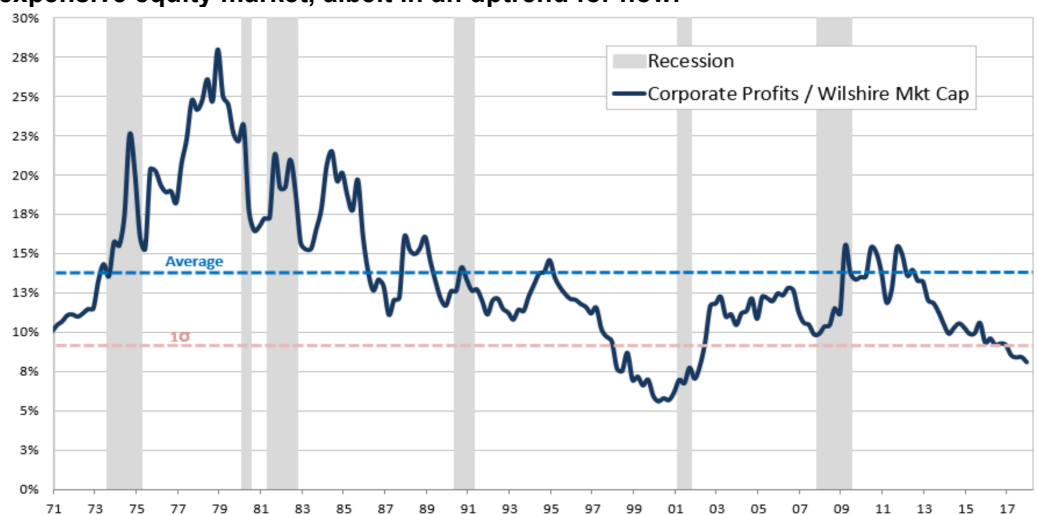
The USD averaged 100 in Q4 of 2016 and 101 in Q1 of 2017, **and we are expecting for 2018 the USD to continue to weaken by -5% to -7% towards USD 0.88. Given our currency outlook, and a weakening USD from here, we continue seeing better value for the short and medium term still in Asian and EU stocks, and continue recommending for investors to overweight equities in both areas relative to US equities and likely achieve higher returns until year-end 2017 and into Q1 of 2018.**



Although US 2017 corporate profits for equities will gain substantially from the weaker USD, and which we see continuing to weaken throughout 2018 by another -5% to -8%, and particularly against the Euro, we believe that on a relative basis, US equities are very expensive by a multitude of valuation metrics:

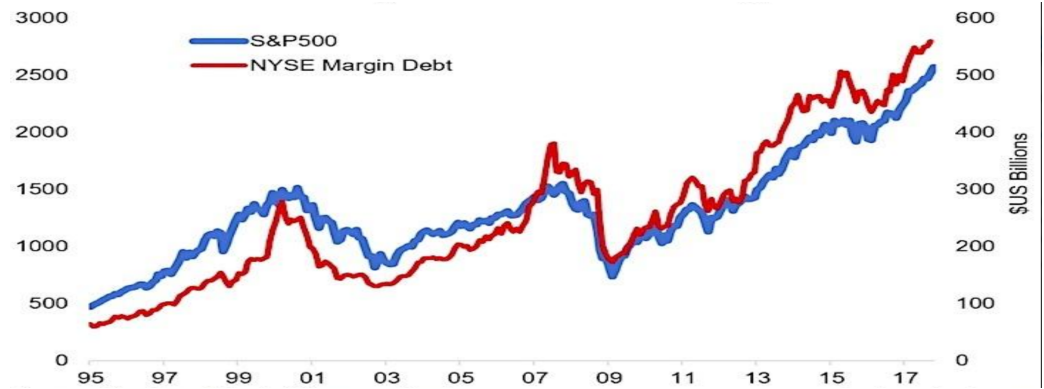
- P/E
- P/CF
- P/CAPE
- P/BV
- MKT CAP/GDP

When put into perspective, in 1H of 2017 corporate profits, which declined y-o-y by -\$32 Bn. For Q3 however, companies posted strong gains of \$92 Bn. Y-o-y profits have gained +5.4%, outpacing nominal GDP growth of +4.2%. Nevertheless, with stocks at record highs, the ratio of profits to equity market cap has declined to 8.1%, the lowest level since the dot-com bubble. **This is another measure confirming we're in an expensive equity market, albeit in an uptrend for now.**



One other longer-term development noteworthy to highlight is the fact that US margin debt relative to equities is at an all-time high, however, given the low cost of financing, this should be adjusted versus historical levels.

#### US NYSE Margin Debt/S&P500



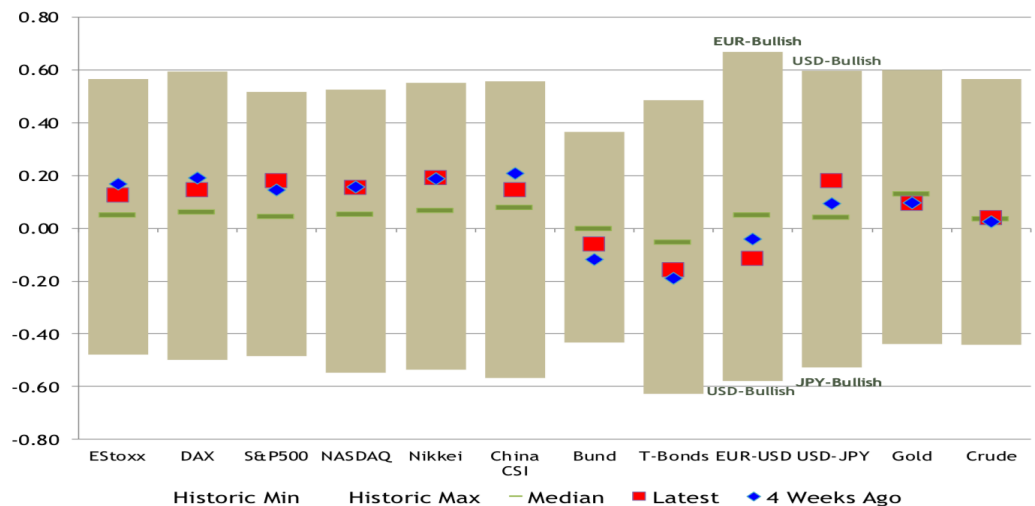
During the past 20 years, the S&P 500 Index bottomed on average on October 10<sup>th</sup>. Historically, the months of November and December have been the strongest months of the year of the S&P 500 Index (mainly during the last two weeks in December).



## Investor Sentiment indicators

The latest **sentix** investors survey revealed that the recent turnaround in sentiment towards Eurozone bonds versus equities is continuing into year-end, while at the same time investors' medium-term strategic bias on the EuroSTOXX continues to weaken. In terms of near-term equity sentiment, survey readings are running at modestly positive levels. However, beneath the surface, investors' neutrality on the near-term outlook for the EuroSTOXX index has reached historic highs.

### Short-term Sentiment in a Longer-term Context



source:sentix

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