Market SitRep

Max Dissonance

Topics

- Risk On, Risk Off
- Equity Valuations

Risk On, Risk Off

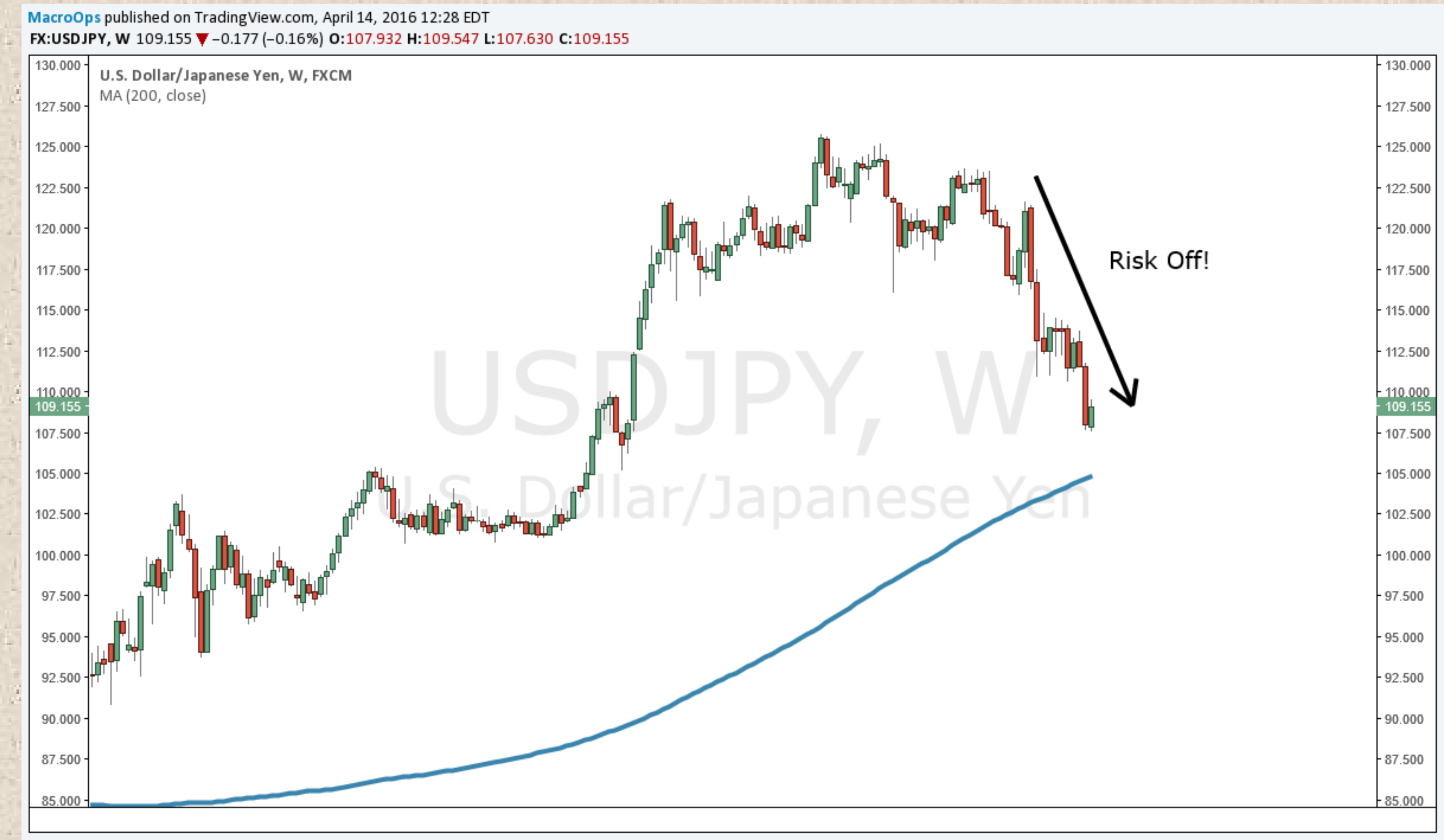
Max Dissonance

- Markets are at a “max dissonance” point.
- Max dissonance means price action and underlying long term fundamentals strongly disagree.
- Conflicting signals litter the marketplace.

Risk On

MacroOps published on TradingView.com, April 14, 2016 12:26 EDT
INDEX:SPX, W 2083.81 ▲ +1.39 (+0.07%) O:2050.23 H:2083.81 L:2039.74 C:2083.81
S&P 500 Index, W, INDEX-CBOE
MA (200, close)
2500.00
2400.00
2300.00
2200.00
2083.81
2000.00
1900.00
1800.00
1700.00
1600.00
1500.00
1400.00
SPX, W
S&P 500 Index
Risk On!
Vol (50, false)
20M
0
2013
May
Sep
2014
May
Sep
2015
May
Sep
2016
May
Sep

Risk Off


MacroOps published on TradingView.com, April 14, 2016 12:28 EDT
FX:USDJPY, W 109.155 ▼ −0.177 (−0.16%) O:107.932 H:109.547 L:107.630 C:109.155
U.S. Dollar/Japanese Yen, W, FXCM
MA (200, close)
USDJPY, W
U.S. Dollar/Japanese Yen
Risk Off!
130.000
127.500
125.000
122.500
120.000
117.500
115.000
112.500
110.000
109.155
107.500
105.000
102.500
100.000
97.500
95.000
92.500
90.000
87.500
85.000

Risk On


MacroOps published on TradingView.com, April 14, 2016 12:31 EDT
BATS:JNK, W 34.65 ▼ −0.01 (−0.03%) O:34.18 H:34.74 L:34.18 C:34.65
SPDR BARCLAYS HIGH YIELD BOND ET, W, BATS
MA (200, close)
JNK, W
SPDR BARCLAYS HIGH YIELD BOND ET
42.00
41.00
40.00
39.00
38.00
37.00
36.00
35.00
34.65
34.00
33.00
32.00
31.00
Risk On!

Risk Off

MacroOps published on TradingView.com, April 14, 2016 12:32 EDT
CBOT_EOD:ZB1!, W 165'28 ▲ +0'27 (+0.51%) O:166'08 H:166'25 L:164'25 C:165'28
T-BOND FUTURES - ECBT, W, CBOT
MA (200, close)
Risk Off!
ZB1!, W
T-BOND FUTURES - ECBT
172'00
168'00
165'28
164'00
160'00
156'00
152'00
148'00
144'00
140'00
136'00
132'00
128'00
Vol (50, false)
4M
2M
0
2013
Jun
2014
Jun
2015
Jun
2016
Jun
2017
Jun

Risk On

MacroOps published on TradingView.com, April 14, 2016 12:33 EDT
BATS:XLK, W 44.52 0.00 (0%) O:44.08 H:44.59 L:43.55 C:44.52
TECHNOLOGY SELECT SECTOR SPDR FU, W, BATS
MA (200, close)
XLK, W
TECHNOLOGY SELECT SECTOR SPDR FU
Risk On!
52.00
50.00
48.00
46.00
44.52
44.00
42.00
40.00
38.00
36.00
34.00
32.00
30.00
28.00
26.00
24.00

Risk Off


MacroOps published on TradingView.com, April 14, 2016 12:35 EDT
BATS:XLU, W 48.65 ▼ −0.03 (−0.06%) O:48.85 H:49.16 L:48.42 C:48.65
UTILITIES SELECT SECTOR SPDR FUN, W, BATS
MA (200, close)
Risk Off!
Vol (50, false)
XLU, W
UTILITIES SELECT SECTOR SPDR FUN

Risk On


MacroOps published on TradingView.com, April 14, 2016 12:37 EDT
NYMEX_EOD:CL1!, W 41.76 ▼ −0.41 (−0.97%) O:39.72 H:42.42 L:39.25 C:41.76
LIGHT CRUDE OIL FUTURES, W, NYMEX
MA (200, close)
CL1!, W
LIGHT CRUDE OIL FUTURES
Risk On!
Vol (50, false)
2014
Apr
Jul
Oct
2015
2016
2017

Risk Off


MacroOps published on TradingView.com, April 14, 2016 12:50 EDT
COMEX_EOD:GC1!, W 1248.3 ▼ −12.6 (−1%) O:1241.8 H:1264.7 L:1241.4 C:1248.3
GOLD FUTURES, W, COMEX
MA (200, close)
GC1!, W
GOLD FUTURES
Risk Off!
Vol (50, false)
1520.0
1480.0
1440.0
1400.0
1360.0
1320.0
1280.0
1248.3
1240.0
1200.0
1160.0
1120.0
1080.0
1040.0
1.2M
800K
400K
0
Oct
2014
Apr
Jul
Oct
2015
Apr
Jul
Oct
2016
Apr
Jul
Oct
2017

Who's Wrong?

- Someone is.
- One of these groups is going to collapse.

The Lynchpin

- We think all these moves upward are due to USD weakness.
- USD is the numeraire.
- Since USD is the lynchpin when it weakens short term everything priced in it rallies short term.

Dollar Against Oil

The Lynchpin

- All assets are rallying on Fed dove-talking the dollar down.
- The world continues to push the easing agenda in the face of stagnant growth.

Max Dissonance

- What we are left with is an extreme dissonance between price and fundamentals.
- Long-term strategic positioning here is tough.
- Short-term tactical trading is the only option in this environment.

Max Dissonance

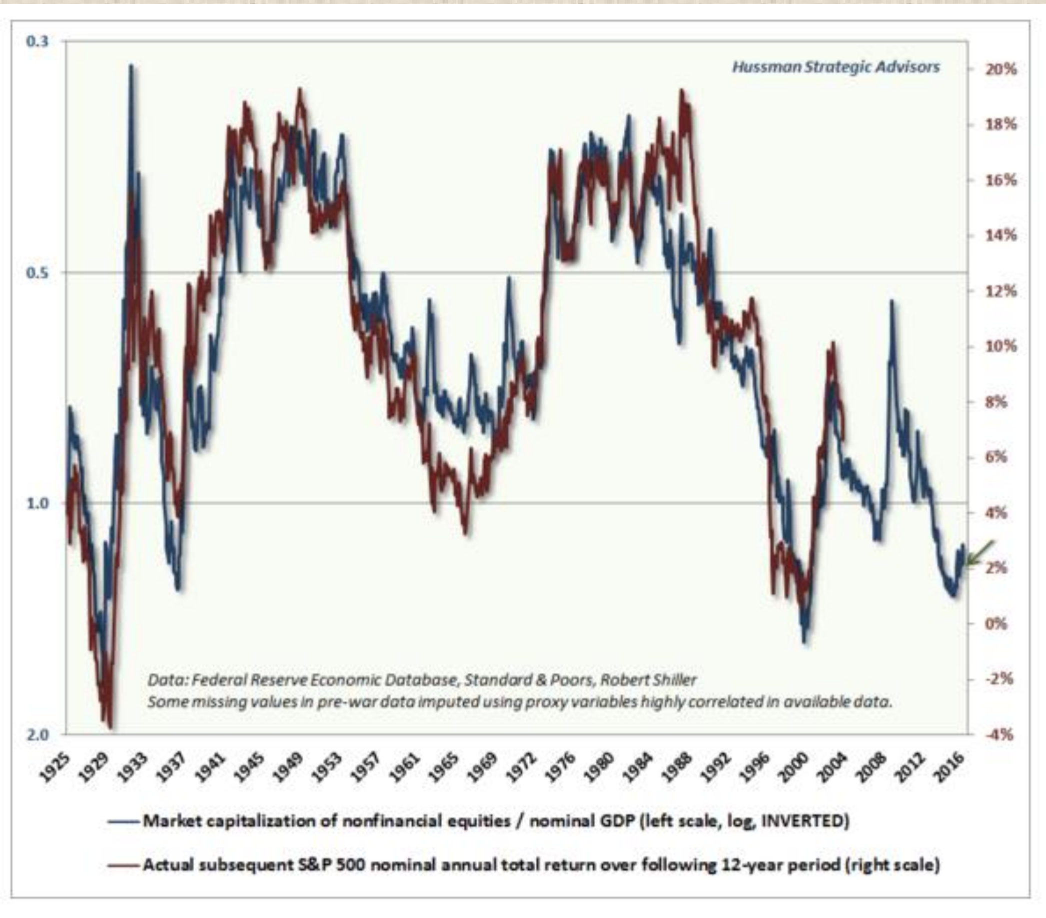
- Investment managers continue to chase yield and returns because they have to or they are fired.
- It is all short-term money chasing the hottest theme.
- Is long-term value here? No.

Equity Valuations

The Big Picture

- The Fed can talk the dollar down and get some short term relief in energy and junk debt.
- But the easing doesn't make stock valuations any cheaper.

Market Cap to GDP



Market Cap To GDP

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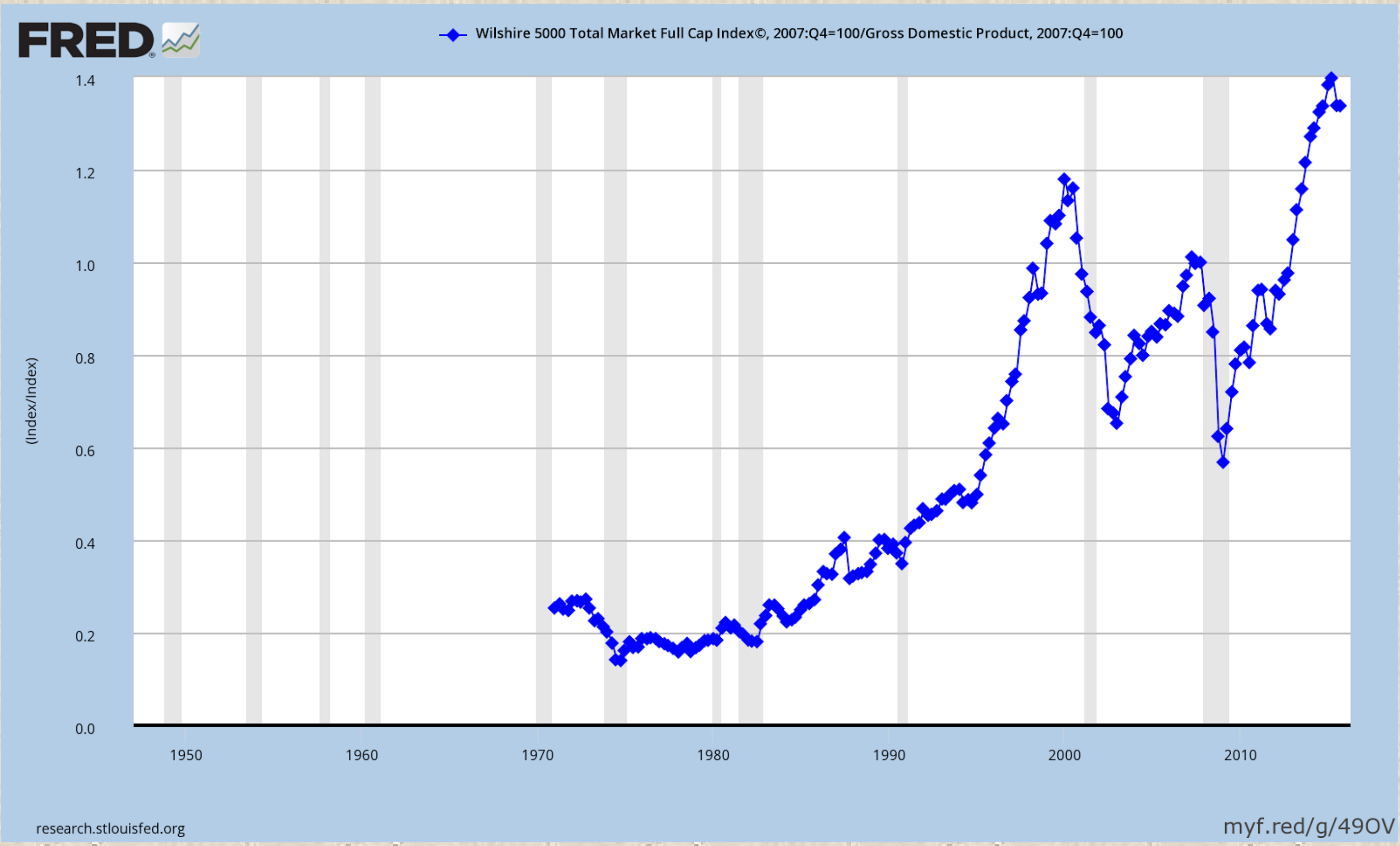
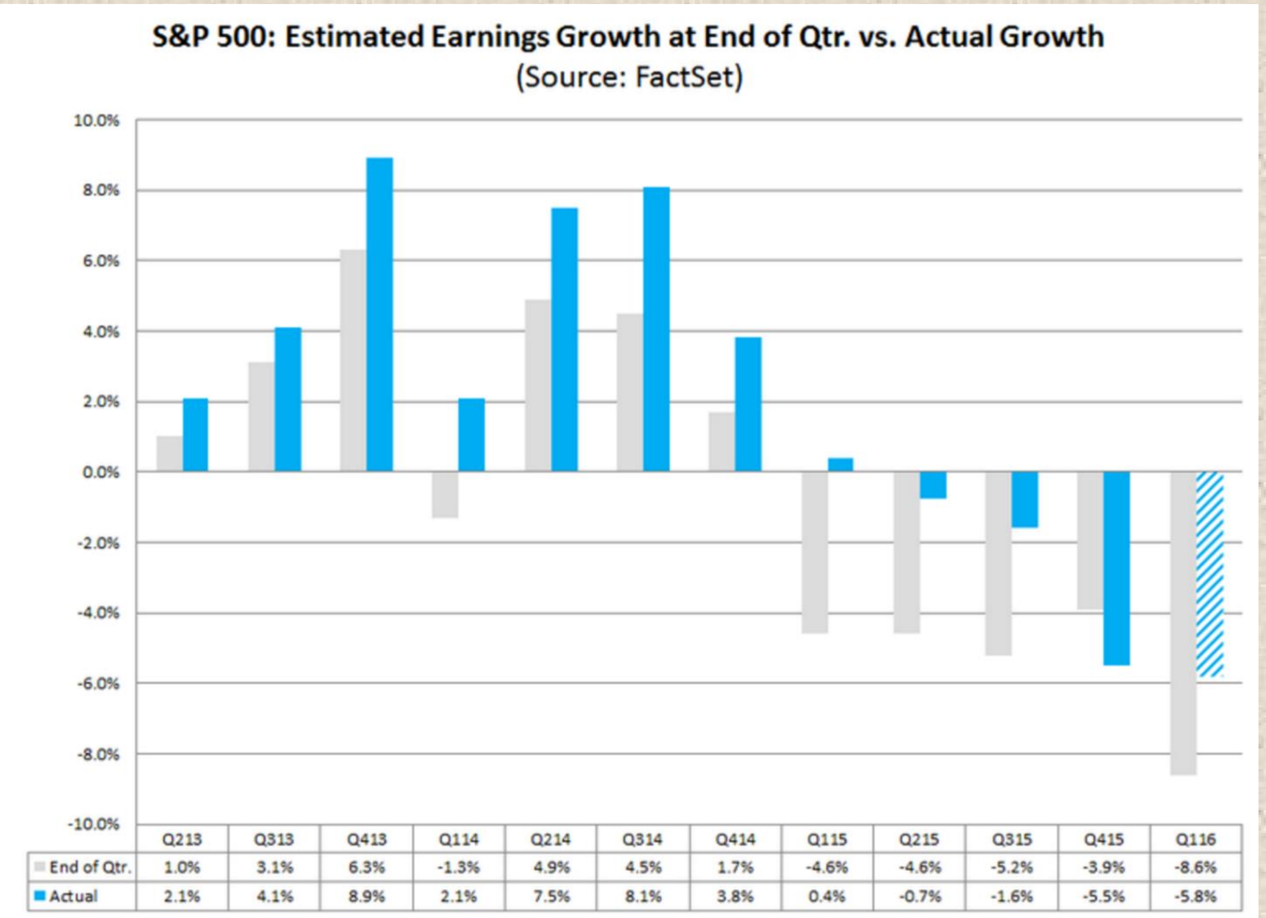
Target. Deploy. Profit.



The Big Picture

- There is no easy way out unless an aggressive growth spurt kicks in.
- And that looks very unlikely given the growth rates we are seeing in EPS.

EPS Growth Dismal



	Q213	Q313	Q413	Q114	Q214	Q314	Q414	Q115	Q215	Q315	Q415	Q116
End of Qtr.	1.0%	3.1%	6.3%	-1.3%	4.9%	4.5%	1.7%	-4.6%	-4.6%	-5.2%	-3.9%	-8.6%
Actual	2.1%	4.1%	8.9%	2.1%	7.5%	8.1%	3.8%	0.4%	-0.7%	-1.6%	-5.5%	-5.8%

Cost of Money

- The cost of money will rise.
- It will happen one of two ways. Inflation scenario or deflation scenario.
- When this happens the picture flips quick.

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Inflation Scenario

- CPI continues to rise and forces Fed to raise.
- Inflation expectations increase drastically and the long end rallies.
- Or commercial banks raise the rate on their loans in order to stay in business.

Inflation Scenario

- If inflation scenario plays out rates would increase, the cost of money will go up and squeeze corporates who are already nearing the end of a cyclical peak.

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Deflation Scenario

- In deflation "lower for longer" scenario real cost of debt goes up and corporates are still in profit margin bind.

Profit Margins

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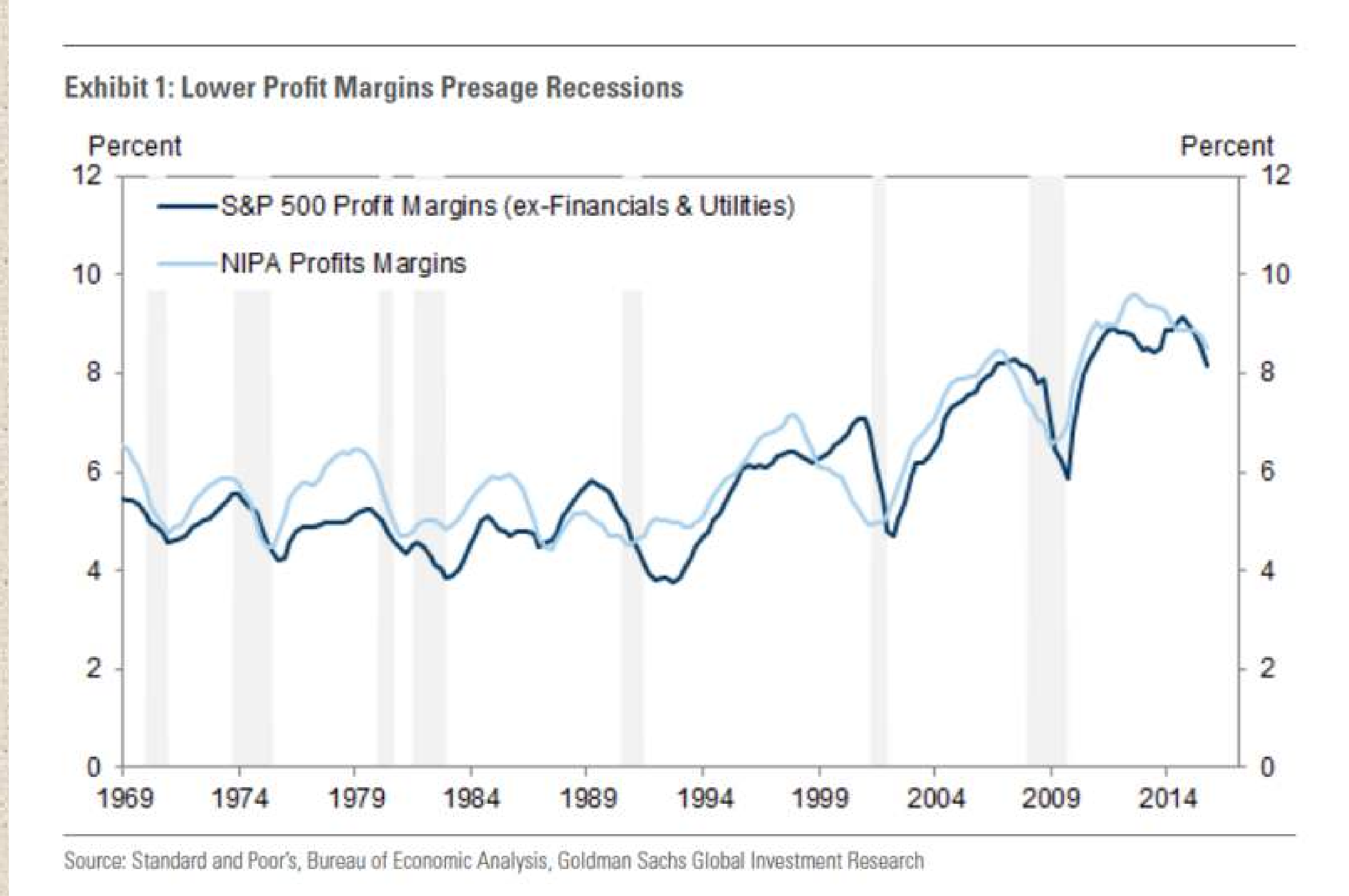
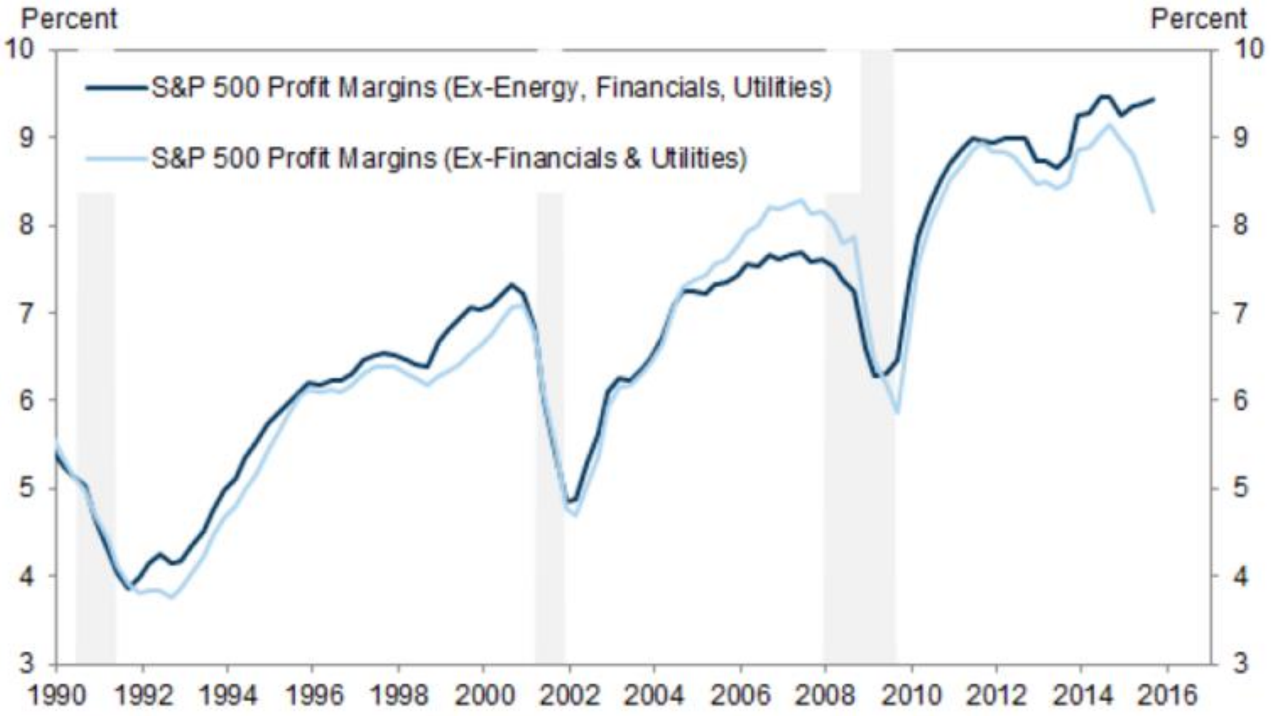


Profit Margins Ex-Energy

Exhibit 2: Lower Margins Attributable to Energy Firms



Source: Standard and Poor's, Goldman Sachs Global Investment Research

Long In The Tooth

- Margins are stalling, mostly due to energy now.
- But current business cycle is long in the tooth.
- At the end of a biz cycle labor costs rise because low unemployment means labor has more negotiating power.
- Costs go up and profit margins decrease.

The Dollar Bull Still In Play

- Europe and Japan are too weak to let their currencies strengthen considerably against the USD.
- They will intervene.
- The USD lynchpin will resume its rally as well putting more pressure on corporate profits and margins.

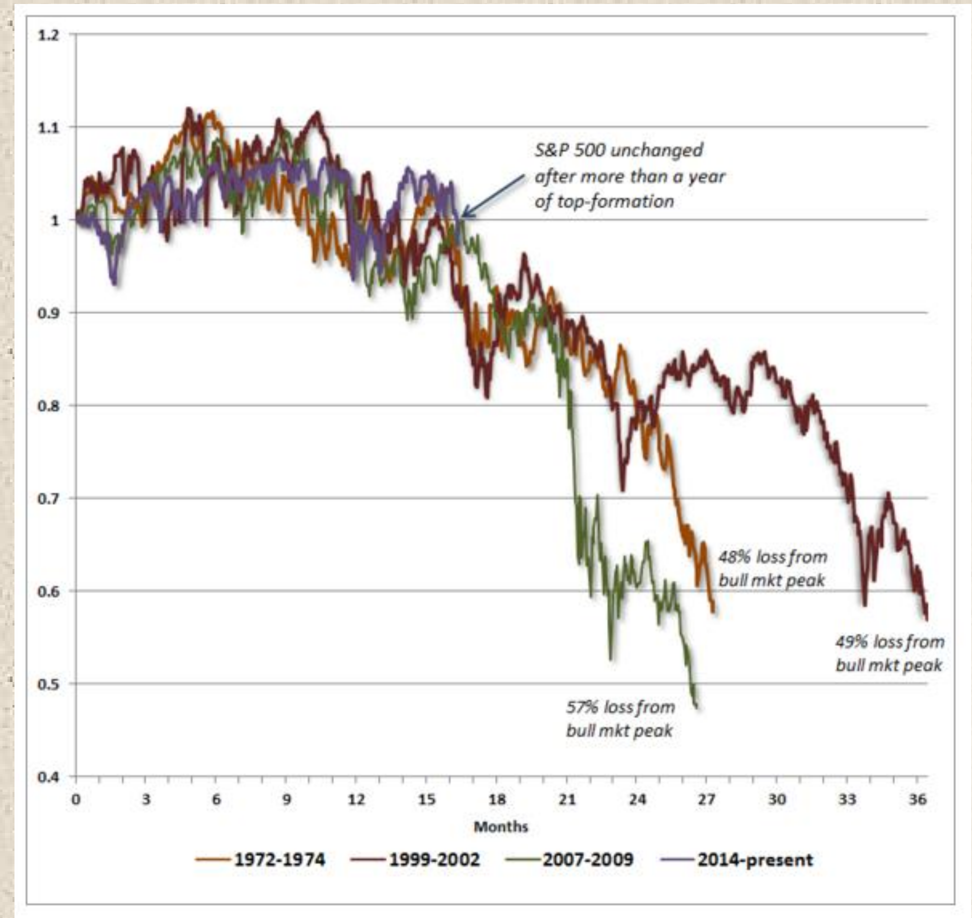
Takeaway

- So we are left right now with a very fragile system with little upside.
- Short term tactical trading is fine.
- But hard to strategically put long term money at work here because the high level of dissonance.

Takeaway

- It's great to be in cash right now waiting for things to get murdered like in the energy sector so you can scoop up and buy things for pennies on the dollar with dry powder.
- There will be great buys in the future for those that are patient enough.

Market Tops Are Volatile



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