TENZING PACIFIC
INVESTMENT MANAGEMENT

2018 Q'2 OUTLOOK

RESEARCH

3 May 2018

Q'1 Review

Q'1 started off with a bang, with most stock indexes globally rising 5% ++ during January. Things quickly turned extremely volatile, with inflation and interest rates surprising on the upside in the US, and the new Federal Reserve Chairman, Jerome Powell, came across as hawkish in initial statements, bringing an end to the "goldilocks" rally in equities.

***CBOE 6-month Volatility Index**

Next came the trade rhetoric with the US government proposing $200 billion of duties on Chinese imports, starting with steel and aluminum. This, once again lead to angst in stock markets as investors feared repercussions by the Chinese and some allies, which would derail the global synchronized growth and trade story. The rhetoric kept coming back & forth during March, leading to further market angst. Much of the rhetoric obviously lacked teeth, as president Trump is well known for entering negotiations from an extreme position in order to shift a compromise in his favor. Both the Chinese and Americans know that a trade conflict is in nobody's best interests, and history tells us that a potential policy error of such a magnitude could very well lead to a recession. Best and worst performers by ETF YTD:

Symbol	Name	YTD Return
VMAX	REX VolMAXX Long VIX Futures Strategy ETF	78.27%
NIB	iPath Dow Jones-UBS Cocoa ETN	52.23%
WTIU	ProShares Daily 3x Long Crude ETN	44.60%
TAPR	Barclays Inverse U.S. Treasury Aggregate ETN	28.83%
SZK	ProShares Ultrashort Consumer Goods	26.72%
UBIO	ProShares UltraPro Nasdaq Biotechnology	-21.28%
CANE	Teucrium Sugar	-21.17%
INDL	Direxion Daily India Bull 3x Shares	-18.50%
TUR	iShares MSCI Turkey ETF	-17.58%
NUGT	Direxion Daily Gold Miners Bull 3X Shares	-16.93%

***Best and worst performing ETFs YTD, courtesy of ETF DB**

Investor sentiment vs. stock valuations

This is a key part of the story as it relates to equities and how to construct a portfolio going into the rest of this quarter. While investor sentiment remains strong, it seems that valuations will now become a greater focus as underlying economic growth which was previously priced into assets has now been crystallized, according to recent data, and the market is going to adopt a "prove that you can do more" attitude when it comes to stock valuations and buying decisions. This is contrary to 2017 where

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investors piled into equities blindly, with blatant disregard for valuations.

State Street's investor confidence index, which measures the risk appetites of institutional investors in North America, Europe and the Asia Pacific region, currently clocks in at 114.5 points, a 1 year high. **Barron's latest Big Money Poll** of professional investors finds the majority (55%) remain bullish on the outlook for equities, while the bears make up only 11%. Additionally, 58% of **McKinsey Economic Conditions Survey** participants say conditions in their home economies are better today than 6 months ago, with Latin America & India reporting the rosiest views.

Stock valuations paint a different picture though. The **Shiller Cyclically Adjusted Price-to-Earnings Ratio (CAPE)** remains at one of the highest levels in history, lower only to the dot.com bubble of the late 90's, currently sitting at 31.5, where the mean value = 16.15. **Morningstar's Price/Fair value estimates = 1.03**, indicating equities continue to be overvalued on an aggregate basis. Interestingly, when evaluating 29 major economies across all regions, the majority (51%) look slightly overvalued when comparing their current P/E vs. a 5-year average.

Update (02 May)	5-year average PE	Current PE	Undervalued
US	15.97	24.16	No
Canada	18.63	16.8	Yes
Mexico	32.39	18.3	Yes
Eurozone	16.86	17.1	No
UK	16.22	17.1	No
France	16.14	17.3	No
Germany	14.98	14.3	Yes
Italy	-124.29	12.66	No
Russia	7.34	7.7	No
Turkey	17.29	9.4	Yes
Brazil	18.28	20.4	No
Chile	22.42	22.16	Yes
S. Africa	20.22	19.1	Yes
China	13.48	17.58	No
Japan	16.62	27.1	No
India	19.20	23.23	No
S. Korea	13.58	13.06	Yes
Hong Kong	14.67	12.77	Yes
Taiwan	14.68	15.94	No
Australia	17.54	16.4	Yes
Malaysia	28.32	16.51	Yes
Philippines	21.51	21.14	Yes
Singapore	15.11	18.16	No
Thailand	14.01	17.9	No
Indonesia	21.52	19.6	Yes
Vietnam	19.11	15.22	Yes
Saudi Arabia		16.45	No
Qatar	17.94	12.95	Yes
UAE	16.71	14.42	Yes

See the contrast? Our guess is that valuations will continue to plague stock performance for the remainder of the quarter, and that stock allocations will have to be done on a deep value basis, or by identifying unique short-term catalysts and special situations.

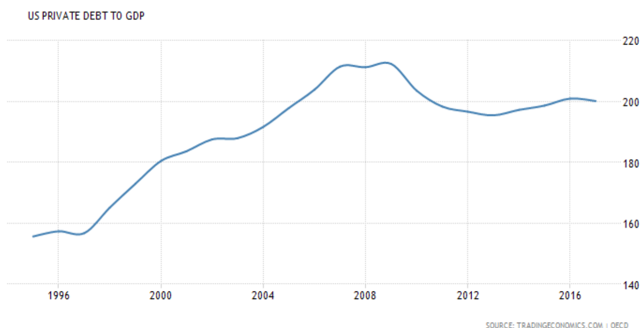
No more easy money in stocks? Where are we in the growth cycle?

Stock prices today reflect what investors will believe will happen in the real economy going into a future, which means they basically act like an economic crystal ball. That being said, they've done a good job predicting growth, both on an economic scale and in terms of corporate earnings. The key question after q'1 is: have prices overestimated growth going into 2019? Let's take a look at some hard data:

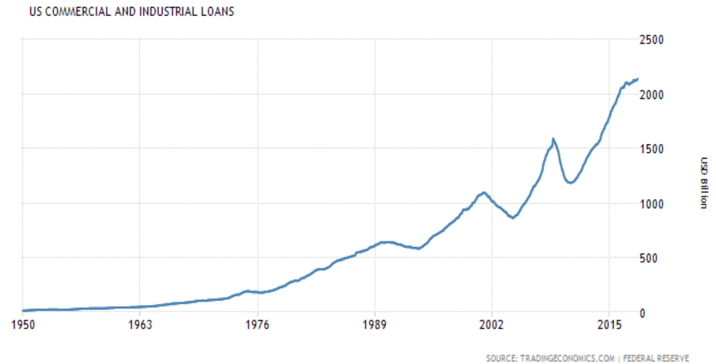
The IMF is maintaining its global growth forecast of 3.9% for both 2018 & 2019, while it has upwardly revised growth for 95 countries for 2018 and a further 102 for 2019. Positive, indeed. If we look at where we currently stand in terms of the economic, or credit, cycle, specifically in the US, we've noted that after looking into growth cycles in the US, and calculating the cumulative economic growth for each cycle and adjusting for inflation, we currently sit around the median point, and around 11% under the average rate, indicating there is still a little room left in the current cycle.

Trough	Peak	# of months	Cumulative GDP growth	Cumulative CPI	Cumulative Real GDP growth per cycle
May 1954	Aug 1957	40	24.46%	5.00%	18.53%
Apr 1958	Apr 1960	24	16.58%	2.00%	14.30%
Feb 1961	Dec 1969	108	99.37%	27.00%	56.98%
Nov 1970	Nov 1973	37	35.51%	16.00%	16.82%
Mar 1975	Jan 1980	59	72.67%	48.00%	16.67%
Jul 1980	Jul 1981	12	16.47%	11.00%	4.93%
Nov 1982	Jul 1990	93	76.97%	33.00%	33.06%
Mar 1991	Mar 2001	122	73.55%	31.00%	32.48%
Nov 2001	Dec 2007	74	137.23%	18.00%	101.04%
Jun 2009	**Dec 2017**	**104**	**37.63%**	**14.00%**	**20.73%**
Extreme number of months	**122**	**Mean Growth Months**	**67**		
Extreme real growth	**101.04%**	**Median Cumulative Real Growth**	**19.63%**		
Median growth in months	**66**	**Mean Cumulative Real Growth**	**31.55%**		

Looking at the credit cycle, specifically in the US, **current US private debt to GDP = 200%,** above the 1995 - 2017 average of 189% and just below the all-time high of 212% reached in 2009. A little worrying considering we equity bull markets live and die by credit cycles.



Looking at the **longer-term credit cycle** we're pretty much at the all-time high and miles above the historical average of 575.64 USD since 1950.



What does this mean for stocks? Put simply, companies are going to have to continue to prove to the market that they are capable of continuing to surprise with earnings and revenue. So-far-so-good this earnings season, with **Thomson Reuters April positive/negative favorable with a 1.2 earnings surprise ratio, and 78% of companies beating earnings expectations which had reported by 30 April** in the US. We're going to need some serious late cycle boost + US supply side stimulus to pull through ASAP if we're going to see these types of surprises continuing for the next 18 months.

What does this mean in terms of asset allocation?

It would seem prudent to begin rolling out of richly-valued equities into some deep value plays which have been ignored in favor of growth and momentum allocations. There are still plenty of opportunities to be captured around the world in terms of aggregate demand. The consumer has not looked this good in a long time, and we are in an unprecedented period of innovation. Simple index allocations are not going to cut it for the remainder of 2018.

Bonds are still going to struggle as we head toward the end of the credit cycle and a synchronized global increase in inflation begins to arrive. It would make sense to keep your duration short and avoid rate sensitivity as well as overly leveraged corporates.

Global Macro SWOT Analysis

Strengths	Weaknesses
• Investor sentiment • Current corporate earnings • Global growth realized forecasts • Political stability • Inflation	• 2019 earnings growth projections • Firms returning cash to investors instead of investing in new projects • Creeping uncertainty and volatility
Threats	**Opportunities**
• Trade disruptions • Interest rates • Chinese credit • US credit cycle	• Firms investing excess cash productively and late cycle acquisitions • The emerging Asian consumer • A new age in transportation • New payment processing methods

	What We Like	What We Don't Like
Stocks	- Deep value US - Korea - Brazil - China healthcare - European banks - Energy - Philippines	- US growth stocks - South Africa - UK
Bonds	- Australian investment grade - Negative/Short duration - Treasury inflation protection	- US longer-dated treasuries - Chinese credit
Commodities	- Natural Gas - Crude - Silver	- Cotton - Soybeans
Alternatives	- Hedge Funds - Invoice financing	- Wine - Real Estate

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