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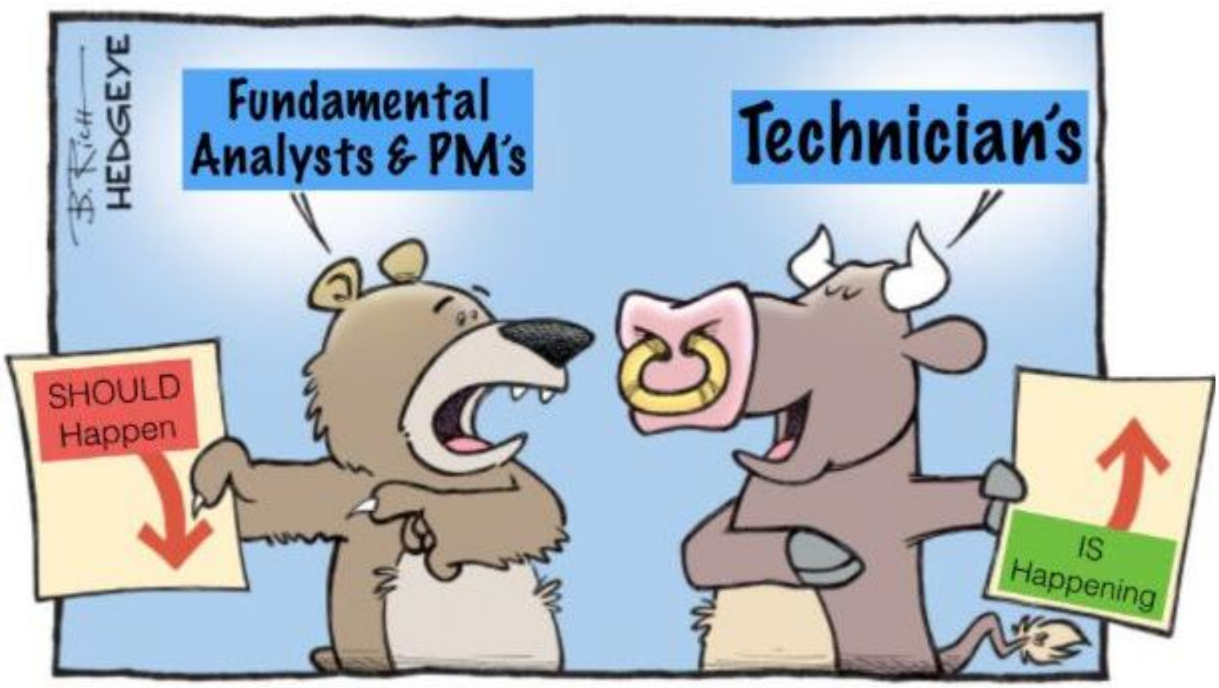
TECHNICALS BEGINNING TO ALIGN WITH FUNDAMENTALS

The Divergences are Becoming Too Many to be Sustained

ANALYTIC INSIGHTS – DRIVER$



Gordon T Long
4/11/2016

TECHNICALS BEGINNING TO ALIGN WITH FUNDAMENTALS

The Divergences are Becoming Too Many to be Sustained

FALLING PROFITS ARE HURTING CASH FLOW; HURTING FLOWS

It is now expected that 2016 Q1 earnings will be the biggest quarterly drop in US corporate profits since 2009.

S&P Forward Earnings expectations have been steadily falling since mid 2014 and have again dverged from stock prices.

Cash flows and EBITDA have correspondingly been falling which is hurting investment flows.

SocGen's Albert Edwards in his *Global Strategy Weekly*

> "A recession is now virtually inevitable" …. it **"will surely be swept away by a tidal wave of corporate default."**
>
> ***… Our failsafe recession indicator has stopped flashing amber and turned to red***. Newly released US whole economy profits data show a gut wrenching slump. ***Whole economy profits never normally fall this deeply without a recession unfolding.*** And with the US corporate sector up to its eyes in debt, the one asset class to be avoided – even more so than the ridiculously overvalued equity market - is US corporate debt. The economy will surely be swept away by a tidal wave of corporate default.
>
> ***Recent whole economy profits data show that while the Fed plays its games, the economic cycle is withering and writhing from within.*** For historically, when whole economy profits fall this deeply, recession is virtually inevitable as business spending slumps. And if I had to pick one asset class to avoid it would be US corporate bonds, for which sky high default rates will shock investors.
>
> .. ***when whole economy profits begin to fall sharply, this is usually followed shortly after by the overall economy tipping over into recession, driven by the volatile business investment cycle***.
>
> … ***historically all recessions are effectively caused by slumps in business investment driven by a profits downturn: the chart below shows that whenever GDP growth (dotted line) is negative it is almost totally overlaid by the contribution of GDP growth in business investment (red line).***"

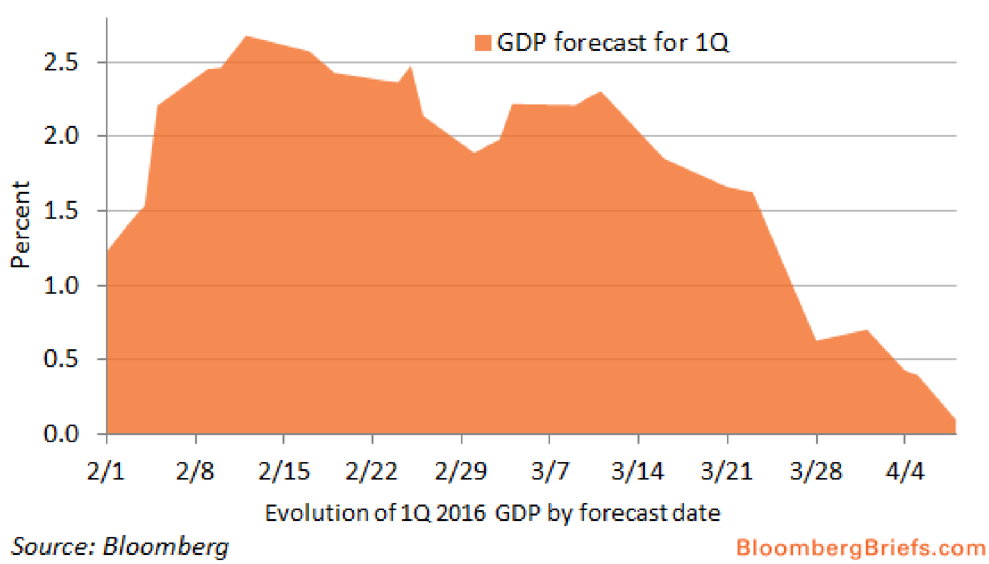
David Stockman writes:

> *"The signs of an impending macroeconomic and profits implosion are now so overwhelming that it is truly remarkable that there are any bids left in the casino at all!"*

Jesse Edgerton, an economist with JPMorgan Chase & Co. in New York says:

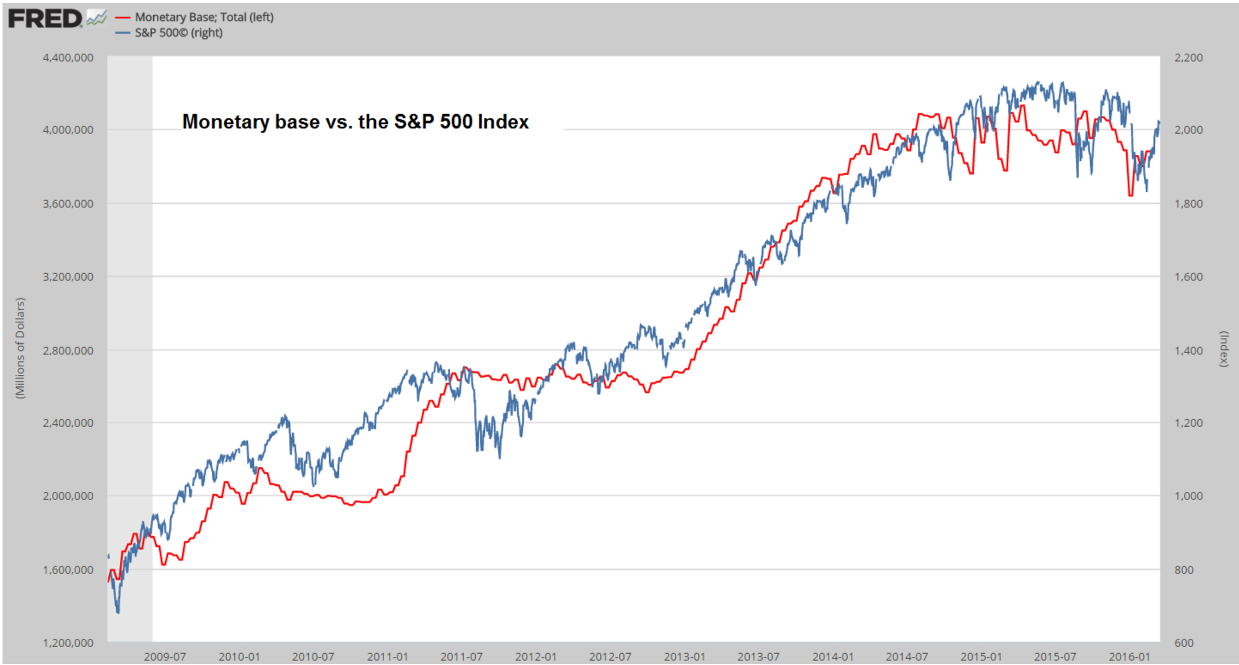
> *"Yes, the poor earnings outturn was due to energy companies struggling with lower oil prices and manufacturers hit by a strong dollar. But it also likely reflects the beginnings of a profit-margin squeeze driven by tighter labor markets, rising wages and weak productivity, and that is something to fear."*

It is believed that this US Economic forecast (chart below) by the Richmond Fed prompted an emergency 04-11-16 FOMC meeting and a visit by Chairperson Janet Yellen to the White House immediately following the meeting.



FALLING MONETARY BASE HURTING LIQUIDITY; HURTING FLOWS

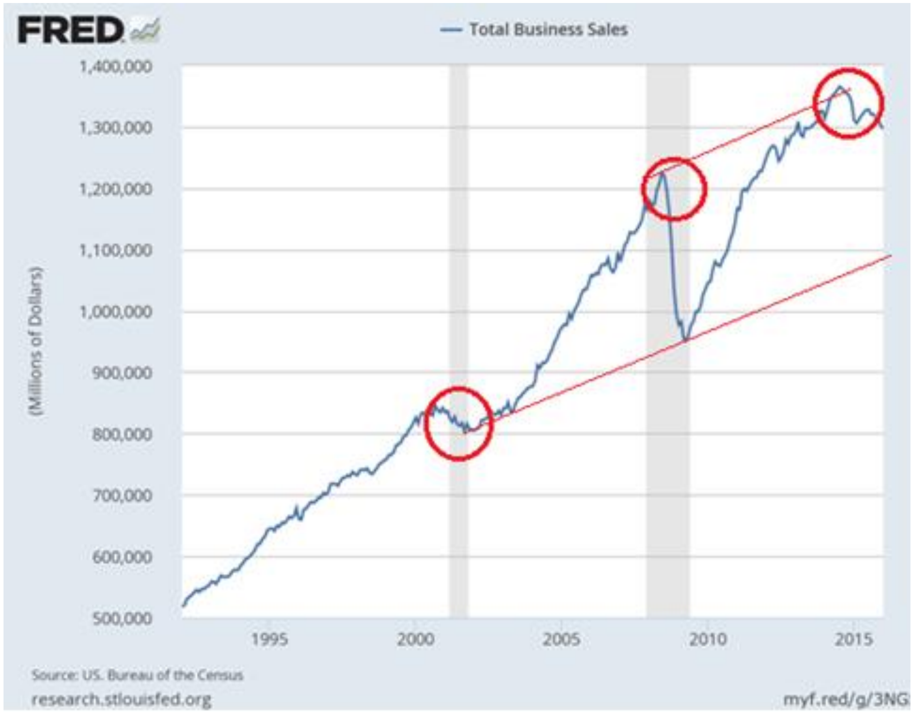
The total US Monetary Base has began shrinking and the correlation with weakness in the S&P 500 index is evident.



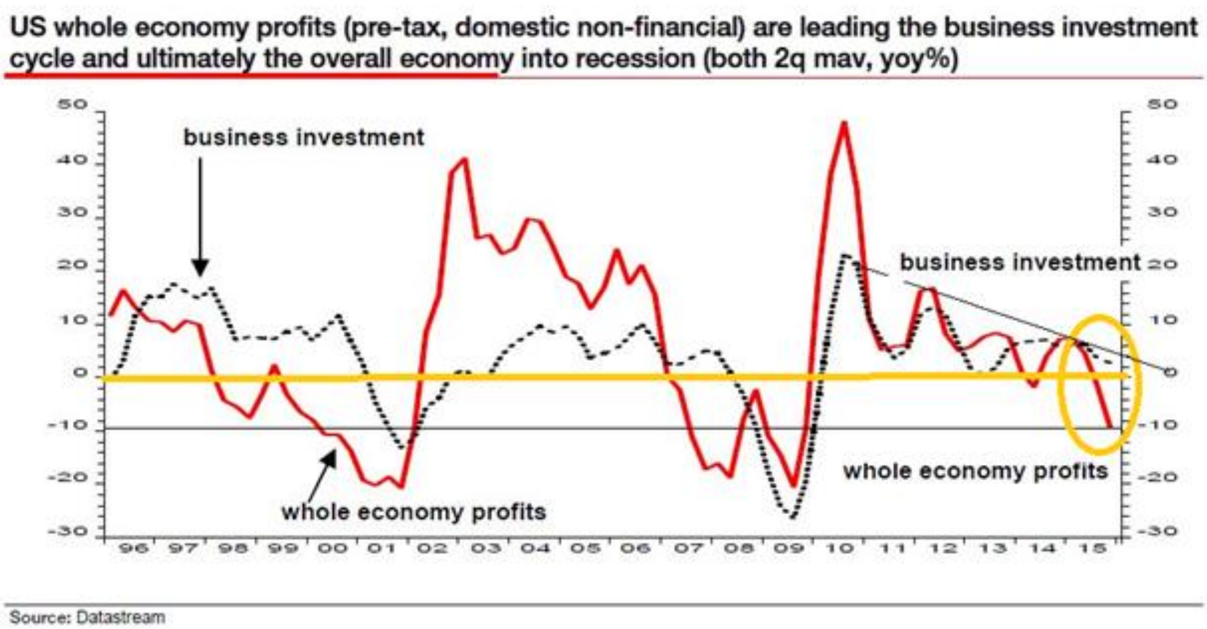
Global trade has been slowing at rates corresponding to 2007 and now the 2016 US consensus GDP growth is being reduced. Like earning expectations it is diverging from a still buoyant US stock market.

ECONOMIC SLOWING IS OCCURRING

A lack of CAPEX spending and business investment is now showing in falling top line revenue and sales growth.



Normally it can be expected that a slowing business investment cycle will lead the overall economy into recession when business investmewnt contracts (goes below "0" in the chart below).



MARKETS SENDING OMINOUS SIGNALS THAT CURRENT LEVELS ARE UNSUSTAINABLE

The market is beginning to react to the above issues and we now see a classic rounded top appearing**.**

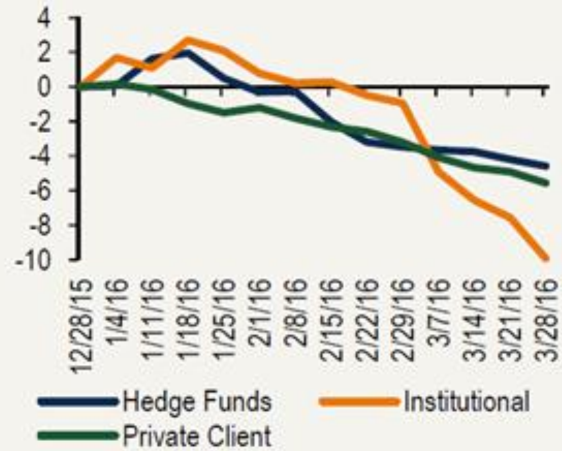
Since the early spring high of 2015 the markets have established a downward trend channel.

MARKETS SENDING OMINOUS SIGNALS

INVESTORS STEADILY "GETTING OUT OF DODGE"

Professional and sophisticated investors have been exiting the market is an accelerated fashion since year beginning 2016.

Chart 3: 2016 year-to-date flows by BofAML client type ($bn)

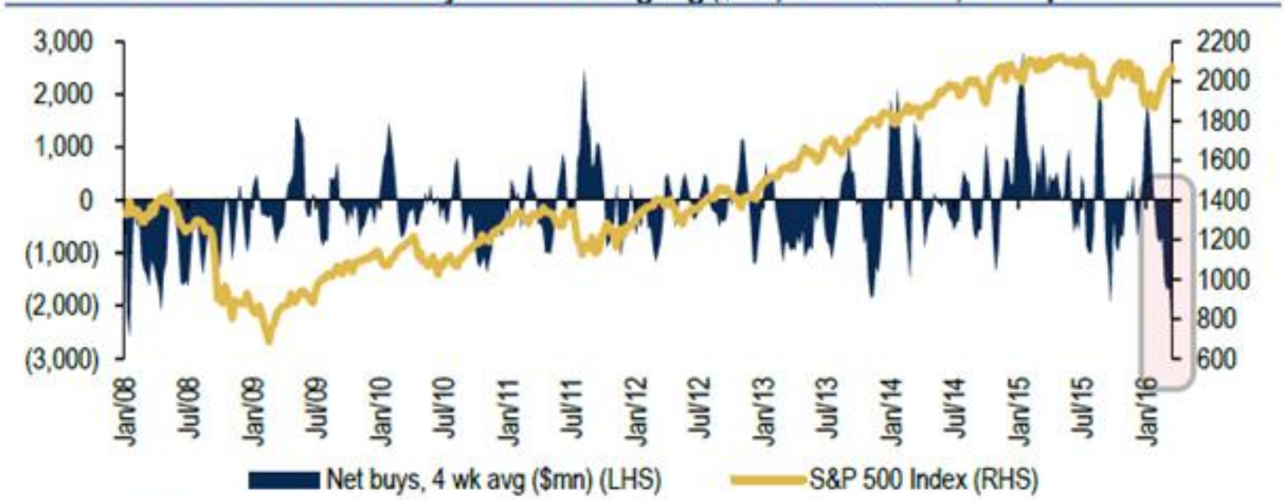


Source: Bank of America Merrill Lynch

BoAML reports that its clients are net sellers of the market at a significant rate based on four week moving averages.

"The 4 week average selling has been the greatest almost on record."

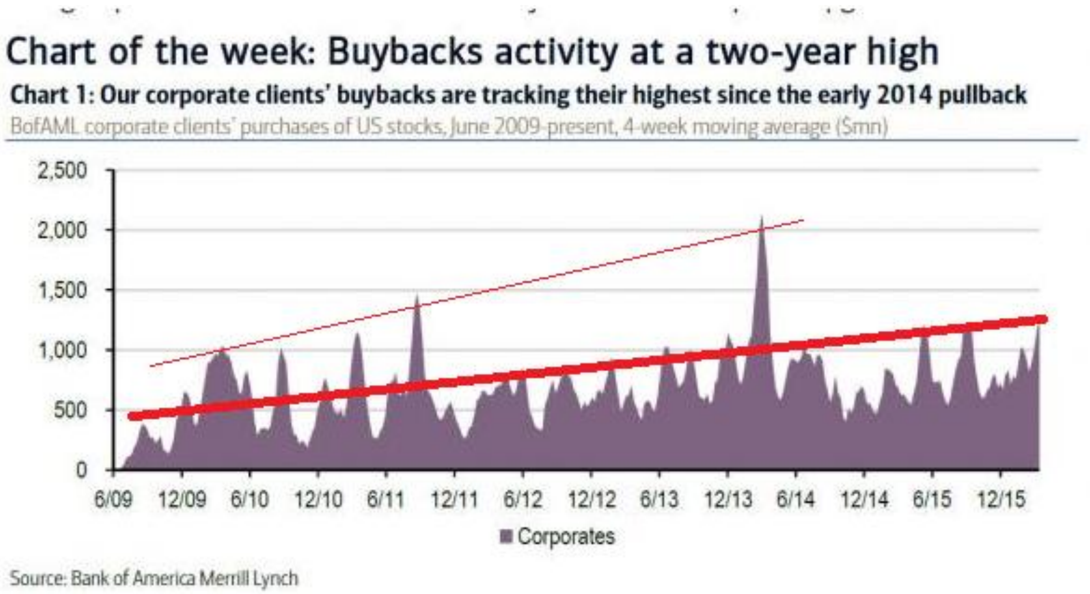
Chart 4: BofAML client total net buys: 4-wk moving avg ($mn) and S&P 500, 2008-present



Source: Bank of America Merrill Lynch

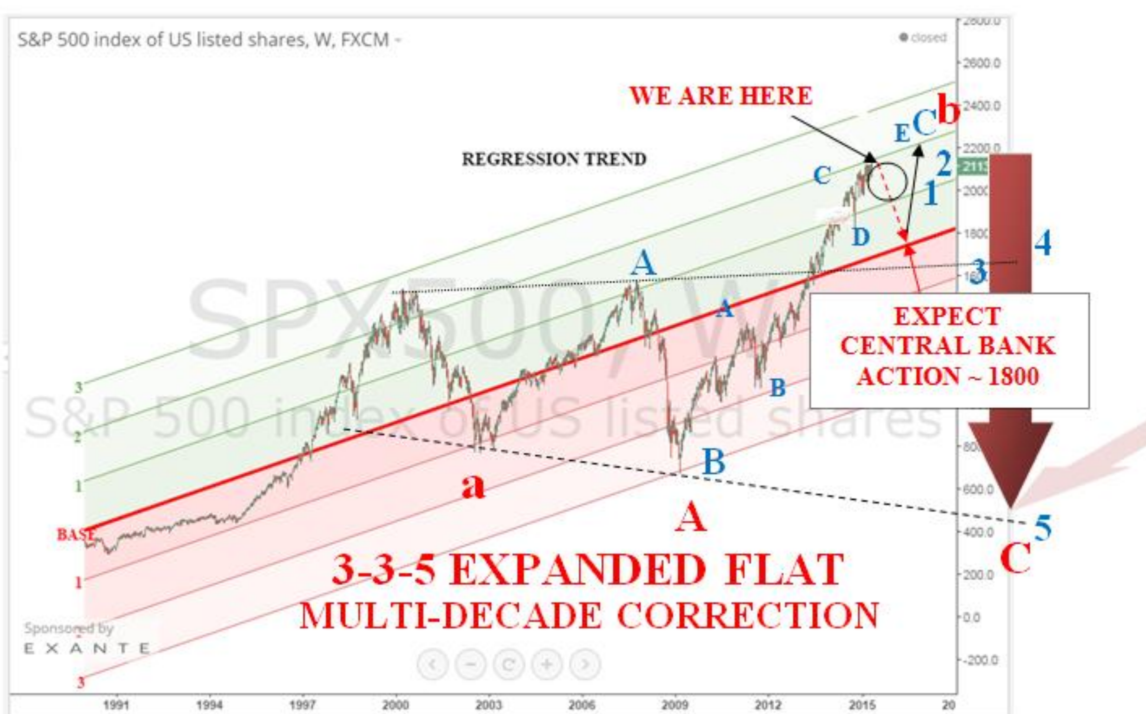
BUYBACKS & GOVERNMENT HOLDING UP UNSTABLE MARKET

It appears the only buyer of the market swimming agains this current are corporate buybacks, which only continue to increase.



WHAT WE EXPECT

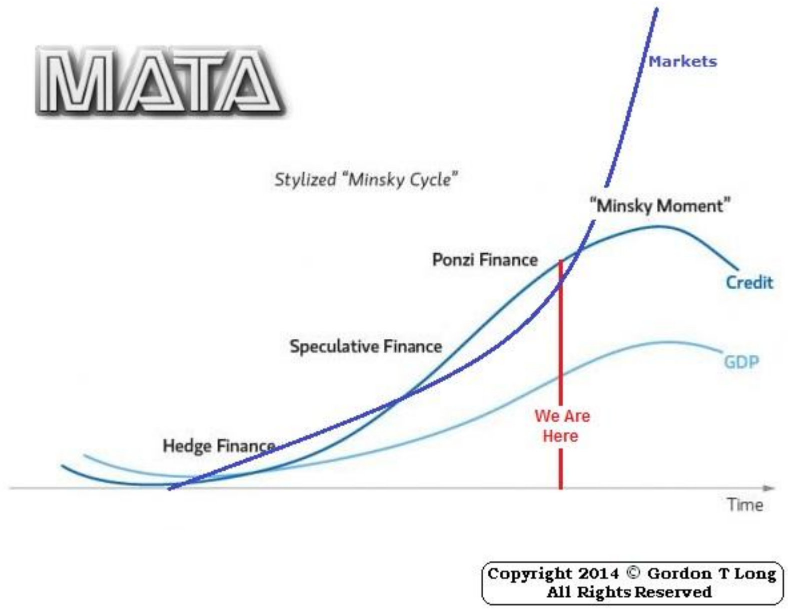
We expect the market to fall in late Q2 – Q3 before rallying to potentially new highs to complete our long predicted "M". The circle below represents the current market activites and within it the recent strong bear market rally.



HAVEN'T CHANGED OUR POSITION

After the near term expected correction we still expect markets to head higher towards a "Minsky Moment" in late 2016 early 2007.

This is based on the assumption that Central Banks will react to any deterioration in the financial markets with yet more and even "heavier handed" crisis driven liquidity pumping!



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