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WARNINGS SIGNS ARE EVERYWHERE!

Risk Adjusted Returns At All Time Lows

ANALYTIC INSIGHTS

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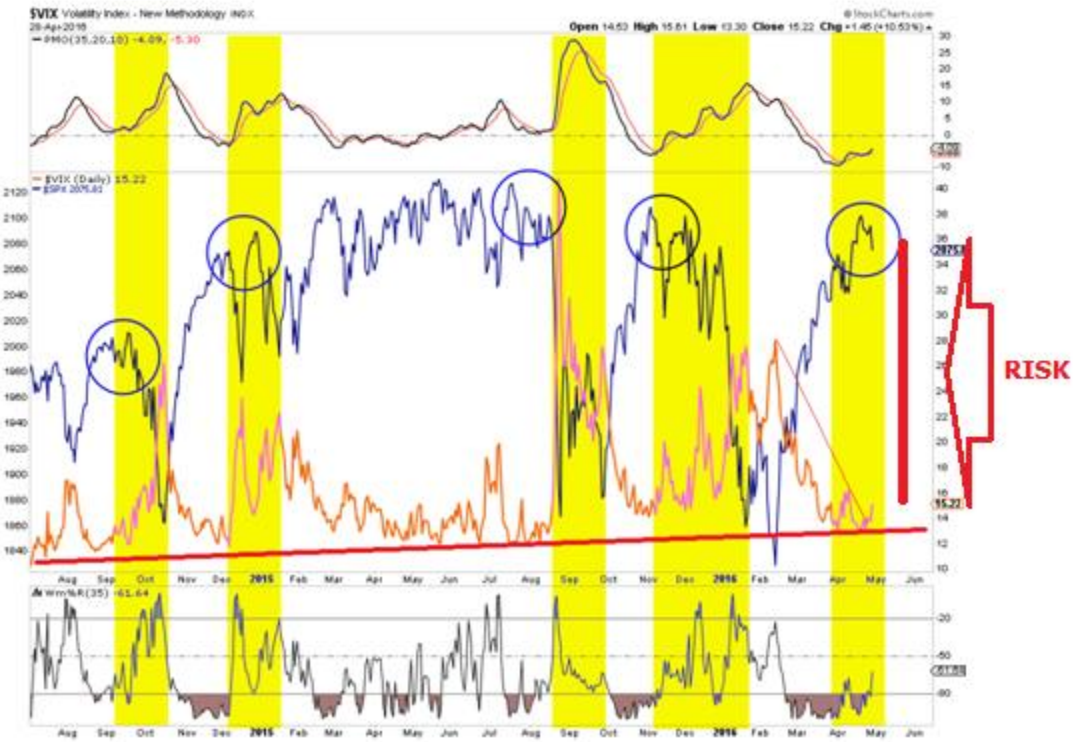
Risk Adjusted Returns At All Time Lows

The Wyckoff Model is clearly showing a decline at some point in 2016 should be expcted.

When earnings decline it typically allows the distinction of whether there is a Bullish Consolidation occurring or a Bear Market Counter Rally (Bear Trap). Q1 Earnings were the worst they have been since 2009 (see more charts later in this note)

The level of complacency as shown by the VIX is also a warning sign. The correlation highlighted by the yellow bars shows the extreme levels we are presently experiencing.



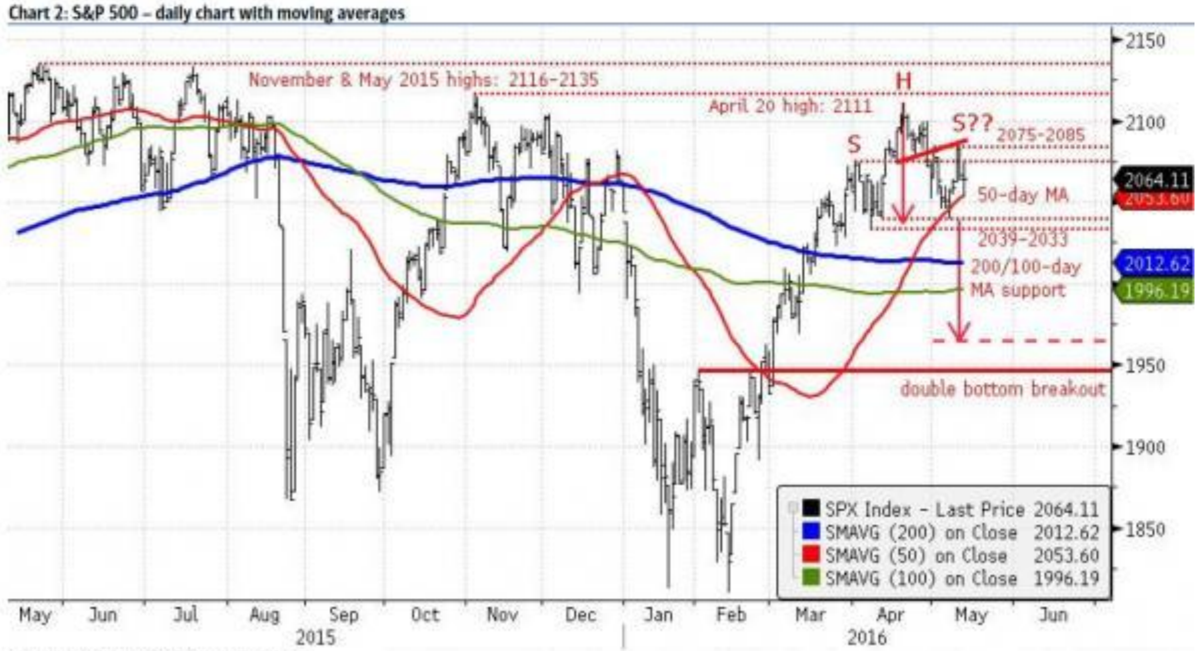
The bond market (Yield Curve Shape of the 10s-2s) and the consensus 2016 GDP expectations of analysts suggests that non-equity market participants see slowing economic activity. A Recession is a real possibility which we have outlined in detail in previous reports.

AN INTERMEDIATE TERM HEAD & SHOULDERS

A double bottom started this rally in the S&P 500. Does a head-and-shoulders top end it?

> The S&P 500 has stalled at 2075-2085 resistance. While below this resistance, the risk is for a head-and-shoulders top off the late March-to-early May peaks. **The rising 50-day MA is acting as support near 2054 and it would take a decisive loss of support at 2039-2033 to confirm the head-and-shoulders top and suggest a pullback toward 1965-1950 (top projection and February double-bottom breakout point).**
>
> A decisive push above 2075-2085 is required to negate this potentially bearish tactical setup for the S&P 500.

Chart 2: S&P 500 – daily chart with moving averages



Source: BofA Merrill Lynch Global Research, Bloomberg

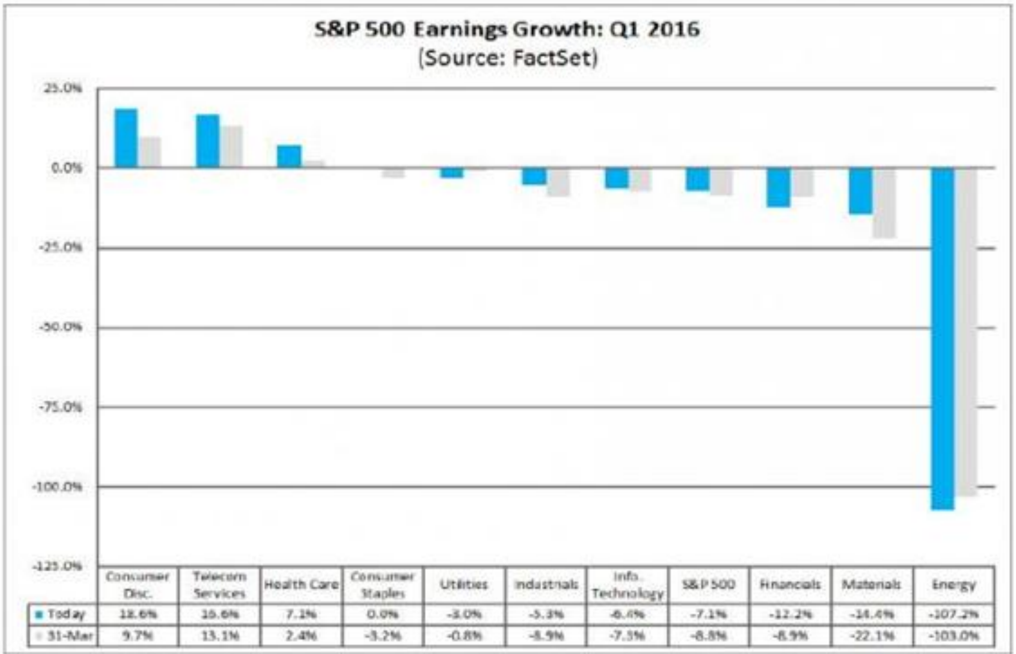
EARNINGS ARE HORRENDOUS

The first quarter marked the first time the index has seen four consecutive quarters of year-over-year declines in earnings since Q4 2008 through Q3 2009.

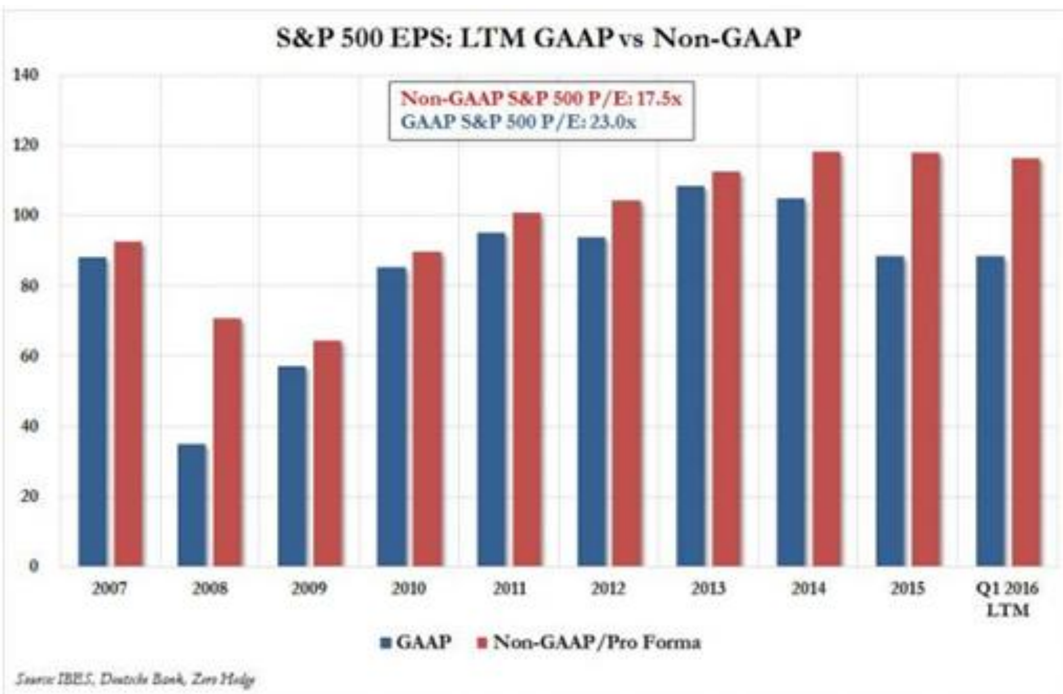
It also marked the largest year-over-year decline in earnings since Q3 2009 (-15.7%).

The ongoing contraction in both sales and earnings in Q1, now forecast to continue into Q2, means that after a drop in 2015 earnings, the consensus estimates for a 0.9% increase in full year EPS (cut in half from March 31) and 1.5% in revenues, will both be slashed over the coming months, and will almost certainly result in yet another full year of declining top and bottom line corporate results, leaving margin expansion (and stock buybacks) as the only means for future stock market upside.

Q1 2016: Growth

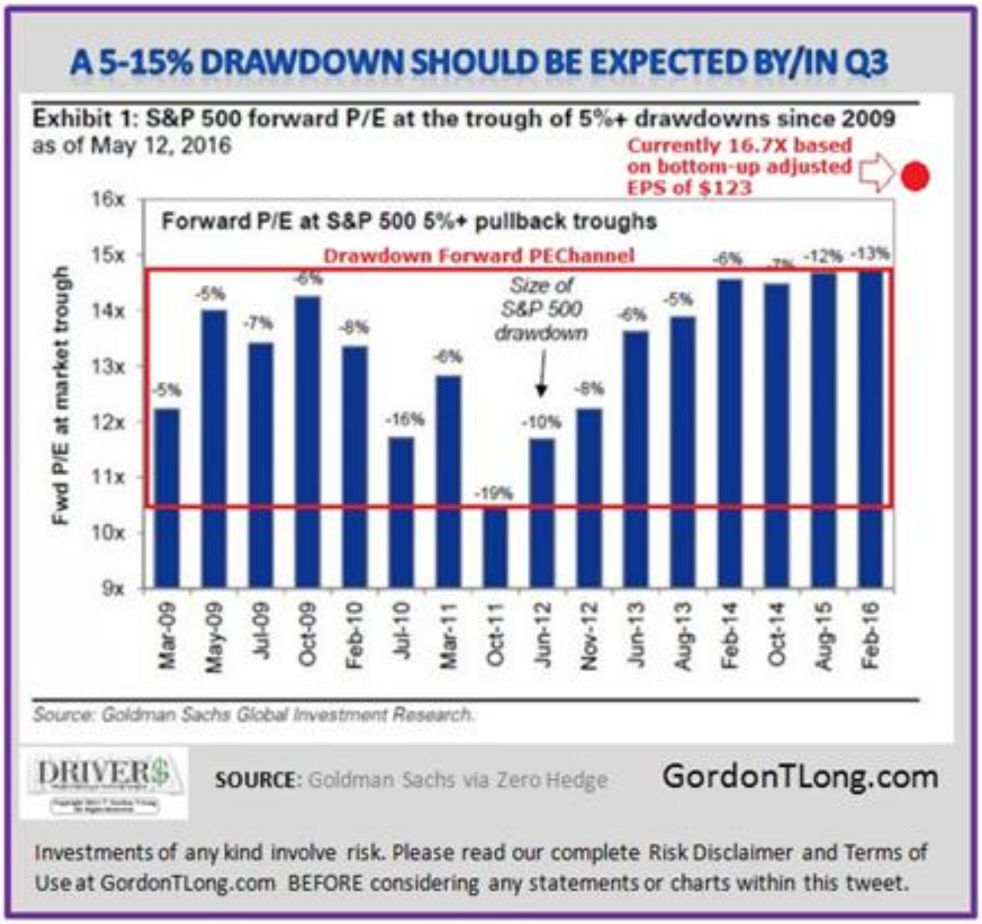


When GAAP Earnings are considered the problem is even worse.

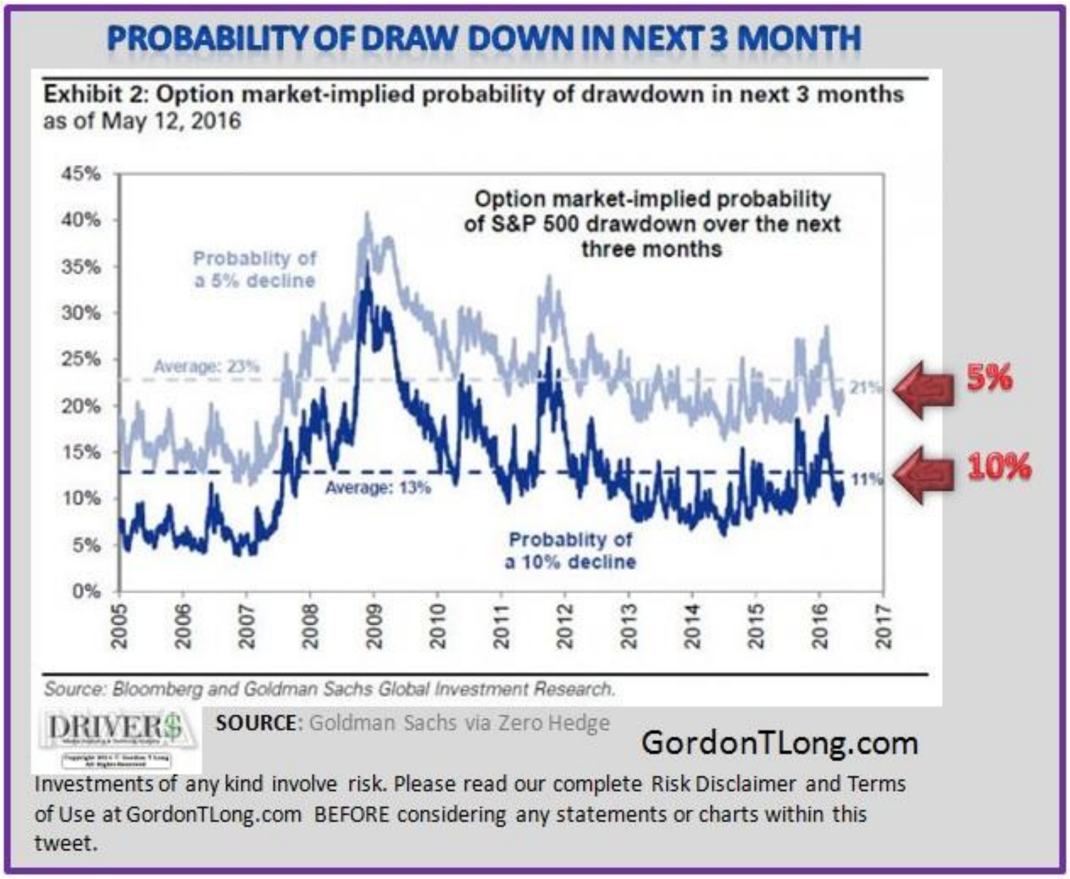


A CORRECTION IN THE CARDS FOR Q3

With S&P Forward PEs currently at 16.7X (on a bottom up adjusted basis) the market is above any previous level since the Financial Crisis when a market drawdown of from -5 to -19% was eperrienced within the following 3 months.



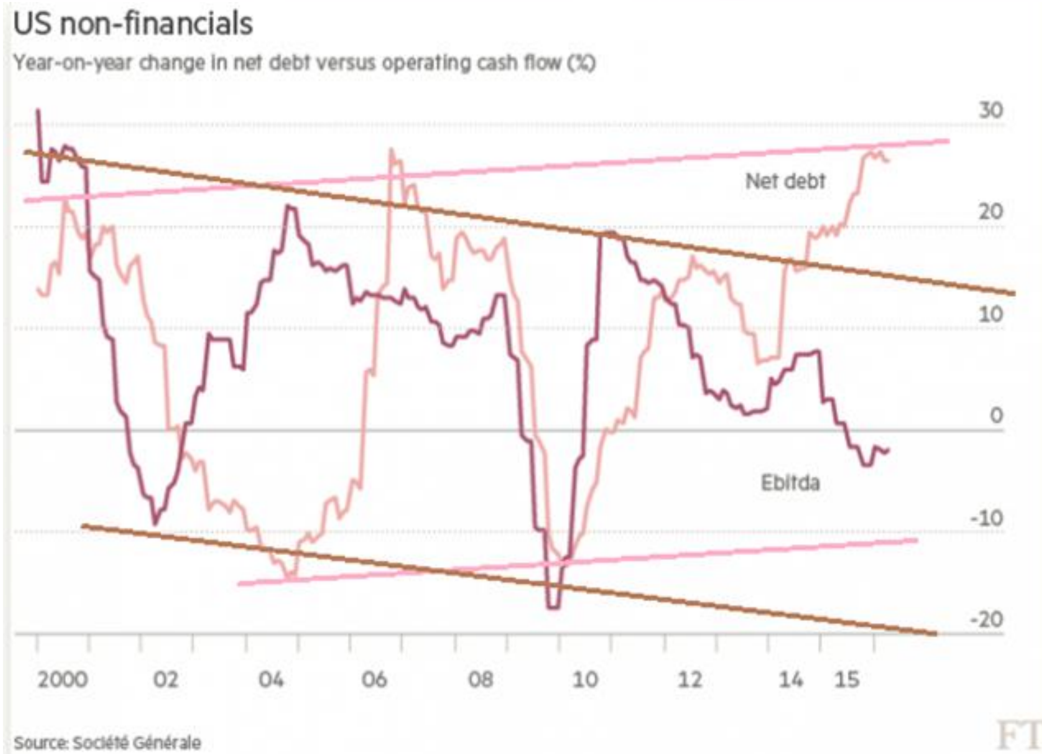
The drawdown probabilities according to Goldman Sachs reflect a 21% chance of a 5% decline and a 11% chance of a 10% decline. We suspect Goldman is being very conservative (below) after examing the chart above.



THREE MAJOR MARKETS HEADWINDS

1- **Buybacks**

Deteriorating Corporate EBITDA and Cashflows versus Debt levels is problematic for sustained high levels of stock buybacks and dividend payouts.



2- Redemptions

Acccererating Hedge Fund Redemptions is now signaling a significant trend change.

INCREASING HEDGE FUND REDEMPTIONS FROM INSURANCE & PENSION FUNDS

1. BREVAN HOWARD which was served with an cash call for $1.4 billion, and
2. TUDOR which has seen $1 billion in redemptions, while
3. NEW YORK CITY PENSION for civil employees voted this month to pull $1.5 billion from hedge funds.
4. AIG: Then, just three days ago, AIG joined the anti-hedge fund fray when it announced it would redeem $4 billion from its hedge fund investments,
5. CALSTRS: while Chris Ailman, who runs investments at the $187 billion California State Teachers' Retirement System, or CALSTRS, said that the hedge fund industry's two-and-twenty fee model is "broken" and "off the table" for large institutional investors.
6. Met Life is seeking to redeem $1.2 billion of the $1.8 billion in holdings, a process that may take a couple of years to complete

3- APPLE WEAKENESS IS PROBLEMATIC

Apple is one of the most highly held companies on any exchange. Apple earnings have underpinned the market and have been more than 50% of the markets net earnings. iPhone sales are now under pressure with no blockbuster products on the drawing board with Steve Jobs no longer supplying the visionary leadership.

Chart 1: Apple Inc. (AAPL) – daily chart

Source: BofA Merrill Lynch Global Research, Bloomberg

Caution is advised!

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