February 13, 2017

MARKET INSIGHTS

The latest Market Insights
from the Connected Wealth team

2,901 days

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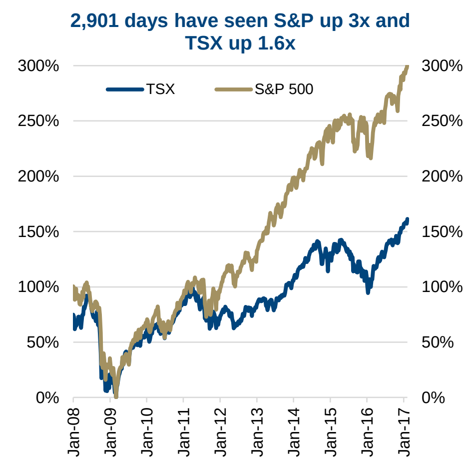
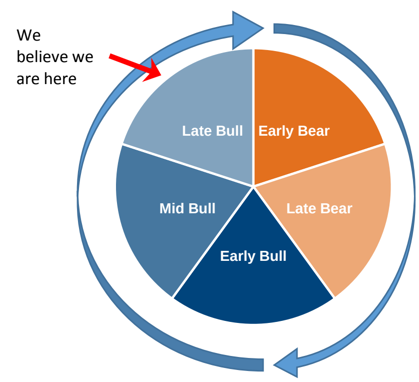


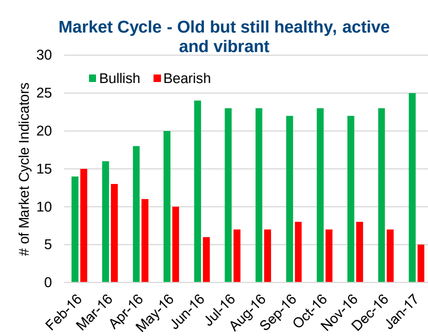
Or if you prefer, 414 weeks or 7.97 years. That's how long ago the market bottomed and a new market cycle was born. As with all Early Bulls, it was on shaky ground but confidence slowly improved thanks to rising markets, improving economic data and better company fundamentals. While we would not disagree this has been a rather 'special' market cycle with unprecedented monetary policy and counterproductive fiscal policy, the cycle seems to be rhyming with many past iterations. And now there is a sense of optimism in the market thanks to fiscal spending plans and other policies that appear market friendly. Could they extend the bullish phase of the market cycle? Perhaps, but it has been our experience that while policies matter, they take a distant back seat to the traditional drivers of the market cycle. So let's see where we are.

Late Bull phase of the cycle – old but healthy



No question an 8-year bull market is a long one by historical standards, but that doesn't mean much. By comparison, the average life expectancy of 81 years doesn't translate into believing someone who is 90 has one foot in the grave. If said 90 year old is healthy, active and vibrant, we would conclude there are many years to go. So our 8 year old market cycle isn't about to turn into a bear due to age. Especially since most of our indicators seem to point to a cycle that is indeed healthy, active and vibrant.

Our Market Cycle framework incorporates 30 different forward looking models or indicators that have in the past proven effective at signalling changes in the market cycle. We use 30 as there is no single indicator that works all the time as each cycle has different nuances. Some of these indicators are interest rate driven, such as the yield curve or Fed Funds, and some are economic, like the leading indicators or credit creation. Some are global, some are valuation based, some are company fundamentals and some are momentum. We believe using this holistic approach better enables us to determine where we are in the cycle and when a change is imminent.



Currently 25 of the 30 models/indicators favour a continuation of the bullish phase of the cycle. That compares to about a 15/15 split a year ago. Historically, we don't really get worried about the end of a cycle until the number of positive indicators drop below 10. The number of positive indicators dropped to 5 in December of 2007, and dropped to 4 in January of 2000. The chart to the right shows how these indicators have tracked along over the past year. And on the next page we share all the indicators and where they read today.

Market Trender	Current	Nov-16
Canada	Bullish	
U.S.	Bullish	
Consumer Model	Bullish	

Rates	Current	Nov-16
Fed Funds	Bearish	Bullish
Yield Curve	Bullish	
Yield Curve Change	Bullish	

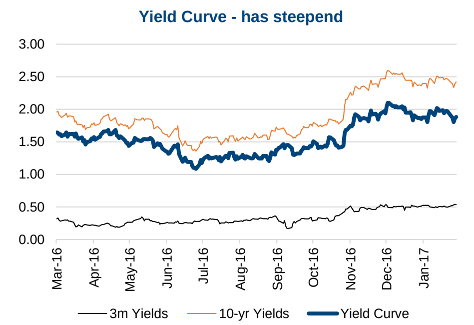
Fundamentals	Current	Nov-16
Valuation Canada	Bearish	
Valuation US	Bearish	
Earnings Growth	Bullish	
Sales Growth	Bullish	
Margins	Bullish	

US Economy	Current	Nov-16
Leading Ind (3m)	Bullish	
Leading Ind (6m)	Bullish	
PMI	Bullish	
PMI New Orders	Bullish	
Cons Confidence	Bullish	Bearish
Cars	Bearish	Bullish
Homes	Bullish	
Credit	Bullish	
Chemical Activity	Bullish	
Rail	Bullish	
Energy Demand	Bullish	Bearish

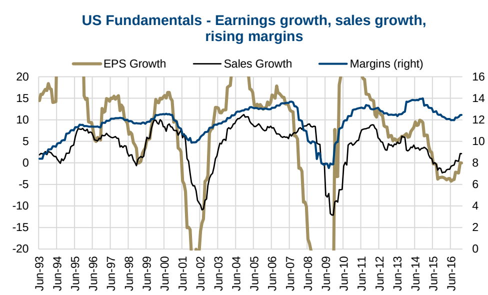
Global Economy	Current	Nov-16
CRB	Bullish	Bearish
Oil	Bullish	Bearish
Copper	Bullish	
Baltic Freight	Bearish	Bullish
KOSPI	Bullish	Bearish
Emerging Mkts	Bullish	Bearish
Global PMI	Bullish	

Where is strength and where is weakness

There is certainly more strength than weakness. Currently the only bearish signals are valuations in Canada and the U.S., Fed Funds, Baltic Freight and Cars. Valuations are elevated — not nosebleed levels, but you would be hard-pressed to find anyone who calls this market cheap. Fed Funds is pretty straight forward: they are tightening. Cars is tricky as auto sales have been sitting at or near all-time highs. While not cratering, they appear to be coming off the highs. For Baltic Freight, many argue this indicator has not been reliable over the past decade due to a glut of supply. Maybe, but we can't throw it out even if it proves less reliable this cycle. It could be a good one next cycle.



The positive indicators are plentiful. Earnings growth has returned to the U.S. market, as has sales growth. This could even partly offset the negative of higher valuations. The yield curve is one of the more important cycle signals, and it remains decently steep. The lesser known chemical activity, rail traffic or global PMI are all positive.



With this data we are confident the end of the cycle is not a near-term risk. It's important to note though that does not mean we couldn't see a market correction or period of weakness. Political risk is high and the markets have had a good run, so we could easily see a pullback. The good news is with so many positive indicators, we would view any pullback as a buying opportunity.

On the flip side, if the indicators begin to turn bearish, we would change our mind. Just like Keynes, whether he said it or not – "when the facts change, I change my mind. What do you do?"

Why do we think it is the Late Bull phase?

This has been a different cycle given monetary policy and the last recession was a credit recession which tends to see delevering. This should have reduced the liability side of balance sheets, making for a slower, more gradual and longer economic recovery. But monetary policy tripped this up and while some have delevered (US consumer), others have not (corporations, government, Canadian consumer). While a different cycle, it nonetheless has many similar patterns. The

Fed is now tightening — this is late cycle. Wages are rising and labour markets are tightening. Late cyclical sectors, such as energy and materials, were the top performing sectors in Canada and the U.S. in 2016. Leadership appears to be forming in the market.

Final Thoughts

It is late cycle and the time to start thinking a bit more defensively is likely close at hand. Perhaps just at the margin given our market cycle indicators remain so positive and we could easily see more healthy market returns. But timing the turning point is impossible, even with a well research process like our 30 indicators. The best strategy is to try and manage the turn, adding some defense now and more later, should we see deterioration in the signals.

Charts are sourced to Bloomberg unless otherwise noted.