

August 29, 2016

MARKET INSIGHTS

The latest Market Insights from the Connected Wealth team



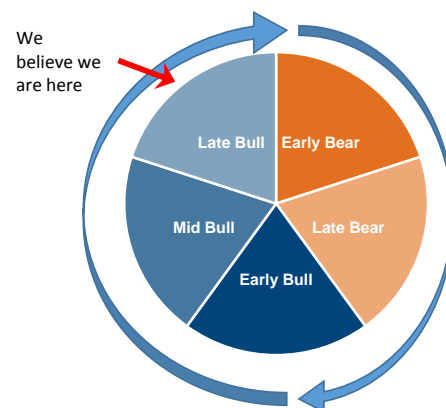
Market Clock – what time is it?

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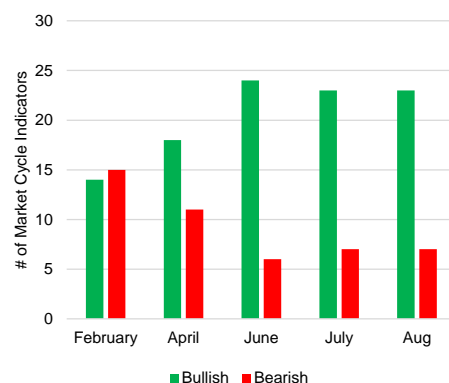
As the end of summer rapidly approaches, the S&P 500 sits near all-time highs, the TSX has been one of the strongest performing markets in 2016, bond yields are low and the economic data has been alright. A whole lot more of a pleasant summer than last year. So what better time to publish an update on our Market Clock framework. For those that have not seen this body of work, we use this to help guide our tactical tilts and asset allocations for the Connected Wealth investor profiles ([Growth](#), [Balanced](#), [Conservative](#)). The basis for the Market Clock is if you can ascertain in which phase of the market cycle we are currently, this helps tilt asset, geographic, active/passive and style allocations to better position the portfolio compared to a static asset allocation approach. However, ascertaining which phase of the cycle is not an exact science and we use a multitude of models and indicators, 30 to be precise. These models are cross-disciplinary, including rates, fundamentals, momentum, valuation and economic. So, what time is it?

We break the market cycle into five phases (chart top right). These phases are not equal in duration but they do have a number of distinct characteristics that are common in most market cycles looking over the decades. Given the current environment, most of the characteristics point to the 'Late Bull' phase of the cycle. These include narrowing of leadership in equity markets, higher volatility and central bank policy beginning to tighten. This of course is good news, as it is a bull market, but also has a negative side in that it is the last phase of a bull market. Historically this phase has often been the longest and has also seen some very handsome returns. But we must be on guard for the cycle ending, which is where our 30 indicators enter the picture.

Currently, we see 23 of the 30 models/indicators favouring the continuation of the bullish phase in the market (2nd chart). Historically, that is a very strong signal that the cycle will continue. For example, in February with markets in disarray, oil below \$30, rumblings of a potential U.S. recession, the indicators were roughly split half bullish and half bearish. Half doesn't sound great, but historically bull markets have ended when the bearish indicators have exceeded 22 or 23. Again, not an exact science but certainly encouraging for the continuation of the current bullish phase of the cycle an exact science but certainly encouraging for the continuation of the current bullish phase of the cycle.



Market Cycle - Still strong and bullish



Where is strength, where is weakness

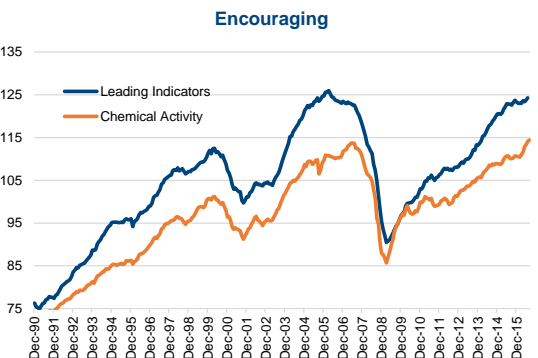
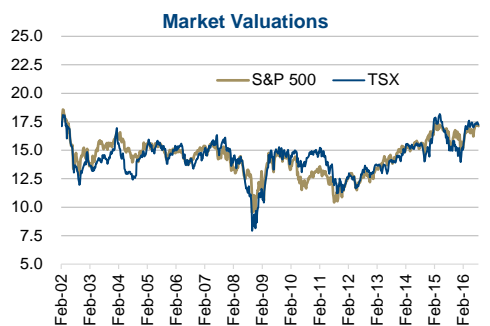
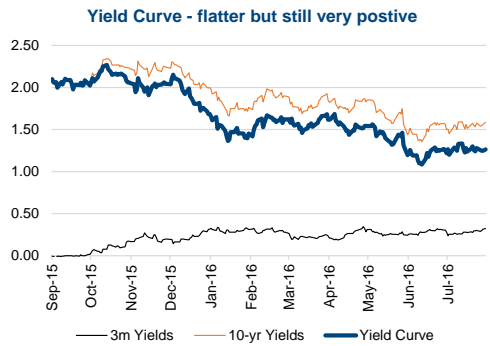
With 23 indicators bullish and 7 bearish (detailed table on next page), what else are the signals telling us? The market trender models, which are momentum driven, are positive. This shouldn't come as a surprise given the performance of the equity markets this year. And while the Consumer Model is bearish, it is very close to turning back to positive. Model driven by Rates are a bit mixed. As the Fed has not raised rates in the past six months, this has gone from bearish back to bullish. However given the flattening of the yield curve, this has become bearish. Longer rates have declined over the past year while shorter rates are rising, hence a flatter yield curve. That being said, it is still very positive (chart top right).

Valuations are a bit stretched with the TSX trading at 17.2x and the S&P 500 trading 17.1x consensus earnings over the next 12 months. These are bearish but they are not extreme as if they were a point or so lower, it wouldn't be a negative sign. The 2nd chart is the price to earnings of both the S&P and TSX over the past 15 years. A bit elevated but not enough to be very worrisome. And with earnings growth starting to resume, this may help a bit with valuation.

This brings us to the economy, which contains more than half our indicators. We would highlight that many of these indicators are timely or forward looking compared to measures such as employment or GDP. On the U.S. side, we continue to see many more positive signs than negative. Leading indicators are rising. PMI is encouraging for manufacturing and industrials, an area that has been soft in the economy during the past few quarters.

The 3rd chart on the right is the U.S. leading indicators index and chemical activity barometer. Leading indicators is a basket of indicators that have historically signalled changes in overall economic activity ahead of time. Chemical activity is similar albeit more narrow. This index from the American Chemistry Council measures the activity level across chemical companies. The premise is chemical activity is very far up the industrial supply chain and increased activity up there is a precursor of more activity at other stages. Both of these indicators have proven to be good signals for a change in direction in the economy.

Finally, international economic data has been improving as well. Take all these indicators together and we continue to feel confident that 1) we are in the late bull phase of the current cycle and 2) the probability of this phase ending in the near term is very low.



Market Trender	Current (previous)	Rates	Current (previous)	Fundamentals	Current (previous)
TSX	Bullish	Fed Funds	Bullish (Bearish)	Valuation TSX	Bearish
S&P	Bullish	Yield Curve	Bullish	Valuation S&P	Bearish
Consumer Model	Bearish	Yield Curve change	Bearish	Earnings Growth	Bullish
				Sales Growth	Bullish
				Margins	Bullish
U.S. Economy	Current (previous)	Global Economy	Current (previous)		
Leading Ind (3m)	Bullish	CRB	Bullish (Bearish)		
Leading Ind (6m)	Bullish	Oil	Bullish		
PMI	Bullish	Copper	Bearish (Bullish)		
PMI New Orders	Bullish	Baltic Freight	Bullish		
Cons Confidence	Bearish (Bullish)	KOSPI	Bullish		
Cars	Bullish (Bearish)	Emerging Mkts	Bullish		
Homes	Bullish	Global PMI	Bullish		
Credit	Bullish				
Chemical activity	Bullish				
Rail	Bullish				
Energy demand	Bearish (Bullish)				

Charts are sourced to Bloomberg unless otherwise noted.

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