



**April 11<sup>th</sup>, 2016**

## **Stocks stuck in no man's land...**

Last week was a rather muted week in the capital markets with U.S. stocks registering weekly declines for the second time in the last three weeks. The Dow Jones Industrial Average, S&P 500 and Nasdaq Composite lost a little more than -1% while steeper declines were experienced in the Russell 2000 (-1.8%), S&P 400 Midcap Index (-1.7%), and Dow Jones Transportation Average (-1.9%). The recent weakness in the Transportation Index (declining in 10 of the last 13 trading sessions) since reaching a year-to-date high on March 21<sup>st</sup> is a troubling omen as this index has lead

the overall market – both up and down – since Q4 2014. Not to belabor this point, but for those Dow Theorists out there the Transports haven't confirmed this latest move in the Industrials and were registering a sell signal as we came into April.

Fixed income markets were bid last week with the yield on the 10-year T-Note falling 5bps as it ended the week at 1.72% and pushed its year-to-date gain to 5% while the 30-year Treasury bond appreciated almost 10% on the year. Arguably, the fact that almost \$7 trillion of government bonds globally (27% of total outstanding sovereign debt) now trade with an interest rate below zero is one of the most compelling reasons why U.S. equities (considered the best house on a bad block) are only 4% off their all-time highs.

Sticking with the theme of what has been working for investors this year, Gold tacked on to its strong start to 2016 gaining 1% last week and now sits on an almost 17% gain for the year. With the U.S. dollar index in decline (down almost -5% on the year) and interest rates around the globe continuing to fall, it has created a goldilocks environment for the yellow metal which has pushed above its 50, 100, and 200 day moving averages and looks set to breakout into a new bull market.

I've always been skeptical about this bear market rally given the low-quality leadership and lack of participation from the financial sector. All one has to do is look at the year-to-date sector performance scorecard to see that capital flows are congregating in the defensive areas of the market: Utilities +13%, Telecom +12%, and Consumer Staples +6%. Financials are down nearly -7% on the year in

the U.S. which look good only when compared to the -25% year-to-date decline in European banks (down almost -40% since last April) – just goes to show you that the lower yields go the worse the sector performs.

The action in the equity markets so far in April has to be considered within the context of the huge March rally and has a bit of a déjà vu aspect to it. It was only seven months ago in August 2015 when stocks tanked by -11% in a matter of weeks to only stage an enormous rebound into November before flat-lining and checking time into year end. April has an eerily similar feel to December 2015 and hence warrants caution on the behalf of investors with little upside risk for those investors willing to be patient and wait for additional data to get reported over the next couple weeks in order to make a more informed decision about how they want to

proceed with their allocations through what is seasonally the weakest time of year for stocks (May – September).

That being said, it appears as though we are back into no man's land for the equity market as indicators mount suggesting this rally has reached the point of exhaustion and near-term catalysts look to be few and far between:

- Sentiment is no longer a tailwind with the latest Investors Intelligence poll showing the bull camp expanding to 45.4% from 43.3% – tied for the second highest reading since early November.
- High yield spreads bottomed nearly three weeks ago.
- CBOE Volatility Index (VIX) looks to have put in a higher low on April 1<sup>st</sup> and has risen more than 17% since then.

- Global sovereign bond yields – Japanese JGB's, German Bunds, French OAT's, and U.S. Treasuries – are all trading back down near their year-to-date lows.

Last week's sharp rebound in the oil market was impressive and there remains hope that some good comes out of the gathering of OPEC leaders next week, but everyone knows that nothing material can happen unless the Saudis are on board, and they are not willing to entertain any agreement unless Iran is a part of it (and that just ain't going to happen at this time). Yes, oil has rallied back up to the \$40/bbl level, but this doesn't change the fate of those producers that are already financially strapped (these companies need prices up in the mid-50's and that is a level that is not fundamentally justified in the near-term – late 2016 and 2017 is an entirely different story).

From a capital markets perspective it's a bit precarious to see oil rally strongly over the last couple trading days, yet the oil volatility index (OVX) has been moving higher. Look back to when oil bottomed on February 11<sup>th</sup> and within a couple days the OVX topped out and staged a large reversal to the downside, which was interpreted in the capital markets as a confirmation that a floor was established for the price of oil. The trading activity over the last couple days is very reminiscent, but today's conditions are the inverse of what ultimately materialized in mid-February (could a short-term top be at hand?).

The technical setup for stocks suggests there are a plethora of bearish divergences that could cap the rally that started in February, but it's not until the S&P 500 breaks below the 2,022 level that investors need to worry about a deeper decline (down to 1,950) and a

possible retest of the 1,810 lows (if 1,950 doesn't hold). In Europe and Japan the picture is much more worrisome with the Stoxx Europe 600 and Nikkei 225 both down double digits year-to-date and more than 20% from their 52-week highs. Unless the objective of the most recent round of central bank actions from both the ECB and BOJ was to cause their respective currencies to appreciate and financial conditions to tighten (highly unlikely) then these policies have fallen flat on their face. What's more is that the failure of these actions to have their intended outcomes could perhaps mark the beginning of the end in the central bank belief system that has propped up asset prices and prolonged this global expansion beyond what is fundamentally justified (time will tell, but this is something to watch).

Looking ahead, investors will be focusing their attention on first quarter earnings season with 9% of S&P 500 companies set to report this week and over 50% of constituents reporting over the next three weeks. The below chart puts into context just how far the earnings bar has been lowered with estimates falling from +15% EPS growth as of a year ago to a decline of -7.9% as recently as last week. It's a similar story for Q2 earnings expectations, but of note is the improvement in breadth with only four of ten sectors estimated to report an earnings decline in Q2 relative to seven of ten sectors reporting declines in Q1.

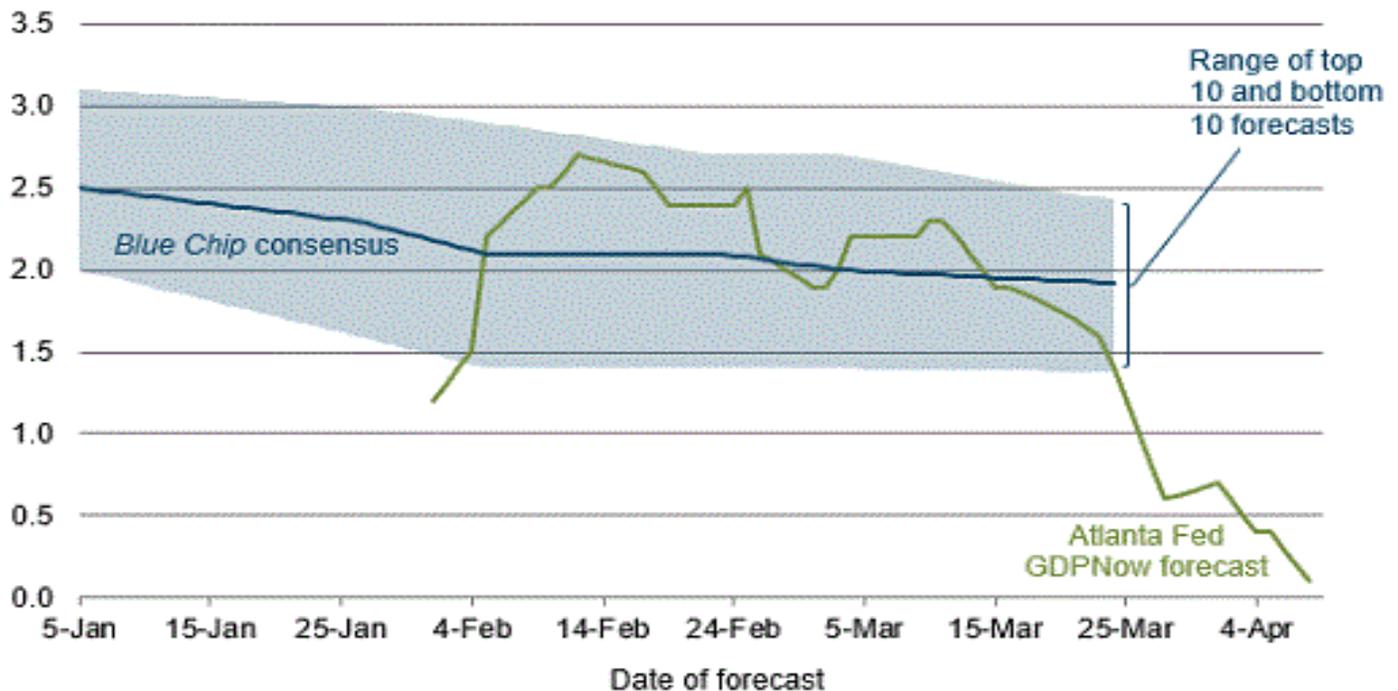
Estimated Earnings Growth for 1Q2016*					Estimated Earnings Growth for 2Q2016*						
	Today	1 Jan	1 Oct	1 July	1 April		Today	1 Jan	1 Oct	1 July	1 April
Cons. Disc.	11.37%	15.87%	18.47%	19.34%	19.50%	Cons. Disc.	11.45%	14.17%	14.81%	19.07%	16.59%
Cons. Stpls	-3.41%	2.02%	5.69%	7.61%	10.12%	Cons. Stpls	-2.10%	1.43%	4.87%	9.32%	8.92%
Energy	-105.23%	-42.54%	-30.29%	3.29%	38.85%	Energy	-80.60%	-26.20%	-14.91%	37.46%	56.78%
Financials	-5.02%	1.94%	6.24%	6.03%	16.01%	Financials	-3.84%	3.60%	6.87%	12.23%	14.06%
Healthcare	2.84%	6.10%	6.71%	7.92%	16.29%	Healthcare	3.57%	5.12%	5.92%	14.08%	13.30%
Industrials	-7.73%	-0.08%	4.55%	4.68%	12.52%	Industrials	4.80%	9.43%	12.53%	7.04%	7.89%
Info. Tech.	-5.88%	1.74%	6.08%	8.58%	13.71%	Info. Tech.	1.34%	6.23%	8.10%	13.77%	12.82%
Materials	-19.01%	3.49%	12.94%	16.18%	25.44%	Materials	-7.14%	6.40%	9.94%	18.67%	20.54%
Telecom. Svcs	4.98%	5.96%	5.12%	5.10%	4.01%	Telecom. Svcs	1.33%	0.85%	1.66%	2.95%	3.68%
Utilities	-1.02%	2.29%	2.71%	1.82%	3.88%	Utilities	3.28%	4.69%	5.90%	7.00%	3.43%
S&P 500	-7.87%	1.21%	5.04%	7.79%	15.07%	S&P 500	-2.77%	4.11%	6.78%	13.42%	13.90%

Given the beaten down expectations going into this reporting season what is likely to be of most interest to investors will be the forward guidance and the confidence management espouses in their business over the balance of this year. At this point it is far from a secret that economic growth in the U.S. has flat lined with the most recent Q1 GDP estimate from the Atlanta Fed's GDPNow Model coming in a 0.1% (down from an estimate as high as 2.7% in mid-February).

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**Evolution of Atlanta Fed GDPNow real  
GDP forecast for 2016: Q1**  
Quarterly percent change (SAAR)

**GDPNow™**



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

So here we are near the top end of the stock markets trading range where the obstacles constraining additional near-term gains seem pretty formidable. In order for the S&P 500 to break above the 2,075 – 2,080 resistance level it is going to require a substantiated flow of good news, as less bad news (which is what rescued stocks from their downward spiral in

mid-February) is no longer going to move the needle.



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