TOP DOWN CHARTS

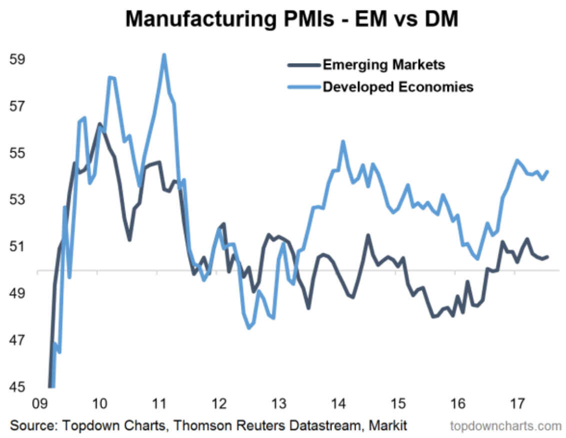
Monthly Chartbook

August 2017

The monthly chartbook presents a collection of the most interesting and important charts to have on your radar to get the global macro picture and stay on top of the risks and opportunities across asset classes and markets. It also brings together our key views and conclusions, which are summarised on page 2-3.

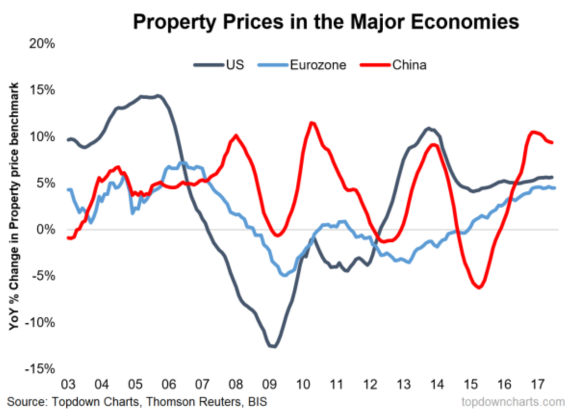
Topdown foreword: Globally the predominant trend is for ongoing growth and steady reduction of spare capacity, and hence an eventual pickup in inflation. This presents a supportive macro backdrop for risk/growth assets in favour of defensive/income assets. Yet the tides are turning in global monetary policy, valuations are steadily moving higher, and as we were reminded of last week – geopolitical risks remain lurking in the shadows. Thus, it's not time yet to turn away from equities, but the preference remains to look for value rather than chase momentum, and tread with caution on income assets and beneficiaries of the low yield easy money regime.

1. Manufacturing activity has recovered, but further acceleration remains elusive

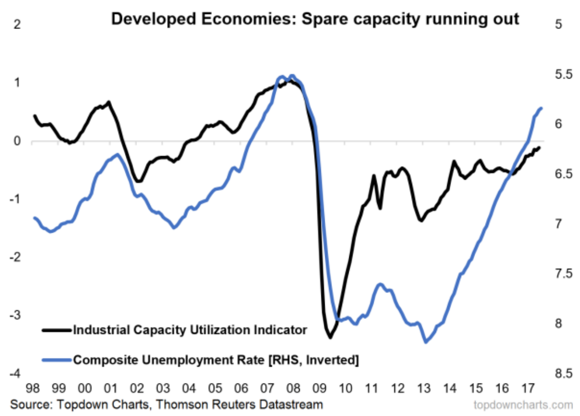


2. Likewise, hard data and soft data indicators show global trade growth has rebounded.

3. Property prices, a major macro driver and risk factor, still rising in the major economies.



4. Developed economies are slowly running out of spare capacity, this is typically inflationary.



Publication date: 16 August 2017

The view from the top

Global Economic Outlook: Global PMIs have topped out, but remain supported by the growth tailwinds of rising property prices in the major economies, improved consumer confidence, solid global trade growth, rebounding industrial production and corporate earnings growth, alongside still very stimulatory monetary policy. This makes for an above trend global growth outlook. Steadily tightening capacity in developed economies means nascent inflationary pressures are likely to become more evident in the months and quarters ahead. Base case is that the growth/inflation rebound is more of a rebound to solid levels than a new regime, a number of growth tailwinds look likely to diminish or turn next year.

Risk backdrop: The most pressing and challenging known risks are geopolitical in nature e.g. North Korea, Middle East, South China Sea, Trump. These risks aren't likely to go away any time soon in a meaningful way and could escalate at any time (as we saw last week), but in most cases, aren't directly hedgeable except to hold higher (some) cash allocation. Other risks are more traditional market risk e.g. increasing number of overvalued assets versus the removal of extraordinary monetary policy stimulus.

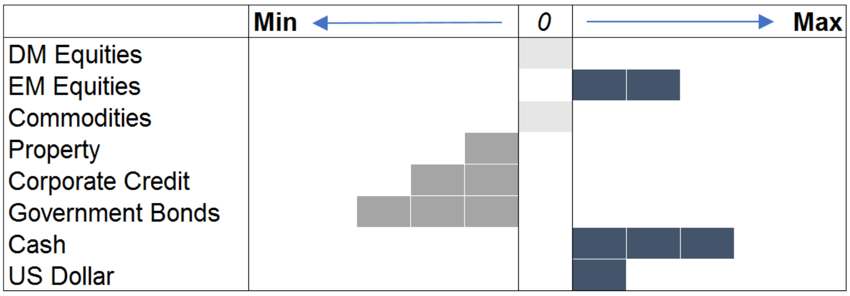
Summary view across asset classes (global unless otherwise noted)

Asset Class	Short-Term View	Medium-Longer Term View
DM Equities	Considerable momentum short-term, but increasing risk of a correction (sentiment, valuation, technicals).	Favour DM ex-US on relative value. Increasingly higher absolute valuations, gradual withdrawal of stimulus to present challenge to MT returns.
EM Equities	Sentiment becoming stretched to the upside, vulnerable to weakness in commodities/rebound in USD.	Solid relative value vs DM, but absolute valuations toward the upper end of the range. Improved economic conditions, policy support to underpin earnings.
Commodities	Neutral short-term view; mixed signals at an aggregate level.	Anticipate China headwinds to resurface & stronger US dollar, to reinforce secular bear market in commodities.
Property	Most property markets still see tailwinds, but an increasing number of markets are presenting as overvalued.	Signs of overvaluation across selected geographies, sectors. Clear reliance on low bond yields. Returns likely to be lower and more volatile going forward.
Corp. Credit	Credit spreads at rock-bottom, albeit leading indicators yet to turn.	Miniscule credit risk premium means very low compensation for taking on credit risk. Be wary of pushing risk for income.
Govt Bonds	Elevated risk of a move higher in bond yields on positioning, sentiment vs still decent inflation & growth dynamics.	Low bond yields = low expected returns for buy and hold. Despite overvaluation, bonds retain value as a diversifying asset.
Cash	Low cash rates = low real returns, but cash is still the most reliable means of capital preservation (which is valuable).	Expect a gradual normalisation in cash rates globally over the medium term, led by the USA, followed by rest of DM.
US Dollar	Looking oversold, futures positioning reset, window for stronger dollar on policy divergence.	US dollar can rally short-term on policy divergence, but rate differentials look near a peak, USD richly valued vs major pairs, US political risk is elevated.

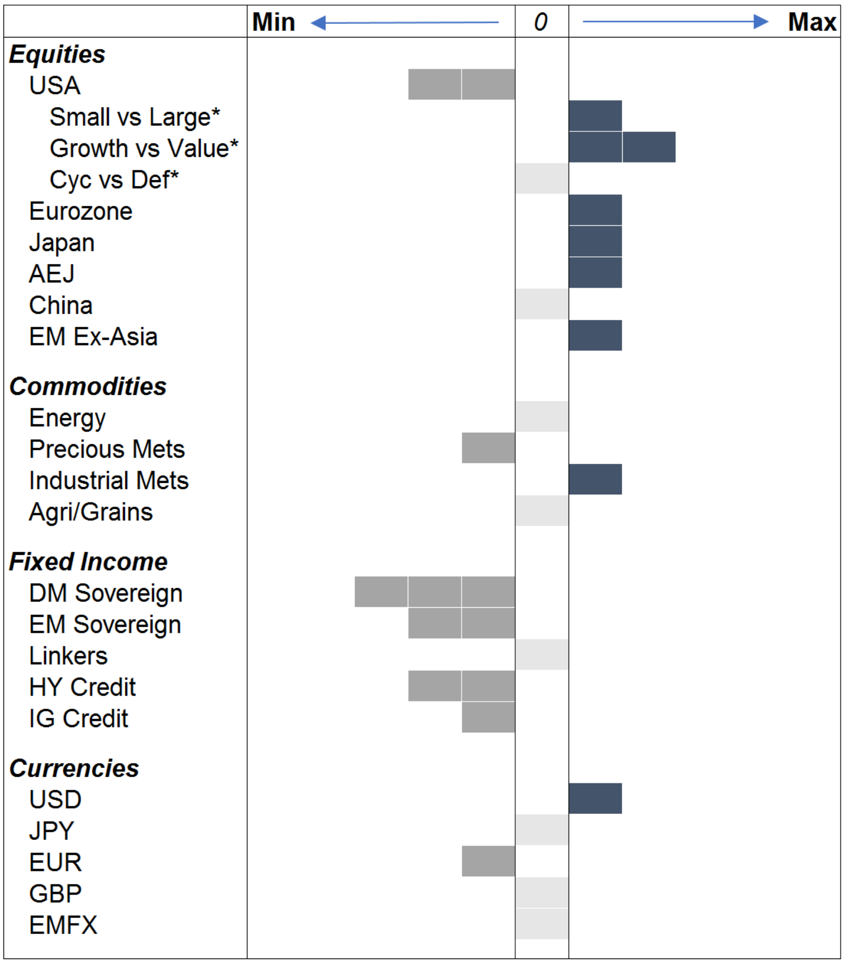
Notional positioning indication

As a reminder, we do not manage any money, or provide personal financial advice, nor offer securities. The purpose of the following tables is to provide a notional indication of positioning based on our analysis and indicators across the various asset classes, from an unbiased/generic multi-asset perspective.

Positioning Indication - Basic



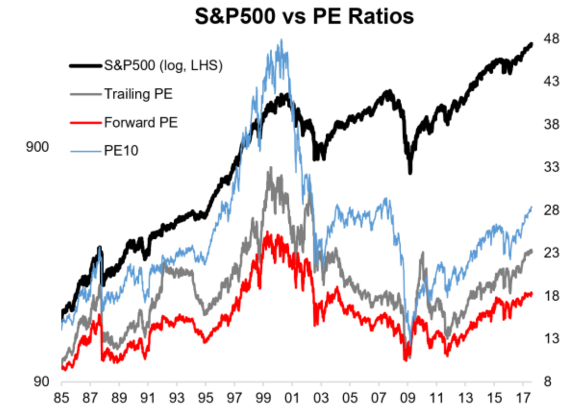
Positioning Indication - Extended



Max/Min: Qualitative ratings. Refers to overall view on that asset with 5 squares representing the highest possible conviction in either the Max (long) or Min (short) direction.

***XXX vs XXX:** Relative views, e.g. small vs large, interchange “min” with first mentioned e.g. for small vs large a maximum bullish view on small caps vs large caps would show as 5 boxes on the left side.

5. On most measures US equities look expensive – more like pre-2000 vs pre-2007.

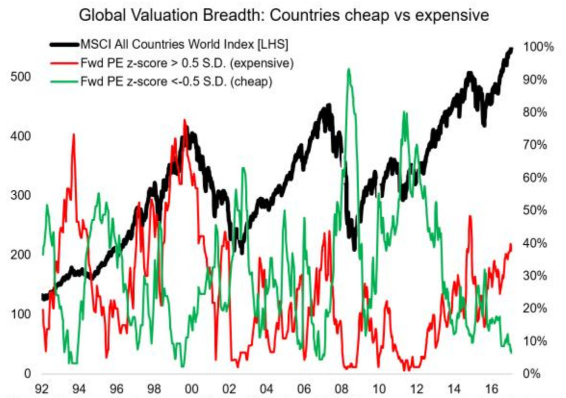


Source: Topdown Charts, Datastream, I/B/E/S

6. Yet for now the earnings outlook is decent in America, driven mostly by cyclical sectors.

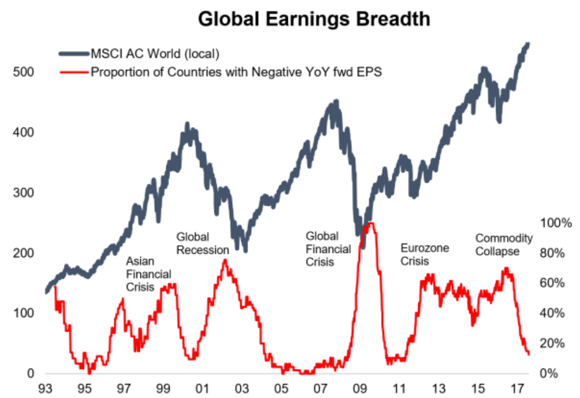
Source: Topdown Charts, Datastream, I/B/E/S

7. Global Equity Valuation Breadth: More expensive countries, less cheap countries.



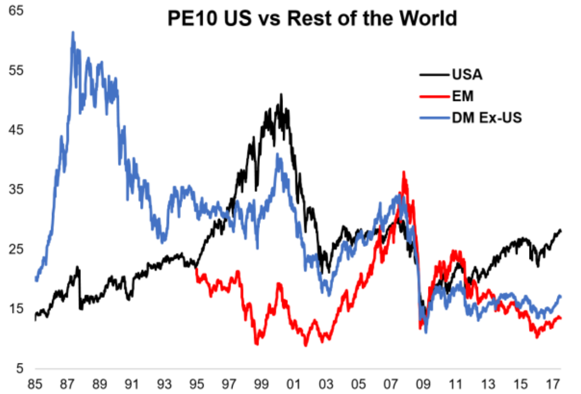
Source: Topdown Charts, Thomson Reuters Datastream, I/B/E/S

8. In the context of a big positive turnaround in forward earnings breadth.



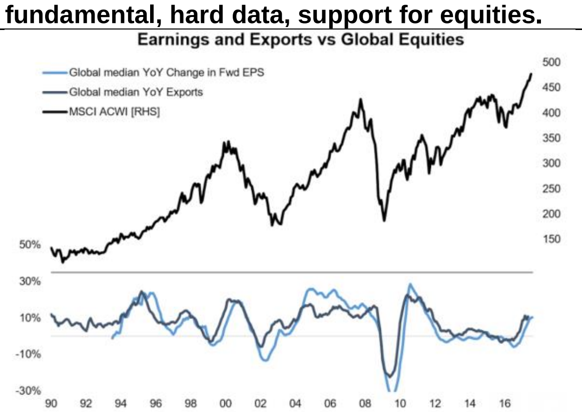
Source: Topdown Charts, Thomson Reuters Datastream, I/B/E/S

9. On most measures US looks expensive, makes relative value Ex-US more attractive.



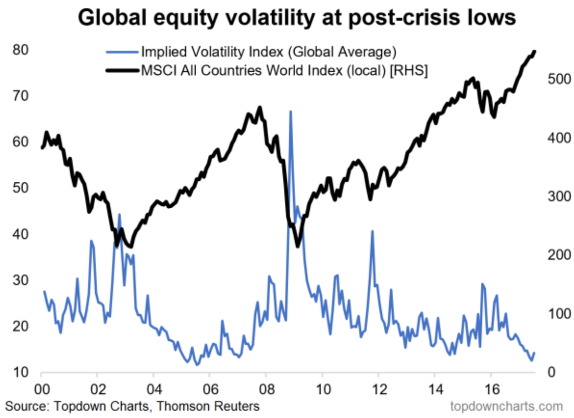
Source: Topdown Charts, Datastream

10. Improving earnings and exports = a real fundamental, hard data, support for equities.

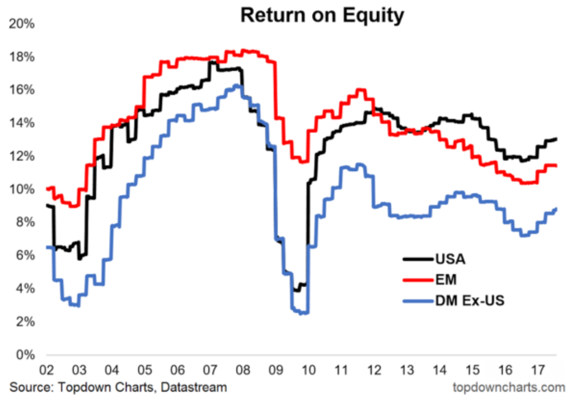


Source: Topdown Charts, Thomson Reuters Datastream

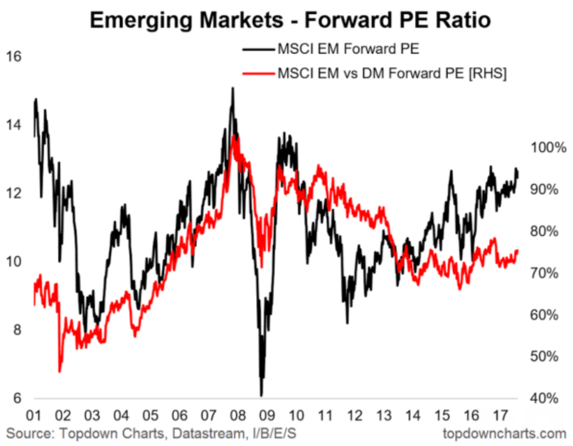
11. Global equity volatility behaving as usual during the start of a (new?) bull market



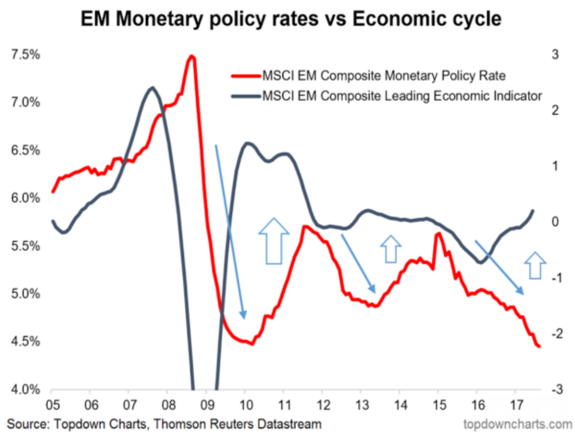
12. The return of the Return on Equity: a different but similar story across the regions.



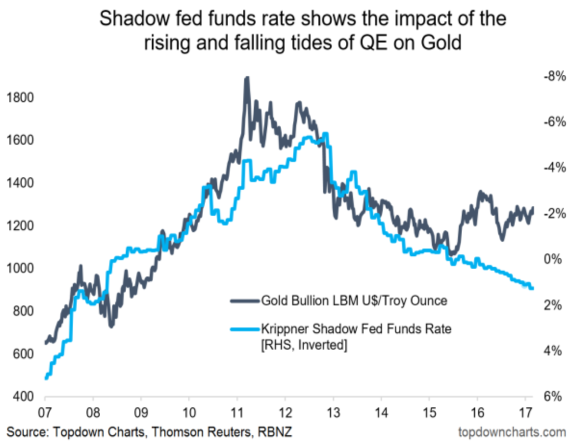
13. Versus history EM forward PE ratios look high, but still look cheap relative to DM.



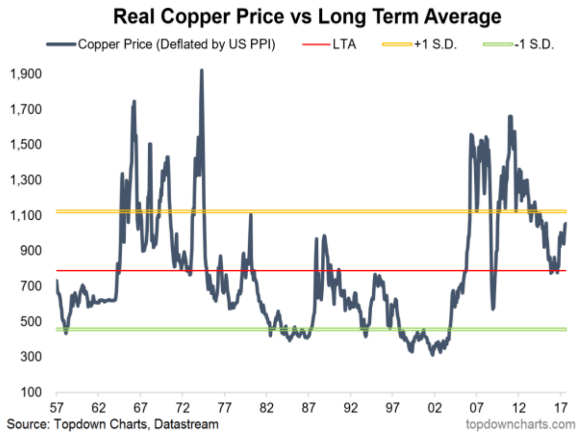
14. EM monetary policy increasingly easier, which supports the economic/earning outlook.



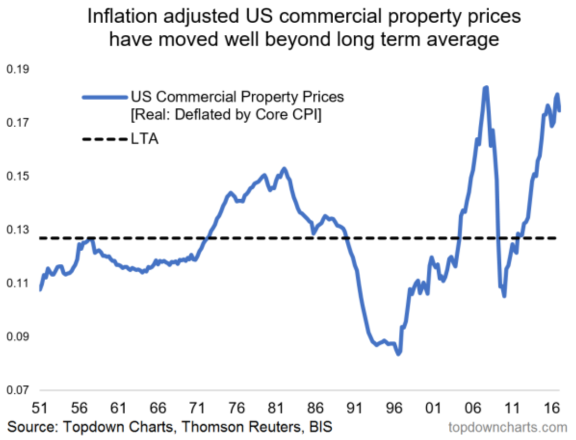
15. The gradual and ongoing withdrawal of stimulus by the Fed is a headwind for gold.



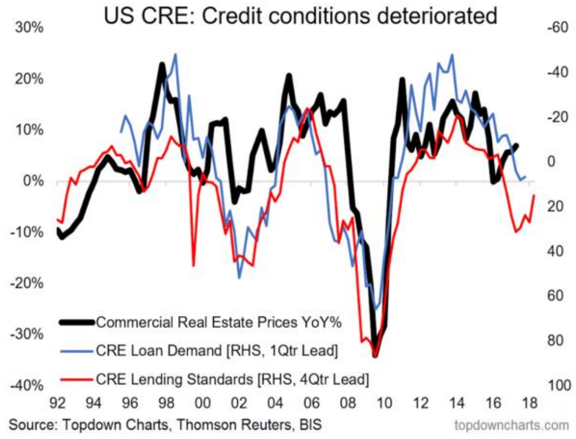
16. Copper riding the US dollar correction and China cyclical rebound; short term upside only.



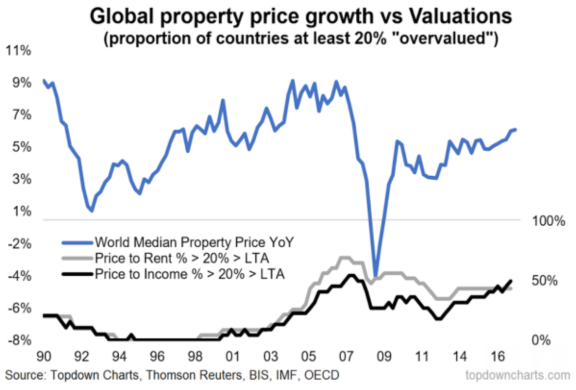
17. US commercial real estate looks bubbly – same as 2008: a concern and a vulnerability.



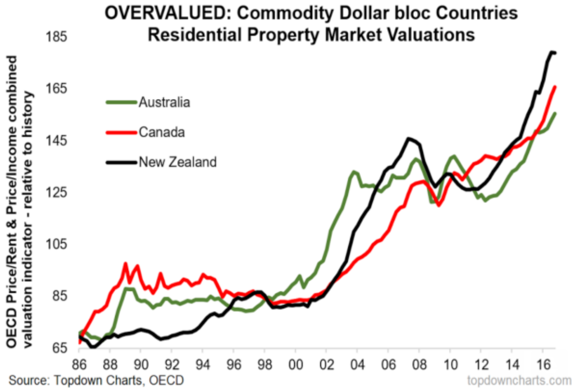
18. At the same time credit conditions had been tightening for CRE, a risk to monitor.



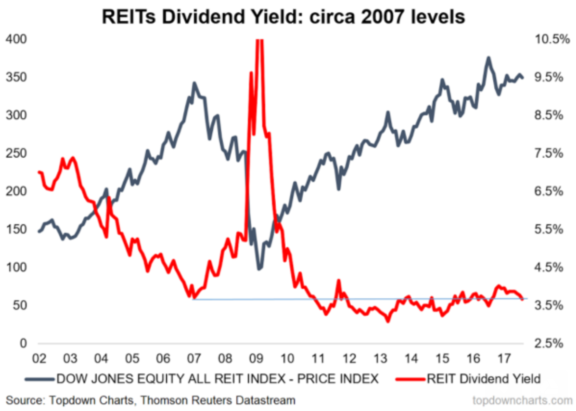
19. Globally seeing trend of rising property prices, and greater incidence of overvaluation.



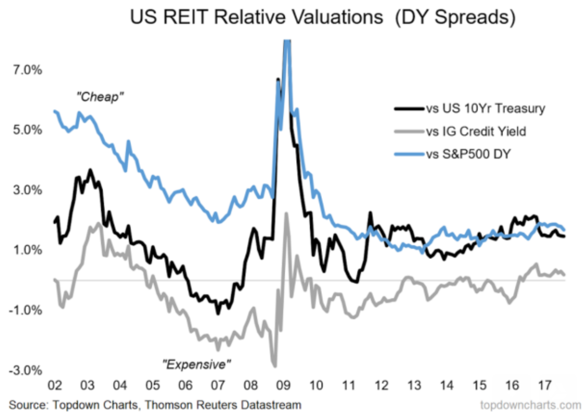
20. 'CANZ economies' particularly overvalued, also have high household leverage ratios.



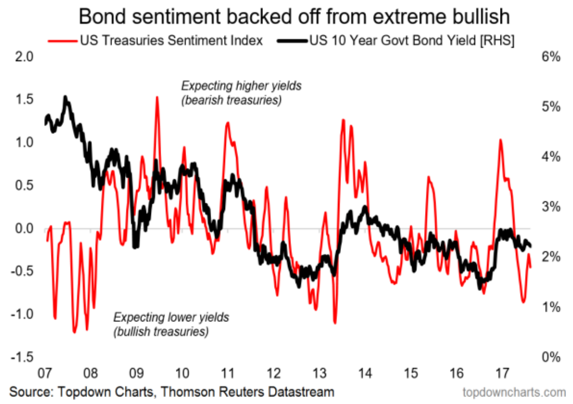
21. Search for yield has seen a structural shift to more expensive levels for US REIT yields.



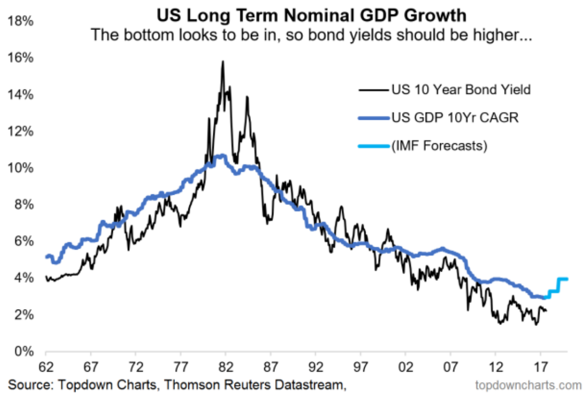
22. US REITs benefit from substantial yield support, but could turn substandard quickly.



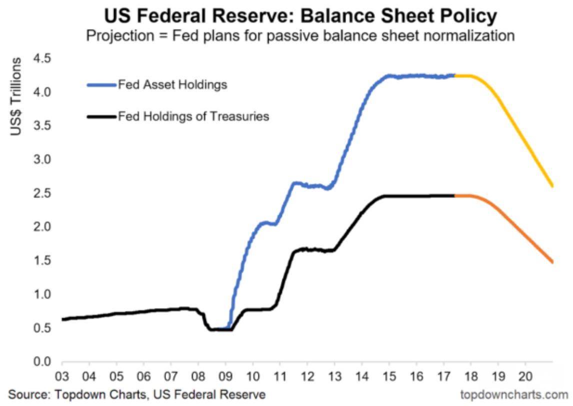
23. Bond sentiment reversed from extreme bullish sentiment, could change quickly.



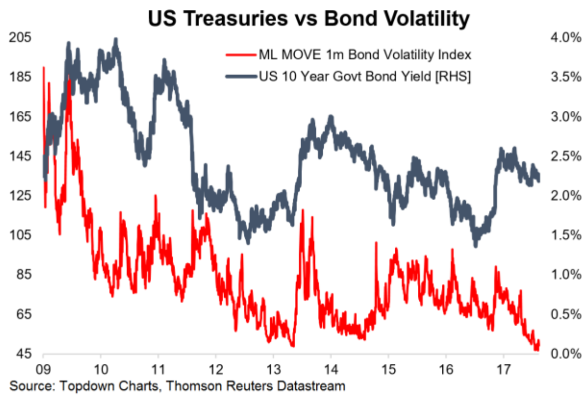
24. Longer term US nominal GDP growth likely bottomed; meaning upside for bond yields.



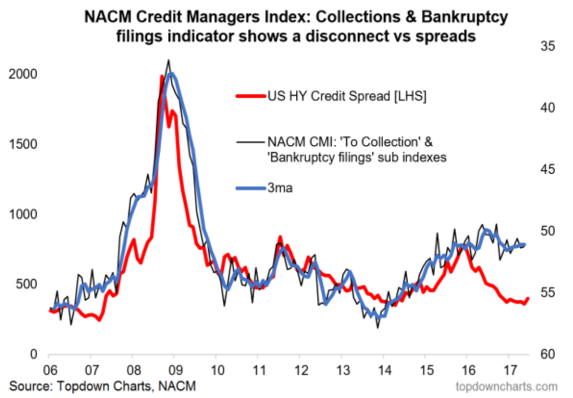
25. Fed moving closer to balance sheet normalization aka QT [Quantitative Tightening]



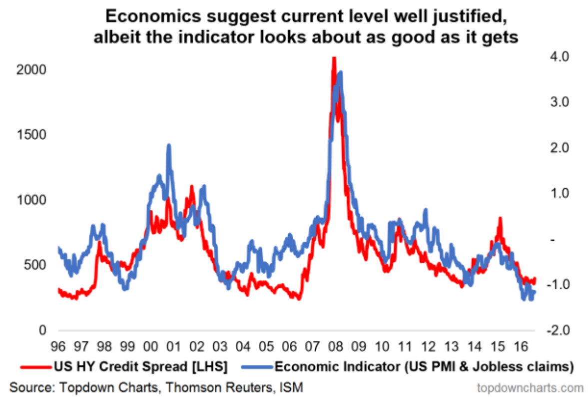
26. The "bond VIX" has fallen to pre-taper levels, just as QT looks all but imminent.



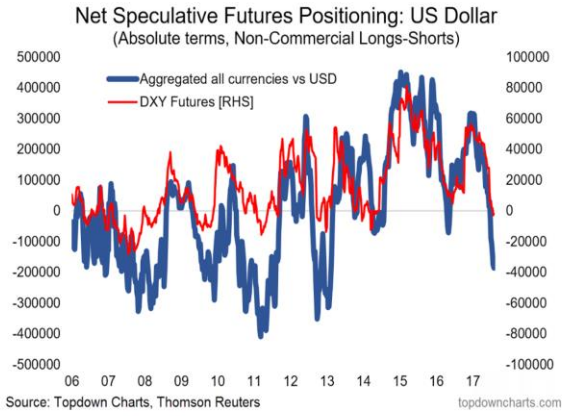
27. Credit managers index points to wider HY credit spreads from extremely low levels.



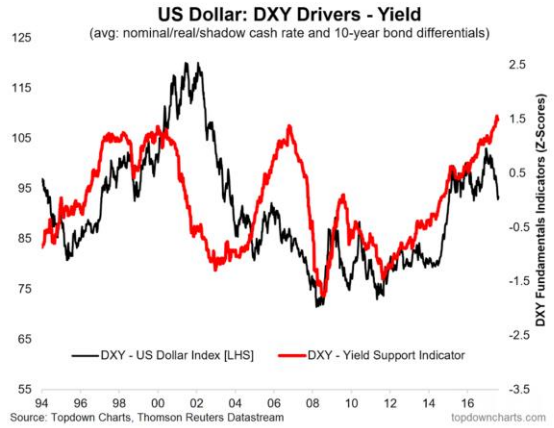
28. Yet current economic conditions arguably justify the current level of spreads, for now…



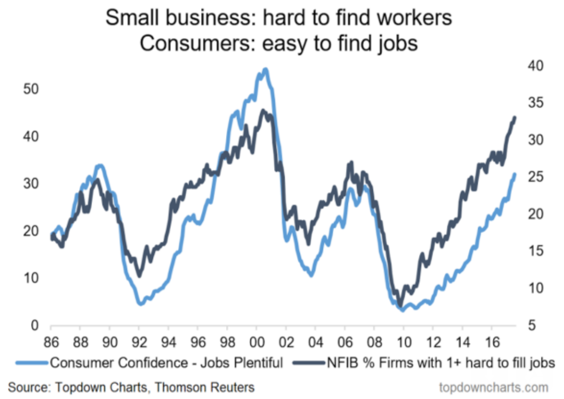
29. USD speculative futures positioning from crowded longs to increasingly crowded shorts.



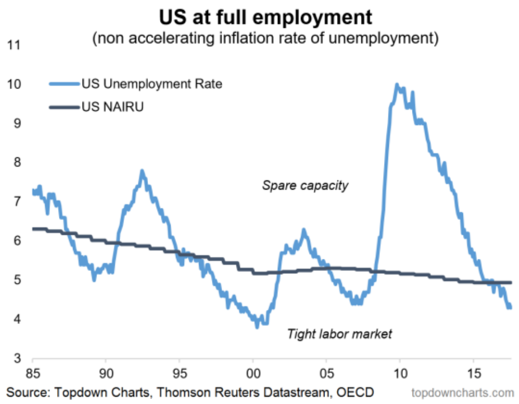
30. US dollar continues to see significant yield support on a number of fronts.



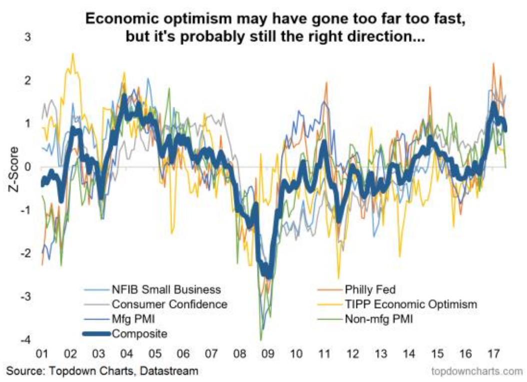
31. US labour market looks increasingly tight, ticks one box for the Fed on normalization.



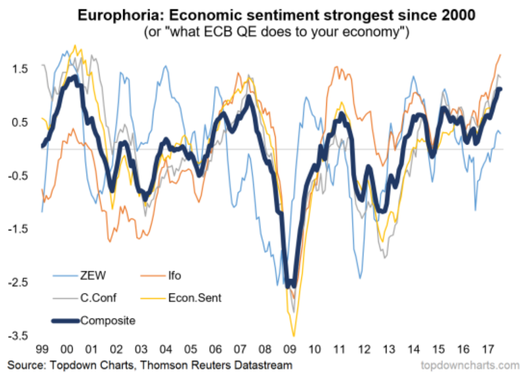
32. Tight labour market will eventually lead to wage inflation, risk that Fed goes faster.



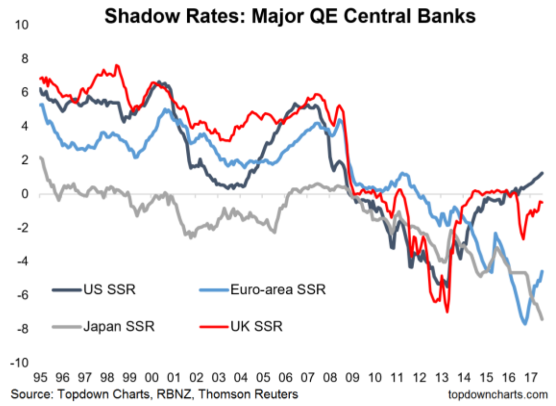
33. US economic confidence indicators pulled back lately, but still running very hot.



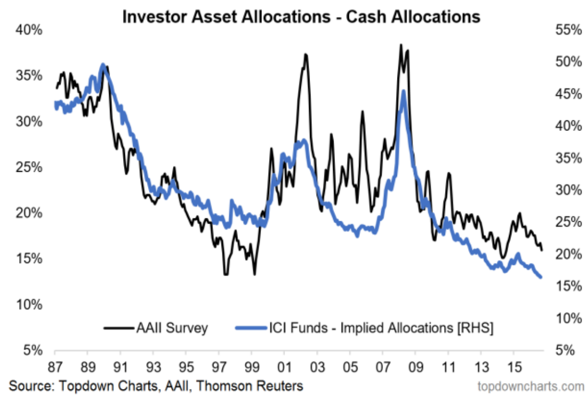
34. Likewise Eurozone economic confidence the strongest since 2000, ECB take note.



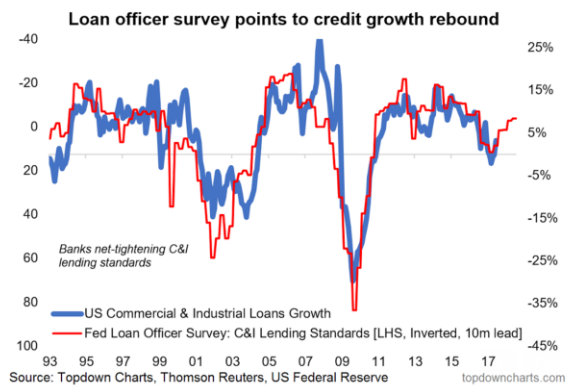
35. Monetary tides are thus shifting rapidly; the central banking experiment continues…



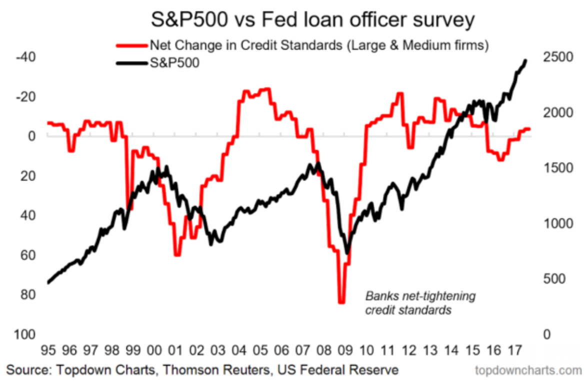
36. Cash allocations at very low levels (well, cash rates are low after all…)



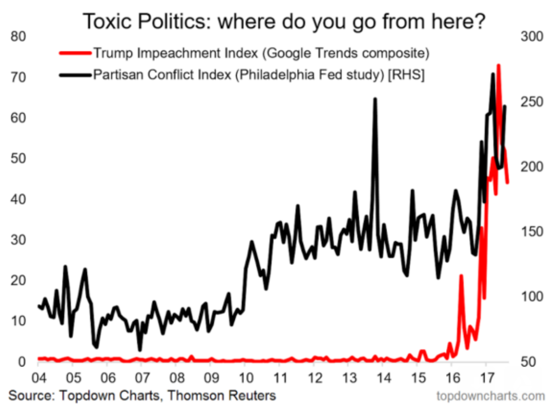
37. One worry sign for the US economy was loan growth – we see no need to worry here.



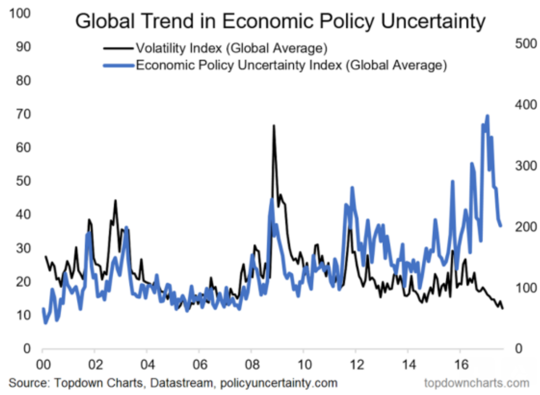
38. The bear market warning indicator is all clear at this point.



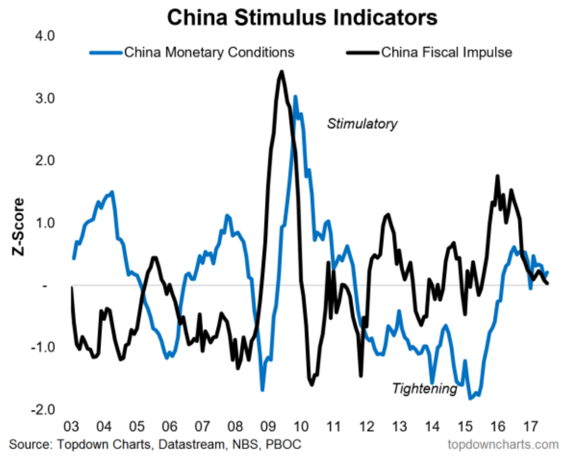
39. Political risk in America could easily turn into geopolitical risk (e.g. via North Korea).



40. Global economic policy uncertainty remains elevated, but has peaked on a cyclical basis.

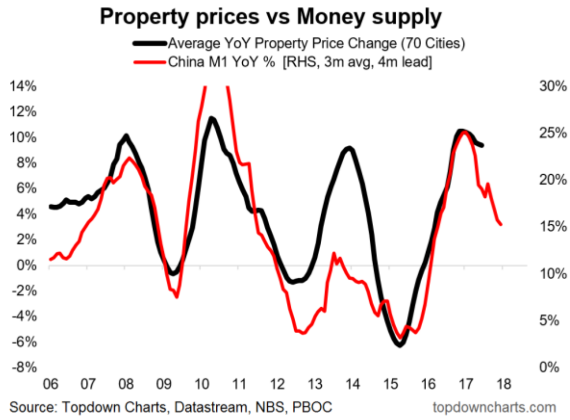


41. China stimulus indicators have gone from a big easing push to more neutral levels.

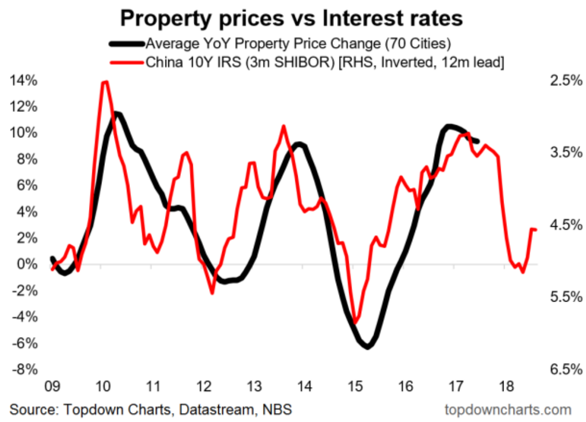


42. China's coordinated monetary and fiscal stimulus achieved a measured rebound.

43. Money supply growth rolling over points to property market slowdown later this year…



44. Property is a key variable for the growth/risk outlook in China, so watch these charts.



Report by Callum Thomas, Head of Research at Topdown Charts

About Topdown Charts

Topdown Charts provides chart-driven primary research across a global macro and multi-asset universe. The key offering is the Weekly Macro Themes report which has been designed specifically for multi-asset portfolio managers, asset allocators, and macro-driven fund managers. The perspective is that of a buyside strategist and the key deliverables of the report are: investment idea generation, top-down global macro insights, risk management input, and asset allocation research.

APPENDIX: Australia & New Zealand

Economic view: The Australian economy sees short-term support from better China macro this year (not so much next year as tailwinds turn to headwinds for China). Financial conditions remain somewhat supportive (low rates, and until recently lower FX). The strong housing market has been a support, but is showing signs of peaking as supply growth has been substantial and credit standards have tightened somewhat along with out-of-cycle mortgage rate hikes. Overall makes for benign growth/inflation outlook.

New Zealand economy looking late cycle in some respects (except headline monetary policy). Housing market and equity market are both increasingly overvalued and present downside risks. Net migration boom starting to peak, likewise building activity likely to peak along with prices. Yet policy remains overall supportive, likewise terms of trade, and still substantial net migration gains. A subdued growth/inflation outlook with risks skewed to the downside should macro-prudential measures push the housing market over.

Monetary policy outlook: The RBA is likely on hold through later 2018 as inflation and domestic consumption remain soft. The RBNZ has given forward guidance that it's likely to keep rates on hold at record lows until late 2019 – the macro-prudential tightening measures aimed at the housing market certainly provide scope to keep the OCR lower for longer.

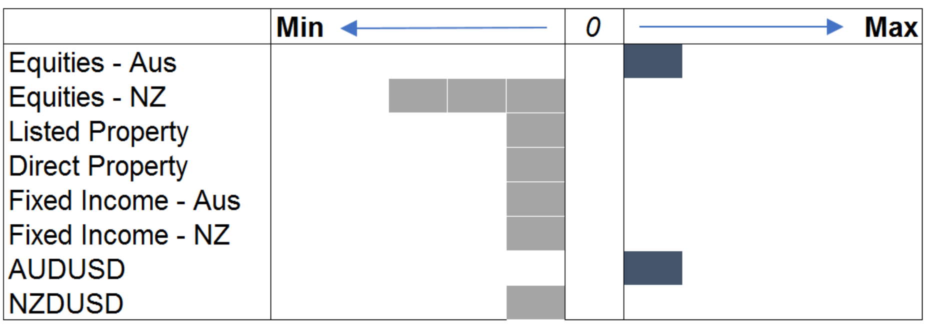
Summary view across asset classes

Note: Given many of these assets have similar drivers, the view is for "Australasia" unless specified otherwise.

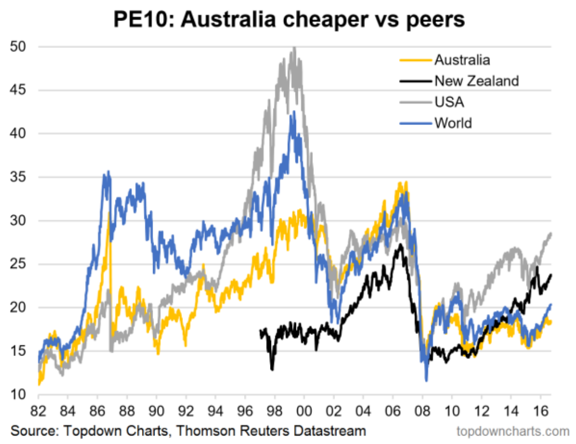
Asset Class	Short-Term View	Medium-Longer Term View
Equities	Short term could push higher on sentiment and flows.	Downside risks in China a concern for Australian risk assets, meanwhile NZ equity valuations look very stretched.
Listed property	Vulnerable to bond market selloff, yet monetary policy settings still supportive	Negative bias over the medium term as property market valuations generally stretched due to yield demand
Direct Property	Global search for yield likely to drive ongoing demand in the near term.	Prices, valuations becoming stretched, vulnerable to a downturn, spike in yields.
Fixed Income	Bearish global duration. Albeit, still some relative value vs global. Cautious view on corporate credit spreads.	Both countries see positive relative valuation vs global. And retain value as a diversification asset in event of downturn.
Currency	Relative monetary policy settings favour USD vs AUD & NZD.	Expect AUD to outperform NZD over medium term. Valuation becoming favourable for both vs USD.

The table below reflects a notional positioning indicator based purely on the above views.

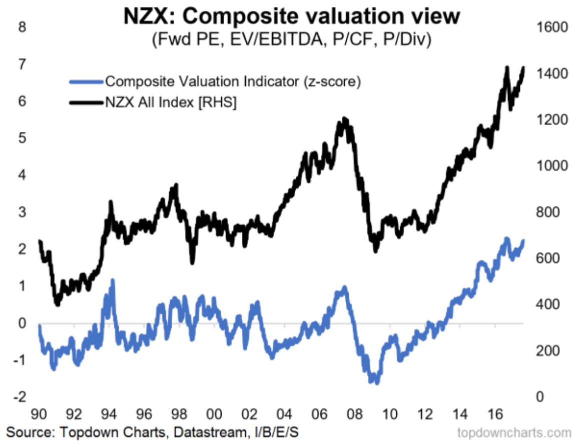
Notional Positioning Indication - Australia & New Zealand



i. On a PE10 basis, Australian equities look cheap vs peers. New Zealand however…

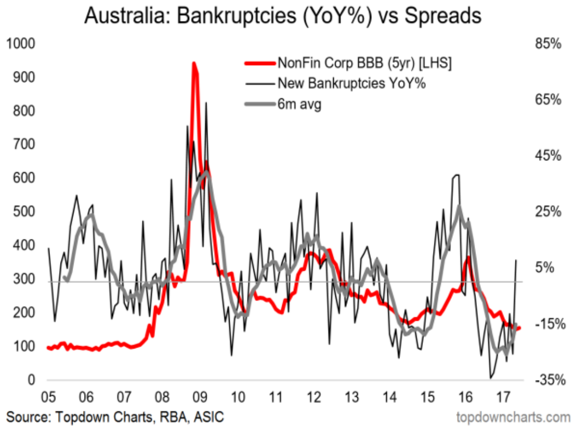


ii. Various views of valuations show NZ equities as extremely expensive vs history.

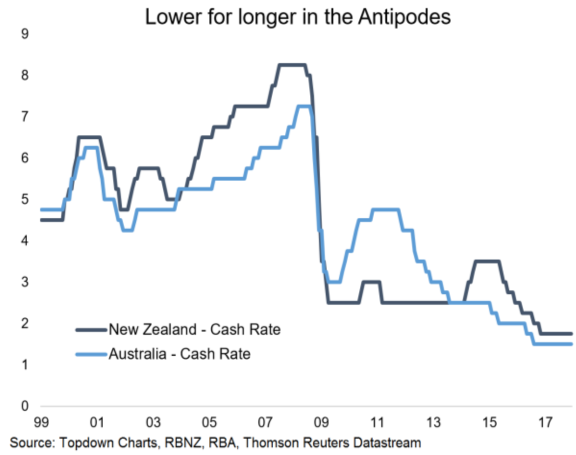


iii. Lukewarm rebound in China RE FAI has lifted Iron Ore, but likely to be short-lived.

iv. Australian bankruptcies YoY spiked in May; noisy series but warrants close monitoring.



v. Official cash rates likely to remain on hold in both countries through to late 2018.



vi. Ongoing gains in property prices resulted in stretched housing market valuations.