

Weekly Macro Themes

End of Year Special Edition - 2017

"The End of Year Special Edition takes a different format to the usual weekly ppt chartbook, and presents you with highlights, reflections, and some of the best charts of 2017. I sincerely hope you enjoy it!"

-- Callum Thomas, Head of Research and founder of Topdown Charts

Topdown foreword: As we sign-off on 2017, it's interesting to reflect (in hindsight) on how calm and relatively straightforward markets have been. Equities for the most part performed well, the global economy improved, and the Fed began QT without major incident. Inflation was benign, commodities range-bound, and much feared bond-yield-spikes hard to come by.

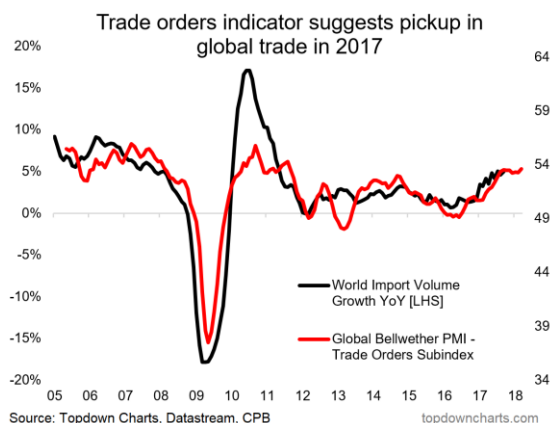
Looking forward, in my view the three key themes for 2018 will be: i. increasing incidence of overvaluation across asset classes; ii. a maturing business cycle; and iii. a turning of the tides in global monetary policy stimulus. This should make for a more challenging investment environment so keep the questions coming, and I'll continue to focus on bringing you the charts that matter.

In the meantime, please enjoy this selection of charts which I meticulously selected from reviewing all 49 editions of the Weekly Macro Themes report from the year 2017. As an exercise in reflection it's been rewarding and insightful, and I trust you will likewise get a lot out of this special edition. I look forward to catching up with you in the new year.

Section A. Charts That Worked

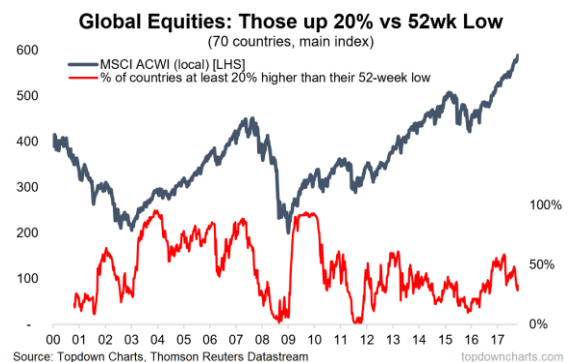
First up is a look at some of the charts and calls that worked particularly well during the year.

1. Global trade leading indicator picked the rebound: (13 Jan 2017) *"global trade growth has been steadily declining over the past couple of years, but leading indicators point to a rebound in global trade growth in 2017 -- a non-consensus call in the current backdrop of populist protectionism and political risk."*



2. The new bull market in global equities: (13 Jan 2017) *"after an almost 20% fall, it's fair to say that the MSCI ACWI underwent what was effectively a minor bear market - and in my view that was enough to drive enough of a reset (and you can see it in the charts) to pave the way for a new bull market"*

"Despite some mixed signals, the weight of evidence says we are in a new bull market for global equities."



3. More of a table than a chart (although some people like to call tables charts), but the cycles analysis for the ISM PMI picked the rise to 59 (and beyond) [final stats for the table were 12.8pts and 21 months to the peak of 60.8] (13 Jan 2017)

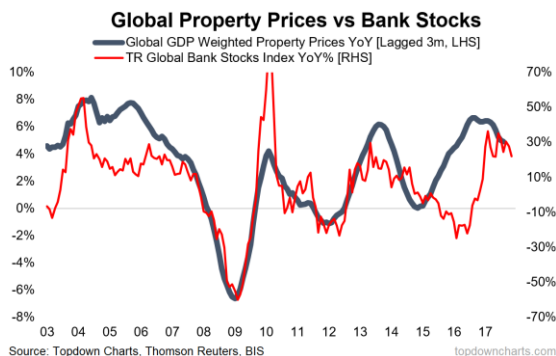
"The average expansion of the US manufacturing PMI since the mid-80's (period prior to that excluded due to being too volatile and not representative) was 12.5pts (or 11.1 if you exclude 2008) and took an average 14 months. The current move has so far been 6.7pts across 12 months. If you input the average ex-08 it would suggest a potential move to 59.1 (or further upside of around 4.4pts)."

Average Expansions of the US (ISM) Manufacturing PMI

	Trough		Peak	pt Move	Months
May-85	47.1	Dec-87	61	13.9	31
Aug-89	45.1	Apr-90	50	4.9	8
Jan-91	39.2	Sep-91	54.9	15.7	8
Jun-93	49.6	Oct-94	59.4	9.8	16
Jan-96	45.5	Jul-97	57.7	12.2	18
Dec-98	46.8	Dec-99	57.8	11	12
Oct-01	40.8	Jun-02	53.6	12.8	8
Apr-03	46.1	May-04	61.4	15.3	13
May-05	50.8	Oct-05	57.2	6.4	5
Dec-08	33.1	Mar-10	58.8	25.7	15
Nov-12	48.8	Aug-14	58.1	9.3	21
Dec-15	48	?	?		
Average				12.5	14
Average (ex-2008)				11.1	14
So far...(Dec 2016)				6.7	12

Source: Topdown Charts, ISM

4. Global property price trends and bank stocks (27 Jan 2017) *"Where it becomes meaningful is when you compare it to changes in global bank stock prices - there seems to be a link between them (as you might expect), and the recent moves would suggest more upside for bank stocks and would tend to make the breakout in bank stock prices somewhat more sustainable."*



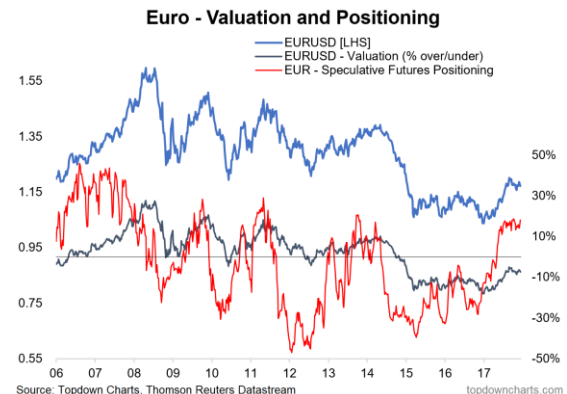
5. Emerging market equity breakout (17 Feb 2017) *"Emerging market equities look to be breaking out with still considerable potential follow through on flows and positioning, supportive-to-neutral valuation, and benign-to-bullish macro factors."*

"the PPI indicator - positive Chinese PPI inflation is historically consistent with strong EM performance [and supports the breakout]"

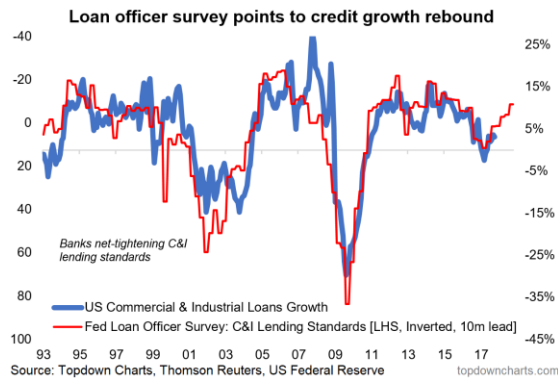


6. The Euro turnaround (31 Mar 2017) *"The tides are turning for the Euro as valuation, technical and macroeconomic indicators point to brighter times ahead for the Euro."*

"Bullish divergence spotted on the weekly chart - often a good sign of a major market bottom, while valuation signal is still positive (undervalued) [and positioning still relatively light]"

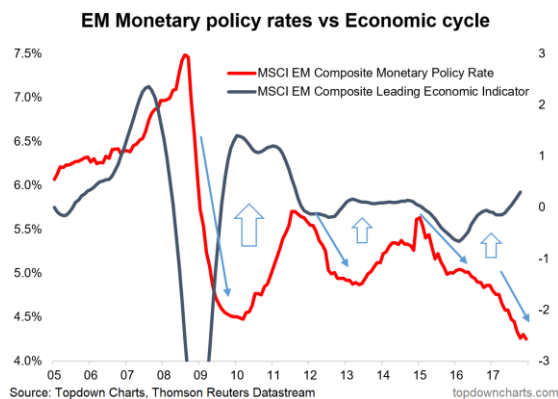


7. Were you one of the ones worried about the loan growth slowdown back in March? We weren't, the SLOOS + NACM data allowed us to run cool heads on this non-issue... (31 Mar 2017) *"[the] NACM survey points to robust applications and approvals, while the SLOOS appears to have flagged the slowdown [in loan growth] (and subsequent probable rebound)."*



8. Emerging markets monetary policy – staying the course after the easy/valuation-driven gains were banked... (16 Jun 2017) *"The 'easy' gains in emerging markets have been had. Relative value and monetary policy are supportive but sentiment is getting stretched and risk pricing looks complacent."*

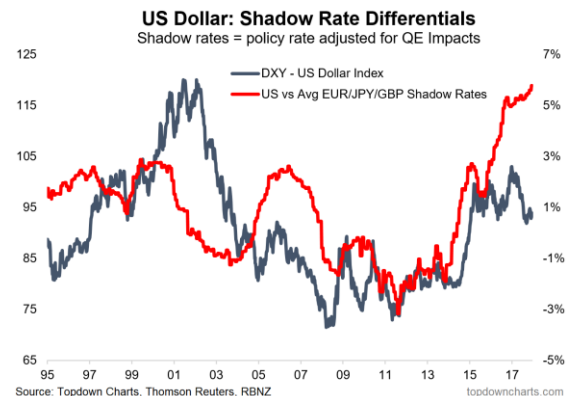
"The move lower in composite monetary policy rates and improved (at least less bad) economic picture underpins the earnings outlook."



Section B. Charts That Didn't Work

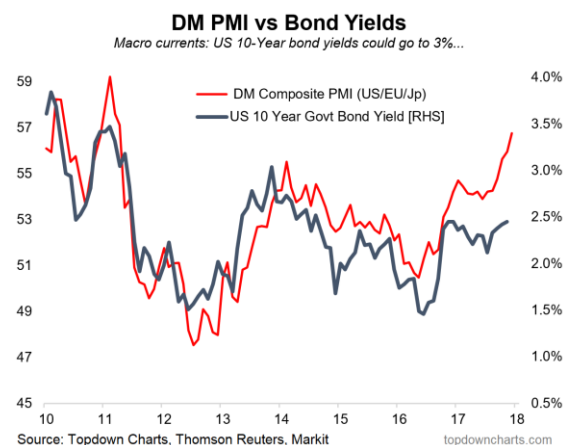
Of course, it wouldn't be complete without a look at some of the charts that didn't work (or shall we say the ones that worked "less well!").

1. DXY and the shadow policy rate differentials: (13 Jan 2017) *"Looking again at Krippner's shadow rate differentials, there is similarly a strong case for further upside in the US dollar index"*

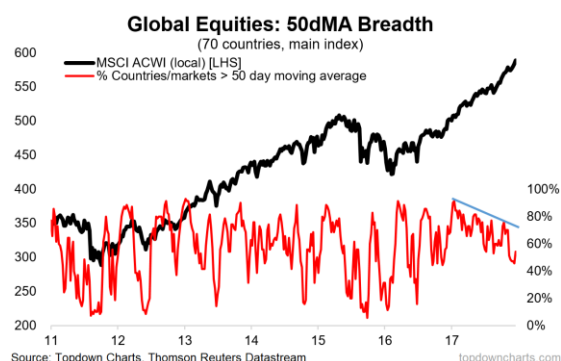


2. Bond yields and the PMI who cried wolf... I've rolled this one out a few times throughout the year, particularly lately as the gap grows. It may well be a case of 'not wrong but just early' (although that in many cases is simply another type of wrong). I would say though you could just as easily put this in the ones to watch for 2018 section.

(15 Dec 2017) *"The December flash PMIs showed improvement across Europe, US, and Japan – placing the composite "global flash" reading at a very strong 56.8. As I've previously highlighted, this would be consistent with US 10-year bond yields around 3.5%."*

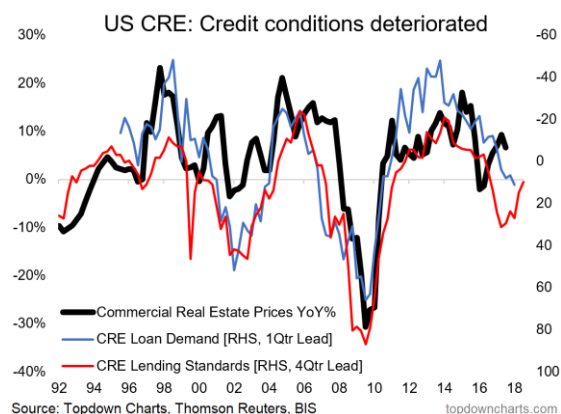


3. Global equities bearish breadth divergence – the short-term downside risks did not (yet?) eventuate although the signal persists [earnings growth acceleration on the other hand did continue!] (24 Mar 2017) *“Short-term downside risks are elevated for global equities, but with signs of earnings growth acceleration it may end up being a classic “buy the dip” scenario.”*



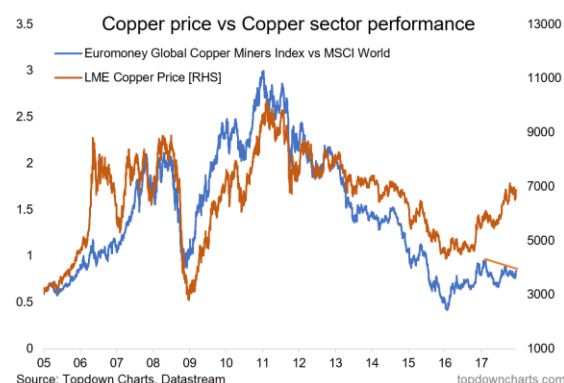
4. US commercial property outlook – no downturn (yet?). Another one of those ones where the risks look to be rising, but yet to show up (19 May 2017)

“Inflation adjusted commercial property prices have moved well beyond the long-term average to levels that look worryingly similar to those seen just prior to the crisis. The other issue is credit conditions have been tightening for commercial real estate and CRE loan demand has been falling. [which tend to lead price growth]”



5. Another one of those in the category of perhaps not wrong as such but still yet to play out: (21 Jul 2017) *“After the rebound in late 2016 Copper faces a couple of headwinds as signals have gradually turned neutral to mildly negative.”*

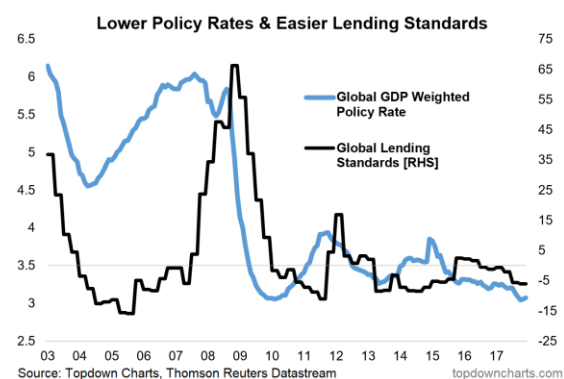
“Copper prices have diverged vs copper mining stock relative performance - this divergence could close up in a benign fashion should copper mining stocks start to outperform again, but it serves as a short-term risk flag for now.”



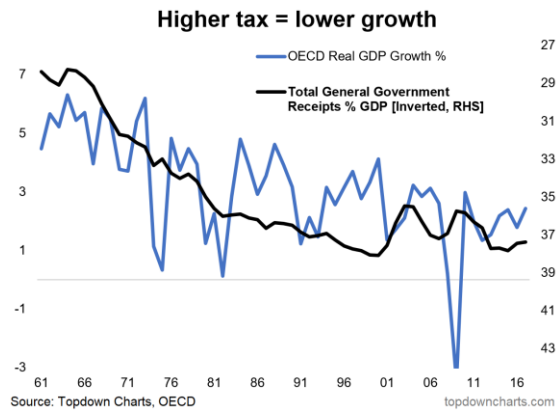
Section C. My Favourite Charts

These are some of my favourites – mostly ones I simply enjoyed coming up with (some of my favourite moments are designing a new chart/indicator which brings a complete new perspective or insight on something).

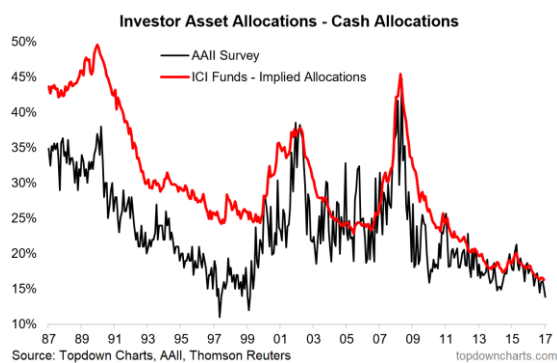
1. Global lending standards and the global GDP weighted monetary policy rate (3 Nov 2017) *“However one reason for optimism is the point that global (DM focused) lending standards remain easier and at an aggregate level monetary policy rates remain low.”*



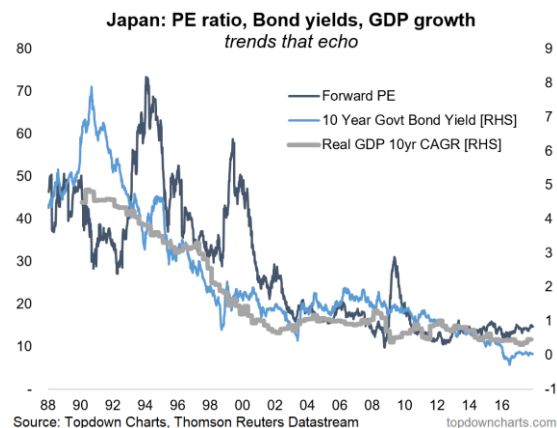
2. Tax takes and GDP growth (10 Feb 2017) *"While there are many factors at play, the rise of general government receipts as a % of GDP could be a contributing factor to the slowing of GDP growth through time for OECD countries."*



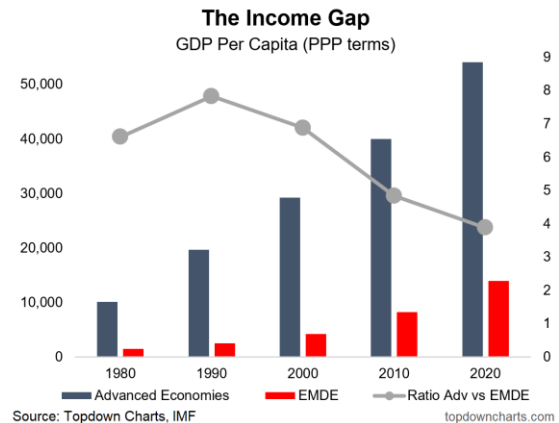
3. Retail investor cash allocations – about as low as it gets [signs of capitulation buying] (2 Jun 2017)



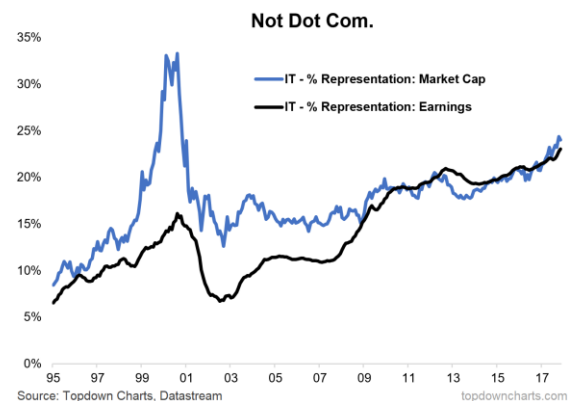
4. On the mantra that low bond yields are automatically a good thing for stocks... (4 Aug 2017) *"The conundrum of valuation, risk free rates, and growth in Japan"*



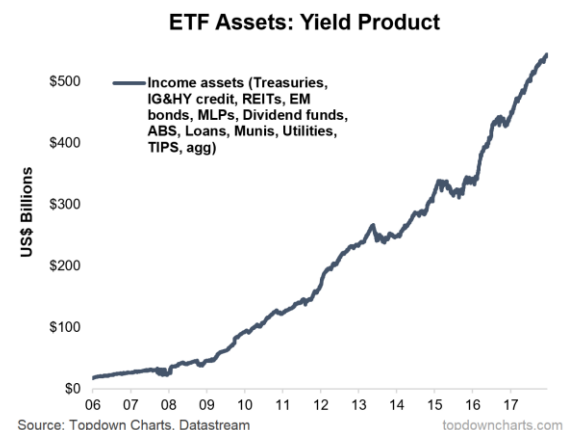
5. The income gap (EM vs DM): (14 Apr 2017) *"The ratio of DM to EMDE GDP per capita went from a high of 8x in 1990 to below 5x in recent years - while it's unrealistic to expect parity there is still scope to move on this with trends like productivity gains, structural reforms, and the impact of technology on inclusion and enabling."*



6. Market capitalization and earnings share of the S&P500 [tech sector]. (7 Jul 2017) *"Not Dot Com"*



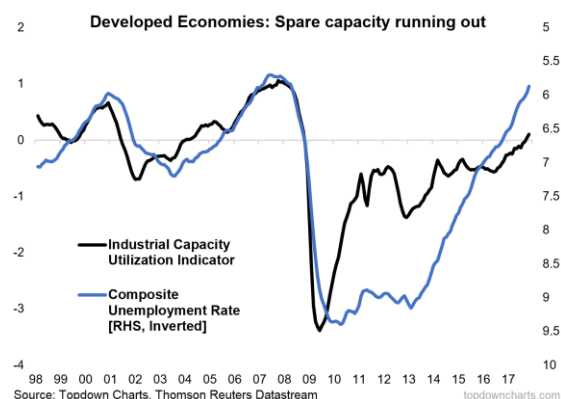
7. The great yield rush... (4 Aug 2017) *"The yield oriented ETF market has ballooned to over half a trillion dollars."*



Section D. Charts to Watch in 2018

As interesting and sometimes amusing as it is to look back, as investors we get paid for looking forward, and there's a few existing trends and themes that will remain front of mind and be key to keep on the radar in 2018. Following is a selection of the key charts and indicators we will be watching in the new year.

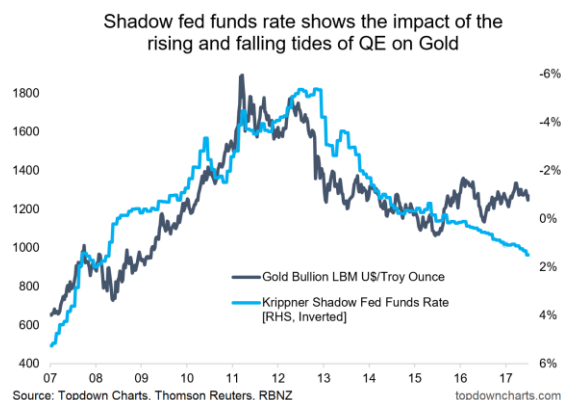
1. No more spare capacity in DM. (= Inflation)



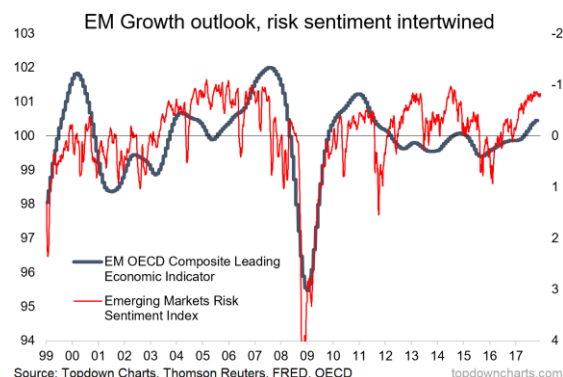
2. A secular bottom in 10-year bond yields.



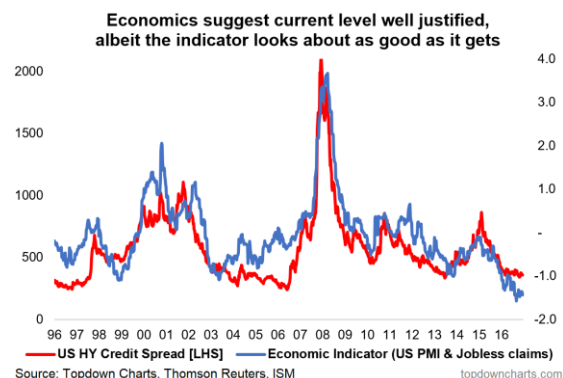
3. The monetary tides are going out. (be careful!!)



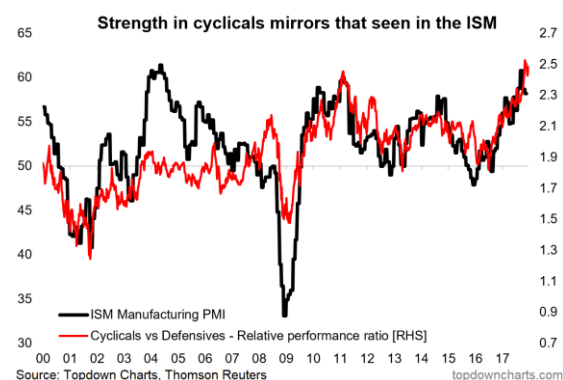
4. Emerging Markets cross-asset risk pricing is complacent, but for now is engaged in a virtuous cycle with improving economics.



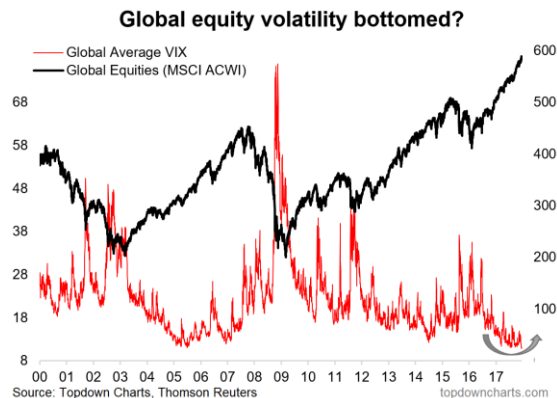
5. Likewise, US HY credit spreads are anchored by solid macroeconomic cycle dynamics... i.e. "expensive" can stay expensive for the time being.



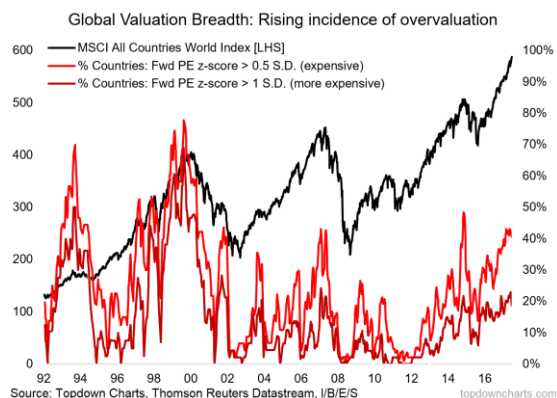
6. US cyclical stocks are closely keeping pace with the ISM manufacturing PMI but the relative performance ratio looks very stretched, likewise absolute and relative valuations. This is a key area to keep on top of as the new bull market in America (and globally) has been driven by solid outperformance by the cyclical stock sectors.



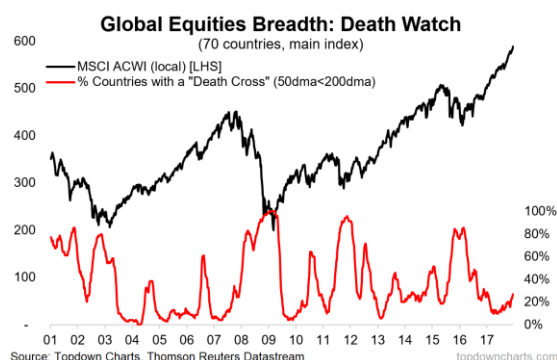
7. An open question for 2018: will the second great moderation continue? Or will global equity volatility reach a turning point?



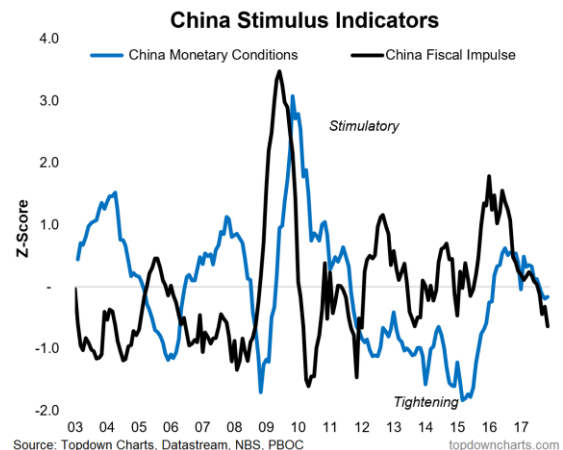
8. One issue (along side the themes of a maturing business cycle and a turning of the tides in global monetary policy) is a rising incidence of overvaluation across markets (and assets). It's not at previous extremes yet, and valuation is not by itself a reason for markets to fall, but it is an important fact to incorporate.



9. Global death-cross watch: a nice & novel chart which tracks the proportion of 70 global stock markets which have a "death cross" (i.e. the 50-day moving average passing below the 200 day).



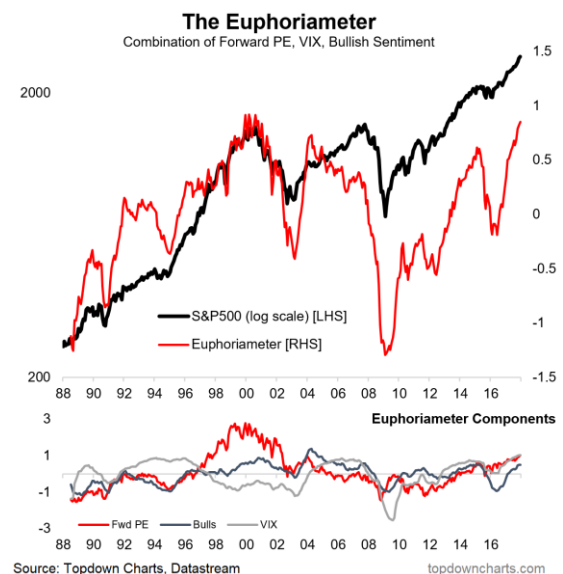
10. Last but certainly not least is China. A number of the big tailwinds (property, exports, stimulus) that helped China avoid a recession in 2015/16 are starting to turn. The fiscal/monetary policy stimulus indicators in this chart helped us pick the turnaround in China, and I think this will be a key one to monitor when thinking about the outlook for China in 2018 and beyond.



Section E. Honourable Mentions

Those charts worthy of mention but not quite fitting in the previous categories...

1. "The Euphoriameter" – a holistic composite view of investor sentiment based on survey responses, market risk pricing, and valuations. At present the indicator shows euphoria has become the dominant mood in the market.



FinTech?? (Financials & Tech driving returns)

Percentage point contribution to index rolling 12-month returns

Legend:

- En
- Ut
- HC
- IT
- Telc
- CD
- CS
- Mats

Source: Topdown Charts, Datastream

Governance ranking vs Expected returns

$R^2 = 52\%$

Expected Return %

Composite Governance Ranking

Source: Topdown Charts, Thomson Reuters, IMF, WEF, World Bank

topdowncharts.com

Winning: Momentum/Low Div/Growth/Cyclicals
(average of relative performance ratios: Momentum vs ACWI, Low Dividend Yield vs ACWI, Growth vs Value, Cyclicals vs Defensives)

Source: Topdown Charts, Thomson Reuters, MSCI

Equity vs Bond "fundamentals" net-bullish sentiment (4wk avg)

Legend: Equities [LHS] (black line), Bonds [RHS, inverted] (blue line)

Source: Toodown Charts. ©Callum Thomas

toodowncharts.com

S&P500 Sectors: average pair-wise correlations

12m S&P500 Sector pair-wise Correlation
1m S&P500 Sector pair-wise Correlation

Source: Topdown Charts, CBOE, Thomson Reuters topdowncharts.com

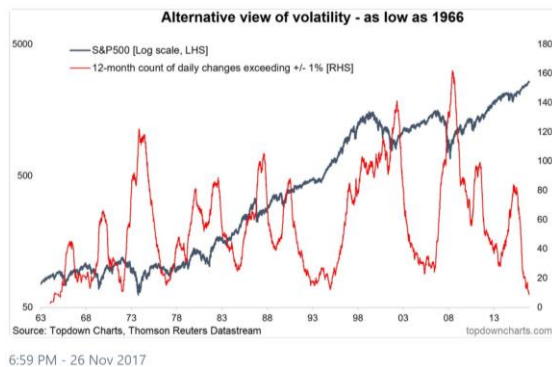
Section F. People's Choice Charts

In this section I defer to our followers on Twitter (@topdowncharts) for the most popular charts based on views and engagement. These charts are not updated to the latest as with those in the previous sections.

But first, why do we post charts on Twitter?

- Build profile and brand image/credibility (this is good for clients and good for the business)
- Gauge reactions and investor sentiment (when charts get either a huge reaction or zero reaction it can be very telling!)
- Business development (as much as I love my work, I still need to feed my family!)

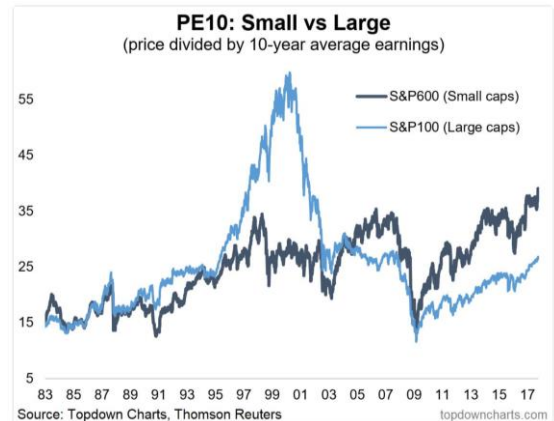
1. First is the alternative volatility metric for the S&P500 (rolling 252-day count of daily moves greater than +/-1%), punchline is this measure of volatility has fallen to a 50-year low!



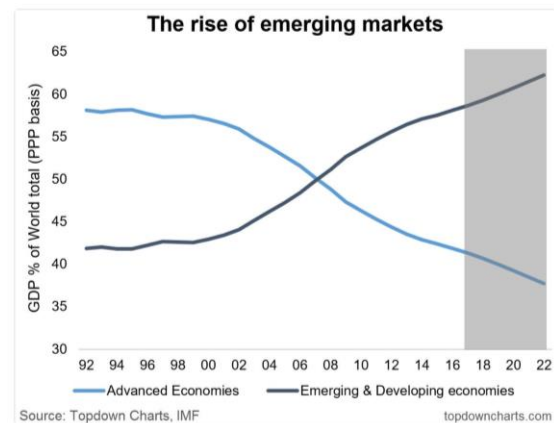
2. Next is a look at S&P500 seasonality – that red line actually managed to defy gravity and avoid the Sep/Oct lull with a close-to straight-line rally through much of the year.



3. S&P again, this time the 600 (small caps) and the 100 (large caps). By this, small caps look expensive in both absolute and relative terms.



4. One of the classics (could have easily put this in the favourites section) IMF PPP measures show Emerging & Developing economies now account for the dominant share of world GDP.



5. And a similar chart, but a big contrast, emerging market equities account for around 15% of global equity market cap, which is interesting compared to ~55% for GDP share.



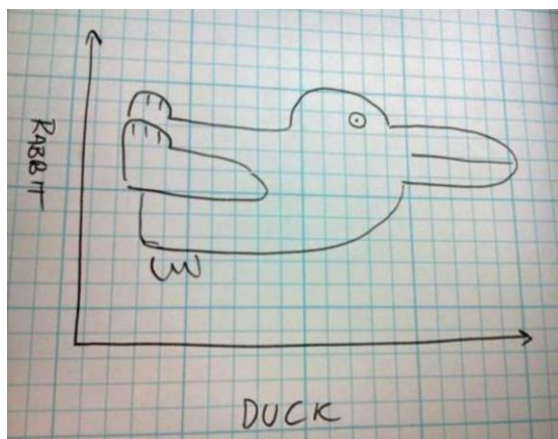
Section G. Fun with Charts

No end-of-year-special would be complete without some silly charts for the silly season!

1. I don't really use pie charts that much, but here's one I always refer to, especially during the festive season.

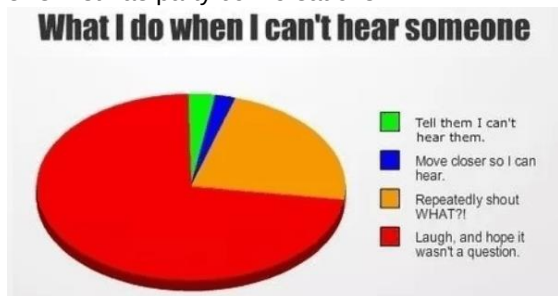


2. As often is the case, time series charts require a certain degree of interpretation, and often times the conclusion is in the eye of the beholder...



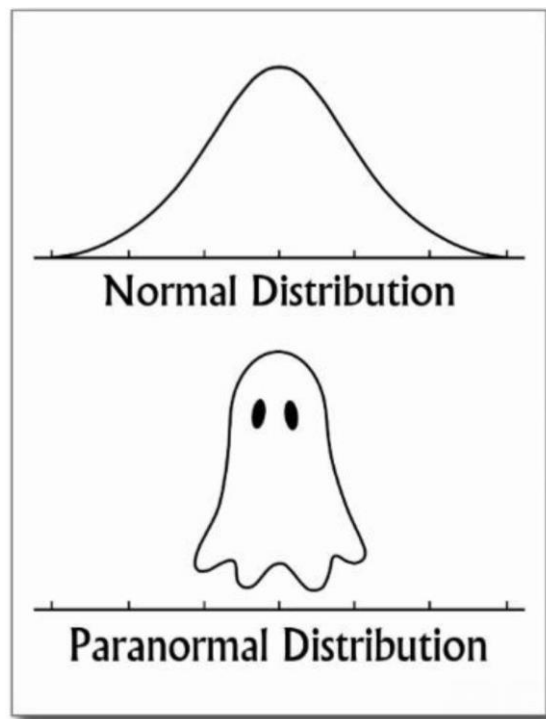
(both sources: <https://www.antivia.com/blog/top-8-funniest-charts/>)

3. Christmas party conversations...

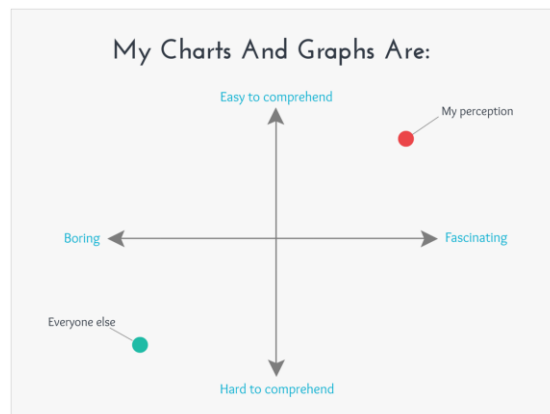


(source: <http://runt-of-the-web.com/funny-pie-charts>)

4. Sometimes it seems like the "paranormal distribution" provides a more accurate statistical description of financial markets...



5. My worst fear...



(source: <http://blog.visme.co/funny-graphs/>)

That's it!

Happy holidays, and thanks for your support this year. Hope you have a safe, enjoyable, festive season. Wishing you all the very best in 2018!

Best regards,
Callum Thomas



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, active asset allocators, and macro-driven fund managers. The perspective is that of a buy-side strategist and the key deliverables of the report are: investment idea generation, top-down global macro insights, risk management input, and asset allocation research.

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