Nov 3-16

Good Morning to All;

THE CURRENT MACRO TRENDS

I always try to keep my finger on the "big picture" pulse or the evolving macro trends that influence the economy, the consumer and ultimately our stock choices.

The macro appeals to my thinking process especially the trends that are easier to quantify such as demographic trends, credit trends, and of course the business cycle itself where I believe we are in the very, very late innings. By having a good feel for these macro trends I am better able to position portfolios BOTH for the upside gains (e.g. Health care boom due to boomers) and protecting on the down side by being more defensive when risks are high (e.g. such as now being very late in this cycle with frothy valuations at a time of FED rate hikes).

Here is a list of some of the current Macro Trends that I am following and how they are influencing my tactical asset mix AND stock selections. As you will read I see some good opportunities in a couple of new areas because of these new trends e.g. infrastructure and India

#1 EXCESS GLOBAL DEBT

What we know about "excessive" debt levels is that it slows economic growth for many years (e.g. Japan and the 1930s) and we are seeing this in the US and globally where GDP numbers are just above recessionary levels and have been for several years. In fact, this has been the slowest US recovery EVER based on GDP. The deleveraging time frame is very long from these high debt levels based on history so we can expect slow growth for many more years.

In more simple terms, we have seen two decades of excessive borrowing and spending (thanks to the boomers) and so now we can probably expect the opposite for the next two decades.

Data from BIS shows that the debt ratio for both developed and emerging markets is now 35 basis points HIGHER as a % of GDP than during the Lehman crisis…

The level of Corporate debt in the US is enormous and stands at 45% of the GDP—the highest ever fyi.

This excessive global debt is reflected by the very slow global trade over the last few years…in fact global trade has not grown since 2008!

Because we have pulled so much growth from the future (with excessive borrowing & spending) we can expect continued low growth for years and many expect muted stock market gains as well for the next 5-7 years.

This macro trend makes dividend growing stocks look very attractive and we have capitalized on this for the last 3-4 years.

#2 ZERO INTEREST RATES POLICY (ZIRP)

We have had ZIRP and NIRP (negative) and global QE programs in place since the start of the Great Recession and most believe that these Monetary Policies have run their course and are now doing more harm than good. There is no doubt that these experimental (and untested) programs have caused multiple asset bubbles in equity markets, bond markets (esp. high yield), and real estate markets.

These bubbles will continue to inflate and distort capital as long as these policies remain as they cause a terrible misallocation of capital e.g. it is a no brainer for CEOs to borrow at zero and then buy back their own shares with a 3% dividend and this is what they have been doing. The problem is that there has been no Capex spending and so these CEOs are focused on the short term and not the midterm, and this leads to poor aggregate growth when all CEOs are participating in this Financial Engineering scheme.

It is mind boggling that after a decade of extremely low-zero IR that we are having so much trouble raising rates by just 0.25%!!!??? and this with unemployment at “4.9%”.

This tells me just how FRAGILE the whole system is, and although we need higher rates the FED is worried that a 0.25% rate hike will bring the stock market crashing down and bring on the next recession in 2017!

My bet is that we will have low interest rates for many years ahead so I am OK holding selective short duration bonds in all client portfolios as a great anchor.

I will give you my thoughts on the FED and the Dec rate hike later.

#3 THE CHINA SLOWDOWN

China is working its way towards a more consumer based economy and is making progress but its economy still remains at risk because of the enormous housing and debt bubble. Its 10% GDP days are gone and we expect 5-6% GDP going forward. If China was to have a hard landing in the next 1-2 years this would be very bad for the global economy.

With the 2008 market crash, China was able to help the global economy with its enormous fiscal spend BUT this will not happen when the next US recession hits and this is a worry for me.

So for now we have zero China exposure and my macro bet is that most commodities will struggle for several years because of the china slowdown (The Baltic Dry Index supports this view) and so we have very low commodity exposure (exception is gold).

#4 DEMOGRAPHIC TRENDS—The Good and The Bad

The bad is that the 55-70 yo boomers control most of the money/stocks/bonds and they are well past peak spending years (they just did two decades of spending and borrowing), and so many industries will suffer from this weak boomer spending trend …but others will benefit such as health care.

The “good” news is that the millennial population is larger than the boomers BUT they are poor (massive student debt and excessive education as there are no jobs available) and will not be taking the spending torch for a few more years (esp. on housing), and so if we have a recession in the next 1-2 years it could be a BAD one as the rich boomers won’t spend and the poor millennials can’t spend making for a nasty deep recession next time around

Many refer to the “Killer Ds” for this economy-- debt, demographics and deflation. The deflation is a “by-product” of excessive debt and boomers not willing-wanting to spend and millennials not able to spend.

On a more positive note we are able to take advantage of the Elder boom trend with a higher exposure to health care stocks which we have in all portfolios.

#5 HOUSING

Almost all prior US recoveries (from recessions) since WW2 were accompanied by a booming real estate market and especially the new single family home builds. But not this recovery! Yes, housing has improved but the numbers for new home builds are still very, very low for a 7 year recovery, and the number of first time buyers (i.e. millennials) remains very low.

The reasons are multiple- but excessive debt (esp. student debt) and a generally weak global economy (i.e. excessive debt and poor demographics) where we are NOT seeing high paying job creation (for the middle class) accounts for most of the housing malaise. These problems cannot be fixed quickly and so are “structural” in nature.

A healthy housing recovery is crucial for a strong economic recovery because of the many spin offs from a new home build— flooring-carpet, Washer –Dryer, new furniture, legal and real estate fees, etc.

In Canada we are seeing record home ownership rates at 70% but also record debt levels and the Cdn gov is worried about this so they have brought in many new rules to squash the Cdn housing boom.

Until we see the new home builds data improve in the US this recovery will remain weak and recession prone. In Canada my bet is that apartment REITS will do very well going forward as home ownership drops back to 65% over the next few years, and we have positioned all portfolios for this with our core REITs.

(PS—a deflating Canadian housing bubble and record consumer debt is a reason to think hard about your Cdn bank stock exposure…as we have done in all client accounts)

#6 UNEMPLOYMENT 5%!! Ya Right!!

One of the main reasons that there is no wage inflation is because the REAL unemployment is NOT 5%!!

And wage inflation is much more important for the economy than the monthly job report because if the 125 million employed workers do not get a raise then the economy and retail sales remain weak (as they have been). The month to month jobs report is important esp. the trend but the 'hourly wage growth' and the "weekly hours worked" are far more important for the economy.

So the fact that we are not seeing normal wage growth in the US is very disturbing and points to a continued tepid "recovery".

The gov favorite measure of employment is the Labor Markets Condition Index –this index peaked in Dec 2015 and has been in decline ever since, which is very bad news as this duration of decline is almost always followed by a recession says Doug Short….

I could say much more about US unemployment but suffice to say that the real unemployment rate is most likely somewhere between 8-9% (Gary Shilling), and the tepid job recovery is reflected by the weak aggregate consumer demand in retail sales. Another reflection of this is the weak US Restaurant data over the last year…when times are tuff home meals and beer replace restaurant meals.

The weak employment data in the US has forced me to be very conservative and defensive over the last 1-2 years as you all know as 70% of the US economy is consumer based and the consumer is not doing well in the US.

#7 WHERE ARE WE IN THIS BUSSINESS CYCLE?

By most accounts we are very, very late!

I just mentioned the weak restaurant activity which is a leading indicator, but we are also past peak auto sales and now seeing weak light truck sales—another leading indicator, BUT the most recent indicator that confirms my late-late conviction is the Merger-Acquisition MANIA (now at the same level as the Tech Bubble—YIKES) which has always been an excellent indicator of the end of a cycle and subsequent market decline.

So historically when we are this late in the cycle we can expect a recession within 1-2 years and this fits with the 4 Year Presidential Cycle where 98% of the recessions occur in year 1 or 2 ….Year 1 begins next week fyi….

Bottom line here from the Buss Cycle Macro Trend is that now is a time to be DEFENSIVE and we are!!

#8 RECESSION RISK 2017?

Most believe that the recession risk is 10-20% in the next year BUT I am well above 50% on this "guesstimation" and so I MUST remain defensive with this "insight".

The Curran risk here is that very few get the recession call correct but I am very happy to be in this contrarian camp with the current election fireworks and the 75% odds of the FED raising rates in Dec….

I worry that with the next recession there could be massive selling by the herd. In 2000 the passive dollars in the equity markets (via ETFs and passive MF) was in the 10% range but in 2016 this is now at 40% so we now have a huge % of the market participants buying equities REGARDLESS of the price or valuation i.e. the herd is again buying blindly.

We know that the loss emotion is felt 2.5 times more than the greed-gain emotion so my bet is that these blind passive investors will be dumping their ETFs in droves with the next recession, or even if the markets drop 15% (recall that the average intra year decline since 1946 is 14% and we have not seen this in many years…).

For me this is another reason to have +++ dry powder and a mindset ready to buy (not sell).

#9 THE EQUITY MARKETS MACRO TREND

Basically since QE was stopped October 2014 the US stock market is up 3% over two years!!

Additionally, Oct 2014 was also the peak in Corp earnings…

The famous Stan Drukenmiller is famous for saying that “liquidity is more important than earnings” and liquidity has been in decline since Oct 2014, and the sideways market for two years is telling me to be careful!!

The equity markets are leading indicators and for the last two years have been flashing yellow.

#10 GOV FISCAL SPENDING

The path forward for most G7 countries will be more fiscal spending and higher deficits so as to put more of the middle class back to work. I am not sure if this will happen before or after the next recession (the US may need a recession to unlock the gridlock) but my bet is that infrastructure spending will boom over the next several years and I aim to benefit from this.

I will be sending out more info to clients on this in the next few days.

#11 MARKET VALUATION

Not a great timing tool as you know simply because the herd (and the FED) can push valuations to zany levels for prolonged periods, but worth keeping in mind here that despite terrible GDP growth for the last 5 years—the S&P 500 returns have been outstanding (but stalled over the last 2 as stated) and this market gain has been all about P expansion and not E growth.

The famed GMO value investing group recently stated that “any market rally purely predicated upon P/E multiple expansion is a house built on sand” …this is my thinking folks and a reason to be defensive.

#12 THE US ELECTION

Now too close to call but either way odds are for down markets later in 2017...here are my guesstimations:

If Trump wins the endless uncertainties associated with his "verbal diarrhea and synaptopenia" will send markets down next week 10-15% or more…this outcome is definitely NOT priced into the markets!!

If Clinton wins the markets will go down slowly as the FED WILL then raise rates in Dec (a massive policy mistake I believe) and then with higher taxation President Clinton will push the US into a recession later in 2017 is my bet???

Either way the Macro call here is to be defensive and cautious going into 2017!!!!

#13 FED IR HIKE DEC?

Basically they are between a rock and hard place—they should have done this over a year ago…the future markets say 70% odds and that is a good bet for Dec.

The famous Ray Dalio says it's a big mistake to raise rates now and I agree. In fact he sees great similarities between 1935 (when the Fed mistakenly raised rates) and what he sees in 2016!

Right now we have a weak (declining) economy, weak credit, no decent wage growth, massive debt levels, declining liquidity…so a Dec rate hike carries a BIG RISK for the economy and the markets.

From a selfish viewpoint I want the rate hike as it could allow us an excellent buying opportunity…so we will see how this plays out.

CONCLUSION

I have not covered all the Macro Trends due to the length of this report and I wanted to get this out today (also getting sore fingers) but this gives you a good background on where I am coming from and why we remain defensively positioned going into the US election and the possible December FED rate hike. Simply stated—the risk still FAR outweighs the reward in this market!

I did not cover the potential positives for the markets such as fund managers cash is very high so a contrarian positive, Nov to April is seasonally positive for markets, and the possible global infrastructure spending that could spur growth as I think these are weaker trends than the negative ones mentioned here. That said once we have the election results and the Dec rate decision behind us we may have several new Macro Trends to look at so stay tuned.

Terry

PS I ran out of time and space to cover our new India gem position and will do this in a separate note to clients next week

PS ATTACHMENTS BELOW

1. Consumer Confidence weak
2. Demographics and 86 million millennials
3. US recession odds 50%
4. AT&T rings the Bell re Merger and Acquisitions
5. Restaurant Industry leading and weak
6. Monetary Policy is done—great read
7. The World without China—great read