EVERGREEN GAVEKAL

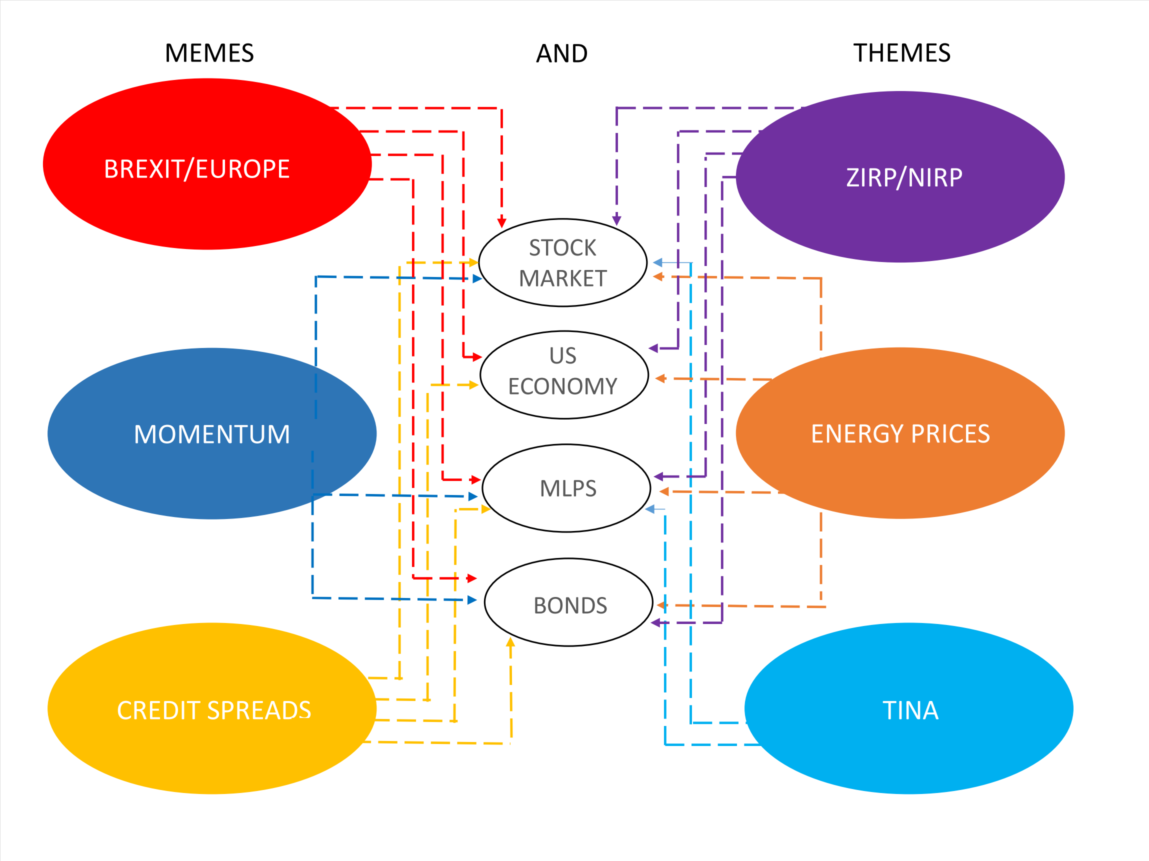
Webinar EVA

August 5th, 2016

EVERGREEN GAVEKAL

Is it Deja 2007 All Over Again?

Themes, memes, and dreams—Widely-held beliefs that influence markets and the economy



EVERGREEN GAVEKAL

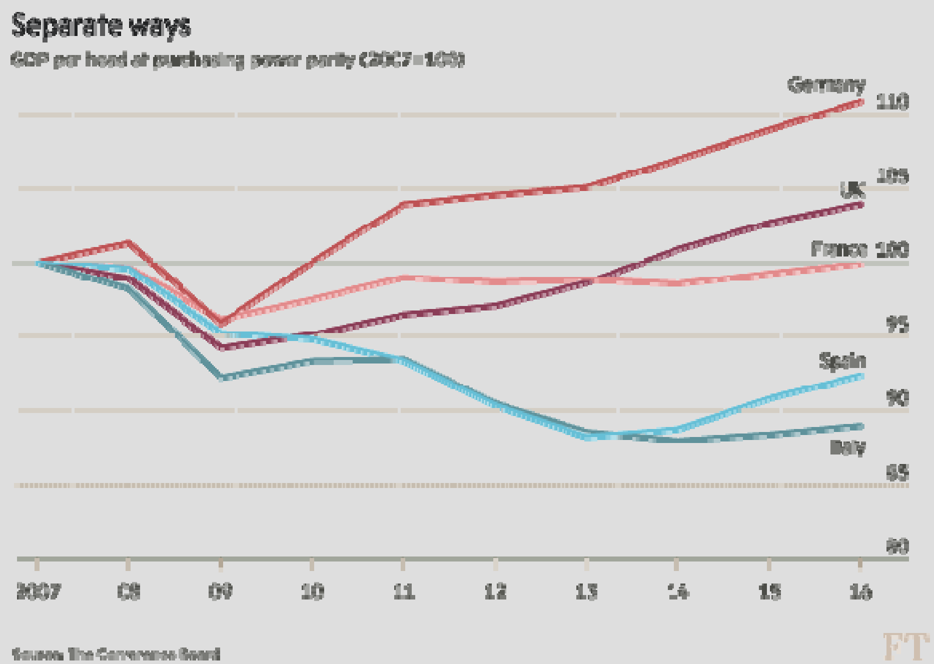
August 5th, 2016

Let's start with biggest news lately: Brexit

- Initial meme: bearish. Sell all risk assets; buy govt bonds
- Rationale: Europe falling apart, global growth slowing even more
- Then: bullish. Buy all risk assets—and govt bonds!
- Rationale: central banks will buy even more govt debt, flooding system with money
- And then: even more bullish. Brexit a non-issue but the money’s still flowing!

What could cause this meme to change?

- Italy—next possible domino to fall in Europe
- Why? Banks are totally broke; desperately need a bail-out (which we think they'll get)
- Its economy is in tatters



But it's only Italy—non c'e problema

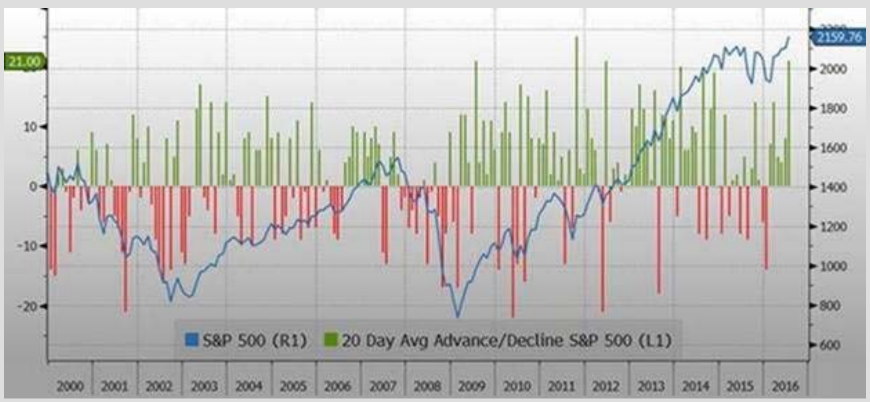
- Non e vero—not true: 3rd largest bond market in the world
- Also, crucial to survival of EU that it stays in
- Huge vote in October (though not an exit referendum)
- Anti-EU party leading in the polls

"This started with Brexit but will not stop there, any more than '08 fiasco started and ended with New Century Financial."

-David Rosenberg

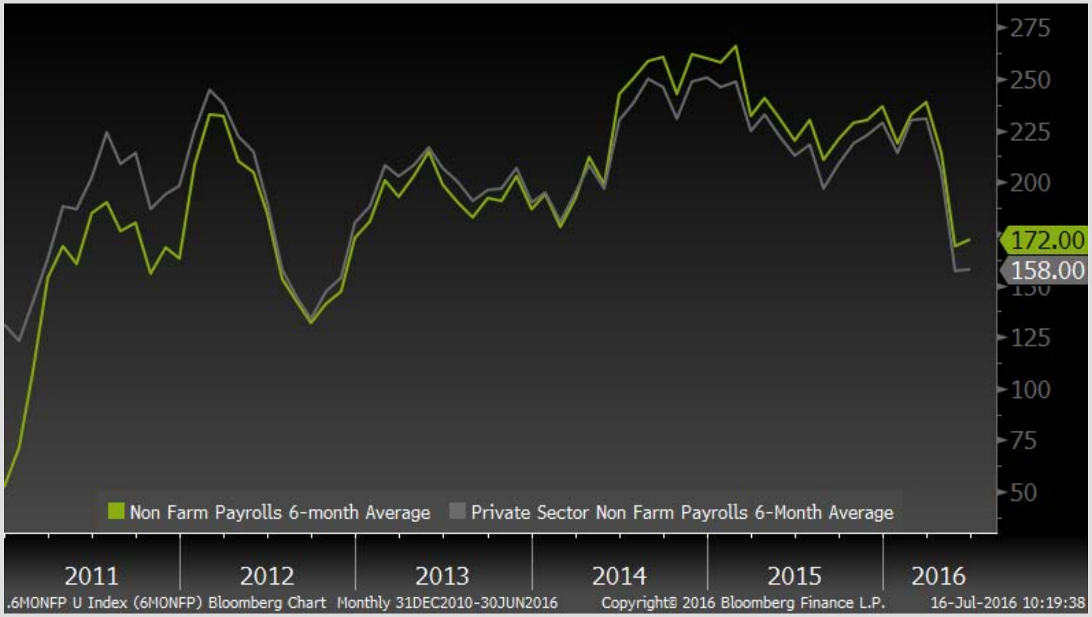
For now, this meme/theme is on the rise—better than goldilocks!

- Robust growth with the Fed on hold due to Brexit
- Case in point: June jobs number
- Led to a huge rally and new all-time high



Is the market falling for a fairy tale (a classic meme)?

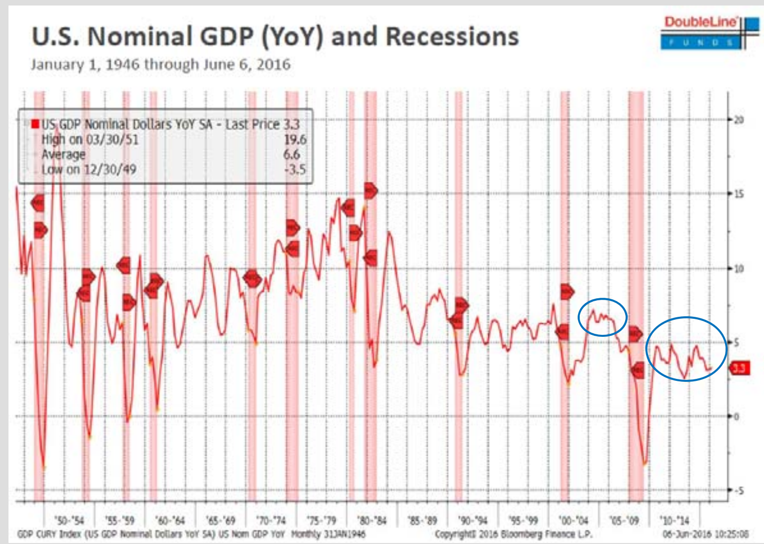
- Six month trend in jobs not encouraging (actually, even since late '14)

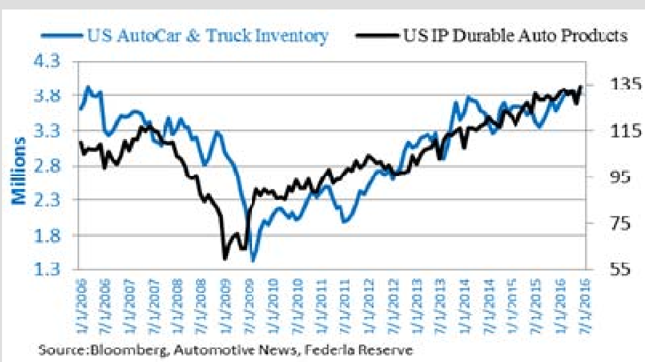


- Huge factoid: Household Survey very weak (down 517,000 jobs this year)
- HS better at picking up inflection point
- Achtung! Echo of 2007
- More than one

Other echoes

- Citi: Longest down phase on record (not as sharp as '07 but longer)
- Nom GDP: trend is not our friend-- Q1'15 to Q2'16 – 4.5%, 4.1%, 3.3%, 3.0%, 2.8%, 2.4%.
- Auto inventories--very 2007—and sales look ugly (Ford: vy weak Q2 and outlook)



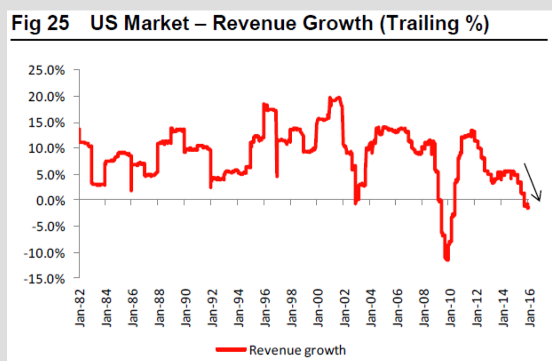


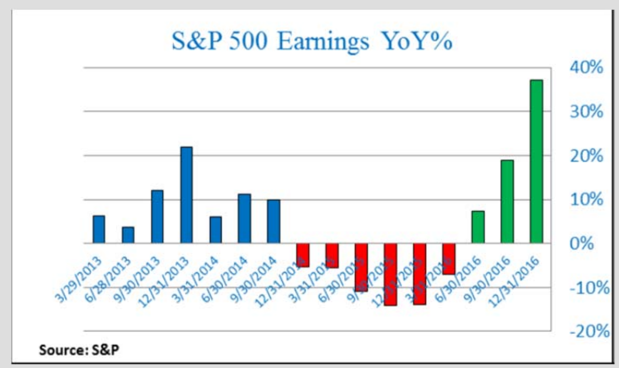
EVERGREEN GAVEKAL

These echoes challenge another meme: the US uber alles

- Used to justify valuations far above the rest of the world
- The US has been crushing overseas markets for years

- Yet, what is the reality?

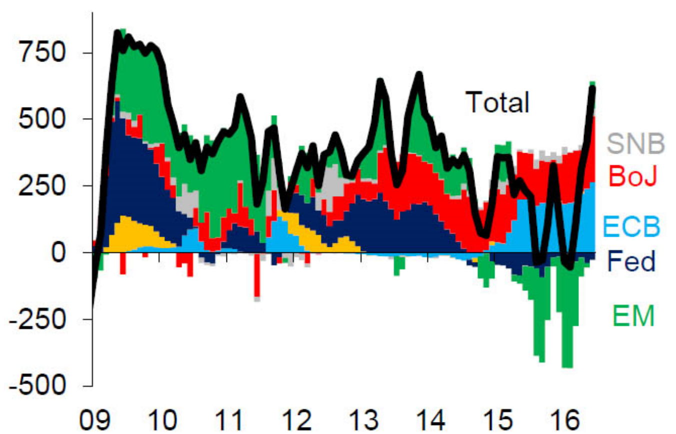




But another reality pushing the other way: ZIRP/NIRP

- Zero/Negative interest rates—lowest in recorded history (King Tut)
- Every problem (Brexit, Chinese deval, energy crash, etc) met with trillions of funny money
- Central banks have gone wild lately

Figure 1. Global central bank liquidity rises to highest since 2013
CB* asset purchases, rolling 3m, $bn



Source: Citi Research. *EM number based on 3m change in foreign exchange reserves (FX-adjusted).

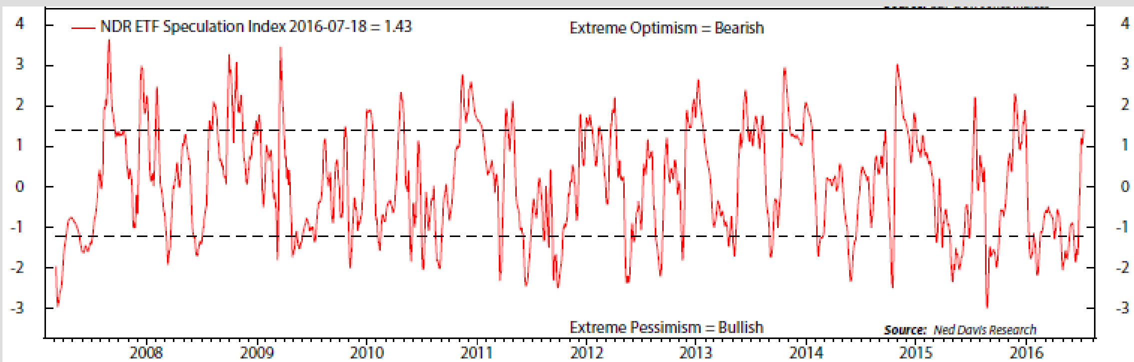
Interest rates gone missing creates another meme: TINA

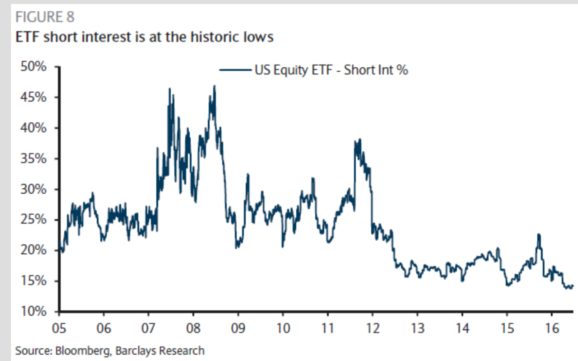
- There Is No Alternative but to buy stocks
- Sure feels that way
- Another force comes into play here—The Big MO
- Possible blow-off top (like 1999)

EVERGREEN GAVEKAL

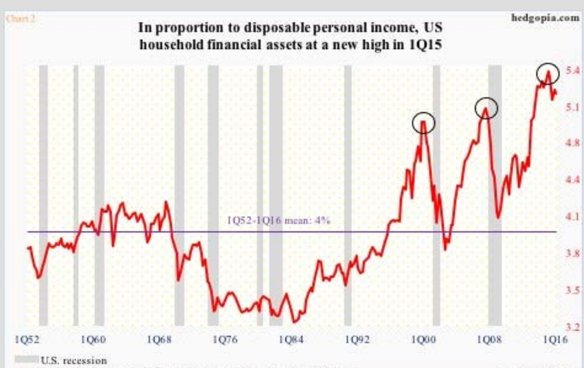
Could be fun for awhile but…

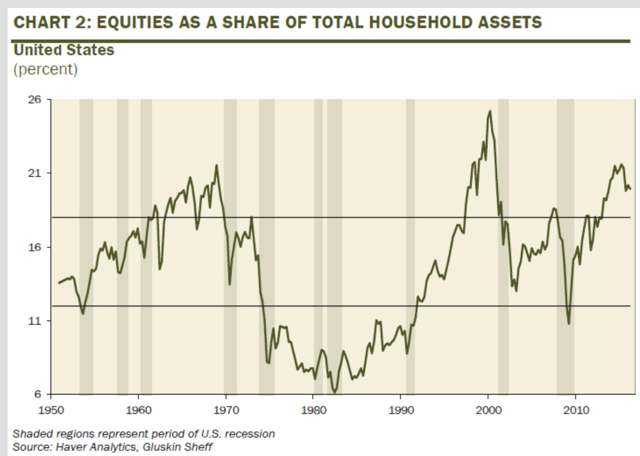
- …a rally to rent, not own
- Froth building





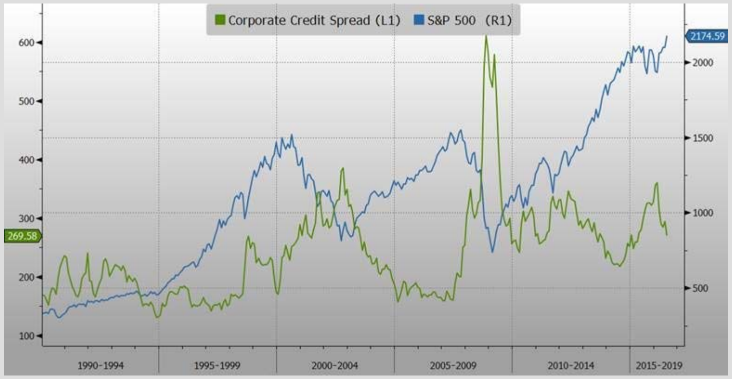
- Financial asset values way above normal



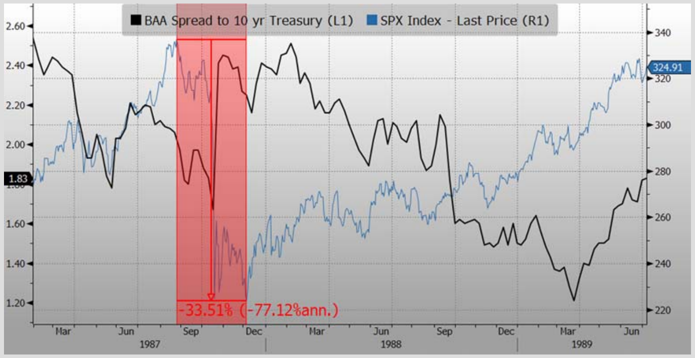


Credit spreads: one of the most powerful forces in markets

- Their trend can even overwhelm central banks

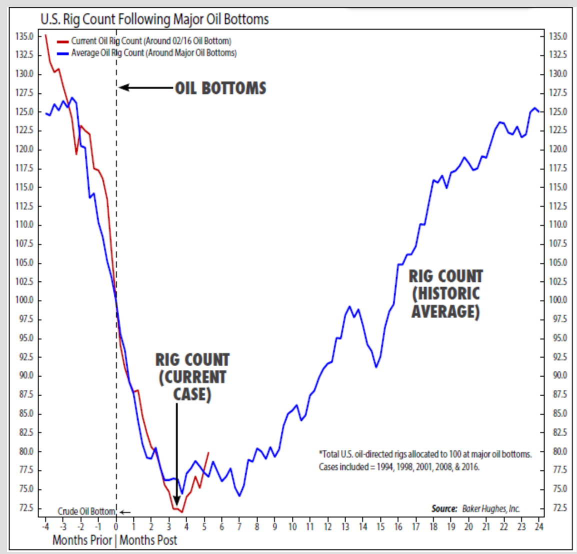


- Good news: they continue to fall
- Caveat: spreads are not good at picking up sudden shocks



To close, let’s weigh the positive and negatives

- First, despite recent pullback, worst of energy storm likely passed



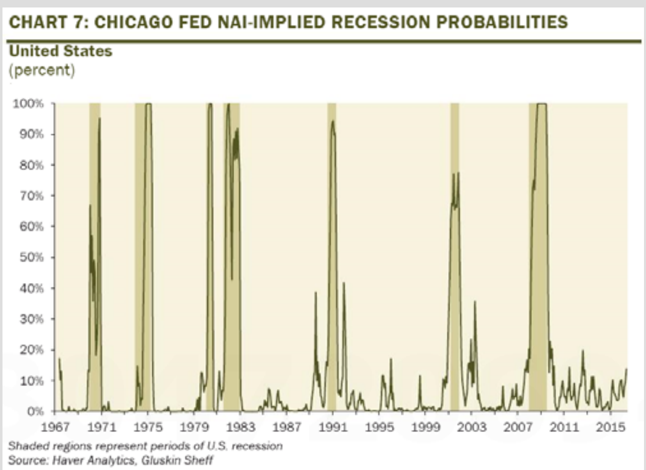
- Following usual pattern
- Expect rig count to fall again
- Oil might hit the 30s near-term, but huge supply shortage looming
- 7 mill bpd of production likely lost by 2019/2020 due to $1 trillion of cancelled projects
- Net/net: oil not likely to implode as it did in ’15 and destabilize the markets

EVERGREEN GAVEKAL

Other positives:

- Initial claims for UE not even close to recession zone

- Fed's Chicago Natl Activity Index (NAI) also signaling no worries



EVERGREEN GAVEKAL

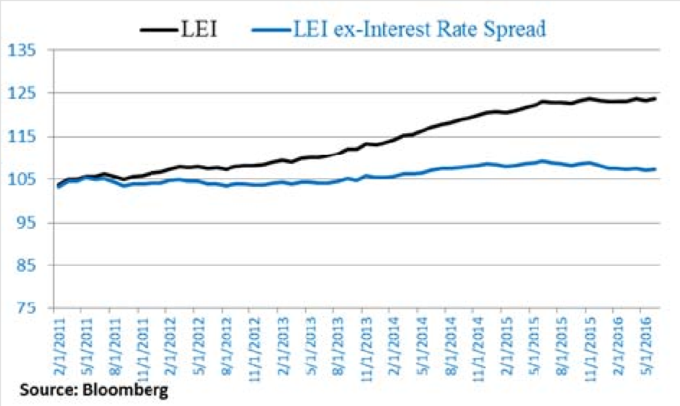
Other positives: (continued…)

- Further, ECRI has called the last three recession (whiffed in 2012, however)…
- …and they are trending the right way

- As noted last week, credit spreads still falling (very good news)

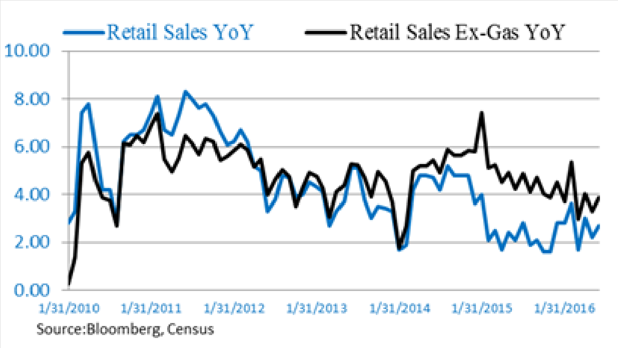
Then the other side of the ledger…

- Backing out financial factors (Fed distorted), leading indicators much less upbeat



- And industrial production is down for 10 straight months

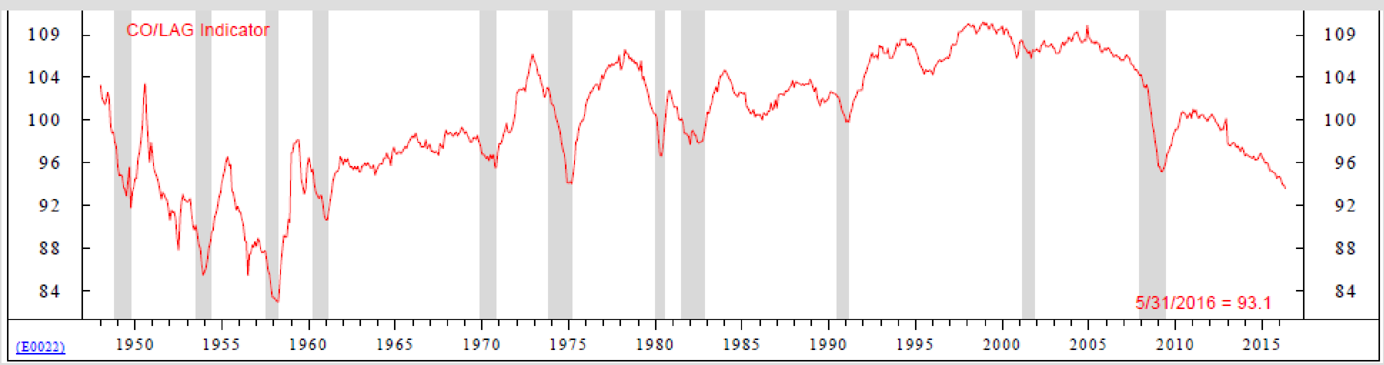
- US economy service-based but never happened outside of recessions since 1919!
- Speaking of the consumer…



A bit more to curb your enthusiasm…

- Durable goods orders are one of the very best "crosswalk" signals

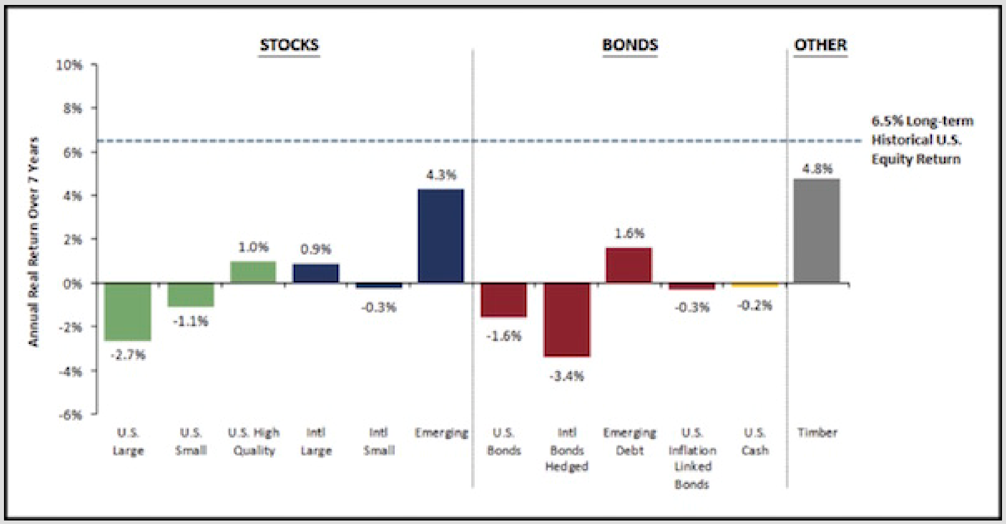
- Another one of the most accurate CW signals: Coincident vs Lagging Indicators



- Have to go back to '50s to find similar lows (heading to recessions)

Key takeaways

- Goldilocks this ain't! Too many leading indicators eroding.
- For sure, many mixed signals—typical of turning points
- Watch credit spreads! If these suddenly reverse course, batten down time.
- Short-term market moves impossible to predict
- But longer-term, returns are much more predictable
- And the outlook is ominous



- Cash is not trash! It will come in very handy at some point
- Possibly as soon as this fall—again!!

EVERGREEN GAVEKAL

Thank you!