

SEVENS REPORT *alpha*

Webinar #23: 2nd Half 2018 Market Outlook

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Presenter: Tom Essaye

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Schedule for Today's Webinar

- Bull Case vs. Bear Case
- Trade Drama Deep Dive: Where Are We, How Can It Get Worse, How Can It Get Better?
- Why Are Treasury Yields So Low?
- 2H '18 Catalysts To Watch
- Anecdotal Economic Indicators

Market Update: Bull vs. Bear

- Bear Case
 - We were already close to a peak in this market/economic cycle, and the trade uncertainty just brings it closer.
 - Trump is only getting started on trade.
 - Yield Curve – Clearly signaling close to the end of the expansion.
 - Rising Rates – Real Rates are no longer negative.
 - Growth bifurcation: U.S. growth is fine but long in the tooth. The rest of the world can't seem to generate momentum.

Medium Term Macro Update: Bull vs. Bear

- Bull Case
 - Away from trade worries, things still look pretty good:
 - EPS Growth
 - \$159ish in 2018
 - \$175ish in 2019.
 - \$190ish in 2020.
 - 10% yoy
 - Valuation
 - $2725/175 = 15.57$ 2019 EPS: Cheap Based on Previous Years. That multiple can easily expand to 17X, which means S&P 500 2975.
 - Economic data remains strong (Big Q2 rebound – potentially 4% GDP).
 - Strong equity positive dynamics: M&A strong, buybacks strong.

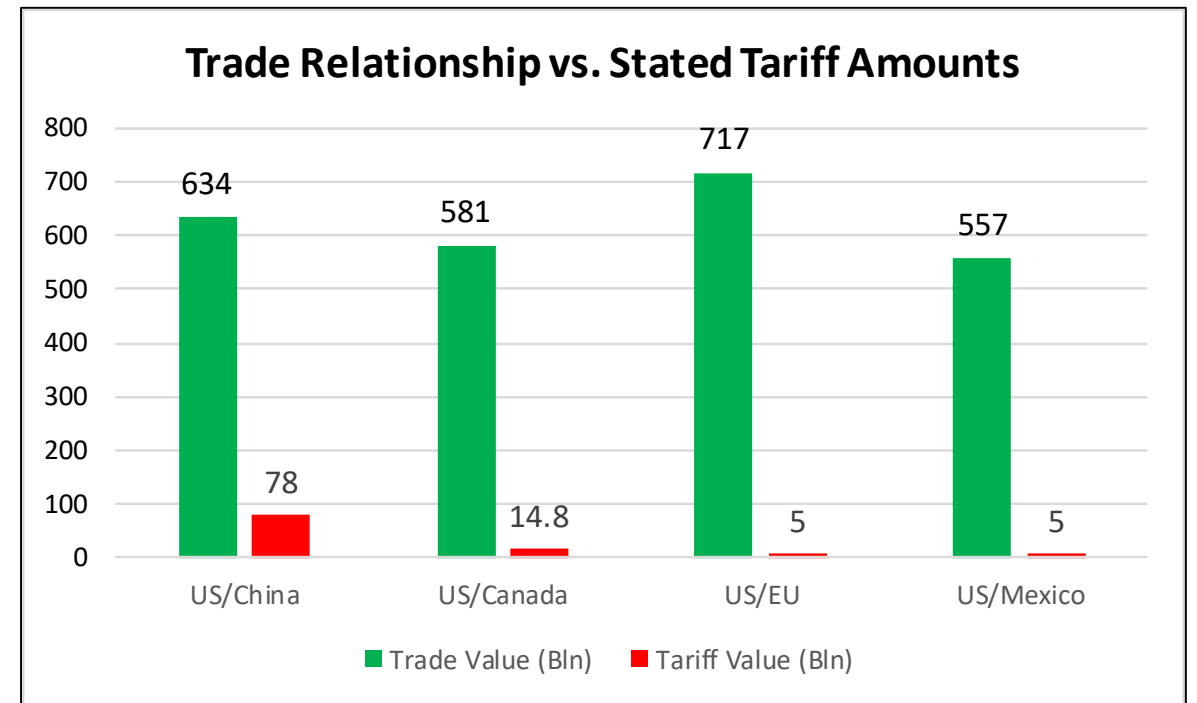
Medium Term Macro Update: Bull vs. Bear

- Why Bears Are Wrong:
 - Why Now? Yield curve flattening but hasn't inverted materially yet – and even on an inversion usually 18-24 months left of rally.
 - Trump probably isn't going to cause a global trade induced recession
 - Economy and earnings are what matters and both appear strong.
- Why Bulls Are Wrong:
 - Earnings always grow until they don't.
 - What's the next catalyst? No more tax cuts. Margin compression possible. Fed removing accommodation.
 - A non-trade disaster is not a reason to buy stocks.

Trade Drama Deep Dive: Where Are We?

- Current Situation:
 - U.S. Announced Tariffs:
 - 10% Aluminum (Value approx. \$2.34B)
 - 25% Steel Tariffs (Value approx. \$7.75B)
 - \$36 Billion in Various Chinese Goods (to go into effect tomorrow – China expected to retaliate).
 - Retaliation
 - China:
 - 3 Billion in tariffs on pork, recycled aluminum, etc. (so far).
 - Canada
 - 12.8 Billion in tariffs
 - Mexico
 - 3 Billion in tariffs
 - EU
 - 3.2 Billion in tariffs

But context is needed:

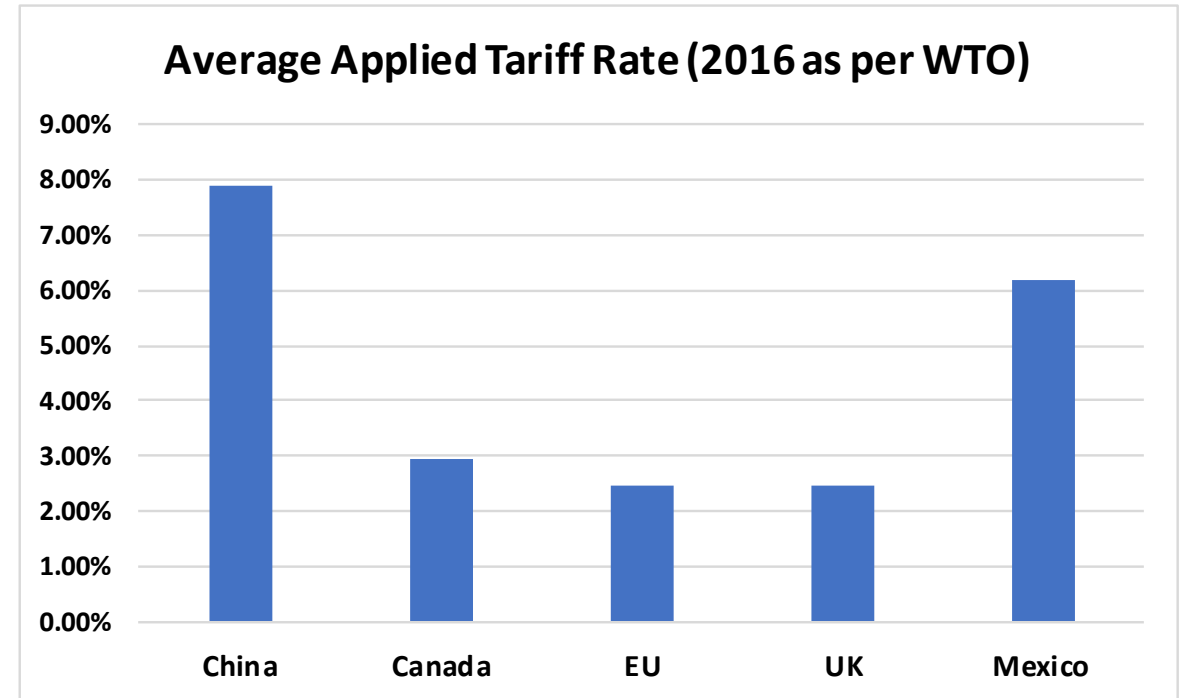


Trade Drama Deep Dive: How Can It Get Worse?

- U.S. is serious about the 200 bln + 200 bln tariff threat if China responds.
 - If the U.S. begins to flush out a legitimate list of products, that's an escalation, although again we think this remains very, very unlikely.
- Auto Tariffs
 - If the U.S. Commerce department declares the automobile industry to be a national security interest, that would allow the President to unilaterally apply tariffs to autos, which would be a major escalation. It's unclear if the Commerce Department will do this, and it could meet with Congressional pushback.
- Tech Freeze-Out
 - Three companies (ZTE, QCOM, NXPI) are important for the tech industry, which is a key support for the markets.
 - If the U.S. reverses course on the ZTE deal, that's a negative.
 - If China does not allow QCOM to buy NXPI, that's a negative.
 - Both are unlikely.

Trade Drama Deep Dive: How Can It Get Better?

- Global Tariff Levels Are Reduced
 - Tariff-less trade is generally preferable to the global economy.
 - All this fighting may end up with global tariffs starting to come down.
 - Not as far-fetched as we think:
Two reports today (Thursday, July 5th) imply the EU is looking to hold a global summit aimed at reducing auto tariffs. Meanwhile, German auto manufacturers are open to removing tariffs on U.S. autos.

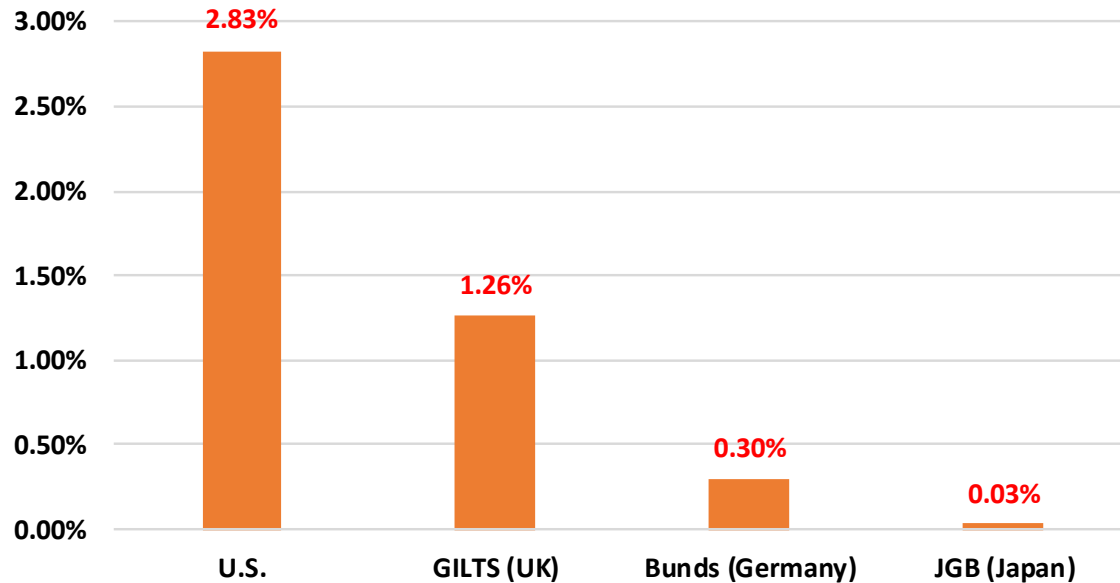


Why Are Treasury Yields So Low?

European & Japanese Investor Demand

Inflation Expectations Remain Anchored

10 Year Government Bond Yields (7.5.18)



5 Year TIPS/Treasury Breakeven Rate



2nd Half Catalyst List

- Tomorrow: \$34 Bln of U.S. tariffs on Chinese goods to go into effect.
 - What will be China's response? $\leq 34B$ "ok" for the market. $> 34B$ not "ok" for the market as it will likely prompt response from the U.S.
- July 13th: Start of Q2 earnings season.
 - July 16th-August 3rd: Heart of Q2 earnings season
- September 26th: Fed Decision
 - Will they hike 25 bps here? Expectation is "yes."
- November 6th: U.S. mid-term elections.
 - How disruptive will political headlines become in the run-up to the election?
- December 3rd: OPEC Meeting
 - Will they increase output again?
- December 19th: FOMC Meeting
 - 4th rate hike of the year?

Anecdotal Economic Observations

- Starting to feel a lot like 2005/2006 from an anecdotal standpoint.
 - Florida unique in that it's on the edge of marginal consumption.
 - Doesn't have the consistent industry that other states/regions have, so local economic observations can be useful.
 - Overall observation: Things are booming.
 - Real estate at all-time highs.
 - Buildings going up.
 - Massive housing developments.
 - Wait lists for plumbers, contractors, etc. All have too much work.
 - Used boat market extremely tight.
 - Boat storage facilities totally full.
 - Advertisements for Bahamas islands for sale in local magazines.
 - This doesn't mean the peak is imminent. Same observations could have been made in '05 and the rally lasted 2 ½ more years. But this is starting to feel like a peak here on the ground – and I think that is notable and please feel free to share with clients if helpful.

Looking Forward

- Very proud of the menu of ideas we've produced during the first year of Alpha.
 - We've provided something for everyone, from aggressive, thematic strategies, to uncorrelated, income focused ideas, to Alpha generating cash management solutions.
- Our ideas have outperformed, and we're committed to continuing to provide ideas that:
 - Can generate long term Alpha
 - Provide compelling stories that can help impress prospects and strengthen client relationships, regardless of whether the specific ETF we recommend ever gets transacted.