



**2017 has been a tough year
for Ebearnezer Scrooge**

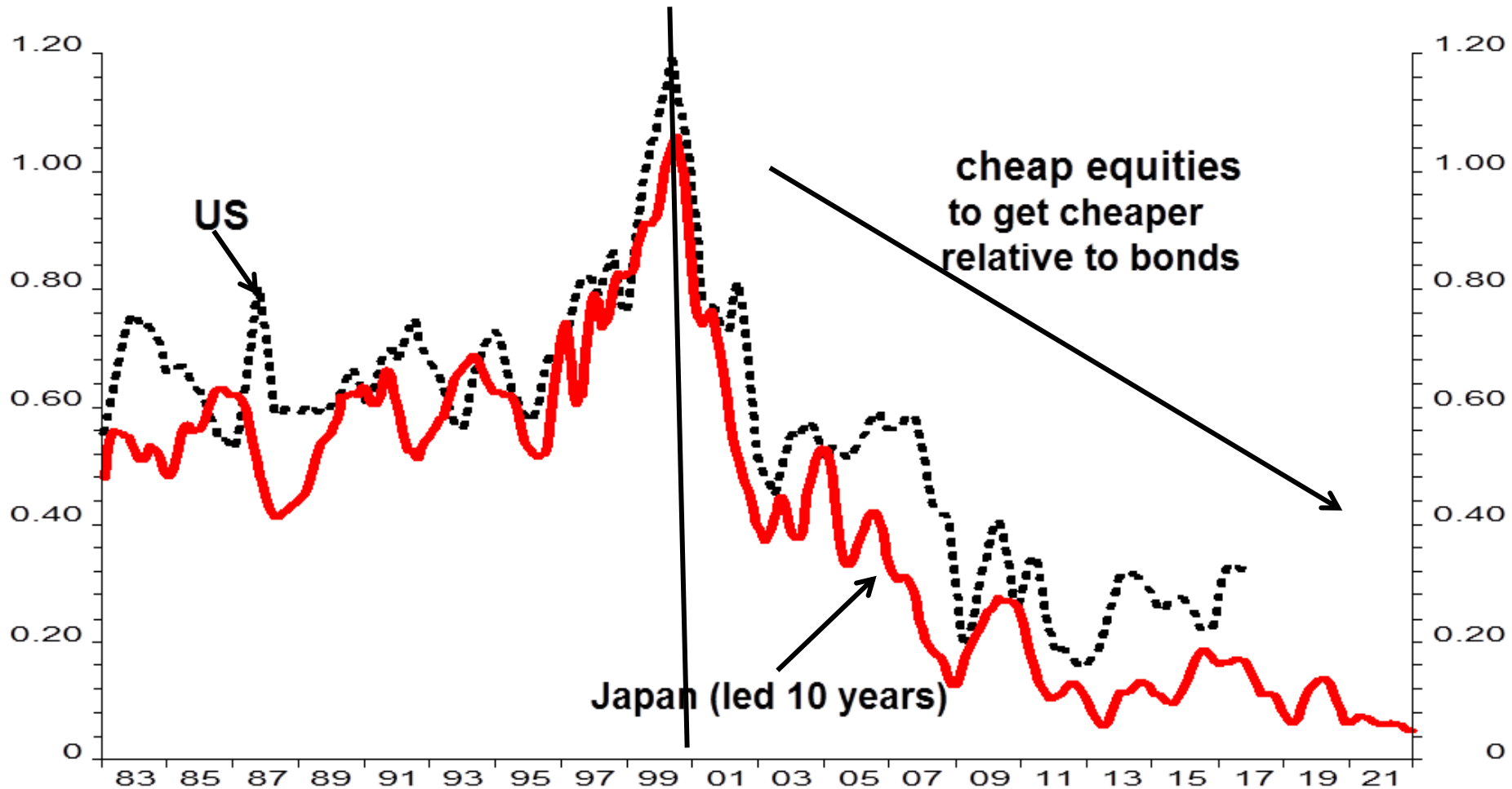
**THE BULL JUST GOES
ON AND ON
AND...**

**(OR HOW TO CORRECTLY PREDICT 10 OF THE
LAST 1 MARKET CRASHES)**

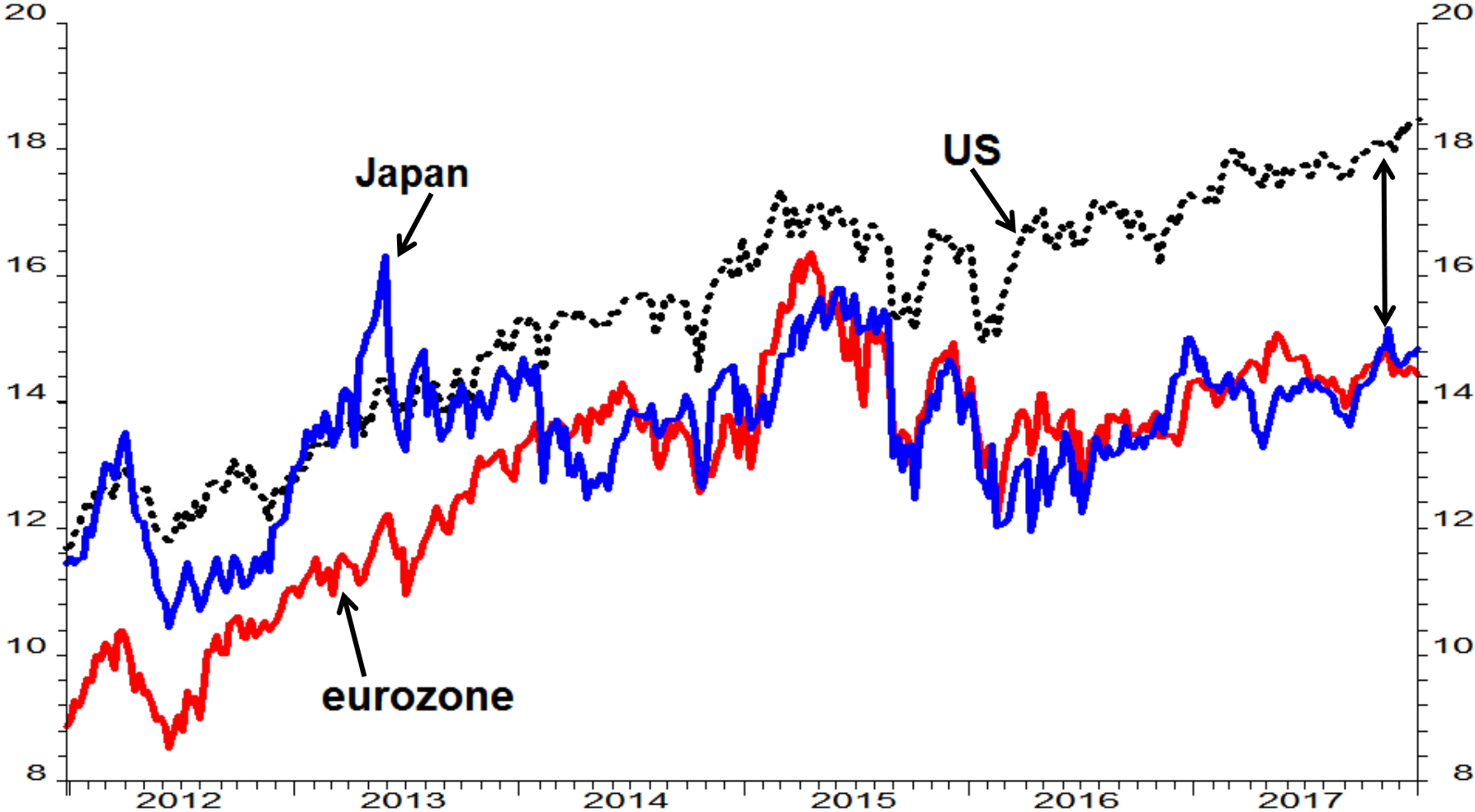
Albert Edwards



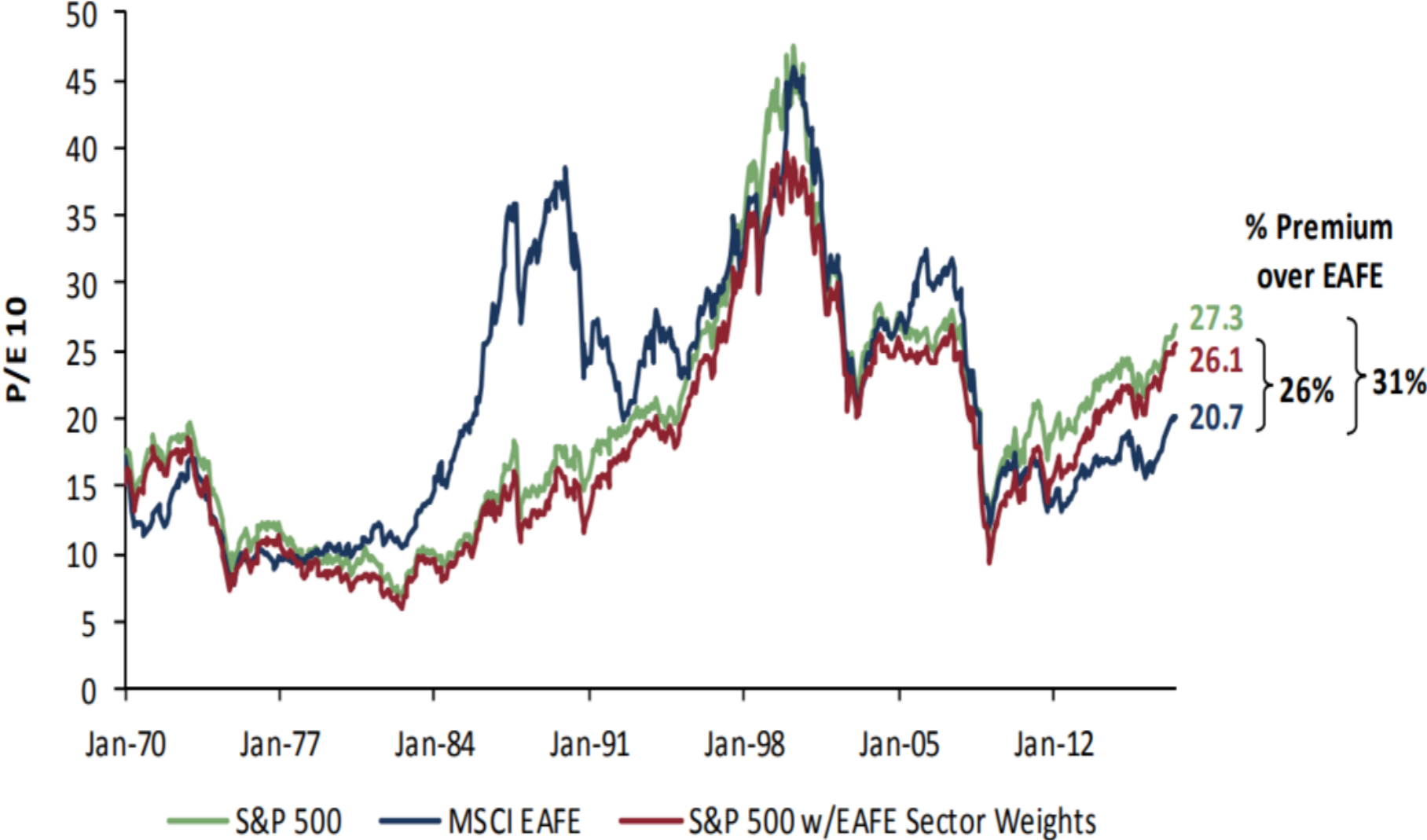
IS ICE AGE SECULAR DE-RATING OF EQUITIES V BONDS OVER? BOND/EQUITY YIELD (CASHFLOW) RATIO



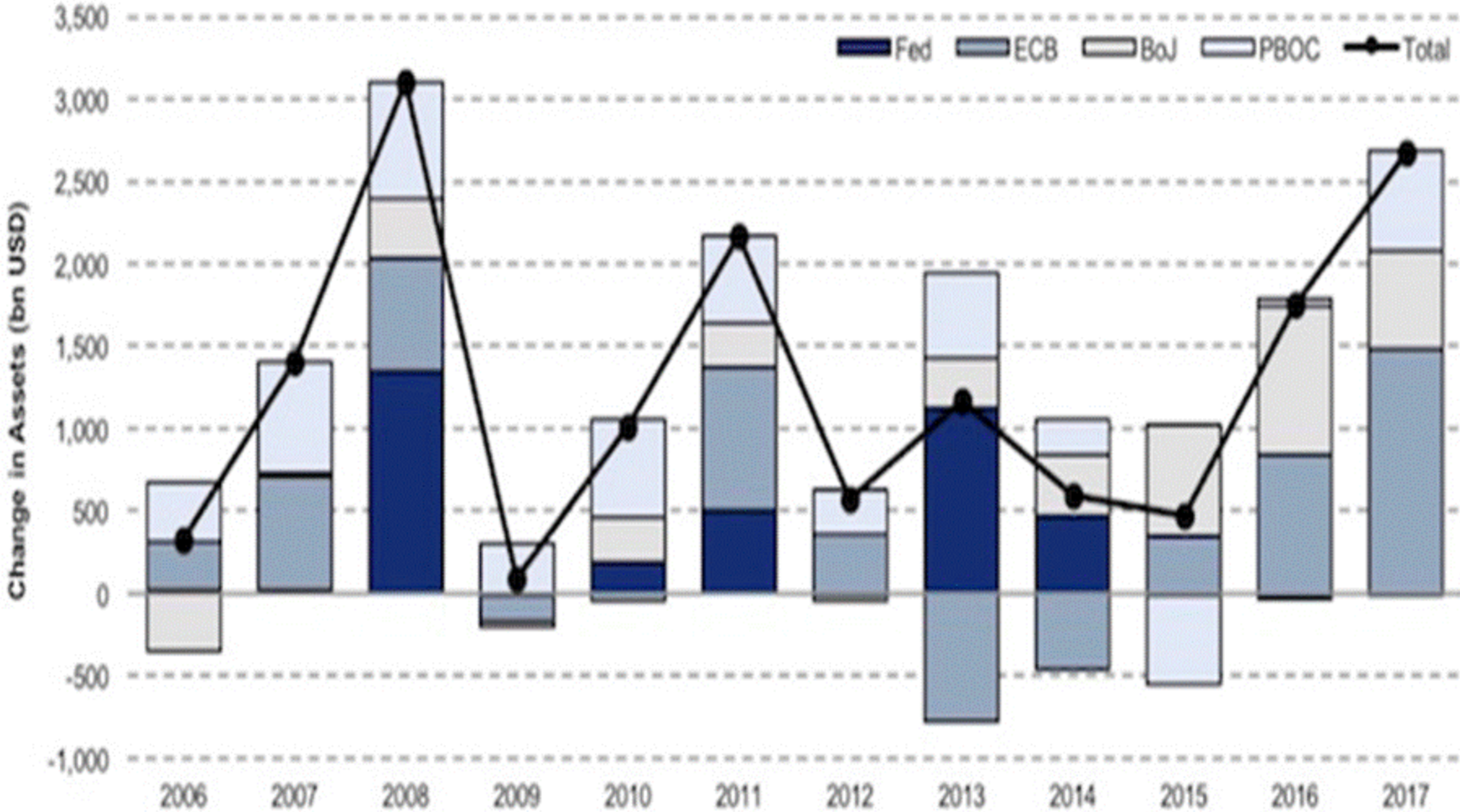
VALUATIONS DON'T MATTER APPARENTLY? FORWARD PE



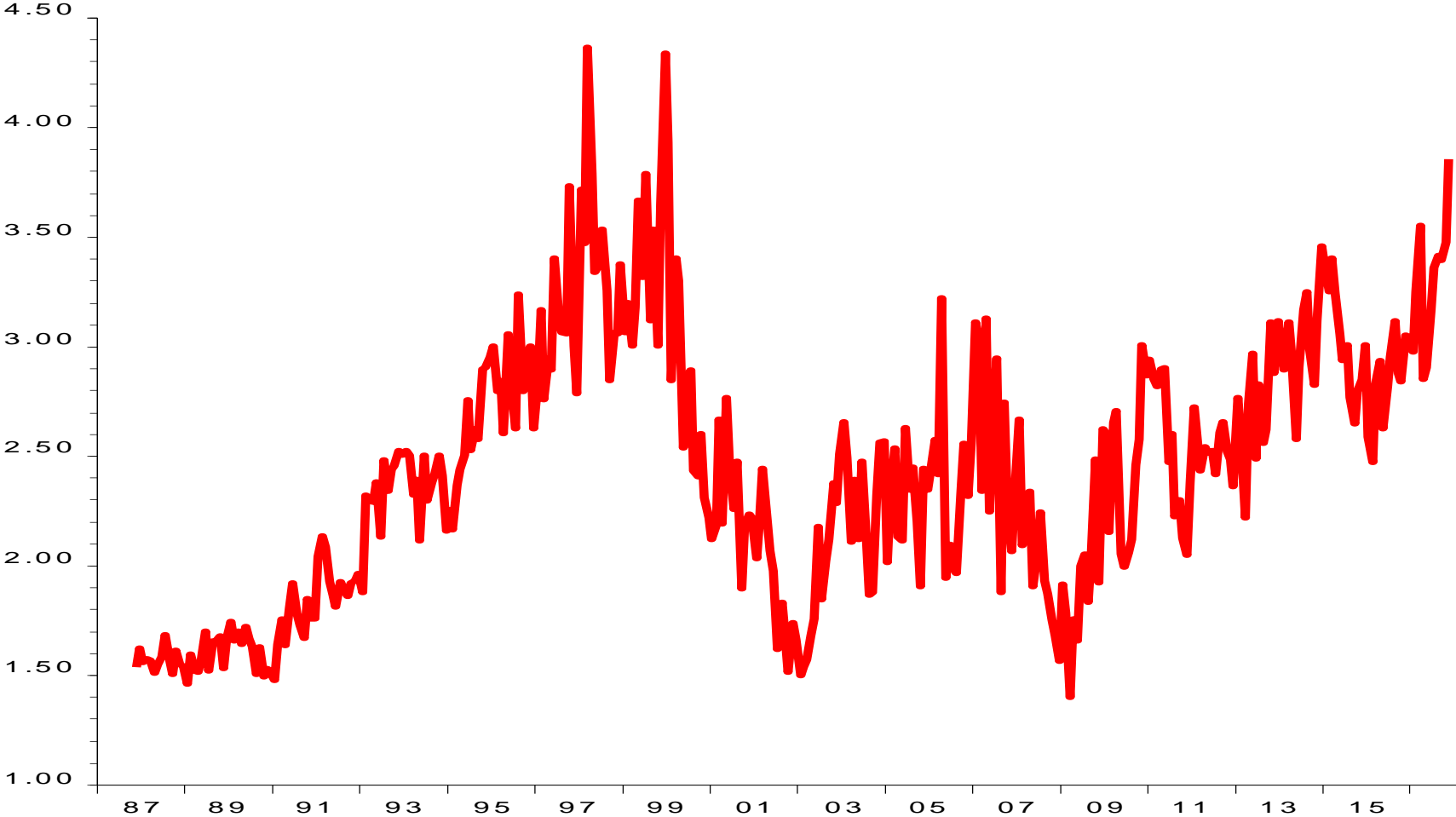
SHILLER (P/E10) RATIOS : S&P 500 SECTOR-MATCHED TO EAFE



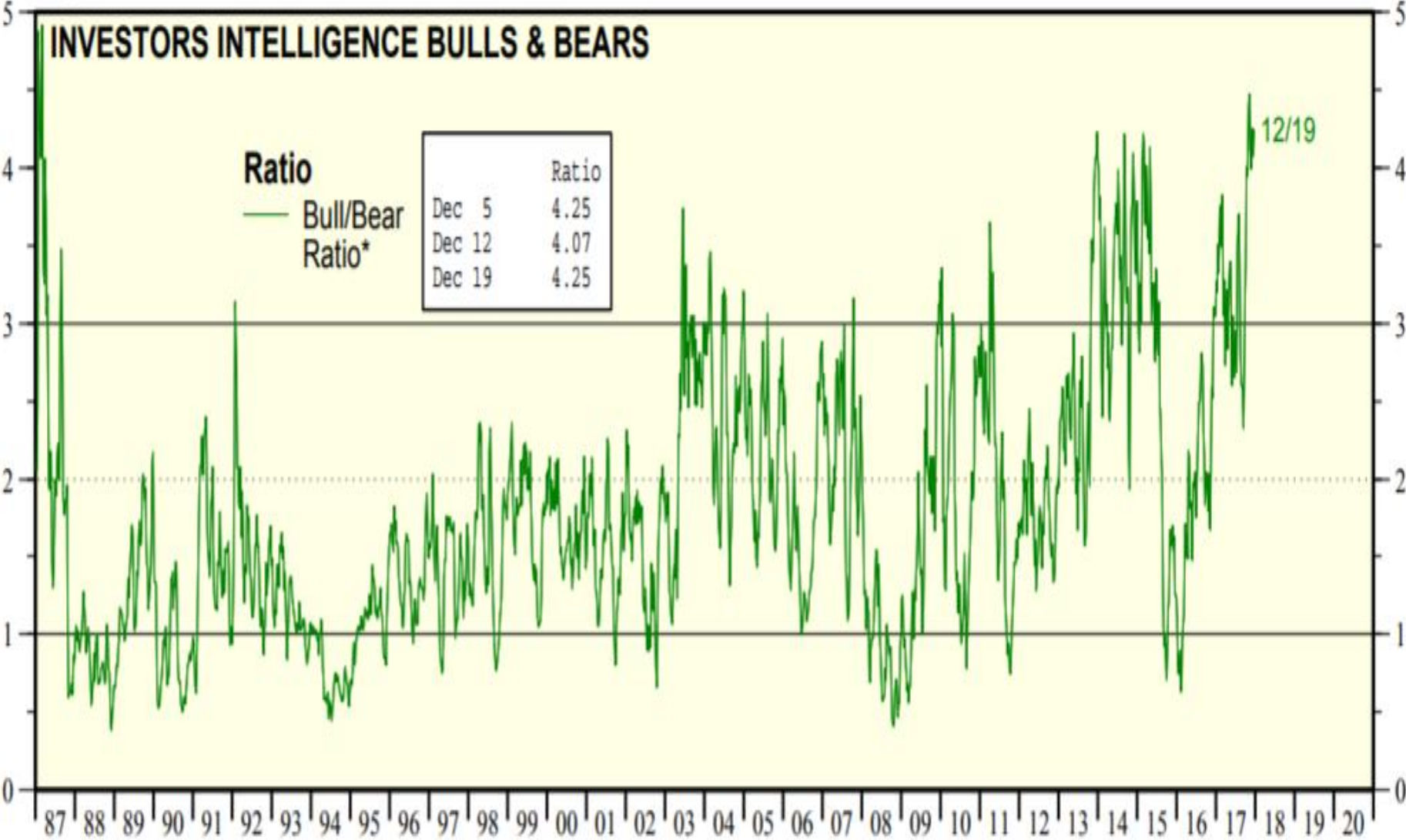
2017 SAW BUMPER CENTRAL BANK MONEY PRINTING



INDIVIDUALS STOCK EXPOSURE IS EXTREME RELATIVE TO CASH



PROFESSIONAL ADVISORS ARE AS ALSO EXTREMELY BULLISH

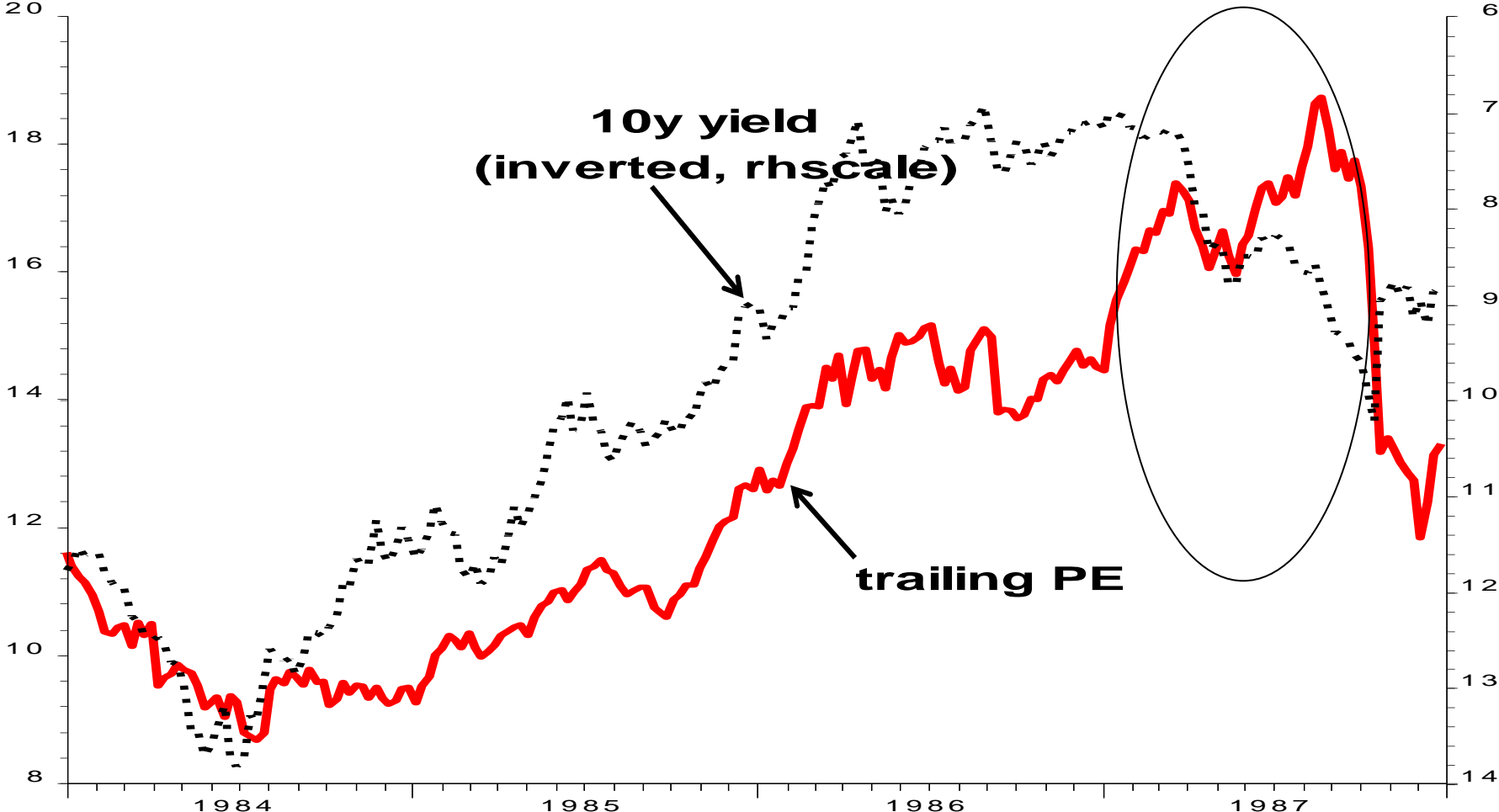


THE DONALD IS ALL BULLED UP TOO!

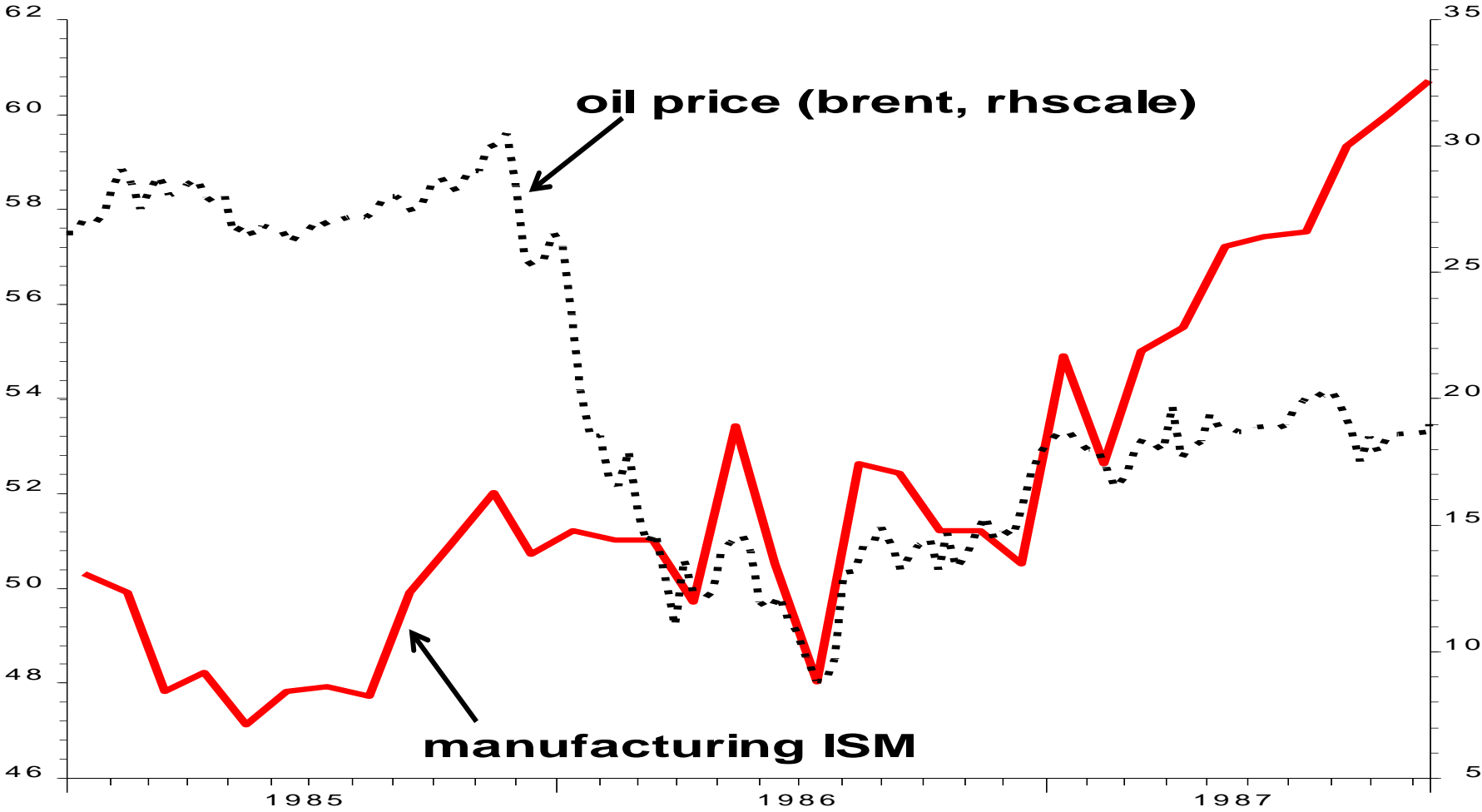


Stock Market had another good day but, now that the Tax Cut Bill has passed, we have tremendous upward potential. Dow just short of 25,000, a number that few thought would be possible this soon into my administration. Also, unemployment went down to 4.1%. Only getting better!

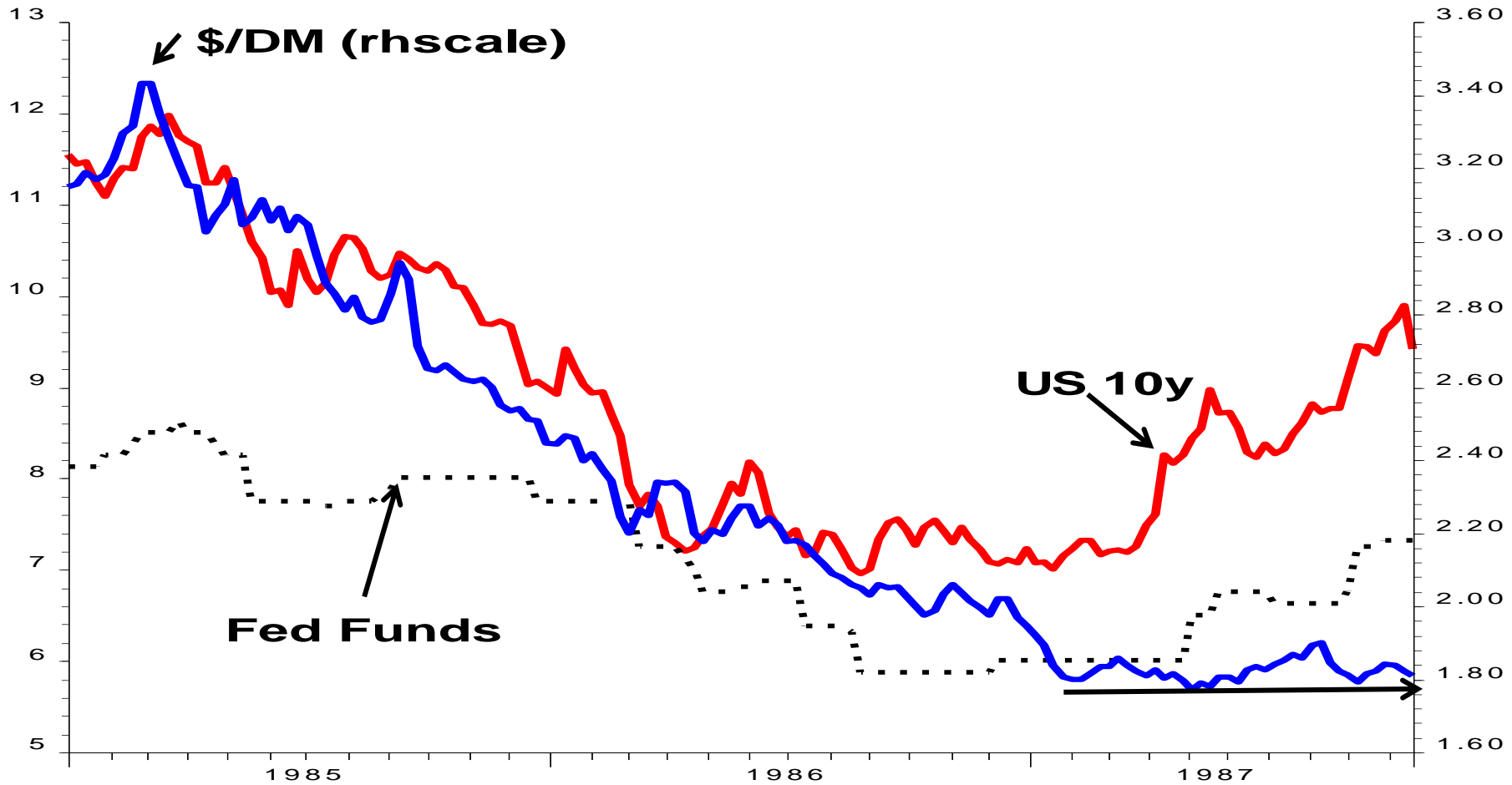
US EQUITIES RALLIED THROUGH 1987, DESPITE BOND SELL-OFF



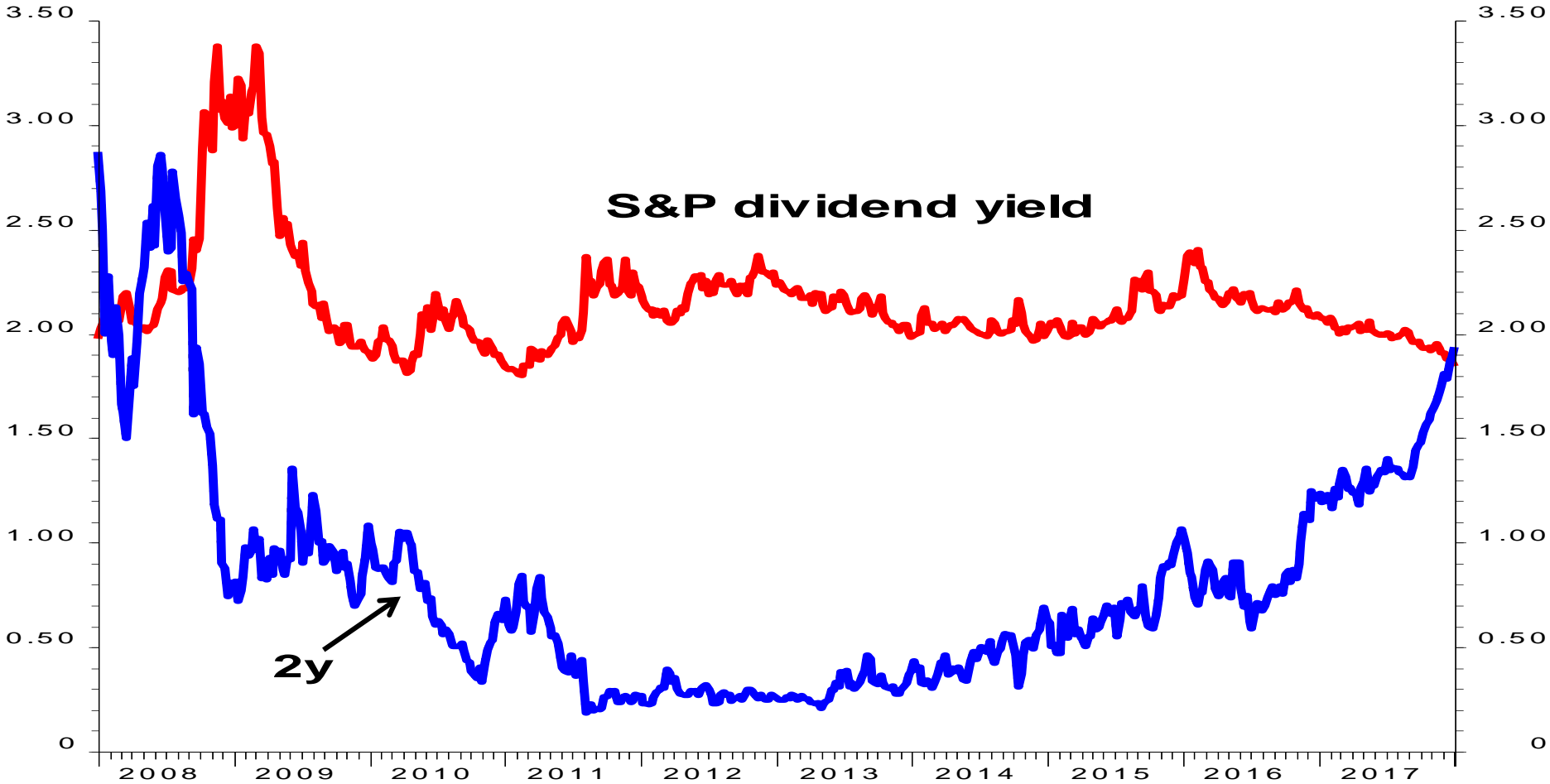
US ISM AND BRENT OIL PRICE (JAN 1985-OCT 1987)



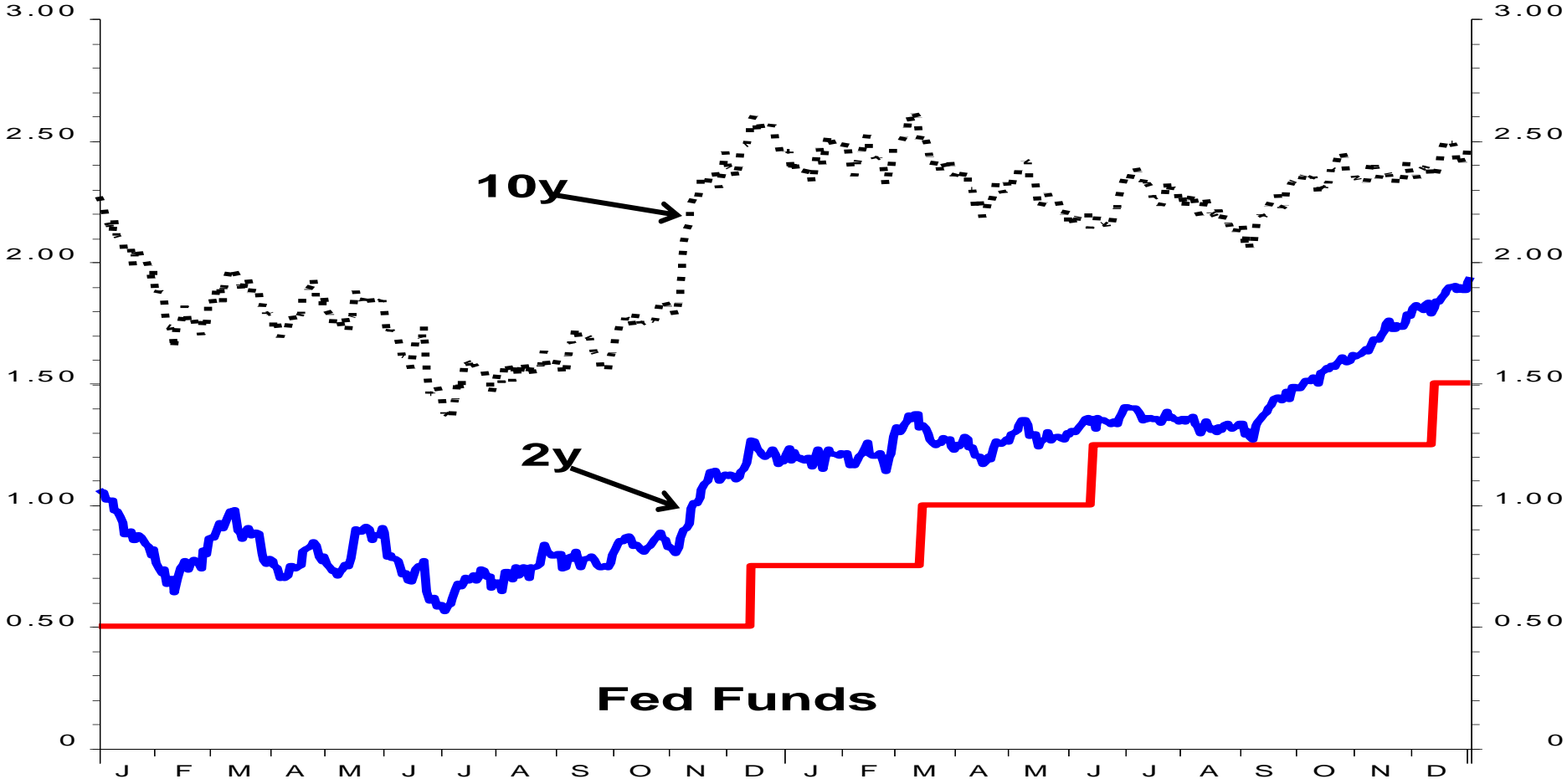
\$ STABILIZED IN 1987 DUE TO HIGHER RATES & LOUVRE ACCORD



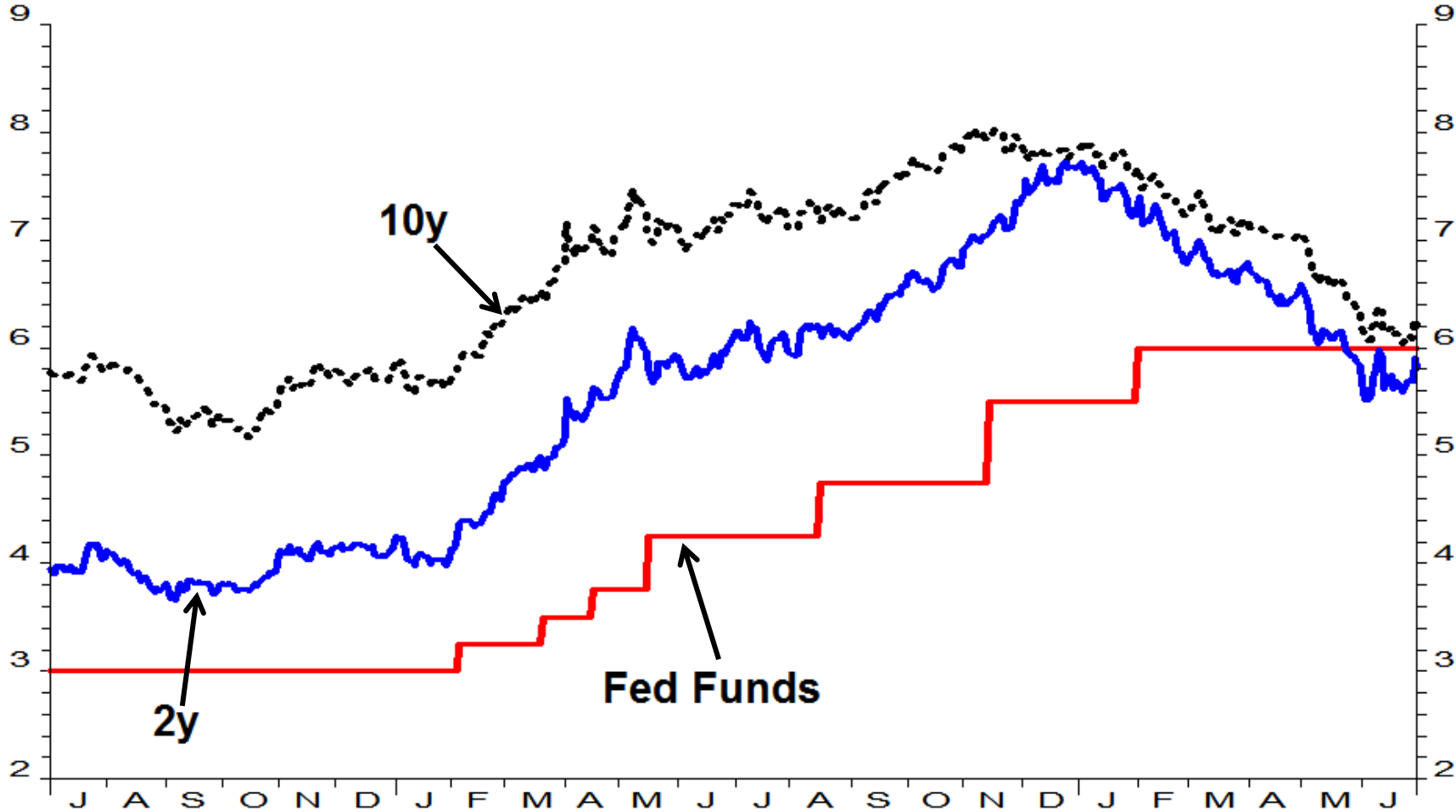
IS THIS LIKE 1987? EQUITIES IGNORE RISING YIELDS - FOR NOW



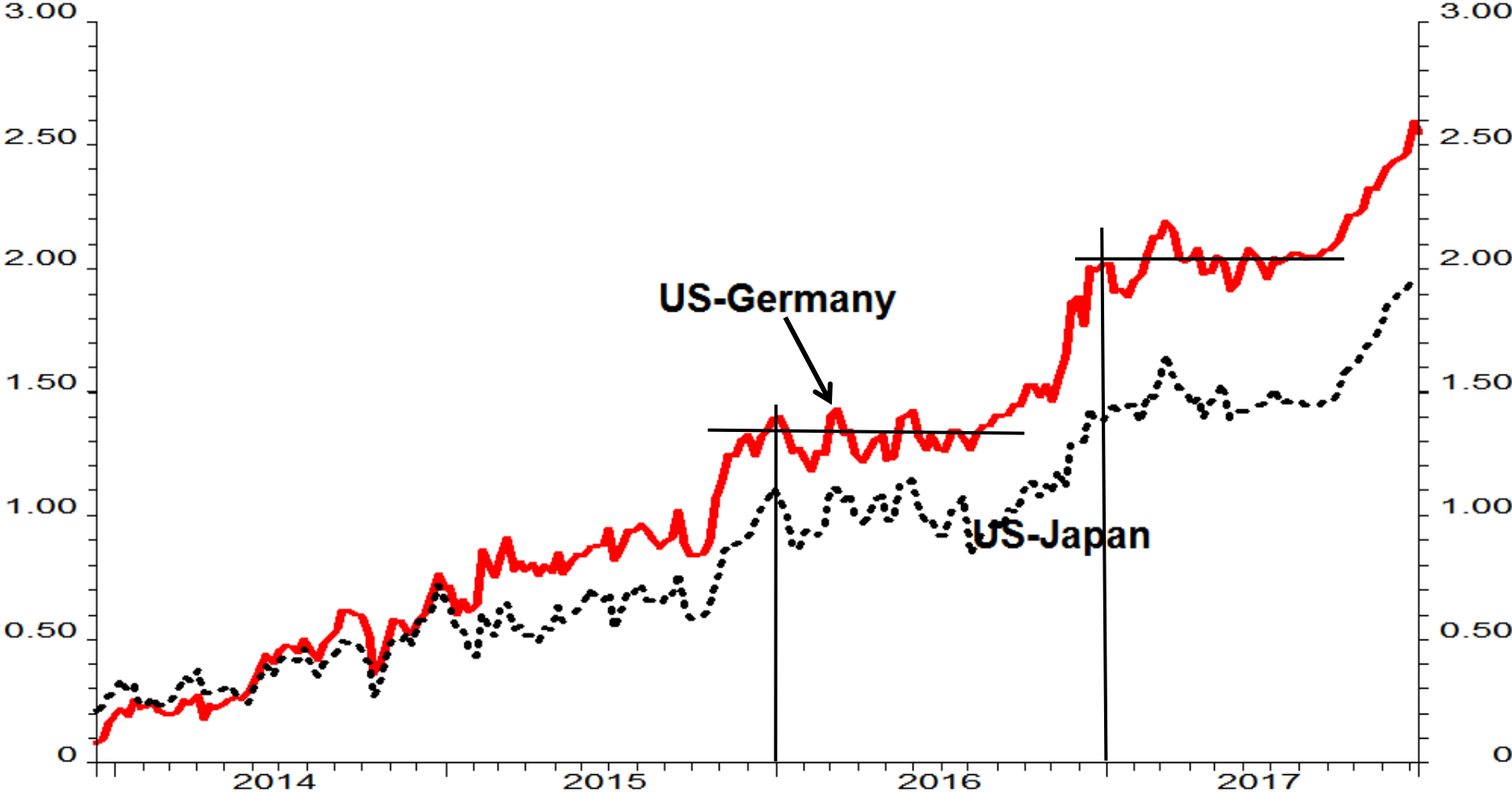
THE MARKET HAS LITTLE BELIEF IN FED TIGHTENING PROMISES



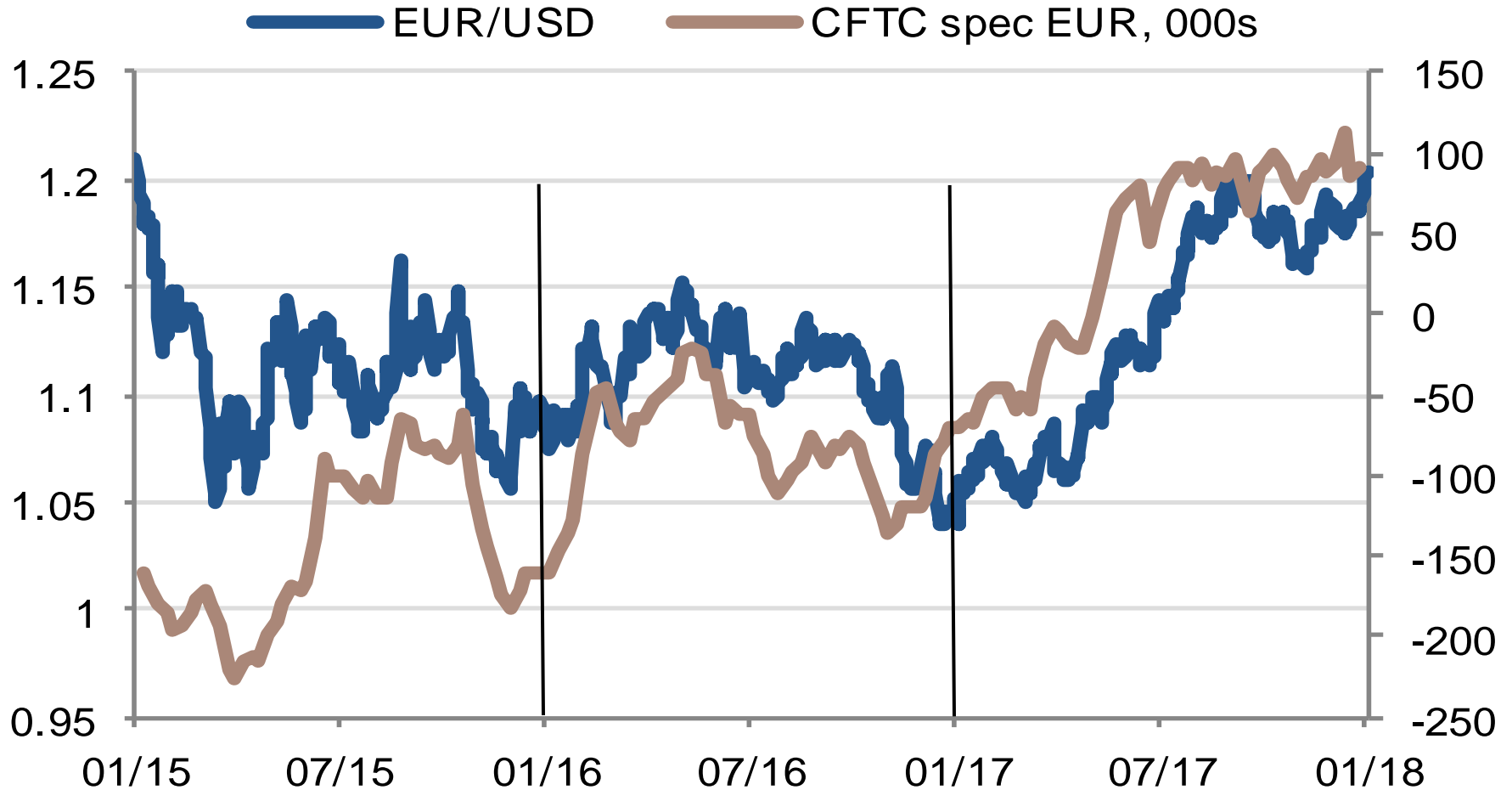
IT LOOKED SO DIFFERENT IN 1994



US DOLLAR NOT BEING DRAGGED UP AS US 2Y YIELDS RISE

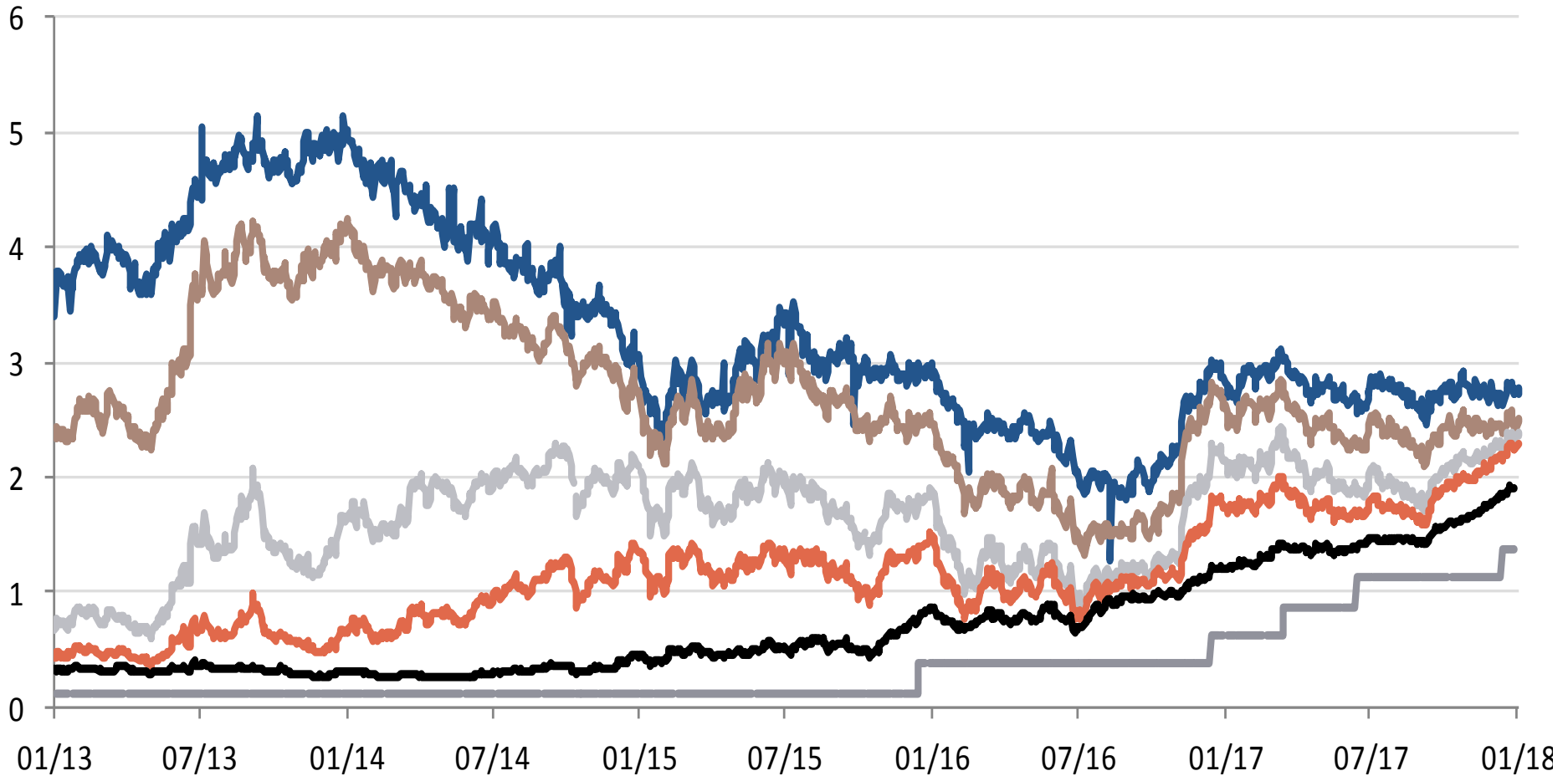


SPECULATORS ARE VERY SHORT THE DOLLAR NOW AGAINST € THIS TIME LAST YEAR THEY WERE VERY LONG!

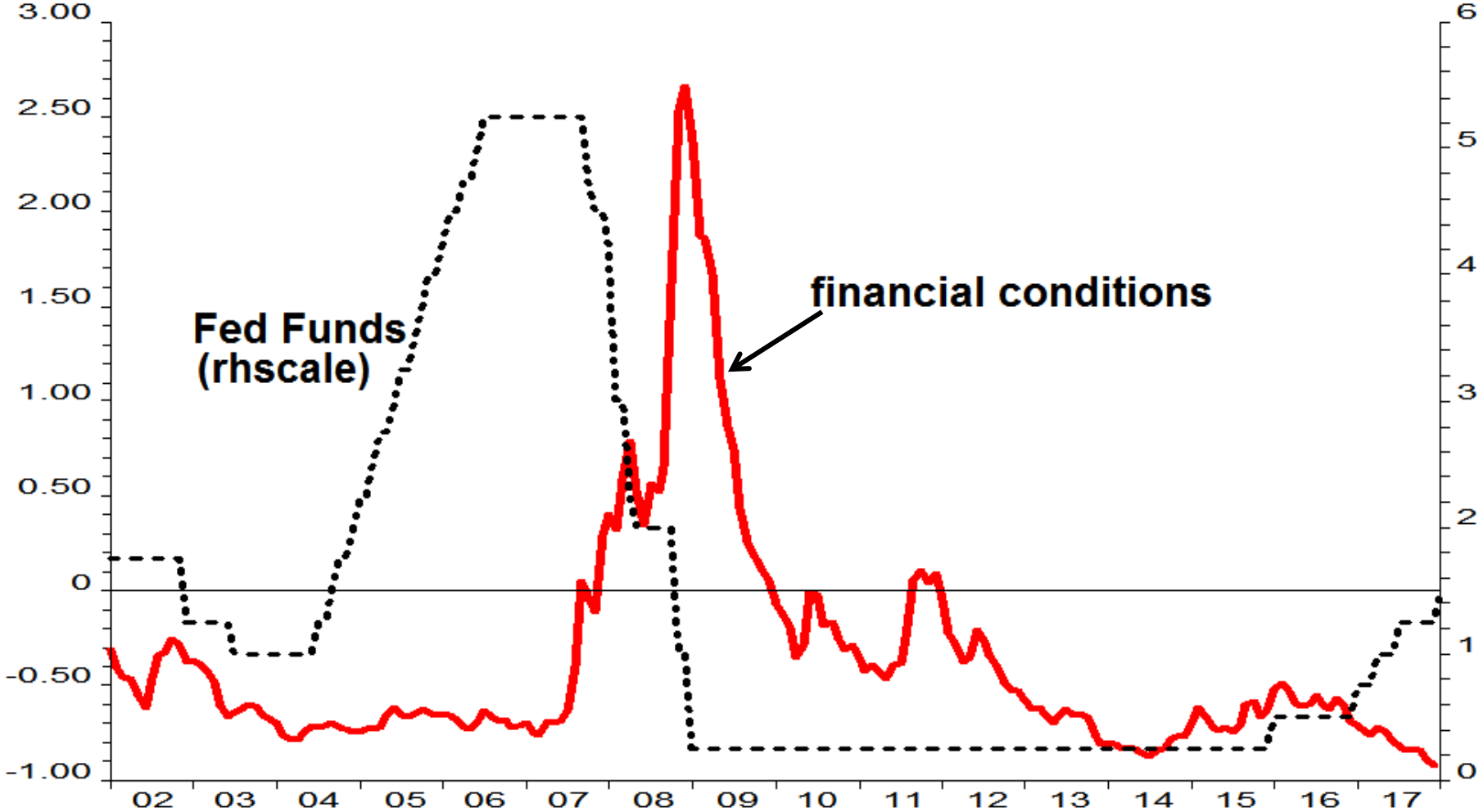


THE FED'S TAPER TANTRUM COWARDLINESS = CONVERGENCE

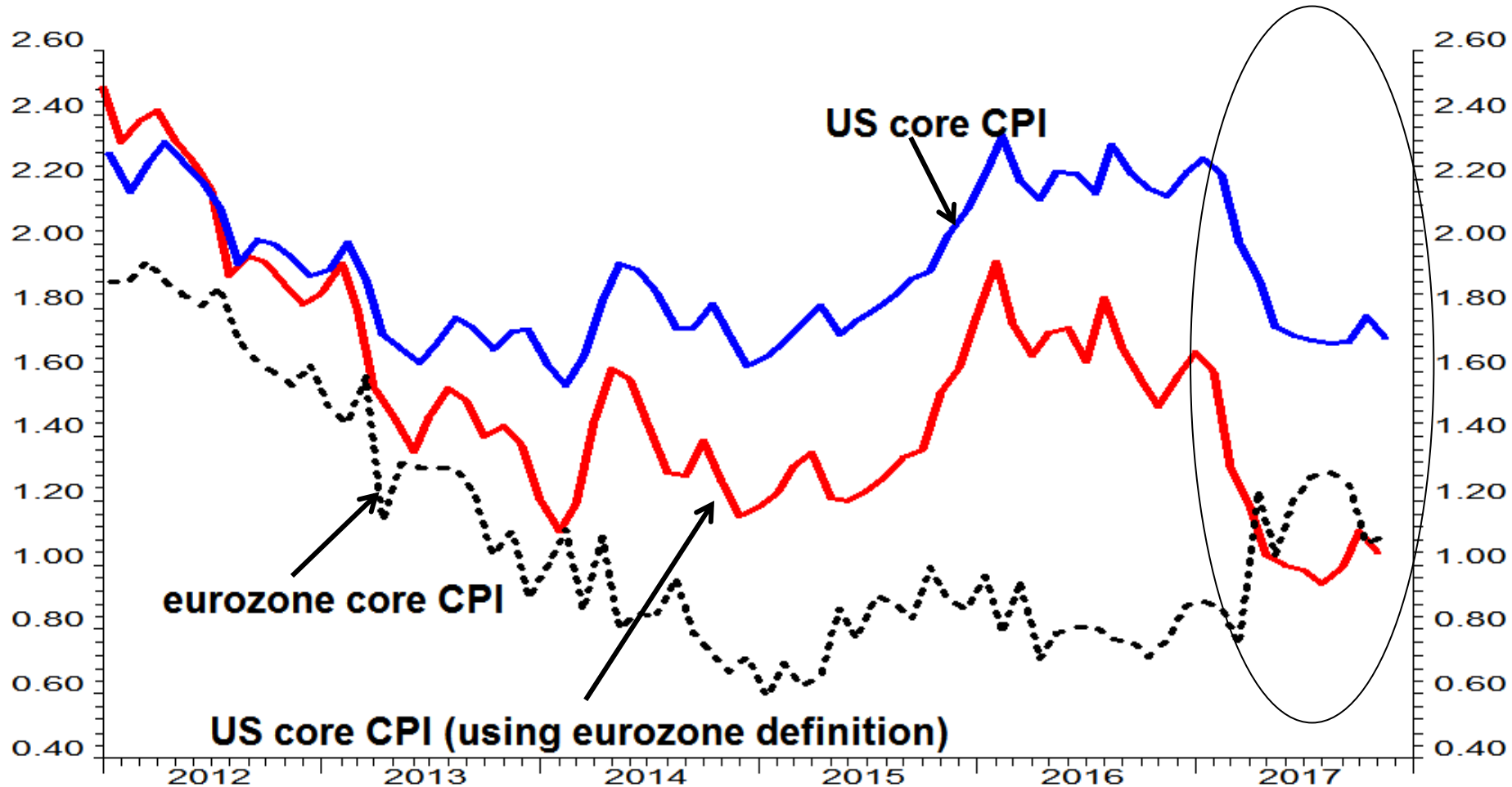
US 1y in 10yrs 1y in 5yrs 1y in 2yrs 1y in 1yr 1yr swap Fed Funds



DOVISH HIKES HAVE LOOSENED FINANCIAL CONDITIONS

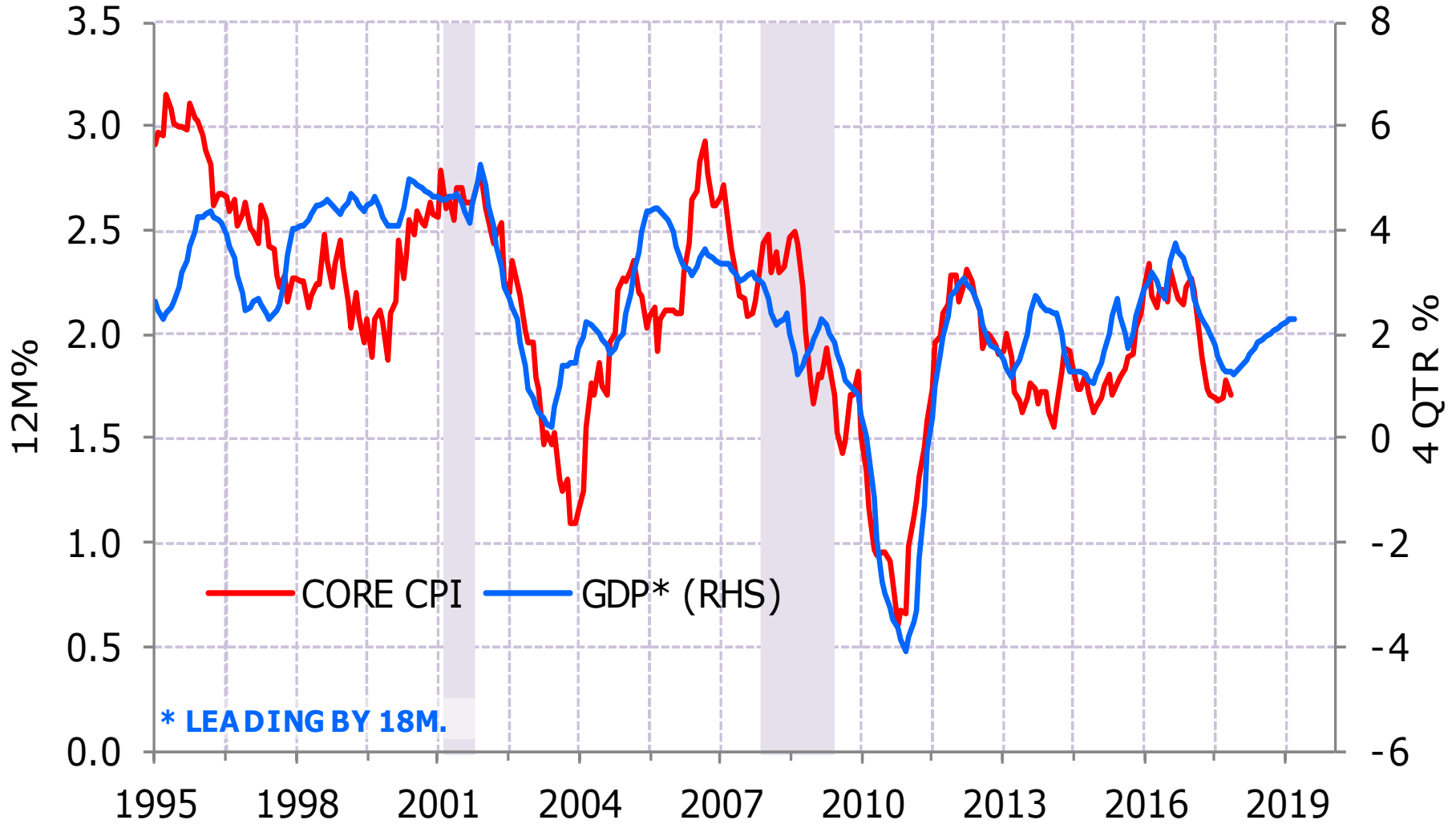


THE MAIN REASON THE MARKET IS BELOW THE FED DOTS IS...



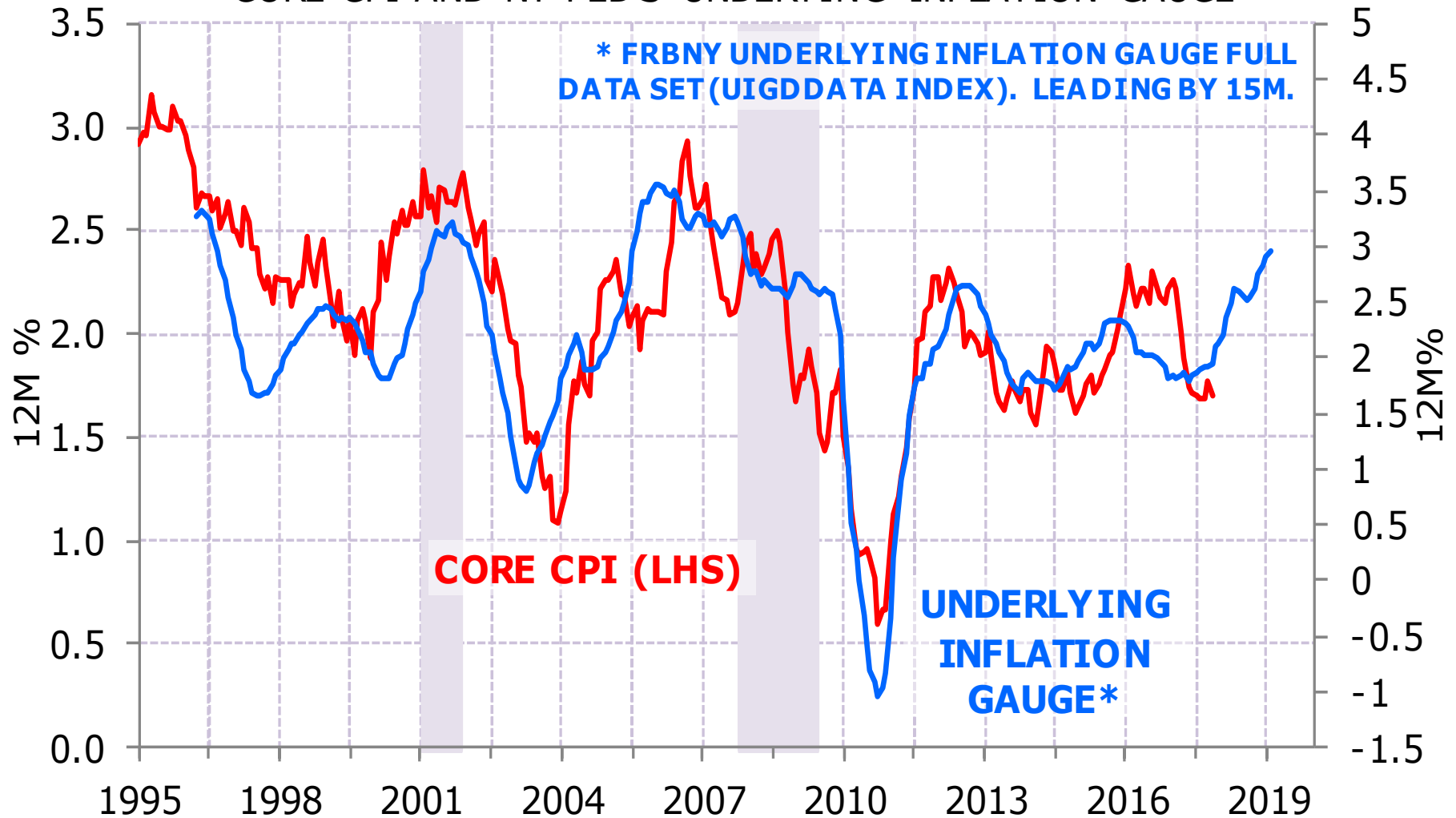
BUT IS US CORE CPI SET TO RISE?

US GDP AND CORE INFLATION

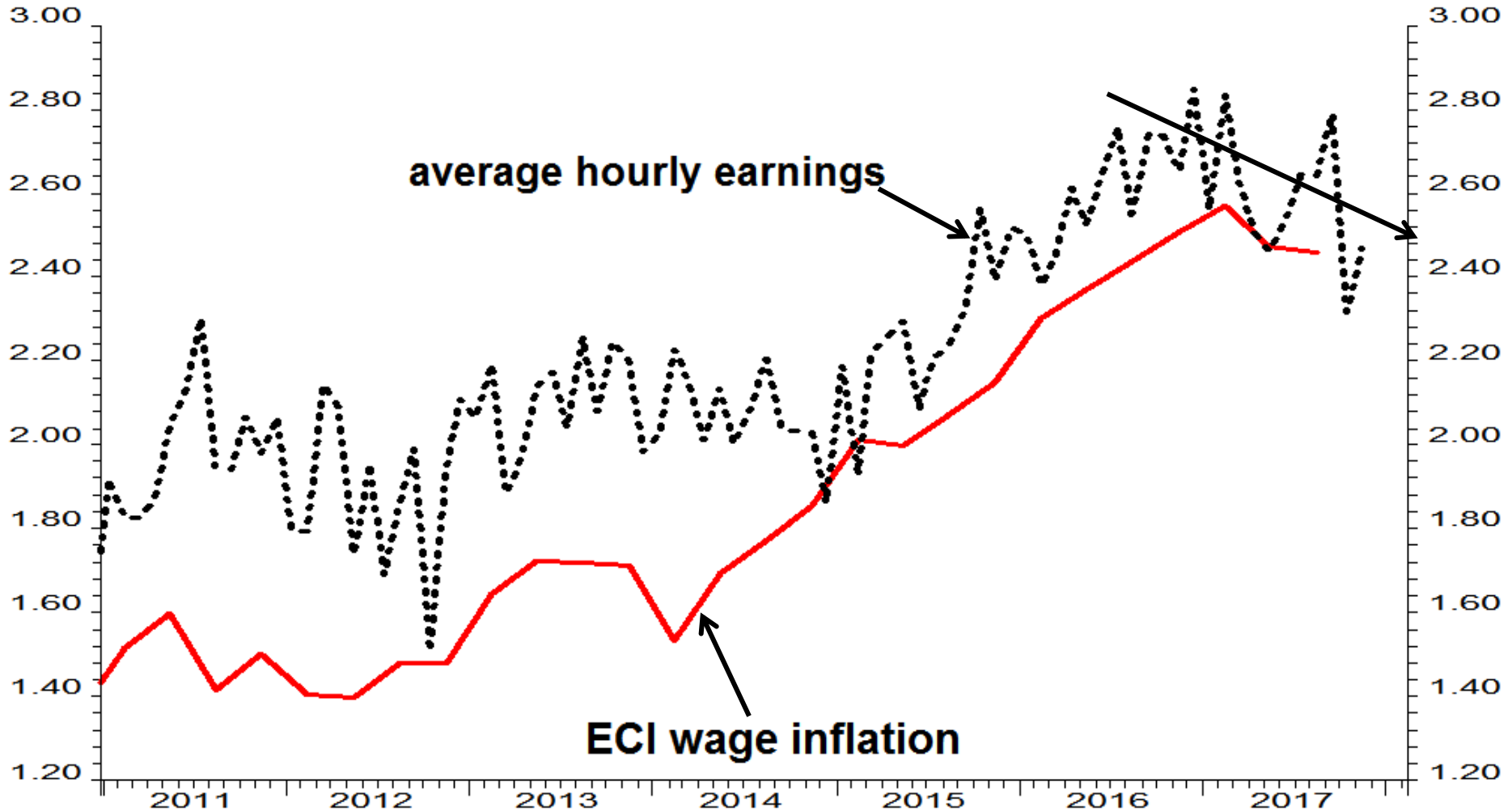


NY FED SUGGESTS US CORE CPI COULD SURGE

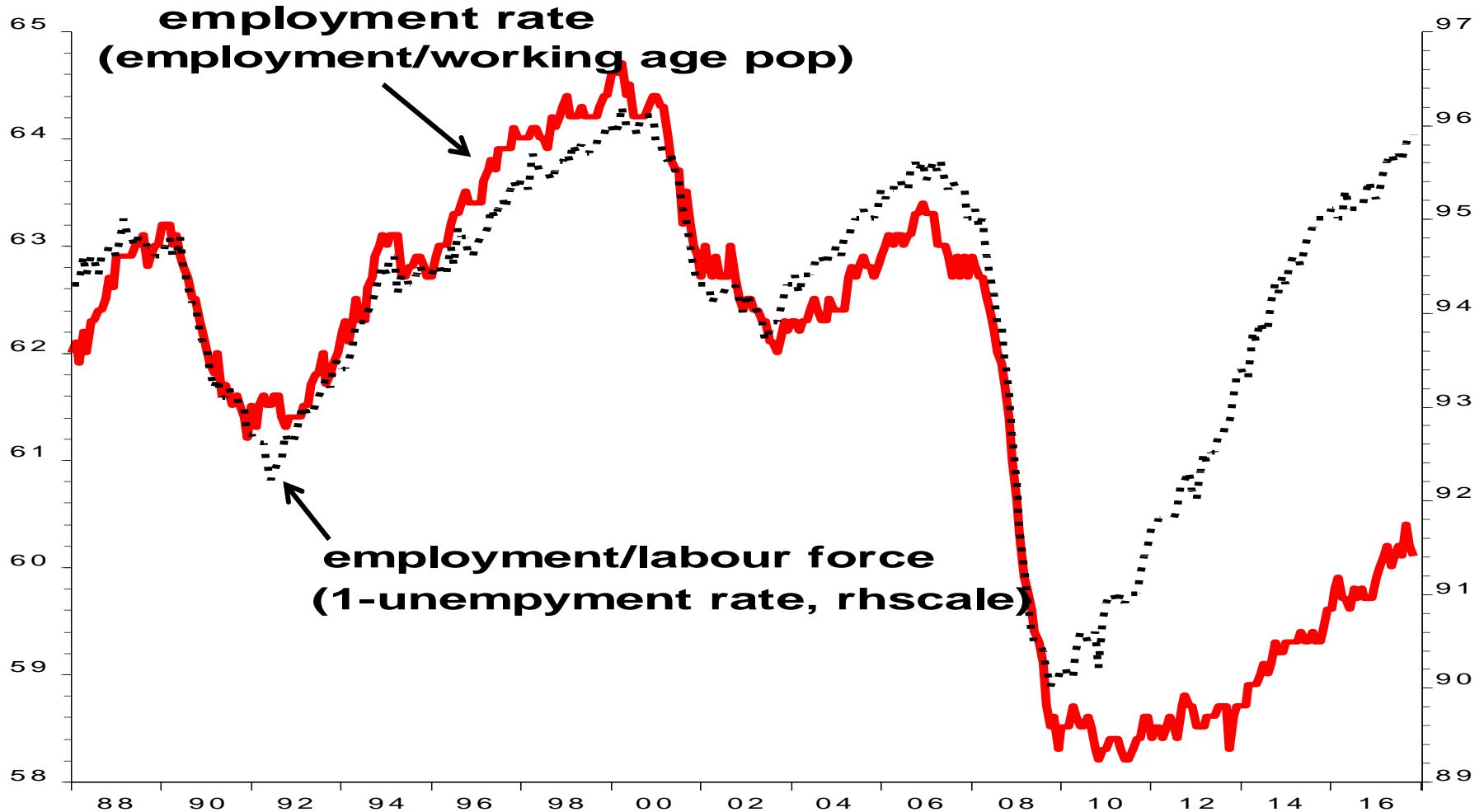
CORE CPI AND NY FED'S UNDERLYING INFLATION GAUGE



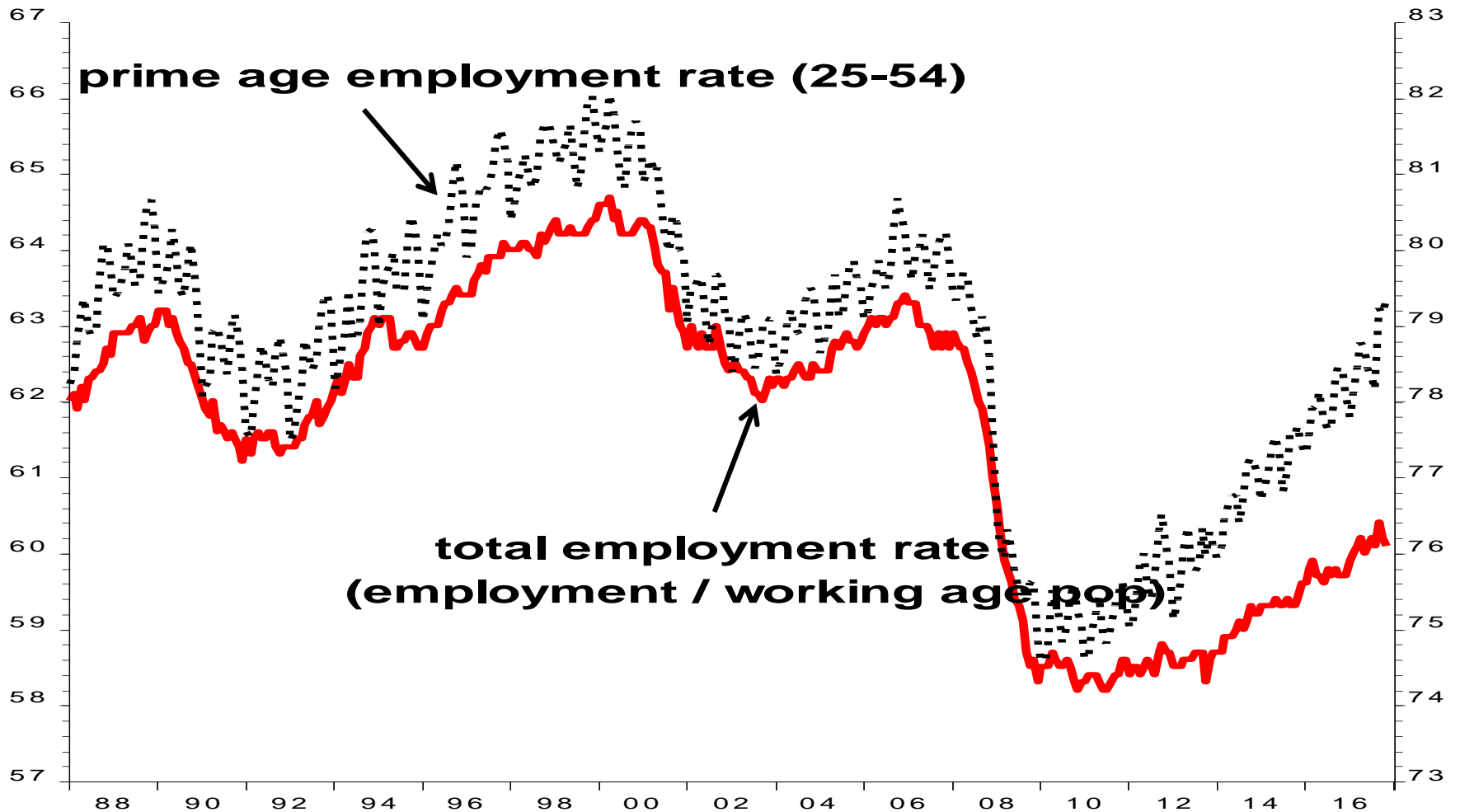
US WAGE INFLATION HAS DRIFTED DOWN!



LOTS OF LABOUR SLACK IN THE US?

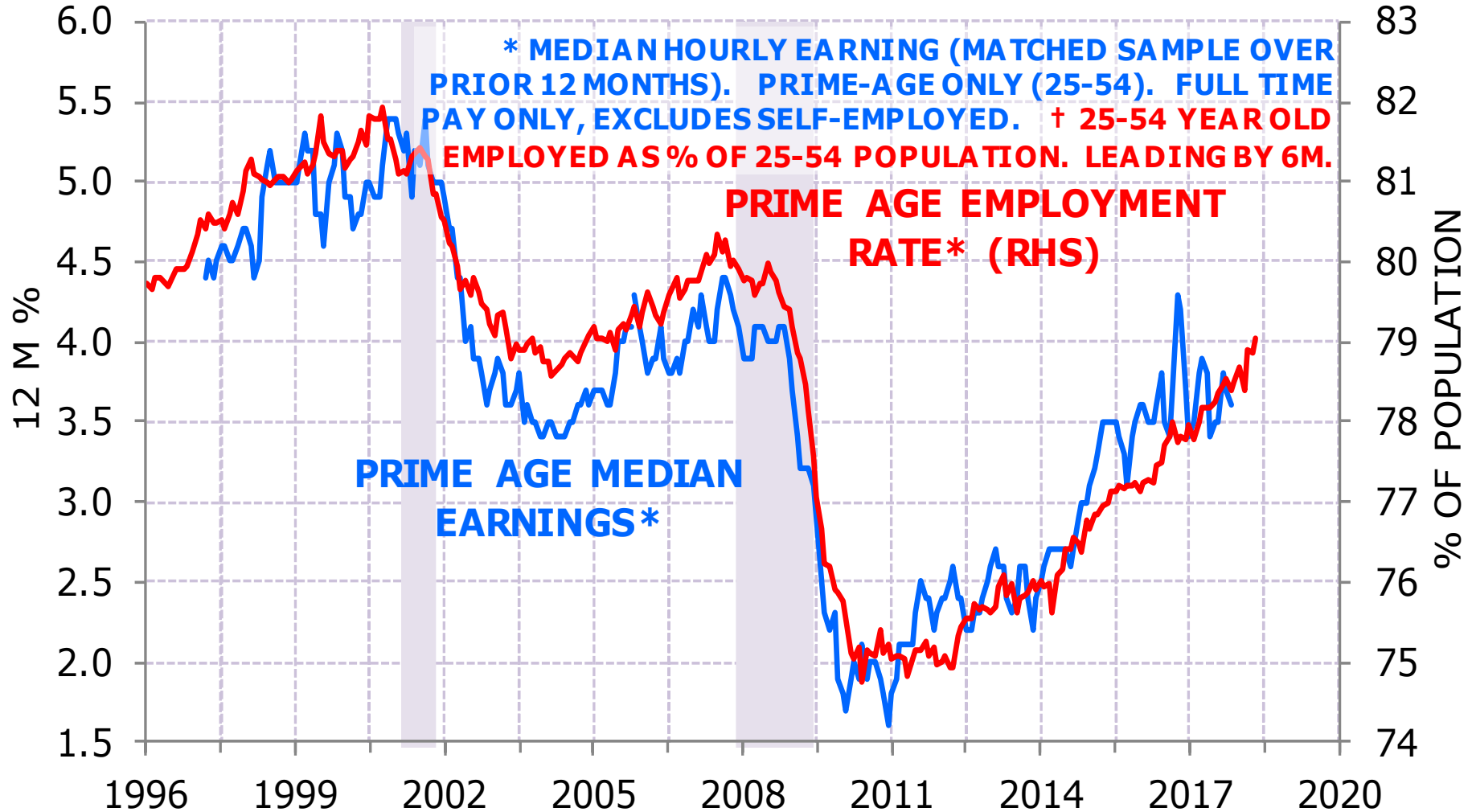


PRIME AGE EMPLOYMENT RATE STRONGER THAN TOTAL

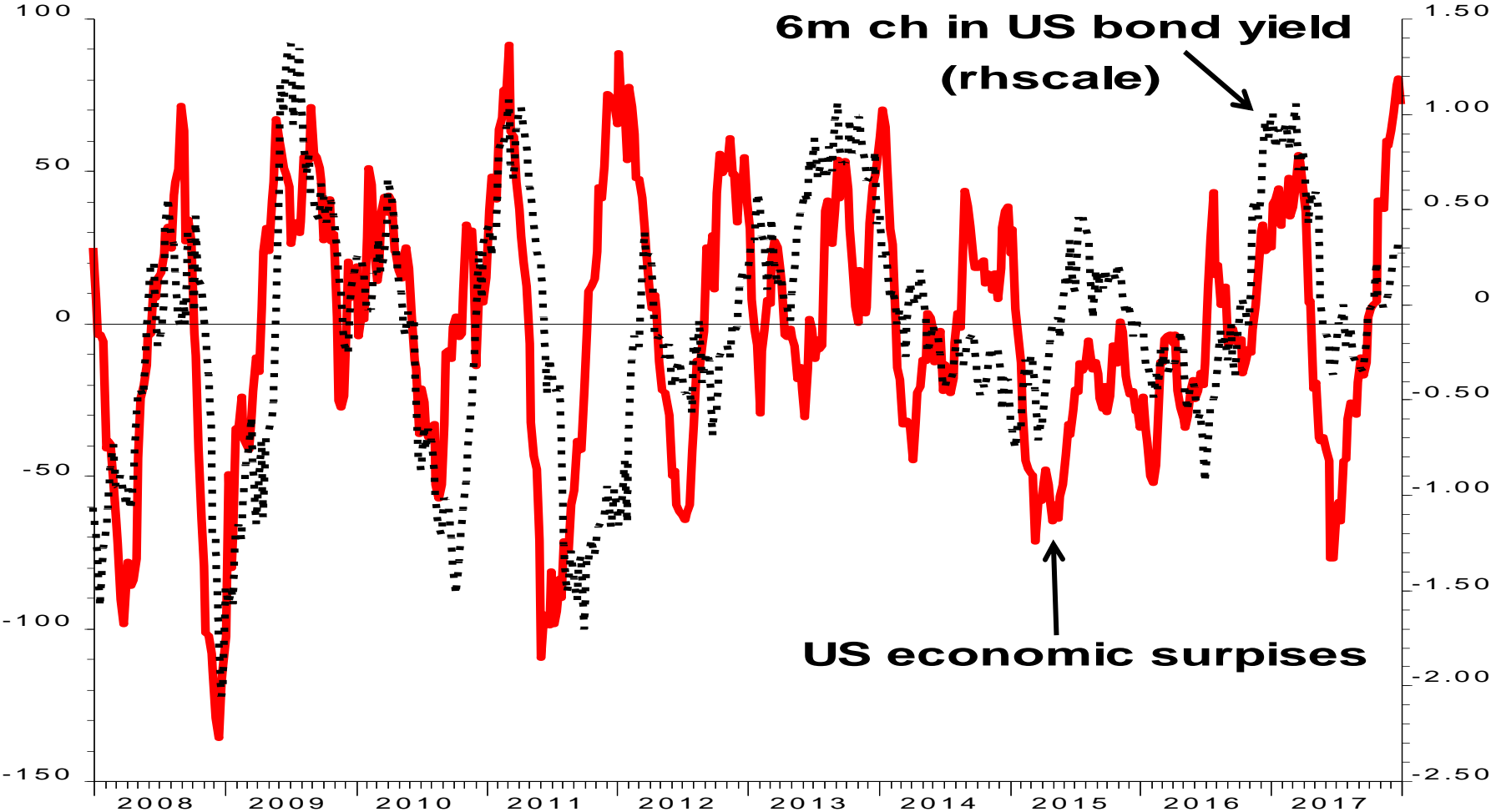


US PHILLIPS CURVE IS NOT DEAD

PRIME AGE WAGE GROWTH AND CORE EMPLOYMENT RATE



WHY AREN'T US BOND YIELDS RISING MORE QUICKLY?



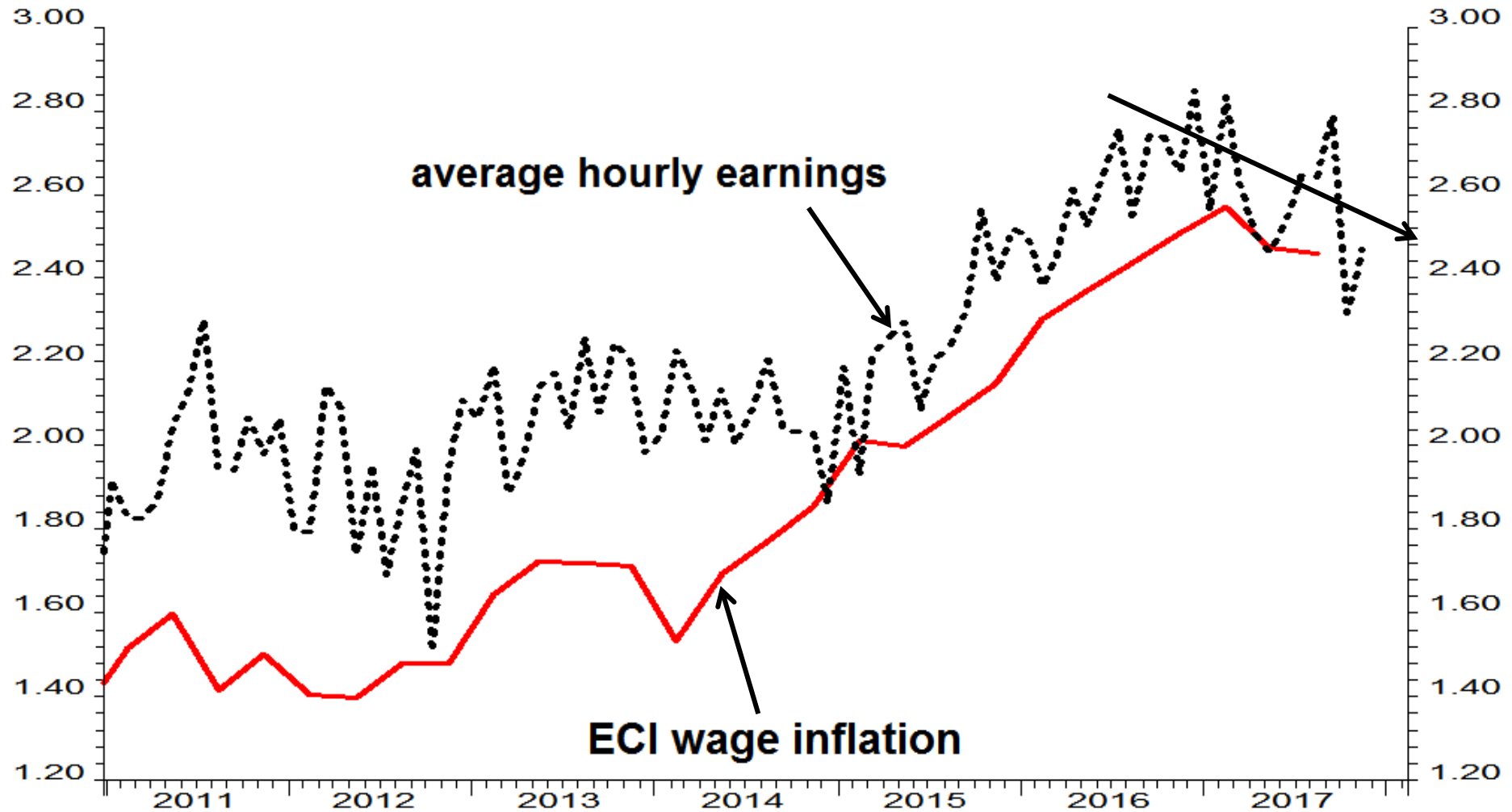
THE MOST IMPORTANT CHART IN THE WORLD?



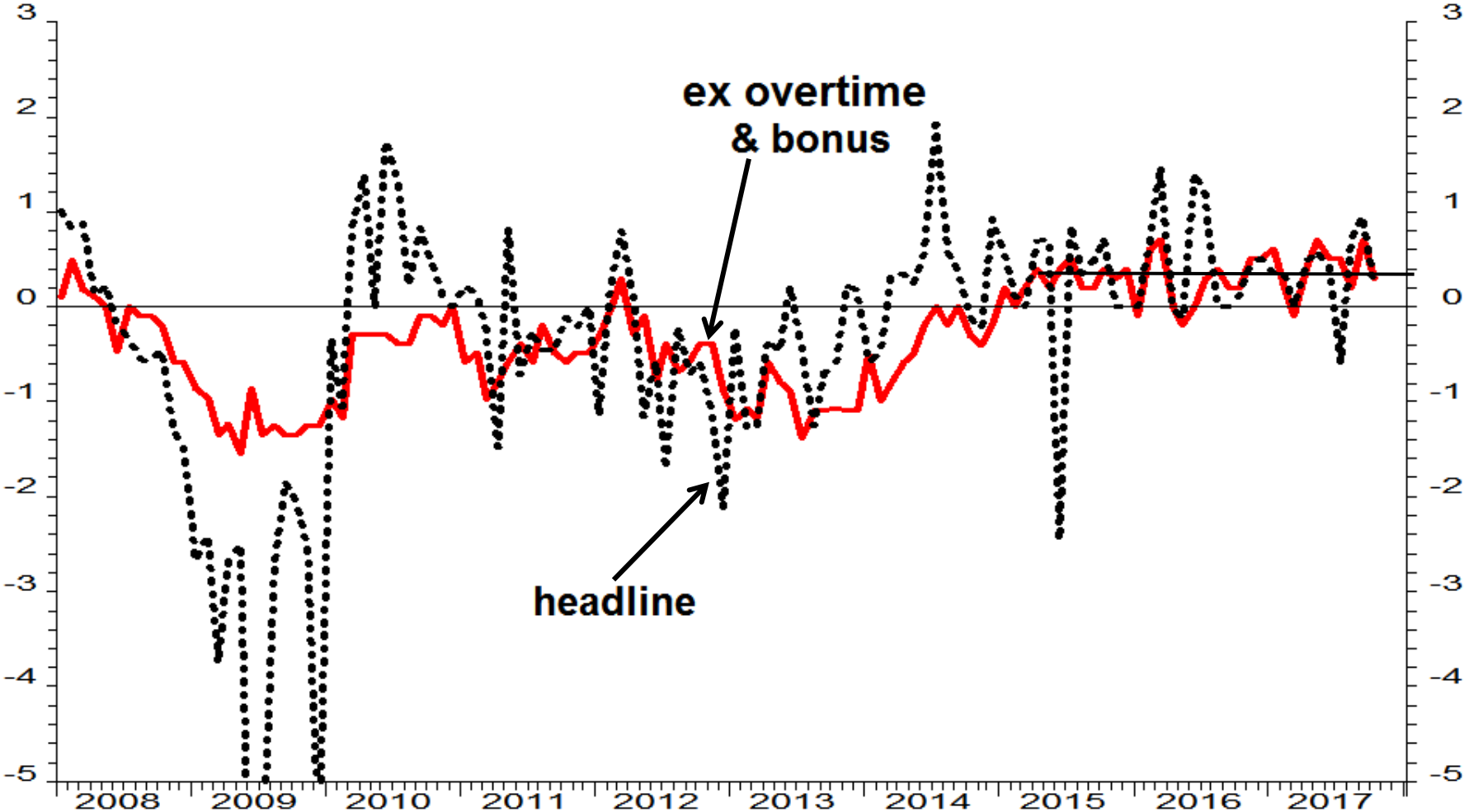
US 10Y YIELD CAN RISE TO 3% AND STILL BE IN A BULL MARKET



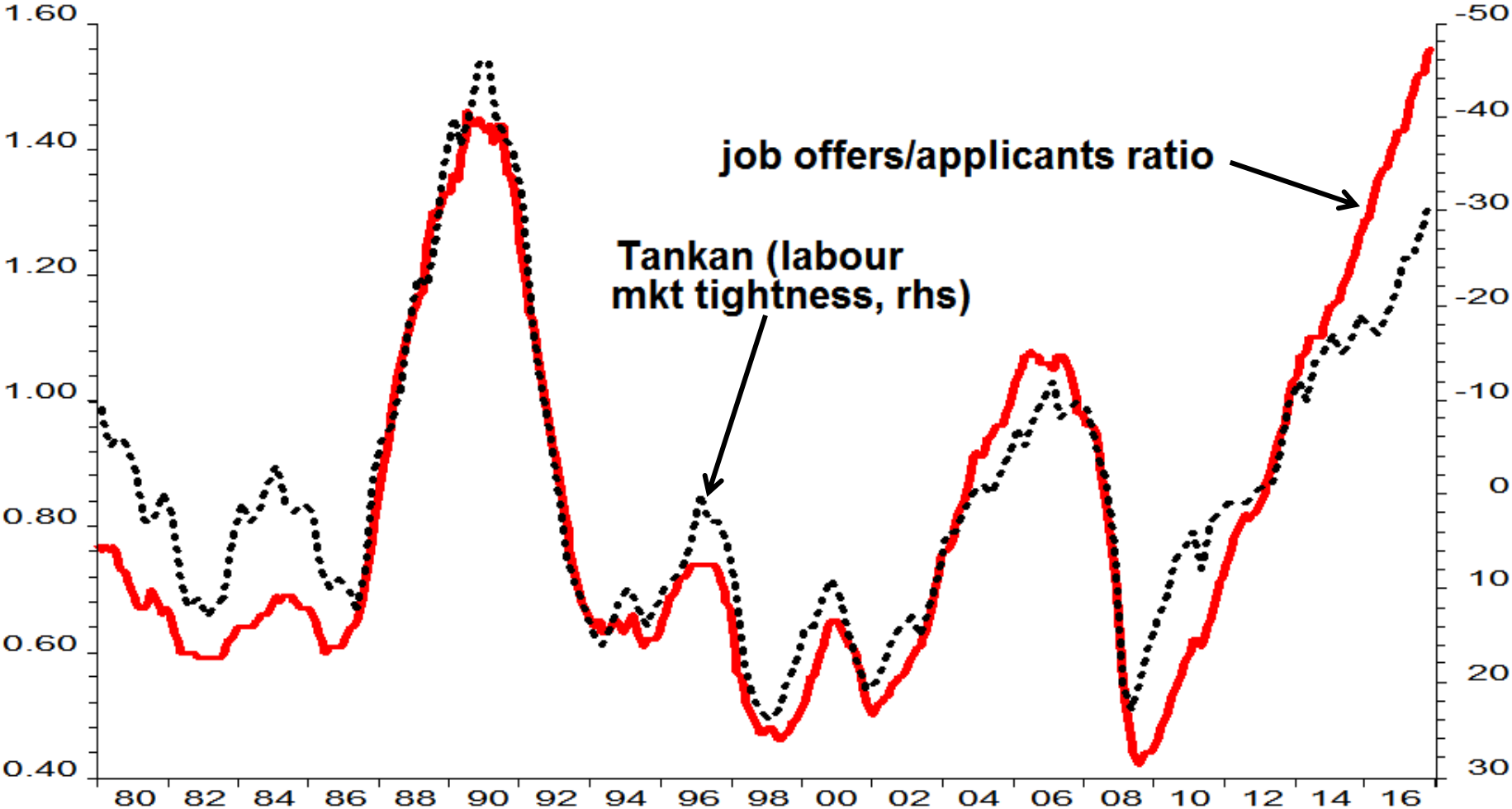
...BACK TO THE WAGE CONUNDRUM....



JAPANESE WAGE INFLATION BUMPING ALONG AT 1/2% YOY



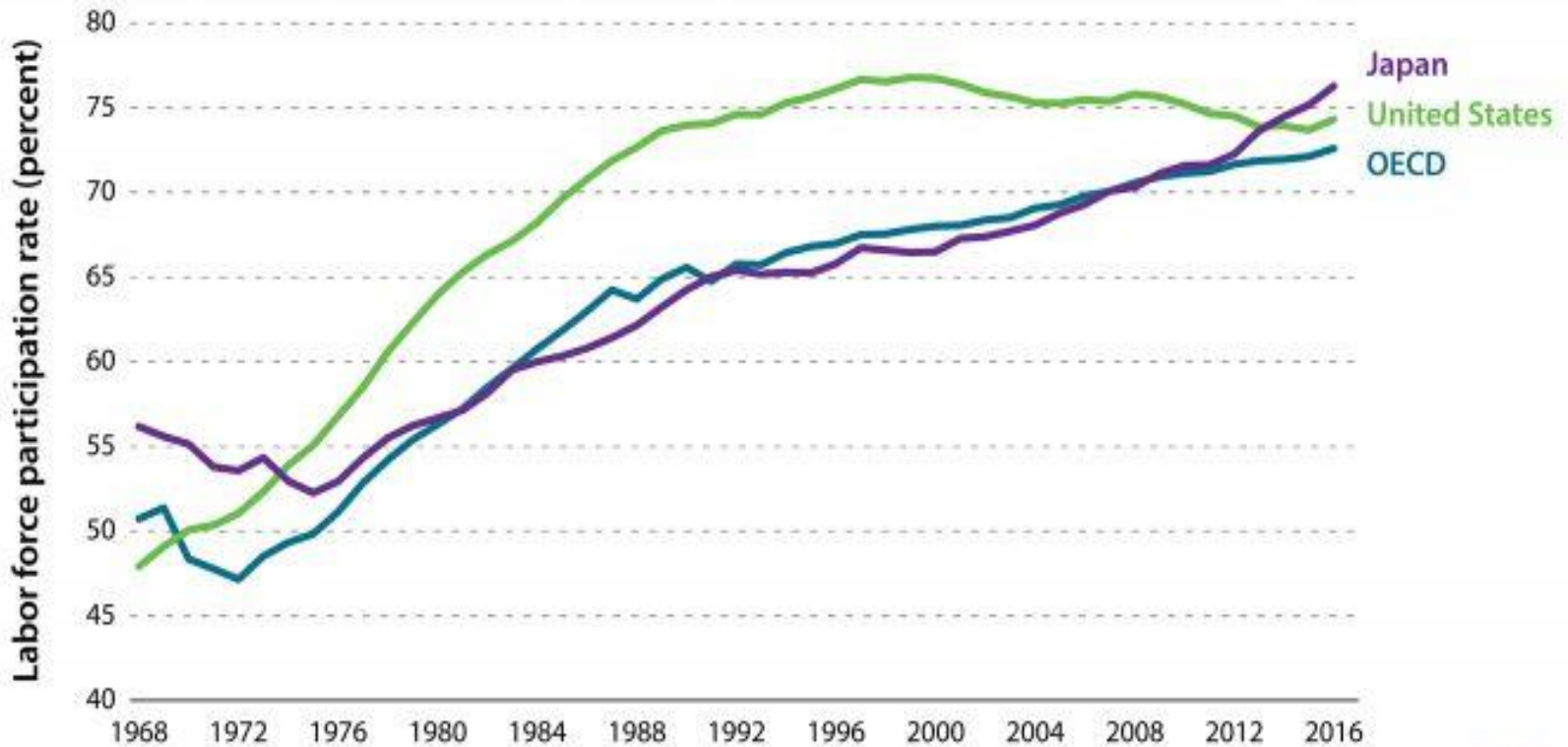
JAPANESE LABOUR MARKET MUCH TIGHTER THAN THE US



JAPAN: A BIG INCREASE IN FEMALE PARTICIPATION RATIO

FIGURE 1.

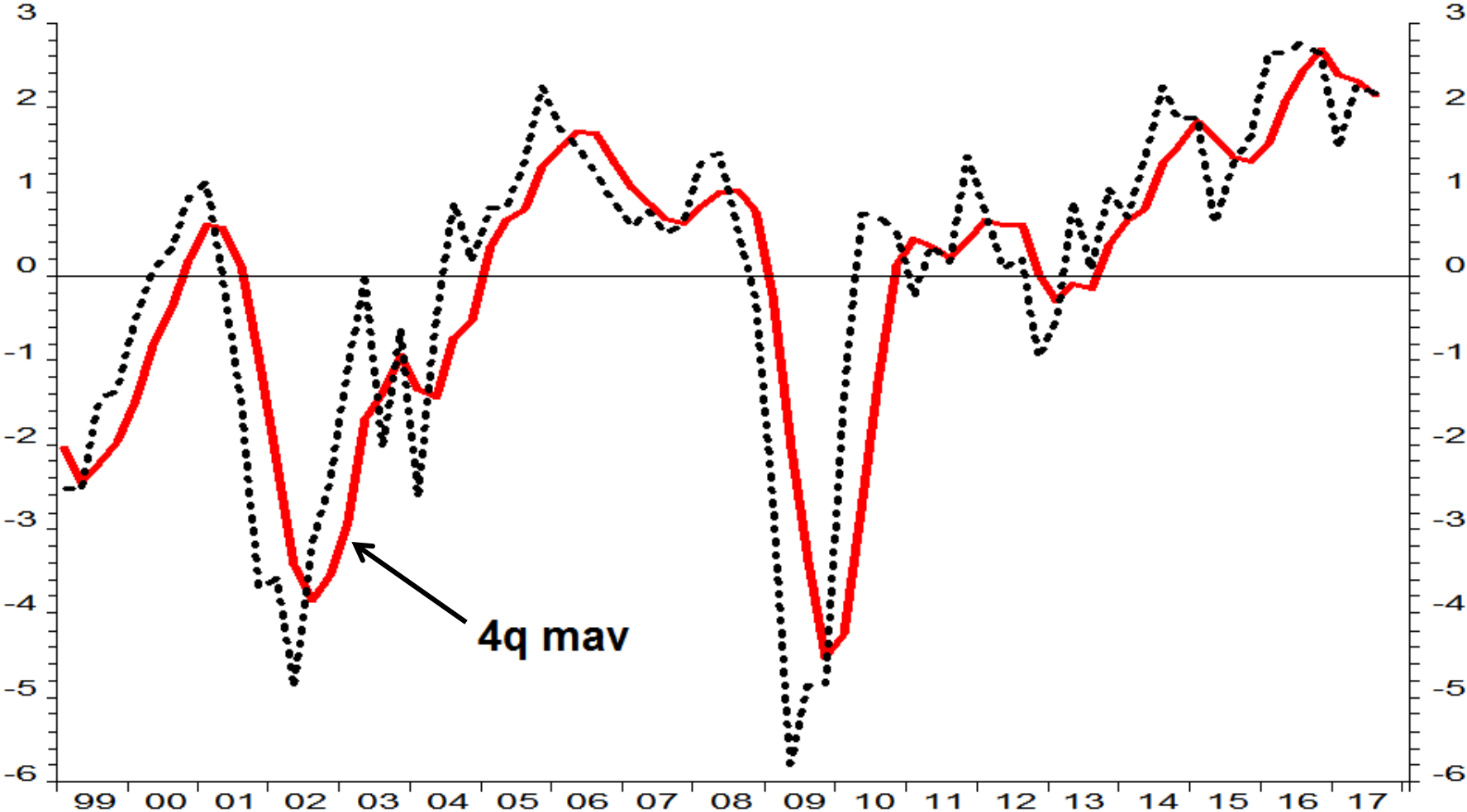
Labor Force Participation of Prime-age Women from 1968–2016, by Country



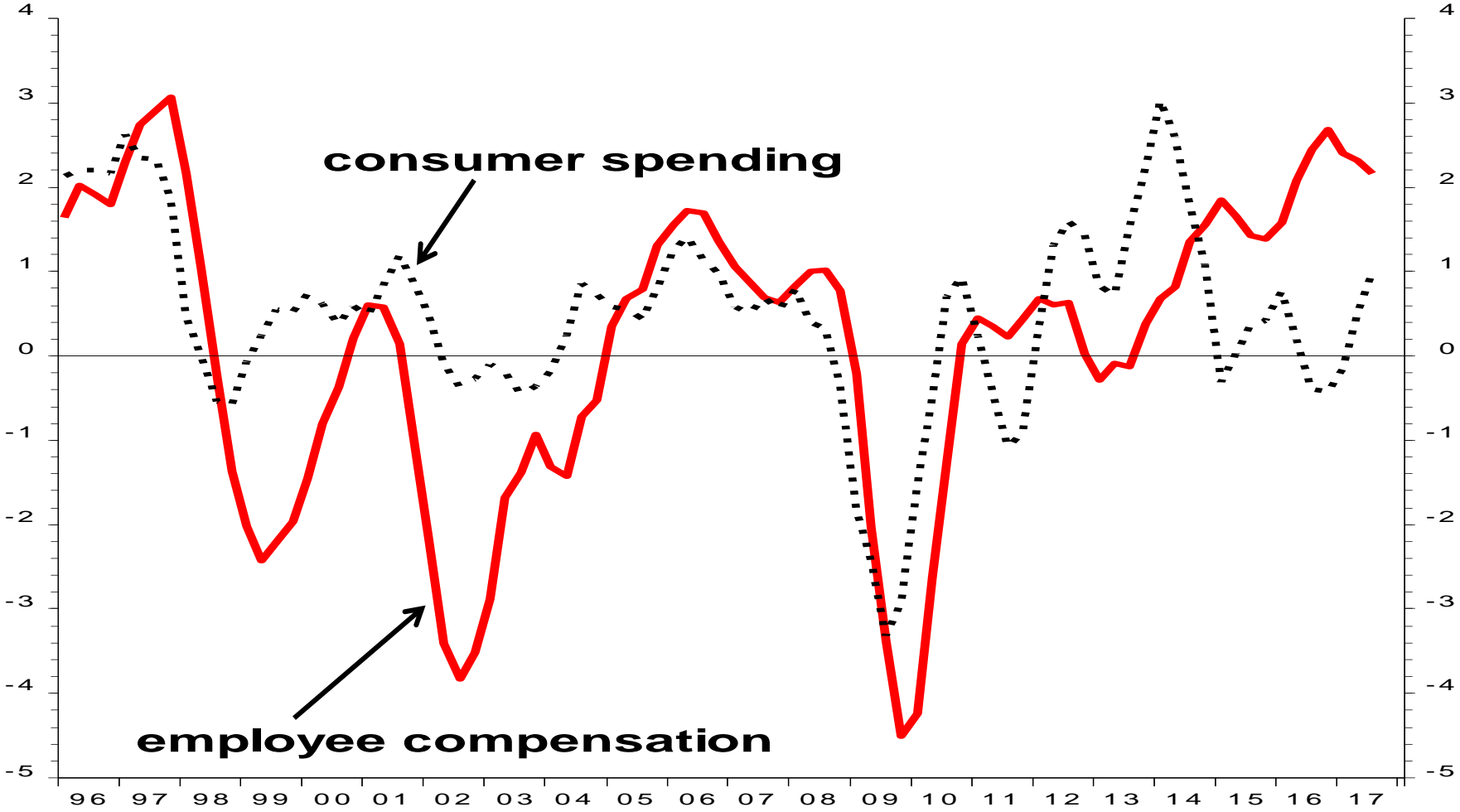
Source: OECD Labour Force Statistics.

Note: Prime-age indicates 25–54.

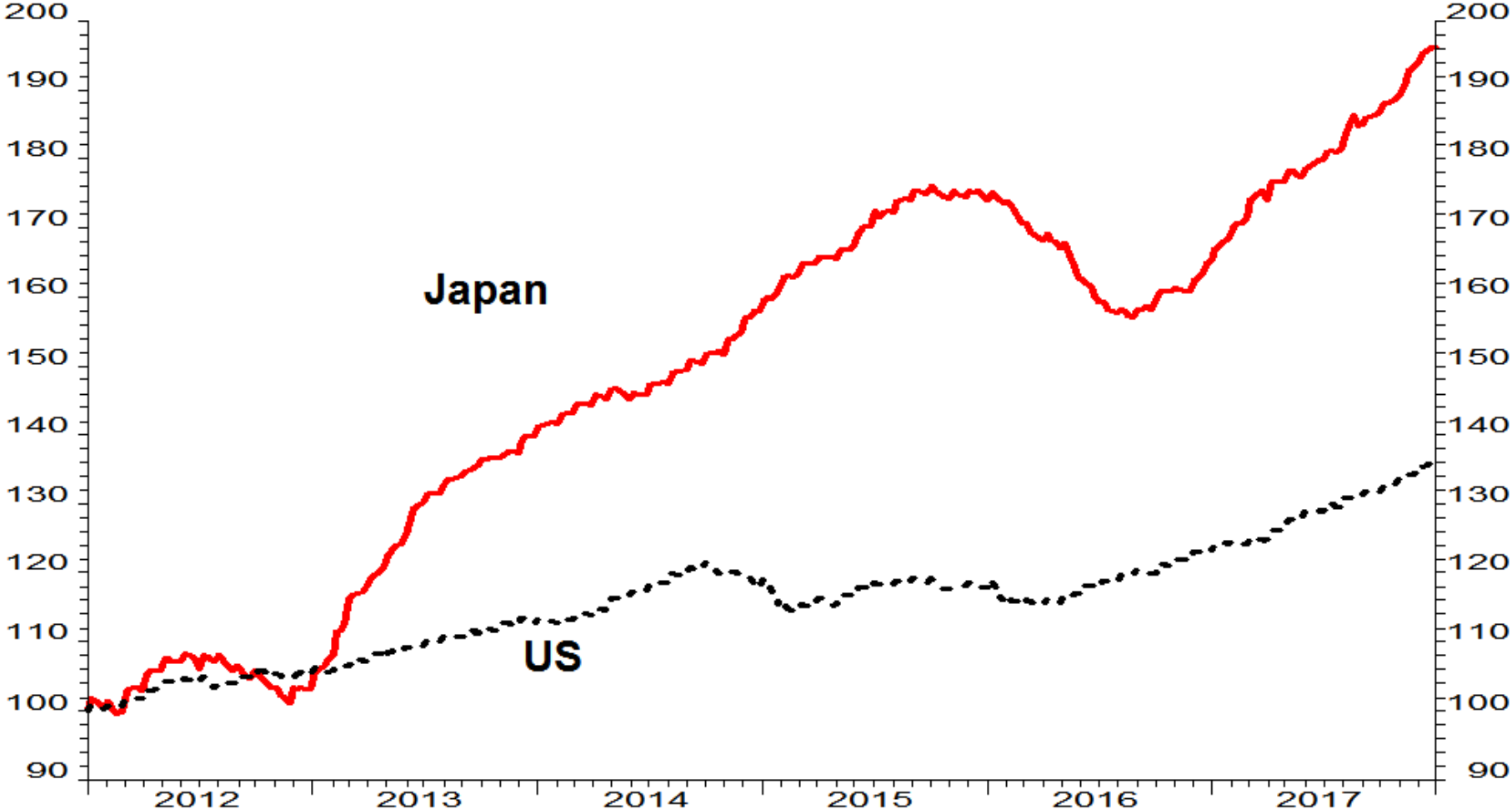
JAPANESE HOUSEHOLD INCOME IS STRONG (YOY%)



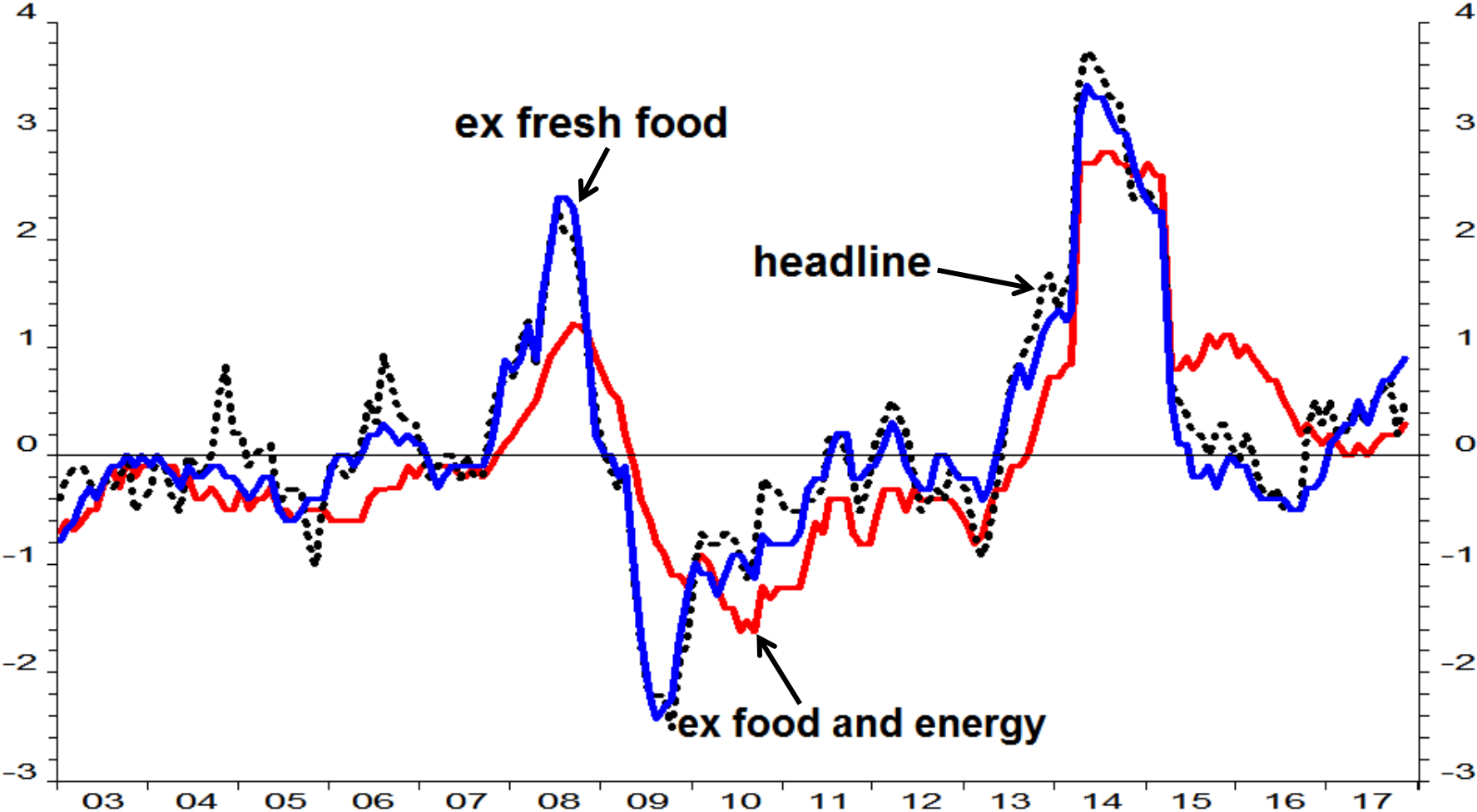
JAPAN: CONSUMPTION WEAK V INCOME – UNLIKE THE US & UK!



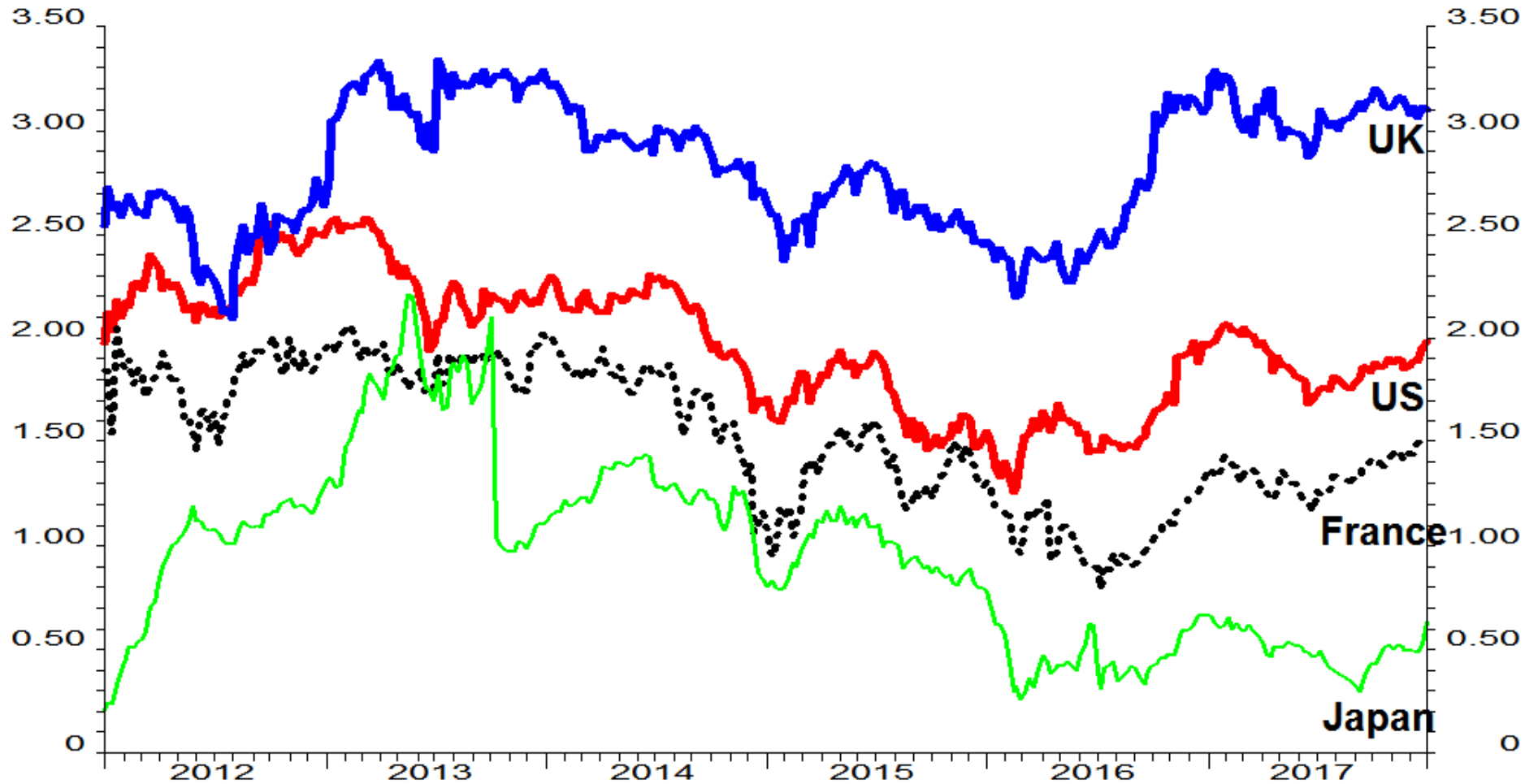
JAPANESE STOCKMARKET PROFITS SURGING



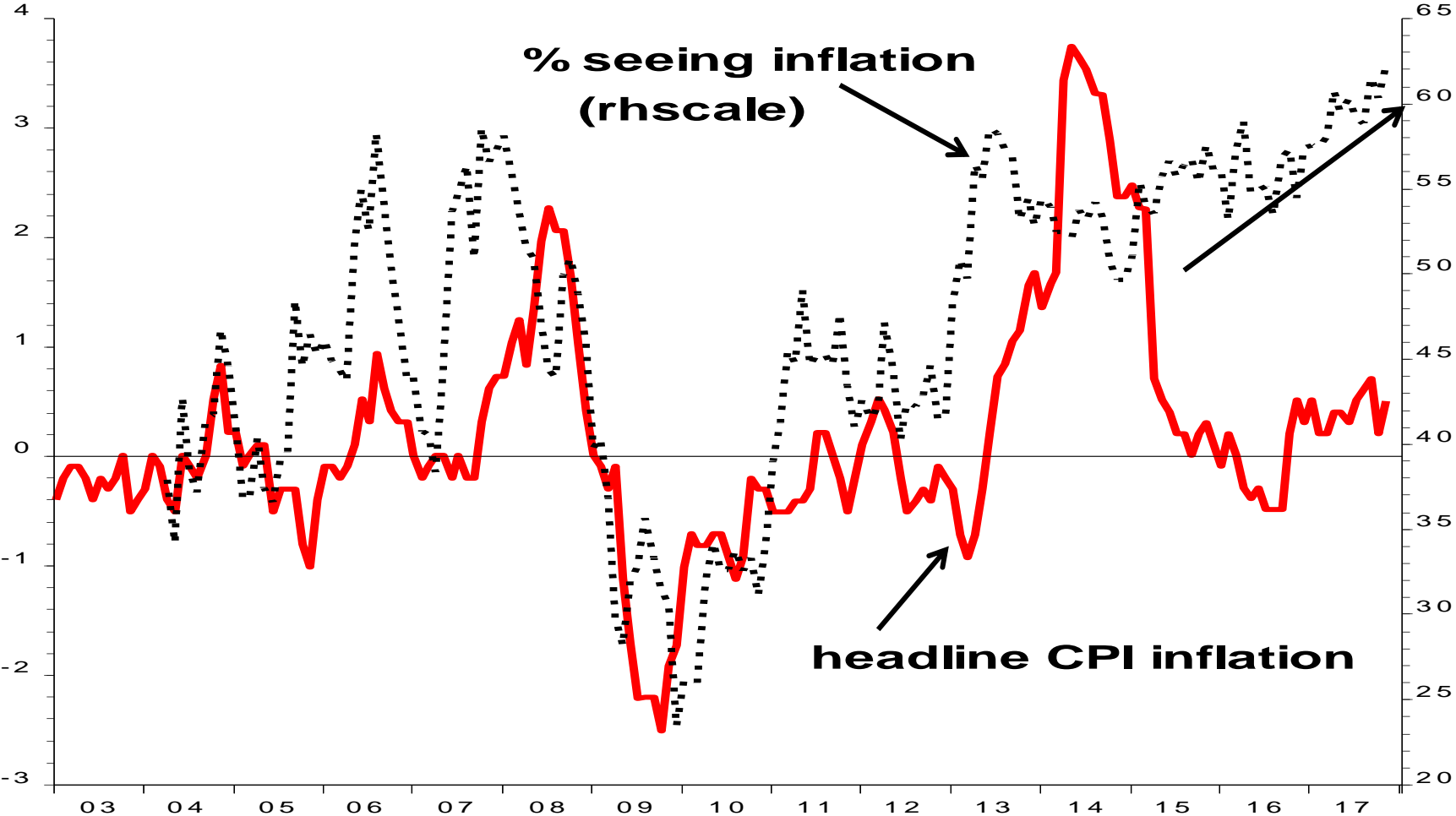
JAPANESE CORE CPI INFLATION RISING



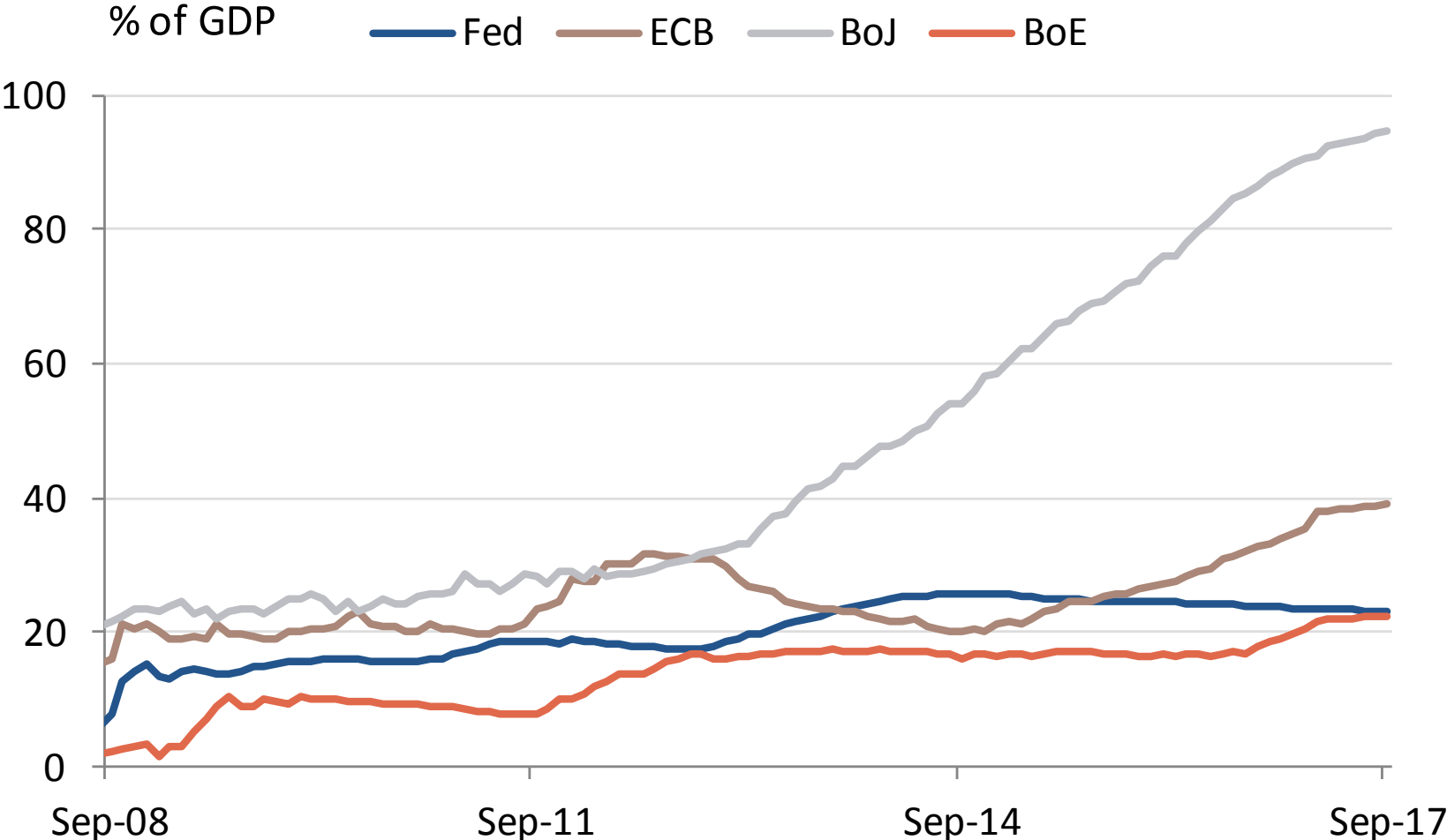
JAPANESE IMPLIED INFLATION EXPECTATIONS BOTTOMING?



JAPANESE BEGINNING TO BELIEVE IN INFLATION AGAIN!

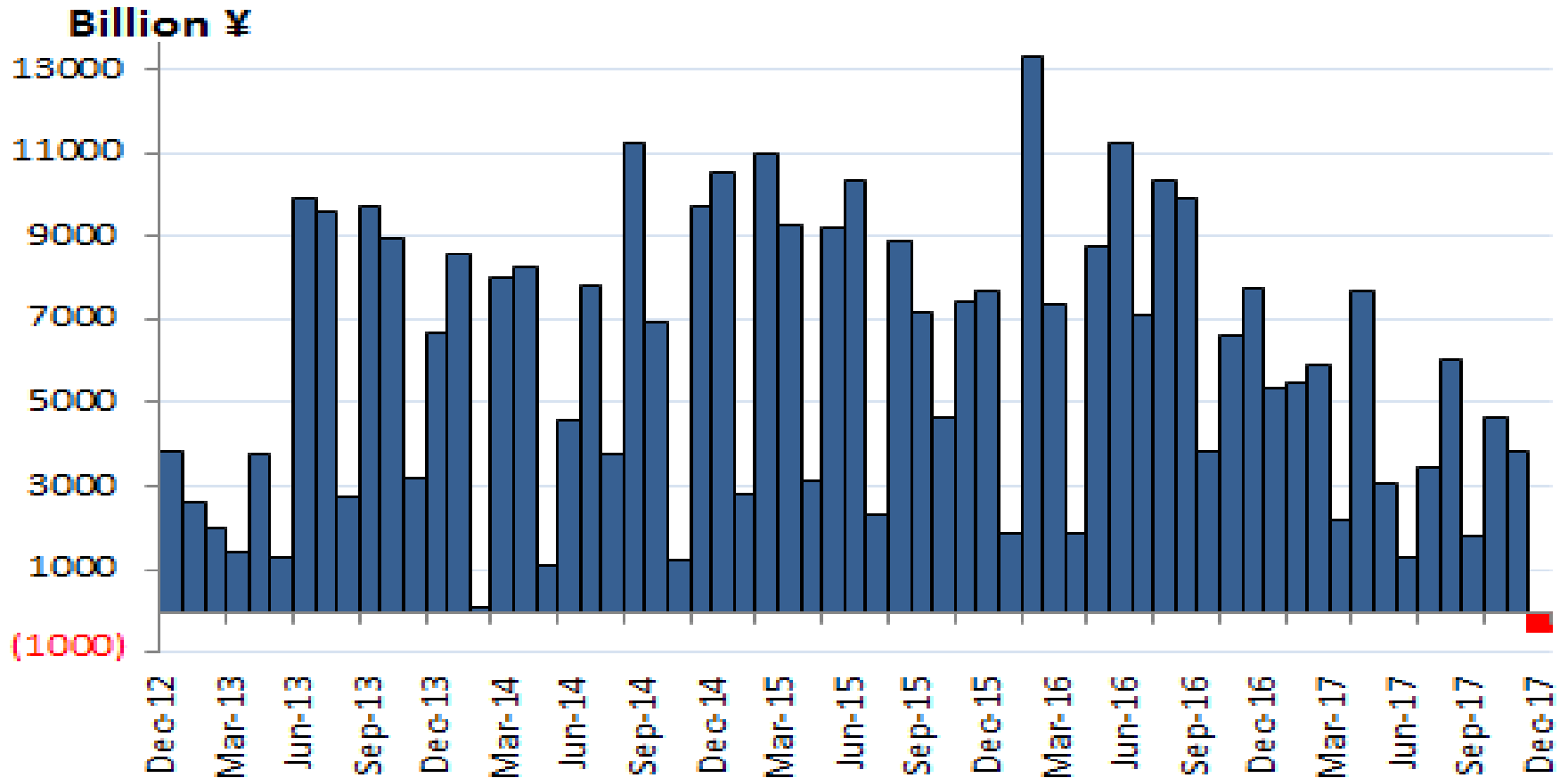


JAPANESE QE IS OFF THE SCALE. COULD THEY TAPER TOO?



HAS QT ALREADY STARTED IN JAPAN?

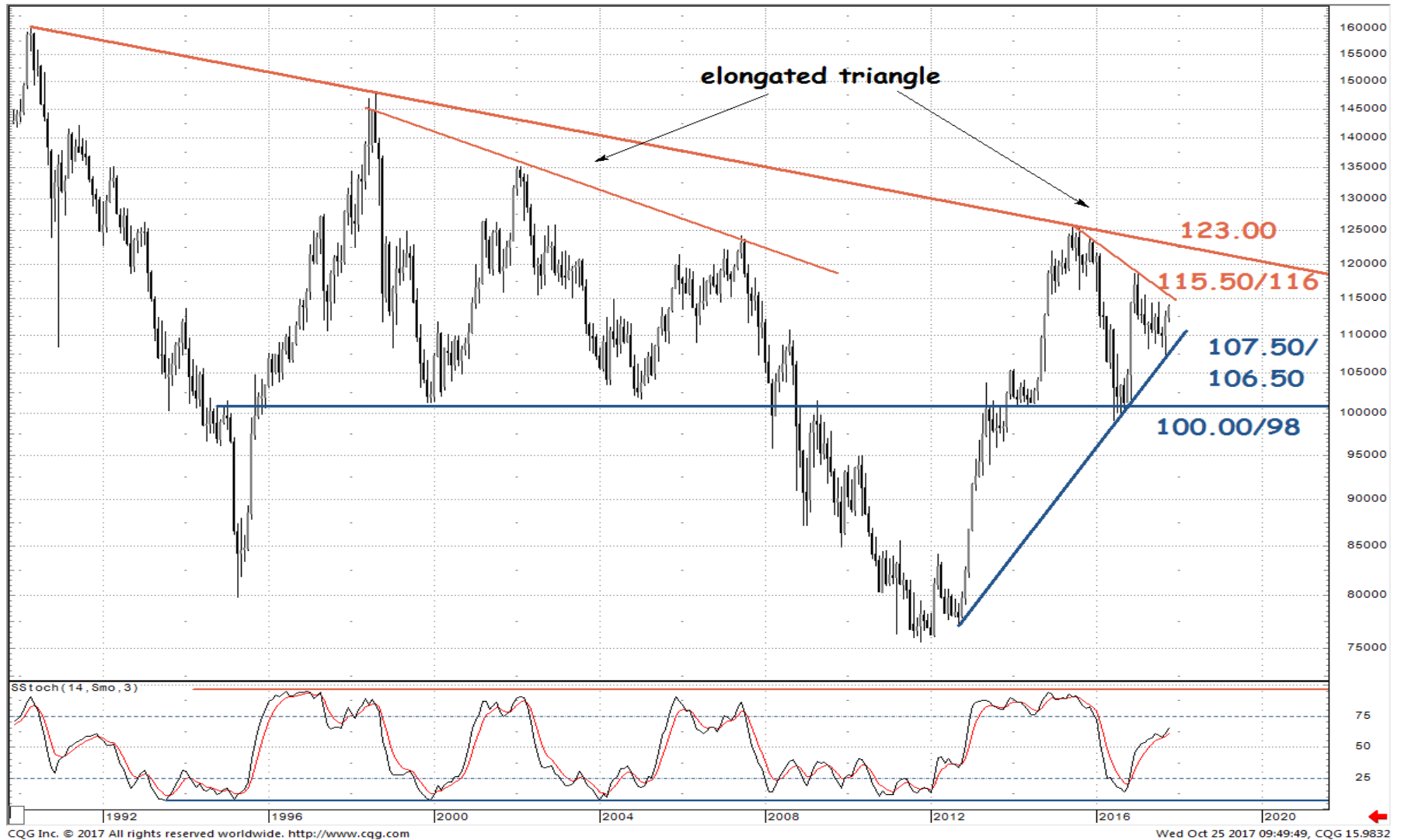
Bank of Japan Month-to-Month Change in Assets



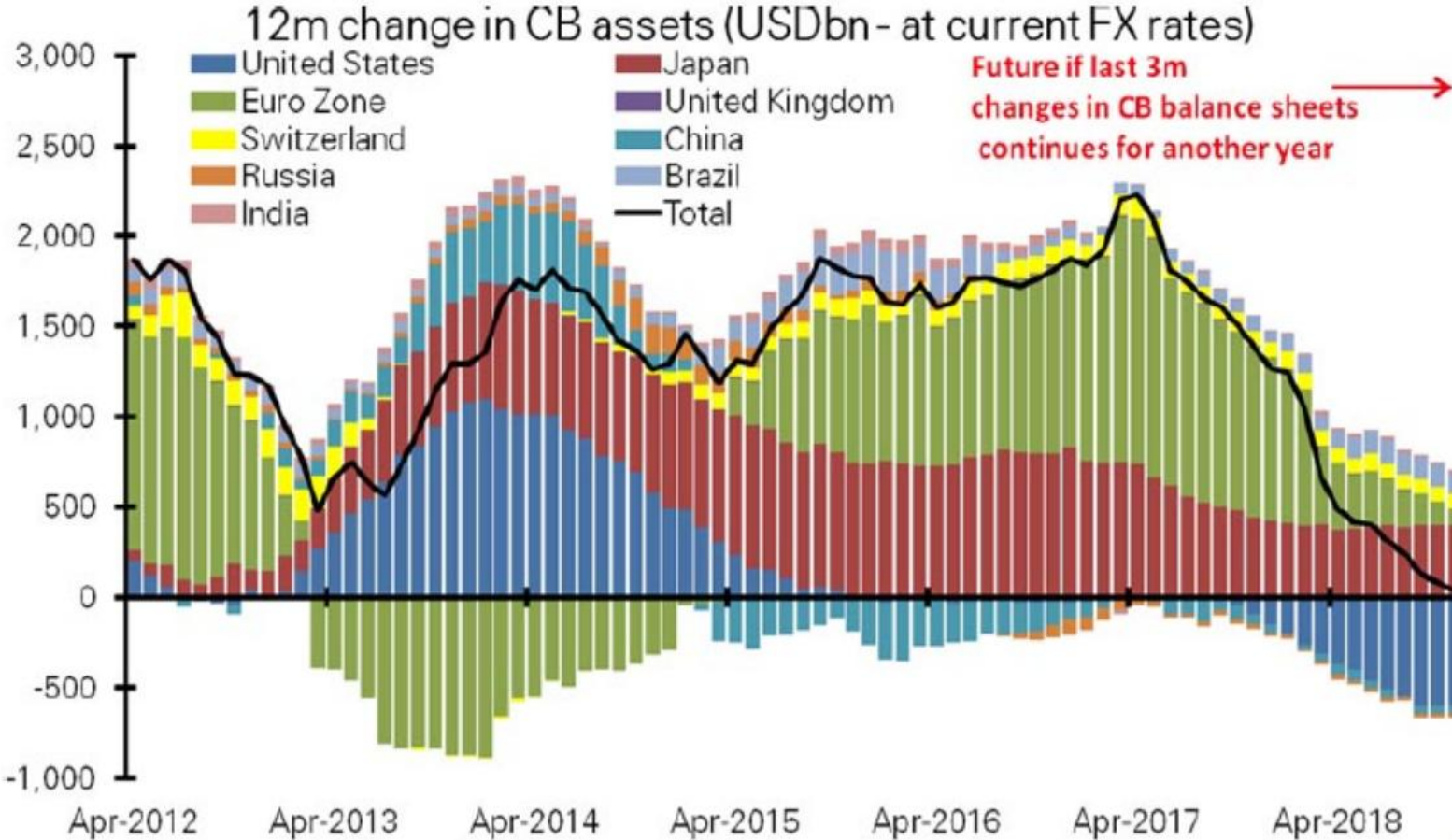
Source: Bank of Japan

WOLFSTREET.com

KEEP A CLOSE EYE ON YEN/US DOLLAR. STRONGER YEN?



CENTRAL BANK QE UNWIND – WHAT IMPACT?



UNWINDING QE IS GOING TO BE SO EASY...APPARENTLY!

“I have absolutely no doubt that when the time comes to reduce the size of the balance-sheet that we’ll find that a whole lot easier than we did when expanding it.”

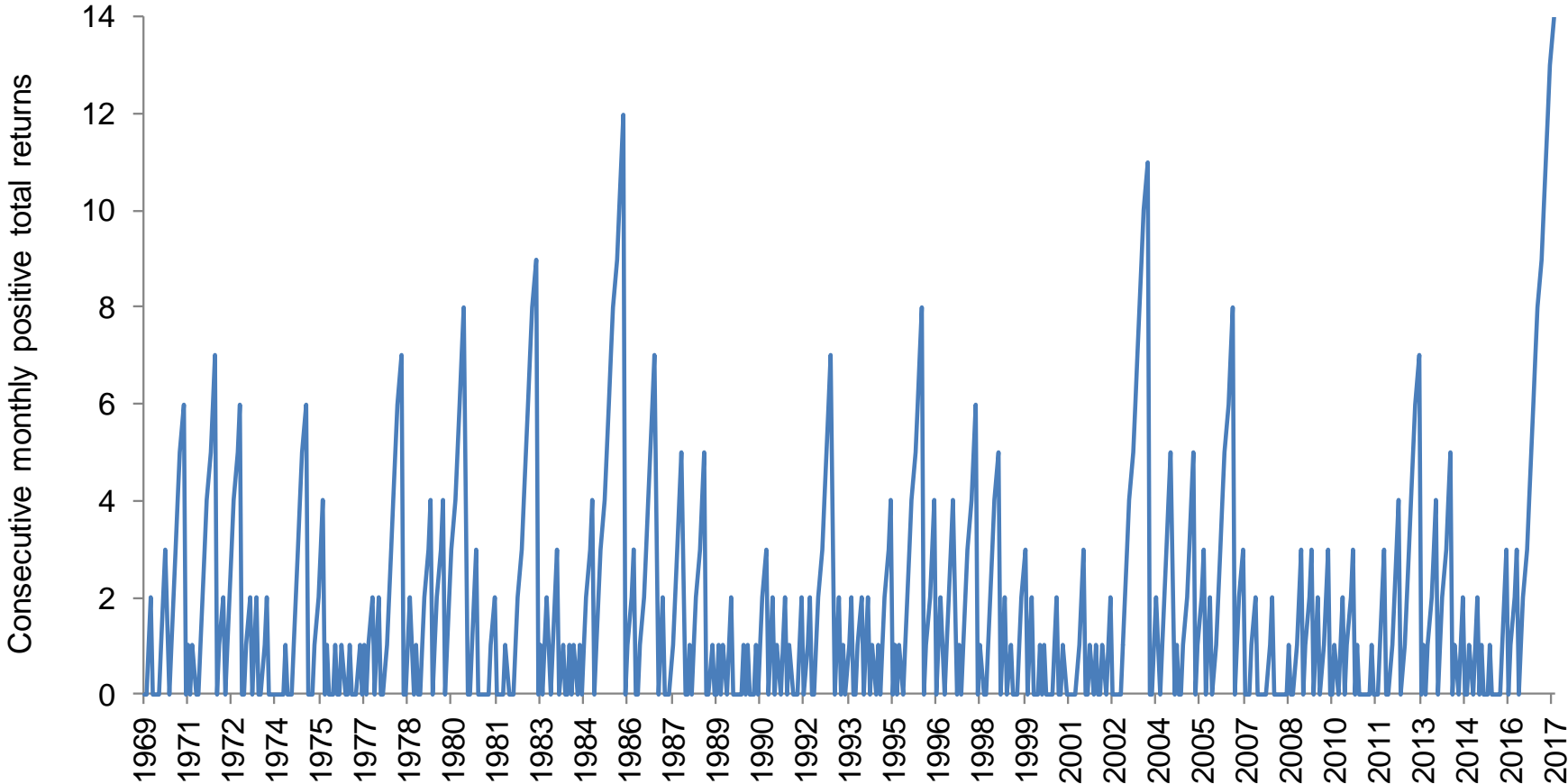
Mervyn King BoE Governor, Feb 2012

EASY MONEY

Andrew Laphorne
GLOBAL QUANTITATIVE STRATEGY

2017: A RECORD BREAKING YEAR FOR MSCI WORLD

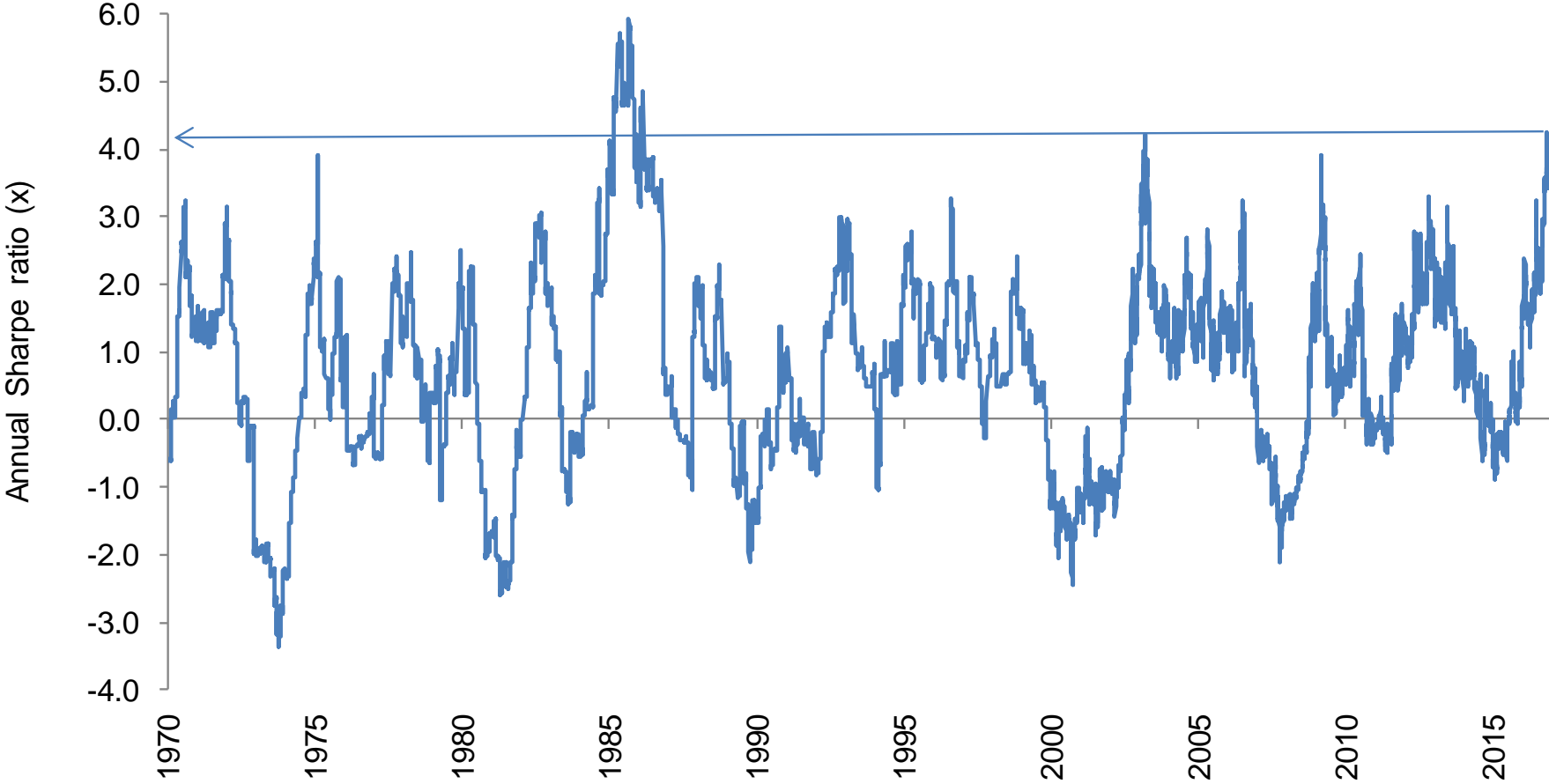
14 months of consecutive total returns for MSCI World



Source: SG Cross Asset Research/Equity Quant, Factset

WHO NEEDS HEDGE FUNDS!

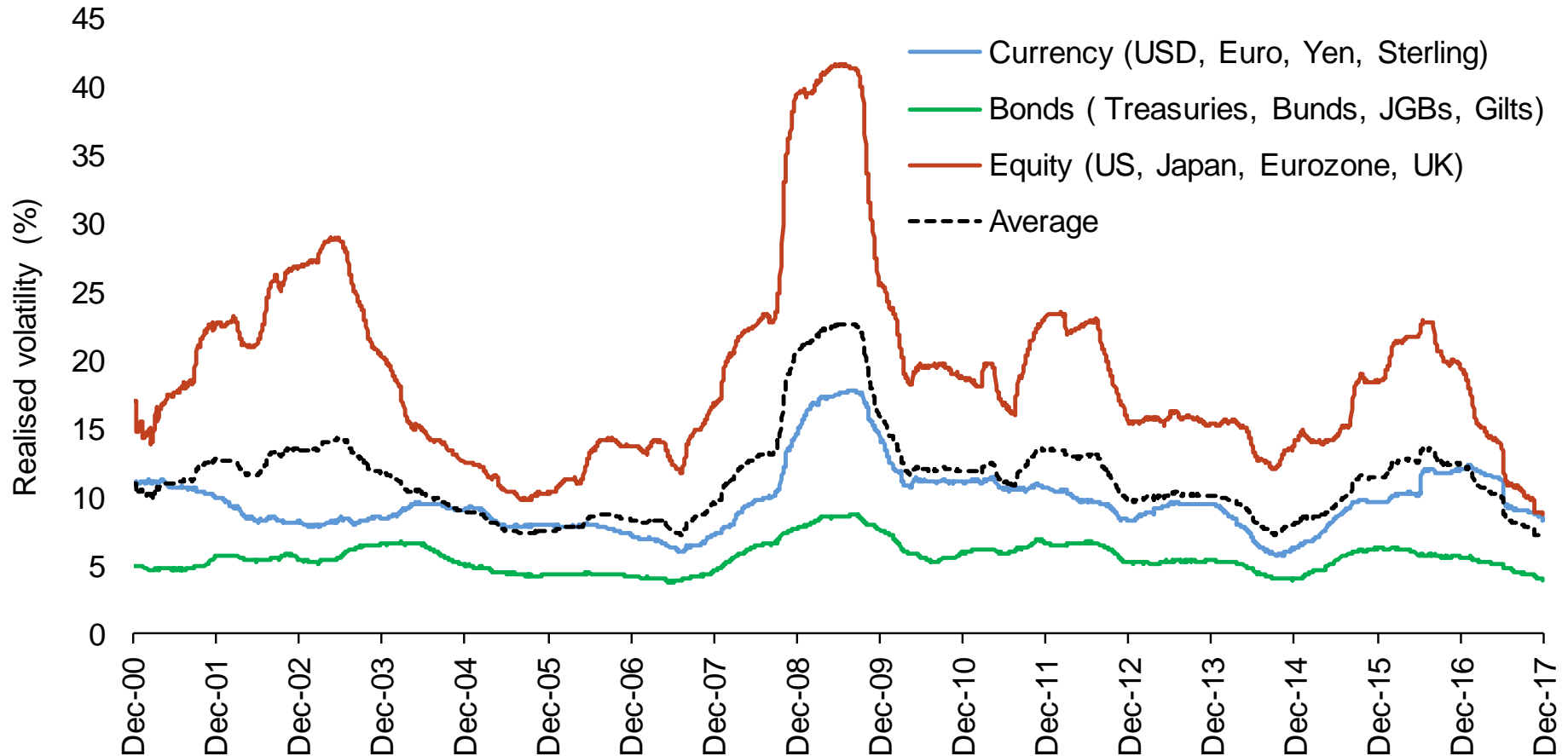
MSCI World delivered a Sharpe Ratio of more than 4.0x!



Source: SG Cross Asset Research/Equity Quant, Factset

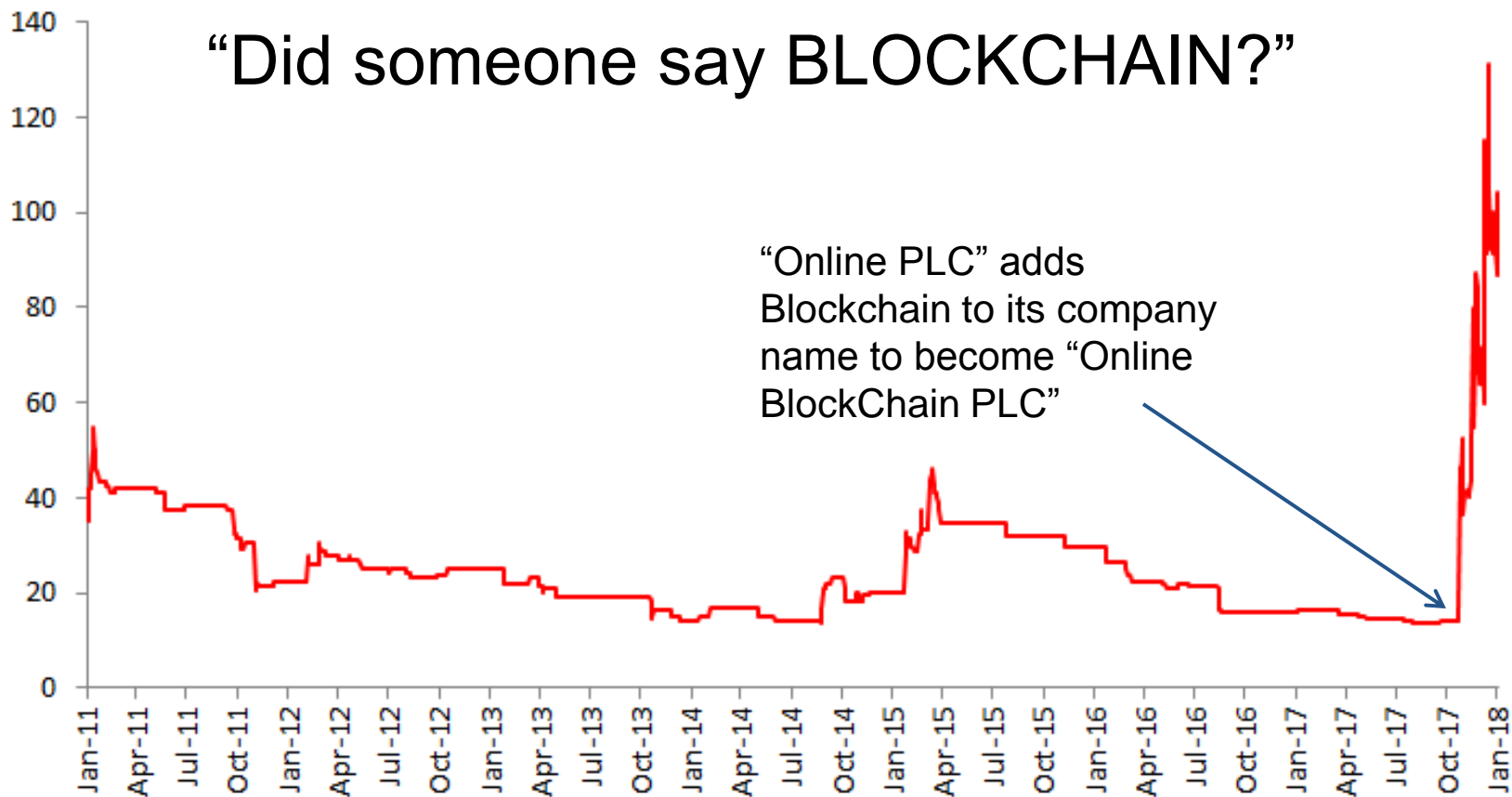
VOLATILITY FELL, PARTICULARLY IN EQUITY

Realised Equity, Bond and FX annualised realised volatility



Source: SG Cross Asset Research/Equity Quant, Factset

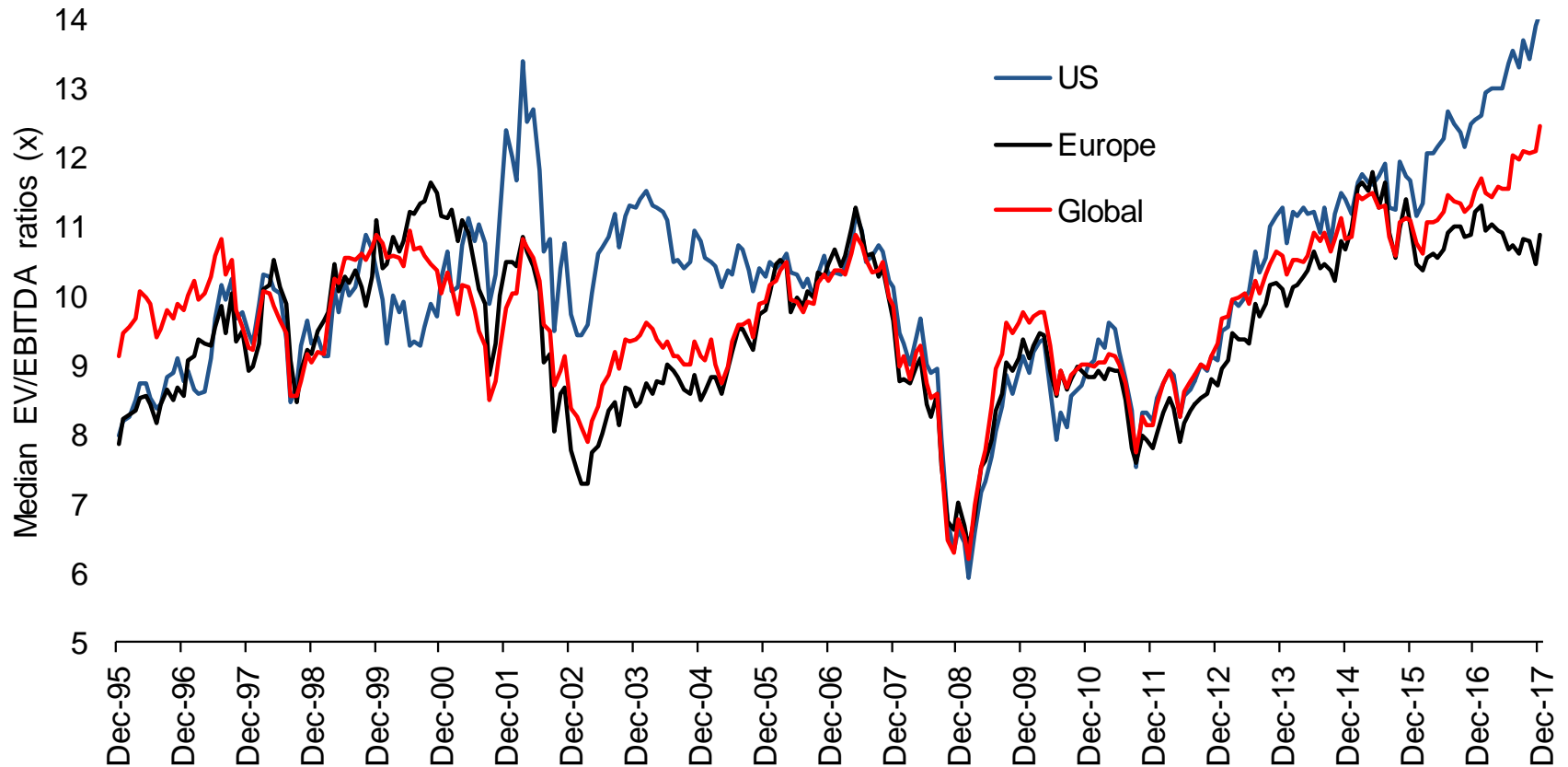
NATURAL LANGUAGE PROCESSING BECAME POPULAR



Source: SG Cross Asset Research/Equity Quant, Factset

PEAK EQUITY VALUATIONS

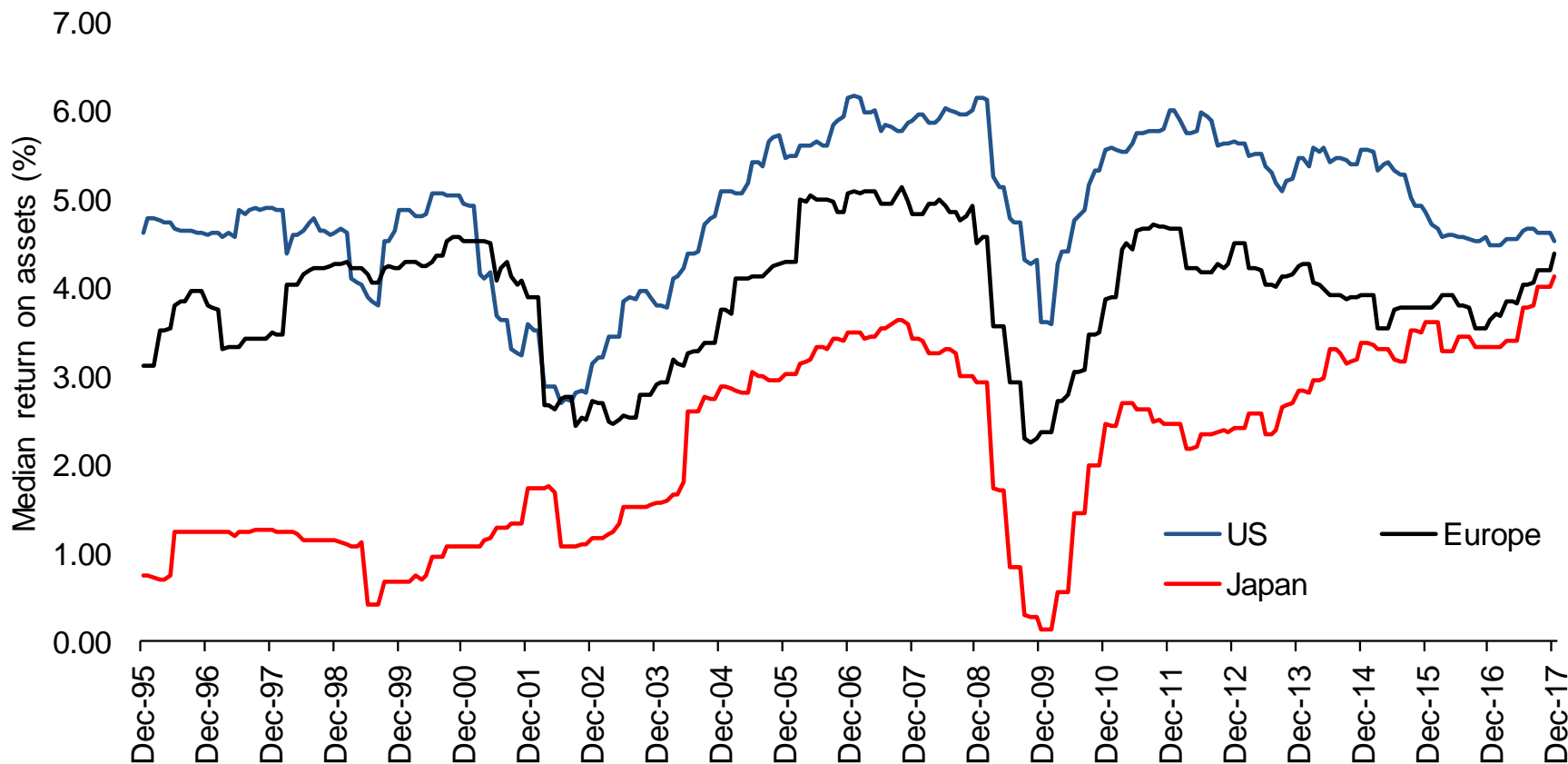
Median EV/EBITDA ratios Globally, US and Europe



Source: SG Cross Asset Research/Equity Quant, Factset, MSCI

REGIONAL RETURN ON ASSETS ARE CONVERGING

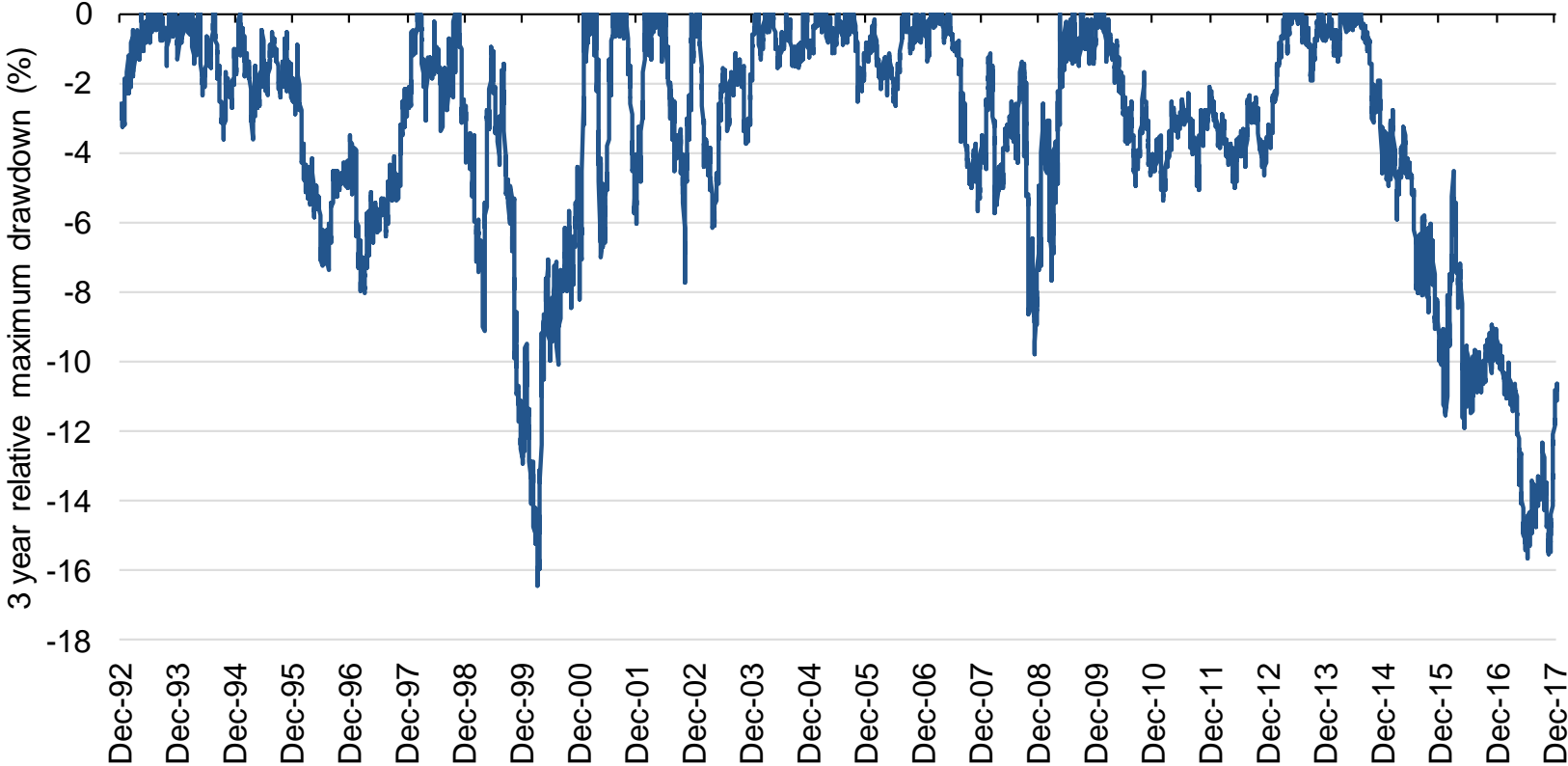
Median company return on assets by region (%)



Source: SG Cross Asset Research/Equity Quant, Factset

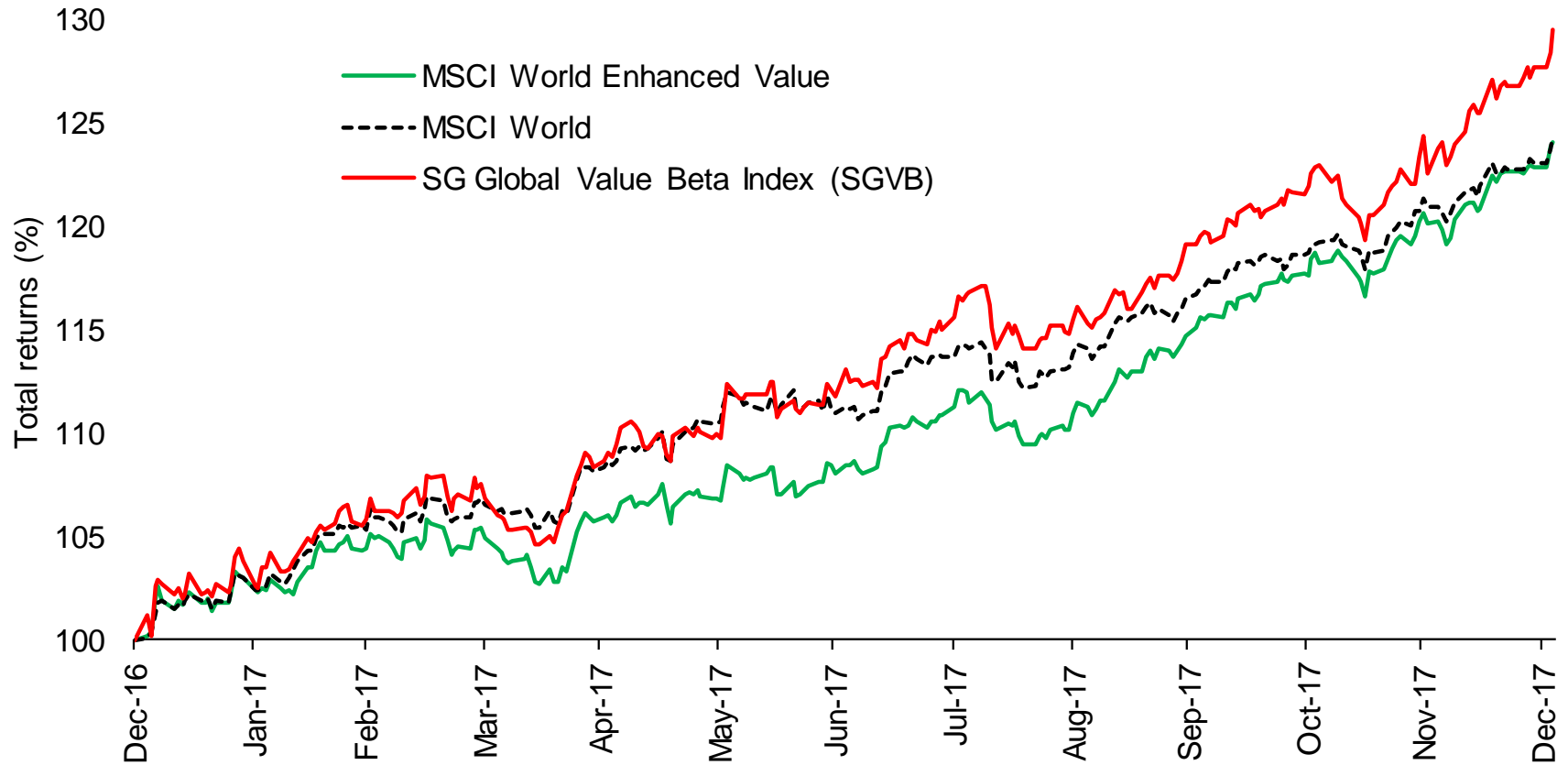
PEAK PAIN FOR US VALUE INVESTORS

Sector relative FCF yield - 3 year maximum drawdown versus Benchmark



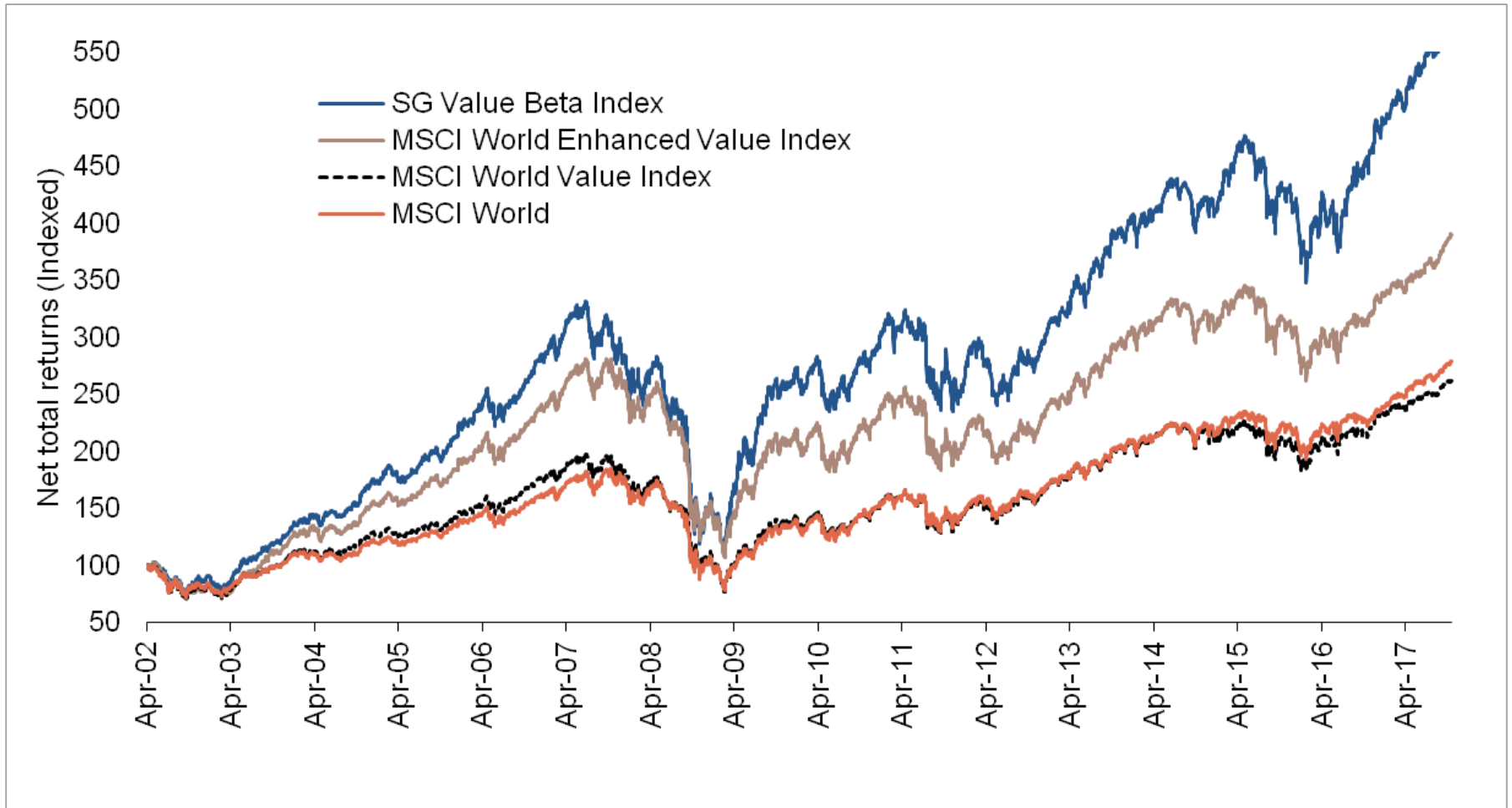
Source: SG Cross Asset Research/Equity Quant, FactSet, IBES

GLOBALLY, OUR (SGVB) VALUE INDEX HAD A PRETTY GOOD YEAR



Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet .

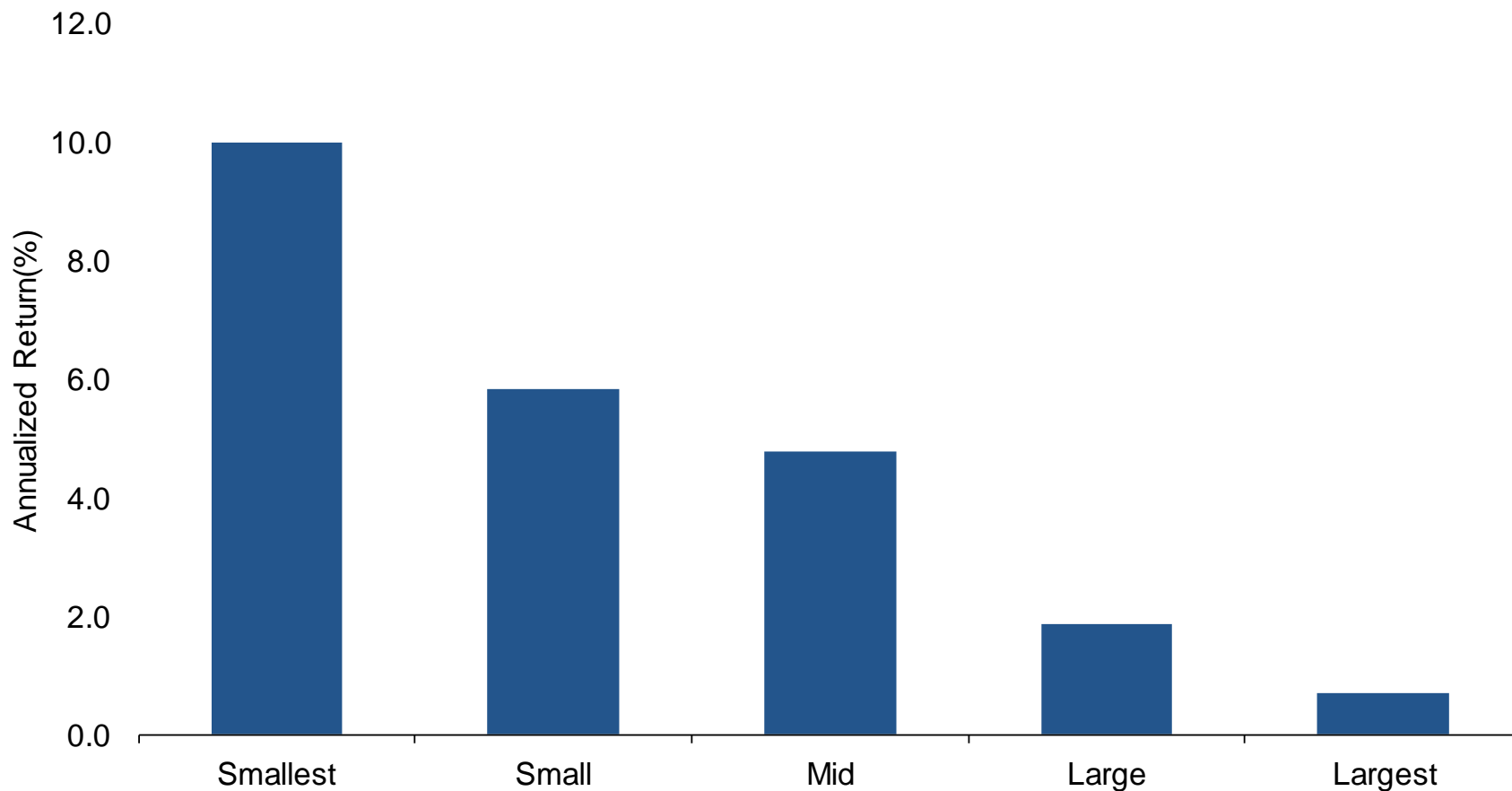
AND IN THE LONG RUN



Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet .

VALUE DOESN'T WORK AMONGST THE LARGEST CAP

VALUE PERFORMANCE PER SIZE SEGMENT (DM, LONG/SHORT, 1990-2017)



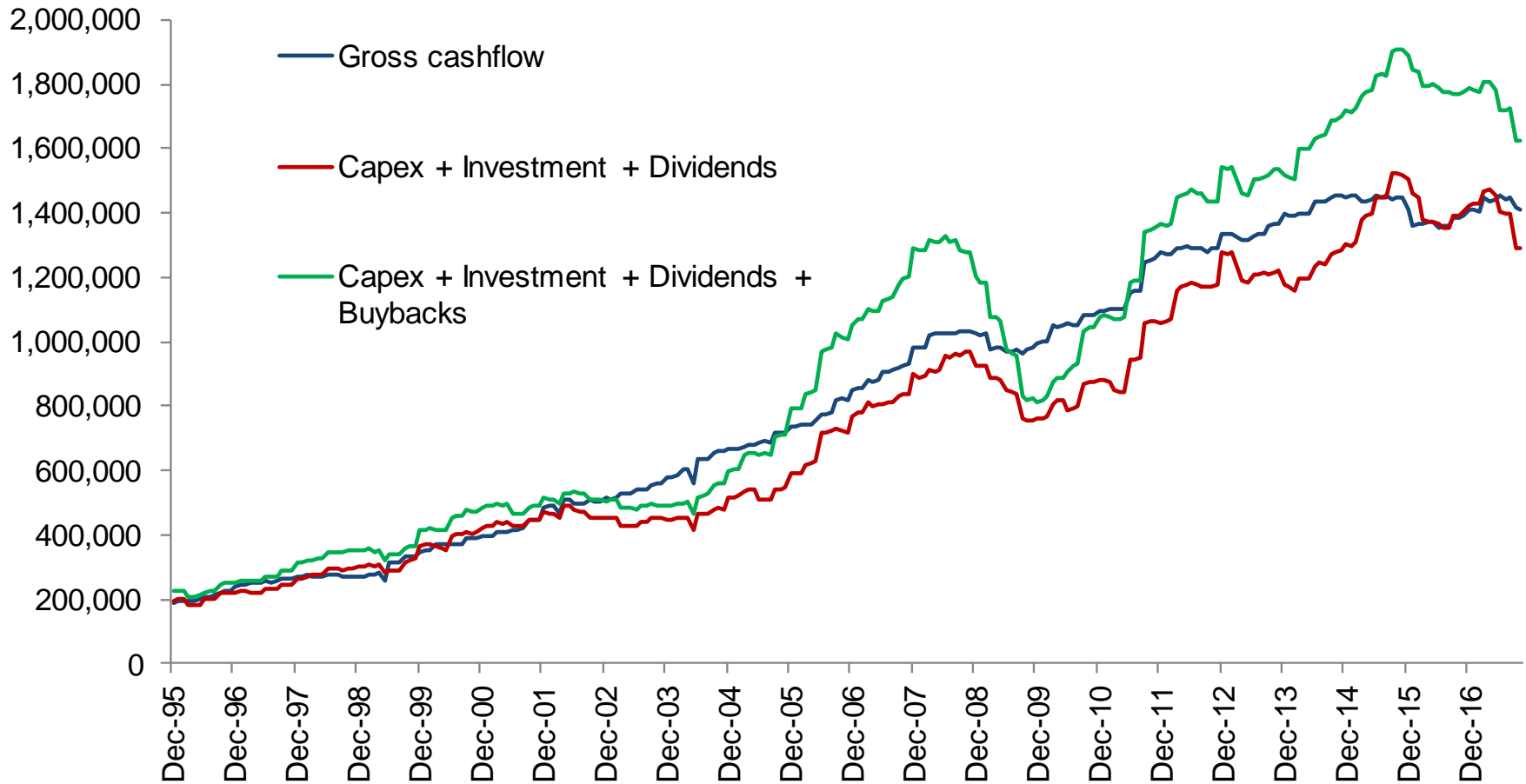
Source: SG Cross Asset Research/Equity Quant, FactSet, IBES

JAPAN AND FINANCIALS DOMINATE THE CHEAP UNIVERSE

	Basic Materials	Industrials	Consumer Services	Oil & Gas	Financials	Consumer Goods	Utilities	Technology	Health Care	Telecoms
Asia/Pacific Ex Japan	1.0	1.5	1.5	0.5	6.0	0.5	0.0	0.0	0.0	0.0
Europe	0.0	1.5	2.5	1.0	13.0	3.5	1.0	0.5	0.0	0.0
Japan	8.0	10.5	0.5	0.0	15.0	7.5	2.0	2.0	2.5	0.5
North America	0.0	1.5	4.0	1.0	4.0	1.5	0.0	2.0	3.0	0.5

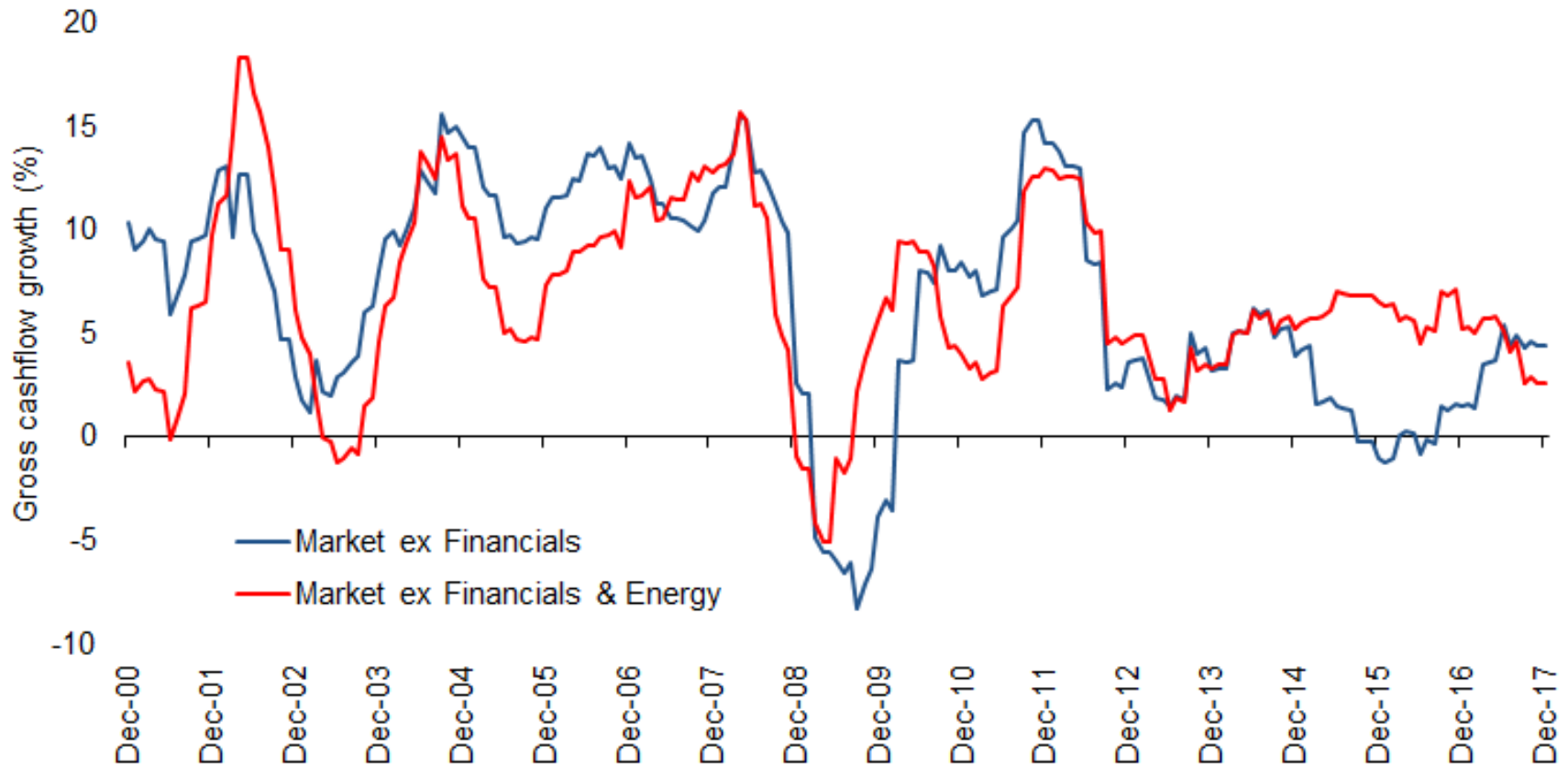
Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet .

US CORPORATES ARE STILL OUTSPENDING CASH FLOW...



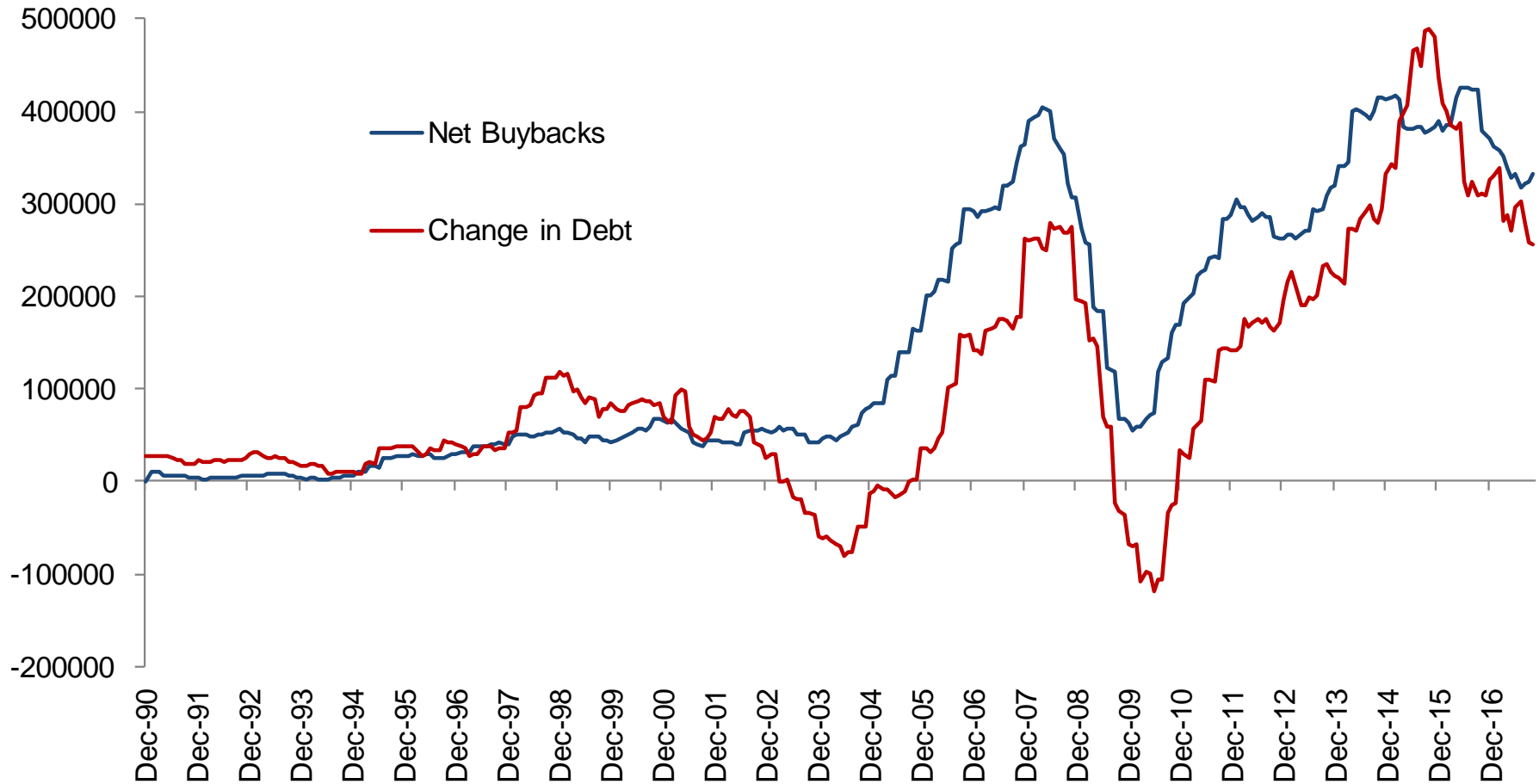
Source: SG Cross Asset Research/Equity Quant, Factset

US CASH FLOW GROWTH IS NOT AS STRONG AS YOU THINK



Source: SG Cross Asset Research/Equity Quant, Factset

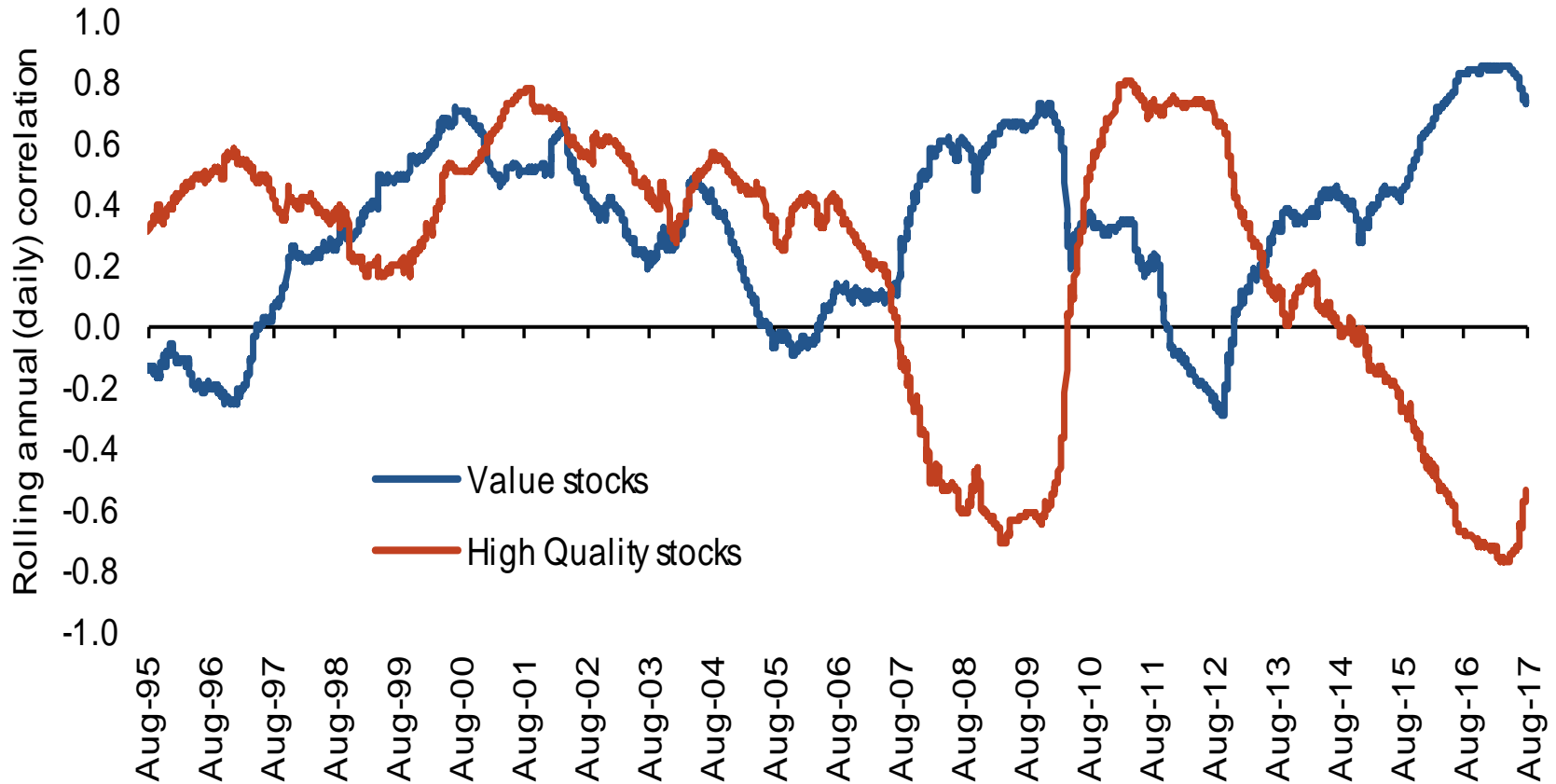
BUYBACKS ARE FINALLY DECLINING



Source: SG Cross Asset Research/Equity Quant, Factset

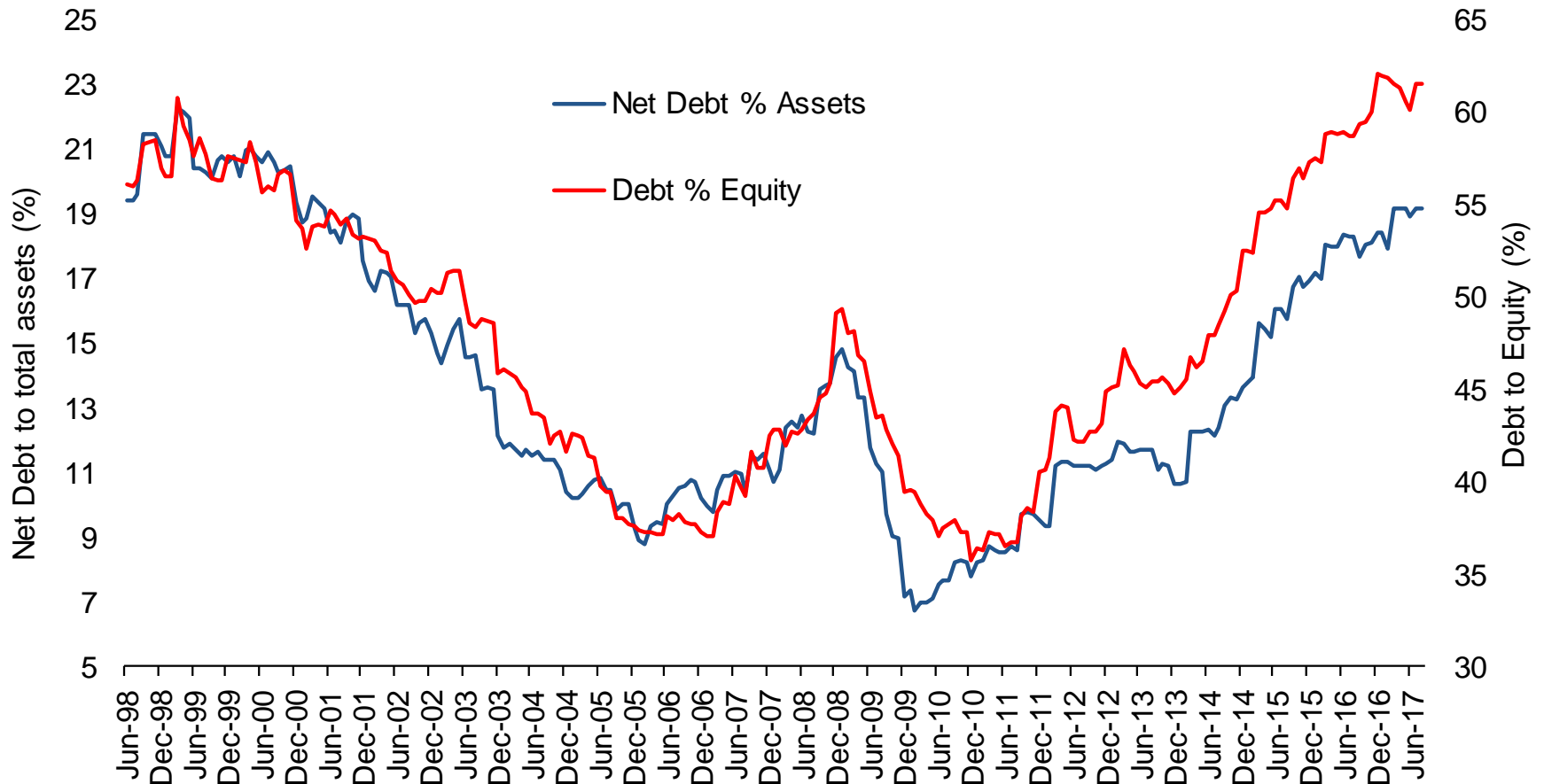
BUYBACKS ARE A SIGN OF WEAKNESS NOT STRENGTH

Correlation between stocks with the highest buyback yields versus Value and Quality stocks



Source: SG Cross Asset Research/Equity Quant, Factset

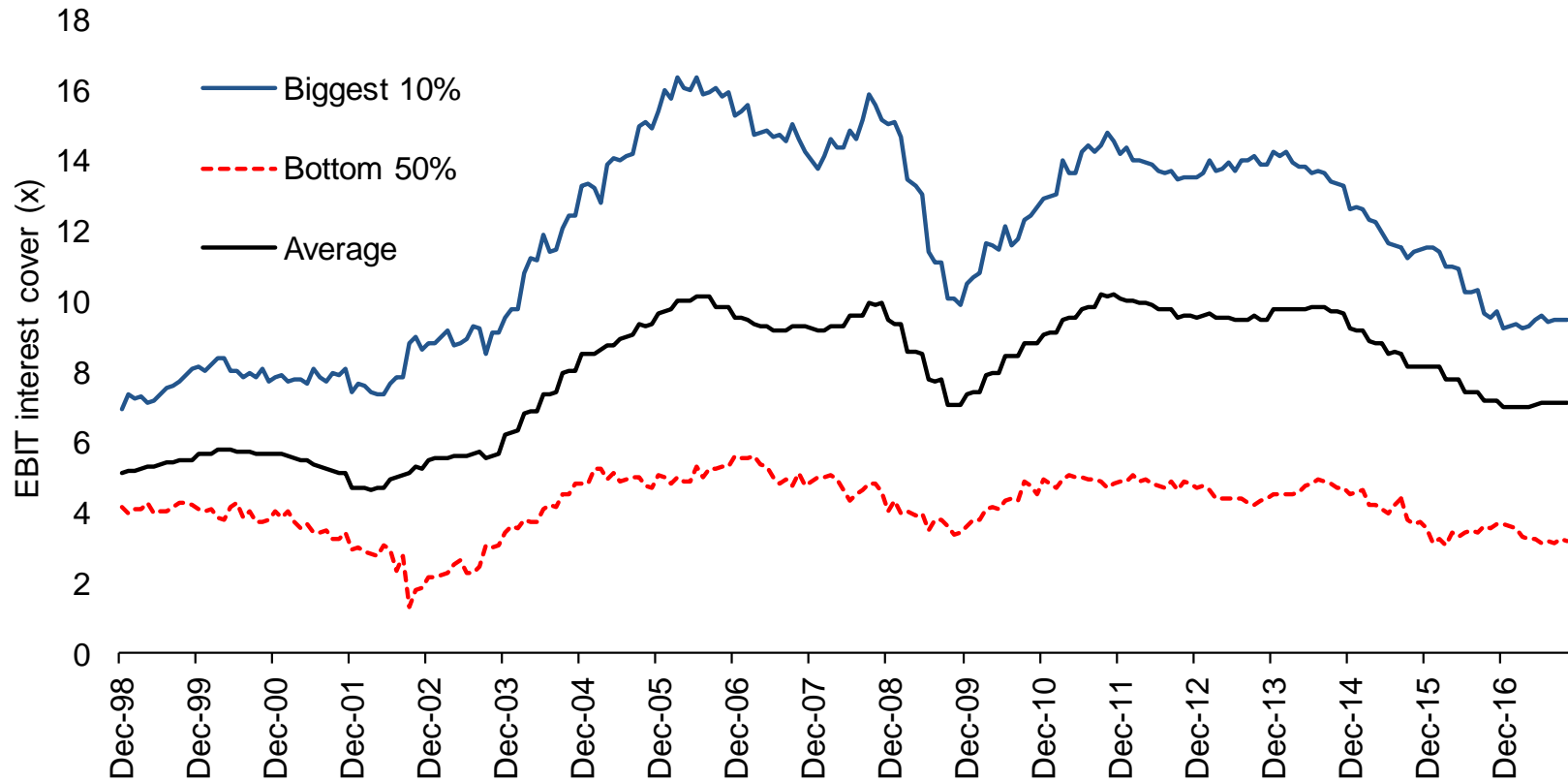
MEDIAN S&P 1500 EX FINANCIALS LEVERAGE RATIOS



Source: SG Cross Asset Research/Equity Quant, Factset

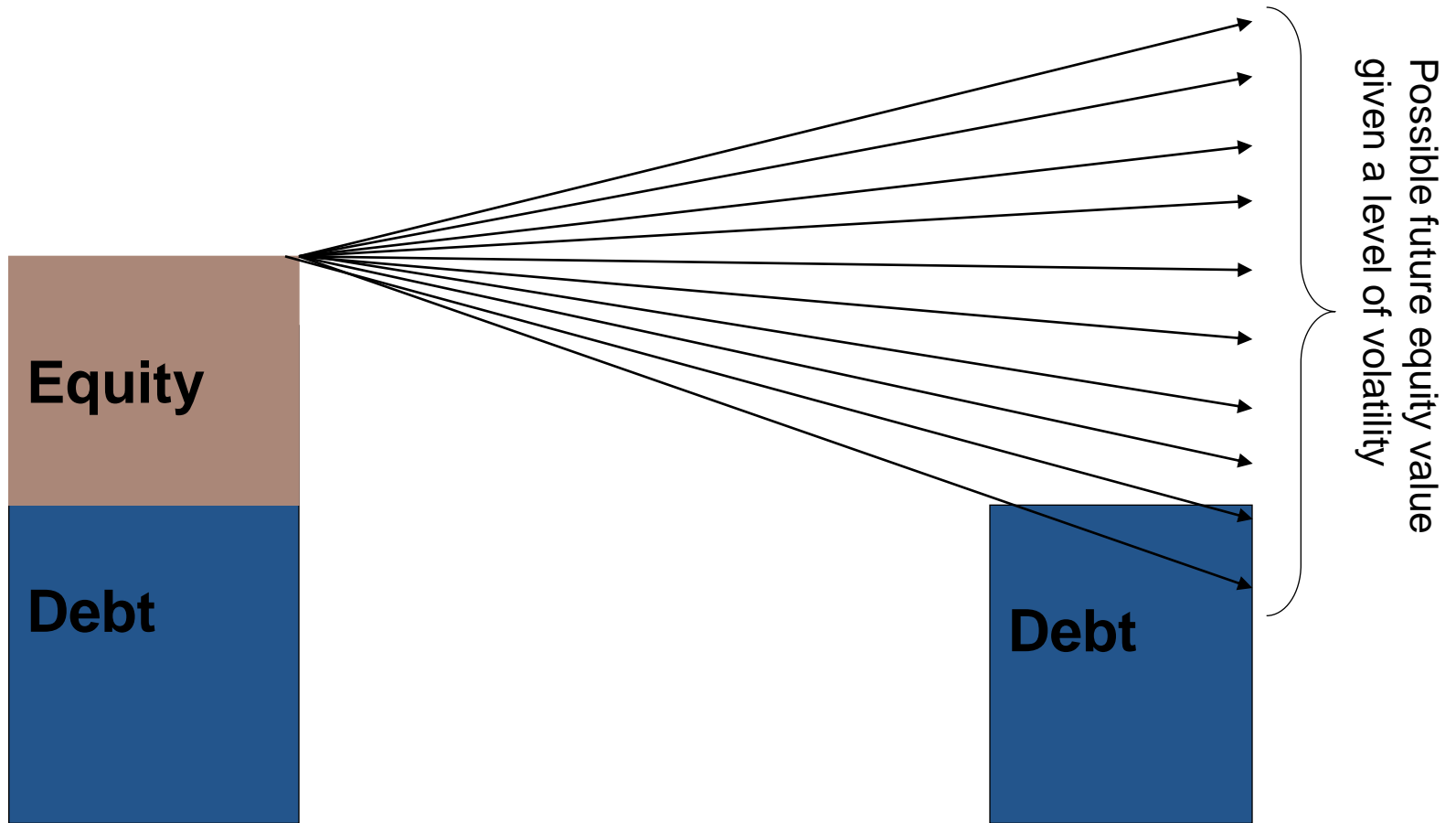
NO WONDER THE IMF IS FINALLY CONCERNED ABOUT LEVERAGE!

Interest cover by size segment



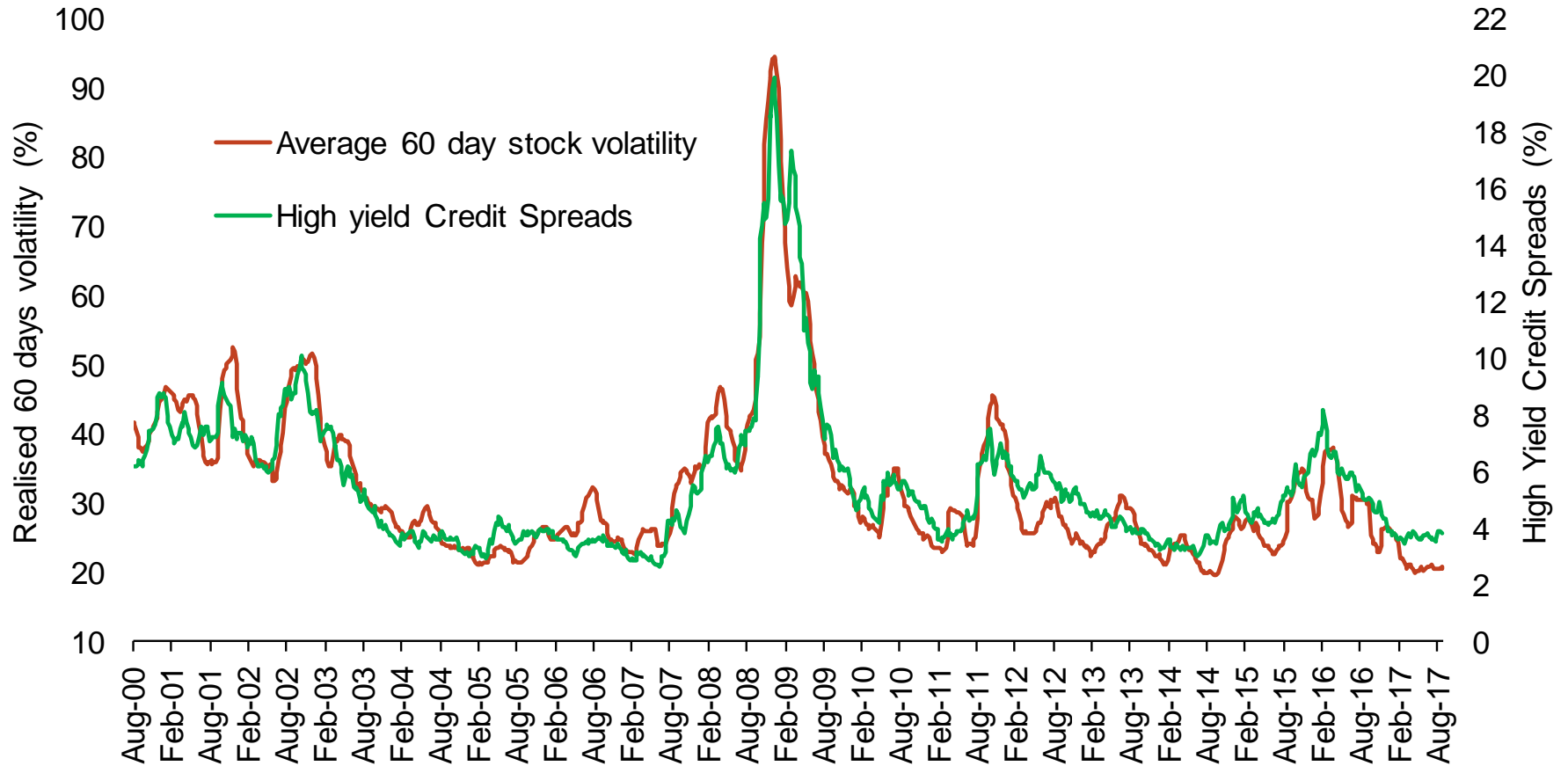
Source: SG Cross Asset Research/Equity Quant, Factset

MERTON DISTANCE TO DEFAULT – A MARK TO MARKET CREDIT MODEL



Source: SG Quantitative Research

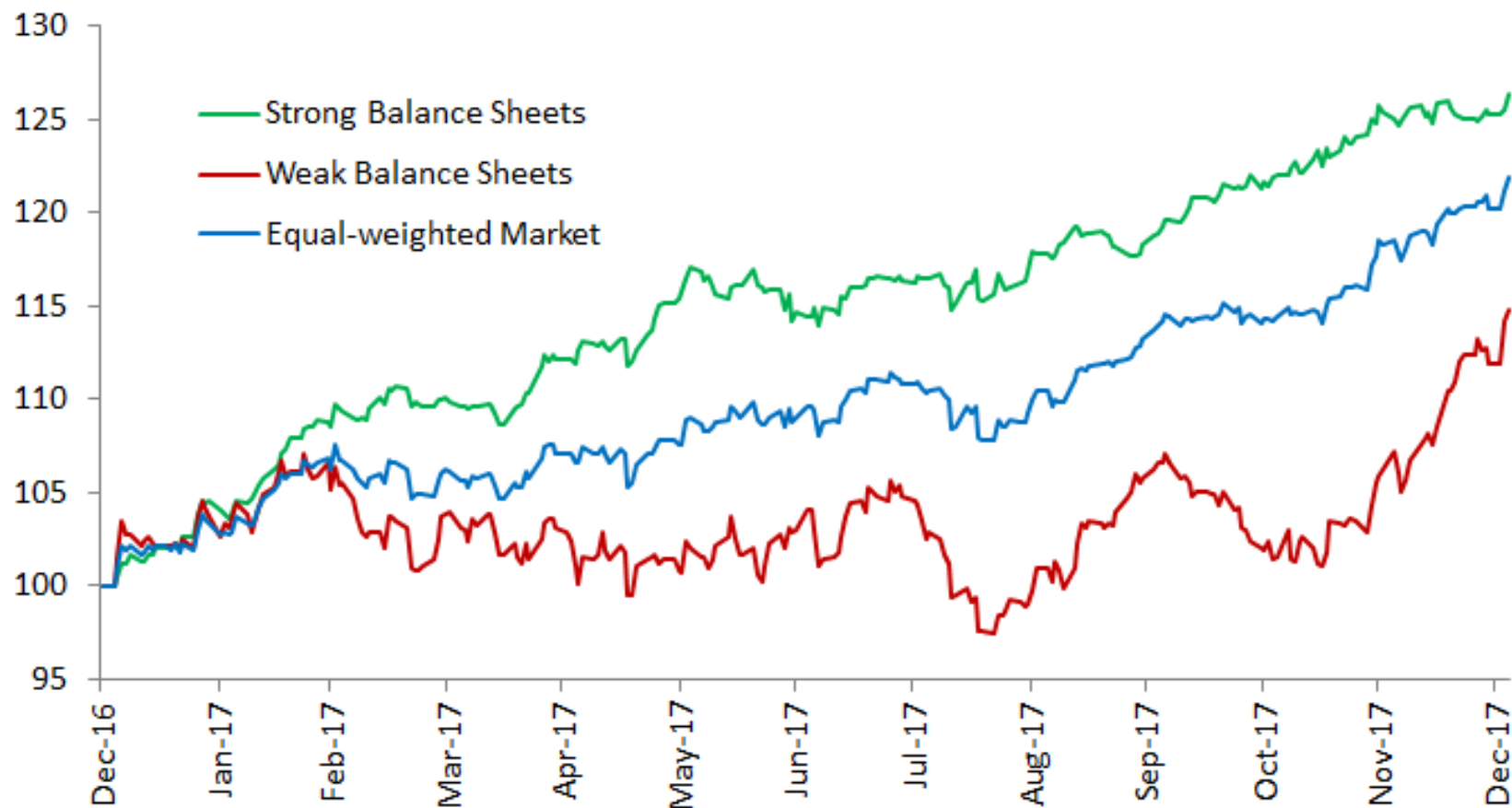
CREDIT RISK AND EQUITY VOLATILITY IS THE SAME THING



Source: SG Cross Asset Research/Equity Quant, Factset

BALANCE SHEETS WERE A KEY PERFORMANCE DRIVER LAST YEAR

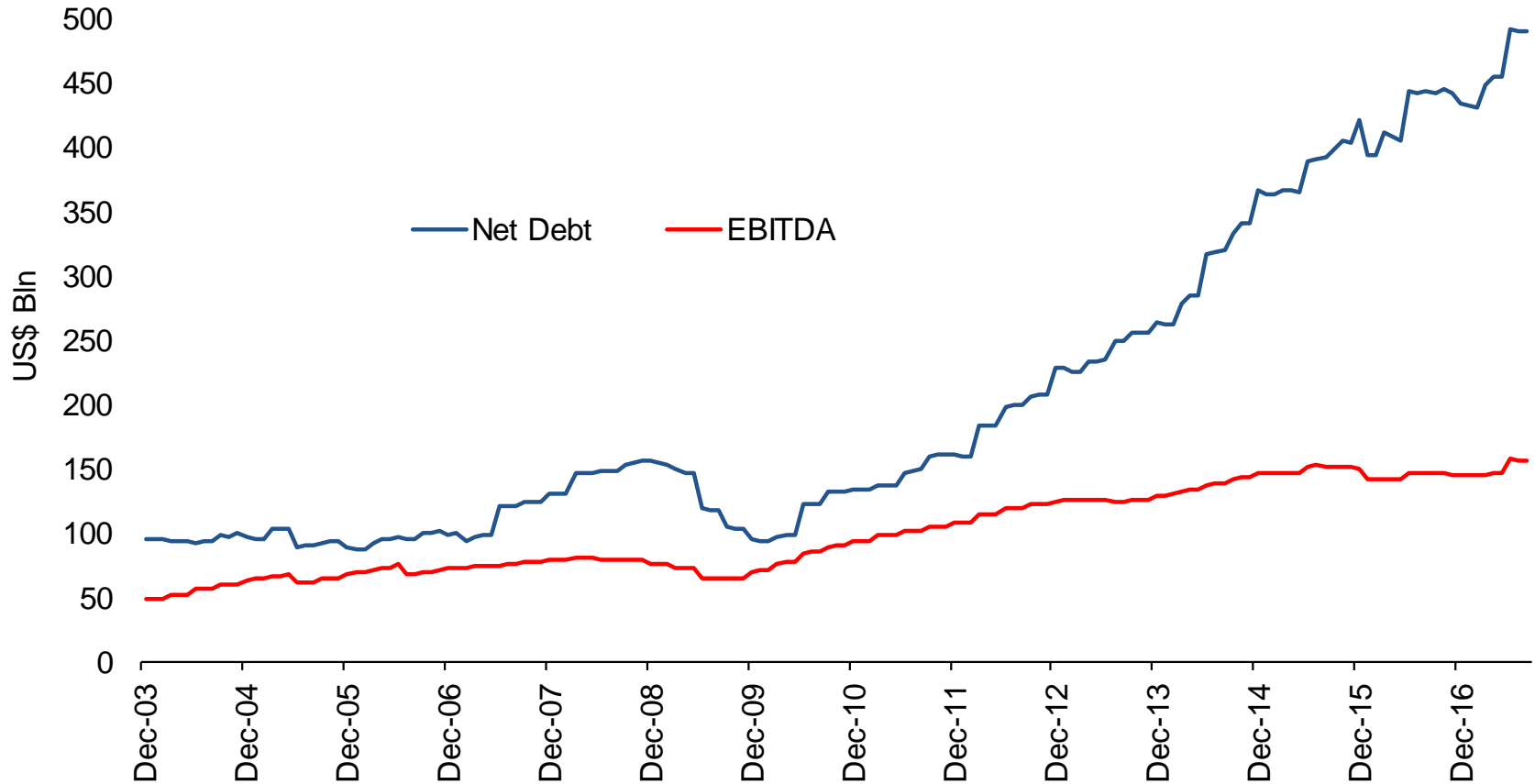
Top vs Bottom 20% US stocks based on Merton Distance to Default



Source: SG Cross Asset Research/Equity Quant, Factset

THERE IS A GOOD REASON WHY MANY ARE SHORT RUSSELL 2000!

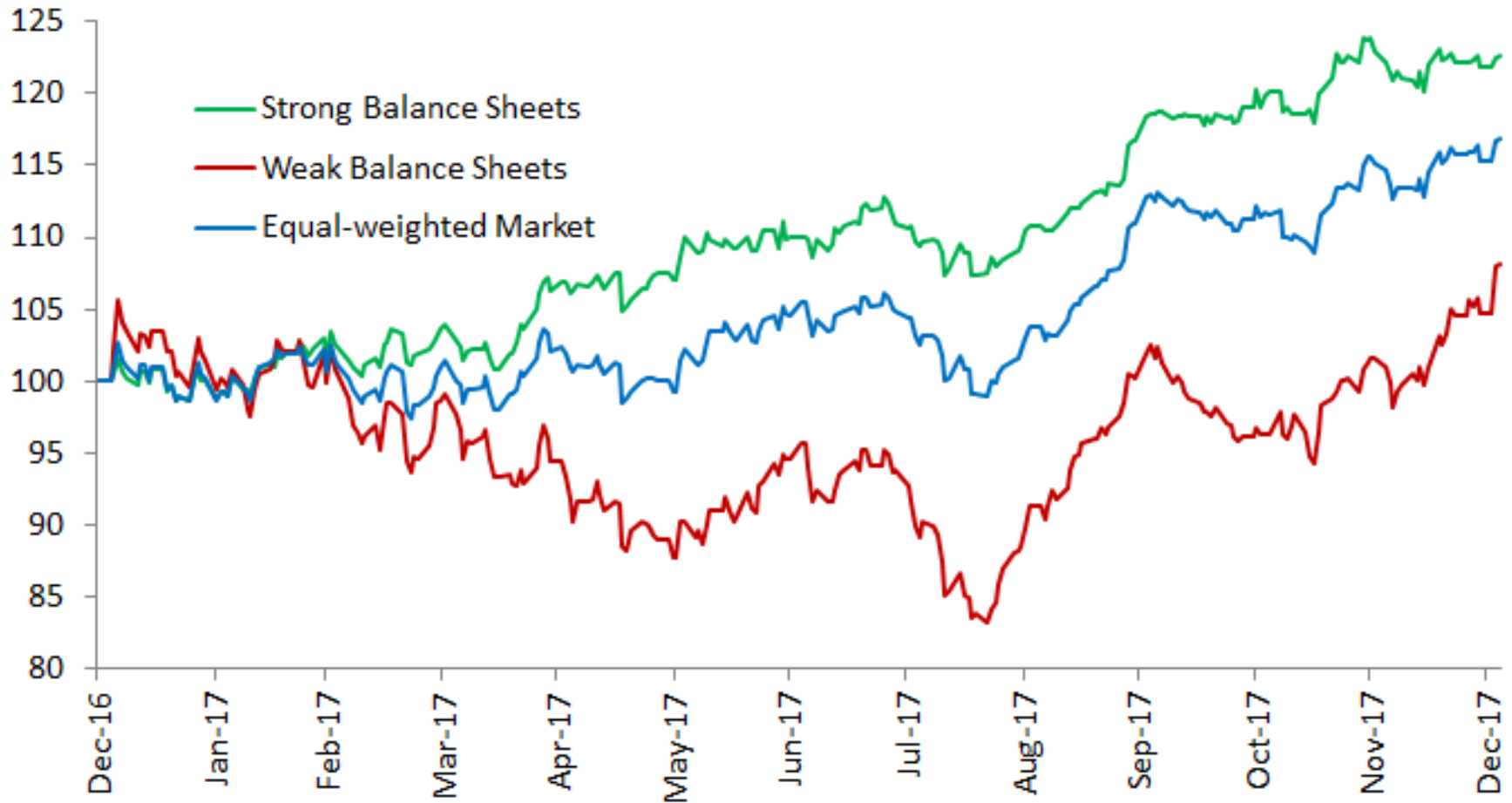
Net Debt versus EBITDA for the Russell 2000



Source: SG Cross Asset Research/Equity Quant, Factset

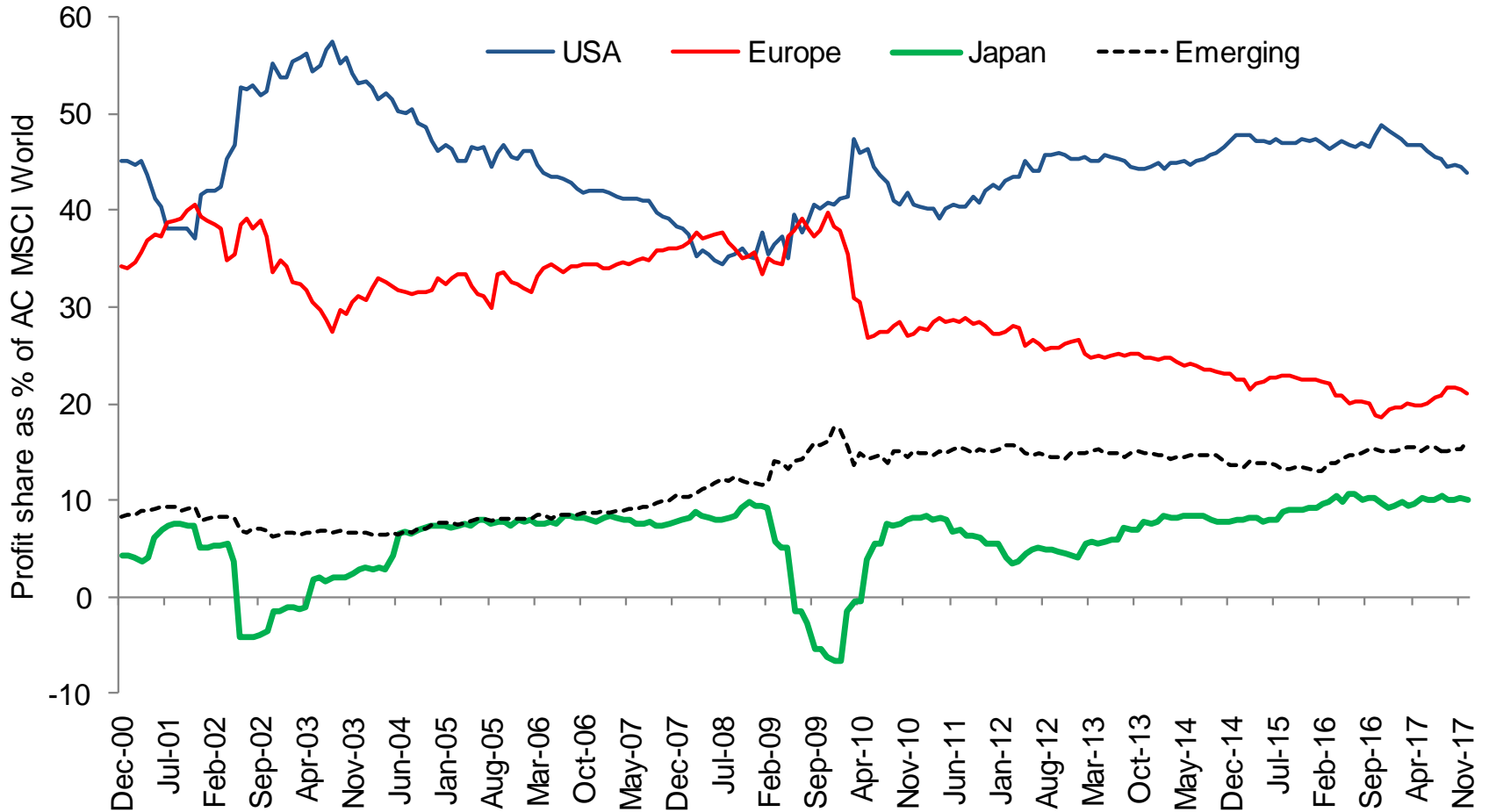
WE'RE WATCHING THE RED LINE CLOSELY!

Balance sheet performance in the Russell 2000



Source: SG Cross Asset Research/Equity Quant, Factset

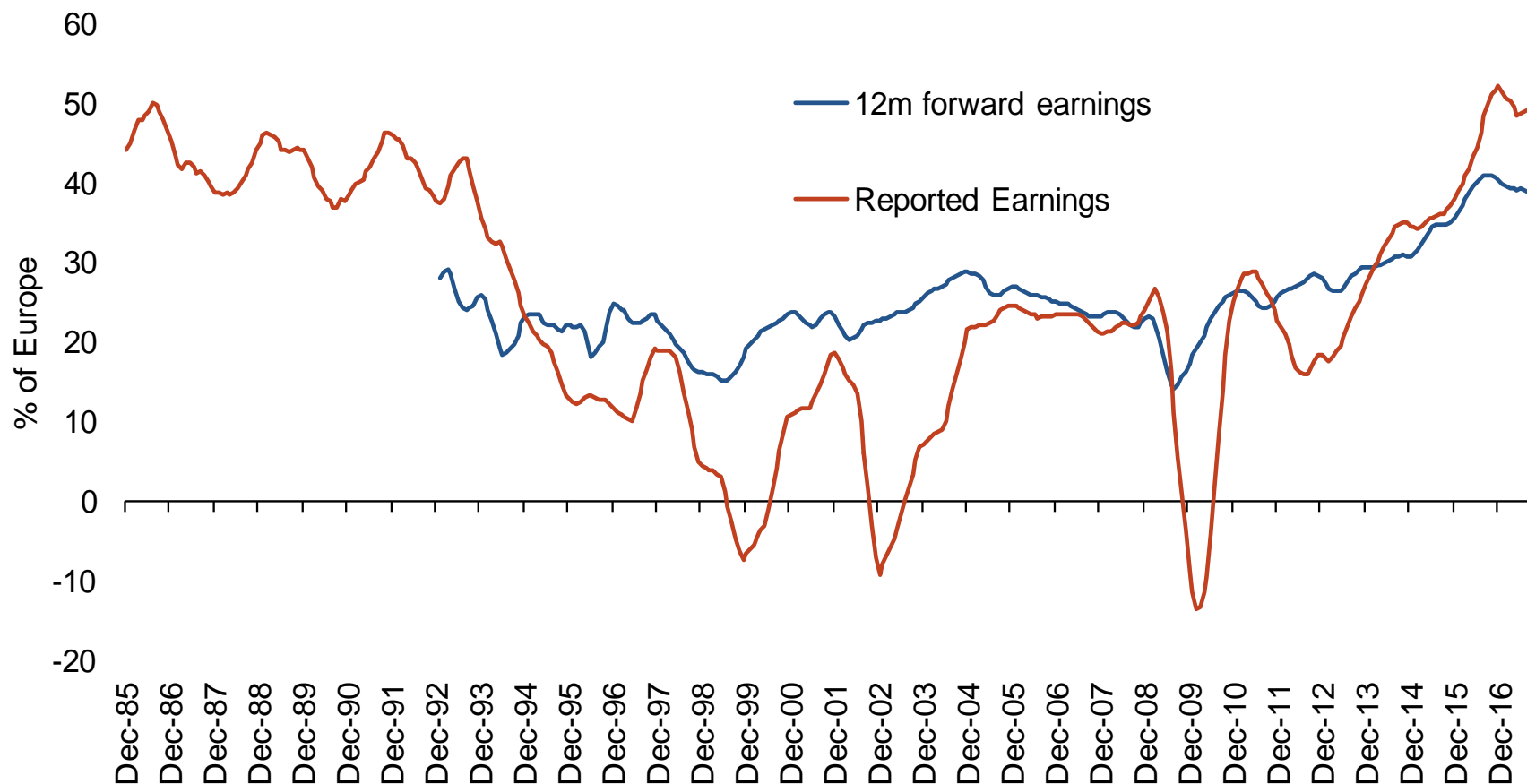
THE EUROPEAN QUOTED SECTOR IS LOSING GLOBAL RELEVANCE



Source: SG Cross Asset Research/Equity Quant, FactSet, IBES

JAPAN NOW GENERATES THE EQUIVALENT OF 50% OF EUROPEAN PROFITS

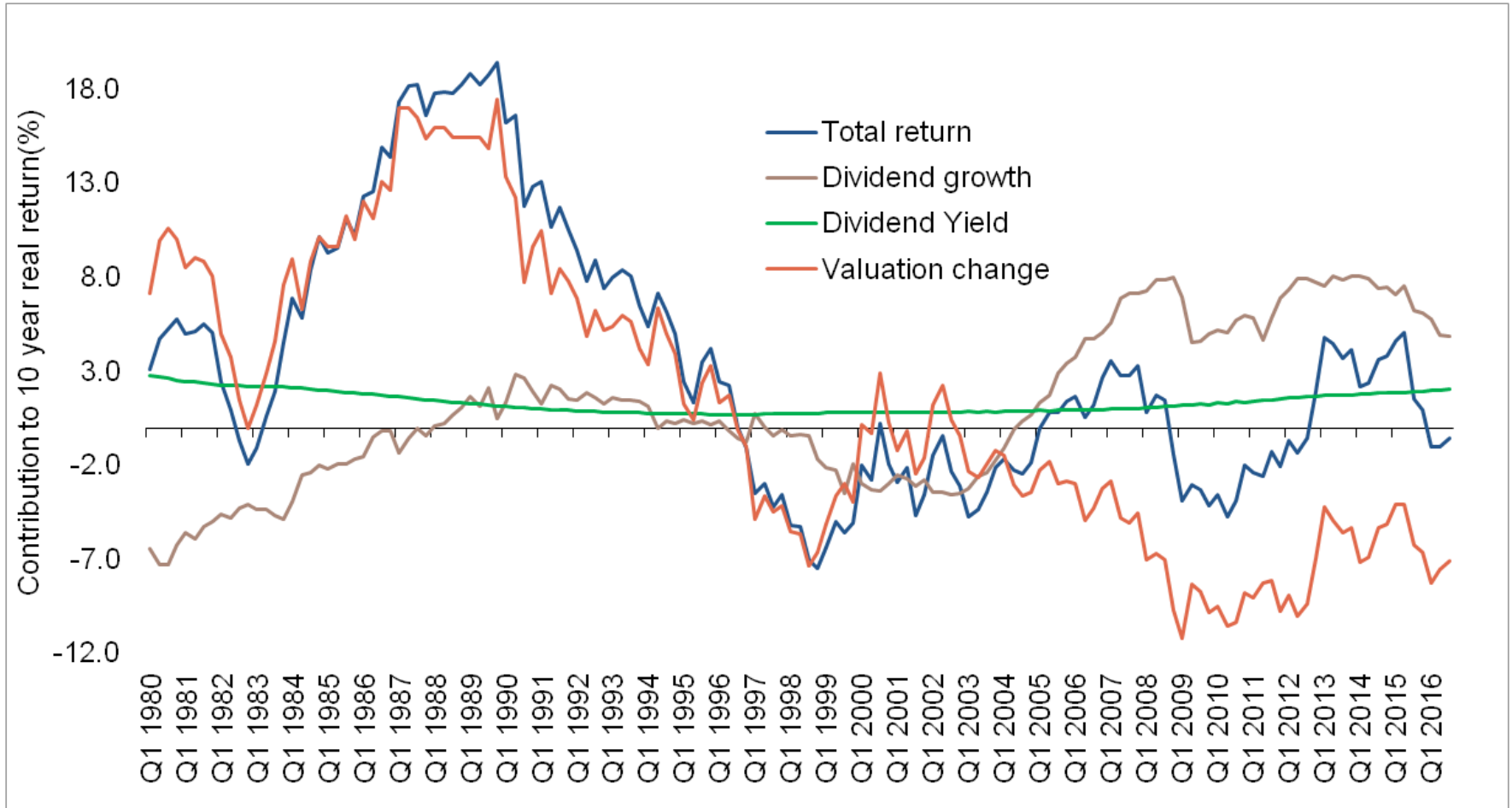
(MSCI Japan total 12m forward and reported earnings as % of MSCI Europe in USD)



Source: SG Cross Asset Research/Equity Quant, FactSet, IBES

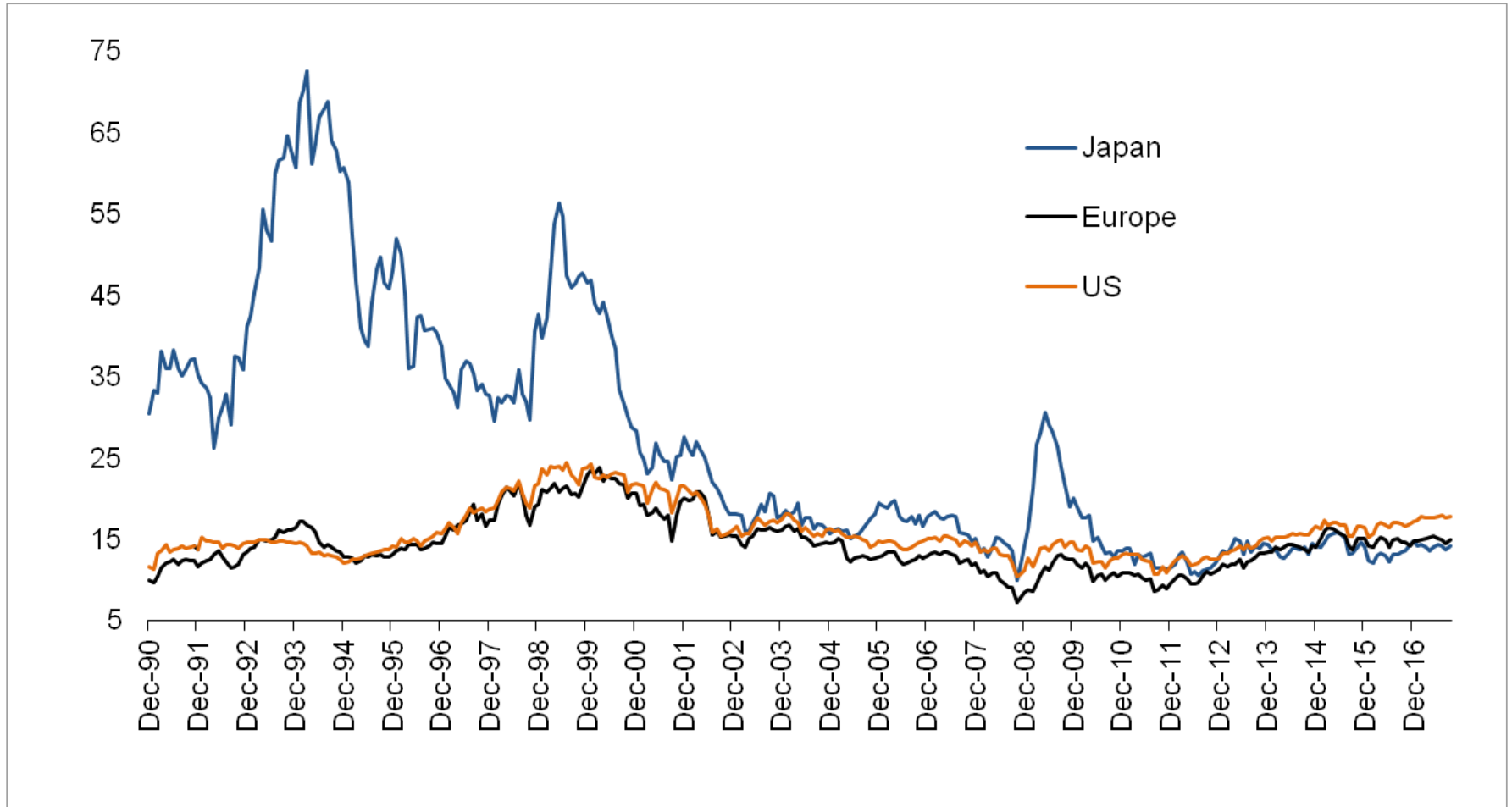
Japan – seriously!

FUNDAMENTALLY JAPAN HAS BEEN OKAY – VALUATION WAS THE ISSUE



Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet .

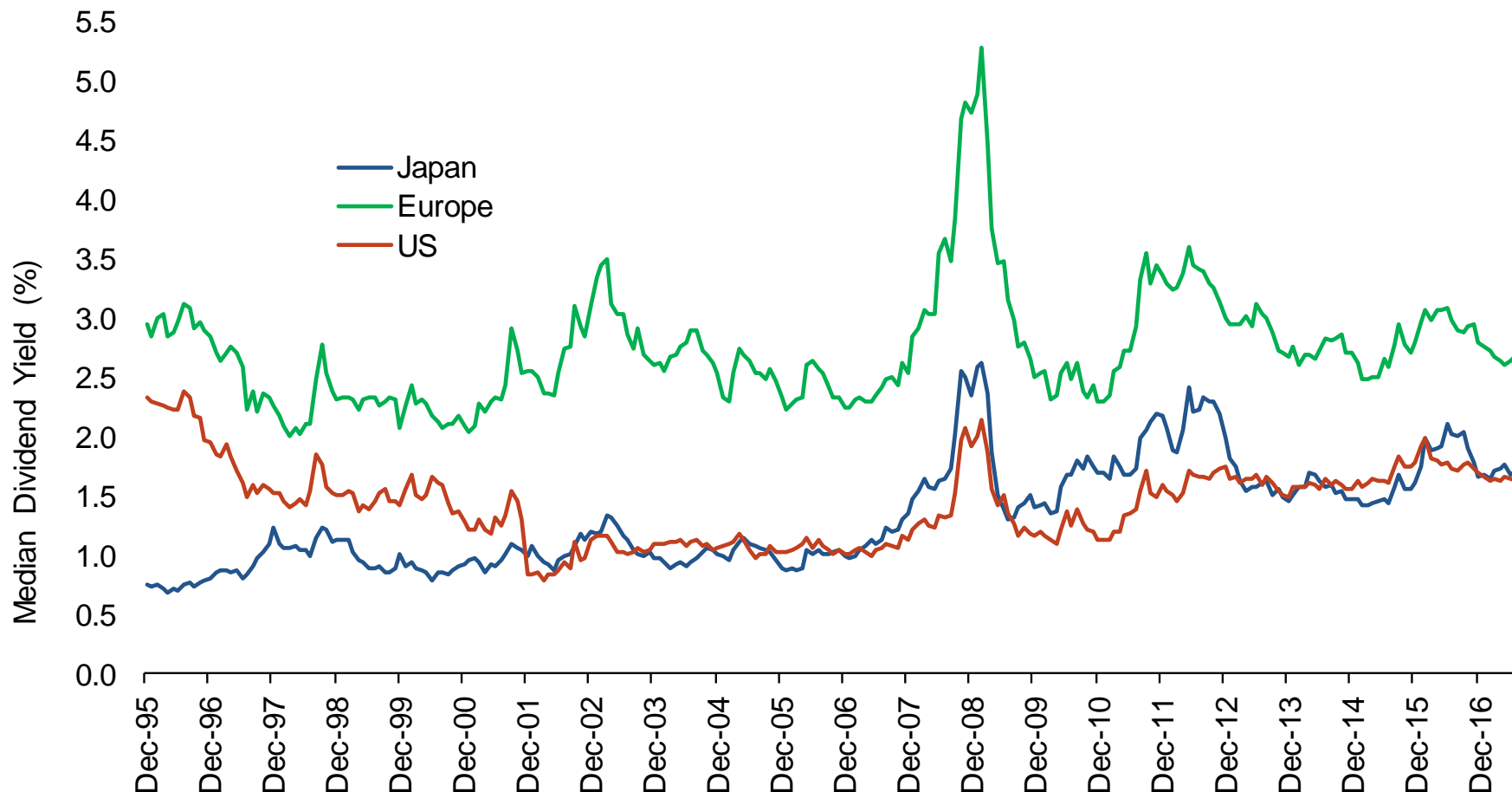
THE LONG ROAD TO NORMALISATION – 12M FORWARD PE BY REGION



Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet .

MEDIAN JAPAN DIVIDEND YIELD IS SIMILAR TO THE US

Median company dividend yield by region

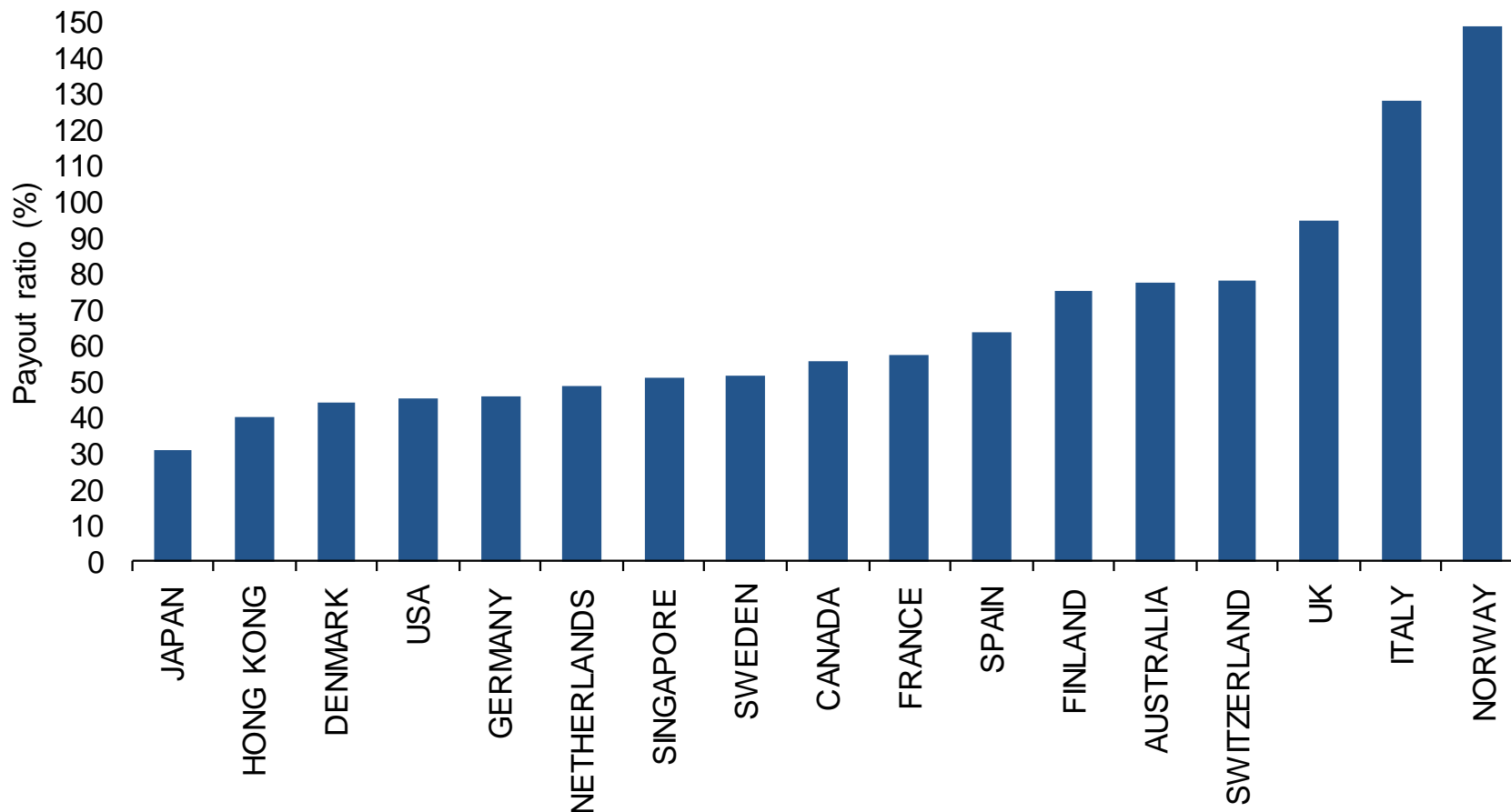


Source: SG Cross Asset Research/Equity Quant, FTSE, I/B/E/S, FactSet

Note: Past performance is not indicative of future performance. Portfolio presented assumes no transaction costs. For additional details on portfolio performance please contact us.

JAPAN HAS THE LOWEST PAYOUT RATIO

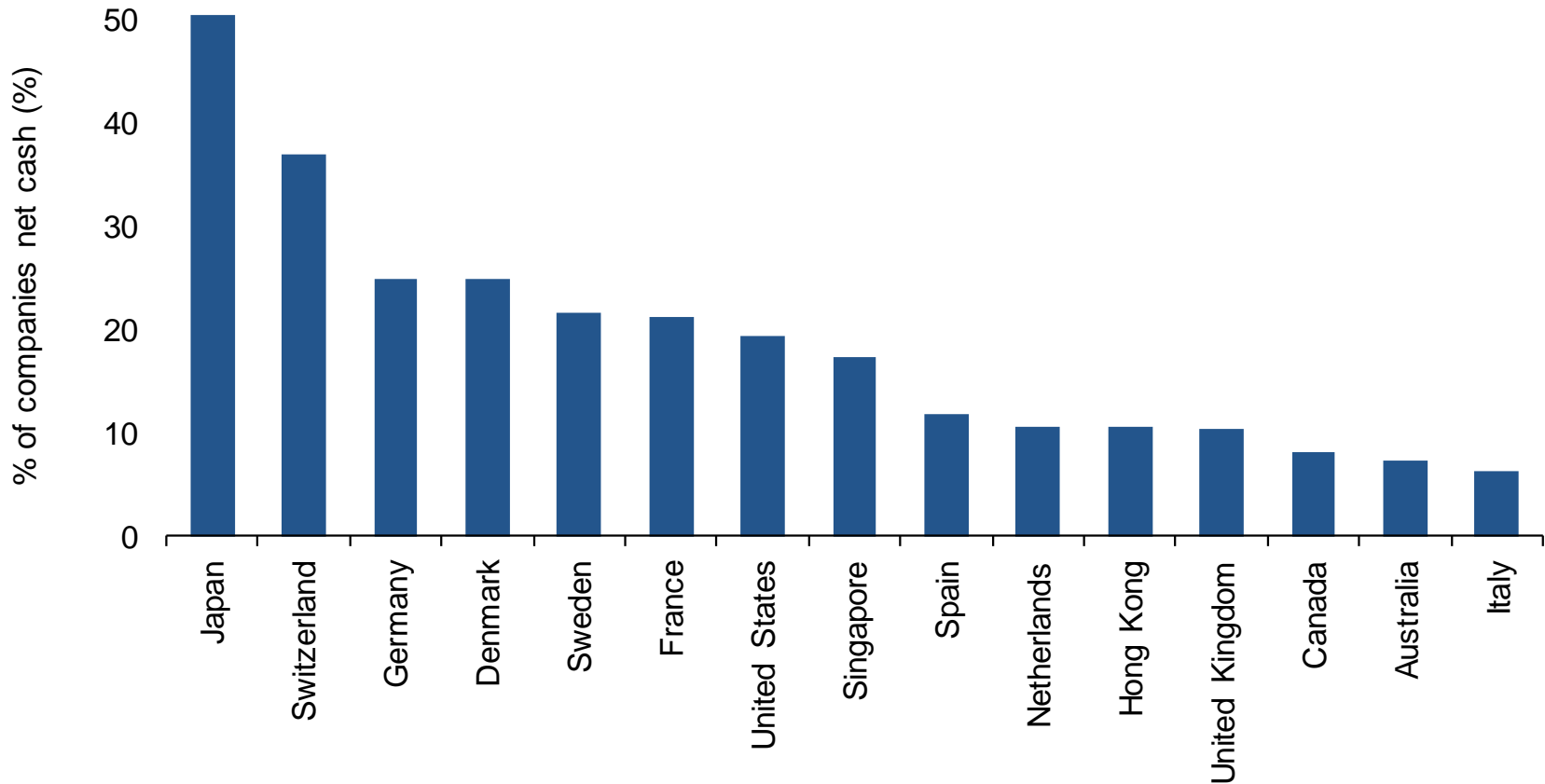
Dividend payout ratios by region



Source: SG Cross Asset Research/Equity Quant, MSCI

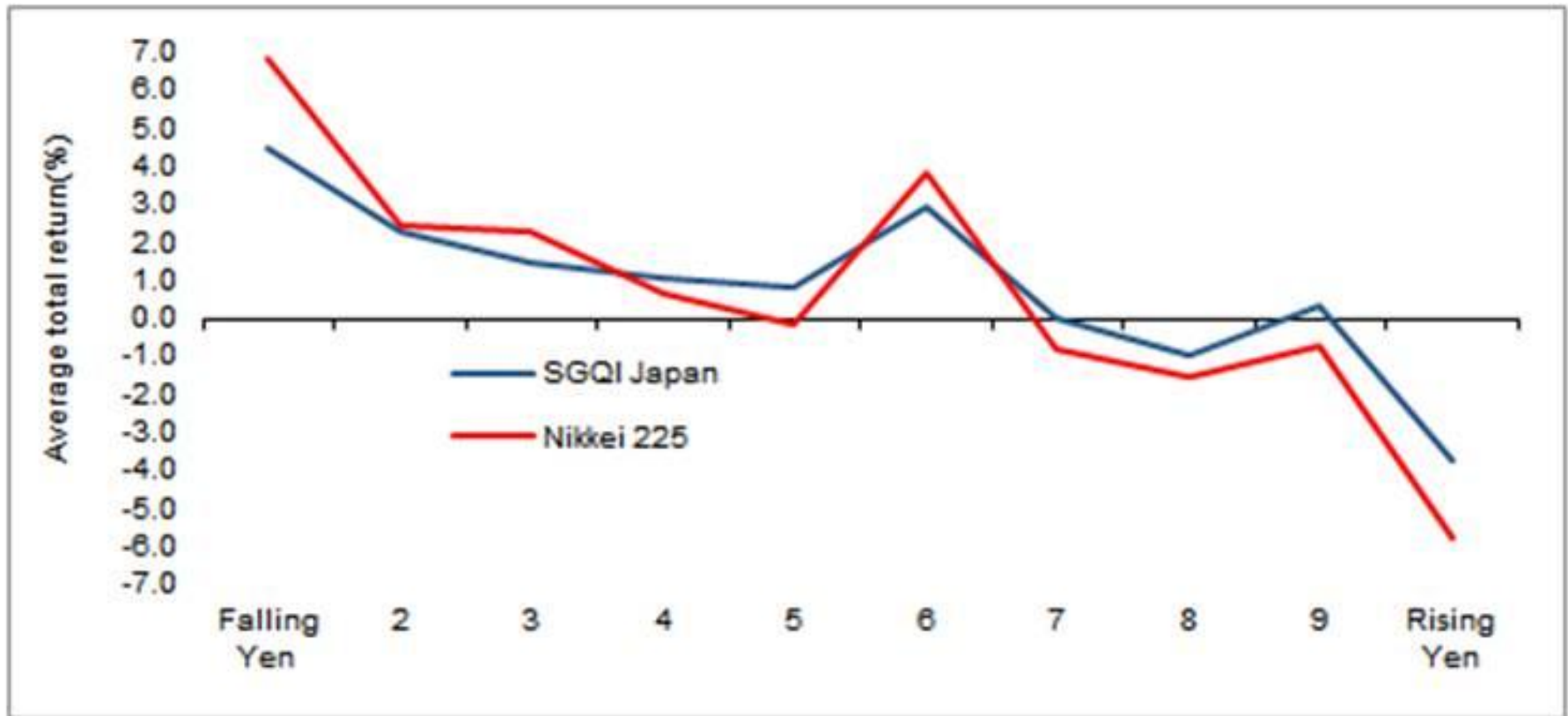
JAPAN HAS MORE NET CASH BALANCES THAN OTHER REGIONS

Percentage of companies with a net cash balance (MSCI Indices)



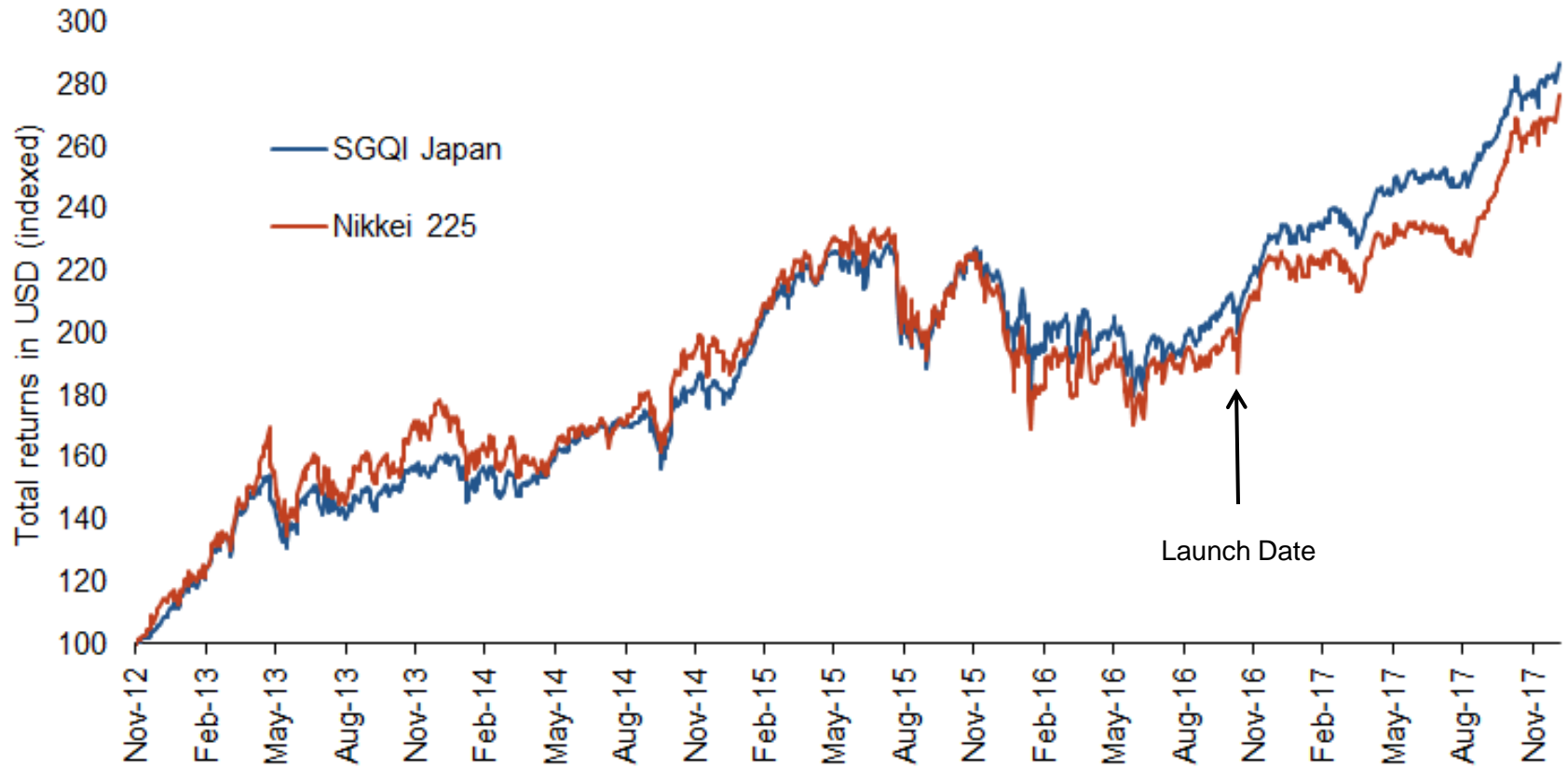
Source: SG Cross Asset Research/Equity Quant, MSCI, FactSet

SGQI JAPAN VS NIKKEI 225 YEN SENSITIVITY



Source: SG Cross Asset Research/Equity Quant, FactSet, IBES

SGQI JAPAN PERFORMANCE



Source: SG Cross Asset Research/Equity Quant, Bloomberg

CONCLUSIONS

- Central bank policies have resulted in record valuations and record levels of corporate leverage – well done!
- US corporate sector is vulnerable; average corporate profitability is weak and balance sheets are in a dangerous state. US small caps could be the source of the next market crisis.
- Central banks will not be able to hold back the wave of balance sheet issues in 2018, as they couldn't in 2017.
- Will still like Japan, the equity market is cheaper and less leveraged than Europe or the US and now represents a sensible long term investment proposition..

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