Biiwii Commentary

***e*Research Corporation** is pleased to provide an article, courtesy of Biiwii.com, and written by Heisenberg, with a link provided to its website.

The article, starting on the next page, is entitled: **"Five Things to Worry About in Equities"**

Biiwii.com was created in mid-2000 solely as a way to help get the message out about deeply-rooted problems about too much debt and leverage within the financial system. The concerns were confirmed and the message proved justified 3 to 4 years later as the system began to purge these distortions, resulting in a climactic washout extending from October, 2008 to March, 2009.

Along the way, a geek-like interest in technical analysis, a long-time interest in human psychology, and various unique macro market ratio indicators were added to the mix, with the result being a financial market newsletter (and dynamic interim updates), Notes From The Rabbit Hole (NFTRH) that combines these attributes to provide a service that is engaged and successful in all market environments by employing risk management first, and opportunity for speculation second.

But It Is What It Is: You can access Biiwii at its website: **www.biiwii.com**.

Notes From The Rabbit Hole: You can access NFTRH at its website: **www.NFTRH.com**

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Bob Weir, CFA
Director of Research

Five Things to Worry About in Equities

By **Heisenberg**

Look, here is the thing you need to understand about Citi: there is an epic internal struggle going on between the equity folks and the credit folks. You can read about it here.

The equity desk is bullish. Matt King's credit team thinks that may be insane given the looming QE cliff and what it portends for markets that have become dependent on central bank liquidity.

The bank's internal meetings are probably a lot like *Gangs of New York*. Or like the fight scenes in *Anchorman*.

I don't know where Jeremy Hale stands on all of this. He is the bank's head of global macro strategy, so maybe he just sits back and takes bets on the fist fights.

All I know about Jeremy is that on Monday (see below) he is out with something called "Five Worries For Equities."

If you are still long stocks at this juncture, then God bless you for hanging in there and here is hoping that your justification for sticking around has something to with an unshakable belief that central banks will not ultimately pull the plug, because that is about the only rationale that makes any sense up here.

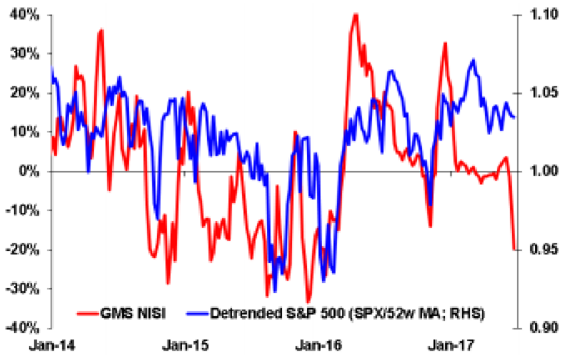
For those interested, here are the five things that keep Jeremy Hale (but probably not Robert Buckland) up at night…

Via Citi

***Sentiment**: Our NISI Index (news implied sentiment indicator, Figure 1, next page), has fallen sharply into bearish territory in the latest print, to its lowest level since end January 2016. As we have highlighted this year, as Trump "Optimism" fades, there may have been too much spirit priced into the SPX. The latest print in NISI suggests renewed skew towards pessimistic sentiment and, thus, looking at past correlations to the NISI, the SPX may fall relative to trend for a period on this measure.*

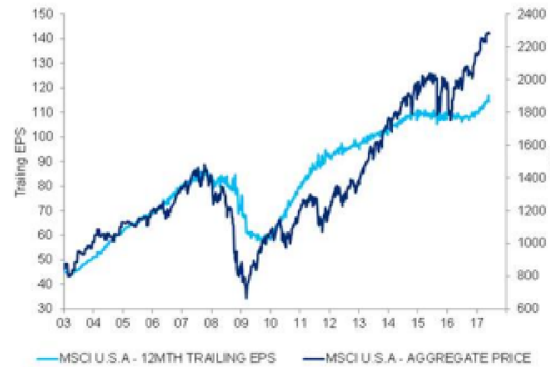
***Valuations**: Arguably already rich and perhaps increasingly reliant on earnings to do the "heavy lifting" from here. Breaking down the P/E ratio to P vs. E illustrates how much the market has re-rerated significantly in the last couple of years (Figure 2, next page). Even value stocks are expensive in the USA. Additionally, estimates for the current ex-ante ERP are starkly below average historic excess equity returns of +4.7%. In order to even achieve this mean level of excess return, we'd need to see a nominal GDP growth rate of >5.25% (which would be above trend on a 5y, 10y and 30y basis). As such, this would require significant upwards revisions to Citi's current growth outlook, at a time where Citi Economists say they are close to the cyclical peak in global growth and see increasing downside risks to their forecasts. Combined with undershooting inflation/ declining inflation expectations, this seems even more unrealistic and makes equities appear richer on this basis.*

Figure 1. NISI (Red) vs. S&P 500 (Blue)



Source: Bloomberg and Citi Research

Figure 2. Decomposing P and E



Source: MSCI and Citi Research

Earnings Outlook: *We have no doubts 2017 will indeed be a positive earnings year, but the key is for this to also transpire next year globally. This will require the feed through of higher oil prices (due to the commodity sensitive UK and EM EPS). Whilst Citi currently forecasts higher oil prices, we note that the strong base effects witnessed more recently are slowly rolling off as we move past the oil trough in a one year rolling window. Meanwhile, spot oil prices are trending lower. And earnings surprises have been strong in commodity-related sectors. So, we need to see earnings strength broaden out heading into 2018.*

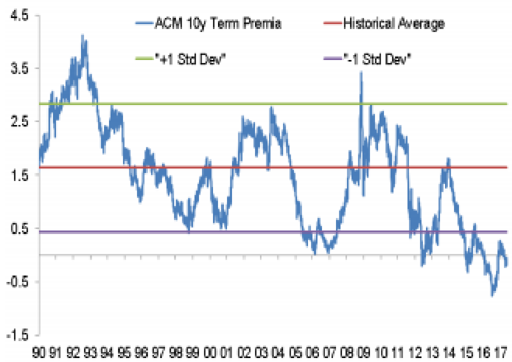
Liquidity: *As Matt King points out, a global shift to tighter monetary policy next year may be quite threatening to risk assets, given how important unconventional monetary policies have been for markets in recent years. His chart, which plots risk asset momentum vs. global central bank asset purchases in a 12 month rolling window, suggests in the event that all major CB's shrink liquidity together, the implied path may see stocks correct* ***30%*** *(Figure 3).*

Figure 3. QE Withdrawal Risk?

Source: Bloomberg and Citi Research

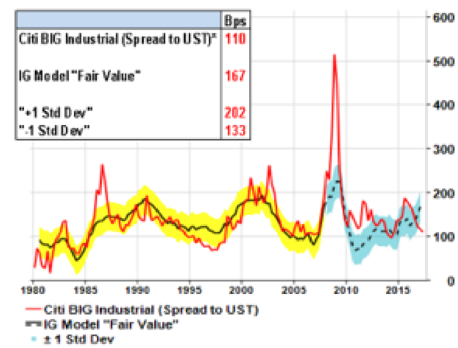
***Other Asset Classes**: As Figure 4 & Figure 5 show, it is not just equities which are rich in valuation terms. Term premia in long-end $ rates remains compressed and close to all-time lows. Our credit FV models also indicate that spreads in $IG and $HY are rich, to a magnitude of > 1 std. deviation.*

Figure 4. Fed Estimates of Term Premia



Source: Bloomberg and Citi Research

Figure 5. CGMS Credit FV Model



Source: Macrobond and Citi Research

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