Third Party Research September 6, 2017

Charts To Watch

***e*Research Corporation** is pleased to provide an article by Scott Grannis for his Blog, "Calafia Beach Pundit".

In this article, Mr. Grannis provides a general overview of market influences.

The article is reproduced below, beginning on the next page, or you can go to this specific Blog at the following link: **12 charts to watch**

You can also visit Scott Grannis' Home Page for his Blog at the link below:
http://scottgrannis.blogspot.ca/

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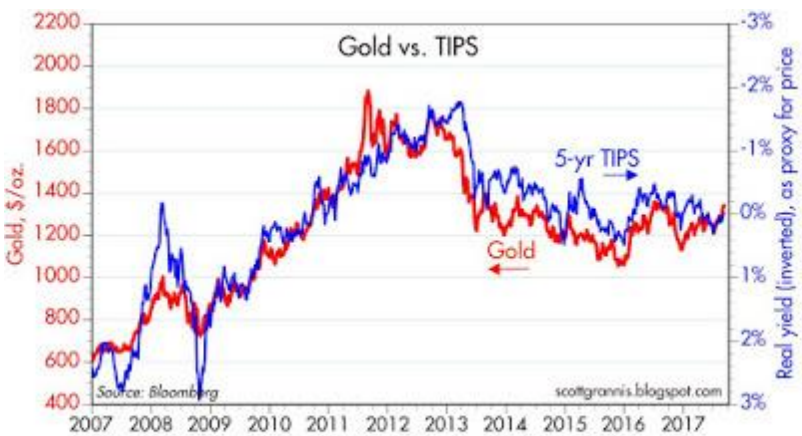
Tuesday, September 5, 2017

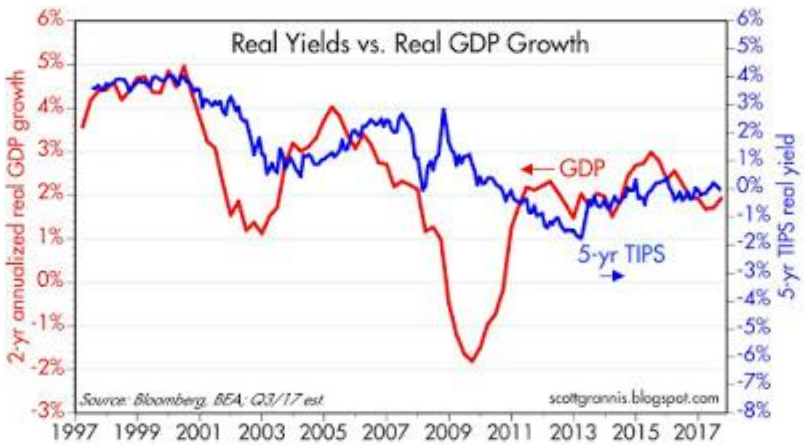
12 Charts To Watch

North Korea remains the biggest threat to world peace, but markets remain nonplussed. Gold prices have inched higher, but are nowhere near levels that would suggest panic buying. The dollar has declined about 10% so far this year, but it is still trading above its long-term, inflation-adjusted average value relative to other currencies. Stocks show no sign of any significant correction despite trading near record highs. Sovereign yields are uniformly low, but still comfortably above their all-time lows of mid-2016.

Is the market overly complacent? Overly optimistic? Absurdly cheap or expensive? A great buy on dips? "No" is the best answer to all these questions, in my view. Nothing obvious is staring us in the face. I am with Howard Marks in thinking that now is not a time to take on oversized risks, but neither is it a time to cash in all your chips.



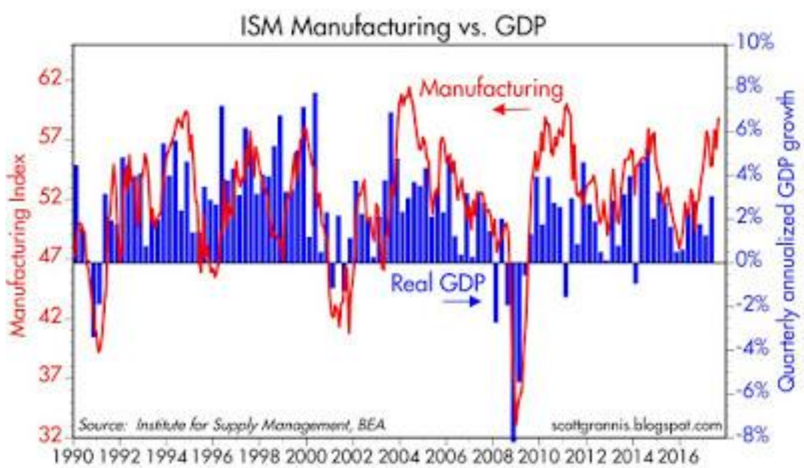
I have been fascinated by the above chart for years. Why is it that the prices of two unique assets—gold and 5-yr TIPS—have been tracking each other for the past decade? The best answer I have come up with is that both are havens of a sort—safe ports in a storm. TIPS protect you against inflation and default, gold protects you from systemic collapse. At current levels, they tell us that, although conditions today are somewhat better than they were 5 years ago, investors are nevertheless still paying a premium for safety. The long-term average, inflation-adjusted price of golds is somewhere in the range of $500-600/oz., by my calculations; in normal times the real yield on TIPS would be expected to trade around 1% to maybe 2%. Both are priced to a premium these days, which suggests risk-aversion is still alive and well in today's market.



The chart above shows that the real yield on TIPS tends to track the trend growth rate of the economy. With a real rate today of zero, the TIPS market seems to be expecting real growth of the U.S. economy to continue to average about 2% per year, which is what we have seen for the past 8 years.

The value of the dollar *vis-a-vis* other currencies rose following the November elections, but it has fallen by about 10% so far this year. As the chart above shows, the dollar is still above its long-term, inflation-adjusted average against two baskets of currencies. No big message here, but it seems to rule out excessive optimism and excessive pessimism.

The chart above shows how the market has reacted to major events in recent years. The recent reaction to the heating up of North Korean risk is rather tepid, and significantly less than other episodes of panic attacks.



Last week's release of the ISM manufacturing indices for August was very encouraging. The chart above suggests that the new-found strength of the manufacturing sector points to overall economic growth of at least 3-4% in the current quarter. The Atlanta Fed's GDP Now forecast for this quarter currently stands at 3.2%, a bit better than the second quarter's 3.0%.

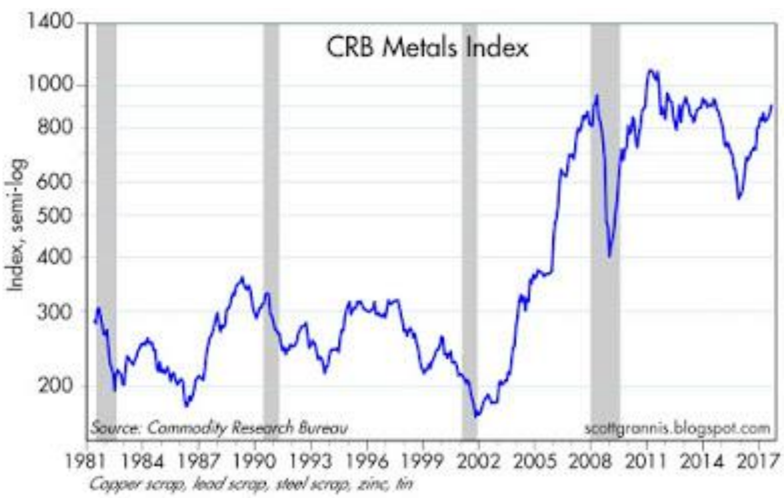
The manufacturing employment index was very strong, suggesting that manufacturers see improving conditions and, thus, plan to ramp up their hiring plans.

The upturn in U.S. manufacturing mirrors a similar improvement in the Eurozone. Synchronized recoveries are always welcome!

Based on past correlations, the strength of the ISM manufacturing index says that revenues per share of major U.S. corporations are likely to remain strong for the foreseeable future. Coupled with near-record profits, this provides a reasonable basis for a continuing rally in equity prices.

Not all industries are looking up, however. The August report on car sales was decidedly weak, as the chart above shows. Construction activity has softened in recent months, and bank loans to small & medium-sized businesses have been flat for over six months. There are pockets of strength and weakness, and that probably means [no boom and no bust](), as I noted last month.

The USA may be stuck in slow-growth mode, but emerging markets are on fire. Measured in dollars, the Brazilian stock market has climbed 150% in the past 20 months. It is still far below its previous highs, however. Brazil is hardly booming, though, but the outlook has changed from dire to somewhat promising. This is one of those cases where the market was expecting a disaster which has failed to materialize. Regardless, emerging markets are riding the crest of two powerful waves: a weaker dollar and rising commodity prices. There is reason to be optimistic about the outlook down south, mainly due to ongoing improvement in the outlook for fiscal policies and politics in general.

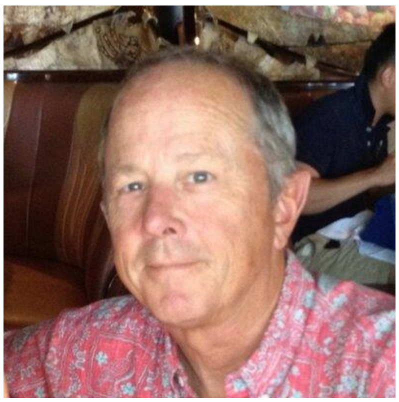


Industrial metals prices are up 66% in the past 18 months. This strongly suggests that global economic activity is picking up.

The fact that the dollar is now weakening as commodity prices rise (which is their natural tendency) suggests that the rise in commodity prices may reflect a weakening in the demand for dollars at a time when their supply is abundant, and that is a classic recipe for rising inflation. It is premature to make a big rising inflation call, however, since the bond market continues to expect inflation to be relatively low, in the range of 1.5-2.0% for the foreseeable future. As I mentioned last week, this is something to worry about, not a reason to panic.

BW: See ABOUT THE AUTHOR on the following page.

ABOUT THE AUTHOR



Scott Grannis was Chief Economist from 1979-2007 at Western Asset Management, a Pasadena-based, global manager of fixed-income portfolios for institutional clients.

He now enjoys keeping up on economics, markets, and politics from his condo overlooking Calafia Beach on the southern California coast, where he likes to think that he is immune to Wall Street group-think.

Married for 45 years to his Argentine wife, Norma, he has four children and five grandchildren (four boys and one girl).

He is a believer in supply-side economic theory, as practiced by his mentors, the late Jude Wanniski, Art Laffer, and Larry Kudlow. John Rutledge is another of his mentors, from the days that they worked together at Claremont Economics Institute.

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