A LOOK AHEAD

July 2018

Beside a sharp but relatively short correction early this year, global equities seem to be unaffected by rising interest rates on the short and on the long end as well as balance sheet reduction by the Fed. Remember, the current bull market is one of the longest on record and also the economic expansion in the U.S. has become the second longest since 1850 according to the National Bureau of Economic Research. Has the bull market reached its final stage? On the following pages we will try to find answers and will provide you with our roadmap for the second half of 2018 and beyond.

A Look Back – Key Messages Last December

Equities

The key message in December was that the rally in world equities and especially US stocks is in its final stage but that a major top is still a few months away. We were expecting a pullback in January, followed by a rally into May. In the U.S., major indices pulled back sharply in January and hit their lows in early February. The following rally was weaker than expected and with the exception of technology stocks and small and mid caps, indices are still well below their January highs. The correction in Europe lasted longer. The German Dax and the Euro STOXX 50 reached a bottom in late March.

Interest Rates

Our view was that in the US 10yr yield, medium to long-term the risk was rather to the downside and that we would not expect the 3% threshold to be broken to the upside. Temporarily, the yield reached 3.11% but is now trading again well below that key resistance.

Currencies

We were expecting the Dollar index to break the 91 support and EURUSD to reach 1.23 in the first half of 2018. The Dollar Index traded as low as 88.25 while EURUSD execeeded our target by reaching 1.255. Since then, a rally in the Dollar has started. We were right by expecting EURCHF to weaken, but we have to admit that the rally in the Euro lasted longer than expected.

Commodities

It was our expectation for commodities to rally into summer 2018. We were right by expecting oil to rally and any pullback to be only short-lived.

We were also saying that we would not chase copper at current levels but that we expect higher prices in 2018. The year is not over yet but while we were right by not chasing copper, we did not expect such a deep correction. The rally in the dollar and fears of a trade war were a bad mix for Copper,

Gold

On the back of our expectation of a major top in equities in 2018, another downturn in the US dollar and a possible burst of the cryptocurrency bubble, we viewed gold as a good hedge should the "everyting-bubble" burst. Year-to-date gold is down 4%.

A Few Thoughts

Since June 2009, the U.S. economy is expanding. If it keeps growing until July 2019, it will become the longest economic expansion in history, according to the National Bureau of Econmic Research. The current expansion started with stimulus spending that passed in early 2009 to battle the great recession. But taking into account the massive and unprecedented monetary stimulus, growth has been very slow. Real GDP growth has averaged only 2.3% p.a. since the recovery began in 2009. This compares to 4.6% between 1996 and 1999 and 3% between 2003 and 2007. We wrote about that in our outlook last December.

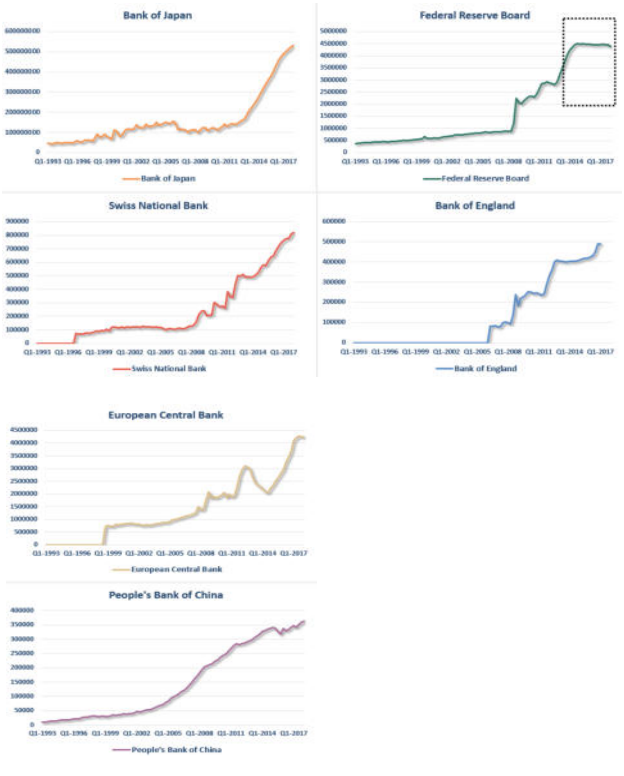
US business cycle expansions (in months)

Source: www.zerohedge.com

The rate hike in December 2015, the first since May 2006, marked the start of a series of rate hikes. Considering that more than half of all recessions since 1960 were triggered by rising interest rates, it is questionable if the current expansion will continue for long. Especially as the Fed has also started its balance sheet reduction in October 2017. The plan is to reduce the balance sheet from its peak of US$4.5tn to US$4.0 this year and to US$3.4tn next year. Also, if everything goes according to plan and the ECB stops QE at the end of this year, it will be the first time that liquidity (on a global level) is being reduced. In other words there are two factors that will sooner or later start weighing on the economy: Futher rate hikes AND balance sheet reduction.

Currently the rate of growth is only beginning to slow, balance sheets globally continue to expand. This might be an explanation why so far we haven't seen a larger impact on financial markets.

Central Banks – Balance Sheets



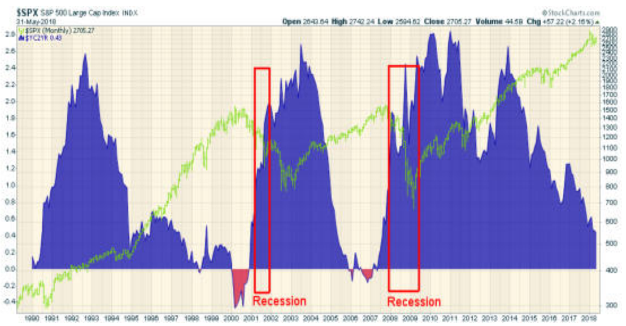
Source: www.realinvestmentadvice.com

According to Deutsche Bank analyst Jim Reid, historically the U.S. entered a recession about 33 months after the first rate hike. As he believes that the rate hike cycle has begun in December 16 when the Fed raised rates for the second time, a recession could start as early as September 2019. No doubt, the current cycle is mature.

The **yield curve**, the difference between Treasury yields of long and short maturities, keeps falling and has reached the lowest leve since 2007 (0.29%). An inverted yield curve (shorter rates higher than longer rates) is widely considered to indicate an imminent economic recession. The average lead time of the last five decades was 18 months. The shortest lead time was 13 months. If history is a guide and should the yield curve invert later this year, a recession will not start before late 2019.

By the way, the lead time before the stock market reaches its final bull market high is 10 months on average. That could point to a top in late 2018/early 2019. But more on that later.

US Yield Curve



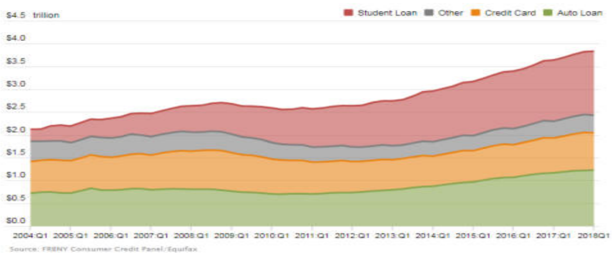
Source: www.stockcharts.com

Interest rates are rising in the areas of the economy that impact consumers directly through variable-rate debt like **credit cards**. Not surprisingly, rising rates are already causing rising delinquencies.

US consumers have accumulated an aggregate US$1.04tn credit card debt, an all-time high. But fewer than 40% of consumers regularly pay their credit card bills. With most credit card debt tied to Fed funds, even the WSJ admitted that "the combination of stagnant wages, rising interest rates and rising consumer debt could have potentially explosive consequences for the US economy". With the savings rate for US consumers having plummeted to its lowest level since November 2007, the US household's purchasing power – that driver behind 70% of US GDP – is at risk.

Total American household debt skyrocketed beyond US$13tn at the end of 2017, well beyond historic highs. This is the fifth consecutive year of household debt increases, including credit cards, mortgages, auto loans and student loans. Beside credit card debt, **student loans** and **auto loans** are also at an all-time high. At the same time, auto subprime loan delinquencies for example have reached a 22-year high. When the economy is reportedly doing so well, why are consumers defaulting? In Europe, the situation doesn't look much better. Household debt as a percentage of GDP hit all-time highs in Belgium, France, Luxembourg, Norway, Sweden and Switzerland.

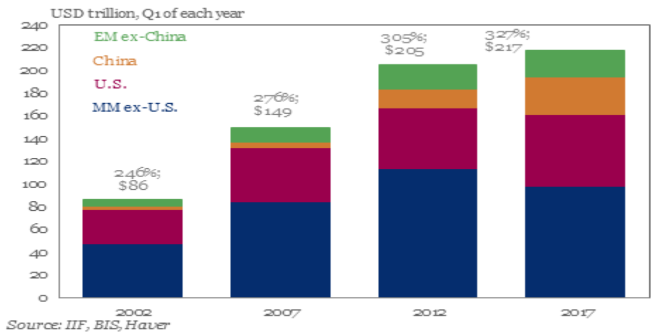
US Non-Housing Debt Balance



Source: www.newyorkfed.org

But it is not only US household debt that has reached worrisome levels, also **public debt and global debt** in general have risen to new records. A global debt analysis by the IIF (Institute of International Finance) disclosed that global debt rose to record US$237tn at the end 2017, US$70tn higher than a decade ago. In early March, the IMF called on indebted governments to seize the opportunity offered by synchronised global growth to cut their borrowing. The fear is that many countries will enter the next downturn with government debt at or near record highs.

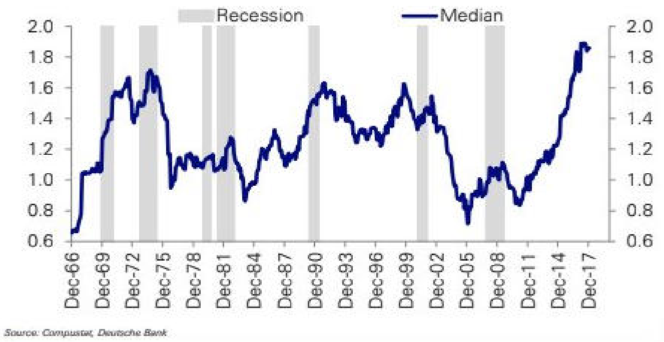
Total Global Debt



Source: www.zerohedge.com

Corporations have also taken on record levels of debt thanks to artificially low interest rates. Since 2009, US corporate debt has increased 49%, hitting a record of US$8.8tn. The U.S. **corporate debt**-to-GDP ratio recently hit an all-time high of over 45 percent, which is even more extreme than the level reached during the late 1990s Dot-com bubble and mid-2000s U.S. housing and credit bubble. The same applies to the ratio of debt versus earnings. S&P 500 members ex-financials have now nearly twice as much debt as profits.

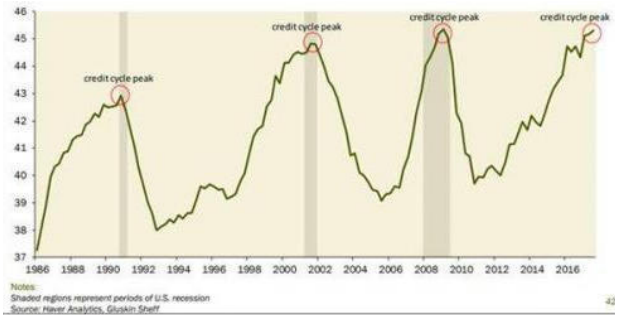
S&P 500 ex-financials Net debt to EBITDA



Source: Compustat, Deutsche Bank

Much of this debt is being used for share buybacks and dividend payments. Buying back shares at such high valuations and with borrowed money is, in our view, highly questionable. Financial engineering at its extreme will put many corporates at risk should interest rates continue to rise or the economy to slow down. Moody's has already warned that "the record number of highly leveraged companies has set the stage for a particularly large wave of defaults when the next period of broad economic stress eventually arrives".

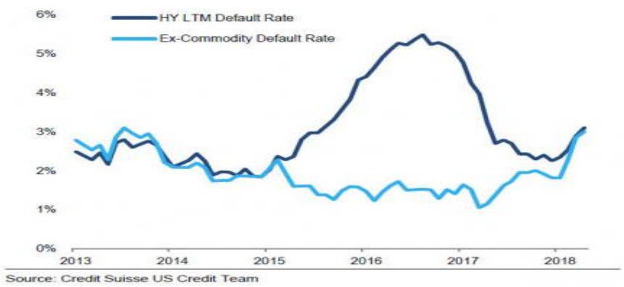
US Corporate Debt-to-GDP



Source: www.zerohedge.com

Default rates have already started to pick up. Therefore we strongly recommend to keep a close eye on credit spreads and to stay away from highly leveraged companies. If already overly optimistic investor sentiment weakens, such companies will find it hard if not impossible to raise capital or rollover debt.

Default rates on the rise



Source: www.zerohedge.com

While we do not believe in an imminent recession, there are signs that the economic recovery is mature and in its late stage. Beside the risks mentioned above (rising rates, quantitative tightening, flattening yield curve, debt at record levels and rising default rates), an intensifying trade war, a geopolitical event or increasing European political instability are additional threats to the economic expansion. At the same time we cannot rule a "boom and bust" scenario for the U.S. economy. The combination of spending hikes and tax cuts could cause the U.S. economy to overheat. Adding stimulus when the economy is already at full employment seems wrong to us. To cite Ben Bernanke (something we usually don't do!): "Stimulus is going to hit the economy in a big way this year and next year and then in 2020, Wile E. Coyote is going to go off the cliff, and it's going to look down". But the outcome would not change. Record high global debt and the lack of room for monetary policy response to a recession could make a downturn much more painful than many can imagine. During the two most recent recessions, the Fed cut interest rates by 500bps each. Today, at Fed fund rates of 1.75-2.00% and possibly a few more rate hikes to follow, the potential for rate cuts is very limited. Even worse is the situation for other central bank such as the ECB, where rates are still negative.

Equities

Back in December 2017 we said that from an Elliott wave perspective, the S&P 500 is "trading in the final 5th wave. In other words, the advance is very mature and in its final stage". But healthy breadth and momentum especially in large caps made us believe, that a major market top "is still months away". At the same time we were expecting a pullback into early Q1, followed by higher prices and a potential (major?) top in May. As we all know, the market did correct indeed. A bottom in the S&P 500 was reached in early February. Since then and in contrast to the Nasdaq and small and mid caps, it has not managed to reach new highs and is rather range-trading. So what do we expect from the market in the second half of 2018?

From an Elliott Wave perspective, we continue to believe that the S&P 500 is trading in the final wave 5. Within this wave 5, we label the early 2018 correction as a wave 4 correction. In other words, we expect the market to make new highs in the coming months to complete the 2009 bull market. For all those not familiar with Elliott wave, bull markets take place in five waves. This includes three upwaves (1,3 and 5), interrupted by two corrective waves (2 and 4).

S&P 500 Weekly

Source: www.stockcharts.com

Beside Elliott Wave, it is mainly the advance-decline line that makes us believe that the January was not THE top yet. Prior to the highs of 2000 and 2007, the **advance-decline line** was already falling. This was a sign of narrowing participation. Fewer and fewer stocks helped to lift the benchmark indices. Right now, the advance-decline line of small, mid and large cap indices is still rising which is a sign of a broad participation and therefore a healthy market. Also, past major tops have been characterized by multi-month **distribution** patterns. Prior to the financial crisis of 2008, the market traded more or less sideways for eight months before it broke down in January 2008. In the final stage of the Dotcom bubble, the S&P 500 moved sideways for six months. Recent price action has signs of a distribution but the all-time high of the large cap indices from January was not revisited yet, something we would prefer to see.

On the other hand, several indicators are confirming our view that the rally is mature and in its final stage:

Dotcom 2000

Subprime 2008

Current

Source: www.stockcharts.com

- Market Breadth – In the past, major market tops have been preceded by signs that buying is becoming more and more selective. The following quote from Lowry Research Corp best describes the way into such a major market top: "*The period leading up to a major market top shares a number of similarities with the Autumn season as it transitions into Winter. That is, in Autumn the leaves begin to fall from the trees in a very gradual process one at a time, until the trees are eventually bare at the onset of Winter*". These signs are currently present. When small- and mid caps and the Nasdaq 100 made new highs in June, between 18% and 22% of all stocks were already trading 20% or more below their all-time highs. At the same time, between 31% and 40% of all stocks were trading below their 200day moving average. These signs of a continuously falling participation are a clear warning signal. Fewer and fewer stocks manage to lift indices higher! This stays in contrast to the still bullish advance-decline line and shows that breadth has only started to deteriorate.
- Small Caps – Prior to major market tops, small and mid-cap stocks almost always start to underperform large caps months ahead. This was also the case in 2000 and 2007. Therefore, the June breakout to new highs in small and mid-cap stocks does not signal a pending major top. But it might be different this time. The underperformance of large caps can be explained by the risk of a trade war which clearly affects large and multinational stocks more than small- and mid-caps.

- RSI-Divergence – New highs in the S&P 500 in 2000 and 2007 were not confirmed by the RSI (Relative Strength Index). This non-confirmation was an early warning that upside momentum was weak. So far, such a divergence is still missing in large cap indices. But recent new highs in small- and mid-cap stocks as well as the Nasdaq were not confirmed by higher momentum anymore. Another warning signal.
- Selectivity - Increasing selectivity is a sign that equities have reached the late stage of this bull market. Several indices such as the SMI, EuroSTOXX 50, OMXC (Danmark), OMXS30 (Sweden), Bovespa and CSI 300 (China) have fallen below their 50-week exponential moving average and are still trading below. This selectivity is typical in a late-cycle rally and suggests that more and more markets will roll over into underperformance.

While we do expect new highs for the S&P 500 (the S&P 500 could reach 2980 – 3020), there are more and more signs that the bull market is coming to an end. In the coming few months you should keep a close eye on market breadth, small- and mid cap stocks as well as sector performance.
Semiconductors for example are often leading the broad market. Unless we are seeing new highs soon, the Philadelphia Semiconductor Index (SOX) is at risk of topping out. The weekly divergence between price and momentum is worrying and the price chart is about to form a bearish head-and-shoulder pattern (neckline at 1200).

Philadelphia Semiconductor Index (SOX) Weekly

Source: www.stockcharts.com

Another sector we are closely watching is the technology sector. As we all know, especially the FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) performed extremely well and contributed a large part to the S&P 500 index performance in recent years. The NYSE FANG+ index that also includes Alibaba, Baidu, Nvidia, Tesla and Twitter more than tripled since December 2016! In the meantime, recent new highs in the index itself as well as many components were not confirmed anymore by new highs in momentum. These weekly divergences are a warning signal that the uptrend is losing momentum. Taking some chips off the table is advisable while a break in the Nasdaq 100 below 6300, the lows from April 2018 would trigger a sell signal.

NYSE FANG+ Index

Source: www.theice.com

To finish our analysis of the US market, we would like to present one of our favourite long-term charts. Prior to the two major tops of this decade, a bearish momentum crossover gave an early warning signal. Then one sell signal after the other followed: Break of a multi-year uptrend, bearish 0-line cross by the Coppock curve, break of a neckline and finally a bearish cross of the 32month moving average. So far, only a bearish momentum crossover has occured. If history repeats, then the other sell signals will follow a few months later.

S&P 500 Monthly

Source: www.stockcharts.com

From a pure technical point of view Europe looks much weaker than the US stocks. Long-term, the broad Europe STOXX 600, the SMI and the DAX (Price Index instead of Performance Index, which excludes dividends) have all failed to break above the highs from 2000. In other words, they have traded sideways for nearly 20 years! Now, most European indices are already trading below their 50week moving average, something that is not the case yet in the States. The Europe STOXX 600 Index is such an index that is trading below. A bearish momentum divergence adds to the bearish picture. A break of the 2011 uptrend and especially a move below the March 2018 lows at 360 would trigger a clear sell signal. Reduce exposure in the next rally and/or a break below 360.

Europe STOXX 600 Weekly

Source: www.stockcharts.com

DAX Price Index

Source: www.dasinvestment.com

SMI Weekly

Source: www.stockcharts.com

Also increasingly mature looks the **Nikkei 225**. A divergence in the monthly RSI is a sign, that the rally is losing steam. Especially as the Nikkei is trading in the final 5th wave. While we do expect new highs in the coming weeks and months, we expect this to be the final move before a larger correction will start. Such a correction could bottom around the breakout level and low of wave 4 at 15'000.

Nikkei 225 Monthly

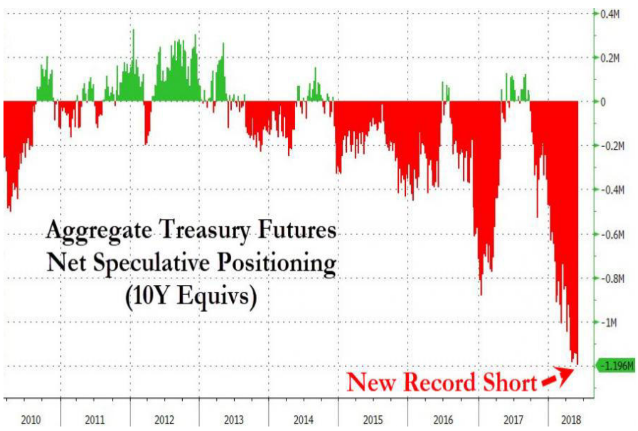
Source: www.stockcharts.com

Interest Rates

While additional rate hikes by the Fed should follow in the second half of this year, we do not expect US 10yr yields to move significantly above 3%. On the contrary, weekly divergences in the 10 and 30yr yields are both indicating a pause in the current uptrend if not an outright decline. Considering the record short position of speculators in US 10yr futures, falling yields could become reality indeed. In early June, when Italian rates spiked, investors herded into treasuries which caused the yield to drop by 35 bp. Next support in in the US 10yr yield is between 2.71 and 2.75, the lows from March and May respectively. Below that, 2.57 (50% retracement) and 2.44% (61.8% retracements) are the next stops.

10-year US Treasury Yield Weekly

Source: www.stockcharts.com



Source: www.zerohedge.com

On the long-term chart it is interesting to see that the recent break above the upper trendline of a multi-decade downward channel and the 96month exponential moving average is significant. Together with the 2012/2016 double bottom we have clear indication, that a major bottom is in and that the 36 year old bull market in bonds is about to end. History has shown that such turning points last for many years but we have to prepare for many years of rising rates.

10-year US Treasury Yield Monthly

Source: www.stockcharts.com

A risk to our thesis of falling interest rates on the long end is an intensifying trade war. If for example China starts dumping US treasuries (Russia already sold US$47.4b out of US$96.1b in April only), yields could suddenly spike. Be aware, foreign demand is critical for the US to offset an expected surge in federal borrowing needs. To finance the huge spending bill, the Treasury Department plans to auction US$1.4tn in treasuries this year.

Our view of higher fed fund rates and stable or even lower US treasury yields will further flatten the yield curve. With a spread of only 29bp between 10 and 2yr treasuries, the risk of an inverse yield curve should not be underestimated. Remember, an inverse yield curve is widely considered to indicate an imminent economic recession. The average lead time of the last five decades was 18 months. The shortest lead time was 13 months.

Foreign Exchange

In December 2016 we turned long-term bearish on the dollar after reaching a 7-year cycle peak and a non-confirmation in the monthly RSI.

It was our expectation late last year that the Dollar index would break below the 91 support and EURUSD to reach minimum 1.23. After reaching 1.255 (EURUSD) and 88.15 in the Dollar index in February – a near perfect test of the broken long-term trendline - a strong rally has started in the dollar. Is the current rally only a countertrend rally or the start of a much more substantial move, which of course would negate our view of a major dollar top in late 2016?

US Dollar Index Monthly – 7yr Cycle

Source: www.stockcharts.com

Dollar Index

The move off the late 2016 highs was an impulsive 5-wave move down that found support right at the long-term downtrendline. At the same time, the divergence on the weekly chart was a clear indication that a rally was in the cards. We expect the rally to be nearly over. While it is possible for the dollar index to reach 96 (50% retracement), we would not chase the dollar anymore. We give our long-term bearish view on the dollar the benefit of the doubt and view the current rally as only a countertrend move within a long-term downtrend.

US Dollar Index Weekly

Source: www.stockcharts.com

EURUSD

With nearly 60% weight, the Euro is the main component of the Dollar index. Being bearish on the dollar should therefore translate into a bullish view on the Euro. By reaching 1.25 in early January, EURUSD hit a strong resistance (see chart on the next page). The following correction found support at

1.15, the 50% retracement. The weekly MACD is not far from a bullish crossover and also the RSI has turned bullish. We expect the Euro to move towards the January highs at 1.25 again, a key resistance. It is where the 2008 downtrend and the 2005 neckline meet..

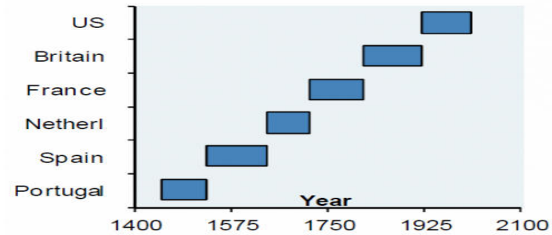
EURUSD Weekly

Source: www.prorealtime.com

De-Dollarization

Earlier we wrote about the reduction of treasury holdings by Russia. While Russia was by far the largest seller of US treasuries, other such as Japan and China also liquidated small parts of their holdings. Earlier this year, China introduced yuan-denominated oil futures that already account for 12% of global oil trading and 14% of WTI volume. An impressive start. Also the LME (London Metal Exchange) plans to launch yuan-denominated metals futures. Then, in early June, Moscow and Beijing signed an agreement to raise the share of trade settlements in national currencies. Already in October 2017, China launched a payment system for transactions in the Renminbi and the Russian currency. This gradual shift away from the dollar is only the beginning and will cause a tectonic shift in the world order. The status of a currency as a reserve currency does not last forever. There are clear signs that the American century is coming to an end.

Reserve Currency Status Does Not Last Forever



Source: www.zerohedge.com

Commodities

Last December we said that we would expect the CRB index to break above the highs from 2016 and 2017 and to continue to rally in the first half of 2018.

While the CRB index managed to break out indeed, the rally was only short-lived which makes the move look like a false breakout. In the long-term we still believe that commodities are preparing for a big breakout (basing pattern since 2016) but we might see lower prices in the coming few months. The weekly RSI has just crossed the 0-line to the downside. Remember, all commodity indices are heavily weighted towards the energy sector (30-35%). Therefore it is important to look at oil specifically.

CRB Index Weekly

Source: www.stockcharts.com

WTI Crude Oil

Last December, we were bullish on Oil and expected any pullback to be only short-lived. When WTI Crude Oil hit US$72.80 in late May (+20% since year-end), momentum did not confirm this new high anymore. Therefore, the pullback to US$63.50 did not come as a big surprise. The rally that followed has reached a new high but again, weekly momentum indicators do not confirm this new high. We would not chase WTI at current levels and rather expect a pullback in the second half of 2018. US$61/62 is where the next support area is (38.2% retracement and 40-week moving average resp.). In expecting lower oil prices in the weeks ahead, a breakout in the CRB index is unlikely.

WTI Crude Oil Weekly

Source: www.stockcharts.com

Copper

Our recommendation not to chase Copper was correct but we have to admit that we did not expect the metal to have such a weak start into 2018 (-14% since year-end). Next support is at US$2.77, the 38.2% retracement. But with a weekly RSI below 50 and a fresh sell signal in the MACD, a test of the 50% retracement at 2.60 is more likely.

Copper Weekly

Source: www.stockcharts.com

Gold

Our call in December 2015 to expect a major bottom in gold was based on the 8yr cycle, a momentum divergence and the bullish break above the 20month moving average. In the following two years, the metal in dollars was among the best asset classes performing 8.5% (2016) and 13% (2017). Considering major headwinds in 2018 (rising rates, stronger dollar), gold is only down 4% year-to-date.

Technically, gold has fallen below a key support at US$ 1275, the very significant 20month moving average, and is now testing US$ 1250/1260, the lower end of a bullish multi-year triangle. It is vital that the latter support zone holds. A break below would likely trigger a sharp sell-off towards US$ 1200, the 2011 downtrend. Below next bigger support is at US$ 1120, the lows from late 2016. On the other hand, if gold manages to bounce off this support, a test of key resistance between US$ 1360/1380 would be in the cards. How important this resistance is, can be seen on the weekly chart below. If the metal breaks above US$1360/1380, gold could reach US$ 1670, the measured move of the triangle.

We are afraid that on the back of bearish moving averages and momentum indicators not in oversold territory yet, the support zone mentioned above will not hold. A washout towards next support at US$ 1200 would be the consequence. This would cause the already bearish sentiment towards gold to spike, which from a contrarian point of view is usually a great time to enter.

Gold Weekly

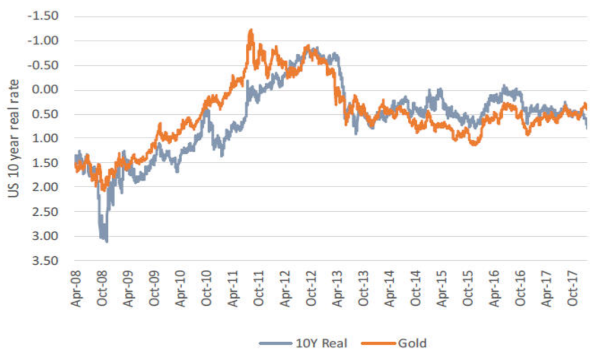
Source: www.stockcharts.com

Gold 20month Moving Average

Source: www.stockcharts.com

Also, gold is often seen as an inflation hedge but in our view, real interest rates (nominal yields less inflation) have a much bigger effect on the price of gold. As we do not expect yields to rise but inflation to pick up (falling real rates), gold should do well.

Real Interest Rates vs. Gold



Source: Canaccord

Longer-term we remain constructive for gold as we continue to view gold as a monetary asset rather than a commodity and as an insurance against any accident that could happen. If the “everything-bubble” bursts (and it will), gold is a must have asset.

Conclusion

Since 2009, equity markets have been steadily rising against a backdrop of extraordinarily loose monetary policy. This is about to change. While the Fed has already started to raise rates and reduce the balance sheet, the ECB has announced to start reducing its balance sheet by the end of this year. This will mark the first time that liquidity (on a global level) is being reduced. Liquidity was the main driver behind this multi-year bull market. Therefore we expect that the withdrawal of liquidity will have a similar, but negative impact on global equities.
Also, the current economic expansion is among the longest in history. But signs are mounting that the current cycle is mature and we see the risk of a recession by autumn 2019 the earliest. Taking into account that equity markets usually start to rollover months before a recession has become official, a top by the end of 2018 seems possible.

From an Elliott Wave perspective, we continue to believe that the S&P 500 is trading in the final wave 5. Within this wave 5, we label the early 2018 correction as a wave 4 correction. In other words, we expect the market to make new highs in the coming months to complete the 2009 bull market. Typcial for a bull market in its final stage is weakening market breadth and increasing selectivity. We are beginning to see both. When small- and mid cap stocks as well as the Nasdaq reached new highs in June, participation was already much smaller than at the previous all-time highs. Also an increasing number of indices is now trading below key moving averages, a sign of increasing selectivity.
Still, we do expect large cap indices to test the January all-time highs in the coming few months but very likely with weakening participation and accompanied with momentum divergences. That would signal us that the time has come to leave.
Clearly we can be wrong and the top in January was already THE top of this bull market. In the coming weeks and months we will keep on watching key support levels of several indices.

No doubt, with the 2012/2016 double bottom we have a clear indication, that a major bottom is in and that the 36 year old bull market in bonds is about to end. But history has shown that such turning points last for many years and therefore we do not expect in an immediate breakout to the upside. On the contrary, a weekly divergence in the 10yr yield as well as a record short position of speculators in US 10yr futures make us believe that we are going to see a pause and more likely an outright decline in US 10yr yields in the months ahead.
Also we do expect the yield curve to move into negative territory which would be another indication, that a recession in the US is looming.

We do expect the current dollar rally to be nearly over and the dollar to resume its downtrend in the second half of this year. The Euro on the other hand is likely to retest major resistance at 1.25. In the big picture, we remain long-term bearish on the dollar and view the current rally as only a countertrend move within a long-term downtrend.

With a false breakout, a bearish break of a trendline and momentum indicators turning bearish, the CRB index looks weak. Also, we would not chase WTI Oil, a major component of most commodity indices. The same applies to Copper, where we have a major divergence in momentum. Later this year on the back of a weaker dollar, the CRB index could make another attempt to breakout.

Longer-term we remain constructive for gold as we continue to view gold as a monetary asset rather than a commodity and as an insurance against any accident that could happen. But short-term, gold has broken through US$1270, the 20month moving average. Gold is also struggling to hold above its next key support zone at US$1250/1260, the lower end of a bullish multi-year triangle. We are afraid that on the back of bearish moving averages, the supports mentioned above will not hold. A washout towards next support at US$ 1200 would be the consequence. This would cause the already bearish sentiment towards gold to spike, which from a contrarian point of view is usually a great time to enter. Long-term, we remain very bullish for gold.

"A key to successful investing lies in selling when we're closer to the top, and buying when we're closer to the bottom"

Howard Marks, Oaktree Capital Management

Appendix – Equity Valuations Matter

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In all our recent issues, special attention has been paid to equity valuations (that get more extreme every time we write about them). We are totally aware that markets can stay overvalued much longer than any of us can imagine- But in our view, the bottom line remains always the same: this time is never different.
Instead of rewriting the story, we have decided to only update the numbers. We strongly recommend first time readers to read this chapter carefully, as all of the valuation methods mentioned below present an invaluable tool for the long-term success.

The **Shiller P/E** or **CAPE ratio** was developed by Nobel Prize winner Dr. Robert Shiller and Dr. John Campbell. It divides the S&P 500 by the 10-year average of inflation-adjusted earnings. It therefore captures earnings over one or two business cycles instead of only one year. While earnings over only one year have frequent ups and downs, the 10-year average better reflects sustainable earnings.

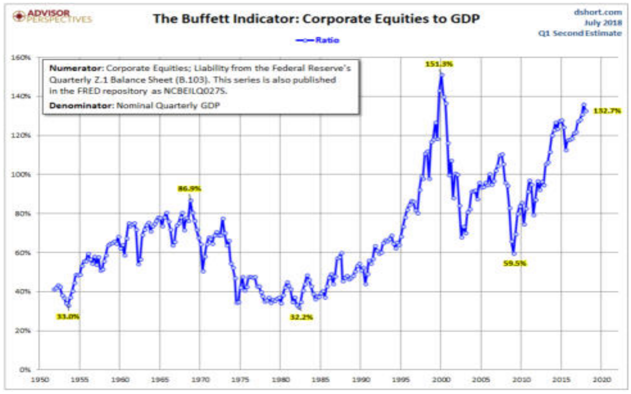
Shiller PE (1800–current)

Source: www.multpl.com/shiller-pe/

Using data going back to 1900, the median value for the CAPE ratio is 15.64, which compares to today's ratio fo 32.8. Not only is today's ratio more than 80% above its historic norm, it is now higher than in 1929.
Yes, the current Shiller PE is much lower than its 1999 peak but if today's historically high profit margins are adjusted to 1999's levels, the ratio today is much closer to its 1999 peak. If stocks were to revert to their long-term median value, that would imply a decline of more than 40% from today's prices.

Next is the **Buffett Indicator**. According to Warren Buffett, it is "probably the best single measure" of the total market valuation at any given time. The indicator compares total market capitalization to GDP and currently shows that investors have only paid more for stocks at the peak of the tech bubble in 1999. The current level of 132 implies a more than 60% overvaluation in stocks relative to their median value. Similar to the CAPE ratio, a fall back to the long-term historic norm would be equivalent to a fall in stocks by roughly 40%. As a side note: Berkshire Hathaway currently holds a record amount of cash (36% of its assets).

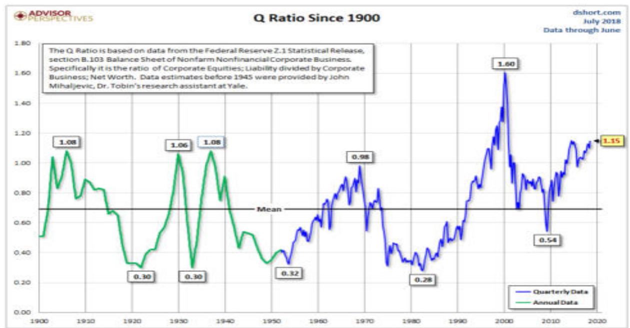
Buffett Indicator (Market Cap to GDP)



Source: www.advisorperspectives.com

Last but not least the **Tobin's Q ratio**, which compares stock-market values with the real-world prices of corporate assets, is another indicator that signals overvaluation. A ratio above 1 means that the market is worth more than the replacement costs of all the companies. The current ratio of 1.15 is way above historic average, which is around 0.65. While it is still far below the extremes from 2000 (1.61), it clearly signals that the market is overvalued.

Tobin's Q Ratio



Source: www.advisorpersepctives.com

Another way of looking at the huge overvaluation of US equities is to look at a simple price to sales ratio. By this valuation, the US stock market has not been more overvalued since 2000.
These numbers tell us, that investors buying US equities at current levels and just holding them will very likely suffer poor returns over the next decade. Based on the Shiller P/E or CAPE ratio, the U.S. market is expected to return -2.6% (!) including dividends over the next eight years. The Buffett Indicator indicates a return of -2.1% over the same period (including dividends)!
While these return estimates have historically a strong correlation with real returns, markets can stay overvalued a very long time. It is all about timing and therefore it is worth to have a look at the technical picture of the markets too.