10 For Thursday

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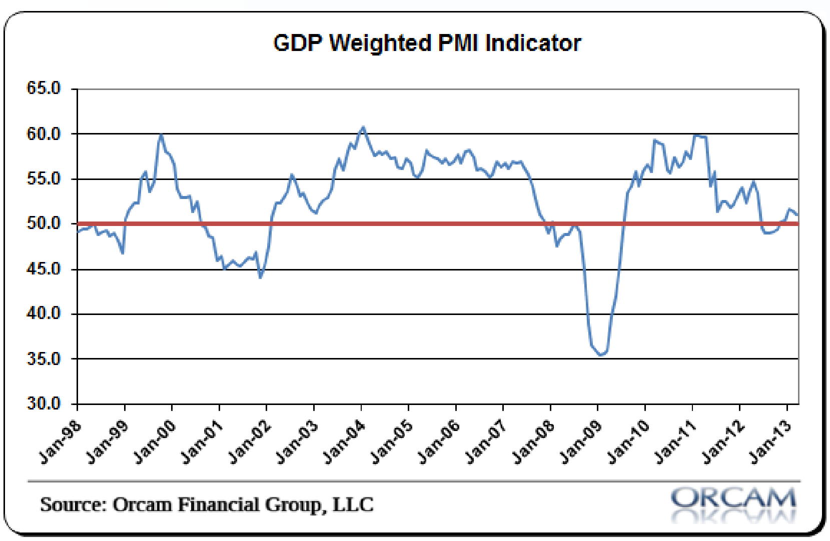
Okay, "10 for Thursday" doesn't rhyme as well as "10 for Tuesday", but like the endlessly levitating equity market I can't control the days of the week….

1. Global PMIs Are Generally Sluggish

The globally weighted PMI has weakened a bit in recent months as notable sluggishness in Europe and China have dragged the index down. The latest reading of 51.1 is barely above the expansion line and likely to move lower in the coming months as the recent Flash PMI reports showed continued weakness. The best houses in a bad neighborhood remain the USA, India and Brazil.

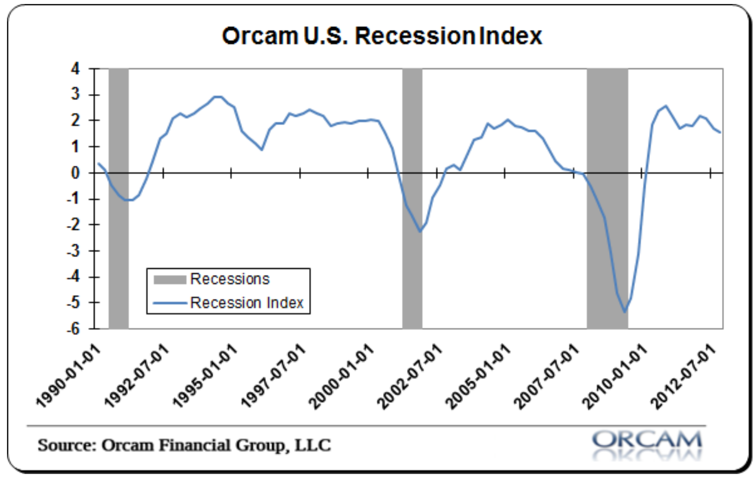


(Figure 1—GDP Weighted PMI)

"Failure to prepare is preparing to fail."
-Coach John Wooden

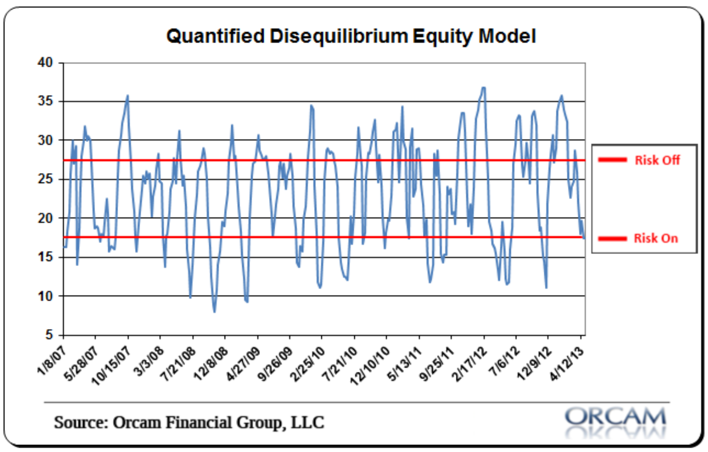
2. Recession Risk in the USA Remains Low

The risk of recession in the USA remains low according to the Orcam US Recession Index. This diffusion index tends to lead the business cycle and is presently consistently with continued modest growth in the USA. This is extremely important to our cyclical view of the markets as the worst downturns tend to occur within recessions.



(Figure 2—US Recession Index)

3. Market Timing Indicators Remain Negative

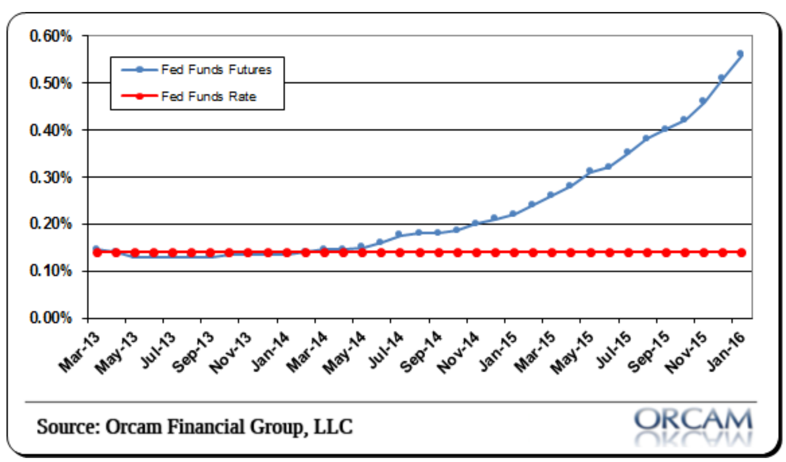


(Figure 3—QD Model)

The relentless equity rally of 2013 continues and as the market powers higher our tactical equity model has remained in risk-off mode even though it's improved recently. The lack of negative volatility is setting records as the current 110 session rally without a 5% correction has only occurred 3 times in the last decade. We're truly in uncharted territory and while it might be tempting to chase the market, my signals still point to prudence and preference towards risk management.

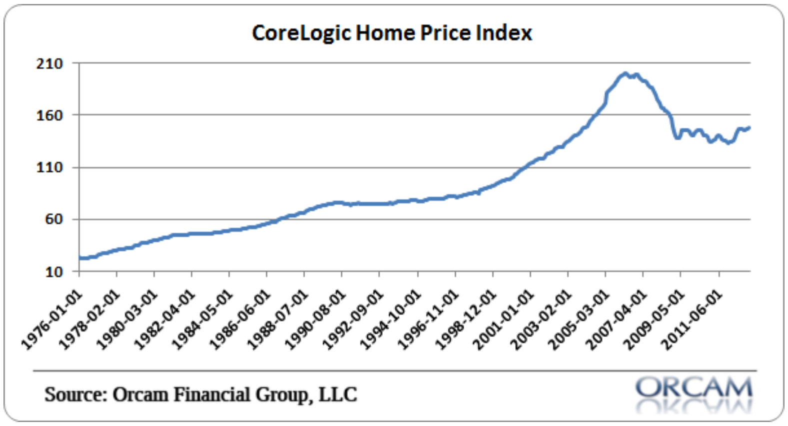
4. Fed Funds Futures = Bond Bull Is Alive

The single best predictor of future bond prices remains the Fed Funds Futures Curve. Investors are still pricing in a rate increase as early as 2015 and I just don't think the odds of this occurring are very high. That means that curve has to come down as bond traders will price-in a continuing easy Fed. That means upward pressure on the curve is likely to remain muted in the near-term. The bond bull is very much alive.



(Figure 4—Fed Funds Futures Curve)

5. U.S House Prices Have Started to Rebound

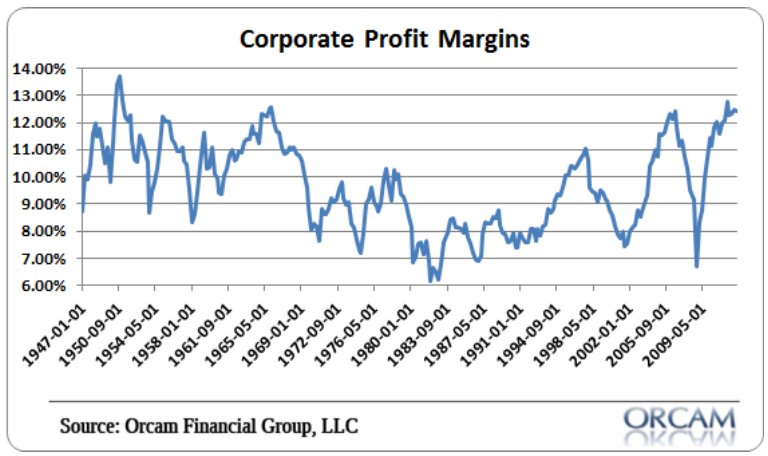


(Figure 5—CoreLogic Home Price Index)

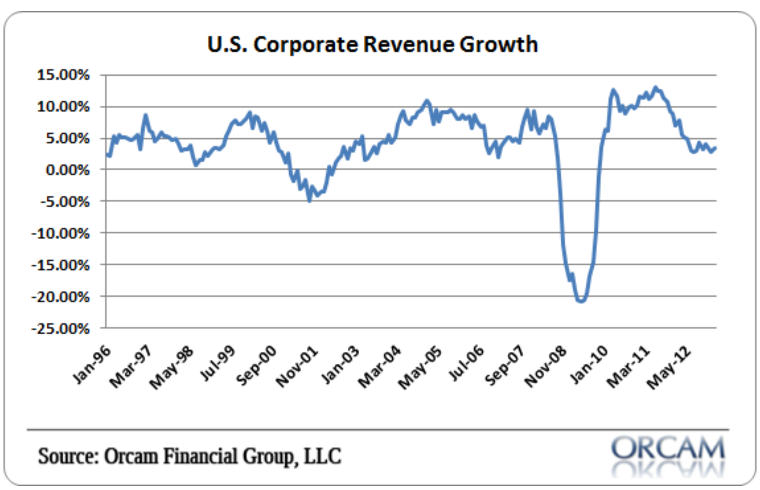
Home prices in the USA appear to have found some footing in 2013 as prices are now up double digits compared to 2012. Inventory declines and low interest rates appear to be fuelling some demand. Add in the improved credit conditions from the waning balance sheet recession and you have a recipe for a decent real estate market. I would expect prices to expand at a more modest rate going forward though.

6. Corporate Profits Margins Remain Fat

Corporate profit margins remain extremely healthy as unit labor costs remain low, the government's deficit remains wide and private investment improves. The key here will continue to be the government's deficit and private investment. As of now, I think it's safe to say that a substantial margin contraction is not in our immediate future as private investment improves and the deficit remains wide.



(Figure 6—Corporate Profit Margins)



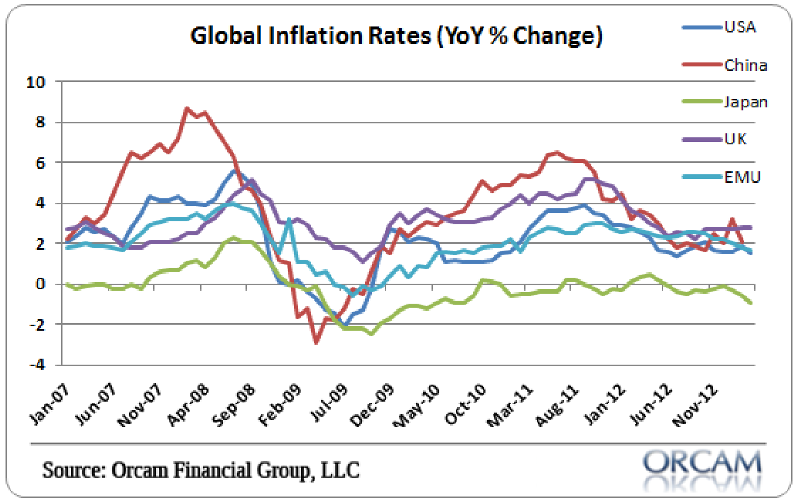
(Figure 7—US Corporate Revenues)

7. Revenues Are Tepid at Best

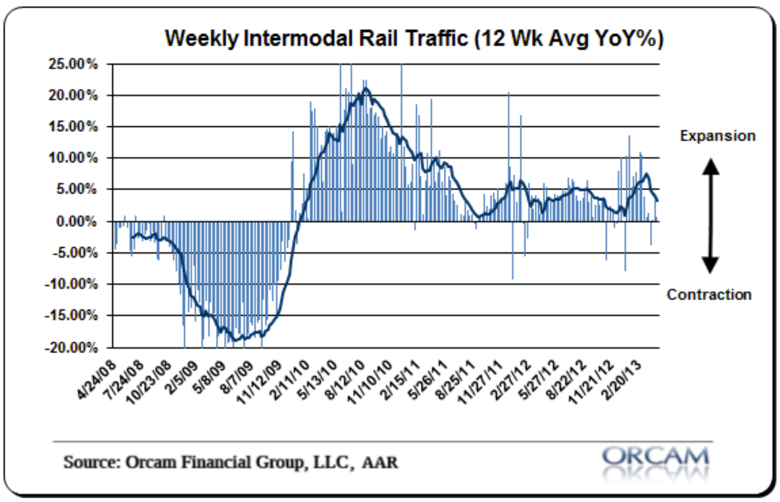
Corporate revenues are growing at just 3.4% according to recent data from S&P. This is consistent with readings from the last year, but certainly a downtrend over the last few years of mid to high single digit growth. While not alarming this is a trend worth keeping a close eye on.

8. Global Inflation Remains Low

Global inflation remains extremely low and trending even lower. Japan reported its worst deflation in 2 years this evening and while the rest of the globe is not quite in a deflationary funk it's not terribly far off. As of now, inflation remains a relatively meager problem though likely to rise in the coming years.



(Figure 8—Global Inflation Rates)



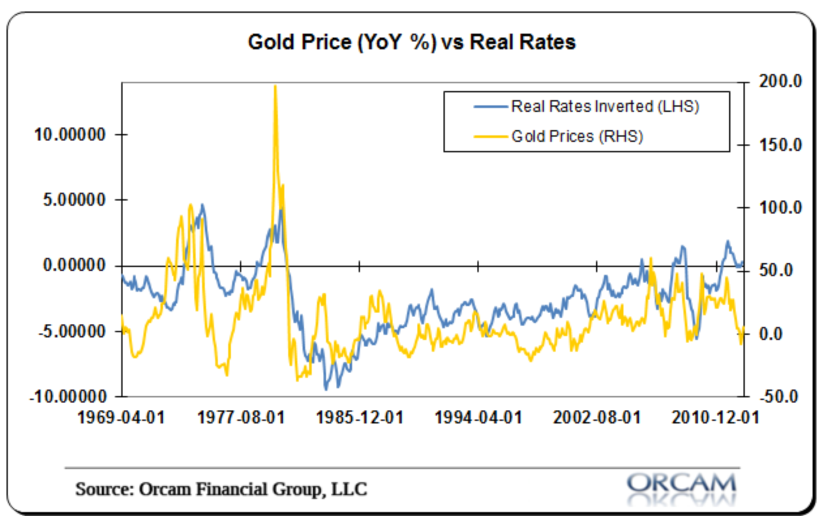
(Figure 9—Rail Traffic)

9. Rail Traffic Remains Constructive

Recent rail traffic readings showed a 12 week moving average of 4%, but have softened substantially as Q2 begins. The recent softness is something we will be keeping a close eye on as the year progresses. Expansion is expansion, but a persistent dip into the red would be alarming.

10.Recent Dip in Gold is a Buy Opportunity

Despite the brief panic in gold prices in recent weeks the fundamental story has actually changed very little. Real rates continue to be the primary driving force behind future gold prices and we see little reason to be alarmed by what looks like panicky selling due to Cyprus. Gold should be a substantial underweight in your portfolio (relative to cyclical stock and bond positions), but not a negative or 0% holding.



(Figure 10—Gold Versus Real Rates)

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