BTIG Equity & Derivatives Strategy
The Year of Living Dangerously
October 2019

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Please Read: Important disclosures and analysts’ certifications appear in the appendix
BTIG Equity & Derivatives Strategy: Key Points

- S&P 500 Estimates
  - 2019 Year-end Price Target: 3,000
  - 2019 EPS Estimate: $168
  - 2020 EPS Estimate: $179

- Broader, Deeper, More Volatile – Cyclical Bear, Secular Bull
  - (Almost) One Year Later: Yes, Virginia, that was a (Non-Recessionary) Bear Market
  - Peak Everything vs. Still (?) Strong: Further upside is a state of mind, stabilizing data, and political will
  - Minding the Megaphone: The message of higher highs + lower lows = Something’s Gotta Give?

- RISK and REWARD in The Year of Living Dangerously
  - Options Market Memos: VIX Floor, S&P 500 Ceiling; Fear of the Future, Europe Sleepwalking?
  - Bricks in the “Wall of Worry”: Inflation, Rates/Fed/Yield Curve, Growth Here and Abroad
  - Fed Wars: How much can be done? MMT?
  - Politics: Gridlock (and Impeachment proceedings) widens the range of outcomes
  - Trade Wars: If it ain’t broke, hopefully it gets fixed anyway
  - In Search of Alpha: Leadership tends to narrow in late cycle
  - Growth & Value: Can a shift “accommodate” the Bull?
  - Bonds – The Biggest Bubble Ever?: Keynes vs. Stein
  - Other Markets/Assets/“Wars”: Will RoW play catchup?; on USD, Gold and Bitcoin

- BTIG Sector Recommendations – Focus on Value and Valuation
  - Overweight: Energy, Financials, Health Care
  - Underweight: Consumer Discretionary, Consumer Staples, Utilities
  - Neutral: Communication Services, Industrials, Materials, Real Estate, Technology
# S&P 500 Year-End Estimates

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019e</th>
<th>2020e</th>
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<td>2,673.61</td>
<td>2,506.85</td>
<td>3,000.00</td>
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<td>% Growth</td>
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<td>19.42%</td>
<td>-6.24%</td>
<td>19.67%</td>
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<td>EPS ($)</td>
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<td>133.61</td>
<td>161.57</td>
<td>168.00</td>
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<td>% Growth</td>
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<td>11.98%</td>
<td>20.93%</td>
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<td>6.55%</td>
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<td>Forward P/E (BTIGe)</td>
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<td>16.8x</td>
<td>16.5x</td>
<td>14.9x</td>
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<td>Trailing P/E</td>
<td>18.8x</td>
<td>20.0x</td>
<td>15.5x</td>
<td>--</td>
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</table>

Source: Factset, BTIG
Broader, Deeper, More Volatile – Cyclical Bear, Secular Bull
Yes, Virginia, That Was a Bear Market

- The S&P 500 fell into a “technical bear market”, down 20.2% from the 9/21/18 peak to the 12/26/18 trough. The decline fell just short of that mark on a close-to-close basis, and went unreported by the financial media – similar to the 2011 “Debt Default Bear” and 1998’s “LTDM Bear”.

- “Fall’s Fall” gave way to a seasonal surprise, uncharacteristic weakness in December. Tax loss selling, Passive selling, Hedge Fund liquidation, a government shutdown, a “tone deaf” Fed.

- While 4Q2018 VIX fell short of its February 2018 “Volmageddon” highs near 50, less-liquid Small Caps reflected a higher level of fear as Russell 2000 volatility hit a 4 year high. Small Caps continue to be a conspicuous underperformer in 2019 YTD, perhaps fearful of the slow growth message of plunging long-term interest rates.
Peak Everything vs. Still (?) Strong (Part 1: GDP)

- The 4Q2018 Bear Market was rooted in fears of peak profits, peak margins, peak earnings, peak growth, peak employment, peak confidence, peak China ... “Peak Everything”.
- Expectations are reset, shifting the perspective to “Still (?) Strong”.
- U.S. GDP is expected to grow at 2.3% (BTIGe 2.2%) in 2019, 1.7% (BTIGe 1.9%) in 2020, supported by rates historically low in the grander scheme, an accommodative Fed, and a strong labor market. While the Trade War issues weighs on growth, is there a pre-Election 2020 Deal in sight? Perhaps only politicians know for sure.
With the Trade Wars 18 months old, earnings estimates continue to drift lower, from $178.30 in August 2018 to $164.47 currently; BTIGe $168. YoY growth remains positive. 2020 consensus $181.58, looks too high (BTIGe $179) but 2020 is not a concern until closer to year end in this TradeWar year, 2019.

Question remains: where is the risk to 2019 consensus? Upside pending trade deal(s) or further downside with an unresolved China situation?

Perhaps only politicians know for sure.
Recession Red Flag, or Red Herring?

- Risk of recession remains elevated as trade tensions and anemic growth abroad dominate.
- While consumer confidence remains high in the present, the view of the future is historically downbeat, as was the case in 1998.
- Questions remain: How accommodative is the Fed? Can Trade War damage be repaired near term, or not until 2020 or beyond? And how does Presidential Impeachment proceedings affect the calculus?
- Perhaps only politicians know for sure.

Recession Prob. Above 20% – Red Flag or Red Herring?

Source: Bloomberg, BTIG

Goodbye Yellow Brick Road?

Source: Bloomberg, BTIG
Trade War-Weary, Economic Canaries Still Sing – For Now

- Jobless Claims remain near generational lows.
- C&I Lending moderating but not materially. Credit markets still near tights with record September issuance.
- ISM bent but not broken – particularly Services, 85% of the U.S. Economy.
- Is the Services/Manufacturing divergence setting up to resemble 2016’s “Recession That Wasn’t”?

*Initial Jobless Claims*

*Source: Bloomberg, BTIG*

*C&I Lending*

*Source: Bloomberg, BTIG*

*ISM Manufacturing & Services*

*Source: Bloomberg, BTIG*
New “Canaries” Worth Watching?

- The IPO market has begun to underperform, replete with mispriced and scuttled deals.

- History (4Q2018, 1Q2016) says this does not necessarily need to be a concern, but memories of 2000 are renewed.

- On an even deeper level, memories of the 1980’s and 1990’s are resurfacing with the Fed’s Repo market/liquidity challenges.

**IPOs Not “Working” as of Late**

**Repo – Frequent Spikes, Esp. at the Turn**

Source: Bloomberg, BTIG
<table>
<thead>
<tr>
<th>Start Date</th>
<th>End Date</th>
<th>Bear Market Length (Mo)</th>
<th>Bear Market High to Low Perf.</th>
<th>New High Mo to Recession/Non-Recession</th>
<th>New High Date</th>
<th>New High</th>
<th>Mo to Recession/Non-Recession</th>
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<tr>
<td>9/16/1929</td>
<td>11/13/1929</td>
<td>1.9</td>
<td>-44.6%</td>
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<td>300.2</td>
<td>Recession</td>
<td></td>
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<td>6/1/1932</td>
<td>25.7</td>
<td>-83.0%</td>
<td>12/9/1952</td>
<td>272.0</td>
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<td>9/7/1932</td>
<td>2/27/1933</td>
<td>5.7</td>
<td>-40.6%</td>
<td>5/26/1933</td>
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<td>10/19/1933</td>
<td>3.0</td>
<td>-29.4%</td>
<td>10/22/1935</td>
<td>27.1</td>
<td>Non-Recession</td>
<td></td>
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<td>2/6/1934</td>
<td>3/14/1935</td>
<td>13.3</td>
<td>-31.8%</td>
<td>9/10/1935</td>
<td>19.1</td>
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<td></td>
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<td>3/10/1937</td>
<td>3/31/1938</td>
<td>12.7</td>
<td>-54.5%</td>
<td>2/5/1946</td>
<td>106.8</td>
<td>Recession</td>
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<tr>
<td>10/25/1939</td>
<td>6/10/1940</td>
<td>7.5</td>
<td>-31.9%</td>
<td>7/10/1944</td>
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<td>11/12/1940</td>
<td>4/28/1942</td>
<td>17.5</td>
<td>-34.2%</td>
<td>3/29/1943</td>
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<td>6/9/1950</td>
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<td>-20.6%</td>
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<td>3/24/2000</td>
<td>10/10/2002</td>
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<td>7/13/2007</td>
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<td>9/21/2018</td>
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<td>3.2</td>
<td>-20.2%</td>
<td>4/29/2019</td>
<td>7.3</td>
<td>Non-Recession</td>
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<tr>
<td>Average</td>
<td></td>
<td>10.6</td>
<td>-35.1%</td>
<td></td>
<td>56.2</td>
<td>Recession</td>
<td></td>
</tr>
</tbody>
</table>

The economic “Canaries” sing, “No Recession”. Not yet. BTIG does not forecast a recession prior to Election 2020.

- Non-Recessionary Bear markets over the past century have lasted 7 months and averaged -29% downside.
- 4Q2018’s “technical bear” hit the lower end of past Ursa Minors’ duration and drawdown range. Do new highs mean the worst is behind us? Perhaps only politicians know for sure with the 2020 Election in sight.
Minding the Megaphone

- The S&P 500 “V” rebounded from its Bull market support line from the 2009 lows, also along the psychologically important 200-Week Moving Average.
- Can the rally that began on Boxing Day 2018 extend into 4Q019 (with memories of last year’s Fall Fall still fresh) and into 2020, a Presidential Election year?
- More volatility, both upside and downside, has resulted in a “broadening pattern” or “Megaphone”. While this can mark the end of a major trend, higher lows could keep the old Bull young.

**Will the Thin Blue Line Hold in 2020?**

**The Market’s Megaphone**

Source: Bloomberg, BTIG
• The Fed, fixed on its 2% inflation target, lifted stocks and expectations together in 1H2019. The Trade War has doused these expectations – a threat to the equity rally.

• The Fed cut on 7/31 and again on 9/18 to little effect. Is it all about the Trade War?

• And the 10-Year Yield, suppressed by global growth fears and European rate weakness, is a battleground for whether growth will continue and Fed policy will be effective.


**Does the Bull Die Without Reflation?**

**Led Weight (Irrational?) Zeppelin**

Source: Bloomberg, BTIG
High Stakes in The Year of Living Dangerously

- While markets have seen upside in 2019 with expectations reset and the Fed supportive, baggage carried from 2018 – Trade War, U.S. political tension, Brexit uncertainty, to name a few – will continue to pose risks.

- The Trade War is the most worrisome. Should the situation further deteriorate into an “Economic Cold War” multiples may revisit their lower levels seen prior to 1990, during the Cold War. Fix China, and Europe still needs solving.

- Talk of 70% top tax rates, anti-business sentiment rising, “Socialism” and Impeachment in 2019’s lexicon, multiple compression threatens from within the U.S. And Modern Monetary Theory (MMT)? A recipe for a weaker U.S. Dollar, Higher Interest Rates and lower valuations. It is Never “Different This Time”.

- These risks should continue to underpin volatility, which ebbs and flows but shifted cyclically higher in February 2018.

### S&P 500 Valuation, From Wall to Wall

- **S&P 500 Trailing 12M P/E**
- **Period Average**

### VIX and the Six (Year Cycle)

- **VIX**

Source: Bloomberg, BTIG
RISK and REWARD in The Year of Living Dangerously
Options Market Memos (Part 1)

- The Fed stopped (hiking), abruptly pivoted, then reversed (to easing) on 7/31 and again on 9/18, as political independence is questioned.
- Growth has been slowing (especially in China and Europe), political risks are rising. A perfect recipe for higher volatility.
- Maybe we shouldn’t be surprised by 2018-19’s new high/Bear Market/new high in the span of one year (ok, 7 months!) – it happened in 1998 and in 1990-91 as well.
- Higher volatility is a frequent occurrence in the latter stages of Bull markets.

Another “Year of Living Dangerously”

S&P 500 Average 1-Year Volatility

<table>
<thead>
<tr>
<th>Start</th>
<th>End/Current</th>
<th>1yr Prior to Market Top</th>
<th>2yrs Prior to Market Top</th>
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<td>6/1/1932</td>
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<td>17.5</td>
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<td>3/31/1938</td>
<td>11/9/1938</td>
<td>35.3</td>
<td>22.4</td>
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<td>4/11/1939</td>
<td>10/25/1939</td>
<td>26.7</td>
<td>36.2</td>
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<td>4/28/1942</td>
<td>5/29/1946</td>
<td>14.8</td>
<td>10.4</td>
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<td>6/13/1949</td>
<td>8/2/1956</td>
<td>13.2</td>
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<td>10/22/1957</td>
<td>12/12/1961</td>
<td>8.1</td>
<td>9.8</td>
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<td>6/26/1962</td>
<td>2/9/1966</td>
<td>6.3</td>
<td>5.2</td>
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<td>10/7/1966</td>
<td>11/29/1968</td>
<td>9.8</td>
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<td>12.8</td>
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<td>20.0</td>
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<td>3/9/2009</td>
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</table>

Avg. (ex current): 15.2 14.5

Source: Bloomberg, BTIG
Options Market Memos (Part 2)

- Those who cannot remember the past are condemned to repeat it – George Santayana
- Since volatility pivoted higher at the end of 2017, the VIX has consistently held its floor while the S&P 500 cannot break through the ceiling.
- Complacency (VIX sub 14) has had a price – flat to down near-term returns. The current “Seasonal Slide” is no different.
- Will the “Summer Slide” which began at the 7/26 high continue to range trade, or are new lows in store? Washington and Beijing hold the keys. The rest of the world watches, nervously.

VIX Floor, S&P 500 Ceiling – Still a Very Fine House

Sizing Up Past Summer Slides

<table>
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<tr>
<th>Jan-Aug Max Date</th>
<th>Jan-Aug Max</th>
<th>Following Min Date</th>
<th>Mo. to Min</th>
<th>Following Min</th>
<th>% Chg to Min</th>
<th>New High Date</th>
<th>Mo. to New High from Prev.</th>
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<td>-9.2%</td>
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<td>8/15/2016</td>
<td>2,193.81</td>
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<td>8/29/2018</td>
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<td>2346.58</td>
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<td>4/17/2019</td>
<td>7.6</td>
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</tbody>
</table>

All Avg. 2.5 -12.2% 5.2
Same Yr New High Avg. 2.3 -10.1% 3.6

Source: Bloomberg, BTIG
Volatility itself remains volatile in both Equities and Fixed Income. Where are the opportunities?

While U.S. equities remain rangebound, S&P 500 Skew 18 months out continued to steepen (expensive downside puts relative to upside calls) as investor caution into and through Election 2020 is elevated. Can this degree of caution - skew often being a contrary indicator at extremes – help drive market upside if outcomes on a variety of geopolitical issues between now and then prove more favorable than expected?

The Euro has been remarkably calm this year, but the upcoming 10/31 Brexit deadline could reawaken volatility from historic lows. Other catalysts include a growing embrace of stimulus. The ECB announced it will resume QE, and will Germany follow the Netherlands’ lead for more aggressive fiscal stimulus in addition to its budget-neutral climate initiative?
What Keeps Us Up at Night

- With growth heading lower in the U.S. and elsewhere, and the 10/2 Yield Curve presciently predicting past recessions, the Fed is listening – and cutting – very carefully.
- With 10/2 at “Absolute Zero”, will the curve steepen, can recession be averted and are ultralow bond yields here to stay?
- Is the White House now as sensitive about the 10/2 Yield Curve as it is about the level of the Dow Jones Industrial Average with the 2020 Election looming?
- Near-record Consumer Confidence has begun to plateau, fatigued by reversal-prone trade rhetoric. Broken confidence has accompanied every recession since 1970, and the importance of reaching a trade deal cannot be understated.

10/2 Yield Curve – The Chilling Effect of “Absolute Zero”

Consumer Confidence with 12 & 36 Mo. Moving Averages

Recessions Shaded
Source: Bloomberg, BTIG
When the Trade War is making headlines, stocks decline.

Will the “Seasonal Slide” bottom over a “Trade Truce” or do politicians continue to push toward 1987 style policy and asset market brinkmanship?

The U.S. economic data remains reasonably strong; the consumer and his/her confidence is paramount.

Impeachment proceedings against President Trump add a new facet to already contentious U.S. politics. Do they risk weighing on consumer and investor sentiment?
The Fed: Wishes, Wars & Politics

- The Fed wants to manage risk, desires inflation, needs political independence.
- Two cuts with little effect as Repo woes and Manufacturing woes take center stage.
- Is there more beyond repo “liquidity management”? Will that be viewed as QE? Is 2% inflation something really to be desired? What can the Fed do to counteract Trade Wars?
- MMT is likely good for Germany, but ... MMT “light” has existed since Reagan. Institutionalization of MMT beckons the 1970s.
- Economic Nationalism, “Green New Deal”, all have the potential for stoking inflation.

Above 2%? Panacea or Pandora’s Box?

MTT – Been There, Done That

Source: Bloomberg, BTIG
Debunking the Myth that Gridlock Is Good for Stocks

- In the Rearview: The longest government shutdown ever, Mueller, Budget and the Debt Ceiling no longer an issue. Yet acrimony remains high as the flames of Impeachment are fanned – 2019’s rally is in spite of, not because of government. The statistics bear it out.

- Gridlock in general underperforms Unified government (5.6% vs. 9.0% annual return, 1928-2017), but the range of outcomes is wide, particularly when Unified becomes Divided government, as is now the case into the next Election.

- Trade Wars, investigations and intensifying social class frictions promise to keep politics a central issue for stocks at least until November 2020.

<table>
<thead>
<tr>
<th>Midterm Date</th>
<th>Pre-Midterm Control</th>
<th>Post-Midterm Control</th>
<th>Next Yr. Return</th>
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<td>Divided</td>
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<td>Democrats</td>
<td>41.4%</td>
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<tr>
<td>11/8/1938</td>
<td>Democrats</td>
<td>Democrats</td>
<td>-5.2%</td>
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<td>11/3/1942</td>
<td>Democrats</td>
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<td>19.4%</td>
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<tr>
<td>11/5/1946</td>
<td>Democrats</td>
<td>Divided</td>
<td>0.0%</td>
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<td>11/7/1950</td>
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<td>Democrats</td>
<td>16.3%</td>
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<tr>
<td>11/2/1954</td>
<td>Republicans</td>
<td>Divided</td>
<td>26.4%</td>
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<tr>
<td>11/6/1962</td>
<td>Democrats</td>
<td>Democrats</td>
<td>18.9%</td>
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<td>11/8/1966</td>
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Source: Bloomberg, BTIG
Trade Wars
Upending the World Order Is Messy Business

- Global trade, the greatest engine of prosperity in human history as the last 40 years have shown, is being redrawn.

- Part of 4Q2018’s U.S. market selloff and 2019’s May, August and October volatility spikes is China’s weakness inevitably washing ashore. The world can ill afford a “hard landing” in China. Especially if it means China selling U.S. Treasuries to “cushion the downside”.

It’s a Wonderful Life

China Holdings of U.S. Treasuries

Source: Bloomberg, BTIG
After months in hibernation, FX returns to center stage. China is a “currency manipulator” – Currency War on! The U.S. Dollar moves toward multi-year highs.

And Boris Johnson in the PM post in the UK – Outcomes less clear than ever.

Could GBP/USD, EUR/USD and EUR/GBP all go to 1.00? Not if Washington can help it – at all.

Does Treasury Secretary Mnuchin have his finger on the “Sell Dollars” Intervention Button?
Not All Boats to Be Lifted?

- Percentage of stocks above their 200DMA’s, a market breadth indicator, fell sharply during 2018’s February-March selloff, plunged in 4Q2018 and remains weak in 2019 despite the S&P 500 new highs. Leadership tends to narrow in late stage Bull markets – as seen leading up to the 2000 Tech Bubble and 2007 GFC tops. Many stocks have already made multi-year tops.

- Sector and stock selection become increasingly important – Alpha over Beta. Active over Passive? Buy Low, Sell High?

- Are Bond Proxies (Utilities, Staples, Software) “Onward Ever Upward”? Will Value ever cease being a “trap”?

---

**Bull Market Over for Some Stocks?**

- % NYSE Stocks Above 200DMA

**Tech Bubble Narrowing Leadership**

- % NYSE Stocks Above 200DMA

**Pre-GFC Narrowing Leadership**

- % NYSE Stocks Above 200DMA

Source: Bloomberg, BTIG
Value and Growth, Correlation and Causation?

- In 20 years, there have been two major trend changes between Value and Growth, March 2000 and May 2007.
- 2007 notable because of the “Quant Fund Quake”. In 2019-20, could a Trade War and an Election cycle tilt in favor of Value over Growth as FAANG comes under scrutiny? Could Passive become too Aggressive?
- Will a turn in the correlation between stocks and bonds (think pre-1998 as well as February 2018) cause a “Factor Flameout”?
- Does a reversal in ultralow long-dated global government bond yields, “The Biggest Bubble Ever”, cause Growth to underperform? Was September a “dress rehearsal” for further Value/Growth reversion?

![Growth vs. Value – Growth Spurt](image)

Source: Bloomberg, BTIG

- Markets can stay irrational for longer than you can remain solvent – John Maynard Keynes
- Without “anchored expectations” of disinflation/deflation or outright societal chaos, how can the idea of a lender paying money to lend to a borrower make rational economic sense?
- Perhaps only the Index benchmarked funds or the passive algorithms know the answer?
- After a 30+ Year global bond bull market, are the buyers of German 10-Year Yields at -0.55%, Italy 10-Year at 0.90%, Austria 100-Year sub 1% or the U.S. 10-Year ($22T Debt, Election 2020 ahead) at 1.6% the same people who bought Dutch Tulips in 1637, Japanese stocks in 1989, or Dot.Com stocks in 2000?
Global Government Bonds: The Biggest Bubble Ever? (Part 2)

- That which cannot go on forever, won’t – Herbert Stein
- Eventually bubbles pop; Homebuilder stocks topped in 2005, House Prices in 2006, the Financial Crisis Stock top was 10/2007.
- A catalyst is needed. On the positive side: Successful Central Bank reflation, an end to the Trade Wars, a smooth Brexit, or “The Golden Ticket” – German fiscal stimulus.
- Negative catalysts include further sales of U.S. Treasuries by China and the recognition of systemic sovereign risks (No deal Brexit?), particularly in Europe.
- Did August’s parabolic yield plunge and September’s sharp reversal pop the Bubble?

**German 10-Year Yields vs. Breakevens – Extreme Divergence**

**Japanese 10-Year Yield**

Source: Bloomberg, BTIG
Global Government Bonds: The Biggest Bubble Ever? (Part 3)

- Technical analysis helps to put parameters around the irrational and the unsustainable.
- Extreme moves often end in notable divergences.
- Could the U.S. 10-Year Yield not trading below its 2016 low despite new 30-Year Yield lows in 2019 signal a change coming?
- Nasdaq’s refusal to make a new low in March 2009 despite further S&P 500 weakness was a sign of reversal – the end of the GFC Bear Market.

**Treasury Yield Non-Confirmation**

**Nasdaq Divergence Foreshadowed GFC Low**

Normalized to 7/8/2016, U.S. 10-Year Yield all-time closing low
Source: Bloomberg, BTIG

Normalized to 11/20/2008, Nasdaq GFC closing low
Source: Bloomberg, BTIG
Other Markets – Buy Low, Sell High?

- Investors have soured on Europe, Japan, China and EM broadly.
- Could even the slightest daylight between Trump and Xi catalyze international equities?
- Could a “clean Brexit” and pumping ECB ignite the “biggest losers” – European Banks?
- Or is the chaos of a “no-deal Brexit” the entry for European equities investors have been waiting for?
- Japan, long sensitive to recovering U.S. growth, higher yields, and weaker FX looks attractive as the ultimate “cyclical” market.

### International Markets & S&P 500 Valuation Heat Maps

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<th>Year</th>
<th>S&amp;P 500</th>
<th>MSCI EAFE 1</th>
<th>STOXX Europe</th>
<th>Nikkei</th>
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Data as of 10/1/2019
Note: Annual numbers are the average month-end NTM P/E estimates for the corresponding year.
^1MSCI EAFE proxied with EFA. ^2MSCI EM proxied with EEM.
Source: Factset, BTIG
Dollar Decision Due, $2,000/oz. Gold in 2020?

- Everyone wants a weak currency. Does President Trump tweet the loudest? Does the Fed have the most ammunition to ease?

- Gold, the barbarous relic, where speculators became net short in 2018 for the first time in a generation, could eventually reclaim the all-time highs. After a great run in 1H2019, a bit of “digestion”, as the Bond Bubble “pops”, is in order. Yet in a world of geopolitical uncertainty, Trade, Currency and Fed Wars, the seeds of inflation being planted, and as an alternative for rational investors unwilling to pay borrowers for the right to lend, $2,000/oz. in 2020 or post the U.S. Election, in 2021, is in sight.

- All That Glitters is not just stocks and bonds.

U.S. Dollar – Something’s Gotta Give

Gold – Attractive Hedge in an Uncertain World?

Source: Bloomberg, BTIG
Bitcoin – Yes, Bitcoin. Is this NASDAQ 2002?

- Boom Bust, Boom Bust, Boom? – Bitcoin has crashed numerous times past. It is now largely ignored and volatility has collapsed, similar to tech stocks in the early – mid 2000s.

- If Block Chain is indeed technologically important, could cryptocurrency in general and Bitcoin in particular, rise once more? History seldom repeats but often rhymes.

- Bitcoin’s rise YTD has exceeded our expectations, but bodes well for the future. Similar to Gold, after a great run in 1H2019, a bit of “digestion”, as the Bond Bubble “pops”, is in order.
BTIG Sector Recommendations – Focus on Value and Valuation
Sector Recommendations Overview

- Preferences driven by sector specific as well as broader macro dynamics – selectivity is crucial.

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<th>Overweight</th>
<th>Neutral</th>
<th>Underweight</th>
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<tr>
<td></td>
<td>Info Tech</td>
<td></td>
</tr>
</tbody>
</table>

PAGE 35
Overweight

Energy, Financials, & Health Care

Energy
- Sector at historical low S&P 500 weighting
- Oil Futures curve in backwardation
- Accommodative Fed anchors inflation expectations
- Producers’ commitment to cuts to assure markets (despite U.S. pressure)?

Financials
- “ Biggest Bubble Ever” popped, historically low (negative) yields headed higher?
- Accommodative Fed encourages yield curve steepening
- Price-to-Book valuation inexpensive relative to historical average

Health Care
- Favorable demographic trends
- Attractive absolute, relative valuations
- Monitoring U.S. Health Care debate

WTI Crude vs. U.S Crude Oil Inventory
Source: Bloomberg, BTIG

Financials Prefer Curve Steepening
Source: Bloomberg, BTIG

Health Care – Affordable?
Source: Bloomberg, BTIG
Underweight

Consumer Discretionary, Consumer Staples, & Utilities

**Consumer Discretionary**
- Absolute, relative valuations elevated, both highest among sectors
- Multiples at risk if volatility returns, as seen in Q4 2018? Trade War casualty?
- Retail Sales remain slower as consumer sentiment has plateaued

**Consumer Staples**
- Absolute, relative valuations elevated
- “Biggest Bubble Ever” popped, historically low (negative) yields headed higher?
- Input costs pressures, result of Trade War

**Utilities**
- Absolute, relative valuations at historical highs
- “Biggest Bubble Ever” popped, historically low (negative) yields headed higher?
- Regulatory headwinds from environmental and pricing concerns?

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**Consumer Confidence on the Cusp?**

Source: Bloomberg, BTIG

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**Consumer Staples & 10-Year Yields**

Source: Bloomberg, BTIG

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**Utilities & 10-Year Yields**

Source: Bloomberg, BTIG
Communication Services

• Valuation, while rising, below dot-com levels of former Tech, CD, and Telecom sectors
• Long-term Growth vs. Value trend intact despite recent pressure
• Could increased regulatory scrutiny dampen investor sentiment?

Industrials

• Absolute, relative valuations below historical averages
• On the Trade War front line
• Dollar headwind to abate with accommodative Fed?
• Manufacturing slowdown – inventory-stocking pause or something more?

Information Technology

• Valuations, while rising, still below Dot.Com and pre-GFC levels
• Software relatively expensive within Tech
• Long-term Growth vs. Value trend intact despite recent pressure
• Could growing regulatory scrutiny dampen investor sentiment?

Communication Services Valuations Below Peaks

Manufacturing Gears Slipping

Technology Is the Bull Market
Neutral (Cont’d)

Communication Services, Industrials, Materials, Real Estate, & Technology

Materials
• Absolute, relative valuations elevated
• On the Trade War front line
• Accommodative Fed anchors inflation expectations
• Dollar headwind to abate with accommodative Fed?

Real Estate
• Absolute valuation at historical high, relative valuation elevated
• Continued home and land price improvement
• “Biggest Bubble Ever” popped, historically low (negative) yields headed higher?
### S&P 500 and Sector, S&P 600 Valuation Heat Map

**Data as of 10/1/2019**

**Note:** Annual numbers are the average month-end NTM P/E estimates for the corresponding year.

1. Financials numbers are Price/Book, historical numbers include Real Estate.
2. Real Estate numbers are Price/Funds From Operations.

**Source:** Factset, BTIG

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Data as of 10/1/2019

Note: Annual numbers are the average month-end NTM P/E estimates for the corresponding year.

1. Financials numbers are Price/Book, historical numbers include Real Estate.
2. Real Estate numbers are Price/Funds From Operations.

Source: Factset, BTIG
Summary

- 3,000 year-end 2019 price target
- Overweight: Energy, Financials, Health Care
- Underweight: Consumer Discretionary, Consumer Staples, Utilities
- Late stage cyclicality: Steeper yield curve, higher stocks and volatility
APPENDIX A: Investment Risk

The past does not determine the future, though it’s certainly an influencing factor. While investment cycles do reoccur, so does fundamental change.

The primary risk we identify of the strategies discussed in this analysis is mean reversion, of both volatility and leaders versus laggards.

Exogenous factors capable of disrupting our analysis can always intervene. Extreme events such as war, natural disasters and cataclysmic accidents, as well as far less dramatic but still unanticipated events are always capable of invalidating, or at least substantially distorting the time framework of any investment strategy based on mean reversion. As these risks, which may occur alone or in combination, cannot by definition ever be properly accounted for in our view, we highlight them here.

In the case of volatility-reliant strategies, the risk is actually the lack of any material change, a no surprises, steady-state ‘more of the same’ kind of financial environment, in which the market shrugs off potentially destabilizing risks and opportunities, seemingly no matter how large they may grow on the horizon.

In the case of low volatility-reliant strategies, the risk is that volatility is higher than anticipated in either direction, resulting in either an actual loss or diminished profit vs. a ‘do nothing’ approach.
APPENDIX B: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Julian Emanuel, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Michael Chu, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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