Churchill Management Group

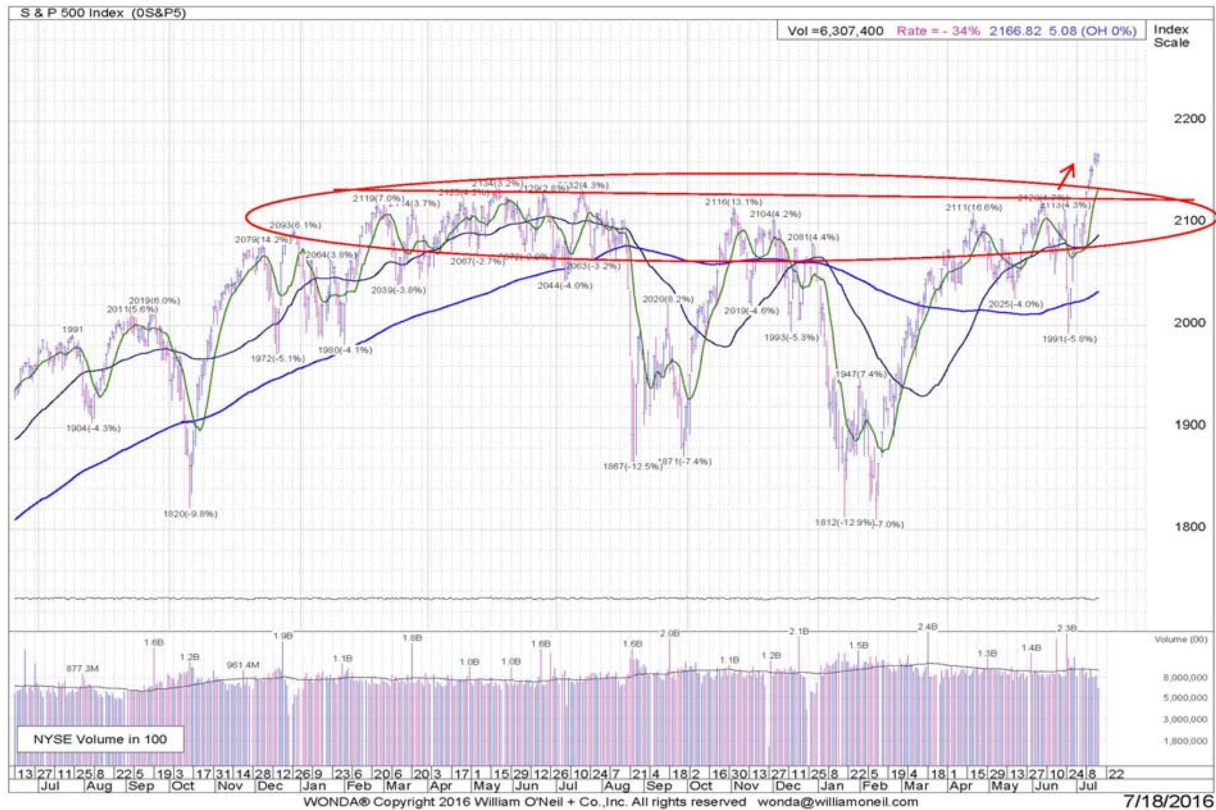
Market Perspective

July 19, 2016

After a brief decline that followed the initial results of the British Exit from the European Union (known as Brexit) vote, the stock market has been on a three week rally which pushed the major indices to all-time highs. From a technical analysis standpoint, the move above what had been rather strong resistance levels is positive. Stocks have tested massive overhead resistance levels for over twenty months, failing to sustain new highs dating back to late 2014. This recent positive breakout has allowed our Premier Wealth Tactical strategies to slightly increase our risk exposure to the markets, though maintaining a fairly cautious position as the fundamentals behind the market and the economy remain a concern. In our fully invested strategies, we continue to be neutral to defensive in our index alternative strategies, (such as ETF Sector Rotation), while enjoying the positive ride year to date in our dividend product.

BREAKING THE RESISTANCE

Prior to last week, the S&P 500 had made no fewer than a dozen failed attempts at taking out the May 2015 highs. This process has created massive technical resistance and a significant barrier to becoming bullish on the market as illustrated in the chart below.



The recent advance to all-time highs on the S&P 500 and DJIA has lifted our technical indicators to a slightly more positive tone and given us reason to raise our equity allocation to the market. Still, the lack of volume and leadership in this rally are reasons to temper enthusiasm. While it is true that volume has been absent throughout the majority of this Quantitative Easing driven rally, dating back to 2011, we do not want to discount its absence completely.

WHAT IS CAUSING THE MOVE?

In short the move is caused by interest rates which are historically low. Whatever economic concerns the Brexit vote brought, it also sent more money flooding into U.S. Treasuries pushing yields even lower. Despite historic lows, U.S. Treasuries were already seeing an inflow of international funds because as low as the rates look to us, they are better than the negative rates seen overseas. As money flows into treasuries, the yield inversely goes lower as noticed in the chart below showing the 10-Year Treasury hitting the recent record lows.

It has become an overplayed saying, but it remains true – what is pushing the U.S. stock market higher is what they call the TINA effect. TINA stands for "There Is No Alternative" to U.S. equities. Bond yields across the globe are low (if not negative as mentioned) and most asset classes are struggling. Hence, investors are pushing more of their money, even if reluctantly, into equities which has pushed prices higher and making stocks expensive, more on that below.

WHAT IS LEADING THE WAY?

No question the leading group of stocks has been those known as "the dividend darlings" stocks that offer a yield. Again, with global rates at all-time lows, investors have determined it better to invest in "relatively" safer equities paying a couple percent dividend, no matter how expensive they might be historically. This outcome has been apparent in our dividend strategy which has had very nice results over the past few years.

Outside of that group, a concern has been the complete lack of sustainable leadership from any market sector. The commodity groups, such as Energy, were awful last year but have rebounded nicely since February of this year. Still, the group does not look extremely attractive for the future. The consumer groups have alternated between leader and laggard over the past few years, as has Healthcare and Technology. Financials have flat out been lagging in the low rate environment. The best play has been to simply shoot the middle, which is why our step forward in our tactical strategies have been with ETFs that closely resemble the indices.

IS THE ECONOMY OUT OF THE WOODS?

The economy is not out of the woods in our view. While we have avoided an economic recession, the US economy as measured by GDP has been growing at a paltry sub-two percent pace (compared to a 4% plus rate post WWII average). Corporate earnings have been declining for six consecutive quarters, and US workers are feeling under employed and under paid.

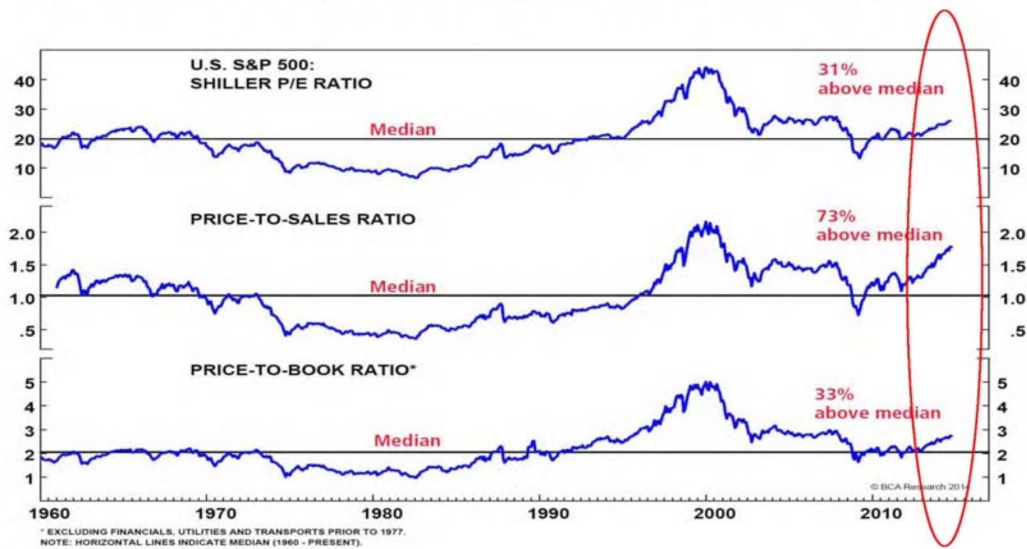
One of our economic advisors, Gary Shilling, recently summed up how the Brexit vote was all part of the growing global angst over economic sloth.

> "The Brexit vote was the culmination of populist movements that have been gaining strength in Western Europe and North America for some time…These movements have been driven by worldwide financial deleveraging and other forces have spawned slow economic growth. This, aided by excess supply of almost everything, has sired falling commodity prices, spreading and deepening deflation and nearly-universal attempts to devalue currencies against the U.S. dollar. All these forces are retarding middle-class incomes in major economies, augmented by other important depressants."

WHAT COMES NEXT?

It is too early to tell, but we will keep the seatbelt on. Basically, the entire market rally for the past few years has been nothing more than a rising Price to Earnings (P/E) ratio pushing stocks to expensive levels. Higher P/E's can be ok if the economy and corporate earnings back them up but they can big a problem if they do not. P/E's are below the peak in 2000 but are expensive by historical standards as shown below.

U.S. Equities Are Expensive By Historic Standards...



Source: BCA Research

Although the lackluster fundamentals remain, the newly positive technical action has allowed our tactical strategies to take a step forward and raise our percent invested. We are doing this while maintaining a conservative stance. We will continue to monitor risk levels to see if they allow for further risk exposure through more equity purchases.

As a note, it would not be unusual at all to have to take a step back out. Prior to the 2008 Bear Market, our tactical strategies stepped out of the market early, then took a small step back in on more positive indicators, only to step back out fairly soon as the market worsened. At these “fork in the road” moments in markets it is not always crystal clear, so moving in slow steps is the prudent approach for our conservative tactical strategies.

Our fully invested strategies will continue to execute their disciplines as well. Our goal is to make sure you have the appropriate balance of safety, dividend and growth to be comfortably positioned for your needs and risk tolerance during whatever market cycle we encounter.

CHURCHILL MANAGEMENT GROUP

** This report is meant to inform the reader of our current market opinion, which we, as professional money managers, use in our decision-making. It should be noted that stock market and bond market data are subject to varying interpretations and any one interpretation will not necessarily guarantee investment success. The information obtained from the sources specified herein and used as basis for our current market opinion is believed reliable, but we do not guarantee the accuracy of such information.
**CMG may purchase significant positions in foreign securities in all of its investment strategies depending on perceived market conditions, often through the use of Exchange Traded Funds.

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