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OVERNIGHT 29/6/17

Bloomberg --

Central banks set the tone on global financial markets Wednesday, with the latest comments from policy officials sparking a risk-on mood that sent U.S. stocks to the biggest gain in two months and roiled currencies from the pound to the loonie.

The S&P 500 Index rebounded from the biggest selloff in six weeks, with bank shares rising to March highs Treasury 10-year note yields climbed above 2.21 percent.

Technology firms snapped back to halt a selloff that dented confidence in the year's biggest gainers. Small caps led the way with a rally that topped 1.5 percent and took the Russell 2000 Index within a point of an all-time high.

The mood in U.S. equities reversed shortly before the open, when European Central Bank officials said markets had misinterpreted as hawkish comments Tuesday from Mario Draghi.

That sent the euro tumbling from the highest in a year versus the dollar on bets stimulus would remain robust in the region. The shared currency reversed again and the pound soared when Bank of England's Mark Carney, in a sign of confidence in the U.K. economy, said rates may need to rise soon. Canada's Stephen Poloz then reiterated he's considering tightening, sending the loonie tearing higher.

The optimistic reading of the latest central bank proclamations -- economies around the globe can withstand tighter financial conditions as growth picks up -- changed the tone in financial markets less than a day after a host of events from an IMF cut to its U.S. growth forecast, a fresh blow to the Republican agenda in Washington and a global cyberattack had ushered in note of caution. A trio of Federal Reserve speakers had also suggested that some assets had gotten rich by conventional measures. Markets also got a boost Wednesday as oil's rebound continued.

Here's what lies ahead for investors:

- China's PMI might have declined in June after unexpectedly remaining unchanged in May, reflecting government offers to cut overcapacity and leverage. That reading is due Friday.
- Also slated this week: Japanese inflation, factory output, unemployment, household consumption and housing starts.

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Stocks

- The S&P 500 Index added 0.9 percent to 2,440.51 as of 4 p.m. in New York, bouncing back from a loss of 0.8 percent. It's on pace for a quarterly gain of 3.3 percent, the seventh straight advance.
-
- Financial shares surged 1.6 percent, touching the highest since March.
-
- The Nasdaq Composite Index jumped 1.4 percent, while small caps in the Russell 2000 Index rallied 1.5 percent, the most since June 1.
-
- The Stoxx Europe 600 Index closed little changed as it heads for a monthly slide of about 1 percent.
-
- MSCI's emerging markets index fell 0.3 percent, paring a quarterly gain of 5.8 percent.

Currencies

- The Bloomberg Dollar Spot Index dropped 0.4 percent to the lowest since October.
- The euro rose 0.4 percent to $1.1385, the highest level since June 2016. The shared currency surged 1.4 percent on Tuesday.
- The pound jumped 0.9 percent to $1.2933 and the loonie surged 1.3 percent to 1.30293.

Bonds

- The yield on 10-year Treasuries added one basis point to 2.21 percent after jumping seven basis points Tuesday.
- The yield on German bunds was little changed at 0.37 percent.

Commodities

- WTI futures advanced 1.1 percent to settle at $44.74 after climbing 4 percent in the previous four sessions. Prices gained as government data showed a drop in U.S. gasoline supplies that have remained stubbornly high at the start of the summer driving season.
-
- Gold rose 0.3 percent to $1,251.35 an ounce, climbing for a second day.

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LAST NIGHTS'S CAPITAL ALLOCATION MOVES A PLUS FOR EQUITIES

American Express Plans 9% Dividend Hike, $4.4b Share Buyback

Bank of America to Buy Back Up to $12b in Shares, Raise Dividend

Citi Plans Up to $15.6b Buyback, Dividend Boost to 32c/Share

Morgan Stanley Authorizes $5b Buyback; Lifts Dividend 25%

Fifth Third to Boost Dividend, Buy Back Up to $1.16b Shares

Huntington Bancshares Sets $308m Buyback, Boosts Dividend

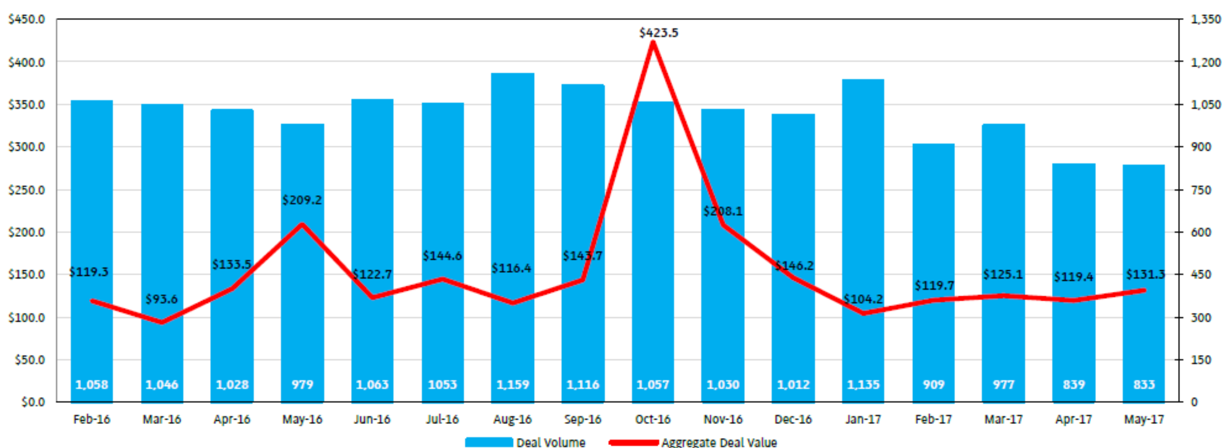
KeyCorp Sets $800m Buyback, Raises Qtr. Div to 10.5c from 9.5c

Regions Financial Plans Up to $1.47b Buyback, Higher Dividend

SunTrust to Boost Div to 40c; Sets Up to $1.32b Buyback

State Street Sets $1.4b Buyback, Boosts Dividend

IN ADDITION TO SHARE BUYBACKS SUPPORTING THE MARKET **M&A** ARE STILL RUNNING AT $ 100 bn + a month.



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ETFS, SHARE BUYBACKS ARE LEADING SOURCES OF EQUITY DEMAND

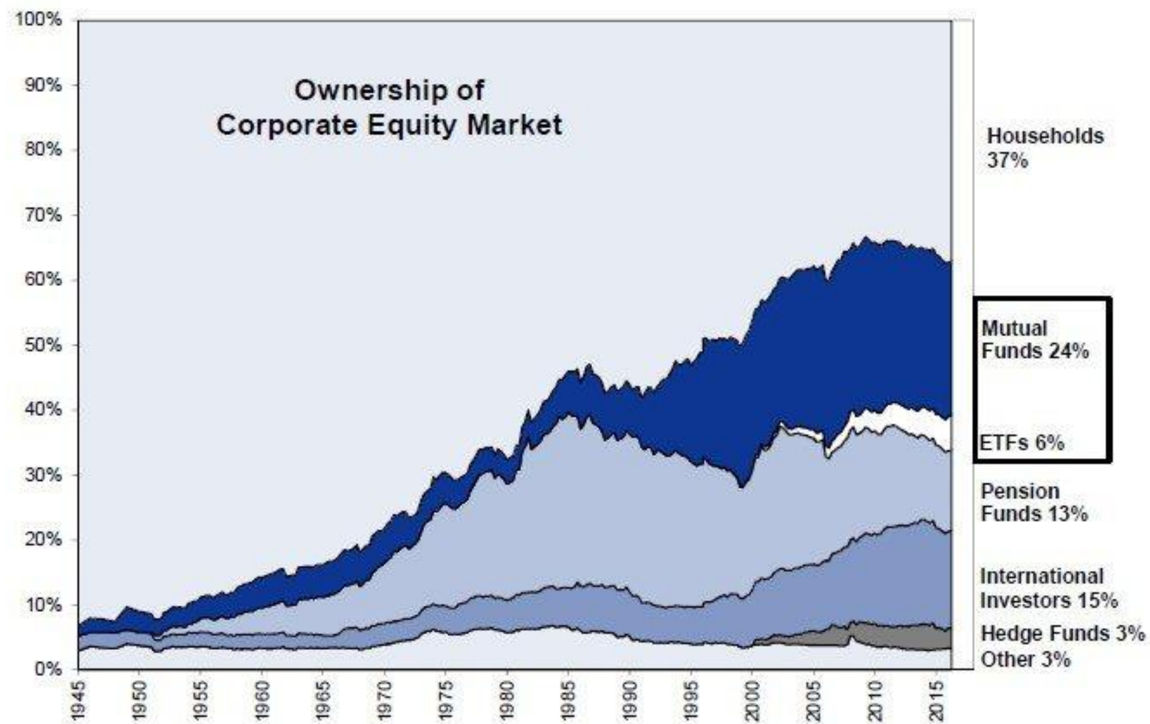
By Michelle Jones ,Valuewalk

Equity demand from exchange-traded funds has soared so far this year as investors increasingly favor passive investing over active. Another key source of equity demand earlier this year has been share repurchases, according to Goldman Sachs, although other firms have found a more recent decline in share buybacks.

Equity demand for ETFs skyrockets

In their June 23 "US Weekly Kickstart" report, Goldman Sachs analyst David Kostin and team offered analysis of the main sources of equity demand this year. They reported that equity demand for ETFs has surged this year, reaching $98 billion just in the first quarter alone. They added that it's on pace to surpass the total demand recorded in both 2015 and 2016 combined.

Exhibit 1: ETF ownership of equities is at the highest level on record
as of 1Q 2017



Source: Federal Reserve Board and Goldman Sachs Global Investment Research.

As a result of this extremely high demand for ETF equities, they boosted their full-year estimate for ETF purchases to $300 billion, which would be a record high if it reaches that level this year.

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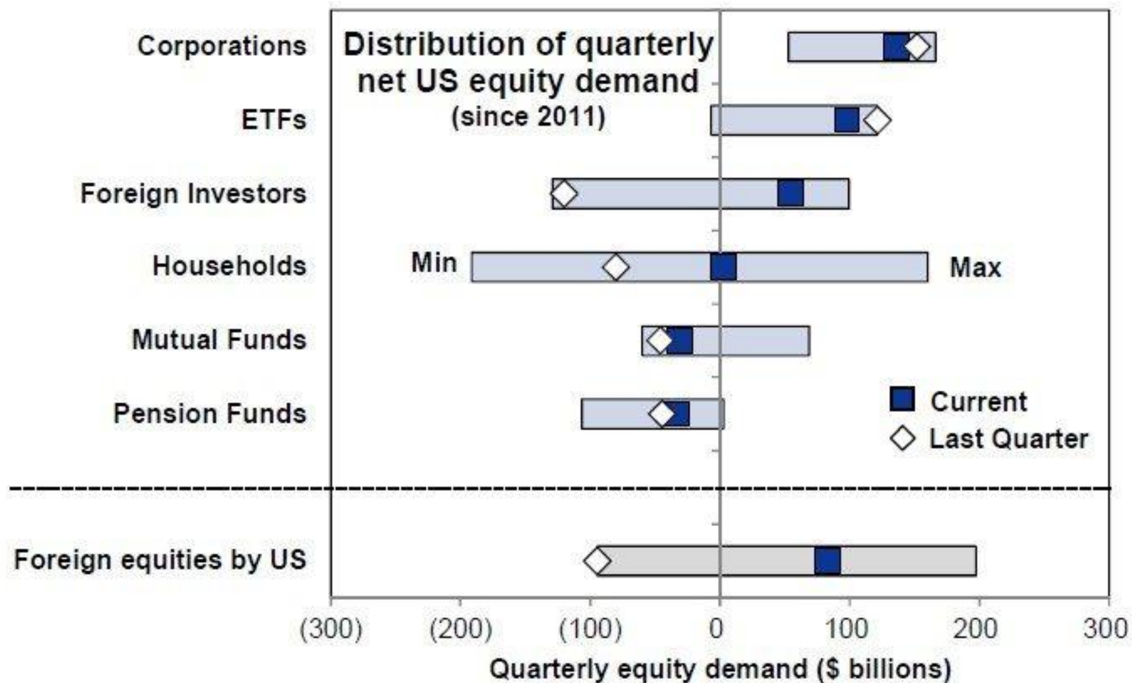
They add that ETFs hold nearly 6% of the equity market, marking ETFs' highest share of the market ever. Meanwhile, ownership of mutual funds has dropped to 24%, the lowest level in more than 12 years.



ETFs face off with mutual funds

ETFs bought $98 billion worth of equities during the first quarter of this year. Equity demand from ETFs amounted to $174 billion in all of 2015 and $188 billion in all of 2016. As ETFs purchase equities, mutual funds have been unloading them, according to the Goldman team. They report that mutual funds sold $31 billion worth of equities during the first quarter, which was the sixth quarter in a row that they have been net sellers of mutual funds. They expect mutual funds to remain net sellers in all of 2017.

Exhibit 3: Net US equity demand by investor type (2015-2017E)
as of June 23, 2017

Category	2015	2016	1Q17 Ann.	2017E	1Q17
	Net US equity demand ($ billions)				
Corporations	$ 559	$ 629	$ 546	**$ 640**	**$ 136**
ETFs	174	188	391	**300**	**98**
Foreign Investors	(187)	(180)	219	**25**	**55**
Life Insurance	32	100	(19)	**-**	**(5)**
Mutual Funds	56	(117)	(124)	**(50)**	**(31)**
Pension Funds	(179)	(154)	(132)	**(175)**	**(33)**
Households	(16)	(196)	11	**(90)**	**3**
Other	(5)	(5)	(54)		**(14)**
less					
Foreign equities by US	(203)	25	(332)	**(300)**	**(83)**
Credit ETF purchases	(55)	(84)	(139)	**(50)**	**(35)**
Total net demand	**$ 176**	**$ 208**	**$ 367**	**$ 300**	**$ 92**

Source: Federal Reserve Board and Goldman Sachs Global Investment Research.

They add that even though mutual funds sold $31 billion worth of equities during the first quarter, net equity demand was still about $15 billion higher than it was in the third and fourth quarters of 2016. In the third quarter, net demand stood at $49 billion, while in the fourth quarter, it was at $46 billion.

Kostin and team forecast a "modest" deceleration in ETF purchases during the second half of this year versus the first quarter because they see a lower "potential for significant equity upside" through the end of the year. They also expect mutual fund demand and inflows will continue to weaken as investors continue to shift from active management to passive funds.

Equity demand among foreign investors to drop

The Goldman team notes that while U.S. stocks rose 6% during the first quarter, foreign investors boosted their share of total corporate equity ownership. They added that foreign purchases of U.S. stocks amounted to $55 billion during the first quarter. It was only the second quarter foreign investors have bought U.S. stocks out of the last eight quarters.

They expect foreign investors to go back to being net sellers of U.S. equities in the second half of the year. They're forecasting total equity demand from foreign investors to be $25 billion for all of this year, which points to net sales of $30 billion in the second half of this year.

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Share repurchases were the biggest equity demand source

Kostin and team also reported that U.S. corporate equity demand, which they define as "buybacks minus issuance," amounted to $136 billion during the first quarter. It was a lower level than the six quarters immediately before it and a 10% decline from the fourth quarter. But despite that, share buybacks remained the greatest source of U.S. equity demand. They found that 22% of the buybacks among S&P 500 companies were by firms in the Financials sector, compared to the sector's five-year average contribution is 15%.

The Goldman team expects U.S. equity demand among corporates to grow 2% to reach $640 billion in all of 2017. They explain that the projected 3% increase in adjusted earnings per share this year, combined with near-record cash-to-assets levels and capacity utilization that remains below average, should drive growth in share buybacks for 2017.

No slam dunk for tax reform yet

They had previously been estimating an 11% increase in buybacks for this year, which would bring the total to $700 billion. However, they revised that estimate to reflect the delay their firm's economists are forecasting for Trump's tax reform, which will enable companies to repatriate cash at a lower tax rate. Tax reform and tax repatriation have been widely considered to be a slam dunk this year, and Barclays was buying value stocks in anticipation of the tax cuts that are expected to be part of the reform. So far, the Trump administration has failed to get anything done on this, however.

The Goldman team had been projecting between $60 billion and $70 billion in cash to be repatriated during the fourth quarter of this year, paired with $50 billion in spending on share repurchases. However, their new forecast eliminates the boost from tax reform for this year and also takes into account the first quarter's weaker-than-expected activity.

All these Share Buybacks and huge M&As have have helped power the rise in Equities since the GFC lows, but some worry that this Liquidity induced rally has not spread into the real economy.

Lacy Hunt: The Fed Has Undermined The Economy's Ability To Grow

By Mauldin Economics

The Fed's hope was that quantitative easing would stimulate economic growth. But a former senior economist for the Fed believes it has done the exact opposite.

Speaking at the Mauldin Economics Strategic Investment Conference, Dr. Lacy Hunt, the executive vice president of Hosington Investment Management and former senior economist for the Dallas Fed, said that quantitative easing has created "significant unintended consequences."

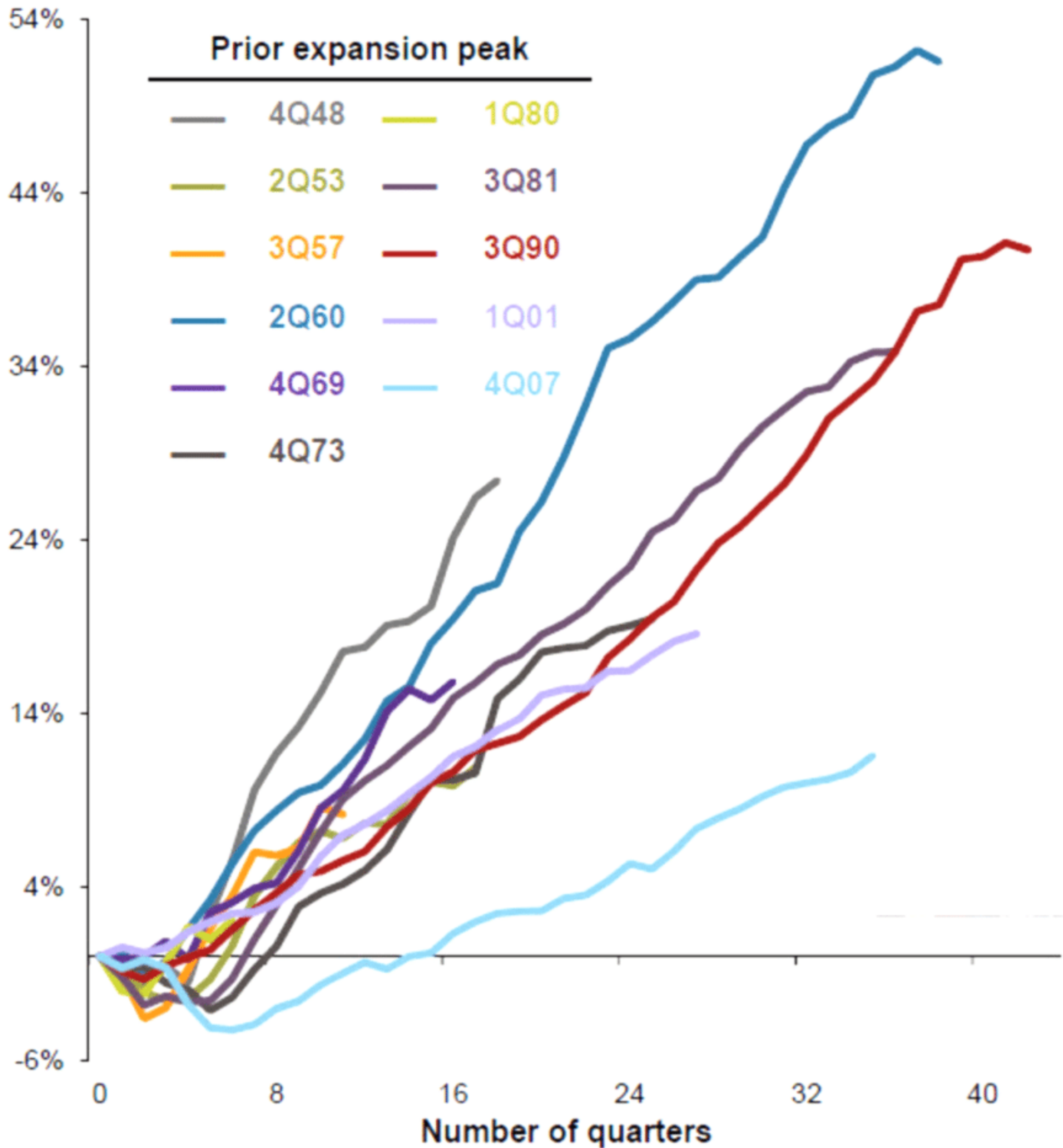
The Worst Expansion in US History

"What the Fed did was, they said to the world we are undertaking quantitative easing so we can boost the stock market… and the stock market will then produce a wealth effect and invigorate the economy."

While the Fed has increased its balance sheet by $3.57 trillion since 2008, and the S&P 500 is up 255% since 2009, Hunt says, "this is the worst expansion in US history."

As just half of Americans own stocks, it's no wonder the wealth effect hasn't percolated through the economy.

The Fed's massive experiment has also created huge distortions in the private sector, which has severe consequences.



Business Leverage at Record Highs

"Quantitative easing has created a lot of negatives, one of the most glaring is this liquidity which has fueled record leverage of the business balance sheet."

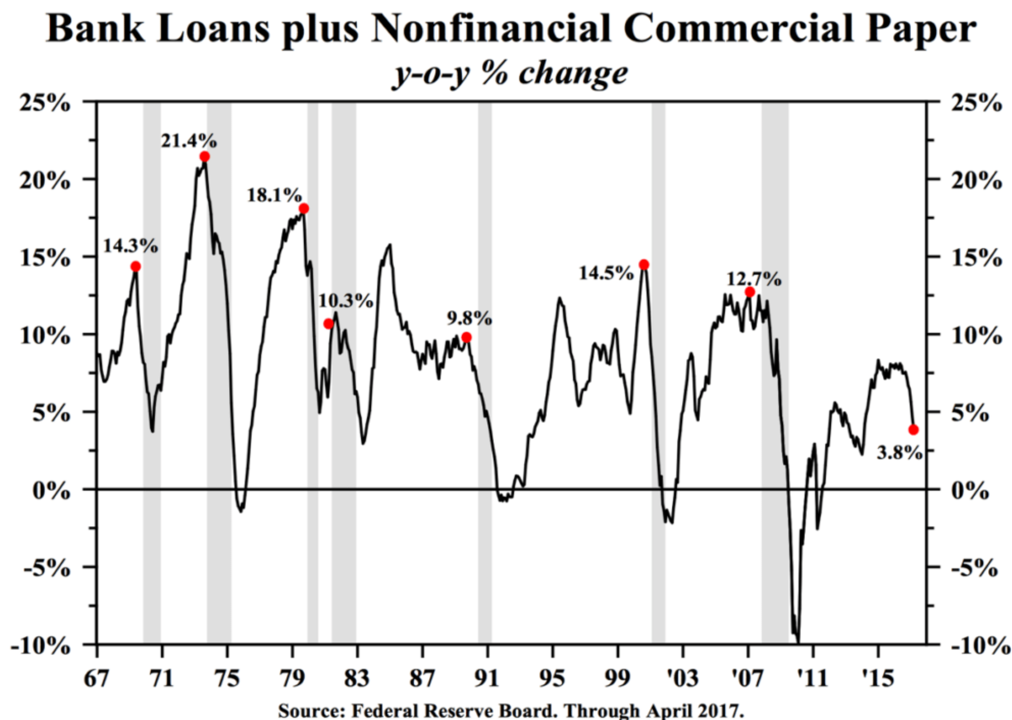
Total business debt is now up 71% since 2008—twice the long-term growth rate. Worse yet, Hunt says much of this debt has been used unproductively: "Quantitative easing encouraged a shift from real investment to financial investment. The Fed's backing your play, engage in financial engineering… buyback shares, raise dividends. The business managers think they can reverse [these actions].''

Although total business debt is at a record high, real investment—expenditures on property, plant, and equipment—is falling.

Hunt goes on to say, "It's the investment, the real investment which grows the economy. The Fed has created very significant unintended consequences, which have undermined the US [economy's] ability to grow and lift the standard of living."

An Ominous Sign for the US Economy

Speaking in an exclusive interview with Mauldin Economics, Hunt also addressed the Federal Reserve's current monetary tightening cycle: "Whether they [raise rates] is immaterial because already they have engineered a contraction in [credit]… all major categories of bank lending are slowing."



"Since 1915, of the 18 recessions, all of them, bar one, were preceded by monetary tightening… the Fed is on very thin ice."

WORKING AGE POPULATION TO DECLINE IN ALL DM AS NIGERIA EXPECTED TO EXPLODE

By Rupert Hargreaves ,Valuewalk

UN Working Age Population To Decline in the West as India and Africa grow in population

In investing, to achieve the best results you have to be able to accurately forecast a company's future projected growth rate, a task that is virtually impossible for most businesses.

One way to skew the odds in your favour is to look to those companies that are set to benefit from a wider trend, as they are lifted by the rising tide there's more room for error from management.

- and economic growth over the next few decades, presenting a tremendous opportunity for businesses. According to the UN's new demographic projections, by 2100 the world's population will have reached 11.2 billion, spurred by population growth in Africa and India.

Even though over the past few decades the world has made enormous strides towards ensuring that the planet's ever-growing population is adequately fed, watered and has access to basic necessities, as the population continues to grow meeting the requirements of the larger population is going to become a critical issue for policymakers.

UN Working Age Population To Decline In All Developed Markets

The biggest problem will undoubtedly be changing demographics, as a new report from analysts at HSBC points out.

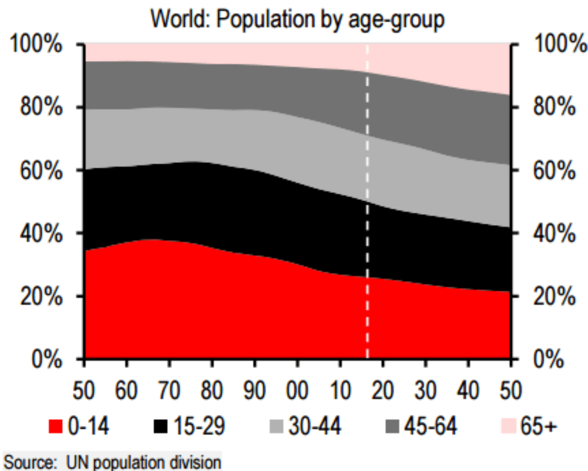
Developed markets are seeing their working-age populations shrink by 0.3% each year, holding back growth, while China's number of working-age people shrank for the first time last year.

On the whole, the shape of the world's labor force is shifting:

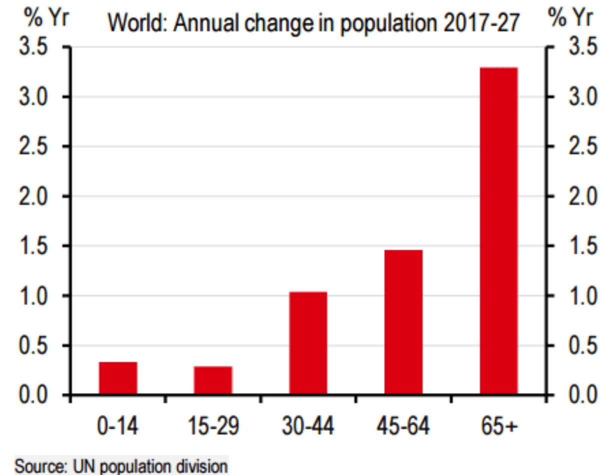
the UN expects 25 million fewer developed market workers,

but nearly 500 million more in emerging markets over the next decade.

1. The world's population is ageing…



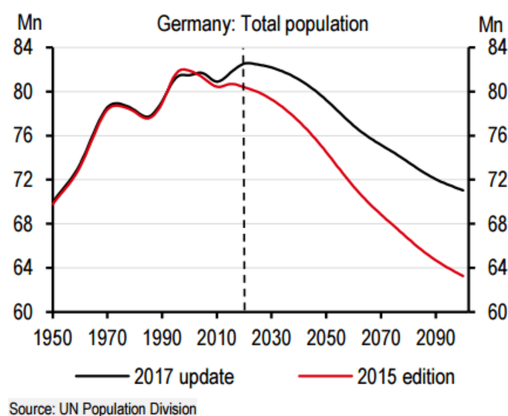
2. …with the number of over-65s set to grow quickly



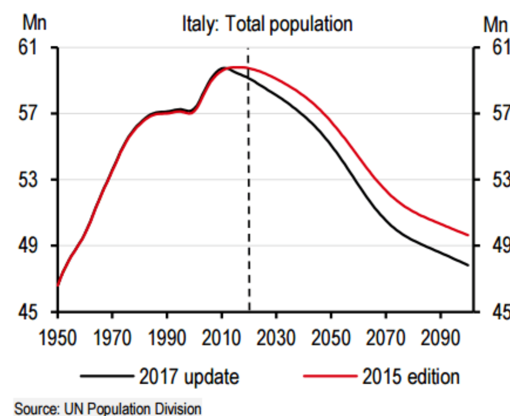
The world's population is going to age at an unprecedented rate over the next decade. The number of over 65s in the world will increase by 38% as we move from having 7.5 workers per pensioner to 6.0 in the space of just ten years.

For developed markets, this problem is going to become increasingly acute. Fertility rates are too low, populations are living longer, and working age populations are shrinking, creating headwinds to growth and balancing public finances. According to HSBC's analysis, of all the developed markets covered, only Sweden and the UK are likely to see an improved demographic backdrop over the next ten years mainly as a result of immigration.

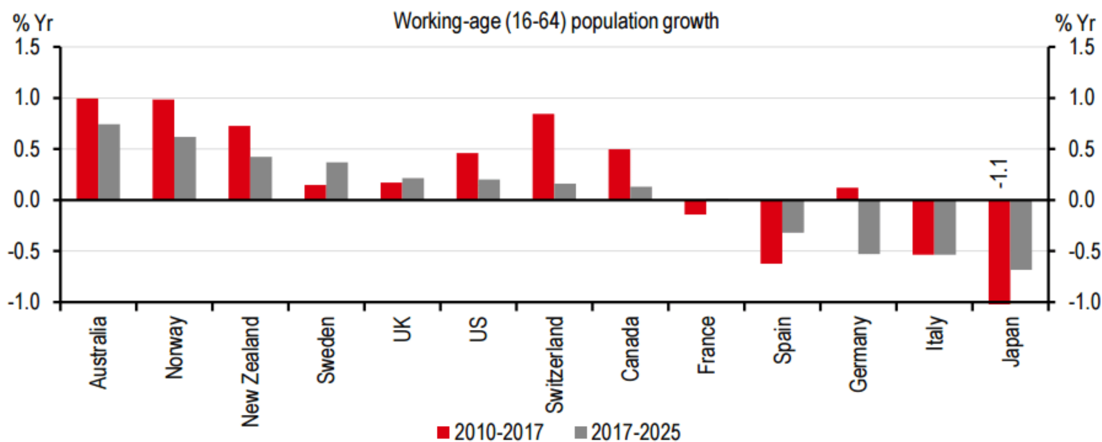
3. Migration delays the inevitable for Germany's demographics…



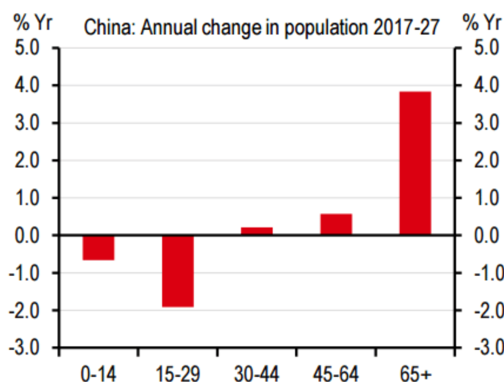
4. …whereas Italy's are just getting worse

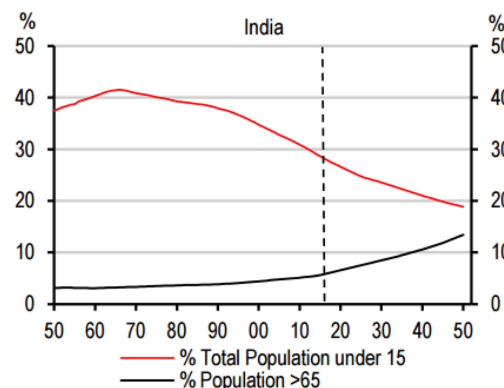


But as developed markets struggle with aging populations, some emerging markets may struggle with the exact opposite. HSBC's report notes that India's working age population is set to grow by 1 million every month for the next five years and in Nigeria, the UN expects the total population to double to 400 million by 2100. Looking at employment data, this means that the country will create 3 million more workers a year than it can accommodate, which could lead to high levels of unemployment and social unrest.



Unfortunately, even though the problems shifting demographics pose well known, there seems to be little political appetite to meet the challenges. Given the global population mix, globalization should be embraced (in the right scenarios which is not the case in most of Europe) so that the capital and labor across the world can mix. But as Trump, Brexit and Le Penn's near victory in France have shown, countries are moving away from this desired course of action.





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Get Ready for Risk Off

Frank Barbera CMT,Financial Sense

Tuesday's steep -100.53 index point decline in the NASDAQ, a loss of -1.61% on the Composite and 20 decline on the S&P (down -0.81%) is yet another sign of weakening internal strength within an aging uptrend. By mid-day on Wednesday, nearly all of the S&P 500 decline has been retraced and a portion of the NASDAQ decline as well. Yet, Tuesday's announcement regarding the postponement of the Healthcare Bill vote, and a lot of the discussion around that proposal seem to suggest that it may take quite some time to finally pass. Senators like Rand Paul appear fairly strongly opposed to the bill in its current form and there is wide disparity among the Senators who are against it, in terms of how to reconcile the bill. The suggestion now is that the Senate may need to work through the August recess until a plan is complete.

Yet, from the market's point of view, it is imperative that the healthcare bill is moved along at a rapid clip, as any extended delay from here into August would mean that tax reform will likely not happen in 2017 and instead will be pushed into 2018. For stocks, that is a serious problem. It is also a serious issue for the Fed, which is anticipating a recovery and pickup in growth with tax reform being the key driver. Any delay would mean that expected growth may not increase as expected and that the Fed may have to step back from its planned sequence of rate hikes. For a stock market that ran up rapidly on the idea that a Republican controlled White House, House, and Senate would be able to quickly push through major changes in public policy (i.e. the end of gridlock), the gap between what current prices have now discounted in versus the potential disappointment regarding both how long legislation will take to enact, along with how significant the legislative changes end up being (should they be watered down)...well, that gap could now be a surprisingly wide chasm.

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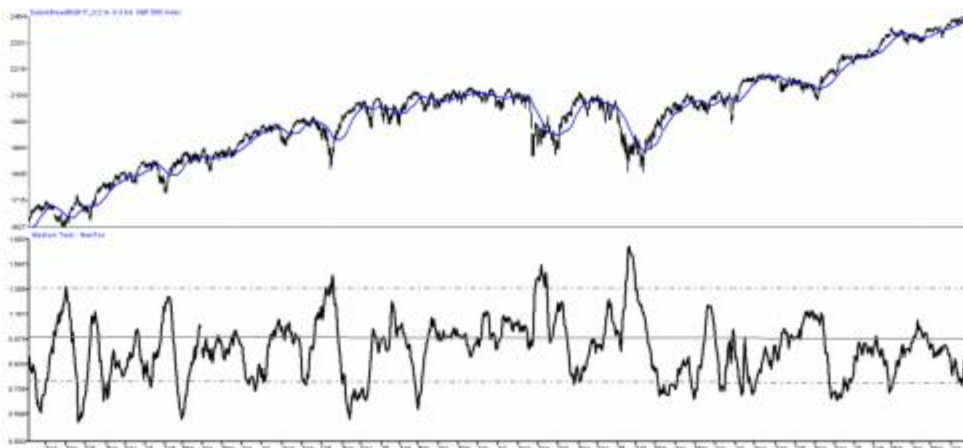
Above: NASDAQ Composite right on lower trendline and 50 day moving average support.

In Salem's view, stocks remain close to levels that could presage a full-scale break down. On Tuesday, the NASDAQ Composite closed right on its rising trend channel line that has been in effect for the last few months. It also closed just above the 50-day moving average which is reinforcing support at that 6100 level. As I noted in my 6/21/17 report (see Could Recent FANG Weakness Be Signaling the End of the Bull Run?), any significant move below 6100 on the NASDAQ Composite would have to be viewed as quite bearish:

The implication at that juncture would be that a larger Elliott Wave downward corrective move would be getting underway that would retrace a portion of the entire preceding bull market advance and with that, likely usher in an end of the friendly "passive" investing environment of the last several years. Alternatively, in the short term, we would be watching the 5630 level on the NASDAQ 100 (NDX) **and 6,100 on the NASDAQ Composite as key zones of support. Any move below the lower boundaries of those ranges on the key NASDAQ Indices, combined with a move below 2,417 on the S&P 500, would negate the potential for new highs and signal a full on intermediate correction or bear market getting underway**.

At the same time, the S&P 500 continues to hold above key support at 2420 and would need to break below 2420 by 8 to 10 points in order to signal an equivalent breakdown. That said, it is becoming clearer with each sell-off that the S&P is laboring internally. Wednesday's strong rally led by Financials looks like it could be setting up some kind of potential right shoulder or final fifth wave. Either way, the composite price action of both markets seems to be pointing to an over-arching conclusion that, at this juncture, we could be seeing a broad distribution pattern tracing out, and that often happens at major tops.



Above: The S&P 500 ARMS Index is coming off very low, top value type readings.

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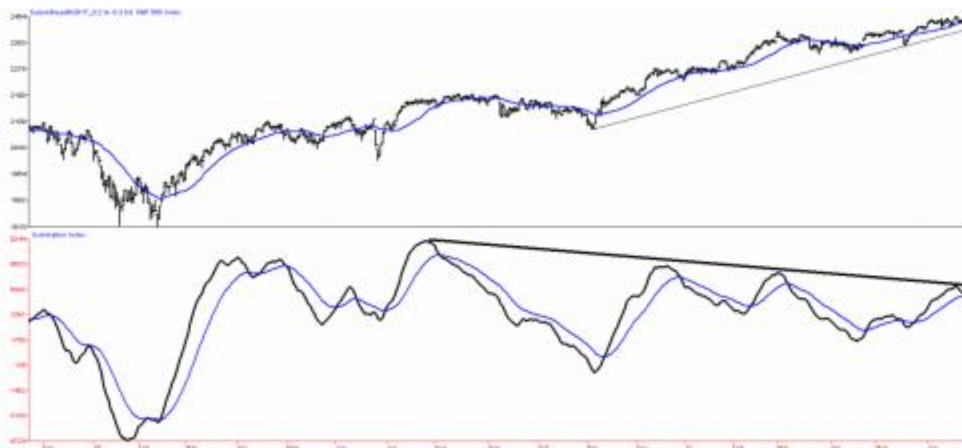
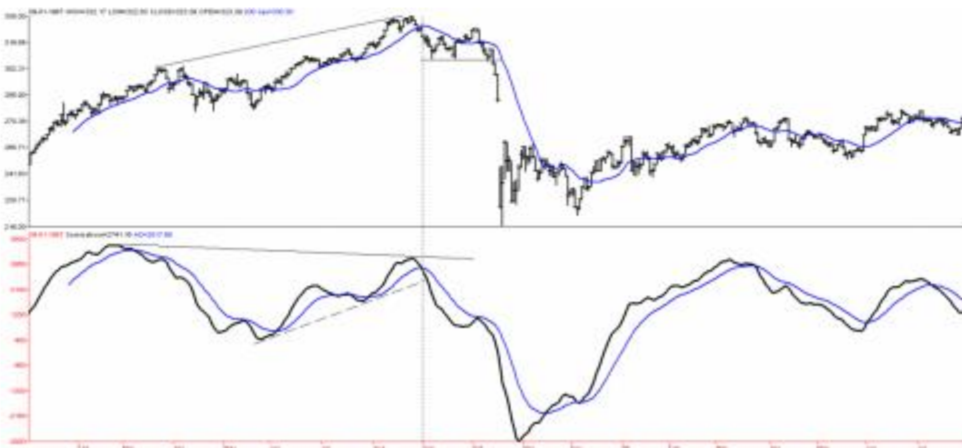
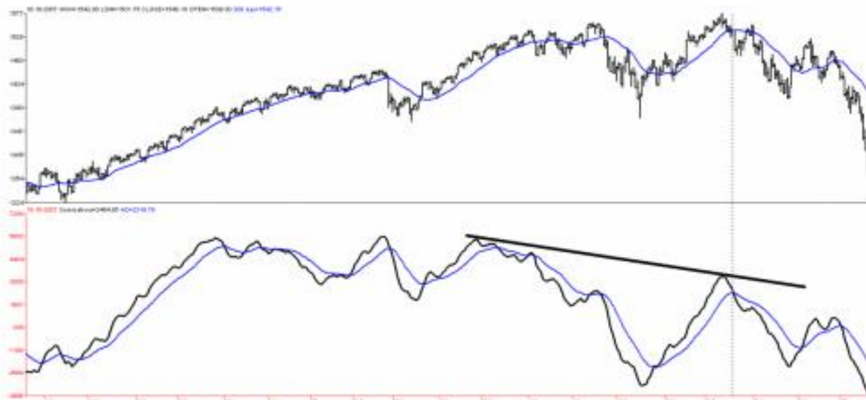
In addition to the bearish chart configuration, it is also worth noting that the ARMS index for the S&P 500 is just coming off record low ("overbought") values. Late in an extended move up, low ARMS Index readings can frequently be a major red flag for an advance. Finally, the McClellan Summation Index for Operating Companies Only crossed below its important short-term moving average yesterday. That could be the beginning of an important trend following sell signal. We note that this bearish crossover took place after the index has been higher for months, and the Summation Index has been sporting a bearish divergence over the same period of time.



Above: S&P with Summation Index - Present day



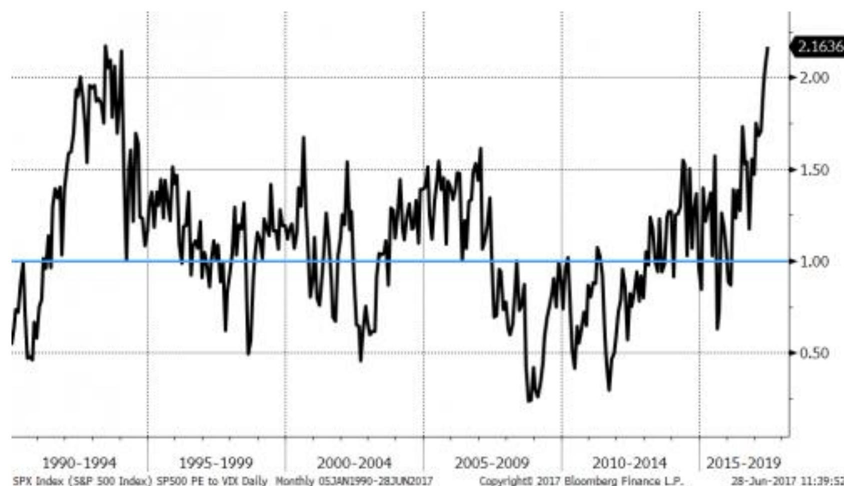
Above: S&P with Summation Index in 1987, pre-October 19 Crash



Above: S&P 500 with Summation Index in 2007-2008

Looking back at past major turning points, these kinds of extended bearish divergence periods on the Summation Index have often been a key ingredient attending major tops. When the Summation Index finally crossed over and started trending down in both 2008 and 1987, serious price damage started to show up in the major stock market averages shortly thereafter.

In the present circumstance, there are a number of parallels to 1987 and 2007-2008. These include very low VIX Index readings, ultra low Put-to-Call Ratios on the S&P, burgeoning weakness in Emerging Market Debt and High Yield credit markets, softness in Energy, and investor apathy toward contrary assets like Gold. For the S&P 500, the Price-to-Earnings Ratio over the VIX Index indicator (see below) now resides at virtually all-time high territory.



This gauge is just screaming the word "complacency", ironically, at the very same time our Fed Chair is waxing on about no more financial crisis in our lifetime. These various signposts form a broad mosiac that points to a sea change that might be underway. The underlying message: get ready for risk off.

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