Quick Take - Don't Worry Be Happy

Let me reiterate why we should not panic with Friday's correction.

1. Markets short-term were simply overbought. A correction is healthy, and we saw that coming taking off some risks and putting on hedges early the week. That is the strength in the team and power of the platforms we used. We know how to hedge, and we can hedge.

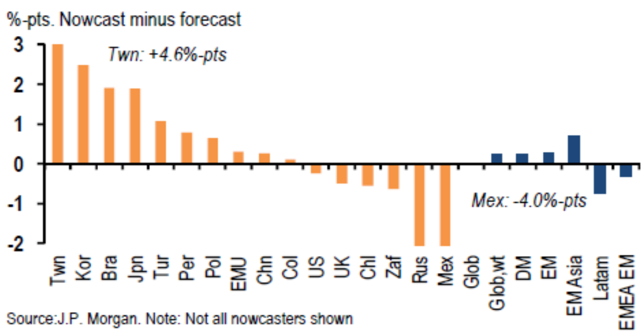
2. Aside from rising rates, which I will comment later, macro-economic data is very strong. Latest incoming GDP prints and nowcasting model is indicating 4Q17 GDP at 3.2 to 3.7% and more importantly points to 1Q18 at 3.80%. The incoming data is confirming consensus forecast for a strong GDP in 2018. The case in point Jan preliminary PMI indicators for both manufacturing and services kept pace with Dec and the average of 4Q17 readings. Further, the improving momentum remains wide-spread as we have commented in our 2018 strategy.

Jan PMI remains strong

%ch, sa (ar for qet). PMIs are levels. Conf is st.dv from 2010-

	4Q17	1Q18	Dec17	Jan18
PMI, mfg	54.7	55.5	55.6	55.6
PMI, serv	53.9	54.2	53.9	53.9
Nowcast	3.7	3.8	3.9	3.9

Many economies tracking above 1Q18 forecast



3. Remember our analysis of QT and expensive valuations where we map numerous economic and market variables like CPI, Yields and earnings. The end conclusion nothing matters more than earnings. Latest earnings seasons is off to a very strong start.

   US – 42% reported. 81% beats EPS – highest in 7 years and 78% beats sales. EPS last quarter was up +12% so far. A record 75% of companies raised FY18 EPS guidance. Impressive!

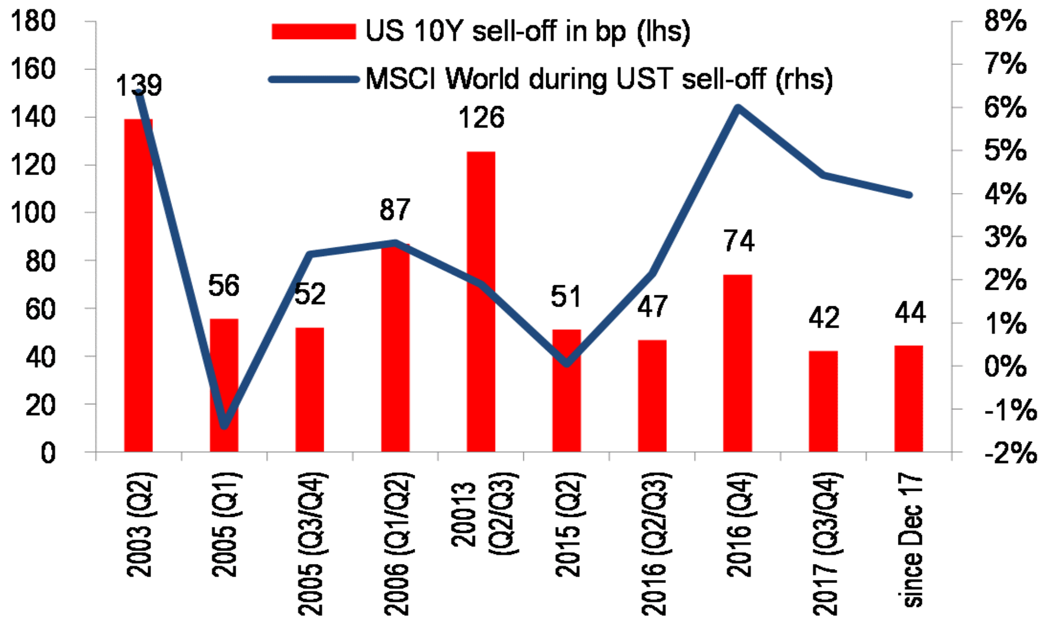
   EU – 20% reported. 52% EPS beats with EPS growth +15% for quarter. 55% beats on sales.

   JN – 38% reported. 61% beats on EPS and sales are above long-term average since 2009 with +14% EPS growth.

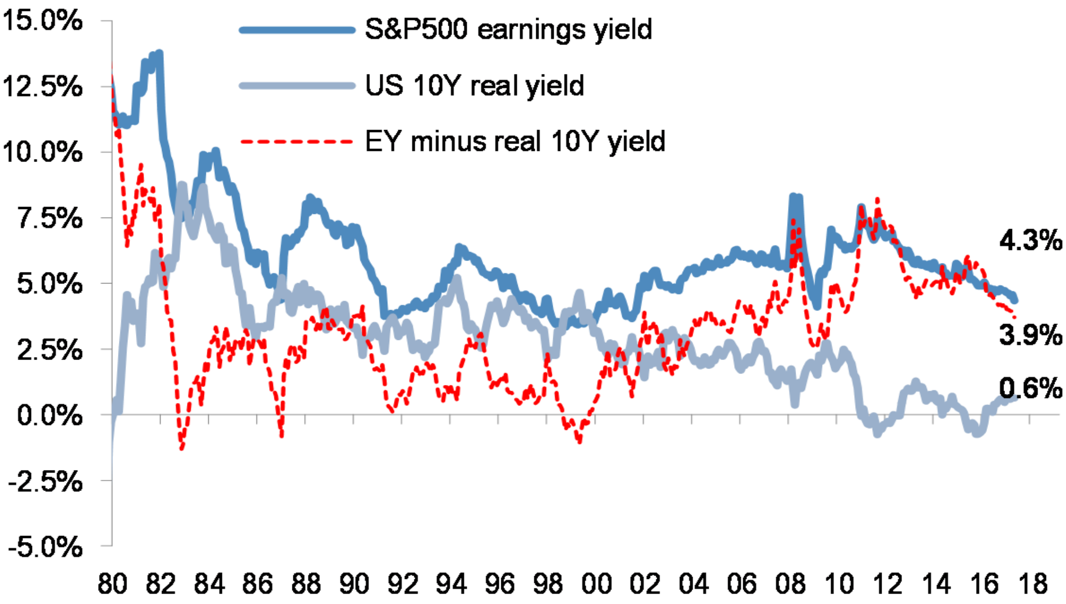
4. As we have mentioned in our 1H18 investment strategy and slides, we know when rates and inflation will hurt us; UST10 >4%, CPI closer to 3%. We are simply not there yet even after Friday US wage data. When we discuss inflation and rates there are multi-modal analysis of causes and effect.

   Inflation ties with economic growth vs capital/labour gaps and productivity. As we shown in the presentation slides, the broad-based capex recovery and the accompanying improvements in productivity are welcome missing narratives that acts as a buffer to rising inputs costs from labour to prices of goods.

Lest we forget, textbook. Rising rates bad for bonds but good for equities. Performance of global equities during ten episodes when US 10Y yields rose about 50bps are the following: Equities and Financials delivered positive returns 90% of the time; US high-yield credit spreads tightened 80% of the time and high-grade 60%; base metals rose in 80% of instances, oil in 70% and the trade-weighted dollar in 60%. Bond bear markets are almost always bullish for rate vol (up in 90% of episodes), but only sometimes bullish for equity and FX vol (VIX and VXY rise 50% of the time).



Even if you argue, rising rates price risk premia higher, equities risk premium is still above norm therefore still +ve for equities.



And rising rates lifts overall S&P EPS growth marginally not detract.

Variable	Model 2018E baseline	Sensitivity: Chg from baseline	Sensitivity: EPS impact	Upside scenario: 2018 variable	Upside scenario: EPS impact
US GDP	2.5 %	+100 bp	+$4	3.5 %	$4
World GDP	4.0 %	+100 bp	+2	4.5 %	1
Core CPI inflation	1.9 %	+100 bp	+1	2.0 %	0
Brent crude oil	$61	+$10	+1	$80	2
10-year UST yield	2.9 %	+100 bp	+0.5	3.5 %	0
USD (trade-weighted)	(2.0)%	+10%	-3	(5.0)%	1
S&P 500 EPS	**$150**				**$158**
Growth vs. 2017E	**14 %**				**20 %**

Note: all variables based on average annual change.

Source: Goldman Sachs Global Investment Research.

Textbook. Improving economy = smaller output gaps = higher inflation = higher rates = bad for bonds good for equities of course higher capex = better productivity = higher chance of of increasing or maintaining corporate profits = sustained momentum in asset prices.

Lastly, there are 2 main types of bond bear market we should worry about. First, bond bear market driven by higher inflation. Again, we are not there yet and this capex narrative acts as an absorber; think early 80s Volcker reign bond bear market. The other is dramatic repricing of markets expectation of rates to be in-line Fed's new direction. Think taper tantrum. Fed has communicated this well telling us 3 hikes this year, maybe four and market end of last year was still at 2. WIRP is currently at 3 now.

Edward Lim, CFA
Chief Investment Officer
edwardlim@covenant-capital.com

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