Gluskin Sheff + Associates Inc.

Paradigm Shift

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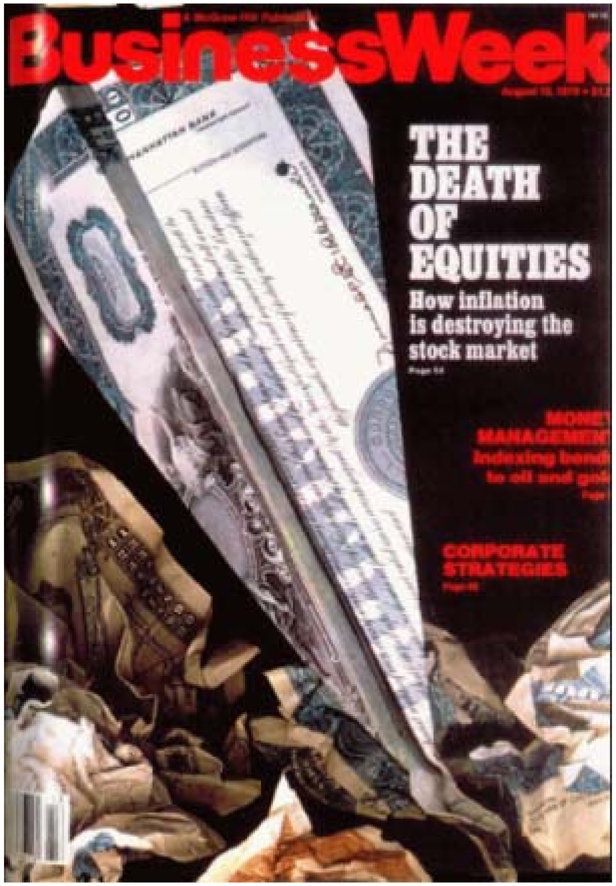
BEWARE OF THE FRONT COVER EFFECT



Notes:
Source: BusinessWeek (August 13, 1979)

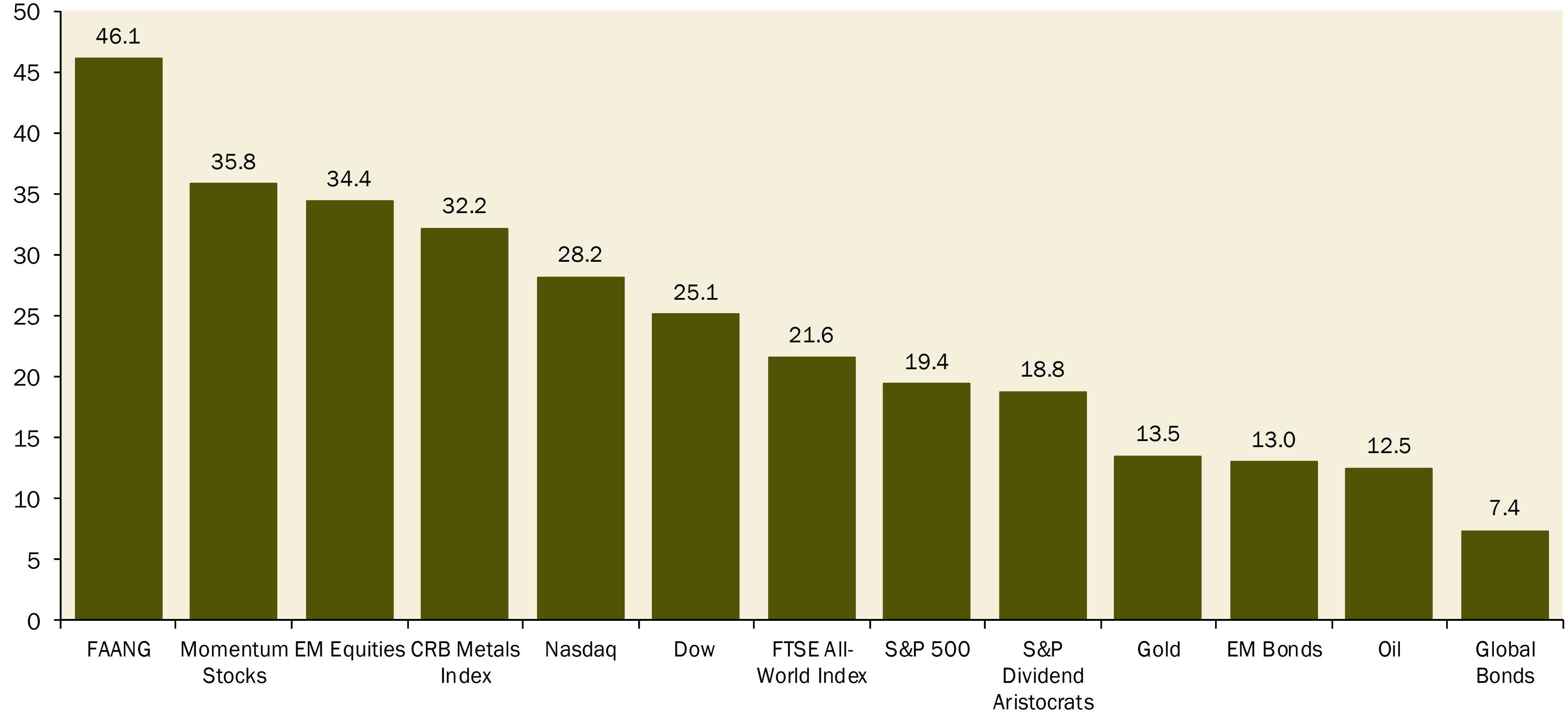
THIS ONE MAY HAVE MARKED THE TOP

Notes:
Source: The Economist (October 7th – 13th, 2017)

EUPHORIA EVERYWHERE YOU LOOKED

2017 Price Returns

(percent change)



As of Jan. 26th, 2018: 304 trading days without a 3% drawdown in the S&P 500; 396 sessions without a 5% pull-back

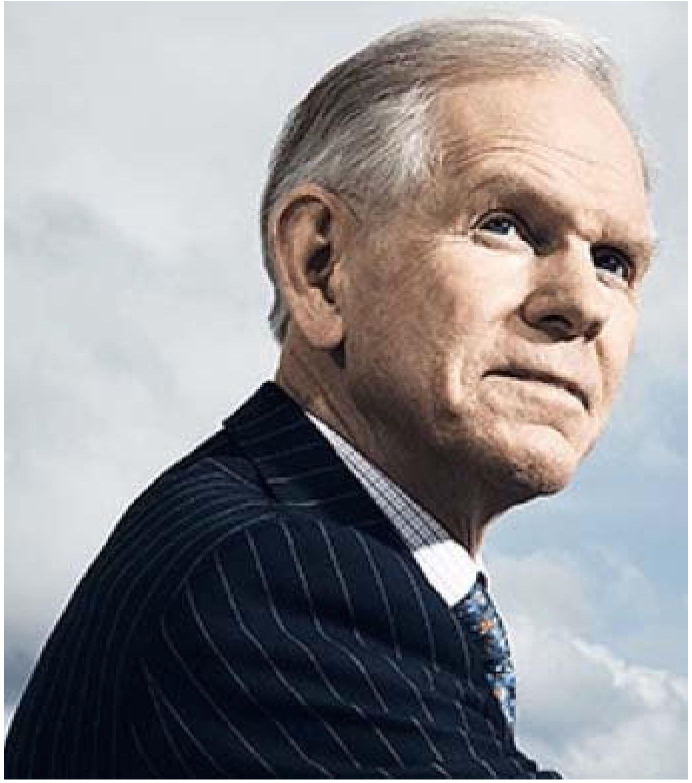
Notes:

Source: Bloomberg, Gluskin Sheff

ONE LAST MELT-UP!

I find myself in an interesting position for an investor from the value school. I recognize on one hand that this is one of the highest-priced markets in US history. ***On the other hand, as a historian of the great equity bubbles, I also recognize that we are currently showing signs of entering the blow-off or melt-up phase of this very long bull market****.*

— Jeremy Grantham, January 3rd, 2018



*<u>Sees the potential for a final 60% surge over the next two years</u>**

S&P 500 END-2018 CONSENSUS FORECAST

Firm	Strategist	2018 Close
Bank of America	Savita Subramanian	2,800
Bank of Montreal	Brian Belski	2,950
Canaccord	Tony Dwyer	3,100
Citigroup	Tobias Levkovich	2,800
Credit Suisse	Jonathan Golub	3,000
Deutsche Bank	Binky Chadha	2,850
Evercore ISI	Dennis DeBusschere	3,000
Goldman Sachs	David Kostin	2,850
HSBC	Ben Laidler	2,650
Jefferies	Sean Darby	2,855
JPMorgan	Dubravko Lakos-Bujas	3,000
Morgan Stanley	Mike Wilson	2,750
Oppenheimer	John Stoltzfus	3,000
Scotiabank	Vincent Delisle	2,750
Stifel	Barry Bannister	2,750
UBS	Keith Parker	2,900
Wells Fargo	Chris Harvey	2,863
Mean		2,875
Median		2,855
Max		3,100
Min		2,650

Notes:
Forecasts as of December 22, 2017
Source: Bloomberg, Gluskin Sheff

The S&P 500 hit 2,873 on January 26th!

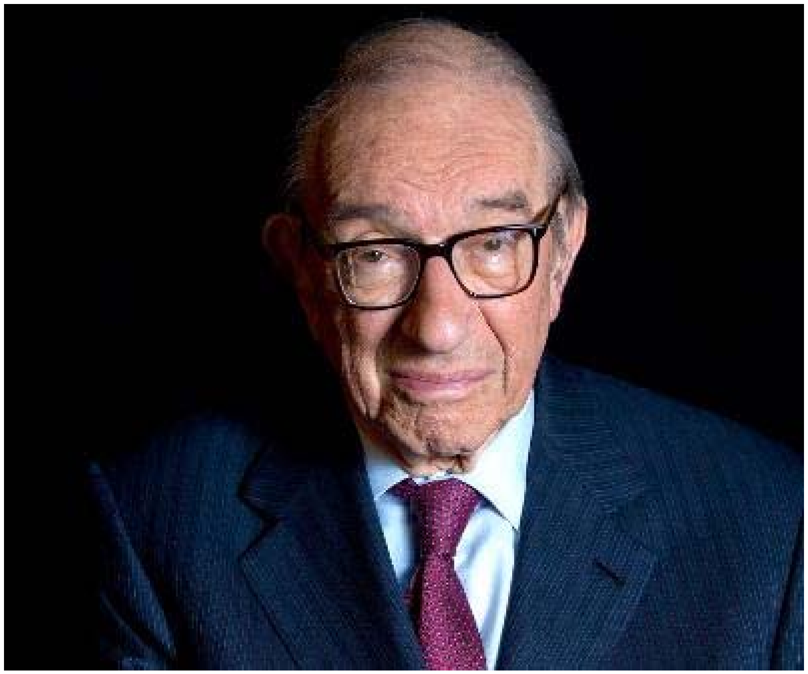
HOW ARE THOSE 401Ks MR. PRESIDENT?

The stock market has smashed one record after another, gaining $8 trillion in value. That is great news for Americans' 401k, retirement, pension, and college savings accounts.

— January 30, 2018

Notes:
Source: State of the Union Address (January 30, 2018)

HE KNOWS BUBBLES BETTER THAN ANYBODY



"<u>There are two bubbles: We have a stock market bubble, and we have a bond market bubble</u>…what's behind the bubble? Well the fact, that, essentially, we're beginning to run an ever-larger government deficit. As a share of GDP debt has been rising very significantly and we're just not paying enough attention to that."

— January 31, 2018

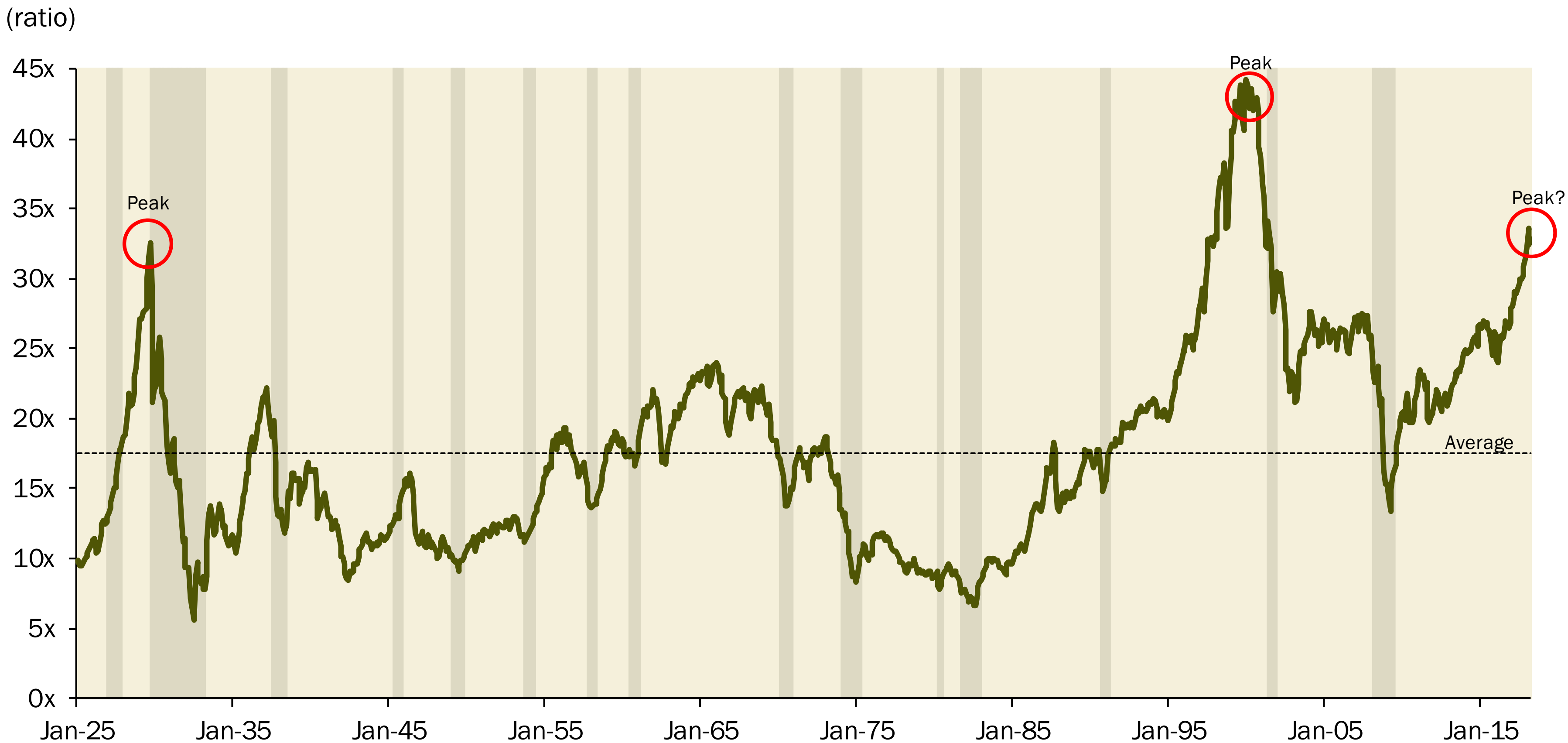
Notes:
Source: Alan Greenspan, Bloomberg TV, January 31, 2018

BOB FARRELL'S 10 MARKET RULES TO REMEMBER

1. Markets tend to return to the mean over time
2. Excesses in one direction will lead to an opposite excess in the other direction
3. There are no new eras — excesses are never permanent
4. Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways
5. The public buys the most at the top and the least at the bottom
6. Fear and greed are stronger than long-term resolve
7. Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names
8. Bear markets have three stages — sharp down, reflexive rebound and a drawn-out fundamental downtrend
9. When all the experts and forecasts agree — something else is going to happen
10. Bull markets are more fun than bear markets

THIRD MOST OVERVALUED STOCK MARKET

United States: Cyclically Adjusted Price-to-Earnings



Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

WHAT'S EVERY PEAK TYPICALLY FOLLOWED BY?

United States: Household Net Worth Share of Personal Disposable Income

Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

SOME WARNINGS FROM THE SAN FRAN FED

*"Current valuation ratios for households and businesses are high relative to historical benchmarks…**we find that the current price-to-earnings ratio predicts approximately zero growth in real equity prices over the next ten years.**"*

*"The net worth-to-income ratio — defined as household assets net of liabilities divided by personal disposable income — provides a valuation metric for a broad set of assets including debt, equity, and real estate weighted by the proportion in which they are being held by households. **Similar to the P/E ratio, this ratio tends to revert toward its historical average and does not remain at extreme values, either high or low, for prolonged periods.**"*

Notes:

Source: Valuation Ratios for Households and Businesses (January 8, 2018)

A SECULAR INFLECTION POINT?

"Change of a long term or secular nature is usually gradual enough that it is obscured by the noise caused by short-term volatility. By the time secular trends are even acknowledged by the majority they are generally obvious and mature. In the early stages of a new secular paradigm, therefore, most are conditioned to hear only the short-term noise they have been conditioned to respond to by the prior existing secular condition. Moreover, in a shift of secular or long term significance, the markets will be adapting to a new set of rules while most market participants will be still playing by the old rules"

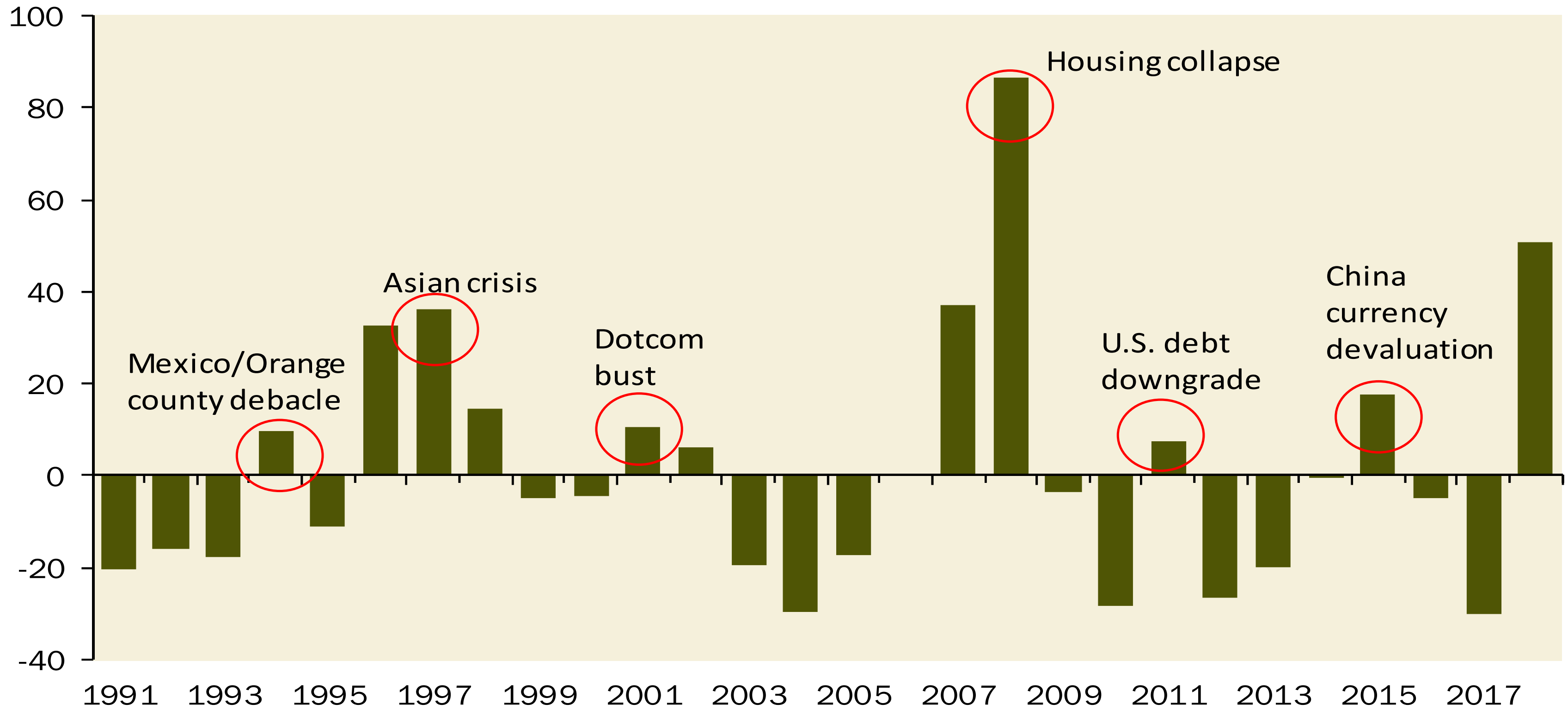
- Bob Farrell Aug. 3, 2001

Notes:
Source: Bob Farrell, Theme & Profile Investing Update, August 3, 2001

VOLATILITY SPIKES GENERALLY USHER IN A NEW ERA OF CAUTION

United States: Annual Percentage Change in VIX

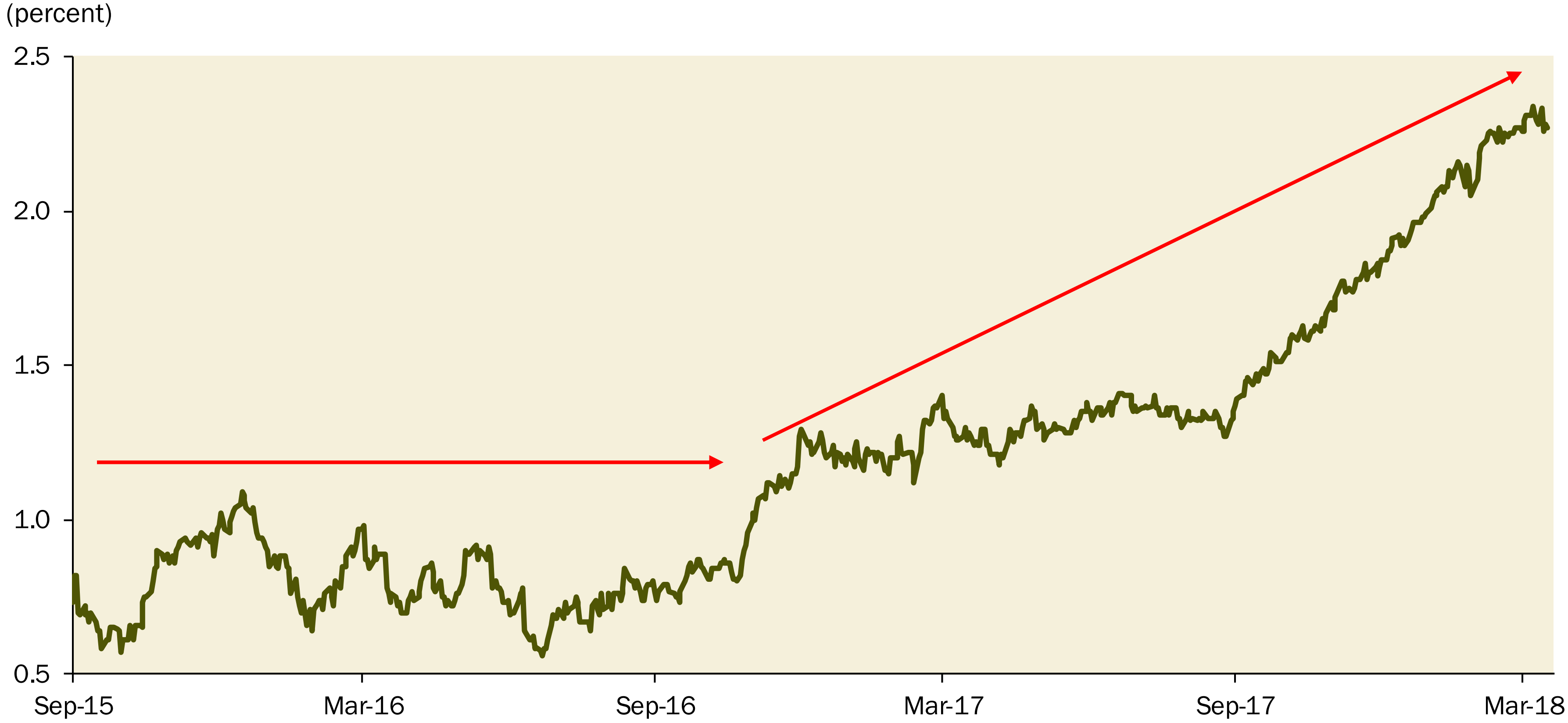
(percent)



Notes:
Source: Haver Analytics, Gluskin Sheff

LOOK FAMILIAR?

United States: 2-year Treasury Note Yield

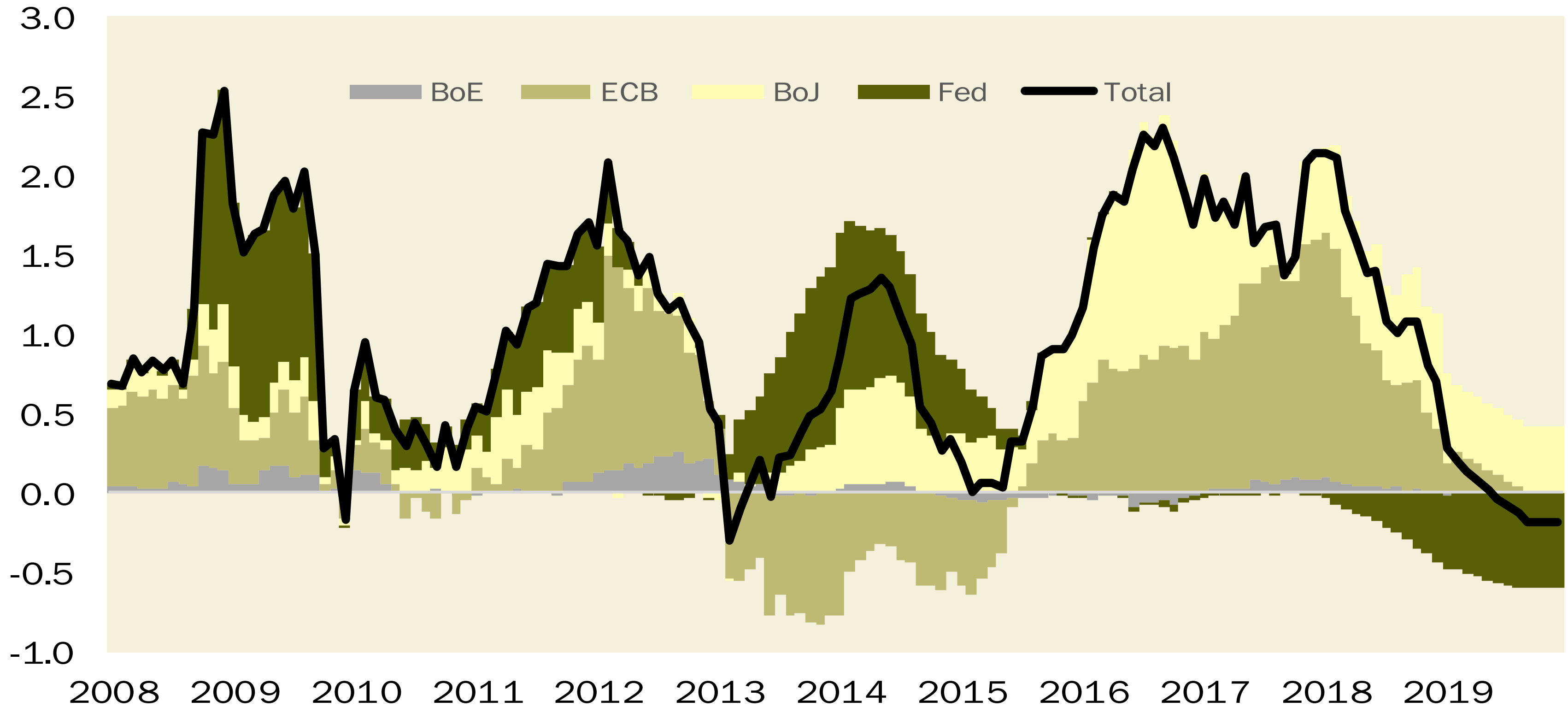


Notes:
Source: Haver Analytics, Gluskin Sheff

LIQUIDITY TURNING FROM A TAILWIND TO A HEADWIND

United States: G4 Central Bank Assets

(year-over-year change; trillions of U.S. dollars)



Notes:

Source: Haver Analytics, Gluskin Sheff


LET'S LOOK AT THAT MAP AGAIN.
THE FED
B. Rich
HEDGEYE

THE WALL STREET JOURNAL.

Pro-Business Populists Flummox Davos Man

Davos man feels conflicted.

The global business elites swarming this year's World Economic Forum are reveling in the best economy in years and an epic bull market.

Yet their joy seems oddly muted, checked by anxiety over spreading populism and nationalism, sky-high asset prices, and slow-burning ills such as inequality and climate change.

Part of this anxiety is legitimate: Stock prices really are priced for perfection.

Part of this is an affect: The World Economic Forum likes to dwell on mankind's most profound challenges, and sometimes it overthinks. Among the potential shocks a WEF report warns of are "AI-piloted drone ships [that] wipe out a large proportion of global fish stocks."

And part of this is because Davos men and women are grappling with a type of politician they haven't seen before: the pro-business populist.

This isn't a contradiction in terms. Populists typically don't define themselves according to economic issues of the left or right, but cultural questions such as national identity and sovereignty. They oppose free trade, immigration, multiculturalism and multilateral arrangements like the euro, all things Davos man (a euphemism for global business elites credited to the late political scientist Samuel Huntington) fervently believes in.

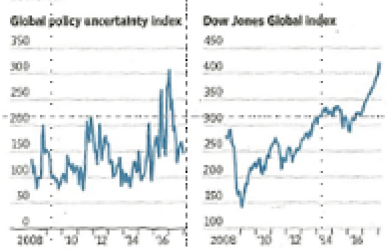
Populist policies are generally not good for growth; some, in the long run, can be disastrous. Yet a populist can more than offset those negatives by also pursuing a conventional pro-business agenda. That combination defines the two leaders bookending Davos this year: Indian Prime Minister Narendra Modi and U.S. President Donald Trump.

The similarities aren't superficially obvious. Mr. Modi opened the conference with a keynote speech that, like Chinese President Xi Jinping a year earlier, took a veiled shot at Mr. Trump: "Protectionism and its forces are rearing their heads." The audience ate it up.

But Mr. Modi's defense of globalization, like Mr. Xi's, is disingenuous. India, like China, is highly protectionist. It took more trade-harmful actions than any other major country save the U.S. between

What, Me Worry?

Political uncertainty is still elevated but global stock markets aren't bothered.



Sources: Economic Policy Uncertainty (uncertainty); S&P Financial (Dow Jones)

THE WALL STREET JOURNAL.

2008 and last June, according to Global Trade Alert, a trade monitoring group. It has regularly stymied the rest of the world's efforts to deepen international trade pacts.

Mr. Modi's version of populist nationalism long predates Mr. Trump's. Since leading the Bharatiya Janata Party to power in 2014, he has sought to "shift the definition of Indian national identity from the inclusive liberal one established by Mahatma Gandhi and Jawaharlal Nehru to one based on Hinduism," the political scientist Francis Fukuyama notes in an essay commissioned by Credit Suisse for Davos. Like Mr. Trump and Mr. Xi, he has built support by "attacking the existing elite, although they themselves are very much part of that elite."

Yet the attention to their nationalist rhetoric masks the more consequential impact of their economic policies. Mr. Modi is, in fits and starts, tackling India's chronically inefficient and burdensome public services, such as by unifying the sales tax and simplifying how to open and close a business or settle a commercial dispute. The International Monetary Fund projects Indian growth at 7.4% this year, faster than any major economy, including China.

Meanwhile, while Mr. Trump has left or threatened to leave multilateral trade pacts, stepped up trade enforcement and raised barriers to immigration, yet these matter less to business than his rollback of regulations covering a host of activities from greenhouse-gas emissions and Internet transmission to overtime pay and bank lending. At a lunch in Davos organized by The Wall Street Journal, Roger Crandall, chairman and chief executive of Massachusetts Mutual Life Insurance Co., enthused, "The change in the regulatory environment in the U.S. is the greatest we've seen in 30 years." Pharmaceutical executives credit the Food and Drug Administration with helping to get new drugs to market faster.

Mr. Trump's tax cut has been panned for increasing the deficit and favoring the rich and corporations. Yet whatever its flaws, it is unambiguously pro-growth: It pares back distortionary tax breaks and lowers tax rates to incentivize work and investment, precisely what economists have prescribed for years.

What will the ultimate economic consequences be? Eventually the boost from reduced tax and regulations will peter out, and the drag from higher trade barriers and less immigration will show. Yet the most important determinant is monetary policy. Historically populists promised favors to their constituents, then forced central banks to finance the resulting deficits by printing money. Venezuela today is a prime example.

Both Mr. Trump and Mr. Modi have so far resisted the temptation. Though they jettisoned highly regarded central bankers, they replaced them with known faces likely to follow much the same policy. Inflation in the U.S. has for years been too low, which explains both low interest rates and high asset prices. Nothing would vindicate Davos anxiety more than the inflation genie escaping the bottle. Right now, though, that's nowhere to be seen—suggesting this pro-business populist moment has a ways to run.

◆ European leaders warn of risks to globalism A16

"What will the ultimate economic consequences be? Eventually the boost from reduced tax and regulations will peter out, and the drag from higher trade barriers and less immigration will show. <u>Yet the most important determinant is monetary policy</u>."

Notes:
Source: Wall Street Journal (January 25, 2018)

PAYING MORE FOR SLOWER GROWTH!

United States: Historical Bull Markets

(annualized percent change)

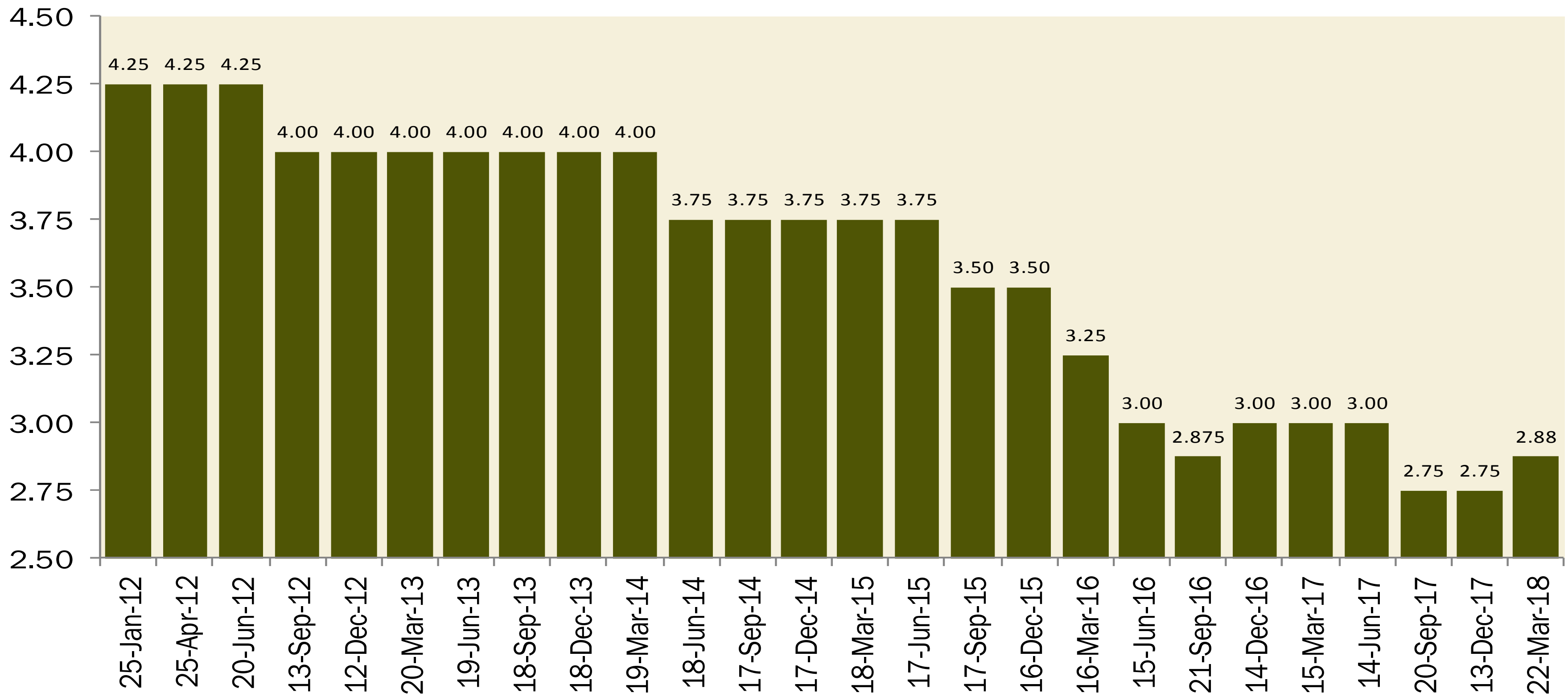
Trough Date	Peak Date	S&P 500	Nominal GDP	Real GDP	Months
13-Jun-49	15-Jul-57	17.3	7.3	4.6	97
22-Oct-57	3-Jan-62	15.4	5.4	3.8	51
26-Jun-62	29-Nov-68	12.0	7.7	5.0	77
26-May-70	11-Jan-73	23.3	10.0	5.1	32
3-Oct-74	28-Nov-80	14.1	10.8	3.2	73
12-Aug-82	16-Jul-90	17.5	7.6	4.2	95
11-Oct-90	24-Mar-00	19.0	5.6	3.5	113
9-Oct-02	9-Oct-07	15.0	5.8	2.9	60
9-Mar-09	26-Jan-18	17.7	3.7	2.1	106
Average		**16.8**	**7.1**	**3.8**	**78.2**
Median		**17.3**	**7.3**	**3.8**	**77.0**

Notes:
Source: Haver Analytics, Gluskin Sheff

THE FED HAS SLICED ITS NEUTRAL POLICY RATE FORECAST

United States: Median FOMC Terminal Funds Rate Forecast

(percent)



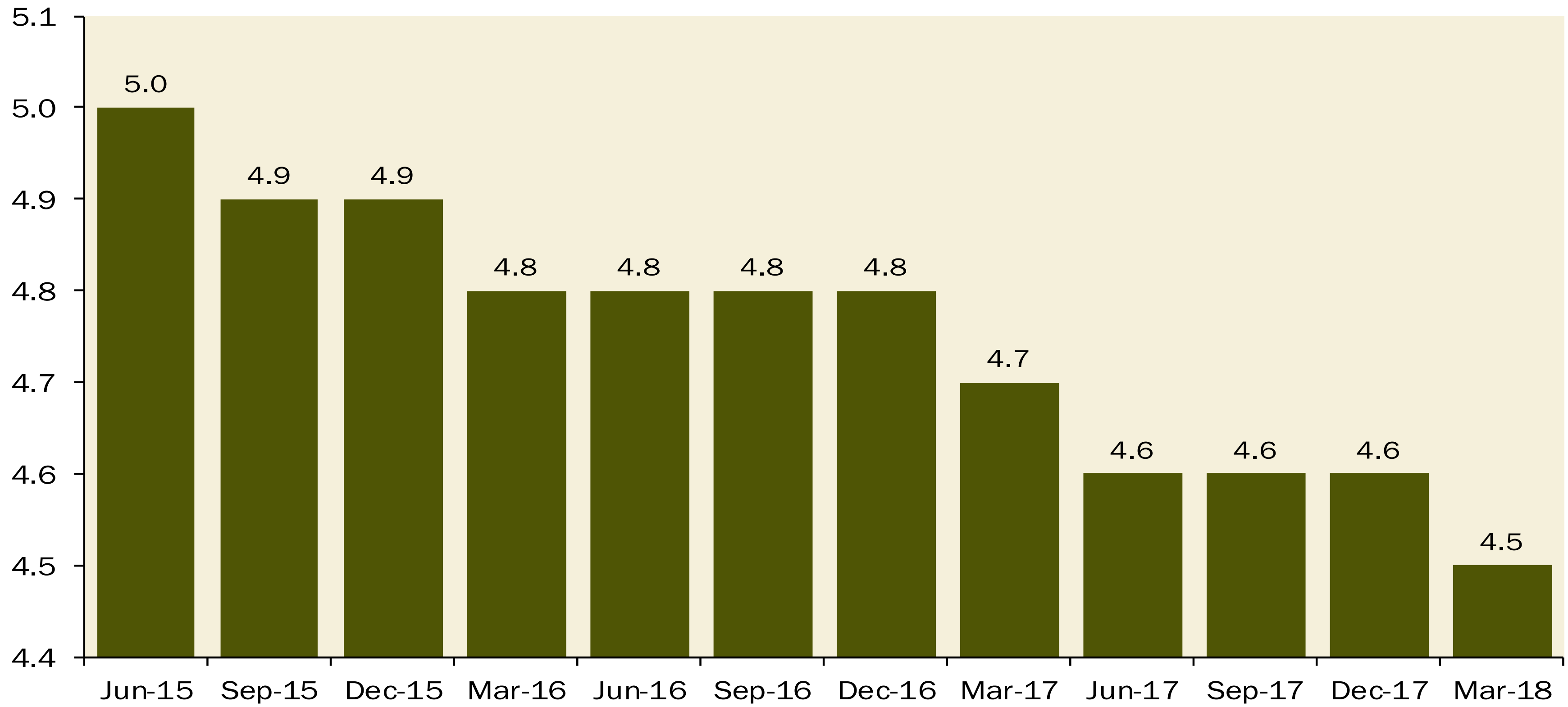
Notes:

Source: Federal Reserve, Gluskin Sheff

FED HAS TAKEN DOWN ITS NAIRU ESTIMATE OVER TIME AS WELL

United States: FOMC Full Employment Forecast

(percent)



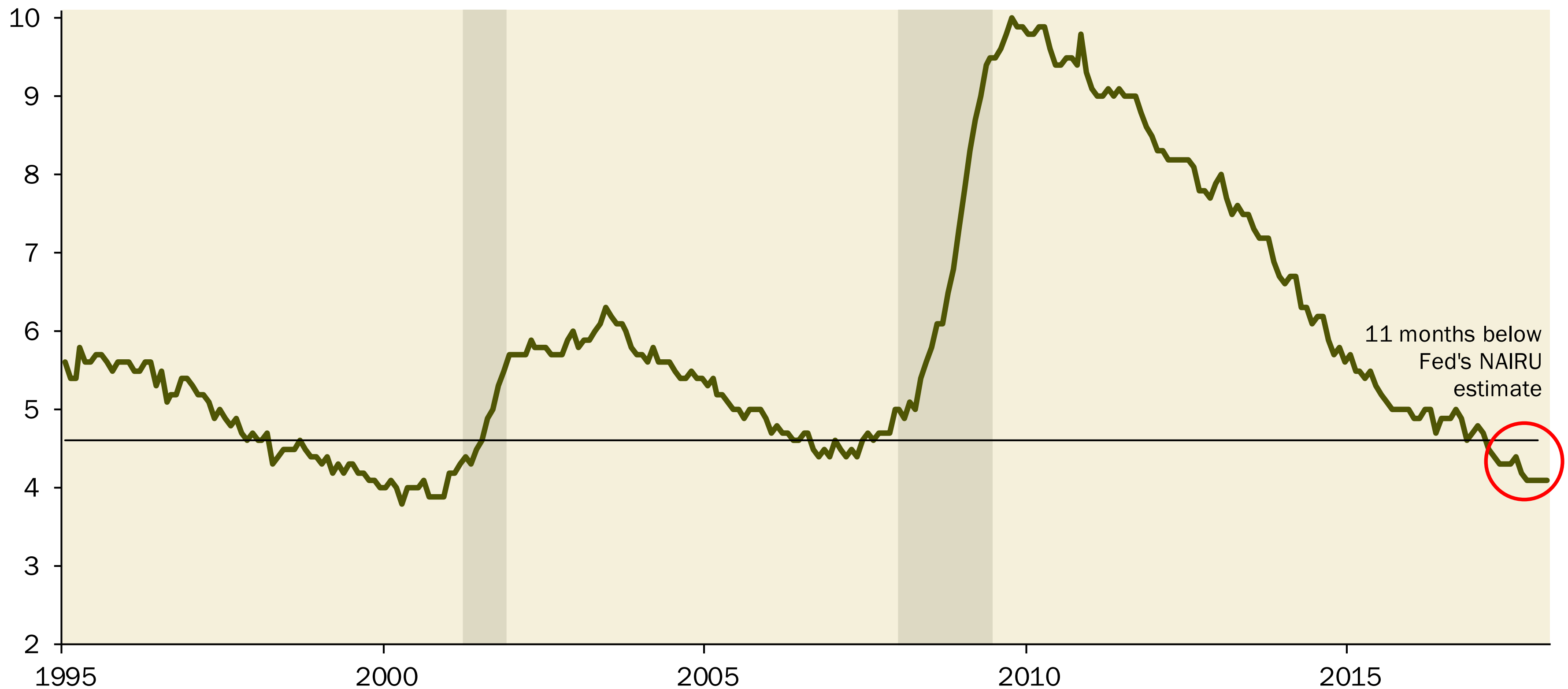
Notes:

Source: Federal Reserve, Gluskin Sheff

LITTLE (IF ANY) SLACK LEFT IN THE LABOR FORCE

United States: Unemployment Rate

(percent)



Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

IS 2% CORE INFLATION REALLY PRICE STABILITY?

***CHAIRMAN GREENSPAN**. Price stability is that state in which expected changes in the general price level do not effectively alter business or household decisions.*

***MS. YELLEN**. Could you please put a number on that?*

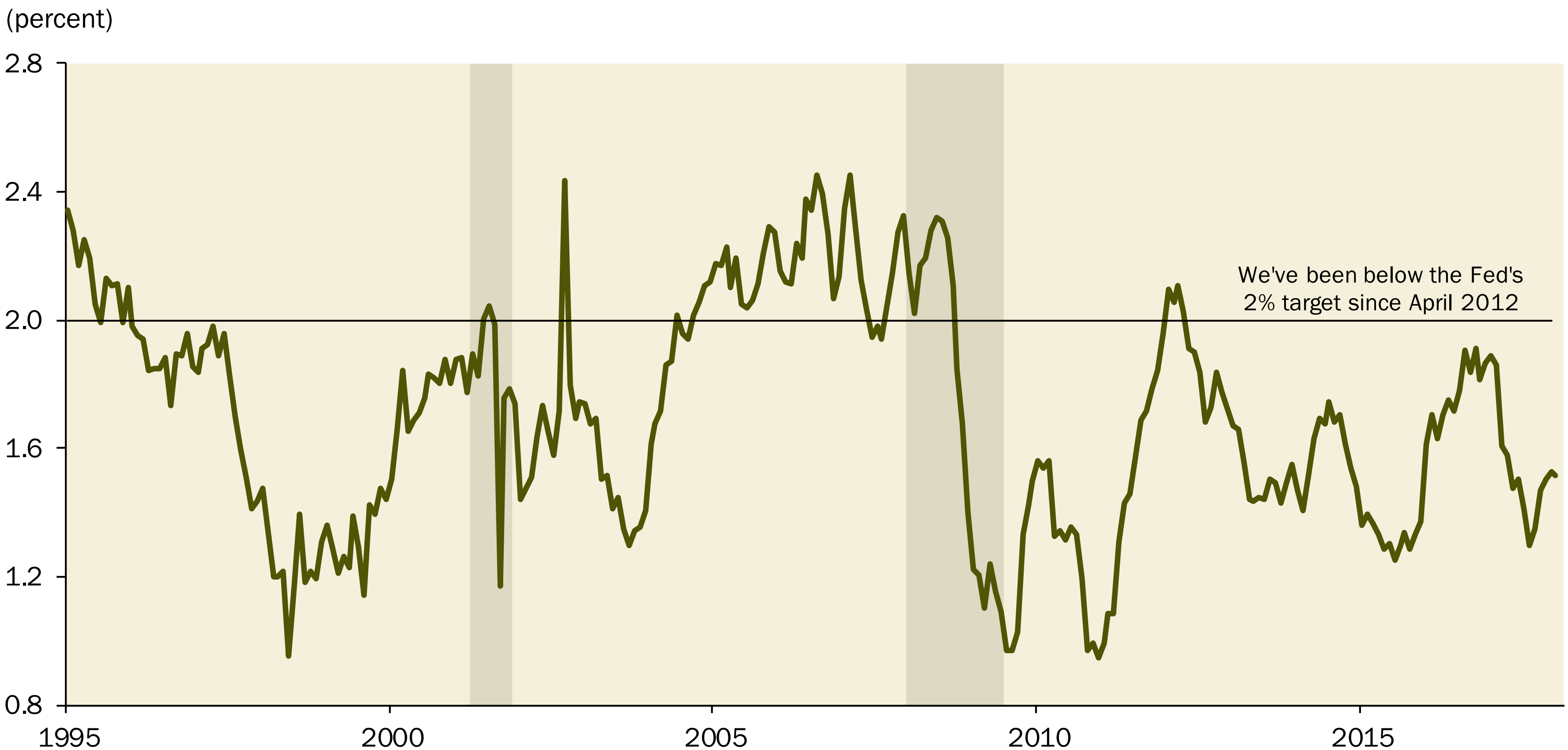
***CHAIRMAN GREENSPAN**. <u>I would say the number is zero</u>, if inflation is properly measured.*

-July 3rd, 1996

Notes:
Source: Meeting of the FOMC (July 2-3, 1996)

AN EVER-ELUSIVE 2% TARGET

United States: Core PCE



Notes:

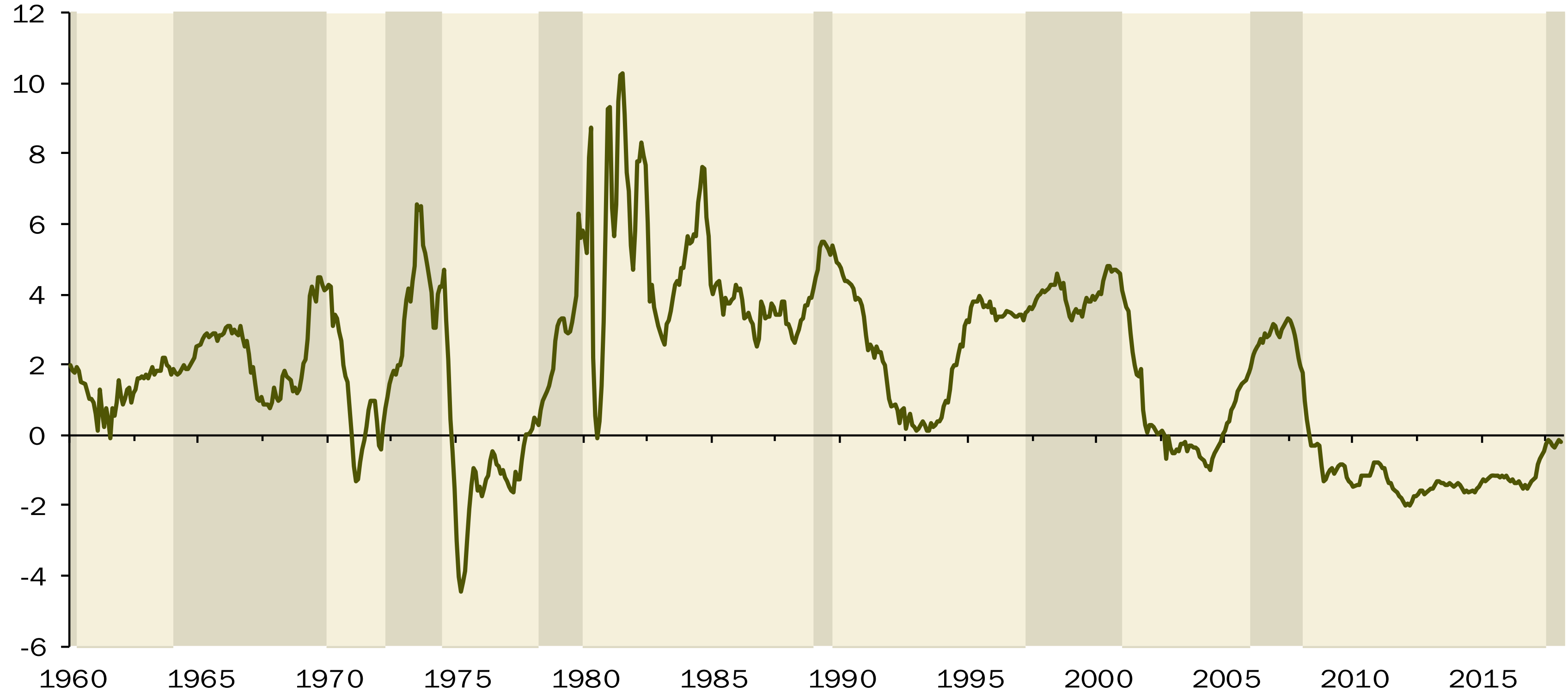
Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

NEGATIVE REAL FUNDS RATE AT FULL EMPLOYMENT??

United States: Real Federal Funds Rate

(percent)



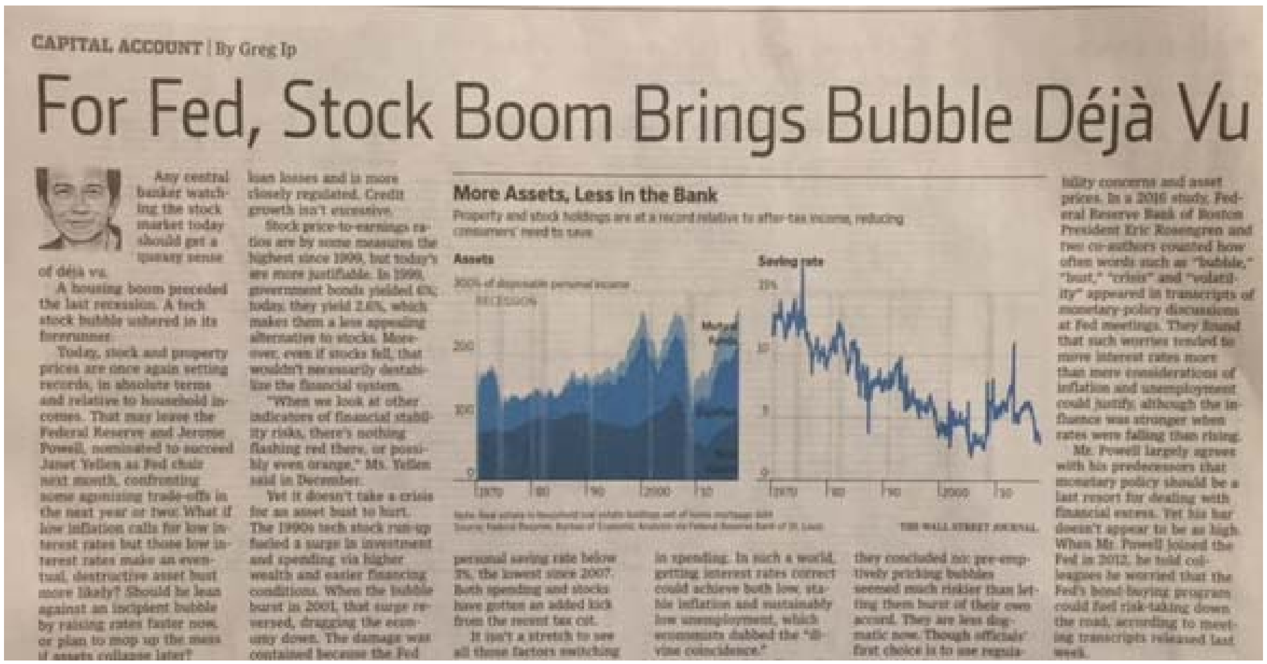
Notes:

Real fed funds rate = nominal fed funds rate less core PCE inflation

Shaded regions represent periods where the output gap has closed

Source: Haver Analytics, Gluskin Sheff

THE WALL STREET JOURNAL.



CAPITAL ACCOUNT | By Greg Ip

For Fed, Stock Boom Brings Bubble Déjà Vu

Any central banker watching the stock market today should get a queasy sense of déjà vu.

A housing boom preceded the last recession. A tech stock bubble ushered in its forerunner.

Today, stock and property prices are once again setting records, in absolute terms and relative to household incomes. That may leave the Federal Reserve and Jerome Powell, nominated to succeed Janet Yellen as Fed chair next month, confronting some agonizing trade-offs in the next year or two: What if low inflation calls for low interest rates but those low interest rates make an eventual, destructive asset bust more likely? Should he lean against an incipient bubble by raising rates faster now, or plan to mop up the mess if assets collapse later?

loan losses and is more closely regulated. Credit growth isn't excessive.

Stock price-to-earnings ratios are by some measures the highest since 1999, but today's are more justifiable. In 1999, government bonds yielded 6%; today, they yield 2.6%, which makes them a less appealing alternative to stocks. Moreover, even if stocks fell, that wouldn't necessarily destabilize the financial system.

"When we look at other indicators of financial stability risks, there's nothing flashing red there, or possibly even orange," Ms. Yellen said in December.

Yet it doesn't take a crisis for an asset bust to hurt. The 1990s tech stock run-up fueled a surge in investment and spending via higher wealth and easier financing conditions. When the bubble burst in 2001, that surge reversed, dragging the economy down. The damage was contained because the Fed

More Assets, Less in the Bank

Property and stock holdings are at a record relative to after-tax income, reducing consumers' need to save

personal saving rate below 3%, the lowest since 2007. Both spending and stocks have gotten an added kick from the recent tax cut.

It isn't a stretch to see all these factors switching

in spending. In such a world, getting interest rates correct could achieve both low, stable inflation and sustainably low unemployment, which economists dubbed the "divine coincidence."

they concluded no: pre-emptively pricking bubbles seemed much riskier than letting them burst of their own accord. They are less dogmatic now. Though officials' first choice is to use regula-

bility concerns and asset prices. In a 2016 study, Federal Reserve Bank of Boston President Eric Rosengren and two co-authors counted how often words such as "bubble," "bust," "crisis" and "volatility" appeared in transcripts of monetary-policy discussions at Fed meetings. They found that such worries tended to move interest rates more than mere considerations of inflation and unemployment could justify, although the influence was stronger when rates were falling than rising.

Mr. Powell largely agrees with his predecessors that monetary policy should be a last resort for dealing with financial excess. Yet his bar doesn't appear to be as high. When Mr. Powell joined the Fed in 2012, he told colleagues he worried that the Fed's bond-buying program could fuel risk-taking down the road, according to meeting transcripts released last week.

Notes:
Source: The Wall Street Journal (January 11, 2018)

WHAT EVER HAPPENED TO TAKING THE PUNCH BOWL AWAY?

*…**The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up**…Nowadays, there is perhaps a tendency to exaggerate the effectiveness of monetary policy in both directions. Recently, opinion has been voiced that the country's main danger comes from a roseate belief that monetary policy, backed by flexible tax and debt management policies and aided by a host of built-in stabilizers, has completely conquered the problem of major economic fluctuations and relegated them to ancient history. This, of course, is not so because we are dealing with human beings and human nature.*

— William McChesney Martin, October 19th, 1955

*Inflation was 0.4% the day of this speech; 2.2% a year later

THE START OF THE 'GREENSPAN PUT'

"I still do not believe we are out of the woods on the market; I don't think all of the yield spreads have gotten back to where they were. All objective measures of stock market levels suggest that, if anything, we are still above normal and that we are vulnerable to a significant decline. ***Consequently, even though under normal circumstances I would say that in this type of environment we probably should be in something of a tightening mode, if rates go up under these conditions I suspect the stock market would go down, and I'm fearful of the extent of that particular decline****."*

— *December 16, 1987*

*"****What's concerning me is that there is a vulnerability out there which is continuing to heal but is not healed yet****. And I'm basically concerned, in a way which in fact Governor Seger raised, that* ***if we were to indicate that we were tightening, the shock to the markets I think would break the stock market and create some real problems****. "*

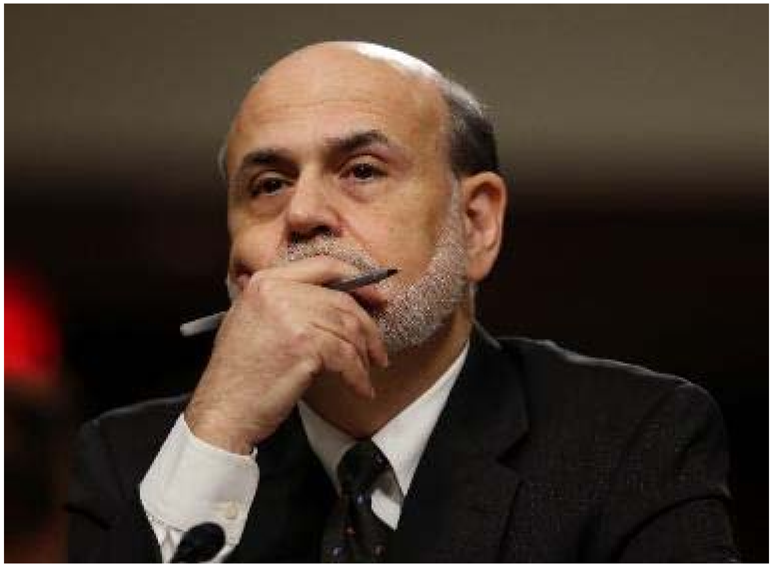
— *February 10, 1988*

Notes:
Source: Meeting of the FOMC (December 15-16, 1987); Meeting of the FOMC (February 9-10, 1988)

FOLLOWED BY THE 'BERNANKE PUT' (WHAT HE SAID THE DAY AFTER QE2)

"*Stock prices rose and long-term interest rates fell when investors began to anticipate the most recent action. Easier financial conditions will promote economic growth. For example, lower mortgage rates will make housing more affordable and allow more homeowners to refinance. Lower corporate bond rates will encourage investment.* ***And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending****. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion.*"

— November 4, 2010



Notes:

Source: What the Fed did and why: supporting the recovery and sustaining price stability; Washington Post (November 4, 2010)

THE 'YELLEN PUT' HAD AN EVEN HIGHER STRIKE PRICE!

"*…We also face the serious risk that inflation, which we currently forecast to run below our target, could decline further over time, raising real interest rates and thereby making it yet more difficult for monetary policy to provide meaningful stimulus.* ***Under such circumstances, there is an important benefit from conveying that we do not intend to take the punch bowl away just as the party is getting going.*** *Frankly, I worried at the time of our September meeting that our open-ended purchase program would be interpreted by markets as tepid support for accommodation. Instead, just the opposite occurred. By linking our purchases to significant improvements in the outlook for the labor market, and coupling this commitment with the statement that we intend to keep rates low as the economic recovery strengthens,* ***we communicated that we will at least keep refilling the punch bowl until the guests have all arrived, and will not remove it prematurely before the party is well under way****…*"

— December 12, 2012

Notes:
Source: Meeting of the FOMC (December 11-12, 2012)

JANET DIDN'T EVEN SEE ORANGE AS THE MARKET WAS SOARING TO THE HIGHS

	Dec. 2017	20-year Avg.
Trailing P/E	22.2x	19.5x
Forward P/E	18.3x	16.3x
High Yield Spreads	364 basis points	582 bps

"I think when we look at other indicators of financial stability risks, there is nothing flashing red there or possibly even orange."

-December 13th, 2017

Notes:
Source: FOMC Press Conference (December 13, 2017)

THE FED'S REACTION TO THE STOCK MARKET

The Economics of the Fed Put

Anna Cieslak (Duke University) and Annette Vissing-Jorgensen (University of California Berkeley)

In summary, the Fed pays attention directly to the stock market rather than merely to variables correlated with the stock market…. these facts are consistent with the view that the stock market is a causal factor influencing Fed policy making.

Our textual analysis suggests that the Fed's focus on the stock market is driven a lot by its concern about the effect of stock market declines have on consumption, with a relatively smaller weight put on other GDP components.

Discussions of stock market conditions by the FOMC attendees are most frequently cast in the context of consumption, with the consumption-wealth effect highlighted as one of the main channels through which the stock market affects the economy.

This result confirms the Fed thinking causally about the stock market as a driver of the economy and the Fed updating its expectations of future economic conditions accordingly. At a time when it has come under criticism for focusing too much on asset prices it would be useful for the Fed to lay out whether it believes the stock market should have an independent impact on the target beyond its effects on Fed growth and inflation expectations.

Notes:
Source: The Economics of the Fed Put (December, 2016)

REVIEW & OUTLOOK

The Tax-Reform Stock Rally

Animal spirits are unleashed, but watch the Fed's great unwinding.

Equity markets took a mild breather on Tuesday afternoon after another morning rally, pausing on what has been a remarkable runup so far in 2018, following eye-popping gains since Election Day in 2016 and throughout 2017. The latest gains look like a tax-reform rally, though it will pay to be mindful that markets inevitably correct, often hard.

We've been hosting an op-ed debate on stock prices, and last week financial consultant Donald Luskin made his case for the running of the bulls as expected corporate earnings are adjusted upward due to tax reform. Harvard economist Martin Feldstein makes the case for caution nearby, arguing that equity prices are fated to fall as the Federal Reserve reverses its long period of asset purchases and low interest rates, and inflation makes a comeback. Both men could be right, depending on your investment time frame.

The bullish case is based on expectations of capitalized profits, which have risen smartly with the cut in corporate tax rates. The higher after-tax returns flow into higher asset values, all else being equal. The surprise is that stocks have kept rising this year, with the S&P 500 up some 4%. This suggests that many investors underestimated the possibility of pro-growth tax reform passing last year, and now they are catching up to the implications.

The harder question is whether rising stocks are also a harbinger of faster growth in the real economy. Business sentiment, from the Business Roundtable to the National Federation of Independent Business, is as bullish as we can recall. Business Roundtable chief Jamie Dimon, also CEO of J.P. Morgan, captured the mood last week when he said "animal spirits" have been unleashed.

He cited tax reform and "proper smart regulation," while the global economy is also growing in sync for a change. With investors willing to take more risks, emerging markets are seeing capital inflows as are Japan and Europe. This greater appetite may explain why the U.S. dollar has been relatively weak despite signs of better U.S. policy and faster growth. Maybe investors feel a reduced need to park money in the safety of dollar assets or Treasurys.

But don't forget Mr. Feldstein's warning about the Fed and its great monetary unwinding. Former Fed Chairman Ben Bernanke justified quantitative easing (QE) as a tool to drive investors into riskier assets, including stocks, which would create a "wealth effect" to spur the real economy. H[…] succeeded on asset prices but failed on growth, which didn't accelerate until better tax an[d] regulatory policies arrived. But if QE lifte[d] stocks as it expanded, will the reverse happe[n] as it unwinds?

It's certainly possible, and students of financial history know that sooner or later rising interest rates will weigh on stock prices. This [is] another way of saying that the biggest thre[at] to growth and financial markets—Dona[ld] Trump's trade agenda or a Speaker Pel[osi] aside—may be the Federal Reserve as it [re]verses Mr. Bernanke's experiment. Mr. Bernanke has already taken a half dozen victo[ry] laps, but they'll have been premature if the [un]winding leads to asset selloffs that create fina[n]cial disruption and a recession.

All of which underscores the importance [of] timing of the GOP tax reform. The current [ex]pansion is already historically long, if also [his]torically weak, and it has needed a second w[ind]. Businesses have had plenty of capital, at h[ome] and abroad, but they had been reluctant to [de]ploy it given the uncertainty of how and w[hat] the Obama regulators and taxers might s[trike] next. Donald Trump's deregulators hav[e re]moved the fear of arbitrary political pu[nish]ment, and now tax reform is raising the e[xpec]tations of returns on investment.

This is the cause for economic optimism [and] bullish equities, but keep in mind that [we've] never lived through a monetary-policy re[versal] like the one that is coming.

THE WALL STREET JOURNAL.

"This is the cause for economic optimism, and bullish equities, ***but keep in mind that we've never lived through a monetary-policy reversal like the one that is coming.****"*

Notes:

Source: The Wall Street Journal (January 17, 2018)

POWELL CAUTIOUS ON RISK-TAKING

	Oct. 2012	Apr. 2015	Today
Trailing P/E	14.5x	18.8x	21.9x
Forward P/E	12.7x	16.9x	16.9x
High Yield Spreads	554 bps	459 bps	366 bps

*"**I think we are actually at a point of encouraging risk-taking, and that should give us pause**. Investors really do understand now that we will be there to prevent serious losses. It is not that it is easy for them to make money but that they have every incentive to take more risk, and they are doing so. Meanwhile, we look like we are blowing a fixed-income duration bubble right across the credit spectrum that will result in big losses when rates come up down the road. You can almost say that that is our strategy."*

-October 24, 2012

*"Overly accommodative monetary policy also poses risks. First, the economy could overheat, and rising inflation could require the Committee to raise rates faster, which--if overdone--could produce a damaging recession. **For now, I would be more concerned with a second risk, which is that more-accommodative policy could lead to frothy financial conditions and eventually undermine financial stability**. While I do not see a troubling buildup of these risks today, tighter monetary policy might eventually be necessary if such risks do appear."*

-April 8, 2015

Notes:
Source: Meeting of the FOMC (October 23-24, 2012), Speech at the C. Peter McColough Series (April 8, 2015)

THE WALL STREET JOURNAL.

Senate Confirms Powell as Fed Chairman

Yellen's successor is likely to continue raising rates to keep the expansion on track

BY DAVID HARRISON

The Senate confirmed Jerome Powell to become the 16th chairman of the Federal Reserve, clearing the way for a new leader likely to continue raising interest rates to keep the nation's economic expansion on track.

Mr. Powell, who was confirmed Tuesday by an 84-13 vote, will take over when Chairwoman Janet Yellen's four-year term as chief ends Feb. 3. She has said she would leave the Fed board of governors once her successor is sworn in.

Although Mr. Powell's nomination attracted broad bipartisan support, it also drew opposition from several potential contenders in the 2020 presidential race. On the Democratic side, those voting against his confirmation included Sens. Elizabeth Warren of Massachusetts, Kamala Harris of California and Cory Booker of New Jersey. On the Republican side, Sens. Ted Cruz of Texas, Rand Paul of Kentucky, Mike Lee of Utah and Marco Rubio of Florida voted no. Independent Sen. Bernie Sanders of Vermont also opposed the nomination.

Jerome Powell, confirmed by an 84-13 vote, will take over next month.

Mr. Powell, a Fed governor since 2012, will inherit an economy on the upswing fueled by a booming labor market and strong global growth. His task will be to sustain the economy's expansion without letting it pick up so much momentum that the Fed would be forced to cool it off with sharp rate increases, risking a downturn.

The Fed has been gradually raising short-term interest rates since late 2015 and last year started shrinking its portfolio of assets purchased to bolster the economy during and after the financial crisis.

Officials in December raised the Fed's benchmark rate by a quarter percentage point to a range between 1.25% and 1.5% and penciled in three more such moves this year.

Mr. Powell is likely to stick with Ms. Yellen's cautious approach to raising rates.

"We've been patient in removing accommodation, and I think that patience has served us well," Mr. Powell said at his confirmation hearing Nov. 28, after being nominated by President Donald Trump on Nov. 2. Now that growth has picked up, "it's time for us to be normalizing interest rates," he added.

But those plans could change depending on how the economy evolves. If inflation remains stuck below the Fed's 2% target, Mr. Powell and his colleagues could decide to hold off on rate increases to let price pressures build. Or if the economy shows signs of overheating, they might want to move more aggressively.

A spurt of growth driven by the tax overhaul could lead the Fed to raise rates more quickly to cool off the economy. That could place Mr. Powell at odds with the White House, which would welcome a stronger expansion.

"We can afford to go more slowly if we determine that inflation is going to perform lower than we thought, and we can move more quickly," Mr. Powell said in November.

Mr. Powell, a lawyer and former private-equity partner, moves into his new role with less formal training in economics and monetary policy than many of his predecessors. He will be the first Fed chairman in three decades who doesn't have a Ph.D. in economics.

Mr. Powell is the second of Mr. Trump's Fed nominees to be confirmed, following Randal Quarles.

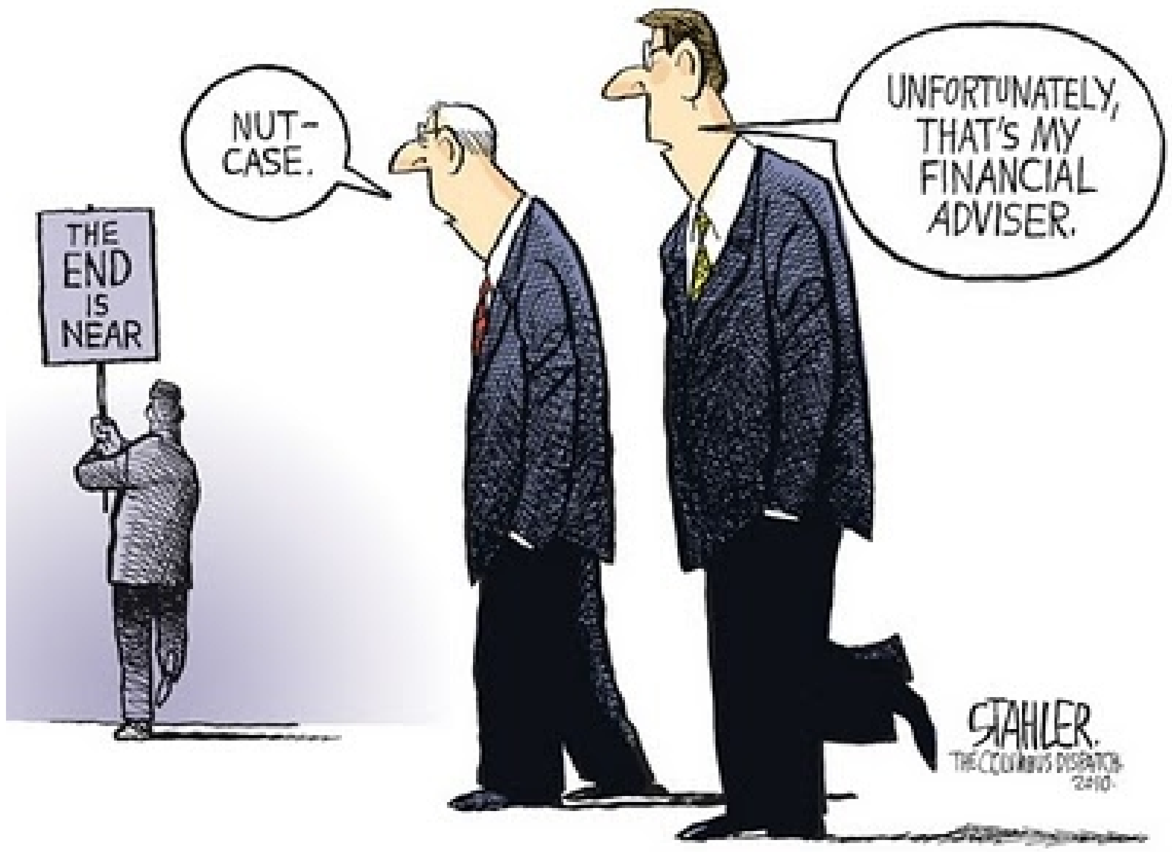
But Mr. Powell still will have to contend with a depleted Fed board: The seven-member panel has three vacancies.

Mr. Trump has nominated Marvin Goodfriend, a Carnegie Mellon University professor and former Fed economist, to fill one of those positions. The Senate Banking Committee held his confirmation hearing Tuesday.

◆ FDIC nominee backs small banks B12

*"**We've been patient in removing accommodation, and I think that patience has served us well,** Mr. Powell said at his confirmation hearing Nov. 28, after being nominated by President Donald Trump on Nov. 2. Now that growth has picked up, **"it's time for us to be normalizing interest rates" he added**"*

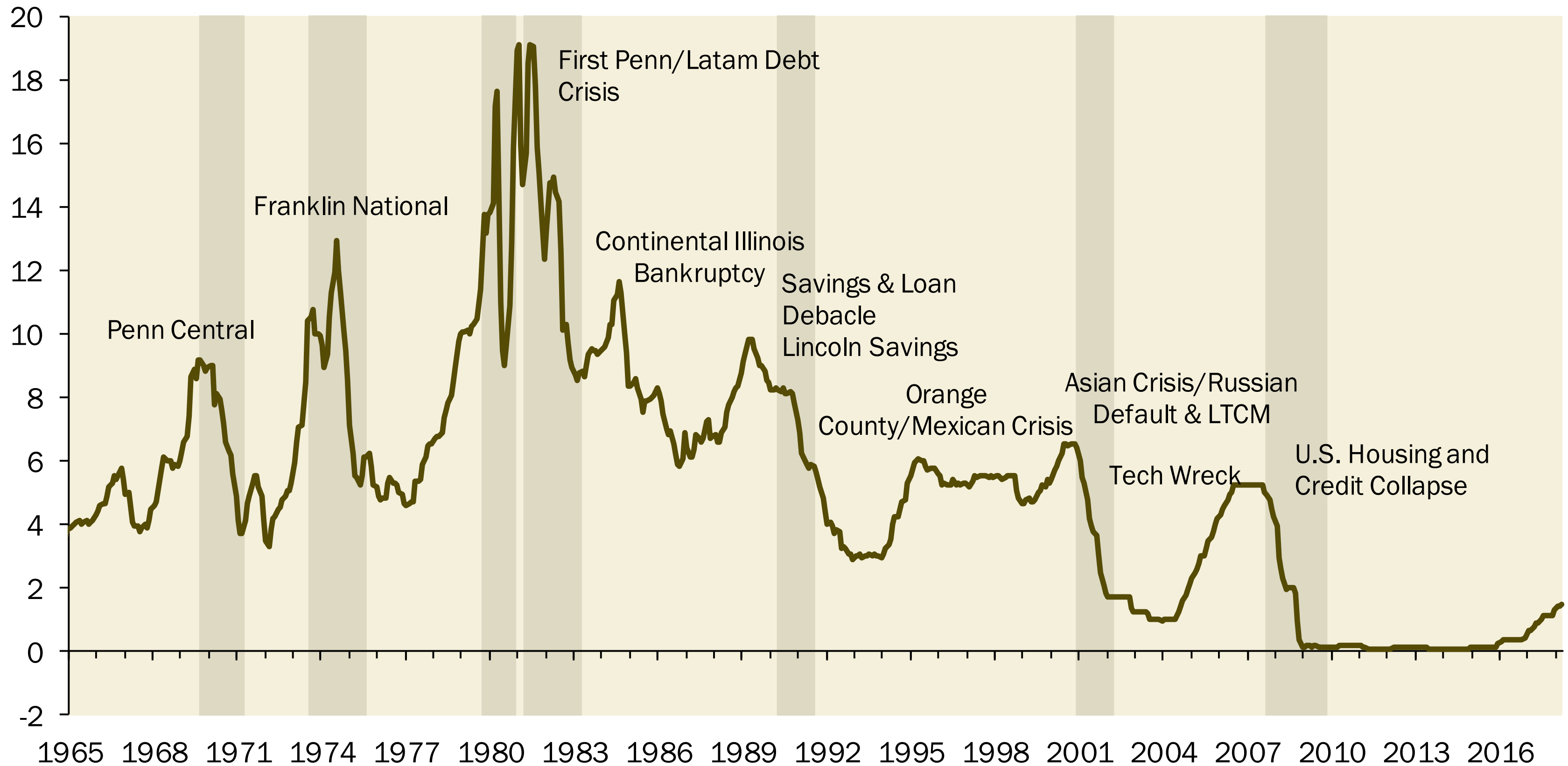
Notes:
Source: Wall Street Journal (January 24, 2018)


THE END IS NEAR
NUT-CASE.
UNFORTUNATELY, THAT'S MY FINANCIAL ADVISER.
STAHLER.

FED TIGHTENING CYCLES AND FINANCIAL EVENTS

United States: Federal Funds Rate

(percent)



Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

FINANCIAL TIMES

Fed research points to risk from non-banks

Alternative US mortgage providers are exposed to shocks, says paper

SAM FLEMING — WASHINGTON
ALISTAIR GRAY — NEW YORK

Rapidly expanding US non-bank mortgage lenders are poorly equipped to weather financial shocks and present mounting risks to taxpayers, warn researchers from the Federal Reserve and University of California, Berkeley.

Analysis to be presented at a Brookings Institution conference finds that non-banks, which originated half of US residential home loans in 2016, are vulnerable to the kind of liquidity pressures that caused several to fail during the financial crisis.

"Non-bank failures could be quite costly to the government, but this issue has received very little attention in the housing-reform debate," says the paper.

"The funding and operational structure of the non-bank mortgage sector remains a significant channel for systemic liquidity risk."

The US residential mortgage market changed dramatically after the subprime disaster and subsequent regulatory crackdown forced banks to retreat. Alternative groups that make loans but do not take deposits from savers have rushed to fill the gap.

While post-crisis regulation forced traditional banks to have larger amounts of loss-absorbing capital and more resilient liquidity backstops, non-banks are in many areas more loosely supervised. The paper warns the typical non-bank lender is exposed to shocks such as a jump in interest rates, a rise in defaults or a withdrawal of credit they tap from traditional commercial banks.

The banks that provide them with warehouse lines of credit could pull the funds quickly in times of financial stress, the paper says. Unlike large banks, it notes, the non-banks cannot tap liquidity facilities in a crisis from bodies such as the Federal Reserve. They are also subject to liquidity risks because they have to advance funds to mortgage investors even when borrowers fall behind on payments.

> 'Failures could be quite costly to the government, but this issue has received very little attention'

At the same time, the researchers say, mortgages originated by non-banks are of a lower credit quality than those from banks — making them more vulnerable to defaults or declines in house prices.

The paper says that if the non-banks find their sources of finance dry up, driving many out of business, it could trigger a credit contraction in some corners of the mortgage market. That could lead to declines in house prices and broader economic problems.

Given the important role they play in providing home credit to minority and lower-income borrowers, a retreat by the sector could do disproportionate damage to individuals in those groups.

The research highlights a lack of data available about non-bank lenders, only a handful of which are publicly traded. Regulators lack the information they need to properly assess the risks, it says.

In a statement before the report was issued, Pete Mills, senior vice-president for residential policy and member engagement at the Mortgage Bankers Association, said non-banks had played a "critical role" as banks pulled back.

"Today, the non-bank sector is subject to higher capital and liquidity standards, more robust regulation at both the state and federal level, and more thorough counterparty oversight than ever before," he added.

In its latest Monetary Policy Report, the Fed was sanguine about broad financial stability risks, describing overall vulnerabilities as "moderate".

However, the research for Brookings is a reminder of the wide range of risks that could pose a threat to financial stability amid surging asset prices. It also shows Fed staffers are keeping an eye on non-banks, even though the central bank does not directly regulate them,

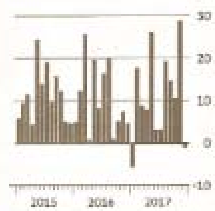
Notes:
Source: Financial Times (March 9, 2018)

FINANCIAL TIMES

Big buyers of US corporate paper show signs of pulling back

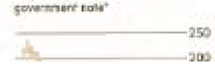
International investors shed corporate bonds in December

Purchases and sales of US corporate bonds by non-US investors ($bn)



US credit returns eroded by rising hedging costs

Relative value for buying a US corporate bond over a local government note*



Lending

US consumers struggle to repay credit card debt

ALISTAIR GRAY — NEW YORK

Overdue US credit card debt has reached a seven-year high, underlining the difficulties faced by many consumers in spite of the strong performance of the economy.

Banking sector data show consumers were at least three months behind repayments or considered otherwise distressed on $11.9bn of credit card debt at the turn of the year, a rise of 11.5 per cent during the fourth quarter.

More Americans are also falling behind on their mortgages, for which problematic debt levels rose 5.2 per cent over the same period to $56.7bn.

In contrast, the level of commercial and industrial loans that banks deemed to be problematic dropped 8.5 per cent to $18.1bn.

Top bankers shrug off concerns about the increasing losses, arguing they are to be expected after a post-crisis recovery in lending. The credit card charge-off rate rose from 3.46 per cent in the previous quarter to 3.77 per cent but remains far short of crisis-era levels.

Gordon Smith, JPMorgan Chase's retail banking chief, told investors yesterday that he was "very encouraged" by the health of his customer base. "The absolute level of losses on any basis is still exceptionally strong," he said.

However, Torsten Slok, chief international economist at Deutsche Bank, said investors were increasingly questioning US consumer wellbeing. Household wealth and unemployment metrics were solid but poorer families had failed to benefit from inflated asset

Notes:

Source: Financial Times (March 1, 2018)

CONSUMER CREDIT QUALITY CONCERNS SURFACING

United States

Credit Cards: Net Charge-off Rate

(percent)

Auto Loans: 90+ Days Delinquent Rate

(percent)

Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

BAIR-ISH!

BARRON'S

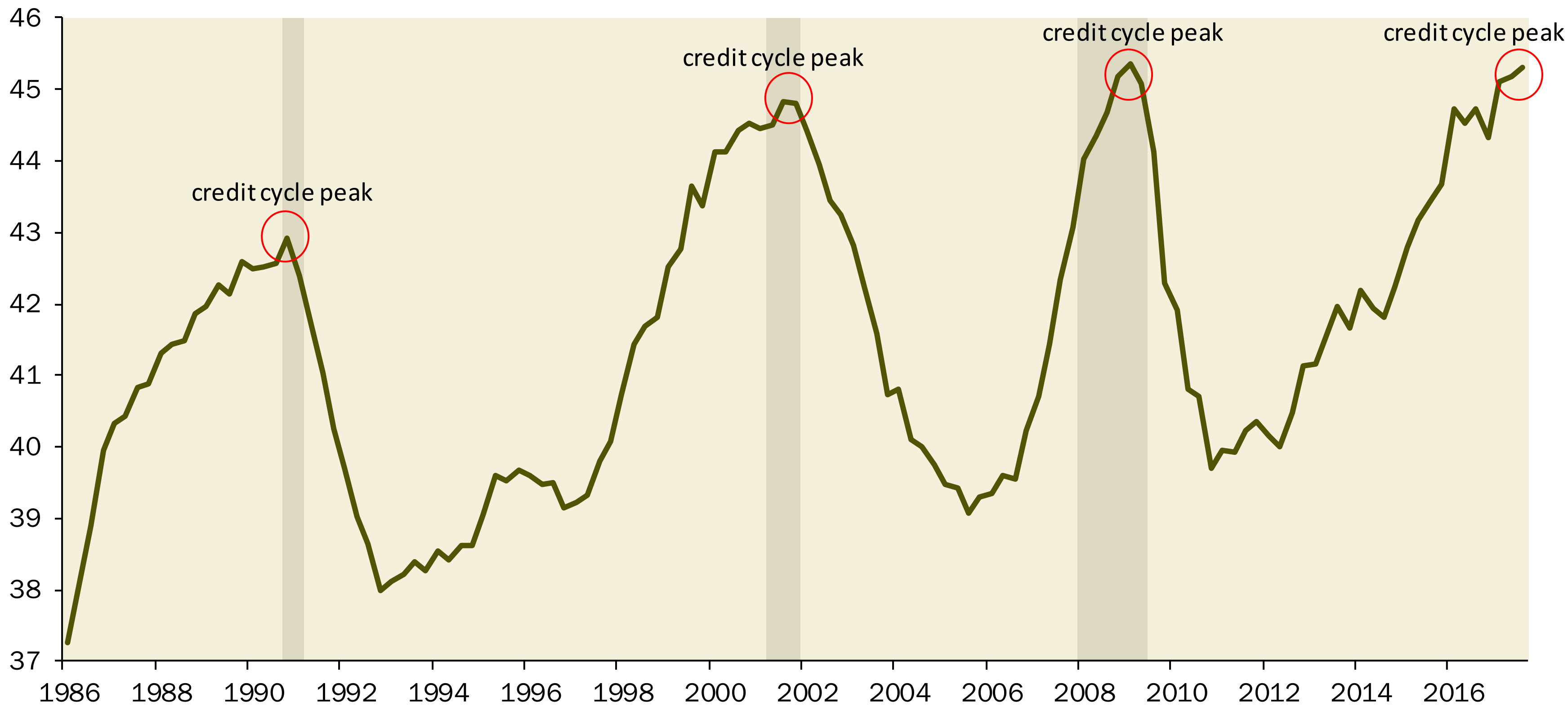
I'd keep an eye on credit-card debt. Subprime auto has been a problem for a couple years, and valuations on loans used to finance leveraged buyouts are high. Any type of secured lending backed by an asset that is overvalued should be a concern. That is what happened with housing. ***<u>Corporate debt also has not gotten as much attention as it should</u>****. It is market-funded, rather than bank-funded, but the banks still have exposure. Then there's cyber-risk. It took us so long to get around to the reforms postcrisis that we got a little behind on systemic cyber-risk, but regulators are very focused on it now.*

Notes:
Source: Barron's (March 5, 2018)

CORPORATE BALANCE SHEETS ARE NOT IN GOOD SHAPE!

United States: Corporate Debt-to-GDP

(percent)



Notes:

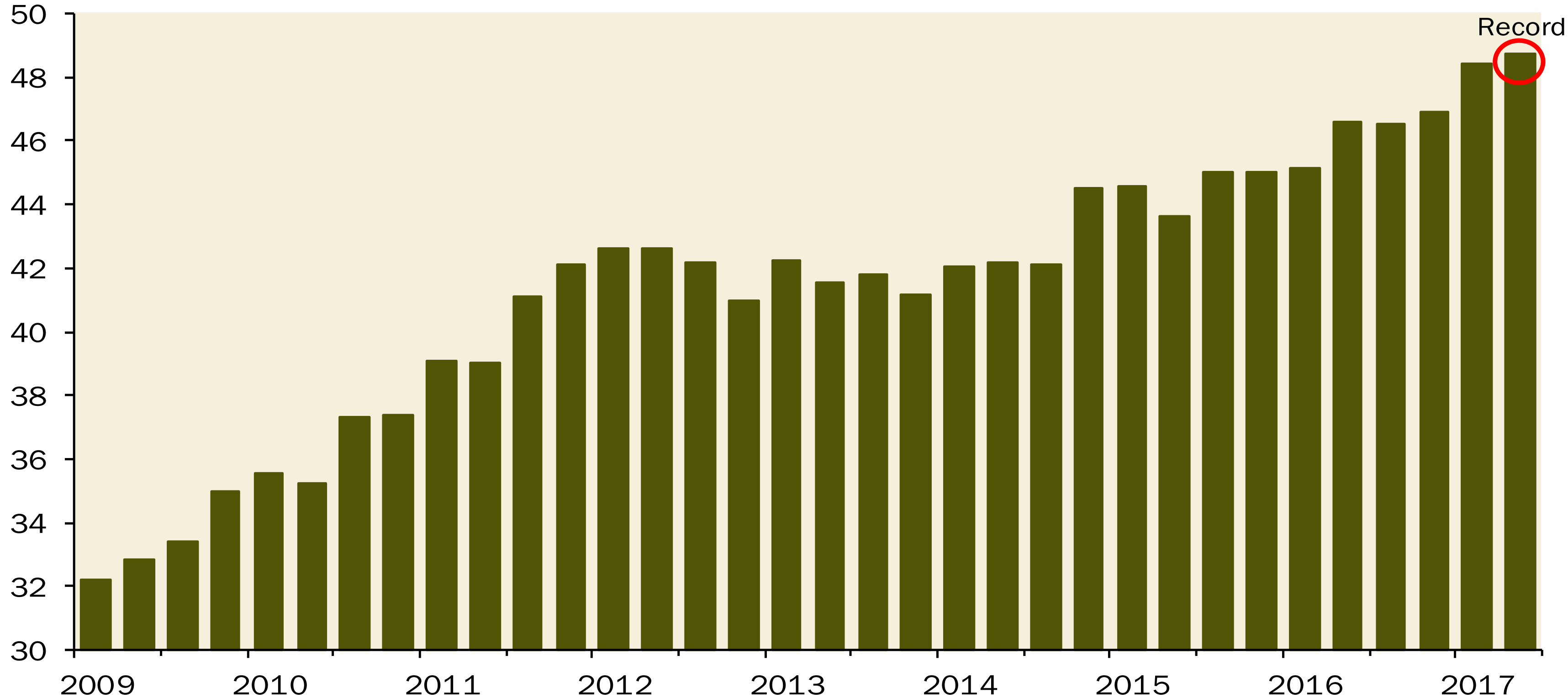
Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

NEARLY HALF OF INVESTMENT-GRADE COMPANIES ARE RATED BBB

United States: BBB Share of Investment-Grade Bonds

(percent)



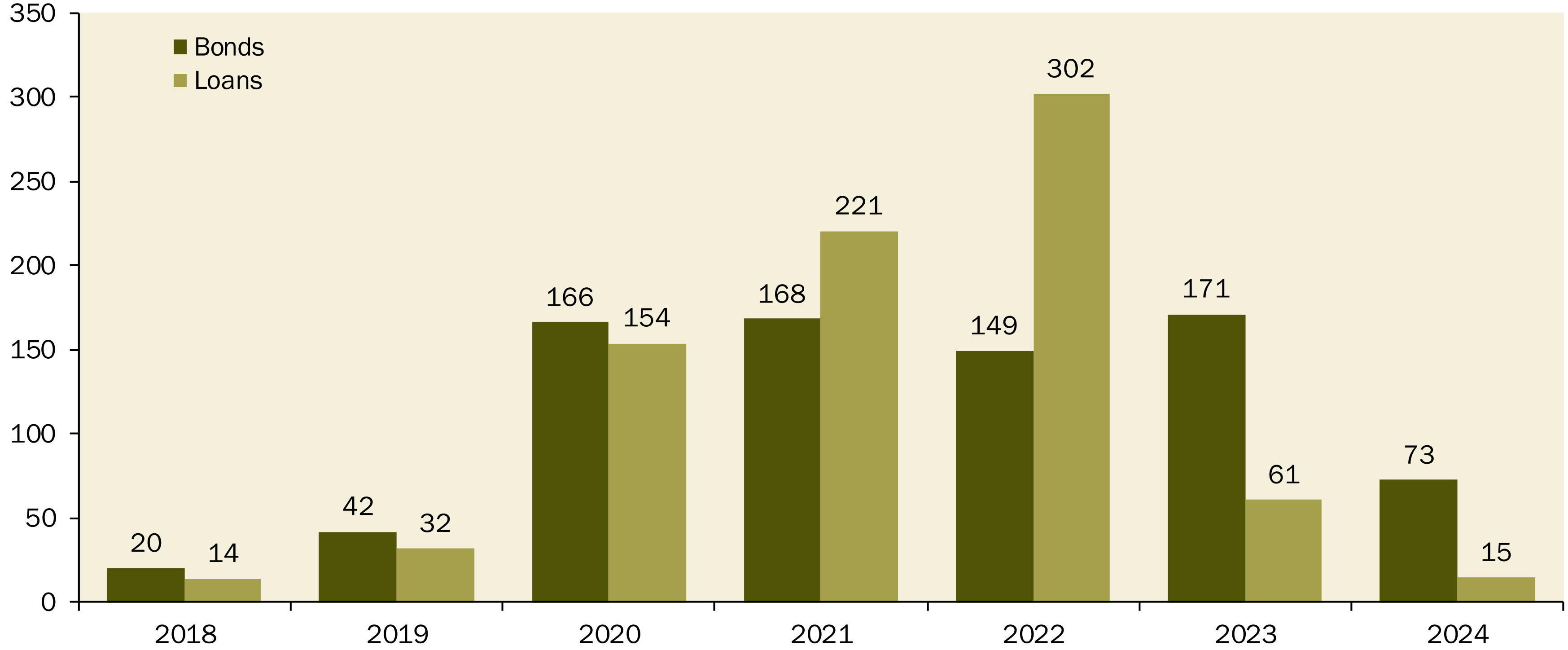
Notes:

Source: Bloomberg, Gluskin Sheff

A LARGE AMOUNT OF HIGH YIELD DEBT IS COMING DUE

United States: High Yield and Leveraged Loan Maturity Profile

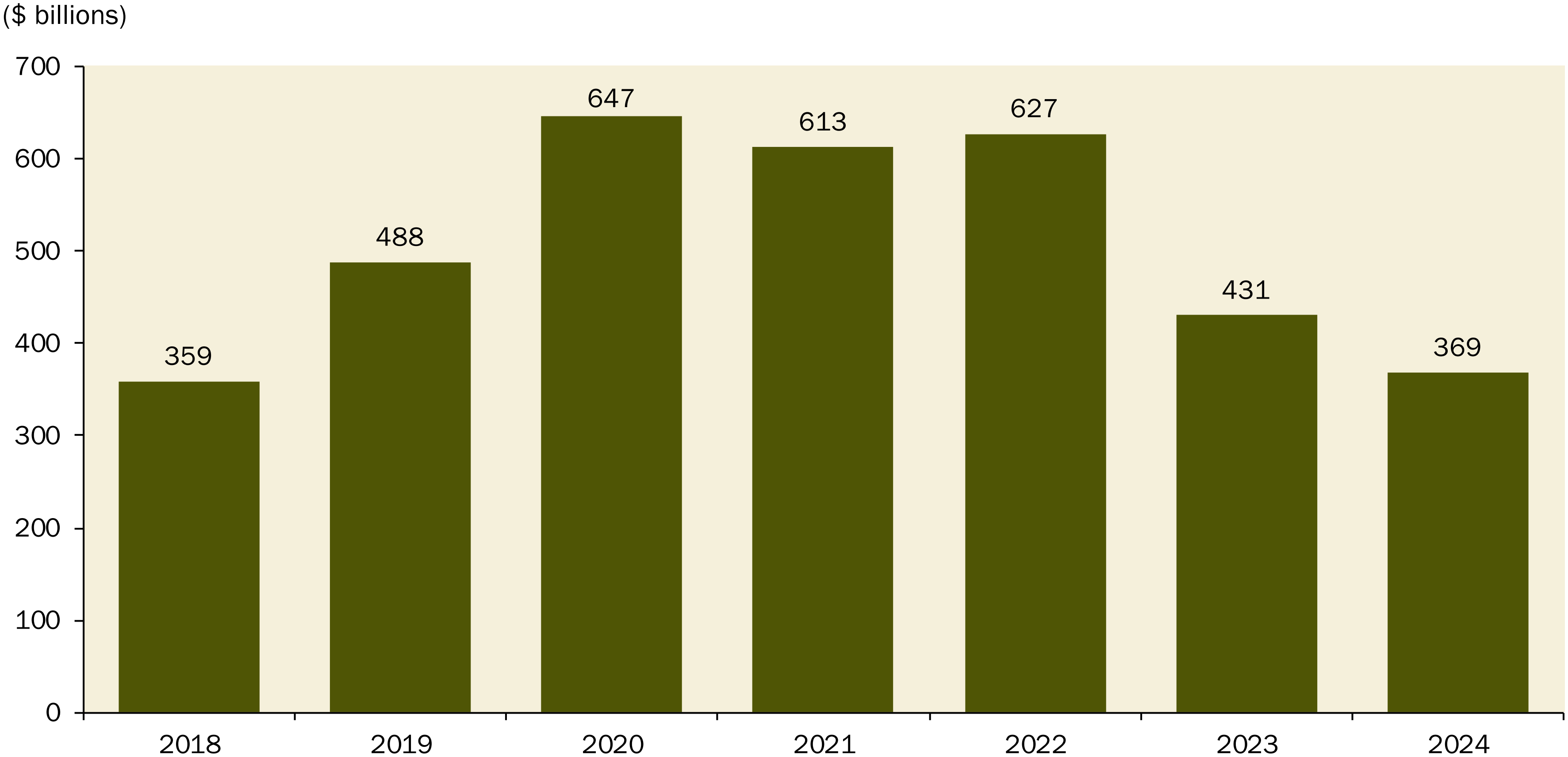
($ billions)



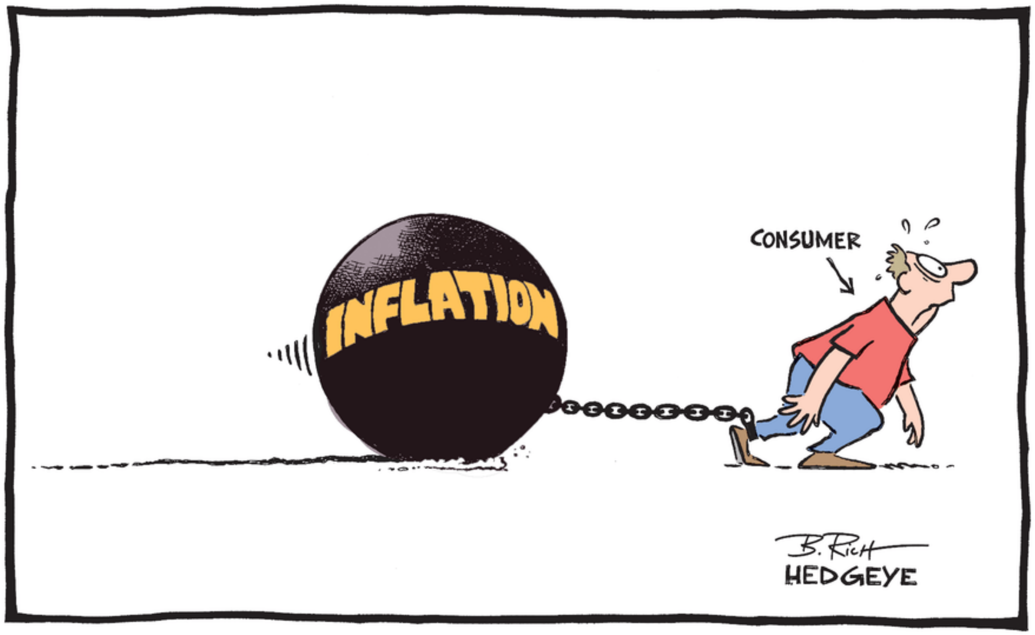
Notes:
Source: BofA Merrill Lynch Global Research, Gluskin Sheff

MATURING INVESTMENT GRADE BONDS SET TO DOUBLE IN NEXT 2 – 3 YEARS

United States: Investment Grade Maturity Profile



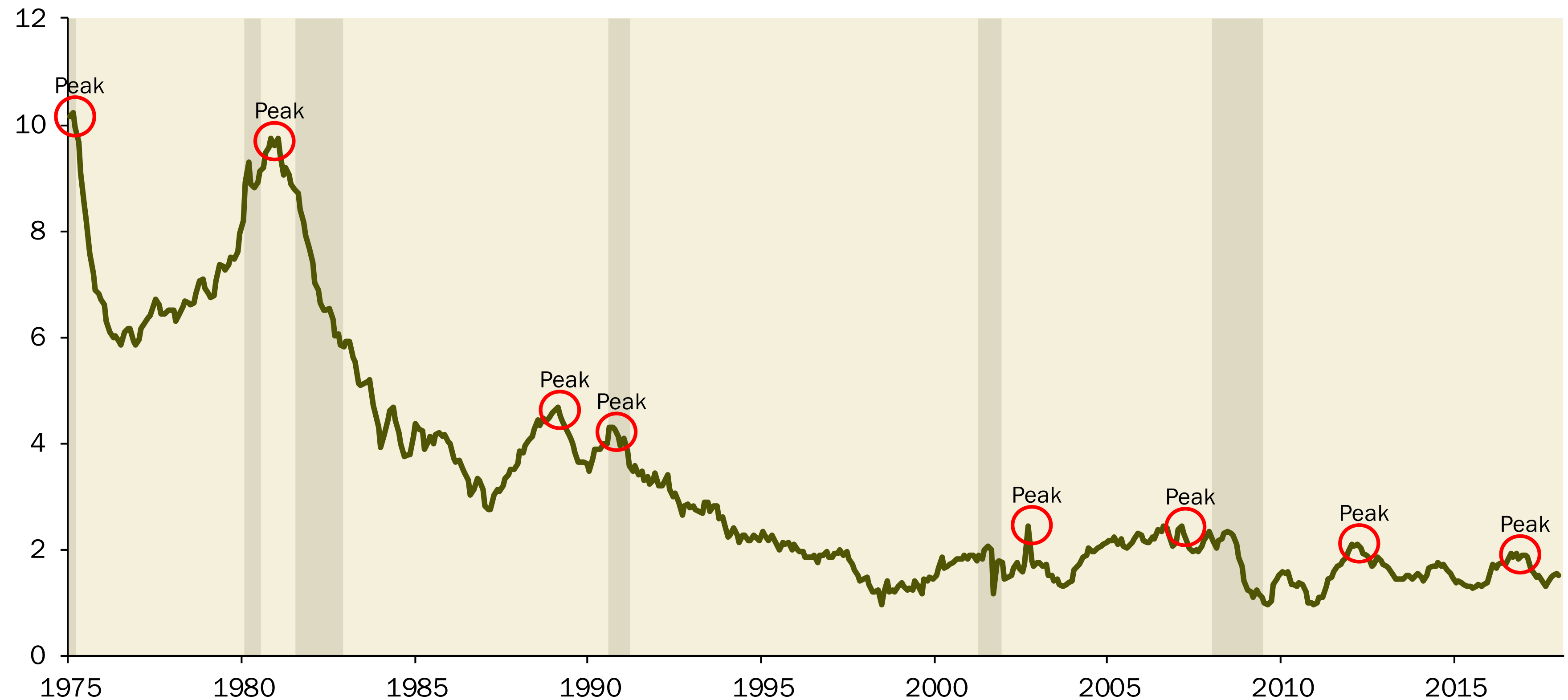
Notes:
Source: BofA Merrill Lynch, Gluskin Sheff


INFLATION
CONSUMER
B. Rich
HEDGEYE

CORE PCE INFLATION PEAKING LOWER AND LOWER

United States: Core PCE

(year-over-year percent change)

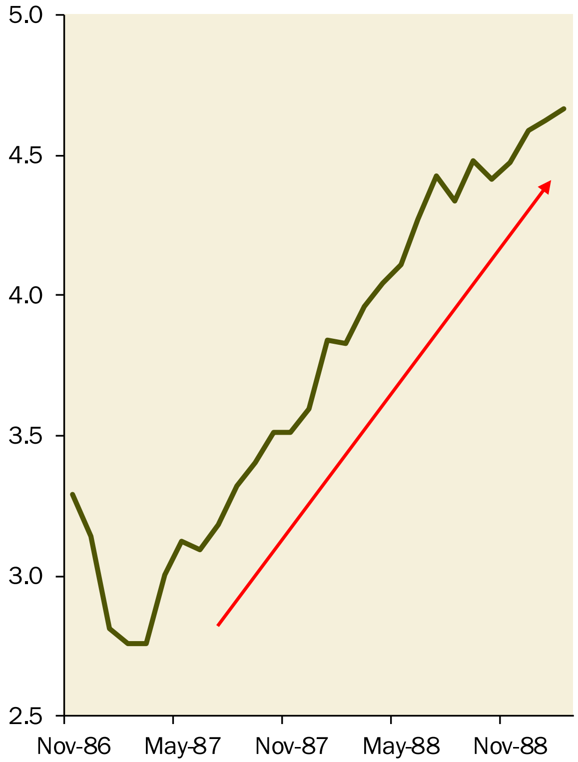


Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

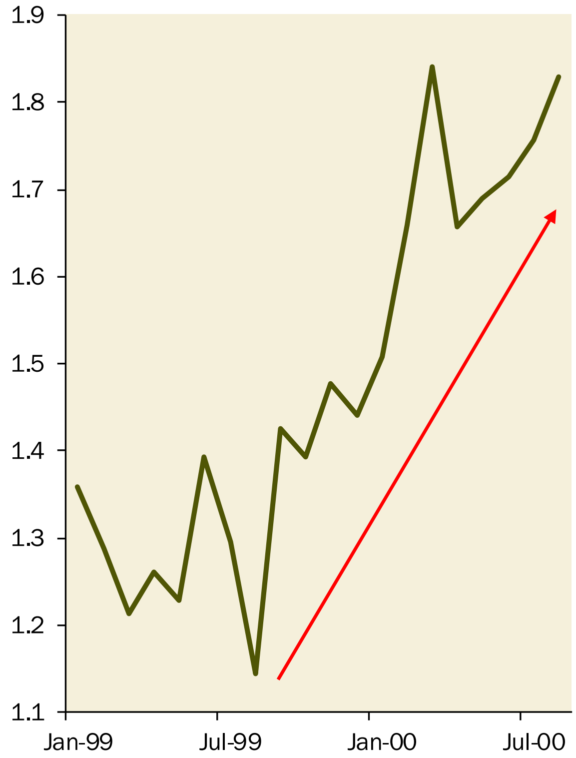
SECULAR DISINFLATION, PUNCTUATED BY CYCLICAL INFLATION

United States: Core PCE

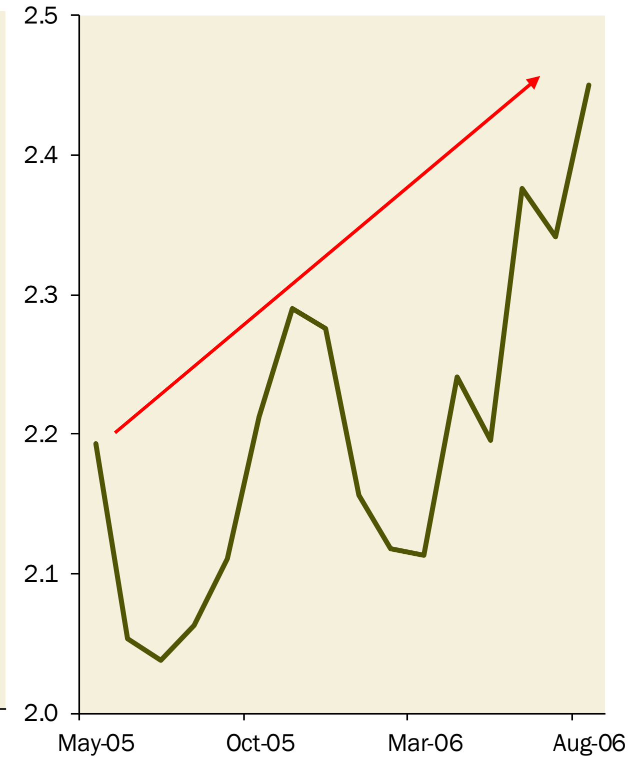
1986 - 1988
(year-over-year percent change)



1999 - 2000
(year-over-year percent change)



2005 - 2006
(year-over-year percent change)



Notes:
Source: Haver Analytics, Gluskin Sheff


CROSS COUNTRY.
DOWNHILL.
10YR YIELD
B. RICH
HEDGEYE
Hedgeye

BOND BULL MARKET OVER…HAVEN'T WE HEARD THAT BEFORE?

2011

- *Gross was right: The bond bubble will burst* — Marketwatch

2012

- *The End of the 30-year Bond Bull Market?* — University of Pennsylvania, Wharton

2013

- *Bill Gross: Bull Market in Bonds Over* — Wall Street Journal

2014

- *This is the 'Doomsday' Bond Market Scenario* — CNBC

2015

- *How to Avoid the Coming 25 Year Bond Bear Market* — Forbes

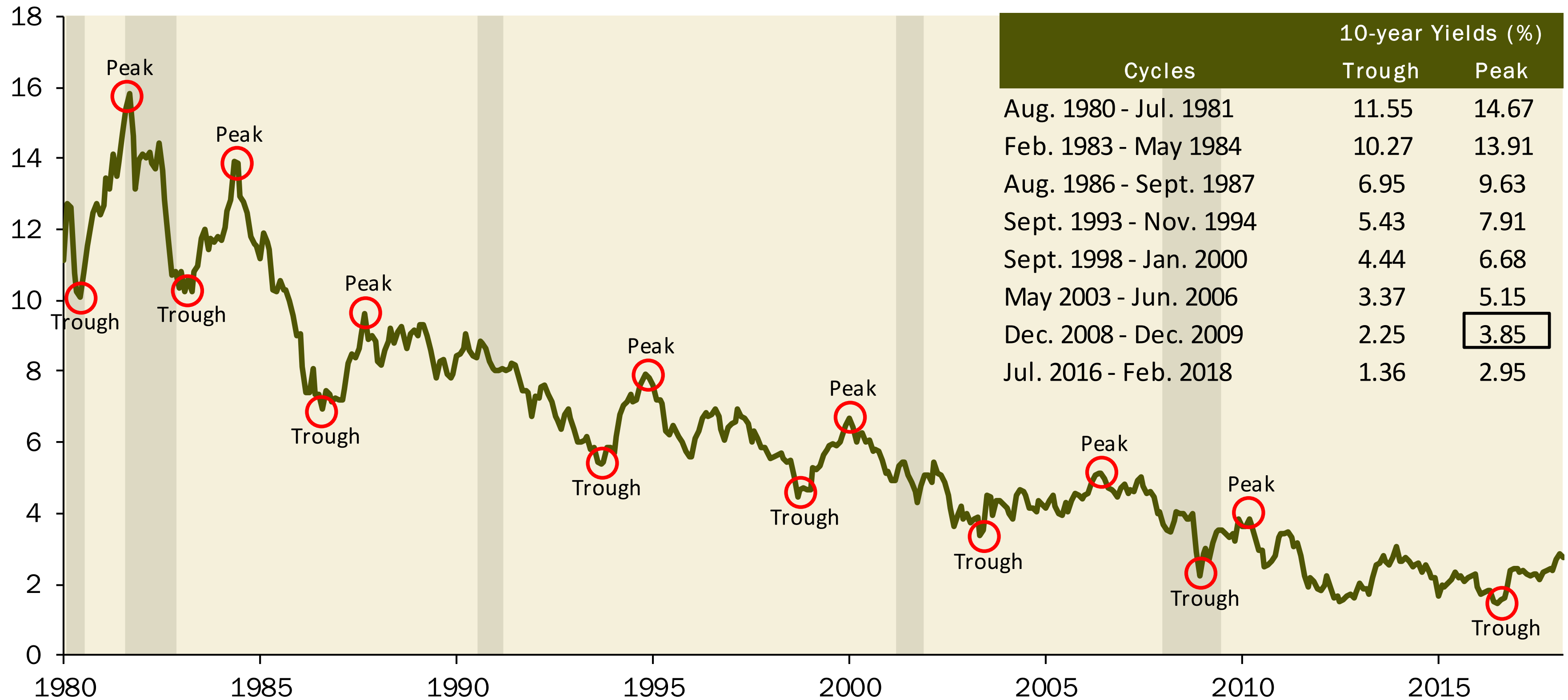
2018

- *The Bear Market in Bonds is Just Getting Started* — Bloomberg

WE HAVEN'T BROKEN OUT OF THE DOWNTREND JUST YET

United States: 10-year Treasury Note Yield

(percent)

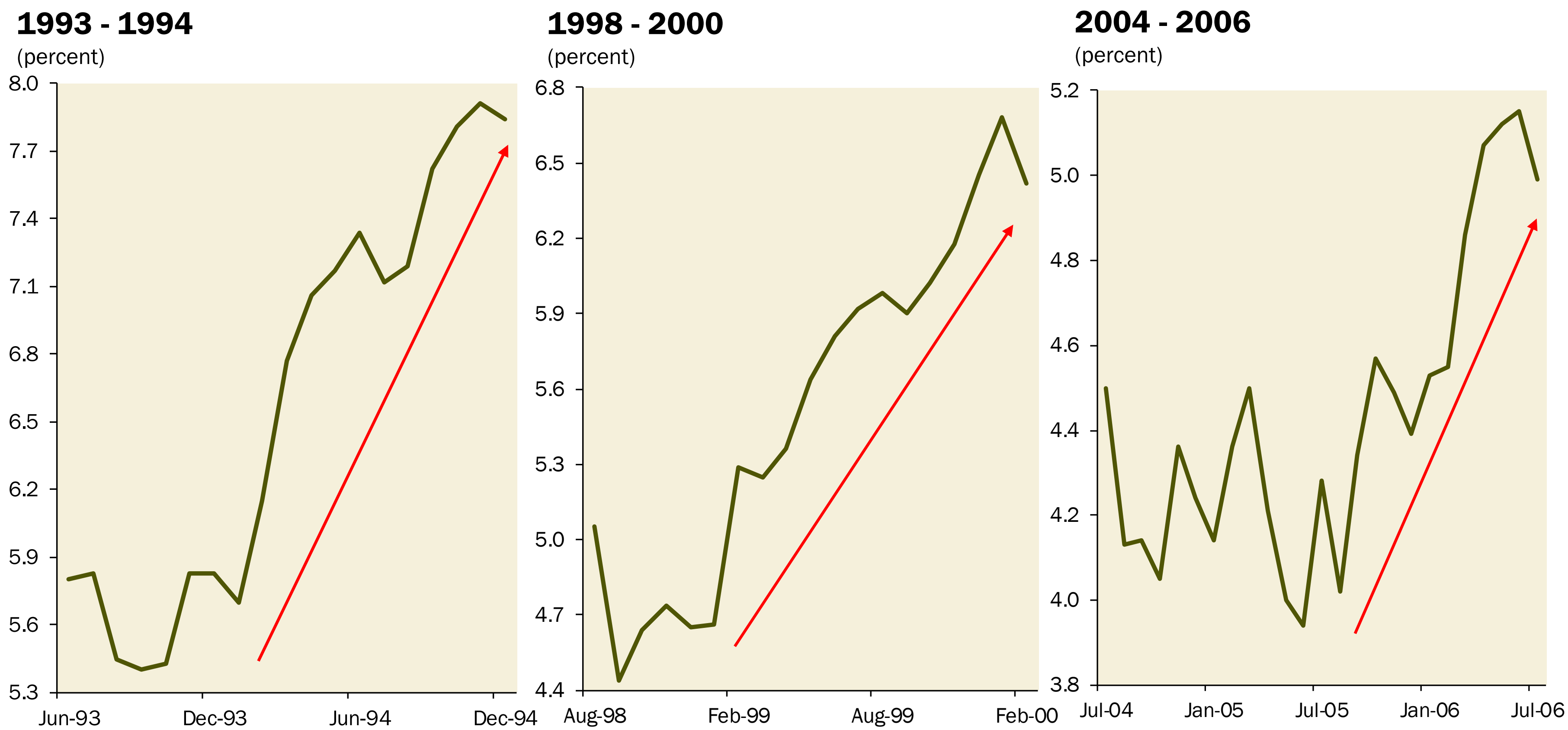


Cycles	10-year Yields (%) Trough	Peak
Aug. 1980 - Jul. 1981	11.55	14.67
Feb. 1983 - May 1984	10.27	13.91
Aug. 1986 - Sept. 1987	6.95	9.63
Sept. 1993 - Nov. 1994	5.43	7.91
Sept. 1998 - Jan. 2000	4.44	6.68
May 2003 - Jun. 2006	3.37	5.15
Dec. 2008 - Dec. 2009	2.25	$\boxed{3.85}$
Jul. 2016 - Feb. 2018	1.36	2.95

Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

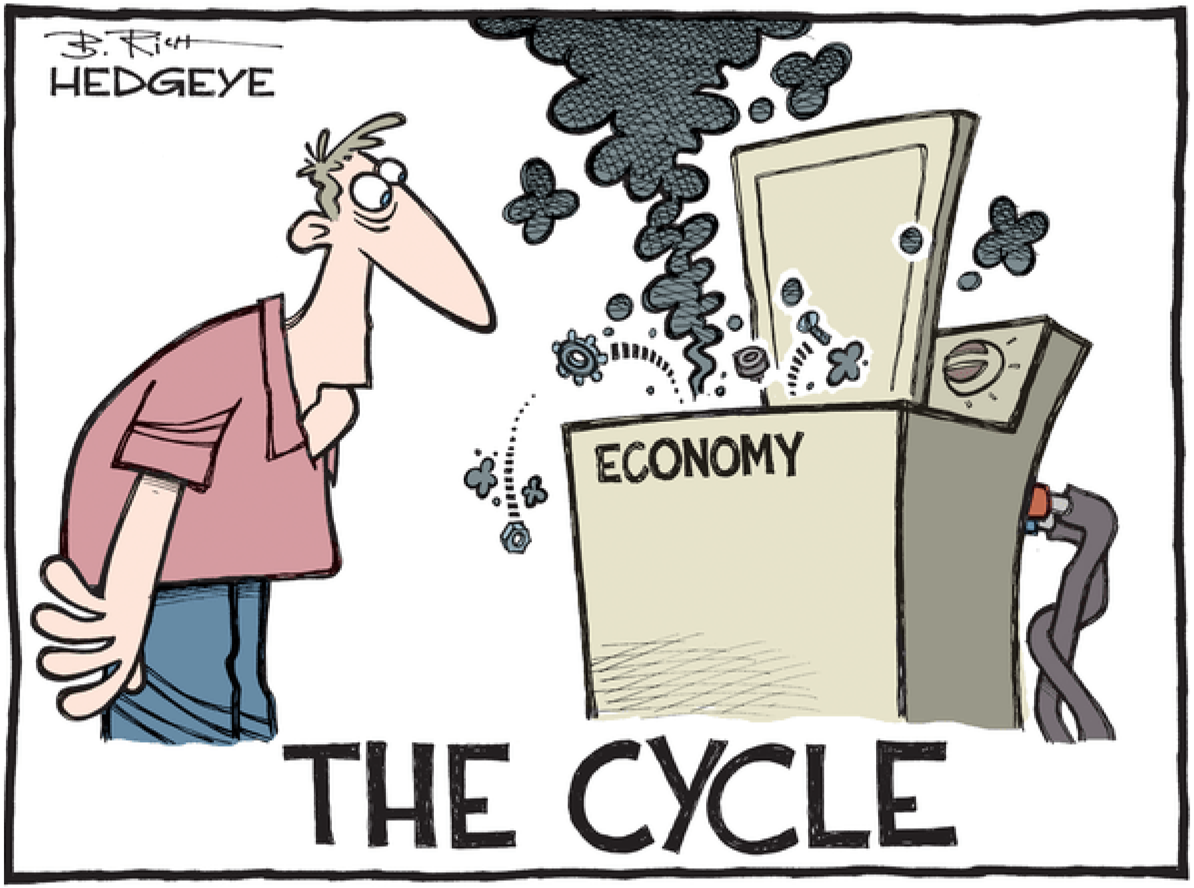
BOND MARKET CORRECTIONS OCCUR DESPITE SECULAR DEMAND

United States: 10-Year Treasury Note Yield



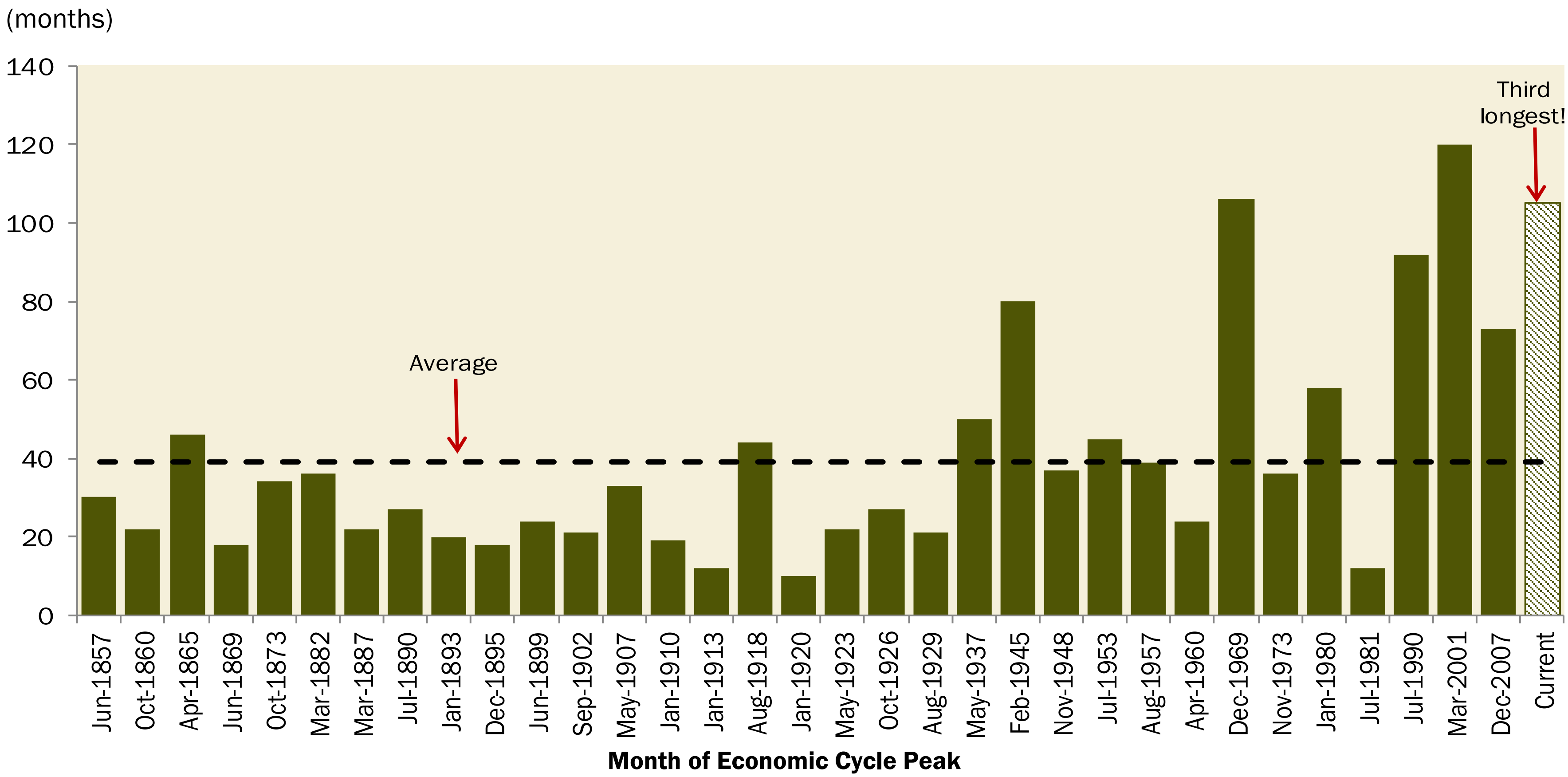
- Bond market corrections occur; can last up to 2 years and see 10-year note yields rise 200 bps

Notes:
Source: Haver Analytics, Gluskin Sheff


B. Rich
HEDGEYE
ECONOMY
THE CYCLE

THE U.S. CYCLE IS VERY LATE

United States: Duration of Economic Expansions



Notes:
Source: National Bureau of Economic Research, Gluskin Sheff

FLATTER YIELD CURVE – CLASSIC LATE-CYCLE

United States: 10-Year Less 2-Year Treasury Yield

(basis points)

Notes:

Shaded regions represent periods of U.S. recession

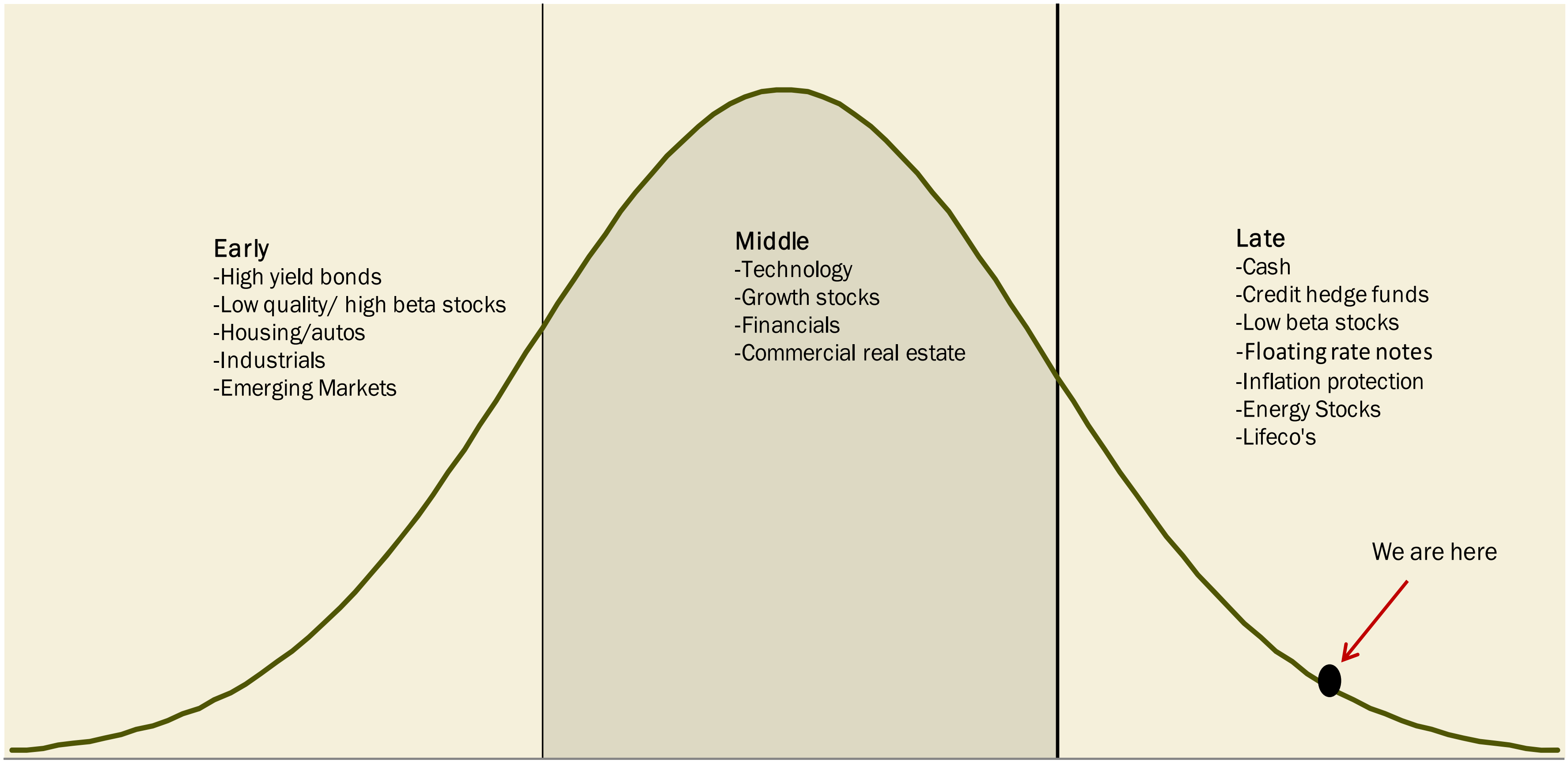
Source: Haver Analytics, Gluskin Sheff

14 OF 15 VARIABLES SUGGEST WE ARE PAST THE SEVENTH-INNING STRETCH

Variable	Average change in expansions (start to peak/trough)	This cycle	Percent of average recovered this cycle
Core CPI (bps)	82.0	60.0	73.2%
CRB Commodity Index (%)	37.0%	48.0%	100.0%
2s/10s Yield Curve (bps)	-183.0	-164.0	89.6%
Industry Capacity Utilization Rate (ppts)	9.0	12.5	100.0%
Unemployment Rate (ppts)	-2.9	-5.2	100.0%
Real GDP (ppts)	8.9	7.4	83.1%
Profit Margins (ppts)	3.9	5.6	100.0%
ISM Manufacturing (pts)	25.0	14.2	56.8%
Auto Sales (%)	56.0%	84.0%	100.0%
Housing Starts (%)	63.5%	127.0%	100.0%
Cyclical GDP Share (ppts)	3.2	3.7	100.0%
Trailing P/E Multiple (pts)	7.8	9.3	100.0%
High Yield Spread (bps)	-662.7	-785.1	100.0%
Employment-to-Population Ratio (ppts)	2.5	0.8	32.3%
Consumer Confidence (pts)	43.9	75.6	100.0%
Average			89.0%
Median			100.0%

Notes:
Source: Haver Analytics, Gluskin Sheff

AS THE CYCLE TURNS…SO SHOULD YOUR PORTFOLIO



Notes:
Source: Gluskin Sheff

THERE HAVE BEEN 13 FED HIKING CYCLES, 10 LANDED IN RECESSION!

First Hike	Last Hike	Result
October 1950	May 1953	Recession
October 1955	August 1957	Recession
September 1958	September 1959	Recession
December 1965	September 1966	Soft Landing
November 1967	June 1969	Recession
April 1972	September 1973	Recession
May 1977	March 1980	Recession
August 1980	December 1980	Recession
March 1983	August 1984	Soft Landing
January 1987	May 1989	Recession
February 1994	February 1995	Soft Landing
June 1999	May 2000	Recession
June 2004	June 2006	Recession
December 2015	???	???

THE FED DOESN'T SEE RECESSIONS WHEN IT IS STARING THEM IN THE FACE

United States

Recession Start	Forecast Growth Coming Year (%)	What Actually Happened (%)	Delta (%)
Dec-69	1.2	-0.1	-1.3
Nov-73	2.4	-1.9	-4.3
Jul-81	0.9	-2.6	-3.5
Jul-90	2.0	0.0	-2.0
Mar-01	2.6	1.4	-1.2
Dec-07	1.3	-2.7	-4.0
Average	**1.7**	**-1.0**	**-2.7**

Notes:
Note: data represents four quarter average of subsequent QoQ (annualized) GDP growth
Source: Haver Analytics, Gluskin Sheff

YIELDS DECLINE DURING RECESSIONS

United States: 10-Year Yield Before, During and After Recessions

(percent)

Expansion Date		Peak Before Recession	Recession Start	Low in Recession	End of Recession
Feb-61	Dec-69	8.1	7.9	6.3	6.5
Nov-70	Nov-73	7.6	6.7	6.7	8.1
Mar-75	Jan-80	11.2	11.3	9.5	10.8
Jul-80	Jul-81	14.7	15.0	10.4	10.7
Nov-82	Jul-90	9.1	8.3	7.8	8.1
Mar-91	Mar-01	6.8	5.0	4.2	4.8
Nov-01	Dec-07	5.3	4.0	2.1	3.6

The 10-year yield declines 160 basis points in recessions

Notes:
Source: Haver Analytics, Gluskin Sheff

WHAT 'IF' WE GET A RECESSION?

United States: S&P 500

Expansion Date		Peak to Recession Start Months	Peak to Recession Start % Decline	Recession Start to Recession Trough Months	Recession Start to Recession Trough % Decline	Peak to Recession Trough Months	Peak to Recession Trough % Decline
Oct-49	Jul-53	6	-7.2	2	-8.2	8	-14.8
May-54	Aug-57	12	-9.1	2	-13.8	14	-21.6
Apr-58	Apr-60	8	-10.4	6	-3.8	14	-13.9
Feb-61	Dec-69	13	-15.1	5	-24.7	18	-36.1
Nov-70	Nov-73	10	-20.2	11	-35.1	21	-48.2
Mar-75	Jan-80	0	-0.9	2	-14.0	2	-14.7
Jul-80	Jul-81	8	-6.8	13	-21.8	21	-27.1
Nov-82	Jul-90	0	-3.5	3	-17.0	3	-19.9
Mar-91	Mar-01	12	-24.0	6	-16.8	18	-36.8
Nov-01	Dec-07	2	-6.2	15	-53.9	17	-56.8
Average		**7.1**	**-10.3**	**6.5**	**-20.9**	**13.6**	**-29.0**

Notes:
Source: Haver Analytics, Gluskin Sheff


Trust ME, I'LL PAY FOR IT ALL TOMORROW...
NY
$58 billion
BUDGET cashier
Cagle.com

THE FED WILL HAVE VERY LITTLE LEEWAY IN THE NEXT DOWNTURN

		Federal Funds Rate (%)		
Start	End	Start Level	End Level	Delta
Oct-57	May-58	3.50	0.57	-2.93
May-60	Jul-61	3.83	1.18	-2.65
Nov-66	Jul-67	5.74	3.79	-1.95
Feb-70	Feb-71	8.95	6.03	-2.92
Sep-71	Feb-72	5.53	3.30	-2.23
Jul-74	May-75	12.91	5.22	-7.69
Apr-80	Jul-80	17.43	9.01	-8.42
Jul-81	Dec-81	19.10	12.44	-6.66
Aug-84	Dec-84	11.50	8.13	-3.38
May-89	Sep-92	9.81	3.00	-6.81
Dec-00	Jun-03	6.50	1.00	-5.50
Aug-07	Dec-08	5.25	0.13	-5.13
Average		**9.17**	**4.48**	**-4.69**
Median		**7.73**	**3.55**	**-4.25**

Notes:
Source: Haver Analytics, Gluskin Sheff

FISCAL POLICY WILL BE SERIOUSLY CONSTRAINED IN FIGHTING NEXT RECESSION

Cycle Peak	Deficit-to-GDP (%)	Year Following Recession	Deficit-to-GDP (%)	Delta (%)
1948	4.5	1950	-1.1	-5.6
1953	-1.7	1955	-0.7	1.0
1957	0.7	1959	-2.5	-3.2
1960	0.1	1962	-1.2	-1.3
1969	0.3	1971	-2.1	-2.4
1973	-1.1	1976	-4.1	-3.0
1980	-2.6	1983	-5.9	-3.3
1990	-3.7	1992	-4.5	-0.8
2001	1.2	2002	-1.5	-2.7
2007	-1.1	2010	-8.7	-7.6
Average	**-0.3**		**-3.2**	**-2.9**
Median	**-0.5**		**-2.3**	**-2.9**

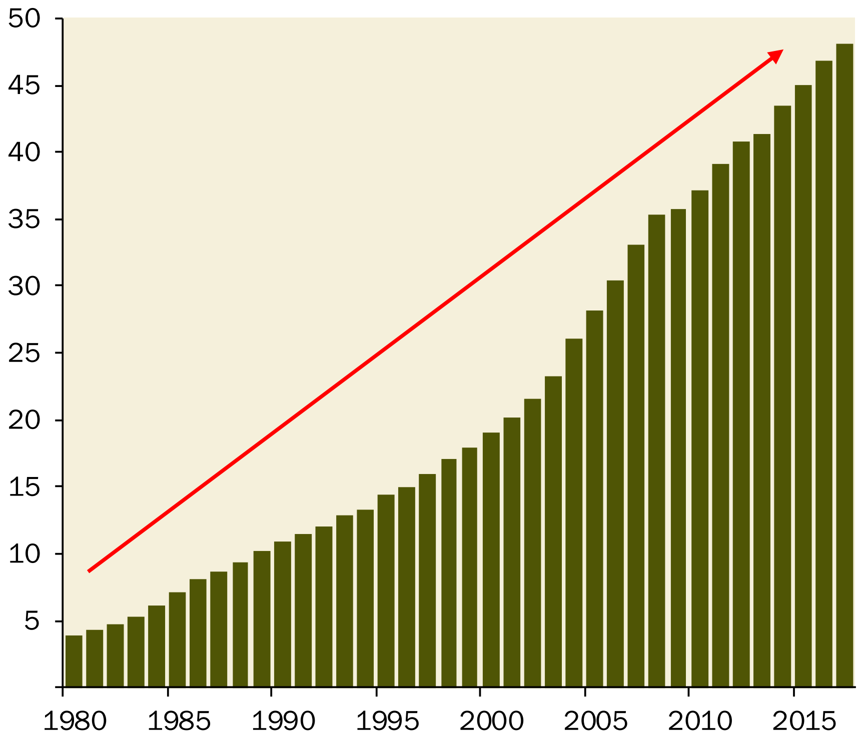
Notes:
Source: Haver Analytics, Gluskin Sheff

WHERE WAS THE DELEVERAGING?

United States

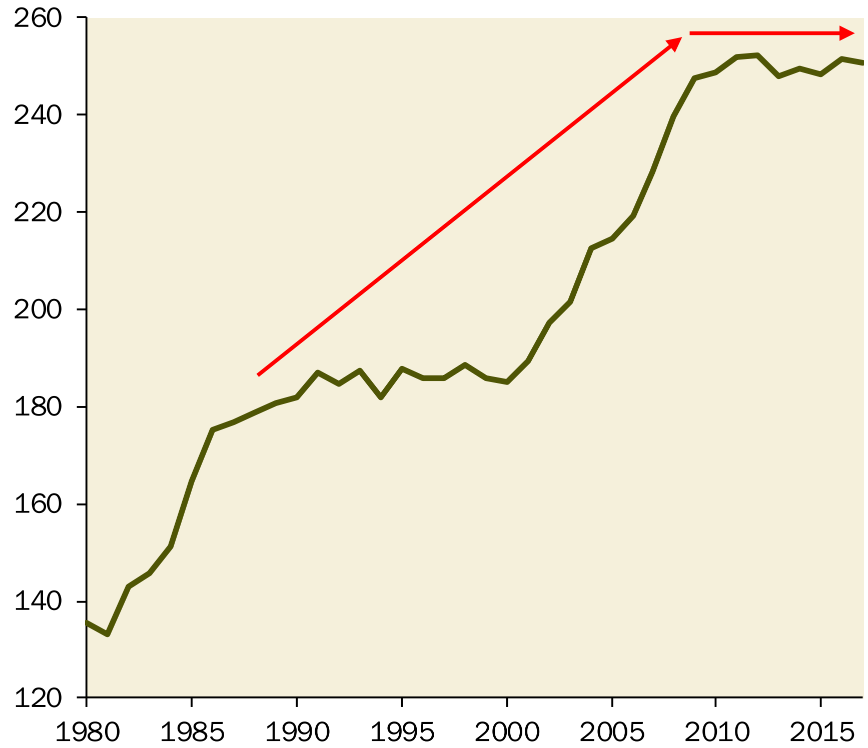
Total Debt

(U.S. Dollar Trillions)



Total Debt-to-GDP

(ratio)



Notes:

Source: BIS, Haver Analytics, Gluskin Sheff

THE END GAME IS THE DEBT JUBILEE

The Federal Reserve Board

Remarks by Governor Ben S. Bernanke

Before the National Economists Club, Washington, D.C.
November 21, 2002

Deflation: Making Sure "It" Doesn't Happen Here

Since World War II, inflation--the apparently inexorable rise in the prices of goods and services--has been the bane of central bankers. Economists of various stripes have argued that inflation is the inevitable result of (pick your favorite) the abandonment of metallic monetary standards, a lack of fiscal discipline, shocks to the price of oil and other commodities, struggles over the distribution of income, excessive money creation, self-confirming inflation expectations, an "inflation bias" in the policies of central banks, and still others. Despite widespread "inflation pessimism," however, during the 1980s and 1990s most industrial-country central banks were able to cage, if not entirely tame, the inflation dragon. Although a number of factors converged to make this happy outcome possible, an essential element was the heightened understanding by central bankers and, equally as important, by political leaders and the public at large of the very high costs of allowing the economy to stray too far from price stability.

Notes:

Source: Ben Bernanke, Deflation: Making Sure "It" Doesn't Happen Here (November 21, 2002)

DISCLAIMER