ZULAUF CONSULTING

INVESTMENT COMMENT

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Markets Diverge from Fundamentals

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POSITION SUMMARY

* Indicates a new position or change in view

MARKET	CYCLE	MEDIUM-TERM *Up to 3 months*
S&P	Neutral	Neutral
30y Long Bond (price)	Bottoming Process	Neutral
Brent Oil	Neutral	Neutral
Gold	Bullish	Neutral
EUR/USD	Bottoming Process	Neutral
USD/JPY	Topping Process	Potentially Bearish*
USD/CNH	Bullish	Neutral/Bullish*

HIGHLIGHTS

- The West is running out of ammunition, which will make it difficult to support Ukraine for much longer. NATO has been discussing the situation at its summit in Vilnius, Lithuania, among other topics. Ukraine membership was postponed as it does not qualify, yet. Friendly nations from the Pacific region were invited as observers.
- Investors are confused by the conflicting information in the news. Clearly we have witnessed bullish action in equities, but the real economy is not portraying such a bullish picture despite the strong US economic data. We are also seeing a weak Chinese economy, a deteriorating geopolitical outlook, and sluggish performance in commodities. Are we already in a recession or just entering one? Are we at the beginning of a new bullish investment cycle as the fans of AI believe, or is it a bubble?
- July is usually a month when equity markets peak, and it looks like most bears have given up. However, in our view a medium-term topping process is unfolding and we think it is possible to see a correction follow.
- Bond yields have risen sharply in recent weeks and 10-year Treasury yields broke briefly above 4%. The Fed signaled another rate hike was likely, and some economic data came in stronger than expected. This almost guarantees another hike. Thus, the monetary tightening and rate hiking continues in the US, as it does in the Eurozone. The risk is that monetary authorities are overdoing it. Monetary policy leads the real economy by around 12 months or longer, and the tightening began in spring of last year. We do not share the rosy outlook by the consensus and expect economic disappointments ahead.
- If we are correct that the economy will eventually weaken well into 2024, we expect the US dollar to strengthen until markets begin to discount Fed easing. This process is still some time away. We expect a minor dip in the US dollar in the next 2-4 weeks, followed by a rebound into fall.
- Our view remains that either the equity market is in its very last gasp on this recovery rally, or policy should reverse immediately. In our view, European markets seem to be ahead and show the clearest signs of peaking. The US will eventually follow. The downside risk is potentially much bigger than what the current consensus imagines.

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We expect surprises to be on the downside, as we give the bearish scenario the highest odds. The big question is timing, as markets can stay irrational longer than fundamental logic suggests.

- If our economic thesis is correct and weakness will spread from the currently weak economies to the currently stronger ones, commodity prices should relapse – but this differs among the various types of commodities. But the downcycle in the commodity complex is already quite advanced and the next phase of weakness will likely offer excellent buying opportunities. Gold is in the early stage of a recovery bounce towards $2,000 but it may then relapse again to the mid-$1800 before moving to new highs.

Geopolitics

The collapse of the Dutch government and the recent riots in France demonstrate a growing dissatisfaction by citizens in Europe with the current government establishment. Similar demonstrations of social unrest have been seen before in Germany as well as other Western nations. The riots are rooted in a culture clash that is tied to immigrants or not-assimilated second generations. President Macron who lacks a parliamentary majority is under pressure domestically in France.

The right-wing parties throughout Europe are gaining in the polls. The Alternative für Deutschland (AfD), a right-wing party that all other German parties in parliament ignore, is showing 20.5% in the polls and is the second largest ahead of all the parties that form the coalition government (Social Democrats, Greens, Free Democrats). And instead of adjusting existing policies to seek a more common ground, the parties in charge simply continue as before which includes ignoring the AfD as a representative political party. Even while the AfD is part of parliament, they are completely ignored by the media and other political parties and never invited to talk shows by the state-owned media.

> European governments all end in weak coalitions as did the Weimar Republic.

The rise of the AfD in Germany represents rising dissatisfaction of the public with the government and policy priorities. It is a widespread phenomenon in Europe, at present. This political shift represents an increase in voters expressing their dissatisfaction with the current trends that are all about climate, gender, diversity, mass-immigration, economic decline or even de-industrialization and war against Ukraine instead of law and order, social and political stability, valuing the own national culture and economic prosperity. The collapse of the Dutch government is a good example. Prime Minister Rutte, an extreme proponent of the WEF agenda, wanted to eliminate 30% of the Dutch farms and their cows as cows are bad for climate. Rutte will leave politics, and this is no loss in our view. The consequence of these trends is that the political landscape with a high number of disparate political parties makes it impossible for European nations to form strong governments and pursue pragmatic and moderate policies. The risk is that European governments all end in weak coalitions as did the Weimar Republic.

At the NATO summit in Lithuania, several important topics were on the agenda, but the war in Ukraine took front and center. Even NATO admits that the Ukrainian offensive has not gone as planned and seems to be failing. The Ukrainian Commander-in-Chief, General Zaluzhnyi, was against the current counteroffensive as he was against the last one because they are extremely costly in terms of troops and equipment lost. He recommended to focus on defense and not offense but was overruled by President Zelensky and NATO. Now, reports are that Ukraine, despite not making much progress in the current offensive, has already lost 25,000 troops and large numbers of tanks, vehicles and weapons. The number of troops is almost half of what Ukraine originally wanted to send into this counterattack. And Ukraine has hardly come close to the fortified resistance line of Russia. The cruel tragedy continues, unfortunately.

Moreover, European nations have been unable to deliver the ammunition

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promised because their stock is exhausted. The US also seems unable to deliver normal (155 mm artillery) ammunition due to already low stock and has therefore decided to send cluster ammunition. President Biden admitted in an interview on CNN that the US and their Western allies are running low on ammunition. For that reason, the US provides cluster ammunition.

We agree with President Biden that the West is running out of ammunition, which we mentioned in a previous report.

The convention of cluster ammunition signed by over 100 nations in 2010 prohibits production, shipment, and use of cluster ammunition. However, neither the US nor Russia nor Ukraine have signed this treaty. The problem of cluster ammunition is that anywhere from 6% (newer versions) up to 40% (older versions) of the smaller shells inside the big shell do not detonate and instead turn into dead duds and remain a risk for the civilian population (like land mines). Russia allegedly used it once earlier in this war in Ukraine. The USA used it in the Iraq war and in Vietnam (they dropped 270 million of such bombs over Laos). Several parties used them in the Syrian war. Using cluster shells will not decide this war. We agree with President Biden that the West is running out of ammunition, which we mentioned in a previous report and expected for later this year. Moreover, time is running out for President Biden, as he does not want to enter the election by losing the war in Ukraine and in which the US public shows little interest. We agree with General Milley, the US joint chief of staff, that Ukraine cannot win this war. Either Ukraine/US will enter talks about the future of Ukraine and the European security structure (which Russia has been requesting to discuss for 20 years) or NATO must send troops, which would escalate into WW3 (enough ammunition?). It would force China to enter, as China cannot risk Russia losing in this conflict.

The risks for companies involved in industries that have China risk or exposure are not discounted by financial markets, yet.

Comments from Moscow confirm that Prigozhin, the head of the Wagner private army, met with Putin on June 29, 2023, with about 30 other high commanders of Wagner, just one week after the mutiny attempt. This may suggest that a smaller Wagner Group may continue to operate in Russia's interest in other parts of the world while the main part of the Wagner troops are now integrated into the Russian regular army, perhaps for special operations. This is what Putin wanted in order to discipline Prigozhin. It also confirms that the Western media's comments and Western political hopes that Putin and Russia were weakened and at the threshold of internal conflict was completely wrong. We have to be careful when interpreting the mainstream media as there is a war and the media content has become speculative and propaganda to a significant extent.

Secretary of the Treasury Yellen visited China. The visit did not lead to an improvement of the conflict laden relationship between China and the USA. Like Secretary of the State Blinken, she tried to calm the waters between the two nations. The Chinese delegation reminded her that the USA subscribed to the one-China policy and have moved away from it despite the original agreement. China also bluntly stated they are not interested in war but if forced to protect their interests (including Taiwan), they would not step aside but instead would fight for it.

The US has recently tightened the sanctions against China further for high-tech electronic equipment, particularly high-performance semiconductors and machines to manufacture them. China has now retaliated by limiting the export of materials that are needed to produce chips (gallium nitride and germanium dioxide). Thus, the conflict continues and will likely grow bigger. The US and China

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both depend on each other, but "de-risking" is the new trend driven by increasing sanctions and rising potential trade risks. It is in line with our description of some de-globalization and the building of two major blocs in a developing multi-polar world. And it is all about interests, influence and power in the world. The risks for companies involved in industries that have China risk or exposure are not discounted by financial markets, yet.

When the Fiscal Support Fades…

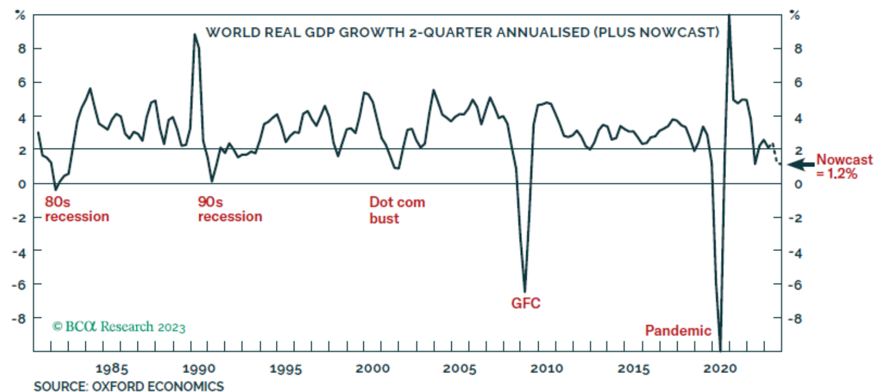
Many pundits on the news and in the investment community like to debate whether there will be a recession or not. We believe this discussion is missing the point to some degree, as the world GDP is already in a recession (chart 1). Recession is whenever real global growth falls below 2% while a true crisis hits when that number goes negative, which has been extremely rare in the last 40 years (1980/82, 2009, 2020 were such crisis events).

> The world economy remains weak but there are pockets of strength, and they usually are results of large government support programs.

The world economy remains weak but there are pockets of strength, and they usually are results of large government support programs. Moreover, the data reported on the world

CHART 1

World Real GDP Growth 2-Quarter annualized (plus Nowcast)



Source: BCA Research

economy remains distorted by the Covid-19 lockdown period and the interventions governments used to fight it. The most support was granted during the pandemic period by the UK, followed by the US, less in Europe and virtually no support in Asia (except Japan). As a result, this is exactly how the world economy presents itself today. It has held up well and better than expected in the UK, the US and Japan, while Europe remains weakish, and China is relatively weak, as there was no support provided.

There is more than just the direct fiscal support for consumers and businesses from the pandemic period, however. Due to the "de-risking" of the globalized supply chains there are all sorts of subsidies for "reshoring" attempts and building of factories, particularly in the US. Taiwan Semiconductor's new manufacturing plant in the US will cost $40 billion of which the government bears part. The same is happening with Intel's new plant in Germany. These are simply two examples of large fiscal support.

While nobody can say with precision when the fiscal support will begin to fade if not even evaporate, we assume it will be towards later this year. In the meantime, however, monetary policy will tighten further. And that is true not just for the US but also for the UK (where fiscal support could last a bit longer) as well as for the Eurozone where the fiscal support is already gone.

Moreover, there is the inventory swing that distorts the economic picture

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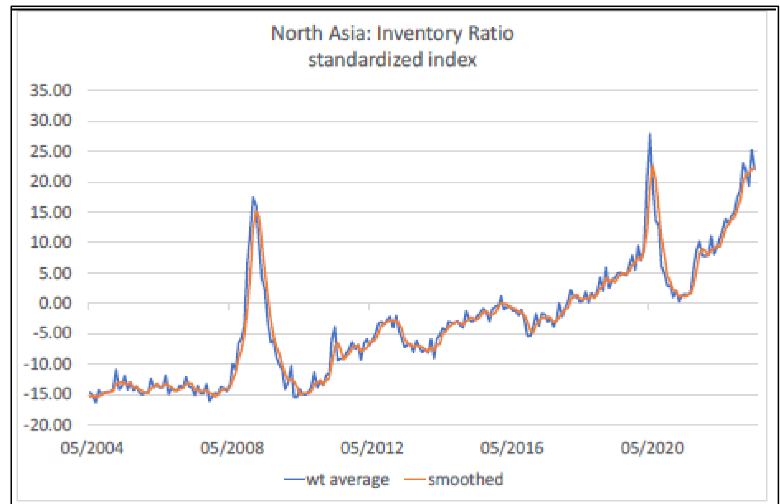
somewhat. And it is important as inventories in Northern Asia (manufacturing place of the world) are extremely high (chart 2). They are also on the high side in Europe if you disregard the excess of the 2020 pandemic slump (chart 3). And in the US, new orders relative to inventories are exceptionally low, suggesting an ongoing involuntary inventory accumulation. This contributes to growth in the short term, as production is still running ahead of sales, and gives a false sense of strength as GDP measures the production side (chart 4, next page). General Domestic Income (GDI) is already declining, however, which usually leads to a weaker economy.

In Europe, the vast majority of economic indicators point to a further deterioration in the economy. We do not expect any sustainable improvement although some numbers may bounce in any given month. Real personal income is still negative – but less than before due to falling inflation rates. Sharp cost increases for energy (despite subsidies) and health insurance may dampen private consumption. The positive factor for GDP growth is the growth in population in some European countries due to the influx of immigrants from Africa, Eastern Europe (Ukraine) and Central Asia in certain Western European countries. But GDP per capita remains weakish.

China is trapped in a deflationary balance sheet recession. The real estate and construction sector with over 40% of GDP will remain a burden for years as the vacancy rate is over 20%. Moreover, the local governments that built the infrastructure and also local housing are tapped out, as they derive their revenues from land sales and real estate transaction fees, which are both in a serious slump. The consumer is also trapped as 2/3 of their savings are invested in real estate that is declining in price. This results in a negative carry (negative asset price and positive mortgage rates), which will likely keep the consumer on the defensive for some time. The government

CHART 2

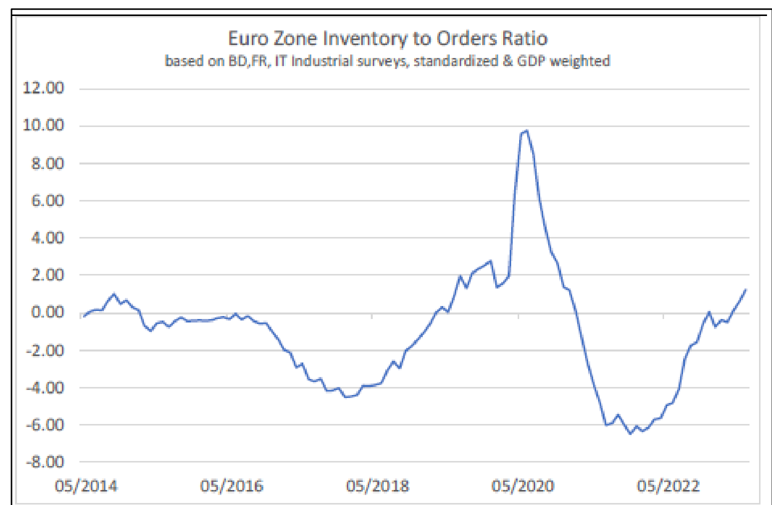
North Asia Inventory Ratio



Source: AHE

CHART 3

Euro Zone Inventories to Orders Ratio



Source: AHE

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will from time to time provide support to prevent the economy from breaking down, but it will not provide stimuli for a new growth era. We expect more monetary than fiscal help.

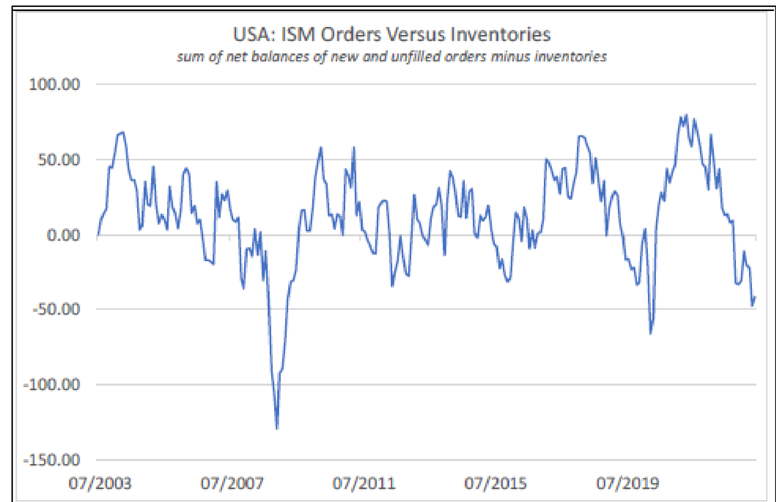
The US, UK and Japan are the only major economies with some modest growth supported by fiscal support that will eventually fade. But monetary policy is tight and tightening everywhere except China (and perhaps not yet in Japan).

Japan is a special case, as the economy has suffered for years from an imbedded deflationary bias due to demographics. As a result, Japan pursued an easy money policy for years to offset those trends and the CPI inflation is finally over 3%. That seems higher than the desired target and we expect the BoJ to move away from yield curve control step by step. Thus, it is likely that they will increase the target rate for 10-year JGBs by 25 basis points this summer as a next step.

In sum, the US, UK and Japan are the only major economies with some modest growth supported by fiscal support that will eventually fade. But monetary policy is tight and tightening everywhere except China (and perhaps not yet in Japan).

CHART 4

USA: ISM Orders vs. Inventories



Source: AHE

Central banks messed up, as they got used to near zero inflation and disregarded continued service inflation of about 3% p.a. for the last 30 years because inflation on traded goods was negative due to the integration of China and other EM economies into the world economy (globalization). When the supply chains broke down due to the pandemic and demand was supported by governments handing out extra money, prices had to rise to balance demand and supply. Now, the world will hardly be as efficiently globalized as before, and this is a major structural change pushing price levels up in the traded goods sector in coming years. Moreover, the lockdown kept services activity on the defensive and what we now see is a delayed catching up. All of a sudden, everybody wants to travel, after having been locked up for almost two years.

We expect central banks to overtighten until something breaks in our system.

But central banks did not understand the service inflation and now need to address it. To break the inflation psychology, inflation must fall below the

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targeted 2%, perhaps to 0%-1%, or central banks risk that it will return strongly once economies strengthen again. Cyclical inflation has peaked and is declining and may decline even more than expected while central banks are still fighting the last war.

In every cycle, something important must break and hurt; it is often something unexpected that breaks.

Central banks always operate by looking into the rear-view mirror and remain therefore focused on breaking inflation hard to prevent another sharp rise in the next cyclical economic expansion. For this reason, we expect central banks to overtighten until something breaks in our system. We first thought the banking crisis in March could be that break – but it was not. As it created a problem for only a few banks and central banks immediately provided liquidity, which paradoxically lengthened the tightening cycle. It is therefore no wonder that short rates have broken above the March highs in money markets. In every cycle, something important must break and hurt; it is often something unexpected that breaks. Once it hurts, it will change the behavior of economic subjects, borrowers and lenders, consumers and business managements and the authorities. We still expect something of that order lies ahead for us.

…and Central Banks Overtighten

US commercial and industrial loans have been weakening and a credit crunch in the real economy is developing. The economy may now be at the point where final demand is weakening, as a certain pick-up in lending is materializing. In contrast to others, we think this pick-up is due to the necessary financing of involuntary inventory accumulation. This is a temporary phenomenon, as management teams will soon begin to react to involuntary inventory accumulation by cutting production and employment. Thereafter inventories will decline again leading to lower C&I loan growth again. This is what we expect for the coming months, first a further build-up of involuntary inventories and a corresponding pick-up of C&I lending, followed by production cuts.

Wall Street believes that the Fed can engineer a soft landing. But that has never really materialized in the past. It was either no landing or a hard landing. For that reason, we assume that the tightening will continue until something breaks, although we do not know when that will be. The Fed, as well as other central banks, know very well if they do not break inflation here, they will likely fight a much bigger inflation monster in the next cyclical expansion. For that reason, we expect central banks in the US and Europe to err on the side of tightening, which Jay Powell has even pointed to.

We lean towards the view that a credit crunch is slowly developing in the US. When the monetary framework is tightening and demand has not weakened yet, interest rates will rise automatically. Some weaker segments of the world and the US economy have already reacted to this process of tighter money. Commercial real estate is one particular segment (see chart 5 of rising quality spreads of commercial MBS, next page) and those banks involved with a large part of the lending in that sector and in highly exposed regions, are at risk. For that reason, we would not be surprised to see a second wave of different banks getting hurt than in the first wave – but not the large money center banks. Housing is another sector, as mortgage rates keep rising. While demographics are favorable for housing, less potential buyers qualify at higher rates and must rent.

…Economic Consequences Follow

The traded goods area or manufacturing is another segment that is already in recession worldwide and will continue to be hurt by the slowing world economy and higher rates/tighter money.

As US used car prices are already declining at 10.3% y-o-y (chart 6, next page), it may be an early sign that the consumer may have already begun to slow its

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spending. The tight monetary framework is hurting Asia considerably, as those currencies have weakened sharply recently. Moreover, import prices from Hong Kong, Singapore, Taiwan and Korea are down 6.3% y-o-y for the month of May. They are down 2% from China and 3.7% from the Association of Southeast Asian Nations, a group of 10 countries.

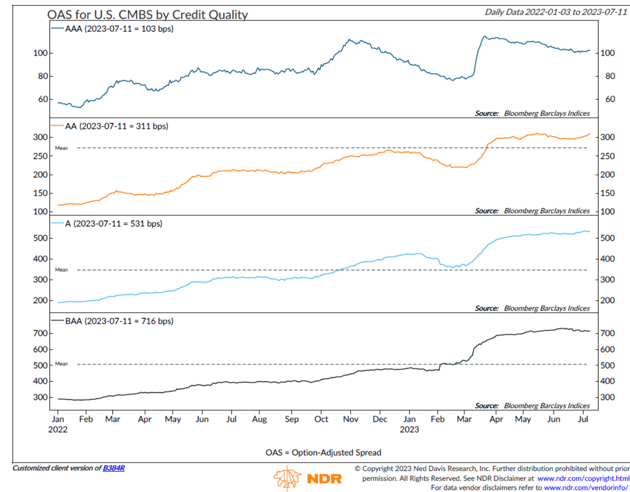
> Corporate profits for the whole US economy have fallen 11.6% in three quarters. This is the biggest decline since the crisis of 2009 and one of the biggest falls in over 50 years. But Wall Street and the financial media keep quiet.

Declining inflation rates will also impact corporate revenues and earnings. Corporate profits for the whole US economy have fallen 11.6% in three quarters (chart 7, next page). This is the biggest decline since the crisis of 2009 and one of the biggest falls in over 50 years. But Wall Street and the financial media keep quiet.

Unfortunately, we only have quarterly data for bankruptcies but zerohedge.com recently had a story that weekly bankruptcy filings have increased sharply (chart 8, next page). To our own surprise, those trends are not reflected in the current credit markets, yet. This is what we recently reported because many high-yield bonds simply do not trade regularly and therefore spread indications based on market prices are outdated and wrong.

CHART 5

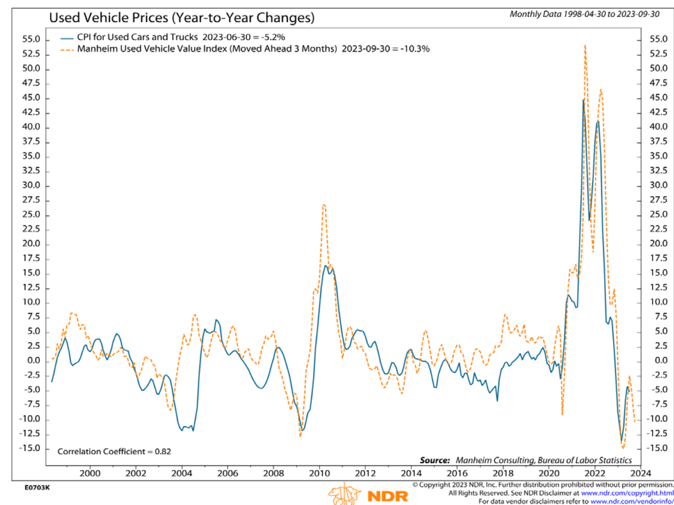
CMBS Spreads Have Widened Significantly



Source: Ned Davis Research, Inc.

CHART 6

US Used Vehicle Prices (Y-o-Y Changes)



Source: Ned Davis Research, Inc.

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While the bulls point to still low unemployment and high employment numbers, we repeat that they are both lagging indicators. U.S. labor productivity growth has slumped from 5% two years ago to a negative 2%, a swing of 7 percentage points. This is normal when the cost of capital rises sharply. As productivity and corporate earnings decline, the corporate sector will react soon and begin to cut personnel, leading to the rise in unemployment that we usually see when a recession hits. While we are not in the camp of a crisis similar to 2009, we still expect a recession with more declines in corporate earnings ahead.

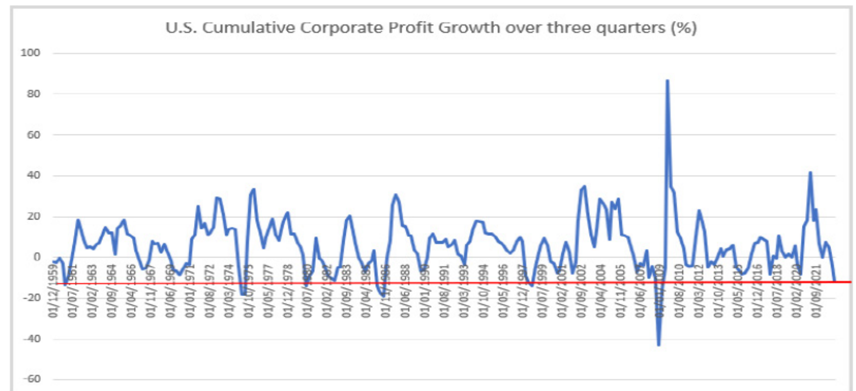
Different Markets Have Different Messages

It has been surprising to see how financial institutions have borrowed briskly from the banking sector. Within a period of slowing bank lending activity, it was the only bright spot and led to rising equity markets, as the borrowers play the leverage game. As long as there are several pockets of strength in the economy with companies still reporting higher profits, the divergence of the general market indices and the underlying weakening of the economy can continue. We have seen this in the past, particularly in 1999. In our view, it is therefore only a question of time until reality bites. But the big question is WHEN?

Now, we need to analyze what the markets' messages are and try to reconcile the fundamentals with the market technical conditions. The Fed signaled higher rates to come at the short end of the market. The 2-year Treasury yield has shot to new highs thereby breaking the highs of March of this year, shortly before the "banking crisis" broke. Very short-term, yields may ease a bit, but we expect another attempt

CHART 7

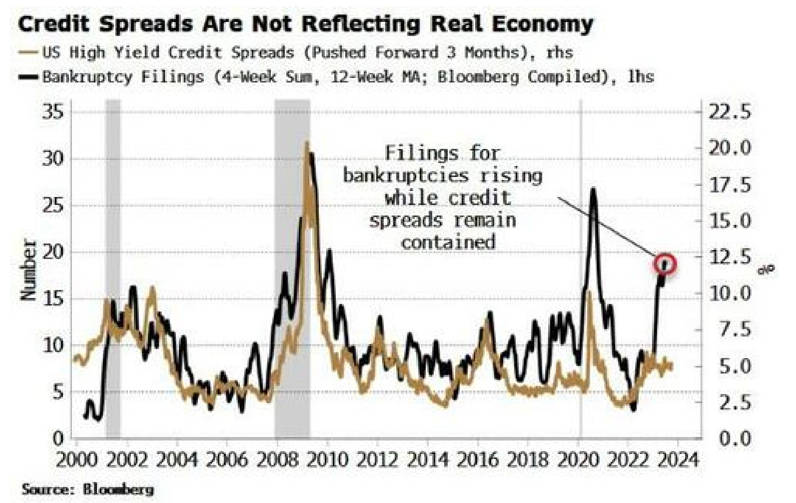
US Cumulative Corporate Profit Growth Over 3 Quarters (%)



Source: Macro Strategy Partners

CHART 8

Credit Spreads Are Not Reflecting Real Economy



Source: Bloomberg/ZeroHedge

and yields zigzagging higher to the mid-5% zone.

We have previously written that we would not go long 10-year Treasuries when they traded in the mid-3% zone, as we saw a range of 100 bp in both directions and

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therefore no attractive risk/reward condition. They recently broke above 4% briefly and are now easing a bit. However, with still substantial amounts of new issuance ahead of us, we would not be surprised to see 10s (chart 9) zigzagging higher into the high 4%, breaking the former high of 4.34% of October 2022, when the SPX traded around 3600.

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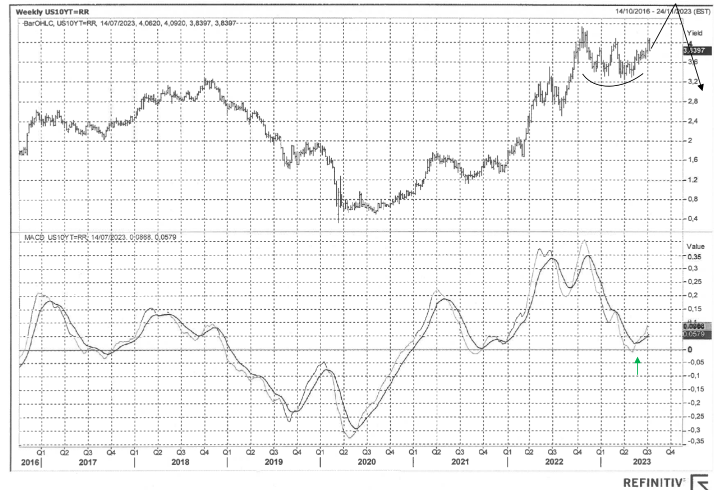
We see similar trends in the European money and bond markets with higher highs to come and yields zigzagging higher until something breaks. Only then will we expect lower rates and yields worldwide.

The US Dollar has been strong against Asia and weak against Europe. This has led to a sideways movement in the low 100's in the US Dollar Index (chart 10). Asian currencies are deeply oversold but indications of a policy change to support them are lacking so far not the least due to weak economies. However, the Japanese yen has been particularly weak, not only against the US dollar but also against Asian and European currencies. As mentioned above, we expect the Bank of Japan to prepare for a policy change towards less easy money. As the market seems very bearish and short the yen, we would not be

CHART 9

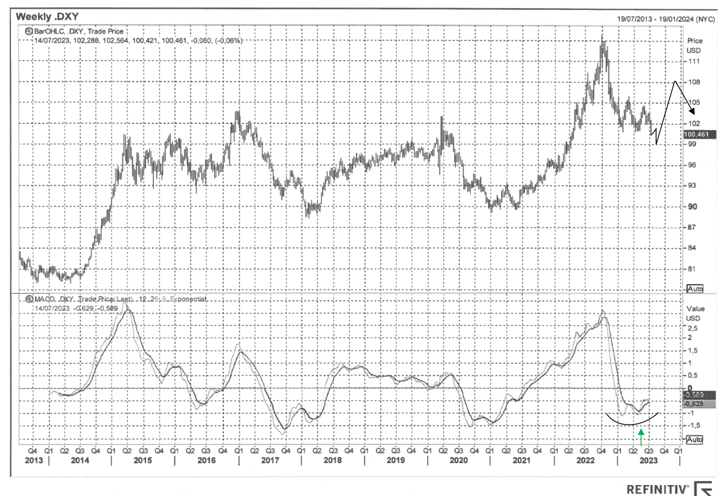
10-Year US T-Bond Yield Weekly & MACD



Source: REFINITIV

CHART 10

US Dollar Index Weekly & MACD



Source: REFINITIV

surprised to see a vicious move up in the yen against other currencies, as short covering may set in. USD/JPY recently peaked at 145 and we could see a decline

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to 120, as the yen could become the strongest currency over the next 12 months.

The Chinese yuan has been very weak, too, as a result of the disappointing economy and the need to steer an easy monetary course when Europe and North America are tightening. Temporarily, the pessimism about China may be overdone and China may help and provide some extra liquidity. Thus, we would not be surprised to see some bounce of the CNH or some weakening of USD/CNY in the very short-term, but we do not see any reason for a sustainable improvement.

We expect the US Dollar Index to marginally dip below 100 but then to rebound to the 108-110 zone.

EUR/USD has paused after its initial recovery attempt from 0.95 to 1.10 against the USD. Our potential target has remained around 1.12 where we see massive trendline resistance. Moreover, the eurozone is even weaker economically than the US and it is questionable how long the ECB can continue to tighten. If the EUR overshoots, it will not be sustainable and not long lasting.

Thus, we expect the US Dollar Index to marginally dip below 100 but then to rebound. If the economy deteriorates and financial markets sour with rising yields, the US dollar could then have a nice rebound and the US Dollar Index could recover to the 108-110 zone. As we see it, the USD global monetary framework is tightening and may support the USD for a good rebound before weakening again when central banks begin to ease.

Equity Markets' Message Diverges from Economic Reality

At present, the economic landscape still carries enough data that provides hope for the bulls for a soft landing. Inflation is declining, interest rates have been hiked markedly and the equity indices have not only held up well but rallied strongly. This leads to the impression that the underlying bullish forces are powerful for whatever reason. Let us look at the major factors:

The monetary background keeps deteriorating with interest rates rising, monetary aggregates weakening and bank lending slowing (except for the financial sector and now to finance involuntary inventory accumulation). As described above, we expect short- and long-term yields to zigzag higher. When the 10-year Treasury yield peaked at 4.34% in October 2022, the SPX traded at 3600. The rise in TGA of almost $500 billion has been largely offset by a decline in the RRP of $400 billion due to money markets pulling funds (likely for equity investments). But the issuance of more Treasury paper will continue and will soak more liquidity while the Fed keeps its QT activity going. Thus, we assess the monetary environment going forward as unfriendly and getting more so. The only fly in the ointment is the ongoing lending by banks to the financial sector. Once this lending stops, we think markets will correct – and if a recession deepens, it could be painful. Chart 11 (next page) shows how much the NASDAQ 100 deviates at present from the bond market. Usually, the Growth segment of the market corresponds highly with inverted yields (higher yields equals lower valuation and therefore lower prices). The chart shows how well the index corresponded with bond yields but has completely broken away from it. In the past, such deviations could last but eventually got aligned again over time.

We addressed the valuation/earnings case before. Valuation is high and earnings are eroding to be moderate. At present levels of yields, rates, and earnings, there is no fundamental valuation support to this market. Price to sales or price to earnings are still extremely high on a historical comparison basis (chart 12, next page). Of course, a market frenzy can push valuations even higher before reversing. However, the high valuations simply shows the unfavorable risk/reward for future returns. High valuations lead to low returns and vice versa.

The valuation problem is smaller in Europe and in Japan, where valuations are lower. But those markets are driven primarily by US capital. And if the US market goes up, they go up and vice versa.

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The sentiment is extremely bullish based on put/call ratios and sentiment surveys. In fact, 3-day put/call ratios at the CBOE are now trading at the same level as at the August 2022 rally high of the market. Bulls as a percentage of bulls and bears among institutional investors is at 72% (chart 13, next page), the highest since Q4 of 2021. And the survey of individual investors shows 63% bulls as a percentage of bulls and bears, also the highest since the major indices peaked in early 2022. In addition, the CNN greed and fear index is at 80, which is in extreme greed territory and the highest level in over a year. It is only the positioning in the futures market that sends a bullish message, as large speculators are short, and commercials are long – and it should be the reverse to confirm a bearish assessment. Thus, positioning is a weak point in our analysis, we must admit.

The sentiment is extremely bullish.

The final segment is momentum, and it remains bullish for the cyclical trend. The Coppock curve has reversed upwards around the turn of the year and keeps rising. As we showed in our Q2 Chart Pack Webinar the track record of this momentum indicator is excellent and in the last 40 years we have only found one wrong signal in 2001. It had turned bullish for a medium-term recovery but then the market fell to new lows after a recovery rally and the Coppock curve relapsed together with the market slump before giving its next and correct buy signal. Without any major correction here, the Coppock curve could support the market up to Q1 of next year under normal consideration. It would only relapse if there were sharp declines of about

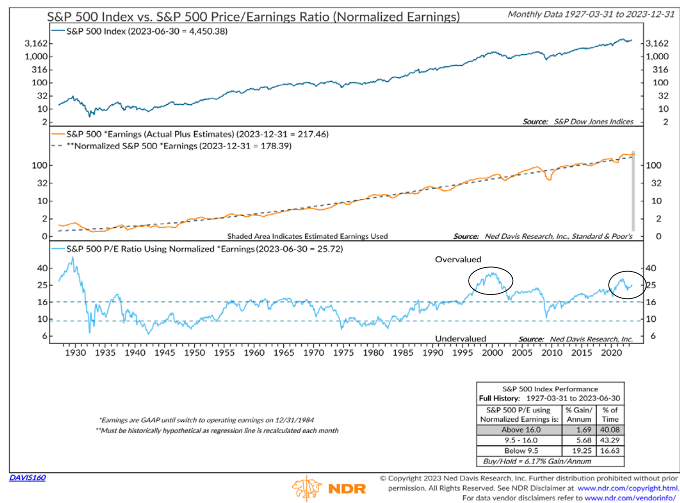
CHART 11

NASDAQ 100 vs. 10-Year T-Bond Yield Inverted

Source: Bloomberg LP

CHART 12

S&P 500 and P/E Ratio



S&P 500 Index Performance
Full History: 1927-03-31 to 2023-06-30

S&P 500 P/E using Normalized Earnings is:	% Gain/ Annum	% of Time
Above 16.0	1.69	40.08
9.5 - 16.0	5.68	43.29
Below 9.5	19.25	16.63
Buy/Hold = 6.17% Gain/Annum		

Source: Ned Davis Research, Inc

15%-20% in the major market indices around the world. However, these numbers change as time goes by and decline every month. It is also important to keep an eye on all of the indicators, not just the Coppock curve. We are simply saying

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that the timing of our call could get extended based on what the technicals look like and we will continue to monitor this indicator along with all the others.

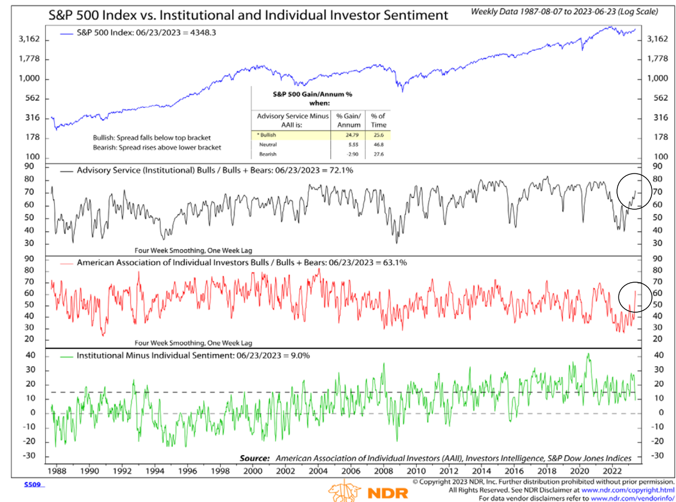
> The Coppock curve could support the market up to Q1 of next year under normal consideration. It would only relapse if there were sharp declines of about 15%-20% in the major market indices around the world.

Our own proprietary medium-term momentum indicators suggest global equity markets are near an important high point and close to beginning a correction. However, neither the MACD indicator (chart 14) nor the pattern of the decline for US markets have so far signaled that the reversal has materialized, yet. European markets like DAX and EURO STOXX 50 looked a bit more impulsive and could have topped. Moreover, their weekly MACD indicators are now on sell signals.

The combined 1-, 4- and 10-year cycle suggests a peak in mid-July and that is where we are now. Seasonality for the NASDAQ 100 suggests a peak later in July. Moreover, the recent declines have not shown the impulsive pattern that we would like to see. Thus a few more days of upside attempts are conceivable with even a marginal new high in some of the broad market

CHART 13

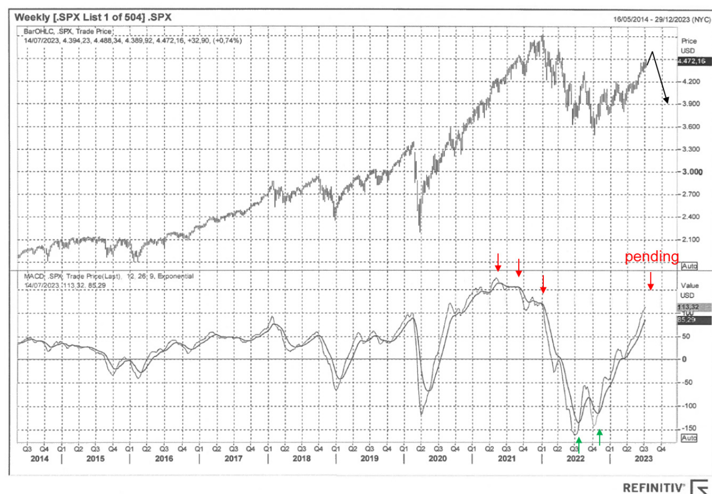
S&P 500 vs. Institutional and Individual Investor Sentiment



Source: Ned Davis Research, Inc.

CHART 14

S&P 500 Weekly & MACD



Source: REFINITIV

equity indices. We would like to have more evidence and confirmation before we turn decidedly bearish. For that reason, we keep our neutral assessment and are

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waiting for more data and information from the markets themselves before we get aggressive in our trading.

A few more days of upside attempts are conceivable with even a marginal new high in some of the broad market equity indices. We would like to have more evidence and confirmation before we turn decidedly bearish. For that reason, we keep our neutral assessment and are waiting for more data and information from the markets themselves before we get aggressive in our trading.

We have seen in the past, that markets can have a life of their own and not correspond to the fundamentals in the "normal" way. The late 1990s was such a case. We also remember Japan in the late 1980s when the Nikkei made high after high, and it did not correspond to the real economy (this writer was heavily under-weight Japan and suffered but shorted at the first trading day of 1990, right at the peak and the index declined about 50% in the six months thereafter). The driving force was a strange originally liquidity driven mania when it appeared that Japan owned the world. The valuation of the Imperial Palace and its gardens in Tokyo was worth more than all the real estate of California combined. Markets can stay irrational longer than fundamental logic suggests. But eventually they get aligned again.

It often takes an exogenous event to turn the tide and tightening the monetary reins will eventually get us there – but it is still open as to WHEN that will be. We will certainly report as soon as we gain more conviction on this matter.

A Bounce in Gold and Oil

As the US dollar may weaken somewhat in the next 2-4 weeks, we are expecting a bounce in gold towards $2000. Moreover, July is the seasonal low for the yellow metal. Traders can therefore go long gold as well as gold mining stocks for a short-term trade. Whether we will then see another relapse to the mid-$1800 before a bigger move to new highs remains open as a possibility. But our view remains that gold has more upside into next year, even if it might relapse once again before that move. Silver is similar.

As the US dollar may weaken somewhat in the next 2-4 weeks, we are expecting a bounce in gold towards $2000. Traders can therefore go long gold as well as gold mining stocks for a short-term trade.

While the physical market of crude oil is well supplied, news about further production cuts by OPEC+ including Russia, is triggering a bounce that could lead to the around $80. However, if our view of the world economy is correct, we expect another decline thereafter, most likely to slightly below $60.

As China consumes approximately half of most metals of the world, metal prices have declined sharply since they peaked in spring of 2022 due to slow economic and construction activity in China. But some of the metal prices have also recovered from their lows in summer/fall of 2022 to different degrees. Thus, like equities, base metals recovered from their extreme lows on the hope that

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the world economy would have a soft landing. Inventories on the different exchanges are on the low side as production has stagnated or even fallen due to lower prices and low investments. Large producers prefer to buy smaller competitors instead of building new mines, as new mines take 7-10 years to become productive while buying existing mines is productive from day one – but does not expand total capacity. The current offer by Glencore to take over Teck is just an example.

The medium-term rally in crypto currencies is in a late stage and the odds are rising for a medium-term correction to begin soon.

Our long-term momentum indicators for base metals have declined and are at new buy signals or approaching them, similar to what we saw in equities around the turn of this year. Simply based on these technical momentum indicators, one would turn bullish. But if the world economy surprises to the downside during the second half and into next year, we would assume that another relapse is likely. We stay neutral for the time being, prepared to buy on a relapse, however.

Crypto currencies have some similarities to equities and base metals in the technical picture. However, we are concerned that we are dealing with a world economy that has been supported by fiscal policy measures that are beginning to fade and a tight monetary policy. We already see increasing stress in the system that the investment community and the media disregard. Our view remains that the medium-term rally in crypto currencies is in a late stage and the odds are rising for a medium-term correction to begin soon. Stay tuned!

Felix W. Zulauf
July 13, 2023

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