



## Thesis: Increase Long Equities Exposure ↑

Last Update: December 31, 2018

**Increase Long Equities Exposure: ↑**

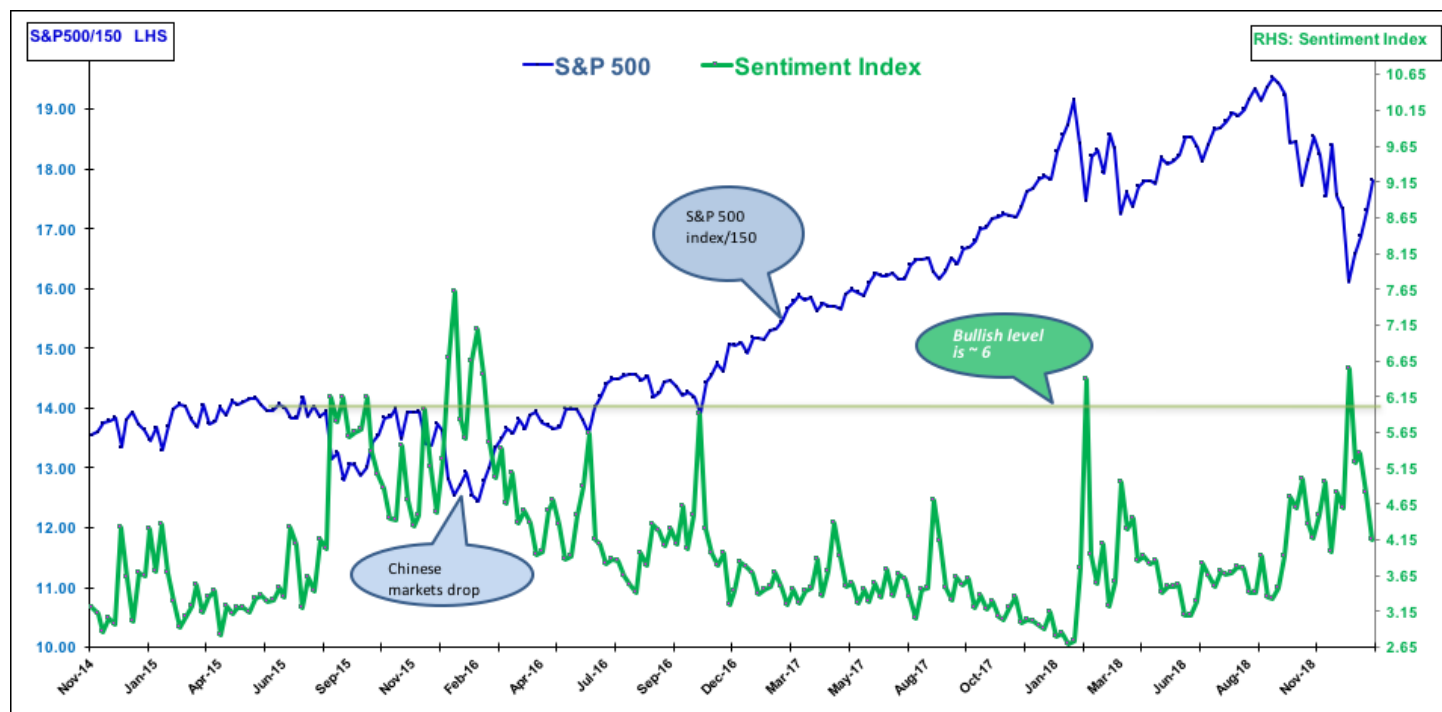
*The Fed-induced morphine-drip supporting the equity bubble has now burst. So long as U.S. economic growth remains positive and corporate defaults manageable, stocks are likely to renew their upward move.*

**Dec'18 Commentary:** The sharp decline in U.S. equities raised fears of an impending slowing to GDP growth. In fact, GDP growth is expected to slow as the effects of lower corporate taxes ebb. However, economists expect more of a "soft-landing" rather than a recession. Fears of slowing U.S. economic growth will make the Federal Reserve more dovish. The China-U.S. trade war is likely to resolve by 1Q'19 given the blowback effects taking place in Europe (Germany) and the U.S. (e.g., smartphone sales).

Our **Risk & Sentiment Index** indicates that risk premiums have risen.

- Thus, investors are more likely to be compensated for both credit and equity risk in 2019.
- The index is typically bullish at levels over 6 (green line).
- Its usage is for quarterly asset allocation, rather than market timing. The chart below shows data from 2014 through 2018, though our database has over a two decade history.
- Backtesting: the indicator worked 58%, 75%, 78% of the time for the 30 day, 60 day, and 90 day periods, respectively, after breaching 6.0. The average and medium number was 6.7 for those breaches included in the backtesting.

Regardless the level of our Risk (Sentiment) Index, we recommend a fairly high level of dollars be allocated to equities given the fact that equities rise over the very long term (20+ years). Consequently, a 70% equity allocation is a good starting point with a range of 60%-80% allocated to equities depending on the client's risk tolerance and strategies.



## Charts related to the market and rates (charts are retained given the evolution of the data over time):

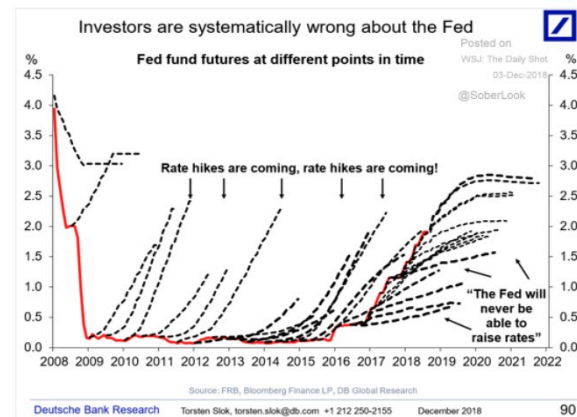
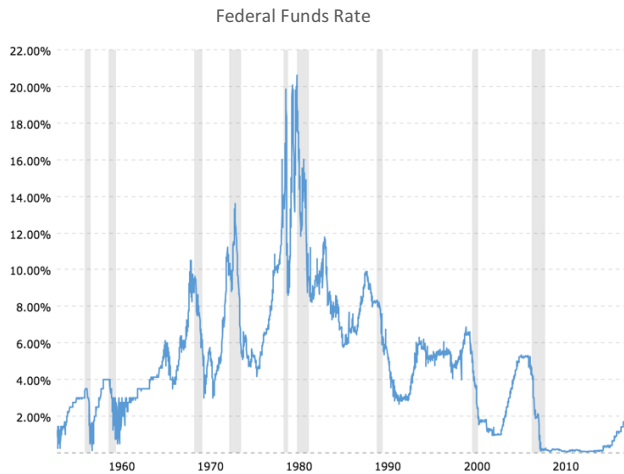
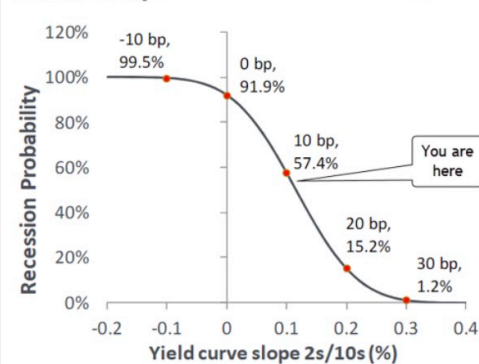


Figure 41: The odds of a recession increase substantially as the spread drops below 10 bp



Source: PiperJaffray



### How Cheap Is Cheap Enough?

Forward price-to-operating-earnings ratio

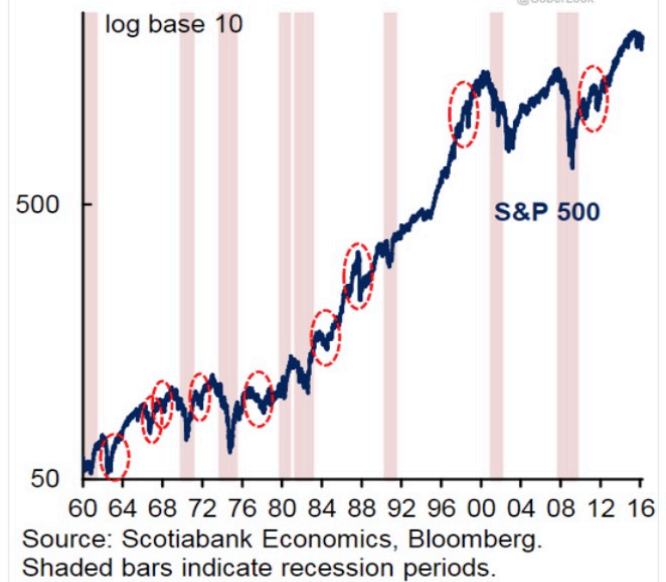
- MSCI World (developed markets)
- MSCI All Country World
- S&P 500



Note: As of Dec. 24

Source: Refinitiv

### Equity Declines Over-Predict Recessions



Source: Scotiabank Economics, Bloomberg.  
Shaded bars indicate recession periods.