Gluskin Sheff + Associates Inc.

Paradigm Shift
David A. Rosenberg

November 2018

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Gluskin Sheff

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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

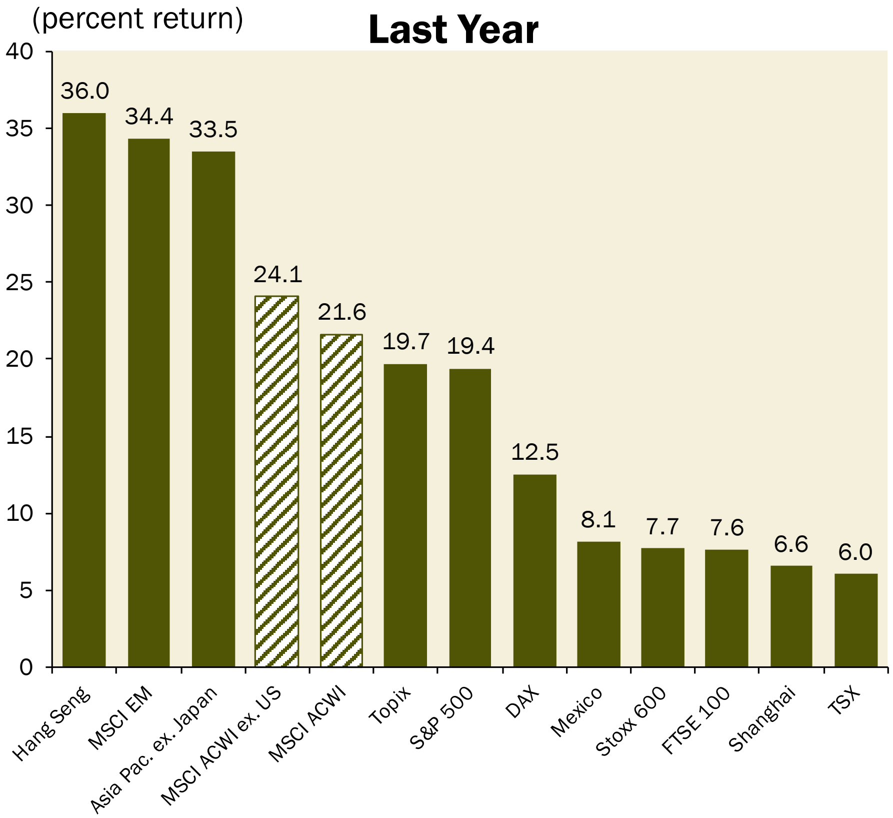
Notes:
Source: Bob Farrell, Theme & Profile Investing Update, August 3, 2001

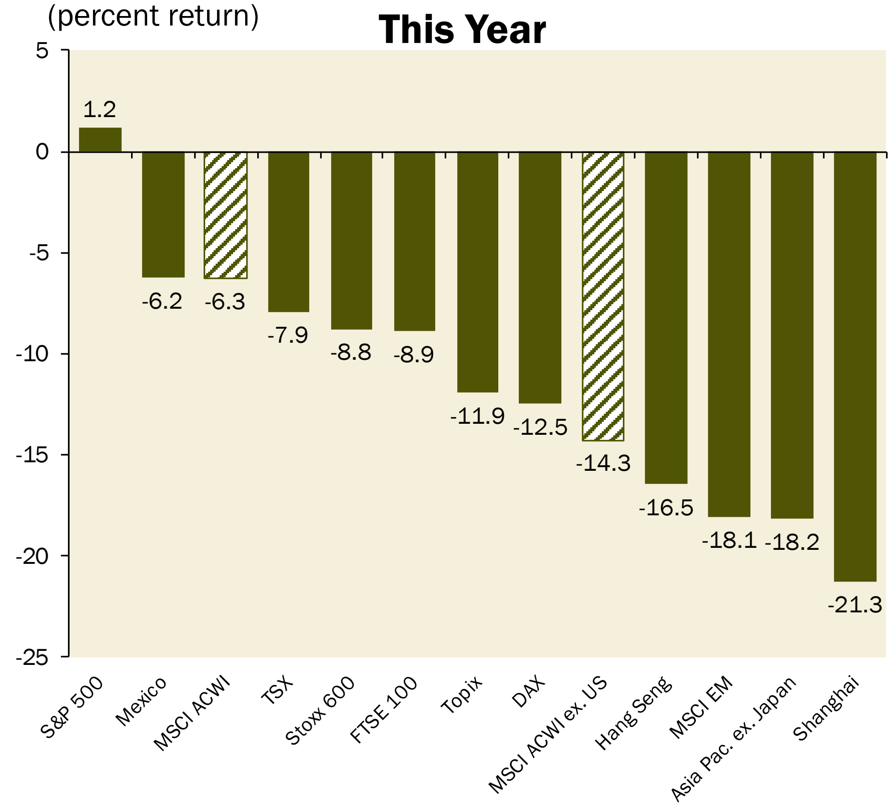
THIS ONE MAY HAVE MARKED THE TOP FOR THIS CYCLE!

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

2018: A REVERSAL OF FORTUNE

Global





Notes:
2018 returns as of October 25th
All returns in local currencies
Source: Bloomberg, Gluskin Sheff

STEEP CORRECTION OUTSIDE THE USA

United States: Dow Jones World ex. US Index

Notes:
Source: Haver Analytics, Gluskin Sheff

EVEN THE UNITED STATES HAS SEEN A CHANGE IN COMPLEXION

United States: S&P 500

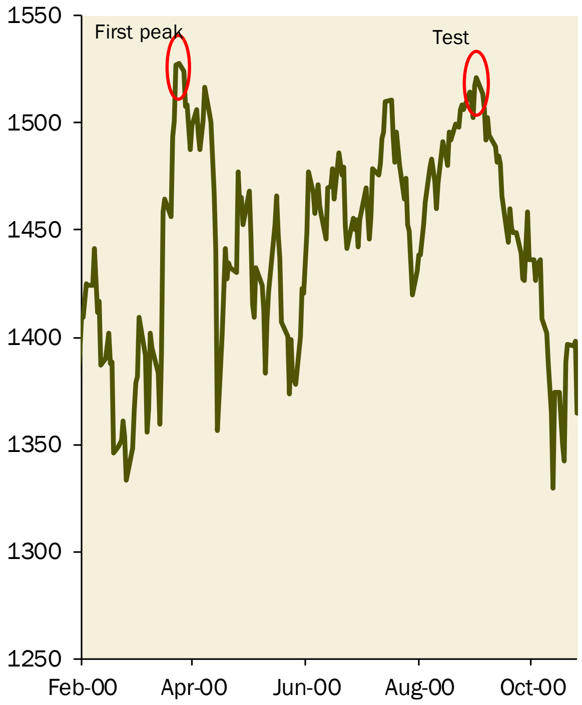
Notes:
Source: Bloomberg, Gluskin Sheff

HISTORICAL DOUBLE TOPS – CLASSIC TOPPING FORMATION

United States: S&P 500

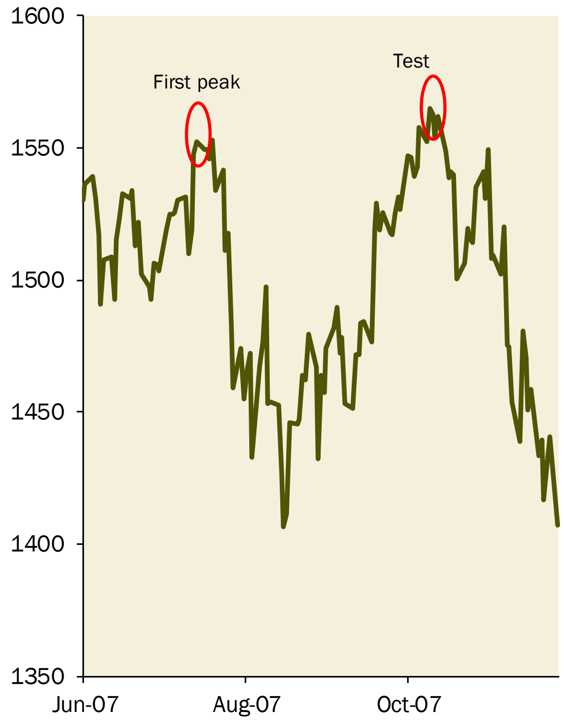
2000

(index)



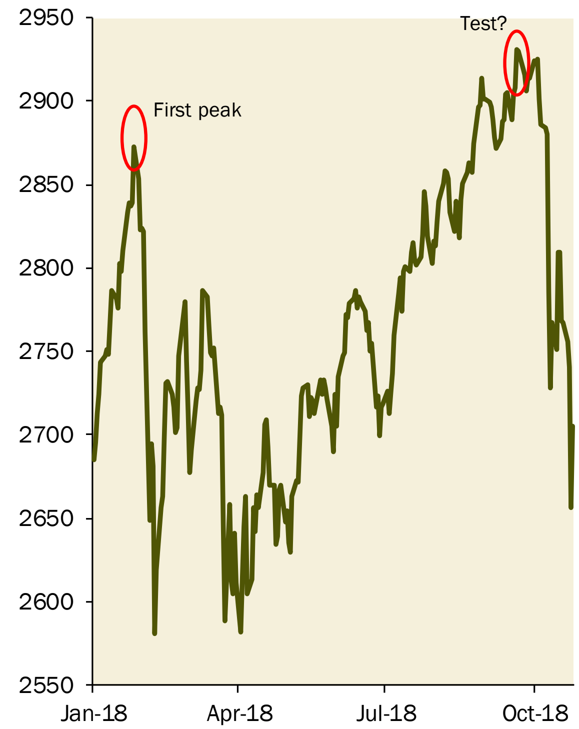
2007

(index)



2018

(index)



Notes:

Source: Haver Analytics, Gluskin Sheff

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 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.

What, Me Worry?

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

Global policy uncertainty index | Dow Jones Global index

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

THE WALL STREET JOURNAL.

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. ***Yet the most important determinant is monetary policy."***

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

REVIEW & OUTLOOK

The Tax-Reform Stock Rally

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.

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

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. He succeeded on asset prices but failed on growth, which didn't accelerate until better tax and regulatory policies arrived. But if QE lifted stocks as it expanded, will the reverse happen 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 threat to growth and financial markets—Donald Trump's trade agenda or a Speaker Pelosi aside—may be the Federal Reserve as it reverses Mr. Bernanke's experiment. Mr. Bernanke has already taken a half dozen victory laps, but they'll have been premature if the unwinding leads to asset selloffs that create financial disruption and a recession.

All of which underscores the importance of timing of the GOP tax reform. The current expansion is already historically long, if also historically weak, and it has needed a second wind. Businesses have had plenty of capital, at home and abroad, but they had been reluctant to deploy it given the uncertainty of how and where the Obama regulators and taxers might strike next. Donald Trump's deregulators have removed the fear of arbitrary political punishment, and now tax reform is raising the expectations 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 reversal 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)

THE FRONT END OF THE CURVE HAS HAD A CORONARY

United States: 2-Year Treasury Note Yield

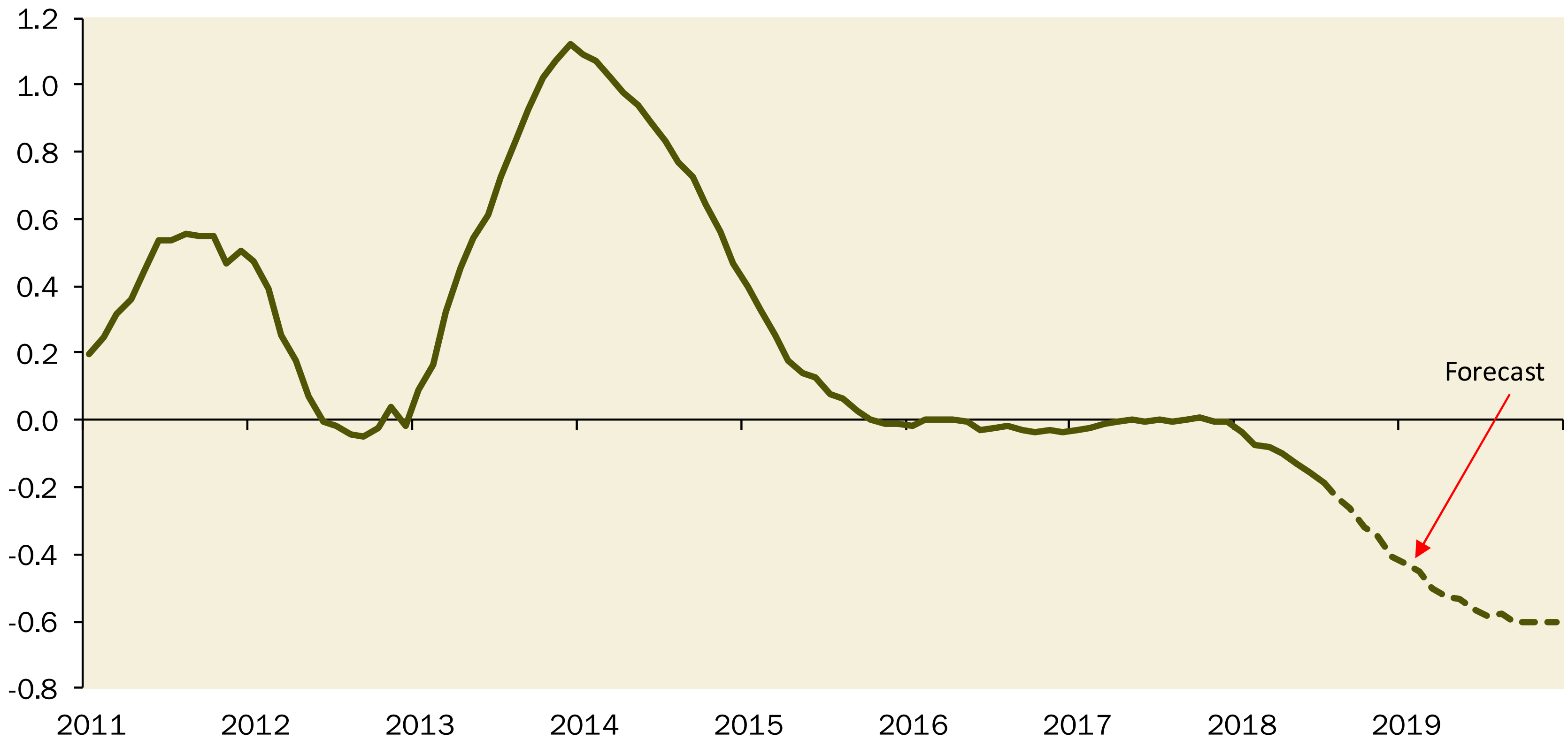
(percent)

Notes:
Source: Haver Analytics, Gluskin Sheff

COUPLED WITH A SHRINKING FED BALANCE SHEET

United States: Fed Balance Sheet

(12-month change; $ trillions)



Notes:
Source: Haver Analytics, Gluskin Sheff

POWELL CAUTIOUS ON RISK-TAKING

	Oct. 2012	Apr. 2015	Today
Trailing P/E	14.5x	18.8x	18.6x
Forward P/E	12.7x	16.9x	15.2x
High Yield Spreads	554 bps	459 bps	369 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)

POWELL AT JACKSON HOLE

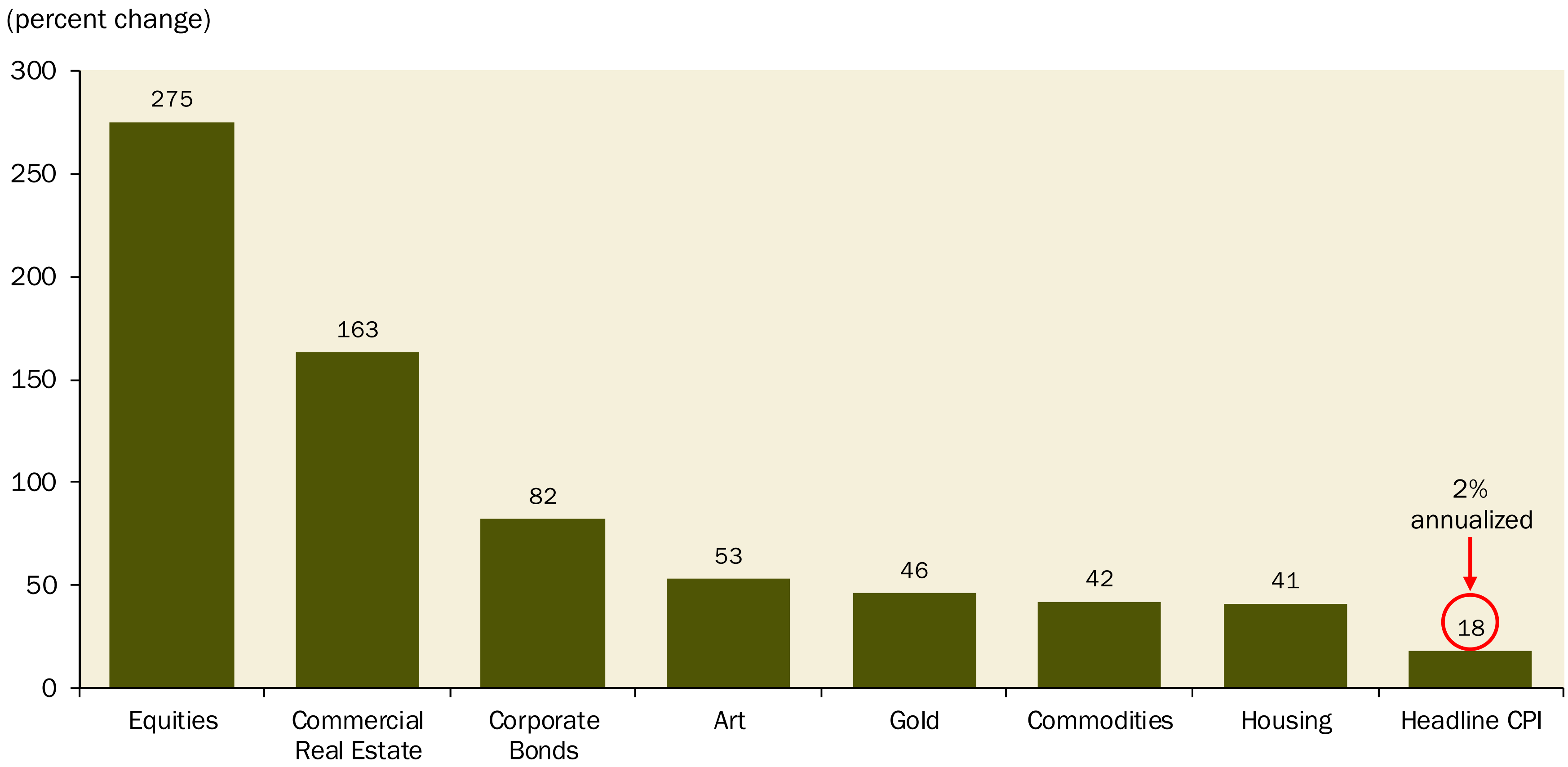
*"Whatever the cause, in the run-up to the past two recessions, **destabilizing excesses appeared mainly in financial markets rather than in inflation**. Thus, risk management **suggests looking beyond inflation for signs of excesses**."*

— August 24, 2018

Notes:
Source: Jerome Powell; Monetary Policy in a Changing Economy; August 24, 2018

SO WHERE HAS INFLATION BEEN?...IN ASSETS!

Price Change Since 2009



Notes:
Source: Haver Analytics, Gluskin Sheff

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	20-Sep-18	16.6	3.8	2.2	114
Average		**16.7**	**7.1**	**3.8**	**79.1**

Notes:
Source: Haver Analytics, Gluskin Sheff

SUPPLY-SIDE FORCES HAVE BEEN UNDERPINNING EQUITY MARKET

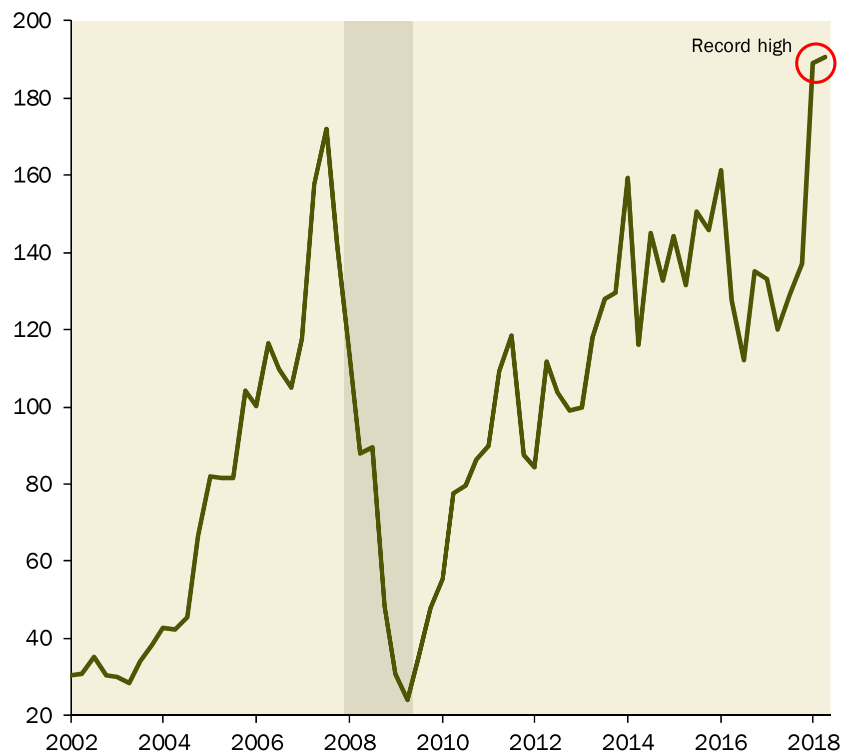
United States

S&P 500 Divisor

(billions of shares)

S&P 500 Buybacks

($ billions)



Notes:

Shaded area represents period of U.S. recession

Source: Haver Analytics, Gluskin Sheff

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

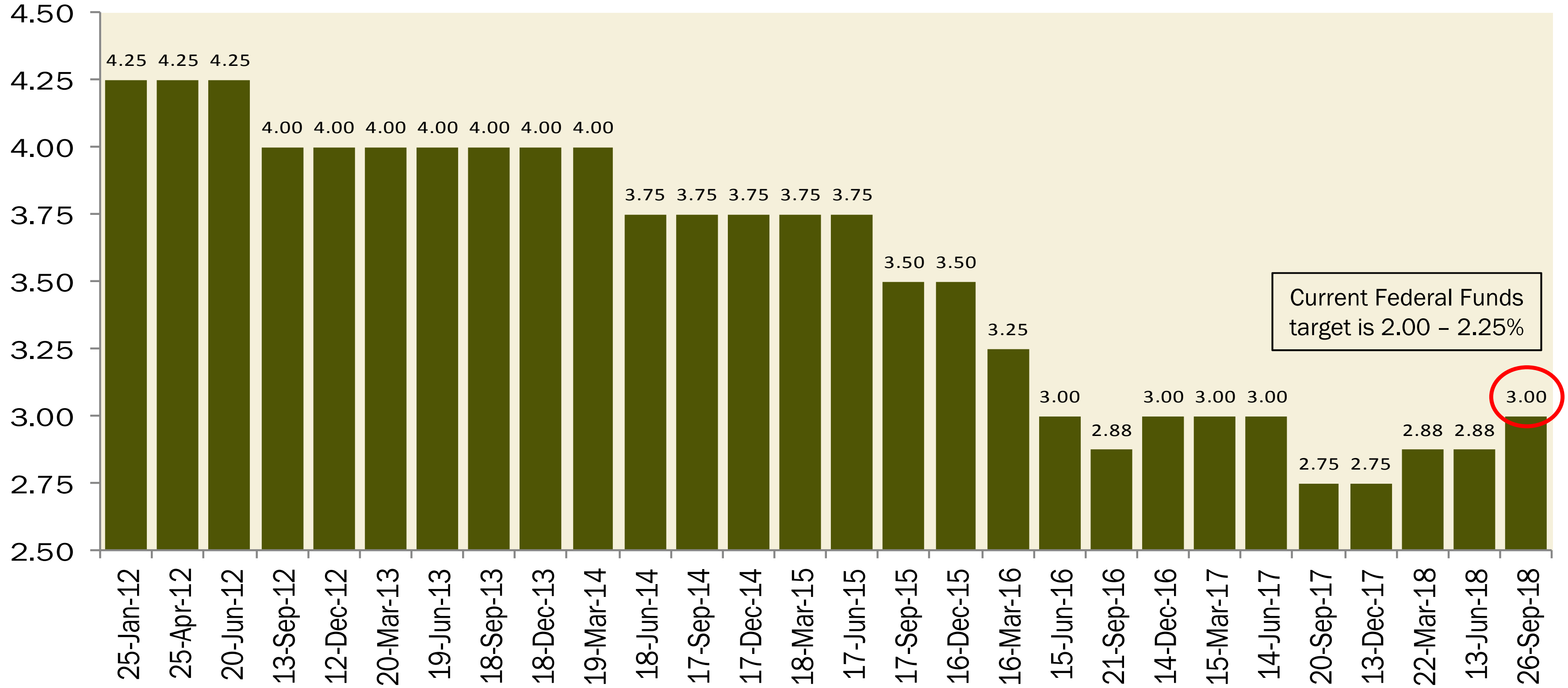
*"**We've been patient in removing accommodation, and I think that patience has served us well,** Mr. Powell said at his confirmation hearing Nov. 28, after being nominated by President Donald Trump on Nov. 2. Now that growth has picked up, **"it's time for us to be normalizing interest rates" he added**"*

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

THE FED HAS SLICED ITS NEUTRAL POLICY RATE FORECAST

United States: Median FOMC Terminal Funds Rate Forecast

(percent)



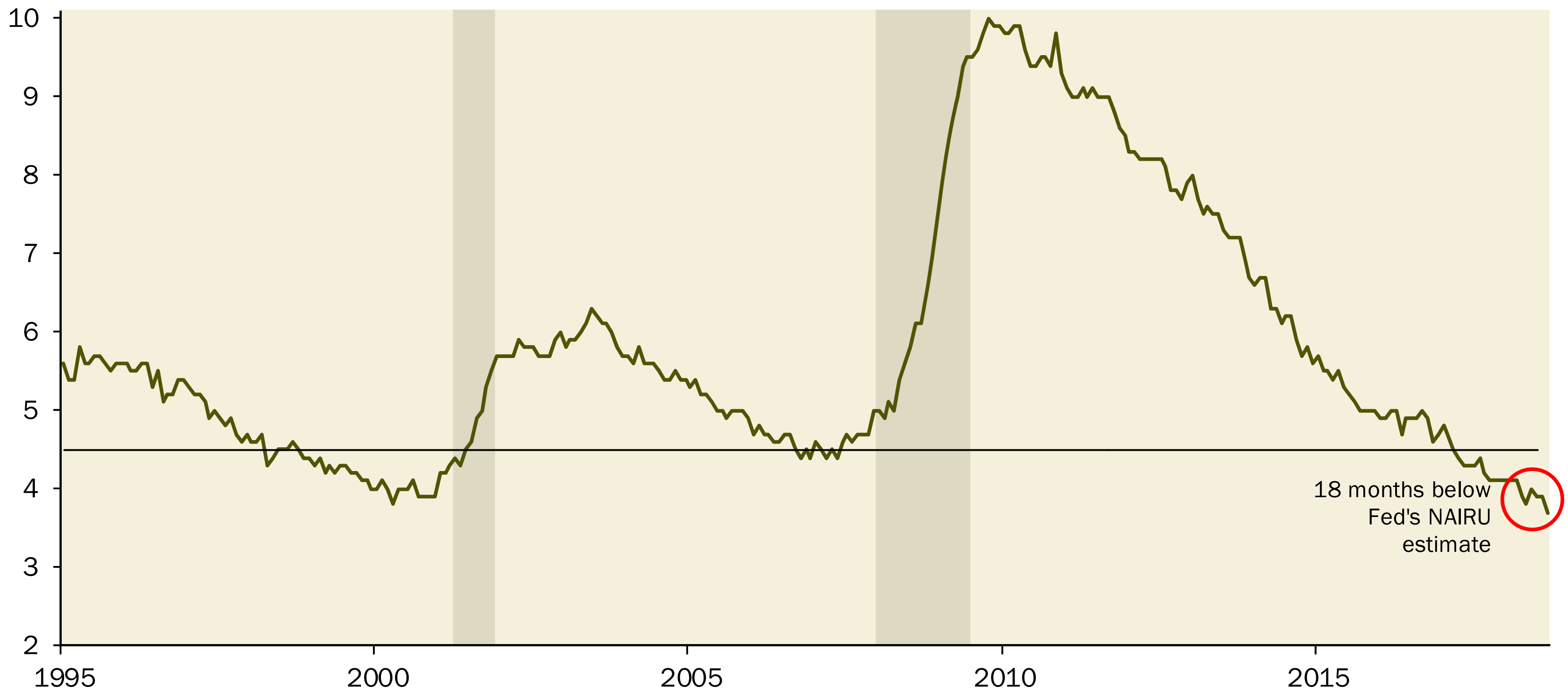
Notes:

Source: Federal Reserve, Gluskin Sheff

LITTLE (IF ANY) SLACK LEFT IN THE LABOR FORCE

United States: Unemployment Rate

(percent)



Notes:

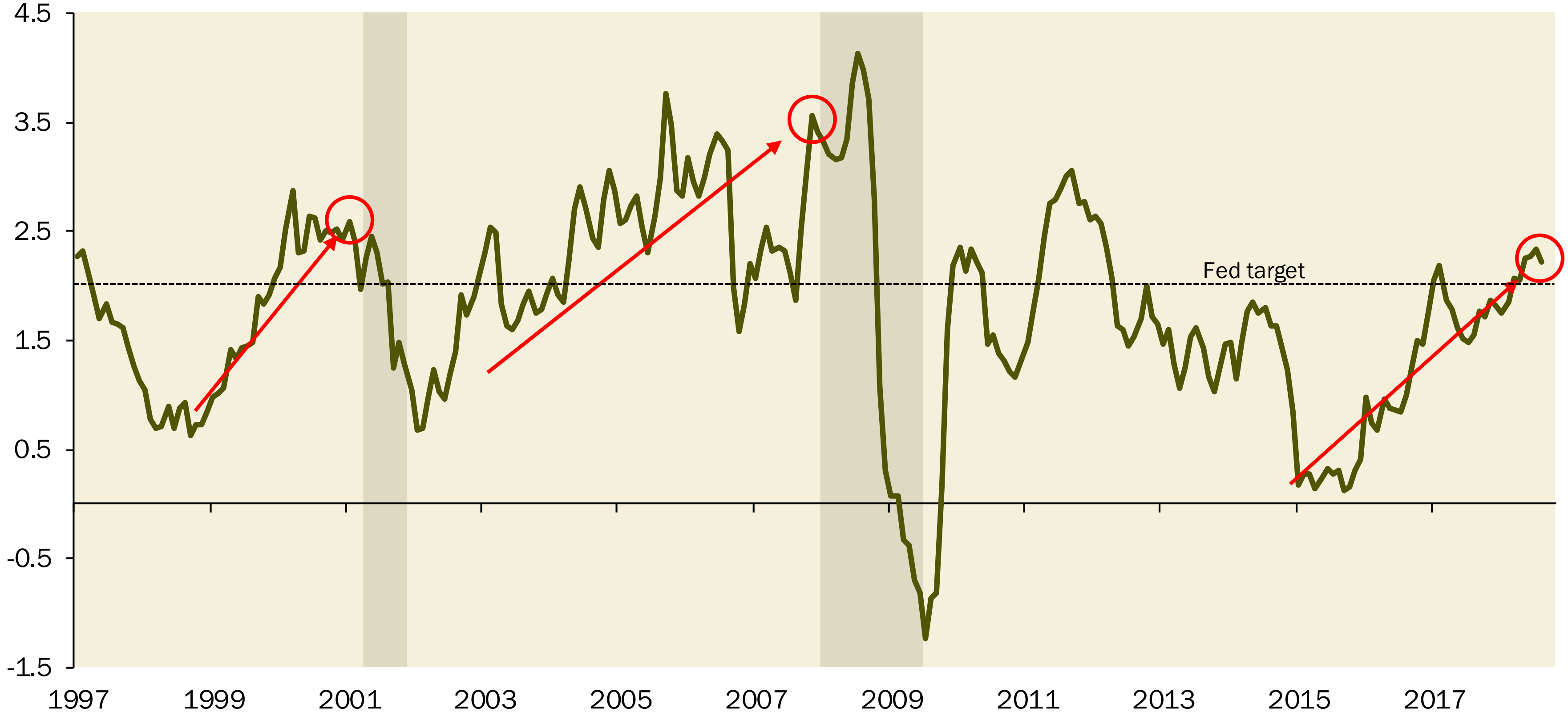
Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

MAKING INFLATION GREAT AGAIN!

United States: PCE Deflator

(year-over-year percent change)



Notes:

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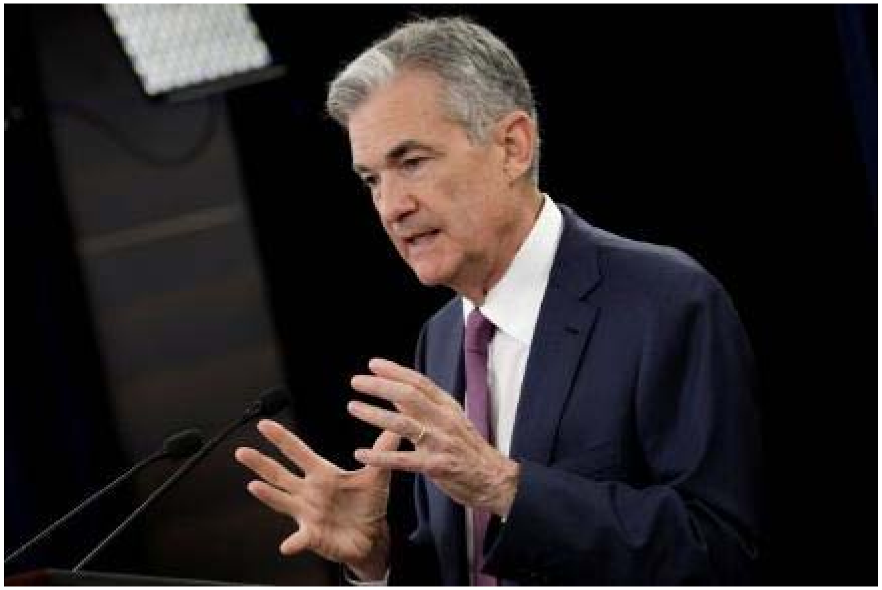
Source: Haver Analytics, Gluskin Sheff

TO NEUTRAL…AND BEYOND!



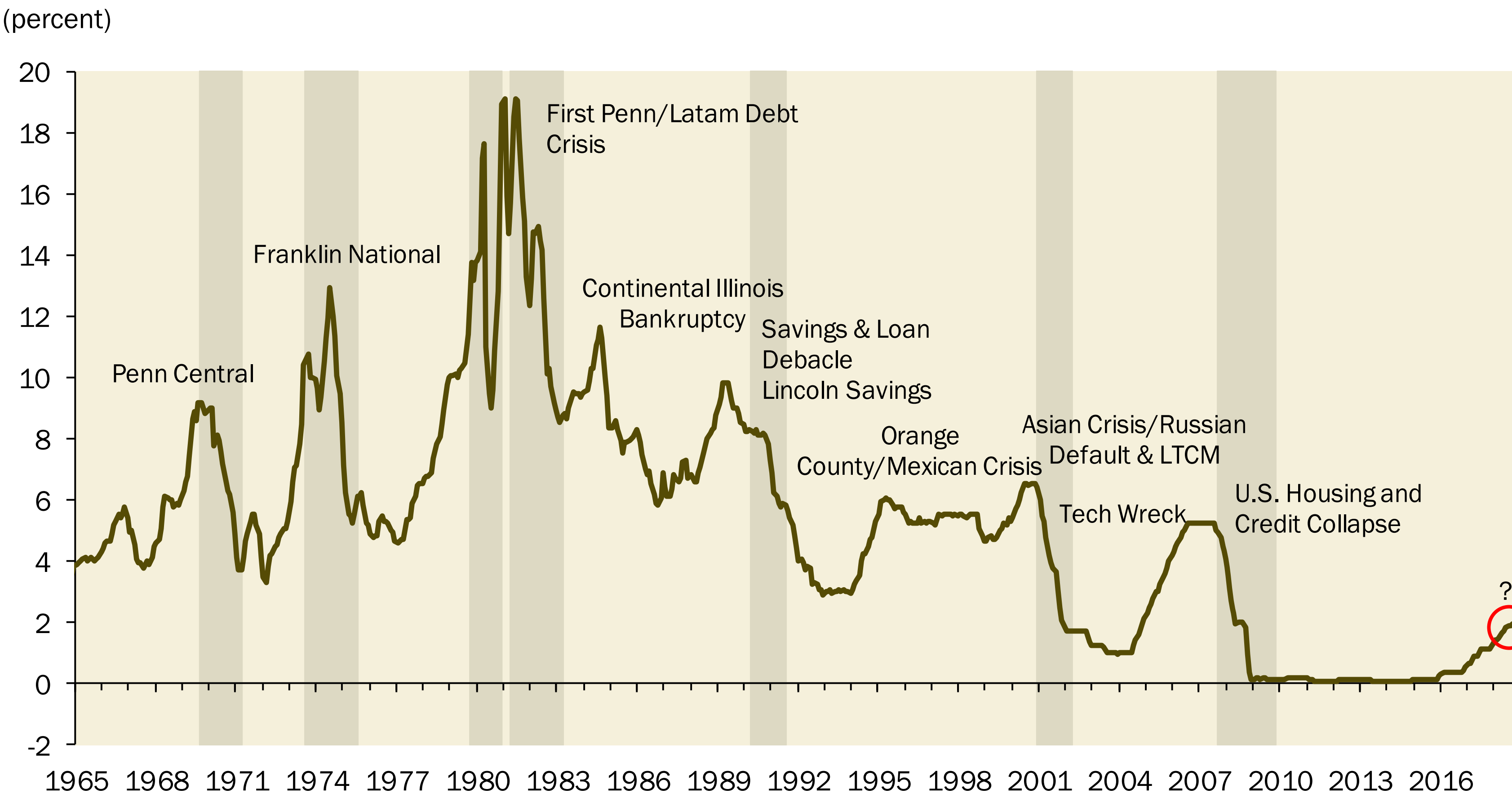
*"…interest rates are still accommodative, but we're gradually moving to a place where they will be neutral…***we may go past neutral.*** But we're a long way from neutral at this point, probably."*

\- *October 3, 2018*

Notes:
Source: Interview with PBS (October 3, 2018)

FED TIGHTENING CYCLES AND FINANCIAL EVENTS

United States: Federal Funds Rate

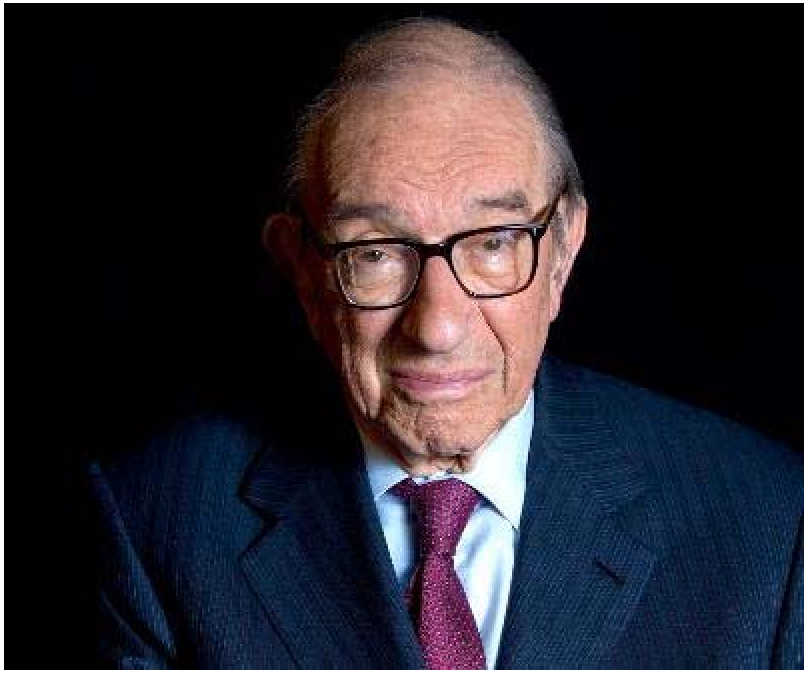


Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

HE KNOWS BUBBLES BETTER THAN ANYBODY



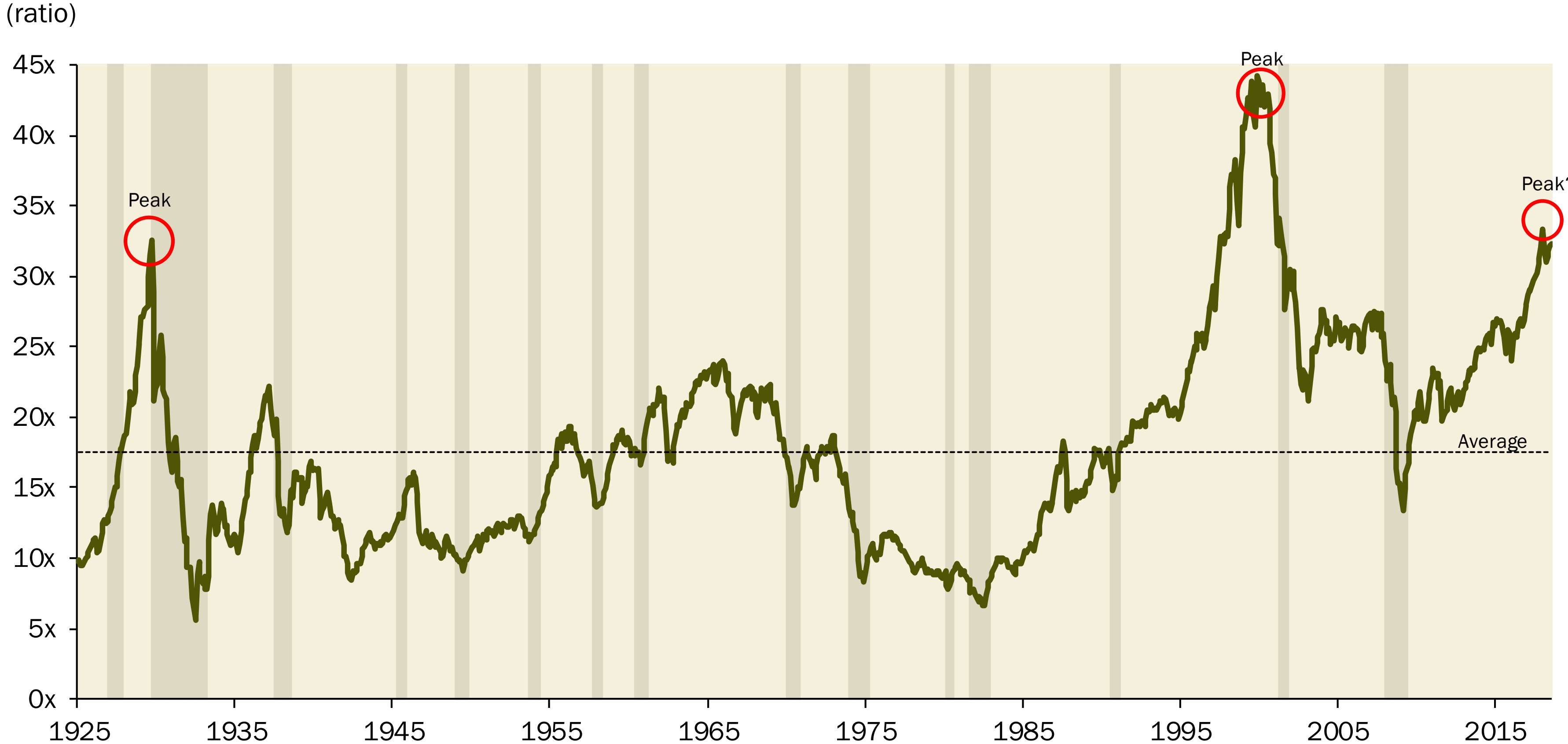
*“**There are two bubbles: We have a stock market bubble, and we have a bond market bubble**…what’s behind the bubble? Well the fact, that, essentially, we’re beginning to run an ever-larger government deficit. As a share of GDP debt has been rising very significantly and we’re just not paying enough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

— January 31, 2018

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

THIRD MOST OVERVALUED STOCK MARKET

United States: Cyclically Adjusted Price-to-Earnings Ratio



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

CAVEAT EMPTOR AT 17%!!

United States: Market Cap as a Share of S&P 500

FAANGM Stocks

(percent)

Microsoft, Intel, Lucent, Cisco, Oracle, and Dell

(percent)

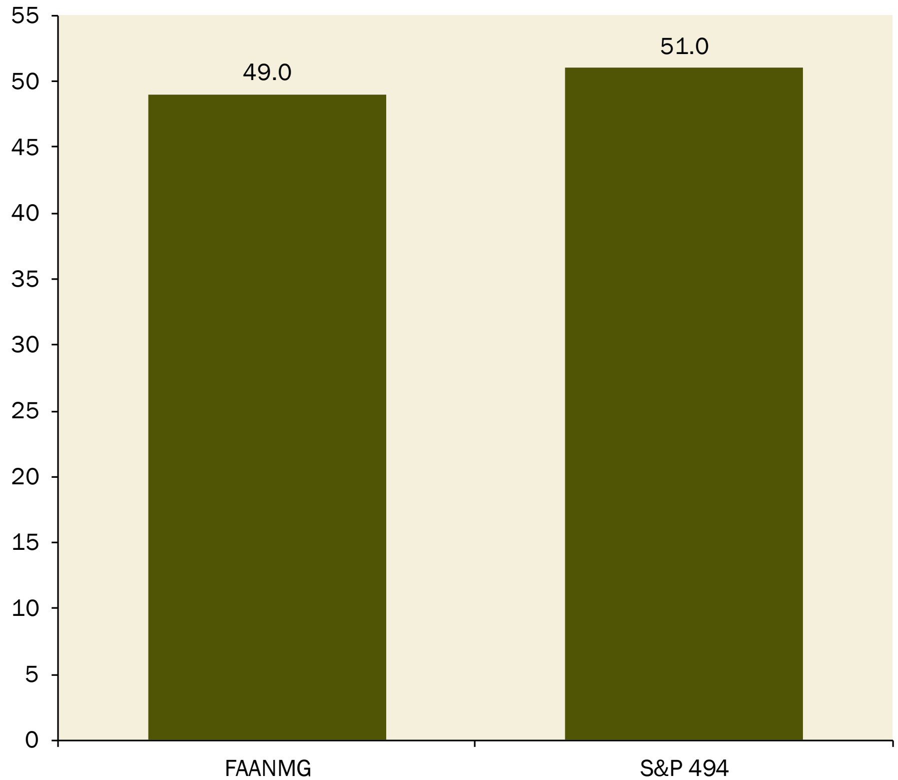
Notes:

Source: Bloomberg, Gluskin Sheff

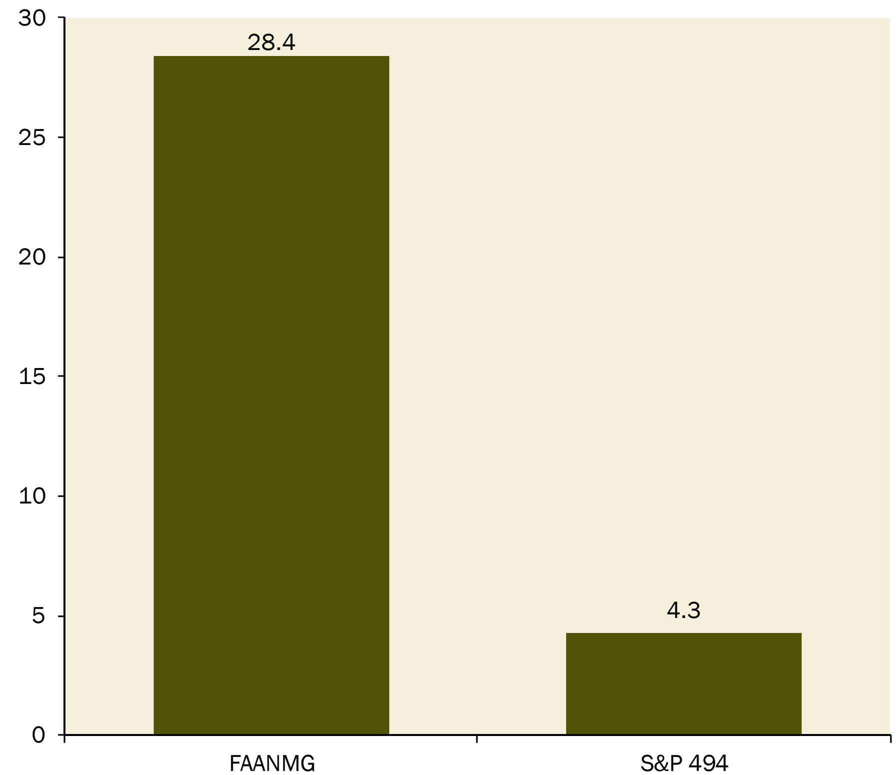
U.S. STOCK MARKET HIGHLY CONCENTRATED

United States

Relative Contribution of the S&P 500 – 2018
(percent)



Percent Change – 2018
(percent)



Notes:
As of September 28, 2018
Source: Bloomberg, Gluskin Sheff

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

The Economist

Buttonwood | Where will the next crisis occur?

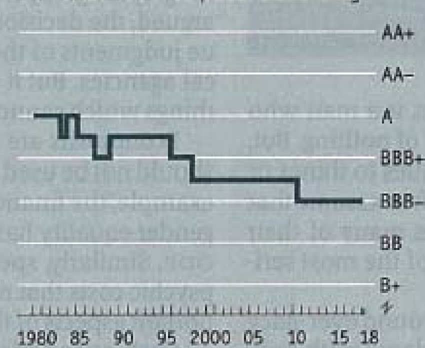
Corporate debt could be the culprit

INTEREST rates are heading higher and that is likely to put financial markets under strain. Investors and regulators would both dearly love to know where the next crisis will come from. What is the most likely culprit?

Financial crises tend to involve one or more of these three ingredients: excessive borrowing, concentrated bets and a mismatch between assets and liabilities. The crisis of 2008 was so serious because it involved all three—big bets on structured products linked to the housing market, and bank-balance sheets that were both overstretched and dependent on short-term funding. The Asian crisis of the late

The A to B of decline

S&P Global median corporate-credit rating



Source: S&P Global

the London Business School, Alex Brazier, the director for financial stability at the Bank of England, compared the yield on corporate bonds with the risk-free rate (the market's forecast for the path of official short-term rates). In Britain investors are demanding virtually no excess return on corporate bonds to reflect the issuer's credit risk. In America the spread is at its lowest in 20 years. Just as low rates have encouraged companies to issue more debt, investors have been tempted to buy the bonds because of the poor returns available on cash.

Mr Brazier also found that the cost of insuring against a bond issuer failing to re-

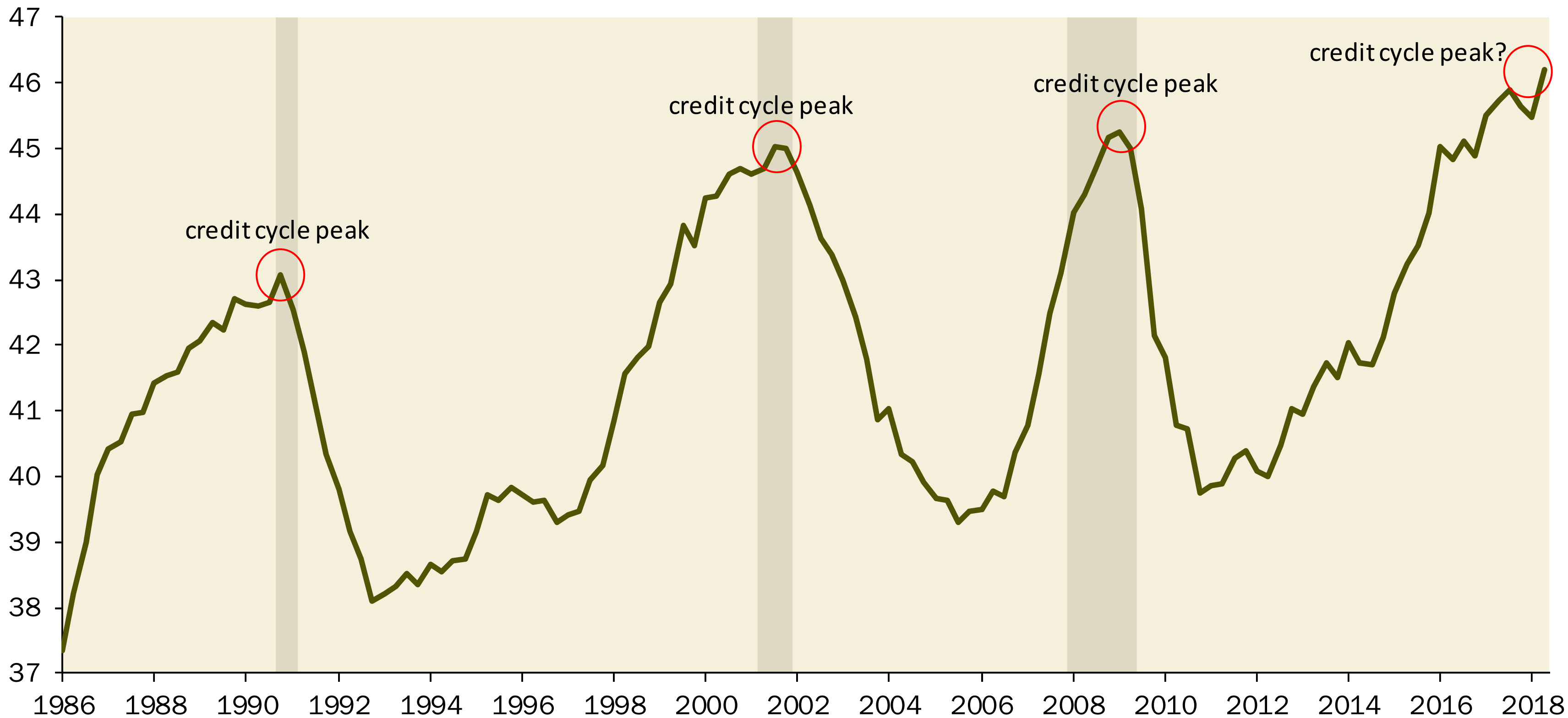
Notes:

Source: The Economist (May 5th – 11th, 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

THE WALL STREET JOURNAL.

STREETWISE | By James Mackintosh

There Have Never Been So Many Bonds That Are Almost Junk

Investors often turn to corporate-bond markets for early warning of trouble, and currently find reassurance that all is well. But look closer and the real message is that hidden risks are building. The next downturn could be more painful than usual for creditors, with knock-on effects for shareholders.

Credit markets send two classic signals: The first shows excessive risk taking, when companies pay very little above Treasury bonds—as in the late 1990s and 2007, and again today. This is a handy reminder that shareholders realize the danger. Trouble appeared in U.S. junk bonds months before the S&P 500 peaked in 2007, and gave several weeks' notice of the 2011 selloff. It isn't infallible—the dot-com bubble carried on for two years after the 1998 bond selloff—but is worth watching.

At the moment investors may be scratching their heads. The first signal is flashing, but the second is confused. U.S. junk bonds have been doing great, suggesting nothing is wrong, even as higher-quality bonds sell off.

The option-adjusted spread—a standard measure of the extra yield over Treasury Federal Reserve rate rise. What is going on?

The explanation is that high-quality bonds aren't as high-quality as they used to be, while junk bonds are a little safer than they were. This summer for the first time more than 40% of the value of U.S. corporate bonds was rated BBB, just eking over the line into investment grade, and an even higher proportion was BBB in Europe.

Back in 2007, bond spreads were a little lower than today, but a smaller slice of bonds was on the bottom rung of investment grade and so at risk being downgraded to junk; only 26% of U.S. bonds were rated

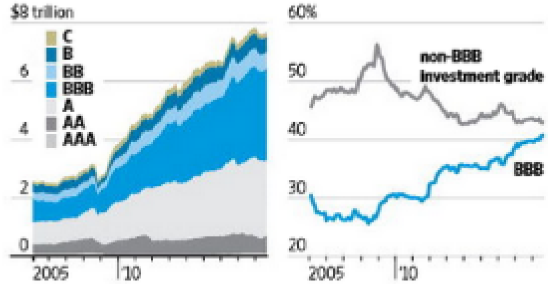
BBB My Baby

The explosion of corporate bonds since the last recession has been led by the lowest investment-grade rating, BBB.

Value of U.S. corporate bonds by rating

The lowest investment-grade rating category makes up more than 40% of all U.S. corporate bonds for the first time.

Percentage of U.S. corporate bonds by value



Source: ICE Data Services

THE WALL STREET JOURNAL.

amount to about half of the existing size of the $1 trillion U.S. junk market. In Europe those close to the edge would add about 35% to the €347 billion ($405 billion) junk market if all were downgraded.

The good news is that after the 2008 crunch, lots of bond-fund managers changed their rules to allow them to hold at least some bonds that weren't part of their benchmark, so they wouldn't have to dump downgraded paper immediately. But it isn't clear whether they could cope with the scale of downgrades that might result from the changed structure of the market.

All this is bad news for in-

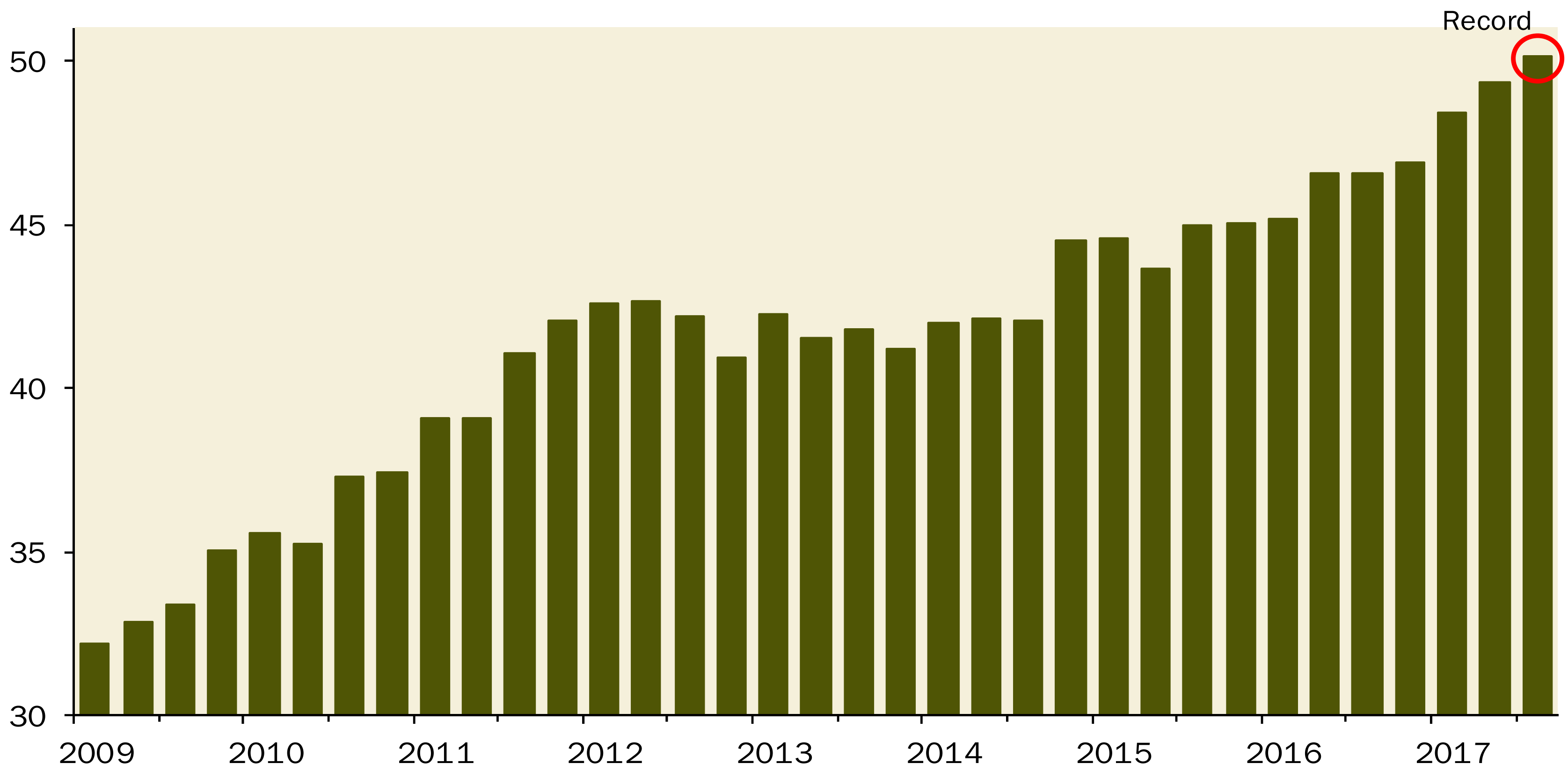
Notes:

Source: Wall Street Journal (September 21, 2018)

HALF OF INVESTMENT-GRADE COMPANIES ARE RATED BBB

United States: BBB Share of Investment-Grade Bonds

(percent)



Notes:
Source: Bloomberg, Gluskin Sheff

BRAINARD ON HEIGHTENED RISKS

*"The past few times unemployment fell to levels as low as those projected over the next year, **signs of overheating showed up in financial-sector imbalances rather than in accelerating inflation**. The Federal Reserve's assessment suggests that financial vulnerabilities are building, which might be expected after a long period of economic expansion and very low interest rates. **Rising risks are notable in the corporate sector, where low spreads and loosening credit terms are mirrored by rising indebtedness among corporations that could be vulnerable to downgrades in the event of unexpected adverse developments**."*

— *September 12, 2018*

Notes:
Source: Lael Brainard; What Do We Mean by Neutral and What Role Does It Play in Monetary Policy?; September 12, 2018

CORPORATE BOND SPREADS SUPER TIGHT

United States: Industrials: BBB Credit minus U.S. Treasuries

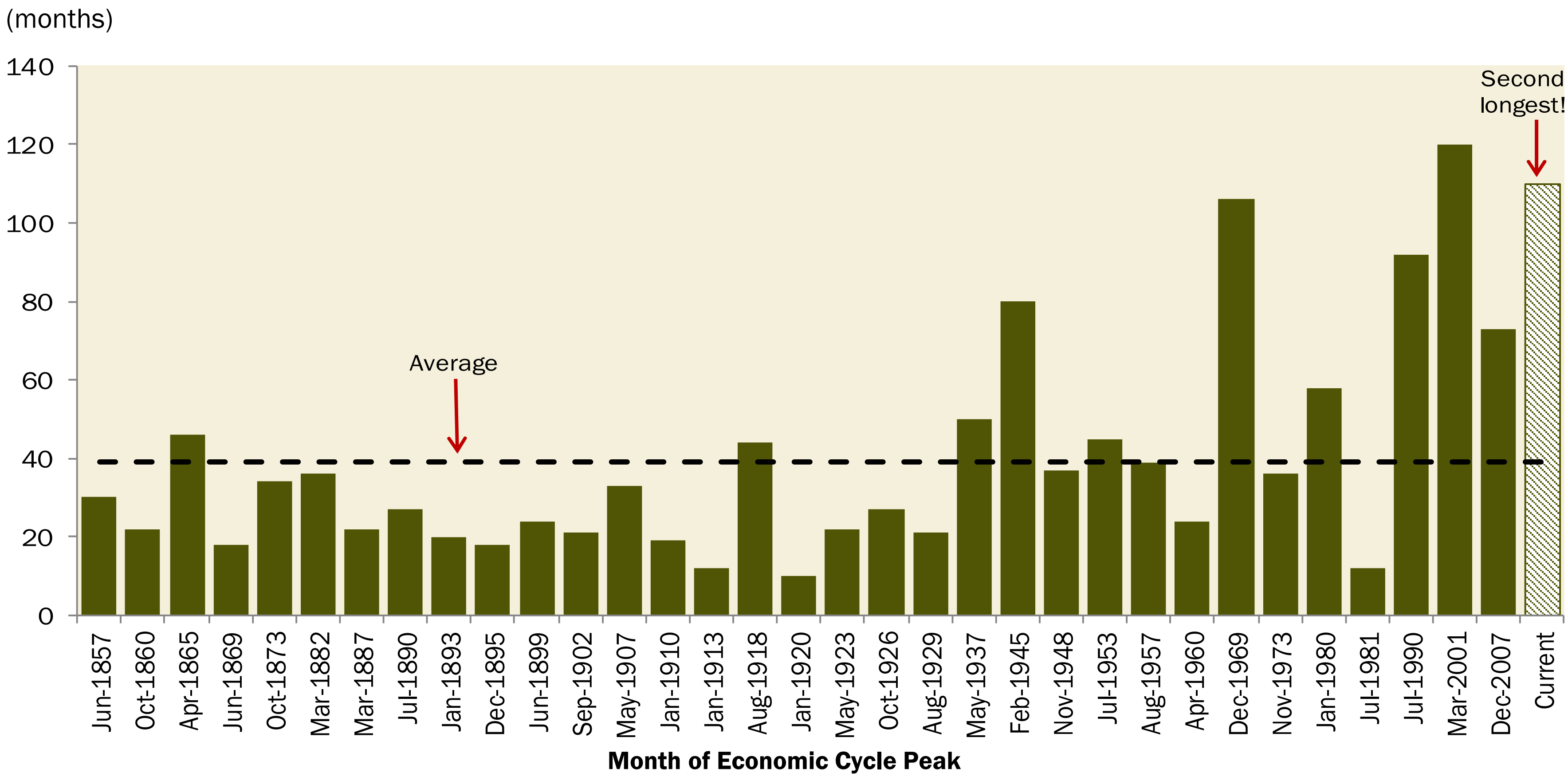
Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

THE U.S. CYCLE IS VERY LATE

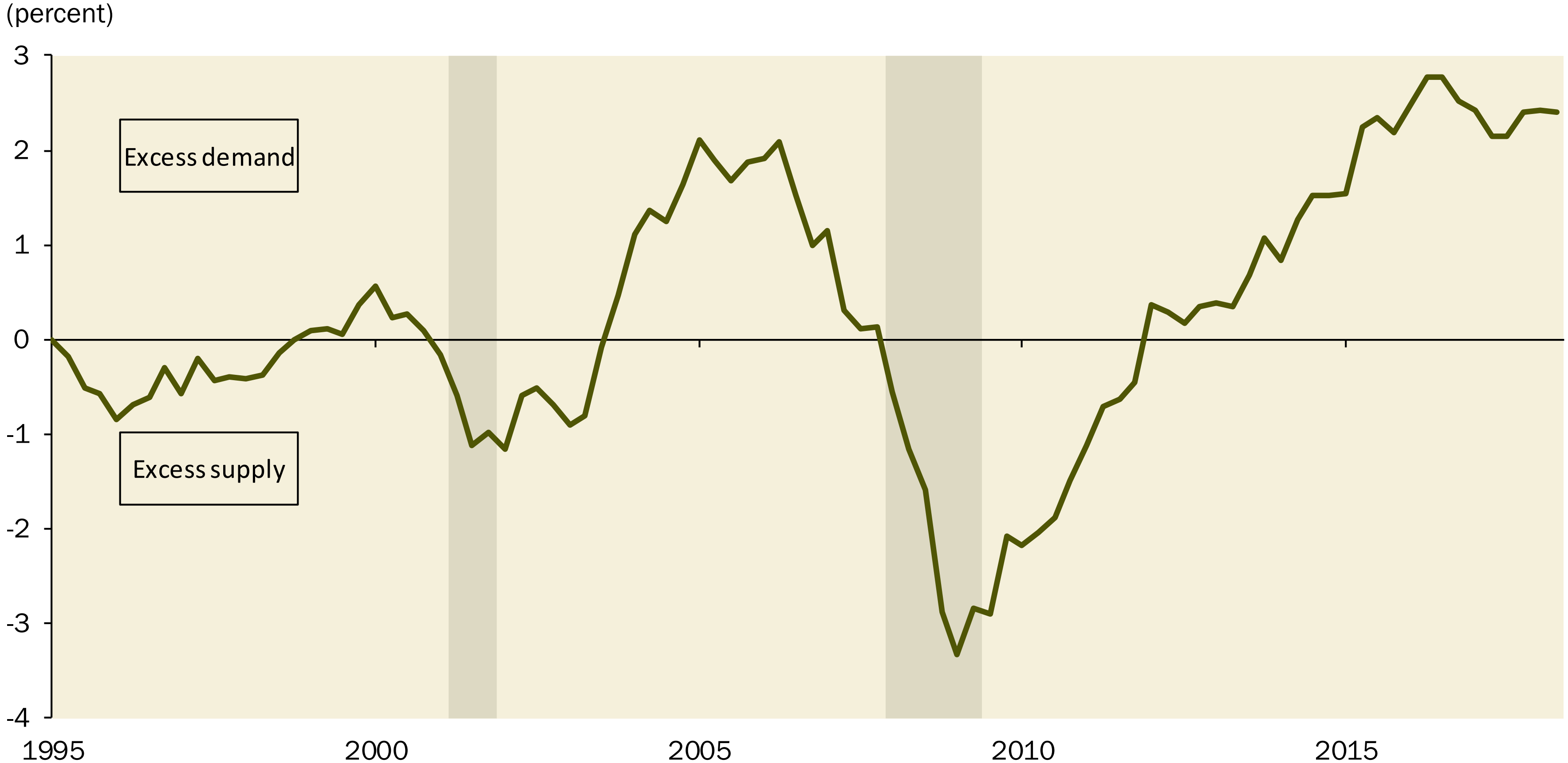
United States: Duration of Economic Expansions



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

U.S. ECONOMY HAS SHIFTED TO AN EXCESS DEMAND BACKDROP (INFLATIONARY)

United States: Output Gap

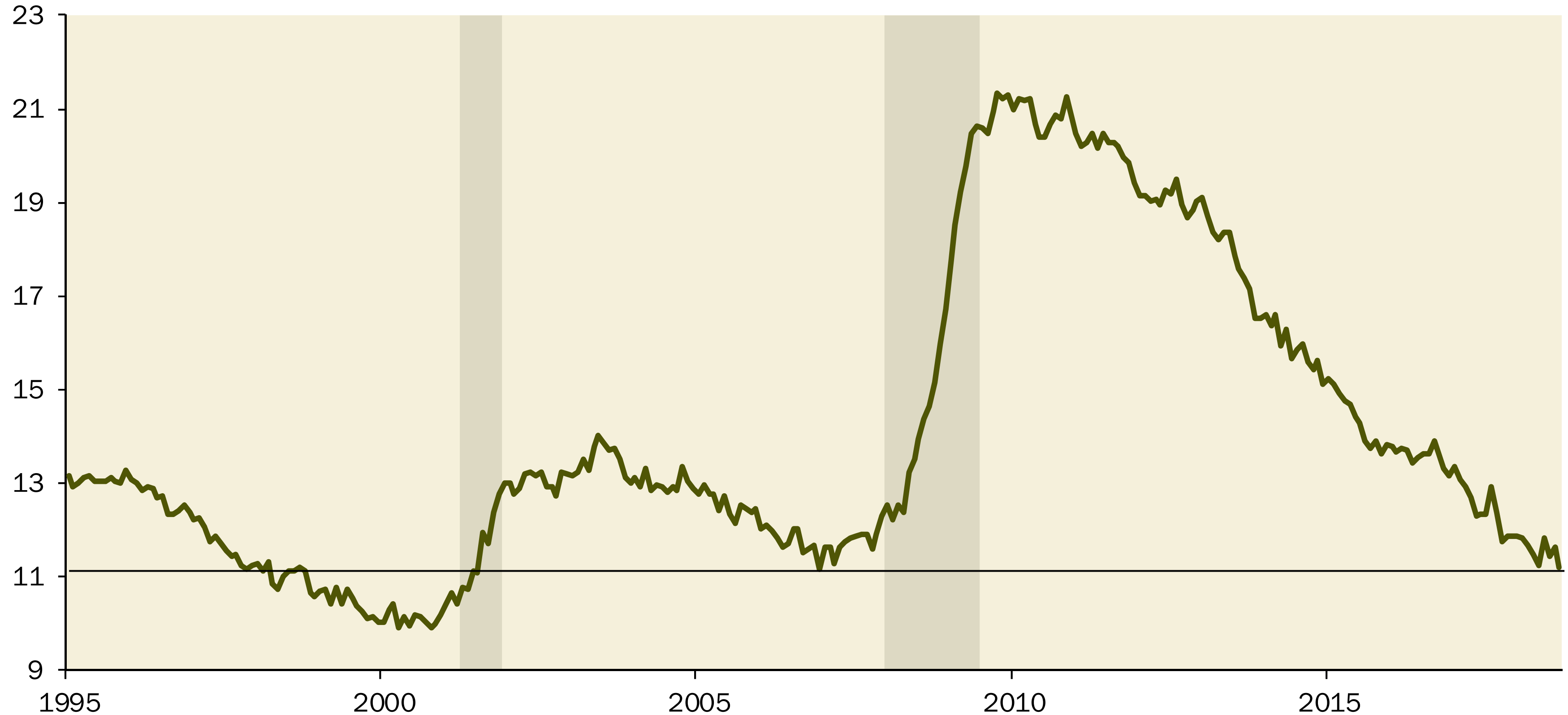


Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

RUNNING OUT OF WORKERS

United States: Available Labor Supply

(millions of people)

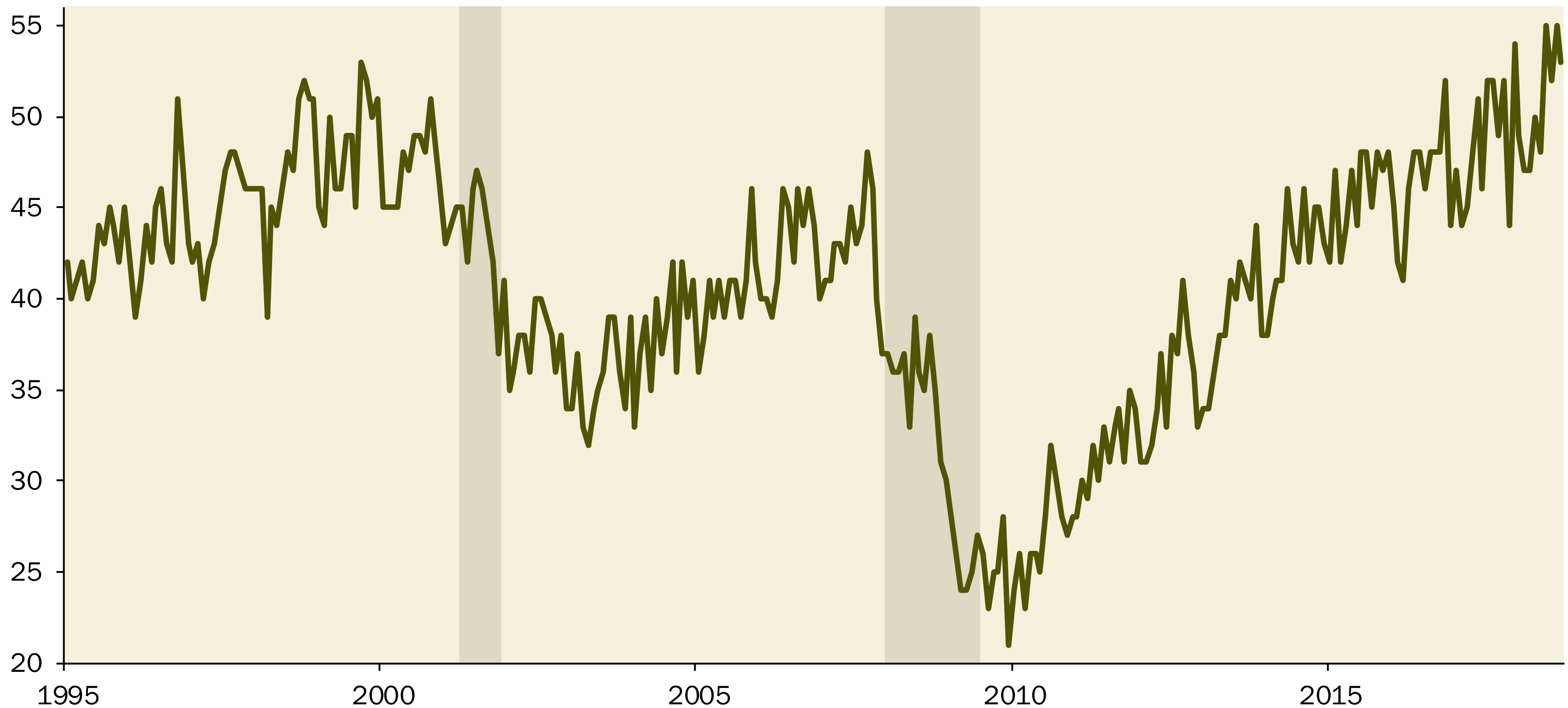


Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

A SKILL-LESS JOBS EXPANSION

United States: NFIB: Businesses with Few or No Qualified Applicants for Job Openings

(percent share)



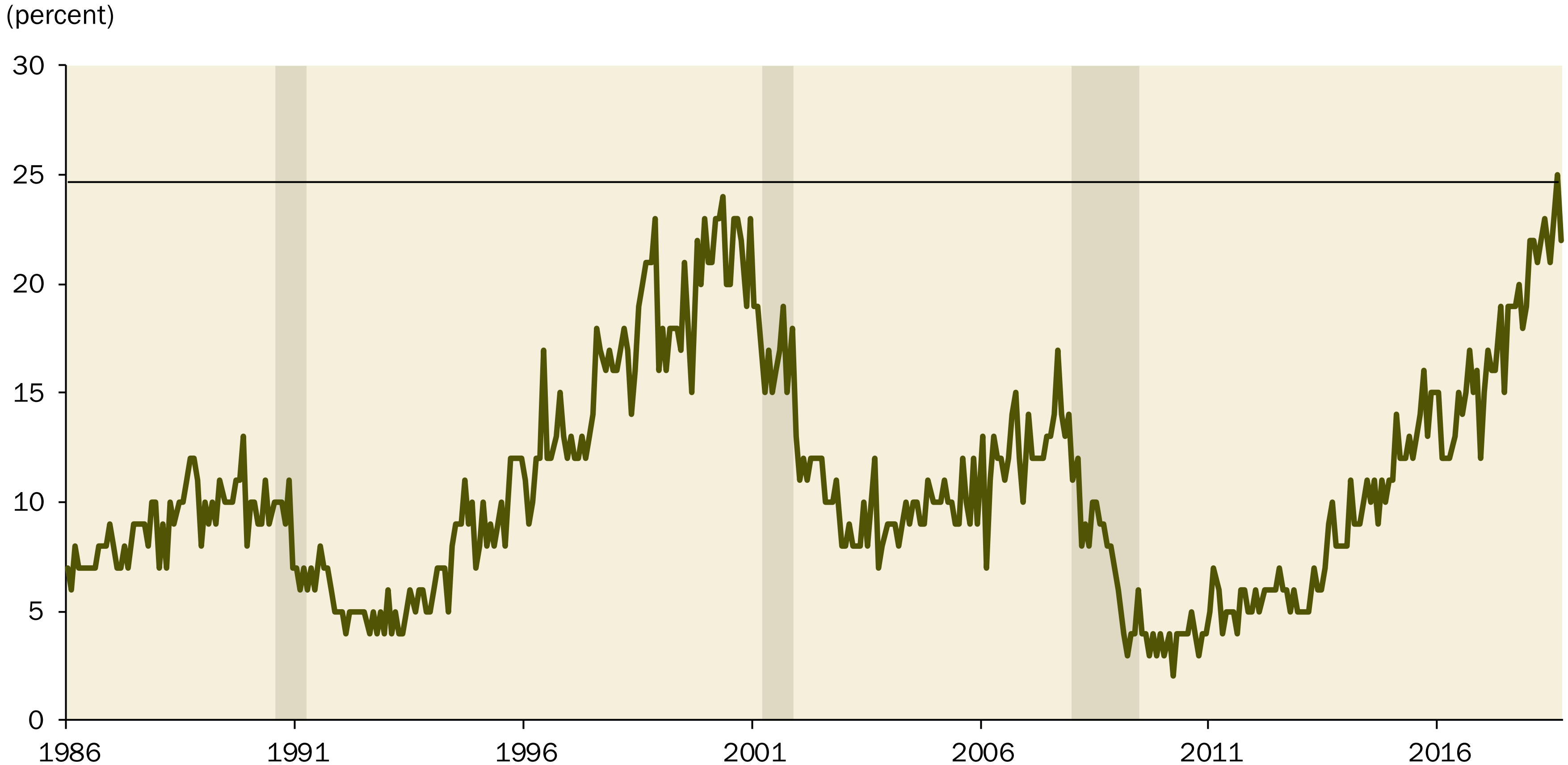
Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

DITTO!

United States: NFIB: Quality of Labor Single Most Important Problem



Notes:

Shaded regions represent periods of U.S. recession

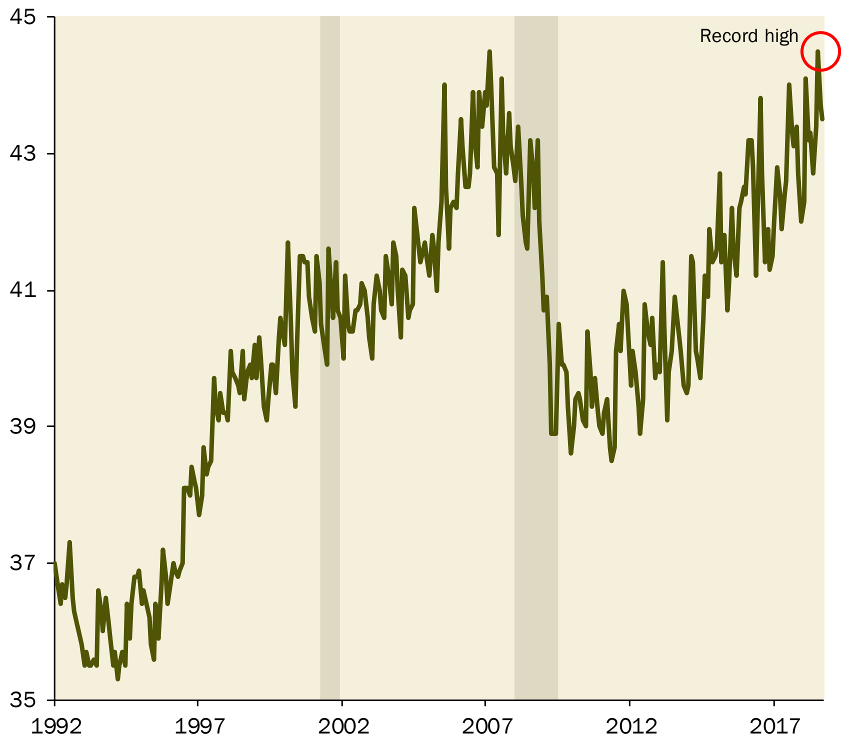
Source: Haver Analytics, Gluskin Sheff

A SKILL-LESS JOBS RECOVERY

United States

Employment/Population Ratio: Less Than HS Diploma

(percent)



Unemployment Rate: Less Than HS Diploma

(percent)

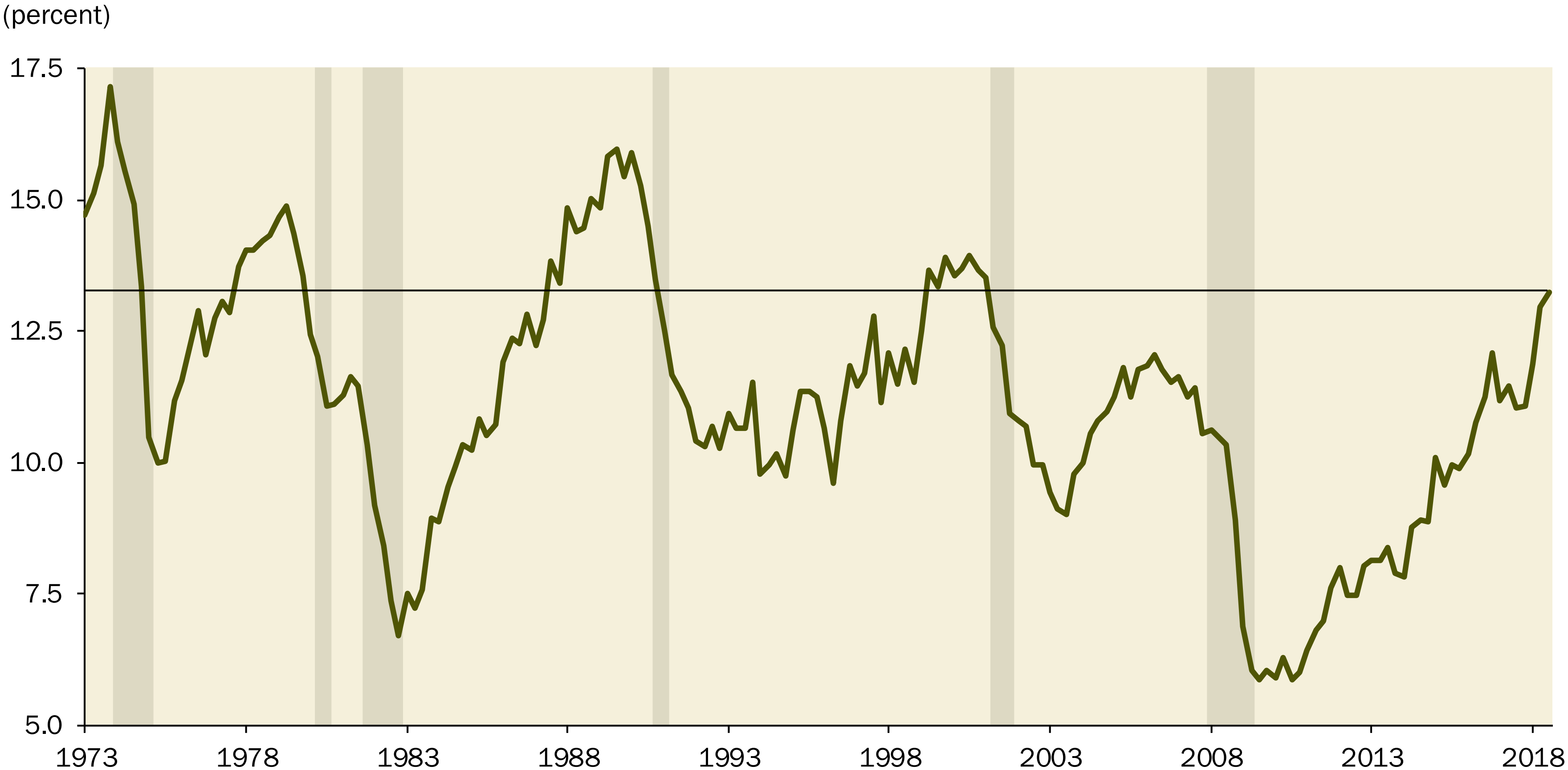
Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

WORKERS ARE JOB HOPPING THE MOST IN YEARS

United States: Job Leavers Share



Notes:

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

EVIDENCE OF RISING WAGE GROWTH

United States: Average Hourly Earnings: Production & Nonsupervisory Workers

(year-over-year percent change)

Notes:

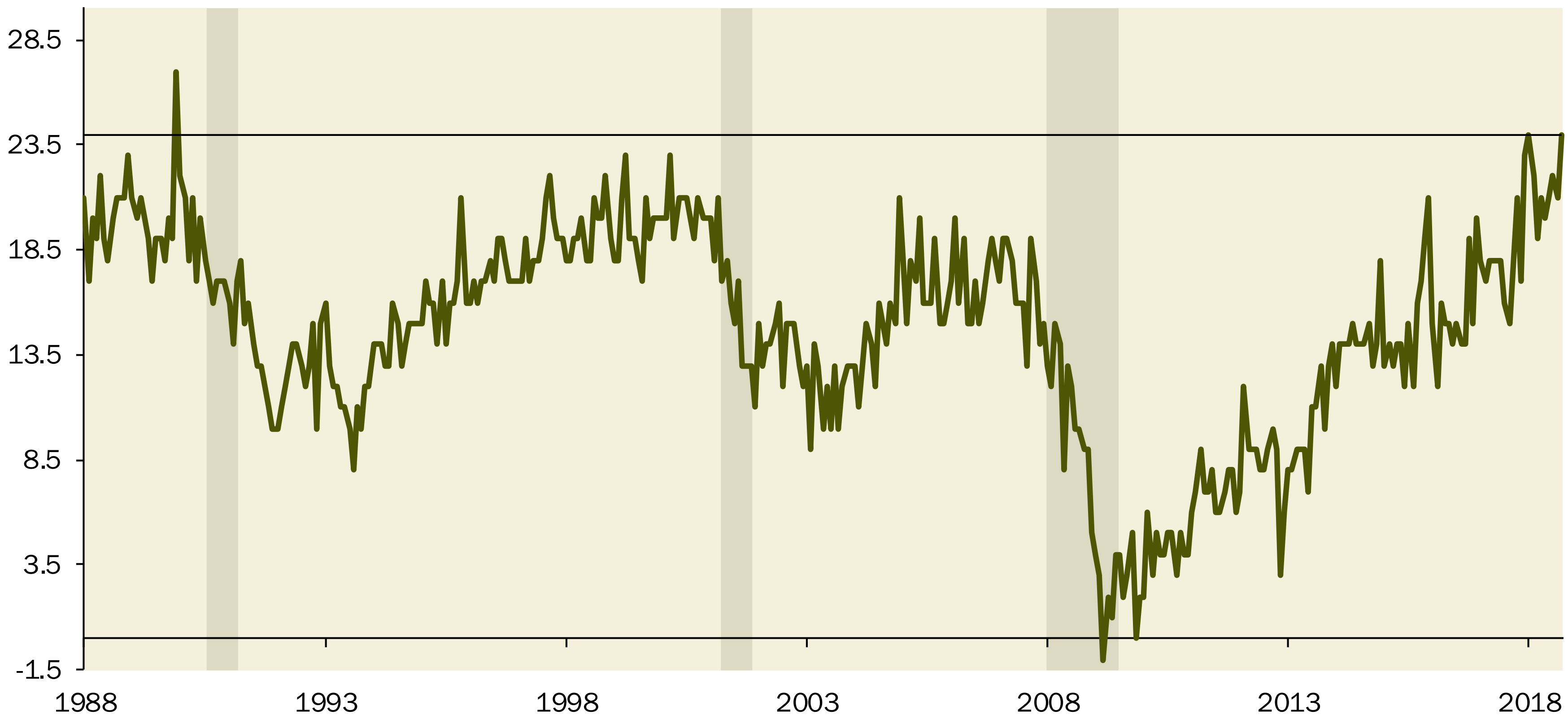
Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Gluskin Sheff

MORE WAGE ACCELERATION IS ON ITS WAY

United States: NFIB: Planning on Raising Wages in Next 3 Months

(percent)



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

A RETURN TO LARGE FISCAL DEFICITS

Once Hawkish, Republicans Open Money Spigot

Budget Deficits Would Balloon Under the Bipartisan Spending Deal

By ALICIA PARLAPIANO

The deal would increase spending for bipartisan priorities.

Defense spending

Non-defense spending

How $200 Billion For Infrastructure Becomes $1.5 Trillion

By KEITH COLLINS and PATRICIA COHEN

TRUMP'S BUDGET FAVORS MILITARY, INFLATING DEFICIT

$4.4 TRILLION PROPOSAL

SENATE LEADERS AGREE TO A DEAL TO LIFT SPENDING

G.O.P. Stimulus Moves Are Stoking Fears of Inflation and Deficits

By JIM TANKERSLEY

WASHINGTON — Republicans are pouring government stimulus

Maya MacGuineas, the president of the Committee for a Responsible Federal Budget. "We should be

Trump Gambles on Deficits, Inflation

Out of Sync

President Proposes $4.4 Trillion Budget

Wider Gap

Acting NASA Administrator Robert Lightfoot discussing the fiscal 2019 budget proposal this month in Huntsville, Ala.

NASA Budget Calls

Notes:

Source: WSJ, The New York Times (February 7, 8, 9, 12, 13, 16, 2018)

AN UNPRECEDENTED LATE-CYCLE FISCAL BOOST

*…"**participants generally regarded the magnitude and timing of the economic effects of the fiscal policy changes as uncertain, partly because there have been few historical examples of expansionary fiscal policy being implemented when the economy was operating at a high level of resource utilization.** A number of participants also suggested that uncertainty about whether all elements of the tax cuts would be made permanent, or about the **implications of higher budget deficits for fiscal sustainability and real interest rates, represented sources of downside risk to the economic outlook.**"*

Notes:
Source: Minutes of the Federal Open Market Committee (March 20-21, 2018)

THE FED ON TRADE DISPUTES

"In addition, ***all*** *participants pointed to ongoing trade disagreements and proposed trade measures as an important source of uncertainty and risks.* ***Participants observed that if a large-scale and prolonged dispute over trade policies developed, there would likely be adverse effects on business sentiment, investment spending, and employment.*** *Moreover, wide-ranging tariff increases would also reduce the purchasing power of U.S. households.*

Further negative effects in such a scenario could include reductions in productivity and disruptions of supply chains."

Notes:
Source: Minutes of the Federal Open Market Committee (July 31 - August 1, 2018)

FINANCIAL TIMES

Price of Trump's tariff war likely to be paid by consumers, warn Fed chiefs

SAM FLEMING — JACKSON HOLE

Moves by US companies to shift the cost of President Donald Trump's tariffs to their customers risk complicating monetary policy decisions as the Federal Reserve seeks to keep inflation steady, the central bank's policymakers have warned.

Raphael Bostic, president of the Atlanta Fed, told the Financial Times that he believed the US was at an "inflection

annual conference in Jackson Hole.

"Businesses have told me that they have been able to absorb a fair amount of the price increases to date but that their ability to do that is diminishing."

Weighing the impact of the tariffs is emerging as a challenge for the Fed. While rising duties and retaliation could become an inflation concern, policymakers say the trade wars could also damp growth by dragging on corporate confidence and prompting companies

higher costs over to consumers. "More and more of them are telling me for the first time in years 'I am putting through price increases' or 'I intend to put through price increases'. It wouldn't surprise me if we see it show up in the data here in the near future."

Loretta Mester, president of the Cleveland Fed, said part of the reason companies felt better able to pass on higher prices to consumers was they were enjoying stronger demand. If the

*"**An increasing number of firms are telling us that they are going to start passing the cost increases through and will be reflected in final goods prices**. Businesses have told me that they have been able to absorb a fair amount of the price increases to date but that their ability to do that is diminishing" (*Raphael Bostic, President of the Atlanta Fed).

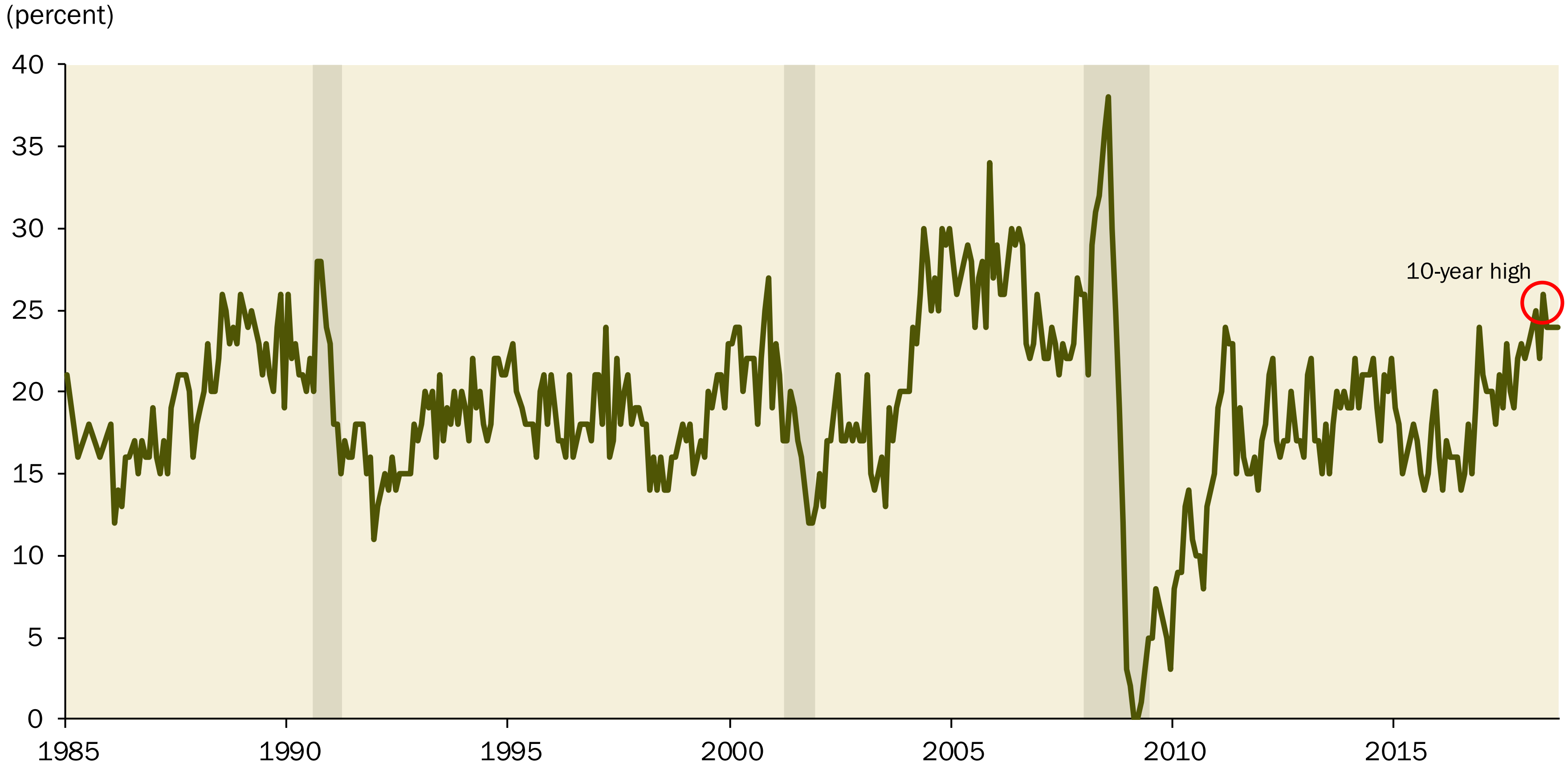
*"More and more of them [ed note: companies] are telling me for the first time in years '**I am putting through price increases' or 'I intend to put through price increases**'. It wouldn't surprise me if we see it show up in the data here in the near future"* (Robert Kaplan, President of the Dallas Fed).

*"If we continue to have these rolling tariffs where they keep increasing and adding on and adding on then you could have a **longer spurt of inflation** and that would make things a little more complicated"* (Loretta Mester, President of the Cleveland Fed).

Notes:
Source: Financial Times (August 27, 2018)

BUSINESSES ARE PLANNING TO RAISE PRICES

United States: NFIB: Percent Share Planning to Raise Average Selling Prices

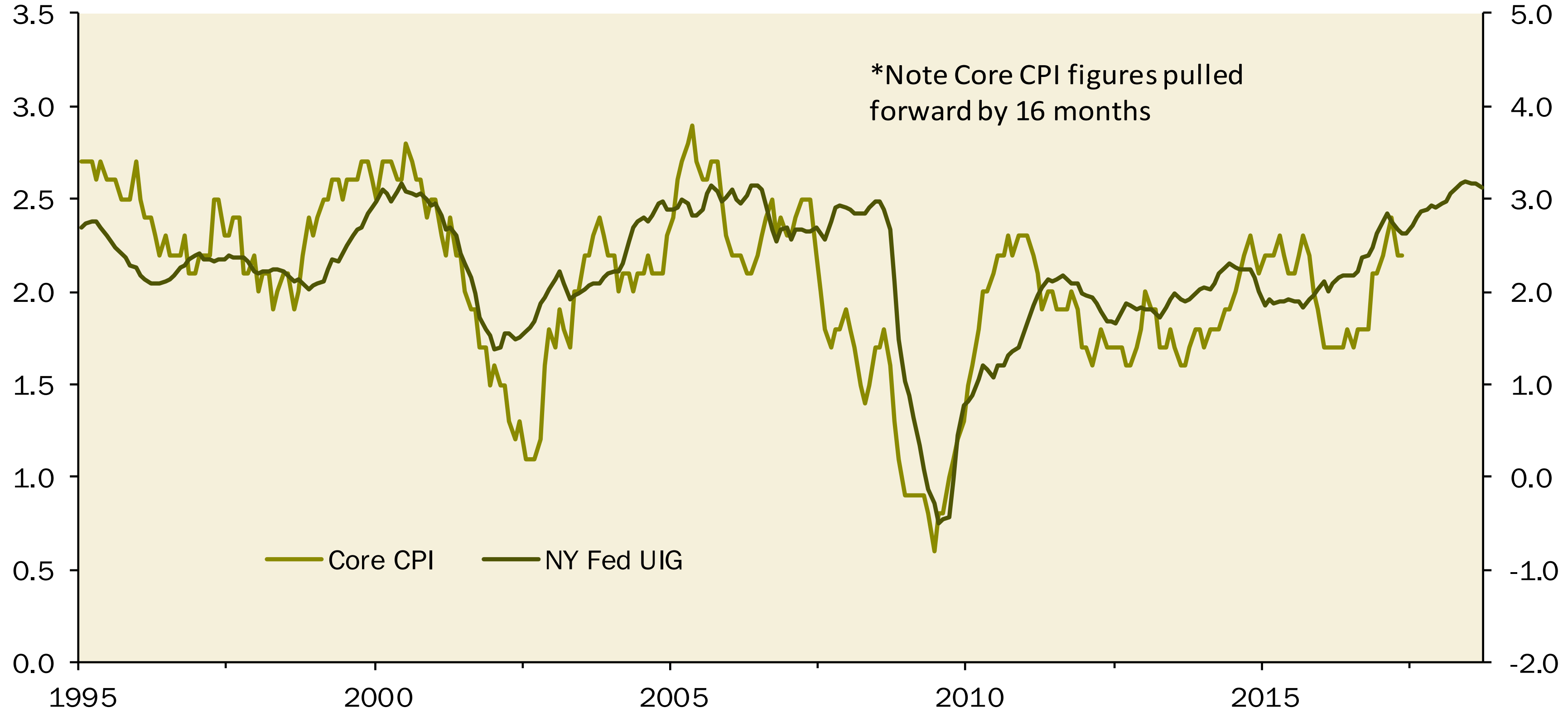


Notes:
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

LEADING INFLATION INDICATORS POINTING UPWARD

United States

(year-over-year percent change)



Notes:

Source: Haver Analytics, 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

THE WALL STREET JOURNAL.

Flattening Yield Curve Splits Investors

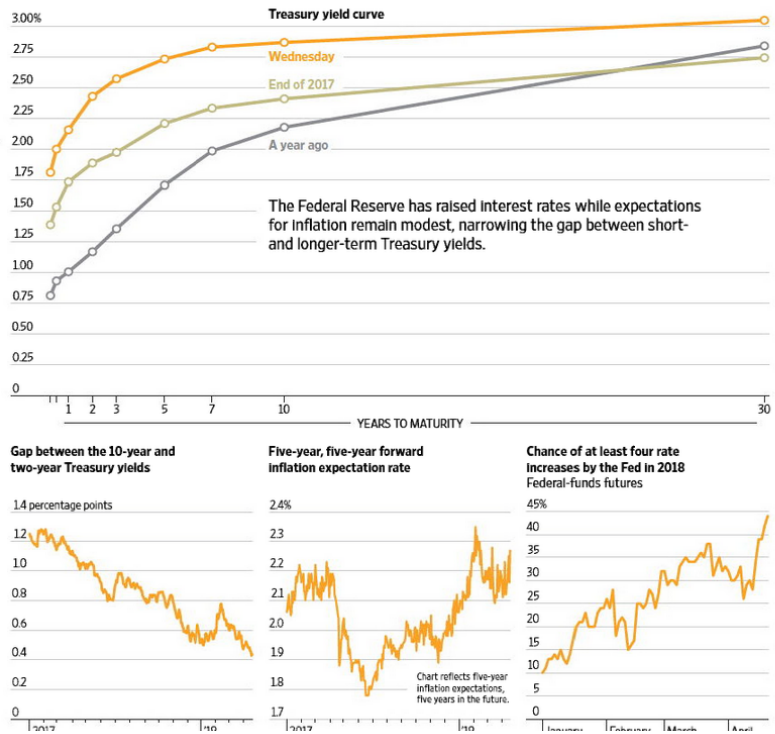
Treasurys' move often warns of a recession, but current economic growth remains steady

BY DANIEL KRUGER AND SAM GOLDFARB

The gap between short- and long-term Treasury yields is at its narrowest in more than a decade, reflecting investors' confidence that the Federal Reserve will maintain its current pace of interest-rate increases despite continuing skepticism about the longer-term outlook for economic growth and inflation.

The difference between the two-year Treasury yield and the 10-year Treasury yield, known on Wall Street as the 2-10 spread, settled Tuesday at 0.428 percentage point, its tightest since 2007, before steepening modestly Wednesday. Two-year yields tend to rise along with investors' expectations for tighter Fed interest-rate policy, while longer-term yields are more responsive to sentiment about prospects for the economy.

The so-called yield curve, which measures the spread between short- and long-term rates, is a key indicator of sentiment about the prospects for economic growth, but investors remain split on what the signal shows now. Because short-term rates have exceeded longer-term rates before each recession since at least 1975—a phenomenon known as an in-



helps manage the BMO TCH Core Plus Bond Fund. "We don't necessarily believe the market will be able to withstand a terribly hawkish Fed."

Ms. Mardarovici said she is betting that the yield curve will continue to flatten. Her portfolios are overweight 10- and 30-year Treasurys and underweight three-to-five-year government debt, she said.

On the other hand, higher short-term yields suggest investors have confidence that inflation will reach the Fed's 2% target, but stable longer-term yields suggest a lack of concern that policy makers will lose control, said Michael Pond, head of inflation-linked strategies at Barclays PLC. The Fed "has shown its ability to control inflation" and prevent an overshoot, he said.

After dipping below 0.5 percentage point in early January, the 2-10 spread reached as high as 0.779 percentage point in February as investors saw signs that persistently tight labor markets might be translating into higher wages. Though those signs of rising wages were subsequently revised lower, leading the yield curve to resume its trend toward flattening, policy makers have expressed confidence in forecasts that growth and inflation will continue as they raise rates.

Investors and analysts are unsure how closely Fed officials will watch the bond market to help guide monetary policy, said Aaron Kohli, an interest-rate strategist at BMO Capital Markets. Mr. Kohli, who is fore-

Notes:

Source: Wall Street Journal (April 19, 2018)

FRBSF Economic Letter

2018-07 | March 5, 2018 | Research from Federal Reserve Bank of San Francisco

Economic Forecasts with the Yield Curve

Michael D. Bauer and Thomas M. Mertens

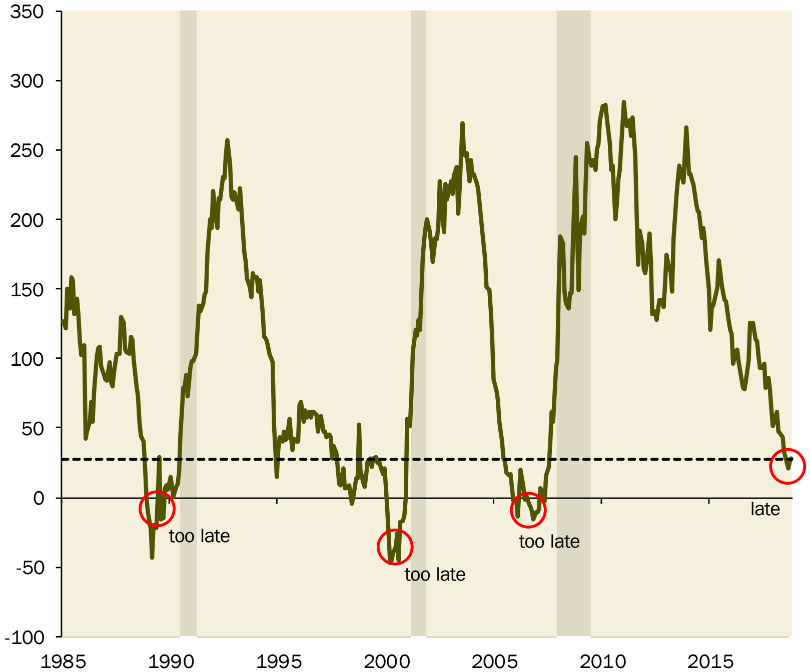
"The term spread—the difference between long-term and short-term interest rates—is a strikingly accurate predictor of future economic activity. Every U.S. recession in the past 60 years was preceded by a negative term spread, that is, an inverted yield curve. Furthermore, a negative term spread was always followed by an economic slowdown and, except for one time, by a recession. ***While the current environment is somewhat special—with low interest rates and risk premiums—the power of the term spread to predict economic slowdowns appears intact.****"*

Notes:
Source: Economic Forecasts with the Yield Curve (March 5, 2018)

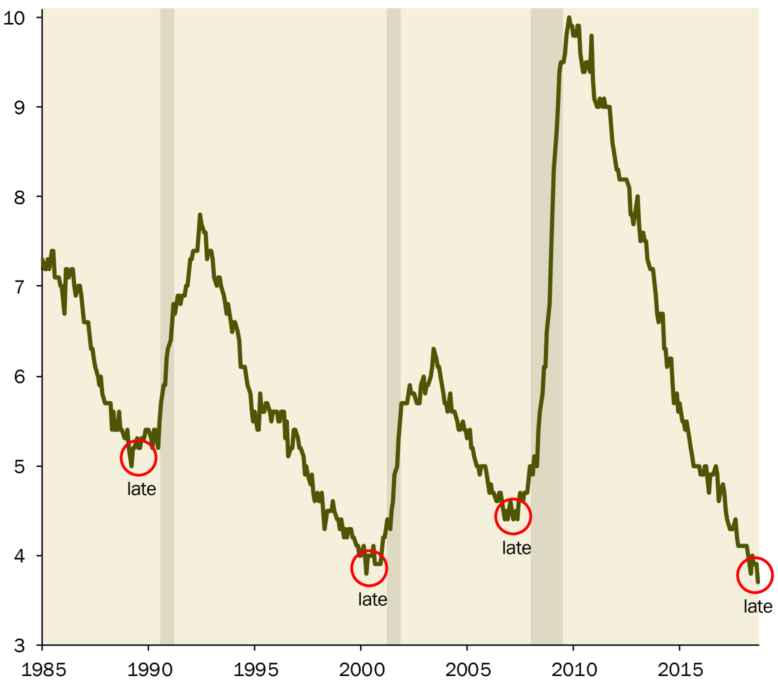
THIS IS WHAT THE ST. LOUIS FED HAS TO SAY…

United States

U.S. 10-Year T-Note Yield LESS U.S. 2-Year T-Note Yield
(basis points)



Unemployment Rate
(percent)



"On average, since 1969, the unemployment rate trough occurred nine months before the NBER-determined recession trough, while the yield curve inversion occurred 10 months before…based on this evidence, it appears that both indicators tend to be reliable predictors of a business recession."

Notes:
Shaded regions represent periods of U.S. recession
Source: Economic Synopses; Recession Signals: The Yield Curve vs. Unemployment Rate Troughs (June 1, 2018), Haver Analytics, Gluskin Sheff

RECESSION PROBABILITIES ARE INCREASING

United States: NY Fed Probability of U.S. Recession 12-Months Ahead

Notes:

Shaded region represents period of U.S. recession

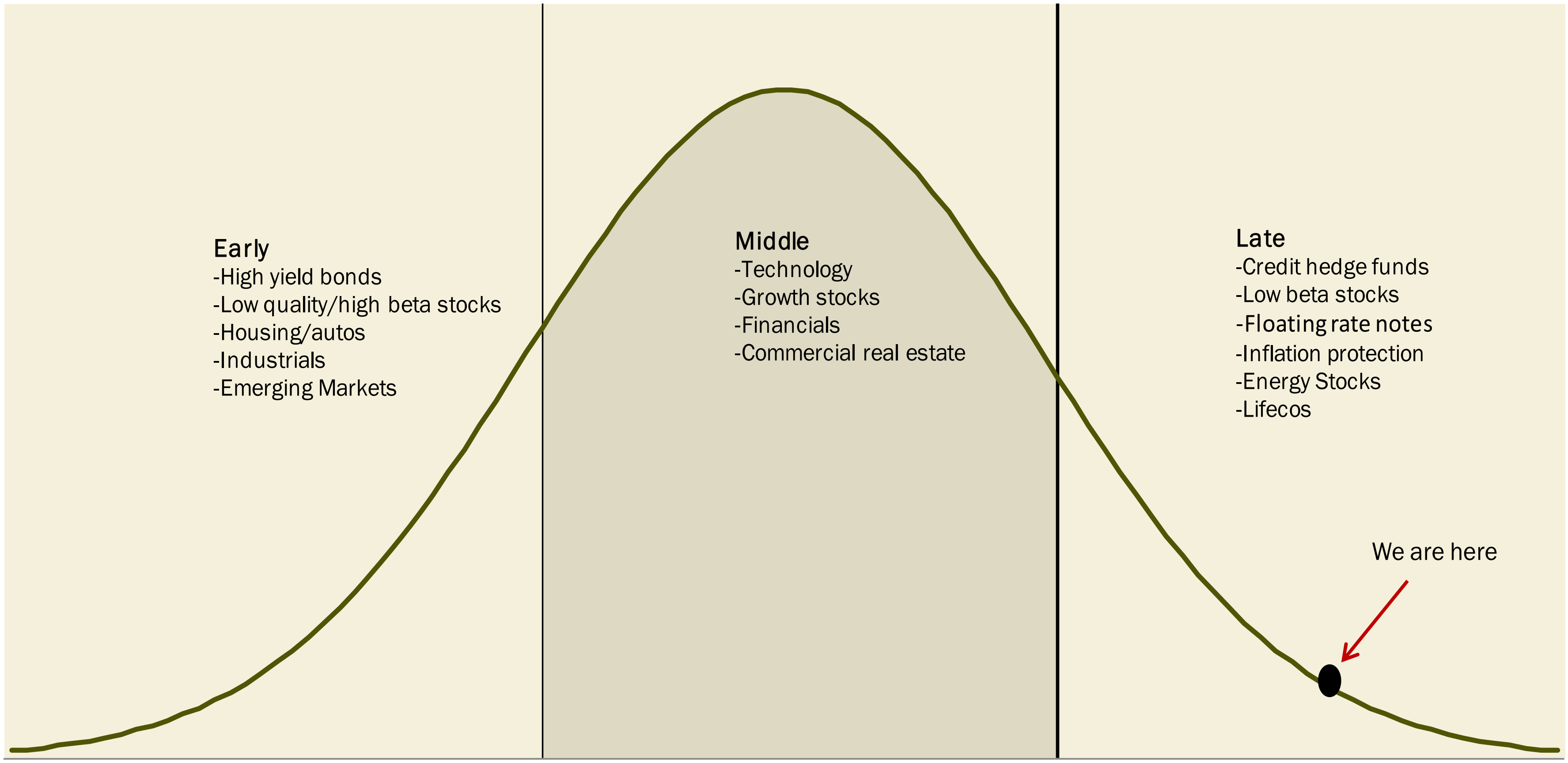
Source: Haver Analytics, Gluskin Sheff

14 OF 15 VARIABLES SUGGEST WE ARE IN THE FINAL INNINGS IN THE U.S.

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%	48.2%	100.0%
2s/10s Yield Curve (bps)	-183.0	-209.0	100.0%
Industry Capacity Utilization Rate (ppts)	9.0	12.9	100.0%
Unemployment Rate (ppts)	-2.9	-5.7	100.0%
Real GDP (ppts)	8.9	7.8	87.6%
Profit Margins (ppts)	3.9	5.6	100.0%
ISM Manufacturing (pts)	25.0	15.0	60.0%
Auto Sales (%)	56.0%	85.8%	100.0%
Housing Starts (%)	63.5%	128.5%	100.0%
Cyclical GDP Share (ppts)	3.2	4.3	100.0%
Trailing P/E Multiple (pts)	7.8	9.1	100.0%
High Yield Spread (bps)	-662.7	-817.7	100.0%
Employment-to-Population Ratio (ppts)	2.5	1.0	40.3%
Consumer Confidence (pts)	43.9	80.7	100.0%
Average			90.7%

Notes:
Source: Haver Analytics, Gluskin Sheff

AS THE CYCLE TURNS...SO SHOULD YOUR PORTFOLIO



Notes:
Source: Gluskin Sheff


Mark Hulbert
Special to USA TODAY

Now is time to prepare for end of bull market

Don't be surprised when next bear comes calling

The vast majority of investors will be caught by surprise when this bull market in stocks finally comes to an end. Cultivating a healthy sense of skepticism will help protect you from the irrational exuberance that invariably accompanies a market top.

This is far easier said than done, however. Bull markets often end with a burst of impressive performance, leading even die-hard skeptics to question themselves and throw in the towel on their bearishness.

Over the last six months of the bull market that ended in March 2000, for example, the Nasdaq doubled in value. By then, not surprisingly, most of that era's erstwhile bearishness had given way to enthusiasm and euphoria.

We all know what happened next.

That early-2000 experience was hardly unique. Consider the average recommended stock market exposure among several dozen market timers monitored by my *Hulbert Financial Digest* performance-monitoring service. At bull market tops of the last three decades, their exposure level averaged more than 70 percentage

USA TODAY

*"**Invest in "boring" companies:** Another way of preparing for an eventual bear market is to begin to shift your holdings away from riskier companies towards firms with the strongest balance sheets – as measured by financial quality ratings like those given by companies such as Standard & Poor's. The stocks of such firms are likely to go up as long as the bull market continues but lose a lot less than the market when it turns down. Wal-Mart stock, to provide one spectacular example, actually went up during the 2007-09 financial crisis, gaining 7% even while the S&P 500 fell 57%.*

To be sure, these higher quality companies, much of whose long-term return comes from dividends, can seem boring at a time when the stock market is regularly hitting all-time highs. But if it's excitement that you crave, just wait until the next bear market. One will begin someday."

Notes:
Source: USA Today (January 15, 2018)

DISCLAIMER