

2014 Economic & Stock Market Outlook

Mid-Year Chart Pack Update

June 12, 2014



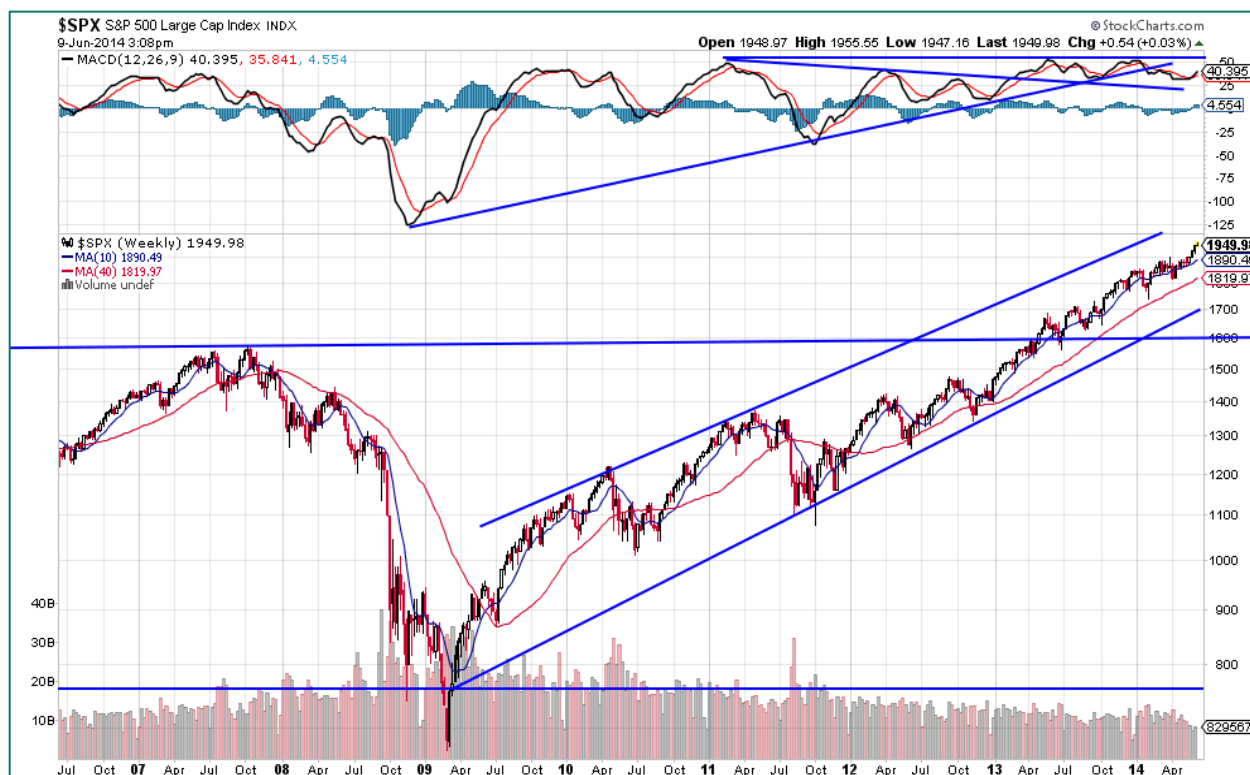
Please refer to Appendix – Important Disclosures.

The following charts and comments are meant to provide a mid-year update in our 2014 Economic and Stock Market Outlook ([Signs of Secular Progress?](#) and [Supplemental Chart Pack](#)).

Except where otherwise noted, the source for these charts is Ned Davis Research.

Our weight of the evidence has moved from a mildly bullish reading at the start of the year to arguing for caution more recently. Most recently, we have seen optimism toward excessive levels across a number of indicators. Countering this has been a modest improvement in market breadth. Continued improvement in breadth could clear the way for a resumption of the cyclical rally. A more likely course (based on what we are currently seeing) is that ongoing geo-political tensions keep a damper on economic growth while optimism becomes excessive. If this is the path, stocks could face growing headwinds during the summer. As always, we will try to balance what could/should be with what is and try to stay in harmony with the message from the markets. Here, in chart form, is how we see it as we approach the halfway point in 2014.

The multi-year up-trend is intact, but the weight of the evidence argues for caution.



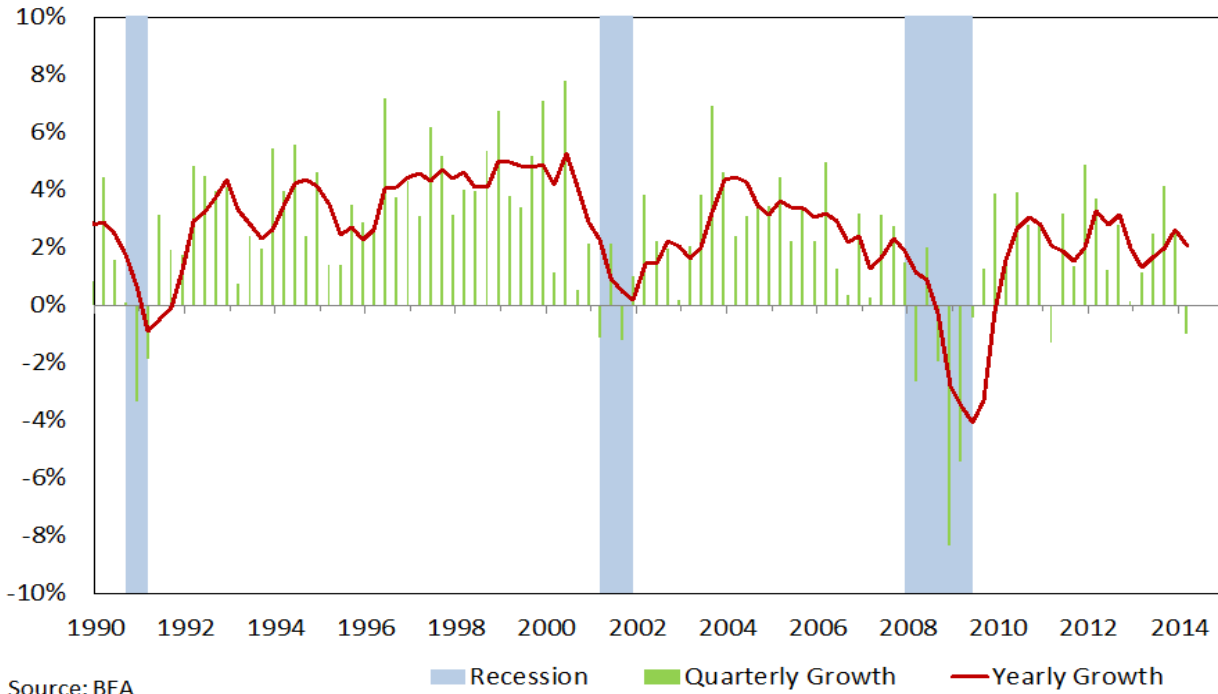
Source: StockCharts

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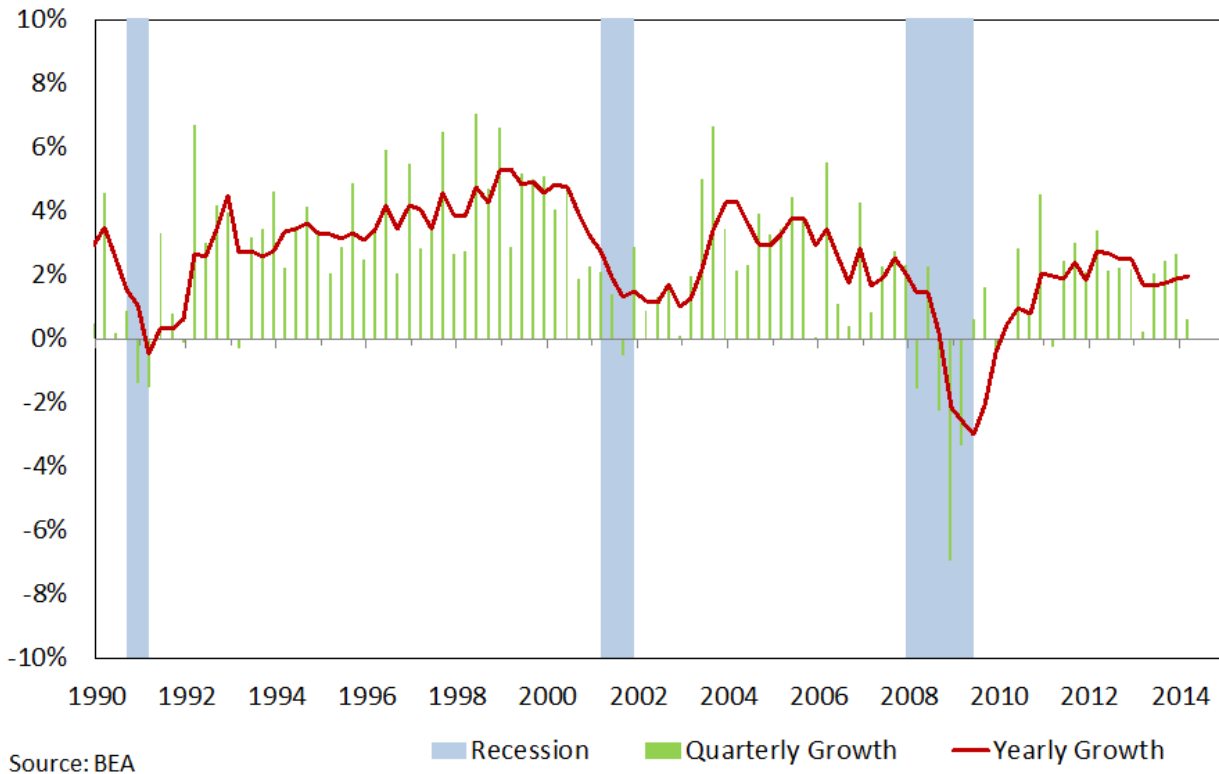
GDP contracted in Q1 – not the start to 2014 many were looking for.

Real Gross Domestic Product (GDP)

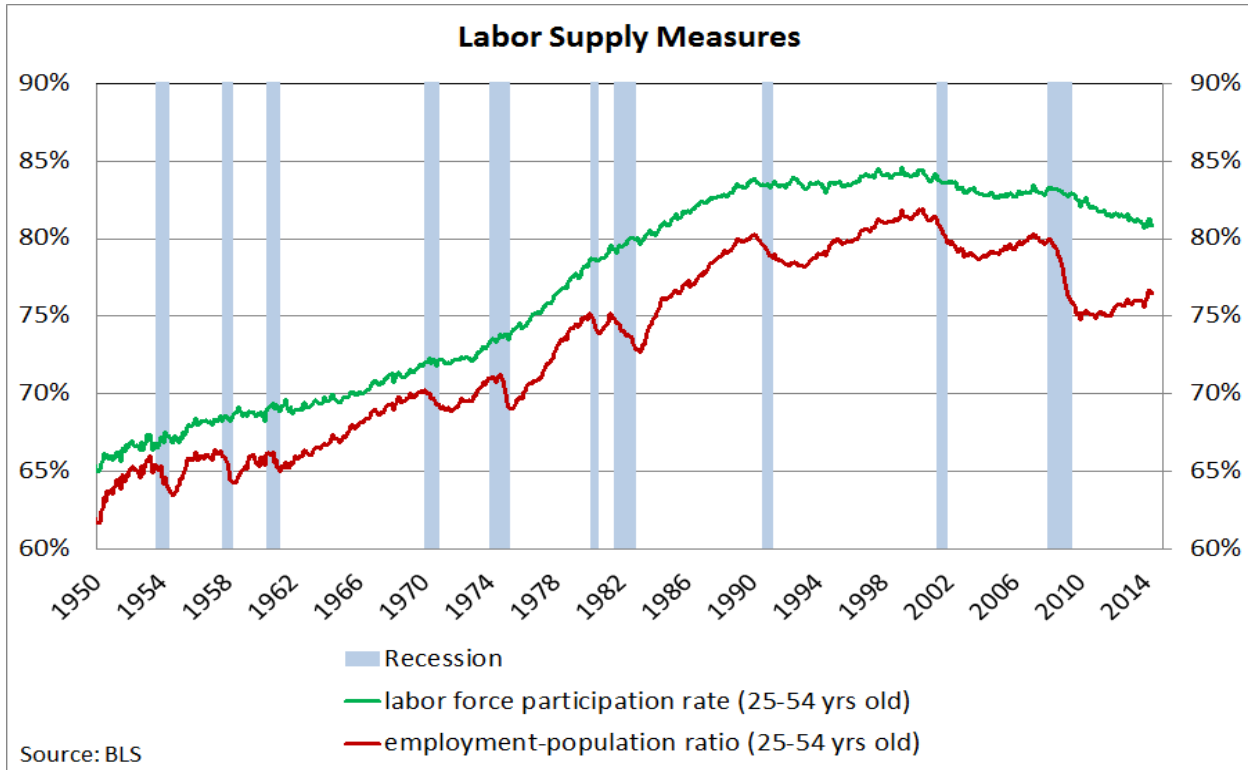


Final Sales, however, continued to grow in 2014, and the trend is drifting higher.

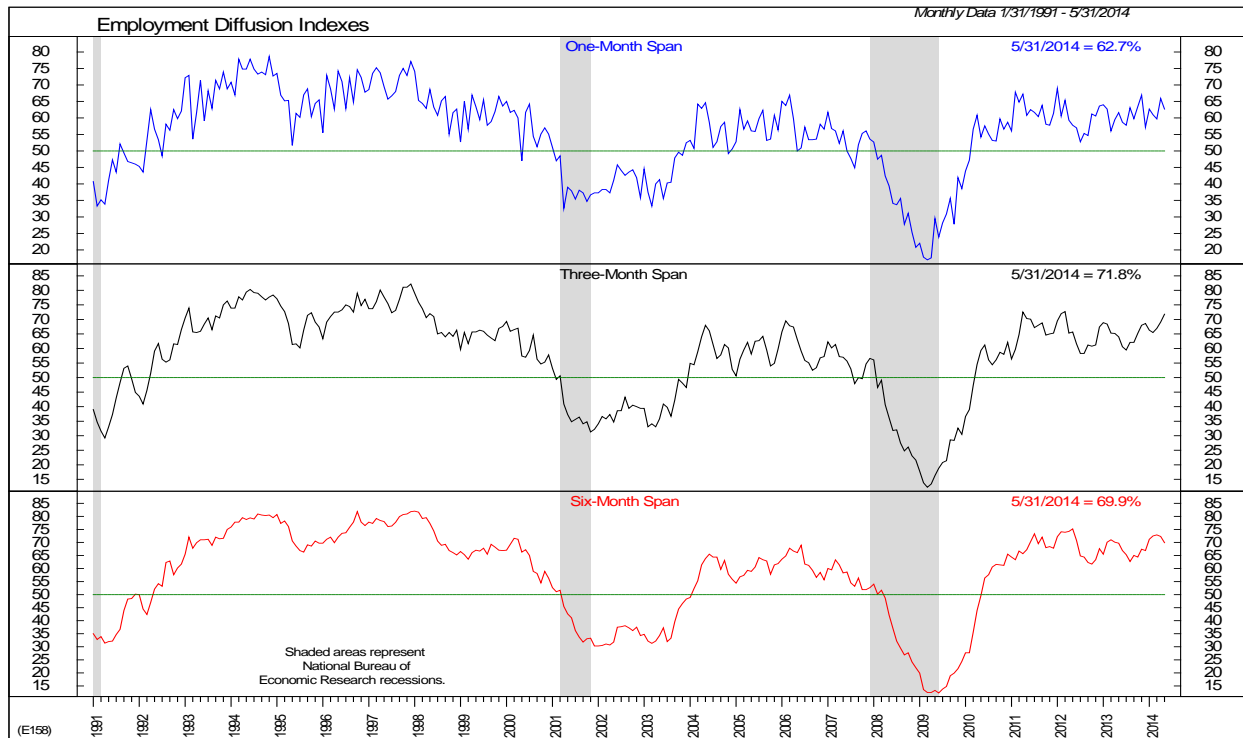
Real Final Sales of Domestic Product



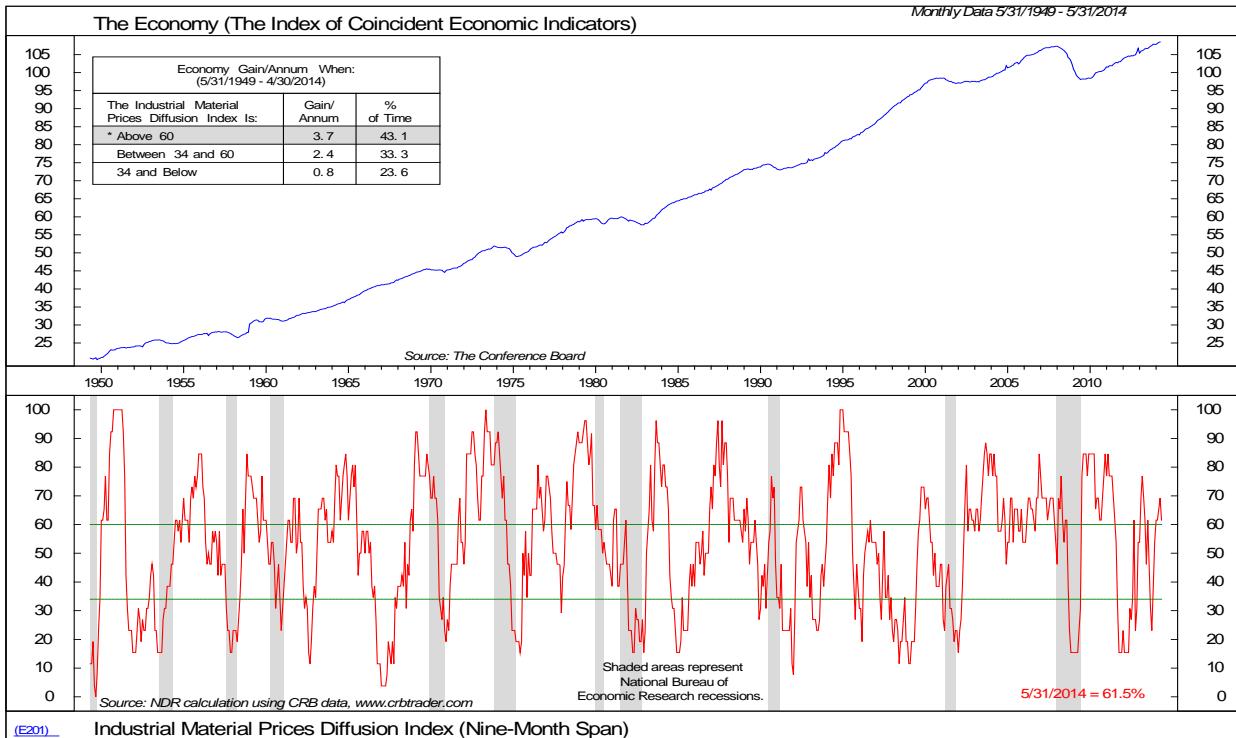
Slow improvement in employment-population ratio is encouraging for labor market.



The number of industries seeing employment gains is also trending higher.

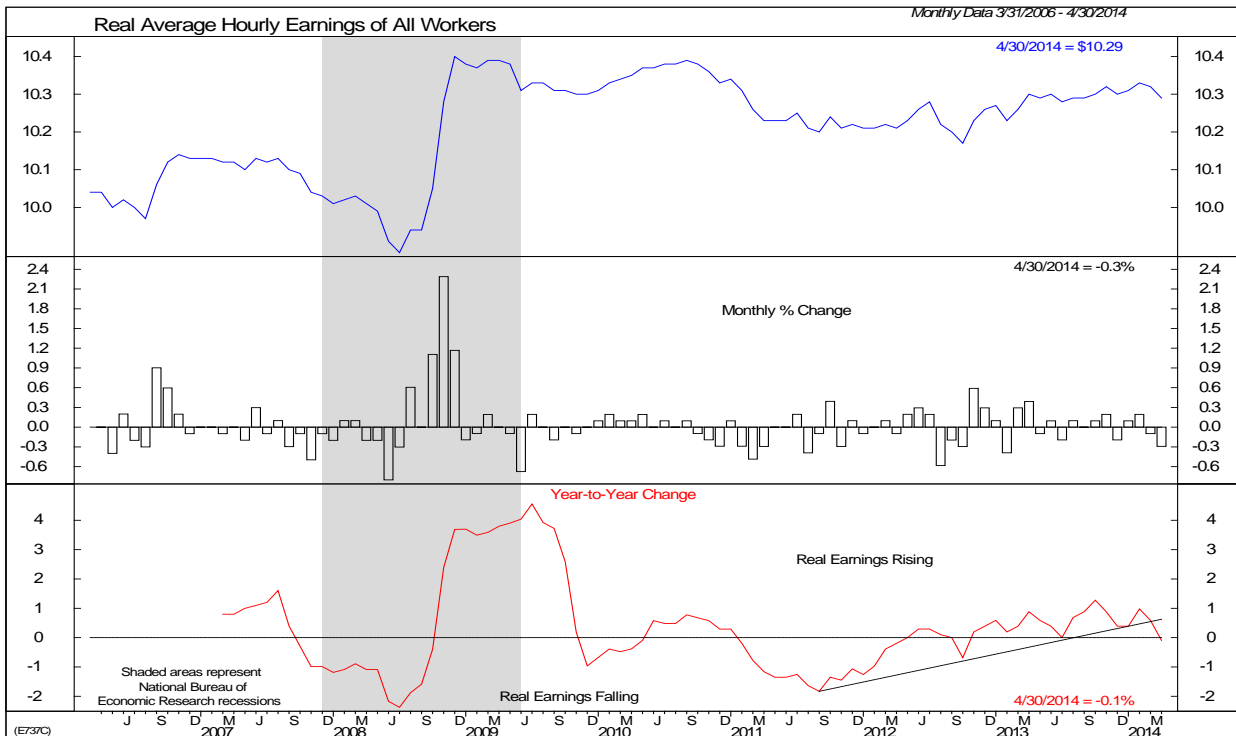


The rise in commodity prices suggests better growth, and for some, higher inflation.



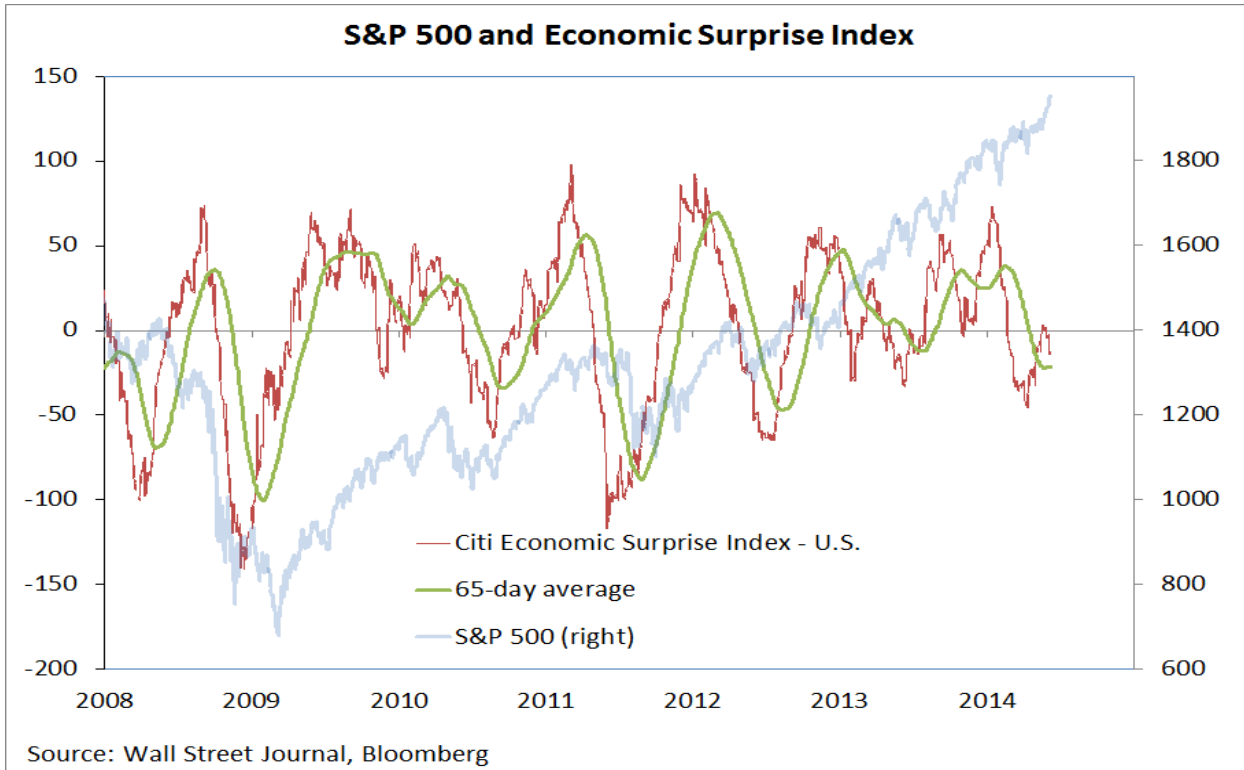
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Without better wage growth, inflation concerns are likely overblown.

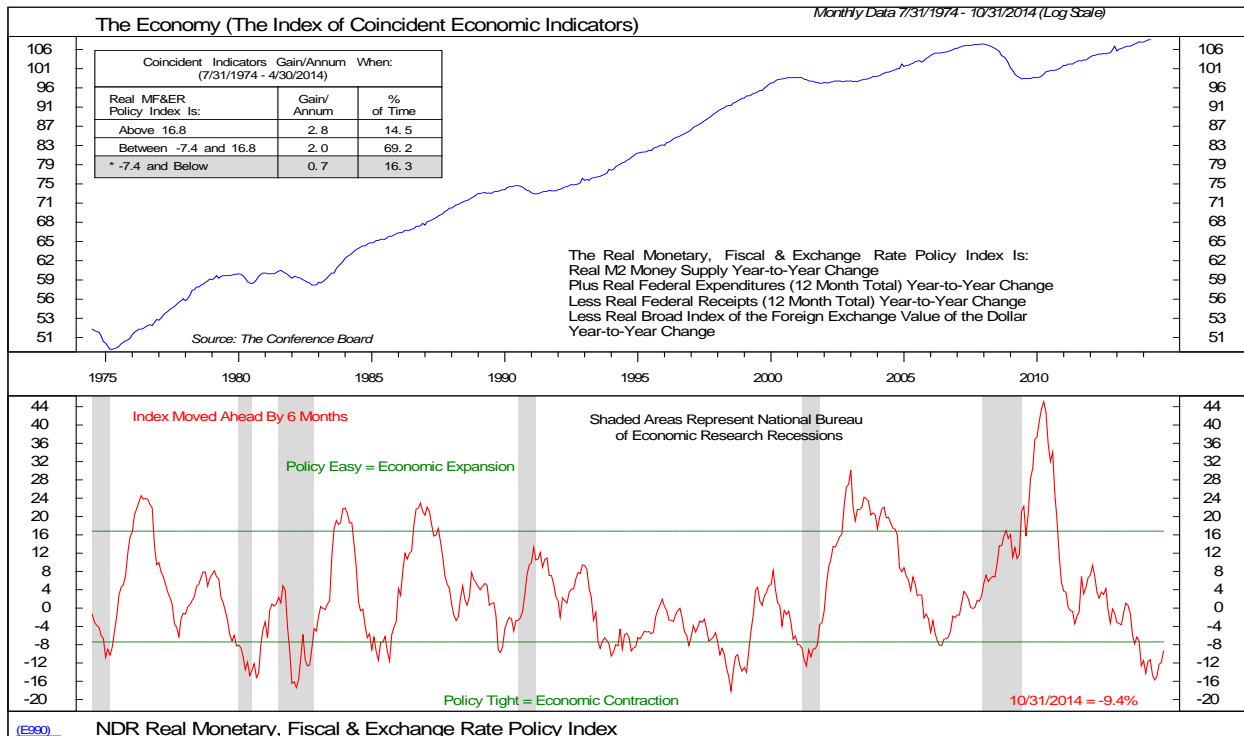


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Expectations for an economic bounce are high – this could limit upside surprises.

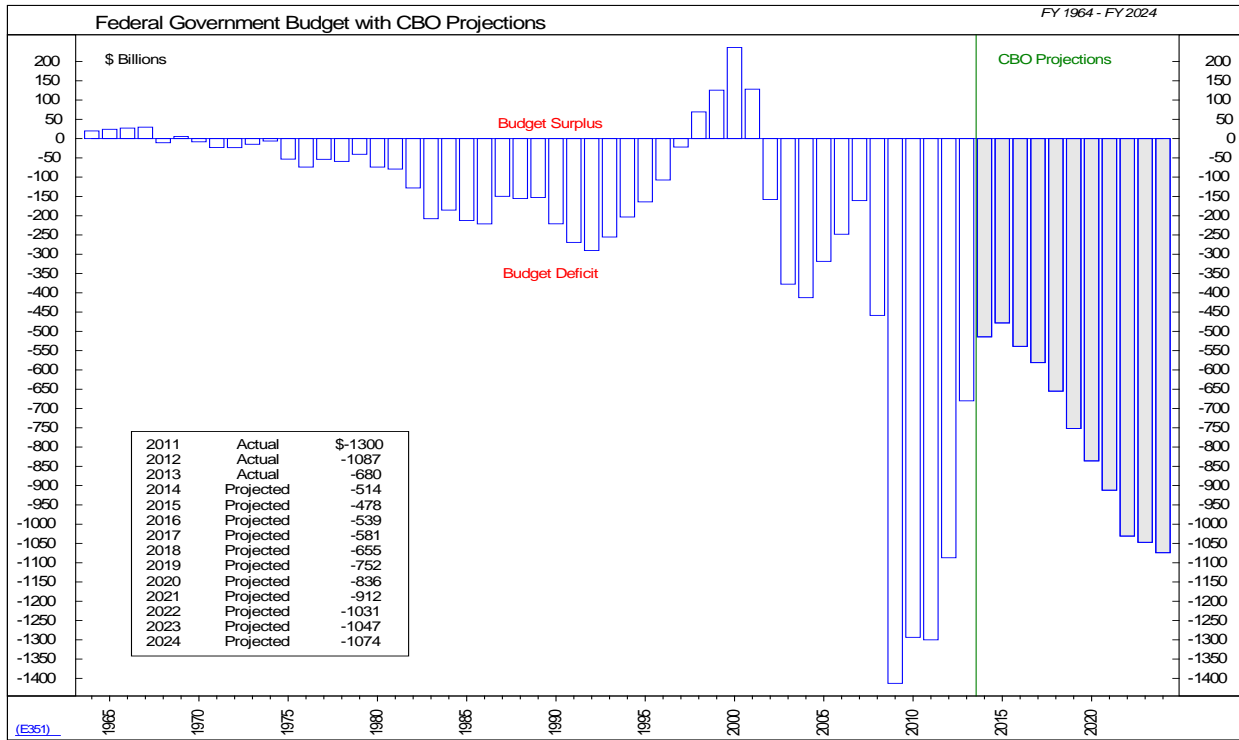


The policy environment is improving, but is still a net drag on the economy.

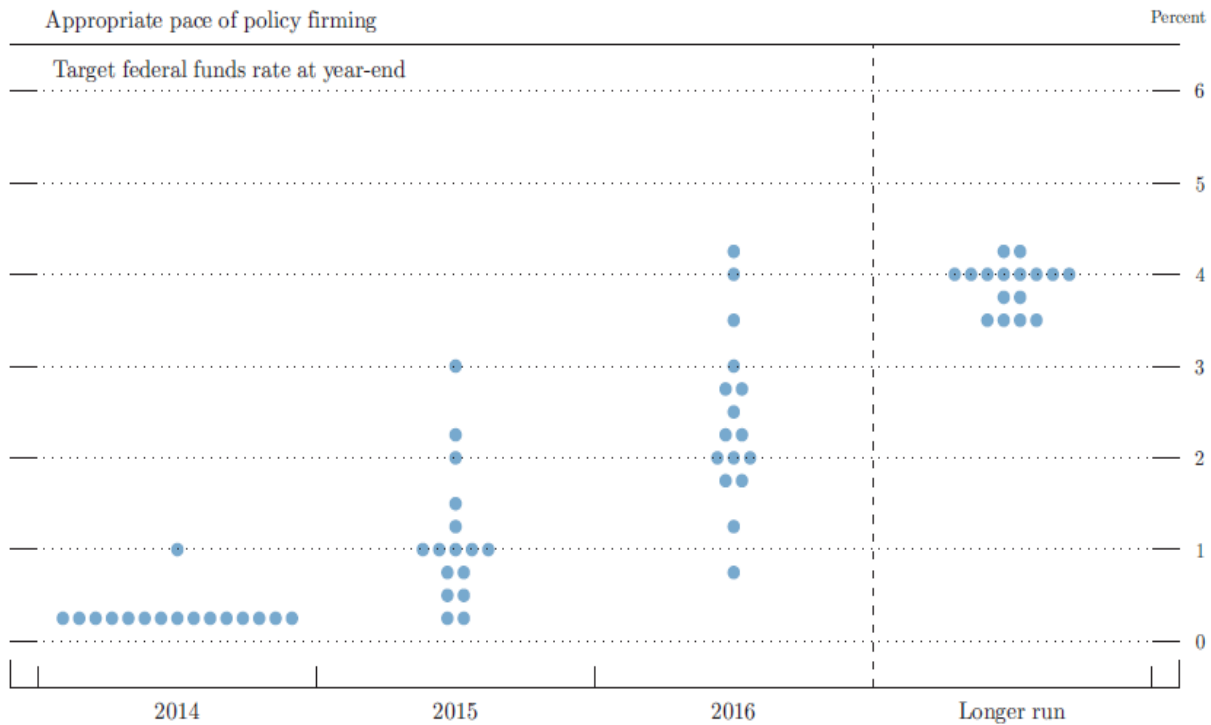


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Policymakers need to be proactive as recent gains are on course to reverse.

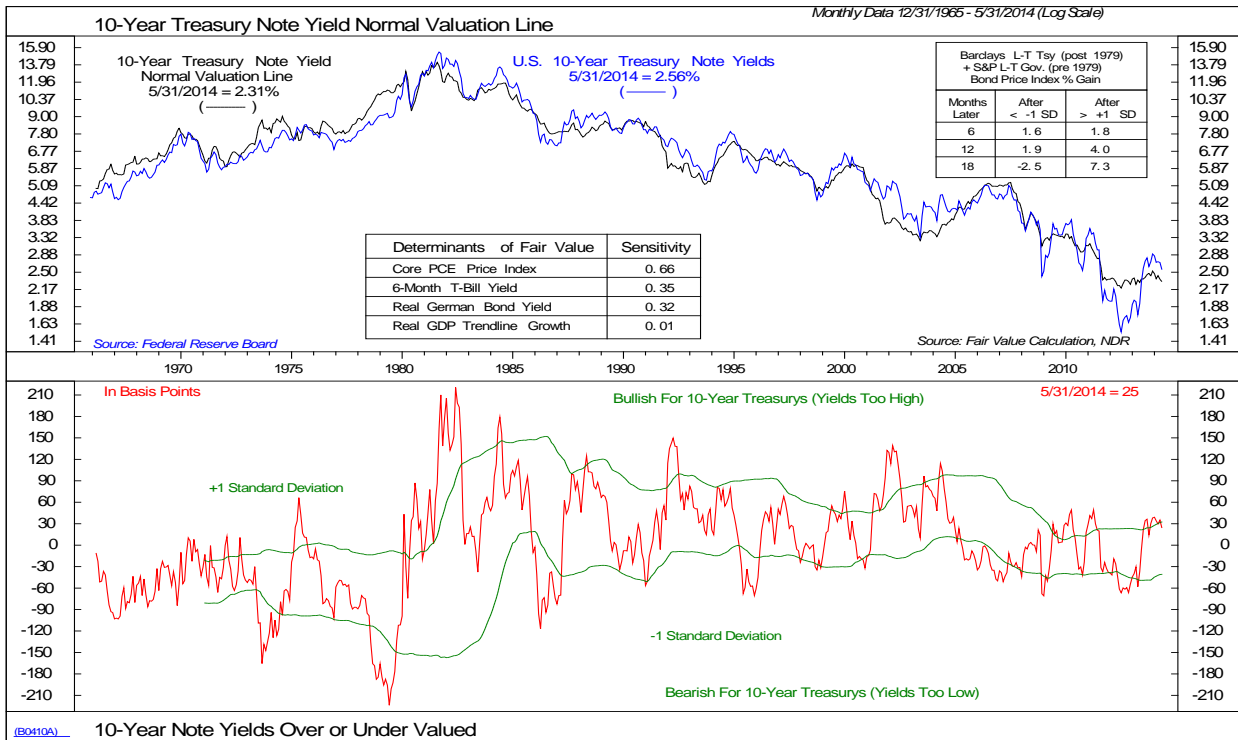


Fed-talk has turned from taper pacing to the timing of rate hikes, still a year out.



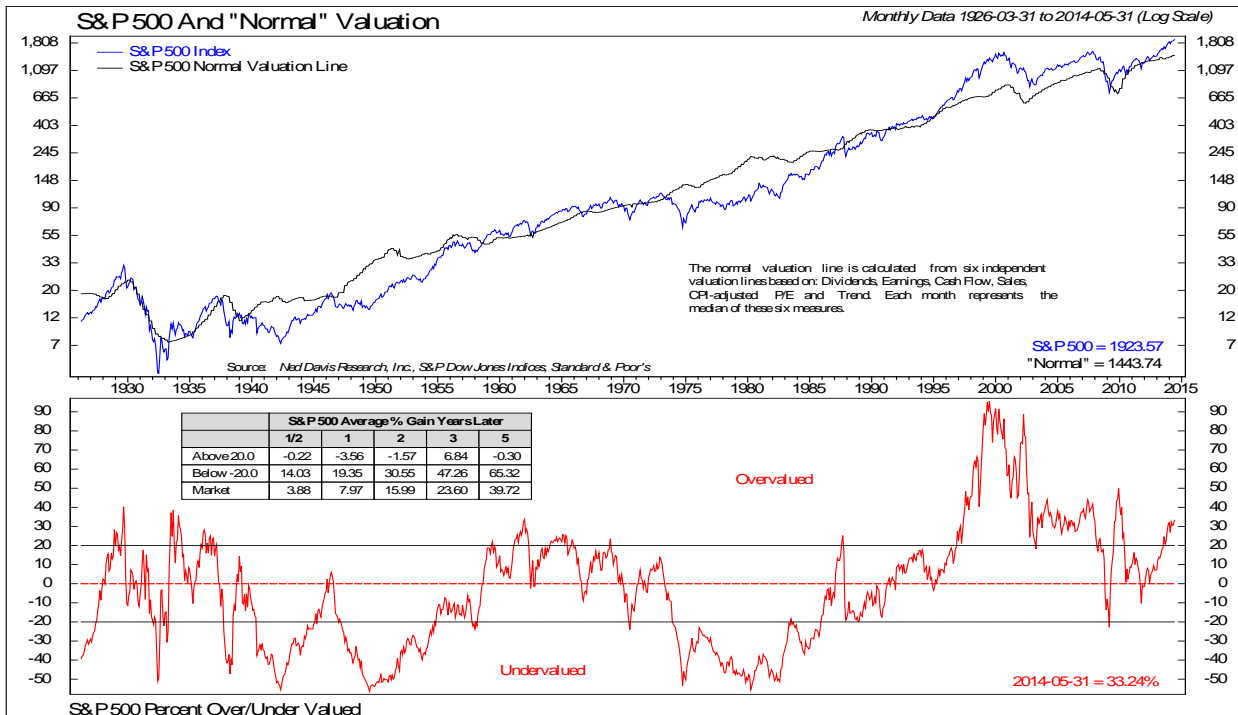
Source: Federal Reserve

Bond yields appear about right given the current macro backdrop.



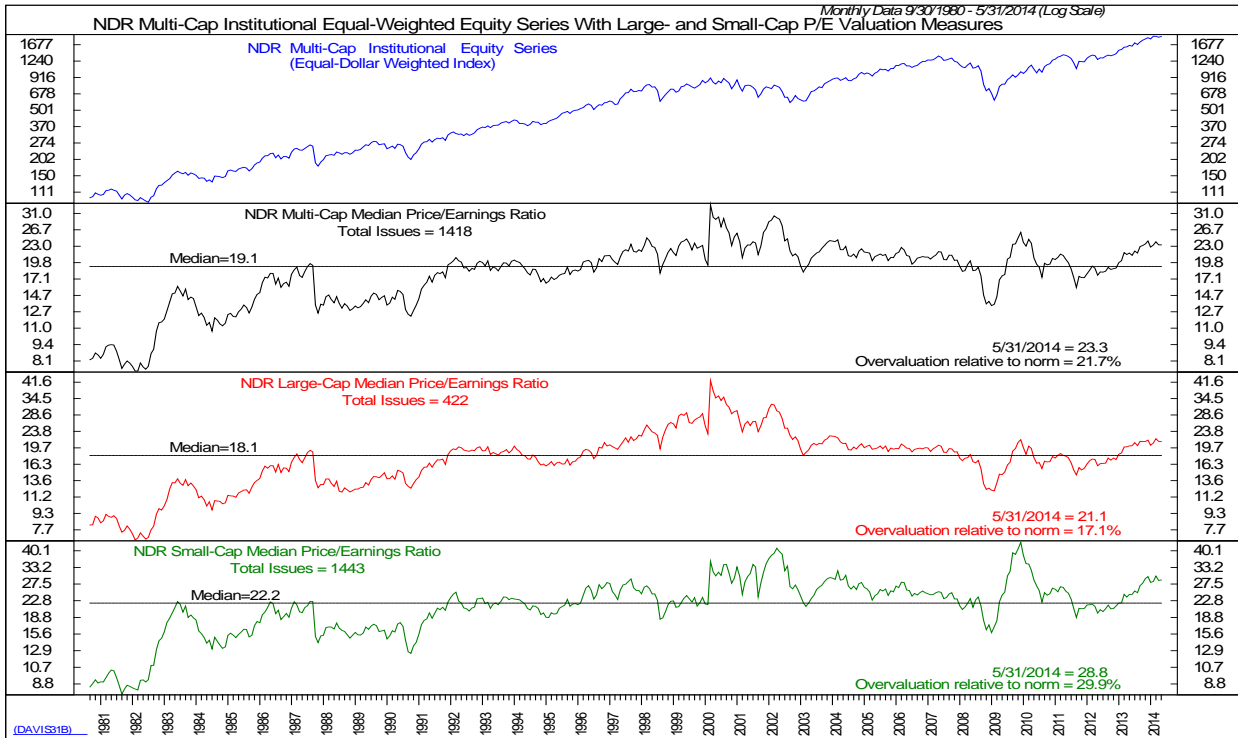
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Stocks remain overvalued – by about 30% based on this comprehensive look.



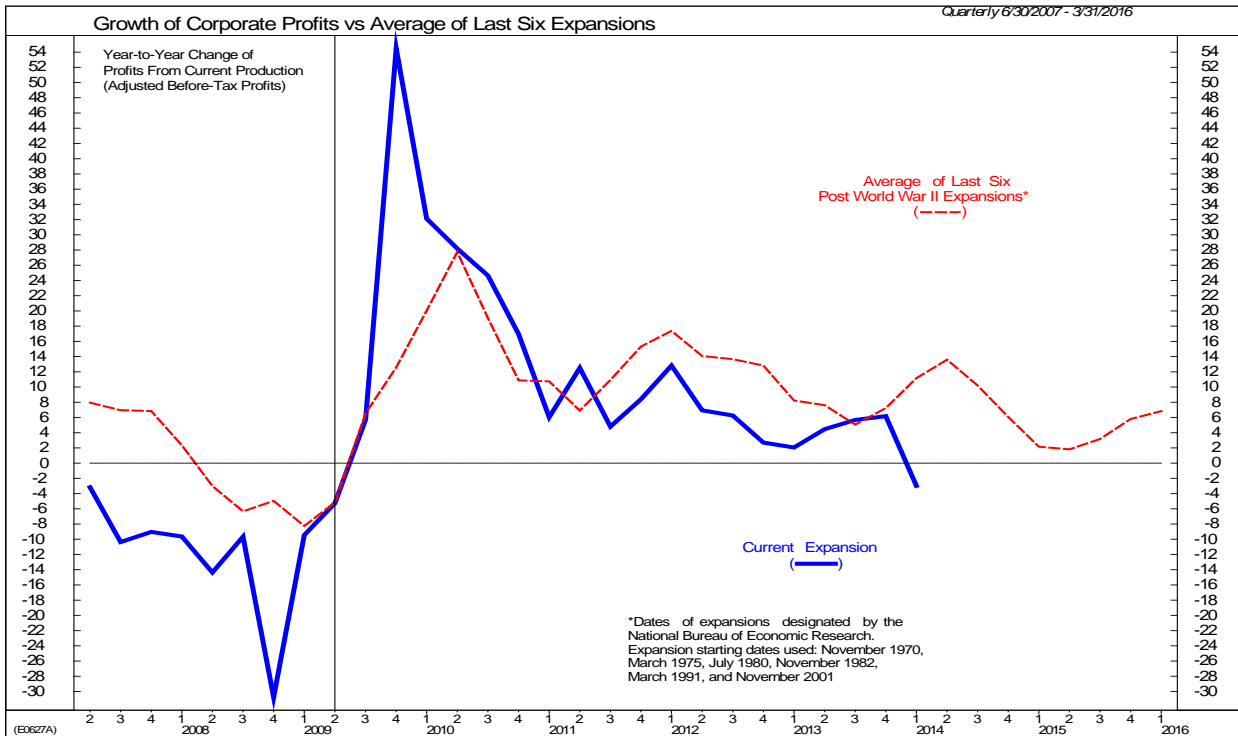
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From a size perspective, mid-caps are the least overvalued and small-caps, the most.



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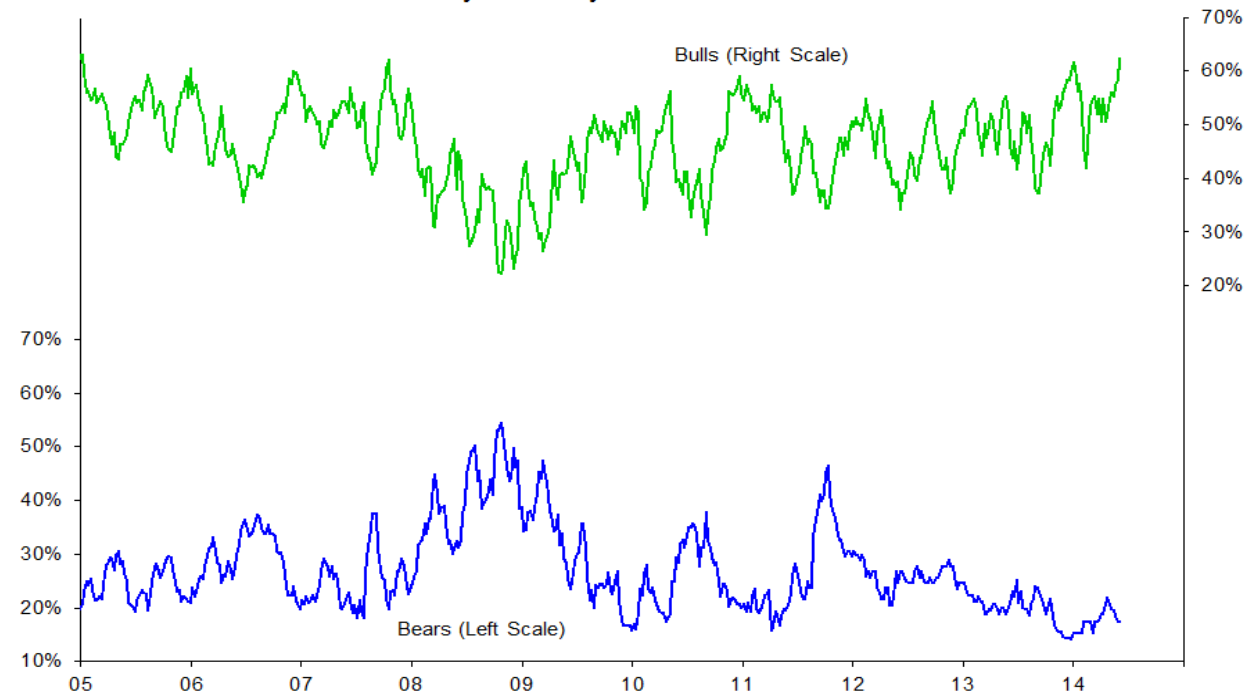
Earnings are not providing any valuation relief, and this is with margins still high.



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Now optimism is returning – advisory services are their most bullish in 10 years.

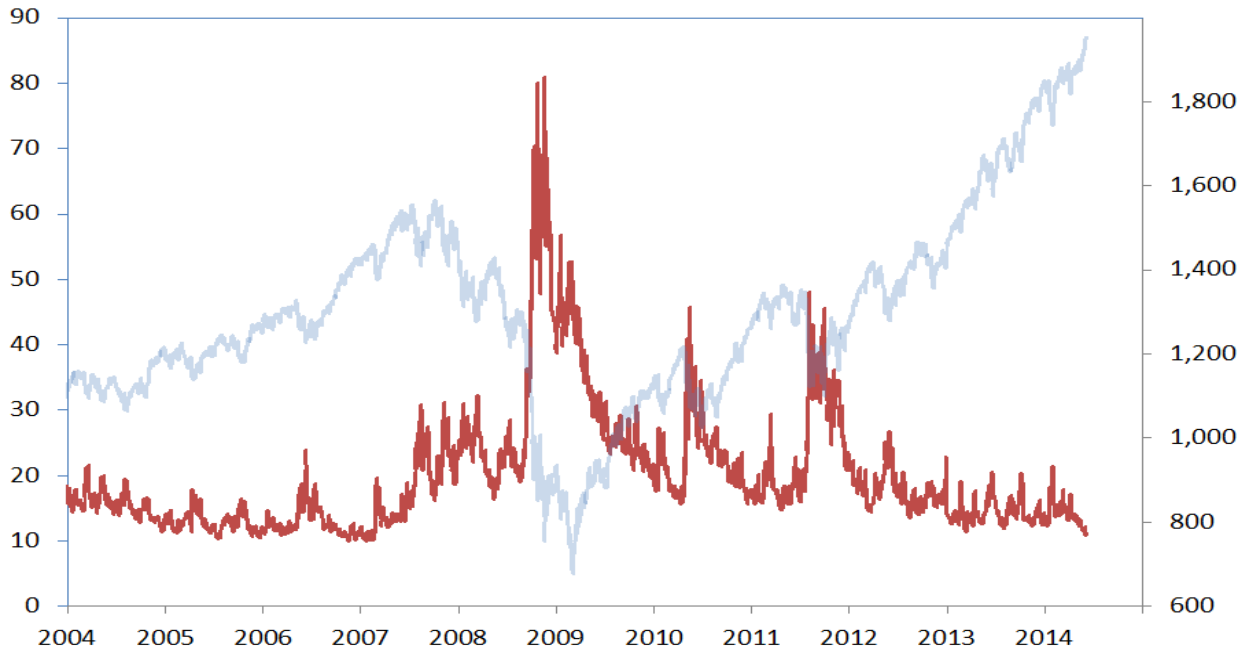
Weekly Advisory Service Sentiment



Source: Investors Intelligence

Dip-buying has become conditioned and complacency is now widespread.

Volatility and the S&P 500

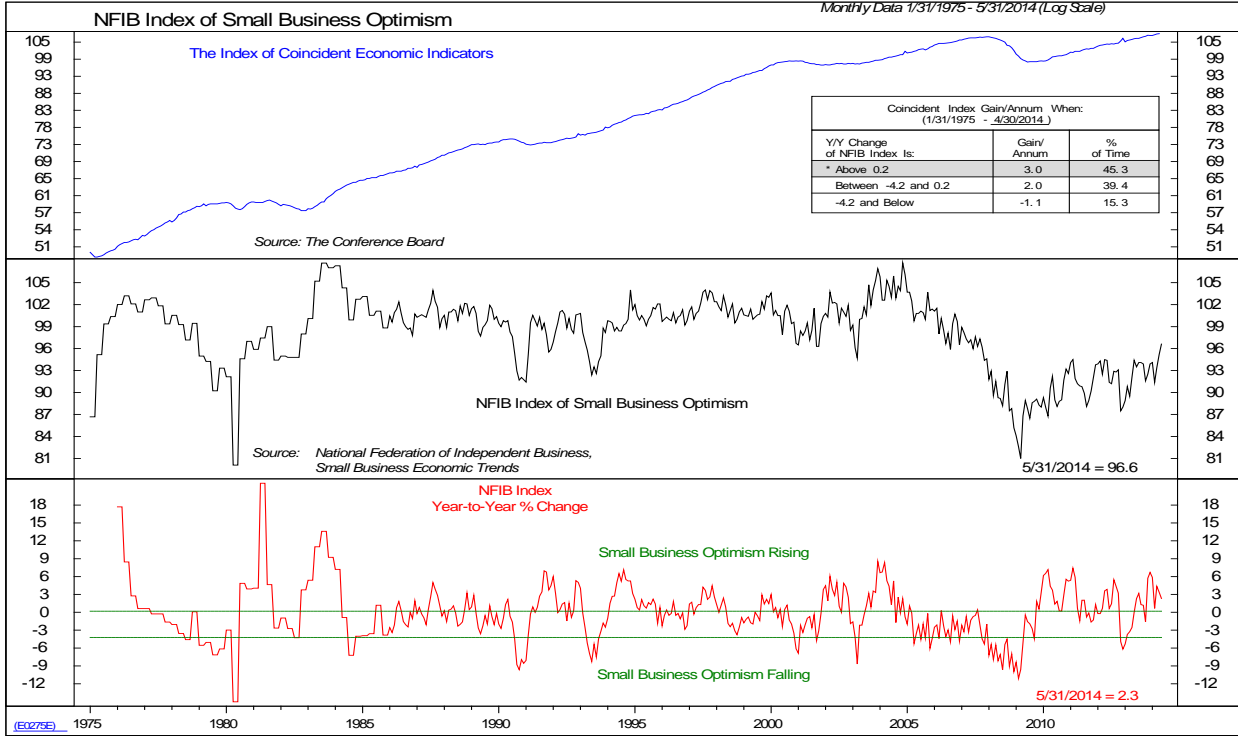


Source: CBOE, Wall Street Journal

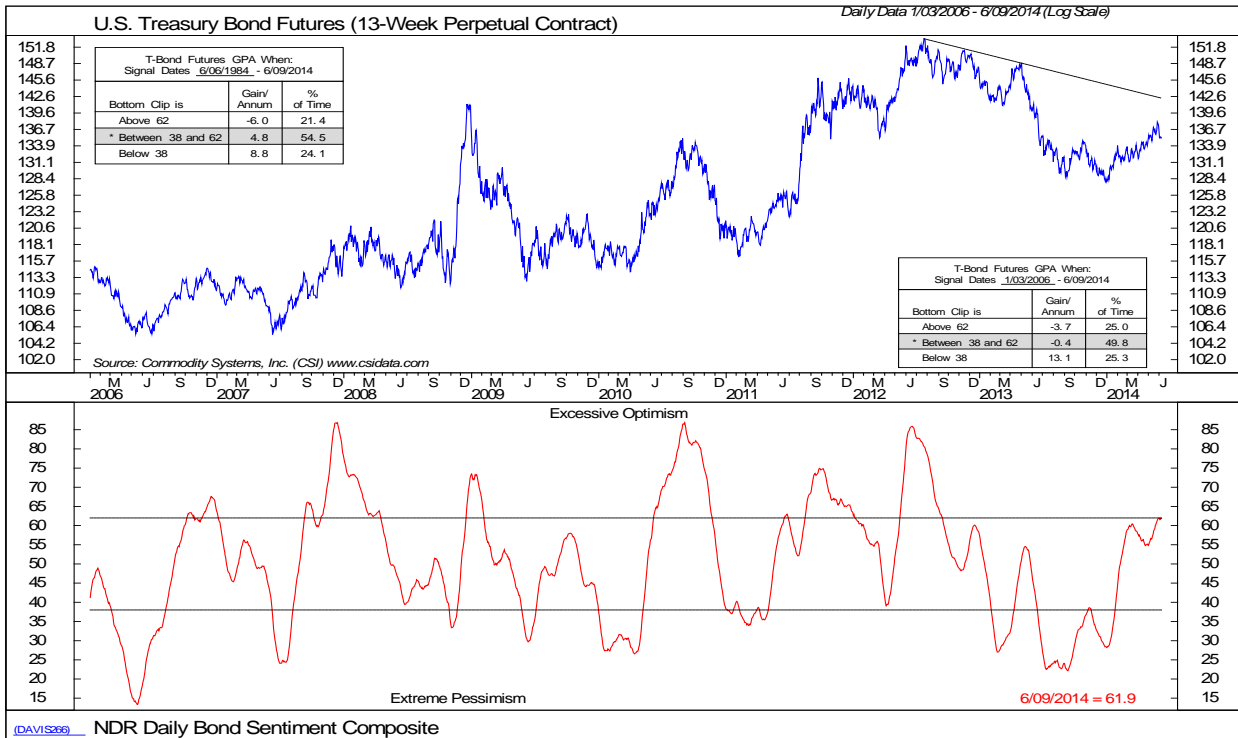
— VIX

— S&P 500 (right)

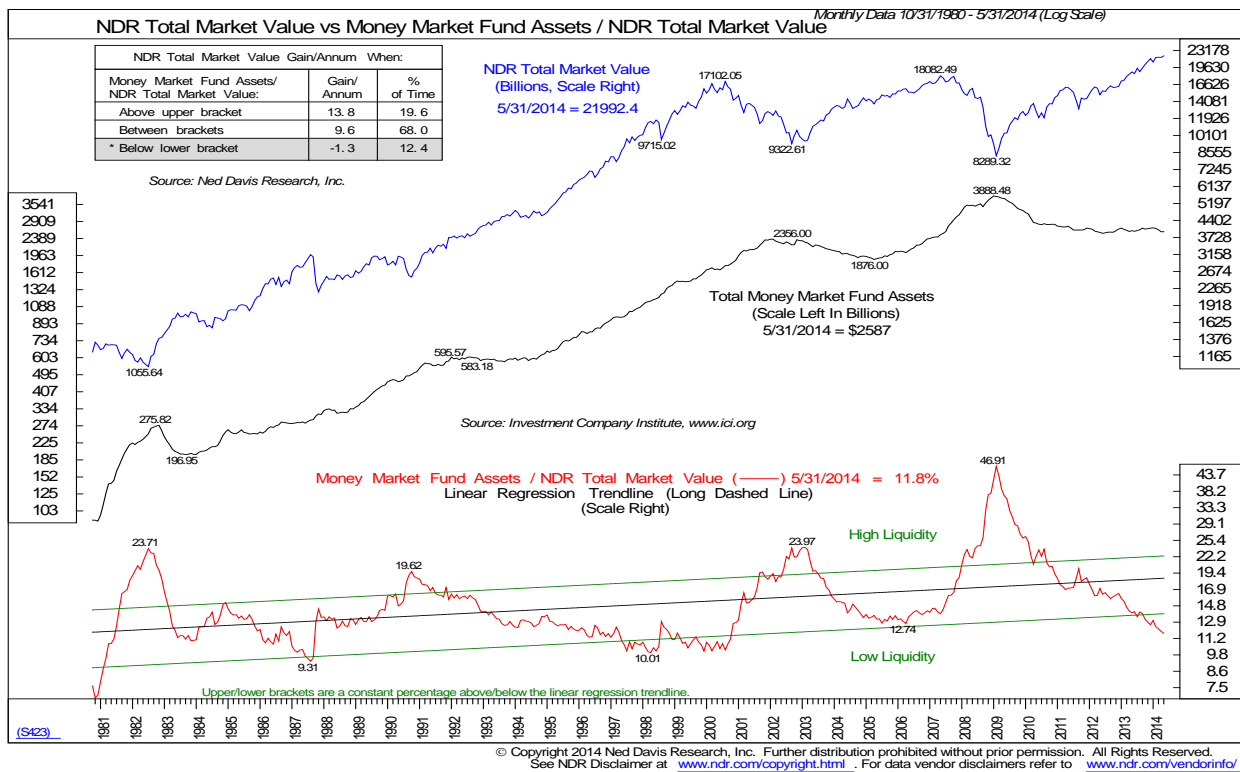
The economic optimism missing at the beginning of 2014 has begun to build.



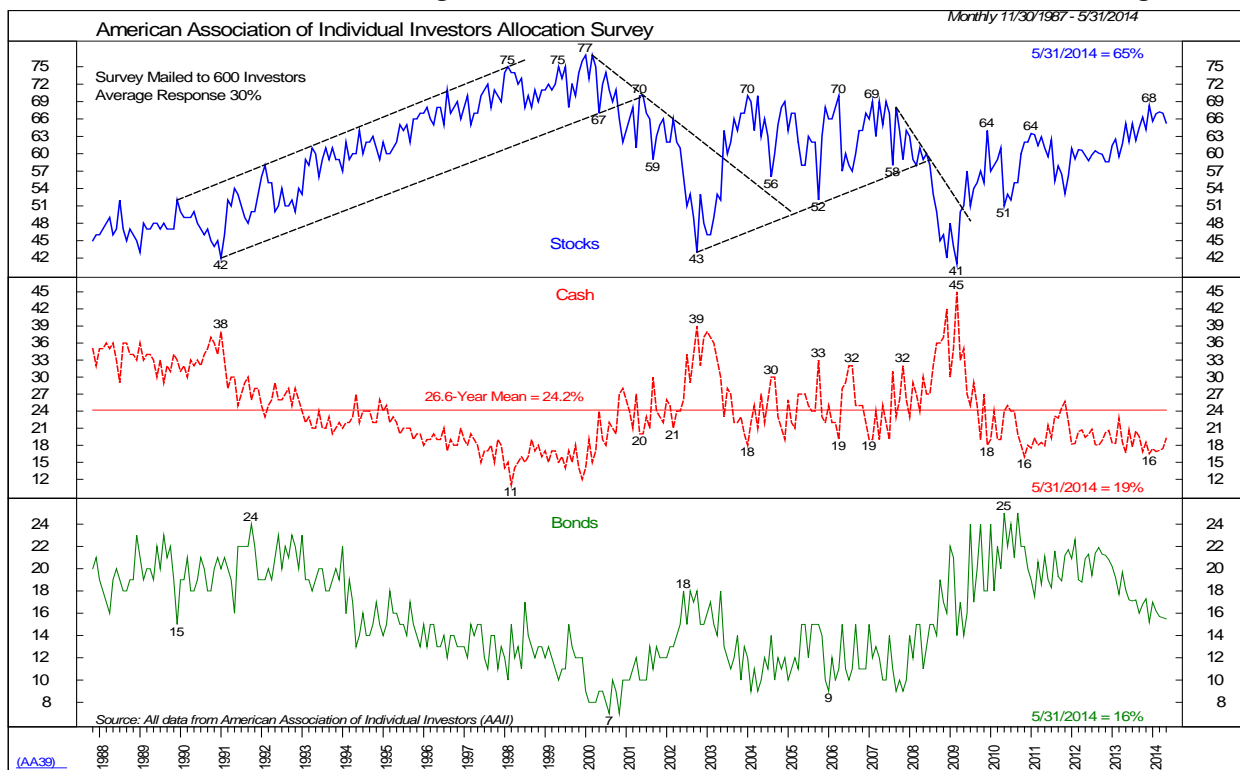
Bond sentiment has moved from excessive pessimism to widespread optimism.



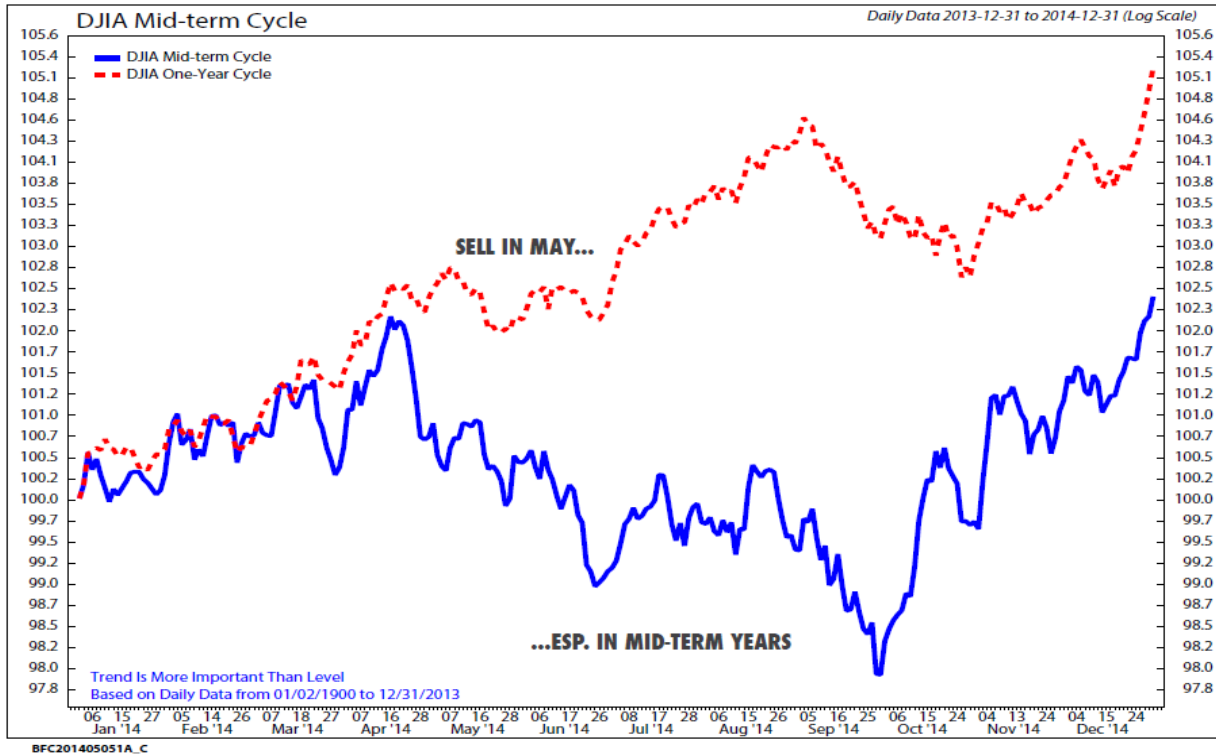
A lack of liquidity could exacerbate any selling that does emerge in 2014.



Allocations to stocks remain high and allocations to cash are well-below average.



Sell in May was a no show, but the pattern says look for weakness into mid-terms.



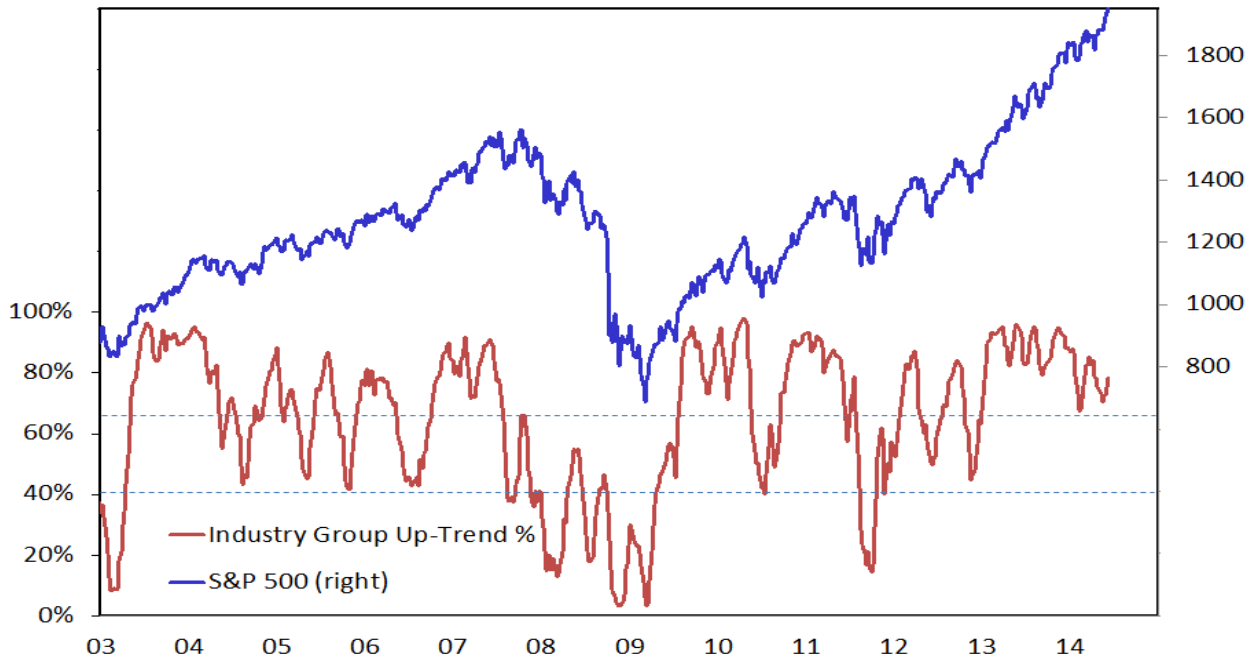
2014 is year 6 under Obama – the recent instances of a 6th year have been positive.

S&P 500 INDEX BY PRESIDENT											
Year	Johnson	Nixon	Ford	Carter	Reagan	Bush I	Clinton	Bush II	Obama	Median	% Positive
1	9.1	-11.4	N/A	-11.5	-9.7	27.3	7.1	-13.0	23.5	-1.3	50
2	-13.1	0.1	-29.7	1.1	14.8	-6.6	-1.5	-23.4	12.8	-1.5	44
3	20.1	10.8	31.5	12.3	17.3	26.3	34.1	26.4	0.0	20.1	89
4	7.7	15.6	19.1	25.8	1.4	4.5	20.3	9.0	13.4	13.4	100
5	N/A	-17.4	N/A	N/A	26.3	N/A	31.0	3.0	29.6	26.3	80
6	N/A	N/A	N/A	N/A	14.6	N/A	26.7	13.6	N/A	14.6	100
7	N/A	N/A	N/A	N/A	2.0	N/A	19.5	3.5	N/A	3.5	100
8	N/A	N/A	N/A	N/A	12.4	N/A	-10.1	-38.5	N/A	-10.1	33

Source: S&P Dow Jones Indices
Ned Davis Research Group

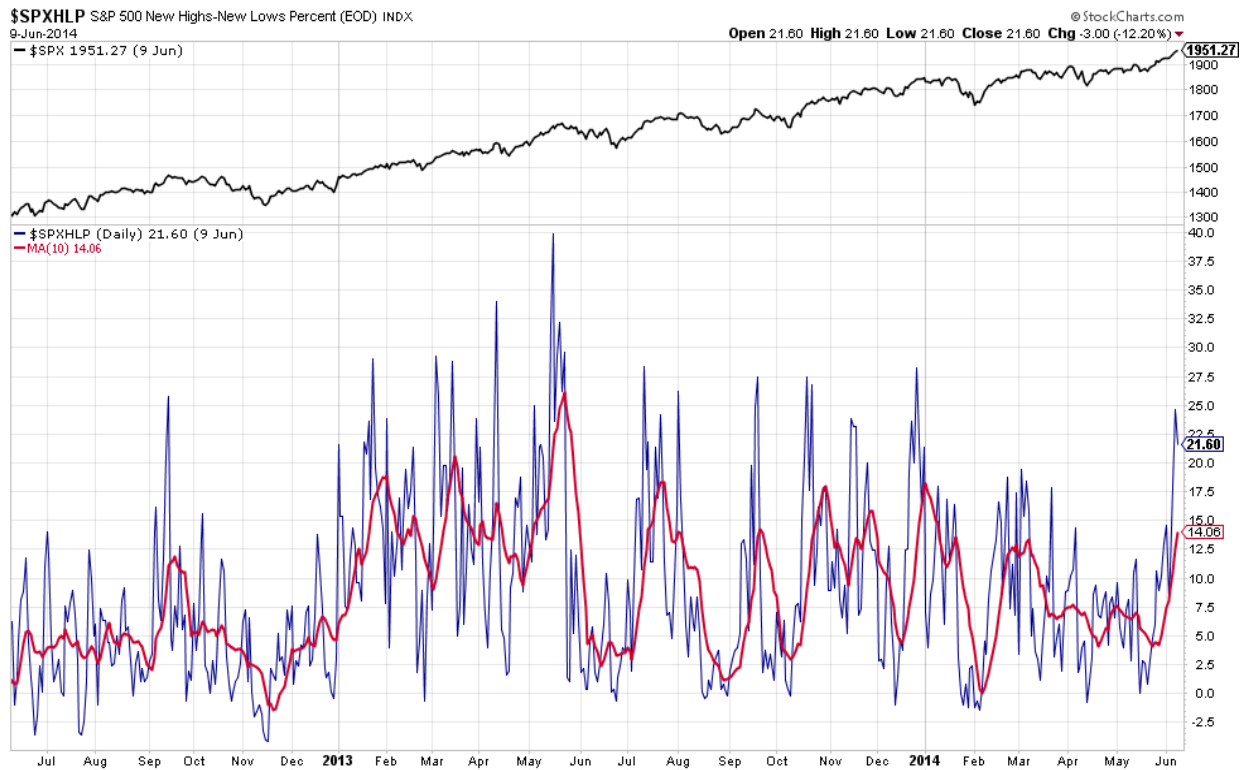
Breadth at the industry group level has deteriorated, but has not broken down.

S&P 500 and Industry Group Breadth



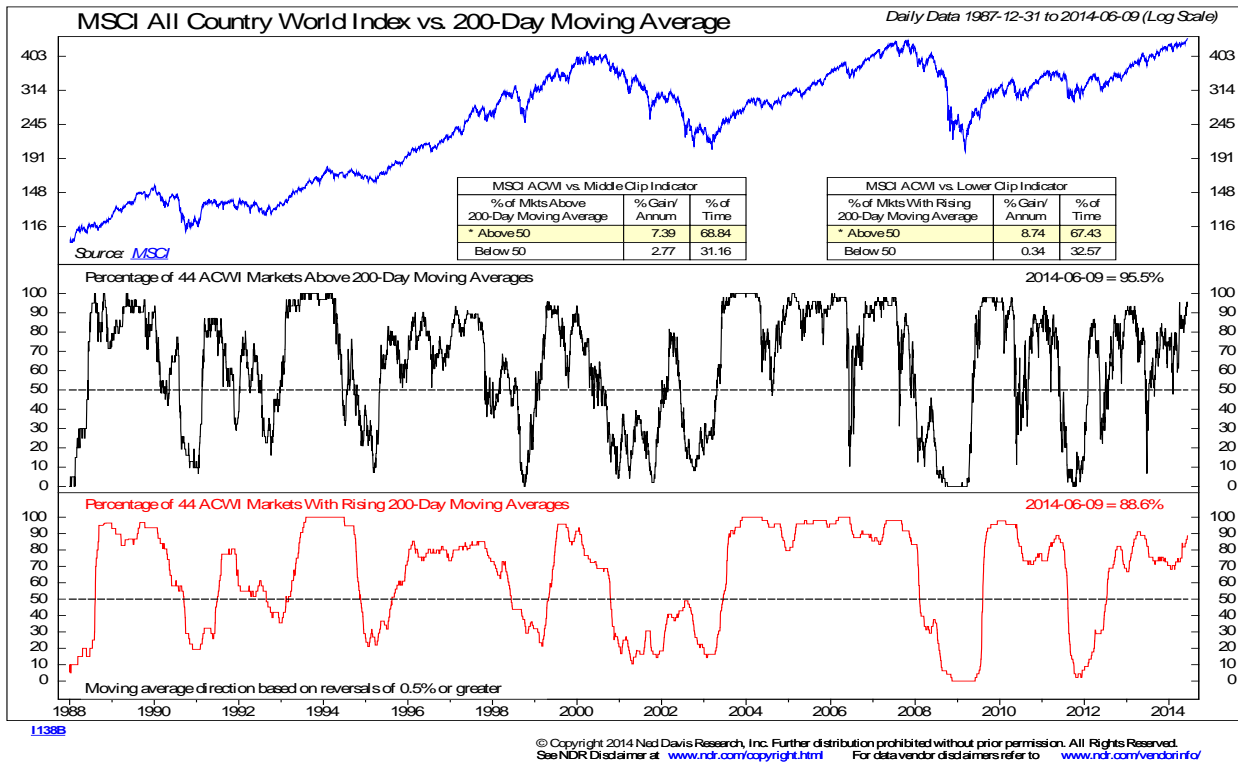
Source: FactSet, RWB Calculations

The number of new highs has expanded recently, but is still below previous peaks.

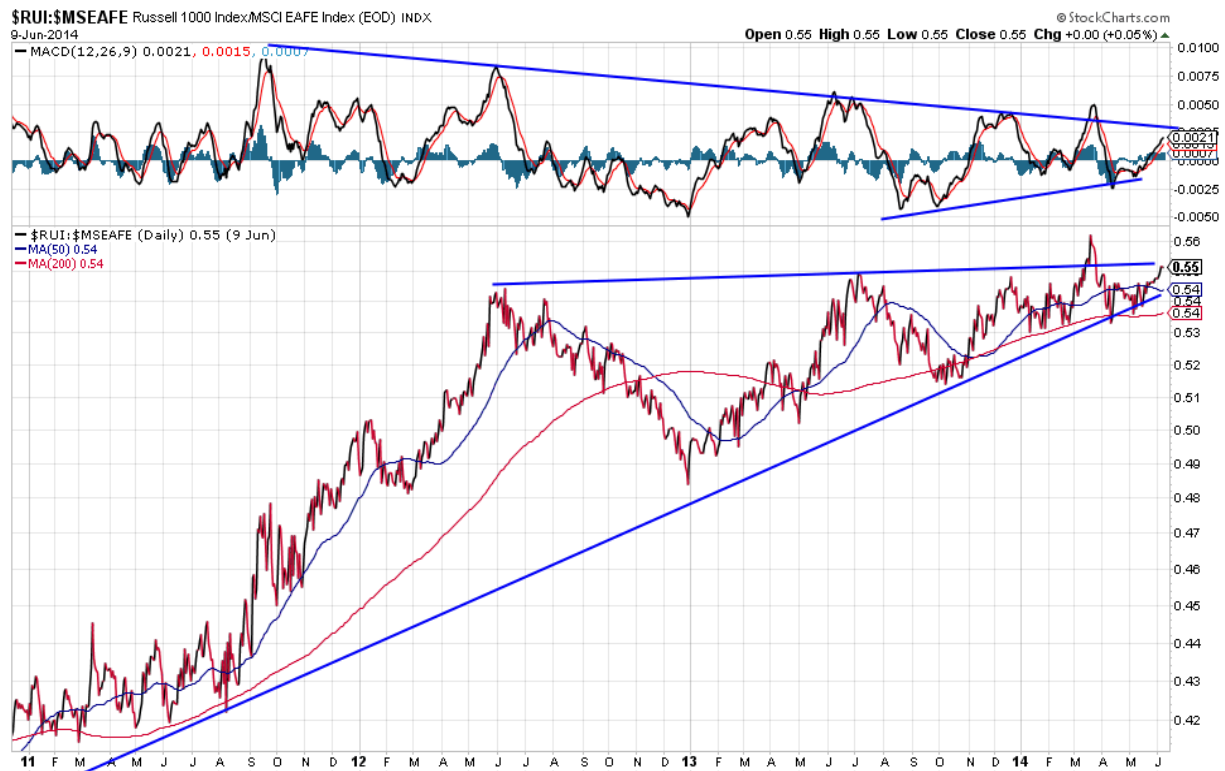


Source: StockCharts

Global breadth has improved with an increasing number of markets in rising trends.

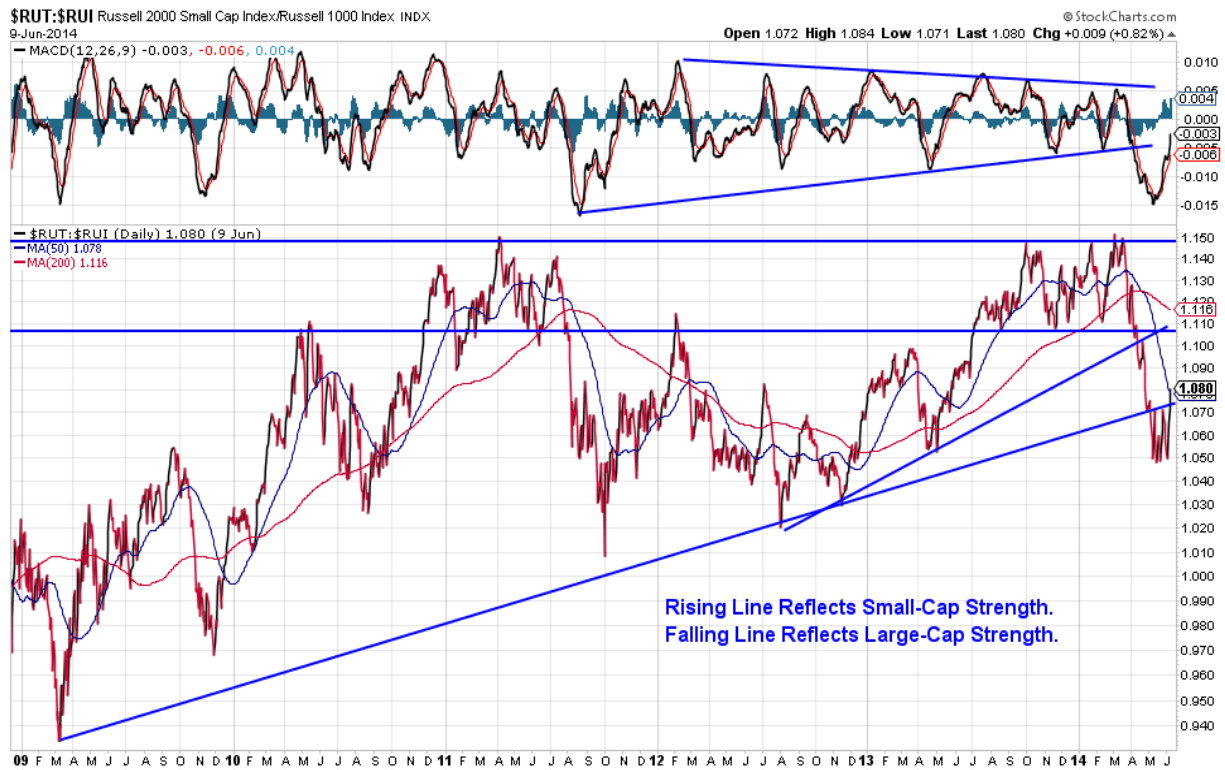


The trend favoring U.S. stocks over international exposure is poised to break out.



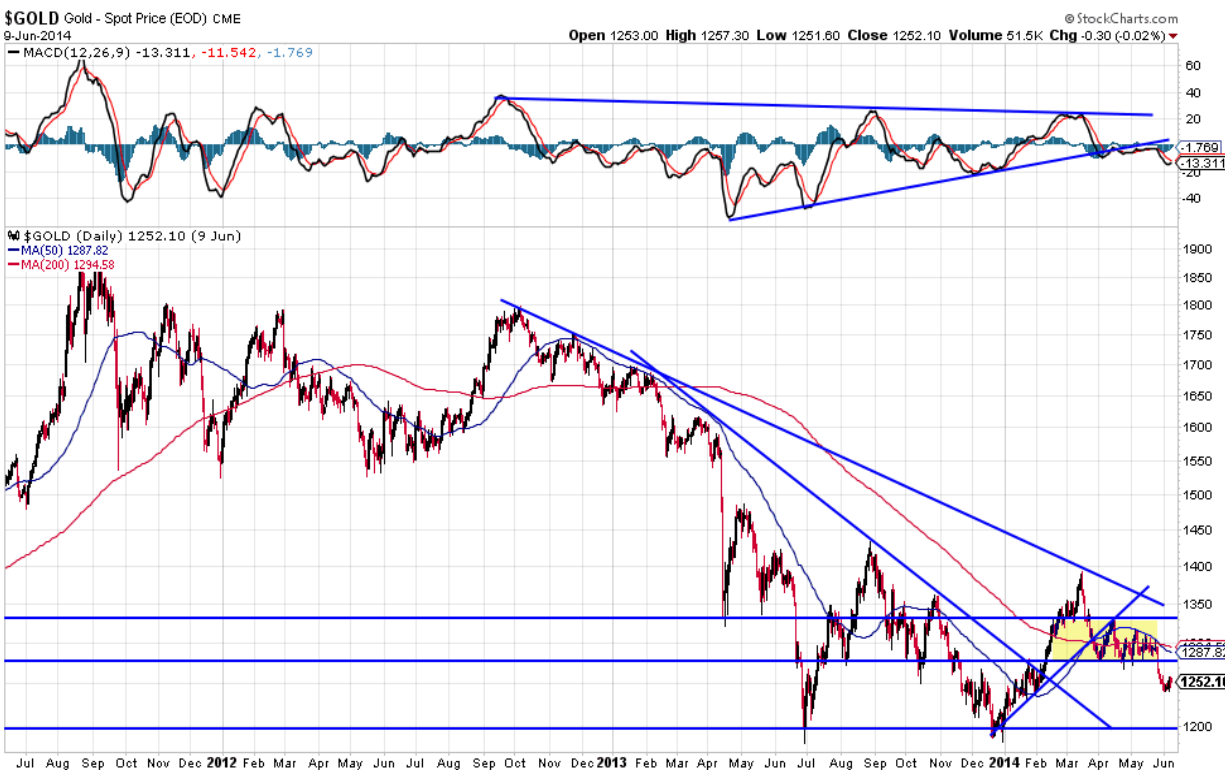
Source: StockCharts

Small-caps losing ground to large-caps is typical of the late stages of a cyclical rally.



Source: StockCharts

Gold rallied to its down-trend and still appears to be basing. Pessimism is emerging.



Source: StockCharts

Appendix – Important Disclosures

Disclaimers

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