

EVERGREEN  GAVEKAL



# Monthly Chartbook

APRIL 2015

BY JEFF EULBERG

## Who's driving?

These days, there's almost no debate that central banks are the driving force behind global asset prices. Central bankers are not only influencing valuations, but they're also setting the pace and magnitude of market movements. In many countries, despite it being seven years after the great recession, these banks still have the pedal to the metal when it comes to monetary policy. And they are using just about every tool at their disposal to force stocks higher and bond yields lower. Here in the US, though, it's become a different story. The Fed is now looking for the right moment to head in for a pit stop. While there is little doubt central bank decisions will dictate the ultimate direction of markets in 2015, the timing and the repercussions of these monetary decisions will ultimately determine the fate for asset prices.

With so many central bank decisions being determined by current economic data, we thought it would be timely to do a thorough review of the world's current economic climate. We'll start here in the US, where most Federal Open Market Committee (FOMC) members have stated that an eventual interest rate move higher will be "data-dependent". Going off that assumption, we'll highlight the most recent releases



that could affect this decision. Then, we'll move to the eurozone where quantitative easing is in the early stages. Finally, we'll review the data coming out Asia where many central banks have felt the need to follow suit and implement massive monetary easing.

BY JEFF DICKS & JEFF EULBERG

## CITIGROUP ECONOMIC SURPRISE INDEX

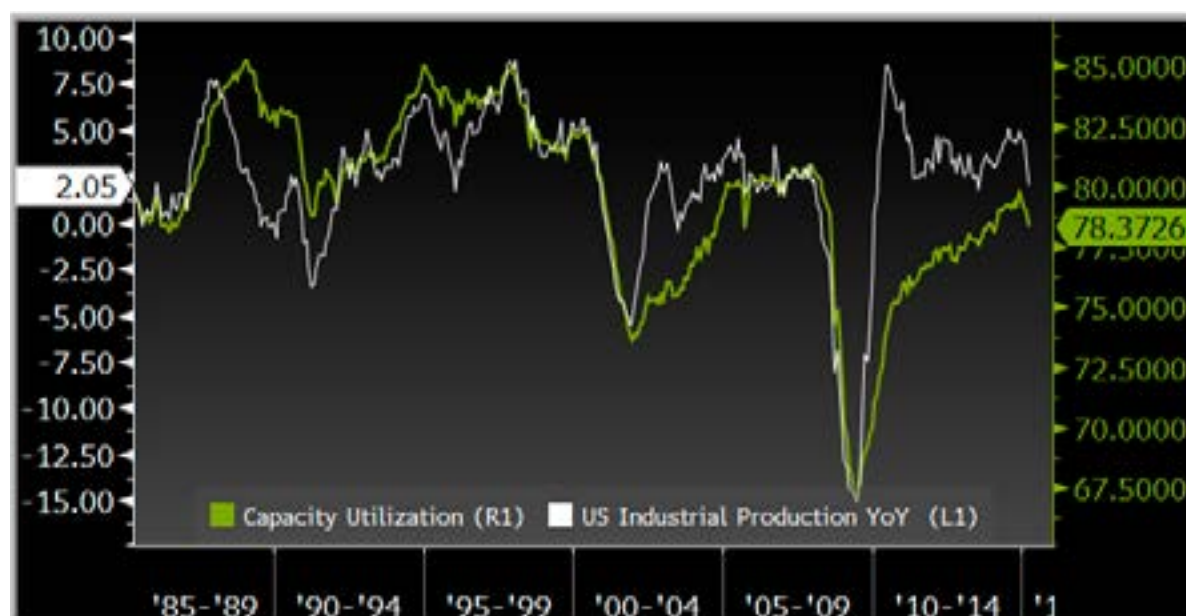


Source: Evergreen GaveKal, Bloomberg

In the US, as seen in Citigroup's Economic Surprise Index, recently released numbers have clearly disappointed relative to expectations. You'll notice this is not an uncommon event and has clearly taken place multiple times throughout this recovery. However, what's concerning to us is the magnitude of the decline. You can see the scale of this year's decline is much greater than last year, when harsh winter weather took a serious toll on the economy. 2014's Polar Vortex 1.0 led to a -2% reading in last year's first quarter. While we don't anticipate a negative GDP number in this year's Q1, another weak opening quarter is certainly not what the Fed was hoping for as it prepares to raise short-term interest rates. Undoubtedly, it was hoping that a strong second half of 2014 would carry over into 2015. Unfortunately, the Fed must again hope that a strong second half will make up for a sluggish start to the year.

BY JEFF DICKS & JEFF EULBERG

## CAPACITY UTILIZATION AND INDUSTRIAL PRODUCTION YEAR-OVER-YEAR RESERVE



Source: Bloomberg, Evergreen GaveKal

A large drag from the aforementioned surprise index has been from the manufacturing sector. This part of the economy has been weighed down by an oil price decline of more than 50%, along with a significant rally in the US dollar. As you can see in this section's chart, capacity utilization has had its biggest drop this cycle and has fallen four straight months. This is a key data point because it illustrates the productive capacity of a country and indicates that US producers appear to be losing their luster. Further confirming this viewpoint, industrial production has also seen a significant decline. Admittedly, data has been dragged down by unique circumstances such as a harsh winter weather and port closure's, but also changing currency dynamics and lower energy prices. Now, the FOMC will need to determine if the worst is in the rear-view mirror, or if the deterioration will continue throughout the year.

BY JEFF DICKS & JEFF EULBERG

## ISM MANUFACTURING PMI AND DURABLE GOODS ORDERS YOY



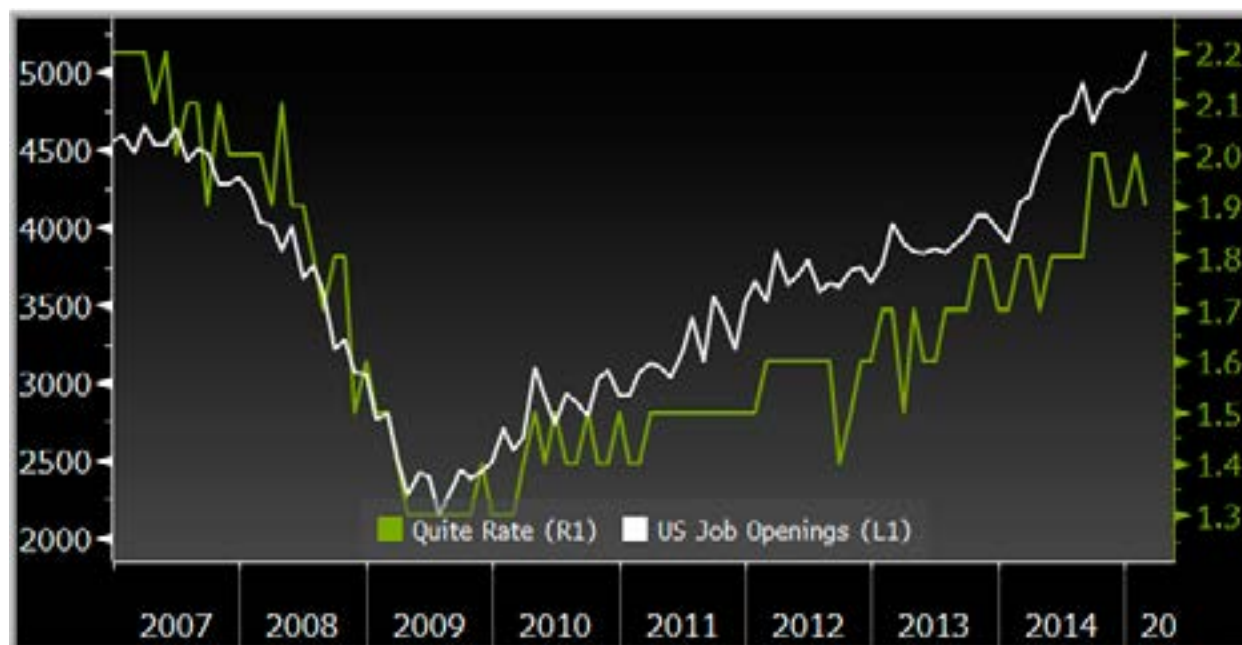
Source: Bloomberg, Evergreen GaveKal

Durable goods orders have carried their downward momentum (save for a spike in July last year due to a significant one-time spike in aircraft orders) into the first quarter of 2015. This metric is crucial because it is a leading indicator of the economy, representing new orders placed with manufacturers. The recent negative trend suggests the Q2 rebound might not be as pronounced as many economists think. It also reaffirms the point that US companies are fighting the headwind of a stronger dollar versus global competitors. Further, the decline in energy, along with the slowdown of US shale production, has led to a perfect storm for manufacturers in the US. This convergence is clearly illustrated by the sharp decline in the ISM manufacturing survey.



BY JEFF DICKS & JEFF EULBERG

## US JOB OPENINGS AND QUIT RATE

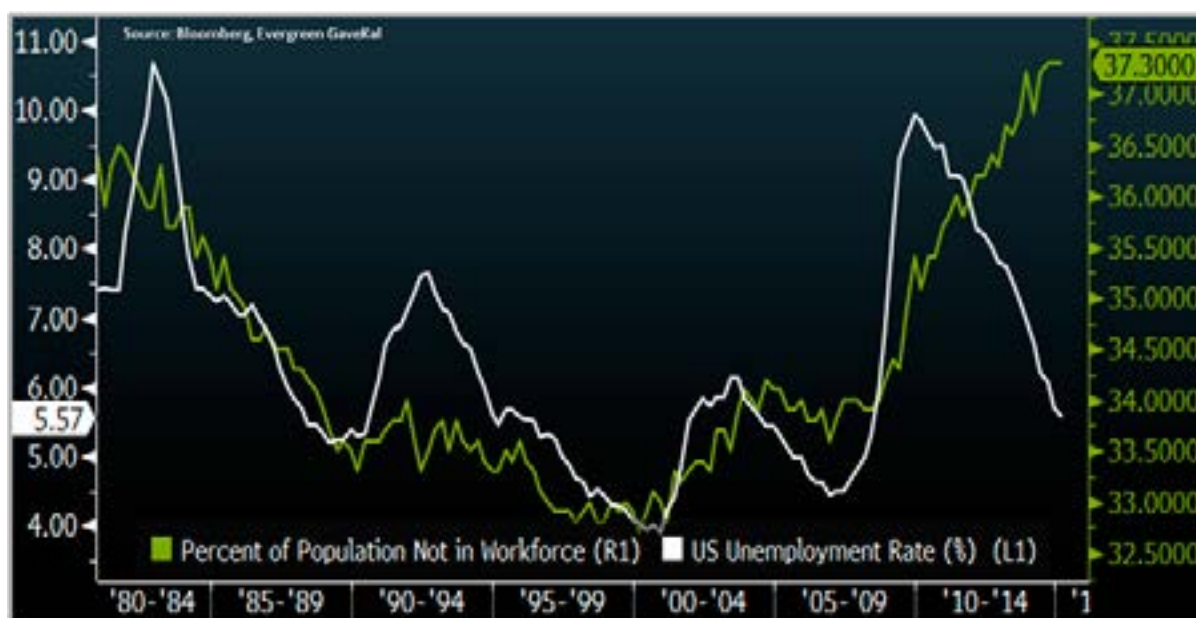


Source: Bloomberg, Evergreen GaveKal

On the bright side for the US, we've seen continued strength in job openings, which now sit at a 14-year high. Additionally, the quit rate, a measure the Fed uses to determine the number of people willing to leave their current position, has continued to trend higher over the last four years. In a sense, this is measure of how confident workers are that they'll be rehired. So, these two stats very much go hand in hand. They also highlight how much stronger the labor market is today, compared to the abyss of the last recession.

BY JEFF DICKS & JEFF EULBERG

## UNEMPLOYMENT RATE AND SHARE OF POPULATION NOT IN WORKFORCE

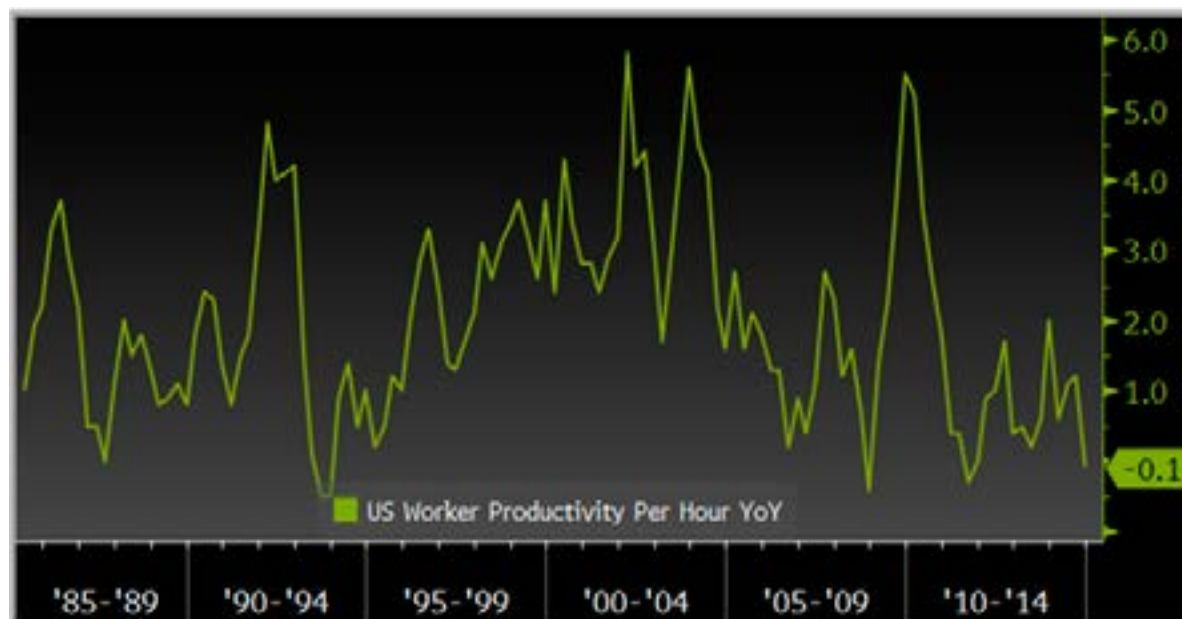


Source: Bloomberg, Evergreen GaveKal

Along the lines of a stronger labor market, we have seen the unemployment rate make significant strides over the last several years. Today's unemployment rate of 5.57% is close to what the Fed considers normal—roughly 5.0-5.2%. The problem is that, historically, when unemployment improves, we've also seen a fairly tight linkage to a rise in the number of people in the labor force. It makes sense: more people finding jobs, the more people that will want to participate in the labor market. This time around, however, the relationship has broken down. The percentage of the population not in the labor force continues to make new highs, which has artificially lowered the unemployment rate. Basically, this is an unhealthy form of lower unemployment, and those not in the workforce will likely continue to drag on the economy.

BY JEFF DICKS & JEFF EULBERG

## US WORKER PRODUCTIVITY



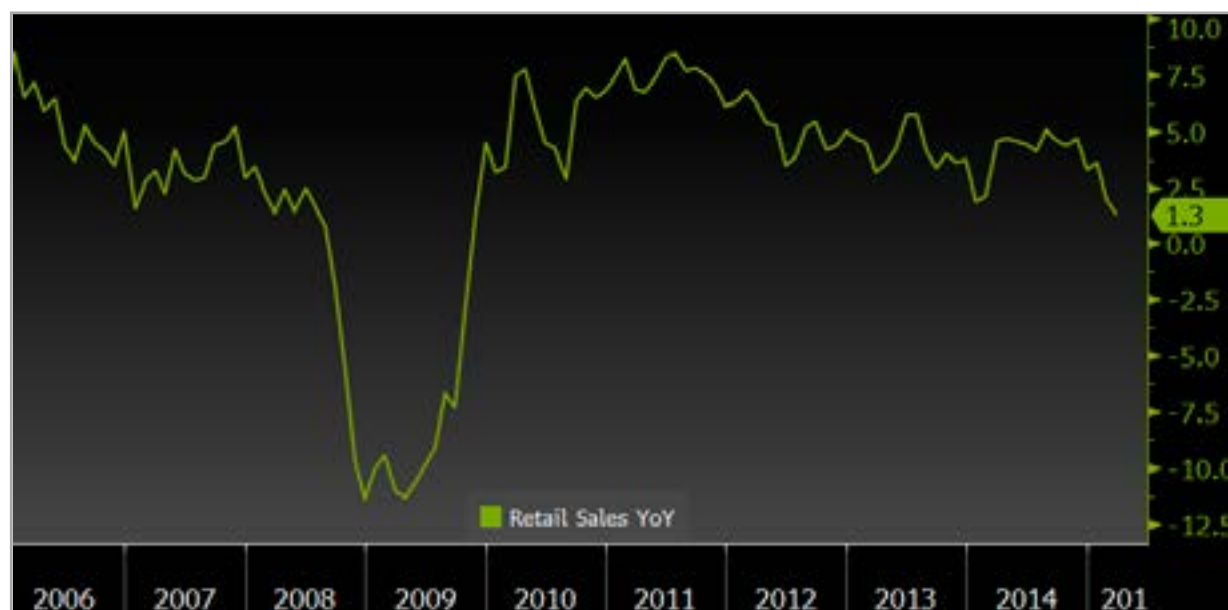
Source: Bloomberg, Evergreen GaveKal

Another issue with the labor market, and the economy for that matter, has been the plunge in worker productivity. Growth in gross domestic product (GDP) can be attributed to three factors: 1) a greater number of people in the workforce (Labor); 2) more equipment to work with (Capital); 3) higher productivity from labor and capital (Productivity). Recently, the latter has been a major drag on the economy and is a key reason this recovery has had the weakest GDP growth on record. A leading cause of the productivity decline is the lack of investment from corporate America. As we've written about before, instead of investing in productive assets, corporations have used excess capital to buy back stock. This has caused the average age of fixed assets, according to Gluskin Sheff economist David Rosenberg, to hit the highest mark since 1958! Unless this trend starts to move the other way, old fixed assets will impair future growth.



BY JEFF DICKS & JEFF EULBERG

## RETAIL SALES YOY

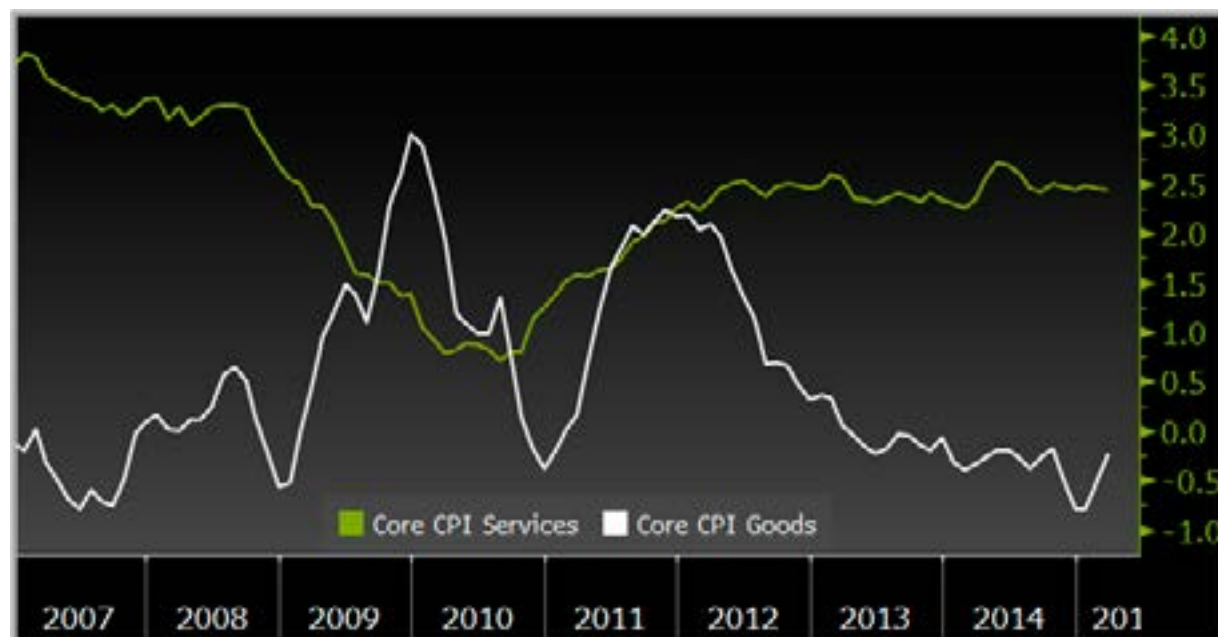


Source: Bloomberg, Evergreen GaveKal

As mentioned earlier, the labor market has no doubt improved, but still has its issues. This may be why we have seen soft retail sales amid low unemployment. As you can see in the chart to the left, retail sales have been trending lower for several years—likely a function of less people in the workforce. This year, while retail sales were down by 1.3% from the previous year, if we take the harsh winter weather into account, the number may not be as bad as it looks. But all in all, despite some headwinds, the consumer looks poised to rebound for the rest of 2015.

BY JEFF DICKS & JEFF EULBERG

## CORE CPI GOODS AND SERVICES



Source: Bloomberg, Evergreen GaveKal

When analyzing price stability measures, the Fed usually leans on the index for personal consumption expenditures, as opposed to the far better-known consumer price index (CPI) that you see in this section. But we want to illustrate the current level at which prices are rising in the service-based economy, compared to the stagnant prices of goods. In recent statements, FOMC members have mostly deflected concerns about declining prices, generally attributing them to the 50% crash in oil. Yet, a continued slide in the cost of goods, in spite of service-based price inflation, would likely keep the Fed from raising rates anytime soon.

Overall, it now appears unlikely the Fed will raise rates in June. We do think the economy could rebound in the latter half of the year, but that revival has yet to show up in the data. Quite simply, 2015 is off to a very disappointing start for the US economy.

BY JEFF DICKS & JEFF EULBERG

## CITIGROUP EUROZONE ECONOMIC SURPRISE INDEX



Source: Bloomberg, Evergreen GaveKal

Unlike in America, recent economic data out of Europe has actually been exceeding expectations. While the European Central Bank (ECB) only officially started its quantitative easing (QE) in late March, this program's surprisingly strong results have already moved passive participants off the sidelines. Sustaining the momentum of the initial excitement will be key to the program's ultimate success. So far, though, the early returns are suggesting the once-flat-lining European economy may be showing signs of life.

## EUROZONE ECONOMIC FORECASTS

Country	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Economic Activity</b>										
1) Real GDP (YoY%)	0.39	-4.31	2.13	1.68	-0.37	0.05	1.29	1.65	1.84	1.80
2) CPI (YoY%)	3.32	0.56	1.85	2.81	2.29	1.46	0.66	0.16	1.30	1.53
3) Unemployment (%)	6.82	8.62	8.97	8.91	9.42	9.85	9.44	9.35	8.97	8.46
<b>External Balance</b>										
4) Curr. Acct. (% of GDP)	-0.31	0.58	1.18	1.27	2.05	2.60	1.98	2.11	2.09	1.89
<b>Fiscal Balance</b>										
5) Budget (% of GDP)	-1.69	-6.07	-5.73	-3.72	-3.49	-2.74	-2.44	-2.17	-1.73	-1.59
<b>Interest Rates</b>										
6) Central Bank Rate (%)	2.38	0.91	0.93	0.93	0.70	0.33	0.15	-	-	-
7) 3-Month Rate (%)	2.82	0.66	0.94	1.26	0.26	0.34	0.18	-	-	-
8) 2-Year Note (%)	1.92	1.41	1.57	1.41	-	-	0.17	0.15	-	-
9) 10-Year Note (%)	3.40	3.69	3.65	3.19	-	-	1.30	1.55	-	-

Source: Bloomberg, Evergreen GaveKal

Now, it should be noted, there is a huge difference between beating expectations and a legitimate economic recovery. As you can see in the table, economic results out of Europe over the next few years have a very low hurdle to jump. In fact, at no point in the next three years is Europe expected to grow by more than 2%. And, inflation expectations are so low that any positive number will likely be considered a huge success.

BY JEFF DICKS & JEFF EULBERG

## EUROZONE RETAIL SALES YEAR-OVER-YEAR



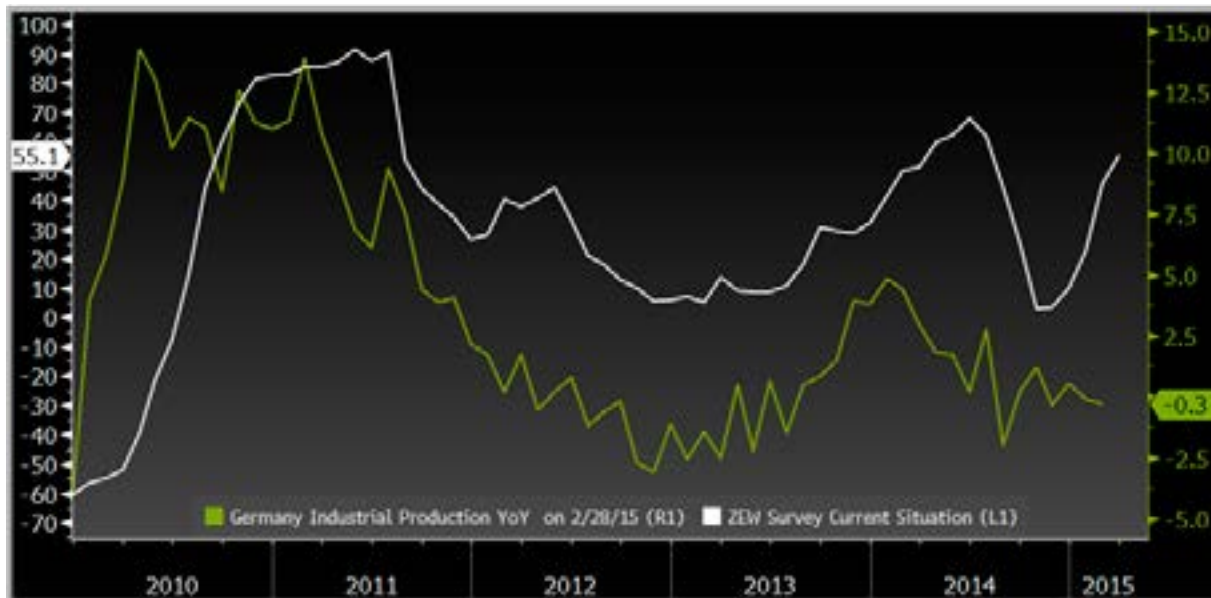
Source: Evergreen GaveKal, Bloomberg

The European consumer has certainly been inspired by the prospect of QE. For the last 15 months, retail data coming out of the region has been consistently encouraging. However, the 2014 data was recovering from an extremely weak 2013, and the European consumer has certainly benefited from lower oil prices. Still, the strength is clearly good news for the long-struggling Continent.



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## GERMAN INDUSTRIAL PRODUCTION AND ZEW SURVEY OF CURRENT ECONOMIC SITUATION

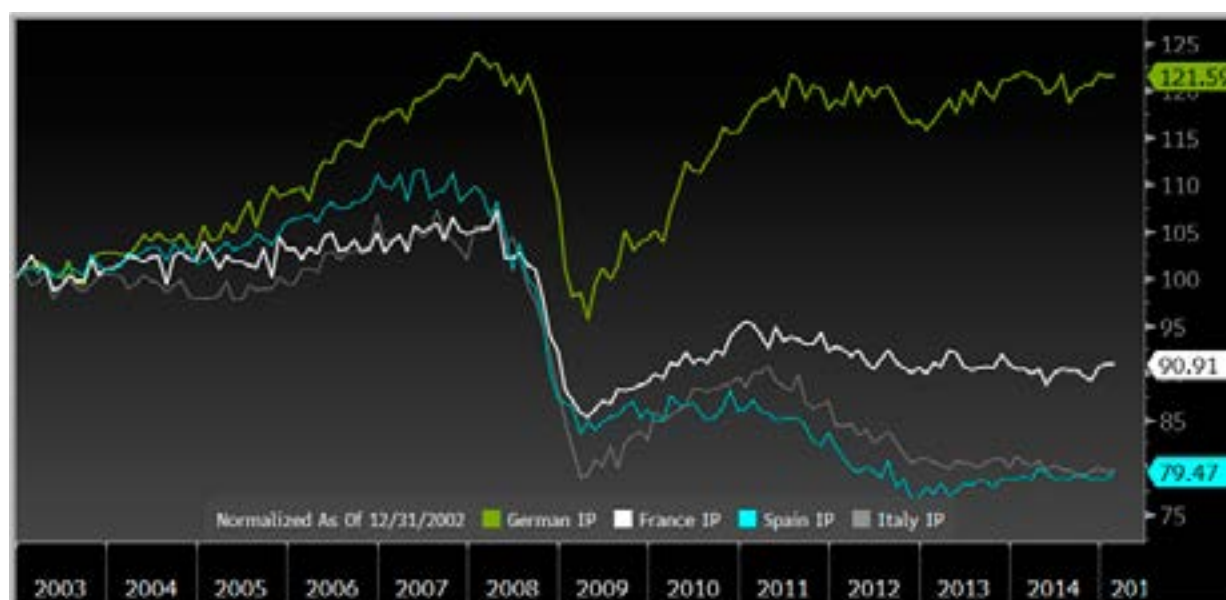


Source: Bloomberg, Evergreen GaveKal

While it may be too early to see ramifications from QE in the industrial production data, some recent survey results suggest future growth is around the corner. And the German economy, one of the rare bright spots in the EU, will almost certainly be the primary catalyst for this revival. As long as the surveys don't disappoint, it's likely that Germany will continue to see significant gains in manufacturing in the years ahead.

BY JEFF DICKS & JEFF EULBERG

## INDUSTRIAL PRODUCTION FOR GERMANY, FRANCE, SPAIN AND ITALY NORMALIZED 12/31/2002

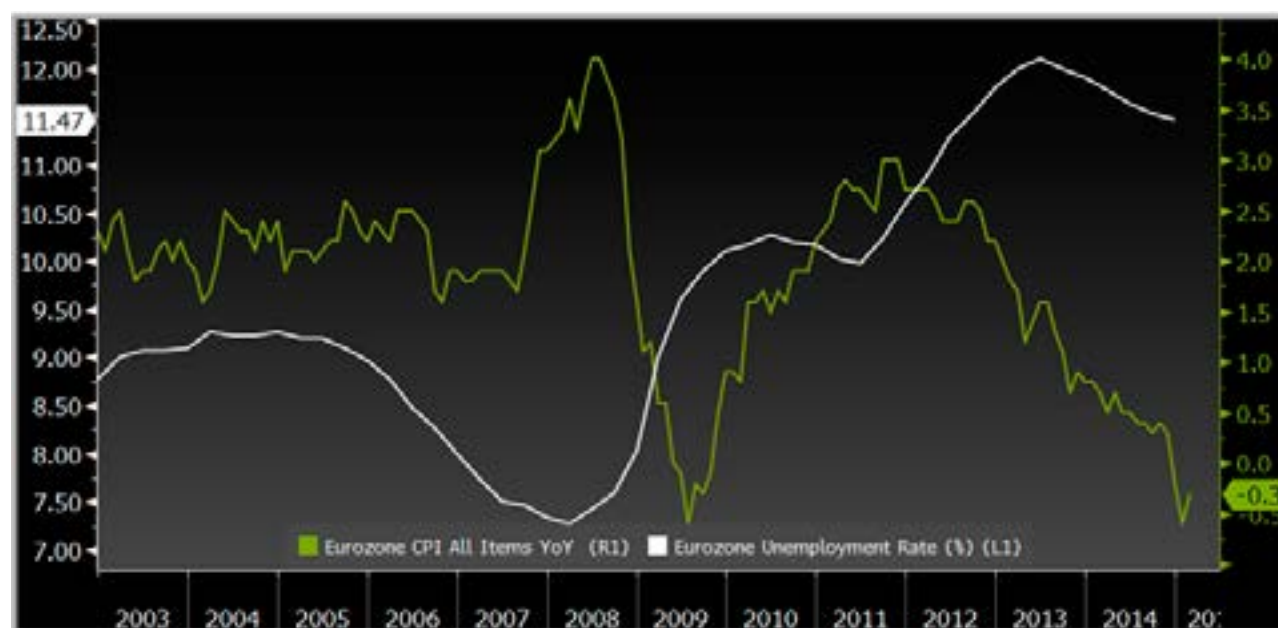


Source: Bloomberg, Evergreen GaveKal

It's clear the strength of the German economy is the least of the ECB's worries. As you can see here, German industrial production over the last decade has seriously outpaced that of its EU peers. The biggest disappointment to European QE may not be the lack of growth it spawns, but rather the increase in the dispersion between Germany and the other economies in the EU. There's little doubt the euro currency is significantly undervalued as far as Germany is concerned, implying an escalating boom for this manufacturing juggernaut.

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## EUROZONE CORE INFLATION AND UNEMPLOYMENT RATE

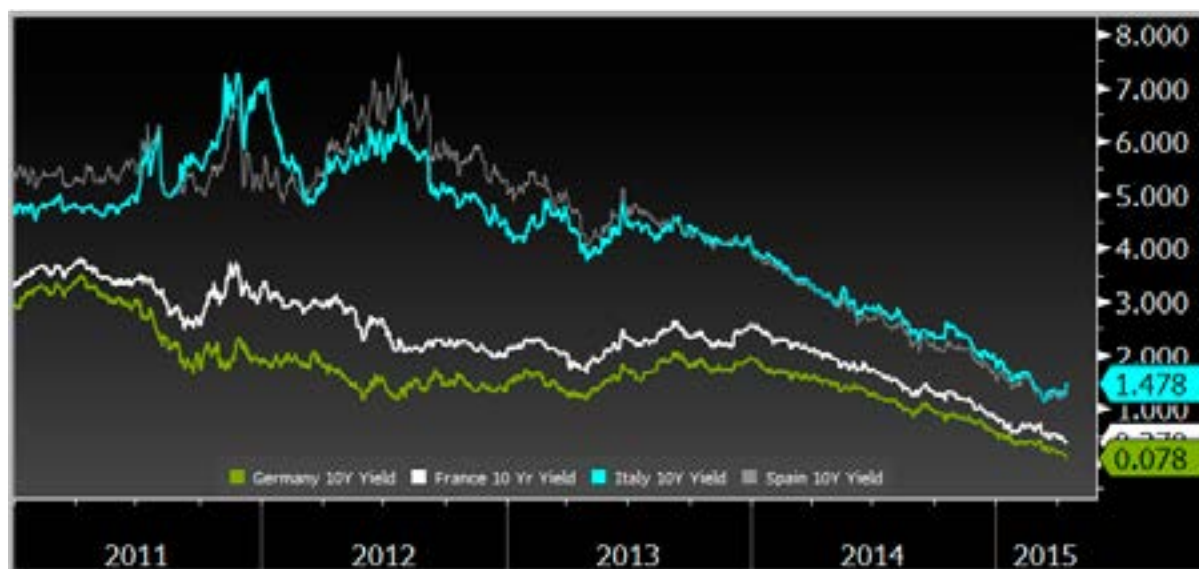


Source: Bloomberg, Evergreen GaveKal

Albeit slight, the Eurozone has seen a recent improvement in its unemployment rate. While still over 11.4%, the current trend does appear headed lower. Further, in spite of inflation remaining negative, headline numbers did turn up in the first quarter of 2015. Recent price movements can be directly linked to the swing in oil prices. Longer term, if a significantly depressed euro—combined with lower oil prices and increased liquidity—fail to spark inflation in the Eurozone, who knows what will.

BY JEFF DICKS & JEFF EULBERG

## GERMAN, FRENCH, SPANISH, AND ITALIAN 10-YEAR BOND YIELDS



Source: Bloomberg, Evergreen GaveKal

If the bond market lives up to its reputation as the best leading indicator for economic activity, don't expect inflation to arrive anytime soon. European bonds show no sign of imminent inflation taking away from their puny yields. While the massive intervention from central banks has definitely hindered some of the bond markets' forecasting ability, Germany is staring down negative yields on 10-year bonds. This suggests that deflation is still a very real concern in the Eurozone—and globally.

Overall, we are impressed with the recent economic data out of Europe, but the numbers are far from strong. With extremely high unemployment levels, huge debt burdens, and a lack of reform, it will likely be tough sledding for significant European growth over the next several years.

BY JEFF DICKS & JEFF EULBERG

## JAPANESE REAL GDP, REAL WAGE GROWTH, AND NATIONWIDE CPI



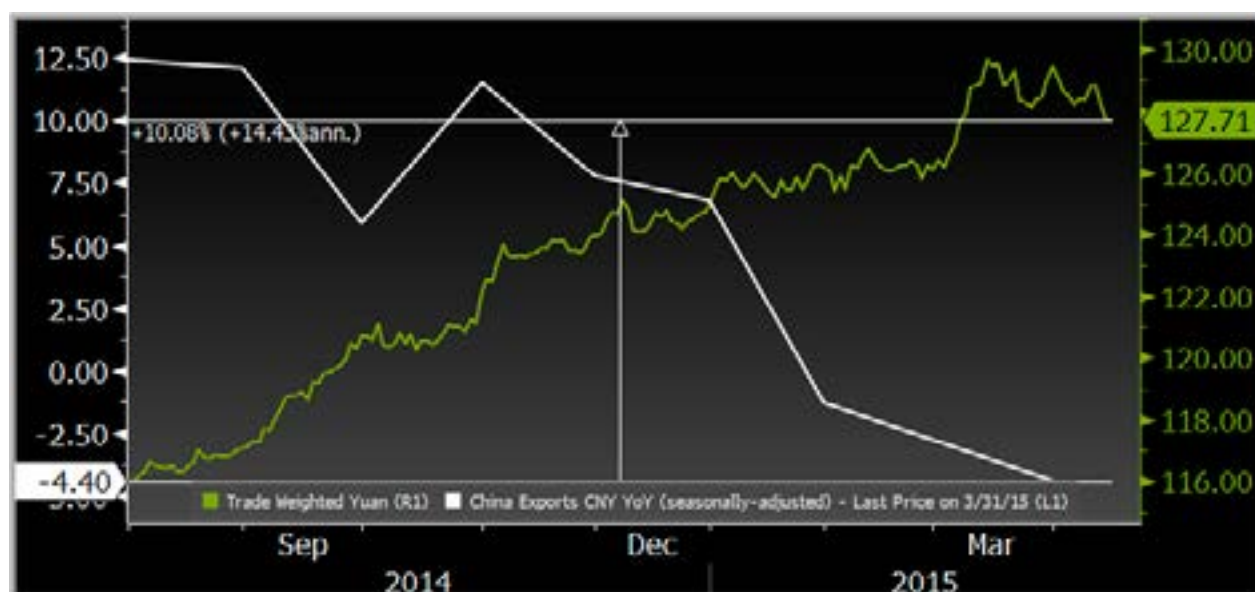
Source: Bloomberg, Evergreen GaveKal

Let's shift our focus to Japan—home to the mad monetarists, who are in the midst of the world's greatest monetary experiment. The Japanese government began buying securities to the sum of 70 trillion yen (roughly \$700 billion US) starting in April of 2013. The initial goals of the program were to push inflation over 2%, increase wages, and restore economic growth by 2015. While the chart here shows inflation of 2.4%, it's a bit misleading since a consumption tax hike was used to prop up prices. If you exclude this uptick, inflation is flat, GDP growth is non-existent, and wages are declining. Overall, Abenomics hasn't spurred the economic results the administration had hoped for. On the positive side, however, Japanese multinationals are seeing dramatic improvements in corporate profits due to the yen's huge decline, as well as new-found focus on increasing shareholder returns.



BY JEFF DICKS & JEFF EULBERG

## TRADE WEIGHTED CHINESE YUAN AND CHINESE EXPORTS YOY

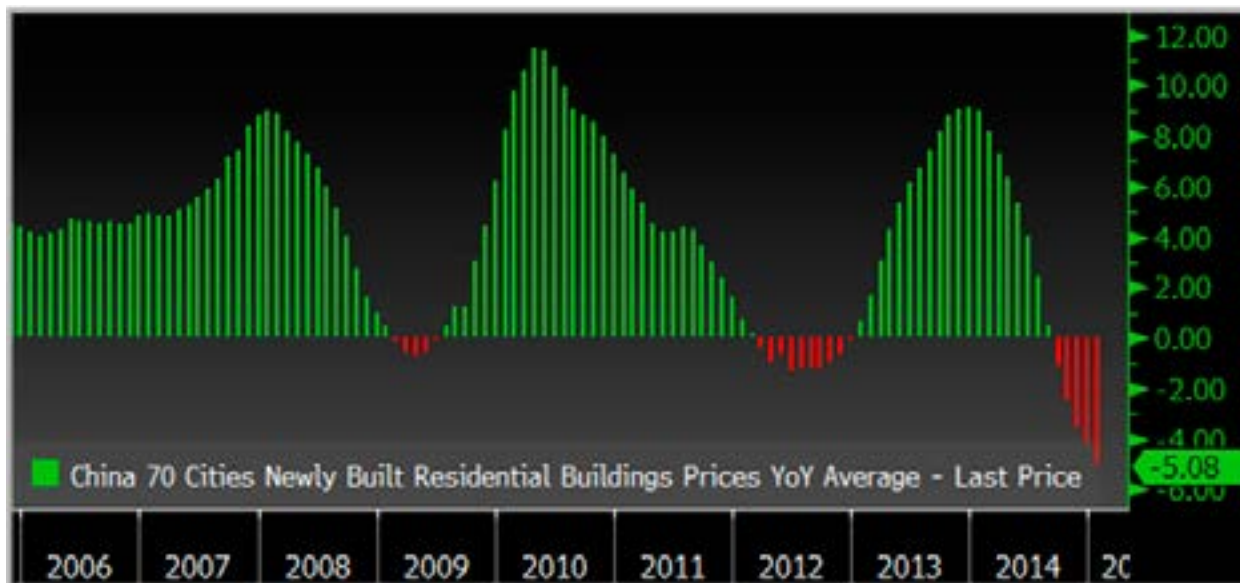


Source: Bloomberg, Evergreen GaveKal

Let's now jump over to China, where that country's central bank appears to have pulled out from the pit stop and is red-lining its stimulus engine. Just this week, in an effort to increase liquidity, the People's Bank of China lowered the reserve requirement ratio for its banking sector for the second time since February. It has also been cutting interest rates. As the chart on the left shows, China, the world's largest exporter, has experienced a significant decline in outbound shipments. It's clear that the Chinese economy is in a slow down phase. Some are convinced China will devalue its currency (the renminbi) as have so many other countries. However, our belief is that in an effort to maintain its credibility as a reliable trading partner—and position the renminbi as a US dollar alternative-- the Chinese will maintain its currency's value, but continue to cut rates. Therefore, we think there is ample opportunity in Asian income vehicles tied to the renminbi.

BY JEFF DICKS & JEFF EULBERG

## CHINA RESIDENTIAL BUILDING PRICES YEAR-OVER-YEAR

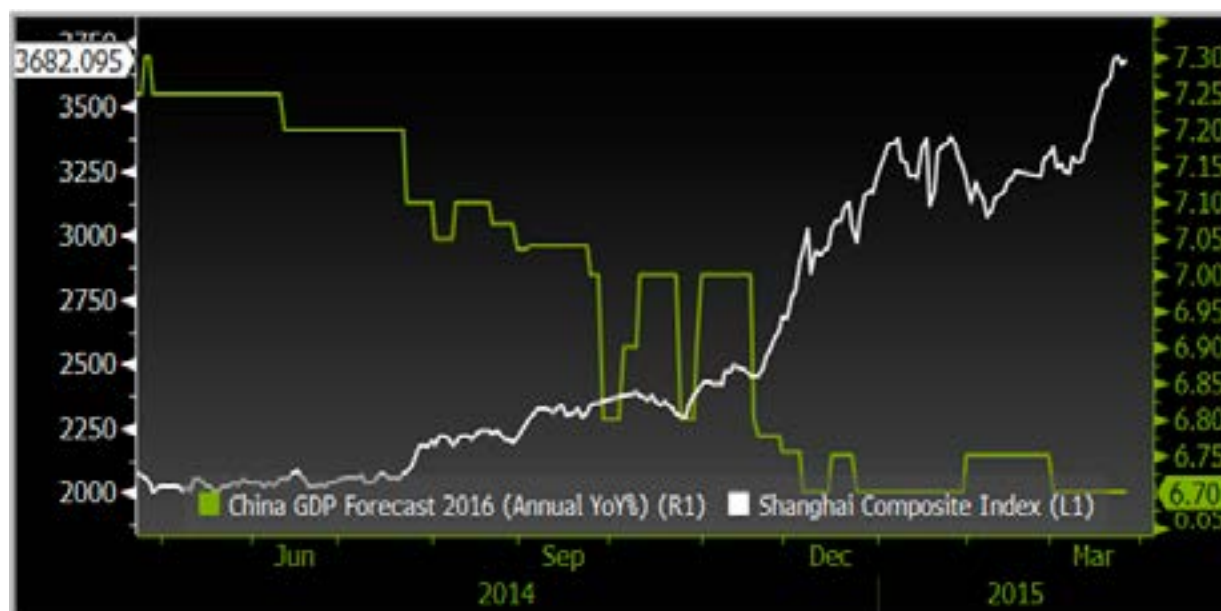


Source: Bloomberg, Evergreen GaveKal

Beyond the export data, China is showing signs of domestic weakness mainly due to a saturated real estate market. Coming out of the Great Recession, a booming housing market allowed China to grow much faster than many of its global peers. Today, in the wake of a massive debt increase to finance this expansion, any sign of price deterioration should be taken seriously. While the Chinese government has access to ample reserves to weather a major slowdown, the fallout from a housing correction could be severe.

BY JEFF DICKS & JEFF EULBERG

## SHANGHAI COMPOSITE AND CHINA 2016 GDP EXPECTATIONS



Source: Bloomberg, Evergreen GaveKal

Although the Chinese economy is unquestionably sputtering, don't expect risk asset prices to follow suit. With the central bank having shifted into aggressive stimulus mode, the Shanghai Composite Index has doubled over the last twelve months. As seen in the US—and Europe and Japan—investors have warmly embraced the extreme generosity of central banks. But should this affection cool, perhaps due to the realization that the boundless monetary largesse isn't helping the global economy (and is creating dangerous overvaluation), it would likely spell trouble for risk assets worldwide.

Overall, Asian markets remain some of the most attractively valued in the world. And while economic data hasn't been spectacular in the Orient, growth is still markedly higher than other regions of the world. Ultimately, as long as central banks remain active and accommodating, we remain fairly optimistic about the economic and financial market outlook for Asia.

# Our Current Likes and Dislikes

There were no changes to our likes and dislikes this week.

## WE LIKE

- Large-cap growth (on a pull back)
- Canadian dollar-denominated bonds
- Emerging stock markets (on a pull back)
- Asian stock markets, including Japan (on a pull-back)
- International developed markets (on a pull back)
- Canadian REITs
- Intermediate Treasury notes
- BB-rated corporate bonds (i.e., high-quality, high yield)
- Cash
- Publicly-traded pipeline partnerships yielding 5%-9% (especially those pounded in the recent mass selling of all things energy-related)
- Intermediate-term investment grade corporate bonds, yielding approximately 4%
- Gold-mining stocks
- Gold
- Intermediate municipal bonds with strong credit ratings

## WE'RE NEUTRAL ON

- Most cyclical resource-based stocks
- Large-cap value
- Short-term investment grade corporate bonds
- High-quality preferred stocks yielding 6-7%
- Long-term investment grade corporate bonds
- Short yen ETF
- Long-term Treasury bonds
- Long-term municipal bonds
- Emerging market bonds (local currency)
- Short euro ETF
- Bonds denominated in renminbi trading in Hong Kong (dim sum bonds)
- Blue chip oil stocks

## WE'RE DON'T LIKE

- Real Estate Investment Trusts (REITs)\*
- Small-cap value
- Mid-cap value
- Small-cap growth
- Mid-cap growth
- Floating-rate bank debt (junk)
- Lower rated junk bonds

\*However, some small and mid-cap issues look fairly valued

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