

Macro Keys

US Equities: 100 Days On

Global Macro Strategy

Global

Markets Embrace the Change

In the overnight hours of November 9th, exactly 100 days ago, Donald Trump gave his Election Victory speech. Since then, it seems markets have voted decisively to embrace Change, with the S&P 500 returning around 10% (15% from the 11/9 pre-dawn lows), the Dow Jones Industrials soaring past the 20,000 mark, and the small cap, domestic revenue ("America First") focused Russell 2000 up 17% (Figure 1). Option markets are pricing in Fear – Fear of Missing Out on further upside. Confidence in the future of the economy has climbed sharply on the part of consumers, CEOs and small businesses as the prospect of deregulation and a year of stronger growth (UBSe 2.4%) beckon. High expectations abound for corporate earnings in 2017 after an emphatic return to increasing profitability in 4Q2016.

Smooth Sailing - or Clouds on the Horizon?

With the VIX near cycle lows, pricing in a cavalier attitude toward market risk, the question is, is there anything to worry about? While signs of an impending recession are reassuringly scant, there are a few clouds on the horizon. Bank lending has softened, capacity utilization continues to indicate no sign of a manufacturing pickup, new home sales are weakening and inflation appears to be firming, causing the Fed to recently reiterate its intent to hike three times in 2017. At 19.5x LTM earnings (17.8x consensus 2017, 18.6x 2017 UBSe), high expectations appear well priced into equities. In this regard, President Trump's 2/28 speech to Congress, where tax reform plans will likely be a focus, looms large. To keep stocks moving higher, investors will want to see the outlines of a proposal – [despite the likelihood of many complications](#) – that can get done in late 2017 or early 2018 as opposed to the last time tax reform occurred, in 1986, 5 years after President Reagan took office. The "Art of the Deal" awaits.

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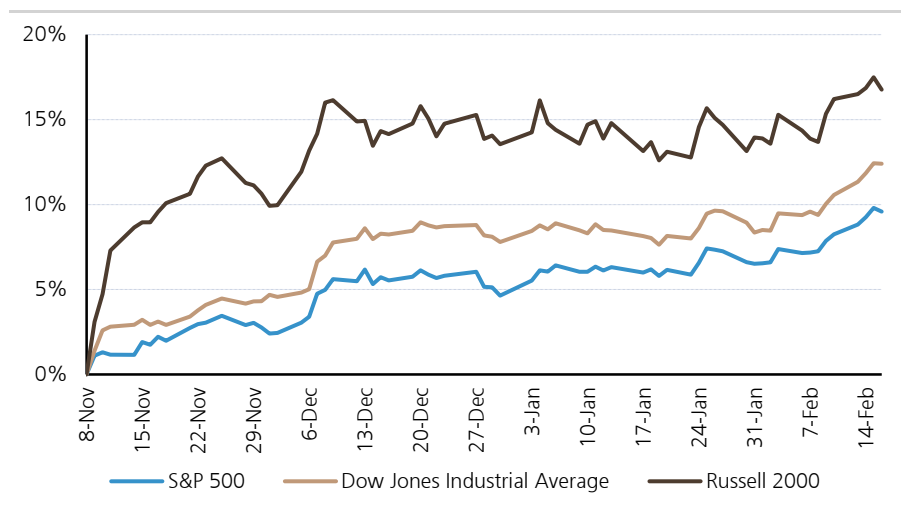
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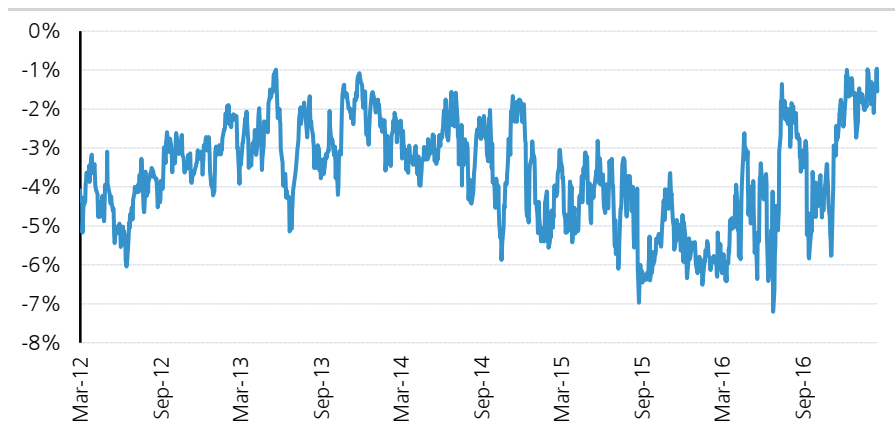
Figure 1: Stocks Play Hail to the Chief (Price Performance Since 11/8)


Source: Bloomberg, UBS

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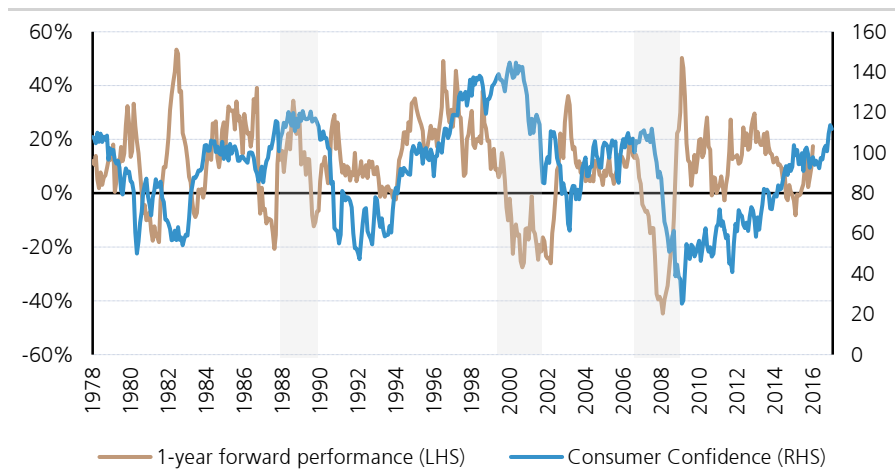
Figure 2: S&P 500 Option Skew, 3 month 110%-100%, % vol



Source: Bloomberg, UBS

From abject fear shortly before Brexit, to today's FOMO, fear of missing the upside, option prices can often be a contrary indicator. Have we "Nothing to Fear but Greed Itself?"

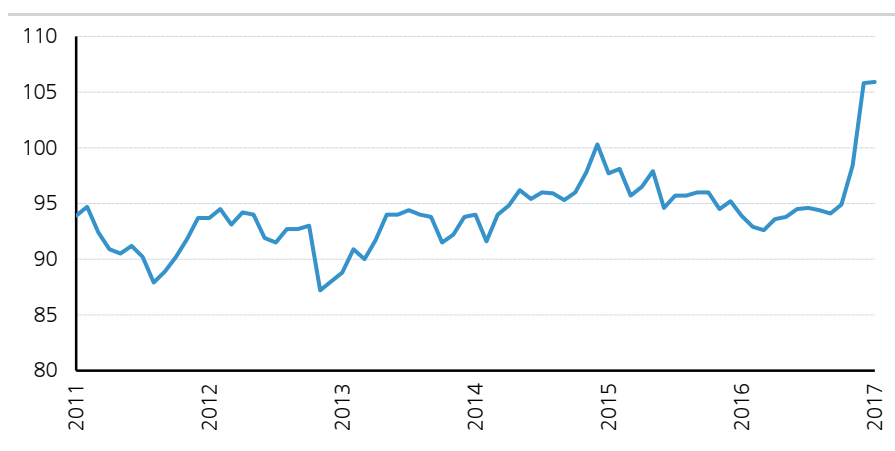
Figure 3: Confidence and Stocks Move Together (Recessions Shaded)



Source: Conference Board, Bloomberg, UBS

The consumer is feeling good; given that confidence and stocks often move together, particularly at or near peaks, maintaining this confidence is critical.

Figure 4: NFIB Small Business Optimism



Source: NFIB, Bloomberg, UBS

Mom and Pop business owners across the land believe in President Trump's pledge to "Make America Great Again."

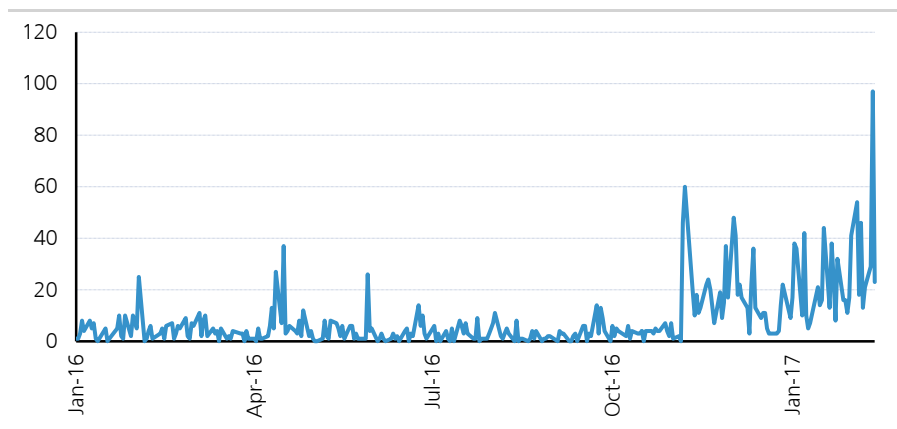
Figure 5: CEO Confidence



Source: Chief Executive Magazine, Bloomberg, UBS

And C-Suite chieftains are brimming with optimism. Why not, with the prospect of "red tape" getting cut in Washington?

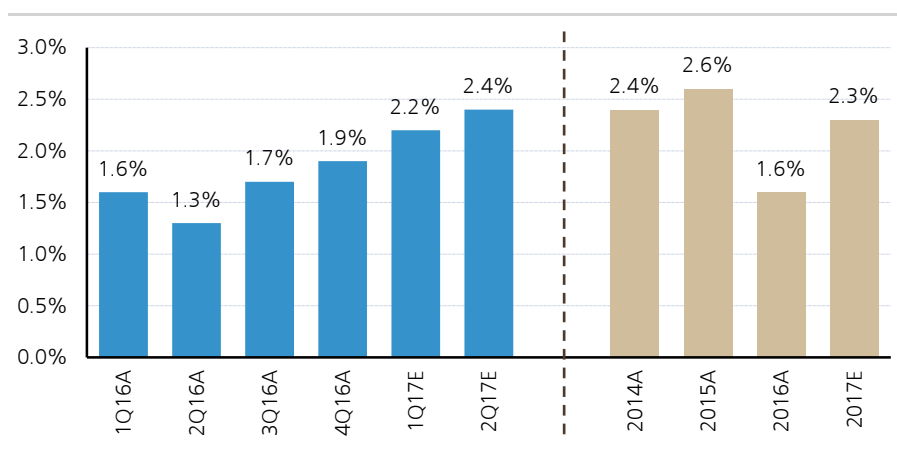
Figure 6: "Deregulation" – Bloomberg Story Count



Source: Bloomberg, UBS

Is simpler better? Fewer rules, more profits, more growth?

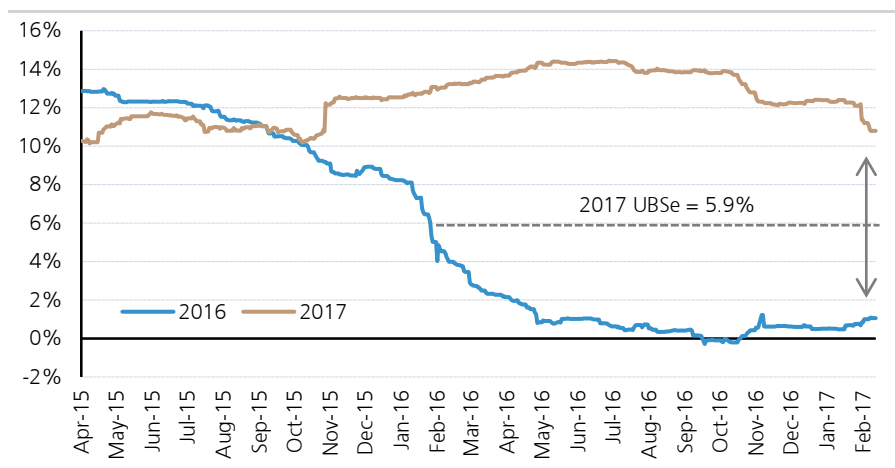
Figure 7: Consensus Real GDP Forecasts (y/y, % change)



Source: Bloomberg, UBS

UBS sees 2017 as growing at 2.4%; expectations may be as high as 2.8%. In any event, it's a big improvement on 2016's anemia.

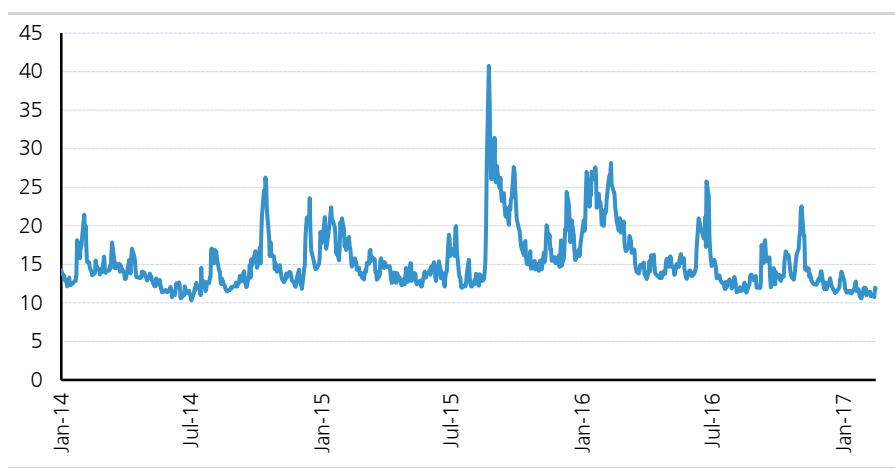
Figure 8: 2017 Earnings Forecast – Convergence Coming?



Source: First Call, FactSet, UBS

A stronger economy, an oil price recovery, **margins which remain elevated**, and expectations of tax reform and incremental fiscal spending keep the earnings optimism robust, albeit somewhat tempered these past few weeks despite a strong 4Q reporting season.

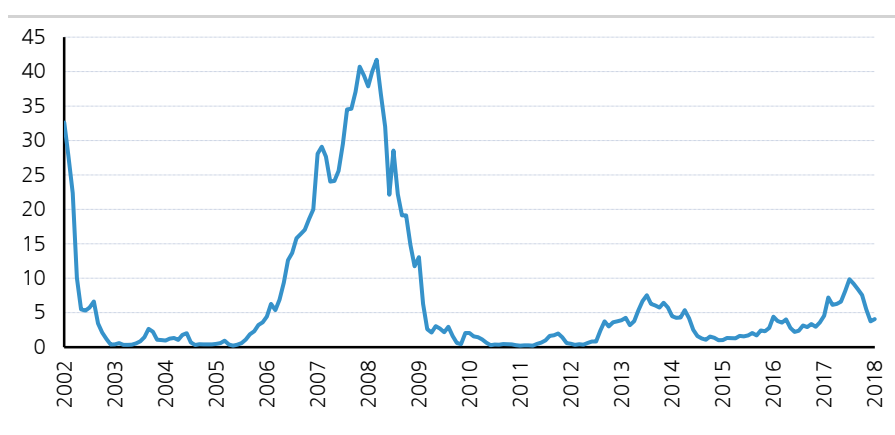
Figure 9: Low Volatility in an Uncertain Environment?



Source: Bloomberg, UBS

The lack of fear at VIX 11 is very apparent. The truth is even more surprising; stocks are moving in this relentless rally as if the VIX should be 6.

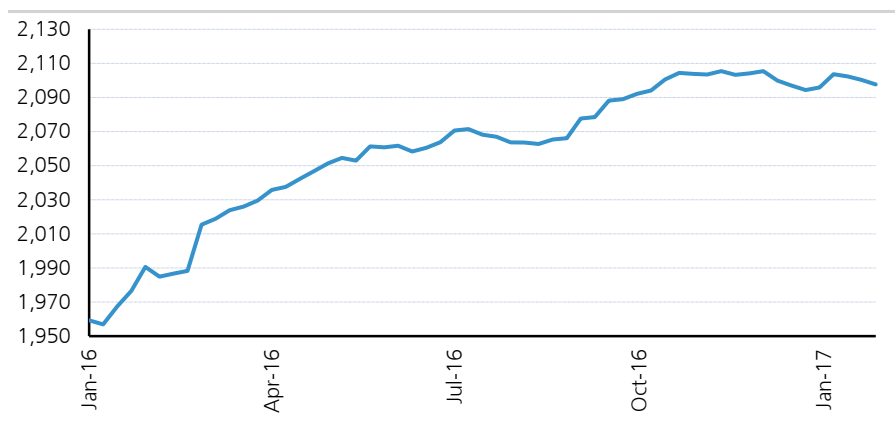
Figure 10: NY Fed Probability of a Recession in 12 months (%)



Source: Federal Reserve Bank of NY, Bloomberg, UBS

Recession – every bull market of the past 27 years has seen a recession start within 12 months of the Top. Fortunately, signs of a recession remain reassuringly scant. Nevertheless, there are a few clouds on the horizon.

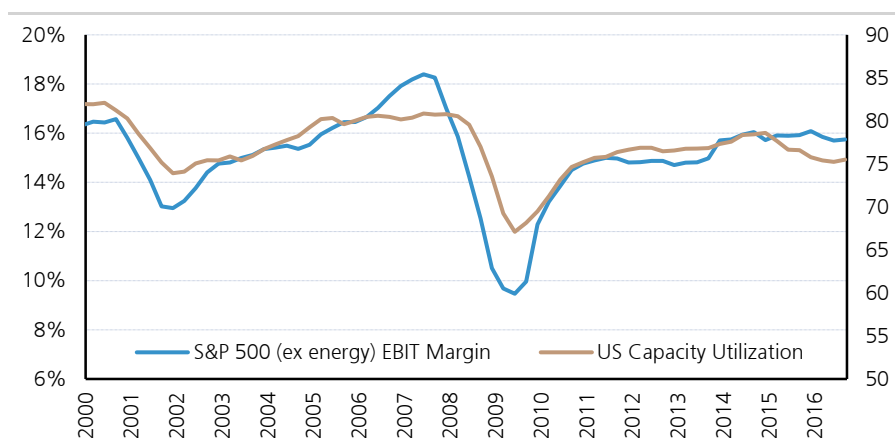
Figure 11: US Commercial Bank Assets - C&I Loans and Leases (\$bn)



Source: Federal Reserve, Bloomberg, UBS

Yes, businesses are confident. But instead of borrowing to expand, "wait and see" continues to be the order of the Day.

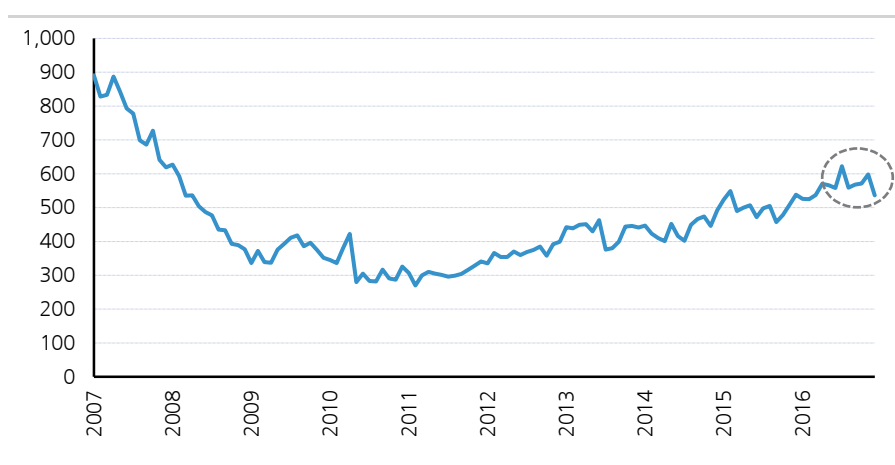
Figure 12: S&P 500 (ex. Energy) EBIT Margin vs. US Capacity Utilization



Source: Federal Reserve, Bloomberg, FactSet, UBS

The long sought manufacturing recovery is not yet exhibiting "green shoots" via "Cap U". This sluggishness, if it persists, will crimp corporate America's ability to expand its bottom line.

Figure 13: US New One Family Houses Sold, Annual Total SAAR ('000s)



Source: US Census Bureau, Bloomberg, UBS

The uptick in interest rates from the "Trump reflation trade" has caused a downtick in home sales. Mortgage applicants are watching the bond market closely. And the bond market is watching Washington, waiting to see if forthcoming proposals will further increase the \$20 Trillion US debt. All while CPI has surged to multi-year highs at 2.5%.

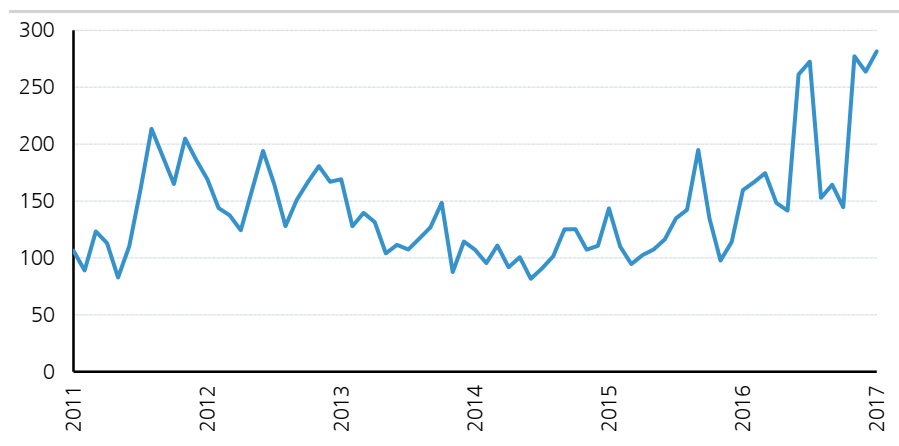
Figure 14: Peak P/E Multiples in Prior Bull Markets

Start Date	End Date	Max P/E Multiple (trailing)
10/22/1957	12/12/1961	22.4x
6/26/1962	2/9/1966	20.0x
10/7/1966	11/29/1968	19.0x
5/26/1970	1/11/1973	20.2x
10/3/1974	9/21/1976	13.7x
3/6/1978	1/6/1981	9.9x
8/12/1982	8/25/1987	22.7x
12/4/1987	7/16/1990	16.6x
10/11/1990	3/24/2000	31.0x
10/9/2002	10/9/2007	21.7x
3/9/2009	?	
Average:		19.7x

Source: Bloomberg, UBS

It has been a glorious 100 days for stocks. How glorious? Valuation, at 19.5x LTM earnings, is now in proximity to prior bull market multiple peaks. Is the broad market due for a pause?

Figure 15: Global Econ Policy Uncertainty Index



Source: Bloomberg, UBS (ticker: EPUCLCP)

Geopolitical relationships are in flux with new leadership in Washington, causing economic uncertainty across the globe as domestic politics take center stage in France, Germany and China over the coming months. In the US, all eyes are on the pending tax reform proposal, due to make its debut on or around February 28th.

Figure 16: The Early Days of Reagan – No Repeat Wanted



Source: Bloomberg, UBS

Why is getting tax reform right, and without undue delay, so crucial? Because high expectations, which have led to substantial gains in equities, likely need to be met or exceeded to keep stocks rallying. Delayed gratification, as was the case during Reagan (tax reform took 5 years to accomplish), resulted in market weakness after the post-election "honeymoon" ended.

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