M I L L E N N I U M

ASSET MANAGEMENT

Date	11/29/2015
S&P 500	2090.11
RUT 2000	1202.38
Fed Funds	0 - 0.25%
10 Yr. T-Bond	2.222%

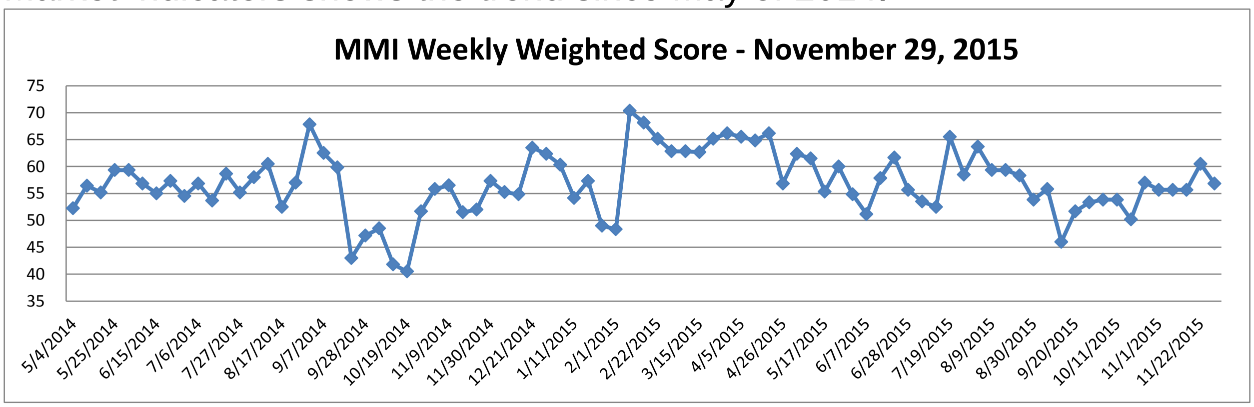
November 29, 2015
Market Indicators
And
Strategy Report

	Raw Score	Weighting	Weighted Score
Market Indicators			**11/29/2015**
Market Sentiment	50.00	10%	5.00
Technicals	46.67	20%	9.33
Liquidity	75.00	20%	15.00
Valuation	50.00	15%	7.50
Earnings Momentum	33.33	15%	5.00
Monetary Policy	75.00	20%	15.00
Overall Assessment		**100%**	**56.83**

Weighted Score	Interpretation
0 - 49	Bearish
50 - 59	Neutral
60 - 100	Bullish

<u>MMI Are Still Neutral</u>

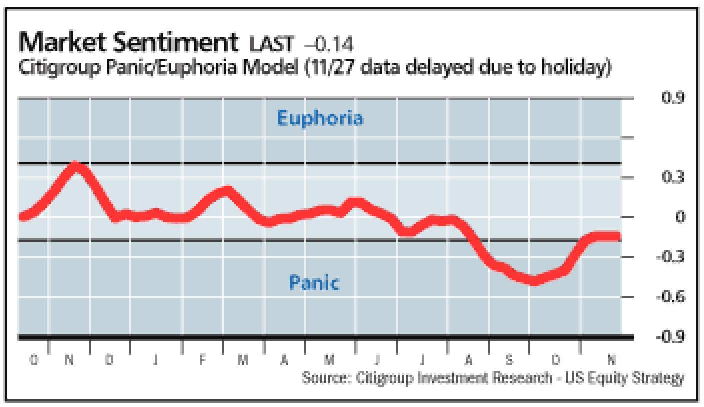
Our Major Market Indicators stayed in neutral territory this week, similar to last month. Since the market bottomed around September 28th the indexes have recovered most of their losses. The S&P 500 is up 11.1% from its bottom; the DJIA is up 11.3%, and the NASDAQ is up 13.5%. The small cap Russell 2000 has been marginally worse, recovering only 10.9%. Over that same period MMI has been in neutral territory most of the time, ending the past week at **56.83**. A reminder: the MMI index is not considered an arbiter for the next week's performance, but rather a longer term outlook of the forward nine to twelve months. Below, the weekly graph of our Major Market Indicators shows the trend since May of 2014.



<u>MARKET SENTIMENT INDICATORS: Neutral</u>

The market sentiment indicators score neutral this past week as bullish and bearish indicators offset each other. Since we use a mostly contrarian judgment on sentiment; a bullish behavior by market participants registers as bearish, and vice versa. In terms of bearish indicators, the Volatility indicators (VIX and VXN) stood at week's end at 15.12 and 17.13, which added one bearish point to our score; we score VIX/VXN at greater than 20 as bullish. The ARMS index on the NYSE and NASDAQ (2.10 and 0.81) were mixed; the <u>NYSE ARMS is bullish</u> at that high a level, while the <u>NASDAQ counts for a bearish</u> reading. The AAII (American Association of Individual Investors) survey of investors registered a ratio of bullish to bearish attitudes of 1.25, also a bearish reading; again this is a contrarian approach. Finally, the TIM Group Market Sentiment Indicator, the Consensus Index and the Market Vane Index registered 50.3%, 64% and 62.0% respectively, all bearish indicators.

On the bullish side of the ledger, the Put-Call ratios are both registering bullish scores. The CBOE Put/Call ended the week at 65/100, which registers as bullish, while the Put-Call on the S&P 100 was also bullish at 209/100. As we noted above, the ARMS index on the NYSE is a bullish contributor. The confidence index, the index of high-grade bonds yield vs. intermediate grade bonds yield (3.75%/5.12%) produces a ratio of 73.2%; we score any spread under 75.0% as bullish. Also, the short ratio on both the NYSE and the NASDAQ were bullish, at 4.30 and 4.44 days to cover respectively. These 6 indicators were the bullish contributors for this week. The chart below from Citigroup indicates their reading of sentiment has backed off from the panic levels previously seen, and is now marginally in a neutral position.



TECHNICAL INDICATORS: Bearish

Our technical indicators scored 7 out of 15 indicator points bullish this week, so the technical sector is marginally bearish overall. The volume ratios we track were actually more bullish than bearish. The advance/decline volume ratio on the NYSE and NASDAQ was 1.16 and 1.48, both of which are bullish. The ratio of the number of issues advancing vs. declining for the week on both the NYSE and NASDAQ was 1.77 and 2.30 respectively, and this is a split decision, with the NASDAQ bullish and the NYSE bearish. The 10 day moving average of up vs. down stocks on those two exchanges was also a split decision: The10-day moving average of the NYSE scored bearish at

1.30 and the 10-day moving average of the NASDAQ was bullish at 1.503. Finally, the ratio of new highs to new lows was 0.93, and this too was bearish.

We also score a number of indexes vs. their 200 day moving average. The most prominent of these indexes were trading above their 200 day moving average, and thus were bullish, by the following percentages: The S&P 500 +1.20%, the NASDAQ Composite +3.17%, and the Dow Jones Industrial Average +1.28%. The other indexes we score continue to lie below their 200 day moving averages, and were bearish: the NYSE Composite (2.50%), the Russell 1000 equal weight ETF (EWRI) (2.26%), and the Russell 2000 equal weight ETF (EWRS) (3.12%).

To sum up the technical picture, the technical indicators remain marginally bearish.

LIQUIDITY INDICATORS: Bullish

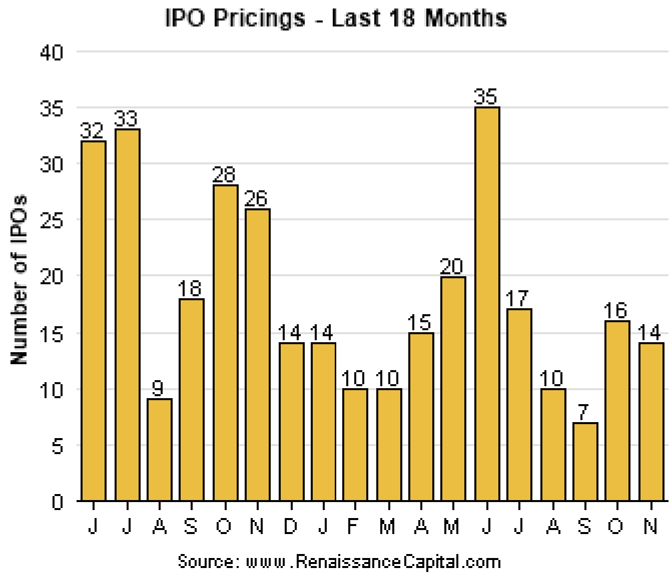
Our liquidity indicators are bullish. Money market funds balances are 11.0% of the market cap of equities, which provides buying power to support stock prices, a bullish score. On the other hand, customer credit balances at brokerages stood at only 28.0% of margin debt at last reading (October 2015), a low level and a bearish score. In a sharp sell-off, customers either have to post more cash to bring their margin account above the minimum maintenance threshold, or margined stocks will be sold to meet the cash call. This low cash level implies increased risk of customers having to meet margin calls with stock sales rather than posting more cash.

Tipping the balance to the positive was our cumulative market liquidity calculation for the trailing four weeks. Total flows into the market as calculated are registering a bullish inflow. Mutual funds (including ETFs) have seen inflows over the past four weeks, with a net $5.3 billion contributed to the market for the four weeks. The corporate acquisition market has been slower than recent months. We count only the cash component of M&A deals as announced, that figure for these four weeks was $30.5 billion. The biggest contributors these last four weeks were the acquisition by Shire DYAX for $5.9 billion, Activision Blizzard (ATVI) buying King Digital Entertainment (KING) also for $5.9 billion, and Air Liquide buying Airgas (ARG) for $10.3 billion.

Announced stock buybacks contributed another $27 billion to our liquidity calculation in terms of total buyback authorizations announced. The most significant buyback announcements were made by Nike ($12.0 billion), Raytheon ($2.0 billion), Fiserv ($1.44 billion), Mylan ($1.0 billion) and Whole Foods Market ($1.0 billion). Stock buybacks have been and continue to be an important source of liquidity to the market.

IPO activity has slowed these last four weeks. $9.25 billion of new market capitalization was added to the market for the trailing four weeks. The biggest new issues were Square (ticker: SQ) at $2.9 billion, and Match Group (ticker: MTCH) at $2.88 billion.

The chart below shows the number of IPOs priced over the past eighteen months. Since the mid-summer downturn in activity we've seen a return to more normal levels.



Secondary stocks offerings have slowed, with only $4.2 billion in the trailing four weeks, similar to the prior month. Note that we exclude sales by large shareholders (private equity) which do not increase the total number of shares outstanding. Insider selling pulled $7.8 billion of net cash out of investor hands in the past four weeks, up sharply from the $2.3 billion of the prior month.

We track cash inflows to domestically focused equity hedge funds on a monthly basis. We calculate cash outflows from domestically focused equity hedge funds at approximately ($1.17) billion in September. Given the relative secrecy of hedge funds this calculation will always be a rough approximation, but we are applying our methodology on a consistent basis, month-to-month.

Overall, we count up a positive net **inflow** of liquidity into the domestic market of approximately $40.3 billion for the past four weeks, which is more than sufficient to warrant a bullish score. We double weight this calculation in our MMI scoring. Combined with the other factors above we arrive at a bullish view on liquidity.

VALUATION INDICATORS: Neutral

Our valuation indicators rank at a neutral level this week. Our fair value target for the S&P 500 is 2322, representing an 11.1% upside from the close on November 27th. That upside potential is a bullish indicator in our calculation. The target uses a 19.5x multiple applied to 2015's estimated operating earnings of 118.89. Our fair value target multiple is arrived at using an intermediate grade bond yield rather than the ten year Treasury bond, due to the artificiality created by Quantitative Easing. The S&P 500 is trading at 17.6 times the trailing four quarters operating earnings (through the second quarter of 2015), compared to an historical norm of 15.5 times operating earnings. The S&P 500 is now trading at 17.6x 2015E and 16.3x 2016E. The upside to the fair value target is sufficient to rate bullish. So too is the ratio of the S&P's earnings yield vs. the Single-A 10-year bond yield (1.36x).

We score the target for the S&P 500 a second time, with a more conservative price target discounted 10% from the prior target. We require a minimum of a 10% upside from the current index price to this second target in order to score the indicator as bullish. The result, 2090, is actually below last Friday's weekly close of 2090.11. Since this is less than a 10% potential gain, it scores bearish.

There are other bearish indicators. Compared to GDP the market is at a 37% premium. Small cap stocks, as judged by comparing the T Rowe Price New Horizons Fund to the S&P 500 are not cheap, at a 1.86 times ratio. However, they look a lot cheaper if we substitute the P/E of the Russell 2000 – 1.23x, or the equal-weighted Russell 2000 ETF – 0.99x.

We estimate the total domestic market capitalization is trading at 92.4% of replacement cost of the asset base of non-farm, non-financial corporate businesses. By this metric, our version of Tobin's q, stocks are cheap. Since this is less than 100% of replacement cost we score this a bullish indicator.

Overall, valuation indicators are neutral, with bullish indicators equal to bearish indicators.

EARNINGS MOMENTUM INDICATORS: Bearish

The MMI score for earnings momentum is bearish this week. The earnings season for the third quarter 2015 (which is over 97% complete) positive to negative ratio of earnings surprises is 2.96x, a <u>bearish</u> score (we set a high bar for this indicator; since the earnings game system is set up to naturally encourage companies to "beat the street" we require a ratio of greater than 3.0:1 for this indicator to score bullish).

Third quarter 2015 earnings are currently estimated at a growth rate of *negative* (1.3%) compared to (2.2%) on October 30th. This improved expectation vs. the prior month's estimate is judged bullish in our scoring. So despite the third quarter's earnings estimated to come in as a negative number, the fact that this negative earnings result has improved since the past month-end is itself a bullish indicator. Earnings expectations the full years 2015 and 2016 continue to decline: 2015E earnings are now projected by the street at a *negative* growth rate of (0.3%) vs. (0.1%) at the end of October. 2016 estimates also have come down to a growth rate 7.8% growth vs. 8.6% at the end of October. A positive change in earnings expectations is bullish, but a flat or negative change in expectations is bearish. We rely on FactSet for these specific estimates.

On a PEG ratio (P/E to growth rate) basis S&P earnings still looks this side of cheap, at a PEG of only 2.33 times, compared to a longer term average of 2.58. Looking at small cap stocks, the Russell 2000 trailing P/E ex: negative earnings were 21.6x at 10/30/15, vs. a five year eps growth rate of 10.76%, implying a PEG ratio of 2.01 times.

Thus, overall earnings <u>*momentum*</u> now scores bearish since only two out of our six indicators scored bullish.

The earnings outlook would look better, if not for the Energy sector, and it would look worse, if not for stock buybacks. If we exclude the Energy sector, the growth rate for S&P earnings for Q3:15 would increase to a positive 5.7% instead of its actually reported negative (1.3%). Over two-thirds, 68.7%, of S&P 500 companies reported a lower share count for Q3:15 vs. Q3:14. In fact 21% of the index members reported at least a 4% lower share count year-over-year (the seventh consecutive quarter for this), while 9% of the index members reported at least a 4% higher share count.

Yet, with reporting for Q3:15 almost over, five of the sectors are reporting earnings growth, and five are reporting earnings decline – it's not all just Energy! It's a case of haves and have-nots. Three sectors are reporting double digit earnings growth: Telecom Services +23.5%, Health Care +14.7%, and Consumer Discretionary +13.3%. Information Technology and Financials are showing positive growth in the mid-single-digits. On the negative side, Energy is the clear loser at (56.8%), but Materials is showing a double digit decline at (15.8%) while Industrials, Consumer Staples and Utilities are posting low single-digit earnings declines.

Expectations for 2016 earnings growth have declined over the course of the year, which is not a big surprise. Notably, early in this year the Energy sector was estimated to have a big bounce-back year in 2016 on the assumption oil prices would rebound. These expectations have evaporated. The Energy sector is now forecast at only a +0.2% earnings growth rate. Notably the Materials sector is forecasting double-digit earnings growth implying a recovery in commodity prices. Is that a realistic bet?

MONETARY POLICY: Bullish

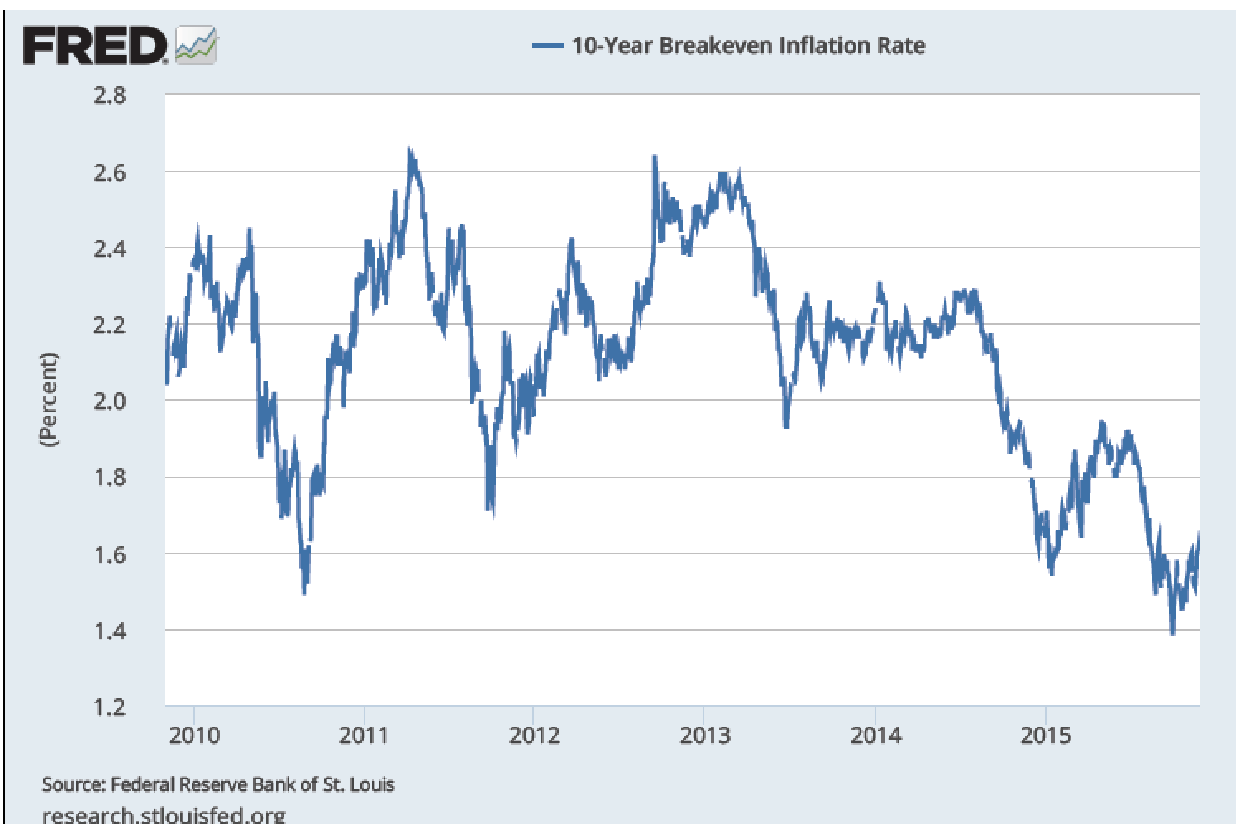
"This time we mean it". That seem to be the underlying message the Federal Reserve is sending the markets regarding a December hike in the Fed Funds rate. Current policy is to hold the overnight Fed funds rate down at zero to 25 basis points. Earlier this year the policy makers blinked and didn't raise the Fed Funds rate. We'll see. However, it's painfully obvious a 25 basis point increase in the Fed Funds isn't all that meaningful in itself, but rather the market may be more focused on the implication there will be many more rate hikes to follow.

Our excess liquidity indicator is bullish at 15 basis points. This means the Fed is providing 0.15% more liquidity than the current nominal GDP growth rate. This figure takes into account the decreased velocity of money in recent periods. We arrive at this figure by subtracting the annual percent change in velocity from the year over year percent change in M2 money supply. Then we subtract the most recent quarter's year-over-year percentage change in nominal GDP. We score this amount of excess liquidity as bullish.

The Treasury yield curve is accommodative to growth. The spread between the ten–year and one-year rates is about 1.70%, a positively sloped yield curve, and we score this bullish.

Junk bonds yields remain elevated. Using the HYG fund as a proxy, the yield-to-maturity of that fund stood at 7.37% this week and the spread vs. 10 year Treasuries stands at 5.18%, and this is bullish, since we judge anything over 4.0% as wide enough to rate bullish.

As shown below, forward inflation expectations remain well below 2.0%. This would appear to indicate the bond market, which we believe is collectively smarter than any one of us, is forecasting a low inflation environment, which runs counter to the hawkish talk about raising rates. This makes us wonder why the Federal Reserve is anxious to raise rates by the end of the year. We note that the ten-year breakeven rate has risen from its recent bottom, but has not yet violated its downward trend.



CONCLUSION: Neutral

In summary, our MMI score sits in neutral territory at the end of last week. Liquidity and monetary policy indicators scored bullish, while technical indicators and earnings momentum score bearish while market sentiment and valuation indicators are neutral.

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