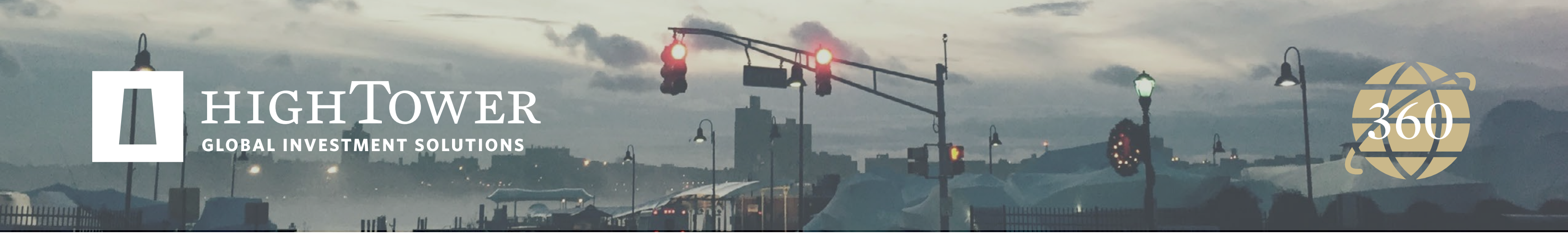
360

2016 Q1

HIGHTOWER
GLOBAL INVESTMENT SOLUTIONS



Technocrats

Investing is both an art and science, and when applied in the right combination, these two contributors will ultimately distinguish successful from less successful investors. One of the most important aspects of the inherent art is to remain focused on value and uncompromised opportunity, even when difficult market conditions intuitively suggest a more tactical, or even emotional, state of mind is needed for making decisions.

Today's inherent challenge of investing, however, is not so much of what it is about, but what it has become. It remains my conviction that global monetary policy has changed the course of price formation and inadvertently influenced the very good work of many, commonly reliable wealth managers. As global assets at large, and especially U.S. domestic stock markets, have benefited from ample liquidity, distinguishing momentum from value and trend has been an unforgiving "fools game."

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Science, now, on the other hand, is suggesting that markets will have to adapt a form of "equilibrium"; whereas patterns never fully repeat, technical analysis paired with a historic economic perspective is suggesting that current conditions are the "early messenger" to an inherently more volatile, but possibly fair, market environment. In the years to come, I expect a reversal of fortune, bringing back the skilled stock picker, analyst, and schooled voice of reason, in lieu of a more simplistic sales approach to asset allocation.

To stay on the topic of equilibrium, asset markets, especially equities, can outperform their respective economics for some time. Nevertheless, in principle, I stay dedicated to the idea that the financial and real economy should adequately reflect each other over longer periods of time; this is not only true for nations, but also for investment themes. Whenever "hype" leads the notion that it is worth paying up for ideas, caution needs to be applied. Think of the commodity boom, emerging markets, shale gas, etc.

HighTower, other than traditional firms, has never adapted the construct of a binding house view; we trust that decades of servicing clients, and dedicated decision-making, especially around capital markets, carry enormous value and benefit. The more common, short-term nature of research cannot compete in this aspect. With, this in mind, however, we have an inherent obligation to constantly challenge each other's best ideas and practices, especially during difficult market periods.

Ever since investors have seen the lows in the S&P 500 in 2009, with the index closer to the 600 mark, there has been great insecurity with every major climb, having stretched all the way above the 2,000 level and even surpassing the previous 2007 record highs. At the same time, valuations are not necessarily attractive any longer, providing little basis to a reasonable assessment, as markets, quite literally, are trading in uncharted territory.

With the above in mind, and in oversimplified fashion, technical analysts use charts to examine past price movements and to understand if previous patterns can be applied to current or even future conditions; in this respect, any financial instrument with a regular price can be used to form a chart, allowing price movements to be expressed and explained in figures and lines.

Thank you for your continued trust and support of our work.

Sincerely,

MATTHIAS PAUL KUHLMEY
Partner & Managing Director
Head, Global Investment Solutions (GIS)

Technocrats—Dedicated To Technical Market Analysis

BY MATTHEW HARRIS, CMT®

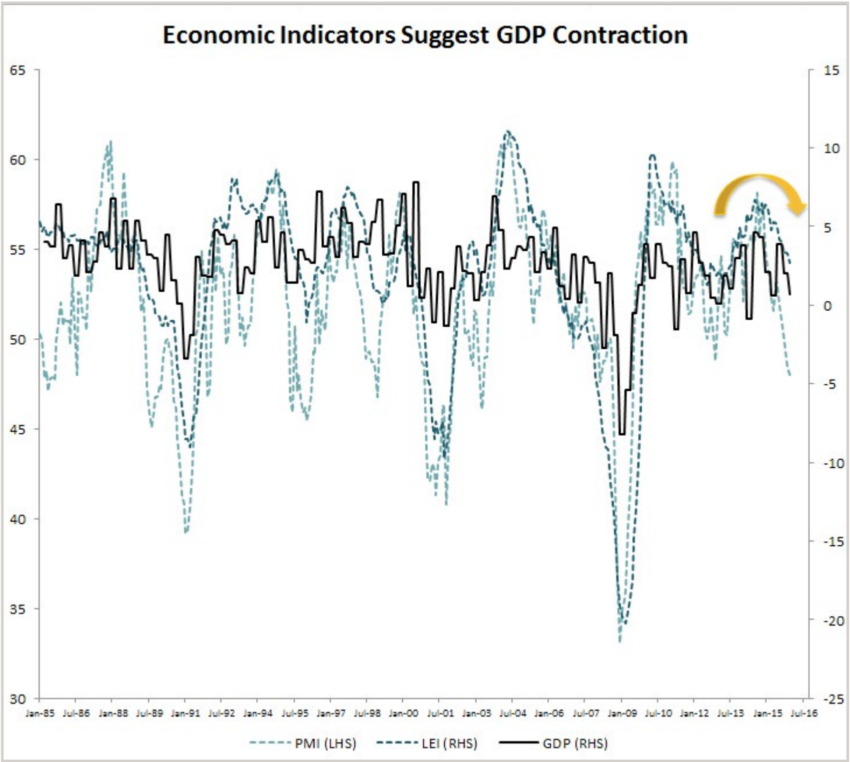
Executive Director, GIS

SUMMARY FINDINGS

In our opinion, diverging central bank policies, the economic environment, and continued volatility in almost all areas of capital markets require us to create a simplified analysis related to our outlook. In fact, we are "stealing" a page out of Howard Marks's book, *The Most Important Thing*, and identifying only the most important items we observe, via a few charts and short paragraphs.

- U.S. economic growth will continue to decelerate...
- ... with global implications to be expected.
- Global equities are trading in a bear market
- U.S. risk assets suggest more pain to come...
- avoid small cap stocks in the U.S.,
- ... with U.S. equity valuations not offering a "buffer."

Chart 1



Data: Bloomberg, HighTower

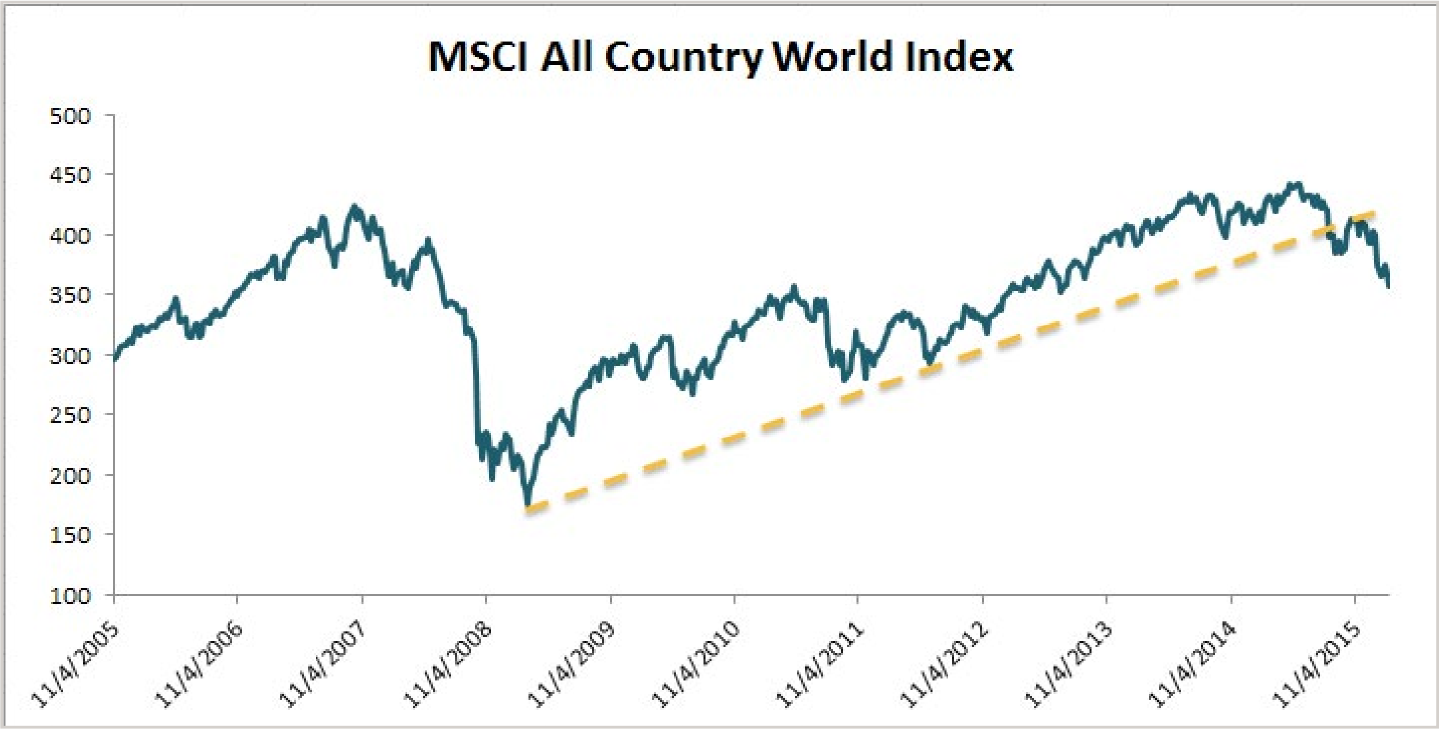
I. THE ECONOMY

Ever since the Fed removed policy support, market participants have been watching economic data more closely than ever before. For the purpose of our technical analysis, we have elected to focus on two key data series that in the past have provided good signals to assess future economic strength: namely, The Institute for Supply Management's Manufacturing Index (ISM) and the Conference Board's Index of Leading Economic Indicators (LEI). Both data series have historically been correlated to Gross Domestic Product (GDP) and provided notice ahead of changes to direction of GDP. As shown in Chart 1, both ISM and LEIs have been in decline since mid-2014, with recent declines accelerating. If the historical relationship holds true, economic growth will continue to weaken in the U.S., potentially even more materially.

II. MARKET TECHNICALS—THE GLOBAL BULL MARKET IS OVER

The MSCI All Country World Index (ACWI) is comprised of 46 different stock markets (23 developed and 23 emerging markets) and represents approximately 85% of all publicly traded companies. The MSCI ACWI has broken its trend line from the 2009 low, clearly indicating that the global bull market in equities is over. This does not mean that select markets cannot potentially outperform others, or even form bull formations, but, generally speaking, global equities will be challenging investments, especially if careful selection of geographies is not part of the screening process.

Chart 2



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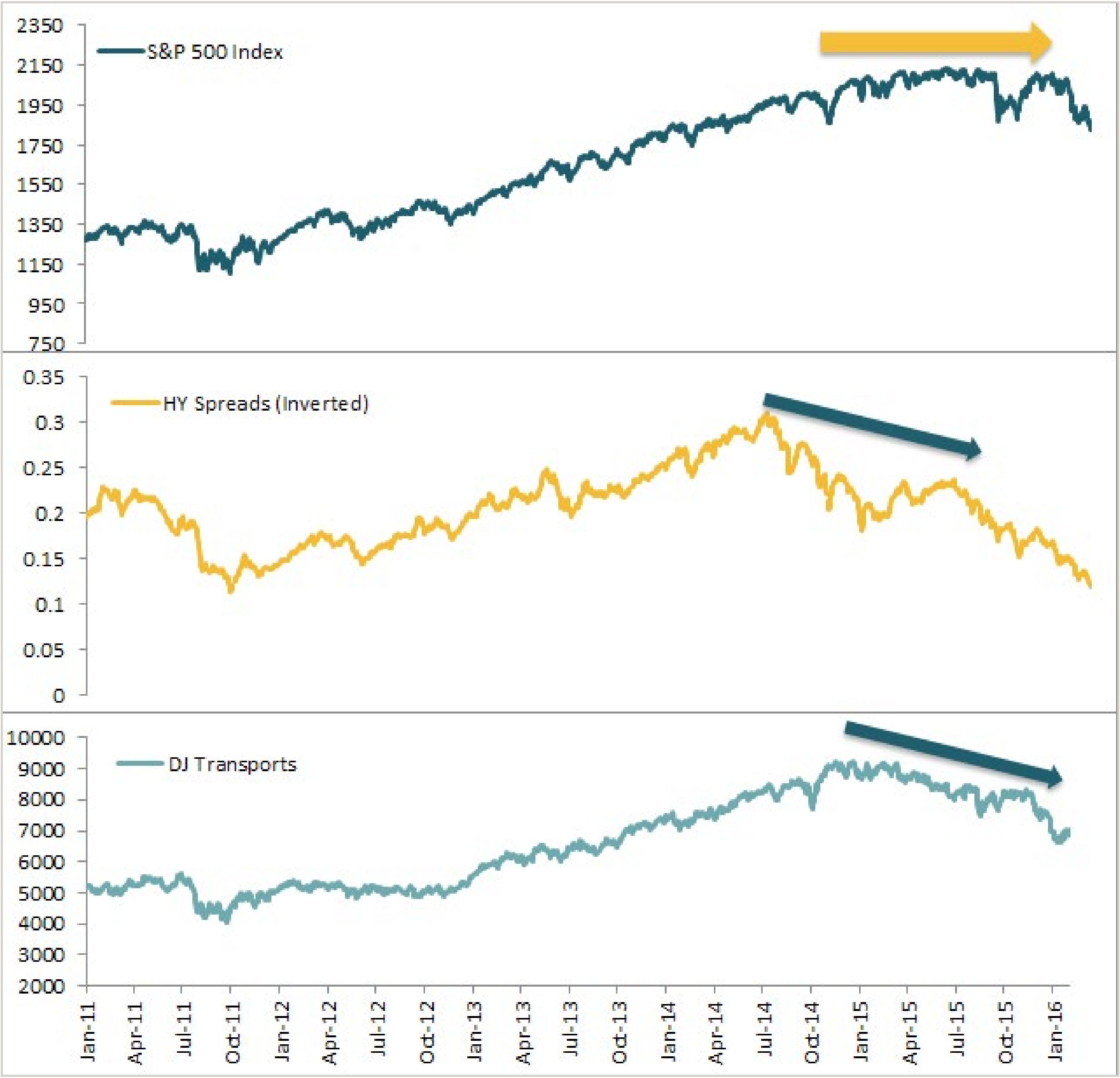
III. U.S. RISK ASSETS

Two markets that can serve as proverbial "canaries in the coal mine" are high yield bonds and transportation stocks. Both have historically been highly sensitive to changes in economic conditions and have "led" other, more mainstream markets, such as the S&P 500. In mid-2014, high yield started to decline, followed by transports at the beginning of 2015. Typically risk assets do not diverge in performance from one another over extended periods of time and, therefore, "realignment" should take place. This adjustment can occur in multiple ways: through a decline of the S&P 500, or through a recovery of high yield bonds and transportation stocks (or a combination of both). Given that we do not observe meaningful stabilization in either market, and there is a continued deterioration in the S&P 500, it is our view that the S&P 500 will decline (further) to align with the other indices.

Chart 3

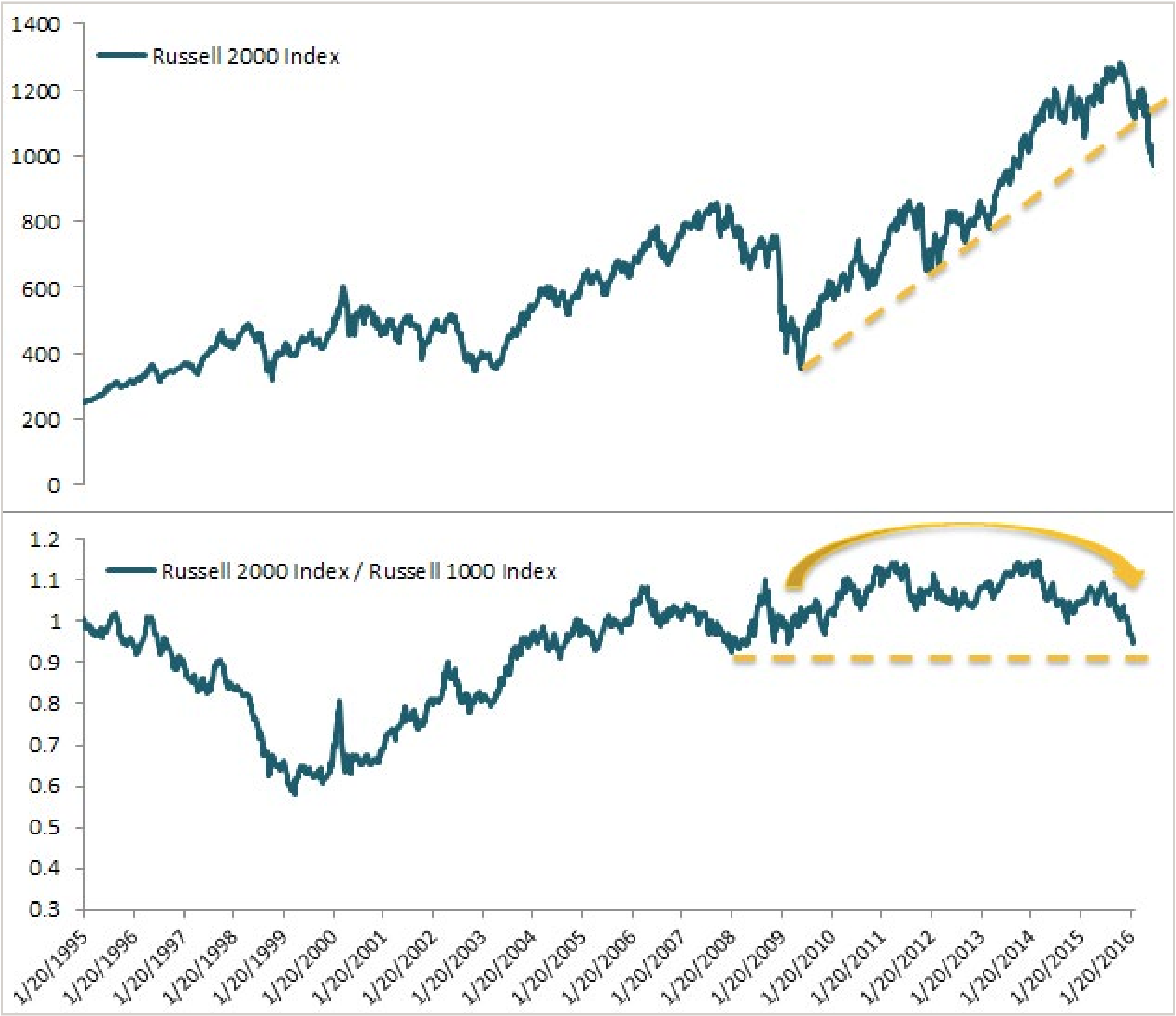


Data: Bloomberg, HighTower

IV. U.S. SMALL CAP EQUITIES

For those that must (or wish) to retain U.S. equity exposure, our analysis shows to avoid small capitalization (small cap) stocks. The index representing small cap stocks, the Russell 2000, has broken its long-term trend line since the 2009 low, similar to the MSCI ACWI. The projected downside (from 971 level) is, at a minimum, 10% to "match" the previous 2007 and 2011 highs. Confirming our view is the observed pattern of lower highs and lower lows in the relative performance of the Russell 2000 vs. the Russell 1000 (large caps), as shown in the second pane of Chart 4.

Chart 4



Data: Bloomberg, HighTower

V. VALUATIONS

Forward looking valuations, as measured by the price-to-earnings ratio (P/E) of the S&P 500, are in line with historical levels. While this aspect may be reassuring to some investors, it is still concerning, as street assumptions related to earnings growth are greatly out of line with "the real world." Analysts are currently expecting earnings to grow at 10% over the next 12 months. The reality, however, is a different one, as, over the last three quarters, earnings have been in a downtrend—the first occurrence since first quarter 2009. In our view, the market is likely overvalued, as the E in P/E estimates are too high.

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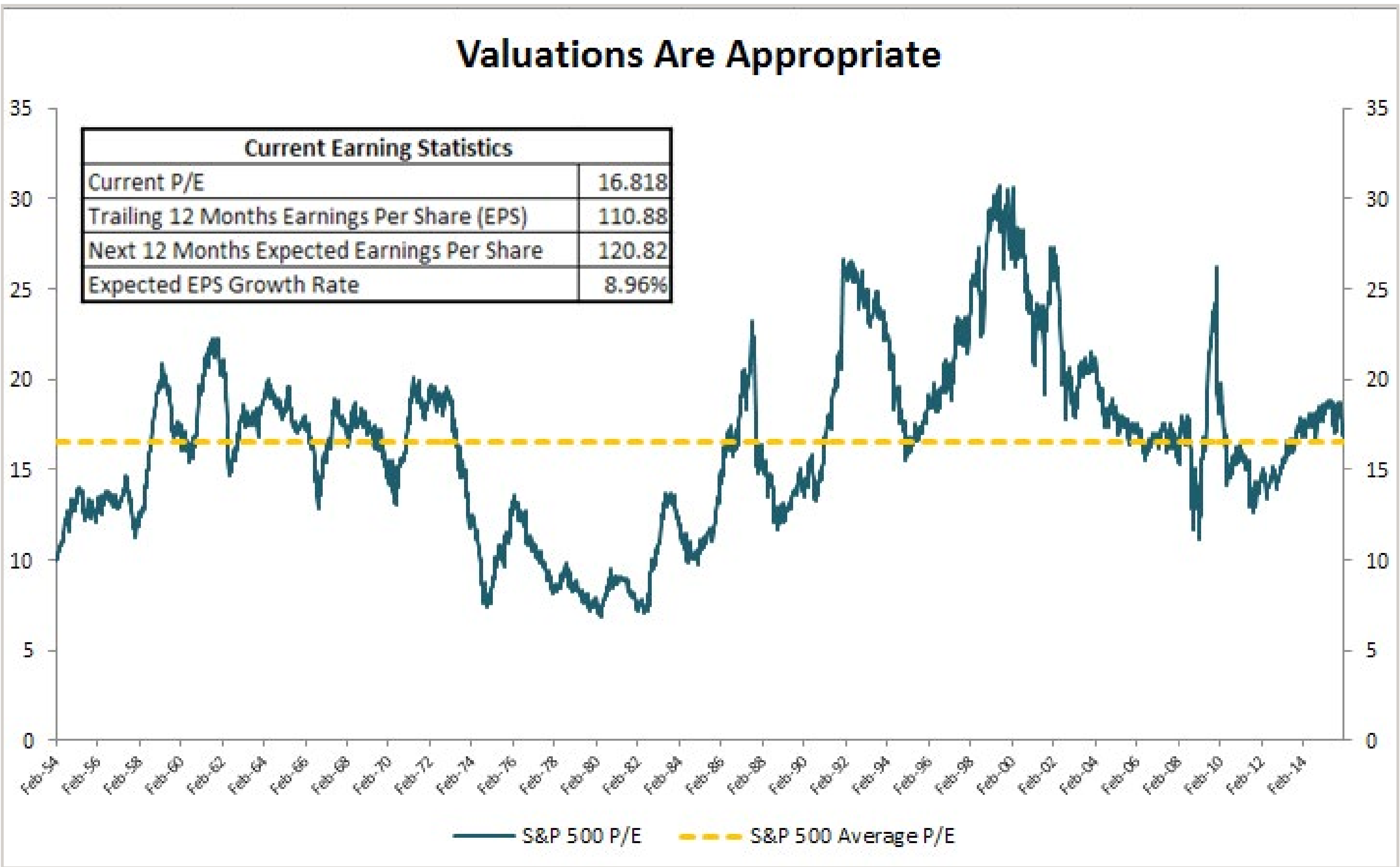
Chart 5



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