# Review of the Current Economic Situation

June 1, 2016

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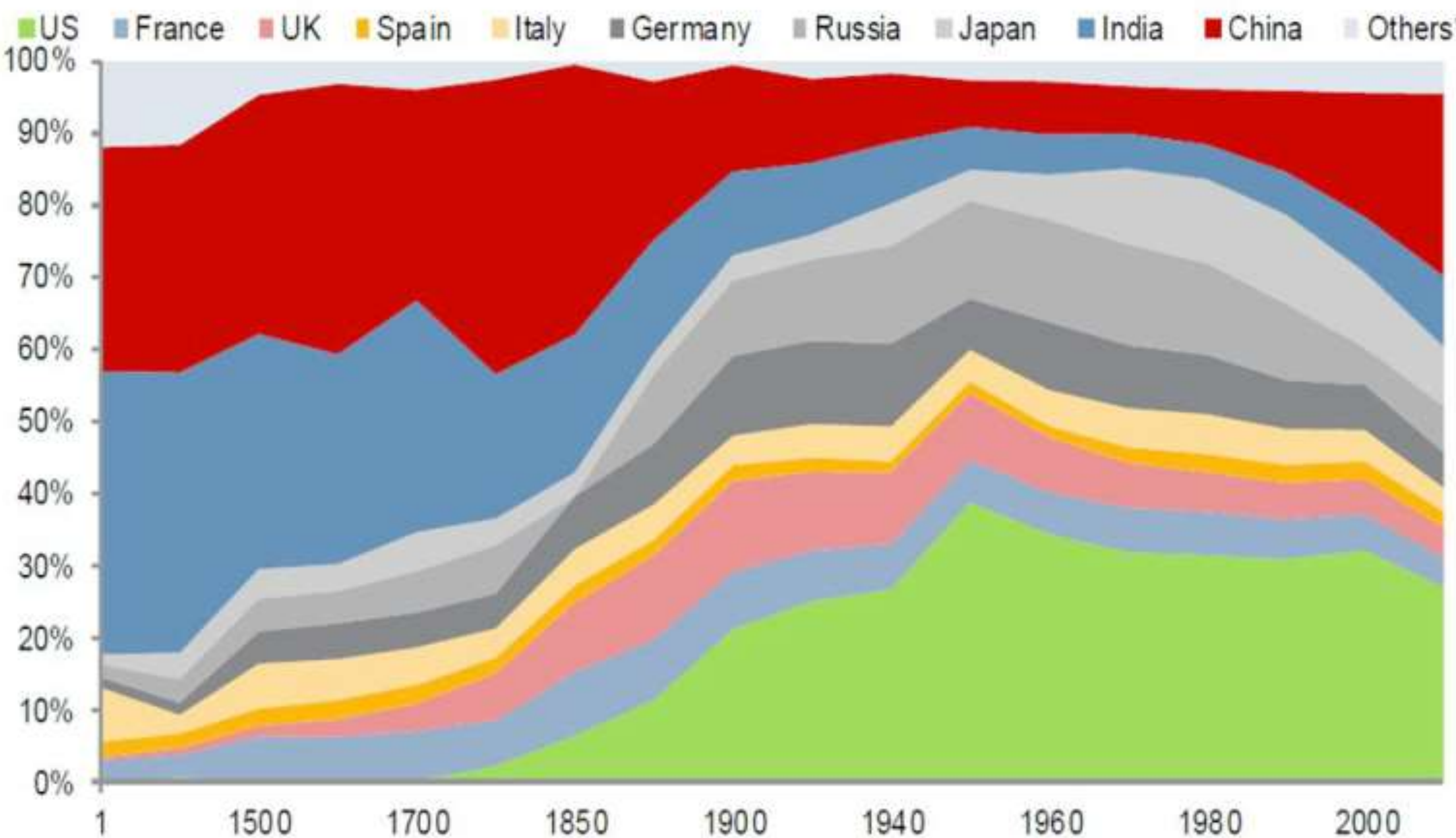
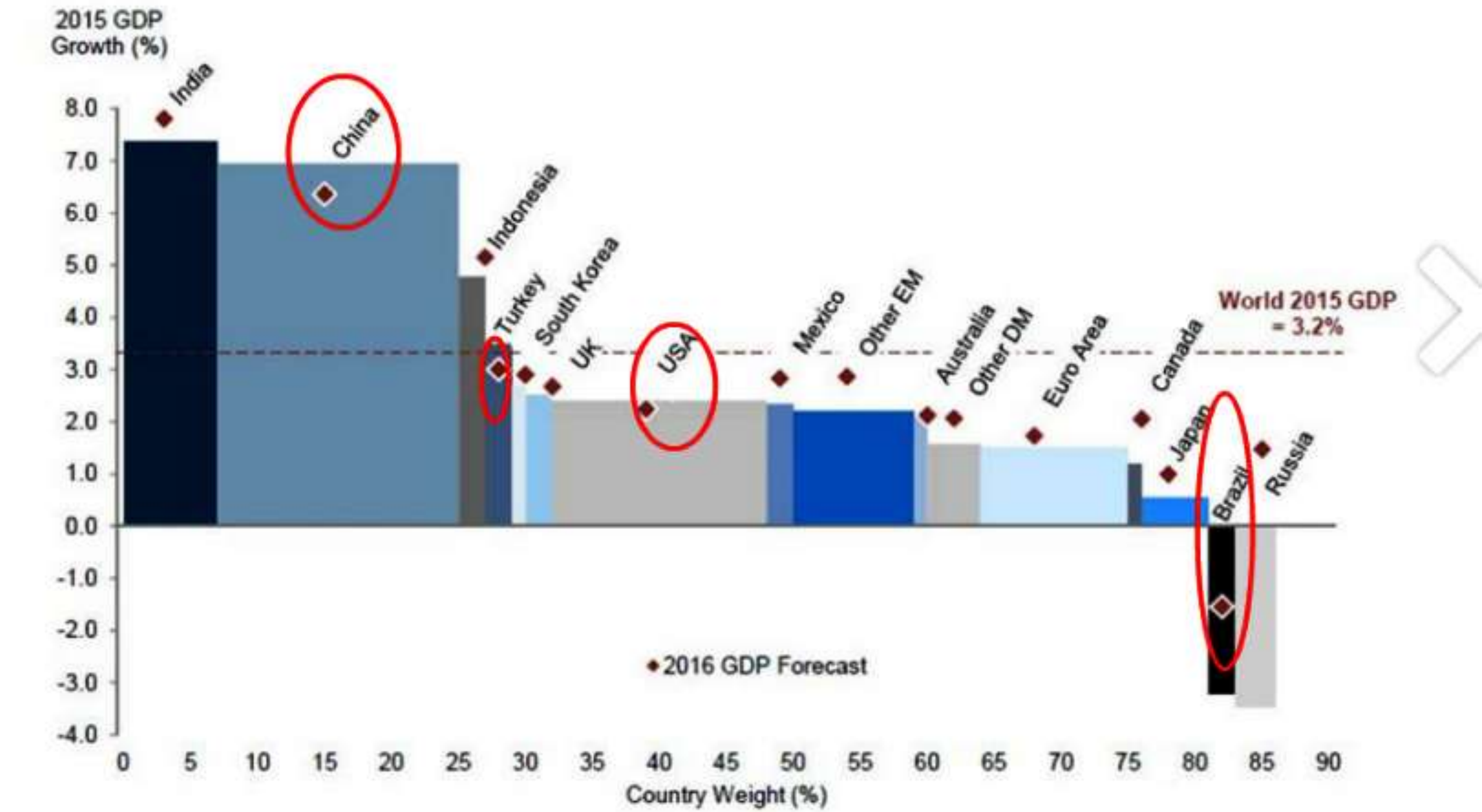
# China Economy

# USA Share of Global GNP Declines as China is Rising

As of June 30, 2015

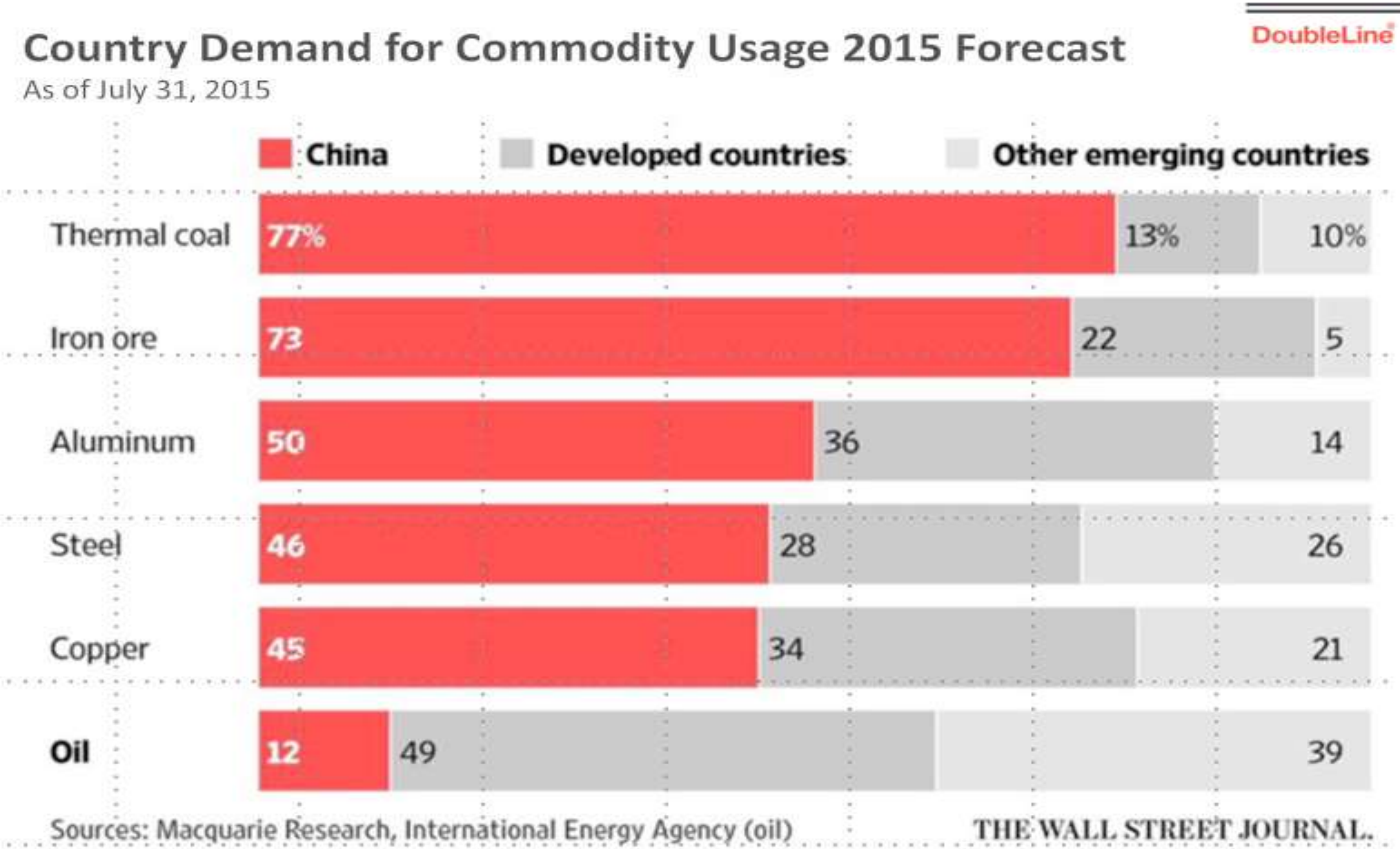


# *Growth of China Overwhelms All Others*

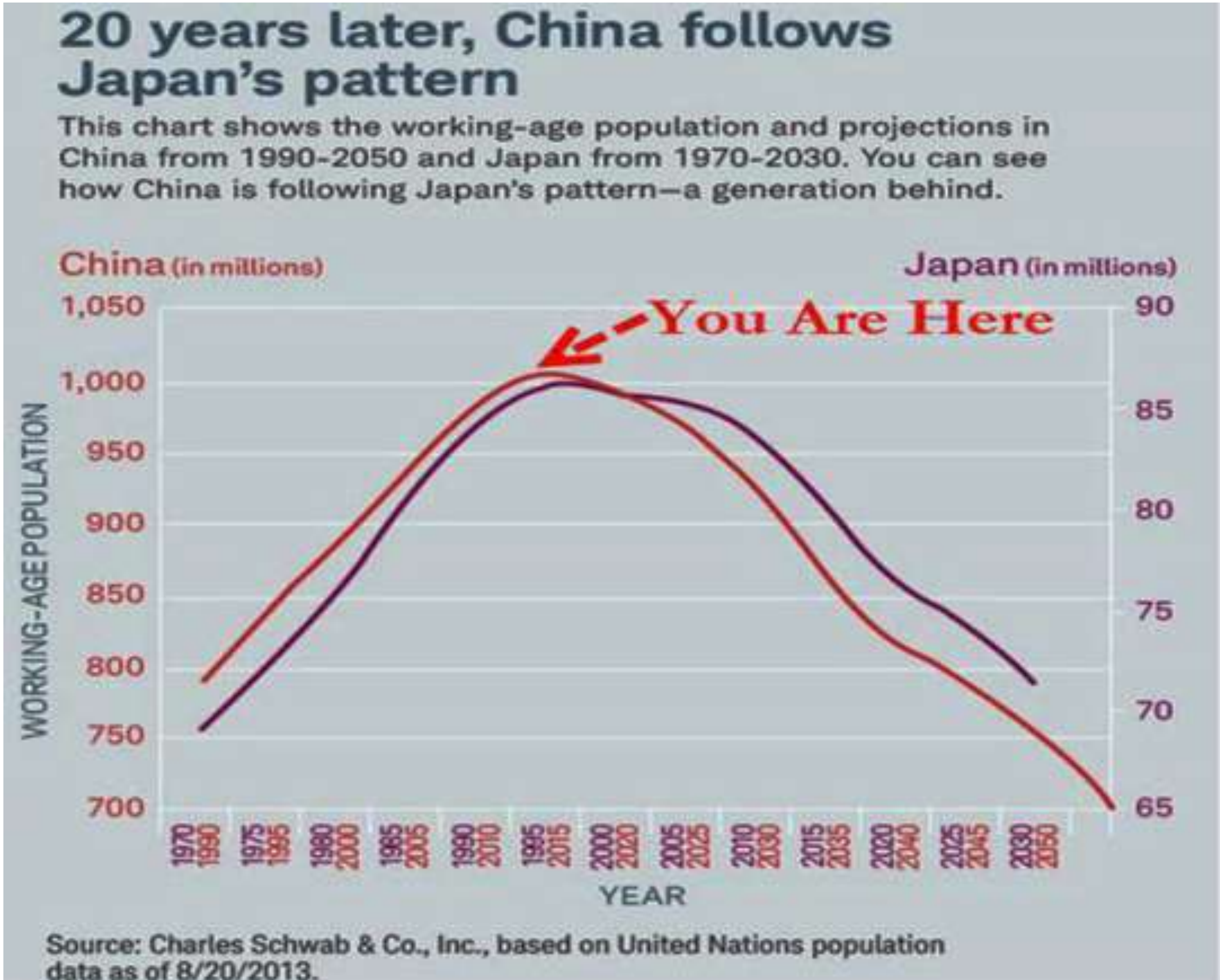



*Source: Goldman Sachs Global Investment Research.*

# *China's GNP Growth Overwhelms the Growth of Emerging Countries*



# *Threat from China Maybe Less than Expected*



# *Falling Commodity Prices Signal Slowing Down of China Growth*

# Robert Shiller - Yale

## *Approaches to Investment Methods*

- **Robert Shiller**
- Ben Graham
- Undervalued Predictable
- Buffett-Munger
- Historical Low Price/Sales
- Historical Low Price/Book
- Peter Lynch Screen
- High Short Interest
- Predictable Companies
- Dividend Stocks

## *Ben Graham Approach*

- Shiller is disciple of Ben Graham
- Acquire issues below two thirds of book value.
- Only net-current-assets are of value.

*Results:*

- Portfolios returned 29.4%, over 13-years compared to 11.5% for S&P 500 Index.

# CAPE – The Key Shiller Indicator

## Investment Process


**10 U.S. Sectors (as per table to the right)**

Examine 30 years worth of index values and earnings for 10 U.S. sectors

**Relative CAPE® Indicator for Each Sector**

Select 5 most undervalued sectors based on Relative CAPE® indicator

**Momentum**

Remove the sector with the lowest 12-month price momentum for selected sectors

**Ranking**

Equal weight in 4 favored, undervalued sectors with most positive price momentum

| Shiller Barclays CAPE® U.S. Sectors |
|---|
| Consumer Discretionary |
| Consumer Staples |
| Energy |
| Financials |
| Healthcare |
| Industrial |
| Materials |
| Real Estate |
| Technology |
| Utilities |

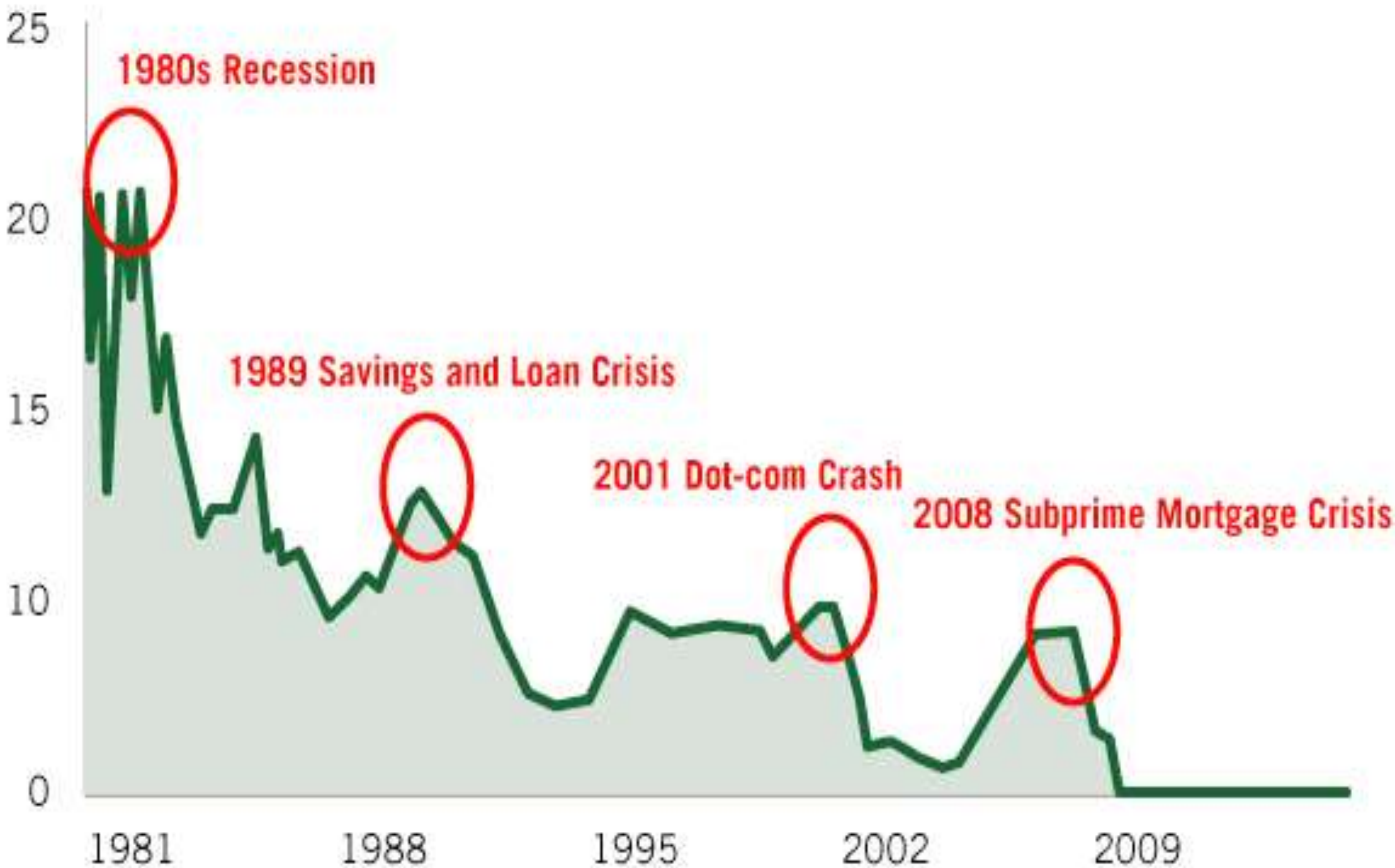
# *The Calculation of CAPE*

- Acclaimed value investors Benjamin Graham and David Dodd noted in *Security Analysis* that equity valuations tend to follow a business cycle of 3-7 years
- The CAPE® Ratio was formulated in the seminal 1988 piece[1] from Professor Robert Shiller and John Campbell.
- **CAPE**® = **C**yclically **A**djusted **P/E** (Price-to-Earnings)

$$CAPE^{\circledR} = \frac{\text{Current Equity Share Price}}{\text{10 Year Inflation Adjusted Average Earnings}}$$

- The CAPE® ratio seeks to assess longer term equity valuation by using an inflation adjusted earnings horizon that is 10 times longer than the traditional P/E measure
- Similar to the traditional P/E the CAPE® can be applied to a single equity, a portfolio of equities, a sector or a broad based index

# *The History of Shiller's CAPE*



# *Current Valuation of the Stock Market According to Shiller*

**Shiller P/E: 25.8 (+ 0.32%)**

Shiller P/E is 54.5% higher than the historical mean of **16.7**

Implied future annual return: **0%**

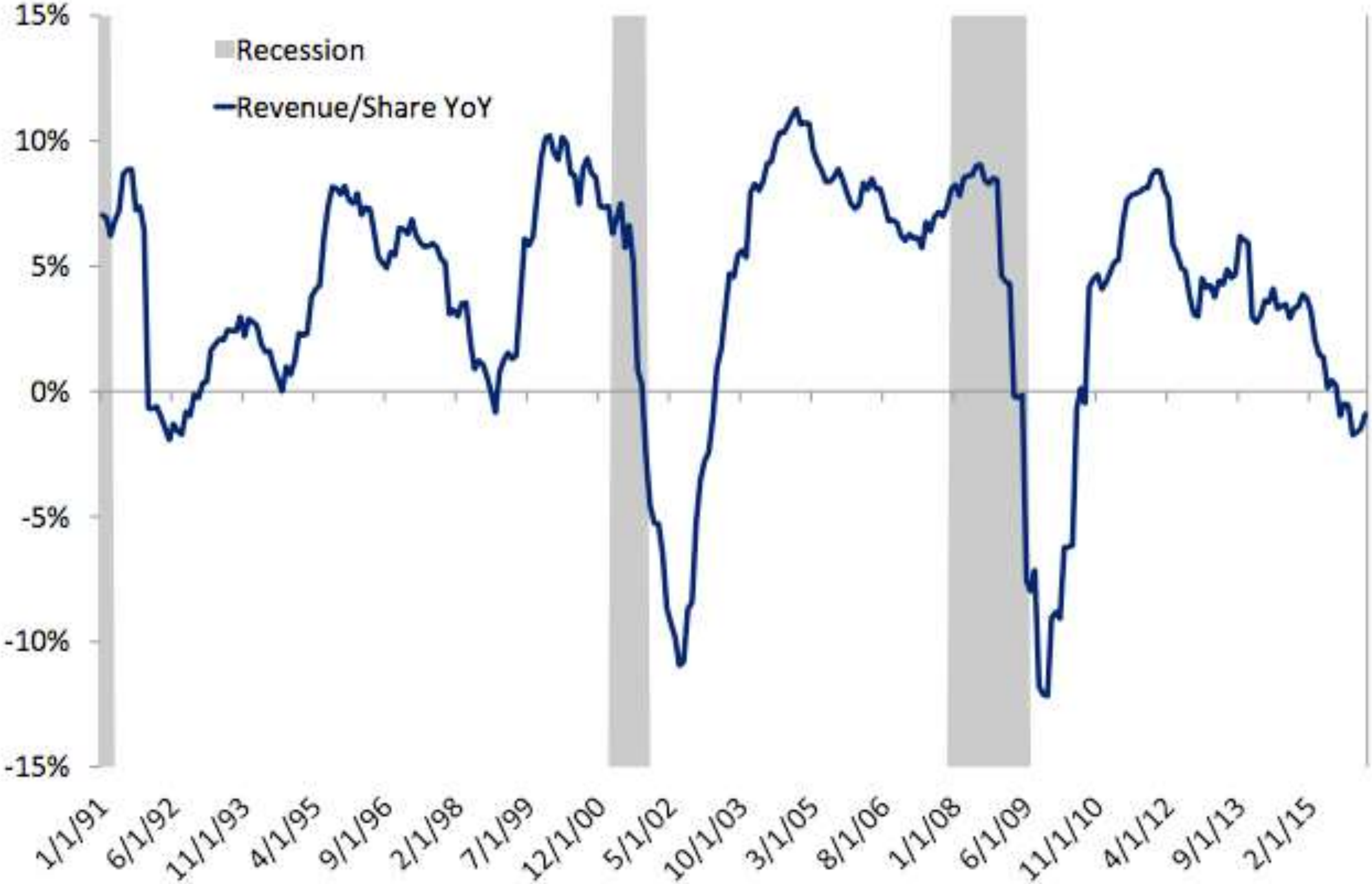
Historical low: **4.8**

Historical high: **44.2**

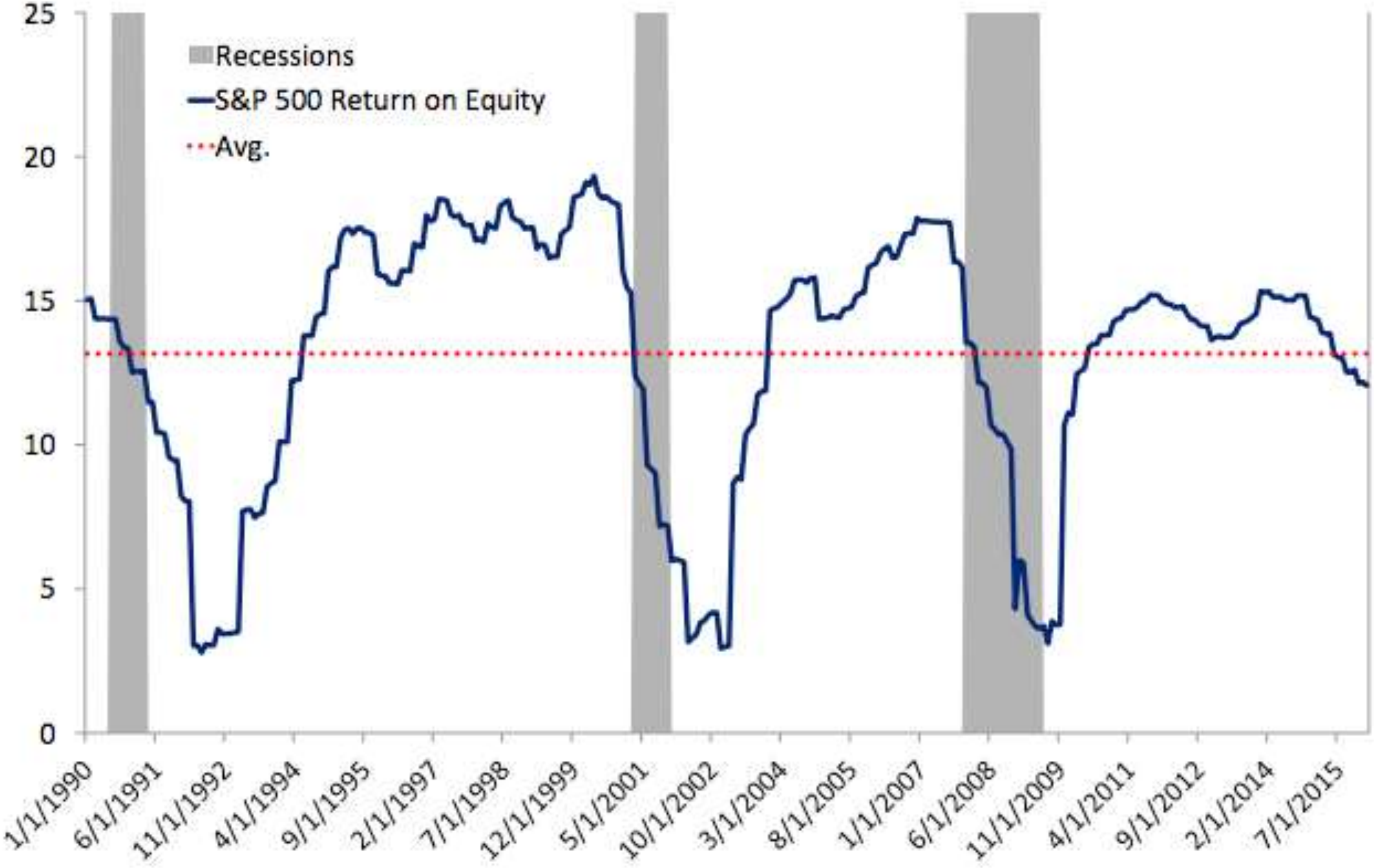
S&P 500: **2057.14**

Regular P/E: **24** (historical mean: )

# Any Other Indicators Suggest Recession?



# *Drop in S&P Also  Suggests a Coming Recession*



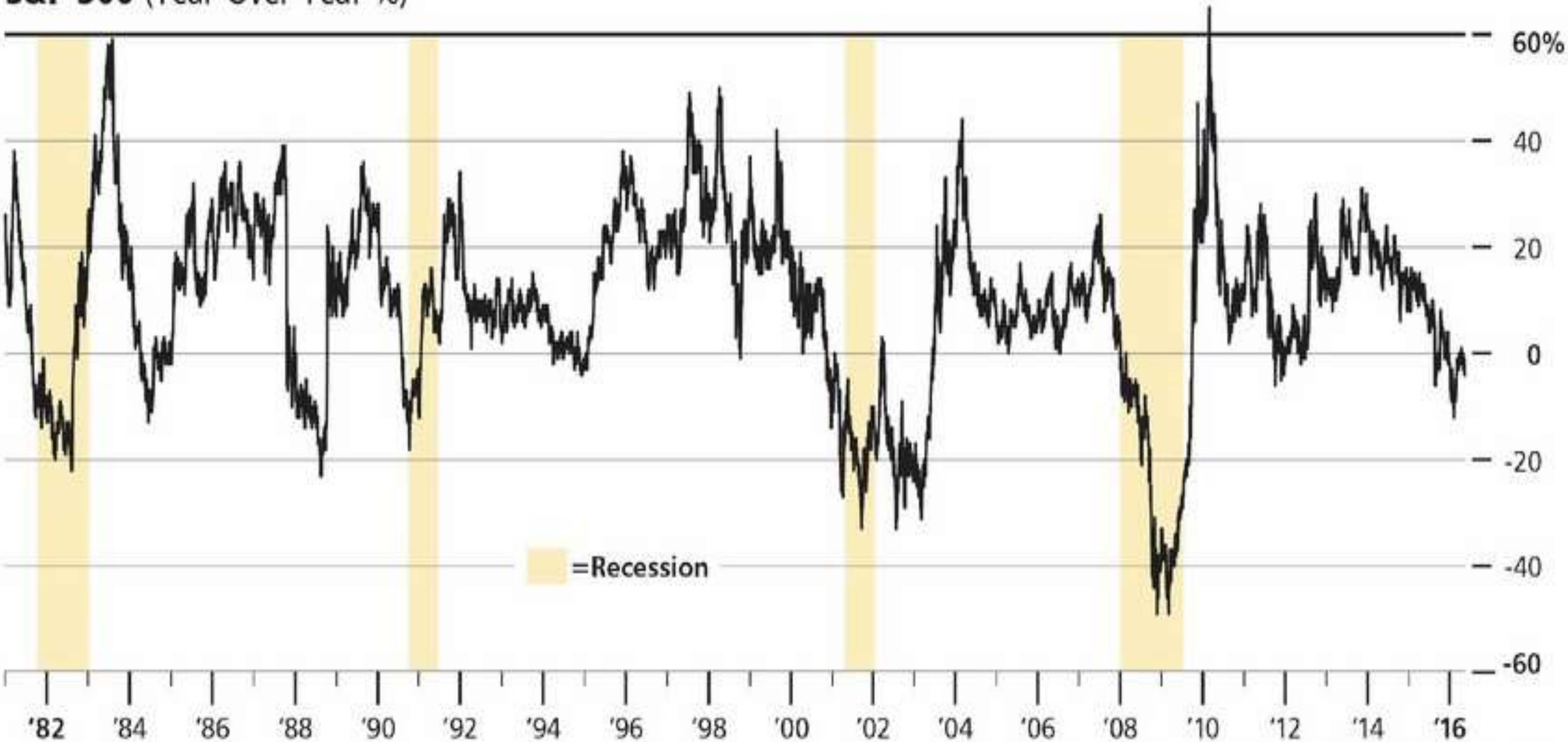

Charts Source: Bloomberg, DoubleLine

# *An Independent Review by NBER Also Indicates Recession Trend*

## MARKET CRASHES AND ECONOMIC RECESSIONS

If a crash in the stock market is defined as a plunge of 20% or more on the S&P 500 that persists for at least 12 months, then market crashes are generally sparked by economic recessions. Over the past 35 years, the only exception has been the crash of 1987-88, associated with Black Monday, Oct. 19, 1987.

**S&P 500** (Year-Over-Year %)

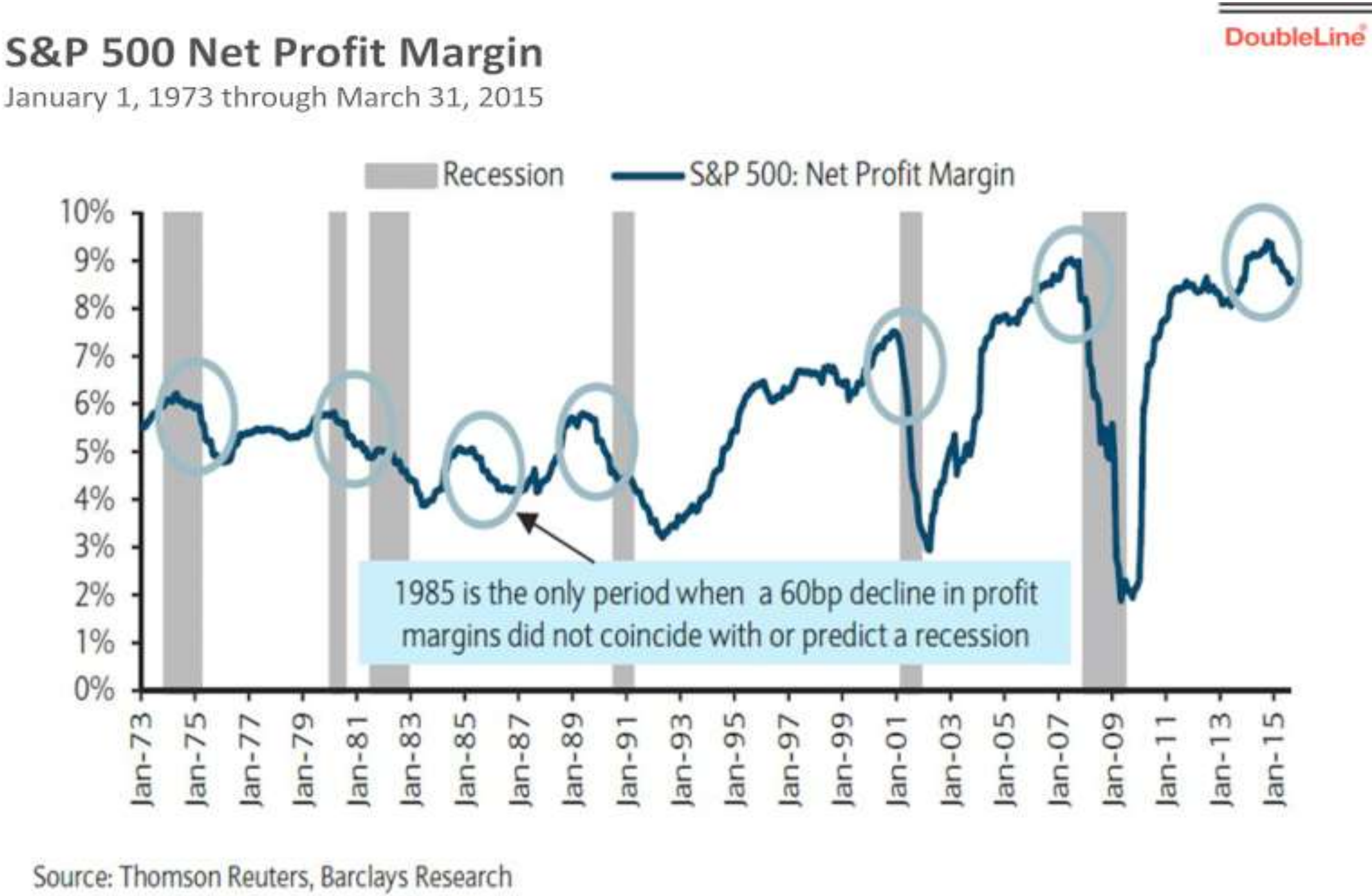



Sources: Standard & Poor's, National Bureau of Economic Research

# *Stock Market Valuations Push the Enterprise Value to Limits*


Chart Source: Bloomberg, DoubleLine

# Net Profit Margins Rise, But Not from Operatios



## *Summary Observations*

- China GNP growth will displace the #1 position of the USA, but will be slowing down.
- Based on Shiller there are strong indications that a recession in incipient, although its time is indeterminate.