the Roseline
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ROSELINE CAPITOL ADVISORS
SECOND QUARTER 2017 MARKET PERSPECTIVE

Asset Class/Index	Q2 2017	YTD 2017
US Equities		
Capitalization-Weighted Indices		
S&P 500 Index	3.09%	9.34%
NYSE	2.34%	6.37%
NASDAQ	3.87%	14.07%
Equal-Weight Indices		
Value Line Geometric	0.46%	3.27%
Economically-Sensitive Indices		
Dow Jones Transportation Index	4.91%	5.75%
Hedged Equity Benchmark Index		
HFRX Equity Hedge Index	1.01%	3.73%
International Equities		
MSCI EAFE (Developed Markets)	6.12%	12.17%
MSCI Emerging Markets	6.27%	16.24%
Fixed Income		
US Treasury Bonds (GOVT)	1.22%	1.92%
Investment Grade Corporate Bonds (LQD)	2.77%	3.96%
Low Quality Corporate Bonds (JNK)	3.78%	7.24%
Precious Metals		
Gold Bullion	-0.64%	7.85%
Silver Bullion	-8.91%	4.57%
Precious Metals Miners (GDX)	-3.20%	5.54%

Sources: Kitco, Google Finance, Standard and Poors, HFR, StockCharts.

Data as of June 30, 2017.

Interest Rates

Interest rates have been a primary tool of global central bankers in their effort to lift asset prices. Globally, interest rates bottomed over the last 12-24 months. Any continued rise will certainly get the attention of markets and policy makers.

An example of still-low rate levels:

	U.S.	Germany	U.K.	Japan
2yr Government	1.35%	-0.63%	0.31%	-0.12%
Official Rate	1.25%	0.00%	0.25%	0.10%

Bond market returns over the last 52 weeks:

Global	-2.55%	**Asian Pacific**	-2.45%
United States	-0.80%	**Pan-European**	-3.22%

From Bob Rodriguez at FPA Advisors:

> *…monetary policy has so totally distorted the capital markets. You are now into the eighth year of a period that is unprecedented in the likes of human history.*
>
> *The closest policy period to what we have now would have been between 1942 and 1951, when the Fed and Treasury had an accord to keep interest rates low. Interest rates were artificially held lower to help finance the World War II effort. With the renewal of inflation after the war, a policy war developed between the Treasury and the Fed on the continuation of a low interest rate policy. The Treasury-Fed of 1951 brought this period to a close. But that is the only time we've had a period of nine years of manipulated, price-controlled interest rates.*

Governments (and for that matter, corporations) can little afford higher interest rates. US federal debt levels have exploded in recent decades.

U.S. Federal Debt

1981	$1 trillion
1994	$5 trillion
2008	$10 trillion
2017	$20 trillion

In addition, there are more "debt-like" liabilities cropping up, including unfunded pension liabilities. Unfunded public liabilities act like debt, because the funding for public pensions comes from the same tax revenue base that pays interest on debt. The state and federal governments have underfunded liabilities equivalent to 40% of GDP, on more than $7 trillion.

The yield of the 10-year US Treasury has bottomed twice over the last five years, near 1.4%. Since mid-year 2016 the rate rise has carried 10-year yields to 2.4%.

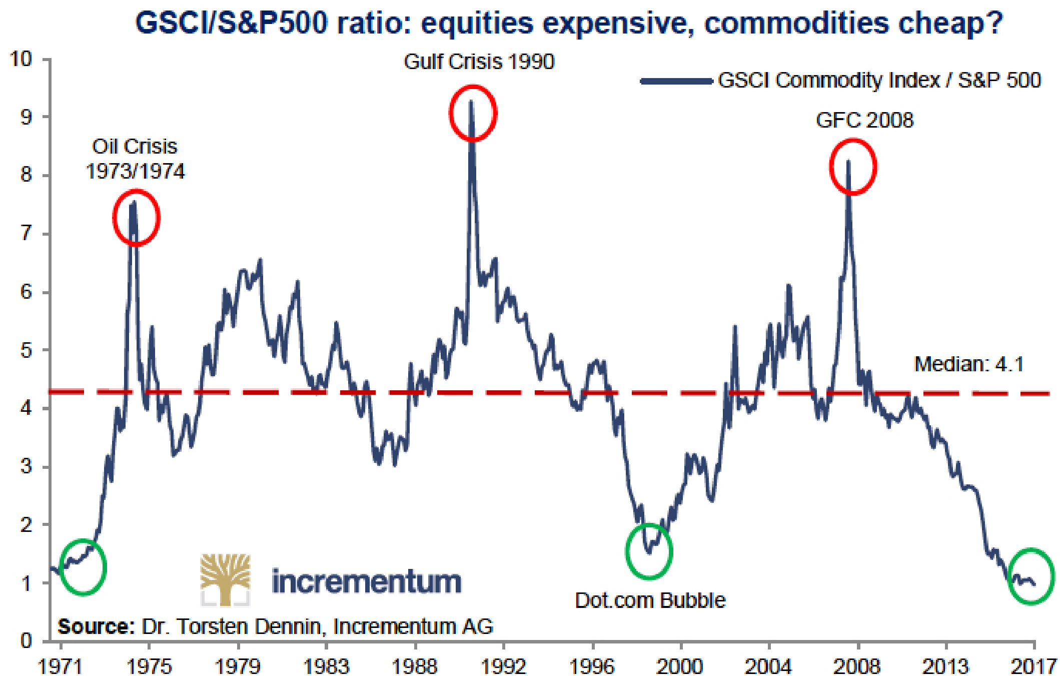
In Japan (the world's second largest bond market) the Bank of Japan recently conducted further yield curve control operations to combat modestly-rising yields. 10-year Japanese government bonds closed only two basis points (0.02%) lower in yield despite the concerted effort to have a greater impact. At the same time, yields on the 40-year bond – least impacted by yield curve control – rose to the highest level since early 2016.

In Italy (the world's third-largest sovereign bond issuer) bond yields bottomed twice, in early 2015 and in mid-year 2016, near 1.0%. Italian yields are currently around 2.25%.

All bond markets are insanely priced, and a tonal change here will very likely have wave effects in other markets.

Commodities vs. Equities

Since 1971, there have been three distinct periods where commodities have been massively cheap versus equities: 1971, 1999, and today.



During the subsequent periods of repricing, there was obviously dramatic differences in return between commodities and the general equity markets. As well, interest rates were at higher levels on average, and generally flat-to-up during the commodity repricing.

Equities

We have shown through time various ways to demonstrate the current valuations of equities.

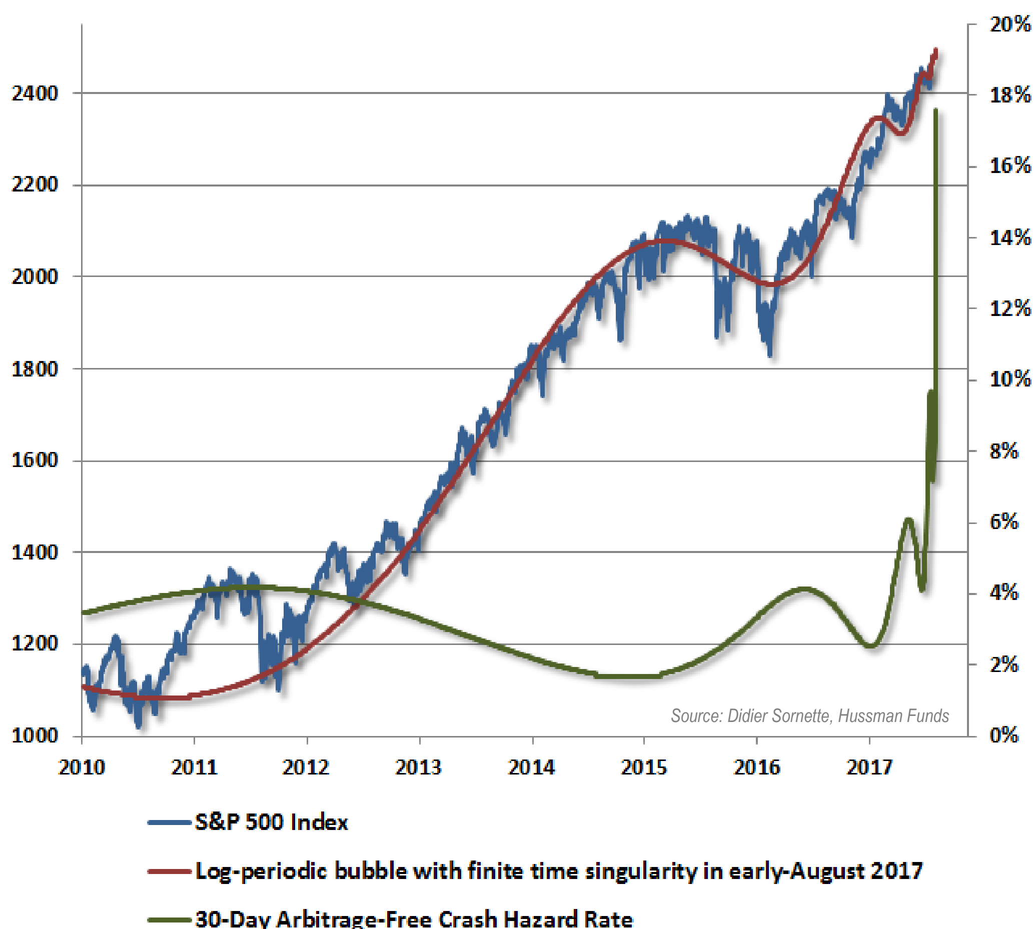
Another is given at right: the number of hours worked to purchase one unit of the S&P 500 has never been higher.

Bubbles

Speculative bubbles are typically marked by an increasingly immediate impulse to buy the dip. This creates price fluctuations that have an accelerating pitch of urgency to them…

As explained in Didier Sornette's *Why Stock Markets Crash:* "A crash is not a certain outcome of the bubble but can be characterized by its hazard rate, that is, the probability per unit of time that the crash will happen in the next instant... It remains rational for investors to remain in the market provided they are compensated by a higher rate of growth of the bubble for taking the risk of a crash."

However, as the bubble proceeds, the "crash hazard" begins to increase at an exponential rate. This can be modelled using the log-periodic approximation shown at right. Increasingly frequent and shallow fluctuations in the market occur as the bubble approaches its critical point, or singularity. This critical point does not necessarily mark the beginning of a crash, but it indicates the shift from "self-reinforcing speculation" to instability.



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F. Index performance is measured using a total return index, which assumes all cash distributions are reinvested.