Market Elements

- The S&P 500 opened strong (retracing half of the June 19, Bernanke-induced fall) then churned for the rest of the day, all 10 global sectors rose; resources lagged.
- Treasuries extended gains helped by month-end buying; strong housing and taper-to-schedule Dudley weakness were trumped by a strong 7y auction; odds of a 2014 rate hike fell below 50% for the first time in one week; corporate default risk fell.
- The yen weakened to a two-week closing low against the greenback; Euro traded an inside day.
- Gold broke below $1,200; base metals remained range-bound for the fourth day. Brent and WTI tracked equities to firm to a one-week high.

### Levels* - Currencies (USD per)

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<th>Symbol</th>
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<th>Level</th>
<th>%Chg</th>
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<tr>
<td>SGD</td>
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<td>SGD</td>
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<td>Euro STOXX</td>
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<td>FTSE 100</td>
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<td>Shang/Sen</td>
<td>L</td>
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<td>0.5%</td>
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<tr>
<td>Sensex30</td>
<td>L</td>
<td>18,876</td>
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<tr>
<td>CDX IG 5Yr</td>
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<td>86.01</td>
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<td>20,440</td>
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<tr>
<td>Sensex30</td>
<td>L</td>
<td>18,876</td>
<td>1.7%</td>
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### Moves - Currencies (spot)

- ZAR
- CAD
- AUD
- NZD
- BRL
- CHF
- GBP
- SGD

### Commodities

- Palladium
- LME N 3m
- LME Zn 3m
- LME Al 3m
- LME Ni 3m
- Gold
- Silver
- Copper

### Government 10- Yr Benchmark

- U.S.
- U.K.
- Germany
- France
- Italy
- Spain
- Portugal
- Greece
- Australia
- Hong Kong
- India
- Japan

### Equity Indices & Sentiment

- China
- Hong Kong
- India
- Japan
- Australia
- Spain
- Italy
- Greece
- France
- Germany
- U.K.
- Ireland
- Japan
- Australia

### Sectors

- S&P Global 1200
- S&P Europe 350
- S&P 500
- S&P/TSX Composite

Source for all data and graphics in this publication: BMO Capital Markets, Bloomberg, Thomson

* H/L = at a new closing 52- wk High/Low; * /# = within 10% of the 52- week High/Low. Colour codes are inverted for bond and sentiment indications.
Daily Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages
Intra Day Charts
2-Day 1-Minute View

Currencies
U.S. Dollar Index

Commodities
D.J.-UBS Commodity Price Index

Bonds
U.S. 10-Yr Bond

Equities
MSCI World Index

Yen
Gold (Spot)
U.S. 5Yr 5Yr Forward Breakeven
S&P 500

Euro
Crude Oil (WTI)
Japanese 10-Yr Bond
S&P/TSX Composite

Asia Dollar Index
Natural Gas (NMX)
Canadian 10-Yr Bond
CDX North American Inv. Grade Index

Canadian Dollar
Copper (CMX)
German 10-Yr Bund
VIX

Australian Dollar
Nickel (LME 3Mo)
Italian 10-Yr Bond
DOOM: 1M Yen IV (AUD, EUR, USD)
Daily Sector Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- Canada – at a 52-week high: Consumer Discretionary.

S&P 500

S&P/TSX Composite

S&P Europe 350
### S&P Global 1200 ex U.S. & Canada

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<td>5020 JT</td>
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<td>GALP PL</td>
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<td>TEC FP</td>
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<td>Marathon Petroleum Corp</td>
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<td>Roper Industries Inc</td>
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<td>Vestas Wind Systems AS</td>
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<td>Keppel Corp</td>
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<td>ADT Corp/The</td>
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<td>Cons Disc</td>
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<td>Mediatel SpA</td>
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<td>Peugeot SA</td>
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<td>Allergan Inc/United States</td>
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<td>CBK GY</td>
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<td>CPU AT</td>
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<td>First Solar Inc</td>
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<td>Softbank Corp</td>
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<td>America Movil SB de CV</td>
<td>AMV TL</td>
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<td>Frontier Communications Corp</td>
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<td>Milcom International Cellula</td>
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<td>Telekom Austria AG</td>
<td>TKA AV</td>
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<td>Cia Paranaense de Energia</td>
<td>ELP UN</td>
<td>-1.7%</td>
<td>Exelon Corp</td>
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**Bold** = move of more than 5%
### U.S. Market Movers

#### Energy
- Symbol: TDW, NUE, MLM
- Symbol: MTRX 15.40 -0.3% FDX

#### Industrials
- Symbol: CKH, MRO, BLL, ALB, OXY
- Symbol: EX H 90.31 1.1% UNP

#### Consumer Discretionary
- Symbol: MRO, BLL, ALB, OXY
- Symbol: BAX 65.48 2.0%

#### Consumer Staples
- Symbol: OXY, EX H 90.31 1.1% UNP
- Symbol: HSP 86.03 -0.3% BAX

#### Technology
- Symbol: CAG 35.04 5.1% CAT
- Symbol: UNP 60.79 1.1% HHB

#### Financials
- Symbol: WFC 18.24 0.6% V
- Symbol: WRB 115.43 2.6% BEAM

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### Health Care
- Symbol: HCR, CBO, RHX, CIGN, MRK
- Symbol: JNJ 115.43 2.6% BEAM

---

### Market Elements
- Symbol: MARKET ELEMENTS
- Symbol: ECO 14.95 0.9%

---

### Abbreviations
- TDW: TDW
- NUE: NUE
- MLM: MLM
- MTRX: MTRX
- FDX: FDX
- CKH: CKH
- H: H
- MRO: MRO
- BLL: BLL
- ALB: ALB
- OXY: OXY
- EX H: EX H
- RDC: RDC
- NE: NE
- ITT: ITT
- RDC: RDC
- NE: NE
- 7: 7
- RDC: RDC
- NE: NE
- C: C
- RDC: RDC
- NE: NE
- 65.48: 65.48
- 2.0%: 2.0%
- 0.3%: 0.3%
- 0.1%: 0.1%
- 5.2%: 5.2%
- 5.1%: 5.1%
- 0.9%: 0.9%
- 0.6%: 0.6%
- 0.5%: 0.5%
- 0.3%: 0.3%
- 0.2%: 0.2%
- 0.1%: 0.1%
- 0.0%: 0.0%
- 2.4%: 2.4%
- 2.3%: 2.3%
- 2.2%: 2.2%
- 2.1%: 2.1%
- 2.0%: 2.0%
- 1.9%: 1.9%
- 1.8%: 1.8%
- 1.7%: 1.7%
- 1.6%: 1.6%
- 1.5%: 1.5%
- 1.4%: 1.4%
- 1.3%: 1.3%
- 1.2%: 1.2%
- 1.1%: 1.1%
- 1.0%: 1.0%
- 0.9%: 0.9%
- 0.8%: 0.8%
- 0.7%: 0.7%
- 0.6%: 0.6%
- 0.5%: 0.5%
- 0.4%: 0.4%
- 0.3%: 0.3%
- 0.2%: 0.2%
- 0.1%: 0.1%
- 0.0%: 0.0%
### Canadian Market Movers

<table>
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<th>%Chg</th>
<th>Symbol</th>
<th>H/L</th>
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<th>%Chg</th>
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<tr>
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<td>-0.3%</td>
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<td>IIU</td>
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<td>KDS</td>
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<td>-0.4%</td>
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<td>AOO</td>
<td>1.08</td>
<td>0.0%</td>
<td>IAR</td>
<td>1.95</td>
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</table>
June 28, 2013
Research Comment
Quantitative/Technical Research Website

Mark Steele
(416) 359-4641
mark.steele@bmo.com
Assoc: Tiberiu Stoichita/Jin Li

Clicks

- On Wednesday, it was Amazon and on Thursday it was Expedia coming back to the fold. Internet Retail industry members garner a 1st decile reading as the vast majority of stocks are either outperforming or are reversing underperforming trends against markets – Figure 1.

- For those looking for established momentum, as opposed to stocks regaining (AMZN, EXPE), our momentum buy list (outperforming market and sector, above rising moving averages, not overbought) includes Orbitz, TripAdvisor, ASOS, Ctrip.com and Overstock.com.

Figure 1: Internet Retail vs. S&P 500 Index

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<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Gtr RS</th>
<th>LT RS</th>
<th>RS</th>
<th>Close</th>
<th>1-day Eq. Chg (%)</th>
<th>5-day Eq. Chg (%)</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>SPX</th>
<th>Trend Slope</th>
<th>RS Hi (Mo)</th>
<th>RS Low (Mo)</th>
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<td>OWW US</td>
<td>Orbitz Worldwide Inc.</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>8.22</td>
<td>4.4%</td>
<td>6.1%</td>
<td>867</td>
<td></td>
<td></td>
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<td>Rakuten Inc</td>
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<td>7</td>
<td>1</td>
<td>1,130</td>
<td>-0.2%</td>
<td>-5.2%</td>
<td>15,297</td>
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<td>2</td>
<td>1</td>
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<td>-1.7%</td>
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<td>1</td>
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<td>9.7%</td>
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<td>1</td>
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<td>1</td>
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<td>6.39</td>
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<td></td>
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<td>6</td>
<td>2</td>
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<td>12.73</td>
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<td>-1.1%</td>
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<td>1</td>
<td>10</td>
<td>5</td>
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<td>3.3%</td>
<td>2.8%</td>
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<td>243</td>
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<td></td>
<td>-51%</td>
<td>12.0</td>
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Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

Breaking out of Pottersville

Why he ever started this cheap, penny-ante Building and Loan, I’ll never know – Figure 1.

George Bailey

- This is a continuation of yesterday’s Curve Ball where we look at the expensive suits drowning their sorrows at Martinis, and the cheap suits finding a hero in the withdrawal of stimulus steepening yield curve.
- The U.S. Thrifts & Mortgage group is breaking out of Pottersville – Figure 1.

• The Subindustry has improved to a 4th decile reading, as 10 stocks have now broken above underperforming trends against the S&P 500 Financial index – Figure 2.
• People’s United is breaking out of an 11-month base – Figure 3.
• New kid on the block EverBank Financial is reversing an underperforming trend against financials – Figure 4.

Attaboy, Clarence

Figure 1: US Thrifts & Mortgage Finance vs. US Financials

Figure 3: People’s United Financial vs. S&P 500

Figure 2: S&L Breaking Above Underperforming Trends vs Financ.

Figure 4: EverBank Financial vs. S&P 500 Financials

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Curve Ball

- There is absolutely no question that the rapid rise in Treasury yields, the continuing widening of MBS-Treasury spreads and the disruption of the carry trade has thrown a curve ball into the banking system.
- Our penchant is for risk analysis. From credit market indications, we glean indications of who may have been standing too close to the plate and could get dinged by the ball. For this we use the positioning of too-interconnected-to-fail banks by their CDS curve. We have watched HSBC and now Goldman Sachs move up toward the weakest member of the group, UniCredit – Figure 1.
- Who benefits from this curve ball?
  - Our strength reading for Regional (largely U.S.) banks moved on up to first decile this week – Figure 2.
  - Apparently, somewhere out there is a Joe Sixpack (who thinks that the Muppets is a cartoon) who can pay off a loan. Joe just found a banker, who, thanks to tapering, now figures that there is a profit to be made from that loan.
- After 18 months of market performance, U.S. regional banks are breaking out relative to the market – Figure 3.
  - On an absolute basis, nothing changes; they continue to rise at a rate of 32%/year.

Figure 1: CDS Trends on Too-Interconnected-to-Fail Banks Sorted by CDS Curve (Closest to Inverted on Top)

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Country</th>
<th>LT Rs</th>
<th>CDS Level</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>CDS Trend Slope</th>
<th>CDS Fl (Mo)</th>
<th>CDS Lm (Mo)</th>
<th>Liquidity</th>
<th>Fl to Equity</th>
<th>CDS Curve 1/5Y</th>
<th>CDS 2-day Chg (%)</th>
<th>CDS 5-day Chg (%)</th>
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<td>UCG IM</td>
<td>UniCredit SpA</td>
<td>Italy</td>
<td>10</td>
<td>0</td>
<td>27,688</td>
<td></td>
<td></td>
<td>-11%</td>
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<td>1</td>
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<td>19%</td>
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<tr>
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<td>8</td>
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<td></td>
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<td>2</td>
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<td>-45%</td>
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<td>3</td>
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<td>1.5%</td>
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<tr>
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<td>-4%</td>
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</tr>
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<td>7</td>
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<td></td>
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<td></td>
<td></td>
<td>-10%</td>
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<td>-3%</td>
<td>26%</td>
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<td></td>
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<td>1</td>
<td>1</td>
<td>0.44</td>
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<td>21%</td>
</tr>
<tr>
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<td></td>
<td>-3%</td>
<td></td>
<td>1</td>
<td>4</td>
<td>0.44</td>
<td>0%</td>
<td>49%</td>
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<td></td>
<td></td>
<td>-38%</td>
<td></td>
<td>8</td>
<td>5</td>
<td>0.43</td>
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<td>15%</td>
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<tr>
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<td>UBS AG</td>
<td>Switzerland</td>
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<td>5</td>
<td>65,488</td>
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<td></td>
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<td>0.39</td>
<td>-5%</td>
<td>20%</td>
</tr>
<tr>
<td>B310 JP</td>
<td>Sumitomo Mitsui Financial Group</td>
<td>Japan</td>
<td>9</td>
<td>8</td>
<td>61,666</td>
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<td></td>
<td>-39%</td>
<td></td>
<td>2</td>
<td>5</td>
<td>0.38</td>
<td>2%</td>
<td>13%</td>
</tr>
<tr>
<td>BAC US</td>
<td>Bank of America Corp</td>
<td>U.S.</td>
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<td>7</td>
<td>135,887</td>
<td></td>
<td></td>
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<td></td>
<td>2</td>
<td>3</td>
<td>0.36</td>
<td>-3%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Figure 2: Regional Bank Relative Strength Decile

Finally Got A Piece of the Pie

Moving On UP

Trend / Width  -1% / 6%

Trend Length  16 mo

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

Figure 3: Regional Bank ETF vs. S&P 500

...Breakout

After an 18-Month Base...
Feral Hogs

“Big money does organize itself somewhat like feral hogs. If they detect a weakness or a bad scent, they’ll go after it.”

– Dallas Fed President Richard Fisher.

- What markets are rooting out is of course the known unknown.
  - as the Treasury curve rapidly tightens and
  - as Treasury volatility surges from an all-time low
  - the carry trade is rapidly unwound.

- Who in 2013 will be the LTCM of 1998 or Carlyle Capital of 2007? How significant will be the hit to the banking system? The feral hogs will seek these out.

- Once the Dragon boat festival was over, we knew that the stress on the Chinese banking system was more than just seasonal, it was structural – Figure 1.

- So the market is rooting out whose structure is most disrupted from the structural shift from loosening to tightening, which disrupts the carry trade – see Tighten Up.
  - It does so both at the sovereign and corporate levels – Figures 2, 3.
  - And as the banking system is threatened, correlations tend toward one.

Figure 1: Odds of a 2014 FED Rate Hike and 1W SHIBOR

Figure 2: China 5-Year Sovereign CDS

Figure 3: HSBC 5-Year CDS

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Tighten Up

- We write this in the early hours of the Japanese market open before travel.
  - Japanese shares, where day traders dominate like they did the dot.com boom/bust, gapped to the upside only to fall as the morning matured.
  - The 3-day rout in U.S. Treasury bonds is turning into a 4-day rout.
- On Friday, we started to reuse the WIRP function on Bloomberg to come up with one of three front page charts in our Focal Points – Tighten Up, which is also out today. We used that chart from our report in today’s RSF – Figure 1.
- The Bank of International settlements on Sunday also spells out the tightening theme.
- The PBOC also considers liquidity reasonable in its Sunday report.
- It seems most reasonable to brace portfolios toward the tightening headwinds.

Figure 1: Odds of a 2014 Fed Rate Hike From Fed Funds Futures

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Japanese Fetchez La Vache Moment

- Hello.
  - Japanese bond yields just broke to the upside. Our upside technical target is 1.20 – Figure 1, top.
    - Japanese bond volatility is suspiciously tame relative to surging U.S. Treasury and German Bund volatility.
    - We do not expect it to remain tame – Figure 1, bottom.
  - Japanese inflation expectations continue to decline:
    - This is the fingerprint of the markets disbelief of Abenomics – Figure 2, top.
    - Which sets the stage for continued strength of the Japanese currency – Figure 2, bottom.
  - Taken together, this is the Fetchez La Vache moment for Japanese policy makers.
  - If you are expecting the GPIF to take your stock off of your hands, they just said thanks, but we already got some.
  - The TOPIX is at the top end of a consolidation pattern. We expect a break to the downside – Figure 3.

- Run away.

---

Figure 1: Japanese 10Y Bonds and JGB Futures Imp. Vol

Figure 2: Japanese Inflation Expectations and the Yen

Figure 3: Tokyo Stock Exchange Tokyo Price Index TOPIX

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Gold, the FED & Napalm in the Morning

- Bernanke killed the gold price at 2:47 p.m. yesterday. Technically, bullion broke to the downside at 3:43 p.m. – Figure 1.
  - His response yesterday to the question “Financial conditions have tightened... bond yields have gone up... Why do you think that is?”, and in several other responses in the Q&A, revealed the FED to be taking a far more optimistic view on what rising Treasury yields mean (see today’s Misplaced FED Optimism & Market Risk).
    - That pushed both U.S. 2- and 10-year yields to new intraday highs.
      - The move in the short end unleashed U.S. dollar strength against the yen and euro (interest rate differentials rule). As a side note, gold is moving more with EUR than it is with JPY this morning.
      - The move in the long end unleashed a new high for treasury volatility. The 2-day $214 downdraft in gold back in April had a fingerprint: rising bond volatility.
    - Our downside risk for gold with full-on pressures on both the long (impacting volatility) and short end (impacting the currency market via rate differentials) of the Treasury curve is $1,160 – Figure 1.

Figure 1: Gold With Bond Market Volatility and Currency Stresses

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
We will be brief, so you can watch the nothingness that is going on in the market (ex. China) while the world waits for Ben.

The U.S. equity market stands so very much above any other global equity market out there – Figures 1, 2.

- What would make the sloppiness of the World x USA (Figure 2) feed back into the U.S. is the concern on treasuries (Figure 3), which would be transmitted back into the U.S. equity market via the creditworthiness of the banking system – Figure 4.
  - An ease of concern (Figure 3), continues the trend of 33-38%/year appreciation of the U.S. equity market.
  - An increase in concern would make Figure 1 look more like Figure 2.
Bennie and the Jets

- A day before Dr. Ben S. Bernanke hits the stage, and tries to perform the delicate PR surgery of trying to slowly, yet surely, let the air out of the credit balloon…
  - …we are watching emerging market currency volatility rebound – Figure 1. A deemed loss of U.S. stimulus is a loss of emerging market (carry trade) liquidity.
  - …volatility would have another leg up if the balloon is deemed too large, and the surgery is deemed a failure.
- China performs its own delicate balance of reining in the shadow banking system, while at the same time trying to add only a moderate stress to the non-shadow banking system. With real estate prices still rising, the pleas of cash from Chinese banks may continue to be denied, yet too sharp a denial may bring on too sharp of a correction. To watch this tug of war, one watches the Chinese interbanking lending curve for indications of short-term stress (Figure 2), and Chinese bank CDS for longer term stress. When short-term stress is acute, these look the same (LEH-like).
- In Japan, it is more about policy traction and the market’s confidence in it that drives momentum investors to and fro.
  - This morning’s rebound (weakening) of the yen runs counter to the market’s gauge of policy traction. Japanese inflation expectations continue to recede (Antiabenomics) – Figure 3.
  - We have let the market tell us which Japanese bank may be stressed the most on the Abe/Antiabenomics fillip. The winner, whose CDS is most liquid, most widened, and has a curve closest to (yet still far away from) a stressed inverted position is Sumitomo Mitsui Financial Group – Figure 4.
- These central bank players are all connected.
  - Collectively they are B-b-b-Bennie and the Jets.

Figure 1: JPM Emerging Market Volatility Index

Figure 2: Chinese and the Interbank Lending Rates and Curve

Figure 3: Japanese Inflation Expectations and the Yen

Figure 4: Sumitomo Mitsui Banking Corp 5yr CDS

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Top Sector – Health Care

- **Health Care** is the best sector in our **Sector Heat Map** (a measurement of the breadth of what the market rewards/disregards), which is embedded in our Group Selection Report – Figures 1, 2.
- Also notable from this report:
  - **Utilities** are rebounding with a more positive leaning in treasuries.
  - **Financials** continue to weaken.
  - **Materials** continue to garner the worst strength reading.
- We carved out two lists of earnings-growth-related health care stocks which have (1) long-term earnings growth expectations higher than 10%/year, (2) positive expected earnings momentum (FY3E>FY2E>FY1E), low credit risk (CDS 1st 6th decile or lower) and (4) good liquidity.
- From this list, the **momentum buys** and **severed market performers** are shown in Figures 3, 4.

**Figure 1:** Sector Heat Map From Our Group Selection Report

**Figure 2:** Health Care Relative Strength Decile

**Figure 3:** Growth Health Care Momentum Buys vs. S&P 500

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>Grp</th>
<th>RS</th>
<th>LT</th>
<th>RS</th>
<th>Close 14-Jun</th>
<th>1-day Equity Chg (%)</th>
<th>MktCap (USE$)</th>
<th>Chg Last Day</th>
<th>SPX</th>
<th>Trend Slope</th>
<th>RS Hi (Mo)</th>
<th>RS Low (Mo)</th>
<th>% Chg wrt S&amp;P MA</th>
<th>Chg wrt 50 Day MA Trend</th>
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</thead>
<tbody>
<tr>
<td>TMO US</td>
<td>Thermo Fisher Scientific, Inc.</td>
<td>Lifesci</td>
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<td>5</td>
<td>1</td>
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<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
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<td>Aetna Inc</td>
<td>MngtCare</td>
<td>3</td>
<td>5</td>
<td>1</td>
<td>60.53</td>
<td>-1.7%</td>
<td>22,895</td>
<td>37%</td>
<td>4%</td>
<td></td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CT US</td>
<td>Cigna Corp</td>
<td>MngtCare</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>68.16</td>
<td>-1.8%</td>
<td>19,448</td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>ABC US</td>
<td>Amvesource/Bergen Corp</td>
<td>HCDistr</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>54.93</td>
<td>0.7%</td>
<td>12,684</td>
<td>32%</td>
<td>1%</td>
<td></td>
<td>Above Rising</td>
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<td></td>
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<tr>
<td>CVO US</td>
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<td>Lifesci</td>
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<td>8</td>
<td>2</td>
<td>75.51</td>
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<td>4,220</td>
<td>27%</td>
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<td></td>
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</tr>
<tr>
<td>MOH US</td>
<td>Molina Healthcare Inc</td>
<td>MngtCare</td>
<td>3</td>
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<td>3</td>
<td>36.99</td>
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<td>5%</td>
<td></td>
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<td></td>
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</table>

**Figure 4:** Growth Health Care Underperformers Breaking Above Underperforming Trends vs. S&P 500

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>Grp</th>
<th>RS</th>
<th>LT</th>
<th>RS</th>
<th>Close 14-Jun</th>
<th>1-day Equity Chg (%)</th>
<th>MktCap (USE$)</th>
<th>Chg Last Day</th>
<th>SPX</th>
<th>Trend Slope</th>
<th>RS Hi (Mo)</th>
<th>RS Low (Mo)</th>
<th>% Chg wrt S&amp;P MA</th>
<th>Chg wrt 50 Day MA Trend</th>
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<td>VAR US</td>
<td>Varian Medical Systems</td>
<td>HCEquip</td>
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<td>6</td>
<td>10</td>
<td>68.88</td>
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<td>-48%</td>
<td>1%</td>
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<td>Above Falling</td>
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<td>CR Bard Inc</td>
<td>HCEquip</td>
<td>5</td>
<td>8</td>
<td>10</td>
<td>111.04</td>
<td>-1.6%</td>
<td>5,837</td>
<td>-20%</td>
<td>8%</td>
<td></td>
<td>Above Rising</td>
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<td></td>
<td></td>
<td></td>
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<td>DSX US</td>
<td>Quest Diagnostics Inc</td>
<td>HCServ Ice</td>
<td>4</td>
<td>8</td>
<td>9</td>
<td>62.62</td>
<td>-0.4%</td>
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<td></td>
<td>Above Rising</td>
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</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
A Second Abenomics Trade - Canadian REITS

One known known from the BOJ minutes, there is concern that the timeframe of stimulus should be restricted (rhymes with FOMC tapering). Antiabenomics has taken over – Figure 1.

- Those still riding the great Abenomics trade of the year are now very much on the wrong side of the market.
- That this should help to ease the pressure on Treasuries (PDRC influence).
  - Stress on yield-related stocks should subside.

Canadian REITS are the fourth-largest REIT bucket in the world, and are similarly sized to Japanese REITS (see graphic in article).

- Canadian REITS typically outperform, or at least market perform vs. Japanese REITS – Figure 2.
- We expect Japanese REITS will shift back to underperformance – Figure 3.

To the Global REIT investor, benchmarked against the FTSE Global REIT index, Canadian REITS used to look like (slaughtered) mining stocks. Not anymore. 40% of them have broken above underperforming trends. For the Global REIT investor, focused on outperformance, CDN REITS are turning positive – Figure 4.
The Known Unknown

Two months ago, when Treasury volatility was hitting an all-time low, economic signalling was weak and German short rates were negative, we pondered the ability for U.S. interest rates to go negative. An astute student of the market reminded us that the precursor to high volatility is low volatility.

- Treasury volatility has shot up 79% of the low.
- It has yet to recede.

The known unknown is that there are carry trades out there that have gone horribly wrong.

- Markets are on alert.
- Asia is in focus: emerging markets are in focus – Figures 1, 2.
- The transmission mechanism of stress from carry trades gone wrong to the blue chip S&P 500 is via the banking system – Figures 3, 4 (next page).
- The best indication of carry trade stress comes via yen carry trade implied volatility, our old friend and the memorably named “DOOM” – Figures 1, 4.
  - This stress indication signals a buy when it has a massive one-day surge. At that point, the known unknown will be known.
  - Stress indications imply that there is very smart, back-testing loving, propeller head blowing up out there.
    - We just don’t know yet who, in 2013, is the Carlyle Capital of 2007 or the LTCM of 1998.
  - But, ultimately, we will.

Figure 1: Yen Carry Trade IV and Asian Sovereign Default Risk  Figure 2: Low Volatility Begets High Volatility

Figure 3: CDS Trends on SIFIs Where Credit Improvement Trends Have Been Broken

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>CDS Level (US$)</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>CDS Trend Slope</th>
<th>CDS Hi (Mo)</th>
<th>CDS Lo (Mo)</th>
<th>CDS Curve 1/5Yr</th>
<th>CDS 1-day Chg (%)</th>
<th>CDS 5-day Chg (%)</th>
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<td>Bank of China Ltd</td>
<td>China</td>
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<td></td>
<td>-13%</td>
<td>8.0</td>
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<td>0.38</td>
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<td>16%</td>
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<td>50,120</td>
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<td>0.32</td>
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<td>10%</td>
</tr>
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<td>Goldman Sachs Group Inc</td>
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<td>2.0</td>
<td></td>
<td>0.32</td>
<td>5%</td>
<td>7%</td>
</tr>
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<td>Citigroup Inc</td>
<td>U.S.</td>
<td>150,440</td>
<td></td>
<td></td>
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<td></td>
<td>0.26</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>HSBC Holdings PLC</td>
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<td></td>
<td>-31%</td>
<td>2.0</td>
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<td>0.45</td>
<td>10%</td>
<td>11%</td>
</tr>
<tr>
<td>Sumitomo Mitsui Financia Group</td>
<td>Japan</td>
<td>61,367</td>
<td></td>
<td></td>
<td>-42%</td>
<td>3.0</td>
<td></td>
<td>0.39</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>Mitsubishi UFJ Financial Group Inc</td>
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<td>86,792</td>
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<td>-40%</td>
<td>3.0</td>
<td></td>
<td>0.30</td>
<td>0%</td>
<td>-1%</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Figure 4: Yen Carry Trade Implied Volatility and the S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Steady or Suffer

- In bond land…
- The stress in treasuries (Figure 1), as the market is troubled with taper tensions, must be front and centre in decision making. You mess too harshly with Treasuries and the yield bubble (which the FED is trying to deflate), and you mess with a whole lot of things.
- At the end of May, we advised being sellers of Treasury panic. The argument was that as the yen strengthened, PRDC-related flows (real and front run) would ease some of the pressure on Treasury pricing (yesterday afternoon’s rally).
  - Treasury implied volatility appears to have crested, but has not subsided yet – Figure 1.
  - Yen strength has impacted the U.S. 30-year swap spread, more than Treasury prices, but the impact is real and in place as long as the yen strengthens – Figure 2.
  - Our lead indication here continues to be Japanese inflation expectations, which have flattened out over the past few sessions (to Abe or Anti-Abe?).
- Getting to equities…
- Yesterday, implied correlations in the S&P 500 broke above a 1-year downtrend – Figure 3.
  - When markets are de-stressed, which has been the bulk of the last 12 months, then (many but not all) equity bull markets flourish.
  - When markets become stressed, correlations tend toward (the destructive power of) ONE and (all) equity markets suffer.
- What drives correlations toward ONE is stress on the banking system. The U.S. banking system stresses when stresses build in the MBS market. Currently, there is enough stress to observe a loose fit between MBS and the cost to protect US banks against default – Figure 4.
  - Further stress will make the fit less casual, and more sufferable.
    - Steady (Fig 1) or suffer (Figs 3, 4).
    - Conviction levels are fluid.

Figure 1: U.S. Treasury Futures (TY) Implied Volatility

Figure 3: CBOE Implied Correlation

Figure 2: Yen and US30Yr Swap Spread (top) and US 10Yr (bot.)

Figure 4: Cost to Protect U.S. Banks Against Default, MBS Stress

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

It’s the Volatility

- This morning, as the U.S. 10-year treasury yield surges through 2.25%, emerging market currency volatility finally surpasses G7 currency volatility.
- When central banks stop loosening to the degree that the market has been accustomed to, the game of credit musical chairs starts to get exciting, and nothing is more exciting than emerging markets. While treasury yields and emerging market volatility rhyme (Figure 1 top), treasury volatility and emerging market volatility fit – Figure 1 bottom, and Figure 2.
- In this environment, the only market standing up against the S&P 500 is Japan, and that game of QE excitement is closing down too – Figure 3.

Figure 1: Treasury Yield and Volatility vs. EM FX Volatility

Figure 2: Fit of Treasury Volatility to EM Volatility

Figure 3: Equity Relative Strength Trends vs. S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Gold – Two Steps Forward, One Step Back

On Friday our gold share strength reading slumped back to 10th decile – Figure 1.

The reason it did so is that the US jobs report helped to spur a weaker yen, and gold moved with the weaker yen, tick for tick – Figure 2.  
- After being bearish on gold for quite some time, we put out a bullish note on Friday.
- We remain bullish on gold. Why? Partially because gold moved with the yen tick for tick – Figure 2.

The larger picture on our bull/bear leaning on gold stems from:
1. A weaker yen, and its deflationary leanings for the world ex Japan, has had a hand in pushing gold lease rates lower, which has forced those that were long gold for the carry to liquidate as the economics of the carry diminished. See our May 9 RSF, “Gold and GOFO” and the references therein. A stronger yen ought to turn that tide – Figure 3.
2. We do not measure Abenomics via a quarterly GDP figure; we measure it via Japanese inflation expectations, which continue to recede this morning (the Anti-Abenomics leaning of the market). As such, after the yen completes its bungee-type bounce, we expect it to continue to strengthen as long as Japanese inflation expectations continue to falter – Figure 4.
3. We see the key driver for the yen to be driven by the Japanese, as opposed to US (Friday’s move) statistics. What Friday did was to help cement the gold/JPY relationship. This is the key for us.
4. Speculative long positions are very low, and started to turn up – see link.

Figure 1: Gold Relative Strength Decile

Figure 2: Gold and the Yen Intraday Friday Morning

Figure 3: Gold, GOFO, Yen

Figure 4: Japanese Inflation Expectations and JPY

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

Anti-Abenomics & Gold

- Abenomics is QE to the moon to inflate Japan and revitalize the economy. When Japanese inflation expectations signal that the experiment is not going well, then investors should position for the Anti-Abenomics trade – Figures 1, 2.
  - Inflation expiations continue to recede.
    - JPY strengthens again today.
- On May 30, our gold equity decile moved out of the weakest, or 10th decile, position; it was a strengthening yen that did the job (we wrote on golds, but also highlighted the other Anti-Abenomics trade, overweighting Utilities). Yesterday, when the yen strengthened the most in over three years, gold shares improved to 8th decile – Figure 3.
- Which gold shares to buy? We prefer the ones that can break above underperforming trends against bullion (Figure 4), else you can just buy bullion; and as of yesterday’s close, technically, you will be early.
  - But then again you should never be late for a gold rally.

Figure 1: Japanese Inflation Expectations and JPY

Figure 2: Gold and JPY (Inverted)

Figure 3: Gold Relative Strength Decile

Figure 4: Shares Breaking Above Underperforming Trend vs. Au

Gold Shares Breaking Above Underperforming Trends vs. Bullion

- NSU CN -9%
- SUE CN -37%
- RR CN -67%
- PVG CN -54%
- AR CN -45%
- KGI CN -102%
- FNV CN -28%
- GOLD US -26%
- SEA CN -48%
- NEM US -29%
- G CN -23%
- AKG CN -66%
- RMX CN -88%
- OSK CN -108%
- SMF CN -105%
- BLD CN -103%
- ALQ CN -90%
- PG CN -154%
- IMG CN -152%
- AES CN -85%
- YRI CN -58%
- CNL CN -148%

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

U.S. Cornerstone Chipped

TOOLKIT

• The Signaling:
  - **The epicenter of recent credit weakness is the USA** – Figure 1.
  - The **cost to protect U.S. banks against default** is at a 1-month high, CDS levels are breaking above 50d MAs, and the cost to protect B of A against default has risen 14% over the past five days – Figure 2.

• The Message:
  - The cornerstone of the U.S. Banking System is the housing market.
    - On **May 22 that cornerstone was chipped by the FED.**
      - You see it as the cost to protect BofA against default, which was converging with the US Govt, is now diverging – Figure 3.
      - You see it in the breakdown in MBS – Figure 4.
  - Stress the creditworthiness of the **U.S. banking system**, and you **stress the equity market**. **Financials** have now **passed the tipping point** and are to be underweighted.

Figure 1: Trends on Credit Default Swap Indices

**Focus of Credit Weakness - U.S.**

<table>
<thead>
<tr>
<th>Name</th>
<th>Chg Last Day</th>
<th>CDS Reward /Risk</th>
<th>Trend Slope</th>
<th>Trend Length (Mo)</th>
<th>CDS Hi (Mo)</th>
<th>CDS Low (Mo)</th>
<th>1-day Chg (%)</th>
<th>3-day Chg (%)</th>
<th>9-mo Chg (%)</th>
<th>%Chg wrt 50d MA</th>
<th>Chg wrt 50 Day MA Trend</th>
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</thead>
<tbody>
<tr>
<td>Eur Sr Fin</td>
<td>-9%</td>
<td>9 1.5</td>
<td>-3%</td>
<td>2.7</td>
<td>4.7%</td>
<td>8.7%</td>
<td>-2.9%</td>
<td>-19.1%</td>
<td>3%</td>
<td>Above Falling</td>
<td></td>
</tr>
<tr>
<td>Eur Sub Fin</td>
<td>-42%</td>
<td>13 4.5</td>
<td>7%</td>
<td>4.3</td>
<td>3.9%</td>
<td>9.9%</td>
<td>-12.9%</td>
<td>-13.3%</td>
<td>-4%</td>
<td>Below Falling</td>
<td></td>
</tr>
<tr>
<td>Eur Main</td>
<td>-24%</td>
<td>9 1.5</td>
<td>-3%</td>
<td>2.7</td>
<td>3.3%</td>
<td>7.7%</td>
<td>-5.4%</td>
<td>-19.7%</td>
<td>5%</td>
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<td></td>
</tr>
<tr>
<td>NA Hi Yield</td>
<td>-30%</td>
<td>13 2.0</td>
<td>7%</td>
<td>4.3</td>
<td>5.6%</td>
<td>13.7%</td>
<td>-3.6%</td>
<td>-20.1%</td>
<td>11%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>NA LG</td>
<td>-35%</td>
<td>13 2.0</td>
<td>7%</td>
<td>4.3</td>
<td>4.8%</td>
<td>11.3%</td>
<td>-5.8%</td>
<td>-21.9%</td>
<td>8%</td>
<td>Above Falling</td>
<td></td>
</tr>
<tr>
<td>Eur XOver</td>
<td>-37%</td>
<td>9 1.5</td>
<td>-3%</td>
<td>2.7</td>
<td>4.7%</td>
<td>8.6%</td>
<td>-7.5%</td>
<td>-30.6%</td>
<td>7%</td>
<td>Above Falling</td>
<td></td>
</tr>
</tbody>
</table>

Figure 2: U.S. Bank CDS Trends

**CDS on US Banks are at 1Mo Wides and are Just Breaking Above 50d MAs**

- C US: Citigroup Inc
  - 1-day Equity Chg: -3.2%
  - 3-day Equity Chg: -12.9%
  - CDS Hi (Mo): 5.6%
  - CDS Low (Mo): 1.0%

- GS US: Goldman Sachs Group
  - 1-day Equity Chg: -2.6%
  - 3-day Equity Chg: -4.4%
  - CDS Hi (Mo): 1.0%
  - CDS Low (Mo): 1.0%

- MS US: Morgan Stanley
  - 1-day Equity Chg: 2.0%
  - 3-day Equity Chg: 2.0%
  - CDS Hi (Mo): 1.0%
  - CDS Low (Mo): 1.0%

- JPM US: JPMorgan Chase & Co
  - 1-day Equity Chg: 1.5%
  - 3-day Equity Chg: 1.5%
  - CDS Hi (Mo): 1.0%
  - CDS Low (Mo): 1.0%

- BAC US: Bank of America Corp
  - 1-day Equity Chg: -1.5%
  - 3-day Equity Chg: -1.5%
  - CDS Hi (Mo): 1.0%
  - CDS Low (Mo): 1.0%

Figure 3: Spread of BofA 5Yr CDS to U.S. Govt 5Yr CDS

Figure 4: iShares Barclays MBS Bond Fund (MBB US)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

Equities Don’t Like Confused

- We have been here for two hours and have not written a word.
- Our test tube window into the social experiment called capital markets is highlighted in Figure 1. It is a series of 2-day intraday pictures of key currency, commodity, debt, credit and equity measures.
  - When they align to tell a story, there is a story to tell; when they diverge, it speaks to a confused market.
  - Equities don’t like confused. The MSCI World Index broke the uptrend this morning again.

Equities: The MSCI World, and the STOXX 600 equity indices have broken below 50d MAs this morning and Japanese shares continue to feel the brunt of momentum investors exiting as the time frame of the Japanese 3rd arrow does not jive with the front running crowd.

Currency: We also note that Japanese inflation expectations continue to fall, which runs counter to Abenomics, which is why JPY should continue to strengthen.

Bonds: Volatility remains high, consolidation patterns in yields have yet to break either way, and quants don’t know how to program for the word “taper” (how can you teach a black box something it has never seen?). We believe that yields should break to the downside along with volatility, but they have yet to do so.

Credit: Yesterday’s 4% widening of North American CDS indices (IG, HY) is followed by further widening this morning. The credit market is moving in an unfriendly direction. Morgan Stanley’s 5Yr CDS breaks above the 50d MA this morning.

Commodities: While bonds are weak, CDS are widening, and equities are breaking below 50d MAs, base metals are strengthening. Hard, non-yielding assets in vogue? Don’t fight China buying? Yet China credit is deteriorating as a tapering FED tightens not only US, but also global, and indeed emerging markets.

Figure 1: Markets as of 7:50 AM (2-day Intraday View)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
China Credit & Emerging FX Volatility

- Whether it be due to the volatility in currency markets (EM, Yen carry trade), global bond markets (TY, JB), shifts in domestic credit policy, or a cocktail of the three, the cost to protect Chinese credits against default has gone from trending higher to soaring higher – Figure 1.
  - The key fit we observe is that of Chinese sovereign CDS to emerging market currency volatility where the fit of returns can shift from fair to good, to great when volatility spikes – Figure 2.

- There are two credit baskets we follow for China:
  - Banks, where Bank of China is the most liquid and this series has just reached a higher high – Figure 3.
  - Real Estate, where our basket has more breadth, and shows a picture of arrested credit improvement – Figure 4.

- Today both FX volatility and the China sovereign CDS levels are receding or improving. This day of calm is a good day to point out volatility spikes are exactly the sort of thing that can go bump in the night to a levered portfolio when the VAR police come knocking.

Figure 1: Chinese Sovereign 5yr CDS

Figure 2: Fit of Chinese Sovereign CDS to EM FX Volatility

Figure 3: Bank of China 5yr CDS

Figure 4: Chinese Real Estate 5yr CDS Index

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

June 3, 2013
Research Comment
Quantitative/Technical Research Website

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Technology Rapidly Nearing Most Favoured

With last month’s rapid rise above neutral (May 6 - a pulse, May 7 – Sixthenth Building, May 17 – Expurgated list), Technology is fast moving toward the favoured sector in our Group Selection Report.

This reading is agnostic to domicile and market capitalization, yet we would also point out that technology indices are either outperforming, or are severing, (reversing) underperforming trends against local benchmarks – Figure 1.

Our last tech list highlighted momentum buys, this time we show the severed market performers in the S&P 500 – Figure 2.

In Canada, 5 of the 7 technology stocks are blemish free – Figure 3.

Figure 1: Technology Sectors vs. Local Benchmarks

Figure 2: S&P 500 Technology Severed Market Underperformers versus the S&P 500

Figure 3: S&P/TSX Technology Stocks vs. S&P/TSX Composite

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
TOOLKIT

- More (BMO clients) will probably care on gold, so we will start there (no figures, just links).
- After spending the entire year cruising at the weakest reading, golds improved to 9th decile in our system yesterday. Gold is still trending lower, the ratio of stocks vs. gold is still trending lower, and despite yesterday’s 5% rally (which we see as EUR related and temporary), gold equity indices are still below falling MAs.
  - We are not ready to catch this falling knife, but consider the strength duly noted and considered.

- On to Utilities now.
- Recall the first shocking weakness in Treasuries this month came exactly three weeks ago and it was yen carry trade related as Y100 was breached.
  - That was when Japanese inflation expectations were rising.
  - Now they are falling, and if they continue to fall we will see Y99, and subsiding pressure on bonds from this source – Fig 1.
- Despite spiking Treasury yields and volatility, U.S. inflation expectations continue to fall - Figure 2.
  - We would be sellers of Treasury panic – Figure 3.
    - Which means being buyers of rather very much oversold Utilities relative strength – Figure 4.
    - There are 8 U.S. Utilities with RSI < 30.

Fig.1: Japanese Inflation Expectations (top) and Yen (bottom)

Figure 2: U.S. Inflation Expectations (5y5y)

Figure 3: U.S. Treasury Implied Volatility

Figure 4: U.S. Utilities vs. S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Where the Momentum Is - USA

- You can dabble in French or German markets trying to reverse underperforming trends, but the US market stands alone in its outperforming stance against global markets.
- We can argue that US banks look outrageous relative to global peers. Add to here right now? Perhaps not, but we would not fight the trend.
- So from 3D systems to Yahoo!, and from Airlines to Wireless, we highlight the 240 momentum buys in the S&P 1500. We could only fit 60 on the page, but the complete list is found at this link.

Figure 1: Momentum Buys in the S&P 1500 (vs. S&P 500)

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>GRP RS</th>
<th>MktCap (US$)</th>
<th>SPX Trend Slope</th>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>GRP RS</th>
<th>MktCap (US$)</th>
<th>SPX Trend Slope</th>
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</thead>
<tbody>
<tr>
<td>PFG US</td>
<td>Principal Financial Group</td>
<td>Lifethings</td>
<td>2455</td>
<td>11,914</td>
<td>36%</td>
<td>39</td>
<td>VIB US</td>
<td>Viacom Inc</td>
<td>Mov &amp; Ent</td>
<td>1</td>
<td>29,683</td>
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<td>VRTS US</td>
<td>Virtus Investment Partners</td>
<td>Asset Management</td>
<td>2480</td>
<td>1,930</td>
<td>116%</td>
<td>32</td>
<td>GILD US</td>
<td>Gilead Sciences Inc</td>
<td>Biotech</td>
<td>8</td>
<td>84,650</td>
</tr>
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<td>AIZ US</td>
<td>Assurant Inc</td>
<td>Multi-Line</td>
<td>2480</td>
<td>3,822</td>
<td>53%</td>
<td>36</td>
<td>DRK/B US</td>
<td>Berkshire Hathaway Inc</td>
<td>Insur</td>
<td>6127</td>
<td>75,545</td>
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<td>LUV US</td>
<td>Live Nation Inc</td>
<td>Mov &amp; Ent</td>
<td>2480</td>
<td>2,709</td>
<td>61%</td>
<td>35</td>
<td>DQ US</td>
<td>Deckers, Inc</td>
<td>Footwear</td>
<td>1</td>
<td>1,640</td>
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<td>SVU US</td>
<td>Supervu Inc</td>
<td>FtdRetail</td>
<td>2480</td>
<td>1,592</td>
<td>177%</td>
<td>37</td>
<td>CBS US</td>
<td>CBS Corporation</td>
<td>Broadcast</td>
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<td>LUV US</td>
<td>Southwest Airlines Co</td>
<td>Airline</td>
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<td>10,288</td>
<td>24%</td>
<td>36</td>
<td>DPH US</td>
<td>Delphi Automotive PLC</td>
<td>AutoParts</td>
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<td>39</td>
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<td>Adv</td>
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<td>38</td>
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<td>TrueBlue Inc</td>
<td>Avionics</td>
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<td>Standard Motor Products Co</td>
<td>AutoParts</td>
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<td>761</td>
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<td>40</td>
<td>GY US</td>
<td>GenCorp Inc</td>
<td>Aero &amp; Def</td>
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<td>Old Republic International Inc</td>
<td>Insur</td>
<td>2480</td>
<td>4,359</td>
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<td>39</td>
<td>WAG US</td>
<td>Walgreen Co</td>
<td>DrugRetail</td>
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<td>Applic &amp; Serv</td>
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<td>MEAS US</td>
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<td>5,312</td>
<td>42%</td>
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<td>Orbital Sciences Corp</td>
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<td>49%</td>
<td>47</td>
<td>PINN US</td>
<td>Pinneb &amp; Financial Corp</td>
<td>Region &amp; Lk</td>
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<td>Hw</td>
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<td>5,276</td>
<td>40%</td>
<td>48</td>
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<td>51</td>
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<td>54</td>
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<td>Food &amp; Bever</td>
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<td>Yahoo Inc</td>
<td>Net &amp; Inf</td>
<td>4</td>
<td>27,943</td>
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Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Financials Approaching the Tipping Point

- Yesterday, we highlighted banks in a 10th decile position, today we widen out to financials.
- The rapid decline in strength this month has coincided with surging global yields and volatility as FED QE winds down, and a Japanese need to rethink/retool its QE program becomes very much the market’s focus – Figure 2.
- On an equal weighted and global basis, financials are approaching the zero mark on our relative strength z-score, or the point where one should be market/underweight – Figure 1.
- On market cap weighted indices;
  - 3 of the 6 are at the breakdown point in terms of relative strength against local markets – Figure 3.
  - Asian and Aussie markets are the only ones breaking price trends so far – Figure 4.

Figure 1: Financials Relative Strength Z-Score

Figure 2: US, German, JGB Bond Yields and Impl. Volatility

Figure 3: Relative Strength Trends of Financials vs. Local Markets

Figure 4: Price Trends of Financials

Aussie and Asian Financials Currently The Only Ones Breaking Price Trends

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Focal Points

Investment & Trading Ideas

Tighten Up

- In May and June, markets started a new dance called the Tighten Up.
  - 1st tighten up on the long end of the U.S. treasury curve – Figure 1.
  - 2nd tighten up the Chinese interbank lending curve – Figure 2.
  - 3rd tighten up on the short end of the U.S. treasury curve – Figure 3.

Sock it to me now
Tighten it up
Archie Bell & The Drells

- A tipping point has been reached. The central bankers’ bank (BIS) now deems that (1) there has been enough stimulus provided to the global economy, (2) more cannot be done without compounding risks that central banks have already created, and (3) easing has led to the delay of structural reforms (BIS Annual Report June 23, 2013).
- After a period of unprecedented central bank easing, and ultra low interest rate volatility, markets are adjusting to now rather rapid tightening and escalating volatility.
  - The known unknown is that when interest rates move from low and highly certain, to high and highly uncertain, that carry trades blow up. This was Long-Term Capital Management, this was Carlyle Capital Corporation, and this is the known unknown that markets are routing out now.

- Our goal over the next few pages is to detail these stresses, which we believe are still at very early stages. We expect global equity weakness to persist over the near term.

Figure 1: U.S., German, and Japanese 10-Year Bond Yields (Top) and Implied Volatility (Bottom)

Figure 2: Chinese Interbank Lending Rates

Figure 3: Odds of a ‘14 Fed Rate Hike From Fed Funds Futures

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

June 24, 2013
Research Comment
Quantitative/Technical Research Website

Mark Steele
(416) 359-4641
mark.steele@bmo.com
Assoc: Tiberiu Stoichita/Jin Li
FOMC: Early Withdrawal? Really?

President Bullard also felt that the Committee’s decision to authorize the Chairman to lay out a more elaborate plan for reducing the pace of asset purchases was inappropriately timed.

FRB of St. Louis June 21

- There has been a change in the calculus of the FED this year. In BIS terms, “Delivering further extraordinary monetary stimulus is becoming increasingly perilous”.
  - U.S. inflation expectations just started to ease leading into the FOMC minutes release in February.
  - On February 20 we learned that the FED was concerned about its open ended QE policy.
    - This was also the start of the market’s fascination with the term “tapering” which has been written about 150 times per day, on average, in the month of June (“NT Tapering” on Bloomberg).
    - One month later, inflation expectations were breaking down globally.
  - While inflation expectations were falling, asset price inflation was picking up. This is obviously not the inflation that the fed targets, but it was the destination that the market was targeting for QE related flows.
  - Would outgoing Bernanke go down as the FED who stoked asset price inflation? – Figure 4.
    - On May 22 Bernanke and the FOMC told the market that QE could be stepped down as early as June.
    - On June 19 Bernanke delivered the withdrawal schedule verbally.
    - Asset price inflation is no longer a problem.
  - Asset price deflation in our clients’ portfolios is our key interest now.

Figure 4: US Inflation Expectations (10-Year Breakeven Rate) Top; FTSE Global REIT Index (TENHGU) Bottom
PBOC: Money Not in the Right Places

- While it may seem to be a stretch to jump from looking at inflation expectations at the long end of the U.S. curve, to the stresses at the ultra short end of the Chinese credit curve, it is not.
  - The combination of low U.S. interest rates, and interest rate volatility encouraged flows into emerging markets with higher-yielding assets.
  - The FOMC, whose policy underpins the world’s largest and most liquid bond market becomes the central banker to the world via the carry trade.
    - $3.9 trillion had flowed into emerging markets over the past four years.
- It is a mistake to apply market western policy thinking to policy action of the new People's Republic of China government, and the PBOC.
  - Rather than releasing stimulus in response to weak economic figures, which was the point where the Chinese sovereign CDS broke to the upside (Figure 5), China has done the opposite, has withheld stimulus, and has allowed banking stress to build – Figure 2.
  - China is getting its plumbing in order by reigning in the shadow banking system, which it needs to get under control such that it can have a handle on its financial system. During this plumbing exercise,
    - Chinese bank CDS levels are soaring – Figure 6.
    - Chinese Real Estate CDS levels are soaring – Figure 7.
- We are sure that the Minsky Moment for many shadowy players in the Chinese financial system is upon them now, but to call this the Lehman moment for China as a whole is premature. Possible, but premature – Figure 8.
  - China has breathing room to tighten up, and so it is.
  - Global growth oriented resource countries such as Canada should continue to be underweighted.

---

Figure 5: Chinese Sovereign CDS

Figure 6: Chinese Bank 5Yr CDS

Figure 7: Chinese Real Estate CDS

Figure 8: Chinese Sovereign CDS Levels and Curve
BIS: Borrowed Time

- The tone of the BIS annual report released Sunday shows central banking thinking turning from carrot to stick:
  
  *What central bank accommodation has done during the recovery is to borrow time...But the time has not been well used*

- The short end of the U.S. curve is tightening up.
  
  *The FED's assessment, disclosed last Wednesday, was to bring the time of a rate hike forward by two months.*

- Nowhere does time seem to be more borrowed than in the European periphery where bonds received a massive ECB (Draghi) induced grace period. It seems that European policy makers could use the stick to un-jam the process that calm has created.
  
  *The stick is coming:*
  - The Spanish sovereign CDS, like many others, has broken to the upside – Figure 9.
  - A peripheral European banks CDS basket is basing and should soon mint a higher high– Figure 10.
  - Italian-German and Spanish-German stress and spreads are just now starting to turn up again – Figure 11.
  - The Italian bank UniCredit remains the SIFI with the most inverted curve – Figures 12, 13.

---

Figure 9: Spanish Sovereign CDS

Figure 10: Average Peripheral Bank CDS

Figure 11: Italian and Spanish Spreads off of German Bunds

Figure 12: UniCredit SpA 5Yr CDS
SIFI: Stresses Rising

- The cost to protect systemically important financial institutions (SIFI) is rising – Figure 13.
  - Where the trends were showing improvement in creditworthiness (green wedges), the trends have broken (red arrows).
  - Our systems’ best fit for most European SIFI CDS trends is towards widening (red wedges).
- Debt protection costs at the short end of the curve (1yr) debt is rising faster than the long end of the curve (5yr).
  - Our SIFI CDS trend list below is sorted by this ratio (CDS Curve 1/5Yr).
  - No curve is even close to being over 100% (LEH-like), but it is interesting (and unflattering) to see Asia-centric HSBC line up close to UniCredit (top two lines in Figure 13).

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<tr>
<th>Name</th>
<th>1-day Equity Chg (%)</th>
<th>5-day Equity Chg (%)</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>Trend Slope</th>
<th>CDS Hi (Mo)</th>
<th>CDS Low (Mo)</th>
<th>CDS Curve 1/5Yr</th>
<th>CDS %Chg wrt 50 DMA</th>
<th>Chg wrt 50 Day MA Trend</th>
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<td>136,803</td>
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<td>0.29</td>
<td>0.29</td>
<td>12%</td>
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US Equities: Last Dot Finally Connected, Picture Now Emerging

- The stress in the banking system is just starting to be felt in the U.S. equity market – Figure 14.
  - The breakout in the cost to protect the US Banks against default last Thursday coincided with the breakdown in the S&P 500.
- The U.S. 2-year swap spread, a gauge of counterparty risk, has just started to get in the game – Figure 15.
  - It is still incredibly low – Figure 16, but will move higher with continued stress in the banking system.
  - When stresses are high enough, one can watch this counterparty risk move with S&P futures tick for tick.
  - We have not seen this yet, but are expecting it. When we see it, we will be closer to an equity bottom.
- The known unknown is that when interest rates move from low and highly certain to high and highly uncertain that carry trades blow up.
  - This is the precursor to LTCM, to CCC, and to the known unknown of 2013.
    - When this unknown is known, we believe equities will be lining up for a bottom.

Figure 14: US Bank CDS and the S&P 500
Average Cost To Protect US Banks Against Default

Figure 15: U.S. 2-year Swap Spread
Just Barely Starting to Get in the Game

Figure 16: U.S. 2-year Swap Spread – Long Term Perspective
Focal Points

Investment & Trading Ideas

Misplaced FED Optimism & Market Risk

- “Yes, rates have come up some. That’s in part due to more optimism, I think, about the economy. It’s in part due to perceptions of the Federal Reserve”
  Fed Chairman Ben Bernanke during yesterday’s Q&A.

- Of the backup in treasury yields, and the associated destruction of “risk on” carry trades, we know that,
  o Very little of the backup in treasury yields increase came from optimism (albeit stronger-than-expected U.S. payroll data on May 3 marked the bottom for treasury yields) – Figure 1
    - Much more comes from perceptions of the FED, which includes the May 22 bomb and yesterday’s “...it would be appropriate to moderate the monthly pace of purchases later this year.....ending purchases around mid-year (next year)”
    - And more still came from yen carry trade (PRDC) related unwind pressure.

- Misplaced optimism, by the world’s central banker, on why treasury yields are rising is causing,
  o another leg up in yields and volatility – Figure 1; and
  o continued collapse of “risk on” carry trades of many descriptions – Figures 2, 3.

- Another notable Bernanke line yesterday was “…as we try to land the ship on a…you know, on a …in a smooth….in a smooth way into the …on to the aircraft carrier.” Communication gap? There is a scene from Apocalypse Now, when the ship drops in a harsh way into the ocean. It ends with “I love the smell of napalm in the morning”

Figure 1: US Treasuries Tighten Global Markets via Higher Yields and Higher Volatility

Figure 2: ACWI exUS Index and Treasury Volatility

Figure 3: North American HY vs IG and Treasury Volatility

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Focal Points

Investment & Trading Ideas

Inflation Expectations Are Trending Higher

- If you look at a chart of U.S. Inflation expectations, you generally see three years of noise. However, within that noise, the current “best fit” trend is higher, at rates of 12–18%, depending on whether you are looking at a simple 10-year breakeven rate or a more rigorous 5-year to 5-year forward measure – Figures 1, 2.
- This week, the downtrend on the 10-year breakeven rate was reversed – Figure 1.
- Given the fact the European stress is receding (Figure 3), and that the Fed is likely to add more QE fuel, the market is starting to embrace resources. Half of global resource relative strength downturns have been severed – Figure 4.
  - Up trending inflation expectations (Figures 1, 2) give some cover for this maneuver.
- We and markets will be watching to see if they ultimately break out of the “noise zone”; for if they do, broken resource relative strength downturns will eventually turn into uptrends.

Figure 1: U.S. 10-Year Breakeven Rate (Inflation Expectations)  
Figure 2: US 5Y5Y Forward Breakeven Rate (Inflation Expectations)

Figure 3: Italian – European AAA Spread

Figure 4: Global Resource Sectors vs. Their Markets

Source: BMO Capital Markets, Bloomberg
Focal Points

Investment & Trading Ideas

Focus Shifts (Back) to Asia

- Yesterday, the Asia dollar index suffered the worst day of the past three weeks. Its sharp decline led oil and other industrial commodities lower – Figure 1.
- The day before, it was Asian CDS that widened the most among fellow sovereigns. While we lamented how copper was not following the recent European credit improvement, it was Asia that the market was focusing on.
- China caught the Spanish flu in March, broke away thanks to a surprise rate cut on June 7, and has started to deteriorate again as of this Wednesday – Figure 2.
- Yesterday, equity markets broke to the downside in concert with the Asian currency basket. Downside risk is 5% lower for the resource heavy S&P/TSX – Figure 3.
- The U.S. equity market is also influenced by moves in the Asia Dollar Index. It has been this way for years. The influence is still not as great as that of counterparty risk (which rose for the first day in six yesterday), but it is still substantial, growing and has the potential to hit the 90s as it did last year – Figure 4.

Figure 1: Asia Dollar Index and Brent Oil – Intraday Yesterday
Figure 2: Chinese and Spanish Sovereign CDS
Figure 3: Asia Dollar Index and S&P/TSX Composite
Figure 4: Asia Dollar Index and S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Major Double Top for Global Real Estate

- Those that do not like banks (and we do not like banks) hide out in insurance.
  - Insurance just broke the uptrend from the 2011 low, like most major equity markets, including the S&P 500.
- Those that do not like insurance hide out in real estate, which has given the most consistent positive performance.
- Real estate just broke the uptrend from the 2011 low – Figure 1.
- Now there are breakdowns, and there are breakdowns.
  - The context behind this one is that money (and you know who you are) has flowed into Real Estate as a yield-oriented safe haven.
  - This has pushed global real estate back to the 2011 high, which forms a major double top. Major support is 16% below current levels, which is when the double top would seem more obvious. Double top downside risk is 33% below the current level.
- The wider context is that a bank run on Greece is a “great fear,” and the ECB is apparently cutting and running.
  - In this environment, risk assets will cut and run.
  - The breakdown shows that this attitude has just started for Global Real Estate.

Figure 1: MSCI ACWI Real Estate

...Raising Concern of a Double Top...

... Which Most Would Ask Only After Major Support (16% Below The Current Level) is Breached...

... Which is Far Too Late When One Gets Paid for AUM as the Downside Double Top Target is 160, or 33% Below Current Levels

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
IMPORTANT DISCLOSURES

Analyst's Certification
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Distribution of Ratings (March 31, 2013)

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<td>47.7%</td>
</tr>
<tr>
<td>Sell</td>
<td>Underperform</td>
<td>4.7%</td>
<td>3.7%</td>
<td>1.5%</td>
<td>4.9%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
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