

Week of April 3, 2017

ETF themes and actionable commentary

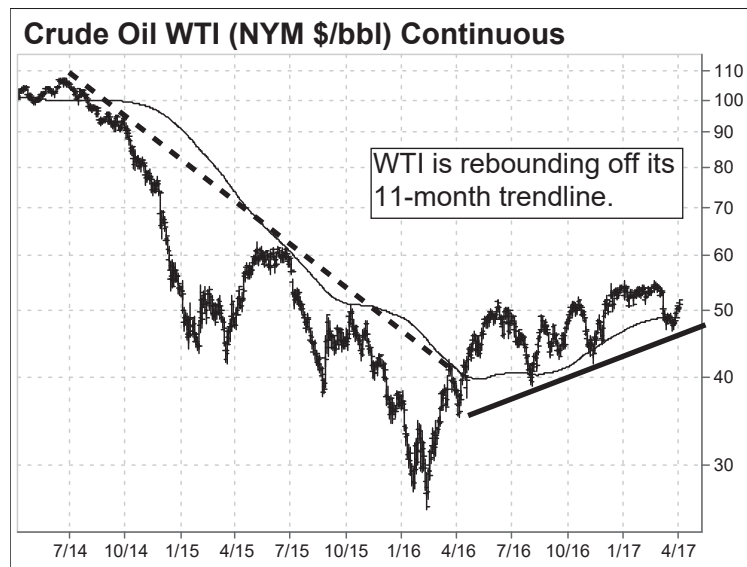
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BIG PICTURE... see page 2

- **Bullish Big Picture.** As we mentioned in our March 6 *ETF Pathfinder*, four days after the S&P 500's historical high, technicals appeared extended, though the broader picture remains bullish. Since then, this extended status has been relieved via a market-wide pullback, and the path of least resistance continues to point higher. The supporting cast of bullish evidence includes: (1) good breadth--negative divergences in advance-decline lines are non-existent; (2) cyclical sectors continue to outperform, with energy beginning to inflect higher; (3) intact long-term trends; and (4) confirming, bullish technicals in overseas markets. Take advantage of pullbacks.
- **Small & Mid > Large Caps.** Small and mid caps have lagged this year, but we view this as a mere pullback in the small/large and mid/large ratios.
- **Value > growth.** Like small caps, value has been shunned so far this year. We view this as mere reversion to the mean forces, *not* a trend reversal. Add exposure to value (recognizing plenty of opportunities are still available in growth).

U.S. SECTORS... see pages 3-5

- **Overweights:** Cyclical sectors, especially Tech (XLK), a long-term leader, Financials (XLF), Industrials (XLI), and Materials (XLB).
- **Energy:** Buy. Breaking out above the 200-day MA, Energy (XLE) is generating a buy signal. WTI is confirming with a rebound off 11-month trendline support (see inset chart).
- **Underweights:** Stay underweight defensive sectors. One exception: Health Care (XLV), where a market weight is justified due to improving breadth and patterns, especially in biotechs.



U.S. INDUSTRIES... see pages 6-9

- **Buy recommendations:** Metals & Mining (XME), E&Ps (XOP), Coal (KOL), and Aero/Defense (ITA).

INTERNATIONAL EQUITIES... see pages 10-11

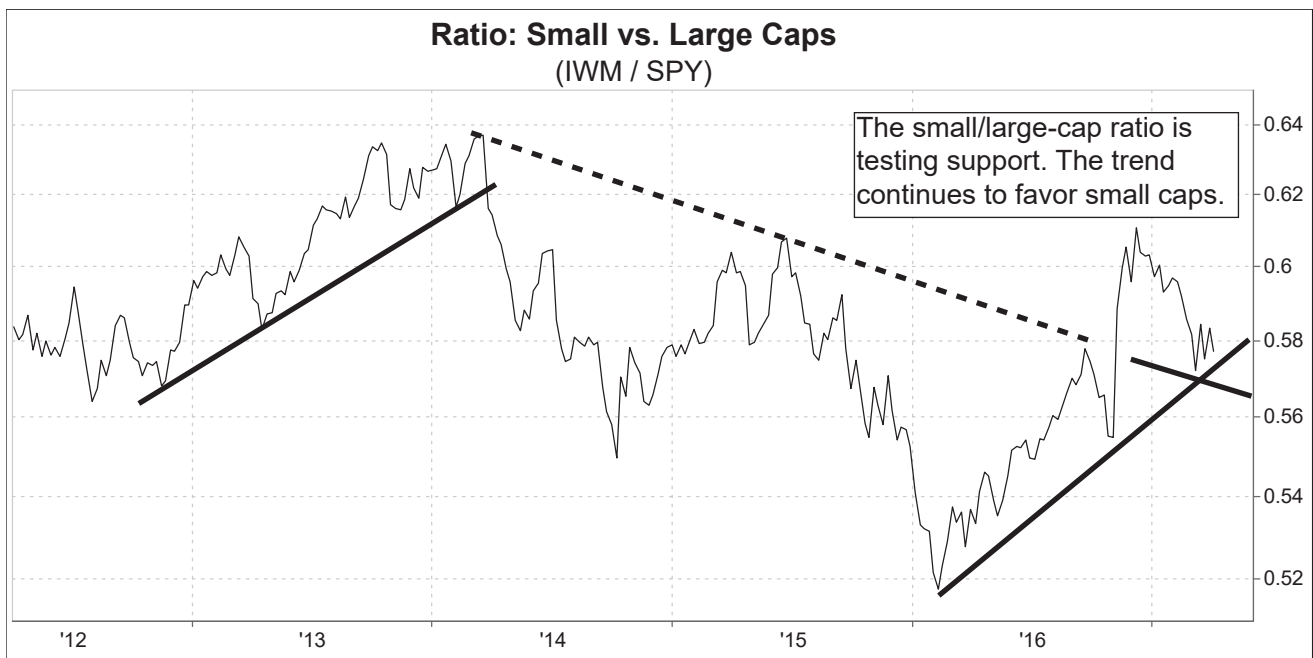
- **EM vs Developed:** For U.S. ETF investors, who are affected by exchange rates, we favor emerging (VWO) over developed markets (EFA), as many EM currencies like the Brazilian real (BZF) continue to strengthen relative to the dollar, providing a technical tailwind.
- **Brazil:** Buy. Brazil (EWZ), a leading market last year, has retraced to a zone of strong support, presenting an attractive entry point. Another technical boon: the Brazilian real (BZF) is one of few currencies advancing to 12-month highs.

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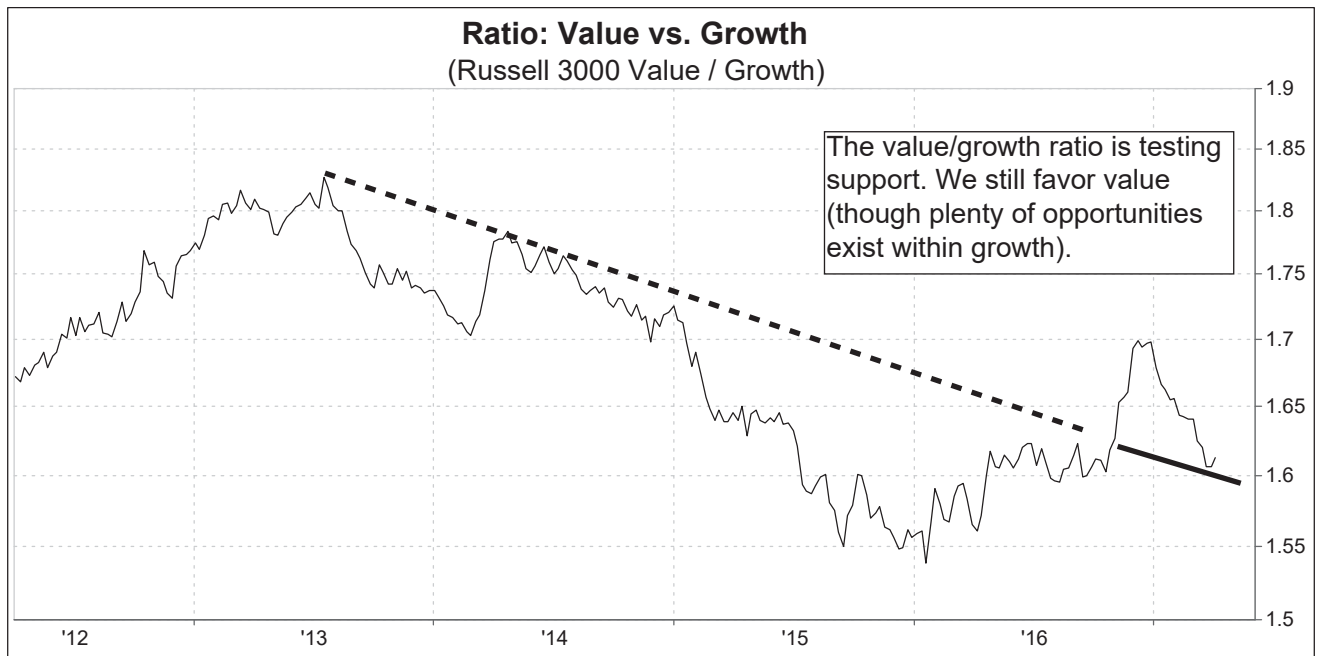
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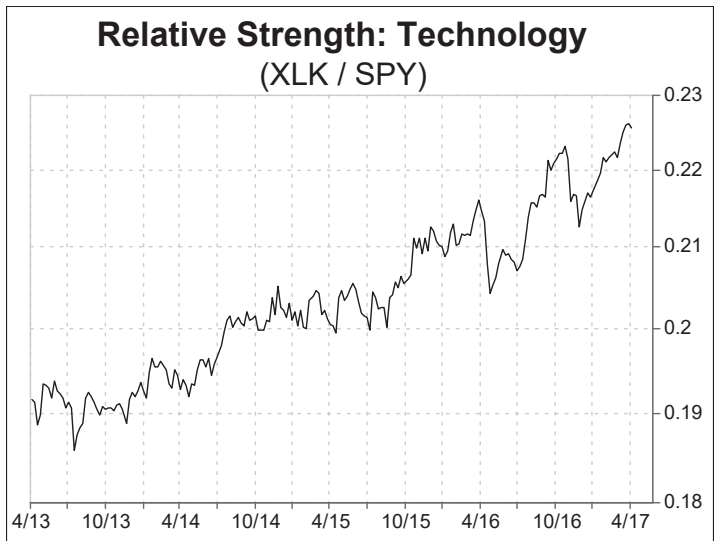
MID VS. SMALL CAPS

Relative pullback opportunity for small caps. Many of last year's leaders have suffered through reversion to the mean forces through Q1 2017, small caps included. We still favor small over large caps, as the Russell 2000/S&P 500 ratio's uptrend (above) remains intact.



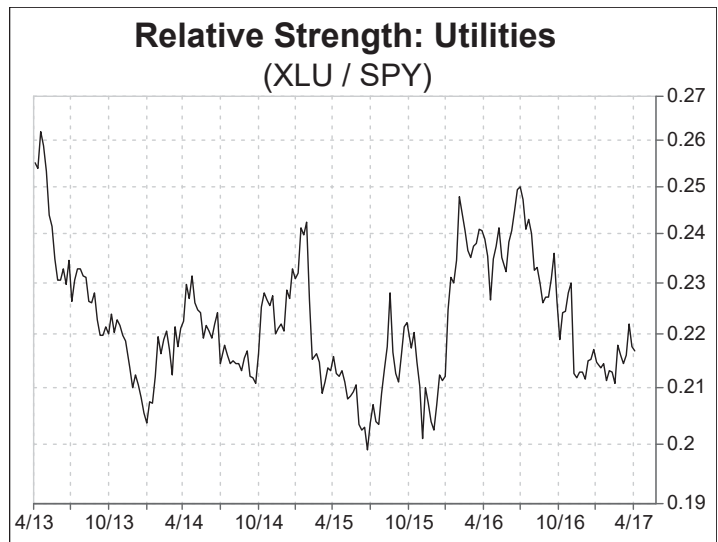
VALUE VS. GROWTH

Pullback opportunity in value. 2017 has not treated value kindly--energy and mining stocks, in particular. This is visible in the value/growth ratio (above). Tech's strength is another culprit. What's next for this ratio? Given the bullish inflections throughout energy, we are watching for this ratio to resume its 2016 advance.



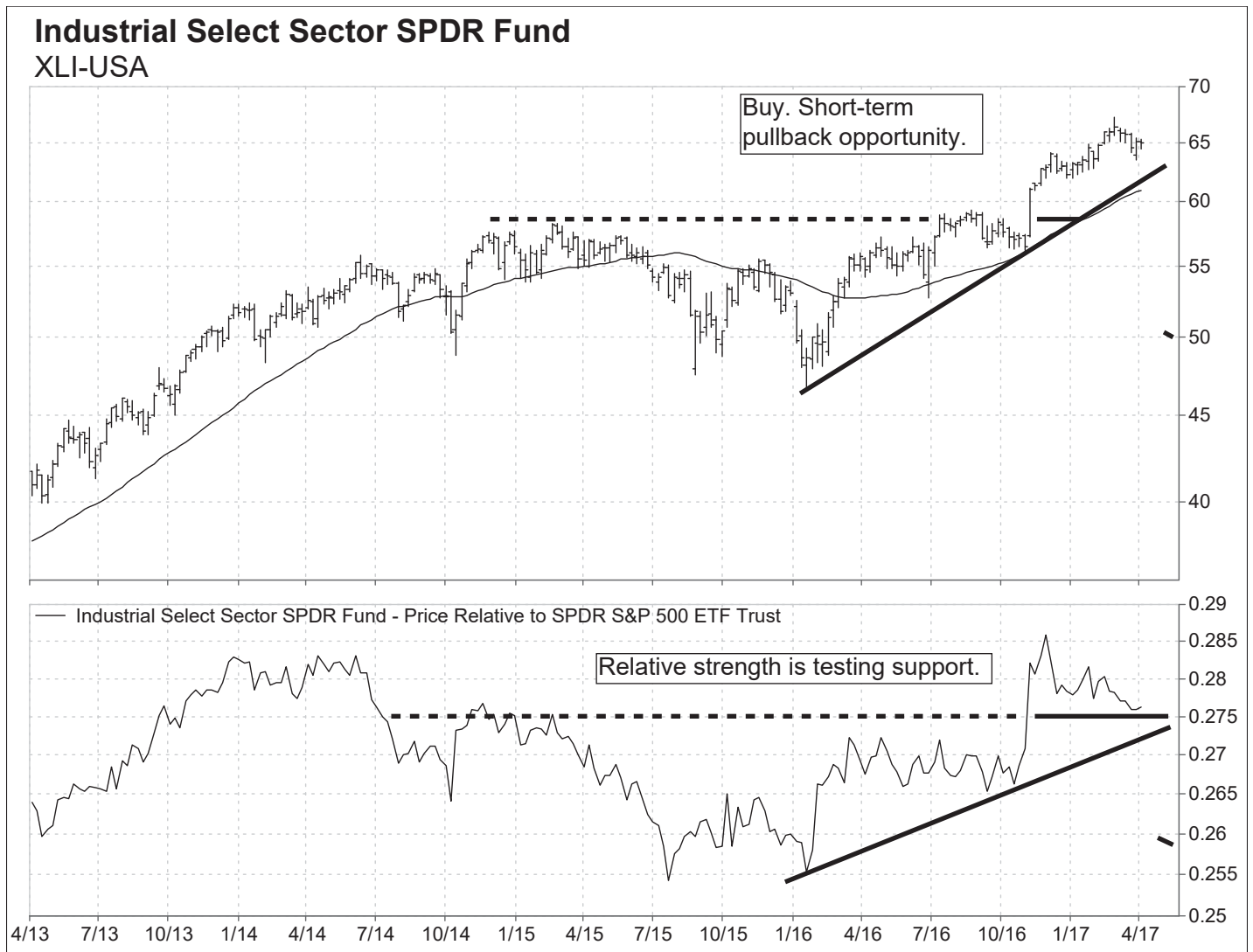
LEADING SECTORS

Overweight cyclicals. Cyclical sectors have yet to relinquish their leadership status. This is particularly true of Tech (XLK), which is trading at decade relative strength highs. Financials (XLF), despite their short-term correction, continue to exhibit an attractive outlook. Industrials (XLI) depicts a *relative strength* pullback opportunity. Materials (XLB) as well. Even Energy (XLE) is beginning to inflect higher (buy).



LAGGING SECTORS

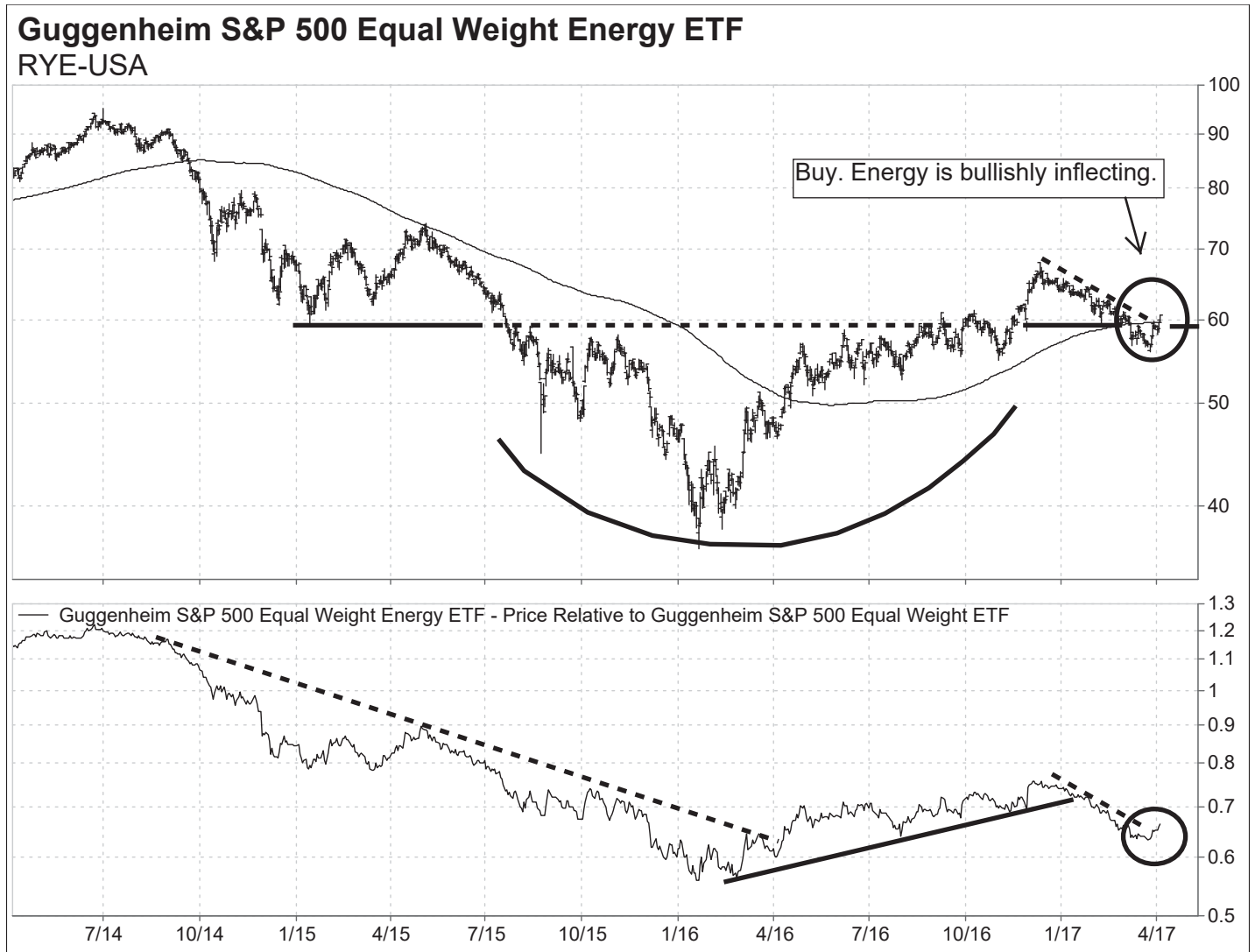
Underweight defense. Defense remains on the defensive. Sure, Consumer Staples (XLP) and Utilities (XLU) have generated strength in recent weeks, courtesy of a pullback in interest rates and the market, but long-term *relative strength* trends continue to point lower -- a healthy sign for the broad market.



INDUSTRIALS (XLI)

Buy. XLI’s chart reveals an attractive pullback, both from a price and relative strength perspective. Internally, aero/defense stocks like **BA** and **GD** continue to charge higher. Also, transport-related names like **UNP** exhibit pullback opportunities.

Top 10 Holdings	
Company	Weighting
GE	9.2 %
MMM	5.5 %
BA	5.0 %
HON	4.7 %
UNP	4.5 %
UTX	4.2 %
UPS	3.5 %
LMT	3.3 %
CAT	2.7 %
GD	2.7 %



EQUAL-WEIGHT ENERGY (RYE)

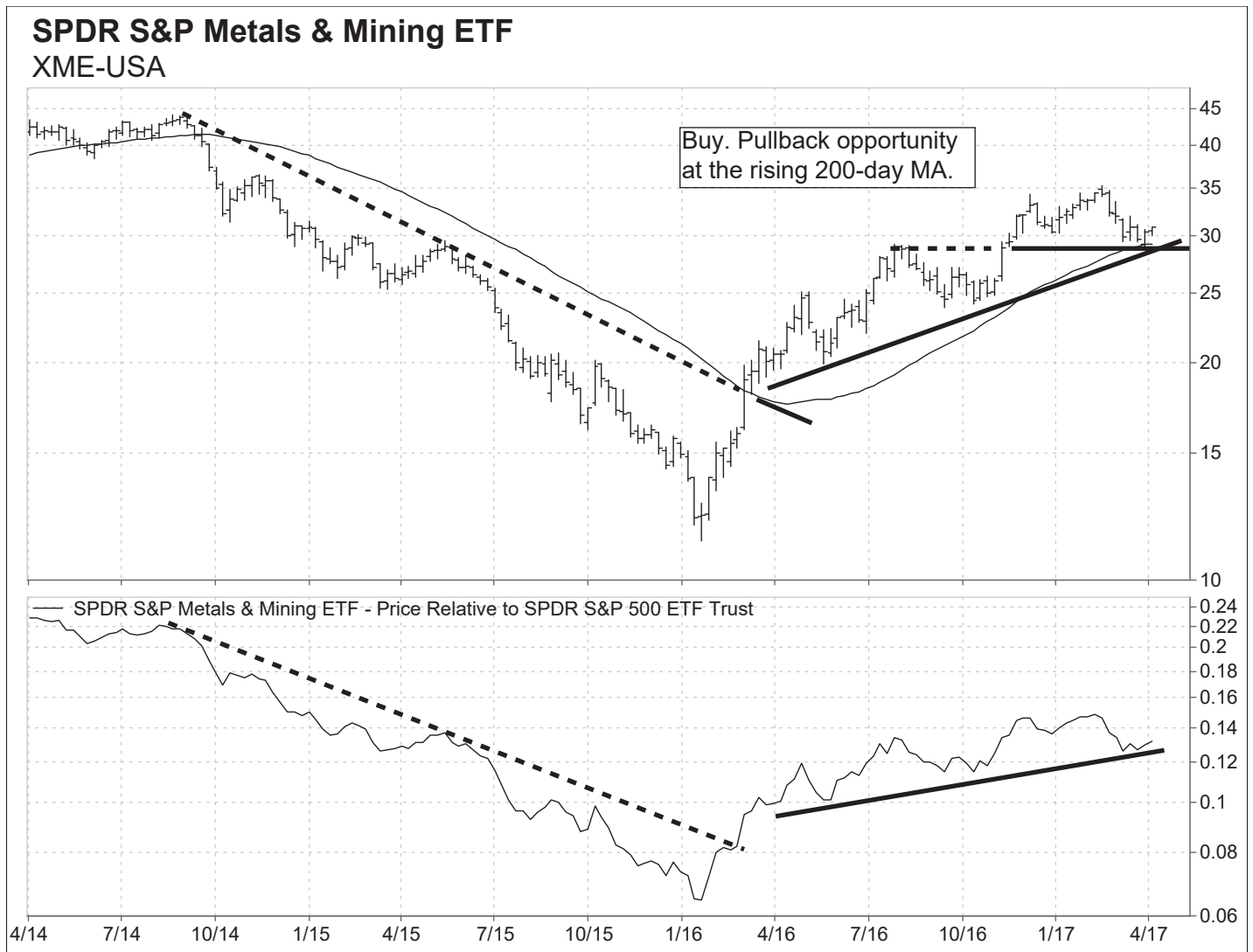
Buy. For the past two months we have recommended Energy as a pullback opportunity. Obviously, a subsequent advance has yet to manifest.

Where do we stand now? No changes--we still believe this correction will produce another leg higher.

One by one, individual names such as **COP** and **PXD** are beginning to inflect higher. Even **XOM**, a laggard, is beginning to carve out a bottom.

In the case of **RYE** (and **XLE**), a breakout above the 200-day MA just generated a buy signal.

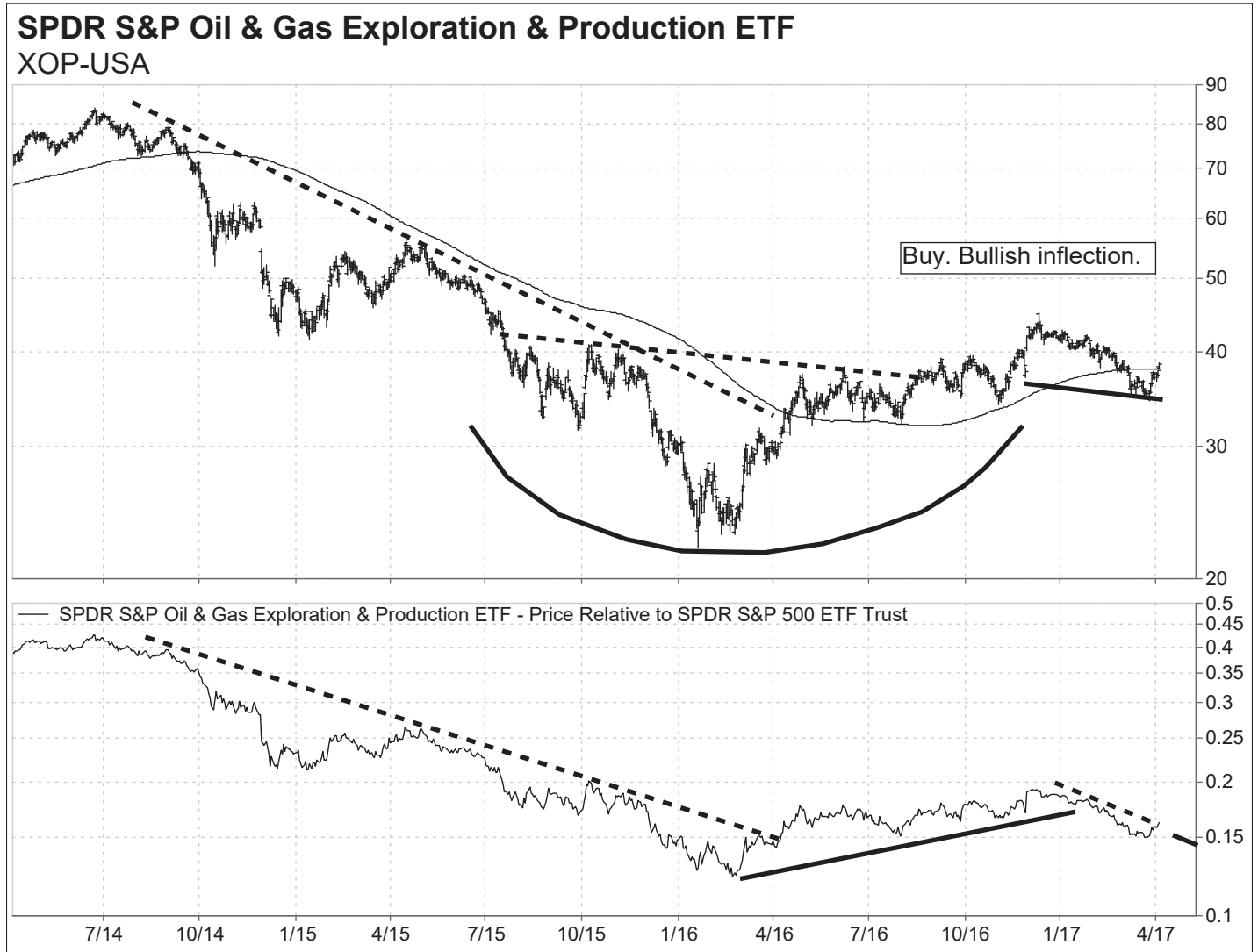
Top 10 Holdings	
Company	Weighting
KMI	3.3 %
COG	3.3 %
MPC	3.2 %
PXD	3.2 %
NOV	3.2 %
WMB	3.2 %
OKE	3.1 %
COP	3.1 %
VLO	3.1 %
CVX	3.0 %



METALS & MINING (XME)

Buy. XME depicts a textbook pullback opportunity at the 200-day MA following a swift, 16% correction. The 12-month uptrend remains intact, with aluminum and steel constituents--like **AA**, **CENX**, and **STLD**--exhibiting particularly attractive entry points.

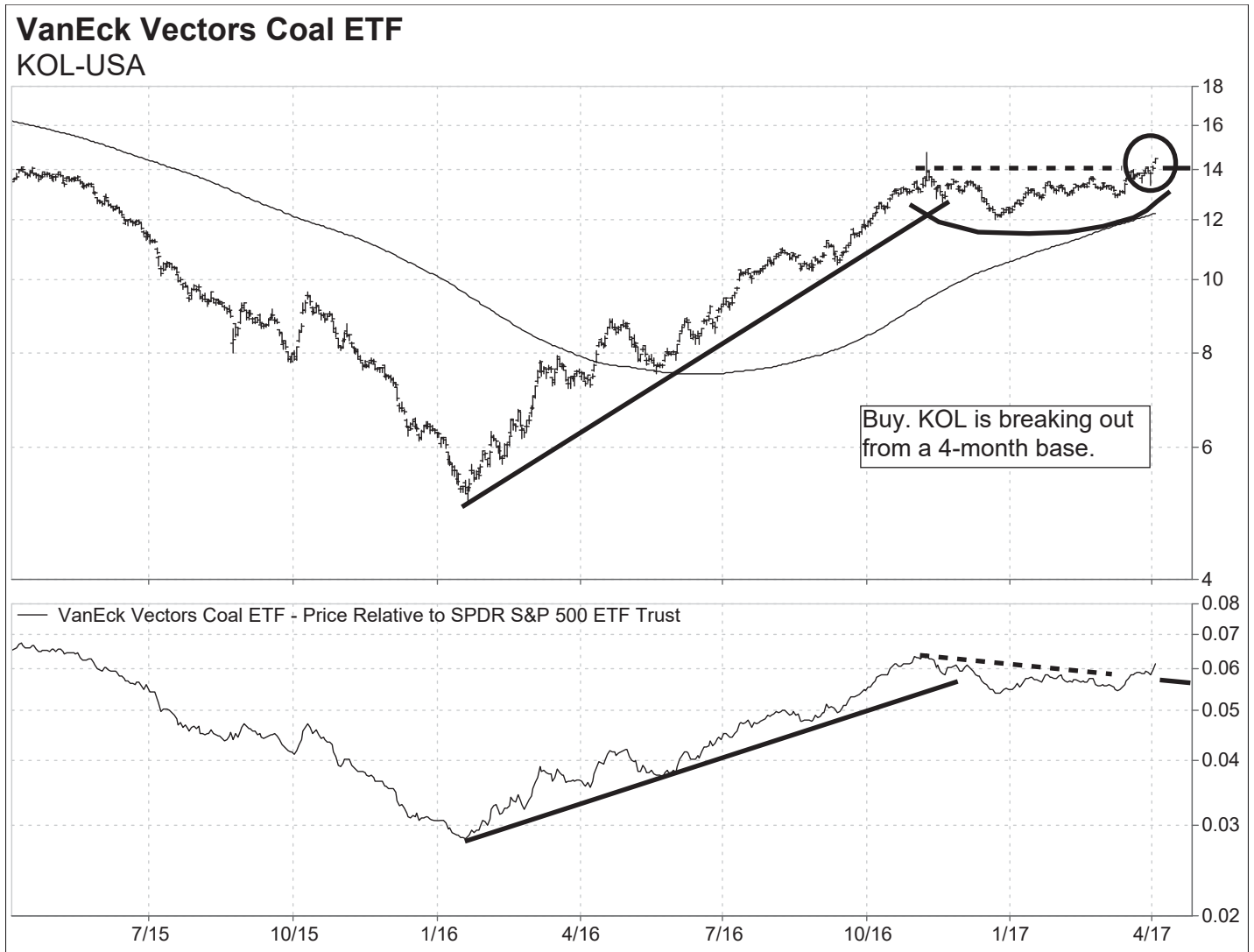
Top 10 Holdings	
Company	Weighting
RS	4.6 %
STLD	4.6 %
X	4.6 %
ATI	4.6 %
NUE	4.5 %
HL	4.4 %
CDE	4.3 %
MUX	4.3 %
CENX	4.3 %
FCX	4.2 %



E&Ps (XOP)

Buy. Like the broad energy sector, E&Ps are bullishly inflecting, retaking their 200-day moving averages. This represents a buy signal.

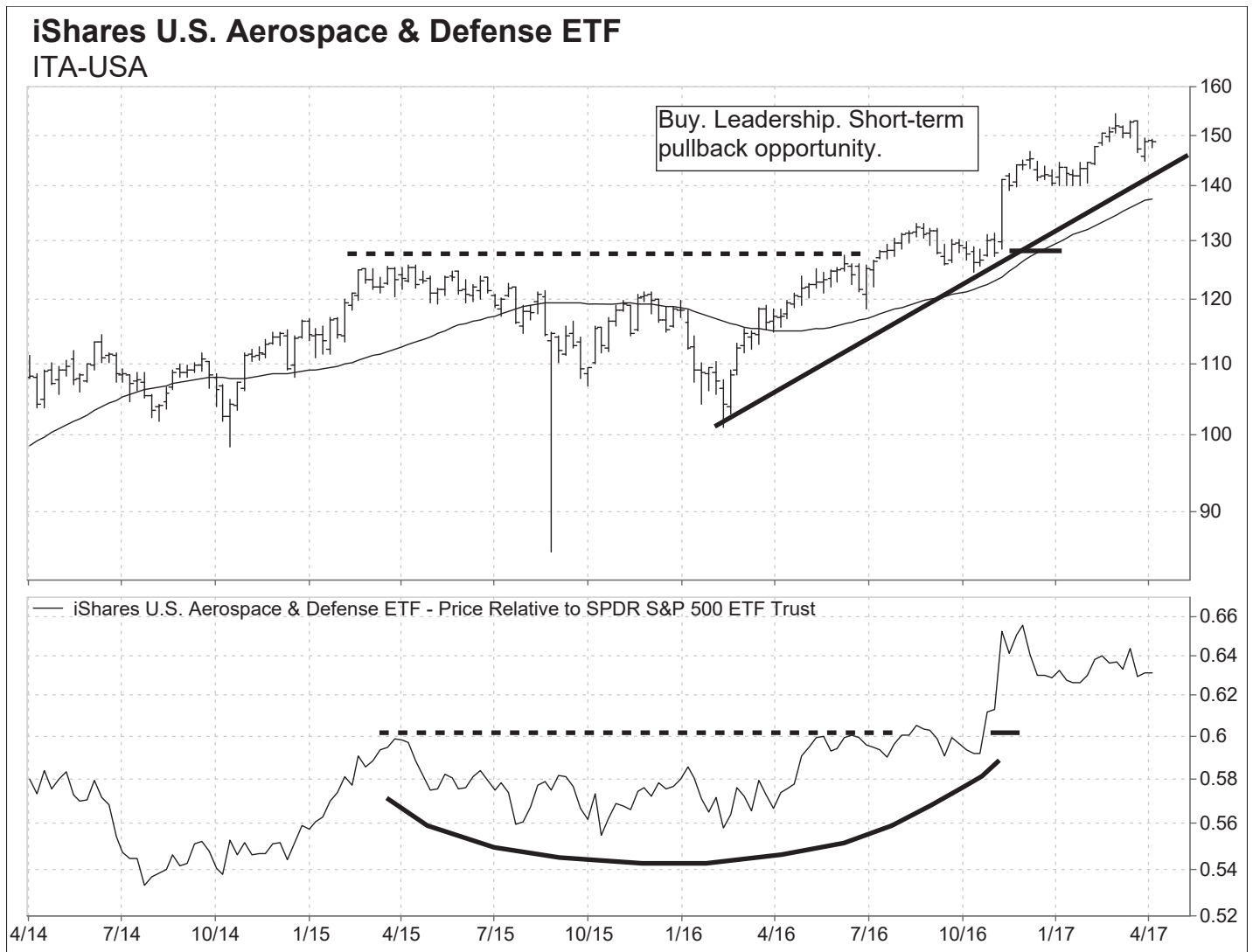
Top 10 Holdings	
Company	Weighting
CWEI	3.0 %
LPI	2.2 %
MPC	2.2 %
COG	2.2 %
PXD	2.2 %
FANG	2.1 %
COP	2.1 %
VLO	2.1 %
RICE	2.1 %
RSPP	2.1 %



COAL (KOF)

Buy. Coal is an unexpected leader within the energy sector. Driven by international holdings, the KOL ETF is breaking out from a 4-month base to multi-year highs. U.S.-based holdings like **CNX** are beginning to bottom.

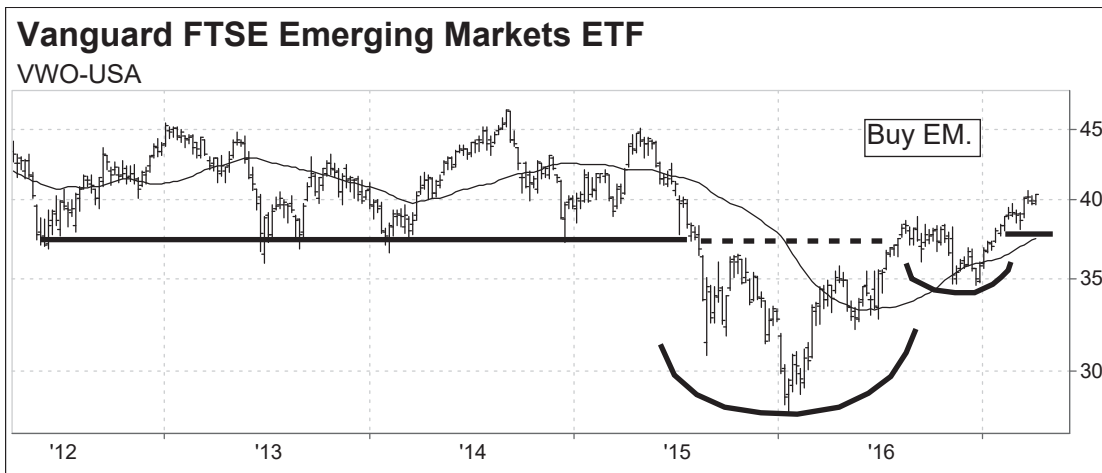
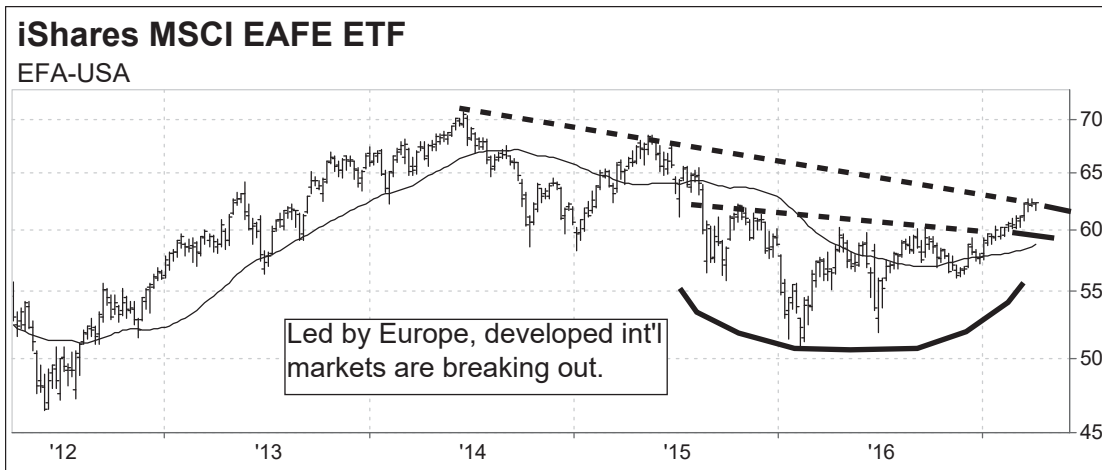
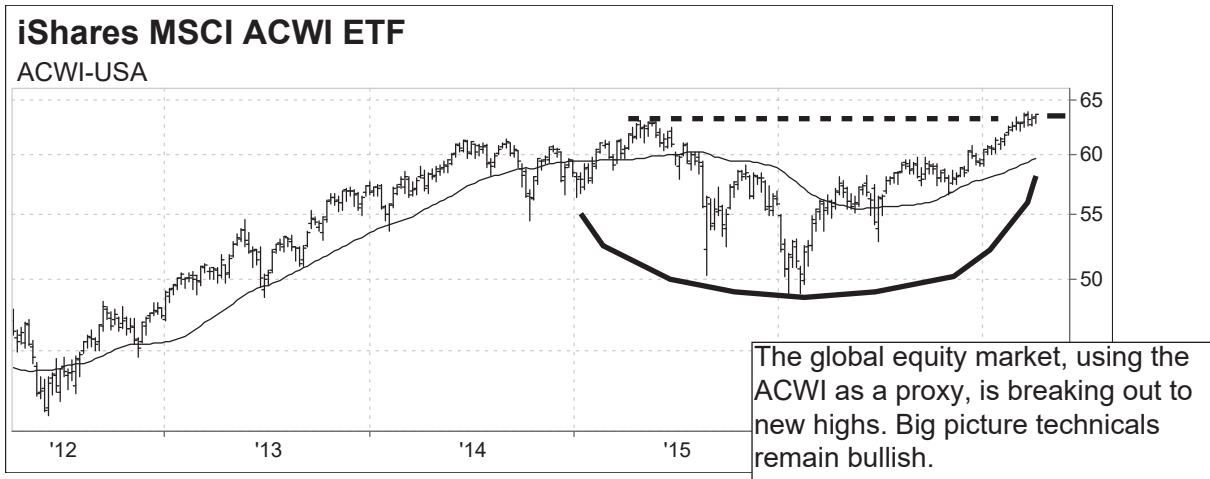
Top 10 Holdings	
Company	Weighting
SOL-AU	5.4 %
ADRO-ID	5.3 %
1171-HK	4.8 %
EXX-ZA	4.7 %
WHC-AU	4.7 %
BANPU.R-TH	4.6 %
SCC-PH	4.5 %
CNX	4.3 %
1898-HK	4.3 %
JOY	4.2 %



AEROSPACE & DEFENSE (ITA)

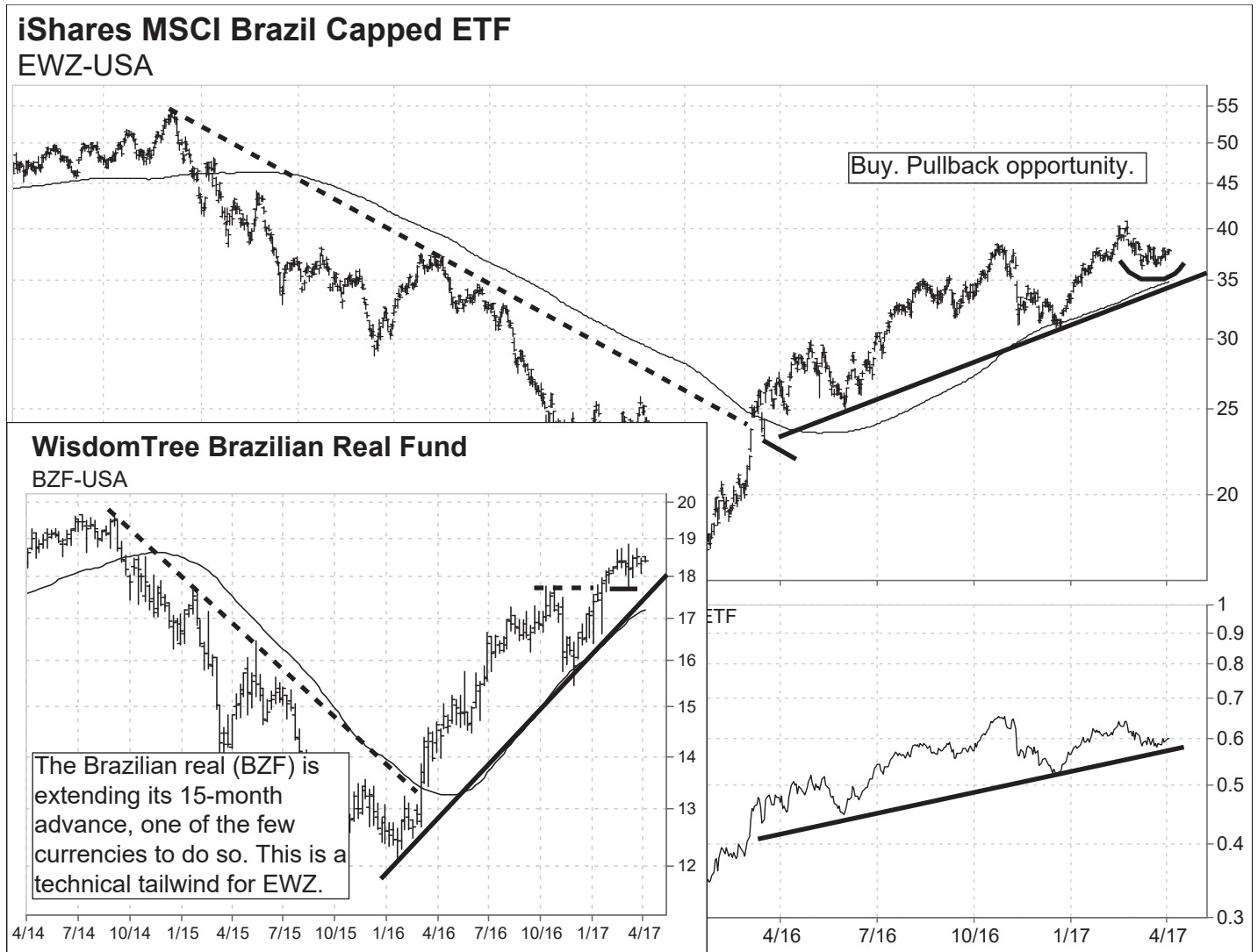
Buy. It's difficult to find an industry with better breadth than aero defense. This is apparent after flipping through each holding in the iShares Aero/Defense ETF (ITA). We view the current correction as a buying opportunity.

Top 10 Holdings	
Company	Weighting
BA	10.1 %
UTX	8.8 %
LMT	7.7 %
GD	6.9 %
RTN	6.2 %
NOC	5.9 %
ARNC	3.5 %
COL	3.3 %
LLL	3.3 %
TXT	3.2 %



INTERNATIONAL MARKETS OVERVIEW

Bearish patterns in overseas indices are an endangered species. International technicals continue to improve, both in developed and emerging markets. For U.S. ETF investors, who are affected by exchange rates, we favor emerging (**VWO**) over developed markets (**EFA**), as many EM currencies like the Brazilian real (**BZF**) continue to strengthen relative to the dollar, providing a technical tailwind.



BRAZIL (EWZ)

Buy. Back by a strong currency (**BZF**; see inset), Brazil continues to top our list of international ideas. EWZ’s correction to the 200-day MA represents an attractive entry point in a global leader.

Top 10 Holdings	
Company	Weighting
Itau Unibanco	11.8 %
Banco Bradesco.	8.5 %
Ambev	7.9 %
PTR Pfd	5.4 %
PTR	4.3 %
Itausa Invest.	3.5 %
BM&F Bovespa	3.4 %
Cielo	2.9 %
Vale	2.8 %
Banco do Brasil	2.8 %

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