

Week of July 17, 2017

Technical strategy for international markets.

07/20/17

THEMES:

- » Top-down and bottom-up technicals continue to articulate a bullish outlook.
- » **A big rotation is underway.** The “anti-reflation” call is a narrative in critical condition. We are seeing a shift into emerging markets and the global materials sector, one with long-term implications. Intermarket analysis gives this outlook the thumbs up; key observations supporting this developing trend include:
 - » **The EM/Developed ratio:** Seen on the next page, this ratio (MSCI EM/EAFE) is emerging from a rounding, multi-year bottom in favor of emerging.
 - » **Materials sector’s relative strength:** The global sector’s RS trend, like EM’s, is steadily reversing a long-term decline (see next page).
 - » **Currencies:** The dollar continues to drop following the failed January breakout, while commodity currencies—Aussie and Canadian dollars—are breaking out from multi-year bottoms (see page 3, 9).
 - » **Commodities:** Though WTI and Brent continue to whipsaw sideways, bullish trend reversals are visible throughout base metals, especially copper (see page 3).
 - » **China:** The country’s major indices—Shanghai Comp, Hang Seng China Enterprises, etc.—are bottoming, with attractive technicals preceding the Q2 GDP numbers.

The emerging market comment requires a caveat: EM’s outperformance is nuanced; it’s confined to large caps only. The small-cap EM/Developed ratio is still stuck in a multi-year decline. Further, sector weightings are playing a big role in the technical shift in favor of EM, especially technology. This sector accounts for a 27% weighting in the MSCI EM Index. In the MSCI EAFE (developed), a meager 6.1% weight.

- » **Europe** presents a short-term pullback opportunity. The STOXX 600’s two-month retracement is stabilizing above support and the rising 200-day MA. This region is still congested with multi-year base patterns -- a reason for our favorable outlook. Highlighted themes: auto parts, materials, and tech... *see page 4*
- » **Japan** continues to break out. The TOPIX, having cleared the 1,400 level, is now trading above a 2-year base, setting the stage for another leg higher. Small-caps look exceptional; the TOPIX Small Index is, as we have highlighted for the past two months, breaking out from a base pattern dating back to the 90’s. Highlighted themes: chemical stocks... *see page 5*
- » **Emerging markets** continue to strengthen, technically speaking. The MSCI EM Index is attempting to break out above long-term resistance to all-time highs. Highlighted themes: Chile’s breakout and US- and Hong Kong-listed Chinese stocks... *see page 6*
- » **Actionable Theme: Materials Sector.** Following on the comments above, in today’s report we highlight a selection of actionable materials stocks, ranging from metals (Rio Tinto, Antofagasta, Norsk Hydro, etc.) to forest products (West Fraser Timber, Western Forest Products)... *see pages 7-8*

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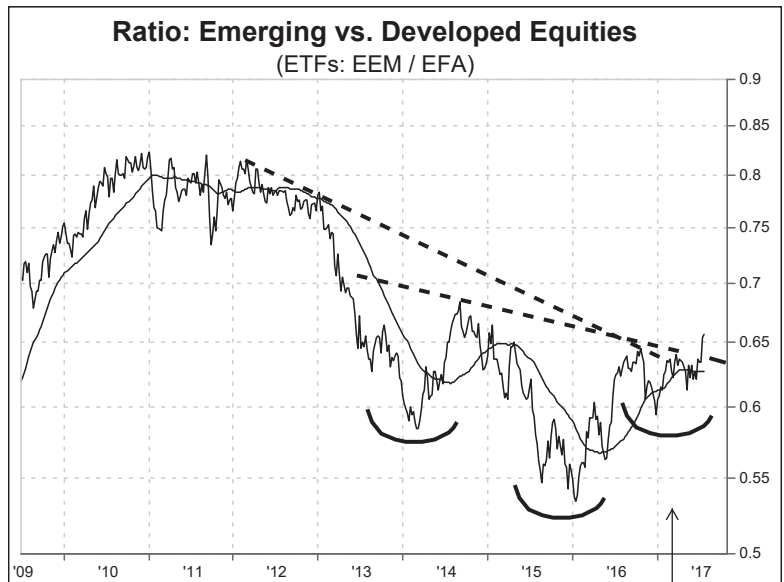
EM strength bodes well for the global materials sector

Historically, what's good for EM is good the global materials sector. This is currently the case.

Since 2009, the correlation coefficient between the **EEM/EFA** (i.e. EM's relative strength) and **MXI/ACWI** (i.e. materials' relative strength) stands at 0.88.

And with EM's relative strength trend breaking out, it's no surprise to see materials' relative strength trend inflect higher.

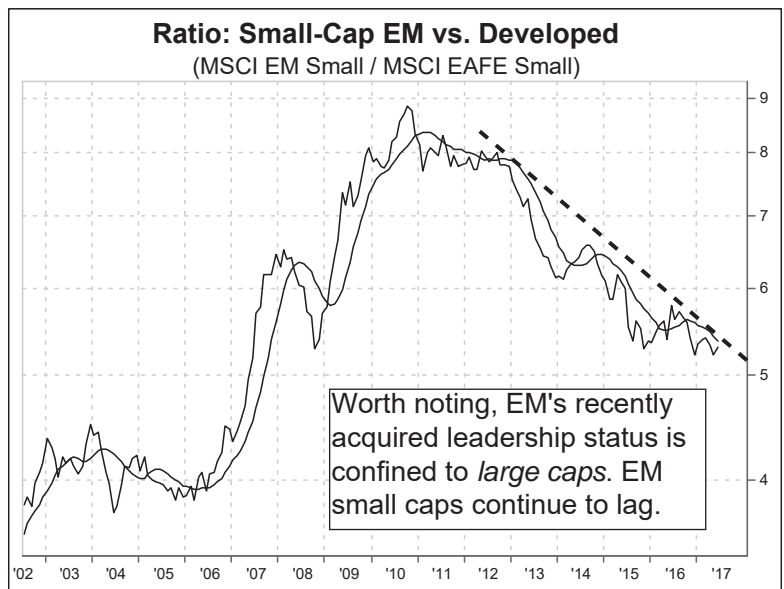
We view this as a signal to increase exposure to both segments.



What about small-cap EM?

EM's new leadership status is still confined to large caps.

Unlike the large-cap EM/EAFE ratio (see cover), the *small-cap* version remains confined to a downtrend in favor of developed international.



Other charts supporting a buy of the global materials sector...

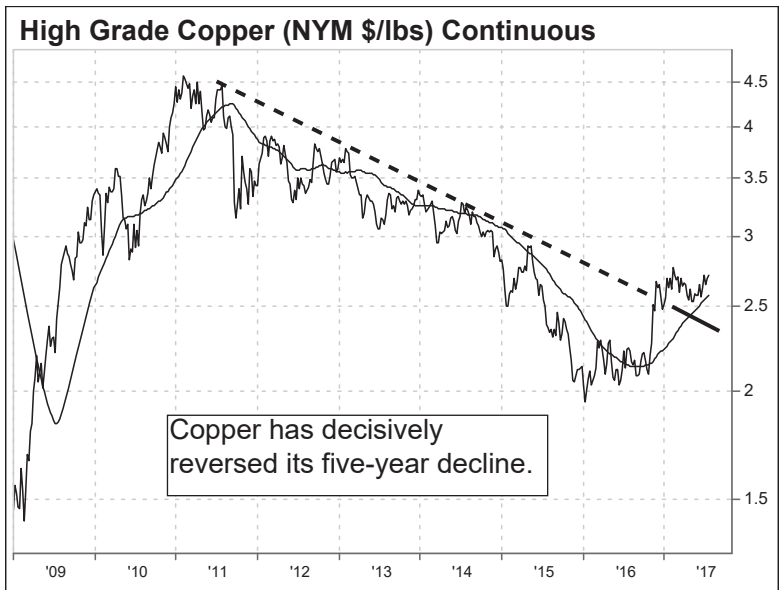
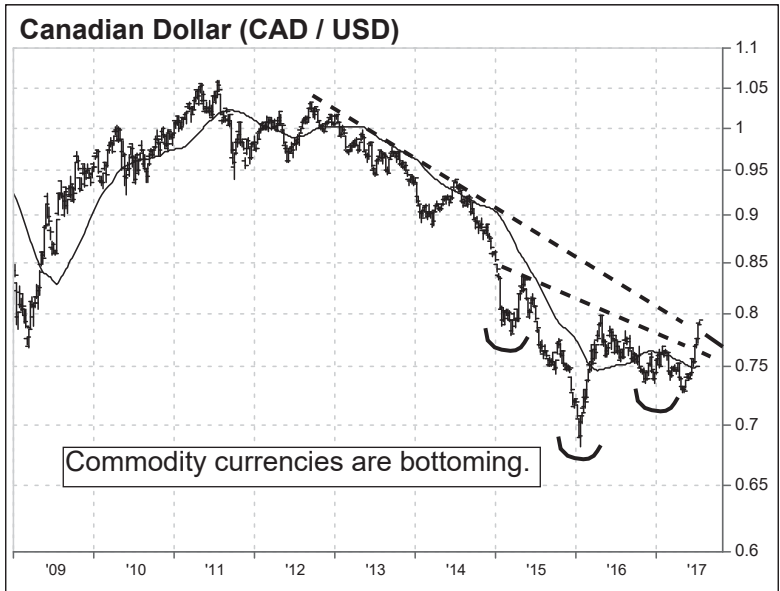
...The U.S. dollar continues to weaken, while commodity currencies like the Australian and Canadian dollars breaking out from multi-year bottom patterns.

And...

...Select commodities are stabilizing. Base metals like copper are reversing cyclical declines.

And...

...Global metals stocks are responding. Buy.



Europe

Europe presents a pullback opportunity. Long-term technicals look great. And the STOXX 600 Index (see right), working through a two-month retracement, offers an attractive entry point.

Dating back to December, our bullish outlook for Europe remains intact, still informed by the abundance of base patterns visible throughout the region.

Internal themes:

- » **Materials stocks are bullishly inflecting.** Later in this week's report we focus on actionable names within this global theme.
- » **Banks remain an attractive theme.** Our initial recommendation (Oct. 2016) remains intact, as many charts depict short-term pullback opportunities. French banks have long-term appeal. The monthly charts of BNP Paribas and Credit Agricole reveal 9-year base patterns. Buy.
- » **Tech continues to lead.** Despite calls for Tech's demise, long-term trends still support an overweight (see inset chart). That said, it's currently difficult to find to locate stocks trading near support.
- » **Buy auto parts.** Europe's auto parts industry is breaking out, both from a price and relative perspective. Actionable charts: Valeo (FR-FR), Faurecia (EO-FR), Plastic Omnium (POM-FR), HELLA (HLE-DE), LEONI (LEO-DE), & Kongsberg (KOA-NO).

STOXX Europe 600 (EUR)



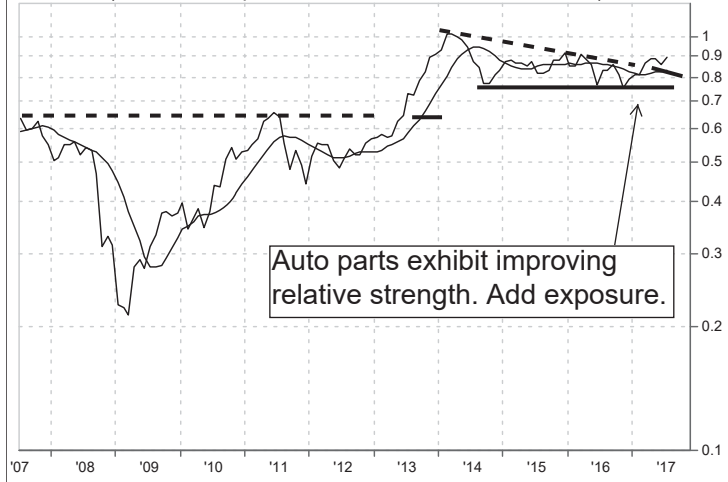
Relative Strength: European Tech Sector

(STOXX Europe 600 Info Tech / MSCI ACWI)



Relative Strength: European Auto Parts

(FactSet European Auto Parts: OEM / MSCI ACWI)



Relative Strength: European Materials Sector

(STOXX Europe 600 Basic Resources / MSCI ACWI)



Japan

Japan continues to emerge from a two-year base pattern, setting the stage for another leg higher.

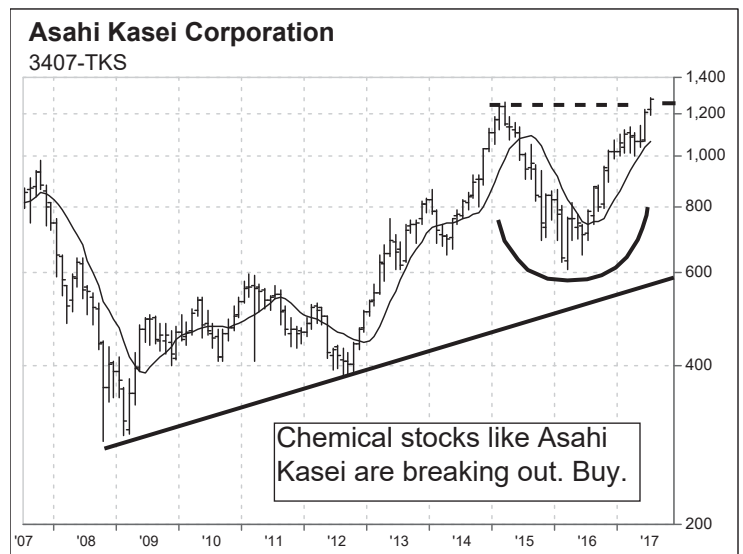
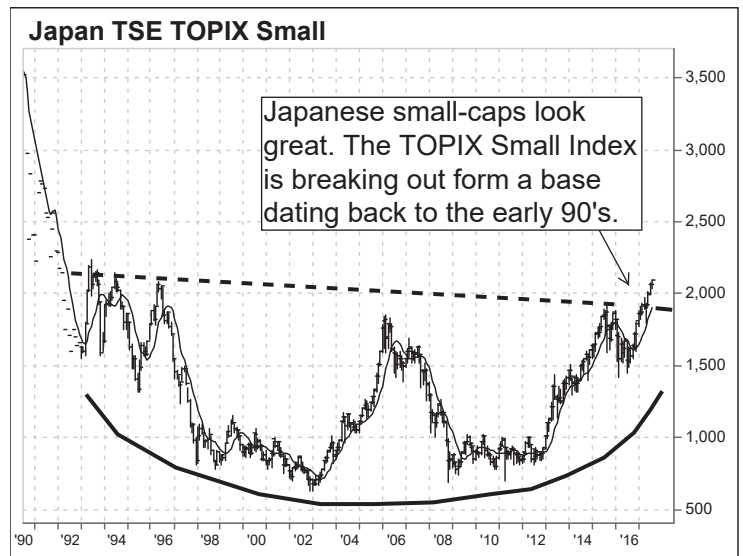
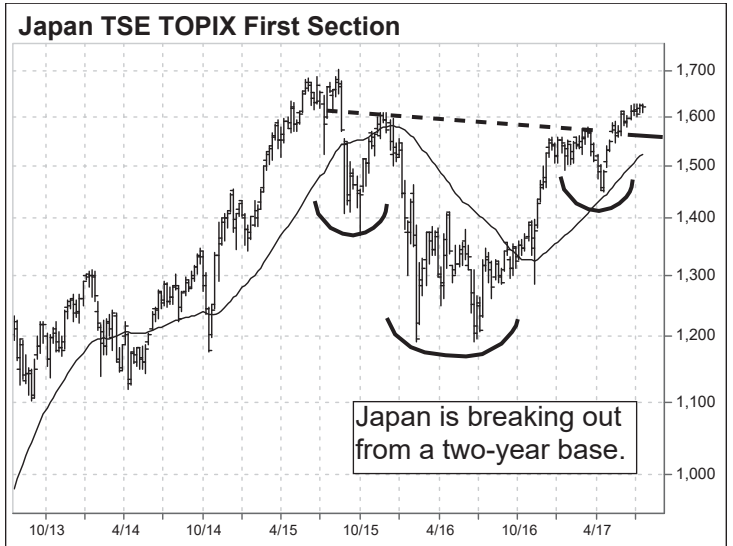
Small caps are particularly attractive; as we've highlighted for the past two months, the TOPIX Small Index (second chart) is breaking out above resistance to 21-year highs.

Internal themes:

- » **Chemical stocks are a leadership theme.** Our Diversified Chemicals Group is breaking out to decade relative strength highs. Actionable charts: Asahi Kasei (3407-JP; see below), UBE Industries (4208-JP), and Soken Chemical (4972-JP).
- » **Engineering & Construction stocks continue to outperform.** The group is rallying to new highs ahead of the TOPIX and Nikkei 225 -- a sign of strength. This is an attractive space for small-cap investors.

Actionable charts:

Shimizu (1803), COMSYS (1721-JP), Toda (1860-JP), Kyowa Exeo (1951-JP), Maeda Road Construction (1883-JP), SHO-BOND (1414-JP), Kumagi Gumi (1861-JP), Takamatsu Construction Group (1762-JP), and Yokogawa Bridge (5911).

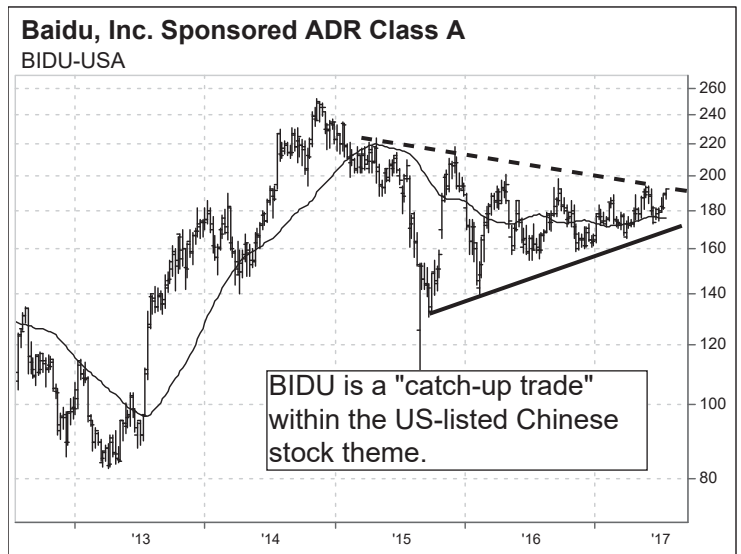
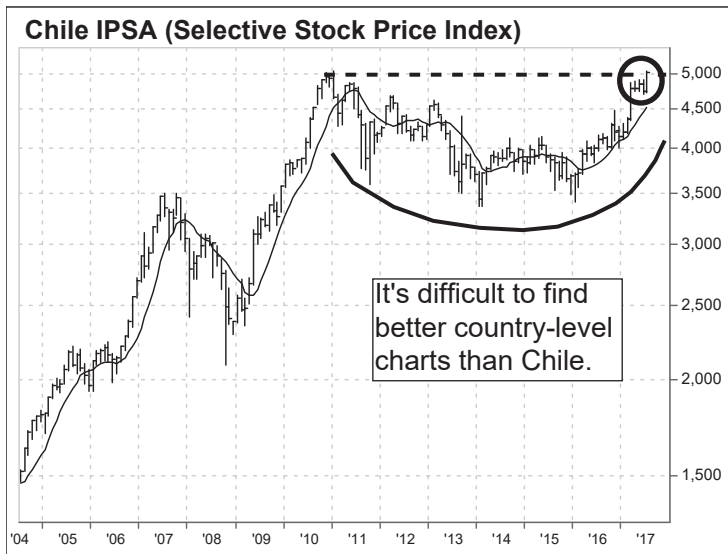
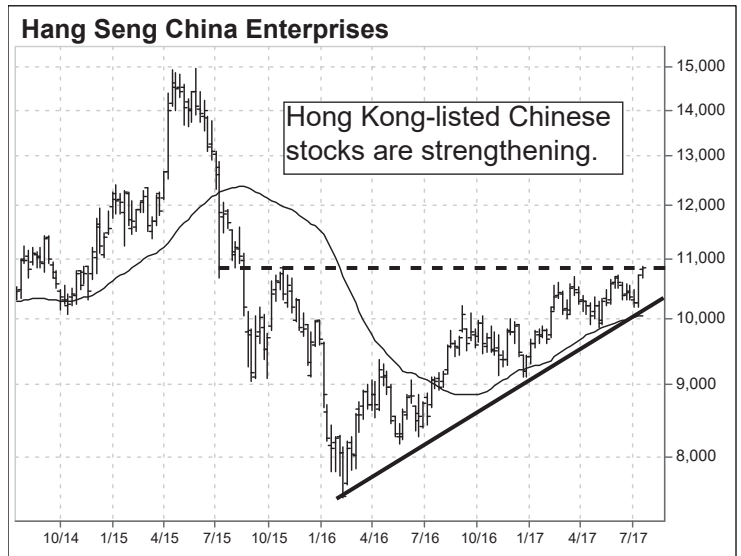
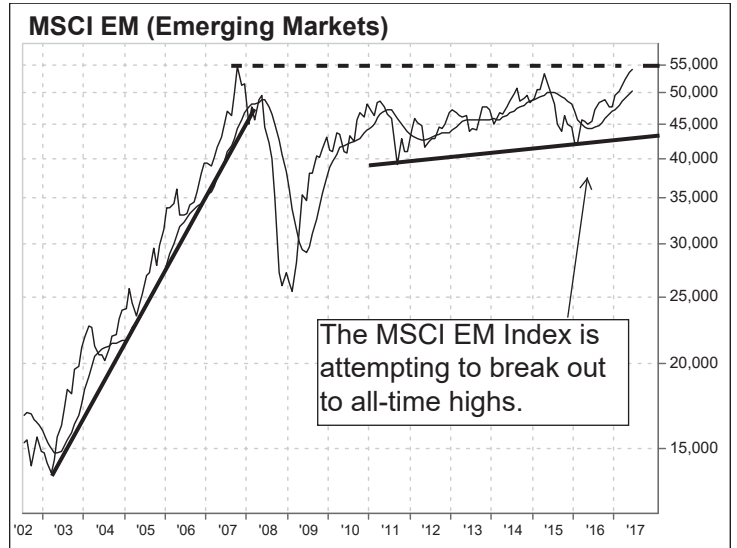


Emerging Markets

Important developments are underway in EM: the MSCI EM Index is (1) breaking out above long-term resistance to new price highs, and (2) bottoming relative to developed markets (see cover chart). Increase exposure.

Internal themes:

- » **Tech continues to lead.** Tech is the only EM sector trading at new relative strength highs. Stay overweight.
 - » **China is bottoming.** All major indices--Shanghai Comp., CSI 300, Hang Seng China Enterprises--are slowly emerging from multi-year bottom patterns. China is *not* a relative leader, but we view its "participation" in the global rally as a positive.
 - » **US-listed Chinese stocks are breaking out.** To reiterate our call in March (and last week), we continue to see breakouts unfold within this theme. Actionable charts include: **BIDU** (see below), **YY**, **CTRP**, **SINA**, **SOHU**, **JOBS**, **CSIQ**, **BITA**, and **NOAH**.
 - » **Chile: A must-own sliver of the EM universe.** Move over Brazil, a new leader is emerging in Latin America: Chile. Seen below, the **IPSA Index** is breaking out from a 6-year base to all-time highs.
- Actionable charts: Enel Americas (ENELAM-CL), S.A.C.I. Falabella (FALABELLA-CL), LATAM Airlines (LFL), Sociedad Quimica y Minera (SQM), and Banco de Credito (BCI-CL).



Materials Sector: Buy

Global materials stocks--from cement to copper--are bullishly inflecting. This is a buying opportunity.

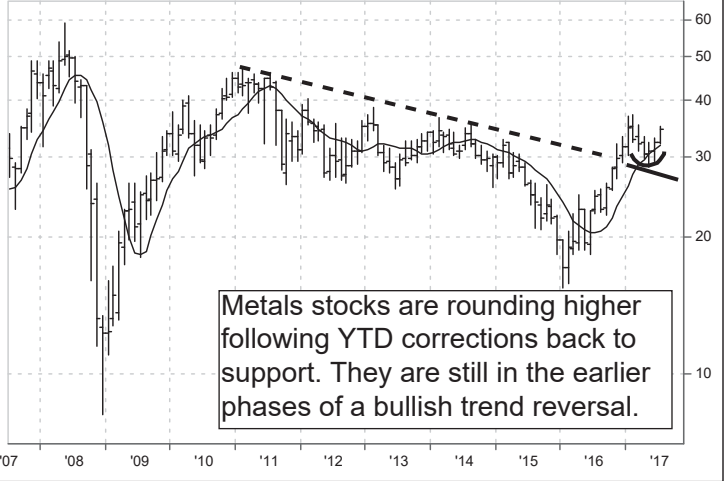
Entry points are attractive. Most stocks, especially the metals, corrected deeply during the first-half of the year, bringing many names back to support.

Internal themes:

- » **Global steel stocks** are rebounding off 200-day moving averages. POSCO (PKX) is a leader.
- » **Aluminum stocks** are breaking out. This applies to developed and EM names: Alocu (AA), Constellium (CSTM), Norsk Hydro (NHY-NO), Southern Copper (SCCO), and Aluminum Corp of China (ACH).
- » **Copper miners**, same story: rebounding off support. Actionable names include: Freeport-McMoRan (FCX), Antofagasta (ANTO-GB), KGHM Polska Miedz (KGH-PL), Lundin Mining (LUN-CA), Jiangxi Copper (358-HK), and Taseko Mines (TGB).
- » **Canadian forest product stocks** are breaking out from base patterns: Western Forest Products (WEF-CA), Norbord (OSB-CA), Interfor (IPF-CA), Canfor (CFP-CA), and West Fraser Timber (WFT-CA). Buy.
- » **Cement stocks**, too, are breaking out. This group held up well throughout the first-half of the year: Cemex (CX), Taiheiyo Cement (5233-JP), Sumitomo Osaka Cement (5232-JP), and Cemtir Holding (CEM-IT).

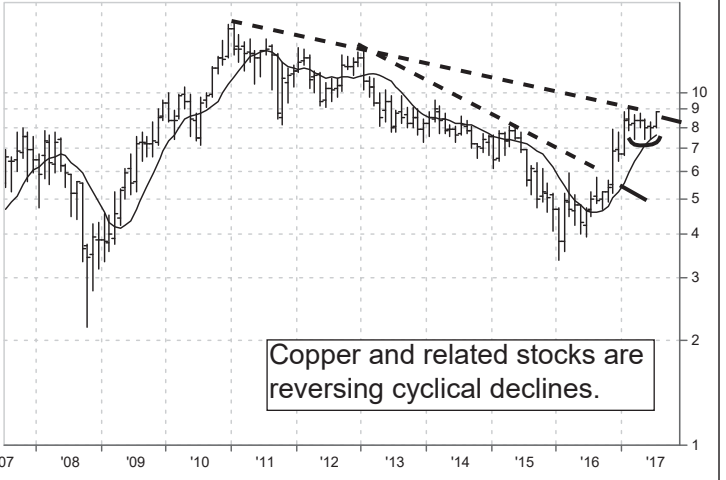
Rio Tinto plc

RIO-LON



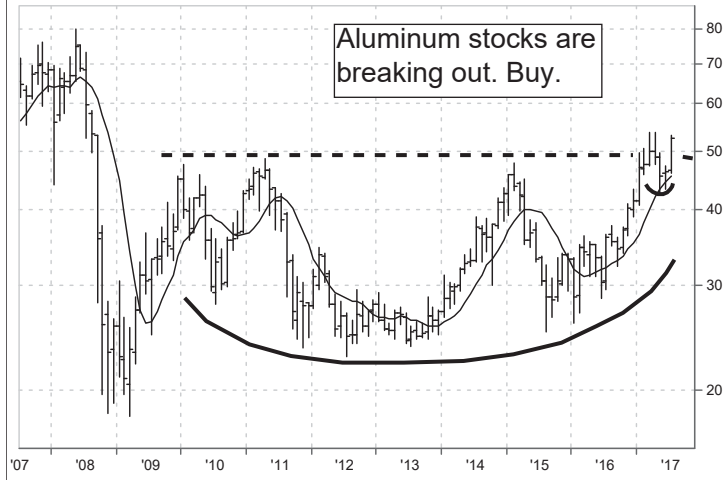
Antofagasta plc

ANTO-LON



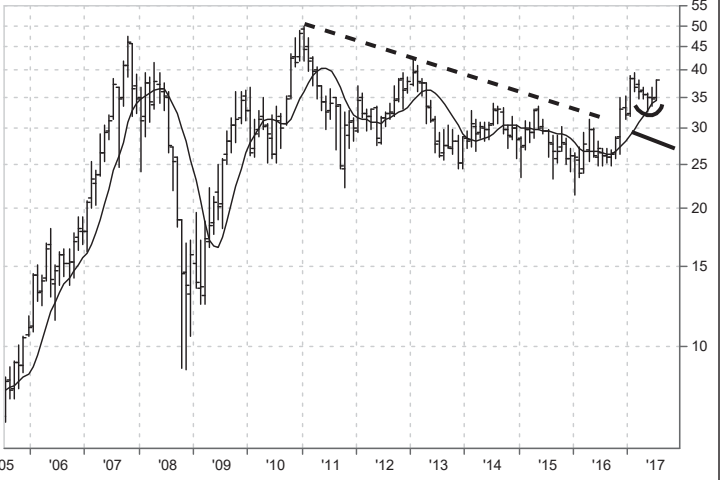
Norsk Hydro ASA

NHY-OSL

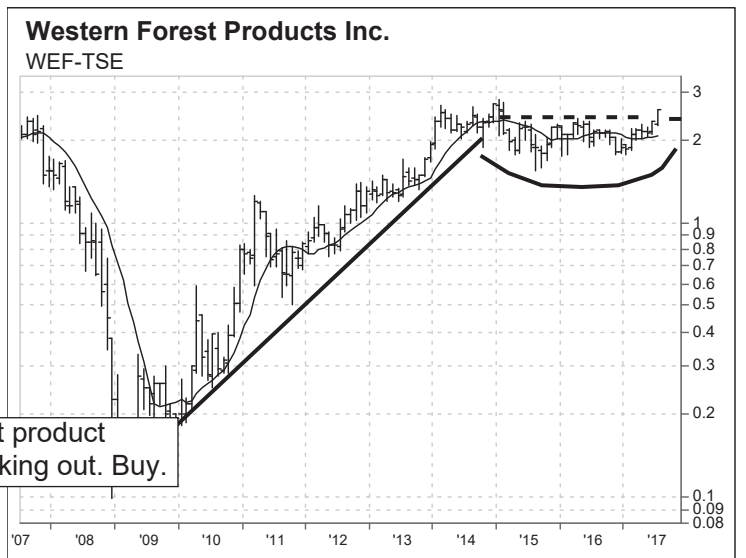
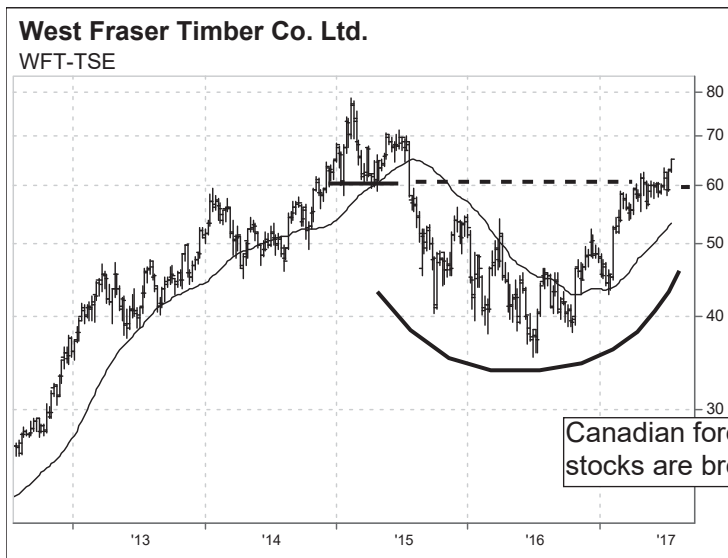
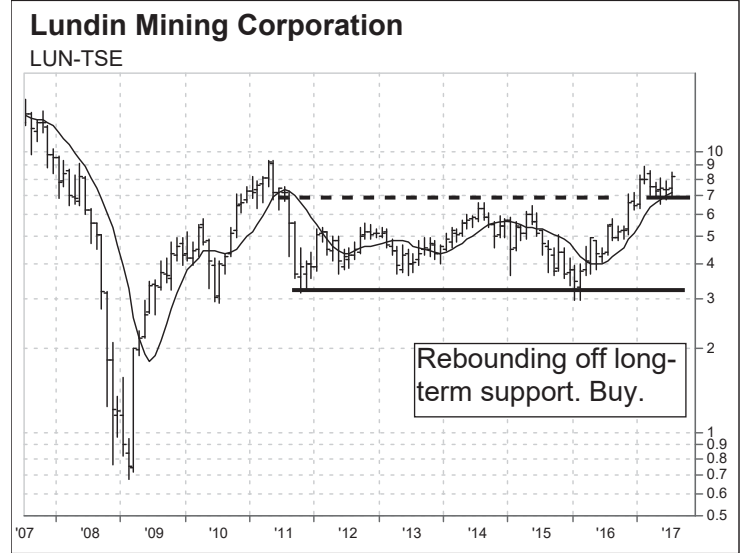
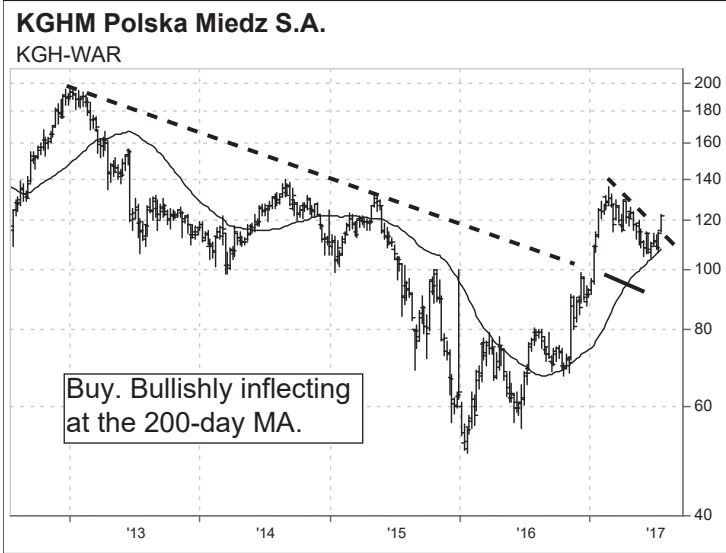


Southern Copper Corporation

SCCO-USA

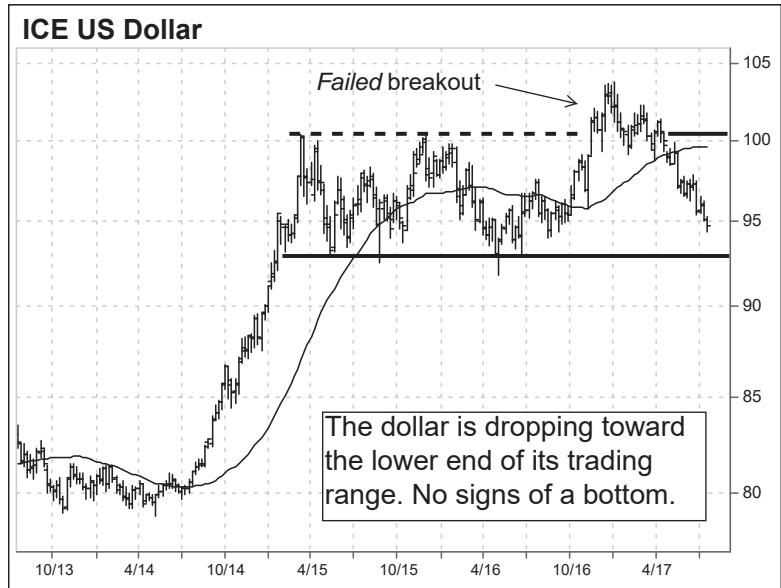


MAJOR THEMES: Add exposure to materials stocks (cont.)



The dollar's 7-mo downtrend remains intact

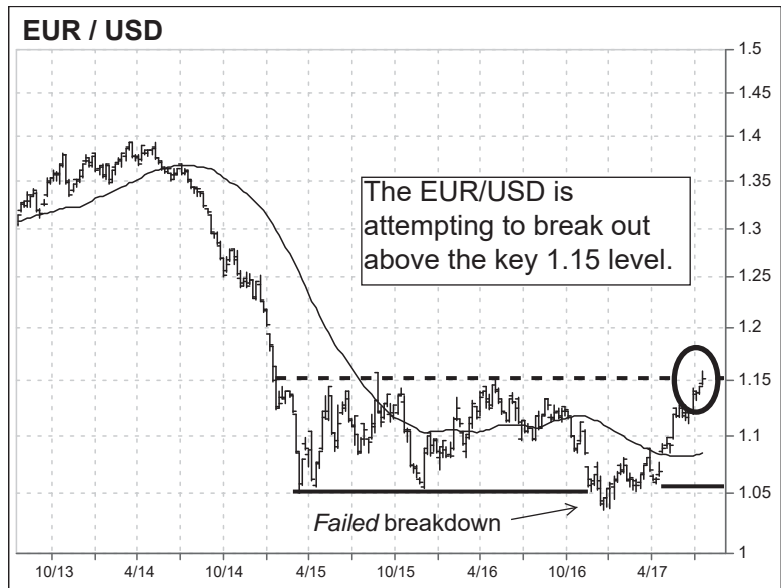
The US Dollar Index's 7-month decline, which followed last year's *failed* breakout, remains intact. We do not see any signs of this trend reversing right now.



The euro is attempting to break out

Last week we highlighted the EUR/USD as a breakout candidate. This week, wasting no time, the cross is staging a breakout attempt above the key 1.15 level.

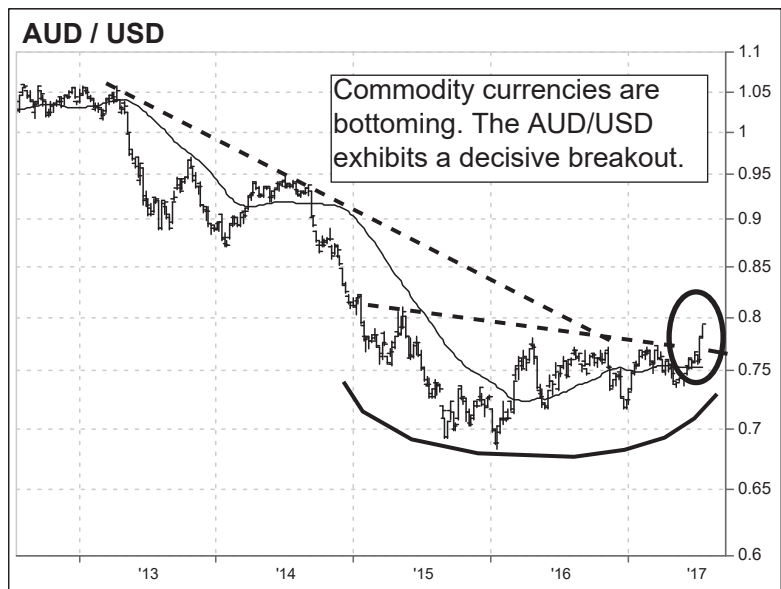
To confirm the breakout, and guard against a false move, we need to see the EUR/USD close above 1.15 for two consecutive weeks.



The Australian dollar is bottoming

The AUD/USD is breaking out from a two-year bottoming process.

Similar price action is visible in the Canadian dollar (CAD/USD).



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