The Solari Report

JULY 2, 2015

2nd Quarter Equity Overview

July 2, 2015

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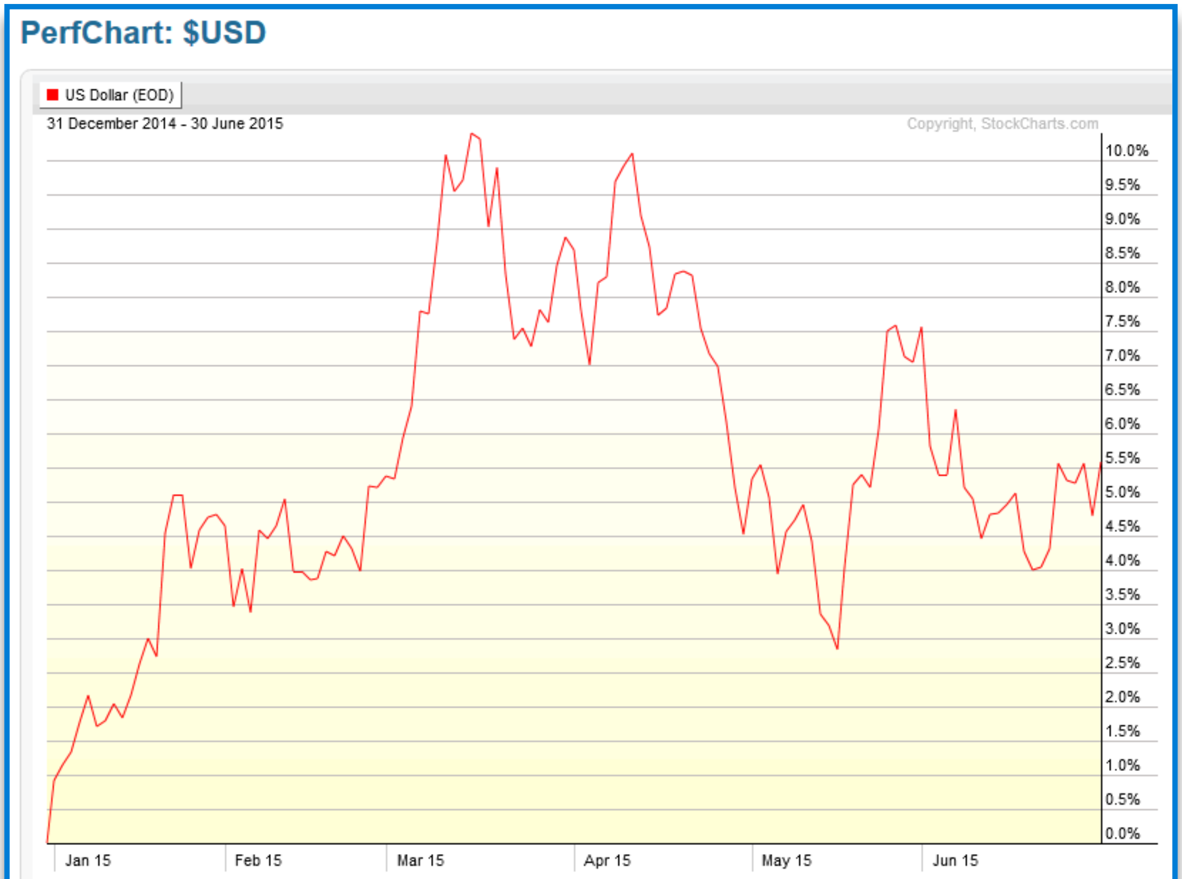
Good evening. Welcome to The Solari Report. This is the 2nd Quarter 2015 Equity Overview. I'm Catherine Austin Fitts, and I'm delighted you could join me this evening.

Well, we've been busy making charts, and if you will link to the commentary that has our 2nd Quarter Equity Overview charts in it, it will help tremendously if you follow along. I'm just going to run down and give you a sense of the 2nd quarter.

The 2nd quarter was really a great shrink. We had a strong 1st quarter, particularly in the emerging markets – in Asia and in Europe, not so much the United States, which is flat for the year. We saw both Germany and China up more than 25% and now back down to approximately 12% each with the US flat. So there was a lot of excitement about gains in the first quarter and a lot of sadness about giving up about half of those gains in the 2nd quarter, but we ended up the year in a reasonable place, particularly in the developed markets and China.

Index	12/31/14	03/31/15	06/30/15	% Q2 Change	% YTD Change
S&P 500	2,058.90	2,067.89	2,063.11	-0.23%	0.20%
DJIA	17,823.07	17,776.12	17,619.51	-0.88%	-1.14%
Russell 2000 (IWM)	119.26	124.37	124.84	0.38%	4.68%
MSCI EAFE (EFA)	59.83	63.10	63.49	0.62%	6.12%
MSCI Emerg. Mkts (EEM)	39.00	39.83	39.62	-0.53%	1.59%
Barclays Agg Bond (AGG)	109.15	110.80	108.78	-1.82%	-0.34%
DAX (^GDAXI)	9,805.55	11,966.17	10,944.97	-8.53%	11.62%
iShares China Large-Cap (FXI)	41.41	44.17	46.10	4.37%	11.33%
PowerShares India ETF (PIN)	20.92	22.50	21.63	-3.87%	3.39%
Gold (oz.)	1,206.00	1,187.00	1,171.00	-1.35%	-2.90%
iShares 20+ Year Treasury Bond (TLT)	124.63	129.87	117.53	-9.50%	-5.70%
US Dollar Index	90.28	98.38	95.55	-2.88%	5.84%
Commodities-Reuters/Jeffries CRB Index ($CRB)	229.96	211.86	227.17	7.23%	-1.21%
Baltic Dry Index	782.00	602.00	800.00	32.89%	2.30%
iShares 7-10 Year Treasury Bond (IEF)	105.15	107.88	105.01	-2.66%	-0.13%

So let's roll through the charts. The first ad gives an overview of many of the different charts we're going to show. The first individual chart is the US Dollar Index. After being up 12% last year, we headed up to another little bit more than 10% in the first quarter, and then have corrected it down to the second quarter being up about 5.5%. We're up a little bit more from then now today with the US dollar index at about 96.

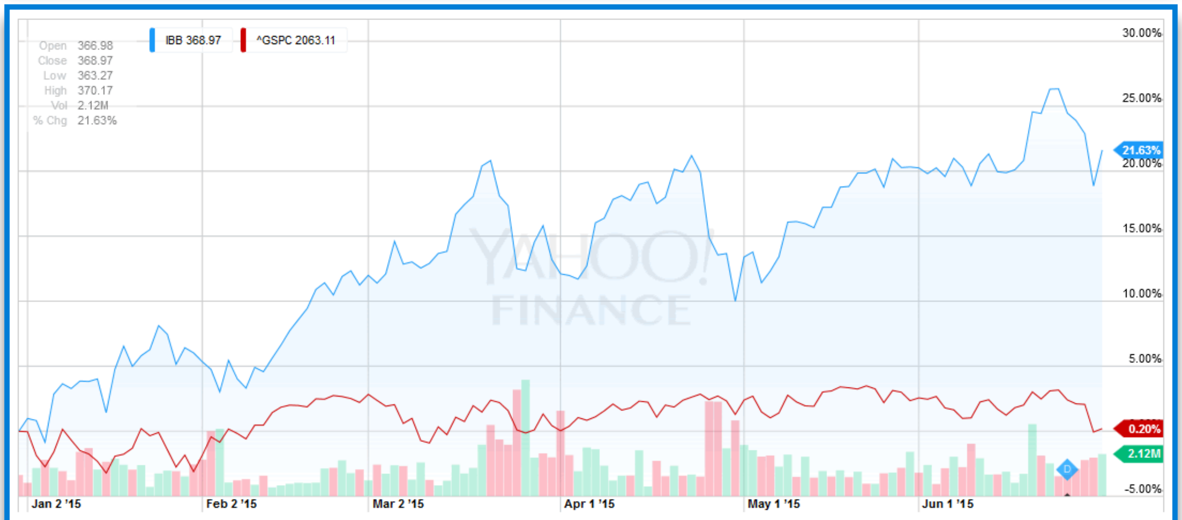


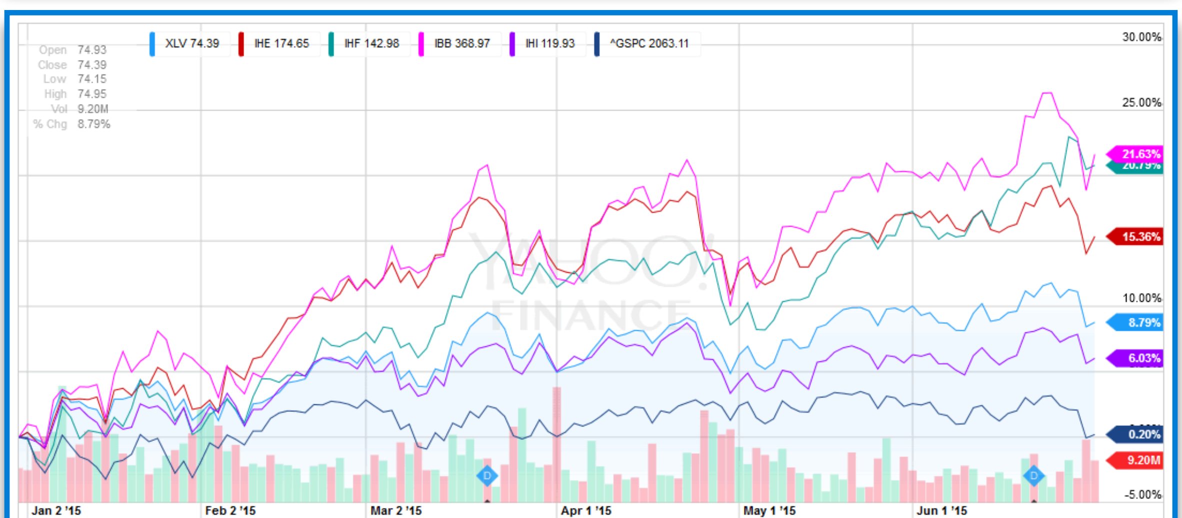
Let's take a look at US Equities. The US equity market was flat, but interestingly enough the sub-performer was large caps and the buy-back shares, and the stocks that did well were the small-caps and the medium-caps. Part of that is you're seeing technology as one of the stronger sectors.

If you look at the *Morningstar* sectors, it looks at global sectors. Real estate was strongest. In the US we really saw healthcare. Again, Obamacare is providing massive subsidy. The corporate side of this market, and now we're starting to see the mergers of the insurance companies, so we may end up with single payer anyway. The merger is going on with the Supreme Court case being final it's quite interesting.

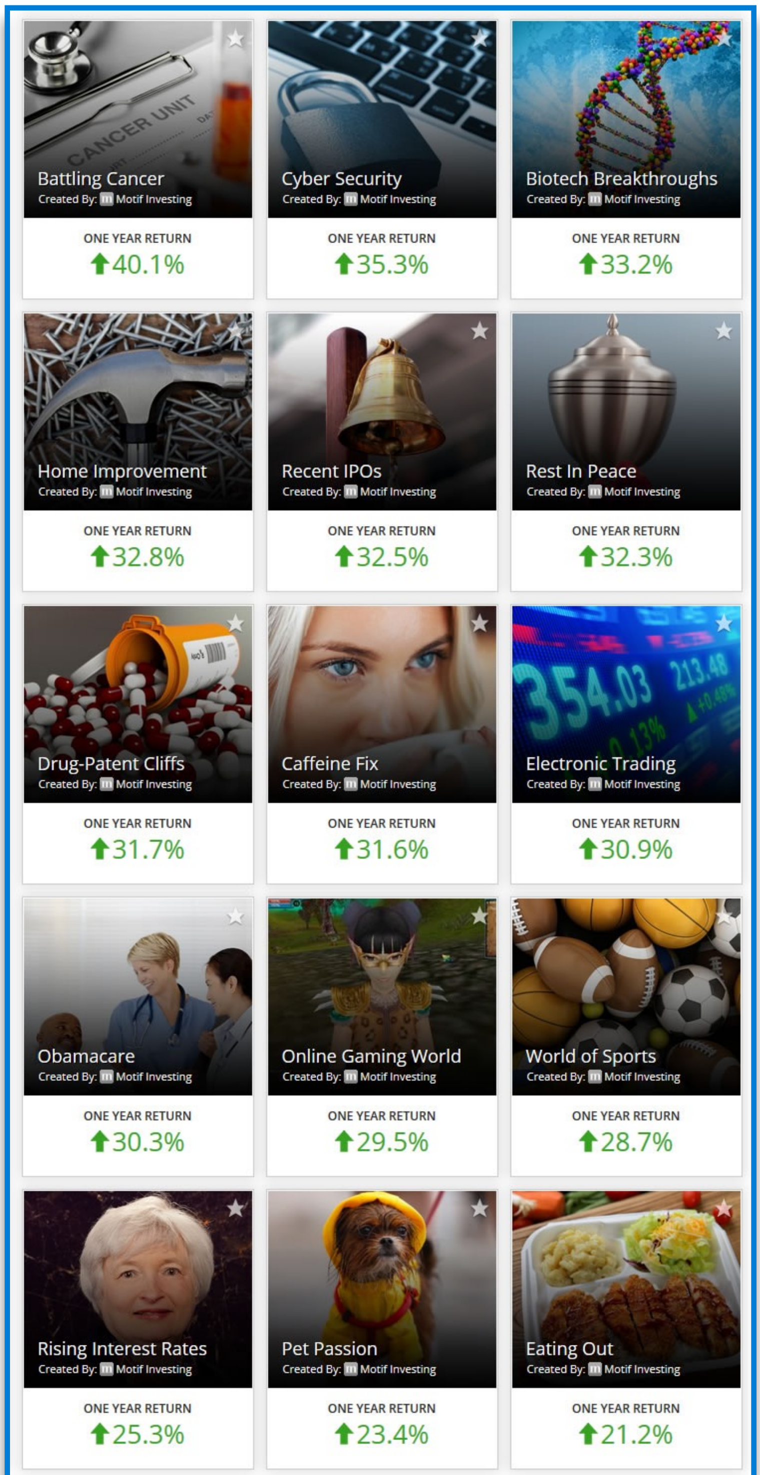
Stock Sectors: Total Returns (%)

Sector Name	5-Day	YTD	1-Month	3-Month	1-Year	3-Year	5-Year
Basic Materials	-0.42	10.69	4.97	5.63	1.90	7.75	6.65
Communication Services	0.19	9.87	1.10	2.41	12.40	16.85	15.28
Consumer Cyclical	1.89	11.52	2.91	4.72	16.27	24.05	20.54
Consumer Defensive	0.97	9.82	2.07	4.91	10.35	16.63	15.80
Energy	-1.40	6.36	-0.83	3.77	-10.92	7.17	8.46
Financial Services	1.12	10.83	3.30	8.83	20.78	22.21	11.44
Healthcare	2.19	14.46	2.17	7.80	28.58	30.51	23.85
Industrials	0.74	10.83	1.47	6.03	16.13	20.79	15.33
Real Estate	1.45	21.10	2.01	3.46	17.72	15.07	14.09
Technology	1.43	12.57	2.80	6.34	26.92	24.20	18.05
Utilities	1.54	0.33	2.63	2.63	3.53	12.60	9.90

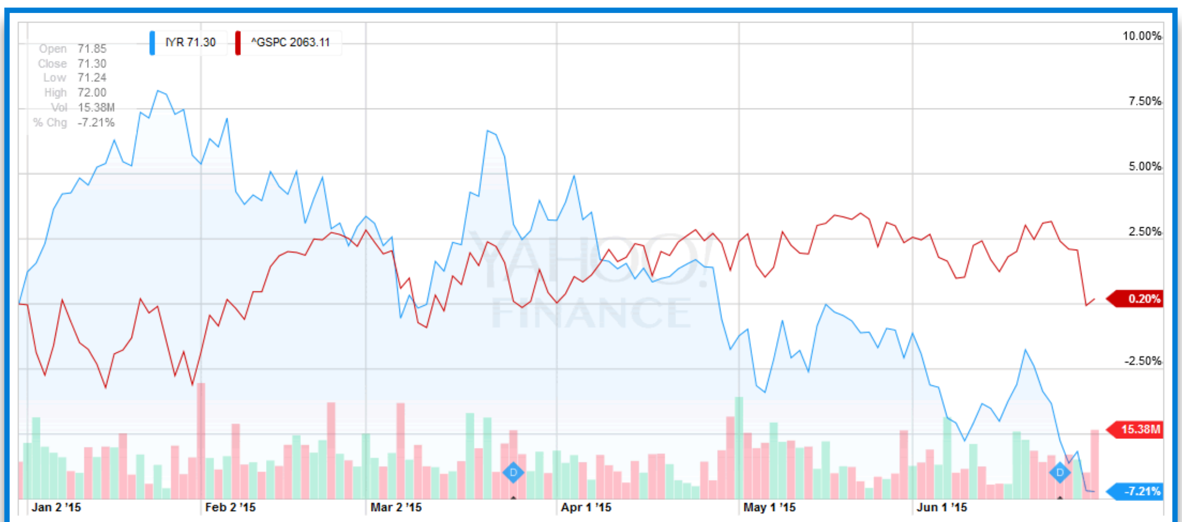




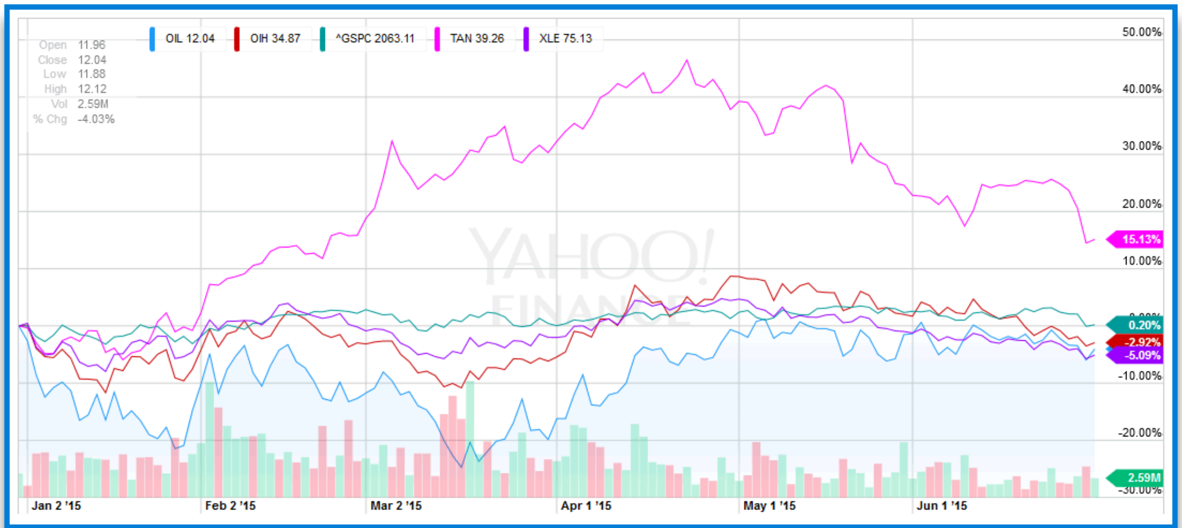
Then I also put up a picture from Motif Investing, which I think has some very clever ideas in ways of looking at the market. It shows that the top spot was battling cancer again, and a lot of drugs – you can see in Obamacare – in the health care sector. Healthcare is leading the way with technology helping.



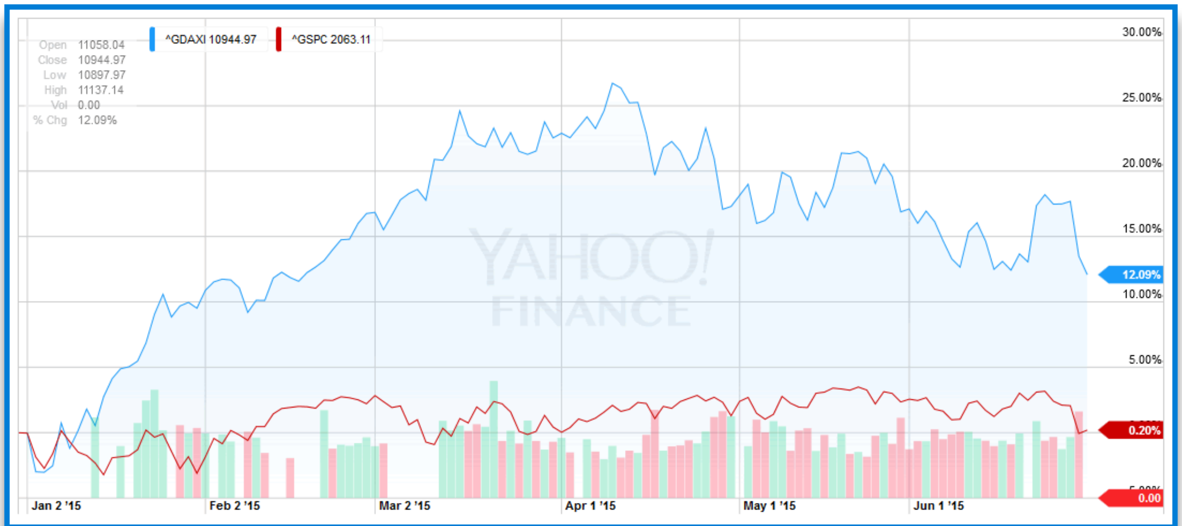
I've talked a lot about the extent to which I believe the administration is doing everything they can to juice the single family home market, and sure enough, home construction outperformed the S&P flat, and the US home construction ATF up a bit more than 6%. Real estate, of course, sunk as they were concerned about interest rates.



To my surprise, oil did not really do anything. If you look at the energy sector, it was solar that had a significant performance this year, and oil has just been bouncing along the bottom and flat. The chart looks weak.



Interestingly enough, despite the oil card still being in effect, Russia came up very strongly, up 24% for the year. That is far from everything they lost last year, but it's a significant recovery, bringing some back. Germany was up more than 25% and then went back down to 11% for the first half. China large-caps are up over 25% and then back down to approximately 11%, and China A-shares had an even better performance up at 23%. Of course they've come down very dramatically in June. India came up with China, up about 26-27%. With China large-caps, China was up about 12.5% and then really sunk and has recovered, so it's up about 3% for the first half.


Open 11058.04
Close 10944.97
Low 10897.97
High 11137.14
Vol 0.00
% Chg 12.09%
^GDAXI 10944.97
^GSPC 2063.11
30.00%
25.00%
20.00%
15.00%
12.09%
10.00%
5.00%
0.20%
0.00
Jan 2 '15
Feb 2 '15
Mar 2 '15
Apr 1 '15
May 1 '15
Jun 1 '15


Open 46.22
Close 46.02
Low 45.75
High 46.25
Vol 19.73M
% Chg 10.57%
FXI 46.02
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30.00%
25.00%
20.00%
15.00%
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Jan 2 '15
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May 1 '15
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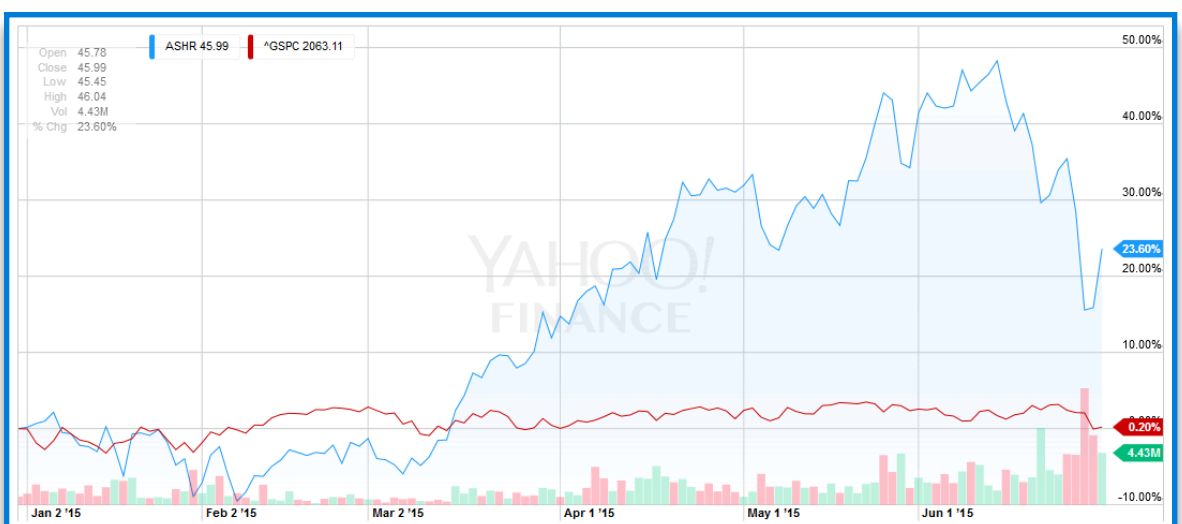

Open 45.78
Close 45.99
Low 45.45
High 46.04
Vol 4.43M
% Chg 23.60%
ASHR 45.99
^GSPC 2063.11
50.00%
40.00%
30.00%
23.60%
20.00%
10.00%
0.20%
4.43M
-10.00%
Jan 2 '15
Feb 2 '15
Mar 2 '15
Apr 1 '15
May 1 '15
Jun 1 '15

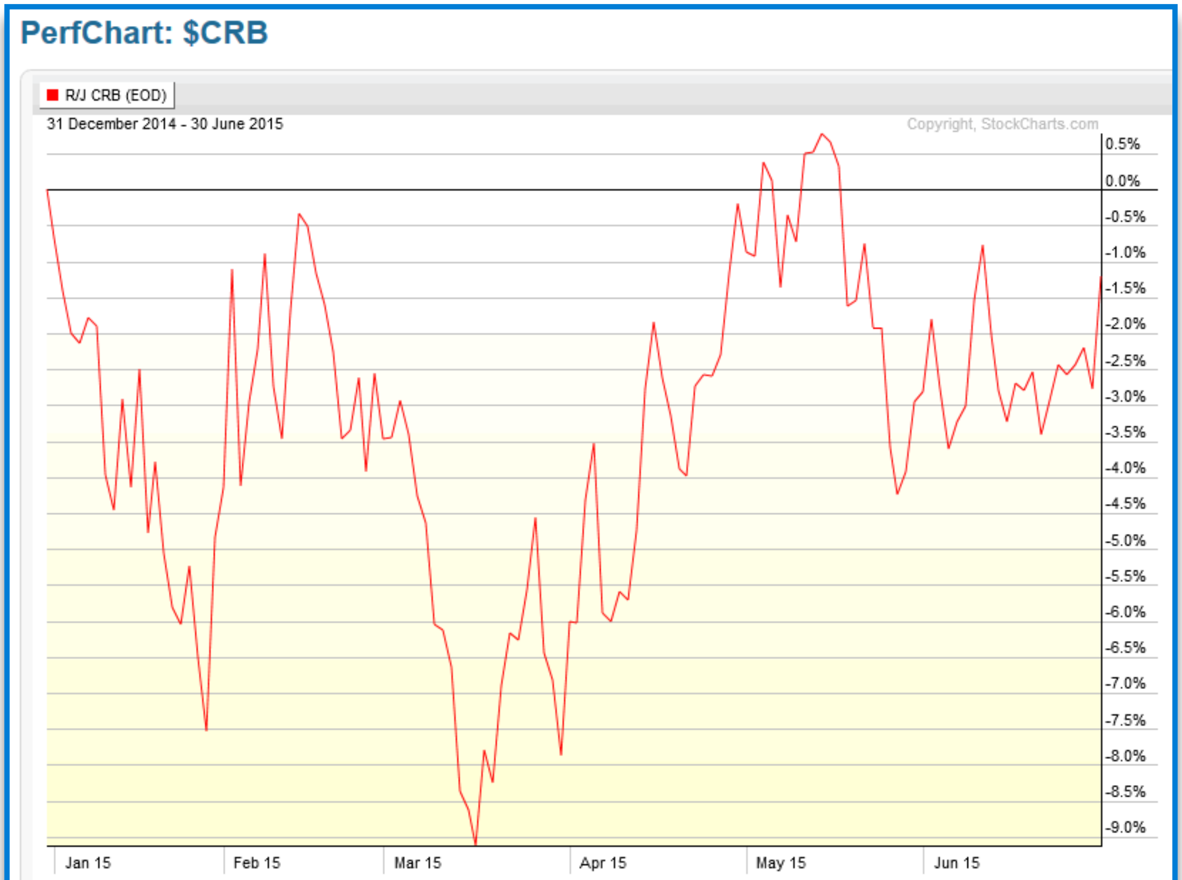
Emerging markets were doing nicely – almost 12% - and now have sunk down to essentially flat for the first half. The developed markets outperformed the US – the international developed markets. The EFA/ETF up about 4.5% for the first half, and the frontier markets sunk. They're down 4%.

I just want to touch on fixed income a little bit because the big turn in the bond market does finally appear to be here, and we have many experts in the second quarter declaring the end of the long-term bull in the bond market. More bad behavior from Bill Gross and a real concern is the fed jawboning about raising interest rates. The question is: Will they before the end of the year? My guess is: Yes, although it will be by tiny amounts.

If you take a look at the fixed income charts that I show, I show ETFs for the bond to aggregate in the 5-7 year intermediate treasury and the long treasury TLT. What you see is bonds were down a tiny bit. I would call that essentially flat for the year, but the long treasury is down about 7%. The long side of the market, once everybody decides that bonds are going to turn, the long bond market is going to be in a real pickle.

I notice Morgan Stanley announced last week that they are adding capacity to their fixed income markets. That's a good sign because liquidity is going to be an issue.

Commodities and precious metals continue to underperform, and the charts look weak, essentially flat or down for the year so far.
It's the same thing with the commodities index. It essentially bounced around but is flat for the year.



I wanted to take a look just because I did spend some time in the second quarter down in Australia and New Zealand. I wanted to talk a little bit about what is happening in those equity markets. As I'm traveling around the world I want to make sure I'm reporting to you on equity markets around the world because they're growing. Investors are getting much more opportunity to invest in markets around the world, and I think it's very important to connect what's going on in the political news and geopolitics with what is happening in the stock market and what they mean to each other.

I've done three charts that are a comparison of several things. First of all is the Australian ETF, and second of all is the New Zealand ETF. I find ETFs to be very useful to just compare performance in a particular market. I would note that if we instead used their exchange index – which I sometimes do, so I used the DAX in Germany – we would get different numbers than if we used the ETF. You just want to be cognizant of that when you look at some of these charts.

I used Australian ETF and New Zealand ETF and compared them to the international developed ETF which is EFA, which I would consider their benchmark in S&P. Now Australia is very commodities dependent. Their tremendous economic boom over the past two decades has really come from providing commodities to China and the rise of Asia. I mean, they're very strategically located down under, and that has been a boon.

Of course, New Zealand is a real agricultural center, and of course they're providing meat and dairy and all sorts of food to that boom as well as to the countries around the world. If you love lamb as much as I do, I'm sure you've eaten New Zealand lamb; it's everywhere.

They have very interesting economies. Before we go through these, let me just talk a little bit about it. Australia and New Zealand compared to the United States and markets that you and I are used to are tiny. Australia is 24 million people compared to our 320 million people. Their land mass is 90% of the US, and 40% of those people live in Sydney and Melbourne. So you have two coastal cities that have a very significant portion of the population. It's a highly urbanized population.

Their stock market is about $1.6 trillion, so that's 2% of the global $70 trillion. Sydney has become a financial center, but it's nowhere near as significant as a city of London or New York City, if you will. It's still pretty sizable. A lot of it represents commodities and the banks that serve the commodities industry.

What's very interesting is when you go to Australia, it's amazing how happy everybody is, certainly in comparison to the United States. If you use the World Bank per capita in statistics, one of the reasons you can see is the per capita income in the United States is $53,000 as of 2013. It's $67,000 in Australia, which means if you looked at those numbers for 1990 we were $23,000 and they were $18,000. They were behind, and they have surpassed us by a significant amount – which is one of the reasons I suspect that they are so happy. In no sense have they gutted the middle class the way we have in America, and it very much shows up in the per capita numbers.

Of course, they have the advantage of being down under to an Asia that is rising and growing with demands for their services and skills, and they have a very sophisticated managerial and legal infrastructure which works to their advantage, and obviously a very beautiful country.

Long supply lines, but protected by those oceans. At the same time, they depend on the US Navy and the US security umbrella to protect those long supply lines. What is interesting is in 2014 they outsourced big systems in their defense infrastructure to Lockheed Martin. If you look at the defense contractors running the United States, it's starting to look very similar down under.

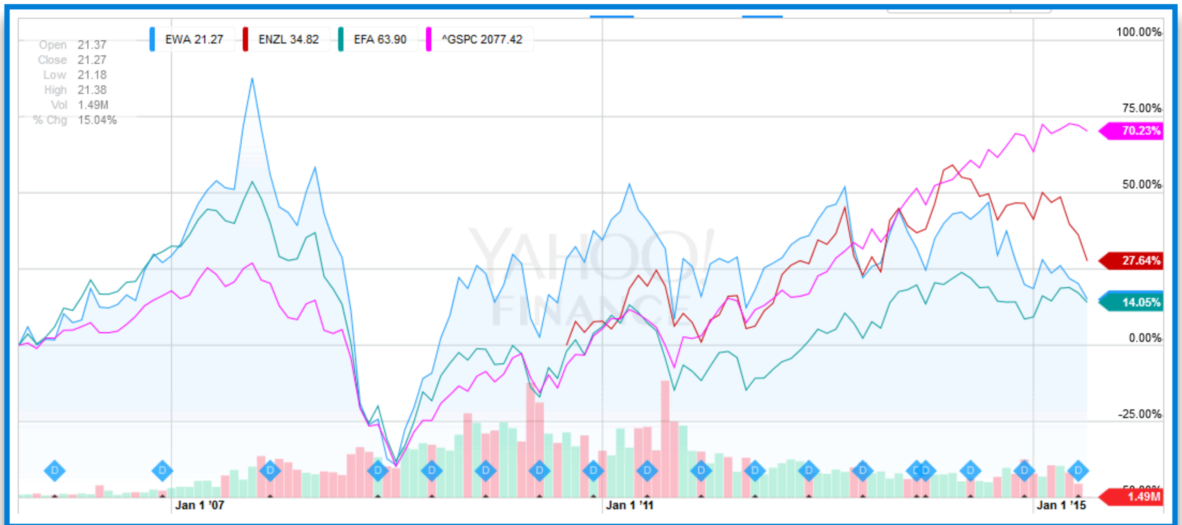
New Zealand is 4.6 million people. Their stock market is $75 billion, which means it's one percent of one percent of the global stock market. It's tiny.

Their real economic juggernaut is agriculture, but they're also – like Australia – an incredibly beautiful country. If you've ever seen *Lord of the Rings* it really is that beautiful. It's quite remarkable and very active, healthy, outgoing people. The food and the lifestyle in both places is unbelievably healthy and very athletic.

These markets compare to the Asian markets. Let me give you a sense. China is 8.6% of global markets. Their markets are about $6 trillion in size. Japan is about 6.5%, so clearly Australia and New Zealand are small not just in the United States but in comparison to the 'big guys' in Asia.

So let's take a look at the charts. I've posted three charts. One, again, compares Australia with New Zealand and the developed international and S&P. I looked at it ten years, five years, and year-to-date.

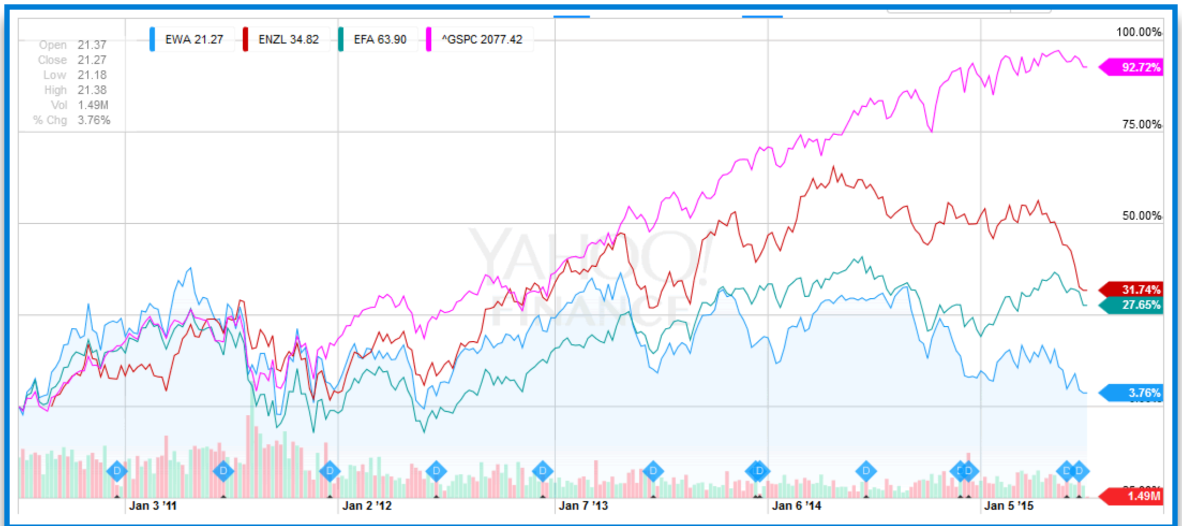
What you see in the ten-year is that with the commodities boom coming into the crash in 2008-2009, Australia was way ahead of the S&P during that period. You really had the commodity super-cycle. Then you get the crash, and Australia comes out of the crash much stronger than the US. That's when the New Zealand ETF got created. It's trading a little bit ahead of the S&P.



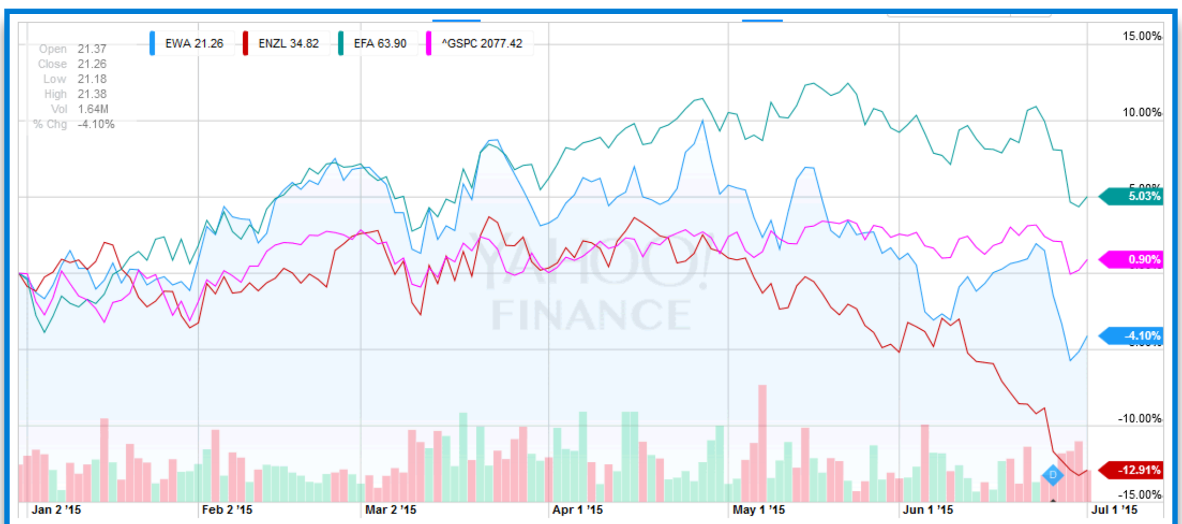
Then we move towards the 2013 period, and sure enough, the US starts pulling away ahead of all markets globally, and commodities soften. You see Australia and New Zealand move down, but you also see the developed markets not doing anywhere as well. Again, it's this idea that we've talked about on the Equity Overviews for the last several years of how astonishing the push of the US markets ahead of most other markets have been for these last few years.

With the US markets flat for the first half of the year, what we're seeing is the other markets – in many respects – start to catch up.

The next chart is the five-year picture, and I just wanted to look a little bit more closely at the last five years. With this picture, you start to see that move ahead clearly in the second quarter of 2013. It's been quite an astonishing divergence for the US. Again, as I said in the other recording that we did for the second overview on the risk issues, a lot of that growth has depended on earnings coming out of borrowing at very low interest rates and using the money to do buy-backs. While that's pushed the market up, it has also, I would say, weakened the real asset base of a lot of companies – more than we might otherwise prefer.



Then if you take a look at year-to-date, as I said, New Zealand and Australia have been struggling with the low commodity prices and the slowdown in the global economy, and then you really see them turn down in the second quarter, New Zealand in particular.



We see the US essentially flat for the year, and Australia down 4% and New Zealand down almost 13% - hit quite hard with the developed international 5+ %. They are significantly underperforming the benchmarks, and part of that, of course, is the commodities issues, New Zealand getting hit pretty hard with low dairy prices because dairy is a very important export for them.

One of the reasons I wanted to take a look at these particular markets at this time is because they've been hit so hard by the slow commodities and the global slowing. They're down and I'm very interested in looking for opportunities to buy. Coming into the 2008 period, I worked with brokers who specialized in getting great dividend and great interest paying stocks and bonds. Australia and New Zealand continue to pay out much higher interest rates internally than we do, so their bonds have always been attractive, and the high-dividend yielding stocks have been attractive as well. There are some excellent companies with very strong dividends that make them attractive.

What's tricky about it is the currencies can swing quite wildly against the US dollar. As a result, not just the value of the stocks but the value of the dividend float can get absolutely hammered by the currency swings, but it works both ways. If you can buy when markets are down and the currency is down against the US dollar and then it turns around, of course it can be particularly glorious. I've been very interested in watching them and looking for opportunities – both on the currency and the stock – to take advantage.

Again, the secret to good investing is to buy something of very high quality when they're at their worst moments. I'm very keen on keeping an eye on their worst moment. Again, I think there is a lot about the long-term fundamentals on Australia and New Zealand that make them particularly attractive.

One of the caveats on that is a very interesting thing that a cab driver said to me when I was going to the airport in Sydney to leave Australia. He said, "Let's face it. We're all – whether Australian or New Zealand, or anybody in the Anglo-American Alliance – we're all under the umbrella of the United States' security arrangements and the US is blowing it. If they don't get their act together and turn it around, we're all in trouble."

I thought that was a very astute comment, and typical – I find – of international cab drivers; they know a lot.

We have a second part of this quarter's Equity Overview. I've done a brief summary called *Unpacking Risk Issues* which we recorded separately, and that was because we were getting so many questions and concerns on risk issues that I thought that would really contribute to our discussion. Rather than handle it in *Ask Catherine* we've prepared a special written overview and audio. If you haven't heard that, I would really recommend that you link to that.

Ladies and gentlemen, that's it for the *2nd Quarter Equity Overview Part One*. I'm Catherine Austin Fitts, and I wish you good luck and good hunting.