
QUARTERLY
INVESTMENT
OUTLOOK

4Q 2019

MACRO THEMES

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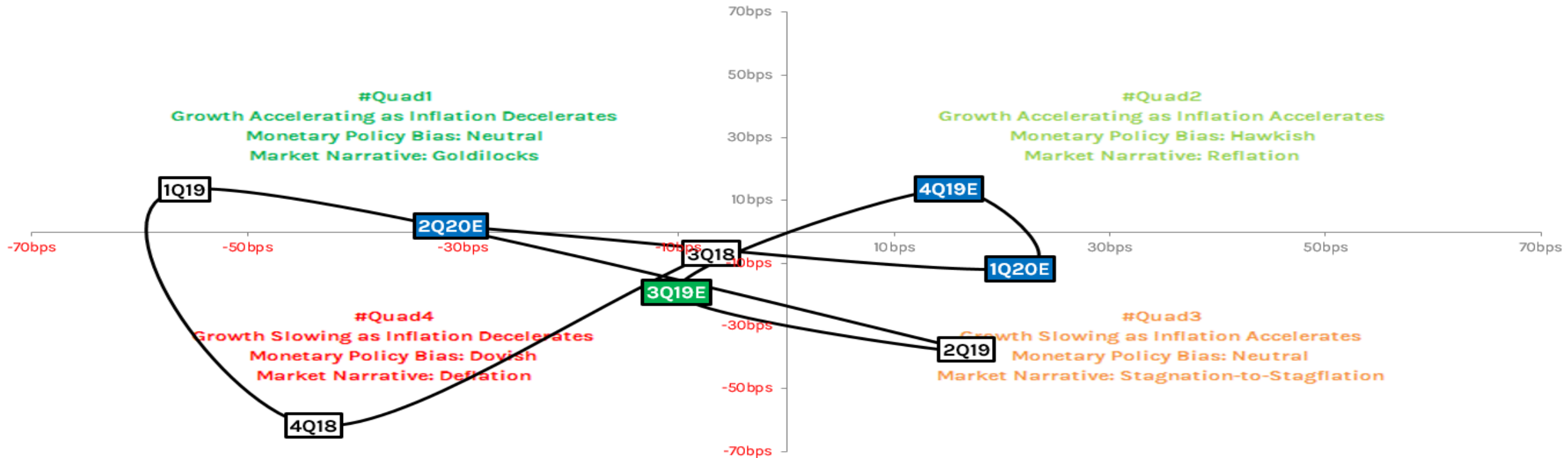
Our Research Process is REPEATABLE

Both Dalio's research and our own findings have proven that the two most important factors for investors to solve for are the marginal rates of change in growth and inflation, as policymakers typically respond to subsequent levels on a lag. #TheMachine is aware of this too.

| United States | 3Q16 | 4Q16 | 1Q17 | 2Q17 | 3Q17 | 4Q17 | 1Q18 | 2Q18 | 3Q18 | 4Q18 | 1Q19 | 2Q19 | ← Actuals Estimates → | 3Q19E | 4Q19E | 1Q20E | 2Q20E |
|-----------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-----------------------------|-------|-------|-------|-------|
| Real GDP QoQ SAAR | 2.20% | 2.00% | 2.30% | 2.20% | 3.20% | 3.50% | 2.50% | 3.50% | 2.90% | 1.10% | 3.10% | 2.00% | Hedgeye Estimates | 2.14% | 1.63% | 2.60% | 2.08% |
| YoY Hurdle Rate | 0.33% | 0.03% | 0.50% | 0.48% | 0.55% | 0.50% | 0.58% | 0.55% | 0.80% | 0.88% | 0.63% | 0.88% | YoY Hurdle Rate | 0.73% | 0.28% | 0.78% | 0.50% |
| Real GDP YoY | 1.56% | 2.03% | 2.10% | 2.16% | 2.42% | 2.80% | 2.86% | 3.20% | 3.13% | 2.52% | 2.65% | 2.28% | Hedgeye Estimates | 2.09% | 2.22% | 2.11% | 2.13% |
| 2Y Comparative Base Effects | 2.78% | 2.39% | 2.80% | 2.35% | 2.00% | 1.97% | 1.86% | 1.75% | 1.99% | 2.41% | 2.48% | 2.68% | 2Y Comparative Base Effects | 2.77% | 2.66% | 2.76% | 2.74% |
| Headline CPI YoY | 1.12% | 1.80% | 2.54% | 1.90% | 1.97% | 2.12% | 2.21% | 2.71% | 2.64% | 2.20% | 1.64% | 1.81% | Headline CPI YoY | 1.71% | 1.86% | 2.08% | 1.76% |
| 2Y Comparative Base Effects | 0.95% | 0.86% | 0.51% | 0.50% | 0.61% | 1.13% | 1.81% | 1.48% | 1.54% | 1.96% | 2.38% | 2.31% | 2Y Comparative Base Effects | 2.30% | 2.16% | 1.93% | 2.26% |

United States

◆ x-axis: First Difference of YoY Headline CPI;
y-axis: First Difference of YoY Real GDP



Data Source: Bloomberg. Green box = Hedgeye Predictive Tracking Algorithm nowcast. Blue boxes = Hedgeye β -Adjusted Comparative Base Effect Model estimates.

Our Asset Allocation Process Is RULES-BASED

#QUAD1

Goldilocks. Maximum gross exposure, wide net exposure.

Asset Class Overweight(s): Equities, Credit

Asset Class Underweight(s): Fixed Income, USD

Equity Sector Overweight(s): Tech, Consumer Discretionary, Industrials, Materials

Equity Sector Underweight(s): Utilities, Consumer Staples, Energy, Health Care

Equity Style Factor Overweight(s): High Beta, Cyclical, Momentum

Equity Style Factor Underweight(s): Low Beta, Defensives, Dividend Yield

Fixed Income Overweight(s): Convertibles, High Yield Credit, Leveraged Loans, BDCs

Fixed Income Underweight(s): TIPS, Short Duration Treasuries, MBS, Medium Duration Treasuries

#QUAD2

Reflation. Maximum gross exposure, wide net exposure.

Asset Class Overweight(s): Equities, Credit, Commodities

Asset Class Underweight(s): Fixed Income, USD

Equity Sector Overweight(s): Tech, Consumer Discretionary, Industrials, Energy

Equity Sector Underweight(s): Telecom, Utilities, Consumer Staples, REITS

Equity Style Factor Overweight(s): Momentum, Growth, Small Caps

Equity Style Factor Underweight(s): Low Beta, Value, Dividend Yield

Fixed Income Overweight(s): BDCs, Convertibles, Preferreds, Leveraged Loans

Fixed Income Underweight(s): Long Duration Treasuries, Munis, Investment Grade Credit, Medium Duration Treasuries

#QUAD3

Stagnation-to-stagflation. Moderate gross exposure, tight net exposure.

Asset Class Overweight(s): Fixed Income, Commodities

Asset Class Underweight(s): Equities, Credit

Equity Sector Overweight(s): Utilities, Tech, Energy, REITS

Equity Sector Underweight(s): Financials, Materials, Telecom, Consumer Staples

Equity Style Factor Overweight(s): High Beta, Quality, Large Cap Growth

Equity Style Factor Underweight(s): Dividend Yield, Small Caps, Value

Fixed Income Overweight(s): Munis, Long Duration Treasuries, TIPS, Investment Grade Credit

Fixed Income Underweight(s): BDCs, Preferreds, Convertibles, Leveraged Loans

#QUAD4

Deflation. Minimum gross exposure, market neutral exposure.

Asset Class Overweight(s): Fixed Income, USD

Asset Class Underweight(s): Equities, Credit, Commodities

Equity Sector Overweight(s): Consumer Staples, Health Care, REITS, Utilities

Equity Sector Underweight(s): Tech, Energy, Industrials, Financials

Equity Style Factor Overweight(s): Low Beta, Dividend Yield, Defensives

Equity Style Factor Underweight(s): Momentum, High Beta, Growth

Fixed Income Overweight(s): Long Duration Treasuries, Medium Duration Treasuries, Munis, MBS

Fixed Income Underweight(s): Convertibles, TIPS, Leveraged Loans, High Yield Credit

1 #Quad4, Then #Quad2 Or #Quad3?

Was the TTM lesson in Full-Cycle Investing just another mid-cycle slowdown or was it a harbinger of recessionary quarters ahead? In the presentation, we'll detail the myriad of downside risks associated with our baseline projection of a narrow inflection into #Quad2 in 4Q19E for both the US and global economies. We'll also provide investors with a playbook for how to risk manage the uncertainty associated with these divergent-but-not-disparate regimes.

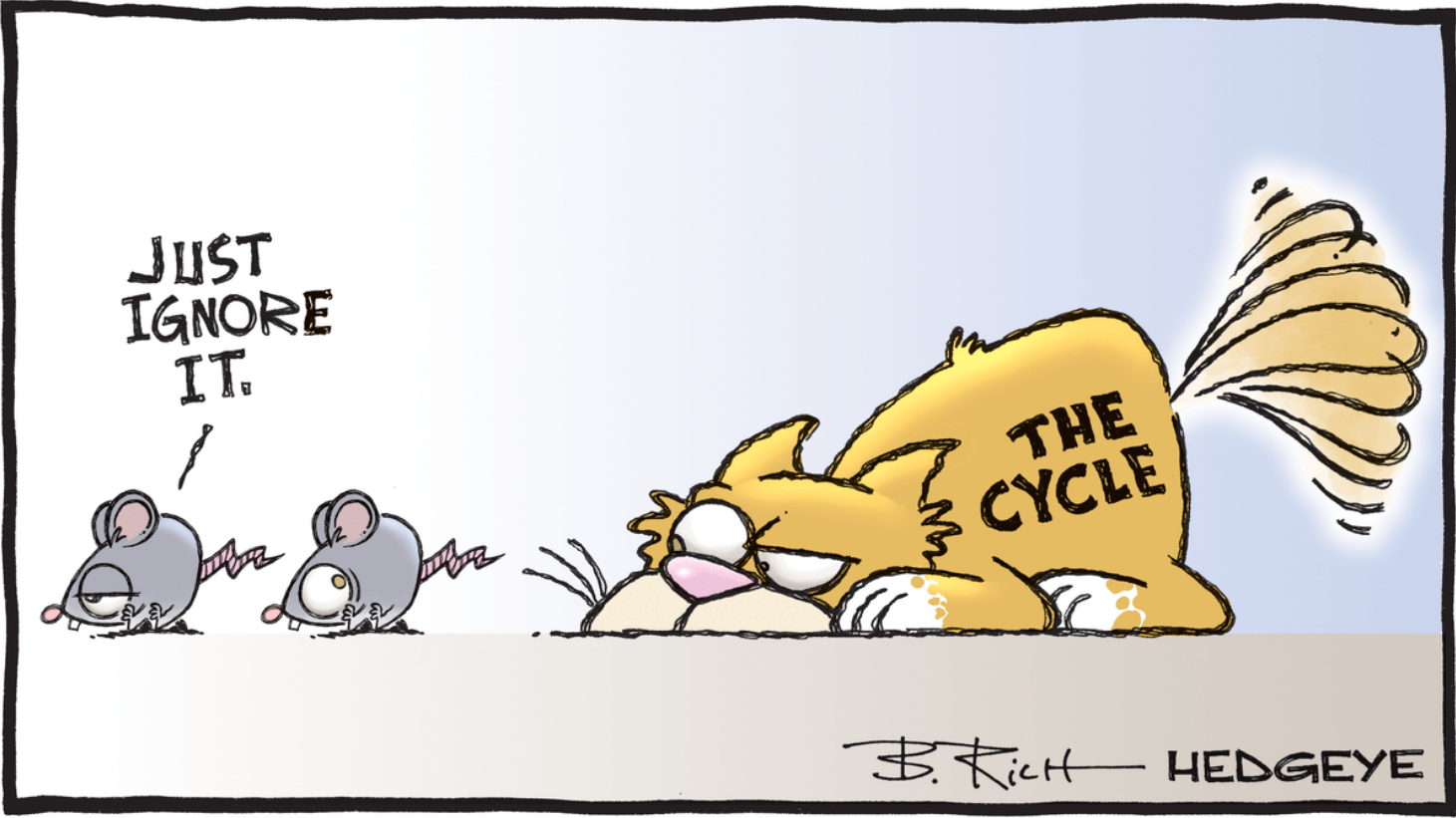
2 EPS #Slowing

After a decade of waiting for Godot on wage growth, we're finally at a point in the domestic business cycle where the relationship between labor and profits starts to matter, big time. In the presentation, we'll detail the downside risks to the consensus 4Q19E/2020E EPS recovery narrative.

3 #InflationAccelerating

As you can probably tell by now, our confidence in stochastically driven projections for recoveries in both the US and global economies is low - as is our faith that Wall St. is going to be right on corporate profits meaningfully recovering in short order. Where we do have conviction, however, is in the return of inflation over both the intermediate and long terms. After a year in which it has paid to take on duration risk in every asset class, we now think the consensus portfolio is under-positioned for a phase transition in inflation expectations.

Q4 2019 Macro Themes



#Quad4, Then #Quad2 Or #Quad3?

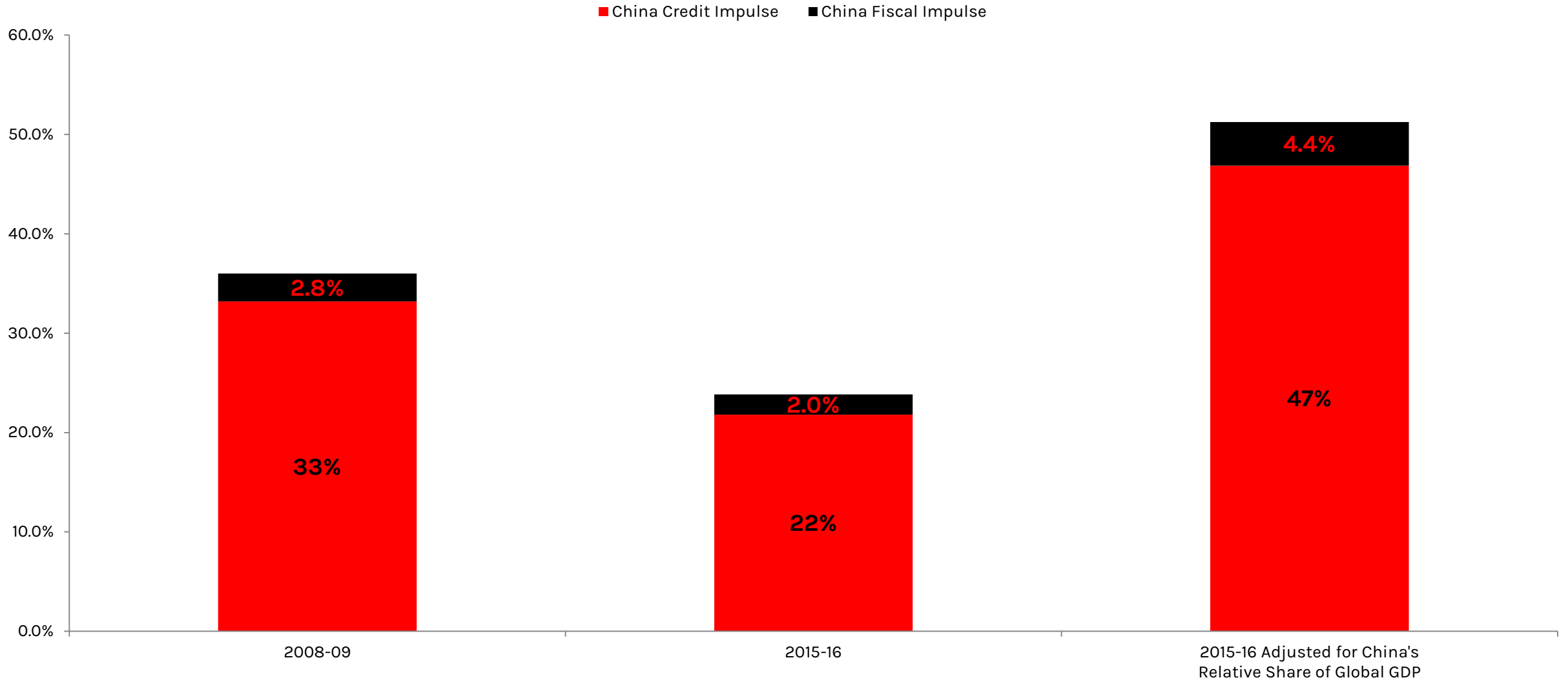
What Do You See, The “4’s” Or The “2’s”?

| 10/3/2019 | Hedgeye Macro GIP Model Signals | | | | | | | | | | | | | High-Frequency Economic Data Signals | | | | | | | | | | | |
|----------------|---------------------------------|------|------|------|------|------|------|------|-------------------|-------|-------|-------|-------|--------------------------------------|-------------------------------------|---------------|-------------------------------------|-------------|-------------------------------------|-------------------|-------------------------------------|--------------|-------------------------------------|-------------|-------------------------------------|
| | Actuals | | | | | | | | Hedgeye Forecasts | | | | | Consumption | | Manufacturing | | Exports | | Manufacturing PMI | | Headline CPI | | Core CPI | |
| | 2Q17 | 3Q17 | 4Q17 | 1Q18 | 2Q18 | 3Q18 | 4Q18 | 1Q19 | 2Q19 | 3Q19E | 4Q19E | 1Q20E | 2Q20E | 6-12M Trend | Percentile of Latest Reading (T10Y) | 6-12M Trend | Percentile of Latest Reading (T10Y) | 6-12M Trend | Percentile of Latest Reading (T10Y) | 6-12M Trend | Percentile of Latest Reading (T10Y) | 6-12M Trend | Percentile of Latest Reading (T10Y) | 6-12M Trend | Percentile of Latest Reading (T10Y) |
| Argentina | - | - | - | 3 | 3 | 2 | 3 | 2 | 2 | 1 | 1 | 1 | 1 | ↑ | 82% | ↓ | 0% | ↑ | 67% | - | - | ↑ | 80% | - | - |
| Australia | 3 | 1 | 4 | 1 | 4 | 3 | 4 | 4 | 4 | 4 | 2 | 3 | 2 | ↓ | 17% | ↑ | 33% | ↓ | 58% | ↓ | 0% | → | 7% | ↓ | 2% |
| Brazil | 1 | 1 | 2 | 4 | 3 | 2 | 4 | 4 | 2 | 1 | 3 | 2 | 4 | ↓ | 54% | ↓ | 40% | ↓ | 39% | ↓ | 91% | → | 12% | → | 7% |
| Canada | 1 | 3 | 3 | 3 | 3 | 2 | 4 | 4 | 2 | 1 | 2 | 2 | 1 | ↓ | 8% | ↓ | 11% | ↓ | 13% | ↓ | 17% | → | 59% | ↑ | 94% |
| China | 4 | 3 | 3 | 3 | 4 | 3 | 4 | 4 | 3 | 3 | 2 | 2 | 1 | ↓ | 1% | → | 0% | ↓ | 28% | → | 12% | ↑ | 73% | → | 26% |
| Eurozone | 1 | 1 | 1 | 4 | 3 | 3 | 4 | 1 | 4 | 4 | 2 | 2 | 1 | ↑ | 75% | ↓ | 14% | ↑ | 59% | ↓ | 0% | ↓ | 34% | → | 38% |
| France | 1 | 1 | 2 | 3 | 3 | 3 | 4 | 1 | 1 | 4 | 2 | 2 | 1 | ↑ | 28% | ↑ | 36% | ↑ | 28% | → | 11% | ↓ | 42% | → | 44% |
| Germany | 1 | 2 | 1 | 4 | 3 | 3 | 4 | 1 | 3 | 4 | 2 | 2 | 1 | ↑ | 85% | ↓ | 6% | → | 47% | ↓ | 0% | ↓ | 24% | ↓ | 24% |
| India | 4 | 2 | 2 | 2 | 3 | 4 | 4 | 4 | 3 | 1 | 3 | 2 | 1 | - | - | ↓ | 53% | ↓ | 13% | ↓ | 29% | ↑ | 15% | - | - |
| Indonesia | 2 | 1 | 1 | 4 | 1 | 4 | 2 | 4 | 3 | 3 | 3 | 2 | 4 | ↑ | 11% | ↓ | 38% | ↓ | 18% | ↓ | 11% | ↑ | 24% | → | 29% |
| Italy | 2 | 1 | 4 | 4 | 3 | 3 | 4 | 4 | 1 | 4 | 2 | 2 | 1 | → | 92% | ↑ | 39% | ↑ | 65% | ↑ | 6% | ↓ | 20% | → | 10% |
| Japan | 2 | 2 | 2 | 3 | 1 | 3 | 1 | 1 | 2 | 4 | 3 | 1 | 3 | ↓ | 71% | ↓ | 10% | ↓ | 11% | ↓ | 0% | → | 51% | → | 61% |
| Mexico | 3 | 3 | 3 | 4 | 1 | 3 | 4 | 4 | 3 | 1 | 2 | 2 | 2 | → | 54% | ↓ | 13% | ↓ | 55% | ↓ | 3% | ↓ | 20% | → | 76% |
| Russia | 1 | 4 | 4 | 1 | 2 | 2 | 2 | 3 | 1 | 4 | 2 | 1 | 3 | ↓ | 28% | → | 50% | ↓ | 34% | ↓ | 0% | ↑ | 20% | ↑ | 18% |
| South Africa | 1 | 4 | 4 | 4 | 3 | 2 | 4 | 4 | 2 | 4 | 2 | 2 | 4 | ↑ | 34% | ↓ | 26% | ↓ | 34% | - | - | ↓ | 14% | → | 25% |
| South Korea | 4 | 2 | 4 | 1 | 2 | 3 | 2 | 4 | 2 | 4 | 2 | 2 | 4 | ↑ | 63% | ↓ | 11% | ↓ | 6% | ↓ | 9% | ↓ | 0% | ↓ | 0% |
| Spain | 1 | 4 | 1 | 4 | 3 | 3 | 4 | 1 | 4 | 4 | 3 | 2 | 1 | ↑ | 82% | ↑ | 53% | ↑ | 42% | ↓ | 0% | ↓ | 27% | → | 73% |
| Turkey | 2 | 1 | 3 | 1 | 3 | 3 | 3 | 1 | 1 | 1 | 1 | 3 | 1 | ↑ | 6% | ↑ | 18% | ↓ | 31% | ↑ | 63% | ↓ | 62% | ↓ | 43% |
| United Kingdom | 3 | 3 | 3 | 4 | 1 | 2 | 4 | 1 | 3 | 4 | 2 | 3 | 2 | ↑ | 46% | → | 26% | ↑ | 56% | ↓ | 9% | → | 29% | → | 19% |
| United States | 1 | 2 | 2 | 2 | 2 | 4 | 4 | 1 | 3 | 4 | 2 | 3 | 1 | ↑ | 90% | ↓ | 21% | ↓ | 22% | ↓ | 0% | ↓ | 43% | ↓ | 76% |
| MODE/MEAN | 1 | 1 | 4 | 4 | 3 | 3 | 4 | 4 | 3 | 4 | 2 | 2 | 1 | ↑ | 49% | ↓ | 25% | ↓ | 36% | ↓ | 14% | ↓ | 33% | → | 37% |

Data Source: Bloomberg, BIS, World Bank, IMF. Intellectual Property of Hedgeye Risk Management.

Was The 2016-17 Globally Synchronized Recovery “Fake News”?

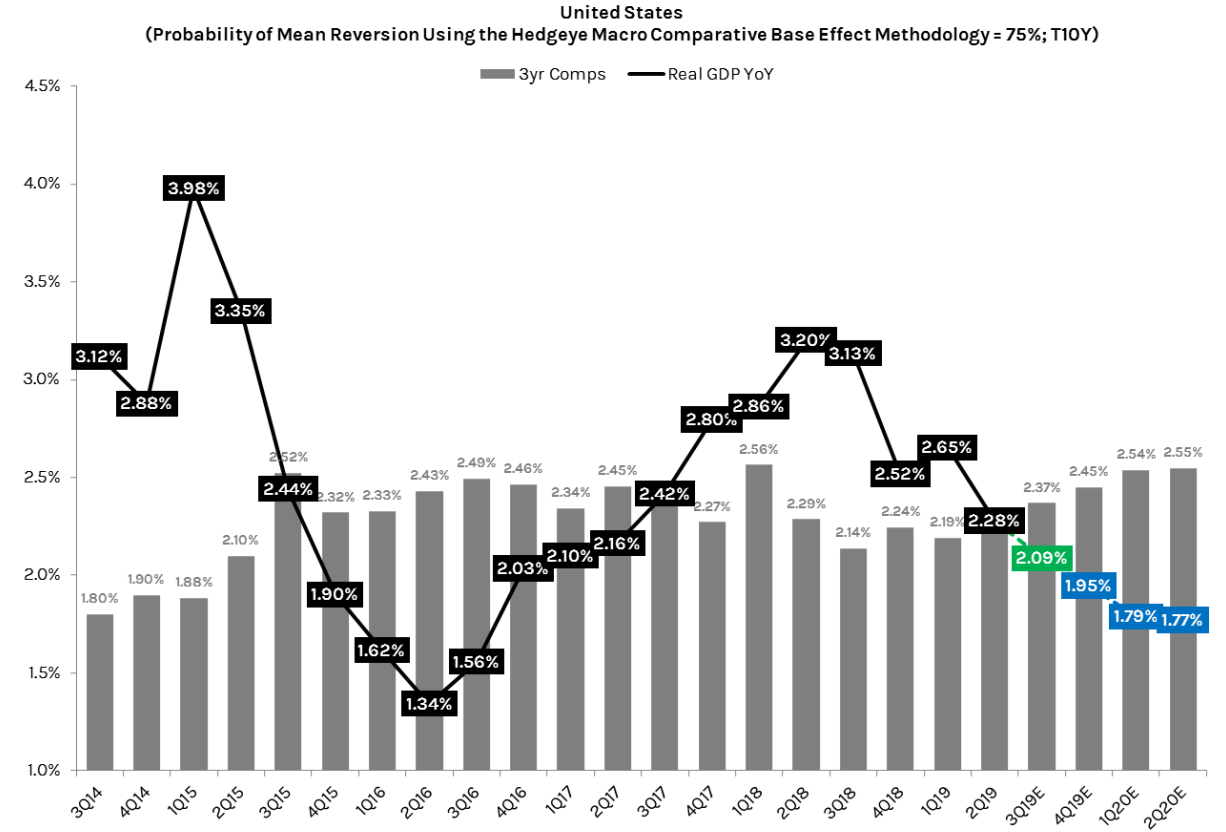
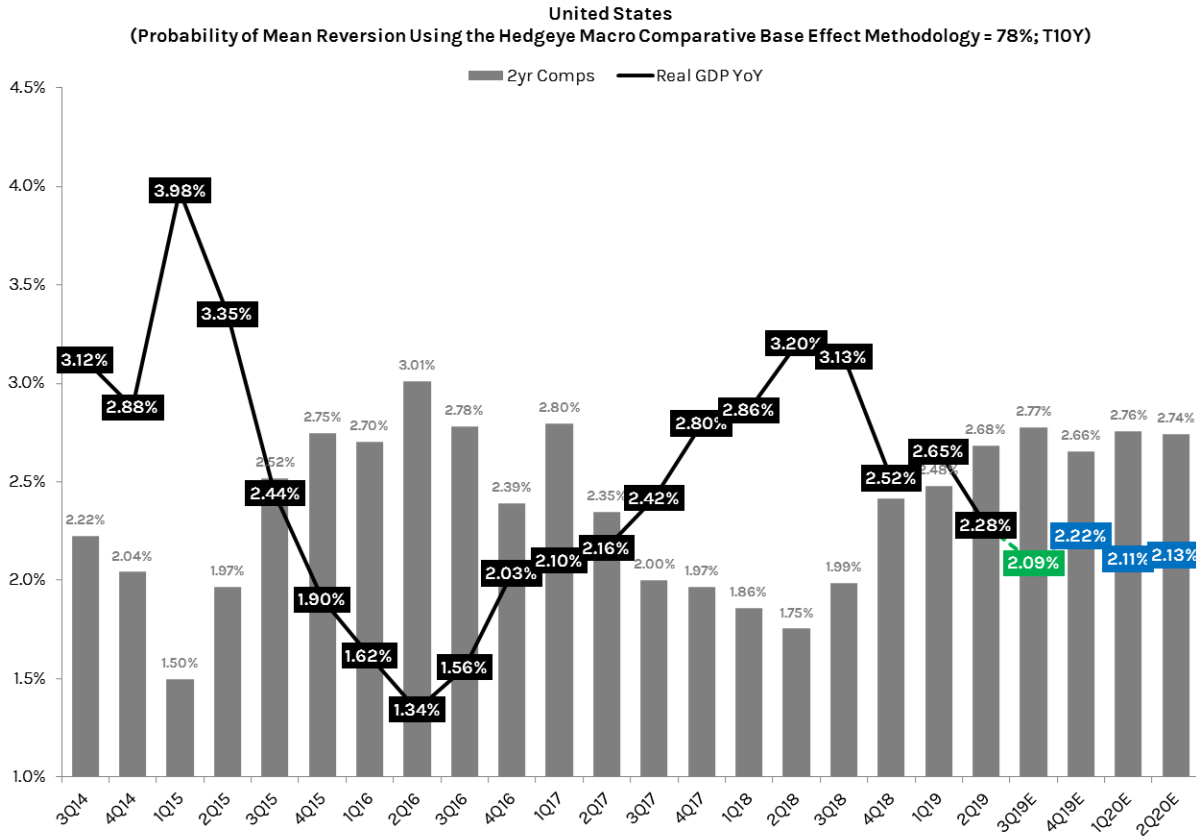
Comparing China's Major Stimulus Initiatives



If It Was, Then We're Still Lapping Those Distortions

2yr comps call for stabilization in the US economy around “trend” GDP growth

... while 3yr comps call for persistent deceleration through 1H20E



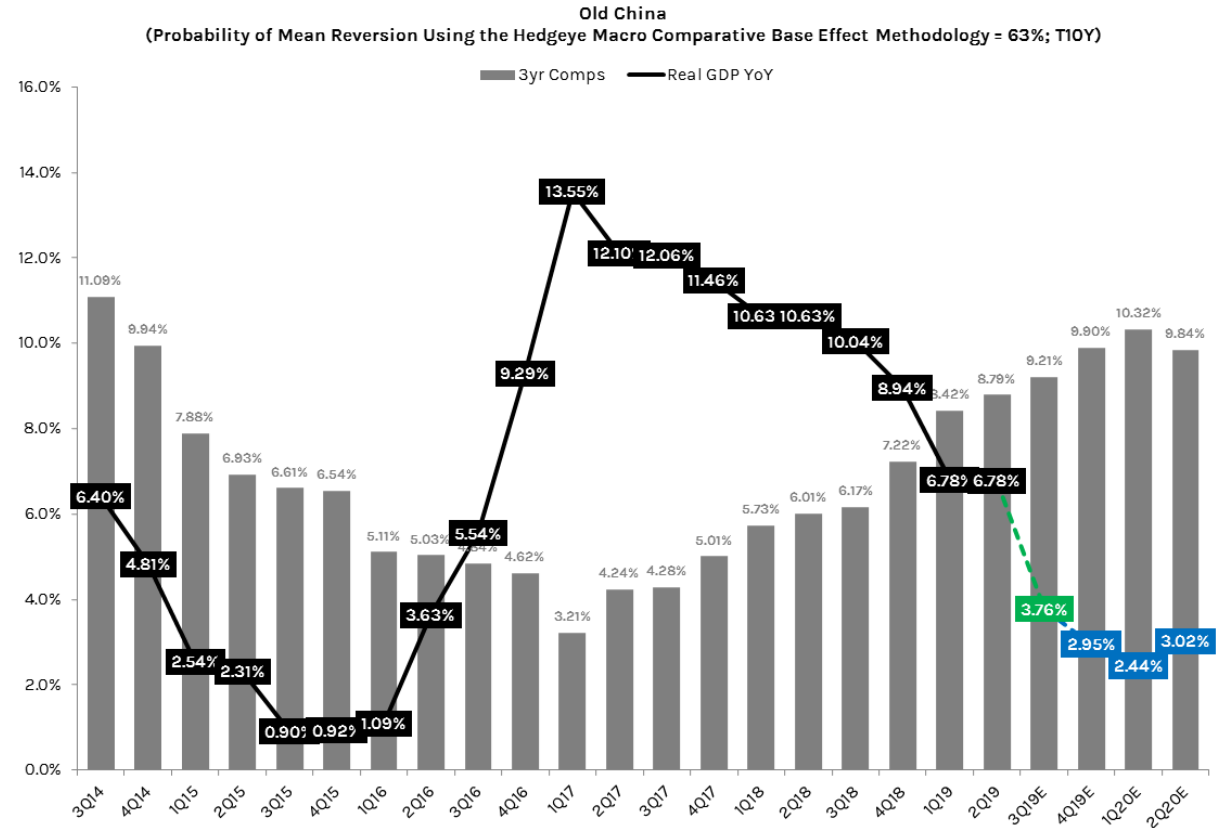
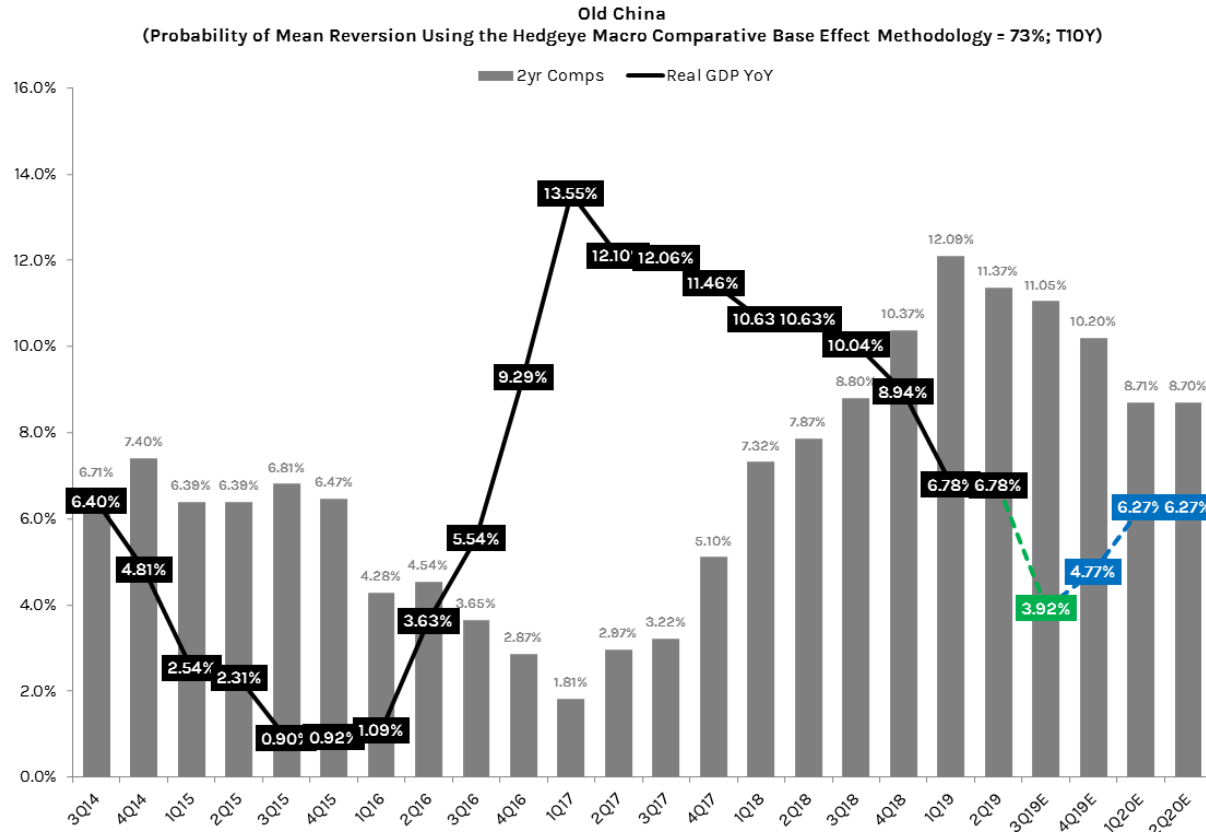
Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β-Adjusted Comparative Base Effect Model estimates.

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If It Was, Then We're Still Lapping Those Distortions

2yr comps call for a rebound in the mainland Chinese economy

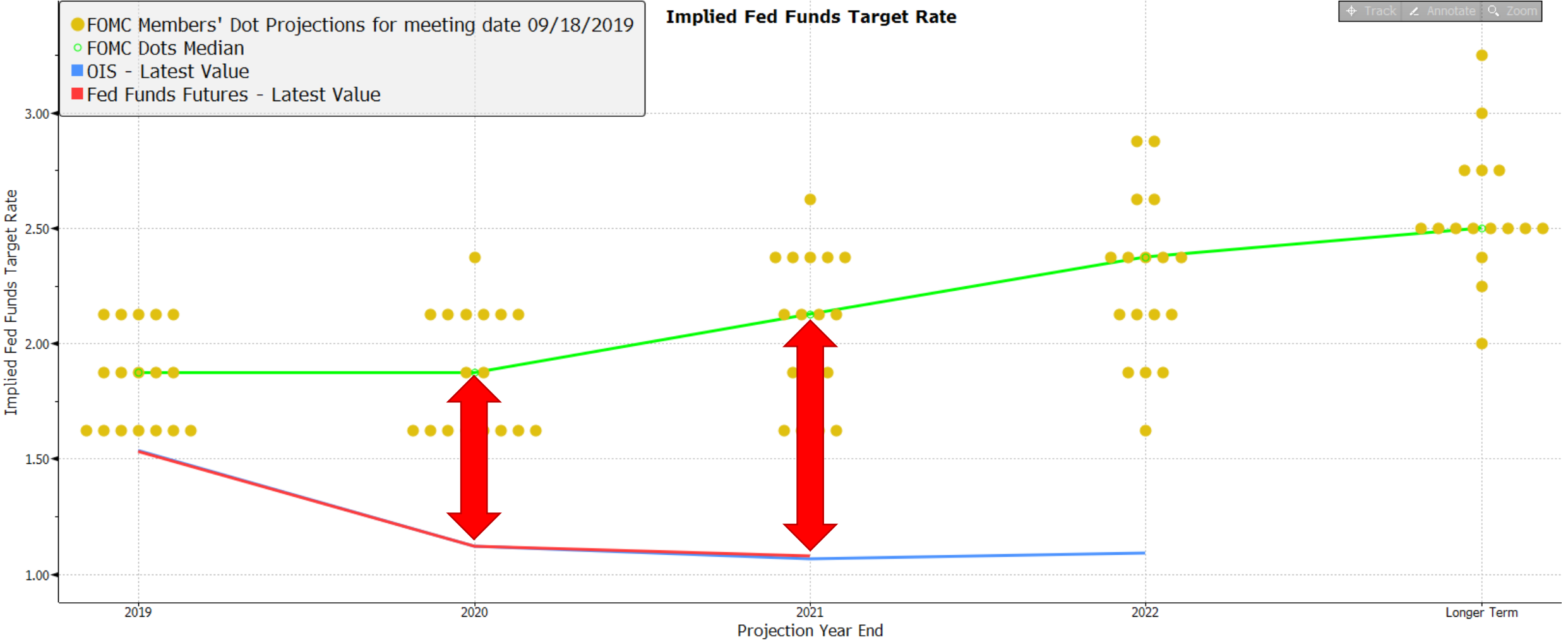
... while 3yr comps call for persistent deceleration through 1Q20E



Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β-Adjusted Comparative Base Effect Model estimates.

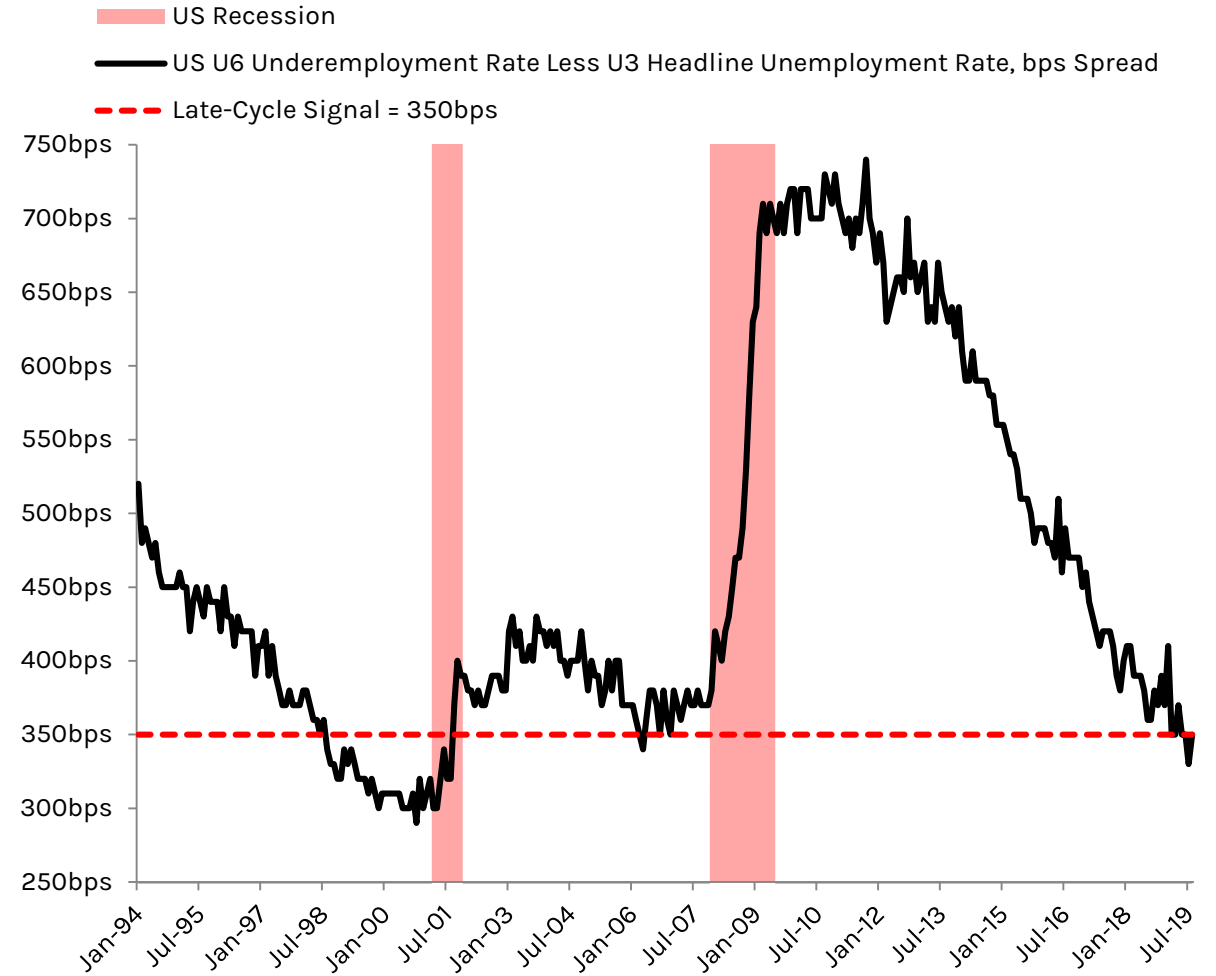
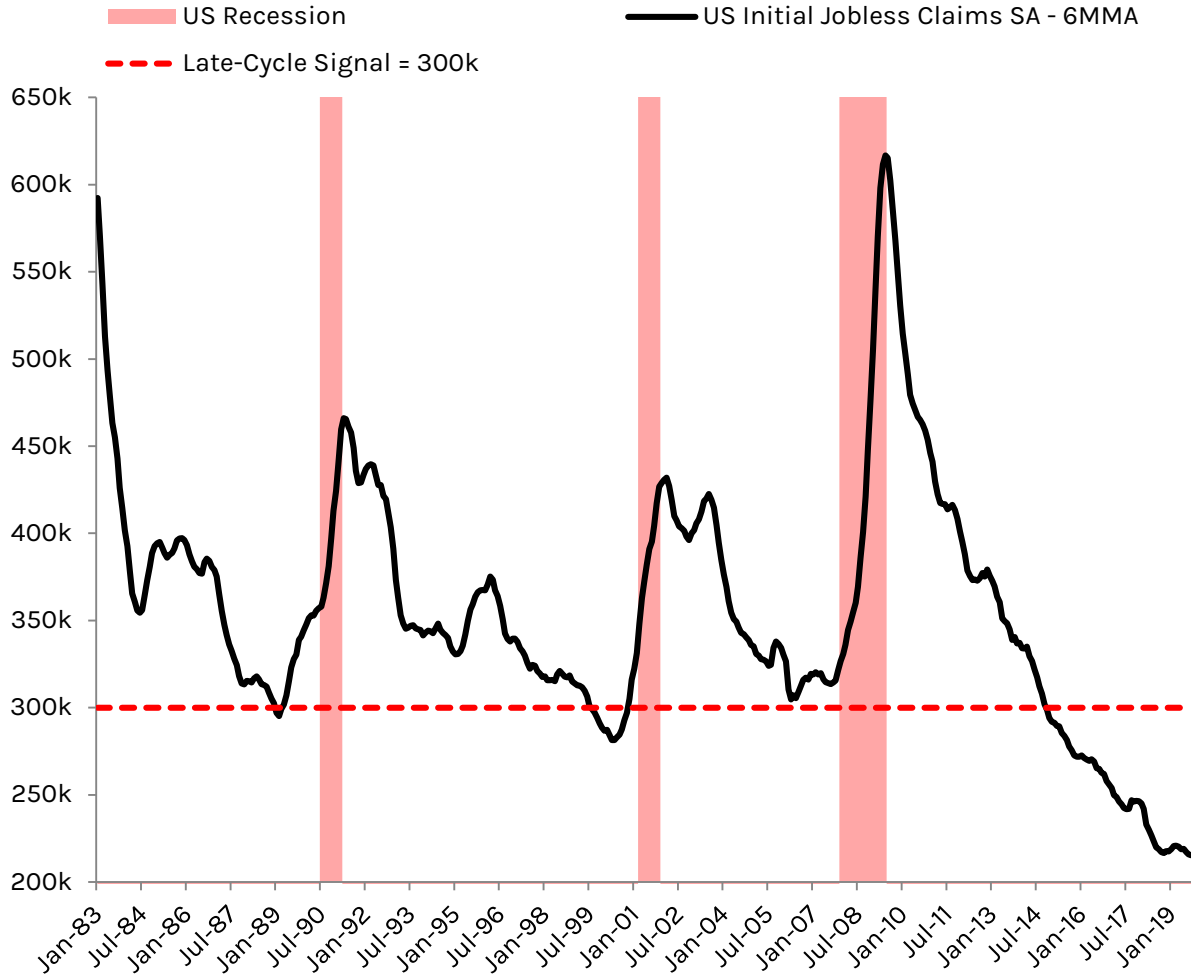
Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β-Adjusted Comparative Base Effect Model estimates.

In Order For Beijing To Bail Us Out, The Fed Has To Capitulate

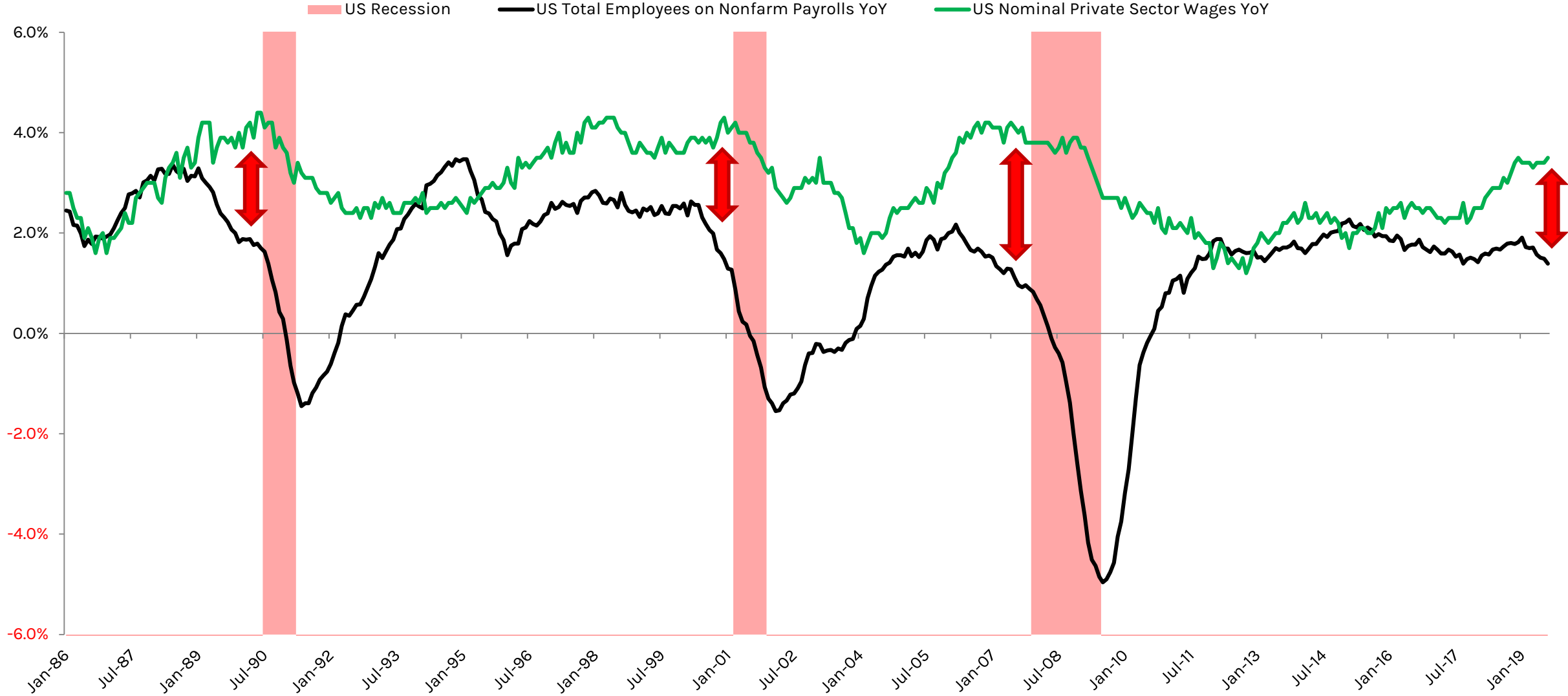


Will A “Shanghai Accord 2.0” (i.e. Fed Capitulates + Interim Trade Deal) Even Help?

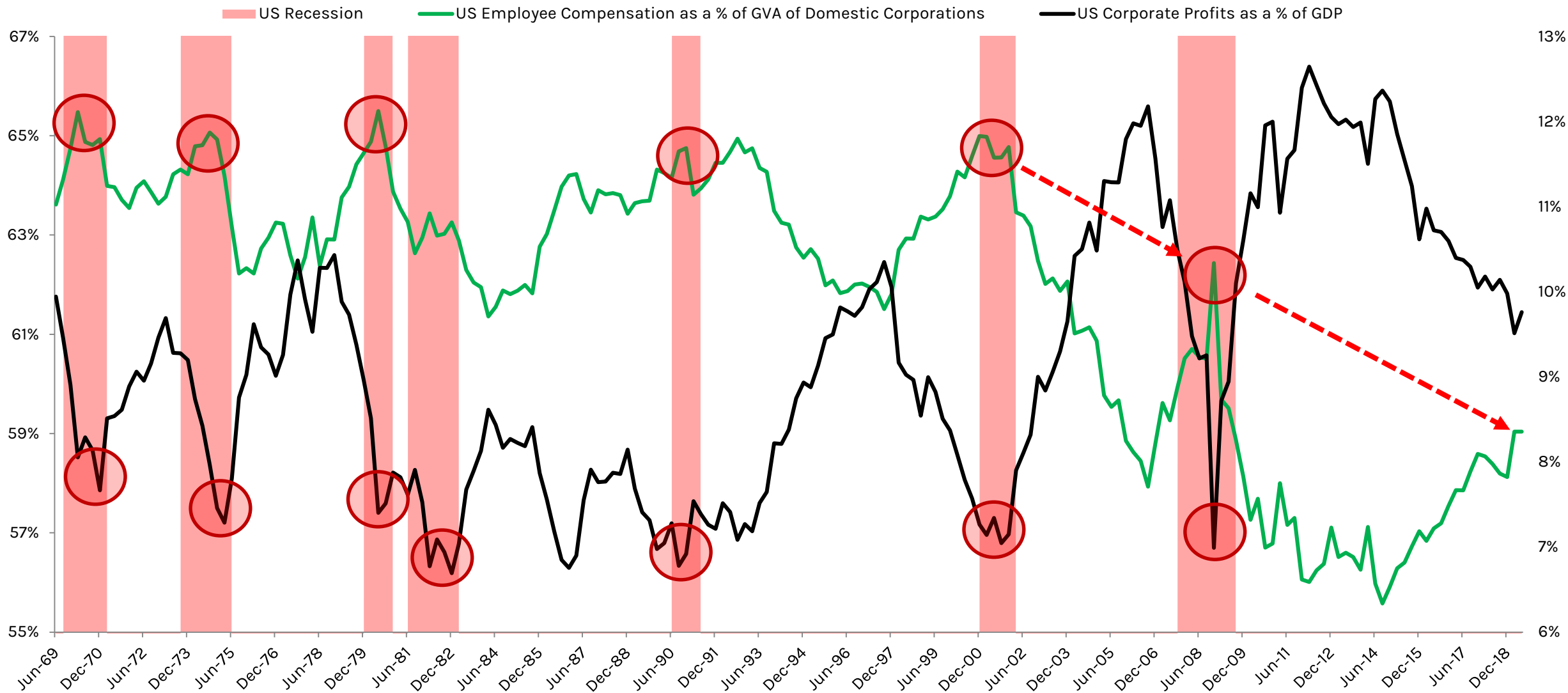
The US labor market – and, by extension, the US economy – had plenty of spare capacity to respond positively to monetary stimulus in 2016 and then fiscal stimulus in 2017. That’s simply not the case this time around.



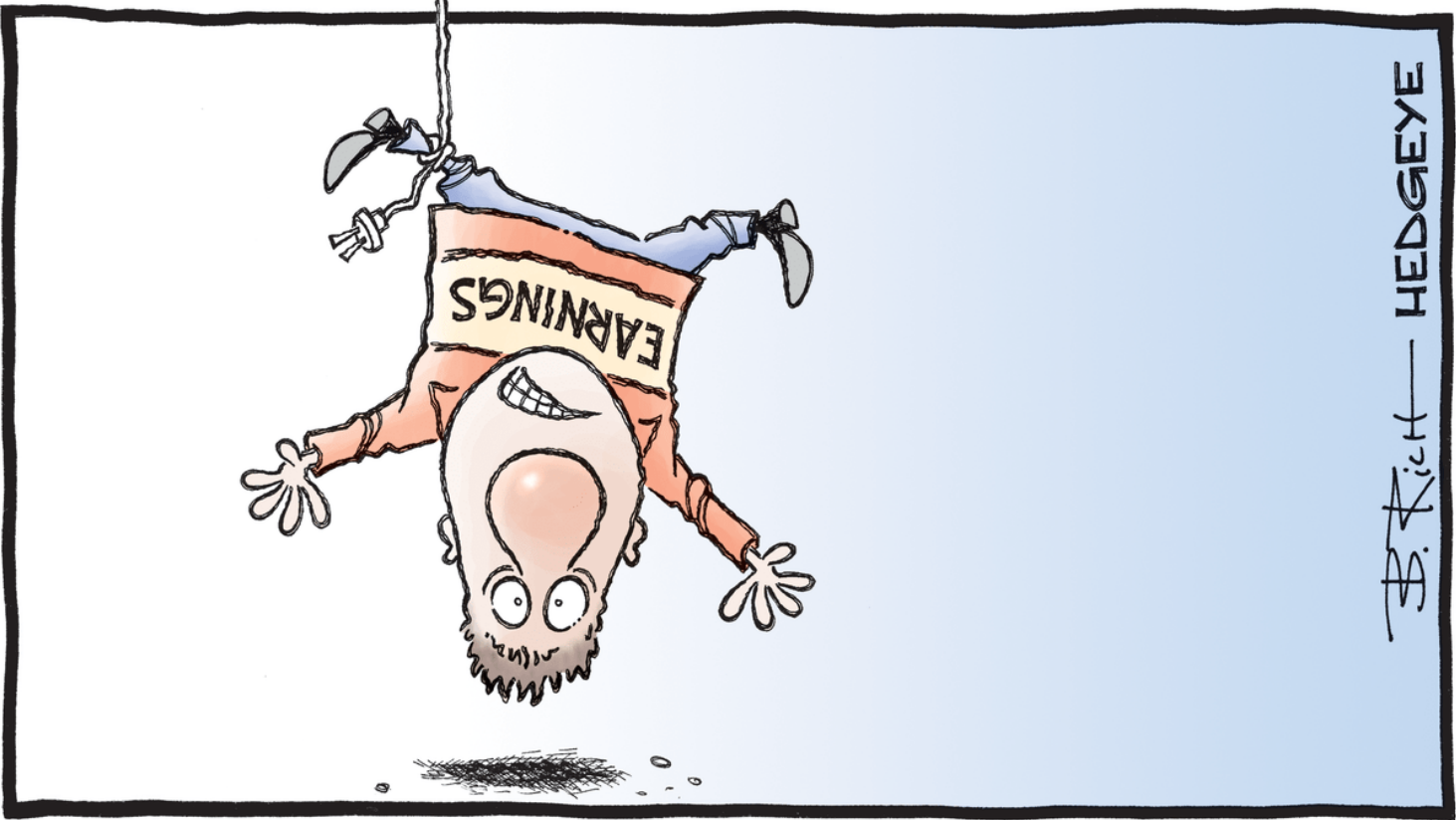
In Fact, We're At A Point In The Cycle Where Employment Growth Should Start To Slow Faster



... Especially If Wages Continue To Eat Into Profits



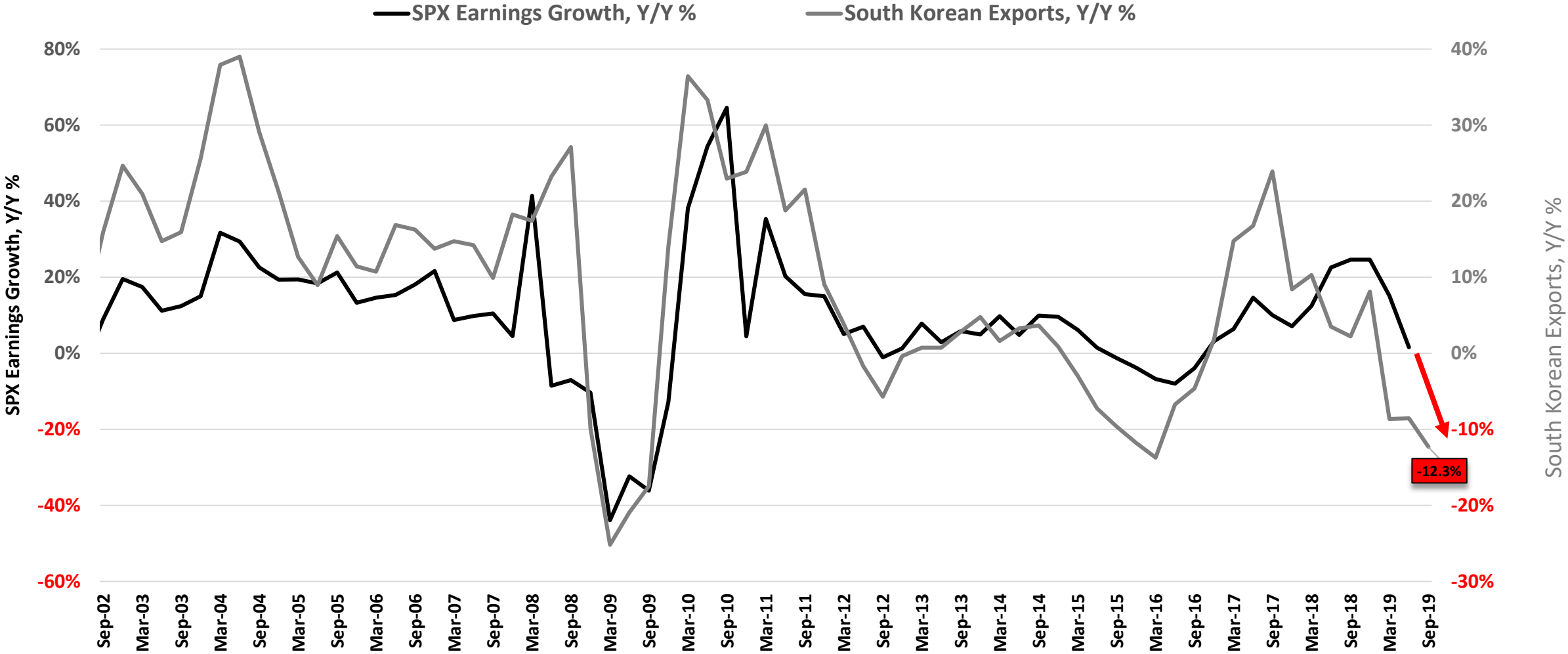
Q4 2019 Macro Themes



EPS #Slowing

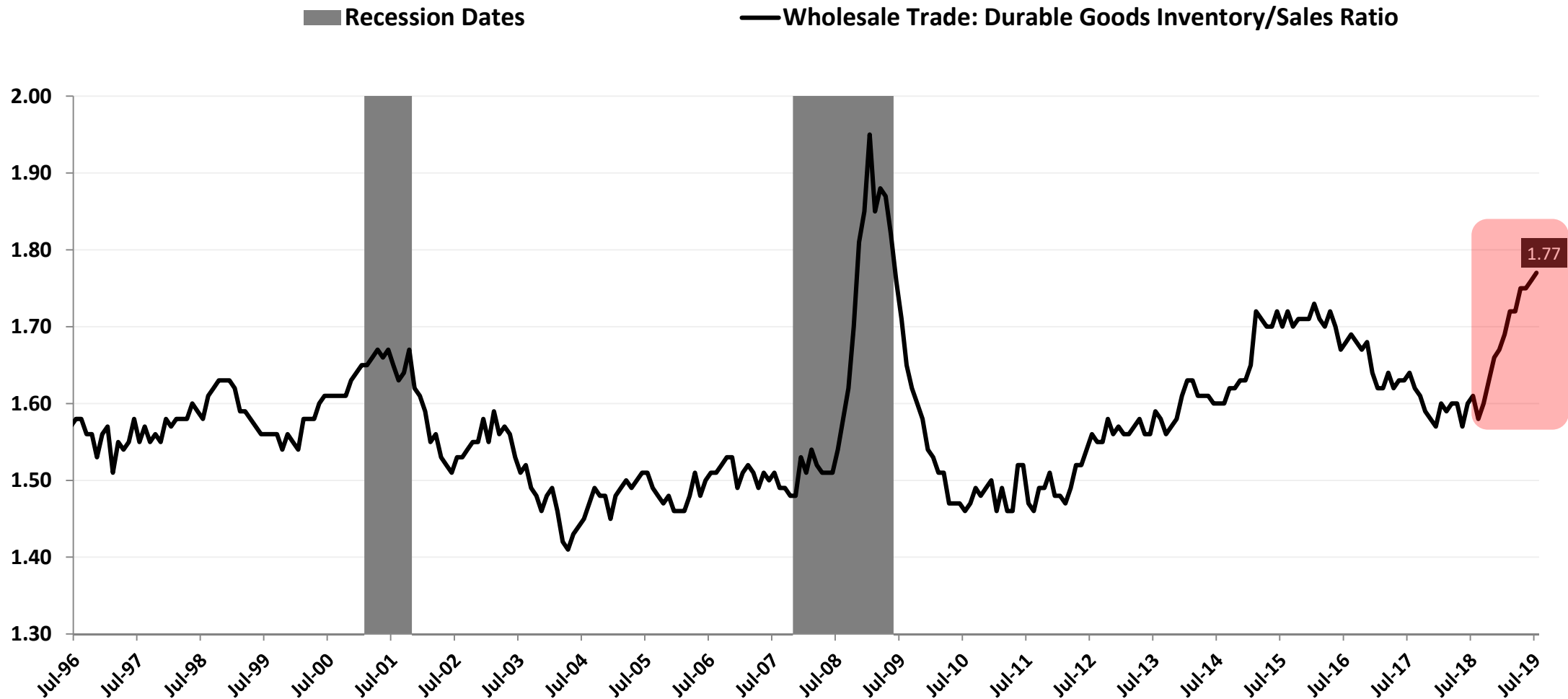
South Korea: From **Bad** → **Worse** = #Quad4 Indeed

Global growth and domestic EPS canary – South Korean Export Growth – continues to make lower lows, suggesting the balance of risk for domestic profits remains to the downside.



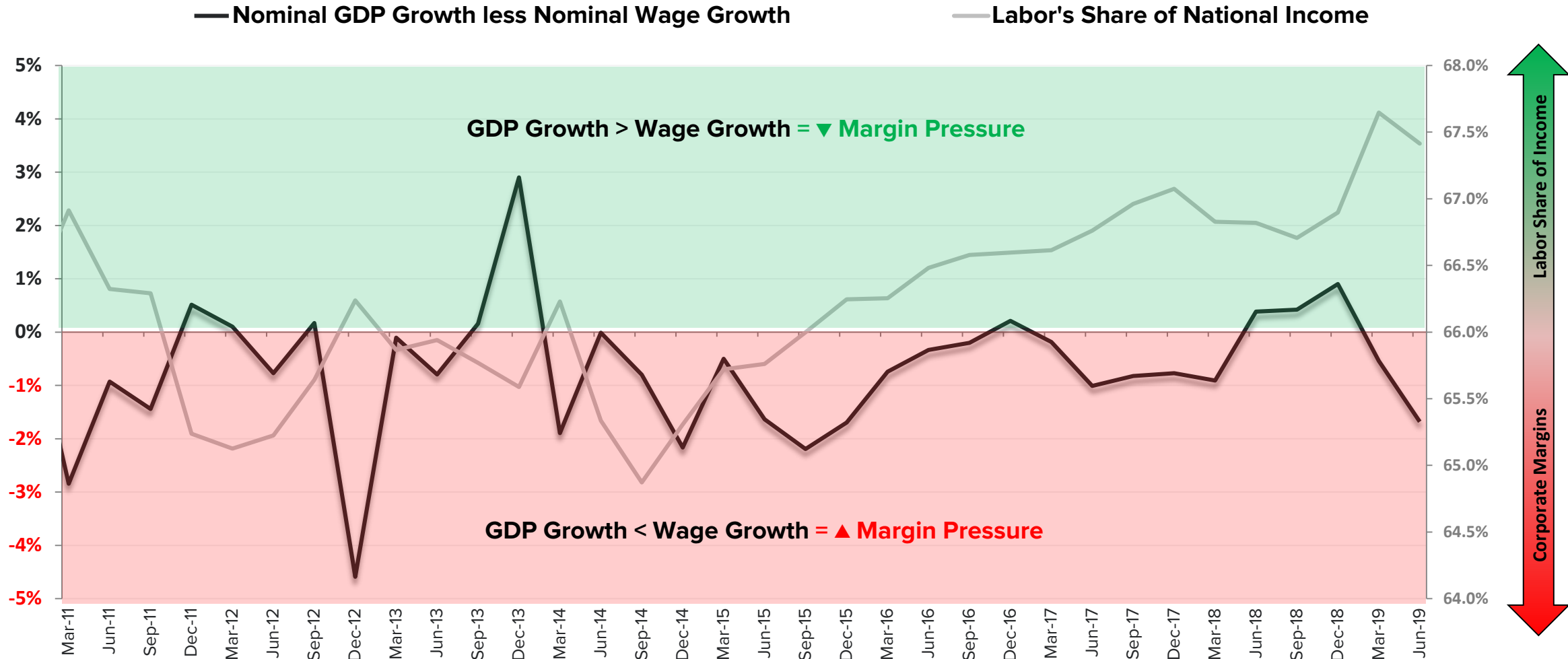
With Demand Slowing... Inventories At Cycle Highs

What started as inventory hoarding ahead of impending tariff implementation snowballed as synchronized global deceleration gained traction and demand destruction followed. Bloated inventories remain both margin negative (discounting) and output negative (reduced demand).



Labor Share of Income \uparrow = Corporate Margins \downarrow

With Aggregate Nominal Wages growing faster than Nominal GDP, Labor's share of national income will continue to increase. Of course, the other side of a rising share of income to labor is a falling share to Business (i.e. margins \downarrow).



USD ↑ + Demand ↓ + Labor Costs ↑ + Peak Comps = #EPS Slowing

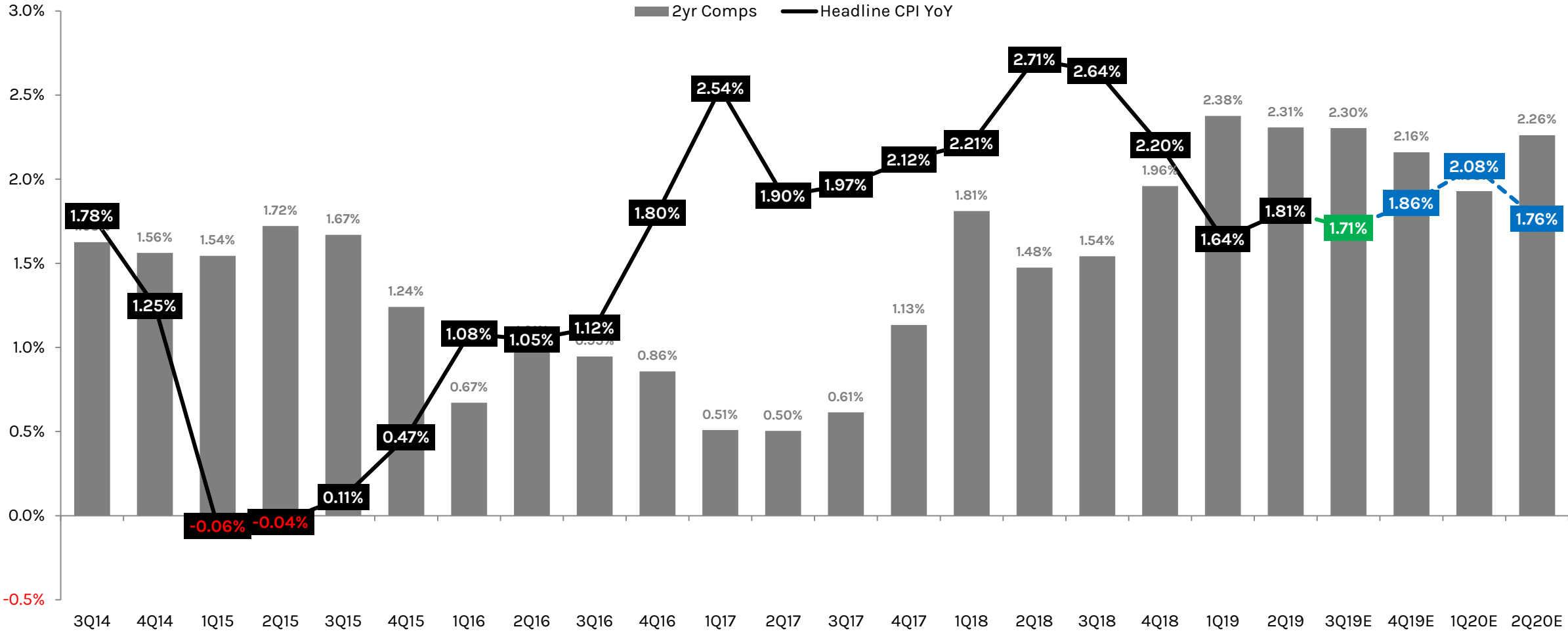
| S&P 500 Index | | | | | | | | | | | | | | | | | | | BBG Estimates | | | |
|------------------------|---|--------|--------|--------|---------|---------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|------------------|--------|--------|--------|
| SALES GROWTH (%) | CQ1 15 | CQ2 15 | CQ3 15 | CQ4 15 | CQ1 16 | CQ2 16* | CQ3 16 | CQ4 16 | CQ1 17 | CQ2 17 | CQ3 17 | CQ4 17 | CQ1 18 | CQ2 18 | CQ3 18 | CQ4 18 | CQ1 19 | CQ2 19 | CQ3 19* | CQ4 19 | CQ1 20 | CQ2 20 |
| S&P 500 Aggregate | -2.6% | -3.2% | -3.7% | -4.0% | -1.9% | -0.3% | 2.4% | 4.9% | 7.8% | 5.3% | 5.3% | 8.3% | 8.2% | 9.5% | 8.0% | 6.0% | 4.3% | 3.6% | 1.4% | 3.8% | 5.5% | 6.1% |
| Energy | -34.6% | -32.0% | -34.4% | -34.4% | -29.3% | -24.2% | -14.2% | 4.2% | 34.1% | 15.8% | 17.9% | 22.5% | 12.8% | 21.7% | 19.6% | 11.2% | -0.7% | -2.1% | -5.8% | -5.2% | 13.0% | 13.0% |
| Materials | -9.5% | -10.5% | -14.0% | -15.5% | -8.8% | -7.3% | -2.4% | 2.7% | 9.1% | 7.2% | 8.6% | 13.6% | 11.7% | 16.3% | 10.7% | 2.7% | -4.1% | -20.1% | -17.3% | -14.5% | -11.3% | 4.3% |
| Industrials | -2.3% | -3.1% | -6.1% | -7.2% | -2.0% | -1.3% | 2.2% | 2.6% | 4.2% | 4.8% | 6.6% | 8.4% | 10.4% | 9.5% | 6.8% | 6.7% | 3.4% | 1.4% | 1.1% | 2.5% | 5.1% | 5.9% |
| Consumer Discretionary | 1.8% | 3.1% | 3.7% | 4.4% | 6.3% | 8.5% | 8.2% | 7.8% | 8.4% | 3.8% | 3.0% | 7.7% | 7.3% | 9.0% | 8.1% | 5.5% | 3.8% | 5.0% | 8.0% | 5.0% | 6.0% | 5.6% |
| Consumer Staples | 0.9% | -0.4% | 0.5% | -0.4% | 1.2% | 0.7% | 1.7% | 2.7% | 2.1% | 2.5% | 4.5% | 5.1% | 5.4% | 5.4% | 2.6% | 1.8% | 1.6% | 2.2% | 6.4% | 3.6% | 3.1% | 3.6% |
| Health Care | 11.5% | 9.4% | 9.5% | 9.6% | 9.2% | 8.8% | 7.0% | 5.4% | 5.7% | 4.0% | 4.5% | 6.8% | 7.7% | 7.7% | 7.2% | 9.0% | 13.7% | 13.8% | 12.5% | 10.3% | 6.4% | 5.8% |
| Financials | 2.2% | 1.2% | 0.1% | 1.0% | -1.7% | 0.7% | 5.6% | 5.5% | 9.3% | 4.5% | 1.7% | 3.3% | 3.4% | 5.9% | 4.6% | 3.9% | 2.7% | 2.6% | 2.6% | 3.5% | 3.8% | 3.5% |
| Information Technology | 4.8% | 1.9% | 1.1% | -5.3% | -6.8% | -5.9% | -2.2% | 0.6% | 7.7% | 8.2% | 6.9% | 11.6% | 13.2% | 12.4% | 10.6% | 1.3% | -0.8% | -0.3% | -6.4% | 3.8% | 6.9% | 7.9% |
| Communication Services | 4.3% | 5.1% | 11.8% | 12.0% | 11.2% | 15.0% | 10.1% | 4.5% | 8.2% | 4.6% | 4.3% | 7.5% | 9.8% | 9.8% | 12.1% | 13.7% | 11.5% | 13.2% | 9.6% | 8.0% | 8.4% | 6.8% |
| Utilities | -3.2% | -5.5% | -2.1% | -12.6% | -10.5% | -2.4% | 3.5% | 8.1% | 7.2% | 6.4% | -2.7% | 3.4% | 3.4% | 0.4% | 1.7% | 2.1% | 1.0% | 0.0% | 6.7% | 4.5% | 2.6% | 5.1% |
| Real Estate | 4.8% | 6.5% | 7.5% | 10.8% | 11.4% | 7.4% | 7.5% | 3.7% | 4.5% | 7.3% | 5.2% | 8.2% | 14.6% | 13.5% | 13.1% | 12.8% | 4.4% | 4.2% | 3.4% | 2.8% | 4.9% | 5.7% |
| EPS GROWTH (%) | CQ1 15 | CQ2 15 | CQ3 15 | CQ4 15 | CQ1 16 | CQ2 16* | CQ3 16 | CQ4 16 | CQ1 17 | CQ2 17 | CQ3 17 | CQ4 17 | CQ1 18 | CQ2 18 | CQ3 18 | CQ4 18 | CQ1 19 | CQ2 19 | CQ3 19* | CQ4 19 | CQ1 20 | CQ2 20 |
| S&P 500 Aggregate | 3.5% | -1.3% | -3.8% | -6.8% | -8.0% | -3.9% | 3.2% | 6.4% | 14.6% | 10.0% | 7.1% | 12.5% | 22.6% | 24.5% | 24.2% | 12.6% | 1.2% | 1.7% | -19.0% | 1.7% | 6.3% | 7.4% |
| Energy | -40.2% | -53.4% | -57.5% | -72.6% | -109.6% | -81.6% | -63.7% | -1.5% | 690.1% | 210.0% | 138.0% | 53.9% | 61.2% | 98.8% | 98.6% | 99.9% | -24.9% | -4.8% | -29.2% | -26.3% | 38.0% | 18.8% |
| Materials | 20.1% | 2.2% | -15.6% | -17.9% | -16.0% | -9.1% | 3.2% | -1.1% | 19.6% | 7.4% | 10.7% | 41.9% | 31.9% | 43.8% | 28.3% | 1.4% | -20.4% | -8.2% | -23.7% | -13.3% | -2.9% | 12.3% |
| Industrials | 5.7% | -3.5% | -0.7% | -5.4% | -7.3% | -1.9% | -1.5% | -5.3% | 1.5% | 6.6% | 0.3% | 5.4% | 24.9% | 17.5% | 17.1% | 18.6% | 3.3% | 2.7% | -4.1% | 2.5% | 8.5% | 10.4% |
| Consumer Discretionary | 9.4% | 10.8% | 13.9% | 9.4% | 17.8% | 10.3% | 6.5% | 4.7% | 7.0% | 1.9% | 1.8% | 9.6% | 14.1% | 20.0% | 22.7% | 15.3% | 5.4% | -1.3% | 10.7% | 2.8% | 5.5% | 13.9% |
| Consumer Staples | 0.9% | -1.1% | -2.1% | -0.7% | 1.2% | 0.0% | 4.4% | 4.0% | 2.9% | 4.1% | 3.1% | 7.3% | 10.1% | 10.8% | 9.1% | 3.6% | -0.4% | -0.4% | 12.7% | 1.3% | 4.3% | 5.2% |
| Health Care | 16.7% | 14.4% | 14.5% | 11.0% | 8.1% | 4.8% | 5.9% | 4.8% | 5.4% | 6.6% | 7.1% | 8.9% | 14.2% | 13.1% | 14.5% | 11.1% | 9.1% | 10.8% | 2.3% | 6.8% | 4.9% | 1.8% |
| Financials | 6.6% | 2.0% | -8.6% | -5.3% | -14.2% | -7.0% | 12.8% | 6.6% | 17.9% | 9.5% | -8.9% | 1.0% | 26.6% | 22.7% | 30.6% | 4.2% | 2.1% | 2.9% | -2.2% | 9.0% | 3.9% | 3.3% |
| Information Technology | 7.1% | 4.7% | 4.5% | -3.8% | -7.4% | -7.3% | 3.9% | 4.2% | 20.8% | 19.2% | 19.8% | 20.8% | 28.4% | 32.1% | 24.8% | 5.8% | -5.6% | -6.7% | -37.6% | -1.6% | 6.4% | 8.8% |
| Communication Services | 6.2% | 5.2% | 23.7% | 27.8% | 16.1% | 19.7% | 14.3% | 11.2% | 16.7% | 3.5% | 16.8% | 19.8% | 23.3% | 37.6% | 27.5% | 22.5% | 13.3% | 10.1% | 2.1% | 4.8% | 6.7% | 9.4% |
| Utilities | 3.9% | 2.9% | 0.8% | -49.6% | -1.9% | 8.9% | 12.6% | 110.6% | 3.5% | 5.1% | -3.5% | 18.9% | 15.6% | 11.7% | 14.8% | -0.1% | 5.4% | 3.5% | 4.2% | 18.7% | 1.9% | 4.0% |
| Real Estate | 8.5% | 9.8% | 12.5% | 14.5% | 8.3% | 7.1% | 8.7% | 3.1% | 6.5% | 7.1% | 7.6% | 10.2% | 8.2% | 6.7% | 8.8% | 10.1% | 7.0% | 4.6% | 3.7% | 1.7% | 4.6% | 6.3% |
| Data Source: BBG | *Start of Tech/ComServ Breakout (all previous periods represent legacy Telecom) | | | | | | | | | | | | | | | | | | *18/499 reported | | | |



#InflationAccelerating

US CPI: Expect A Modest Bounce Back Towards “Trend” Inflation

United States
 (Probability of Mean Reversion Using the Hedgeye Macro Comparative Base Effect Methodology = 70%; T10Y)

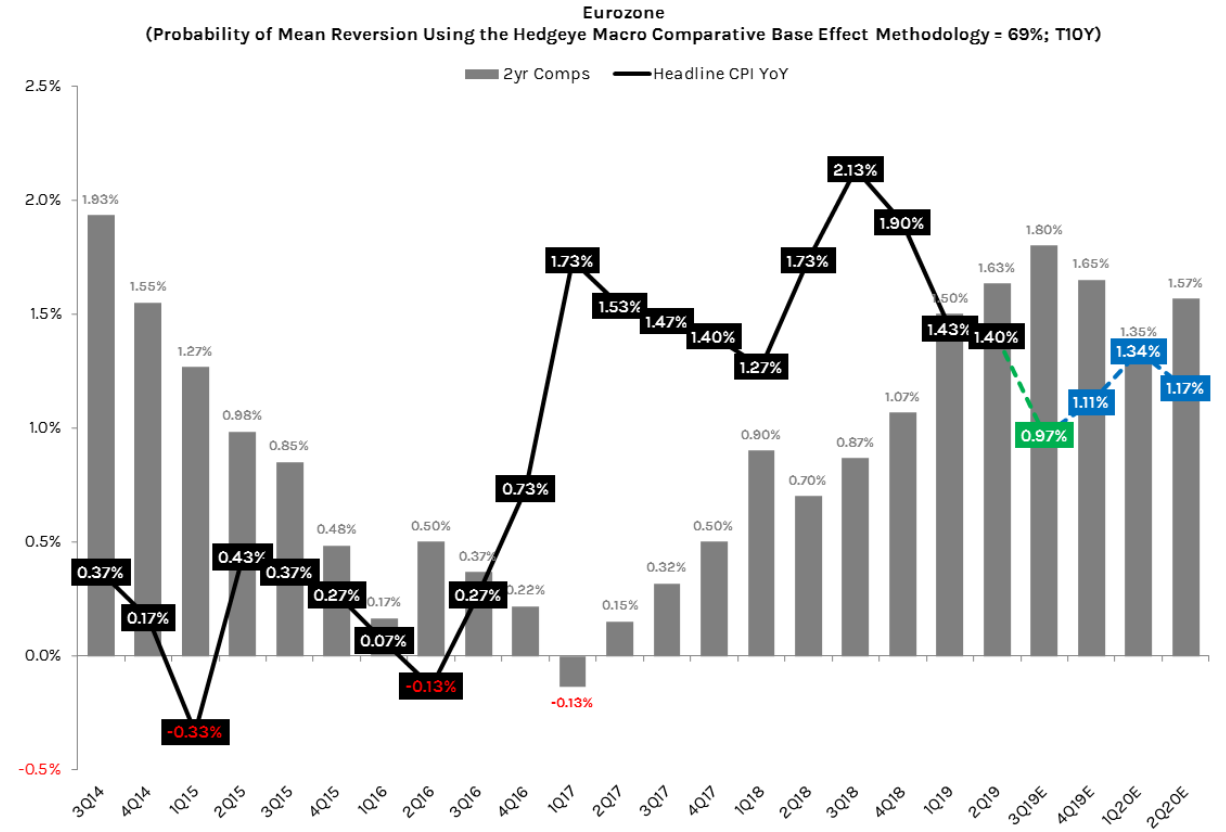
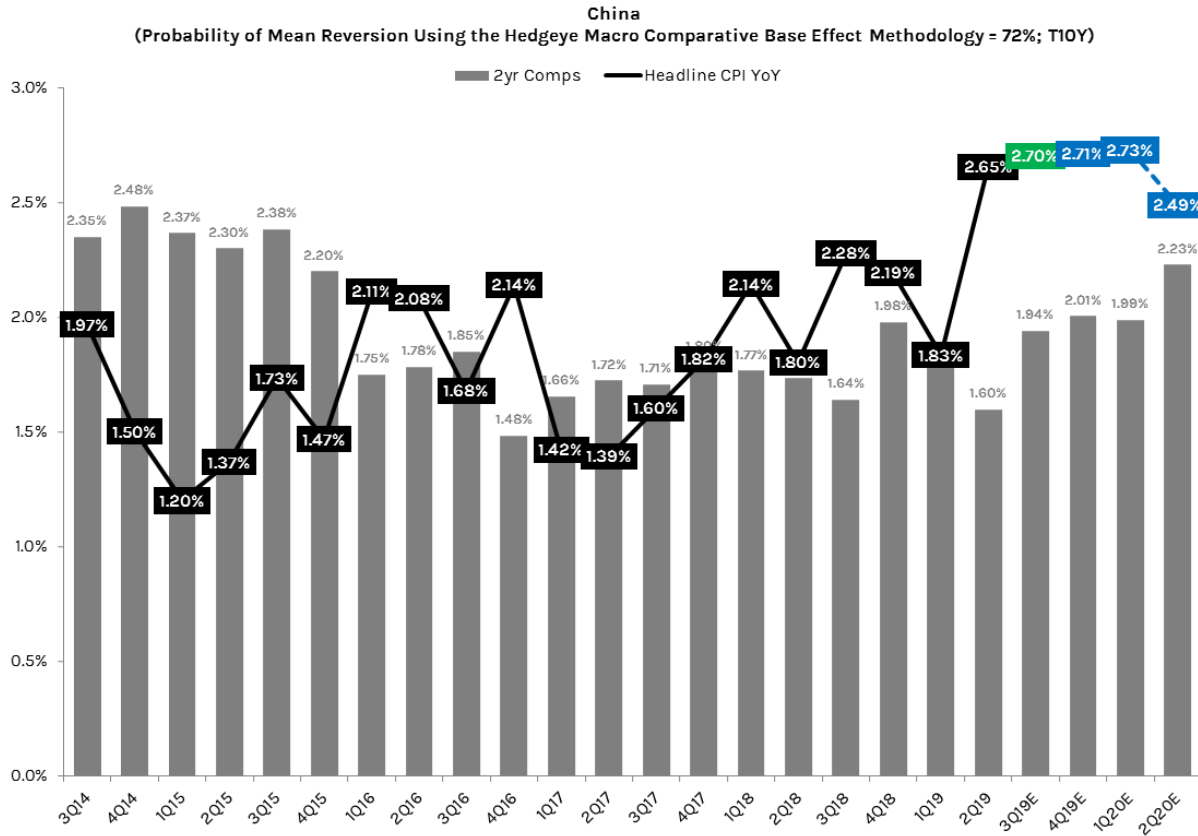


Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye beta-Adjusted Comparative Base Effect Model estimates.

#InflationAccelerating Is Not Just A US Phenomenon

China CPI: High & Sticky

Eurozone CPI: Dead-cat Bounce

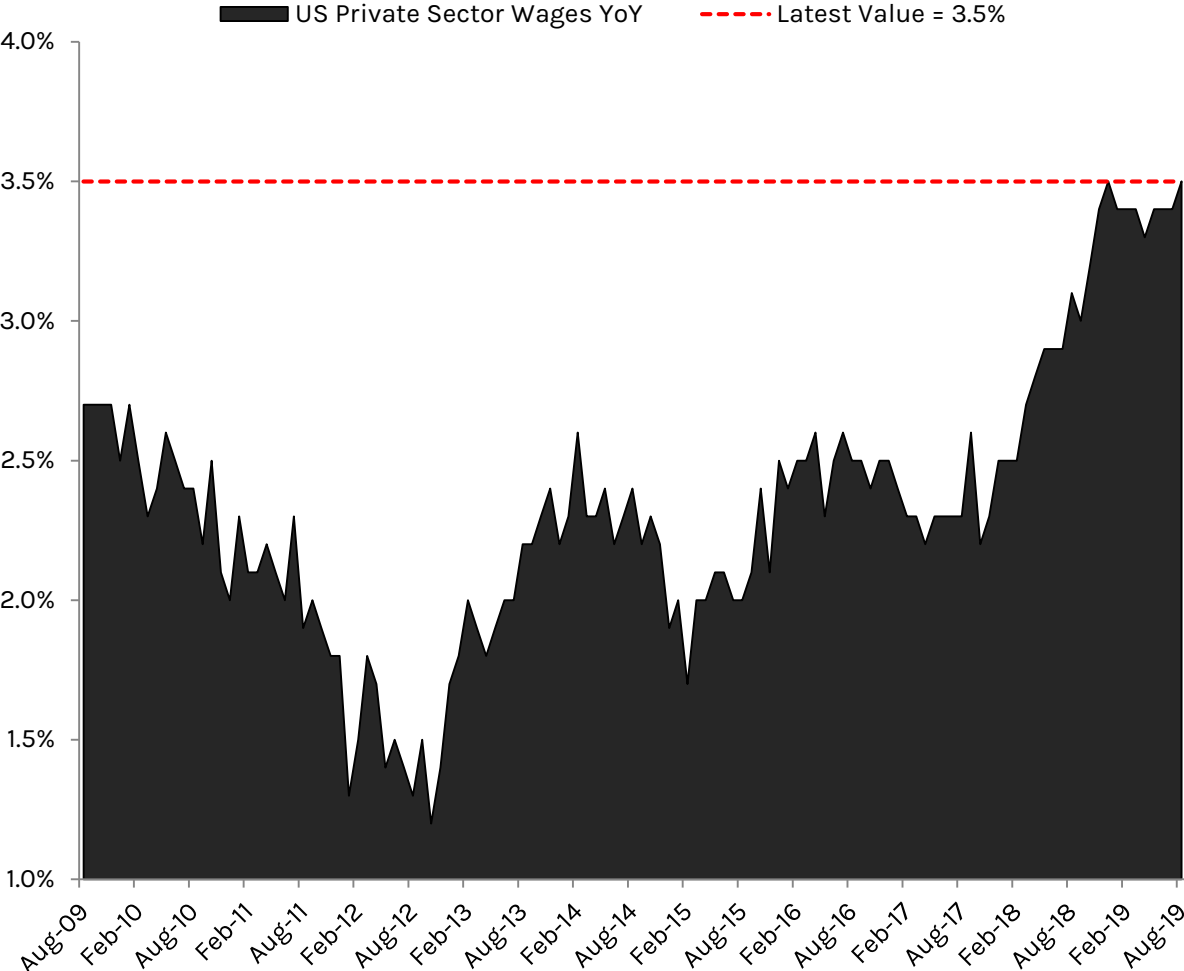


Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β -Adjusted Comparative Base Effect Model estimates.

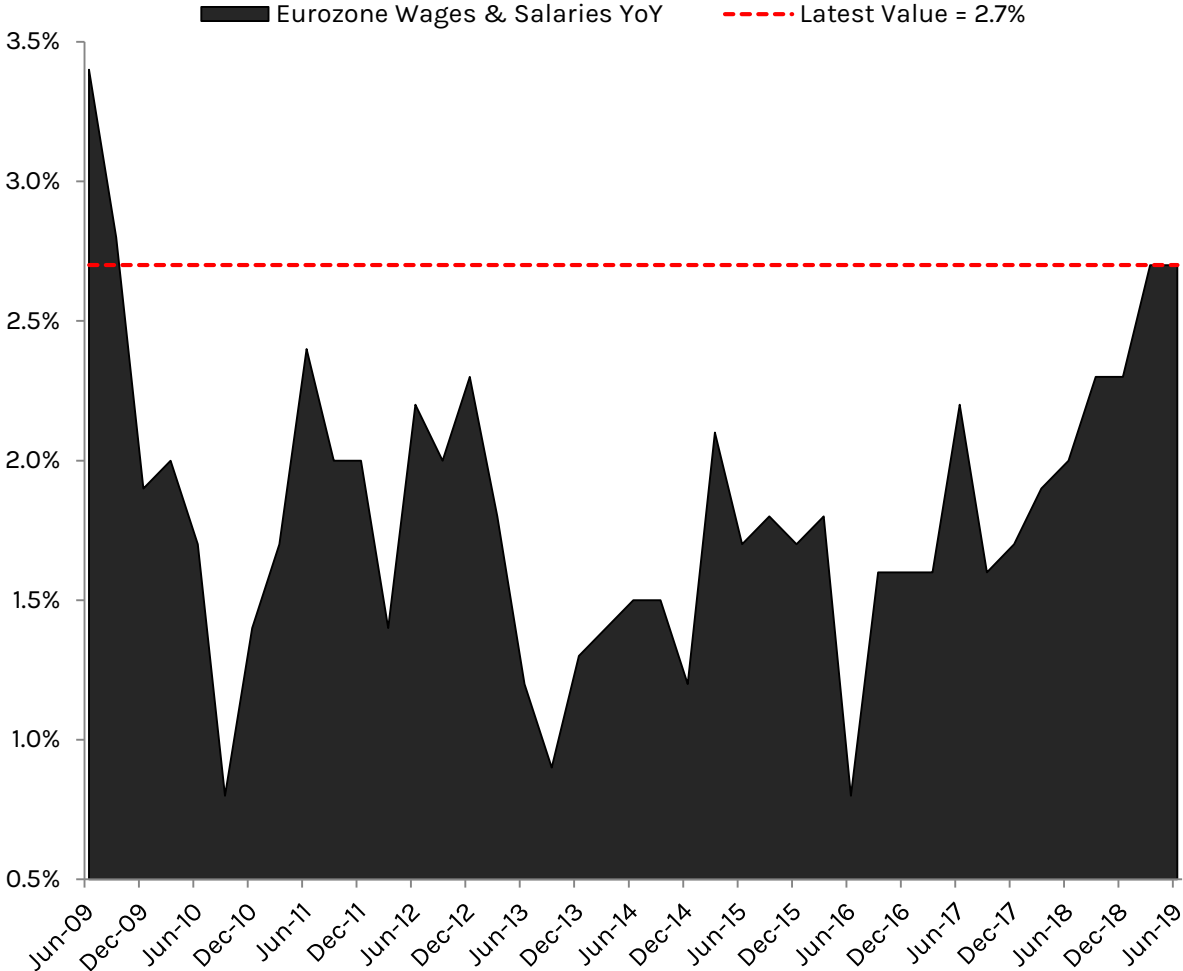
Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β -Adjusted Comparative Base Effect Model estimates.

Idiosyncratic Upside Risks To #InflationAccelerating

Late-cycle, cycle-peak wage growth in the US...

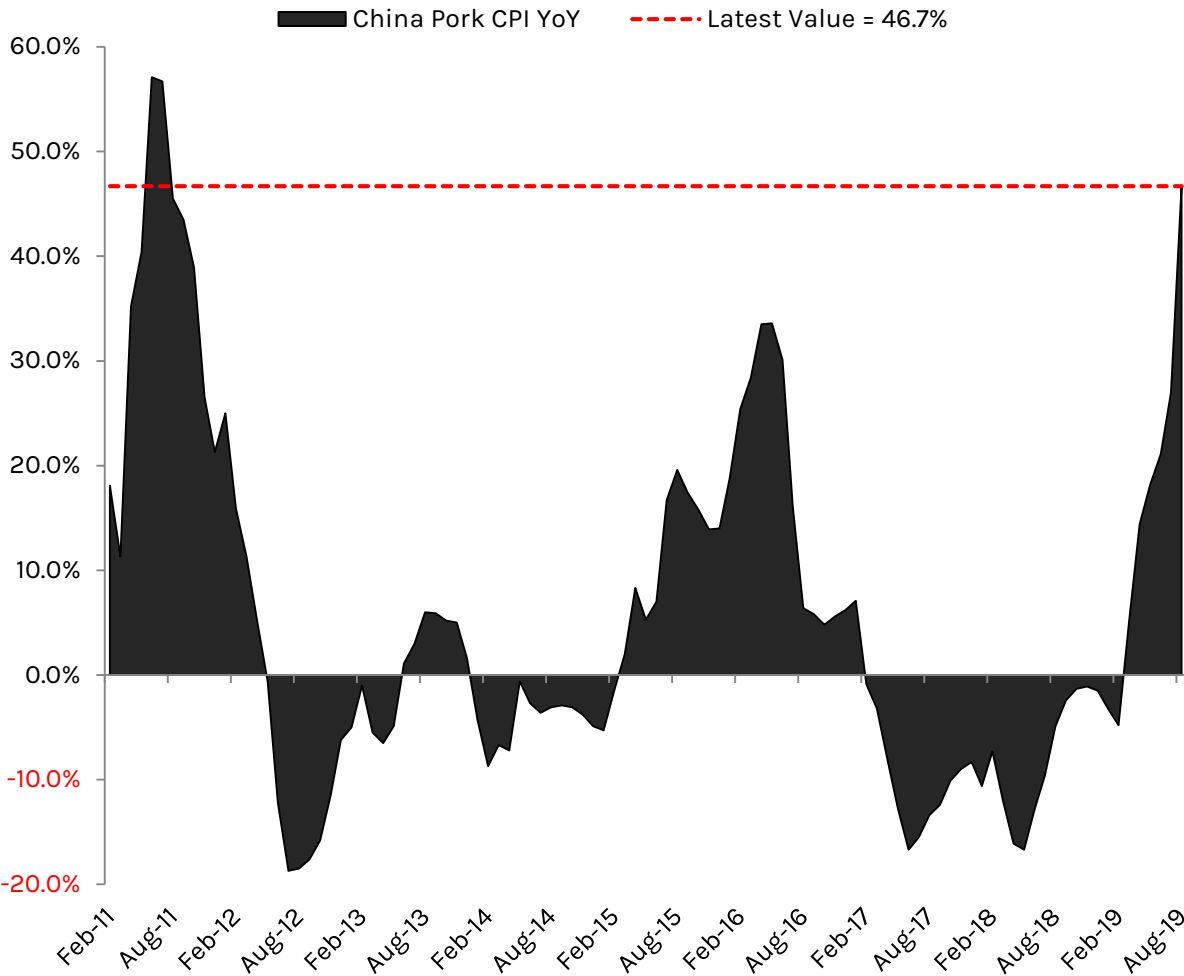


... and European economies

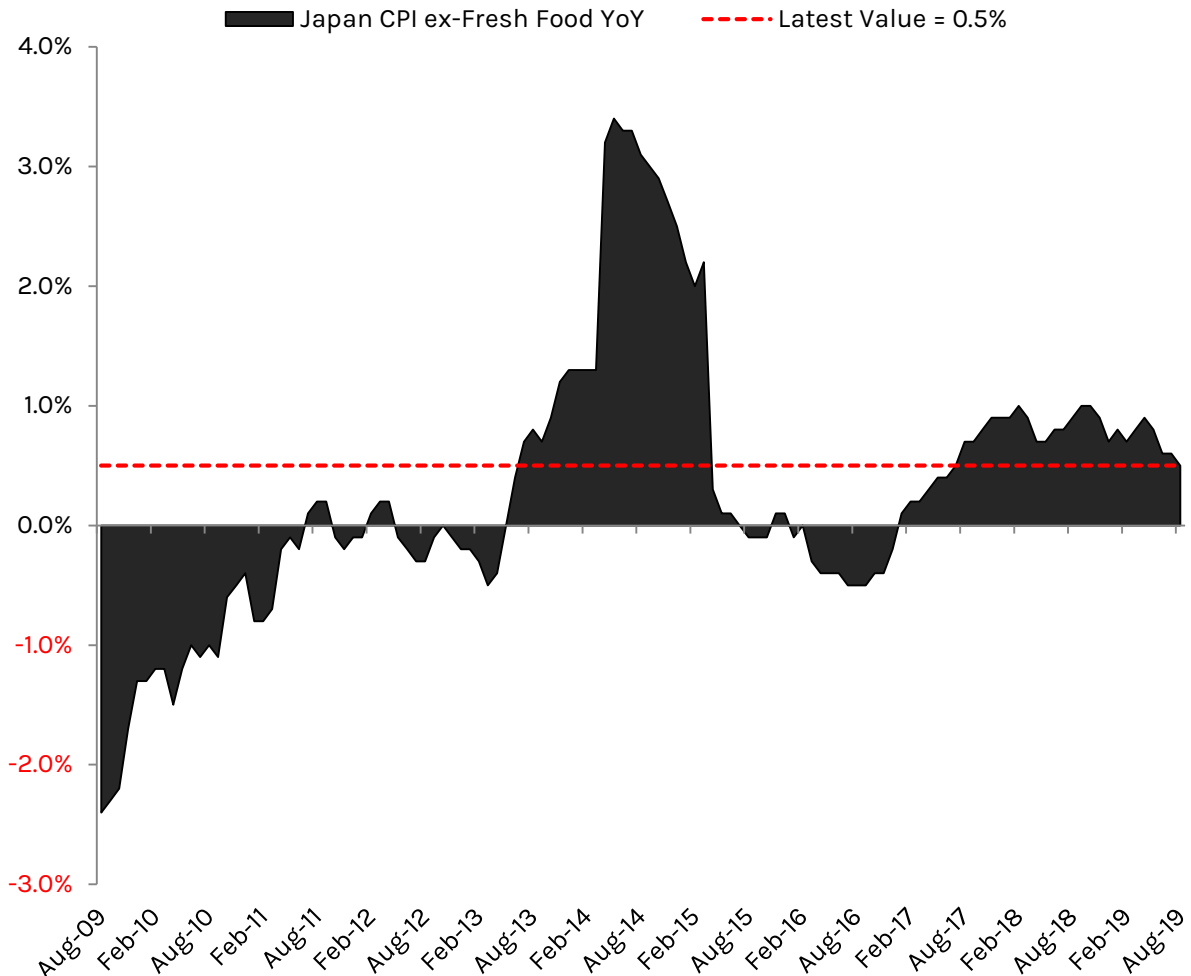


Idiosyncratic Upside Risks To #InflationAccelerating

Swine fever in mainland China...



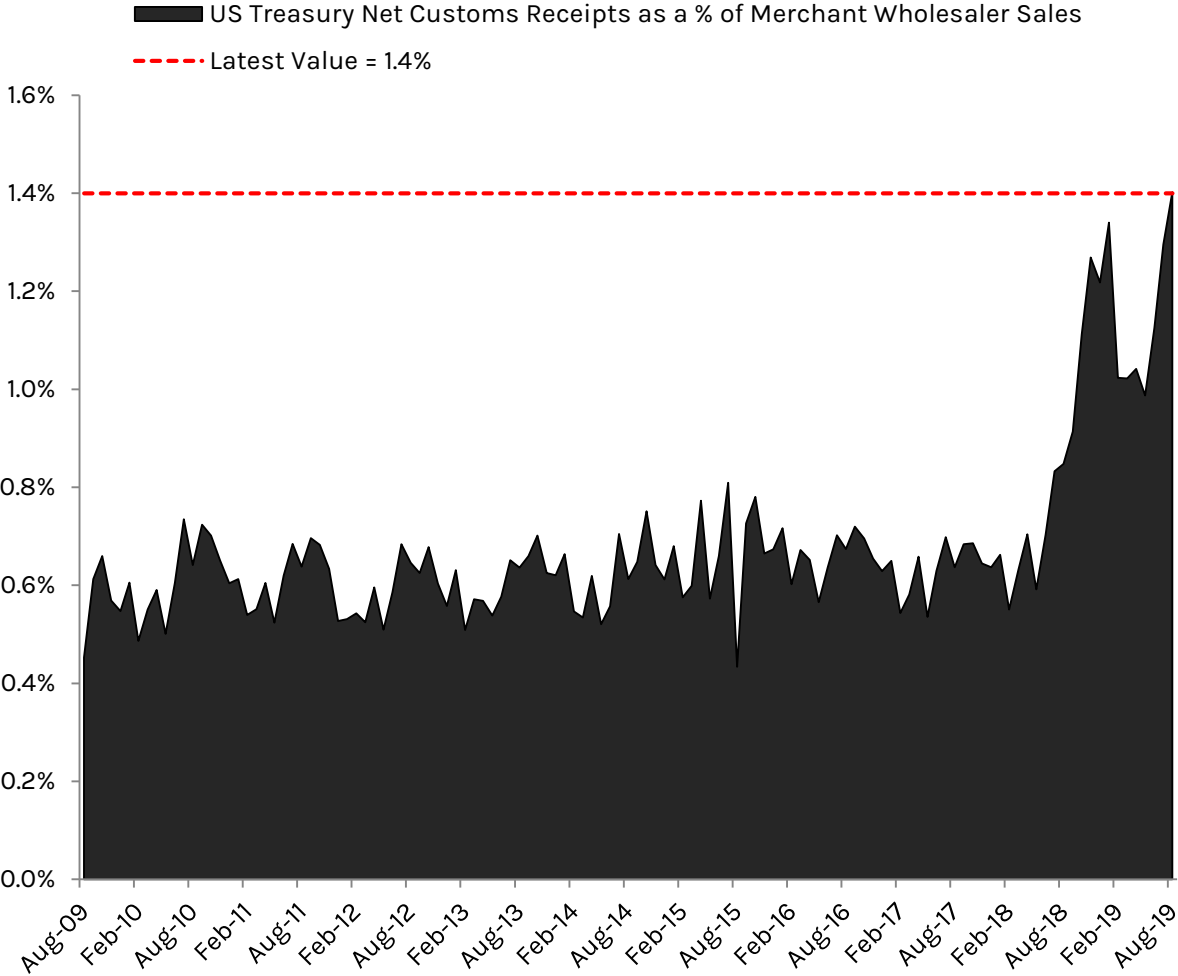
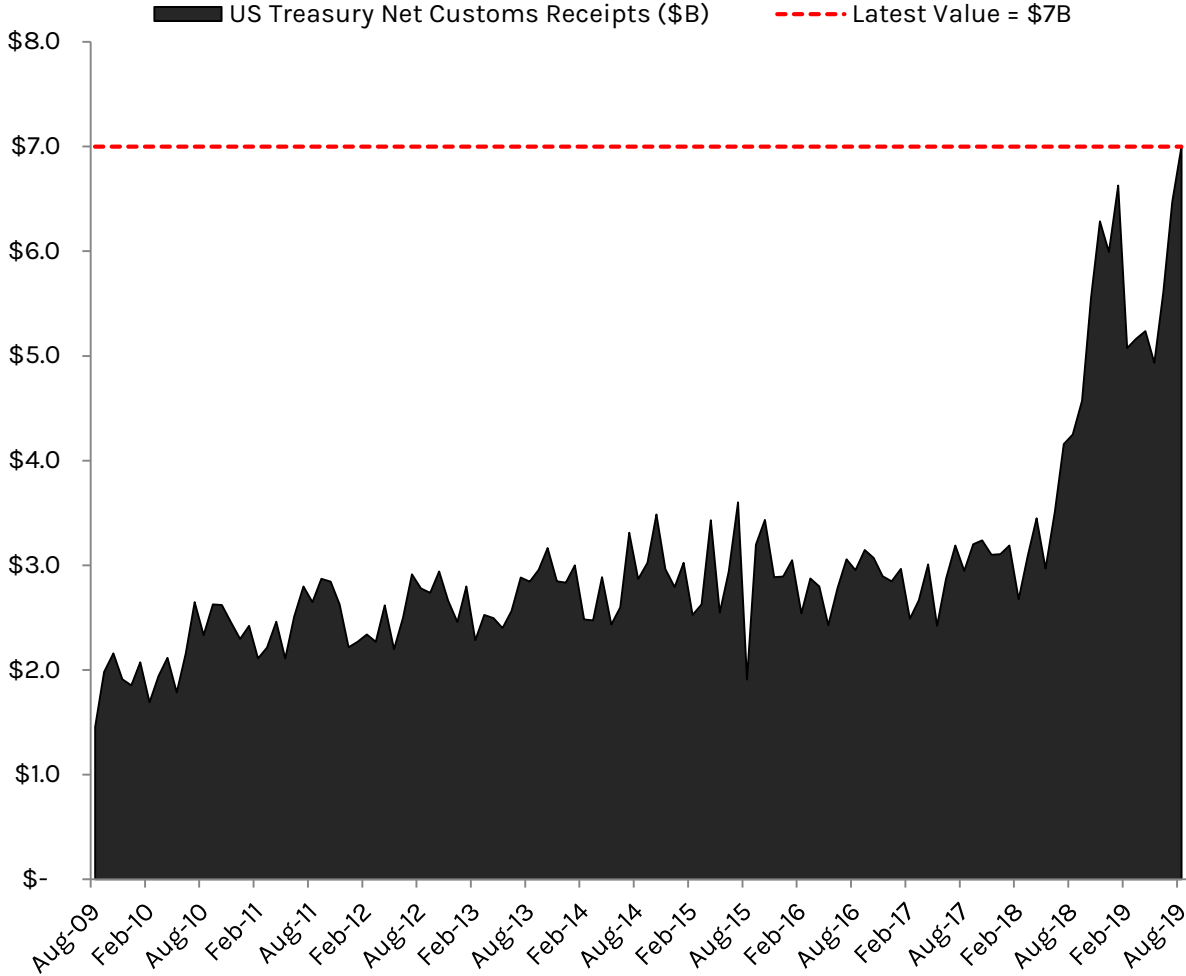
... and the recent consumption tax hike in Japan



Idiosyncratic Upside Risks To #InflationAccelerating

Escalating trade tensions and rising tariffs...

... imply increased pass-through to US consumers

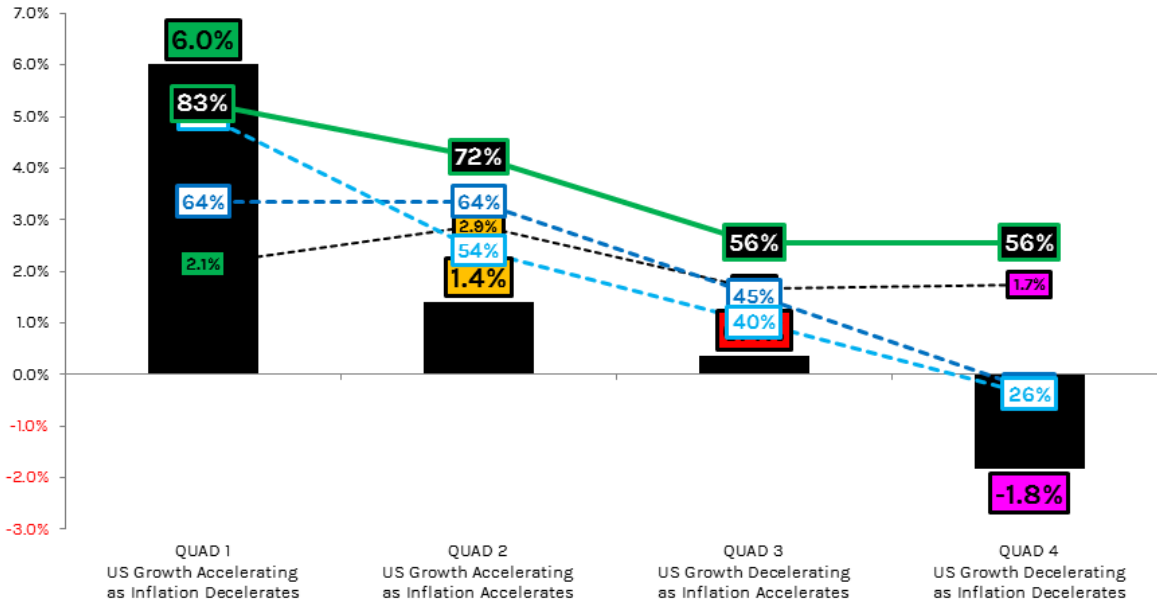


Straddling The Line Between #Quad2 And #Quad3 Is No Place to Be

That demarcation is the difference between “risk on” and a choppy, directionless market.

S&P 500 Index

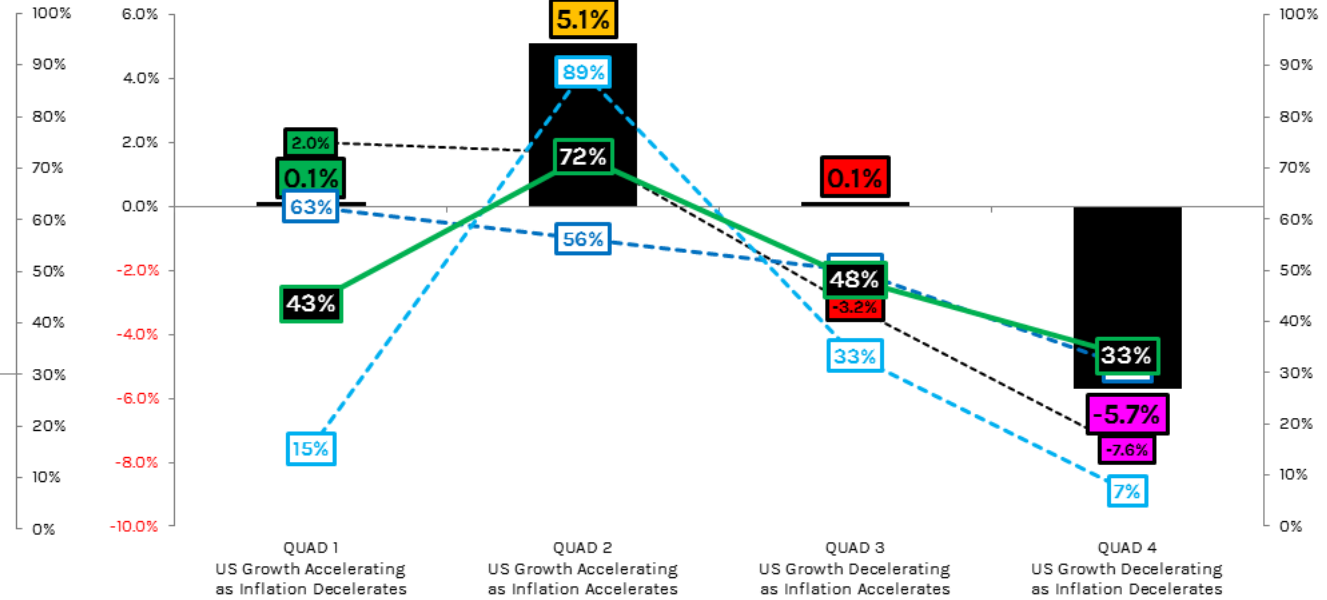
- Expected Value, by Hedgeye Macro GIP Quadrant
- Expected Value, by Hedgeye Macro GIP Quadrant (1st Quartile Δ)
- Percentile of Expected Value, by Sector or Style Factor (rhs)
- Percentile of Expected Value, by Quadrant (rhs)
- Percent Positive Ratio (rhs)



Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

US 10Y Treasury Yield

- Expected Value, by Hedgeye Macro GIP Quadrant
- Expected Value, by Hedgeye Macro GIP Quadrant (1st Quartile Δ)
- Percentile of Expected Value, by Sector or Style Factor (rhs)
- Percentile of Expected Value, by Quadrant (rhs)
- Percent Positive Ratio (rhs)



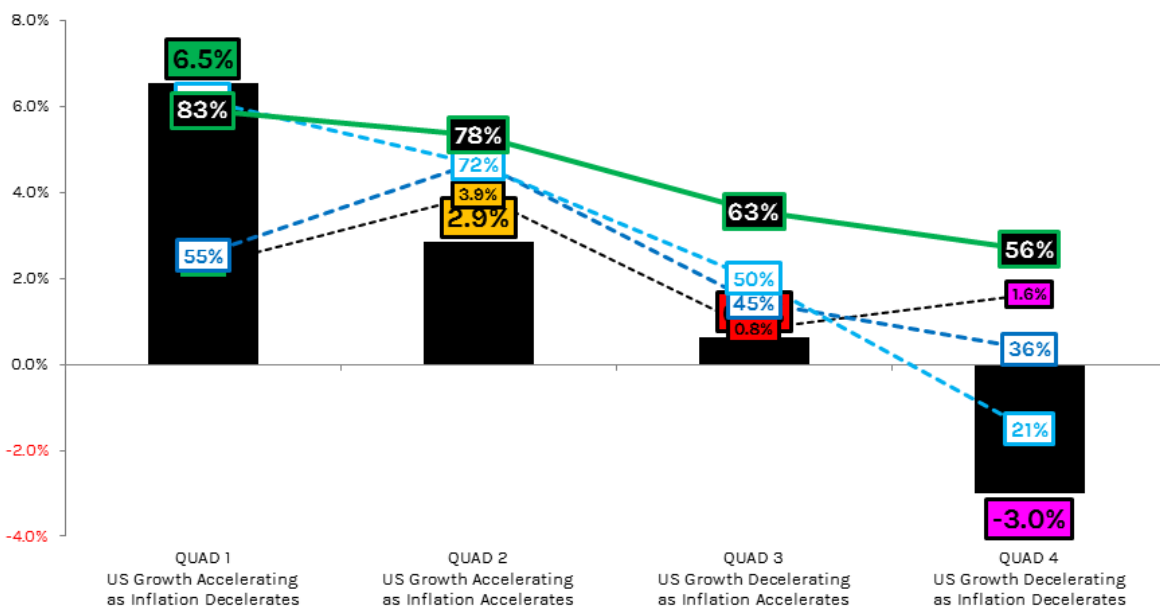
Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

Both #Quad2 And #Quad3 Have Been Supportive For Growth – Especially In Tech

#TheMachine has figured out the only time us humans are willing to part ways with hip, innovation/TAM stories is during #Quad4, when the probability of recession inexorably rises – even if only to a inconsequential level.

Russell 1000 Growth Index

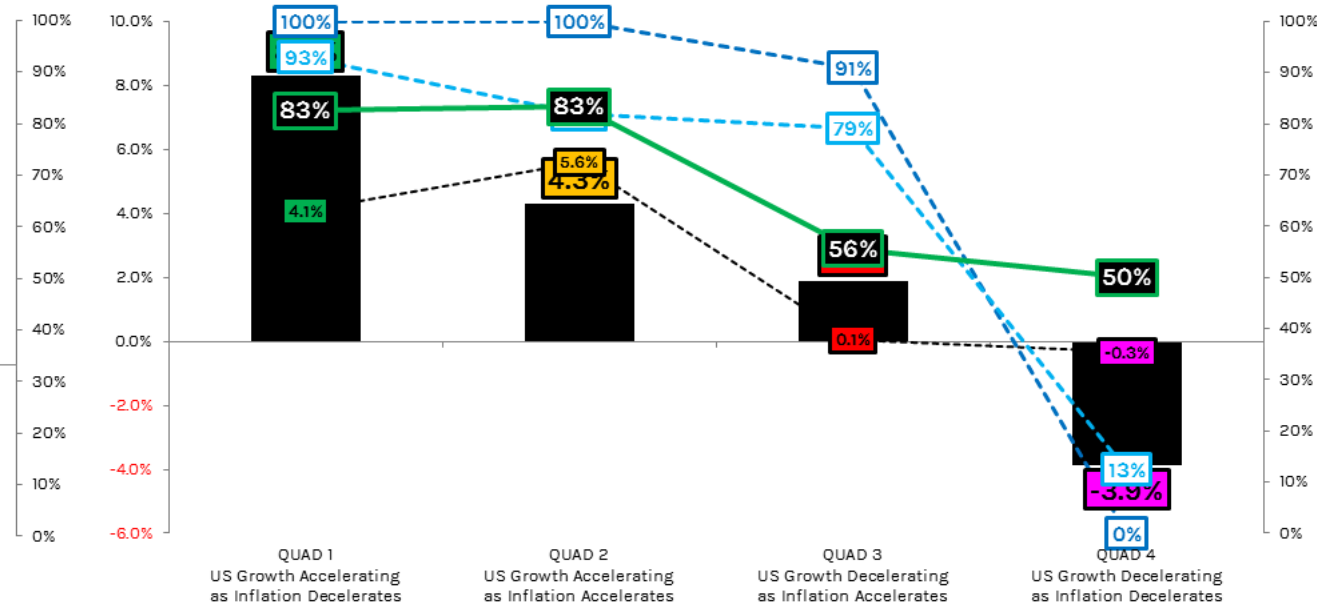
- Expected Value, by Hedgeye Macro GIP Quadrant
- Expected Value, by Hedgeye Macro GIP Quadrant (1st Quartile Δ)
- Percentile of Expected Value, by Sector or Style Factor (rhs)
- Percentile of Expected Value, by Quadrant (rhs)
- Percent Positive Ratio (rhs)



Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

S&P 500 Information Technology Sector Index

- Expected Value, by Hedgeye Macro GIP Quadrant
- Expected Value, by Hedgeye Macro GIP Quadrant (1st Quartile Δ)
- Percentile of Expected Value, by Sector or Style Factor (rhs)
- Percentile of Expected Value, by Quadrant (rhs)
- Percent Positive Ratio (rhs)

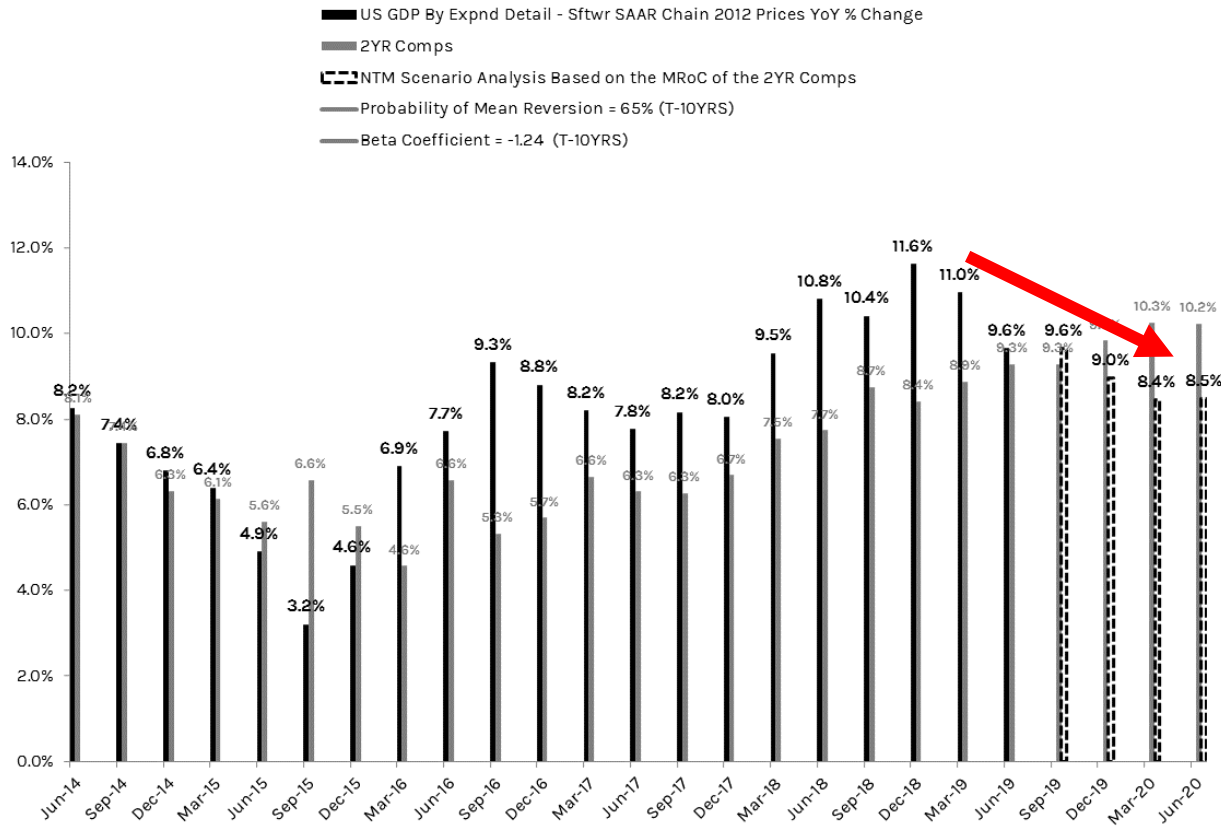


Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

... But “Secular Growers” Are Not Immune To #TheCycle

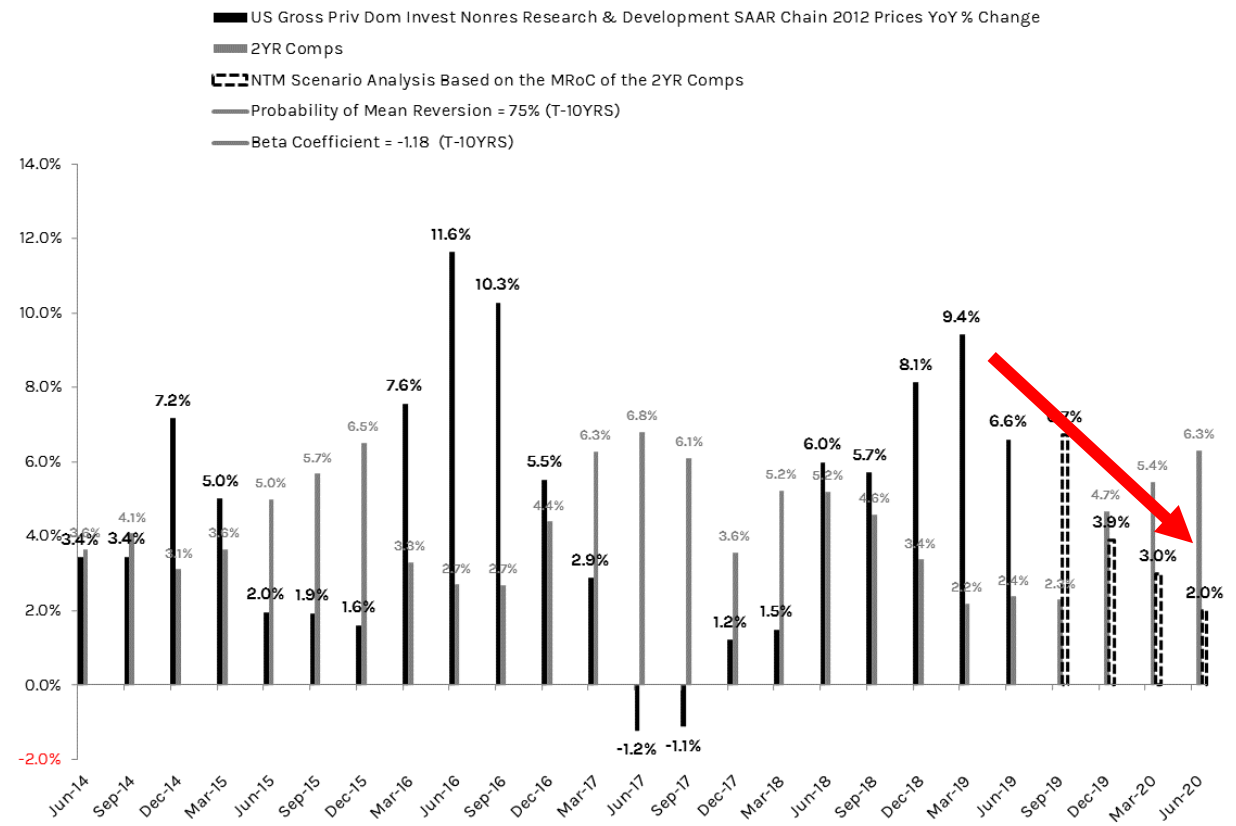
Software investment likely to continue slowing...

... same goes for spending on R&D



Data Source: Bloomberg

© Hedgeye Risk Management



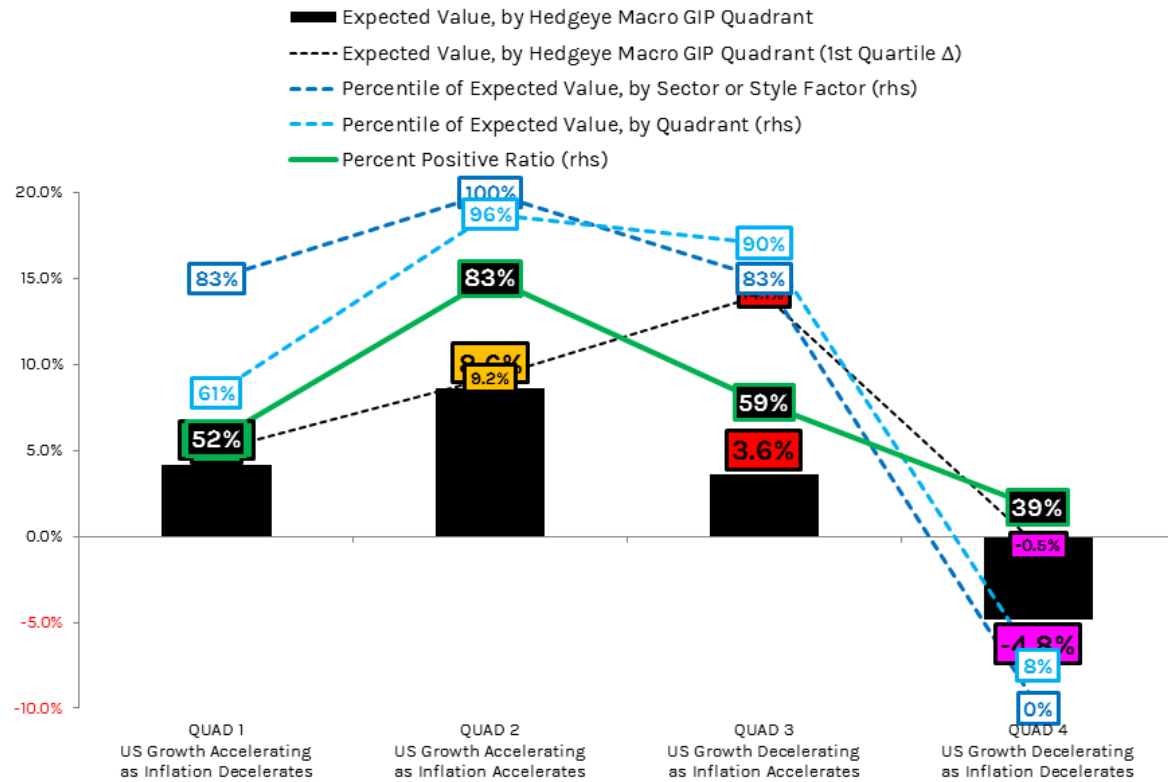
Data Source: Bloomberg

© Hedgeye Risk Management

Energy Likes the #Quad2/3 Straddle... Aaaaaand No One Cares.

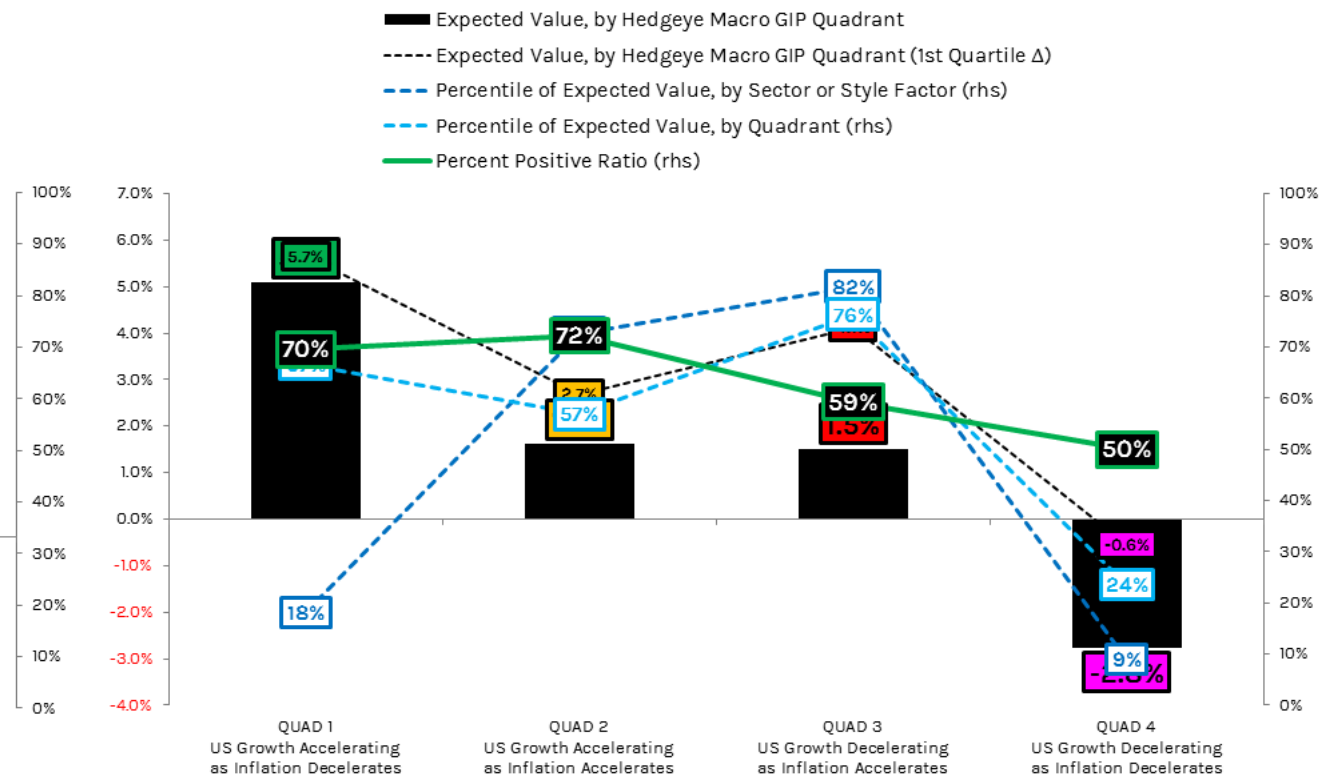
While the oil patch has been repeatedly shot and left for dead over the past half-decade, it's one of the few exposures that offer investors positive absolute returns in both regimes. That's not a large list, so investors might be forced to crowd into what might otherwise be a dead asset class.

Front-month WTI Crude Oil



Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

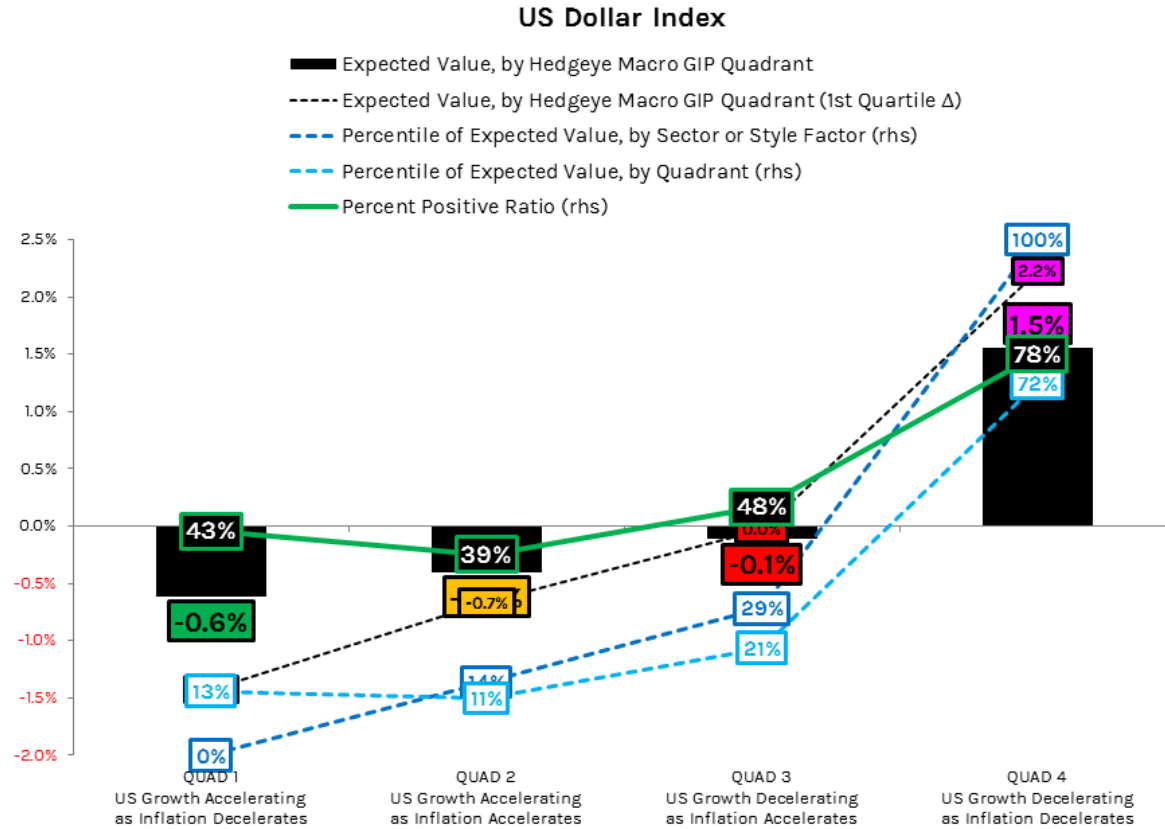
S&P 500 Energy Sector Index



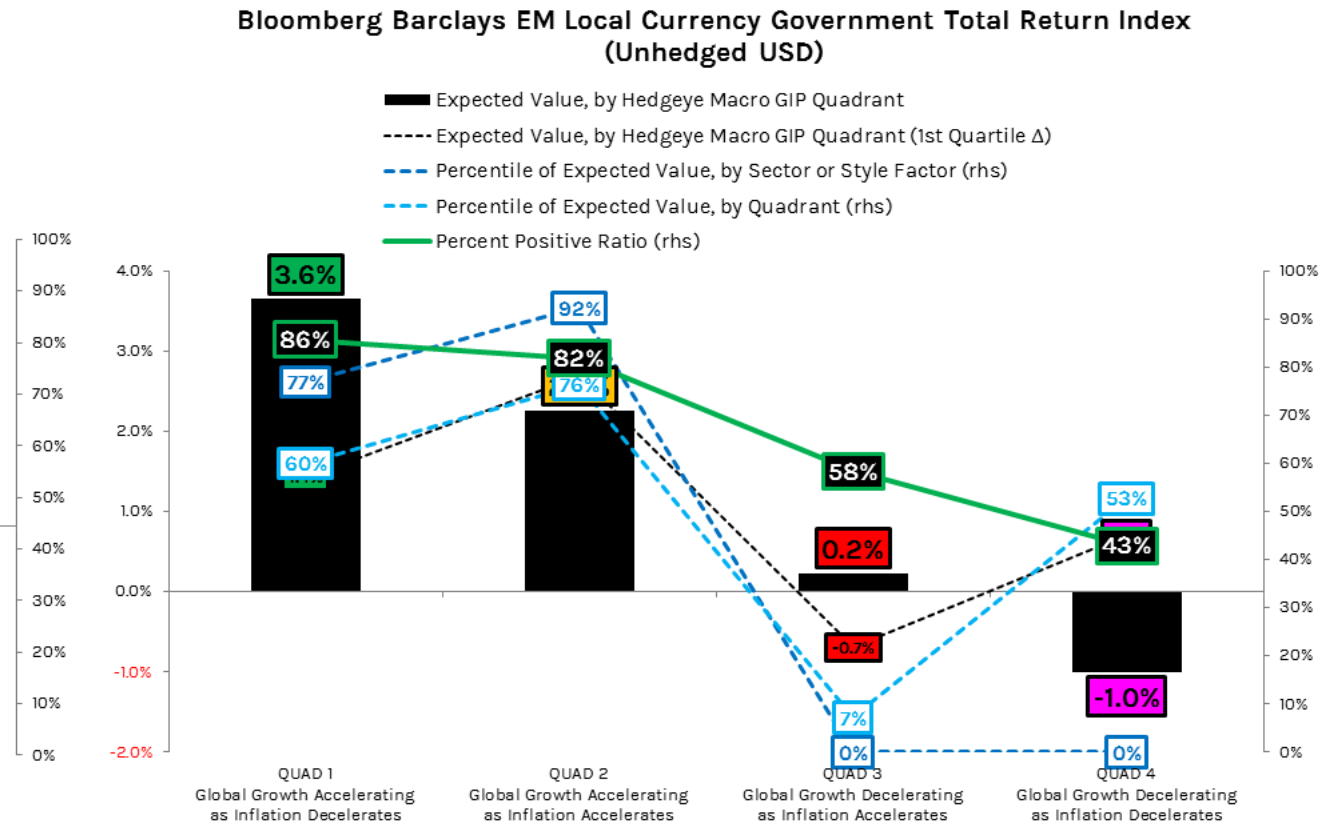
Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

Key Takeaway No. 1: #Quad2 Would Likely Spell The End Of The Global Dollar Short Squeeze

If and when the Fed is forced to engineer sustained dollar depreciation – either by the data or by the markets – that could set off a reflexively positive feedback loop with respect to the availability and pricing of USD funding – both domestically and abroad. Until then, prepare for more #Quad4.



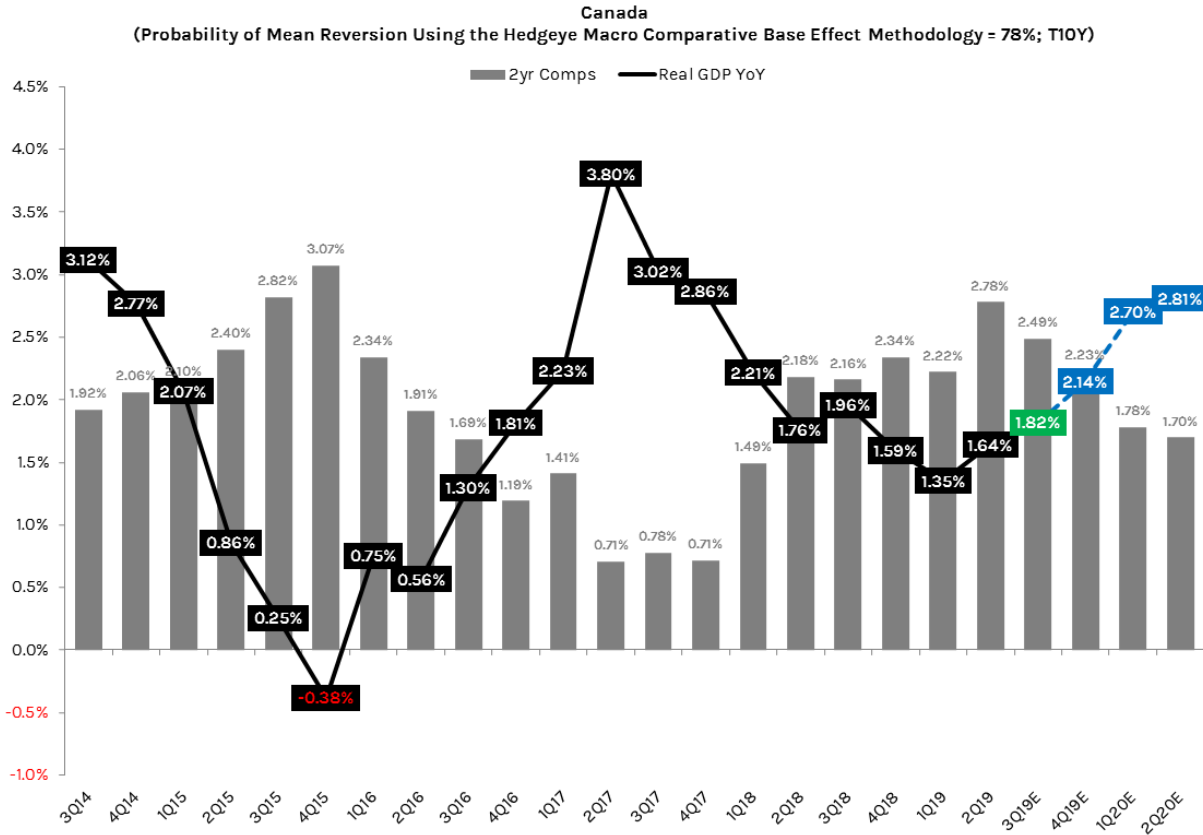
Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.



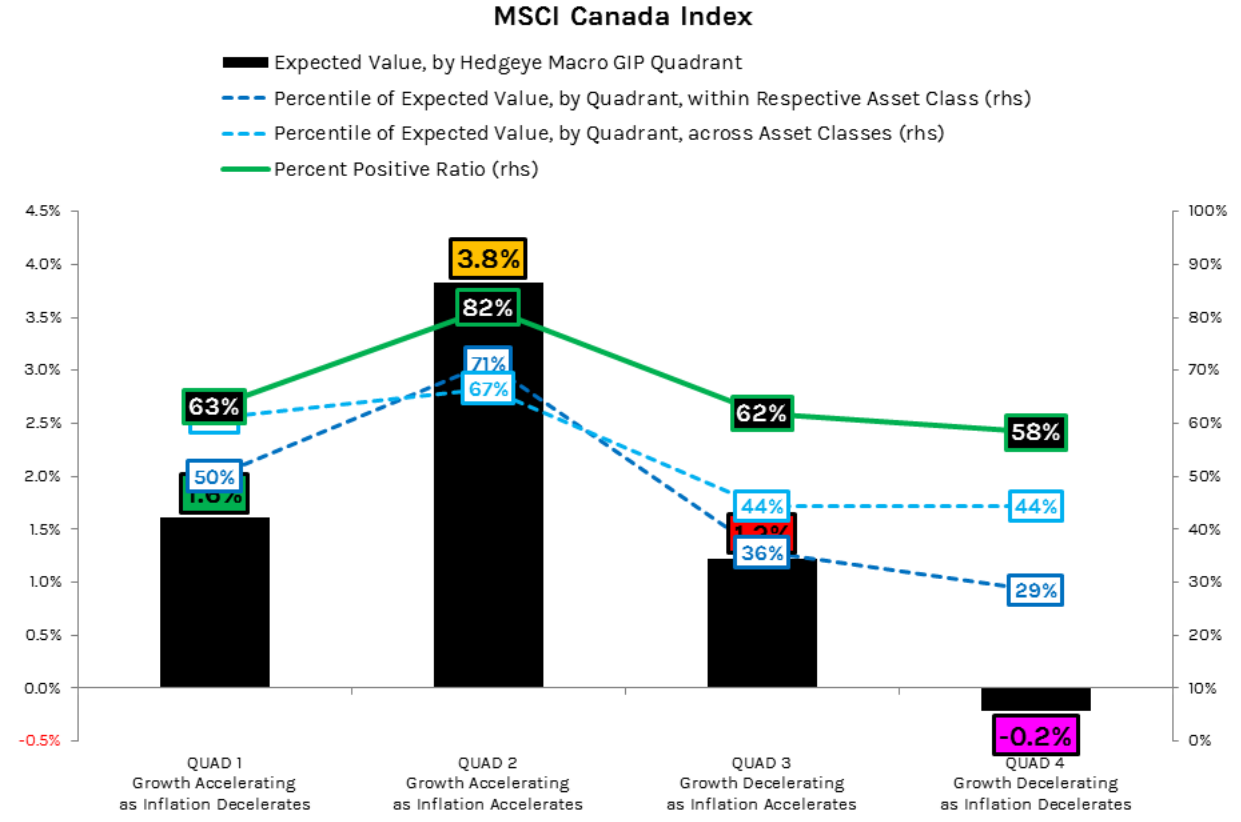
Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

Key Takeaway No. 2: #Quad3 Is The Most Supportive Regime For Idiosyncratic Risk-Taking

Canada currently has one of – if not these best GIP outlooks in the world. Remember: #Quad2 is your friend here (to the extent you're not overweight duration risk if and when that occurs) and #Quad3 is a pure stock/credit picker's market anyway.



Data Source: Bloomberg. Green box = Hedgeye Nowcast estimates. Blue boxes = Hedgeye β-Adjusted Comparative Base Effect Model estimates.



Data Source: Bloomberg. Asset classes include equities, fixed income, currencies and commodities. Quarterly observations starting in 1Q98.

Thematic Investment Conclusions

1 Immediate-term TRADE (introduced 3wks ago or less)

LONGS: TIPS (TIP), Energy (XLE), Canada (EWC), Livestock (COW), Lumber (WOOD)

SHORTS: Consumer Staples (XLP), Communication Services (XLC), Private Equity (PSP)

2 Intermediate-term TREND (introduced 3mos ago or more)

LONGS: Utilities (XLU), REITS (VNQ), 20+ Year Treasuries (TLT), Extended Duration Treasuries (EDV), 1-3 Year Treasuries (SHY), Gold (GLD), Housing (ITB)

SHORTS: Industrials (XLI), Financials (XLF), Junk Bonds (JNK), Russell 2000 (IWM), Software (IGV), Regional Banks (KRE), Hedge Fund Hotels (GVIP)

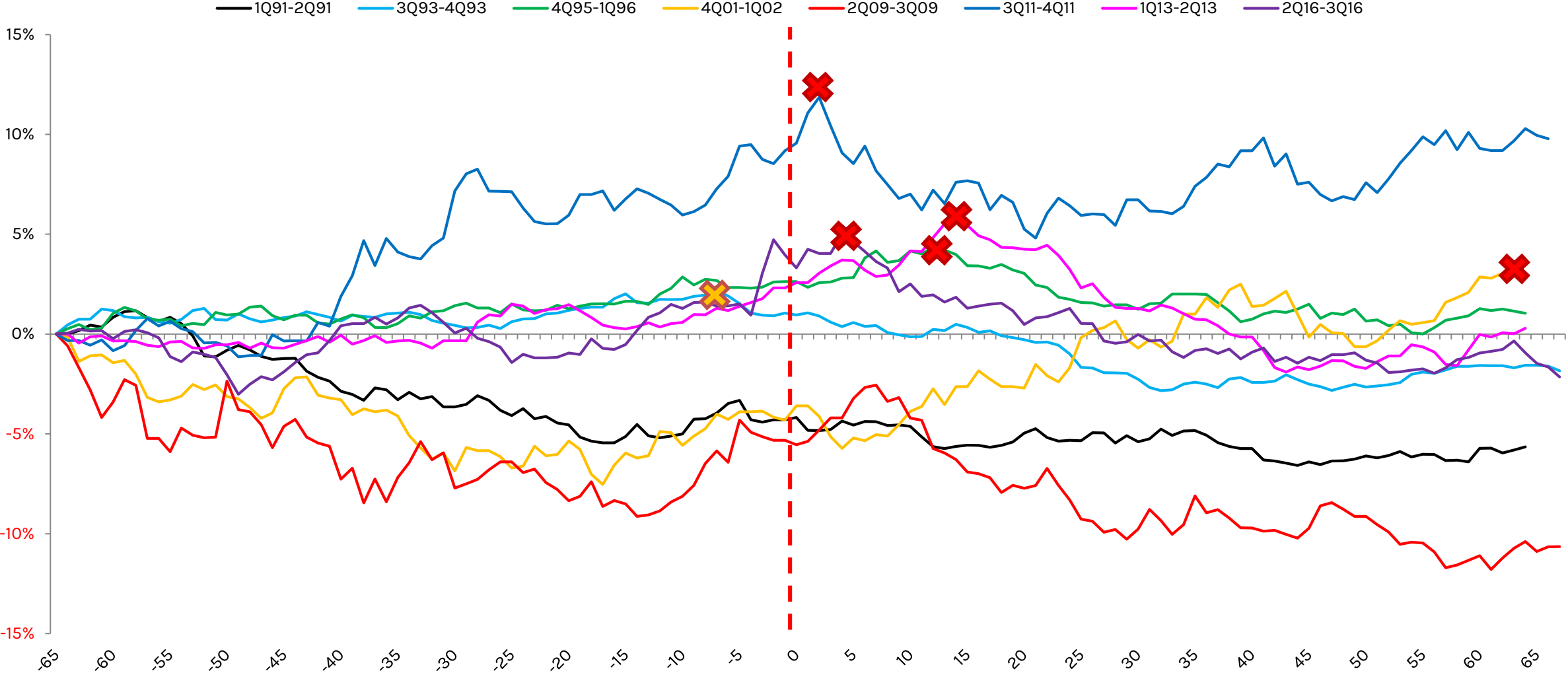
3 Long-term TAIL (introduced 3yrs ago or less)

LONGS: n/a

SHORTS: n/a

Full-Cycle Investing Bottoms Require #Patience And Disconfirmation Of Recession

Normalized Performance of the Ratio of Defensive Equities to Cyclicals During Full-Cycle Investing Troughs in the US Economy, n Days Before/After the Onset of #Quad1 or #Quad2



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MMORAN@HEDGEYE.COM