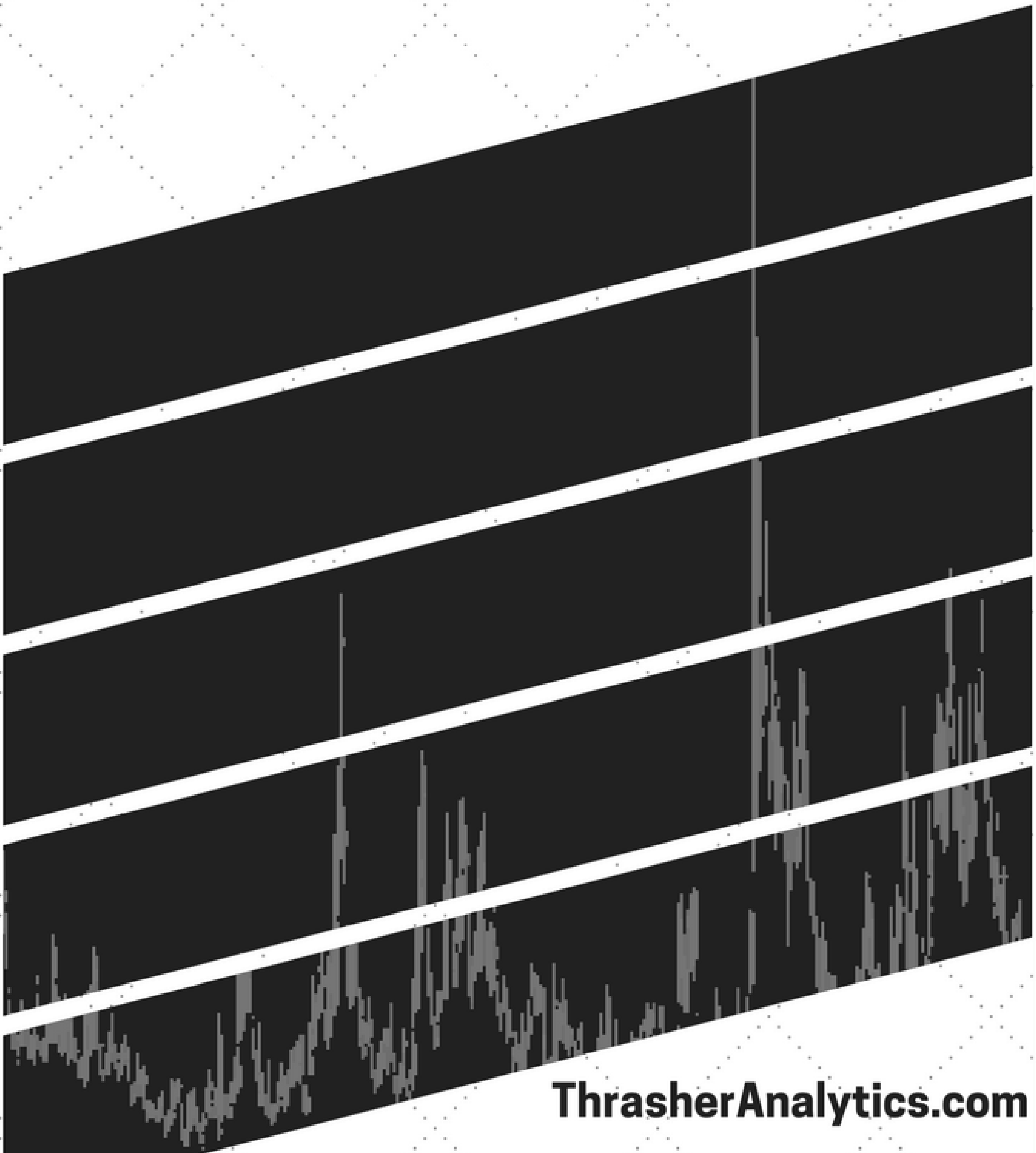
THRASHER ANALYTICS

BI-WEEKLY RESEARCH & ANALYSIS



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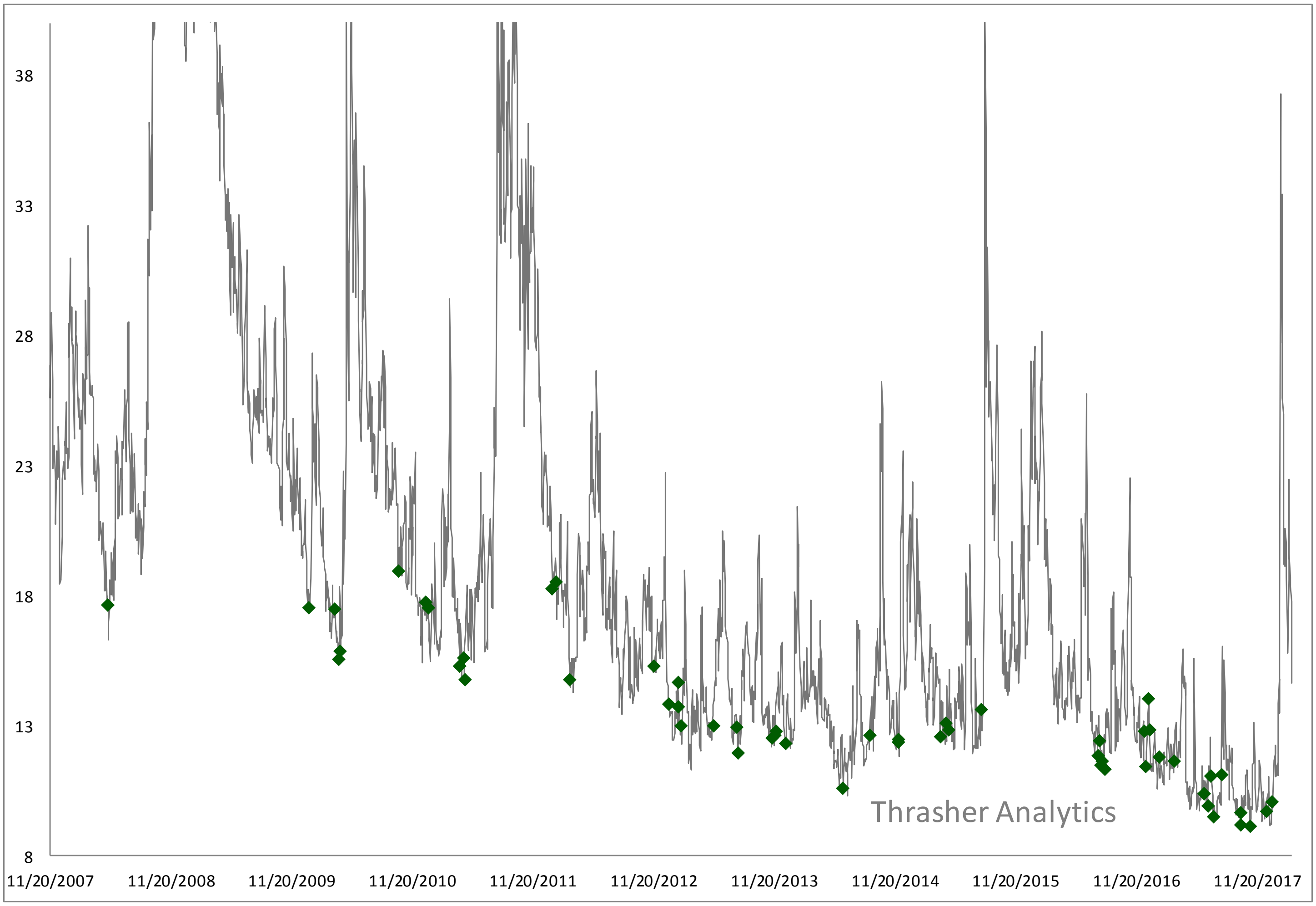
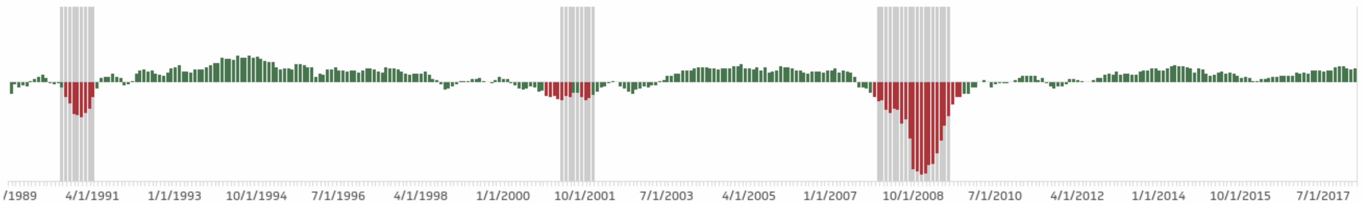
VOLATILITY RISK TRIGGER (VRT)



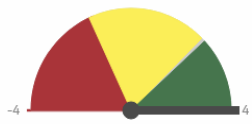
Two weeks ago, soon after my last letter, we had a slight pop in volatility with the VIX moving from under 13 to a bps under 20. While It wasn't a major spike it was a slight jolt to financial markets after volatility had slide below 12 earlier in June. Since then, we've seen volatility retreat once again, finishing last week at 13.37 with 9-day volatility making its way to 11.49 on Friday, which is near its prior June low.

Economic Dashboard

Leading Economic Indicator



Corporate Composite



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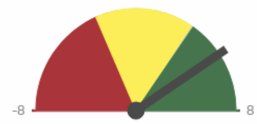
Industrial Composite



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Corporate Indicators

Indicator	Value	Threshold	Trend
Corp. Operating Surplus	1,675,924	1,645,587 Less Than	
Corp. Disposal Income	477,800	464,248 Less Than	
Corp. Cash Flow	-36.6	0 Less Than	

Industrial Indicators

Indicator	Value	Threshold	Trend
YoY Change in Manufacturing Sales	3	0 Less Than	
YoY Change in Industrial Production	4.3	0 Less Than	
YoY change in Non-Defense New Orders	7	0 Less Than	
YoY Change in Durable Goods New Orders	9.6	0 Less Than	
		0 Less Than	

THRASHER ANALYTICS

Economic Dashboard

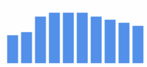
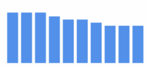
Banking Composite

2

Consumer Composite

-1

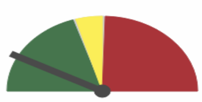
Banking Indicators

Indicator	Value	Threshold	Trend
% of Banks Tightening Standards	-11	0 Greater Than	
% of Banks Tightening Standards for Comercial & Industrial Loans	-3	0 Greater Than	
% of Banks Tightening Standards on Credit Cards	9.4	0 Greater Than	
Deliquency Rate on Credit Cards	2.5	2.5 Greater Than	
Deliquency Rate on Commerical & Industrial Loans	1.2	1.3 Greater Than	
Non-Financial Liabilities	459.8	433 Less Than	
Ratio of Non-Performing Loans	1.2	1.2 Greater Than	
% of Banks Increasing Willingness to Make Consumer Loans	9.2	0 Less Than	

Consumer Indicators

Indicator	Value	Threshold	Trend
YoY Change in Non-Farm Payroll	1.6	0 Less Than	
Avg. Weekly Hours Worked in Manufacturing	42.4	42 Less Than	
3Yr Change in Real Income	3.0	3 Less Than	
YoY Change in Retail Sales	4.1	5 Less Than	
Housing Building Permits	1,379	1,283 Less Than	
YoY Change in Consumer Sentiment	3.5	0 Less Than	
Barrel of Crude Oil	66.1	20% 6-month Change	
Shiller Home Price Index	197.0	194 Less Than	
Labor Slack	-0.8	0 Less Than	

Financial Stress Composite



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Headline Economic Indicators

Real GDP Growth	**2.9%**
Nominal GDP Growth	**4.8%**
YoY Change in Federal Debt-to-GDP	**4.5%**
Unemployment Rate	**3.9%**
Inflation (CPI)	**2.4%**
Core Inflation (CPI)	**2.1%**
Inflation (PCE)	**4.4%**
Core Inflation (PCE)	**1.9%**

Financial Stress Indicators

Indicator	Value	Threshold	Trend
St. Louis Stress Index	-1.0	-1.1 Greater Than	
Kansas City Stress Index	-0.3	-0.4 Greater Than	
Chicago Stress Index	-0.8	-0.8 Greater Than	

Broad Market Commentary

The S&P 500 remains within its wide trading range, requiring extreme patience from active traders and managers in order to not be whipsawed to death. With last week being a holiday-shortened week, volume was (as to be expected) extremely low. We saw a nice move higher on Friday but it was accomplished on one of the lowest volume days this year. In fact the only lower volume day we've seen this year was the half-day before the 4th of July holiday. It seems most traders had taken a long weekend, allowing the algos, interns, and natural market gravity to take stocks on a one-day push.

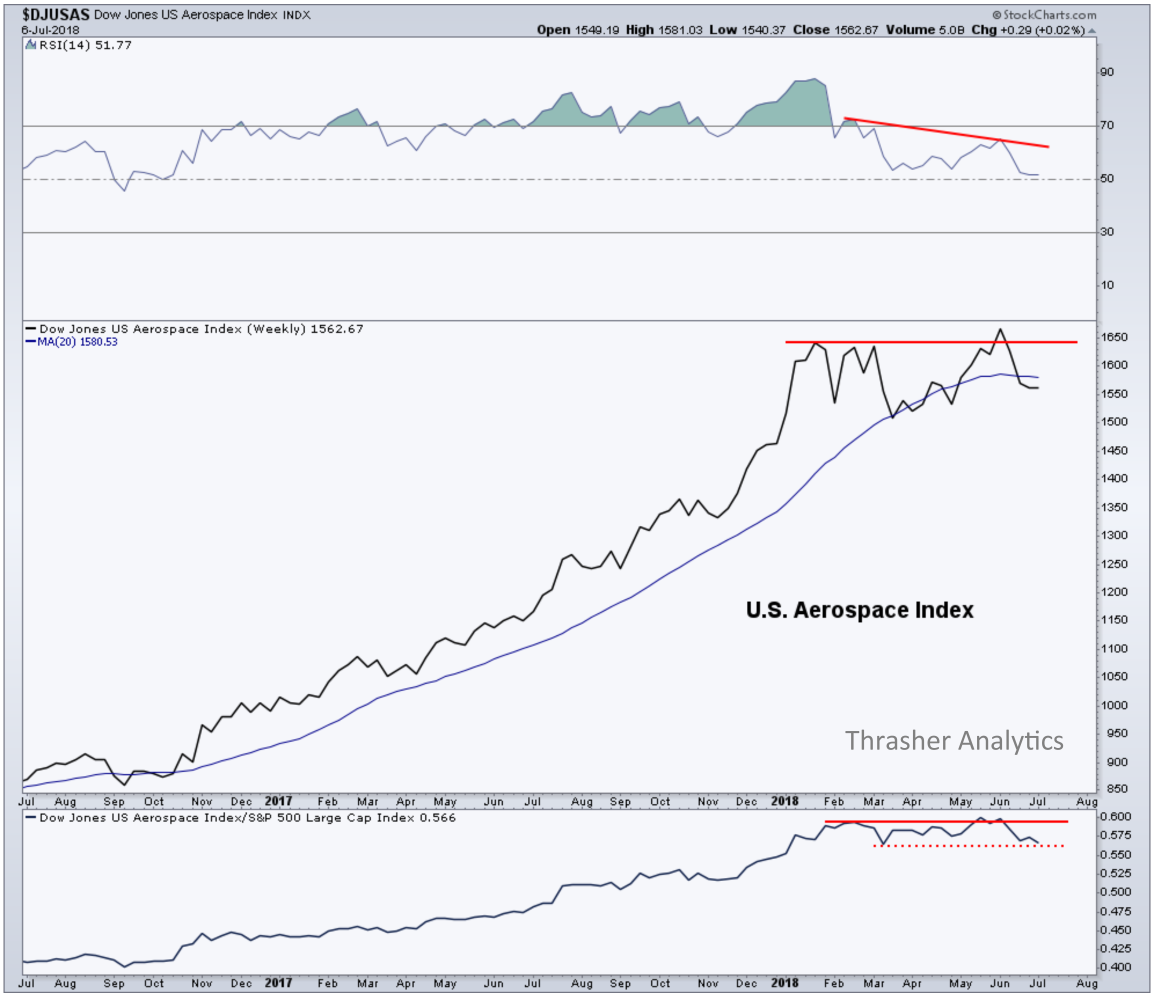
We'll need to see a continuation this week and challenge the prior June and March highs to get faith in Friday's bullish advance. Until then, patience patience patience!

Health Care Rebound

While my main focus with this letter is to highlight risks within the financial markets and specifically equities, I still want to highlight bullish chart setups when the present themselves. Above is a weekly chart of the Health Care sector (XLV) relative performance to the S&P 500. The ratio of this sector to the market has fallen down to test its prior late '16/early '1 low and has put in a false breakdown with health care showing relative strength. I think this is very powerful when we can also note that in the top panel momentum (via the RSI indicator) putting in a large and well defined bullish divergence.

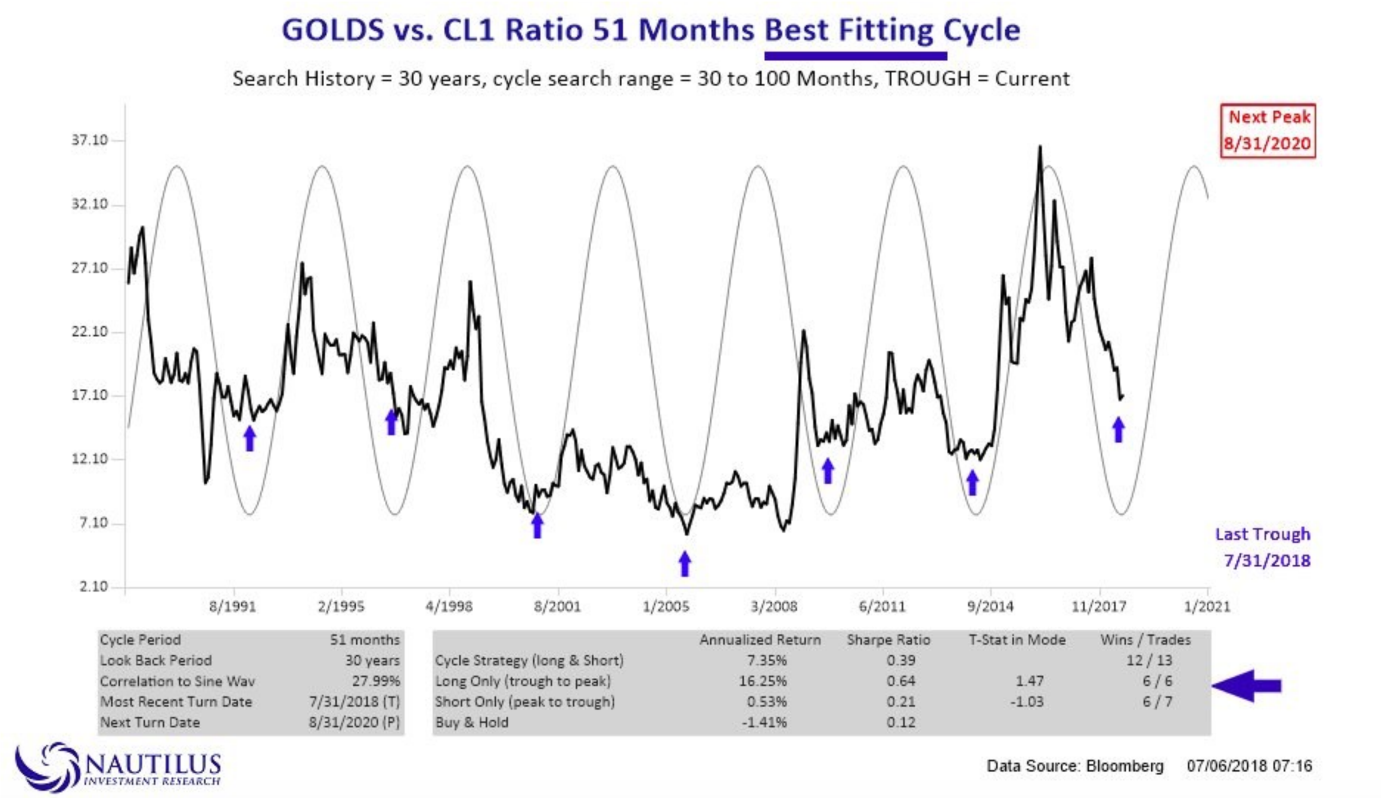
Health Care is one of the sectors I'm most bullish on this summer, with many catalysts coming out of the biotech space that I think will push the sector as a whole higher. We saw a great example of that over the last few weeks, notably on Friday's with Biogen Alzheimer drug success and the stocks 19% advance. There are several other FDA announcements I'm tracking that I believe could also be catalysts for health care. The sector also has a positive headwind with the Trump administration, which has attempted to bring down the red tape of drugs coming to market, using increased competition as their method to fight pharma prices.

Aerospace Breakdown



While Health care has a bullish chart, the Aerospace industry has a bearish one. Above is a weekly chart of the U.S. Aerospace Index. In June the industry put in a false breakout after moving above its prior 2018 high and then falling back under and then crossing below its 20-week Moving Average. With the bearish chart pattern, momentum also created a bearish divergence with the RSI making a lower high. The industry's relative strength, as shown by the ratio in the bottom panel has also been mostly flat this year, not showing any strength and is currently working its way to setting a new '18 low in relative performance.

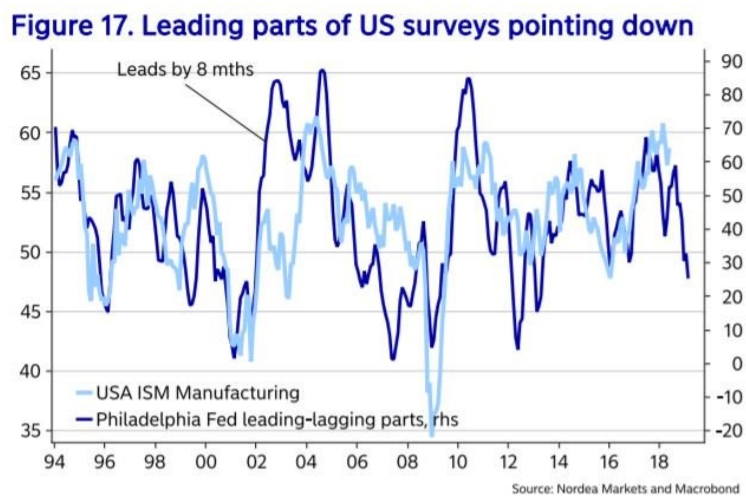
Gold vs. Oil



Nautilus put out this cycle chart, which looks at the ratio between gold and crude oil and the cycle pattern it's been tracking since the early 1990s. Their analysis shows that the cycle bottoms at the end of this month, which would imply that gold will rally and outperform oil.

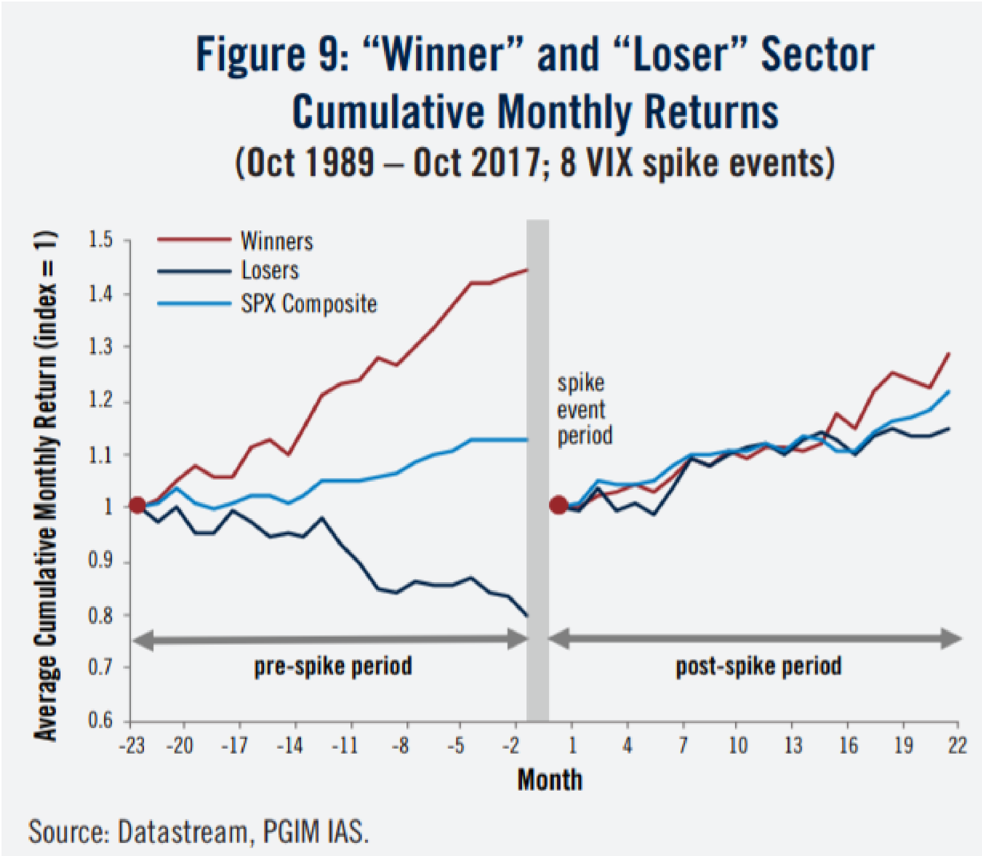
I recently was on TD Ameritrade Network's Futures with Ben Lichenstein Show discussing the energy market and crude oil. In the interview I comment that I believe oil has a stronger risk of moving lower than higher from here as the middle eastern conflicts and sanctions on Iran have been priced into the commodity. Click the above hyperlink to see the full interview and my other thoughts on oil. My main point is I agree with Nautilus's cycle work, especially when you pair it with the extremely low sentiment readings for (more on this later) for gold and the seasonal pattern for oil and the dollar, which are highly correlated. Outside of a macro event, I think oil prices will begin to work its way lower.

Is The ISM Index Headed Lower?



I came across two studies recently that suggest we could see a move lower in the U.S. ISM Manufacturing Production Index. This is important because the ISM Index has been one of the leading signs many have pointed to that the economy may be stronger than GDP data is suggesting. The Index set a high in January at 65 and the current level of 62.3 is still very strong. The first chart above from Variant Perception advances the inverted year-over-year change in the 10-year Treasury Yield by 18 months. The move higher in the Treasury Yield, as this chart suggests, will create a headwind for the ISM and could send it below 50 by later this year. This pairs well with the research of Nordea, which uses the Philly Fed Leading index to suggest the ISM Manufacturing Index will move from expansion to contraction before the end of 2018.

Volatility Acts as a Sector "Reset"

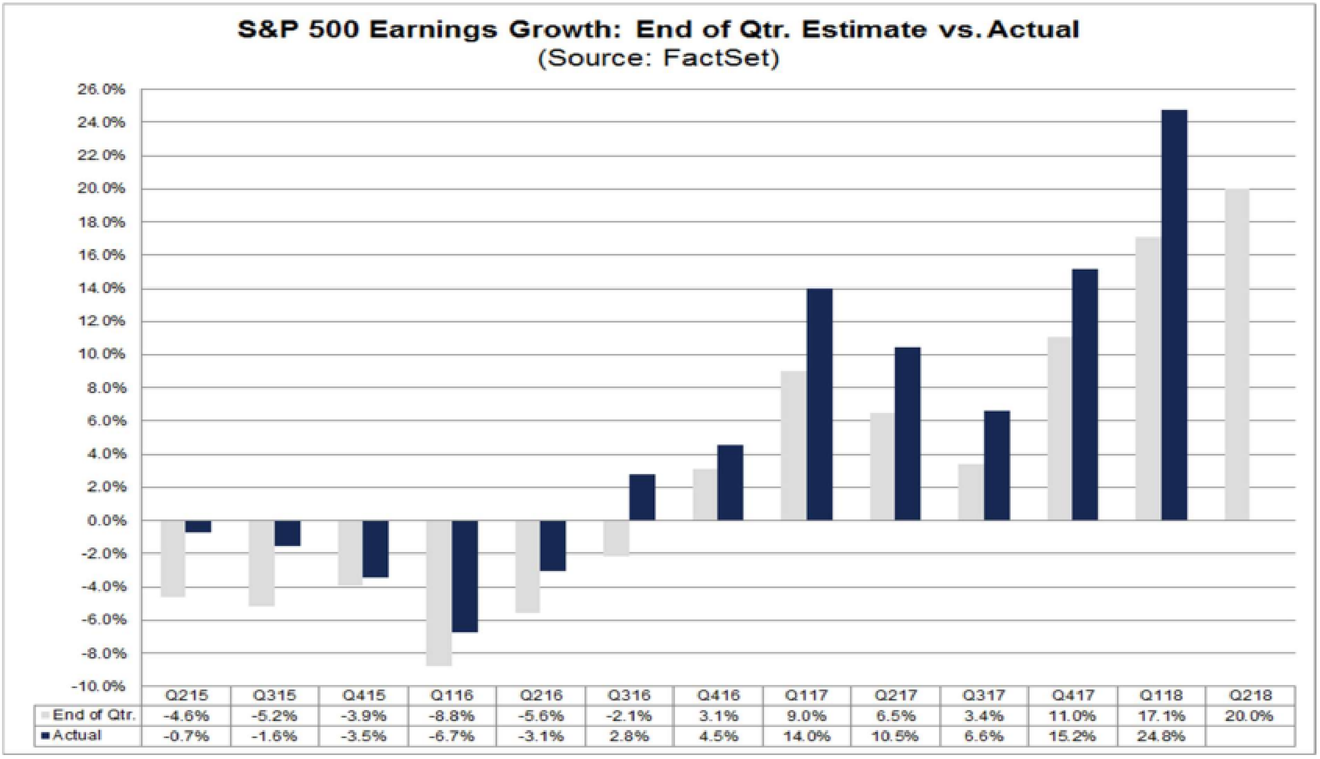


PGIM recently completed a study of the impact on the market when volatility spikes higher. Among other things, they found that the sectors that were showing the strongest performance (Winners) converge with those that were showing the weakest performance (Losers) once volatility spikes higher. While many believe that the strongest sectors going into a period of high volatility will be where traders first turn after the volatility event, PGIM's study found that's not the case. Instead, volatility acts as a "rest" to sector performance, with the Winners and Losers moving with the market for at least the first 6-10 months post-spike. This shows that momentum-style investing sees volatility as a significant risk to the strategy, which often buys the strongest stocks or sectors within a market.

Financial Conditions Lead Emerging Markets

Knowledge Leaders Capital produced the above chart during their bullish argument for emerging market stocks going into the third quarter. The red line shows the LIBOR-OIS spread, advanced by 3 months with the blue line being the relative strength of emerging markets. Their research found that financial conditions, as measured by the LIBOR-OIS spread, lead EM, and currently suggests that we could be seeing a bottom in emerging markets while financial conditions become more favorable.

Second Quarter Earnings Expectations



FactSet has released their latest analysis going into second quarter earnings season. Within the very extensive report, here are the points I believe are important for you to consider:

- Analysts currently estimate 20% earnings growth for Q2. While Q1 was believed to have been a strong quarter, the bar has been raised for Q2. Over the last five years, S&P companies have typically beat estimates by 4.4% and 70% of companies reported EPS above estimates. This would imply Q2 earnings growth will come in at 23.2%, nearly topping the incredible numbers put up by U.S. companies in Q1.
- Historically analysts lower their estimates, except this quarter they've actually been raising their forecasts by 0.8%. Over the last 10 years, earnings estimates have fallen by 5% on average during the quarter. This shows just how high the bar is getting set for Q2.
- Looking at the sector level, five sectors have seen an increase in expected earnings: energy, materials, and tech seeing the largest increases. Meanwhile, five sectors have seen a decrease in expectations, lead by the consumer staples sector.
- Currently 109 companies have given Q2 guidance , 62% of issued negative EPS guidance and 47 have issued positive guidance , implying 57% of companies issuing negative guidance which is below the five-year average of 72%.

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