

# Why Global Markets Will Shape Your Financial Future

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*“Do I buy what’s expensive, where the reality is really worse than advertised—meaning US stocks and bonds? Or do I buy a market that is cheap and perceived as troubled, where the reality isn’t nearly as bad.”*

-Famed investor and creator of Fundamental Indexing, ROB ARNOTT

*“Always drink upstream from the herd.”*

-Advice from an old cowboy

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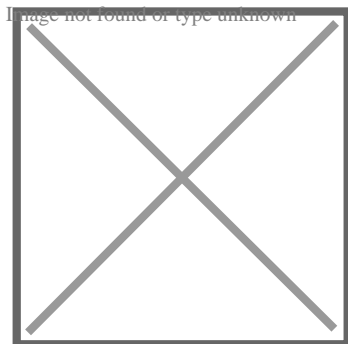
The relative absence of borders limiting participation in global markets has enabled internationally-minded investors to find opportunities that domestic-minded investors might miss. Much like the Silk Road, which opened opportunities to traders throughout Asia, Europe, and Africa, those willing to invest internationally have generally been rewarded for doing so.

But, stepping out blindly without a deep understanding of the intricacies and complexities of the global economy is a fool’s game. In our [June 23rd EVA](#), we presented our case for an internationally-minded investment framework, and briefly highlighted how our partnership with Gavekal, one of the leading independent macro-economic research firms in the world, allows us to overcome our “home country bias.”

In this week’s EVA, we present a conversation between Tyler Hay and Louis-Vincent Gave on global markets. Tyler is CEO of Evergreen Gavekal and Louis is CEO and founder of Gavekal, our partner at Evergreen Gavekal. In this conversation, the two discuss topics that include economic cycles, China, North Korea, international opportunities, the US dollar, cryptocurrencies and the future of the American workforce.

*(Note: This discussion took place at one of Evergreen’s business development events in downtown Bellevue on September 22nd, 2017 and has been summarized from its full-form. Clients will receive a separate email with a link and password to the full-length video. Prospective clients interested in watching the full video should reach out to their Evergreen Gavekal advisor or email [info@evergreengavekal.com](mailto:info@evergreengavekal.com).)*

*The opinions expressed by Louis Gave are his own and do not necessarily reflect those of Evergreen GaveKal.*



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**Tyler:** How do economic cycles impact markets?

**Louis:** The way I've come to see the world over the last 10 years is that everything that changes our world structurally starts in the US. If you look at tech, medical advances, those things start off right here in the US. But, everything that's cyclical starts in China. An example is that a year and a half ago, everyone said that you had to be invested in the US because that's the only place you could find growth. However, over the past 18 months, the US has underperformed pretty much everywhere; both in terms of markets but also in terms of economic growth.

Now, growth in Europe and Japan is greater than it is in the US, which hasn't happened in a while. This isn't because of anything the US has done. If you look at the past 5 years, the US has grown between 2 and 2.5% annually. There's been no cyclical impetus in the US. The shift in the world economy has not occurred because of the US. The cyclical shift we've seen has occurred first and foremost because of China.

The biggest surprise of 2016 wasn't Donald Trump or Brexit; neither of these things were as big for the markets as the rebound in China's growth. If you recall, in early 2016, everyone said that China was about to implode. Yet, in 2016, instead of imploding, China reaccelerated. This reacceleration drove growth all over the world. If you want to understand how cycles impact markets, you have to pay attention to China because China is the cyclical impetus.

**Tyler:** How should we feel about China today?

**Louis:** It's a tricky question because we're entering a period of potential political transition in China. Soon, China will have its 19th Party Congress - where political leaders and policy priorities will be defined. While no one can know what will happen, what we do know is that we're entering into the 19th Party Congress in the midst of a big political clash between President Xi Jinping and the Chinese Communist Party. On one hand, Xi Jinping wants to be another Vladimir Putin and monopolize power. On the other, the Chinese Communist Party believes management by committee is much better.

The good news is that we will know on October 26th whether Xi Jinping or the Communist Party won. If Xi Jinping loses, the cyclical impetus of China will go into hyper-drive.

**Tyler:** What's your perspective on the North Korean situation and how could it impact markets?

**Louis:** The first point I'd highlight is that I don't believe China has as much handle on the situation as many in the US believe. A lot of what Kim Jong-Un is doing is telling both China and the US not to mess with him. The way you can tell, is that at his father's funeral, there were eight pallbearers. Six have now been executed. Why? For being too close to China.

When Donald Trump met with Xi Jinping in Florida in April, Trump essentially told Jinping that he needed to handle the North Korea problem. Xi Jinping's plan was to replace Kim Jong-Un with his younger half-brother. But that information was leaked, most likely by the Chinese Communist Party because of the internal battle Xi Jinping is facing, and Kim had his own half-brother executed. This left Xi Jinping with few cards to play.

The bottom line is that most Asian countries can learn to live with a nuclear North Korea. For Kim Jong-Un, having a nuclear bomb is purely about survival. They're not going to start a war - at least that's the perception in Asia.

**Tyler:** What are your favorite Asian markets and what metrics do you look at to evaluate those markets?

**Louis:** Looking at markets, we rank countries on the interaction of growth and inflation, the relative valuation of currencies on a purchasing power parity basis, the growth of liquidity from a central bank and domestic commercial bank view, the impact of commodities and the impact of global trade.

If you look at this year, South Korea has done well, despite all of the negative headlines. I also like China. The Chinese market is extremely momentum-driven. Today, the Chinese market is ripping higher and if nothing bad comes out of the 19th Party Congress, markets will continue to rip until year-end and through the first quarter of 2018.

**Tyler:** Where are there other opportunities internationally?

**Louis:** We first have to acknowledge that there's been a paradigm shift. As money managers, the worst we can do is not keep up with inflation. From 1980 to 2008, we had central banks all over the world saying they wanted to bring inflation down. This meant they were fighting in our corner; they were making our jobs easier. Today, central banks want to bring inflation up despite the fact that capitalism is about making more with less.

In their bid to push up inflation, they have destroyed cash and fixed income returns and basically sent the message that in order to beat inflation, you have to take more and more risk or find investment niches. If you're a medium-sized money manager, that's still a viable option but it's impossible for larger money managers.

**Tyler:** What's your view on the pace and reverberation of the Fed unwinding its balance sheet?

**Louis:** It's a very important development. If you look at total central banks around the world, in 2015 they pushed an extra \$1 trillion into the system. In 2016, they pushed \$2 trillion. In 2017, they're going to push another \$2 trillion. And you may wonder, "Why did they push \$2 trillion into the system in 2017?" There was no financial crisis anywhere in the world. You haven't even had a 5% pullback in any major stock market.

When I started in this business, I was told that managing money is an easy game; you have to know whether there's more money than fools, or more fools than money. If there's more money than fools, you buy stocks. If there's more fools than money, you buy bonds. One of the very odd things about this bull market is that you have all the tell-tale signs that we're at the top of the market. But, usually at the top of the market, you'll have bankers knocking at your door with IPOs and financial products that drain liquidity from the system. Today, we don't have that.

Instead, over the past ten years, the world has lost about 3,500 listings to private equity, mergers, and acquisitions. If you look here in the US at the Wilshire 5000, it really only has 3,691 companies because there's not 5,000 stocks you could put in there. In the US, there have been fewer and fewer listed companies, and more and more money being injected.

But, things are going to change next year. Between the European Central Bank tapering and the Fed shrinking its balance sheet, we will basically go from \$2 trillion in 2017 to close to \$0 in 2018. This will make for a very different investment landscape. I think it will make for higher bond yields and for steeper yield curves. If that's the case, then it doesn't mean equity markets will collapse, but the rotation within equity markets will be vicious. There will be a big rotation from growth back to value and the rotation within the markets will leave a lot of unprepared investors nursing wounds.

**Tyler:** What's your outlook on the US dollar?

**Louis:** To be honest, I don't like the US dollar. The single most important macro-economic development over the last year has been the turnaround of the US dollar. Today, the US dollar is clearly in a bear market. It keeps making lower-lows and lower-highs, but most investors in the world are still overweight it for historical reasons. Meanwhile, budget deficits in the US are about to go through the roof which will be fundamentally bearish for the US dollar.

**Tyler:** What's your view on cryptocurrencies?

**Louis:** I don't think real currencies go up 400% in three weeks. Cryptocurrencies don't really behave as currencies. Currencies are supposed to be a store of value first-and-foremost. I look at them and see them as speculative instruments.

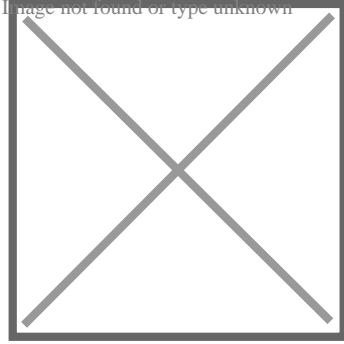
These "currencies" were created to get around capital and government controls. That was a big part of their growth. Cryptocurrencies are now forcing governments to get rid of these controls. And, as this happens, perhaps the enthusiasm for cryptocurrencies will start to wane.

**Tyler:** The rise of robotics is a fascinating subject that's received a lot of coverage lately. What do you think the market will look like in 20 years if much of the labor force is replaced by robotics?

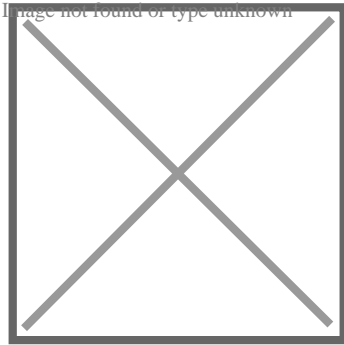
**Louis:** The need for human interaction at the low-end of the jobs spectrum is diminishing. It is a genuine societal problem because you could look at almost any workforce and say, "There's 20% or 25% whose skills are very limited."

Take the US as an example: 4% of the workforce drives automobiles for a living. That 4% of the US workforce, which is millions and millions of jobs, is going to disappear in the next several years. We've seen something similar before between the 1920s and 1940s when 50% of the workforce of most western nations was in farming. Then, we mechanized farming, and in one generation many people were forced to move into cities. This massive dislocation created horrible political movements like Fascism and Communism because it left people looking for answers.

**Tyler:** Thanks for sharing your perspective on global markets, Louis. It's been fascinating to hear your thoughts on these important topics.



**Tyler Hay**  
Chief Executive Officer



**Louis Gave**  
Founder and CEO, Gavekal

*Please remember that clients will receive an email with instructions on how to view this full-length video. Prospects should reach out to their advisor or [info@evergreengavekal.com](mailto:info@evergreengavekal.com) for information.*

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## OUR CURRENT LIKES AND DISLIKES

Changes highlighted in **bold**.

### LIKE

- Large-cap growth (during a correction)
- International developed markets (during a correction)
- Canadian REITs (on a pull-back after a healthy recent run-up)
- Cash
- Publicly-traded pipeline partnerships (MLPs) yielding 7%-12% (we like them even more after their recent correction)
- Intermediate-term investment-grade corporate bonds, yielding approximately 4%
- Gold-mining stocks
- Gold
- Select blue chip oil stocks (wait for a pull-back after their recent strong run)
- Mexican stocks (at lower prices after this year's strong rally)
- Bonds denominated in renminbi trading in Hong Kong (dim sum bonds)
- Short euro ETF **(due to its weakness of late, refrain from initiating or adding to this short)**

## NEUTRAL

- Most cyclical resource-based stocks
- Short-term investment grade corporate bonds
- High-quality preferred stocks yielding 6%
- Mid-cap growth
- Emerging stock markets, however a number of Asian developing markets, ex-India, appear undervalued
- Floating-rate bank debt (junk)
- Select European banks
- BB-rated corporate bonds (i.e., high-quality, high yield)
- Investment-grade floating rate corporate bonds
- Long-term Treasury bonds
- Long-term investment grade corporate bonds
- Intermediate-term Treasury bonds
- Long-term municipal bonds
- Intermediate municipal bonds with strong credit ratings
- Emerging bond markets (dollar-based or hedged); local currency in a few select cases
- Solar Yield Cos (taking partial profits on these)
- Large-cap value

## DISLIKE

- US-based Real Estate Investment Trusts (REITs) (once again, some small-and mid-cap issues appear attractive; also, some retail exposed REITs look deeply undervalued)
- Small-cap value
- Mid-cap value
- Small-cap growth
- Lower-rated junk bonds
- Canadian dollar-denominated bonds (the loonie is currently overbought)

- Short yen ETF (in fact, the yen looks poised to rally)
- Emerging market bonds (local currency)
- Emerging market bonds (local currency)

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