Trade or Trend?

Key economic indicators and capital market events for February 2014 by Joe Terranova, Chief Market Strategist

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Heading into February, the asset allocation consensus for 2014 has been wrong. Following the significant appreciation of global risk assets in 2013, is this just a trade where a natural price and sentiment correction unfolds, allowing for further appreciation as the year evolves? Or are we in the initial stages of a trend that would prove the consensus for 2014 asset allocation incorrect? Year to date, the Nikkei is down a significant 8%, emerging markets are down 7%, and the S&P 500® is down over 3.5%, as of January 28. Yet, gold is up 4% for the year and bonds ironically have had their best start to the year since 2008. With volatility in the emerging markets, particularly currencies, driving asset valuations, February's calendar is less about U.S. economic data and more global headline driven.

February 2014

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
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2	3 10:00 AM: **U.S. ISM Mfg.** **Reaction to China and Global PMIs**	4 **Disney, Estee Lauder Michael Kors, Ralph Lauren, Earnings***	5	6 **BOE Meeting**	7 8:30 AM: **U.S. Labor Report** **Sochi Olympics Open**	8
9	10 **Q4 Earnings Final Stretch**	11 **China Trade Balance**	12	13	14 **France Q4 GDP**	15
16	17 **BOJ Monetary Policy Update** **U.S. Holiday Markets Closed**	18	19 2:00 PM: **FOMC Minutes** **BOE Meeting Minutes**	20 **Reaction to China Flash PMI** **G20 Finance Ministers Mtg.**	21	22
23 **Sochi Olympics Close**	24 **U.S. Debt Ceiling Deadline**	25	26	27	28 **China PMI (February)**	

*Times shown are Eastern Time. *Expected earnings release date; may be subject to change.*

February indicators / events of note:	You should be watching:
U.S. ISM Manufacturing Index The ISM Manufacturing Index is issued by the Institute of Supply Management, and provides an influential monthly measure of the health of U.S. manufacturing based on an in-depth survey of 300 manufacturing firms. An index value of 50 is the dividing line between an expanding or slowing economy. Data released is for the previous month.	Clearly U.S. manufacturing conditions are the strongest globally, and remain supportive of a goods over services investment strategy. Strong manufacturing data has allowed the Federal Reserve to be ahead of its global central bank peers in reducing the unprecedented easy money policy. Consensus expectation is for a moderation in ISM manufacturing. I would argue anything back below 54.0 would be a concern. We haven't seen a reading below 55.4 since the June 50.9 print. U.S. ISM manufacturing readings for the last eight months: > December 57.0 — > August 55.7 > November 57.3 — > July 55.4 > October 56.4 — > June 50.9 > September 56.2 — > May 49.0
Market Reaction to China and Global Mfg. PMI Each country's PMI (purchasing managers' index) is a key measure of the state of that country's manufacturing sector. An index value above 50 indicates growth, below 50 contraction.	**China PMI** –The importance of China on global markets is elevated this month. Unfortunately, China is viewed as the mother of emerging markets, largely dictating much of the sentiment surrounding all emerging markets. Most important will be the market reaction to China's January PMI print released over the prior weekend. In early January, global markets turned lower when China's advance HSBC Flash PMI suggested that manufacturing conditions had deteriorated once again. Last month's China PMI was 51 and consensus is looking for a 50.5 print this month. Should we get a 51 surprise to the upside, this could indicate the stabilization in emerging markets volatility that we need, and would be more suggestive of a trade than a trend. The jury is still out. **Global PMIs** – It will also be important to monitor other global PMIs this month. In Europe, U.K. PMI is worth watching as it will outline to the Bank of England ahead of its monetary policy meeting, just how strong its economy is accelerating. We should also pay special attention to emerging market PMIs right now, including Brazil, Argentina, South Africa, Indonesia, and Turkey. South Korea PMI is also important as that tends to be a fairly strong second emerging markets indicator to China's manufacturing reading.
Earnings Reports: Disney, Estee Lauder, Michael Kors, and Ralph Lauren* On Tuesday, February 4, a number of consumer discretionary bellwethers are expected to release earnings: Disney (DIS), Estee Lauder (EL), Michael Kors (KORS), and Ralph Lauren.	Consumer discretionary, which was one of 2013's strongest sectors to lead the S&P 500 higher, is underperforming this year. On February 4, we'll get a meaningful measure of how consumer discretionary companies performed in the fourth quarter, as we hear from some "best of breed" names in the sector: Disney, whose results will include the Thanksgiving and Christmas holidays; Estee Lauder and Ralph Lauren, both of which were beneficiaries of the recovery in Europe and saw a lift in their stock late in the year; and Michael Kors, currently considered the global consumer discretionary bellwether. I'd like to see if these companies are displaying resiliency in what appears to be overall weakness in the consumer discretionary space.

*Expected earnings release date; may be subject to change.

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Bank of England (BOE) Meeting The BOE releases its monetary policy announcement on February 6 following its monthly meeting.	In terms of developed markets, the U.K. is the next economy whose central bank will start to move away from, or reduce, the quantitative easing measures of the last couple of years. Strength in the U.K. on most metrics, in particular the improving labor conditions, is rather impressive. I'm not sure this is the meeting where the BOE does something – such as reducing the current $375 billion asset purchase program or raising interest rates from the current 50 bps – but I do think they begin to position themselves for reducing asset purchases or start talking about guidance more specifically. The January decline in asset prices has investors asking whether this is a trend or a trade, but if the U.K. can join the U.S. in terms of growth, maybe a trend is developing that will be able to provide investors with some clarity on what looks cloudy right now.
Q4 Earnings Final Stretch Earnings reporting season nears to a close the week of February 10.	This week we're in the "quarter pull" of earnings season, with 60 S&P 500 companies reporting, pushing the total reporting to date well above 400. We should get an accurate read of whether there is, in fact, continued positive growth momentum in earnings. As I write this, 144 S&P 500 companies have reported, with EPS growth of 10.72% and sales growth of 3.87%. My all-important metric of profit margin has risen to 9.25%, continuing five consecutive quarters of expansion.
U.S. Labor Report Private payroll data is part of the Labor Department's monthly U.S. Employment Situation report. This data gives the true employment story, is the best gauge of the economy's direction, and has the power to move markets.	Clearly, weather conditions had a negative impact on the last (December) report. The January report will provide economic evidence on whether the positive momentum that appeared to have stalled in December was real or distorted by weather, as I believe. Evidence to that was the sharp rise in households surveyed to 273,000 reporting to not be at work due to weather conditions. That's nearly double the historical average for the month of December and the highest level since 1977. In December, the headline jobs number added only 74,000 jobs, private payrolls added 87,000, and the unemployment rate dropped to 6.7%. Expectations for January's figures call for a sharp snap-back in the numbers: a headline number of 180,000 to 190,000, private payrolls coming in at 190,000 to 200,000, and the unemployment rate staying at 6.7%.
China Trade Balance The monthly China trade balance report provides important import, export, and interest rate data on the Chinese economy.	With China perceived as the mother of emerging markets, global risk assets are highly sensitive to what is reported out of China. China trade balance is back on our radar and we need to start watching again. Last month, China imports rose 8.3%, but exports rose only 4.3%, which is a problem. The trade balance is still running a surplus, currently $25.6 billion, thankfully. Heaven forbid, China lets its trade balance slip into deficit which is the problem right now for Brazil, India, and Turkey. I don't think that's going to occur. Since May 2010 when China exports were 48.5%, there's been nothing but a series of lower highs and we keep making lower lows. In 2013, we had our first negative print since 2009, so we need to get this number, I would argue, back to mid-double digits, above the fall high of 12.7%.

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France Q4 GDP France's gross domestic product (GDP) growth rate provides an aggregated measure of changes in the value of goods and services produced by this struggling EU country.	I've never included France GDP in the monthly calendar before but it's time. I believe Europe is healing at an incredible pace. However, France remains one area of concern and bears watching. We want to see what's occurring with Europe's so-called "weak sisters," and France clearly is one. The country continues to struggle, as last month's GDP was down 0.10% quarter on quarter. France hasn't achieved a GDP print near 2% on a year-on-year basis since the euro crisis began in early 2011. France continues to waffle, with no growth, and I want to start closely monitoring it.
Bank of Japan (BOJ) Monetary Policy Update The central bank of Japan holds its monthly monetary policy meeting on February 17.	We need to continue to pay attention to the Bank of Japan's monetary policy. The Nikkei Index is under duress. The yen is moving in the wrong direction; it's appreciated 2.5% year to date as we write this. That's not what the BOJ is looking for in terms of growth potential – export growth in particular. Japan's consumption tax hike is coming up in April, and they need to offset it in some capacity. This is where they lay the framework and foundation for future fiscal and monetary easing measures. How do they continue to support what's been a really strong trend since November 2012?
FOMC Minutes The minutes from the January 28-29 FOMC meeting will be released, the first meeting since Janet Yellen assumed Fed leadership.	The focus will be on the "voice" of Janet Yellen. We'll want to read the minutes to try to understand what her leadership will mean for the Fed. Will there be a seamless transition in leadership in the sense of no sentiment change or language change to monetary policy? Many have rightfully suggested that Bernanke and Yellen are one and the same in their views – is that truly the case? Or will she do something to stand out on her own?
Bank of England (BOE) Minutes The Bank of England releases the minutes from its February 6 monetary policy meeting.	We don't expect any policy changes to come out of the February 6 BOE meeting, but how intensive is the conversation about reducing monetary policy? Similar to what the Federal Reserve is doing, I would expect them to be talking about unemployment rate targets and similar growth metrics.
Market Reaction to China Flash PMI China HSBC Flash Manufacturing PMI gives an advance reading of manufacturing conditions for the current month. Official (final) Manufacturing PMI is released on the last day of the month, which when combined with the monthly U.S. ISM Manufacturing Index figure released the next day, gives a clear picture of global manufacturing health. An index value above 50 indicates growth, below 50 contraction.	I don't generally pay attention to the China HSBC Flash PMI, but when the market reacts as it did when that report came out at 49.6 on January 22, below the expectation of 50.5, you have to pay heed to it. If anything, instead of waiting 30 days for China's official end-of-month PMI, the Flash PMI gives us an interim reading.

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G20 Finance Ministers Meeting The meeting of the G20 finance ministers will be held in Sydney, Australia.	The G20 meeting is very important, especially as it will take place in Australia, which has struggled and underperformed its global peers. There's been an extreme reliance on commodities and interest rates on the part of emerging markets, Australia, and Canada. These countries have lived day to day over the last couple of years as though interest rates would be low forever and commodity prices high forever. Investors should look to this meeting for some form of coordination to address some of the current emerging markets volatility.
U.S. Debt Ceiling Deadline The U.S. federal government once again faces the debt ceiling deadline of when it will exhaust its borrowing authority and will be unable to pay its obligations unless the federal debt limit is raised.	The day after the closing ceremonies of the Sochi Winter Olympics, the focus turns back to the U.S. The federal debt ceiling deadline clock begins ticking on this day. U.S. Treasury Secretary Jack Lew recently suggested this issue needs to be addressed by the end of February. I think the debate needs to begin here in order to get a favorable resolution ironed out over the following weeks in March before the funds of the extraordinary measures are potentially exhausted. As a condition for reaching resolution on the debt ceiling limit, I expect Republicans will push for approval of the Keystone pipeline, which was recently suggested by Senate Minority Leader Mitch McConnell. That, I would argue, would be incredibly favorable for the U.S. economy.

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JOSEPH M. TERRANOVA, *Chief Market Strategist, Virtus Investment Partners*

Joe Terranova is chief market strategist for Virtus Investment Partners, a position he was elevated to in 2009, after having started with the company as chief alternatives strategist. In his current role, Mr. Terranova works with Virtus' regional sales teams and the financial advisors who sell the company's investment products, providing insight into the domestic and global investing landscape and has represented Virtus as a keynote speaker for several financial institutions. He is a member of the Virtus Investment Oversight Committee.

Prior to joining Virtus in 2008, Mr. Terranova spent 18 years at MBF Clearing Corp., rising to the position of director of trading for the company and its subsidiaries. In this capacity, he managed more than 300 traders and support staff for MBF, one of the New York Mercantile Exchange's largest firms. His work was highlighted as the feature story in the June 2004 issue of *Futures* magazine.

Mr. Terranova is perhaps best known for his risk management skills, honed while overseeing MBF's proprietary trading operations during some of the most calamitous times for the U.S. markets, including the first Gulf War, the 1998 Asian Crisis, 9/11, and the collapse of Amaranth Advisors. In 2003, he was one of the first Wall Street professionals to make an early call for higher energy, natural resources, and commodity prices. In June 2008, he cautioned investors to move to the sidelines in commodities and, in March 2009, he encouraged investors to ignore the global "embracement of pessimism" and overweight equities. Before joining MBF, Mr. Terranova held positions at both Swiss Banking Corp. and JP Morgan Securities.

Mr. Terranova has been an ensemble member of the CNBC *Fast Money* franchise since 2008. He also frequently contributes exclusively to CNBC's other business programs. He is the author of *"Buy High, Sell Higher"* (Business Plus, 2012), a book about the "new rules" of investing based on his years as a professional trader.

Mr. Terranova is strongly committed to charitable causes benefiting children. He founded and funds the 501(c) South Nassau Rock organization, which provides specialized athletic experiences for children, and works with Nassau County to sponsor the improvement of baseball and outdoor ice rink facilities. In 2007, he established "Bossy's Bunch," a program that rewards academic excellence among elementary school students, with New York Islanders Hall of Fame hockey player Mike Bossy. In 2013, he expanded his charity work with the Islanders, creating and sponsoring the "Courier of Courage" program, which acknowledges children who have overcome hardships, disabilities, or illness.

Mr. Terranova earned a bachelor's degree in finance from the Peter J. Tobin College of Business at St. John's University in New York.

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