The FCO Cockpit – Global Bubble Status Report

Peter Cauwels & Didier Sornette
Chair of Entrepreneurial Risk
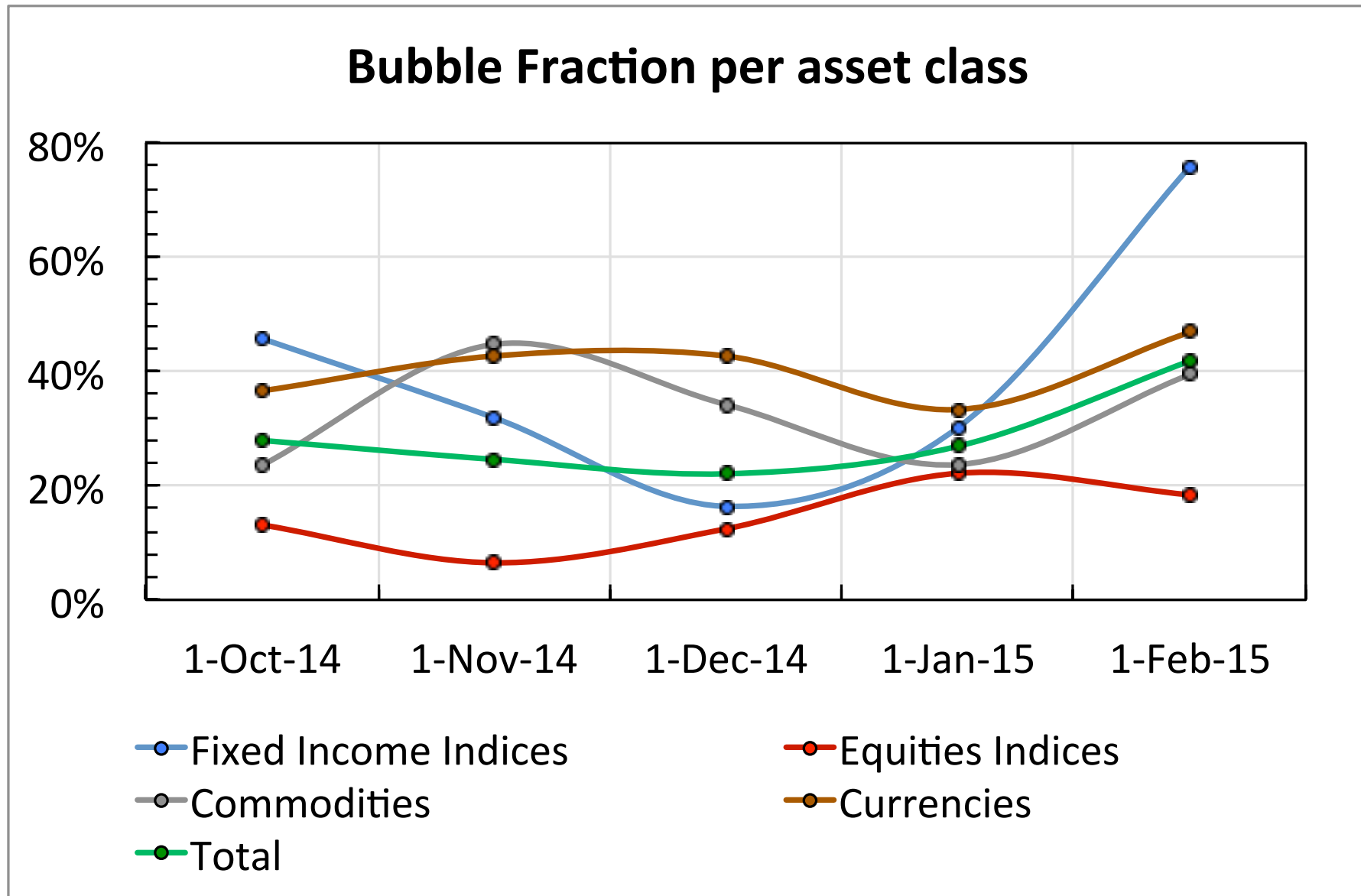
February 1st, 2015

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435 systemic assets are monitored

	# Assets	# Bubbles February 1st	% Bubbles February 1st	% Bubbles January 1st 2015	% Bubbles December 1st	% Bubbles November	% Bubbles October 1st
Fixed Income Indices	116	88	76%	30%	14%	32%	46%
Government	34	28	82%	67%	36%	67%	73%
Corporate	82	60	73%	16%	5%	18%	35%
Equities Indices	185	34	18%	22%	12%	6%	13%
Country	78	16	21%	21%	10%	6%	21%
US-Sector	63	17	27%	38%	22%	6%	11%
EUR-Sector	32	1	3%	3%	3%	9%	3%
Special	12	0	0%	0%	0%	25%	20%
Commodities	38	15	39%	24%	34%	45%	24%
Currencies	96	45	47%	33%	43%	43%	36%
Total	435	182	42%	27%	21%	25%	28%

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Bubble Fraction per asset class

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Main themes of this report:

- The ECB's QE announcement of Jan 22 has had a very significant impact on European Fixed Income indices. We see an unprecedented increase in positive bubble warning signals[+] both in country as in sector indices;
- There is evidence of an imminent Risk-on to Risk-off switch in global markets. Investors are rushing into defense assets as can be seen in:
  - the significant increase in positive bubble warning signals[+] in US Fixed Income Sector Indices;
  - the significant increase in positive bubble warning signals[+] in defensive stocks (like consumers, retail, food, staples, health care …);
  - a first but still soft signal on dividend stocks;
  - and the negative bubble warning signals[°] in base metals especially in Copper;
- The dollar rules, the momentum is extremely strong and global in a wide range of currency pairs;
- Rouble, Russian stocks and oil continue their decline.

[+] *A positive bubble warning signal is an indication of herding when people start buying because prices go up.*
[°] *A negative bubble warning signal is an indication of herding when people start selling because prices go down.*

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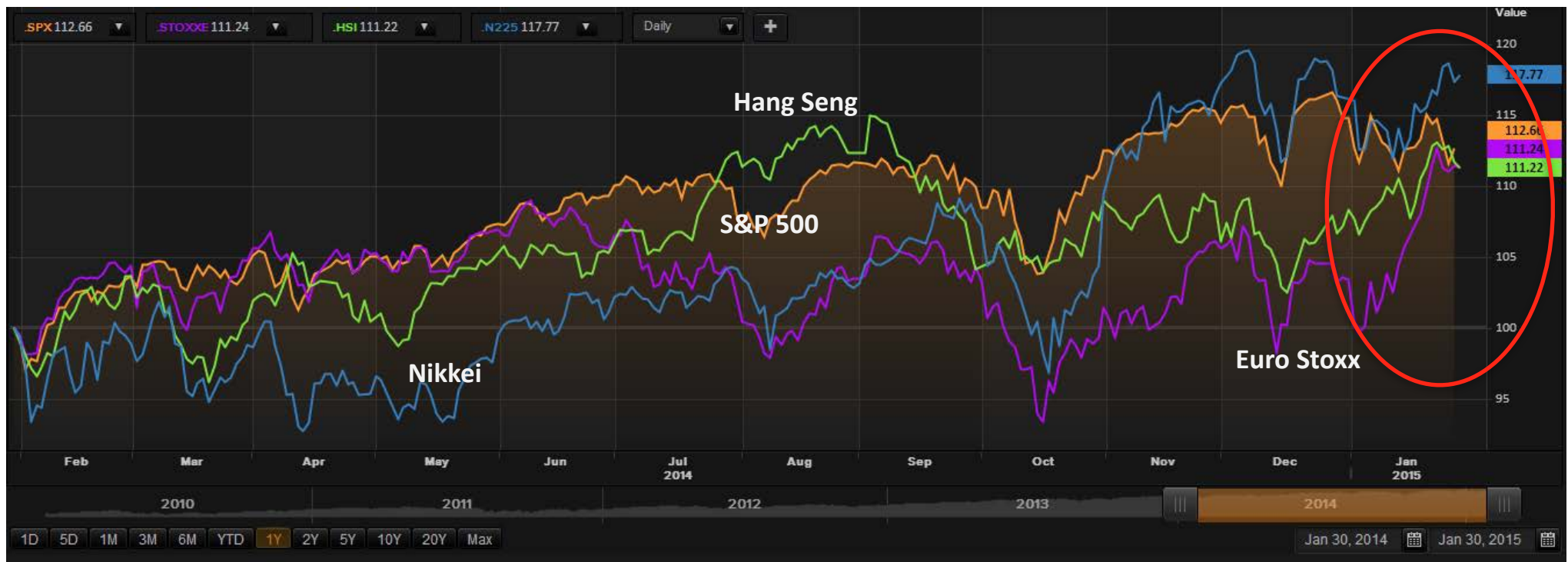
Broad View:
We analyse data with a minimum window of three months and a maximum window of one year. This plot shows the performance of some major equity indices over the past year (the time series are rebased to 100). We see that the ´Draghi Put` puts European equities back in the running, catching up with global indices in one single month.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Asset Class – Fixed Income Country Indices

Fixed Income Country Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
iBoxx EUR Austria	13.3%	40.1%	62.5%
iBoxx EUR Belgium	15.5%	44.1%	73.0%
iBoxx EUR Finland	10.5%	36.7%	60.8%
iBoxx EUR France	13.1%	39.0%	65.2%
iBoxx EUR Germany	10.7%	36.7%	67.2%
iBoxx EUR Ireland	12.7%	15.4%	26.8%
iBoxx EUR Italy	15.9%	16.0%	36.7%
iBoxx EUR Luxembourg	10.8%	18.5%	6.6%
iBoxx EUR Netherlands	12.3%	34.5%	54.8%
iBoxx EUR Spain	14.9%	14.6%	27.4%
iBoxx EUR Supranationals	11.1%	28.8%	23.8%
iBoxx Asia China Government	11.1%	36.3%	13.5%
iBoxx Asia India Government	17.4%	54.2%	42.6%
iBoxx Asia Indonesia Government	22.9%	17.6%	41.3%
iBoxx Asia Korea Government	10.2%	9.4%	8.0%
iBoxx Asia Philippines Government	12.0%	25.9%	27.2%

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Asset Class – Fixed Income Country Indices

We see an increase in warning signals in European Fixed Income indices that is unprecedented. This is the ECB QE announcement/guidance at work.

Interestingly however, ECB purchases will only start in two months.
From Draghi's speech in Jan 22:
„ In March 2015 the Eurosystem will start to purchase euro-denominated investment-grade securities issued by euro area governments and agencies and European institutions in the secondary market. "
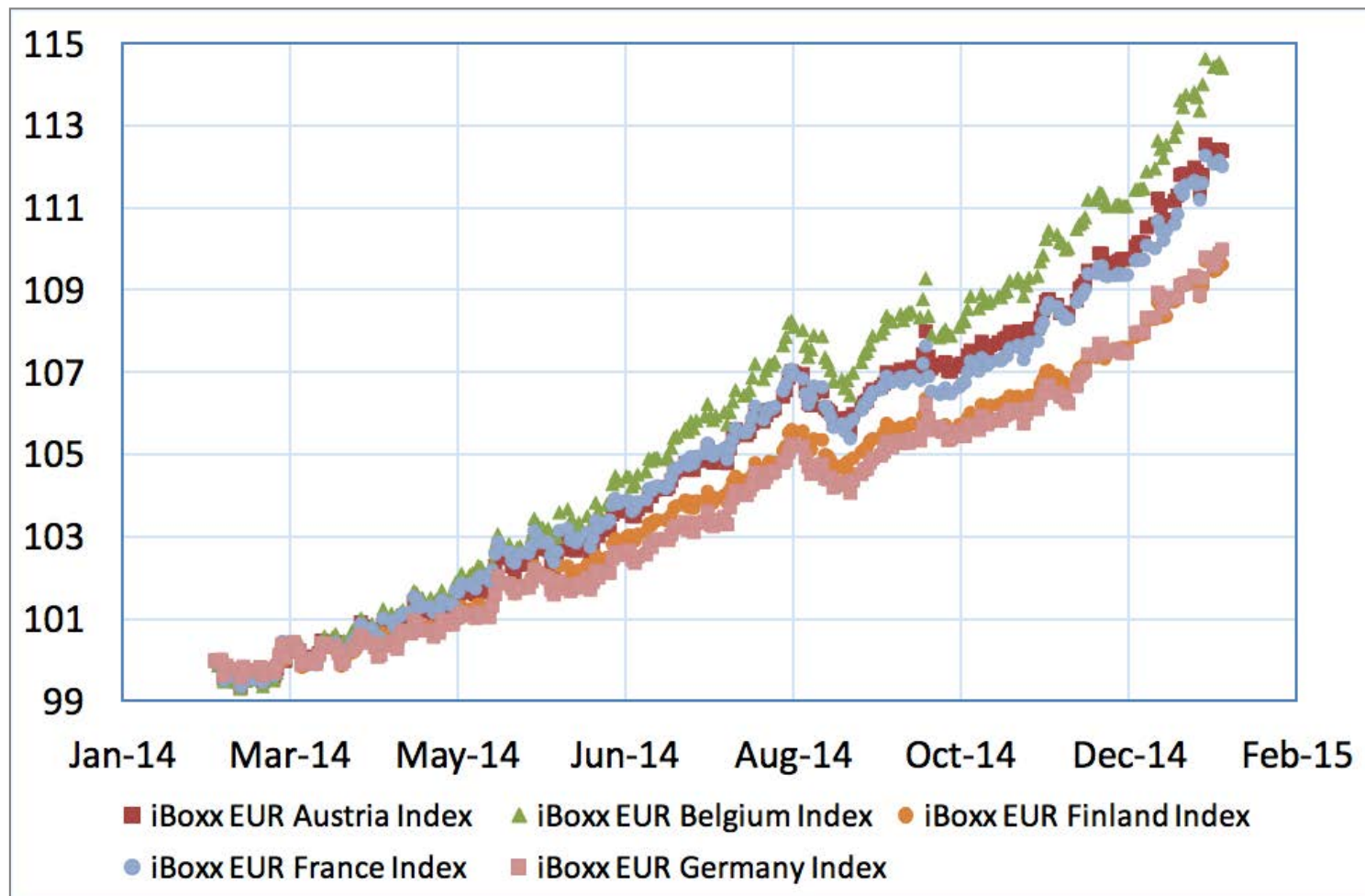(Source: http://www.ecb.europa.eu/press/pressconf/2015/html/is150122.en.html)

Furthermore, the strong trend in Asian Fixed Income indices continues. It started a few months ago with China and India, now Indonesia, Korea and the Philippines have joined the rankings.

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European Fixed Income Indices
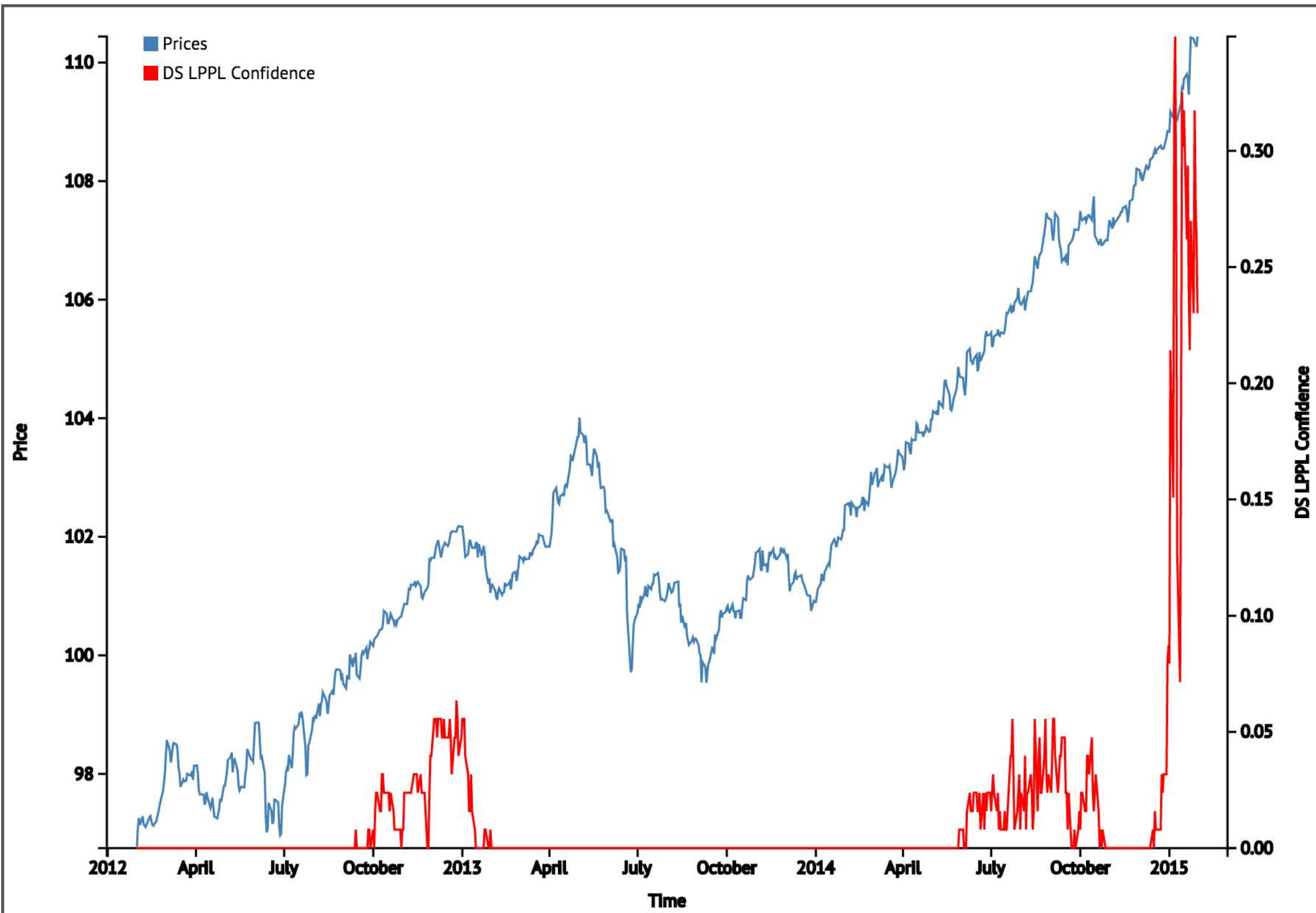

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich
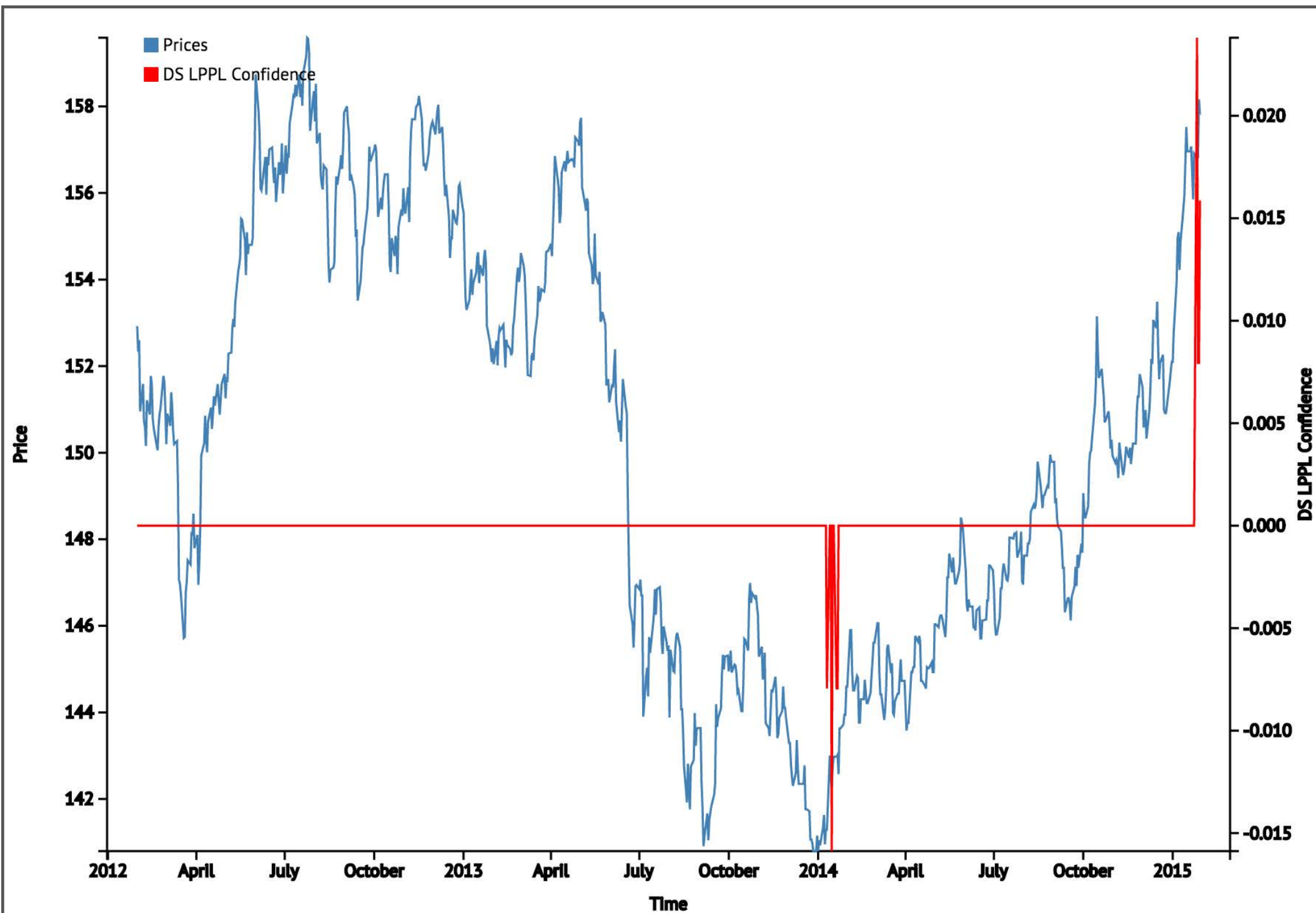
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Asian Fixed Income Indices
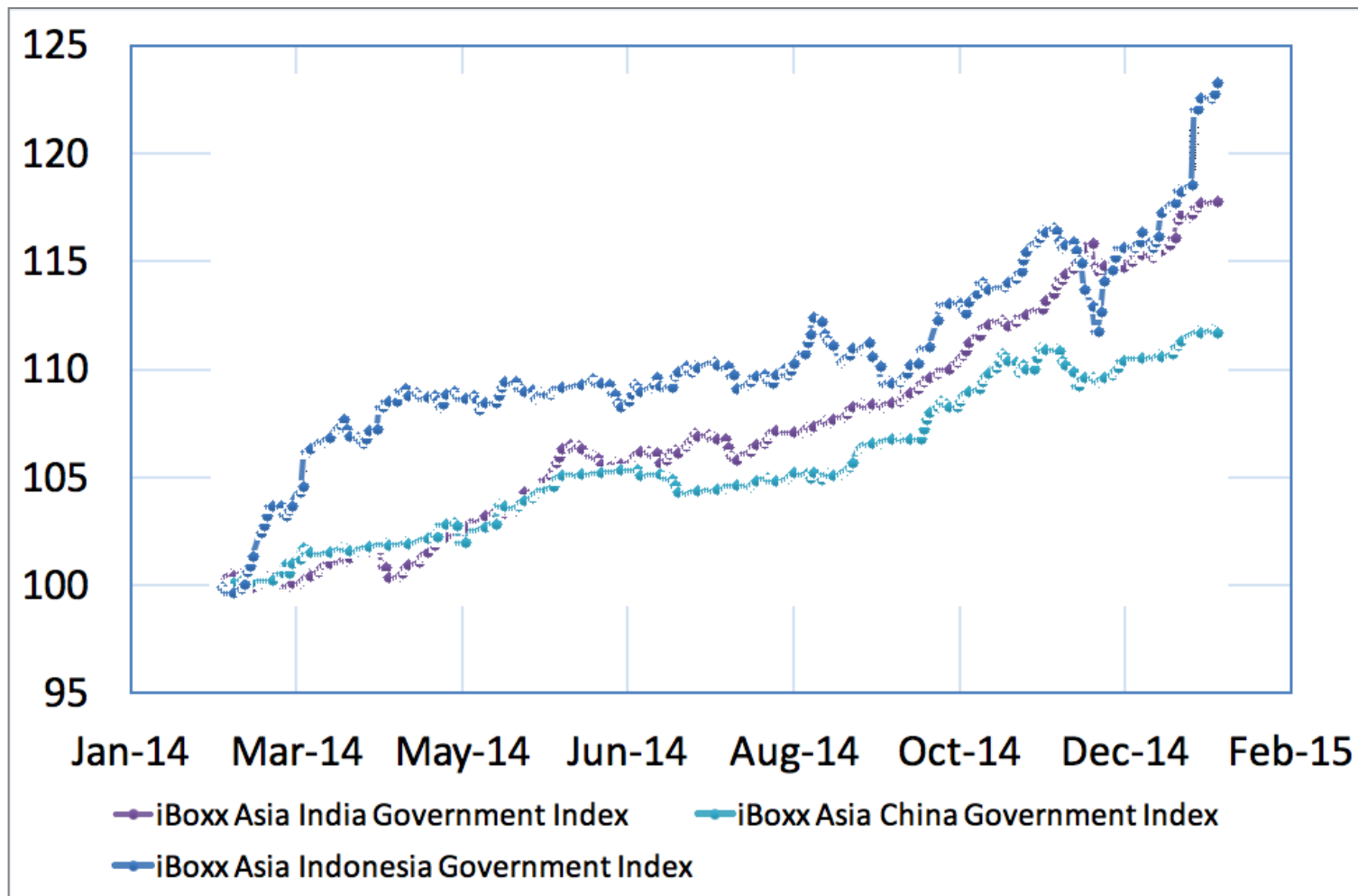
Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich
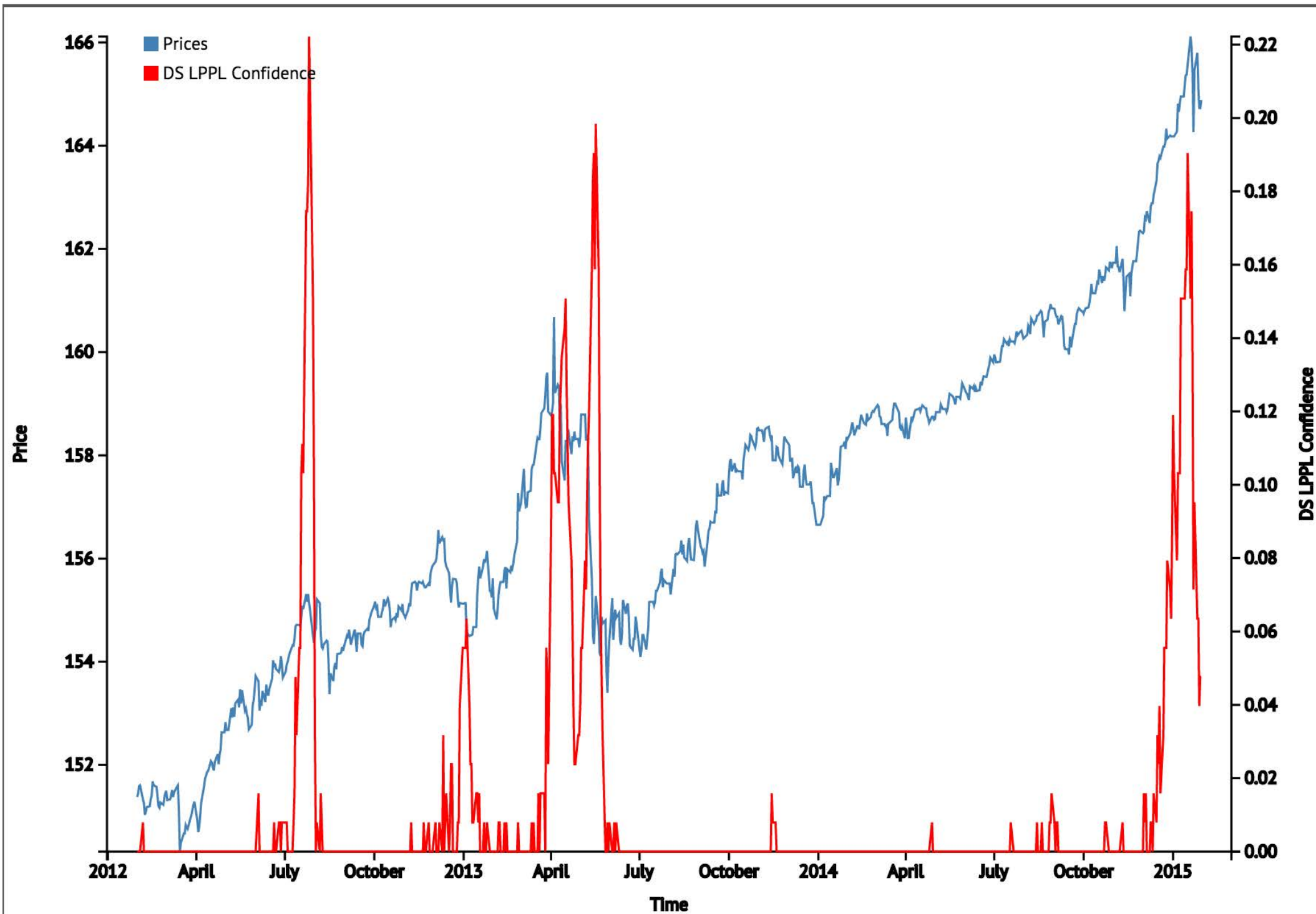
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Asset Class – Fixed Income Sector Indices

Fixed Income Sector Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
iBoxx EUR Utilities	10.1%	39.7%	20.0%
iBoxx EUR Technology	13.9%	36.5%	33.6%
iBoxx EUR Financial Services Subordinated	12.1%	36.4%	26.7%
iBoxx EUR Insurance	10.4%	27.0%	55.0%
iBoxx EUR Insurance Subordinated	11.5%	16.7%	40.3%
iBoxx USD General Retailers	11.4%	16.1%	45.9%
iBoxx USD Industrial Transportation	13.0%	15.3%	38.0%
iBoxx USD Insurance	10.6%	14.2%	33.9%
iBoxx USD Retail	10.8%	12.9%	36.2%
iBoxx USD Electricity	14.3%	12.3%	35.8%
iBoxx USD Aerospace & Defense	10.3%	11.6%	32.2%
iBoxx USD Insurance Senior	10.4%	11.3%	37.4%
iBoxx USD Life Insurance	11.1%	11.0%	26.2%
iBoxx USD Financials Subordinated	10.4%	10.6%	23.4%
iBoxx USD Utilities	12.9%	9.9%	28.9%
iBoxx USD Banks Subordinated	10.5%	9.9%	22.3%
iBoxx USD Consumer Services	12.4%	9.6%	31.2%
iBoxx USD Insurance Subordinated	11.5%	8.8%	19.1%
iBoxx USD Media	14.3%	8.0%	26.2%
iBoxx USD Leisure Goods	10.4%	5.1%	25.1%

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Asset Class – Fixed Income Sector Indices

Also in Fixed Income Sector Indices, the move in warning signals over the past month has been impressive both in European as in US assets.
The former is related to the announced ECB QE program, the latter may point to a general flight-to-quality or flight-to-safety at the beginning of the new year. Could this be a first signal of an imminent Risk-on to Risk-off switch?

For comparison, in the analysis of last month, there were hardly any signals in Fixed Income Sector Indices that were worthwhile mentioning. Now, 73% of the analysed time series shows a warning. This is indicative of a very strong global momentum in the asset class over the past month.

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Asset Class – Equities Sector Indices

Positive Bubbles			
S&P 500 Specialty Retail	33%	32%	33%
S&P 500 Health Care Prvdrs&Sv	33%	25%	22%
S&P 500 Divsf Financi Sv	22%	24%	10%
S&P 500 Multiline Retail	27%	24%	22%
S&P 500 Health Care Equip&Spls	25%	23%	11%
S&P 500 Textls, Aprl & Lxry Gds	14%	18%	8%
S&P 500 Food&Staples Retailing	30%	17%	13%
S&P 500 Electric Utilities	30%	16%	25%
S&P 500 - REITs	35%	13%	34%
S&P 500 Multi-Utilities	29%	11%	29%
S&P 500 Airlines	84%	11%	10%
S&P 500 - Pharmaceuticals	22%	7%	10%
S&P 500 Household Durables	21%	6%	9%
Negative Bubbles			
S&P 500 Engy Equipment & Sv	-18%	21%	25%
S&P 500 Construction& Eng	-29%	15%	32%
S&P 500 Oil, Gas & Cnsmbl Fuel	-9%	12%	26%
S&P 500 Metals & Mining	-17%	11%	36%
STOXX Europe 600 Oil & Gas EUR Price	-8%	28%	21%

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Asset Class – Equities Sector Indices

US stocks are expensive, but what is specifically interesting is the defensive nature of the stocks that give clear bubble warning signals mostly in consumer goods like retail, food & staples, household durables, textiles, ...

Investors are rushing into defensive stocks: *Could this be an indication of an imminent risk-on to risk-off switch, or are these stocks just catching up?*

The strong momentum in airlines stocks continues, this is driven by the low oil prices. When oil prices find the bottom, we may see a rush for the exit in airlines stocks.

Furthermore, we see negative bubble signals in energy, construction, metals & mining stocks. This is consistent with the information we get from analysing commodities prices.

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Asset Class – Equities Sector Indices
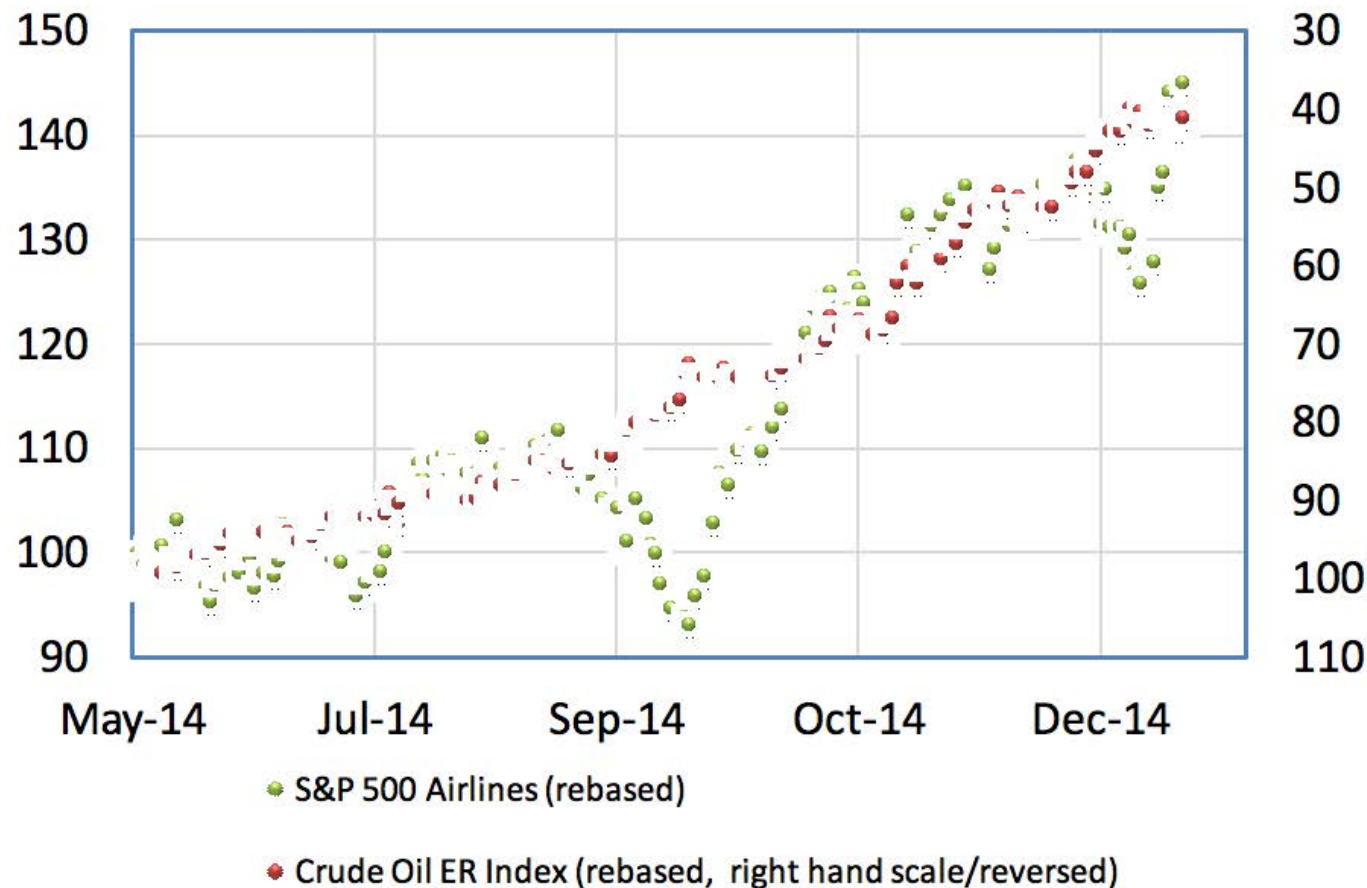
It is interesting to see that the strong momentum in Airlines is driven by the decline in oil prices. This creates positive bubble signals.

In the graph on the left, the indices are rebased to 100 and the Oil Index is reversed and should be read from the right hand axis.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Asset Class – Equities Country Indices

Equities Country Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence	Country
Positive Bubbles				
Shanghai SE Composite	59%	36%	39%	China
SZSE 100	45%	26%	30%	China
New Zealand Se Top50 Free	18%	16%	15%	New Zealand
Karachi SE 100	29%	12%	48%	Pakistan
Dow Jones Composite	16%	6%	8%	US
Negative Bubbles				
RTS	-42%	26%	19%	Russia
Athex Genal Composite Share Price	-35%	19%	43%	Greece
Lima SE Selective	-17%	15%	22%	Peru
CSE Genal	-28%	13%	8%	Cyprus
Colombia SE Genal	-10%	14%	26%	Colombia

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- Over the last two months, Chinese stocks have massively outperformed the US, Europe and Latin America;
- The graph above shows the indices rebased to 100, over a half a year of history. So, the last marks show the half-yearly performance (40%-50% for Shanghai/Shenzhen);
- We see global equities markets at three different speeds: China ahead, in the middle, we have the US, Europe, HK and Japan, and finally, Latin America is lagging.
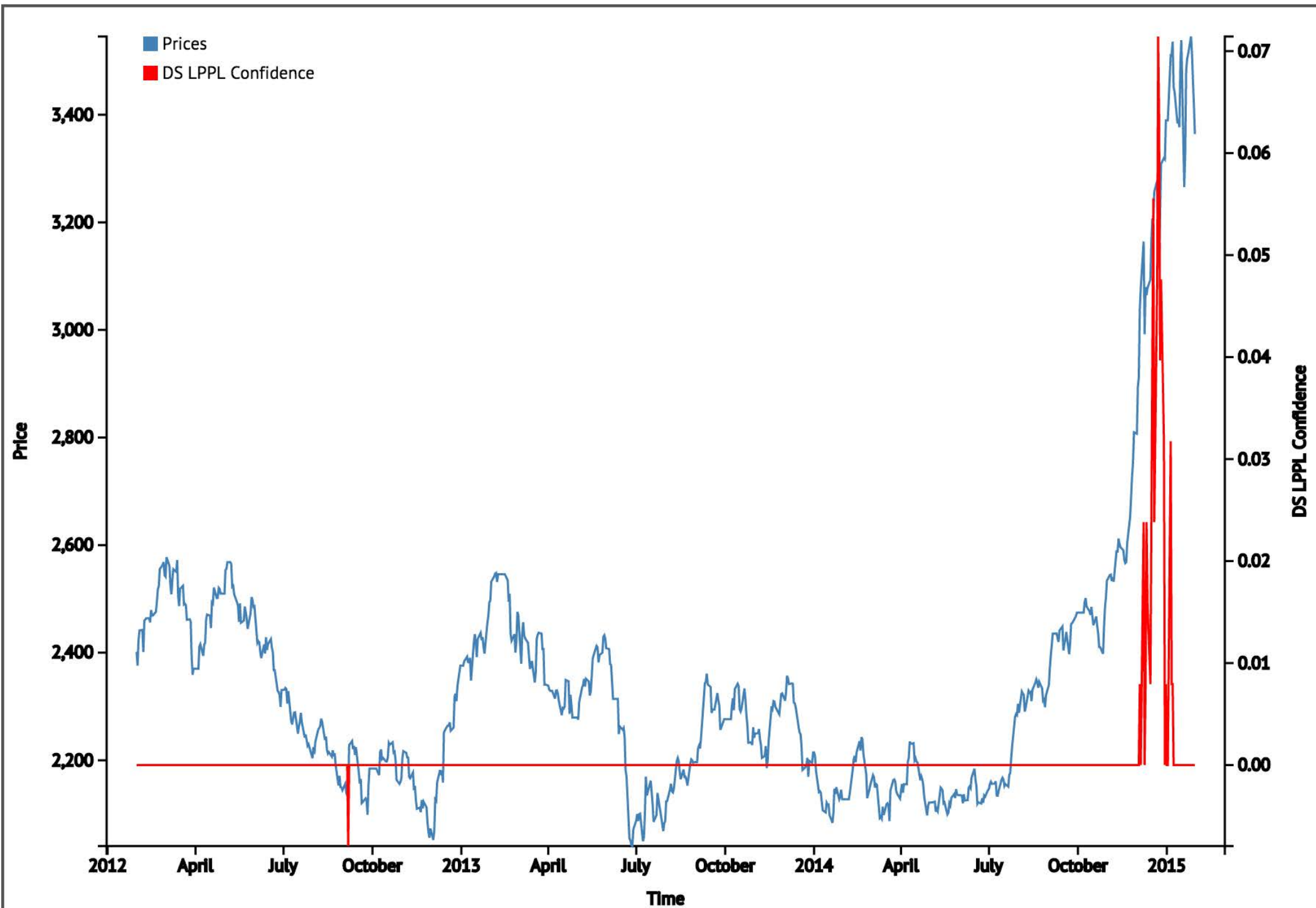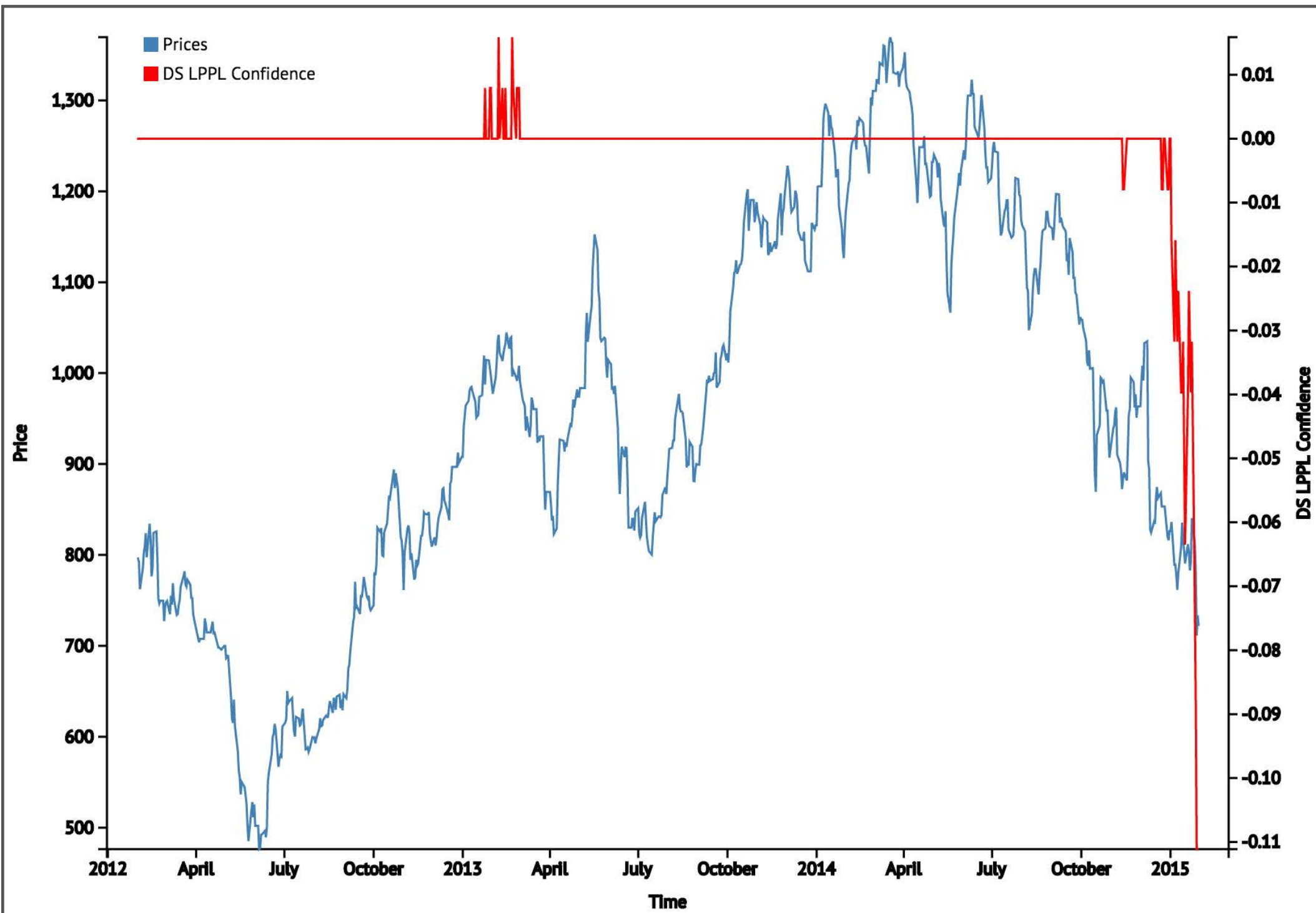
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Asset Class – Equities Indices

The indicators point to an interesting dynamic that was set in motion last summer.

On the one hand, we see:
- Negative bubble signals appearing in Europe along an old faultline where we see Greece and Portugal declining again;
- Negative bubble signals in European energy related stocks (and in Russia);

On the other hand, we see:
- A continued strong momentum in US stocks;
- A significant strengthening of the US Dollar.

This observation in our sentiment indices is confirmed in the figure on the next slide.

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The big picture:
- Greek and Portuguese stock markets are clearly underperforming the broad European Index;
- In the past months we have seen strong negative bubble signals in EUR/USD, Greece and Portugal;
- It is striking to see the simultaneous decline in EUR/USD and Greece/Portugal;
- It seems as though the announced ECB QE intervention had a positive impact on Portugal but not on Greece (most likely this is related to the elections of last Sunday and the fact that QE may apply differently to Greece).

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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The big picture:
- The old classification of core Europe versus periphery seems to have changed somewhat. The GIPSI group (Greece, Italy, Portugal, Spain and Ireland) is divided with mainly Portugal and Greece strongly underperforming;
- The above graph shows the equity indices rebased to 100 over the previous year. So the final mark gives the performance over the previous year. Ireland's remarkable outperformance is striking;
- It seems as though Portugal is trying to catch up.

Source: Thomson Reuters Eikon, Chair of Entrepreneurial Risk ETH Zurich

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Asset Class – Equities Special Indices

Equities Special Indices	Yearly Return	DS LPPL Trust	DS LPPL Confidence
NASDAQ Dividend Achievs	13%	3%	13%
Dow Jones U.S. Select Dividend	15%	2%	8%

The warning signals on Dividend stocks are still premature and do not cross the 5% threshold, yet. However it is worthwhile mentioning here. It confirms the defensive nature of equities investments in the US that we also see in sector indices (consumers, retails, food and drugs, ...).

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Asset Class – Equities Single Stocks

Next to the 185 global sector and country equities Indices, we do a bubble analysis on single stocks taking all S&P 500 and Stoxx Europe 600 constituents with a market cap higher than $ 50 bn, and all Hang Seng and Nikkei constituents with a market cap higher than $ 15 bn.

In total, we analyzed 223 stocks, 55 of these show bubble signals (10 negative and 45 positive bubbles).

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Single Stocks	Yearly Return	DS LPPL Trust	DS LPPL Confidence	Sector	Country
Positive Bubbles					
Costco Wholesale Corp	25%	46%	24%	Other Discount Stores	US
Lowe's Companies Inc	51%	42%	31%	Other Home Improvement Products & Services Retailers	US
Fuji Heavy Industries Ltd	46%	34%	14%	Other Auto & Truck Manufacturers	JP
CVS Health Corp	48%	33%	41%	Other Drug Retailers	US
Shin-Etsu Chemical Co Ltd	35%	32%	24%	Other Commodity Chemicals	JP
Lockheed Martin Corp	28%	29%	19%	Other Aerospace & Defense	US
Berkshire Hathaway Inc	30%	28%	31%	Other Property & Casualty Insurance	US
Home Depot Inc	37%	27%	19%	Other Home Improvement Products & Services Retailers	US
UnitedHealth Group Inc	52%	24%	19%	Other Managed Healthcare	US
Celgene Corp	49%	21%	27%	Biopharmaceuticals	US
Actavis PLC	50%	18%	13%	Other Pharmaceuticals	US
Duke Energy Corp	27%	17%	35%	Other Electric Utilities	US
KDDI Corp	36%	17%	12%	Other Wireless Telecommunications Services	JP
Novartis AG	26%	14%	11%	Pharmaceuticals	EU
Simon Property Group Inc	44%	14%	47%	Retail REITs	US
Anheuser-Busch InBev SA	50%	13%	36%	Food & Beverage	EU
Eli Lilly and Co	31%	12%	23%	Other Pharmaceuticals	US
Central Japan Railway Co	80%	11%	25%	Other Passenger Transportation, Ground & Sea	JP
Bank of Communications Co Ltd	27%	11%	21%	Other Banks	HK
Sony Corp	64%	11%	18%	Other Household Electronics	JP

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Negative Bubbles					
Statoil ASA	-13%	26%	15%	Integrated Oil & Gas	EU
BG Group PLC	-15%	22%	23%	Integrated Oil & Gas	EU
BHP Billiton PLC	-21%	16%	32%	General Mining	EU
BP PLC	-11%	15%	32%	Integrated Oil & Gas	EU
Eni SpA	-11%	12%	33%	Integrated Oil & Gas	EU
Sands China Ltd	-32%	11%	17%	Other Casinos & Gaming	HK

The single stocks analysis confirms the analysis of the indices:

• Most bubble warning signals are in the US and Japan, for Europe there is only Novartis (which is Suisse) and Anhouser-Bush Inbev;
• Positive bubble signals are in defensive sectors;
• Negative bubble signals are in energy and mining, especially in Europe.

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Asset Class – Currencies

FX	Yearly Return	DS LPPL Trust	DS LPPL Confidence
US Dollar/Swedish Krona	28%	60%	75%
US Dollar/Romanian New Leu	19%	47%	72%
US Dollar/Polish Zloty	20%	36%	72%
US Dollar/Norwegian Krone	27%	52%	40%
US Dollar/Mexican Peso	10%	32%	22%
US Dollar/Japanese Yen	16%	22%	7%
US Dollar/Iceland Krona	16%	47%	74%
US Dollar/Hungarian Forint	21%	24%	56%
US Dollar/Danish Krone	20%	35%	63%
US Dollar/Czech Koruna	22%	32%	70%
US Dollar/Chilean Peso	14%	10%	18%
US Dollar/Canadian Dollar	13%	39%	75%
US Dollar/Bulgarian Lev	21%	31%	59%
US Dollar/Australian Dollar	11%	32%	36%

US Dollar strenghtening is global and bubble warning signals show up in a wide range of currency pairs.

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Asset Class – Currencies

Euro/US Dollar	-17%	34%	64%
Euro/Saudi Arabian Riyal	-21%	34%	62%
Euro/Qatar Rial	-21%	35%	63%
Euro/Hong Kong Dollar	-21%	36%	65%
Euro/Egyptian Pound	-11%	33%	48%
Euro/Chinese Renminbi	-17%	10%	30%
Russian Rouble/Euro	-38%	33%	29%
Russian Rouble/Swiss Franc	-47%	31%	58%
Russian Rouble/US Dollar	-96%	38%	38%

Continued strong momentum in Euro weaking and collapse of Russian Rouble

RUSSIAN ROUBLE TO US $

Two months ago, we classified the Rouble (EUR/USD/CHF) crosses as an archetype bubble signal, showing faster-than-exponential growth. After that, we saw a steep correction, but now weakening of the Rouble continues.

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Asset Class – Commodities

Commodities	Yearly Return	DS LPPL Trust	DS LPPL Confidence
Energy Related Products			
Gasoil	-50%	54%	39%
Heating Oil	-44%	51%	42%
Brent Crude	-56%	49%	45%
Gasoline	-47%	46%	43%
Petroleum	-52%	46%	49%
Engy	-51%	45%	49%
Crude Oil	-52%	40%	47%
Natural Gas	-46%	8%	22%
Base Metals			
HG Copp	-23%	17%	42%
Copp	-21%	11%	34%
Lead	-15%	9%	41%
Indtr Mtls	-10%	8%	30%

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Asset Class – Commodities

- Oil and related products continue their long-term slow crash. The negative bubble warning signals are very strong and confirm the long term trend in negative sentiment;
- The negative signal on Copper is a clear indication of a subdued global economic sentiment, this shows up now in other base metals like lead and in the broad industrial metals index. It may be another indication of an imminent risk-on/risk-off switch.

Crude Oil-WTI Spot Cushing U$/BBL

Oil (Brent in orange and WTI in purple), Rouble (in blue) and Russian Stocks (in green) are plunging. There is a very strong negative sentiment leading to strong bubble signals in Russian equities, Rouble exchange rates and Oil.
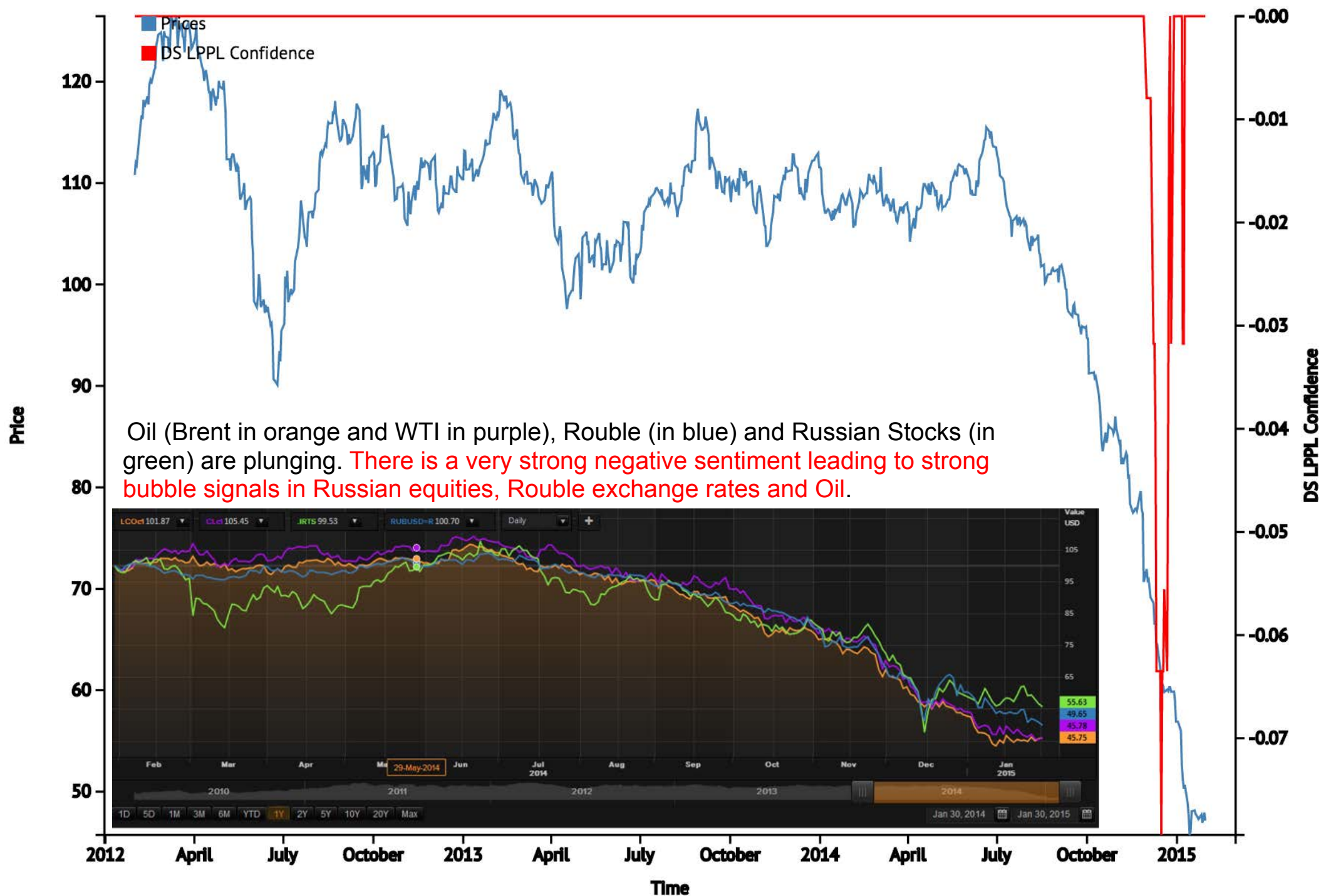
Conclusion

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Fixed Income:

- We see an increase in warning signals in European Fixed Income indices that is unprecedented. This is the ECB QE announcement/guidance clearly at work, even though they haven't started buying yet;
- Furthermore, the strong trend in Asian Fixed Income indices continues. It started a few months ago with China and India, now Indonesia, Korea and the Philippines have joined the rankings;
- Also in Fixed Income Sector Indices the move in warning signals over the past month has been very significant both in European as in US assets. The former is related to the announced ECB QE program, the latter may point to a general flight-to-quality or flight-to-safety at the beginning of the new year. *Could this be a first signal of an imminent Risk-on to Risk-off switch?*

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Equities:

- US stocks are expensive, but what is specifically striking is the defensive nature of the stocks that give strong bubble warning signals mostly in consumer goods like retail, food & staples, household durables, textiles, ... *Could this be an indication of an imminent risk-on/risk-off switch, or are these stocks merely catching up?* Some soft warning signals on Dividend stocks confirm the defensive nature of US equities investments;
- The strong moment in airlines stocks continues, this is driven by the low oil prices. When oil prices find the bottom we may see a rush for the exit in airlines stocks;
- Furthermore, we see negative bubble signals in energy, construction, metals & mining stocks. This is consistent with the information we get from analyzing commodities prices;
- We see global equities markets with three speeds: China ahead, in the middle, we have the US, Europe, HK and Japan, and finally, Latin America is lagging.

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Currencies

- US Dollar strengthening is global and bubble warning signals show up in a wide range of currency pairs. This represents a very significant global repricing;
- Continued strong momentum in weakening of the Euro;
- Weakening of Russian Rouble continues.

Commodities

- Oil and related products continue their long-term slow crash. The negative bubble warning signals are very strong and confirm the long term trend in negative sentiment;
- The negative signal on Copper is a clear indication of a subdued global economic sentiment, this shows up now in other base metals like lead and in the broad industrial metals index. It may be another indication of an imminent risk-on/risk-off switch.