

**Kim Wallace** – Washington & Global Policy

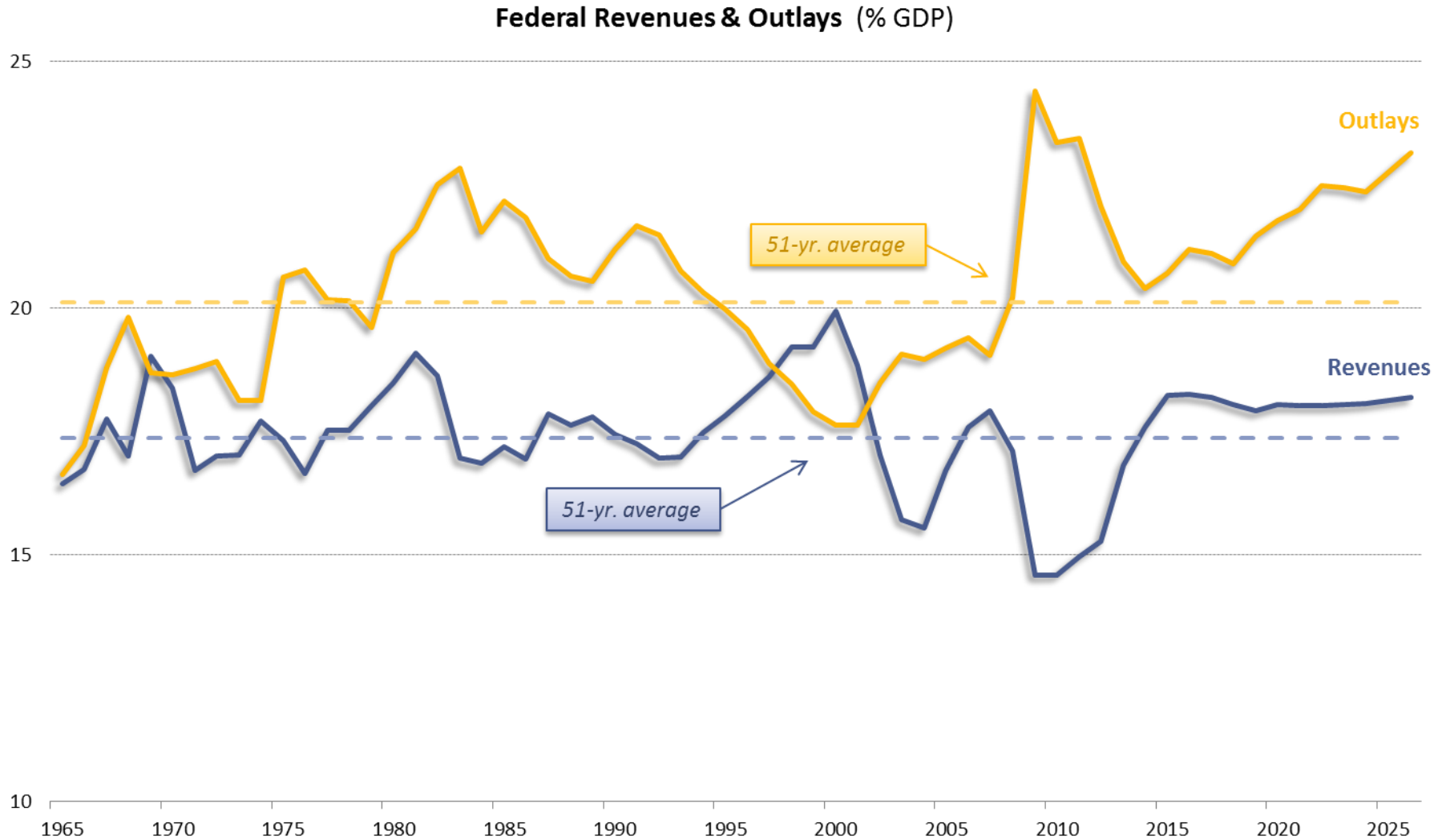
**Neil Dutta** – Economics

**Pete Ward** – Metals & Mining

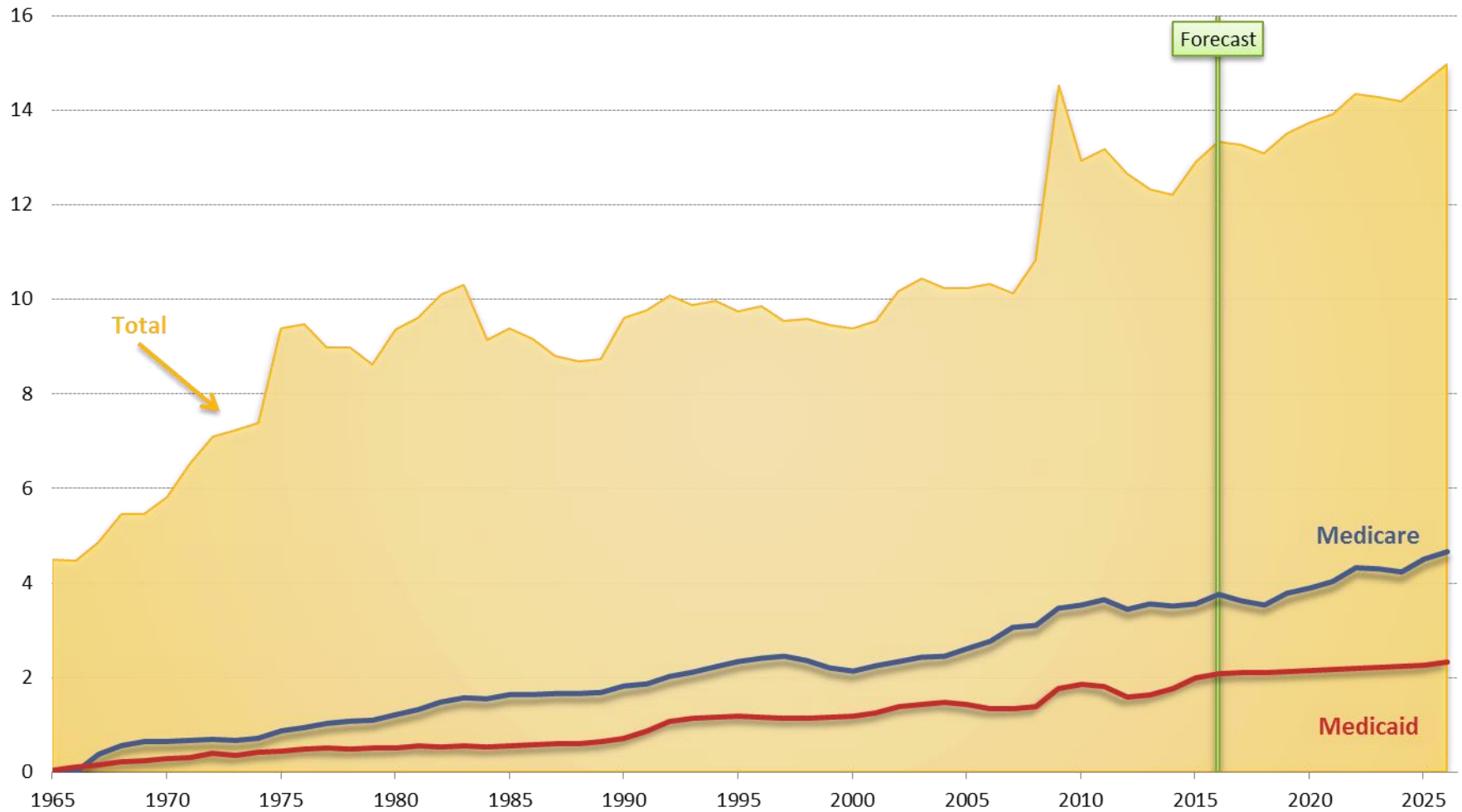
**Jeff deGraaf** – Market Technicals & Strategy

Kim Wallace

- US election: Uncertainties add to global governance concerns, a condition unlikely to abate before 4Q16
  - Campaigns rarely are strict guides to a president-elect's actual policy agenda
  - We continue to expect a divided government outcome; the next more likely scenario involves a divided GOP government
- US economic and corporate fundamentals: Sound enough to preclude further 2016 fiscal or monetary accommodation
- Fiscal policy: Balance of power next year matters, but not as much as the baseline, global economic fragilities, and a restless electorate
- Europe: Challenges preventing elected officials from enacting pro-investment and growth policies weaken ECB's liquidity programs – and the Union
- Geopolitics: Risks in Asia (including Russia) and the Middle East are long-run tests but manageable in the near term; UK referendum global implications long-lived

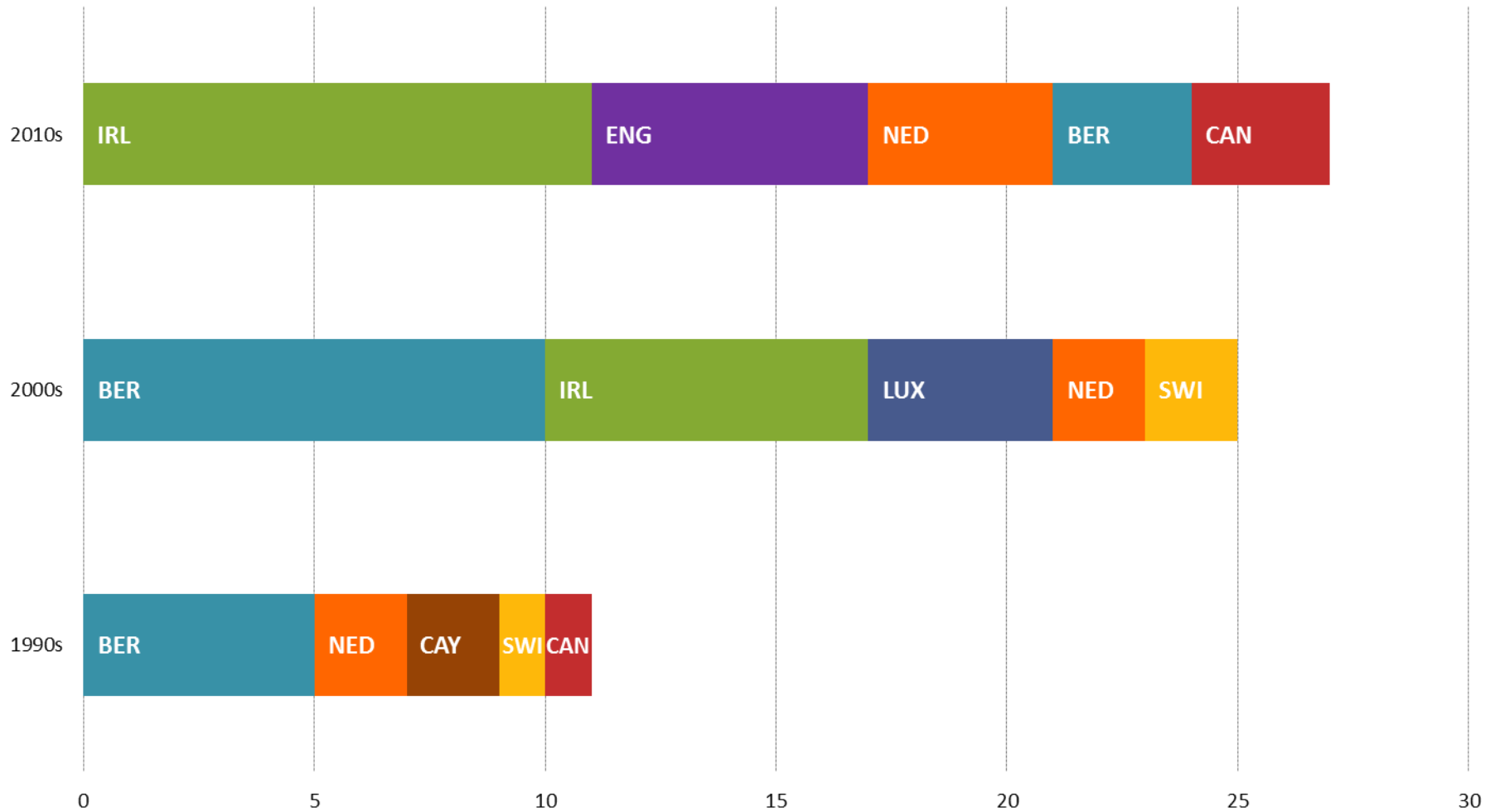


**Mandatory Outlays (% GDP)**

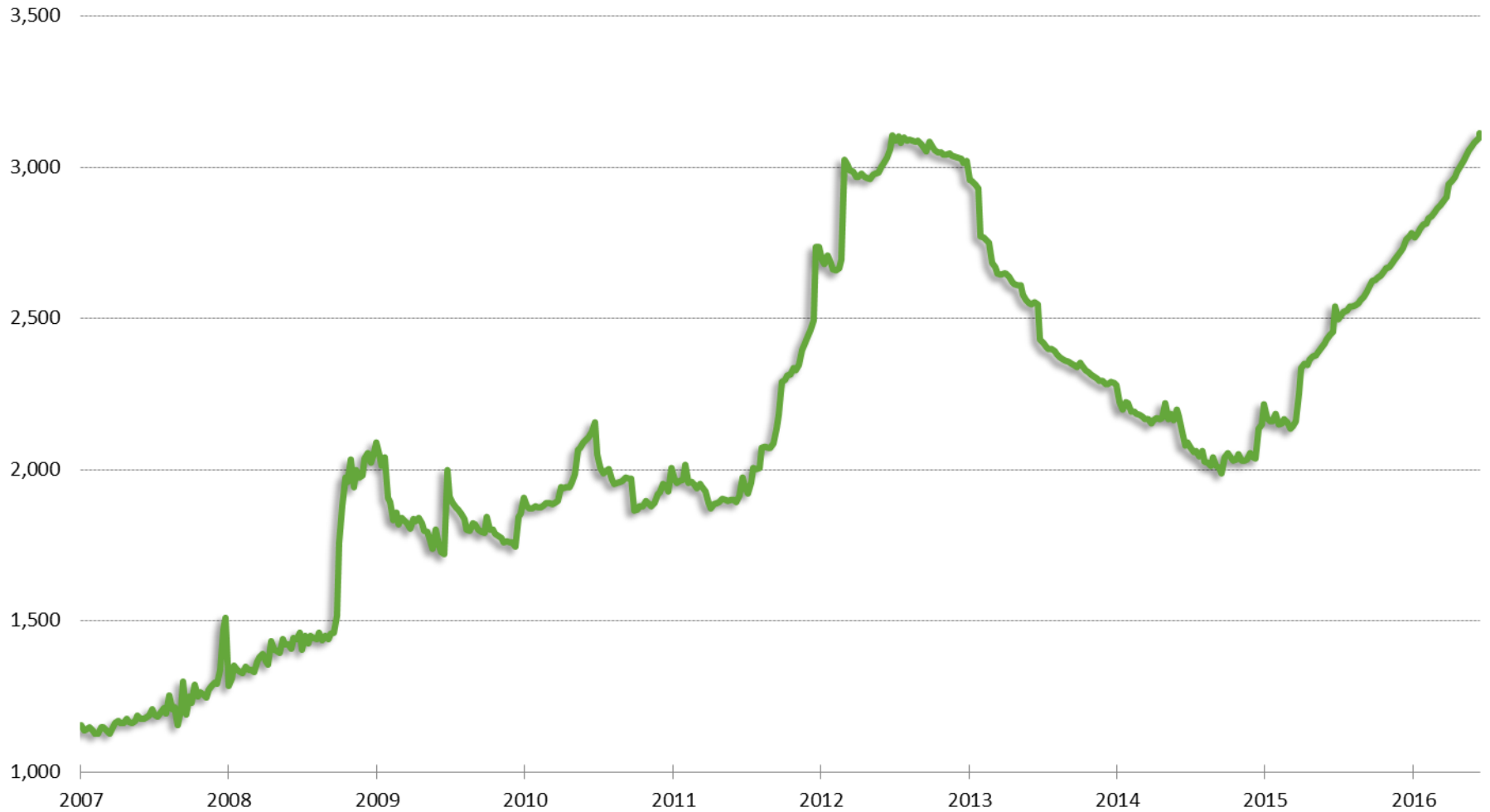


- Tax Reform
- Tax Expenditures
- Entitlement Reform
- Discretionary Spending
- Related (Fed, Trade, FNMA/FMCC)
- Market signals most effective in forcing deficit reduction during periods of stress

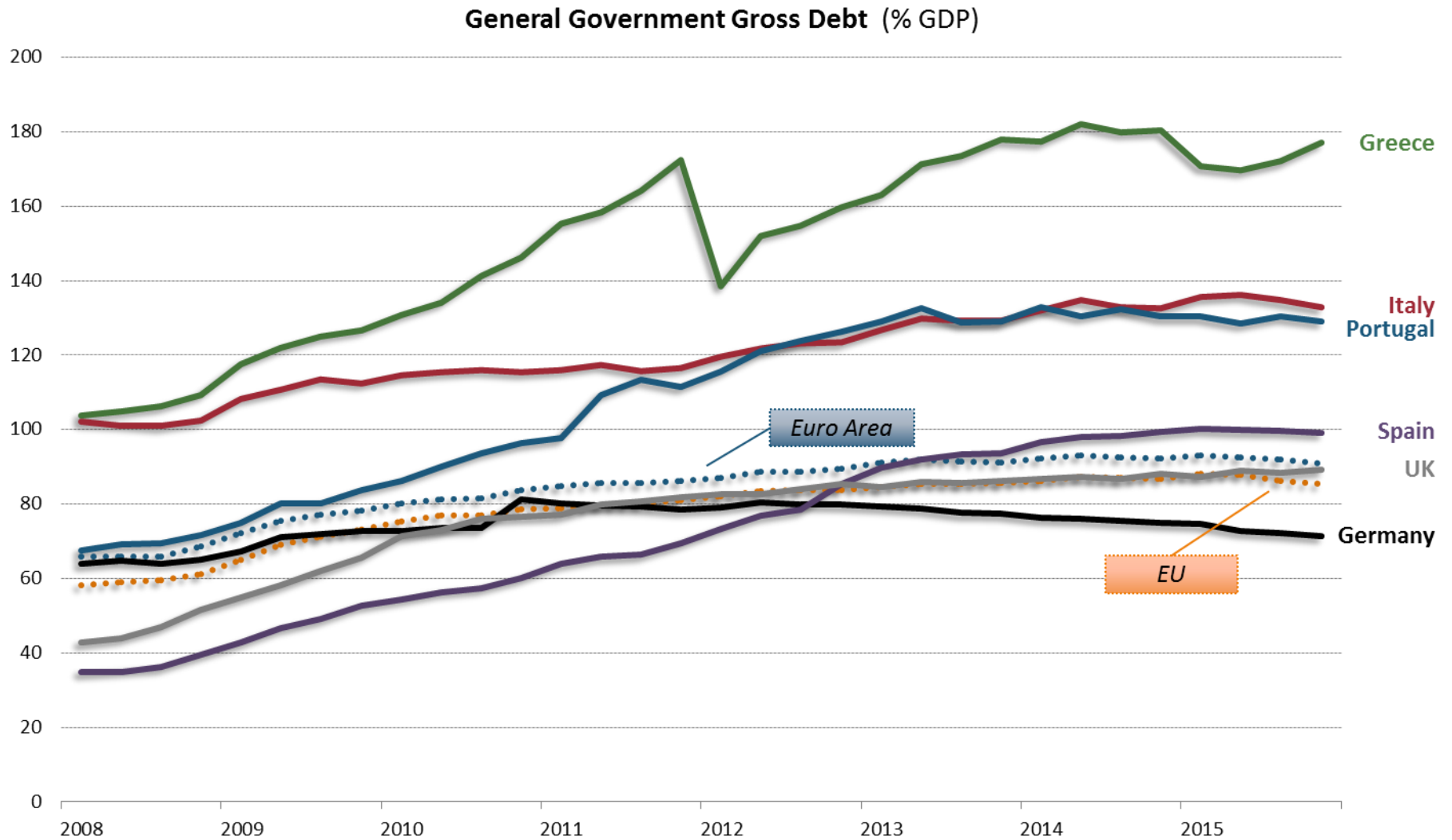
**Corporate Expatriations by Decade (top 5 destinations)**



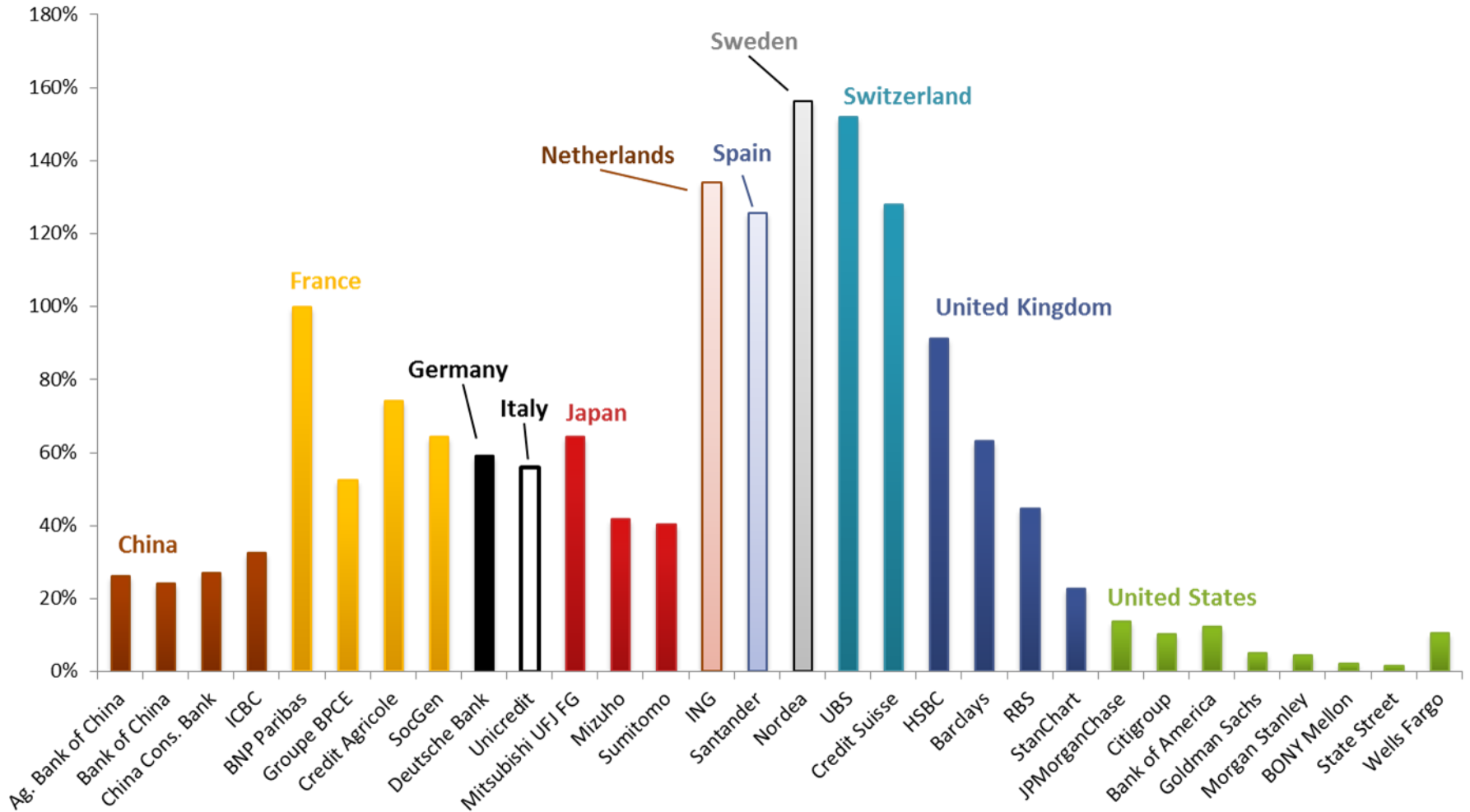
**Eurosystem Balance Sheet (€ bn)**





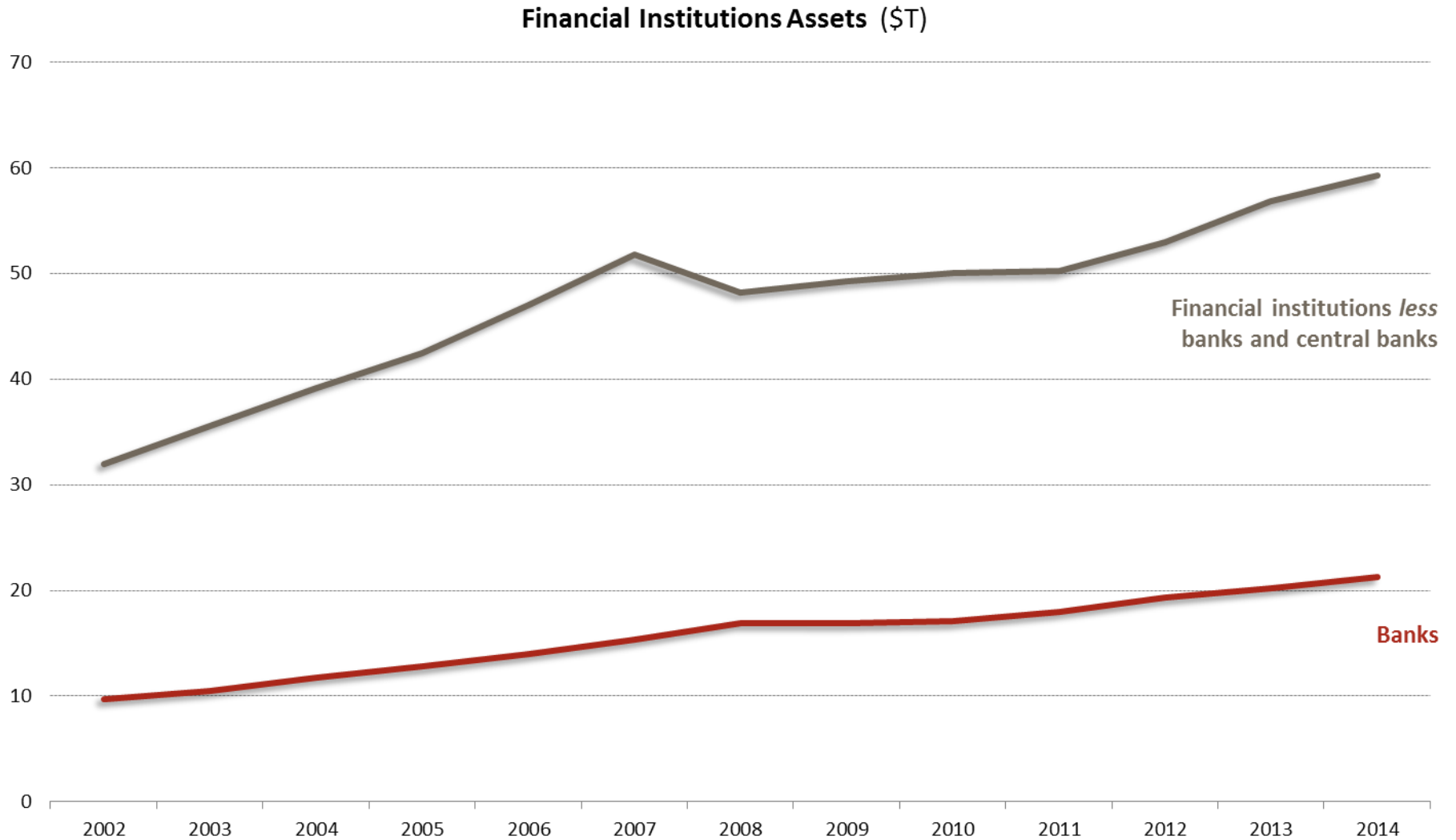


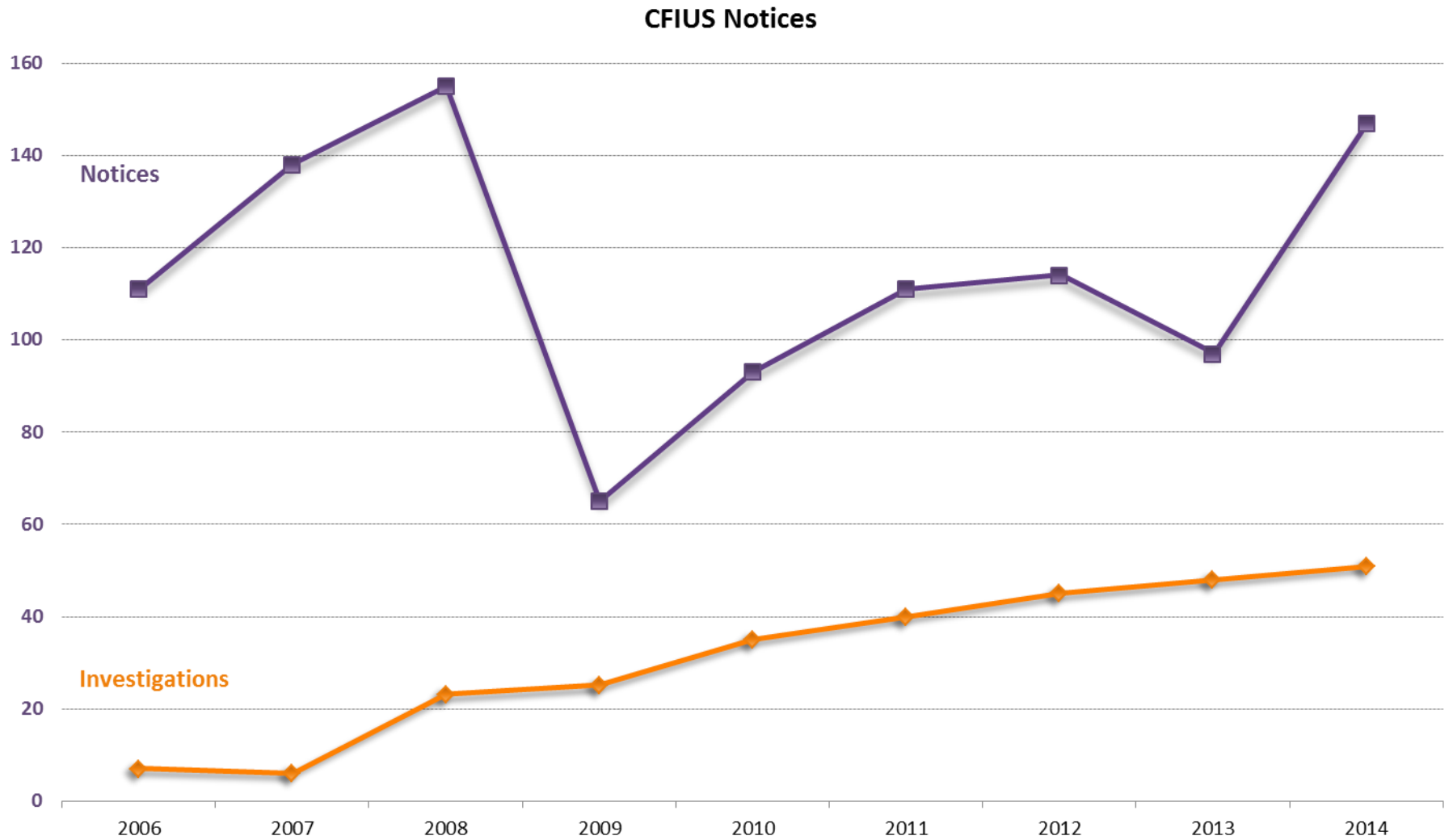
G-SIBs Total Assets (% home country GDP)



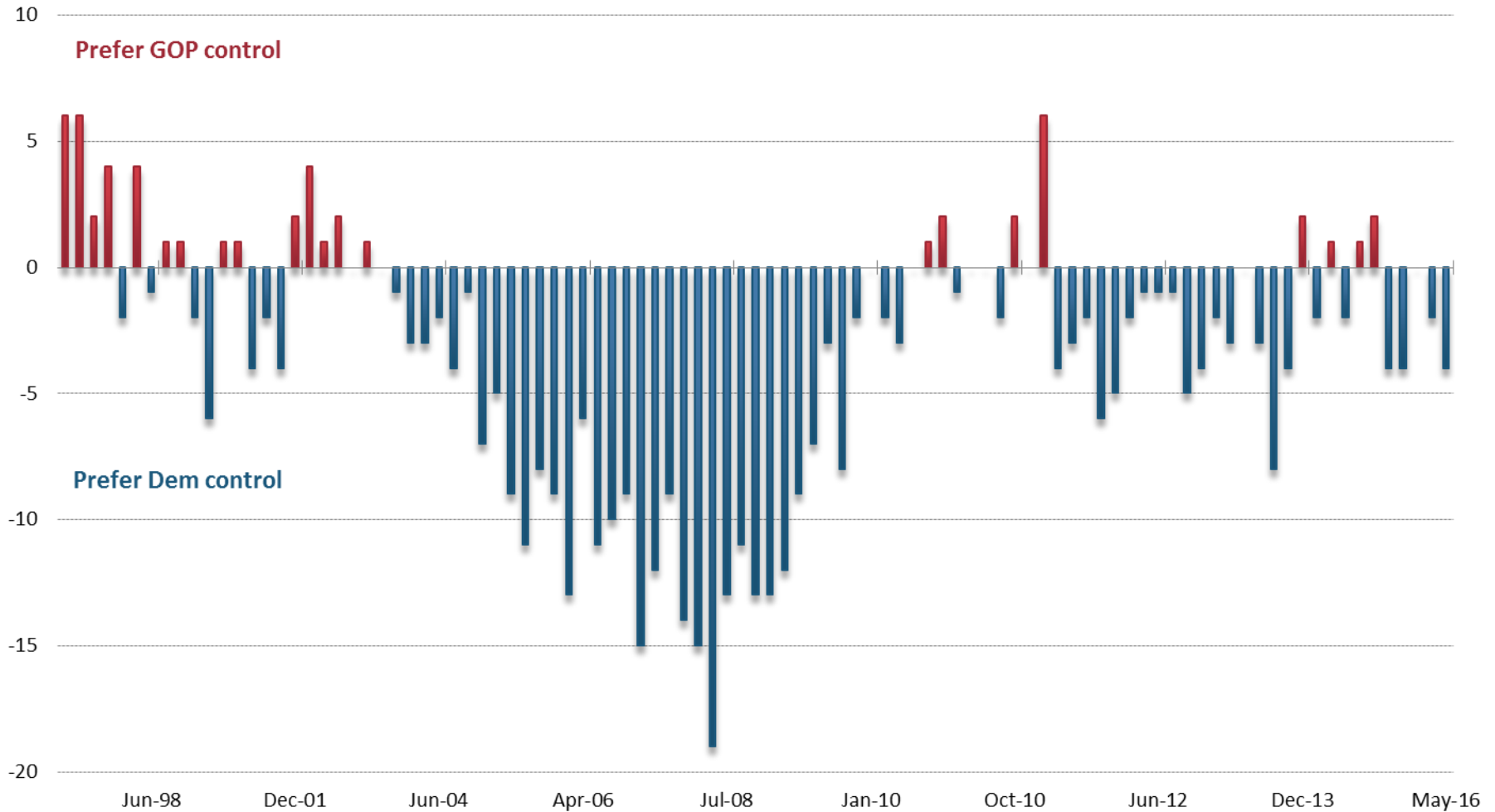
## Market Share of Investment Banks in EMEA

	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>2015</i>
<b>US</b>	38.5	38.9	39.7	36.3	34.7	38.7	40.2	41.2	44.6
<b>European</b>	49.8	49.2	50.0	50.8	53.7	50.1	50.5	49.6	46.0
<b>Swiss</b>	9.7	9.8	10.1	11.7	10.0	9.2	7.6	7.8	7.8
<b>Japan</b>	2.1	2.1	0.2	1.1	1.6	1.9	1.8	1.5	1.5





**Preference for Control of Congress: R-D Spread (registered voters, ppt)**

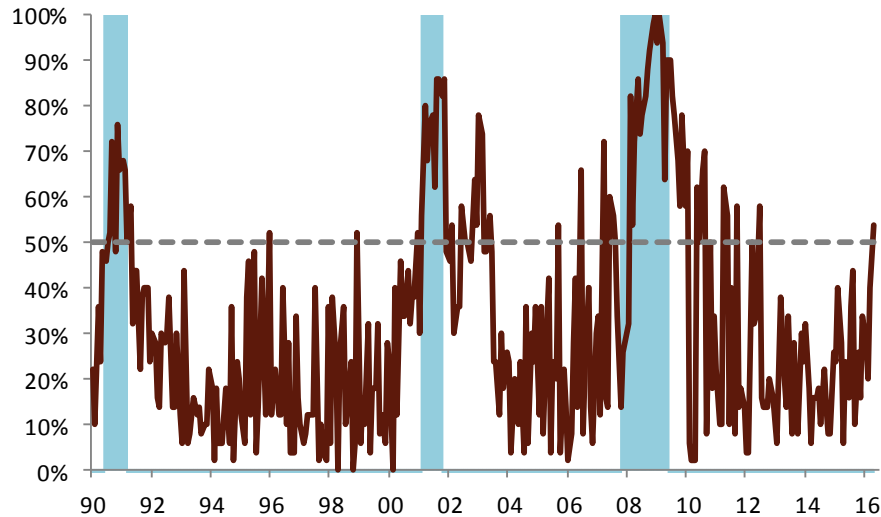


	Country	Election Type	Date ▼
<b>2016</b>	United Kingdom	Referendum	June 23
	Spain	General	June 26
	Australia	General	July 2
	Japan	Upper house	July 10
	Russia	Duma	September 18
	United States	(come on)	November 8
<b>2017</b>	Hong Kong	Chief Executive	March 26
	France	Presidential	April 23, May 7
	Iran	Presidential	June
	France	Legislative	June
	India	Presidential	Before July 25
	Germany	Federal, Chancellor	Between August and October
	South Korea	Presidential	December 20

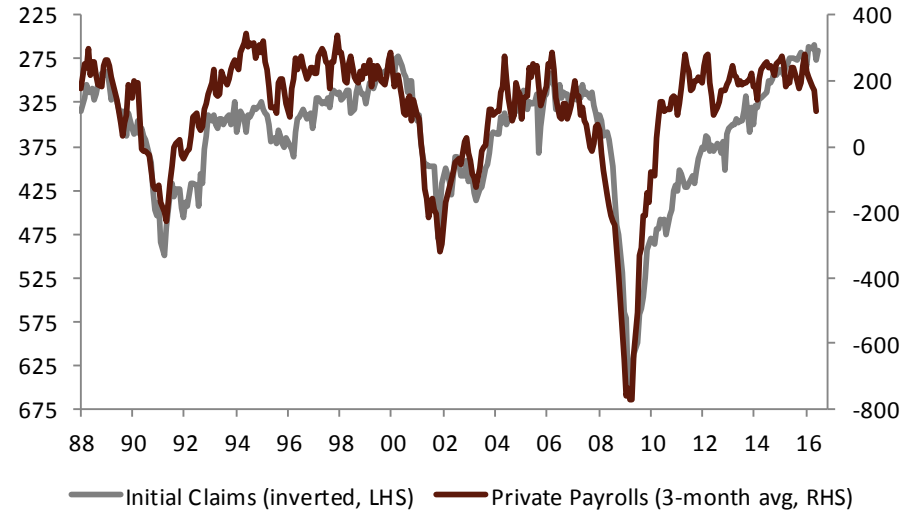
Neil Dutta



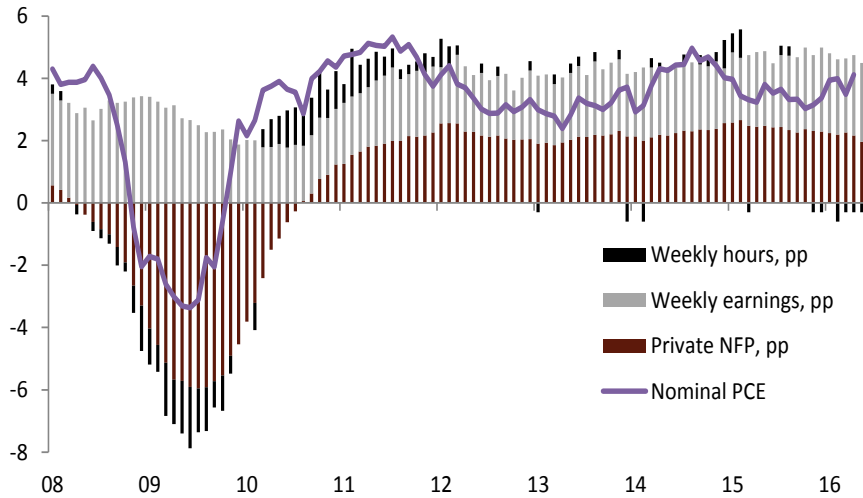
**Breadth of payroll growth has worsened**  
(percent of states with MoM NFP decline)



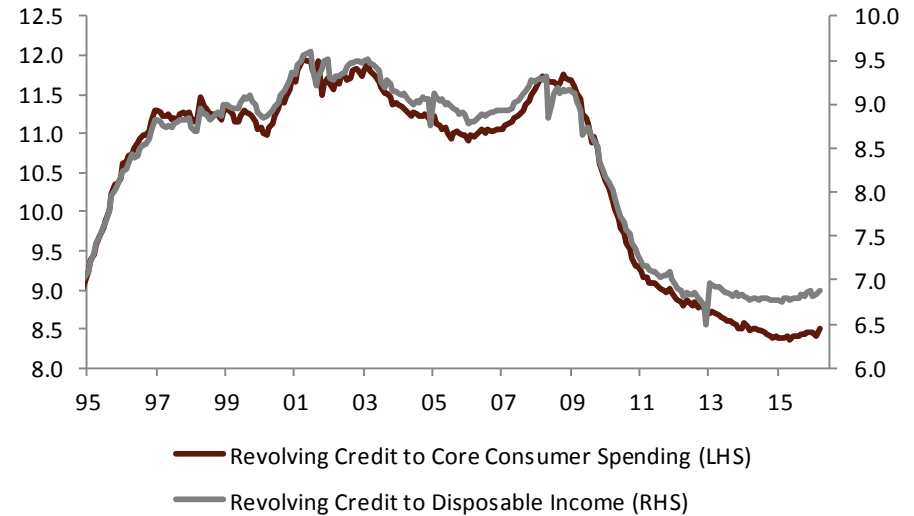
**Firings remain low**



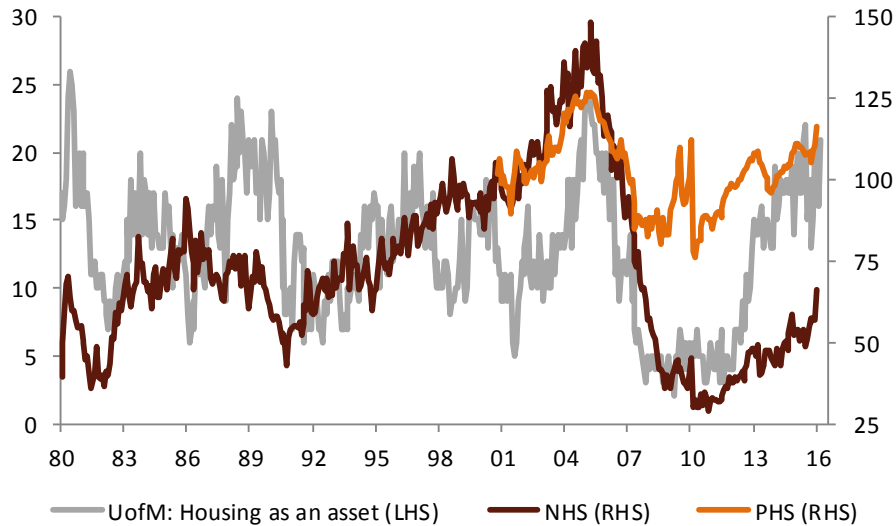
**Income growth a bit faster than spending**  
 (year-over-year % change)



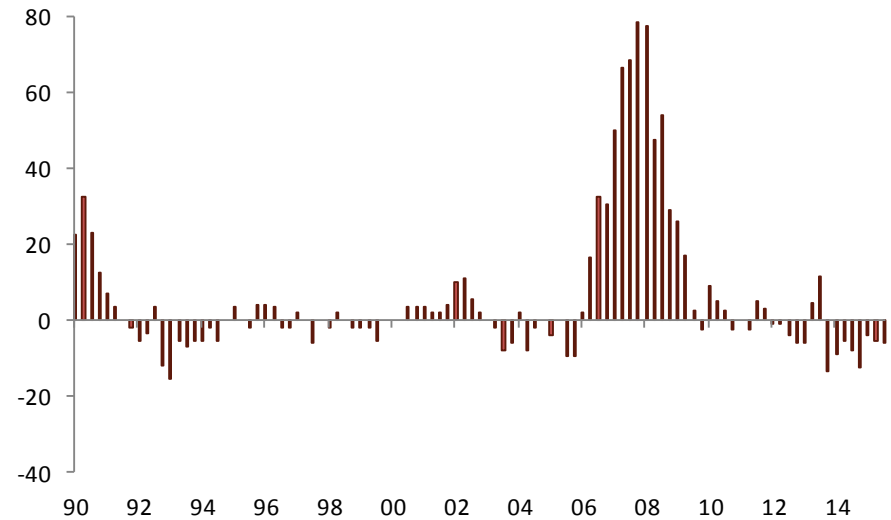
**What if credit cards are tapped?**  
 (percent)



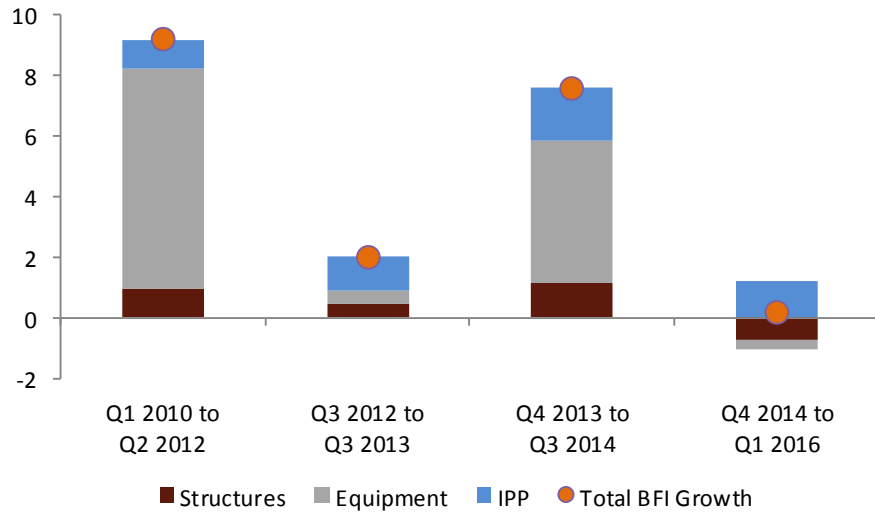
## Housing no longer shunned as an asset class



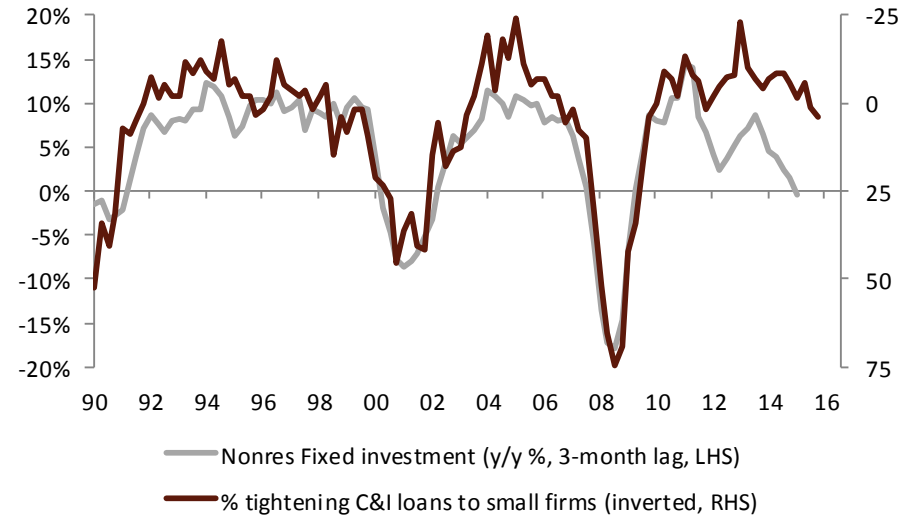
## Lending standards easing (Net % of banks tightening mortgage standards)



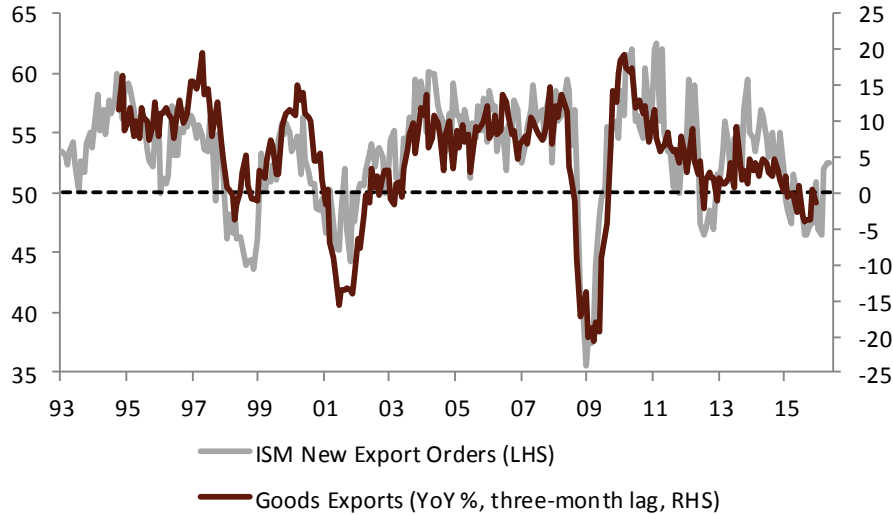
## Four periods for investment during recovery (% change SAAR, contribution to growth)



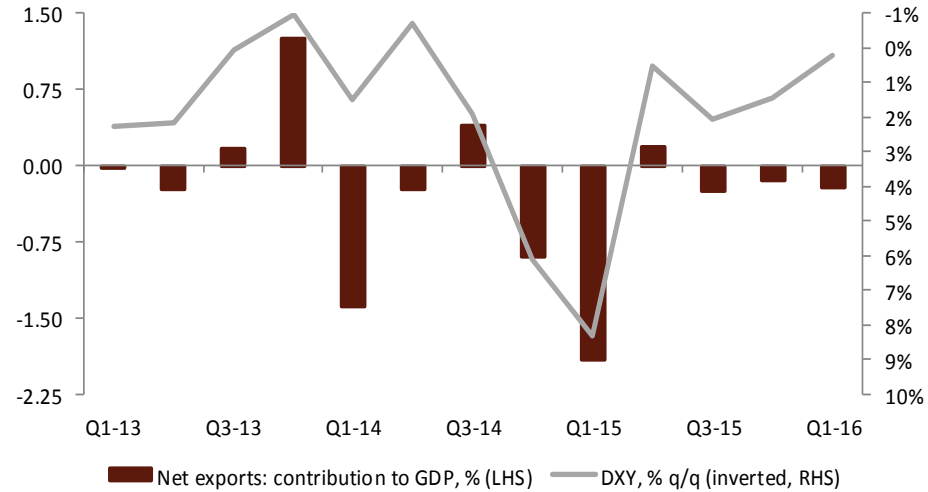
## Lending standards on C&I loans tighten



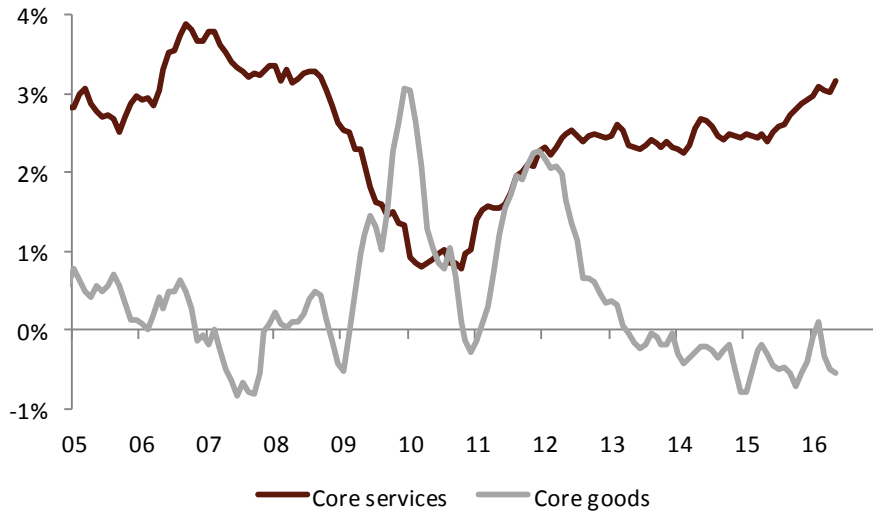
### Early signs of a rebound?



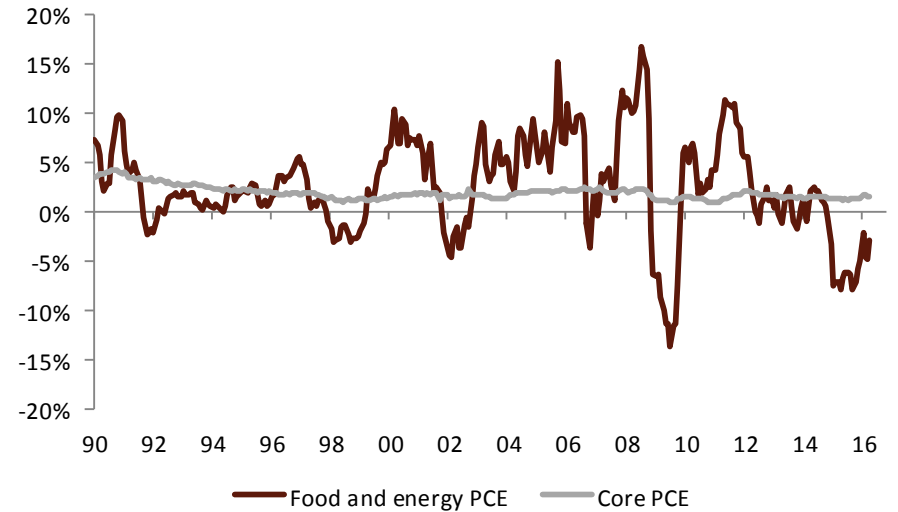
### Fading USD strength helps



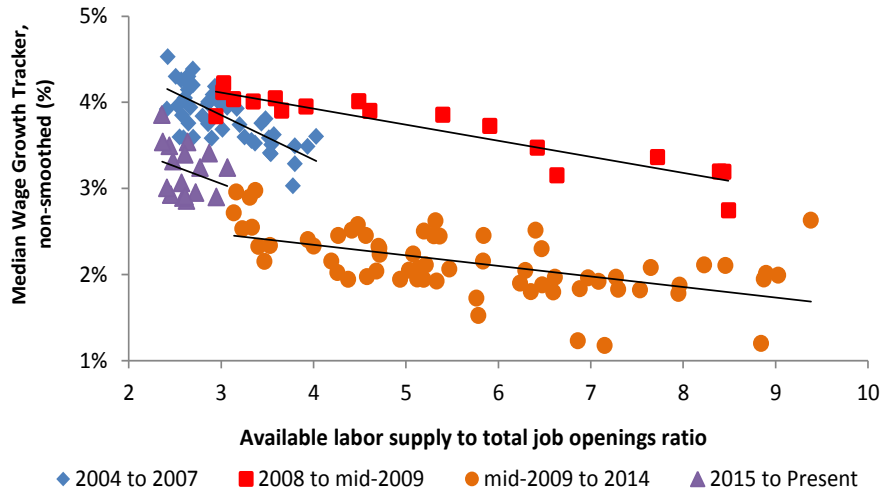
**Services sector inflation picks up**  
(year-over-year % change)



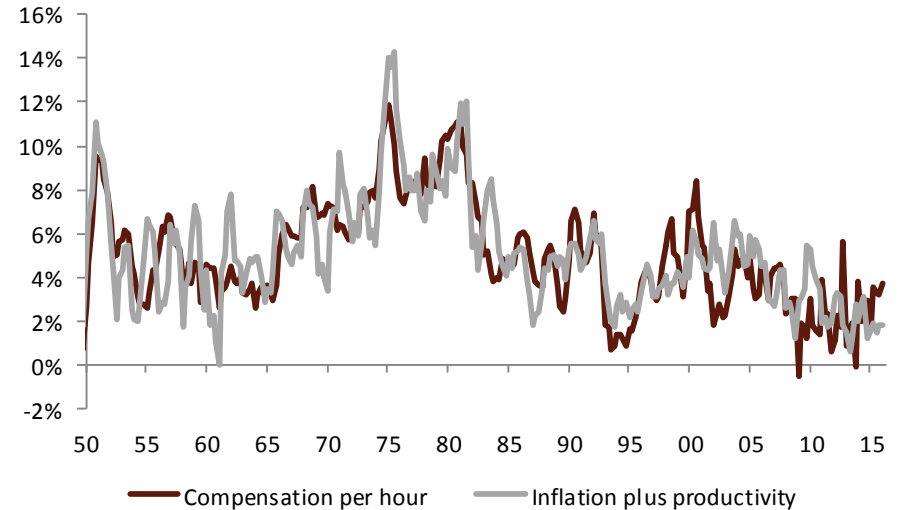
**Limited commodity pass through**  
(year-over-year % change)



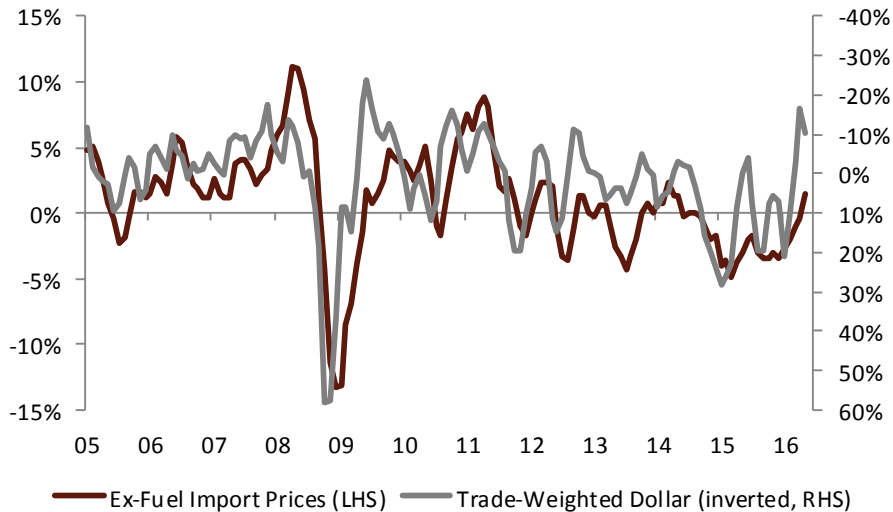
## Wage clock still keeps time



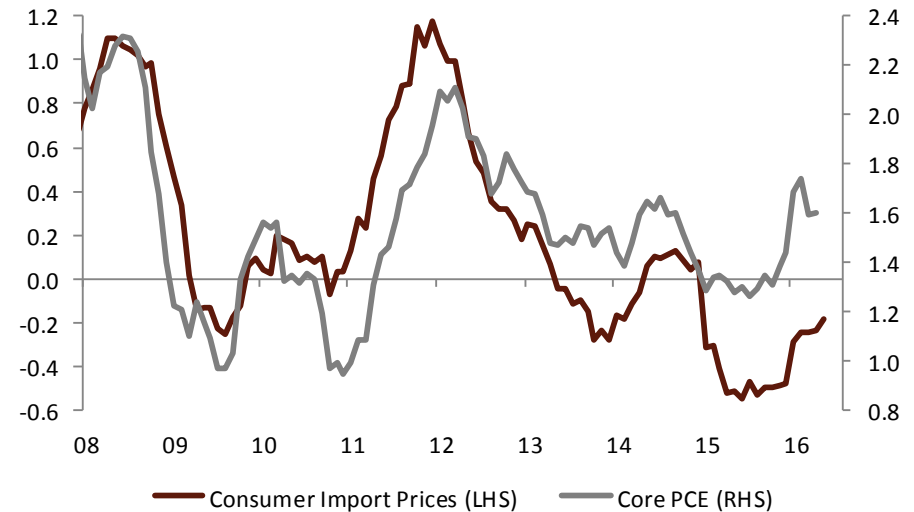
## Compensation = inflation + productivity (% change, year-over-year)



**Dollar leads import prices**  
(three-month % change, SAAR)

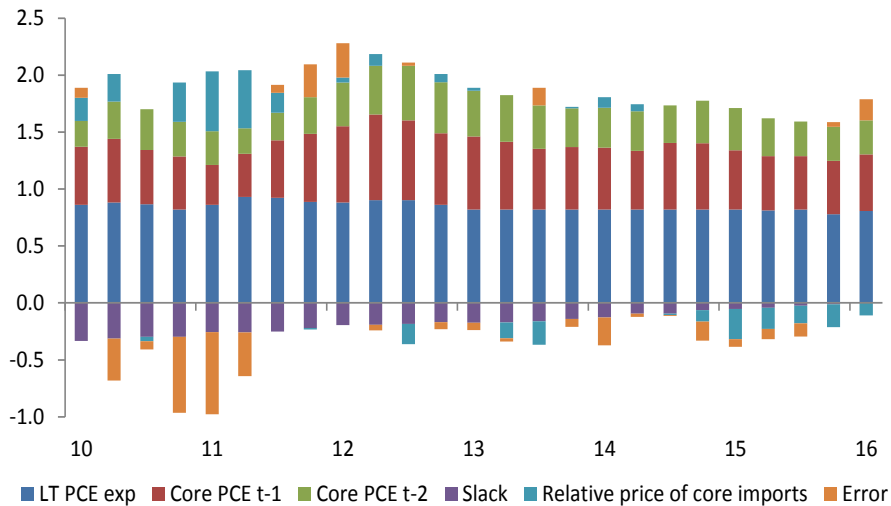


**Consumer import prices lead core PCE**  
(% change, year-over-year)

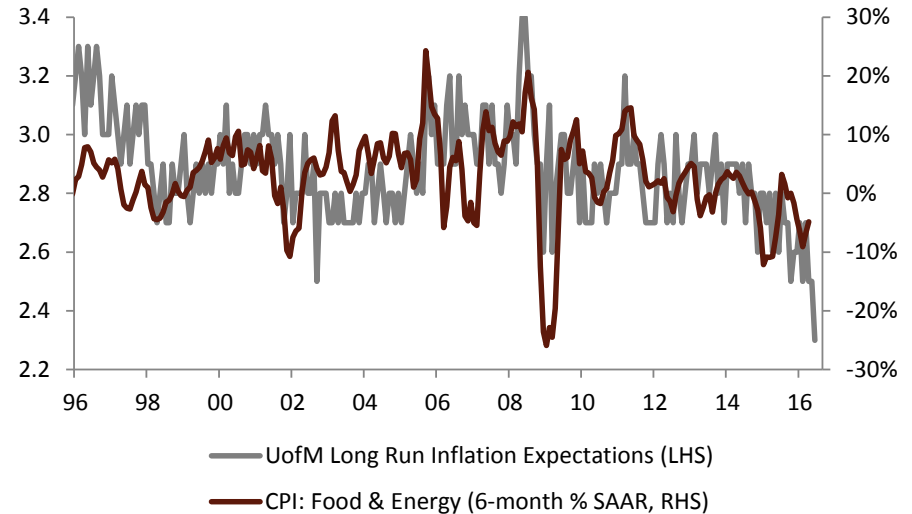




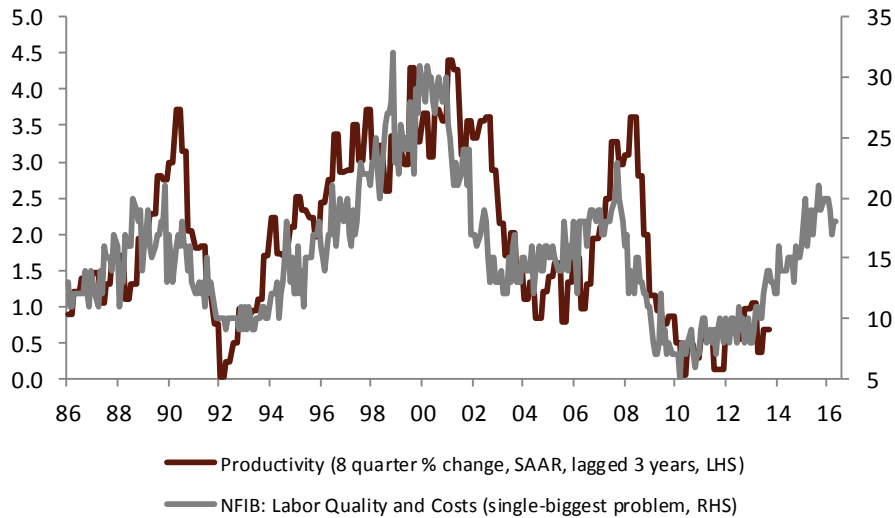
**Expectations and actual inflation matter most**  
Core PCE (contribution to growth)



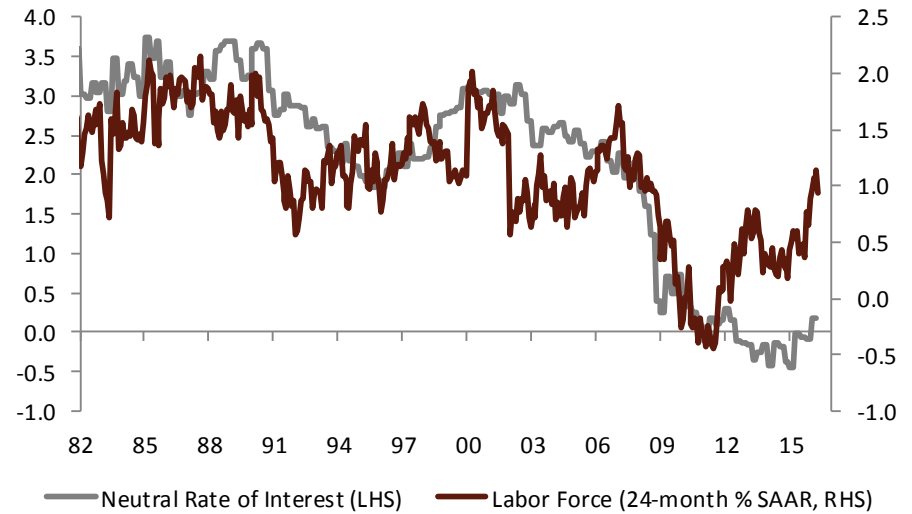
**Unusual drop in expectations**



## Run the economy hot, boost productivity?



## Labor force growth has picked up. Will it last?



Pete Ward

<u>Commodity</u>	<u>Our View</u>	<u>Our Reasoning</u>	<u>Our View Relative to Consensus</u>
Aluminum	Neutral	Limited downside given proximity to the cost curve. Upside limited by the availability of cheap substitutes: steel & plastic. Plus, inventory liquidation should continue.	The consensus remains modestly too bullish expecting higher energy costs to lift the upper end of the cost curve. We see new low cost capacity more than replacing high cost capacity closures.
US Coal	Negative	Other than select geographic areas with mine mouth power plants, coal will likely continue to be replaced by very cheap shale gas.	The consensus expects higher "normal" nat gas prices than we do. Therefore, some are less bearish about US coal's future than are we.
Seaborne Coal	Neutral	The market remains oversupplied. But, at current exchange rates, prices are supported by the cost curve.	In-line.
Copper	LT Positive	We concede the market will remain oversupplied for the next few quarters. But, we believe supply growth will actually turn negative by the end of the decade. With a very inelastic demand curve, this should lead to much higher prices even with slower consumption growth.	ST we are in line. Long-term, just like 15 years ago, some have become complacent with a perpetual neutral view. Copper is our favorite commodity over the next decade.
US Nat Gas	Neutral	The cost reductions coming out of the Utica/Marcellus have been stunning. Prices should continue to recover but modestly.	Consensus has been slow to react to the plunging US cost curve. We have difficulty accepting "normal" gas price forecasts of \$4+.
Gold	Neutral	This cycle, the market will not get help from de-hedging demand. We believe the price is supported by the industry's rising cost curve. However, even slightly higher interest rates could cap upside.	We are slightly less bullish than consensus. More important, we are far more bearish than consensus on gold equities. We continue to favor a pair trade to be long gold and short major gold equities.
Iron Ore	Neutral	After a crushing price decline from \$180, we believe the market will ultimately find balance around \$50.	We are slightly more bullish. There are some who believe the price will keep falling until it hits the marginal cost of the three majors. We believe the rapid supply growth by the Big 3 will start to subside.
Oil	Modestly Positive	The price has already rebounded strongly off its February lows. Relative to mined commodities, oil production has a sharp decline curve. Reduced capex of the past 18 months should continue to support price. But, shale oil has moved the cost curve lower. Previous highs are unlikely.	In-line.

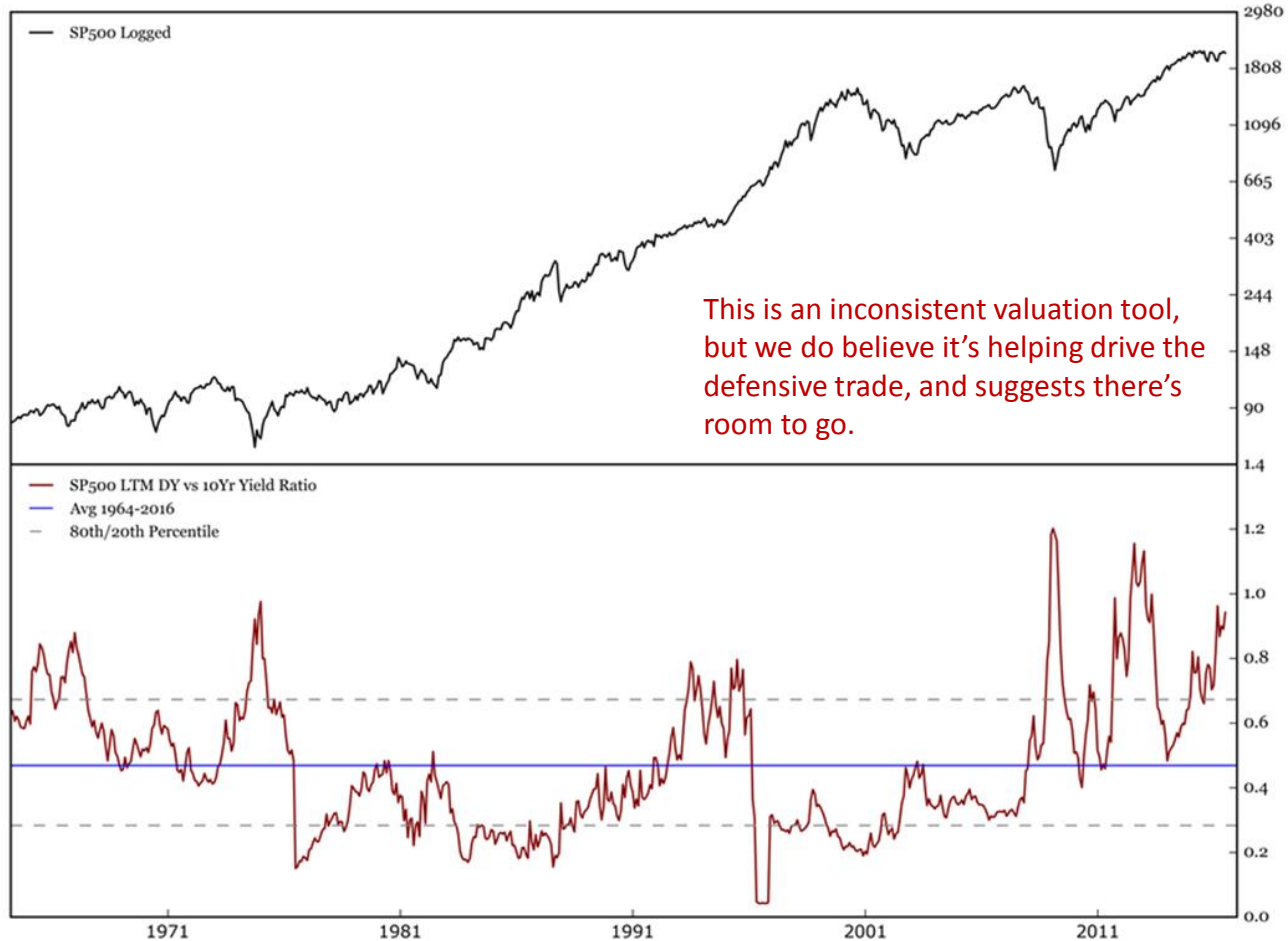
	<u>Recommendation</u>	<u>Current Price</u>	<u>1-Year Target</u>	<u>Major exposures</u>	<u>Justification for Recommendation</u>
<b>Alcoa</b>	Equal Weight	\$9.76	\$10.00	Alumina, Aluminum, Downstream Autos, Downstream Aerospace	Valuation is expensive even with downstream exposure. We see little upside for aluminum prices. And, expectations for dramatically improved downstream earnings have yet to materialize. But, enthusiasm for the pending split remains high. We'd consider shorting above \$10.
<b>Barrick Gold</b>	Underweight	\$19.76	\$17.00	Gold	Very expensive valuation. If we remove Pascua and Cerro Casale from P&P reserves, the company only has a decade. In our opinion, a substantial increase in the gold price is already discounted. We find attraction in a pair trade that is long gold and short major gold mining stocks.
<b>BHP Billiton</b>	Equal weight	852p	900p	Iron Ore, Oil, Copper	Reasonably valued. We like the commodity exposures long term. And, the company's low cost position and strong balance sheet should limit downside. We could move toward OW at a slightly lower valuation or with more clarity around potential Samarco liability.
<b>Freeport-McMoRan</b>	Overweight	\$11.55	\$16.00	Copper, Oil	We like the assets and commodity exposure long term. We believe political risk concerns are overdone. But, copper price upside is likely several quarters away. And, winning back investor trust will take time. Risks are high but we like the risk/reward balance.
<b>Goldcorp</b>	Underweight	\$17.77	\$15.00	Gold	Now that growth has turned negative, Goldcorp's historical growth multiple needs to compress. With just a decade of reserves, we believe GG will have to spend enormously to replace depletion. FCF will be minimal. We like a pair trade to be long gold and short major gold miners.
<b>Newmont Mining</b>	Equal weight	\$35.33	\$34.00	Gold	Equal weight rating leaning UW. We shy away from UW for now simply because 2016/2017 results will likely be decent. But, they are unsustainable. We likely move toward UW at a higher stock price and/or as the market begins to focus on 2018 results. In our experience, it remains early for that.
<b>Rio Tinto</b>	Overweight	2041p	2300p	Iron Ore, Copper, Aluminum	The company has stubbornly focused on only the lowest cost assets which looks brilliant in the current environment. Stock is not terribly inexpensive. But, we believe it still discounts an overly bearish outlook for the commodities. We see modest upside with limited risk.

Jeff deGraaf



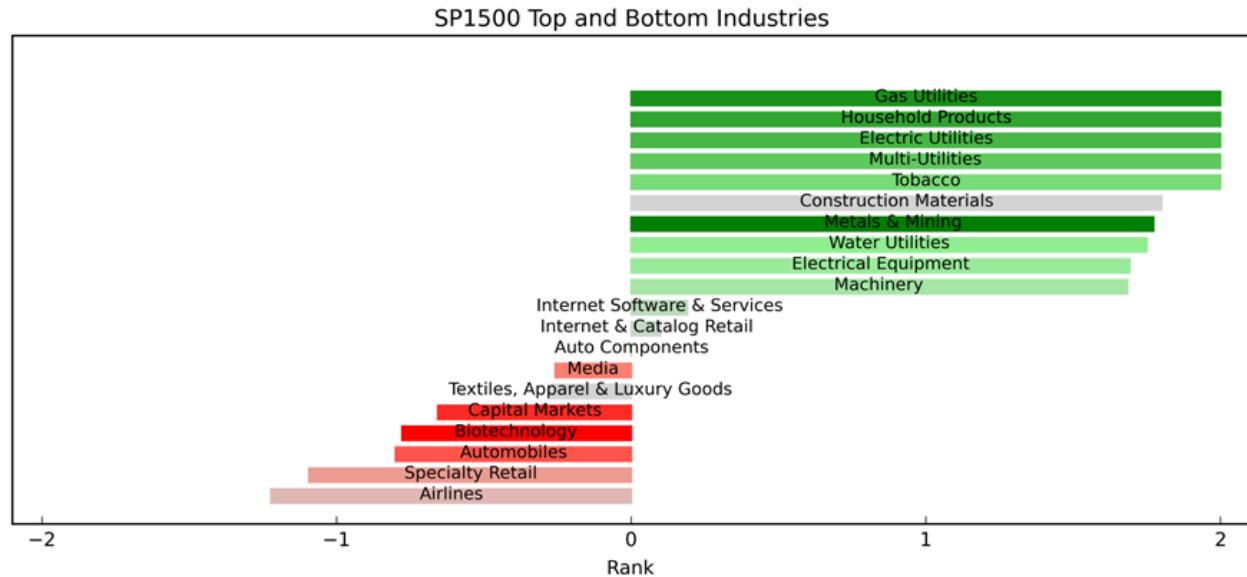
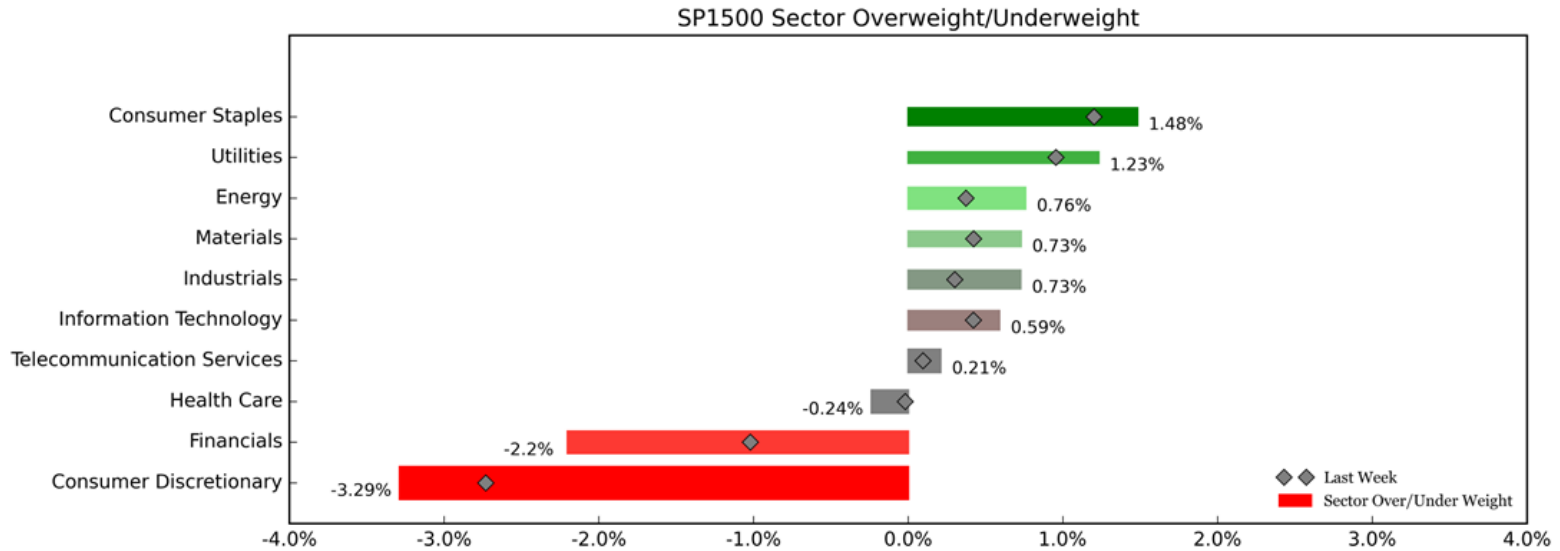


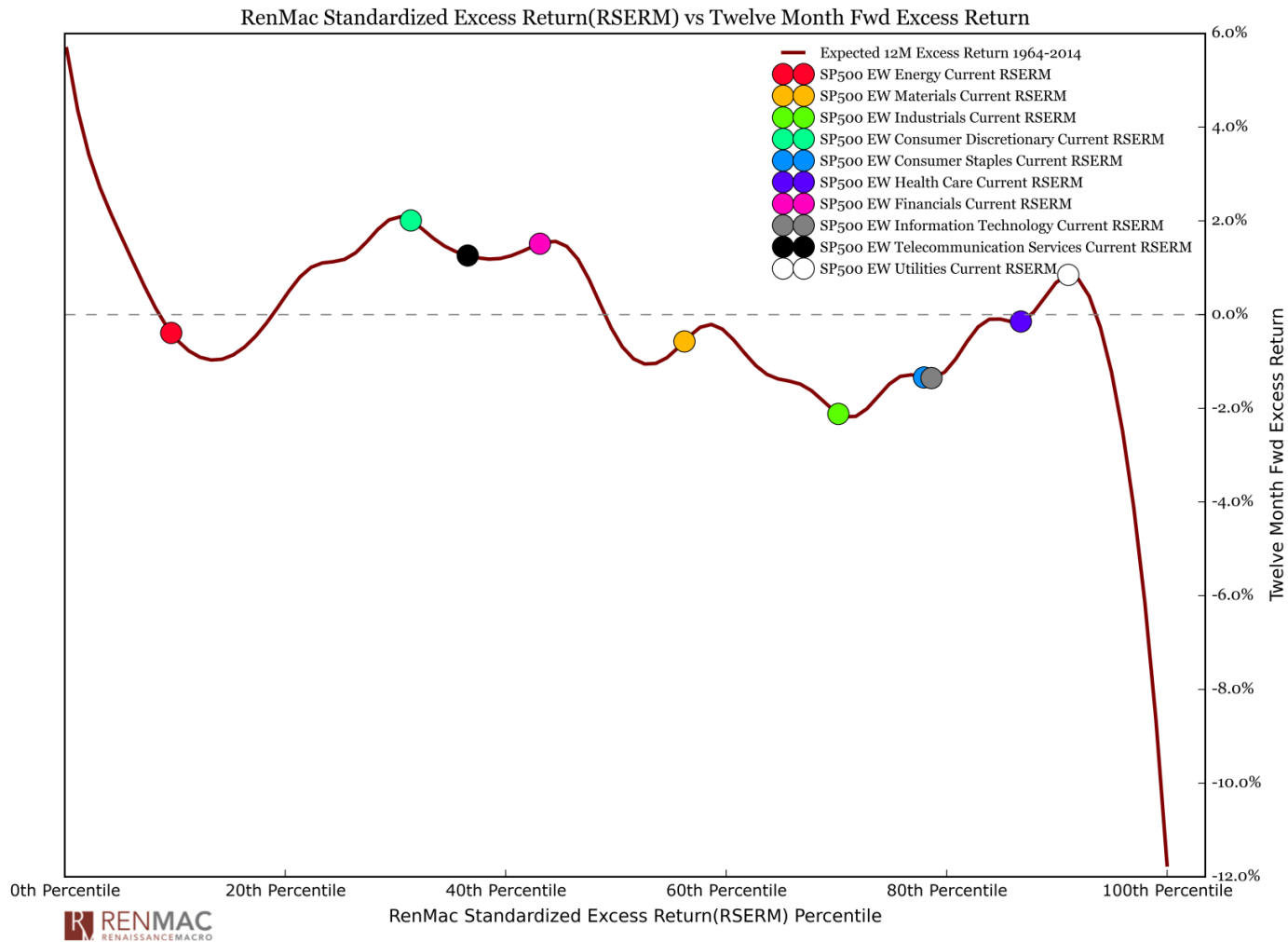




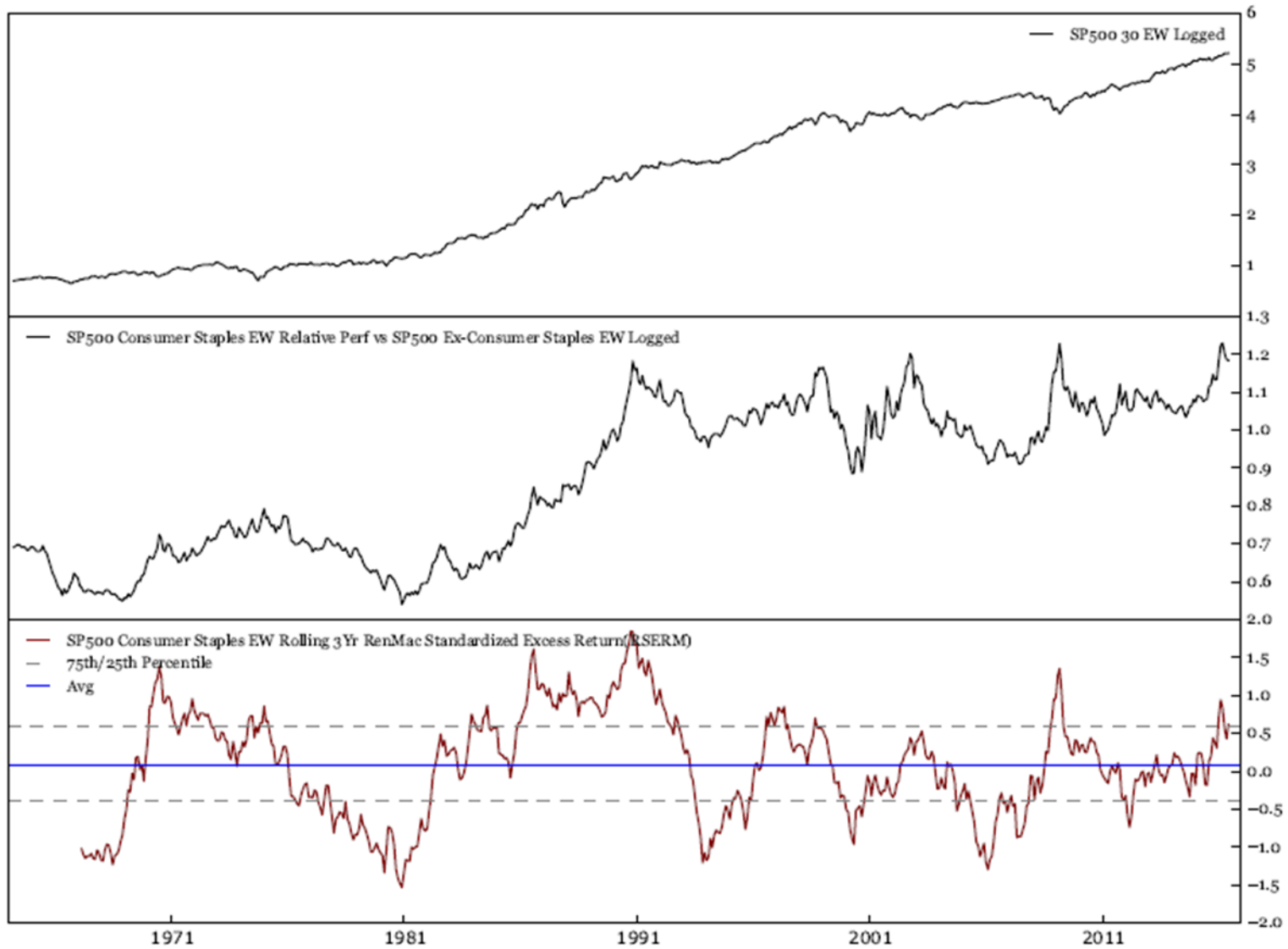
This is an inconsistent valuation tool, but we do believe it's helping drive the defensive trade, and suggests there's room to go.

# Trends favor defensive names

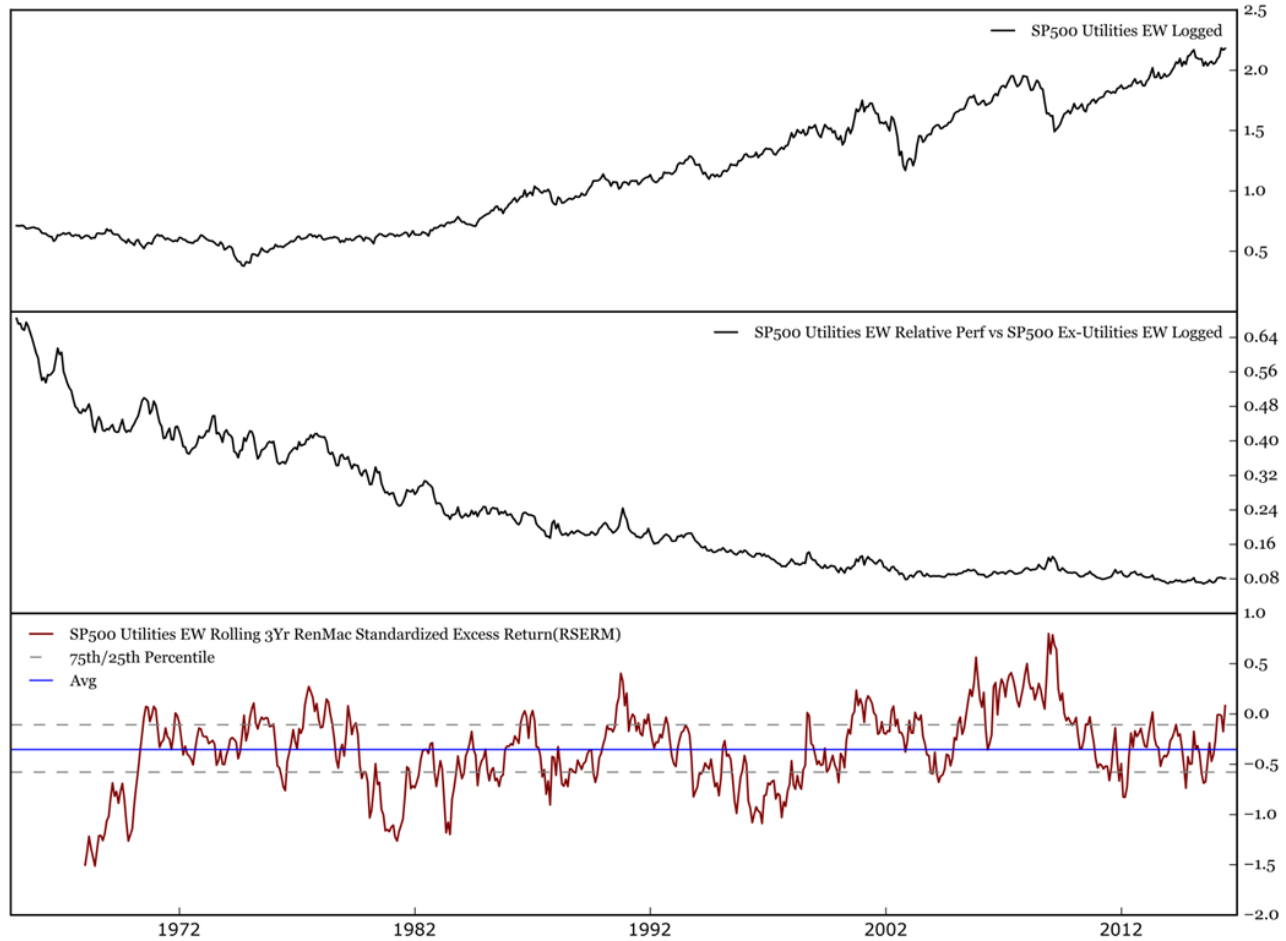




# Staples not extreme

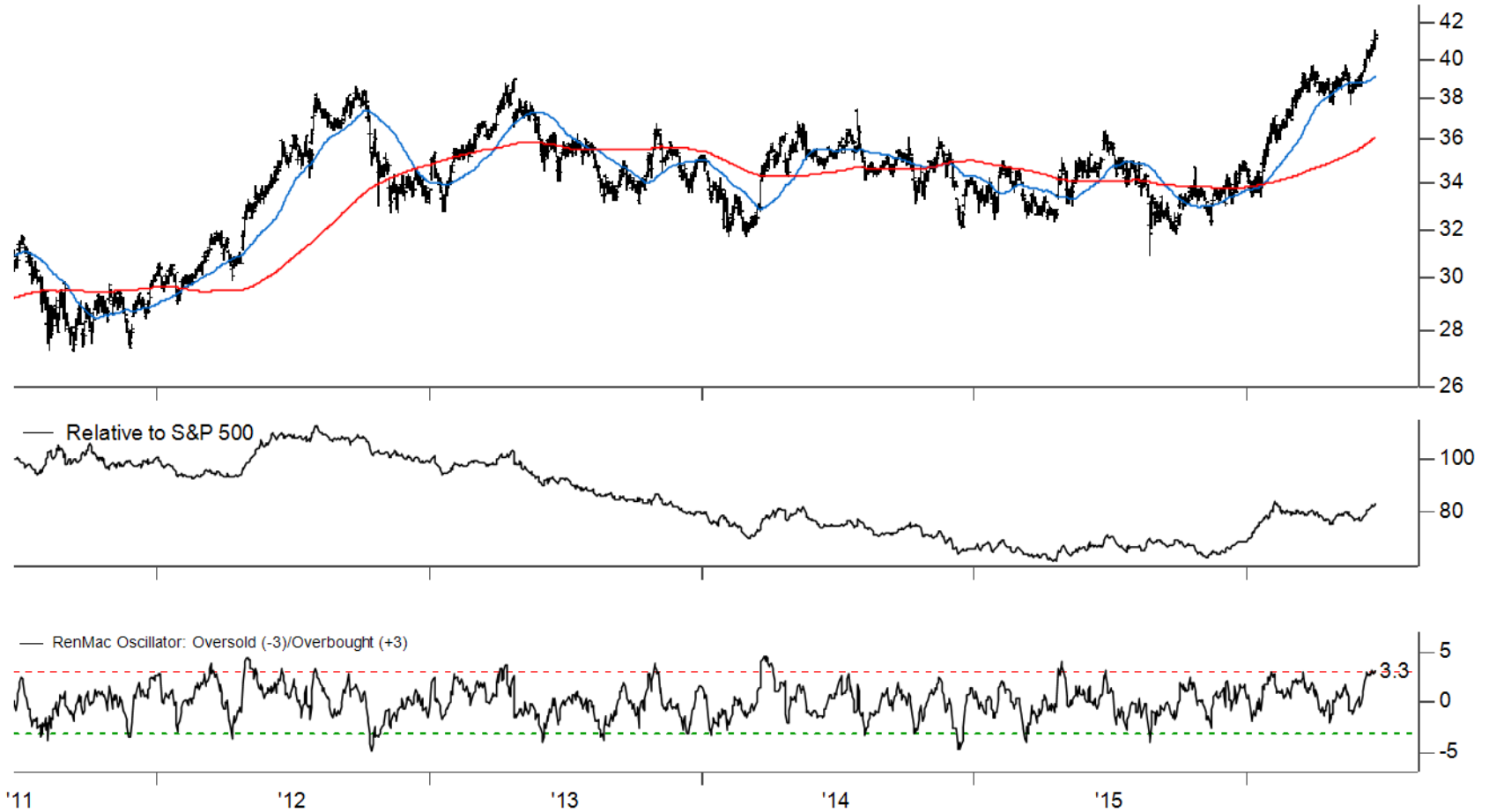


# Utilities not yet vulnerable



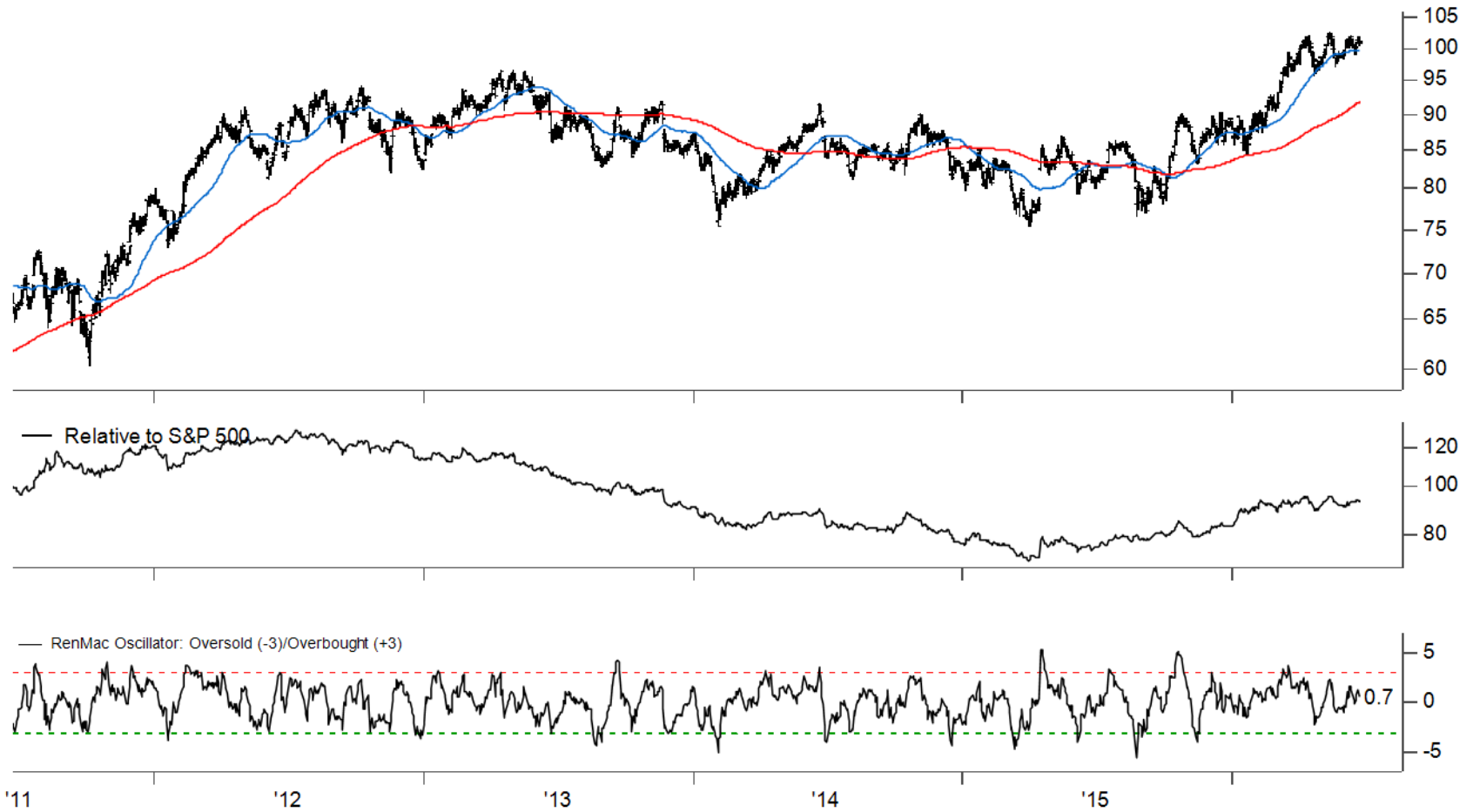
AT&T Inc. (T-USA)  
 RenMac Rank 1

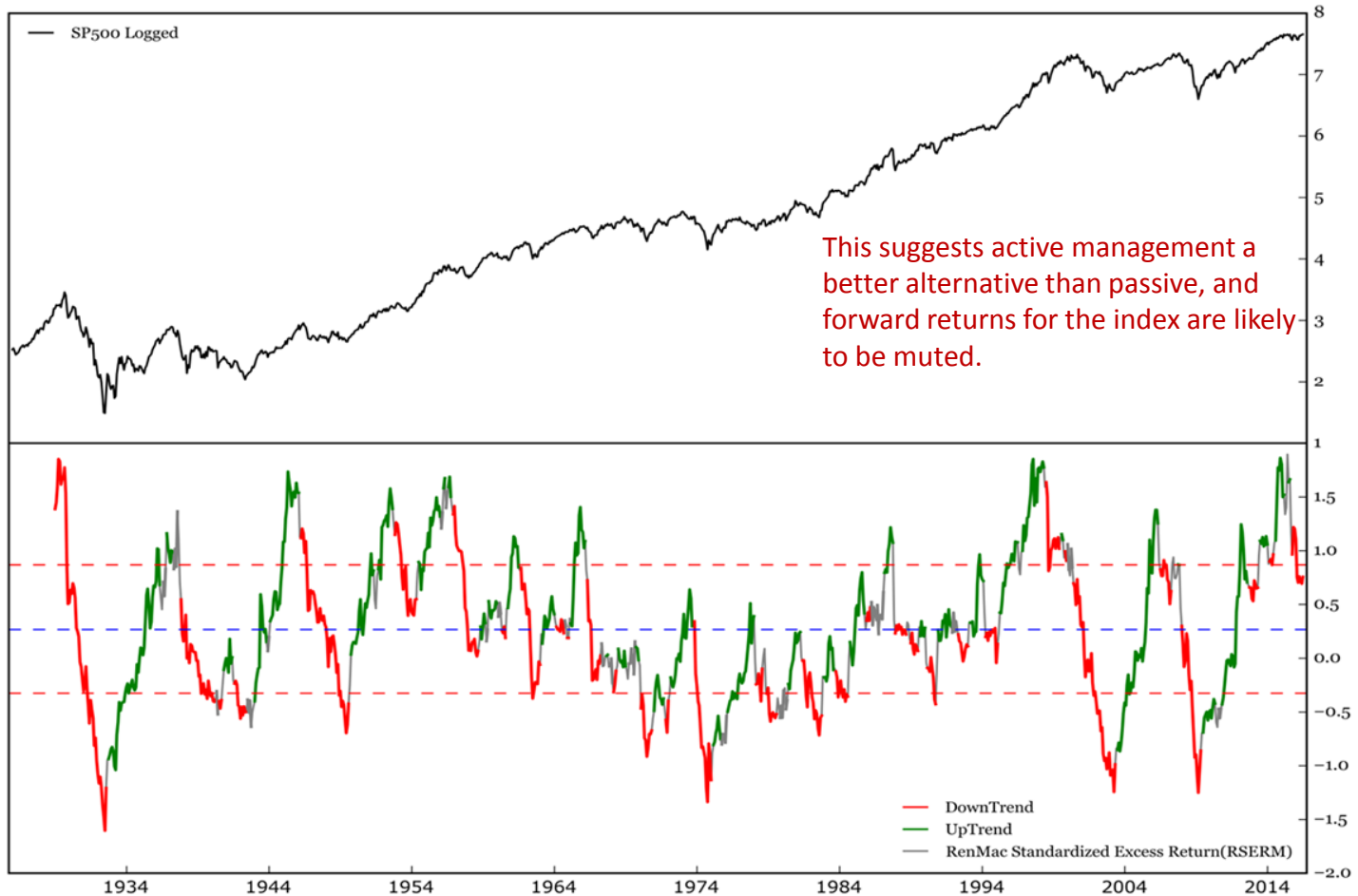
Market Cap: 252845.9  
 Integrated Telecommunication Services



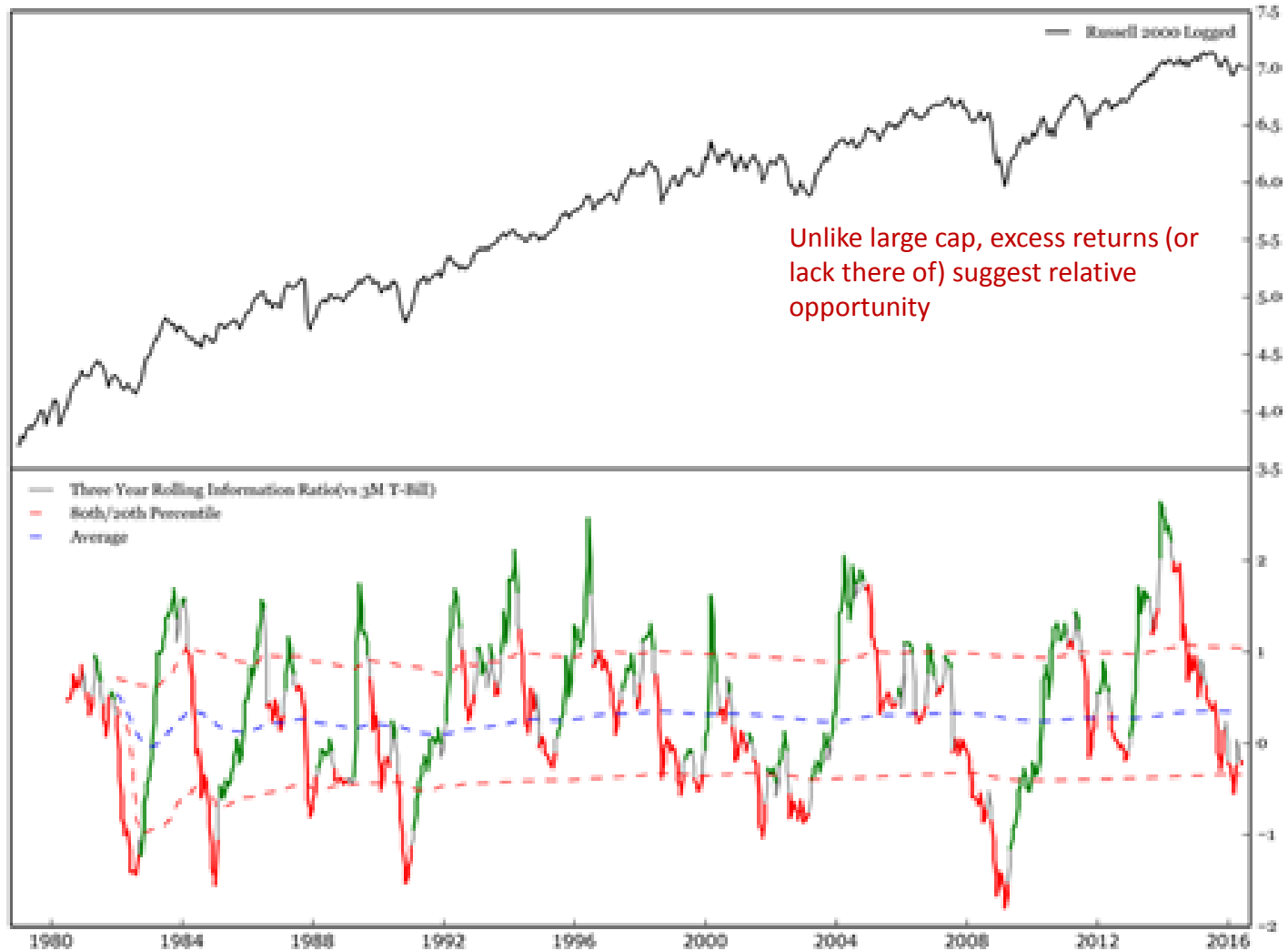
Philip Morris International Inc. (PM-USA)  
RenMac Rank 2

Market Cap: 156445  
Tobacco



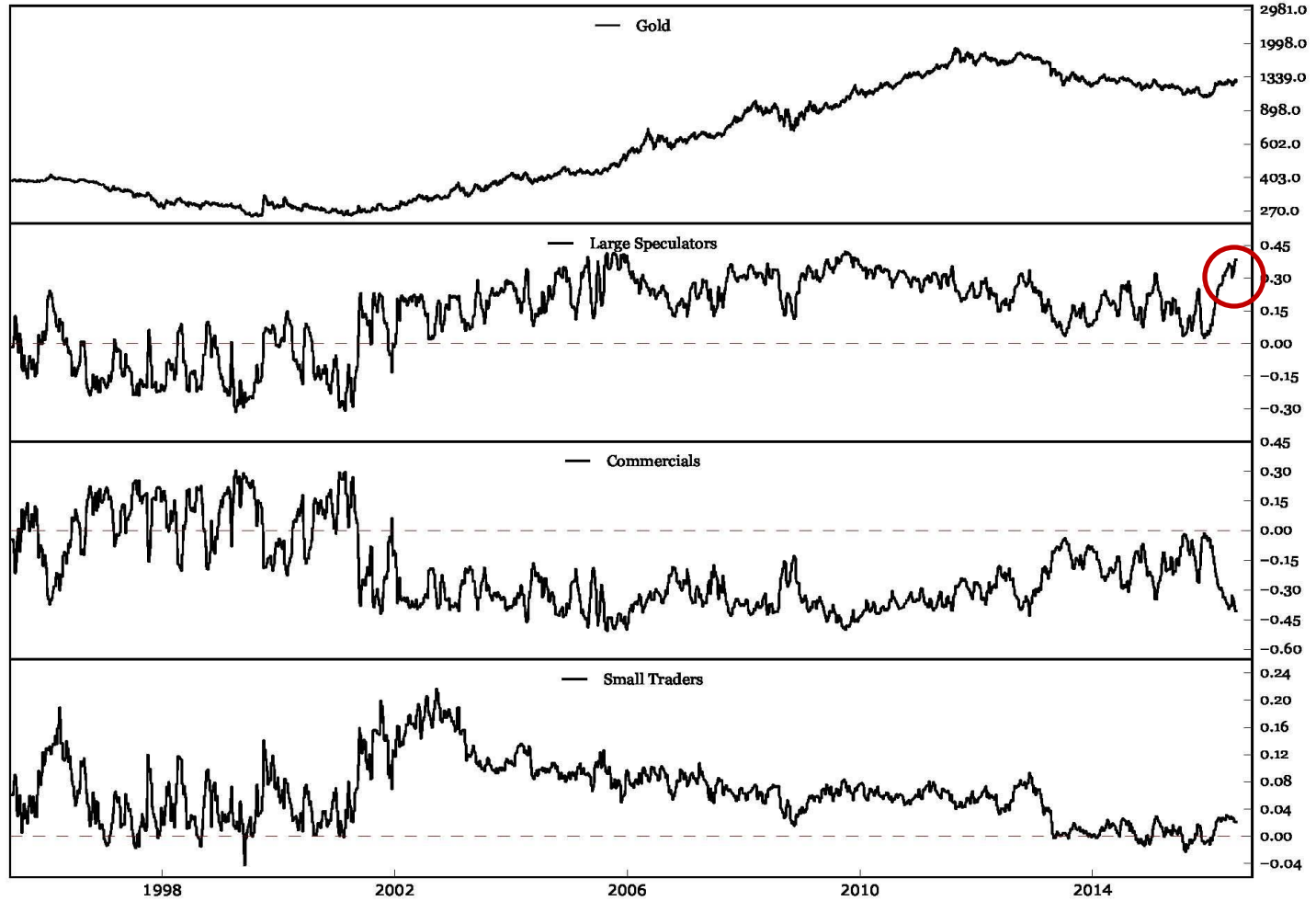


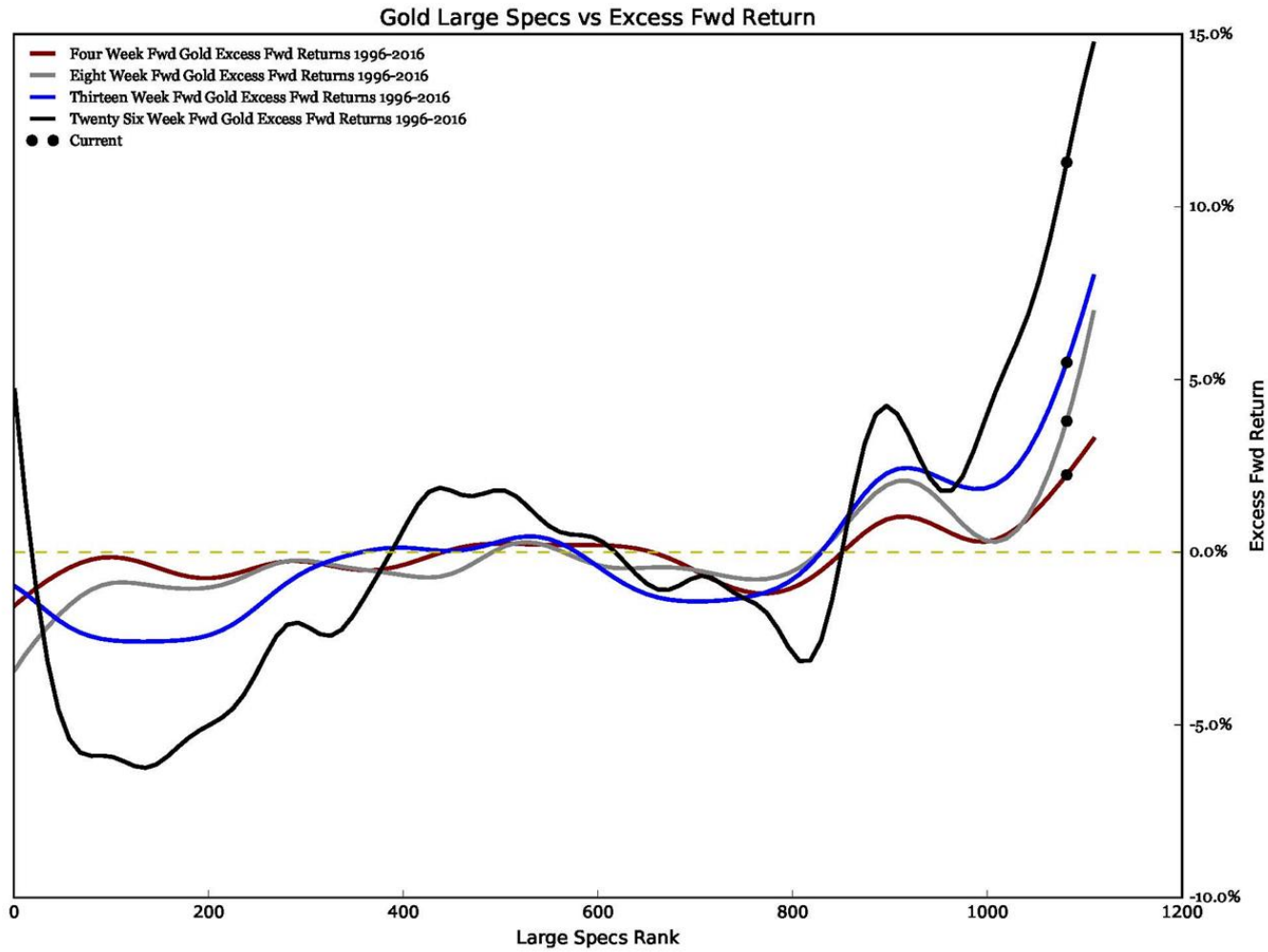


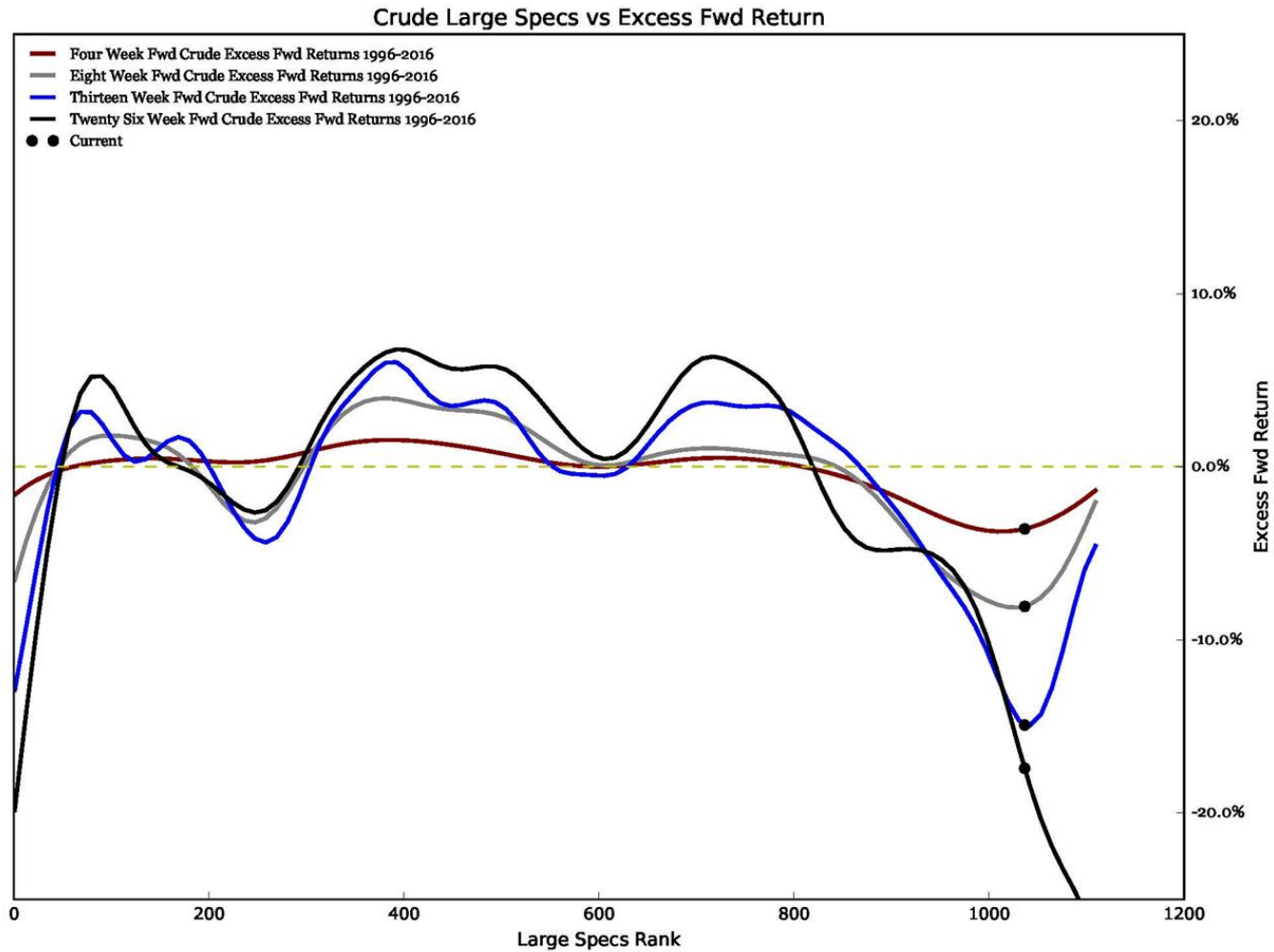


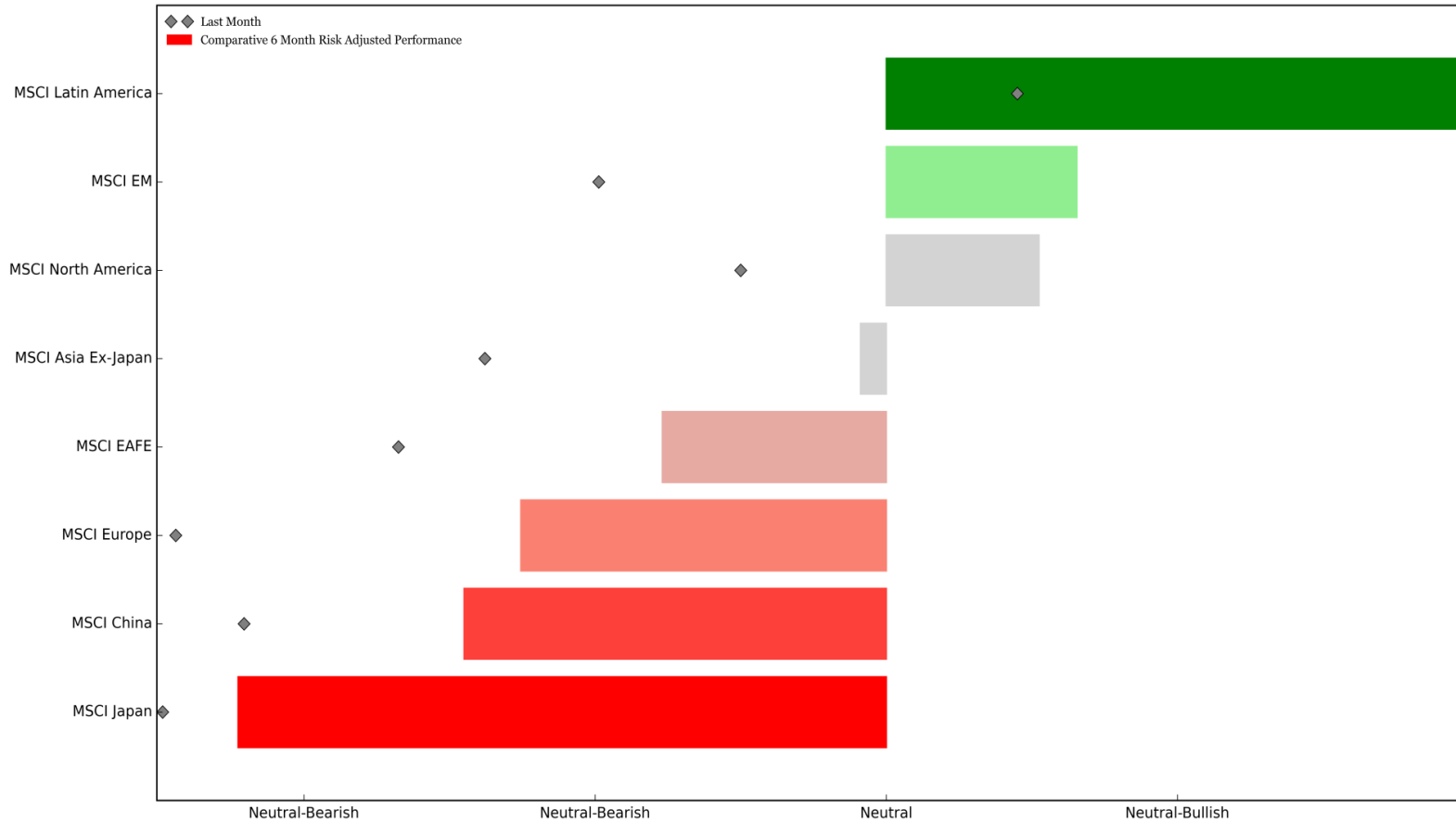


# Gold speculators massively long









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