MONTHLY STRATEGY REPORT
NOVEMBER 2018

THREE CATS, A BUCKET OF WATER, **AND THE FACE OF THE MARKET**

BancaMarch

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Yes, that is Salvador Dali in the photo. The portrait was taken by the great Philippe Halsman in 1948 at his New York studio, long before the advent of Photoshop. Known for his ingenuity and portraits of countless celebrities, including Marilyn Monroe, Einstein and Nixon, Halsman is the originator of the so-called "jumpology" technique. In many of the photographs taken throughout his life, he captured his subjects jumping, in an effort to ascertain more real, faithful images, without artifice, without the brain controlling the facial expressions. In his own words, "When you ask a person to jump [...] the mask falls, so that the real person appears." The result of this approach to portraiture is quite different from what emerges in posed photography.

Philippe Halsman, 1948. Dali Atomicus. LIFE Magazine

What we saw in the markets in October is also a much more real face. Although stock markets have not seen such an abysmal fourth-quarter start since 2008 and tensions are running high, 10% corrections on the S&P 500, while uncomfortable for everyone, reflect the true nature of the market in a much more genuine way.

The most telling evidence of this is volatility, and regardless of speculation about whether or not the cycle is approaching an end, we just finished an October with VIX index averages for the S&P 500 of 19.3%, similar to the average of the last 10 years and in no way excessive. Doubtless if Halsman had to select an instant in which to capture the true face of the US market, he would have opted to click the shutter in times like these, the least amenable in the last two years, when the deterioration of liquidity conditions and the effects of central bank stimulus withdrawal reveal the true face of the market and assets begin to trade in a more natural environment with less intervention.

The photo above is the result of a collaboration whereby Halsman suggested composing an image based on the surrealist painter's work Leda Atomica (the canvas on the right obscured by water). Dali's initial proposal for the picture was to blow up a duck.

But relax, there's nothing explosive coming. The purpose of this text, with jets of water spilling to the floor and three cats lurching into the void, is not to say that the cycle has ended, although at Banca March we began preparing for the close of the cycle in June, ("Investment proposals in light of the changing macro cycle"). While it is true that we are approaching the cycle's final phase (next June it will be the longest economic cycle of all time), there are several reasons to believe we have a ways to go. We will develop this idea further in the third section of this report, but despite the loss of macro momentum, the cycle models suggest that growth should continue, albeit at a slower pace, with strong corporate results, confidence indicators in expansion, and some additional margin gained on the curve slope in the final weeks.

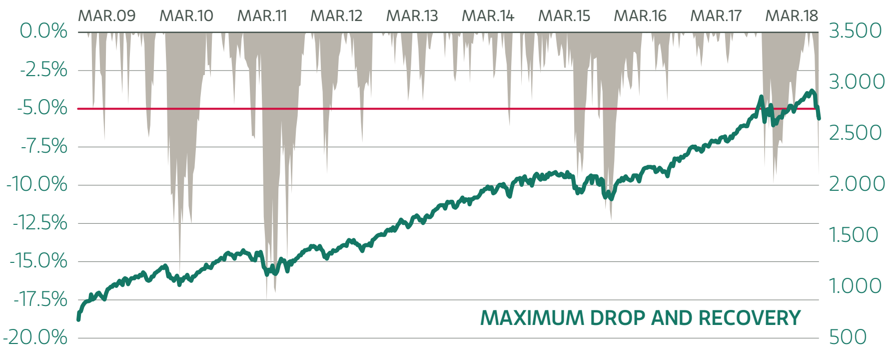
Despite political uncertainty in Europe and the trade dispute between the US and China, the most concerning risk at the moment is that, since 3 October, the US market and the more cyclical sectors have replicated the precipitous drops of other markets in Europe and certain emerging economies.

From our point of view, in the last few days we have witnessed a "normal" correction in a bull market. Therefore, it is important to contextualise the decline of the US market and understand that this is its fourth steepest drop in recent years.

1. EVOLUTION OF THE S&P500. DROPS FROM RECORD HIGHS IN A BULL MARKET *

Source: Bloomberg and Banca March

* Weekly data



How has the S&P 500 performed in past corrections? First, episodes of falling shares within an uptrend, like the present, are not uncommon. Throughout this cycle, which is nearly 10 years old, there have been 10 downswings greater than 5% that, on average, total 9.3%, very similar to the current decline. Second, it is important to note that, as the table below shows, subsequent stability and recovery is not immediate. The process to reach minimums typically takes nine weeks. Once minimums are reached, the market then takes an average of 11 weeks to rebound to previous highs. Therefore, we may continue to see volatility in the weeks to come.

2. ANALYSIS OF S&P500 DECLINES IN THE CURRENT BULL MARKET (WEEKLY CLOSE)

Source: Bloomberg and Banca March

CORRECTIONS > 5%	DURATION TO MINIMUMS (NO. OF WEEKS)	% DROP FROM HIGHS	REBOUND TO HIGHS (NO. OF WEEKS)
2009 Q3	4	-7.1%	2
2010 Q1	4	-6.9%	5
2010 Q3	10	-16.0%	18
2011 Q3	22	-17.0%	21
2012 Q2	9	-9.3%	11
2012 Q4	9	-7.2%	7
2014 Q3	4	-6.2%	2
2015 Q3	30	-12.3%	21
2018 Q1	10	-9.3%	20
2018 Q4 (Actual)	5	-9.3%	
Average	11.3	-10.1%	11.9
Median	9.0	-9.3%	11.0

But getting back to the photo, they didn't get it right the first time. It took no less than six hours and 26 attempts! The scene was carefully choreographed: Halsman counted to four before shooting, the cats and the water were launched on three, and Dali jumped on four. Afterward, the photographer entered the darkroom to develop the photo (chemically, of course) and determine whether it was necessary to make adjustments and reshoot, during which time his assistants dried the floor and calmed the cats. For our purposes, the cats serve as a simile for the market in this photograph: after several "launches" and much suffering from the water, the outcome was a tranquil one; Halsman's daughter, Irene, dried them and pampered them.

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