Contravisory Capital Markets Overview

Q2 2018

U.S. Equities

Following a strong rally that lifted the equity markets to new highs in early 2018, stocks finally corrected during the 1st quarter, interrupting a lengthy period of unusually low market volatility. For the quarter, the S&P 500 slipped 0.8% while the average US stock fund declined 0.4%. International stocks also pulled back, as the Morgan Stanley EAFE Index decreased 1.7%. Even bond investors were not spared from losses as the Barclay's Aggregate Bond Index depreciated 1.5%.

For many pundits, a short-term correction in U.S. and global equity prices was viewed as overdue, especially given the market strength and speculative run up in early January. Markets were vulnerable and needed a catalyst to correct and consolidate. We believe the primary trigger for the pullback was a byproduct of rising U.S. Treasury yields which accelerated in January as fixed income investors became more wary of future U.S. economic growth and inflation. Additionally, as bond yields increase, stocks can become a less attractive asset class and consequently sell off. We believe this mindset will be short lived.

Our perspective on the macro picture is warranted. First, the economic and earnings fundamentals continue to be supportive for equities. Second, the tax overhaul enacted late last year is likely to provide an additional boost to growth. Third, while the Fed is expected to continue on a gradual tightening path, as long as inflation remains tame, a spike in interest rates is unlikely; making stocks the preferable asset class over bonds.

We are watching the back and forth exchanges between Trump and China closely. While implementing tariffs rarely achieves any economic goal, there is good evidence that China takes advantage of the partnership with excessive trade barriers and hijacking American intellectual property. That must stop and if the tariffs bring the two sides together to negotiate a resolution, some good could come of this standoff. In our opinion, the markets are reacting with the same belief in mind.

The market is still bipolar with growth company valuations extended and value company fundamentals more reasonable. If the markets remain volatile, we believe that value companies may overtake growth companies sometime this year. There is very early evidence to support this possibility. Undervalued areas of the market are beginning to demonstrate early relative price strength as the overvalued growth stocks at the top end of the market are consolidating. This character change will likely shift investor interest into broad market themes, extending the bull market through this year and beyond.

Sector Comments:

- Uncertainty is still roiling the markets as Trump's trade war begins to heat up. The market was looking for an excuse to consolidate. Most trends remain intact. If a character change is underway, it has been very orderly so far. Let the media figure out the cause of every market twitch. The rest of us will make adjustments based on the facts as they become available. Stay long.

- The Consumer Discretionary sector is slowly improving. If this price action continues, it is highly likely that this sector will be upgraded from neutral to positive within a month or two. The Consumer Staples sector improves within its downtrend in March. It's not surprising that this defensive sector would "dig in" when volatility ramps up.

- The Energy sector remains in a downtrend but improvement was substantial in March. We are a little snake bitten as this sector has moved in fits and starts for several years now. It is poised for further improvement. Be patient.

- The Financial sector holds steady despite lasts months' volatility. The strength is a little deceiving as we have experienced net negative change for a few months now. Watch this sector carefully.

- The Healthcare sector slides lower in March and is downgraded from positive to neutral. This is a very disappointing result for what was a promising sector in late 2017.

- As Trump's tariff war escalates, the Industrials sector is under short-term pressure. Long-term trends remain positive within this sector that relies heavily on foreign trade, but a handful of important downgrades are notable.

- After a relatively strong February, the market pullback finally caught up to the Information Technology sector as prices consolidate at long last. In the all-important mega cap space, the pullbacks resulted in very little change.

- Like the industrials sector, the Materials sector is under a lot of pressure as trade talks get heated. The damage is more prominent here though and we have downgraded the sector to a negative rating.

- After a punishing February, Telecom stocks rally along with most other interest-rate sensitive groups. If volatility continues to expand this defensive sector could be a good place to hide if the market undergoes a character change.

- The Utilities sector was the top performing sector in March. Those who stayed patient have been rewarded as prices have rallied to much more attractive exit points across the sector.

Sector Rating Summary

Sector	Rating
Consumer Discretionary	Neutral
Consumer Staples	Underweight
Energy	Underweight
Financial	Overweight
Health Care	Neutral
Industrials	Overweight
Technology	Overweight
Materials	Underweight
Telecom	Underweight
Utilities	Underweight

International Equities

Our International sector continues to consolidate its heady gains from last year. The sector remains positive, but prices are at important levels and will need to improve in the short-term to maintain the uptrend.

International Recommendations Matrix

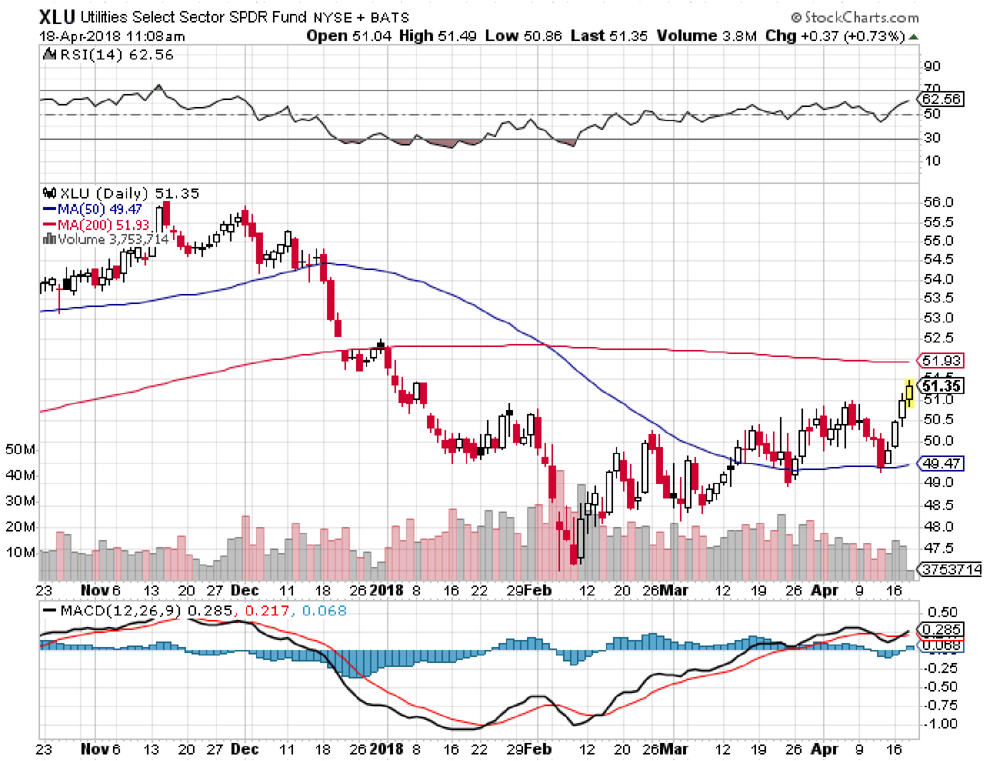
Overweight Developed	Underweight Developed	Overweight Emerging	Underweight Emerging
New Zealand	Belgium	Chile	Taiwan
Singapore	Hong Kong	China	India
Italy	Netherlands	Peru	*Poland
Austria	Israel	South Korea	Colombia
Finland	Spain	Thailand	Indonesia
France	Sweden	Brazil	Mexico
Japan	United Kingdom	South Africa	Philippines
*Norway	Canada	Russia	Turkey
	Denmark		India
	Germany		
	Ireland		
	Switzerland		

*New upgrade/downgrade

Fixed Income

In our prior letter, we expressed our *negative outlook* on fixed income markets. Sure enough, throughout the first quarter, the fixed income markets were vulnerable to a hawkish fed and an improving economy as the Barclay's Aggregate Bond Index *declined* 1.5%. The Fed raised its benchmark rate by 25 basis points and hinted that as many as three additional rate hikes could occur in 2018. As volatility ramped up toward the end of the quarter, bond markets stabilized; however, the long-term trend for fixed income remains bearish. In fact, bonds along with most interest-rate sensitive segments of the equity markets are at ideal levels to *sell*. In the following pages, we share some notable interest-rate sensitive charts and demonstrate their bearish characteristics. We highlight short and long-term term charts of both the XLU (Utilities SPDR) and the TLT (iShares Treasuries).

After bottoming in late February, both short-term treasuries and utilities have rallied to resistance at their 200-day moving average in recent days, an ideal opportunity to reduce exposure.

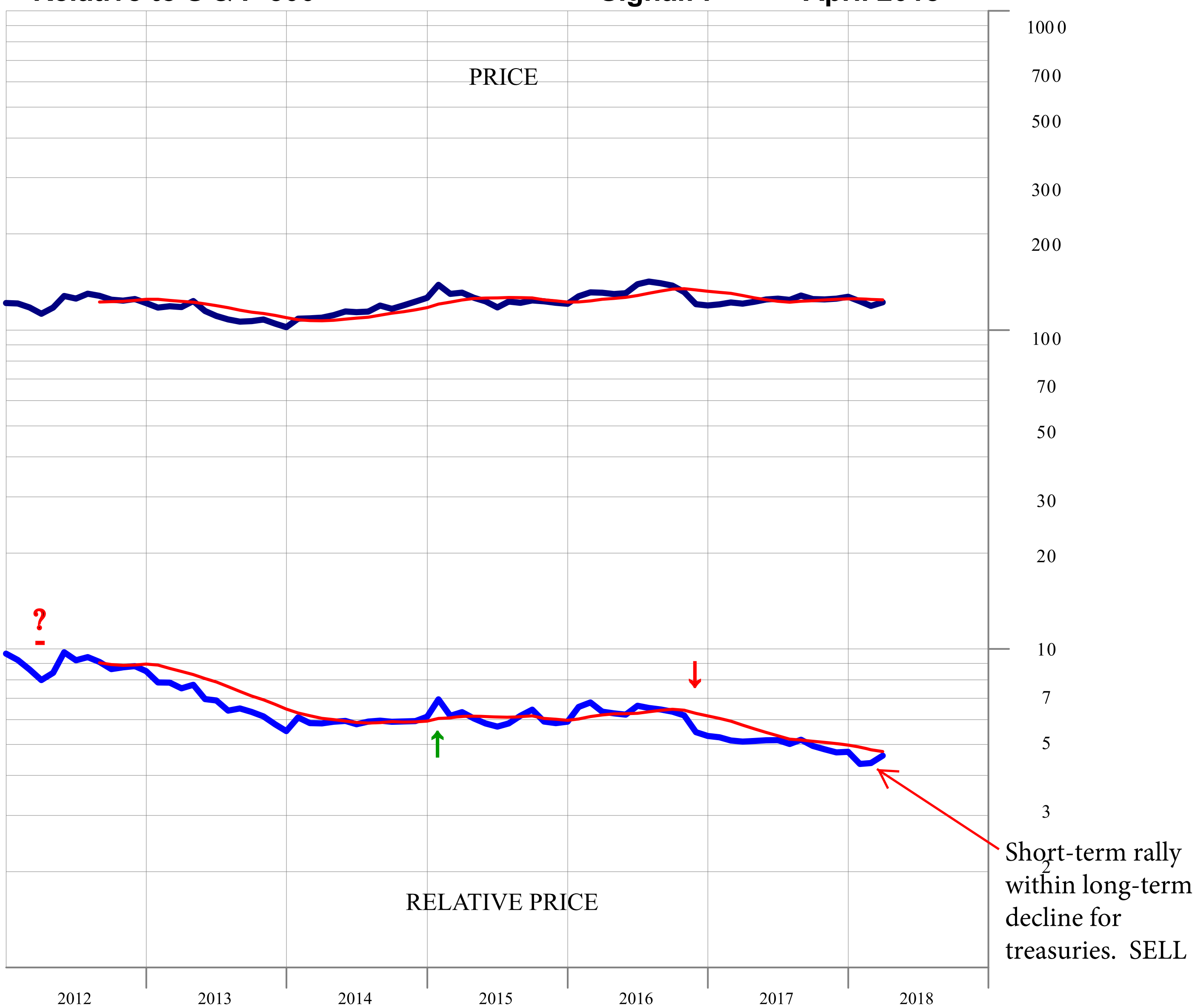


A longer-term perspective confirms that rate sensitive areas remain within long-term relative price declines and recent short-term rallies should be used as an opportunity *to sell*:

Contravisory Investment Management

Ishs LT Trez
Relative to S & P 500

Price: 121.9
Signal: F **April 2018**



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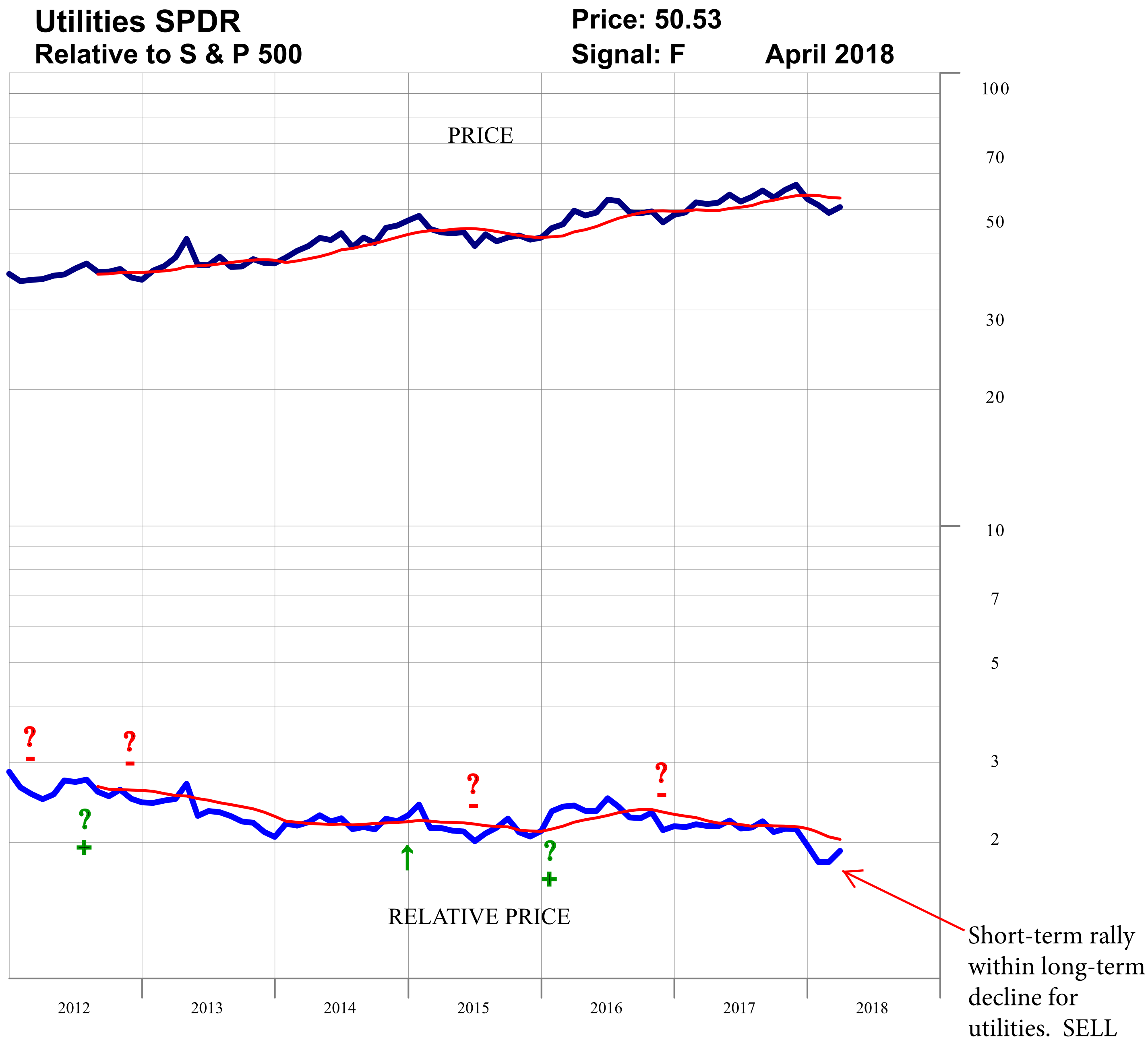

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