MRP CAPITAL INVESTMENTS, LLC

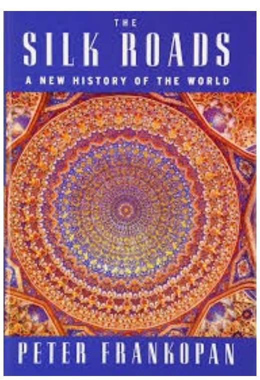
A Brave New World

7/21/2017

Introduction

Inside this report:

Readers of my work know that I have been talking about A Brave New World in my quarterly reports. What I mean by this moniker of “A Brave New World” is that we have put the Financial Crisis of 2008 firmly behind us and we are moving down a new path. In my opinion, this new path is being led by new global powerhouses and shifting global alliances. These new developments should push global profits to new highs and shift power from old, tried and true, countries to new, up-start, ones.



Through the coming pages I will detail:

-Who these Powerhouses are,

-What these new alliances are,

-How high profits could go,

-What to look for as this growth phase winds down.

The Powerhouses

To get our heads around who the Global Powerhouses are, the place to start is annual GDP per country. According to the World Bank, as of 12/31/2016, the Top Ten Countries (or Economic Zones) in terms of Gross Domestic Product in U.S. Dollars were as follows:

1) United States of America	$18.569 Trillion
2) The European Union	$16.398 Trillion
3) China	$11.199 Trillion
4) Japan	$4.9393 Trillion
5) India	$2.2635 Trillion
6) Brazil	$1.7961 Trillion
7) Canada	$1.5297 Trillion
8) S. Korea	$1.4112 Trillion
9) Russia	$1.2831 Trillion
10) Australia	$1.2046 Trillion

When we first look at that data, it is only natural to think that the USA and Europe dominate the global financial landscape. Followed by China and Japan. HOWEVER, it is vital to understand that in 2008 EU GDP was $19.118 Trillion!! Their current reading of $16.398 Trillion represents a decline of 14.23% in GDP over that last 8 years. To be frank, that is catastrophic.

Furthermore, Japan's GDP was up at $6.2 Trillion as recently as 2012. So, it's current reading represents a decline of over 20% in just 4 years. If the EU's problems are catastrophic, then Japan's problems are beyond abysmal.

Meanwhile, China's GDP currently ranks it as the 3rd biggest economic powerhouse. But in 2008, they had a GDP of $4.598 Trillion. Their current reading of $16.398 illustrates that they have grown their GDP 256% over the last 8 years. That is mega-powerhouse material!!

For context, the United States is the current top-ranked GDP powerhouse and they have grown their GDP by $3.85 Trillion over the last 8 years. This represents a gain of 26.16%, which is not too shabby for the Global Leader.

The New Alliances

It is to be expected, as the economic tides ebb and flow, for the struggling economies to try to partner up with the booming economies. And this cycle was no exception to that rule.

The biggest economic disaster appears to be Japan. As we mentioned before, Japan's GDP has shrunk by over 20% in the last 4 years. But what we didn't mention was that their debt ballooned to over $9 Trillion over that time frame. And this puts their Debt to GDP level at an eye-popping 220%.

I would make the argument that this level of debt is unmanageable without outside help. And, it is my belief, that they went looking for outside help from the United States and Donald Trump just as soon as he was elected into office. Not only did Japan's Prime Minister meet with Trump immediately after the election, but Softbank (a major Japanese tech company) met with him as well. The Softbank CEO promised 50,000 new U.S. jobs from a $50 billion investment into the United States to build factories and plants. Not coincidently, those promises lined up perfectly with the agenda Trump laid out in his campaign. Bottom line, without help from the United States Japan is done for.

Another key alliance we see unfolding is the World's relationship with the Middle East, particularly Europe's. As you saw in the last section, the European Union's GDP has been crushed the last few years. What wasn't mentioned was their debt accumulation. In 2008, EU Government Debt was a little over 6.5 Trillion Euros. At the end of 2016, it stood a bit over 9.5 Trillion Euros. Add the shrinking GDP with the soaring debt and, I do believe, they have a major problem.

Perhaps a bigger problem than all of that is the fact that the natural born population of the European Union has been shrinking in recent years. In fact, the only population growth the region has seen has been from immigration. Interstingly, one of the biggest "shrinkers", in terms of natural born population, in the EU has been Germany.

When you begin to process this fact along with the, seemingly, wild immigration policies, it all begins to make sense. The EU has a debt and growth problem; there is no question about that. They also have a shrinking population. They will not be able to meet the future obligations they promised to their citizens given their shrinking population (and therefore a shrinking number of future tax payers) and their current debt load.

So, what's the answer? It seems that they've decided to import mass amounts of people with the hope they turn out to be future tax payers who could provide the government with much needed funds. In my view, this is the only possible way they might be able to make good on the promises their Democratic Socialist governments have given to their citizens.

What's the trade off? A clash of cultures, violence, blood shed, and religious angst as the bulk of these immigrants are Muslims and the bulk of Europe is Christian. Will this work out over the long-term? Only time will tell, but it's a bit "bumpy" right now.

The impact of all of these moving parts is that we see the United States remain the Big Dog of the Global Scene, but China's power and influence is on the rise. This will only be bolstered by the new "Silk Road", which I discussed in the last newsletter. For a brief refresher, this Silk Road is designed to open new trade routes as China's domestic economy slows down and is projected to lift China's cross-border trade to over $2 trillion. It will raise China's status in the region. However, that "region" isn't just the Far East. The Silk Road expands the "region" to include the Middle East, Europe, and Africa.

On top of that, we see a diminishment in global power of Japan and the European Union. However the European Union still has a chance to save itself, mainly through increased immigration from the Middle East. And that, combined with their strategic location in the context of the Silk Road makes the Middle East an economic entity that is gaining power and prestige.

Furthermore, the Aramco IPO, which was also discussed in the last newsletter, adds to the economic power of the Middle East. And, in this specific instance, Saudi Arabia. As Aramco is the Saudi Arabian Oil Company. It is basically the business entity that drills for, refines, and ships all the oil that Saudi Arabia has. The market is putting a $2 trillion valuation on Aramco. Even though they are only offering 10% to the public, it will be the largest IPO in the history of the world and would generate almost 10 times the amount of economic activity as the Trump Wall. Saudi Arabia plans to use the proceeds of this offering to revamp and diversify its economy away from being so reliant on oil.

When you add all of this up, the Middle East has a TON of leverage on the rest of the World. Their population, which is one of the few in the World that is growing, holds the key to saving the European Union from their crushing debt load. They are strategically located to become a key player in regards to China's Silk Road growth plans. Additionally, they will be flush with boat loads of cash when Aramco goes public.

Of course, there are many other global players. But these are the major changes I've seen over the last 8 years, or so.

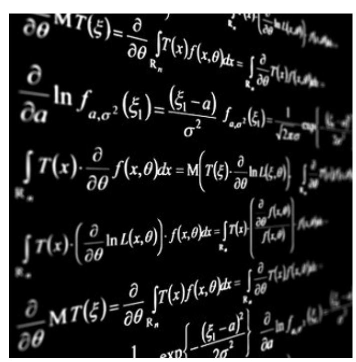
Profit Potential

The natural question that one might ask after consuming all of this information is, “What does all of this mean for me, the investor?”

The answer to that question, in a very basic sense, is that if all of these things can come together, we could see the profitability of business increase. I know this flies in the face of many market observers who think our current economic expansion is long in the tooth and the profit cycle is nearing its apex. But, to be candid, I disagree with the naysayers.

Yes, it is true that our current economic expansion has lasted quite a long time. In fact, the U.S. economy has been expanding since July of 2009. That puts the expansion smack dab at 8 years. However, the expansion that started in 1991 lasted 10 years and the expansion that began in 1961 lasted about 9 years. So, this is far from the longest post WWII expansion. AND it is one of the slowest expansions we’ve ever seen. Given the lack of robust growth, it makes sense that it would last a long time before the “bubble burst”, so to speak, because the “bubble” ain’t that full yet.

In regards to the profit cycle being near its peak, I disagree again. In fact, this is a data point I track VERY DILIGENTLY because it is one of only two ways that the market can go up. The other way, besides the actual earnings figure, is the multiple applied to the earnings figure. And, of course, I track that figure quite closely as well.



In regards to earnings, I track the "as reported" earnings figures of the S&P 500 companies in relation to their "potential" earnings. I've discussed this particular aspect of my research many times over and have written formal papers on it, so I won't get to deep into the weeds on the nuts and bolts of the metric. But it does need to be said that the data provides a very nice indicator for when earnings are peaking or bottoming out. In fact, here is the chart of S&P 500 "as reported" earnings versus "potential" earnings going back to 1939.

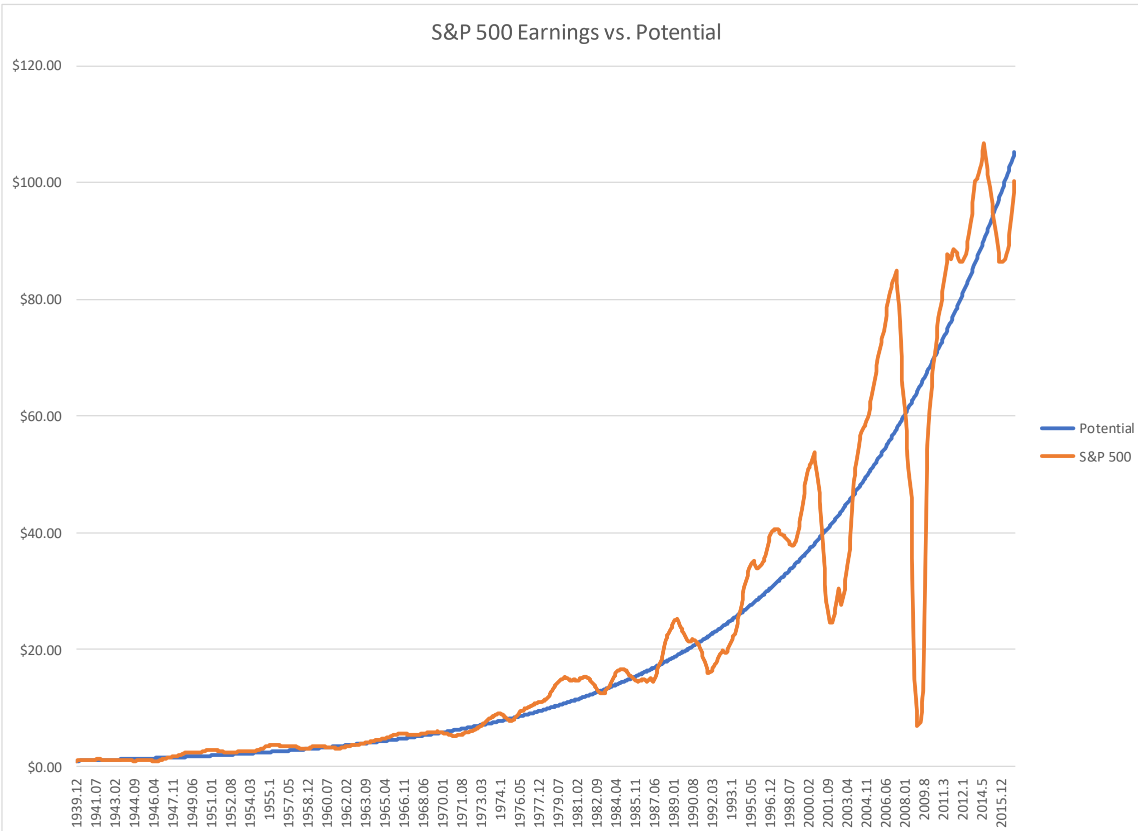


Chart provided by the MRPCI database.

You will note the actual earnings vary up and down around the "potential" earnings line with major troughs setting the stage for market rallies and upside peaks closely correspond with stock market tops, like the earnings peak in June 2007 before the 2008 earnings and stock market collapse.

Furthermore, you will note that we are currently below "potential" in terms of S&P 500 earnings. That means that we still have upside to our current earnings before we even touch on where earnings should be. This simple fact suggests that the market can still be driven higher by earnings growth.

But where it gets really interesting is that if you note that major stock market rallies are driven by earnings that go way above "potential." I've already pointed out the 2007 earnings peak. For point of reference, earnings peaked at that time 32.04% above potential. Other market peaks and their corresponding earnings peaks include the 2000 tech bubble, the 1984 recession, and the 1974 stagflation era. All in all, since the 1970s, we've seen 7 major earning's peaks and those peaks have averaged 22.04% above "potential" earnings. The lowest peak above potential was 14.26% (the 1984 peak) and the largest peak above potential was 32.04% (the 2007 peak).

Looking at the Global Landscape in concert with all of the quantitative data that I track, I see a continuation of strong earnings growth that should push earnings way above potential. And, frankly, I think understanding why this might happen is fairly obvious too. For starters, we have VERY low global interest rates. Therefore, companies (and governments) can finance projects very cheaply. Also, energy and commodity prices are low. Therefore, most inputs used to build out projects are cheap. And we've also got China building out the Silk Road, Saudi Arabia re-tooling their economy with proceeds from the Aramco IPO, Trump looking to institute a Trillion dollar infrastructure plan on top of his $25 billion Wall.

Quite frankly, it looks to me like we just might have the perfect alignment of business plans and government policies to produce a global boom in earnings in the coming years. A boom, that could drive earnings for S&P 500 companies significantly higher than their current level of $118.65. To be precise, my model shows "Potential" earnings for 2020 being $132.63, while "Potential" earnings for 2024 are $170.60. Somewhere during that time frame the run to peak earnings will happen and, as the data above suggests, the minimum premium to "Potential" earnings would be 14.26% (which was the smallest peak recorded in the last 50 years). This implies a 2020 S&P 500 earnings level of $151.54 and/or a 2024 earnings level of $194.93. Applying a "rational" P/E of 20 to those numbers gives us a 3,030.80 level in 2020 and a 3,898.6 level by 2024 (the figures represent 22.5% and 57.67% gains, respectively).

Warning Signs

The next logical question investors need to ask themselves is, "How will we know when this earnings boom is coming to an end?" In a nutshell, the answer is when Euphoria takes over the market.

One of the obvious signs that Euphoria has taken over the minds of investors will be stock prices. They will be rocketing higher and higher seemingly every day. However, there will be very little push back to the idea that this growth is sustainable and game changing. For example, the latest edition of the Wall Street Journal has 17 market-related stories on its front page and 9 are negative. This is pretty normal. However, the March 20, 1999 edition had 17 stories on the front page and only 3 were negative, but only VERY slightly negative. And remember 1999 was the last year of the Internet Bubble and in early 2000 that Bubble burst.

This concept of people getting emotionally excited about things is called "Reflexivity" and I have written about it a lot over the years. The last major paper I wrote on it was on 7/31/2013 and, aptly enough, the report was called "A Path to Reflexivity." Interestingly, in that report I said that the S&P 500 had a ton of upside room left to run from its then current reading of 1,680. I said that a "rational" level for the markets to run to would be 2,494. (For the record, as I type this the S&P 500 sits at 2,472.54). However, when Reflexivity takes over "rational" market valuations get thrown out the window. This implies that the S&P 500 level of 3,030.80 in 2020 and 3,898.6 in 2024, mentioned in the last section, could turn out to be low-ball figures.

And, of course, some will say that is crazy talk. To which I'd say two things: 1) These are probably the same people who called me crazy when in February of 2009 I called for a major Bull Market run in my "Beginning of the Bull…" research report and 2) I'd, actually, say they are right; it is crazy talk. It is crazy talk because what would drive the market to these levels are all the things that are not sustainable in the long-term. Which is why I am writing about it in the "Warning Signs" section of this report.

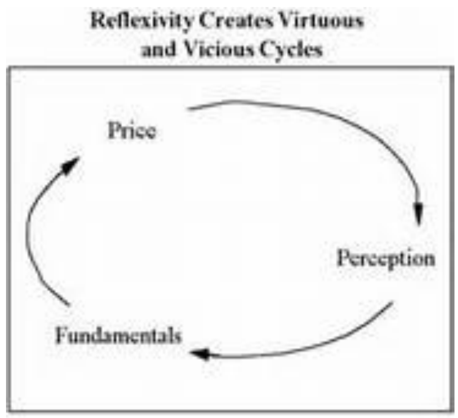
To begin to see the "Warning Signs", we need global co-operation. Aramco would have to go public without a hitch and the Saudi build out of its economy would have to go smoothly. The Silk Road would have to be booming and providing a boost to the Chinese economy and to its neighbors in the expanded region. And Europe would have been saved by their low interest rate, heavy immigration plan.

Could this happen? Absolutely! But, to be frank, this is why so many big and powerful people hate Donald Trump. His America First agenda threatens this global co-operation scheme. Personally, I do think he knows the importance of global co-operation. But the dollars are so big and the stakes are so very high (especially with these sky high levels of global debt), that anyone not preaching the globalism 100% of the time is viewed as an existential threat to the entire global financial system. And if the Global Powerhouse Leader decides not to play along with this global co-operation game then the whole debt-laden global financial system will collapse upon itself. For sure, the Powers that Be will NOT let this happen and will do ANYTHING they have to in order to ensure this global co-operation happens.

Now, for sure, the signs of global co-operation are signs that things are going well and it is a reason to be Bullish. But, they are also Warnings Signs for investors. Why? As investors see this, they will know that profits are coming and stock prices will get bid up. What we need to watch for are P/E's getting too big at a time when earnings are peaking. And earnings could be peaking if all these global projects are clicking all at once.

Furthermore, earnings could be boosted to a Nirvana state as technological innovations continue to occur. The ease of doing business increases and the cost of doing business falls when this occurs. We've seen it time and time again throughout history. People like to call these technological breakthroughs "new paradigms" and they like to say things are "different this time." Again, these are great things and signs of progress. But they are also Warnings Signs that things could be peaking.

Like I mentioned earlier in this section, when all of these good things begin to happen things will begin to snowball. They will build on each other. Revenues will boom. Profit margins will expand. People and businesses will be exuberant, probably irrationally so. These feelings and actions will, in fact, drive the market. And this is the “Reflexive” market I was talking about. Make no mistake about it, a Reflexive Market is a Warning Sign. Sometimes it’s a tough Warning Sign to pay attention to because in a Reflexive Market people are making money hand over fist in the short-run. But wise investors need to be aware of what is going on.



Additionally, all four of the main indicators I track will begin to flash Red signals. Consumer Sentiment will be high for long-enough for it to be, in fact, too high. Earnings, like we discussed before, will be well above their potential. Valuations will be very stretched. And the volatility in the market will be low, as people will have become complacent about market risks.

All that will need to happen at that point is for that one event to occur to make people realize, “Wait a minute! We’ve priced in perfection!” It might be a rate hiking cycle that pushes the economy into a recession. It could be a geo-political event that highlights not everyone is co-operating in the global financial games. Regardless of what that events is, if all of these Warning Signs are in place then investors need to be prepped and ready for the Nirvana Economy to bust.

Summary

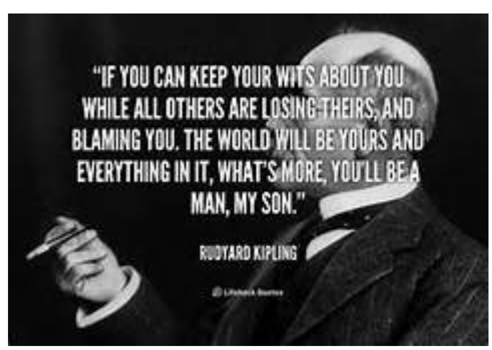
To wrap things up in a concise manner, I think 4 main things need to be remembered:

- We have a new global financial landscape. In this new landscape, power has shifted away from Japan and the European Union and it has moved towards Asia and the Middle East.

- Things are aligning for a major upswing in the profit cycle.

- We could see the market move another 50% higher over the next several years.

- And, if this rally does occur, investors will need to be watching for signs of irrational Euphoria, right at the time the whole world seems to be Bullish.



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