January 2017

The WSJ's biggest headline last month appeared on Thursday: **Dow Tops 20000**. As pointed out by Tony Daltorio, Editor of Investors Alley's Premium Digest: "It's really a non-event though since the index is price-weighted. Just five of its components – Goldman Sachs (NYSE:GS), IBM (NYSE: IBM), Boeing (NYSE: BA),UnitedHealth Group (NYSE: UNH) and JPMorgan Chase (NYSE: JPM) – accounted for half of the index's rise since the election of Donald Trump as President."

Will it, the so-called Trump Rally, continue? We have previously shared our concern about excessive optimism. While fully cognizant of our own Confirmation bias, the first of two edited WSJ analyses from January 26th:

The Fragile Economic Foundation of Dow 20000

Divergence between stocks and bonds shows optimism about Trump outweighs concern about protectionism and European populism

By **GREG IP** Jan. 25, 2017

Britain is leaving the European Union, a protectionist is in the White House, the front-runner in France's presidential election wants out of the euro. Yet paradoxically, investors have concluded the world is getting less risky, not more. The result: a hunger for shares that carried the Dow Jones Industrial Average over the 20000 mark Wednesday for the first time.

It is hard to explain this with economic fundamentals. They have improved since Donald Trump's improbable election victory in November, but not by much. After the election, economists surveyed by The Wall Street Journal added 0.3 percentage point to expected growth over the next two years. At their December meeting, Federal Reserve officials barely touched their growth forecast. Analysts' profit estimates haven't changed much either.

What has changed is how investors assess the balance between upside and downside risks. Their worries about Mr. Trump's protectionism or European populists' growing threat to the euro are outweighed by the pro-business tilt of Mr. Trump's cabinet picks; the prospect of more infrastructure spending and lower taxes, especially on profits; better bank profits from rising bond yields and lower odds of more negative central-bank rates; and the boost to U.S. oil producers since the Organization of the Petroleum Exporting Countries and several other countries agreed to trim production to prop up prices.

One solid bit of evidence of rising risk appetites is the divergence between stocks and bonds. After Britons voted to leave the EU in June, Treasury bond prices soared and yields, which move in the opposite direction, plunged below 1.4%, a historic low. That wasn't justified by any plausible path for inflation. Rather, it reflected a desperate pursuit for protection from threats ranging from a euro breakup to more deeply negative central-bank rates.

By the eve of the election, yields had returned to around 1.9% and since then have shot to 2.5% . Only some of this is because investors expect a quicker pace of Fed tightening. Most of it is simply because in a less risky world, investors aren't as hungry for supersafe assets. That same shift in risk appetites is why stocks have gone in the opposite direction to bonds.

... Stocks are now trading at 21 times the past 12 months’ earnings, compared with 15 when the Dow crossed the 15000 mark in 2013, though far less than the 24 times when it topped 10000 during the dot-com bubble in 1999.

Are investors getting carried away? Perhaps. Congress and Mr. Trump both want to cut taxes but haven’t agreed how and will be hemmed in by the deficit. Nor does Congress have much appetite for Mr. Trump’s infrastructure push. Much of Mr. Obama’s financial and health-care laws may survive.

Direction matters, though. Even if regulations and taxes don’t ease much, that is a notable contrast to the toughening that existed under Barack Obama, which a president Hillary Clinton would likely have continued. Similarly, while recent upgrades to the economic outlook have been minor, they are a cathartic change from the serial downgrades that dogged the expansion from 2009.

This also explains why the market was only briefly set back after the Federal Reserve raised rates last month and penciled in three increases this year, up from two in September. ...

And while there is little sign yet the economy has broken out of the low-growth rut of the past seven years, that too could change. If companies’ animal spirits mirror those of the market, capital spending and risk-taking could revive, dragging productivity higher.

Nonetheless, the market needs a reality check. The U.S. expansion is more than seven years old and retains little momentum from using up spare capacity from the recession. At 4.7%, the unemployment rate is at levels the Fed considers a fully employed workforce. Indeed, recessions usually happen with unemployment around or below 5%. ...

And investors shouldn’t forget that Mr. Trump’s fondness for meddling in business and punishing foreign trading partners could undo much of the goodwill a business-friendly tax reform will generate.

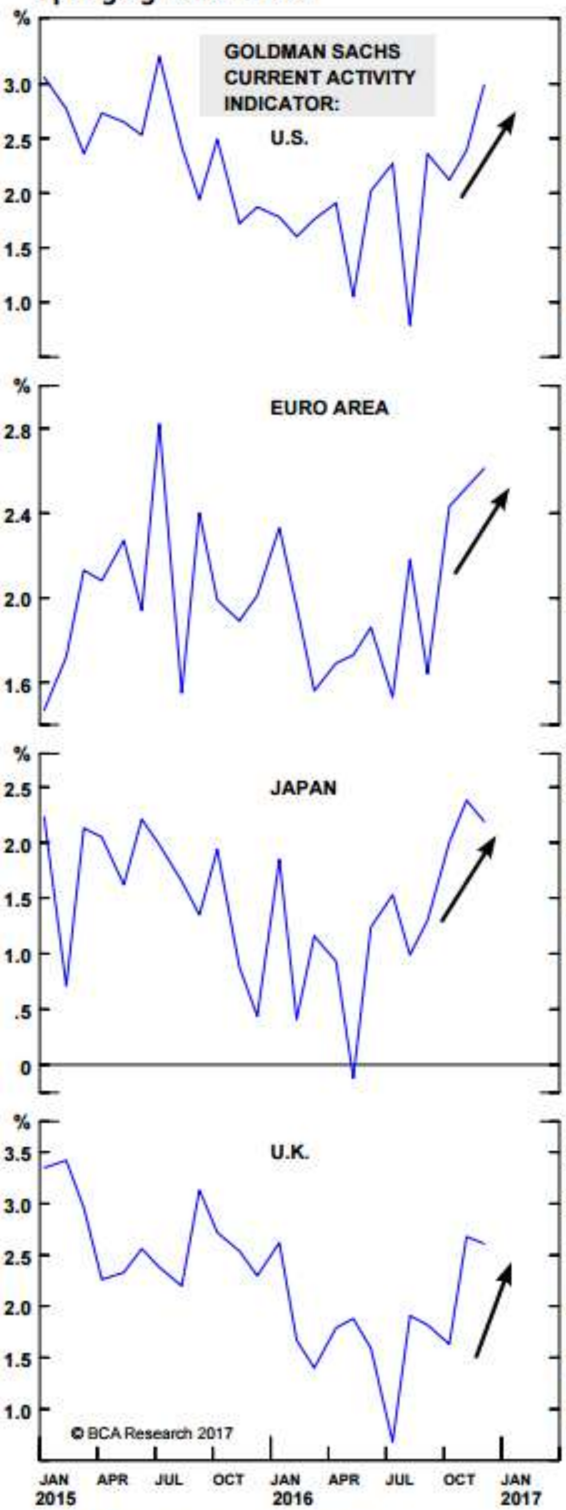
It isn’t that rising trade barriers will cause a recession. There is little historical precedent for that, notes Peter Berezin of the Bank Credit Analyst, an investment research service, in a recent report. (Historians now agree the Smoot-Hawley tariff of 1930 was only a minor contribution to the Depression.) If companies repatriate production from abroad, that could temporarily boost investment and jobs. The real problem, he says, is that protectionism means foreign products aren’t as readily available to satisfy strong spending at home, which leads to inflation pressure and higher interest rates. It also corrodes international cooperation and destabilizes geopolitical relations. (A summary of Berezin's current assessment is provided below.)

This suggests the next decade for blue-chip company profits are going to be tougher than the last. Investors should adjust expectations accordingly.

As reported Friday, the fourth quarter's 1.9% GDP growth rate was below consensus. Last weekend's WSJ front page report was titled **Growth Sputters Through Year-End**, with the subtitle noting "a rate the administration is seeking to double". Why that won't happen was shared on 1/20/17 in **Trump will "fail"**, which is posted on our website. However, Friday's Global Investment Strategy:

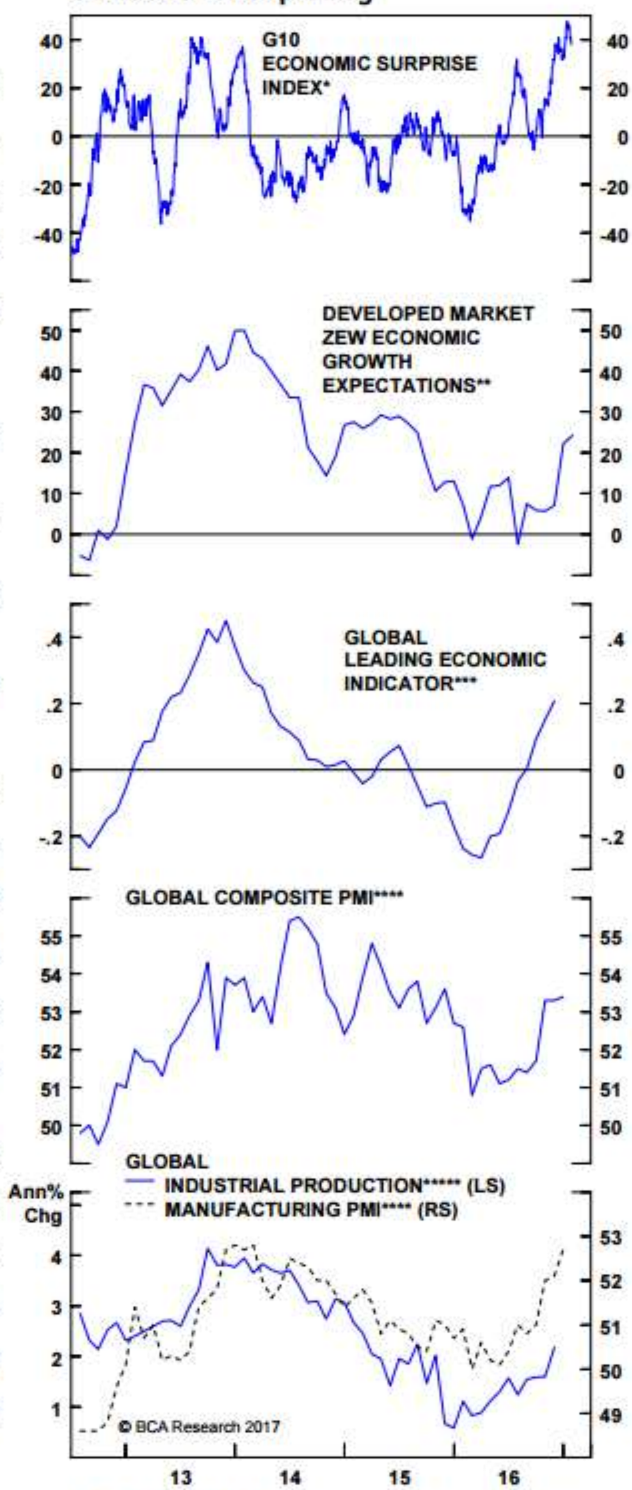
The global economy is on the mend. Measures of current activity are rebounding, as are a variety of leading economic indicators (Charts 1 and 2).

CHART 1
Global Economy Springing Back To Life



SOURCE: GOLDMAN SACHS AND BLOOMBERG FINANCE L.P.

CHART 2
Global Leading Economic Indicators Are Improving



* ROLLING 3-MONTH STANDARD DEVIATION OF DATA SURPRISES. SOURCE: CITIGROUP GLOBAL MARKETS INC.
** GDP-WEIGHTED AVERAGE OF THE U.S., JAPAN, GERMANY, FRANCE, ITALY, AND THE U.K. SOURCE: CENTRE FOR EUROPEAN ECONOMIC RESEARCH (ZEW).
*** INCLUDES 40 COUNTRIES, SHOWN AS A DEVIATION FROM TREND, BASED ON BCA CALCULATIONS.
**** SOURCE: J.P. MORGAN / MARKIT ECONOMICS.
***** INCLUDES 40 COUNTRIES, BASED ON BCA CALCULATIONS.

Markets tend to swing from one extreme to another. This time last year, investors were fixated on secular stagnation. Now they are convinced that we are on the edge of a new global economic boom. Neither position is justified. Global growth has picked up, and this should provide a tailwind to risk assets over the next 12 months.

... The surge in developed market equities since the U.S. presidential election has pushed stocks deep into overbought territory. A correction is likely over the next few weeks. We expect global equities to fall by 5%-to-10%, paving the way for higher returns over the remainder of the year. Once that recovery begins, European and Japanese stocks will outperform their U.S. counterparts in local-currency terms. We continue to expect EM equities to lag DM.

In contrast to stocks, bond yields have already moved off their highs. ... the transition from deflation to inflation will be a protracted one. Nevertheless, the path of least resistance for yields is to the upside. The Fed is likely to raise rates three times this year, one more hike than the market is currently pricing in. This should be enough to keep the dollar bull market intact. We expect the trade-weighted dollar to rise another 5% by year-end, with the risk tilted to the upside if Congress ends up approving a border adjustment tax.

Dow 20000: Don’t Be Euphoric. Be Very Cautious

History suggests you have to wait a long time for the risks of owning stocks to pay off

By **JASON ZWEIG** Jan. 25, 2017

A trader wears a Dow 20,000 hat as he works on the main trading floor of the New York Stock Exchange shortly before the opening bell on Wednesday.

... After the Dow hit 10000 back in early 1999, it seesawed above and below that milestone 33 times until it finally clambered back above 10000 for good on Aug. 27, 2010, says Howard Silverblatt, senior analyst at S&P Dow Jones Indices.

Yes, investors earned dividends along the way. And, yes, the Dow peaked at more than 14000 in July 2007.

But to get from 10000 in 1999 back to the same level in 2010, you had to survive the fall to 6547.05 in March 2009. In a little over a year and a half, the Dow fell by more than half.

And that was after it fell 38% from January 2000 through October 2002.

Looking further back, the Dow didn't surpass its closing highs of 1929 until late 1954, just over a quarter of a century later.

That doesn't count dividends, but most investors didn't reinvest them in those days. Even if they had, that barely would have lessened the ghastly losses that followed the Crash of 1929.

So you may have to wait an exasperatingly long time for the risks of owning stocks to pay off. Another lesson is more subtle: Financial history looks more predictable than it is—or was.

The market often moves in long, sweeping cycles, sailing higher for years, even decades, and then stagnating or falling for years on end.

Think of 1966-82, when stocks went nowhere. Then came 1982 to early 2000, one of the greatest bull markets on record. Or think of the wrenching years from 2000 through 2009, with two epic crashes, followed by 2009 to this year, when stocks have tripled.

Those major cycles seem almost absurdly obvious when you look back at any chart of historical performance. It feels as if a child should be able to see such moves coming.

But the market has always mapped its future trajectory in invisible ink. The clarity of past cycles is an illusion, a luxury of hindsight.

No wonder, then, that academics, analysts and investors have long sought forecasting tools that could identify when the stock market will have high or low returns for years on end.

If you had such tools and knew they would work, you could ride the stock market's gains and dodge its losses.

In a new study on the history of financial markets from the CFA Institute Research Foundation, Antti Ilmanen, a principal at AQR Capital Management in Greenwich, Conn., summarizes the extensive research in that field.

The findings show that when dividend yields are below their long-term average, future stock returns also tend to be below average.

Likewise, when stocks trade at high prices relative to their long-term earnings, adjusted for inflation, future performance tends to be low.

With dividend yields about 2.5% for the Dow and 2% for the S&P, not far from historic lows, and stocks trading at almost 29 times inflation-adjusted multiyear profits, or well above their long-term average of about 16, it seems prudent to expect tepid—maybe even putrid—returns for years to come.

Unfortunately, no one seems to be able to make precise, or even practical, forecasts using dividend yields or multiples of long-term earnings. Those indicators, writes Mr. Ilmanen, "give relatively coarse signals and too often recommend buying or selling too early in a cycle."

Stocks began to seem overvalued by such measures about 1992, at the latest. With the exception of a few months in 2008 and 2009, they've been at least as expensive for almost the entire quarter-century since.

Exploiting such signals, according to Mr. Ilmanen, is "so difficult that most investors are better off resisting the temptation to try."

Reaching a notional milestone like 20000 isn't some magical sell signal or an indication that the Dow is doomed to drift or go down from here.

But the index's own history should remind us all that the good times don't roll forever. So Dow 20000 should make you cautious, not euphoric.

Owning stocks is a long-term undertaking that doesn't just require patience. It also requires higher tolerance for pain and uncertainty than many investors may realize.

Positions

IRT for **IRET** - Both Apartment REITs, an 11% average analyst Target Price differential in IRT's favor was sufficient to justify substituting the 8.3% yielding IRT @ 8.909 for the 4.1% yielding IRET @ 6.901 (green line) in all client accounts.

Insider Buying:

Trade Date↓	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)	Close Price
11/07/2016	1	SCHAEFFER SCOTT F		10,000	8.3700
11/04/2016	2	SEBRA JAMES J, ENDER...		4,500	8.1300
11/02/2016	2	ROSS RICHARD H, PRI...		2,501	7.8400

Independence Realty Trust (IRT: $8.95)
January 17, 2017 Estimate Changes
Rating: Buy Price Target: $10.00

Lowering 2017 Estimates On Revised Guidance Assumptions

Summary

We are maintaining our Buy rating and $10 target on Independence Realty Trust (IRT) while lowering our earnings estimates following updated 2017 guidance, with our 2017E core FFO declining $0.03 and 2017E AFFO falling $0.05 given reduced SS NOI expectations and zero net investment activity. IRT currently trades at 85% of our downwardly revised NAV estimate and 11.8x 2017E core FFO. Our $10 target is 95% of our $10.52 NAV estimate, which compares to multifamily REITs trading at 93% of NAV on average, a modest premium that we believe is warranted given our expectation of SS NOI outperformance in IRT's markets relative to other MF REITs and IRT's growth potential. At $10, IRT would trade at 13.2x 2017E core FFO, a discount to the group trading at 19.2x.

Key Points

Initial 2017 core FFO guidance offered. IRT recently announced FY17 core FFO guidance of $0.72-$0.76, which compared to our $0.79 estimate and the $0.78 consensus. Relative to our expectations, SS NOI was lower than expected (at a range of 3.5%-4.5% vs. our 6% expectation for 2017), while also establishing zero net investment activity ($75mm-$100mm of acquisitions offset by $75mm-$100mm of disposition activity) vs. our expectation of ~$220mm of net asset growth, while cash G&A was also established at $7mm-8mm (in line with our estimate).

$0.03 impact to our core FFO estimate. The reduction in SS NOI expectations (we went from 6% to 4.5%) accounted for a $0.01 reduction to our core FFO estimate, while the impact of the loss of acquisitions represented a $0.02 reduction to our core FFO estimates, though this decline was somewhat mitigated by our expectation of its financing via 65%/35% debt/equity (at $9/sh).

Internalization complete, what's next? With internalization now complete, management continues to maintain a goal (over time) of getting leverage to ~7x EBITDA (which compares to our 9.5x 2017 estimate). While IRT has a pipeline of acquisitions and could fund them with the sale of the four class-C assets in the portfolio, the company is unlikely to increase leverage to buy additional assets (nor utilize preferred equity after recapitalizing the balance sheet earlier this fall).

Lowering estimates. We are lowering our 2017 earnings estimates, with our 2017E core FFO declining from $0.79 to $0.76 and our AFFO estimate declining from $0.68 to $0.63. We do not anticipate any dividend reduction but forecast a 115% AFFO payout in 2017. As such, with SS NOI trends appearing to be slowing down, dividend coverage may not occur even in 2018 without incremental acquisition activity.

Maintaining Buy, $10 target. IRT currently trades at 85% of our downwardly revised NAV estimate and 11.8x 2017E core FFO. Our $10 target is 95% of our $10.52 NAV estimate, which compares to multifamily REITs trading at 93% of NAV on average, a modest premium that we believe is warranted given our expectation of SS NOI outperformance in IRT's markets relative to other MF REITs and IRT's growth potential. At $10, IRT would trade at 13.2x 2017E core FFO, a discount to the group trading at 19.2x.

Craig Kucera Wunderlich Securities

INVESTORS REAL ESTATE TRUST (IRET: $5.84)
September 14, 2016
Rating: Hold Price Target: Old - $6.75; New - $6.00

Lowering Target to $6 On Accelerated Dispositions & Likely Dividend Cut

Company Description

Investors Real Estate Trust is a self-advised equity real estate investment trust. Its business consists of owning and operating income-producing multi-family residential, healthcare, and commercial properties located primarily in the upper Midwest states of Minnesota and North Dakota. Investors Real Estate Trust is based in Minot, North Dakota.

Summary

We are lowering our price target on Hold-rated Investors Real Estate Trust (IRET) to $6 following additional detail regarding its accelerated capital recycling program to move to a pure-play multifamily REIT, which is now captured in our FY18 estimates and NAV; as such, our FY18 FFO is declining from $0.54 to $0.43, and our revised NAV is declining to $6.92. We maintain our Hold rating given our expectation for fundamentals to remain challenged in IRET's portfolio relative to other diversified REITs due to IRET's energy-exposed portfolio and given the likelihood of a dividend reduction to operating cash flow (<$0.09/sh.) levels. Our $6 target represents 87% of our NAV estimate, in line with similarly sized diversified REITs, and 14.1x FY18E FFO vs. similarly sized peers trading at 12.5x.

Key Points

1Q17 highlights - huge impairment charge, -10% SS NOI. IRET reported an in-line 1Q17 of $0.12, but took a significant ($54mm) impairment at a number of its Williston, ND, properties that faced a substantial decline in traffic and lease up during the summer months while already facing a ~50% decline in rent and NOI from a year ago. We estimate these properties were written down to <50% of their cost. In addition, overall SS NOI was down a significant -10% for the quarter as revenue fell 2.5% while operating expenses increased 8.6%.

Senior housing portfolio under contract. Prior to posting earnings, IRET announced that it had placed the remainder of its senior housing portfolio under contract to sell. While we are unclear as to the timing of when these sales will close (~$280mm), we have included them in our FY18 estimates, with some deleveraging (~$125mm) expected as well as the repurchase of the Series A (~$30mm), with the remainder recycled into larger multifamily assets (<6% cap rate).

Cutting estimates, dividend cut likely. We are reducing our FY17 FFO to $0.48, which is the low end of management's guidance range, while cutting our FY18 (which accounts for the aforementioned capital recycling) from $0.54 to $0.43 and driving AFFO to $0.37. Given management commentary, we believe the dividend will be cut from $0.13 to below AFFO; we estimate a $0.09/sh. quarterly run-rate in operating cash flow.

Lowering target from $6.75 to $6. Our downwardly revised price target is based on our FY18 (post-capital recycling) estimates, as we have reduced our NAV estimate to $6.92 (6.5% cap rate). Our $6 target represents 87% of our NAV estimate, in line with similarly sized diversified REITs, and 14.1x FY18E FFO vs. similarly sized diversified REIT peers trading at 12.5x.

Maintaining Hold. There's been significant management turnover over the last several years, and we believe the addition of new President Mark Decker, Jr. is a positive as the strategy has faltered. While a dividend cut is likely to pressure shares, we maintain our Hold rating as IRET trades at a discount to underlying NAV, in our opinion, but at a comparable valuation to other similarly sized diversified REITs.

QMOM - Alpha Architect's Momentum Factor ETF for domestic stocks. We now consider it a Core holding for clients solely focused on Capital Appreciation.

TGI - This IVE System pick for clients focused on Capital Appreciation manufactures Aircraft Components:

Insider Buying:

Participants	Relation	Transaction Type	Shares	Trade Price	Trade Date
HOLZTHUM THOMAS	Officer	Open Market Purchase	10,000	25.5000	11/07/2016
CROWLEY DANIEL J	Officer	Open Market Purchase	50,000	25.5600	11/07/2016
LOVELY RICHARD R	Officer	Open Market Purchase	2,000	25.1300	11/07/2016

TOTL - While we don't recommend attempting to time the market, during times, like now, of excessive optimism we prefer to park excess cash here, instead of in our usual Transitional Funds.

WHLR - is a shopping center REIT trading at 68% of Wunderlich's estimated 2.49 NAV while yielding 12.4%. Externally managed when it went public in 4Q12, it had to effectively “re-IPO” in 1Q15 due to mismanagement. It is now internally managed, our preference, with a new CFO and reduced headcount. When investing in individual REITs we attempt to diversify among Sectors when provided the right opportunity. This particular client is focused on Capital Appreciation.

Insider Buying:

12/20/2016	1	WHEELER JON S		22,000	1.6500
12/19/2016	2	SWEET JR JOHN W, WHE...		18,867	1.6300
12/14/2016	1	ZWERDLING JEFFREY M		11,000	1.5800
12/08/2016	1	WHEELER JON S		6,875	1.5900
12/07/2016	1	MCAULIFFE JOHN		15,000	1.5900

Wheeler Real Estate Investment Trust (WHLR: $1.70)
January 27, 2017 Initiating Coverage
Rating: Buy Price Target: $2.25

Initiating Coverage With A Buy – High-Yielding Retail REIT on the Mend

Summary

We are initiating coverage of Wheeler Real Estate Investment Trust, Inc. (WHLR) with a Buy rating and a 12-month price target of $2.25. We believe WHLR's current valuation is not taking into account the stability of underlying cash flow and recent improvements in G&A expense and balance sheet management, which we project should allow for AFFO dividend coverage in 2017 and act as a catalyst for shares. Our $2.25 price target represents 91% of our $2.49 NAV estimate (7.75% portfolio cap rate) and 10.7x 2017E AFFO vs. a shopping center REIT peer average of 93%/~21x and similarly sized shopping center REITs at ~13x. With improving scale economies and our expectation for WHLR to rapidly acquire more shopping centers, we believe shares are undervalued and we are initiating coverage with a Buy.

Key Points

A secondary/tertiary market, necessity-based, retail play. Acquisition cap rates in WHLR's targeted markets are generally in the 8%-9% range, and WHLR is able to create value on the buy, reinterpreting existing leases to increase CAM recoveries while charging administrative fees, raising NOI by an incremental 300bp-400bp. Acquisitions are priced below replacement cost typically with anchor grocer rents representing <3% of sales, enhancing tenant retention as anchor rents are often profitable at sales levels ~50% of the national average.

Rapidly improving G&A, balance sheet on the mend. WHLR has significantly streamlined its G&A over the past year, which has fallen >40% YoY (inclusive of a number of one-time costs such as severance) as total headcount has been reduced by >20% while management has endeavored to reduce recurring cash G&A expense to a level in line with peers. We expect continued deleveraging of the company as management persists in acquiring new assets as the next phase in balance sheet and operational efficiencies.

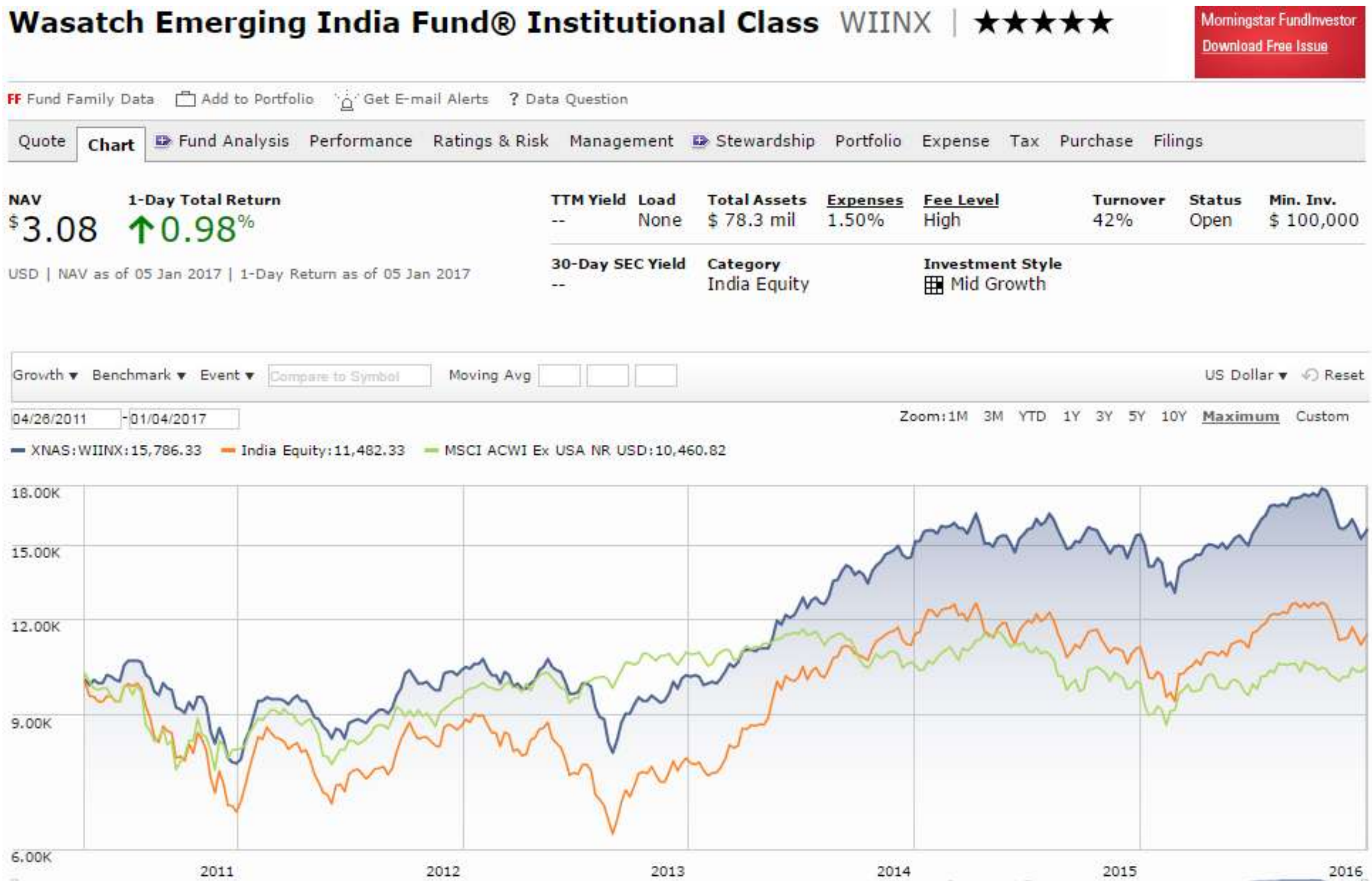
Dividend coverage on its way. Given WHLR's significant reductions in G&A expense and continued balance sheet growth, we believe WHLR should be able to cover its current $0.21 dividend in 2Q17 after deploying the proceeds from recent preferred equity offerings into $115mm of grocery-anchored shopping centers in its targeted markets in the Southeast at an ~8% initial cap rate in 4Q16. Given higher initial cap rates and improved G&A scale, earnings accretion from incremental acquisition volume should accelerate, providing greater coverage.

Establishing estimates. We are establishing 2016, 2017, and 2018 FFO estimates of $0.09, $0.19, and $0.20, which leads us to our AFFO estimates of $0.14, $0.21, and $0.22, respectively, with coverage of the dividend from AFFO forecast in 2Q17 (given some expected seasonality in G&A expense in 1Q17). Our estimates do not assume any incremental acquisitions and we project a 99% AFFO dividend payout ratio in 2017, declining to 95% in 2018 given SS NOI growth, while fixed charge coverage is projected at 1.8x in 2017 and 2018.

Initiating coverage with a Buy, $2.25 target. Our $2.25 target represents 91% of our $2.49 NAV estimate (7.75% portfolio cap rate) and 10.7x 2017E AFFO, which compares to shopping center peers trading at 93% and ~21x and similarly sized shopping center REITs at ~13x. With improving scale economies via recent G&A reductions and our expectation for WHLR to rapidly acquire more shopping centers, we believe shares are undervalued and we are initiating coverage with a Buy rating.

Craig Kucera Wunderlich Securities

WIINX - Despite our previously shared and continuing concern about many Emerging Markets, we followed Quest Opportunity Fund (QOF) into the lower-management-fee institutional shares (made possible by QOF's investment) of this OEF for clients focused on Capital Appreciation. The Grandeur Peak team (GPIIX) came from Wasatch.



From BCA Research's January 6th Global Investment Strategy - Strategy Outlook - First Quarter 2017: From Reflation to Stagflation:

Emerging markets are a tougher call. The combination of a strengthening dollar, growing protectionist sentiment in the developed world, and high debt levels are all bad news for emerging markets. EM equity valuations are also not especially cheap by historic standards. Nevertheless, a reflationary environment has typically been positive for EM equities. ...

On balance, EM equities are likely in a bottoming phase where returns over the next 12 months will be positive but not spectacular. BCA's favored markets are Korea, Taiwan, China, India, Thailand, and Russia (a Kleptocracy we wouldn't touch). We would avoid Malaysia, Indonesia, Turkey, Brazil, and Peru.

From December 29th's issue of Capitalist Times:

India: The Modinator

India’s decision to ban some currency has created problems, but only in the short term. The economy and market remain robust, and the coming volatility is an opportunity to buy.

By Yiannis G. Mostrous

On Nov. 8, 2016, India’s Prime Minister Narendra Modi proved one more time that he’s not an ordinary politician when the government withdrew the legal-tender status of the 500- and 1,000-rupee currency notes.

These notes, which represented 85 percent of publicly held currency by value, must be deposited in banks by the end of the year. Removing the notes caused havoc. Cash amounts to about 14 percent of India’s gross domestic product (GDP), compared with an average of about 5 percent for emerging economies.

The demonetization makes good on Modi’s promise to attack corruption and illegal economic activities while promoting digital banking and financial inclusion. Following through on these promises is quite a challenge. India’s formal economy represents only 15 percent of GDP, which explains why tax receipts as a percentage of GDP are low and why corruption levels are extremely high.

To a point, Modi appears indifferent to the political risk he’s taken. He’s only halfway into his term and important state elections are to be held next year. Perhaps the most vital of those elections is the one in Uttar Pradesh (UP). The state has a population of 205 million, more than 20 percent of which is Muslim. The outcome here could negatively affect the national standing of Modi’s political party (a Hindu nationalistic entity).

The sooner the issues stemming from demonetization are resolved, and they are being resolved relatively quickly, the better for Modi and his plan. Otherwise, the opposition and chattering class will gain momentum against his digital banking and financial inclusion initiatives.

Part of the opposition to the move to ban 500- and 1,000-rupee notes is that cash is used extensively in India during election periods to fill the buses with supporters for political rallies and buy votes. Given the busy election schedule next year, and the constraints demonetization will put on hoarding cash for use during elections, the opposition’s objections are easy to understand.

When it comes to the economy, demonetization will materially affect growth for the next six months. But the economy should experience a V-shaped recovery, with certain parts of the economy taking more time to recover.

Real estate should take the longest to recover, because it’s the sector where black money matters the most and on every level. From land purchase to sales of apartment units, most transactions are in cash and untracked.

Real estate transactions are often a 50-50 deal, with half the money changing hands under the table and half being on the books. The lower the value of the property, the higher the informal component of the transaction. A more expensive transaction is more likely to be audited, so a higher percentage of its price is paid on the table. Real estate accounts for around 90 percent of household wealth in India.

Another change that will affect the sector is the Real Estate Regulation and Development Act (RERA), which goes into effect within the next six months. The regulation requires developers to place 70 percent of cash proceeds from pre-sales into escrow until the completion of the project.

Development projects, therefore, will require more capital, even in only a temporary sense. Consequently, the sector will consolidate, with the financially stronger players absorbing the weaker ones. Nationally, more than 50 percent of the real estate developers currently in operation should disappear. In first-tier cities like Mumbai, the number will be close to 80 percent.

The broader economy also will be affected in the short term, as consumption slows and the investment upturn takes longer than expected to materialize. And that upturn will depend heavily on the government's infrastructure spending, which is expected to reach 2.2 trillion rupees (US$30 billion) next year.

Sales of passenger vehicles will provide insight into the effects of demonetization. Car sales rose by 4.5 percent year over year in October and are up 8.4 percent year over year in the first 10 months of 2016. Many dealerships have offered discounts up to 20 percent to help consumers overcome the demonetization hurdle. The new numbers, due in January, should give a good idea regarding consumption.

Demonetization has proved a positive for the bond market, with the 10-year government bond yield declining to 6.57 percent since the Nov. 8 demonetization announcement. Donald Trump's victory in the US presidential election sent ripples through emerging markets, but India's government bonds bucked the trend and rallied.

Removing the 500- and 1,000-rupee notes will also drive a surge in bank deposits.

India remains the best long-term growth story in Asia; the recent pullback in the MSCI India Index is an opportunity to buy, rather than a reason to sell or stay away.

That India's stock market has held up relatively well amidst an absent investment cycle, tame credit expansion, relatively slow earnings growth and demonetization is an encouraging sign.

India's economy will grow by more than 7 percent in 2017, while the stock market should outperform again as the earnings cycle bottoms out and the positive effects of demonetization filter through the economy.

The biggest risk is if Modi loses the general election in 2019. That would derail India's economy.

In the meantime, India's banking system is far ahead of its peers in recognizing non-performing assets. Financial institutions also continue to clean up their balance sheets and will benefit from an increase in deposits.

Furthermore, the odds favor a looser fiscal policy before the 2019 general election, likely at some point in 2017.

Indian equities could be volatile over the next two to three months, as short-term economic data will be weak. However, the stock market should deliver at least a 10 percent return next year. ...

Morgan Stanley's Quantitative model from their Asia/GEMs Strategy dated January 23:

Exhibit 13: EM/APxJ Country Selection Framework: Green suggests OW signals; Red suggests UW signals

				Quantitative Factors (60%)									MS House Macro & Micro View (40%)				
Weight				10%	5%	5%	5%	10%	2.5%	2.5%	10%	10%	5%	5%	10%	15%	5%
#	Country	Active Risk (bps) Current	Active Risk (bps) Previous	P/B rel to Benchmark 5yr Z-Score	P/E rel to Benchmark 5yr Z-Score	Dividend Yield rel to Benchmark 5yr Z-Score	Earnings Revision Breadth (3mma)	ROE rel to Benchmark 5yr Z-Score	Net Margin 5yr Z-Score	Asset Turnover 5yr Z-Score	Relative Strength Index	Chaikin Money Flow Indicator	Currency	Macro-economics	Political Risk	MS Country Strategist View	MS Stock Analyst View
1	New Zealand	50	0	-0.3	0.8	-0.2	-0.3	1.7	1.0	-1.4	45	-0.2	-0.4	NA	0.0	NA	1.6
2	India	250	250	-0.4	0.3	1.0	-6.3	1.7	-1.3	-0.2	45	0.0	-2.3	2.7	3.0	3.3	2.1
3	Peru	100	50	0.5	-0.9	-0.8	6.6	-0.8	-0.7	-1.3	54	-0.1	-2.2	-0.6	-1.0	3.5	0.8
4	China	250	200	1.0	0.4	-1.2	0.2	-0.8	-1.0	-1.0	57	0.2	-1.5	0.2	2.0	5.0	5.0
5	Chile	100	50	1.3	2.5	0.1	-0.3	0.9	0.3	-2.5	55	-0.2	-0.9	-1.3	-2.0	4.3	0.3
6	Czech Rep	50	50	0.9	1.0	2.2	1.4	0.1	-1.6	-1.3	26	0.2	-2.5	-0.4	0.0	NA	3.6
7	Egypt	0	0	-1.6	0.6	-2.0	8.7	2.4	-2.0	-1.2	55	0.1	NA	NA	NA	NA	2.7
8	Taiwan	0	200	0.4	0.9	1.6	0.0	0.7	1.2	-1.7	36	0.0	0.7	-0.9	-1.0	0.7	1.4
9	Thailand	0	-100	0.9	1.1	0.2	-2.6	0.4	2.6	-1.8	47	0.0	-3.3	-1.5	-1.0	1.1	0.4
10	Hong Kong	0	0	2.2	0.4	2.5	5.0	-0.3	-1.4	0.2	50	0.0	0.0	-1.8	0.0	3.9	2.3
11	Russia	0	0	-1.5	-1.0	0.5	5.0	-0.2	-1.3	-0.1	32	0.0	-3.4	1.2	0.0	NA	-1.2
12	UAE	0	0	-0.6	1.4	1.6	0.0	1.8	-0.1	1.4	41	0.2	NA	NA	NA	NA	0.6
13	Singapore	0	-250	1.4	1.6	1.6	-3.5	-0.3	4.8	-2.6	47	-0.1	-0.1	-1.5	2.0	-2.9	1.2
14	Indonesia	0	0	2.4	0.7	-0.4	-3.1	-2.0	-1.6	-1.3	47	-0.2	-4.4	0.5	-2.0	-2.4	1.3
15	Korea	0	0	1.0	1.4	2.0	-0.4	0.7	0.3	-1.6	49	0.1	0.5	0.6	-1.0	-2.2	2.4
16	Philippines	0	0	2.4	2.6	-0.2	-6.6	0.1	-1.4	-0.9	64	0.2	-0.5	-0.2	-2.0	-4.5	1.7
17	Mexico	0	0	2.7	2.3	3.3	-2.8	0.6	-1.3	-1.0	12	0.1	0.0	-2.0	0.0	-3.5	4.1
18	Brazil	0	0	-2.0	-1.0	-1.7	-0.7	0.1	-0.4	-1.6	67	0.1	-3.0	0.5	-1.0	-0.7	0.6
19	Turkey	0	0	1.9	1.7	0.6	0.1	0.0	0.7	-1.6	35	0.2	1.2	-0.4	-4.0	NA	2.0
20	Hungary	0	0	-1.8	1.0	-1.2	10.3	1.9	2.8	-2.0	51	0.3	-3.3	1.3	0.0	NA	-1.9
21	Greece	0	0	1.1	-0.2	-0.6	-2.6	0.0	1.9	-0.5	37	0.3	-2.1	0.0	-1.0	NA	5.0
22	Qatar	-50	-50	0.3	0.3	0.1	0.0	-0.1	-1.9	-0.7	41	0.0	NA	NA	NA	NA	-0.7
23	Colombia	-50	0	1.1	-1.0	0.5	2.6	-1.4	-1.1	-1.1	39	0.0	-3.5	-3.9	0.0	-5.0	1.9
24	South Africa	-250	-250	1.1	-0.6	1.0	-4.5	-1.8	-1.8	-1.3	61	0.1	-2.1	-0.5	-1.0	-2.0	0.7
25	Australia	-250	-100	-0.5	-0.7	-0.8	-0.2	-0.4	0.0	-1.7	55	0.1	-1.7	-3.1	1.0	-5.0	-1.1
26	Malaysia	-100	-50	2.4	1.8	0.9	-3.2	-0.6	-1.2	-1.6	35	0.2	-2.4	-1.5	-4.0	NA	-0.8
27	Poland	-100	0	0.1	-1.1	-1.6	1.6	-1.3	-0.1	-1.5	58	0.3	-1.8	-1.7	-1.0	NA	-5.0

Source: Morgan Stanley Research. Trailing P/B, Trailing P/E, Dividend Yield, ROE are measured by the respective yield relative to MSCI EM/APxJ Benchmark 5-year Z-score. Asset Turnover and Net Margin are measured by ex-Financial Sectors' Asset Turnover and Net Margin 5-year Z-Score. Fund Flow is measured by EPFR country last 10-week fund flow as % of AUM. Fund Positioning is measured by GEM/APxJ Fund Managers' position rel. to MSCI benchmark relative to its own five-year history.

From their 2017 Asia / EM Equities Outlook dated November 27:

Maintain OW in India: India now ranks #1 out of the 27 EM/APxJ countries in our model.... Our India Equity Strategist, Ridham Desai, believes India equity returns will head higher in 2017. The current low return environment that India seemed to be trapped in may get a breather in 2017 thanks to better equity valuations, the bottoming of the growth cycle (disrupted temporarily by the recent de-monetization) and higher correlations with world equities on which we are more constructive. ... India's macro stability remains in its best shape in several years and policy momentum is the best since 2007. Financial conditions look easy and the inflation trajectory suggests more rate cuts are in the pipeline.

Ridham also thinks there is a case for a big asset allocation shift for domestic investors away from long bonds to equities – the last time an equivalent valuation opportunity arose was in June 2013. Valuation versus EM is at a 26 month low. Superior growth prospects, a shift in funding mix to FDI, better terms of trade, reforms, and a domestic liquidity supercycle for stocks are driving India's P/E premium. Finally, India's overweight position in EM portfolios has eased to a 36 months low.

This last chart is from a Steven Rattner NYT January 3rd op-ed: