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On this week's Consuelo Mack **WEALTHTRACK**: in an exclusive interview, Wall Street's number one ranked strategist, Cornerstone Macro's FRANÇOIS TRAHAN makes a stunning call. The bull market is almost over and it's time to get defensive.

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CONSUELO MACK: This week on WEALTHTRACK, in an exclusive interview, Wall Street's long time number one investment strategist, Francois Trahan, explains why he has turned from market bull to bear. His controversial call and strategy are next on Consuelo Mack WEALTHTRACK.

CONSUELO MACK: Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack. The U.S. has been *the* place to be for investors this year, even more so after the election of Donald Trump as president. Since November 8th, U.S. stock markets have been on a tear, extending their lead over international markets by a substantial margin.

As a recent *Wall Street Journal* article pointed out, the global dominance of U.S. stocks has been boosted by the postelection rally and the strength of the U.S. dollar, which has also been appreciating rapidly against other currencies.

The market capitalization of U.S. stocks reached over $25 trillion in December, comprising more than 40% of the world's stock market value, levels not seen since 2006. No other country comes even close. Despite rapid gains in China's stock market size and value for instance, it still has less than a 10% share of global market value.

With low unemployment, corporate profits expected to pick up, and stimulus anticipated from infrastructure spending, corporate tax cuts and regulatory roll backs more investors are jumping on the bullish bandwagon, which is why the message from this week's guest is such a stunner. In a WEALTHTRACK exclusive Wall Street's top ranked investment strategist is saying it's time to put on the brakes and get much more defensive!

He is François Trahan, co-founder, partner and head of the portfolio strategy team at Cornerstone Macro, an independent macro research, policy and strategy firm he and his partners launched in 2013. Trahan was recently inducted into the all-America research team hall of fame by Institutional Investor magazine, having been ranked the number one portfolio strategist for 10 of the past 11 years by Institutional Investors.

Up until recently Trahan was correctly bullish on the U.S. stock market, as he has been for well over a year. Well no more. He is adamantly telling clients that this rally should be sold. I asked him why?

FRANÇOIS TRAHAN: Every bear market starts from the peak of a bull market. This business is about looking at what's in front of you, and at the beginning of the year when I think back to what our bullish story was about, it was really about one thing, and it was the belief that the economy was going to get better. It was very, very difficult to convince people at the time. The environment was very, very negative, and the data wasn't very good. The truth be told, the data was pretty bad, but when you looked in the rearview mirror, what you saw policy-wise was stimulus.

If you looked at money supply, what you saw is that it had accelerated. You looked at the slope of the yield curve. It had steepened. Even banks had eased lending standards, so all things that are associated with better data ahead. That was the one thing we needed for the bullish call and the risk-on call if you will to happen. So February comes along. All of a sudden the leading indicators of the economy, the PMIs start to turn up, and it started a slow revival of investor appetite towards things that are cyclical.

CONSUELO MACK: Right. Very slow.

FRANÇOIS TRAHAN: Well, yeah, very slow initially. There were a few bumps along the way. We had the big Brexit episode which scared a lot of people, but at the end of the day something like that is scary, but if it doesn't change a trend in the data, it really ends up being noise on a trend. So we really view Brexit as an unbelievable gift to the folks that weren't positioned cyclically at the beginning of the year. This was their opportunity to get in. So what concerns us about 2017 is that when we look at the state of policy now, what we see is a tightening of conditions. So the same indicators that told you the data was going to get better at the beginning of the year are now telling you that as we get into 2017 the data's going to start to slowly slip.

CONSUELO MACK: So which conditions are tightening? Because you've got a new President coming in who is going to have his foot on the fiscal stimulus accelerator. So isn't that a positive?

FRANÇOIS TRAHAN: Well, sure, but none of that money will hit the economy in 2017, and the stock market can't discount that far. At the end of the day we're all speculating as to what will happen policy-wise, but the hype is incredible, and people have convinced themselves of a lot of things such as that when we have a budget, the tax cuts will be retroactive. We think that's very unlikely to happen.

CONSUELO MACK: So you think that's what the market is discounting, that kind of extreme of ...?

FRANÇOIS TRAHAN: Oh, yes.

CONSUELO MACK: Not just tax cuts going forward but tax cuts that are retroactive.

FRANÇOIS TRAHAN: Well, in the last two times that we had big tax cuts with the Bush administration, and before that with the Clinton administration, they were retroactive, but at that time you were in recession and you needed to give the economy a bit of a jolt. This time around it's a lot more about reforming the tax code than trying to put money in people's hands very, very quickly. So it's a different set of conditions, and so on paper of course fiscal stimulus can be a good thing, but when you sit down and think about it, it's very unlikely to play a role in the economy in 2017. Fiscal stimulus takes a long time to be deployed.

CONSUELO MACK: You mentioned tightening. What is tightening? Where are you seeing issues?

FRANÇOIS TRAHAN: At this point everywhere, so every gauge of policy that we look at shows a tightening of conditions, whether it's money supply that had accelerated leading up to the beginning of the year has now slowed across the developed world. It's not just a U.S. story.

CONSUELO MACK: Not just the U.S.

FRANÇOIS TRAHAN: We look at gauges of bank liquidity like swap spreads for instance which had narrowed in the latter part of 2015. Usually a great sign for the economy. It's a sign that liquidity is building, that it's about to be deployed, a sign that the data is about to have a bit of a go at it if you will. Well, they have now begun to widen. We've had big changes in interest rates of course of late, and so every gauge of policy that we looked at at the beginning of the year was telling us that consensus was looking at the wrong thing, and I would say it's the case again today. I would challenge the notion that the rally is about the election, and I realize I sound a little crazy because we're being bombarded.

CONSUELO MACK: Well, the rally seemed to have accelerated with the Trump election.

FRANÇOIS TRAHAN: Well, is that coincidence or is that causality? Let me give you two examples. When we show a chart of the stock market to our clients, we often show it with the Economic Surprise Index, which is a gauge of whether economists have an upside surprise to a data release, and so whether it's better than consensus or a downside surprise. So it correlates really, really well with the stock market of course. So, in the last month the Economic Surprise Index posted its biggest increase in four years.

So we just had the friendliest data set for equities in four years. Now when we plot a chart of Treasuries, the ten-year Treasury bond yield, the strongest correlation you'll find with the Treasury market is with global leading indicators of the economy, the global PMI, the series that we like to use.

CONSUELO MACK: Purchasing Managers Index.

FRANÇOIS TRAHAN: Purchasing Managers Index. Well, in the last two months you just had the biggest two-month increase in four years. So we're not used to ...

CONSUELO MACK: In the PMI. So that's ...

FRANÇOIS TRAHAN: In the global PMI.

CONSUELO MACK: Again that's positive for the economy.

FRANÇOIS TRAHAN: It's fantastic. So if you didn't know there had been an election and I told you the Economic Surprise Index just surged higher, the biggest month in four years, global PMI it turned a corner in July just when bond yields started rising and (Overlap/Inaudible) in the last two months ...

CONSUELO MACK: So it would have happened if Trump or Clinton ...

FRANÇOIS TRAHAN: ... best results in four years, what would you tell the stock market did? What would you tell me bond yields did? You would tell me the stock market went up and bond yields are up, and that's exactly what's happened. So I'm not telling you the elections didn't play a role here, but it's not the primary driver of financial markets. It's contributing. It's a factor, but this is what you should expect when you have the best data you've seen in four years.

CONSUELO MACK: So the best data in four years, but the tightening conditions that you're seeing as well, so they're going to basically overcome the momentum of this data. How significantly are they going to slow the economy's momentum for instance?

FRANÇOIS TRAHAN: Well, so when you have a surge in the stock market like this, the way you know if it's a rally that is sustainable, so the way you know whether it's a rally you want to participate in or fade, is by looking at the past state of policy, because it's policy that will tell you whether the data can be sustained. Again the best data points in four years, whether they can be sustained or not. Unfortunately right now, gauges of policy argue that you're essentially at peak stimulus today. You've got the best data because you essentially are digesting the biggest easing of conditions in the rearview mirror if you will.

So from here incrementally every month things start to change. We start to digest a tightening of monetary conditions. So the question becomes, can the Trump administration come up with a set of policies that can offset this tightening of conditions? President-elect Trump is going to come into office at a time where there is a tightening of conditions in the pipeline. We're not talking about 300 basis points in rate hikes here.

If you look at the Treasury market, it is the equivalent of about three to four rate hikes, so it's not the end of the world, but it's not what you had going into this year where you had an easing of conditions. So at the margin it's different, and it's also tightening in a world economy that has a lot of problems. Everybody's excited about the stock market going up. Everybody wants to talk about the tax cuts. People aren't necessarily talking about the risks that some of the proposed policies bring.

CONSUELO MACK: What are the risks that you're concerned about? Again it was a big call to say risk off from risk on in 2016. So what are the risks that you're saying should make investors very cautious?

FRANÇOIS TRAHAN: Well, I would say before we get there I'm not bearish because I think there's going to be a financial crisis somewhere in the world. I'm bearish because policy tells us the economy is going to slow, and that means lower earnings estimates and, unfortunately right now, it also spells lower market multiples. P/Es right now are behaving in a very unusual manner. What I mean by that is that they're very, very cyclical. That's not the typical state of affairs with market multiples.

CONSUELO MACK: How are they cyclical? How are the P/E multiples, price/earnings multiples?

FRANÇOIS TRAHAN: Historically when you look at the S&P's P/E, it tends to look like the inverse of inflation. So inflation goes up, P/Es come down. Inflation goes down, P/Es go up. That's why there's a lot of slowdowns historically. The exact same picture I'm painting for next year where the stock market goes up, not down, because slower growth hurts earnings but it brings about lower inflation and it helps P/Es go up.

So in a different context you could say there's a silver lining to my story, which is that slower growth will lead to lower inflation, will help multiples go up. Unfortunately, P/Es are not behaving like that. So right now if you look at the S&P's forward multiple, what you're going to see is that it looks a lot like a leading indicator of the economy. So if you take the Conference Board's official LEI ...

CONSUELO MACK: Leading Economic Indicators.

FRANÇOIS TRAHAN: ... official Leading Economic Indicator index and you look at the components, so it's things like building permits, initial jobless claims, B double A credit spreads, if you plot those with the S&P's P/E, you're going to see that they look exactly the same. So that means slower growth, lower earnings, lower P/Es. You don't have to think there's a recession coming to be concerned about stocks when P/Es are behaving this way. It means that any slowdown is going to give you a disproportional decline in the index. That's why I'm bearish.

CONSUELO MACK: You were mentioning earlier that we've got very strong data around the world with the Purchasing Managers Index, but you're also concerned about that there are some fragility in economies around the world that could cause some real problems. So tell me about that. If the U.S. in fact slows, that could set off kind of a domino effect in the global economy.

FRANÇOIS TRAHAN: Well, when we look around the globe there hasn't been a time like this possibly ever where there are so many countries dealing with what we call structural issues, longer-term issues, and they're different for... Brazil is dealing with really a lot of debt in a budget situation. Japan's got demographics that are a drag to the economy. China's got over investment and a lot of excess capacity. What these countries have in common is that when you have something impeding demand in your economy, by default you become much more dependent on other people's growth or in GDP talk ...

CONSUELO MACK: Especially the U.S. Right?

FRANÇOIS TRAHAN: Well, that's right, so in GDP talk what we call exports. When the U.S. economy slows because we are the biggest importer in the world, it means that exports start to slow in all these places. So a U.S. slowdown exposes the weakest links around the world if you will.

CONSUELO MACK: So François, it is not easy to be a naysayer, to be bearish when we're in a bull market. Right? You've been here before.

FRANÇOIS TRAHAN: Yes. So I would say that this is the very late innings of the Bull market. We're not bullish or bearish to try to be counter consensus. We're bullish or bearish based on our view of the outlook of the future economy. So it wasn't any easier being bullish at the beginning of the year than it is being bearish now with regards to 2017. Well, I shouldn't say that. Maybe it was a little bit easier because the reality is our industry is really geared for a rising market because there are a lot more assets in long-only strategies than in market-neutral strategies.

So I think when you have a thesis to be bold enough to come out with a bearish thesis, you really have to believe it. You really have to have high conviction in it. So I would say anyone who's willing to sit across from you, Consuelo, and paint a bearish story of the markets you should pay attention to because you really have to believe it to do that.

CONSUELO MACK: Which you do believe it. You're adamant about this. So what are you telling clients to do?

FRANÇOIS TRAHAN: Well, we're telling them to use this opportunity, to use this phenomenal data and these very strong markets to position yourself for what lies ahead. What our indicators tell us, what the state of policy tells us is that in 2017 the data is going to start to slip. So when the economy starts to slow, it means these really cyclical companies, the ones that have led the charge in recent months all of a sudden don't look so good. Investors ...

CONSUELO MACK: So materials, industrials, financials.

FRANÇOIS TRAHAN: About as good as it can be. People when the economy slows gravitate towards stability.

CONSUELO MACK: So start trimming now before it turns really rapidly which it probably will as it always does on the down side. Or does it?

FRANÇOIS TRAHAN: The stock market and the data, the leading indicators of the economy, are pretty much the same thing. The S&P is actually one of the components of the Conference Board's office LEI, their Leading Economic Indicator index. So use the strong data. Use the strength in cyclicals to sell at a profit and to buy the stuff that is very unpopular. You're not buying it because it's unpopular. You're buying it because the economy is going to slow.

CONSUELO MACK: So what are the kinds of things that you're telling clients to buy?

FRANÇOIS TRAHAN: Well, from an asset allocation perspective, Treasuries are ...

CONSUELO MACK: Whoa. (Laughs)

FRANÇOIS TRAHAN:... very appealing here absolutely.

CONSUELO MACK: Why? Everyone else on Wall Street basically is saying get out of Treasuries. They're high risk. Interest rates are going up. The principal of Treasuries is going to go down.

FRANÇOIS TRAHAN: Well, again leave consensus out of it. What drives Treasuries is the economy. If you plot the ten-year Treasury bond yield with the global PMI, you can barely tell them apart. So it's not about consensus. It's not about what everybody's saying. It's about whether you believe the economy can improve from here, or whether you believe the economy is going to slow from here. It's policy that helps determine that.

CONSUELO MACK: So if the economy does slow, so what's the sweet spot in the Treasury yield curve? I mean is it the ten-year? Is it the five-year? Is it the...

FRANÇOIS TRAHAN: Well, the further out you go the more…

CONSUELO MACK: The more interest rate ...

FRANÇOIS TRAHAN: In the stock market there's a lot of Treasury proxies, and the equity equivalent of Treasuries is leverage. It's companies that hold a lot of debt, because when interest rates come down, all of a sudden that debt is less expensive to service. It makes the earnings of course look better.

CONSUELO MACK: Of course interest rates are still relatively low compared to historical norms at least in the post-World War II era, so how much can they come down?

FRANÇOIS TRAHAN: I feel like I heard that statement for the first time in 1998 when the ten-year Treasury bond yield ... I think it was the first year it went below five percent, and people have made it pretty much every year since.

CONSUELO MACK: Now it’s under three. Yes, they have.

FRANÇOIS TRAHAN:Yet we had zero percent ten-year bonds. In the European economies earlier this year, in Japan of course where I think the ten-year JGB was negative.

CONSUELO MACK: It was negative at one point.

FRANÇOIS TRAHAN: Negative 0.8 or something like that. So listen. If we retouch to lows, that’s an incredible profit particularly if it happens at a time when the stock market’s going down. Your opportunity cost is ... do you want to lose ten percent, 15 percent, 20 percent in a bear market? Remember P/Es are very, very cyclical here, and so you’re in a world where bond yield and a stock market have a very strong inverse relationship or bond prices, I should say, and the stock market.

So utilities, telecoms, REITs, companies with a lot of debt are the ones that tend to do well when interest rates are moving lower. So those obviously are very unpopular investments right now, but those are the types of companies that we would encourage people to think about. Again we’re not talking just about the next four weeks or a month or two here. We’re talking about the next year as the slowdown gains traction.

As people start to realize that fiscal stimulus will take a long time to gain traction in the economy, and at the end of the day people will always ask, “What are my company’s earnings going to do next quarter?” That’s that window you’ve got to worry about, the next three to six months.

CONSUELO MACK: One investment for a long-term diversified portfolio; what should we all own some of now?

FRANÇOIS TRAHAN: (Laughs) Well, so if we’re thinking long term, and again you look around the world and you see all these countries that have these structural issues, you see consumers in the U.S. that are in deleveraging mode essentially since the ’08 crisis ...

CONSUELO MACK: Reducing their debt.

FRANÇOIS TRAHAN: We’re in a world of slower growth both domestically and internationally. Maybe fiscal stimulus will help that in 2018 for a little bit, but if we’re thinking long term, a world of slower growth means that you want companies that have some sort of longer-term story, some sort of what people call growth story. So longer term I would say it’s growth stocks that you want. It happens to be I would argue what you want anyway next year, because again we believe the economy is going to slow, and growth tends to do better than value. Defense tends to do better than cyclicality when the economy is slowing. So longer term I would steer you in that direction.

CONSUELO MACK: Are you allowed to be any more specific than that? (Laughs)

FRANÇOIS TRAHAN: Not without a lot of disclaimers, but I would say if you're able to think just cyclically and think about just the next nine to 12 months, I think you're being presented with an unbelievable opportunity in Treasuries. I think this backup in bond yields is a great gift at the end of the year.

CONSUELO MACK: That should last, this backup in bond yields, which means that the yields are going up. How extensive do you think it's going to be?

FRANÇOIS TRAHAN: Well, if you believe the data is going to deteriorate in 2017, then bond yields are moving down which means bond prices are going up, and so it's an opportunity to make an absolute return even in a bear market in equities which is a possibility next year.

CONSUELO MACK: All right, François Trahan, really lovely to have you on *WEALTHTRACK*. Thanks so much.

FRANÇOIS TRAHAN: Thank you for having me.

CONSUELO MACK: At the close of every *WEALTHTRACK* we try to give you one suggestion to help you build and protect your wealth over the long term. This week's action point is: **Consider adding some tips, or treasury inflation protected securities to your portfolio**. If in fact we are entering a period of higher inflation, even slightly higher, tips offer protection because their principal increases along with inflation, as measured by the consumer price index. The flip side is if inflation decreases so will tips' principal.

Because of the shift in investor expectations from deflation to inflation, tips have gotten a bit more expensive but they are still considered to be well within a reasonable range. You can buy them commission free at auction directly from the U.S. treasury or in fund or ETF form. They are safe, liquid and offer diversification away from the stock market.

Next week we will talk to Rich Bernstein, a former top rated investment strategist, turned successful portfolio manager who has significantly shifted his strategy based on changing conditions. He'll tell us what they are and what he is doing.

On Wealthtrack.com in our extra feature we will ask François Trahan: about the role behavioral finance is playing in his work.

As always we welcome your feedback by email or on Facebook and Twitter. Thank you for watching. Have a great weekend and make the week ahead a profitable and a productive one.