Leading Indicators Continue to Point to Recession

Presented by:

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ZACKS Pro

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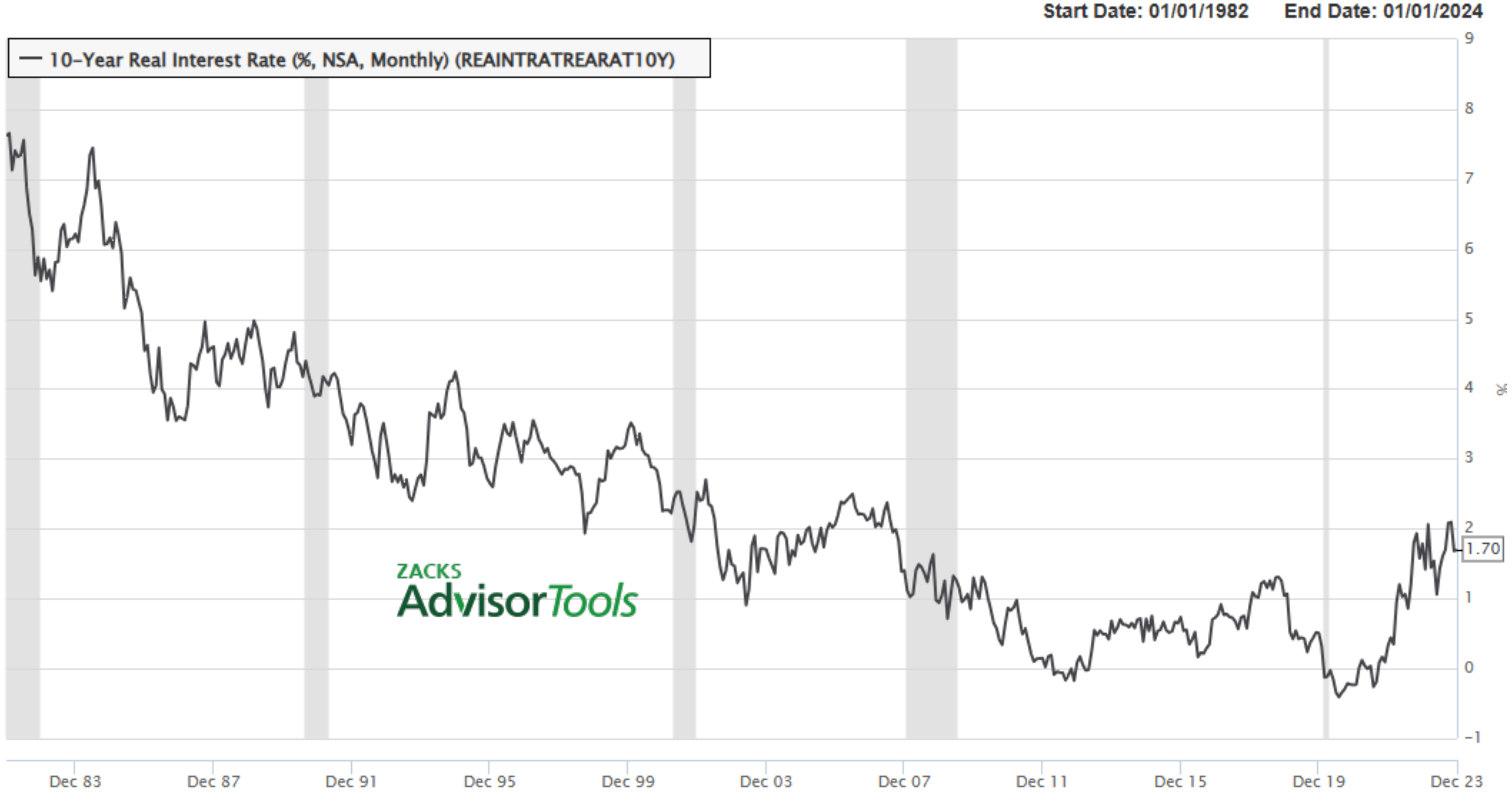
Why I still believe we are entering recession

- **MANUFACTURING: has been in recession for 12-14 months of the past 15 months**
- **INVERTED YIELD CURVE: 10y-2y UST yield curve**
- **LEADING ECONOMIC INDEX: Conference Board Leading Economic Index in contraction for 18 consecutive months**
- **EXCESS SAVINGS well below trend and forecasted to be depleted by 1H 2024**
- **CYCLICAL GDP: Leading indicators of GDP entering contraction: cyclical GDP and real GDI**
- **EMPLOYMENT: Leading indicators of employment entering contraction: cyclical employment**
- **CREDIT: credit contraction, rising loan loss provisions, tightening credit standards, rising credit card delinquencies**

- Unlike past market environments, **the Fed is not supportive of stocks OR bonds right now and wont be until we see a sizable decline**

10-Year Real Yields Briefly Hit 2.1%; Highest Levels in 20 Years

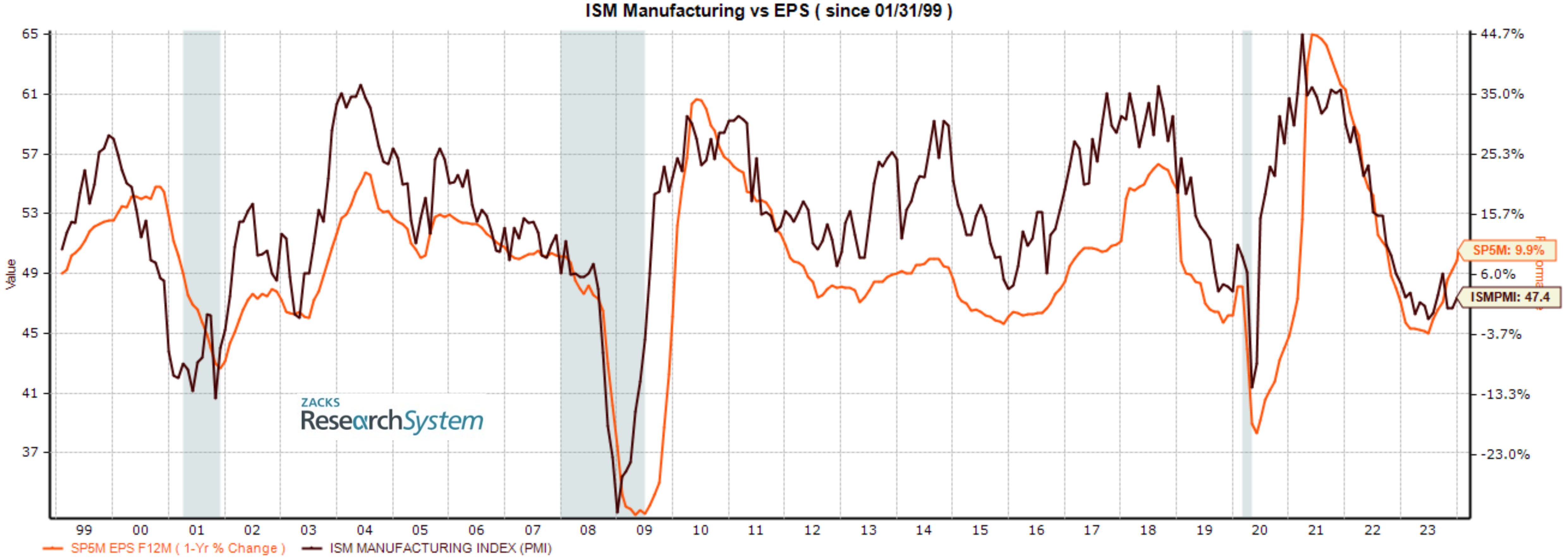


Source: Zacks Professional Services, www.zackspro.com

MANUFACTURING

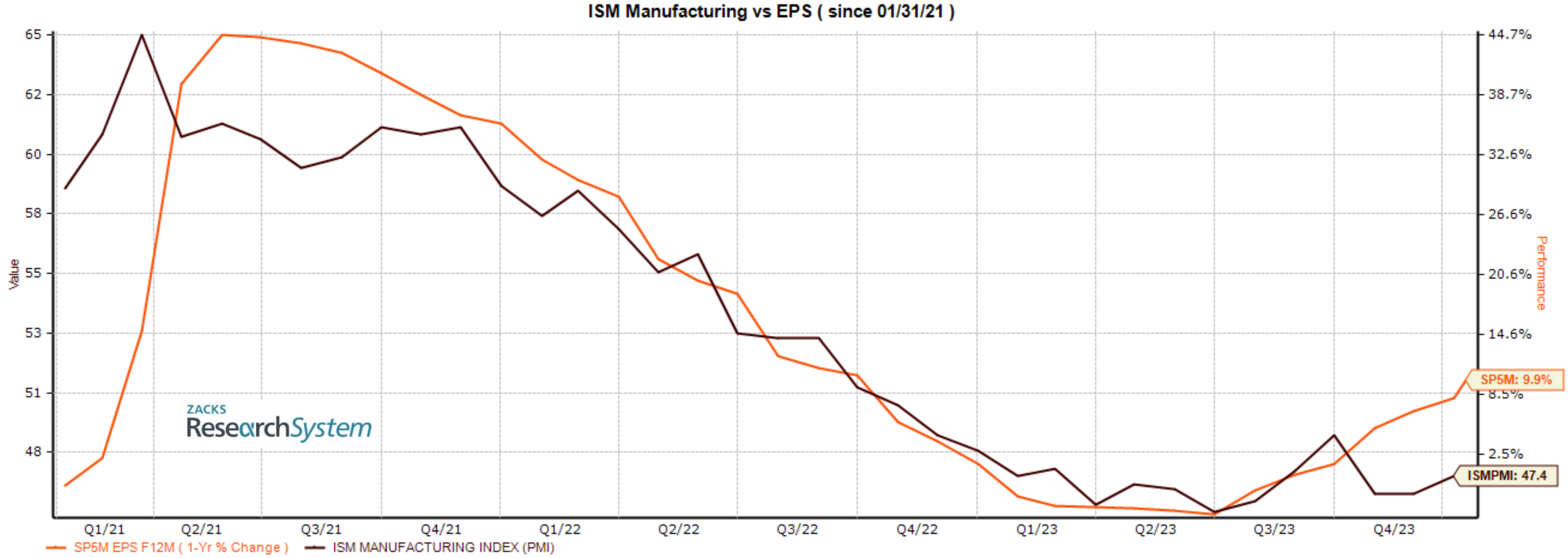
ISM Manufacturing PMI Similarly in Recession Territory

Index has been in contraction for 13 consecutive months, bearish divergence with forward EPS



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Change)	44.68%	-32.67%	8.00%	9.94%	484.43%	6.94%	01-31-1999	01-09-2024
ISM MANUFACTURING INDEX (PMI)	64.70	33.30	52.85	47.40	-6.32%	-0.26%	01-31-1999	12-31-2023

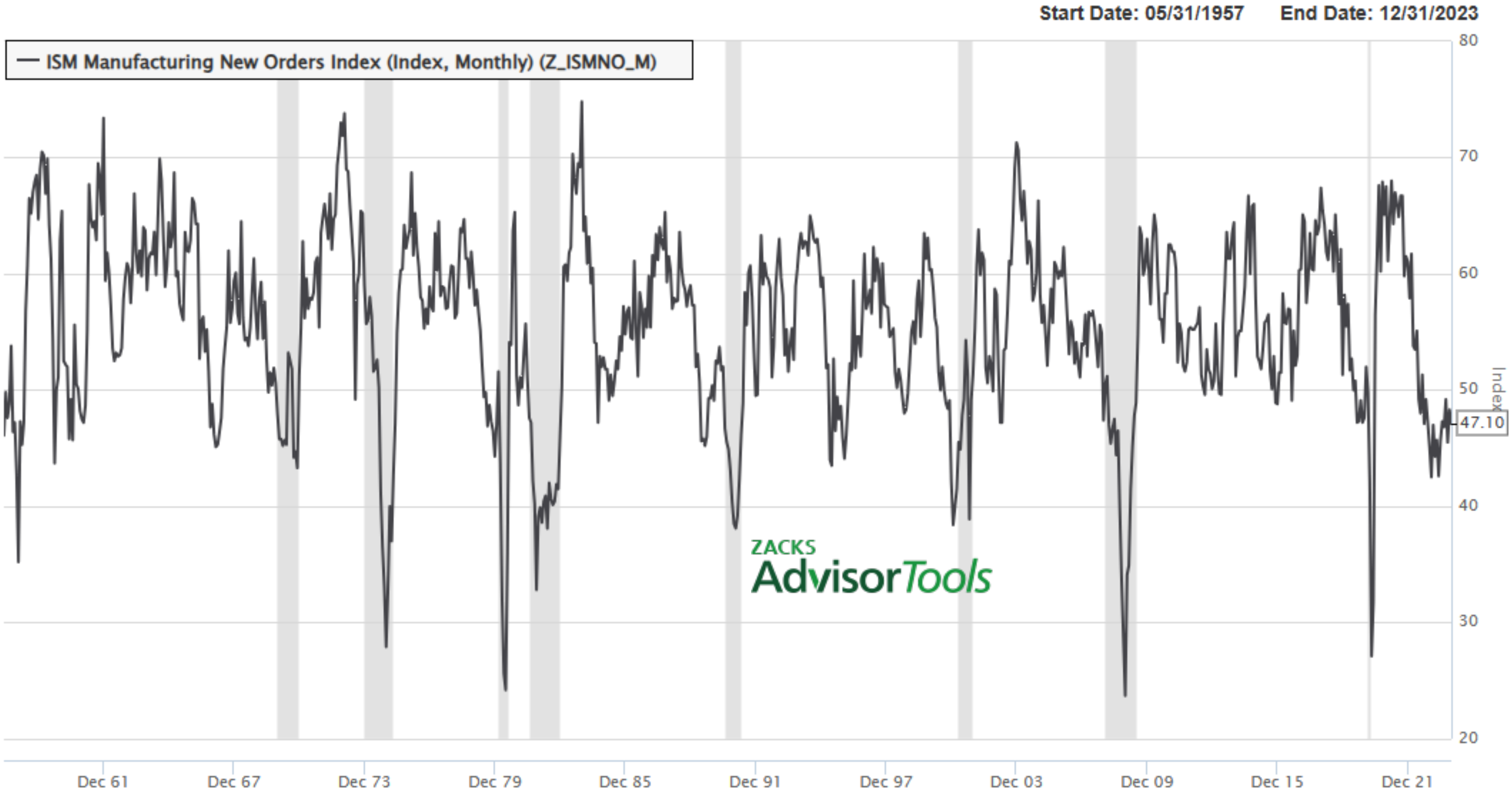
…if we get another month of negative PMIs, I believe we'll start to see a wave of EPS cuts



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Change)	44.68%	-3.50%	10.50%	9.94%	42.03%	9.31%	01-31-2021	01-09-2024
ISM MANUFACTURING INDEX (PMI)	64.70	46.00	52.90	47.40	-19.25%	-7.07%	01-31-2021	12-31-2023

ISM Manufacturing New Orders At Recessionary Levels

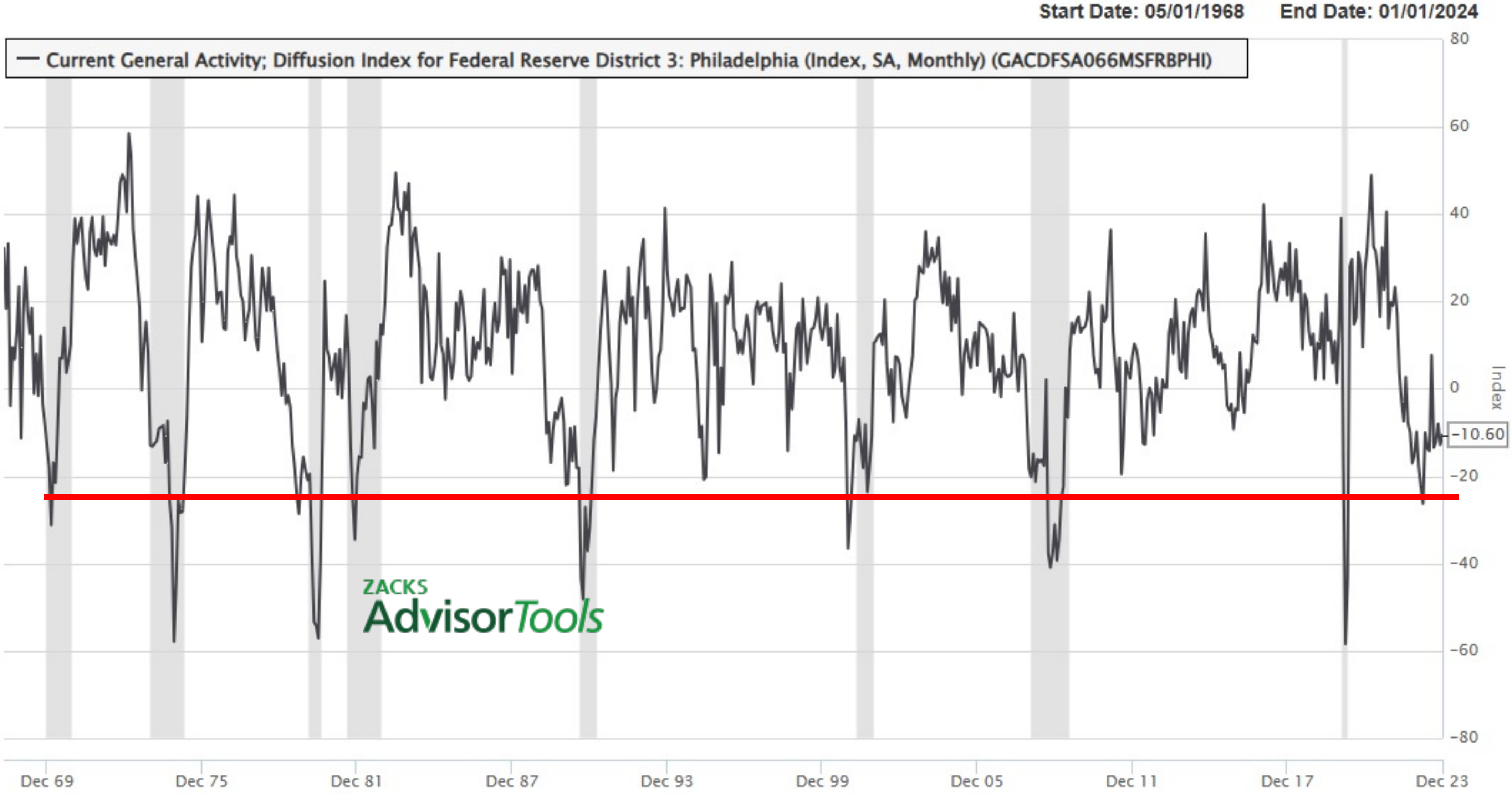
Proxy for industrial demand continues to remain sluggish; 18 consecutive monthly declines, firmly at recessionary levels



Source: Zacks Professional Services, www.zackspro.com

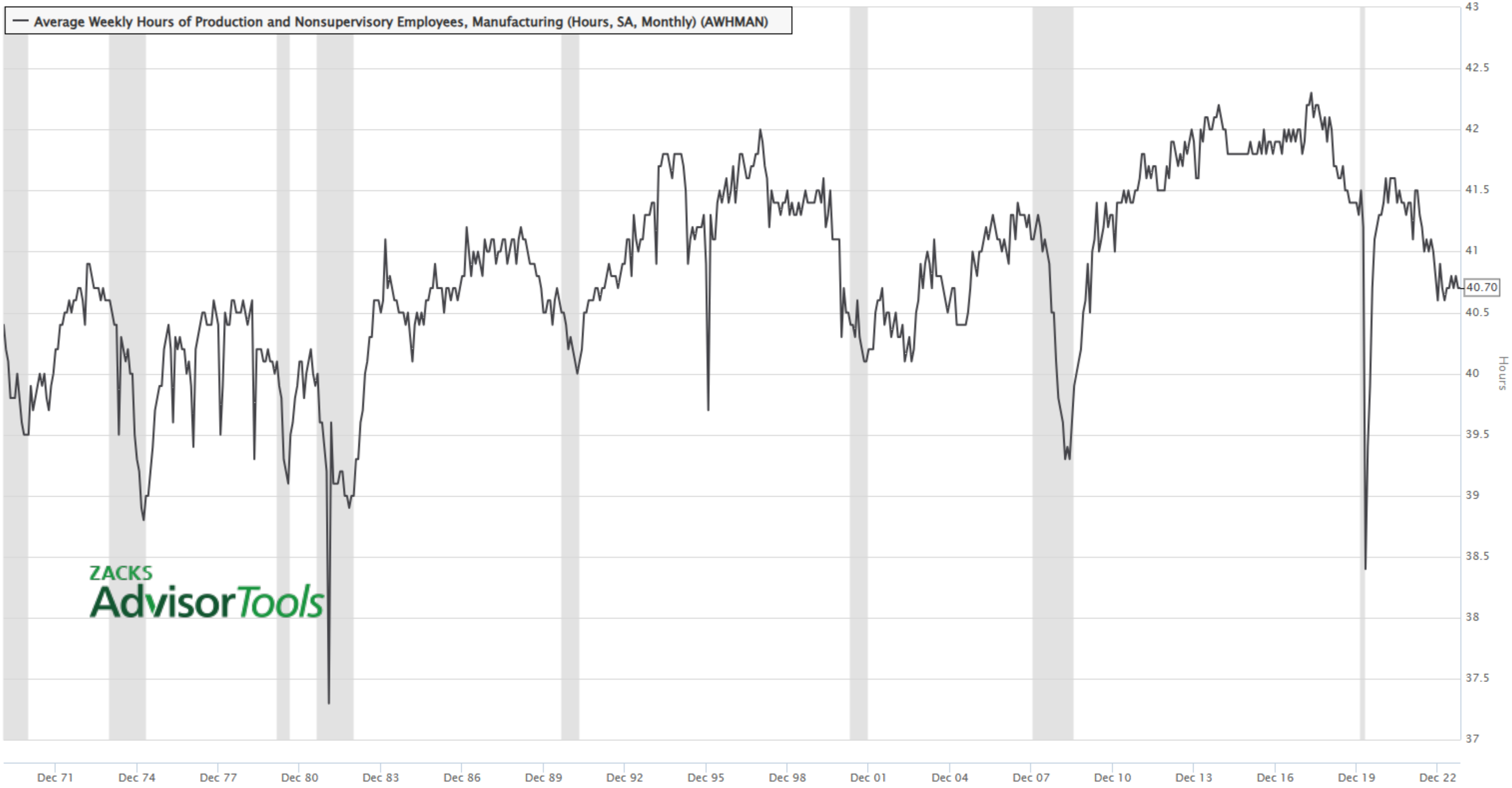
Philadelphia Fed Manufacturing Index at Recession Levels

A single reading below -25 has correctly forecasted each of the last 8 recessions with no false positives



Source: Zacks Professional Services, Philadelphia Federal Reserve

Factories Are Cutting Workweek Hours As Orders Fall

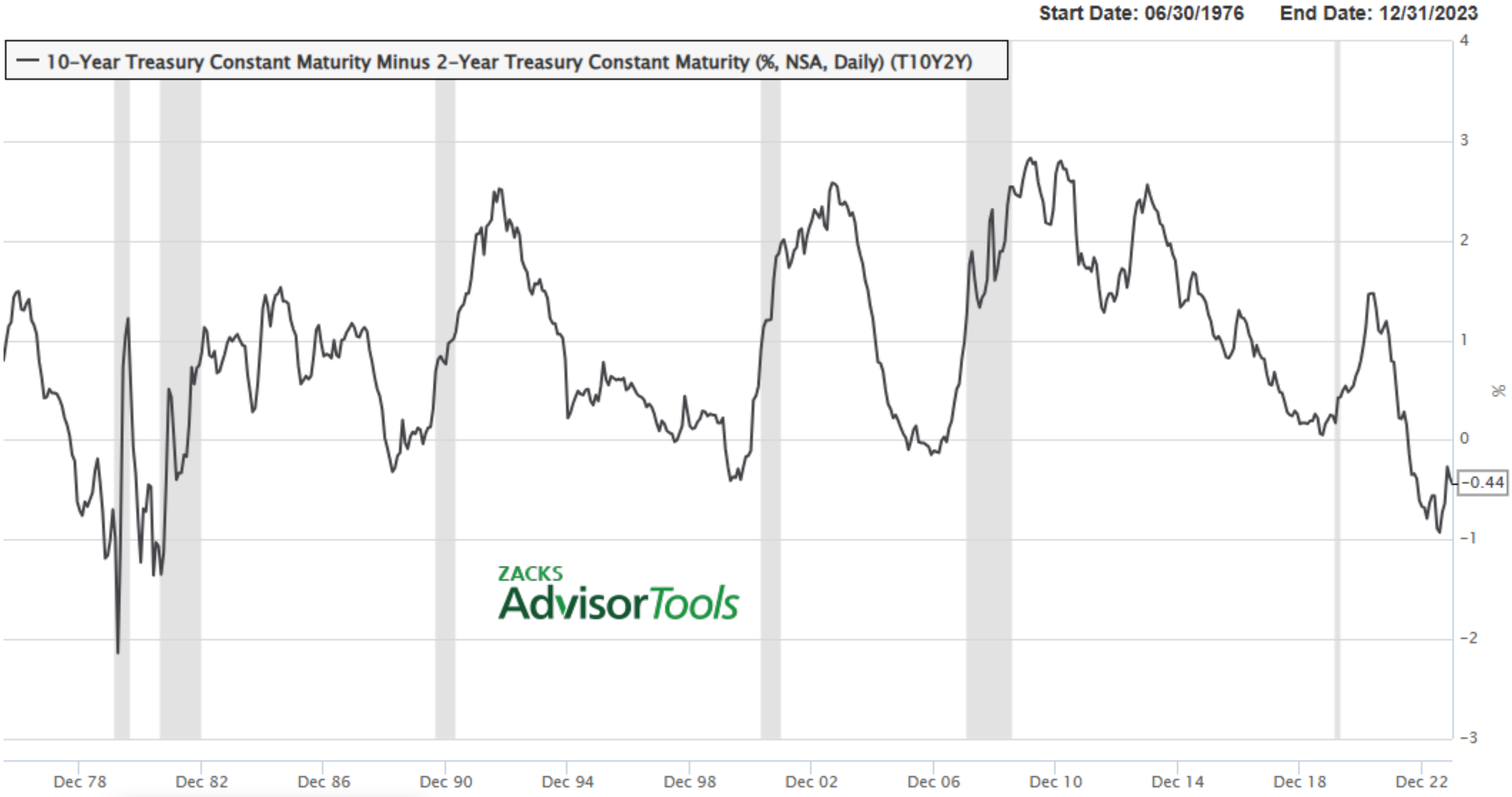


Source: Source: Zacks Professional Services, OECD

INVERTED YIELD CURVE

Deeply Inverted 10y-2y UST Yields Consistent With Recession

Intense Steepening Since September, but has since backed off. Keep a close watch here.

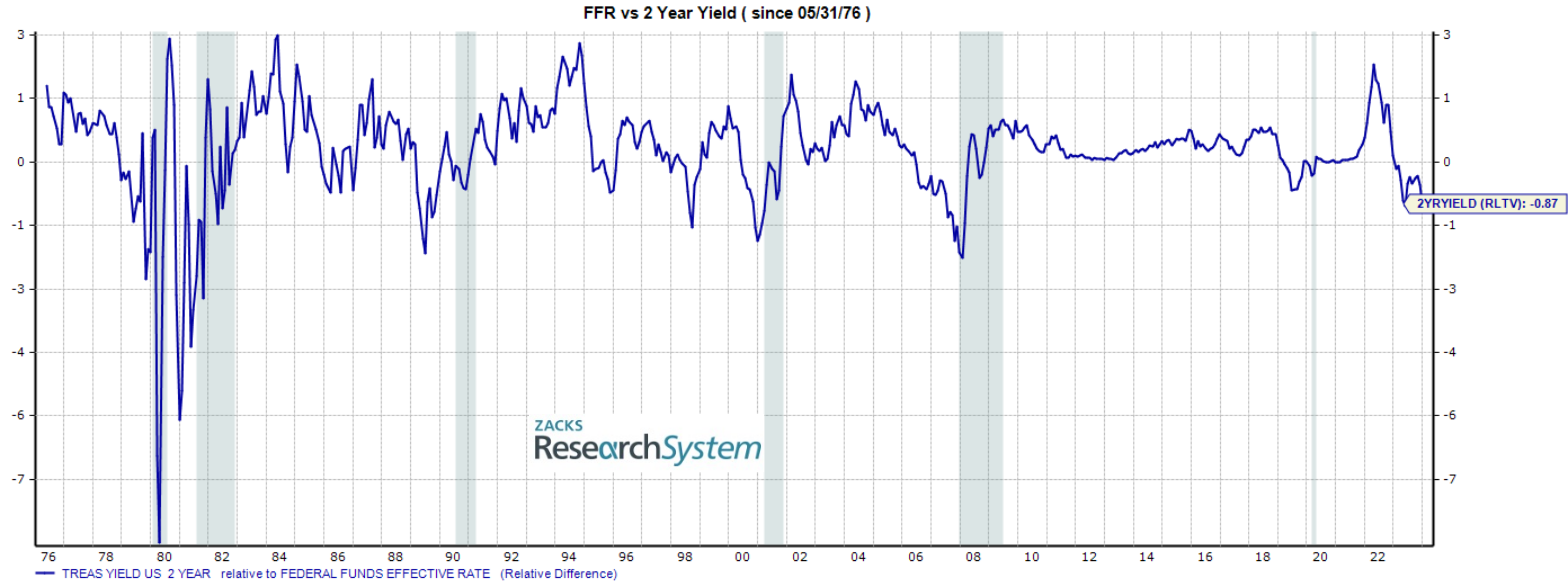


Source: Zacks Professional Services, www.zackspro.com

Yield Curve Beginning to Re-Steepen

Source: Zacks Professional Services, www.zackspro.com

History Has Shown Forced Inversion Breaks Things



Source: Zacks Professional Services, www.zackspro.com

LEADING ECONOMIC INDEX

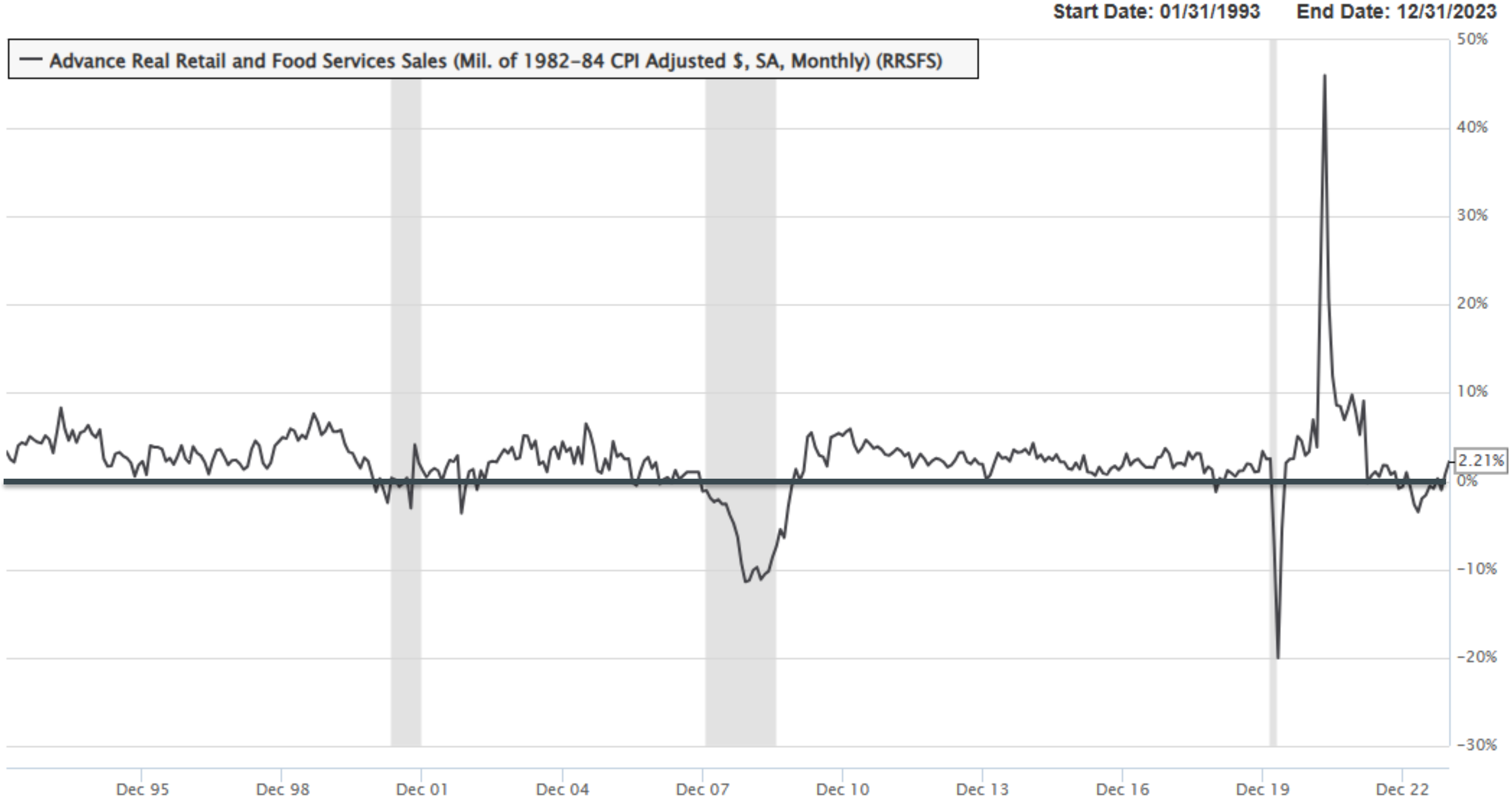
Conference Board's Leading Economic Index has now been in decline for 21 consecutive months.

Firmly at recession levels, led by weakening credit growth and manufacturing new orders

Source: Conference Board

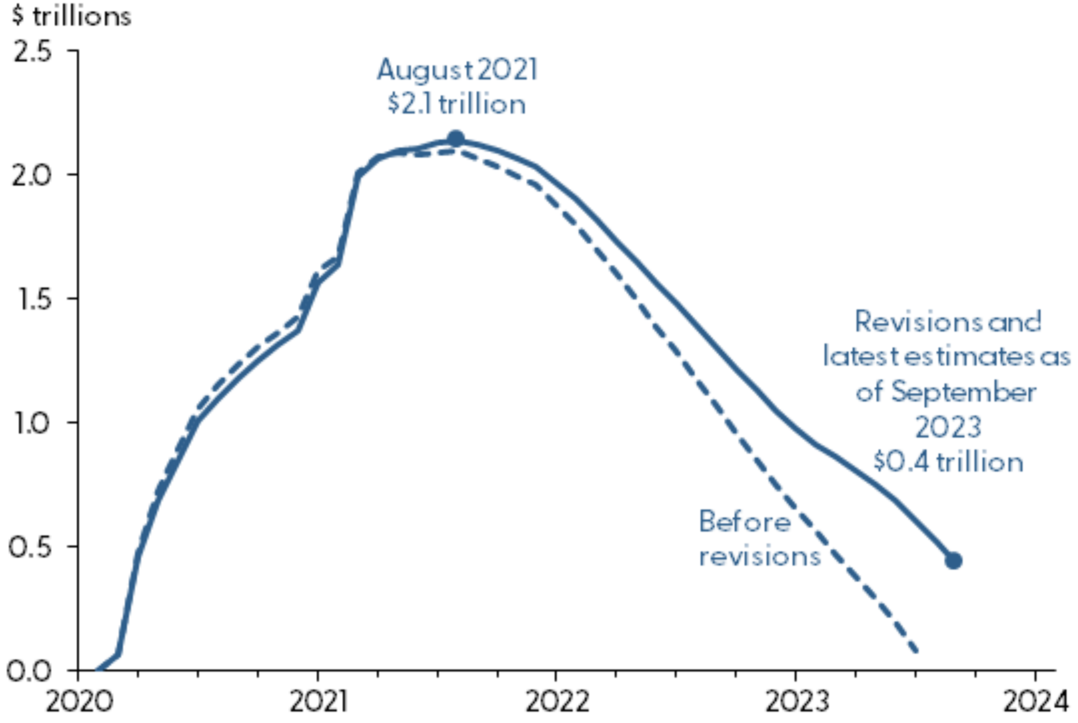
EXCESS SAVINGS

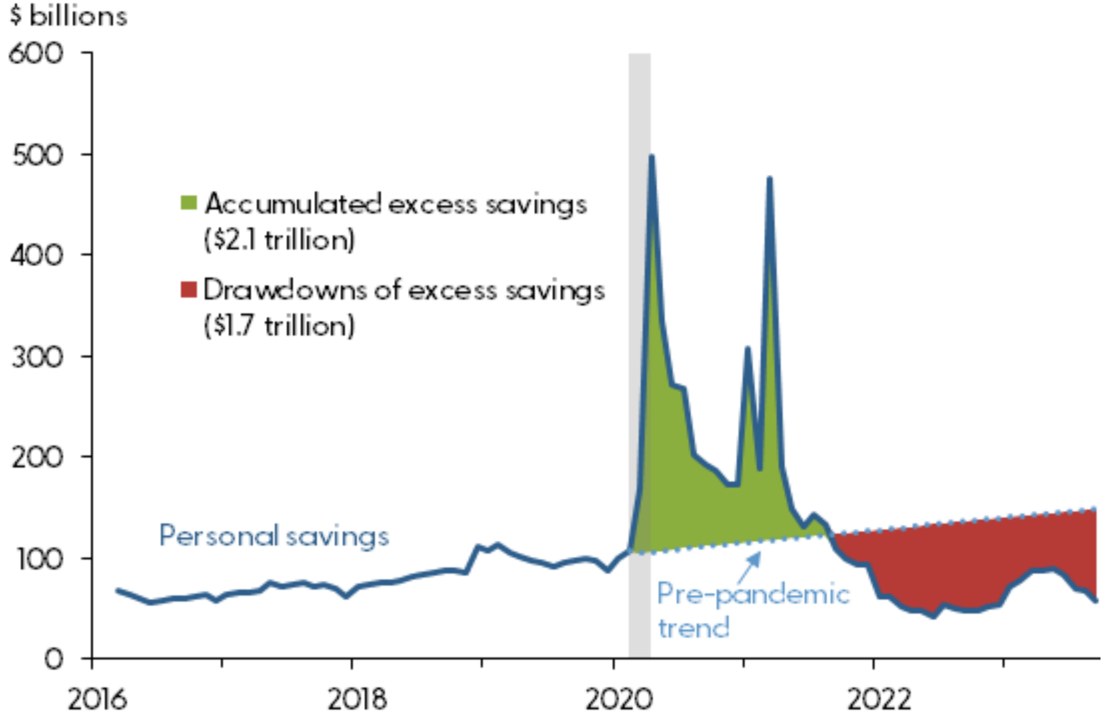
Real Retail Sales YoY Rebounding Strong After Brief Contraction



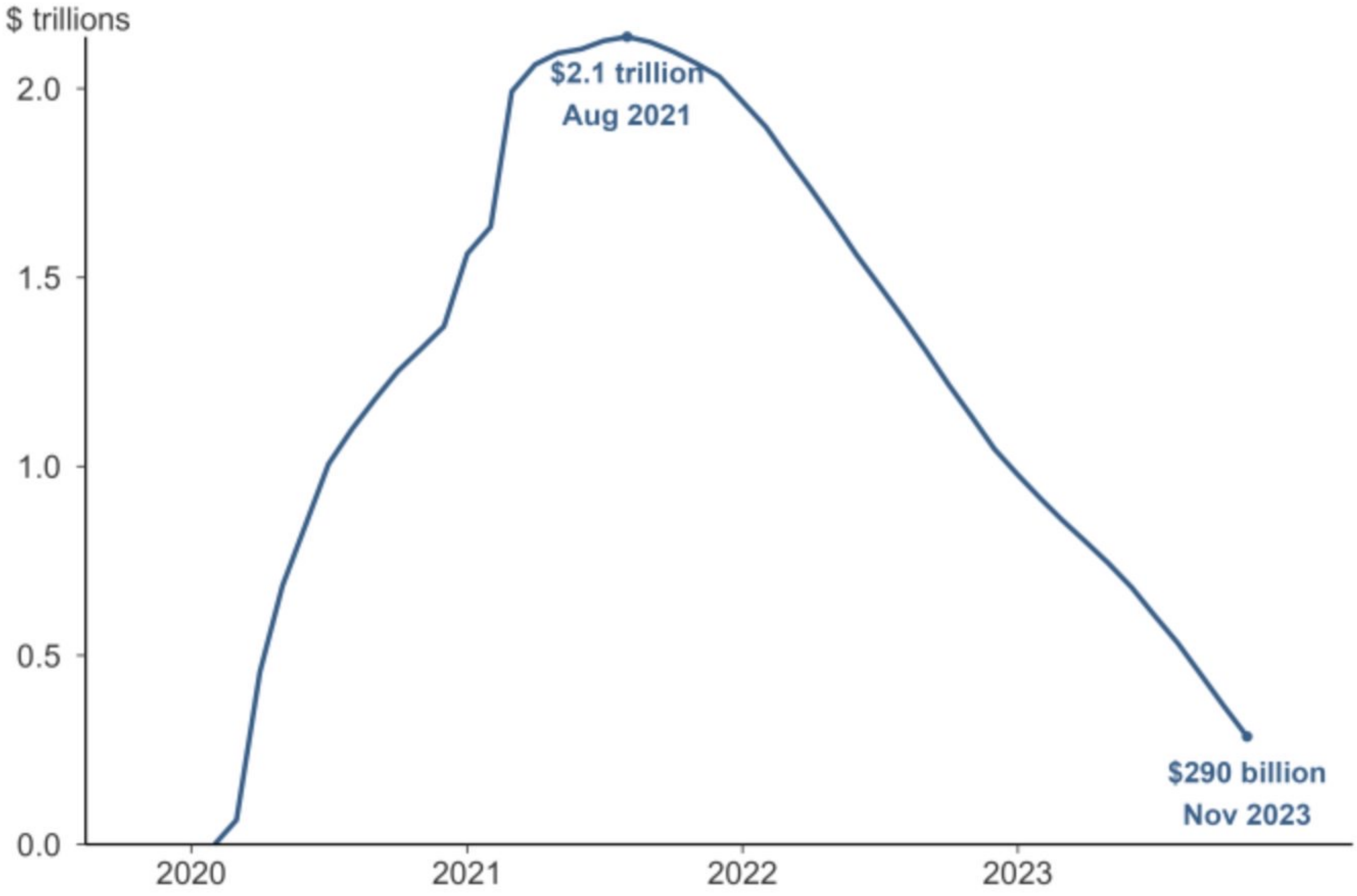
Source: Zacks Professional Services, www.zackspro.com

Real Personal Consumption > Real Personal Income, which means excess savings have been drawdown and will be exhausted by 1H 2024



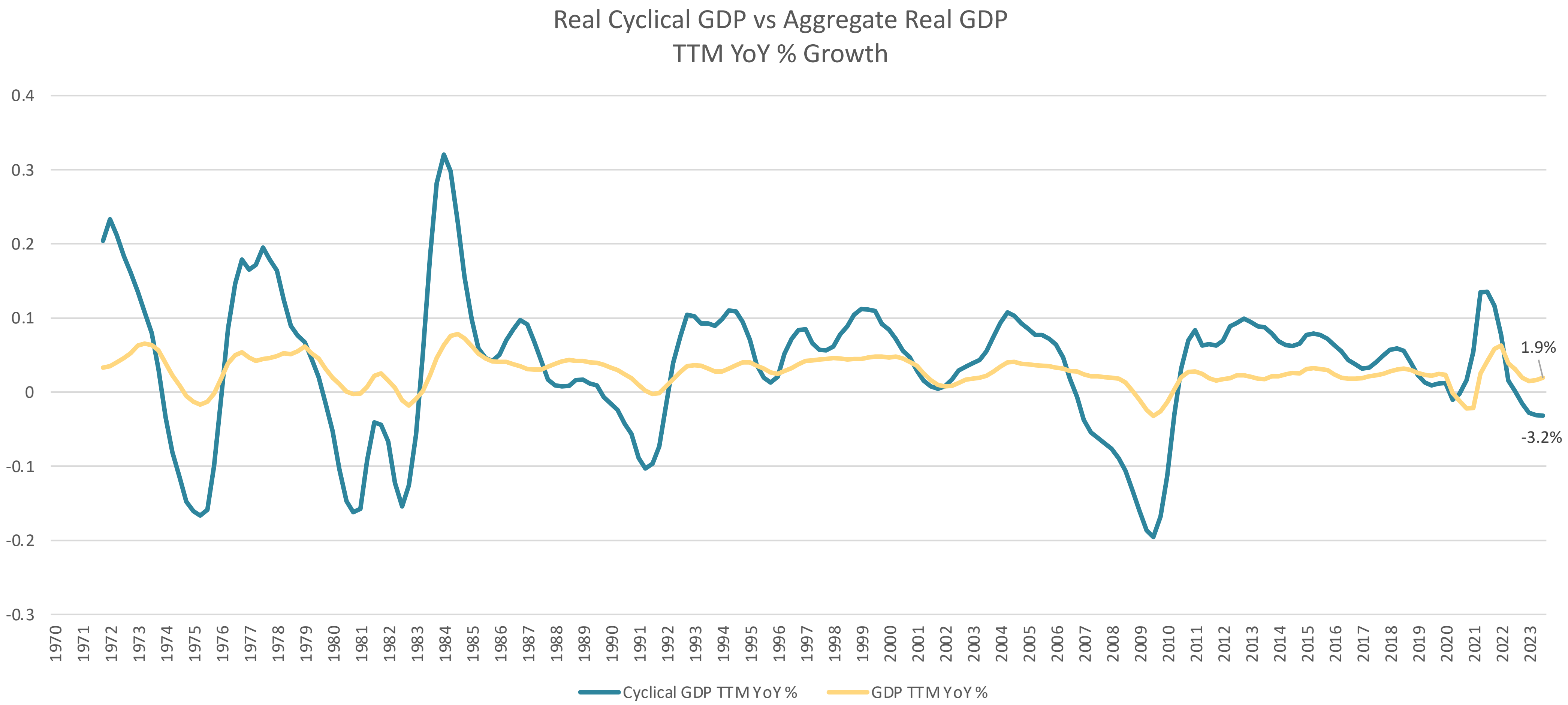


Source: San Francisco Fed



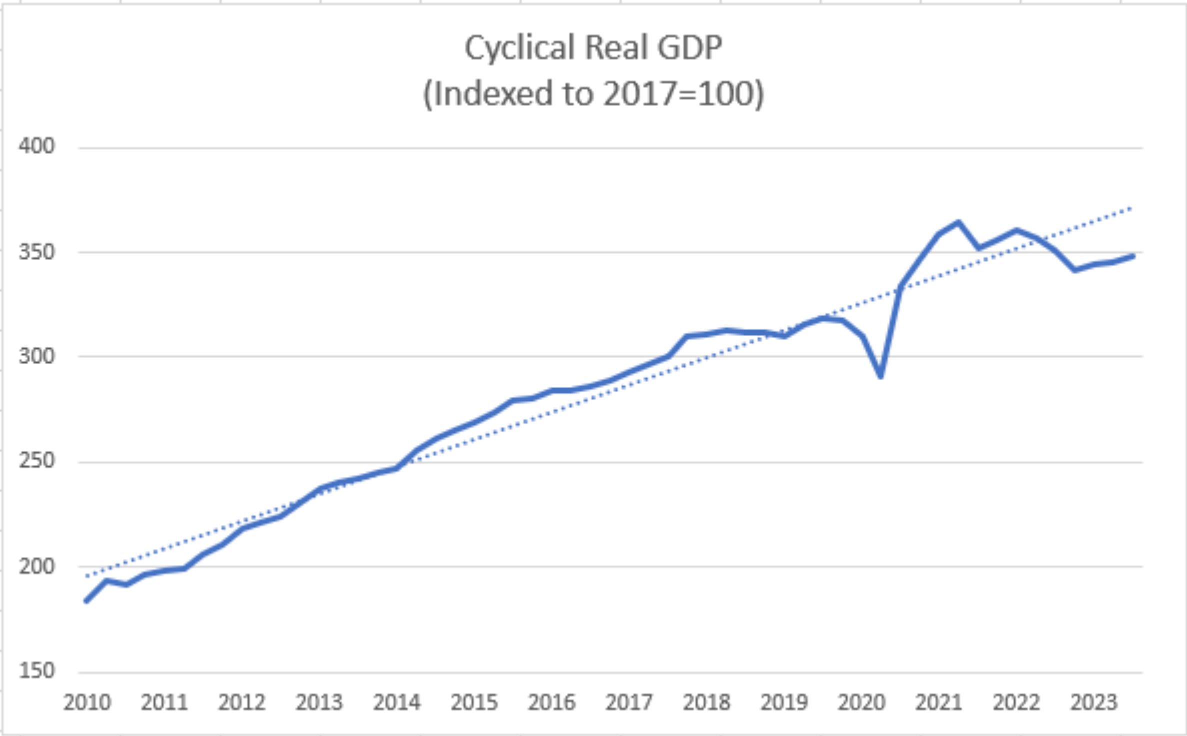
Source: Bureau of Economic Analysis and authors' calculations.

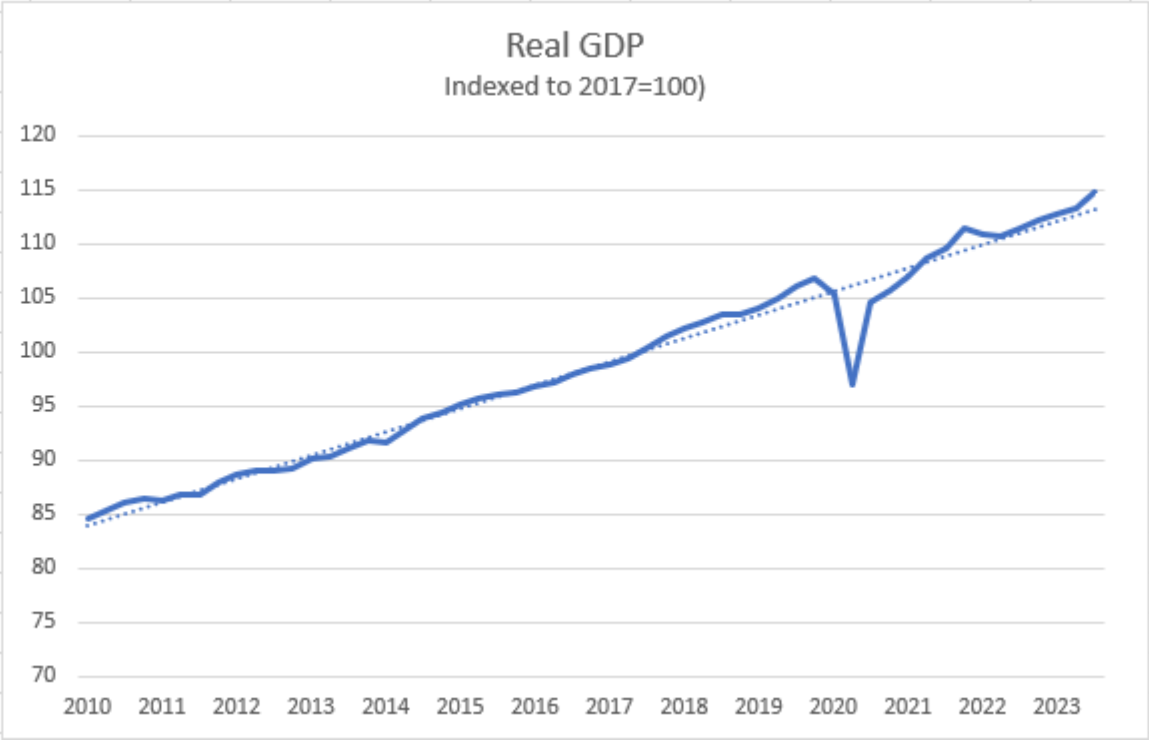
GROSS DOMESTIC PRODUCT



Source: Zacks Professional Services, www.zackspro.com

While GDP At Trend, Cyclical GDP Below Trend





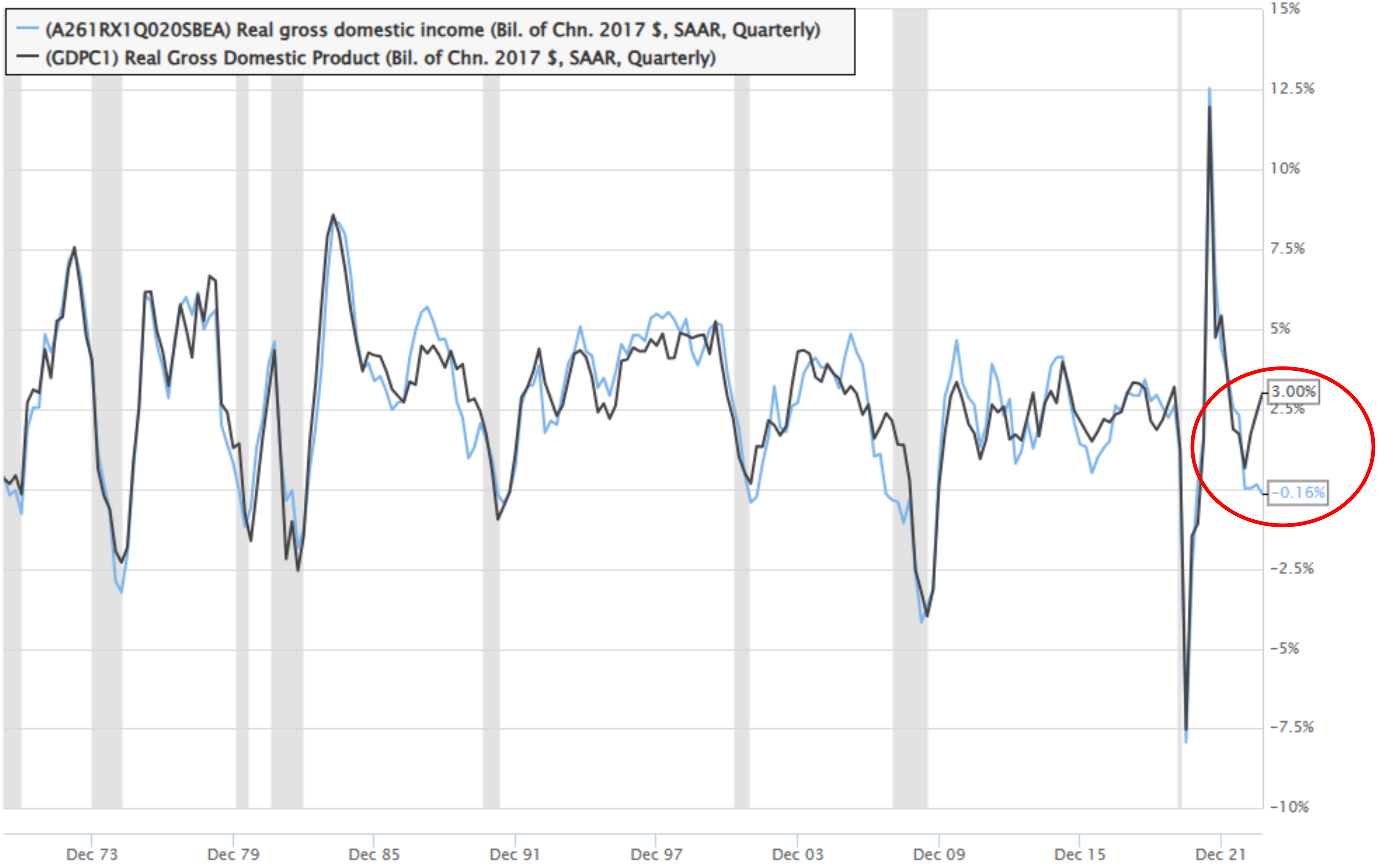
Source: Zacks Professional Services, www.zackspro.com

Gross Domestic Income Continues to Undermine GDP

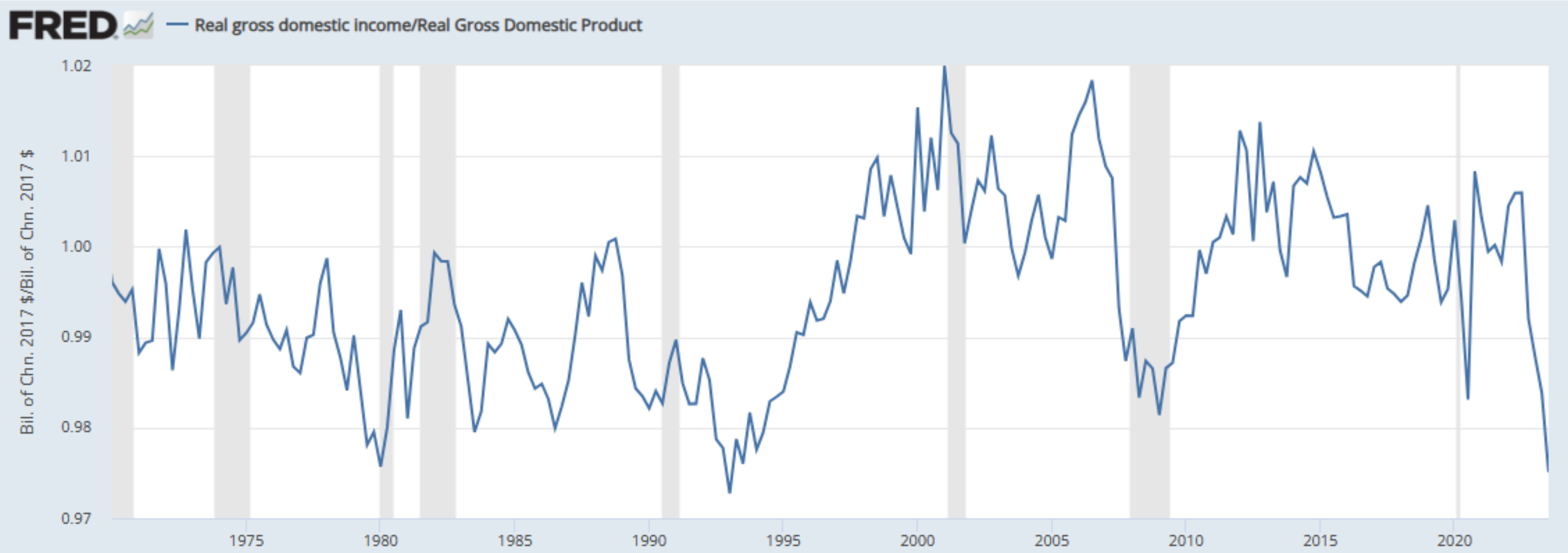
Table 6. Real Gross Domestic Product: Percent Change from Quarter One Year Ago

Line		2019	2020				2021				2022				2023			Line
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2 r	Q3 r	
1	**Gross domestic product (GDP)**	**3.2**	**1.2**	**-7.5**	**-1.5**	**-1.1**	**1.6**	**11.9**	**4.7**	**5.4**	**3.6**	**1.9**	**1.7**	**0.7**	**1.7**	**2.4**	**3.0**	1
2	**Personal consumption expenditures (PCE)**	**2.6**	**0.8**	**-8.6**	**-1.5**	**-0.8**	**3.0**	**16.4**	**7.6**	**7.2**	**5.0**	**2.2**	**1.9**	**1.2**	**2.1**	**1.8**	**2.3**	2
3	Goods	3.8	3.0	-0.9	8.4	8.8	13.6	20.3	6.0	6.6	2.3	-1.2	0.8	-0.6	1.0	1.2	2.5	3
4	Durable goods	5.5	1.6	-0.9	15.3	15.3	28.4	32.8	4.5	5.8	-0.2	-3.7	3.0	0.1	3.1	3.2	4.7	4
5	Nondurable goods	2.9	3.7	-0.9	5.0	5.4	6.4	13.9	6.8	7.0	3.8	0.2	-0.5	-1.0	-0.2	0.1	1.4	5
6	Services	2.0	-0.2	-12.1	-6.0	-5.1	-1.8	14.4	8.5	7.6	6.4	4.0	2.5	2.1	2.7	2.2	2.2	6
7	**Gross private domestic investment**	**1.3**	**-2.0**	**-16.8**	**-2.2**	**2.1**	**3.9**	**19.8**	**4.7**	**7.9**	**10.5**	**9.0**	**2.9**	**-2.4**	**-6.1**	**-2.2**	**2.3**	7
8	Fixed investment	2.9	1.9	-7.9	-3.1	0.7	3.8	14.4	7.0	3.8	3.3	1.8	1.1	-0.8	-1.8	-0.5	1.2	8
9	Nonresidential	3.1	0.6	-9.3	-6.4	-3.7	0.4	11.8	6.8	4.9	5.3	4.3	5.8	5.6	4.4	4.9	4.0	9
10	Structures	6.4	4.7	-10.8	-16.3	-14.9	-12.1	0.1	1.4	-0.9	-3.1	-3.4	-2.7	0.8	8.1	12.3	14.6	10
11	Equipment	-2.1	-7.8	-19.2	-9.4	-3.7	2.5	18.4	4.6	1.4	4.9	3.5	7.2	5.3	0.2	0.9	-1.4	11
12	Intellectual property products	7.3	7.9	3.3	3.4	3.4	5.9	12.2	11.9	11.6	10.3	9.0	9.0	8.3	6.4	4.9	3.8	12
13	Residential	2.2	6.7	-2.7	8.8	15.9	14.8	22.7	7.3	0.4	-2.4	-5.0	-11.4	-17.4	-18.1	-15.4	-7.3	13
14	Change in private inventories	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	14
15	**Net exports of goods and services**	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	15
16	Exports	0.8	-4.3	-24.1	-14.5	-9.7	-5.7	20.3	7.1	6.7	5.2	7.4	11.1	4.3	7.3	2.1	-0.2	16
17	Goods	0.0	-2.2	-24.1	-9.7	-4.4	-3.4	27.2	5.6	5.5	3.1	5.6	11.3	3.2	8.6	1.7	-1.3	17
18	Services	2.5	-8.2	-24.2	-22.9	-19.3	-10.2	8.4	10.0	9.2	9.9	11.5	10.5	6.7	4.4	2.6	2.1	18
19	Imports	-1.9	-5.5	-22.1	-8.4	0.1	5.7	30.4	13.6	11.1	12.7	11.8	8.2	2.1	-1.0	-3.9	-1.5	19
20	Goods	-2.7	-4.9	-19.8	-3.8	5.3	10.3	31.9	10.7	8.7	10.1	9.6	7.1	0.9	-2.0	-4.1	-0.9	20
21	Services	1.7	-8.0	-31.5	-27.3	-20.9	-13.8	23.4	29.3	23.9	27.2	23.4	13.6	8.2	4.1	-2.6	-4.0	21
22	**Government consumption expenditures and gross investment**	**4.7**	**4.4**	**5.0**	**2.2**	**1.1**	**1.4**	**-1.8**	**-0.6**	**-0.2**	**-2.3**	**-1.6**	**-0.6**	**0.8**	**2.7**	**4.1**	**4.7**	22
23	Federal	3.9	4.3	10.2	5.2	4.5	7.6	-1.9	-0.4	0.6	-5.2	-4.0	-1.9	-0.1	3.0	4.3	5.7	23
24	National defense	4.3	3.0	3.4	1.7	3.2	0.3	-1.1	-1.8	-5.0	-4.9	-3.5	-2.8	0.2	2.5	2.9	5.0	24
25	Nondefense	3.2	6.3	20.3	10.6	6.4	18.3	-3.0	1.4	8.6	-5.6	-4.5	-0.8	-0.6	3.5	6.1	6.7	25
26	State and local	5.2	4.5	1.9	0.4	-0.9	-2.2	-1.7	-0.7	-0.6	-0.4	-0.2	0.2	1.3	2.6	4.0	4.2	26
	Addenda:																	
27	Gross domestic income (GDI) [1]	2.6	1.1	-7.9	-2.5	0.2	1.6	12.5	6.6	4.4	3.7	2.5	2.3	0.0	0.0	0.1	-0.2	27

Source: US Bureau of Economic Analysis



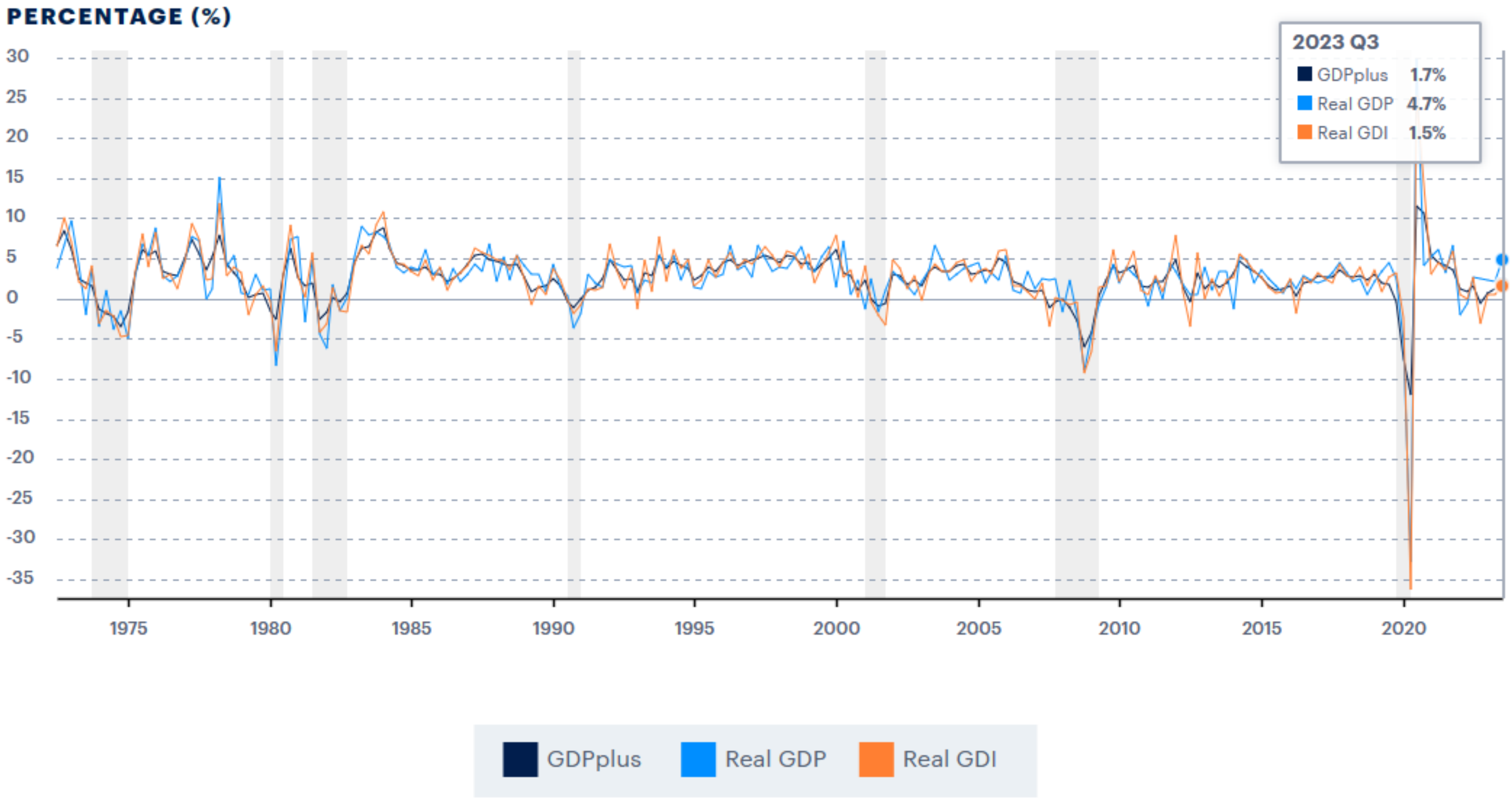
Source: Zacks Professional Services, www.zackspro.com



Source: St Louis Fed, BEA

GDPplus by the Philly Fed Continues to Undercut Headline GDP in Q4

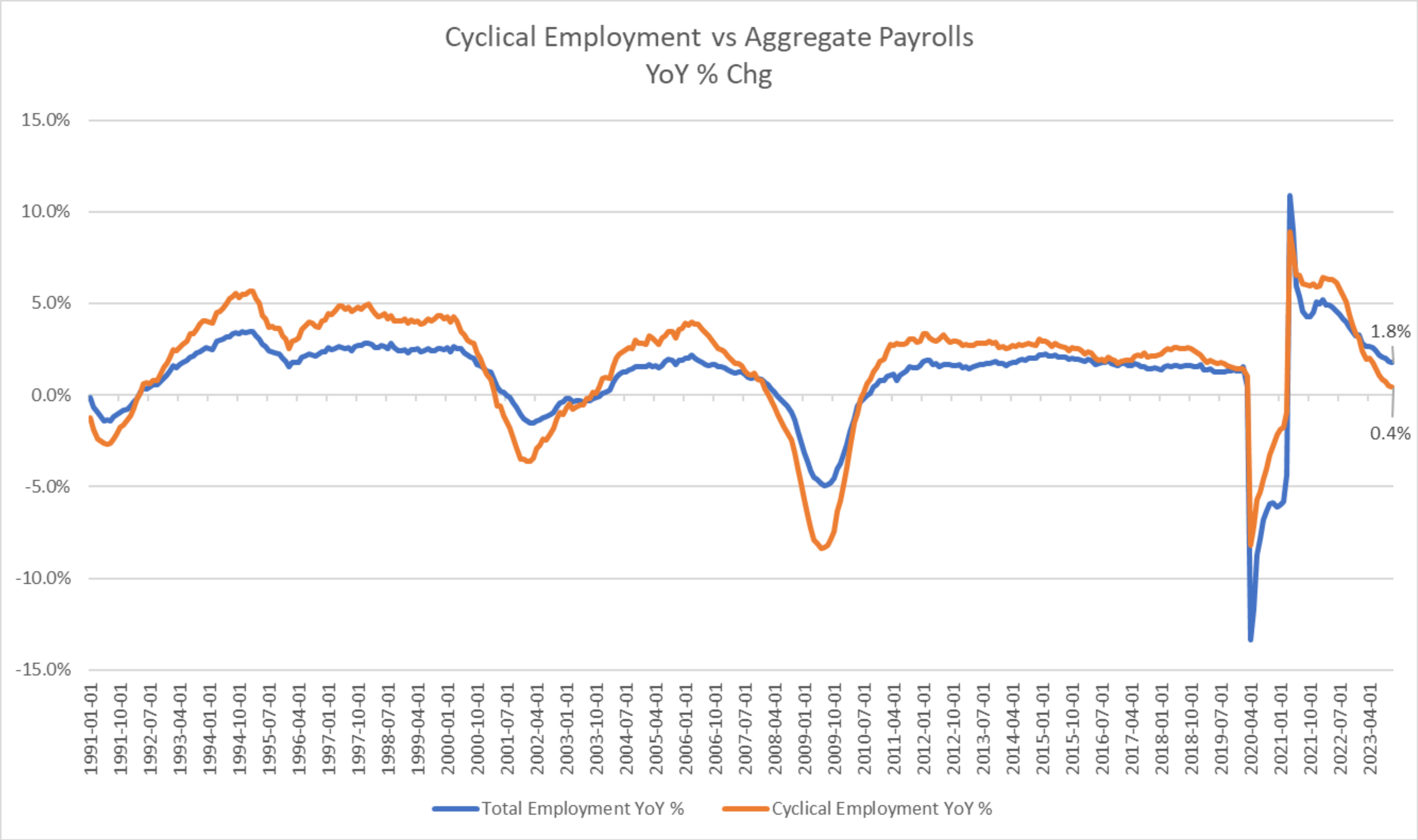
Remains Well Below Headline Real GDP Figures, suggesting potential negative revisions or lower future GDP growth



Source: Philadelphia Fed

EMPLOYMENT

While Headline Job Growth Has Remained Strong, Cyclical Undercurrents Are Weakening Quickly



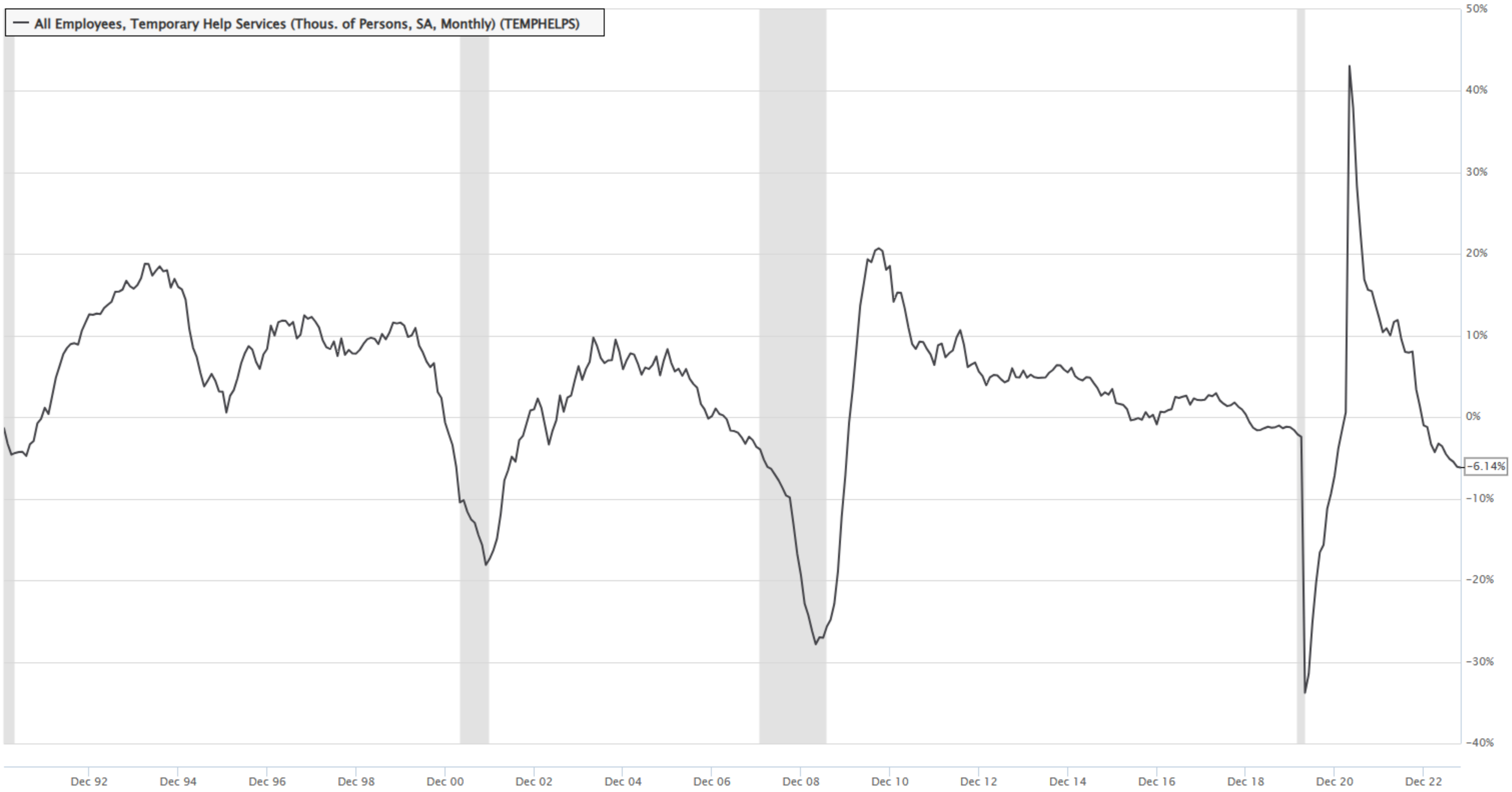
Source: Zacks Investment Research

‘Cyclical’ Employment levels measure the total labor force working in sectors *outside* of government, education and healthcare.

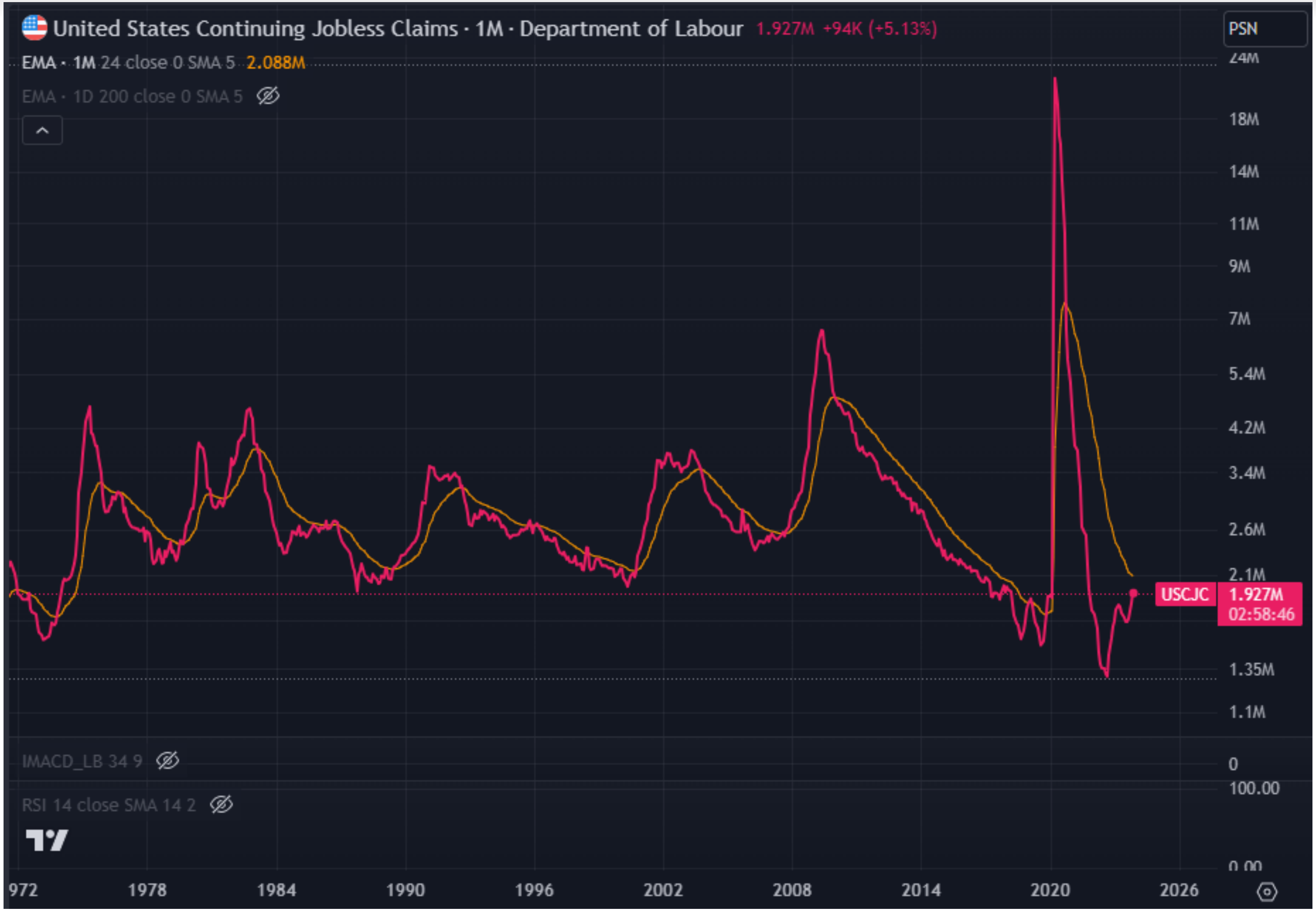
It is important to make this distinction for analytical purposes to understand *where* job gains are coming from: government sector or private sector.

The declining cyclical employment is a more direct reflection of the job situation in the real world and is a leading indicator for aggregate employment.

Temporary Help Services is an example of a cyclical leading employment indicator



Source: TradingView, BLS



Source: TradingView, BLS

Analysts are still expecting +13% EPS growth in 2024, but I believe the leading indicators of earnings suggest these expectations are vastly overstated.

EPS forecasts will be marked down, in my view, as the sharp rise in the cost of capital will inevitably lead to rising delinquencies, defaults, bankruptcies, and ultimately job cuts.

Source: Zacks Professional Services, www.zackspro.com

Recessions are always a slow buildup of many things.

But if we see a rapidly steepening yield curve, this may be a sign of rapid deterioration which can lead to someone being caught ‘offsides’

Banks Continue to Face Tremendous Difficulty:

Large unrealized losses on HTM securities
+ Increasing depositor withdrawals
+ Declining commercial real estate prices
+ Rising loan loss provisions

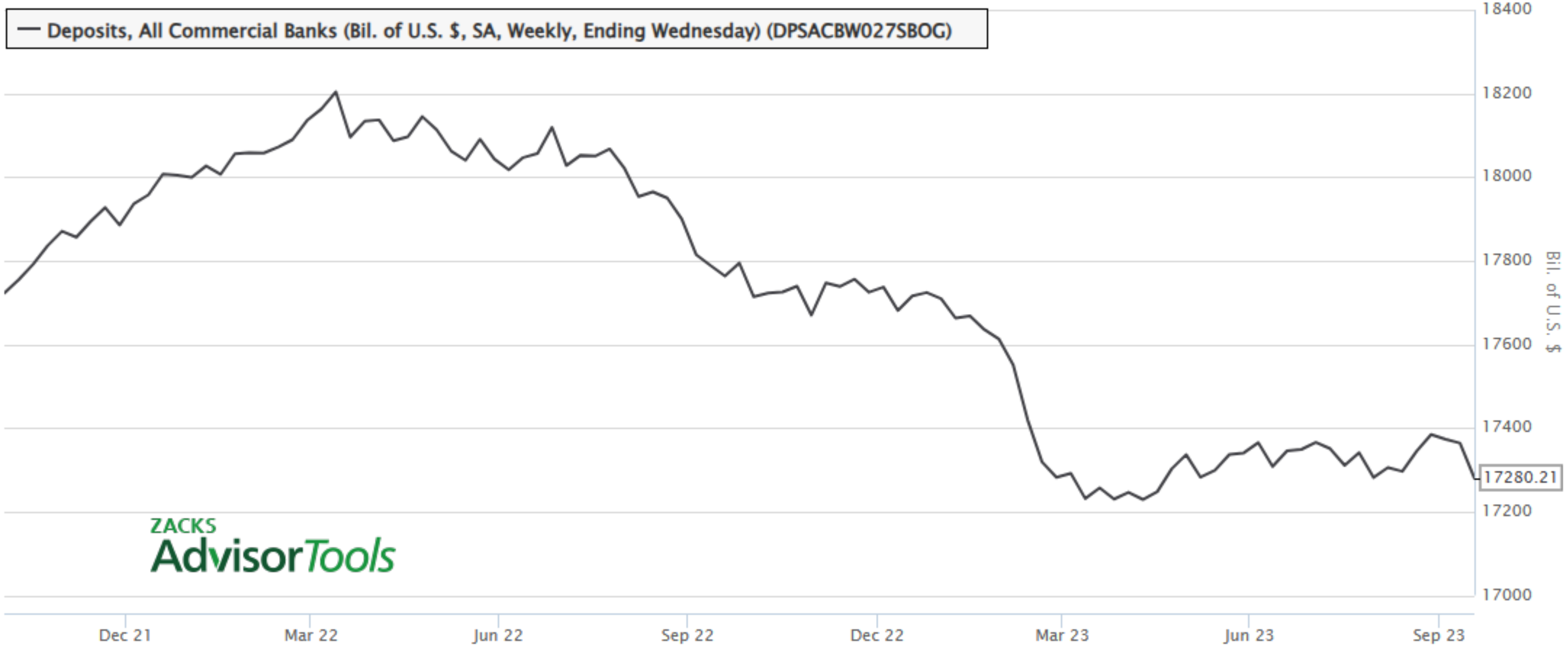
= Tightening credit availability

NBER: 14% of all loans and 44% of office loans are in ‘negative equity’, leading to potentially up to 300 regional banks at risk of solvency runs.

Source: National Bureau of Economic Research

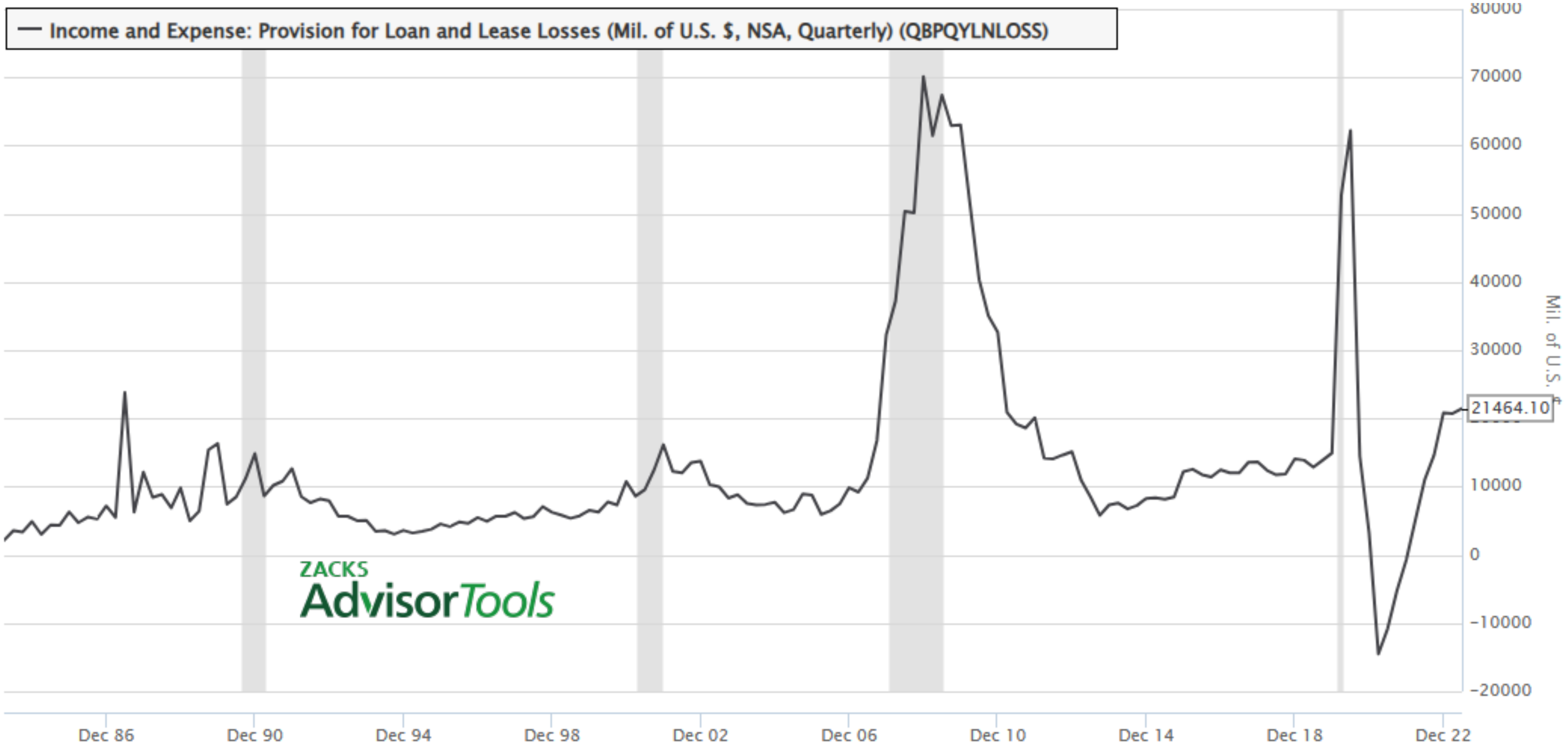
Since March '22, $1 trillion has been removed from US banks

But has been stable since April '23



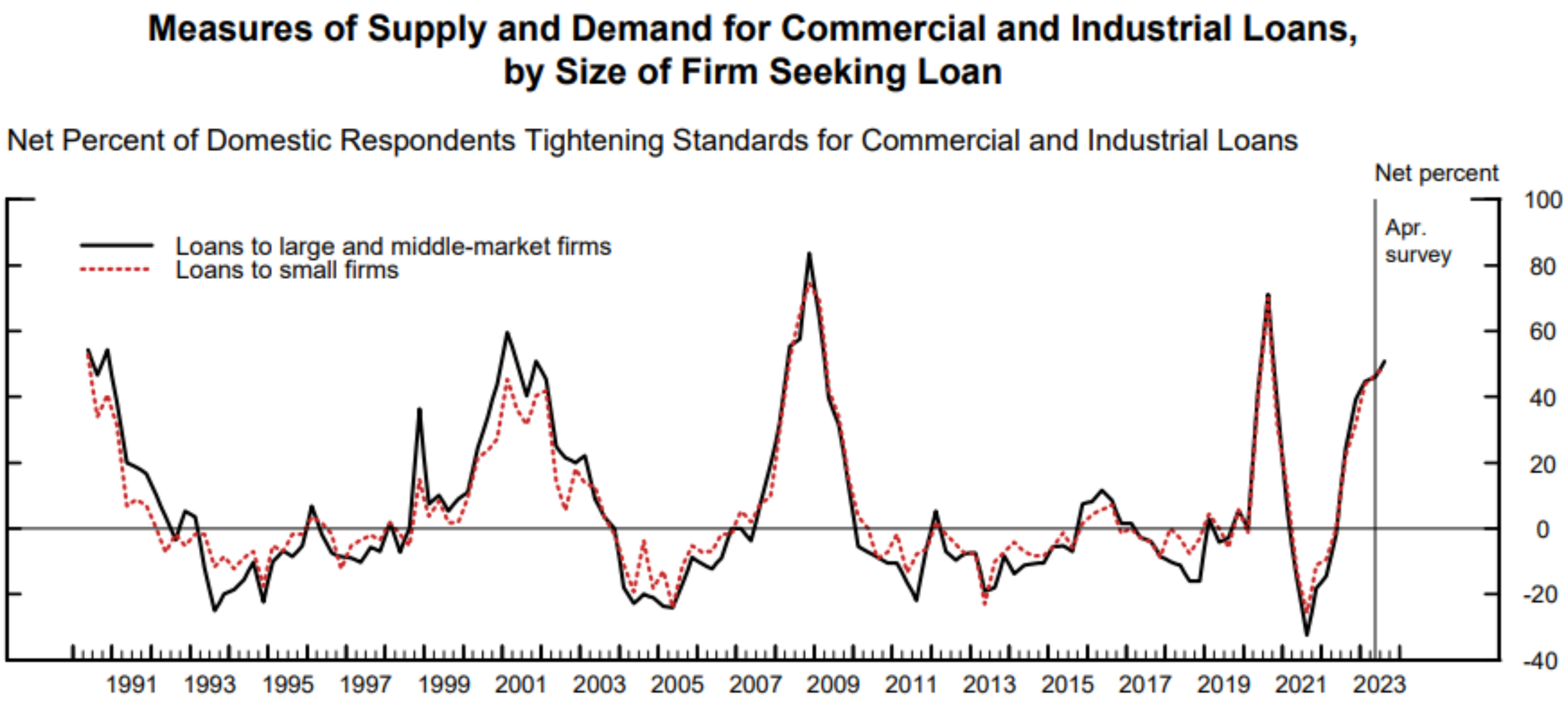
Source: Zacks Professional Services, Federal Reserve Board

While Loan Loss Provisions Are Rising

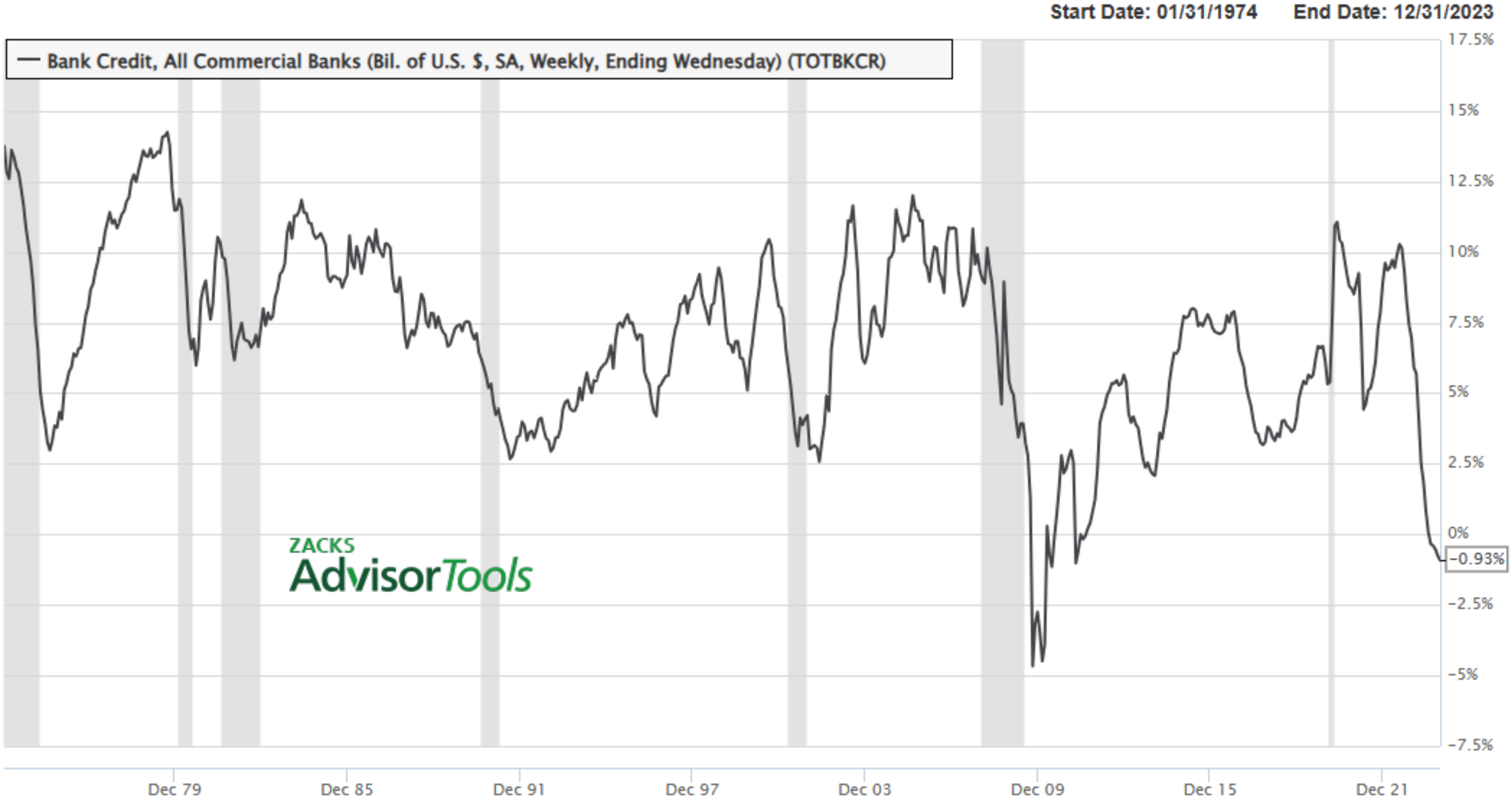


Source: Zacks Professional Services , FDIC

Net Result is Tightening Credit Availability

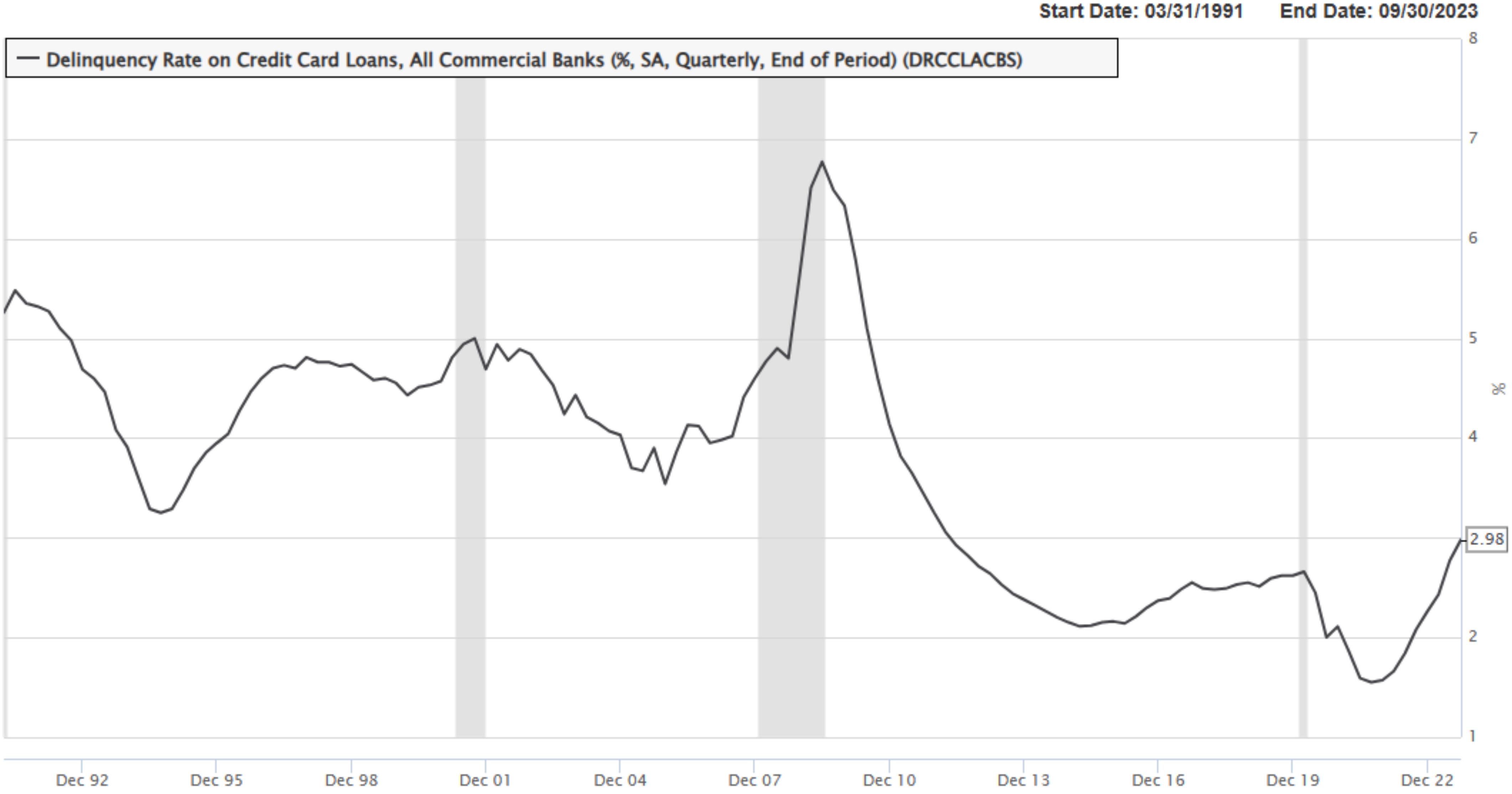


Bank Lending Rarely Contracts Outside of Recessions

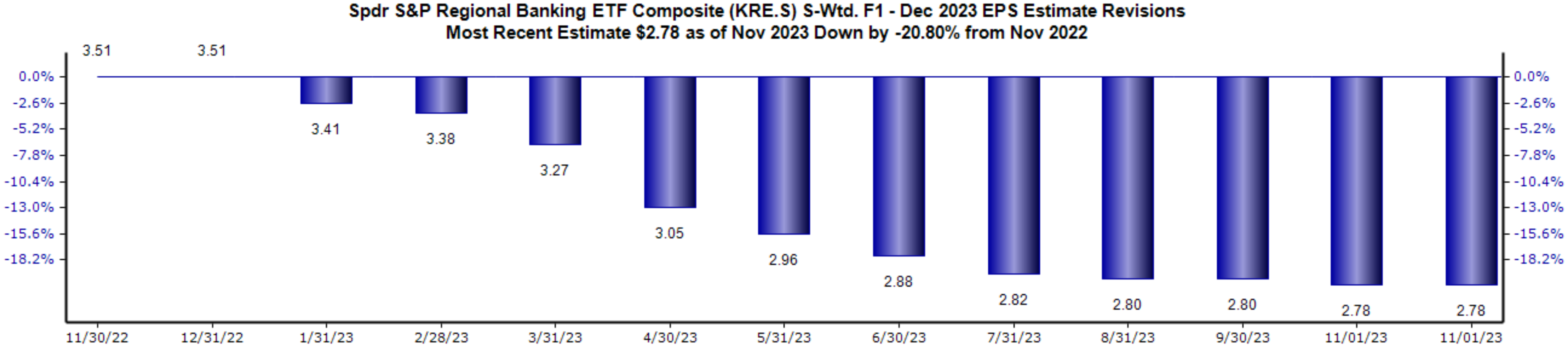


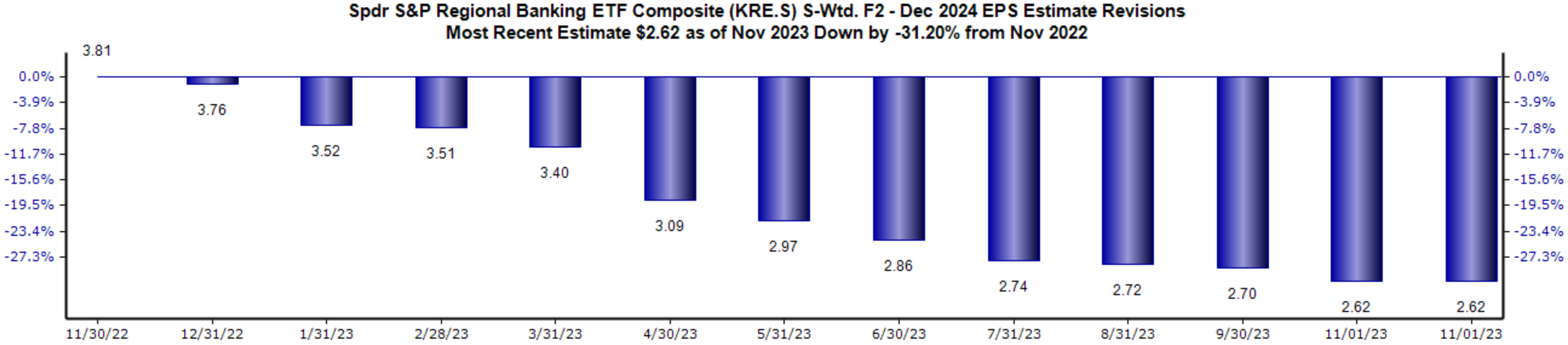
Source: Zacks Professional Services

Delinquency Rates Beginning To Rise Just as Cracks Begin Forming in the Labor Market



…and deep cuts to regional bank EPS forecasts





Source: Zacks Investment Research

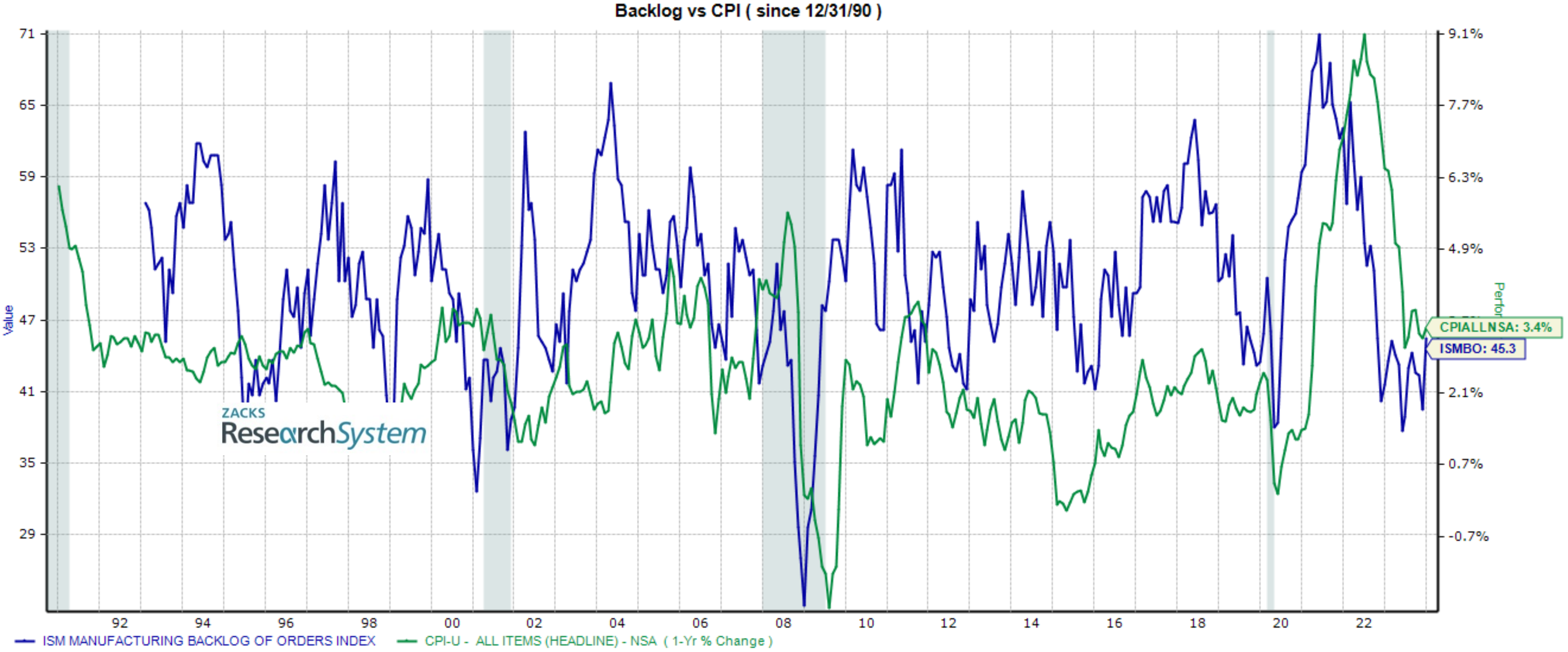
Discover Financial Services (DFS) shares declined -10% following Q4 earnings after the credit card network & lender more than doubled credit loss provisions to $1.9 billion (vs $900m a year ago) on sharply rising delinquencies.

Discover is a bellwether of the health of the American middle class with over 60 million cardholders, mostly of middle incomes.

Source: Discover Financial Services

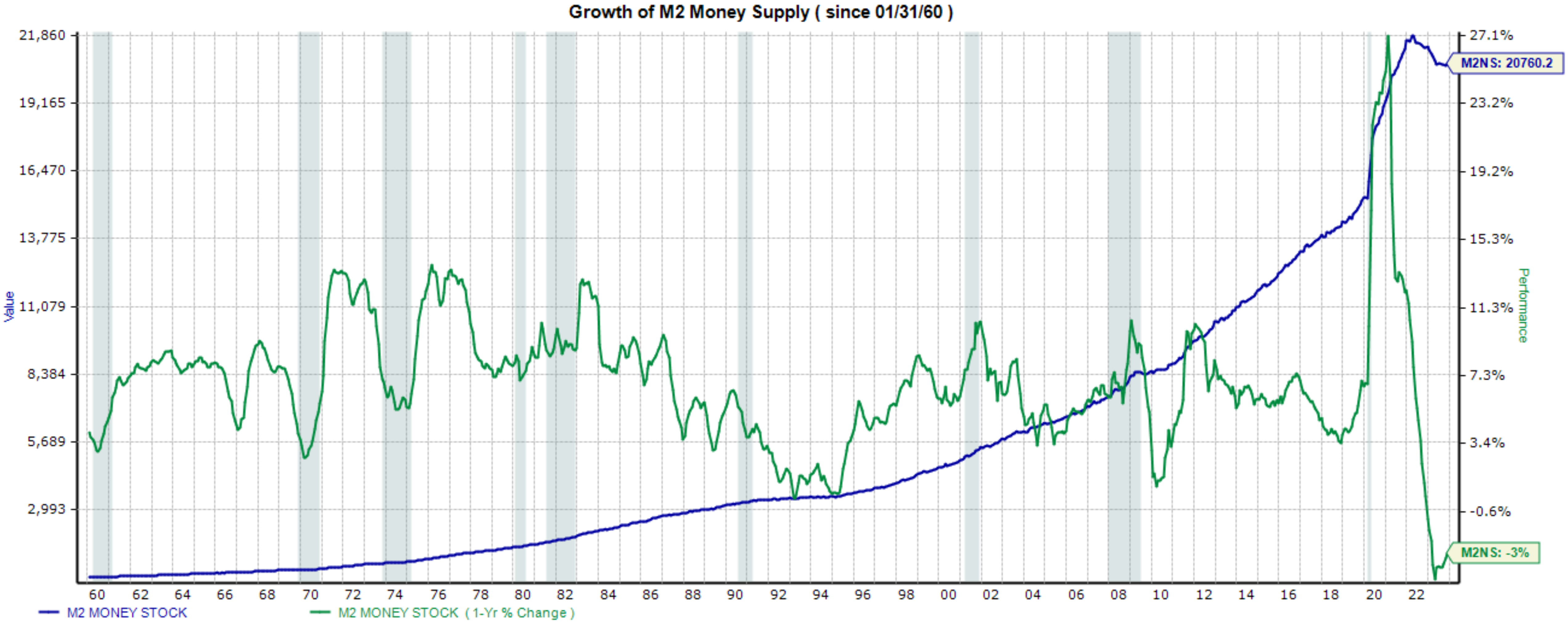
Regional banks are dealing with these fires simultaneously. I believe the banking crisis is not yet over.

Mfr Backlog Remains in Contraction for 15 Consecutive Months Continues to Forecast CPI Normalization



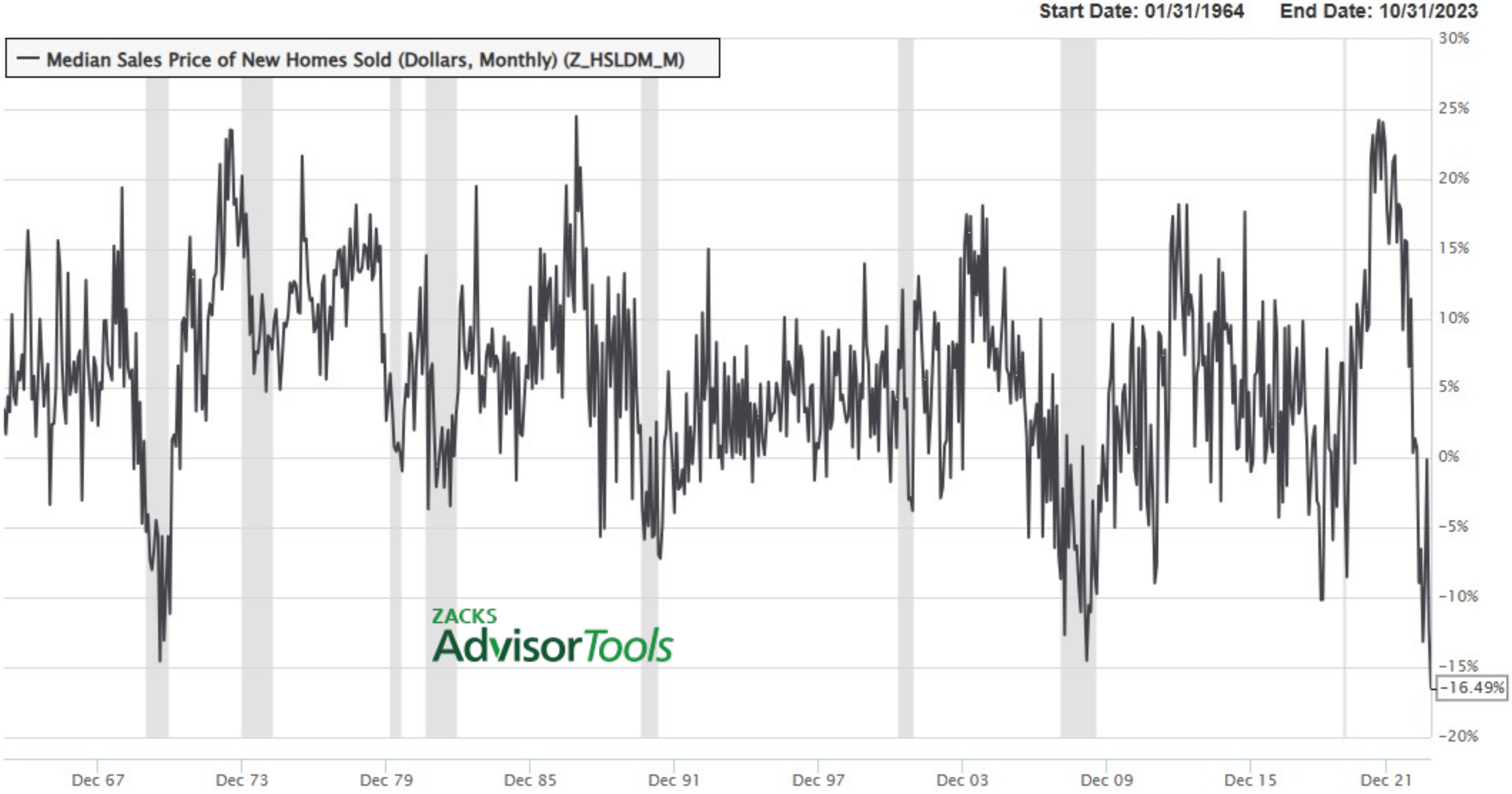
Source: Zacks Professional Services, www.zackspro.com

Fed Continues to Pull Liquidity



Source: Zacks Professional Services, www.zackspro.com

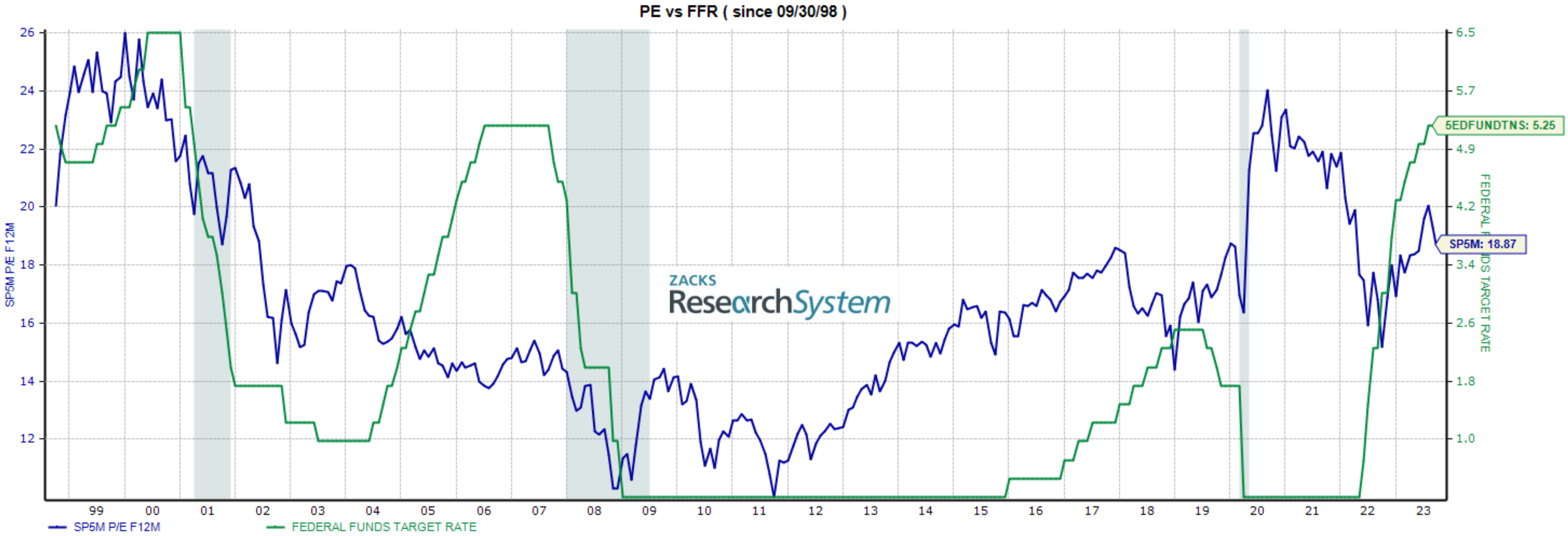
New Home Prices Collapsing On Higher Financing Costs



Source: Zacks Professional Services, www.zackspro.com

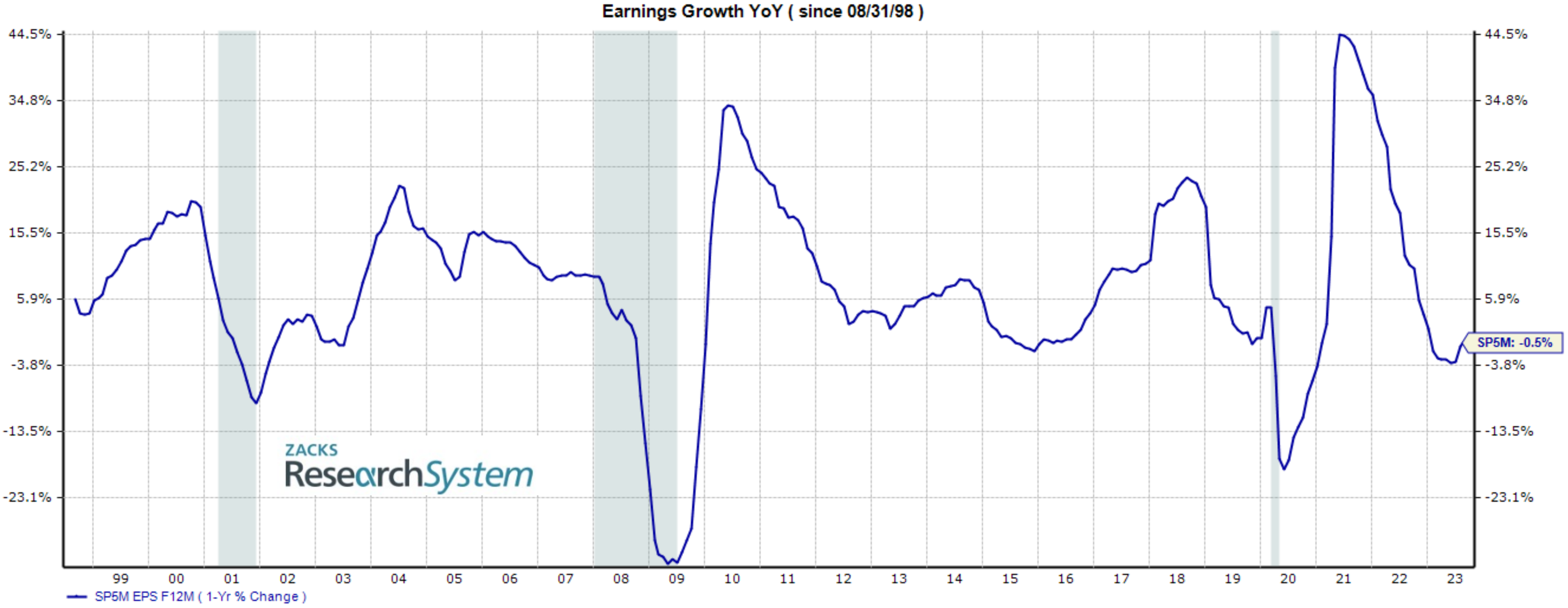
What does all this imply for stocks?

SPX Forward P/E Significantly Higher than Previous 5% Environments



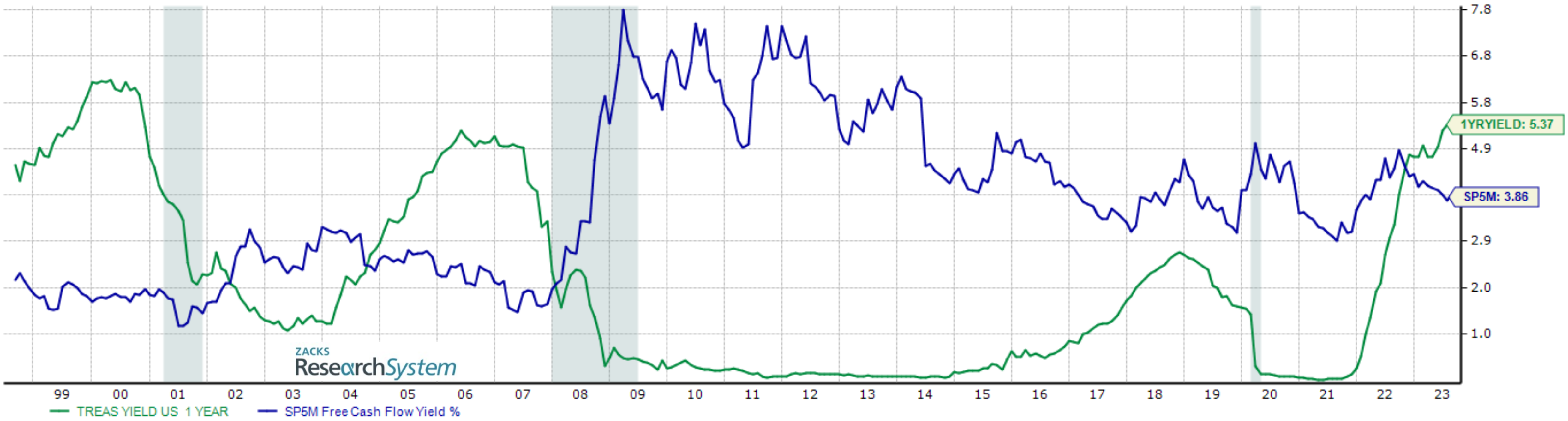
Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
&P 500 Composite Market ETF (SP5M) P/E F12	25.87	10.54	16.54	18.87			09-30-1998	09-20-2023
EDERAL FUNDS TARGET RATE	6.50	0.25	1.25	5.25	0.00%	0.00%	09-30-1998	08-31-2023

...on lower forward EPS growth expectations



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Change)	44.47%	-32.76%	7.90%	-0.47%	479.35%	6.90%	08-31-1998	08-14-2023

1-year UST Yield Comfortably Surpasses SPX Free Cash Flow Yield By Largest Margin Since 2007



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
TREAS YIELD US 1 YEAR	6.28	0.05	1.40	5.37	18.54%	0.68%	08-31-1998	07-31-2023
S&P 500 Composite Market ETF (SP5M) Free Cash Flow Yield %	7.75	1.18	3.66	3.86			08-31-1998	08-14-2023

Source: Zacks Professional Services, www.zackspro.com

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Nieves continues, "There has been a pullback in the rate of growth for the services sector. This is due mostly to the decrease in employment and continued improvements in delivery times (resulting in a decrease in the Supplier Deliveries Index) and capacity, which are in many ways a product of sluggish demand. The majority of respondents indicate that business conditions are currently stable; however, there are concerns relative to the slowing economy."

Fedex Declining Shipping Volumes

“The shipping firm, which is slashing costs to protect profits as demand wanes, said ongoing "demand challenges" prompted its plans to ground 29 more aircraft in the fiscal year that started on June 1.”

CEO Raj Subramaniam: fresh cost cuts would support profit through first half of 2024 “through an environment that we expect to remain marked by demand challenges,”

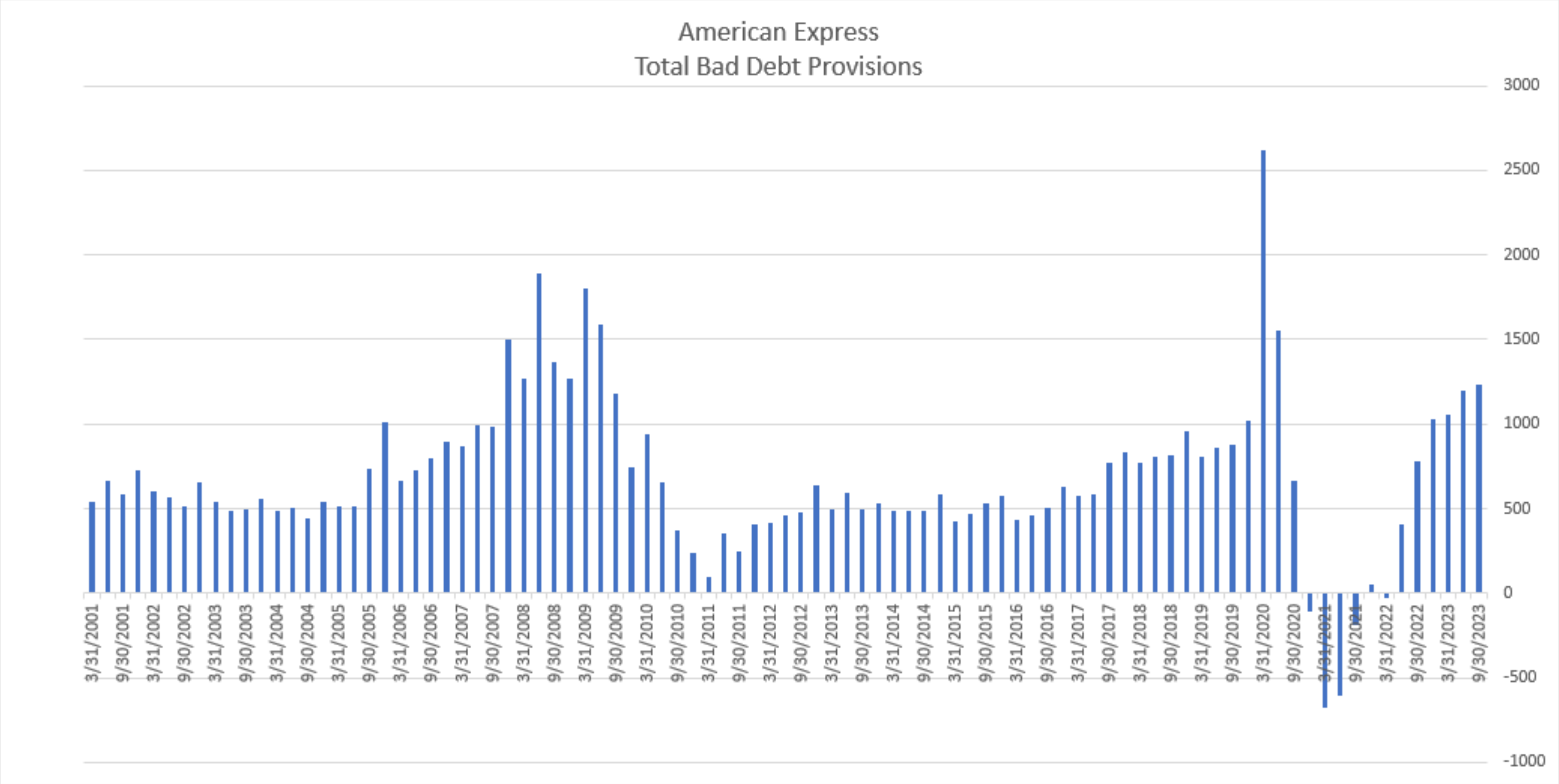
Source: FedEx Company Filings, Zacks Professional Services, www.zackspro.com

Maersk's Profit Warning for 2023

Recently, the #1 global shipping company Maersk in its Q2 earnings report issued a profit warning for 2H 2023 and into 2024, citing major demand challenges stemming from a global trade slowdown. "Survey indicators point to flat growth, at best, in Europe and US in H2 of 2023 and the start of 2024, with a material risk of recession in both regions," they write. "The manufacturing sector continues to struggle, and the Global Purchasing Managers Index has remained in contractionary territory since September 2022…the combination of recession concerns and high inventories has resulted in poor demand growth…currently there is no sign of a substantial rebound in volumes…"

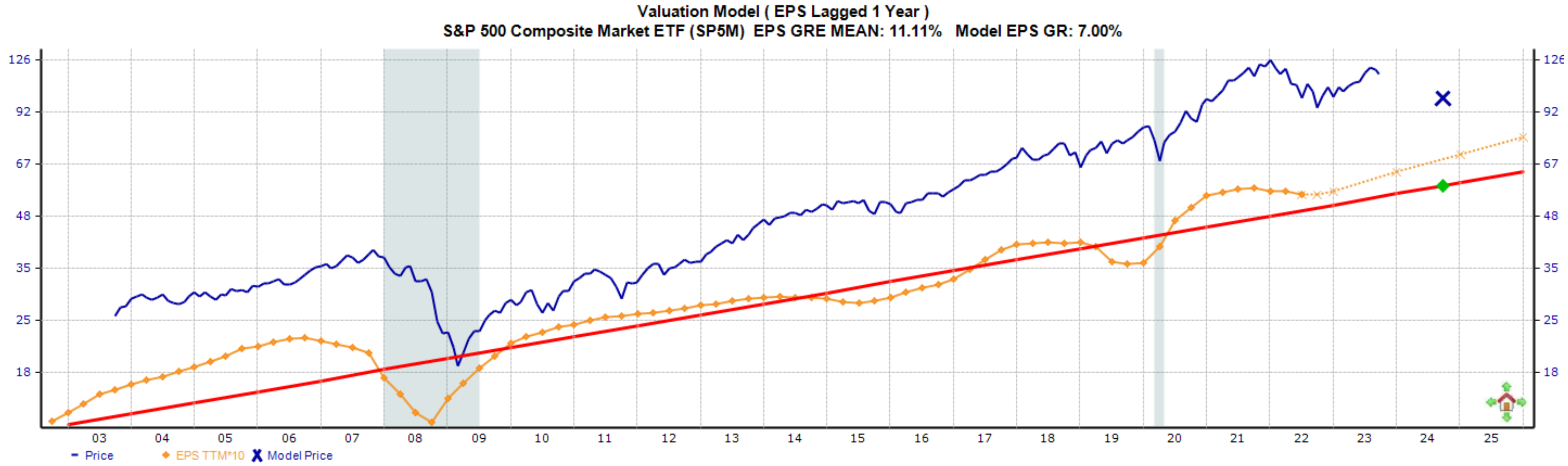
Source: Maersk Company Filings, Zacks Professional Services, www.zackspro.com

American Express (AXP) provisions for bad loans now firmly at levels seen only during recessions (2007-2009 and 2020). $400m in Q2 2022 to now $1.23 billion as of Q3 2023.



Source: AMEX Company Filings, Zacks Professional Services, www.zackspro.com

Discounted Earnings Model Suggests SPX Overvalued by 20%

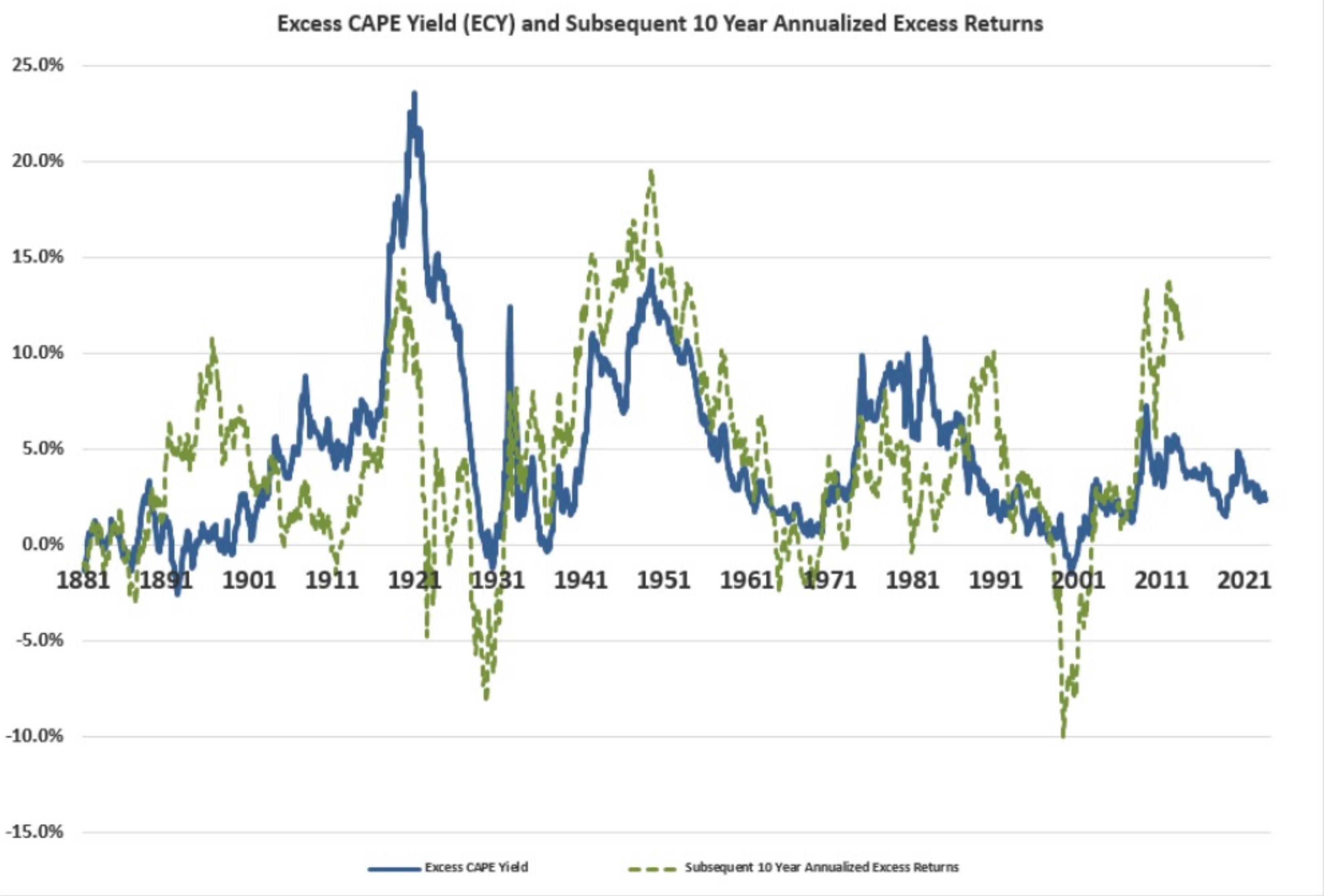


Zacks Valuation Model				Zacks Consensus Estimates				Normalized Earnings	
	Current	House	1-Year		2023	2024	2025	FYE: December	
Risk Free Rate (10Yr Treas)	4.35%	5.00%	4.35%	Mean Estimate	5.65	6.36	7.07	2021	4.52
Equity Risk Premium	1.84%	1.84%	1.84%	Change Y/Y	0%	13%	11%	2022	4.84
Company Specific Risk	0.00%	0.00%	0.00%	High	5.92	7.06	7.76	2023	5.18
Total Equity Discount Rate	6.84%		6.84%	Low	5.42	5.84	6.62	2024	5.54
Actual PE F12M	21.31		20.00	Total				2025	5.93
Model PE F12M	17.23		17.23	#Up (4 weeks)				2026	6.34
Model Price	94.01		100.11 X	#Down (4 weeks)				2027	6.79
Model EPS F12M	5.46		5.81	House Estimate	5.60	5.40	7.00	2028	7.26
Model Return	-19.14%		-12.45%	PE Intraday	20.8	21.5	16.6	2029	7.77

Save Model | Calculate | Default Model

Source: Zacks Professional Services, www.zackspro.com

Shiller P/E Suggests Forward 5-Year Returns May Be Lackluster



Source: Robert Shiller, Yale University

My primary conclusions:

1. the *direction* of leading fundamental indicators (including the rising cost of capital), at the margin, implies negative pressure to S&P earnings. This means analysts *will* mark down both FY 2023 and FY 2024 EPS forecasts.

2. Markets are priced for earnings growth at a forward P/E of 18-20x.

3. If that doesn’t happen, there will be a substantial drawdown. I believe this downturn has already begun.

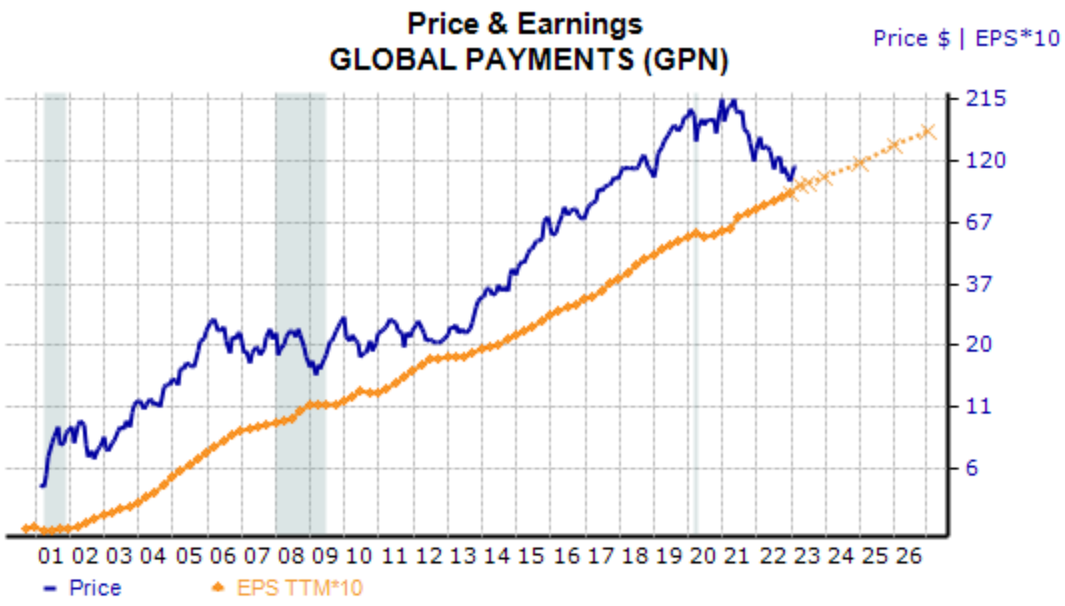
My Ideal Capital Allocation for 2023

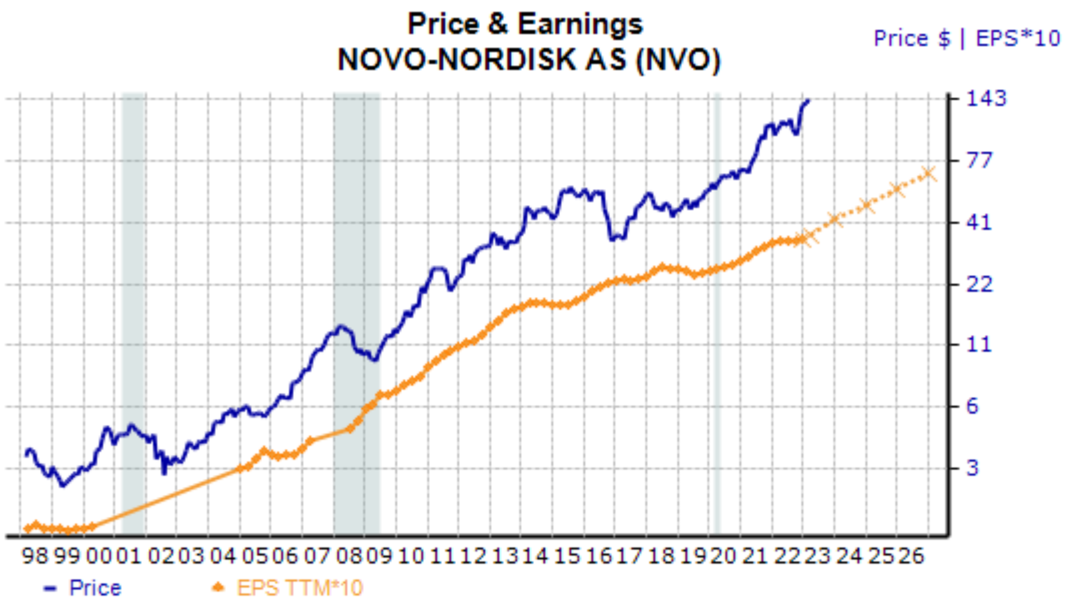
Just two asset classes

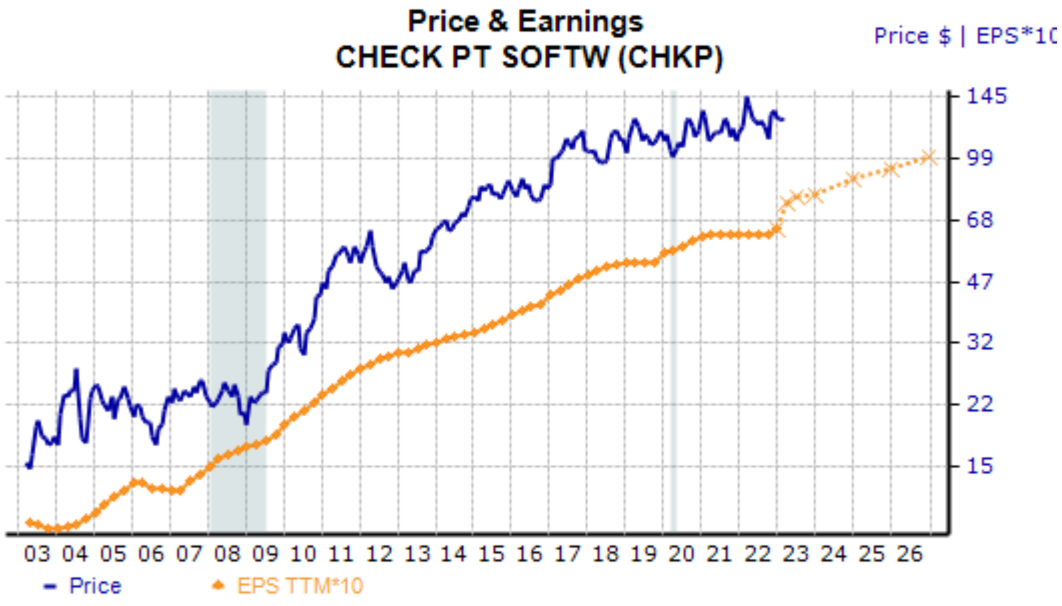
- 1 Year Treasuries which currently pay 5%!
  - Can also buy a money market mutual fund, but be sure to select only those who hold *only* Treasuries and/or deposit funds directly with the Federal Reserve, i.e. Vanguard Treasury Money Market Fund (VUSXX) or the Fidelity Treasury Money Market Fund (FZFXX)
- Zacks Earnings Certain Portfolio
  - Focus especially on the companies with:
    - Lowest beta
    - Dividend growth and/or share buybacks
    - Low Shiller P/E

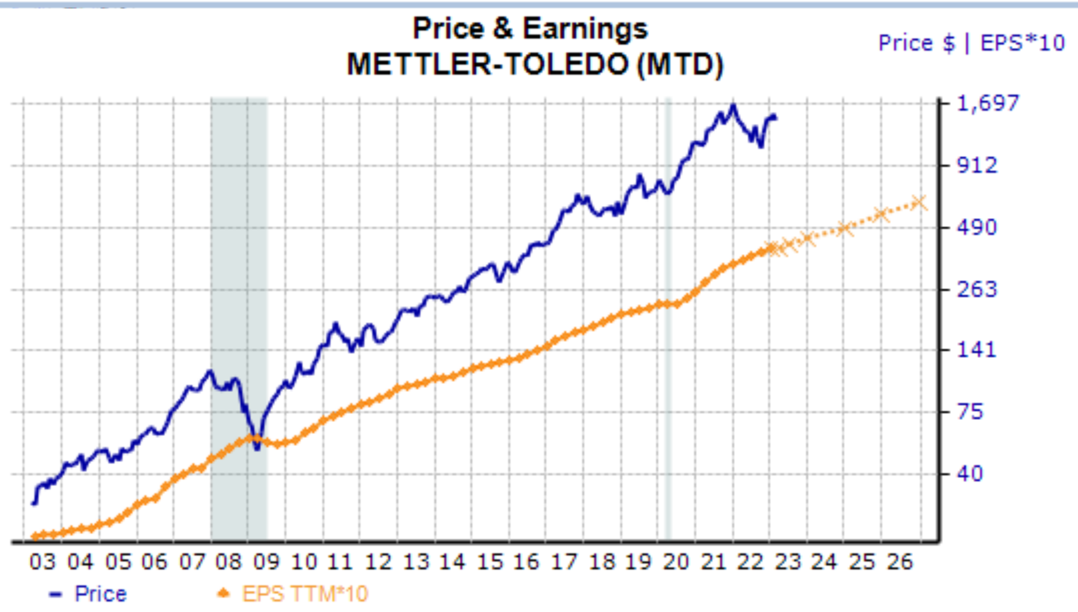
Position for a low-growth environment with a combination of recession-resistant growth (ZECPE) + income (1Y Treasuries).

Zacks Earnings Certain Businesses


Price & Earnings
GLOBAL PAYMENTS (GPN)
Price $ | EPS*10
215
120
67
37
20
11
6
01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Price
EPS TTM*10


Price & Earnings
NOVO-NORDISK AS (NVO)
Price $ | EPS*10
143
77
41
22
11
6
3
98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Price
EPS TTM*10


Price & Earnings
CHECK PT SOFTW (CHKP)
Price $ | EPS*10
145
99
68
47
32
22
15
03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Price
EPS TTM*10


Price & Earnings
METTLER-TOLEDO (MTD)
Price $ | EPS*10
1,697
912
490
263
141
75
40
03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Price
EPS TTM*10

Thank You for Attending!

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