Leading Indicators Continue to Point to Recession

Presented by:

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The Bear Case: Summary

- **US Manufacturing is in recession**
  - Chicago PMI, ISM Manufacturing, Philly Fed Index, Empire State Index all in contraction for 11-13+ consecutive months
  - Backlog in deep contraction as ISM New Orders at lows; implies production will begin to slow, triggering layoffs in manufacturing
  - Implies S&P revenue and EPS will remain under pressure into 2024
  - The longer these gauges remain in contraction, the higher the probability it begins to weigh on growth expectations for 2024

- **Cyclical Employment in its 4th consecutive month of YoY declines**
  - Headline job growth has been impressive, but jobs coming from cyclical industries are contributing to a decreasing % of total jobs created
  - Removing Government, education & healthcare jobs provides additional layer of analysis since these are not representative of the underlying economy
  - Implies a tightening labor market building beneath the surface
  - Temporary Help Services, a leading indicator of recession, has been in contraction for 10 consecutive months

- **Job Losses remain historically low, but are steadily building**
  - Continuing Claims back to 2023 highs
  - Permanent Job Losses on the rise
  - WARN Notices have spiked significantly in recent months; leading indicator to initial claims

- **Inverted UST 10y-2y yield curve, which is now rapidly re-steepening with rising long yields**

- **Real Retail Sales picked up to +0.06% YoY** through September; first positive reading after, 7 consecutive month of YoY declines. Growth remains tepid.

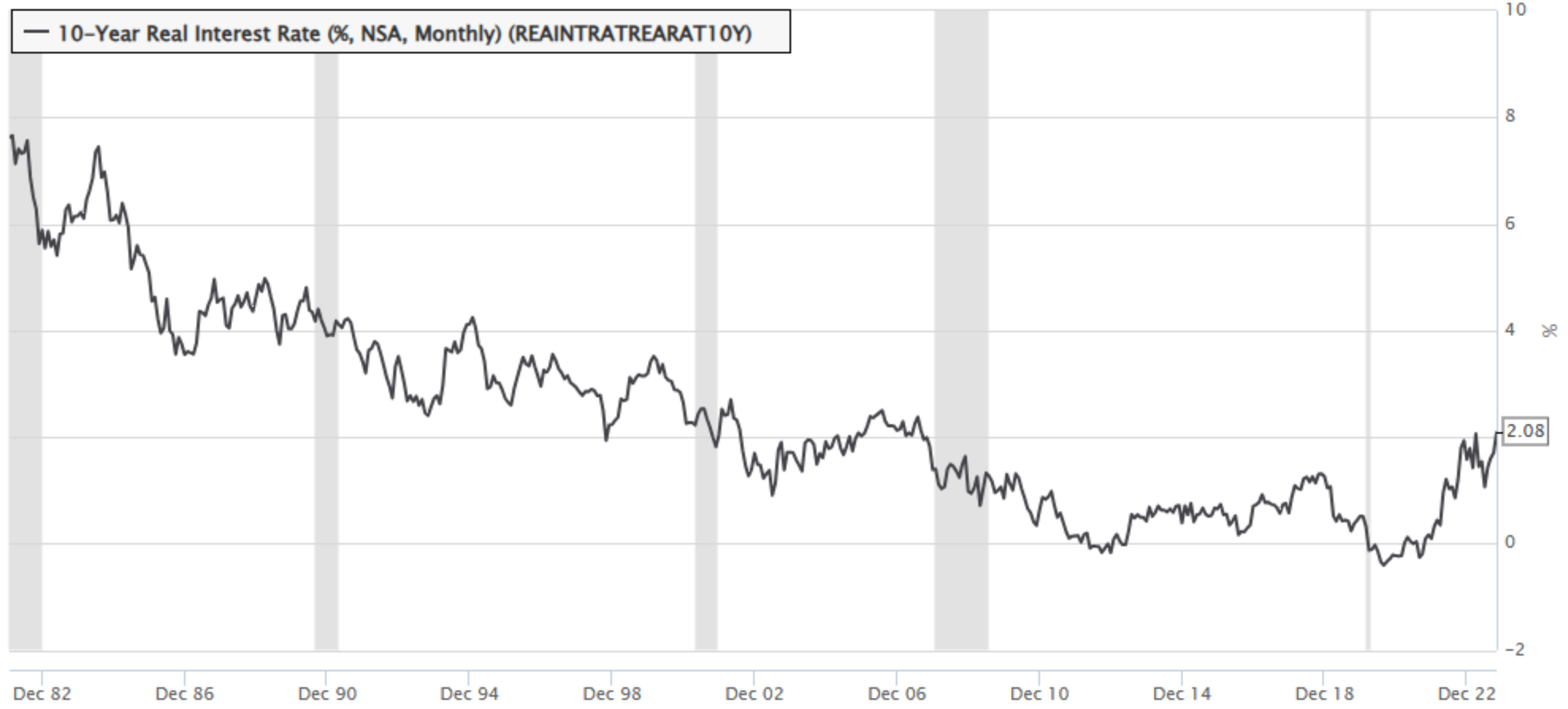
- Conference Board **Leading Economic Index in deep contraction for 16 consecutive months**

- Banks still under tremendous pressure
  - Depositor withdrawals continue at $2 billion per day avg
  - Rising loan loss provisions
  - Commercial real estate rolling over
  - Compounds the ongoing issue of dealing with large unrealized losses on HTM securities
  - XLF EPS estimate revisions deeply bearish
  - All of above points to tightening credit availability

- New lows in **EPS estimate revisions**

- 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 Well Above 2%; Highest Levels in 20 Years



Source: Zacks Professional Services, www.zackspro.com

Three Primary Drivers of Higher Yields Despite Slowing Growth:

1. Upcoming massive UST issuance. Some 30% of all US government debt outstanding is set to mature in the coming 6-12 months

2. Federal government in a deep fiscal deficit, and getting deeper as the US Treasury must refinance this debt at substantially higher borrowing costs. This creates a 'debt spiral' of deeper deficits due to borrowing at increasing interest rates.

3. The Federal Reserve is remaining steadfast at keeping rates higher for longer: now forecasting only 1-2 cuts next year, which is down by 50% from market expectations only three months ago.

This means we will have true price discovery in the bond market amid escalating government deficits and no support from the Fed.

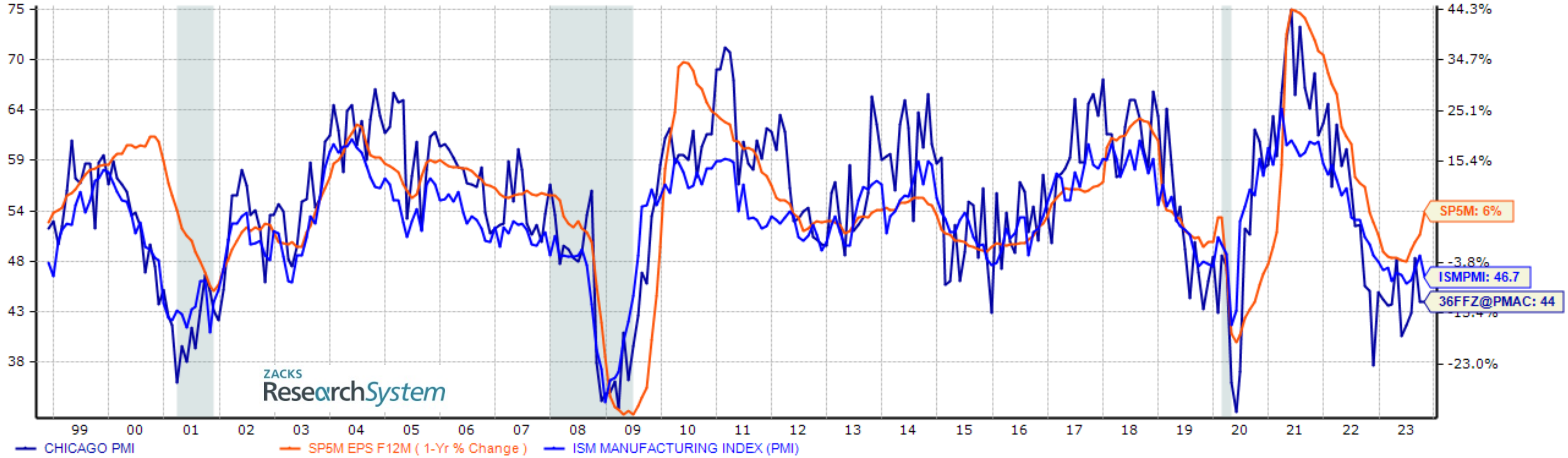
Analysts are still expecting +12% EPS growth in 2024, but I believe the leading indicators of earnings suggest these expectations are vastly overstated.

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

Chicago PMI and ISM Manufacturing PMI at Recession Levels

12 Consecutive Months in Contraction; Bearish Divergence vs SPX Earnings Estimates



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
CHICAGO PMI	75.20	32.30	55.84	44.00	-15.06%	-0.64%	11-30-1998	10-31-2023
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Chang	44.29%	-32.63%	7.90%	6.03%	483.36%	6.94%	11-30-1998	11-01-2023
ISM MANUFACTURING INDEX (PMI)	64.70	33.30	52.85	46.70	-3.11%	-0.12%	11-30-1998	10-31-2023

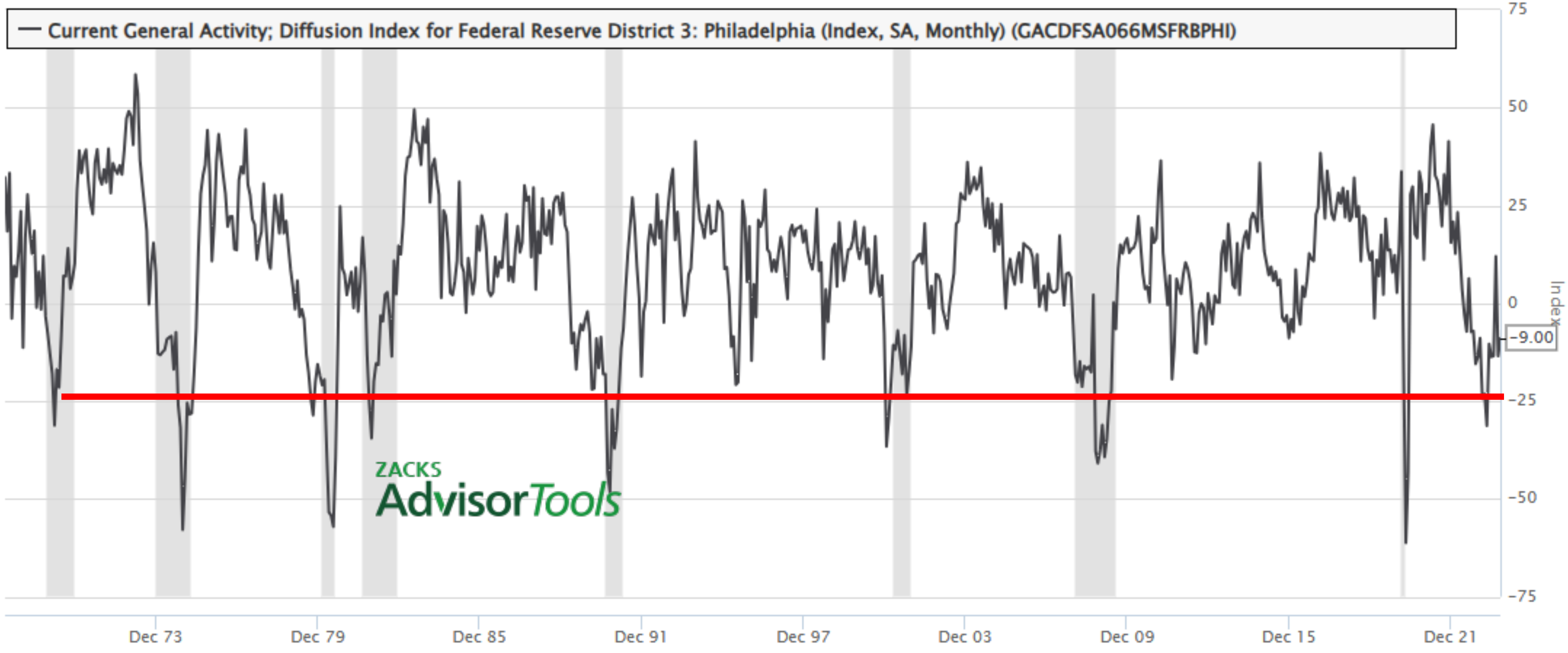
GDPplus by the Philly Fed Continues to Undercut Headline GDP in Q3

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

Source: Philadelphia Fed

Philadelphia Fed Manufacturing Index at Recession Levels

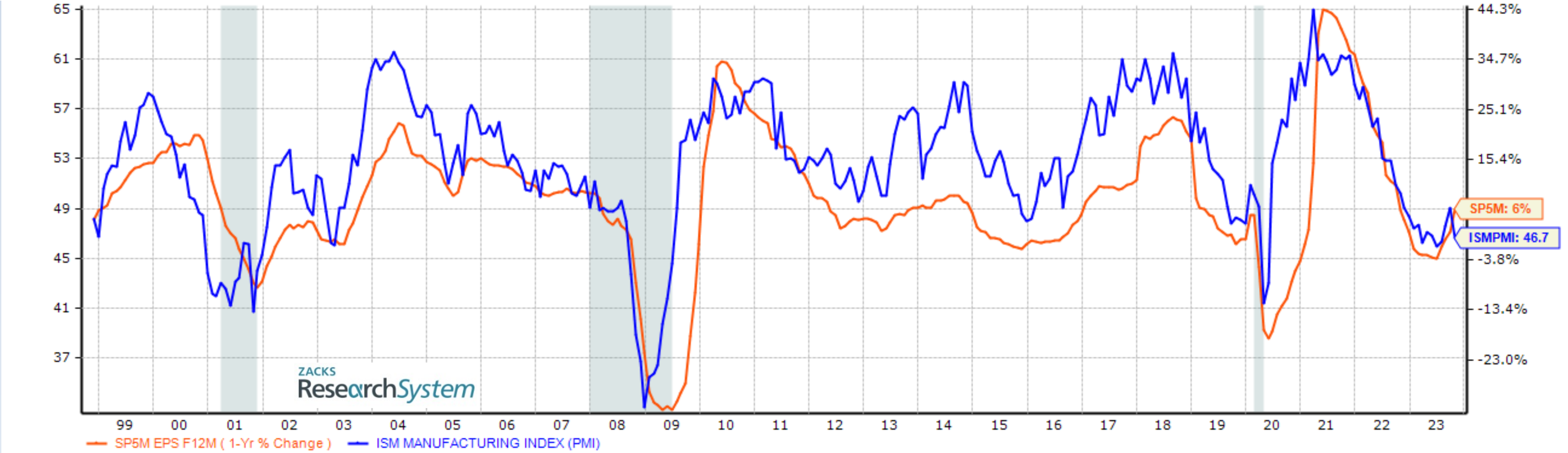
A single reading below -25 has correctly forecasted each of the last 8 recessions with no false positives



Source: Zacks Professional Services, Philadelphia Federal Reserve

ISM Manufacturing PMI Similarly in Recession Territory

Index has been in contraction for 12 consecutive months



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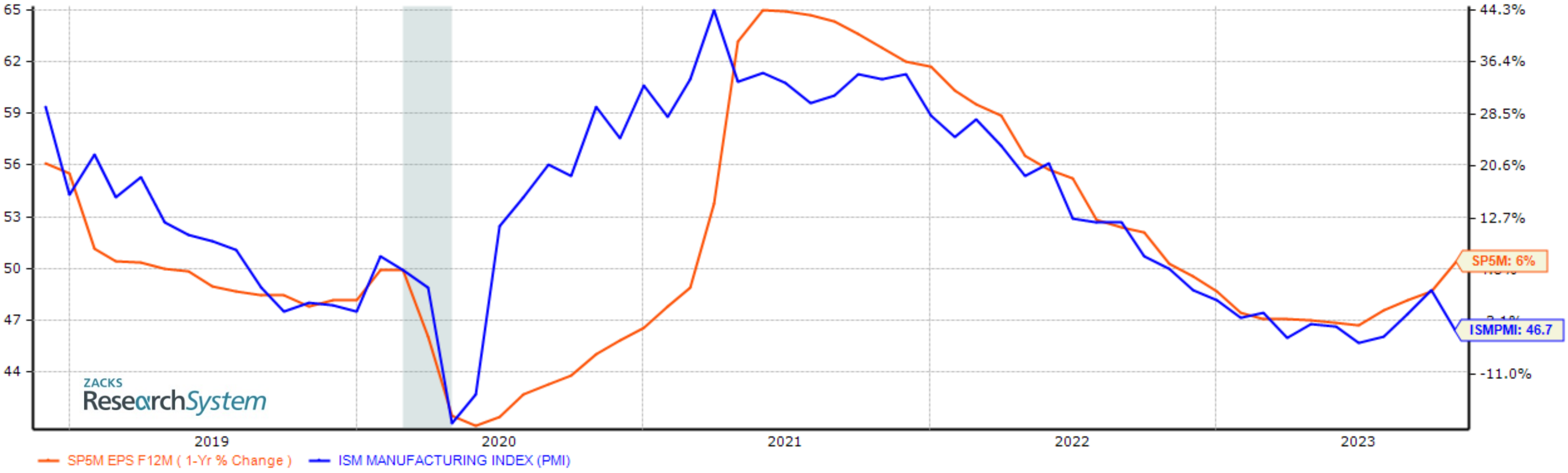
ISM MANUFACTURING INDEX (PMI)	64.70	33.30	52.85	46.70	-3.11%	-0.12%	11-30-1998	10-31-2023

Source: Zacks Professional Services, www.zackspro.com

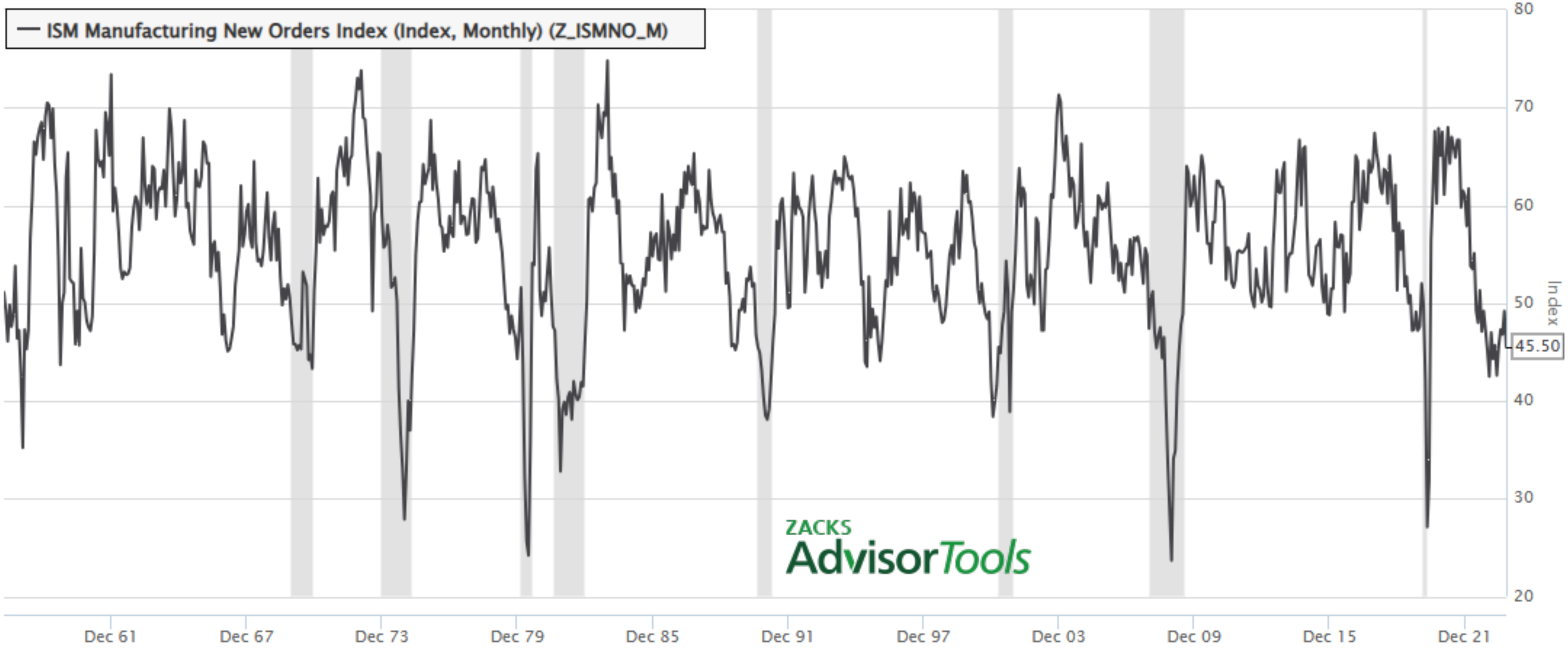
…if we get another month of negative PMIs, I believe we'll start to see a wave of EPS cuts



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	44.29%	-18.93%	4.20%	6.03%	71.01%	9.48%	11-30-2018	11-01-2023
ISM MANUFACTURING INDEX (PMI)	64.70	41.50	52.80	46.70	-21.25%	-4.74%	11-30-2018	10-31-2023

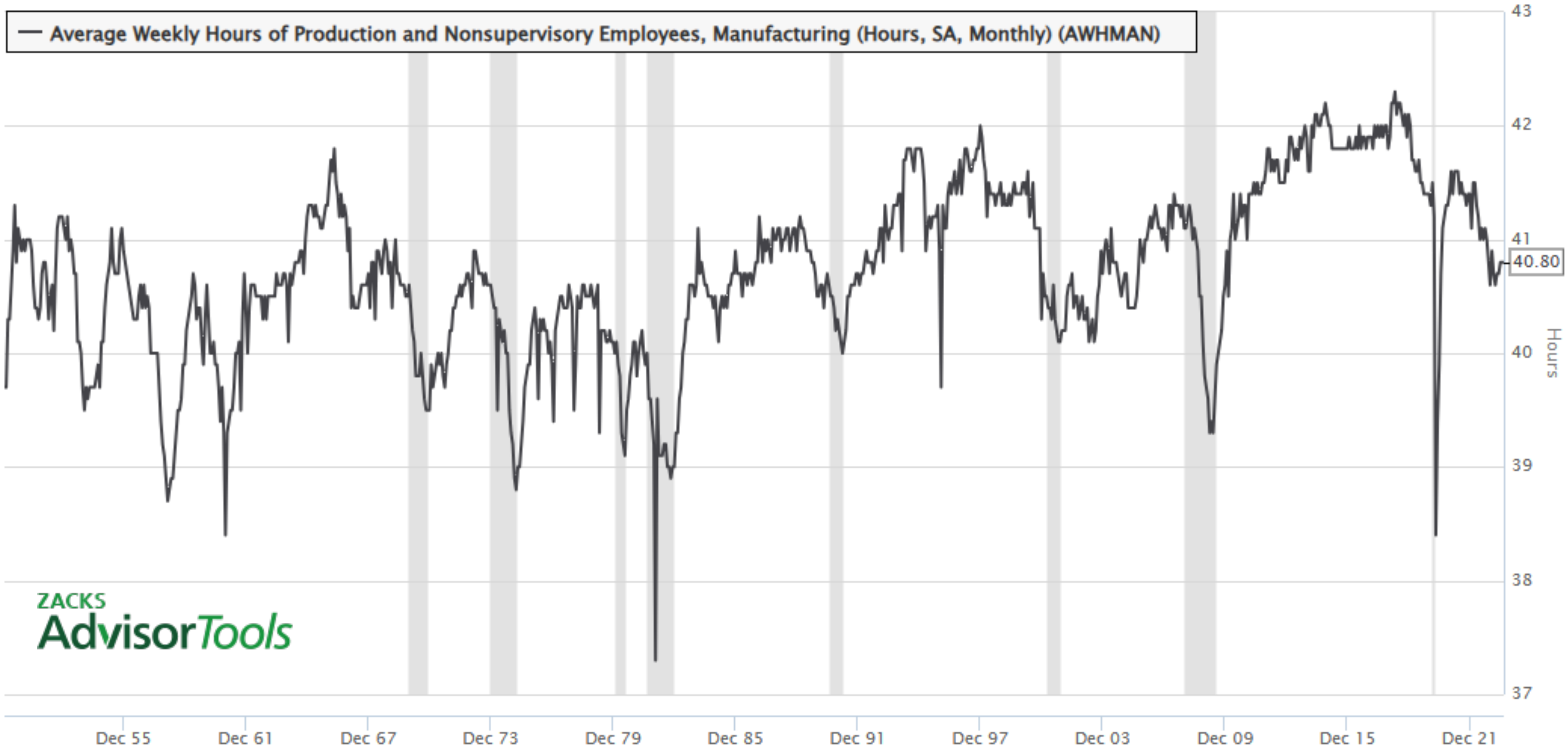
ISM Manufacturing New Orders At Recessionary Levels

Proxy for industrial demand continues to remain sluggish; firmly at recessionary levels



Source: Zacks Professional Services, www.zackspro.com

Factories Are Cutting Workweek Hours As Orders Fall



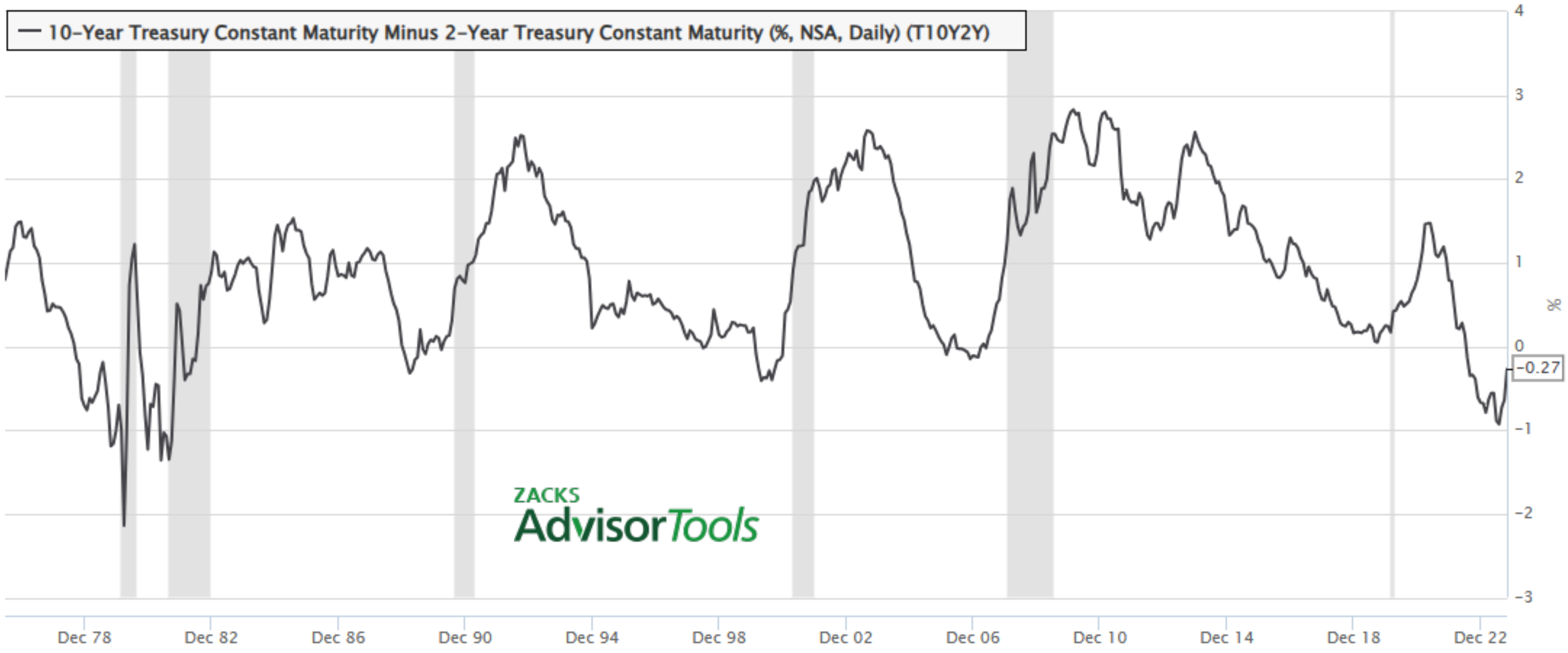
Source: Source: Zacks Professional Services, OECD

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'

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

-27 bps as of today (11/2/23); Intense Steepening Since September. Keep a close watch here.



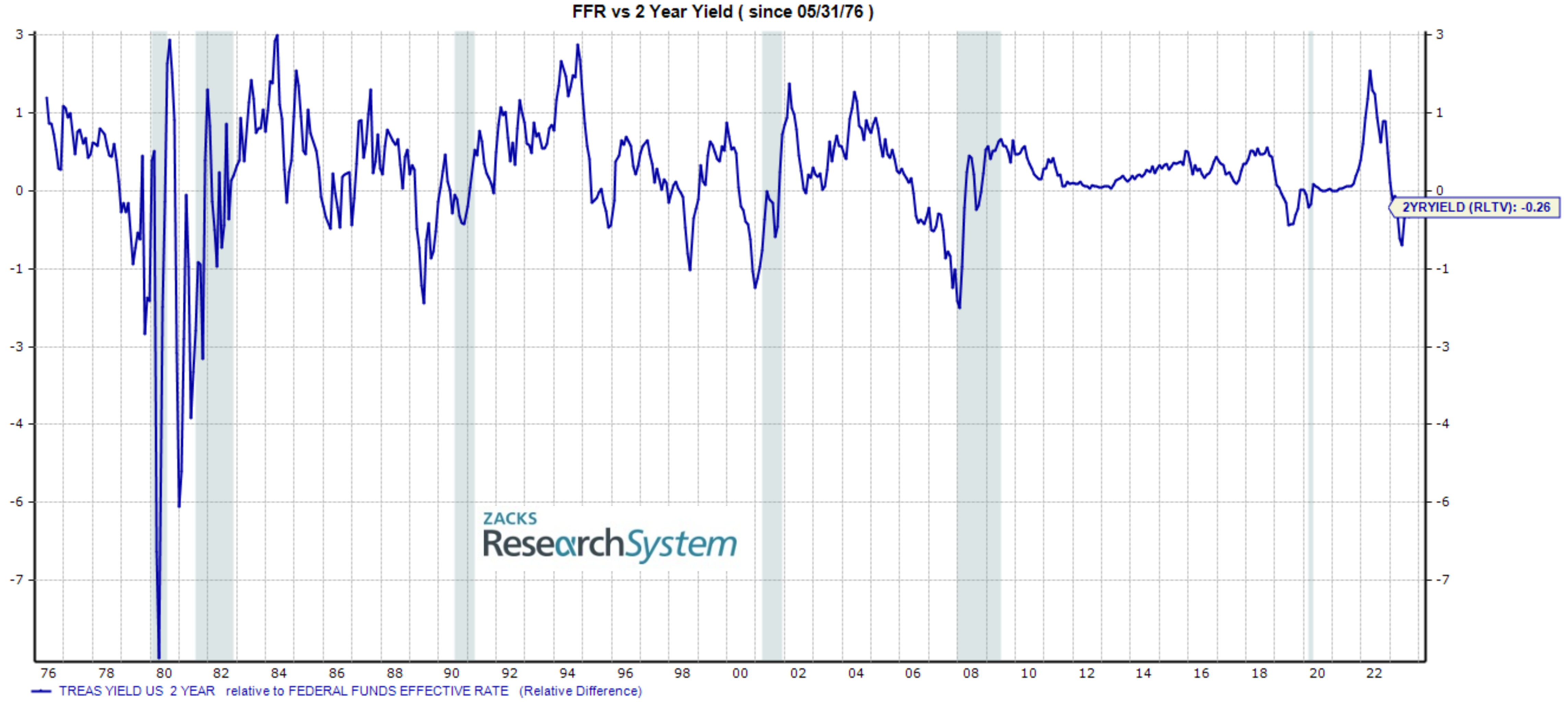
Source: Zacks Professional Services, www.zackspro.com

Conference Board Leading Economic Index has now been in decline for 18 consecutive months.

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

Source: Conference Board

History Has Shown Forced Inversion Breaks Things



Title	High	Low	Median	Current	Start Date	End Date
TREAS YIELD US 2 YEAR relative to FEDERAL FUNDS EFFECTIVE RATE (Relative Diffe	2.85	-8.36	0.42	-0.26	05-31-1976	10-31-2023

Source: Zacks Professional Services, www.zackspro.com

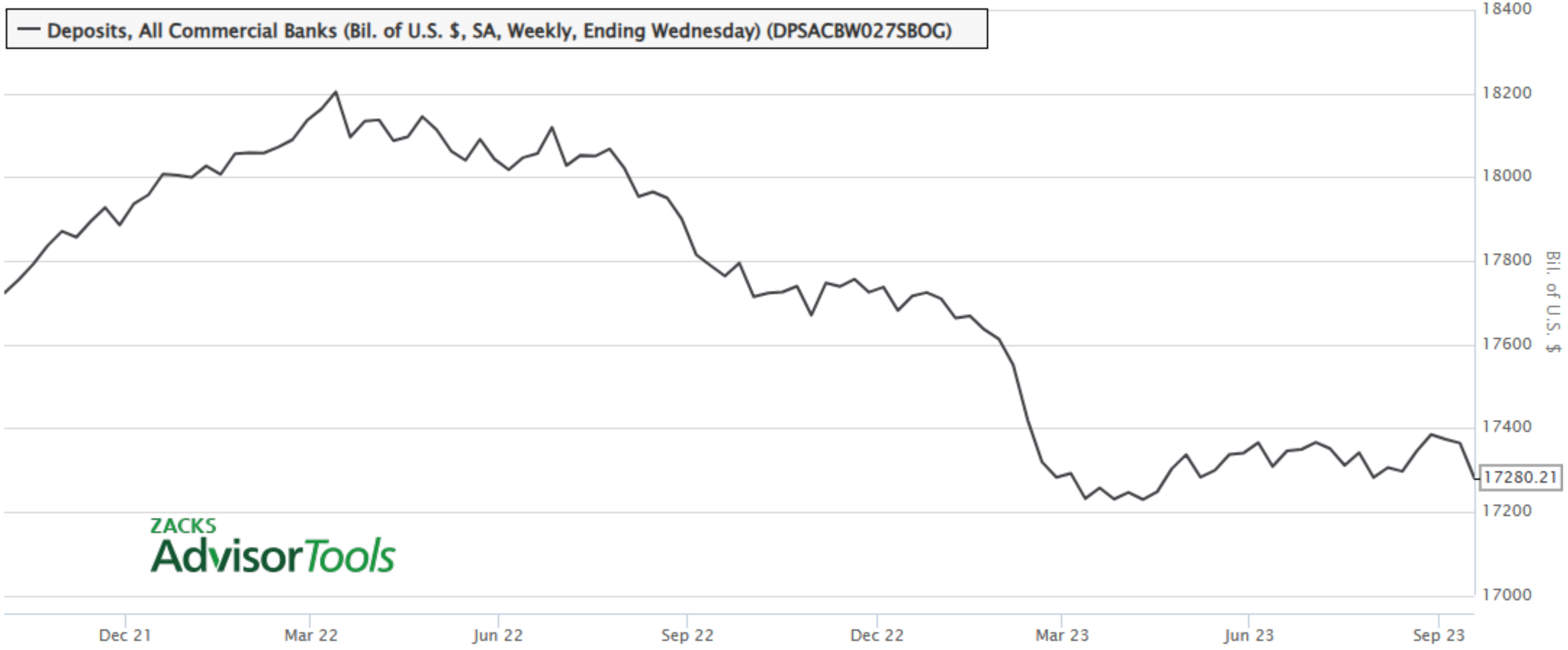
Banks Continue to Face Tremendous Difficulty:

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

= Tightening credit availability

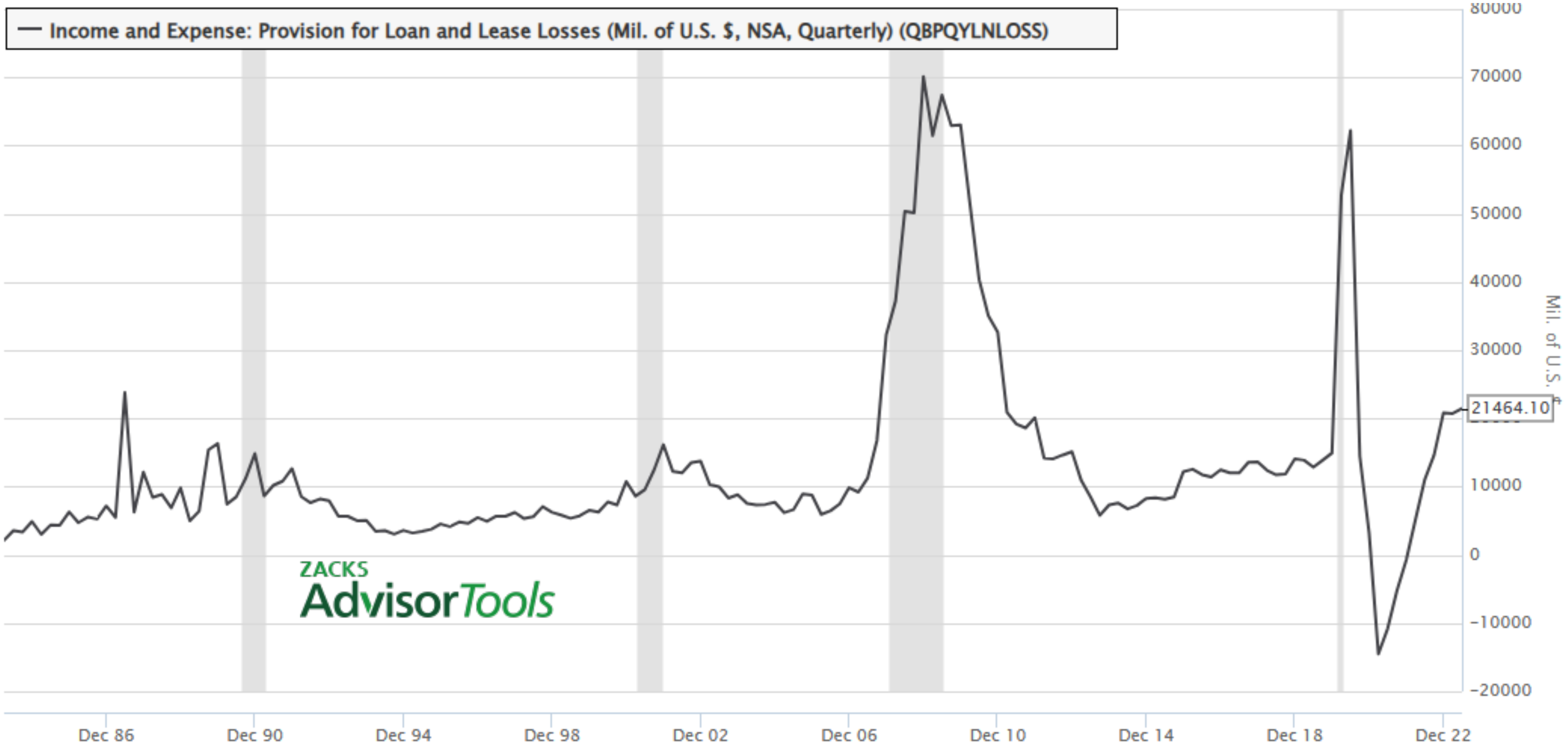
Since March '22, $1 trillion has been removed from US banks

But has been stable since April '23



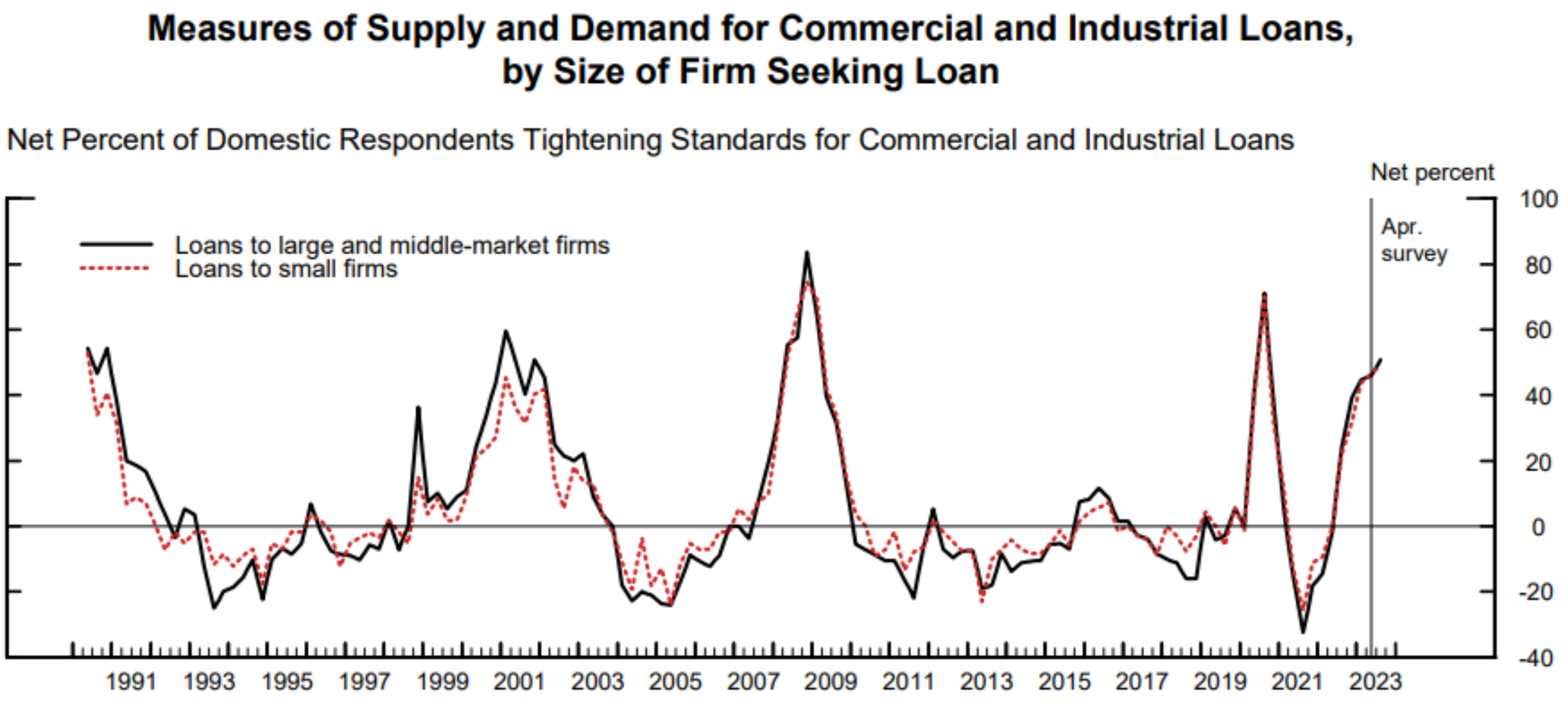
Source: Zacks Professional Services, Federal Reserve Board

While Loan Loss Provisions Are Rising



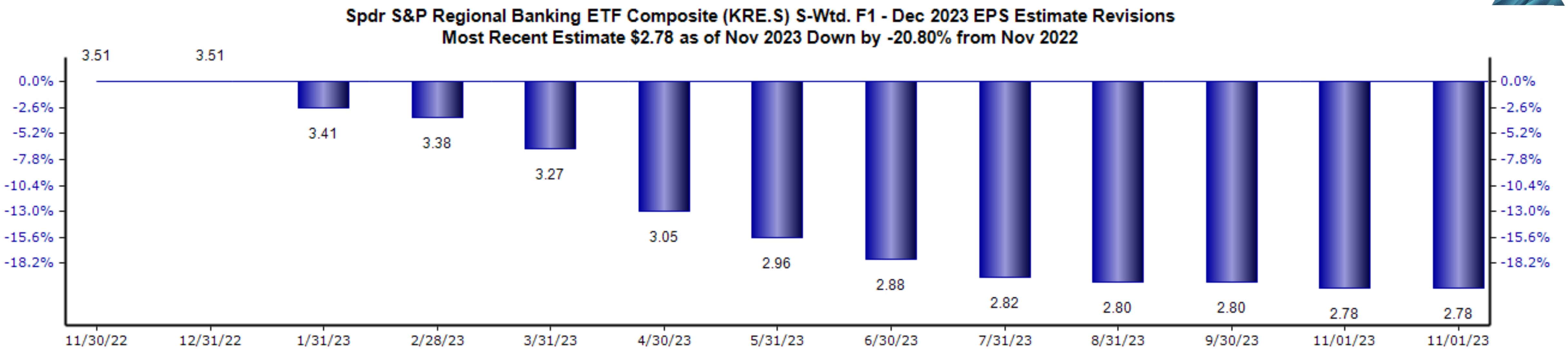
Source: Zacks Professional Services , FDIC

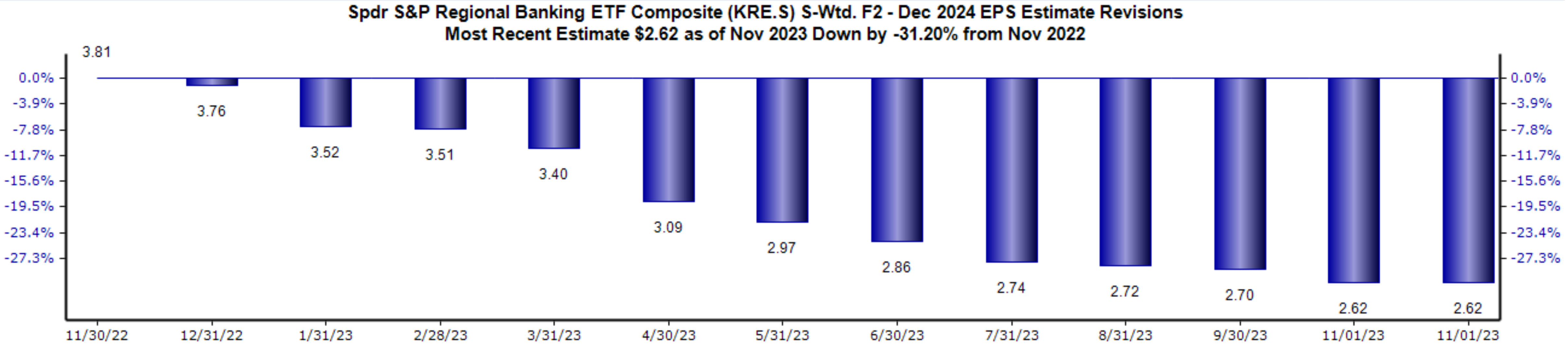
Net Result is Tightening Credit Availability



Source: Federal Reserve

…and deep cuts to regional bank EPS forecasts

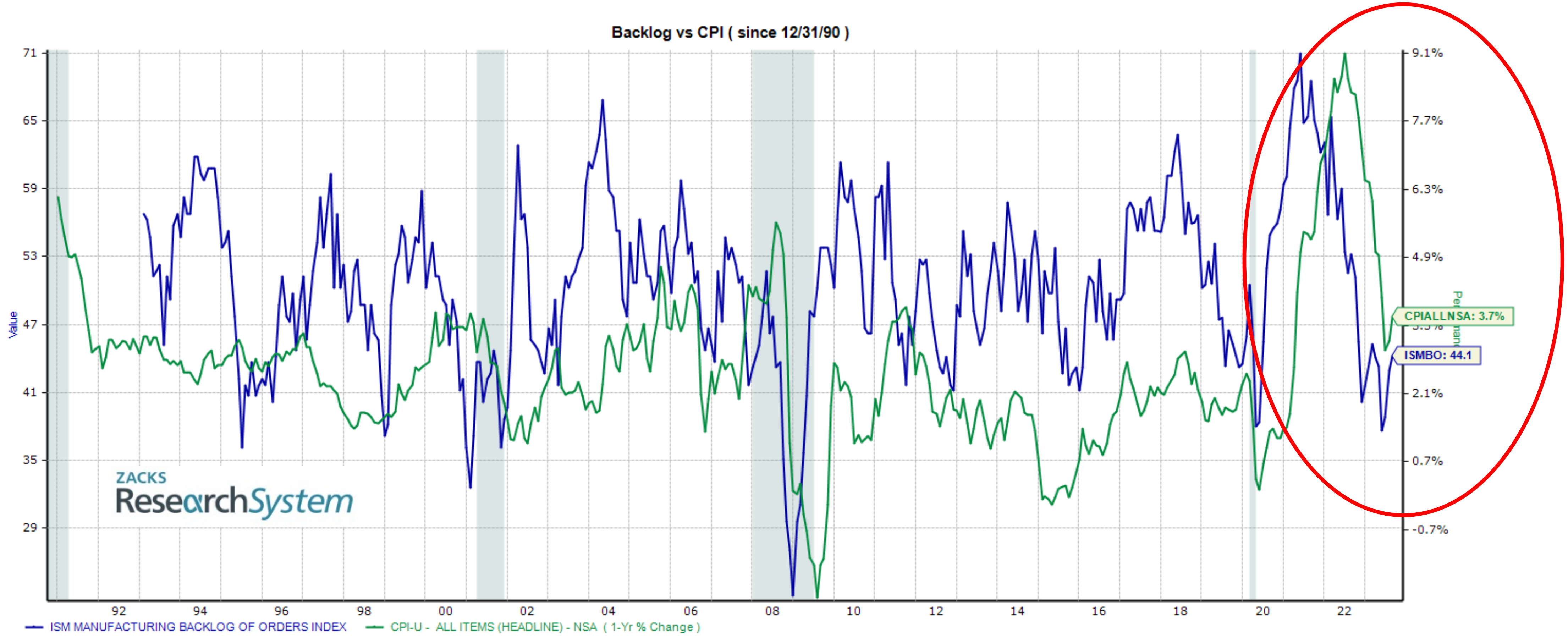




Source: Zacks Investment Research

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

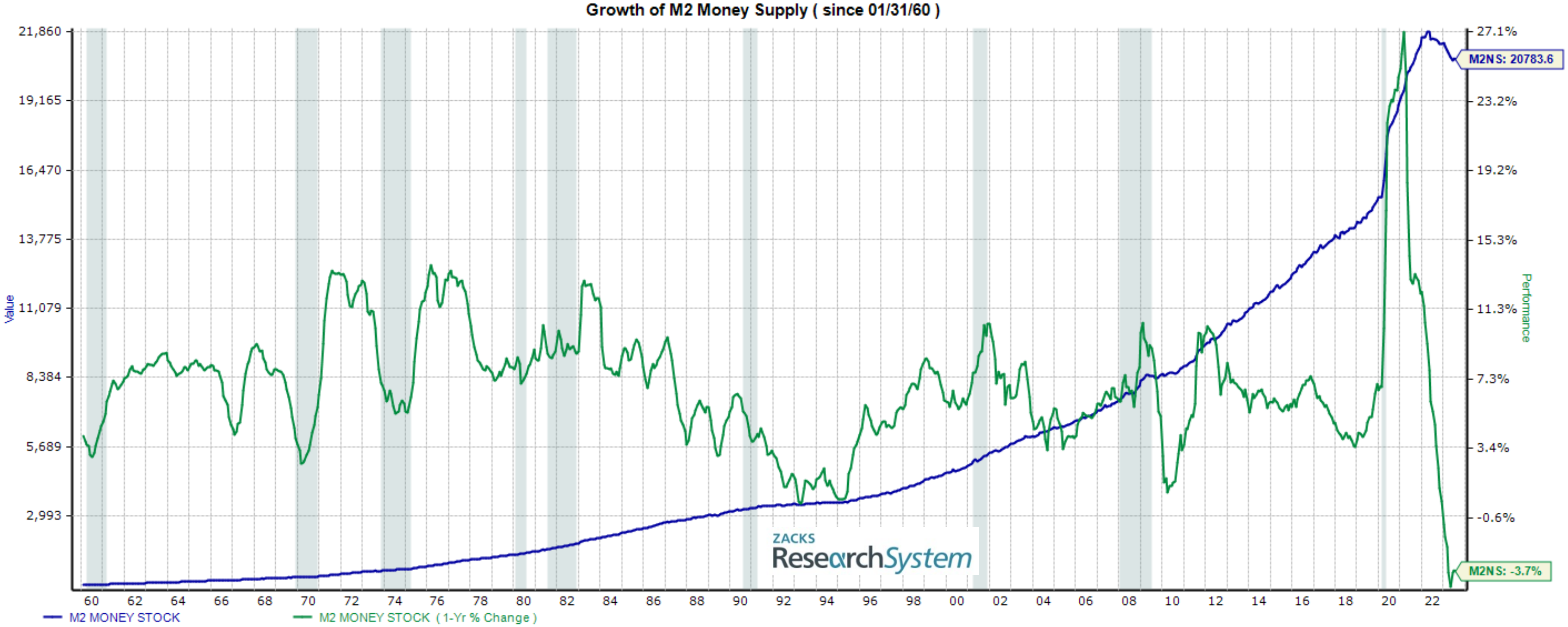
Inflation Bounced Back in August, but
ISM Backlog Continues to Telegraph A Continued Drop



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
ISM MANUFACTURING BACKLOG OF ORDERS INDEX	70.60	23.00	50.50	44.10	-21.95%	-0.80%	01-31-1993	08-31-2023
CPI-U - ALL ITEMS (HEADLINE) - NSA (1-Yr % Change)	9.06%	-2.10%	2.50%	3.67%	143.48%	2.64%	12-31-1990	08-31-2023

Source: Zacks Professional Services, www.zackspro.com

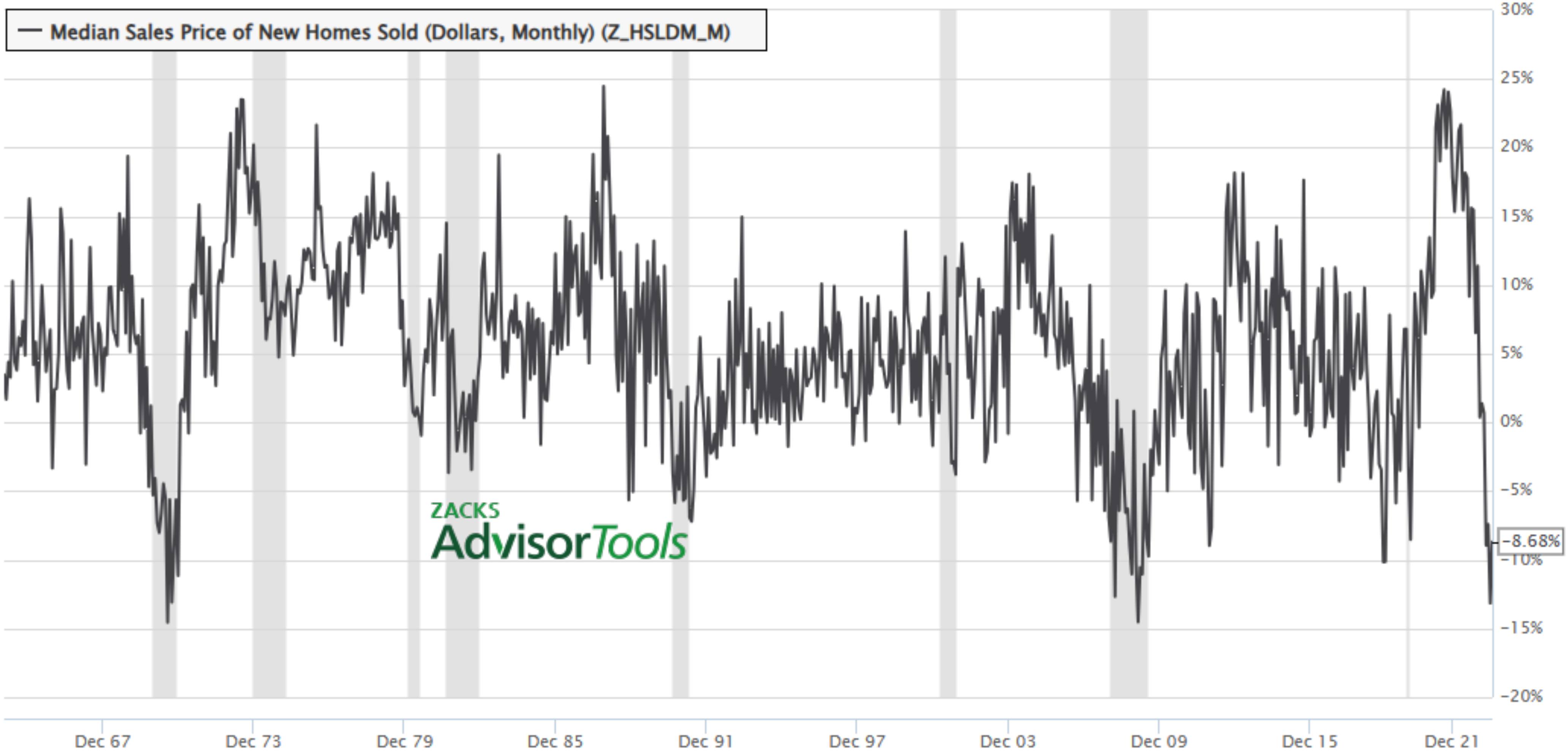
Fed Removing Liquidity:
M2 Money Stock Negative YoY For the First Time Ever



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
M2 MONEY STOCK	21,860.30	298.20	3,359.30	20,783.60	6793.40%	6.79%	01-31-1960	07-31-2023
M2 MONEY STOCK (1-Yr % Change)	27.13%	-4.55%	6.80%	-3.69%	7071.70%	6.75%	01-31-1960	07-31-2023

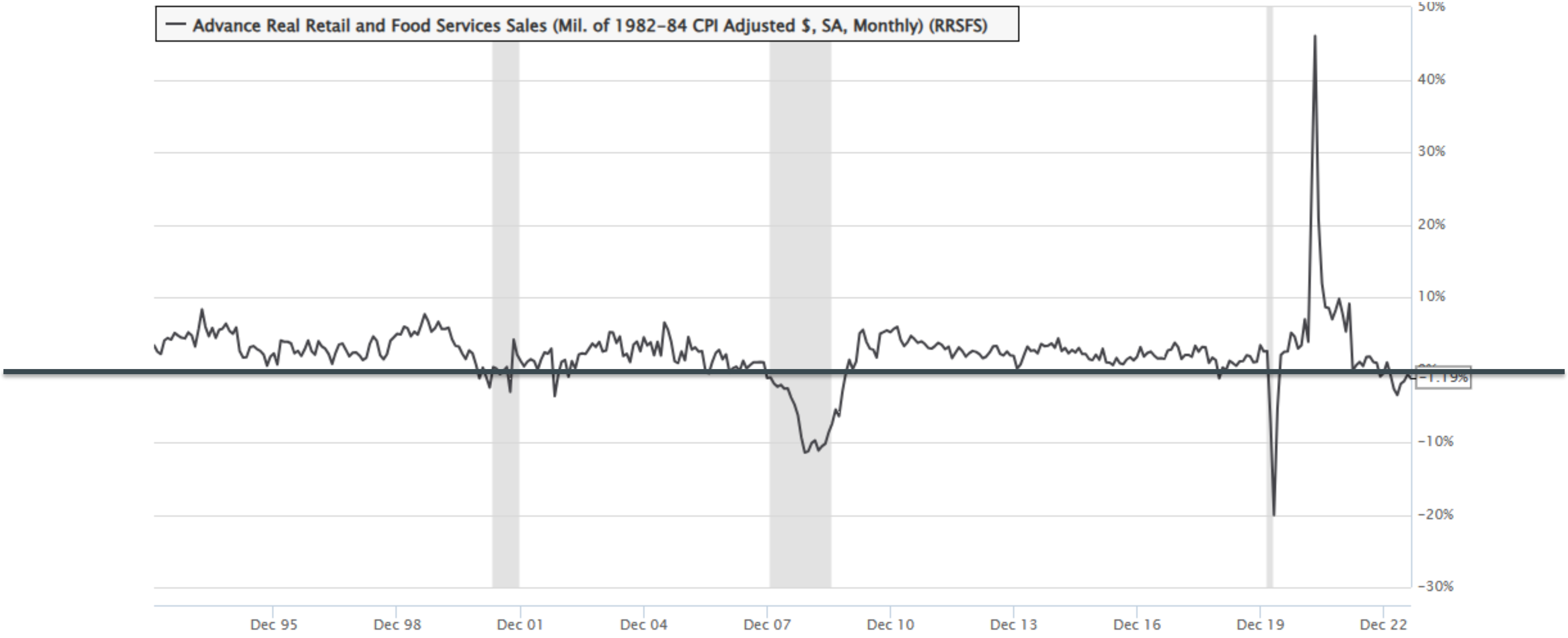
Housing Prices Remain Under Pressure

However, home prices may remain relatively stable as supply shrinks faster than demand



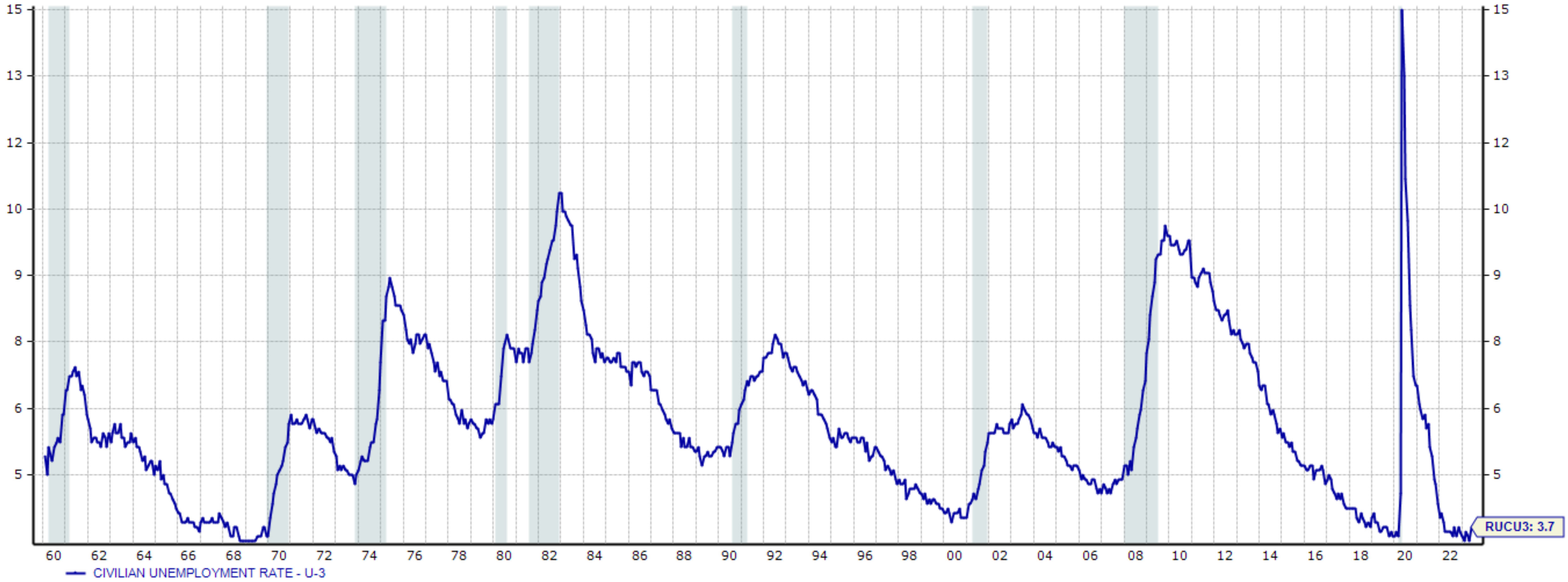
Source: Zacks Professional Services, www.zackspro.com

Real Retail Sales Down YoY For 7 Consecutive Months



Source: Zacks Professional Services, www.zackspro.com

...and this is while unemployment is still low



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
CIVILIAN UNEMPLOYMENT RATE - U-3	14.70	3.40	5.60	3.70	-28.85%	-0.53%	01-31-1960	05-31-2023

Source: Zacks Professional Services, www.zackspro.com

However, ‘cyclical job growth’ has flipped negative YoY for 4 consecutive months

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

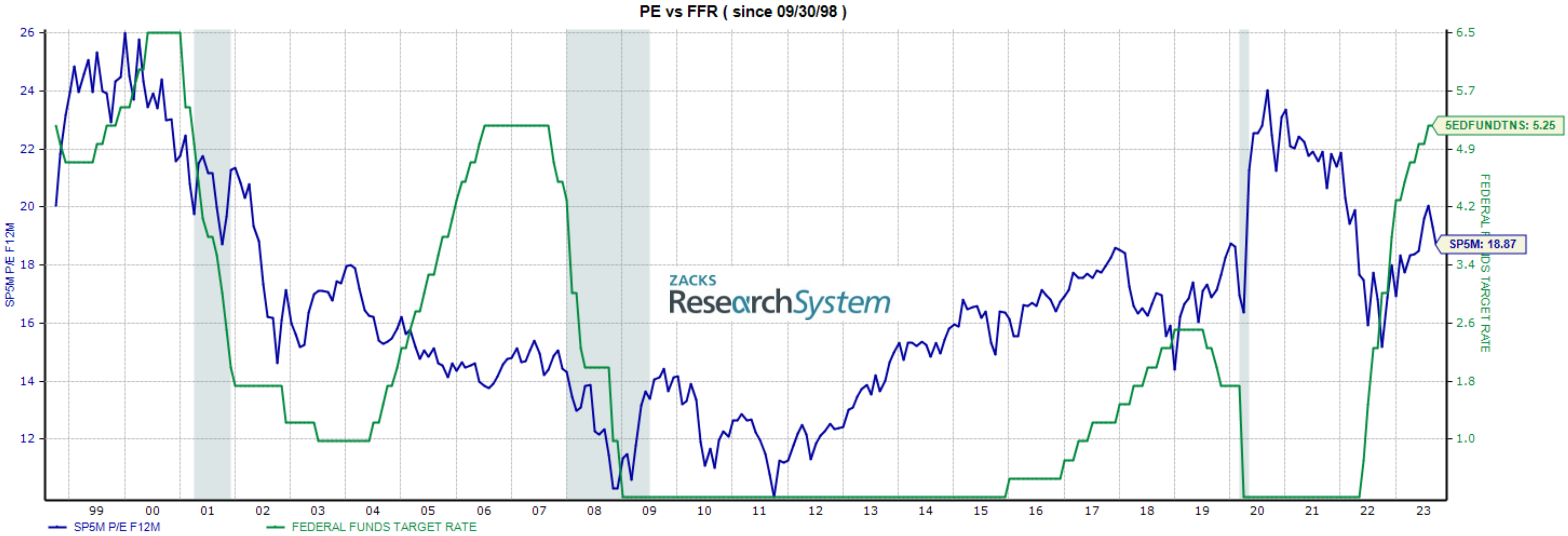
It is important to make this distinction for analytical purposes to understand *where* job gains are coming from: government sector or private sector.

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.

Meanwhile, BLS has revised *lower* the headline NFP number every single month through August 2023 by a total of -16% YTD

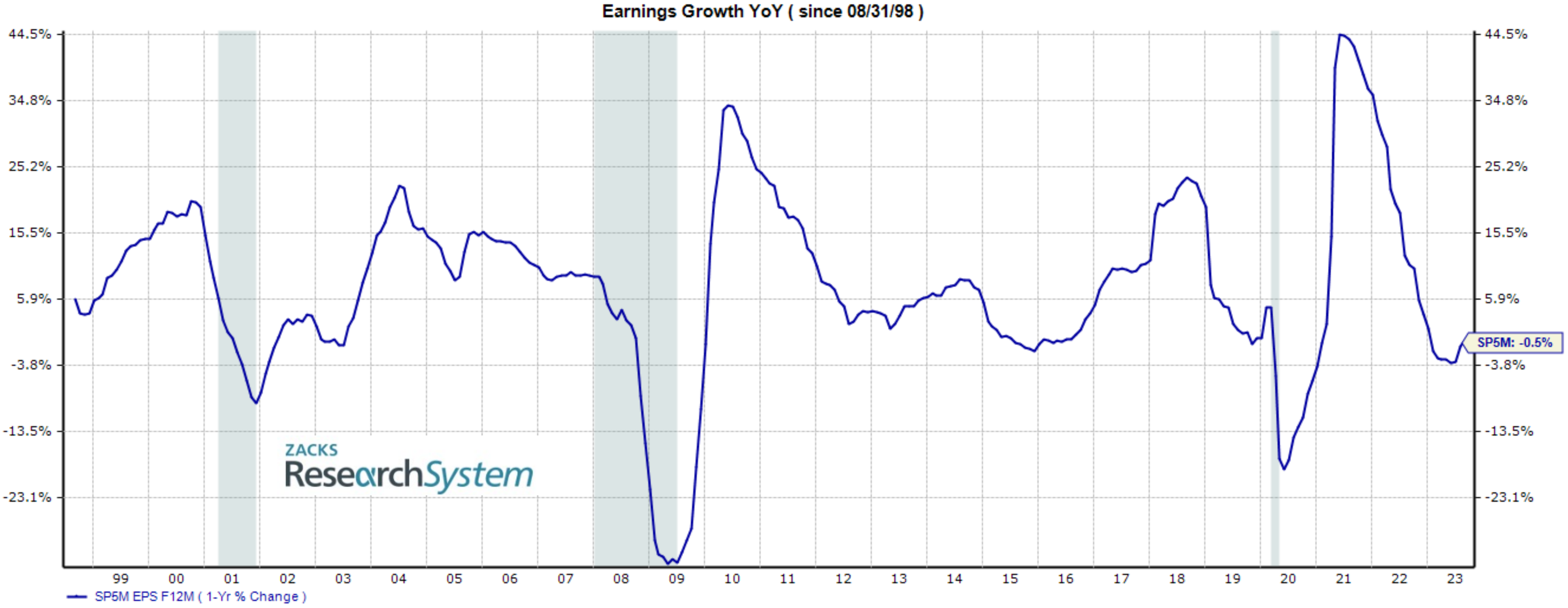
What does all this imply for stocks?

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

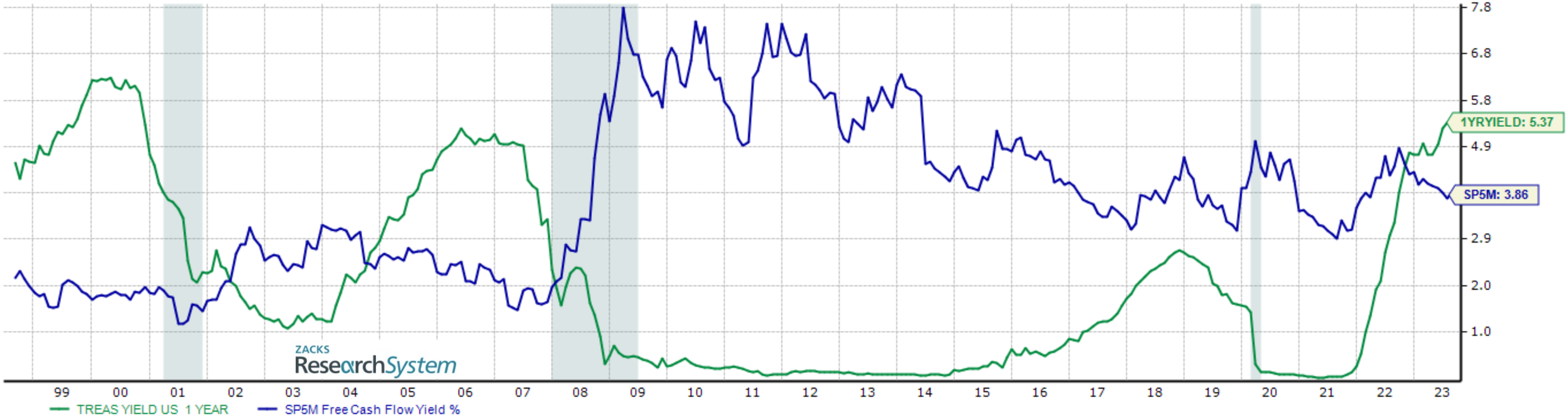
…on lower forward EPS growth expectations



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

Source: Zacks Professional Services, www.zackspro.com

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,"

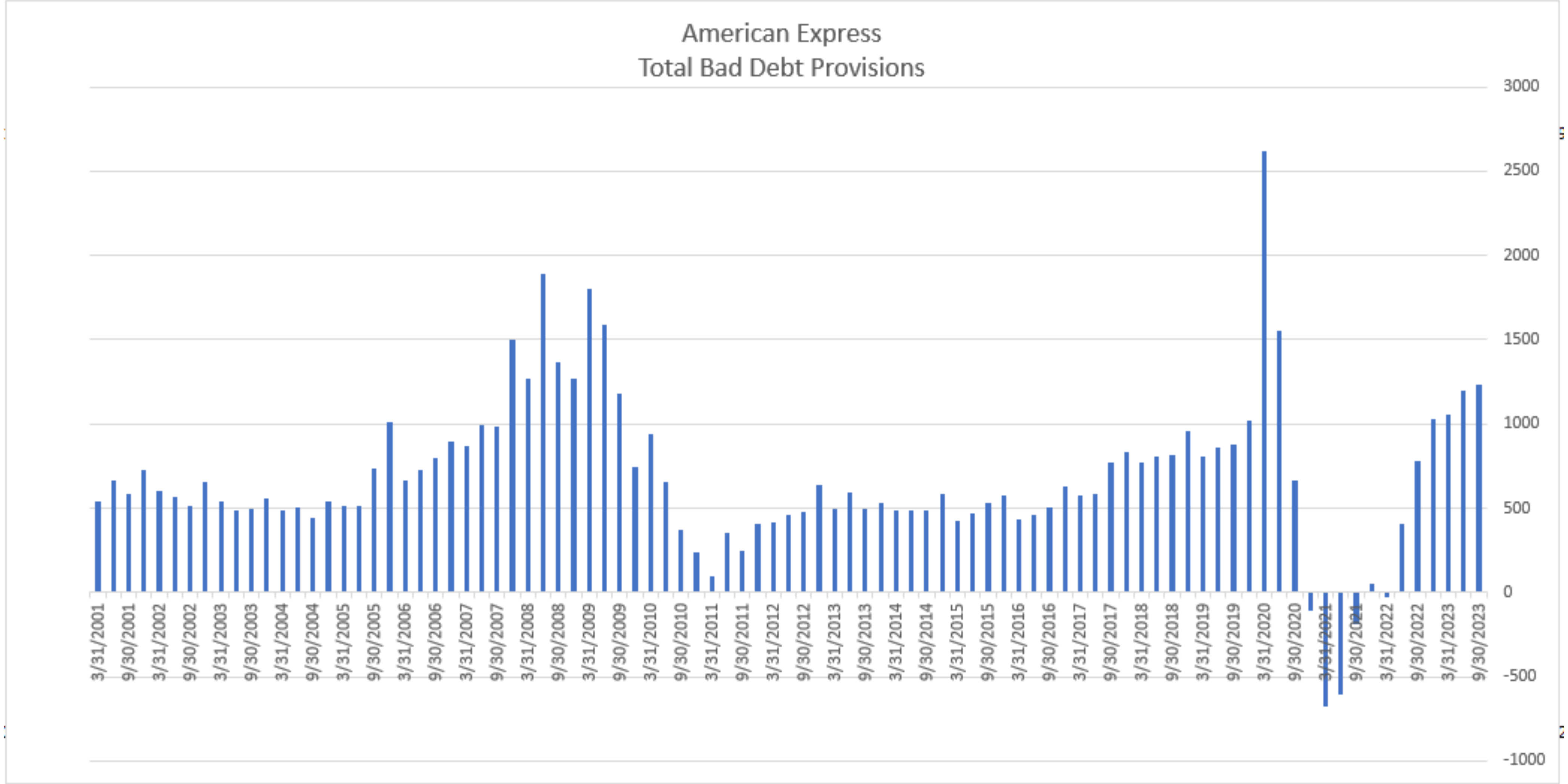
Source: FedEx Company Filings, Zacks Professional Services, www.zackspro.com

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…"

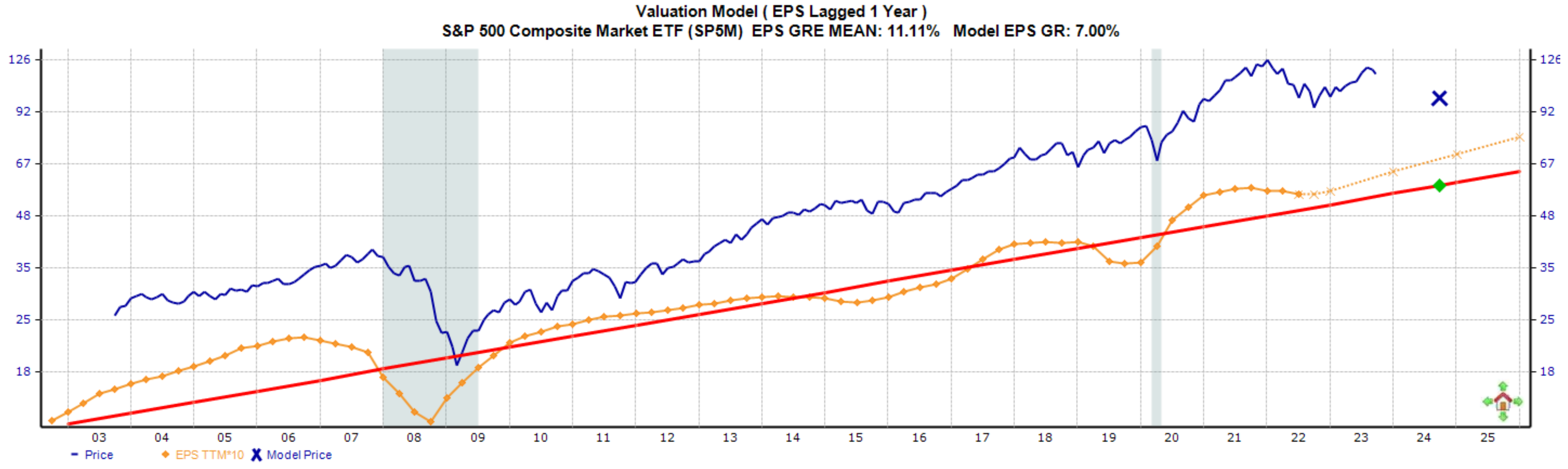
Source: Maersk Company Filings, Zacks Professional Services, www.zackspro.com

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	Current	House	1-Year
Risk Free Rate (10Yr Treas)	4.35%	5.00%	4.35%
Equity Risk Premium	1.84%	1.84%	1.84%
Company Specific Risk	0.00%	0.00%	0.00%
Total Equity Discount Rate	6.84%		6.84%
Actual PE F12M	21.31		20.00
Model PE F12M	17.23		17.23
Model Price	94.01		100.11 X
Model EPS F12M	5.46		5.81
Model Return	-19.14%		-12.45%

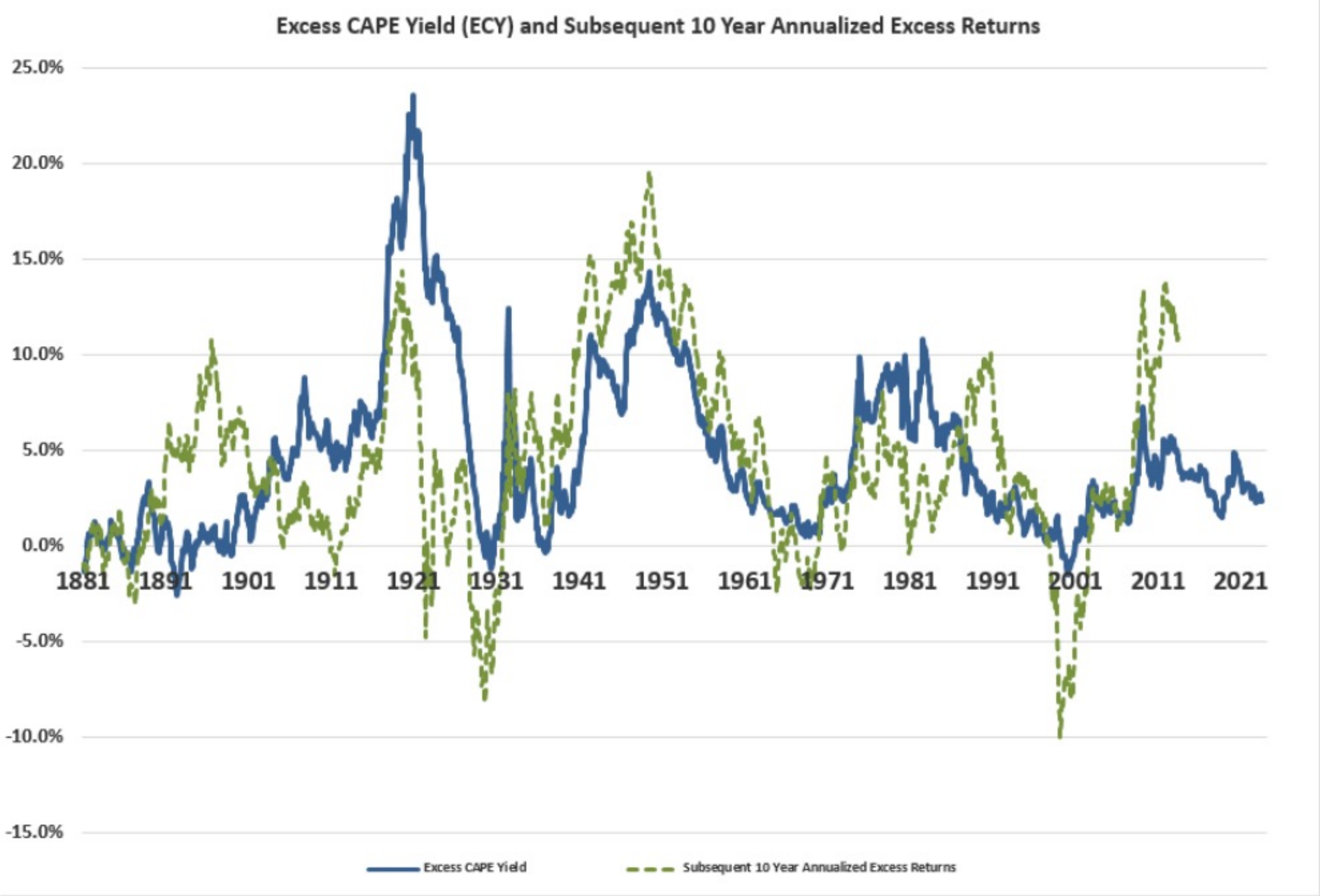
Zacks Consensus Estimates	2023	2024	2025
Mean Estimate	5.65	6.36	7.07
Change Y/Y	0%	13%	11%
High	5.92	7.06	7.76
Low	5.42	5.84	6.62
Total			
#Up (4 weeks)			
#Down (4 weeks)			
House Estimate	5.60	5.40	7.00
PE Intraday	20.8	21.5	16.6

Normalized Earnings FYE: December	
2021	4.52
2022	4.84
2023	5.18
2024	5.54
2025	5.93
2026	6.34
2027	6.79
2028	7.26
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.

Source: Mayur Thaker, CFA, Zacks Investment Research

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

novo nordisk®

METTLER TOLEDO

globalpayments

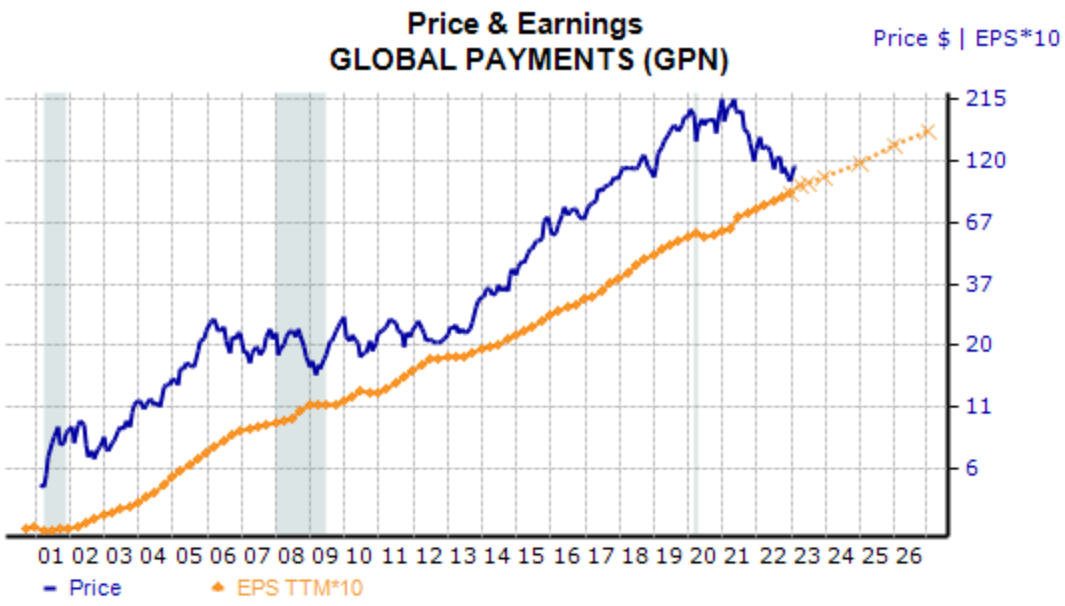
AMERICAN TOWER®

COSTCO WHOLESALE

ice

AMGEN®

CLOROX™


Price & Earnings
GLOBAL PAYMENTS (GPN)
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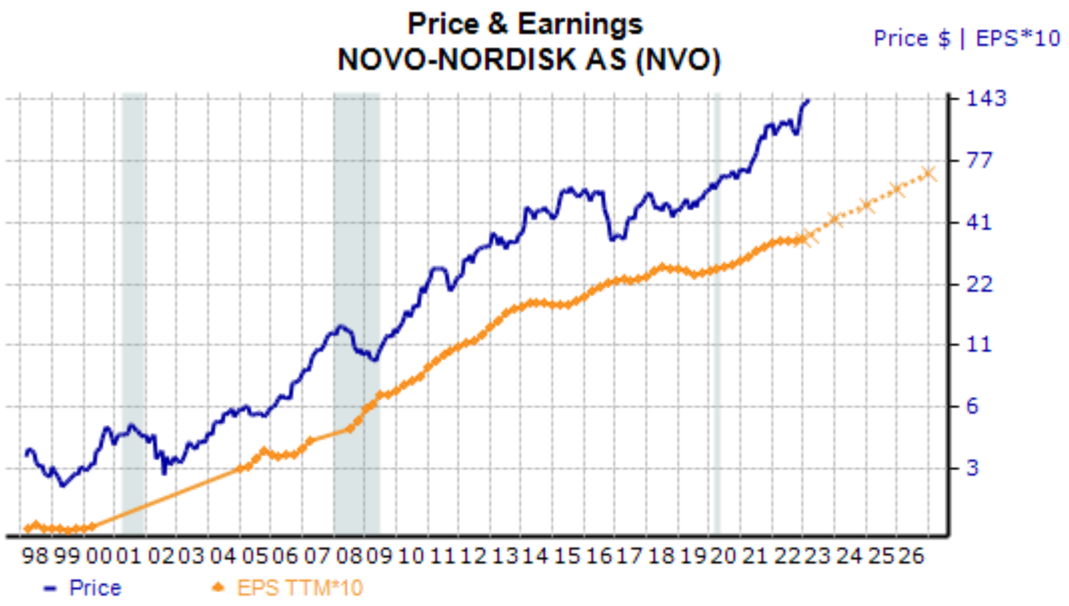
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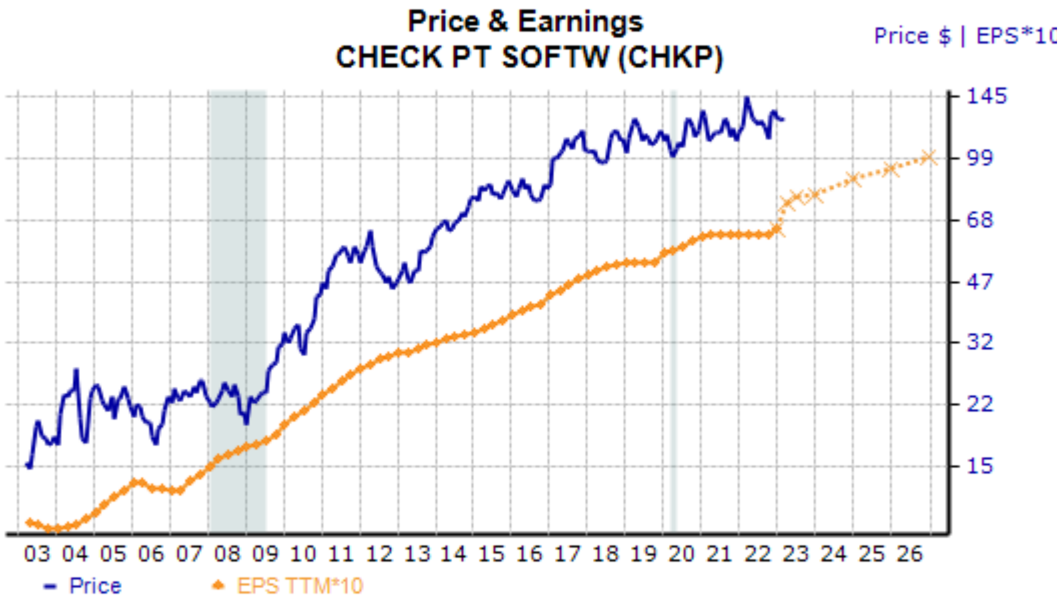
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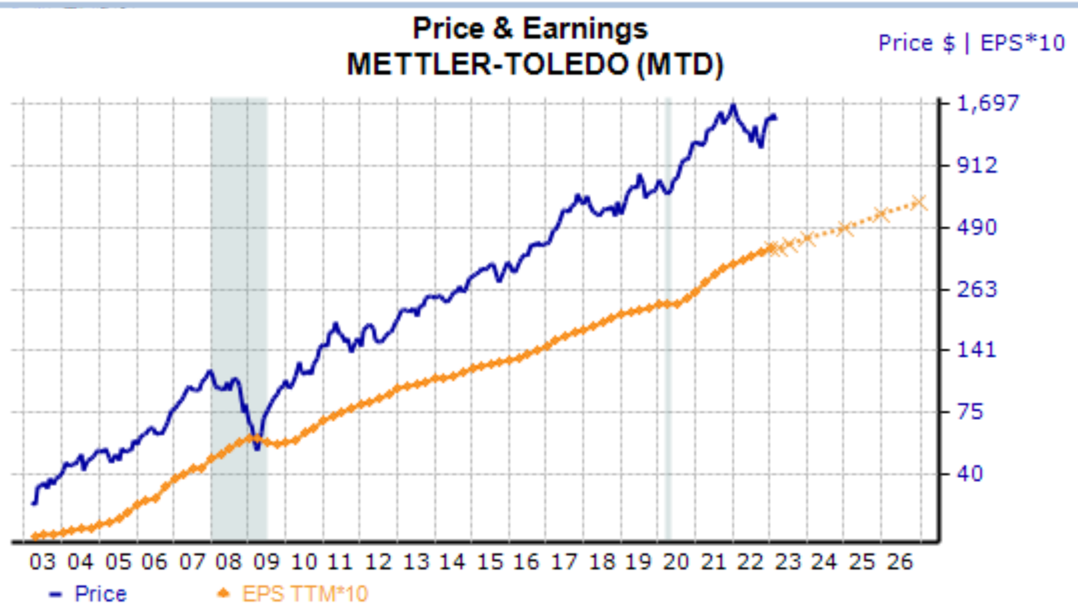
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Price
EPS TTM*10

Thank You for Attending!

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Questions?

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