

Macro Update: February 2024

Cracks are Forming in the Job Market, but 'Soft Landing' Scenario with Accelerating Earnings Growth Remains the Dominant Market View



Presented by:

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Equity Strategist
February 2024

Disclosures



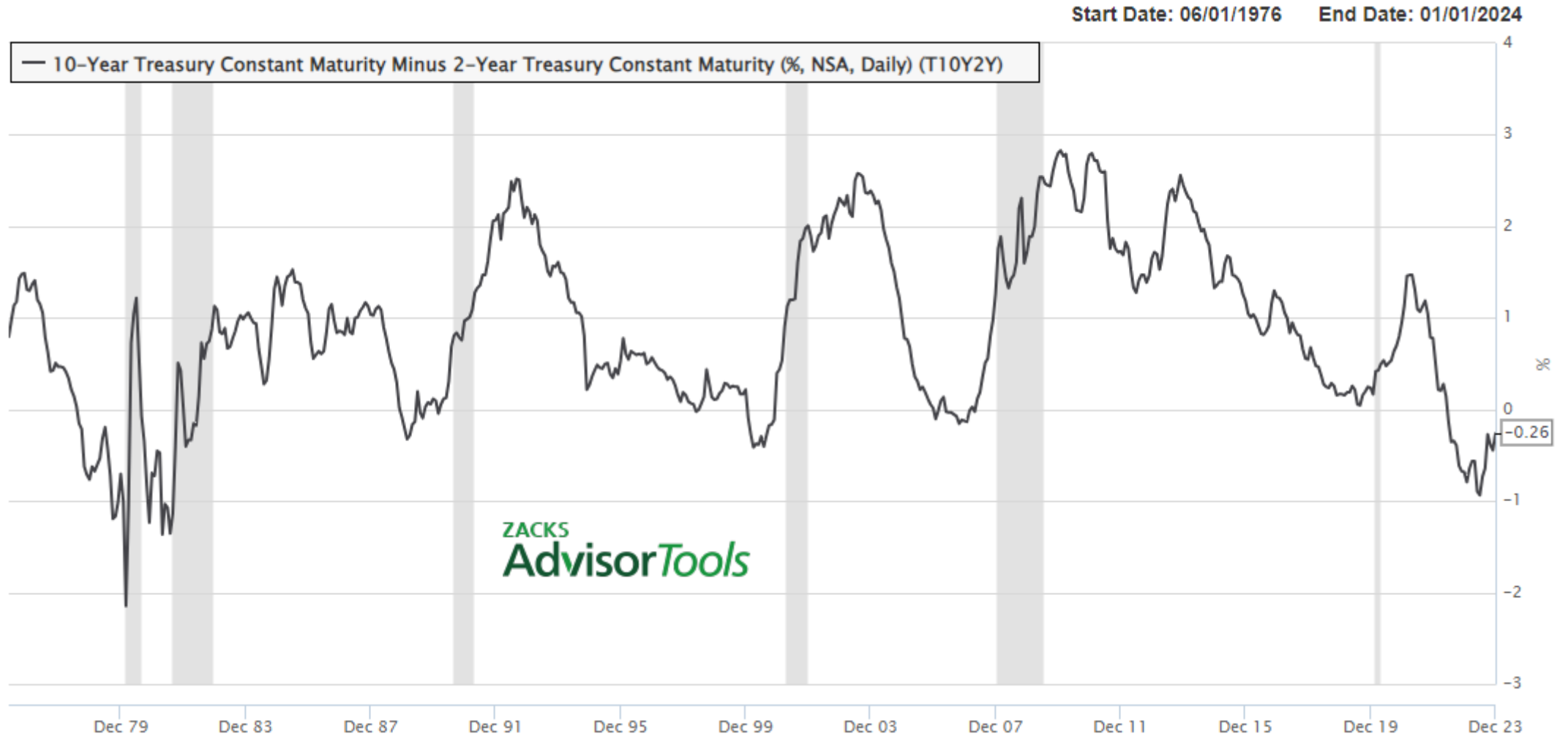
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Why I still believe we are entering recession



- **MANUFACTURING**: has been in recession for 15 months
- **INVERTED YIELD CURVE**: 10y-2y UST yield curve inversion has persisted for 20 months
- **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
- **GDI**: leading indicators of GDP entering contraction: real GDI
- **EMPLOYMENT**: Leading indicators of employment entering contraction: cyclical employment, full-time jobholders and gap between Establishment and Household Surveys
- **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**

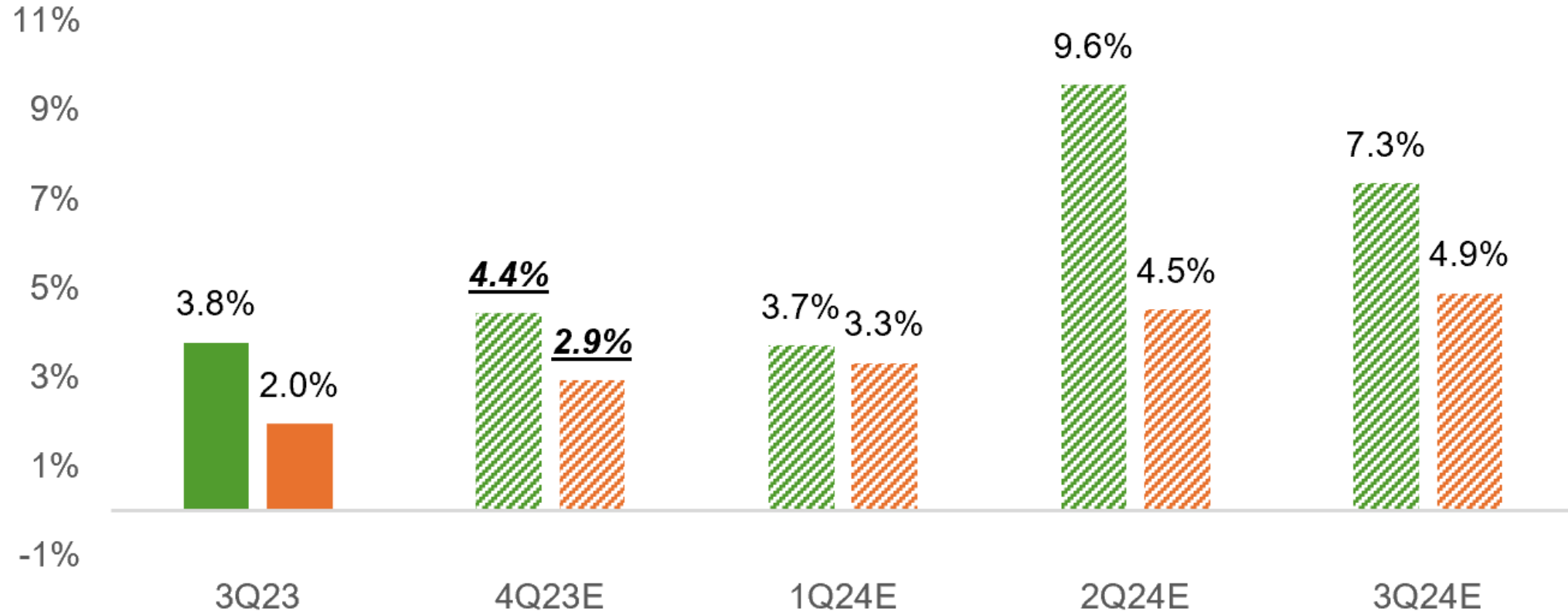
February 2024 will be the 20th month of 10yr-2yr UST Yield Spread Inversion



Q4 EPS and Revenue Growth Have Been Solid

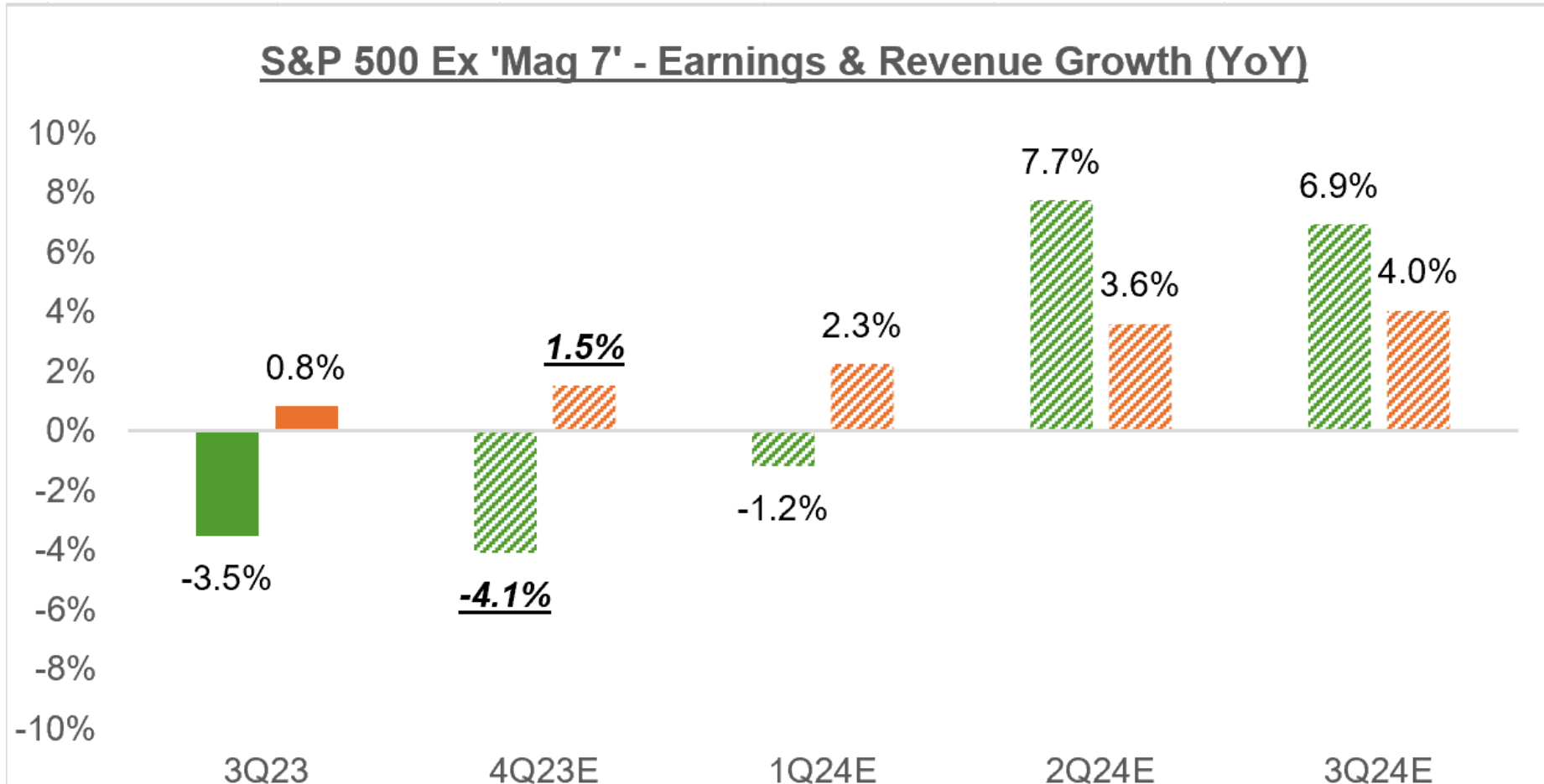


S&P 500 Index - Earnings & Revenue Growth (YoY)



Source: Zacks Investment Research, Inc.

...But Ex Mag 7, Remain Subpar



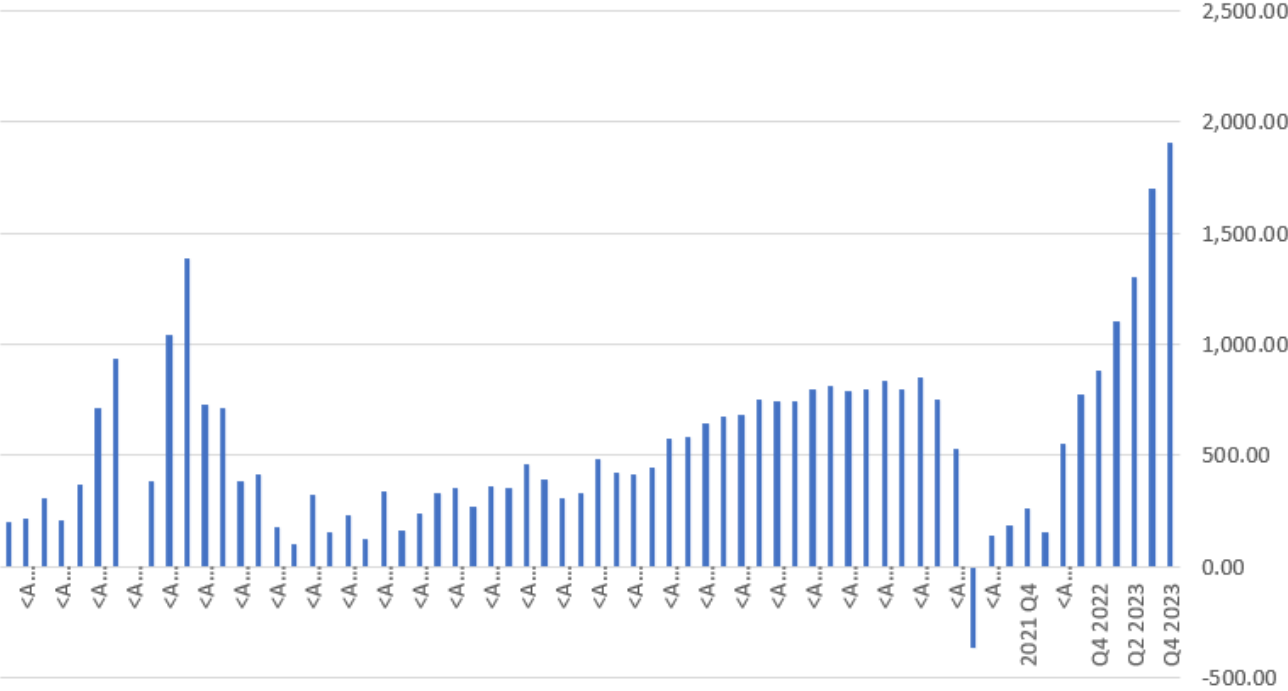
Source: Zacks Investment Research, Inc.

Mag 7 include: AAPL, AMZN, META, GOOGL, MSFT, NVDA, TSLA.

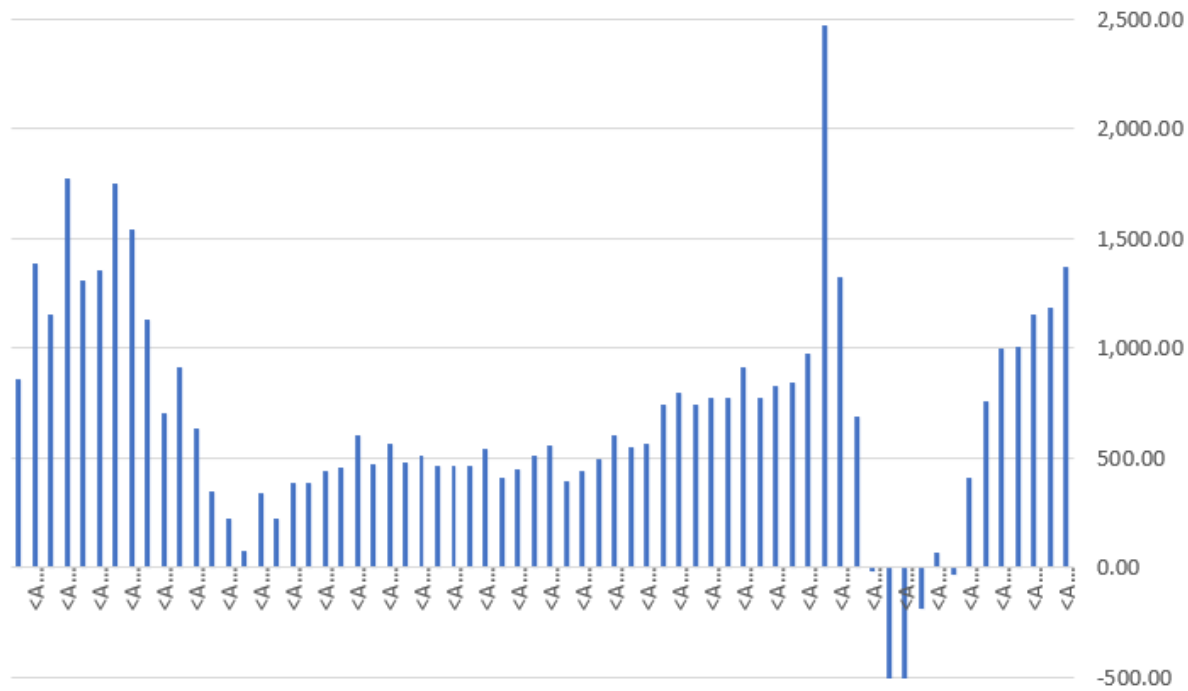
Warnings from credit card lenders American Express and Discover reporting sharply rising delinquencies



Discover
Provision for loan losses

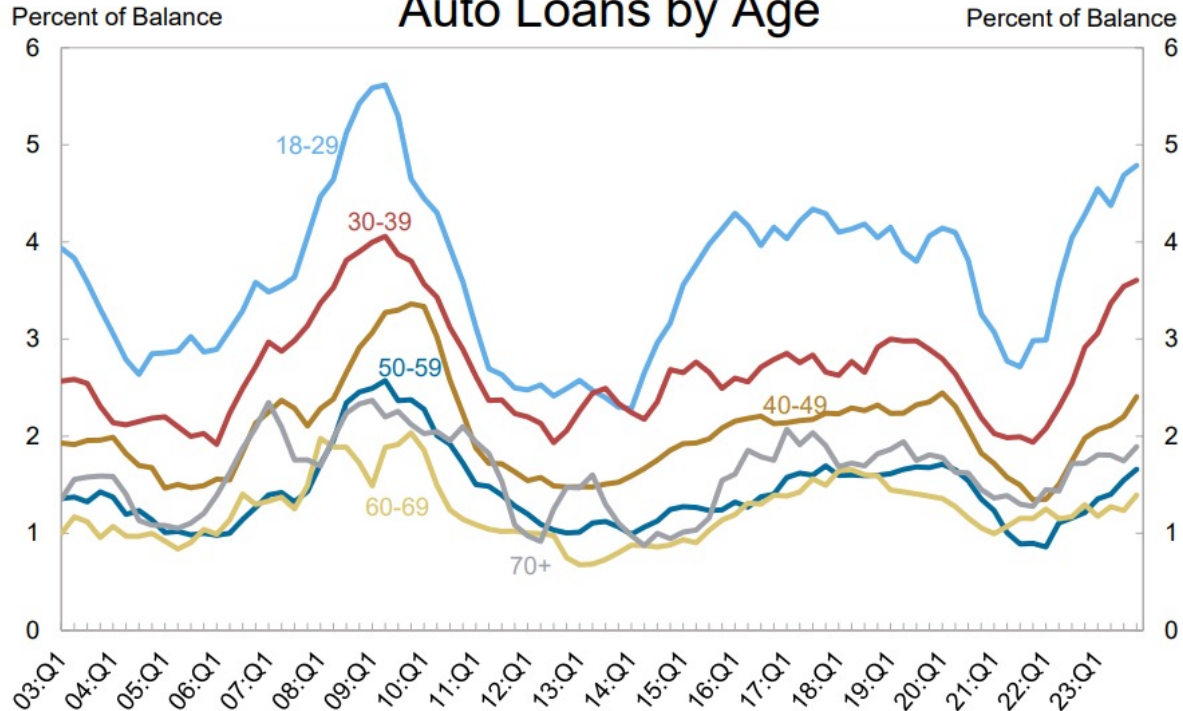


American Express
Total Provisions for Credit Losses





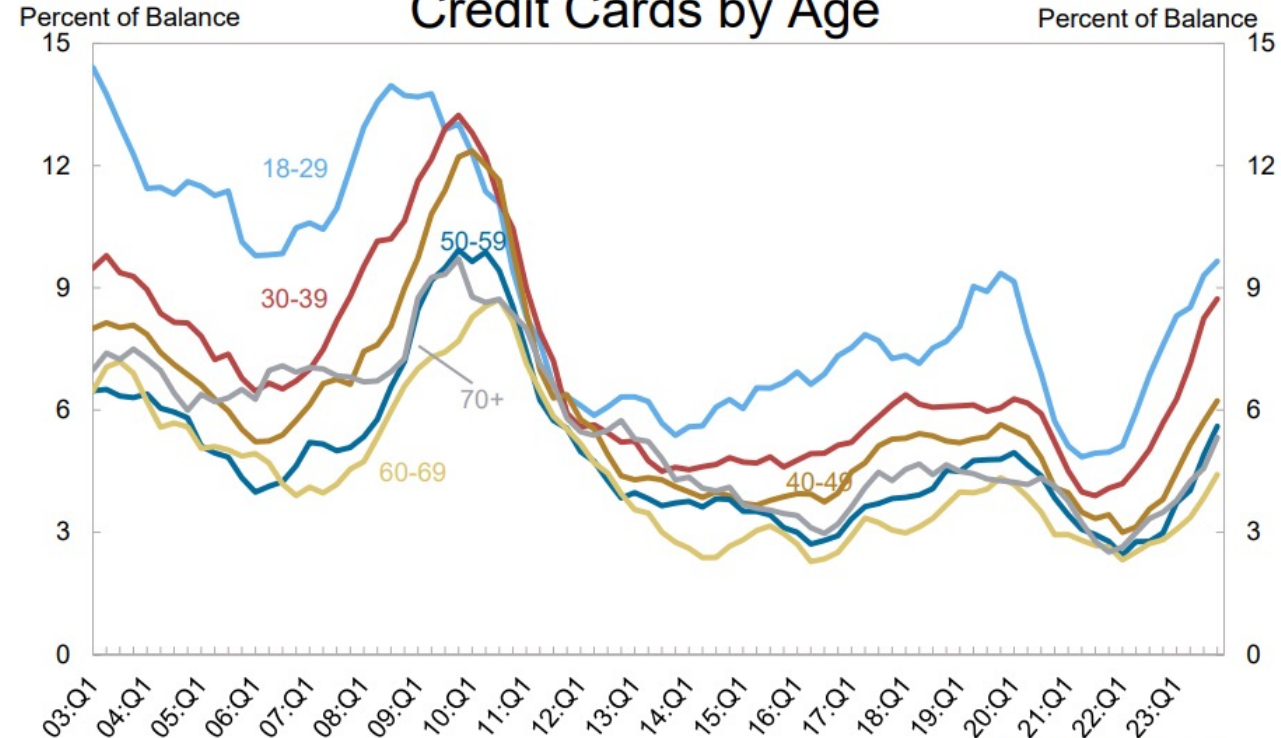
Transition into Serious Delinquency (90+) for Auto Loans by Age



Source: New York Fed Consumer Credit Panel/Equifax

Note: 4 Quarter Moving Sum.
Age is defined as the current year minus the birthyear of the borrower.
Age groups are re-defined each year.

Transition into Serious Delinquency (90+) for Credit Cards by Age



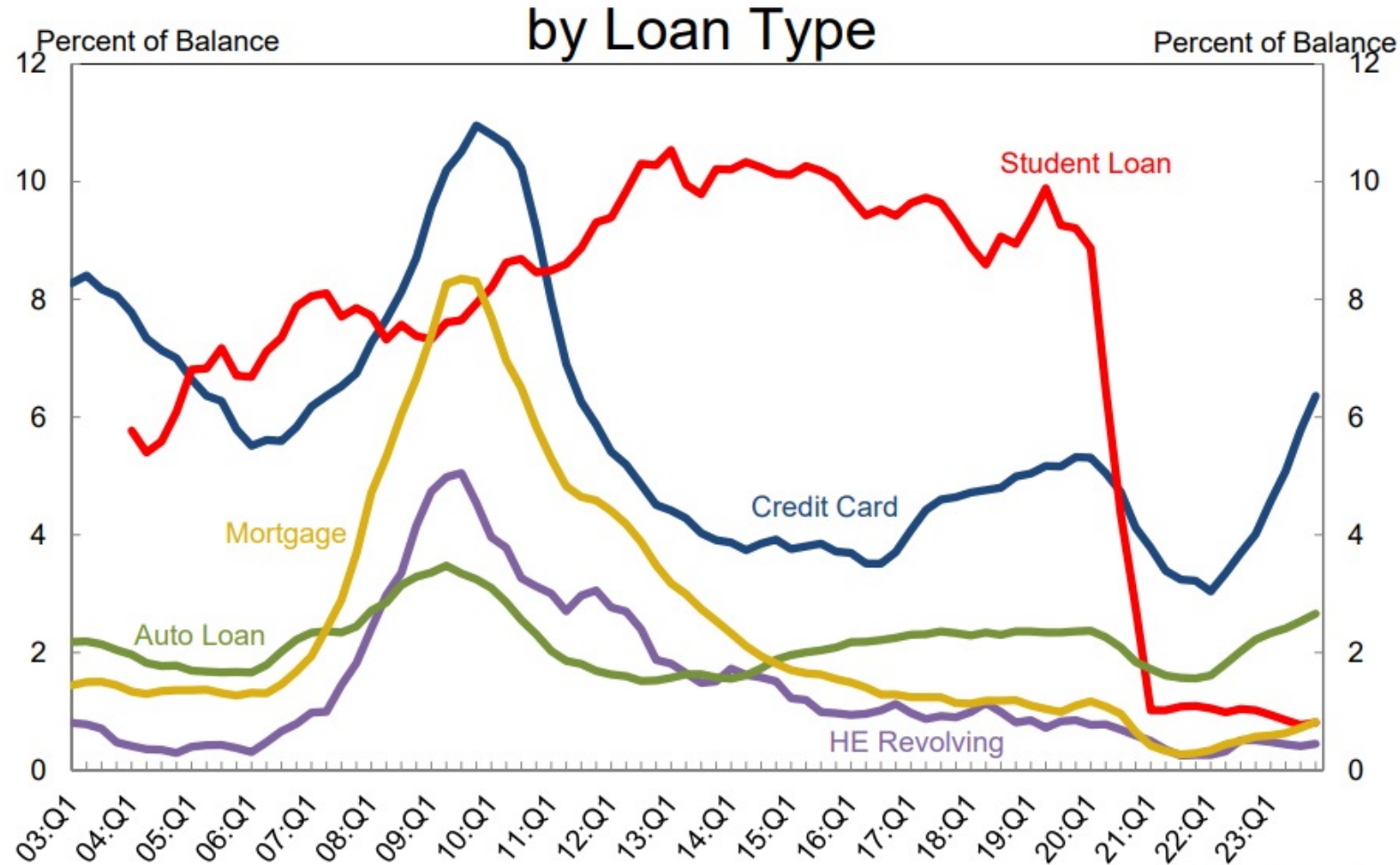
Source: New York Fed Consumer Credit Panel/Equifax

Note: 4 Quarter Moving Sum.
Age is defined as the current year minus the birthyear of the borrower.
Age groups are re-defined each year.

Mortgage Debt Still Very Healthy, Which is Keeping Overall Delinquency Rate Low But This Masks Problems Brewing Beneath the Surface



Transition into Serious Delinquency (90+)



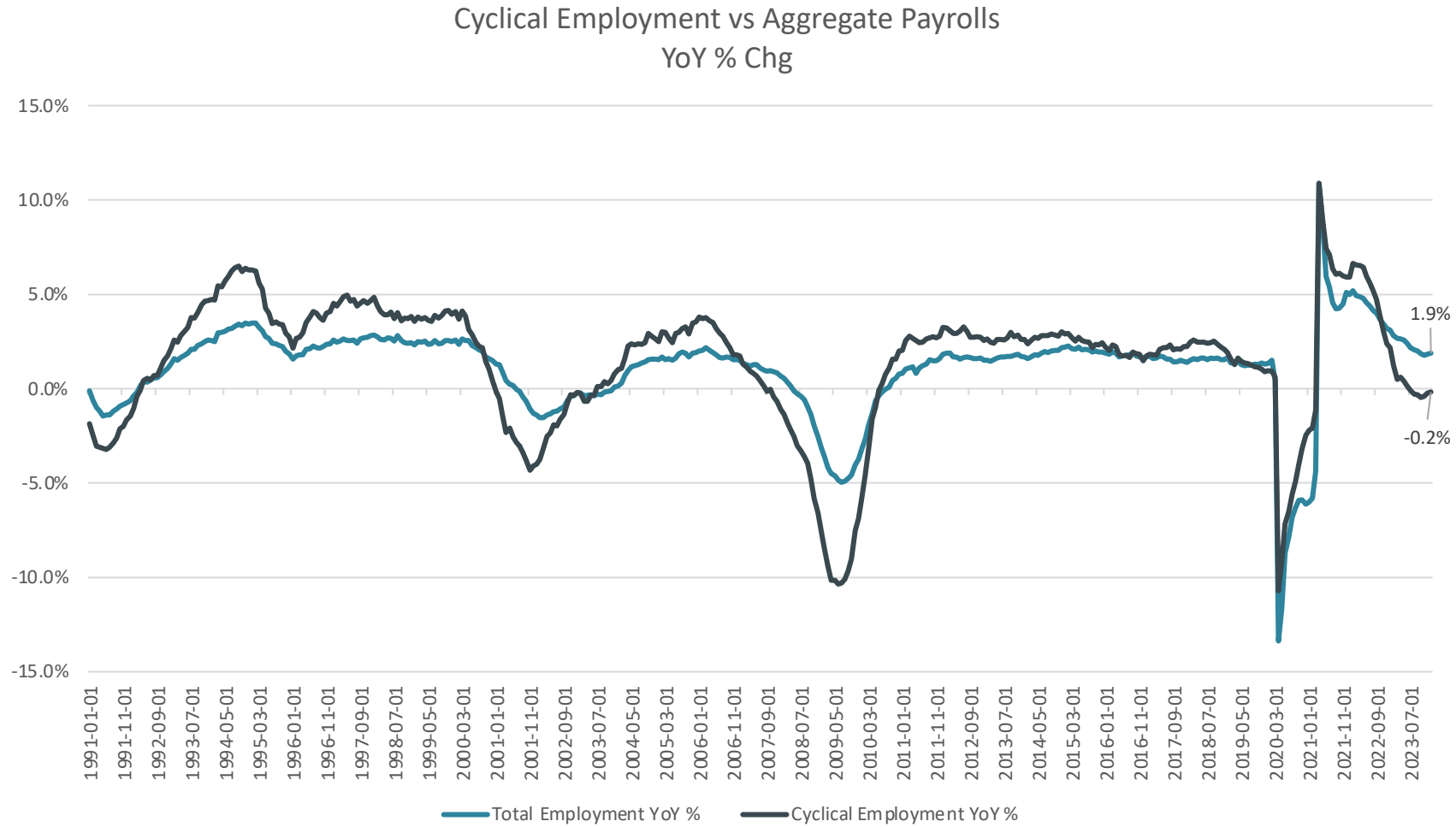
Source: New York Fed Consumer Credit Panel/Equifax

Note: 4 Quarter Moving Sum
Student loan data are not reported prior to 2004 due to uneven reporting

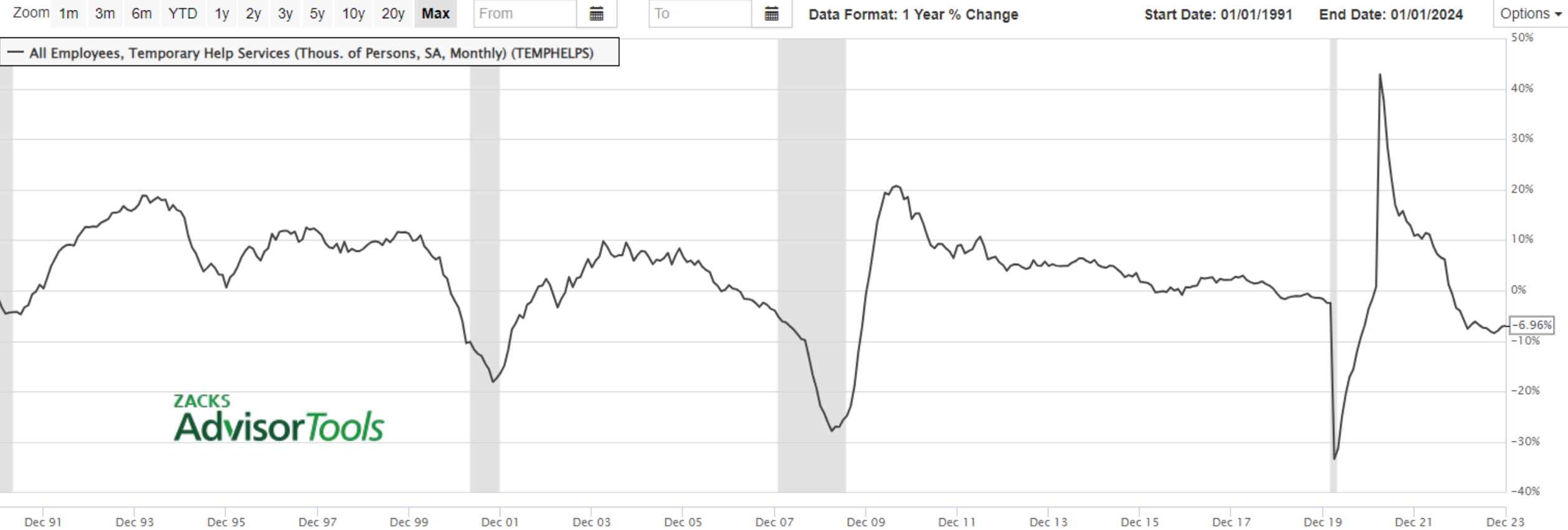


JOB MARKET

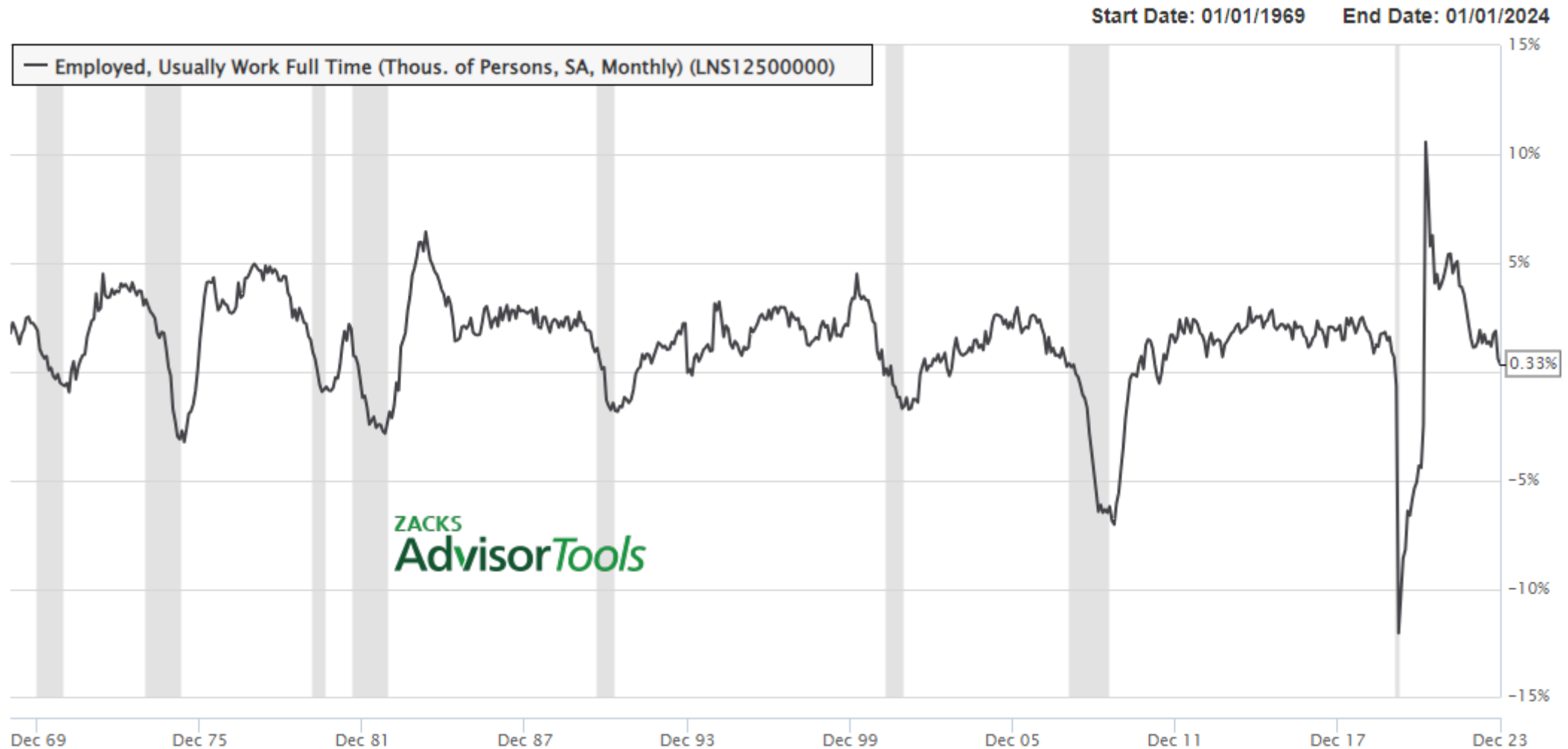
Aggregate Payrolls Ticked up to +1.9% YoY Despite Downward Revisions, But Cyclical Employment Posts 7th Consecutive Month of YoY Contraction



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

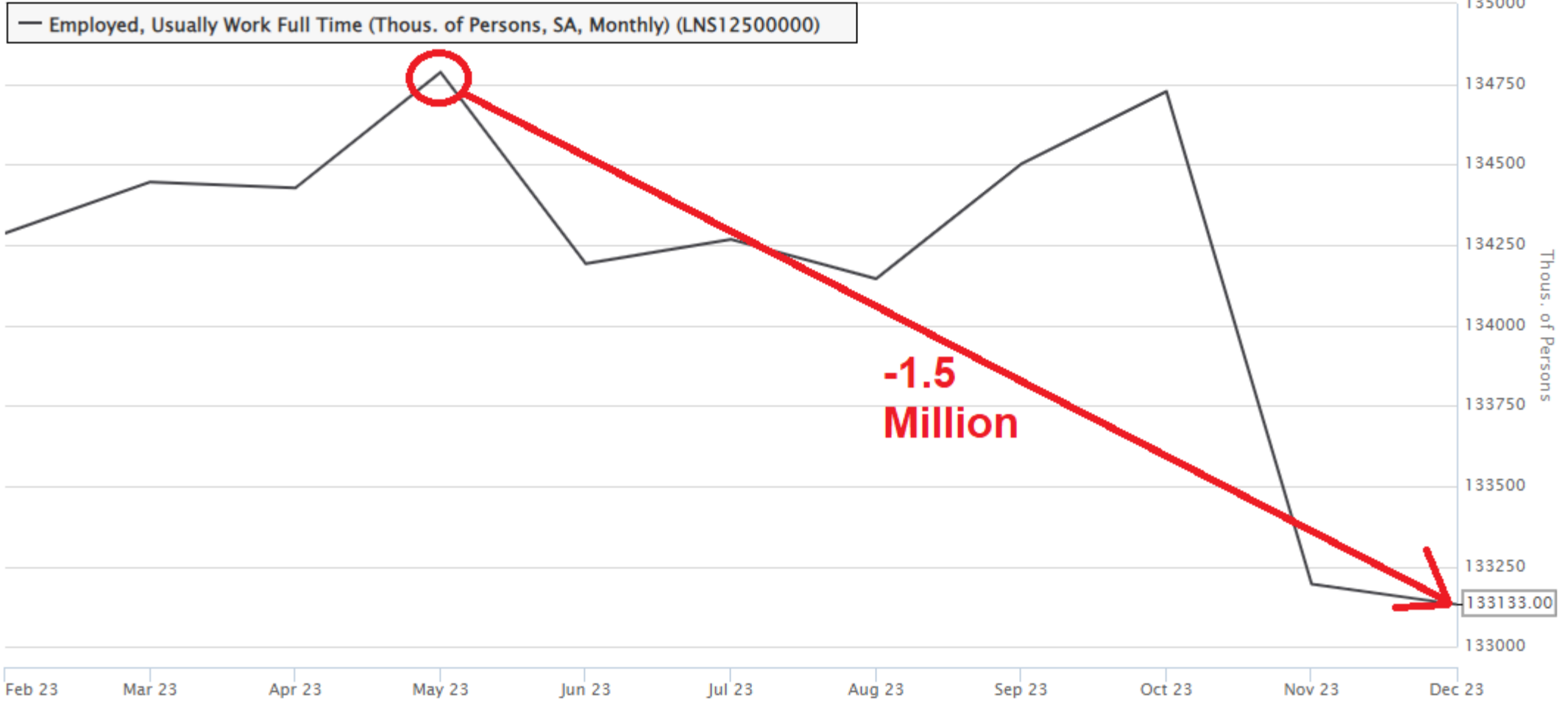


1.5 Million Fewer Full-Time Jobholders Since June 2023 Peak; +0.3% Growth YoY is Among the Slowest Outside of Recessions

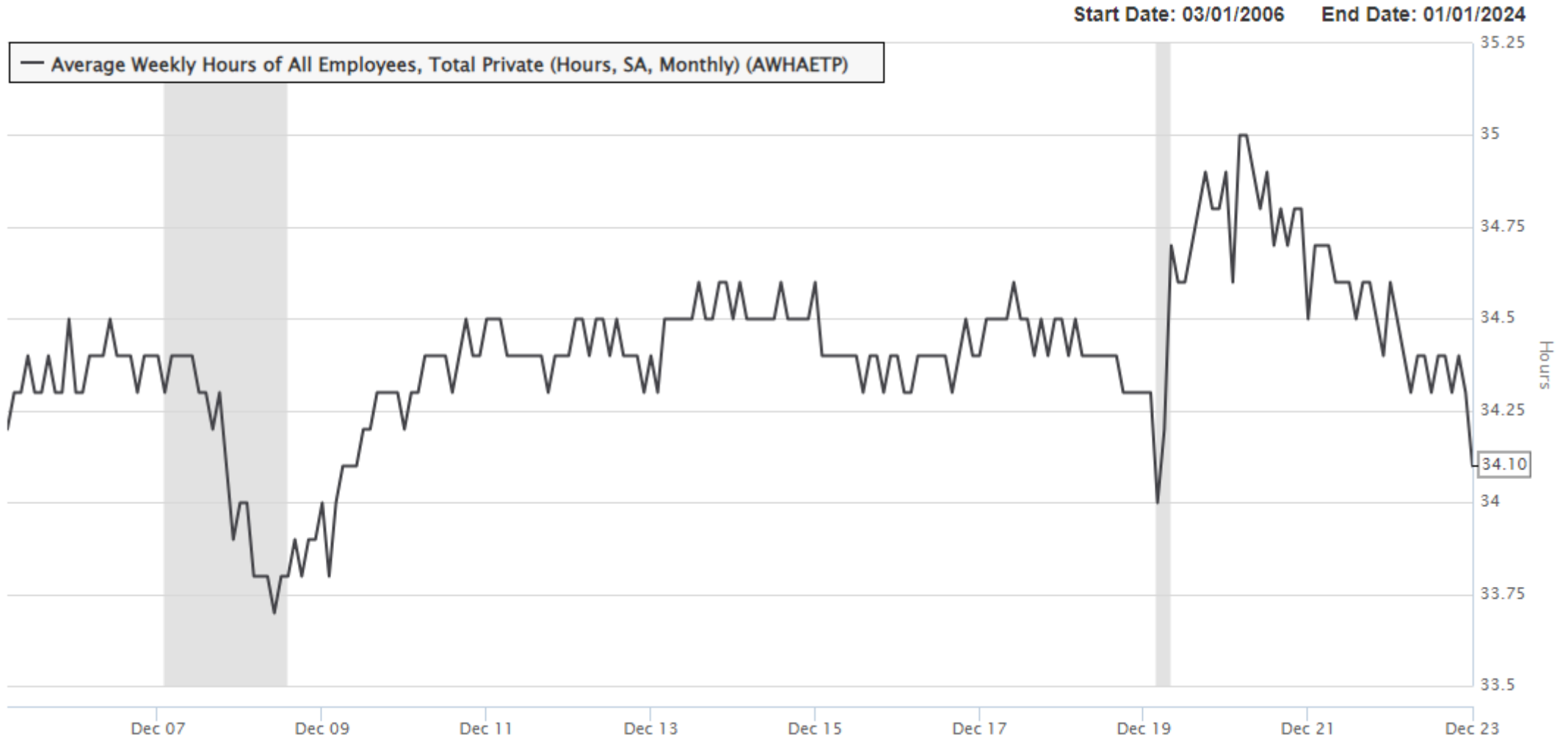




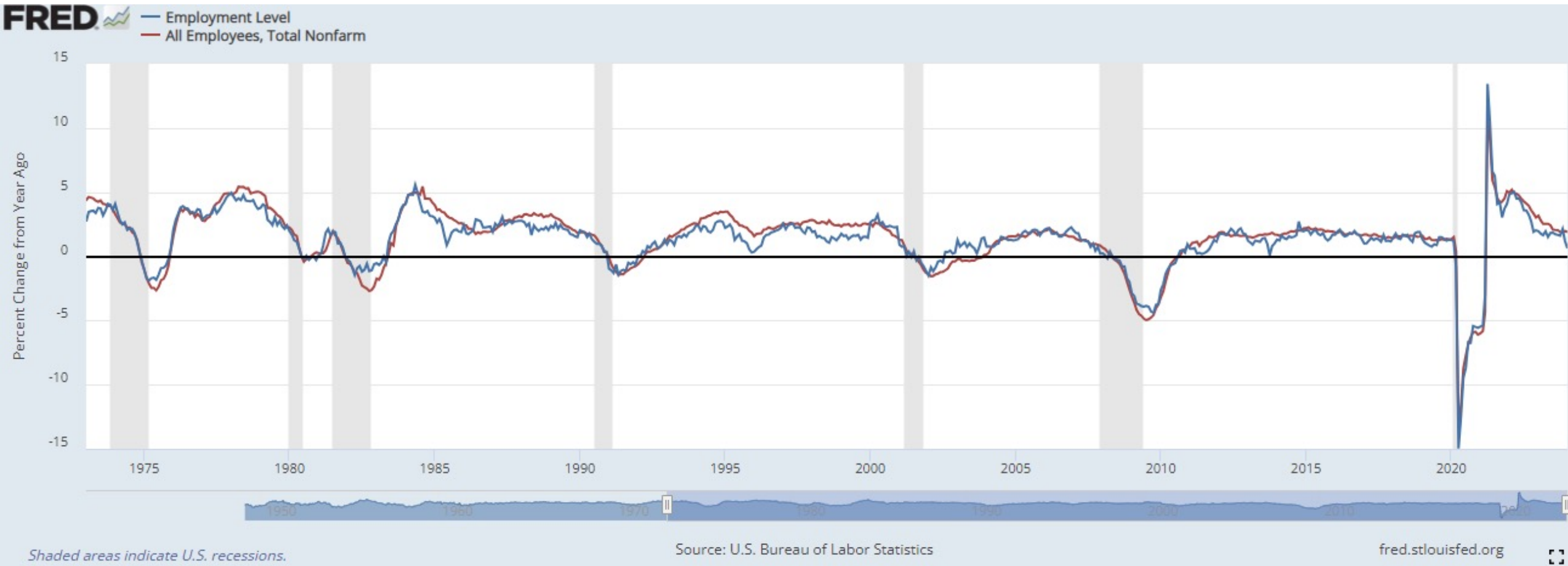
Start Date: 03/01/2023 End Date: 01/01/2024




Average Weekly Hours Therefore In Rapid Decline, Consistent with Recession

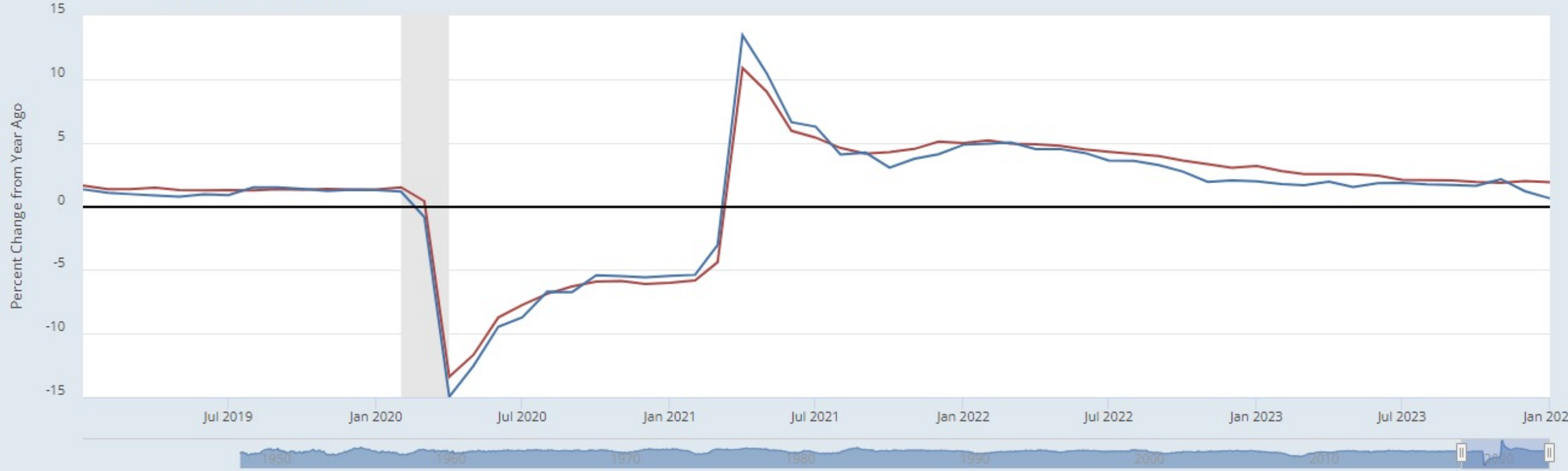


Large Gap Between Household and Establishment Surveys Suggests Job Market Much Weaker than it Appears





FRED  — Employment Level
— All Employees, Total Nonfarm

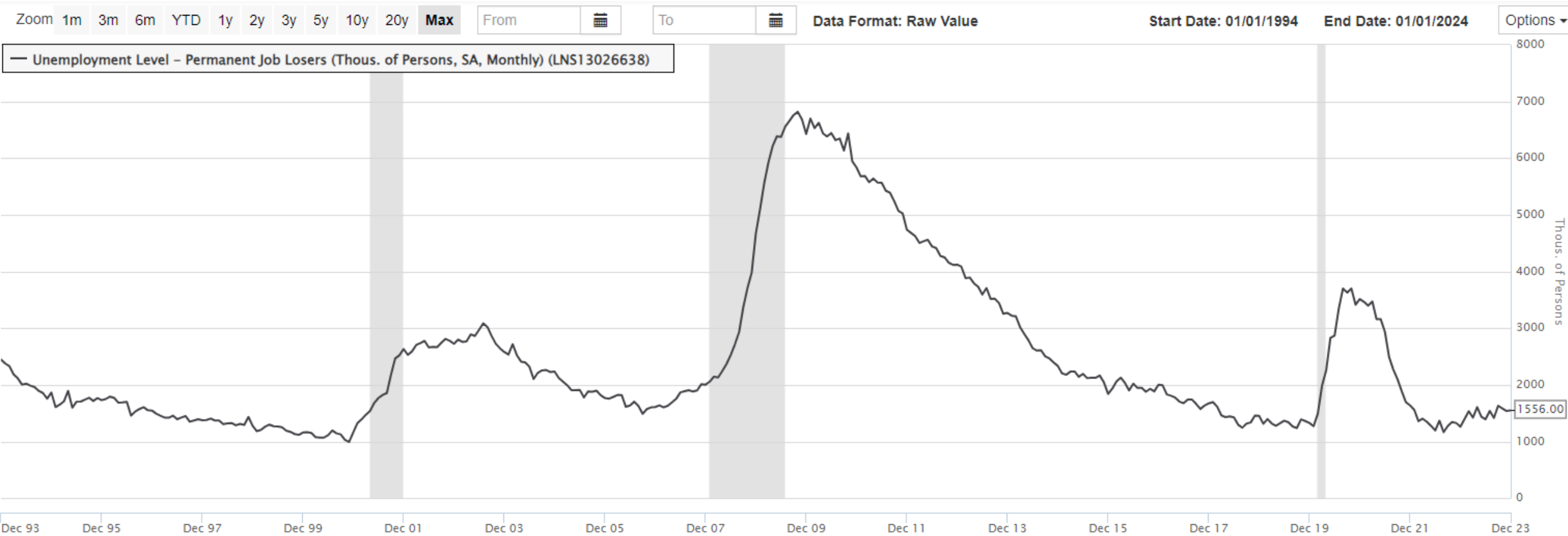


Shaded areas indicate U.S. recessions.

Source: U.S. Bureau of Labor Statistics

fred.stlouisfed.org

However, Job Losers Remain Very Low; Suggests the Decline in FT Jobs is Through Attrition

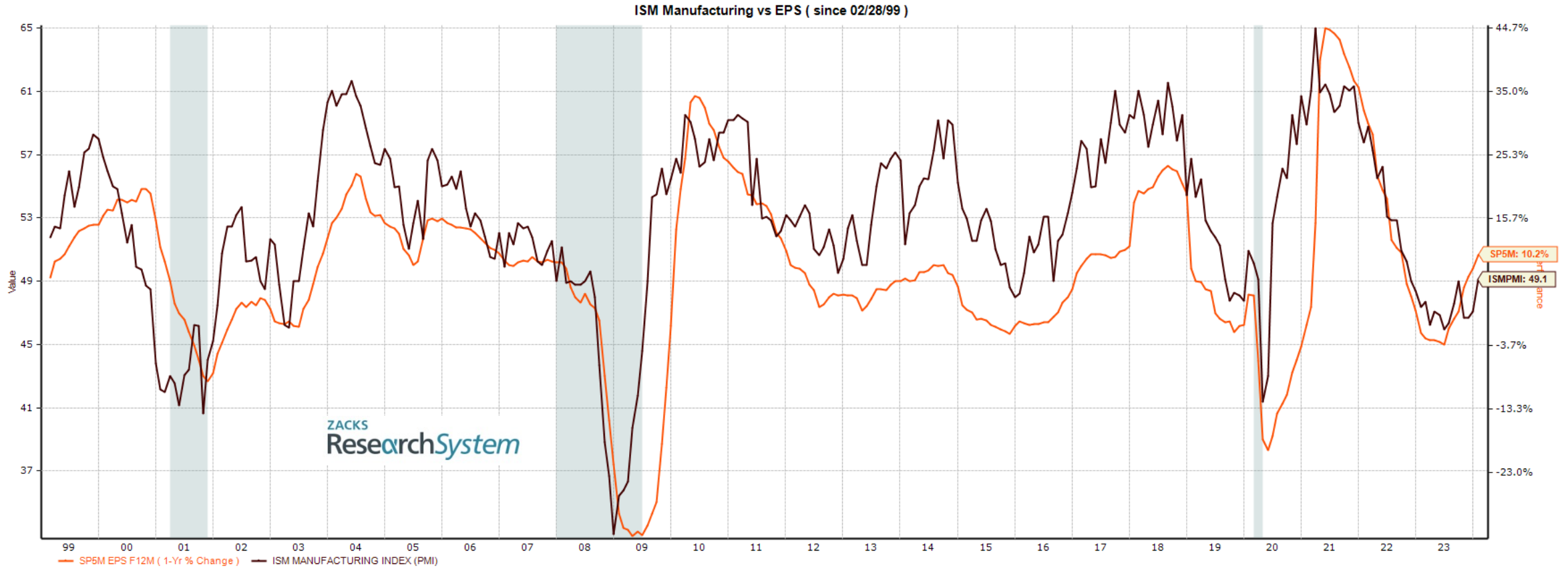




MANUFACTURING

ISM Manufacturing PMI Similarly in Recession Territory

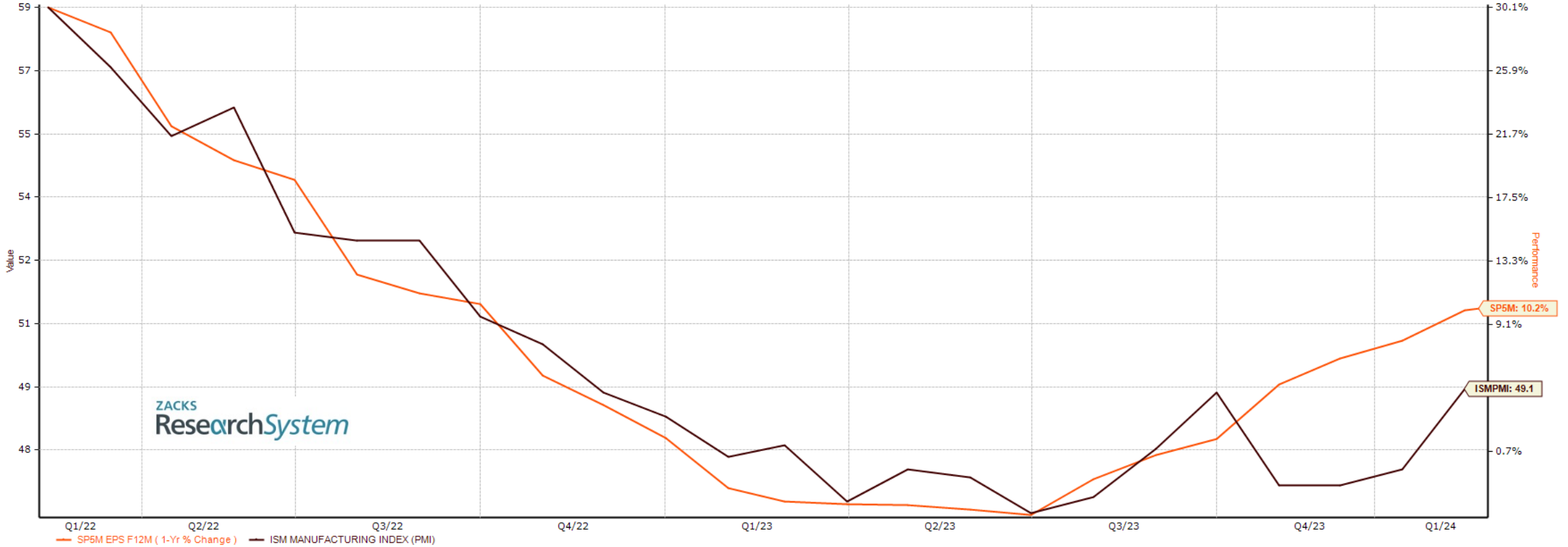
Index has been in contraction for 15 consecutive months, bearish divergence with forward EPS



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%	10.17%	486.60%	6.95%	02-28-1999	02-07-2024
ISM MANUFACTURING INDEX (PMI)	64.70	33.30	52.85	49.10	-5.03%	-0.20%	02-28-1999	01-31-2024



ISM Manufacturing vs EPS (since 02/28/22)

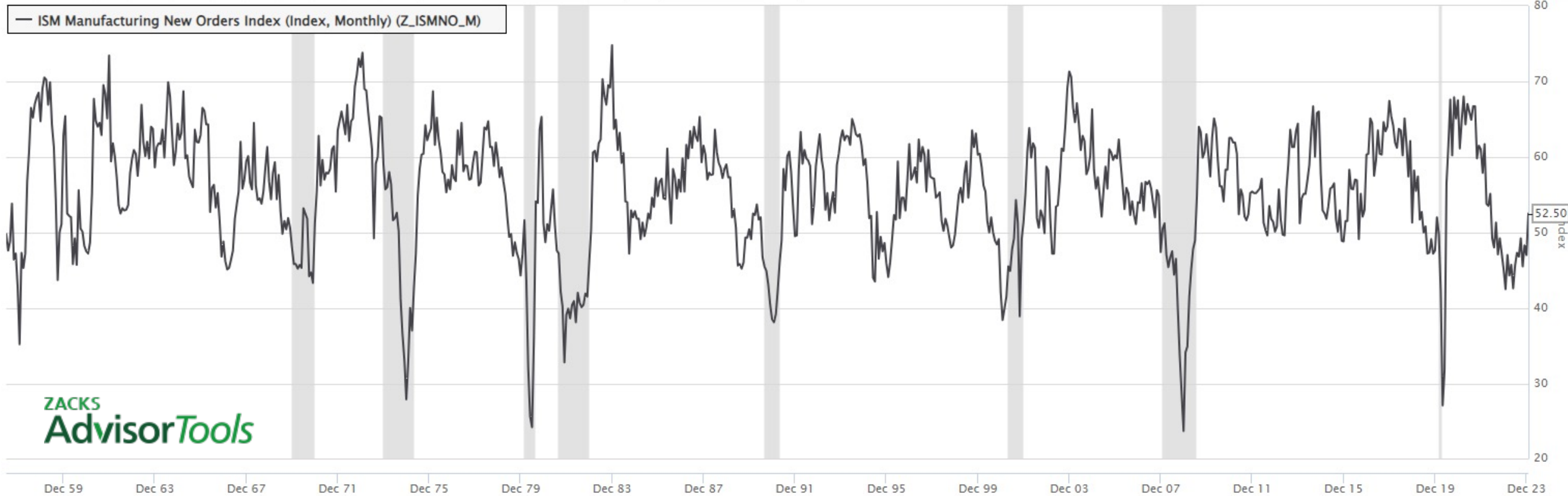


ZACKS
ResearchSystem

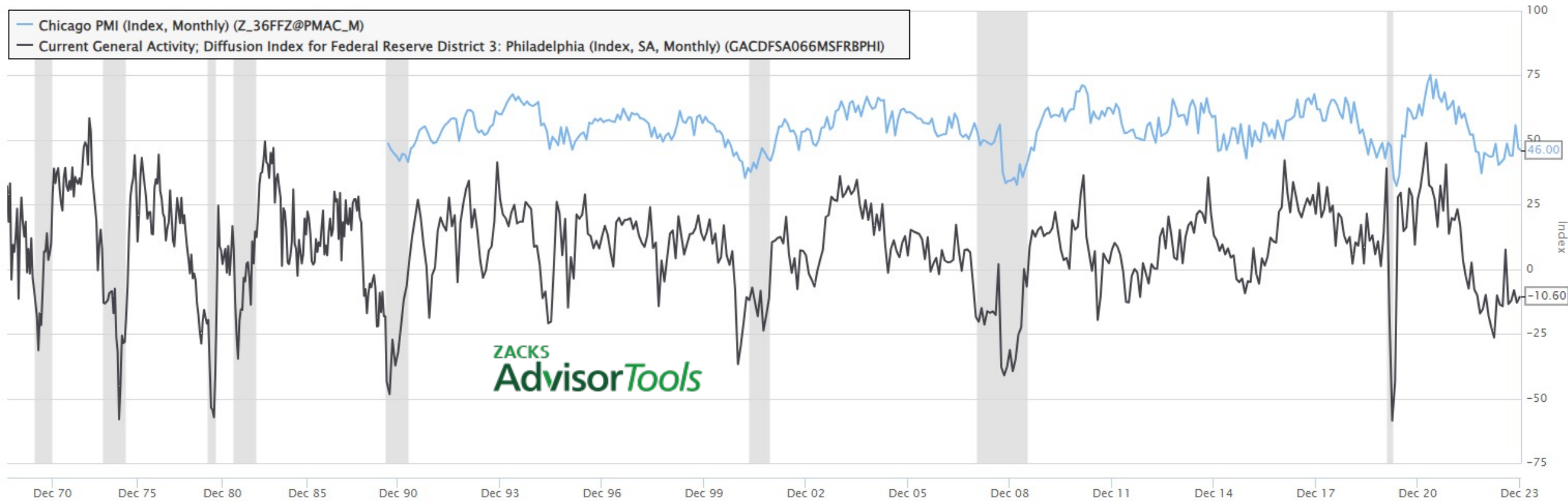
Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Change	30.08%	-3.50%	5.80%	10.17%	39.56%	11.99%	02-28-2022	02-07-2024
ISM MANUFACTURING INDEX (PMI)	58.60	46.00	48.70	49.10	-16.21%	-8.79%	02-28-2022	01-31-2024

ISM Manufacturing New Orders Rebound Big in January

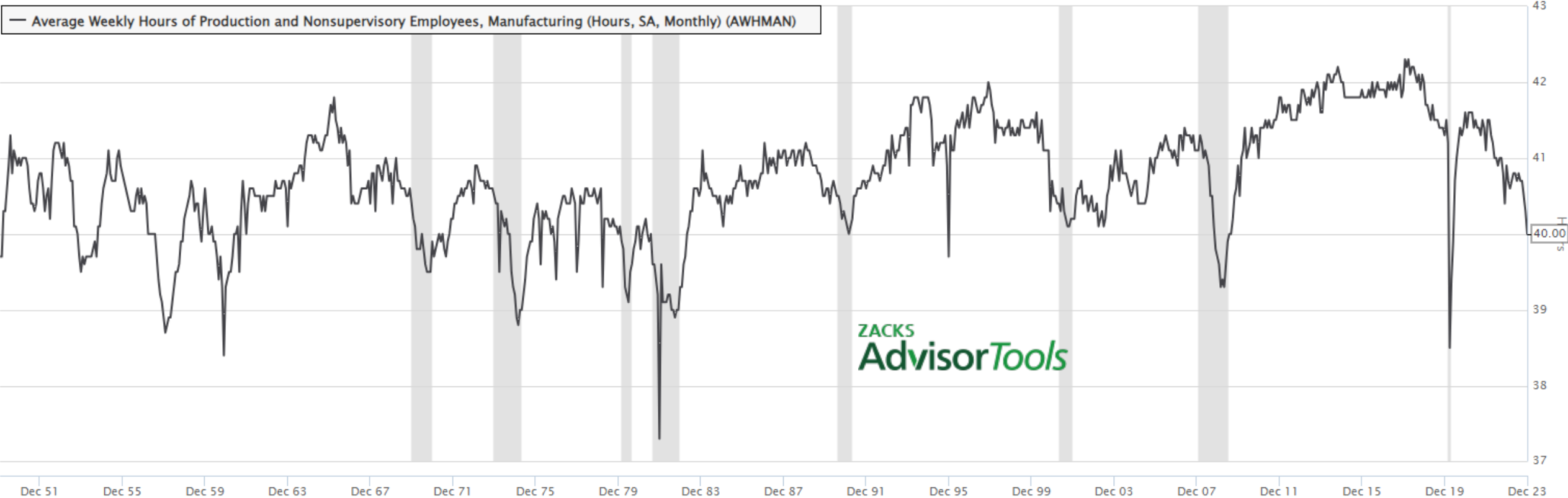
Streak ends at 18 consecutive monthly declines, rebounds as customer inventories are reportedly depleted



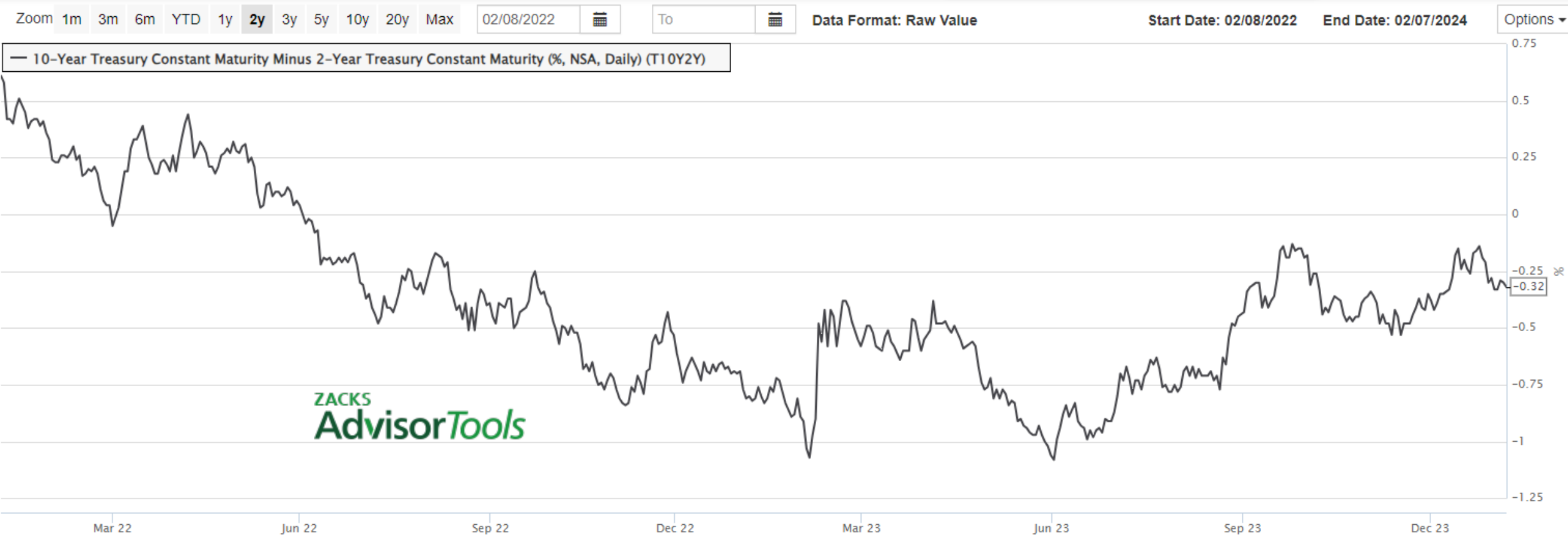
However, the bounceback may be temporary as customer inventories got too low. Chicago and Philadelphia had similar dynamics.



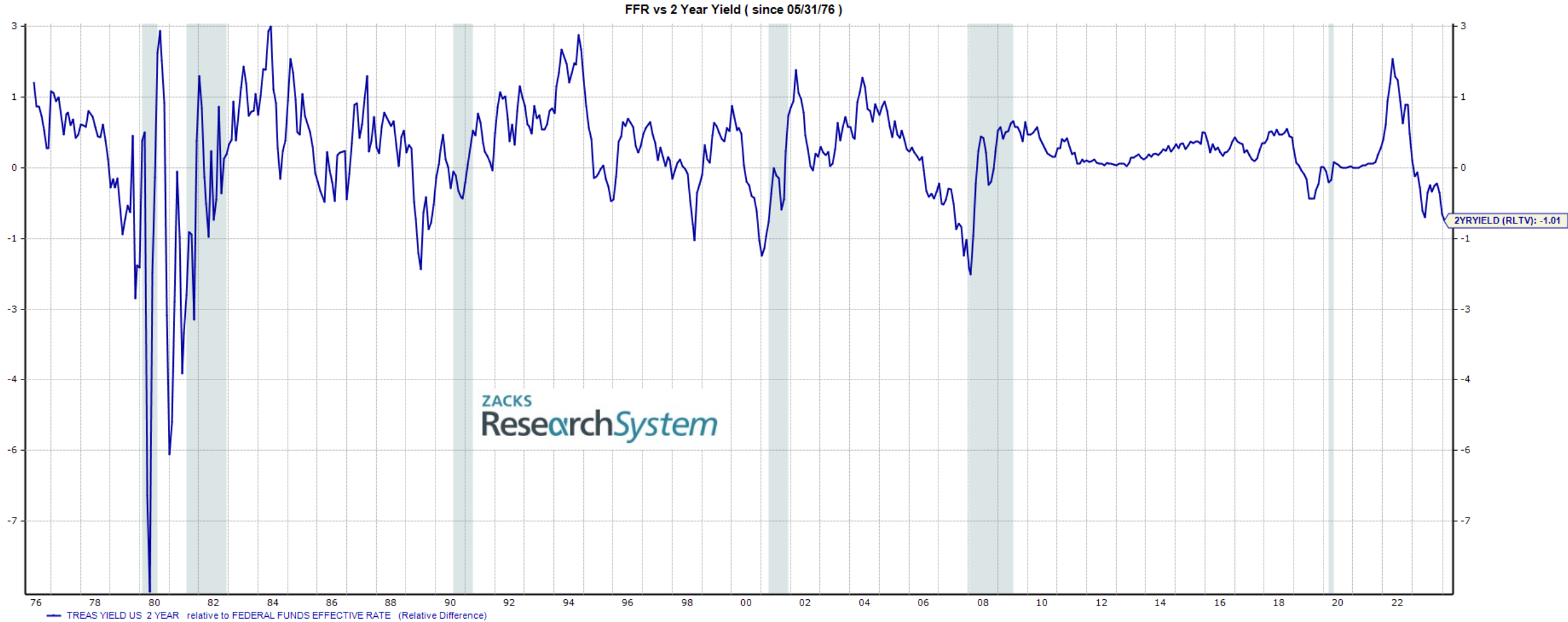
Factories Continue Slashing Workweek Hours to Recessionary Levels



Yield Curve Beginning to Re-Steepen, But Continues to Signal No Imminent Recession



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 Differe	2.85	-8.36	0.42	-1.01	05-31-1976	01-31-2024

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

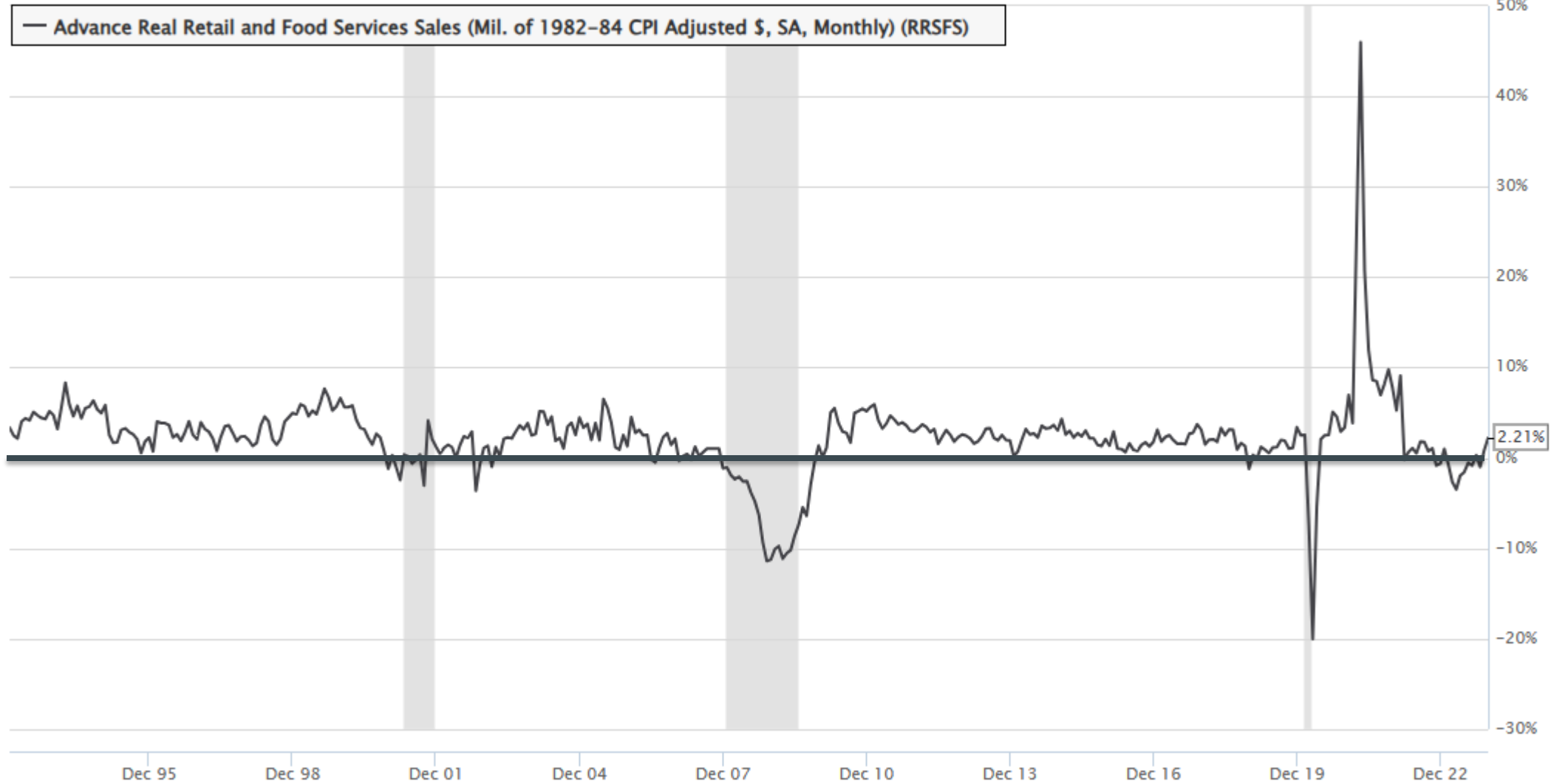


EXCESS SAVINGS

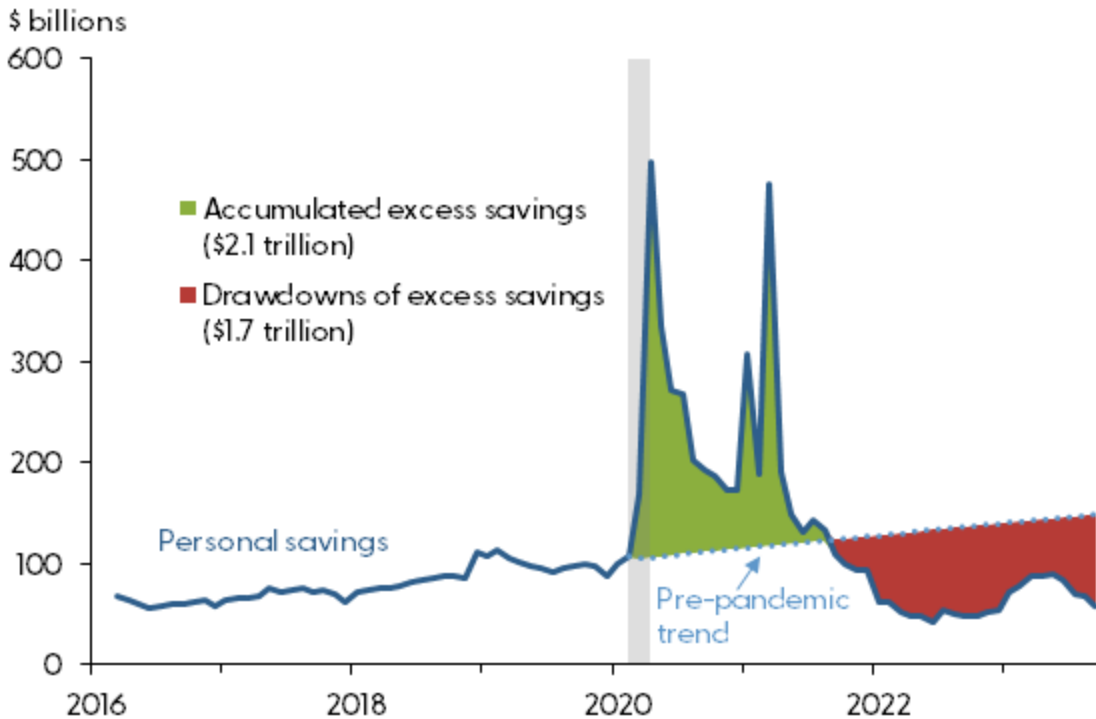
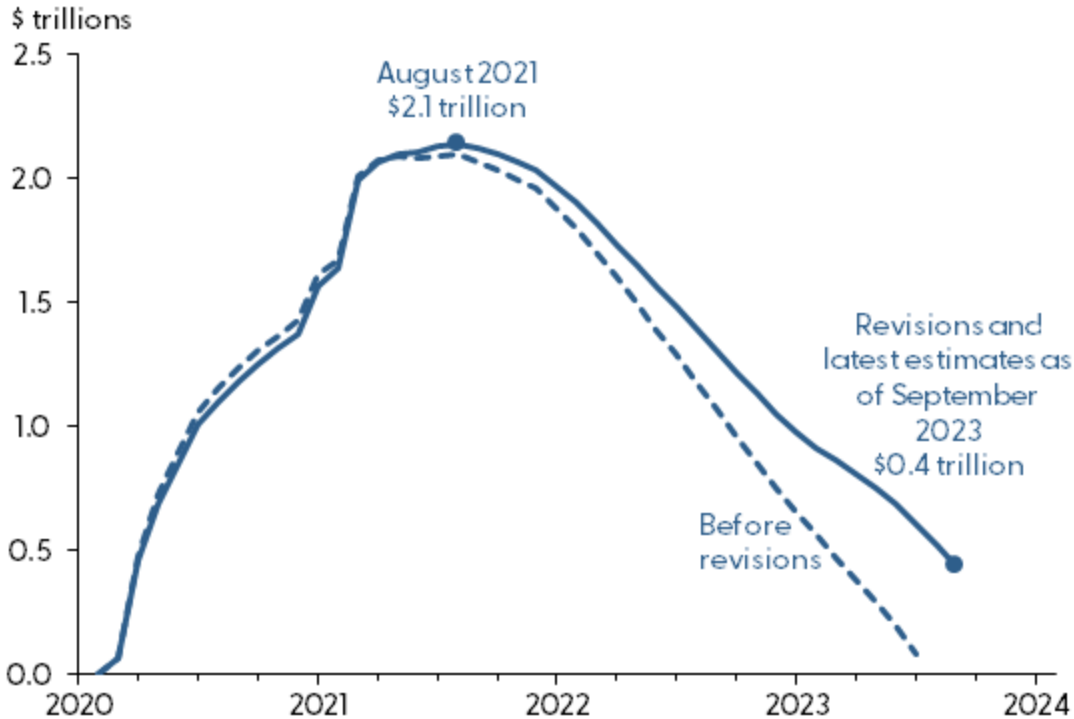
Real Retail Sales YoY Rebounding Strong After Brief Contraction

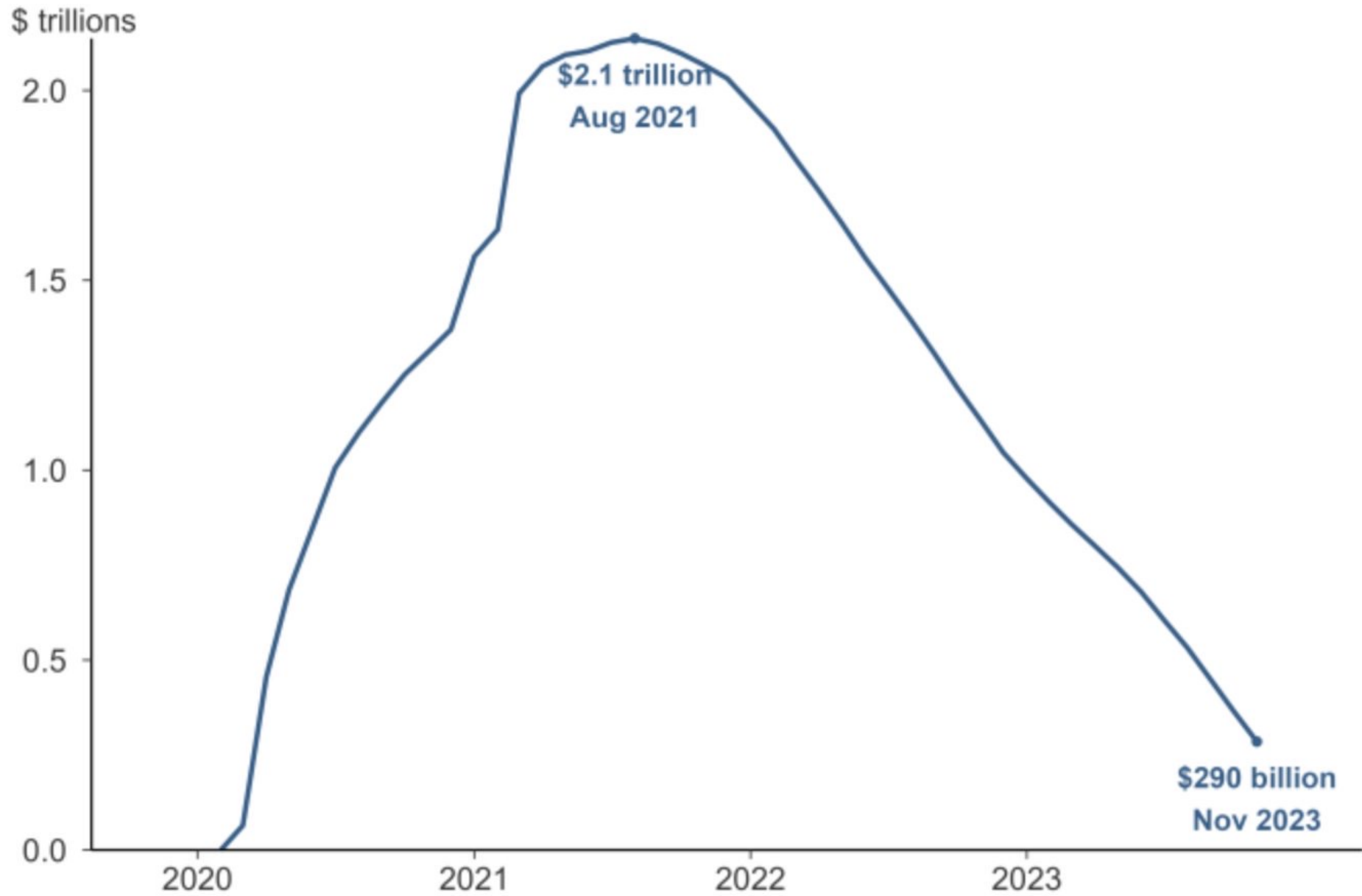


Start Date: 01/31/1993 End Date: 12/31/2023



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





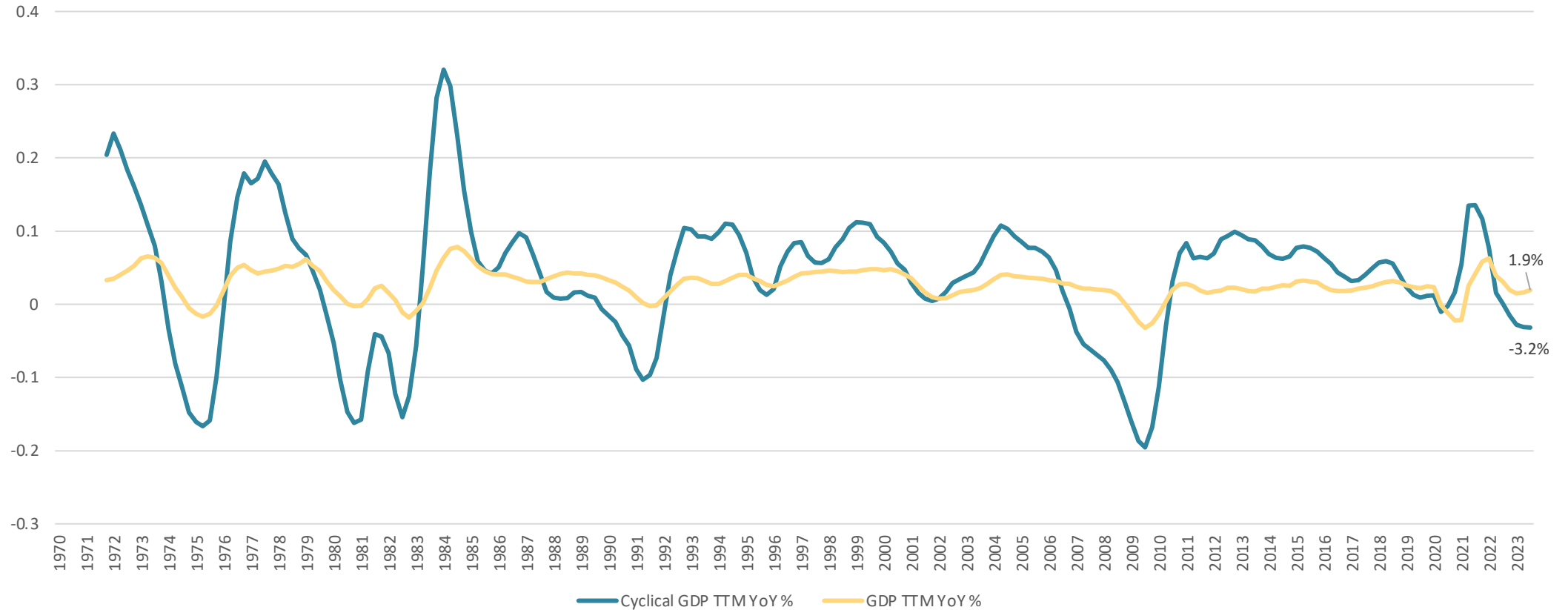
Source: Bureau of Economic Analysis and authors' calculations.



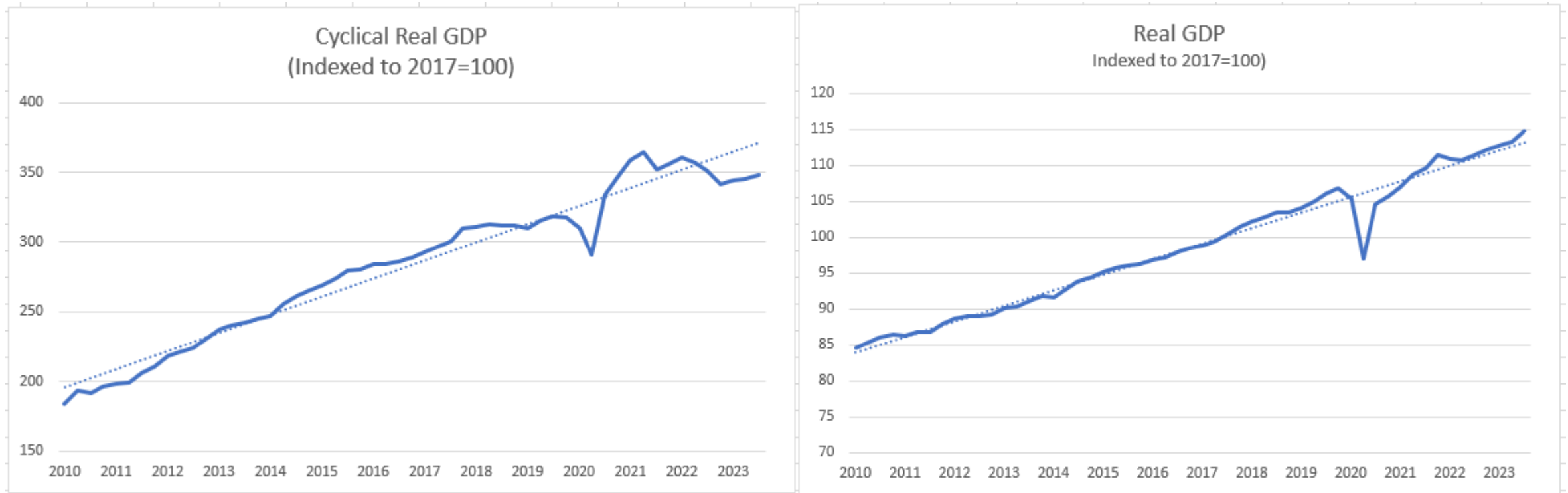
GROSS DOMESTIC PRODUCT



Real Cyclical GDP vs Aggregate Real GDP TTM YoY % Growth



While GDP At Trend, Cyclical GDP Below Trend



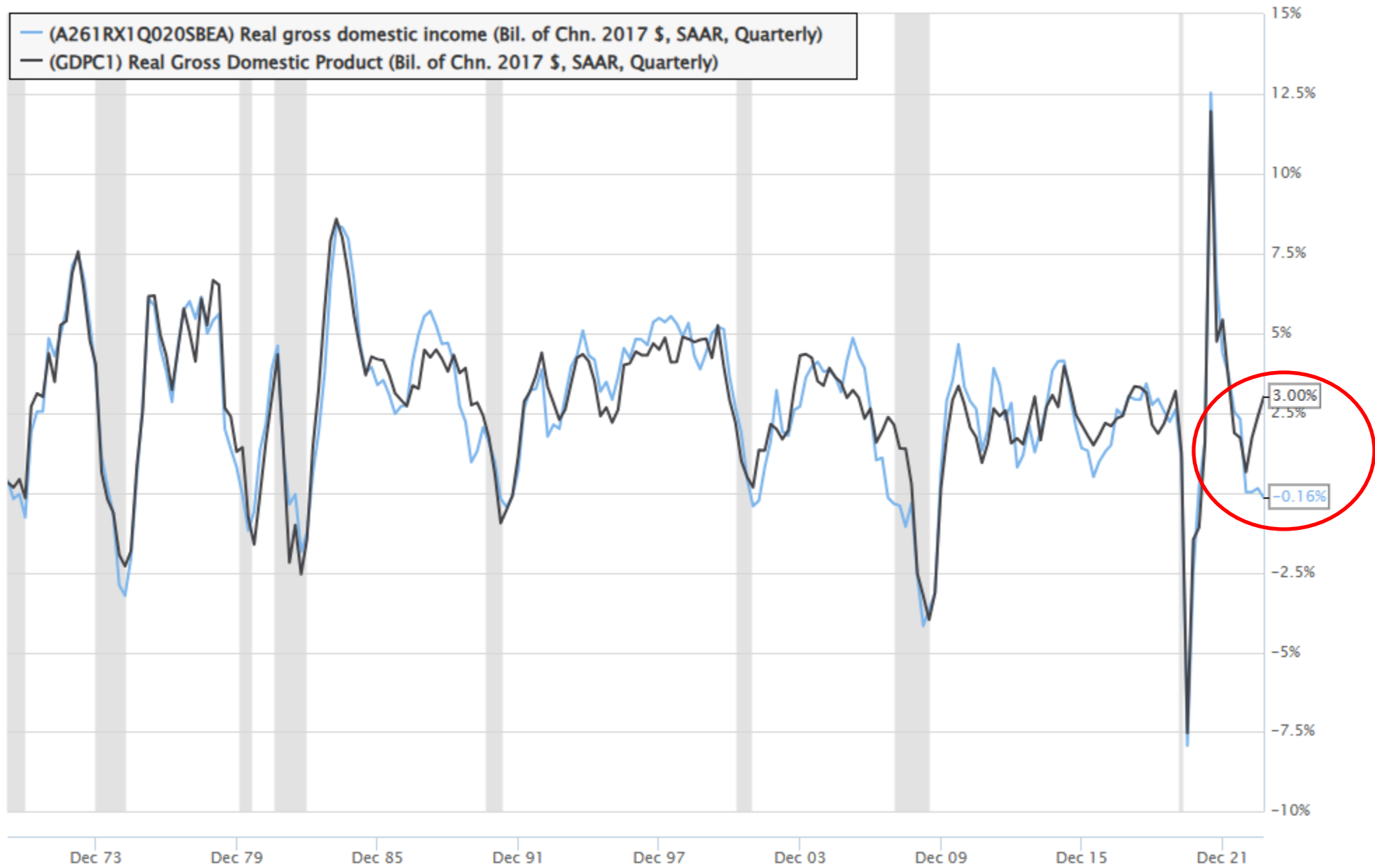
Gross Domestic Income Continues to Undermine GDP

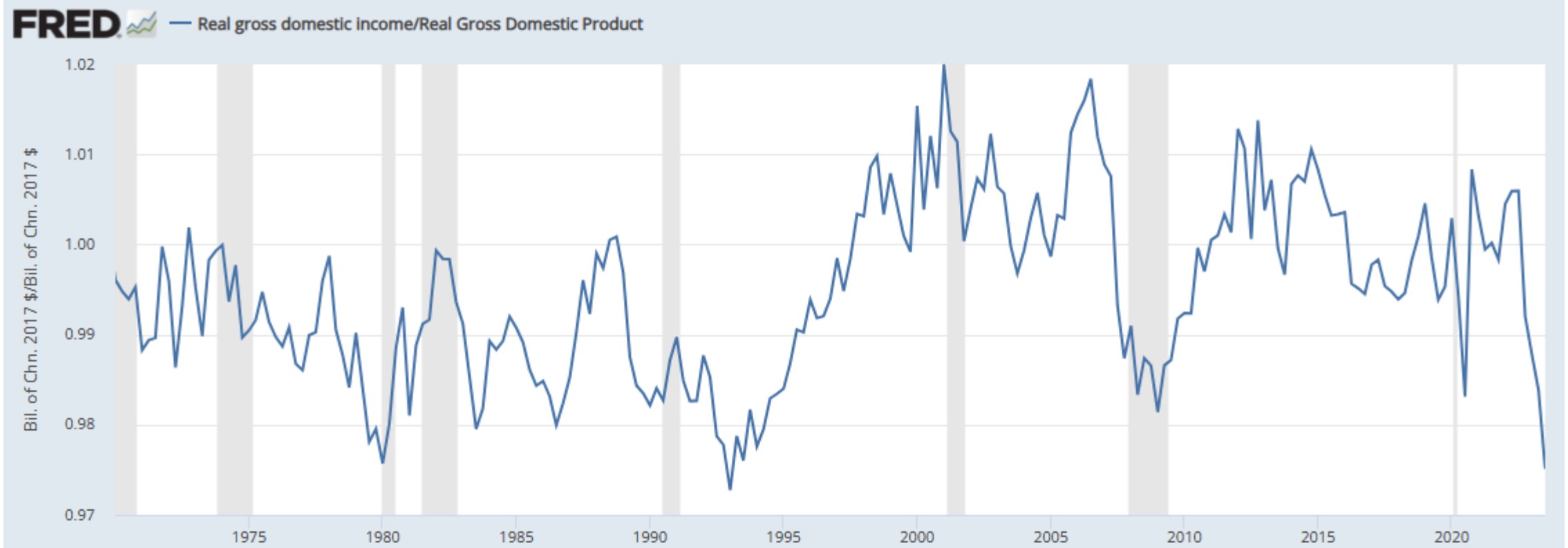


January 25, 2024

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

Line	2020				2021				2022				2023				Line					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4						
1	Gross domestic product (GDP)				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	2.9	3.1	1	
2	Personal consumption expenditures (PCE)				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	2.2	2.6	2	
3	Goods				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	2.6	3.5	3	
4	Durable goods				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	6.1	4	
5	Nondurable goods				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	2.2	5	
6	Services				-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	2.0	2.2	6	
7	Gross private domestic investment				-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	2.1	1.8	7	
8	Fixed investment				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	1.3	3.1	8	
9	Nonresidential				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	4.1	4.1	9	
10	Structures				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	15.7	14.8	10	
11	Equipment				-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	-1.6	-0.1	11	
12	Intellectual property products				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	3.6	2.6	12	
13	Residential				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	-7.2	0.0	13	
14	Change in private inventories				.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	14
15	Net exports of goods and services				.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	15
16	Exports				-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	-0.4	2.1	16	
17	Goods				-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	1.5	17	
18	Services				-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	1.6	3.2	18	
19	Imports				-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	-1.7	-0.2	19	
20	Goods				-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	0.4	20	
21	Services				-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	-5.2	-2.6	21	
22	Government consumption expenditures and gross investment				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	4.8	4.3	22	
23	Federal				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	4.0	23	
24	National defense				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	3.3	24	
25	Nondefense				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	4.7	25	
26	State and local				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	4.3	4.5	26	
Addenda:																						
27	Gross domestic income (GDI) ¹				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	-0.1	27







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.



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

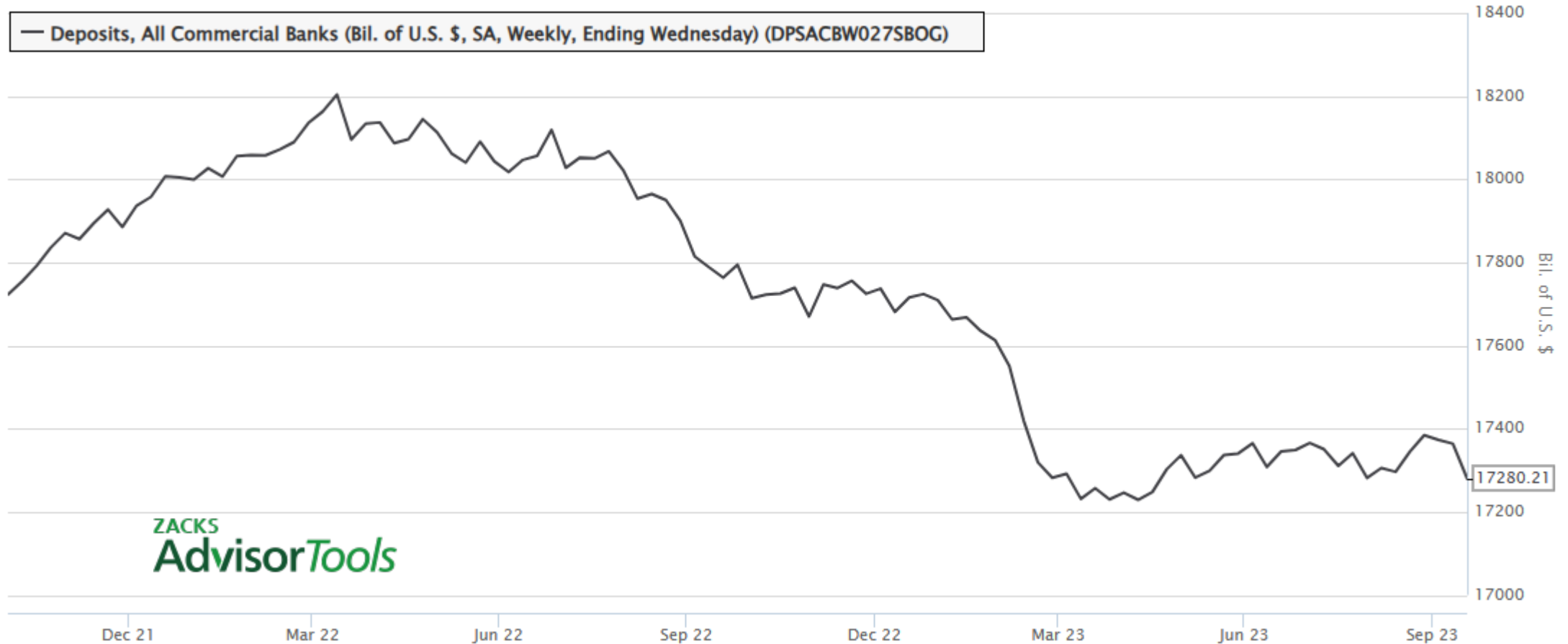
= Tightening credit availability



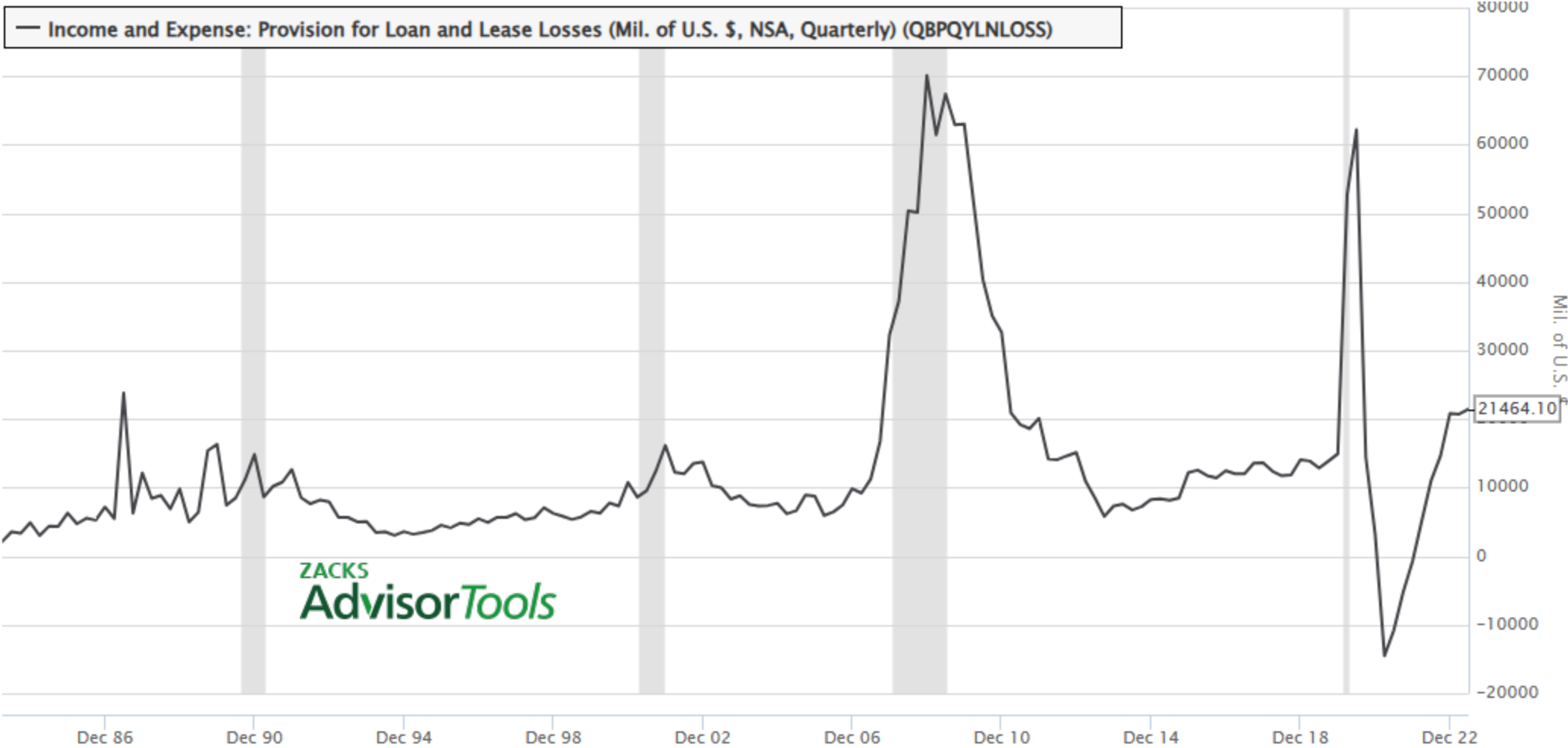
NBER: 14% of all loans and 44% of office loans are in 'negative equity', leading to potentially up to 300 regional banks at risk of solvency runs.

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

But has been stable since April '23



While Loan Loss Provisions Are Rising

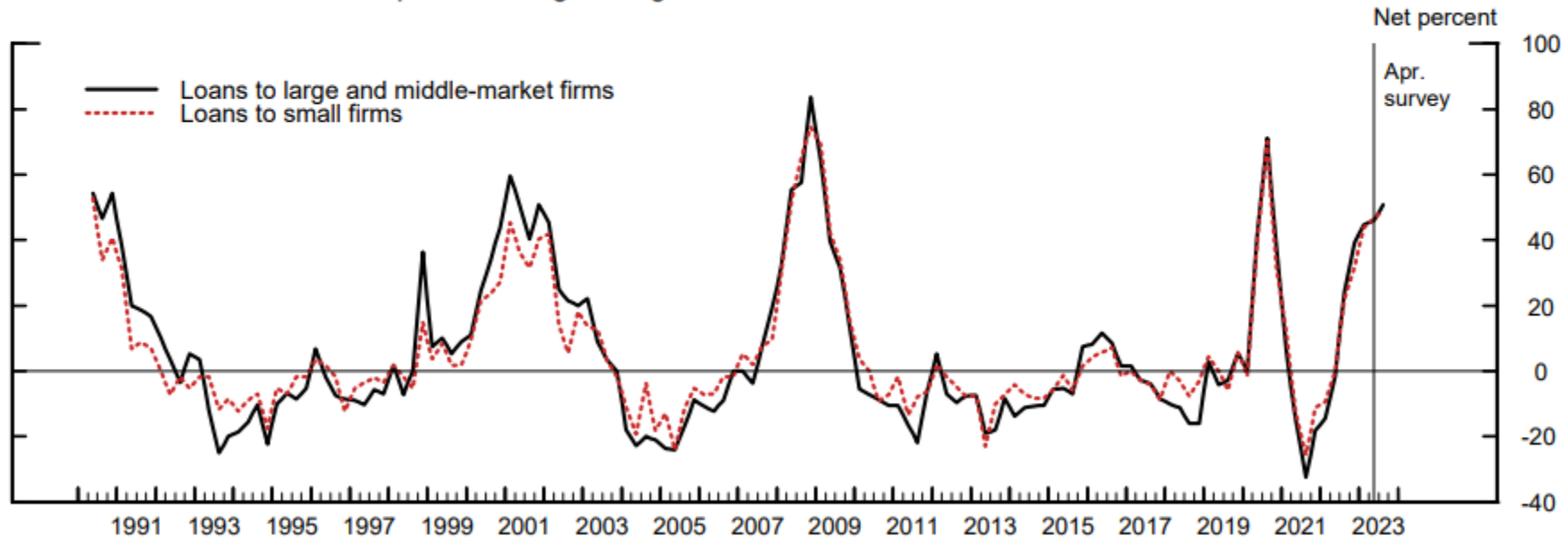


Net Result is Tightening Credit Availability



Measures of Supply and Demand for Commercial and Industrial Loans, by Size of Firm Seeking Loan

Net Percent of Domestic Respondents Tightening Standards for Commercial and Industrial Loans



Bank Lending Rarely Contracts Outside of Recessions



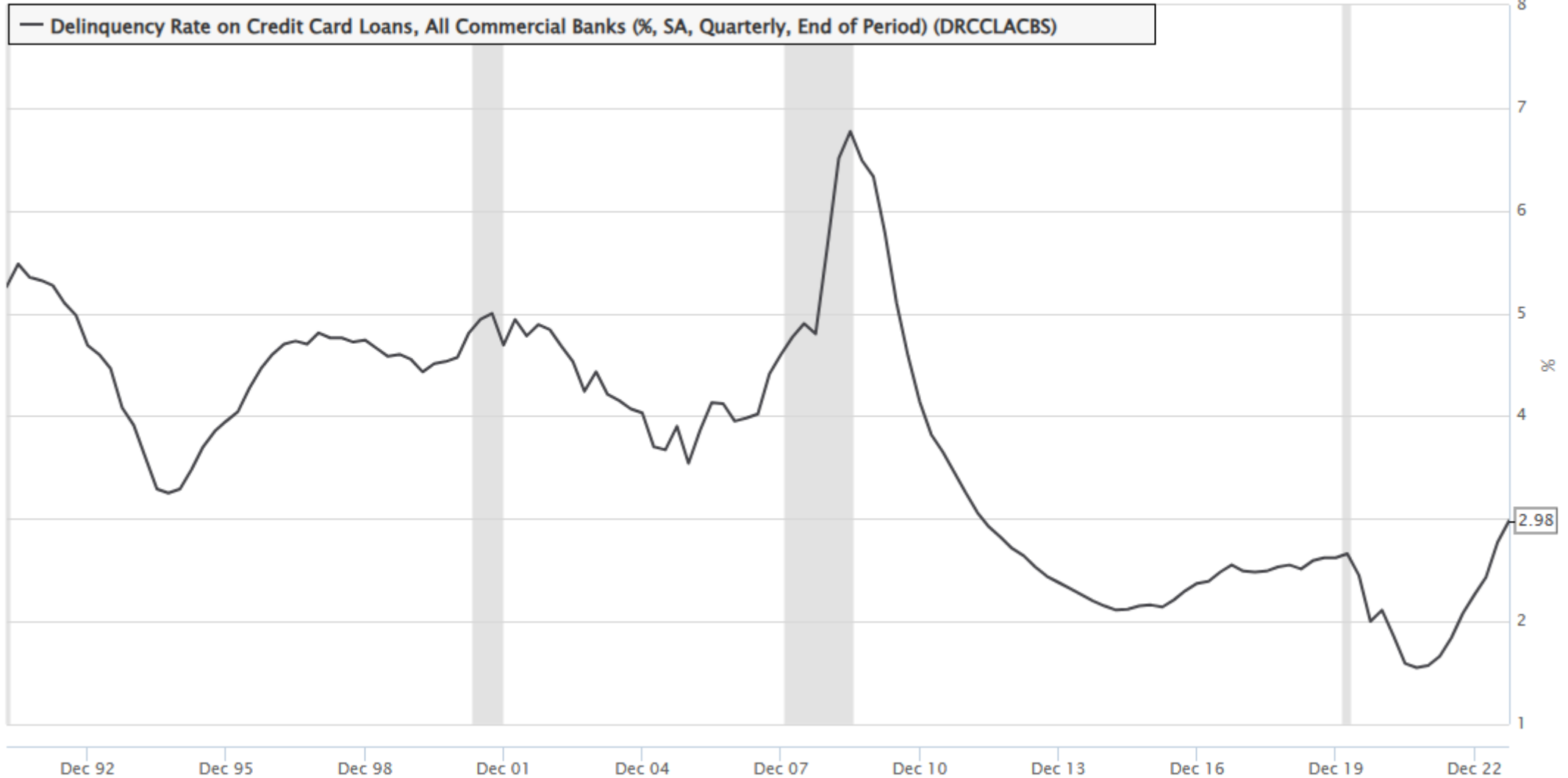
Start Date: 01/31/1974 End Date: 12/31/2023



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



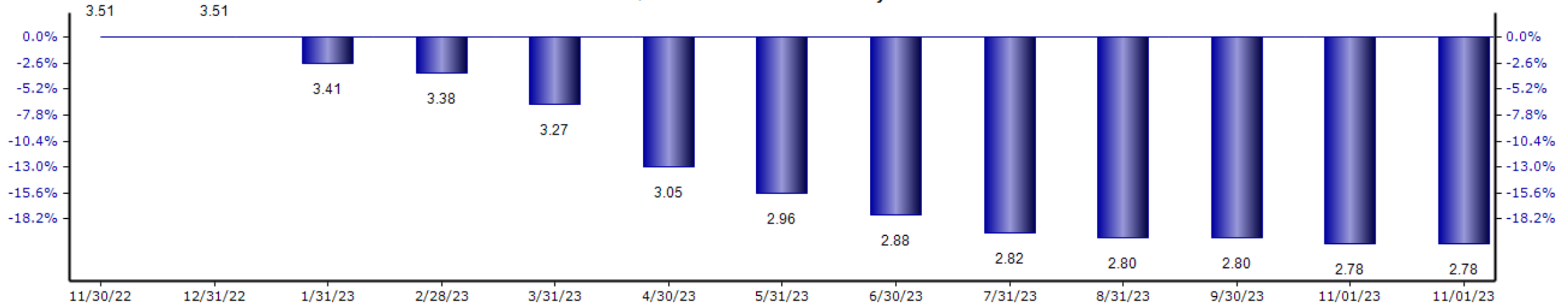
Start Date: 03/31/1991 End Date: 09/30/2023



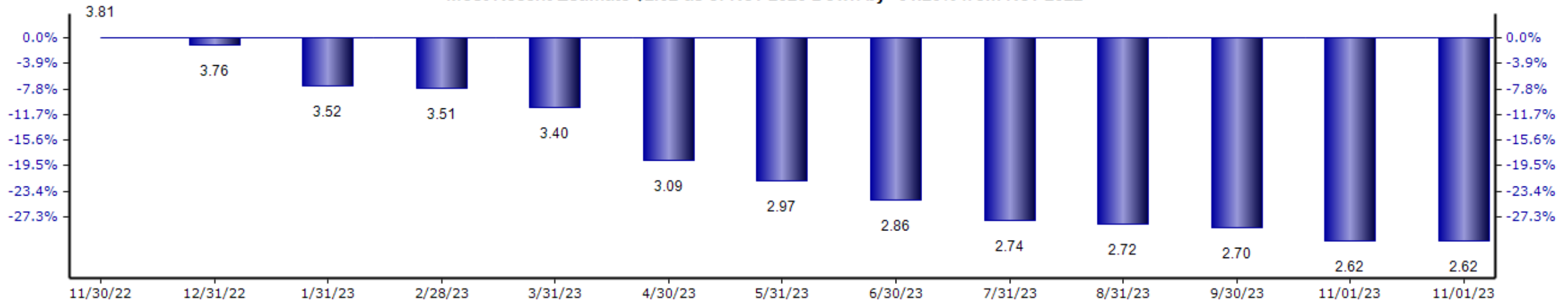
...and deep cuts to regional bank EPS forecasts



Spdr S&P Regional Banking ETF Composite (KRE.S) S-Wtd. F1 - Dec 2023 EPS Estimate Revisions
Most Recent Estimate \$2.78 as of Nov 2023 Down by -20.80% from Nov 2022



Spdr S&P Regional Banking ETF Composite (KRE.S) S-Wtd. F2 - Dec 2024 EPS Estimate Revisions
Most Recent Estimate \$2.62 as of Nov 2023 Down by -31.20% from Nov 2022





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.

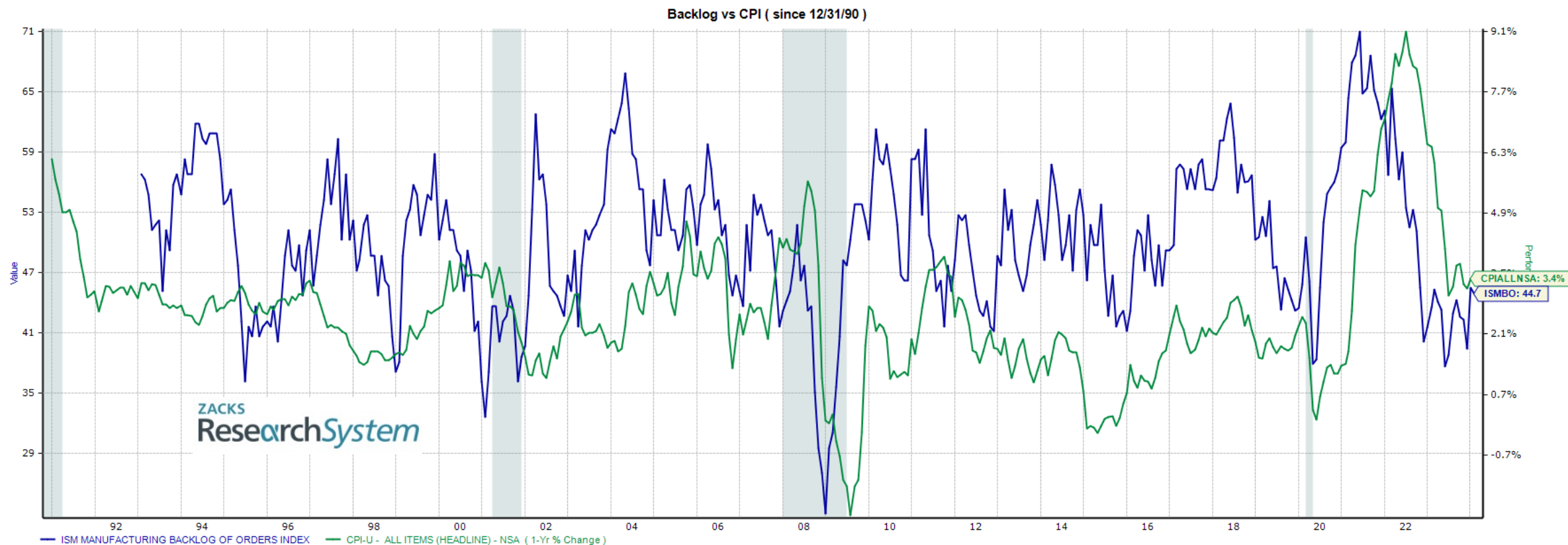
Discover is a bellwether of the health of the American middle class with over 60 million cardholders, mostly of middle incomes.



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

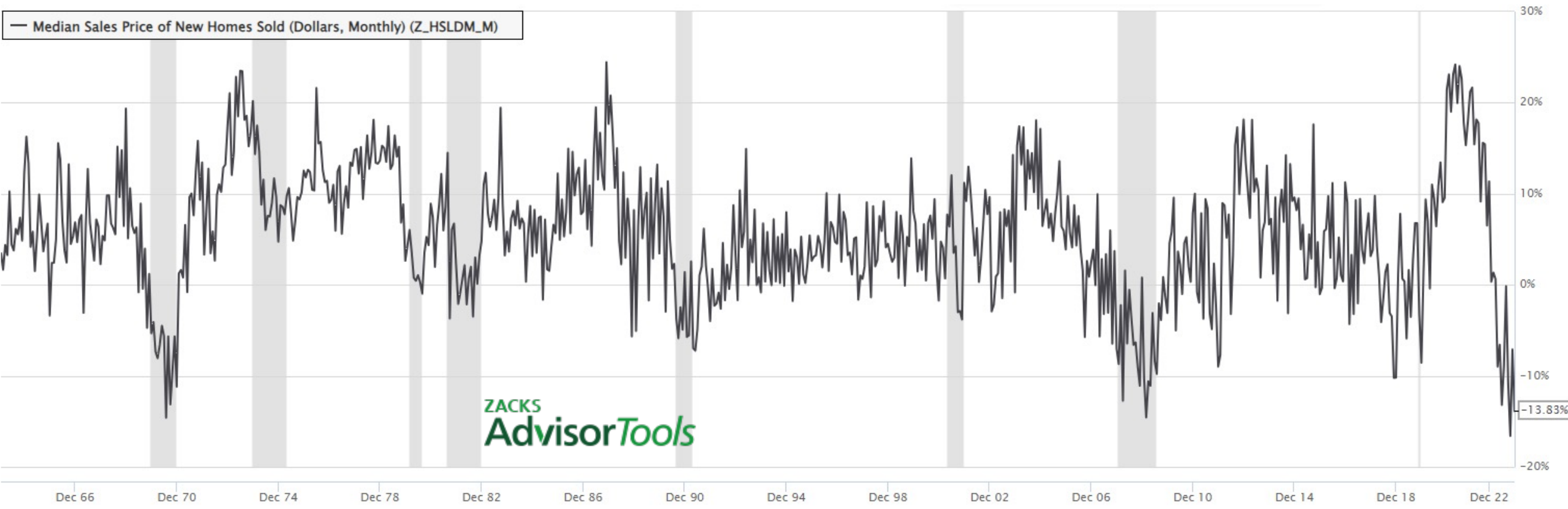
Mfr Backlog Remains in Contraction for 15 Consecutive Months

Continues to Forecast CPI Normalization



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	44.70	-20.88%	-0.74%	01-31-1993	01-31-2024
CPI-U - ALL ITEMS (HEADLINE) - NSA (1-Yr % Change)	9.06%	-2.10%	2.50%	3.35%	143.26%	2.61%	12-31-1990	12-31-2023

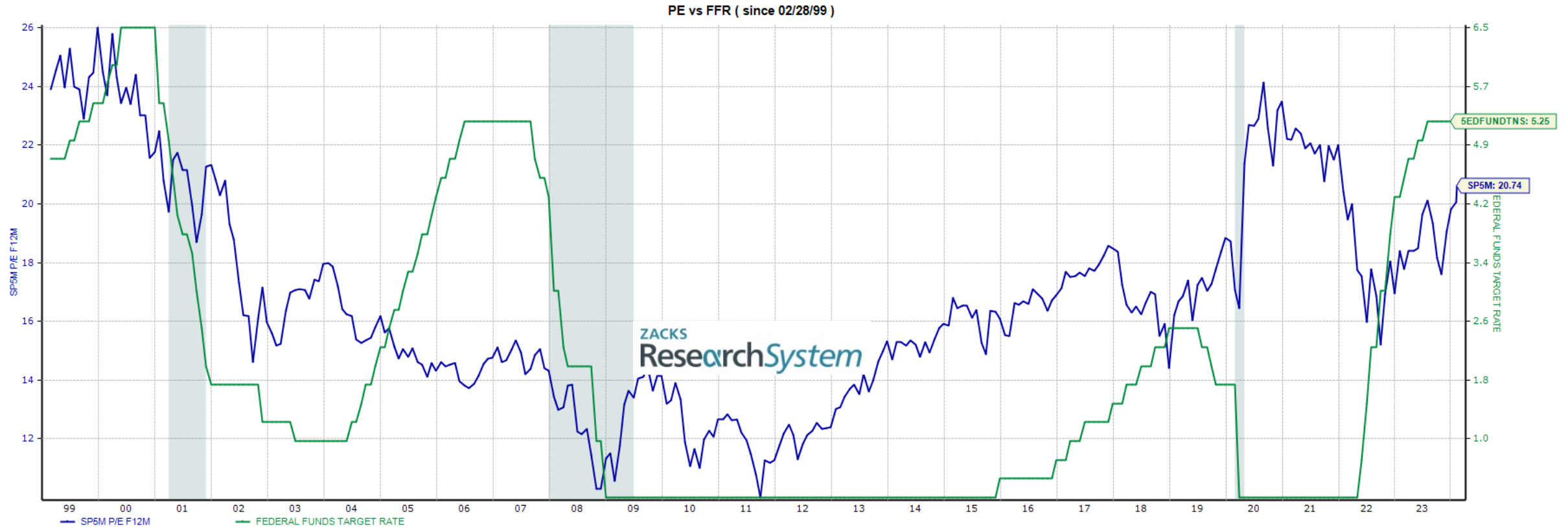
New Home Prices Continue to Collapse On Higher Financing Costs





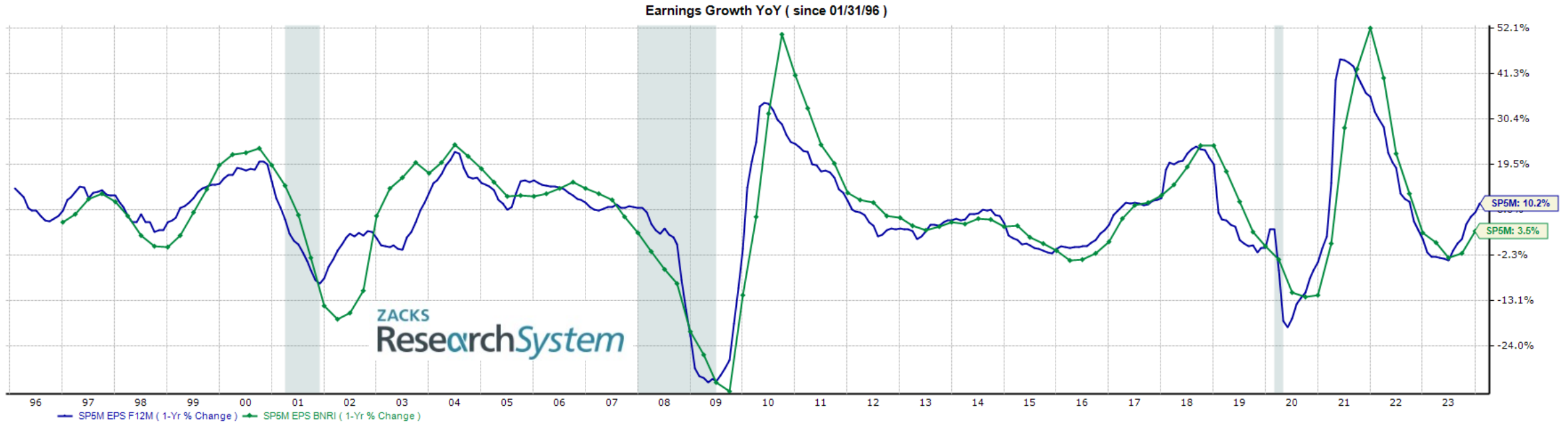
What does all this imply for stocks?

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



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
<u>S&P 500 Composite Market ETF (SP5M) P/E F12M</u>	25.92	10.56	16.56	20.74			02-28-1999	02-07-2024
<u>FEDERAL FUNDS TARGET RATE</u>	6.50	0.25	1.25	5.25	10.53%	0.40%	02-28-1999	12-31-2023

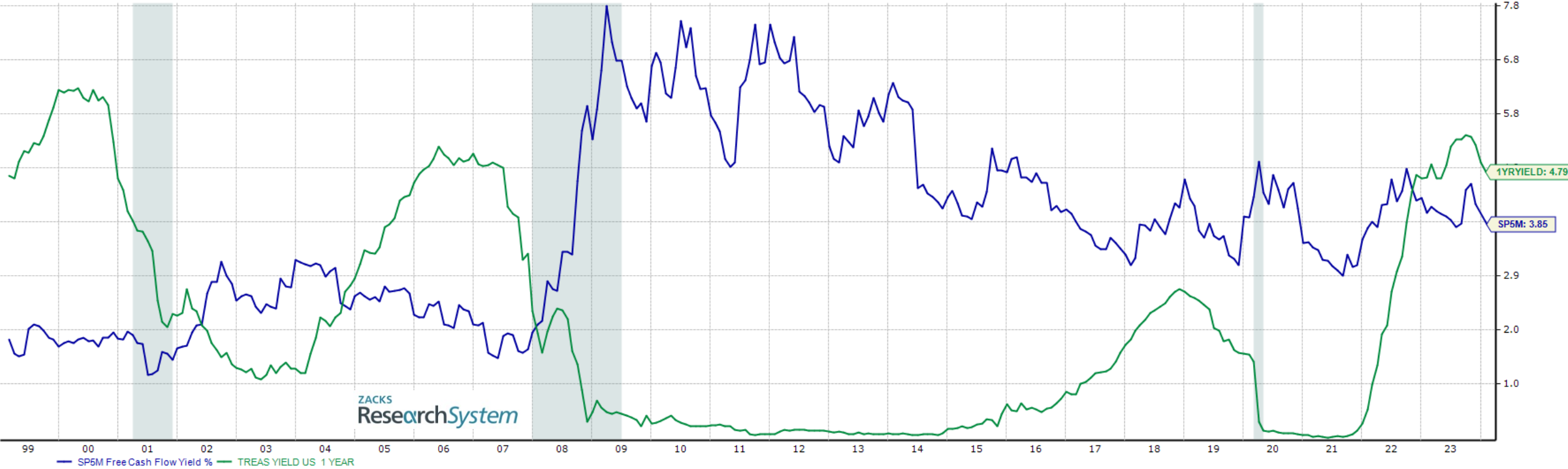
...on expectations of accelerating EPS growth in 2024 + 2025



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EPS BNRI (1-Yr % Change)	52.15%	-34.91%	7.20%	3.55%	616.65%	7.18%	12-31-1996	12-31-2023
S&P 500 Composite Market ETF (SP5M) EPS F12M (1-Yr % Change)	44.68%	-32.67%	8.20%	10.17%	718.23%	7.40%	01-31-1996	02-07-2024

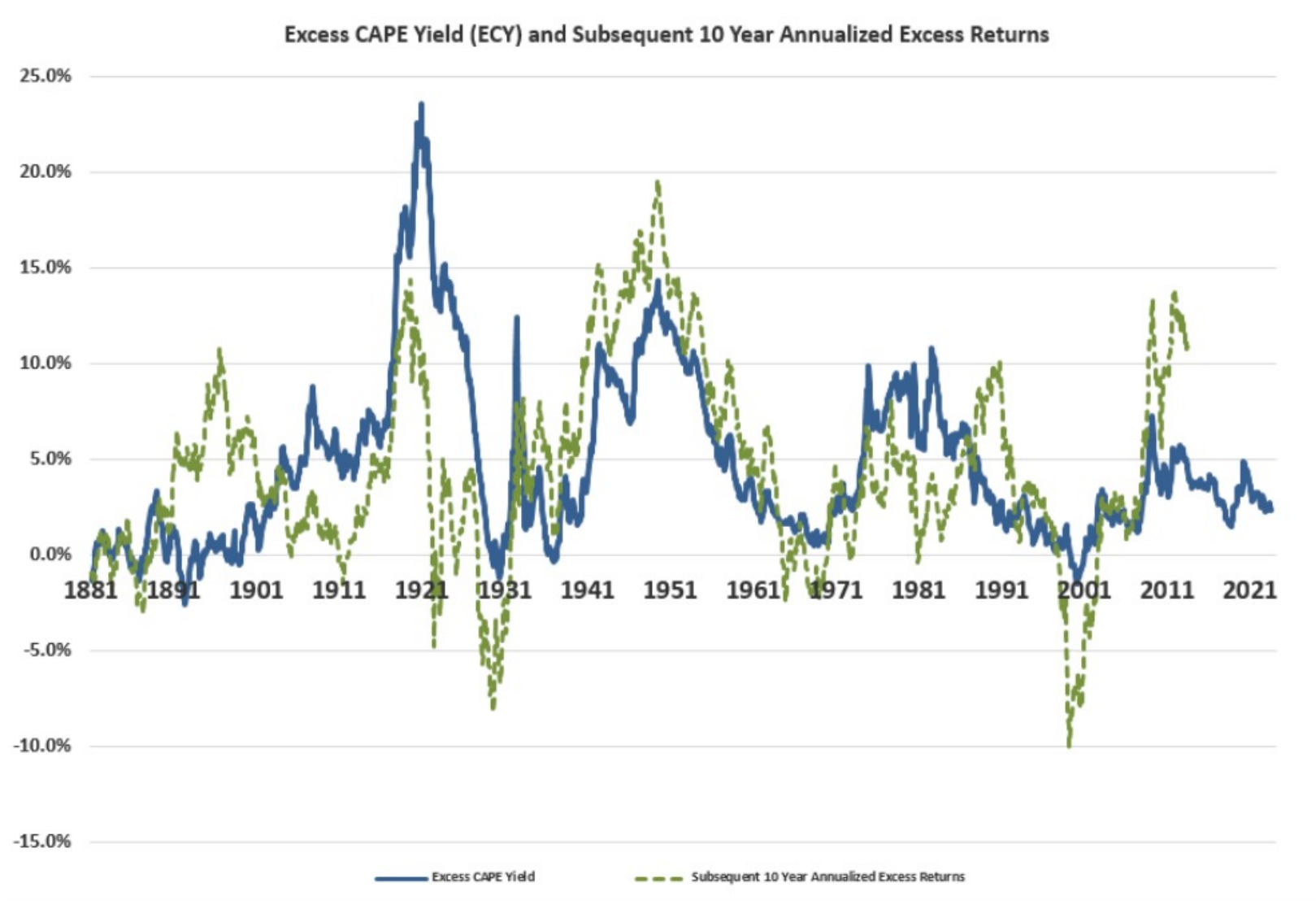


1-year UST Yield Comfortably Surpasses SPX Free Cash Flow Yield By Largest Margin Since 2007



ZACKS
ResearchSystem

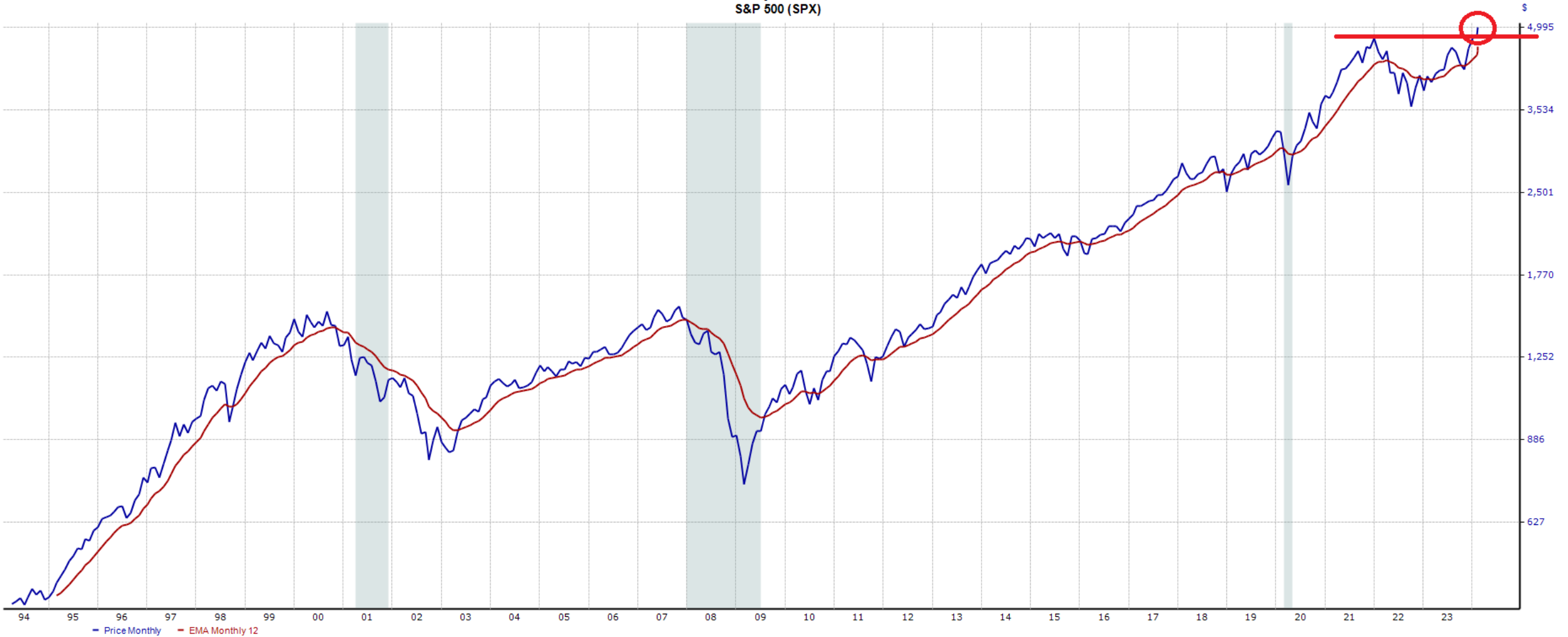
Shiller P/E Suggests Forward 5-Year Returns May Be Lackluster



However, the SPX Chart is Extremely Bullish



Technical Analysis Since 03/31/94
S&P 500 (SPX)



EPS Estimates Remain Strong, Analysts Expect Cyclical Recovery After 6 Quarters of Decelerating Growth



Strong evidence of disinflation across various measures: housing, used cars, and commodities

Easing long-term yields

Together, a 'goldilocks' blend of conditions fueling powerful market rally

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 20x.
3. If that doesn't happen, there will be a substantial drawdown.
4. Wait for the UST yield curve to re-steepen and the SPX to drop below a medium-term moving average (12-month MA, for example) for optimal recession timing

My Ideal Capital Allocation for 2024



- Big Call: remain long risk – S&P 500, Nasdaq-100 as long as it trades above its 12-month or 30-week moving average (your choice)
- Close out the long risk position and go defensive when you get a daily or weekly close below that moving average of your choice
- My Optimal Defensive Portfolio:
 - 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 (FZFX)
 - 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).

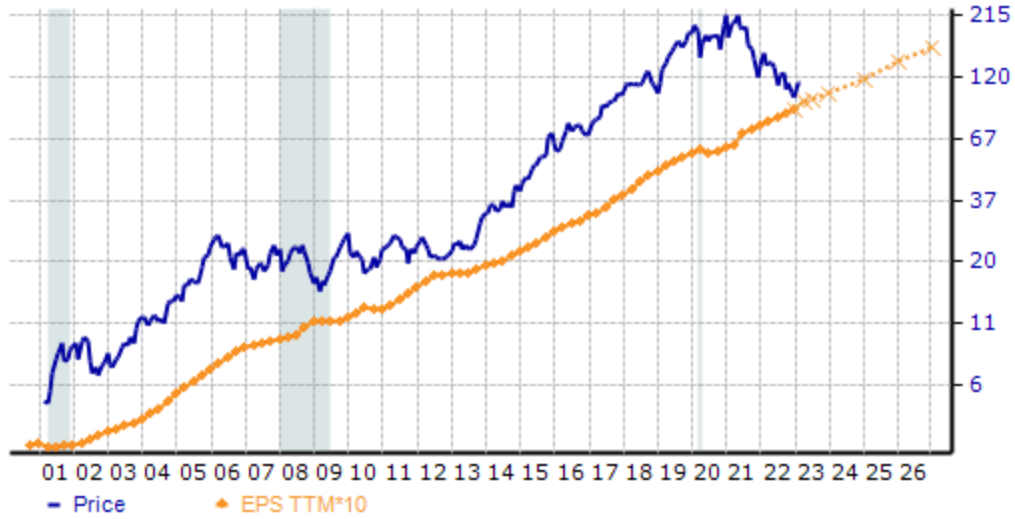
Zacks Earnings Certain Businesses





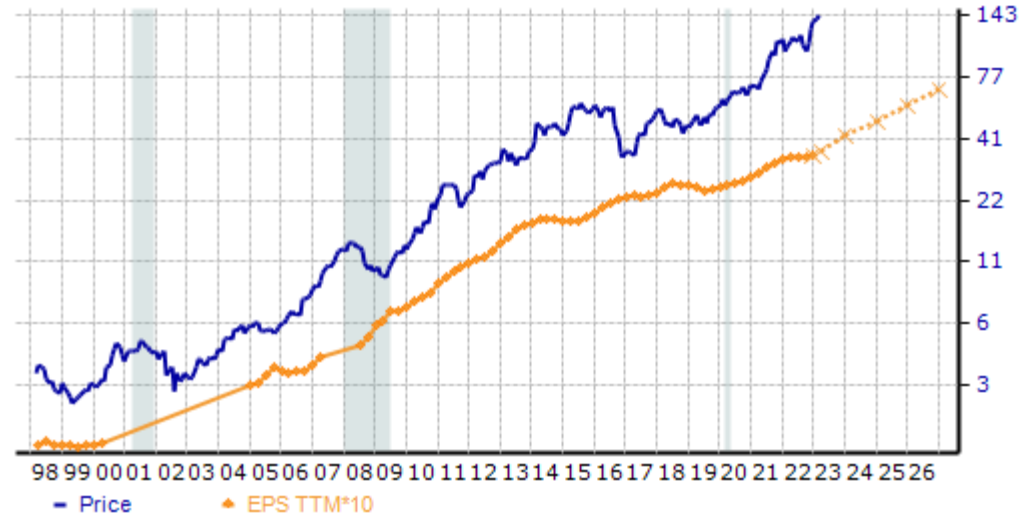
Price & Earnings GLOBAL PAYMENTS (GPN)

Price \$ | EPS*10



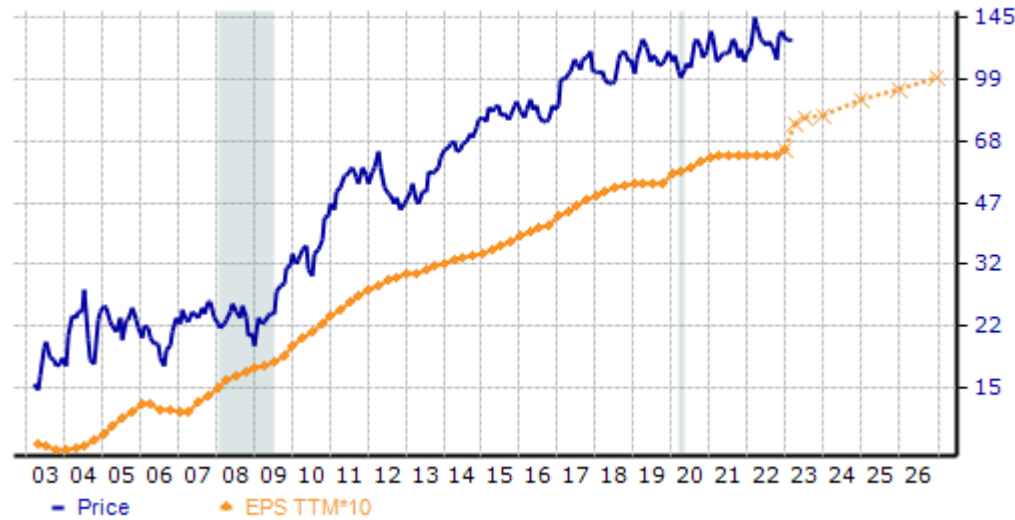
Price & Earnings NOVO-NORDISK AS (NVO)

Price \$ | EPS*10



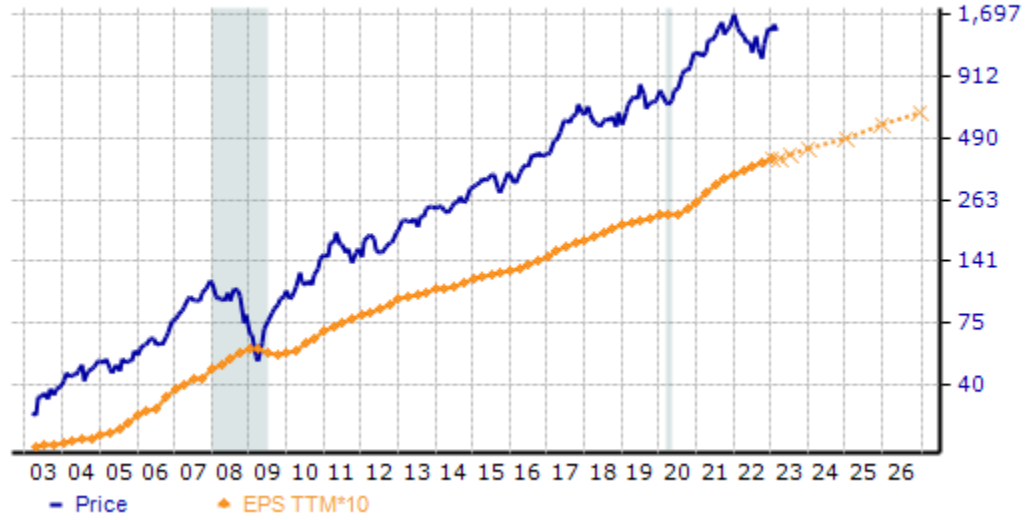
Price & Earnings CHECK PT SOFTW (CHKP)

Price \$ | EPS*10



Price & Earnings METTLER-TOLEDO (MTD)

Price \$ | EPS*10



Thank You for Attending!



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