Macro Update: May 2024

Risks To the Equity Bull Market Continue to Pile On

Presented by:

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May 2024

Disclosures

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Why I still believe we are working towards recession

- **MANUFACTURING: has been in recession for 18 months**
- **INVERTED YIELD CURVE: 10y-2y UST yield curve inversion has persisted for 23 months**
- **CONSUMER WEAKNESS: excess savings depleted, negative real average weekly earnings, sharply rising debt delinquency rates**
- **EMPLOYMENT: leading indicators of employment entering contraction: permanent job losers, leading cyclical employment, full-time jobholders, gap between Establishment and Household Surveys, and Q3 Business Employment Dynamics report**
- **CREDIT: credit contraction, rising loan loss provisions, tightening credit standards, rising credit card delinquencies**
- **Corporate profit growth, outside of big tech, still mostly explained by inflation**
- **Inflation primarily remnants of housing and services**

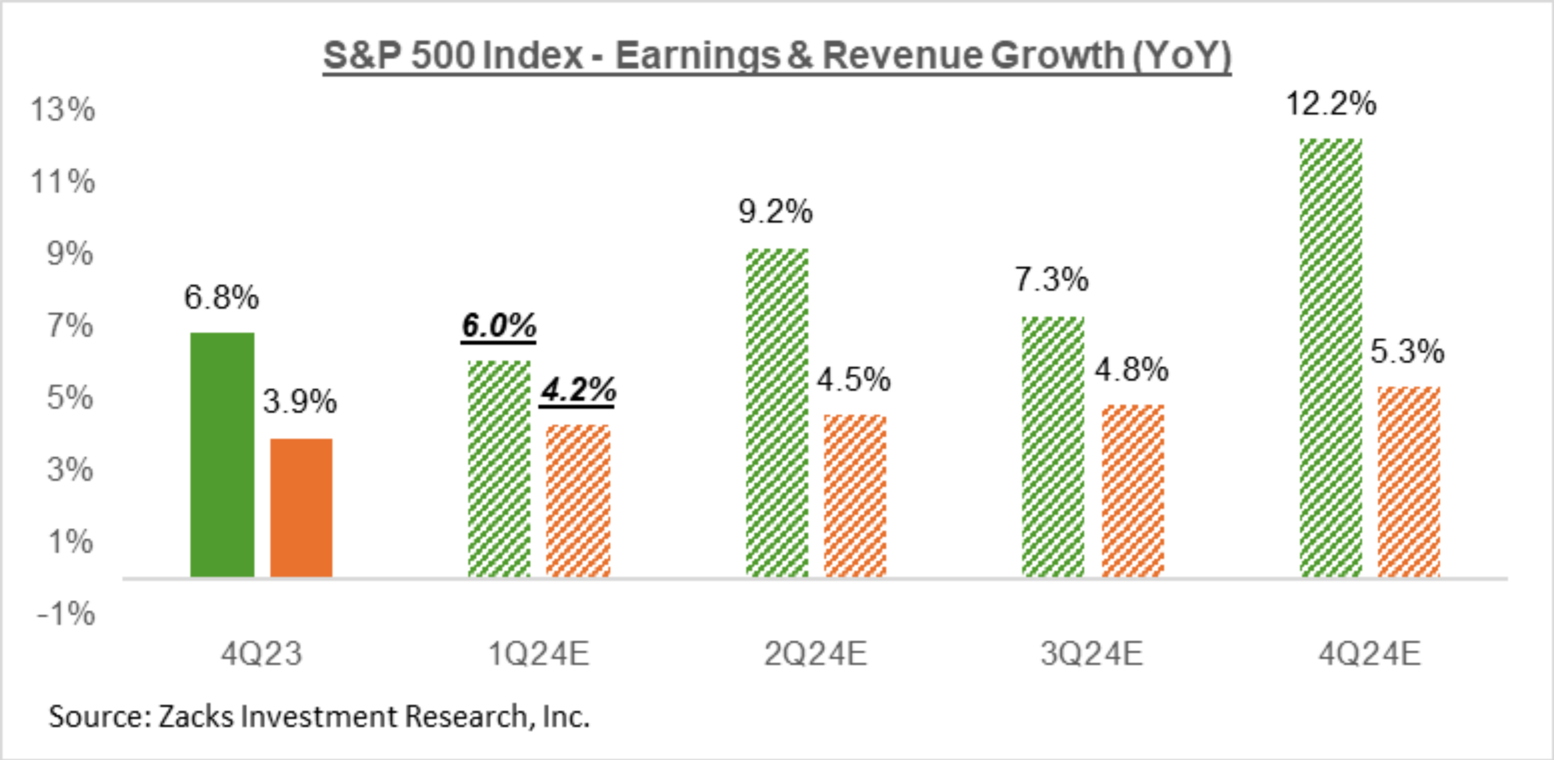
Earnings Recap: Q1 2024

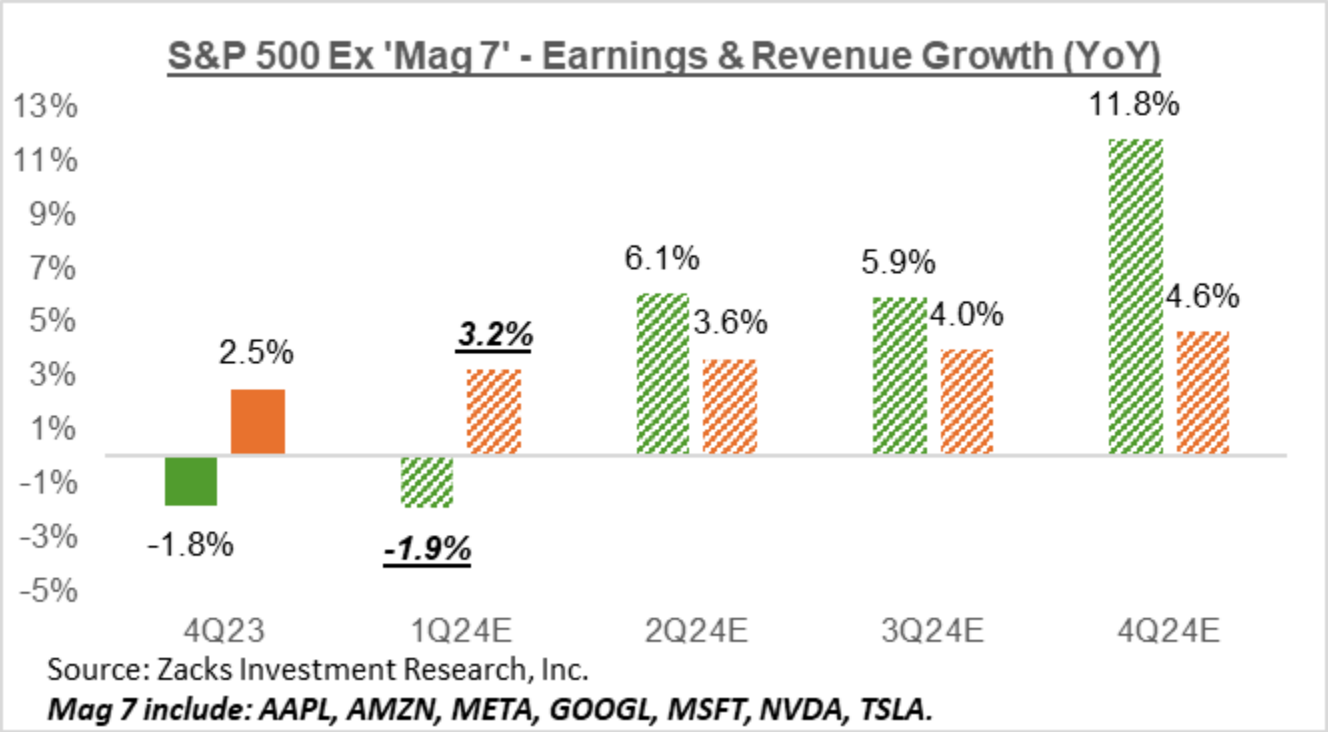
- Of the 461 S&P 500 companies who have reported,
  - EPS +4.8% YoY, 77.4% beat rate
  - Revenue +4.1% YoY, 59.7% beat rate
  - EPS growth improves to +9.0% excluding energy

- However, majority of Q1 growth is attributable to megacap tech:
  - EPS -1.9% YoY
  - Revenue +3.2%

- Overall FY 2024 growth is expected to be:
  - EPS +9.0%, and +6.4% excluding tech
  - Revenue +1.6%

Source: Zacks Professional Services, www.zackspro.com

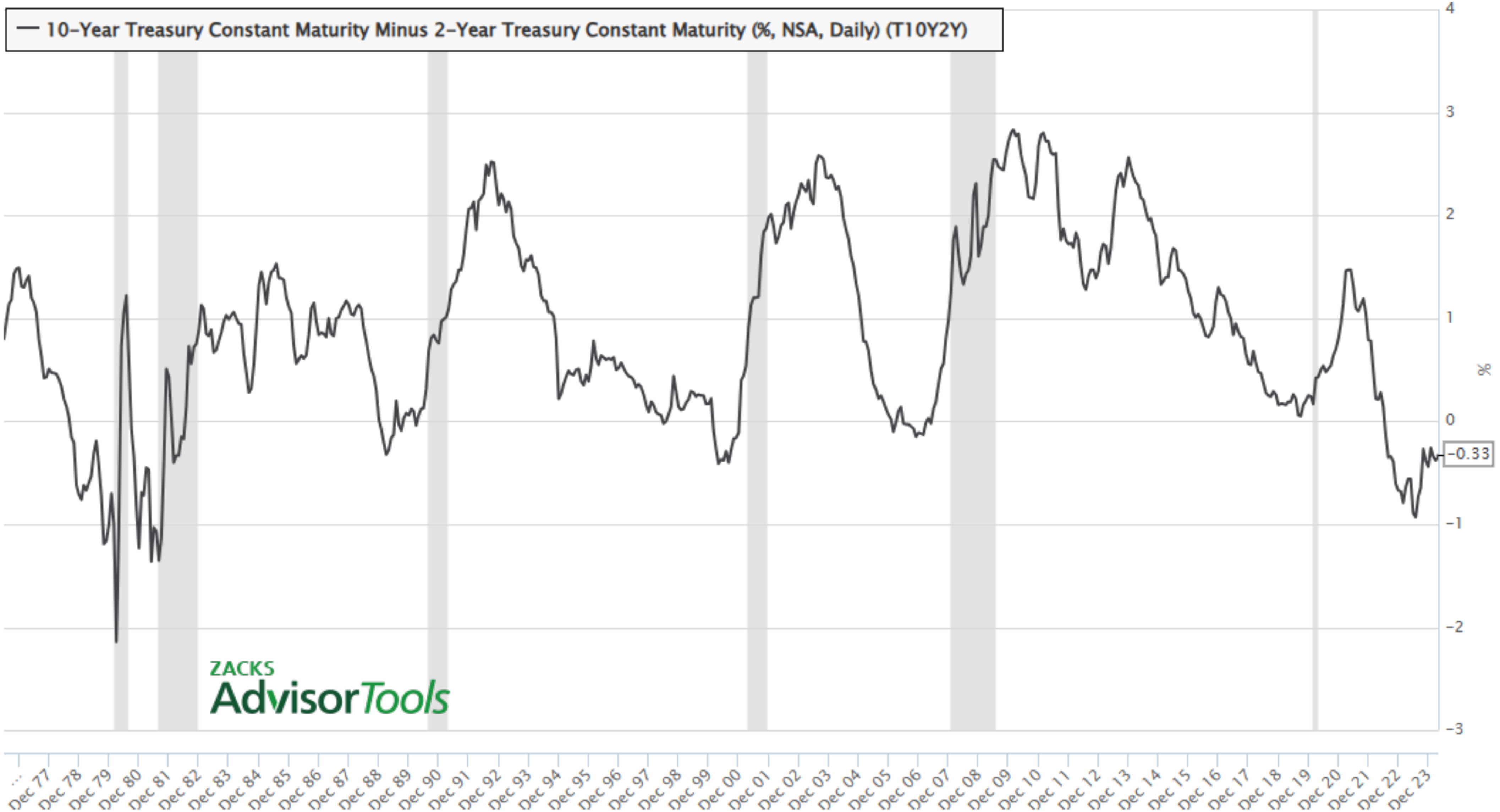

S&P 500 Index - Earnings & Revenue Growth (YoY)
13%
11%
9%
7%
5%
3%
1%
-1%
6.8%
3.9%
6.0%
4.2%
9.2%
4.5%
7.3%
4.8%
12.2%
5.3%
4Q23
1Q24E
2Q24E
3Q24E
4Q24E
Source: Zacks Investment Research, Inc.


S&P 500 Ex 'Mag 7' - Earnings & Revenue Growth (YoY)
13%
11%
9%
7%
5%
3%
1%
-1%
-3%
-5%
-1.8%
2.5%
-1.9%
3.2%
6.1%
3.6%
5.9%
4.0%
11.8%
4.6%
4Q23
1Q24E
2Q24E
3Q24E
4Q24E
Source: Zacks Investment Research, Inc.
Mag 7 include: AAPL, AMZN, META, GOOGL, MSFT, NVDA, TSLA.


Evolution of Aggregate 2024 Earnings (S&P 500 - Billion $)
2180
2160
2140
2120
2100
2080
2060
2040
2020
2000
1980
2,104
2,094
2,084
2,096
2,116
2,123
2,123
2,121
2,108
2,094
2,087
2,092
2,094.3
5/17
6/21
7/26
8/16
9/13
9/27
10/11
10/18
11/1
12/1
2/1
4/17
Today
Source: Zacks Investment Research, Inc.

The earnings environment is that of stable growth, primarily powered by big tech but with assistance from consumer discretionary, big banks, and retail.

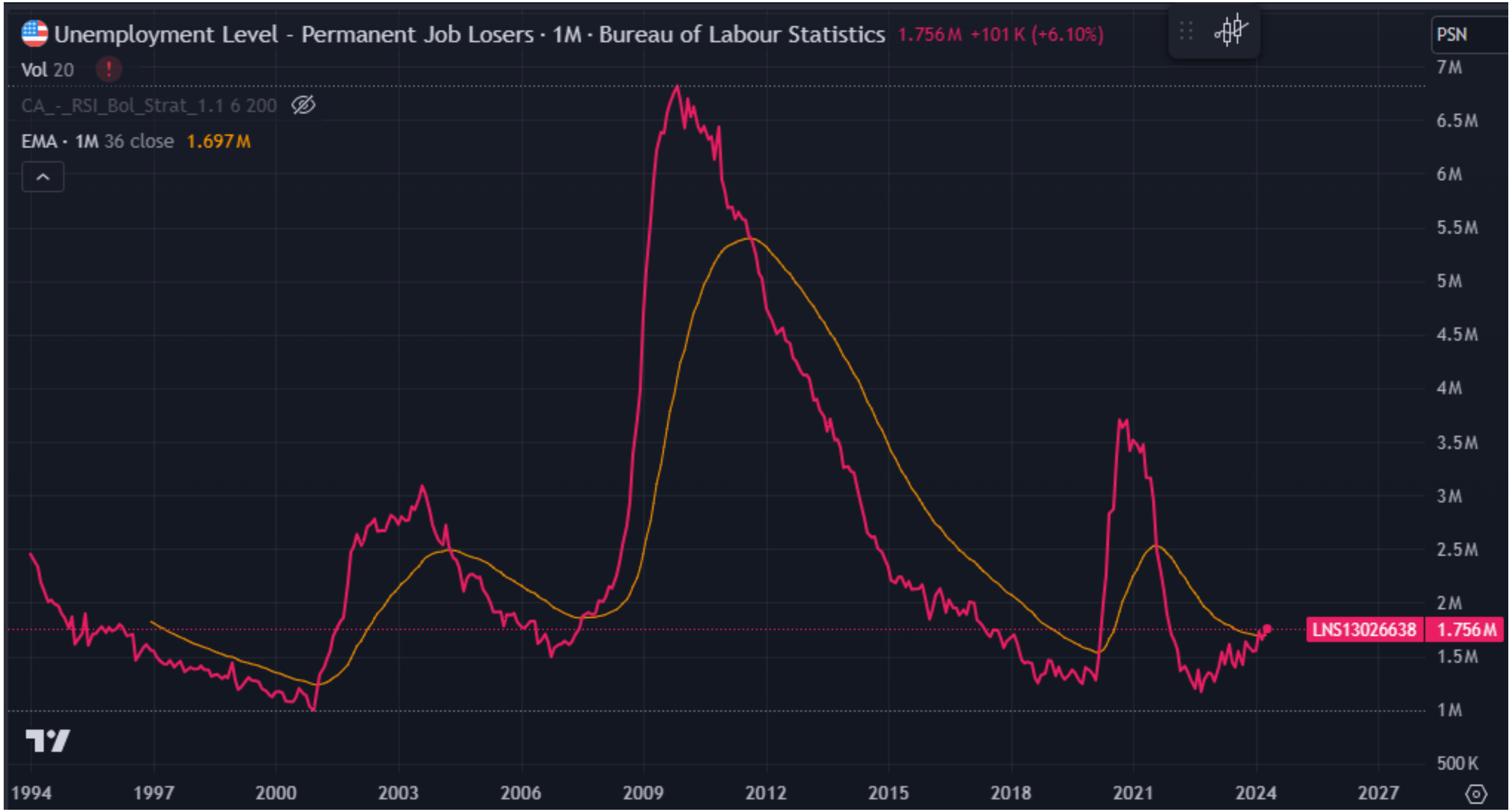
May 2024 will be the 24th month of 10yr-2yr UST Yield Spread Inversion



Source: Zacks Professional Services, www.zackspro.com

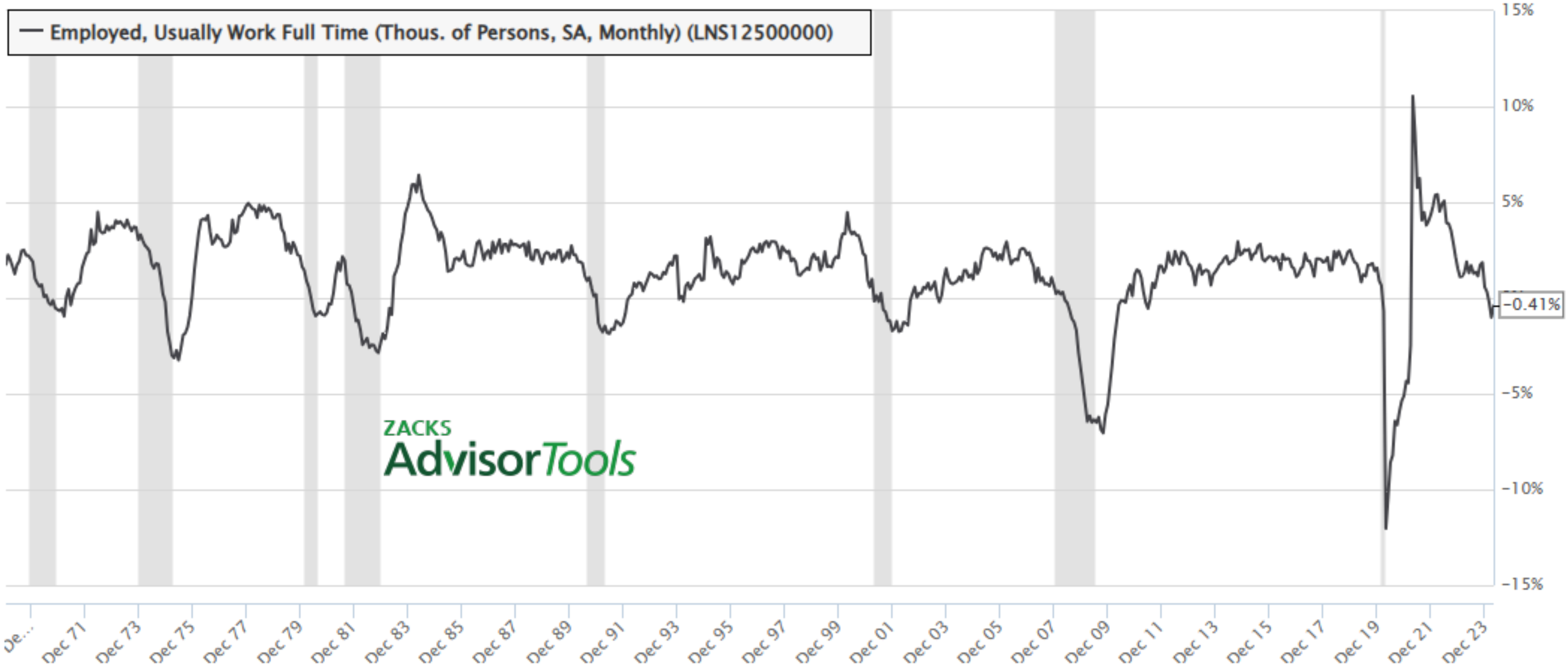
JOB MARKET

Permanent Job Losers Crosses Above 3-yr Moving Avg



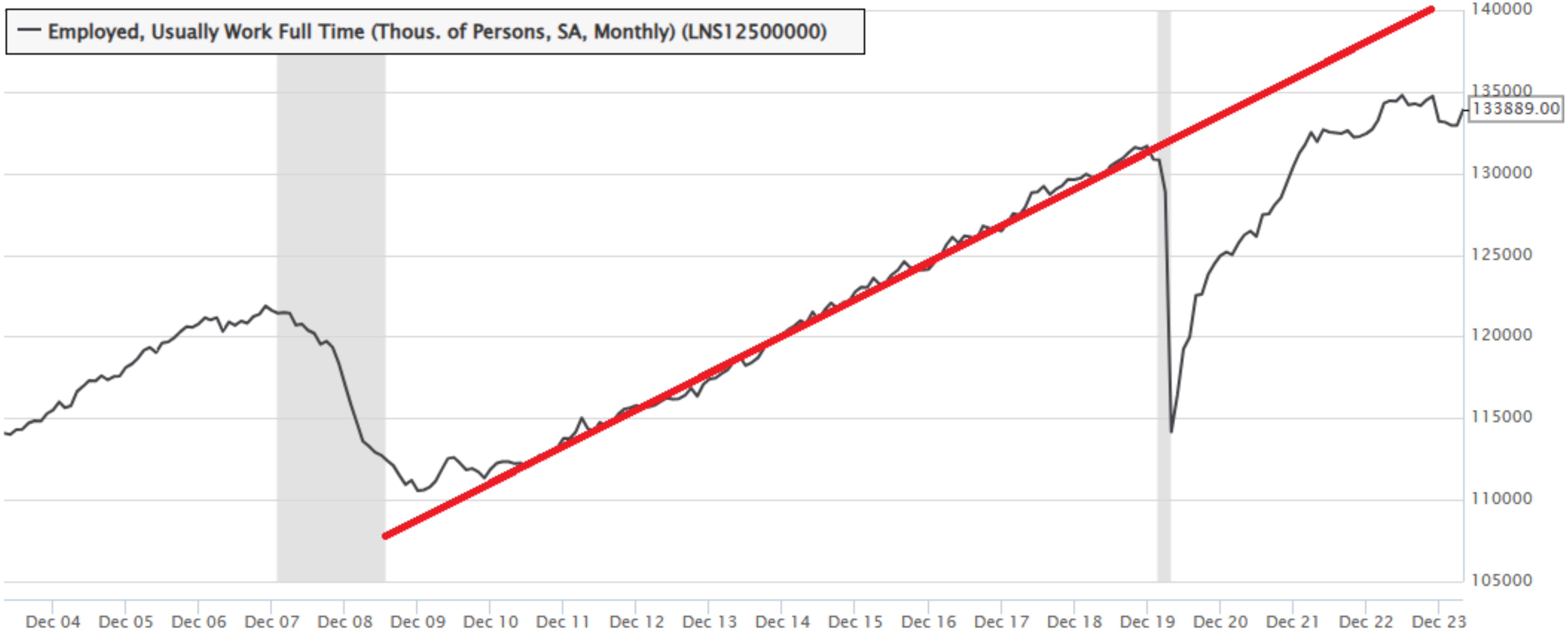
Source: US BLS, TradingView

900k Fewer Full-Time Jobholders Since June 2023 Peak; -0.4% YoY in April, Third Consecutive Month of Contraction



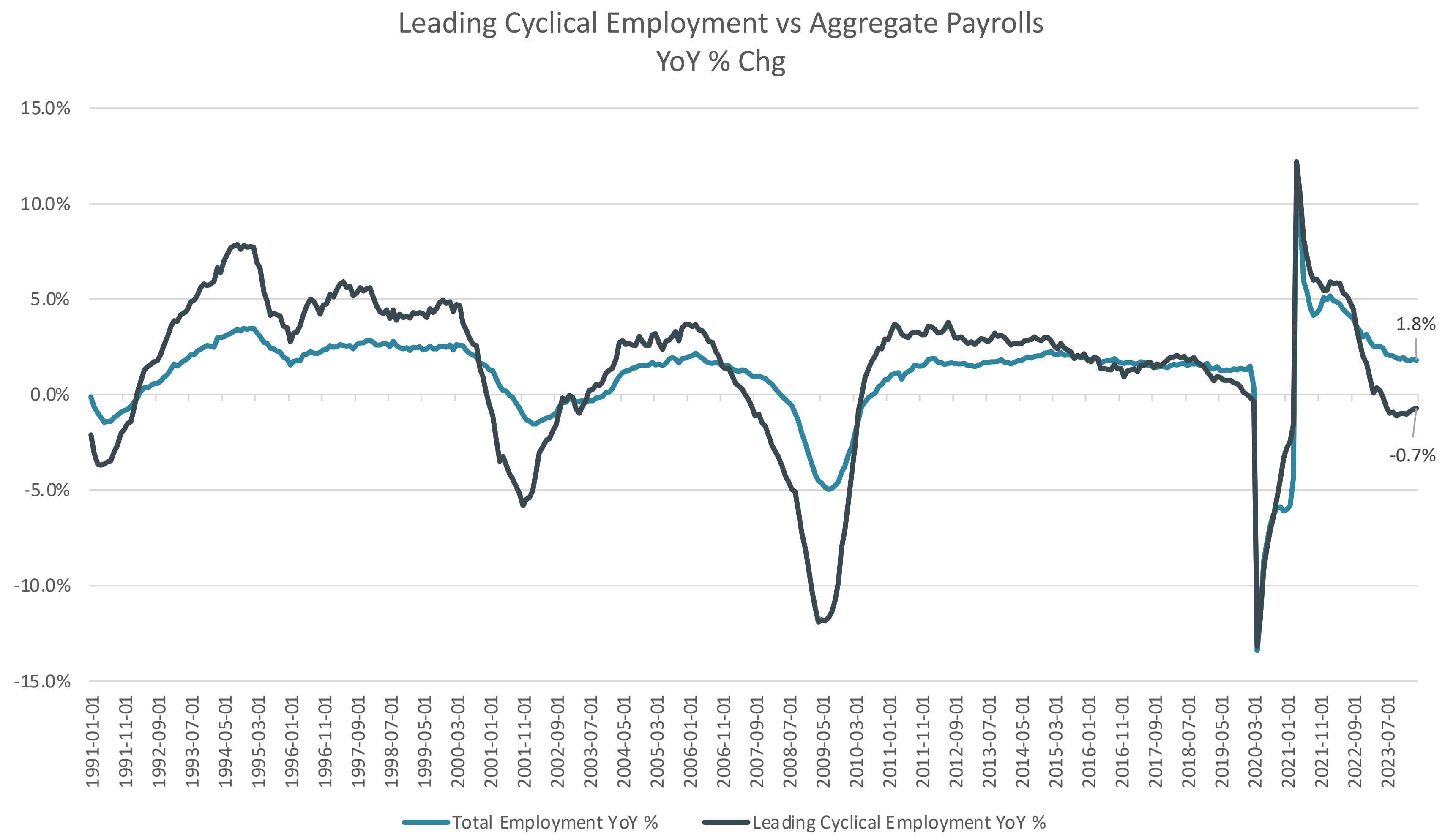
Source: Zacks Professional Services, www.zackspro.com

Full-Time Jobs Down -900k from June 2023 Peak & Well Below Pre-Pandemic Trend



Source: Zacks Professional Services, www.zackspro.com

Aggregate Payrolls at+1.8% YoY Despite Downward Revisions
Leading Cyclical Employment Posts 11th Consecutive Month of YoY Contraction

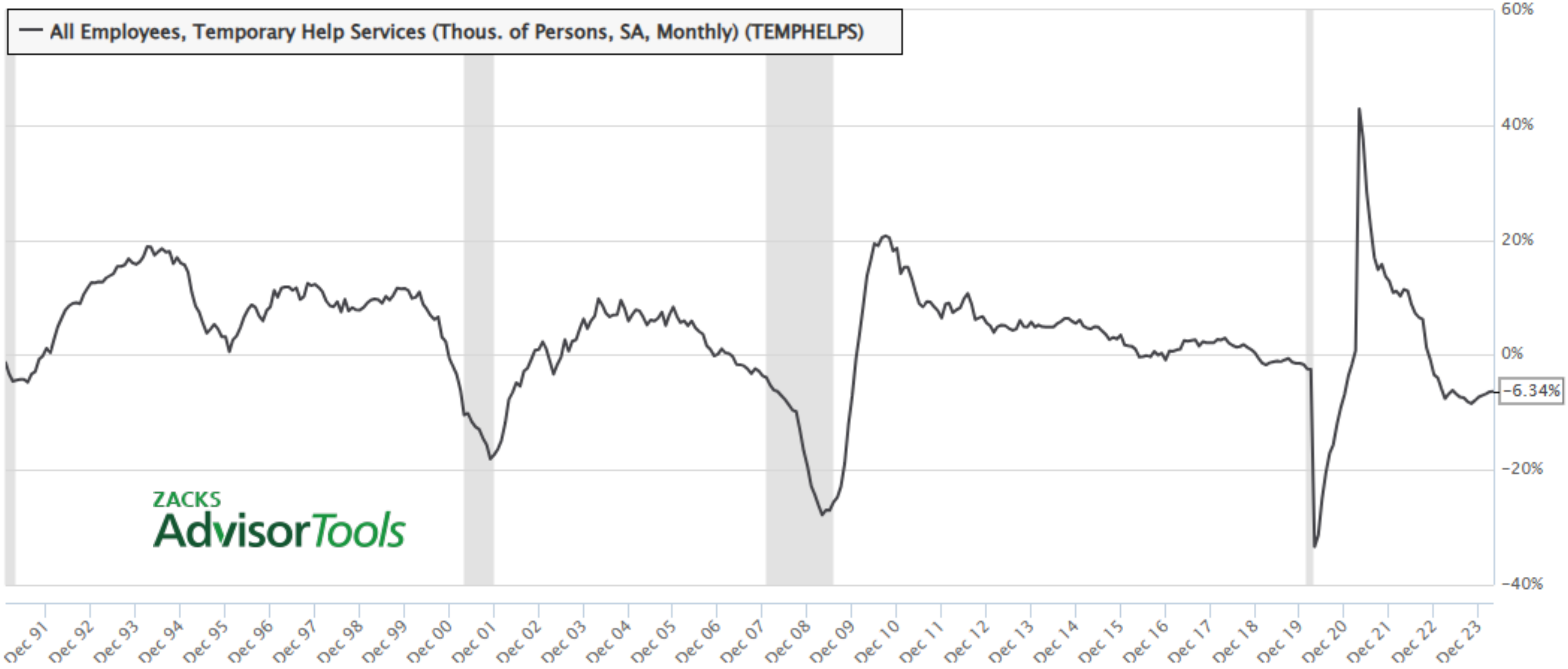


Leading cyclical industries include:

— Plastics and Rubber Products Manufacturing
—Building Material and Garden Equipment Dealers
—Trucking
—Administrative
—Durable Goods Wholesalers
—Residential Building Construction

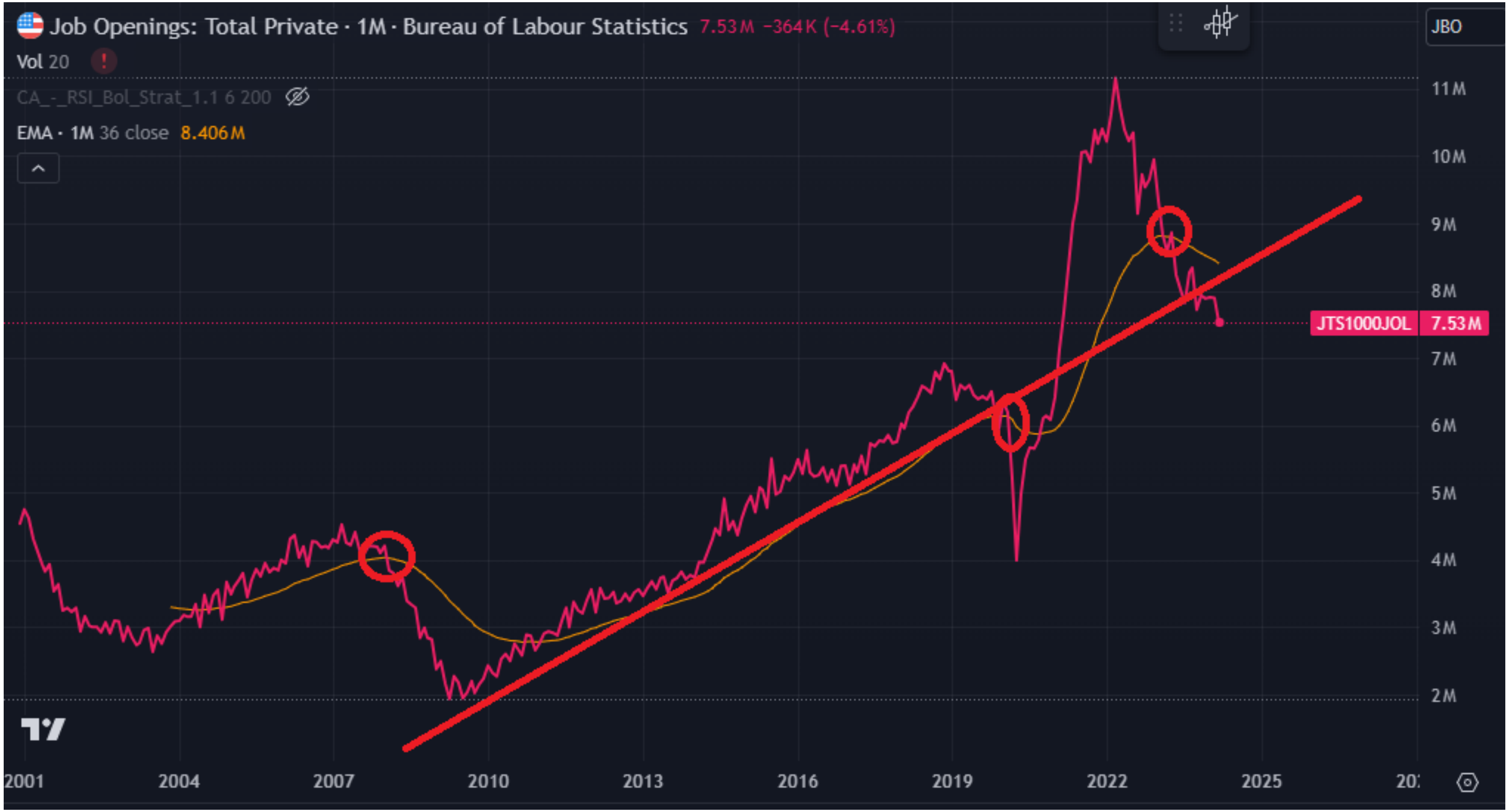
These industries have a history of turning ahead of the broader business cycle because they are inherently more sensitive to changes in aggregate demand than other, more durable industries such as education, healthcare, and government.

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



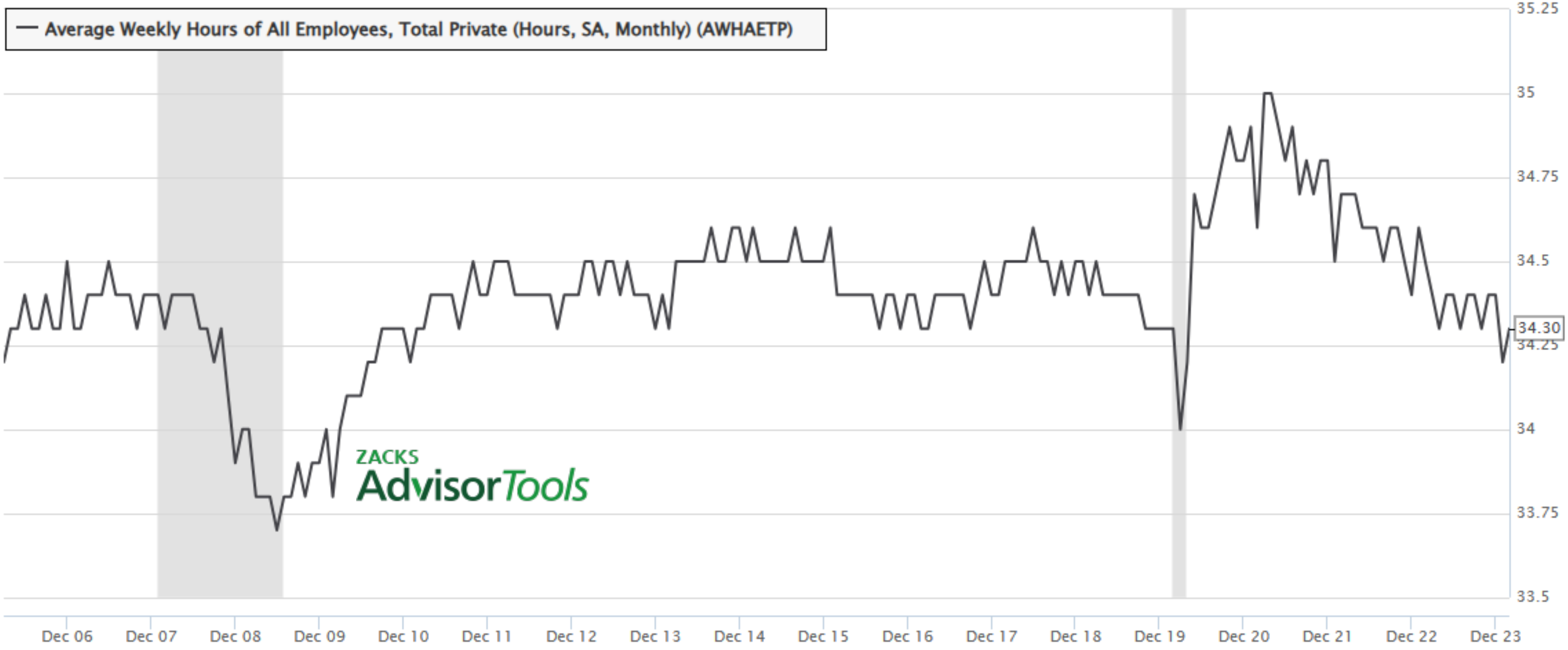
Job Openings (JOLTS) At Cycle Lows

Well below 3-yr moving average and 10-yr trend, which has only occurred at the start of past recessions



Source: TradingView, Bureau of Labor Statistics

Average Weekly Hours Therefore In Rapid Decline, Consistent with Recession

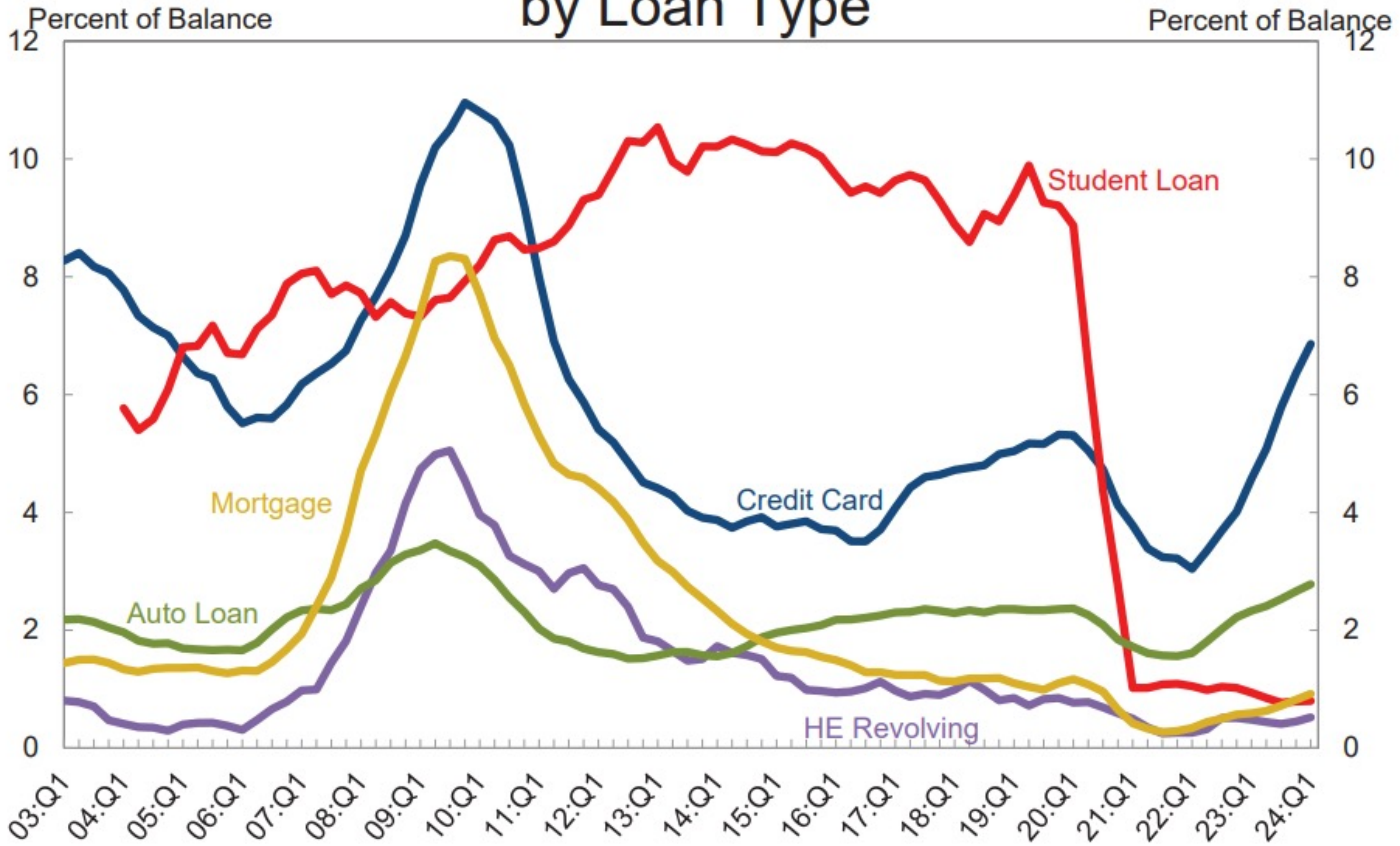


Source: Zacks Professional Services, www.zackspro.com

Leading employment indicators & conditions are pointing to a rapidly deteriorating job market.

This could be why consumers are increasingly delinquent on credit card payments and auto loans.

Transition into Serious Delinquency (90+) by Loan Type

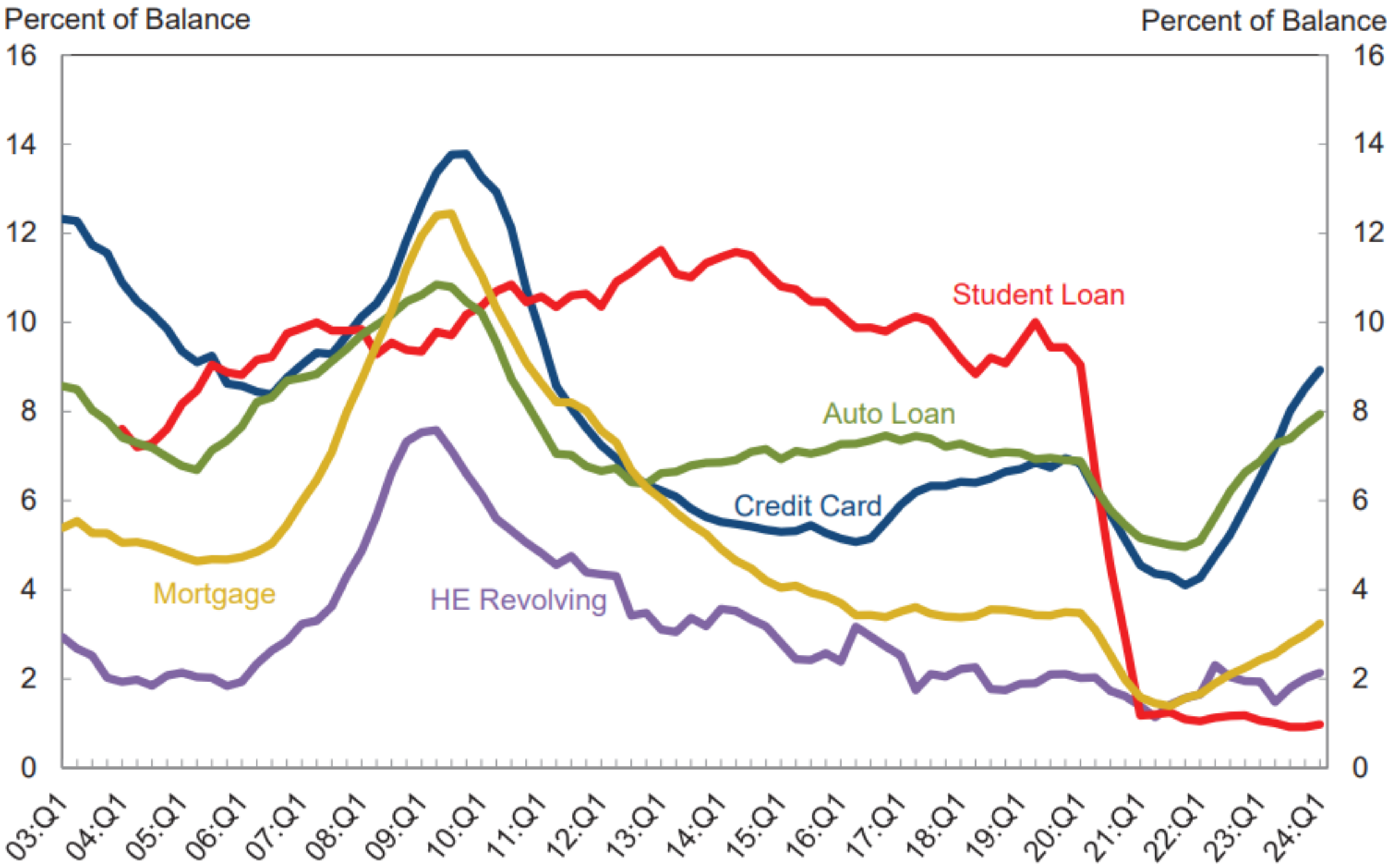


Note: 4 Quarter Moving Sum

Source: New York Fed Consumer Credit Panel/Equifax

Student loan data are not reported prior to 2004 due to uneven reporting

Transition into Delinquency (30+) by Loan Type



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

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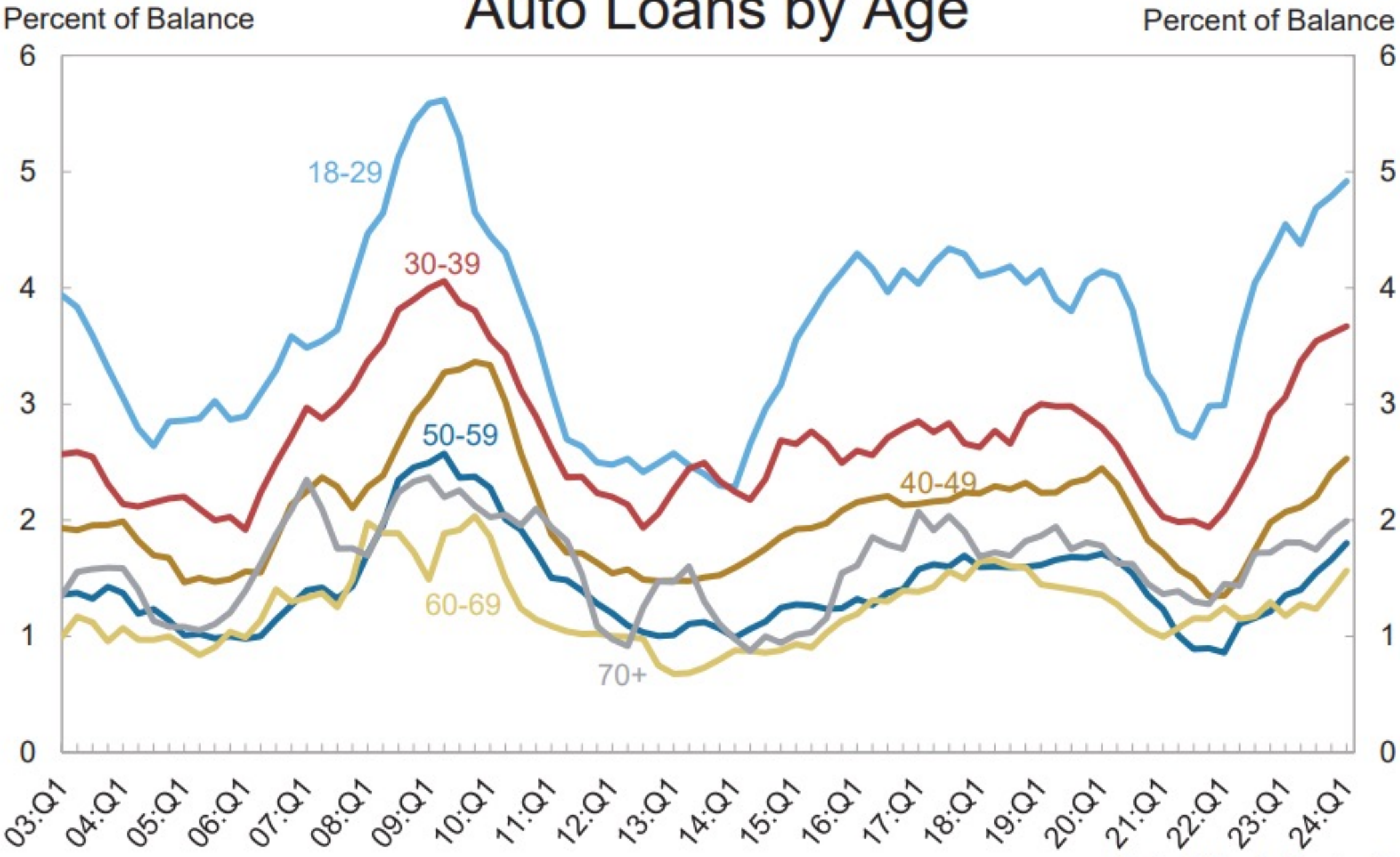
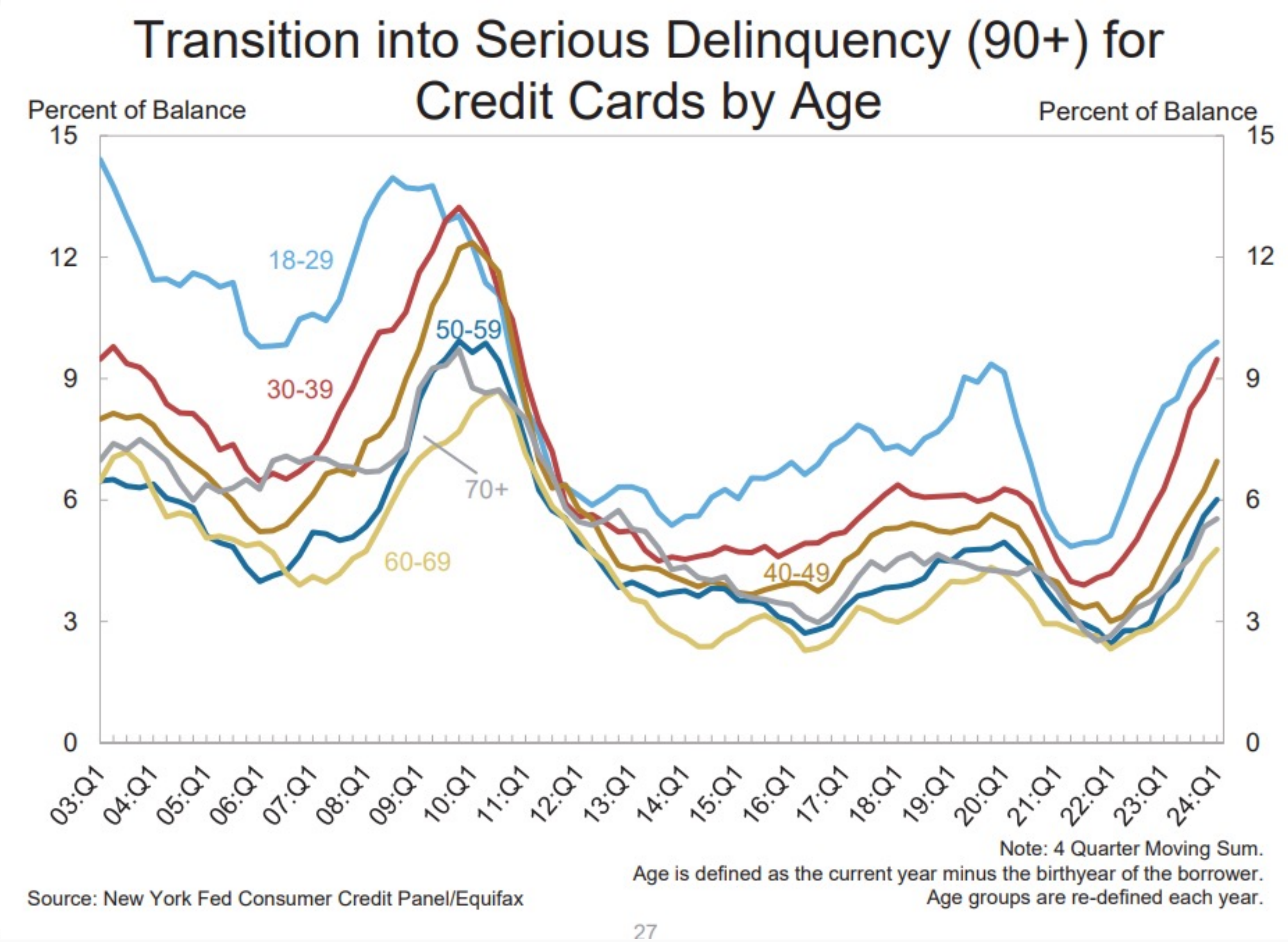
Transition into Serious Delinquency (90+) for Auto Loans by Age



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.

Source: New York Fed Consumer Credit Panel/Equifax


Transition into Serious Delinquency (90+) for Credit Cards by Age
Percent of Balance
Percent of Balance
15
12
9
6
3
0
18-29
30-39
40-49
50-59
60-69
70+
03:Q1
04:Q1
05:Q1
06:Q1
07:Q1
08:Q1
09:Q1
10:Q1
11:Q1
12:Q1
13:Q1
14:Q1
15:Q1
16:Q1
17:Q1
18:Q1
19:Q1
20:Q1
21:Q1
22:Q1
23:Q1
24:Q1
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.
Source: New York Fed Consumer Credit Panel/Equifax
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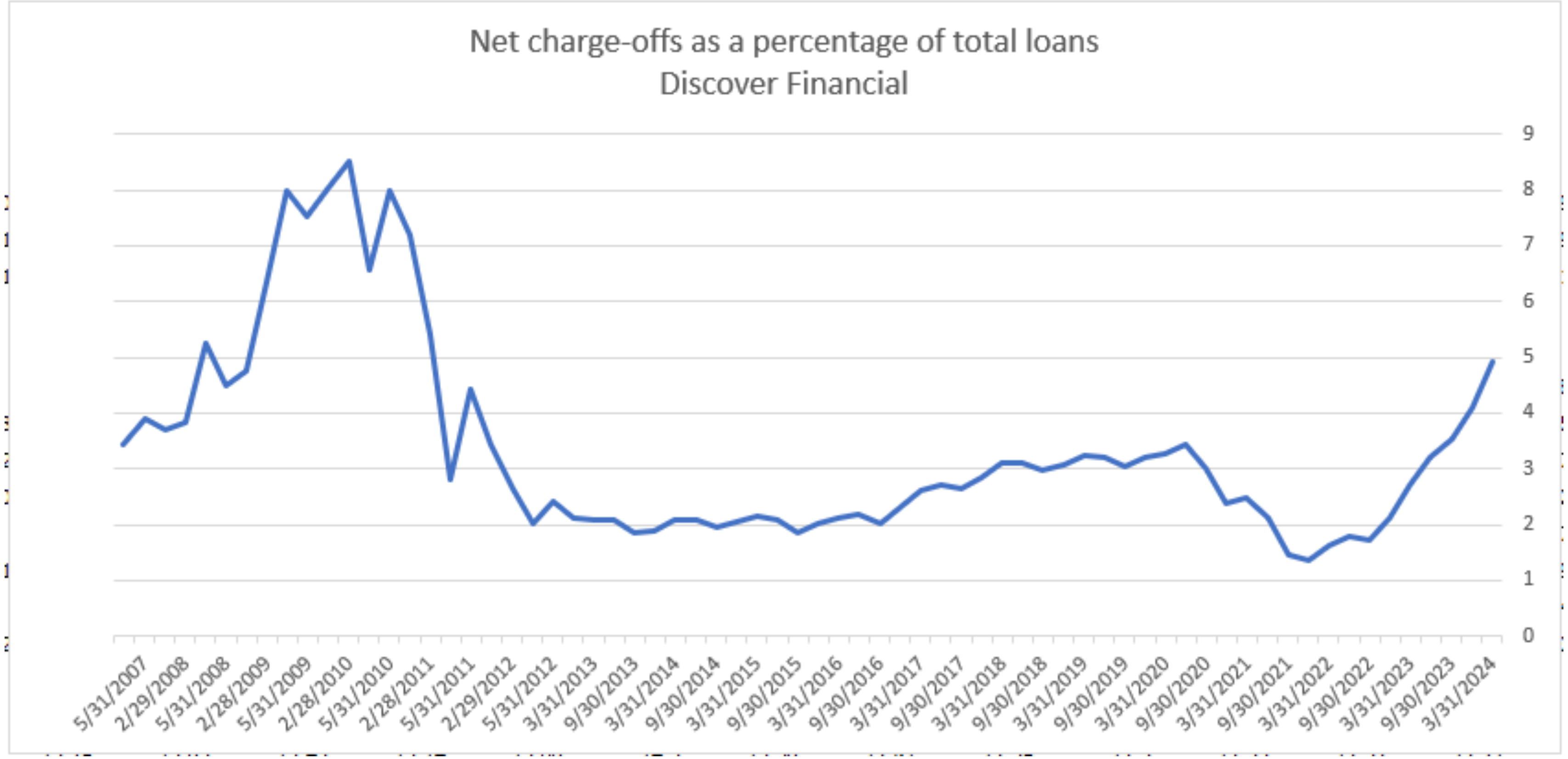
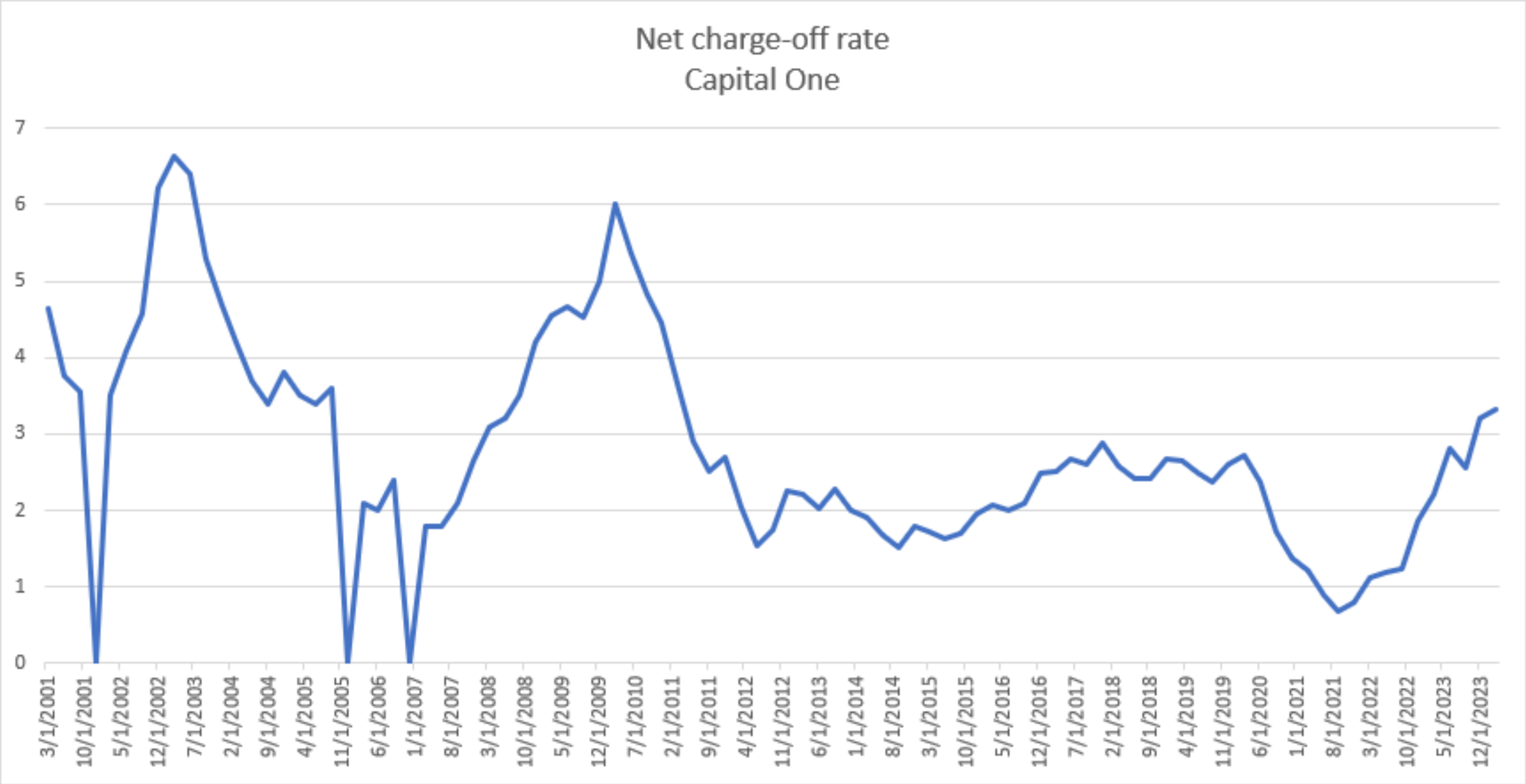
Discover and Capital One Reporting Escalating Charge-Offs Consistent with Past Recessions

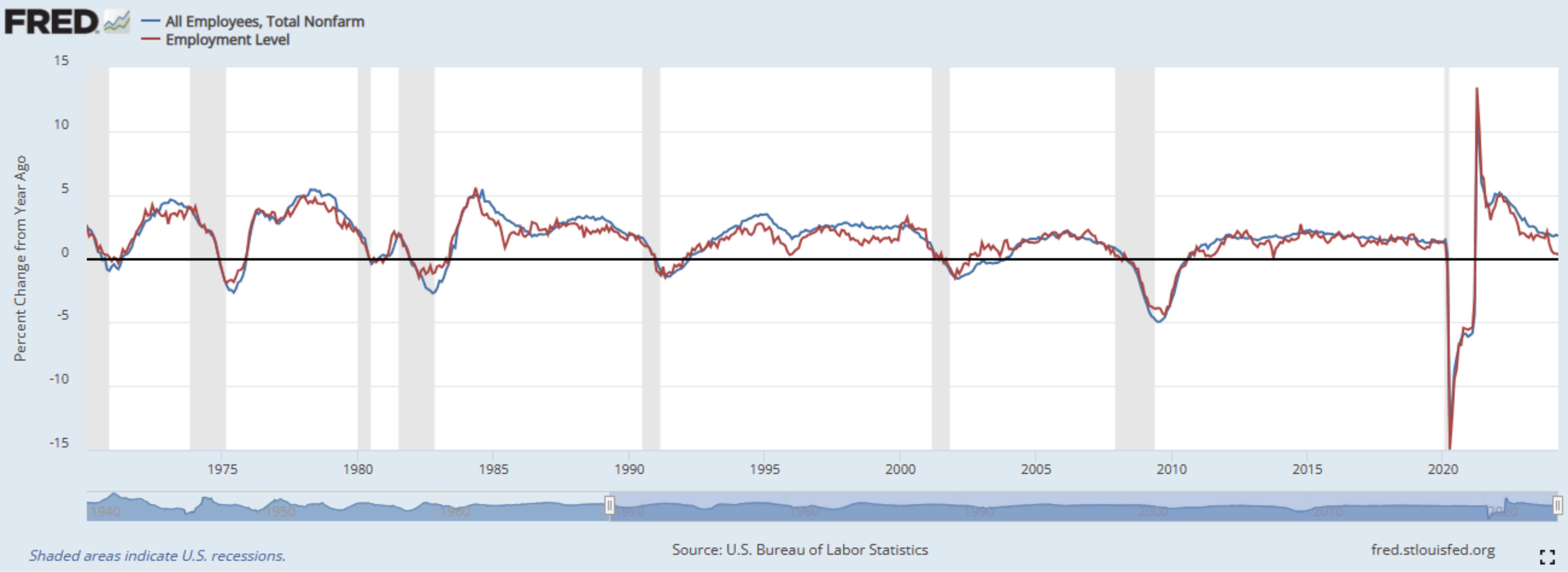


Source: Zacks Professional Services, www.zackspro.com

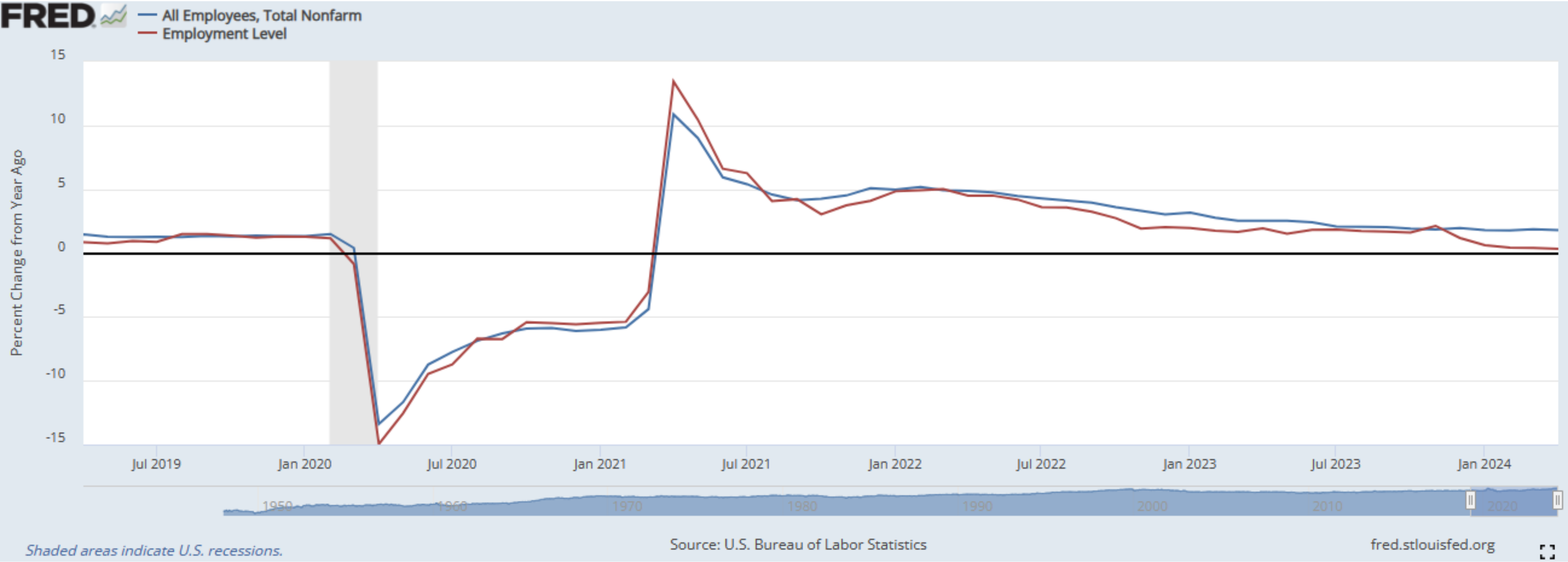


Source: Zacks Professional Services, www.zackspro.com

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



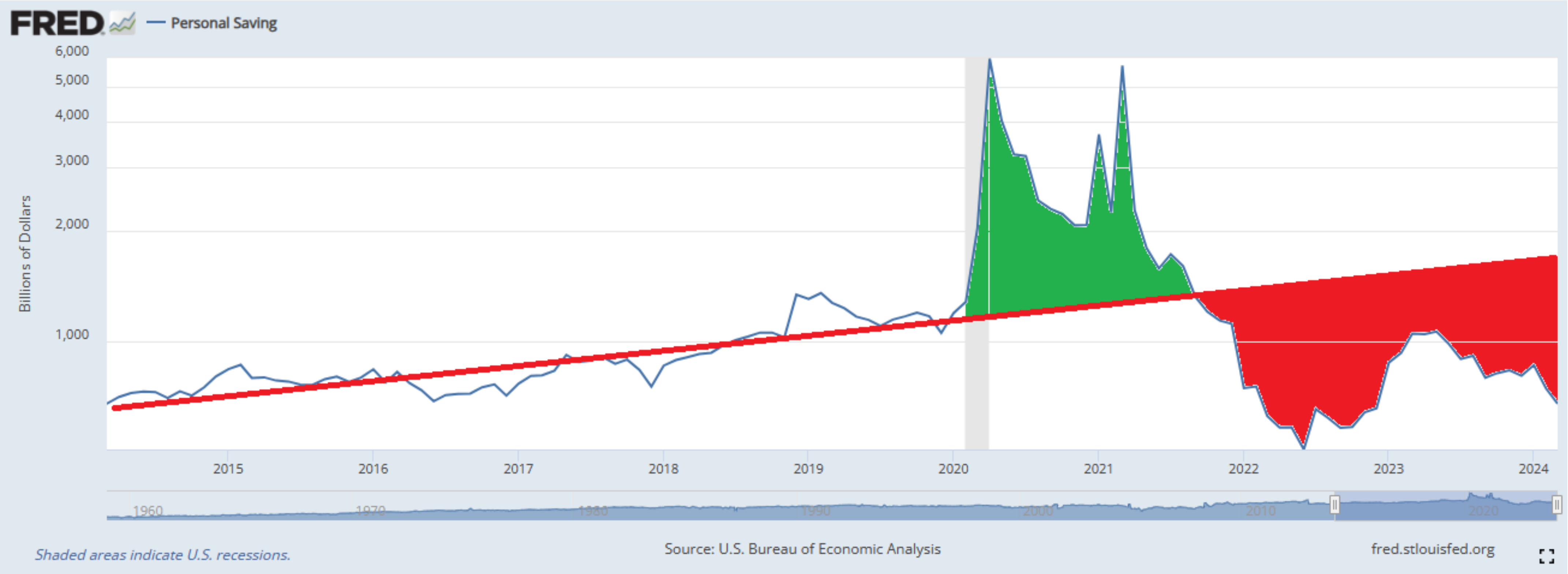
Source: Federal Reserve of St Louis, BLS



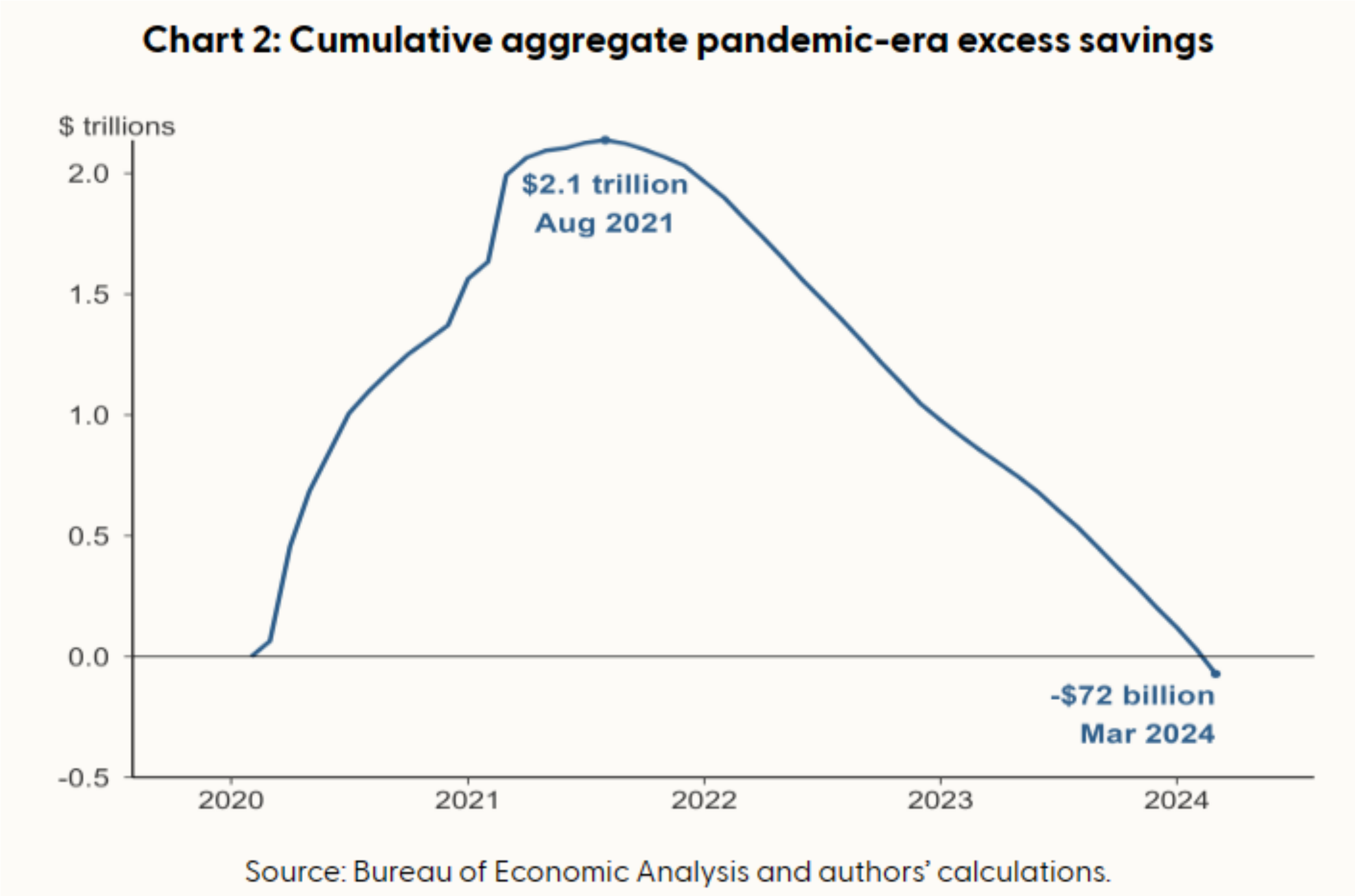
Source: Federal Reserve of St Louis, BLS

EXCESS SAVINGS

Real Personal Consumption > Real Personal Income, which means pandemic-era excess savings have been drawn down and will be exhausted by 1H 2024



Source: San Francisco Fed

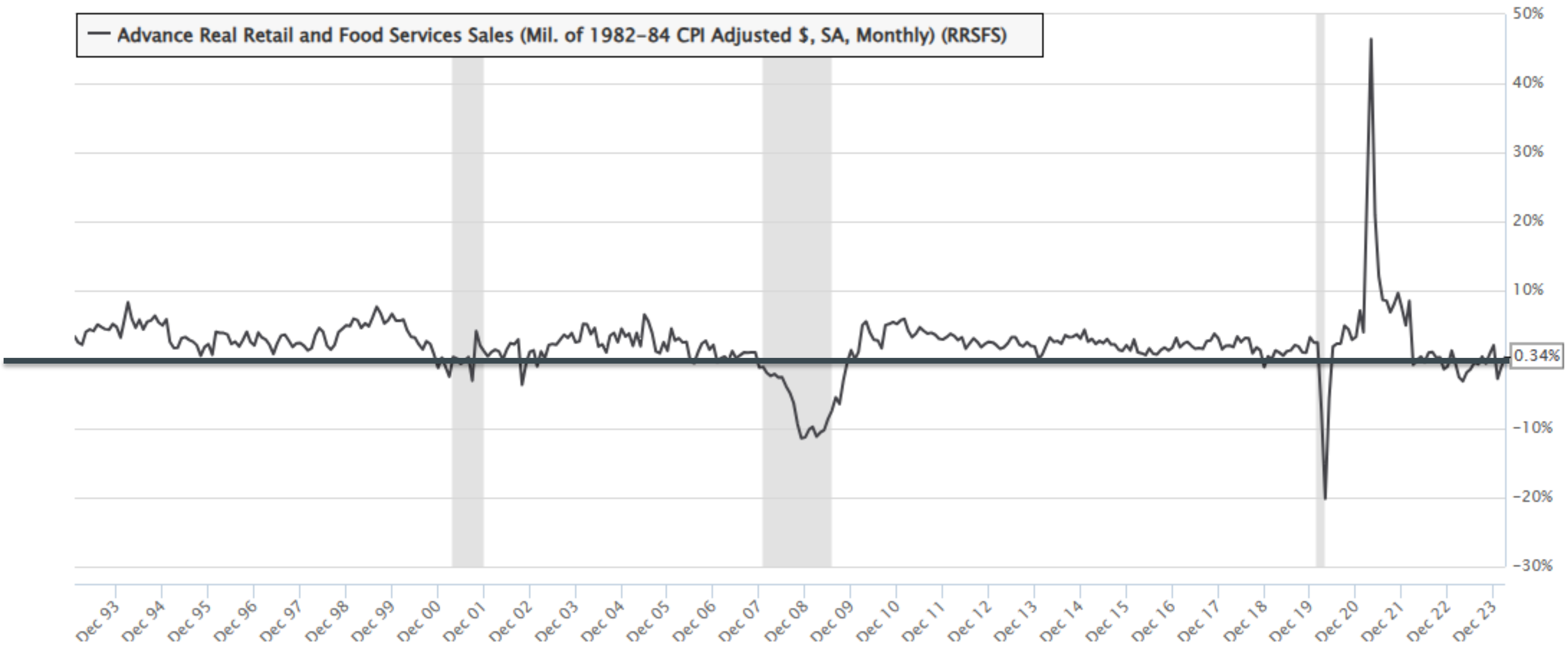


Sources: San Francisco Fed, Bureau of Economic Analysis

Rising joblessness, significantly depleted personal savings, and flat real average weekly earnings are together having an impact which is manifesting in sharply rising delinquency rates.

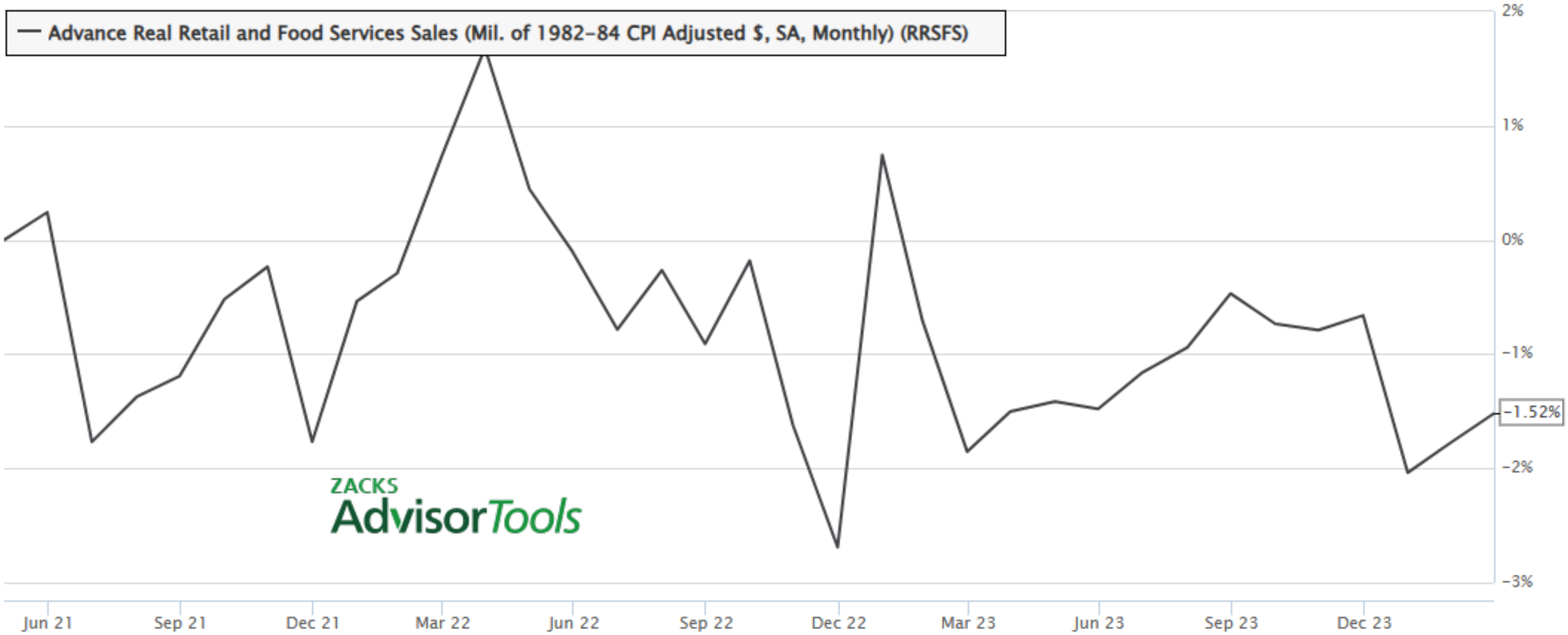
I believe this will begin impacting retail sales.

Real Retail Sales Teetering at 0% YoY



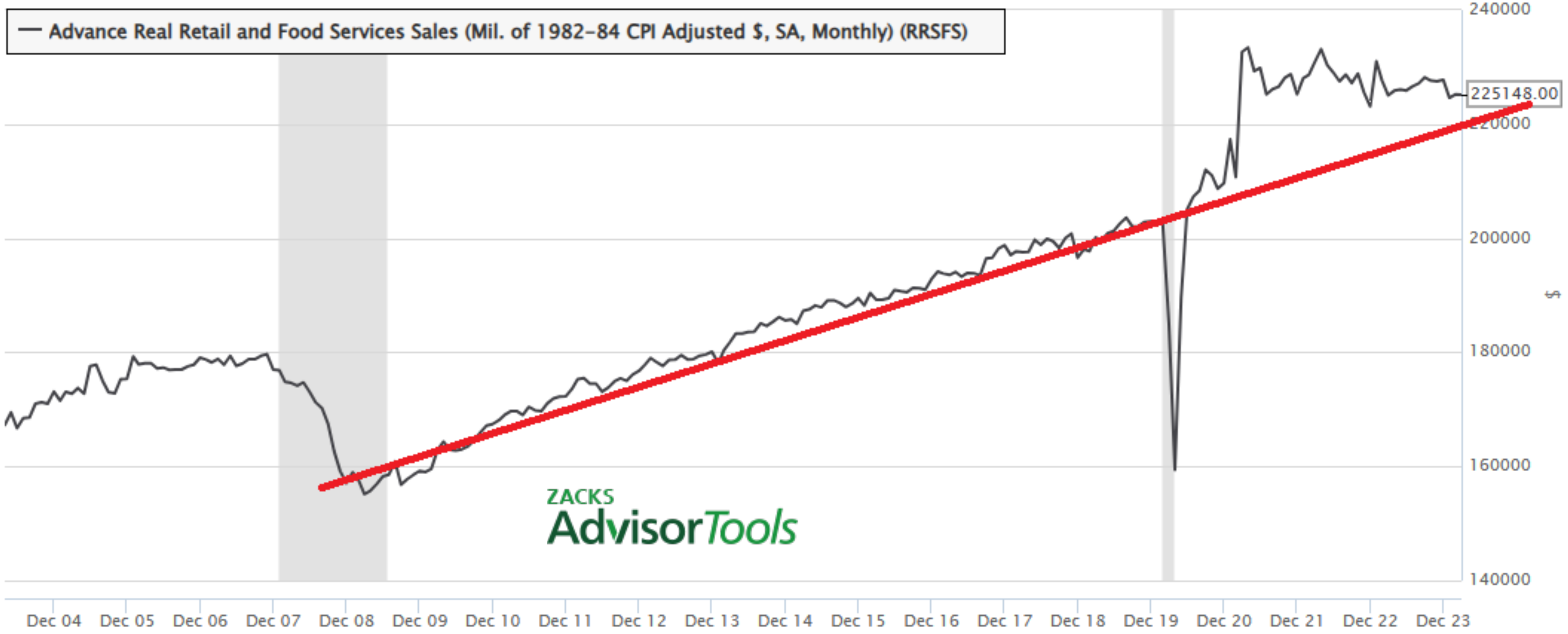
Source: Zacks Professional Services, www.zackspro.com

Negative Real Retail Sales Over the Past 3 Years



Source: Zacks Professional Services, www.zackspro.com

However, it could simply be mean reversion.



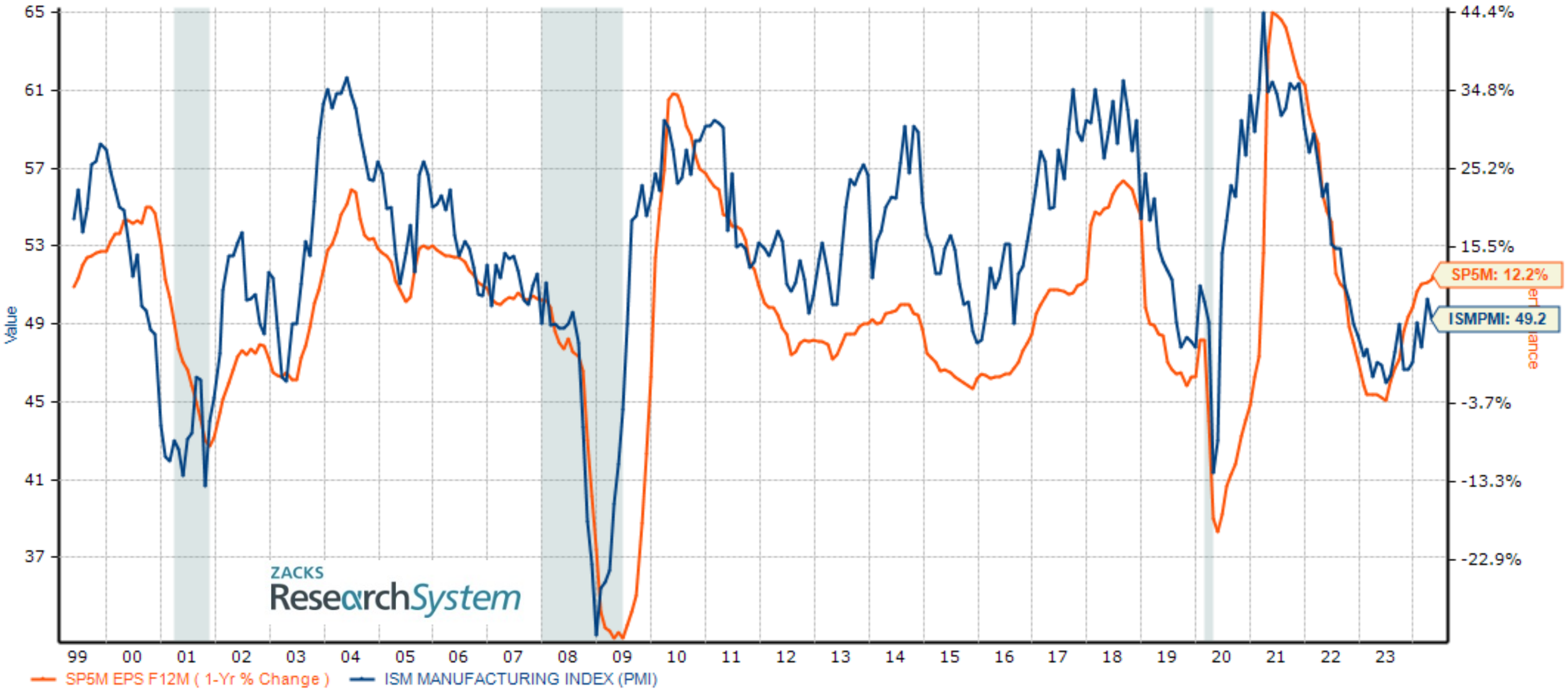
Source: Zacks Professional Services, www.zackspro.com

MANUFACTURING

ISM Manufacturing PMI Continues to Contract

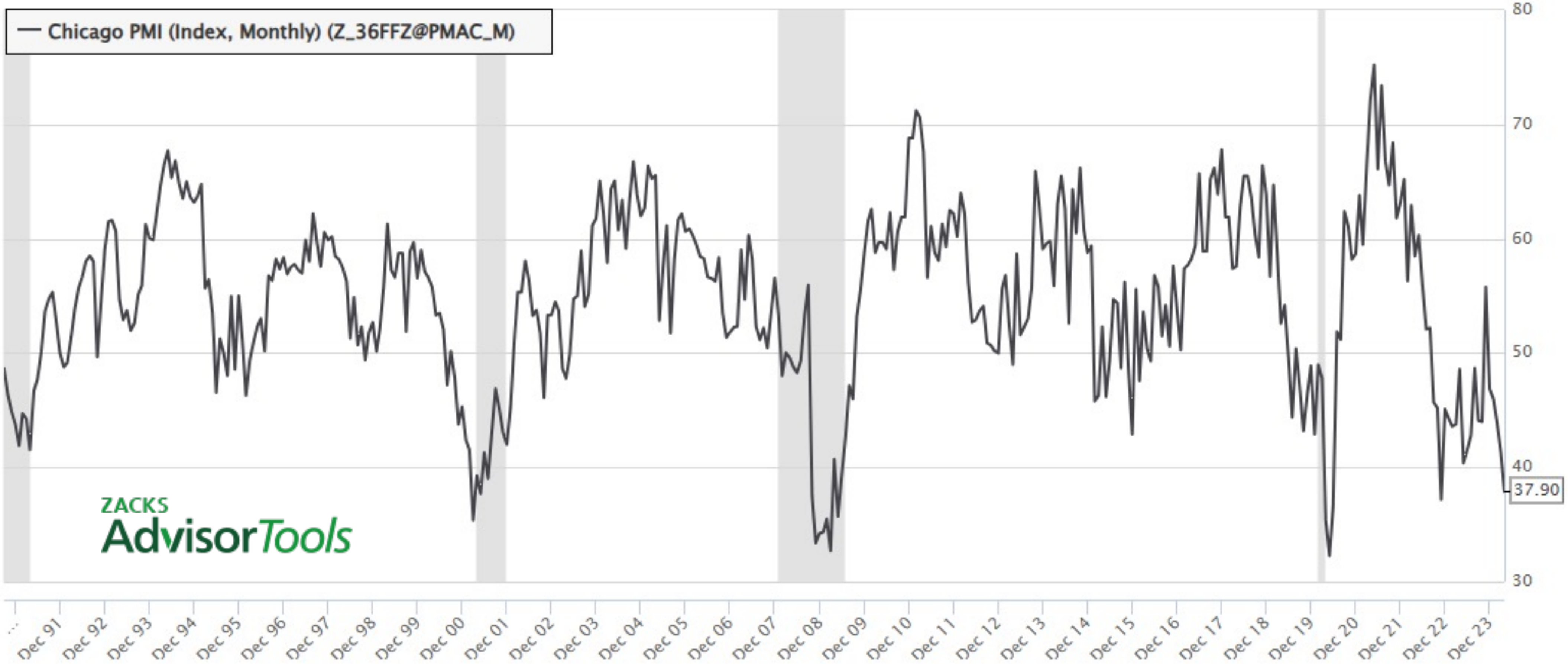
Index has been in contraction for 17 of the past 18 months, but analysts still expecting a lasting turnaround in Q2 '24 onwards

ISM Manufacturing vs EPS (since 05/31/99)



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)	44.37%	-32.49%	8.10%	12.19%	522.25%	7.19%	05-31-1999	05-14-2024
ISM MANUFACTURING INDEX (PMI)	64.70	33.30	52.85	49.20	-9.39%	-0.39%	05-31-1999	04-30-2024

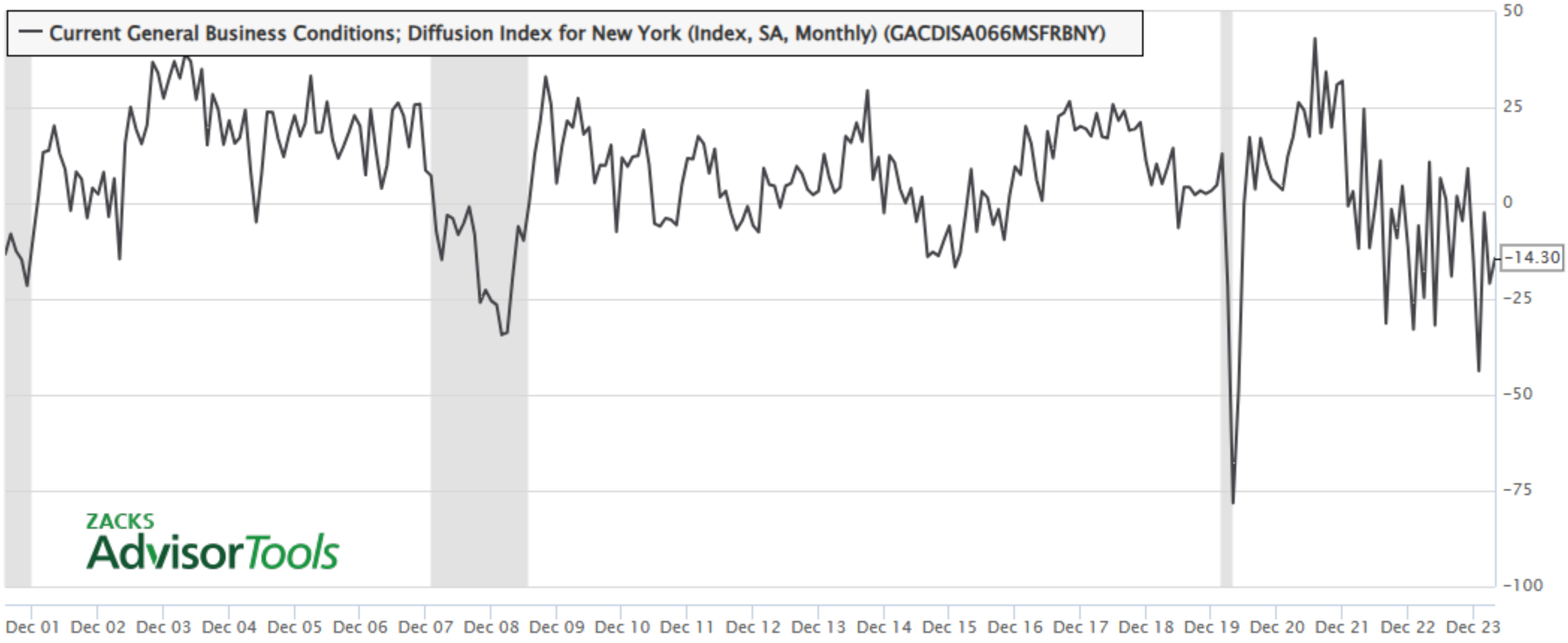
Chicago PMI Remains in Deep Contraction



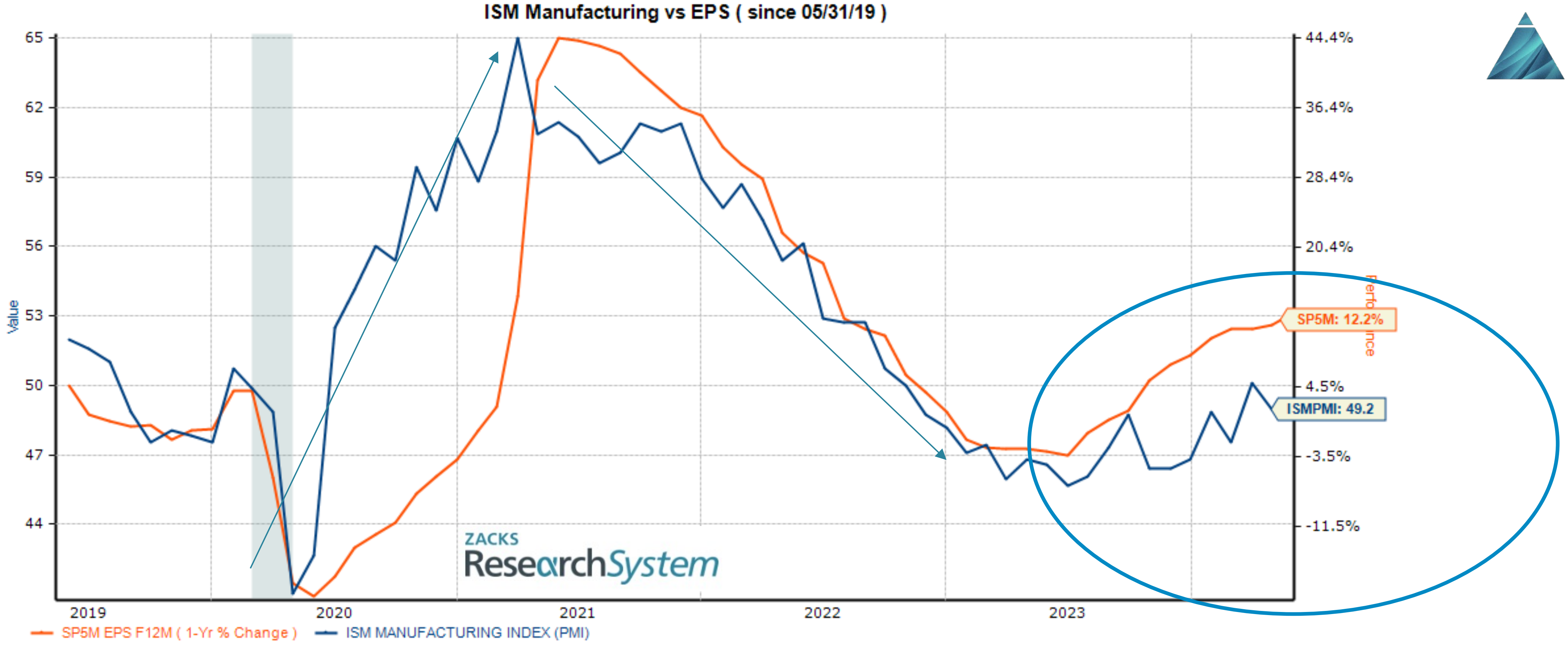
Source: Zacks Professional Services, www.zackspro.com

New York Fed's Empire State Index Similarly In Recession

-15.6 Reading in May 2024



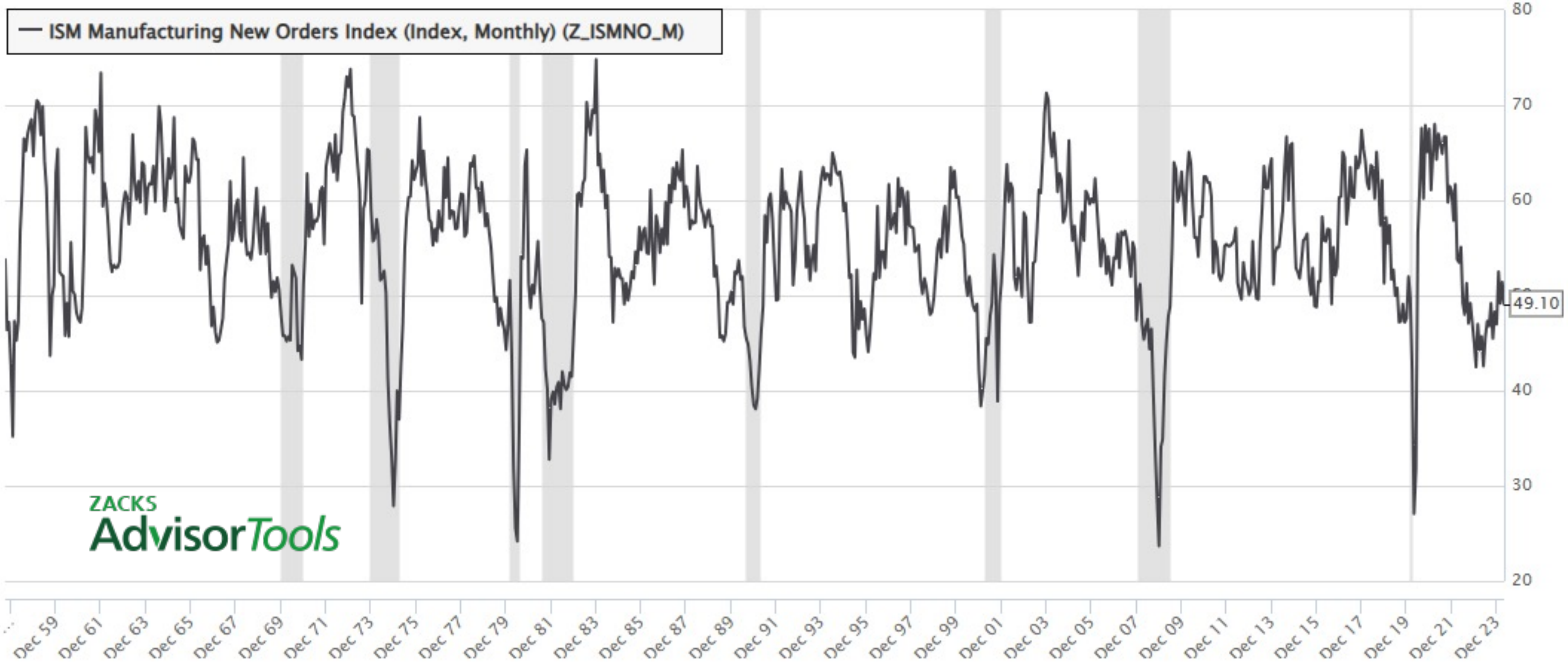
Source: Zacks Professional Services, www.zackspro.com



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)	44.37%	-19.45%	4.10%	12.19%	58.90%	8.08%	05-31-2019	05-14-2024
ISM MANUFACTURING INDEX (PMI)	64.70	41.50	51.05	49.20	-5.57%	-1.16%	05-31-2019	04-30-2024

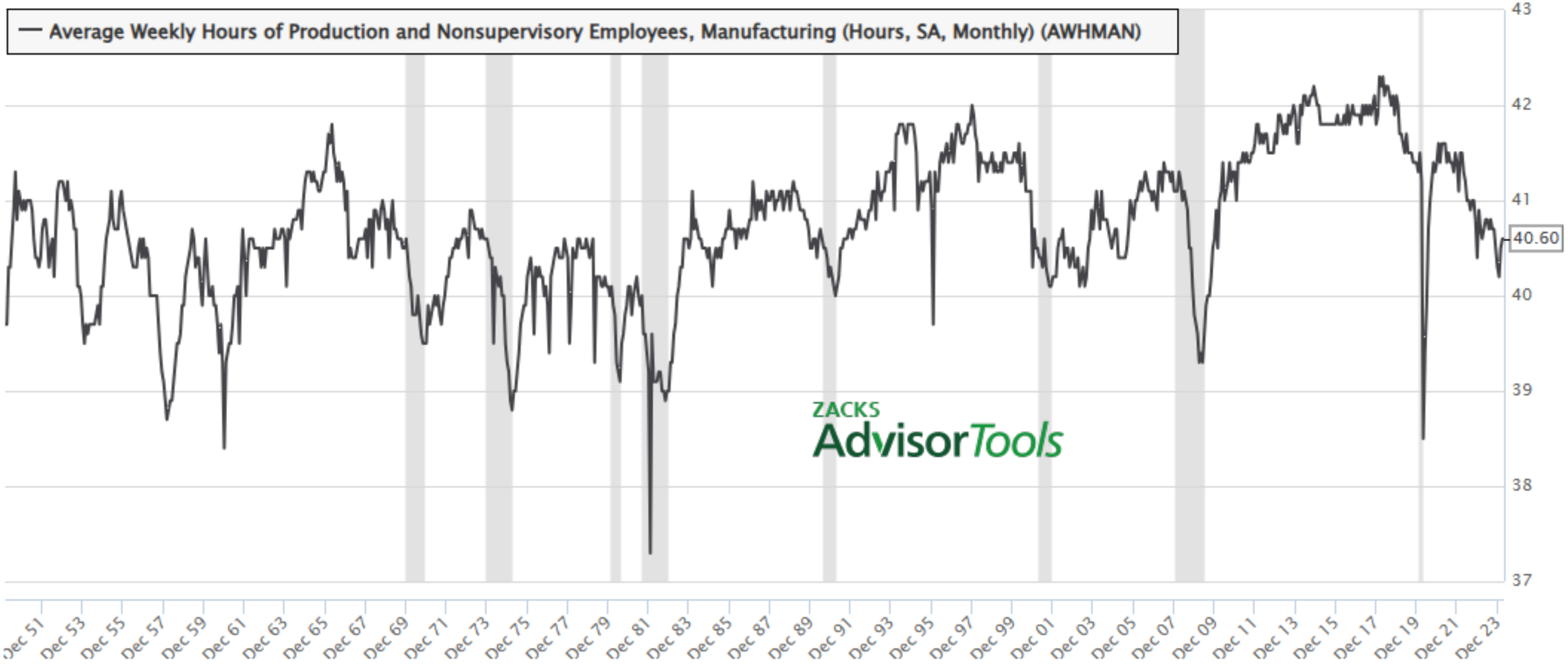
ISM Manufacturing New Orders in Contraction for 20 of the last 23 Months

Streak ended in January at 18 consecutive monthly declines, but falls again in April



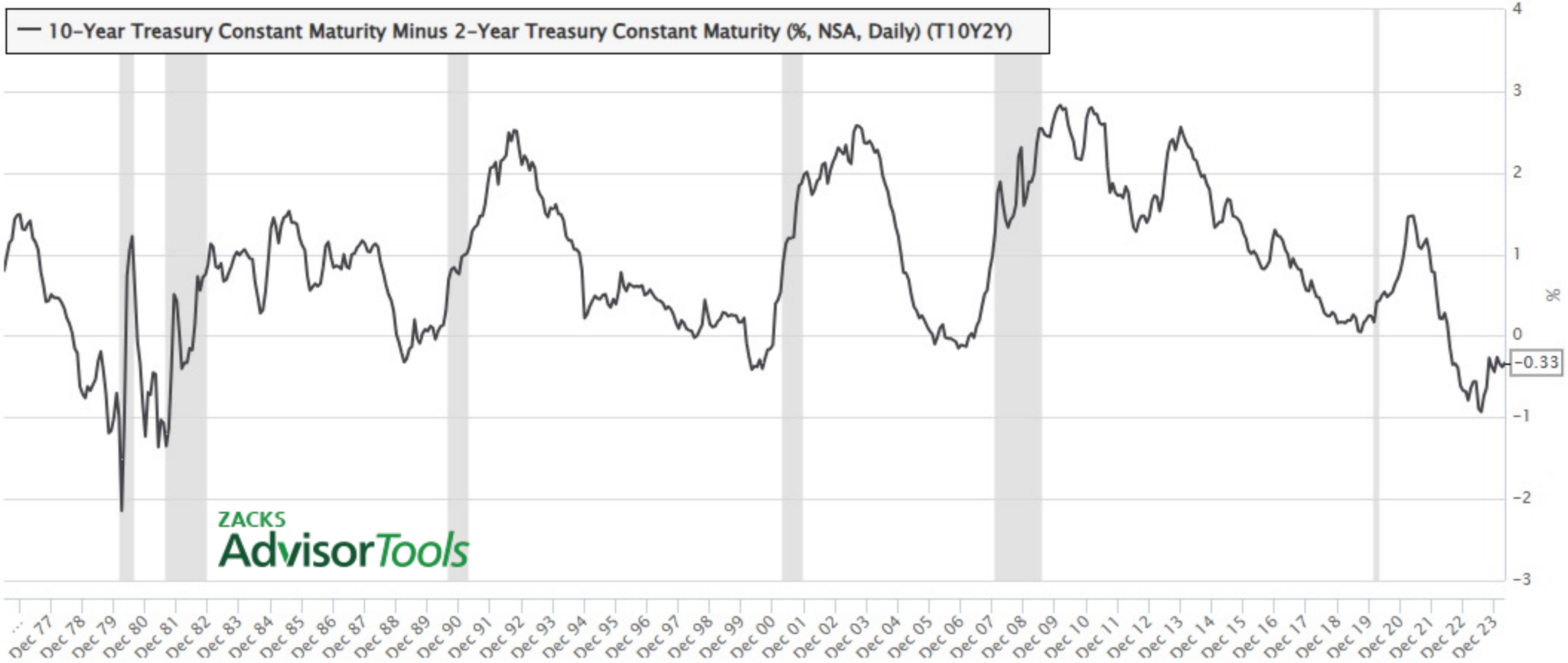
Source: Zacks Professional Services, www.zackspro.com

Factories Continue Slashing Workweek Hours to Recessionary Levels



Source: Source: Zacks Professional Services, OECD

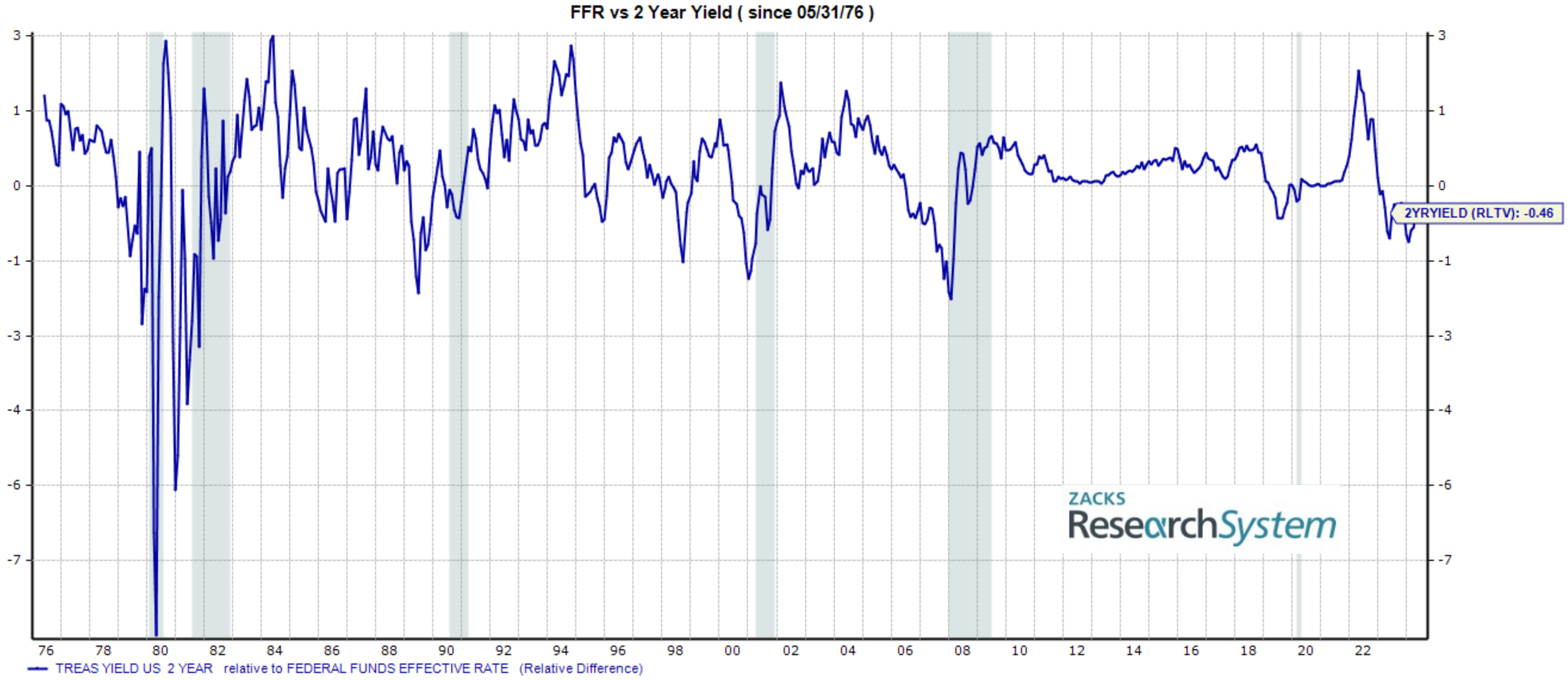
Yield Curve Still Inverted; Continues to Signal No Imminent Recession



ZACKS AdvisorTools

Source: Zacks Professional Services, www.zackspro.com

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	0.41	-0.46	05-31-1976	04-30-2024

Source: Zacks Professional Services, www.zackspro.com

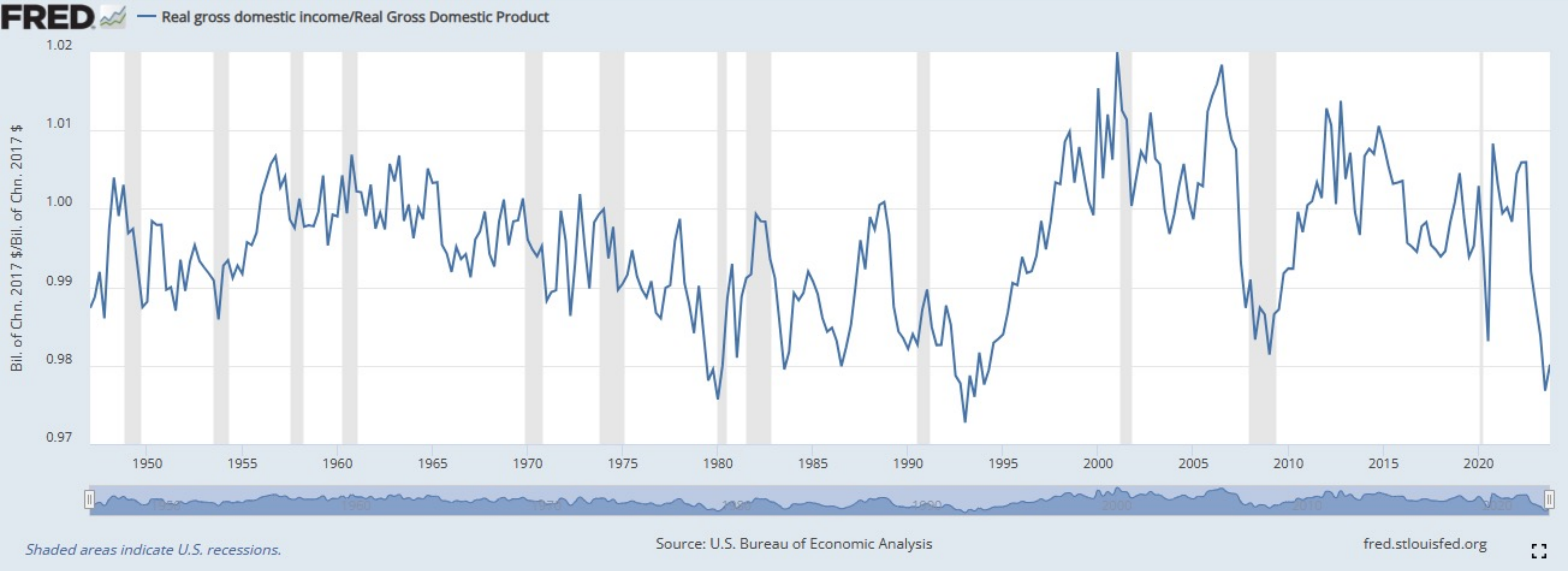
LEADING ECONOMIC INDEX

Conference Board's Leading Economic Index has now been in decline for 23 consecutive months.

Firmly at recession levels, led by weakening credit growth and manufacturing new orders. March update due tomorrow.

Source: Conference Board

Gross Domestic Income Continues to Undermine GDP



Analysts are still expecting +10% 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.

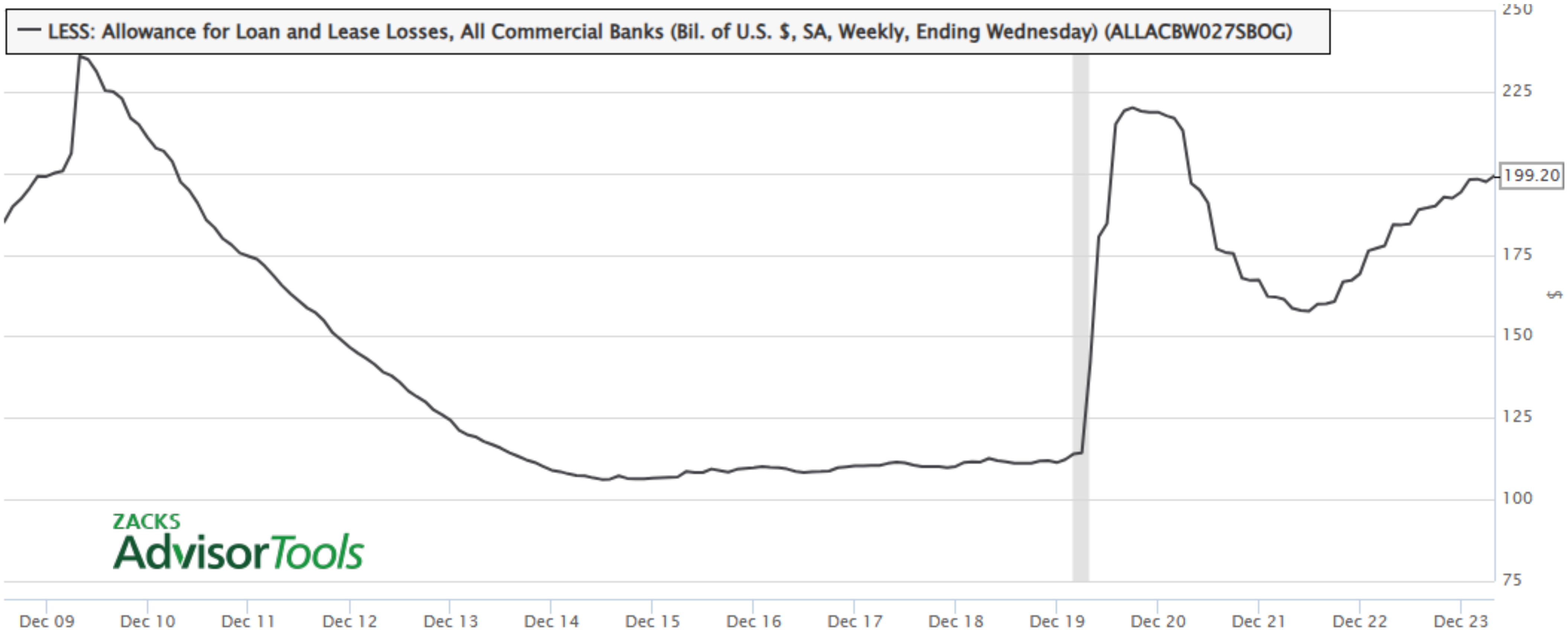
Monetary Tightening, Commercial Real Estate Distress, and US Bank Fragility

Erica Xuewei Jiang, Gregor Matvos, Tomasz Piskorski & Amit Seru

WORKING PAPER 31970 **DOI** 10.3386/w31970 **ISSUE DATE** December 2023

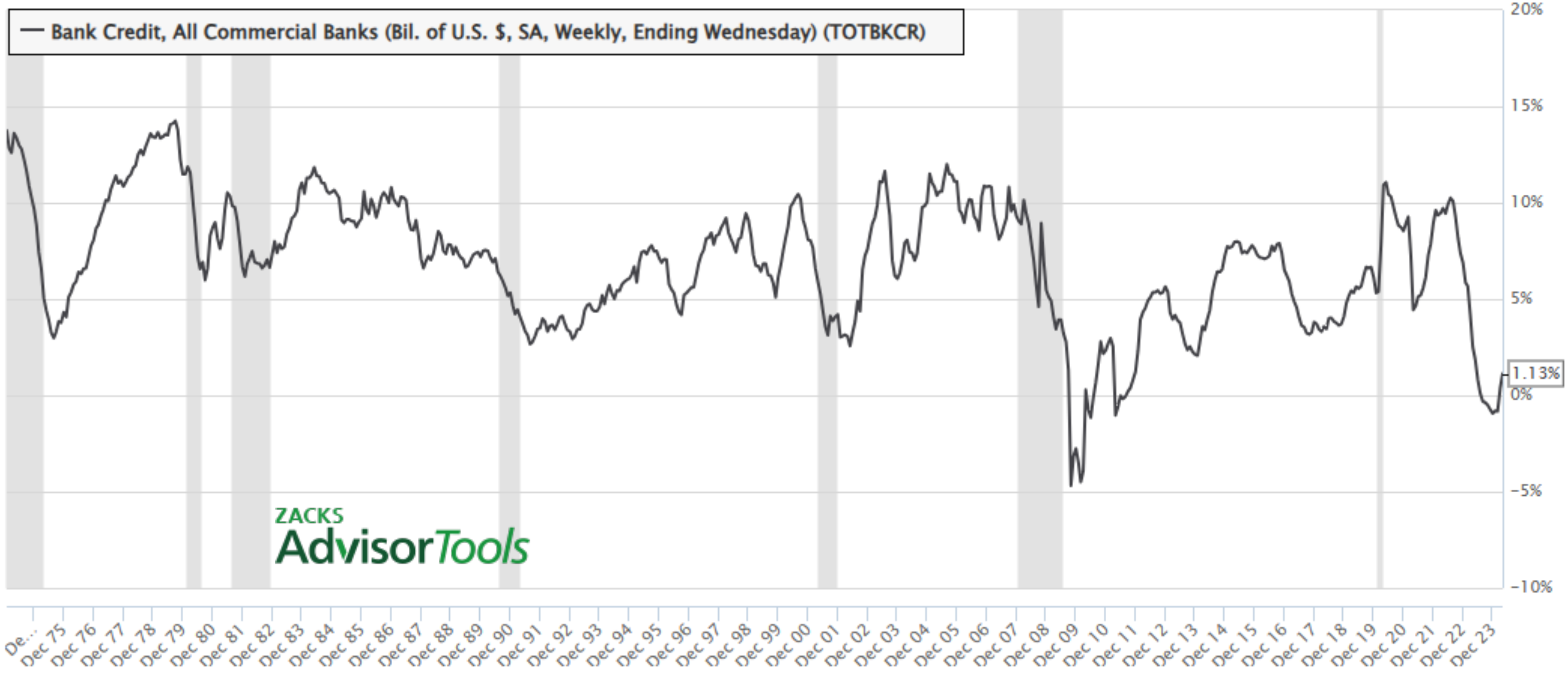
Building on the work of Jiang et al. (2023) we develop a framework to analyze the effects of credit risk on the solvency of U.S. banks in the rising interest rate environment. We focus on commercial real estate (CRE) loans that account for about quarter of assets for an average bank and about $2.7 trillion of bank assets in the aggregate. Using loan-level data we find that after recent declines in property values following higher interest rates and adoption of hybrid working patterns about 14% of all loans and 44% of office loans appear to be in a "negative equity" where their current property values are less than the outstanding loan balances. Additionally, around one-third of all loans and the majority of office loans may encounter substantial cash flow problems and refinancing challenges. A 10% (20%) default rate on CRE loans – a range close to what one saw in the Great Recession on the lower end -- would result in about $80 ($160) billion of additional bank losses. If CRE loan distress would manifest itself early in 2022 when interest rates were low, not a single bank would fail, even under our most pessimistic scenario. However, after more than $2 trillion decline in banks' asset values following the monetary tightening of 2022, additional 231 (482) banks with aggregate assets of $1 trillion ($1.4 trillion) would have their marked to market value of assets below the face value of all their non-equity liabilities. To assess the risk of solvency bank runs induced by higher rates and credit losses, we expand the Uninsured Depositors Run Risk (UDRR) financial stability measure developed by Jiang et al. (2023) where we incorporate the impact of credit losses into the market-to-market asset calculation, along with the effects of higher interest rates. Our analysis, reflecting market conditions up to 2023:Q3, reveals that CRE distress can induce anywhere from dozens to over 300 mainly smaller regional banks joining the ranks of banks at risk of solvency runs. These findings carry significant implications for financial regulation, risk supervision, and the transmission of monetary policy.

While Loan Loss Provisions Are Rising



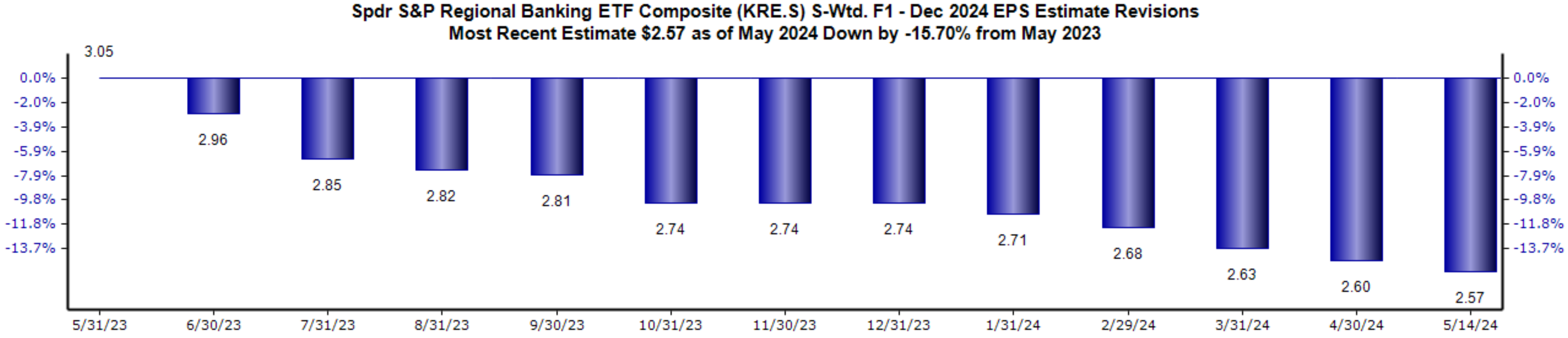
Source: Zacks Professional Services , FDIC

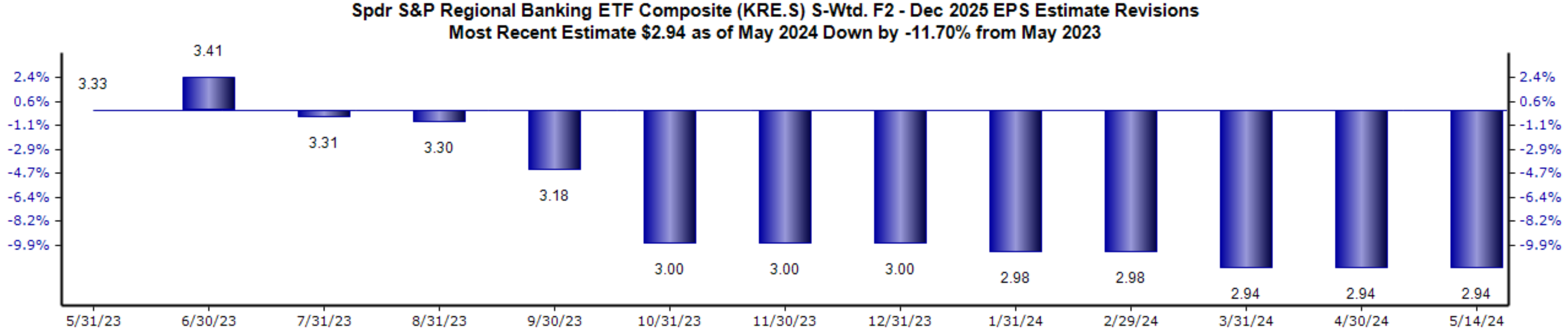
Bank Lending Surprisingly Strong Comeback – Supporting the Bulls



Source: Zacks Professional Services

…but still no bottom for EPS estimates for regional banks



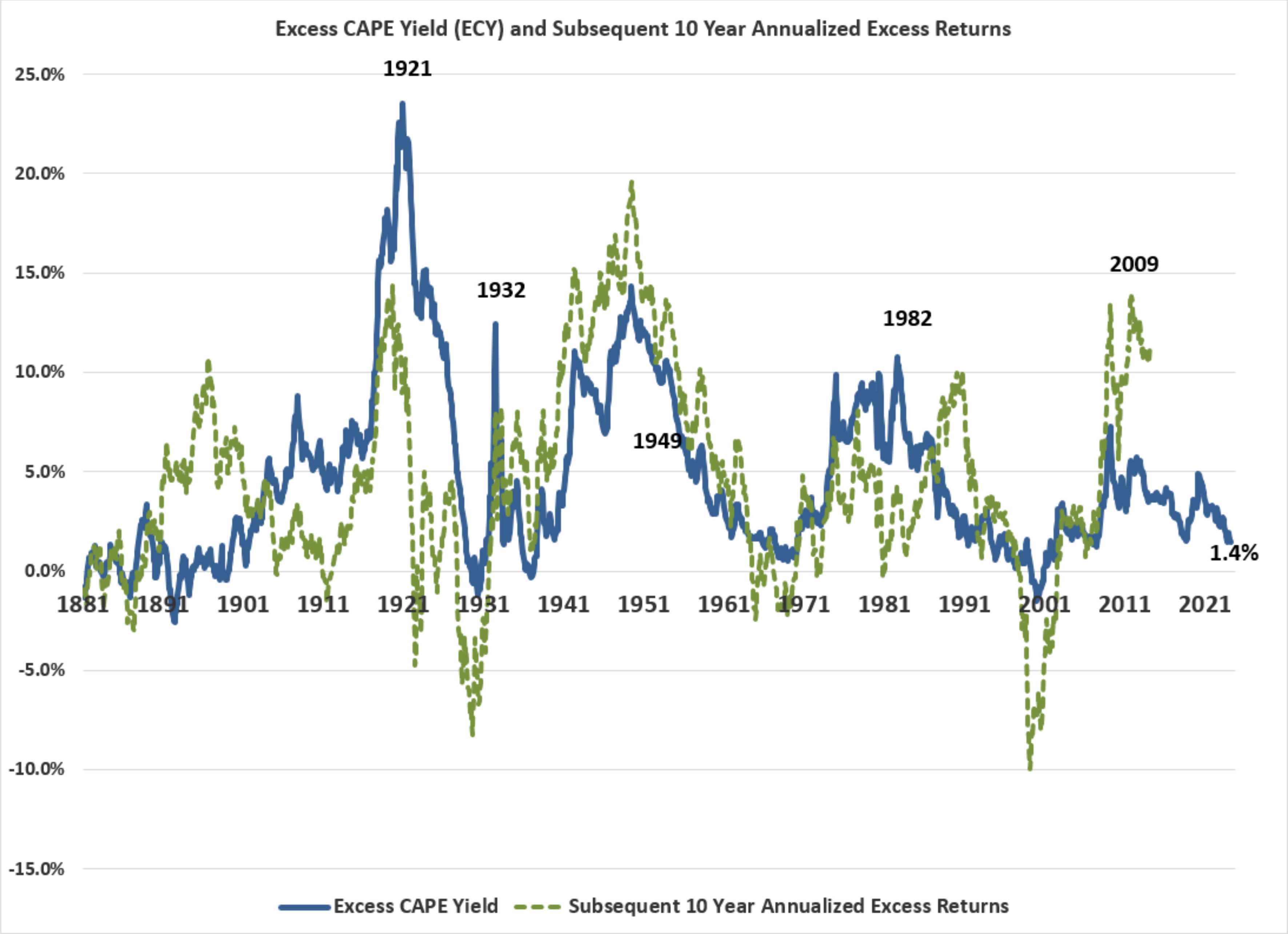


Source: Zacks Investment Research

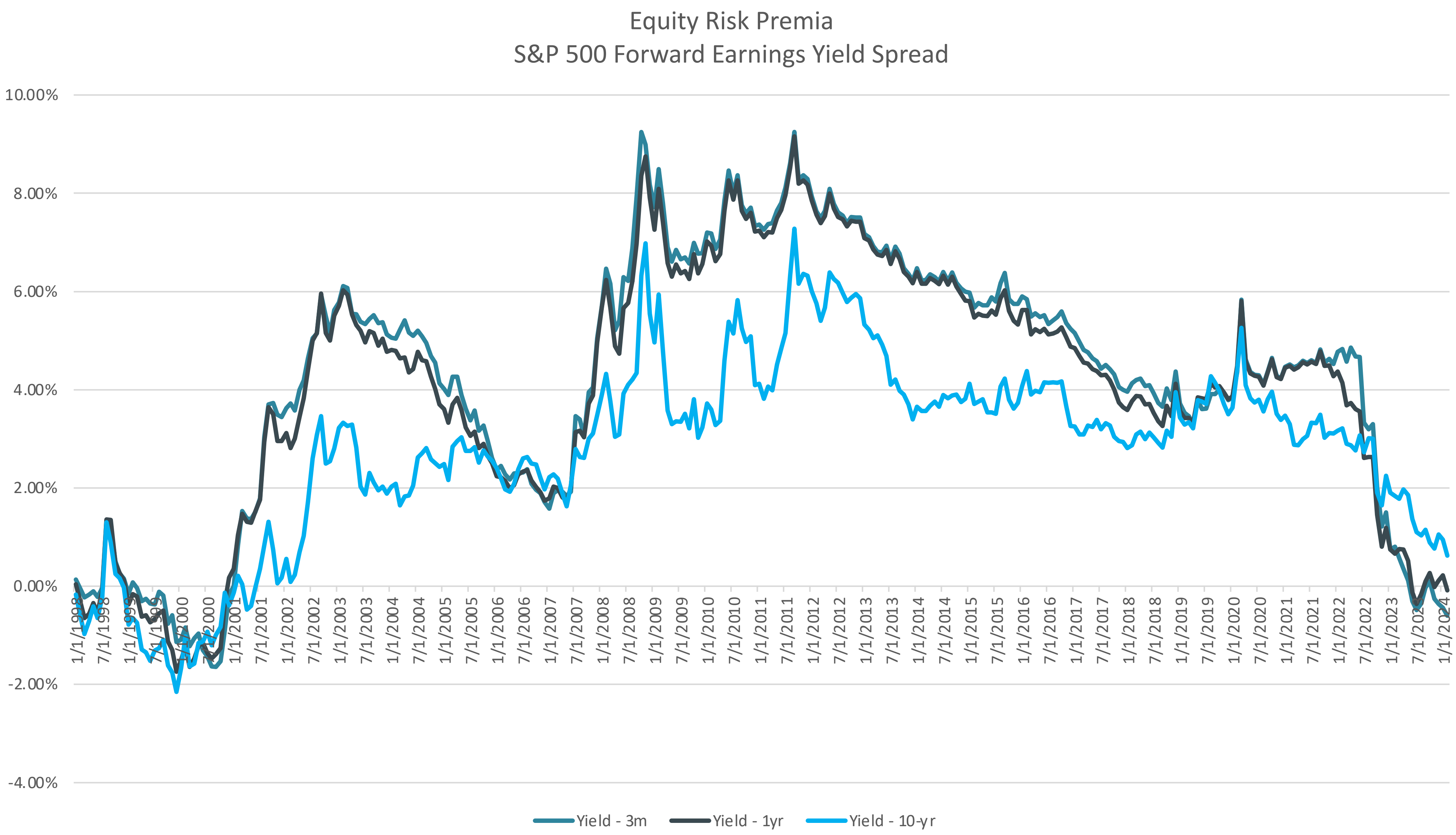
Traditional P/E, P/FCF or EV/EBITDA are still far lower today than in 2000.

Market valuations are approaching the bubble territory of 1999-2000, but still a ways away from their worst levels.

This despite rising threats to corporate earnings is a major reason to be *cautious* and recognize that market returns mostly due to multiple expansion are not sustainable.

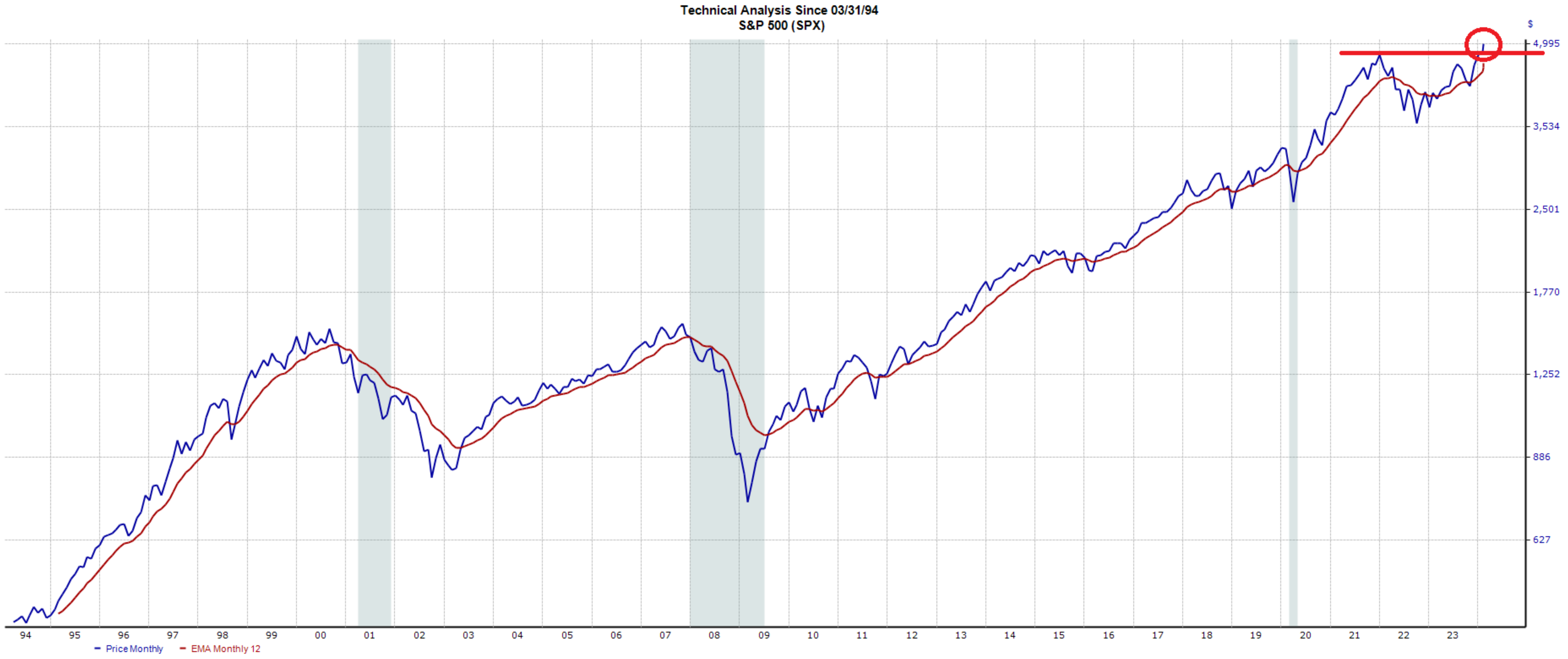


Source: Robert Shiller, shillerdata.com



Source: Zacks Professional Services, www.zackspro.com

SPX Chart is Extremely Bullish



Source: Zacks Professional Services, www.zackspro.com

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

Strong evidence of disinflation across various measures: goods, new homes, used cars, and commodities

Easing inflation, easing long-term yields

Together, a ‘goldilocks’ blend of conditions fueling powerful market rally

My primary conclusions:

1. the *direction* of leading fundamental indicators, at the margin, implies negative pressure to S&P earnings. This means analysts *will* mark down both FY 2024 and FY 2025 EPS forecasts.

2. Markets are priced for strong earnings growth at a forward P/E of 21x and equity risk premiums at 20-year lows

3. If that doesn't happen, there will be a substantial bear market.

Source: Mayur Thaker, CFA, Zacks Investment Research

PLAN of ACTION:

- The Big 3 indicators I am watching:
  - Permanent Job Losers
  - 10yr vs 2yr US Treasury Yields
  - SPX, QQQ vs their respective 200-day exponential moving average (EMA)

  If we see all three of:
  - **Permanent Job Losers rise above its 36-month EMA**
  - **2yr US Treasury Yield crosses below the 10yr US Treasury Yield**
  - **S&P 500 and/or Nasdaq 100 falls below its 200-day EMA**

  Then it's time to go full-blown defensive. The first one just triggered in February, but the next two haven't yet.

- My Optimal Defensive Portfolio:
  - 1-3 Year Treasury ETF (SHY)
  - Money Market Mutual Funds
  - Investment Grade Short-Term Corporate Bonds, such as the JP Morgan Ultra Short Income ETF, ticker JPST
  - 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

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ice

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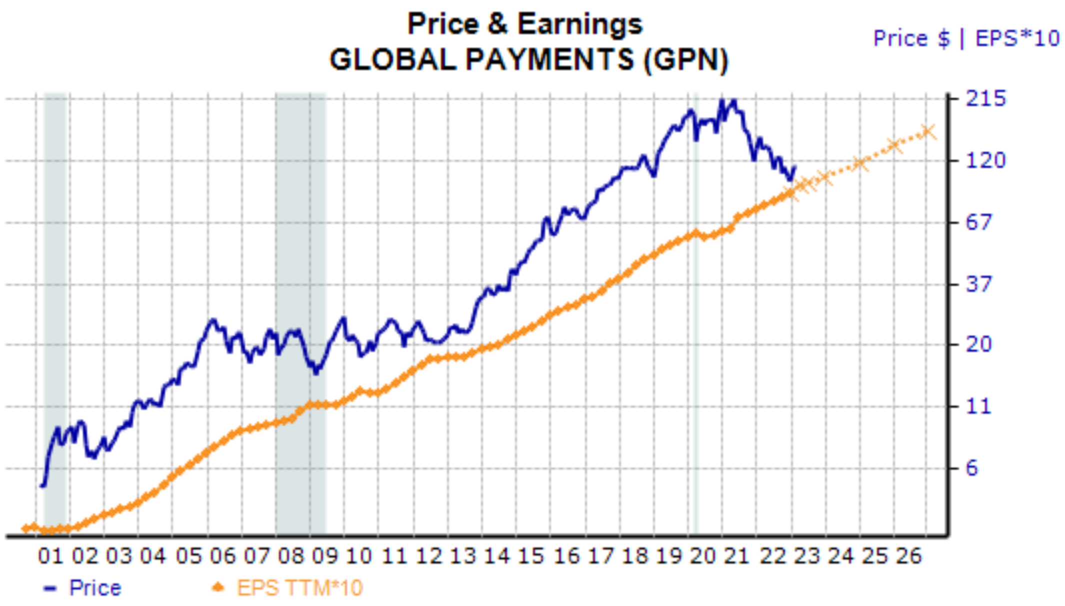
Price & Earnings
GLOBAL PAYMENTS (GPN)
Price $ | EPS*10
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120
67
37
20
11
6
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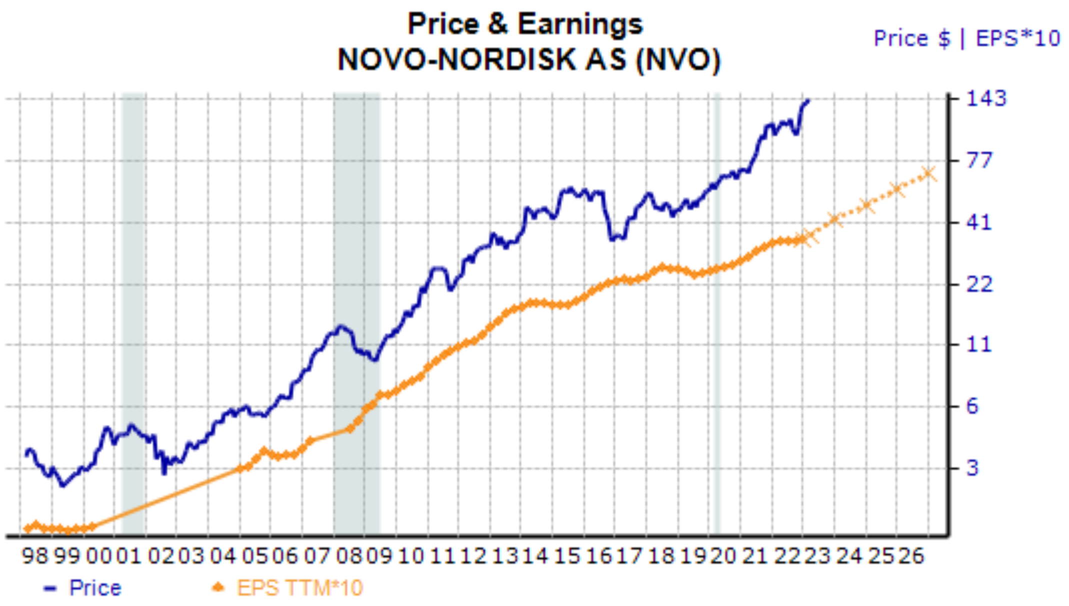
Price
EPS TTM*10


Price & Earnings
NOVO-NORDISK AS (NVO)
Price $ | EPS*10
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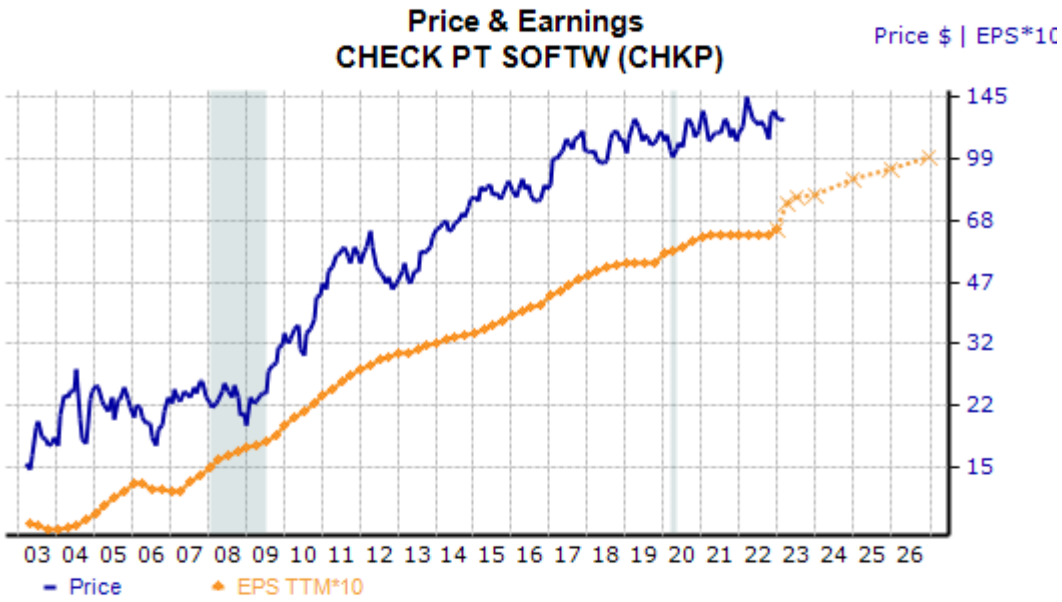
Price
EPS TTM*10


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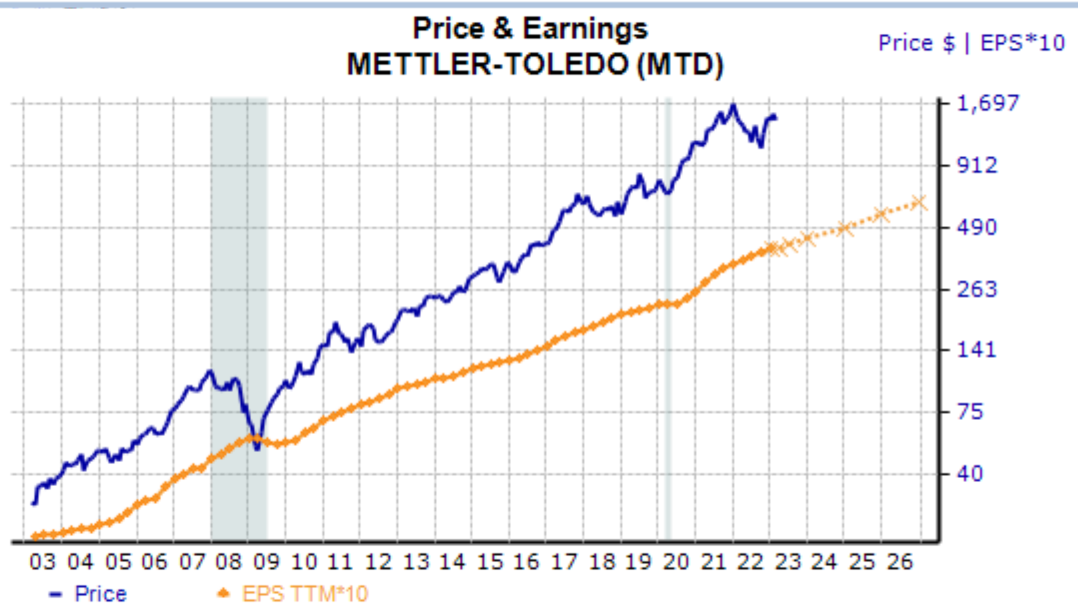
22
15
03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26
Price
EPS TTM*10


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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