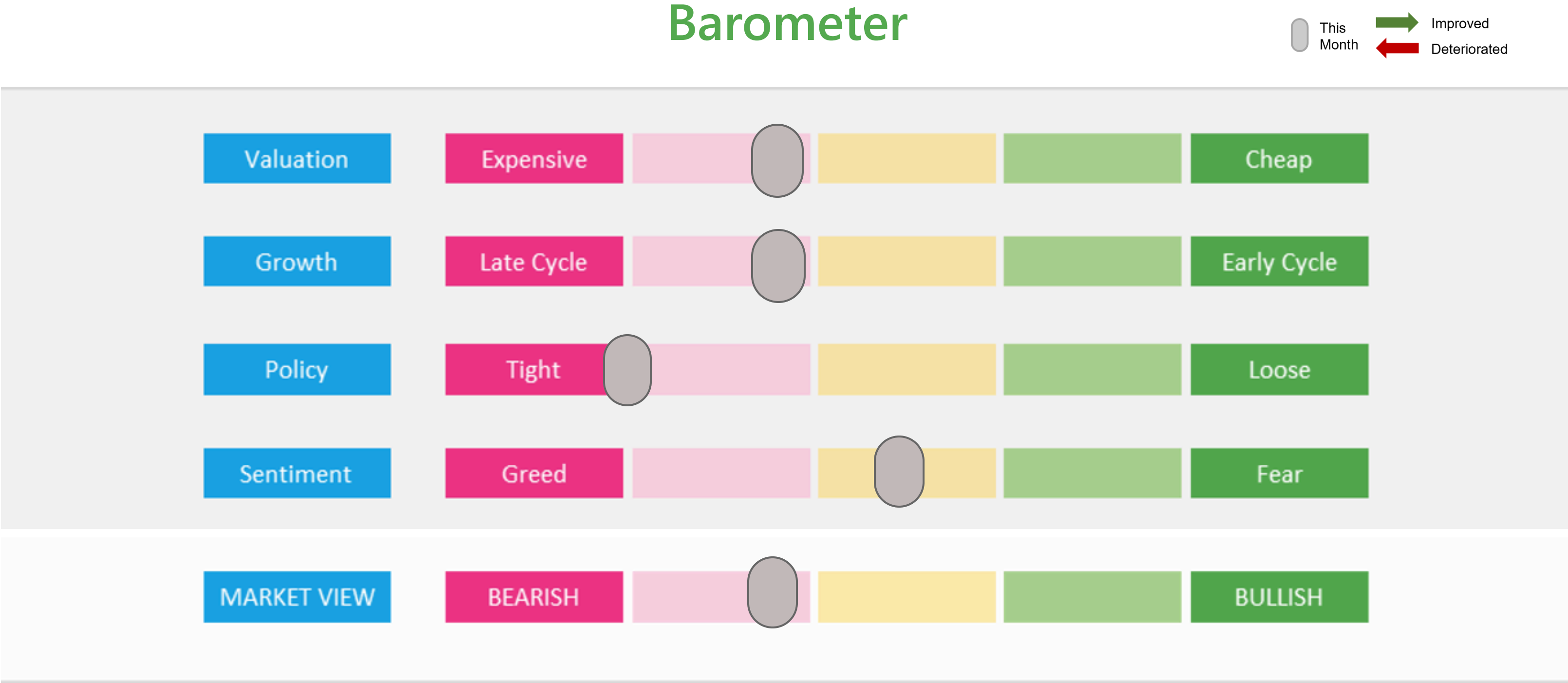
JUNE 2024

CCLA
GOOD INVESTMENT

Market Barometer

Barometer



Steady As She Goes

Our barometer says market fundamentals are solid.

No major changes this month. Earnings season was a decent beat versus expectations, forward earnings estimates are being revised up as time passes (at an 11% annual rate for the S&P500, for example). There has been no mad rush into equities as judged by fund flows, but sentiment continues to gently improve. Valuations are as ever somewhat of a sticking point with credit spreads on their tights or close to, bonds not offering obvious bargains.

Inflation prints have come in generally a touch on the hot side, but we (and the consensus) now expect to see further disinflation - the best inflation regime for paper asset total returns. And there is no longer any great expectation of near term rate cuts, so the market chatter around rates is not a problem for forward equity returns, in our view.

In our Charts of the Month we focus on longer term interest rate expectations and make the point that we think they are too low. Not that this matters right now - the market will care more about rate cuts (or not) this year - but we do think that bonds don't offer obvious attractions longer term outside of a recession.

This month we also look again at the US unemployment rate and reiterate the point we made last month, that it tends to be self-reinforcing - once the U-rate starts going up it usually keeps going up and starts a recession. And it has started to go up! So we watch very closely.

But there is **no change to our overall assessment that risk assets should be fine for the time being based on solid fundamentals - growing earnings, decelerating inflation, and eventually, rate cuts rather than hikes**.

Page intentionally left blank

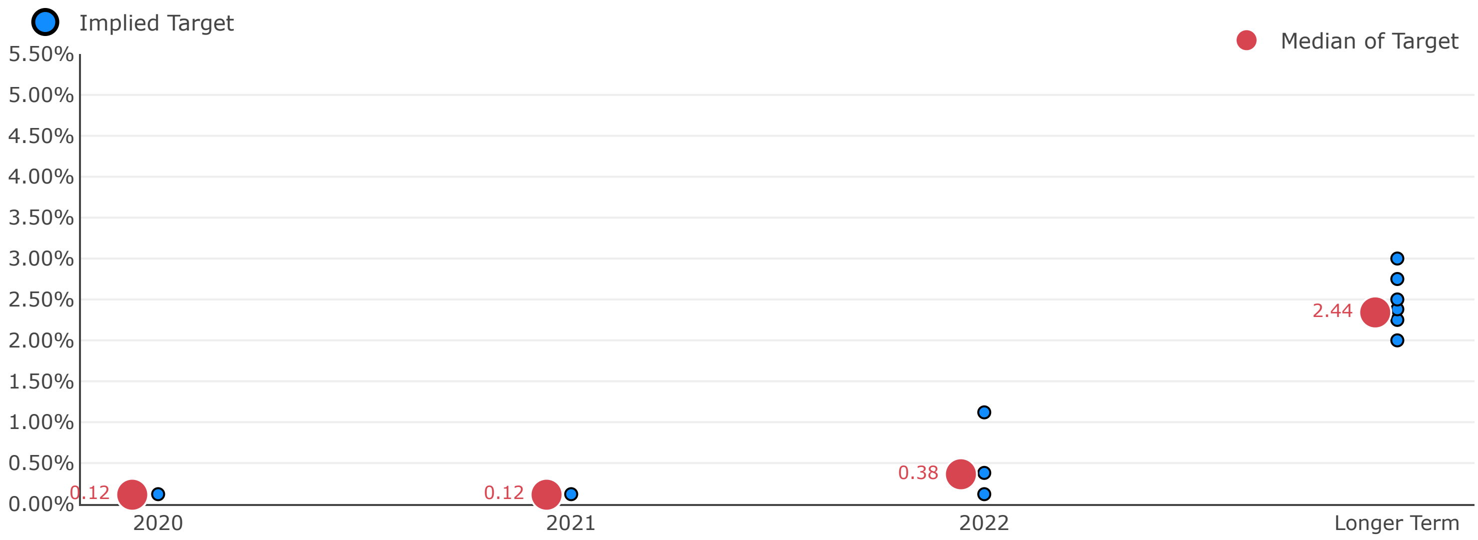
Contents

TOP OF MIND

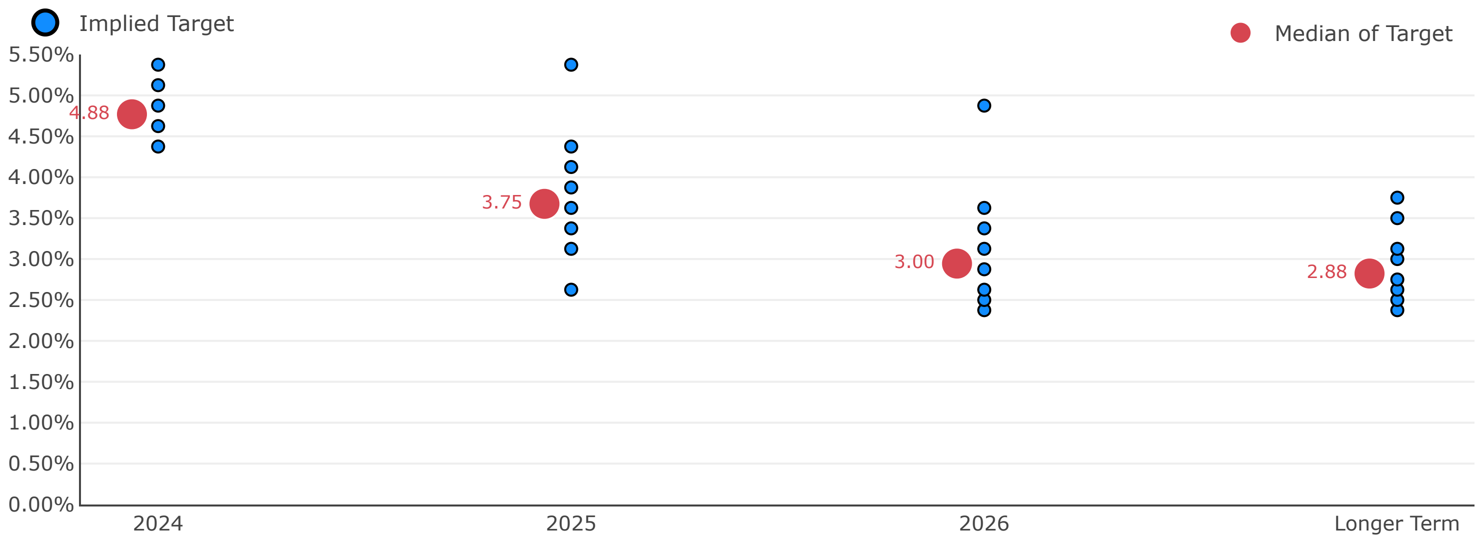
Charts of the Month

We think long term interest rate expectations are too low. The members of the FOMC (Federal Open Markets Committee) each set out their personal interest rate expectation every three months - the so-called Dot Plot. It seemed odd to us in the middle of the pandemic that the Fed thought rates would stay below 0.5% through 2021 and 2022 and even in the longer term only rise to 2.5% (top chart) - as though the pandemic would have a permanent impact on growth and inflation. But it is truly extraordinary to us that after an inflation shock and reacceleration in nominal GDP the current Dot Plot (bottom chart) is still pointing to an interest rate below 3% in the longer term. As we show on page 5, before Y2K nominal interest rates were always somewhere around nominal growth. Nominal growth in the US should be ~4-5%. Rate expectations are too low, in our view.

Fed Dot Plot | 06 October 2020



Fed Dot Plot | 20 March 2024



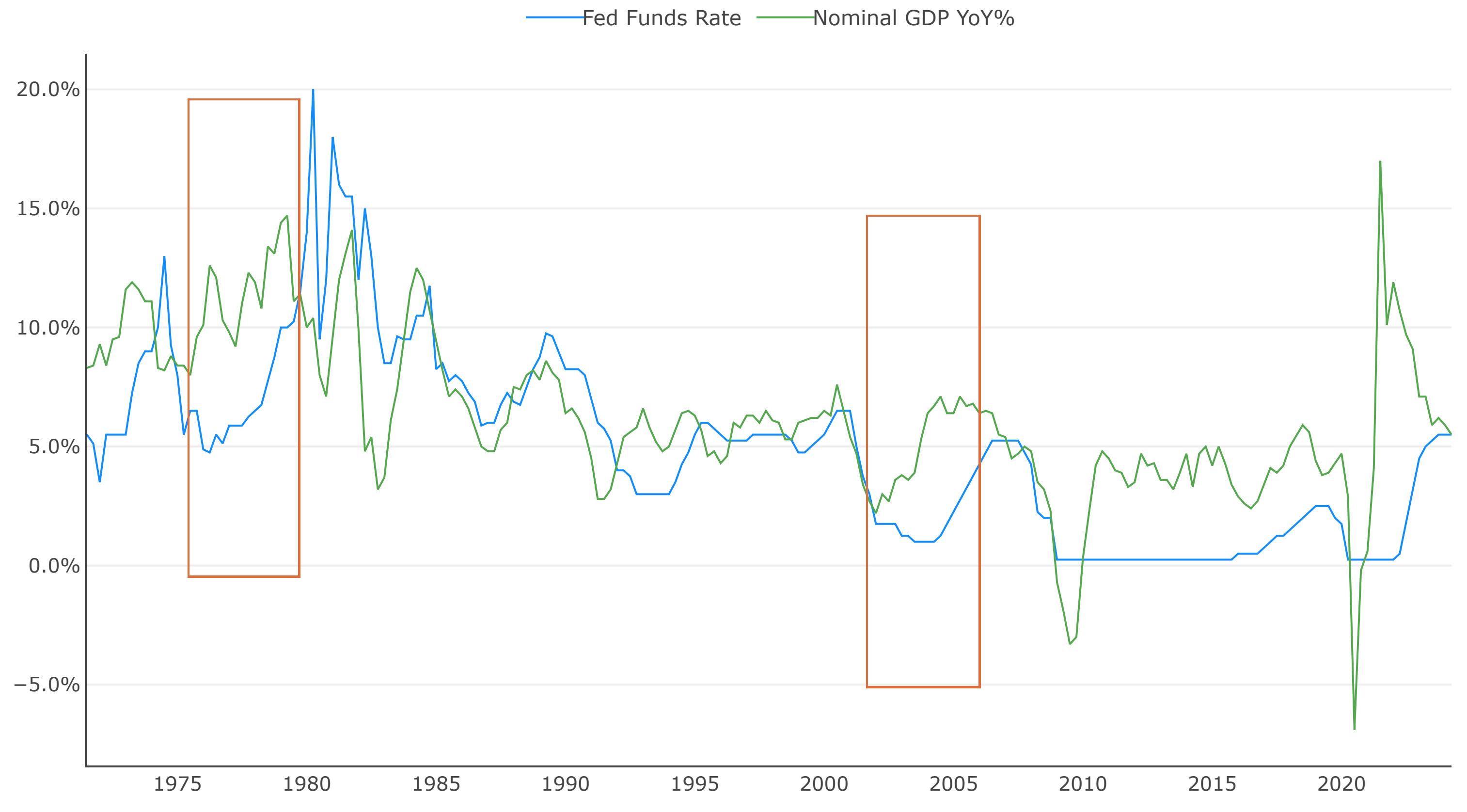
Sources | Bloomberg, CCLA. Data as at May 2024

CCLA

Charts of the Month

Nominal interest rates should be somewhere around nominal growth for policy to be neutral. Edward Chancellor examines this rule of thumb in his book "The Price of Time". The chart shows that in the period from 1980-2000 this was the case, and inflation was controlled. The two episodes highlighted by the red boxes are now seen as policy errors - when Arthur Burns' 1970s Fed kept real rates negative through the second half of the 1970s, and when Alan Greenspan's Fed kept policy too loose in the 2002-2006 recovery from the TMT recession. Both episodes ended badly for markets. Now, policy has finally normalised after the emergency low interest rates of the post-GFC period. **We should not expect rates as low as the Dot Plot suggests based on this relationship, now that deflation risk appears limited.**

US Nominal GDP Growth vs. Fed Funds Rate



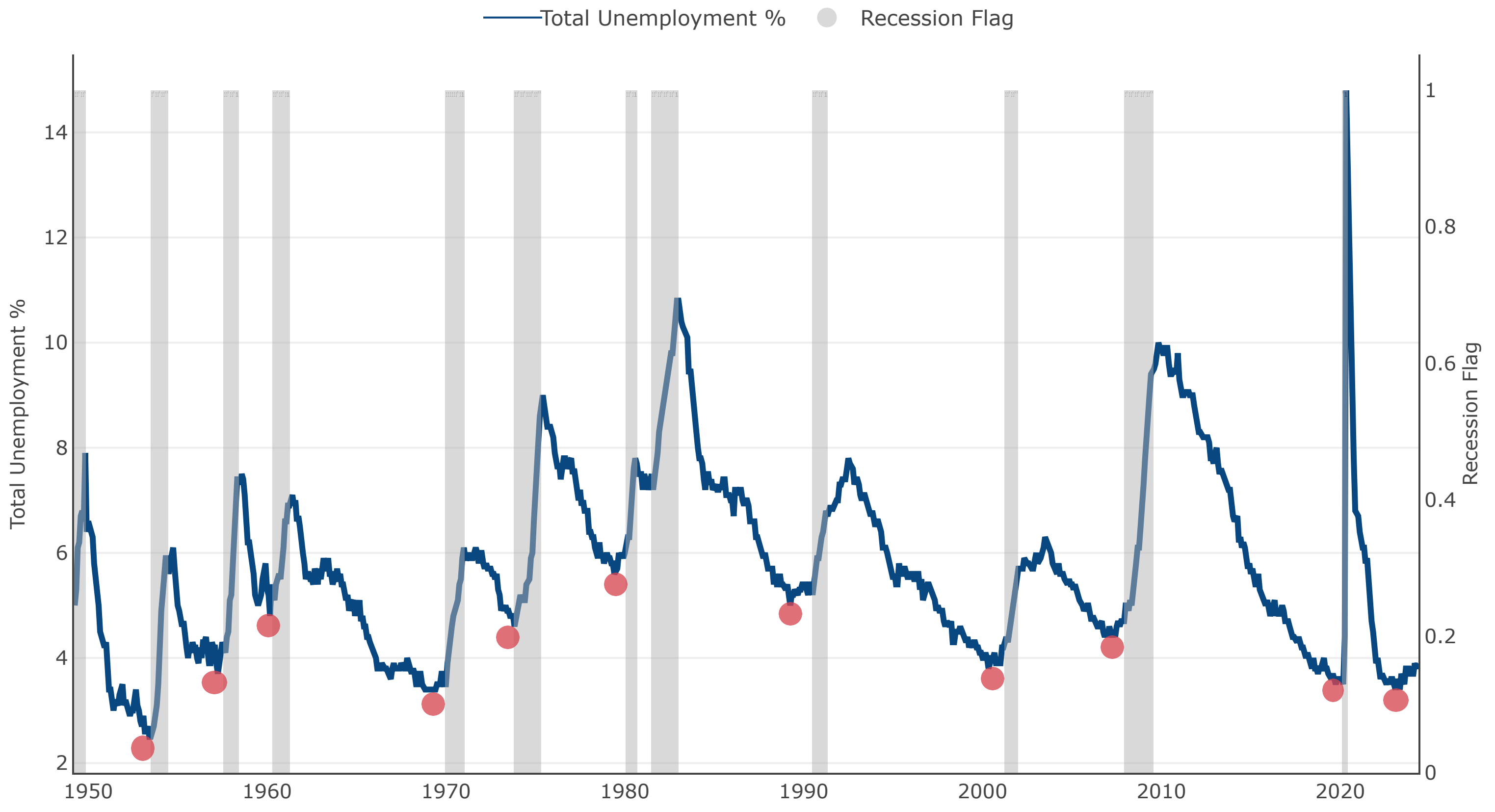
Sources | Bloomberg, CCLA, data as at May 2024

CCLA

Charts of the Month

When the unemployment rate goes up, a recession starts. Last month we showed the Sahm Rule, which says that when the unemployment rate rises 0.5% points from its trough a recession starts. This is an even simpler way to visualise this effect. We observe that, like equity markets, **the unemployment rate doesn't go sideways for very long** - it either falls gradually or rises parabolically. The red dot marks the trough in the U-rate. The shading marks recessions. Worryingly (there is always something to worry about) the U-rate is going up. **It would not be too surprising if the US finally slipped into recession - just as the market has convinced itself that this is a soft landing**.

US Trough Unemployment Rate vs. Recessions



Sources | CCLA, Bloomberg. Data as at May 2024

TOP OF MIND

CCLA

Charts of the Month

The Citi Surprise index is a measure of positive and negative economic surprises over the trailing 60 days. It's spent most of the last four years above zero but has just broken down below zero. Worth watching.

Citi Surprise Index

Sources | Citi, Bloomberg. Data as at May 2024

VALUATION

Equity | USA

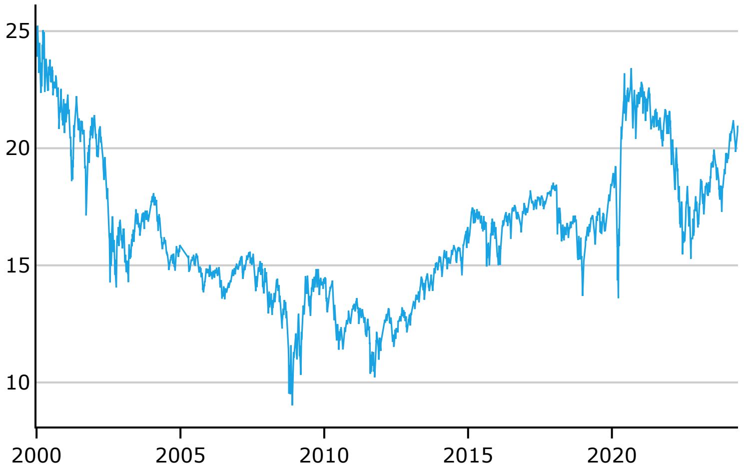
The US equity market ticked lower this month after having sharply re-rated in the prior five months. This leaves the spot PE valuation at 20x, still 25% above its 16x average of the last thirty years.

The CAPE (Cyclically Adjusted PE) has also ticked higher, to 32.8x. A shorthand for future real expected return is the CAPE earnings yield, indicating that US equity may not be expected to return much more than 3% annualised over coming years.

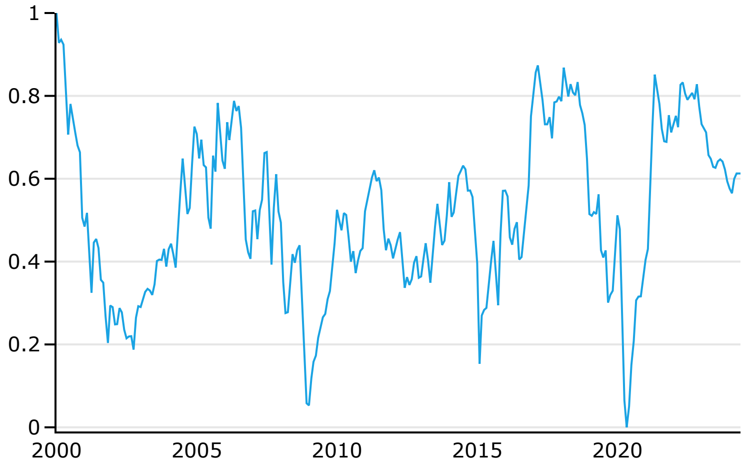
Cross asset valuations are in the 60th percentile, i.e. equity is a little extended but not dramatically so - on our Composite Value Indicator (top right). But absolute valuations are full in the US at least.

S&P 500 Valuations

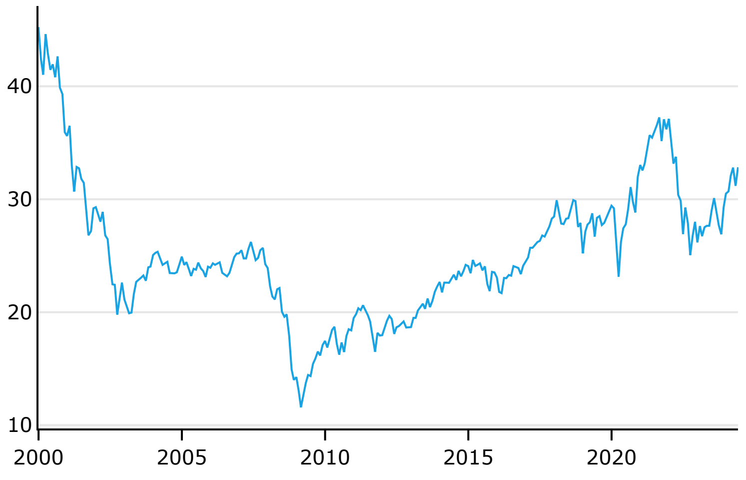
S&P 500 Forward PE



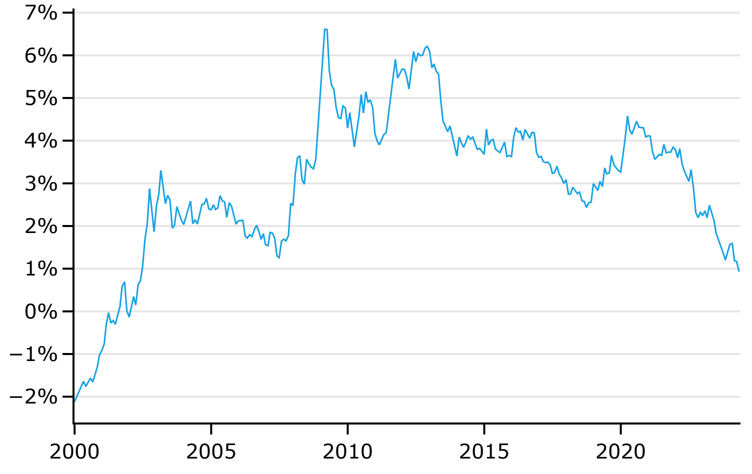
Composite Value Indicator Model



CAPE / Shiller P/E



S&P 500 Equity Risk Premium



Note | Composite Value Indicator was built at Morgan Stanley in 1997 and is published with permission. It is an aggregate of seven equity yields adjusted for bond yield, T bills yield and inflation, and is expressed here in its percentile range. The CAPE / Shiller PE is today's price divided by the average earnings of the last 10 years. The Equity Risk Premium is calculated as the Shiller earnings yield minus the real bond yield.

Sources | S&P 500 PE: Bloomberg, CVI Model: CCLA, Shiller PE/CAPE: Morgan Stanley, Equity Risk Premium: CCLA as of May 2024

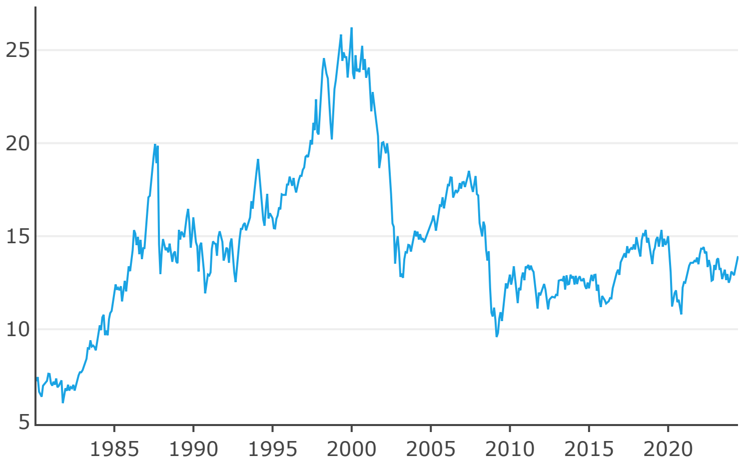
VALUATION

Equity | Regional

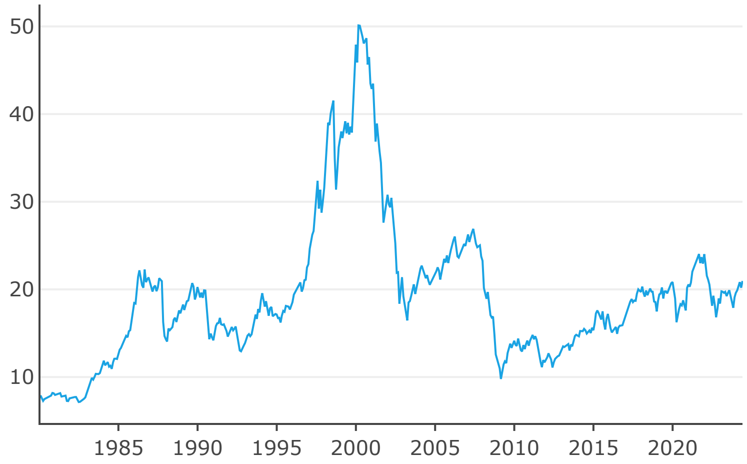
Outside the US (which is 69% of MSCI World), equity markets continue to look reasonable value (UK, Europe-ex-UK) or outright cheap (Japan, EM). The de-rating of last year is notable everywhere. The UK Shiller PE of 13.9 gives an earnings yield of just over 7.1%, which is a good approximation of expected forward real returns. On the same basis, Europe ex-UK PE of 20.9 gives almost a 5% forward real return. Asia and Japan look similarly good value to us, the latter despite its strong recent performance.

Europe

UK | Shiller P/E

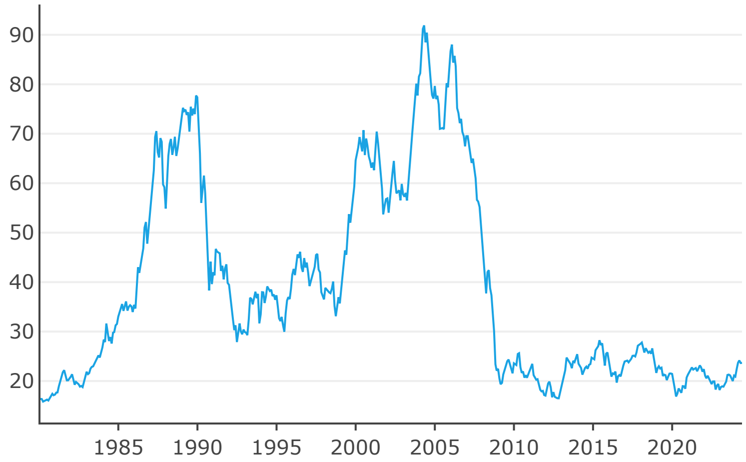


Europe (Ex-UK) | Shiller P/E

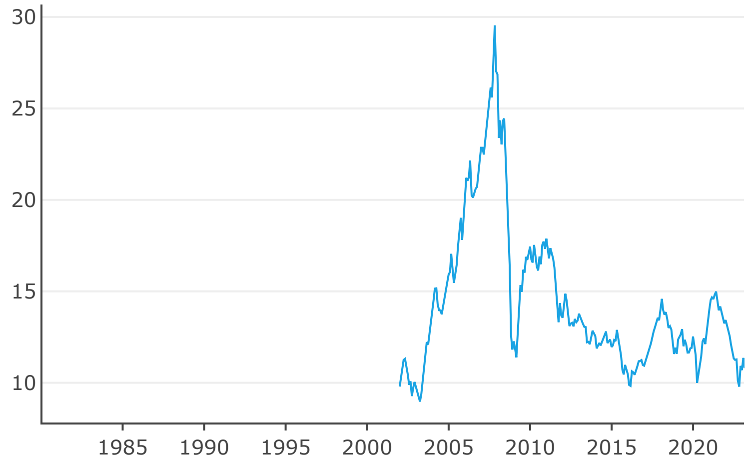


Asia & Emerging Markets

Japan | Shiller P/E



EM | Shiller P/E



Sources | Shiller P/Es: Morgan Stanley as of May 2024. Shiller P/E is calculated as today's price divided by the real average earnings of the last 10 years.

CCLA

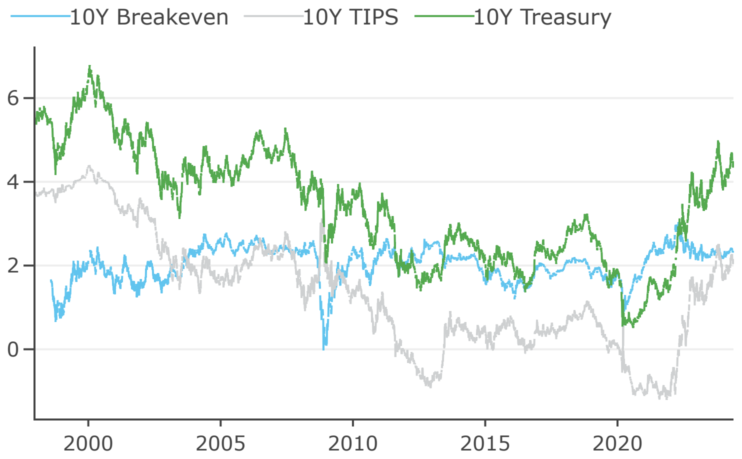
Bonds

Bond markets have given back some of their gains from the "everything rally" of November and December. Since the start of the year, the iBoxx Sterling Gilt index is down 4.5% (albeit 6% above the October-lows), iBoxx Sterling AA (IG) is down c.1.6% and iBoxx Sterling HY is up almost 3.4%.

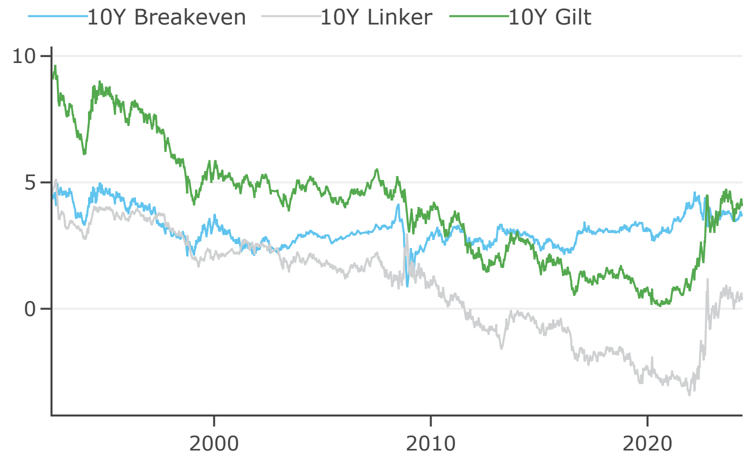
Corporate US BBB yields are still around 5.8%, which, stripping out 2.5% expected inflation, yields above 3.3% real expected total return, **which to our eyes remains reasonably attractive**.

Global Government & Corporate Yields

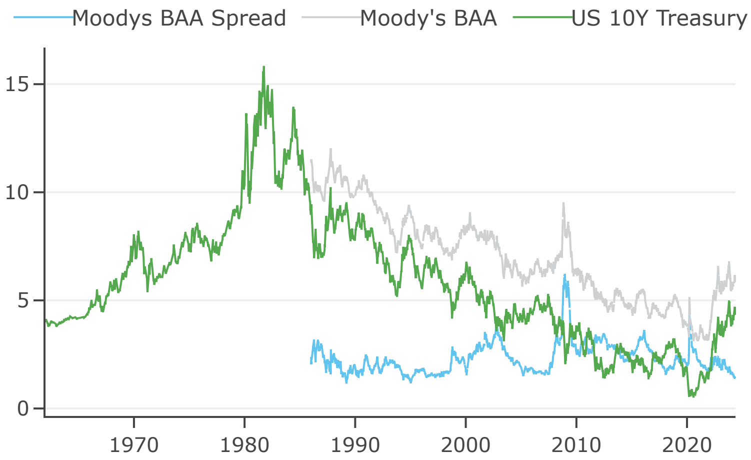
US 10 Year Treasury Yields



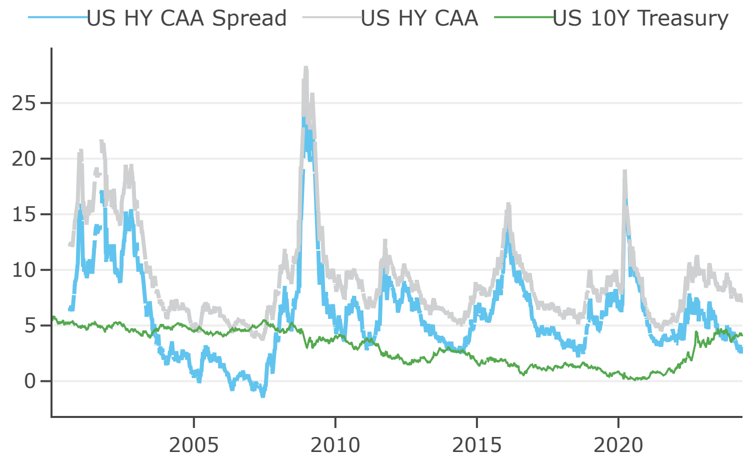
UK 10 Year Gilt Yields



US Corporate Investment Grade Yield



US Corporate High Yield



Sources | Bloomberg as at May 2024

VALUATION

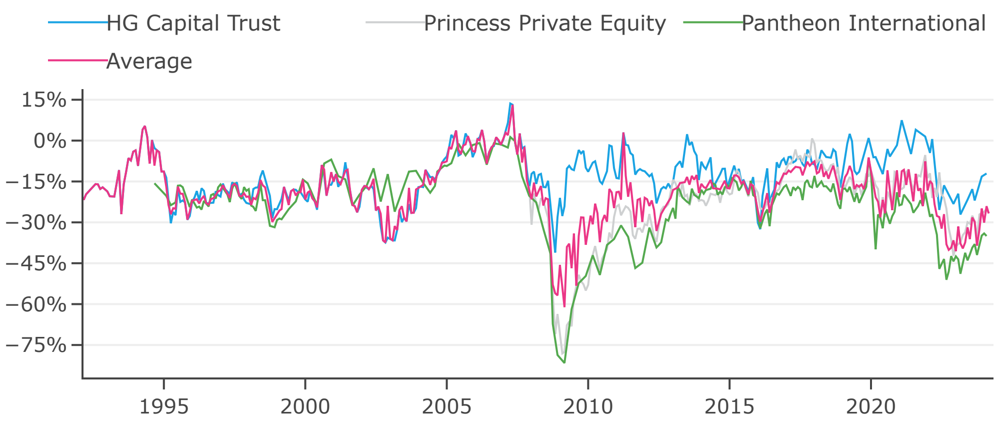
Alternatives

The IRR on Core Private Infrastructure now offers 2.4% return spread over IG corporate bonds, which is still interesting after a much tighter spread over the last two years. Listed Infrastructure trades at 10-35% discounts to net asset value (NAV), which is somewhat more interesting, especially where managers can add value via development. After strong performance last year, Private Equity multiples are no longer at a large discount to public equity, but the discounts to the underlying NAVs remain wide, even if less than they were (top left chart). **Levered Loan yields have risen from 5% to over 9% but are at risk of falling in a rate cutting environment**.

Global Valuations

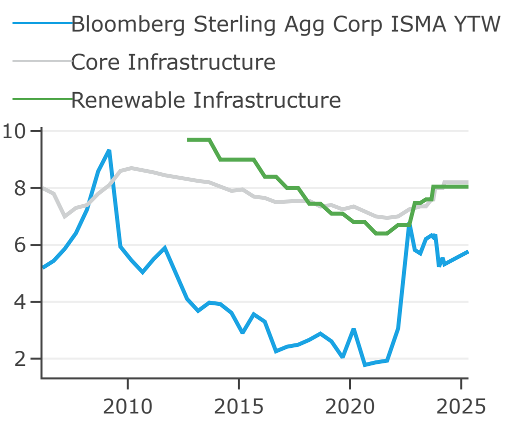
Listed Private Equity

Discount To NAVs



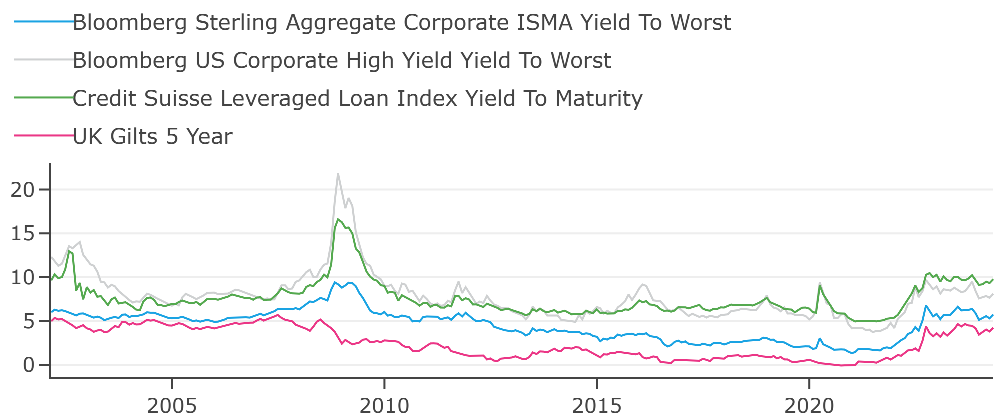
Infrastructure

Infrastructure Discount Rates vs Bond Yields



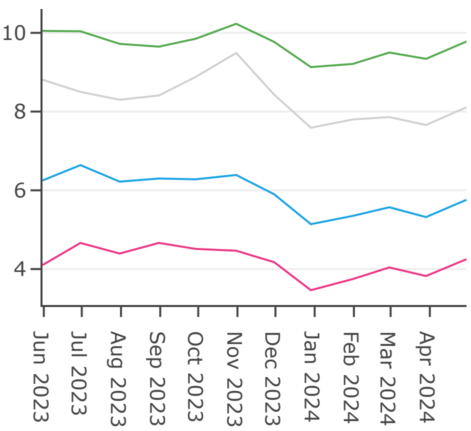
Contractual Income

Income Yields



Last 12 Months

Income Yields



Sources | Infrastructure: CCLA, Bloomberg; Property: MSCI UK Monthly Property Index, Bloomberg; Private Equity: Bain Global Private Equity Report, Bloomberg, Pitchbook; Contractual Income: Bloomberg, Pitchbook. As of May 2024

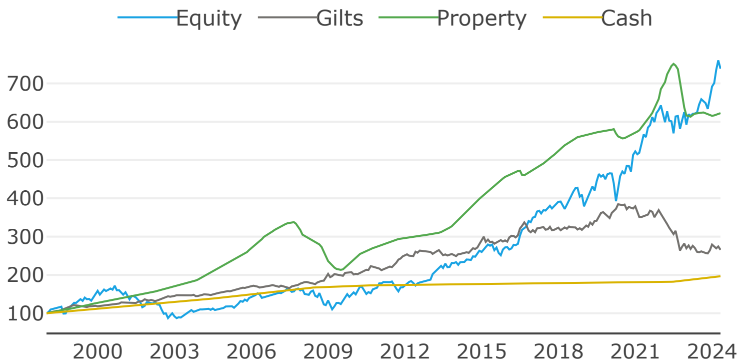
Property

The UK Commercial Property market offers good yields, (c.7.0% Equivalent Yield on average), within the context of the commonly targeted CPI+4% returns at a portfolio level. NAVs appear to have stopped falling, having declined 21% last year. Our Property team characterises the market as "orderly", but with buying and selling activity bumping along the bottom as investors wait to see the full impact of the 14 hikes in Bank Rate that we have already had.

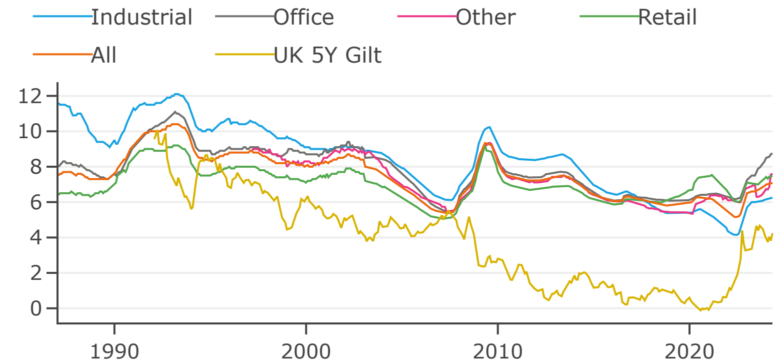
We show that UK Commercial Property has generated similar returns to global equity over the last 25 years (top left chart). Further, that outside of correction phases (one of which we have just been through) **real returns to Property have tended to average around the starting Equivalent Yield** (middle left chart). **This bodes well for forward returns from here**.

UK Commercial Property Market

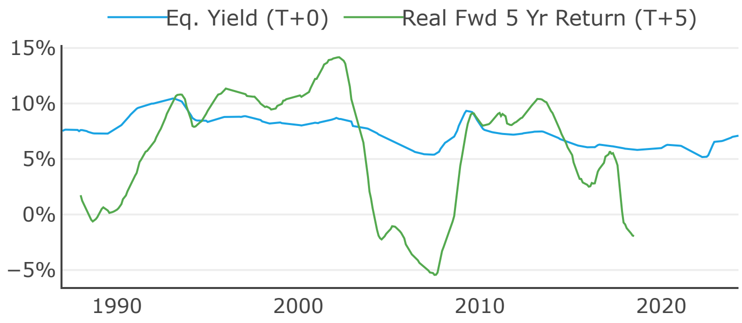
25 Years Of Return 1998=100



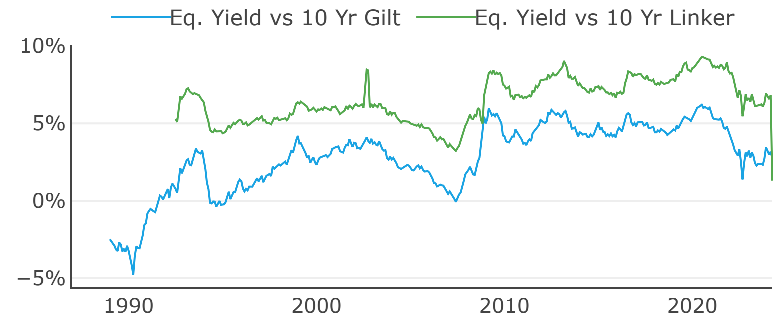
Equivalent Yields vs Gilt Yields %



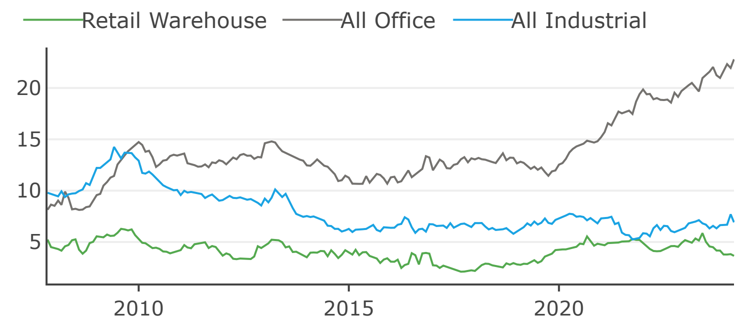
MSCI UK All Property Monthly TR Index %



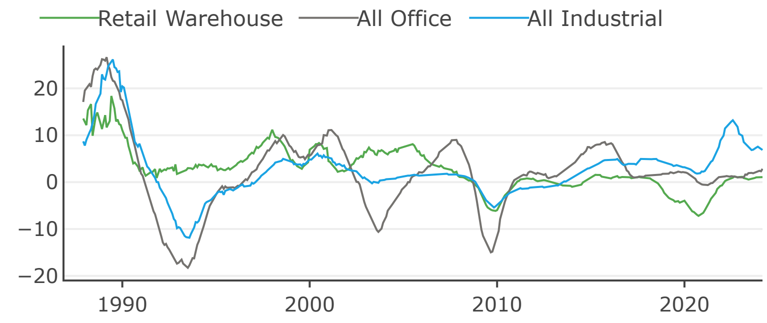
MSCI UK All Property Index - Equivalent Yield Spreads



Vacancy Rate %



Nominal Rental Value YoY Growth %



Sources | Equivalent Yields, Vacancy Rate, and Nominal Rental Value charts: MSCI UK Monthly Property Index as at May 2024. 25 Years of Return, All Property Monthly TR Index as at April 2024

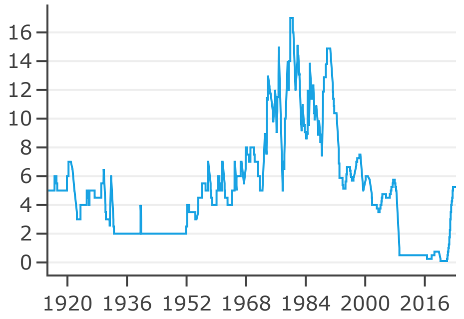
Cash

UK's latest inflation reading has finally fallen within the Bank of England's mandate (2% +/-1%) **-** a feat to celebrate, surely. So why haven't interest rate expectations moderated? There are two points: first, despite the fall in CPI to 2.3%, it was still higher than the Bank of England's and market's forecast of 2.1%; second, the prime driver behind the slowdown was again energy. While key areas such as services and private sector wage growth figures remained sticky at 5.9%.

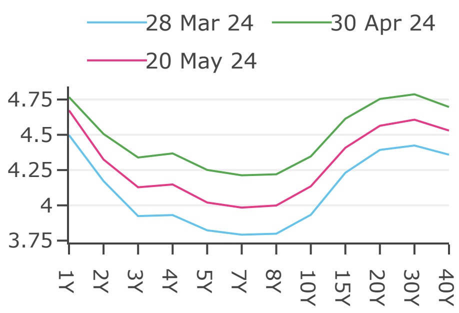
As mentioned last month, the UK has largely exhausted the benefit of falling Goods prices. To ensure sustainably low headline inflation, it will need a decline in services and wages. Having said that, we note that all the stars need not align perfectly for the first rate cut, so **we maintain our expectation of Q3 as the most likely starting point.**

UK Sterling Market

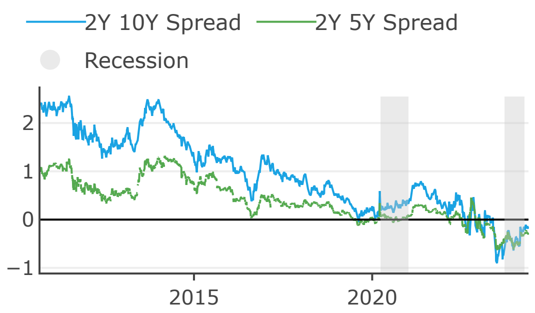
Official Bank Rate



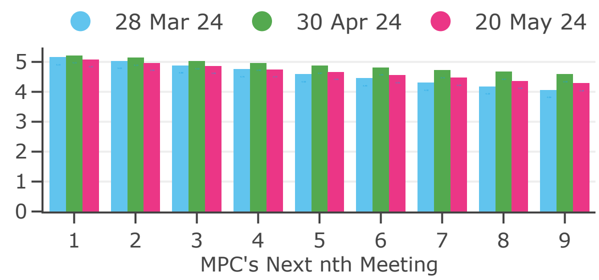
UK Gilt Curve



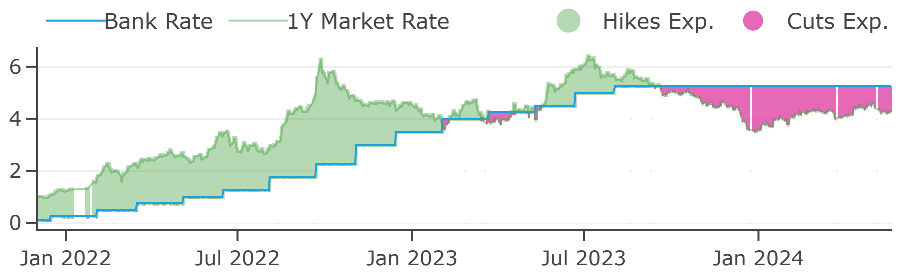
Gilt Spreads



Rate Expectations For Future MPC Meetings



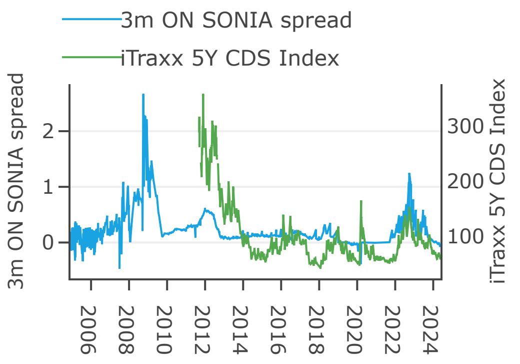
1Y Forward Market Rate Expectations



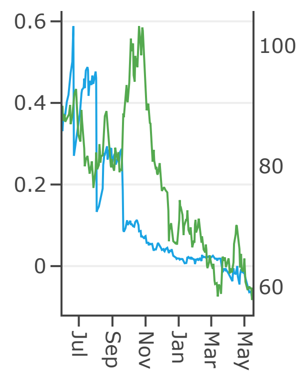
Inflation Readings YoY% | Colour by 10Y Z-Score*

Year	2023	2024			
	Dec...	Jan...	Feb...	Mar...	April
RPI	5.20	4.90	4.50	4.30	3.30
CPI	4.00	4.00	3.40	3.20	2.30
CPI Core	5.10	5.10	4.50	4.20	3.90
CPI Services	6.40	6.50	6.10	6.00	5.90
CPI Goods	1.90	1.80	1.10	0.80	-0.80
Priv. Wages	6.20	5.90	5.80	5.90	

Market Stress



Last 12 Months



Sources | ITraxx CDS is the Markit iTraxx Europe Senior Financial Index, comprising 30 equally weighted credit default swaps on IG European entities. *10 year z-score applied on each series, coloured using gradient with score of 0 as green, at least +/- 2 standard deviations away scores as red.

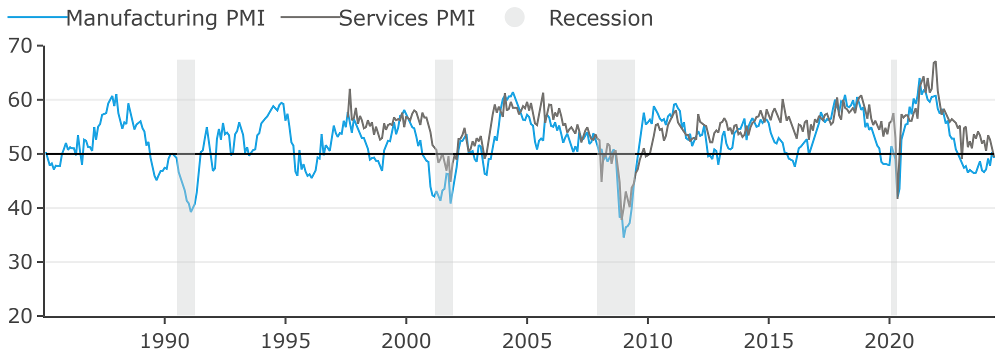
Bloomberg for all charts, as of May 2024

GROWTH

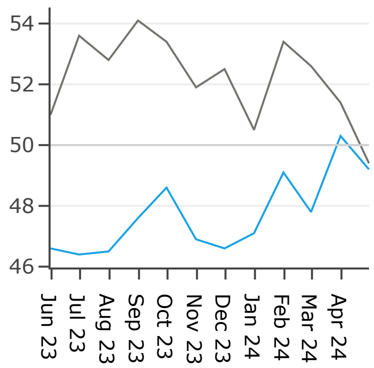
Global PMIs

Leading indicators are just about holding up in aggregate around the world. The key US Services PMI dropped below the 50 line for the first time since Dec '22, showing early signs of slowdown for the ~70% of the US economy that it represents. Adding fuel to the fire, despite its recent break above 50, the US Manufacturing PMI has again fallen back into contraction with its latest reading. On the other hand, Eurozone Services PMI is now solidly above 50. **For now there is no immediate sign of a recession, however, we remain vigilant**.

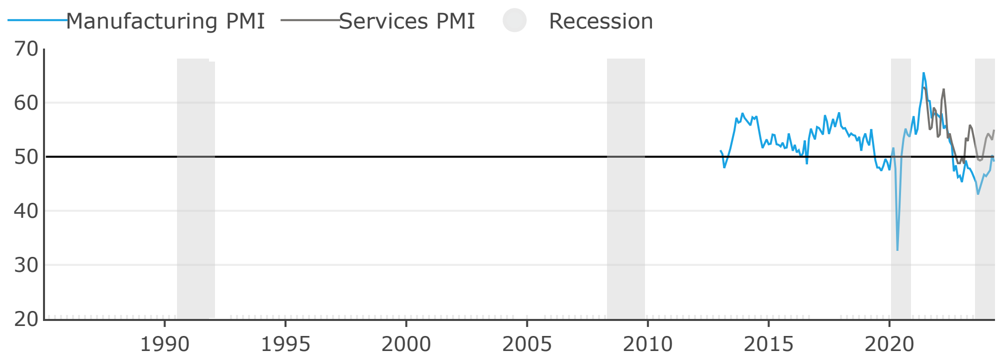
United States



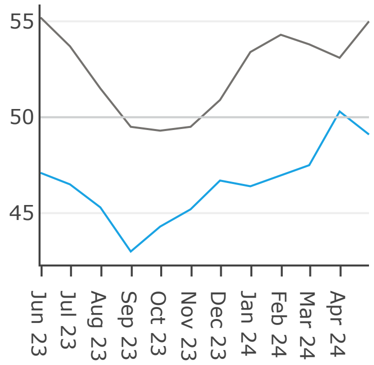
Last 12 Months



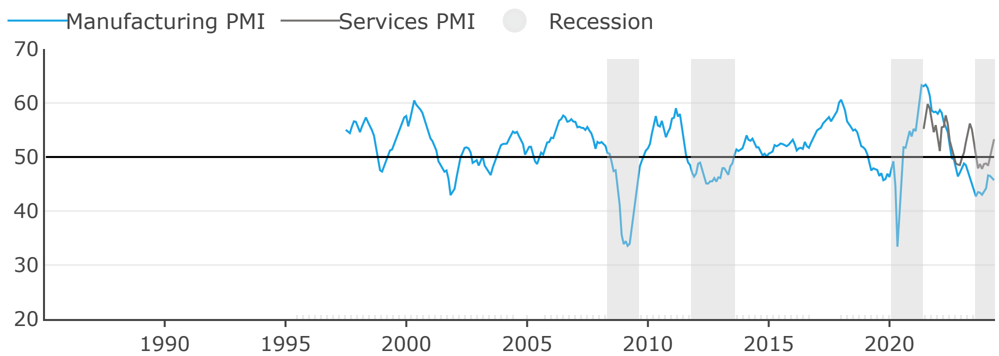
United Kingdom



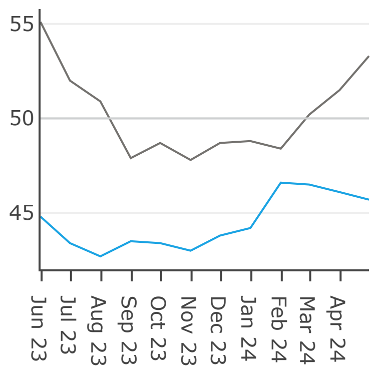
Last 12 Months



Eurozone



Last 12 Months



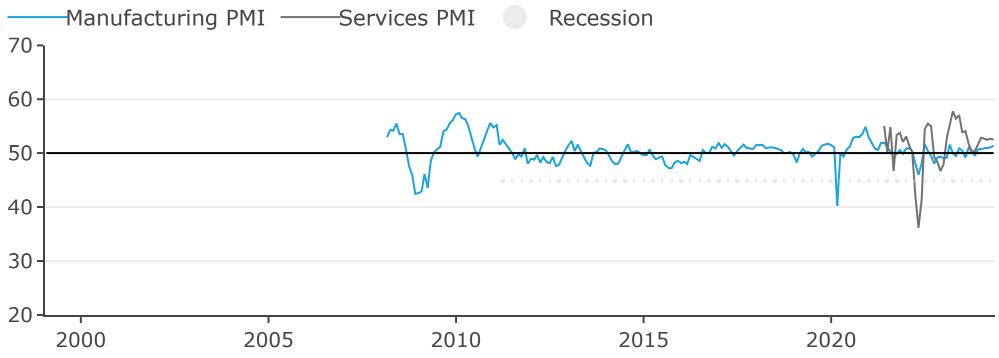
Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of May 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

GROWTH

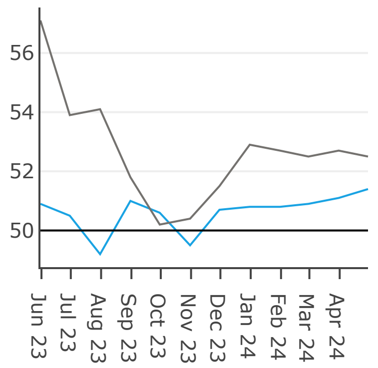
Global PMIs

Both the Global Services and (more recently) Manufacturing PMIs are above 50 (bottom right chart), indicating that the Manufacturing recession is likely over and that there is no imminent recession risk. This can change quickly, but for now, growth is supported.

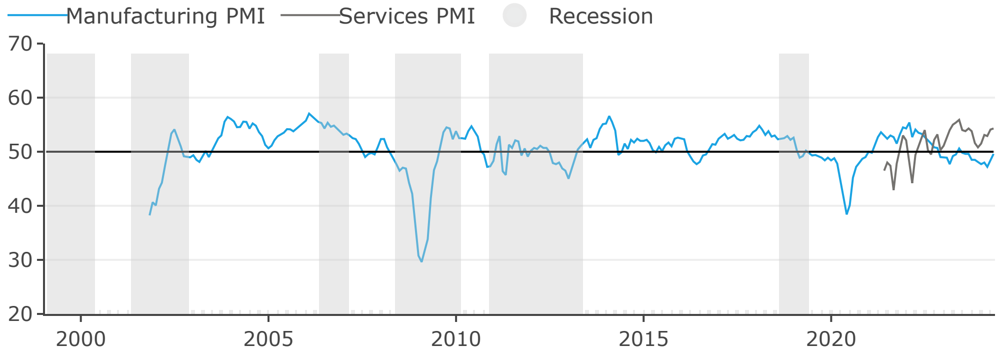
China



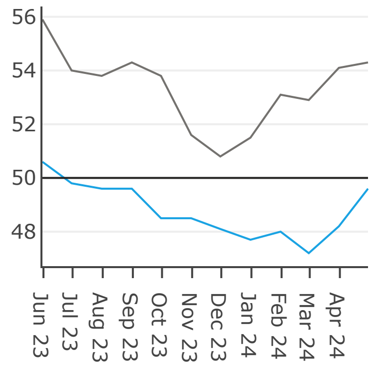
Last 12 Months



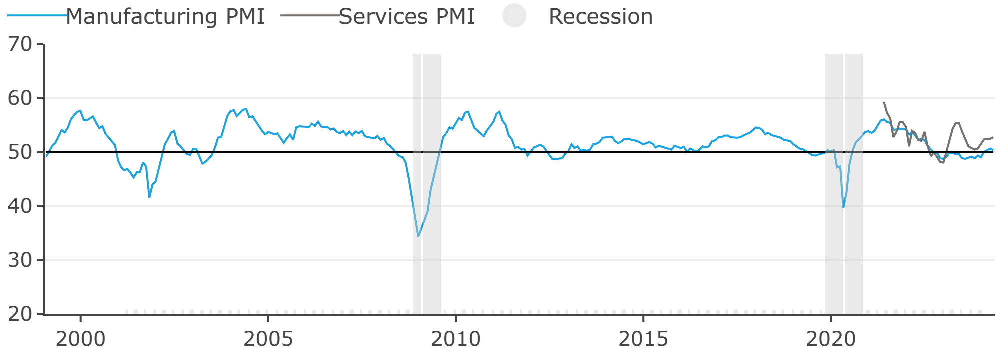
Japan



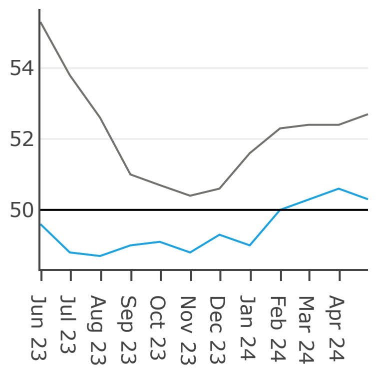
Last 12 Months



Global



Last 12 Months



Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of May 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

GROWTH

CCLA

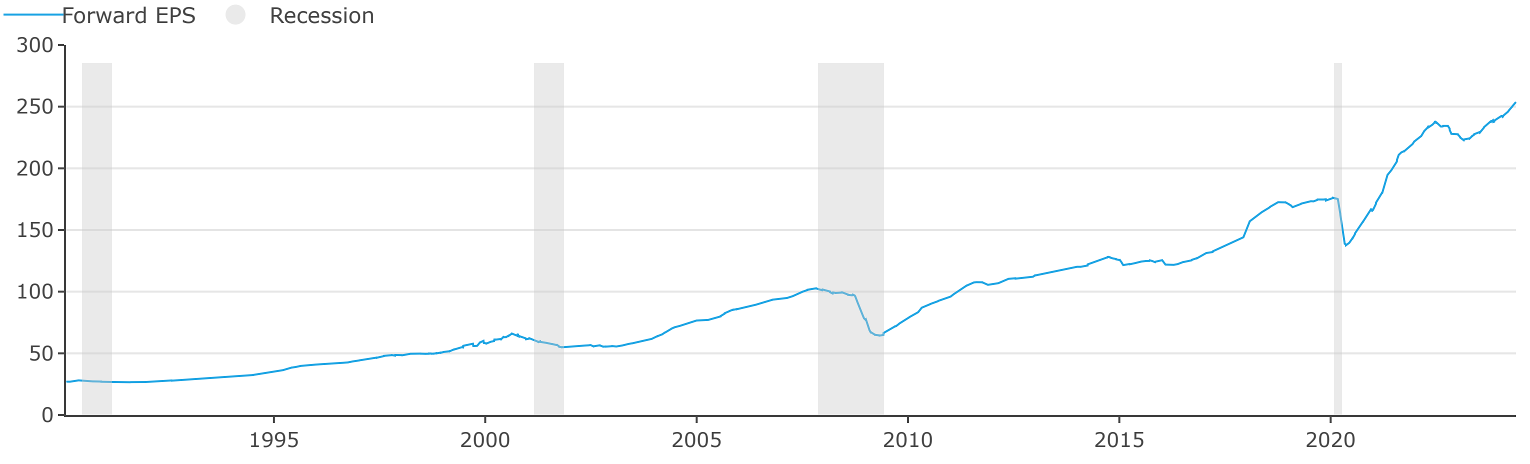
Earnings

Consensus forward earnings estimates continue to recover (top chart) while trailing earnings are just starting to grow again (if you squint at the bottom chart you can just about see it!)

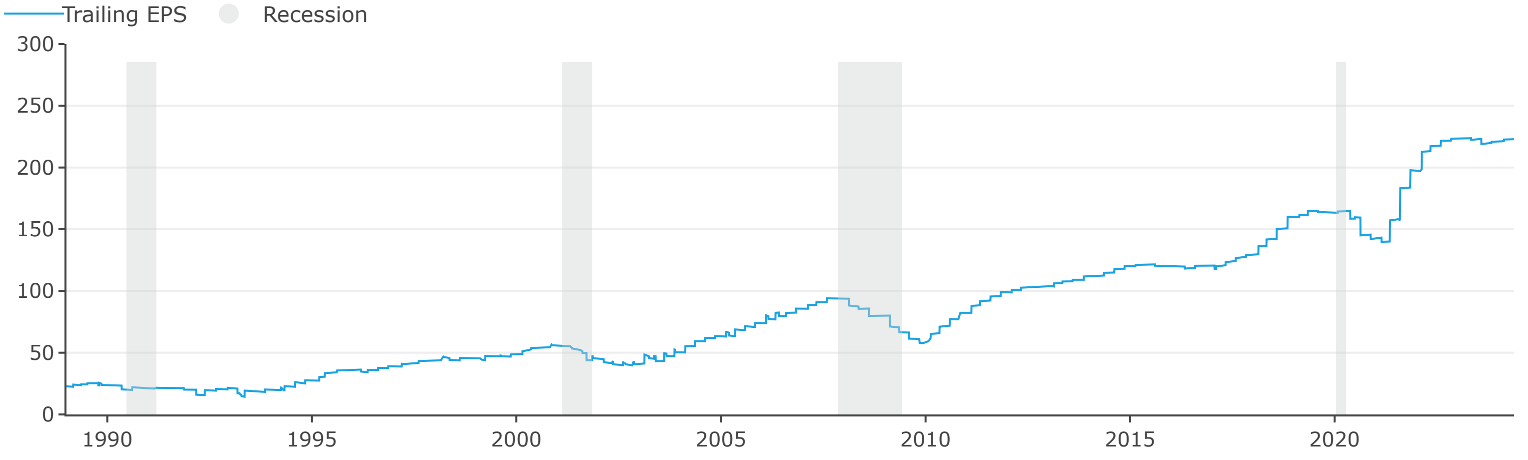
We reiterate that earnings could be in position to take over from PE re-rating in driving the market higher, although clearly a recession would change that.

S&P 500

Bloomberg Est. EPS



12M Trailing EPS



Sources | S&P500 12M Forward EPS using Bloomberg BF transformation, 12M Trailing EPS from Bloomberg as at May 2024

GROWTH

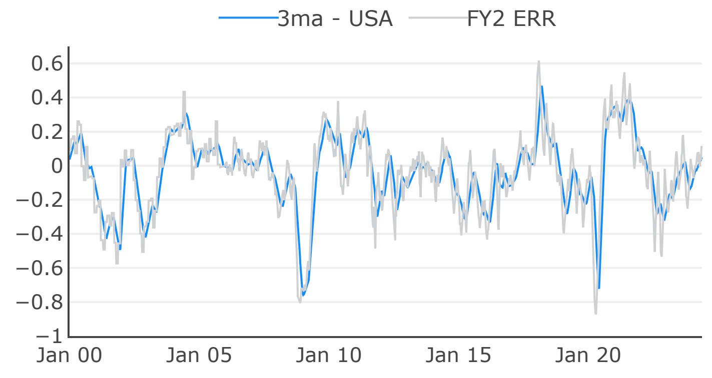
Earnings

These charts show the breadth of earnings revisions, i.e. # upgrades minus # downgrades / total estimates, so it is a directional measure showing how widespread upgrades or downgrades are. Historically, troughs in revisions breadth have been excellent times to add risk.

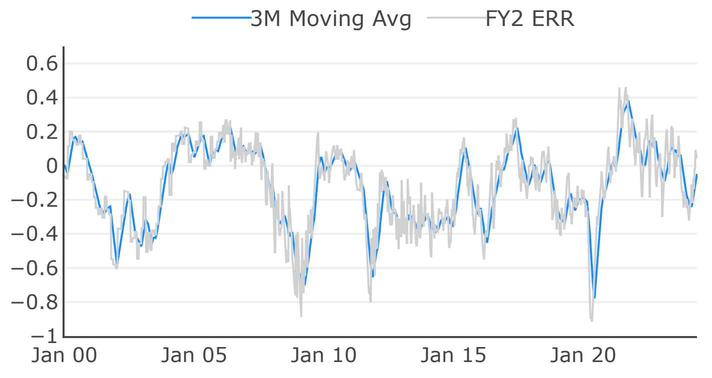
The overall assessment is that earnings breadth is ticking up, with the US now joining Japan in having positive net earnings breadth. This speaks to a broadening out of earnings support from just the Magnificent Seven.

Global Earnings Revisions Ratios

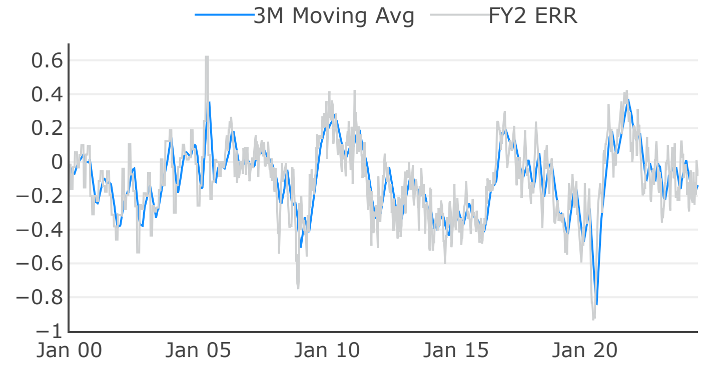
USA



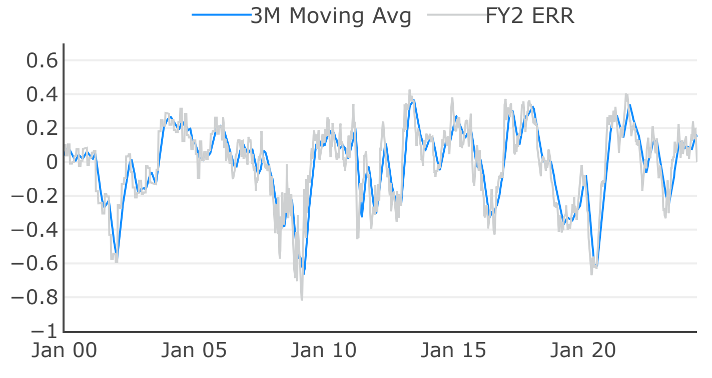
Eurozone



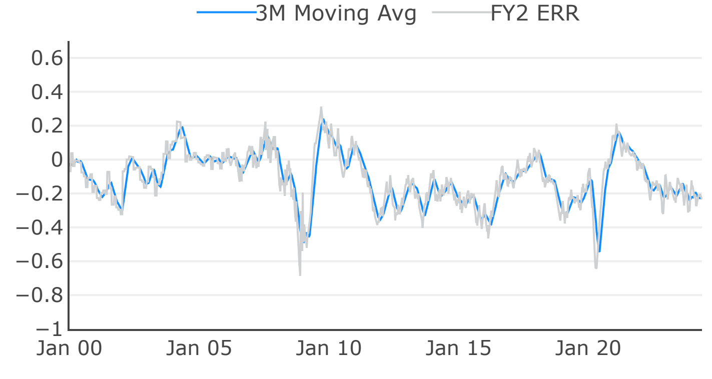
UK



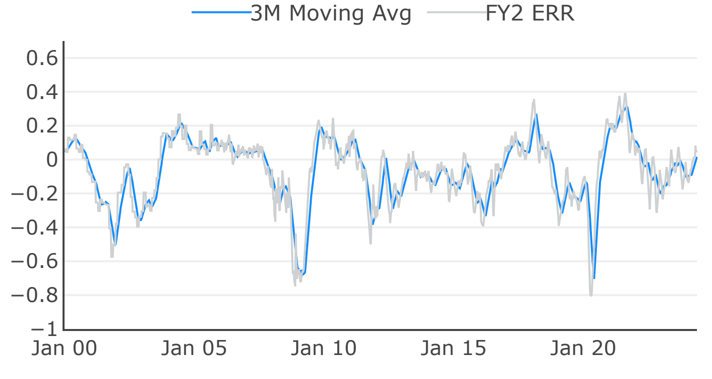
Japan



Emerging Markets



World



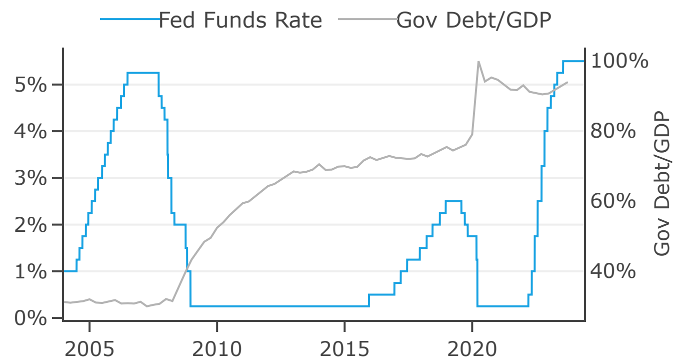
Sources | Eikon, the MSCI index has been used for each respective region, as at May 2024.

POLICY

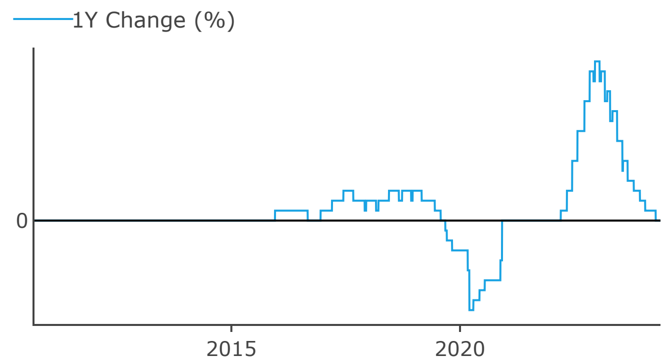
Interest Rates

After April's excitement of a first Japanese rate hike in 17 years, **sticky inflation has pushed the US two year bond yield back up to 4.8%,** from just above 4% earlier this year. The seven rate cuts that were pencilled in for 2024 have dwindled to just two now expected. **To the extent that this is a reflection of a strong nominal growth rate which supports index earnings, this does not have to be a very negative indicator for the stock market**.

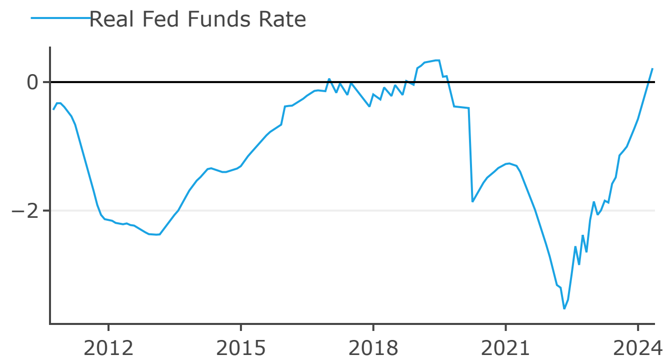
Fed Funds Rate



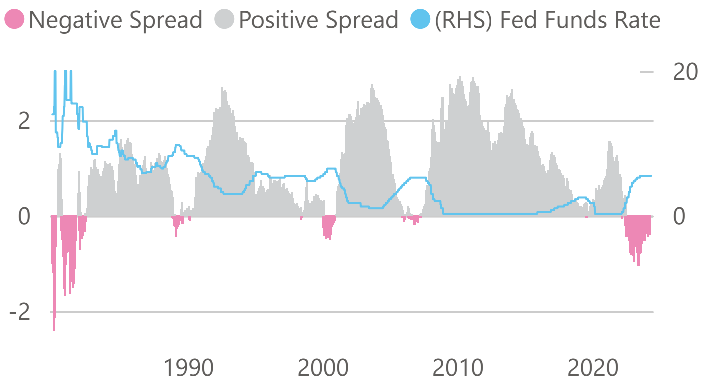
Change in Fed Funds Rate



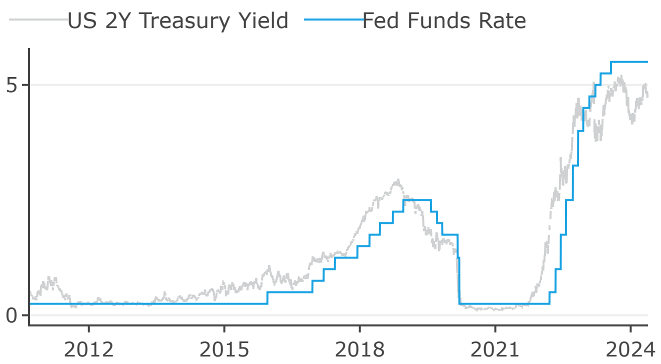
Real Fed Funds Rate (Using 2Y MA CPI)



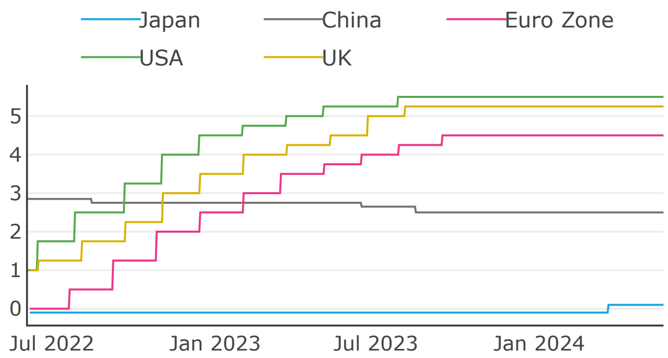
Fed Funds Rate vs 2s10s Curve



Fed Funds Rate vs 2Y Treasury



Global Comparison



Sources | Bloomberg for all charts, as of May 2024

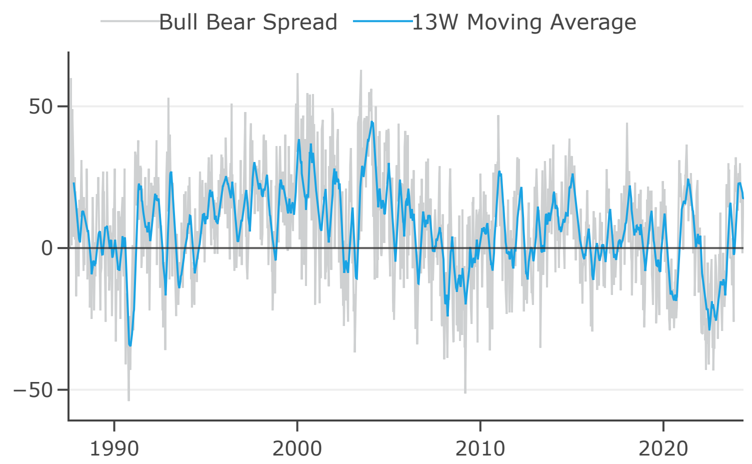
SENTIMENT

Sentiment

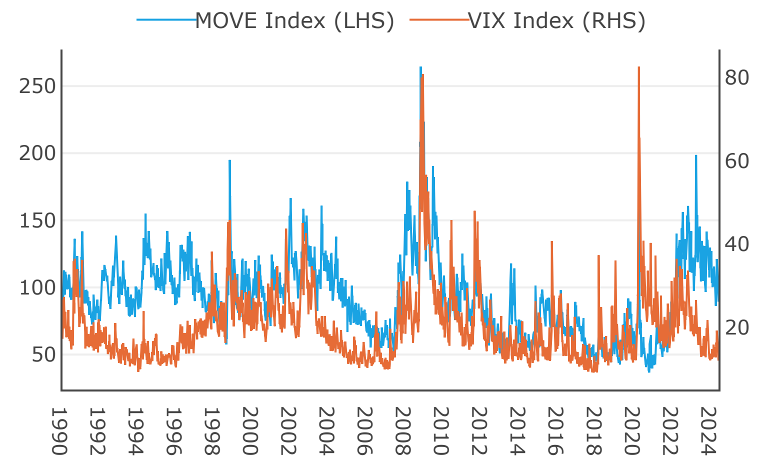
The Hartnett Bull & Bear Indicator has moved from Extreme Bearish sentiment (which is bullish for the market!) in October 2022 **to now jsut above neutral** (the current reading is 5.6/10). In other words, sentiment is neither extended nor washed out, and is therefore unlikely to be a catalyst one way or another.

US Equity Indicators

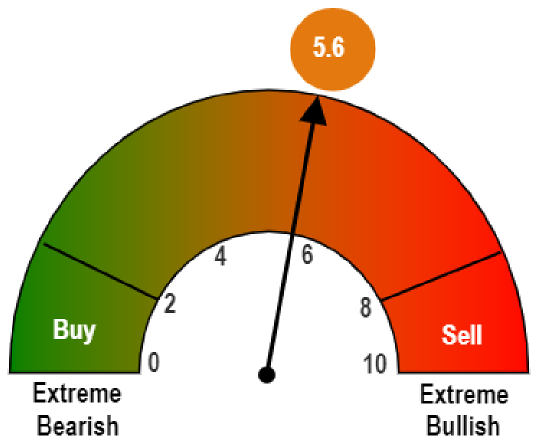
AAII Bull Bear Spread



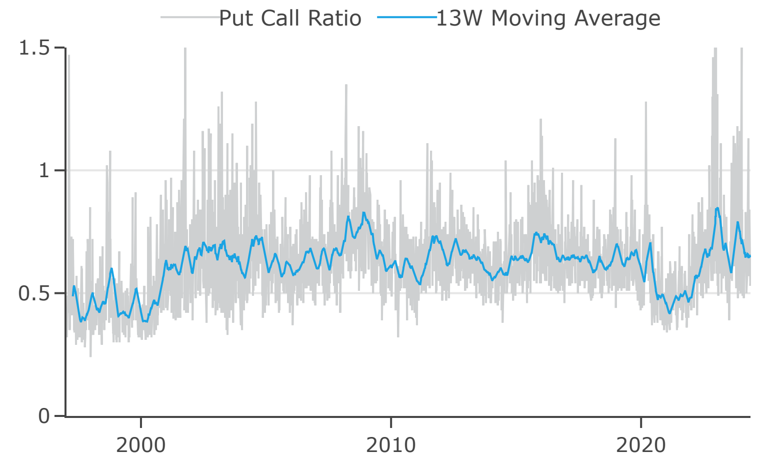
Equity vs. Bond Sentiment



Michael Hartnett's Bull & Bear Indicator (BAML)



Equity Put Call Ratio



Sources | Bull Bear Spread, Vix and Equity Put Call Ratio: Bloomberg. Michael Hartnett's Bull & Bear indicator by kind permission from Bank of America, as of May 2024

SENTIMENT

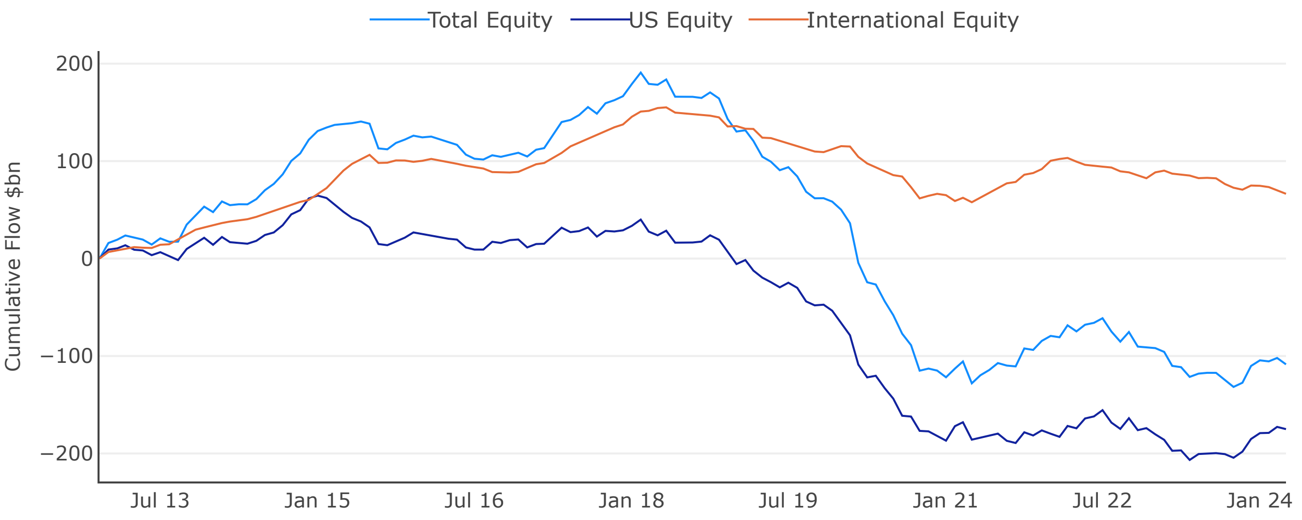
Fund Flows

This page captures US mutual fund flows as reported by the US Investment Company Institute, and flows are shown here as a cumulative total by adding successive months' flows. This excludes ETFs / passive and is therefore only for active flows. In later months we plan to add passive flows to get a feel for how fund liquidity is affecting markets.

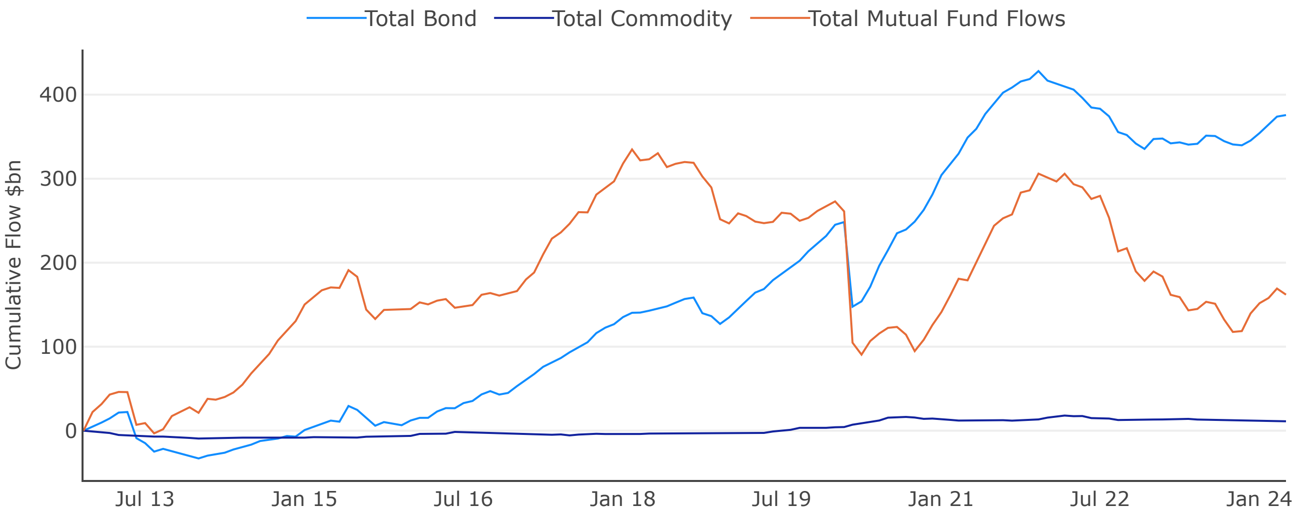
The message in these data points continues to be that there is little enthusiasm for actively managed funds even if the outflows from equity funds have stopped.

US Mutual Fund Flows

Equity Markets Cumulative $bn



Non-Equity Markets Cumulative $bn



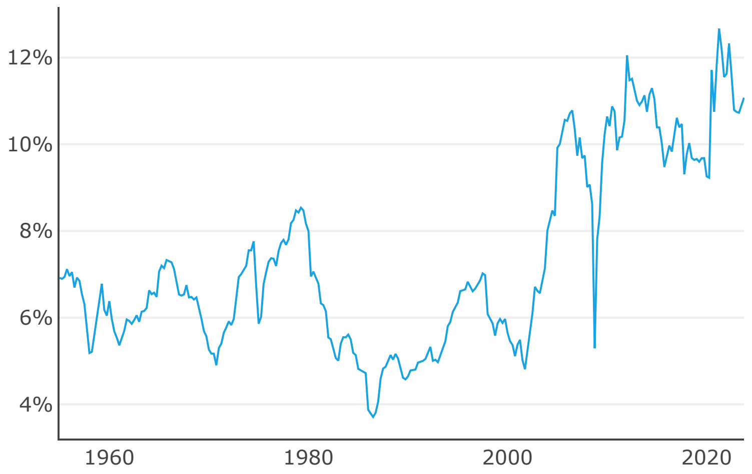
Sources | All charts: Bloomberg ICI fund flow data. Data as at May 2024

The Big Picture

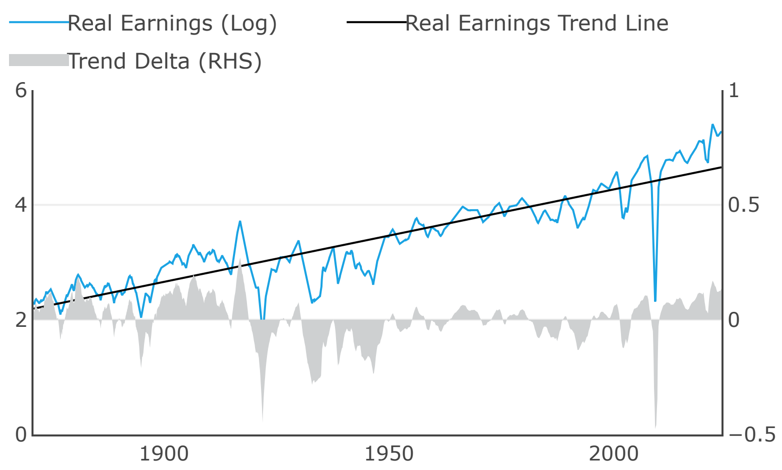
Here we highlight some longer-term imbalances that, **should** they correct, would have an outsized impact on risk asset returns. We don't make predictions but we do watch these. US corporate profit is just off the highest share of GDP that it has ever been since 1929. Its corollary (not shown) is that the wage share is at the lowest level it has been in almost as long. Allied to this, the top right chart shows that earnings are as far above their long run trend in absolute terms as they have also been since 1929. Domestic non-financial debt is also extremely elevated. All of this suggests that if old relationships hold and we get mean reversion, forward 10 year returns could be much lower than suggested by the ERPs.

Long Term Inbalances

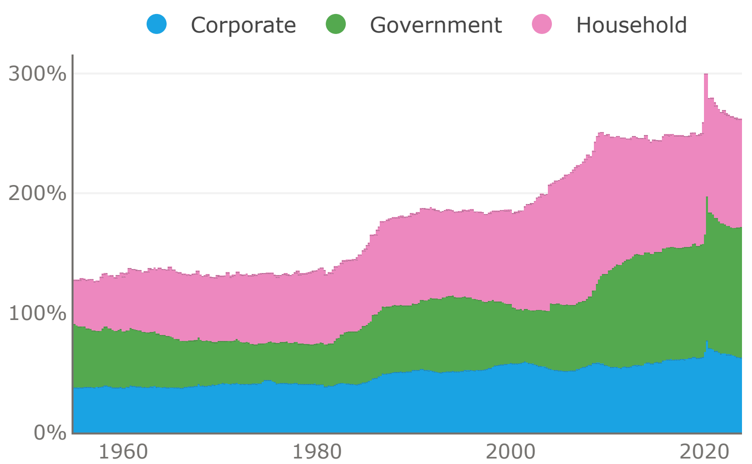
Profit Share of GDP



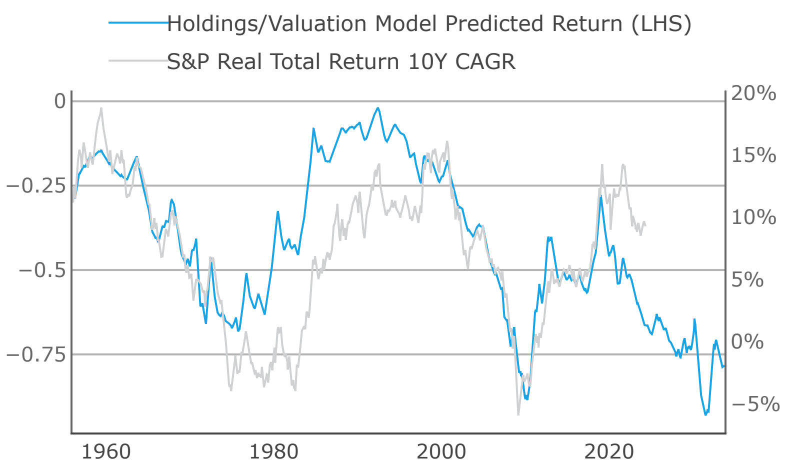
Earnings Deviation From Trend



Non Financial Debt as Share of GDP



S&P 500 10Y Forward Returns



Sources | Profit Share of GDP, and Non Financial Debt as Share of GDP: Federal Reserve Economic Data (FRED); Earnings Deviation From Trend: CCLA using Shiller CAPE data from Yale.edu; S&P 500 10Y Forward Returns: Holdings/Valuation Model uses three inputs: Tobin's Q, Shiller CAPE and Household Equity Holdings to predict 10Y forward returns. All data refreshed as at May 2024.

Important information

This document is produced for professional investors and is also available on request.

This document is not intended for general retail public distribution and must NOT be distributed to other persons without CCLA's permission.

This document is issued for information purposes only. It does not constitute the provision of financial, investment or other professional advice and does not constitute an offer or invitation to make an investment in any financial instrument or in any CCLA product.

The market review and analysis contained in this document represent CCLA's house view and should not be relied upon to form the basis of any investment decisions.

Any forward-looking statements are based upon CCLA's current opinions, expectations and projections. Such opinions, expectations or projections may be subject to change at any time. CCLA undertakes no obligation to update or revise these. Actual results could differ materially from those anticipated.

Past performance is not a reliable indicator of future results. The value of investments and the income derived from them may fall as well as rise. Investors may not get back the amount originally invested and may lose money.

CCLA Investment Management Limited (registered in England and Wales, number 2183088) , whose registered address is: One Angel Lane, London, EC4R 3AB, is authorised and regulated by the Financial Conduct Authority.

CCLA

GOOD INVESTMENT

www.ccla.co.uk

CCLA Investment Management Limited (registered in England & Wales, No. 2183088)
is authorised and regulated by the Financial Conduct Authority.
Registered address: One Angel Lane, London, EC4R 3AB.