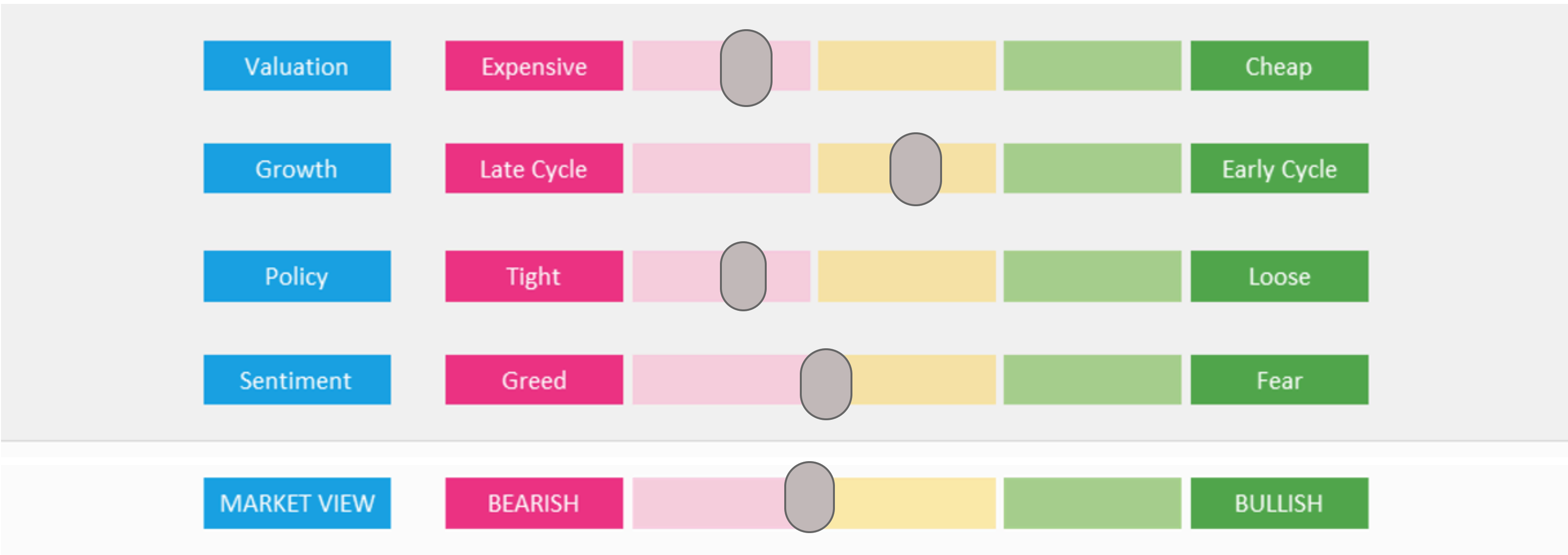
SEPTEMBER 2024

CCLA
GOOD INVESTMENT

Market Barometer

Barometer



Into the Rate Cutting Cycle

- **Fed Chairman Jay Powell fired the starting gun** on a new rate-cutting cycle in his Jackson Hole speech on 23 August, declaring that "the time has come for policy to adjust" but that "the timing and pace of rate cuts will depend on incoming data."
- **Are rate cuts good for stock markets? Well, no,** not usually. Our first Chart of the Month in this issue of the Barometer shows the Fed Funds rate and recessions. Since 1970 there have been nine rate hiking cycles (before the one just ending). Seven of the nine were immediately or almost immediately followed by recession. What this says is that soft landings are possible after a hiking cycle (1984 and 1994) but much more often the tightening engenders recession.
- **But bull markets run from recession to recession.** Nothing in our suite of cycle indicators is sounding an alarm for imminent recession. And as we always say, the last bit of the cycle is often the best bit for returns. There can be a lag between the start of rate cuts and the start of recession / peak of stock market.

In our Charts of the Month:

- As just discussed, we look at timing around interest **rate cycles and recessions**.
- We show charts which demonstrate just how much **earnings drive stock markets**, and reveal where the growth in earnings has been over the last several decades (clue, US and India look good, UK and Europe look bad).
- We sketch out our initial views on the US presidential **election's possible impact on equity markets**. Were Trump to win it might not be as well-received by markets this time around as it was in 2016 because the market is now more worried about inflation than deflation.
- We illustrate the impact of the **yen carry trade** and say it is ~70% unwound, meaning that fundamentals can again take the driving seat.

We remain risk on.

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Contents

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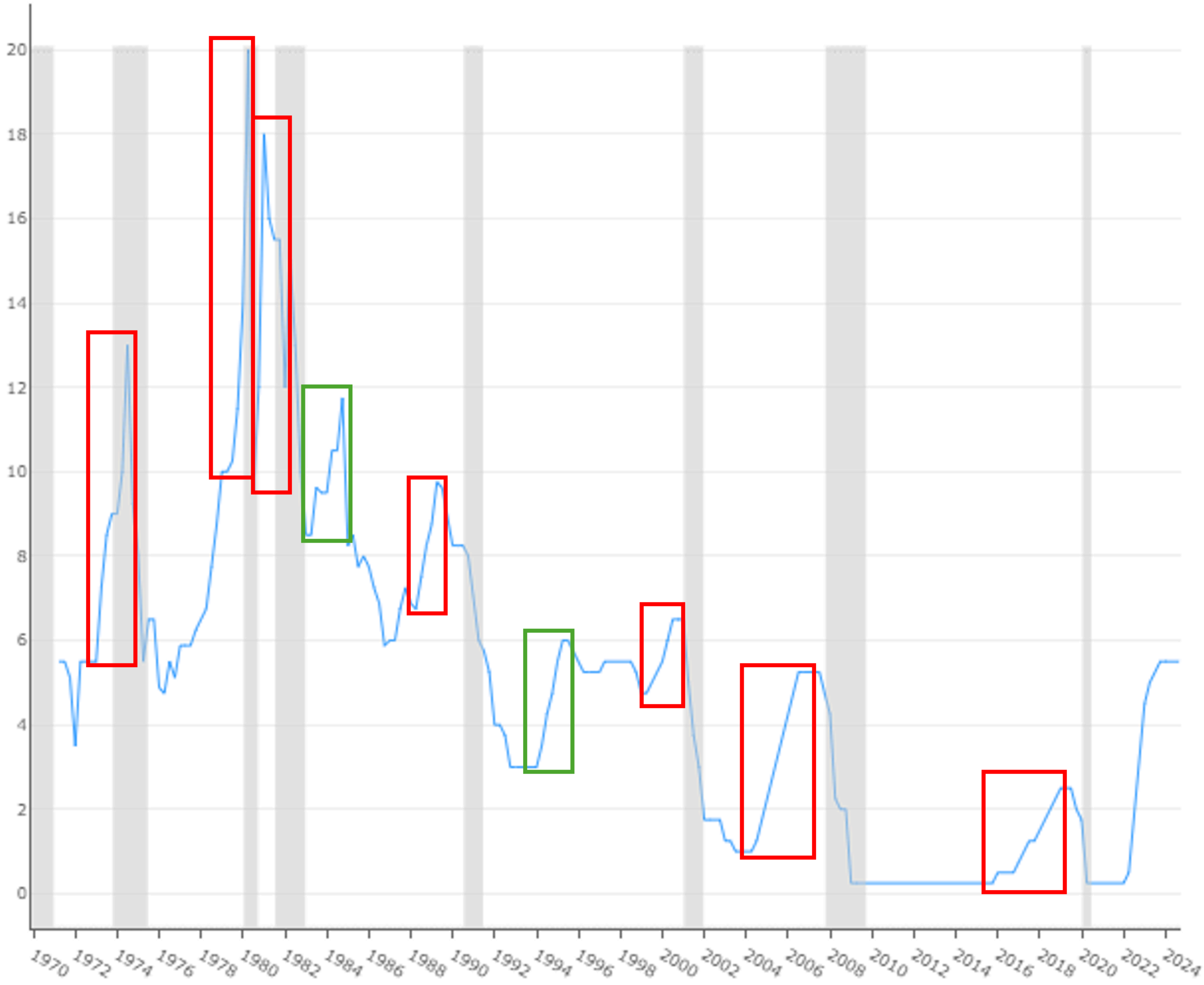
Charts of the Month (1 of 4)

Are interest rate cuts good for equity markets? The short answer is no. Equities always go down in recessions and the interest rates are usually cut going into recession. The chart shows the Federal Reserve policy interest rate in blue, with recessions shaded in grey. The red boxes show seven tightening cycles that ended in recession. The green boxes show the two tightening cycles that ended in soft landing / no recession. 7:2 is quite a margin favouring recession. This said, there can be lags between the first rate cuts and the start of recession. **As with so many indicators, this says we are getting closer but we are not there yet. And as we always say, bull markets run from recession to recession, and the last bit of the bull market is usually the best bit. So we keep risk on.**

Fed Funds & Recessions



Sources | CCLA, Bloomberg. Data as at Aug 2024

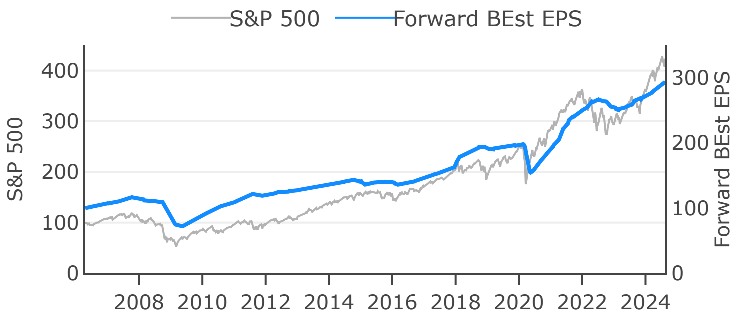
Charts of the Month (2 of 4)

Earnings drive stock markets, stock markets discount future earnings. These charts show the truth in these statements, and explain why we place so much emphasis on progress in the forward earnings integer in our analysis. It's worth noting that the scales on all six charts are the same. You can see where the equity market and its earnings have grown and where they have not. The market line is price not total return.

(As an aside, they also show (to us) the surprising lack of earnings growth in the old world (UK, Europe). Literally zero growth in the last 20 years in the FTSE100 earnings. We find this extraordinary. The grey lines are the stock market price indices in USD terms. Literally no growth in FTSE100 capital in 20 years either. So all of the 5.5% total return has come from dividend yield over that period).

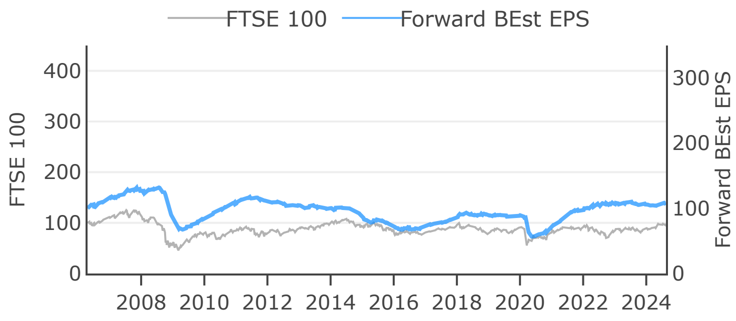
USA

Index = 100, In USD



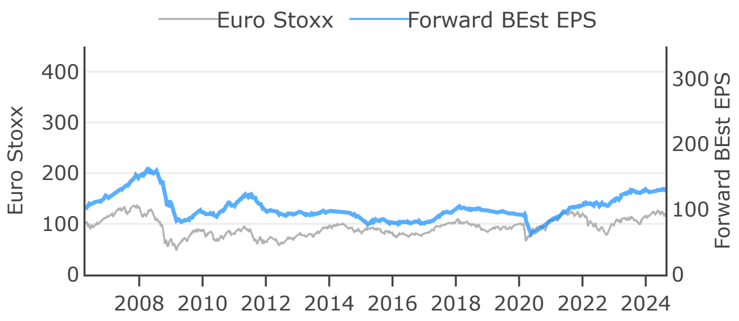
UK

Index = 100, In USD



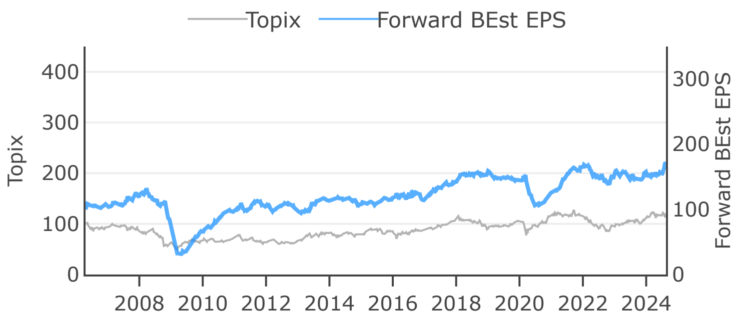
Europe

Index = 100, In USD



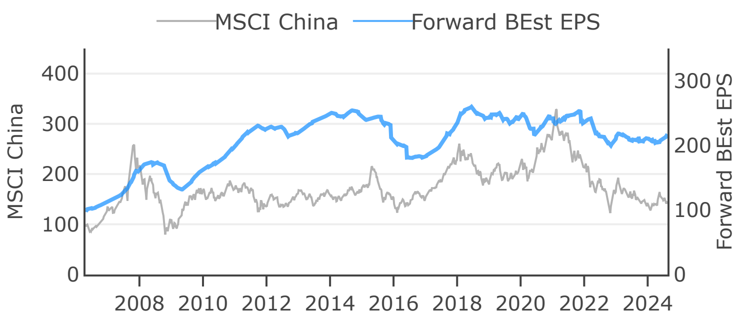
Japan

Index = 100, In USD



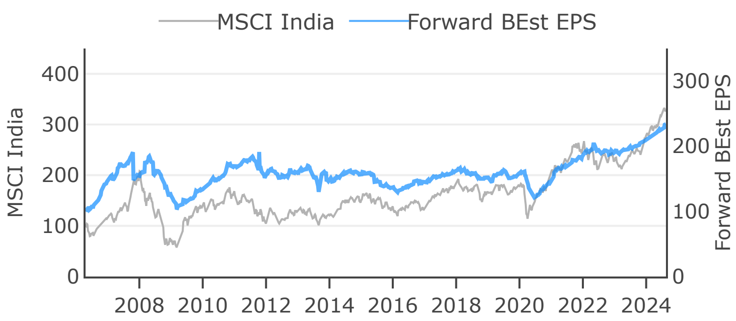
China

Index = 100, In USD



India

Index = 100, In USD



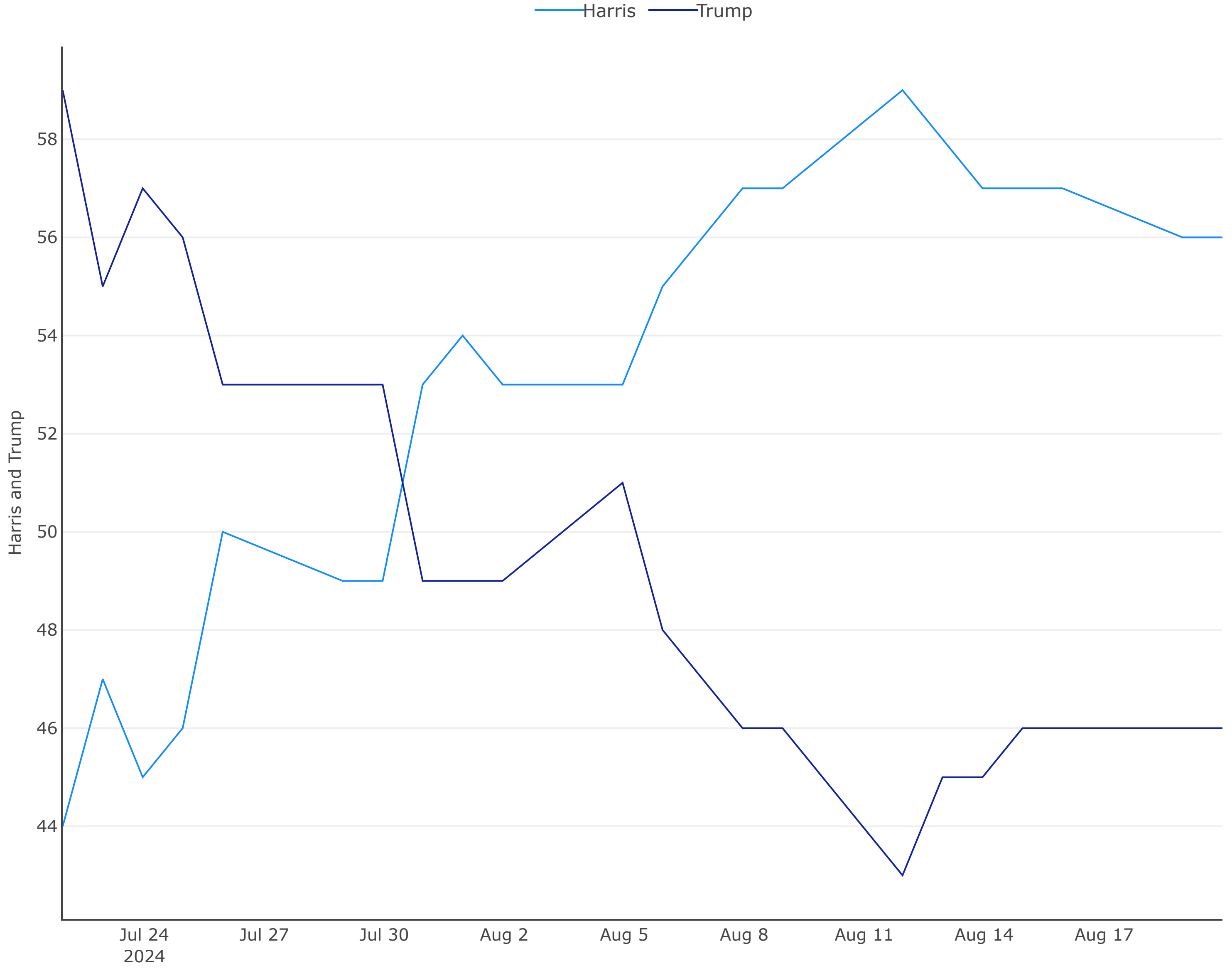
Sources | CCLA, Bloomberg. Data as at Aug 2024

TOP OF MIND

Charts of the Month (3 of 4)

How might the US election impact risk assets? Trump is a very inflationary individual. Think tax cuts, deficit spending, tariffs and trade wars. When he won in 2016 markets were worried about deflation, so an inflationary President was good news. Now, markets are worried about inflation, so an inflationary President may well be bad news. Harris is openly wondering about corporation tax hikes, which is contractionary, and while that may be better news on the inflation front it's a clear negative for a stock market already worried about the December 2025 expiration of the Trump tax cuts. Neither candidate seems likely to rein in fiscal largesse. Neither seems great news for the stock market on their own, but the consolation is that with neither party likely to achieve the clean sweep (control of Oval Office, House and Senate), **it may be that not much gets done anyway, which markets would much prefer!**

Predictit Odds of Winning the US Presidency (from 21 July, Biden's withdrawal)



Sources | Bloomberg, CCLA, data as at Aug 2024.

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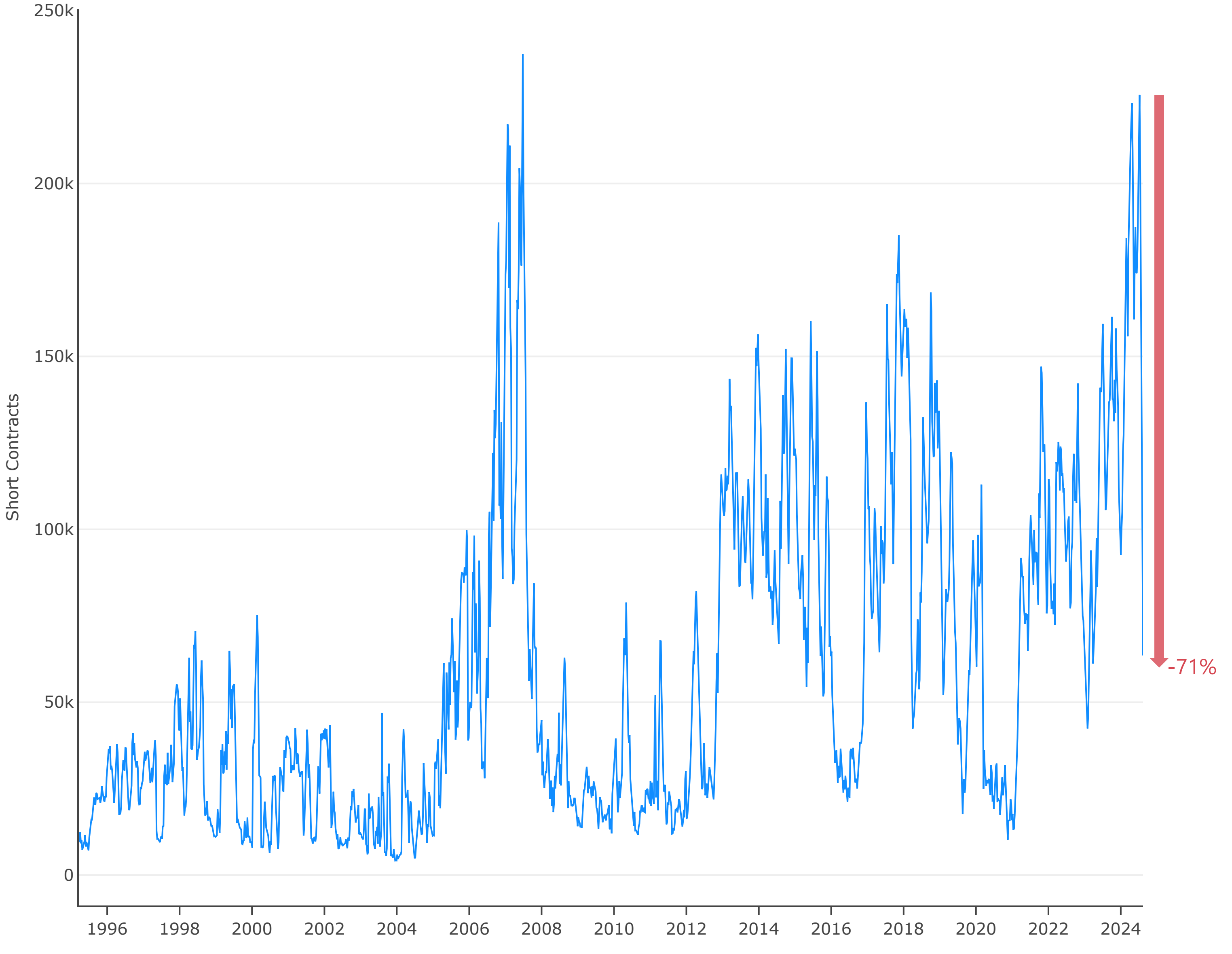
Charts of the Month (4 of 4)

The Yen carry trade has unwound 71% of open interest in just one month, according to this chart. The data is from the Commodity Futures Trading Commission and shows the number of contracts that non-commercial traders (i.e. speculators) hold shorting (betting against) the Japanese yen. Market participants had become very short the yen, equalling the 2006 record, by early July this year, on the basis that with close to zero interest rates the cost of shorting the yen was close to zero. So one could "borrow" yen in order to reinvest in higher-yielding assets in Japan or overseas - the so-called yen carry trade. This worked until Japan started raising interest rates and other economies started cutting interest rates, making the yen carry trade less lucrative. Some traders started to cover their short yen, meaning they had to sell the risk assets that those yen borrowings were funding. This was the main cause of market turbulence in July-August. This chart says that's now behind us.

Yen Carry-Trade Unwind



Sources | Bloomberg. Data as at Aug 2024

VALUATION

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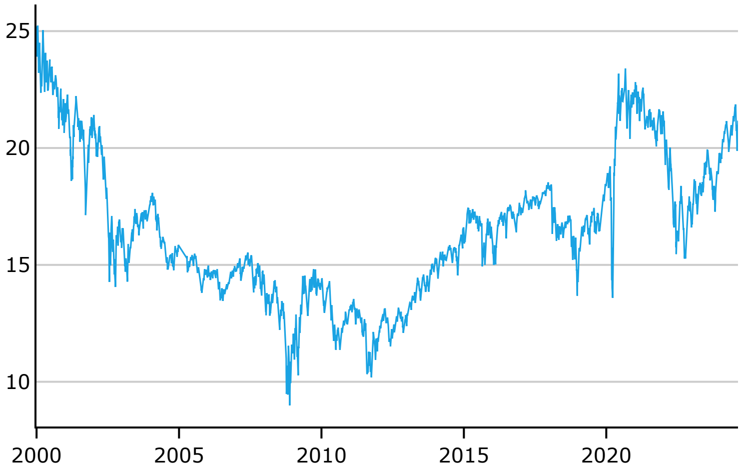
Equity | USA

The first few days of August were greeted with an 8% sell-off for US equities. While this drawdown is the largest so far this year, it is still far from what we would associate with bearish markets (~-20% to -30%). Given the snappy recovery since, +1.4% MTD*, **we believe this correction was based on Yen carry-trade technical factors and not fundamentals. We remain positive on equities.**

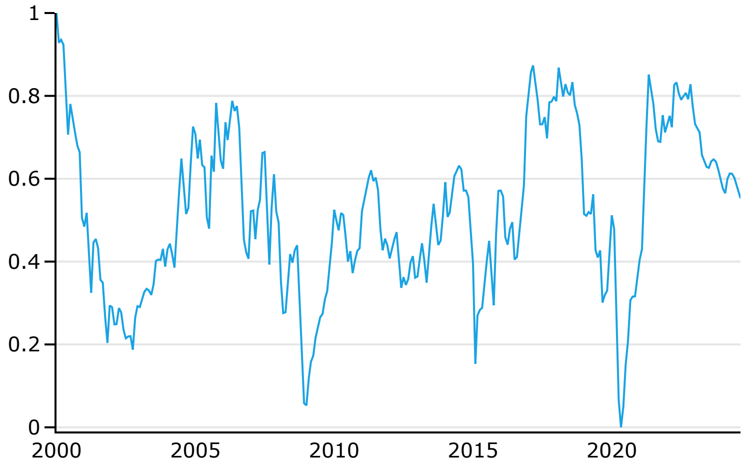
Despite the cross-asset valuation dropping to the 55th percentile (top right), equity risk premium (bottom right) still looks rich at 1.2%. Similarly on an absolute measure, the CAPE (cyclically adjusted PE) still stands near recent highs at 33x, creating an earnings yield and forward real expected return close to 3% annualised.

S&P 500 Valuations

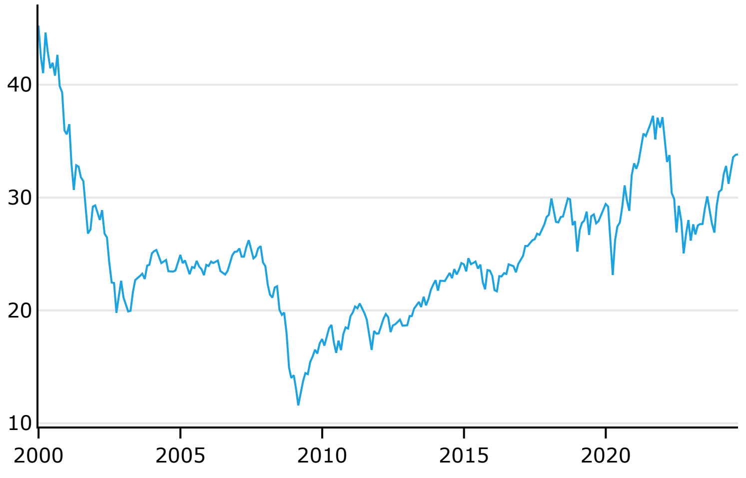
S&P 500 Forward PE



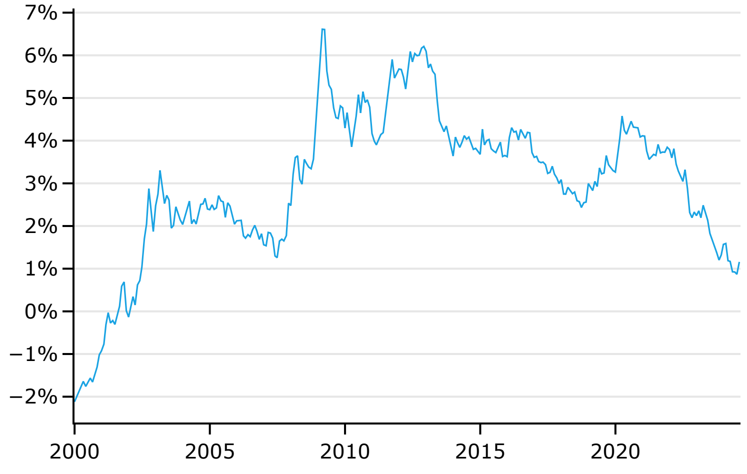
Composite Value Indicator Model



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. *MTD from 1 Aug 24 to 20 Aug 24.

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

VALUATION

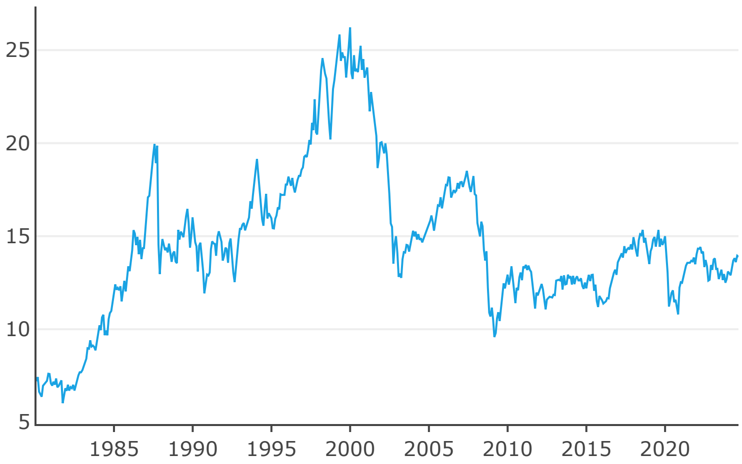
Equity | Regional

Outside the US we continue to see better top-down market value. In the UK, **attractive valuations, improved political clarity, and high dividend yields in a declining Gilt yield market, with a low beta to MSCI World, all make for interesting prospects.**

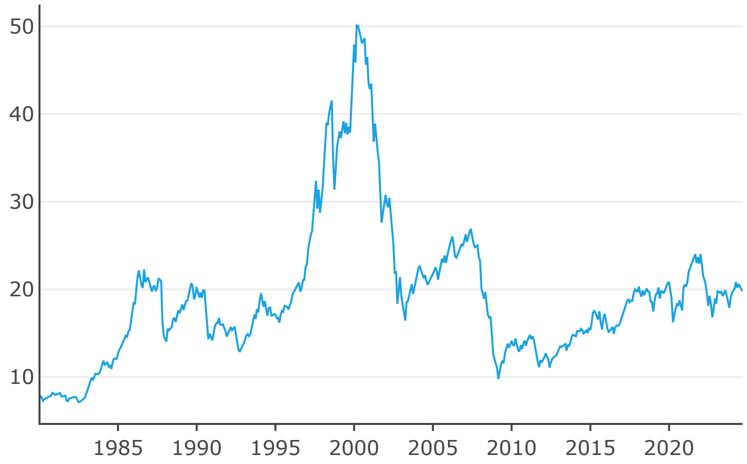
Shiller CAPEs highlight UK as 13.8x with an earnings yield (and expected forward real returns) over 7%, with Europe and Japan around 20x and ~5%, and EM 12x and ~8% respectively.

Europe

UK | Shiller P/E

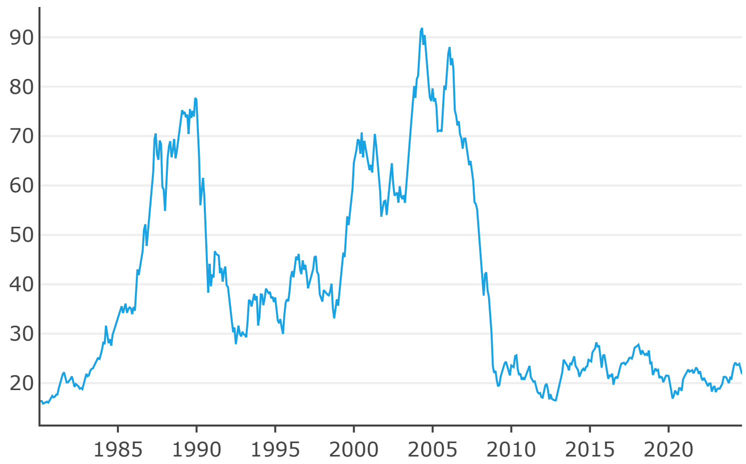


Europe (Ex-UK) | Shiller P/E

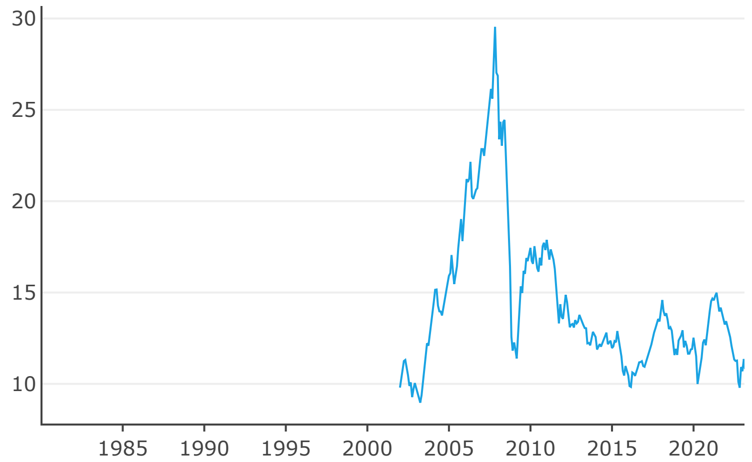


Asia & Emerging Markets

Japan | Shiller P/E



EM | Shiller P/E



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

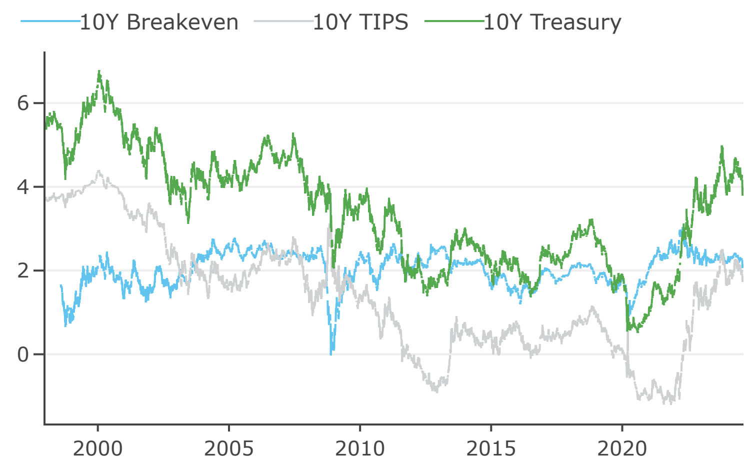
Bonds

UK and US sovereign bond yields have continued to fall since their May peaks, creating the first consistent bullish environment for bond holders since Q3 last year. 10Y UK and US Treasuries (UST) fell 45bps and 80bps respectively. Worth noting that almost two-thirds of the fall in UST is due to a repricing of the US inflation-linked bonds, i.e. a reduction in long-term growth expectations for the US, now at 1.7%. Comparatively, only one-third of the fall can be explained by linkers for the UK, now at 0.4%.

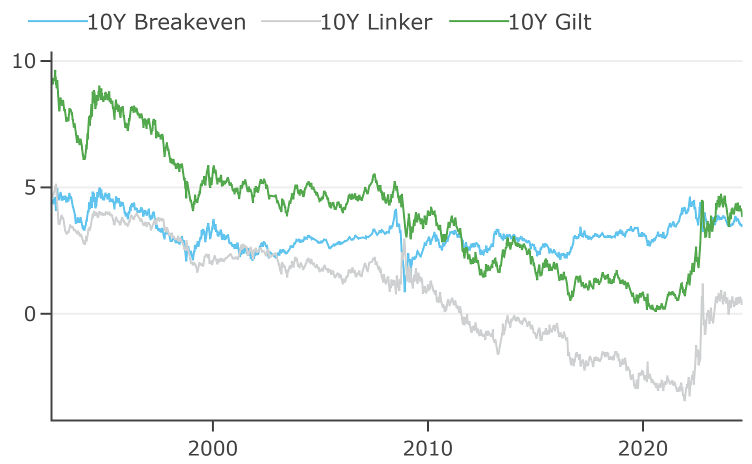
Corporate US BBB spreads have increased, however overall yields have followed US TIPS very closely downwards suggesting the reduction in long-term US growth is driving most of the recent US IG performance. **After stripping 2.5% for expected inflation, IG real yields of 3.1% still look reasonably attractive.**

Global Government & Corporate Yields

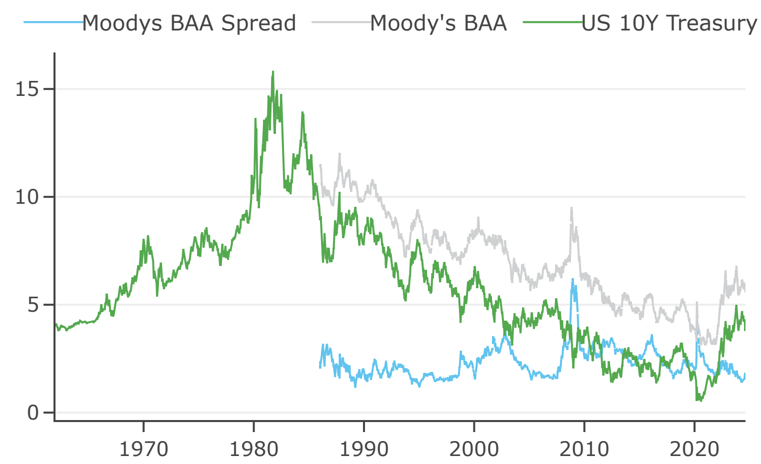
US 10 Year Treasury Yields



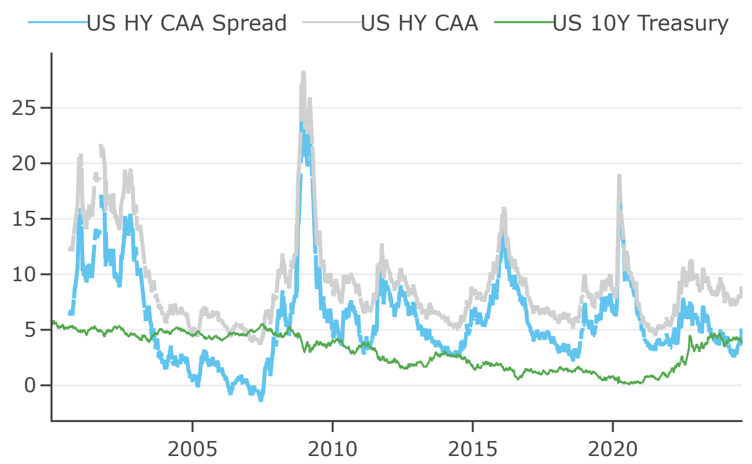
UK 10 Year Gilt Yields



US Corporate Investment Grade Yield



US Corporate High Yield



Sources | Bloomberg as at Aug 2024

Alternatives

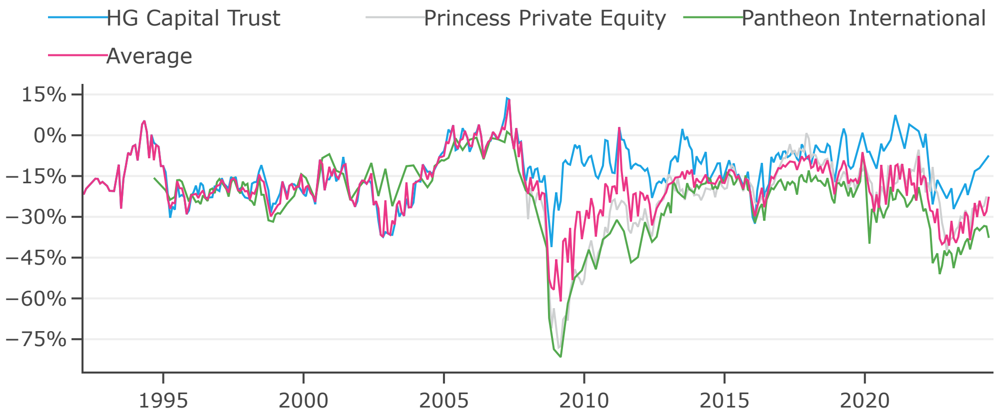
Industry reports peg dry powder in the Alternatives asset class at a very large $4.5trillion*, with over two-thirds coming from Buyout, Credit and Infrastructure market funds. Given the subdued activity in 1H24, there is a growing urge to transact, especially with the potential for US rate cuts on the horizon.

Rate cuts could also boost the Infrastructure market. Dividends make up a high proportion of the market's total returns, lending it bond-like characteristics. **We believe Infrastructure should perform well in a rate-cutting cycle.**

Global Valuations

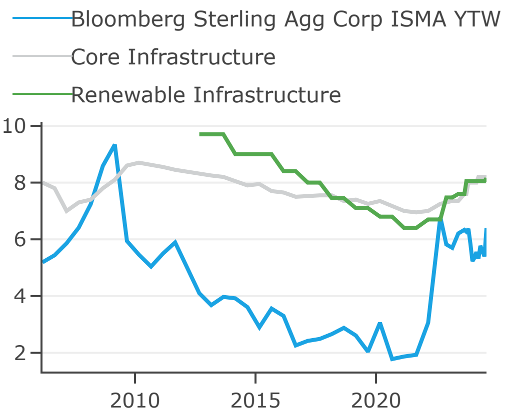
Listed Private Equity

Discount To NAVs



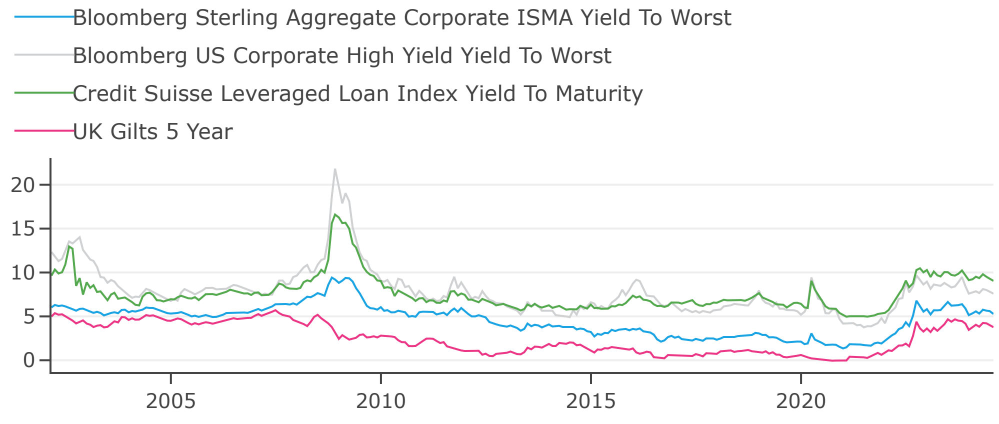
Infrastructure

Infrastructure Discount Rates vs Bond Yields



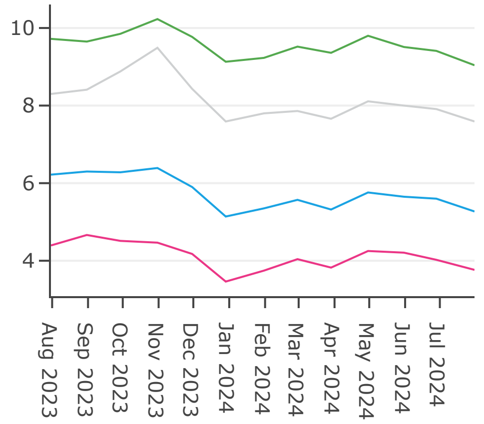
Contractual Income

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 July 2024. *Morgan Stanley: How Private Equity is Spending its $4.5tr Cash Pile, 16 July 2024

VALUATION

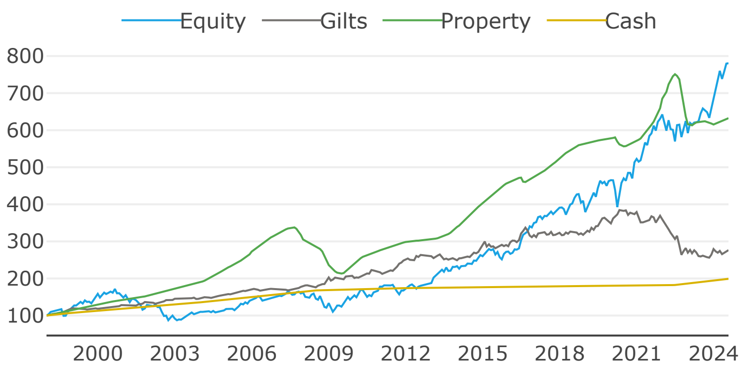
Property

The UK Commercial Property market offers good yields, (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% in 2022. Underlying physical transaction volumes are bumping along the bottom but have not started to recover. Meanwhile, ongoing outflows from open-ended property funds are reported.

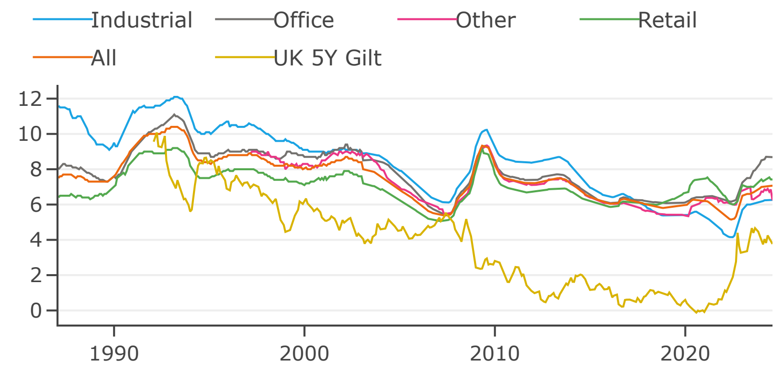
We show that UK Commercial Property has generated similar returns to global equity over the last 25 years (top left chart). Further, that outside of correction phases (one of which we have just been through) **real returns to Property have tended to average around the starting Equivalent Yield** (middle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

UK Commercial Property Market

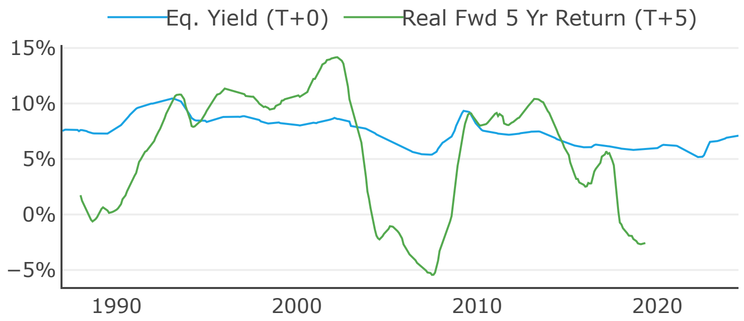
25 Years Of Return 1998=100



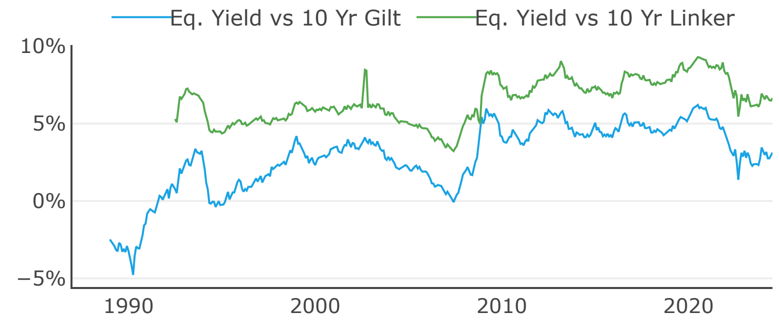
Equivalent Yields vs Gilt Yields %



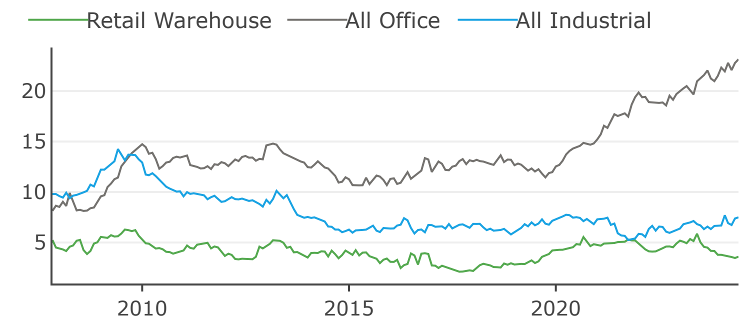
MSCI UK All Property Monthly TR Index %



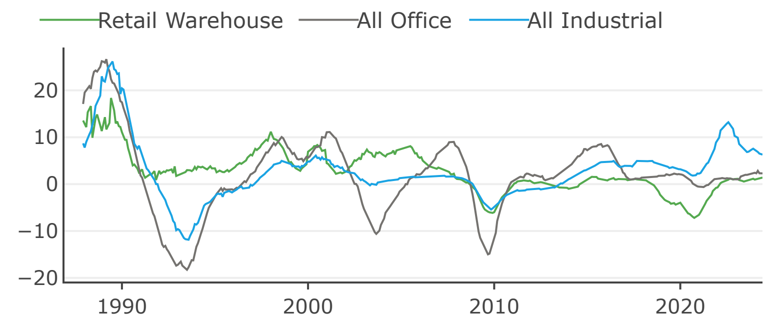
MSCI UK All Property Index - Equivalent Yield Spreads



Vacancy Rate %



Nominal Rental Value YoY Growth %



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

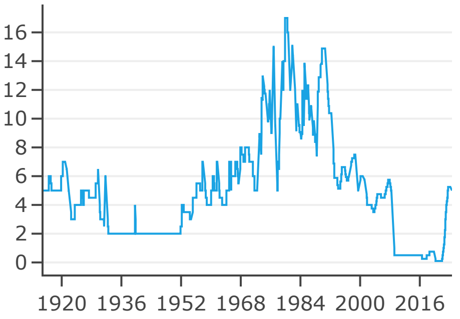
Cash

UK interest rates fell for the first time in over four years, the 25bps drop brings the Official Bank Rate to 5%. Governor Bailey made it clear in a Bloomberg interview, "Don't expect we're going back to zero because zero was the product of huge global shocks". Given where medium-term inflation expectations currently are (~2.4% Headline CPI*), and the Bank's estimate of short-term real GDP growth (1.3%*), **it is not unreasonable to assume nominal rates in the region of 3-4% over the foreseeable future.**

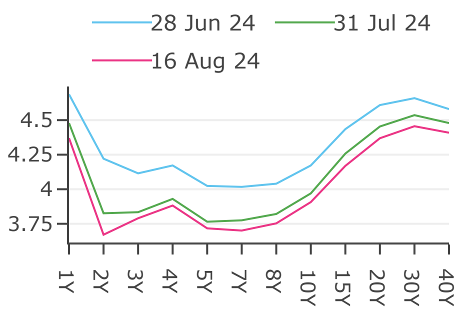
Services inflation has fallen to below the Bank's estimates and the Decision Makers Panel survey suggests further softening in wages over the next year. All consistent with steady rate-cutting environment. **Markets expect rates to be at 4.50% by year end.**

UK Sterling Market

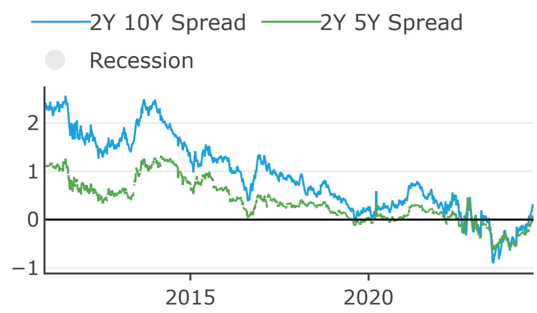
Official Bank Rate



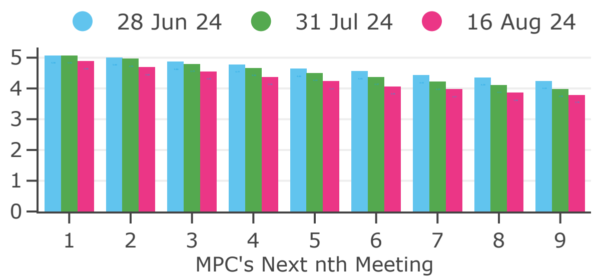
UK Gilt Curve



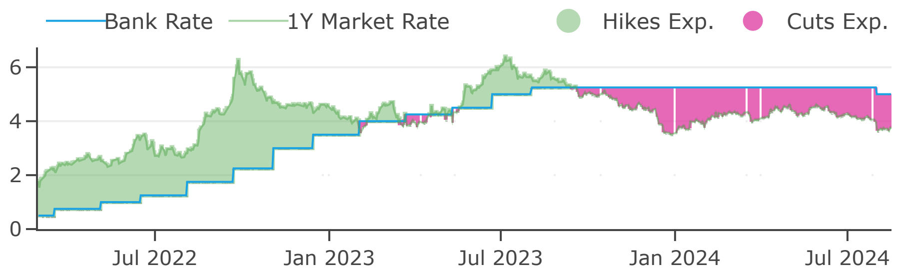
Gilt Spreads



Rate Expectations For Future MPC Meetings



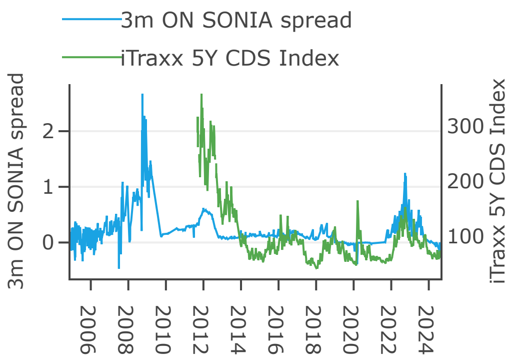
1Y Forward Market Rate Expectations



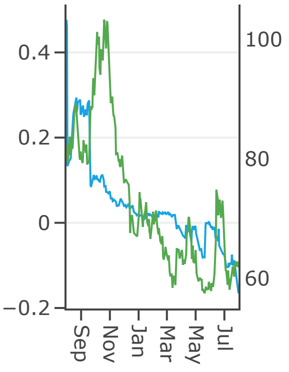
Inflation Readings YoY% | Colour by 10Y Z-Score*

Year	2024					
	Feb...	Mar...	April	May	June	July
RPI	4.50	4.30	3.30	3.00	2.90	3.60
CPI	3.40	3.20	2.30	2.00	2.00	2.20
CPI Core	4.50	4.20	3.90	3.50	3.50	3.30
CPI Services	6.10	6.00	5.90	5.70	5.70	5.20
CPI Goods	1.10	0.80	-0.80	-1.30	-1.40	-0.60
Priv. Wages	5.80	5.90	5.90	5.00	4.90	

Market Stress



Last 12 Months



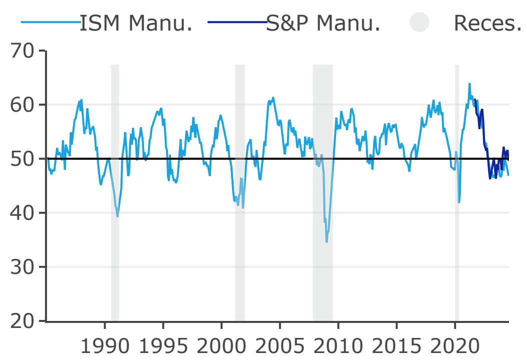
Sources | ITraxx CDS is the Markit iTraxx Europe Senior Financial Index, comprising 30 equally weighted credit default swaps on IG European entities. *10 year z-score applied on each series, coloured using gradient with score of 0 as green, at least +/- 2 standard deviations away scores as red. Bloomberg for all charts, as of Aug 2024.
*21 Aug: 5Y Break-evens at 3.4% minus 1% CCLA CPI conversion estimate; 1.3% BoE 2026 real GDP growth estimate.

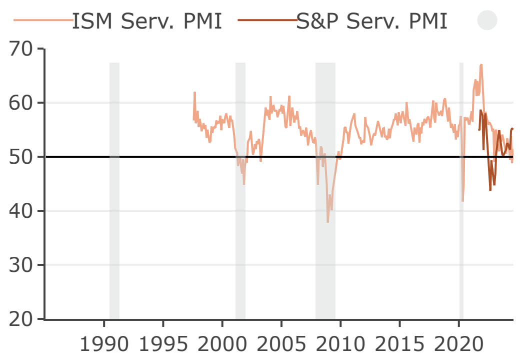
Global PMIs

We have included both S&P Global and ISM PMI readings for the US. Both surveys are a collection of responses from varying sets of US corporations and therefore the respective results may vary. **We do not have a preferred survey, rather the combination helps give us a holistic understanding of the economy.**

US Manufacturing continues to weaken across backlogs, new orders and importantly, employment. However, Services which represents over 70% of US corporate output, is showing the exact opposite and remains strong despite recent fluctuations. **The UK continues to outperform the G7 with strong readings across all industries.**

United States





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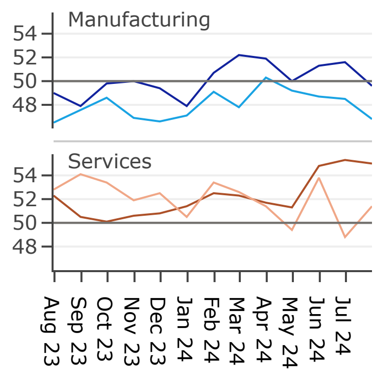
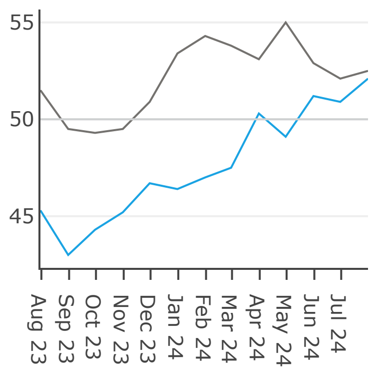
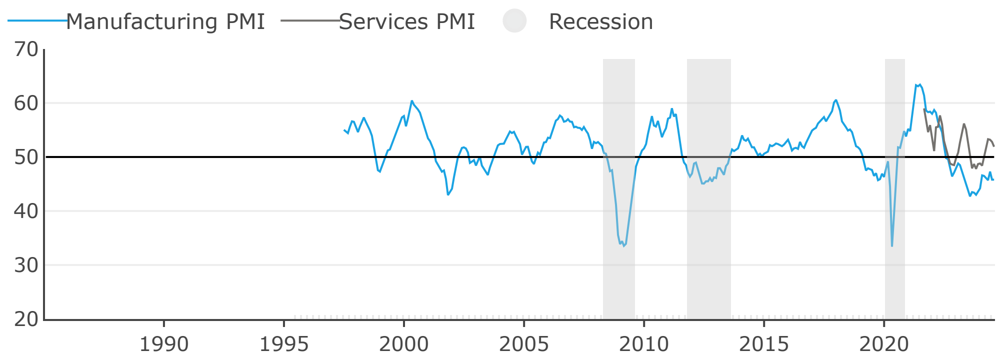


United Kingdom

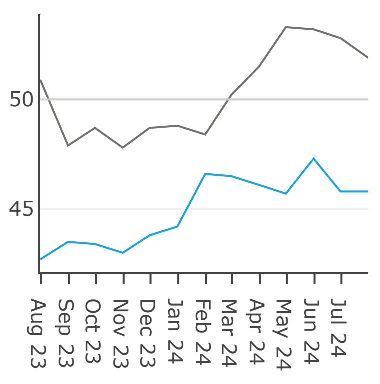
Last 12 Months



Eurozone



Last 12 Months



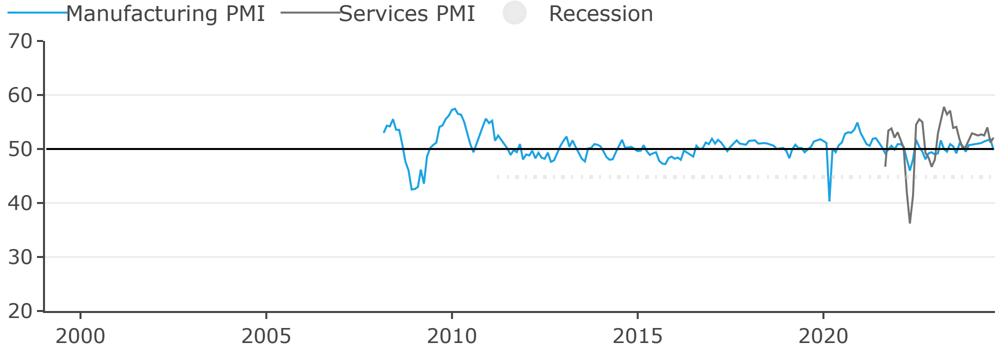
Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of Aug 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

Global PMIs

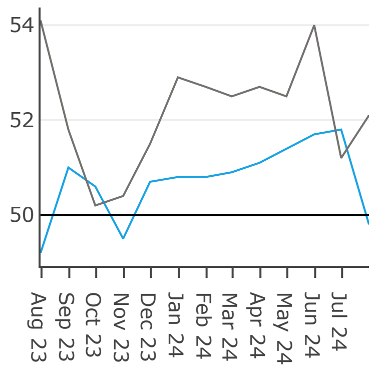
Global Manufacturing PMI fell below 50 for the first time this year. Surveys suggest companies remained reluctant to hire additional staff while cost and cash flow were top of mind. There were cut backs in purchasing activity too, as a result of contraction in new orders. None of this bodes well for global growth.

Services on the other hand continued to expand strongly, posting above 50 readings across employment, new business and future activity. **At present, Services are maintaining the buoyancy of the global cycle.**

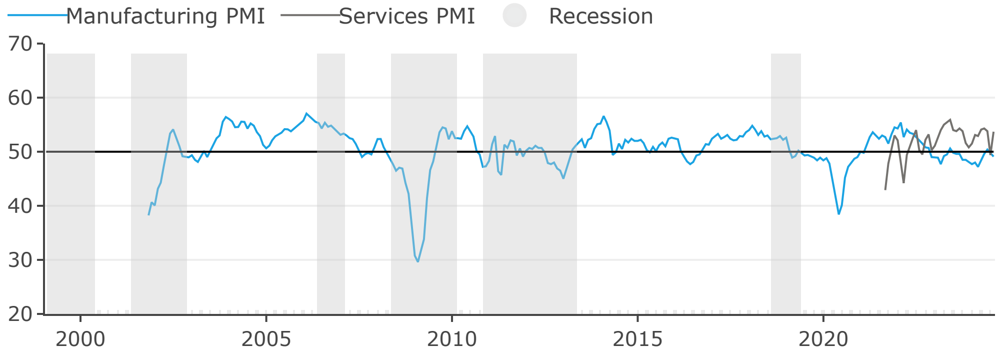
China



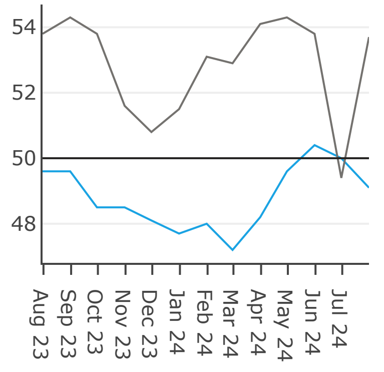
Last 12 Months



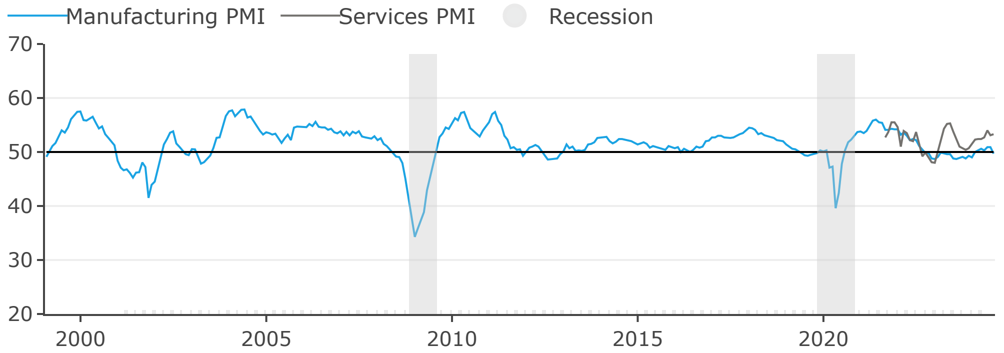
Japan



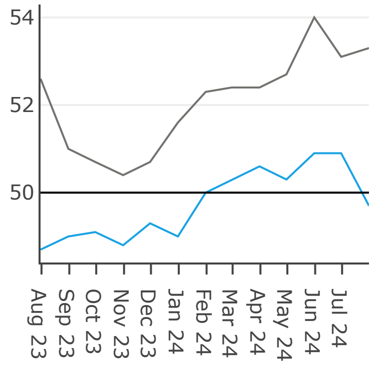
Last 12 Months



Global



Last 12 Months



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

GROWTH

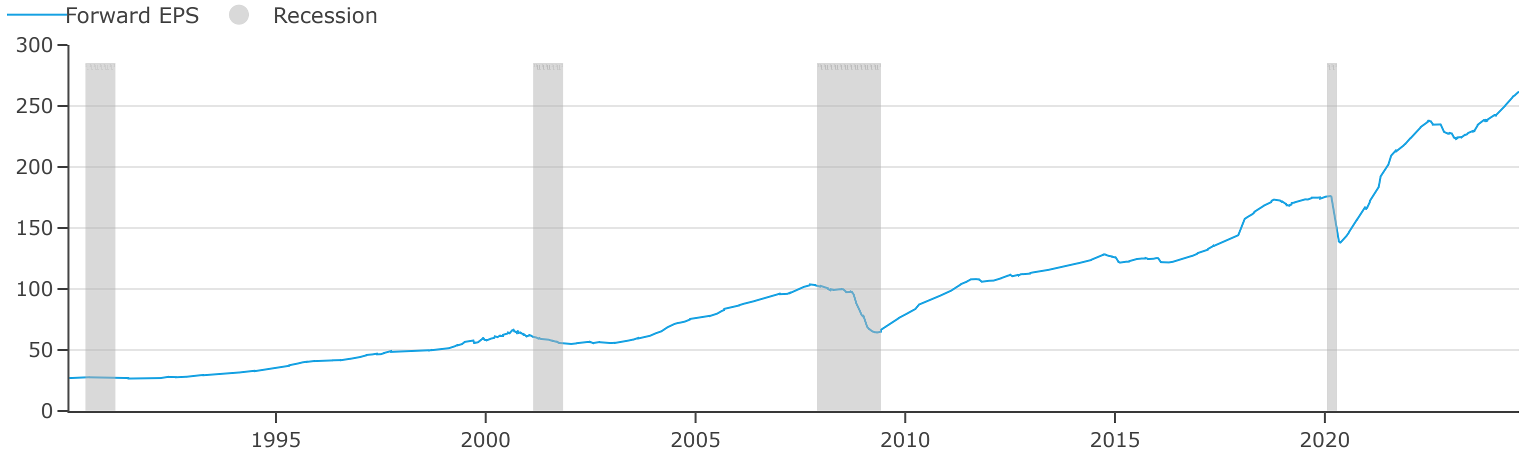
Earnings

Consensus forward earnings estimates continue to recover (top chart) while trailing earnings are just starting to grow again. With 95% of S&P500 companies having reported for Q2 earnings as we go to press, year over year EPS have grown 9% and results on average beat estimates by 5% points - both solid readings. On a sector level, 9/11 sectors have shown positive earnings growth, with Materials and Industrials being the two laggards.

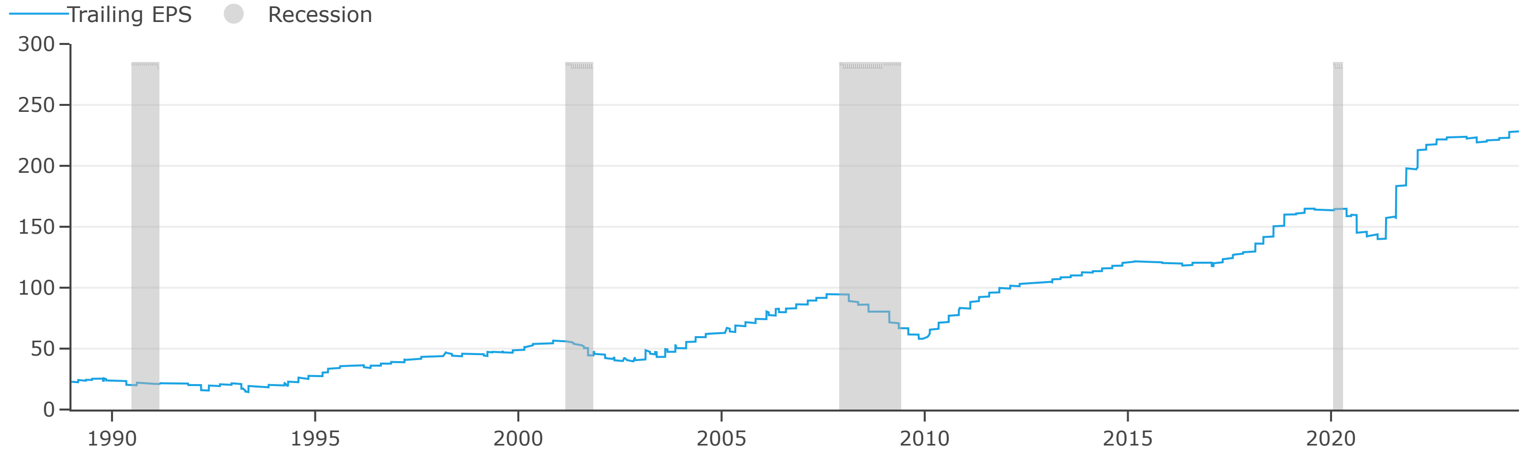
We continue to believe that earnings are in position to take over from PE re-rating in driving the market higher.

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 Aug 2024

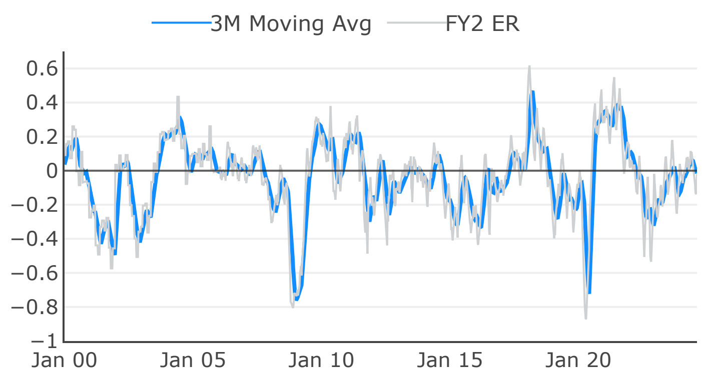
Earnings

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.

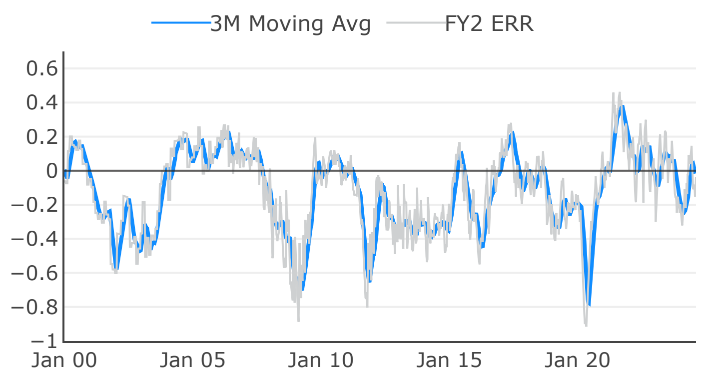
The overall assessment is that earnings breadth is ticking up, with the US now joining Japan in having positive net earnings breadth. This speaks to a broadening out of earnings support from just the Magnificent Seven.

Global Earnings Revisions Ratios

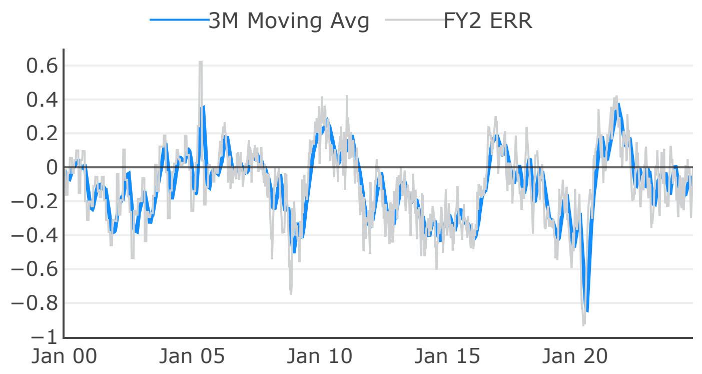
USA



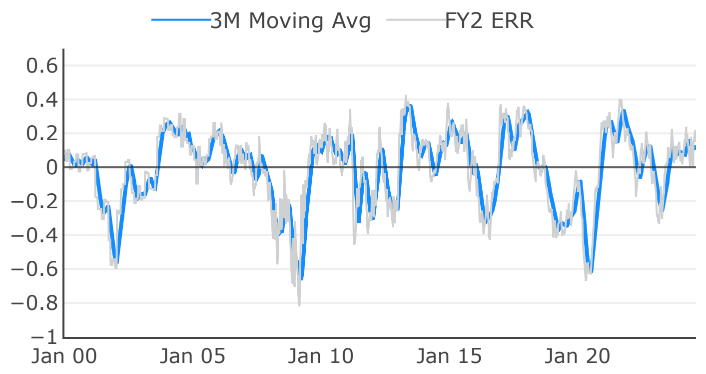
Eurozone



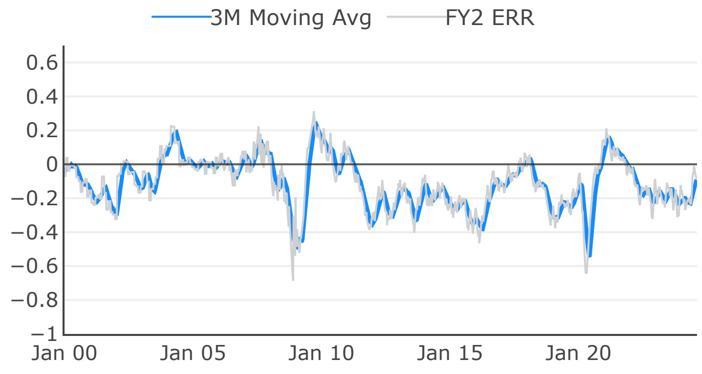
UK



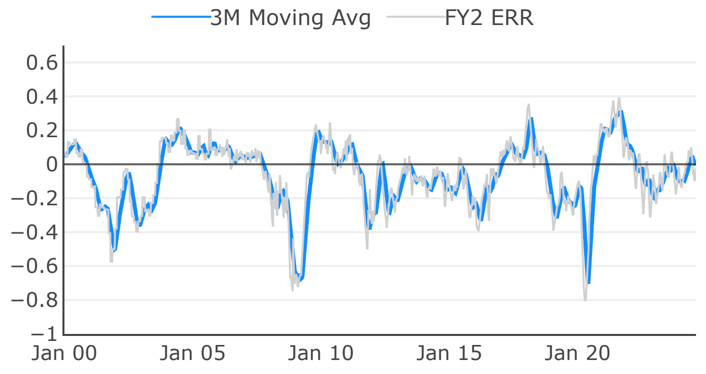
Japan



Emerging Markets



World



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

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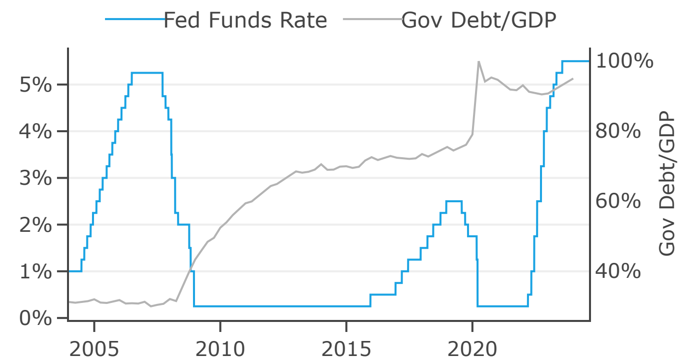
Interest Rates

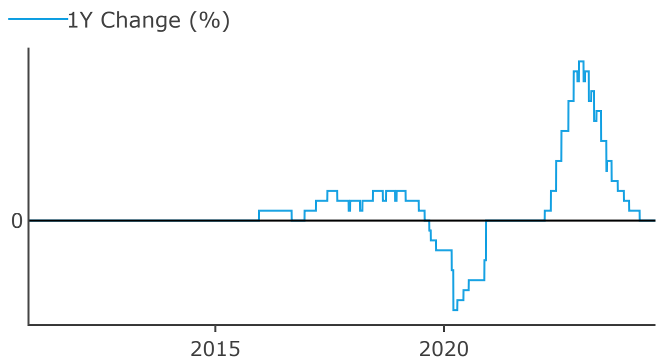
US inflation finally fell into the 2%-range (just!) bringing two year bond yields to 3.94%, a 108bps drop from its peak in May. The stickiness in Services also looks to be loosening, with latest readings in shelter falling below 3%. By our measure, middle-left, it seems to be that the impact of real rates is finally feeding into the economy.

Having said that, the seven rate cuts that were pencilled in for 2024 have lost some steam, with latest expectations now of "only" four. **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**.

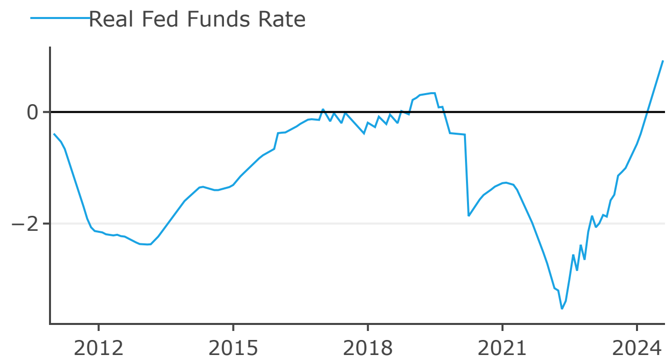
Fed Funds Rate



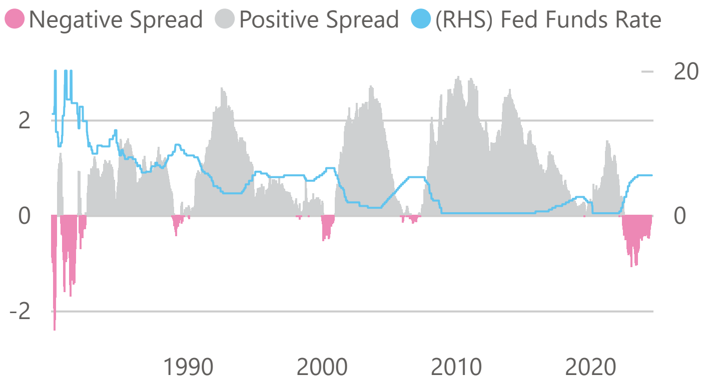
Change in Fed Funds Rate



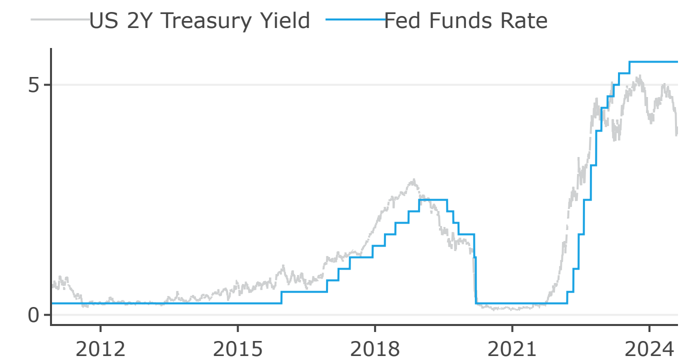
Real Fed Funds Rate (Using 2Y MA CPI)



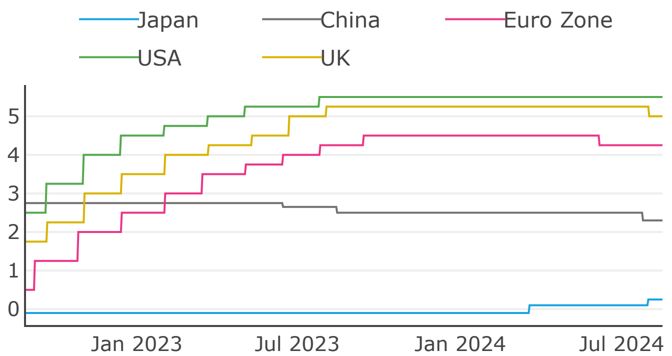
Fed Funds Rate vs 2s10s Curve



Fed Funds Rate vs 2Y Treasury



Global Comparison



Sources | Bloomberg for all charts, as of Aug 2024

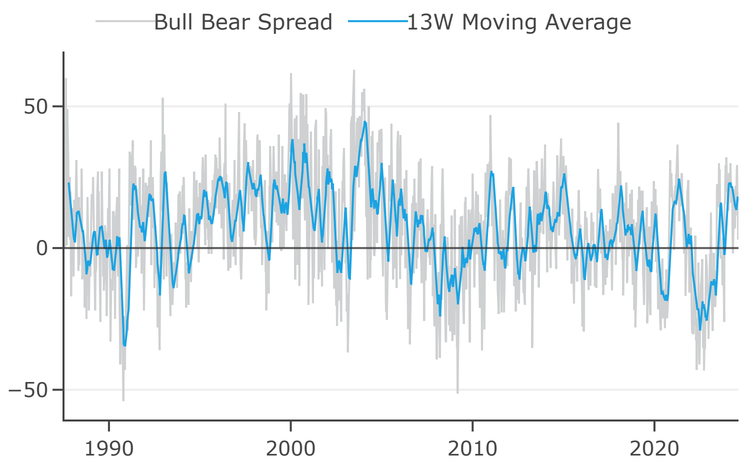
Sentiment

The Dollar-Yen carry-trade unwind did create some short, but intense, selling pressure at the start of August. **This lead the VIX to spike to levels above 40, similar to the likes of the COVID period in June 2020.** The panic lasted just a few days before the VIX normalised back towards its <20 levels.

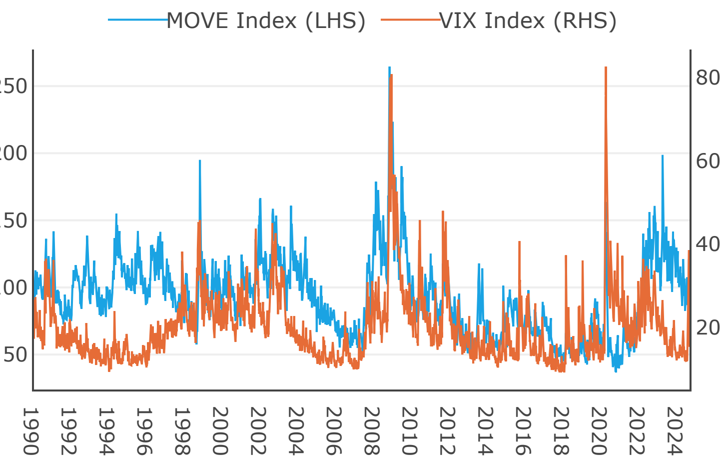
The BAML Hartnett Bull & Bear Indicator has moved from Extreme Bearish sentiment (which is bullish for the market!) in October 2022 **to now above neutral** (the current reading is 6.1/10). In other words, sentiment is edging towards the bullish side, albeit with some fluctuations, but has not reached extreme levels yet.

US Equity Indicators

AAII Bull Bear Spread

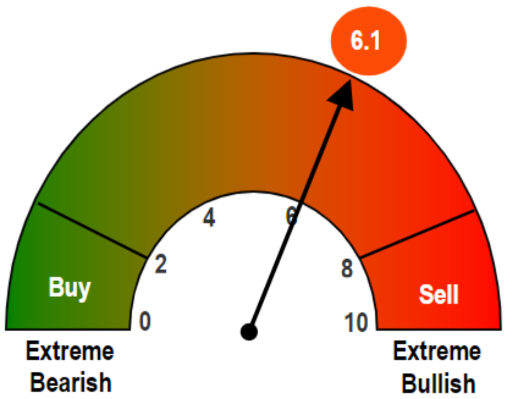


Equity vs. Bond Sentiment

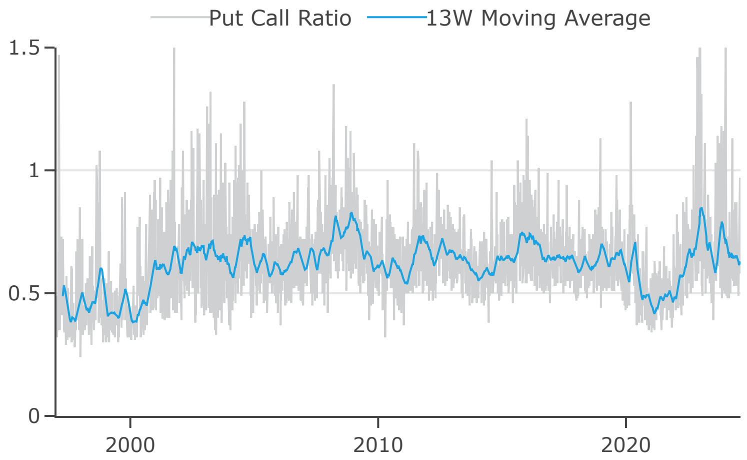


Michael Hartnett's Bull & Bear Indicator (BAML)

Drops to 6.1 from 6.3



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 Aug 2024

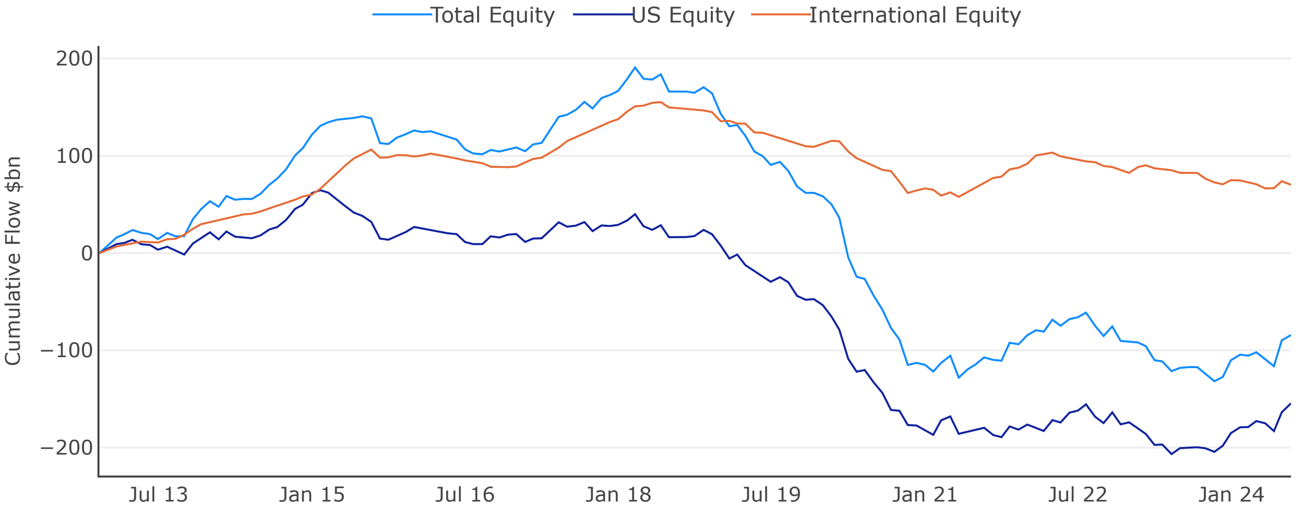
Fund Flows

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.

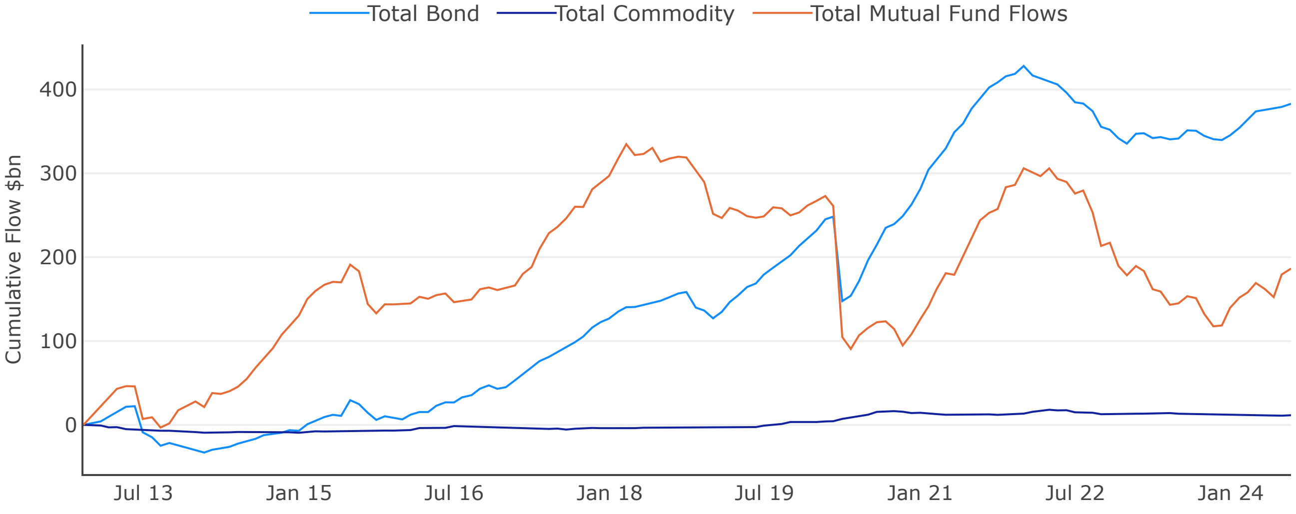
The message in these data points continues to be that there is little enthusiasm for actively managed funds even if the outflows from equity funds have stopped.

US Mutual Fund Flows

Equity Markets Cumulative $bn



Non-Equity Markets Cumulative $bn



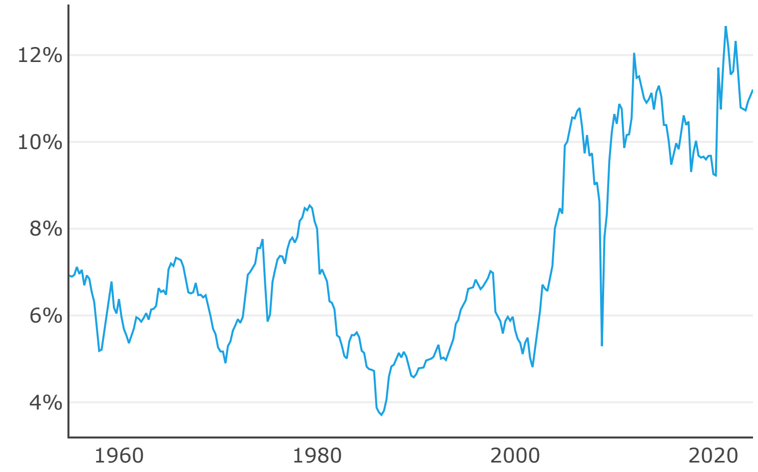
Sources | All charts: Bloomberg ICI fund flow data. Data as at Aug 2024

The Big Picture

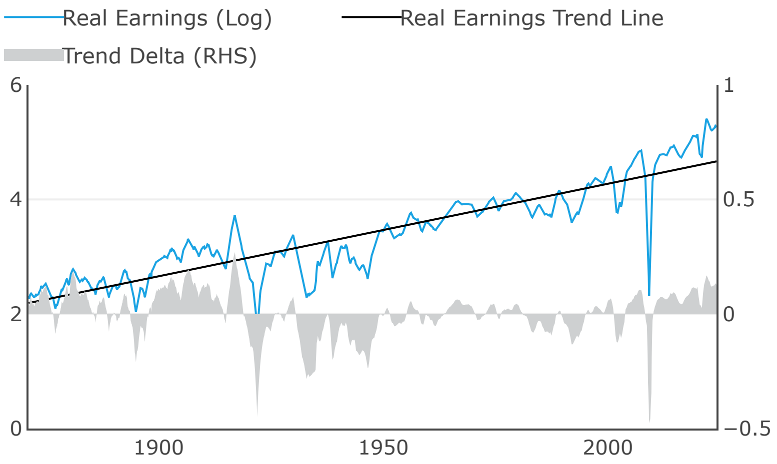
Here we highlight some longer-term imbalances that, **should** they correct, would have an outsized impact on risk asset returns. We don't make predictions but we do watch these. US corporate profit is just off the highest share of GDP that it has ever been since 1929. Its corollary (not shown) is that 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

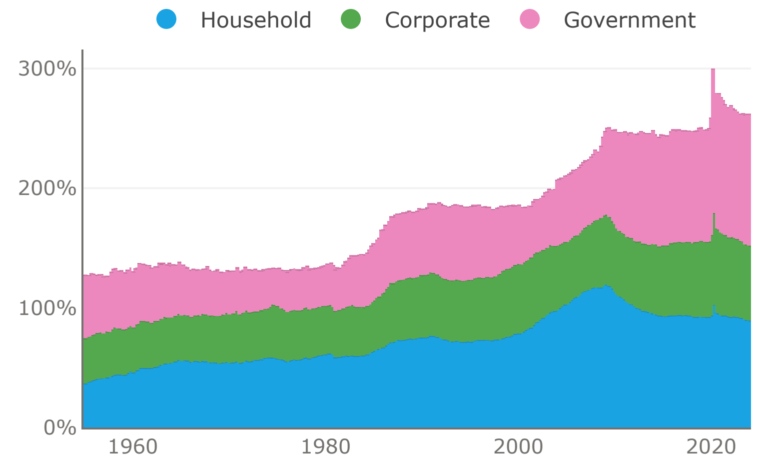
Profit Share of GDP



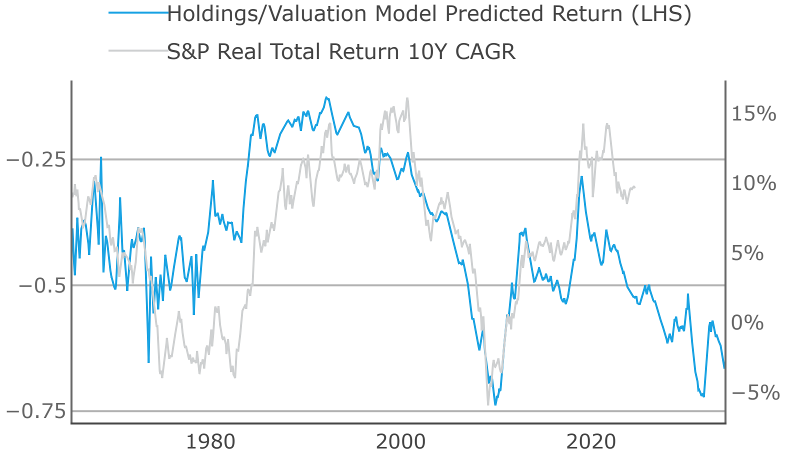
Earnings Deviation From Trend



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 Aug 2024.

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