Navigating The Late Stages Of The Investment Cycle

Dallas Spring Symposium
May 2023

Peter Perkins
Partner
Global Strategy

MacroResearchBoard
mrb partners
Independent Investment Strategy

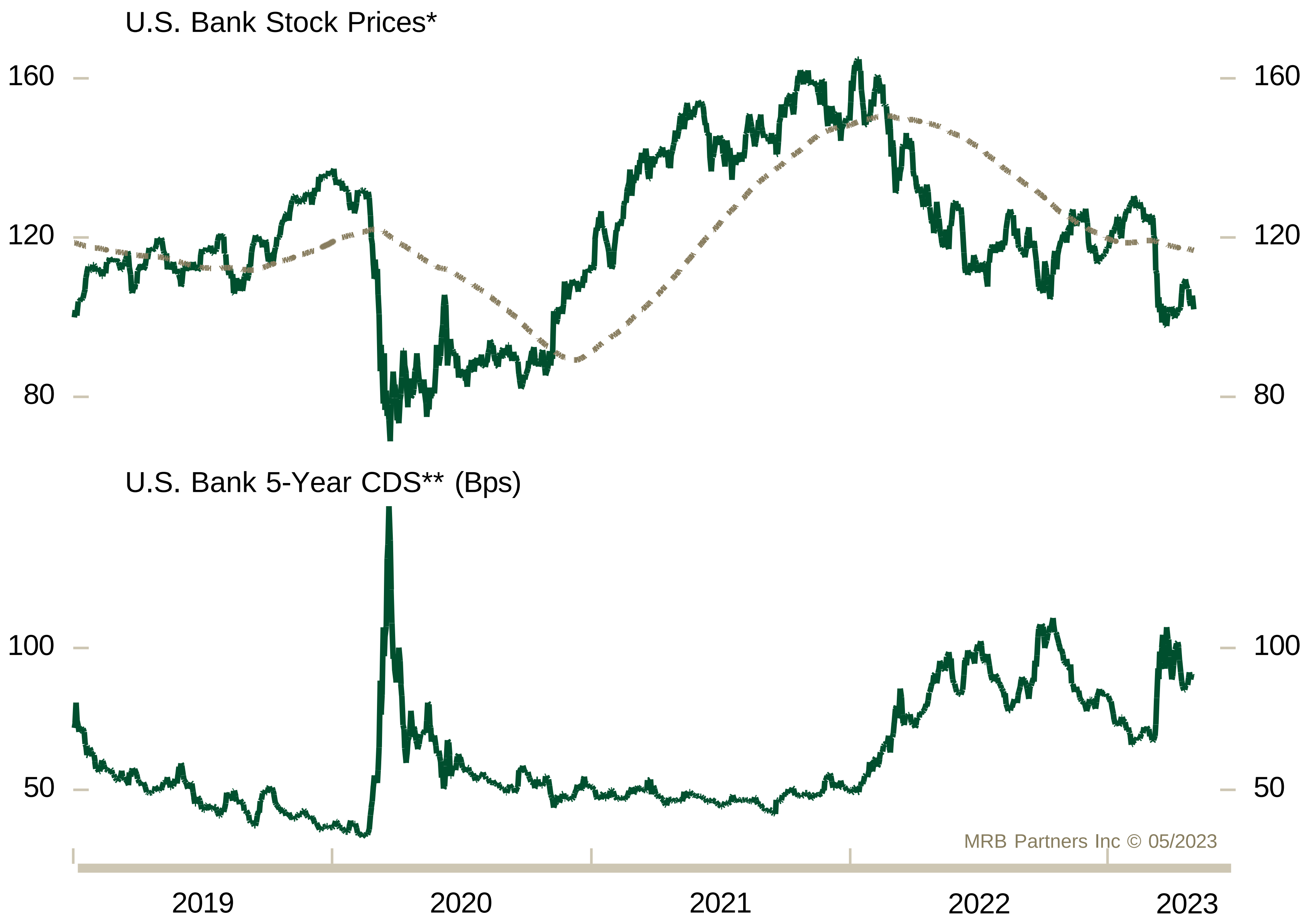
FPA PLATINUM PARTNER

FPA FINANCIAL PLANNING ASSOCIATION

Key Points And Investment Strategy

- The financial sector crisis will not trigger a U.S. or global recession.
- Appealing yields and unattractive alternatives underpin our overweight recommendation on cash in a multi-asset portfolio on a 6-12 month horizon.
- Stay underweight bonds; yields are biased to the upside as market takes out Fed rate cuts.
- Maintain neutral exposure to global equities, but the next move is more likely a downgrade than an upgrade. Non-U.S. equities are more attractive, with the euro area and emerging markets our preferred exposures.
- Commodities face crosscurrents and lack a clear theme. Neutral exposure is appropriate.
- Improving economic momentum in the euro area and China point to a weaker U.S. dollar ahead.

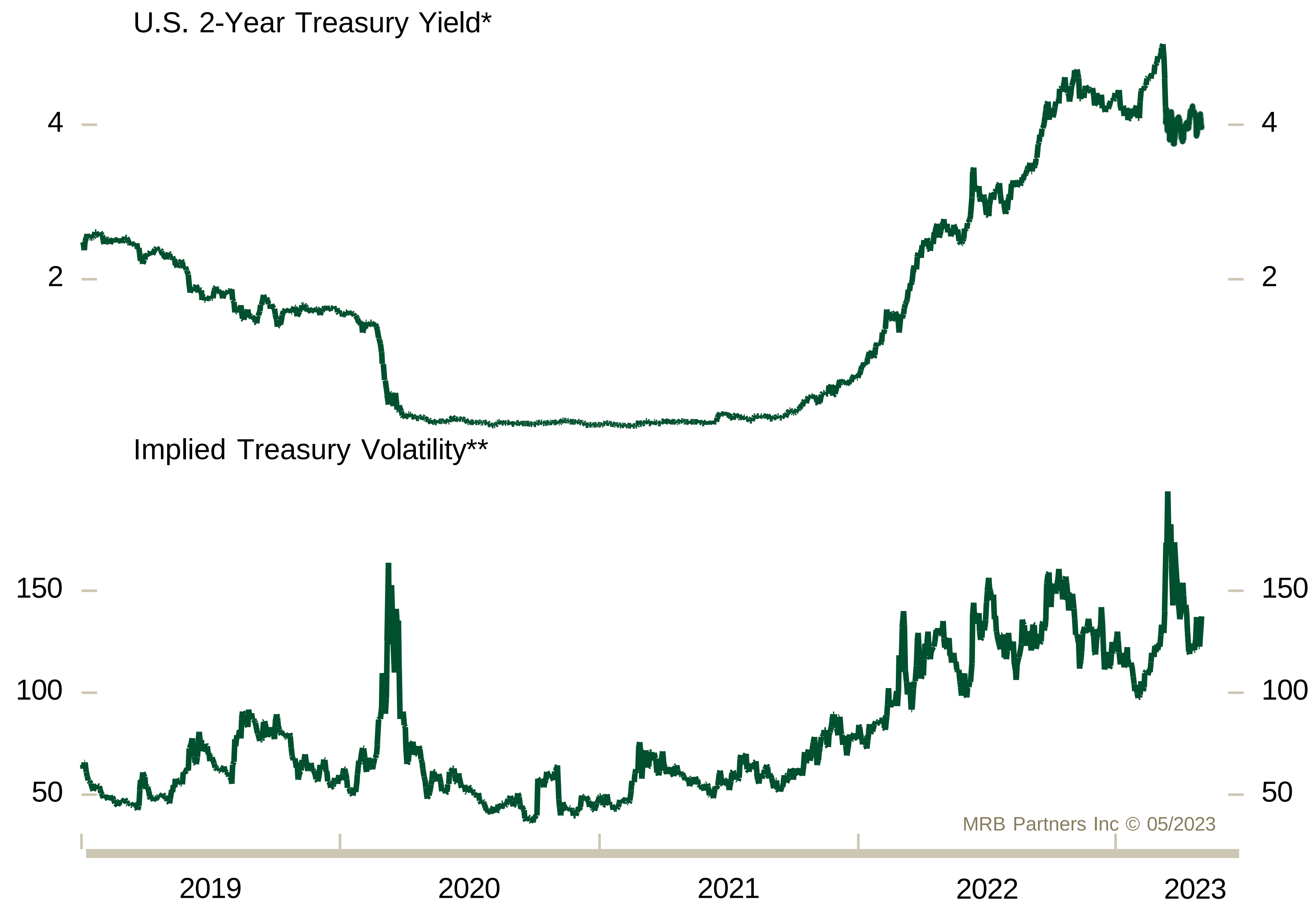
Banks Remain Under Pressure



* Rebased; source: MSCI
** Source: Datastream

mrb The Macro Research Board

Banking Crisis Spillover To Bonds



* Source: Macrobond
** Source: Bloomberg

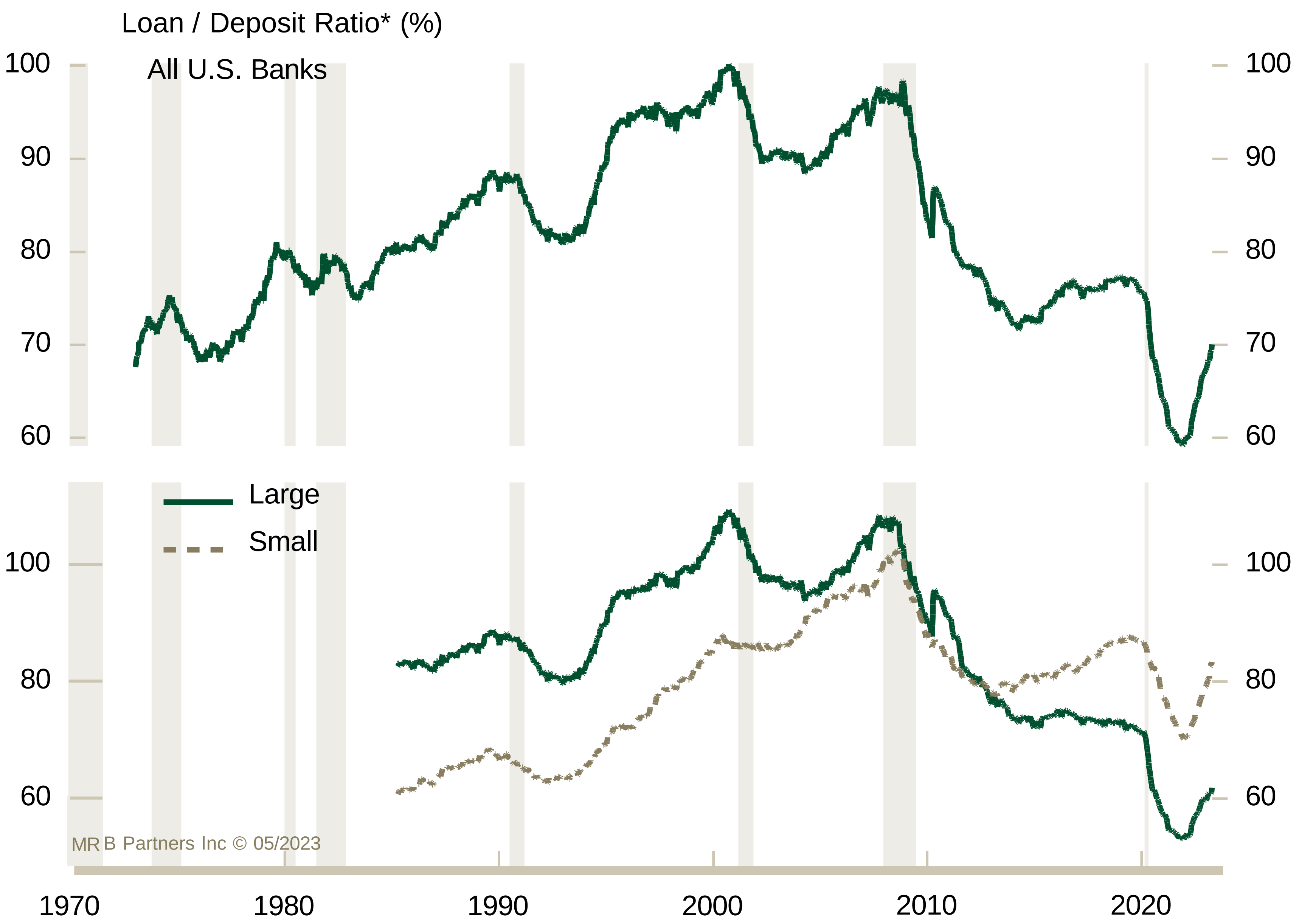
U.S. FDIC institutions (Banks & Savings Inst): Facts & Figures*

- 4,706 institutions; 13 largest have 56% of assets and deposits and 51% of net income.
- **Number of problem institutions:** 39; assets of problem institutions: US$47 bn (oops!).
- **Loan / Deposit Ratio:** 64%
- **Equity Capital:** US$2.2 tn; tier 1 risk-based capital ratio = 13.65%
- **Net Income in 2022:** US$263 bn.
- **Unrealized losses on securities:** US$620 bn; available for sale: US$280 bn; held to maturity: US$341 bn.

*Data as of Q4 2022; source: FDIC

mrb The Macro Research Board

U.S. Big Banks Are Awash In Deposits



* Smoothed; source: Federal Reserve
Note: Large banks refer to the largest 25 banks, small is all other
Shaded for NBER-desingated U.S. recessions

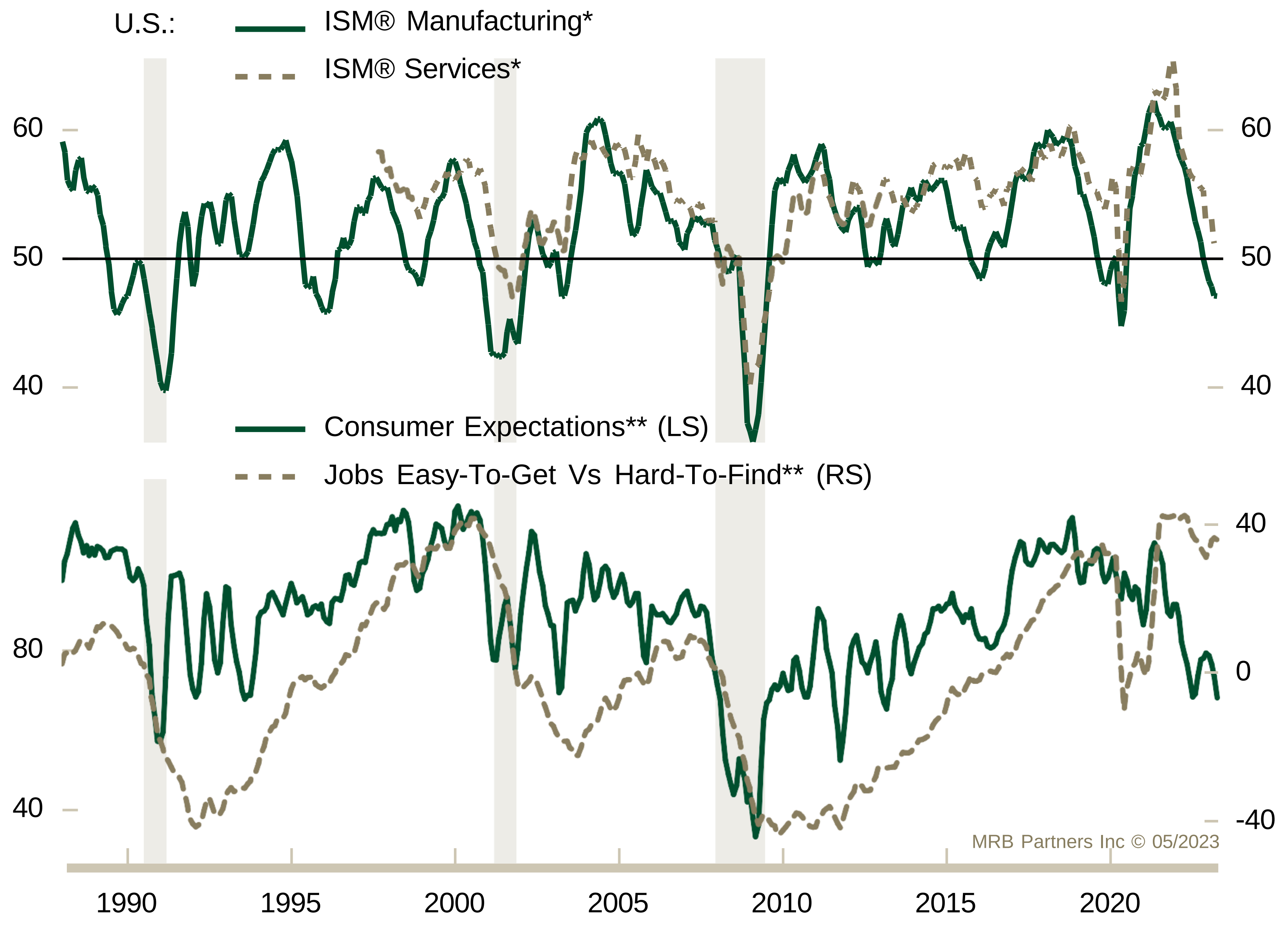
A Resilient Global Economy

- The U.S. and euro area banking sectors are healthy and are not at major risk. Still, policy support/commitments are needed to bolster confidence.
- China's re-opening provides timely support for the global economy.
- The euro area economy will continue to gain momentum as the energy crisis fades.
- The U.S. will avoid a recession, with activity supported by steady consumer spending and corporate capex. Possible debt-ceiling delay, but eventual passage.
- Sturdy global growth means underlying inflation will be stickier than markets expect.
- Markets will unwind recent Fed/ECB rate cut expectations as financial sector anxiety eases.

Why No Recession In The U.S.?

- U.S. consumers and businesses have healthy balance sheets, incomes and debt-servicing capacity.
- Interest rates relative to income growth are not historically high.
- Ignore the headline real GDP data, which is distorted by swings in inventories, net exports and government consumption and investment.
- Focus instead on unemployment, real personal consumption and nonresidential private investment. They will indicate whether a recession looms or is underway.

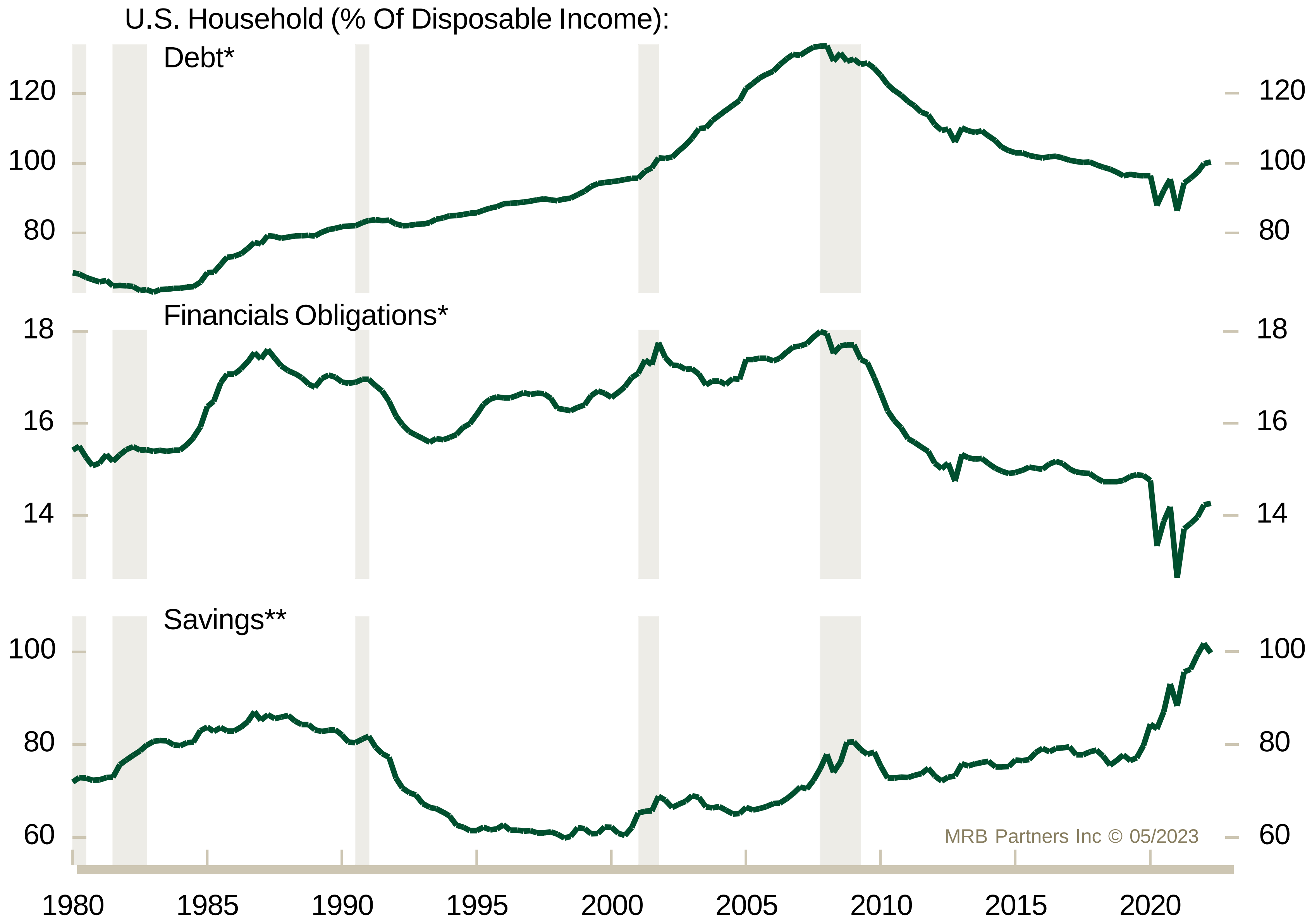
Natural Moderation Of U.S. Growth, But Worries Will Persist



* Smoothed; source: Institute for Supply Management®
** Smoothed; source: The Conference Board
Note: Shaded for NBER-desingated U.S. recessions

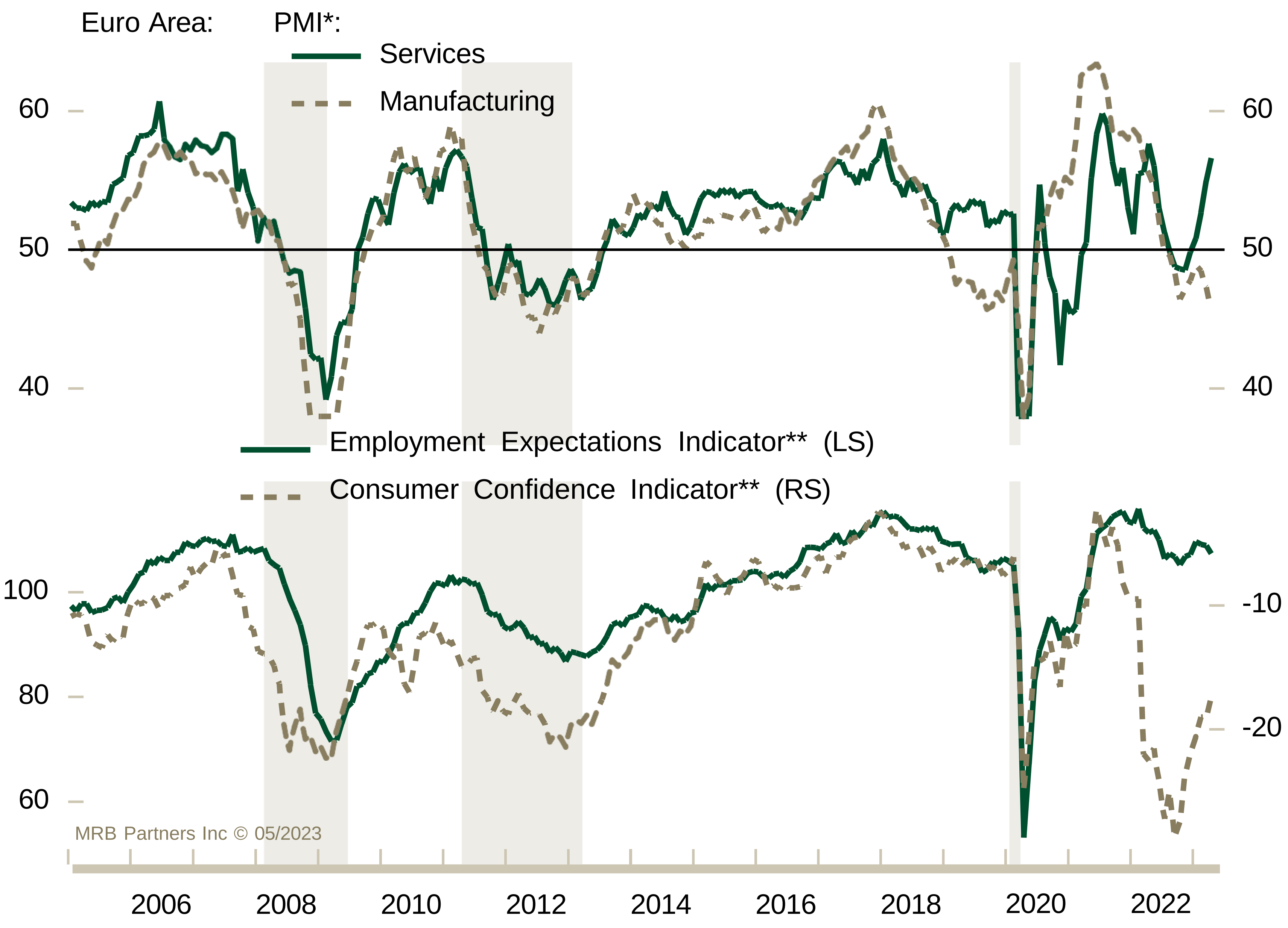
mrb The Macro Research Board

Strong Household Support For The U.S. Expansion



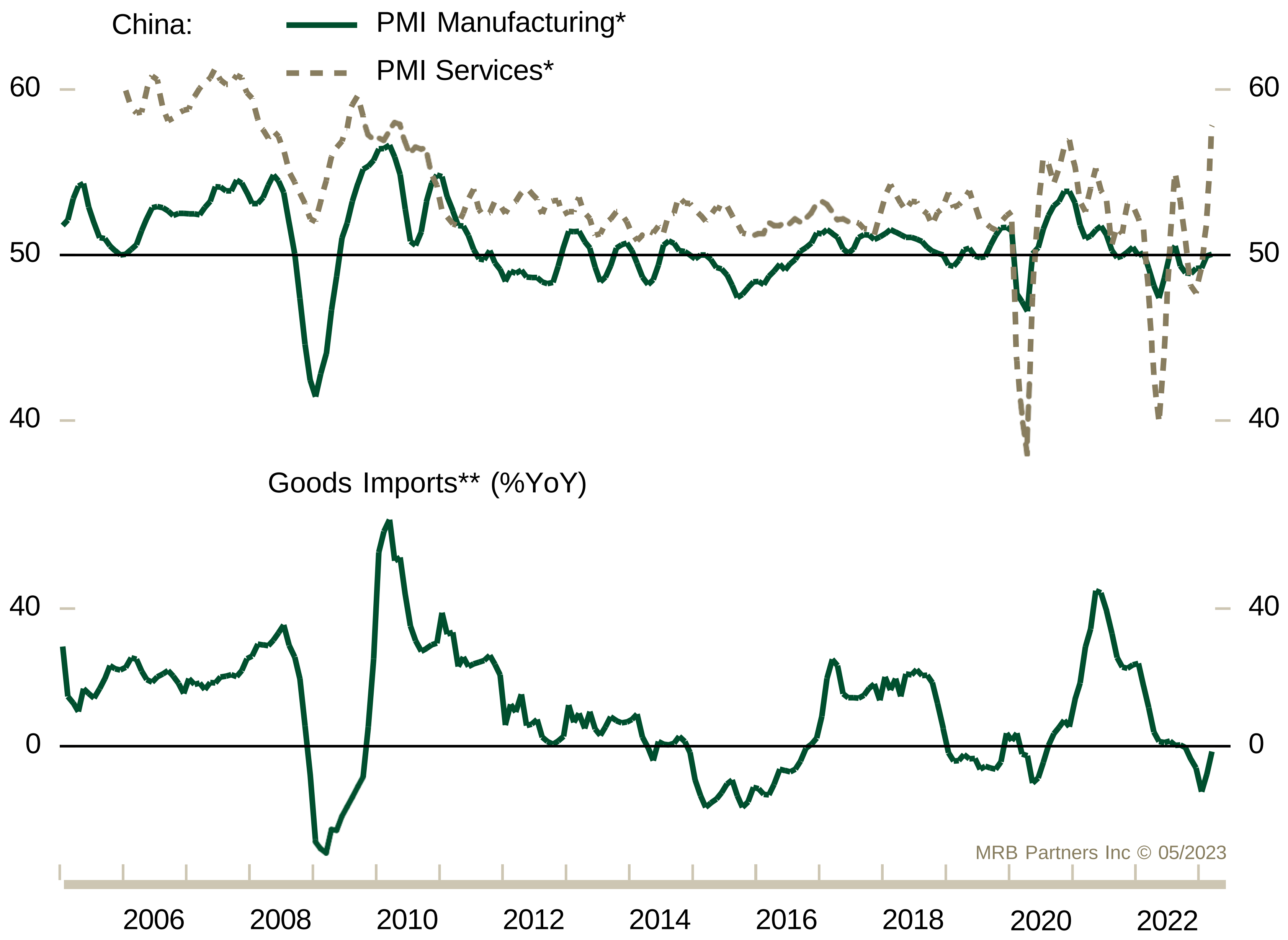
* Sources: Federal Reserve and Bureau of Economic Analysis
** Checkable and time deposits, short-term investments and money market funds
Note: Shaded for NBER-designated U.S. recessions

Sentiment Is Recovering In The Euro Area



* Truncated below 38; source: Markit Economics
** Source: European Commission
Note: Shaded for Center for Economic Policy Research-designated euro area recessions

China Is Poised For A Growth Revival



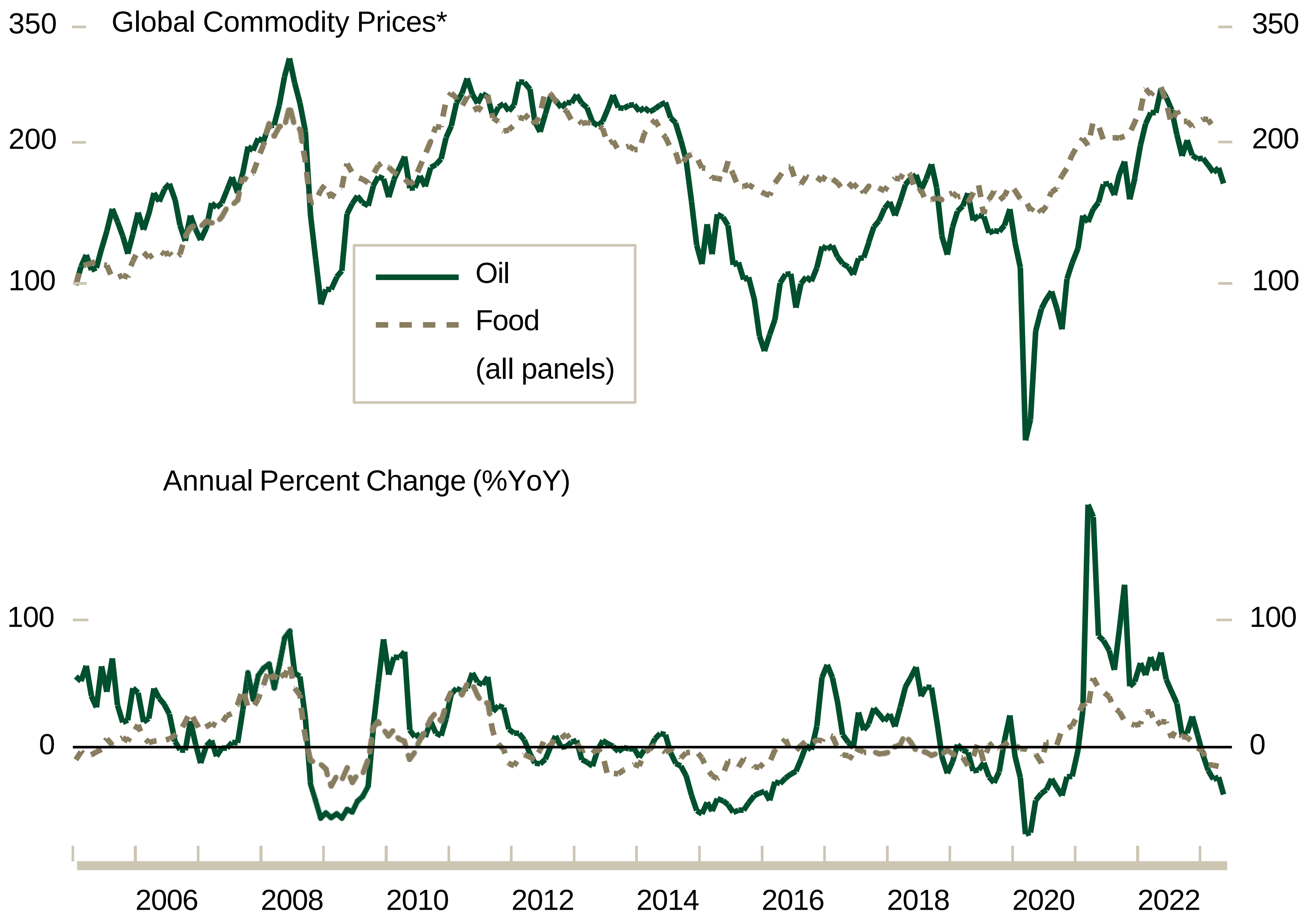
* Smoothed; source: IHS Markit
** U.S. dollars; smoothed; source: China Customs

Inflation Will Continue To Ease, But Path To 2% Is Difficult

- Raw food and energy prices are well off peaks.
- Supply-chain pressures are easing.
- Goods price inflation momentum (MoM) is moderating.
- Service price inflation is proving stickier (especially because of rents).
- Inflation is easing, but path to 2% contingent on sustained weak growth.

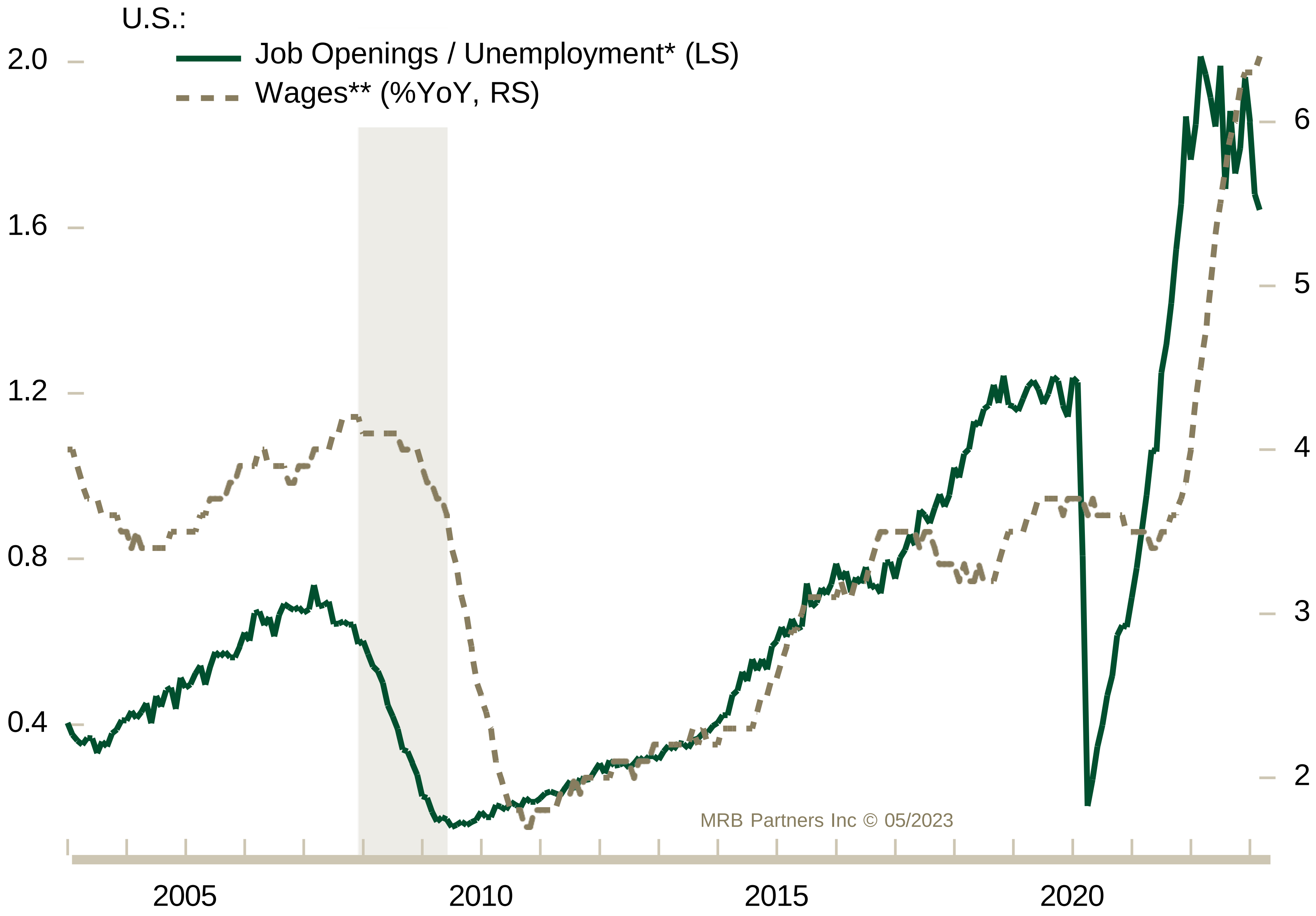
mrb The Macro Research Board

Commodity Price Base Effects Will Dampen Inflation



* Source: The Economist via Macrobond
Note: Panel 1 is rebased

Tight Job Market Will Keep Pressure On Wage Costs



* Source: FRED

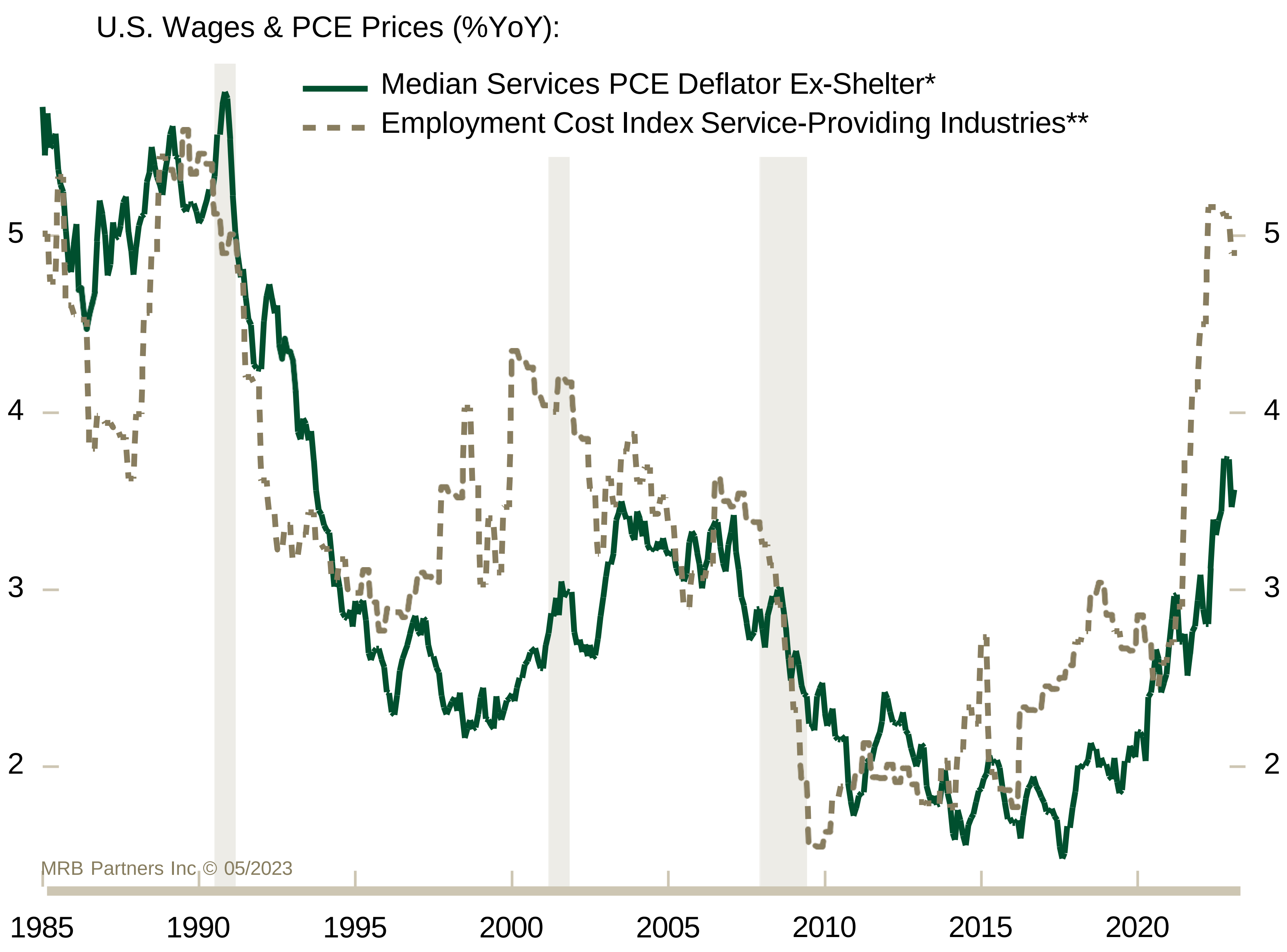
** Sourc: Atlanta Fed via Macrobond

Note: Shaded for NBER-designated U.S. recessions

The Macro Research Board

mrb

Wage Costs Key To Core Services Inflation



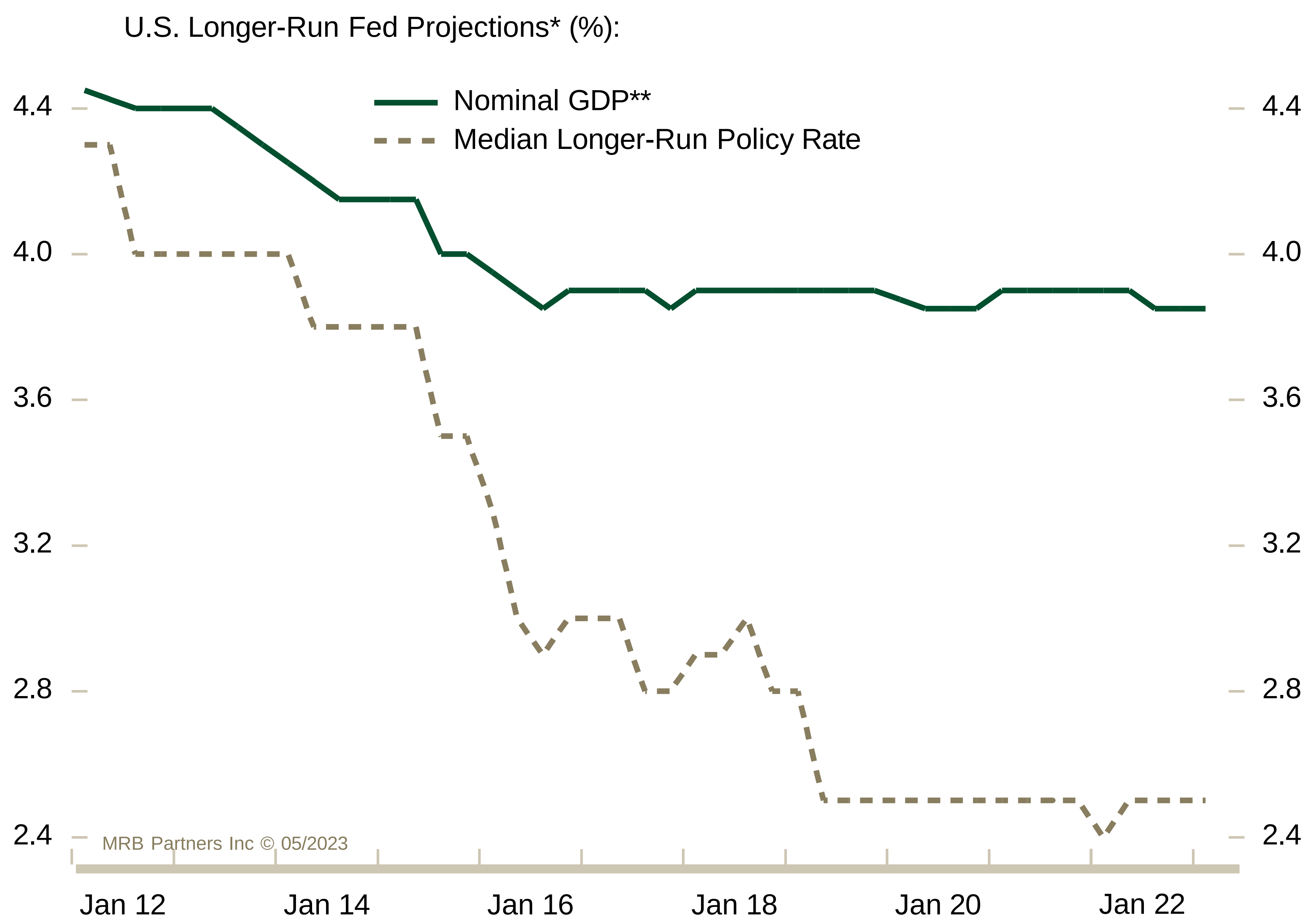
* MRB calculations; source: U.S. Bureau of Economic Analysis
** U.S. Bureau of Labor Statistics

The Macro Research Board
mrb

Conflicting Challenges For Central Banks

- Financial sector stability is the paramount policy issue in the near term.
- CBs will be separating interest rate policy and financial stability.
- Policy is reactive to data rather than based on a clear framework, adding to interest rate volatility.
- Projected policy rates are not yet restrictive, and interest rate expectations will be revised up once the financial crisis ebbs.
- The Fed is pausing, but rate cut expectations are unjustified.
- Policy divergences will increase over the balance of 2023.

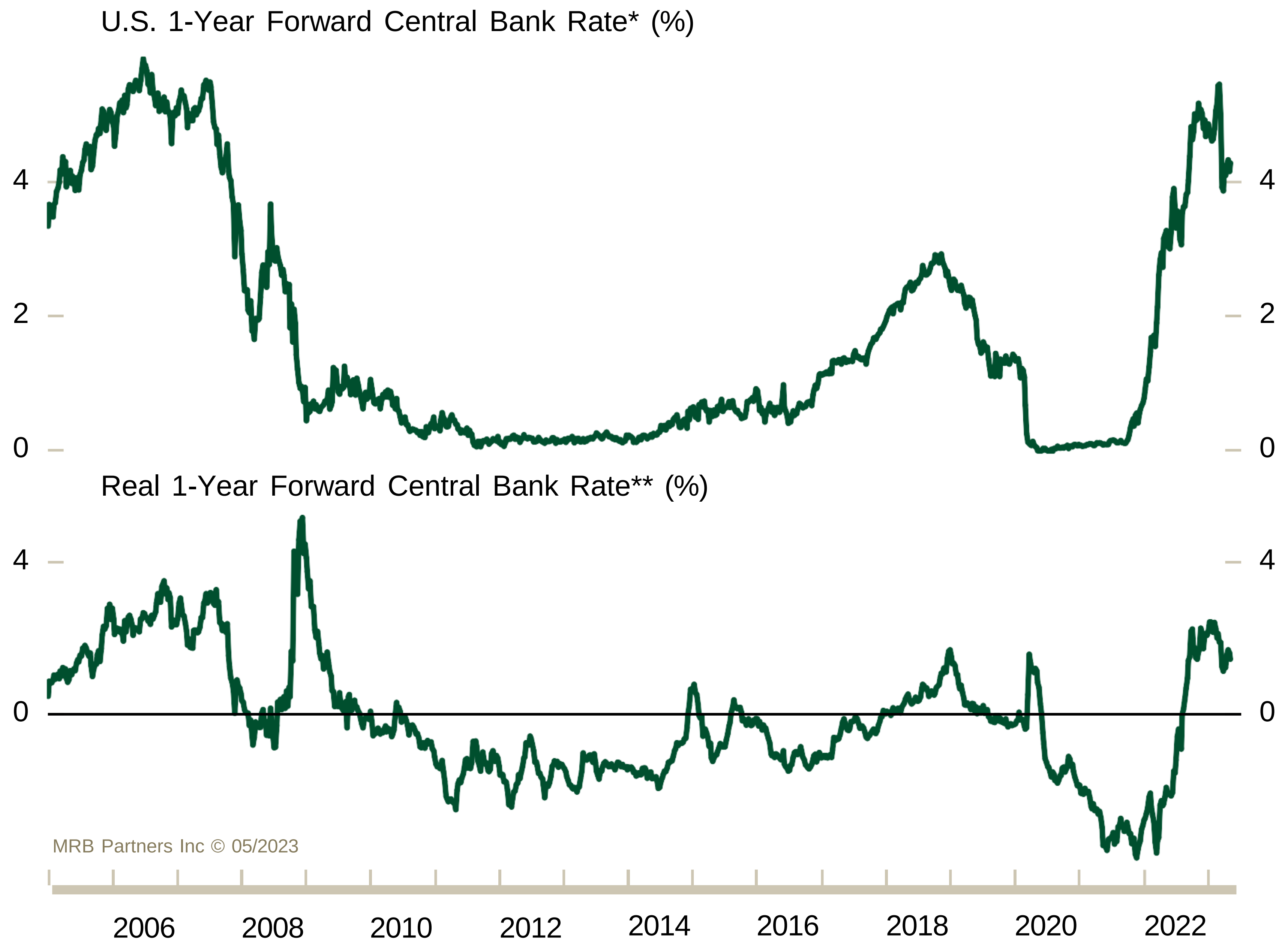
Fed Long-Run Policy Rate Is Too Low



* Source: Federal Reserve

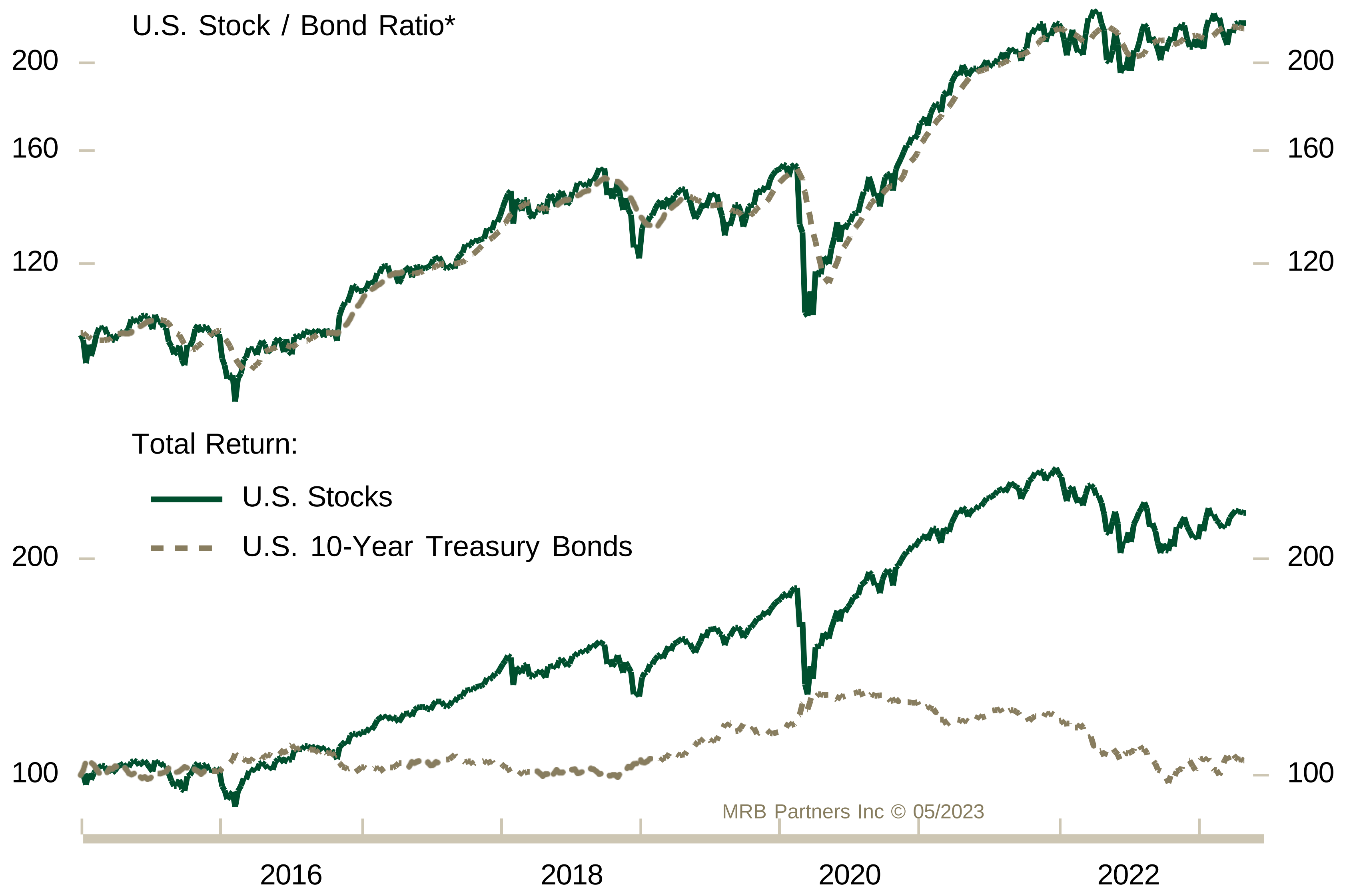
** Midpoint of central tendency plus 2% inflation; median omitted for shorter forecast history

Rapid Rate Hikes, But Real Rates Are Not High



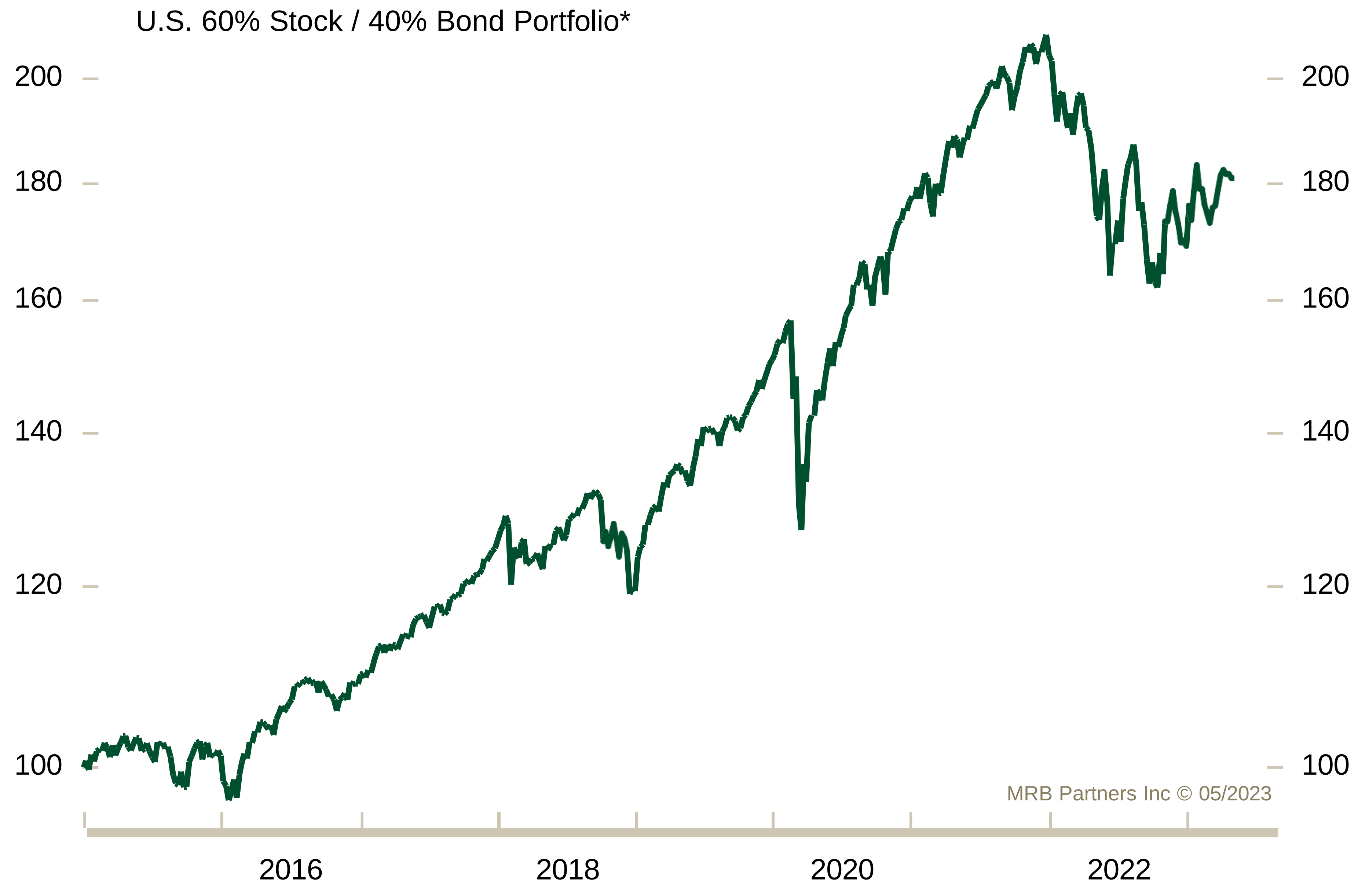
* Source: Bloomberg
** Deflated by 1-year CPI swap rate; source: Bloomberg

Stock/Bond Ratio Signaling Economic Uncertainty



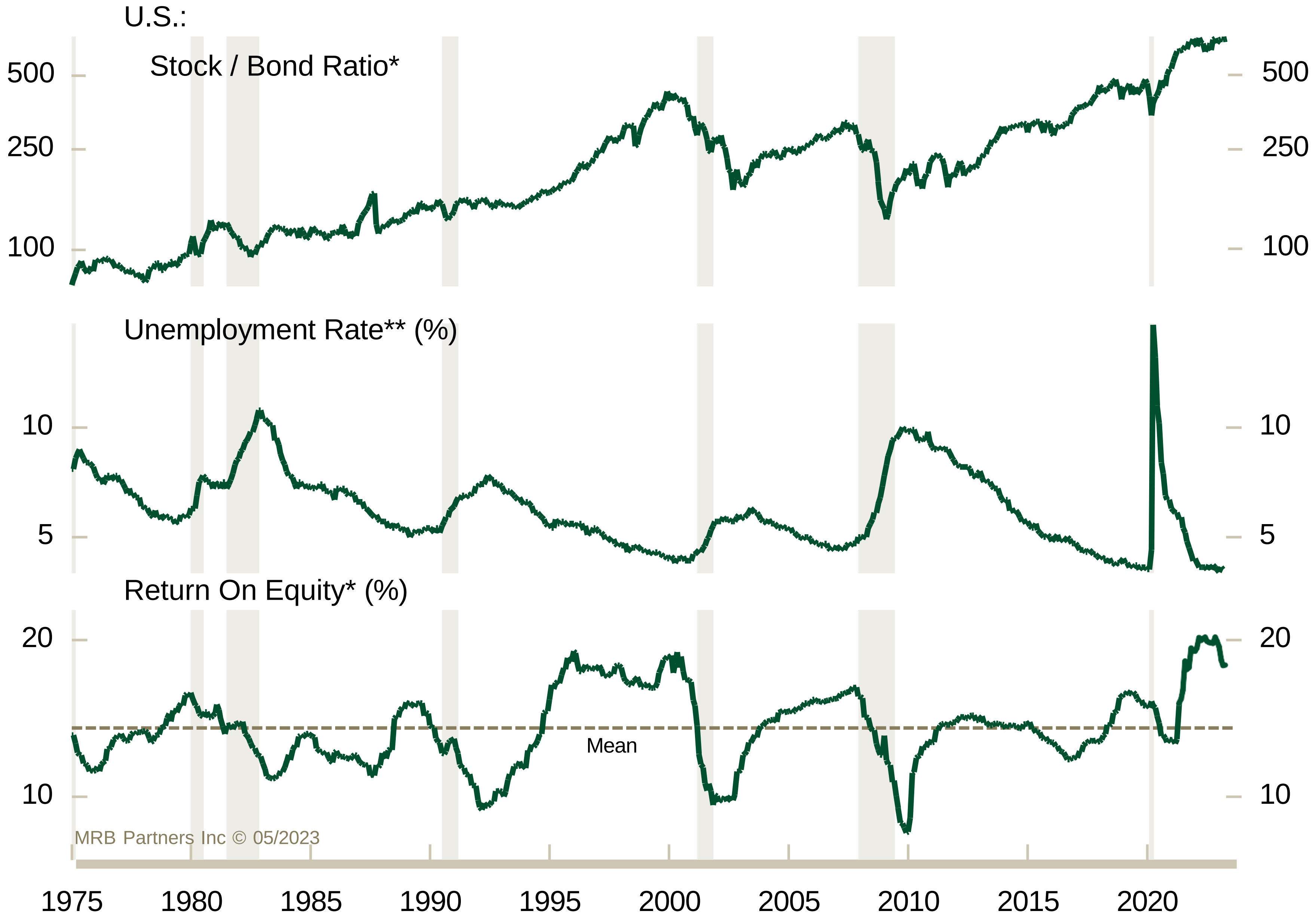
* MSCI stock market total return index divided by U.S. 10-year government bond total return index
Rebased; source: MSCI, Bloomberg
Note: - - - 40-week moving average in panel 1

60/40% Portfolio: Languishing, But Not Dead



* 60% MSCI stock market total return plus 40% 10-year government bond total return index; rebased

Late-Cycle Economic Conditions



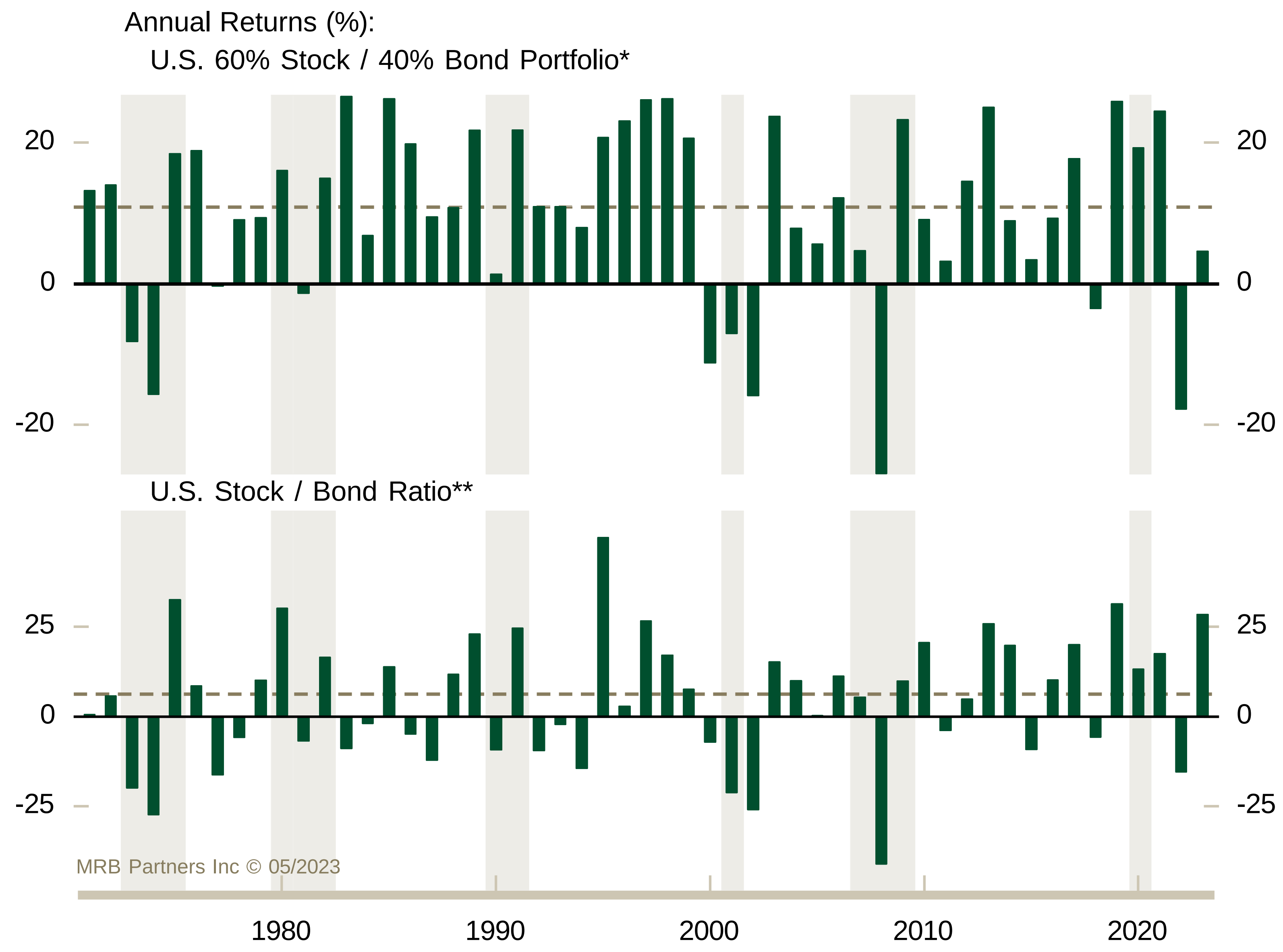
* MSCI stock market total return index divided by U.S. 10-year government bond total return indexl
Rebased; source: MSCI & Macrobond

** Source: FRED

*** Source: MSCI

Note: Shaded for NBER-designated U.S. recessions

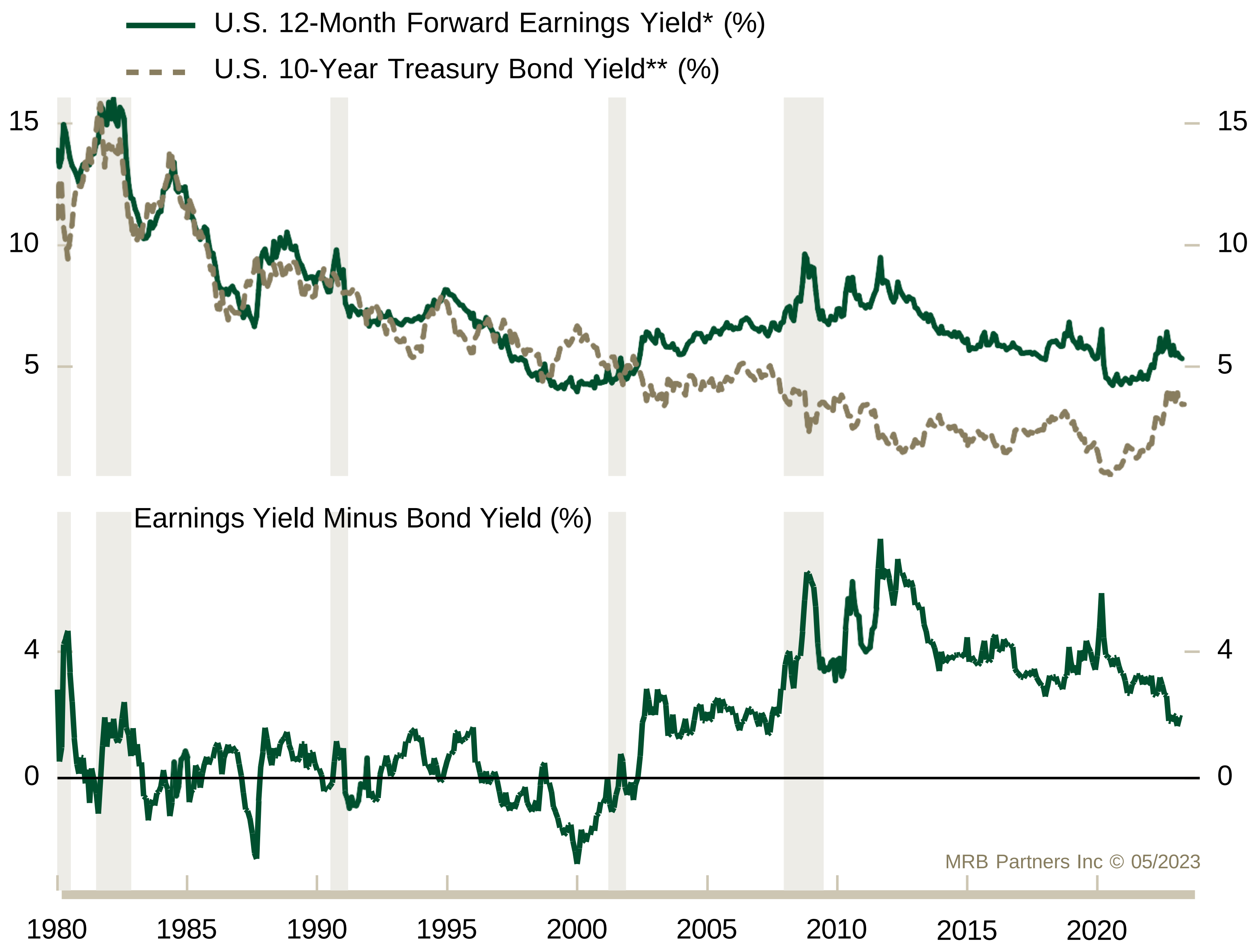
Back-To-Back Portfolio Losses Are Unusual



* Total returns for 60% U.S. equities and 40% U.S. 10-year government bonds; source: MSCI & MRB calculations
** U.S. MSCI stock market total return index divided by U.S. 10-year government bond total return index
Rebased; source: MSCI
Note: Dotted lines = median; 2023 is YTD; shaded for NBER-desingated U.S. recessions

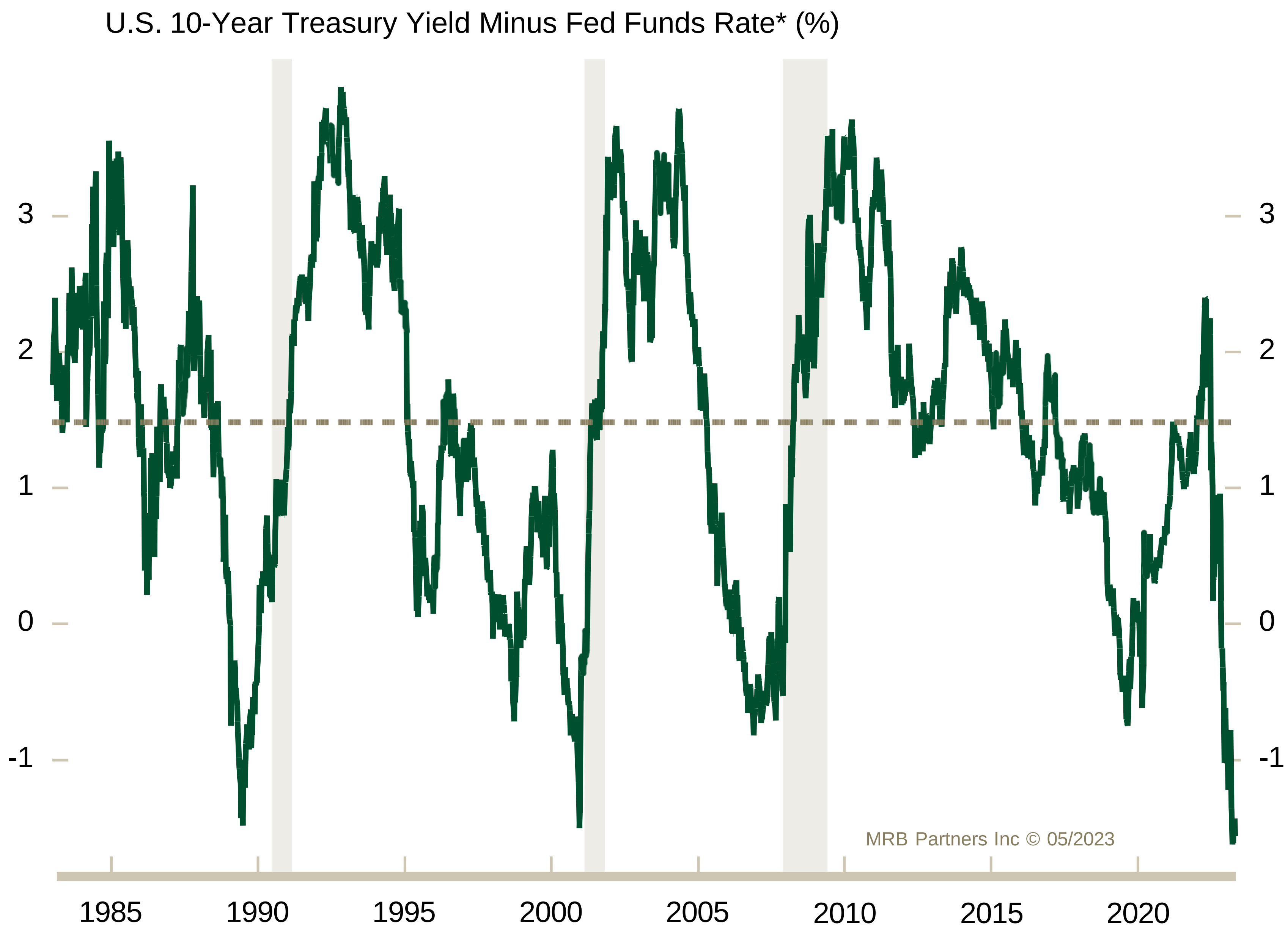
mrb The Macro Research Board

Equity And Bond Valuations Still In Sync



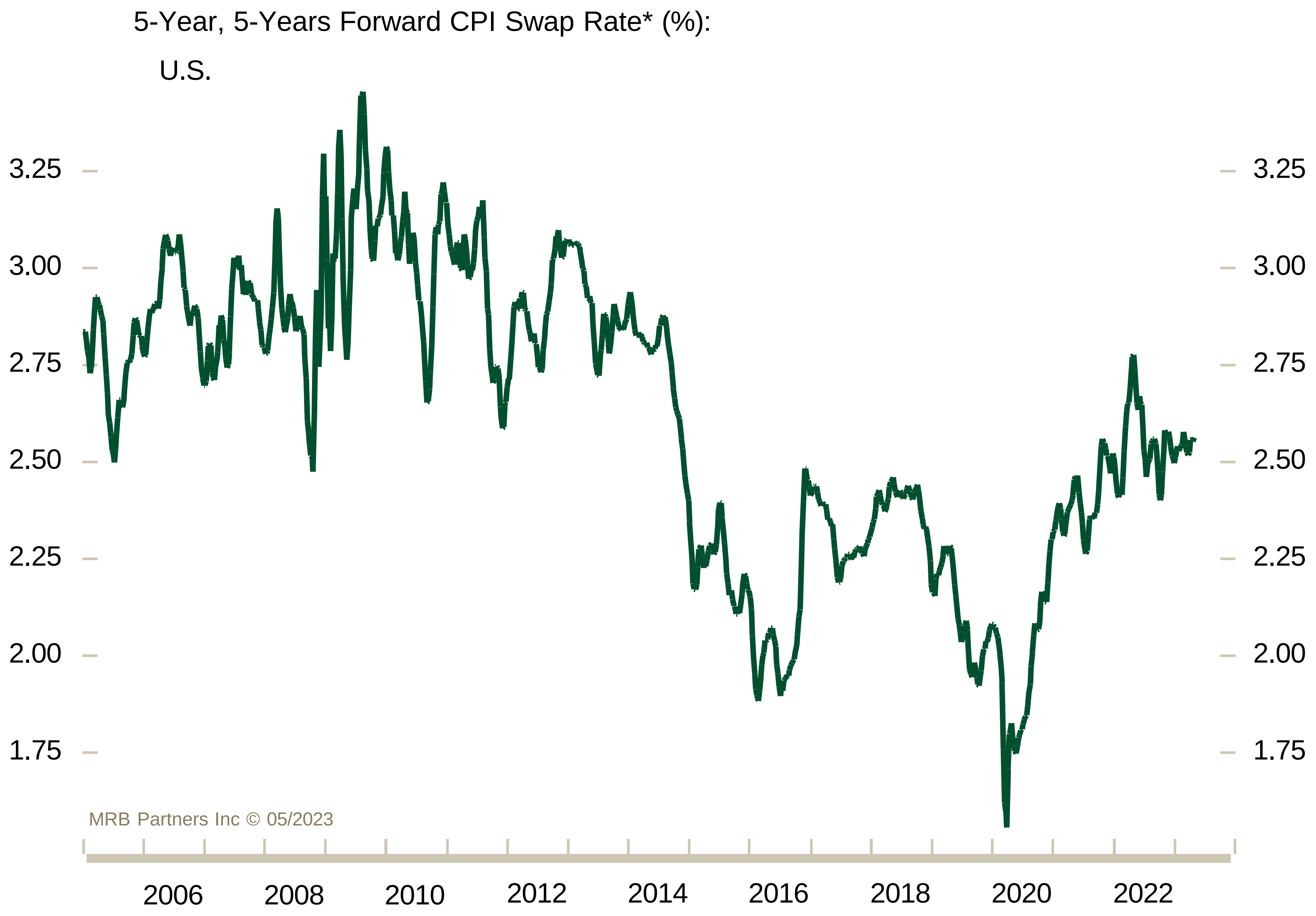
* Source: MSCI
** Source: Bloomberg

The 10-Year Yield Is Low Relative To Fed Funds



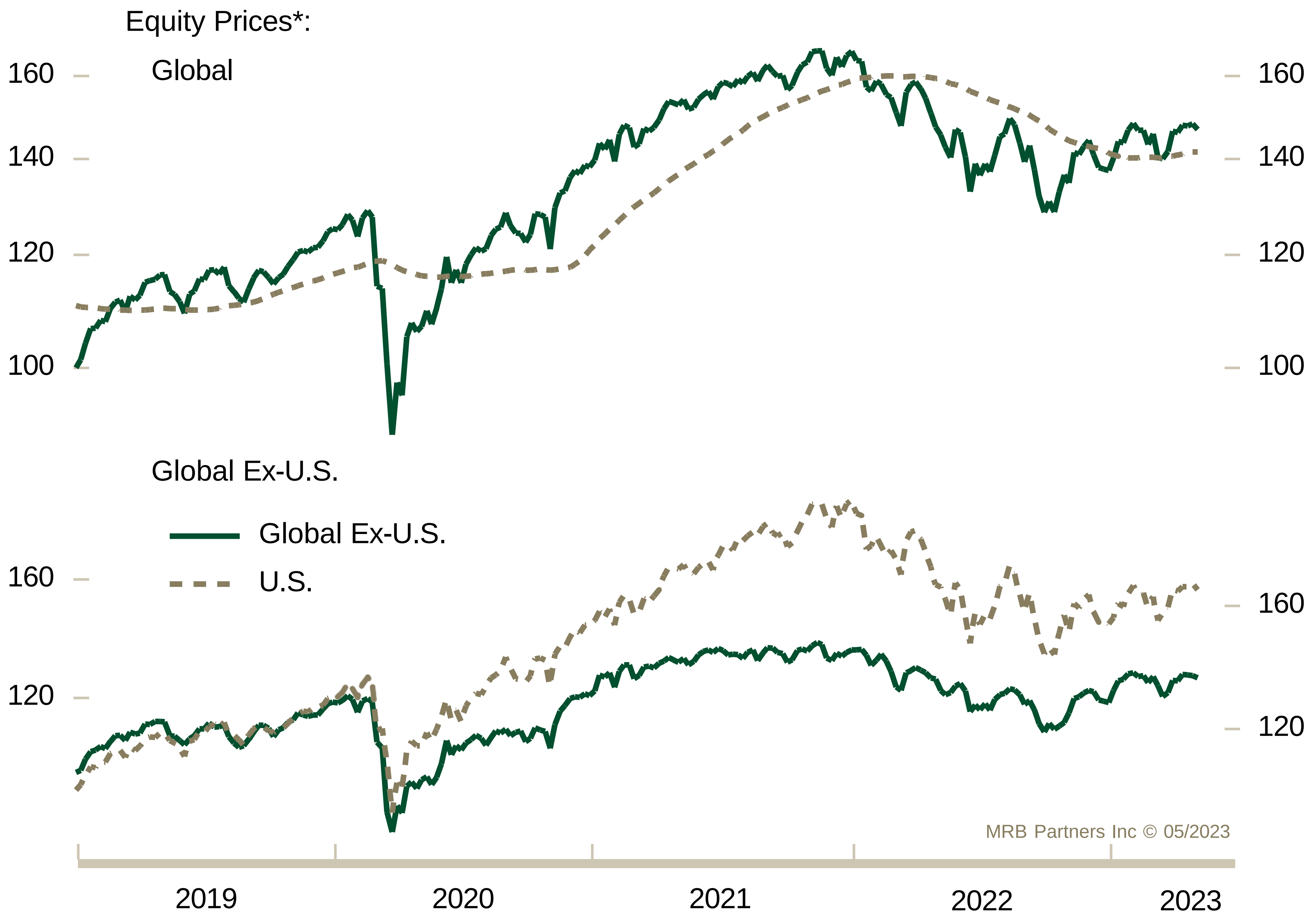
* Source: Bloomberg
Note: - - - historical mean

Markets Are Too Complacent About Inflation



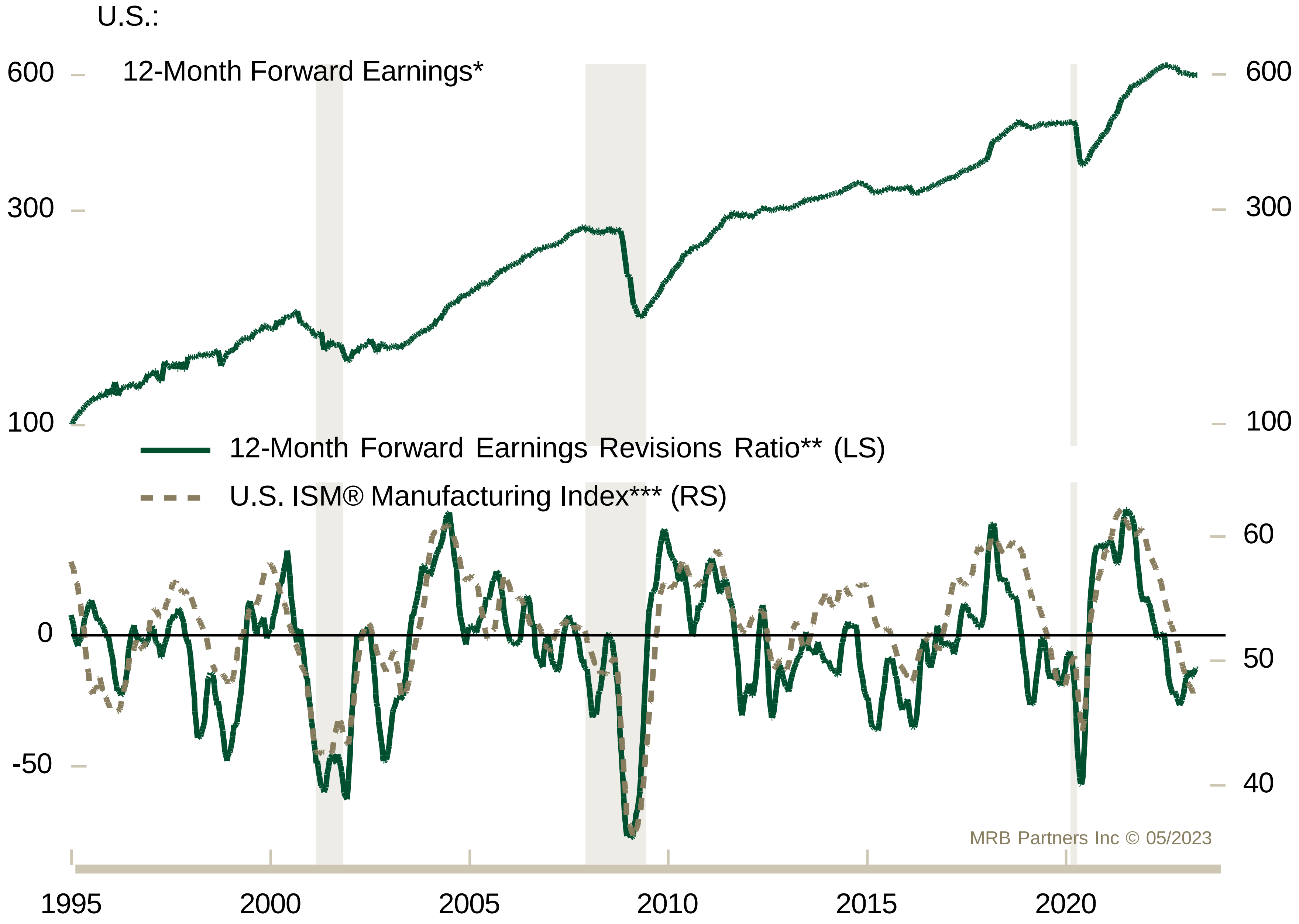
* Smoothed, source: Bloomberg

Positive Equity Market Trends Have Faded



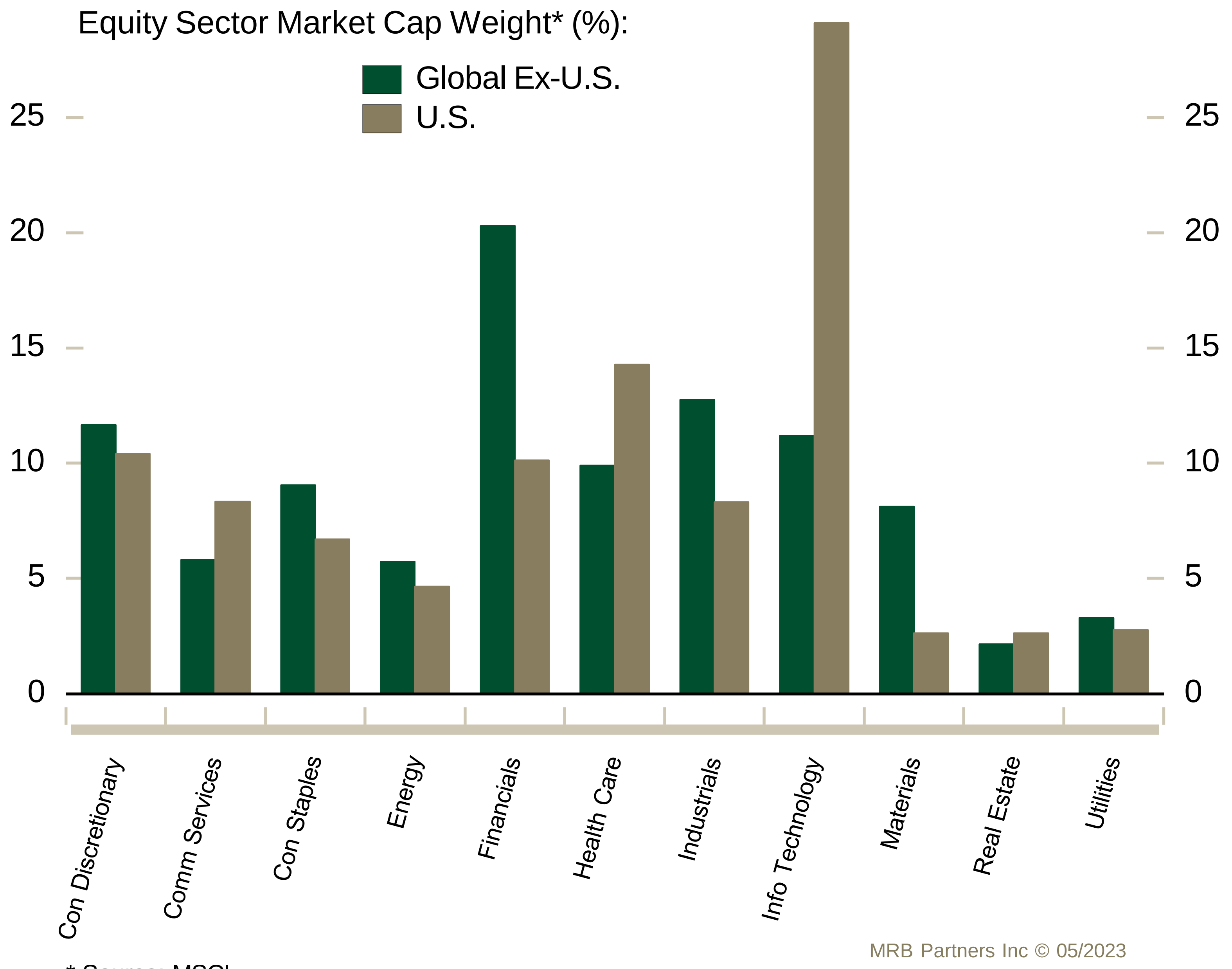
* Local currency; rebased; source: MSCI
Note: - - - 40-week moving averages

More Earnings Downgrades Coming



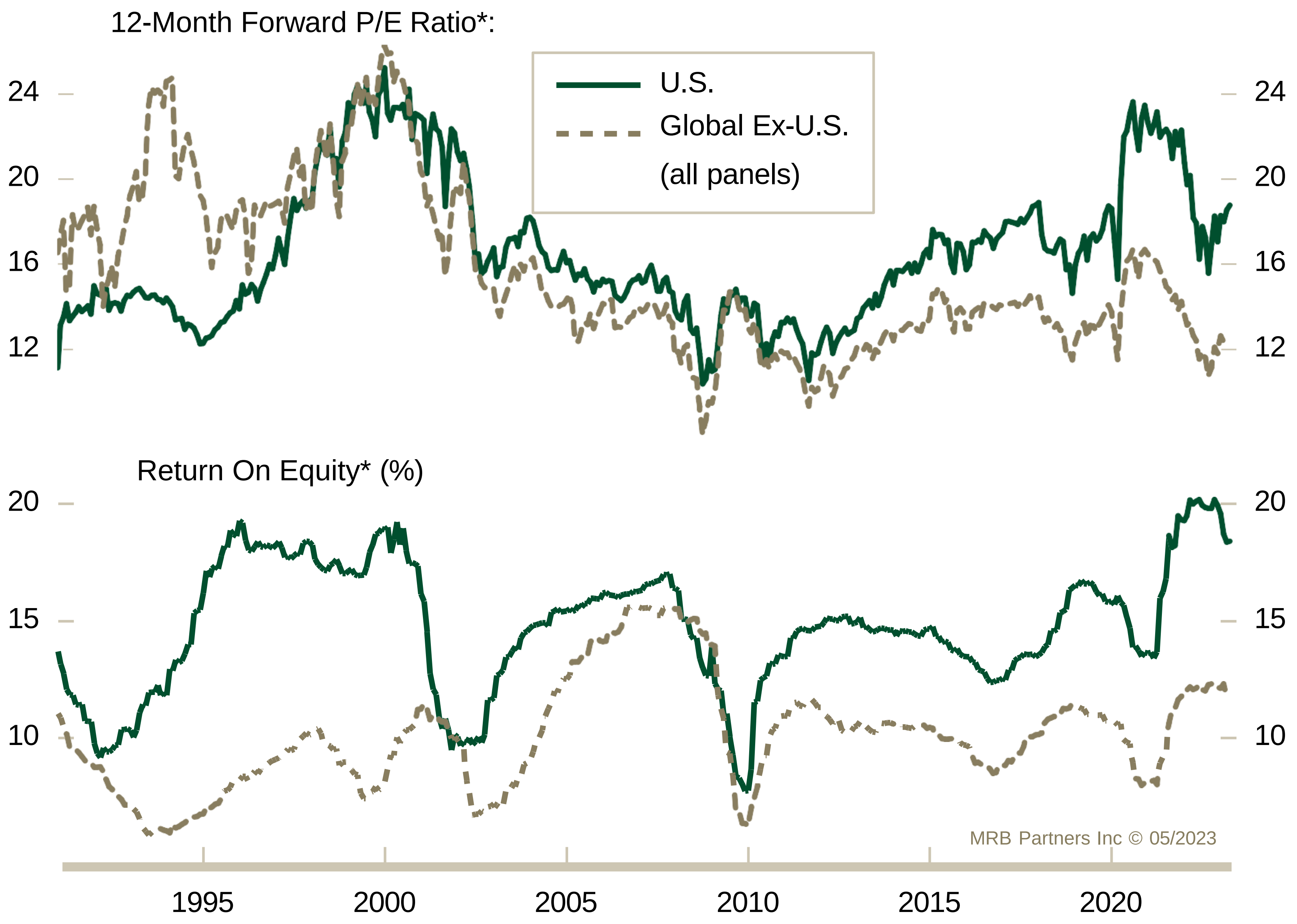
* Smoothed; source: Rinfinitiv I/B/E/S Global Aggregates
** Upgrades minus downgrades as a percentage of total revisions
*** Smoothed; source: Institute for Supply Management®
Note: Shaded for NBER-designated U.S. recessions

U.S. Is More Tech, Ex-U.S. More Financials, Cyclicals



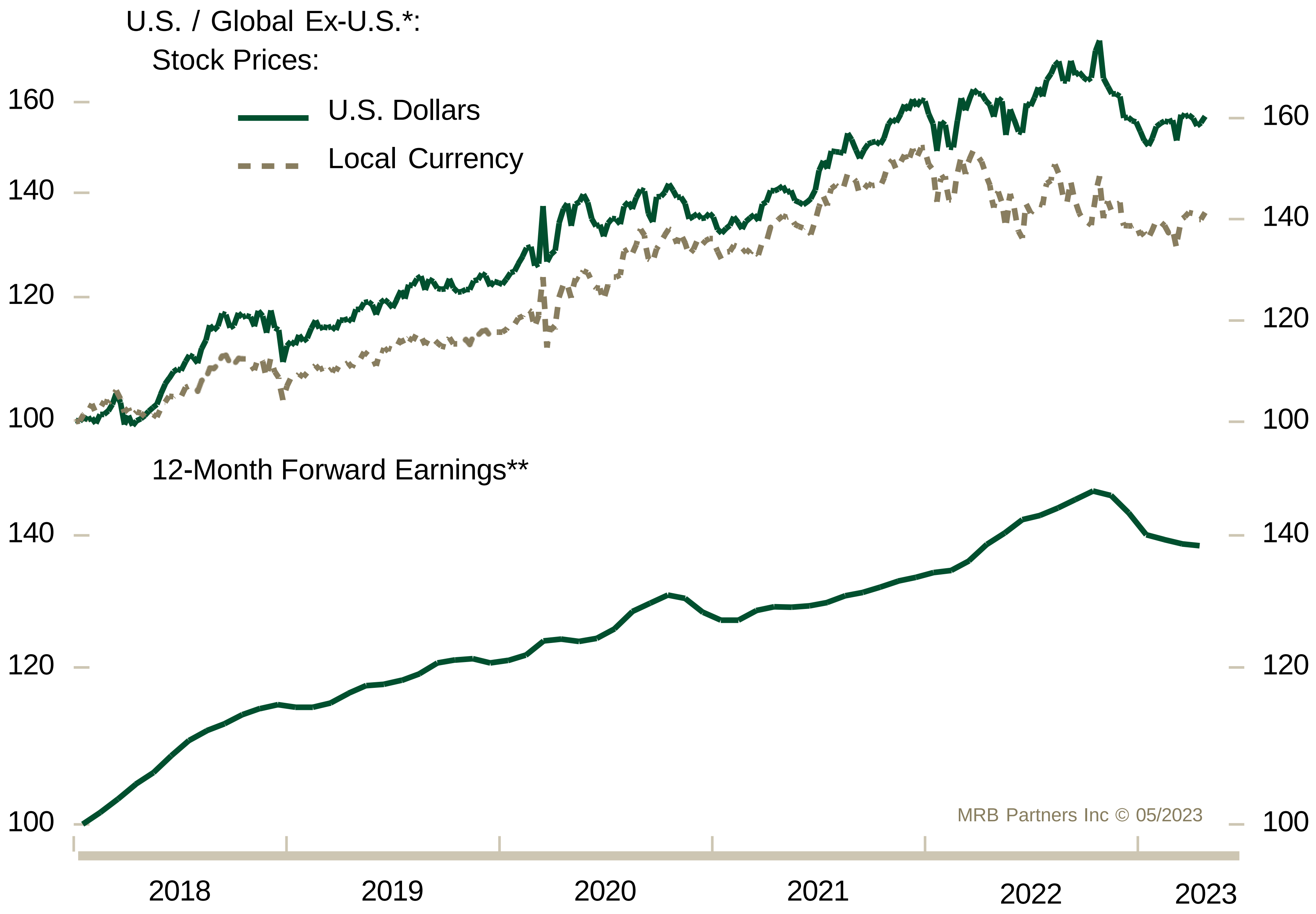
* Source: MSCI

Huge Divergence Between U.S. And Ex-U.S. Equities



* Source: MSCI

Shift In Favor Of Non-U.S. Equities Continues

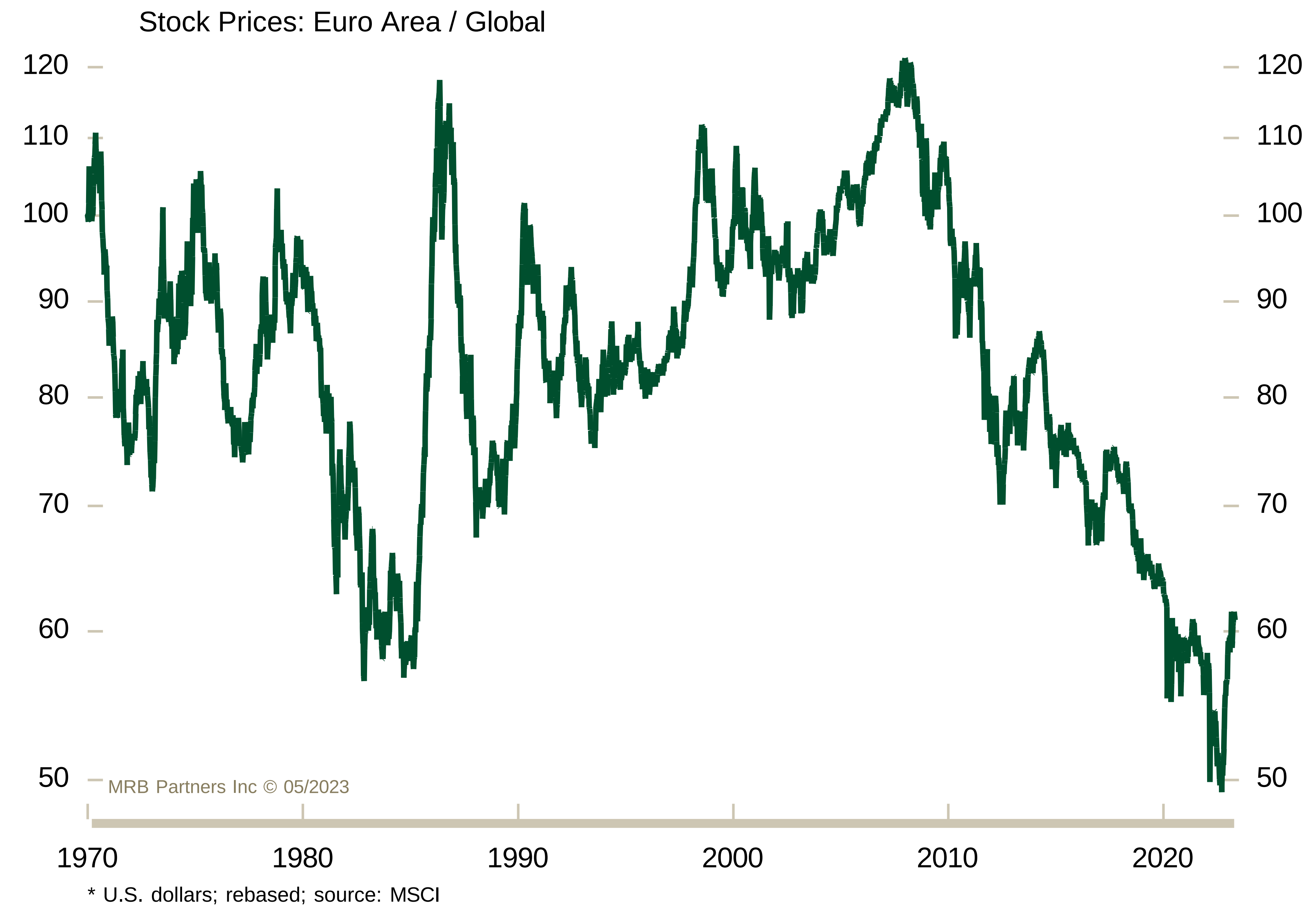


* Rebased; source: MSCI
** U.S. dollars
Note: - - - 40-week moving average in panel 1

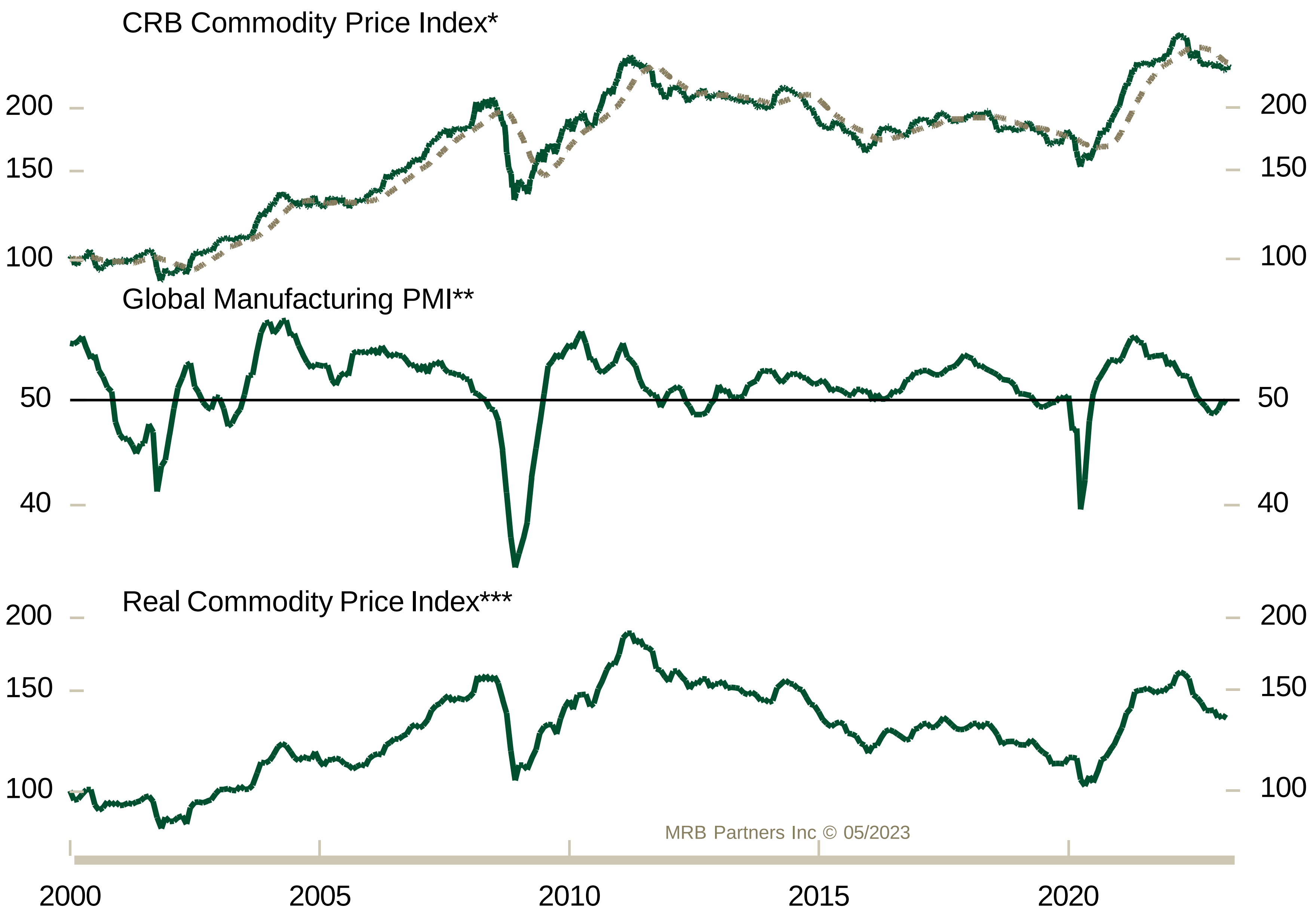
Dramatic Improvement In Euro Area Performance

* Versus the global benchmark; U.S. dollars; rebased; source: MSCI
Note: - - - 40-week moving averages

Euro Area Relative Stock Prices Are Still Depressed

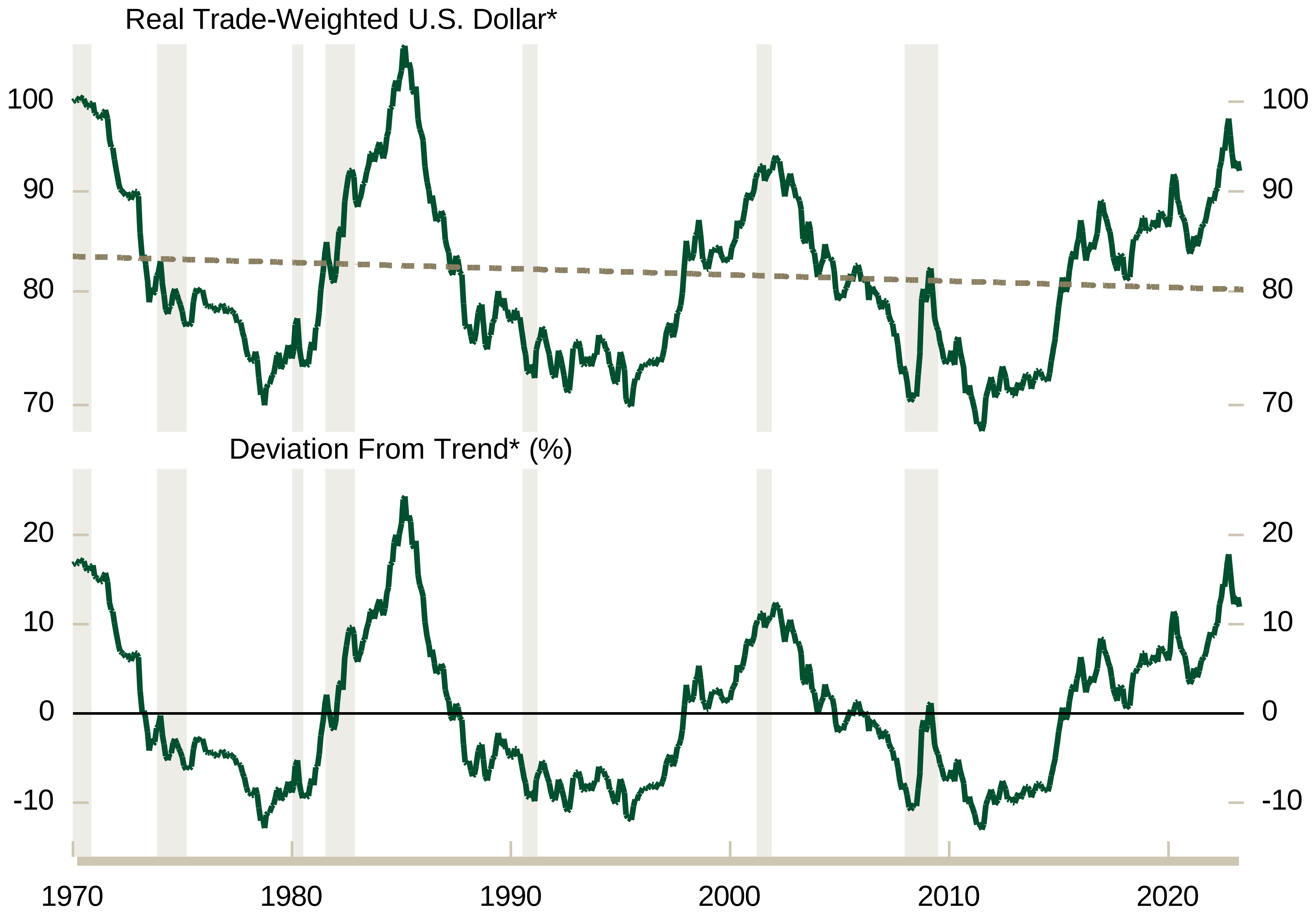


No Clear Theme For Commodities



* Rebased; source: Bloomberg
** Smoothed; source: IHS Markit
*** Nominal price index deflated by U.S. CPI; rebased
Note: - - - 40-week moving average in panel 1

The U.S. Dollar Is Still Elevated



* Source: Federal Reserve and Bank for International Settlements; - - - trend
Note: shaded for U.S. recessions

MRB Partners Inc © 05/2023

mrb The Macro Research Board

MRB Asset Allocation And Recommendations[1]

Overall Asset Allocation

	−	N	+
Equities		■	
Fixed Income	■		
Cash			■
Commodities		■	

Regional Equities[2]

	−	N	+
Australia	■		
Canada	■		
EM Markets			■
China			■
Ex-China		■	
Euro Area			■
Ex- Germany			■
Germany			■
Japan		■	
Sweden		■	
Switzerland		■	
U.K.		■	
U.S.	■		

U.S. Equity Sectors[3]

	−	N	+
Consumer Discretionary	■		
Communication Services			■
Consumer Staples		■	
Energy		■	
Financials			■
Health Care			■
Industrials		■	
Information Technology	■		
Materials	■		
Real Estate		■	
Utilities		■	

Emerging Markets Equities[4]

	−	N	+
Brazil	■		
China			■
India			■
Indonesia			■
Korea		■	
Mexico	■		
South Africa		■	
Taiwan		■	
Turkey		■	

Fixed Income

		−	N	+
Duration		■		
Government Bonds		■		
Yield Curve[5]			■	
Inflation Protection			■	
Corporate Bonds[5]:	Investment-Grade			■
	High-Yield		■	
EM Sovereign:	USD Debt		■	
	Local Currency Debt			■

DM Government Bonds[6] (Currency Hedged)

	−	N	+
Australia			■
Canada			■
Euro Area	■		
Ex- Germany	■		
Germany	■		
Japan		■	
New Zealand			■
Norway			■
Sweden			■
Switzerland		■	
U.K.		■	
U.S.	■		

Currencies (vs US$)

	−	N	+
Australia	■		
Canada	■		
Euro Area			■
Japan			■
New Zealand	■		
Norway	■		
Singapore			■
Sweden	■		
Switzerland		■	
U.K.	■		
Emerging Markets			■

Emerging Markets Currencies (vs EM Basket)

	−	N	+
Brazil		■	
China			■
India		■	
Indonesia			■
Korea	■		
Mexico		■	
South Africa		■	
Taiwan	■		
Turkey	■		

1 6-12 month horizon
2 Relative to common currency global equity benchmark
3 Relative to common currency U.S. equity benchmark
4 Relative to common currency emerging markets equity benchmark
5 + = Steepener and - = Flattener
6 Relative to hedged global fixed income benchmark

Note: Apart from the Asset Allocation section, recommendations are within asset classes; + = overweight, N = neutral and – = underweight

mrb partners
MacroResearchBoard

Special Offer For FPA Members

- Free 60-day access to all of MRB research reports and webcasts.
- Invitation to upcoming webinars by Chief Strategists + interactive Q/A.
- Ask questions directly to Senior Research Team.
- Exclusive discount on an MRB subscription.

No Commitment
No Credit Card

Independent Investment Research For Professionals

MacroResearchBoard

mrb partners

Independent Investment Strategy

About The Macro Research Board

MRB is a privately-owned independent top-down research firm that provides integrated, global, multi-asset investment strategy as well as actionable absolute and relative return ideas. Our views incorporate a long-term outlook based on in-depth thematic research, together with a rigorous set of frameworks and forecasting models/indicators that drive 6-12 month asset market performance. MRB's team of analysts and strategists leverage the firm's robust research engine and their extensive experience to form one cohesive house view and ensure that investment strategy is articulated in a client-friendly manner.

London 24 Old Bond Street, 3rd Floor
London, W1S 4AP, United Kingdom
Tel +44 (0) 20 3667 2160

Montreal 1275 Avenue des Canadiens-de-Montréal, Suite 500
Montreal, Quebec H3B 0G4
Tel +1 514 558 1515

New York 1345 Avenue of the Americas, FL 2,
New York, NY, 10105, United States
Tel +1 212 390 1148