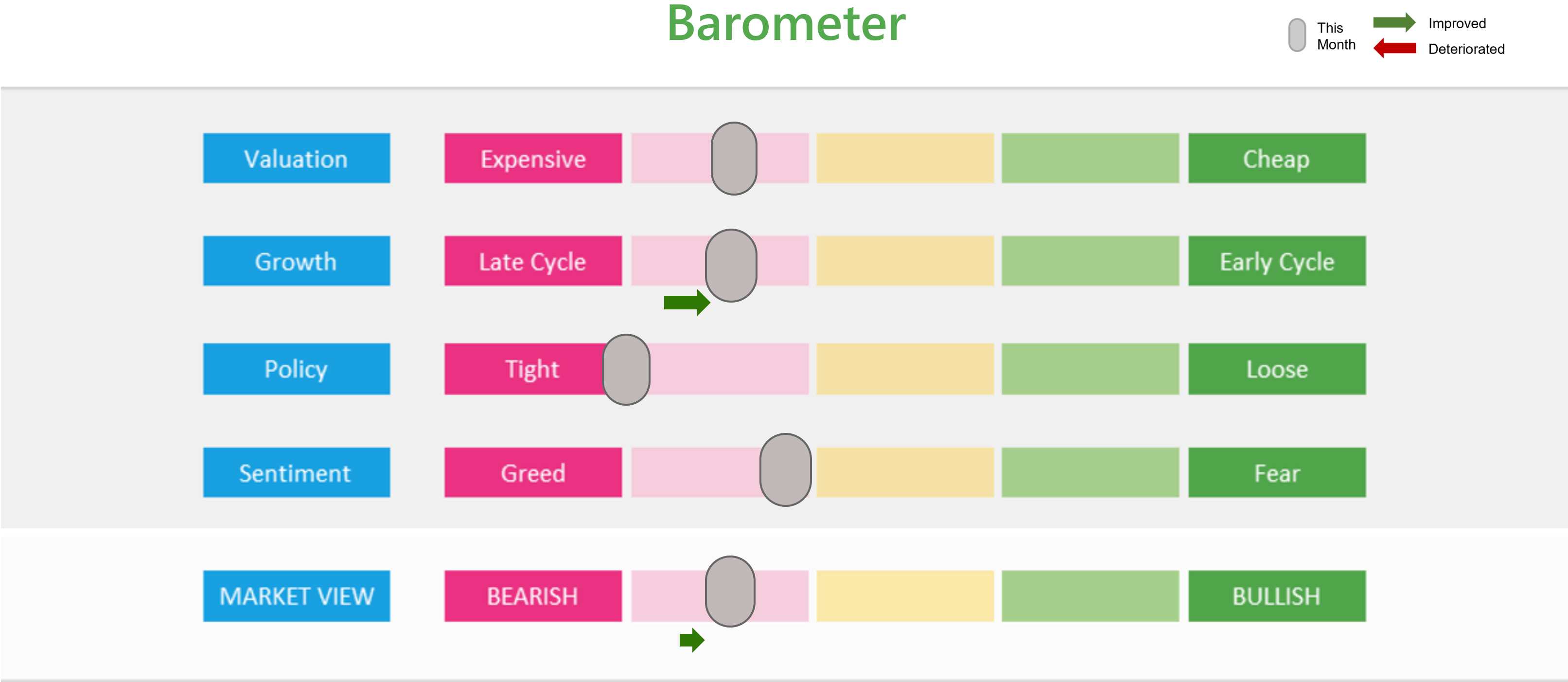
APRIL 2024

CCLA
GOOD INVESTMENT

Market Barometer

Barometer



Goldilocks (cont'd)

The long and the short of it is that **EPS are rising** on both a trailing and a forward basis, while **inflation is moderating, and the tightening cycle is now behind us** (apart from Japan which just hiked for the first time in 17 years, and that's a good thing). **All this is positive**.

The less positive observations we would make are that **sentiment has recovered** from the washed out levels of 18 months ago, but not to levels that on their own are alarming.

Market breadth is narrow but not terrible. YTD 47% of S&P 500 constituents have outperformed the S&P 500 for example, so despite all the headlines about the Magnificent Seven, performance is broadening out.

We need to keep an eagle eye on the US labour market for signs of weakening. **Temporary staffing is weakening** and that's a lead indicator.

In our Charts of the Month we look at why the UK has been such a stagnant economy.

Labour policy in government would aim to stimulate national capital investment in order to release productivity. The UK is the only G7 member state to have investment levels below 20% of GDP, and we show this has been the case ever since 1992.

Similarly the number of long term sick has risen by 700,000 people just since the pandemic.

In summary, if Labour forms the next government and **if they are able to deliver on some of their main targeted reforms, it could be transformative for the UK** economy and for the valuation of UK assets, which languish on record discounts to developed market peers. We will be watching, but there is many a slip between cup and lip.

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Contents

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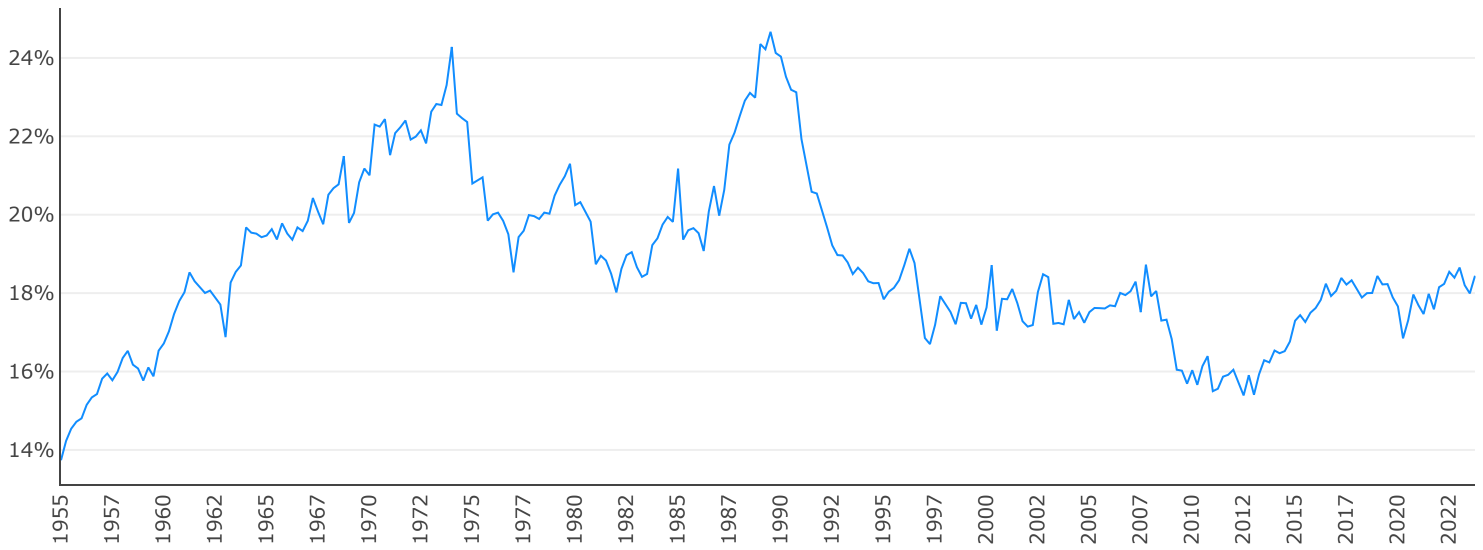
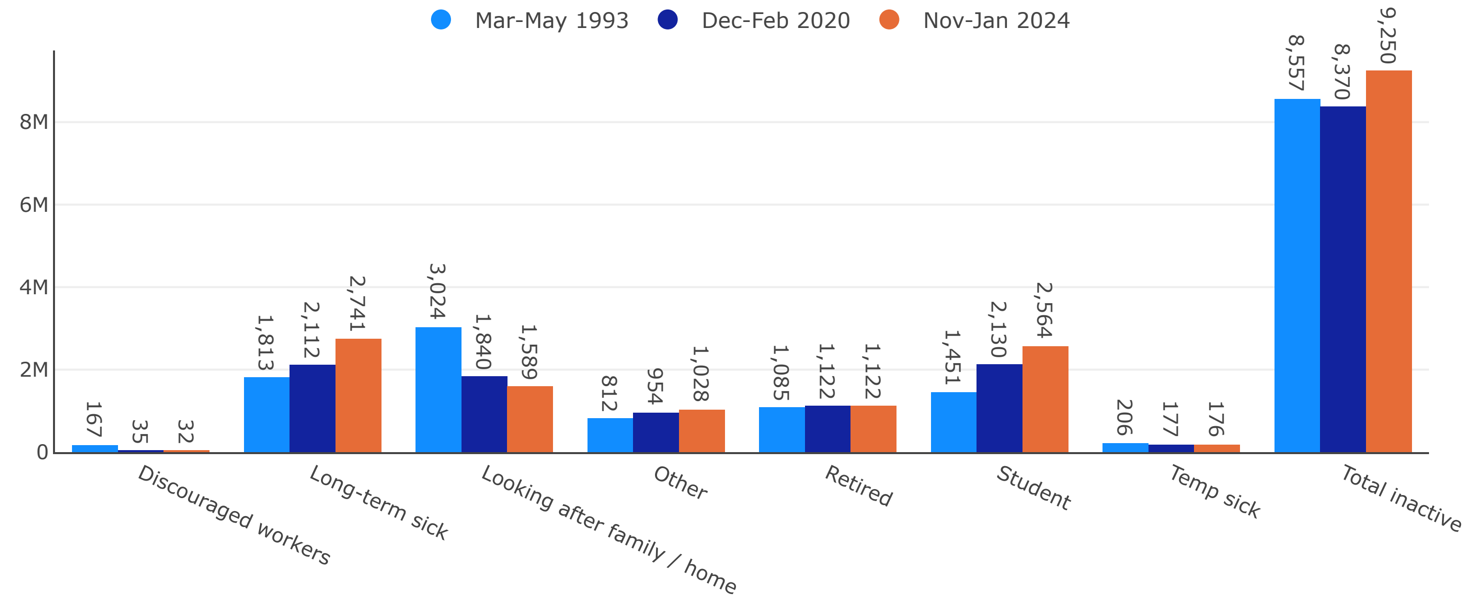
Charts of the Month

This month we focus on the UK following Rachel Reeves' important policy speech in the Mais Lecture on 19 March. As presumed Chancellor-in-waiting what she says matters for UK asset prices. Her speech identified low national investment as the root national problem, causing low productivity and poor GDP/capita growth. The Labour plan is to revitalise investment by reforming the planning system, hiring "hundreds of planners", setting mandatory local housebuilding targets, and instituting a new British Infrastructure Council. She says the UK is alone in the G7 with investment below 20% of GDP - see the first chart below. She also wants to reverse the huge rise economic inactivity, particularly in the long-term sick - see the second chart below. **If a new government can do even half of this, it could be transformational for UK assets,** which are currently at record wide valuation discounts to the rest of the developed world. That said, we have heard a lot of this before, so **it will all come down to implementation**, assuming they are elected.

UK Gross Fixed Capital Formation / GDP



UK Economically Inactive By Type '000



Sources | ONS, CCLA. As of March 2024. Note: Discouraged workers are those who do not believe there are any jobs available. "Other" includes people who do not need or want a job, or have not started looking for a job.

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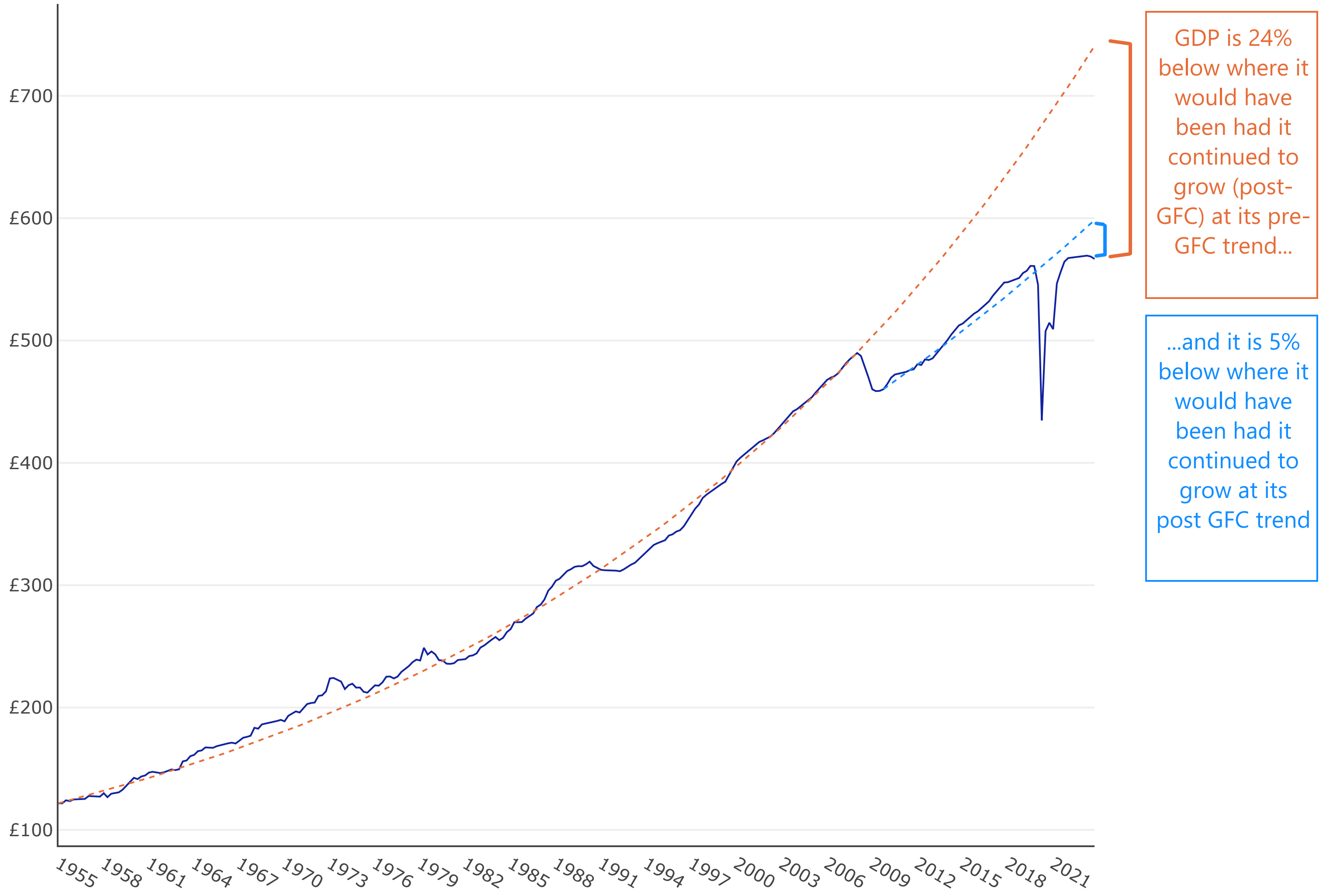
Charts of the Month

The scale of the UK's problem, and the potential economic upside if we can fix it, is very large. In the chart below we have added our own extrapolations of pre-existing trend growth rates to the outturn UK real GDP data. What we see is that the UK grew on a consistent trend (the orange dotted line) of 2.7% annualised between 1955 and the GFC in 2008. Then it grew at a slower trend rate of 1.9% in the decade post GFC until the start of the pandemic in 2020, shown in the blue dotted line. Post pandemic it has flatlined at zero growth. The effect of this failure to maintain the growth trend the effect is very large. **GDP is 24% lower than it would have been had it continued (post GFC) to grow at its 50 year pre GFC trend**. The failure in the last three years to get back even to the post GFC / pre pandemic trend has cost us 5% of UK GDP.

We must hope that an incoming Labour government, should that be the outcome of the next general election, is able to deliver on its plans, not for political reasons but for reasons of national welfare.

UK Real GDP Trend



Sources | ONS, CCLA. As of March 2024. Concept from Torsten Bell, CEO, Resolution Foundation.

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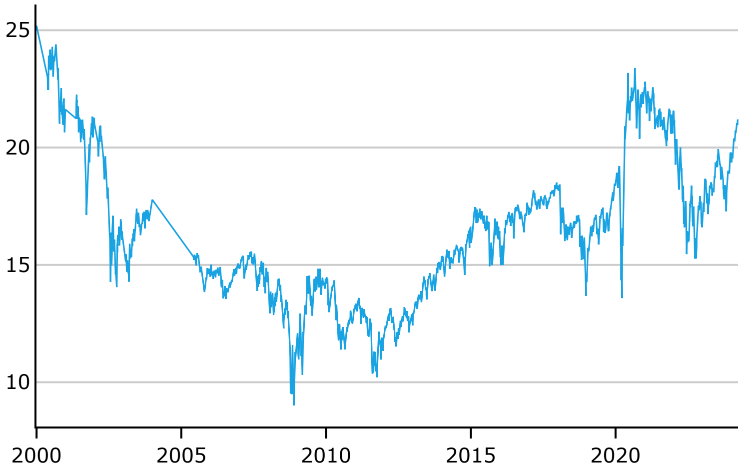
Equity | USA

The US equity market has re-rated sharply in the last five months, from 17x to 21x consensus forward earnings (top left chart). This leaves the spot valuation nearly 26% above its 16x average of the last thirty years. **For the PE multiple to continue to re-rate back to its 22.5x high of 2020 would take a large rally in bond yields or a bout of what Alan Greenspan called Irrational Exuberance**. Note that the US 10 year yielded 0.5% in 2020 vs 4.2% now.

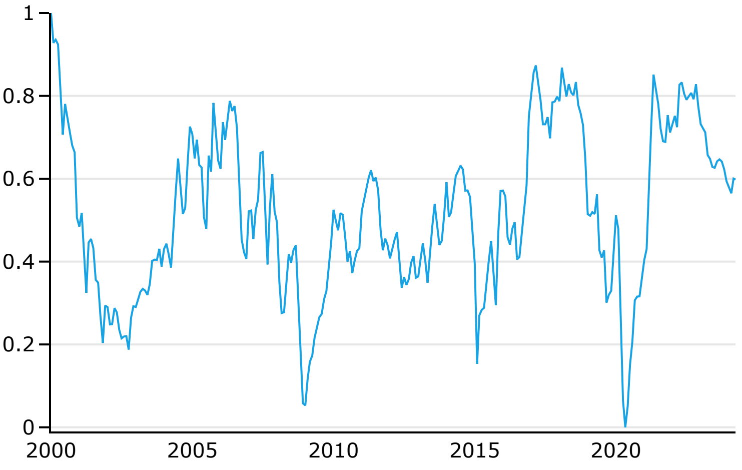
The CAPE (Cyclically Adjusted PE) is 32.8x. A shorthand for future real expected return is the CAPE earnings yield, indicating that US equity may not be expected to return much more than 3% annualised over coming years.

S&P 500 Valuations

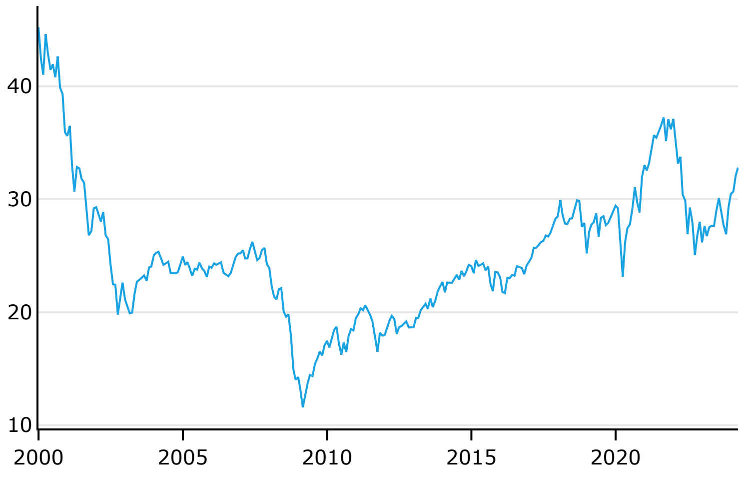
S&P 500 Forward PE



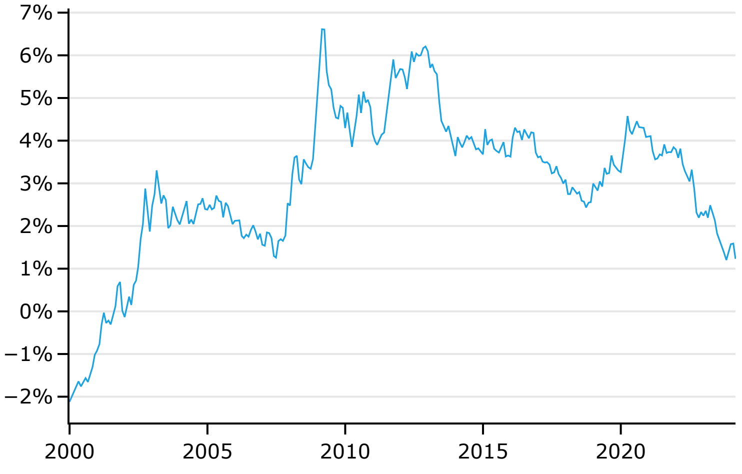
Composite Value Indicator Model



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 March 2024

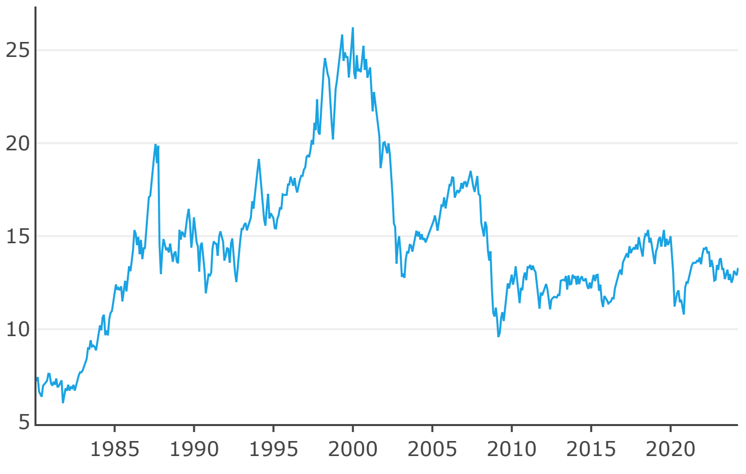
VALUATION

Equity | Regional

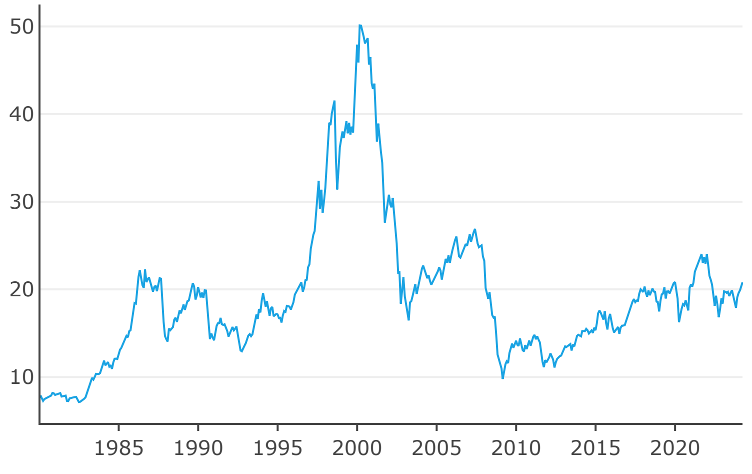
Outside the US (which is 69% of MSCI World), equity markets continue to look reasonable value (UK, Europe-ex-UK) or outright cheap (Japan, EM). The de-rating of last year is notable everywhere. The UK Shiller PE of 13.3 gives an earnings yield of just over 7.5%, which is a good approximation of expected forward real returns. On the same basis, Europe ex-UK PE of 20.8 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

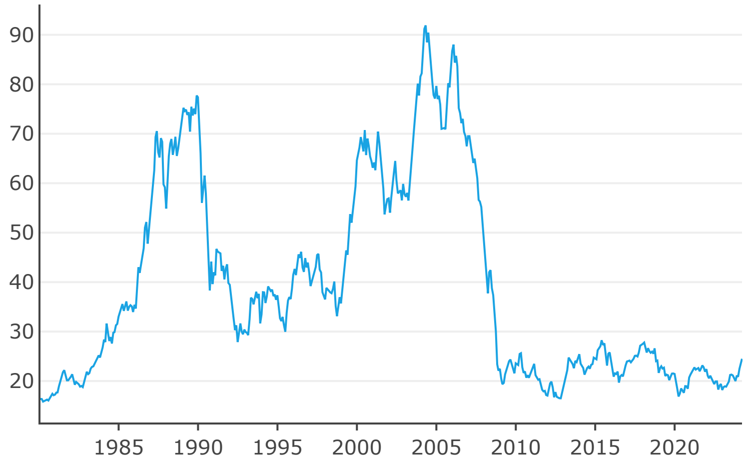


Europe (Ex-UK) | Shiller P/E

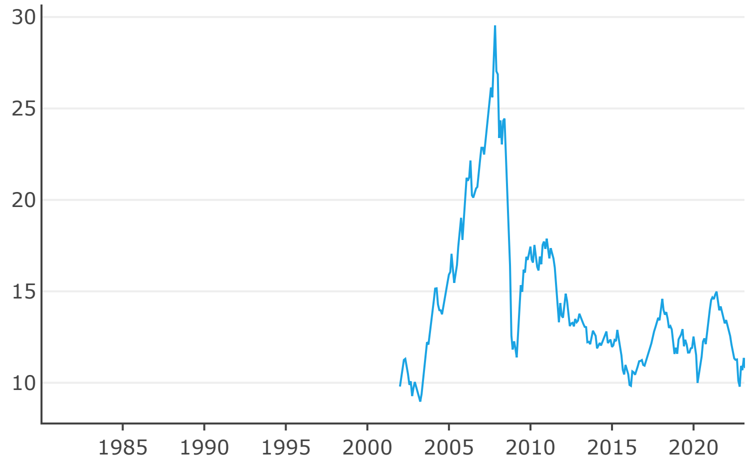


Asia & Emerging Markets

Japan | Shiller P/E



EM | Shiller P/E



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

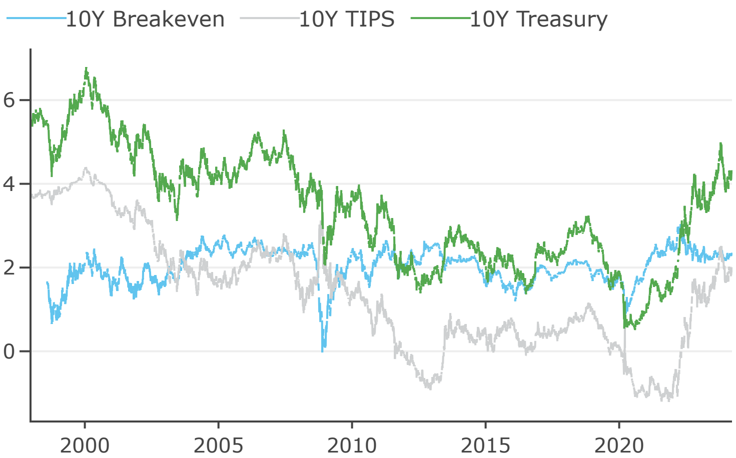
Bonds

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 2.3% (albeit 8% above the October-lows), iBoxx Sterling AA (IG) is down c1% and iBoxx Sterling HY is up almost 3%.

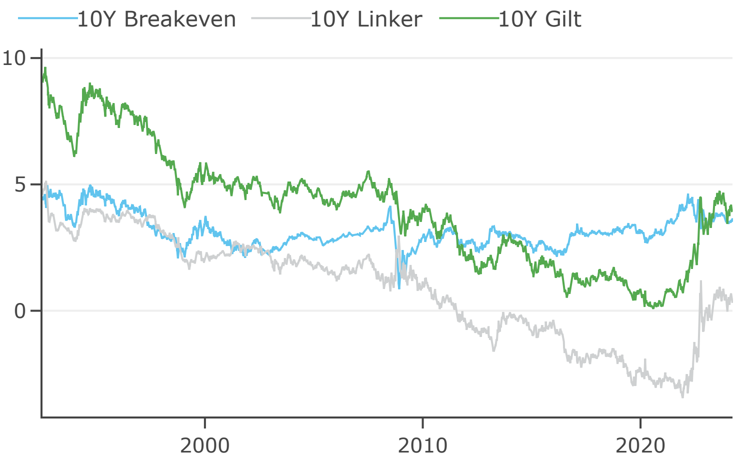
Corporate US BBB yields are still around 5.80%, which stripping out 2.5% expected inflation yields above 3.3% real expected total return, **which to our eyes remains reasonably attractive**.

Global Government & Corporate Yields

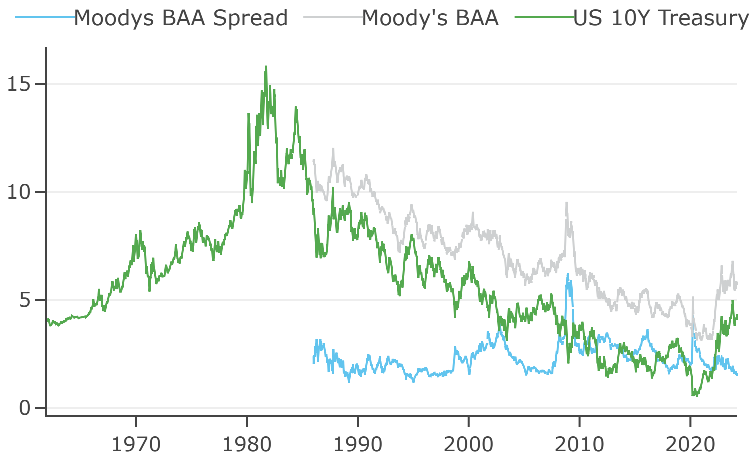
US 10 Year Treasury Yields



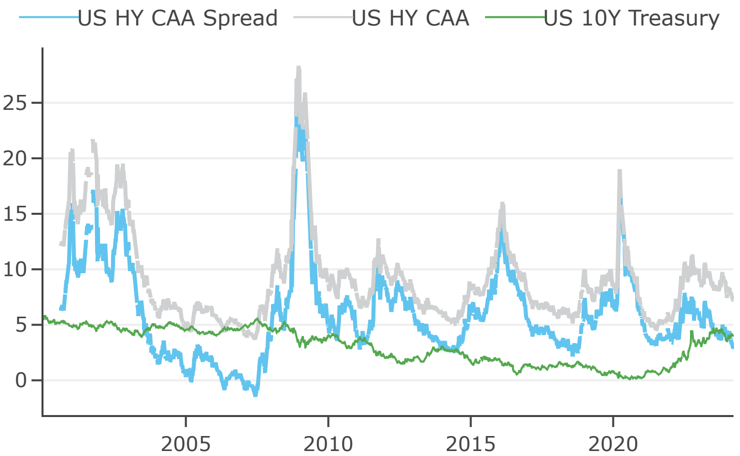
UK 10 Year Gilt Yields



US Corporate Investment Grade Yield



US Corporate High Yield



Sources | Bloomberg as at March 2024

VALUATION

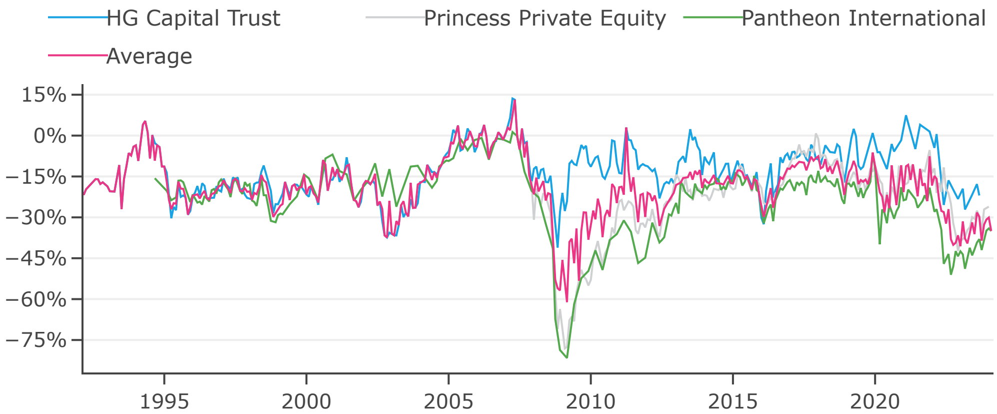
Alternatives

The IRR on Core Private Infrastructure now offers 2.5% return spread over IG corporate bonds, which is becoming more interesting after a much tighter spread over the last two years. Listed Infrastructure trades at 20-35% 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 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

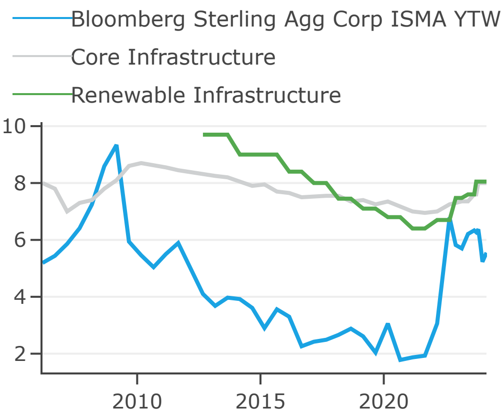
Listed Private Equity

Discount To NAVs



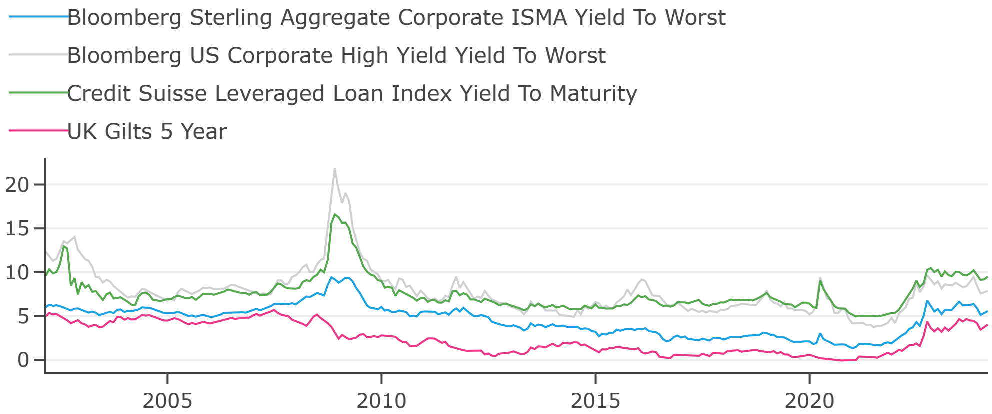
Infrastructure

Infrastructure Discount Rates vs Bond Yields



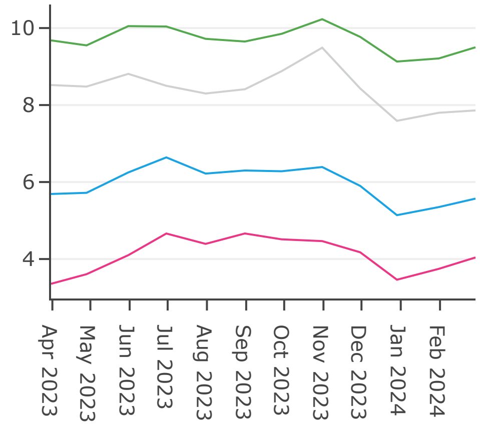
Contractual Income

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 March 2024

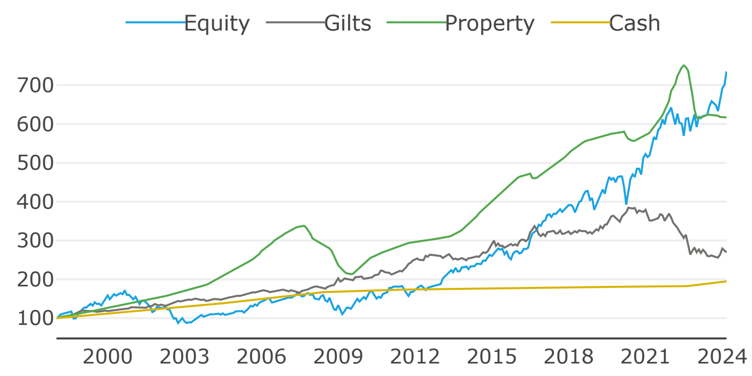
Property

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% 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.

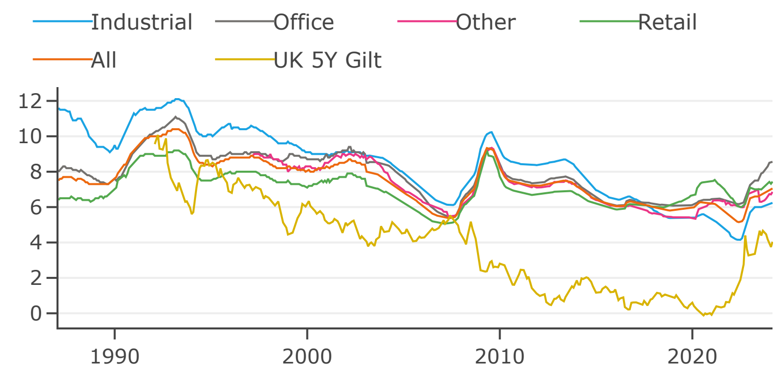
We show that UK Commercial Property has generated similar returns to global equity over the last 25 years (top left chart). Further, that outside of correction phases (one of which we have just been through) **real returns to Property have tended to average around the starting Equivalent Yield** (middle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

UK Commercial Property Market

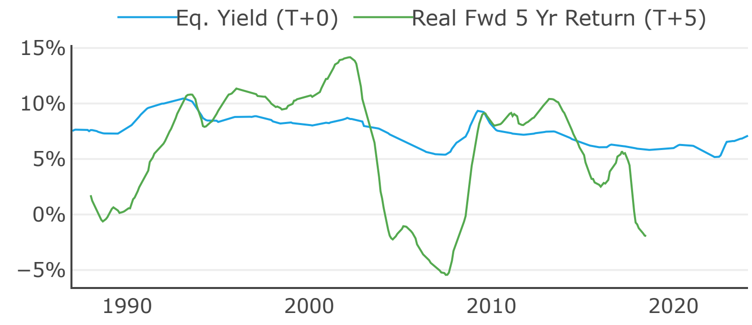
25 Years Of Return 1998=100



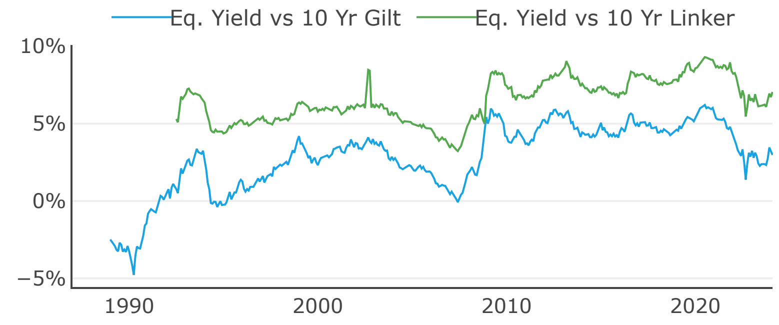
Equivalent Yields vs Gilt Yields %



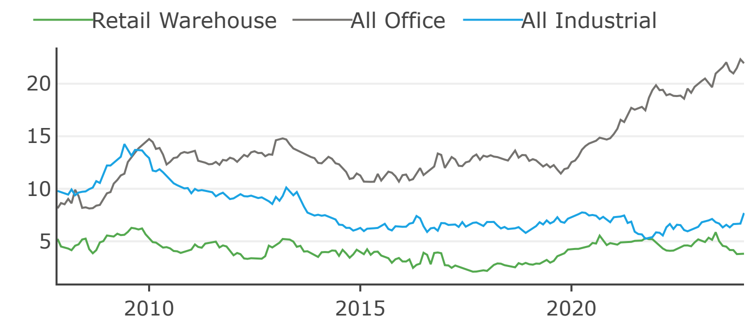
MSCI UK All Property Monthly TR Index %



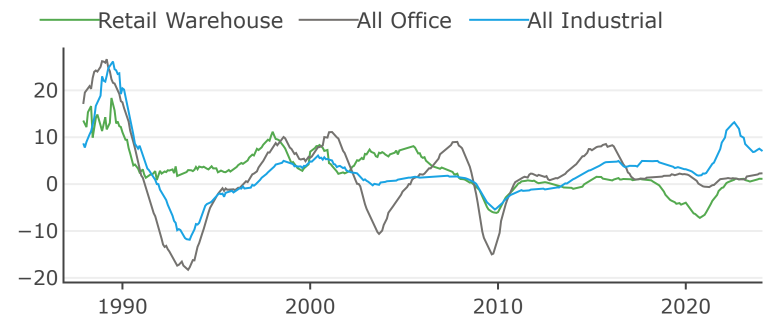
MSCI UK All Property Index - Equivalent Yield Spreads



Vacancy Rate %



Nominal Rental Value YoY Growth %



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

VALUATION

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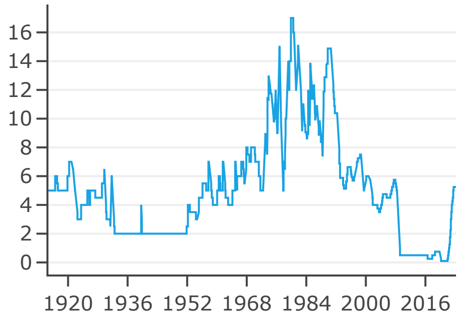
Cash

Last month, we discussed three conditions that could increase the likelihood of a rate cut. The latest economic readings show **headline CPI decelerating to 3.4%, nearing the 2% +/-1% mandate**. Private sector wage growth and unemployment on the other hand remain significantly distant, albeit heading in the right direction.

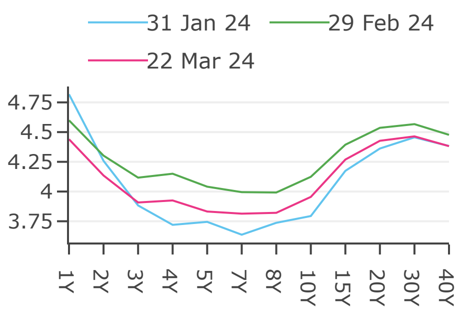
Granted, **we may not need to see all three elements align simultaneously for the first cut,** given the already restrictive policy in place. Forecasts suggest that base effects will drive private wages below 5% by the summer and around 4-4.5% by year-end, by when headline inflation is expected to fluctuate around 2%. **This could be enough to see the first rate cut in Q3 this year**, allowing the BoE to move in lockstep with its counterparts at the Fed and ECB.

UK Sterling Market

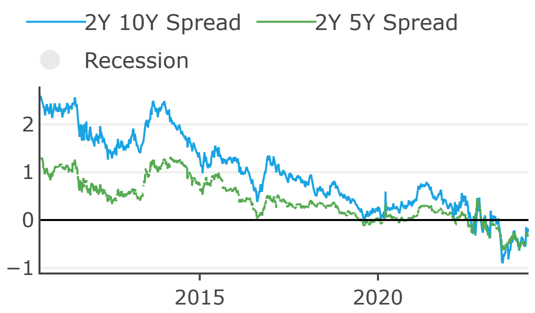
Official Bank Rate



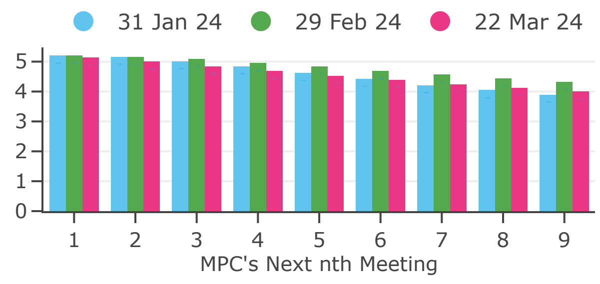
UK Gilt Curve



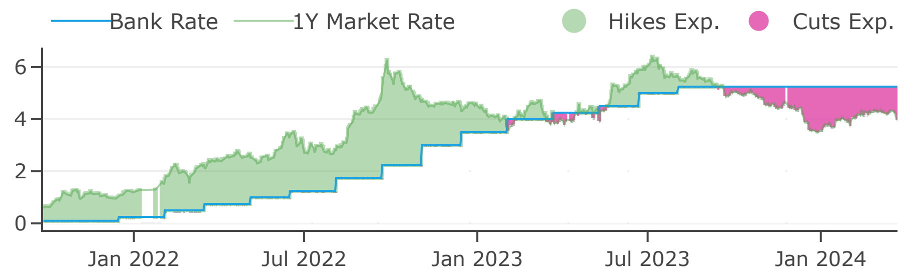
Gilt Spreads



Rate Expectations For Future MPC Meetings



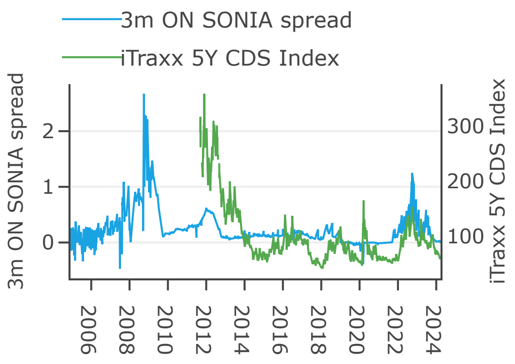
1Y Forward Market Rate Expectations



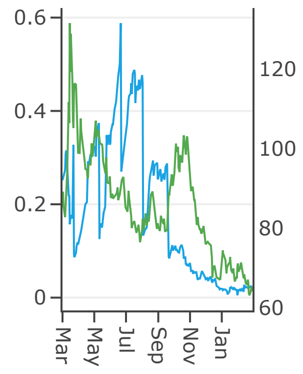
Inflation Readings YoY% | Colour by 10Y Z-Score*

Year	2023				2024	
	Sep...	Oct...	Nov...	Dec...	Jan...	Feb...
RPI	8.90	6.10	5.30	5.20	4.90	4.50
CPI	6.70	4.60	3.90	4.00	4.00	3.40
CPI Core	6.10	5.70	5.10	5.10	5.10	4.50
CPI Services	6.90	6.60	6.30	6.40	6.50	6.10
CPI Goods	6.20	2.90	2.00	1.90	1.80	1.10
Priv. Wages	7.50	6.20	6.30	6.20	5.80	

Market Stress



Last 12 Months



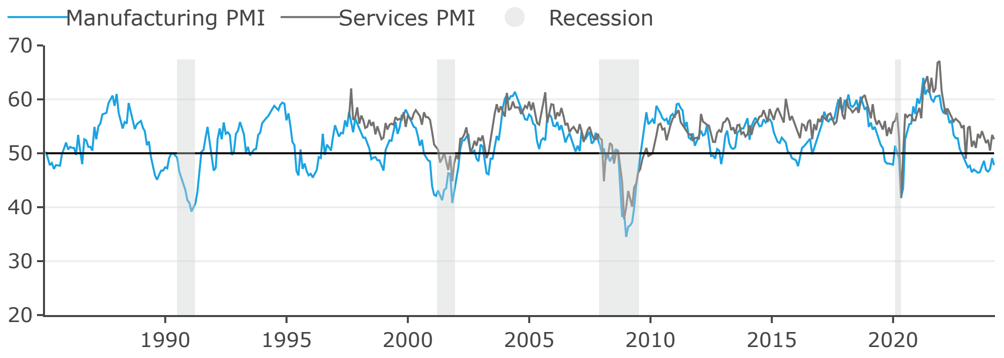
Sources | ITraxx CDS is the Markit iTraxx Europe Senior Financial Index, comprising 30 equally weighted credit default swaps on IG European entities. *10 year z-score applied on each series, coloured using gradient with score of 0 as green, at least +/- 2 standard deviations away scores as red.
Bloomberg for all charts, as of March 2024

Global PMIs

Leading indicators moderated for the US in February, giving back some of the gains from January, but the key Services measures (2/3rds of GDP) remains solidly in expansion zone. Cross checking this with Evercore's Company Survey, for example, corroborates that activity remains solid.

UK and Eurozone PMIs held up well, with Services in the expansion zone and Manufacturing still slowly emerging from the recession zone.

United States



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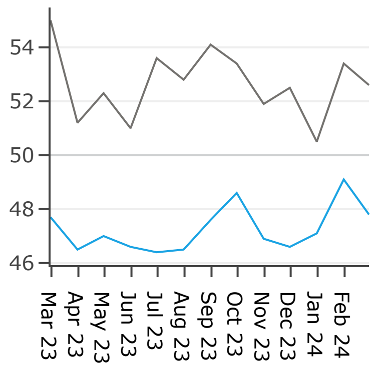
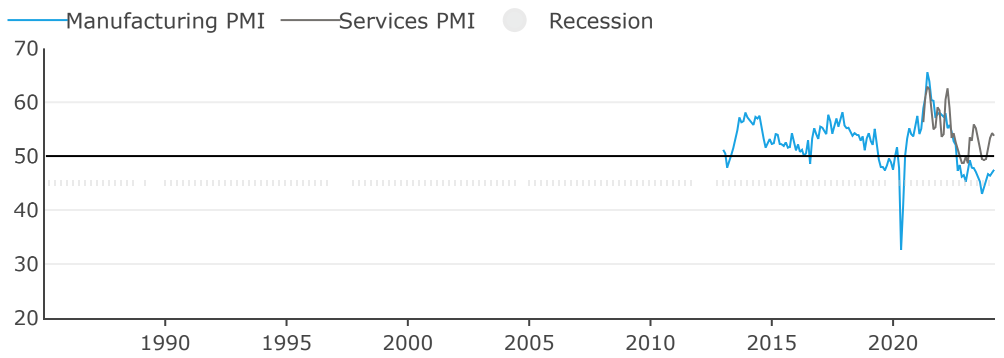


United Kingdom



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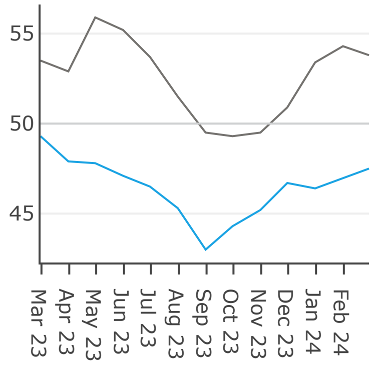
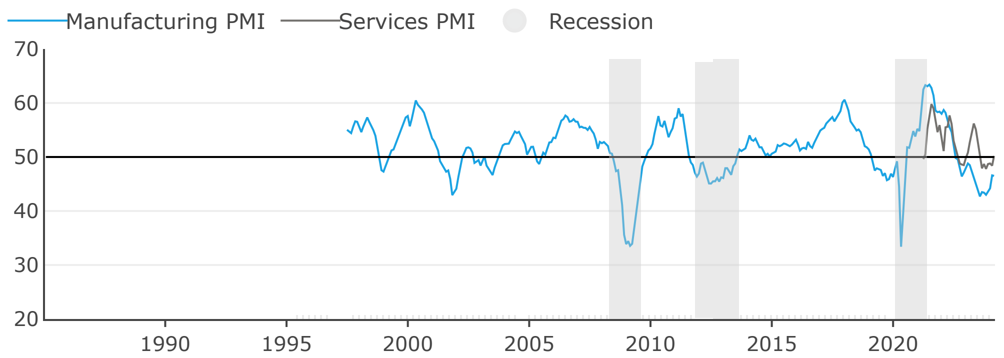


Eurozone



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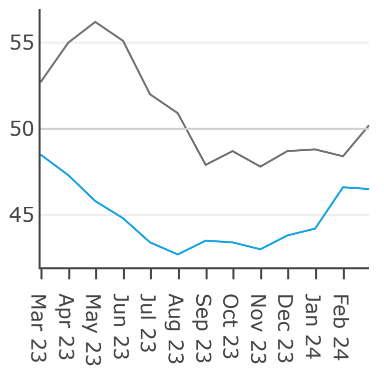
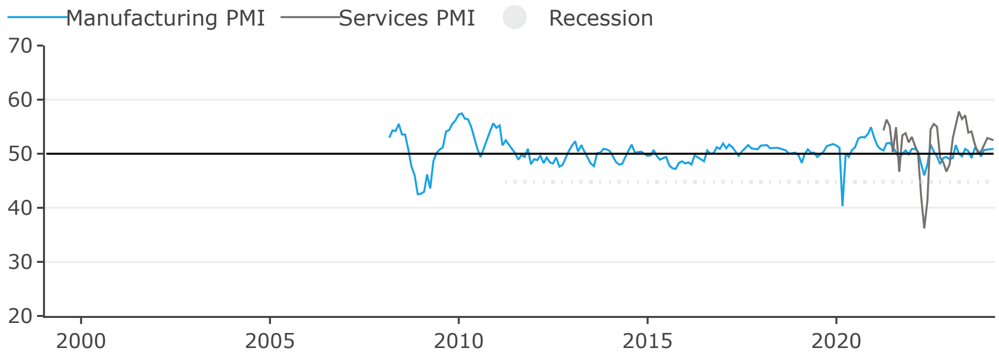


Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of March 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

Global PMIs

Global leading indicators therefore continue to hold up despite Japan's manufacturing slump. The bottom right chart is key - Global PMIs for both Services and Manufacturing are above 50 and in the expansion zone. **It points to Goldilocks** growth - not too hot, not too cold.

China



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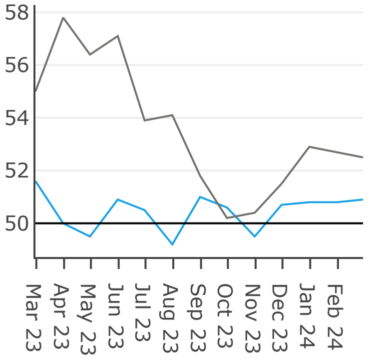
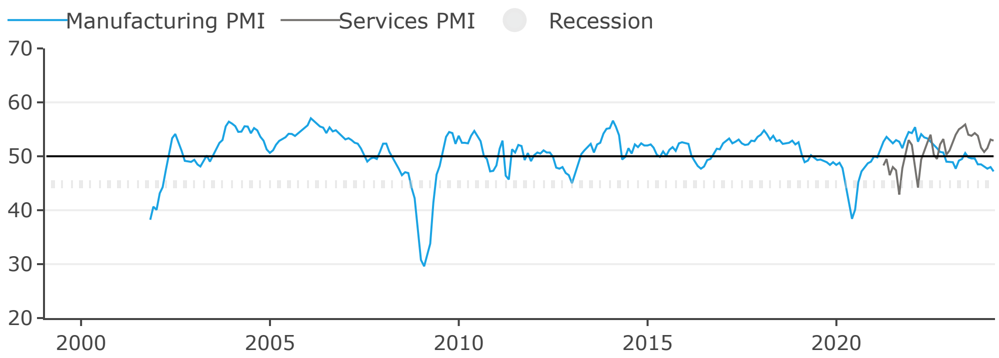


Japan



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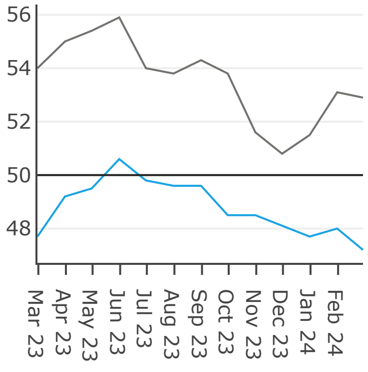
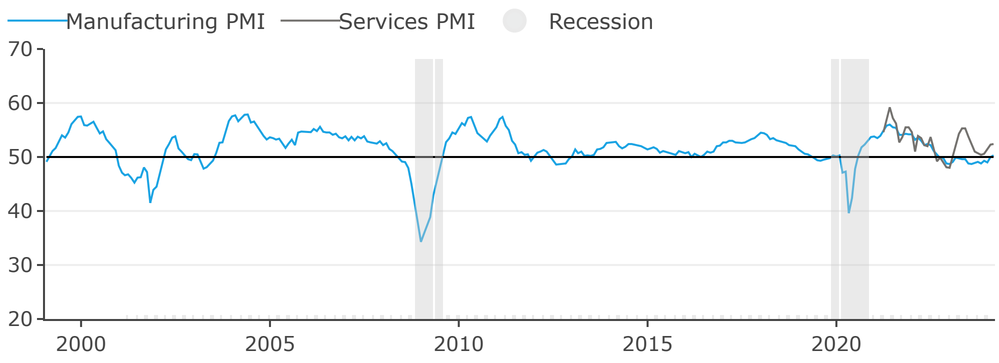


Global



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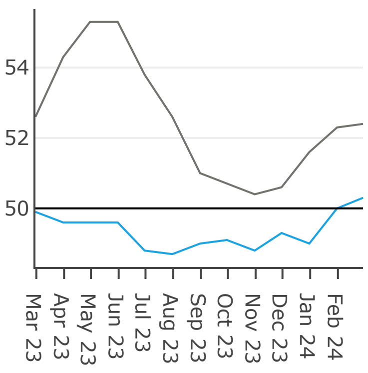


Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of March 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

GROWTH

CCLA

Earnings

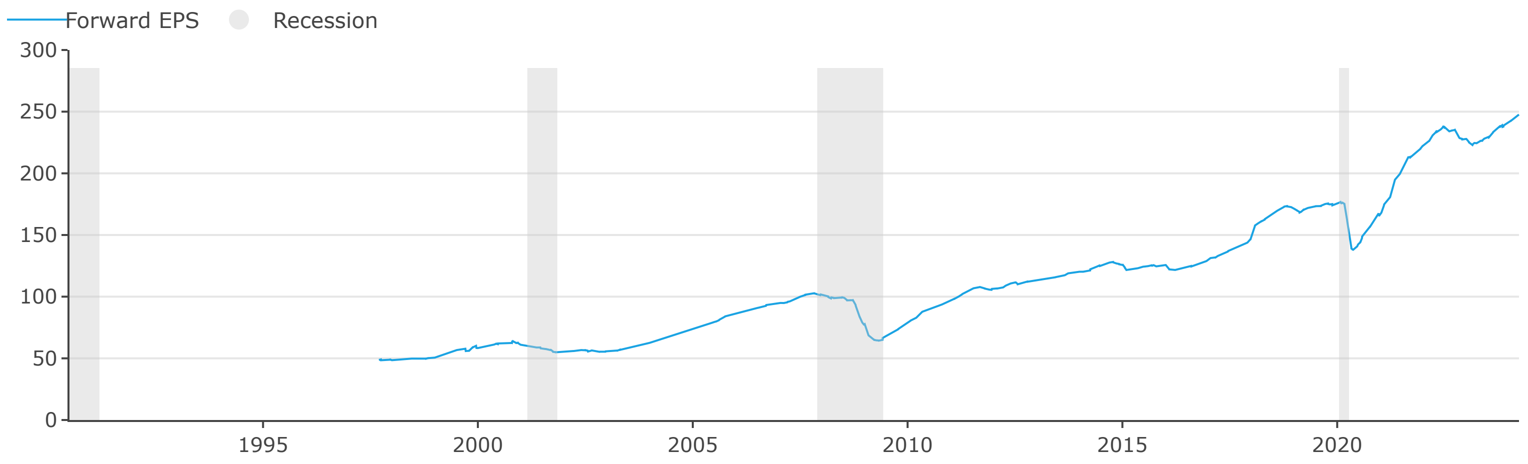
Consensus forward earnings estimates continue to recover (top chart) while trailing earnings are just starting to grow again (if you squint at the bottom chart you can just about see it!)

Q4 earnings season was strong for the S&P500. EPS ended the quarter (and year) up 8% with only three sectors (of 11) down on the year - Healthcare, Energy and Materials.

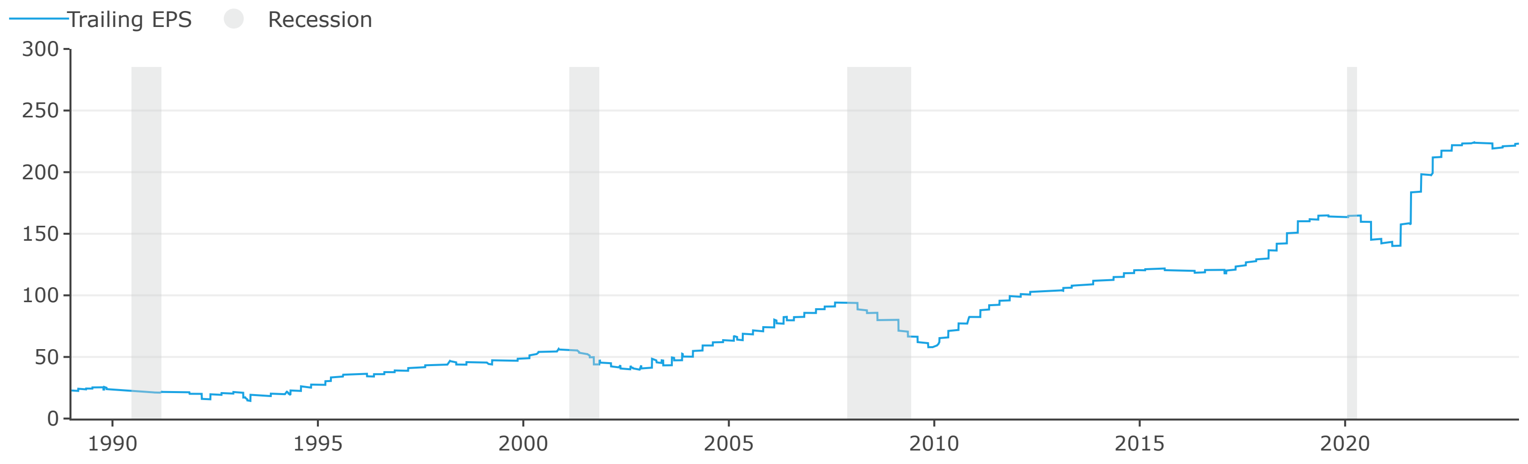
We reiterate our view that earnings could be in position to take over from PE re-rating in driving the market higher, although clearly a recession would change that.

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 March 2024

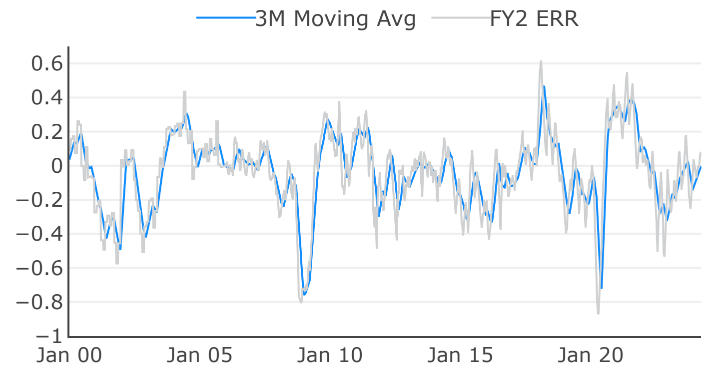
Earnings

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.

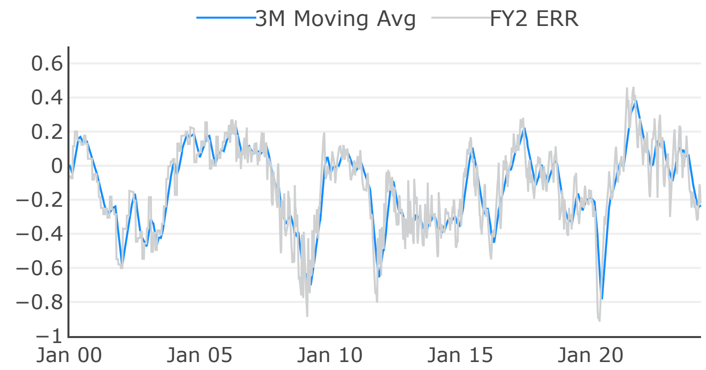
The overall assessment is that earnings breadth is ticking up in the US (now net upgrades are neutral, which is much better than the average position of downgrades)**; and Japan stands out as the only major market with positive net earnings breadth.**

Global Earnings Revisions Ratios

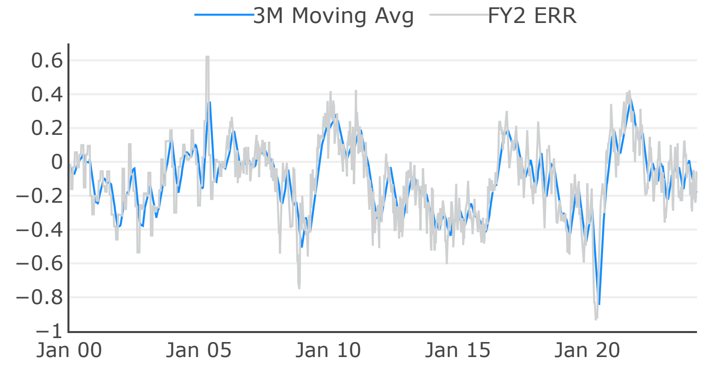
USA



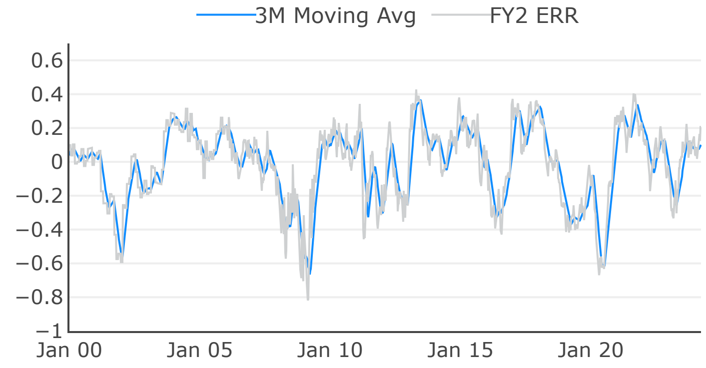
Eurozone



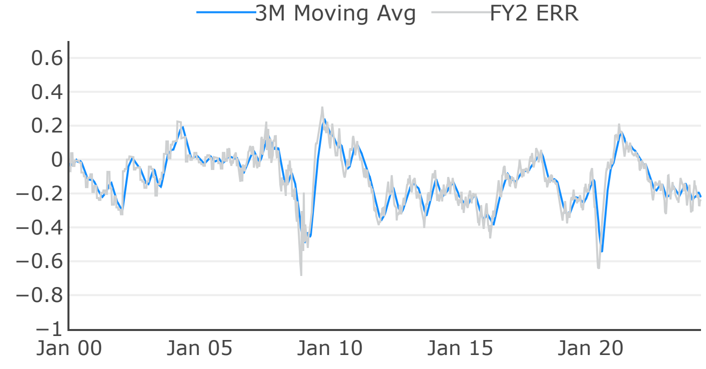
UK



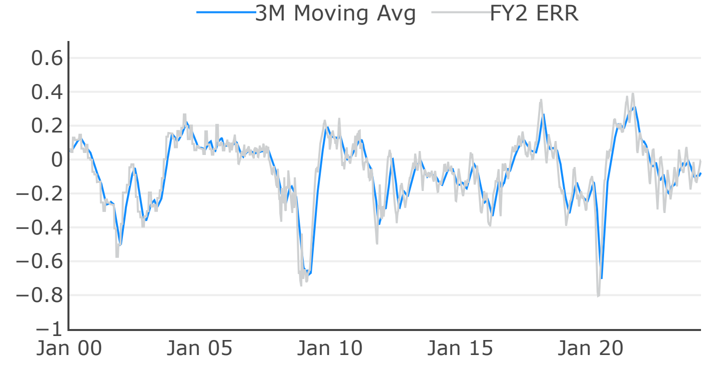
Japan



Emerging Markets



World



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

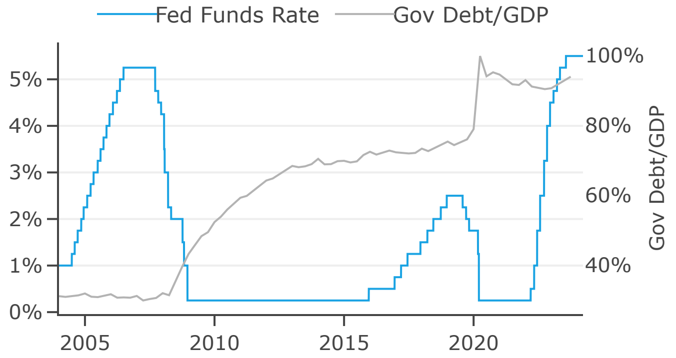
POLICY

Interest Rates

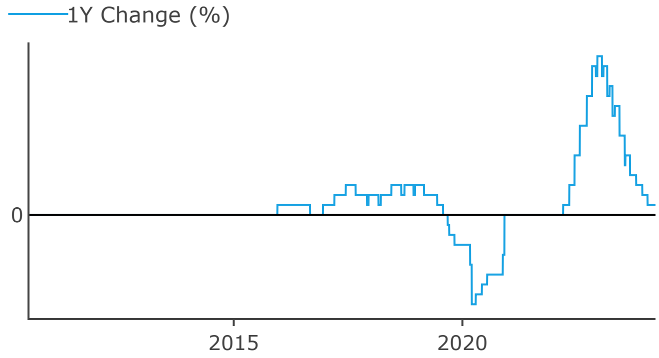
The big news this month was we had a rate HIKE from the Bank of Japan, from -0.1% to +0.1%! (You can just about see this in the bottom right chart, the blue line). It was the first hike in 17 years, and is a very healthy sign of policy normalisation after years of economic and market sclerosis.

The December FOMC meeting had all but confirmed the US tightening cycle was over. Now, we would point out the middle chart on the left hand side - because inflation has decelerated so quickly, **the REAL Fed Funds rate (nominal rate less CPI) is still rising**. Our view is that with Fed Funds at 5.5% and inflation coming back towards 2% (currently 3.2%), the real interest rate will only rise, putting some pressure on the Fed to cut the policy rate later in the year.

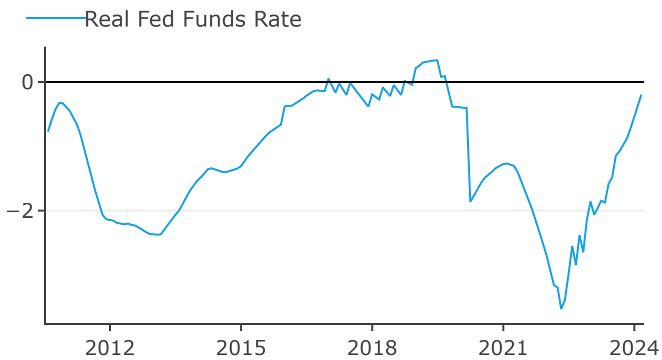
Fed Funds Rate



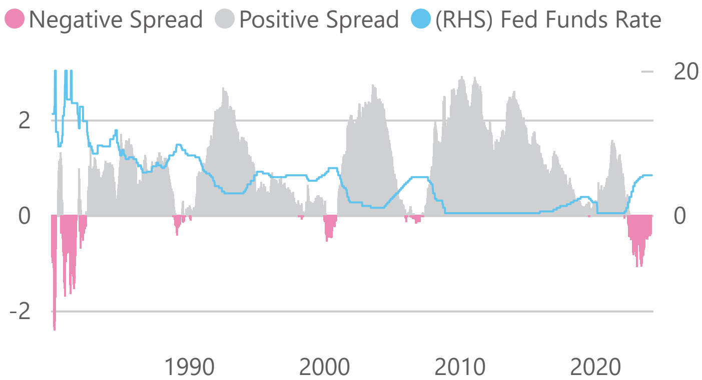
Change in Fed Funds Rate



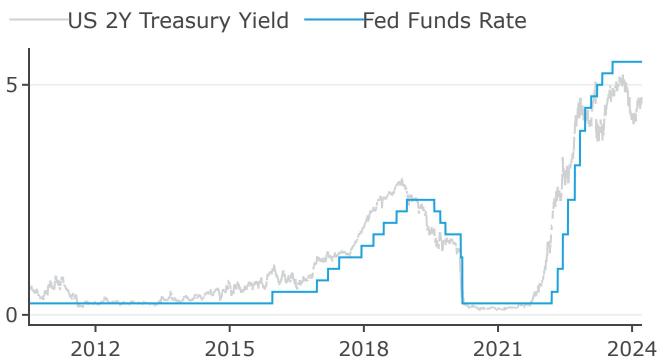
Real Fed Funds Rate (Using 2Y MA CPI)



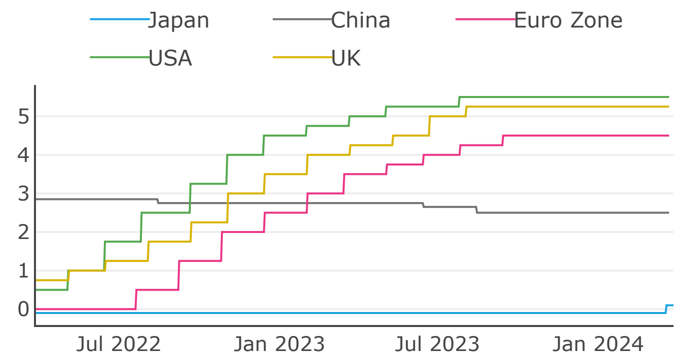
Fed Funds Rate vs 2s10s Curve



Fed Funds Rate vs 2Y Treasury



Global Comparison



Sources | Bloomberg for all charts, as of March 2024

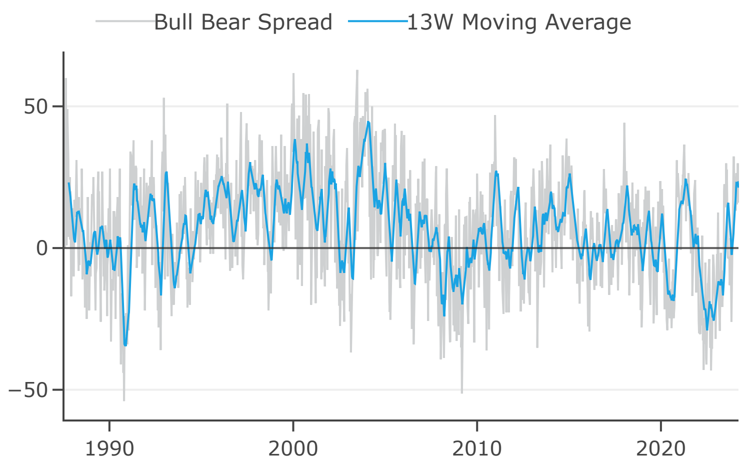
Sentiment

The Harnett Bull & Bear Indicator has moved from Extreme Bearish sentiment (which is bullish for the market!) in October 2022 **to now just beyond neutral** (the current reading is 6.1/10). In other words, while we have been able to say that institutions and individuals were not taking enough risk over the last couple of years, we can no longer say that.

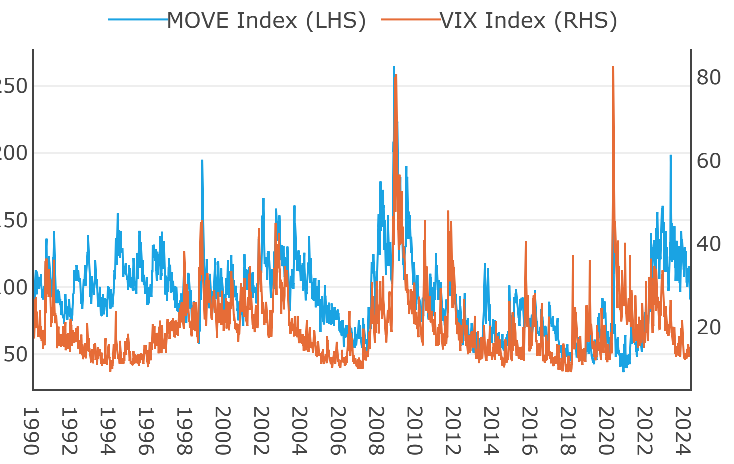
Drivers of the normalisation in sentiment, according to Michael Hartnett, include "strong inflows to HY bonds, better credit market technicals and a big improvement in equity market breadth". Similarly, Bull Bear spread from the American Association of Individual Investors (AAII), (top left) shows **individual US investors are now net bullish equities**, and the VIX index of implied volatility for the S&P500 is back to its lows.

US Equity Indicators

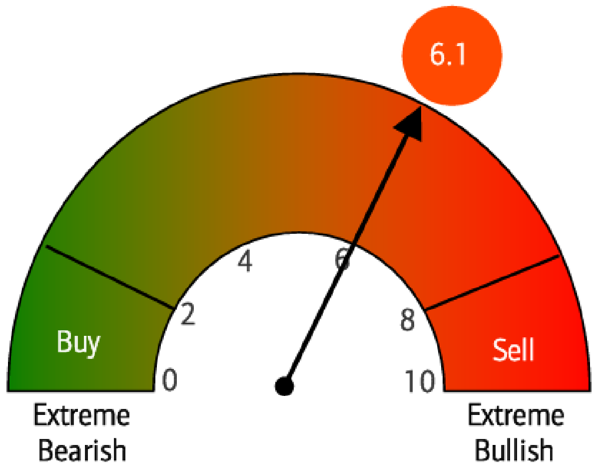
AAII Bull Bear Spread



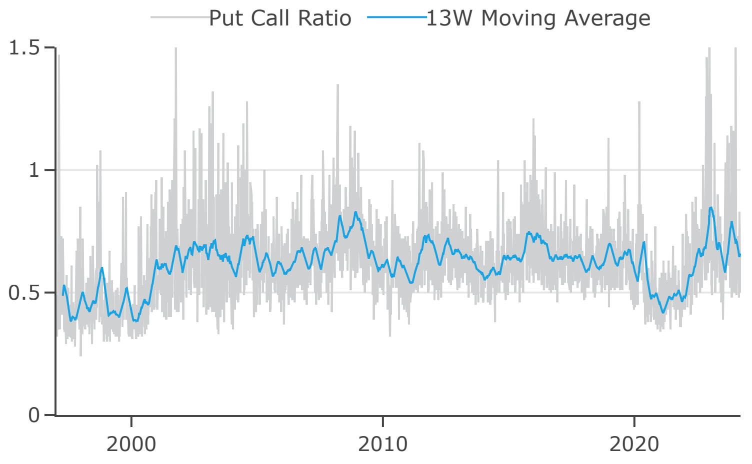
Equity vs. Bond Sentiment



Hartnett Bull & Bear Indicator



Equity Put Call Ratio



Sources | Bull Bear Spread, Vix and Equity Put Call Ratio: Bloomberg, Hartnett: kind permission from Bank of America, as of March 2024

Fund Flows

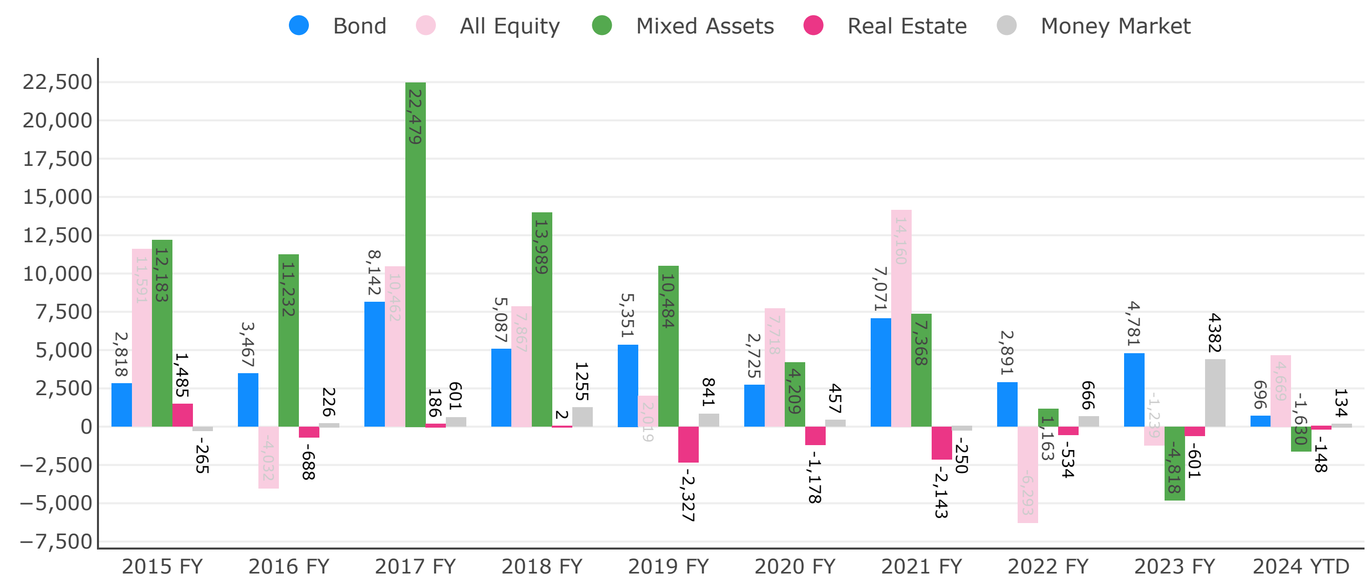
This page captures UK investment fund flows only, as a measure of how optimistic or pessimistic sentiment has become.

There has been an extraordinary inflow into cash (shown here as "Money Markets") and out of Equity and Mixed Asset funds. Bond flows are modest but do show inflow. In short, flows have shown investors repositioning defensively. This is bullish at the margin for forward returns to risk assets, as a contra-indicator.

UK Investor Sentiment

Net Fund Flows by Asset Class £m

Date	Bond	All Equity	Mixed Assets	Real Estate	Money Market (MM)	Total Net Flows (incl. Other)
2022 Q2	534	-672	1,247	61	-111	3,408
2022 Q3	1,197	-4,701	-287	-85	423	-1,331
2022 Q4	1,666	341	-945	-226	310	4,198
2023 Q1	2,747	258	397	-93	456	9,275
2023 Q2	1,684	447	-190	-148	1256	9,066
2023 Q3	-111	-2,384	-1,407	-184	1265	4,642
2023 Q4	460	441	-3,618	-176	1405	5,976
2024 01	367	2,011	-968	-72	56	4,383
2024 02	329	2,658	-662	-76	78	5,851



Sources | All charts: Calastone Fund Flow Index as at March 2024. Fund Flow data measures UK investor sentiment, showing the net flow of capital to and from open-ended investment funds.

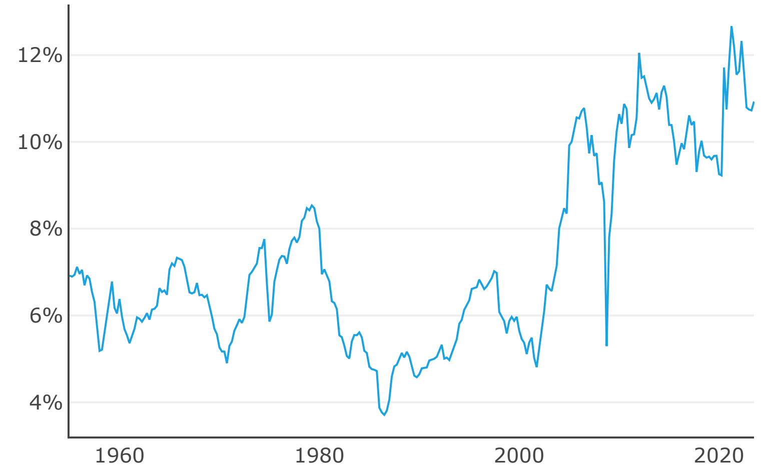
OTHER OBSERVATIONS

The Big Picture

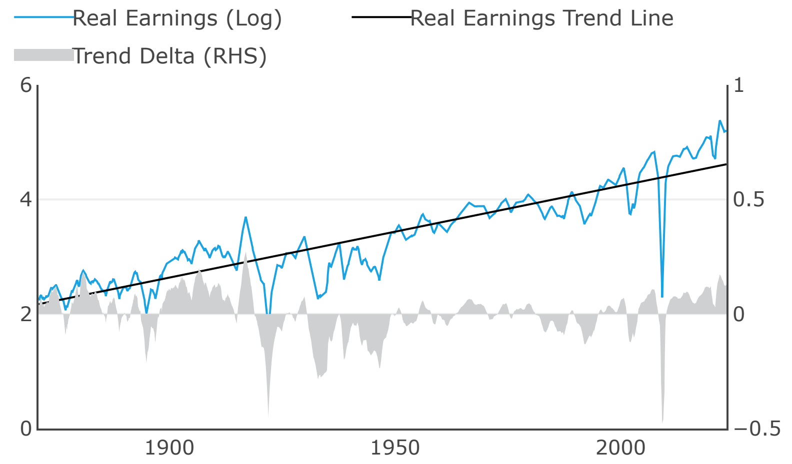
Here we highlight some longer-term imbalances that, **should** they correct, would have an outsized impact on risk asset returns. We don't make predictions but we do watch these. US corporate profit is just off the highest share of GDP that it has ever been since 1929. Its corollary (not shown) is that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

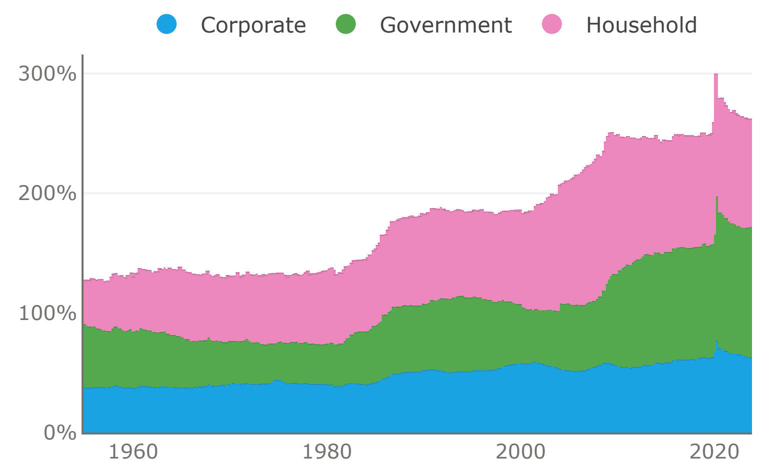
Profit Share of GDP



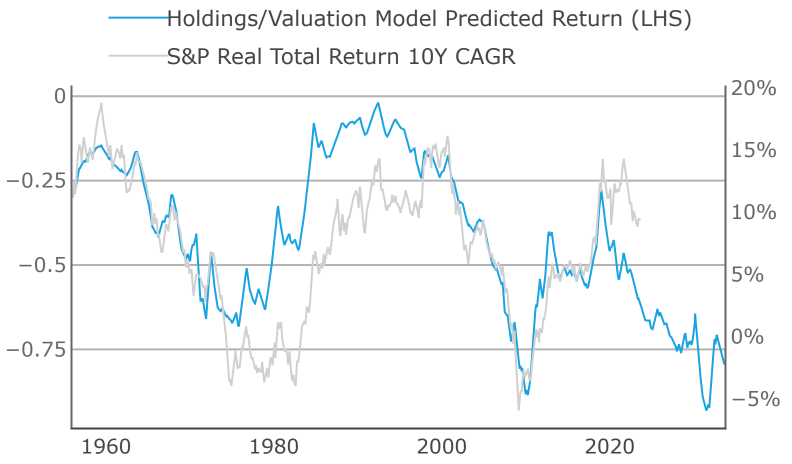
Earnings Deviation From Trend



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 as at March 2024.

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GOOD INVESTMENT

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