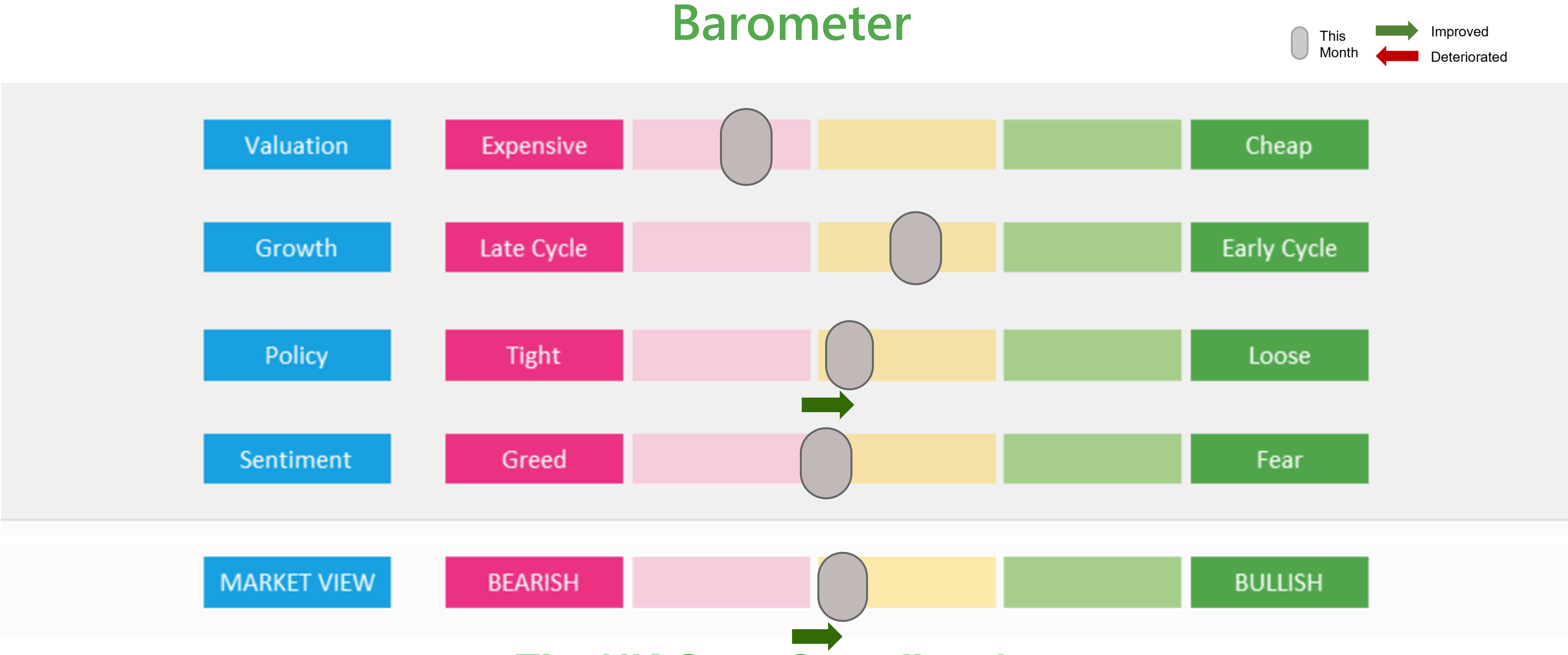
NOVEMBER 2024

CCLA
GOOD INVESTMENT

Market Barometer

Barometer



The UK Goes Scandinavian

- **UK Chancellor Rachel Reeves delivered the largest fiscal expansion since the Blair era** in her first budget. The £70bn rise in annual government spending is a 6% increase - that's huge. The question is whether government investment can crowd in the private sector, and whether Labour can catalyse a much-needed and long-absent rise in public sector productivity. If the answers to these questions are positive, the UK might start to transition to more of a Scandinavian economic model. If not, the UK risks Truss/Kwarteng v2.0. As we go to print the day after the budget, bond markets are selling off / Gilt yields rising, but so far it seems controlled, and sterling, while down a little, is not reacting as it did in Sept 2022.
- **Our key market indicators are generally still supportive of a risk-on stance.** The 12 month forward earnings integer continues to rise at an 11% annual rate; inflation remains under control. Bonds have sold off a little, perhaps pre-figuring a Trump election win, but not enough to cause alarm.

In our Charts of the Month:

- **We contrast the impact of geopolitics** with that of earnings and conclude that, as ever, "it's all about earnings".
- **We compare Trump's and Harris's policies**. If it's to be Trump (we go to print four days ahead of the election, so E&OE) we think equity markets would initially rally on the expectation of tax cuts, but would be more concerned about risks of a trade war and of rising inflation. If it's to be Harris, it's more of the same but the market will have to absorb the 1 Jan 2025 expiry of the Trump tax cuts from 2018. That would be bad for equities but good for bonds.
- We illustrate why we remain sceptical of any longer-lived China equity market rally.
- And we give more detail on the UK budget

We remain risk on.

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Contents

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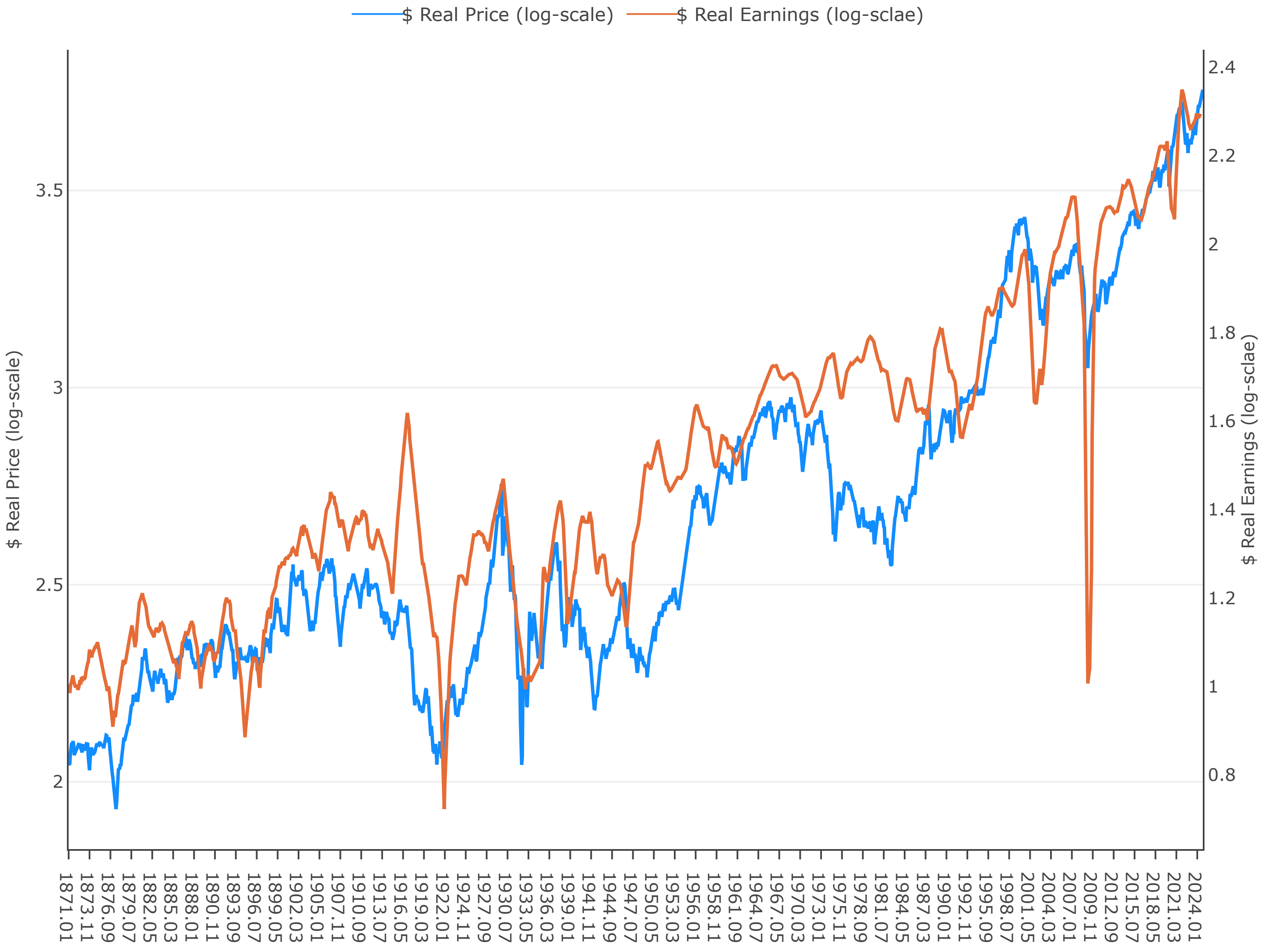
Charts of the Month (1 of 4)

Geopolitics vs earnings. One of the most common questions we are asked by our clients is, "how are you factoring the geopolitical situation into your asset allocation?" It is a perfectly understandable question. International affairs dominate the conversation in this hypermedia age. Today's top concerns are: Trump vs Harris; Israel-Iran-Palestine-Lebanon; Russia-Ukraine; China-Taiwan; North Korea-South Korea; inflation vs recession; the Japanification of China; rising global debt... we could go on. It would be quite a portfolio that was hedged against bad outcomes in any / all of these risks.

We always point to this chart to answer the question. **In the end it always comes down to earnings**. Despite this, we do explore the possible market impact of the US election and of the UK budget in this issue of the Barometer.

Real S&P 500 Stock Price vs Real Earnings



Sources | CCLA, Shillerdata.com. All data as at Sept 2024.

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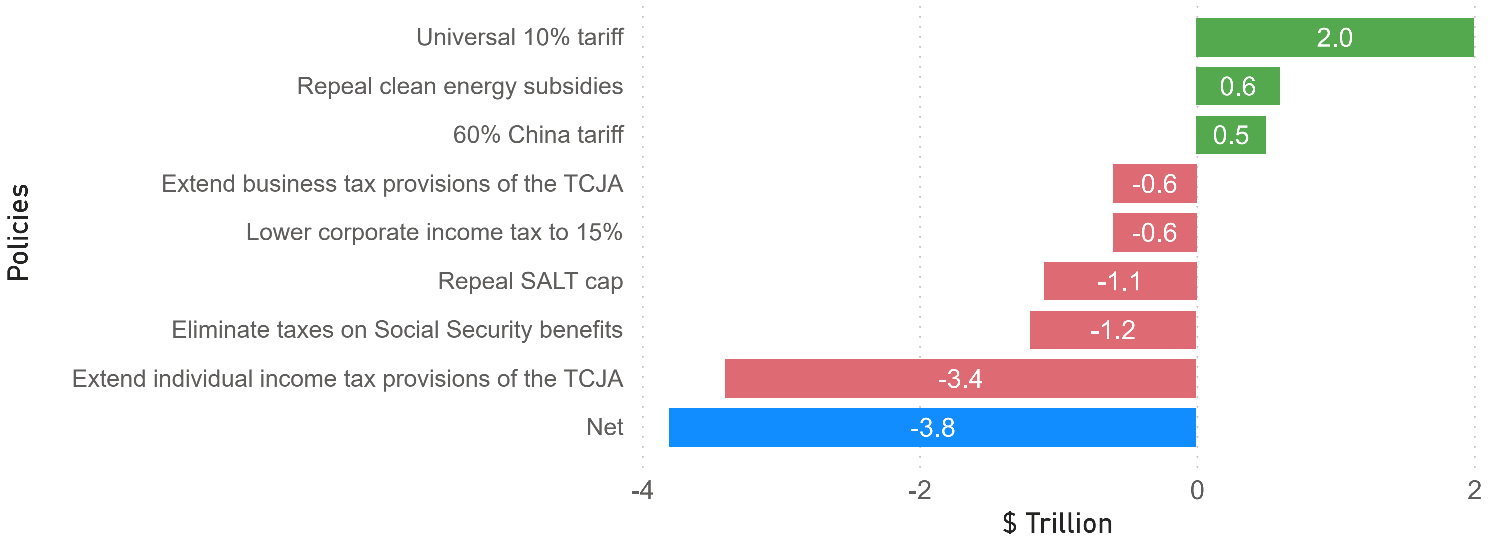
Charts of the Month (2 of 4)

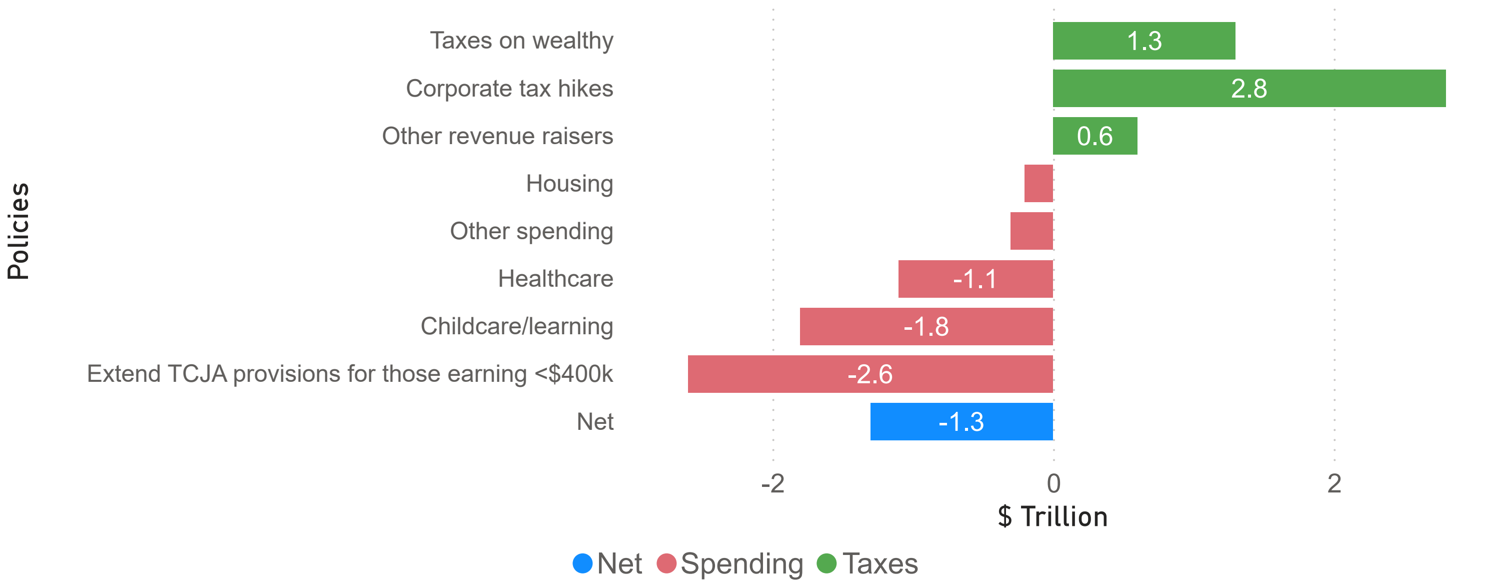
US election (E&OE). If it's Trump, we expect equities to rally in the short term as the market focuses on his promised extension of the TCJA 2018 (Tax Cuts and Jobs Act) beyond its scheduled lapse on 1/1/25. The TCJA cut corporate income tax from 35% to 21% and he may further reduce tax on domestic profits to 15%. Personal income taxes were cut by 2-4% points back then. Tax cuts could add 2.4% to GDP according to the Tax Foundation. Against this his proposed 10% across the board tariff (60% on Chinese imports) would cut GDP by 1.7%, and overall debt would rise $4trn. **Longer term Trump is bad for bonds and probably not great for equity. If a trade war ensues it's very bad for equity full stop - the S&P500 fell 20% in Q4 2018 on this.**

If it's Harris it's "more of the same" but taxes will go up as the TCJA expires. Also not great for equity.

Trump | Impact of Proposed Policies on National Debt



Harris | Impact of Proposed Policies on National Debt



Note | The above is based on the modelling conducted by Penn Wharton and JP Morgan. It covers the cumulative 10-year budget balance impact of most of the proposed policies by the two candidates.

Sources | CCLA, Penn Wharton Budget Model, JP Morgan. All data as at Oct 2024

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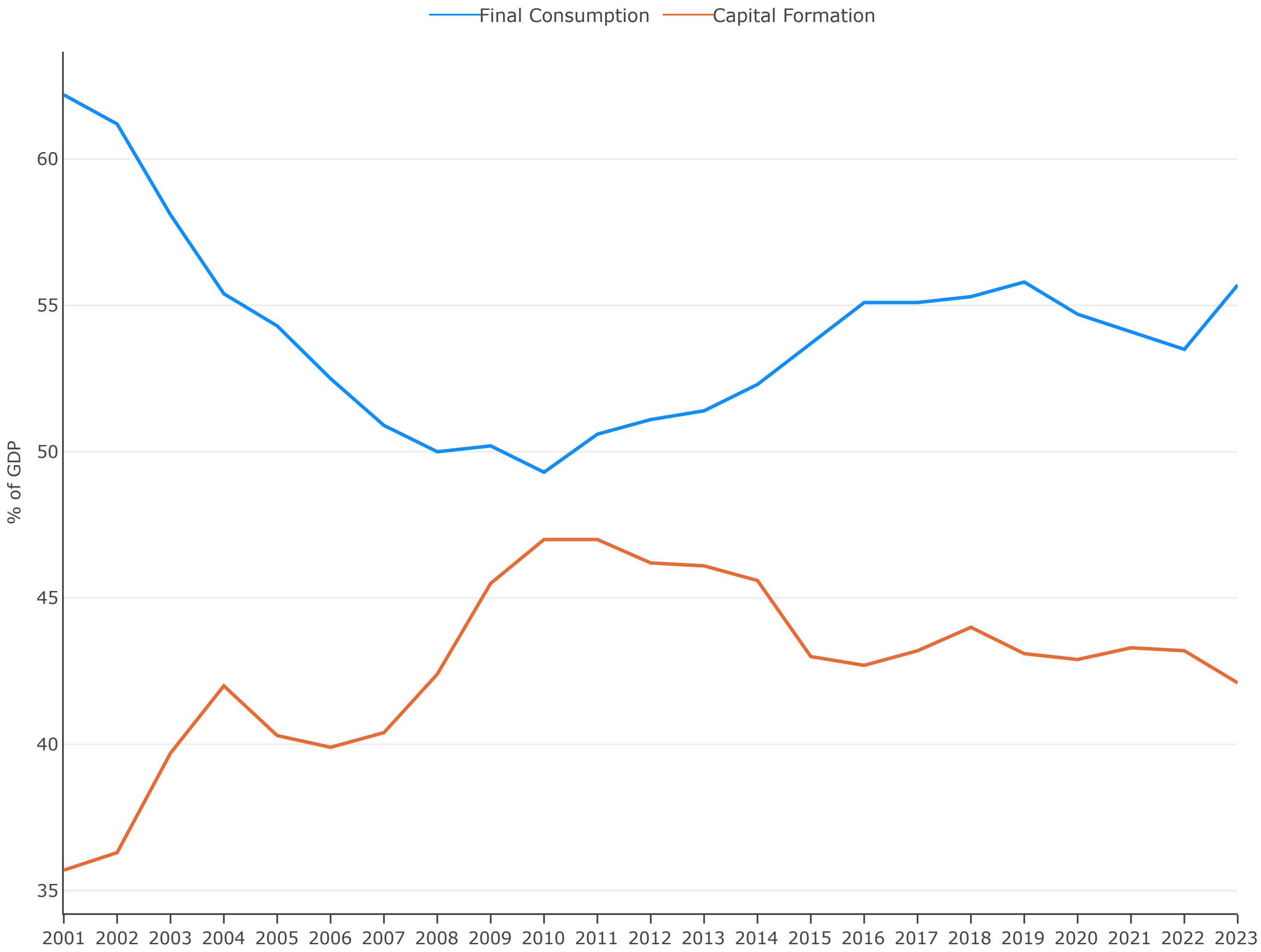
Charts of the Month (3 of 4)

China stimulus is probably not enough to start a new bull market. China is 25% of MSCI Emerging Markets and 2.5% of MSCI All Country World. Clearly it matters. And things are finally happening on the policy front, but will they impact earnings, or in other words, will they matter sustainably for markets? The MSCI China index was up nearly 40% in just 18 days after the announcement of the government's "big bazooka" stimulus, but as the announcement was digested it gave back half of that rally. The key chart to watch, we think, is this one. China's problem is too little consumption and too much investment. In a country with excess capacity and deflation, this needs to reverse. To do that will require fiscal stimulus and supply side policies. We do not believe what has been announced so far will be sufficient to achieve this. Precautionary saving is high because families save for education and healthcare provision, and for retirement. **We remain sceptical.**

China Expenditure as Proportion of GDP



Sources | CCLA, Bloomberg, National Bureau of Statistics of China. Data as at Oct 2024.

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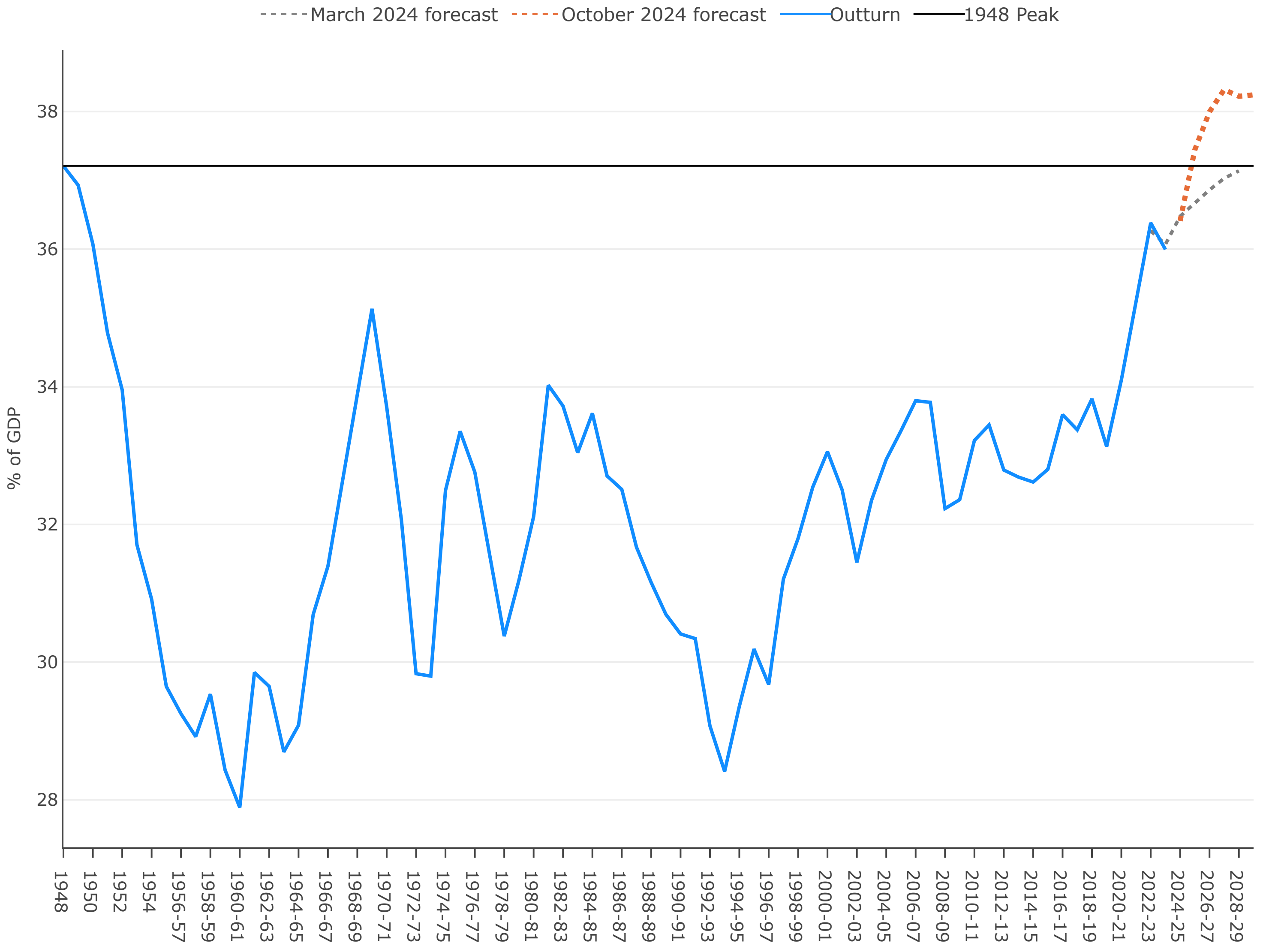
Charts of the Month (4 of 4)

The UK goes Scandinavian. The UK budget of 30 October is the very definition of "tax and spend". Spending is raised by £70bn (2% of GDP) per year (£45bn current spending, ~£25bn capital spending). The tax take is forecast to rise by £36bn per year (1% of GDP). As the chart below shows, tax/GDP will rise to a new UK (ex pandemic) high of 38% of GDP. The new government has gone all in on being able to increase public sector efficiency (they have a new 2% productivity growth target) to offset the inflationary impact these measures might have. Borrowing rises by £32bn per year (1% of GDP). Despite this, the OBR forecasts Public Sector Net Debt to remain stable and below 100% of GDP. **All will depend on what return this huge rise in government investment can make, but there is a lot of low-hanging fruit, we would suggest.**

UK Tax Burden Over Time as % of GDP



Sources | UK Office of Budgetary Responsibility. Data as at Oct 2024

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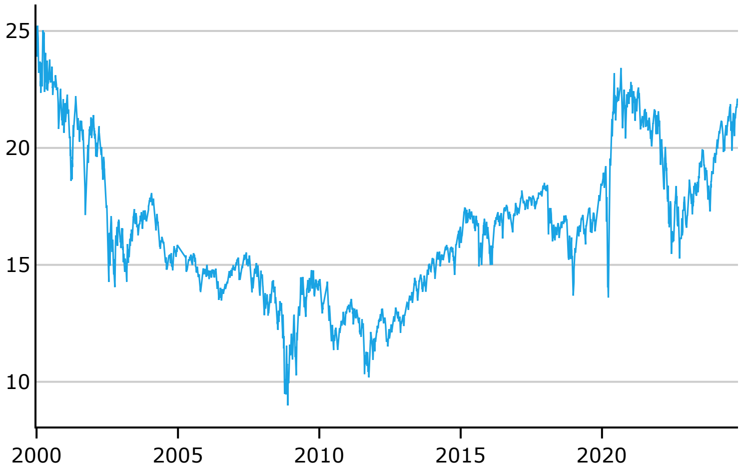
Equity | USA

Earnings season is well underway, with 88% having reported and the final 12% of companies closing the season in November. A lot of attention is given to the Magnificent-7 (Mag-7), yet it's worth noting, even the remaining 493 companies have grown just shy of 18% YTD*. In fact, to their credit, performance is broadening. **Since mid-July, S&P-493 have clawed back 12% performance vs. Mag-7** and opened Q3 with earnings growth forecast of +1.4%.**

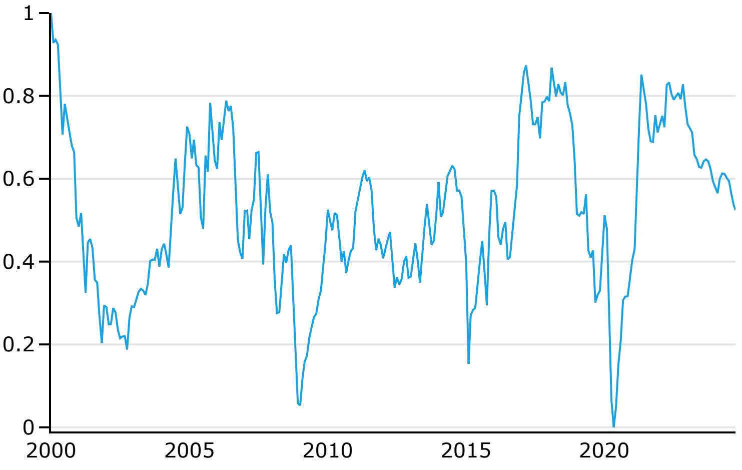
Despite the cross-asset valuation dropping to the 52nd percentile (top right), equity risk premium (bottom right) still looks rich at ~1.3%. Similarly, on an absolute measure, the CAPE (cyclically adjusted PE) still stands near recent highs at ~35x, creating an earnings yield and forward real expected return close to 3% annualised.

S&P 500 Valuations

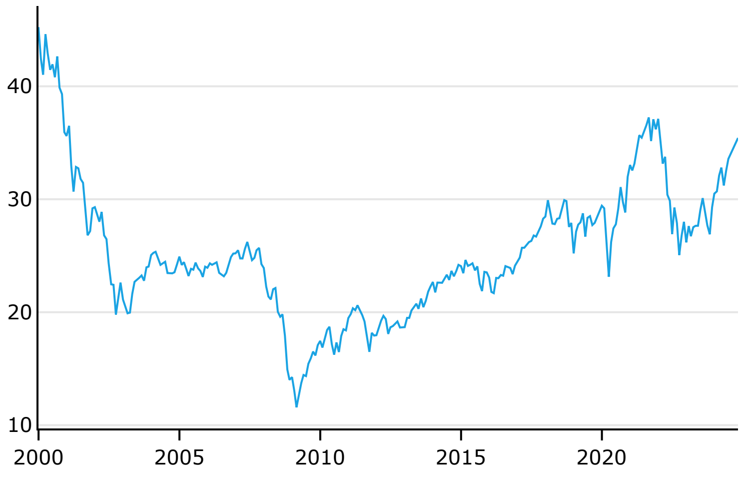
S&P 500 Forward PE



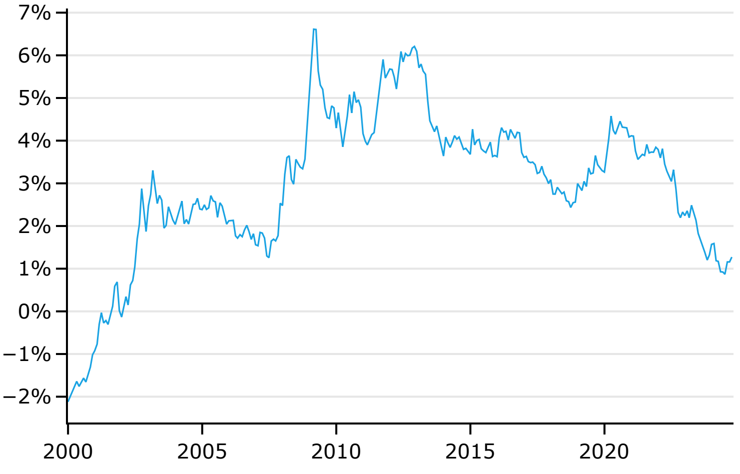
Composite Value Indicator Model



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. *YTD to 23 Oct 2024. **10 Jul 24 to 24 Oct 24 using UBS Ex-Mag-7 vs UBS Mag-7 indexed at 100. Sources | S&P 500 PE: Bloomberg as at Oct 2024. CVI Model: CCLA as of Sept 2024, Shiller PE/CAPE: Morgan Stanley, Equity Risk Premium: CCLA as of Oct 2024

VALUATION

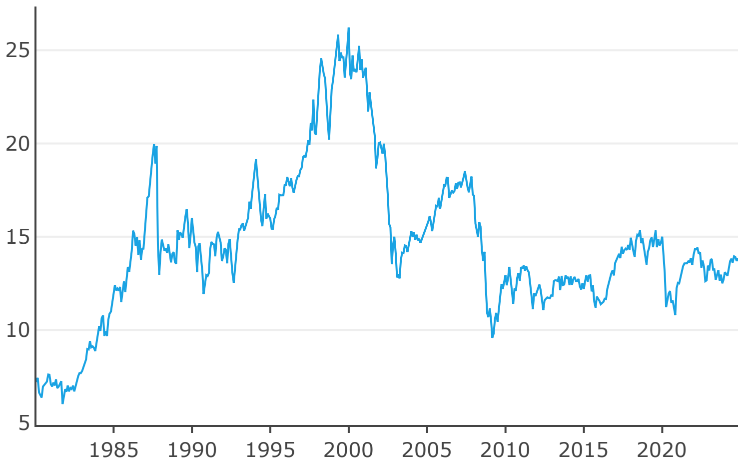
Equity | Regional

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, continue to make for interesting prospects.**

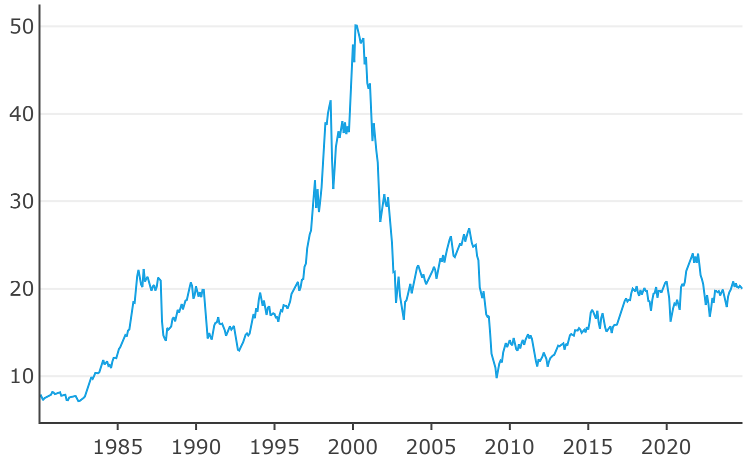
Shiller CAPEs highlight UK as 13.8x with an earnings yield (and expected forward real returns) over 7%, with Europe and Japan around 20x and ~5%, and EM around 12x and ~8% respectively.

Europe

UK | Shiller P/E

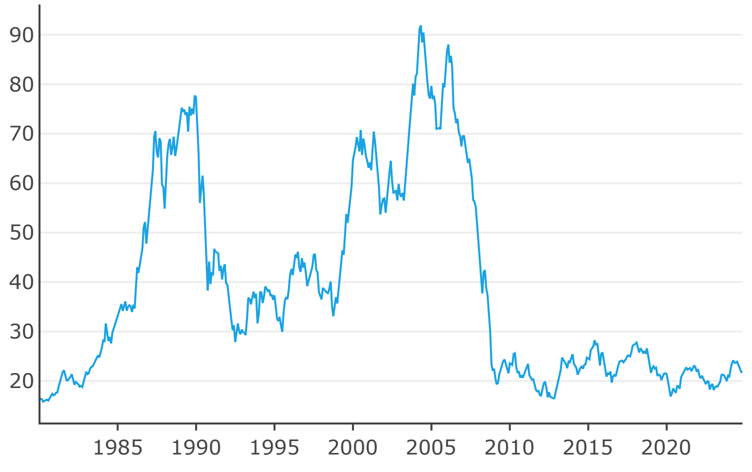


Europe (Ex-UK) | Shiller P/E

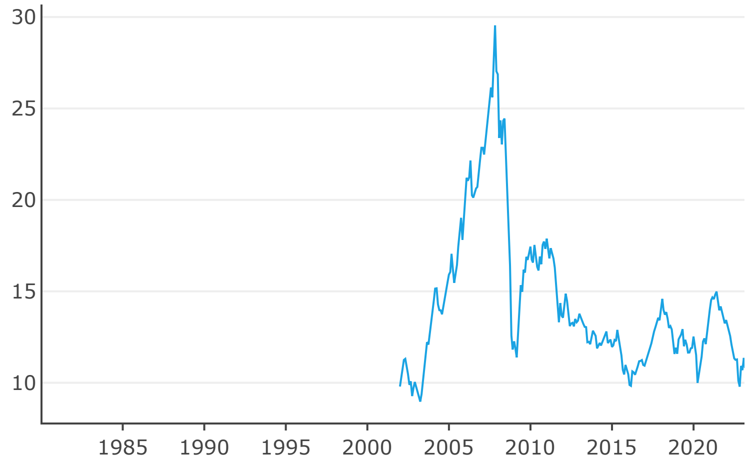


Asia & Emerging Markets

Japan | Shiller P/E



EM | Shiller P/E



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

VALUATION

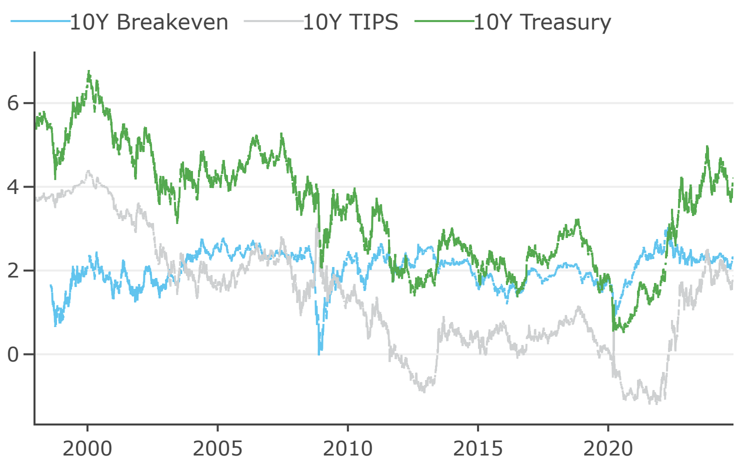
Bonds

With the US election right around the corner, there is now a clear Trump tilt. Odds he wins the Oval Office are now 61%* and in line with his strong polling across 4/6 of the swing states.

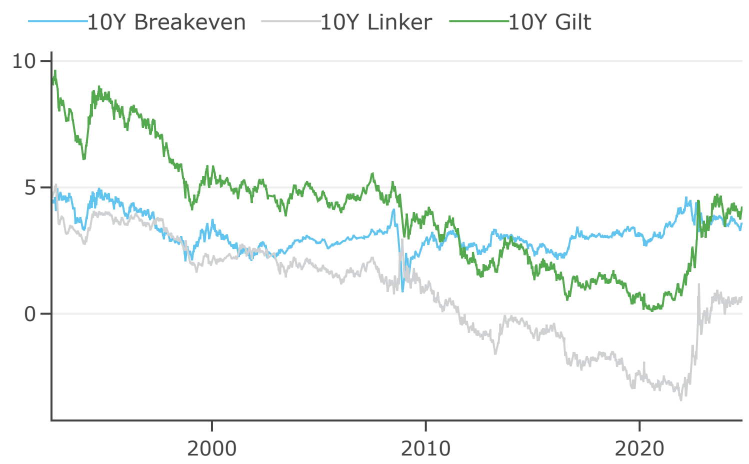
Based on his tariff policies alone, research suggests the US could see a 0.9% increase in inflation during the *first* year of his presidency. However, this view may not be shared by the bond market. Over October the ~50bps increase in US 10Y Treasury yield has been almost perfectly correlated with the upward trajectory of Trump's winning odds, suggesting the market is taking this prospect seriously. Interestingly, the re-pricing of yields is largely attributed to US *growth* expectations (~40bps), and *not* inflation - break-evens hardly increased (~10bps). **Not to be left behind, Gilt yields are up ~33bps, luckily for the Chancellor, most of the shift (~23bps) can be attributed to increase in growth expectations.**

Global Government & Corporate Yields

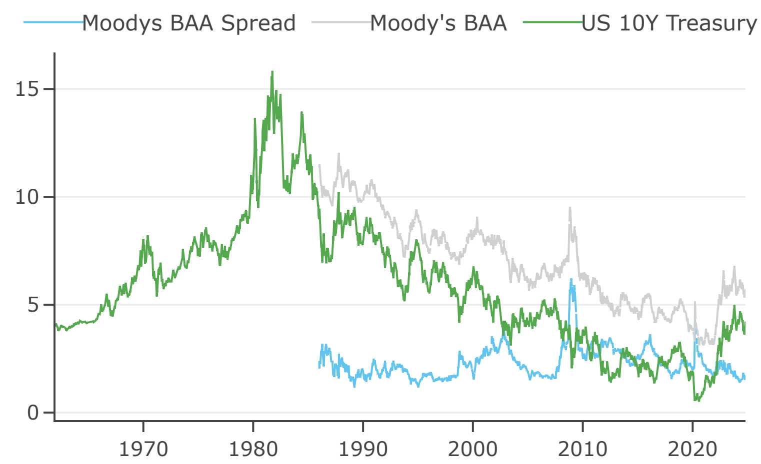
US 10 Year Treasury Yields



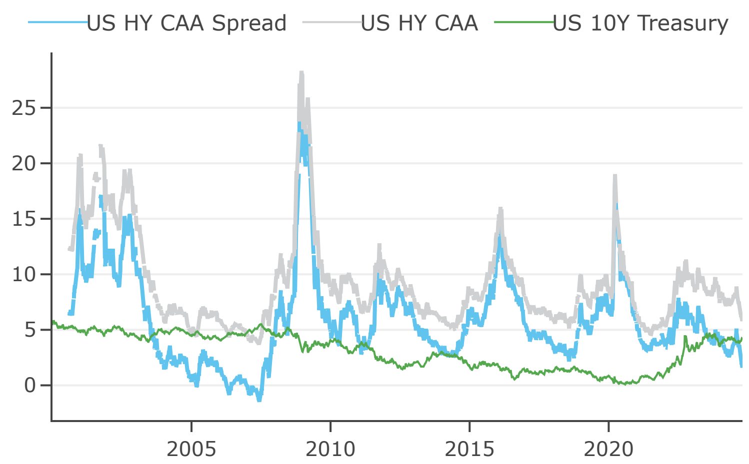
UK 10 Year Gilt Yields



US Corporate Investment Grade Yield



US Corporate High Yield



Sources | Bloomberg as at Oct 2024. *RealClearPolitics 27 Oct 2024.

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Alternatives

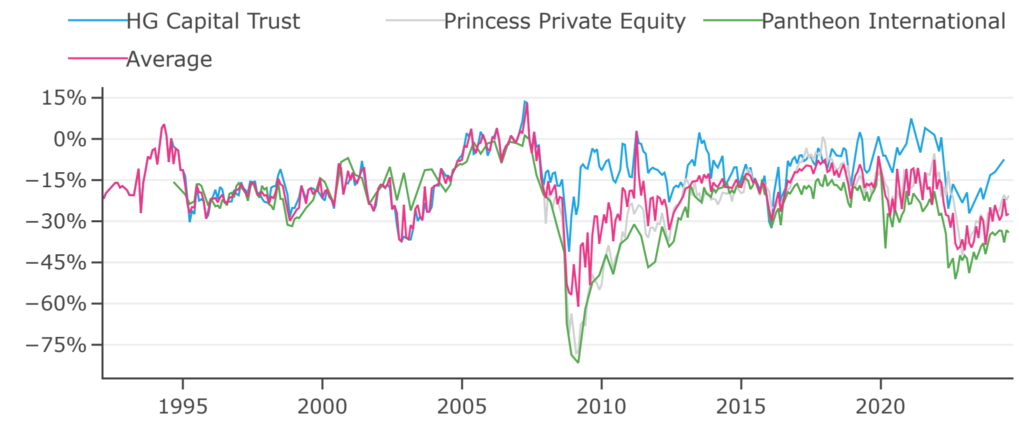
Private credit continues to grow in popularity. Within the US it has now reached almost $1tr (including $250bn of dry powder) across Infrastructure, Real Estate, Asset Backed Finance, and other asset classes.* The challenge, however, remains around the subdued M&A activity. The reduced demand to borrow money for deal-making has become a real headwind to deploy capital, and increased the competition for the few companies that are looking to engage. **Loosening covenants to stand-out seems to have become the new trend.**

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

Global Valuations

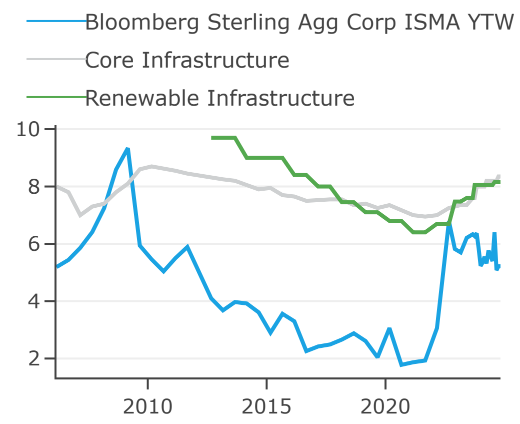
Listed Private Equity

Discount To NAVs



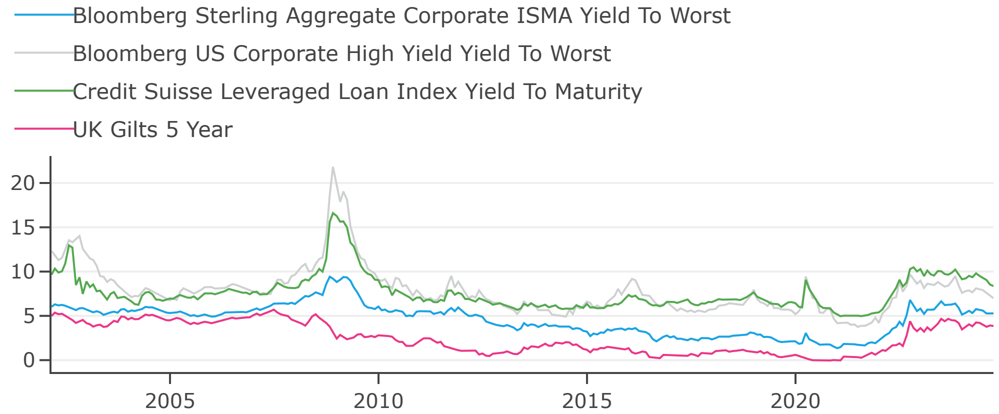
Infrastructure

Infrastructure Discount Rates vs Bond…



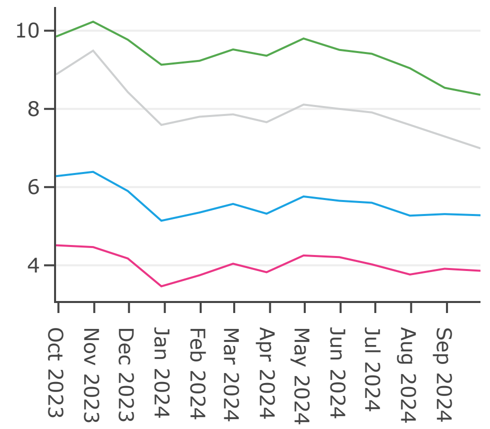
Contractual Income

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 Sept 2024. *Bank of America: Evolution into a lower rate environment. 27th Sept 2024

VALUATION

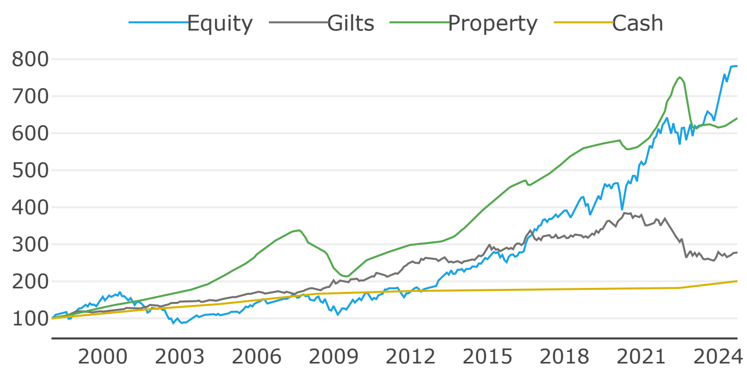
Property

UK commercial property yields and capital values have stabilised in recent months. According to MSCI, transaction volumes across Europe look to be in a "recovery phase" with the UK likely to rebound faster. This can be seen through several UK listed real estate investors raising equity to go after relatively cheap opportunities. **On the other hand, given most purchases are financed, the start of the Bank of England's cutting cycle could also add fuel to this growing demand.**

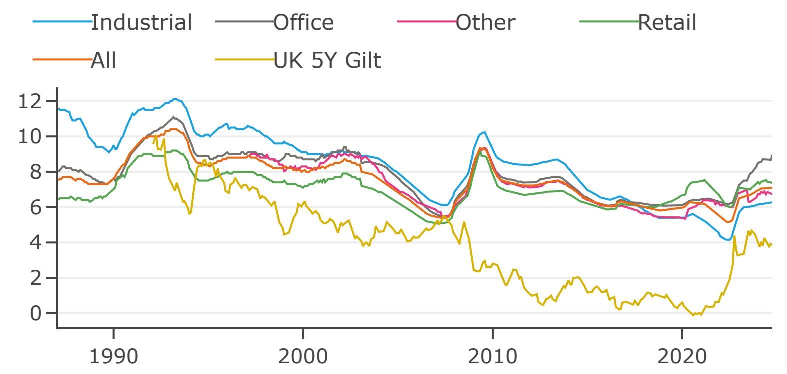
Within the context of CPI + 4%, current equivalent yields look attractive at 7% on average. Worth also noting, real returns to Property have tended to average around the starting Equivalent Yield (middle left chart). **This bodes well for forward returns from here.**

UK Commercial Property Market

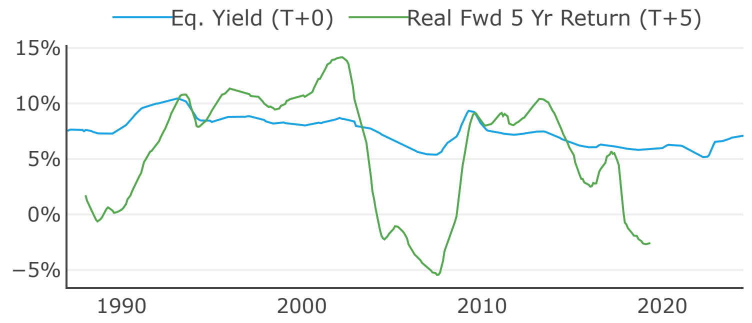
25 Years Of Return 1998=100



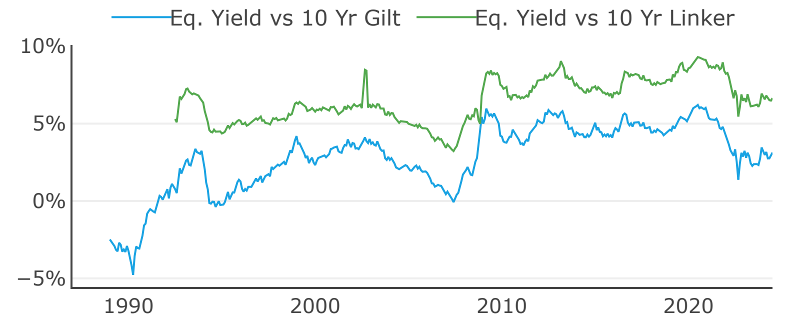
Equivalent Yields vs Gilt Yields %



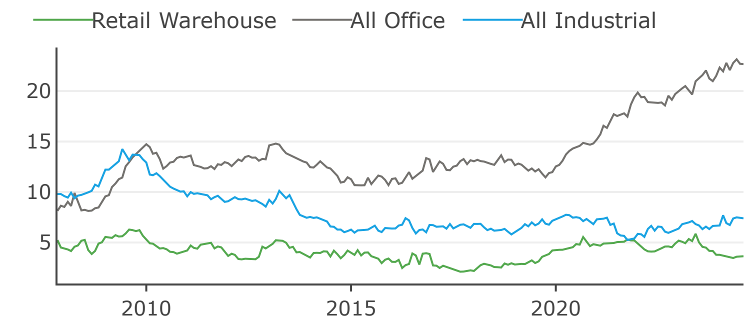
MSCI UK All Property Monthly TR Index %



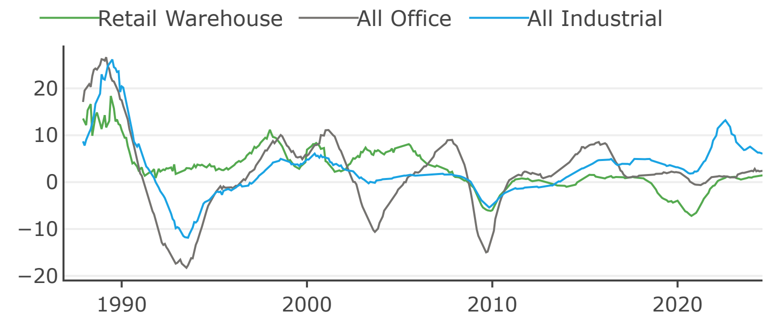
MSCI UK All Property Index - Equivalent Yield Spreads



Vacancy Rate %



Nominal Rental Value YoY Growth %



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

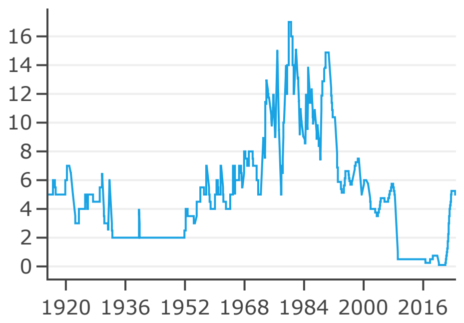
Cash

Examining the October Budget across five factors: spending, taxes, borrowing, investment and economic growth; we note that this budget delivers one of the largest increases in the first three factors, compared to recent history. Yet only marginally increases GDP growth in the first two years, before falling behind prior forecasts for the remainder of the parliament. A silver lining is that much-needed investment is considerably higher than previous forecasts, however, the supply-side boost to GDP only kicks in the last three years.

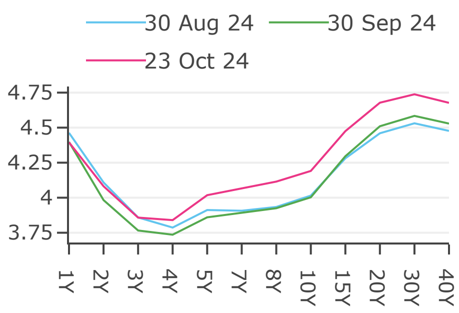
Half of the ~£70bn spend is being financed by borrowing, with the remaining through taxes. Notably, according to the OBR, the £24bn increase in Employer NICs is likely to ultimately reduce employee salaries in real terms over the years which negatively impacts GDP every year of the forecast. **The looser fiscal policy also leads to marginally higher inflation than expected, but still contained within the 2%-handle.**

UK Sterling Market

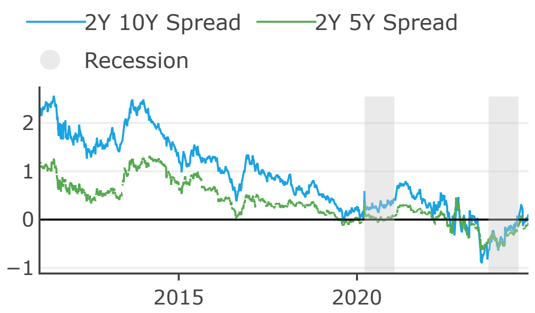
Official Bank Rate



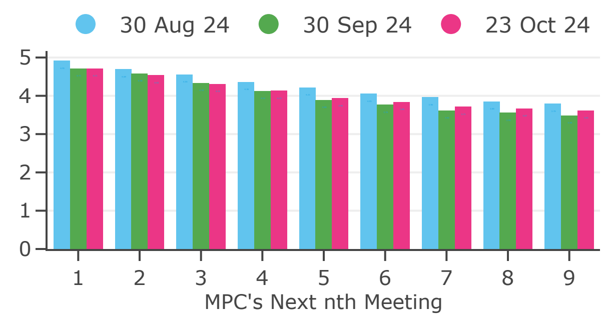
UK Gilt Curve



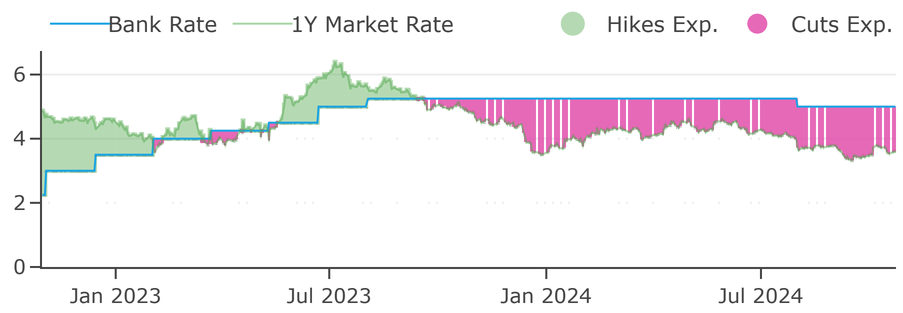
Gilt Spreads



Rate Expectations For Future MPC Meetings



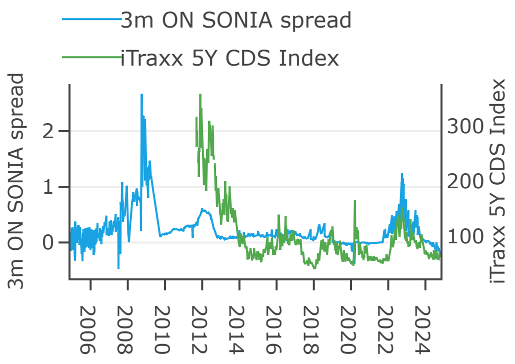
1Y Forward Market Rate Expectations



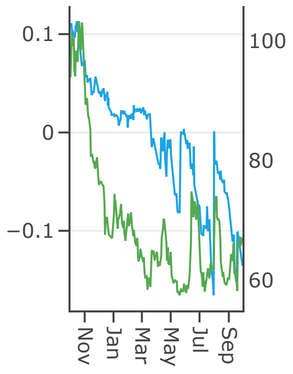
Inflation Readings YoY% | Colour by 10Y Z-Score

Year	2024				
	May	June	July	August	Sep…
RPI	3.00	2.90	3.60	3.50	2.70
CPI	2.00	2.00	2.20	2.20	1.70
CPI Core	3.50	3.50	3.30	3.60	3.20
CPI Services	5.70	5.70	5.20	5.60	4.90
CPI Goods	-1.30	-1.40	-0.60	-0.90	-1.40
Priv. Wages	5.00	5.00	4.90	4.50	

Market Stress



Last 12 Months



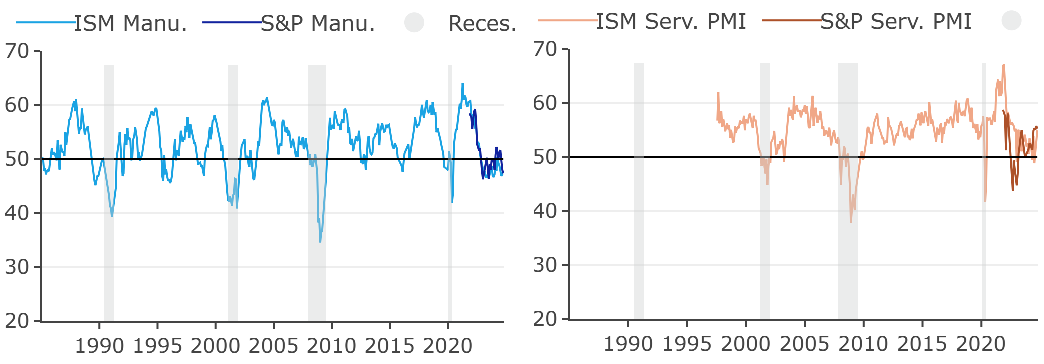
Sources | ITraxx CDS is the Markit iTraxx Europe Senior Financial Index, comprising 30 equally weighted credit default swaps on IG European entities. *10 year z-score applied on each series, coloured using gradient with score of 0 as green, at least +/- 2 standard deviations away scores as red. Bloomberg for all charts, as of Oct 2024. 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 Oct. flash estimates continue to contract across backlogs, new orders and employment. However, Services which represents over 70% of US corporate output, showed another 52+ flash reading. **The weakness in the employment sub-index continued for a third consecutive month. The silver lining being that the drop in headcount was often linked with non-replacement of leavers, rather than layoffs.**

United States



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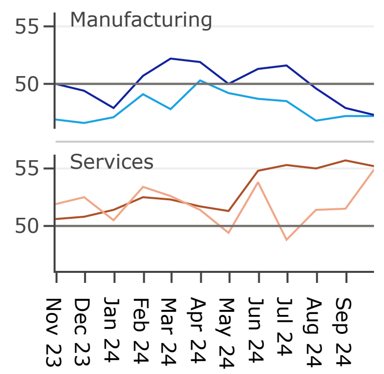
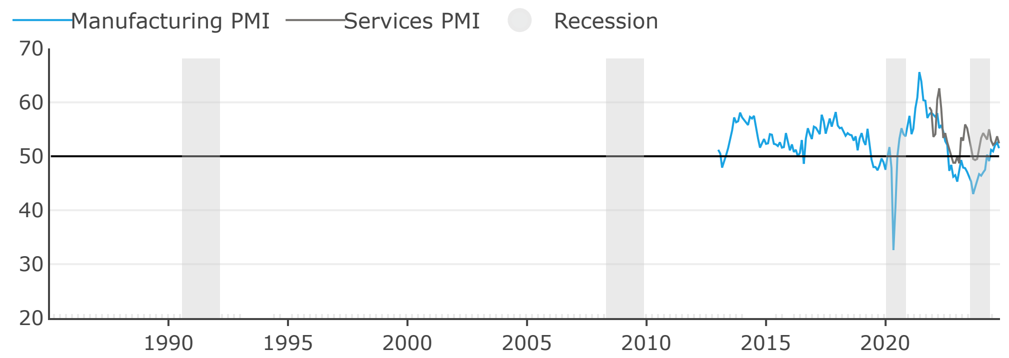


United Kingdom



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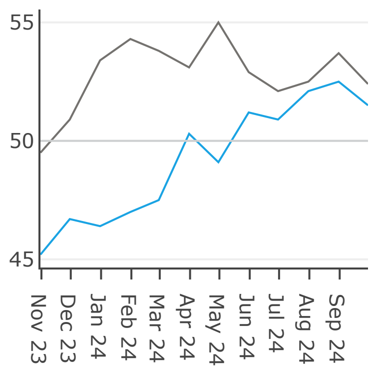
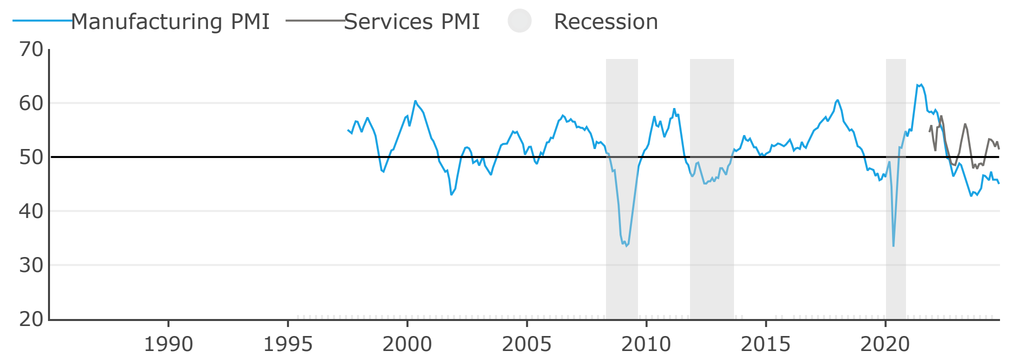


Eurozone



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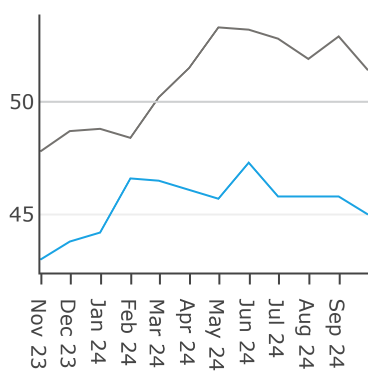

Sources | US Services and Manufacturing: ISM; All other countries including global: S&P Global as of Oct 2024. Recession defined as two consecutive negative quarters of GDP, recession ends with two consecutive positive quarters in GDP

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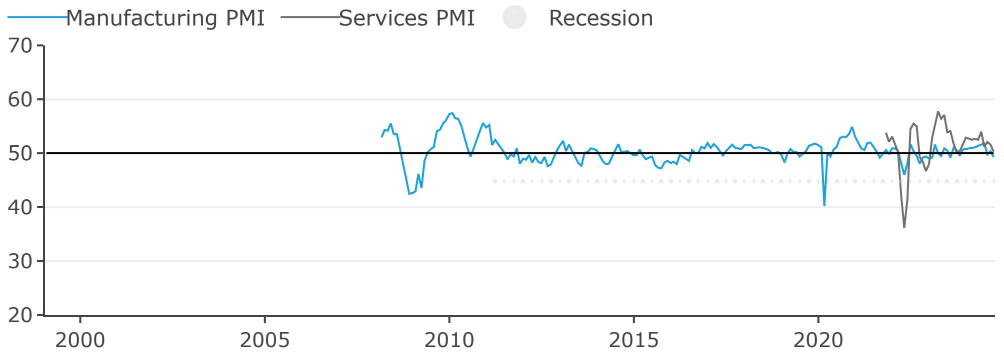
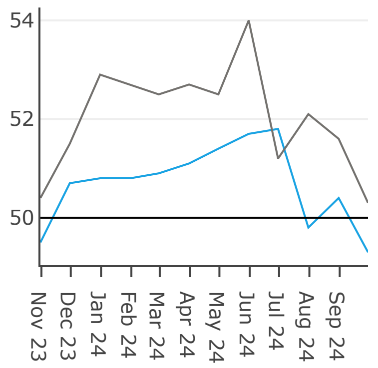
Global PMIs

Manufacturing has been the weak leg globally for most of this year, however, Services is now showing signs of slowing. In September, Global Services business activity, new orders and future expectations all continued to grow, but at a slower pace. **Overall though, these readings are comfortably in expansion territory and do not cause any immediate concern.**

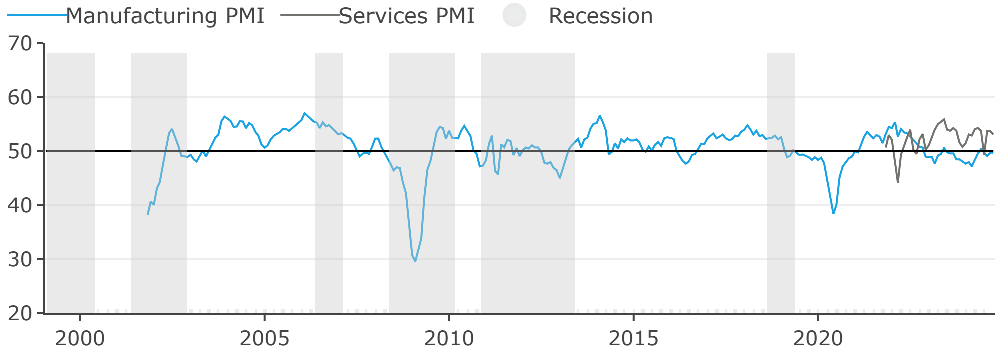
China



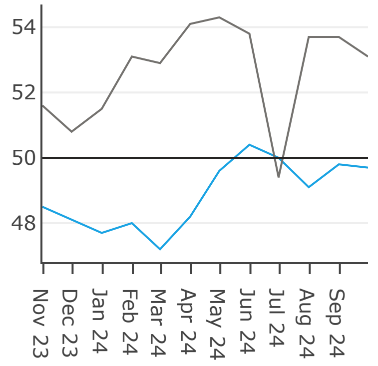
Last 12 Months



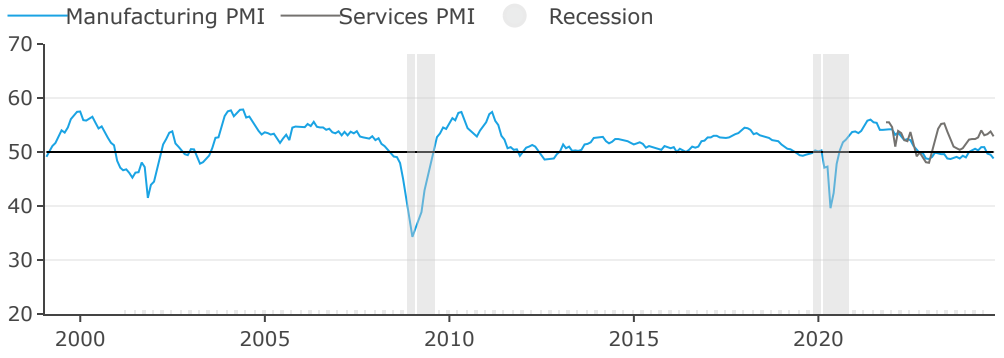
Japan



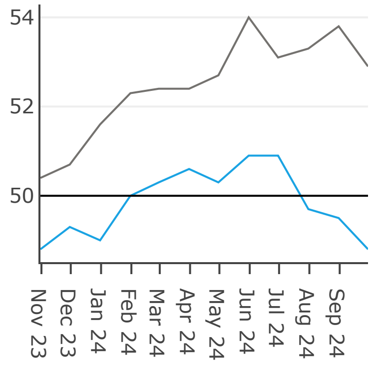
Last 12 Months



Global



Last 12 Months



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

GROWTH

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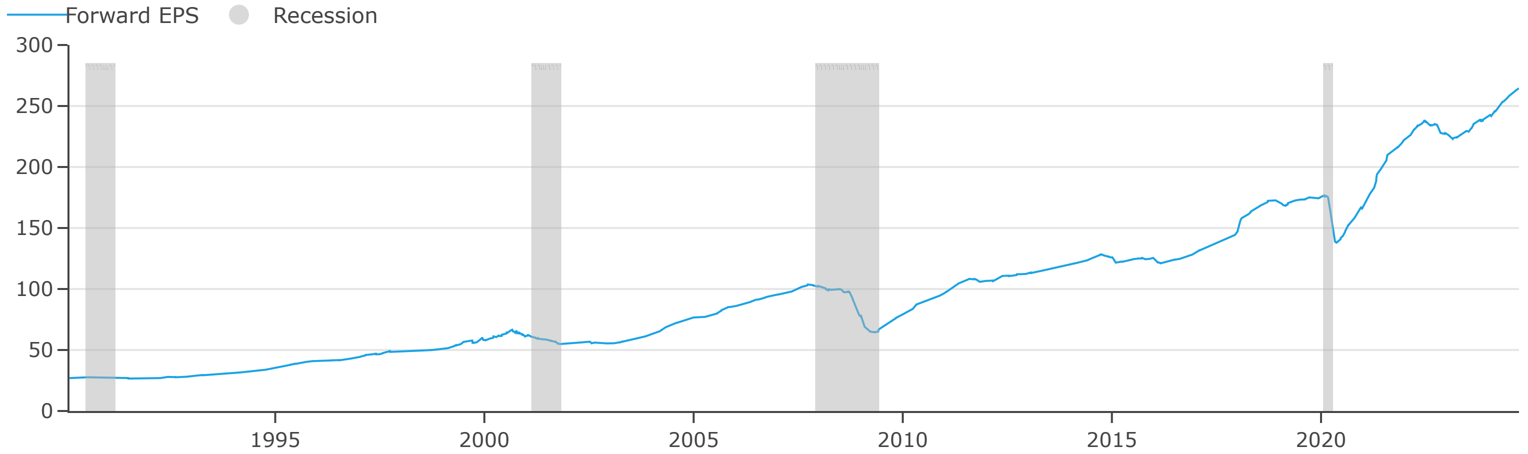
Earnings

Consensus forward earnings estimates remain positive for Q3. The season began with EPS growth expectations of ~4%, albeit slower than the ~8% projected a few months ago. Nonetheless this lowers the hurdle rate, **which is shaping up to be quite important given the extreme bullish positioning by the buy-side in US equity futures***.

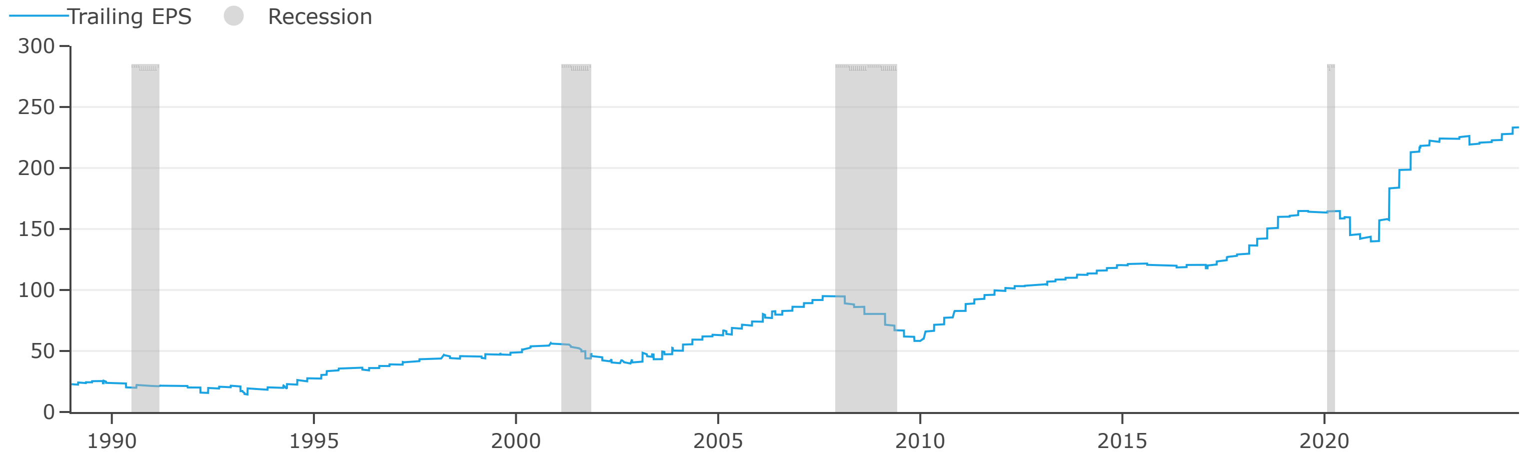
Mag-7 earnings growth has slowed over the year, even Q3 expectations are almost half of Q2. Nonetheless, growth expectations are at a whopping 17%, and so far Mag-7 has comfortably beaten expectations over the last 6 quarters. **Tech and Communications are expected to contribute ~70% and ~45% of total 2024 and 2025 EPS growth respectively.**

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 Oct 2024. *JP Morgan Flows & Liquidity: current US equity positioning by asset managers and leveraged funds are above 2 standard deviations from the 2012-2024 average.

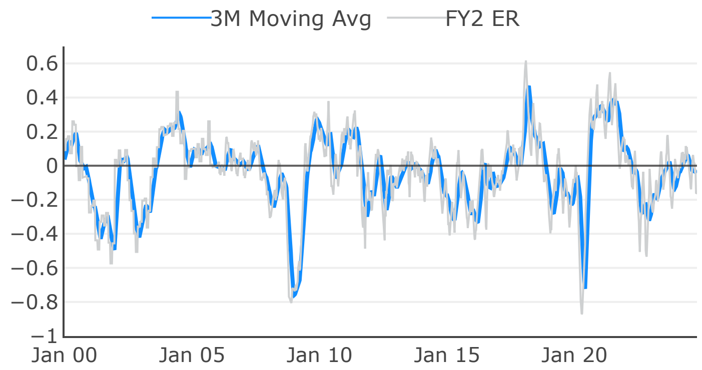
Earnings

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.

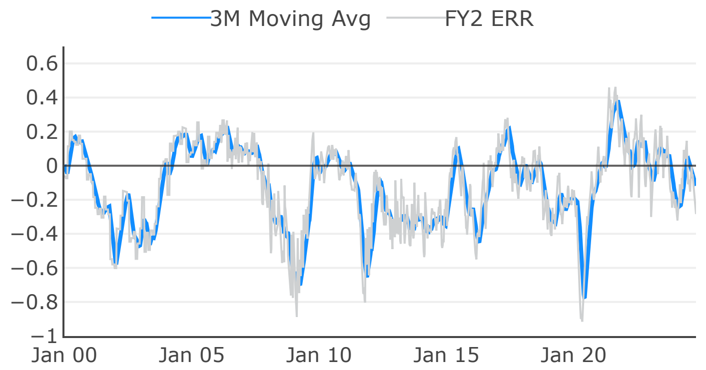
US Q3 earnings estimates have been revised negatively over the last few months. However, **revisions are very seasonal and the current change is very much in line with the last 25+ years of average monthly trend revision.** The US was not alone, UK and EU also faced negative revisions. However, Japan stood out positively driven in part by the strength of their Banking sector.

Global Earnings Revisions Ratios

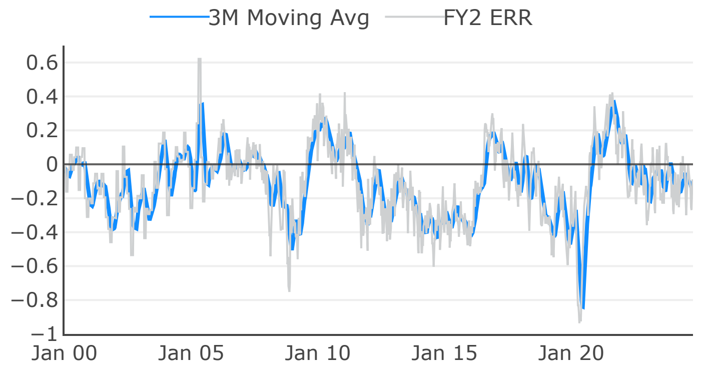
USA



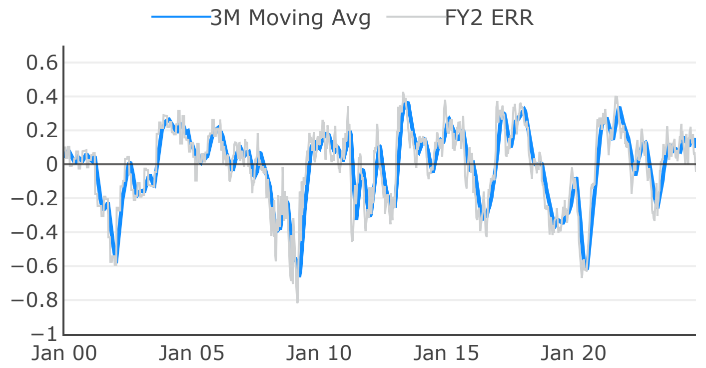
Eurozone



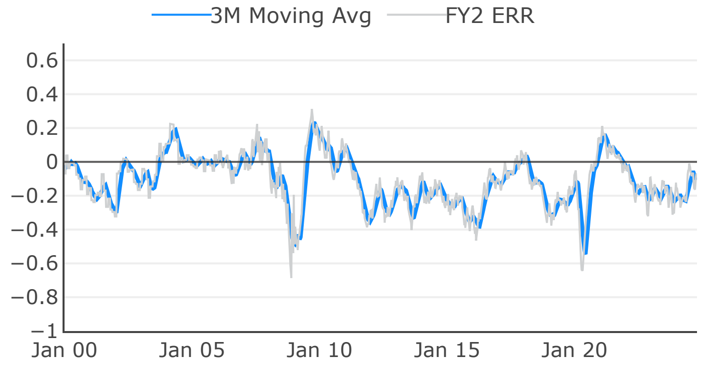
UK



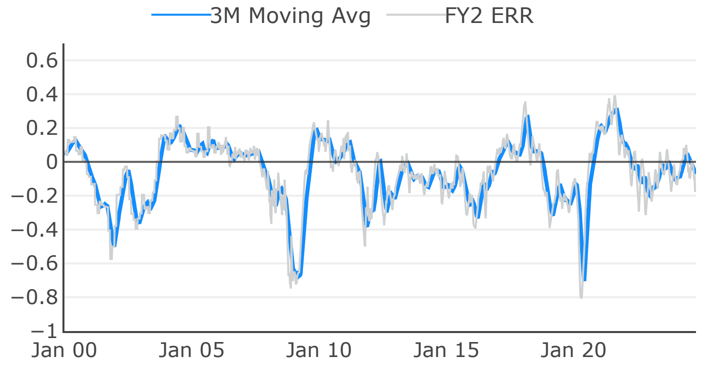
Japan



Emerging Markets



World



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

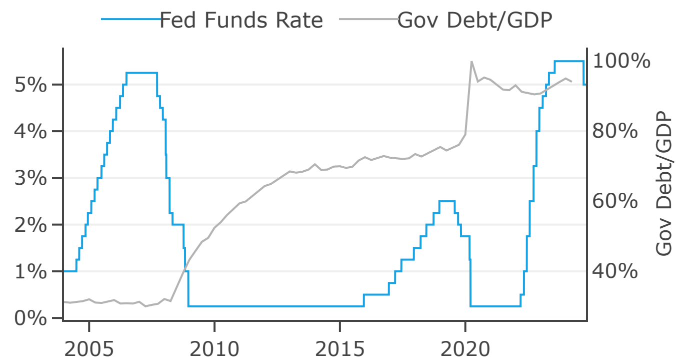
POLICY

Interest Rates

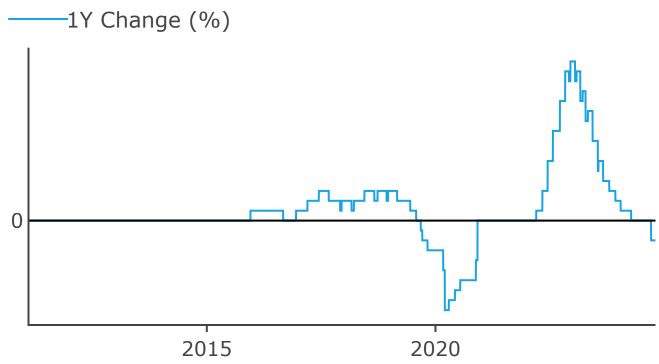
The Fed has shifted its focus to the labour force, and the rates market has too. Earlier this month the 254k non-farm payrolls print significantly pushed up rate expectations, shaving over 20bps of expected cuts this year, over the week from the print. **Markets now forecast US rates at 4.5% by year-end.**

Given both Presidential candidates are fiscally loose, **it is worth mentioning that 33% of all US government debt is to mature over the next 12 months.** The re-issuance will be expensive. The effective rate of all US marketable debt is ~3.4% - much lower than the current 3-month T-Bill rate of 4.5%*. **This has caused some jitters in the CDS market - US 5Y CDS spreads have been on the rise since Sept and are now at 2024 highs, however not yet at worrying levels.**

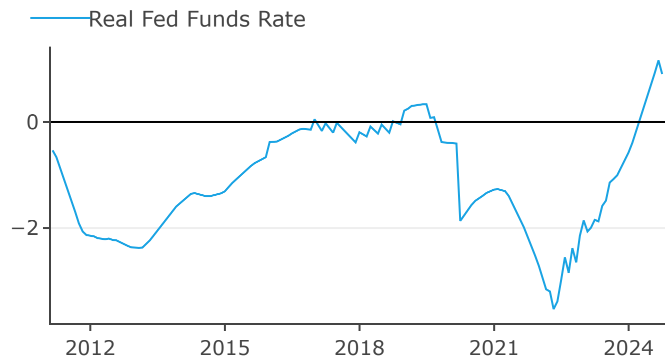
Fed Funds Rate



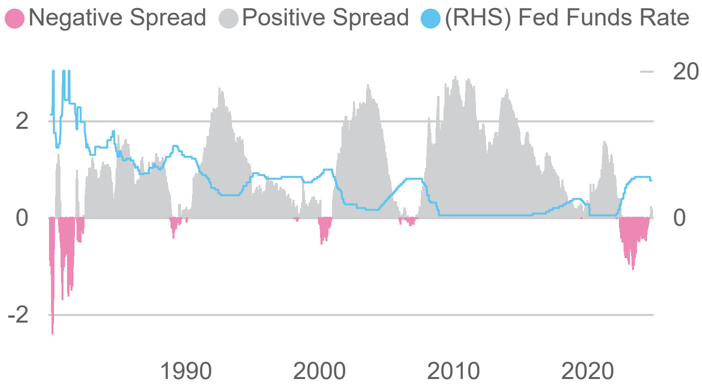
Change in Fed Funds Rate



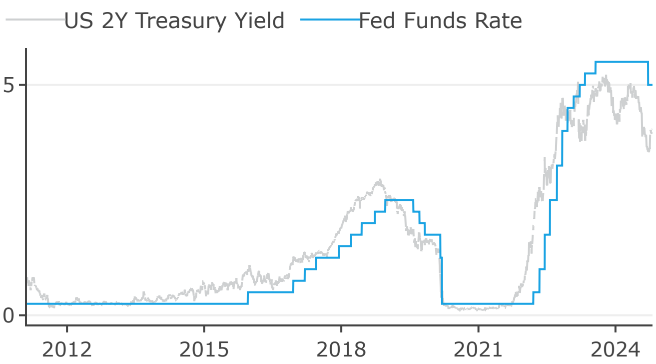
Real Fed Funds Rate (Using 2Y MA CPI)



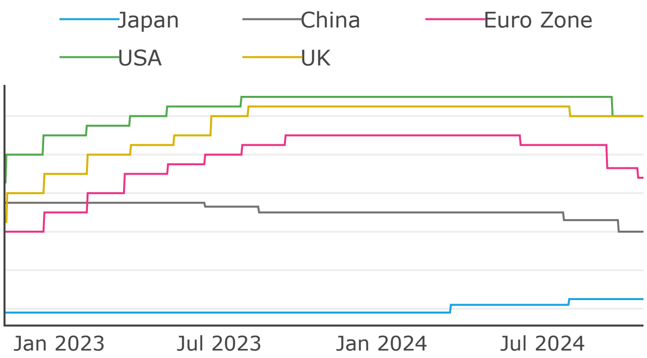
Fed Funds Rate vs 2s10s Curve



Fed Funds Rate vs 2Y Treasury



Global Comparison



Sources | Bloomberg for all charts, as of Oct 2024

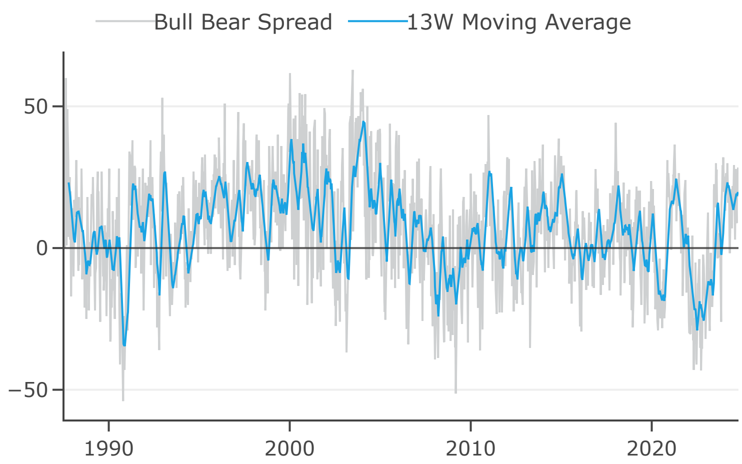
Sentiment

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.

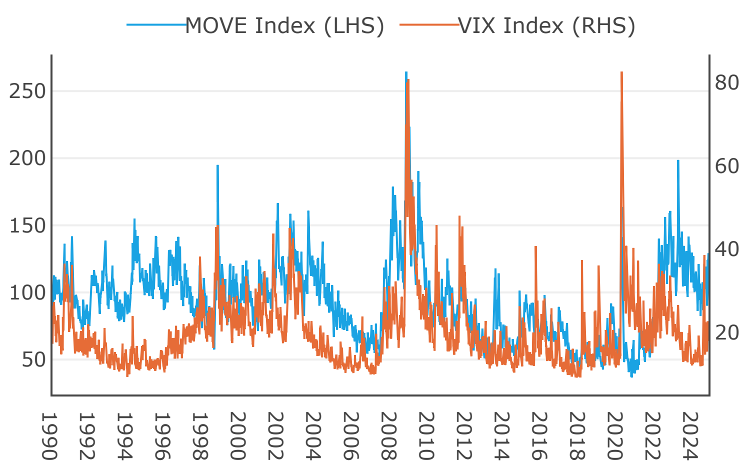
The BAML Hartnett Bull & Bear Indicator has moved from Extreme Bearish sentiment (which is bullish for the market!) in October 2022 **to now mildly bullish** (the current reading is 6.8/10).

US Equity Indicators

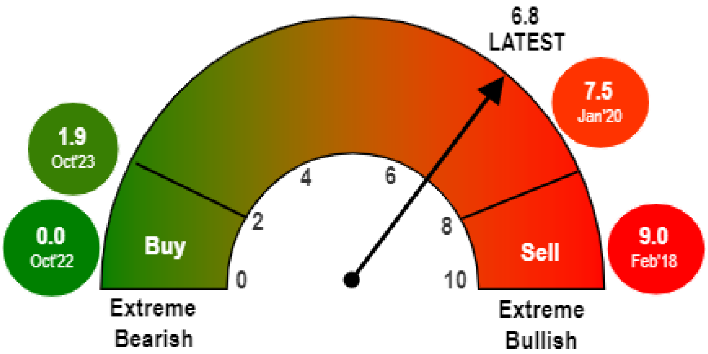
AAII Bull Bear Spread



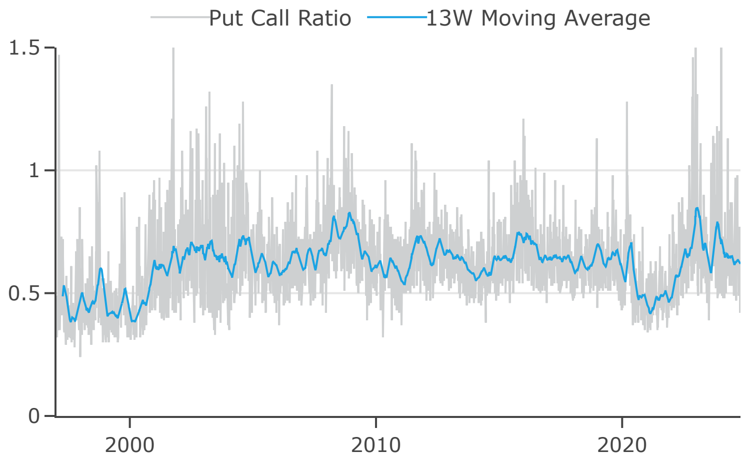
Equity vs. Bond Sentiment



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 Oct 2024

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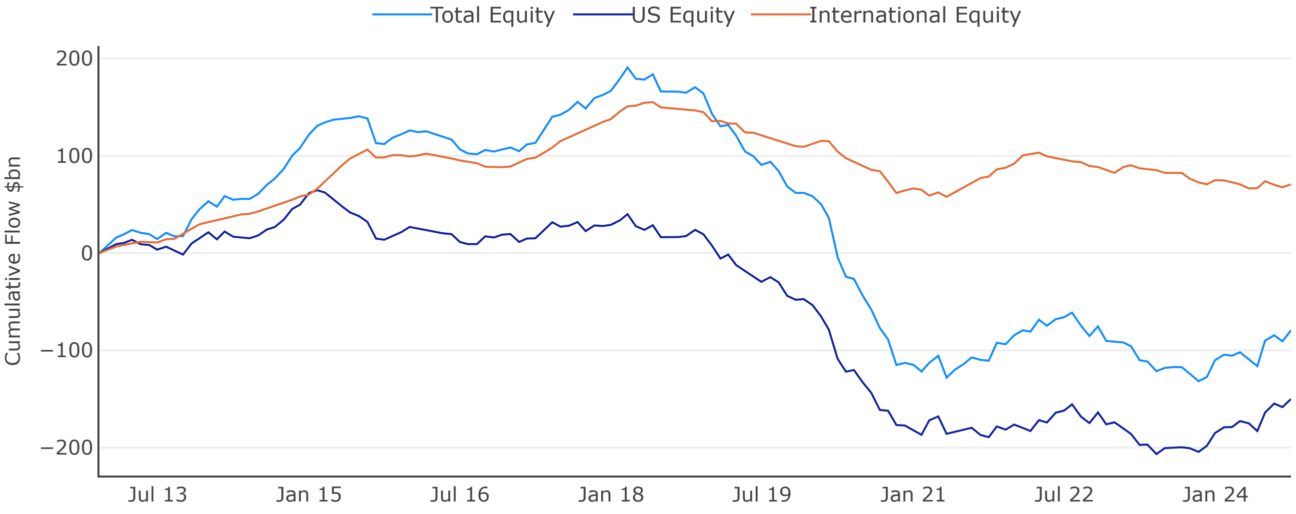
Fund Flows

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.

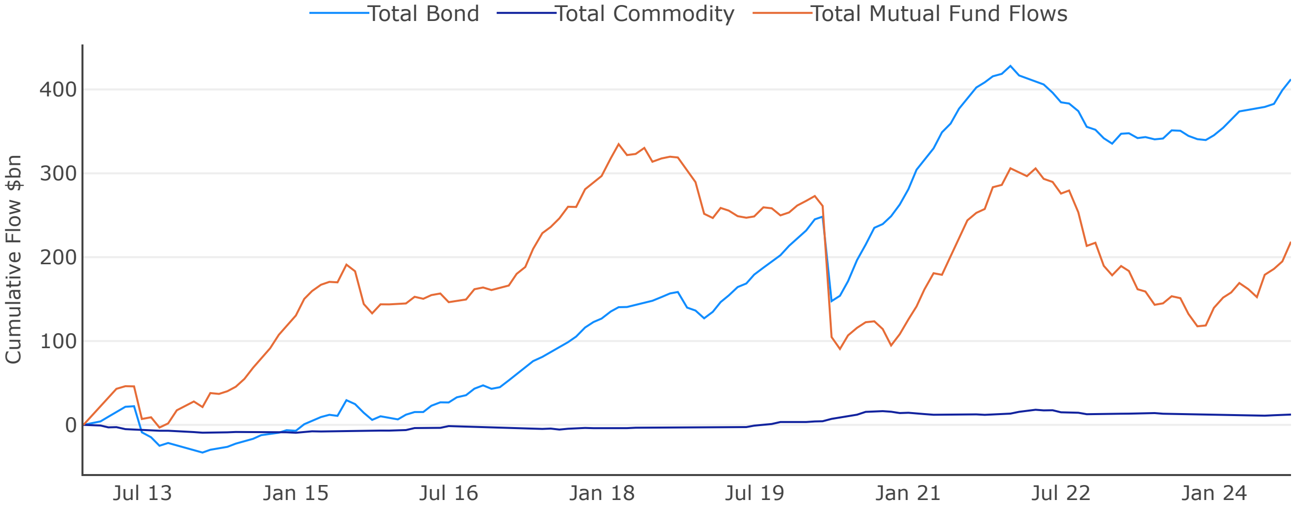
The message in these data points continues to be that there is little enthusiasm for actively managed funds even if the outflows from equity funds have stopped.

US Mutual Fund Flows

Equity Markets Cumulative $bn



Non-Equity Markets Cumulative $bn



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

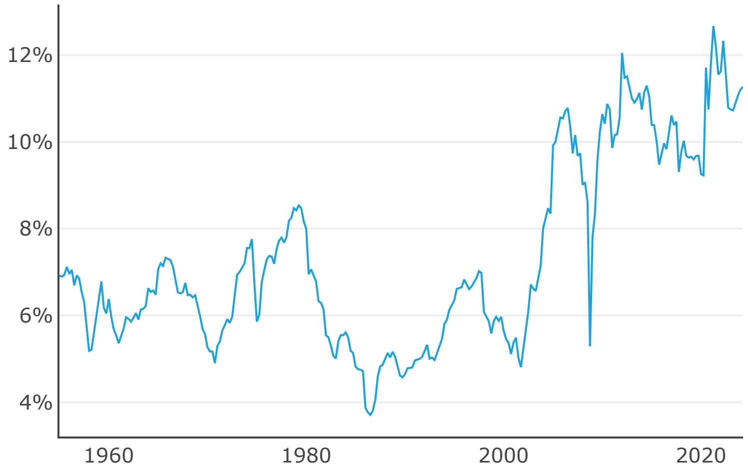
OTHER OBSERVATIONS

The Big Picture

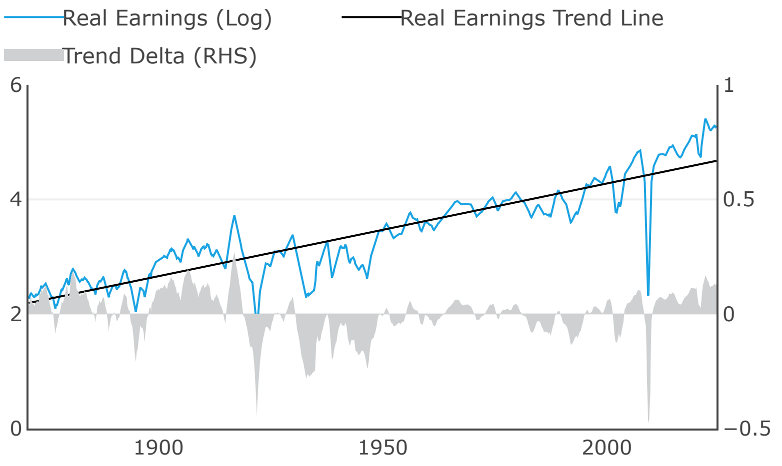
Here we highlight some longer-term imbalances that, **should** they correct, would have an outsized impact on risk asset returns. We don't make predictions but we do watch these. US corporate profit is just off the highest share of GDP that it has ever been since 1929. Its corollary (not shown) is that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

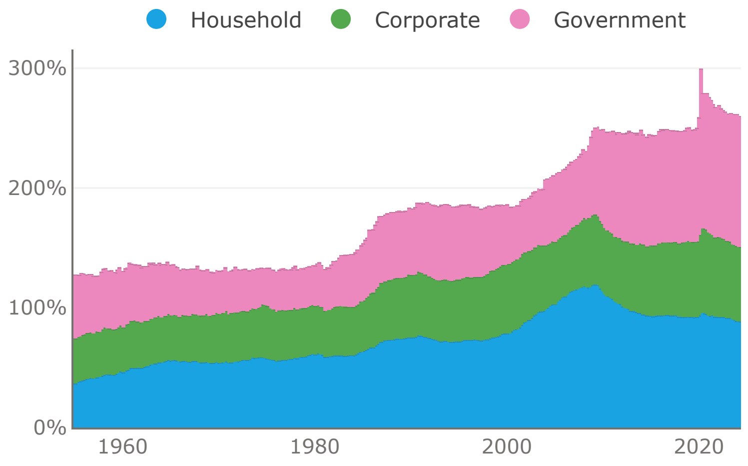
Profit Share of GDP



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 data refreshed as at Aug 2024.

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