MARKET VIEWS

Charts of the Week

04.12.2023

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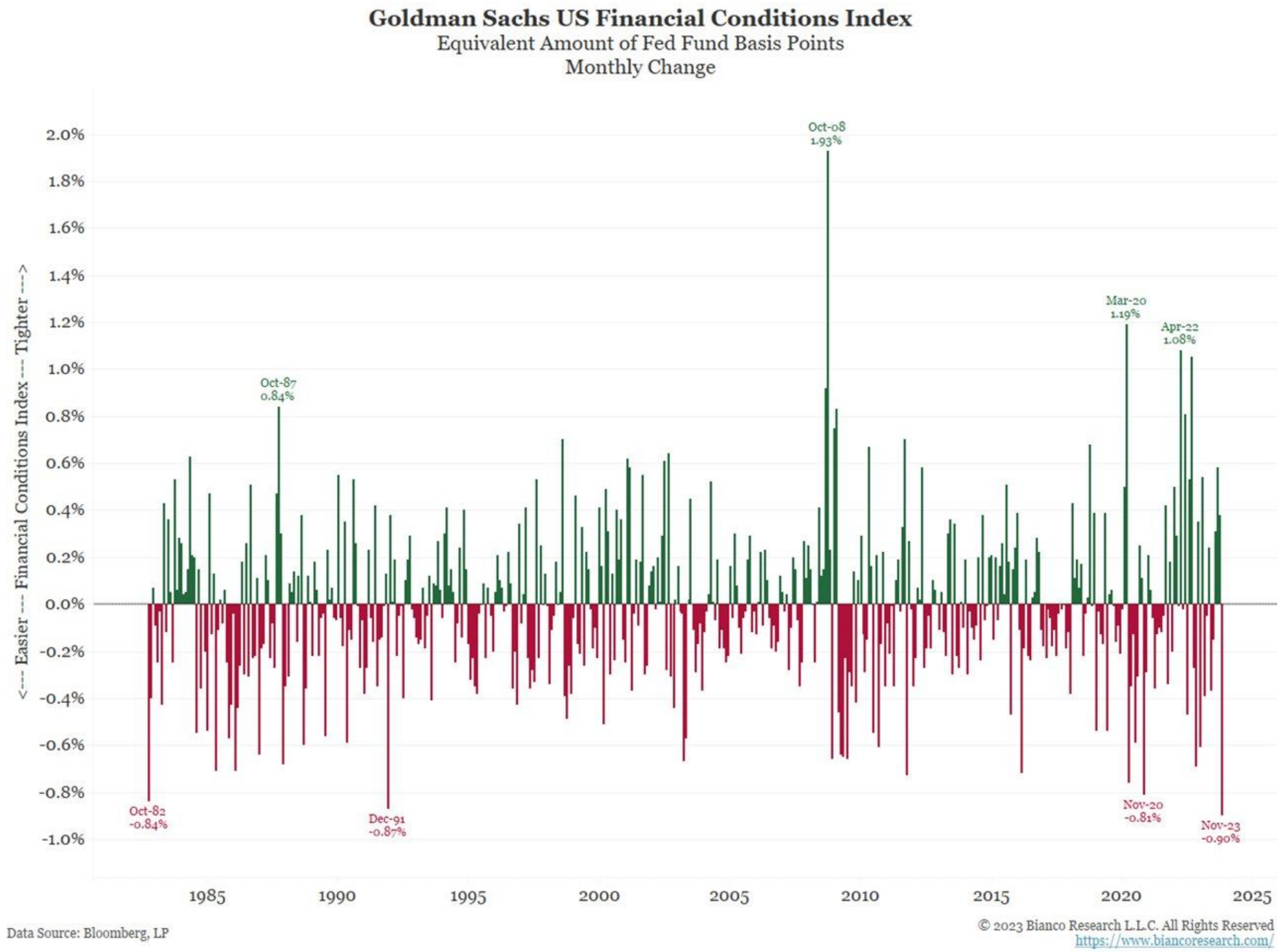
Largest easing in financial conditions in 40 years

The sharp fall in yields and the USD, combined with the ferocious rally in equities has led to the largest Goldman Sachs financial conditions index in 40-years, supposedly representing the equivalent of a 90bps Fed rate cut.



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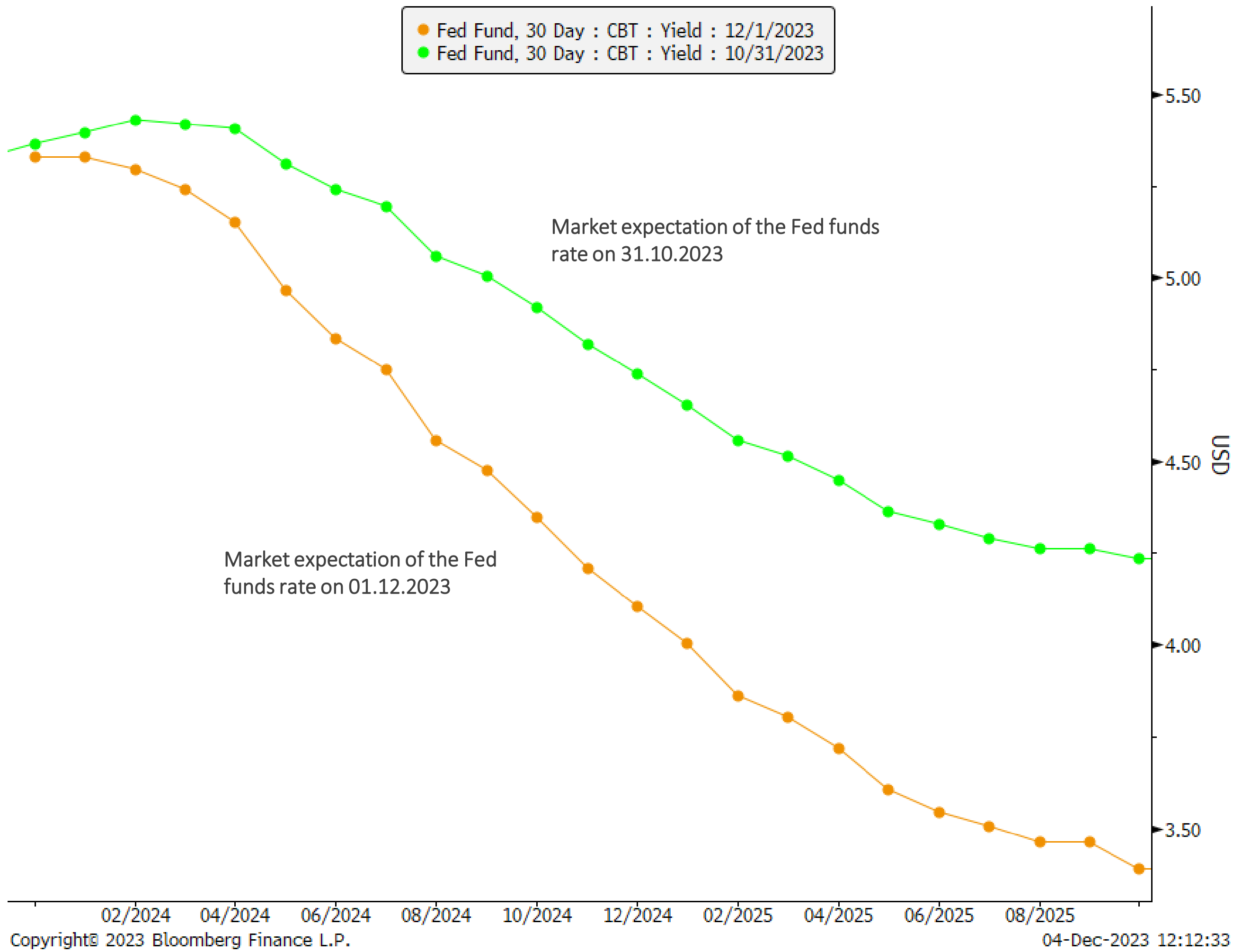
The market is giving up on higher for longer…

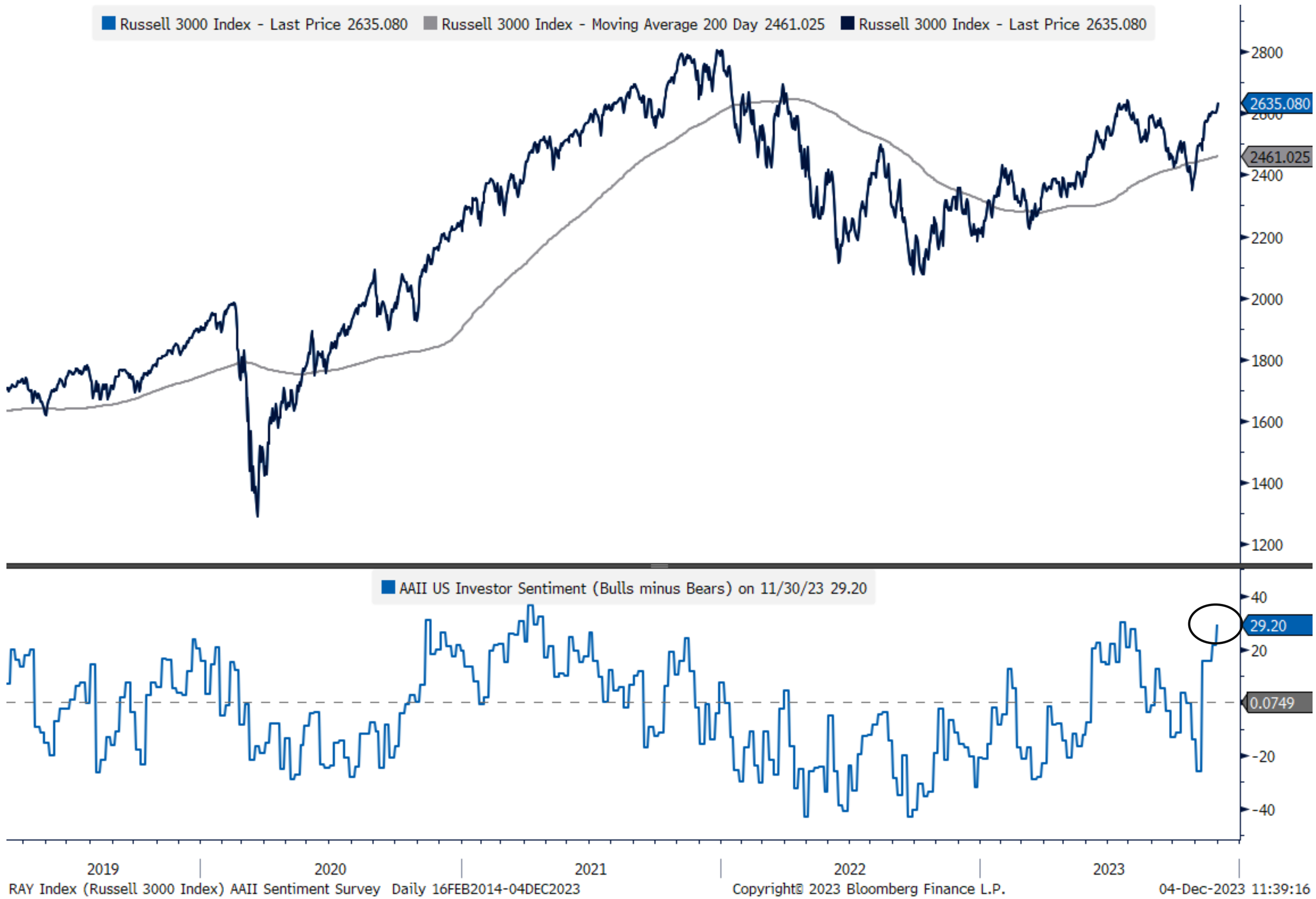
Despite Powell pushing back last week against rate cuts as premature, markets are now assigning a 60% probability of cuts in March 2024. Over the last month, markets have gone from pricing a Fed funds rate of 4.75% in December 2024 to 4.1% currently.



Expectations are for 12% earnings growth in 2024 in the US

Markets now expect the Fed to cut by 125bps next year, earnings to grow by 12% and the economy to be in a soft landing (i.e. to grow around 1-1.5%). Such an ideal combination is very unlikely to materialize.

Sentiment is back to being overly bullish and equities are stretched



Downside protection is very cheap right now

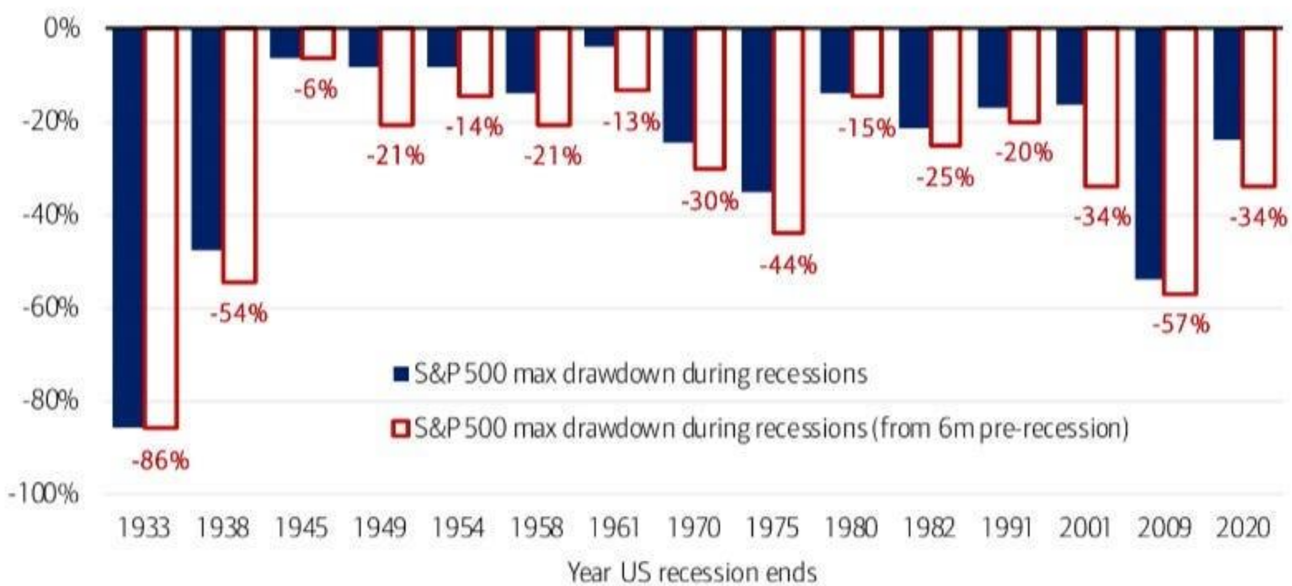
While we still expect equities to remain resilient into year-end, the collapse in volatility is offering investors with an opportunity to hedge some equity exposure for the coming quarter, during which the interplay between economic strength, yields and profit growth will become trickier. Put options are currently the cheapest in years.

Markets tend to believe in the soft landing until the very last moment

This chart illustrates that recessions are rarely anticipated by equities. In other words, the bulk of a recession-induced correction occurs when the economic evidence of a large growth slowdown is beyond doubt; until then, investors tend to cheer economic weakness. We currently find ourselves in the latter environment.

Exhibit 31: Recessions are painful for equities and hardly discounted in advance: in the median recession-related drawdown, 81% of the losses happen during the actual recession and not in the 6m prior

S&P 500 max drawdowns during recessions (from 6m pre-recession)

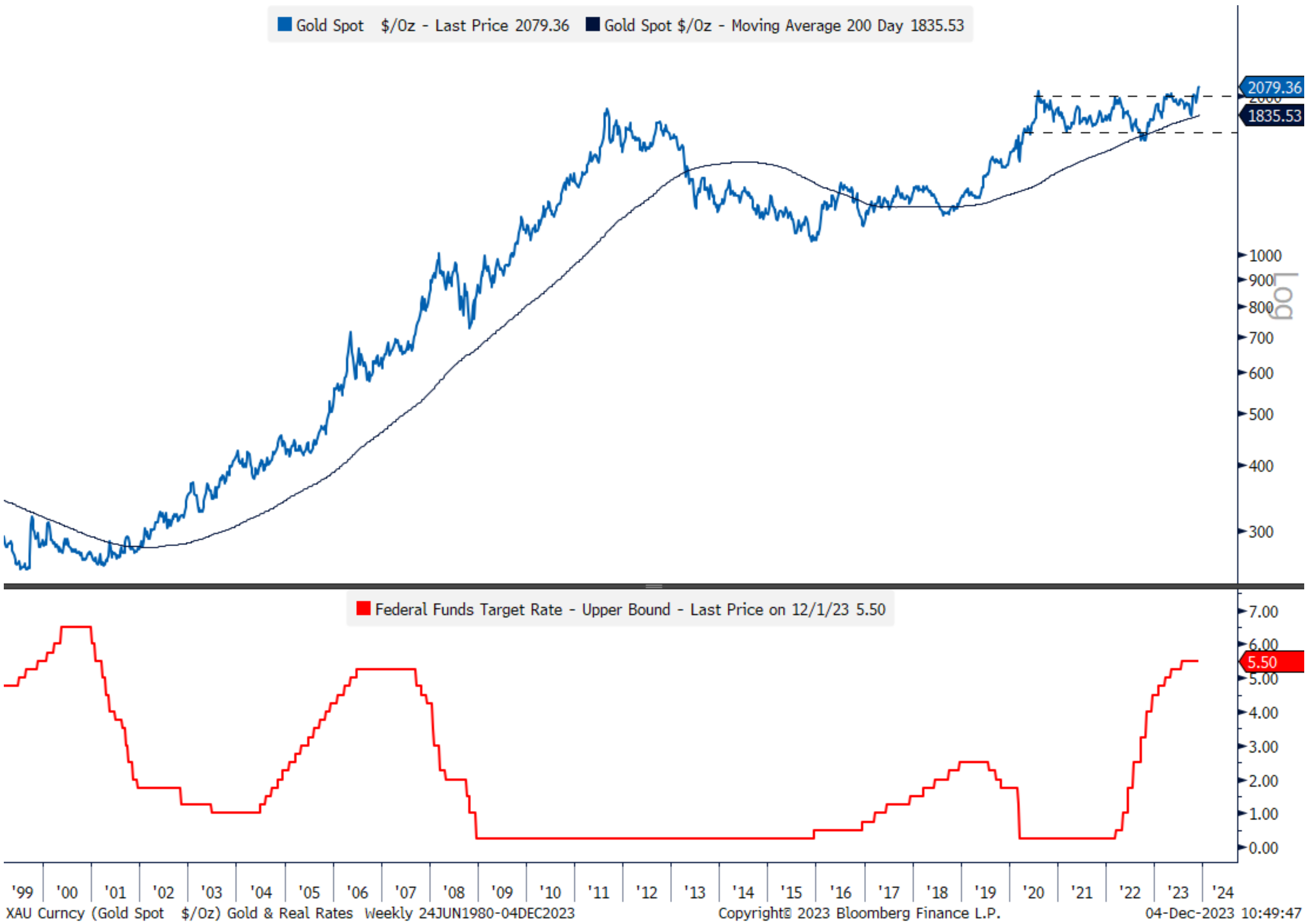


Source: BofA Global Research, NBER recessions. Data since 1927.

BofA GLOBAL RESEARCH

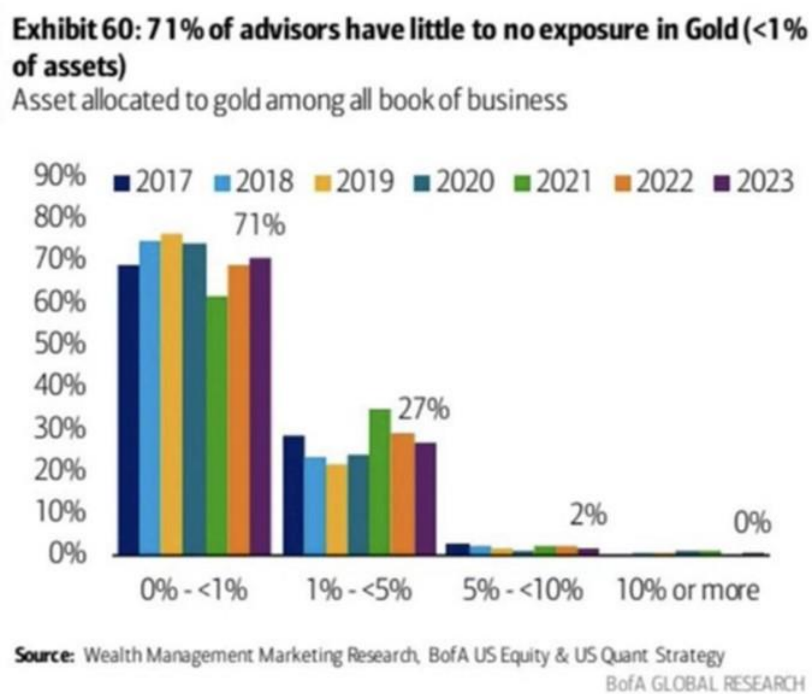
Gold believes in rate cuts and closes at record highs

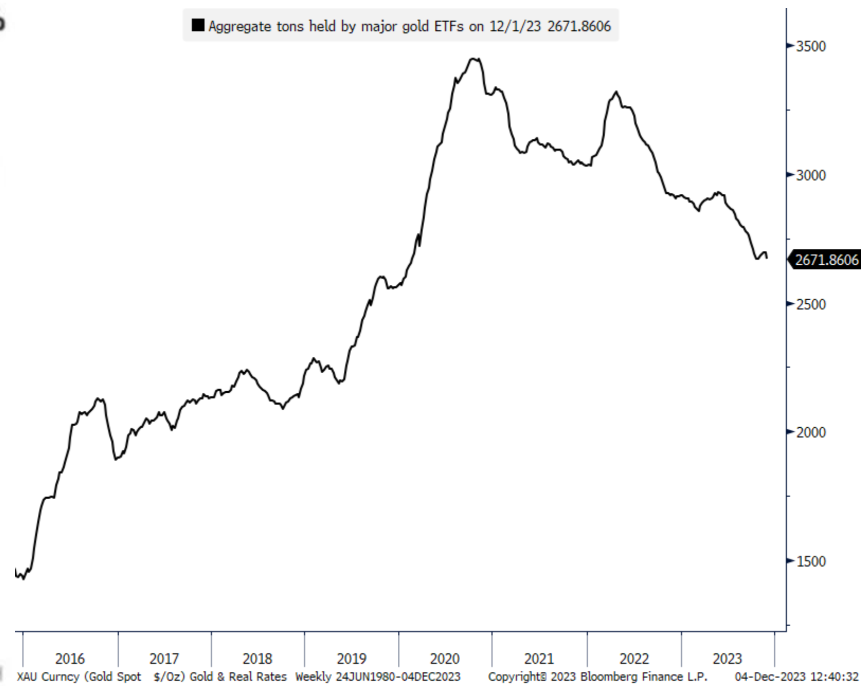
Gold has managed to make a new monthly and weekly record closing high, giving credence to the breakout. Barring a sharp reversal below USD 2000, investors should assume that gold's next leg up is starting. Historically, a peak in the Fed funds rate has been a reliable indicator of further gains ahead.



Investment advisors own very little gold

According to Bank of America's survey, 71% of US advisors own less than 1% of gold, a position that will be difficult to defend should gold confirm its breakout into new record highs. Physical gold held into major ETFs is also suggesting that a lot of buying power remains on the sidelines.





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