June 2024

Did someone pull the plug?

H2 2024 market outlook

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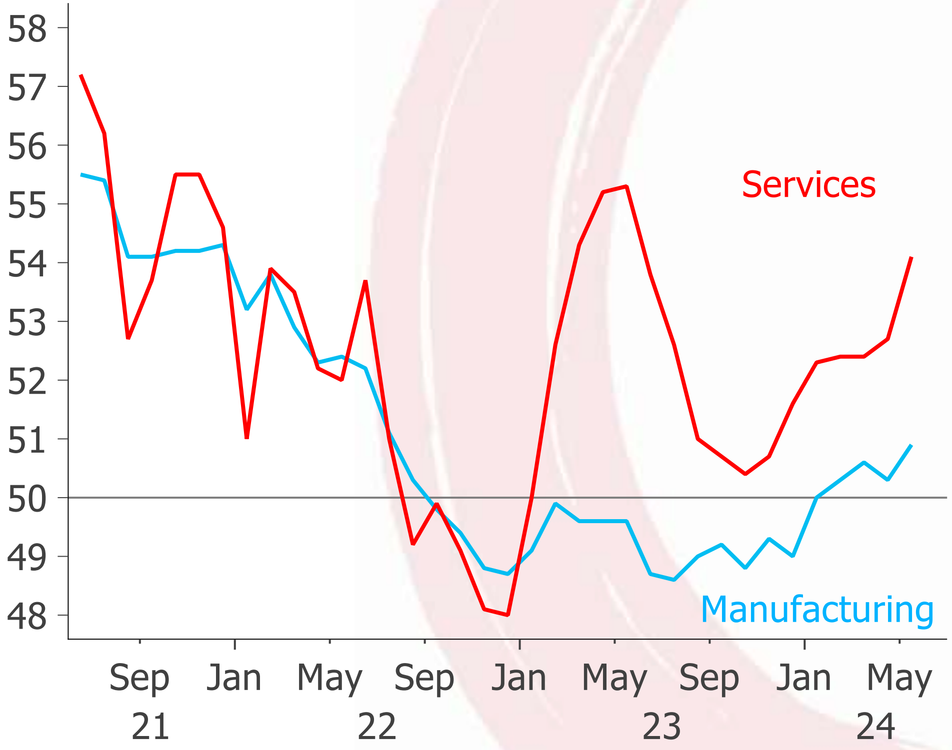
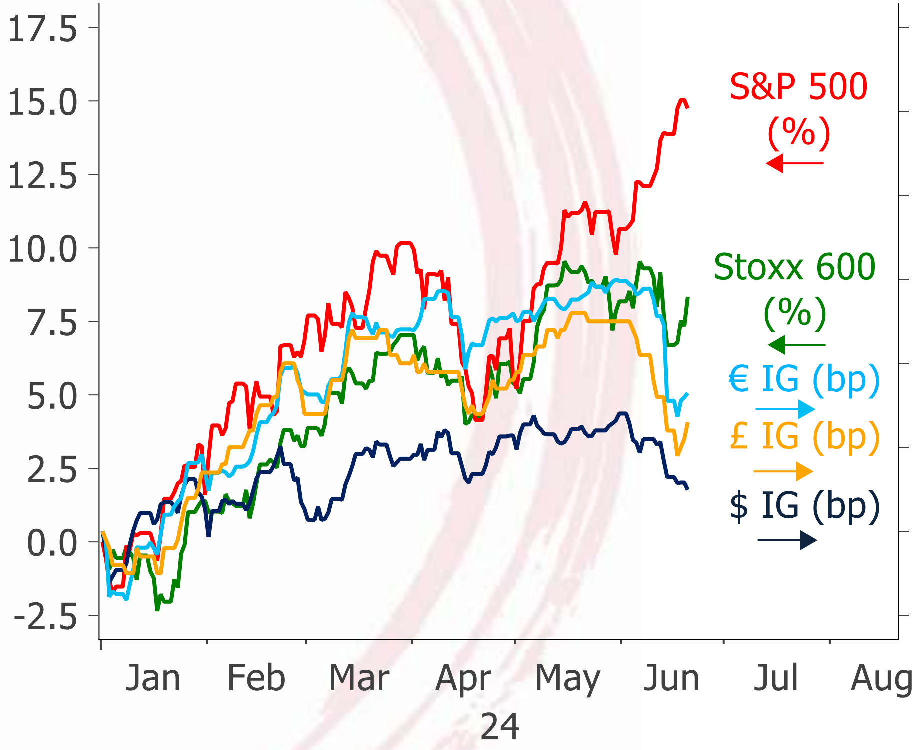
The economic outlook is fine

If the outlook is steadily improving
S&P global PMIs, 50=expansion



Source: S&P Global, Macrobond, Satori Insights.

Why are many markets faltering?
YTD performance in credit spreads and equities



Source: Bloomberg, Macrobond, Satori Insights.

But markets are suddenly faltering

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Agenda

A dwindling base of support

An unnerving gap to fundamentals

Prospects for H2

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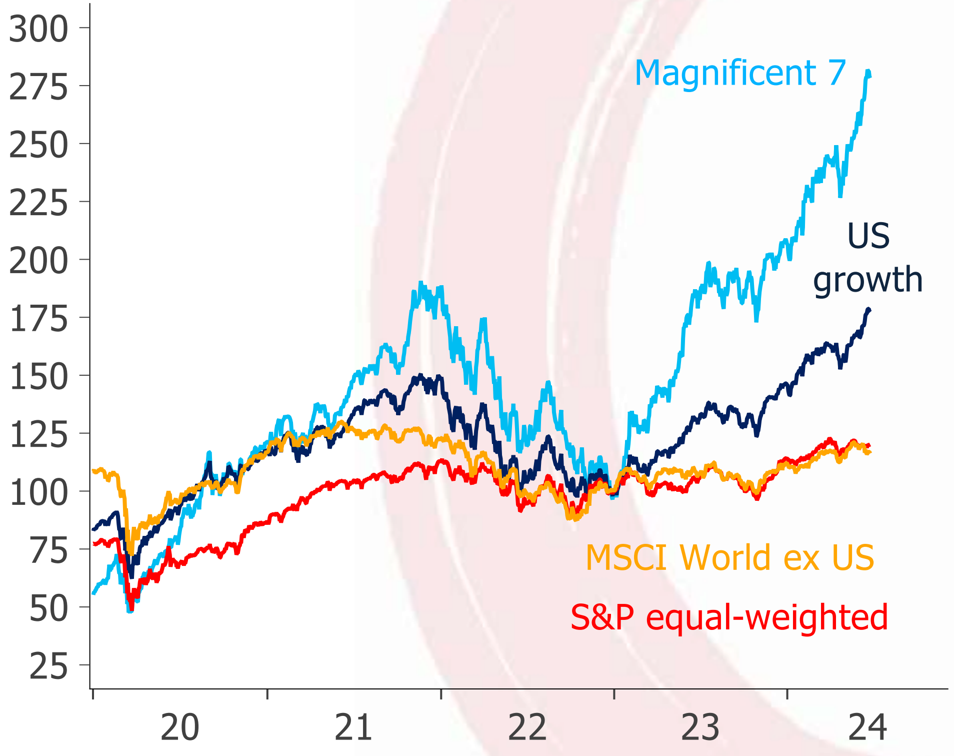
At first sight, equity benchmarks are still making new highs

Rally has been narrowing alarmingly

Stock indices, Jan23=100



Source: Macrobond, S&P Global, MSCI, Satori Insights.

More recent = narrower

US equity heatmaps

YTD

Past 1m

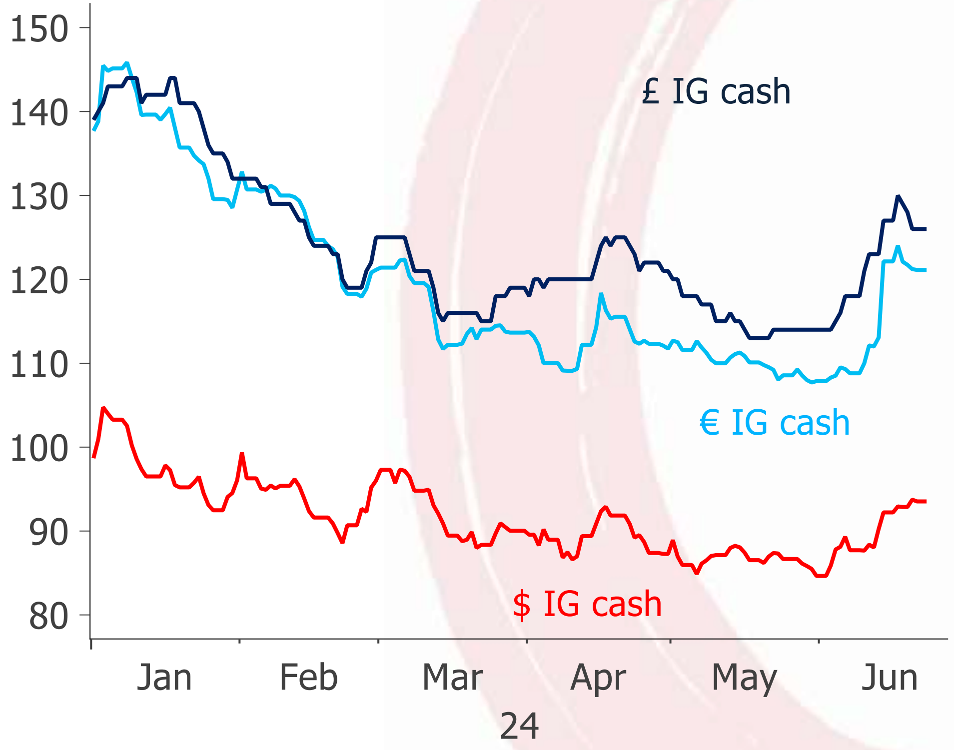
Source: Finviz.

Mag7 strength conceals weakness elsewhere

Much commentary pins the weakness on Europe

Don't blame Macron!

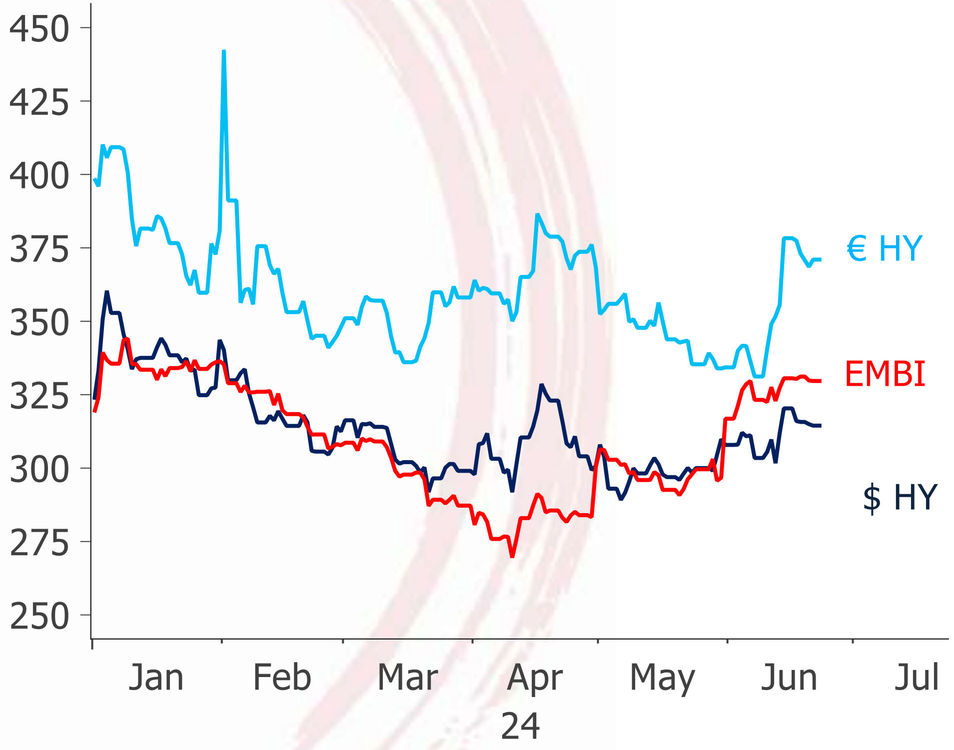
Investment grade spreads to govies, bp



Source: Bloomberg.

Softness elsewhere started earlier

Credit spreads to govies, bp



Source: Bloomberg.

But a broader phenomenon suggests a different cause

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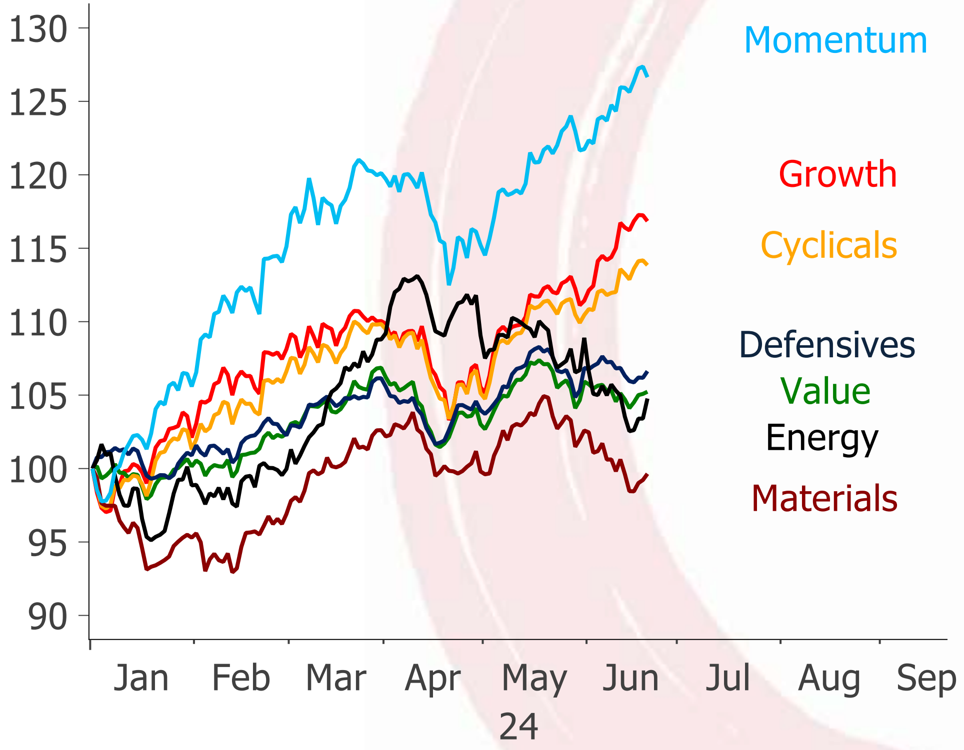
Market has "momentum" – but not much else

This rally has Momentum

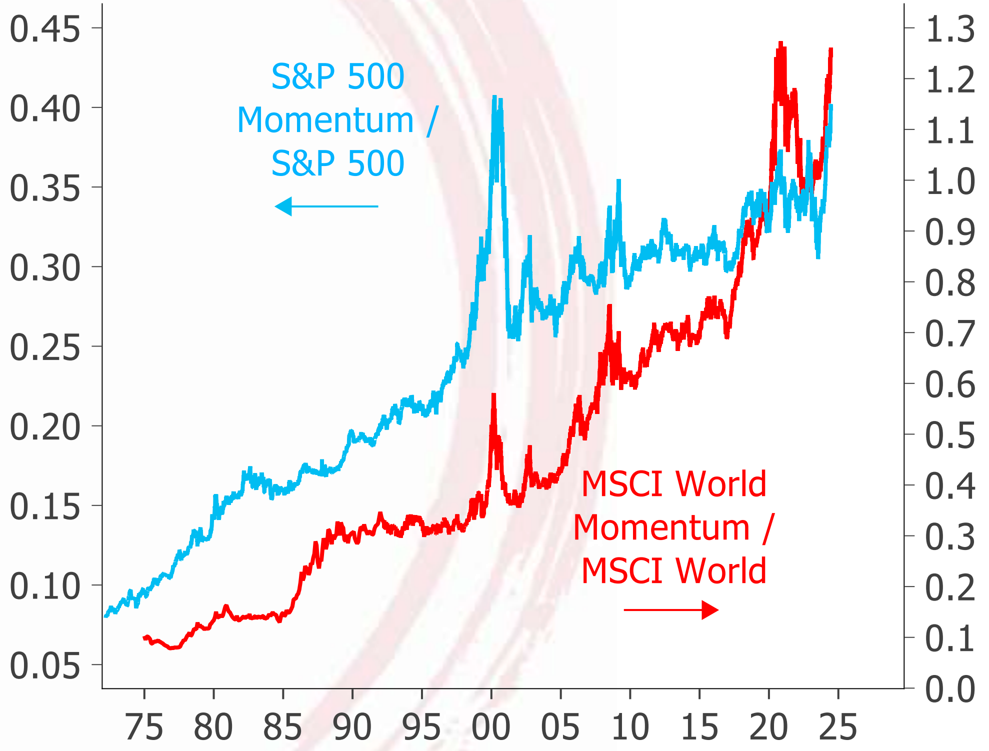
MSCI World equity factors, Jan24=100



Source: MSCI, Bloomberg, Satori Insights.

Momentum surges often a last hurrah

US and global performance of equity momentum factor



Source: Bloomberg, Satori Insights.

Rallies driven by momentum are by nature unstable

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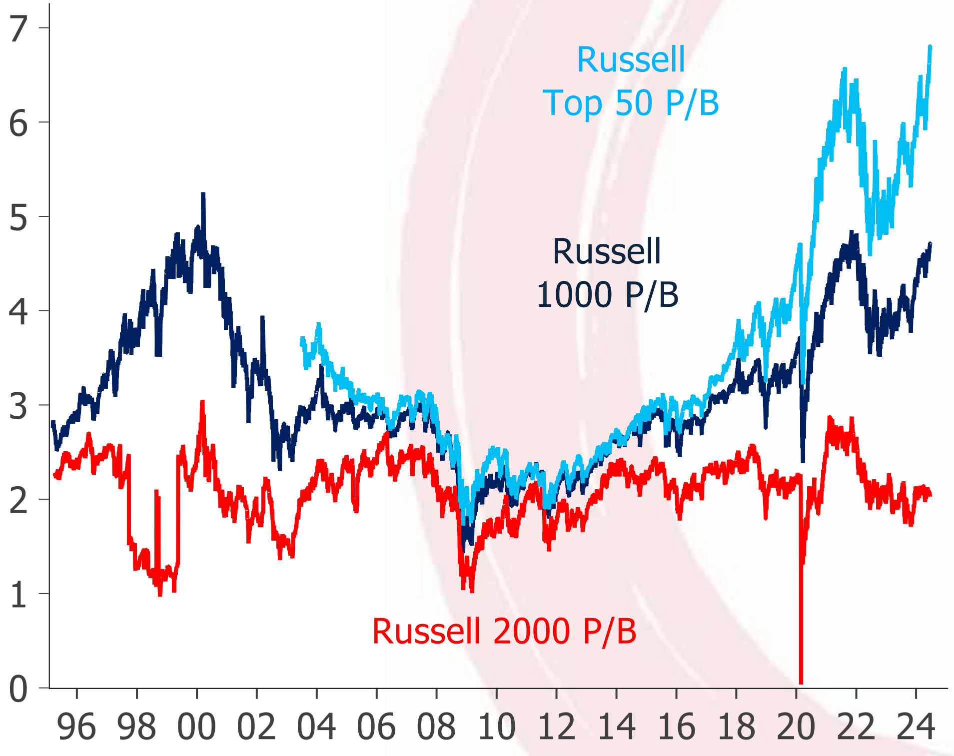
This is more than just an AI story

Scalable tech justifies higher valuations

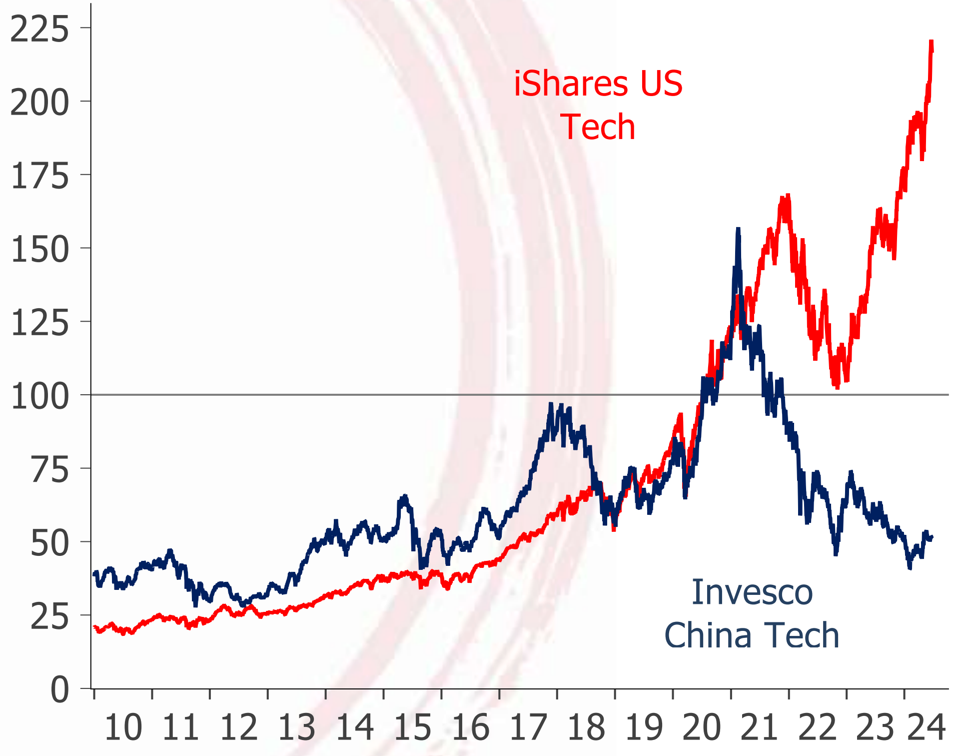
US equity price-to-book ratios



Source: Bloomberg, Macrobond, Satori Insights.

But why only in the US?

Equity ETFs, Jul20=100



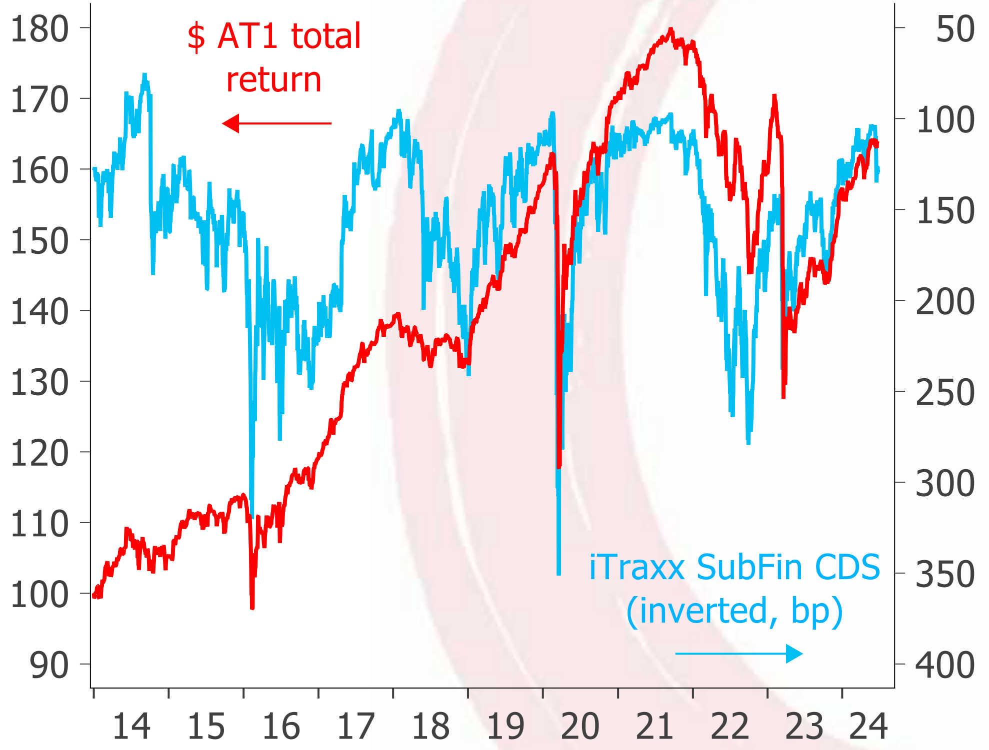
Source: Macrobond, Bloomberg, Satori Insights.

US megacap outperformance has more to do with money flows than tech supremacy

Pockets of concern are appearing

Short memories mean rude awakenings

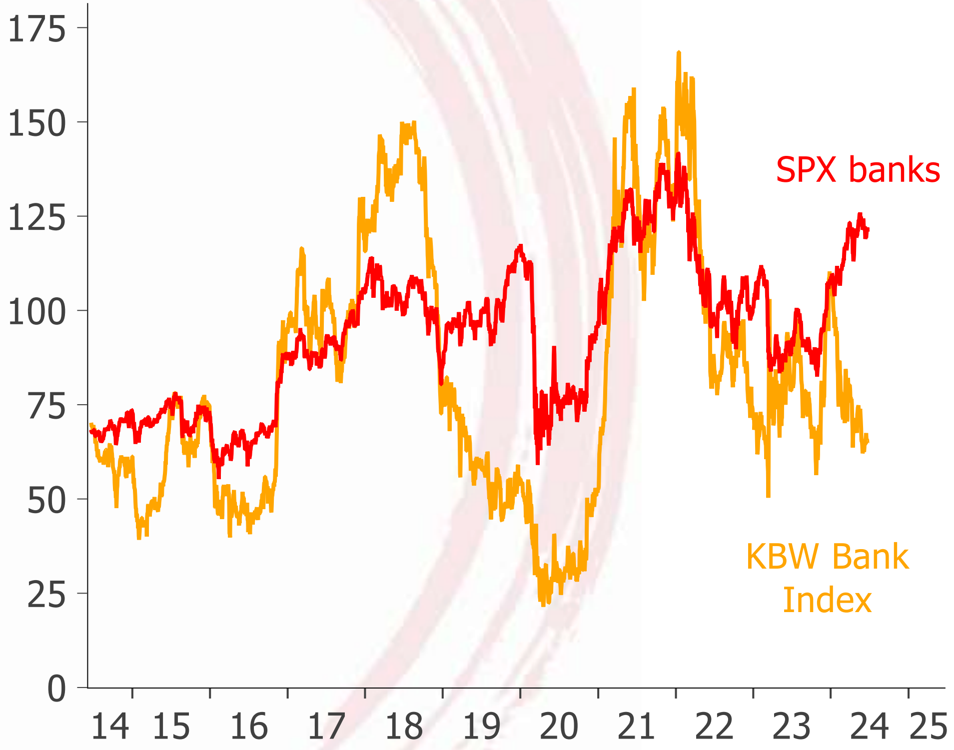
Subordinated bank bond returns and CDS spreads



Source: Markit, Bloomberg, Satori Insights.

When small is not beautiful

US bank equity indices, 2017=100



Source: Bloomberg, Satori Insights.

"Bull markets narrow; bear markets broaden"

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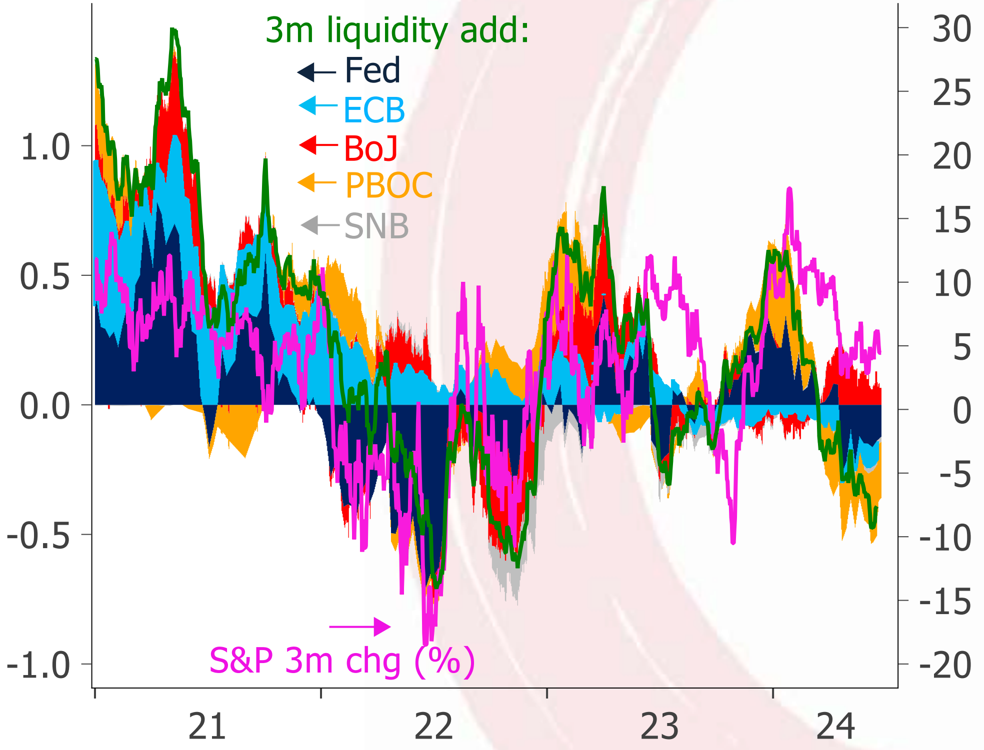
What's really striking is the relationship with CB liquidity (1)

Equities have continued to do well

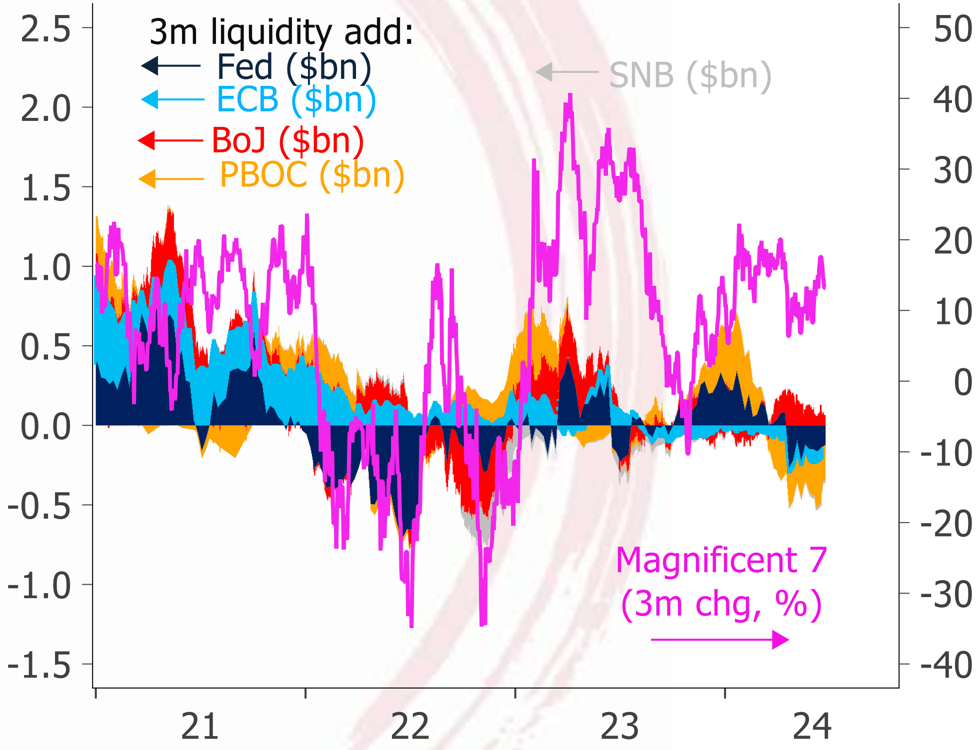
Global CB reserves chg, rolling 3m, vs equities



Source: national central banks, Macrobond, Satori Insights. ECB uses securities-govt deposits.

Led by the Magnificent 7

Global CB reserves chg, rolling 3m, vs equities



Source: national central banks, Macrobond, Satori Insights. ECB uses securities-govt deposits.

Equities have been outperforming

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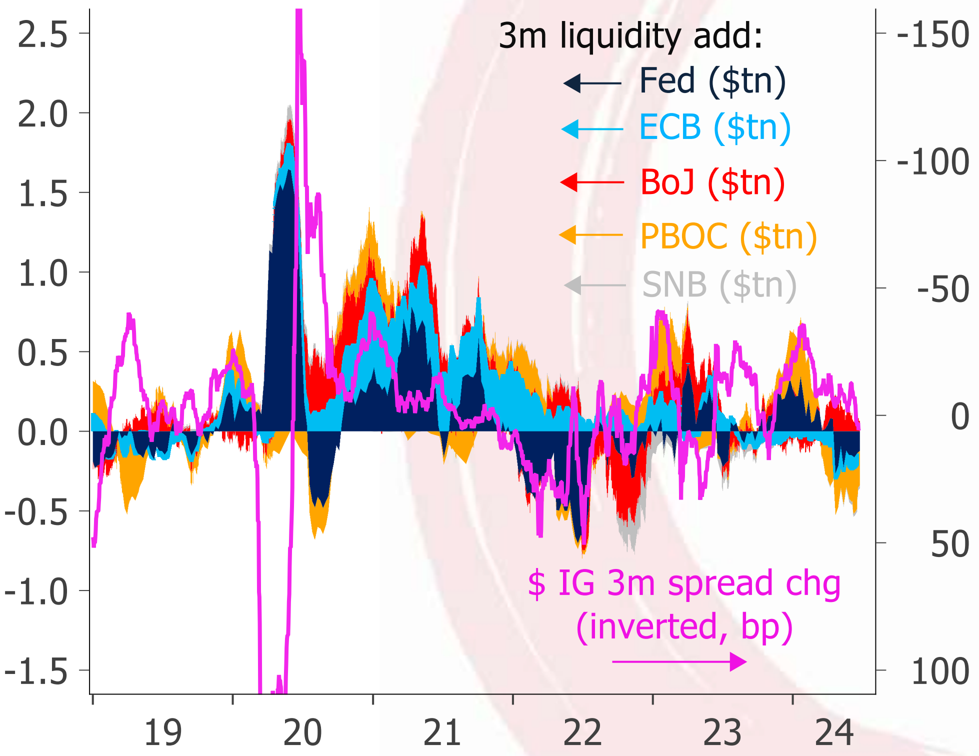
What's really striking is the relationship with CB liquidity (2)

Credit looks less out of line

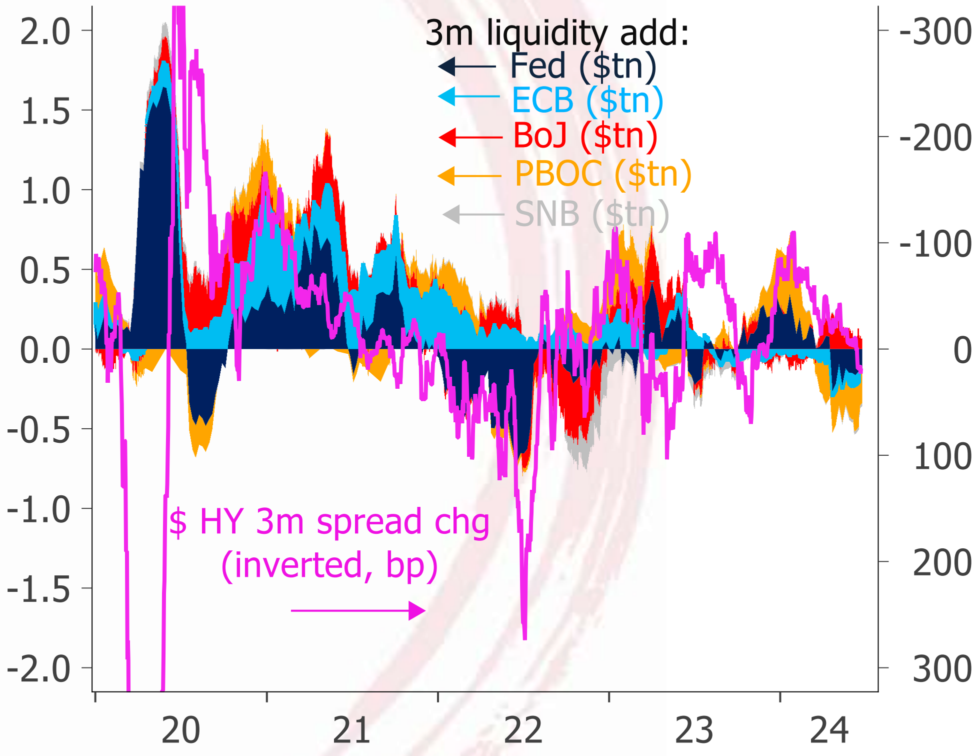
Central bank reserves vs $ IG, rolling 3m chg



Source: national central banks, Bloomberg, Macrobond, Satori Insights.

So too does HY

Central bank reserves changes vs HY spreads, rolling 3m



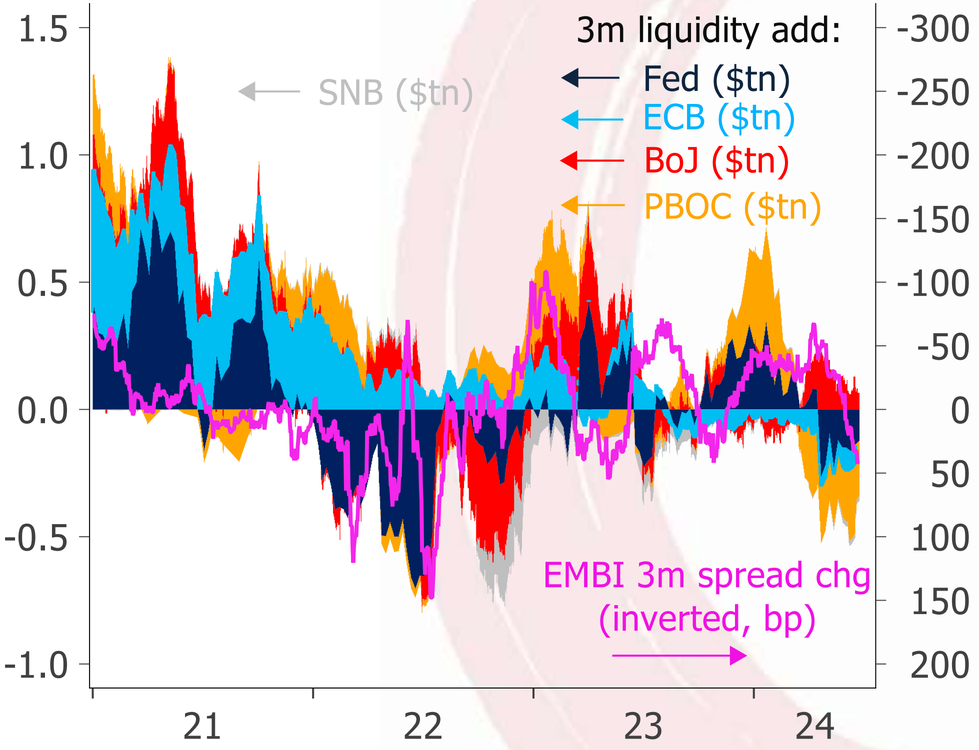
Source: Bloomberg, national central banks, Macrobond, Satori Insights.

Credit looks much more in line

What's really striking is the relationship with CB liquidity (3)

EM has weakened as expected

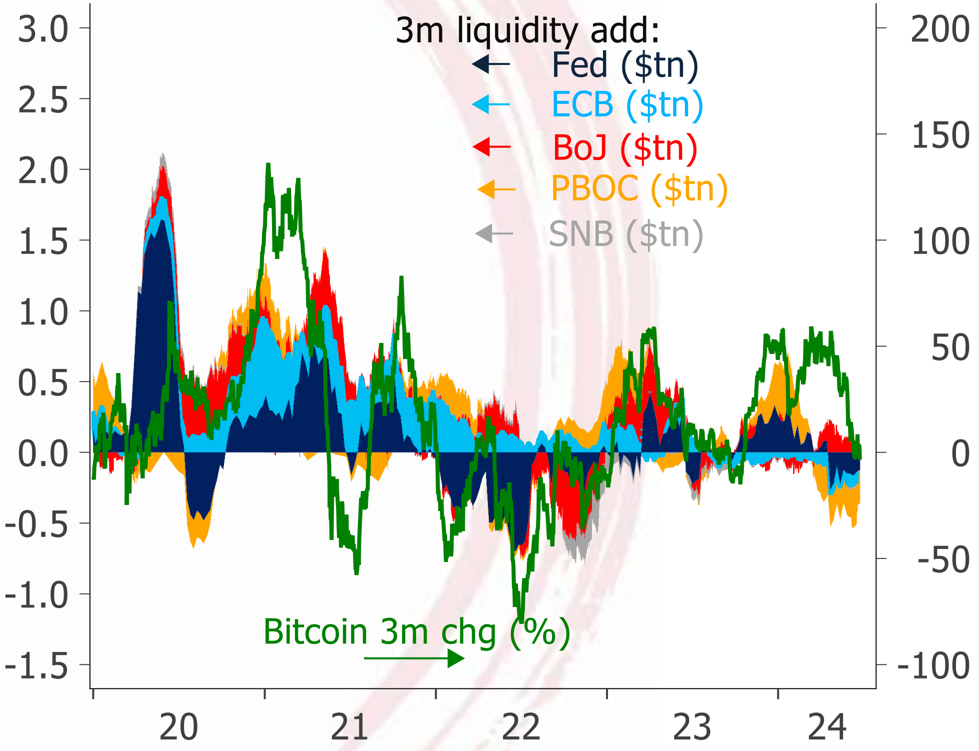
Central bank reserves vs EMBI, rolling 3m chg



Source: national central banks, Bloomberg, Macrobond, Satori Insights.

Even crypto has stopped rallying

CB reserves vs bitcoin, rolling 3m chg



Source: national central banks, Macrobond, Satori Insights. ECB uses securities-govt deposits.

Most assets are weaker because the taps are turned off

Agenda

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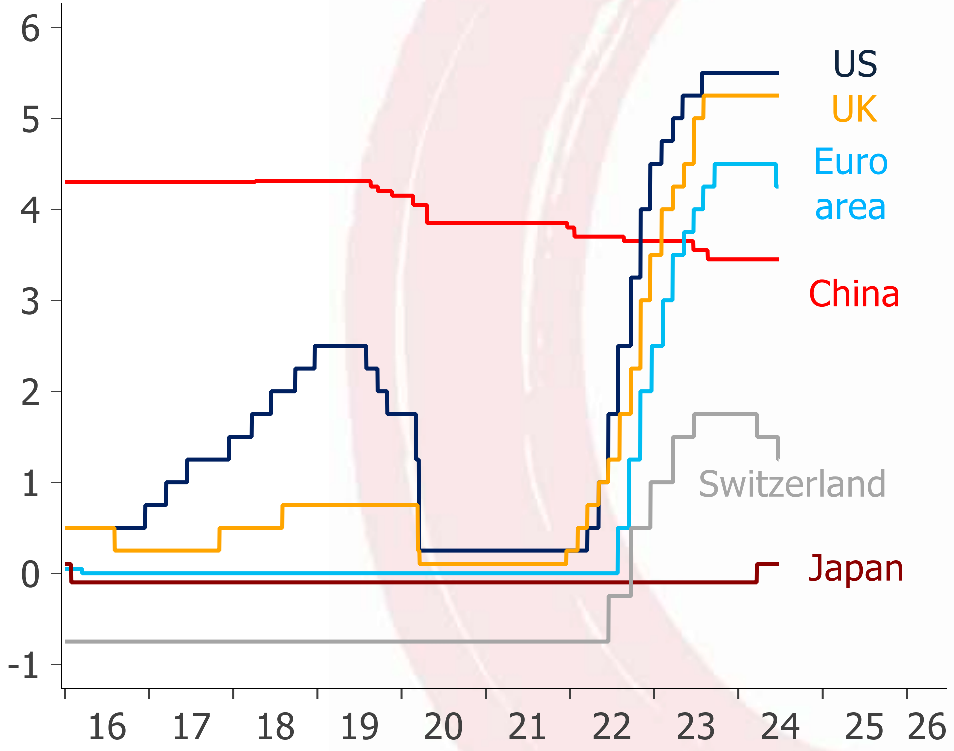
Prospects for H2

Remember what's driving this market

Radically different monetary policy

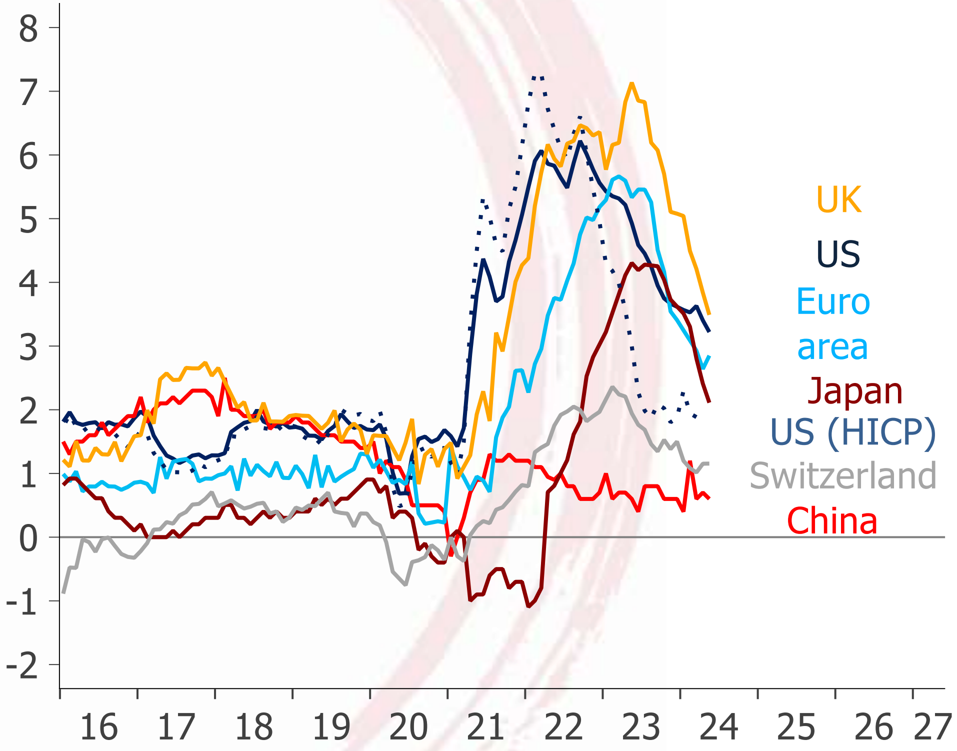
Policy rates, %



Source: PBoC, ECB, BOJ, Fed, BoE, SNB, Macrobond, Satori Insights.

Quite similar inflation dynamics

CPI ex food & energy, % yoy



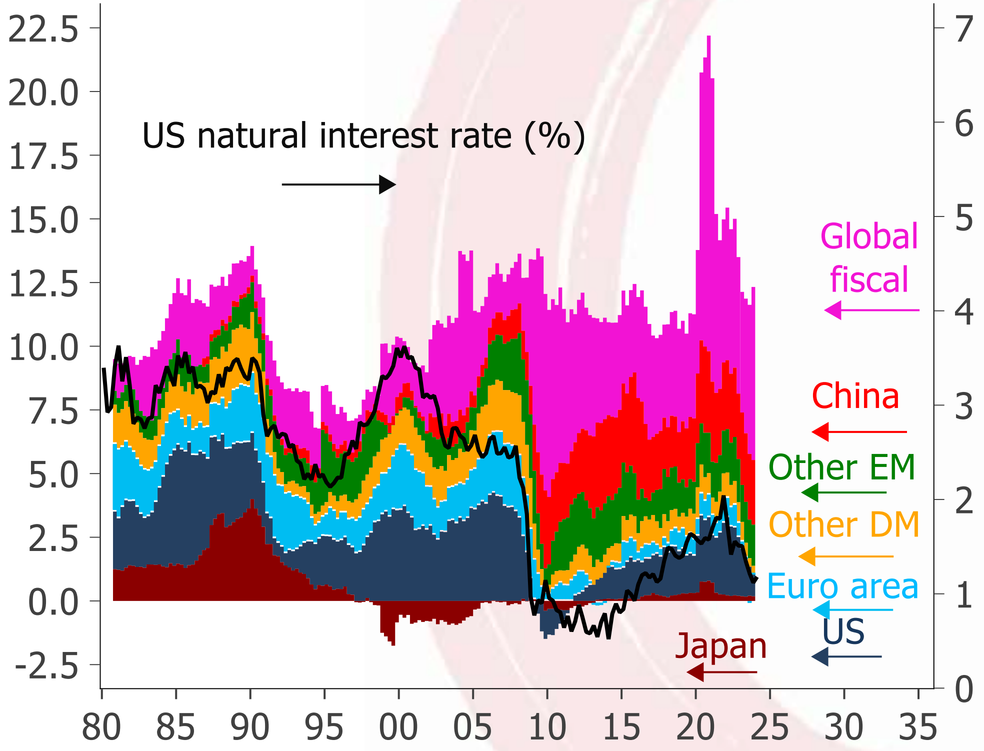
Source: BLS, BEA, PBoC, BoJ, Eurostat, SNB, BoE, Macrobond, Satori Insights.

Inflation and rate moves less significant than often thought

What matters is money creation and rotation

Private credit growth has collapsed

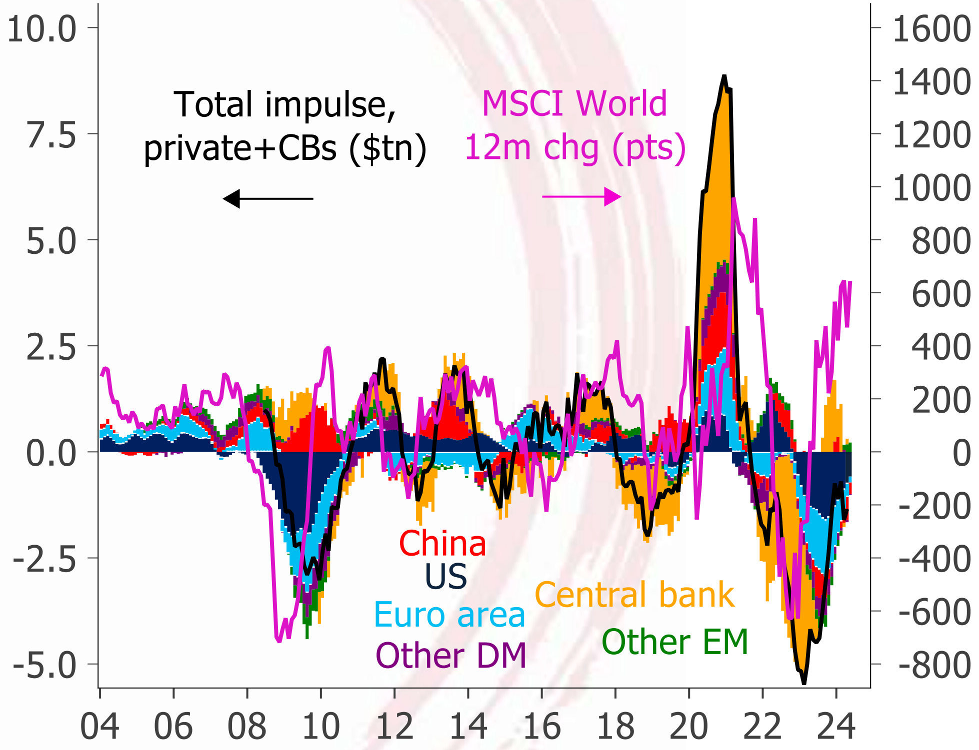
Global private+fiscal credit growth (% global GDP) vs r*



Source: BIS, IMF, Eurostat, MSCI, New York Fed, Fed, Richmond Fed, Satori Insights.
See *When star stands for confusion*, Satori Insights, 4 June.

Money driving markets comes from CBs

12m chg in 12m credit creation (HH+corp) vs equities



Source: national central banks, MSCI, BIS, Macrobond, Satori Insights.

Rate rises haven't mattered because money has come from elsewhere

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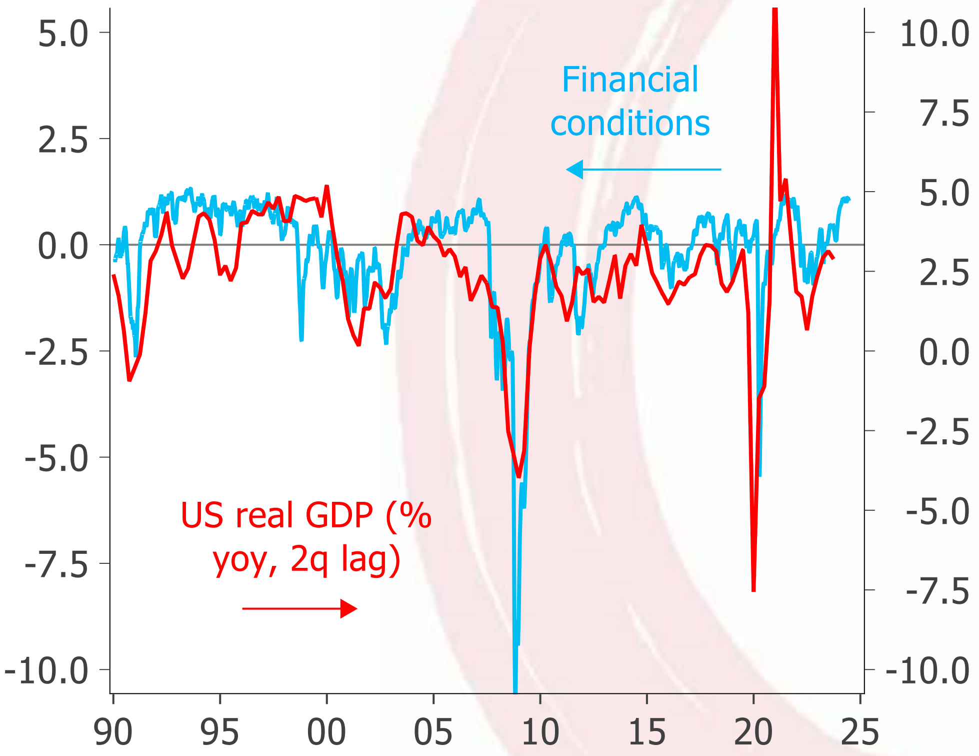
Fundamentals are very much lagging

Financial conditions often lead

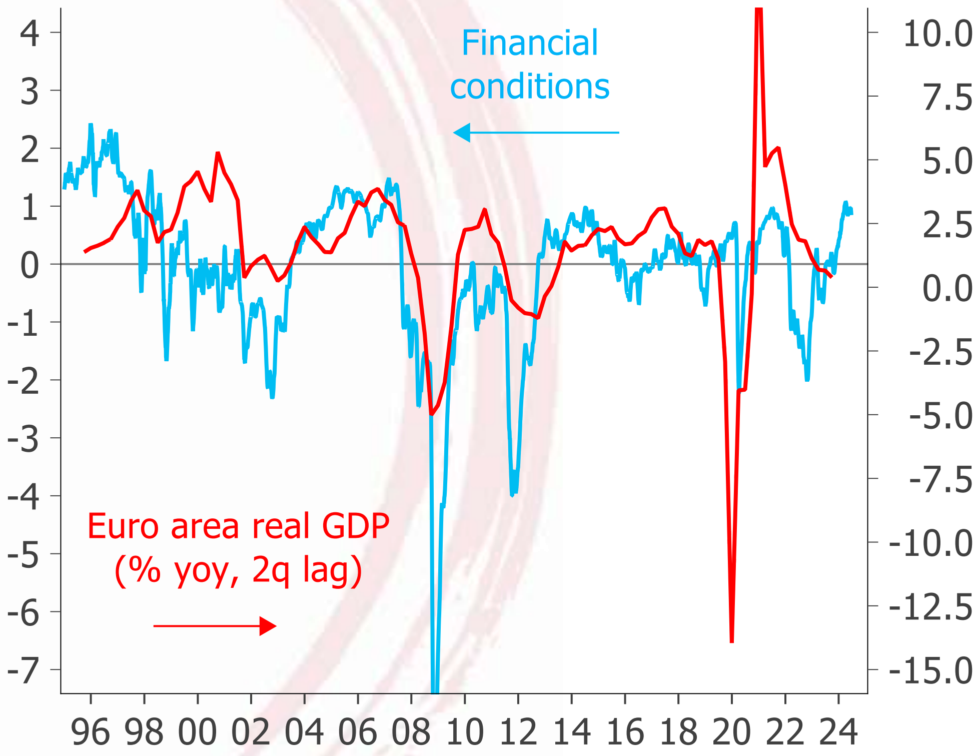
US GDP vs Bloomberg FCI (1m mov avg)



Source: Bloomberg, Macrobond, Satori Insights.

More than anticipating, they drive

Euro area GDP vs Bloomberg FCI (1m mov avg)



Source: Bloomberg, Macrobond, Satori Insights.

By all means look, but don't base the view on them

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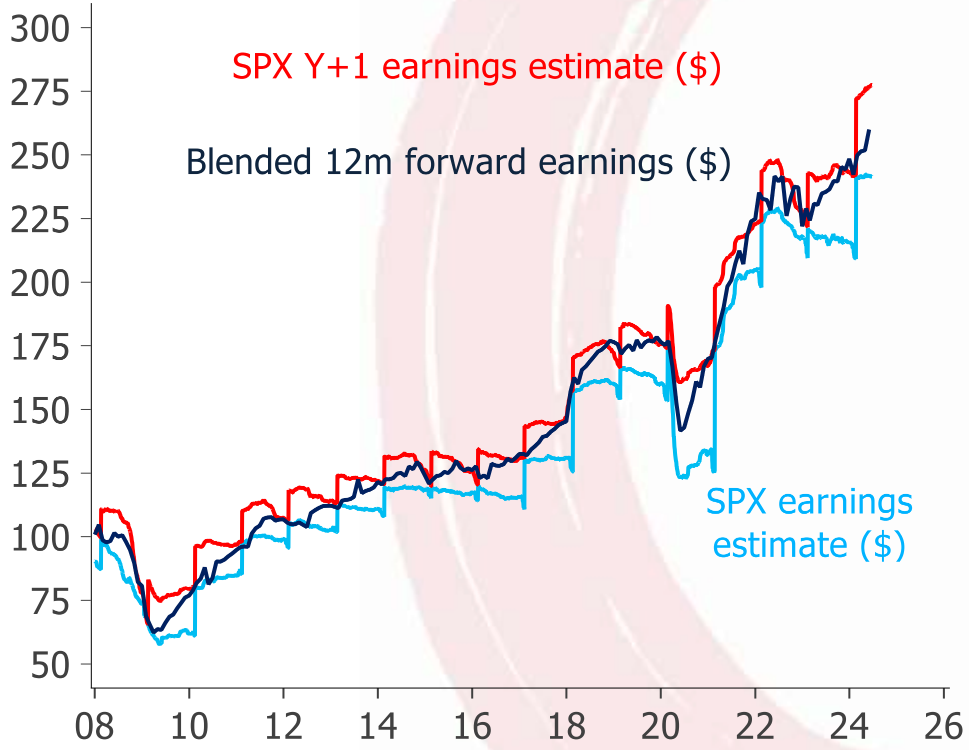
Profits remain particularly strong

Earnings estimates keep improving

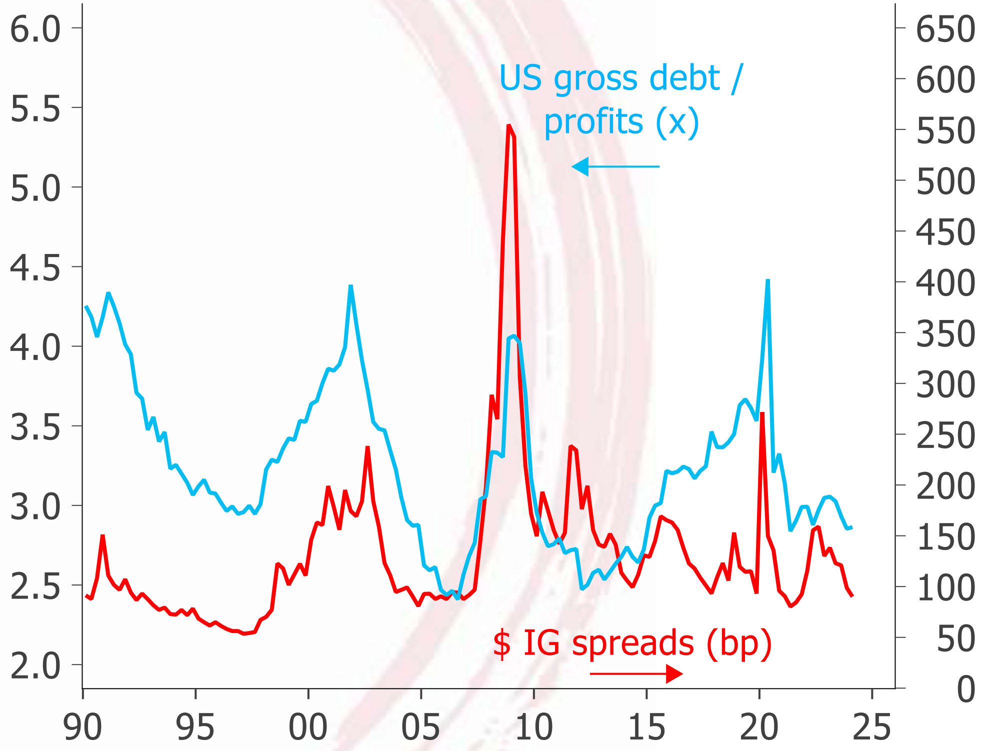
S&P calendar vs blended earnings ($)



Source: Bloomberg, Macrobond, Satori Insights.

Profits still in great shape vs debt

US nonfin corp gross debt/profits vs spreads

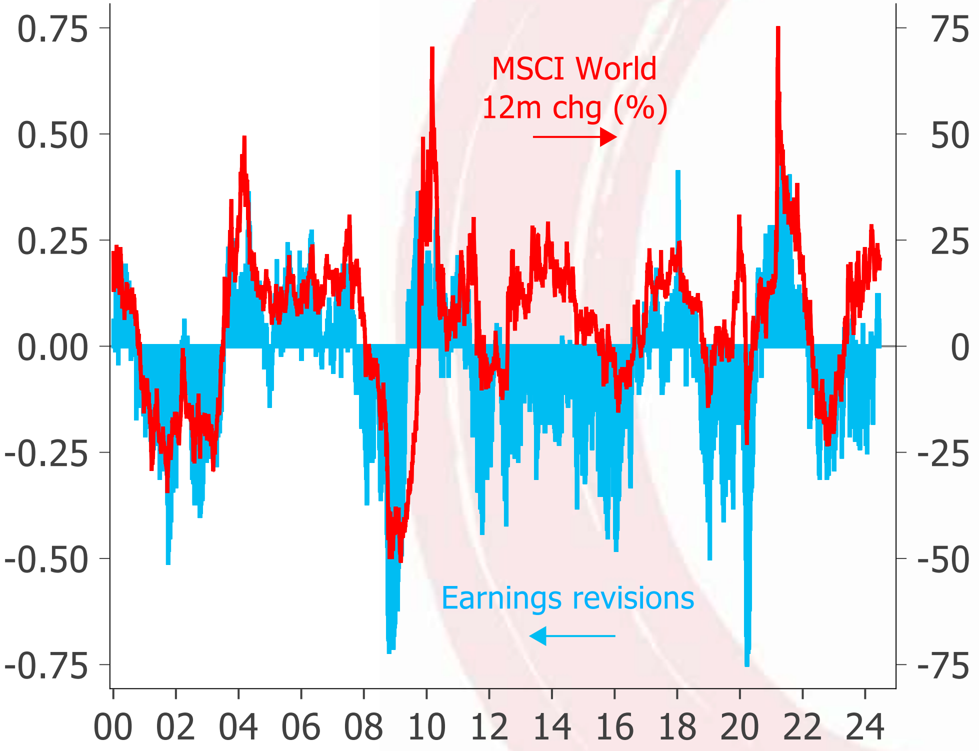


Source: Fed, BEA, TCB, New York Fed, Satori Insights.

There's no obvious problem with fundamentals

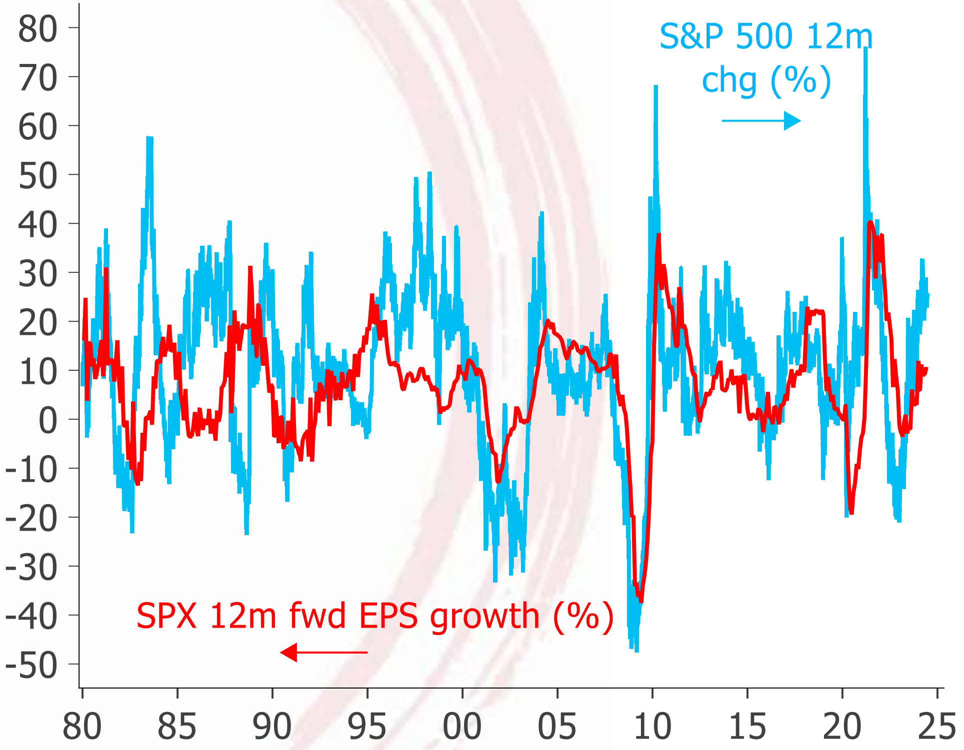
Surely profits optimism helps drive markets higher?

A mismatch, but it has been greater
Global net earnings revisions vs equities



Source: Citi, Bloomberg, MSCI, Satori Insights.

But they're mostly following the market
US consensus earnings growth vs price change, %



Source: S&P, Macrobond, Satori Insights.

At present it's the other way round

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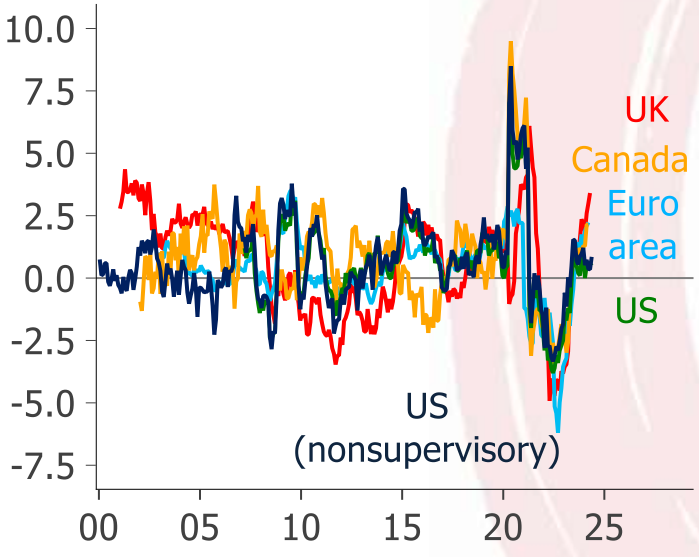
How sustainable are these strong profits?

Real incomes growing again

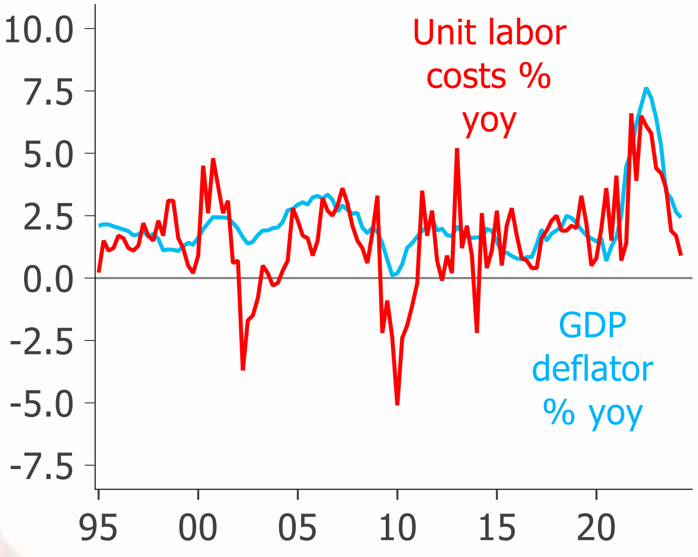
Real wage growth, %



Source: ONS, StatCan, BEA, Eurostat, Macrobond, Satori Insights.

US margins well protected

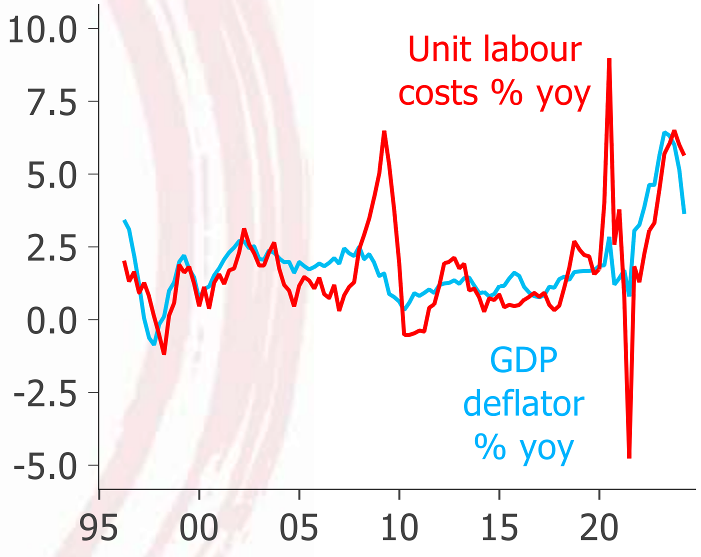
US profit margin proxy



Source: BEA, BLS, Satori Insights.
Margins proxied by gap between output prices and labour costs.

Euro area margins less so

Euro area profit margin proxy



Source: ECB, Eurostat, Satori Insights.
Margins proxied by gap between output prices and labour costs.

Little sign of margin pressure to date

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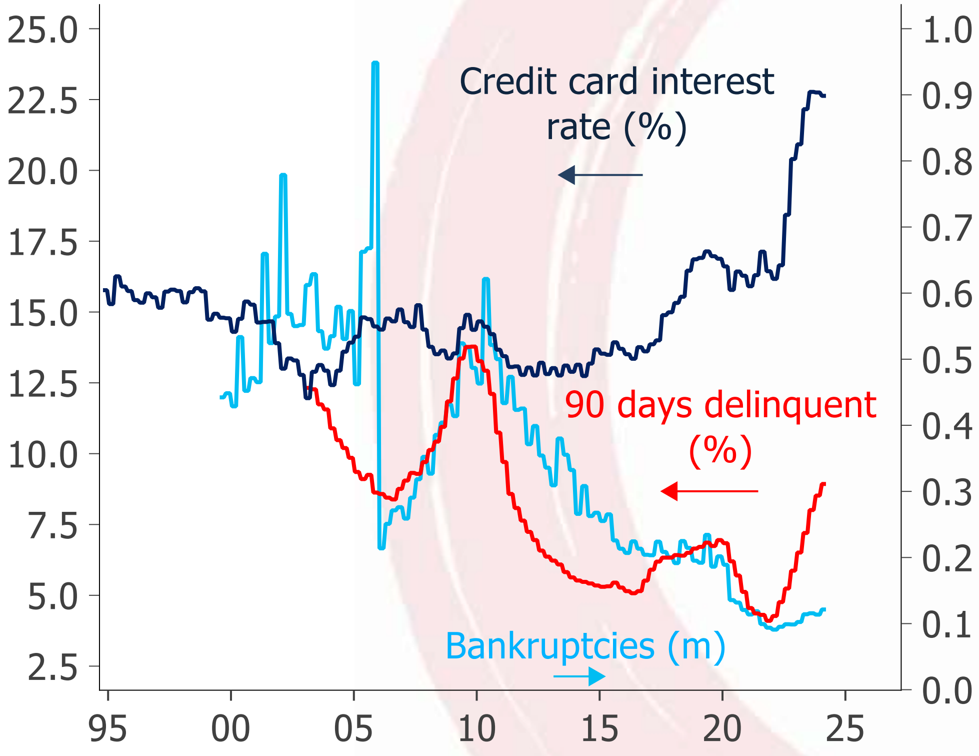
Credit problems still lurk in the background

Higher rates take time to bite

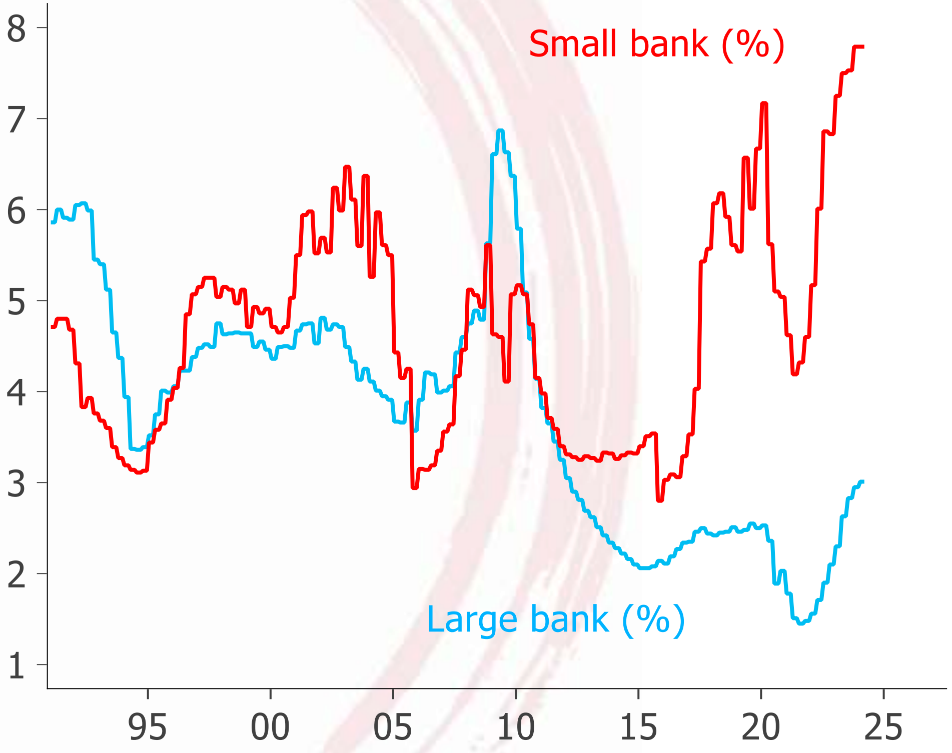
US credit card rates & delinquencies vs bankruptcies



Source: Fed, New York Fed, FDIC, BEA, ABI, U.S. Federal Courts, ISED, Eurostat, Satori Insights.

The source of small bank woes?

US credit card delinquencies by bank size (% outstanding)



Source: FDIC, Macrobond, Satori Insights.

Even credit problems are largely slow-burning and non-systemic

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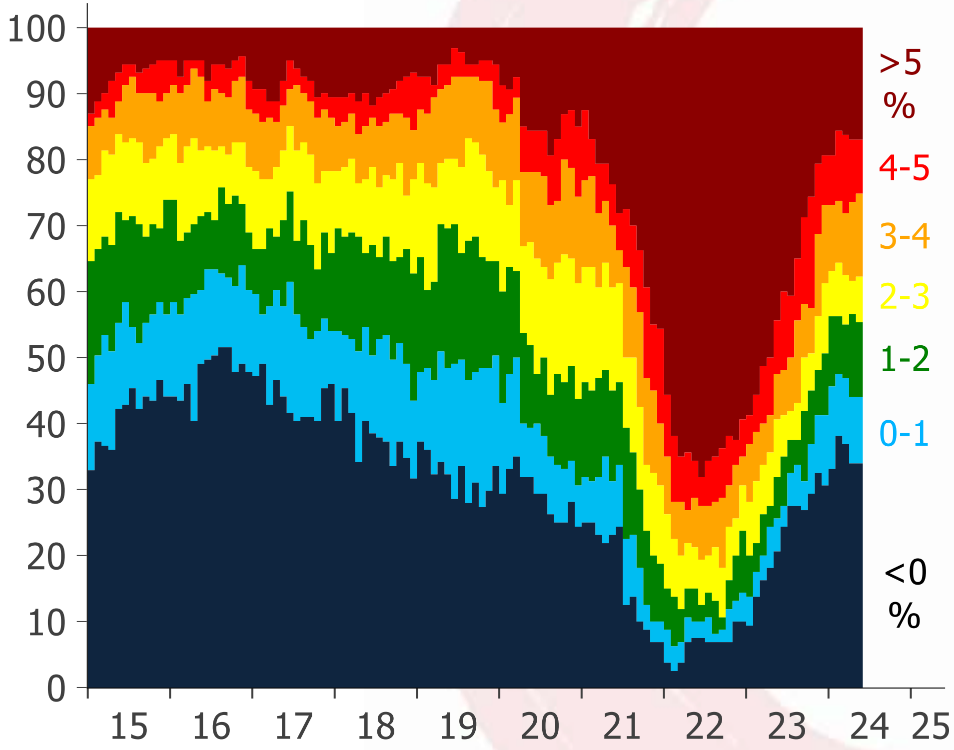
Central banks are returning to easing

Just a few sticky items remaining

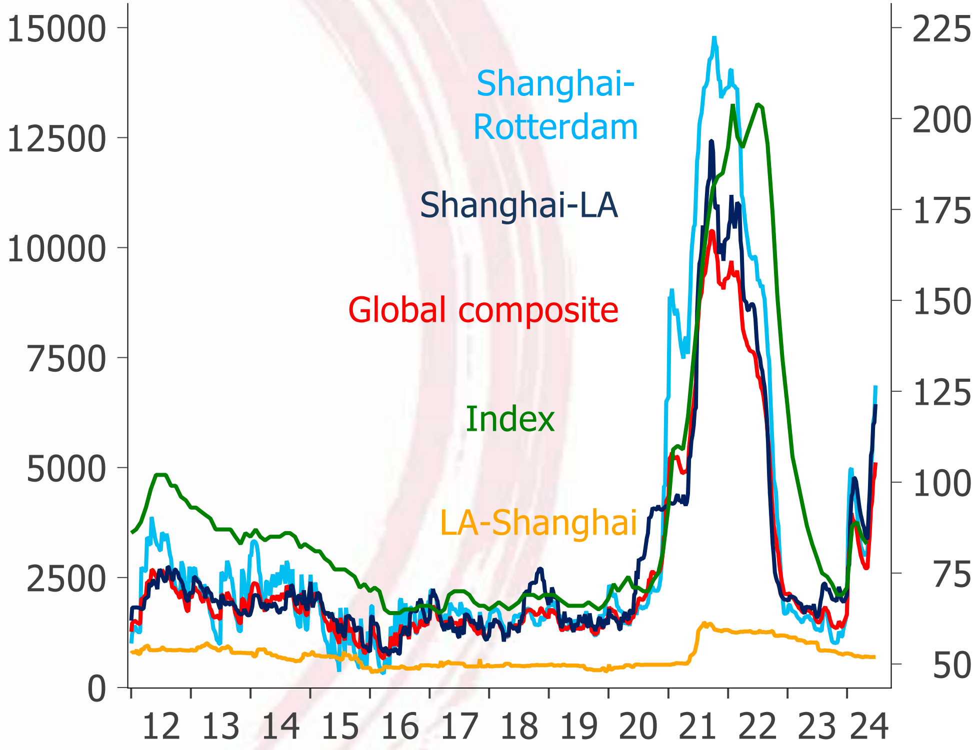
Distribution of price changes on US CPI items, % basket



Source: BLS, Macrobond, Satori Insights.

Not again!

Freight shipping rates and indices



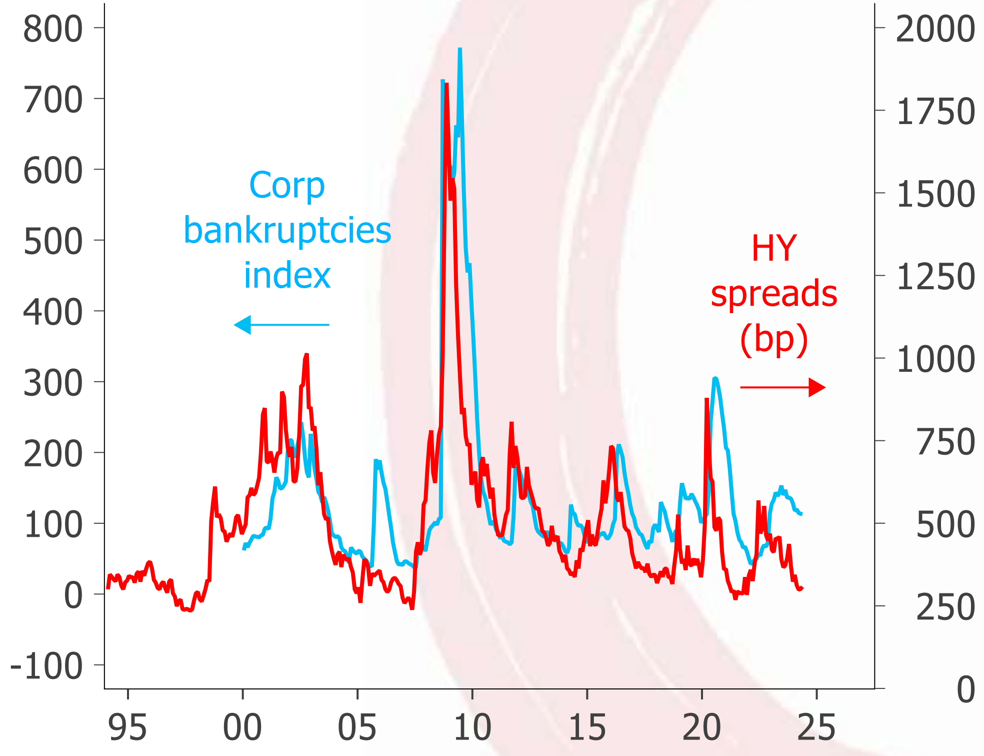
Source: Ports of Long Beach and Los Angeles, Container Trades Statistics, Satori Insights.

Though lingering stickiness may constrain rapid cuts

The real problem lies with valuations

Defaults up, spreads down

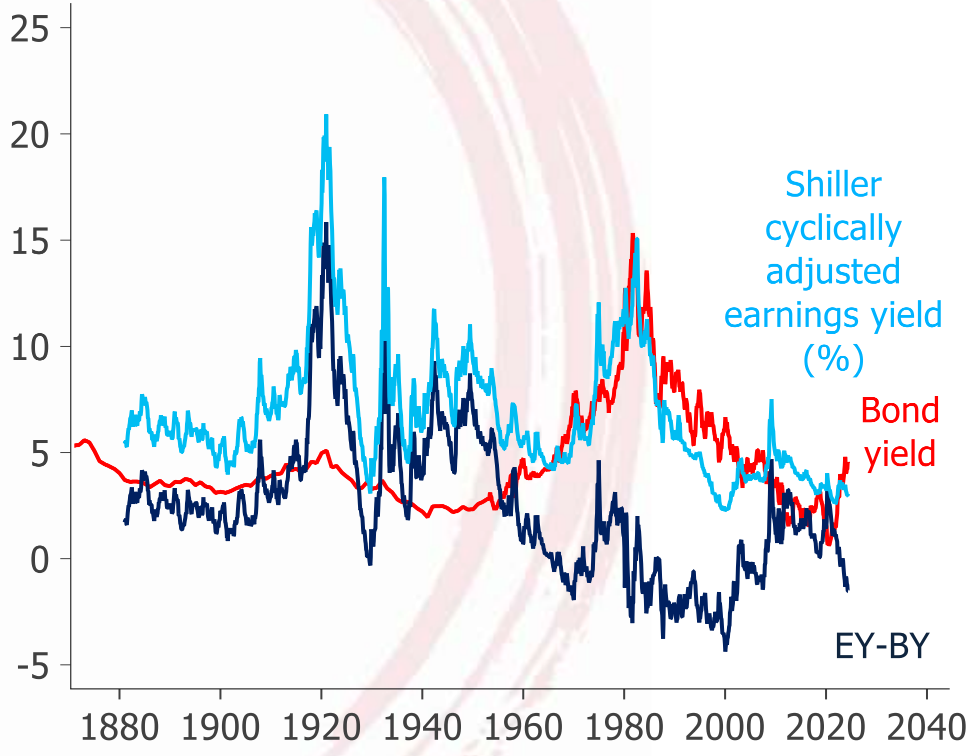
Bloomberg US bankruptcy index vs spreads



Source: Bloomberg, Satori Insights.

Record multiples on record earnings

US earnings yield (1/CAPE) vs bond yields, %



Source: Robert Shiller, S&P Global, BLS, U.S. Treasury, BEA, BIS, Fed, Macrobond, Satori Insights.

Fundamentals are good –
but markets are priced to perfection

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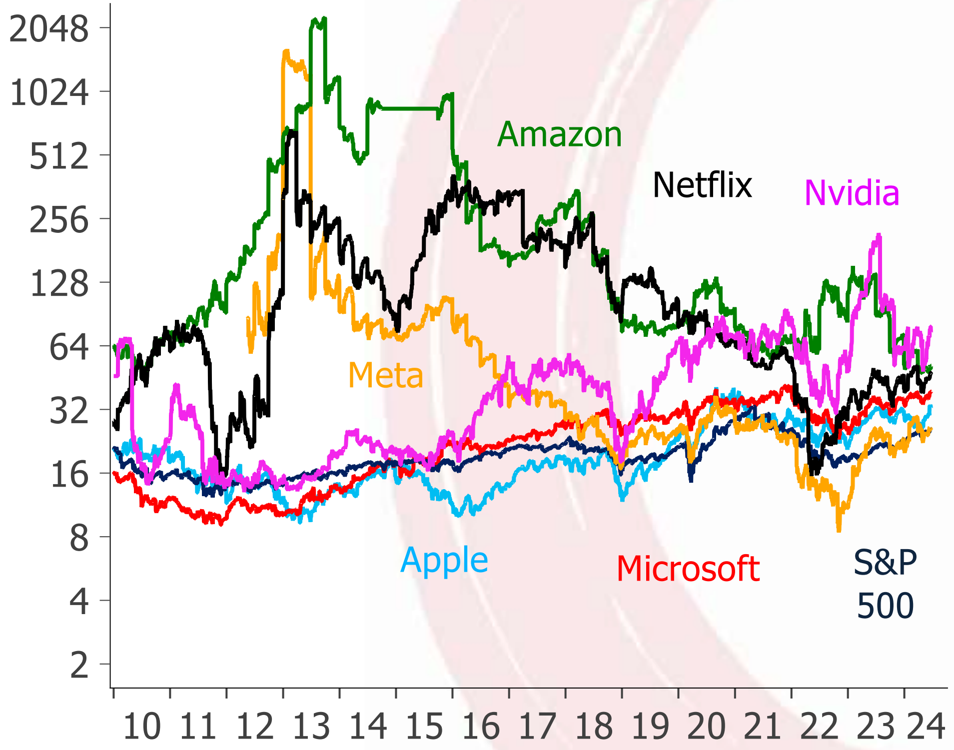
Valuations are always a long-term factor

We've seen crazier

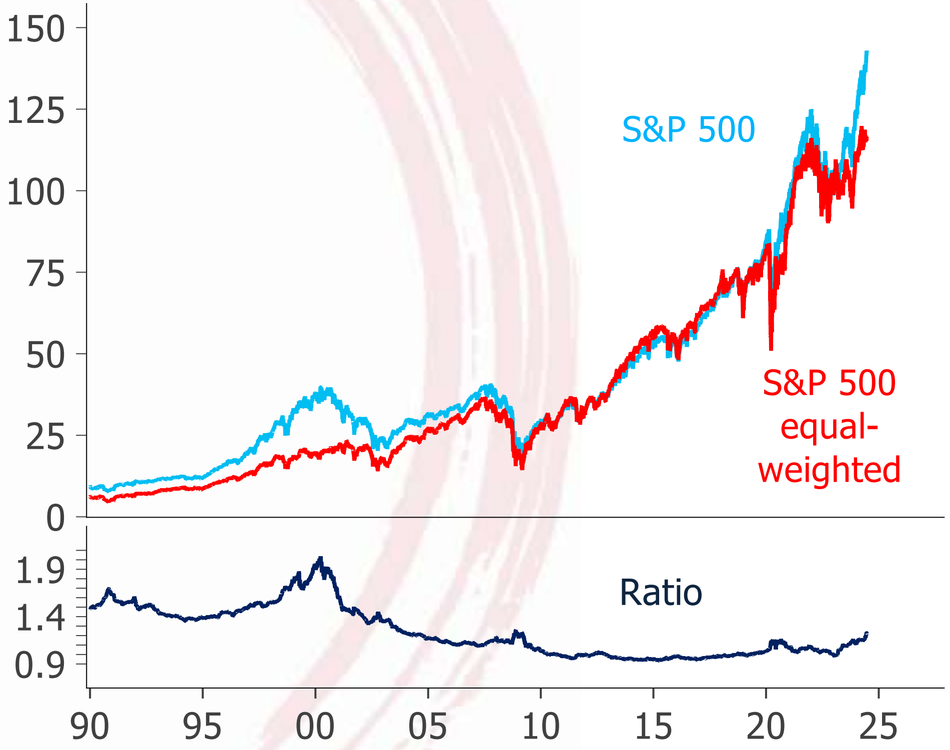
Price-to-forward-earnings ratios, log scale



Source: Bloomberg, Satori Insights.

Such concentration has precedent

US stock, indices, Jan23=100



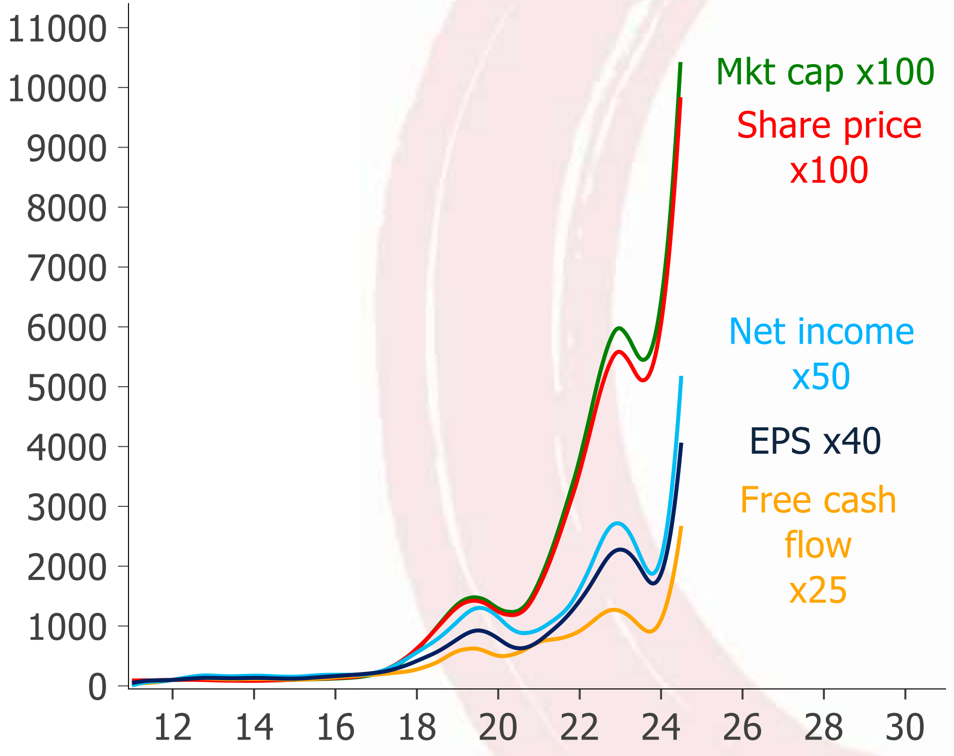
Source: Bloomberg, Macrobond, Satori Insights.

What's extreme can easily become more so

What to make of tech itself?

At least Nvidia's FCF has grown sharply

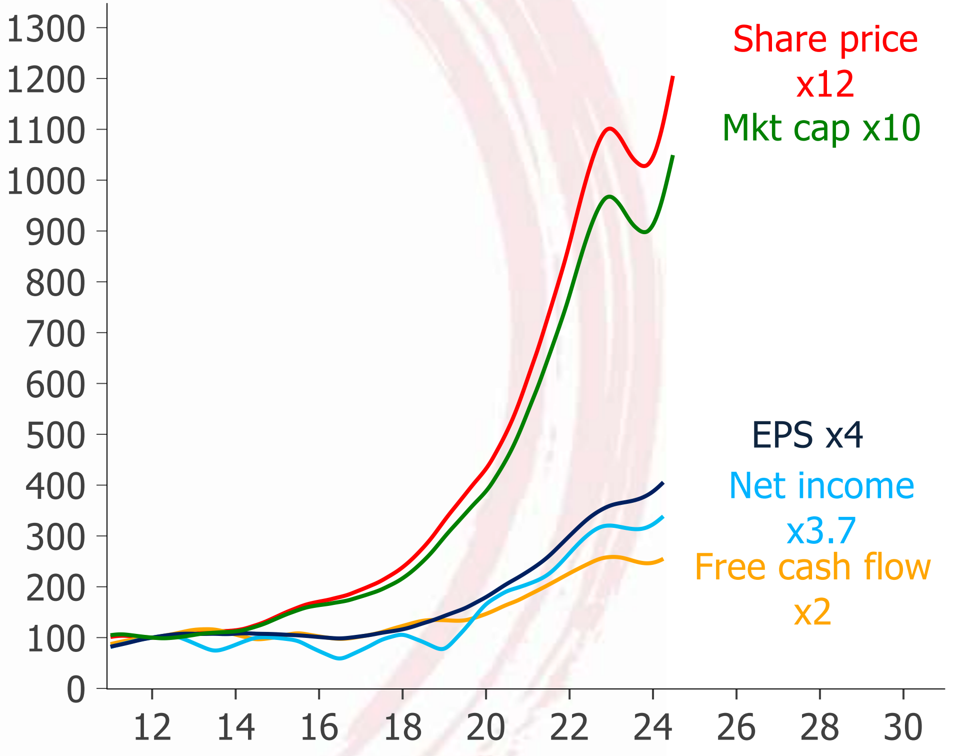
Nvidia profit metrics, indices, 2011=100, 1y mov avg



Source: Bloomberg, Satori Insights.

Pattern elsewhere is less persuasive

Microsoft profit metrics, indices, 2011=100



Source: Bloomberg, Satori Insights.

Fundamental enthusiasm outstripped by scale of rally

Agenda

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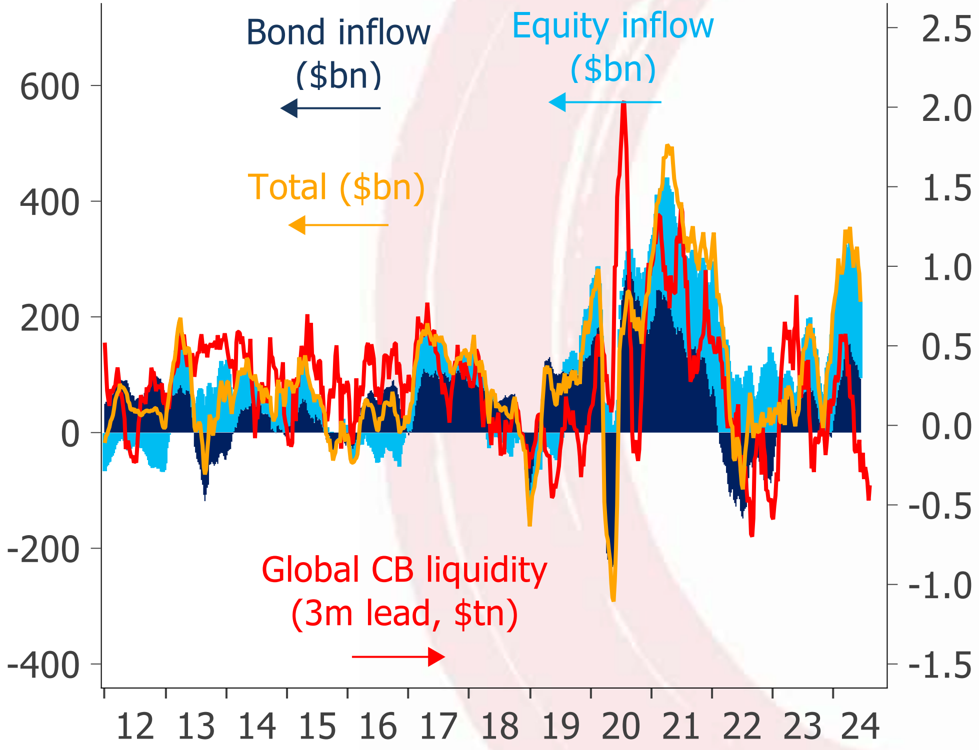
The real reason risk assets are faltering

Did central banks just pull the plug?

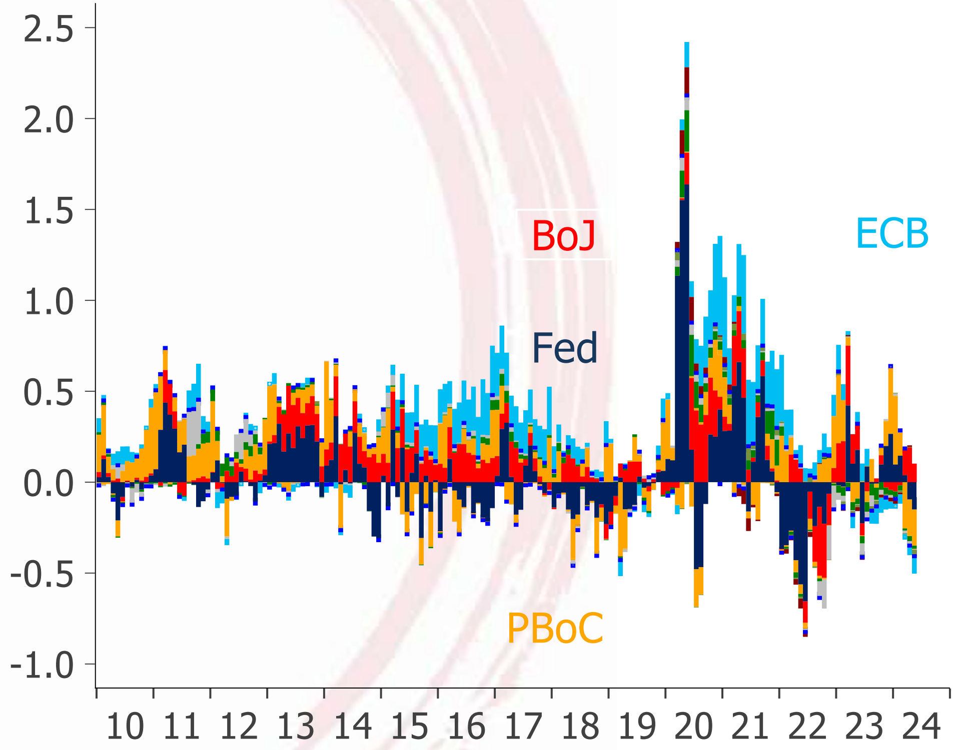
Global reserves chg vs mutual fund+ETF flow, rolling 3m



Source: national central banks, ICI, Macrobond, Satori Insights.

Finally remembering how to tighten

Global central bank reserves chg, rolling 3m, $tn



Source: national central banks, Satori Insights. ECB uses securities-govt deposits.

The flows driving them all but stopped

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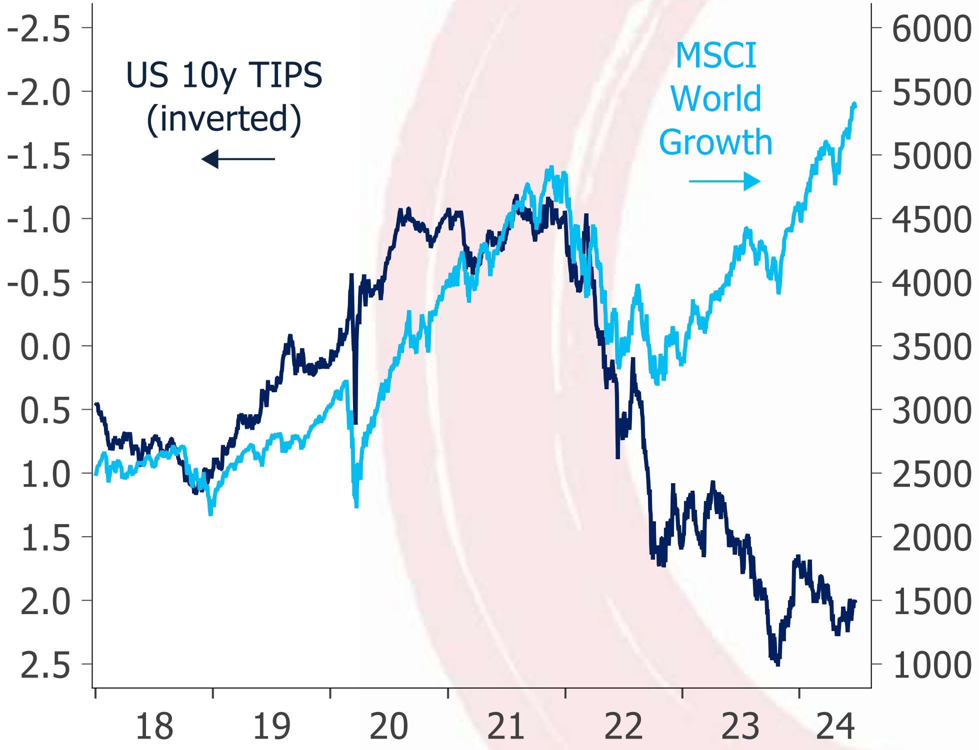
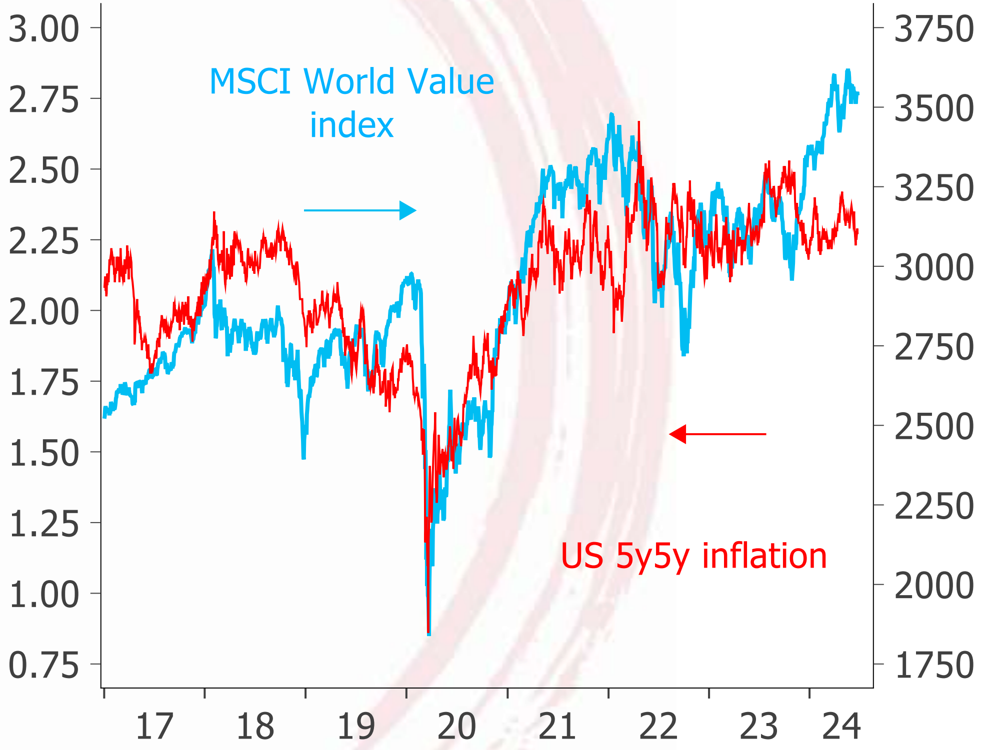
It’s not obvious rate cuts will come to the rescue

So much for real yields driving Growth
Equities vs TIPS



Source: MSCI, Federal Reserve, Macrobond, Satori Insights.

Value more than broke even
Equities vs UST inflation breakevens (%)



Source: Federal Reserve, Macrobond, MSCI, Satori Insights.

Rates never drove this rally in the first place

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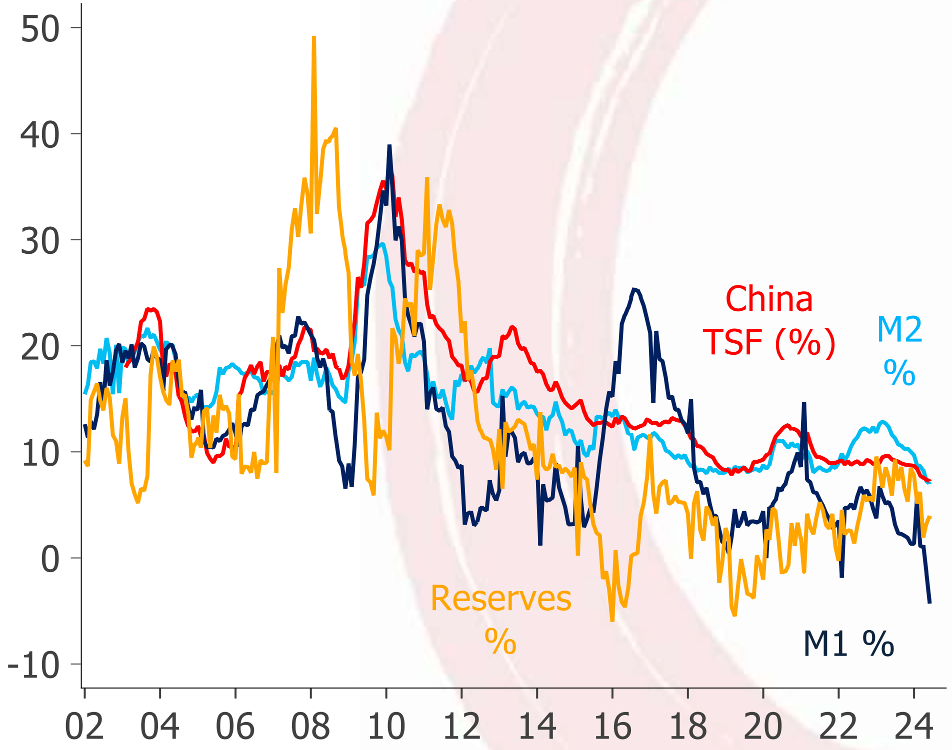
China currently acting as the largest drag

Never mind rates - watch credit growth

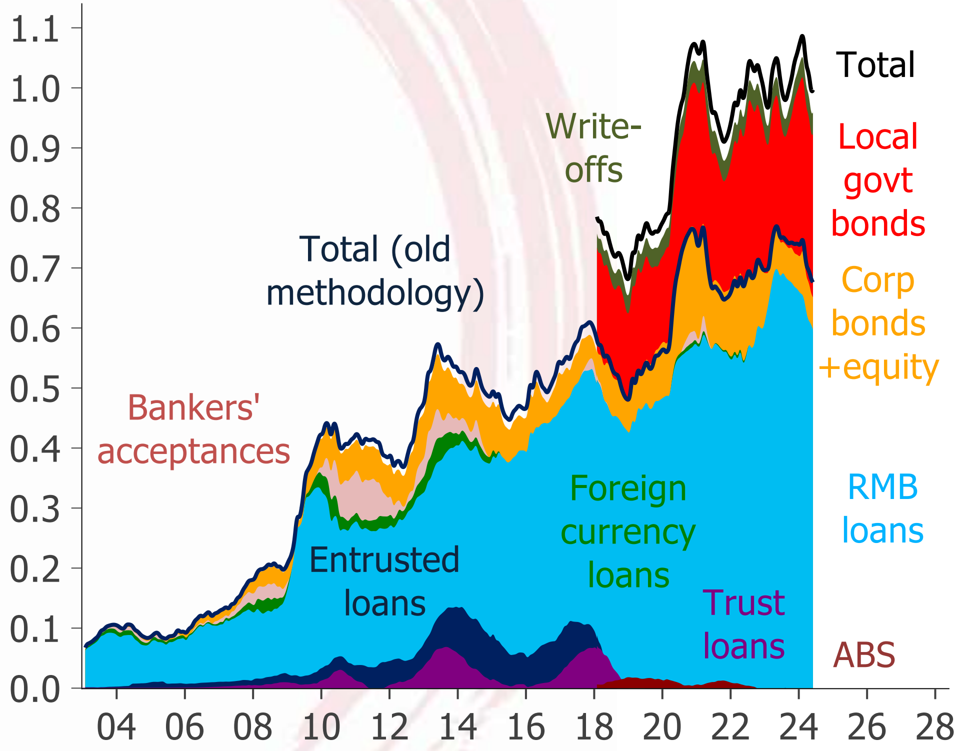
China credit growth metrics, % yoy



Source: PBoC, Macrobond, Satori Insights.

Totally State Financed

China total social financing, rolling 12m sum, RMBqn



Source: PBoC, Macrobond, Satori Insights.

No sign of reacceleration in narrow or broad credit

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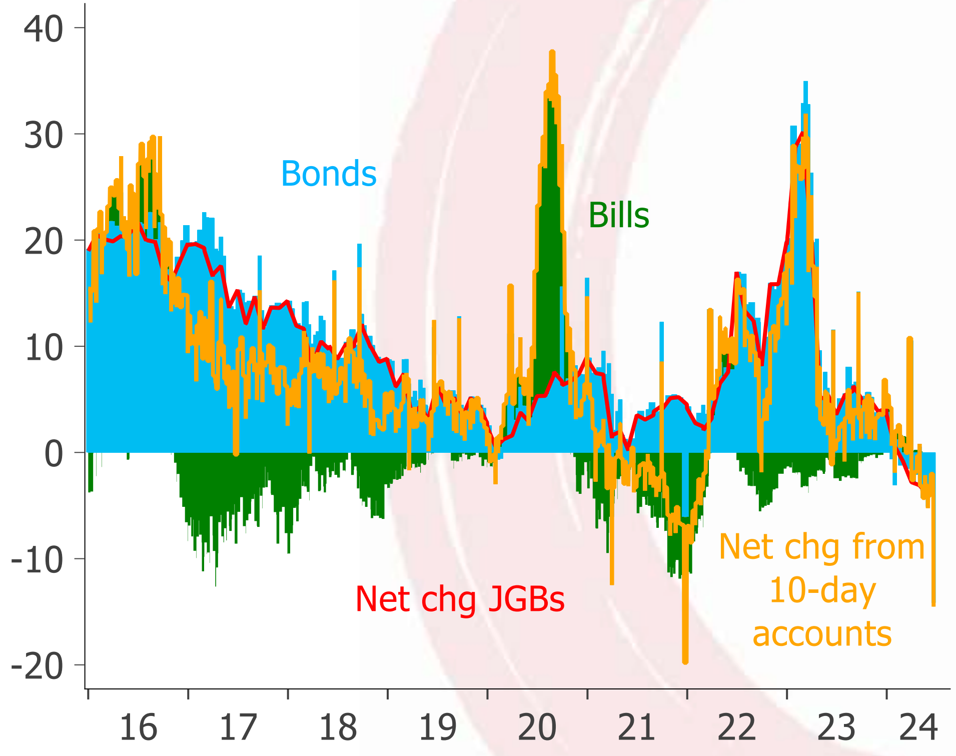
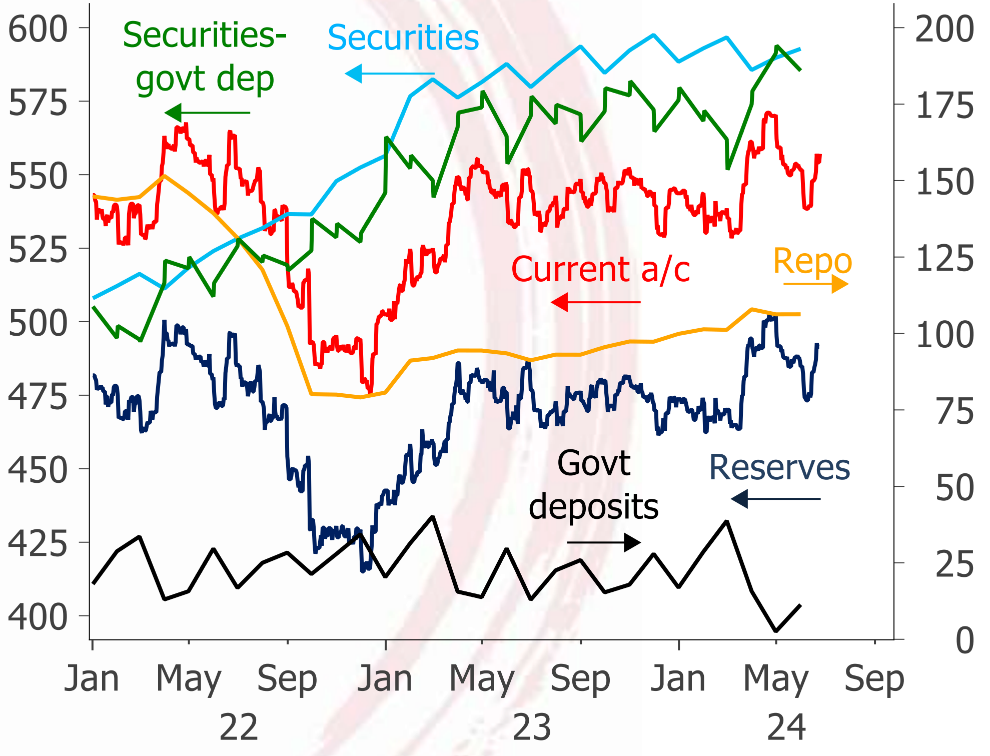
BoJ had been last lingering source of global liquidity

JGB purchases declining anyway
Net chg BoJ securities holdings, rolling 3m, ¥tn



Source: BoJ, Macrobond, Satori Insights.

Reserves boost from govt dep, not JGBs
BoJ balance sheet items, ¥tn



Source: BoJ, Macrobond, Satori Insights.

Slow shift to tightening makes this unlikely to be repeated

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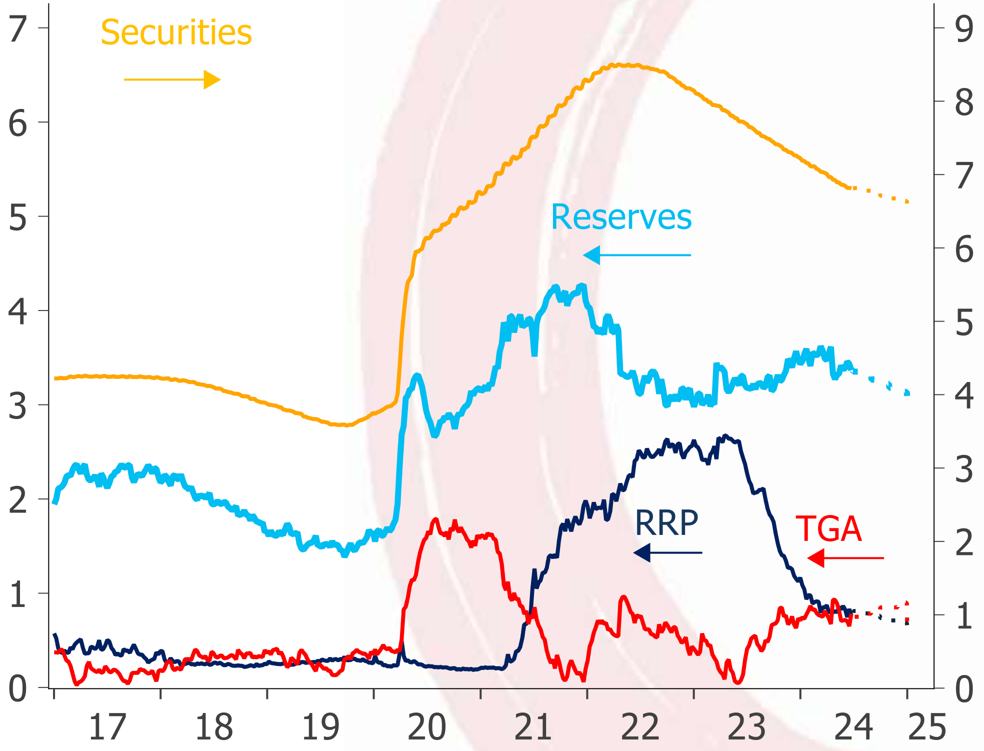
Fed remains the greatest source of uncertainty

ΔReserves ≈ ΔSecurities - ΔRRP - ΔTGA

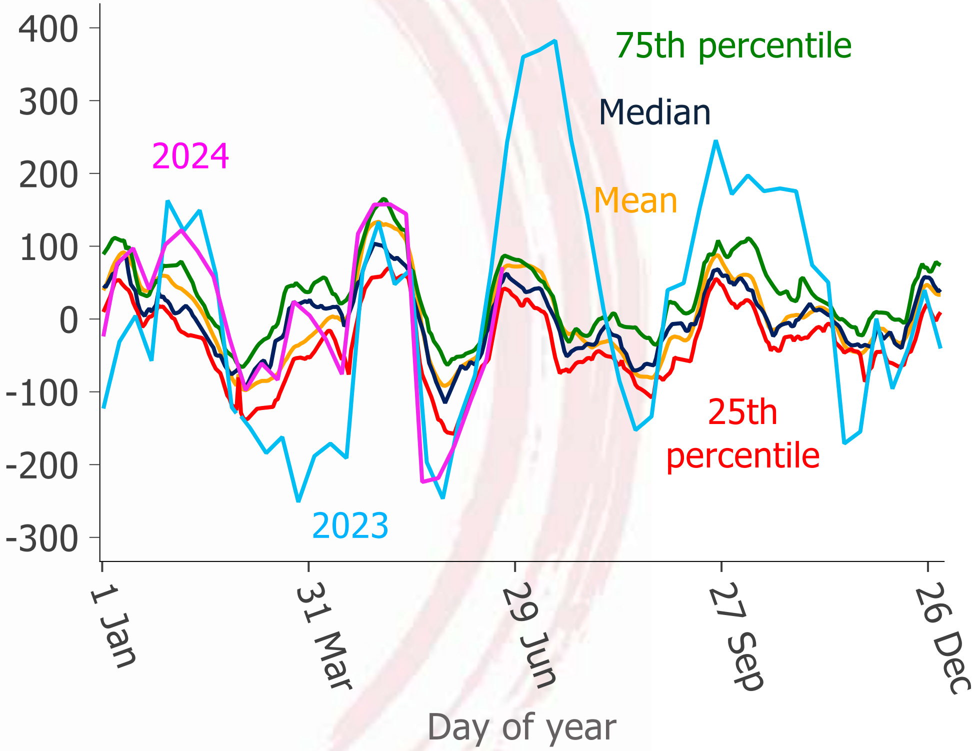
Fed balance sheet items with projections, $tn



Source: Federal Reserve, Macrobond, Satori Insights.

TGA seasonals to turn favourable again

Treasury General Account seasonals, 4-wk chg, 2010-



Source: US Treasury, Macrobond, Satori Insights.

RRP trajectory more important than QT taper

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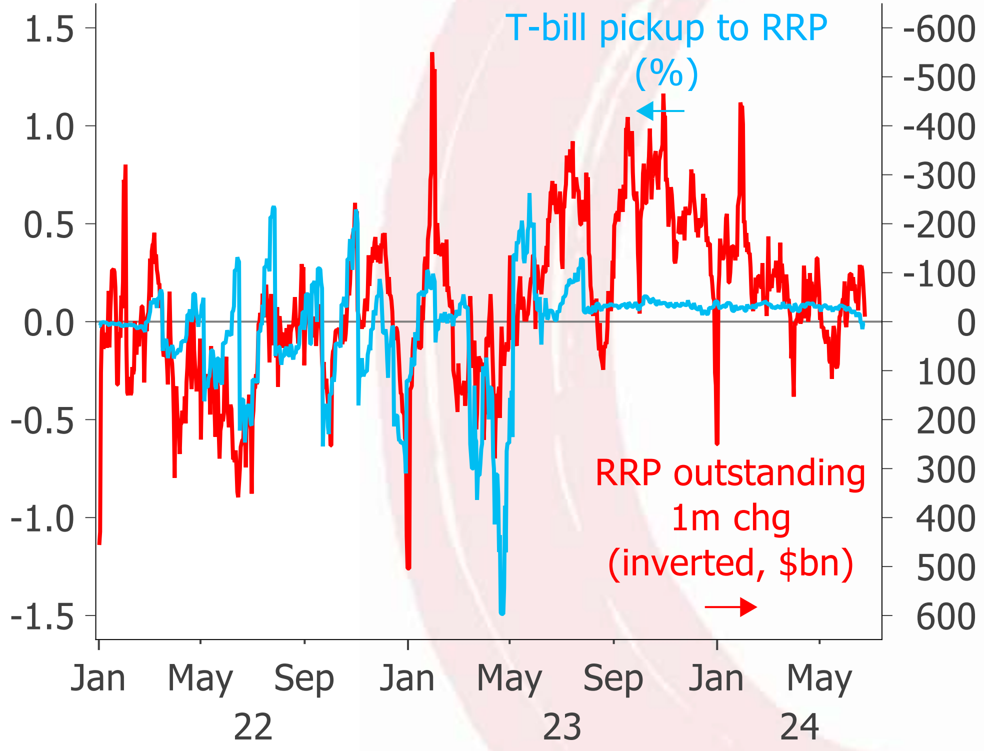
How likely is RRP decline?

T-bills no longer pay better

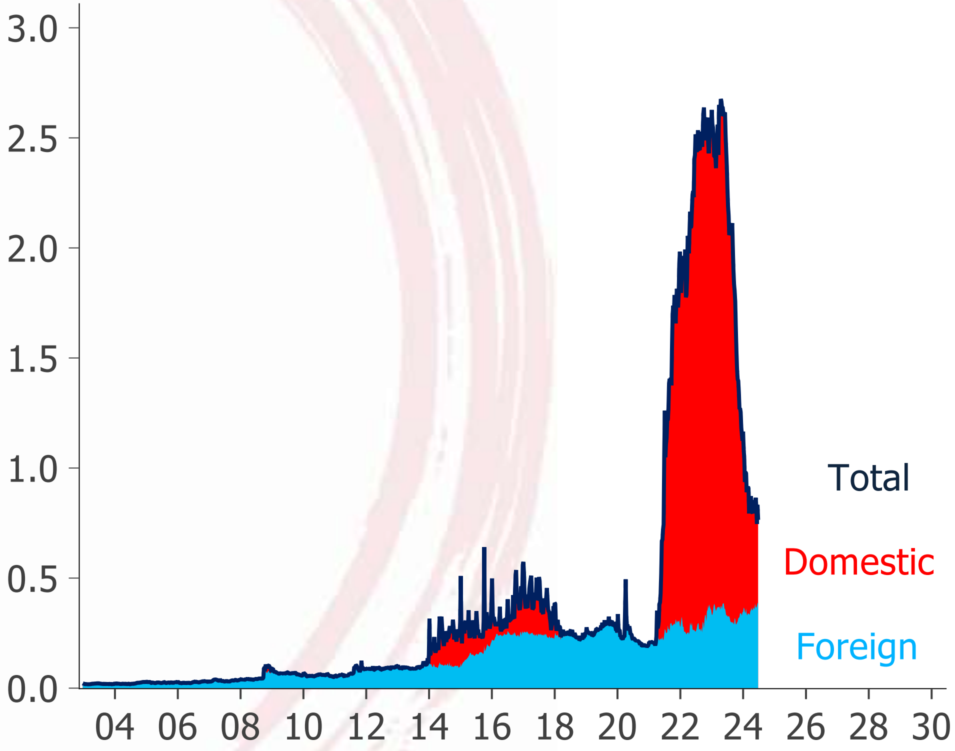
1m Tbill pickup to RRP vs RRP balance



Source: Bloomberg, Federal Reserve, Satori Insights.

Foreign RRP has grown steadily

Fed RRP usage by depositor type, $tn



Source: Federal Reserve, Satori Insights.

RRP likely to become stickier from here – putting downward pressure on reserves

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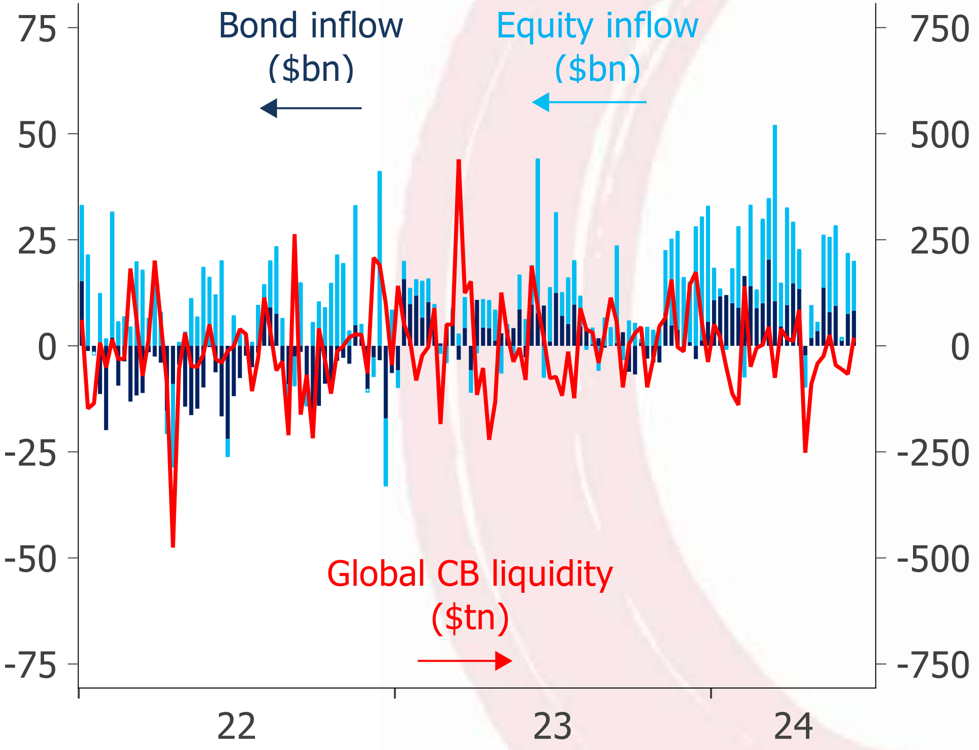
The most likely bull case is momentum continuing anyway

Can the inflows continue anyway?

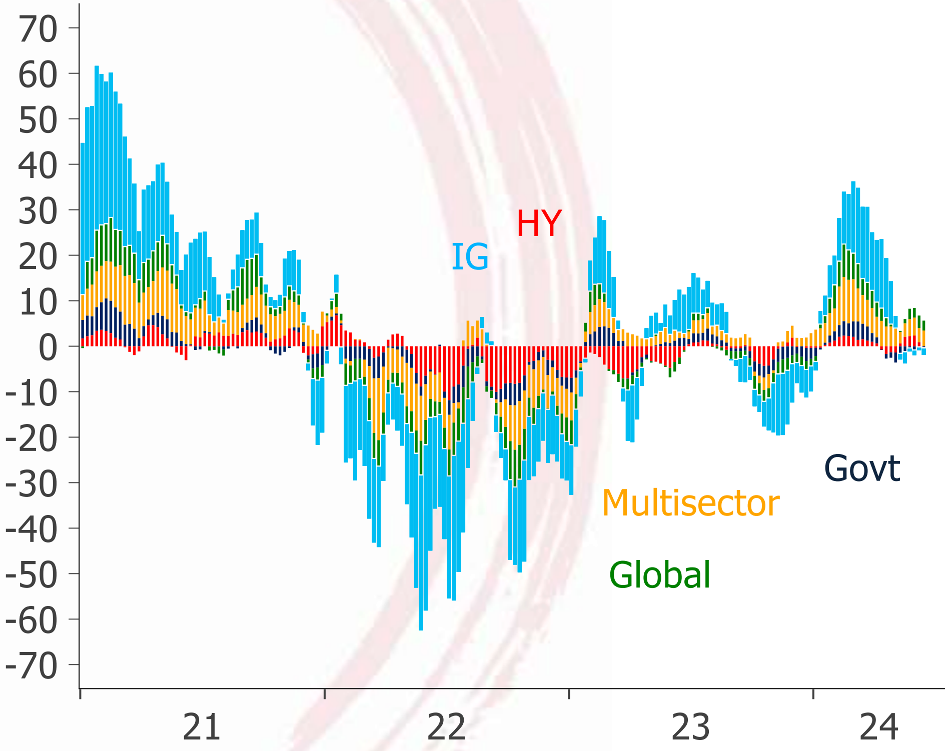
Global reserves chg vs mutual fund+ETF flow, rolling 1w



Source: national central banks, ICI, Satori Insights.

Credit inflows have largely dried up

Mutual funds only, rolling 1m, $bn



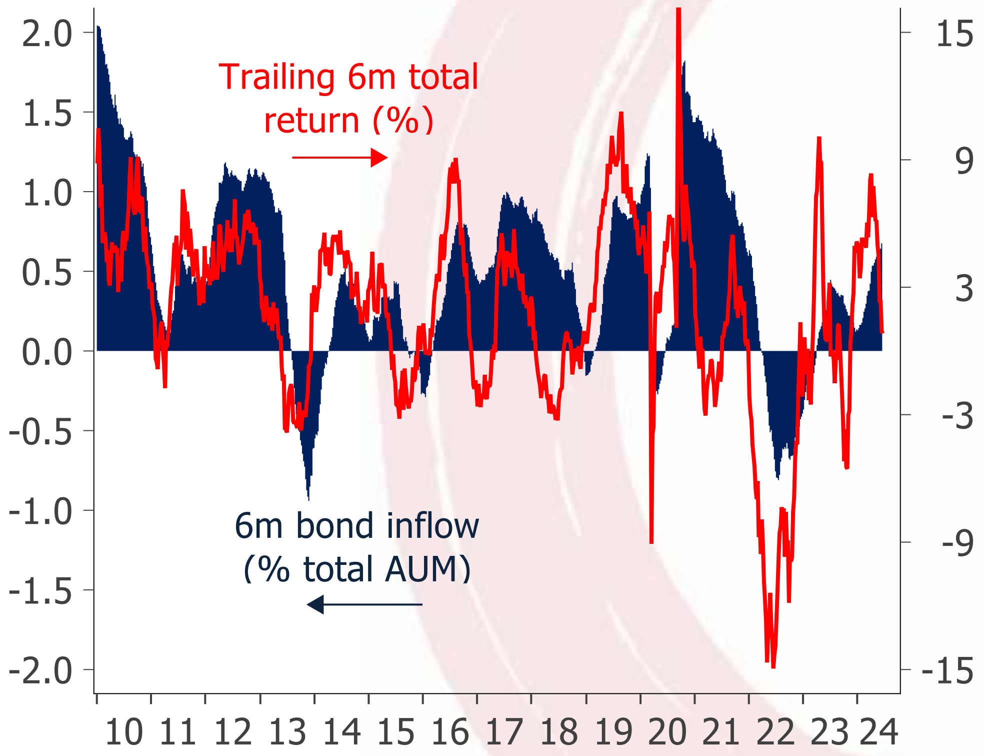
Source: ICI, CBOE, Satori Insights.

Plausible but becoming less likely

To some extent people always chase the price action

Chasing returns rather than yields

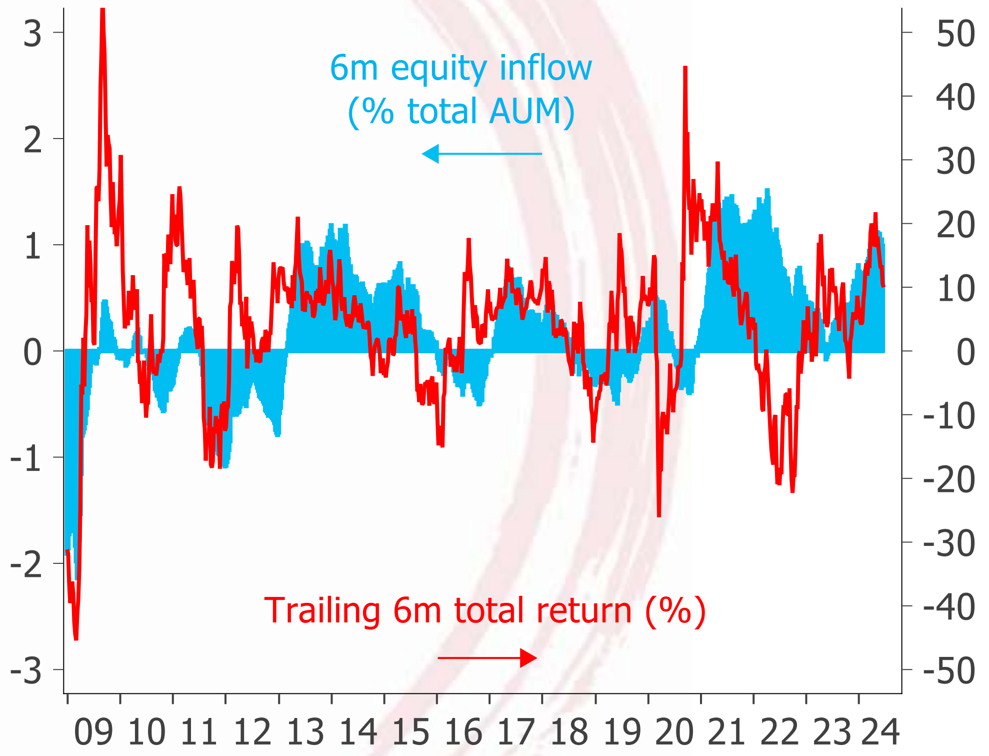
Mutual fund+ETF inflow, total bonds, rolling 6m



Source: ICI, Bloomberg, Satori Insights.

Momentum chasing

Mutual fund+ETF inflow, total equities, rolling 6m



Source: ICI, Bloomberg, Satori Insights.

Faltering in returns would probably lead faltering in fund flows

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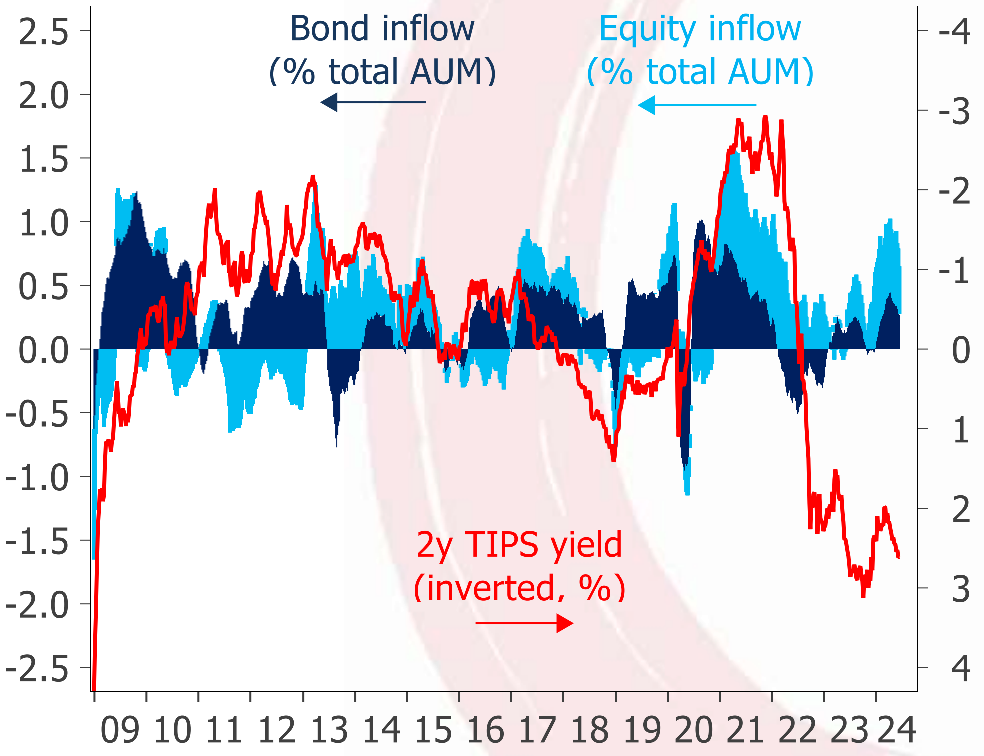
Won’t rate cuts help fund flows?

These rates usually drive outflows

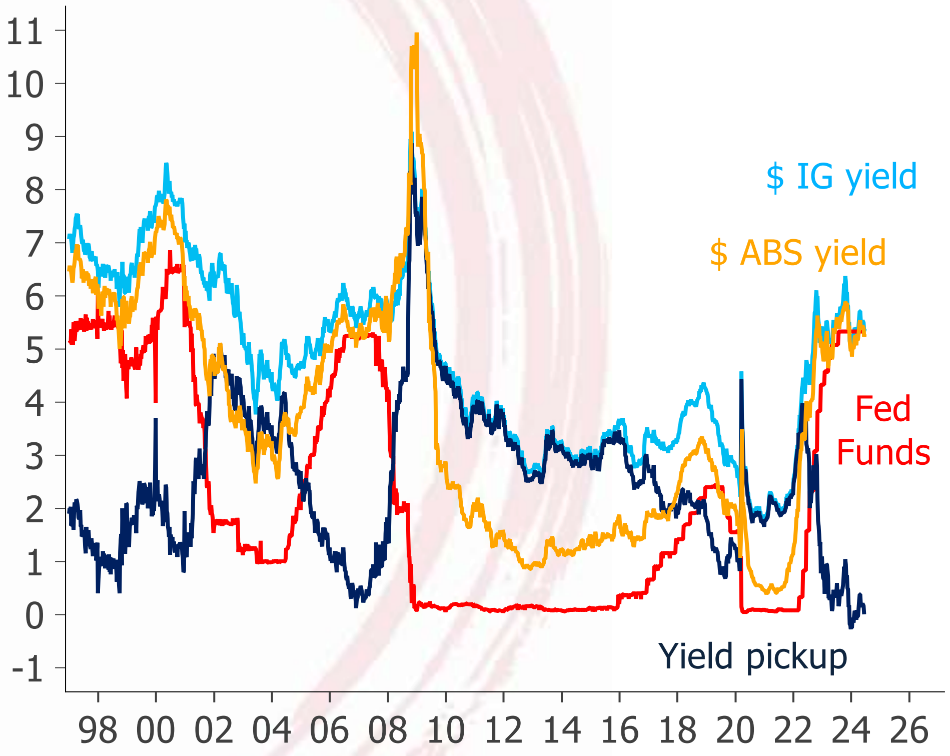
Mutual fund+ETF flows, rolling 3m, vs US real yields



Source: ICI, Fed, Satori Insights.
See *The asymmetric Fed*, Satori Insights, 9 May.

Credit yield pickup at record lows

US investment grade yield vs cash, %



Source: ICI, Federal Reserve, Macrobond, Satori Insights, Bloomberg.

Main benefit is not the rate but the idea of the put

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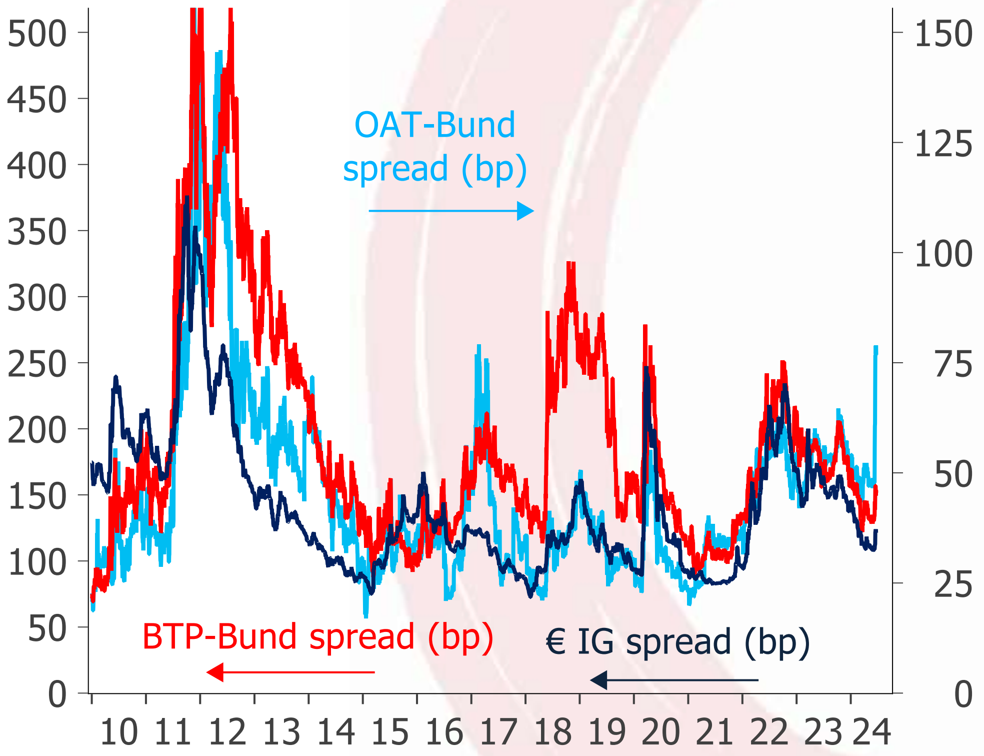
Stand by for election uncertainty

This effect may yet broaden

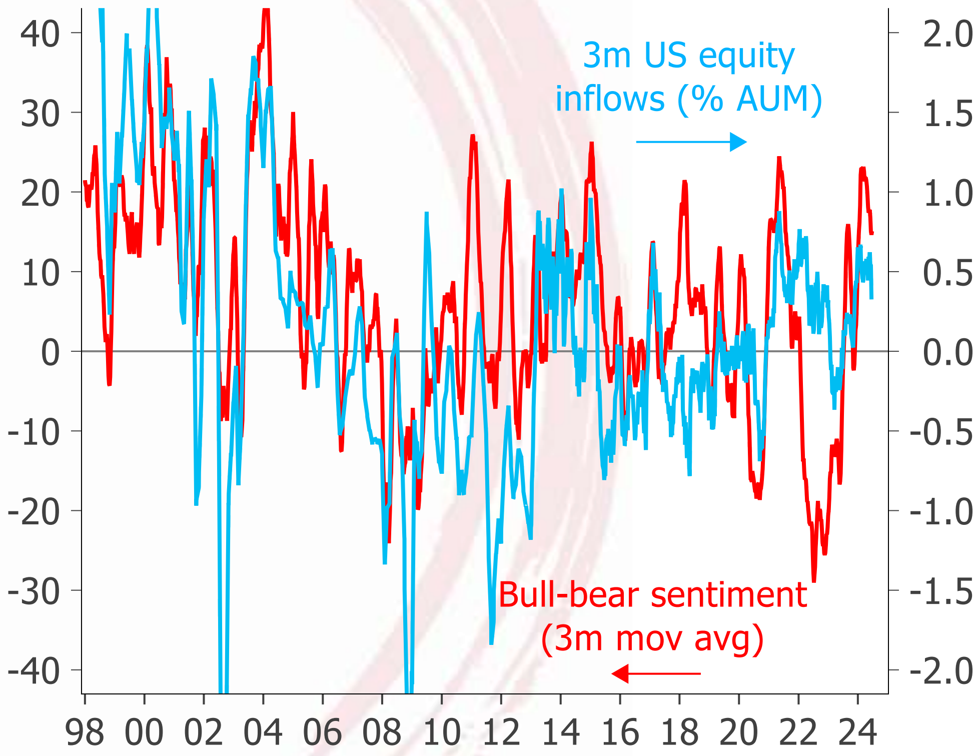
€ govt vs credit spreads, bp



Source: Bloomberg, Satori Insights.

Pulling back from peaks

US equity fund+ETF inflows vs sentiment



Source: FINRA, S&P Global, AAII, MSCI, ICI, Satori Insights.

Sell the rumour, buy the fact – but premia start from still compressed levels

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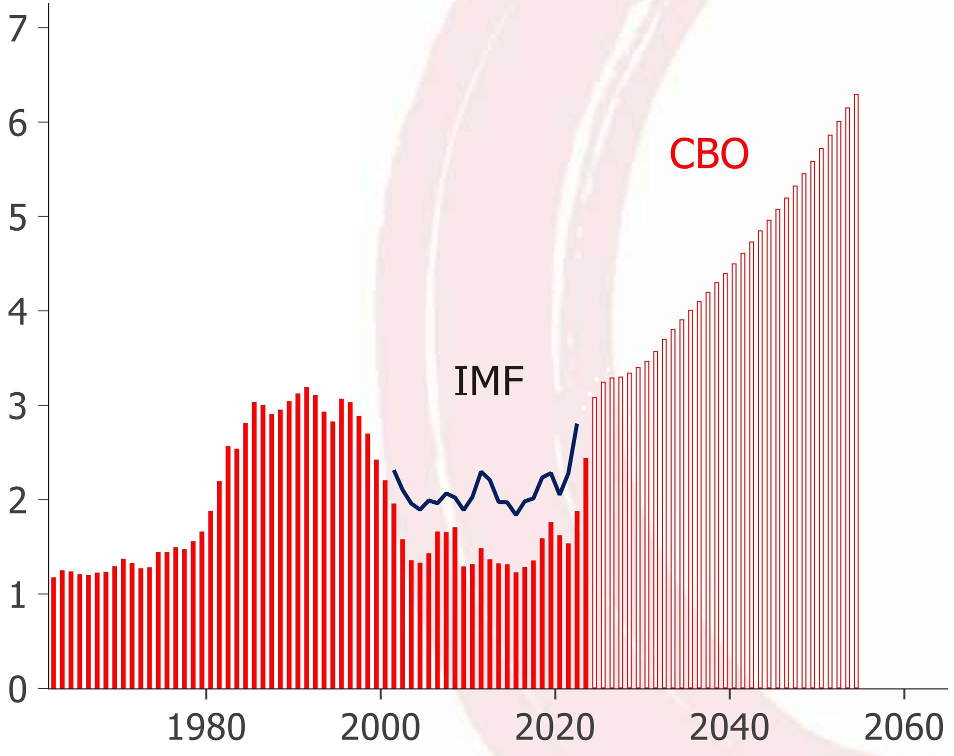
So where's bro to hide? (1)

Will it take a crisis to fix this?

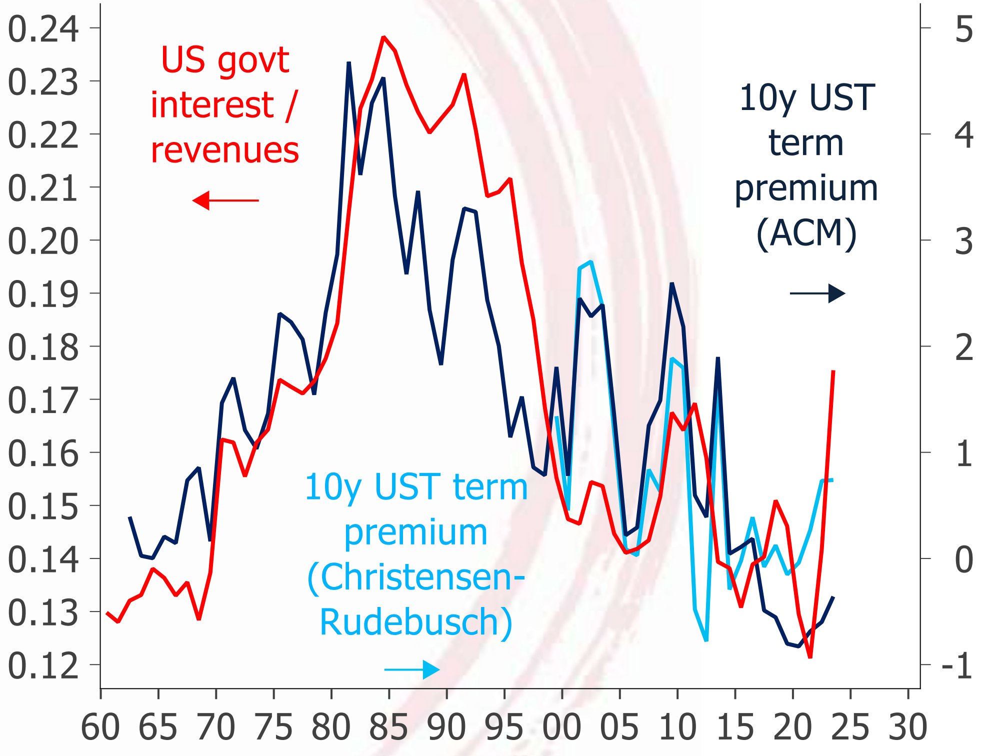
US govt interest projections, % GDP



Source: IMF, CBO, Macrobond, Satori Insights.

Premium pricing

US term premium models (%) vs govt interest payments



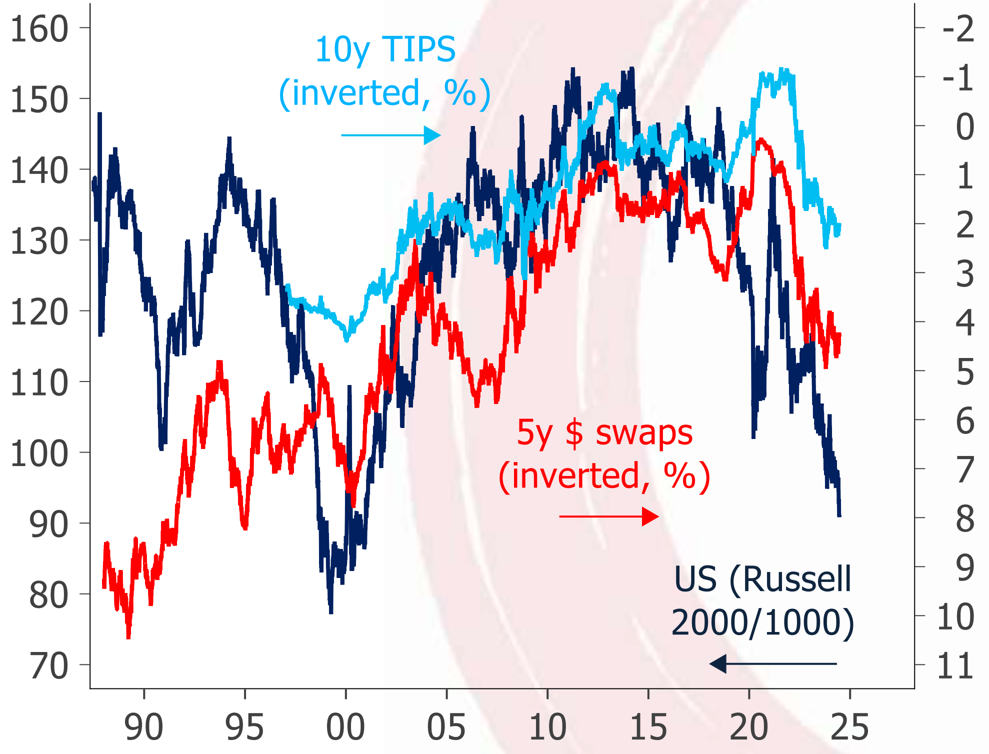
Source: IMF, CBO, BEA, BIS, U.S. Treasury, San Francisco Fed, New York Fed, Satori Insights.

Normally in govies – but fiscal concerns weigh heavily

Where's bro to hide? (2)

Real yields up = smallcaps down

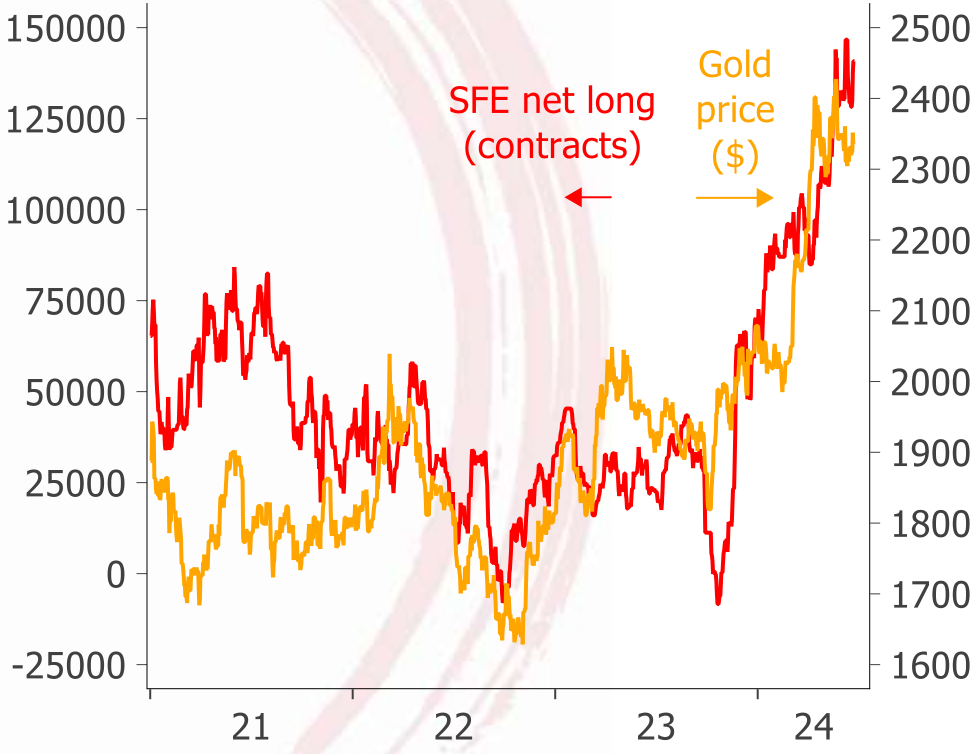
US small/large caps vs rates



Source: Russell, S&P Global, MSCI, Macrobond, Satori Insights.

Becoming extended again

Shanghai Futures Exchange net gold longs vs prices



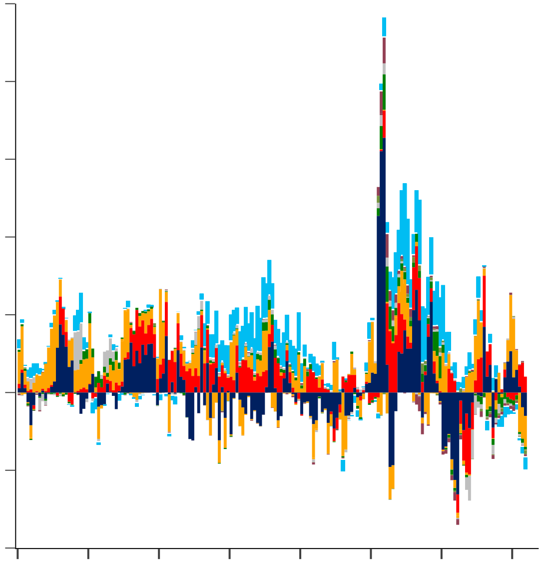
Source: SFE, LBMA, Satori Insights.

Try to find alternatives – though many carry a large premium already

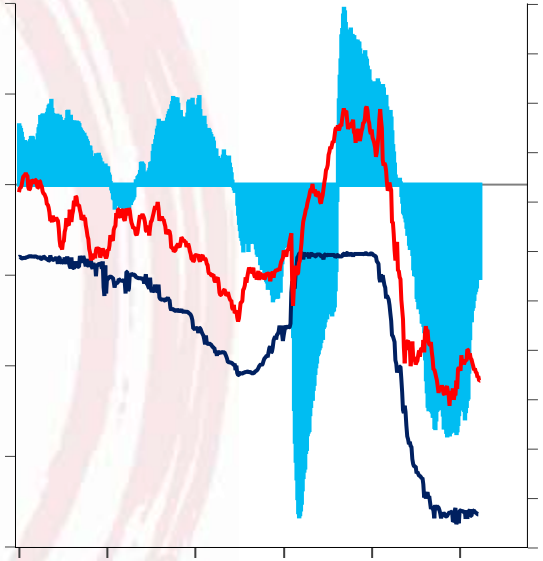
Conclusion

Not just a France-inspired wobble

The fuel for the rally has faded



Rate cuts unlikely to revive it

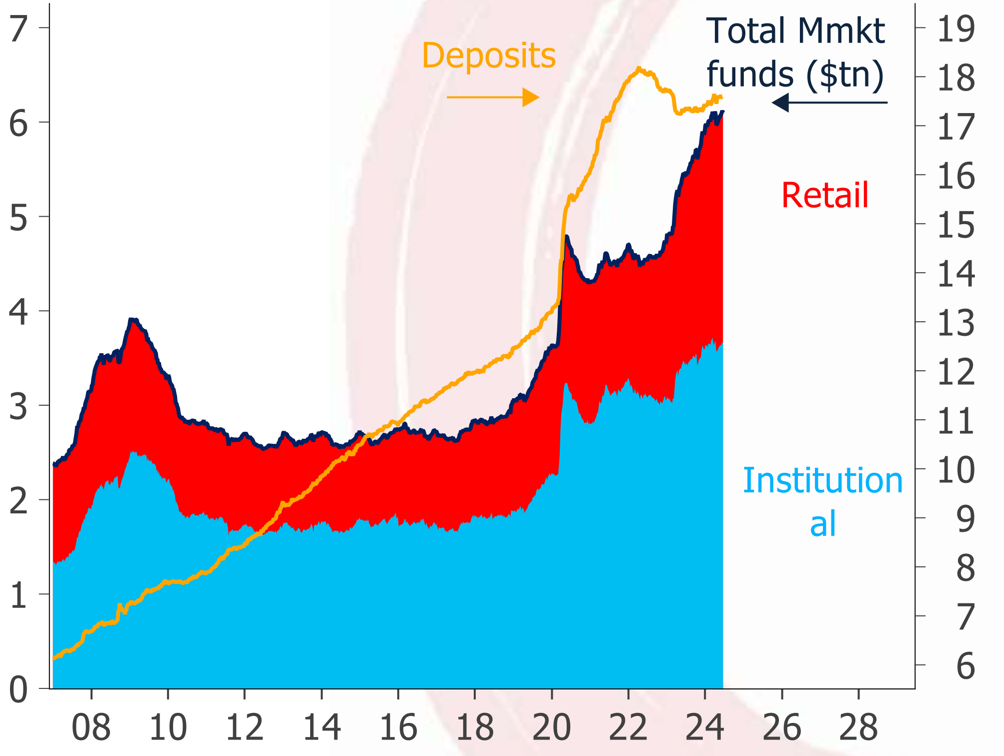


Factors driving markets are not those driving the economy

Appendix: Why haven't rates driven money rotation?

Cash "on the sidelines" at records

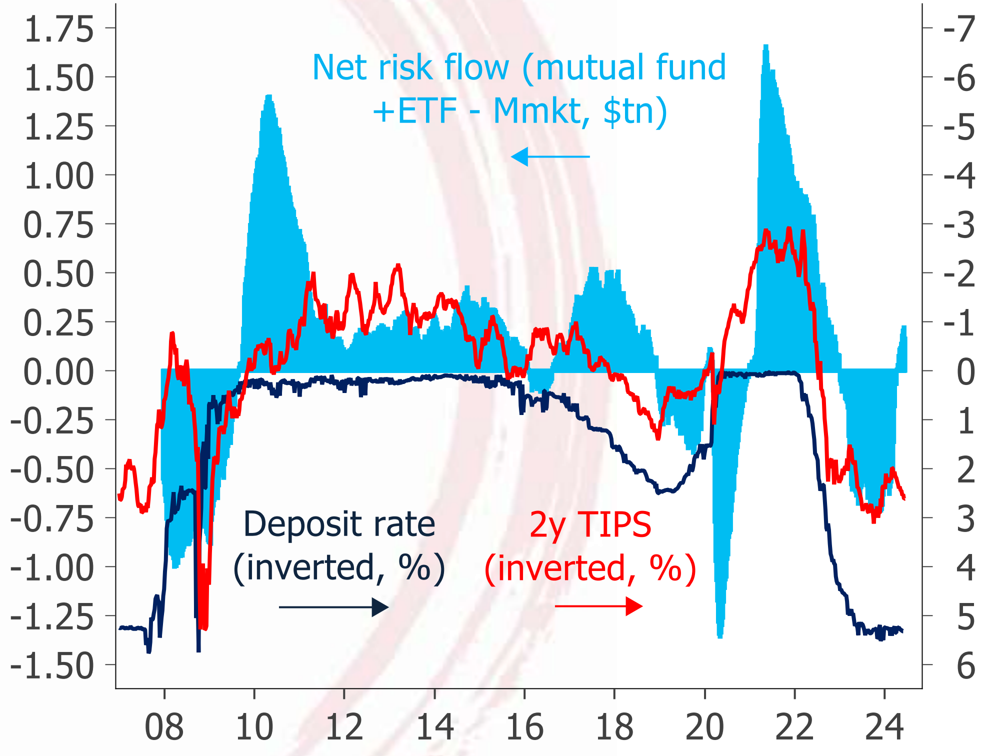
US money market fund assets and deposits, $tn



Source: ICI, Federal Reserve, Macrobond, Satori Insights.

But don't count on it moving into risk

Rolling 1y US net risky mutual fund+ETF flow vs rates



Source: ICI, Federal Reserve, Macrobond, Satori Insights.

Because until recently we were creating so much of it

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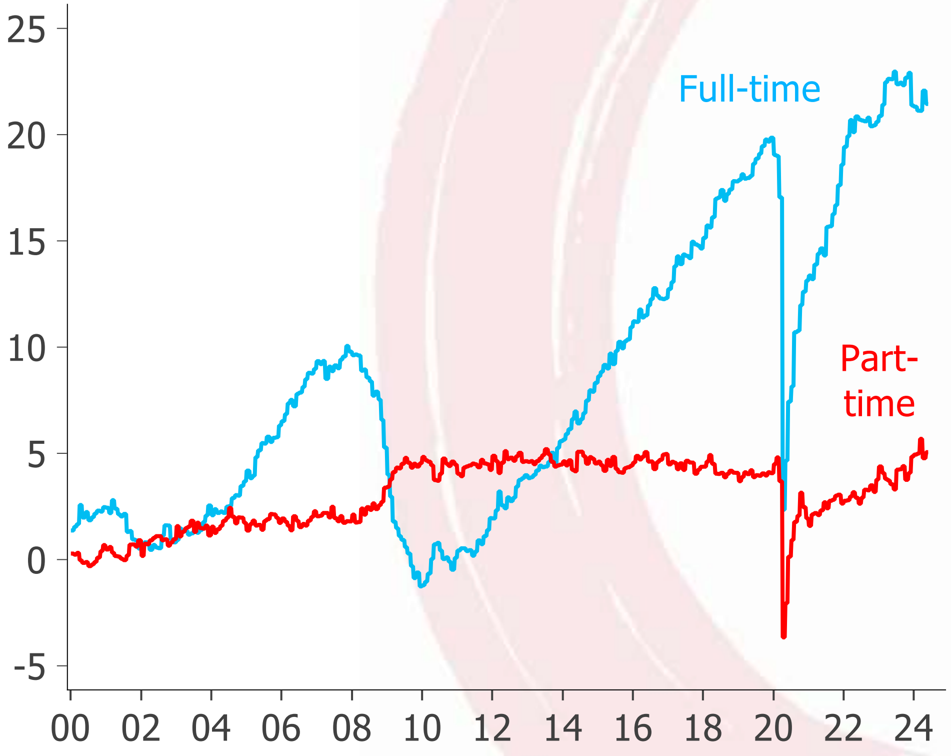
Appendix: how strong is the labour market really?

Recent jobs skewed to part-time

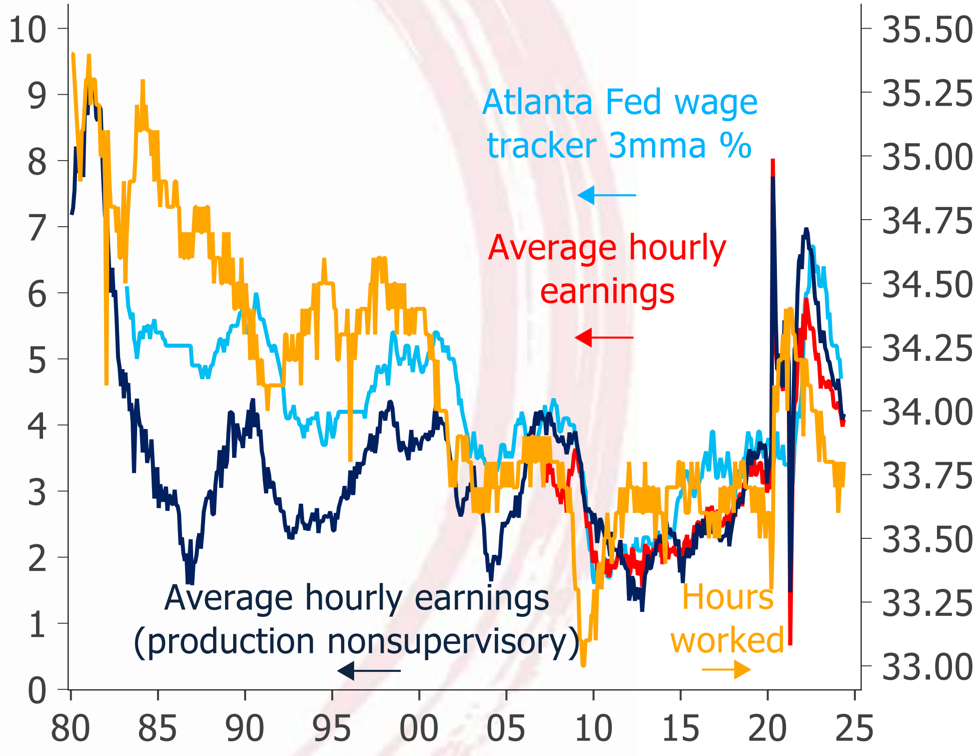
US job creation by type, net change since 2000, million



Source: BLS, Macrobond, Satori Insights.

Keep watching hours worked

US wage growth (% yoy) vs hours worked



Source: BLS, DOL, BEA, Macrobond, Satori Insights.

Payrolls exaggerates labour market strength

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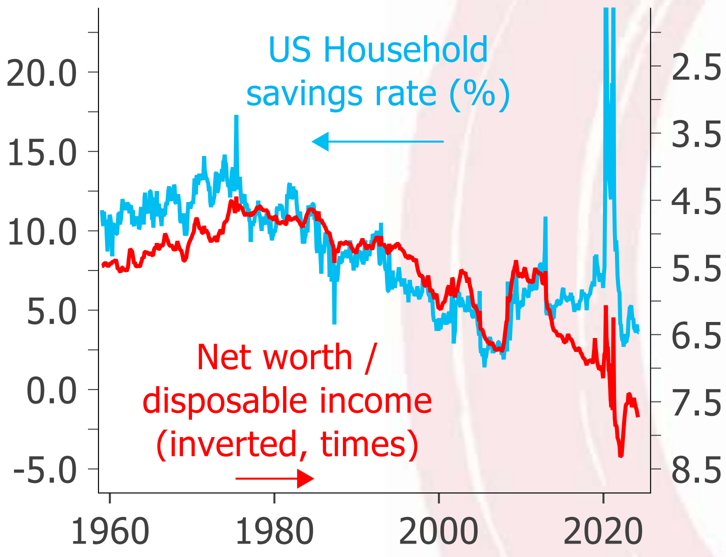
Appendix: The distribution matters – for markets and for elections

Wealth outstripping spending

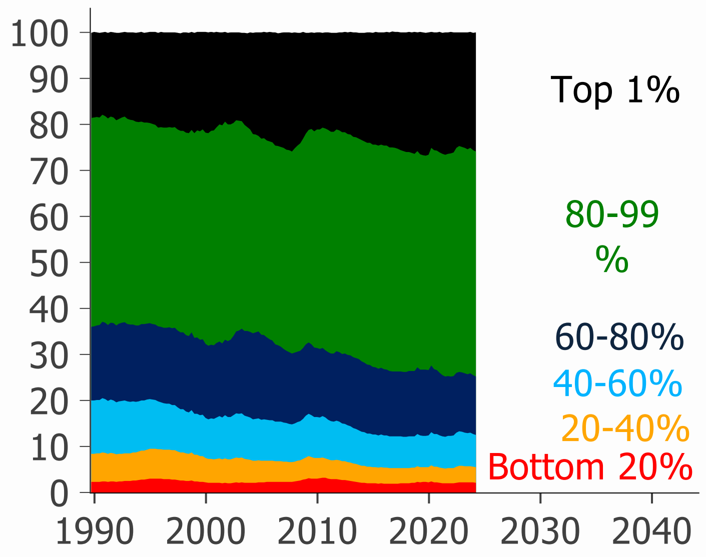
US savings rates vs household net worth



Source: Federal Reserve, BEA, Satori Insights.

The wealthy own the assets

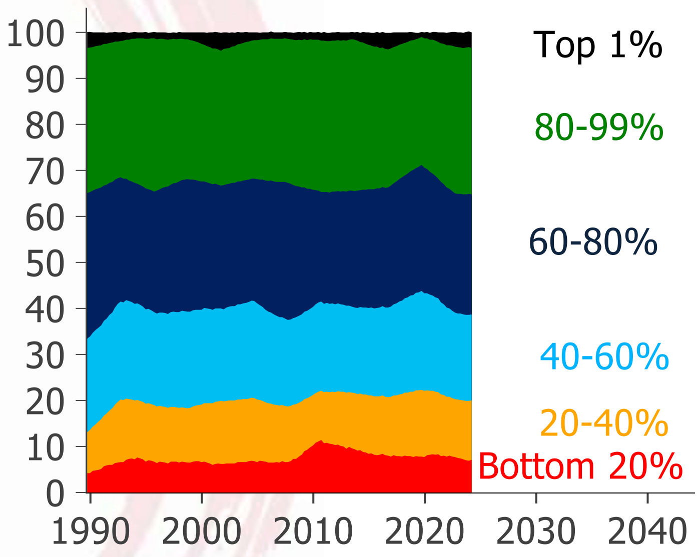
Share of US financial assets by income, %



Source: Fed, Satori Insights.
For more on distributional effects and tipping points, see *End Times*, P. Turchin (2023).

The poorest have the debt

Share of US consumer credit, %



Source: Fed, Satori Insights.

Markets struggle to predict societal tipping points