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Capital Creek Partners

Monthly Market Update

November 2023

Strategy Headlines for November

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- Fixed income is upgraded from tactically underweight to overweight
- Equities are upgraded from tactically underweight to overweight
- Cash moves from a strong tactical overweight to neutral
- We introduce our 2025 SPX earnings estimate of $247.00, up 5.1% from our 2024 estimate of $235.
- We introduce our calendar year-end 2024 S&P 500 Index price target of 4,850—a nominal all-time high
- TIPS represent excellent value and should be bought on any back up in real rates.
- Private credit remains a favorite theme as we head into 2024.

- **Fed Rate Cycle Likely Over:** The Fed's historic rate tightening campaign appears to be over as the US economy slows, the labor market slackens, and inflation continues to gradually trend lower. Amazingly, the Fed has been able to execute the most dramatic tightening of monetary policy in over forty years without causing an official NBER recession. However, quantitative tightening (QT) continues to run silently in the background and real policy rates continue to tighten as inflation falls.

- **Bond Yields Peak:** Benchmark 10-year U.S. Treasury bonds have been locked in a historic bear market for over three years. We think there is a solid chance we have seen the highs in Treasury yields for this cycle. The combination of the Fed pausing, economic slowdown, along with falling inflation are likely to lead to lower bond yields. From a strategic perspective, we are moving from underweight to neutral on Treasury bonds. We avoid going overweight because of the structural factors supporting higher inflation longer-term and the technical fact that the uptrend in yields is yet to be decisively broken.

- **Equities Soar:** The S&P 500 Index is up 9% since 10/31. This is an impressive, powerful, and broad rally that has triggered some technically important breadth thrust indicators. Positioning had become light, the powerful 4Q seasonal kicked in, bond yields peaked, the Middle East war did not spread, 3Q earnings were legitimately better than expected, and inflation data continued to surprise and trend lower. We think the next phase of the bull market that started in October 2022 is now underway. Accordingly, we leave our strategic view (longer-term) at neutral and take our tactical view (3-6 months) from underweight to overweight. We currently lack model support to move to a strategic overweight on equities (see pg. 4). From an execution standpoint, we would not "chase" overbought markets but would be buyers of any significant weakness from now through year-end. We expect pullbacks to be shallow because investors and traders were caught flatfooted by the speed and magnitude of the recent burst higher.

- **Middle East War Contained:** During the last month, the war between Israel and Hamas has not spread beyond Israel and Gaza. Iran has not gotten directly involved. Major Arab nations, while dismayed by the grave situation in Gaza have kept their longer-term strategic interests in focus and have largely remained on the sidelines. So far, in rooting out Hamas, Israeli forces have made faster progress and taken fewer casualties than most expected. The whole situation is a tragedy, but markets are relieved that the worst-case scenario of a spreading regional conflict involving superpowers is not happening.

- **3Q23 Earnings are Solid:** The 3Q23 earnings reporting period is effectively over with over 85% of SPX companies having reported. My read on the data is that earnings have come in solidly better than expected, especially for the large capitalization technology companies. SPX revenue growth was tepid at +1.2% YOY while earnings growth looks close to +6% YOY. The surprise in the numbers was that over 80% of companies reporting beat estimates compared to the longer-term average beat rate of 66%. Company margins are holding up better than most market participants have expected.

Market Overview (2/2)

Market Indicators

- **Models:** Our equity model, Tactical Equity Strategy model ("TES"), is now neutral after being bearish in September and October. The model turned neutral based on the renewed uptrend in prices, bullish seasonality, and cycle components, along with a dramatic easing in financial conditions. Our Tactical Asset Allocation model ("TAA") model remains bearish toward equities, bonds, credit, and commodities. The TAA model continues to overweight cash.

- **Leading Indicators:** U.S. Leading economic indicators from the Conference Board and the OECD still point to the high probability of recession over the next four quarters. However, exceptionally strong fiscal spending, along with the new realities of the post-Covid economy, have lowered our confidence in the predictive capability of leading indicators in this cycle. We are in the slow growth camp but do not expect a recession any time soon.

- **Cycle Monitor:** Our Cycle Monitor (see page 6) has become more mixed and has shifted from almost exclusively recessionary readings to now mostly a mix of mid-to-late cycle readings. This underscores how the probabilities have shifted away from recession to a more extended cycle heading into next year.

- **Inflation:** Inflation continues to trend lower and has beaten estimates to the downside by small margins in recent months. The inflation narrative for bonds and stocks has gone from a headwind to a tailwind. Core PCE and "Super Core inflation" remain around 3.7% on a YOY basis. The lagged downturn in Owners Equivalent Rent (OER) is a major depressing factor for inflation for months to come and reinforces the disinflationary trend.

- **Volatility:** Implied equity volatility (VIX Index) has been falling persistently since the end of October and is nearing the lows of the year. The fixed income volatility gauge, the MOVE Index, has also been falling along with Treasury yields but remains around the average levels of the last three years of the bond bear market.

- **Policy:** The 11/1/2023 Fed meeting, recent economic data, and market pricing are making it abundantly clear that the Fed will not hike rates at the December 13th policy meeting. The markets are now pricing rate cuts to begin in May/June of 2024. Fiscal policy remains highly stimulative, and we are willing to "take the over" on fiscal policy next year ahead of the general election.

- **Liquidity:** Liquidity remains constrained due to global central banks hiking rates and quantitative tightening policies. U.S. M2 growth remains moribund. The Fed and ECB balance sheets continue to contract. However, global policy rates have likely peaked, China is now stimulating, and Bitcoin, a leading indicator of liquidity, has put in a sustained rally. Risk assets appear to rallying on liquidity moving from atrocious to less bad.

- **Credit:** Credit availability continues to become more constrained at the margin. The October Senior Loan Officer Opinion Survey (SLOOS) showed that banks continue to tighten credit standards across the board. Quality borrowers have access to credit but at much higher interest rates along with heavy covenants and better collateralization for lenders.

- **U.S. Dollar:** We believe the next leg of the dollar bear market could be underway as risk assets are under upward pressure and yields are now trending lower. Fed policy support for the dollar has likely peaked. Fiscal policy is likely to remain a headwind for dollar strength during the election year ahead. The broad dollar has turned out to be a non-event for markets in 2023 with the Bloomberg Dollar Index unchanged on the year.

CCP Capital Markets Framework

2024E Economic Assumptions

Cycle Scoring	Mid-to-Late Cycle	Fed Policy:	On Hold
Headwinds / Tailwinds	Trending to tailwinds	Fed Funds Rate:	4.75%
Real GDP:	1.5% to 2.5%	Debt Levels / Spreads:	High / Tight
Inflation:	2.5% to 3.5% (2024) / 2% to 4% (Long-Term)	Volatility:	Moderate/Falling
Unemployment:	3.5% to 5.0%	Earnings:	$220--2023 / $235--2024/ $247--2025
Consumer Spending & Confidence:	Neutral	Equity Valuations:	Expensive relative to history

Directional Views

Strategic (Long-Term) and Tactical (6-12 month) Views on Broad Asset Classes

Asset	Strategic View	Tactical View	Commentary
Cash Strategies	+1	Neutral	Strategically, cash is compelling, with the highest nominal yields in many years. Cash has the added benefit of providing ballast to a portfolio and valuable optionality. Our tactical view on cash returns to neutral to fund tactical overweight to bonds and equities.
Fixed Income	Neutral	+1	We think Treasury yields have peaked for the near-term. It remains unclear if the long-running bear market in bonds is over, as the uptrend in yields is not even close to being broken. Tactically, we see the US economy slowing and want to buy bonds on weakness. We see no need to chase falling yields.
Credit	-1	-1	We are strategically underweight public credit as spreads are tight and a credit downcycle is underway. Tactically, we are underweight, seeing little value and potential vulnerability as the credit cycle downturn matures. Our view is that private credit is much more attractive than public credit.
Equities	Neutral	+1	We were tactically underweight from July through October and now shift to overweight equities in November. A year end rally is underway and is supported by falling inflation, falling rates, Fed on hold, a slowing economy, and better than expected earnings. We think the rally has legs at least through January-February of 2024. We would be buyers of corrections in SPX.
Private Markets	+1	+1	We believe non-traditional return streams offer substantial upside opportunities along with diversification benefits.

Source: Capital Creek Research

Underweight | Neutral | Overweight

Cycle Monitor – Mid-to-Late Cycle

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	Metric	Early Cycle	Middle Cycle	Late Cycle	Recession
Economic Metrics	**Overall Economic Output**	Below potential, rising	Near potential, rising	**Above potential, rising**	Contracting
	Consumption	Low, lagging income	Recovering	**High, ahead of income**	Falling
	Capital Investment	Low as % of GDP	Rising moderate as % of GDP	**High as % of GDP**	Falling
	Residential Investment	Low as % of GDP	Rising moderate as % of GDP	High as % of GDP	**Contracting**
	Vehicle Sales	Low	**Moderate, rising**	Peaking, high	Past peak, falling
	Price Inflation	Below central bank target, stable	Below CB target, rising	**At/Above CB target**	Falling
	Wage Inflation	Low, stable	Moderate, rising	High	**Falling**
	Private Credit Formation	Low, starting to rise	Rising in line with output	Rising faster than output	**Falling**
	ISM New Orders (Manufact.)	Improving	Mid 50s / Moderate	Past peak, falling	**Below 50, falling**
	Personal Savings Rates	High relative to income	Starting to decline	**Low relative to income**	Rising vs. income
	Unemployment Rate	Well above NAIRU	Above NAIRU	**Above or Below NAIRU**	Rising sharply
	Unemployment Claims	Past peak	Falling Sharply	Trending lower / Stable	**Rising**
	Consumer Confidence	**Low**	Moderate	Exuberent	Falling

	Metric	Early Cycle	Middle Cycle	Late Cycle	Recession
Asset Mkt. Metrics	**EPS Revision Ratios**	Downgrade cycle, improving trend	**Upgrade cycle, improving trend**	Second derivative falling	Downgrade cycle, falling trend
	Corporate Margins	High	**High/Peaking**	Declining	Low
	Credit Spreads	Wide, contracting	**Tight, stable**	Past cyclical trough	Wide, unstable
	Aggressive Issuance	**Low as share of total**	Moderate as share of total	High as share of total	Nonexistent
	M&A Activity	Low	**Moderate**	High as share of total	Nonexistent
	Yield Curve	Rates low, curve steep	Rates rising, curve flattening	**Rates high, curve inverted**	Rates falling, curve steepening
	Volatility (Implied)	Vol high, skew falling	**Vol low, skew high**	Vol starting to rise, skew rising	Vol high, skew high

Implied Cycle	**Current macro indicators suggest the market is between a mid-to-late cycle**

Source: Capital Creek Partners Research, Bloomberg

Market Dashboard – as of October 31, 2023

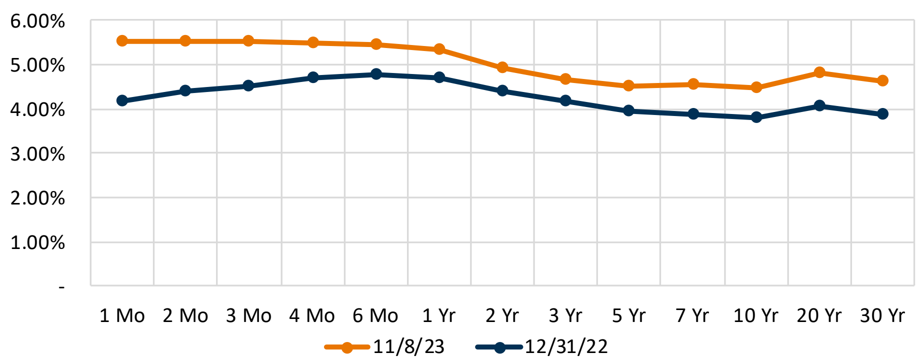
U.S. Equities	Current	MTD	QTD	YTD	LTM
Dow Jones Industrials (DJIA)	33,052.87	(1.4%)	(1.4%)	(0.3%)	1.0%
S&P 500 (SPX)	4,193.80	(2.2%)	(2.2%)	9.2%	8.3%
NASDAQ 100 (NDX)	14,409.78	(2.1%)	(2.1%)	31.7%	26.3%
S&P Mid-Cap 400 (MID)	2,366.40	(5.4%)	(5.4%)	(2.6%)	(2.7%)
S&P Small-Cap 600 (SML)	1,084.10	(5.8%)	(5.8%)	(6.3%)	(9.3%)
Volatility Index (VIX)	18.14	3.5%	3.5%	(16.3%)	(29.9%)

International Equities	Current	MTD	QTD	YTD	LTM
Developed Markets (EFA)	66.92	(2.9%)	(2.9%)	3.8%	15.4%
Emerging Markets (VWO)	37.94	(3.2%)	(3.2%)	(1.3%)	10.3%
Japan (EWJ)	58.96	(2.2%)	(2.2%)	9.0%	19.0%

U.S. Industry Sectors	Current	MTD	QTD	YTD	LTM
Communications (XLC)	64.72	(1.3%)	(1.3%)	35.8%	35.5%
Consumer Discretionary (XLY)	152.10	(5.5%)	(5.5%)	18.6%	6.6%
Consumer Staples (XLP)	67.86	(1.4%)	(1.4%)	(7.3%)	(4.3%)
Energy (XLE)	85.19	(5.8%)	(5.8%)	0.0%	(1.8%)
Financials (XLF)	32.36	(2.4%)	(2.4%)	(4.1%)	(2.8%)
Health Care (XLV)	124.54	(3.3%)	(3.3%)	(7.2%)	(4.7%)
Industrials (XLI)	98.36	(3.0%)	(3.0%)	1.4%	6.0%
Materials (XLB)	76.06	(3.2%)	(3.2%)	(0.7%)	4.8%
Real Estate (XLRE)	33.10	(2.8%)	(2.8%)	(8.1%)	(6.6%)
Technology (XLK)	164.01	0.0%	0.0%	32.6%	29.5%
Utilities (XLU)	59.69	1.3%	1.3%	(13.3%)	(7.7%)

Fixed Income	Current	MTD	QTD	YTD	LTM
Bloomberg Dollar Index (BBDXY)	1,276.36	0.8%	0.8%	2.4%	(5.3%)
7-10 Year Treasury Bonds (IEF)	89.34	(1.9%)	(1.9%)	(4.5%)	(2.5%)
US Inflation Linked Bonds (TIP)	102.35	(0.7%)	(0.7%)	(1.4%)	(0.9%)
Municipal Bonds (MUB)	100.77	(1.2%)	(1.2%)	(2.3%)	2.1%
Corporate Bonds (LQD)	98.81	(2.4%)	(2.4%)	(3.0%)	1.8%
High-Yield Bonds (HYG)	72.18	(1.0%)	(1.0%)	3.1%	4.7%

U.S. Treasury Yield Curve



Commodities	Current	MTD	QTD	YTD	LTM
BBG Commodity Index (BCOMTR)	238.05	0.3%	0.3%	(3.2%)	(1.0%)
Crude Oil (Brent)	87.41	(8.3%)	(8.3%)	1.7%	(7.8%)
Natural Gas (Henry Hub)	3.58	22.1%	22.1%	(20.1%)	(43.7%)
Gold (CMX)	1,985.20	7.4%	7.4%	9.1%	21.4%
Copper (LME)	3.64	(2.3%)	(2.3%)	(4.3%)	6.7%
Bitcoin	34,667.78	28.8%	28.8%	108.8%	69.1%

Note: All numbers are estimates. The data reflect total returns. Data reflect adjusted share price including dividends, splits, and fees. Please use statements as final value.
Source: Capital Creek Partners Research, Bloomberg

U.S. 10 Year Treasury Bond Yields Collapse on Fed, Treasury funding, and lower inflation

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Source: Capital Creek Partners Research, Bloomberg

Beware a steepening yield curve following deep inversions… they often lead to recessions

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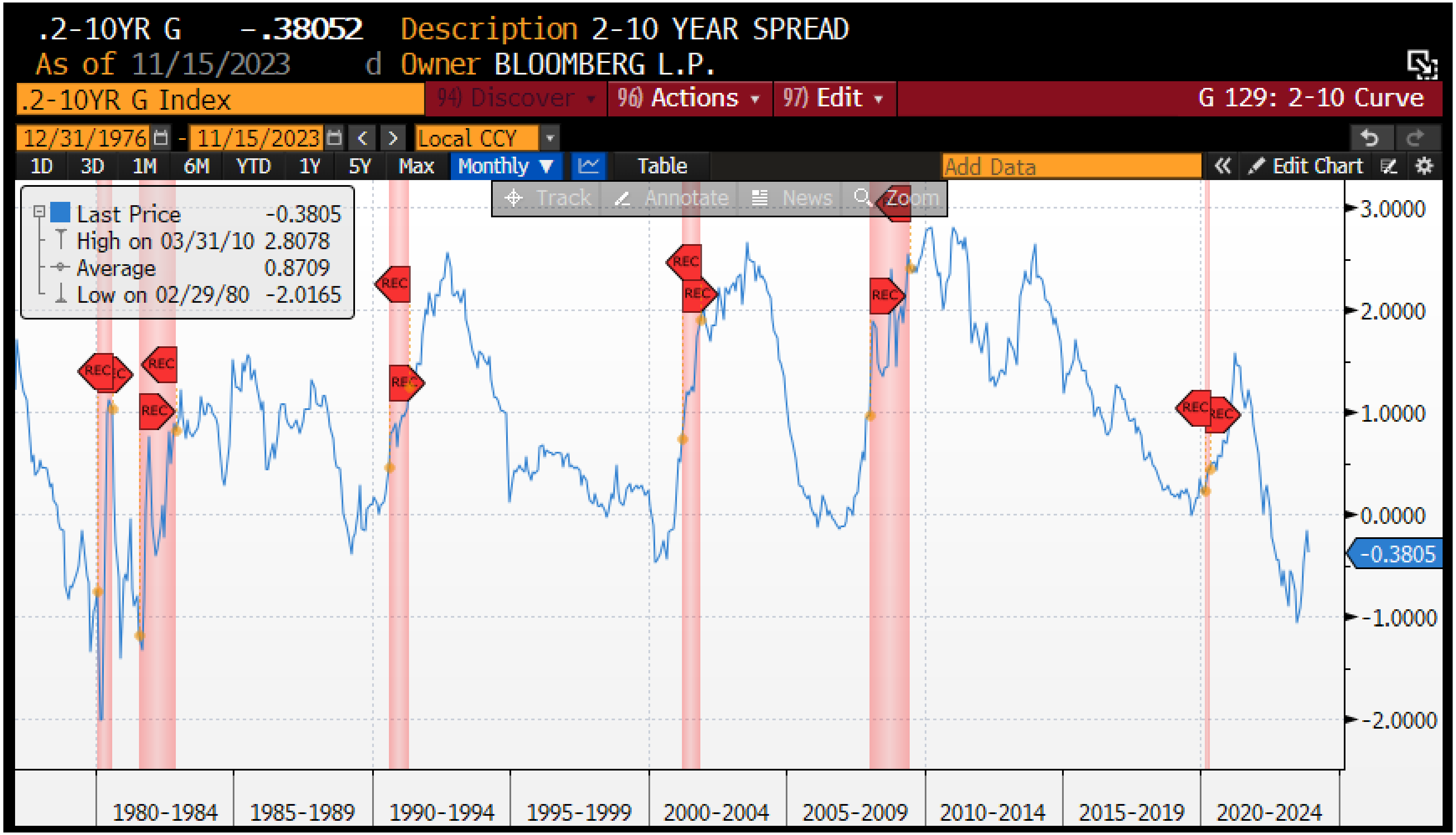

Source: Capital Creek Partners Research, Bloomberg

This SPX trading channel has worked all year.
Next rally target around 4700 by February.

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Source: Capital Creek Partners Research, Bloomberg

QQQ is still the fastest horse in the race. Now at fresh 52-week highs

Source: Capital Creek Partners Research, Bloomberg

Disclaimers

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