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Capital Creek Partners

Monthly Market Update

April 2024

Strategy Highlights for April 2024

- March Headline and Core US Consumer Price Inflation (CPI) data have beaten estimates to the upside for the third month in a row. Supercore Inflation or Core Services ex housing is in a clear uptrend and hit a robust 4.8% YOY in March (see chart on pg. 8). By our analysis, services prices are proving quite sticky to the upside. In addition, the ISM Manufacturing Prices Paid series also surprised to the upside and is now in a clear uptrend. Core PCE Inflation printed in line at 2.8% YOY. The March Core Producer Price Index (PPI) printed in line at a moderate 2.4% YOY. However, several key commodities, including oil, gasoline, copper, and gold, are continuing to rally, raising concerns over the future path of producer price inflation. The clear downtrend in inflation that started in the summer of 2022 is now in question. The data dependent Fed is now in a compromised position and will likely push out rate cuts till later in the year.
- This month, we are adding the commodity asset class to our directional views with a strategic and tactical Overweight rating. We believe a commodity "supercycle" began at the depths of the Covid-19 pandemic in early 2020. Structural factors including persistent underinvestment, massive fiscal expansion, reshoring, geopolitical uncertainty, supply-chain challenges, and infrastructure spending are long-term drivers of higher commodity prices (see chart on page 9).
- After being both strategically and tactically Overweight equities since last fall, we are downgrading our tactical rating to Neutral and keeping our longer-term strategic view at Overweight (see the table on page 4). Our upside year-end target for SPX has been and remains 5,300. Our target was effectively reached earlier this month, and we see no reason to raise our target today. We are unable to push our earnings estimates and multiple assumptions higher. The US stock market is due for a healthy pause or correction as we head into the seasonal challenges of the summer and the US elections. We are also concerned about a continued resurgence of inflation and market interest rates. We remain steadfastly long-term bullish in the context of a resilient global economy, rising productivity, continued advances in artificial intelligence, and eventually a more accommodative Fed and ECB.
- We are downgrading Fixed Income (US Treasuries) from strategically and tactically Overweight to Neutral. We believe attractive current yields are offset by sticky inflation, enormous supply, a tight labor market, and an unfettered US economic expansion. The Fed will likely be forced to delay or reduce the magnitude of rate cuts and reductions in QT until well into 2H2024. The uptrend in 10-year US Treasury yields which began in 2020 appears to have resumed (see chart on page 10). We continue to Overweight private credit in fixed income portfolios due to higher yields, lower duration, and less correlation to higher interest rates.
- The current geopolitical backdrop is the most dangerous and problematic we have seen in our thirty-five-plus-year career. The US/China relationship has stabilized but continues down a path toward overt confrontation. A new axis of anti-western powers has been formed between China, Russia, Iran, and North Korea. The Russia/Ukraine war continues to tilt in favor of Russia as the US Congress appears incapable of even holding a vote on funding for Ukraine. The Israel/Hamas war grinds on with Biden and Netanyahu in open conflict. In our view, risk assets near all time highs are not discounting a Russian military breakthrough in Ukraine or a wider Middle East war. As 2024 progresses, what appears to be a close and potentially destabilizing US election season is coming into focus.

Market Overview – *Market Indicators*

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- **Models:** Our Benchmark Equity Model (TES) has been bullish since last fall. The TES Model turned more constructive based on a positive breadth thrust, an upturn in our earnings growth leading indicator, positive investment flows, improvement in our model composite, and an easing in financial conditions. Our Tactical Asset Allocation Model (TAA) remains bearish toward equities, bonds, credit, and commodities. The TAA Model continues to overweight cash. The TAA Model is bearish toward risk assets based upon negative leading indicators and a forecast for a rising unemployment rate. The unusual post-COVID economic cycle continues to result in model-related discord.
- **Leading Indicators:** The Conference Board Leading Indicator (LEI) remains negative but continues to turn back up for the first time in almost four years. The USA OECD Leading Indicators (CLI) has been improving since early last year, rising for the thirteenth consecutive month in March. Taken together, the LEIs are sending a more constructive message. Exceptionally strong fiscal spending, along with the new realities of the post-COVID economy, have caused traditional leading indicators to misfire in this cycle.
- **Cycle Monitor:** Our Cycle Monitor on page 5 continues to move further away from recession. This month, the ISM New Order series has burst well above the 50 level. This shifts another key indicator from late to early cycle. Indicators continue to shift away from recession to a more extended cycle. The April Cycle Monitor underscores our belief that there will be no US recession in 2024.
- **Inflation:** Please see page 2 for detail on our inflation view.
- **Volatility:** Equity volatility has moved up from the cycle lows of last December but remains well below the average levels of the last five years. The fixed income volatility gauge, the MOVE Index, has ripped back higher in April following unsettling inflation data. Commodity and currency vol are also at historically low levels. The reality is that asset prices are not moving around nearly as much as they did in the pandemic or the 2022-2023 bear market. In our mind, implied volatilities across assets are underpriced, given the prevailing economic and geopolitical risks on the horizon. We anticipate higher volatility as the year progresses and hedging strategies on equities are becoming more attractive in our view.
- **Policy:** Monetary policy in the US has pivoted from a tightening bias to an easing bias. However, increasingly uncooperative inflation data have constrained the Fed's desire to lower policy rates for now. US fiscal policy remains historically stimulative, especially during an economic expansion. The Biden Administration has proven to be highly skilled at using its legislative and non-legislative "levers" to over-deliver fiscal stimulus to the US economy. We expect more of this in a Presidential election year to stimulate the economy ahead of November voting. However, more fiscal stimulus may result in higher inflation.
- **Liquidity:** Global policy rates have likely peaked, China is now overtly stimulating, and Bitcoin, a leading indicator of liquidity, has hit fresh all-time highs. Risk assets are rallying on improving liquidity at the margin. We expect the improving liquidity conditions to remain in place through the remainder of 2024.
- **Credit:** Credit availability and demand are improving at the margin. The January Fed Senior Loan Officer Survey (SLOOS) showed that banks continue to tighten credit standards across the board, but the percentage of banks tightening lending conditions has fallen for the second quarter in a row. Market-based credit spreads remain remarkably well-behaved, showing little to no stress. Consumer loan default rates continue to rise from historically low levels, and corporate defaults continue to rise gradually. Remarkably, despite massive Fed tightening, credit conditions are modestly improving in our view.
- **U.S. Dollar:** The Bloomberg Dollar Index (BBDXY) is up a moderate 3% YTD in 2024. We await more exciting currency moves later in the year as Fed policy support begins to wane. The structurally negative dollar fundamentals of political dysfunction, massive budget and trade deficits, combined with the longer-term thrust of "de-dollarization" may crystalize as we move closer to the November elections. We remain dollar bears and favor other stores of value.

CCP Capital Markets Framework

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2024E Economic Assumptions

Cycle Scoring:	Mid Cycle	Fed Policy:	Easing Bias
Headwinds / Tailwinds:	Well-Balanced	Fed Funds Rate Est. (YE):	4.75%
Real GDP Est:	1.5% to 2.5%	Debt Levels / Spreads:	High / Tight
Inflation (Core PCE):	2.5% to 3.5% (2024) / 2% to 4% (Long-Term)	Volatility:	Moderate
Unemployment:	3.5% to 5.0%	Earnings:	$220 (2023) / $240 (2024) / $250 (2025)
Consumer Spending & Confidence:	Rising	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	Neutral	Neutral	Cash is no longer as compelling with the Fed poised to reduce policy rates later In 2024. It makes more sense to move out the curve into 2 to 5-year Treasury notes to lock in solid yields for longer. We are tactically and strategically neutral cash as we believe now is an attractive time to redeploy into higher returning opportunities in private markets and equities.
Fixed Income	Neutral	Neutral	We are strategically and tactically neutral fixed income. We believe attractive current yields are offset by rising supply, sticky inflation, and unfettered US economic expansion. The Fed may be forced to delay or reduce the magnitude of rate cuts in 2H'2024 to keep inflation in check. In addition, the uptrend in 10-year US Treasury yields appears to have resumed.
Credit	-1	-1	We are strategically underweight public credit as spreads are tight and a slow-motion credit downcycle is underway. Tactically, we are underweight, seeing little value and potential vulnerability as the credit cycle downturn matures. We are structurally overweight private credit for higher yields, wider spreads, stronger covenants, and greater overall opportunity.
Equities	+1	Neutral	We have downgraded our tactical recommendation on SPX from Overweight to Neutral. Our strategic or longer-term recommendation remains overweight. SPX effectively hit our 5,300 target earlier in April and we cannot fundamentally justify a higher target. We think gains become tougher with inflation back in play and market interest rates trending higher.
US Dollar	-1	-1	We are strategically and tactically underweight the US dollar as the Fed slowly pivots toward an easing cycle, the expansion continues, and massive structural deficits exert downward pressure on the currency. We continue to be concerned about the long-term trend toward "de-dollarization."
Commodities	+1	+1	We are strategically and tactically overweight commodities as we believe a commodity super-cycle is resuming. We believe under-investment, energy transition, reshoring, geopolitical uncertainty, supply-chain challenges, and infrastructure spending are structural drivers of higher commodity prices.
Private Markets	+1	+1	We believe non-traditional return streams offer substantial upside opportunities along with diversification benefits. Our 2024 forecast for moderate growth and declining inflation are also supportive for private markets.

Underweight | Neutral | Overweight

Source: Capital Creek Research

Cycle Monitor – Mid-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	**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 mid-cycle**

Source: Capital Creek Partners Research

Market Dashboard – as of March 28, 2024

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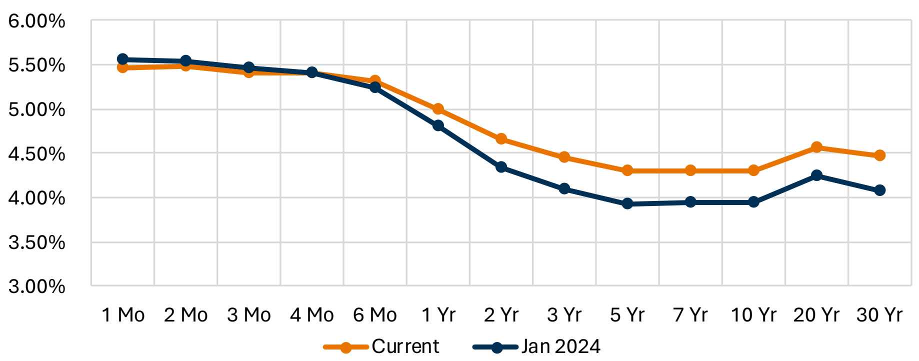
U.S. Equities	Current	MTD	QTD	YTD	LTM
Dow Jones Industrials (DJIA)	39,807.37	2.1%	5.6%	5.6%	19.6%
S&P 500 (SPX)	5,254.35	3.1%	10.2%	10.2%	27.9%
NASDAQ 100 (NDX)	18,254.69	1.2%	8.5%	8.5%	38.5%
S&P Mid-Cap 400 (MID)	3,046.36	5.4%	9.5%	9.5%	21.3%
S&P Small-Cap 600 (SML)	1,344.66	3.0%	2.0%	2.0%	13.8%
Volatility Index (VIX)	13.01	(2.9%)	4.5%	4.5%	(30.4%)

International Equities	Current	MTD	QTD	YTD	LTM
Developed Markets (EFA)	79.86	3.4%	6.0%	6.0%	15.1%
Emerging Markets (VWO)	41.77	1.9%	1.7%	1.7%	7.2%
Japan (EWJ)	71.35	3.2%	11.2%	11.2%	24.1%

U.S. Industry Sectors	Current	MTD	QTD	YTD	LTM
Communications (XLC)	81.66	3.2%	12.7%	12.7%	42.2%
Consumer Discretionary (XLY)	183.89	(0.1%)	3.1%	3.1%	23.9%
Consumer Staples (XLP)	76.36	3.3%	6.8%	6.8%	5.2%
Energy (XLE)	94.41	10.5%	13.5%	13.5%	17.9%
Financials (XLF)	42.12	4.8%	12.4%	12.4%	33.3%
Health Care (XLV)	147.73	2.4%	8.7%	8.7%	16.0%
Industrials (XLI)	125.96	4.4%	10.8%	10.8%	26.6%
Materials (XLB)	92.89	6.5%	9.0%	9.0%	17.5%
Real Estate (XLRE)	39.53	1.8%	(0.7%)	(0.7%)	9.5%
Technology (XLK)	208.27	0.8%	8.4%	8.4%	39.0%
Utilities (XLU)	65.65	6.6%	4.5%	4.5%	0.3%

Fixed Income	Current	MTD	QTD	YTD	LTM
Bloomberg Dollar Index (BBDXY)	1,245.39	0.1%	2.7%	2.7%	1.2%
7-10 Year Treasury Bonds (IEF)	94.38	0.7%	(1.3%)	(1.3%)	(1.6%)
US Inflation Linked Bonds (TIP)	107.35	0.6%	(0.1%)	(0.1%)	0.1%
Municipal Bonds (MUB)	107.34	(0.3%)	(0.5%)	(0.5%)	2.4%
Corporate Bonds (LQD)	108.51	1.5%	(0.9%)	(0.9%)	3.6%
High-Yield Bonds (HYG)	77.33	1.1%	1.5%	1.5%	9.2%

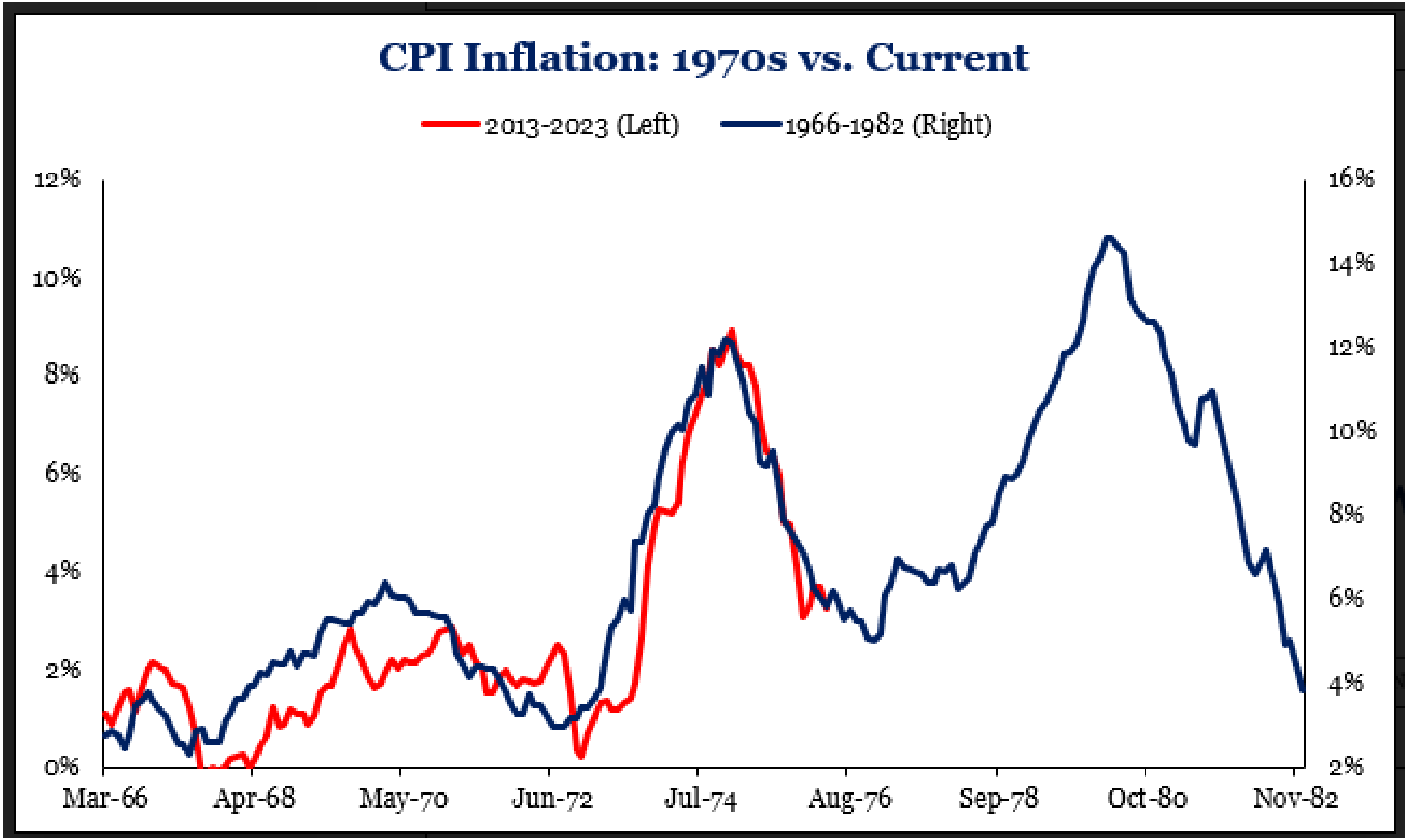
U.S. Treasury Yield Curve



Commodities	Current	MTD	QTD	YTD	LTM
BBG Commodity Index (BCOMTR)	231.40	3.3%	2.2%	2.2%	(0.6%)
Crude Oil (Brent)	87.48	4.6%	13.6%	13.6%	9.7%
Natural Gas (Henry Hub)	1.76	(5.2%)	(29.9%)	(29.9%)	(20.4%)
Gold (CMX)	2,217.40	8.4%	7.5%	7.5%	12.6%
Copper (CMX)	4.00	4.4%	3.2%	3.2%	(2.5%)
Bitcoin	70,744.95	15.6%	68.0%	68.0%	148.4%

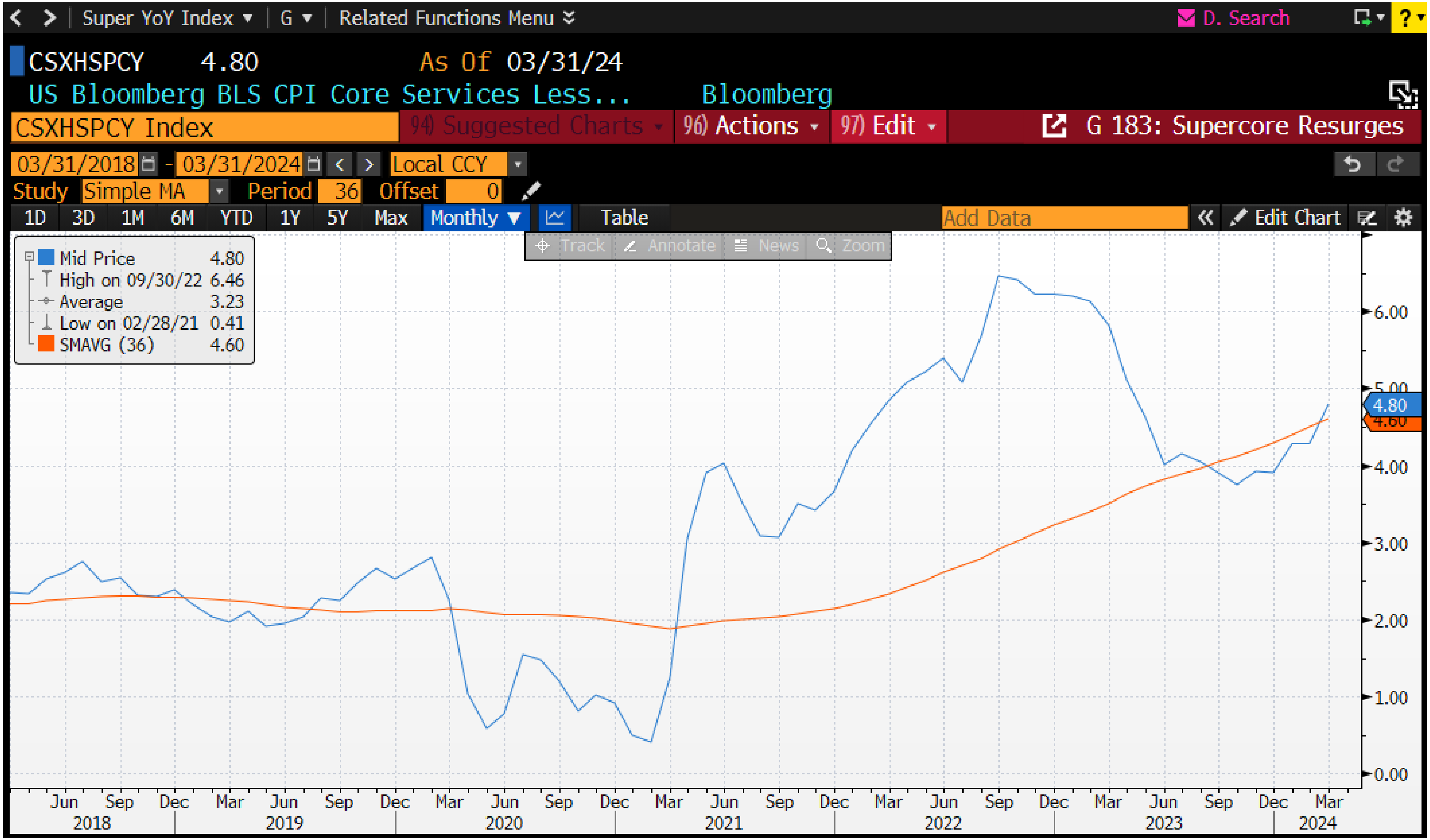
Note: All numbers are estimates. Data reflects price returns for indices and net total returns for ETFs. Total returns include adjustments for dividends, stock splits, and fees.
Source: Capital Creek Partners Research, Bloomberg

The big risk is a reacceleration in inflation



Source: Strategas

Supercore Inflation at 4.8% is inconsistent with price stability



Source: Capital Creek Partners, Bloomberg

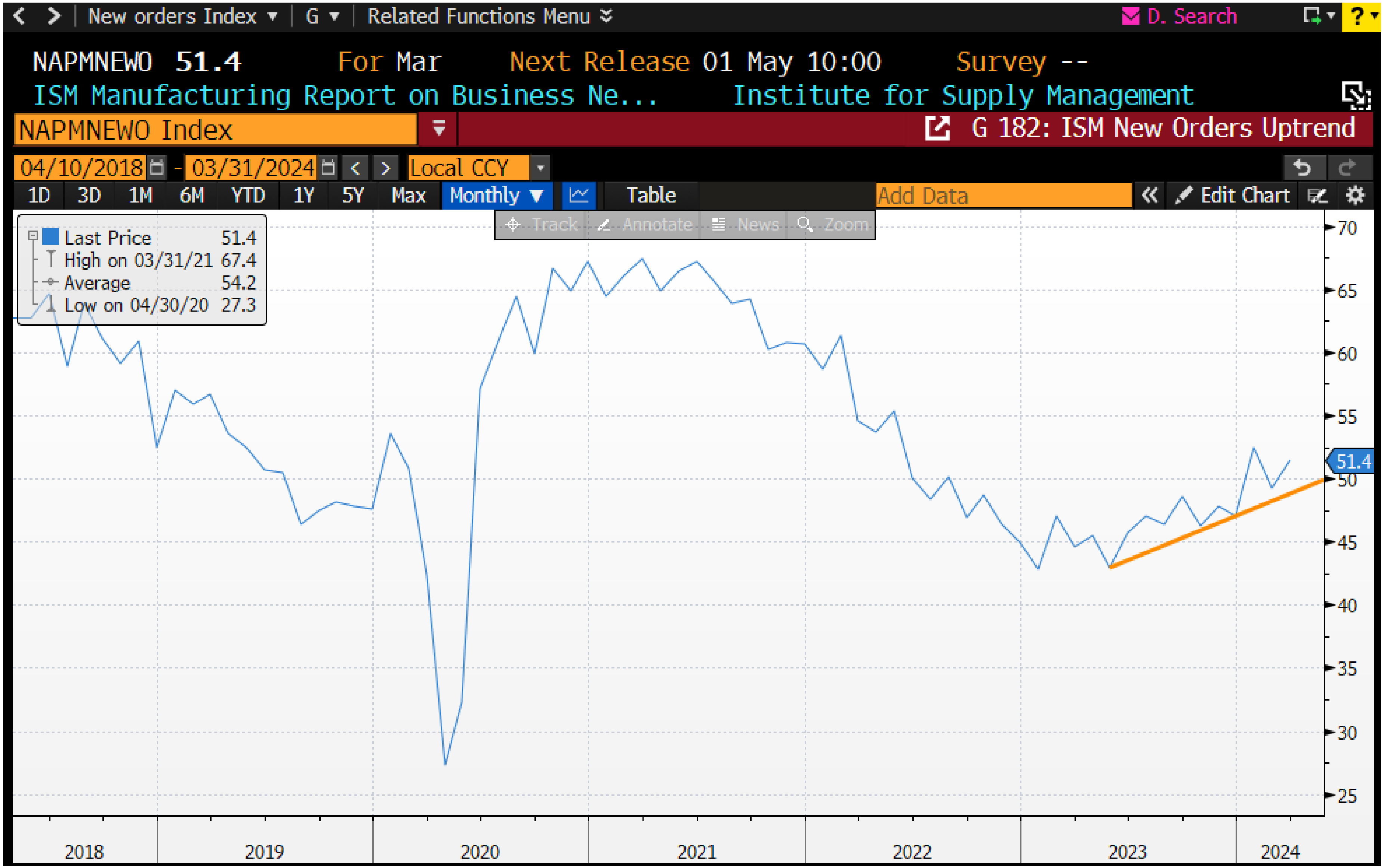
After two years of consolidation, the commodity bull market reemerges

Source: Capital Creek Partners, Bloomberg

The uptrend in 10-year US Treasury yields remains in force

Source: Capital Creek Partners, Bloomberg

ISM New Orders > 50 for first time in two years indicates industrial expansion



Source: Capital Creek Partners, Bloomberg

Disclaimers

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