Capital Creek Partners

Monthly Market Update

September 2023

Market Overview

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August Highlights

- ***China Malaise:*** The last month has been dominated by weak data and underwhelming policy action out of China. Our central case is that China will muddle through neither collapsing or returning to strong growth. We believe that a slower growing and more introspective China should help reduce US and European inflation, lower geopolitical tensions, and reduce global carbon emissions. We see this as good news for investors and the world.
- ***Jackson Hole Perspective/Fed Pass:*** Fed Chair Jay Powell was balanced in his Jackson Hole speech. Powell reiterated that policy has long lags and that rates are now well into restrictive territory. Once again, Powell reiterated that the Fed's inflation target remains 2%. The subtle message is that policy rates will remain in restrictive territory until core inflation moves much closer to 2%. The cuts priced into the curve for mid 2024 continue to be challenged by the Chairman's narrative. US Treasury yields initially fell on Powell speech but have since rebounded all the way back and close to cycle highs. Money markets are clearly priced for the Fed to pass on another rate increase at the 9/20 meeting.
- ***King Dollar:*** Tight monetary policy in the US has created significant rate differentials that favor the dollar. With the dual currency weakness of both China and Japan, the Bloomberg Asia Dollar Index has been in persistent decline. The silver lining of a stronger dollar is that it helps the Fed in its inflation fight. However, a strong dollar tends to be a depressant for risk taking and equity multiple expansion. From a year-to-date perspective, the dollar is essentially unchanged for 2023.
- ***Credit Rumblings:*** The consumer credit data appears to be weakening slowly but surely. However, the publicly traded IG and HY credit markets show few signs of trouble as credit spreads are remarkably well behaved. Private market credit opportunities continue to look very compelling as money is tight and expensive to borrow. Only emerging market credit spreads are showing signs of stress, while European and US IG/HY credit spreads remain tight relative to their histories.
- ***Stocks in a Torpor:*** US equity Indexes struggled in August and early September as the bear market in bonds rolls on, core inflation persists well above the Fed's target, seasonality is a headwind, earnings are tepid, and stocks appear richly valued in a rising real rate environment. We anticipate this period of choppy trading will persist deeper into fall. We see downside risk to 4100-4200 on SPX. Our year end target for SPX has been 4500 all year long and we see few reasons to change it.

Market Indicators

- ***Models:*** Our equity model (TES) is now neutral after being bearish last month. Our Tactical Asset Allocation (TAA) model remains negative on stocks, bonds, commodities, and public credit. Cash is a clear tactical overweight in our TAA model.
- ***Leading Indicators:*** Leading economic indicators are now mixed with the Conference Board Leading Indicator pointing to the high probability of recession over the next four quarters. However, the Philadelphia Fed State Leading Indicator is back to a low probability of recession. Very strong fiscal spending has offset monetary tightening and has lowered our confidence in the predictive capability of leading indicators in this cycle.
- ***Cycle Monitor:*** Our Cycle Monitor 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.
- ***Inflation:*** While inflation has come down steadily so far in 2023, the outlook has become clouded by rising oil and gasoline prices (see page 7). High profile wage gains by big labor may begin to undermine inflation expectations. In addition, medical costs and used car prices are unlikely to continue to decline. Housing prices and rents are also beginning to rise again. Our sense is the easy declines in the rate of inflation could be behind us and the risk is increasing for an upside inflation surprise in coming months.
- ***Volatility:*** Equity volatility is back to cycle low levels after jumping higher in August. Fixed income volatility has also receded back to historically normal levels despite the ongoing bear market in Treasury bonds. We see value in both equity and bond volatility in the context of the current macro backdrop.
- ***Policy:*** See left hand column on Jackson Hole/Fed.
- ***Liquidity:*** Liquidity remains constrained by Global CB rate hikes and QT. US M2 growth remains moribund. The Fed, ECB, and PBOC balance sheets continue to contract. Global liquidity growth is unusually weak and remains a headwind for risk assets.
- ***Credit:*** See left hand column on Credit Rumblings.
- ***US Dollar:*** See left hand column on King Dollar.

CCP Capital Markets Framework

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2023E Economic Assumptions

Cycle Scoring	Late-Cycle	Fed Policy:	On Hold with Tightening Bias
Headwinds / Tailwinds	Trending to Headwinds	Fed Funds Rate[1]:	5.5%
Real GDP:	1% to 2%	Debt Levels / Spreads:	High / Tight
Inflation:	3% to 5% (2023) / 2% to 5% (Long-Term)	Volatility:	Moderate
Unemployment:	3% to 4%	Earnings:	$215 - 2023 / $235 - 2024
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	+2	On a nominal basis, cash is very compelling at the highest yields in many years. Cash has the added benefit of providing ballast to a portfolio along with valuable optionality. Real cash yields are also rising as the Fed continues to raise rates and inflation falls.
Fixed Income	-1	-1	We are strategically and tactically underweight fixed income given bearish price trends combined with massive fiscal spending and heavy supply overhangs. However, we acknowledge that the lagged impact tighter monetary policy could hit in the second half of this year or in 2024.
Credit	-1	-1	We are strategically underweight public credit as spreads are tight and a credit downcycle is underway. Tactically, we are underweight as we see little value and potential vulnerability as the credit cycle downturn matures. Private credit is much more attractive than public credit in our view.
Equities	Neutral	-1	We are strategically neutral weight and tactically underweight equites. Our tactical models remain cautious. We envision better buying opportunities in Oct-Nov within the context of a new bull market. We see the S&P 500 as vulnerable down to the 4100-4200 range.
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	**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

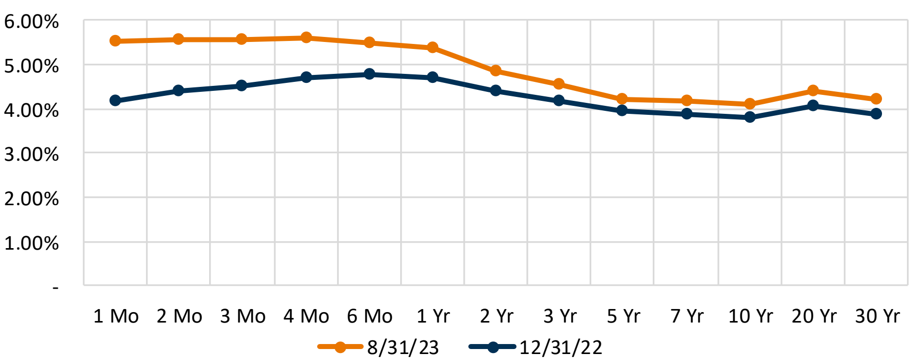
Market Dashboard – as of August 31, 2023

U.S. Equities	Current	MTD	QTD	YTD	LTM
Dow Jones Industrials (DJIA)	34,721.91	(2.4%)	0.9%	4.8%	10.2%
S&P 500 (SPX)	4,507.66	(1.8%)	1.3%	17.4%	14.0%
NASDAQ 100 (NDX)	15,501.07	(1.6%)	2.1%	41.7%	26.3%
S&P Mid-Cap 400 (MID)	2,645.47	(3.0%)	0.9%	8.9%	8.8%
S&P Small-Cap 600 (SML)	1,226.89	(4.3%)	0.9%	6.0%	3.6%
Volatility Index (VIX)	13.57	(0.4%)	(0.1%)	(37.4%)	(47.5%)

Fixed Income	Current	MTD	QTD	YTD	LTM
Bloomberg Dollar Index (BBDXY)	1,240.15	1.8%	0.6%	(0.5%)	(4.8%)
7-10 Year Treasury Bonds (IEF)	94.56	(0.7%)	(1.4%)	0.6%	(3.6%)
US Inflation Linked Bonds (TIP)	105.75	(0.8%)	(0.8%)	1.3%	(3.7%)
Municipal Bonds (MUB)	105.23	(0.8%)	(0.7%)	1.5%	2.3%
Corporate Bonds (LQD)	105.78	(1.2%)	(1.2%)	3.0%	1.0%
High-Yield Bonds (HYG)	74.93	0.2%	1.3%	5.8%	7.0%

International Equities	Current	MTD	QTD	YTD	LTM
Developed Markets (EFA)	71.53	(3.9%)	(1.3%)	11.0%	18.5%
Emerging Markets (VWO)	40.53	(5.9%)	(0.4%)	4.6%	2.1%
Japan (EWJ)	61.64	(2.8%)	(0.4%)	14.0%	16.1%

U.S. Treasury Yield Curve



U.S. Industry Sectors	Current	MTD	QTD	YTD	LTM
Communications (XLC)	67.73	(1.5%)	4.1%	41.7%	25.7%
Consumer Discretionary (XLY)	170.71	(1.7%)	0.5%	32.8%	10.9%
Consumer Staples (XLP)	72.76	(3.9%)	(1.9%)	(1.2%)	2.1%
Energy (XLE)	88.92	1.6%	9.5%	3.6%	15.0%
Financials (XLF)	34.38	(2.7%)	2.0%	1.5%	6.2%
Health Care (XLV)	133.21	(0.7%)	0.4%	(1.2%)	8.5%
Industrials (XLI)	108.23	(2.0%)	0.8%	11.1%	18.5%
Materials (XLB)	82.89	(3.3%)	0.0%	7.7%	12.3%
Real Estate (XLRE)	37.02	(3.1%)	(1.8%)	1.9%	(8.2%)
Technology (XLK)	175.66	(1.5%)	1.0%	41.8%	31.1%
Utilities (XLU)	62.96	(6.1%)	(3.8%)	(9.3%)	(12.7%)

Commodities	Current	MTD	QTD	YTD	LTM
BBG Commodity Index (BCOMTR)	239.08	(0.8%)	5.4%	(2.8%)	(6.7%)
Crude Oil (Brent)	86.86	1.5%	16.0%	1.1%	(10.0%)
Natural Gas (Henry Hub)	2.77	5.1%	(1.1%)	(38.1%)	(69.7%)
Gold (CMX)	1,938.20	(1.6%)	0.9%	6.5%	13.2%
Copper (LME)	3.77	(5.6%)	0.8%	(0.9%)	7.2%
Bitcoin	25,931.47	(11.3%)	(14.9%)	56.2%	29.3%

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 Trend Higher

Source: Capital Creek Research, Bloomberg

Brent Crude Oil Prices Hit 2023 Highs in September

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Source: Capital Creek Research, Bloomberg

Credit Spreads Show No Signs of Weakness

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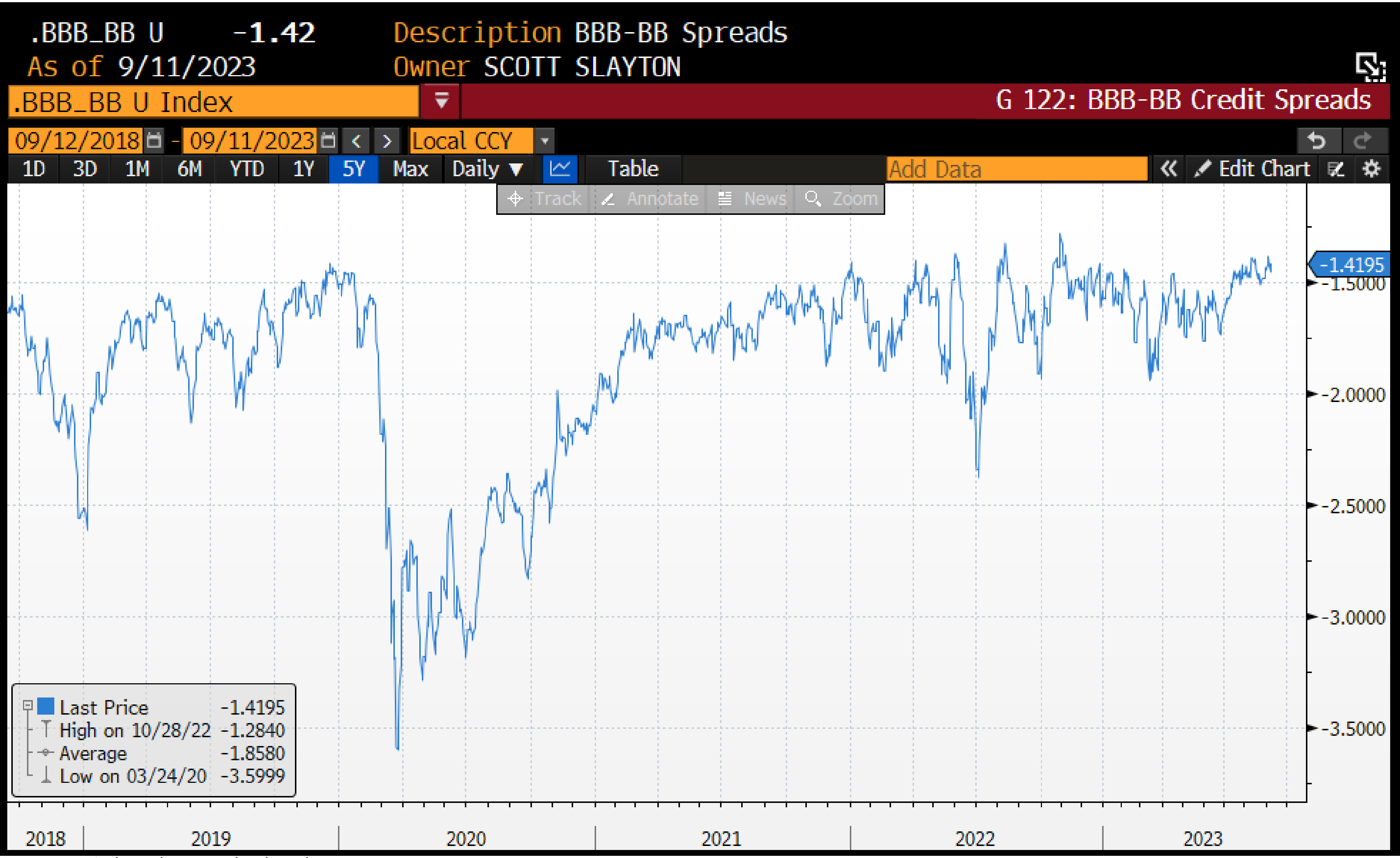

Source: Capital Creek Research, Bloomberg

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