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Monthly Market Update

February 2024

Strategy Headlines for February 2024

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- Major developed global equity markets, including the S&P 500, Nasdaq 100, Euro Stoxx 50, and Nikkei 225, are all hitting multi-decade or even all-time highs early in 2024. The Bloomberg Magnificent Seven Total Return Index is already up > 10% year to date. Investors are experiencing a global bull market for equities.
- US economic data have been stronger than expected across the board in January and early February this year. Employment data, retail sales, PMIs, and consumer confidence numbers have all exceeded expectations.
- In general, the inflation data have been market-friendly and continue to trend toward the Fed's 2% target on Core PCE.
- Geopolitical risks continue to mount in the early stages of 2024, as the Middle East war appears to be drifting closer to outright confrontation between the US and Iran. Russia increasingly appears to be gaining the upper hand in its war with Ukraine. Venezuela is now amassing tanks and troops on the border with Guyana and is threatening to invade. Markets have largely ignored these rising risks.
- US political dysfunction remains on full display as Republicans and Democrats once again fail to secure a border deal or additional funding for Ukraine or Israel. The results of the early primaries point toward a Biden vs. Trump rematch in November.
- Our Cycle Monitor puts the US economy in mid-cycle territory, not on the cusp of a recession.
- Our Equity Model has been on a buy signal since December, while our Tactical Asset Allocation Model remains on a sell signal for equities, bonds, credit, and commodities. The unusual post-COVID cycle continues to result in model-related discord.
- We expect liquidity conditions to continue to improve as we get closer to developed market Central Bank policy rate reductions in the second half of the year. China's PBOC continues to grow its balance sheet quietly and consistently. Japan's BOJ continues to grow its balance sheet via QE and yield curve control. Some EM Central Banks are already reducing policy rates. We expect that QT will terminate sometime in the second half of the year.
- We are making no changes to our strategic and tactical over/under weights for the month of February. We remain both strategically and tactically overweight equities and Treasury bonds.
- We maintain strategic and tactical underweights to public credit and the US dollar. We much prefer private credit to public credit.

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- **Models:** Our equity model (TES) has been bullish since December. The model turned more constructive based on a positive breadth thrust, an upturn in our earnings growth leading indicator, positive investment flows, a big improvement in our model composite, and a dramatic 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.
- **Leading Indicators:** US Leading Economic Indicators from the Conference Board remain deeply negative but have started to turn back up for the first time in almost four years. The OECD LEI has been improving since early last year. Taken together, the LEIs are now sending a more nuanced message. Exceptionally strong fiscal spending and the new realities of the post-COVID economy have lowered our confidence in the predictive capability of leading indicators in this cycle.
- **Cycle Monitor:** Our Cycle Monitor on page 5 continues to move further away from a recession. This month, we shifted ISM New Orders and Corporate Profit Margins into the Early Cycle category. This underscores how the probabilities have shifted from recession to a more extended cycle. The Monitor underscores our belief in no recession for 2024.
- **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 shifted from a headwind to a tailwind. The average Core PCE and "Supercore inflation" remain around 3.4% on a YOY basis—too high for Fed comfort. 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:** Equity volatility has fallen persistently since the end of October and remains near the lowest levels of the last two years. The fixed income volatility gauge, MOVE Index, has also been falling along with Treasury yields but remains around the average levels of the last two years of the bond bear market. In our mind, volatility is underpriced, given the prevailing economic and geopolitical risks on the horizon.
- **Policy:** Monetary policy has pivoted from a tightening bias to an easing bias. Fiscal policy remains historically stimulative, especially during an economic expansion. The Biden Administration has proven 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.
- **Liquidity:** Global policy rates have likely peaked, China is now stimulating, and Bitcoin, a leading liquidity indicator, has put in a sustained rally. Risk assets are rallying on improving liquidity at the margin. Treasury Secretary Yellen has been adroit at using less obvious tools such as the General Treasury account and shortening government term funding to manufacture greater liquidity.
- **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. Credit conditions are improving in our view.
- **U.S. Dollar:** The dollar has been mildly stronger to start 2024, up 2.5%. We believe the recent strength is unsustainable, given that Fed policy support for the dollar has diminished in the wake of the recent policy pivot. The structurally negative dollar fundamentals of massive budget and trade deficits combined with the longer-term thrust of "de-dollarization" may crystalize as we move closer to the November elections.

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):	4.50%
Real GDP:	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/Falling
Unemployment:	3.5% to 5.0%	Earnings:	2023: $220 // 2024: $240 // 2025: $250
Consumer Spending & Confidence:	Rising	Equity Valuations:	Expensive relative to history

Asset	Strategic View *Long-term*	Tactical View *6-12 months*	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 public equities.
Fixed Income	+1	+1	Fixed Income has an opportunity to produce solidly positive returns in 2024, recovering from deep losses experienced in 2021-2023 due to high inflation. Inflation is on a glide path lower for the first half of 2024, and the Fed will be cutting rates in 2H; both are supportive of more gains in the Treasury market.
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	+1	+1	We are strategically and tactically overweight equities early in 2024. Our Tactical Equity Strategy (TES) model has turned bullish for the first time since 2021. We believe equity returns in 2024 will be driven by improving market breadth, improving liquidity, and a sustained rally in small and mid-cap equities.
US Dollar	-1	-1	We are strategically and tactically underweighting the US dollar as the Fed 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."
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

Cycle Monitor – Mid-Cycle

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Economic Metrics

Metric	Early Cycle	Middle Cycle	Late Cycle	Recession
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

Asset Mkt. Metrics

Metric	Early Cycle	Middle Cycle	Late Cycle	Recession
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 January 31, 2024

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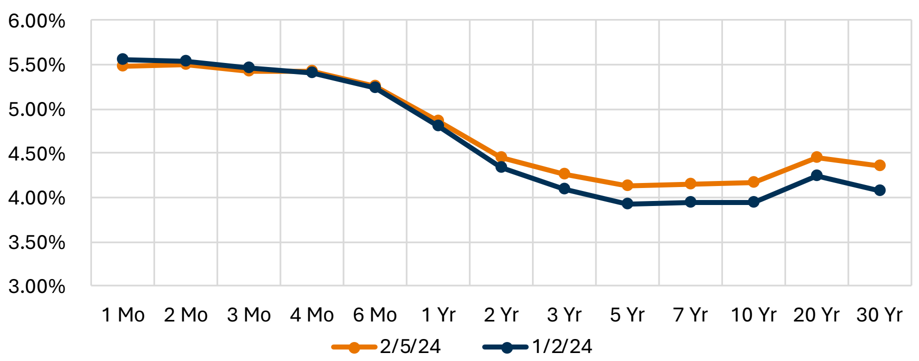
U.S. Equities	Current	MTD	QTD	YTD	LTM
Dow Jones Industrials (DJIA)	38,150.30	1.2%	1.2%	1.2%	11.9%
S&P 500 (SPX)	4,845.65	1.6%	1.6%	1.6%	18.9%
NASDAQ 100 (NDX)	17,137.24	1.9%	1.9%	1.9%	41.6%
S&P Mid-Cap 400 (MID)	2,732.18	(1.8%)	(1.8%)	(1.8%)	3.0%
S&P Small-Cap 600 (SML)	1,265.19	(4.0%)	(4.0%)	(4.0%)	(0.1%)
Volatility Index (VIX)	14.35	15.3%	15.3%	15.3%	(26.0%)

International Equities	Current	MTD	QTD	YTD	LTM
Developed Markets (EFA)	75.01	(0.5%)	(0.5%)	(0.5%)	8.1%
Emerging Markets (VWO)	39.64	(3.6%)	(3.6%)	(3.6%)	(2.7%)
Japan (EWJ)	66.21	3.2%	3.2%	3.2%	15.2%

U.S. Industry Sectors	Current	MTD	QTD	YTD	LTM
Communications (XLC)	75.88	4.4%	4.4%	4.4%	39.1%
Consumer Discretionary (XLY)	170.92	(4.4%)	(4.4%)	(4.4%)	15.9%
Consumer Staples (XLP)	72.92	1.2%	1.2%	1.2%	1.5%
Energy (XLE)	83.41	(0.5%)	(0.5%)	(0.5%)	(3.8%)
Financials (XLF)	38.76	3.1%	3.1%	3.1%	8.0%
Health Care (XLV)	140.38	2.9%	2.9%	2.9%	7.0%
Industrials (XLI)	112.89	(1.0%)	(1.0%)	(1.0%)	12.8%
Materials (XLB)	82.21	(3.9%)	(3.9%)	(3.9%)	(0.8%)
Real Estate (XLRE)	38.13	(4.8%)	(4.8%)	(4.8%)	(2.7%)
Technology (XLK)	197.68	2.7%	2.7%	2.7%	46.7%
Utilities (XLU)	61.45	(3.0%)	(3.0%)	(3.0%)	(8.1%)

Fixed Income	Current	MTD	QTD	YTD	LTM
Bloomberg Dollar Index (BBDXY)	1,238.07	2.1%	2.1%	2.1%	1.3%
7-10 Year Treasury Bonds (IEF)	96.22	0.1%	0.1%	0.1%	0.1%
US Inflation Linked Bonds (TIP)	107.85	0.3%	0.3%	0.3%	2.0%
Municipal Bonds (MUB)	108.20	0.0%	0.0%	0.0%	3.1%
Corporate Bonds (LQD)	109.78	(0.4%)	(0.4%)	(0.4%)	3.6%
High-Yield Bonds (HYG)	77.10	0.1%	0.1%	0.1%	7.7%

U.S. Treasury Yield Curve



Commodities	Current	MTD	QTD	YTD	LTM
BBG Commodity Index (BCOMTR)	227.33	0.4%	0.4%	0.4%	(6.9%)
Crude Oil (Brent)	81.71	6.1%	6.1%	6.1%	(3.3%)
Natural Gas (Henry Hub)	2.10	(16.5%)	(16.5%)	(16.5%)	(21.8%)
Gold (CMX)	2,048.40	(0.7%)	(0.7%)	(0.7%)	6.2%
Copper (CMX)	3.85	(1.1%)	(1.1%)	(1.1%)	(8.0%)
Bitcoin	42,582.61	1.1%	1.1%	1.1%	84.0%

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

US Natural Gas Market Update—Below pandemic pricing levels

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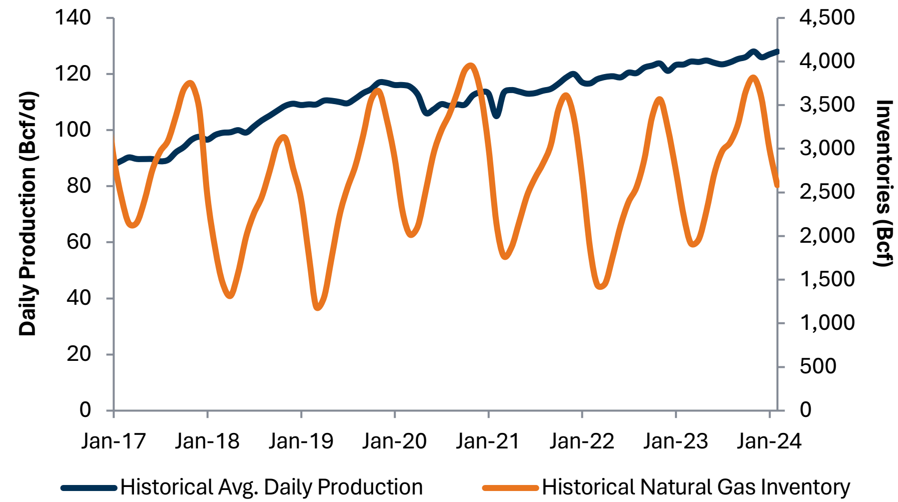
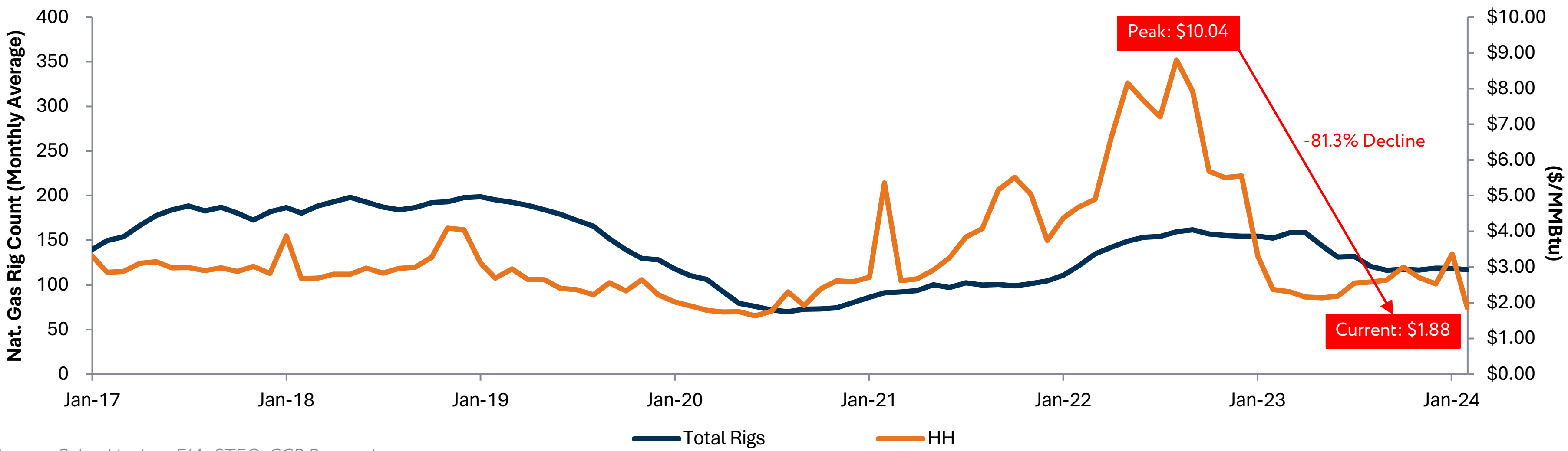
Recent Market Commentary

- Natural Gas Production: Because of cold weather disruptions in mid-January, dry natural gas production fell from a monthly record of 106 billion cubic feet per day ("Bcf/d") in December to 102 Bcf/d in January. February US dry gas production is forecasted to increase and reach 105 Bcf/d by March as weather-related disruptions subside (STEO Forecasts).
- Natural Gas Consumption: 118 Bcf/d of natural gas was consumed in the United States in January, a new monthly record driven by the electric power sector. EIA forecasts predict that US natural gas consumption will increase by 5% in Q1'24 compared with Q1'23, which was one of the warmest first quarters on record.
- Natural Gas Storage: In January, increased natural gas consumption and reduced production resulted in a withdrawal of almost 920 Bcf from storage for the month, the third-most ever. However, because January began with 13% more natural gas in storage than average over the past five years, inventories remain above the five-year (2019–2023) average.

Natural Gas Production vs Inventory Levels



US Natural Gas Rig Count and Natural Gas Prices ($MMBtu)



Source: Baker Hughes, EIA, STEO, CCP Research

10 Year US Treasury Bond yields appear to have peaked for the cycle around 5%

Source: Capital Creek Partners, Bloomberg

Is Gold about to shatter the glass ceiling above $2,100 per oz.?

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Source: Capital Creek Partners, Bloomberg

The Mag7 continues its rampage higher early in 2024

Source: Capital Creek Partners, Bloomberg

SPX has escaped from the channel that defined all of 2023

Source: Capital Creek Research, Bloomberg

China's large equity market has lost value over the last decade in contrast to SPX

Source: Capital Creek Partners, Bloomberg

Disclaimers

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