ALPINEMACRO
A Unique Mind On The Markets

SPECIAL REPORT

July 19, 2024

Of Technical And Nominal Recessions: Lessons From 2022 And 2015

- Perfect landing remains our baseline scenario. However, there is a nontrivial risk of a mild recession as the economy slows and pricing power ebbs, although severe financial and economic stress is highly unlikely.

- There are four lessons for what could go wrong with our baseline scenario from the 2022 "technical recession" and 2015 "nominal recession". First, monitor China, oil markets and junk bond spreads for hints of deflation. Second, watch for earnings downgrades in sectors that have previously seen upgrades. Third, volatility in risk assets would rise if there were a "whiff of deflation". Finally, a double-bottom in the broad equity market is more likely than a V-shaped trajectory in a mild recession risk scenario.

- We continue to recommend quality small caps, barbell exposure to defensive growth and select cyclicals, biotech and long bond duration for their hedge value.

Table 1 Mild Versus Average Recession Comparisons

	Peak-to-Trough Change		
	Nominal Recession 2015	Technical Recession 2022	Average During Actual Recessions
S&P 500	-13%	-25%	-38%
10-Year Treasury Yield	-98 Bps	290 Bps	-266 Bps
Real GDP	0.5%	-0.5%	-3.8%
S&P 500 Forward EPS	-5.4%	-8%	-19.2%
S&P 500 EPS	-3.3%	-	-24.6%
WTI Oil Price	-58%	7%*	-60%
High Yield Spread	650 Bps	130 Bps	1082 Bps
High Yield Ex. Energy Spread	400 Bps	210 Bps	926 Bps

*This is the change for 2022, the actual drawdown was -36% from the Russia-Ukraine War peak

ALPINEMACRO 2024 INVESTMENT CONFERENCE

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237 Park Avenue, New York, NY 10017

Tipping Point In Financial Markets: A Melt-up or Meltdown?

Agenda

08:10 - 08:30 **Opening Remarks : The Shifting Macro Landscape: Opportunities & Risks**
Chen Zhao, Chief Global Strategist

08:30 - 9:30 **Emerging Mega Trends: How Should Investors Be Prepared?**
Ruchir Sharma, Chairman of Rockefeller International and Founder and Chief Investment Officer of Breakout Capital

09:30 - 10:30 **Inflation, Disinflation and Fed Policy: Are We on the Right Path?**
Mike Dooley, Professor Emeritus at University of California, Santa Cruz and Chief Economist at Figure Technologies

10:30 - 10:45 Coffee Break

10:45 - 11:45 **Fireside Chat: Bull Bear Debate**
Francois Trahan, Founding Partner of The Macro Institute Versus
Jim Paulsen, Author of the Paulsen Perspectives research newsletter on Substack

11:45 - 12:30 **The Long and Shorts of U.S. Equities**
Gina Martin Adams, Bloomberg Intelligence Global Director of Portfolio Strategy, Chief Equity Strategist

12:30 - 14:15 **Luncheon Speaker: Biden Vs Trump: How The World Will Be Changed**
Greg Valliere, Chief U.S. Policy Strategist AGF Investments

14:15 - 15:00 **How Is AI Reshaping the Money Management Business?**
Gareth Shepherd, Co-Head of Voya Machine Intelligence (VMI) & Portfolio Manager, Voya Investment Management

15:00 - 15:15 Coffee Break

15:15 - 16:30 **Commodity Panel: Secular Trend, Energy and Prospect of ESG**
Tavi Costa, Partner/Macro Strategist at Crescat Capital
Lenka Martinek, Managing Partner, Sustainable Market Strategies, Nordis Capital
Adam Rozencwajg, Managing Partner, Goehring & Rozencwajg

16:30 - 17:30 **Cocktails & Networking**

Guest Speakers + Alpine Macro Strategists


Ruchir Sharma


Greg Valliere


Mike Dooley


Gareth Shepherd


Francois Trahan


Tavi Costa


Jim Paulsen


Lenka Martinek


Gina Martin Adams


Adam Rozencwajg

Conference Details & Registration: conference.alpinemacro.com | conference@alpinemacro.com | +1 (514) 558-1414

Chart 1 2022 Technical Recession

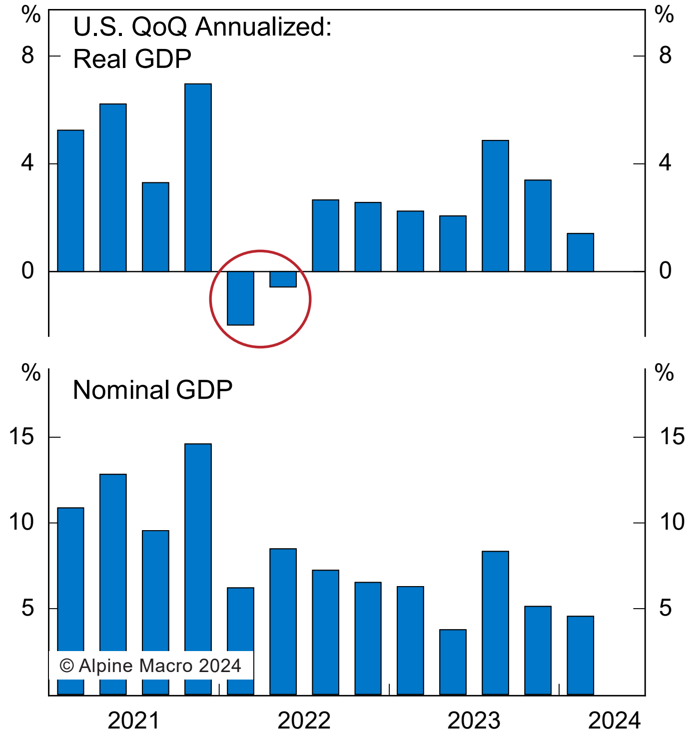
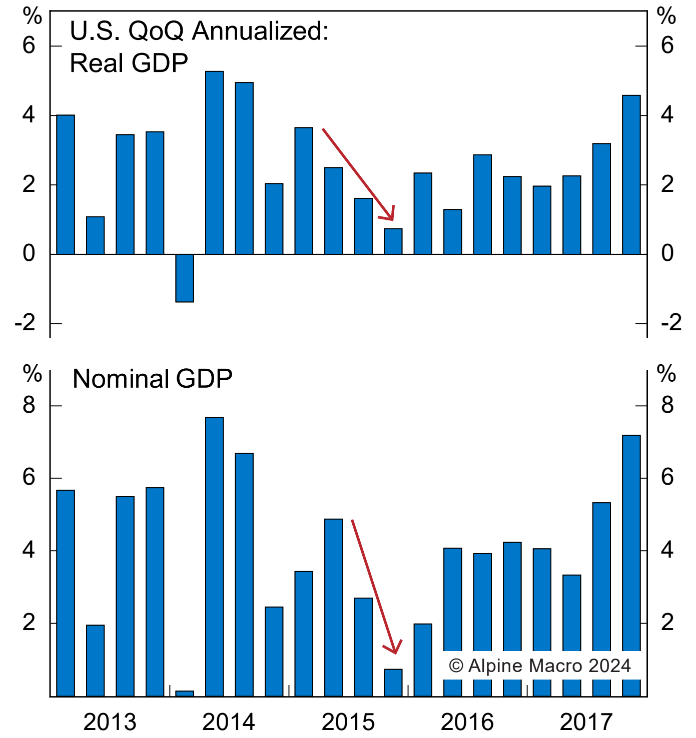


Chart 2 2015 Nominal Recession



The longstanding Alpine Macro baseline scenario continues to be a perfect landing, both for capital markets and the economy. Recent data releases and Fed comments are consistent with this perfect landing.[1] Under our baseline scenario, the Fed will cut interest rates into an expanding economy where sectors such as tech and manufacturing already underwent recessions in the past two years. Inflation will decline but rising productivity will moderate the hit to margins. Both stocks and bonds will benefit. Corrections in risk assets will be vicious, but hard to time both the beginning and end. Manias and overshoots are to be expected.

We acknowledge that perfect landings are a rare species because they require everything to go right on policy, macro and geopolitical fronts. Internal discussions at Alpine Macro increasingly focus on the risks that could derail our baseline scenario, especially given the uncertainty surrounding U.S. elections in November.[2]

We have two high-conviction views about "what to worry about". First, the risks to a perfect landing are skewed heavily towards "a whiff of deflation", and away from too much growth and sticky inflation. Second, the odds are low of prolonged economic and financial pain that would cause a sustained bear market in risk assets. Previous reports have provided the reasoning why we hold these two views about what could go wrong.

This *Special Report* focuses on two episodes that provide insights into how the perfect landing could go awry and how to control risk if our forecast proves

1 Alpine Macro *U.S. Themes & Strategy* "Equity Perfect Landing?" (July 15, 2024).

2 Alpine Macro *Geopolitical Strategy* "United States: An Increasingly Wild Election Season?" (July 17, 2024).

wrong. Neither of these episodes involved a broad-based economic contraction or financial stress. Nevertheless, the impact on capital markets was negative and violent, albeit selective and relatively short lived.

The 2022 technical recession resulted from unanticipated monetary and price shocks. The Fed jacked up interest rates and inflation shot up to levels not seen in decades. The risks this time are in the other direction, but the impact on real GDP and equity volatility could be similar if there is a technical recession.

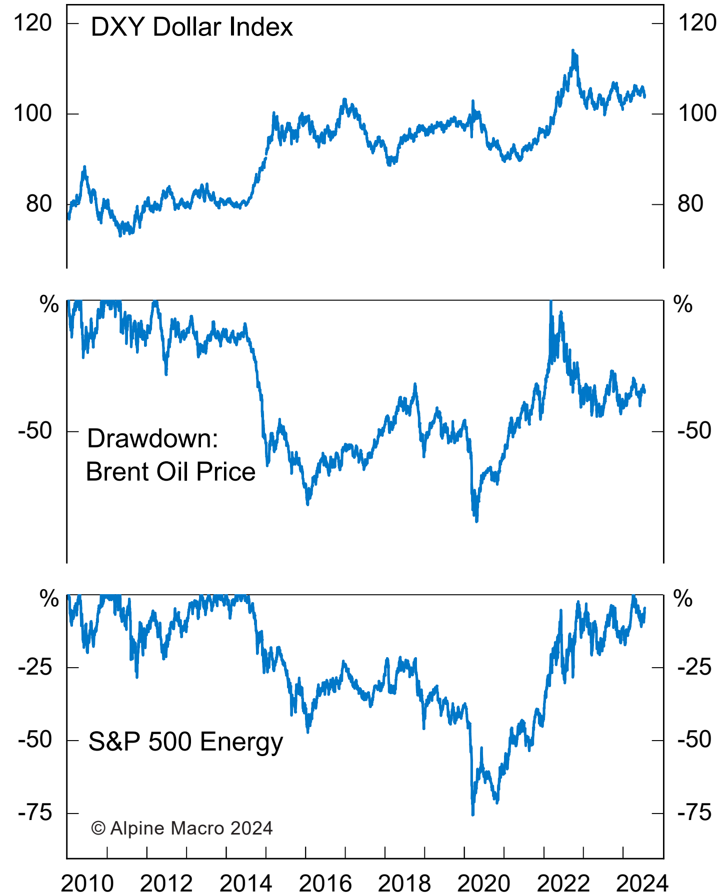
The 2015 nominal recession resulted from plunging oil prices and Chinese deflation that undermined pricing power and profits. Either or both developments could repeat. However, they would need to be severe to have a negative impact on capital markets. Again, the impact would be selective but overall market volatility would increase.

Technical And Nominal Recessions: Stylized Facts

Two phases of economic weakness hold insights for what could go wrong with our perfect landing outlook. In 2022, a shallow contraction in real GDP produced a technical recession. In 2015, nominal GDP and profits came under pressure because of deflation emanating from China and energy markets (Charts 1 and 2).

These episodes differed from each other and from the current environment. Still, the similarities offer lessons for how investors can gauge whether the economic slowdown will be worse than we anticipate. Table 1 compares these two episodes with recession averages:

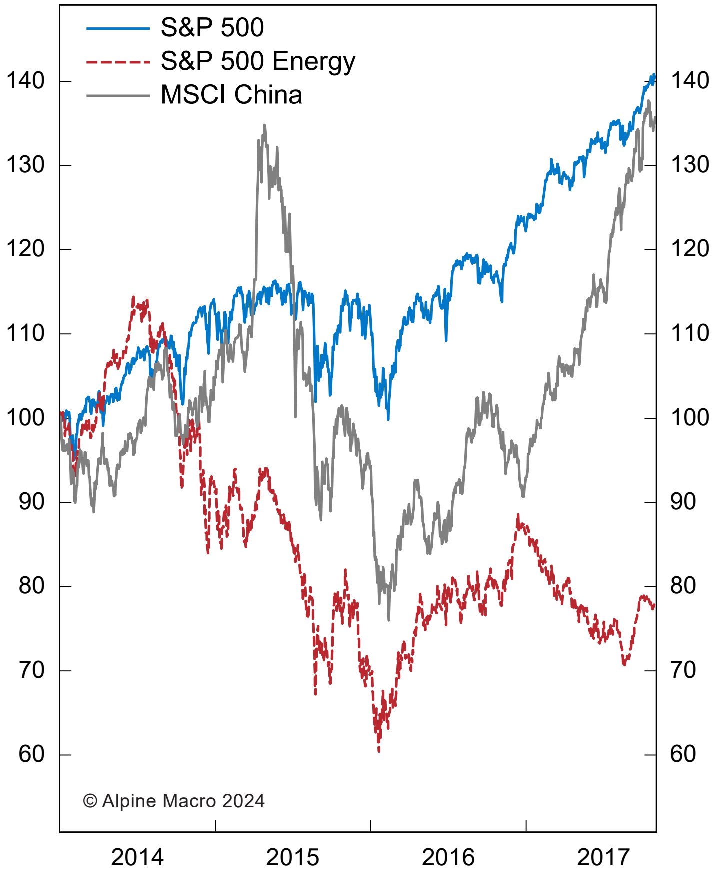
Chart 3 Dollar Rose And Oil Dropped In Mild Recessions



Note: Only data starting 2010 considered for peak-to-trough calculations

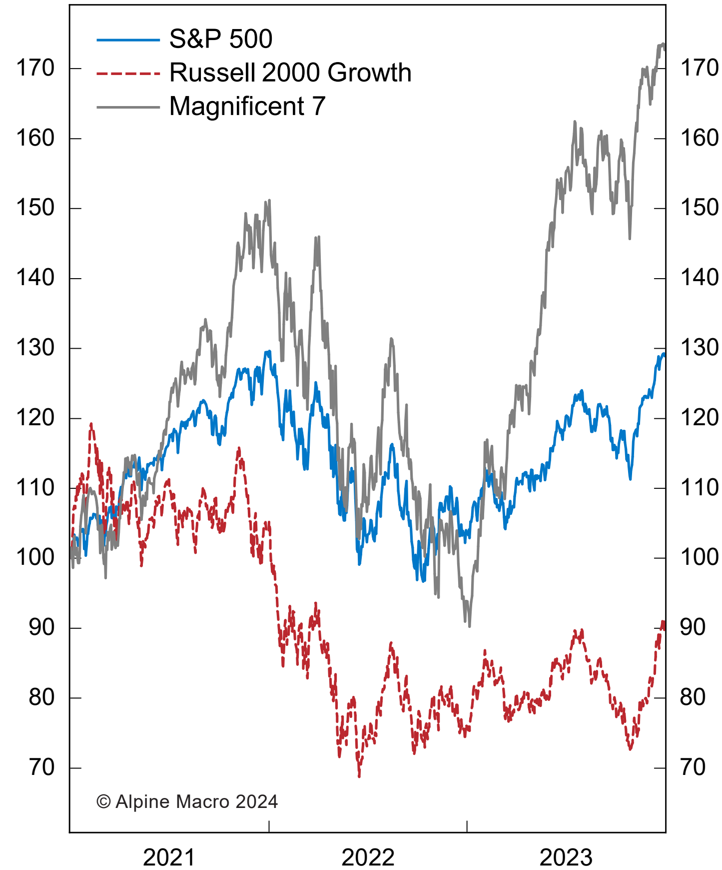
- The S&P 500 had double-digit declines from peak to trough, but the declines were far smaller than the 38% average drop surrounding the average recession.
- Bond price movements were in opposite directions, rising in 2015 and falling in 2022, owing to differing Fed policy and inflation trends.
- Real GDP was little changed, versus a 3.8% drop in the average recession.
- Forward EPS dropped by single digits, while actual EPS declined by even less.
- Oil dropped and the dollar rose (Chart 3).

Chart 4 S&P 500 Completed Double-Bottom As Energy And Chinese Stocks Plunged



Note: All series are rebased to Jan 2014=100

Chart 5 S&P 500 Completed Double-Bottom As Tech And Growth Kept Falling



Note: All series are rebased to Jan 2021=100

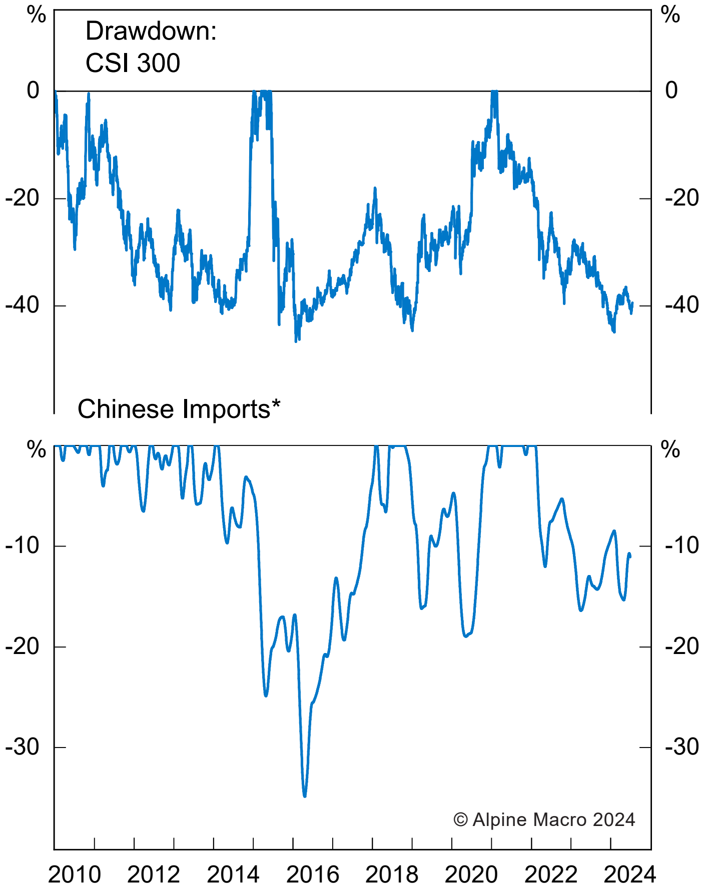
- Junk bond spreads widened, but by nowhere near the average 1,082 bps widening in the average of previous recessions.[3]

Moreover, each episode had a vulnerable sector that was especially exposed to the shock that spurred the recession (Charts 4 and 5). In 2015, energy stocks led the selloff, dramatically underperformed the S&P 500 and failed to participate when the latter finished a "double-bottom" in February 2016, only 7 months after the cyclical peak. China plays also were savaged, owing to unnecessarily restrictive policy settings (Chart 6).

In 2022, the shock was rapid monetary normalization and the end of pandemic-related surging tech demand. As discussed in Alpine Macro publications at the time, there was a vicious stealth bear market in "anything small" and "anything tech", even Big Tech, as the Fed hiked interest rates. These groups diverged negatively from the broad market, after it completed a "double-bottom" in June and October 2022. For example, the small cap Russell 2000 Growth Index sold off by 30% in just 6 months and retested its low in October 2023.

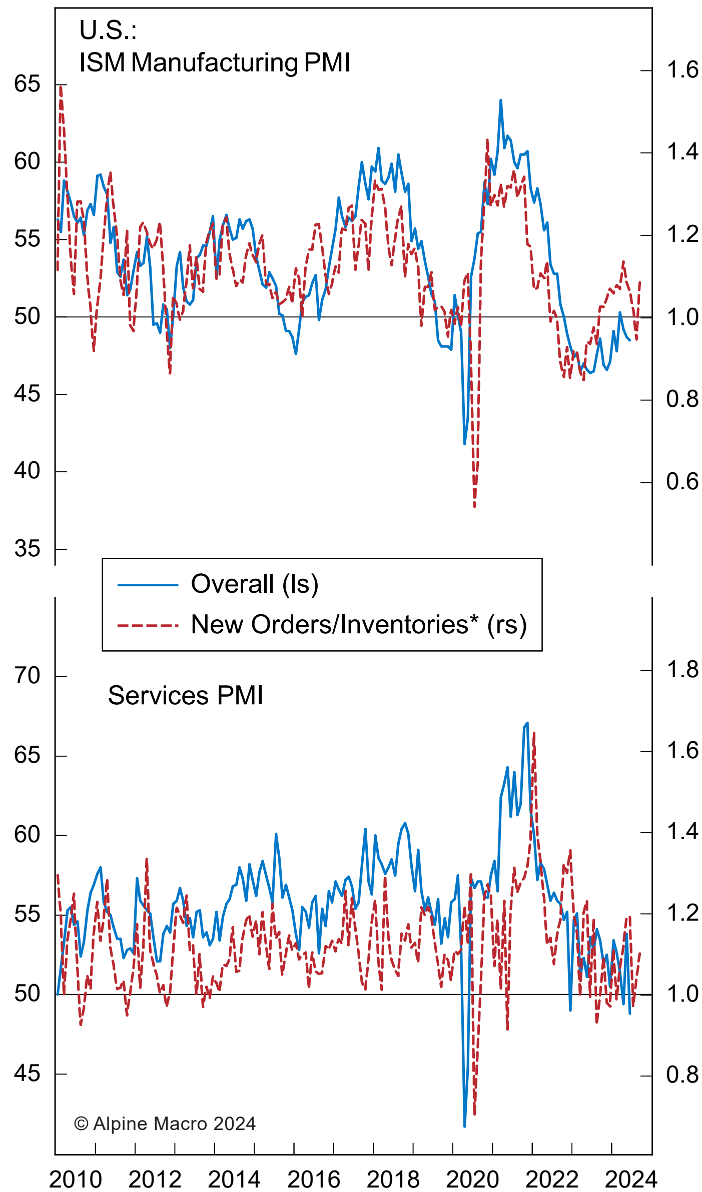
3 We exclude the energy sector from junk yields for the 2015 nominal recession because it was affected by the oil collapse, not the type of broad macro deflationary forces that cause junk spreads to blow out in every official recession.

Chart 6 China Plays Reflected Deflation And Policy Mistakes



*Shown as 3-month moving average
Note: Only data starting 2010 considered for peak-to-trough calculations

Chart 7 ISMs Are Soft, As In 2015 And 2022

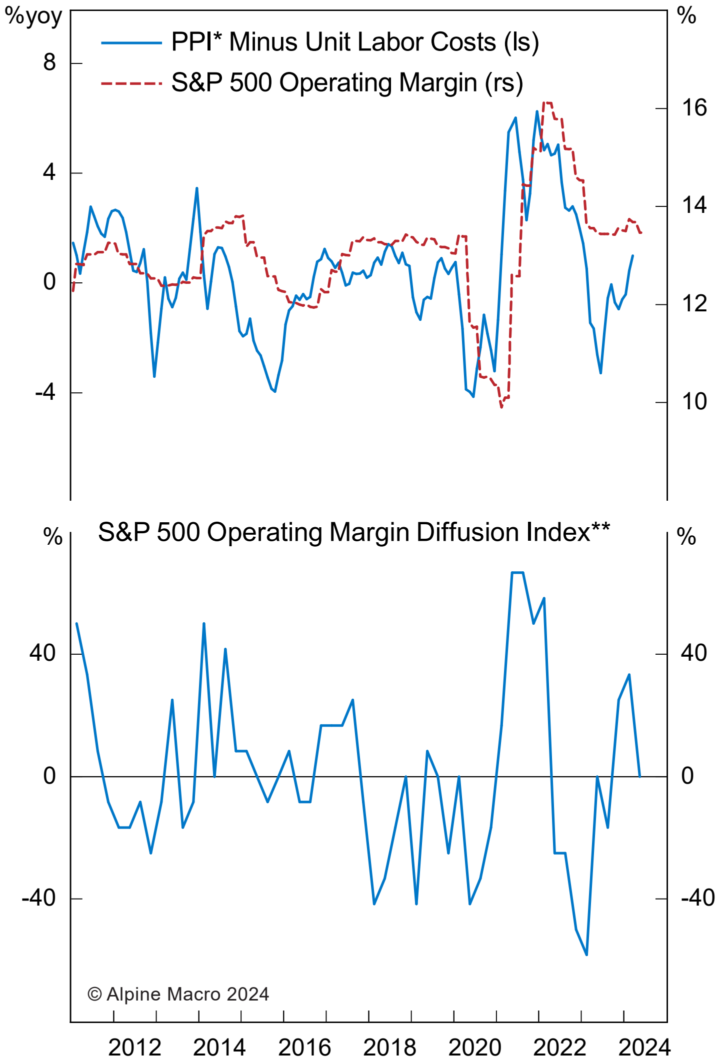


*Advanced by 3 months

This time around, real growth and pricing power are again softening as was the case with declines in both ISM manufacturing and non-manufacturing surveys for the 2015 and 2022 episodes (**Chart 7**). That is always bad for profits, but easing unit labor costs are a critical tailwind to monitor that may be different this time. Wage increases are slowing even before the economy weakens, while productivity is increasing. As a result, producer price inflation is rising *vis-à-vis* costs and operating margins are not yet contracting, according to our S&P 500 sub-sector diffusion index (**Chart 8**).

Bottom line: There is a fine line between dis-inflationary subpar growth and mild economic contraction. Neither causes a major bear market, but for a time, the latter can feel that way for sectors in the epicenter of the slowdown. Meanwhile, falling cost inflation could cushion profit downgrades even if there is a "whiff of deflation".

Chart 8 Margins Could Hold Up Better Than Usual



*PPI Final Demand
**% of industry groups with rising operating margins minus % of industry groups with decreasing operating margins
Source: Bloomberg Finance L.P.

What Could Go Wrong: Four Lessons

Our perfect landing scenario for the economy and markets is on track, but equity positioning and cycle-sensitive market indicators already reflect a chunk of this (**Charts 9** and **10**). There are four lessons from the 2022 and 2015 episodes for what could go wrong with our baseline perfect landing view.

First, monitor Chinese deflation, oil markets and junk bond spreads. The Chinese property sector has been contracting for three consecutive years and policy stimulus has been nowhere near what is needed to "fill the deflationary hole" in the private sector. That could undermine global pricing power, as well as commodity plays, including oil. Add to this OPEC spare capacity and Saudi's concerns that Russia may be overproducing, and there is a chance that the longstanding oil price range could give way to the downside, as discussed in the Sam Rines *Feature Report* discussion.[4] More generally, junk bond spreads are hyper-sensitive to deflationary strains and often lead equity market downturns.

Second, watch for earnings downgrades in sectors that have previously seen upgrades. **Appendix** tables show that this applied to the energy and tech sectors, respectively, in 2015 and 2022. Big Tech offers quality and profitability, but high expectations allow for downgrades. Some segments such as Materials, Consumer Discretionary, and even Software are at risk if growth disappoints given expectations in a pickup of cyclical volumes.

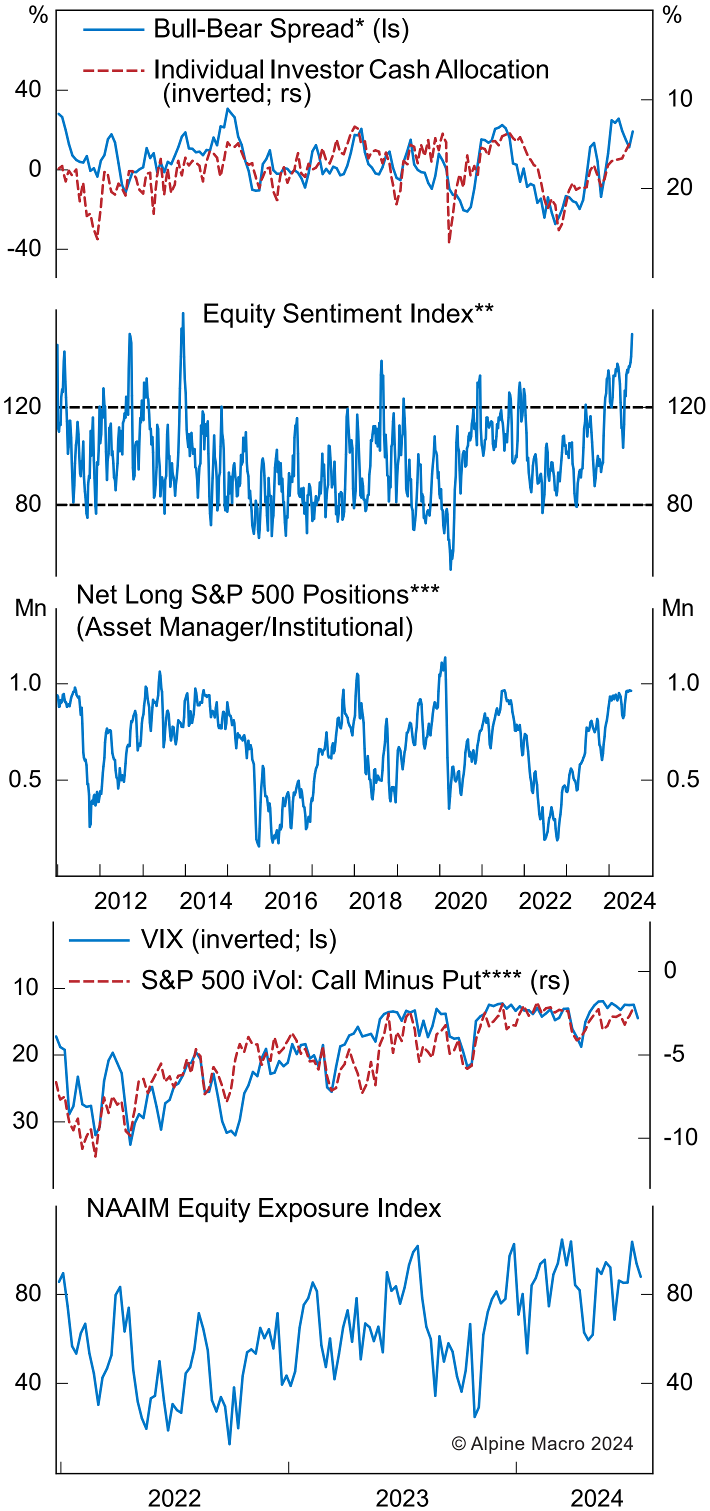
Third, volatility in risk assets will rise. Positioning is overextended and implied volatilities are low across the board, as was the case before the 2015 and 2022 episodes (**Charts 11** and **12**). A vicious correction already has begun in momentum factor stocks.[5]

Finally, a "double-bottom" in the broad equity market is more likely than a V-shaped trajectory.

4 Alpine Macro *Feature Report* "Energy And Macro Outlook" (June 19, 2024).

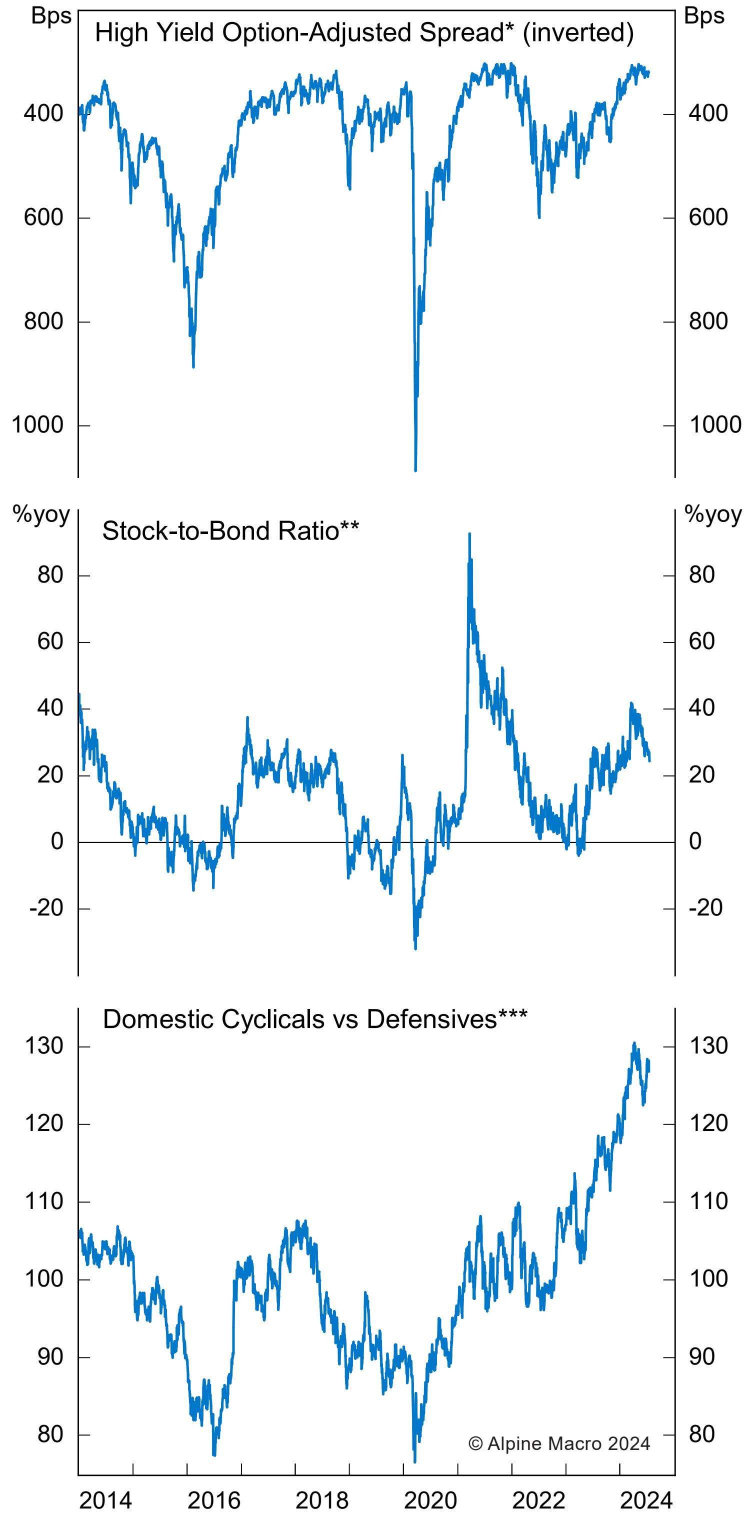
5 Alpine Macro *Equity Strategy* "Momentum Mo' Problems?" (May 14, 2024).

Chart 9 Equities Are Overextended By Any Measure



*Shown as 3-month moving average; source: AAII
**Shown as 4-week moving average; source: ISE
***Shown as 2-week moving average; source: CFTC
****25-Delta 2nd month contract; source: Bloomberg Finance L.P.

Chart 10 Market Indicators To Monitor



*Source: BofA Merrill Lynch
**S&P 500 total returns divided by 10-year Treasury total returns
***Rebased to Jan 2022=100; source: Bloomberg Finance L.P., Goldman Sachs

Chart 11 Equity Volatility Was Low, Then Reversed Sharply In 2015

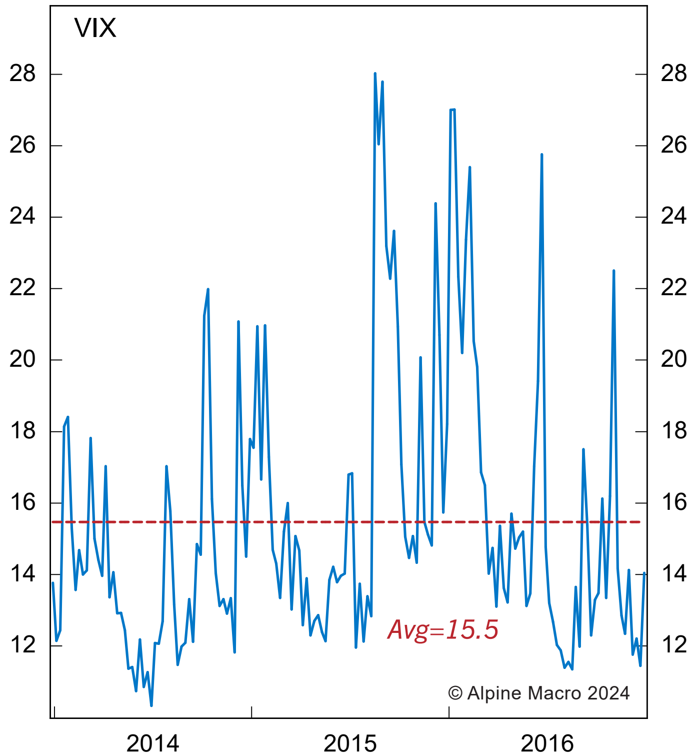
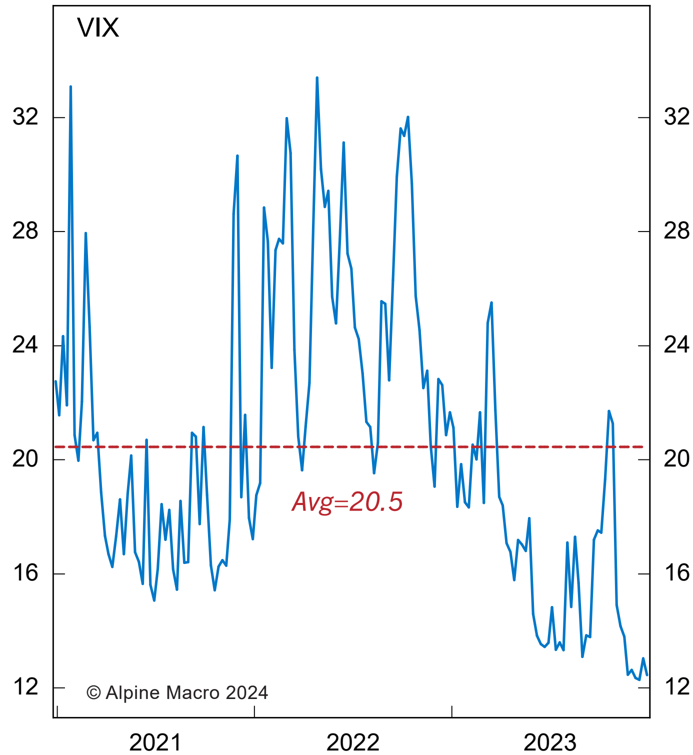


Chart 12 Equity Volatility Was Low, Then Reversed Sharply In 2022

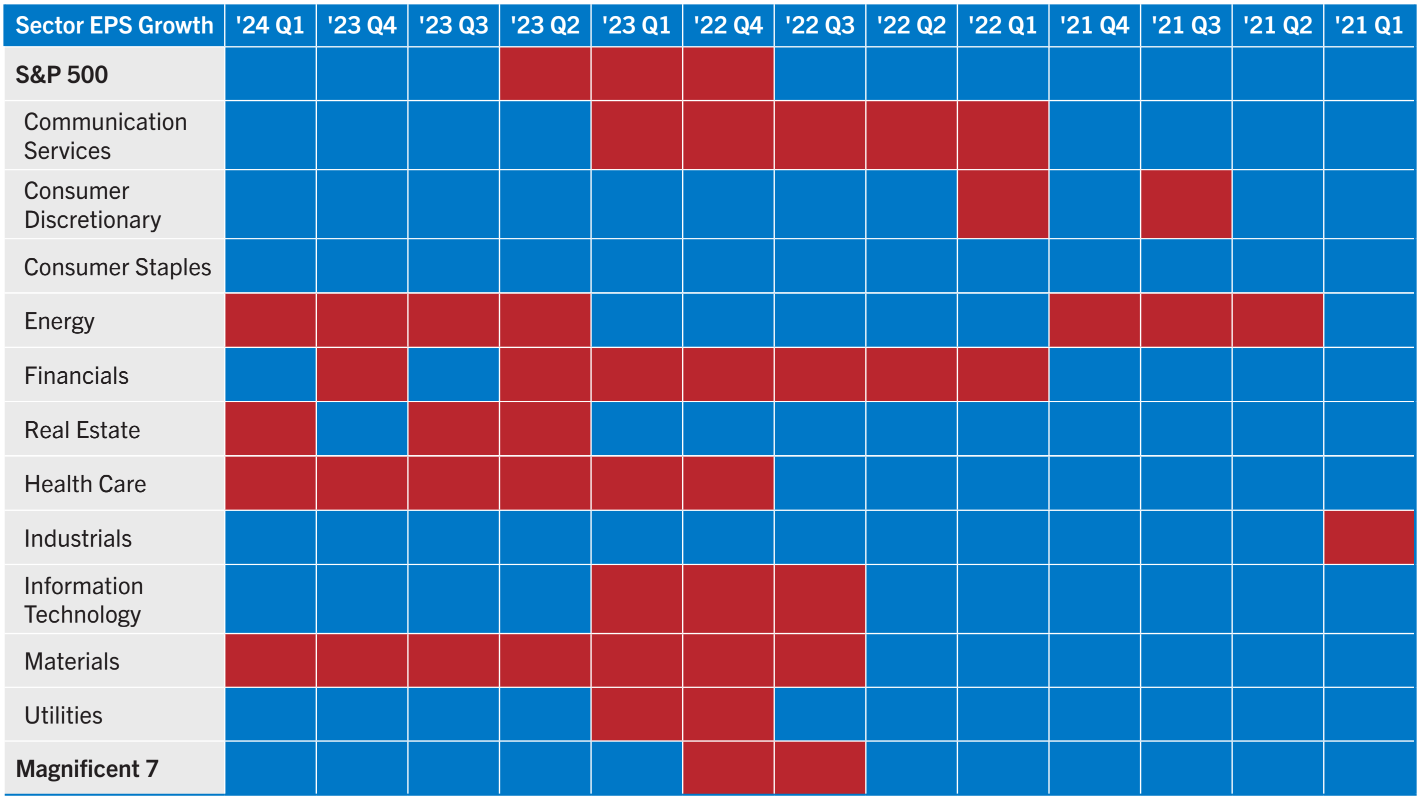


V-shapes require economic deflation and a financial stress event, leading to a market riot that forces an open-ended commitment to provide liquidity from policymakers. We see little evidence of balance sheet recession or financial excesses, after consumers pared back debt on the back of pandemic subsidies.

Bottom line: We are monitoring China, oil markets and junk bond spreads to gauge whether there will be a deflation scare. Double-digit profit declines are not necessary to spur a double-digit equity selloff, though capital markets may well "see over the trough" given the low odds of severe economic and financial stress.

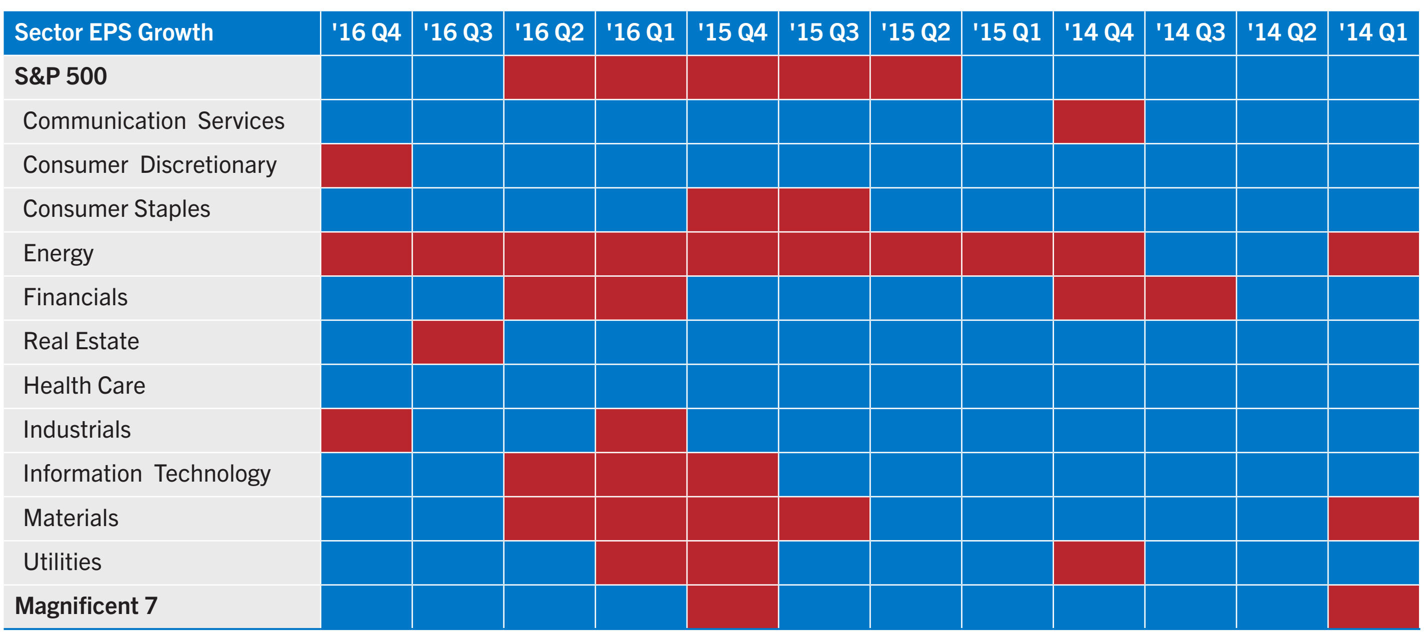
David Abramson
Chief U.S. Strategist & Director of Research

Appendix 1 EPS Growth Reversed Sharply In 2022 In Vulnerable Sectors



Note: Red cells denote quarters of negative YoY EPS growth

Appendix 2 EPS Growth Reversed Sharply In 2015 In Vulnerable Sectors



Note: Red cells denote quarters of negative YoY EPS growth

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