Transition Blips Or Major Shifts?

- While the U.S. labor market is cooling, a pronounced slowdown in consumption remains unlikely.
- Markets have factored in the Fed's shift toward neutral policy settings, supporting a benchmark duration weighting for the time being.
- Although global growth is in a mini-downcycle, the fall in yields, oil and the dollar should be sufficiently reflationary to reinforce the broader recovery.
- Oil is entering a window of risk, but the cyclical downside should be limited. Reduce exposure to neutral.
- The upcoming easing cycle will benefit, not hinder, equities. Investors should capitalize on market rotation by focusing on rate-sensitive growth stocks and small caps.

Global Asset Allocation	Underweight	Neutral	Overweight
Equities			●
Bonds		●	
Cash	●		
Equity Regional Allocation (USD Terms)			
U.S.			●
EAFE	●		
EM		●	
Equity Style Allocation			
Defensive		●	
Cyclical		●	
Value	●		
Growth			●
Large Cap	●		
Small Cap			●
Bonds			
Interest Rate Duration		●	
Treasuries	●		
IG & HY Corporates		●	
Securitized Product			●
FX/Commodities			
U.S. Dollar		●	
Gold			●
Materials/Base Metals			●
Oil		●	← ○

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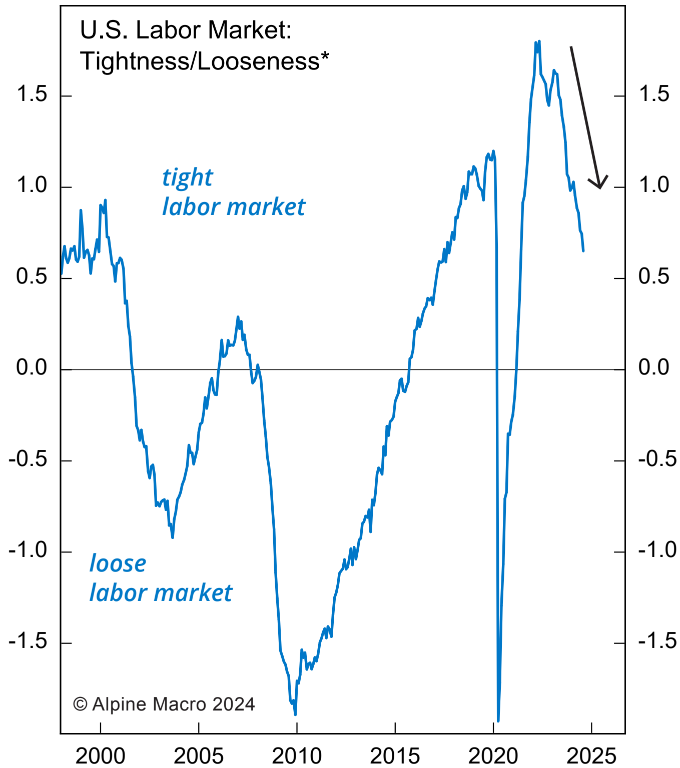
Chart 1 A Loosening, But Still Tight, Labor Market



*Standardized summary statistic based on 1) unemployment rate relative to trend, 2) prime-age participation rate relative to trend, 3) job vacancies relative to number of unemployed, 4) quits rate, and 5) Conference Board "jobs plentiful" minus "jobs hard to get"

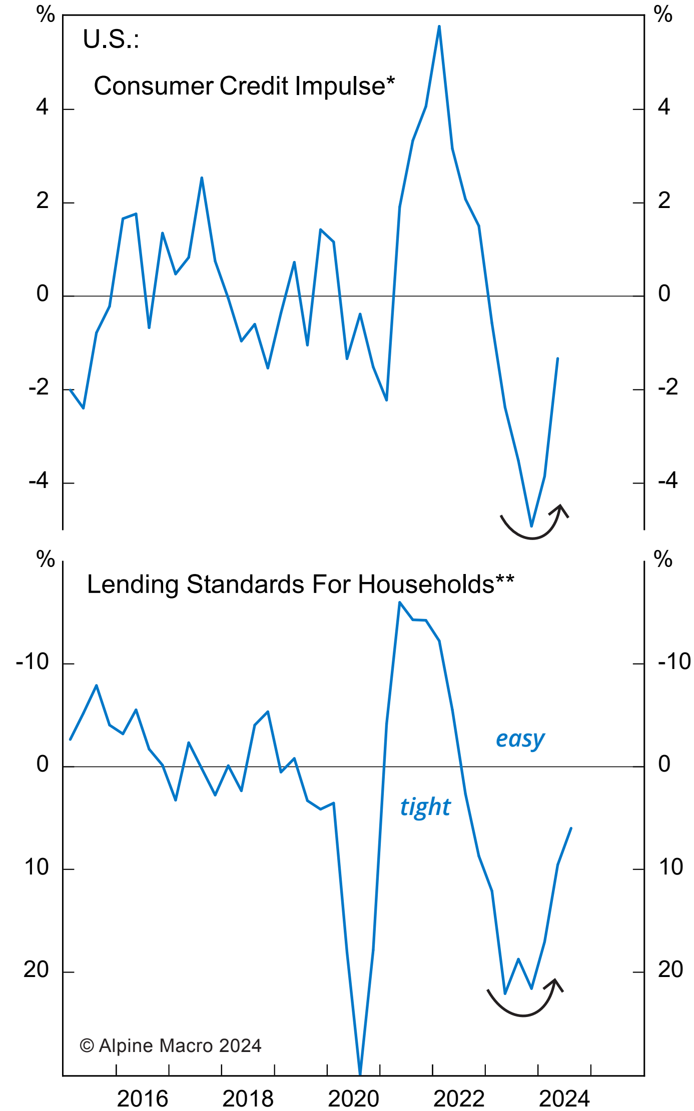
Theme 1

U.S. Consumption To Hum Along Despite A Cooling Labor Market

Market skittishness is resurfacing as Fed easing looms later this month. Investors are zeroing in on every U.S. labor data release for signs of a possible "hard landing". Sputtering demand conditions globally have only heightened the anxiety.

Without delving into all the specifics, the U.S. labor market is clearly slackening, but is far from collapsing. Our summary statistic suggests that the labor market can still withstand moderate additional cooling before entering "loose" territory (**Chart 1**).

Chart 2 Easing Headwinds For Consumer Credit



*Measured as the annual percentage point change in annual consumer credit growth; source: Federal Reserve Bank of New York
**Truncated at 30 in 2020; source: Federal Reserve Senior Loan Officer Opinion Survey, Alpine Macro calculation

From a broader perspective, the household sector does not appear to be buckling under stress. We are closely tracking the following indicators to gauge whether any consumption slowdown will be benign or more pernicious:

- Real private aggregate earnings—a function of the level of private employment, inflation-adjusted hourly wages, and weekly hours worked — are rising at a solid 2.5% annual pace, with no sign of rolling over. As a proxy for household income growth, this is arguably a more insightful measure to look at than focusing solely on the pace of monthly payrolls.

- The personal saving rate is still trending lower, reflective of healthy household balance sheets. Savings would need to sustainably rise to indicate a precautionary cutting back in consumer spending in anticipation of tougher times ahead.

- The household credit impulse, while still negative, is hooking higher. Further improvement, on the back of falling rates and easing lending standards, should bolster consumption (**Chart 2**).

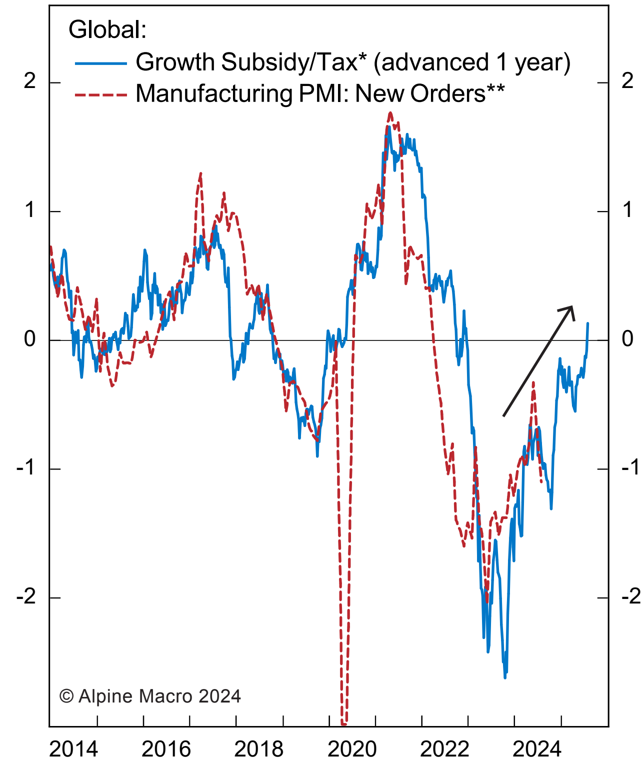
The key point here is that the odds of an orderly growth deceleration remain high, provided the Fed charts a steady course towards neutral monetary policy.

What about faltering growth outside the U.S.? Slumping commodity prices and the sharp decline in Chinese credit data are certainly cause for concern. The real question is whether this signals a brief downcycle or if the global economy has lost its growth momentum altogether.

For now, we lean toward the former.

It is important to remember that markets are highly self-correcting in response to economic shifts. The decline in U.S. yields, the dollar, and oil prices translates into a meaningful easing of global financial conditions, which should act as a growth "subsidy" for the global economy (**Chart 3**).

Chart 3 **A Coming Global Growth "Subsidy"?**

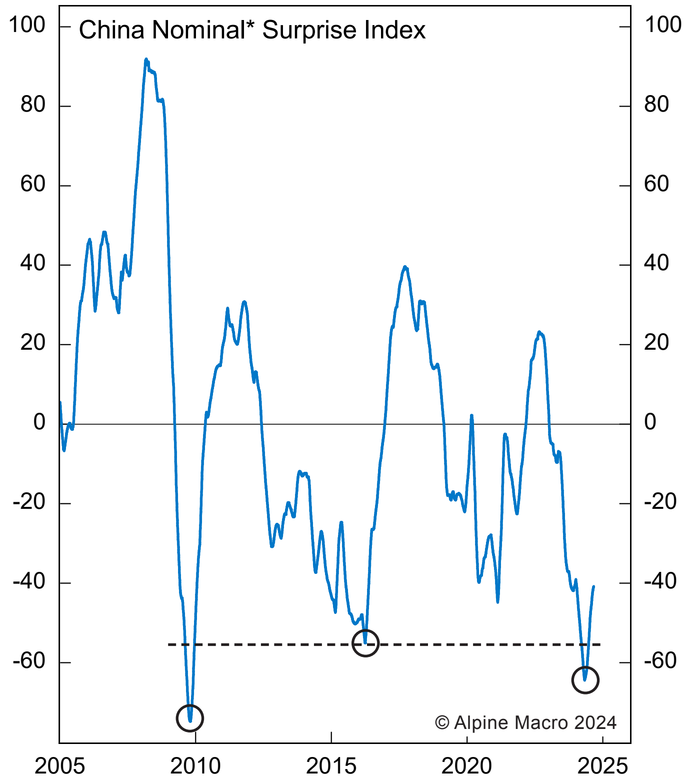


*Based on deviations from trend of the U.S. 10-year yield, trade-weighted U.S. dollar and oil prices; rising figure represents a growth tailwind; Alpine Macro calculation
**Proxied by the U.S., Sweden, Austria, Taiwan, and New Zealand; truncated at -3
Note: Both series shown standardized

Turning to China, its overly restrictive monetary and fiscal policies continue to exert a deflationary impulse on the rest of the world. It has become challenging to pinpoint what might break policymakers' inertia. However, what we can say is that the cumulative growth and inflation disappointments are at levels comparable to those seen in 2009 and 2016 (**Chart 4**). This suggests that a major policy reversal, which would represent a positive surprise for global growth and markets, may not be far off.

Bottom Line: Moving beyond the myopic focus on U.S. payrolls, the anticipated trend in consumption remains consistent with a mild growth slowdown.

Chart 4 Chinese Data Disappointments On Par With 2009 And 2016



*Combines both economic and inflation surprises; shown as a 1-year moving average; source: Citi

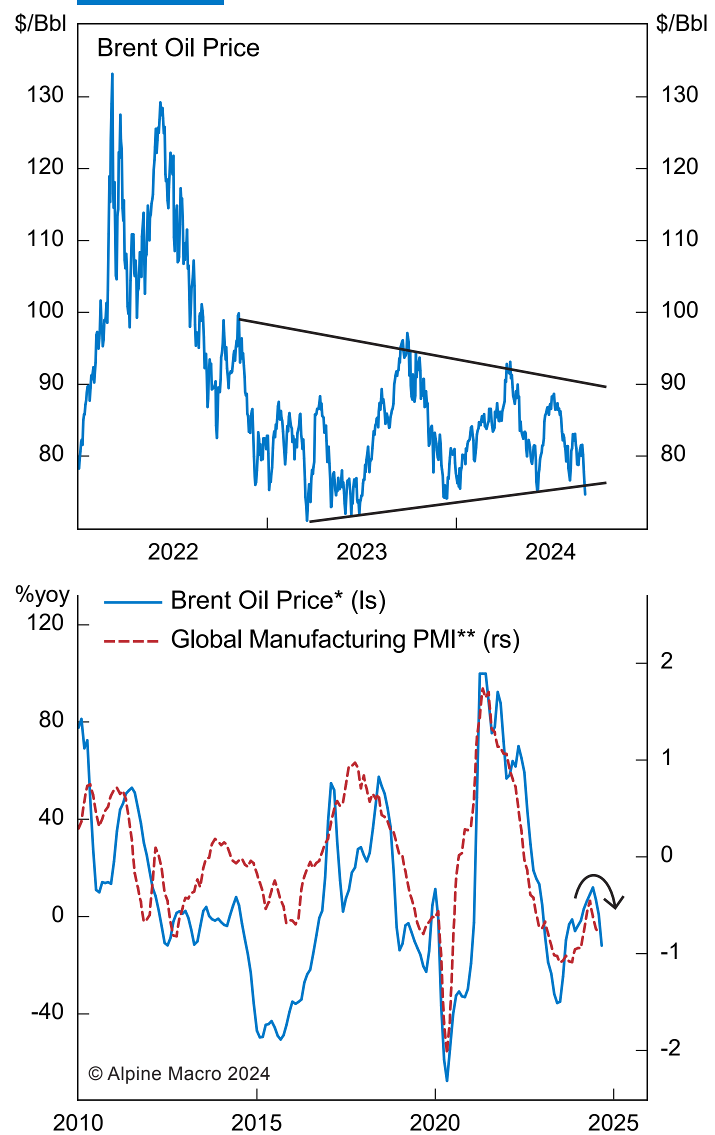
Maintain a neutral duration stance for now as markets have already priced in a substantial amount of Fed easing.

Theme 2

Oil Likely To Settle In A Range

Crude oil is breaking below key support and falling out of its "tapered wedge" formation (Chart 5, top panel). Recent price weakness, beginning in early May, aligns closely with the mini-relapse in global manufacturing that started around the same time. Since early last decade, oil prices have largely tracked the cyclical swings of the global business cycle (Chart 5, bottom panel). The notable exceptions were Saudi Arabia's

Chart 5 A Window Of Risk For Oil...

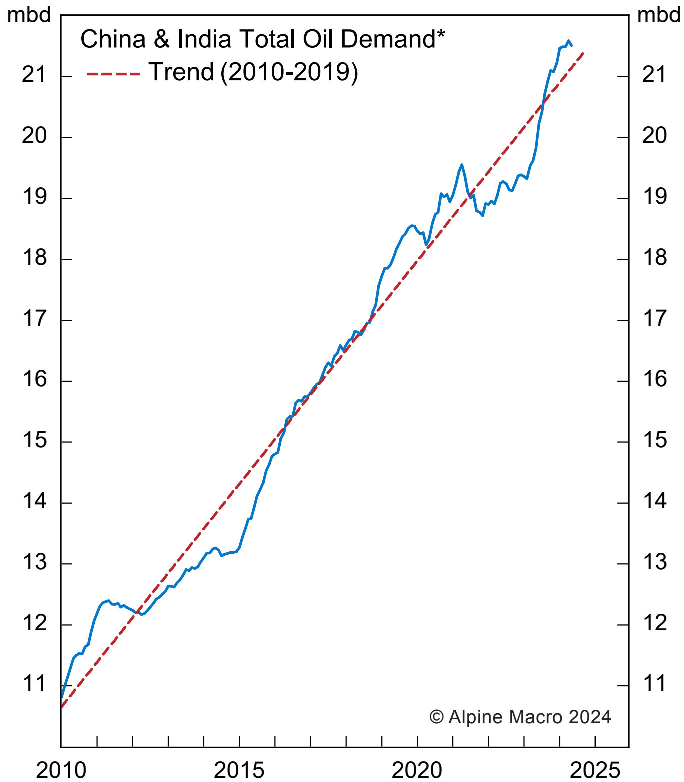


*Truncated at 150
**Standardized median PMI of 10 countries; Alpine Macro calculation

temporary disbanding of OPEC in 2014 and Russia's invasion of Ukraine in 2022, both significant supply shocks.

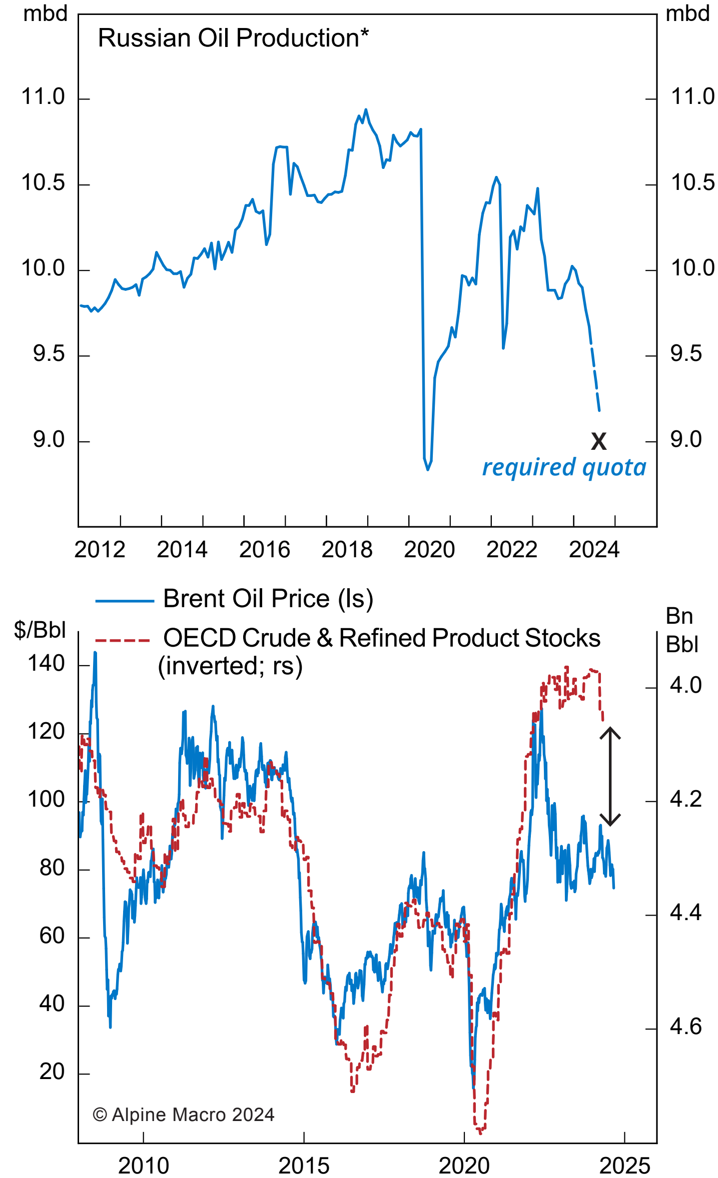
Some further price downside is possible as U.S. growth softens and Chinese activity remains sluggish without aggressive policy stimulus. Of course, the technical backdrop is also disconcerting.

Chart 6 ...But Medium-Term Demand Outlook Remains Positive



*Shown as a 12-month moving average; source: JODI

Chart 7 Oil Downside Likely To Be Capped



*Dashed line represents Alpine Macro forecast; source: JODI, EIA

That said, investors are advised to exercise caution before chasing oil lower. As noted above, easing financial conditions will help cushion the recovery in global manufacturing. Meanwhile, the positive medium-term consumption outlook remains intact. Despite immediate worries, combined Chinese and Indian demand continue to outpace the trend of last decade (Chart 6).

Several other factors suggest that Brent could find a broad base around $70/bbl:

- OPEC+ has already scrapped its initial plan of partially reversing production cuts this fall, and is almost certain to extend the cuts well into next year should oil remain on the backfoot. This stands in contrast with unfounded fears that Saudi Arabia might impose discipline on Russia, akin to its actions against U.S. shale in 2014. By our estimates, Russia is now a stone's throw from meeting the cartel's 9 million bbl/day quota (Chart 7, top panel).

- Lower prices should encourage the U.S. to step in more aggressively to rebuild its Strategic

Petroleum Reserve after a nearly 50% drawdown in 2021–23. The government had already begun extending bids once WTI dropped below $80/bbl.

- OECD stocks of crude and refined product remain alarmingly low (Chart 7, bottom panel). This heightens the odds of a price spike in the event of supply disruptions. Our *Geopolitical Strategy* team believes that a broadening and sustained Middle East war is the most significant conflict risk over the 6-9 months.

Bottom Line: Trim oil exposure to neutral as U.S. growth slows and Chinese policymakers hold back from more forceful reflationary policies. However, downside risk should be limited around $70, supported by OPEC+ management, U.S. SPR restocking, and depressed global inventories.

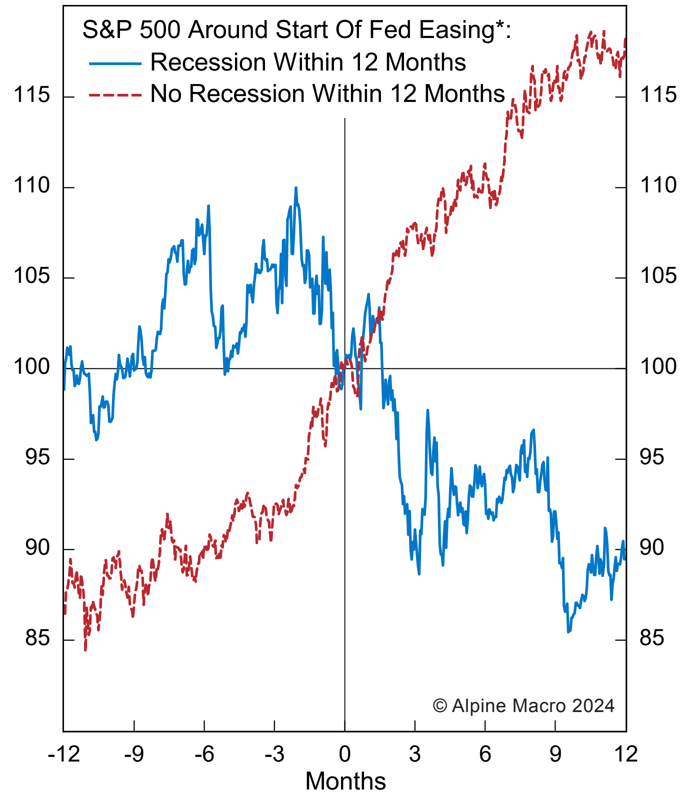
Theme 3
Equity Consolidation And Rotation

We have often made the case that the mid- to late 1990s offers the most likely roadmap for the current stock market cycle.[1] While no two periods are ever the same, today's macro backdrop is not profoundly different. The Fed is about to chop rates in the context of a remarkably resilient U.S. economy that is outperforming the rest of the world.

The market implications are two-fold: a continued runup in stocks, and a rotation of capital into the lagging segments of the market. In other words, equities should gain additional "height" and "width".

1 Alpine Macro *Global Strategy* "Narrowing Leadership: Is The Market Walking A Tightrope?" (July 29, 2024)

Chart 8 Equities Perform Exceptionally With Rate Cuts And No Recession



*Sample size includes 9 easing cycles since 1974, with 4 not followed by a recession in the subsequent 12 months (1984, 1989, 1995, 1998); rebased to 100 at start of Fed rate cuts

Some argue that Fed rate cuts are an unambiguously bearish market signal, indicating an economy in trouble. Yet, the evidence tells a different story. There have been 9 easing cycles since 1974, 4 of which were not associated with a recession in the subsequent 12 months.[2] Of course, this distinction is crucial for equity performance, as shown in Chart 8. In all 4 non-recessionary instances, equities posted positive returns, delivering an impressive median gain of 18%.

2 This includes the easing cycle that started in mid-1989, where a recession began only in late 1990 and largely due to the significant spike in oil prices related to the Gulf War. Additionally, we exclude the 2018-19 easing cycle from our sample given its proximity to the exogenous pandemic shock.

While it is still uncertain which category the upcoming easing cycle will fall into, there are already ample signs of a healthy broadening out of stock performance.

still v v high

The Magnificent 7 have seen their share of the S&P 500 fall from 35% to 31%, a roundtrip from their earlier surge. This pullback serves as a much-needed reset from the previously excessive hype surrounding the AI theme (**Chart 9**, top panel). Looking out, Big Tech can overshoot again with the arrival of liquidity expansion — the one missing element that is common to manias.[3]

Encouragingly, the S&P 493 is picking up the proverbial baton. Despite some volatility, the broader market has been steadily trending upward within a defined channel since early April (**Chart 9**, bottom panel).

Bottom Line: The impending easing cycle will be a boon, not a bane, for equities. Investors should take advantage of market rotation by favoring rate-sensitive growth stocks outside of the Magnificent 7, as well as small caps.

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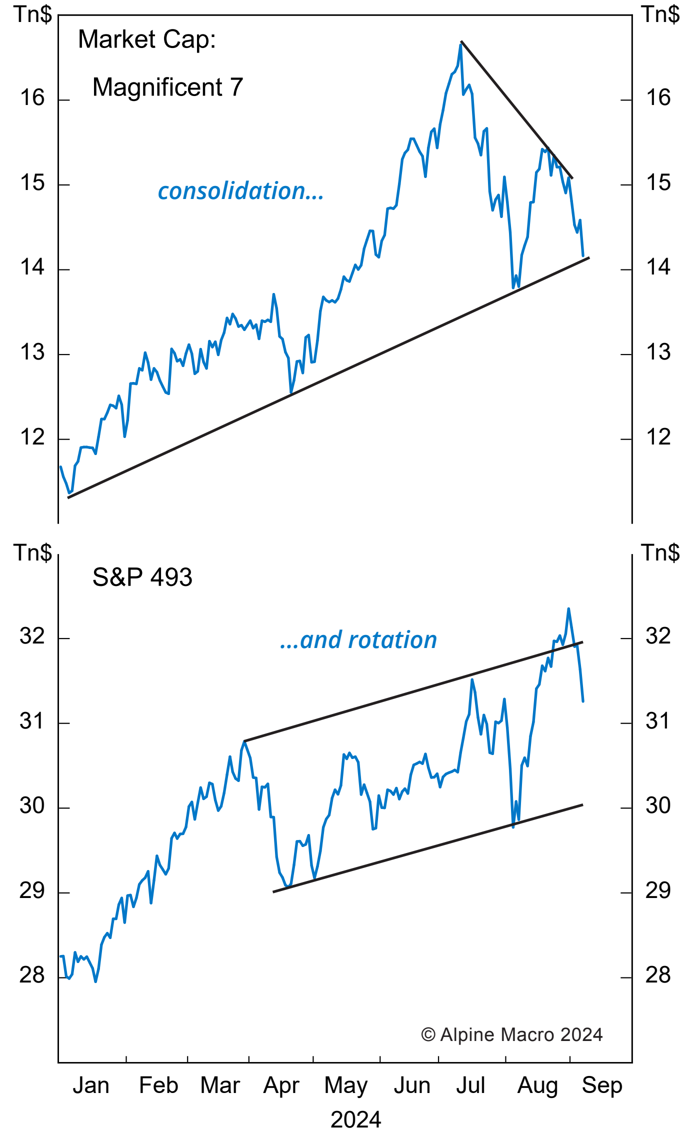
Chart 9 No Warning From Stock Market Internals



3 Based on the framework of the late Charles Kindleberger in his seminal book "Manias, Panics, and Crashes: A History of Financial Crises". The 3 other elements already in place are: a fundamental displacement, difficult-to-define valuations, and investment vehicles that are large enough to absorb mass participation and speculation.

Global Asset Allocation		Underweight	Neutral	Overweight	Rationale for View (3-6 Month Outlook) September 10, 2024
	Equities			●	A mild U.S. growth slowdown coupled with prompt Fed easing is bullish for equities. Easing financial conditions should also reinforce the global manufacturing recovery.
	Bonds		●		Fixed income is fully pricing in a goldilocks growth scenario. This limits the degree to which yields can fall further from current levels and leaves equities with more total return upside.
	Cash	●			The opportunity cost of maintaining a high cash weighting is high as the global easing cycle powers incremental gains for equities and longer duration fixed income assets.
Equity Regional Allocation (USD Terms)	U.S.			●	Despite its high valuation, an expanding productivity gap with the rest of the world reduces the odds of a sustained downturn in U.S. relative earnings growth.
	EAFE	●			Euro area earnings prospects are restrained by contracting exports and a weak credit impulse. Also, a strengthening yen from ultra-cheap levels will likely hinder Japanese common currency equity performance.
	EM		●		Given that a broad troughing in global growth remains intact, EM equities should rise relative to EAFE. Any positive policy surprise from China would further bolster stock outperformance.
Equity Style Allocation	Defensive		●		A neutral weighting in defensives provides a valuable hedge against anything more than a benign slowdown in U.S. growth.
	Cyclical		●		With no imminent recession on the horizon and rate cuts on the way, cyclicals should perform reasonably well. However, returns may be tempered if the dollar stays around current levels.
	Value	●			The window for value to outperform growth has likely closed now that rates are heading lower once again. Instead, this style factor should do well in the context of small cap outperformance.
	Growth			●	Growth equities remain on a mania path, with solid earnings growth and declining yields offering key support. Growth stocks outside the Mag 7 could meaningfully contribute in the next performance upleg.
	Large Cap	●			Large caps' relative valuation premium already discounts robust relative margin resilience, while small caps are poised to benefit as rates head lower once again.
	Small Cap			●	The resumption of a downward trend in yields should be a catalyst for a relative valuation revival in small caps given small firms' higher relative gearing and exposure to floating rate debt.
Bonds	Interest Rate Duration		●		Substantial pricing of Fed easing warrants a neutral weighting for now. Cyclically, yields still have room to head lower on the back of slowing growth, continued disinflation, and a cooling labor market.
	Treasuries	●			Fixed income investors are likely to keep moving out the risk curve given resilient growth and low odds of a severe recession.
	IG & HY Corporates		●		Potential returns on investment grade and high yield corporates are more limited compared to other credit given the tight starting point for spreads.
	Securitized Product			●	Respectable earnings growth, diminished odds of Fed rate hikes, and a latent capacity/willingness among investors to jump into the fixed income space should favor securitized product.
FX/Commodities	U.S. Dollar		●		The dollar should trade broadly sideways as a peaking growth and rates divergence with the rest of the world is counteracted by faltering Chinese growth.
	Gold			●	The gold bull market will be underpinned by a topping in the dollar and real yields, along with increased hedging demand due to rising geopolitical tensions.
	Materials/ Base Metals			●	The secular uptrend in usage intensity and overall demand via electrification amid weak capacity growth are structurally bullish.
	Oil		● ←	○	**Crude is likely to be caught in a range as a soft patch in global growth is counteracted by steadfast OPEC+ discipline, peaking U.S. shale output, and depressed global crude and refined product inventories.**

A Unique Mind On The Markets