Perfect Macro Landing: Strategy And Risks

- Economic data remain consistent with a 1-2% glide path for both real growth and inflation. In this environment, equity corrections will remain technical in nature and the window remains open for a Magnificent 7 overshoot.

doesn't exist anymore!

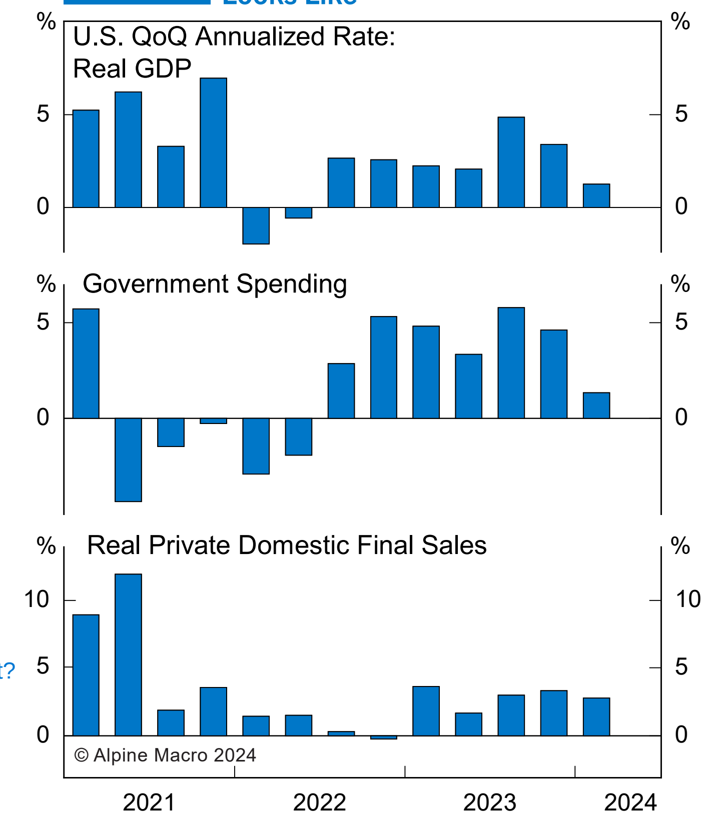
- Perfect landing would be moderately bond bullish. We raised duration to above average on June 10, after yields shot up following the strong nonfarm payrolls report.

- Treasuries (and bond proxies) offer "hedge value". The risks of a deflationary recession are far greater than an inflationary boom, though neither is our baseline scenario. The Fed has plenty of room to ease aggressively if there is a surprisingly rapid deterioration in the economy.

won't it be too late for that?

- Commodities and related assets will eventually outperform, but that requires stronger growth outside the U.S.

Chart 1 **What A Perfect Macro Landing Looks Like**



"We do see today's report [May CPI release] as progress and as, you know, building confidence. But we don't see ourselves as having the confidence that would warrant beginning to loosen policy at this time."

- Fed Chairman Jerome Powell
June 12, 2024 at post-FOMC Press Conference

U.S. economic indicators are consistent with a perfect macro landing. A moderate growth slowdown, disinflation and rising productivity should persist into the second half of this year, consistent with our *2024 Outlook*.[1] Risk assets have already rallied significantly and our indicators show widespread investor complacency. At the same time, the Fed wants to avoid an easing in financial market conditions that would offset monetary restraint.

1 Alpine *Macro Outlook "The Outlook For 2024 & Beyond: Disinflation, Reflation And The Roaring 2020s"* (December 4, 2023).

ALPINEMACRO 2024 INVESTMENT CONFERENCE

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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

Nevertheless, corrections will be fleeting and hard to time. The underlying trend in both stock and bond prices is up. Moreover, Treasuries provide "hedge value" if the economy tips into recession. This also applies to underperforming defensive equity sectors, such as healthcare, as will be discussed in Friday's *Special Report*, and utilities.[2] More generally, Big Tech still has mania potential and equity breadth should expand to include SHOULD less attractive but cheaper companies than the Magnificent 7 (Mag 7) but still offer reasonable growth prospects.

Theme 1

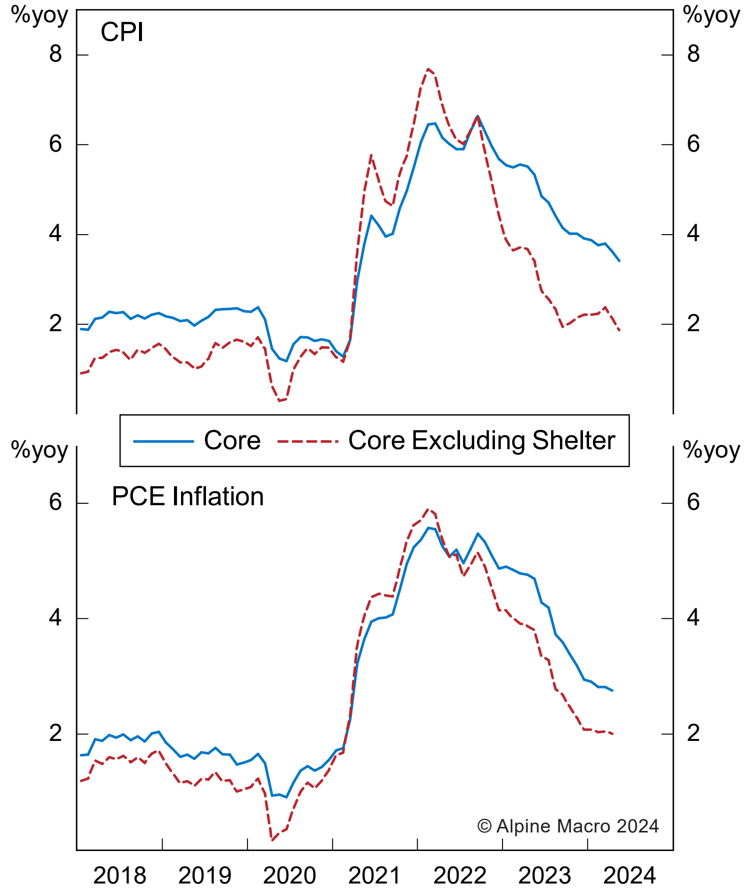
Perfect Macro Landing And Risks

Perfect macro landings are extremely rare. Still, the picture painted by coincident and leading economic indicators is exactly what would be expected for an economy that is "neither running too hot nor too cold". The Fed would have room to steadily lower interest rates even without a recession, a combination that would make corrections in risk assets fleeting and hard to time.

Chart 1 shows that Q1 GDP softened purely because of the unwinding of earlier fiscal stimulus. Real private domestic final sales, which excludes government, trade and inventories, continued to expand steadily. For Q2, the New York Fed Staff Nowcast and Atlanta Fed GDPNow project 1.9% and 3.1% growth, respectively. At the same time, the string of upside CPI surprises is over. Both core and core ex-shelter inflation are falling (**Chart 2**).

2 Alpine Macro *Special Report* "The Utes Are Alright" (June 12, 2024).

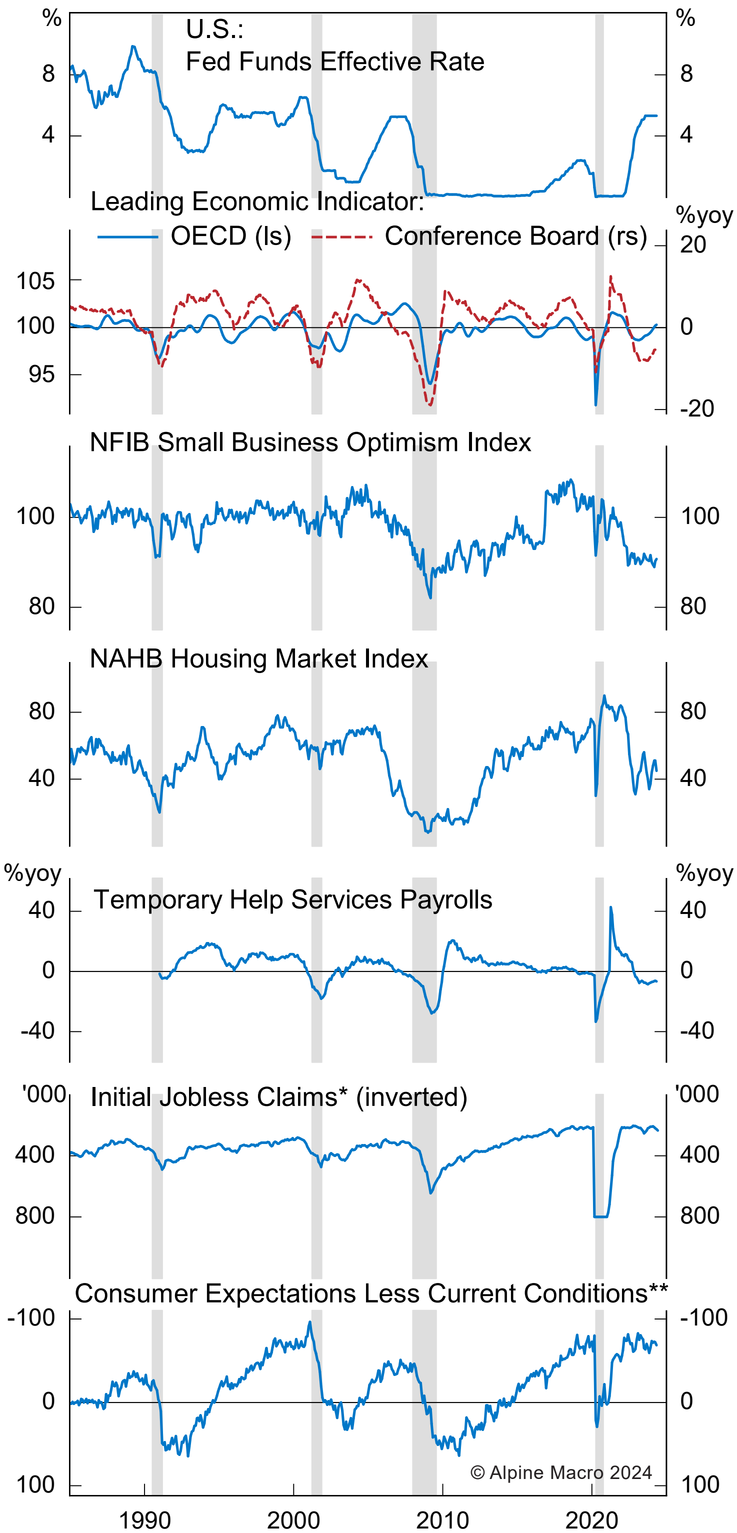
Chart 2 Underlying Inflation Downtrend



These indicators are not forward-looking, but they confirm that the U.S. economy is on a path that would justify Fed easing and support risk assets. Leading indicators also show exactly the cross-currents that would be expected if positive, but below-trend, growth lies ahead:

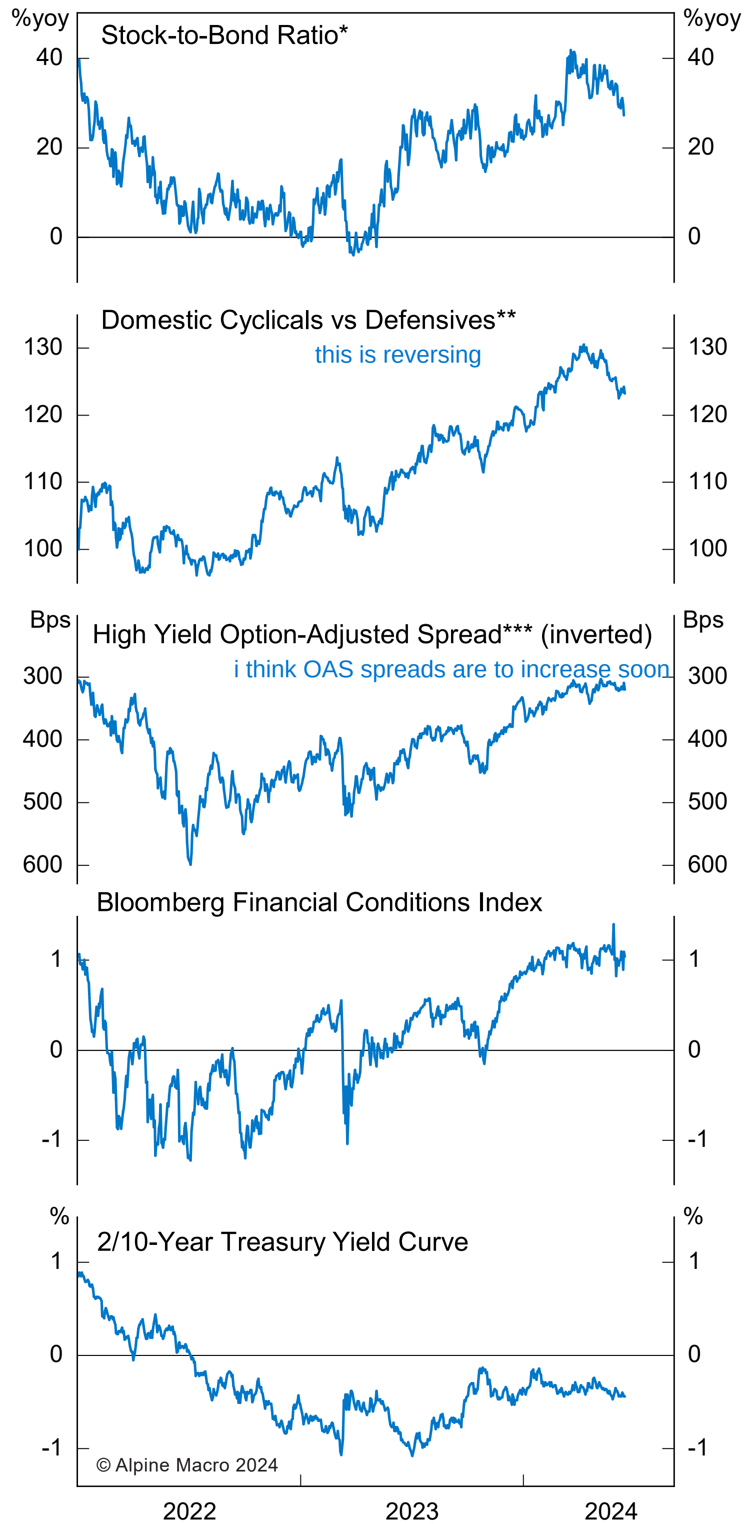
- Economic measures that have reliably led recessions in the past have flattened out after incorrectly warning of recession in 2023 (**Chart 3**). not yet
- Market-based measures trended higher for most of 2023, correctly anticipating a buoyant economy (**Chart 4**). So far in 2024, these indicators have gone flat or gently rolled over, although the yield curve remains inverted.

Chart 3 Macro Leading Indicators: No Trend



*Shown as 3-month moving average; truncated at 800
**Shown inverted; source: Conference Board
Note: Shading denotes U.S. recessions

Chart 4 Financial Leading Indicators: Unclear Trend



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

- ISM manufacturing and services surveys present a mixed message consistent with positive, below-trend growth (**Chart 5**). There is considerable variance between the ISM and S&P Global surveys because of different methodologies and coverage. Still, the overall picture is one of a weak manufacturing recovery and a firm services sector.

- Financial aggregates are soft but past the worst (**Chart 6**). Money and credit are off the bottom, but delinquency rates are rising. Commercial banks continue to tighten lending standards but at a much slower pace than in 2023. The starting point for household debt service is favorable by historical standards.

- Labor market indicators paint a clear picture of rising productivity, slowing wage growth and a softening labor market (**Chart 7**). Unit labor cost inflation is declining and leading employment indicators are uniformly falling. In addition, the pace of job creation is easing in the SLEC sectors (45% of total employment) that have accounted for the bulk of post-pandemic job gains (**Chart 8**).

All of this gives the Fed plenty of room for maneuver, the exact opposite of the “sour spot” of late 2021/early 2022 when the Fed was behind the inflation curve.

So why the “hawkish hold” at the June 12 FOMC meeting? First, the central bank awaits clear signs that inflation is returning to 2% after three consecutive upside CPI surprises earlier this year. Second, the Fed does not want investors to front run Fed

Chart 5 **Volatile PMI Trends**

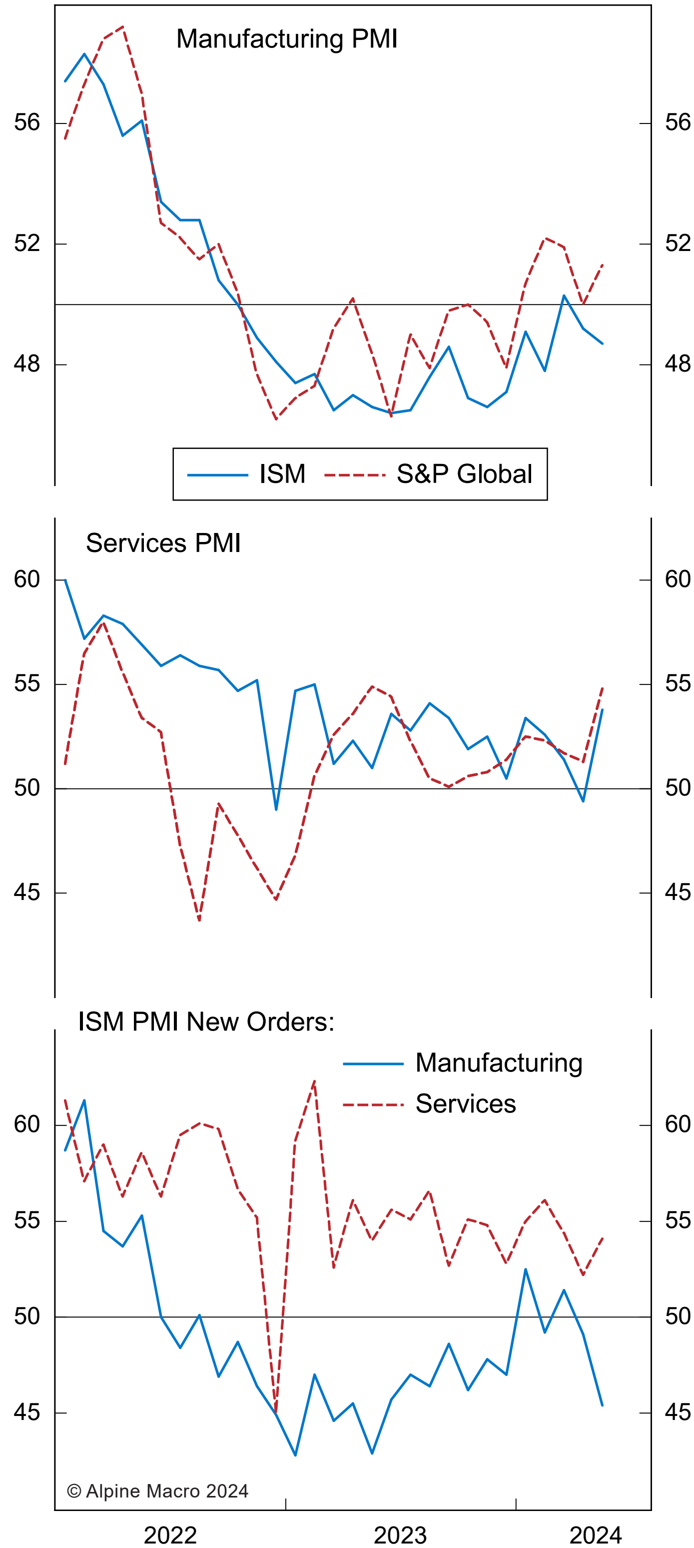
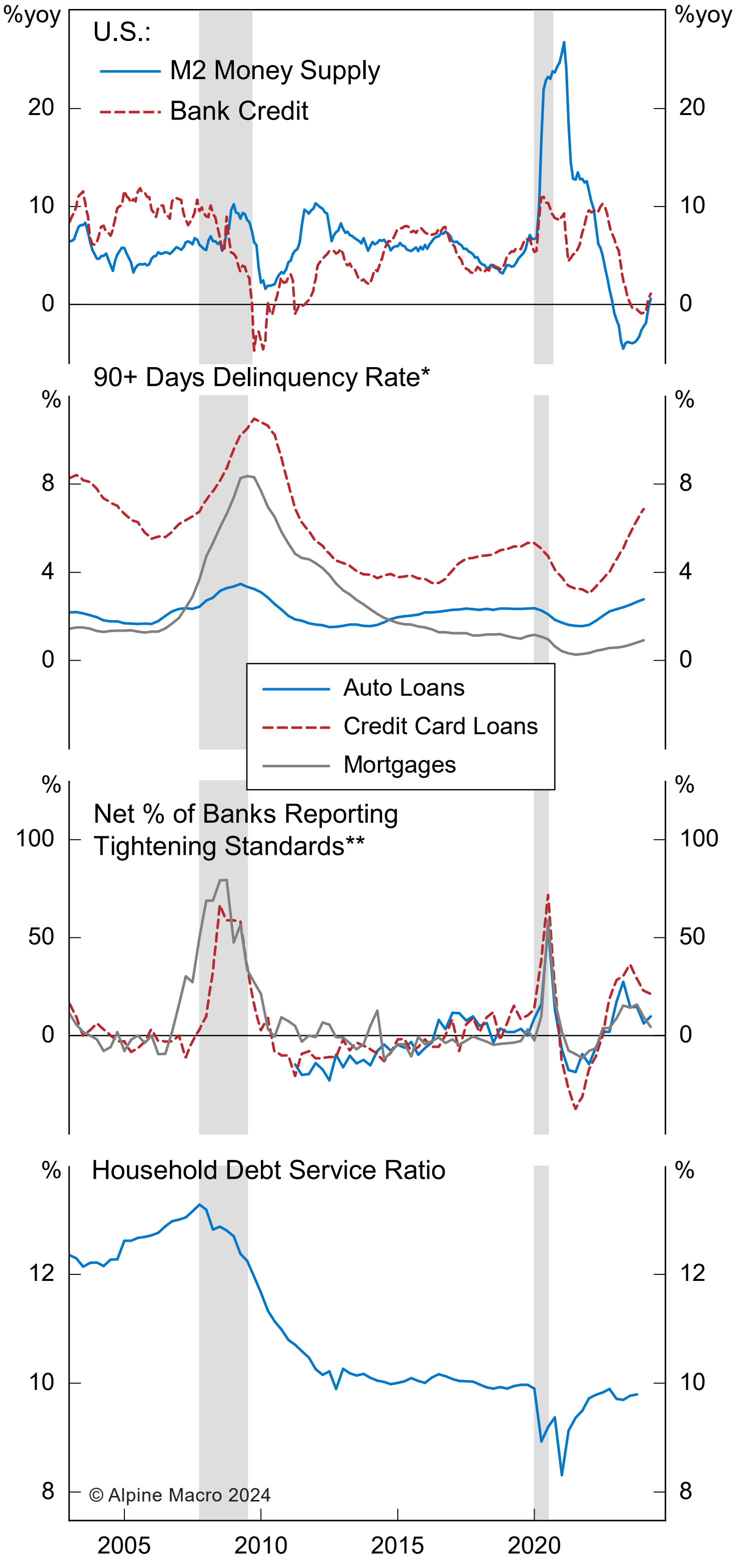


Chart 6 Perfect Money And Credit Landing?



*Source: Federal Reserve Bank of New York
**Source: Senior Loan Officer Opinion Survey, Federal Reserve
Note: Shading denotes U.S. recessions

Chart 7 Labor Market Should Soften

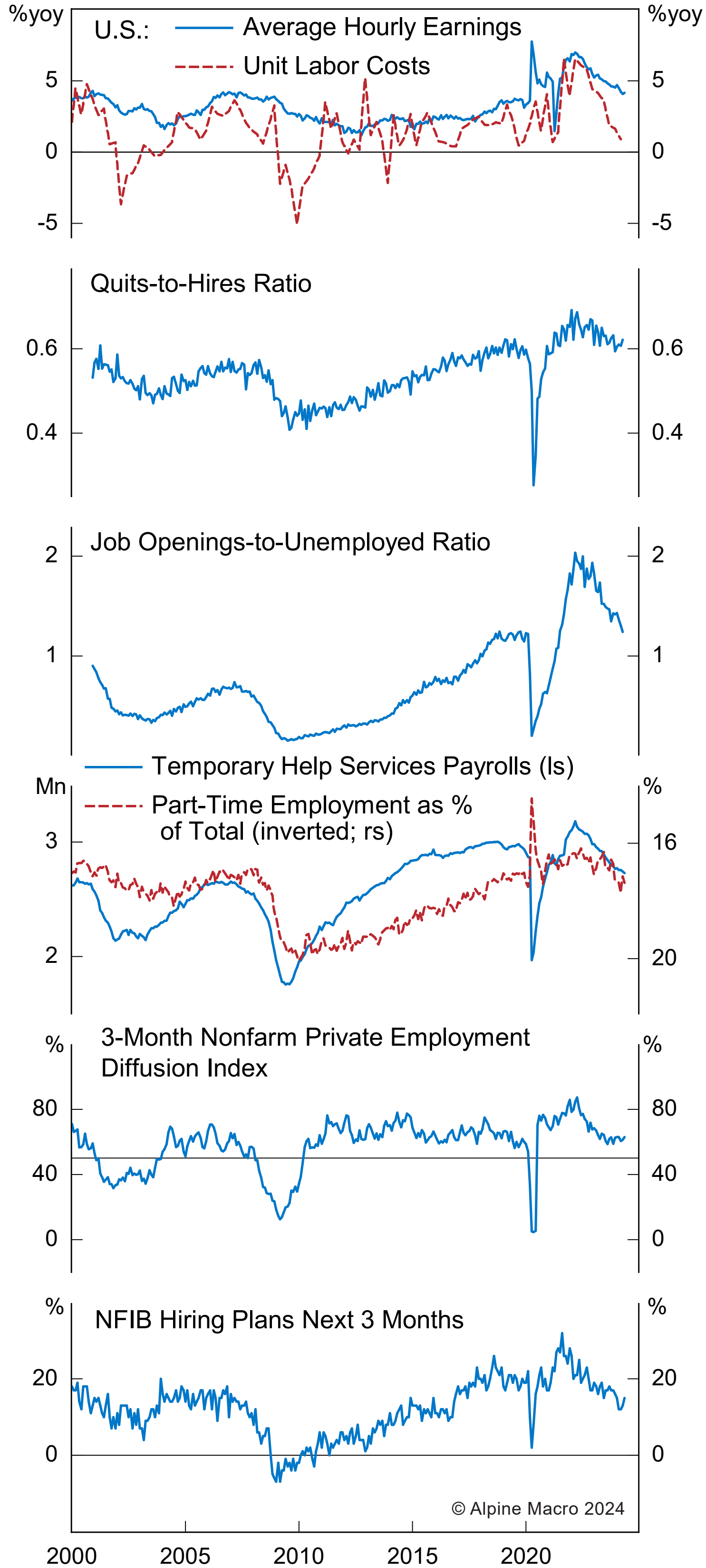
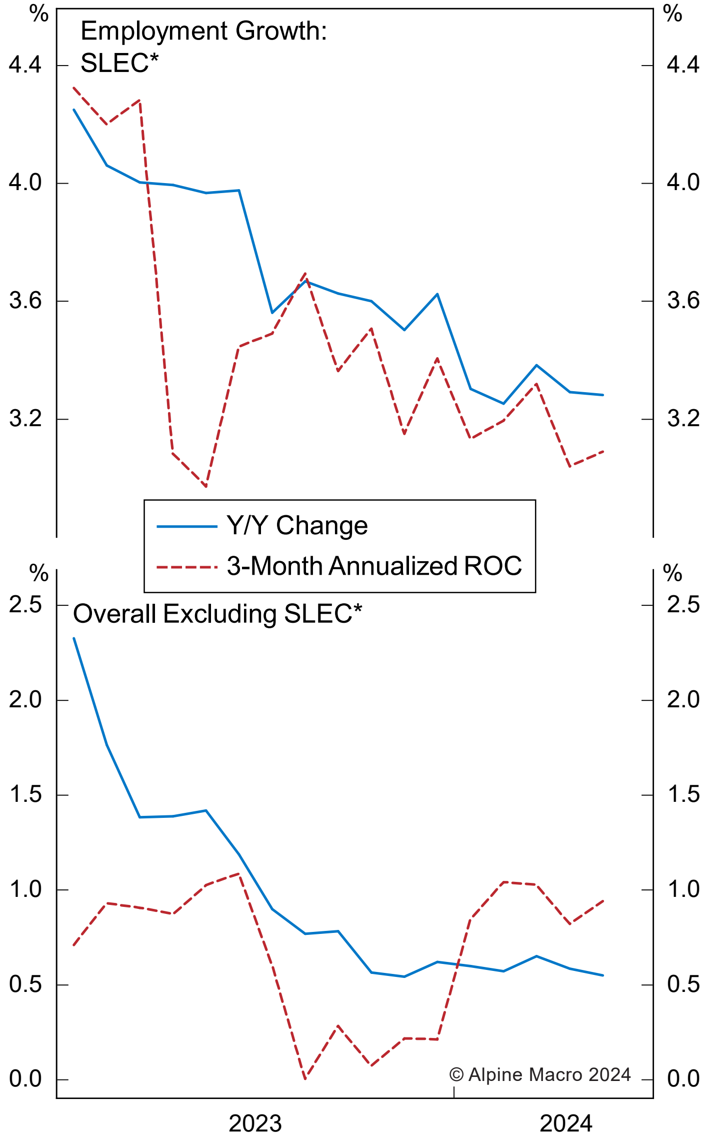


Chart 8 SLEC Hiring Slowdown



*State & Local Government, Leisure & Hospitality, Education & Health Services, and Construction

rate cuts, because that would ease financial conditions "too soon". Third, there does not appear to be systemic financial stress that would force the Fed to move quickly.

The corollary is that the Fed will lose control of the ability to cap stock and bond rallies if, as we expect, labor markets soften and inflation keeps falling. For a thorough analysis of recent inflation data and why the Fed will turn dovish sooner rather than later, see "The Dual Mandate", *Global Fixed Income & Currency Strategy*, June 14, 2024.

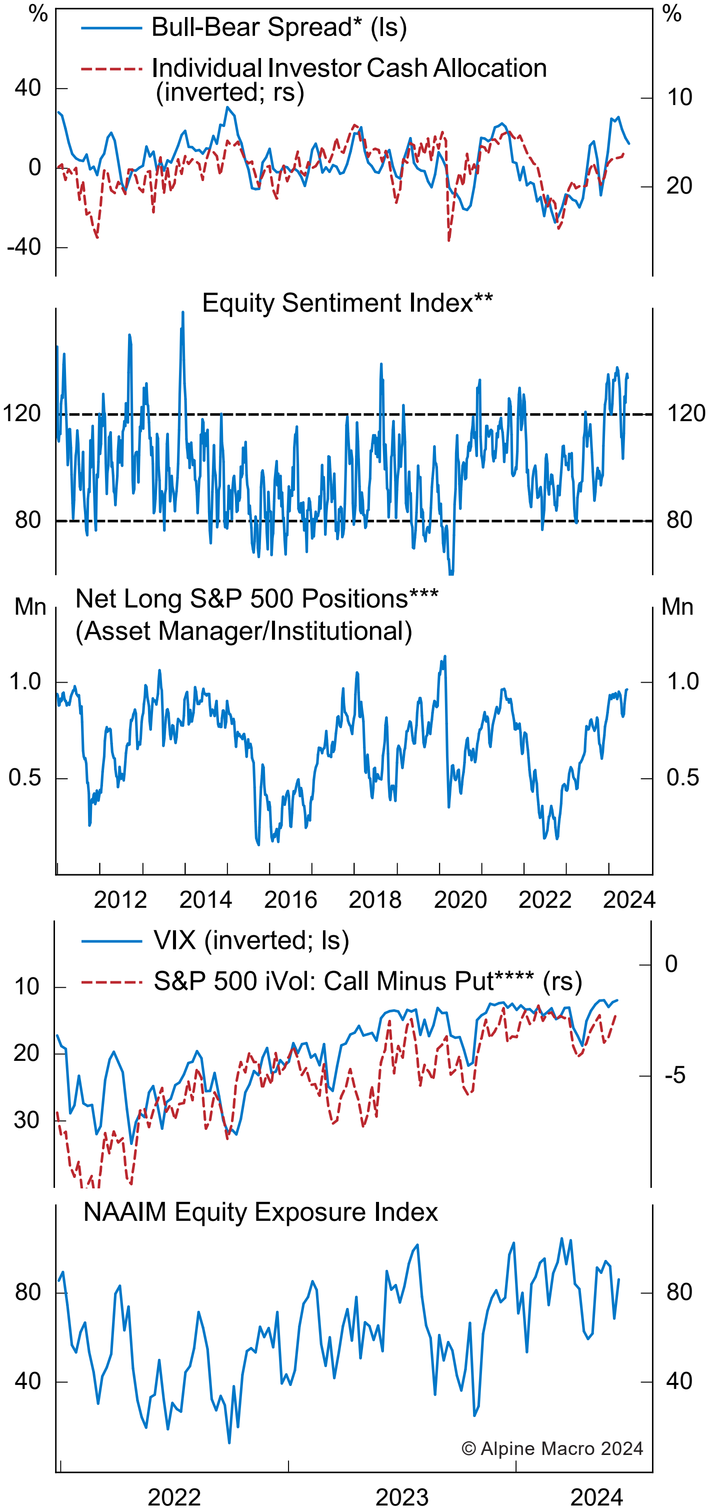
The risks to our rosy baseline scenario are heavily on the side of growth disappointment rather than an inflationary boom. Commercial real estate and small businesses could prove more vulnerable to a slowing economy than we expect, which could in turn devastate regional banks just as their Treasury mark-to-market exposure has improved.[3] Consumers have run down excess savings from pandemic subsidies.

Having said this, a recession would need to be severe to disturb capital markets. A mere "technical recession" would be more important for intra-equity selection than the overall market. The Fed has plenty of room to ease with short-term rates above 5% and inflation just above 3% and falling. Ergo, a brief, moderate economic contraction would boost interest rate sensitive sectors and growth stocks, including tech, even as cyclical and growth stocks get hit.

Bottom line: Perfect macro landing remains our baseline scenario, under which the Fed loses control of its ability to prevent exuberance in risk assets. Risks to our outlook are skewed on the side of recession and away from an economic boom, which makes "deflation hedge assets" attractive from a risk management perspective (see **Theme 3** on p.11).

3 Alpine Macro *Feature Report* "CRE: Different This Time, A Conversation With Lee Menifee" (May 17, 2023).

Chart 9 Equities Are Technically Overextended



*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.

Theme 2

Equities Overbought, Mania Potential Persists

Needless to say, equities will move higher if inflation declines, the economy avoids severe recession and the Fed steadily cuts interest rates. The bigger questions for strategy are: Should investors wait for the inevitable correction with stocks overbought and market gains concentrated in a handful of stocks? Related to this, will breadth continue to narrow and market concentration stay high? Finally, will market leadership remain with the Mag 7 or rotate elsewhere?

Chart 9 shows that equities are technically overextended and a correction could come at anytime. Moreover, earning estimates for Q2 of 8.7% for S&P 500 companies may be overly rosy given the slowing economy.

Consistent with this, our earnings growth model is improving, but below forward estimated EPS (**Chart 10**). Still, it is difficult to make the case that earnings will contract in the absence of severe recession. Consensus forward EPS are accelerating; unit labor costs are barely rising; and our operating margin diffusion index is holding near zero.

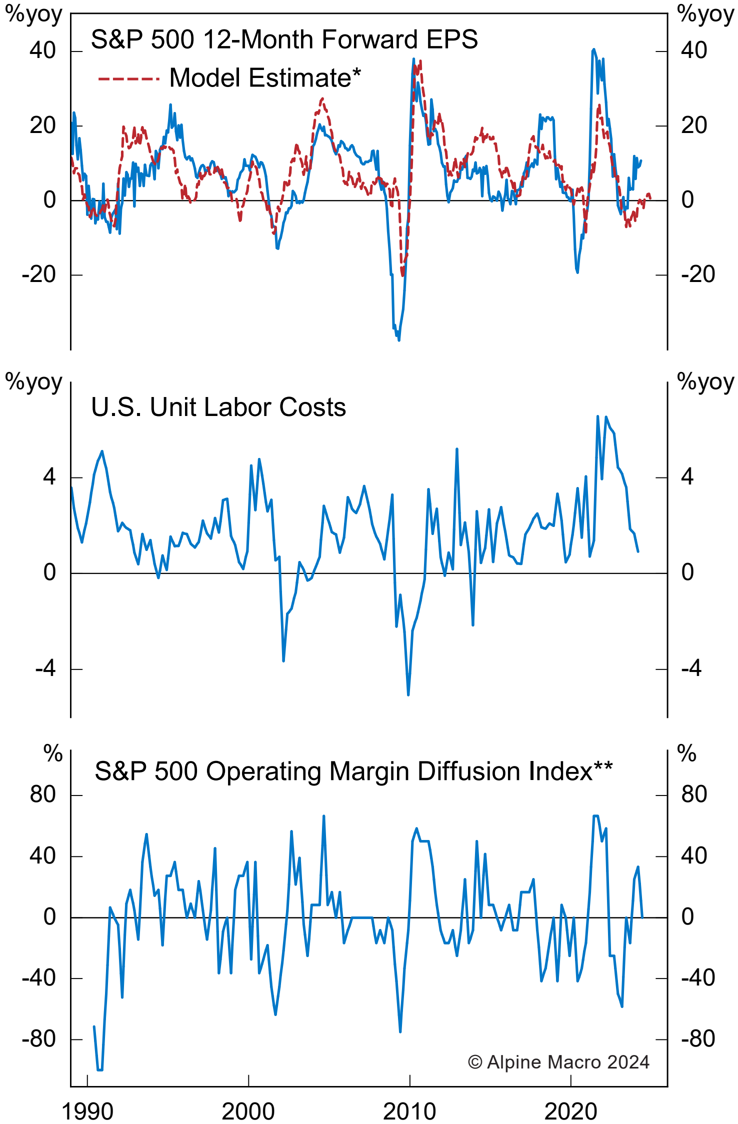
what about the slowing consumer?

Mega cap tech (and "obesity pharma") remain mania candidates if a perfect macro landing plays out, even though they are expensive and widely owned. We made the case in April for a Mag 7 mania in a *Special Report*.[4]

- **Market concentration:** Mag 7 and, more generally, growth and momentum stocks, have dramatically

4 Alpine Macro *Monthly Special Report* "Mania Roadmap: AI And Macro Drivers" (April 17, 2024).

Chart 10 No Earnings Recession



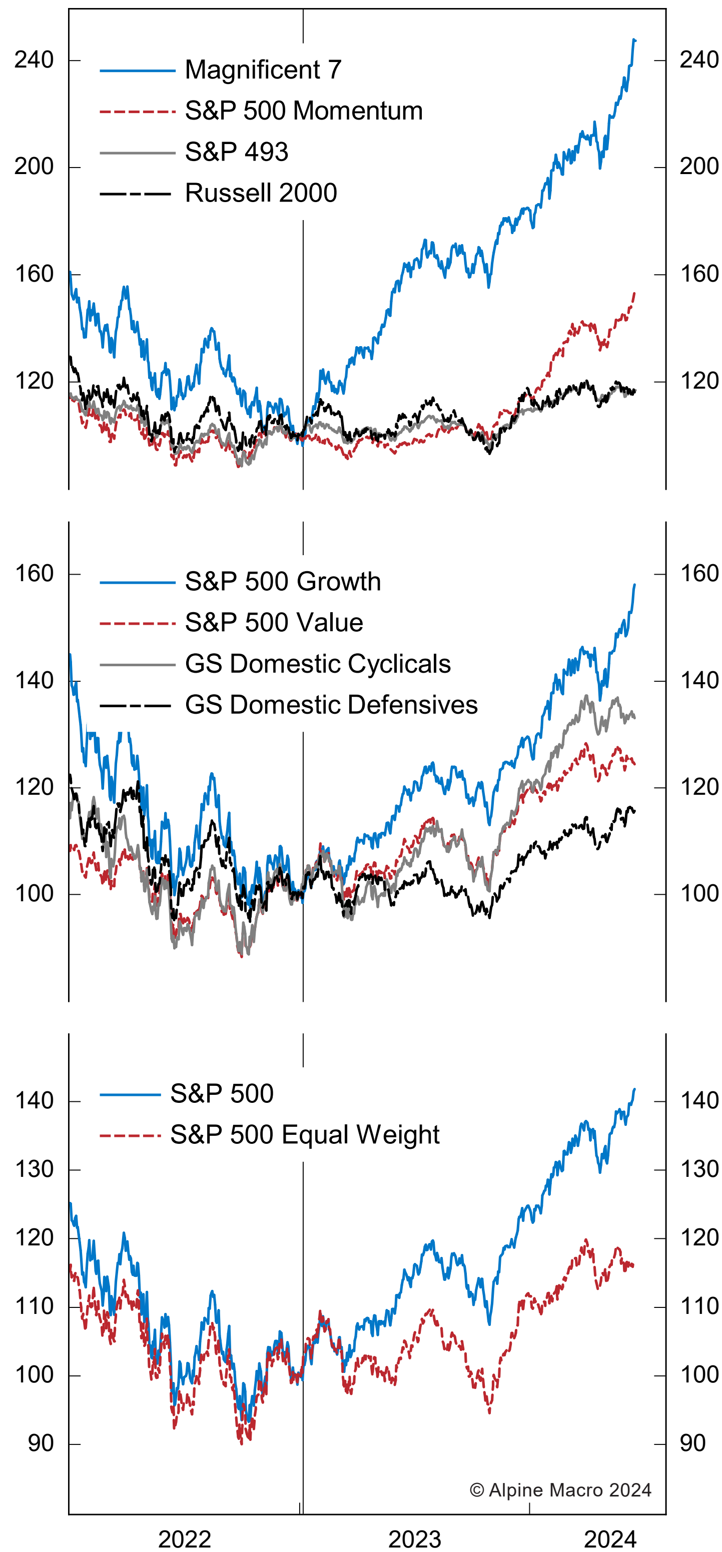
*Based on Treasury yield curve, trade-weighted dollar, high-yield spreads and ISM manufacturing PMI

**% of industry groups with rising operating margins minus % of industry groups with decreasing operating margins

outperformed the rest of the market (**Chart 11**). For similar reasons, the equal-weighted S&P 500 was trendless in Q2, while the market-cap weighted S&P 500 hit successive new highs. Eventually, this reliance on a handful of stocks is unsustainable, but it may require a macro catalyst to either broaden the rally or end it. Until then, there will be pressure on fund managers to

i do not see a broadening in the near future

Chart 11 Mag 7, Momentum And Growth Lead The Way



Note: All series are rebased to Jan 2023 = 100

Chart 12 Mag 7 Expanding Margins, Improving Sales Growth

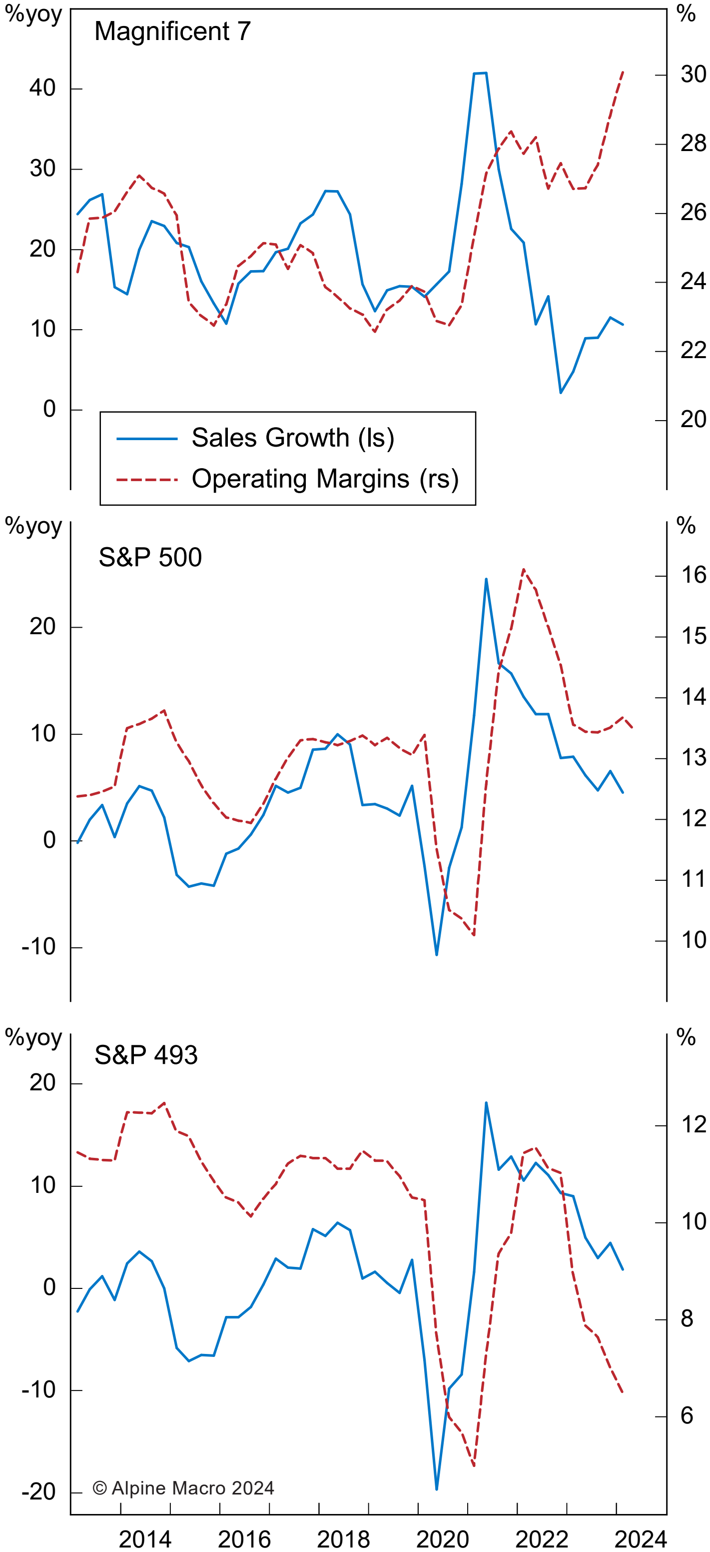
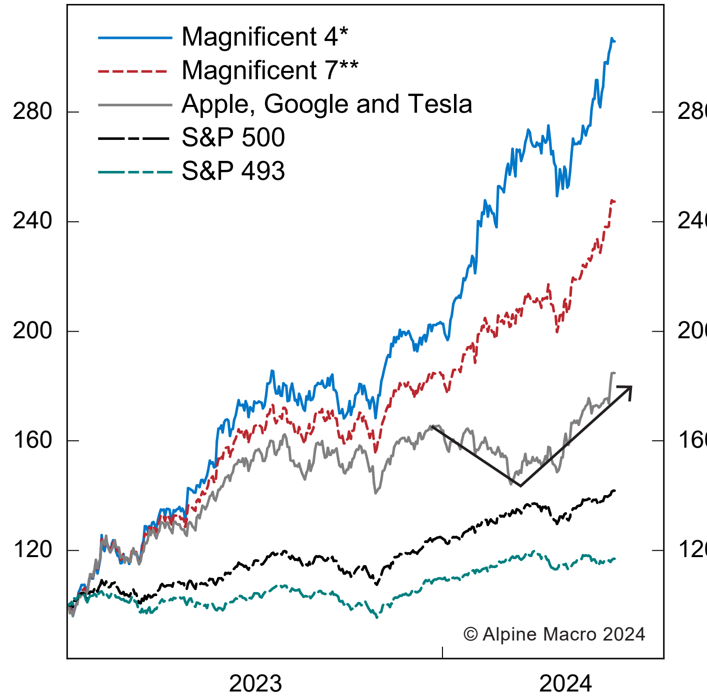


Chart 13 Big Tech Mania Potential



**Meta, Amazon, Microsoft and Nvidia
**Meta, Apple, Amazon, Microsoft, Google, Nvidia and Tesla
Note: All series are rebased to Jan 2023 =100

hold 7 stocks that account for 33% of the S&P 500 market cap, to avoid large tracking error.

- **Robust Mag 7 fundamentals:** Operating margins are high and expanding, while sales growth is reaccelerating after a post-pandemic consolidation, in contrast with the rest of the S&P 500 in aggregate (**Chart 12**). sales growth look slowing to me!!!

- **Self-reinforcing buying:** The attempt to mark down Tesla, Apple and Google because of weaker fundamentals versus the rest of the Mag 7 ("Mag 4") shows signs of abating (**Chart 13**). "Buying the dips" is a hallmark of manias as investors view corrections as opportunities to increase exposure to excellent companies at a cheap price, regardless of underlying valuation.

Market concentration may well decline as prospects for Fed easing draw nearer. The rally could broaden to include defensive sectors and profitable, cheap small caps. These segments have significantly underperformed since the Fed began to hike interest rates in March 2022, as the Mag 7 have diverted investor flows.

At some point, market leadership will shift to stocks that benefit from global economic expansion. However, timing is much less clear. **Chart 14** shows that commodity prices and related equities are sensitive to the pace of global manufacturing and trade, which we expect to improve over the next 12-18 months. So far, the pace of that recovery is patchy, including in the U.S. where is the mfg if consumer demand slows?

Bottom line: The cyclical equity bull market is intact. Big Tech is not yet in a mania, and remains a candidate for one. Small and mid cap companies that offer some combination of quality and growth, but have not yet been bid up like the Mag 7, are attractive.

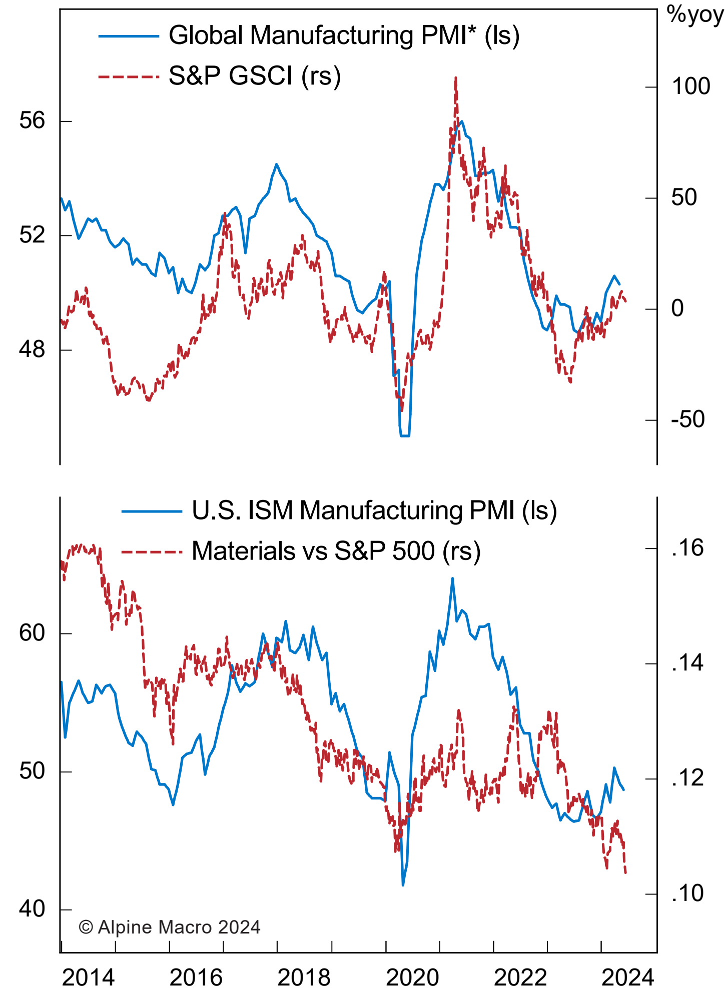
Theme 3

Bonds And Related Proxies Are Attractive

Bond fundamentals are improving. The economy will struggle to grow at trend, given the end of fiscal stimulus, high real interest rates, and pockets of weakness in small business and office real estate sectors.

Moreover, monetary conditions will "automatically" tighten at current interest rates. Mortgages (70% of total household debt) are mainly at fixed rates for long maturities. But this insulation from Fed

Chart 14 **Rotation Ahead, Timing Much Less Clear**



*Truncated at 45; source: JPMorgan

rate hikes automatically shrinks over time as new houses are built and existing homes turn over. At the same time, there are signs of rising inventories and price cuts of houses for sale.

In this environment, Fed-sensitive 2-year Treasury yields will drag down long-term yields, just as they pulled them higher on two occasions since the beginning of 2023 (**Chart 15**). The bulk of the decline should come from TIPS yields, which drove the earlier selloff, and tend to have bigger swings than inflation breakevens.

Chart 15 Two- And Ten-Year Yields Have Moderate Downside

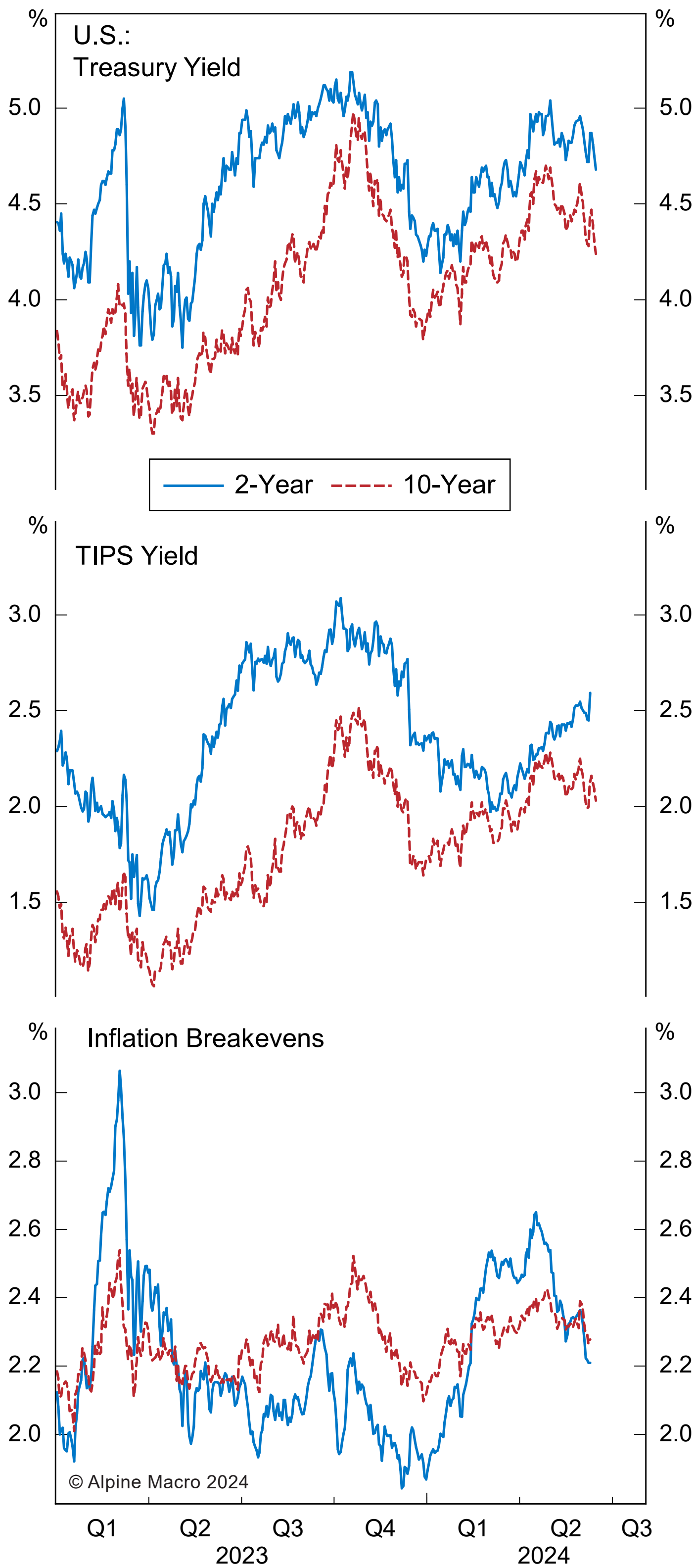
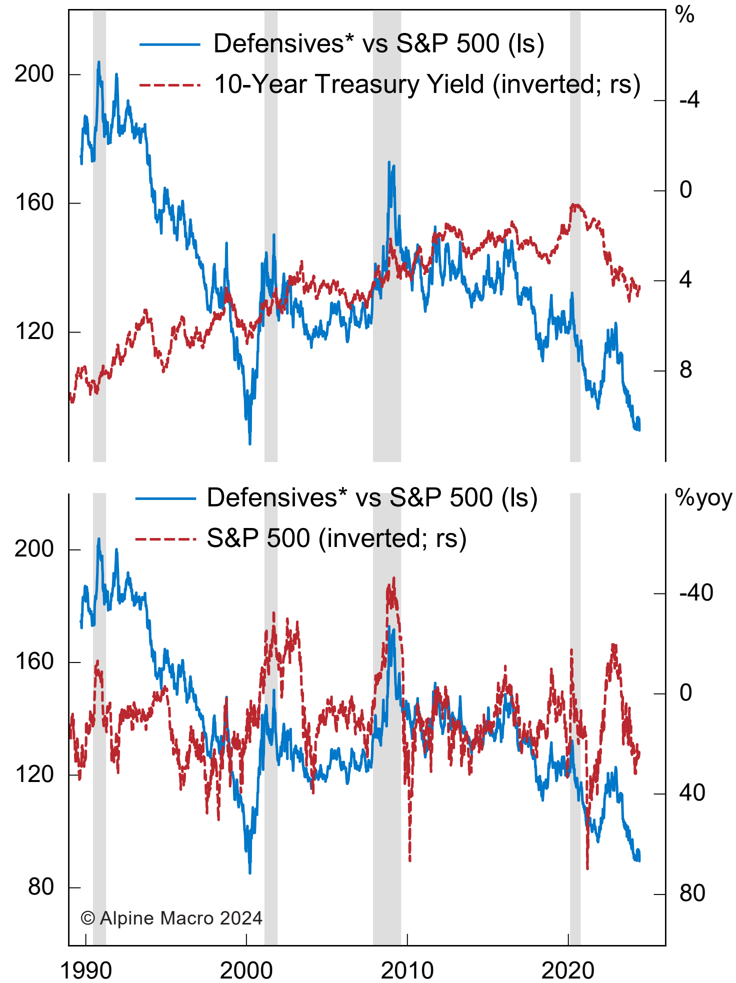


Chart 16 Defensives Have "Hedge Value"



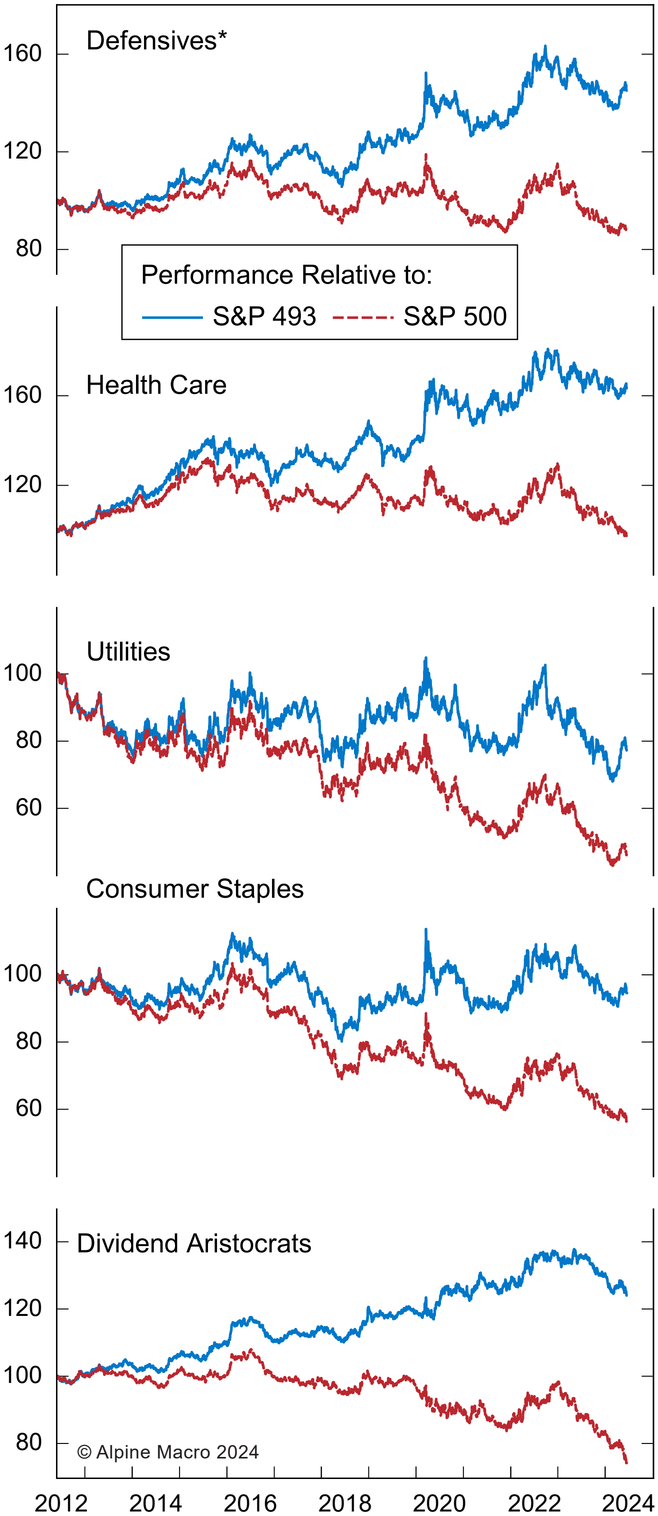
*Average of healthcare, utilities and consumer staples
Note: Shading denotes U.S. recessions

Breakevens could ease lower, but already have returned to their normal range. The exception would be if oil plunges; downside risks to oil will be covered in the upcoming *Feature Report* with Sam Rines on Wednesday, June 19.

Defensive equity sectors also offer "hedge value" for similar reasons:

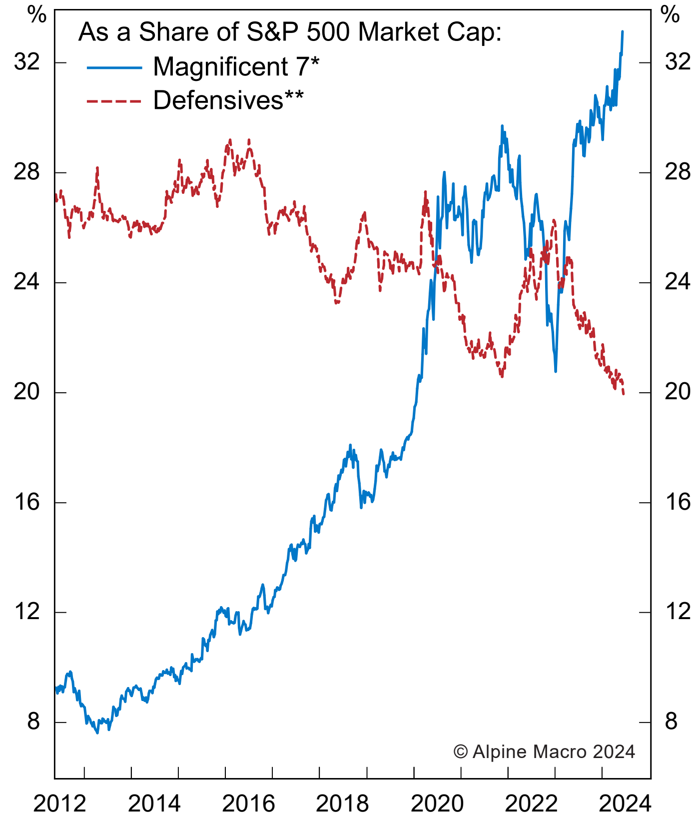
- **Recession and equity bear hedge:** Chart 16 shows that defensive equities do not always

Chart 17 Defensives Holding Up, If Mag 7 Excluded



*Average of healthcare, utilities and consumer staples
Note: All series are rebased to Jun 2012=100

Chart 18 Defensive Equities Are Oversold



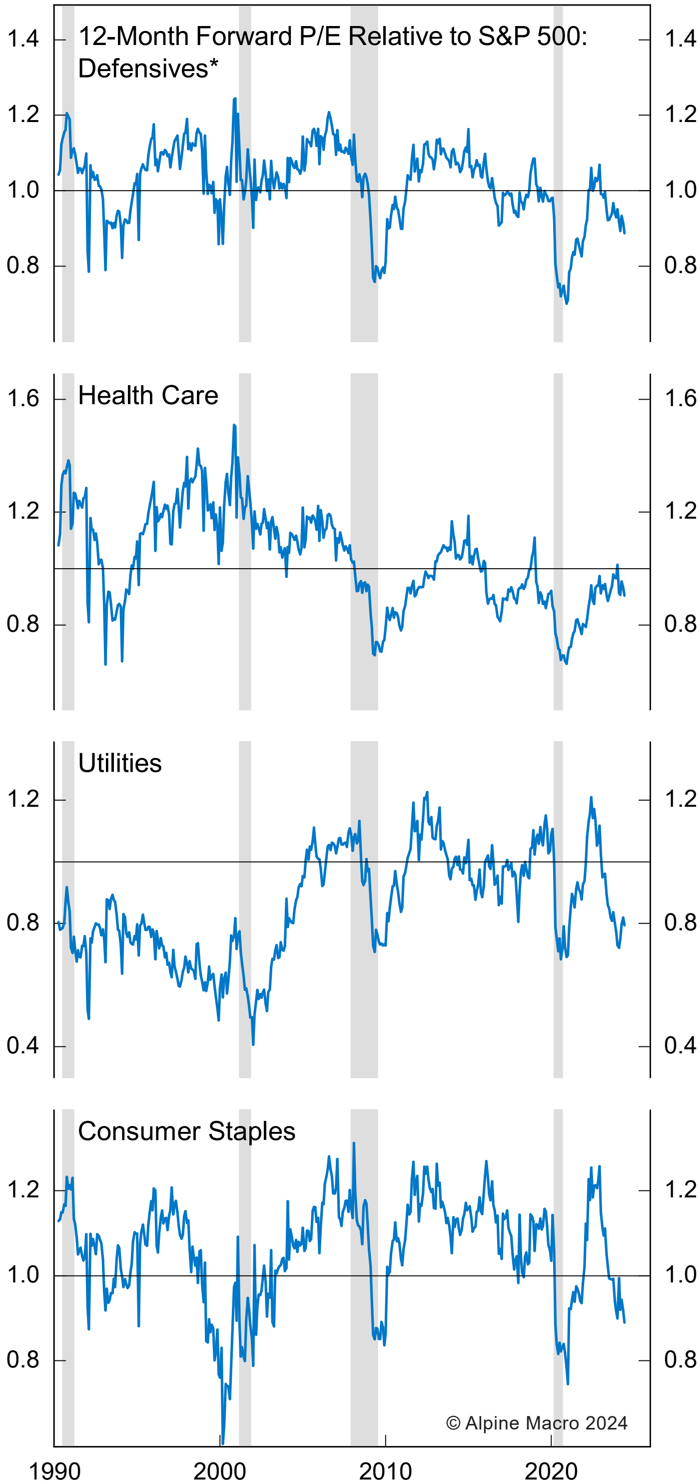
*Apple, Microsoft, Google, Amazon, Nvidia, Meta and Tesla
**Consists of healthcare, utilities and consumer staples

trade inversely with bond yields. However, they always outperform during recessions and equity bear markets.

- **Oversold versus "S&P 493":** As with most stocks, defensive equities have steadily lagged the Mag 7 tech stocks. However, defensives are at the low end of a rising channel relative to the rest of the market, or "S&P 493" (Chart 17).

- **Hedge versus Mag 7:** Defensive stocks have steadily lost market cap share to the Mag 7, but are oversold relative to that declining trend (Chart 18).

Chart 19 Defensives Are Slightly Cheap Vs Broad Market



*Market cap weighted average of health care, utilities and consumer staples
Note: Shading denotes U.S. recessions

- **Cheap relative valuation:** Forward P/E ratios for overall defensives, as well as the main defensive sectors, are all below their long-term average *vis-à-vis* the S&P 500, though nowhere near previous cheap extremes (**Chart 19**).

Bottom line: We continue to believe that 10-year Treasury yields formed a double top in the 4.5-5% region, and increased bond duration to above-benchmark on June 10 after the payroll-related bond selloff. Bond proxies are attractive from a risk/reward perspective, even though they will underperform for as long as the "risk-on" environment persists.

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

A Unique Mind On The Markets