The U.S. macro backdrop is unfolding as anticipated in Alpine Macro's baseline scenario, characterized by softening growth, a gradual loosening of the labor market, and a definitive return to disinflation.

Given this context, the optimal asset allocation is to remain pro-risk by overweighting equities and maintaining a benchmark weighting to fixed income. However, an overweight duration stance within the latter is increasingly warranted for the coming 3-6 months given accumulating U.S. data disappointments. As for the dollar, its positioning should be adjusted lower to neutral as U.S. growth and rates momentum peak relative to the rest of the world.

ALPINEMACRO
A Unique Mind On The Markets

GLOBAL ASSET ALLOCATION

July 16, 2024

# Stay Committed To The Disinflation Trade

- Downside growth surprises and renewed disinflation will increasingly pressure long bond yields lower. Overweight duration within fixed income.
- Beyond a near-term correction, the equity bull market should broaden out into lagging segments given impending monetary easing.
- A closing growth and rate divergence between the U.S. and the rest of the world should cap dollar strength.
- The substantial valuation discount of small caps is bound to be unlocked by falling yields and an improving earnings outlook.
- Asset allocators should overweight small caps *via* the S&P 600. This avoids exposure to chronically unprofitable firms that persistently drag down the Russell 2000 index.

| 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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**Chen Zhao**
Chief Global Strategist

**David Abramson**
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**Harvinder Kalirai**
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FX Strategist

**Jeremy Huang**
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# ALPINEMACRO 2024 INVESTMENT CONFERENCE

NEW YORK | MONDAY, SEPTEMBER 16th **USD $1,995 - REGISTER NOW**

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

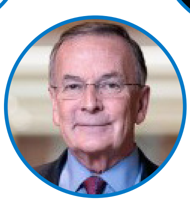
15:00 - 15:15 Coffee Break

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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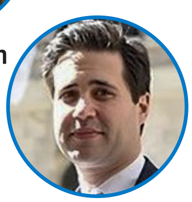

Adam Rozencwajg

## Theme 1

## For Now, 'Bad' News Is Good News

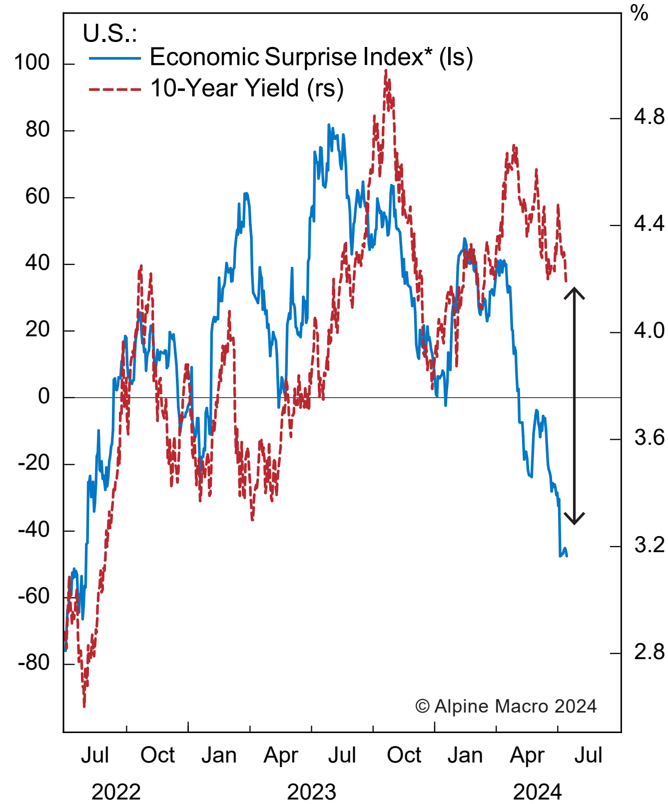
The U.S. macro backdrop is unfolding as anticipated in Alpine Macro's baseline scenario, characterized by softening growth, a gradual loosening of the labor market, and a definitive return to disinflation. Recent data, including the ISM surveys, nonfarm payrolls report, and CPI print, as well as other lower-tier releases, collectively convey this message.

The natural configuration for asset allocation is to remain pro-risk by overweighting equities and favoring a benchmark weighting to fixed income. However, an overweight duration stance within the latter is becoming increasingly warranted for the coming 3-6 months.

As regularly highlighted across our publications, trends in the U.S. 10-year yield are heavily influenced by where the market expects Fed policy to settle in two years time. Currently, both the market and the Fed foresee the funds rate falling to about 3.5% by that 'terminal' date. Assuming inflation glides back to the 2% target, that would suggest a real policy rate still standing at 1.5%. We find this implausible, as it implies restrictive monetary policy for another two years. Unless a faster and deeper rate cut outlook is discounted, the Fed would likely miss both sides of its dual mandate.[1]

So far, the decline in the 10-year yield has been halting despite accumulating data disappointments over the past quarter (**Chart 1**). Overweighting exposure to the long bond should offer investors an effective hedge against additional downside growth surprises.

**Chart 1** Growing Air Pocket For The 10-Year Yield?



*Source: Citi

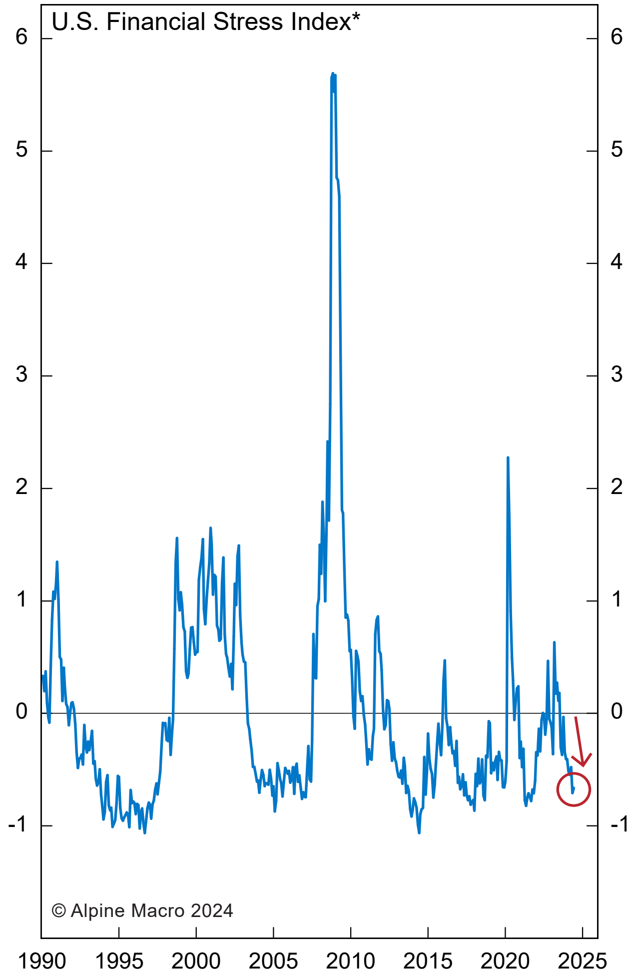
As for stocks, a corrective phase can occur at any moment given the recent melt-up. Nevertheless, investors are advised to ride out the turbulence:

- In the absence of economic or financial stress, pullbacks should remain of a "garden variety" sort (**Chart 2**). Of course, unforeseen shocks can develop rapidly, yet almost by definition, such events cannot be forecasted. In terms of strategy, an overweighting of duration as noted above should protect investors from deflationary tail risks.[2]

1 Alpine Macro *Global Fixed Income & Currency Strategy* "More Good Data" (July 12, 2024).)

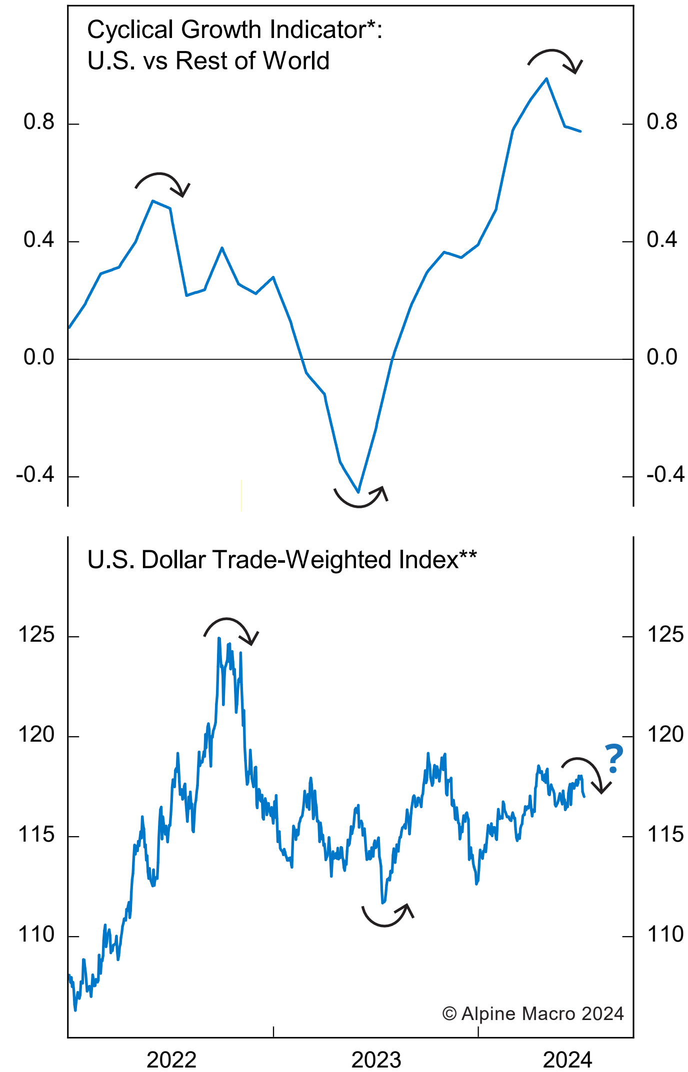
2 Alpine Macro *Global Asset Allocation* "On The Rumors Of 60/40's Demise" (April 18, 2024)

**Chart 2** Receding Financial Stress Limits Market Downside




*Shown as a 3-month moving average; source: Federal Reserve Bank of Kansas City

**Chart 3** U.S. Growth Momentum Is Peaking Relative To RoW




*Based on amplitude-adjusted composite leading indicators for 17 countries, and ZEW economic conditions situation for U.S., Euro Area and China; source: OECD, ZEW, Alpine Macro
**Relative to a basket of currencies from advanced foreign economies; source: Federal Reserve

- Rising expectations for a dovish shift by the Fed should lend a new lease on life for lagging segments of the market that have been weighed down by onerous rates. Underperforming growth stocks outside of the Magnificent 7, as well as small caps, stand to benefit from this broadening out of the bull market.

**Bottom Line:** Downside growth surprises, coupled with dissipating inflationary pressures, is a classic set-up for a sustained drop in yields. Maintain an overweight duration position. Equities should also be kept overweight as pullbacks are likely to remain shallow and forthcoming monetary easing should reinvigorate market breadth.

## Theme 2

### Dollar Strength Reaching Exhaustion

We are downgrading dollar positioning this month from overweight to neutral, in line with the theme of softening U.S. growth and our long duration call.

The dollar had scope to rise when the Fed was wholly dissuaded from cutting rates, even as a global easing cycle began in earnest. The latter developed in response to overly tight real policy rates in the G9 and EM, which have suppressed aggregate demand and led to a faster pace of disinflation outside of the U.S.

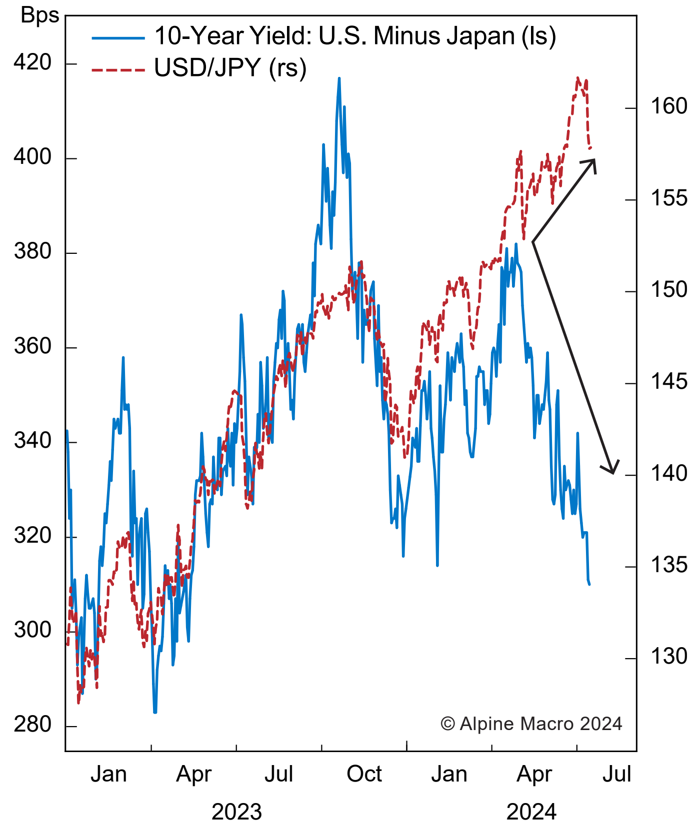
However, the window for outright dollar strength is now closing.

First, growth between the U.S. and the rest of the world is likely passing peak divergence (**Chart 3**). Going into the second half of the year, the world economy should get more in sync as U.S. growth returns to trend and stagnation in other major blocs ends. Of course, a softening U.S. economy and resumption of the disinflationary trend will raise the odds that the Fed cuts earlier and more quickly than is currently discounted.

Second, recent firming in the dollar has gone beyond what some key interest rate differentials would suggest. This is particularly evident with the yen. Despite a persistent narrowing of the U.S./Japan 10-year yield spread over the past three months, USD/JPY has until recently traded at a generational high above 160 (**Chart 4**).

Beyond the well-known valuation arguments for the yen, the currency could experience a sharp snapback as technical indicators have reached extremes. Momentum is severely oversold, sentiment is overwhelmingly bearish, and speculators are heavily short the yen. A catalyst for a rebound could be FX intervention by the MoF/BoJ, leading to a powerful short covering squeeze.

**Chart 4** USD/JPY Has Significantly Overshot




While further dollar upside is likely capped, a new cyclical downtrend is not yet imminent given faltering Chinese growth. As China is the primary driver of global growth outside of the U.S., its business cycle and the counter-cyclical dollar tend to be inversely correlated. Until Chinese policymakers stimulate demand more aggressively, the dollar should stay steady against the currency majors.

**Bottom Line:** Downgrade dollar exposure to neutral. Peak growth and rate divergence between the U.S. and the rest of the world should spell the end of dollar strength for now. Nevertheless, a sputtering Chinese recovery will preclude any significant weakness in the greenback.

## Theme 3

### Forthcoming Relief For Small Caps

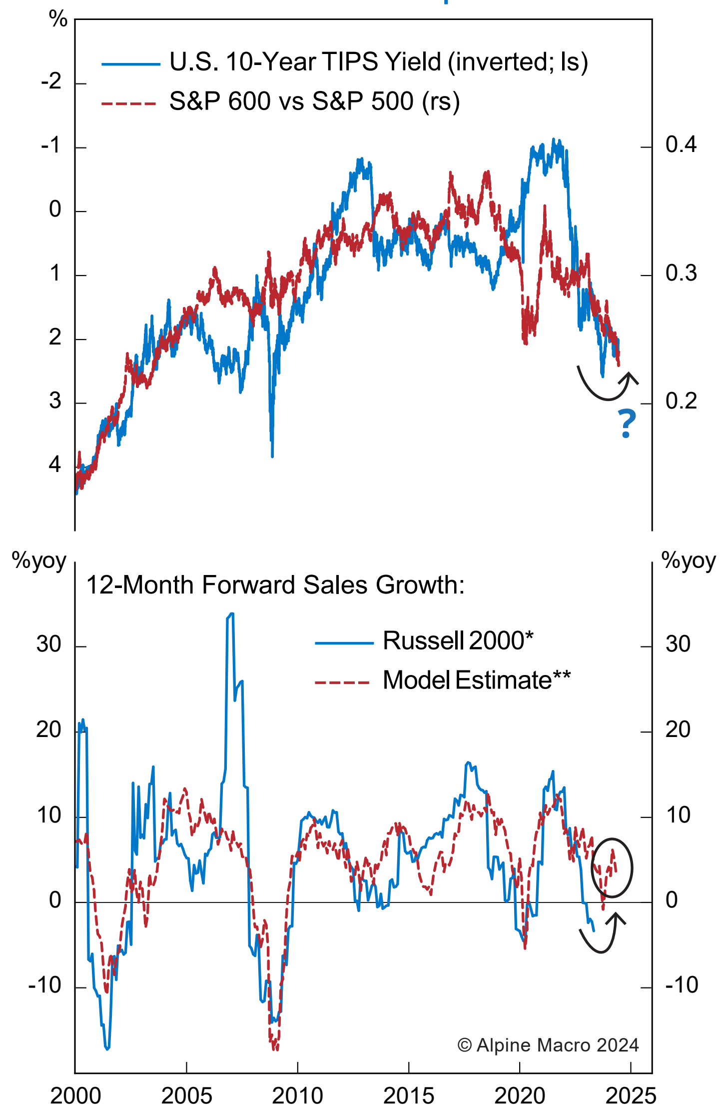
Small caps continue to trade at a significant discount relative to large cap stocks, mostly owing to the absolute overshoot in the mega-cap tech space. Underperformance has been exacerbated by weak earnings growth, with profits virtually flat for the median small cap company over the last year. In fact, small caps have endured a rolling earnings recession, with profits yet to recover to their cyclical peak from late 2021.

Looking ahead, the balance of risks is titled in favor of a turn higher in the relative return of small caps.

First, lower yields tend to correspond with small cap outperformance. Small firms are about three times more geared on a net debt-to-EBITDA basis, and far more exposed to floating rate debt, than their large cap counterparts. Therefore, the prospect of lower real rates would ease the liquidity burden and credit risks faced by small caps, acting as a powerful catalyst for their relative re-rating (**Chart 5**, top panel).

Equally important, the factors needed to drive higher margins and top-line growth are also falling into place. A troughing in industrial activity, tightening spreads, and looser monetary policy should boost

**Chart 5** Rates And Earnings Outlook Should Bolster Small Cap Performance




*Source: Bloomberg Finance L.P.
**Alpine Macro proprietary model

the revenue outlook (**Chart 5**, bottom panel). Our *Equity Strategy* service projects small cap earnings to end the year 50% higher than in 2023, surpassing consensus expectations.[3]

Asset allocators can enhance their opportunity for success with small caps by employing more effective

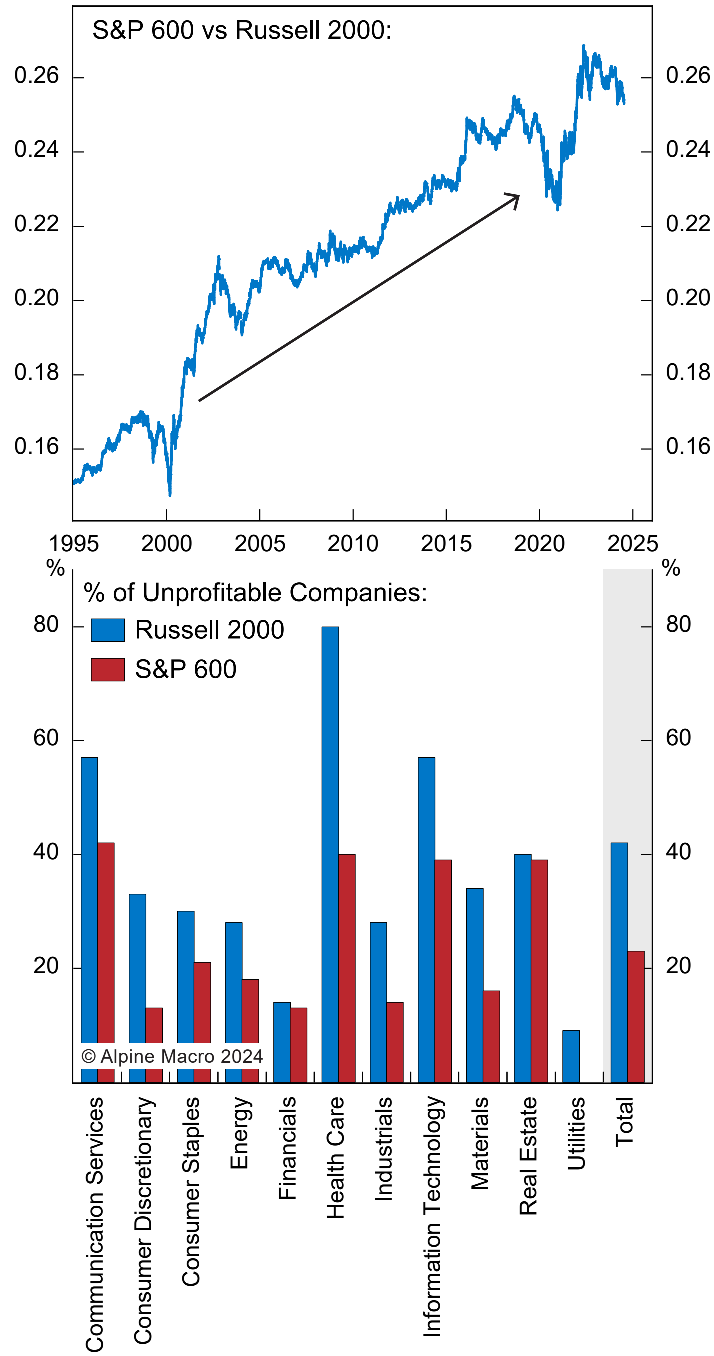
3 Alpine Macro *Equity Strategy* "How To Make Money In Small Caps" (June 26, 2024).

benchmarking strategies. Unlike the Russell 2000, the S&P 600 incorporates an earnings component within its construction that helps cut the level of unprofitability in half. Chart 6 demonstrates how this crucial differentiator has led to a structural rise in the S&P 600 relative to the Russell 2000.

**Bottom Line:** Easing financial conditions and an improving earnings outlook should disproportionately favor small caps. The S&P 600, with its embedded screening for profitability, is the most effective way to gain overweight exposure.

**Bassam Nawfal**
*Chief Asset Allocation Strategist*

**Chart 6** **Play Small Caps *Via* S&P 600**




Source: Bloomberg Finance L.P.

| | Global Asset Allocation | Underweight | Neutral | Overweight | Rationale for View (3-6 Month Outlook) July 16, 2024 |
|---|---|---|---|---|---|
| | Equities | | | ● | A disinflationary expansion should bode well for equities, as it supports the continued expansion of corporate profits and diminishes the likelihood of harmful tail events. |
| | Bonds | | ● | | Fixed income will outperform cash if the broad disinflationary pace continues, allowing bond yields to drop from current levels. However, equities have more total return upside. |
| | Cash | ● | | | The opportunity cost of maintaining a high cash weighting will rise as disinflation powers incremental gains for equities and longer duration fixed income assets. |
| Equity Regional Allocation (USD Terms) | U.S. | | | ● | U.S. earnings growth potential maintains the upper hand, until the rest of the world's growth rebounds *via* stimulus in China. Tech stocks are poised to remain on a mania path. |
| | EAFE | ● | | | Euro area earnings prospects are restrained by contracting exports and a weak credit impulse. The euro and yen are on a weak footing, which could further weight on common currency returns. |
| | EM | | ● | | Increasingly bold Chinese reflationary efforts, a global growth upswing, and a brightening technical backdrop augur for better EM equity performance. |
| Equity Style Allocation | Defensive | | ● | | A strengthening of major macro indicators and lofty yields warn against overweighting defensives. |
| | Cyclical | | ● | | Signs point to an upturn in growth and risk-on indicators, which typically favors cyclicals. However, performance will be tempered by a strong dollar. |
| | 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 | | | ● | Slowing growth, renewed disinflation, and a cooling labor market should revive the bull market in long-duration bonds that began last October. |
| | Treasuries | ● | | | Fixed income investors are likely to move out the risk curve with growth resilient yet the odds of a resumption in rate hikes remaining low. |
| | 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 an eventual peaking in the dollar and real yields, along with increased hedging demand due to rising geopolitical tensions. |
| | Materials/ Base Metals | | | ● | Improving global growth should lift demand for base metals. The secular uptrend in usage intensity and overall demand *via* electrification amid weak capacity growth are structurally bullish. |
| | Oil | | | ● | Cyclical demand growth should coincide with steadfast OPEC production discipline, escalating geopolitical conflicts, and inventories already under strain. |

A Unique Mind On The Markets