

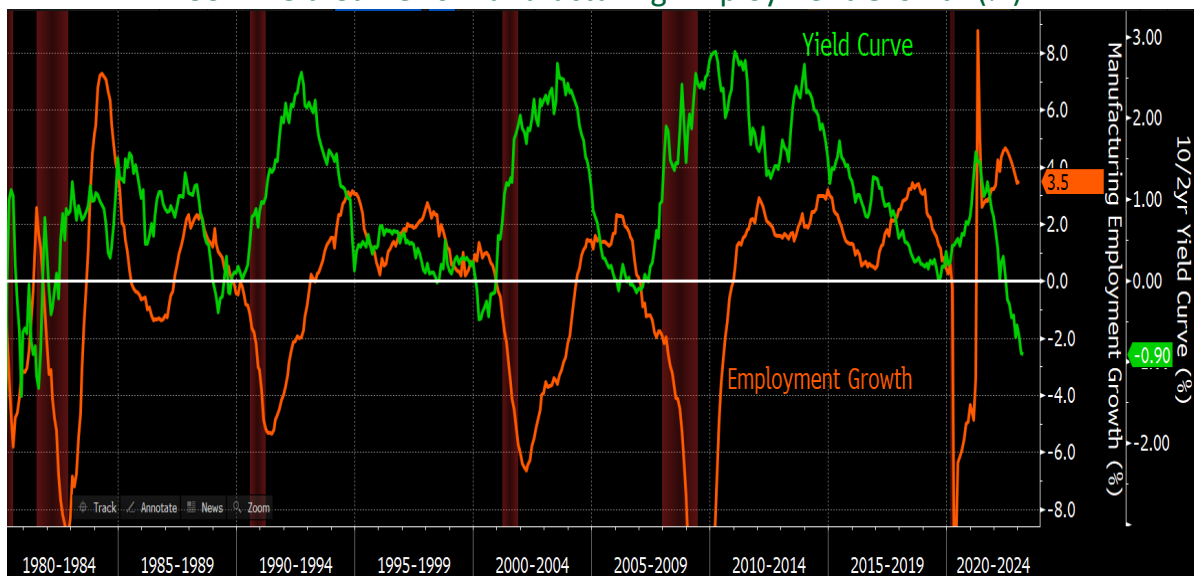
“Great minds do not think alike. They challenge each other to think again.”

Adam Grant

1. US RECESSION

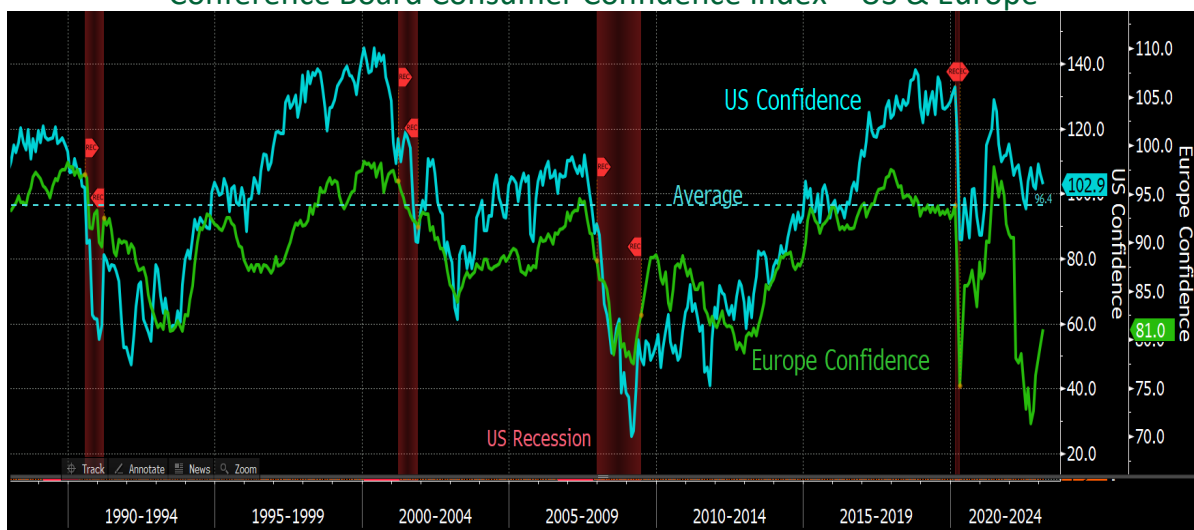
The two main investor concerns currently are US inflation and a potential recession. We commented on the former in our previous note. Investors face an interesting conundrum on the latter:

US – Yield Curve vs Manufacturing Employment Growth (%)



Leading economic indicators are implying an upcoming recession. As an example, the yield curve in the above chart is currently at the most extreme inversion level in forty years. Against this, manufacturing employment growth (with a strong record of early warnings of a recession) is currently growing at an elevated level of +3.5%, rather indicating continued economic growth.

Conference Board Consumer Confidence Index – US & Europe

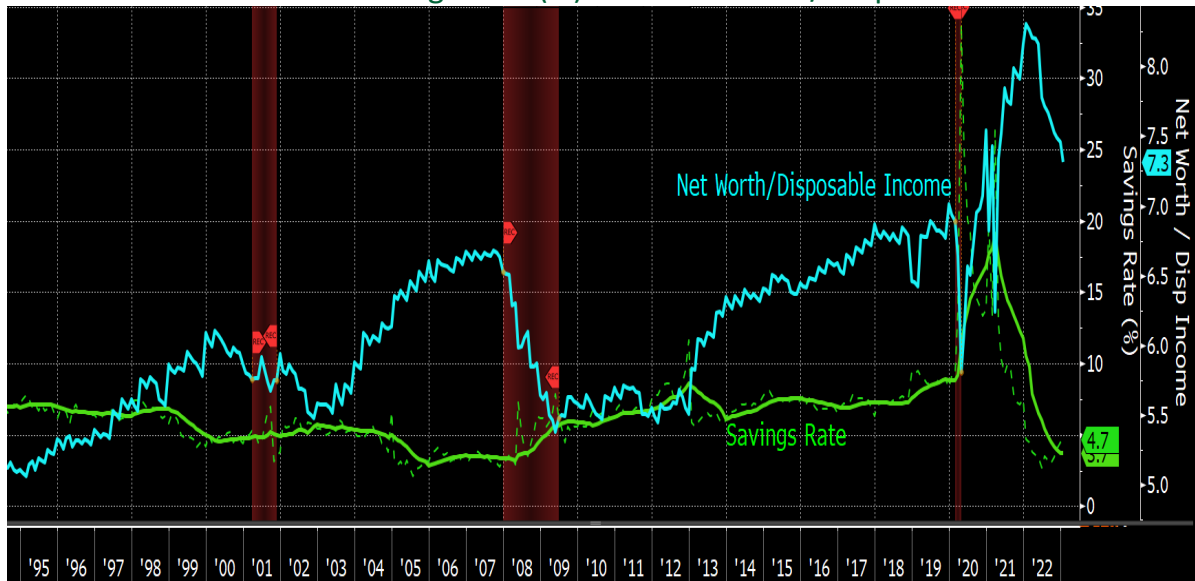


US consumer confidence remains relative healthy, with retail sales currently growing at +6%. European consumer confidence is in process of recovering off a recent record low level. On these bases and China’s economic recovery, it does not seem that a US or a global recession is imminent.

2. US HOUSEHOLD FINANCES

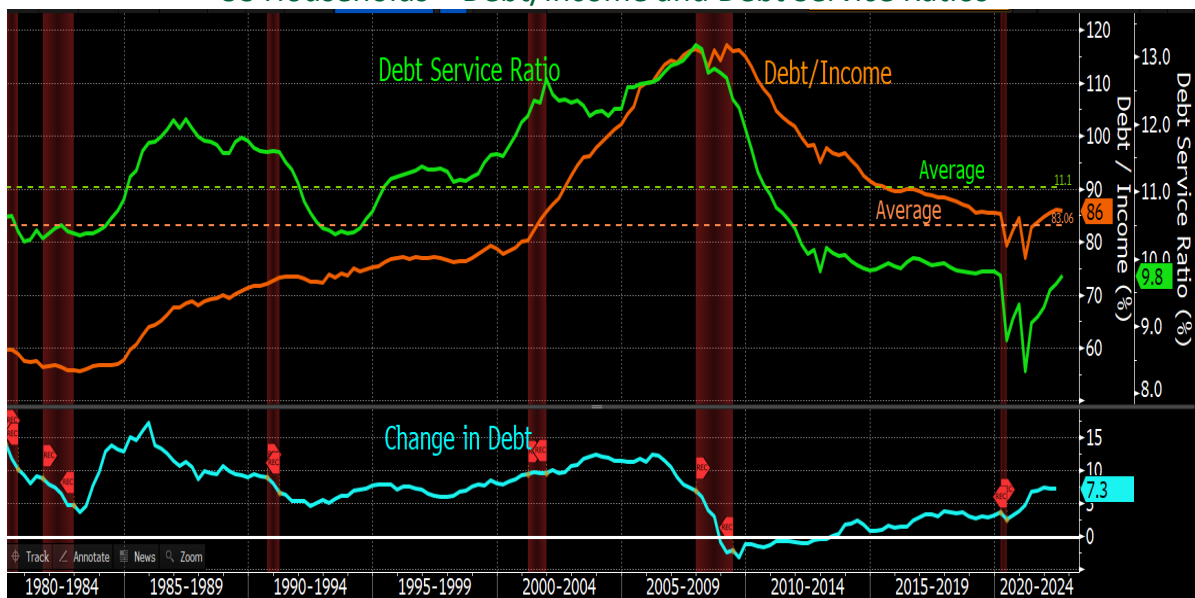
The US economy, and by implication global investors, are very dependent on the ability of US households to maintain their lifestyle. We consider some of the important risks in this context:

US Households – Savings Rate (%) and Net Worth / Disposable Income



Their savings rate is currently close to a record low, comparable to the pre-Financial Crisis era. Against this, with strong employment, their net worth is currently over seven times their income, more than previous peak levels. It therefore seems they have ample reserves in place.

US Households – Debt/Income and Debt Service Ratios

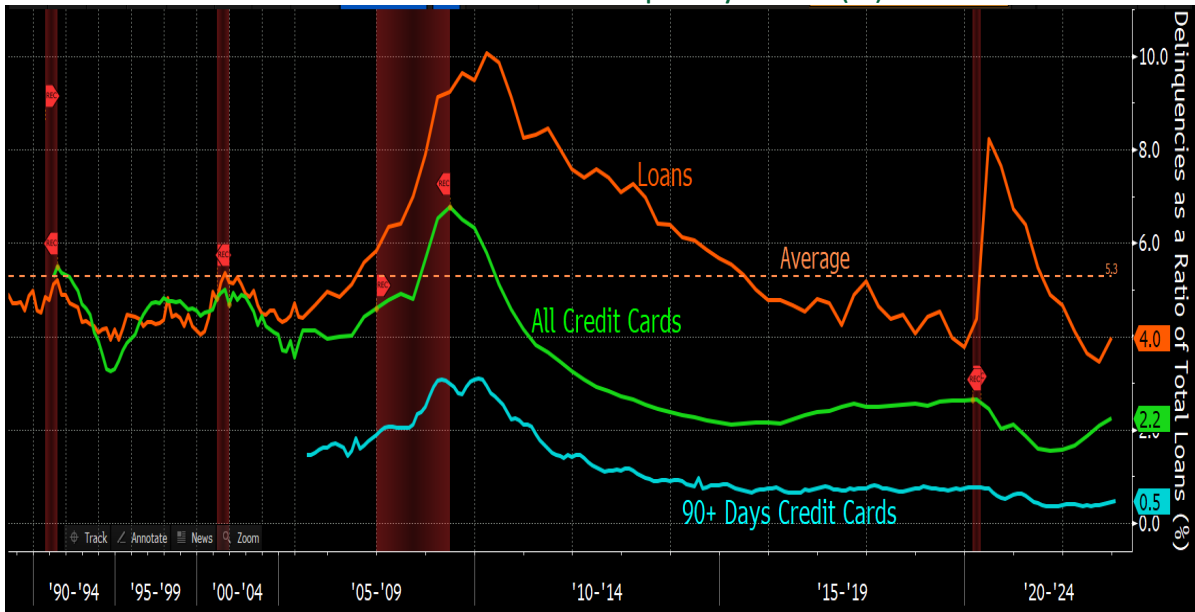


Their debt levels at 86% of their income is close to the long-term average level, despite the 7% increase in their debt levels. Their debt service ratio has recently increased sharply from extremely low levels at 10% required payments, close to pre-Pandemic levels, and well below the long-term average. Their debt situation therefore seems well under control.

This conclusion is supported by their debt delinquency ratios in the chart on the following page. The delinquencies against total loans at 4% is currently close to a record low level. Similar constructive conclusions are made considering longer-term credit card and total credit card debt. The banking counterparties currently have excellent experiences on their issued cards. Despite the low current savings rate, all-in-all it seems we do not need to be overly concerned about US household finances.



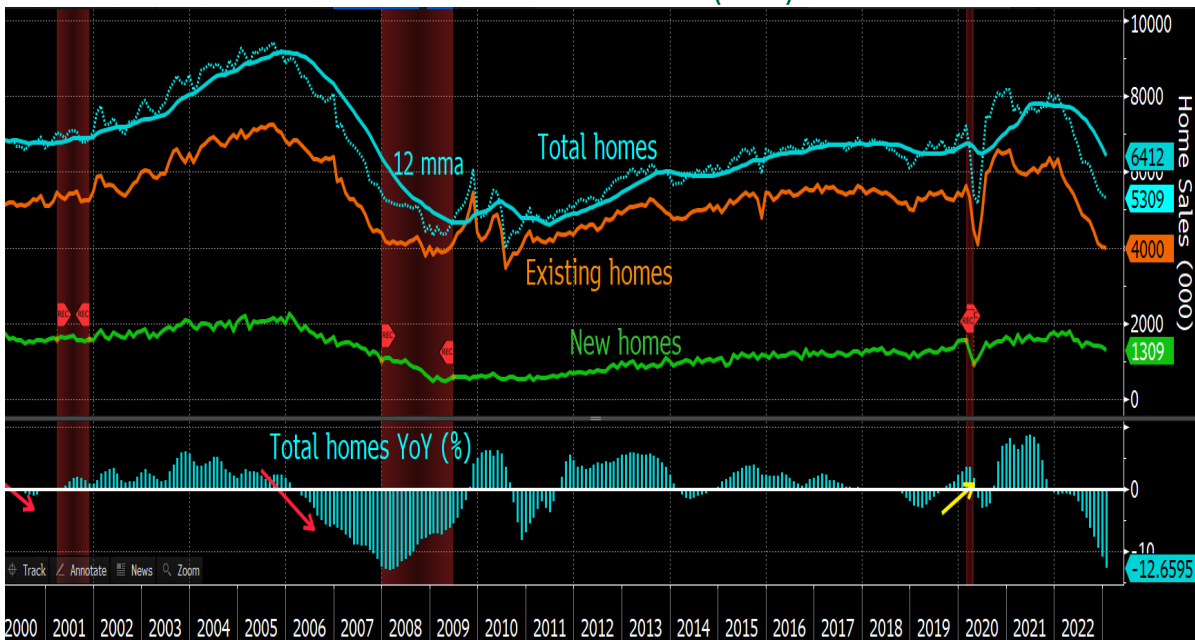
US Households – Delinquency Ratios (%)



3. RISK OF A US HOUSING CRISIS

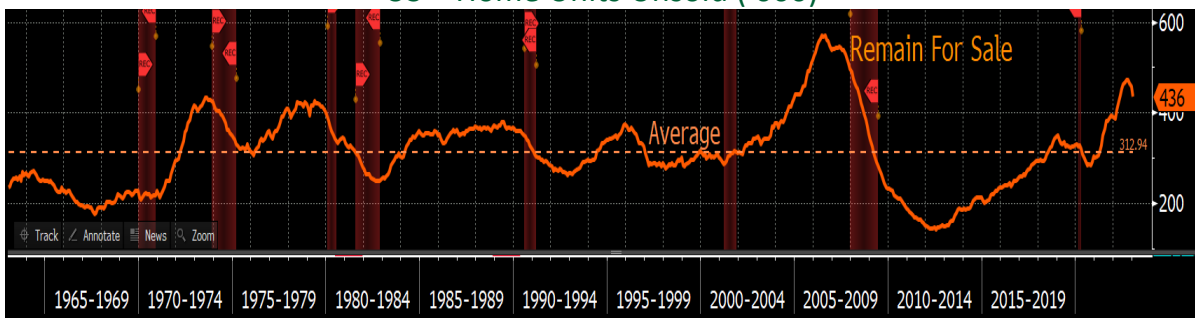
US home sales have recently dropped at a potentially alarming rate:

US - Home Unit Sales ('000)



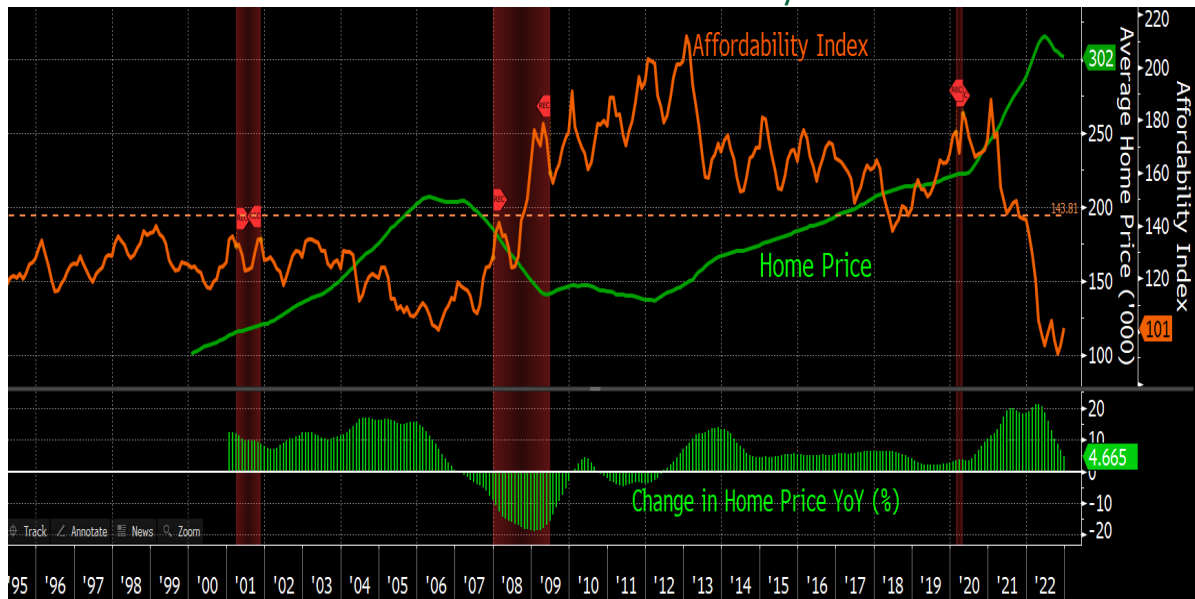
Unit home sales are currently -12.7% against a year ago. This compares with the tough level with the Financial Crisis.

US – Home Units Unsold ('000)



As per the immediate preceding chart on the previous page, the number of unsold units has increased to levels well above the long-term average - above peak levels bar that experienced with the Financial Crisis. This indicates risk for further drops in home prices.

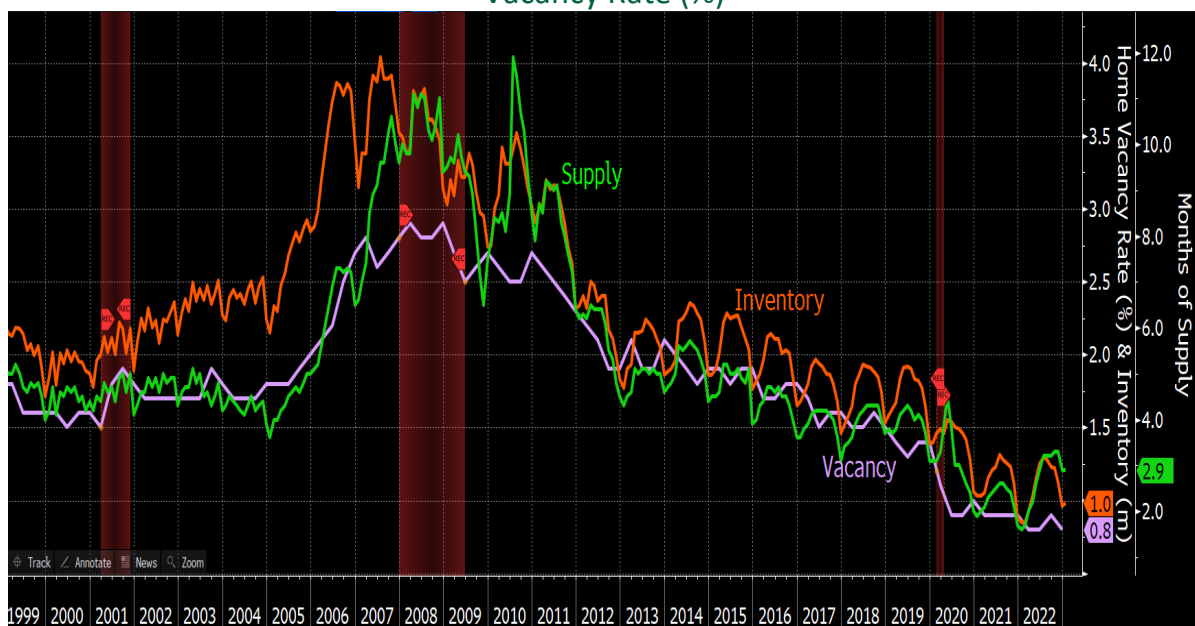
US – Home Prices vs Affordability Index



The above chart reflects the average home price (green line) and affordability index (orange line). Prices have increased by 20% over 2021/22 to a peak level of over \$300,000. The average price has recently started to drop, with year-on-year growth currently close to being flat, increasing the risk of further drops in prices.

Also on the above chart (in the orange line), the home affordability index has dropped to record low levels. This is expected to further hold back transactions and put pressure on prices.

US Housing Market – Existing Home Supply (Months) & Sales Inventory (m) and Vacancy Rate (%)

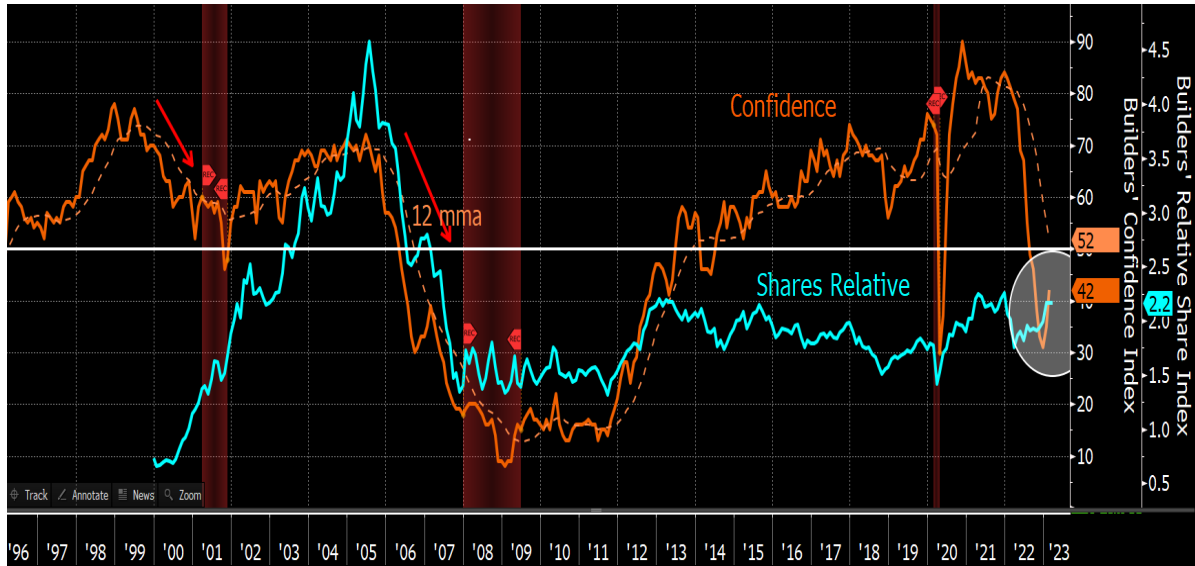


A major difference in the US housing market this time, and especially compared to the Financial Crisis, is that the vacancy rate is currently at a record low. Despite the drop in sales, the inventory of homes for sale is also close to a record low. The supply of homes (in terms of months) has picked up somewhat (also because of falling sales), but is still at record pre-Pandemic low levels.

From these perspectives the US housing market does not seem at the Financial Crisis level of risk.



US Home Builders Confidence Index vs Home Builders' Share Price Index Relative to S&P 500 Index



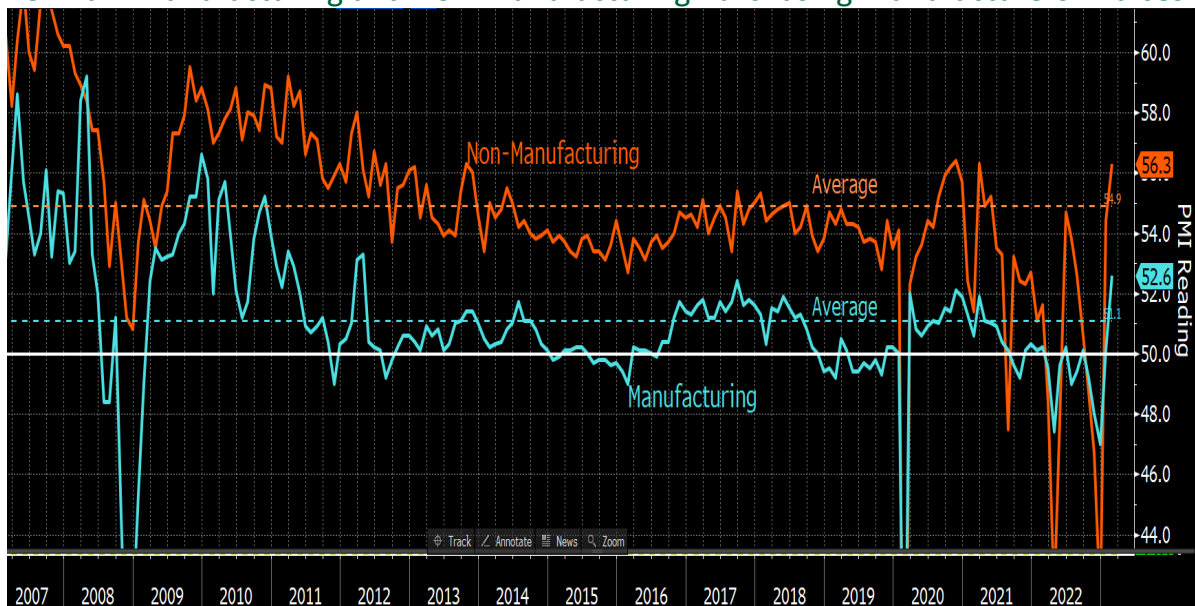
The US Homebuilders Confidence Index (orange line) has a strong record of pre-empting US recessions, and acts as a solid leading economic indicator. The index collapsed early in 2022 with the onslaught of rising interest rates. It has recently turned the corner and has recovered by a third. Along with this, the Homebuilders Share Price Index (expressed on a relative basis to the S&P 500 Index, the blue line) remains stable despite the interest rate backdrop.

It seems the US homebuilders have learned major lessons from the Financial Crisis. All-in-all, therefore, we believe the long duration nature of the US mortgage market offers some protection and therefore that the US housing market may be weak for a while until inflation fears settle, but we do not perceive it to have excessive risk of a major collapse.

4. CHINA

The unlocking of the Chinese economy has happened at an important time for the global economy facing a potential recession.

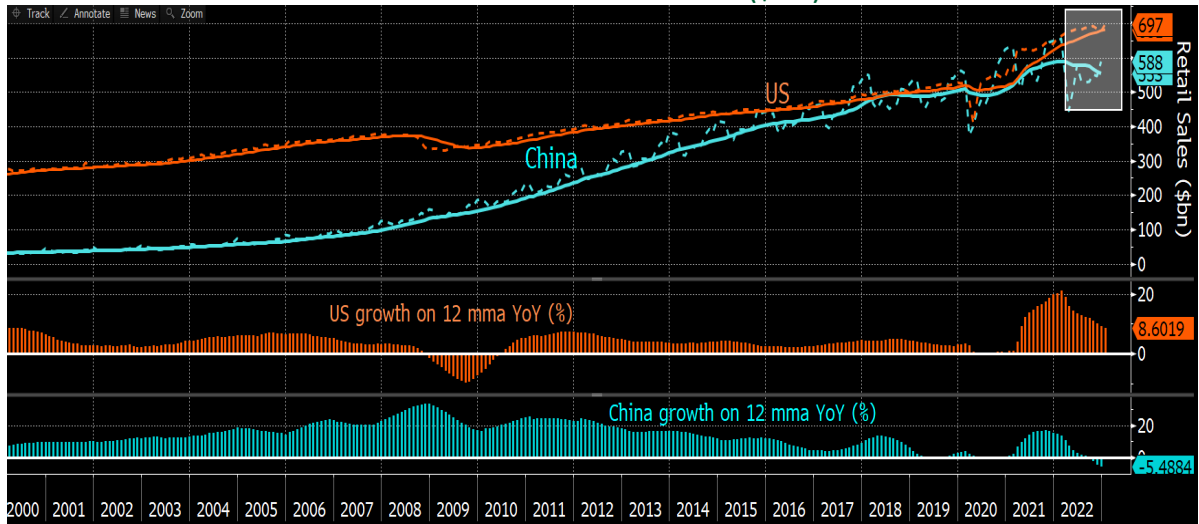
China – Manufacturing and Non-Manufacturing Purchasing Manufacturers' Indices



Both the indices in the preceding chart have increased sharply to above average and two year record levels. This bodes well for the recovery of the Chinese economy.



Retail Sales – US vs China (\$bn)



At the beginning of this century, US retail sales exceeded China's by a ratio of seven to one. The latter caught up with the US by 2018. Their extended economic lockdown resulted in the gap widening again, and is currently about a quarter. US retail sales are currently growing at +8% against China's at -5%. We believe the opening of the latter's economy can lead to the gap narrowing again. We have several global operators in our portfolio that can benefit directly from this.

World Trade – Imports vs China Exports Growth (%)



World trade is currently growing at +6% despite China's exports at -10% as a result of their economic lockdown. The reversal of the latter may soon start to filter through, further supporting world trade and its economies, including that of the US.

5. TECHNICAL PICTURE

S&P 500 and Moving Averages



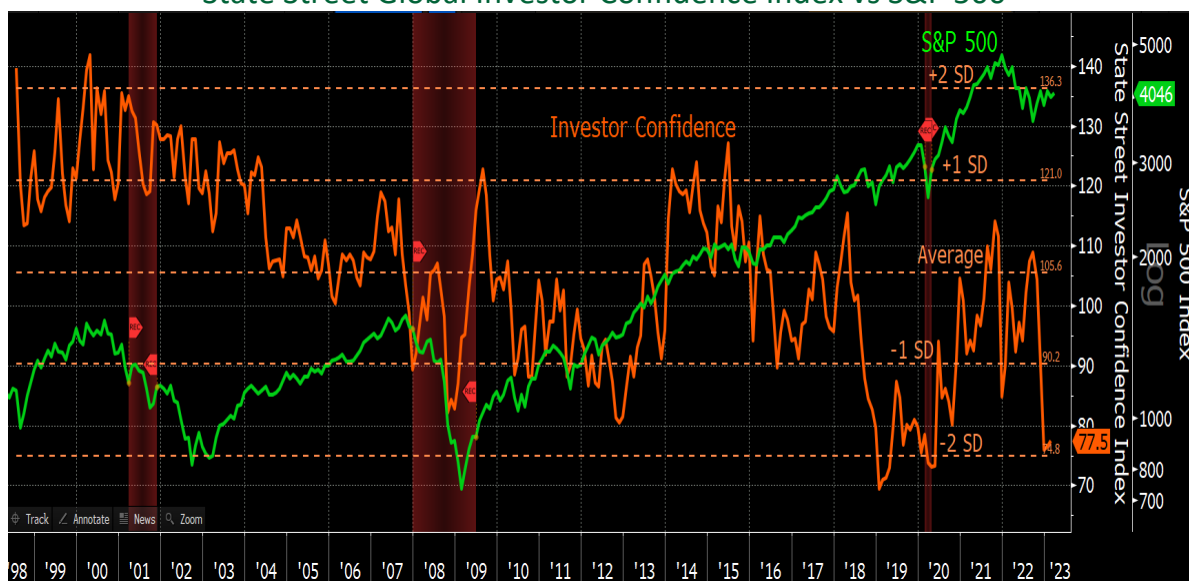
As per the preceding chart, the S&P 500 recently tested its 200-day moving average, but has bounced back, staying constructive after forming a golden cross at the end of January.

Growth in S&P 500 (%) vs Copper/Gold Ratio



The correlation between the S&P 500 Index and the Copper/Gold ratio has remained intact. On this basis, there seems to be further recovery potential in the Index.

State Street Global Investor Confidence Index vs S&P 500



The Global Investor Confidence Index in the above chart is currently at an extremely low level (-2 standard deviations). Such low levels have historically indicated upcoming opportunities to invest.

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RISK DISCLOSURE

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