

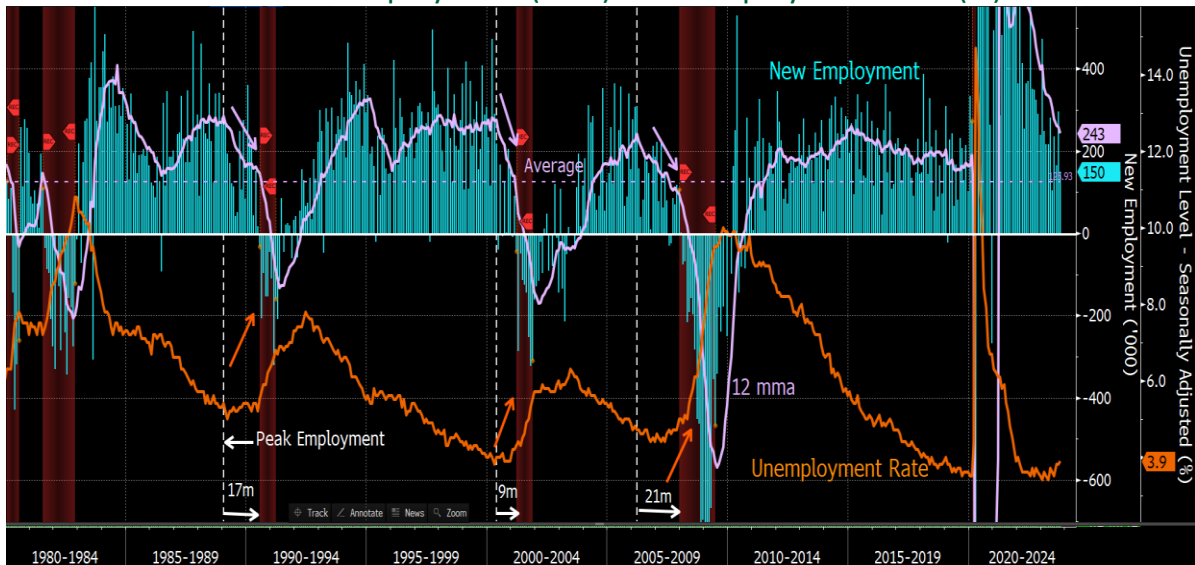
*"The best ability is dependability."*

Tom Gayner

## 1. BAD MAY BE GOOD

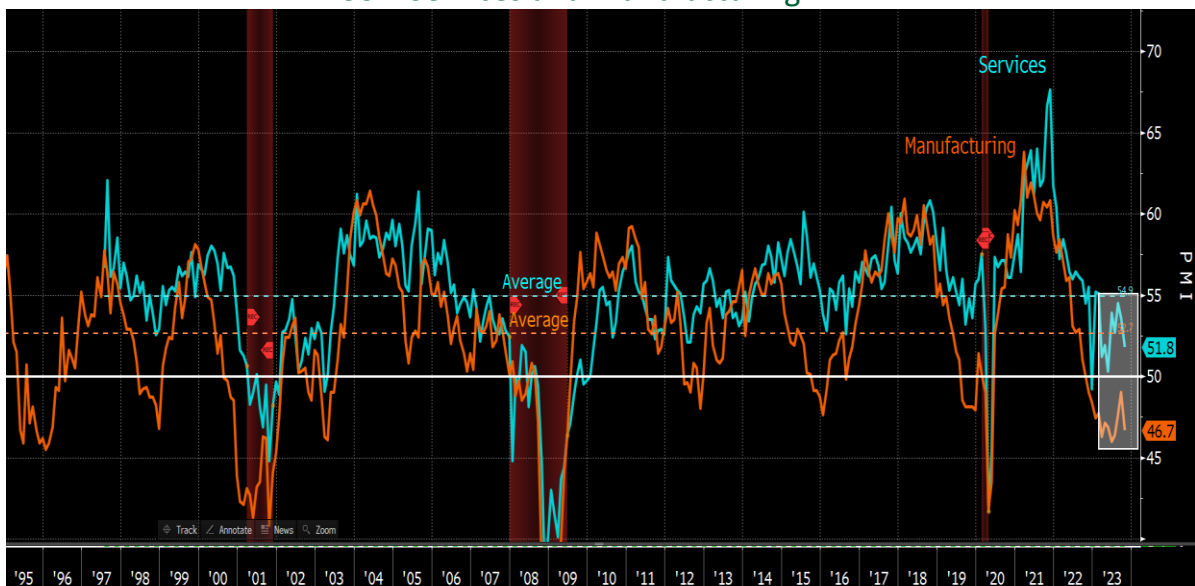
With the consistently firm stand the Federal Reserve (Fed) has taken on keeping interest rates high for longer, investor sentiment has been well tempered, pushing 10-year Treasuries to 5%.

US – New Employment ('000) vs Unemployment Rate (%)



The October new employment number of 150,000 was lower than expected, with the unemployment rate also weaker at 3.9%. Investors perceive this cooling effect as an indication that the Fed can start having less concerns about overly strong employment, and that further rate hikes may not be necessary anymore.

US – Services and Manufacturing PMI



Both the Services and Manufacturing PMI Indices' positive trajectory turned sharply lower in October. This serves as further indication that the economy is cooling and that the Fed's tightening task may be done.

## 2. US INTEREST RATES

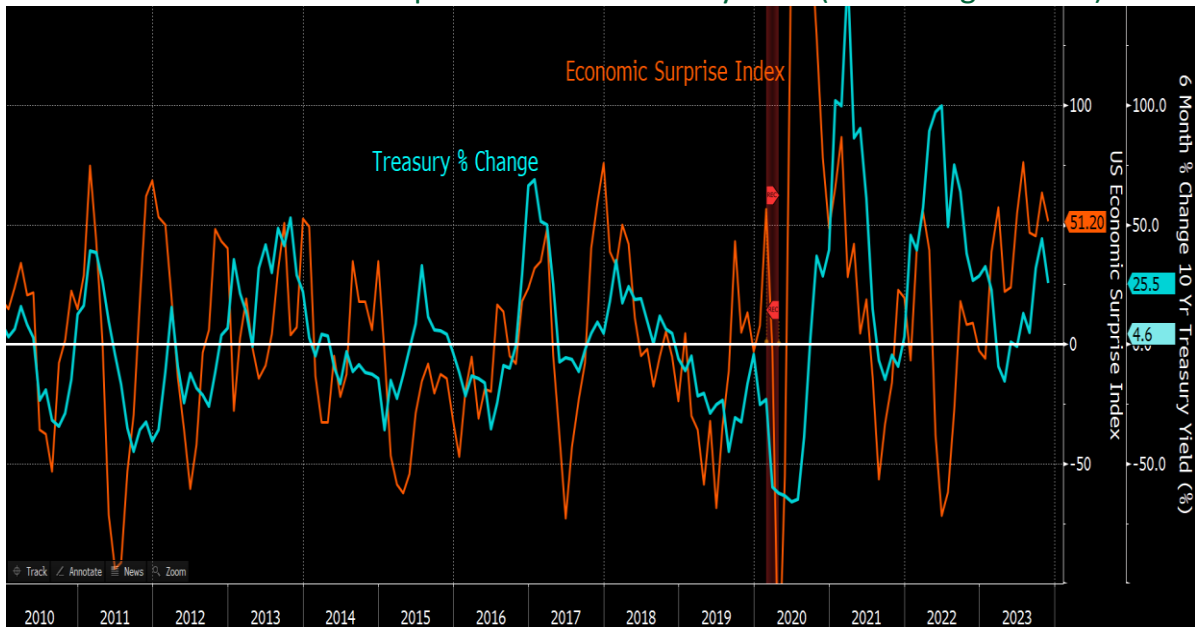
Market perceptions of US interest rates seem to be in process of changing.

### Fed Fund Target Rate vs December 2023 and 2024 Futures Rates



Despite the firm stand the Fed is taking on interest rates, their target rate has already been kept on hold since July. The December 2023 futures (yellow line in the above chart) have recently drifted marginally, but not to any extent to take serious cognisance of. Against this, the December 2024 futures have risen sharply since July, reflecting the Fed's 'higher for longer' stance. Strikingly, though, these futures have recently started reflecting a somewhat more positive stance for lower rates (the blue line).

### US – Citi Economic Surprise Index vs Treasury Yield (6-month growth %)



If, as is seemingly is in process, the US economy is starting to cool, the Economic Surprise Index in the above chart should drop from its current elevated level. The positive correlation with the Treasury Yield (blue line) indicates a potential negative trend for interest rates.

All-in-all, a perception is growing that the Fed may have been able to take interest rates to the necessary level without material damage to the economy. With only Rent of Shelter remaining a major contributor, inflation may become less of an obsession while they have the necessary reserves to stimulate the economy when it may become necessary.



### 3. COMPANY EARNINGS

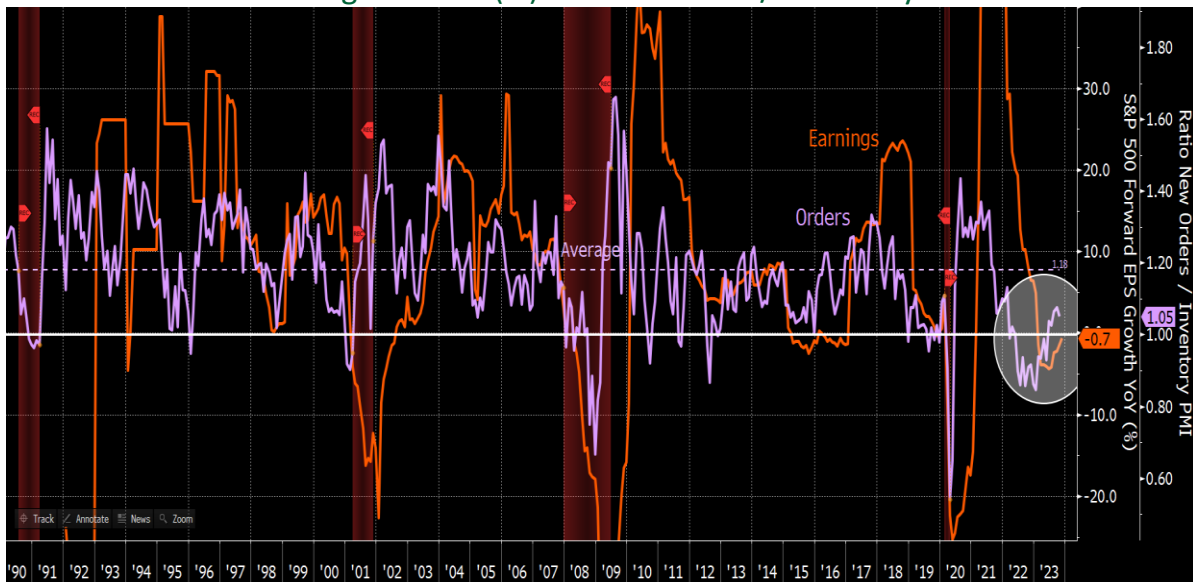
With over three quarters of S&P 500 companies having already reported, the overall result of 2% top-line and 3% bottom-line is respectively 1% and 7% better than consensus expectations.

#### MSCI World – Price Index vs Index of Number of Earnings Upgrades for Constituents



Analysts are generally downgrading their earnings projections (the green line in the above chart). This Upgrade Index is currently at a negative standard deviation away from average, reflecting a cautious stance. This may be reflected in share prices. Considering that the index historically has a strong correlation with share prices (the orange line), we take a more positive view of potential investment opportunities.

#### US – S&P 500 Earnings Growth (%) vs New Orders / Inventory PMI Index Ratio



Despite a dull economy, the New Orders / Inventory Ratio (purple line) in the above chart has recently turned positive. Whilst new orders may not be that strong, we perceive it more of a matter that inventories may be depleted. As Earnings (the orange line) is still depressed and follow this ratio, we are not overly concerned and reckon these issues are already reflected in share prices (as indicated above).

Our task is to identify businesses that, from an operational perspective, can grow sustainably. With expected double-digit compounding earnings growth over the medium term, the current uncertain environment offers us good investment opportunities.



## 4. CORPORATE BONDS

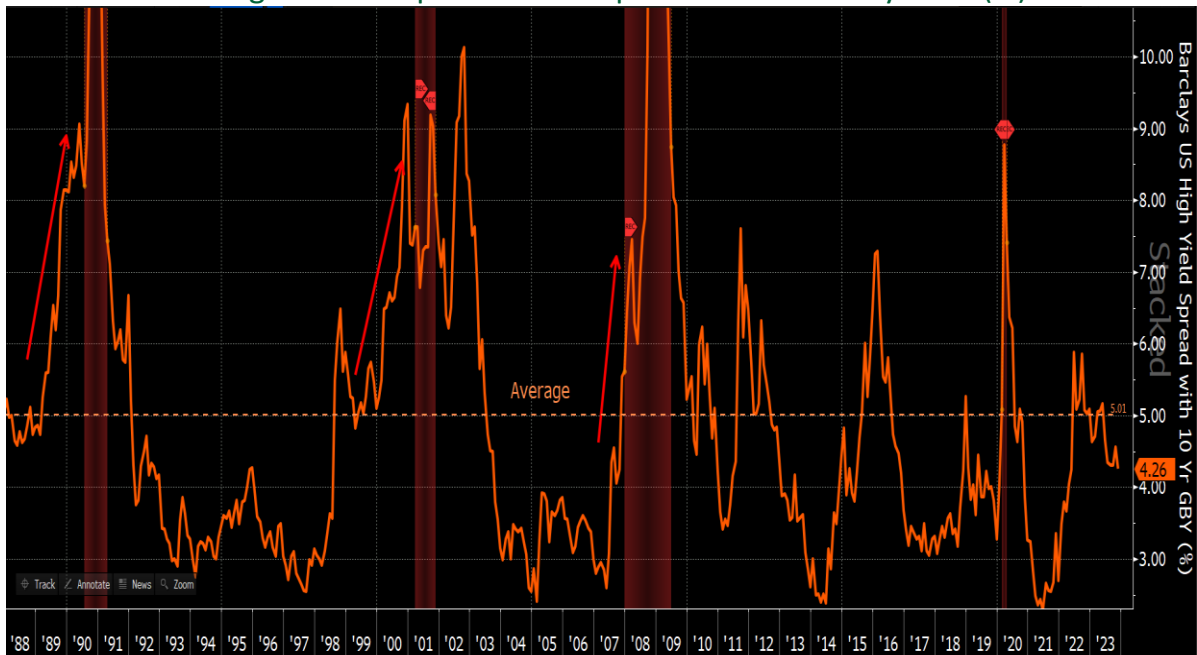
The Corporate Bond market is a valuable economic indicator.

### US High Yield Corporate Bond Yield (%) vs S&P 500



The Corporate Bond Yield (orange line, presented on an inverse scale), has remained relatively stable over the past year despite sharply rising interest rates. It has dropped somewhat recently. This indicates a generally positive investor view of US corporates. The (negative) correlation with share prices (green line) is striking.

### US High Yield Corporate Bond Spread with Treasury Yield (%)



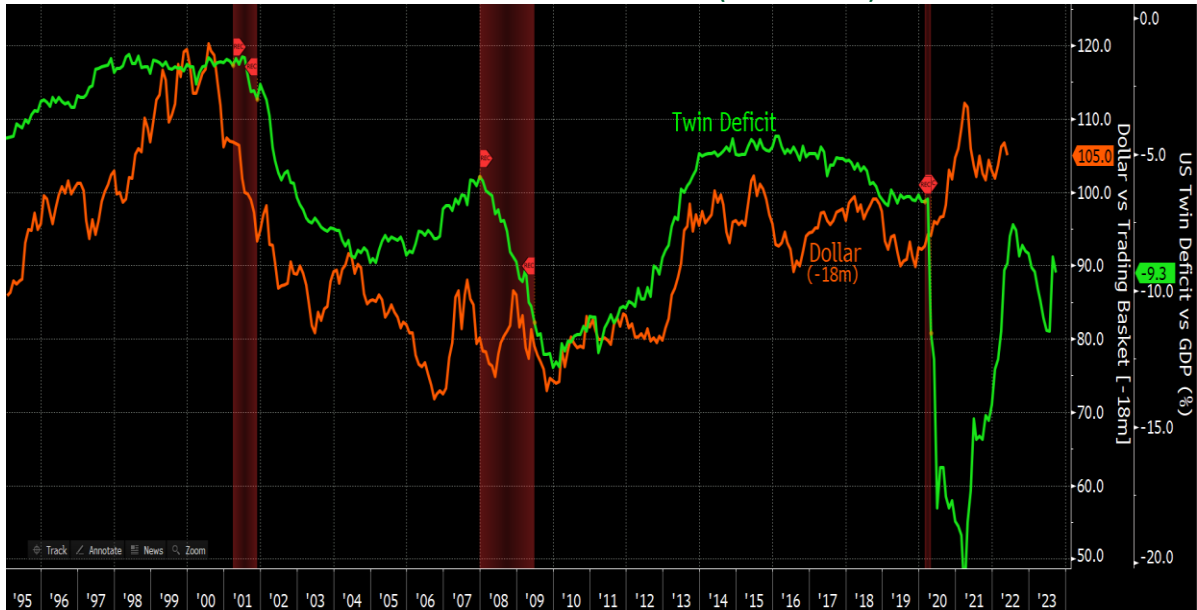
The spread with Treasuries (above chart) continues drifting. This trend also confirms our above comment. Furthermore, a negative trend in this spread has historically indicated constructive economic conditions. On this basis, we conclude that, despite general indications of a softer economy, a deep recession is not imminent and that the US may be on course for a soft economic landing.



## 5. DOLLAR CURRENCY

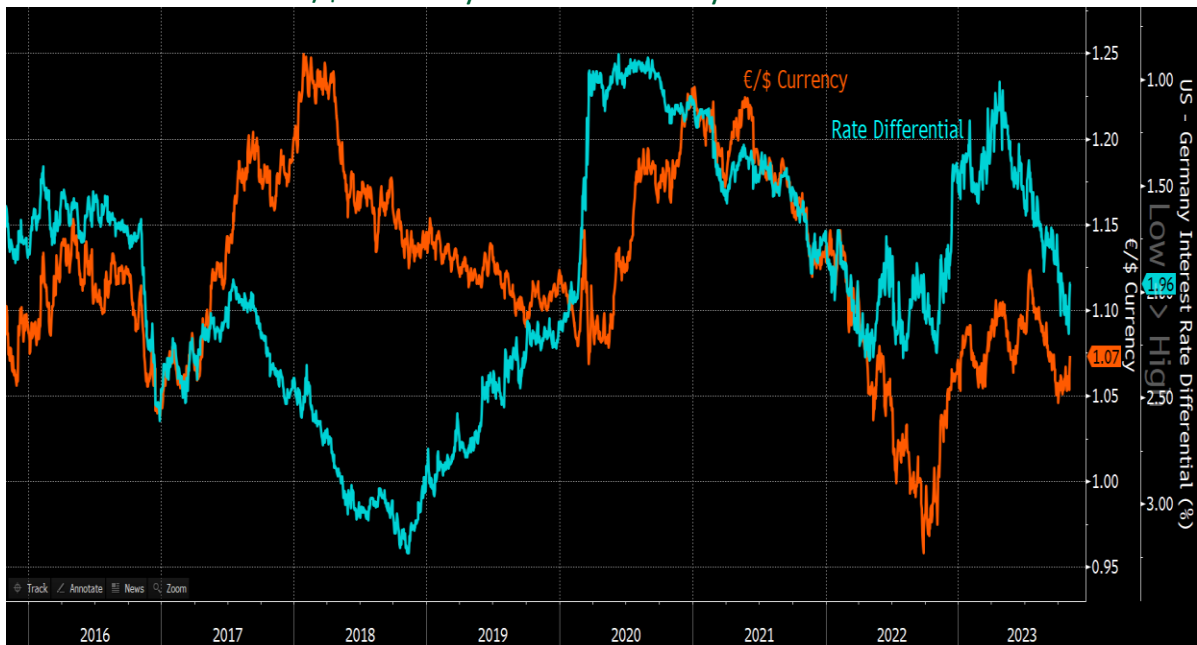
The US dollar has very recently weakened with indications of a softer economy and lower interest rates.

### Dollar Value vs Twin Deficit (% off GDP)



Considering the large twin deficit (combination of the fiscal and trade deficits), it seems the Dollar has, with the Pandemic, benefitted from investors seeking a safe-haven and therefore strengthened disproportionately. On a structural basis, we budget for a longer-term depreciation of the currency. This is not of material concern, as a weaker Dollar supports international trade, and therefore many different economies and, by implication, capital markets in general.

### €/ \$ Currency vs US – Germany 5-Year Rates



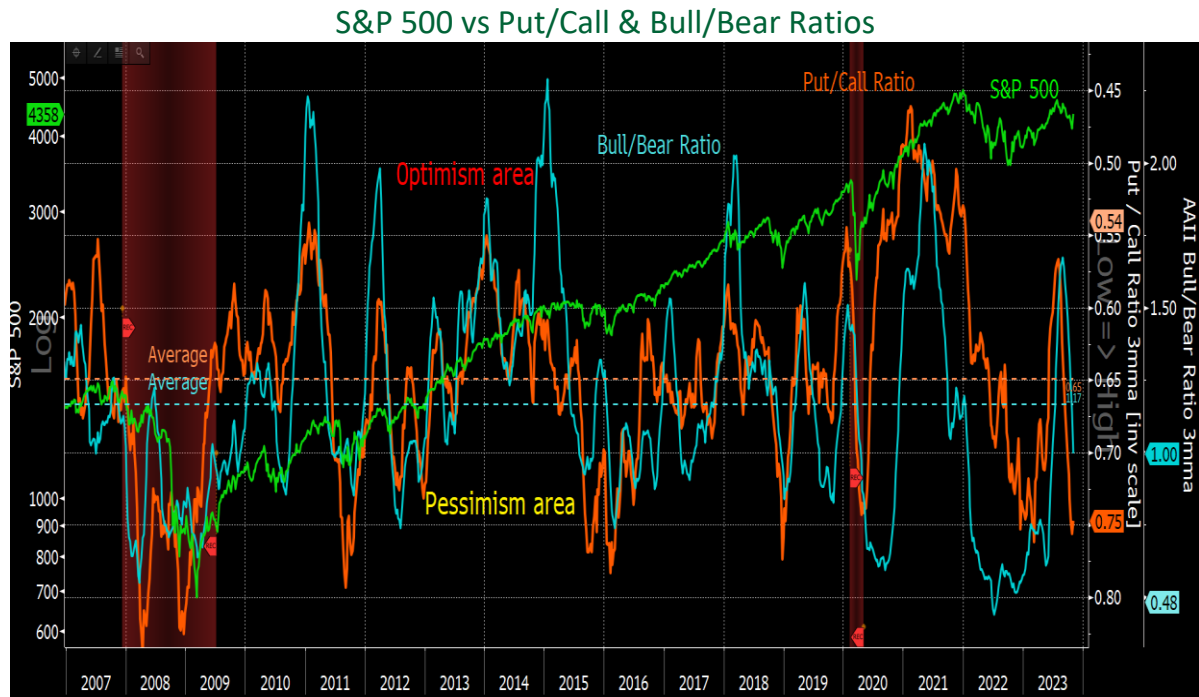
Considering shorter term moves in the currency, we take cognisance of rate differences with other major economies. The above chart reflects the correlation between the €/ \$ currency and the US and German rate differentials. Despite a recently weaker Dollar, the Euro has weakened more (blue line), because of a weaker European economic outlook and lower European rates.

Despite a structural negative outlook for the Dollar, we caution against an overly negative shorter-term outlook for the currency.



## 6. TECHNICAL PICTURE

The S&P 500 Index's technical picture looks good. It has crossed through its 50-day (on Friday) and also its 200-day moving averages. It seems the usual positive trend over the last quarter is back on track.



Both the Put/Call and Bull/Bear ratios have dropped materially over recent months. Compared to the S&P 500 Index, they have started to indicate buying opportunities from a technical perspective.

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