

Quarterly Global Asset Allocation No. 56, 21st December 2023

(i.e. 6 months – 2 years global asset allocation views)

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Implementing Thematic Bets in Strategic Portfolio

a.k.a. Downgrading US Recession Risk

Summary Extract:

“...As such, and while the chance of a US recession in 2024 remains non trivial (35% probability), the risk reward favours removing UW positions in strategic portfolios, and moving modestly overweight risk...”

...However, instead of classic ‘risk on’/‘risk off’ bets, at this stage, we favour thematic bets (i.e. with a relatively balanced mix of ‘safe’ vs. ‘risky’ assets)...”

Table of Contents – Key Sections:

1	Section 1: Summary & Conclusion	p. 2 – 7
2	Section 2: Top Level Asset Allocation Recommendations	p. 8 – 13
3	Section 3: Detailed Asset Allocation Recommendations	p. 14 – 17
4	Section 4: Key charts	p. 18
5	Section 5: Global PMI Trends	p. 19 – 20

Published as Separate Individual Extracts

- 6 Eurozone Macro Analysis & Traffic Lights – available [HERE](#)
- 7 US Macro Analysis & Traffic Lights – available [HERE](#)
- 8 Chinese Macro Analysis & Traffic Lights – available [HERE](#)
- 9 Global Valuation Analysis – available [HERE](#)

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Implementing Thematic Bets in Strategic Portfolio a.k.a. Downgrading US Recession Risk

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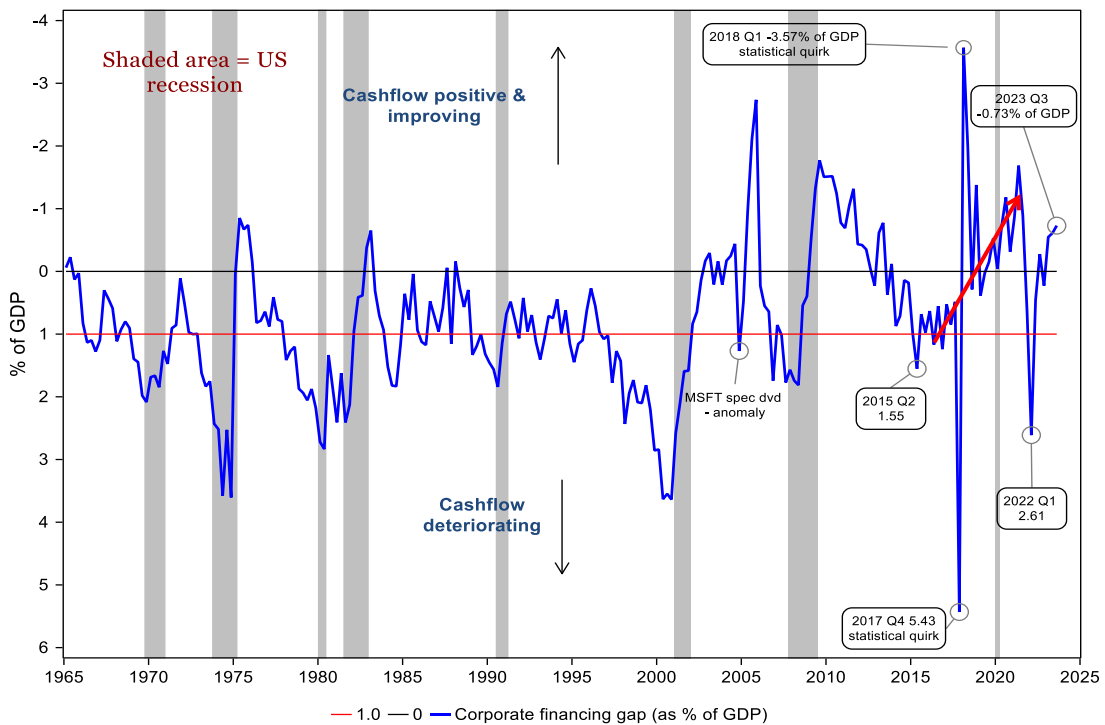
Summary & Conclusion

We are shifting our recession probability from above 50% to below 50%. That is, we have assigned a **65% probability to ‘no US recession in 2024’**. As such, and while the possibility of a recession in 2024 is not completely off the table, it’s not our central case. For that reason (and others as outlined below), the risk reward, therefore, favours making changes to our strategic portfolio this quarter. Those changes are laid out below.

The rationale reflects the Fed’s decisive policy shift last week (from ‘higher for longer’, to expecting to loosen in 2024), as well as a number of other factors.

In particular, recessions have historically been driven by a combination of: (i) tight money; (ii) a shock of some form (a bursting bubble, deflating housing market, GFC etc.); and/or (iii) a corporate sector which is overstretched and begins to cut back/retrench.

Fig 1: US corporate sector financing gap (% of GDP)



Source: Longview Economics, Macrobond

Factor (iii) has been consistently missing in 2023, as highlighted by the corporate financing gap (fig 1) and raised by us as a key risk in 2023. In a similar

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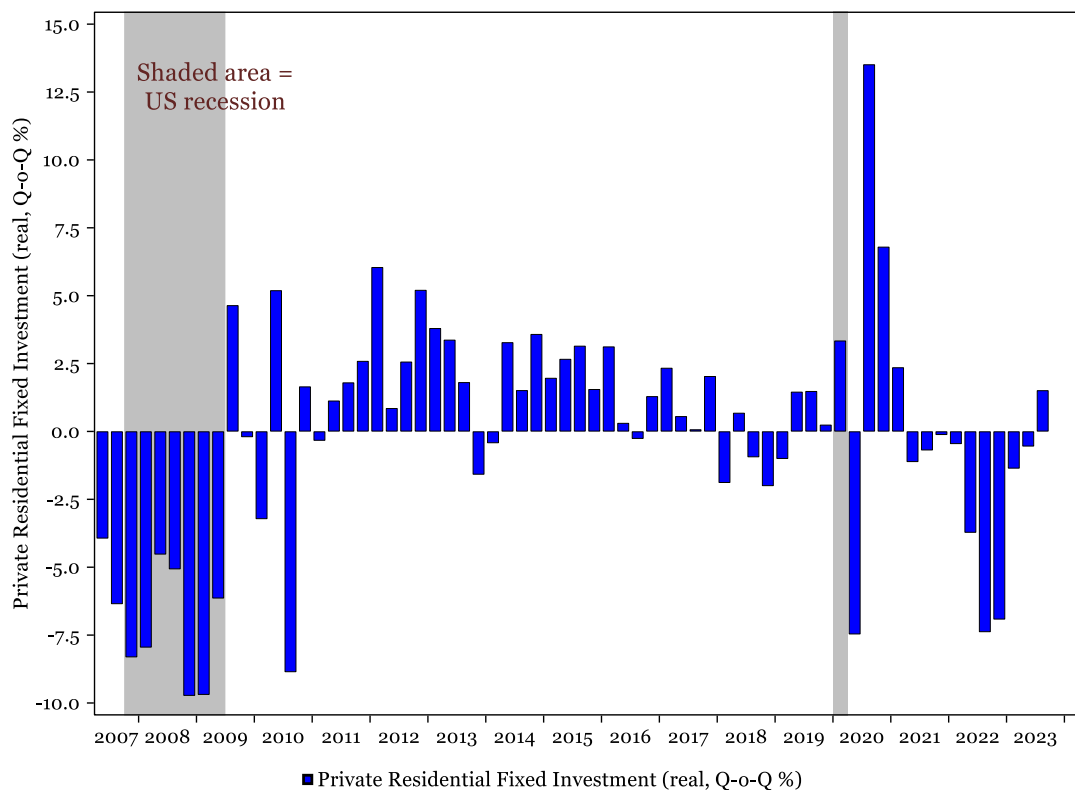
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vein, GDP profits have been revised higher, such that the contraction in Q2 is modest (and reverses on the latest data, i.e. in Q3). Looking through history, profits usually contract for a number of quarters before recession starts.

With respect to factor (i), our focus has been on tight money creating a recession and probably also **causing ‘something to break’**. The Fed, though, has now shifted its focus and **there’s** an absence of anything breaking (since the banking crisis in March). As such, and while there are currently no major (recession inducing) shocks, the three factor recession framework is no longer as convincing.

Furthermore, whilst tight money takes time to work its way through the system, **it’s clear that:** (i) Housing activity is poised to bounce (and therefore add to GDP growth instead of detracting from it, with some measures of activity already turning higher, see fig 1a); (ii) the manufacturing sector, having been in recession for the past 12 months, is likely to recover (**that’s the message of** certain leading indicators, e.g. fig 4a); (iii) already looser financial conditions should lead to **looser credit conditions (that’s the historical pattern); while** (iv) **rallying bond prices will ease the losses in the ‘HTM’ part of the regional banks’ bond portfolios** (and, at the margin, help to **restore banks’ risk appetite/loosen credit conditions**). Banks, after 12 years of healing post-GFC, are also well capitalised (despite some stress in some parts of the loan books).

Fig 1a: US private residential fixed investment (Q-o-Q %)

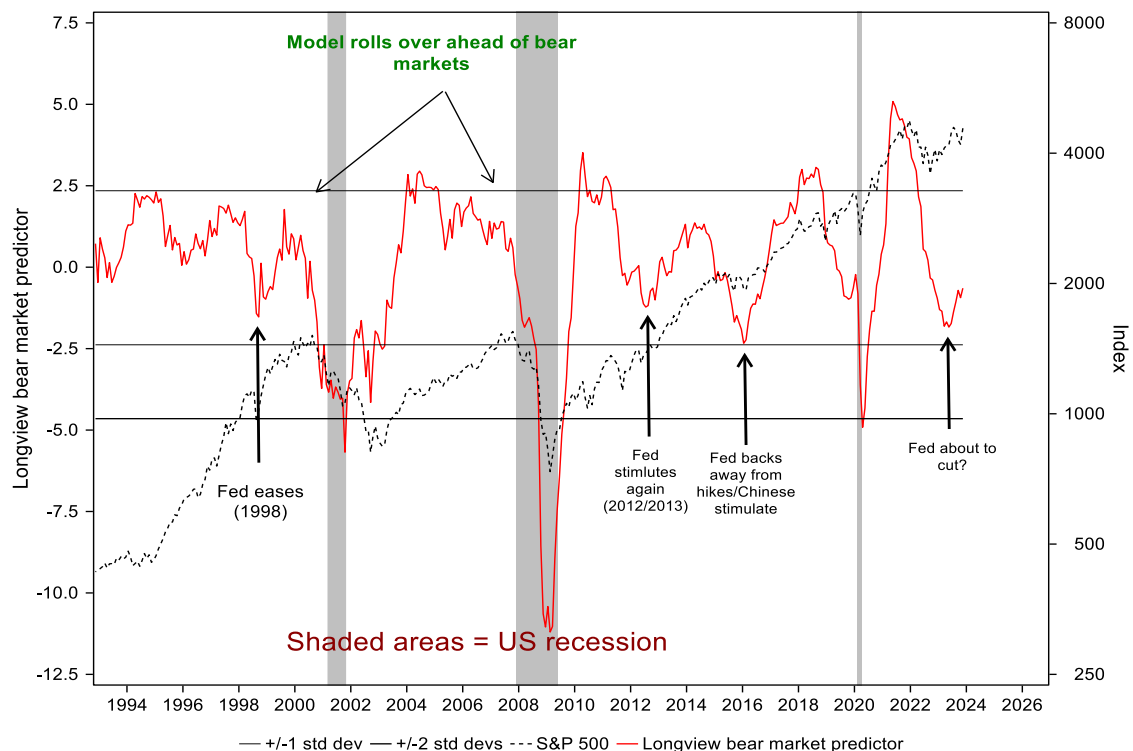


Source: Longview Economics, Macrobond

Added to which, and while the signal from our recession framework noted above has become less convincing, a number of other models/frameworks have also moved away from signalling an imminent US recession.

Our ‘US Recession model’, for example, has not risen to significantly high levels (fig 4b). **It’s not, therefore,** confirming the current warning signal from our Liquidity Indicator (i.e. **which is something we’d look for, i.e.** to gain conviction about a US recession). Equally, our US ‘bear market predictor’, having trended down for the past two years, has stabilized/begun to trend higher. Usually, when this signal turns higher from low levels, it signals falling/reduced recession risk (see fig 1b). Other models have also moved away from recession warning levels, including the US ‘inventories less new orders’ model (shown in fig 4a).

Fig 1b: Longview bear market predictor vs. S&P500



Source: Longview Economics, Macrobond

We also remain cognizant that, somewhat unusually, **there’s been a bear** steepening of the US yield curve this year (July to October), i.e. on 2s10s. Typically, curve inversions are followed by a bull (not bear) steepening of the curve. That is, both 2 and 10 year yields fall, with 2 year yields falling faster than 10s (as the bond market prices a Fed easing cycle). Recession then begins, usually within a few months of the curve steepening up to about +50bps. **That’s** the history of recent decades. At this point, though, the curve (i) has not bull steepened; and (ii) remains inverted. For now, in that respect, the risk of an imminent recession remains relatively low, albeit recession risk bears watching/thinking about through that lens in coming months.

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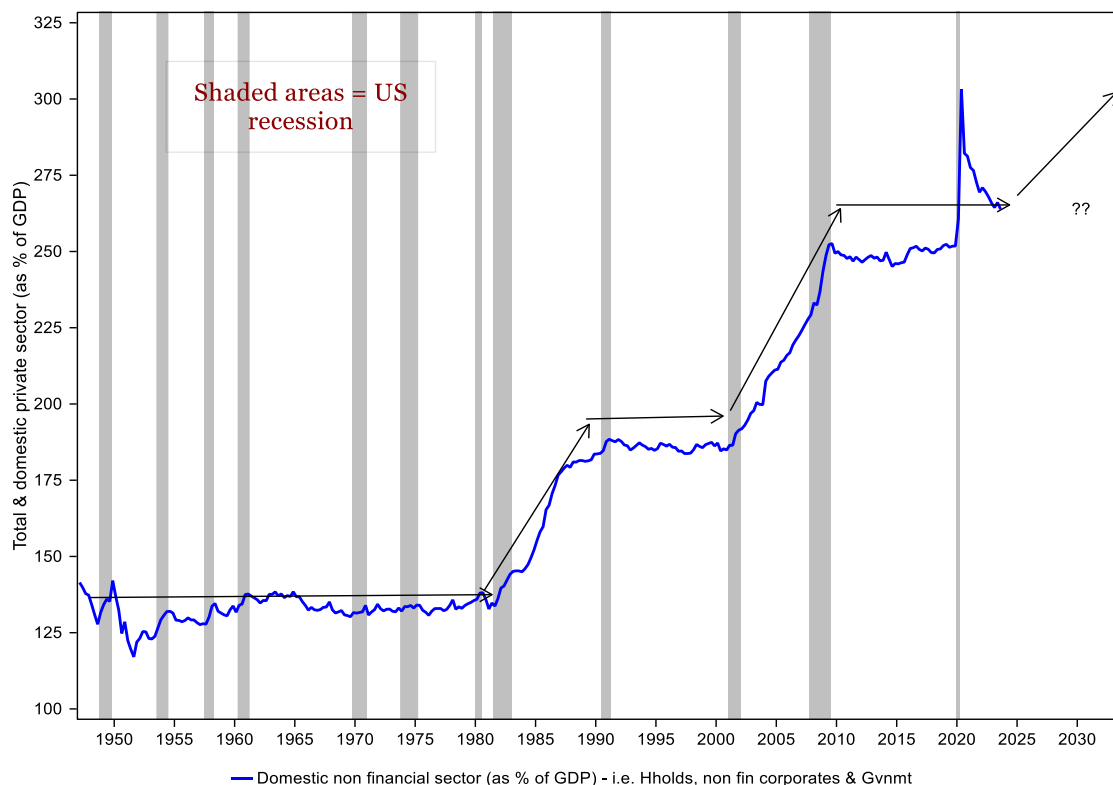
Overall, therefore, our view is that even though a US recession is averted in 2024, the ECB & the BoE will follow the Fed with a change in policy emphasis, albeit with a lag (i.e. as we expect inflation to keep coming down – discussed [HERE](#)).

With major Western central banks starting to ease, defensive and then cyclical parts of the global stock market should outperform (with the ‘magnificent seven’ used as a source of funding for those other areas of the market). As such, non-US equities should outperform.

We have outlined this theme in detail in “[The Forthcoming Great Global Sector Rotation](#)” – written on 13th October 2023 (available [HERE](#)). That theme should be underpinned over the next 1 – 4 years by the ‘winners curse’ phase of the 18 year land cycle (as explained [HERE](#)).

Winners curse phases are the final 2 – 4 years of strength in housing/land prices in the 18 year land cycle, which are then followed by major busts (due to economic excess and overstretched borrowing). The last two ‘winners curse’ examples occurred in the noughties and the second half of the 1980s. Both phases had a consumer and private sector lending boom (see fig 1c below) and ended up with a banking crisis (S&L in the late 1980s & GFC in 2008). Ahead of the crisis phase, though, non-US/non-tech equities outperformed (we wrote more about that concept in the “[The Rhythm of Bear Markets](#)” Longview on Friday, 5th May 2023).

Fig 1c: US non-financial sector leverage (households, corporates & government, % Of GDP)



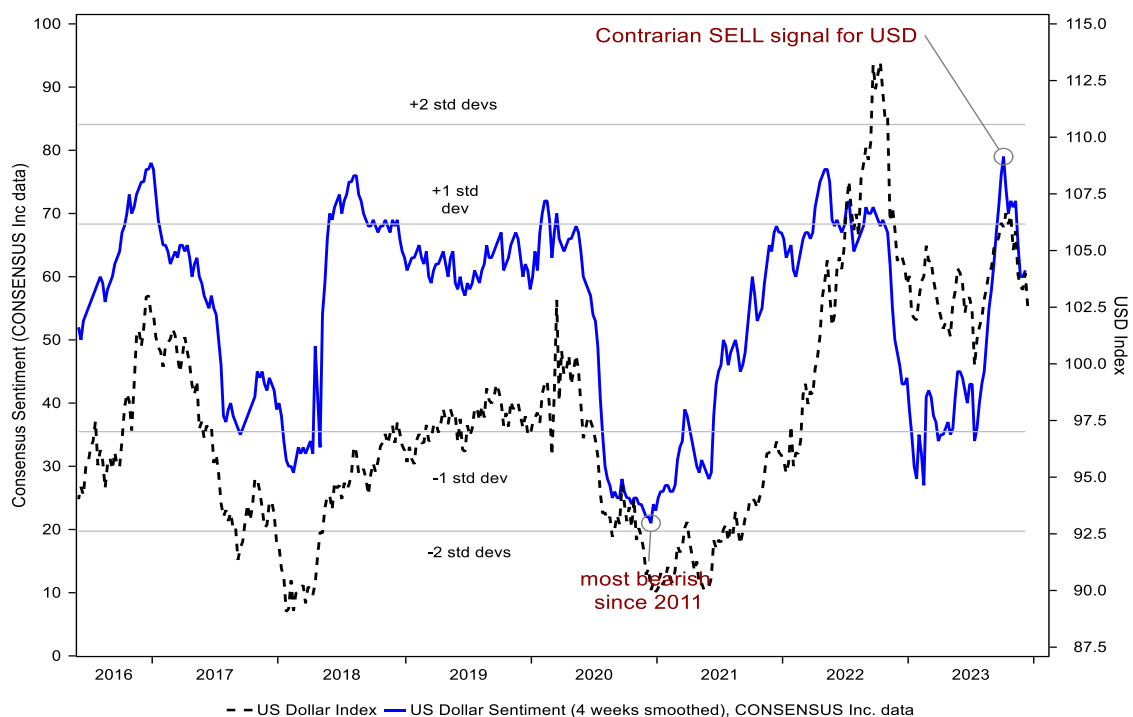
Source: Longview Economics, Macrobond

As such, and while the chance of a US recession in 2024 remains non trivial (35% probability), the risk reward favours removing UW positions in strategic portfolios, and moving modestly overweight risk.

However, instead of **classic ‘risk on’/‘risk off’ bets, at this stage**, we favour thematic bets (i.e. with a relatively balanced mix of ‘safe’ vs. ‘risky’ assets). Those are laid out in detail in tables 1 & 1a, and section 2 below, and include:

- Tilting away from US equities, and towards parts of the global equity market that are (i) cheap; (ii) with more exposure to defensive and cyclical sectors (as well as small & mid-caps); and (iii) which have less potential earnings/macro downside (e.g. in Europe, see section 2 for full rationale).
- Remaining overweight US Treasuries (albeit with a reduced position size, for now). **In particular that reflects our ‘Age of Monetarism’ theme and the case for further downside inflation surprises**, see Section 2.
- Long/OW oil: We ZERO weighted oil in September, and increased gold weightings in October. With those prices moving sharply since then (i.e. oil lower, gold higher), the risk reward favours switching back towards oil.
- UW the US dollar, as markets rotate away from frothy/expensive assets in the US (i.e. tech/growth stocks), and as bullish sentiment/crowded long positioning in the dollar (continues to) unwind, e.g. see fig 1d below. We therefore favour some modest exposure to EM equities and commodities.

Fig 1d: US dollar sentiment (CONSENSUS Inc.) vs. DXY



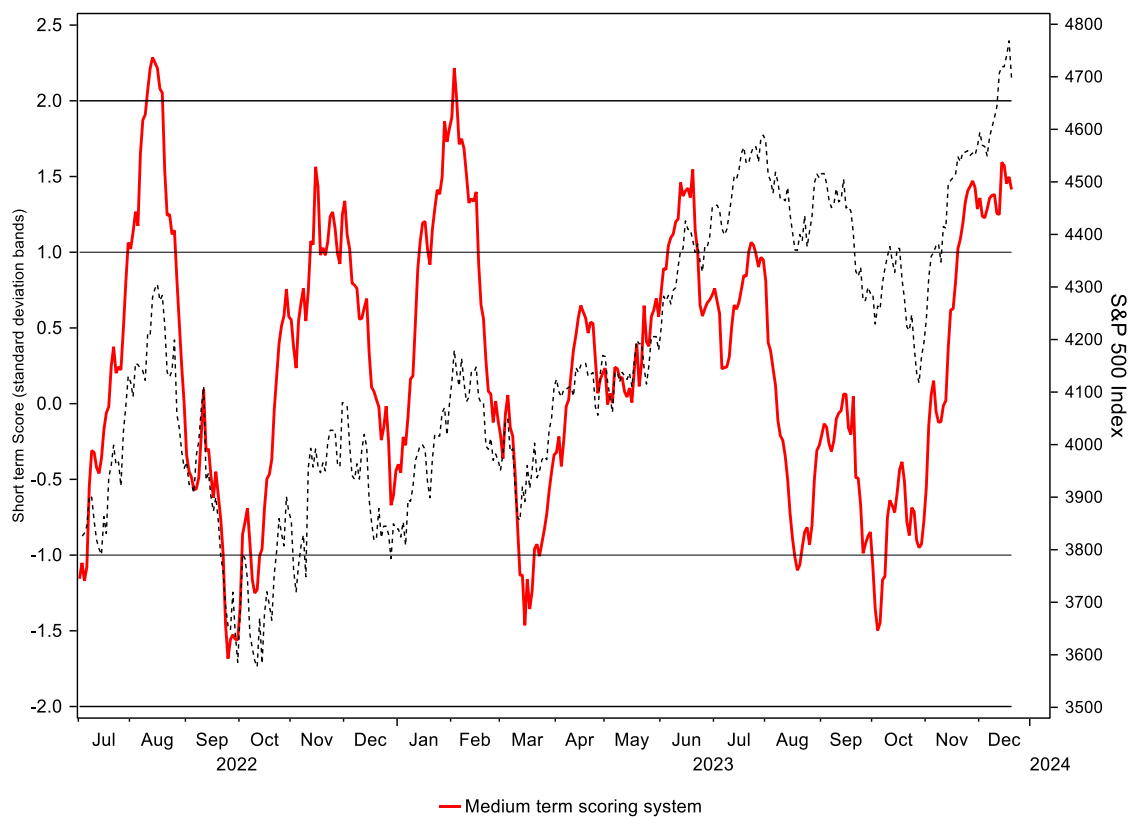
Source: Longview Economics, Macrobond, CONSENSUS Inc.

Risks are always multiple when weighing a broad range of conflicting messages/evidence. Naturally our **key concern is that we're** downgrading US recession risk (from >50% to 35%), and increasing portfolio risk, at a time when the US economy could be close to entering recession.

It's possible, for example, that the (popular) 'rolling recession' narrative is indeed the correct one, and the consumer is next (which would probably **generate an 'economy wide' US recession**). **As we have argued throughout this** year, though, if a recession occurs it's likely to be shallow and short (given that economic excess is minimal). In which instance, our switch would have been early but would eventually emerge as the right theme.

Other risks are around the *timing* of our switch away from UW risk positioning in the portfolio. That is, some of our medium term market timing models have started to move towards SELL levels (for equities/other risk assets), e.g. see fig 1e. To balance those risks, we therefore favour a balanced mix of 'risky' vs. 'safe' assets, for now, with the view to adding to risk positions on weakness, if forthcoming.

Fig 1e: Medium term scoring system vs. global equities (MSCI, all cap)



Source: Longview Economics, Macrobond

Table 1a: Benchmark & Recommendations*

RISKY Assets				SAFE Assets			
Asset	L'view B'mark (%)	Dec '23 weight'g (%)	OW/UW (pp)	Asset	L'view B'mark (%)	Dec '23 weight'g (%)	OW/UW (pp)
DM Equities	25	25	-	Developed Sovereign Debt	25	28	+3
EM Equities	10	11	+1	Cash	15	10	-5
Commodities	5	6	+1	HG Corporate Debt	10	10	-
HY & EM Corporate Debt	5	5	-				
EM Sovereign	5	5	-				
Total RISKY	50	52	+2	Total SAFE	50	48	-2

Source: Longview Economics

*Split of safe haven assets vs. risk assets (& vs. benchmarks).

Table 1b: Top level Strategic Recommended Asset Allocation (% weightings)

Asset Class	NEW		Change from last update	OLD
	% of total (Updated Dec '23)	% Breakdown		% of total (updated Oct 23)
Equity:	36		+12	24
- Developed		25	+7	18
- Emerging		11	+5	6
Corporate Debt:	15		+2	13
- US High grade corporate		7	-1	8
- EZ High grade corporate		3	-1	4
- US High yield corporate		2	+2	-
- EZ High yield corporate		2	+1	1
- EM corporate debt		1	+1	-
Commodities:	6		-1	7
- Gold		2	-3	5
- Silver		-	-2	2
- Agricultural		-	-	-
- Base metals		1	+1	-
- Energy		3	+3	-
Sovereign debt:	33		-6	39
- Developed		28	-6	34
- Emerging		5	-	5
Cash	10	10	-7	17

Source: Longview Economics

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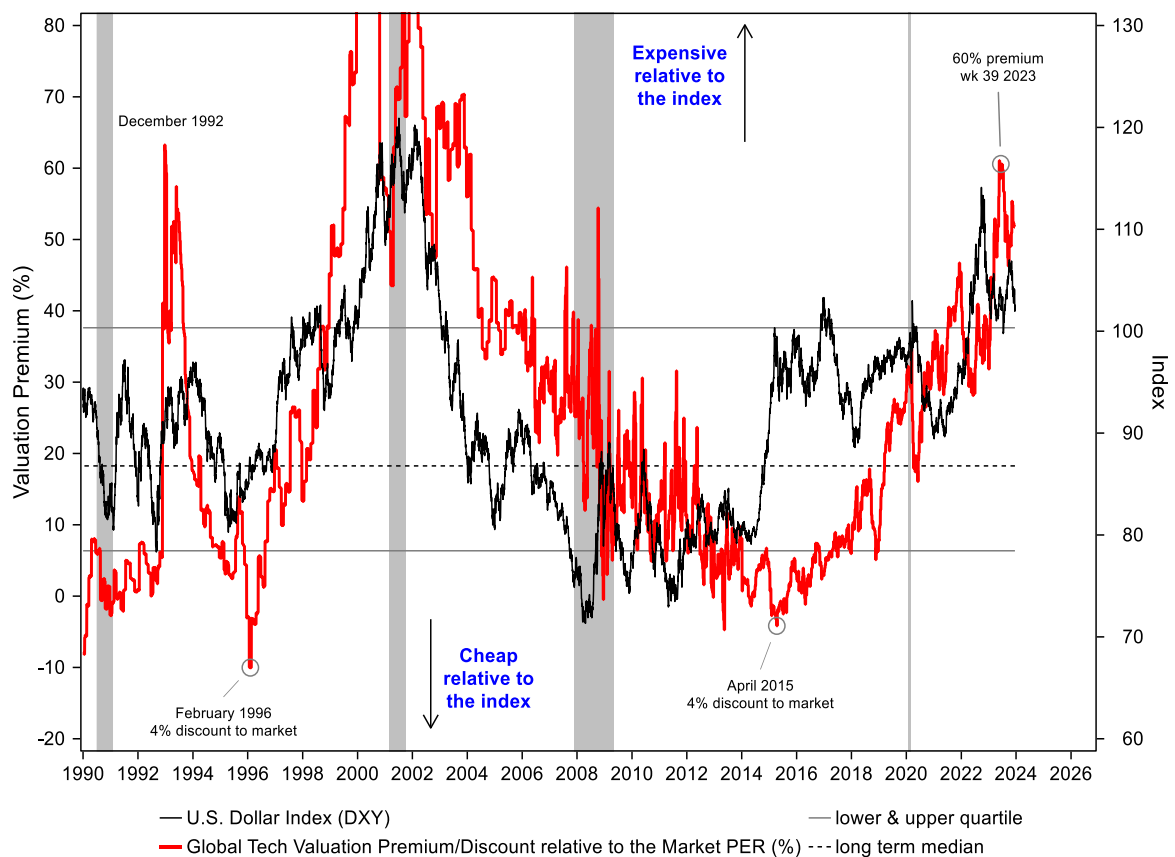
Section 2: Top-level Asset Allocation Recommendations

DM Equities: Move NEUTRAL relative to benchmark (from 7pp. UW).

Within DM equities, we favour OW positions in European equities and an UW position in the US. The rationale is threefold. In particular:

(i) European equities are trading at **multi-year cheap** levels relative to the US (fig 4), which is where the froth/excess has been building in global markets. From that relative valuation perspective, therefore, Europe is poised to outperform over the next 1 – 2 years (and potentially beyond). Or, put another way, global tech stocks are at their most expensive relative to the global market since the TMT bubble. As the chart below shows, that has been accompanied by a strong US dollar bull market in the past decade (i.e. consistent with the asset allocation switch into the US/away from other markets).

Fig 2: Global Tech PER rel. to Global Equity Market vs. USD index

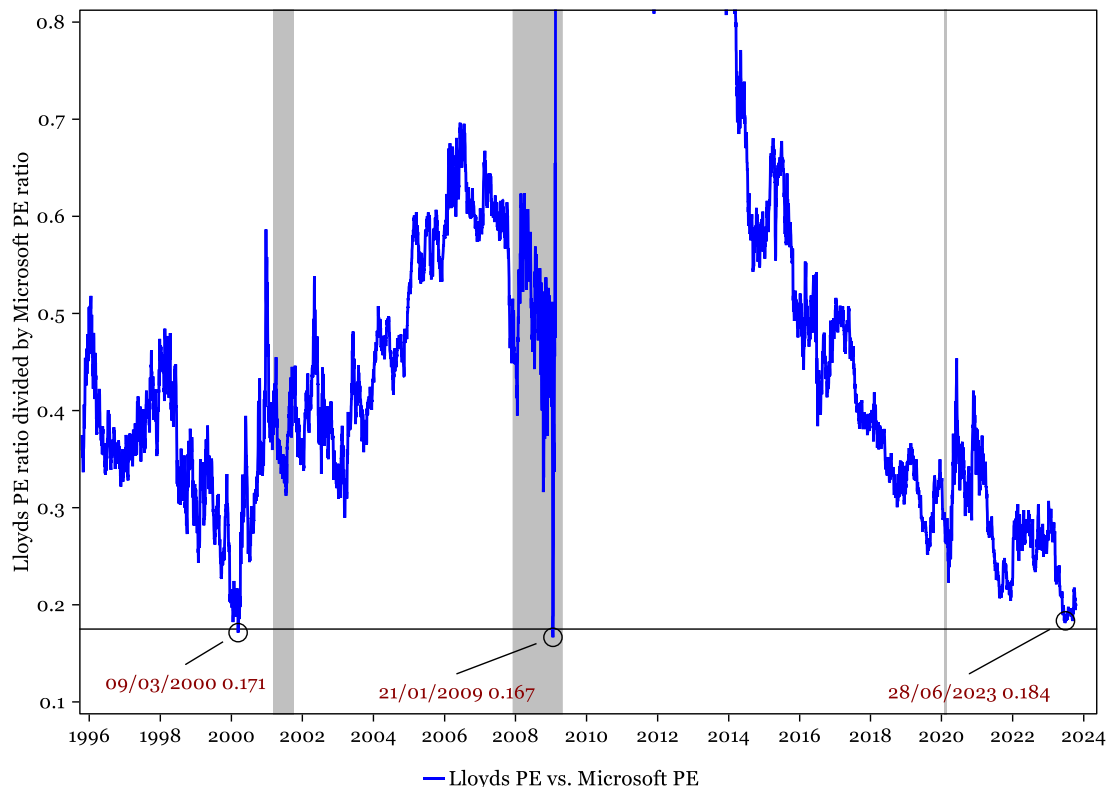


Source: Longview Economics, Macrobond

(ii) a new fashion in global equities is likely. Usually, sector leadership switches occur when (a) valuation divergence becomes extreme; and (b) when there’s a new macro theme. **With respect to (a)** the valuation discrepancy between US/growth stocks and European/value stocks is marked (as

highlighted above). That divergence is also illustrated by the chart below (showing that Lloyds's forward PE is about 20% that of Microsoft's). That's only occurred twice in recent history (in the GFC and at the peak of the tech bubble).

Fig 2a: Lloyds PER relative to Microsoft PER (both based on consensus EPS)



Source: Longview Economics, Macrobond

With respect to (b), a cycle of US/Western interest rate cuts (and ongoing falls in bond yields) is a new theme, which has the potential to drive rotation into the defensive and cyclically sensitive areas of the global equity market. UK & EZ markets should be the beneficiaries of that rotation, given that they are dominated by value (old economy) sectors, including banks and resources. Other attractive parts of the European equity market include small and mid cap stocks (please see [HERE](#) for full analysis).

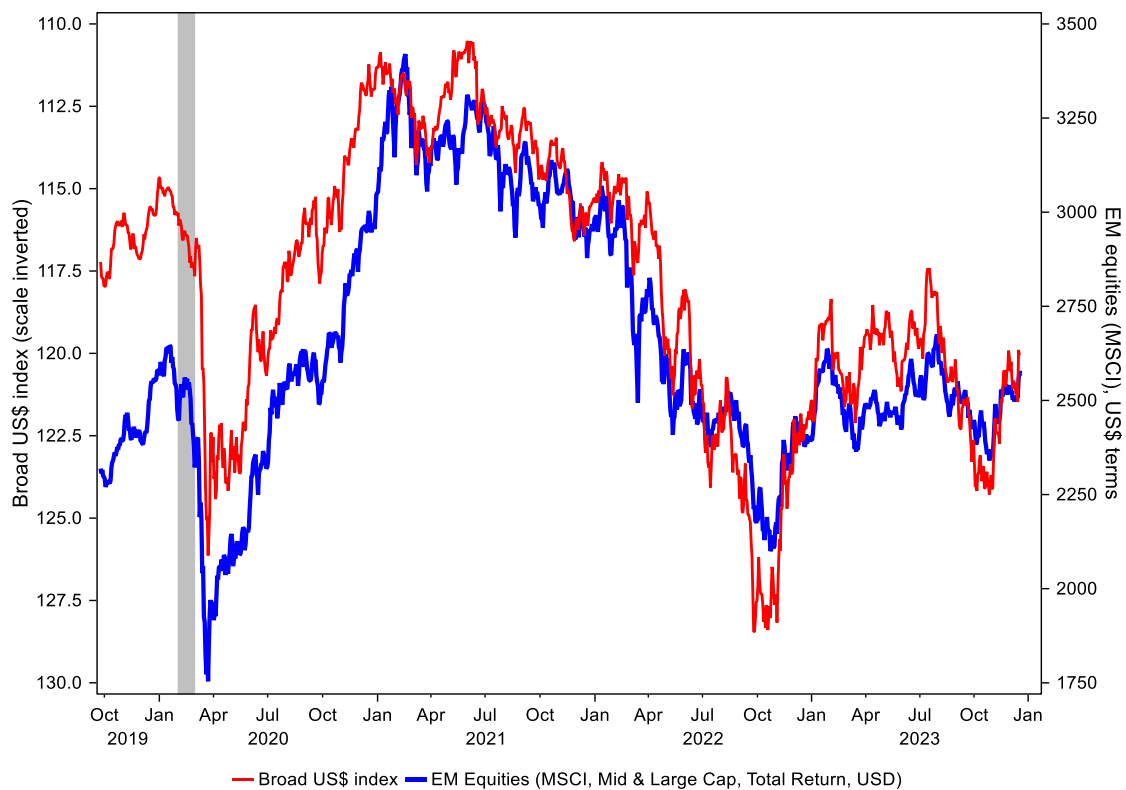
(iii) downside risks to the European economy are low relative to the US. As we highlight [HERE](#), Europe is probably already in recession (albeit a shallow one). That may deepen somewhat in coming quarters. There is little, though, by way of economic excess in Europe and we'd expect the recession to remain relatively shallow. In the US, in contrast, real GDP growth in Q3 was 5.2% annualised (and the Q4 Atlanta Fed GDPNow estimate is 2.7%). There's more potential therefore for a sharp growth deceleration in the US. There's also a reasonable chance of a recession. The risk reward, in that respect, favours tilting portfolios towards European equities over the US (please see fig 3 for detailed recommendation).

EM Equities: Move modestly OW (i.e. to +1pp. OW, from -4pp. UW).

Given the bearish outlook for the US dollar (see above), we favour a modest OW EM equity position in the strategic portfolio (i.e. as a short dollar play). The inverse correlation between the US dollar and EM equities is relatively tight in that respect, and shown in the chart below.

We would also note that EM equities are currently technically oversold relative to DM equities (i.e. given the latest phase of marked DM equity outperformance). As such, and with Western central bank easing likely next year (and with Brazil and certain other EM central banks already starting to cut rates), we favour adding some/modest OW exposure to EM equities (please see table 3a for detailed EM country recommendations).

Fig 2b: EM equities absolute (in USD terms) with the dollar



Source: Longview Economics, Macrobond

Bonds: Stay OW US Treasuries, but reduce position size from +9pp. to +3pp. OW relative to benchmark (see tables 1a & 1b).

Our view on US Treasuries is largely unchanged. That is, bond yields should (continue to) move lower in 2024, given that shrinking money supply (fig 4c) should increasingly generate deflationary pressures in Western economies. **That's the conclusion of a theme we call the 'Age of Monetarism'** (which is laid out in detail [HERE](#)). Inflation risks are therefore skewed to the downside, i.e. a key reason to stay OW Treasuries.

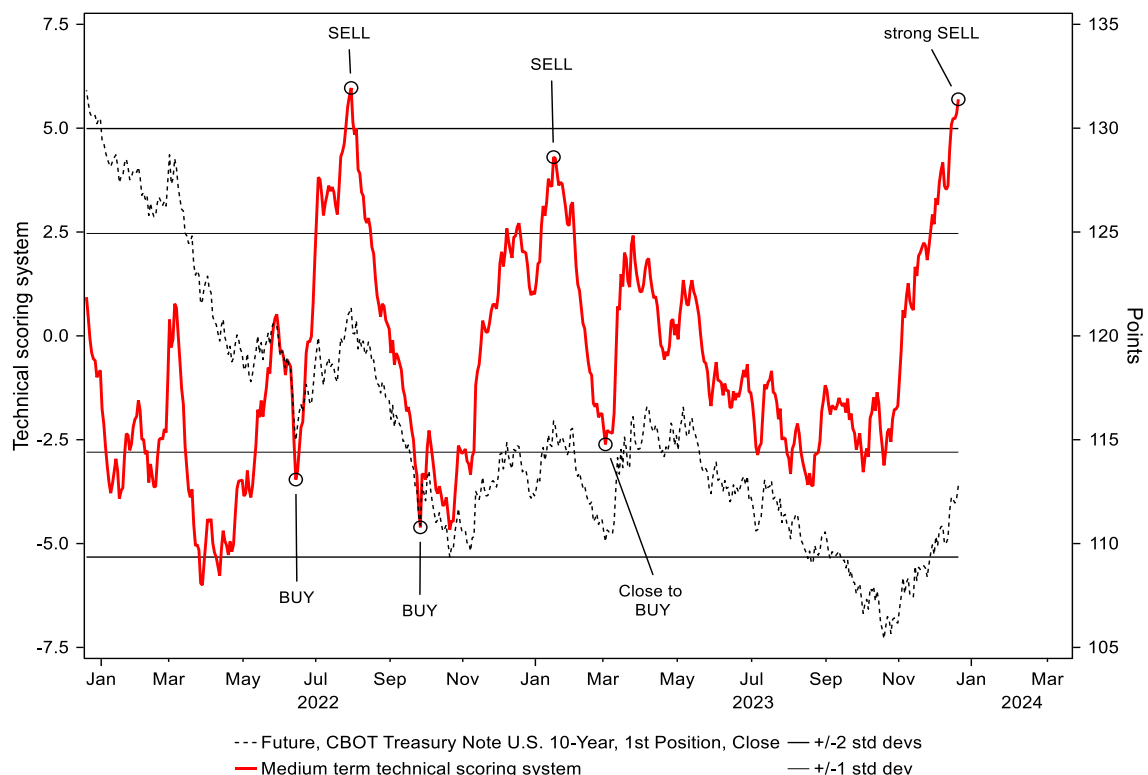
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Added to which, the risk of a US recession in 2024 is relatively significant (35% chance in our view). If it materialises, that would naturally enhance the case for owning bonds. Furthermore, the market is still net short and sentiment has recently been at bearish levels (generating a contrarian BUY signal).

In the near term, though, and given the speed of the rally, bonds are now technically overbought. We therefore recommend dialling back our bond weightings (with the view to adding on weakness/if forthcoming – i.e. as/when SELL signals unwind and move back to BUY), see fig 2c.

Fig 2c: Longview medium term technical scoring system vs. US 10y futures



Source: Longview Economics, Macrobond

Commodities: Modestly reduce OW position (from +7pp. to +6pp.). Within that OW position, reduce precious metals exposure and switch into OIL (as well as base metals).

In September we took oil weightings down to ZERO, for a number of positioning and fundamental reasons (highlighted [HERE](#)). We then added exposure to gold in October, following a BUY signal from our gold market timing model ([HERE](#)).

Given the rotation theme noted above, in which 2024 rate cuts should support cyclically sensitive asset prices, we recommend switching back into oil (and establishing some/modest exposure to base metals). In particular, oil is technically oversold and is also finding support at a key technical level (see fig 3d). With that, our oil ‘market timing model’, which combines sentiment,

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positioning, and technical models, is effectively generating a BUY signal (see fig 2d). Our gold market timing model, on the other hand, is close to SELL (fig 2e).

Fig 2d: Brent oil market timing model vs. oil price (US\$/barrel)

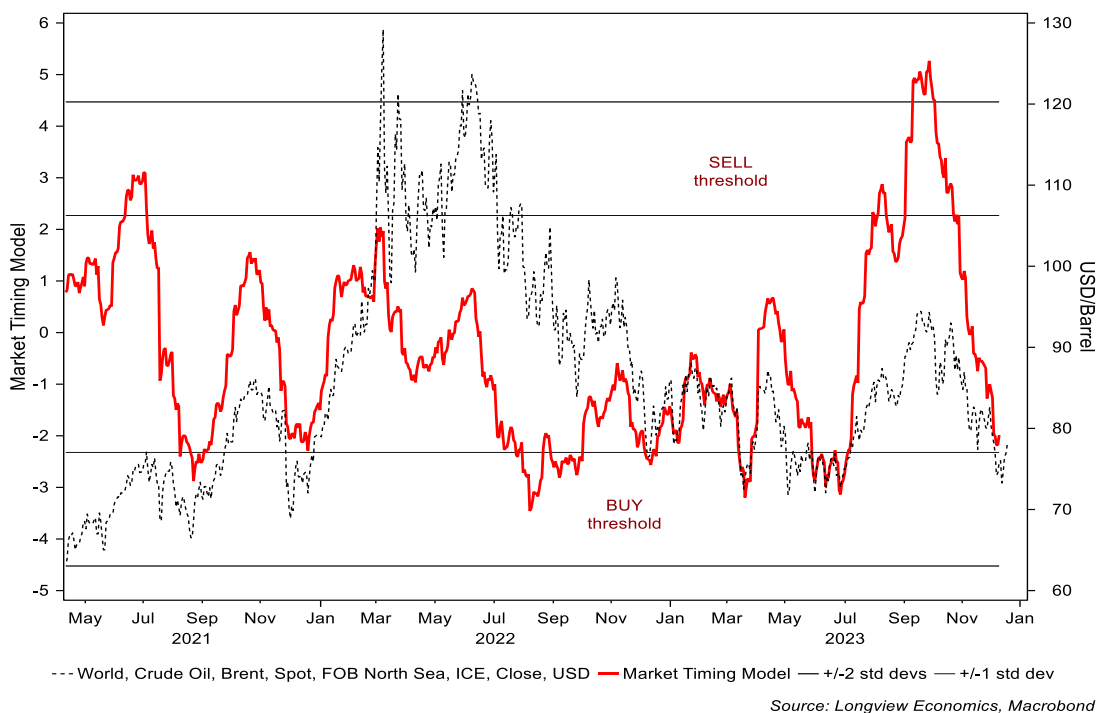
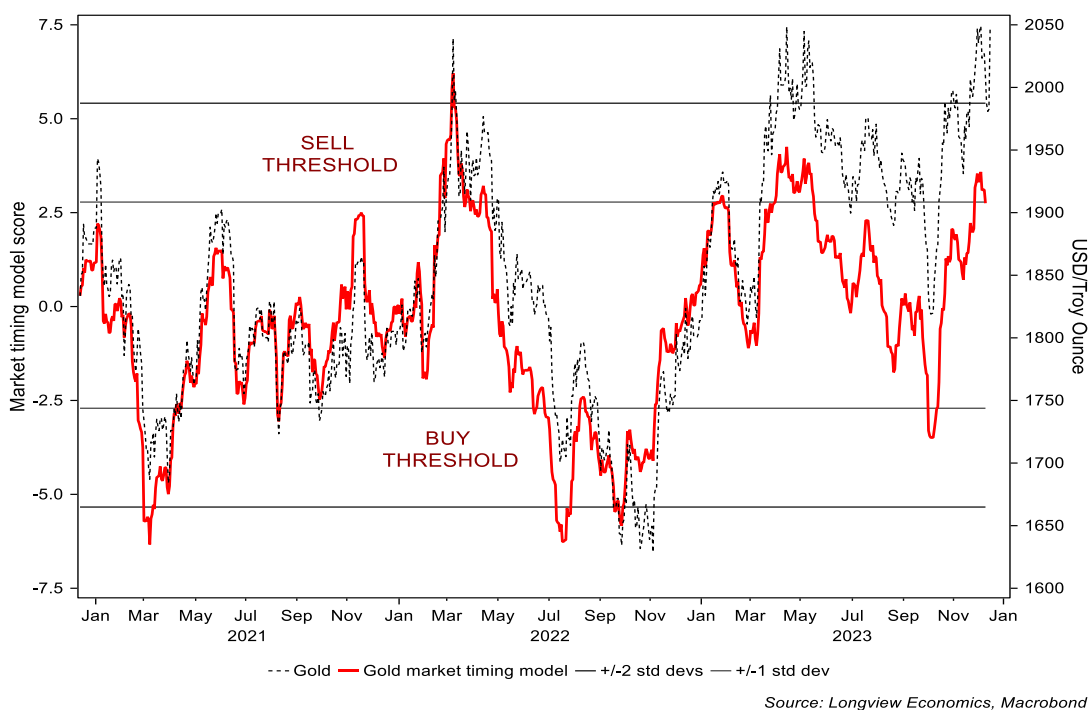


Fig 2e: Gold market timing model vs. gold price (US\$/oz)

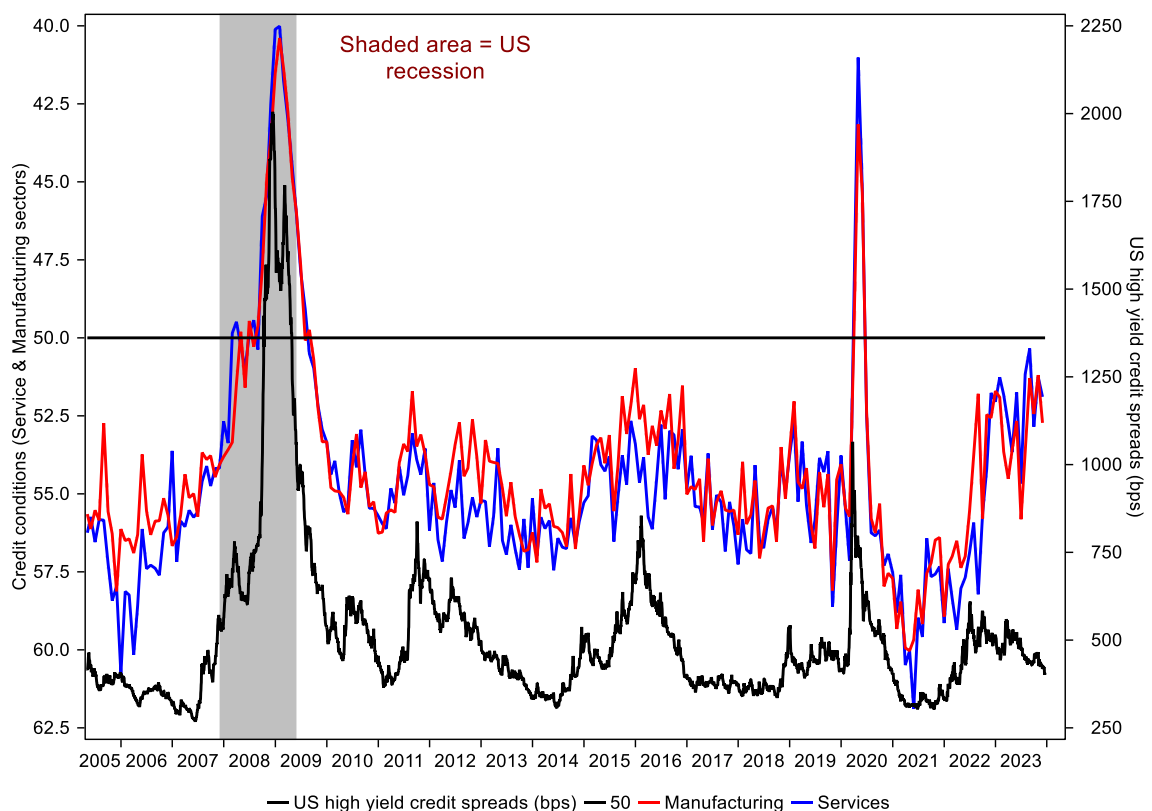


Credit: Move NEUTRAL (from -4pp. UW).

High yield spreads have narrowed sharply in recent months. In the US they are trading at 400bps over Treasuries, from around 550bps in March. European spreads have also narrowed (to 452bps currently, from 578bps in March). With the Fed about to loosen policy, and given that companies are throwing off free cashflow (fig 1), there's a reasonable case for a further narrowing of spreads. Of note, that's likely to be aided and abetted by looser financial conditions, which feed through into looser credit conditions (both trade and banking credit). Indeed, as the chart below shows, looser trade credit conditions are typically associated with a narrowing of spreads.

On balance, though, and given that US recession risk is not insignificant, the risk reward favours a NEUTRAL position in high yield credit. We also favour NEUTRAL positions in high grade credit (given the OW US Treasury position, which offers a similar type of exposure in the portfolio).

Fig 2f: Trade credit conditions (scale inverted) vs. US HY spreads (bps)



Source: Longview Economics, Macrobond

Section 3: Detailed Asset Allocation Recommendations

Developed market equities: As noted above, we recommend neutral weightings in DM equities relative to our benchmark. Within DM, though, we favour tilting away from the US and towards defensive and cyclically sensitive DM equity markets (i.e. in Europe and Japan). In certain indices we recommend adding exposure to small and mid-cap indices (i.e. in Spain and the UK). Within the US, we recommend 1/3rd allocations across large, mid, and small caps (see above for full rationale).

Fig 3: Longview DM Equity OW/UW recommendations³ vs. S&P DJ B'mark Weightings³ⁱ

Region	Category/ Theme	Country	DM index weighting	B'mark allocation (pp.)	OW/ UW	Total allocation	Large caps (% of total)	Mid caps (% of total)	Small caps (% of total)	Percentage points OW/UW						
										-10	-5	0	5	10		
Americas	Tech/Growth	USA	67%	16.7	(6.9)	9.9	33.3	33.3	33.3							
	Commodity	Canada	3%	0.8	0.0	0.8	In line with benchmark									
Asia & Oceania		Commodity	Australia	2%	0.5	0.0	0.5	In line with benchmark								
	Japan		7%	1.8	1.3	3.1	100	0	0							
	US Dollar	South Korea	2%	0.4	0.0	0.4	In line with benchmark									
		Hong Kong	1%	0.2	0.0	0.2	In line with benchmark									
Europe	Cyclicals	Germany	2%	0.6	0.8	1.3	In line with benchmark									
		Sweden	1%	0.3	0.6	0.8	In line with benchmark									
	Defensives	Switzerland	3%	0.6	1.2	1.8	In line with benchmark									
		Spain	1%	0.2	1.3	1.4	0	50	50							
	Growth/ Expensive	Netherlands	1%	0.3	0.0	0.3	In line with benchmark									
		France	3%	0.7	0.0	0.7	In line with benchmark									
	Value	UK	4%	1.0	1.4	2.4	50	25	25							
	Italy	1%	0.2	0.3	0.5	In line with benchmark										
Other			3%	0.8	0.0	0.8										
DM Equities			100%	25.0	0.0	25.0										

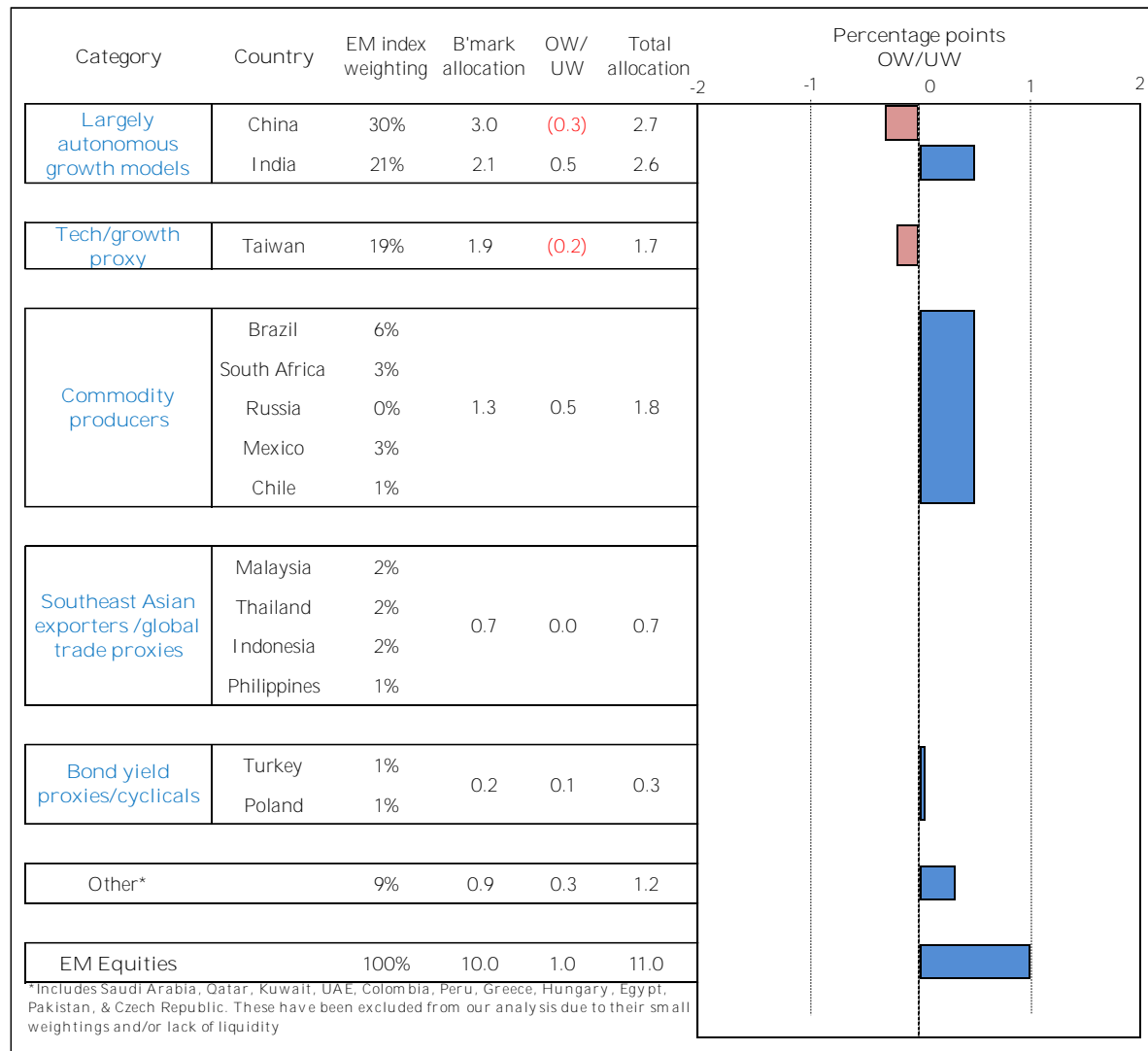
Source: Longview Economics, S&P Dow Jones DM index

³ The large, mid and small cap equity indices for the countries listed above are (respectively): For the US: S&P500, S&P400, S&P600. For the UK: FTSE100, FTSE250, FTSE SmallCap Index. For Spain: IBEX35, IBEX Medium Cap, IBEX Small Cap.

³ⁱ Other includes: Denmark, Singapore, Belgium, Finland, Israel, Norway, Ireland, Austria, New Zealand, Luxembourg, Portugal & Iceland. NB numbers on this table may not add due to rounding.

Emerging market equities: We recommend a modest +1pp. OW position in EM equities. In particular, we favour adding exposure to commodity sensitive country indices with small UW positions in Taiwan (growth heavy) and China (where we remain concerned about the growth outlook), see above for detailed rationale.

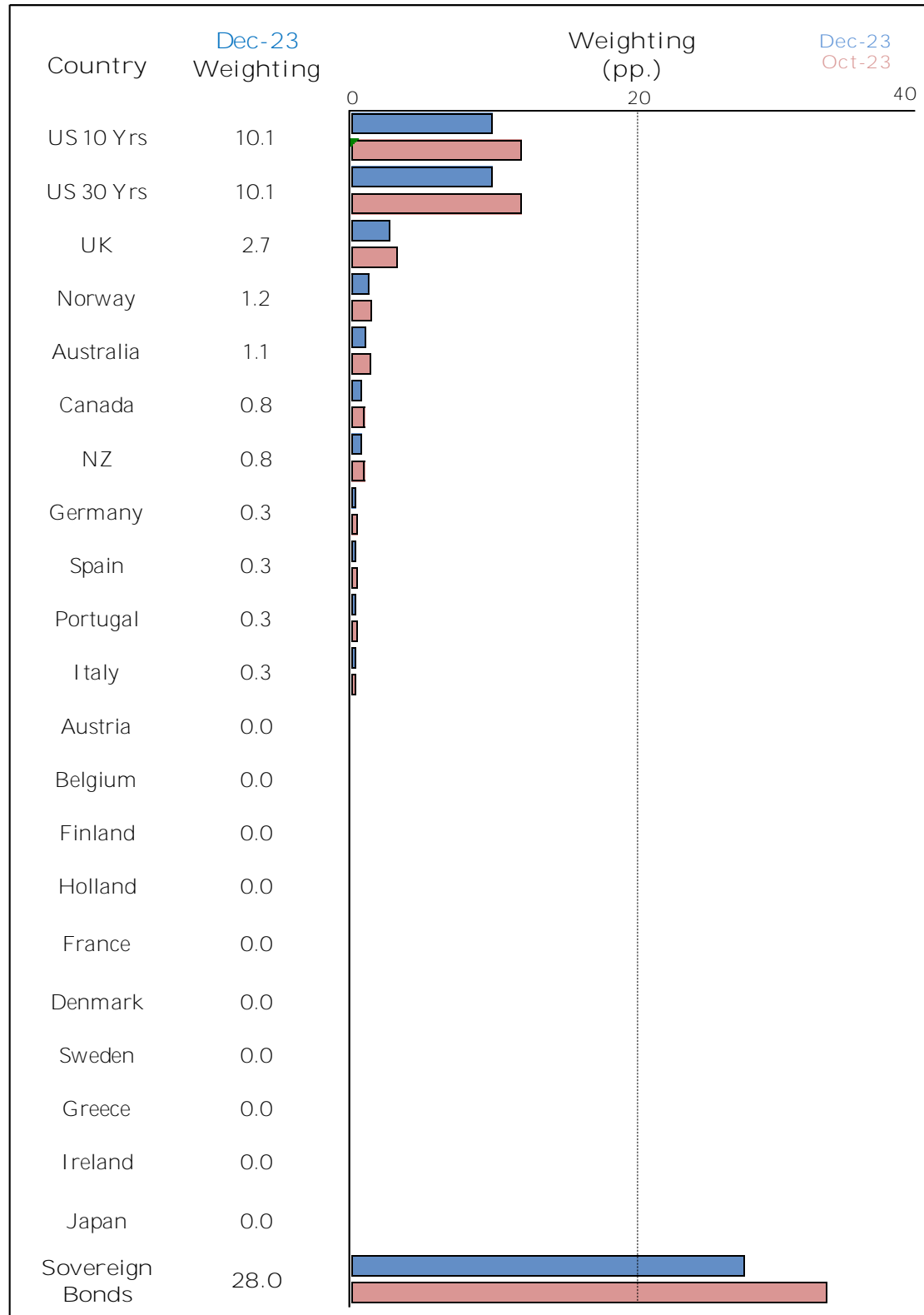
Fig 3a: EM equity OW/UW recommendations vs. benchmark EM Weightings



Source: Longview Economics, S&P Dow Jones EM index

Developed market sovereign bonds: Given the rationale laid out above, we recommend staying OW sovereign bond positions (albeit with a smaller position size).

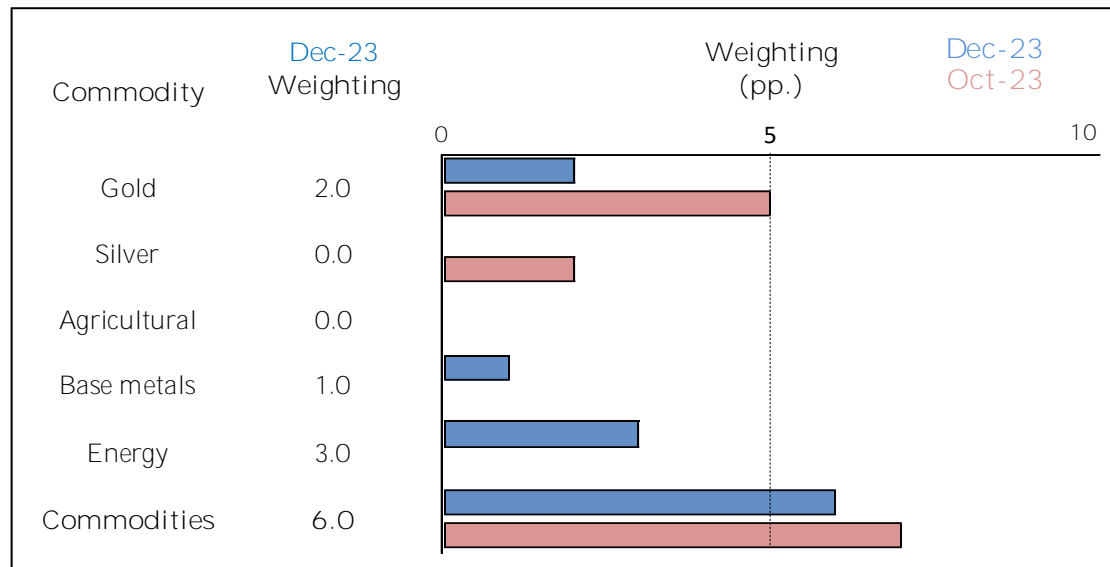
Fig 3b: Longview DM Sovereign Bond weightings



Source: Longview Economics

Commodities: We are modestly reducing commodity exposure (from +2pp. OW to +1pp. OW). **Within that, we're switching** away from precious metals and towards oil and base metals (please see above for detailed rationale).

Fig 3c: Commodities weightings



Source: Longview Economics

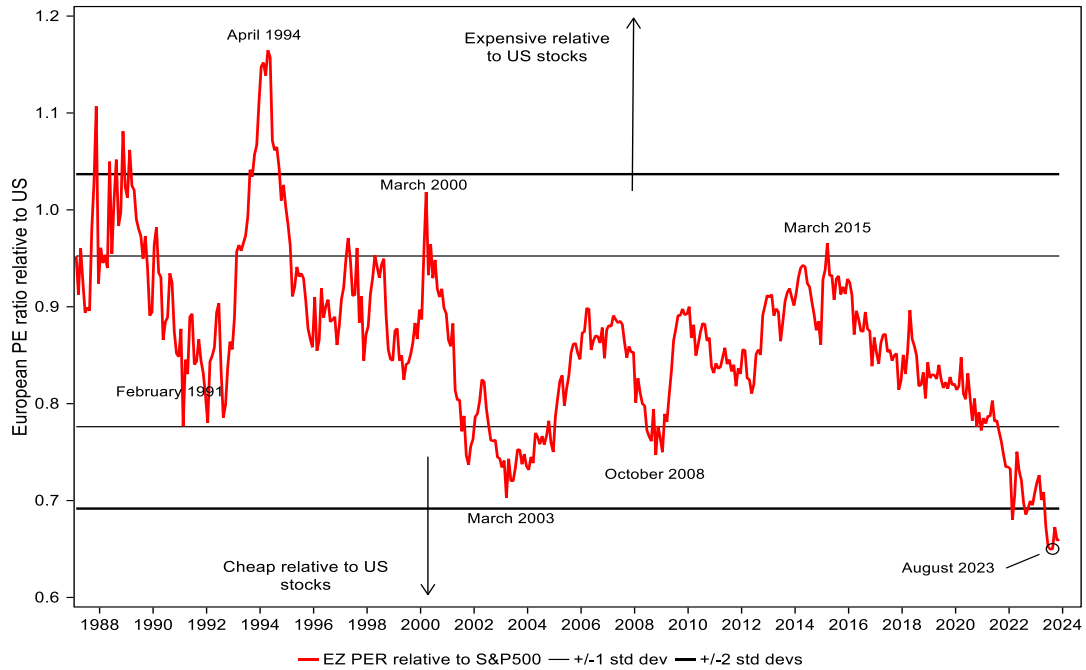
Fig 3d: Brent oil candlestick shown with key moving averages (USD/barrel)



Source: Longview Economics, Macrobond

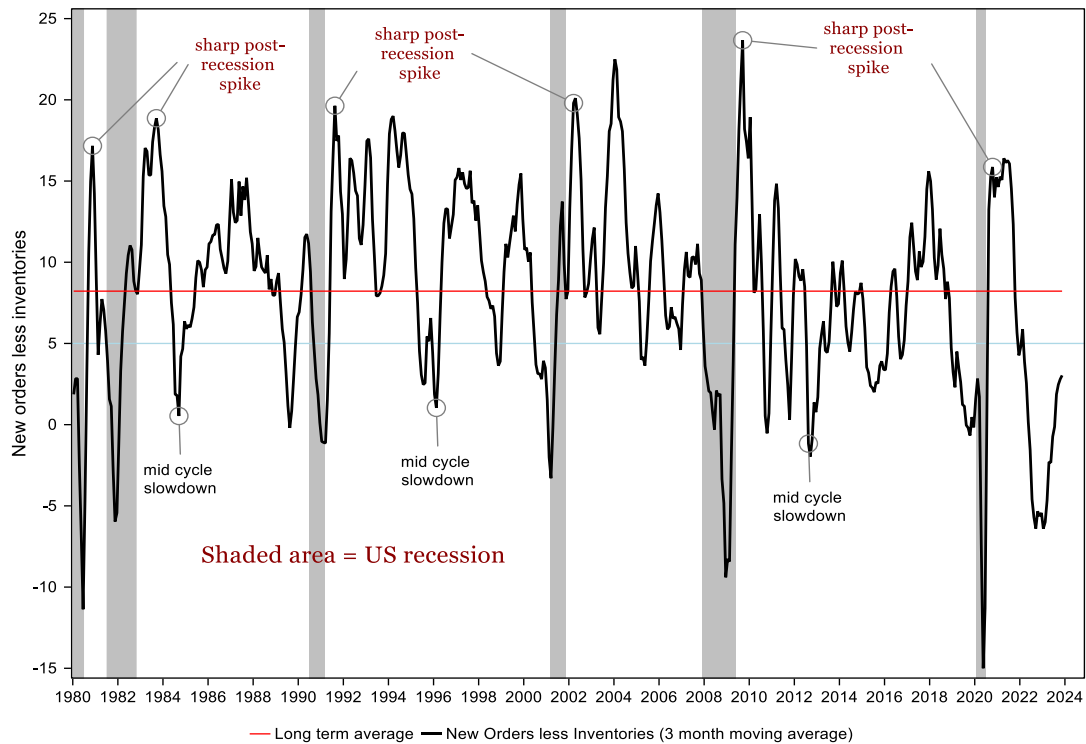
Section 4: Key charts

Fig 4: Eurozone PER relative to the US, with +/- 1 & 2 std deviation bands



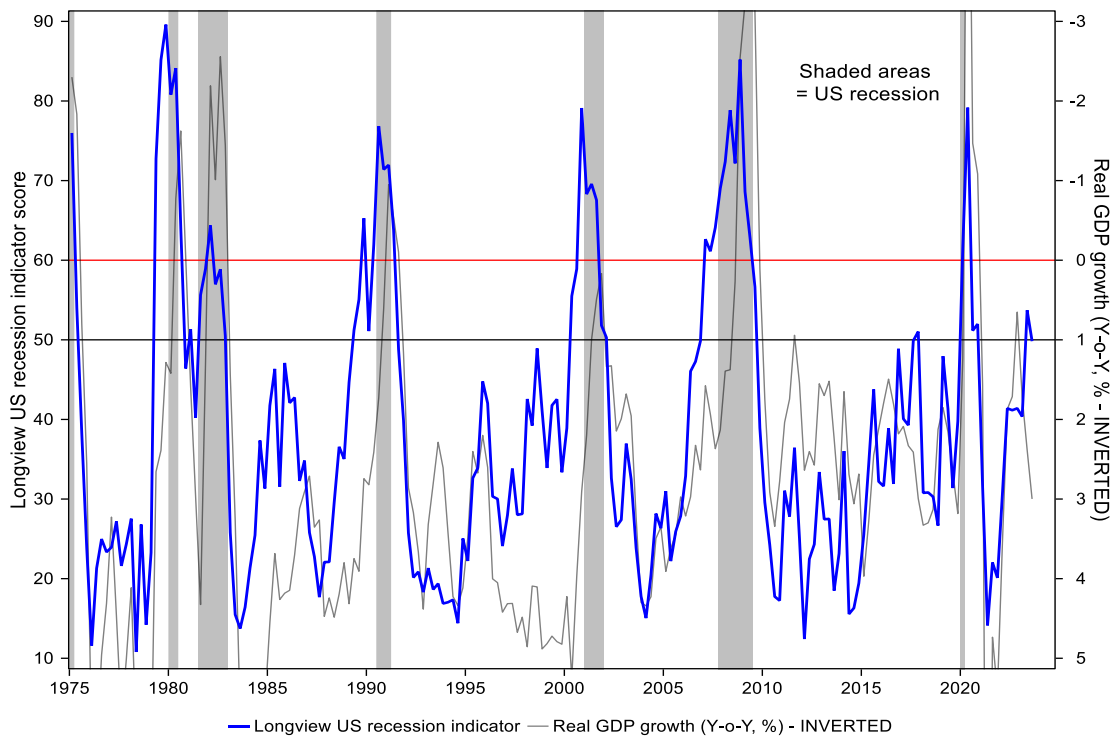
Source: Longview Economics, Macrobond

Fig 4a: ISM new orders less inventories (3 months smoothed)



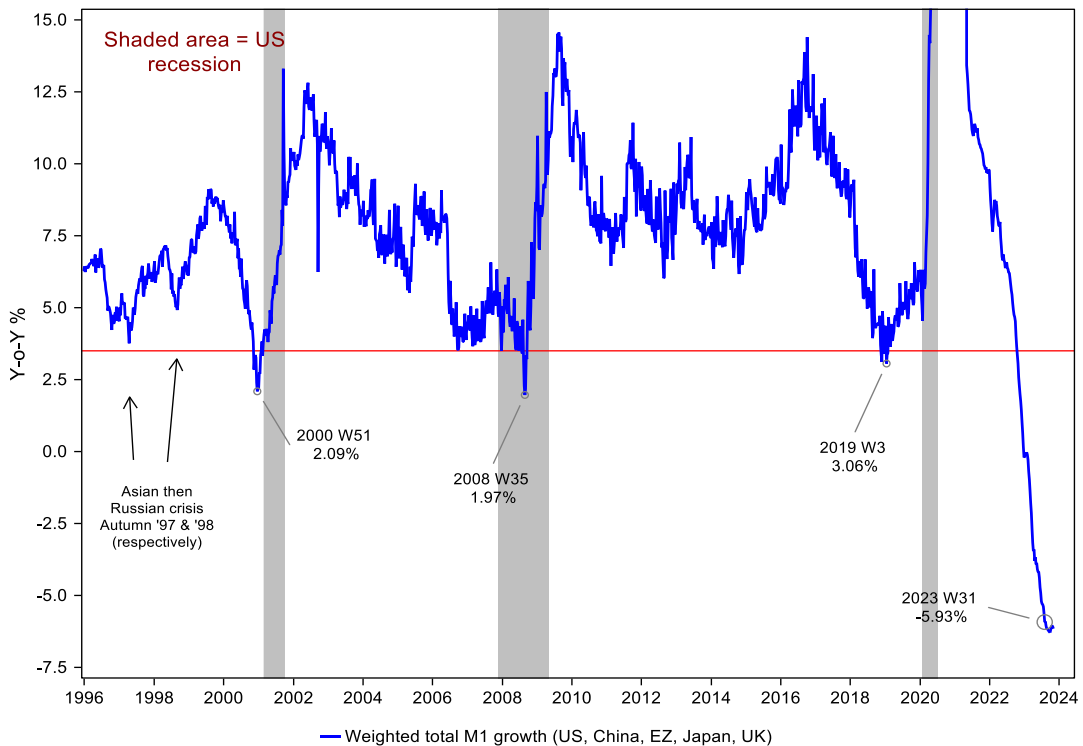
Source: Longview Economics, Macrobond

Fig 4b: US recession model shown with US real GDP (Y-o-Y %)



Source: Longview Economics, Macrobond

Fig 4c: Global M1 money supply, Y-o-Y % (US, China, EZ, Jpn, & UK, GDP weighted)



Source: Longview Economics, Macrobond

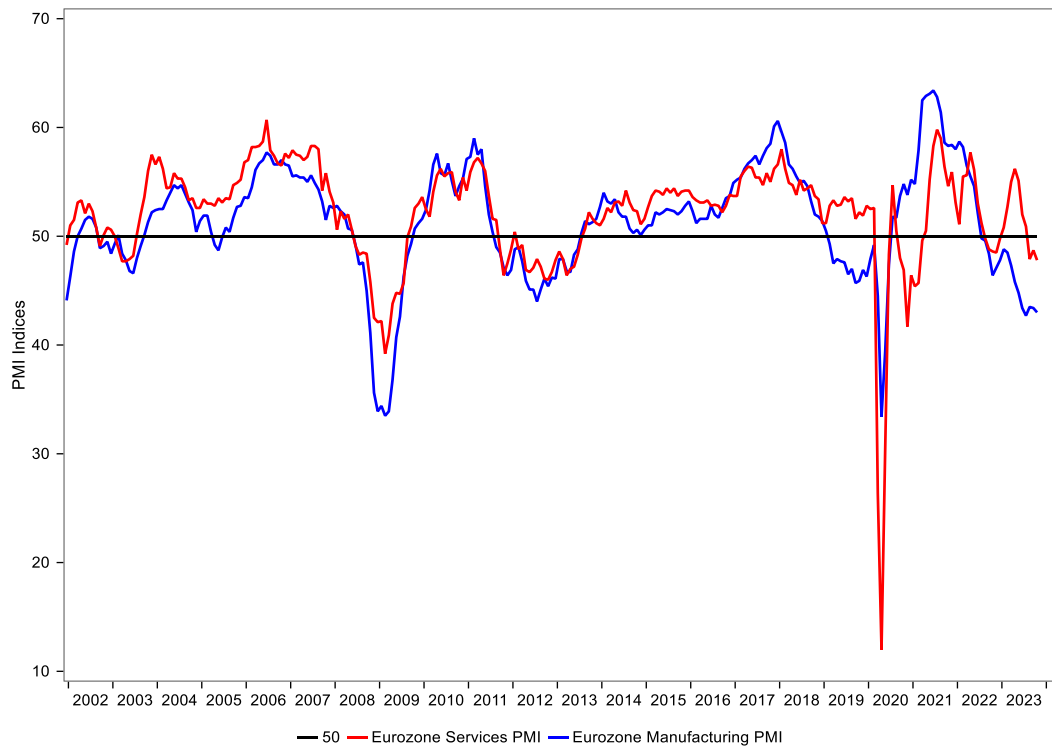
Section 5: Global PMI trends

Table 5: Various trends in PMI indices – Western economies

Country - PMI Type	10/23	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23	12/22	11/22
US - ISM Manufacturing	49.0	47.6	46.4	46.0	46.9	47.1	46.3	47.7	47.4	48.4	49.0	50.2
US - ISM Non-Manufacturing	53.6	54.5	52.7	53.9	50.3	51.9	51.2	55.1	55.2	49.2	56.5	54.4
Eurozone - Manufacturing	43.0	43.4	43.5	42.7	43.4	44.8	45.8	47.3	48.5	48.8	47.8	47.1
Eurozone - Services	47.8	48.7	47.9	50.9	52.0	55.1	56.2	55.0	52.7	50.8	49.8	48.5
Germany - Manufacturing	40.7	39.6	39.1	38.8	40.6	43.2	44.5	44.7	46.3	47.3	47.1	46.2
Germany - Services	48.0	50.3	47.3	52.3	54.1	57.2	56.0	53.7	50.9	50.7	49.2	46.1
France - Manufacturing	42.6	44.2	46.0	45.1	46.0	45.7	45.6	47.3	47.4	50.5	49.2	48.3
France - Services	46.1	44.4	46.0	47.1	48.0	52.5	54.6	53.9	53.1	49.4	49.5	49.3
UK - Manufacturing	45.2	44.3	43.0	45.3	46.5	47.1	47.8	47.9	49.3	47.0	45.3	46.5
UK - Services	49.2	49.3	49.5	51.5	53.7	55.2	55.9	52.9	53.5	48.7	49.9	48.8
Italy - Manufacturing	46.8	45.4	44.5	43.8	45.9	46.8	51.1	52.0	50.4	48.5	48.4	46.5
Italy - Services	49.9	49.8	51.5	52.2	54.0	57.6	55.7	51.6	51.2	49.9	49.5	46.4
Sweden - Manufacturing	43.3	45.5	47.6	45.2	40.9	45.9	45.5	47.2	46.9	45.9	45.8	46.6
Sweden - Services	46.3	48.4	52.7	45.9	50.2	51.1	49.9	46.4	51.2	53.3	54.3	56.6

Source: Longview Economics, Macrobond

Fig 5: Eurozone manufacturing & service sector PMIs



Source: Longview Economics, Macrobond

Table 5a: Various trends in PMI indices – Asian economies

Country - PMI Type	10/23	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23	12/22	11/22
China - Manufacturing (Official)	50.2	49.7	49.3	49.0	48.8	49.2	51.9	52.6	50.1	47.0	48.0	49.2
China - Services (Official)	51.7	51.0	51.5	53.2	54.5	56.4	58.2	56.3	54.4	41.6	46.7	48.7
China - Manufacturing (HSBC)	50.6	51.0	49.2	50.5	50.9	49.5	50.0	51.6	49.2	49.0	49.4	49.2
China - Services (HSBC)	50.2	51.8	54.1	53.9	57.1	56.4	57.8	55.0	52.9	48.0	46.7	48.4
Japan - Manufacturing	48.5	48.5	49.6	49.6	49.8	50.6	49.5	49.2	47.7	48.9	48.9	49.0
Japan - Services	51.1	53.8	54.3	53.8	54.0	55.9	55.4	55.0	54.0	52.3	51.1	50.3
India - Manufacturing	57.5	58.6	57.7	57.8	58.7	57.2	56.4	55.3	55.4	57.8	55.7	55.3
India - Services	61.0	60.1	62.3	58.5	61.2	62.0	57.8	59.4	57.2	58.5	56.4	55.1
South Korea - Manufacturing	49.9	48.9	49.4	47.8	48.4	48.1	47.6	48.5	48.5	48.2	49.0	48.2
Singapore - Manufacturing	50.1	49.9	49.8	49.7	49.5	49.7	49.9	50.0	49.8	49.7	49.8	49.7
Taiwan - Manufacturing	46.4	44.3	44.1	44.8	44.3	47.1	48.6	49.0	44.3	44.6	41.6	41.5
Indonesia - Manufacturing	52.3	53.9	53.3	52.5	50.3	52.7	51.9	51.2	51.3	50.9	50.3	51.8
Hong Kong - Manufacturing	49.6	49.8	49.4	50.3	50.6	52.4	53.5	53.9	51.2	49.6	48.7	49.3

Source: Longview Economics, Macrobond

Table 5b: Various trends in PMI indices, other countries

Country - PMI Type	9/23	8/23	7/23	6/23	5/23	4/23	3/23	2/23	1/23	12/22	11/22	10/22
Brazil - Manufacturing	49.0	50.1	47.8	46.6	47.1	44.3	47.0	49.2	47.5	44.2	44.3	50.8
Brazil - Services	48.7	50.6	50.2	53.3	54.1	54.5	51.8	49.8	50.7	51.0	51.6	54.0
Russia - Manufacturing	54.5	52.7	52.1	52.6	53.5	52.6	53.2	53.6	52.6	53.0	53.2	50.7
Russia - Services	55.4	57.6	54.0	56.8	54.3	55.9	58.1	53.1	48.7	45.9	48.3	43.7
Turkey - Manufacturing	49.6	49.0	49.9	51.5	51.5	51.5	50.9	50.1	50.1	48.1	45.7	46.4
Poland - Manufacturing	43.9	43.1	43.5	45.1	47.0	46.6	48.3	48.5	47.5	45.6	43.4	42.0
Hungary - Manufacturing	47.4	46.7	45.7	44.2	57.1	61.9	56.0	56.3	55.0	59.3	54.7	56.4
Czech Rep. - Manufacturing	41.7	42.9	41.4	40.8	42.8	42.8	44.3	44.3	44.6	42.6	41.6	41.7
Canada - Manufacturing	53.1	53.5	48.6	50.2	53.5	56.8	58.2	51.6	60.1	49.3	51.4	50.1
South Africa - Manufacturing	45.4	49.7	47.3	47.6	49.2	49.8	48.1	48.8	53.0	53.1	52.6	50.0
Australia - Manufacturing	44.7	49.6	50.2	49.3	52.5	54.0	52.4	58.5	55.7	53.2	48.4	48.4
Australia - Services	45.6	47.7	48.0	53.3	51.7	48.8	49.2	57.8	56.2	60.0	56.2	56.2

Source: Longview Economics, Macrobond

Eurozone: Teetering...

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Section 6: Summary & Conclusion

“We are at a level where we believe that, if kept long enough, and this ‘long enough’ is not trivial, will take us to the 2% medium term target”...

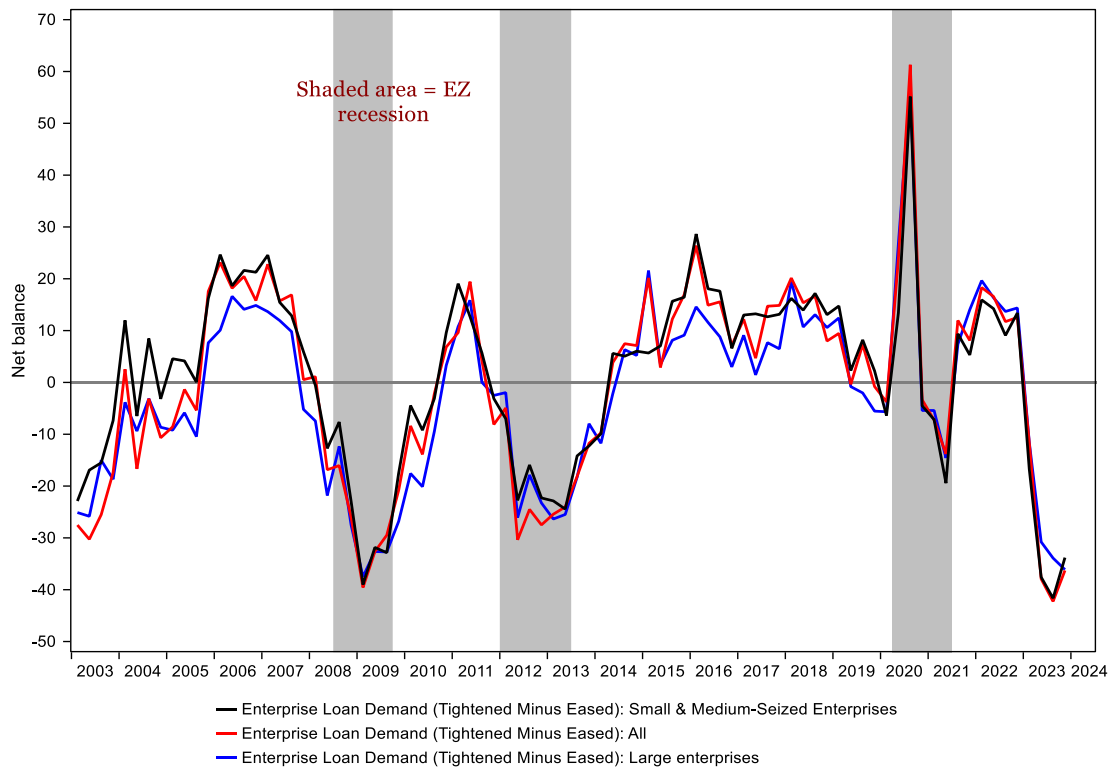
“What I can tell you, though, is that ‘long enough’ is long enough”. And it’s not something that, in the next couple of quarters, we’ll see change... ..Long enough has to be long enough”

Source: Lagarde comments in FT interview, 20th November 2023 (available [HERE](#))

Eurozone growth has stalled over the past 6 months. After quarterly real GDP growth of +0.1% in Q2, the economy contracted by 0.1% in Q3 (i.e. net zero over the past two quarters, fig 6k).

That slowing is evident in the breadth of the macro data: Euro area industrial production is 6% lower over the past year, given high inventories and weak demand. As such, the volume of German new orders is 20% off its highs (from 2 years ago), while the Euro-area industrial new orders index is close to its Eurozone crisis lows.

Fig 6: EZ Business Loan Demand (Forward Looking Three Months)

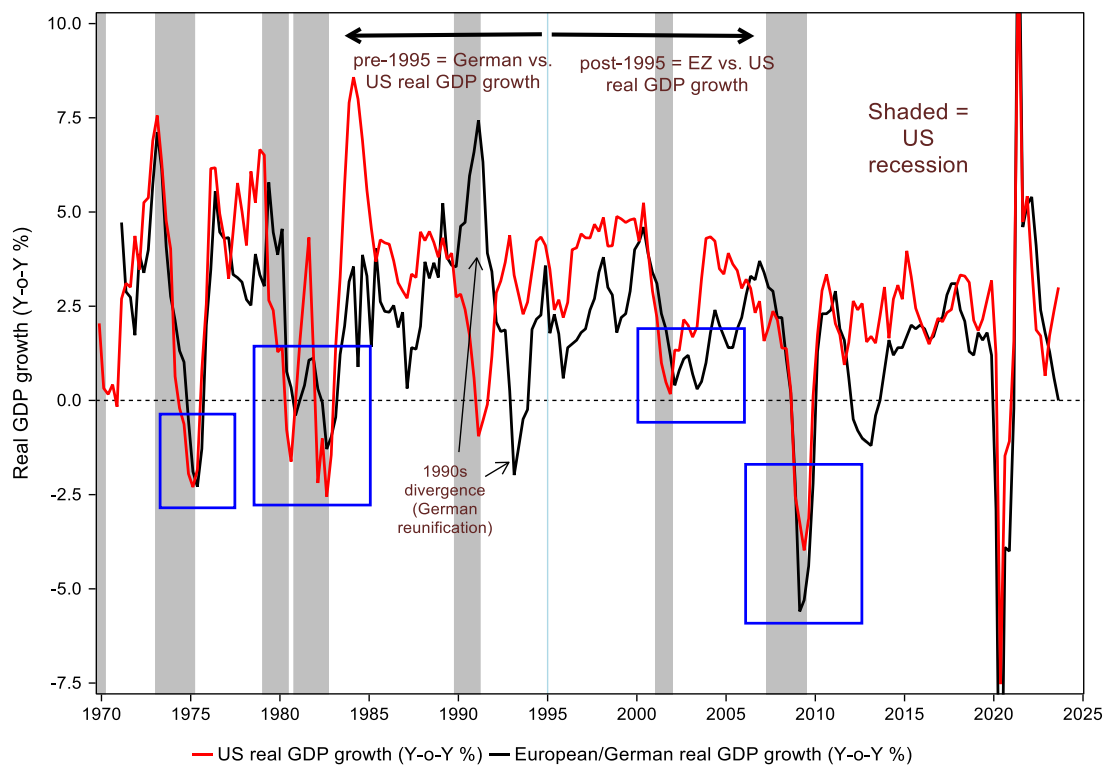


Source: Longview Economics, Macrobond

Construction and housing, meanwhile continue to suffer as high interest rates discourages households and corporates from borrowing. French mortgage lending is at 25 year lows, the German construction PMI is at 36 (significantly below the neutral 50 level), while most Eurozone country construction data is contracting sharply. **Added to which, ‘demand for lending’ by enterprises (businesses) is running at multi year lows (fig 6).**

All of which illustrates the vulnerability of the European economy to shocks. Indeed, as always, it remains a play on global growth. The old adage that when the ‘US sneezes, Europe catches a cold’ is now amplified for Europe given its significant reliance on China as well as the US. For the US, that link is illustrated in fig 6a below, which shows that when the US enters a recession, Europe also follows (over the past 50 years⁶).

Fig 6a: US vs. Eurozone/German real GDP growth (both Y-o-Y %)



Source: Longview Economics, Macrobond

⁶ The only exception was in 1990. That is, the US entered a recession, while the European economy boomed because of the major fiscal stimulus associated with German reunification (from 1989 – 1991).

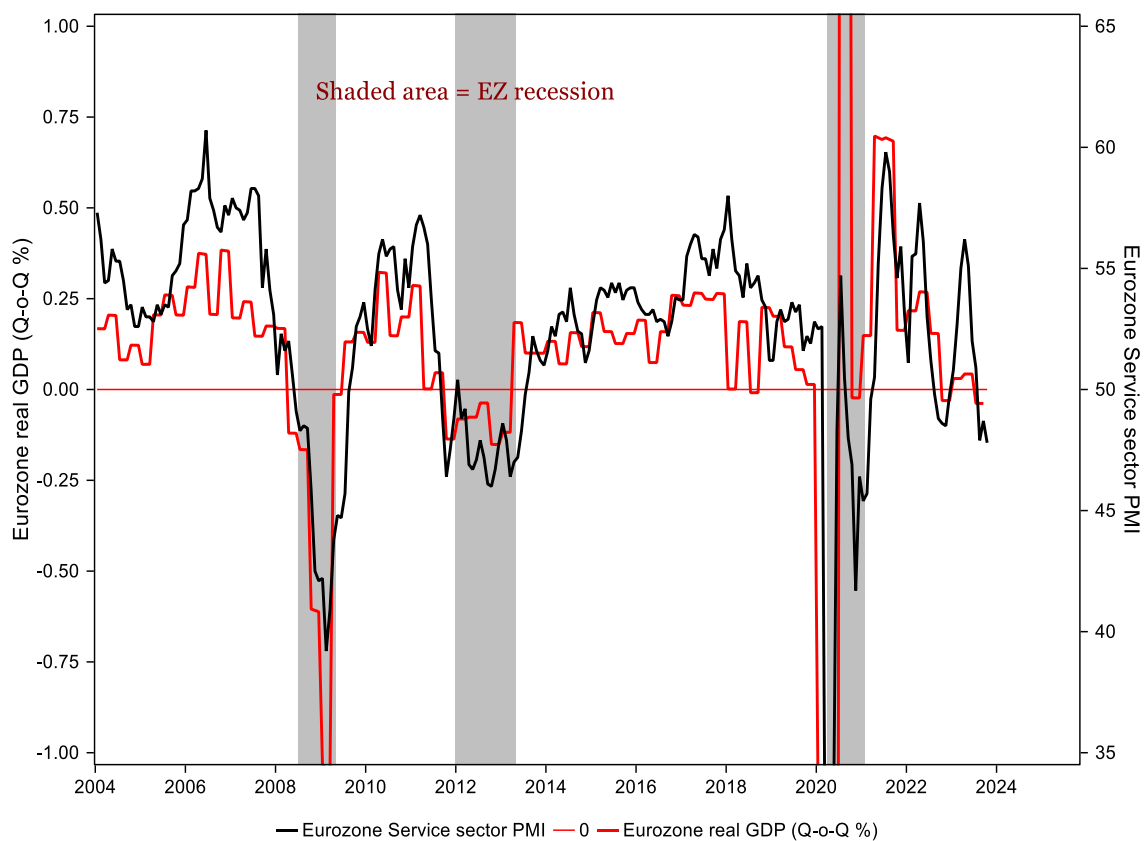
Both the US and China are, though, themselves vulnerable and/or weak. Our US views were updated [HERE](#) last Thursday, with our latest China views due out this week. Our initial thoughts on China, however, were published last month, following on from our week long visit to China in November. Critically, it’s clear that the Chinese economy remains under significant cyclical (& structural) pressure, with the housing downturn weighing upon growth.

That Eurozone vulnerability is then compounded by: (i) overly tight monetary policy, and, therefore, early signs of deleveraging ([point 1](#)); (ii) high inventory levels, which companies will likely attempt to draw down, i.e. thereby further dampening activity ([point 2](#)); (iii) growing evidence that companies are looking to cut back on labour ([point 3](#)); and (iv) signs that households have spent their ‘spare cash’ ([point 4](#)).

Added to which, and despite those growing signs of weakness in the Eurozone economy, the ECB remains intent on keeping policy tight in order to fully purge inflation from the system ([see Lagarde’s comments above](#)).

In other words, given the backdrop laid out above (and points 1 – 4 below), the ECB will probably be slower to cut rates/respond to weakness in the economy (than it would otherwise). That should deepen **Europe’s** recession. Ongoing weakness in the Eurozone service sector PMI is instructive in that respect, and suggests that recessionary dynamics have already started (see fig 6b below).

Fig 6b: Eurozone services PMI vs. Eurozone GDP (Q-o-Q %)



Source: Longview Economics, Macrobond

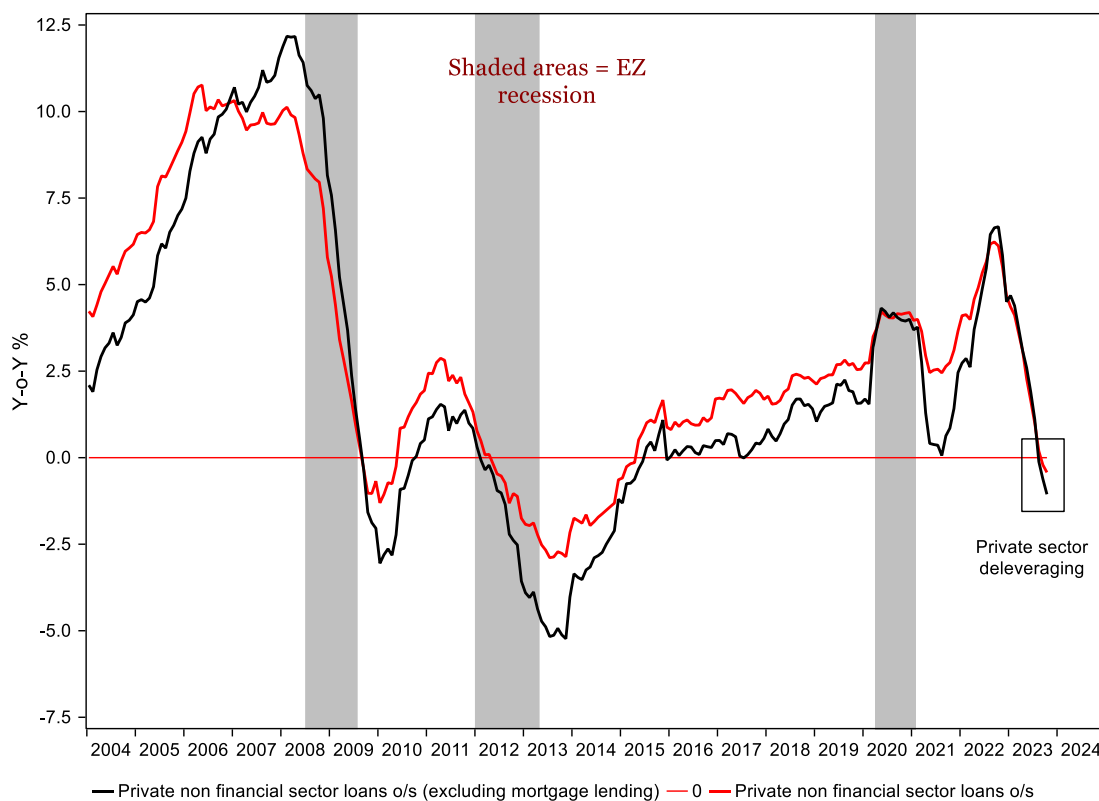
Key Points

1. **ECB policy is ‘too tight’** and, as such, the private sector is beginning to deleverage/retrench. That should enhance recessionary dynamics in Europe in coming months and quarters.

Of note, and illustrating the tightness of money, interest rates have risen rapidly to high levels (e.g. with the average bank lending rate offered to companies rising to 5.3%, up from 1.3% two years ago, fig 6o). Credit conditions have also deteriorated (**although there’s been some modest improvement recently**). Furthermore, as the **ECB’s survey suggests, ‘demand for credit’ remains close to multi-year lows** (and at levels typically associated with a turn lower in the credit and economic cycle, see fig 6).

All of which has played a key role in causing money and credit to contract in Europe. As fig 6c shows, total outstanding bank loans to the private sector have started to shrink (which is typically associated with recession). In a similar vein, real growth in money supply is a key leading indicator of **Europe’s economic cycle. Currently, real M1 money supply is contracting at its fastest pace on record** (i.e. since 1992, and, with that, suggests that real GDP should contract further). NB real money supply typically leads economic growth by ~12 months (see fig 6g).

Fig 6c: Private sector bank lending (including/excluding mortgages), Y-o-Y %

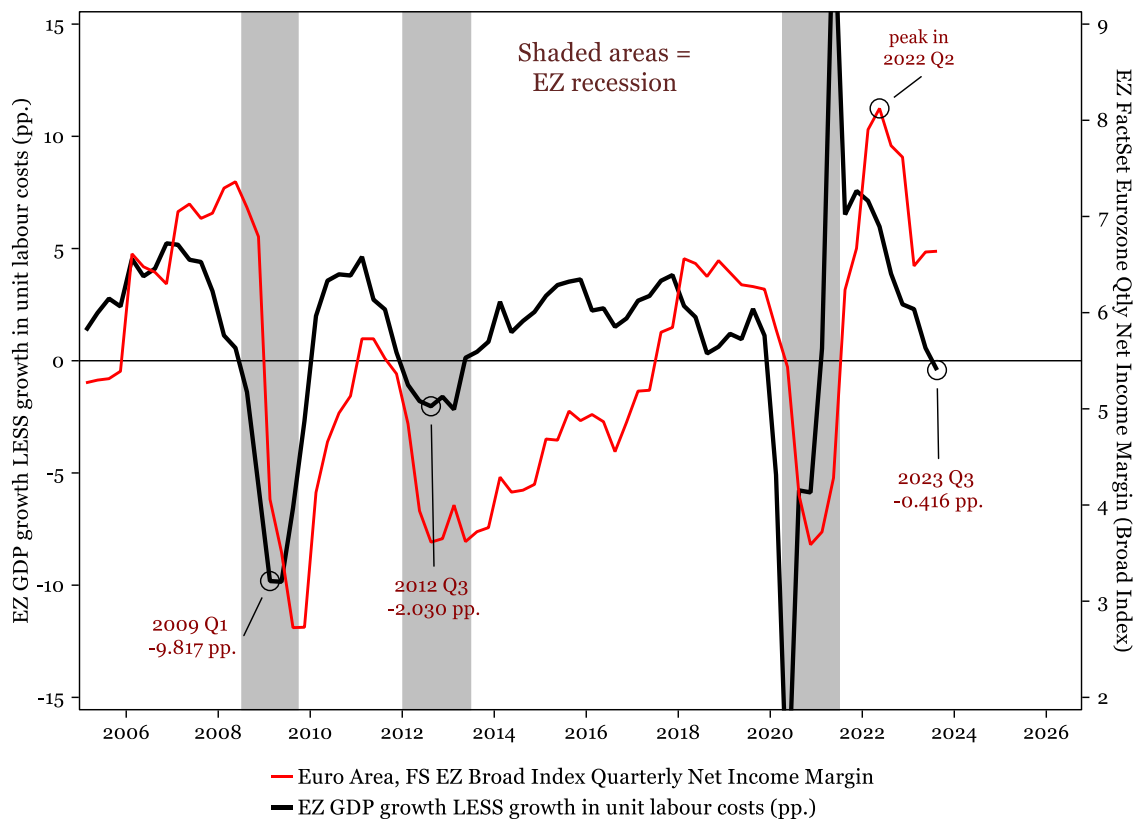


Source: Longview Economics, Macrobond

2. Corporate sector margins are being squeezed.

That’s illustrated by our Eurozone corporate sector margins model. In particular, on the latest data, growth in unit labour costs has accelerated to 6.8% Y-o-Y, which is one of its fastest growth rates on record (fig 6i). That’s a proxy for the (growth of the) **corporate sector’s** largest cost item (labour), which is now growing faster than nominal GDP (which acts as a proxy for **revenue growth**). As a result, our Eurozone ‘margins model’ has turned negative on the latest data (albeit only just, see fig 6d). Often, as the chart below suggests, that’s consistent with a fall in **FactSet’s broad measure of net income margins** for the corporate sector, and typically the start of the retrenching process/recession.

Fig 6d: EZ profit margins model (adv. 6m) vs. Eurozone FactSet broad index net income margin (%)

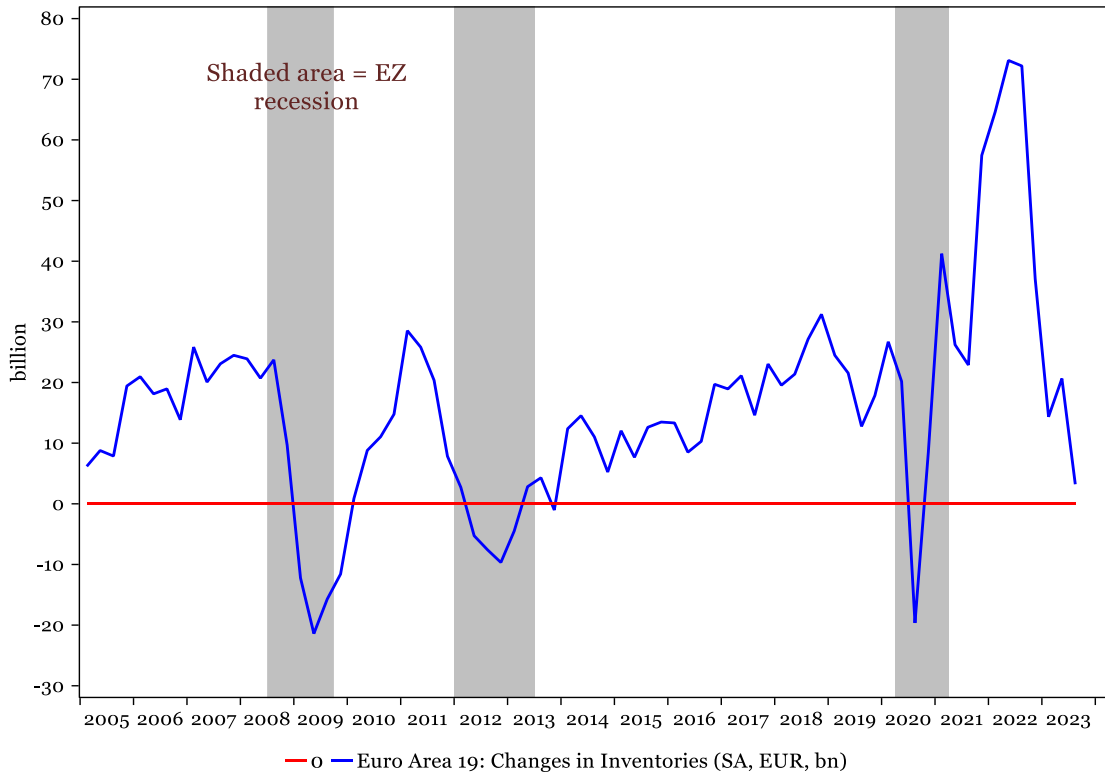


Source: Longview Economics, Macrobond

In other words, companies are poised to tighten their belts. Of interest, in that respect, business confidence has turned negative (on the EcoFin survey), which typically occurs just before companies begin to retrench/cut back on labour (fig 6h). Elsewhere, hiring intentions are trending down; business demand for credit is close to multi decade lows (fig 6); and companies have started to cut back on capex (e.g. see fig 6j).

- Adding to that weak corporate sector outlook, companies are poised to start drawing down on inventories, from high levels. As the chart below shows, that is a key part of the recession dynamic (i.e. companies slow production and ‘use up’ excess stock in response to weak demand). That is, inventory shrinks in recession (fig 6e).

Fig 6e: Eurozone inventory change (SA, EUR, billion)



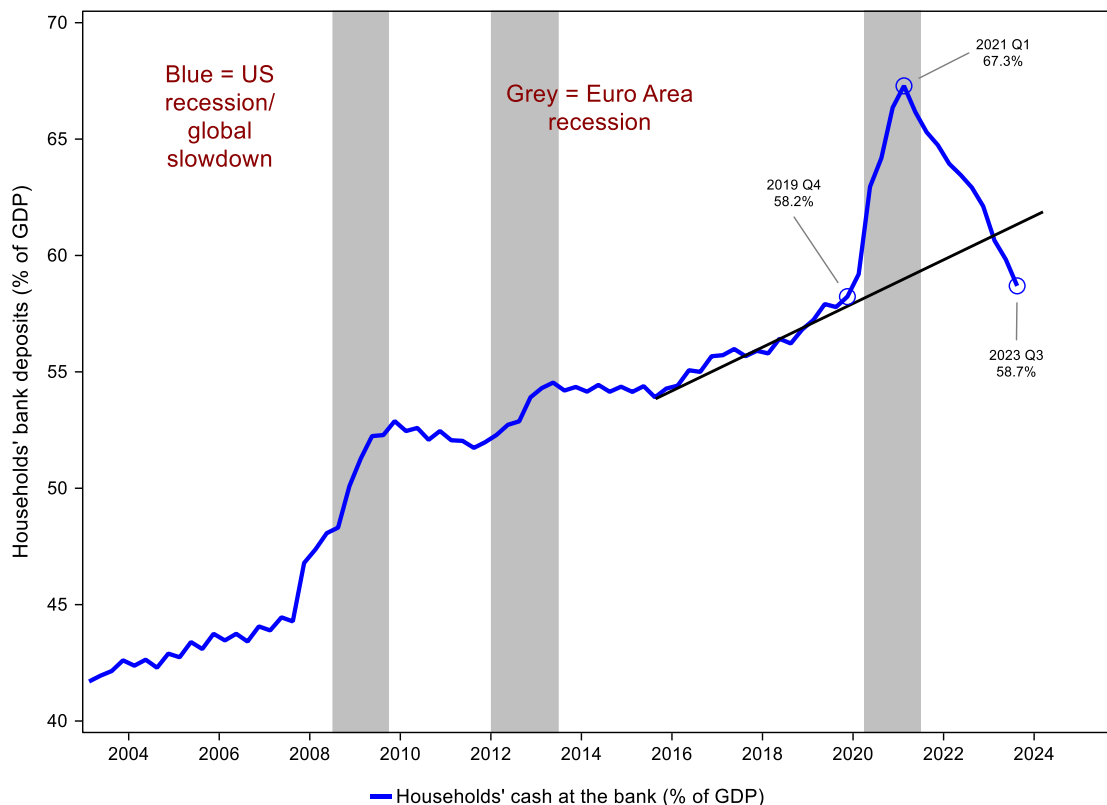
Source: Longview Economics, Macrobond

Of note, in that respect, surveys show the level of inventories in the manufacturing sector remain elevated, both in absolute terms and relative to orders. The monthly assessment of inventory in Germany and the broader Eurozone, for example, is at multi year highs (fig 6l) while new orders are contracting (e.g. see German real new orders, see fig 6n).

Summarising all of that, the ‘orderbooks less inventories’ index is trending down, indicative of companies’ high/rising appetite to draw down stock levels. Unsurprisingly, that index typically leads GDP growth in Europe and currently points to an ongoing deceleration in activity (i.e. over coming months/quarters, see fig 6m).

4. Eurozone households have spent their spare cash, and are starting to retrench. Of note, household bank deposits rose sharply in the pandemic, from 58.2% of GDP to 67.3% (i.e. by approx. 10pp of GDP). Since peaking in 2021, though, they are now back to their late 2019/pre-pandemic levels (see fig 6f). They are also below their 2016-19 uptrend. In **other words, the 'excess' cash buffer from the pandemic has been fully depleted** (at least on that measure).

Fig 6f: Eurozone household bank deposits (% of GDP)



Source: Longview Economics, Macrobond

Added to which, house prices are falling relatively rapidly in certain economies, most notably in Germany (-12% Y-o-Y %). Dutch house prices are also shrinking (currently -2% Y-o-Y, up from -6% in May), while house price growth has decelerated relatively sharply in France, Italy, and Spain. In other words, the impact of tight money is starting to impact housing, which should, as that impact builds, dampen consumer appetite to spend/borrow (i.e. through the usual negative wealth effect channels). As such, and with job insecurity likely to keep rising (see point 2), we expect households to (continue to) cut back on spending. **That's already evident in** retail sales, which have been trending down for the past two years (in real terms).

Key charts & tables

Table 6: Traffic light indicators

Key Leading Indicators

Indicator	Status	Comment
Leading indicators	GREEN/AMBER	Back to growing Y-o-Y & M-o-M
Belgian leading indicators	RED	Negative trend
German IFO expectations less current conditions	RED/AMBER	Still low vs. history
New car sales	GREEN/AMBER	Growing Y-o-Y but at relatively low levels vs. history
German new manufacturing orders	RED	Trending down (albeit volatile)

Credit Indicators

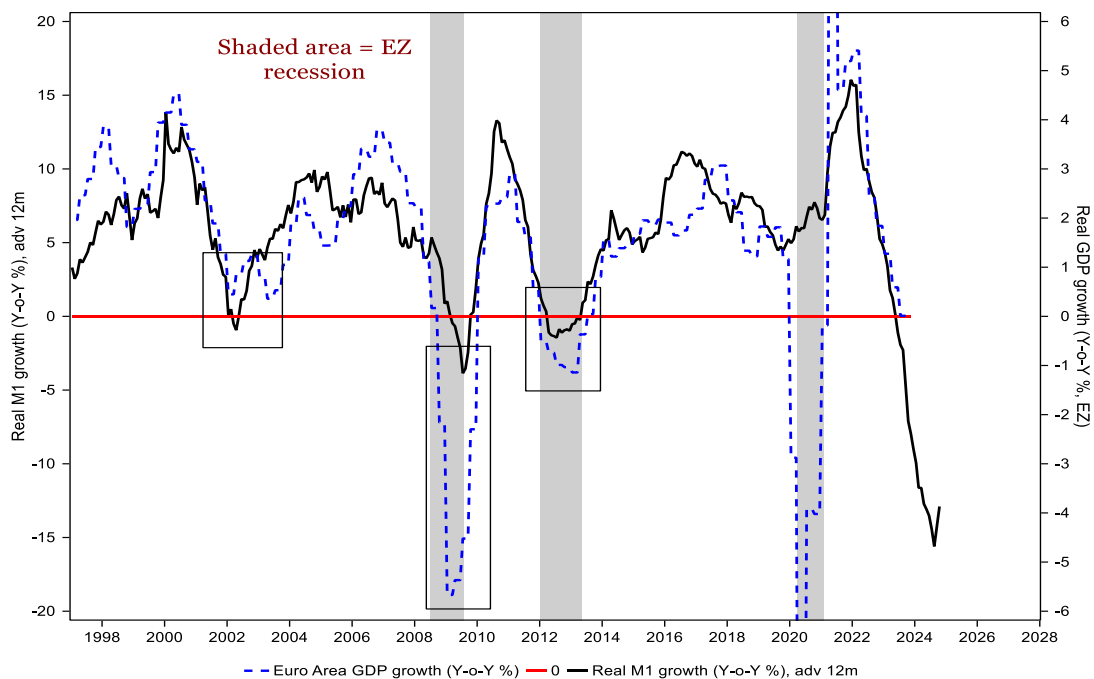
Indicator	Status	Comment
Private sector credit growth	RED	Contracting at negative Y-o-Y levels
Consumer credit growth	RED	Currently growth at 0% Y-o-Y
German yield curve	RED	Deeply inverted (2s10s)
Monetary conditions	AMBER	Steep tightening but still relatively loose vs. history
Real M1 growth	RED	Contracting rapidly Y-o-Y
M3 money supply growth	RED	Decelerating & way below ECB target
Credit conditions – businesses	AMBER	Just above neutral
Credit conditions – mortgages	AMBER	Above neutral

Coincident Indicators

Indicator	Status	Comment
Consumer confidence	RED/AMBER	Low but higher in past year
Business confidence indices	AMBER	Flat in recent months
Euro zone Manufacturing PMI	RED	Well below 50, at 2009 & 2020 levels
Euro zone Services PMI	RED	Slightly below 50

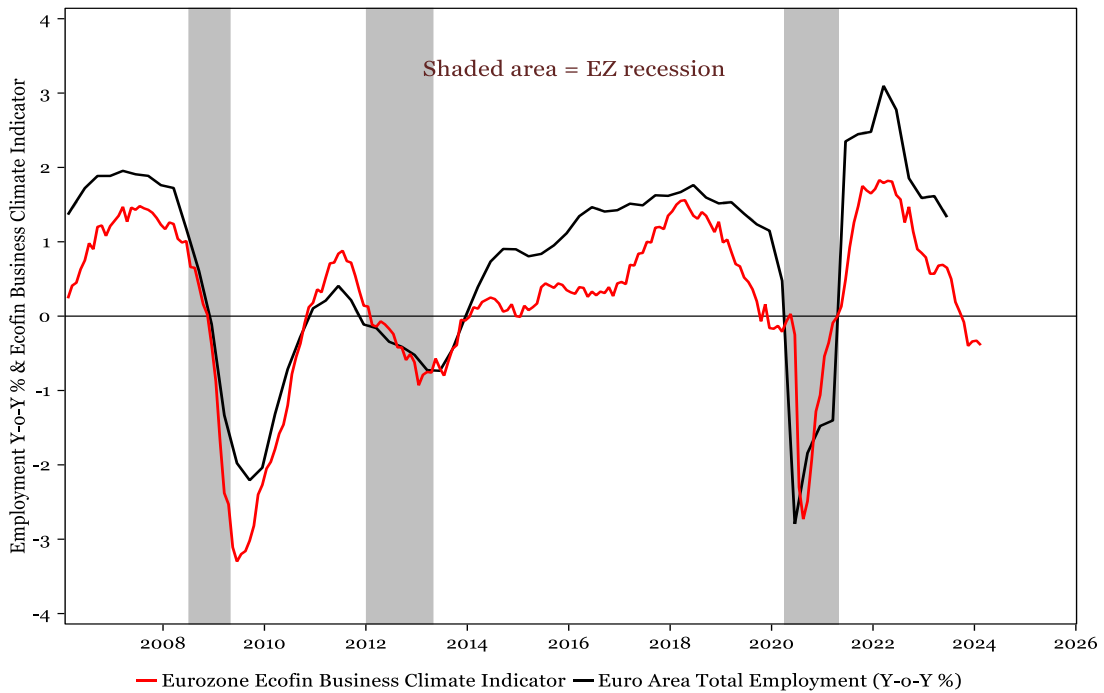
Source: Longview Economics

Fig 6g: Real M1 money supply (Y-o-Y %, adv. 12m) vs. EZ GDP (Y-o-Y %)



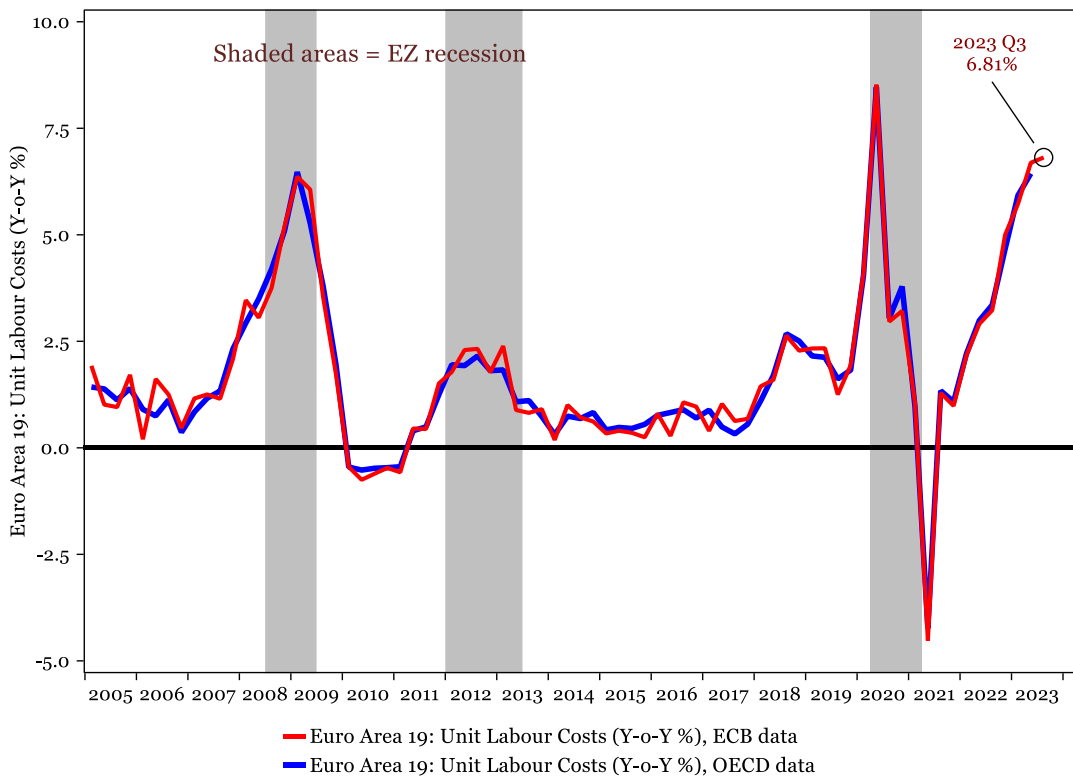
Source: Longview Economics, Macrobond

Fig 6h: EZ business climate index vs. total employment growth (Y-o-Y, %)



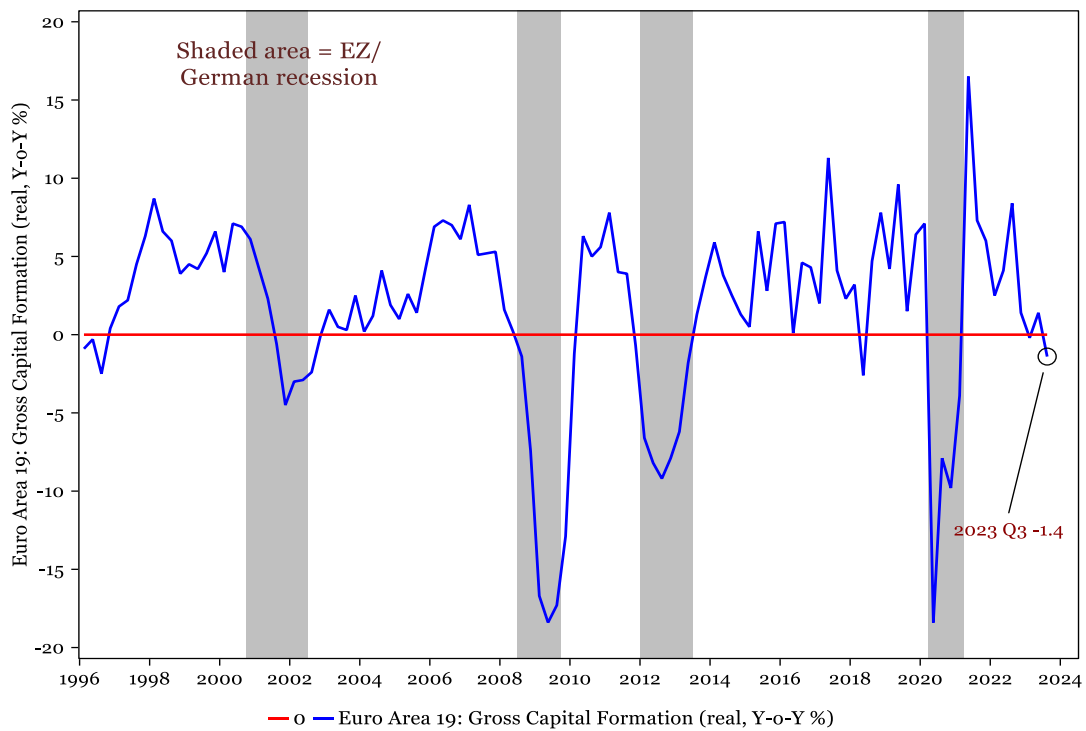
Source: Longview Economics, Macrobond

Fig 6i: Eurozone unit labour costs (Y-o-Y %)



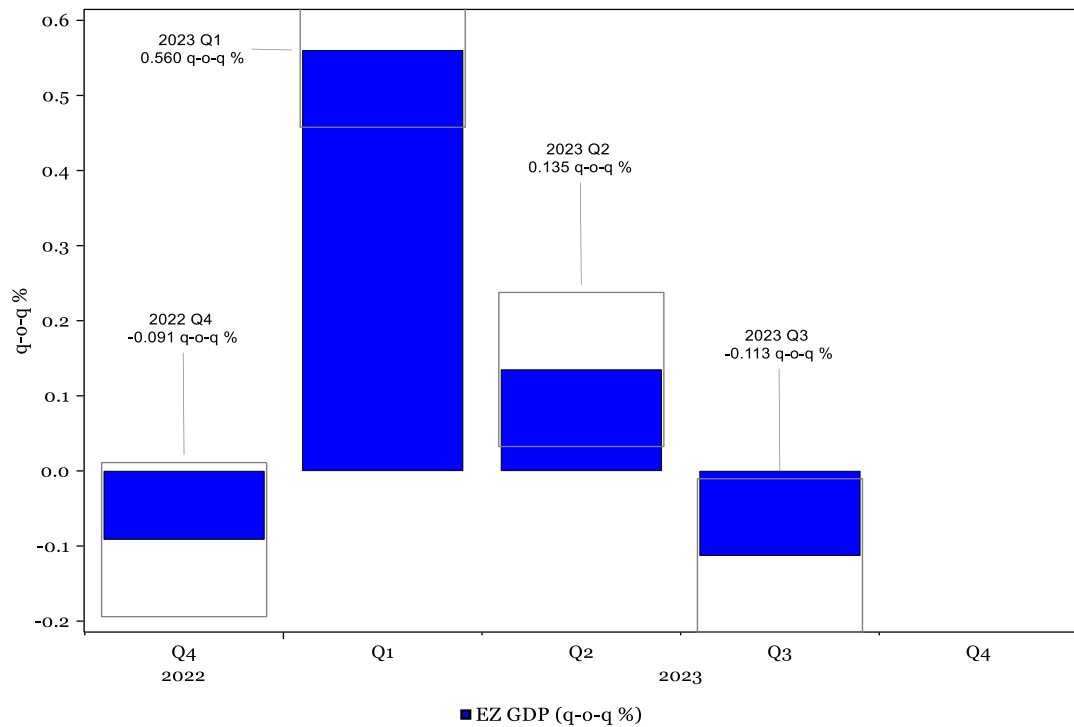
Source: Longview Economics, Macrobond

Fig 6j: Eurozone real gross capital formation (Y-o-Y %)



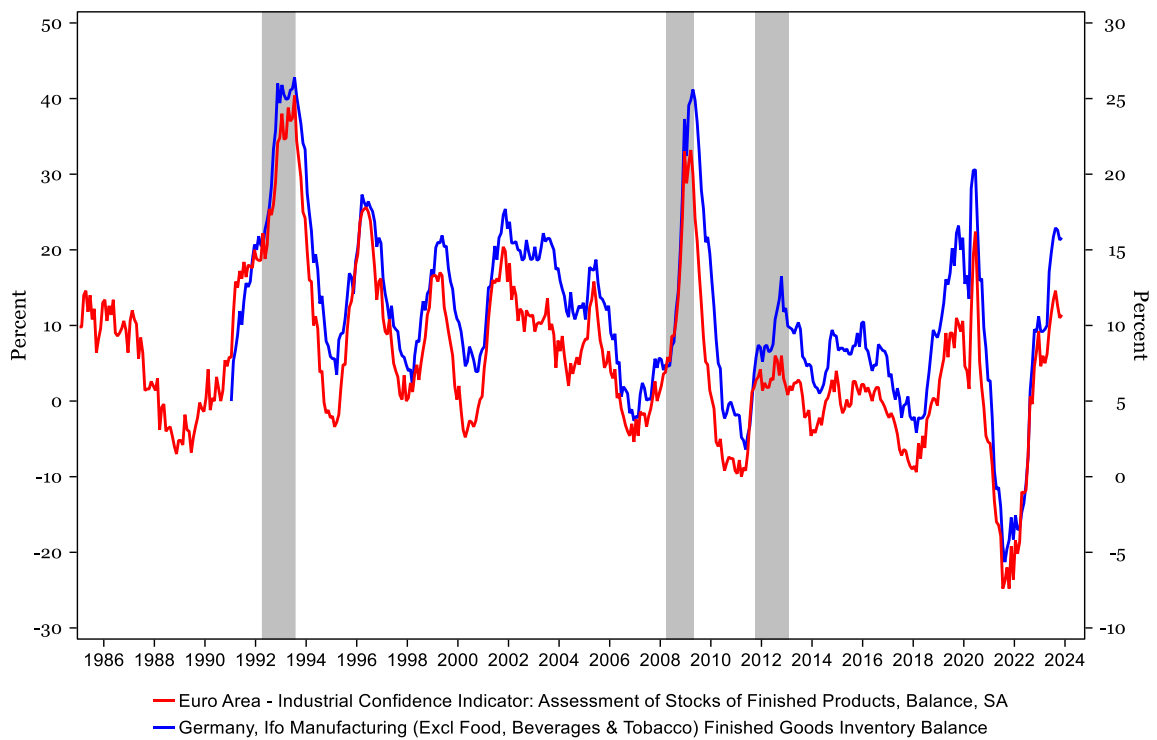
Source: Longview Economics, Macrobond

Fig 6k: Eurozone GDP (q-o-q, %)



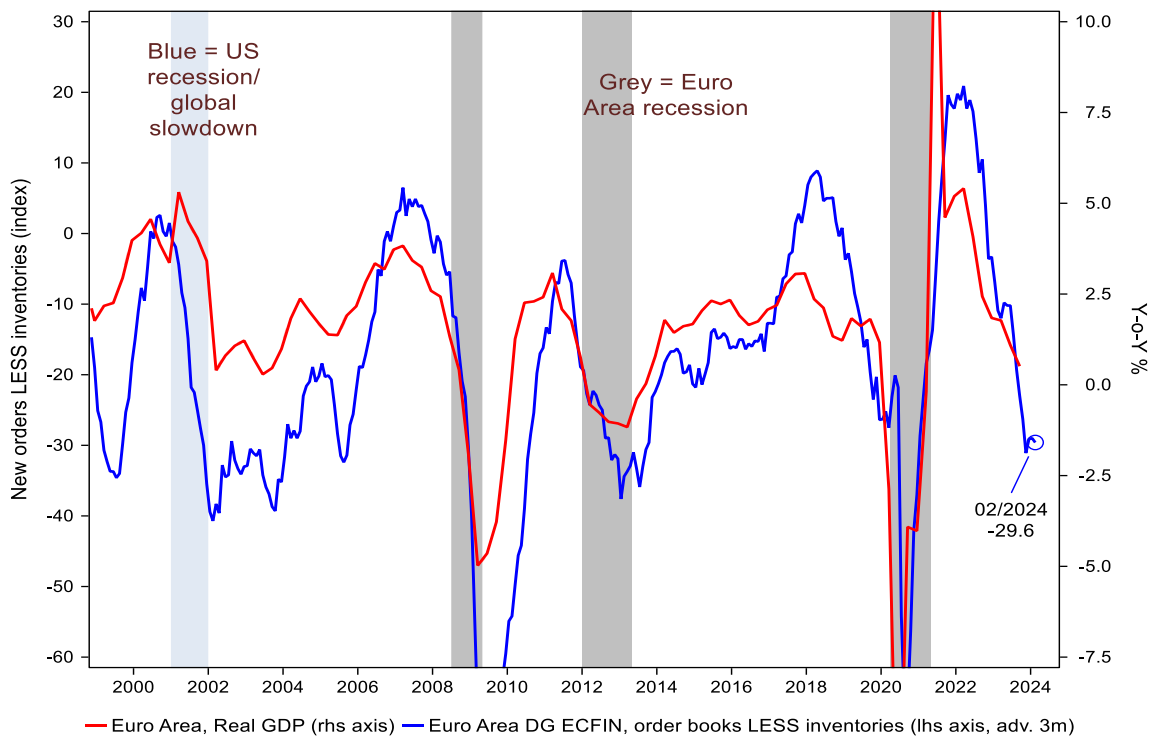
Source: Longview Economics, Macrobond

Fig 6l: Monthly Survey Assessment of Eurozone inventories



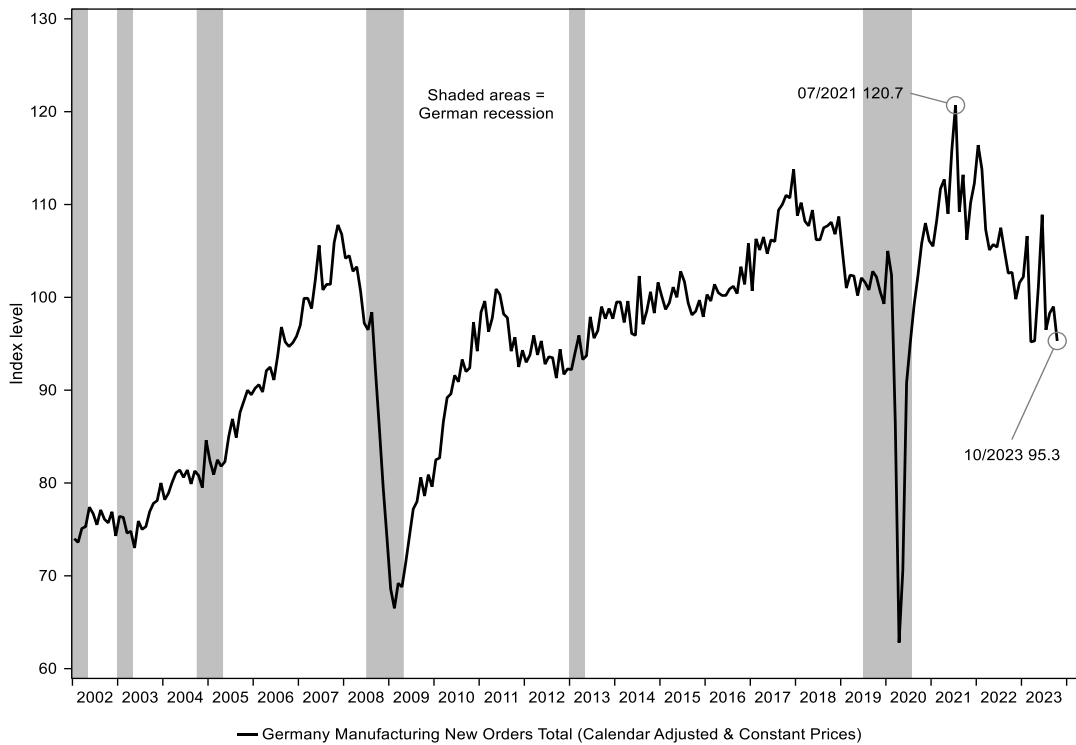
Source: Longview Economics, Macrobond

Fig 6m: Eurozone order books LESS inventories vs. EZ real GDP (Y-o-Y %)



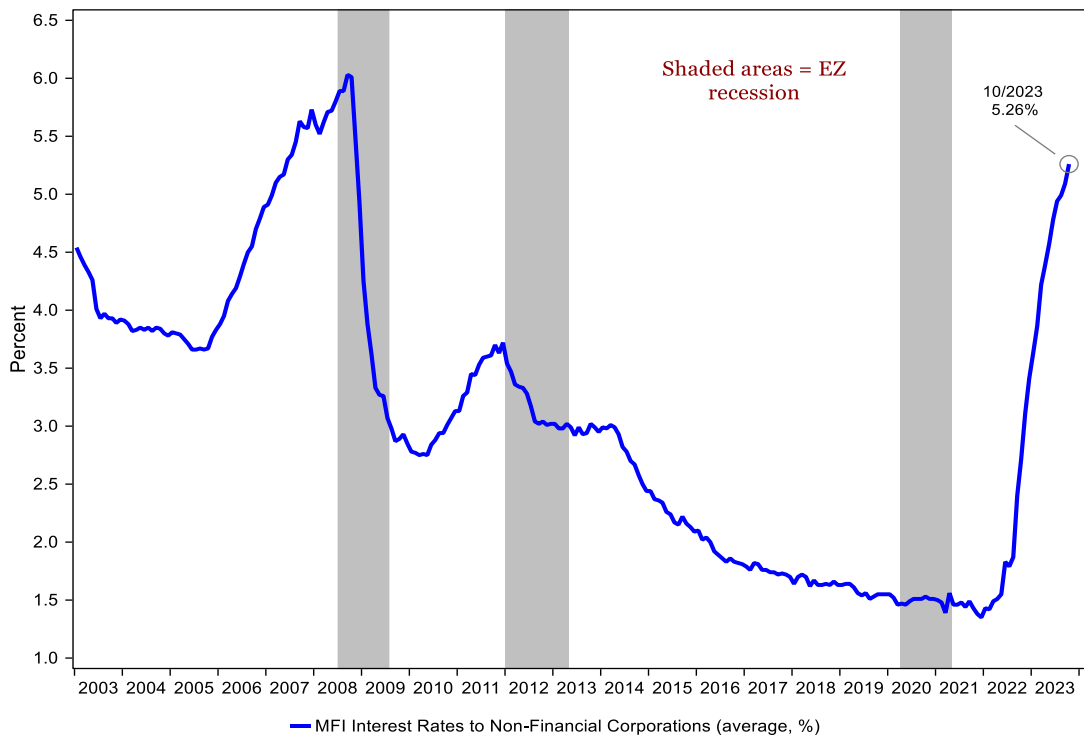
Source: Longview Economics, Macrobond, DG ECFIN

Fig 6n: German new orders (index, real) with German recession bands



Source: Longview Economics, Macrobond

Fig 6o: Average MFI interest rate to nonfinancial corporations (%)



Source: Longview Economics, Macrobond

US Labour Market Cracks Emerging

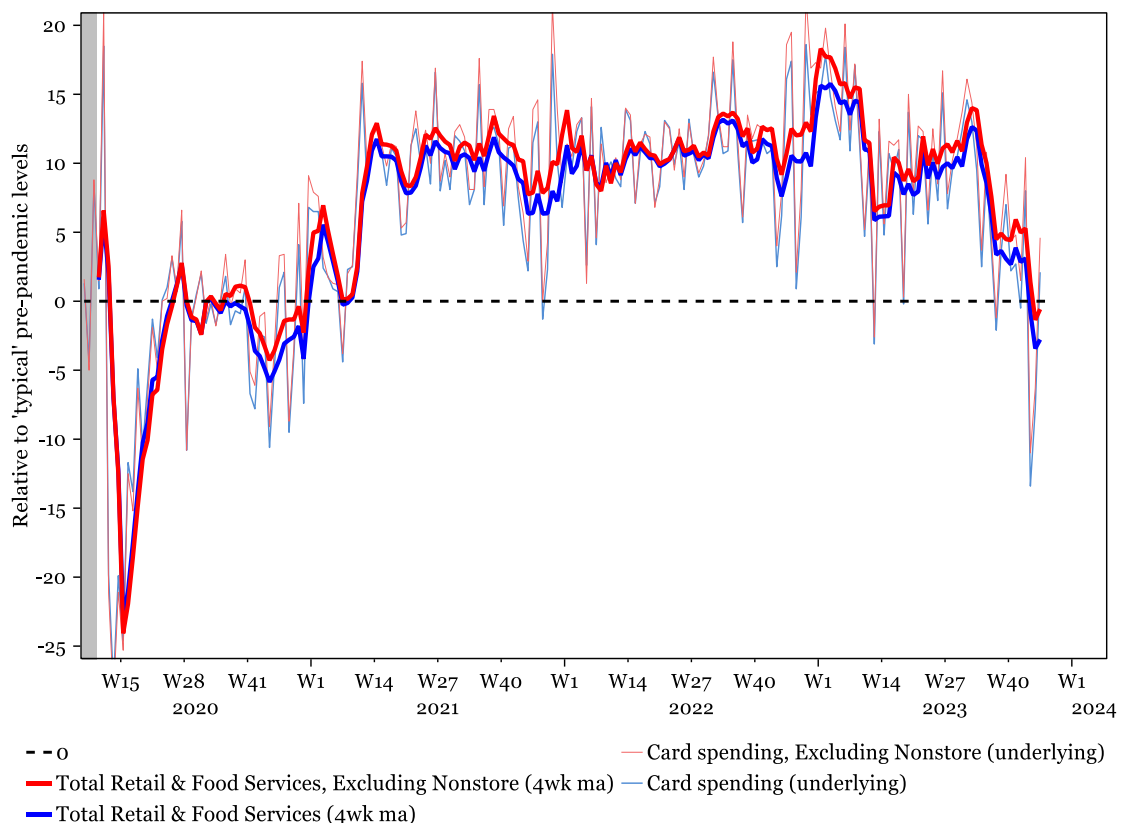
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Section 7: Overview & Conclusion

Many expected a US recession to start this year, yet the economy has remained resilient. In particular, several leading indicators of the economic cycle, after generating clear warning signals earlier this year, have proven to be early or, as some would suggest, wrong. Investors and commentators are therefore experiencing ‘US recession fatigue’.

Indeed, some of those indicators have started to improve in recent months. ISM ‘new orders less inventories’, for example, has turned higher; CEO confidence has bounced; and certain manufacturing indicators have accelerated higher (e.g. the Chicago PMI). As a result, the US ‘soft landing’ narrative has gained momentum.

Fig 7: Real time card spending (relative to ‘typical’ pre-pandemic levels⁷)



Source: Longview Economics, Macrobond

⁷ BEA method document available [HERE](#).

The key question, therefore, is: Will that soft landing narrative prevail in 2024? That is, will ‘American exceptionalism’, helped by a mix of different fiscal stimulus packages in recent years, generate a ‘goldilocks’ outcome for the US

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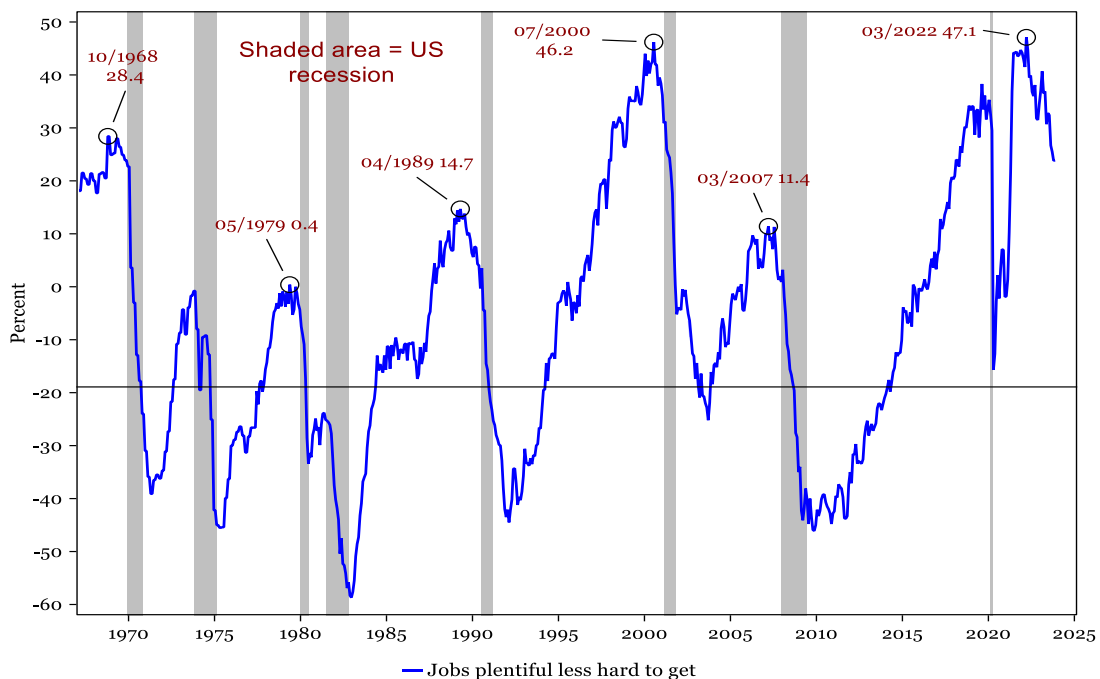
economy? And, in that vein, has the speed and magnitude of Fed tightening been ‘just right’ (enough to control inflation, but not ‘too much’ to cause a recession)?

Or, do the recession warning signals from leading indicators still count? Many still have a clear warning message (e.g. the yield curve, LEIs and so on), and are confirming other signs that the Fed has significantly over-tightened monetary policy (fig 7j). **Is it the case, therefore, that the fiscal impulse (and the excess household savings) is starting to fade, at a time when ‘tight money’ is starting to bite?**

In particular, in that respect, tight money often takes 1 – 2 years to fully work its way through the economy. Hence why the inversion of the yield curve (an indication of tight money) often generates a recession warning signal up to 1 – 2 years ahead of the start of the recession. Initially, the tight money starts to work on the more interest rate sensitive sectors of the economy, most notably housing and autos, before it then spreads more widely to other areas.

Housing, in that respect, is clearly under significant pressure. The NAHB homebuilders index is at one of its lowest levels in the past decade; the Michigan home buyers confidence index is close to 40 year lows; while the pending home sales index is below its GFC lows (fig 7b). The auto sector is also under pressure, with car sales trending lower (most recently) since June (another sign of tight money/expensive auto loans), while auto loan delinquencies have picked up (see below).

Fig 7a: Conference Board “Jobs plentiful” less “hard to get”



Source: Longview Economics, Macrobond

As such, the key question is whether or not that tight money is about to feed through more broadly to other parts of the economy. In particular, is it about to impact the consumer and labour market? In a recession, that is the last piece of the puzzle. Once those areas are impacted, then the recession is underway (mathematically).

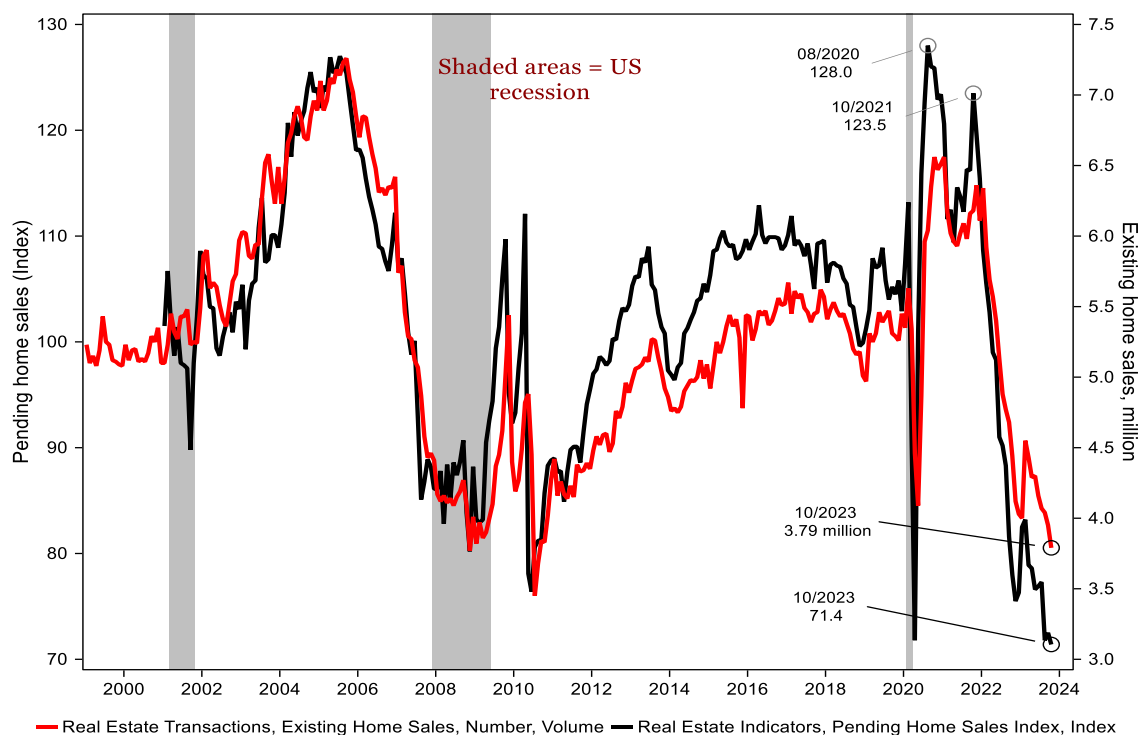
The evidence reinforces that expectation (that the consumer is about to retrench). Of note:

The corporate sector is poised to cut back on labour (see [point 1](#)). Rising unemployment will then dent confidence, and push the savings ratio higher (increase precautionary savings). Furthermore, the consumer has just recently run out of excess savings (reinforcing the above dynamic).

All of which is occurring at a time when the consumer is already beginning to slow/cut back on spending ([point 2](#)) and, somewhat troublingly, is beginning to show signs of stress, i.e. by increasingly defaulting on auto loan and credit card borrowing (i.e. evidence that money is ‘too tight’, and starting to impact the real economy, see [point 3](#)).

All of that is consistent with the latter scenario laid out above, and with the suggestion **that the ‘recession’ has been delayed, not cancelled’**. Our US Traffic lights, updated/shown in table 7, broadly confirm that expectation (i.e. with most either flashing ‘RED’ or ‘RED/AMBER’).

Fig 7b: US existing home sales (number) vs. pending home sales (index)



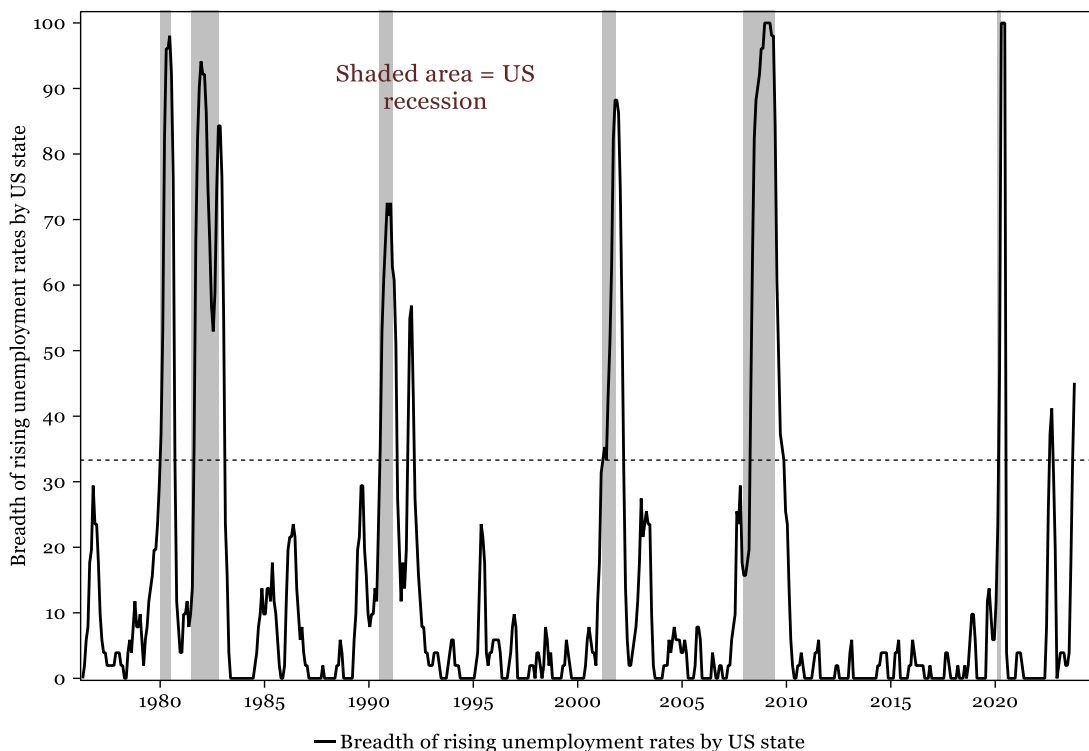
Source: Longview Economics, Macrobond

Key Points

1. Cracks in the US labour market are emerging and point to a recession in 2024. In particular, having likely hoarded labour in the past 12 – 18 months, companies are now poised to let go of workers. The early/leading labour market **indicators suggest that’s likely to happen** over coming months (probably in 1H 2024).

Of note, and while the national unemployment rate is trending higher, that weakness is broad based across the 50 states of America. **That’s illustrated** in fig 7c below, which measures the percentage of states which have recorded a 0.3pp. increase in their unemployment rate (cumulatively) over the prior three months. Currently that share is 45%, which is typically associated with a US recession.

Fig 7c: Breadth of rising unemployment across US states⁷¹ (%)



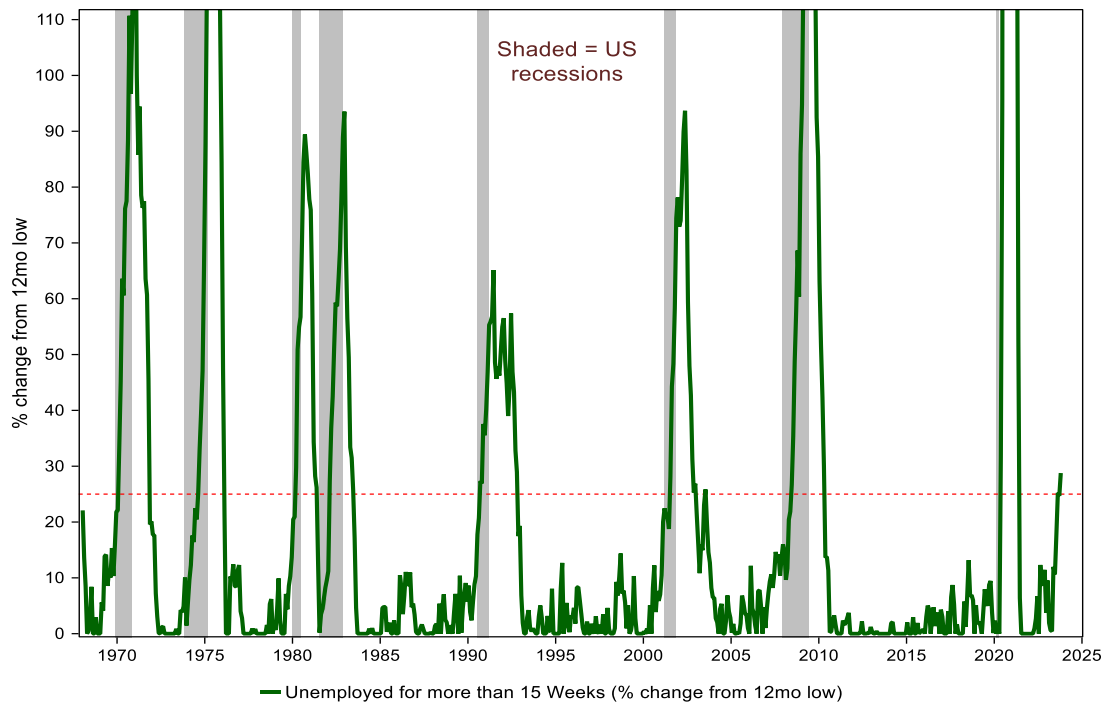
Source: Longview Economics, Macrobond

⁷¹ This indicator measures the % of US states (plus the District of Columbia) which have recorded a 0.3pp. rise in their unemployment rate cumulatively over the past three months.

Other labour market indicators carry a similar recession warning signal. The **Conference Board’s ‘jobs plentiful less hard to get’** index, for example, has turned sharply lower. In its 60 years of history, that has always signalled a forthcoming US recession (fig 7a). Consistent with that, job openings are trending down (fig 7i); those unemployed for more than 15 weeks is rising (fig 7d); **while ‘temporary help’ in the services sector is falling**, fig 7h (all of which are recession signals).

Elsewhere, key measures of employment have started to soften. The number of people working part time because they can't find full time work, for example, is rising. That's happening in absolute terms and relative to the number of full time workers (fig 7g). Often, a switch away from full time workers (towards part time) is the first step companies take in cutting labour and it typically happens ahead of recessions. Of note, the trend in monthly payrolls growth is down (fig 7p), while the latest household print is negative (fig 7o).

Fig 7d: Unemployed for more than 15 weeks (% change from 12m low)



Source: Longview Economics, Macrobond

- The consumer is under pressure and starting to cut back on spending. That's illustrated, somewhat anecdotally, by various comments from retailers in their recent earnings reports/analysts calls (e.g. Walmart & Target):

[shoppers are] “still very choiceful and using discretion.”

“This gives us reason to think slightly more cautiously about the consumer versus 90 days ago”.

Source: Walmart's Chief Financial Officer John David Rainey, 16th November 2023

“Target sales declined by an average 7% in August and September alongside declines in transaction count and value, TD Cowen said in a note ahead of its earnings.”

“Cornell cautioned that although shoppers are still spending, the company was not out of the woods as higher interest rates, the resumption of student loan repayments, increased credit card debt and reduced savings keep up the pressure.”

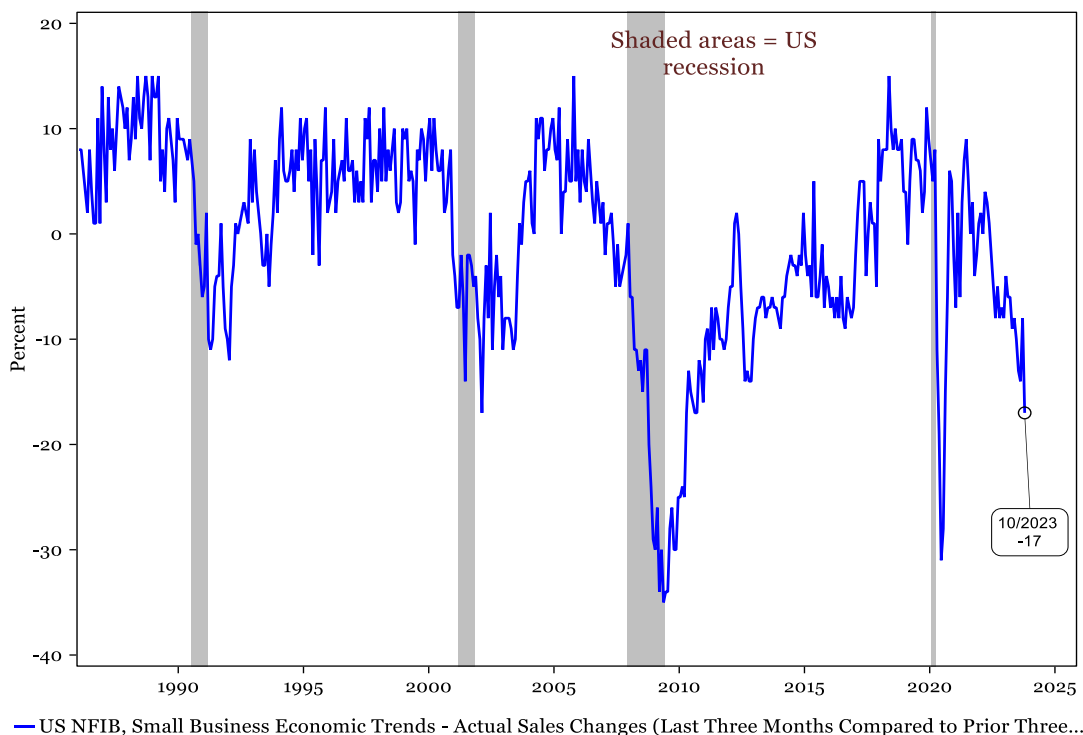
“This is a clear indication of the pressures they're facing as they work to stretch their budgets until the next paycheck,” he said.”

Source: Reuters article, available [HERE](#)

That’s also the message of the hard data. Weekly spending on credit/debit cards, for example, has begun to roll over in recent days/weeks (and is now contracting relative to trend, see fig 7), while retail sales have arguably started to soften (after three strong prior months, see fig 7l).

Of interest, in that respect, the NFIB reported last month that actual sales by small companies are falling sharply, **and behaving in a way that’s typical** into/ahead of recessions (fig 7e). **That’s** unsurprising, given the (multi-year high) number of mentions of the phrase ‘**weak demand’ on earnings calls** this reporting season. All of which is consistent with weak consumer confidence and evidence that **households’ spare cash buffer has been** significantly depleted (and will be at/close to ZERO by the end of this month, see [HERE](#) for detail). In other words, the consumer appears to be on the edge of a (stimulus) cliff (with little to support spending once the cash has run out).

Fig 7e: US NFIB actual sales (last 3 months vs. previous 3 months)



Source: Longview Economics, Macrobond

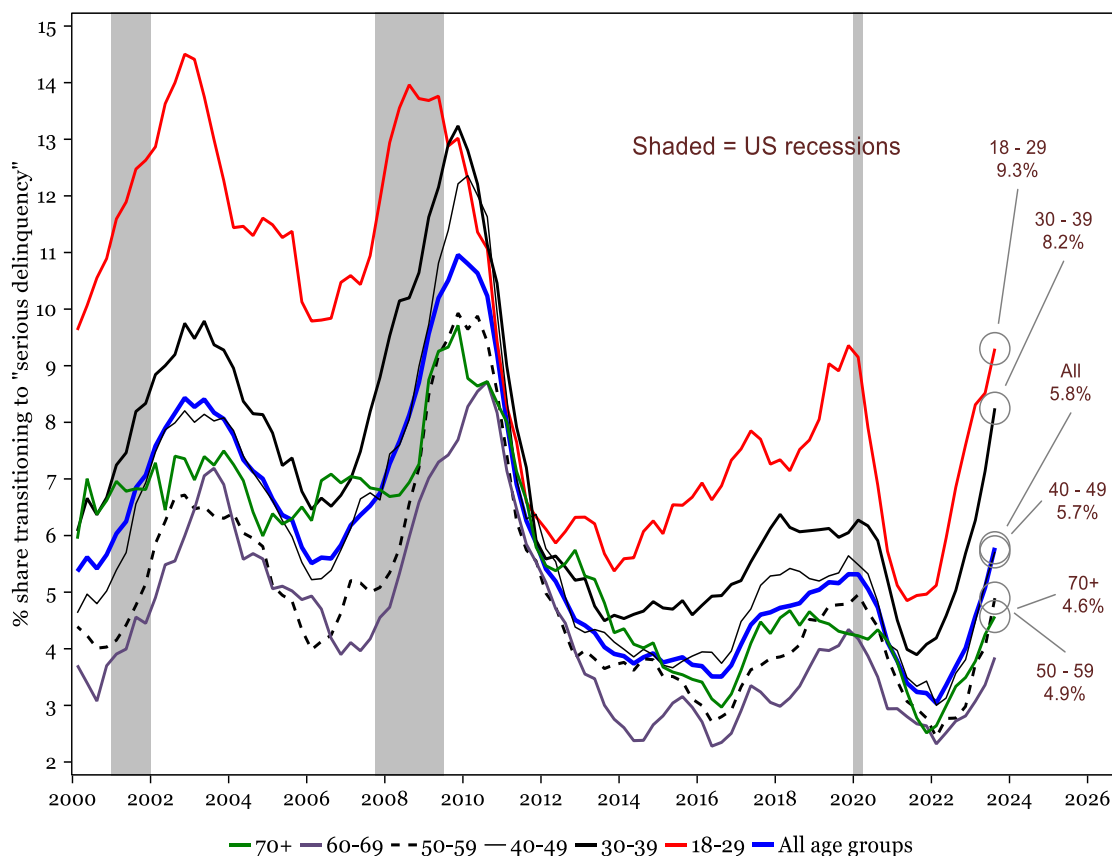
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3. Signs of stress are building in the household sector. In particular, and consistent with emerging labour market weakness, and weaker spending, delinquency rates are trending higher. **That is, there's a growing number of consumers who are missing payments on their borrowing. That's most** marked for auto loan and credit cards, where the delinquency rates are trending up for all age groups (particularly younger groups, i.e. <40 years old), see figs 7f & 7m. Usually, rising delinquency rates is a precursor to defaults/bankruptcies and, as the chart below shows, **it's** typical ahead of (and into) a recession.

Consistent with all of that, banks' **credit conditions** for consumer borrowing have tightened to levels typical of a recession (see fig 7n), suggesting that consumer credit growth should slow further (and increasingly begin to contract, see fig 7k). Banks, in that respect, remain pro-cyclical – and add to the case for consumer weakness (as well as, more broadly, an ongoing contraction in system wide bank lending).

Fig 7f: US credit card delinquency rates by age (%)



Source: Longview Economics, Macrobond

Traffic Light Indicators

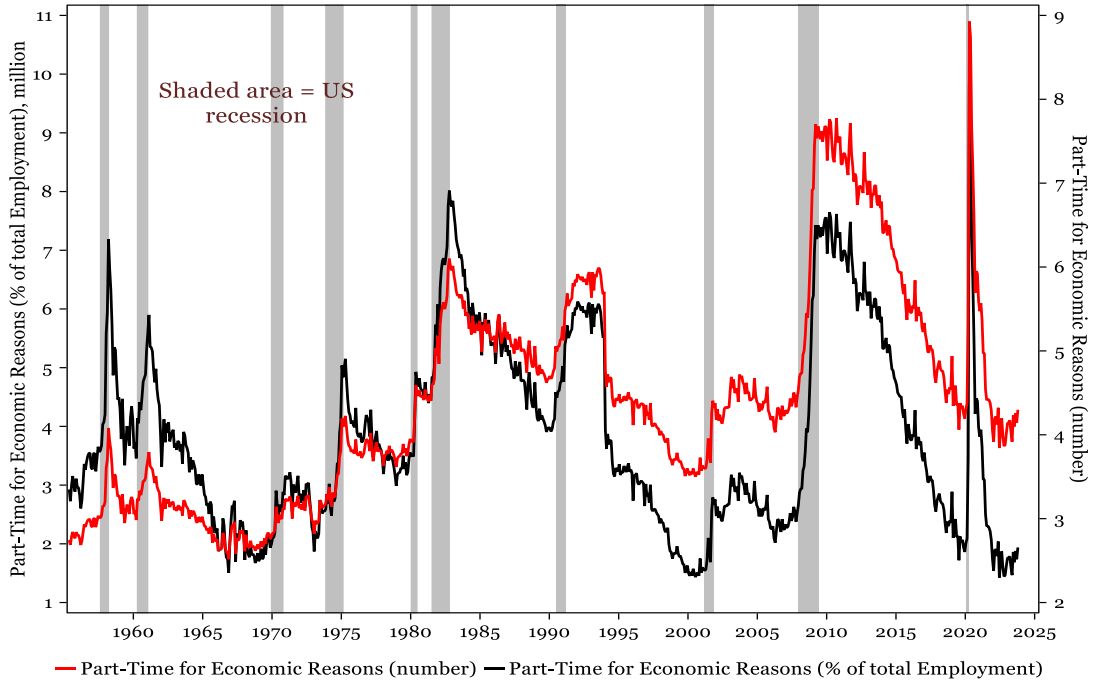
Table 7: US Traffic Light Indicators

i) Tightness of Monetary Conditions		
Yield curve	RED	Currently inverted
Real short rates	RED	Rapid increase in past 12 months
Real shadow Fed funds rate	RED	+8.2pp. increase in real (shadow) fed funds in 18 months
Real M1 growth	RED	Shrinking Y-o-Y (-13% on latest data)
ii) Tightness of Credit Conditions		
Credit conditions – corporate (tightening lending standards)	RED	At tight levels and effectively warning of recession
Credit conditions – corporate (Increasing Spreads of Loan Rates)	RED	At recession warning levels
Credit conditions – household	RED	At recession warning levels
Credit Conditions – Banks: Economic outlook as reason for easing/tightening conditions	RED	Reasonably tight on latest data
Credit Conditions Banks’ reasons for easing/tightening: ‘Specific Industry problem’	RED/AMBER	At reasonably tight levels
iii) The state of financial conditions		
US HY Corp bond spreads	AMBER	At mid-range levels relative to history
TED spreads	GREEN	At narrow levels currently
Kansas City Financial Stress index	RED/AMBER	Somewhat elevated relative to history
US CCC HY corporate bond spreads	AMBER	Mid-range relative to history
iv) State of Corporate Sector Health		
Corporate financing gap	GREEN	Cashflow surplus
Corporate cashflow earnings less uses (non-financial, i.e. post share buybacks)	GREEN	Cashflow surplus
NIPA Corporate profits	RED/AMBER	Shrinking Y-o-Y (just)
Corporate profit margins model (nominal GDP growth LESS unit labour costs)	GREEN/AMBER	Stable in recent quarters
v) The message of leading economic indicators		
Leading Economic Indicators (conf. board Y-o-Y %)	RED	Shrinking M-o-M & Y-o-Y
vi) Wealth effect and other indicators		
Car Sales	AMBER	Stronger in the past 12 months
Housing	RED/AMBER	Data mixed in recent months
Weekly jobless claims (smoothed)	GREEN/AMBER	At reasonably low levels
US H’hold wealth effect	GREEN/AMBER	Stronger Y-o-Y on latest data

Source: Longview Economics

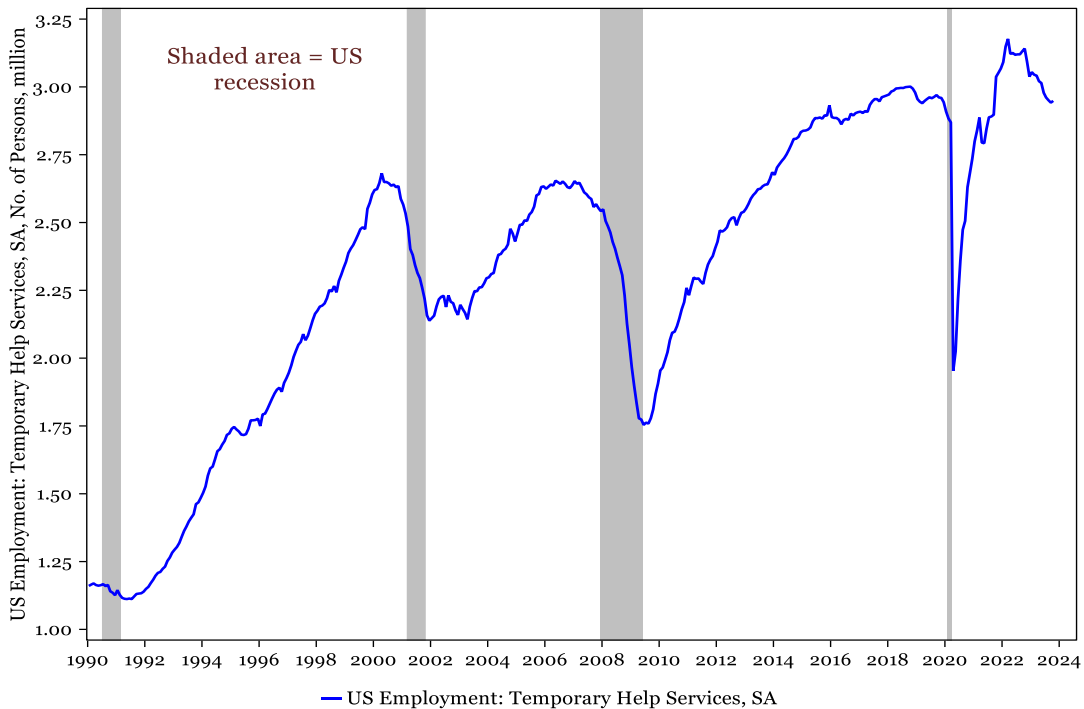
Key Charts

Fig 7g: Part-time for Economic Reasons (number & % of employment)



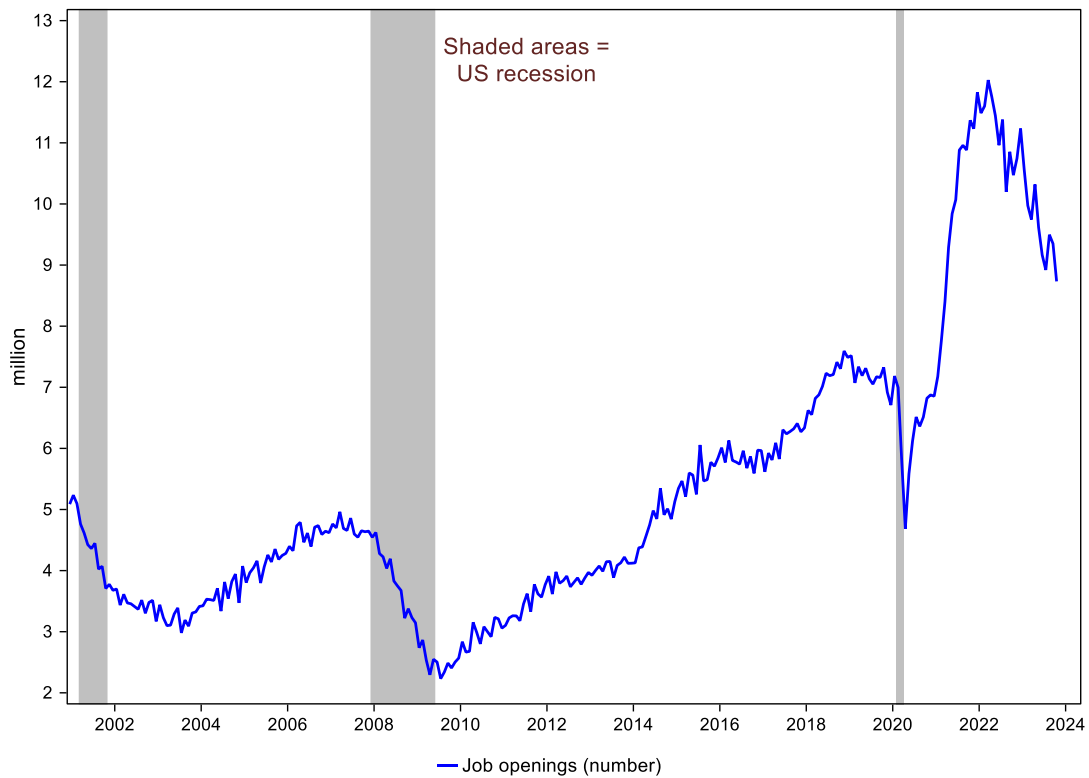
Source: Longview Economics, Macrobond

Fig 7h: US Temporary Help Services (SA, no. of people employed)



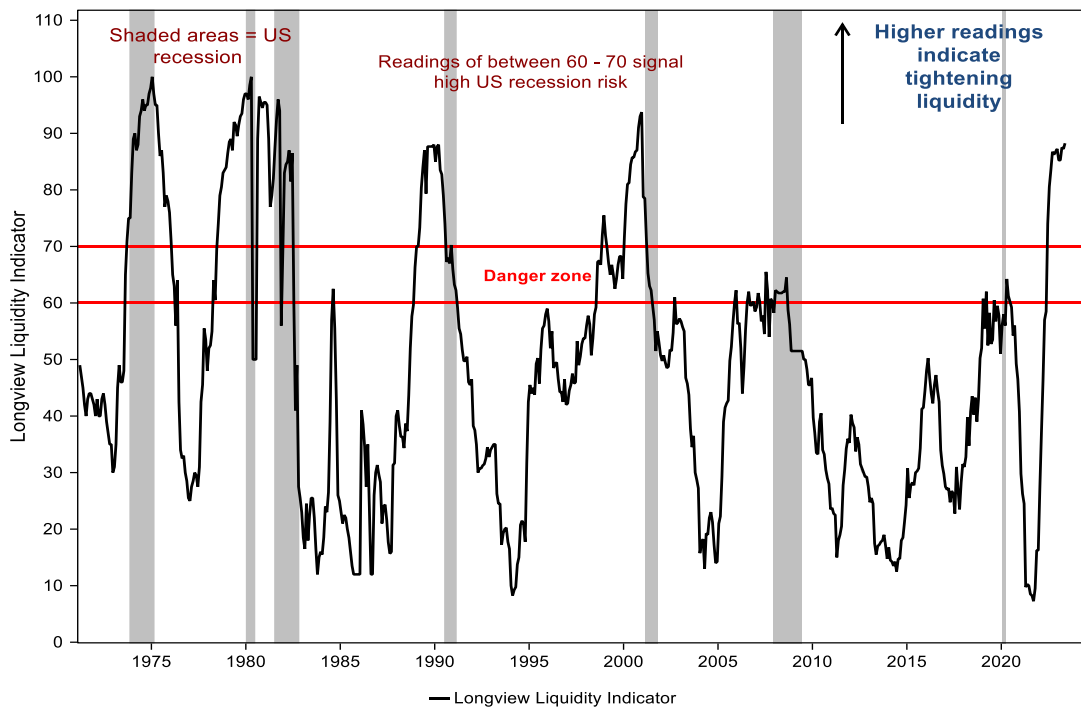
Source: Longview Economics, Macrobond

Fig 7i: US job openings (JOLTS data, shown with US recession bands)



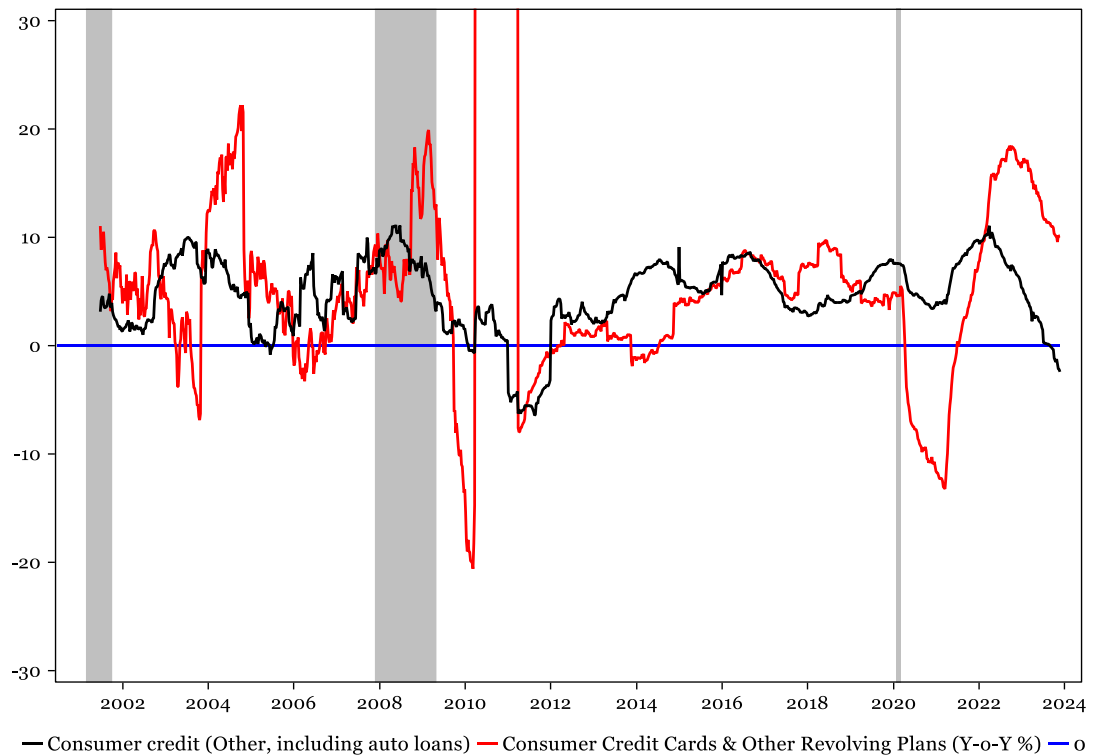
Source: Longview Economics, Macrobond

Fig 7j: Longview US liquidity indicator shown with US recession bands



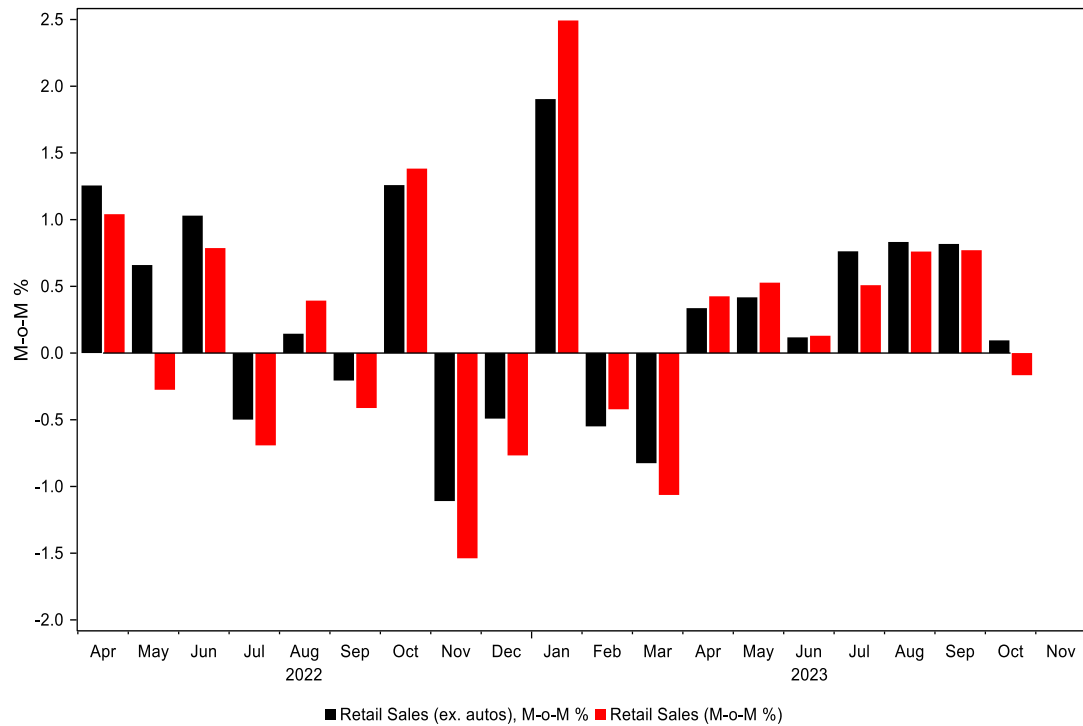
Source: Longview Economics, Macrobond

Fig 7k: Credit card spending vs. 'other' consumer borrowing (Y-o-Y %)



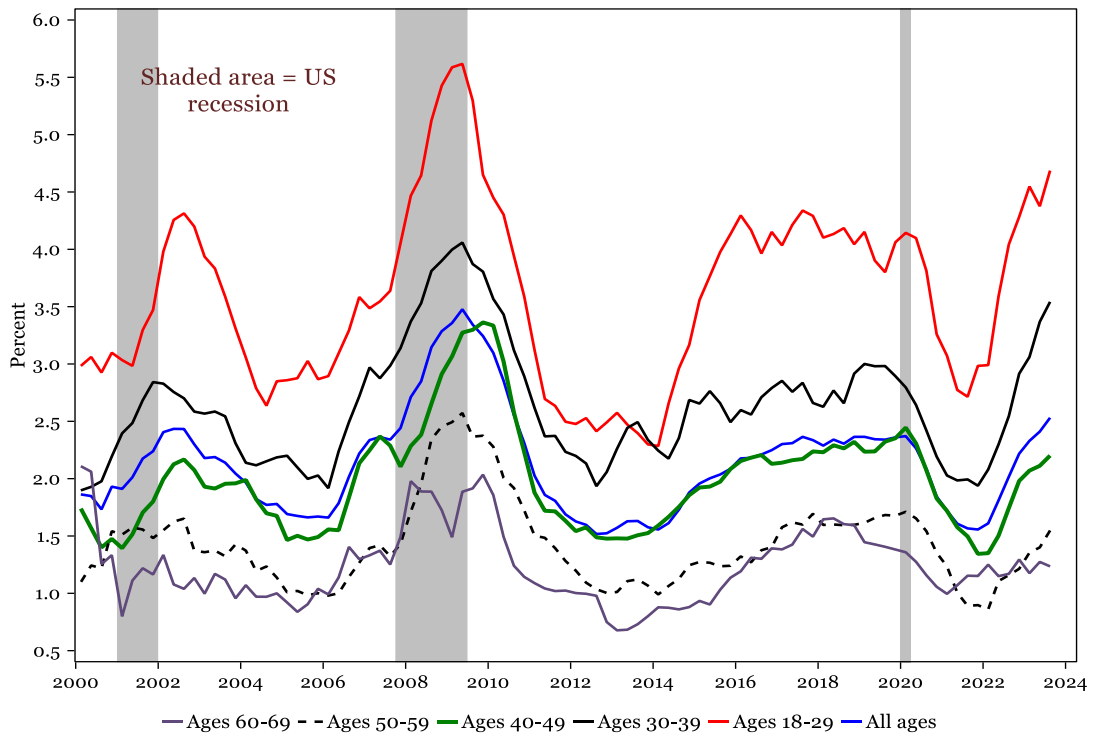
Source: Longview Economics, Macrobond

Fig 7l: US retail sales (M-o-M %), headline and ex. autos



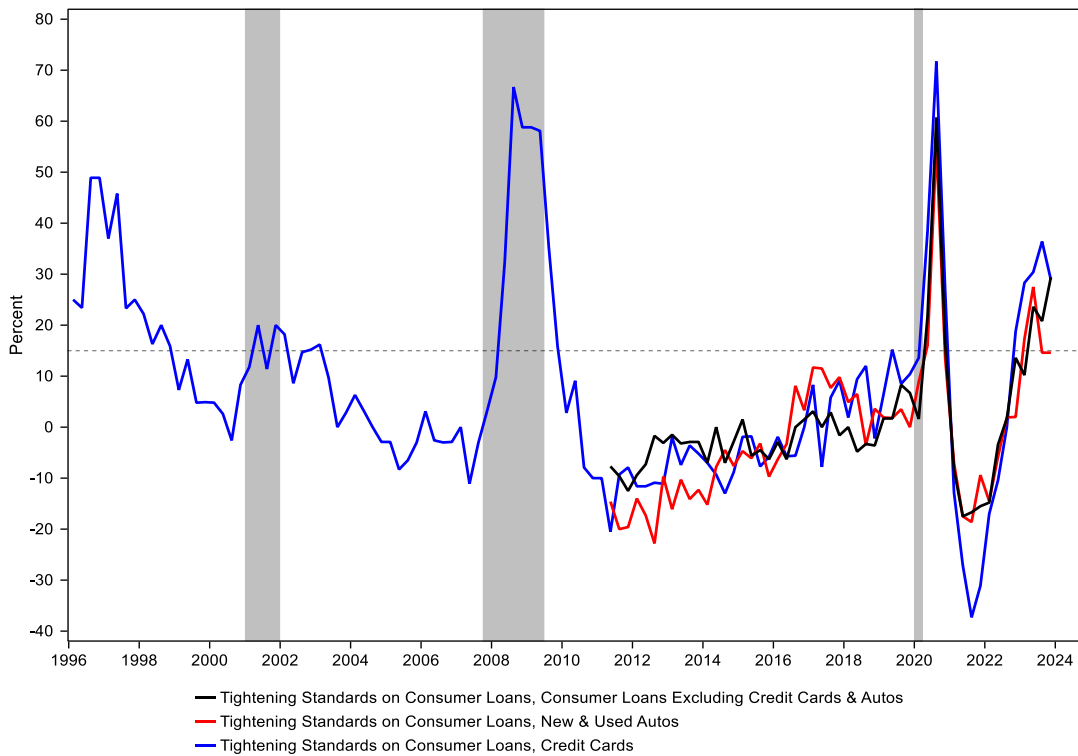
Source: Longview Economics, Macrobond

Fig 7m: Auto loan delinquency rates by age (%) shown with US recession bands



Source: Longview Economics, Macrobond

Fig 7n: US consumer bank credit conditions (autos, credit cards, cons loans)



Source: Longview Economics, Macrobond

Fig 7o: US employment (monthly change), household survey

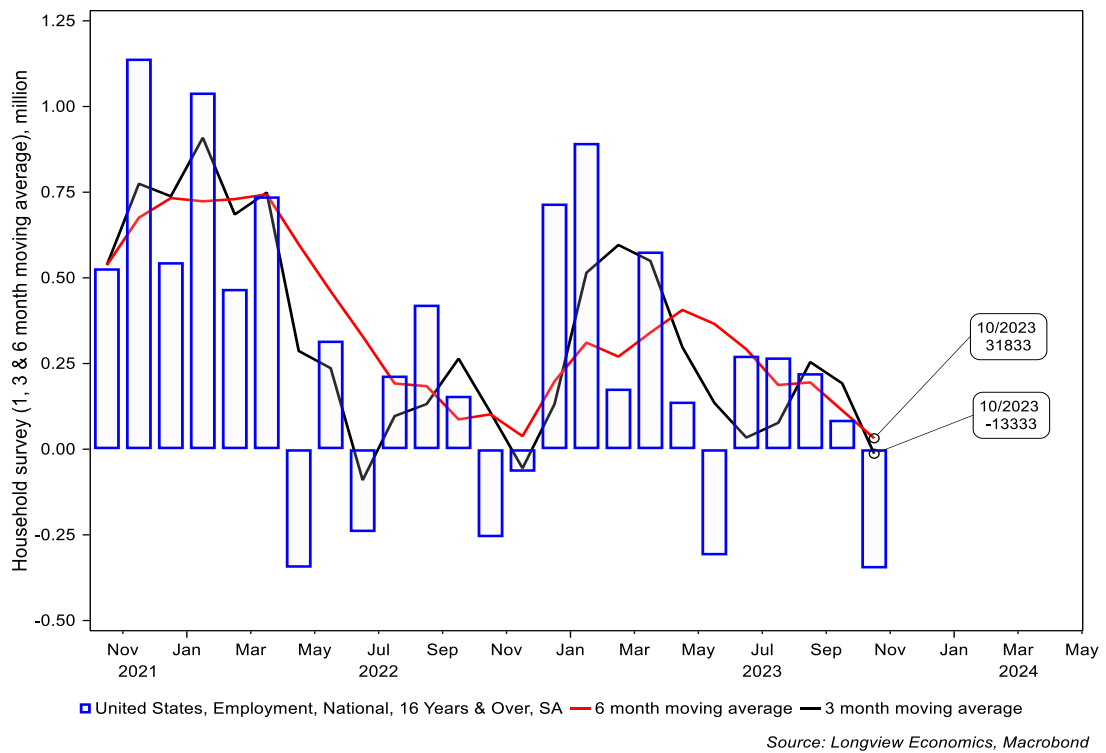
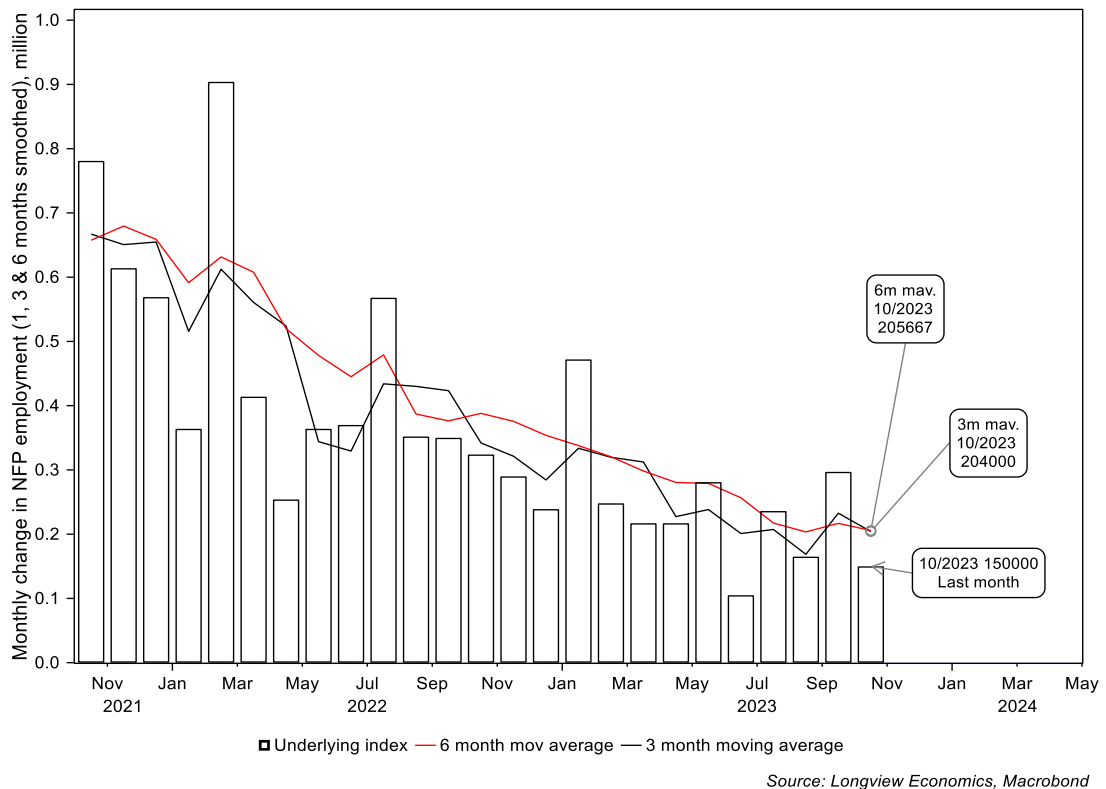


Fig 7p: US employment (monthly change), establishment survey



China: In a Balance Sheet Recession?

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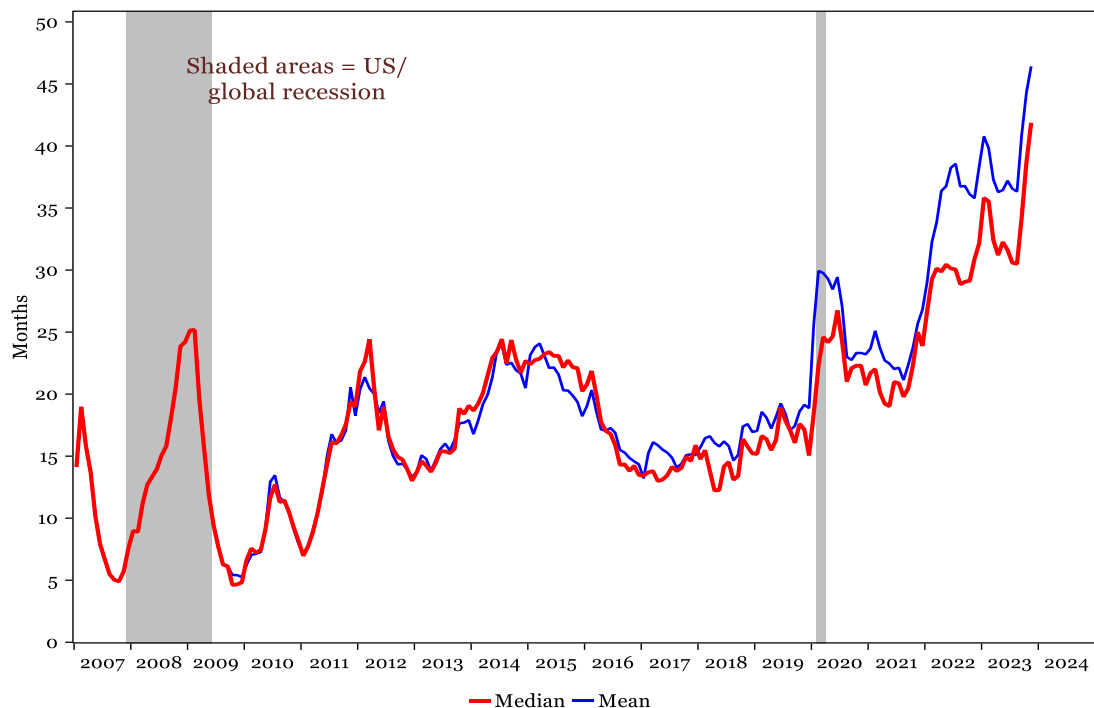
Section 8: Summary & Conclusion

Chinese real estate has been in one of the largest bubbles in the world in recent history.

Not only are certain Chinese cities some of the most expensive in the world (i.e. when measured per square metre as well as on a price to income multiple) but added to that, the real estate sector has grown to 30% of Chinese GDP⁸ and has, therefore, become a key imbalance (sign of excess) in the economy. As that bubble has built, **it's** been a major driver of: (i) High levels of leverage in the economy; (ii) the record high investment share of GDP (reaching 47% at its peak); & (iii) a significant misallocation of capital.

That bubble, though, has burst and is now deflating. The mechanics of that are laid out [HERE](#). In summary, though, highly leveraged property companies have failed, and construction & investment activity has therefore collapsed (with sharply weaker land sales, lower housing starts and private investment spending, and so on, e.g. see figs 8j & 8k).

Fig 8: Clearance time by major Chinese cities⁸ⁱ (average months to sell)



Source: Longview Economics, Macrobond

⁸ Including both direct and indirect links in the economy to the real estate sector, as Rogoff and Yang showed [HERE](#) in 2020.

⁸ⁱ Key cities include Hangzhou (excluding Xiaoshan & Yuhang districts), Nanjing, Chengdu, Dalian, Xiamen, Xi'an, Wuxi, Shenyang, Qingdao, Jinan, Hefei, Lanzhou, Guiyang, Wenzhou, and Suzhou.

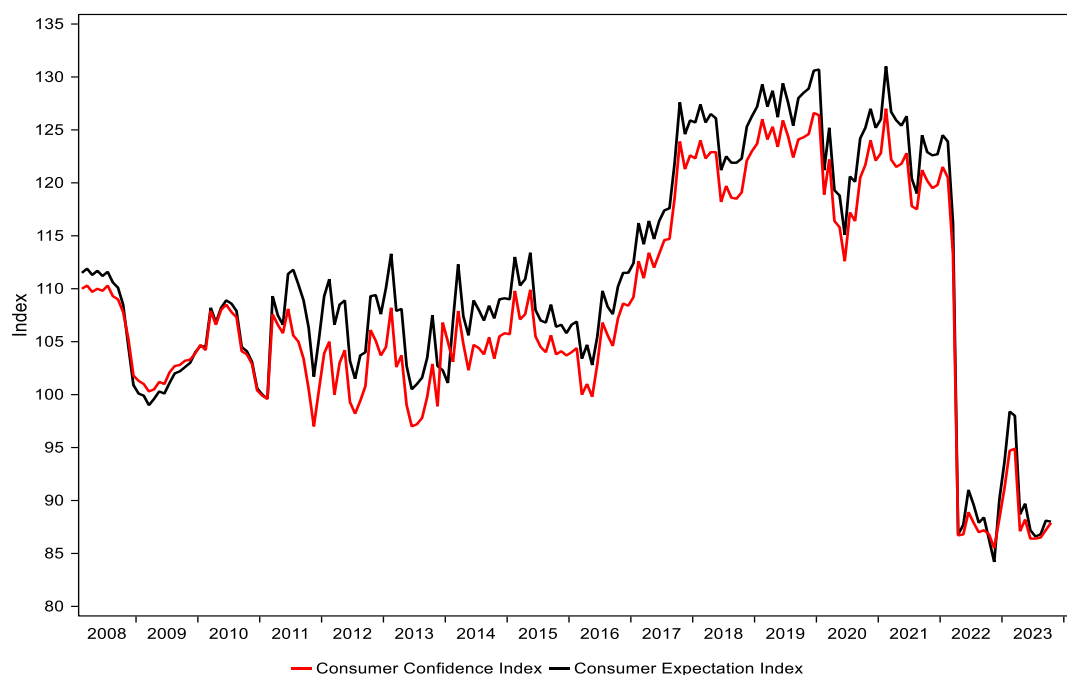
Added to that, with property developers going bust and prices down sharply, investor psychology has broken.

That is households, having invested heavily for the past 10 – 20 years in property, are no longer likely to view it as a key place to save (i.e. as a store of wealth). Switching out of/selling property, though, has become challenging, with it taking up to 3 – 4 years to sell in major cities, fig 8. In other words, the process of price discovery has stopped working properly and, without significantly lower house prices, the market is unlikely to clear/function properly.

Linked to all of that, consumer confidence remains close to its pandemic lows (fig 8a). That is, despite the re-opening of the economy post-lockdown, the sentiment amongst consumers is still downbeat.

That was also the mood ‘on the ground’ during our trip to China last month, where there were heightened concerns that (i) the ‘social contract’ between the state and individuals is broken (see [HERE](#)), and (ii) that belief in the Chinese economic model has been damaged by the authoritarianism of Xi’s leadership, both domestically and overseas.

Fig 8a: Chinese consumer confidence (indices)



Source: Longview Economics, Macrobond

Structurally, the unwinding of those imbalances should generate long term **headwinds for China’s economy**. In particular, and to maintain social stability (and party legitimacy), the policy response **to the bursting of China’s real estate** bubble has been designed to support land and house prices, as well as government revenues (albeit artificially).

Extract Quarterly AA No 56, 14th December 2023

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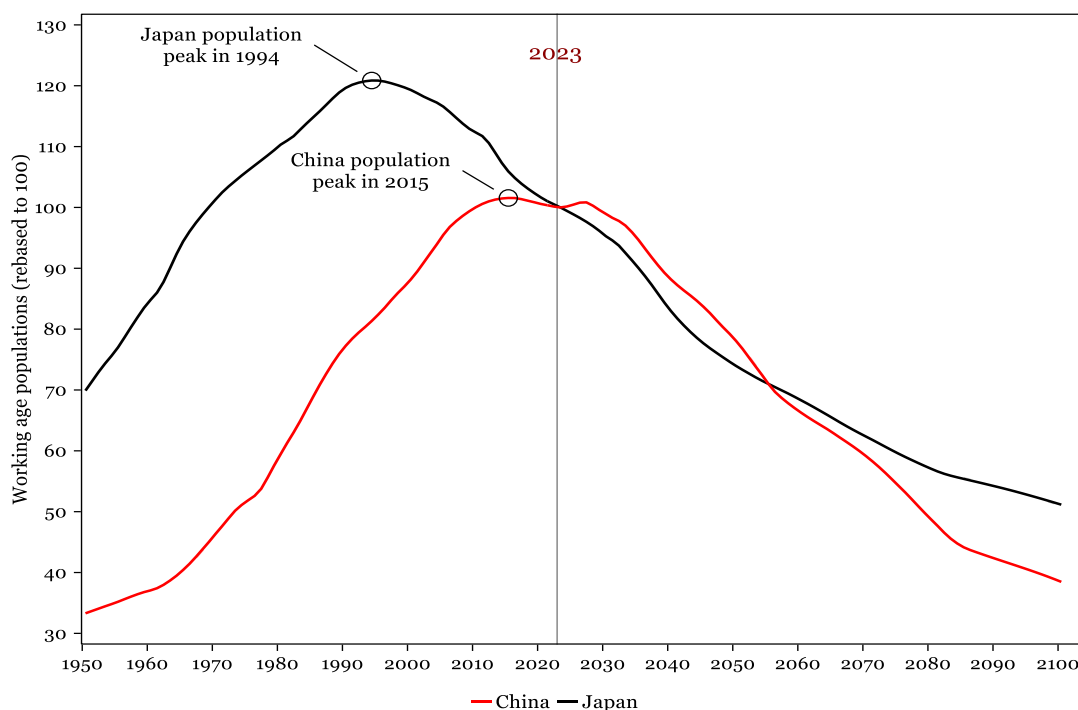
That response, as highlighted [HERE](#), socialises the losses from the real estate sector, increases government indebtedness, and lengthens the time it takes for the housing market to clear, and for the excesses in the real estate sector to unwind. In other words, and unlike the West in the GFC, **it's an 'extend and pretend' policy**, which spreads out the pain of the deflating bubble over many years (i.e. more akin to the Japanese approach, following the bursting of its bubble from 1990 onwards).

All of that raises key questions about trend growth in China.

So far, China has followed the 'usual' economic development model, witnessed by other developing Asian economies. That model is laid out [HERE](#), and involves strong trend growth (10% real) for a number of decades. That is then followed by a phase of lower trend growth (~5% real), which then falls to much lower levels once economies become more advanced (e.g. 0-1% p.a. in Japan).

The risk for China, given the backdrop above, is that the low trend growth phase starts early. Of interest, in that respect, Japan transitioned to **its 'low growth' phase from 1990 onwards (once its bubble burst/started to deflate)**. That also happened to be the start of a sharp fall in the growth rate of **Japan's working age population**, see fig 8l (which then contracted from 1994 onwards). China shares similar parallels with Japan, both in terms of a bursting bubble, but also from a demographics perspective. Indeed, **China's working age population** is expected to grow slowly for the next four years, before then contracting rapidly/in earnest from 2028 onwards (see fig 8b).

Fig 8b: Chinese & Japanese working age populations (rebased to 100 in 2023)



Source: Longview Economics, Macrobond

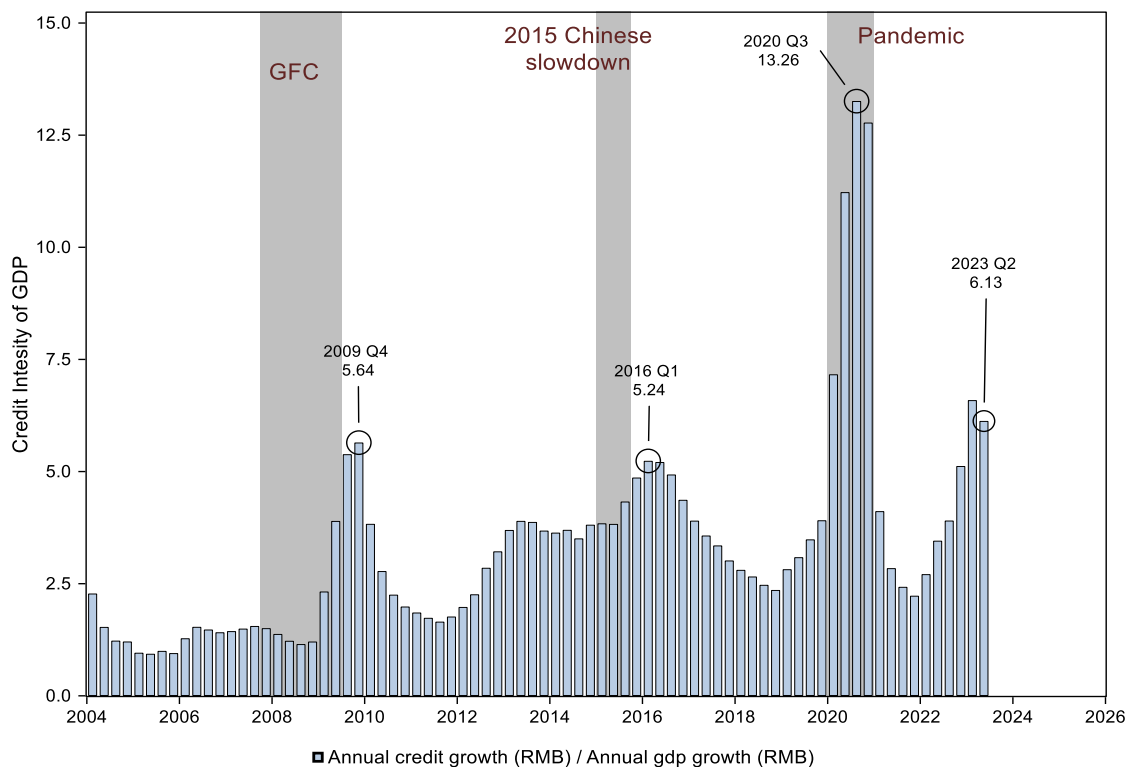
Cyclically, China remains in the midst of a housing bust. Usually, when housing bubbles burst, they take between four to seven years to fully deflate. They can, of course, take longer, depending on the policy response (e.g. 20 years in the case of Japan).

As we highlight above, **China's 'extend and pretend'** approach will probably spread the housing pain over several years. That may preclude a major Minsky moment/credit event in China in the next 12 – 18 months. In that respect, and encouragingly for the bulls, **there are some 'bright spots' in the Chinese economy**. They include, for example, signs of consumer resilience (travel has picked up, while box office sales reached a record high this summer) as well as strong production and sales of EVs.

Despite that, three key factors highlight the downside risks to **China's** economy in the near term. In particular:

1. **There's a lack of** stimulus from policymakers and, therefore, ongoing signs of stress. **Illustrating that stress, China's 'credit intensity of GDP'** has accelerated higher, as it often does in crises (fig 8c). That is, newly created credit is less effective in driving GDP/economic activity because it's largely channelled towards bailouts and supporting companies in distress (e.g. it's **used to 'roll up'** unpaid interest payments into loan principal, etc.).

Fig 8c: Chinese credit intensity of GDP shown with US/global recession bands

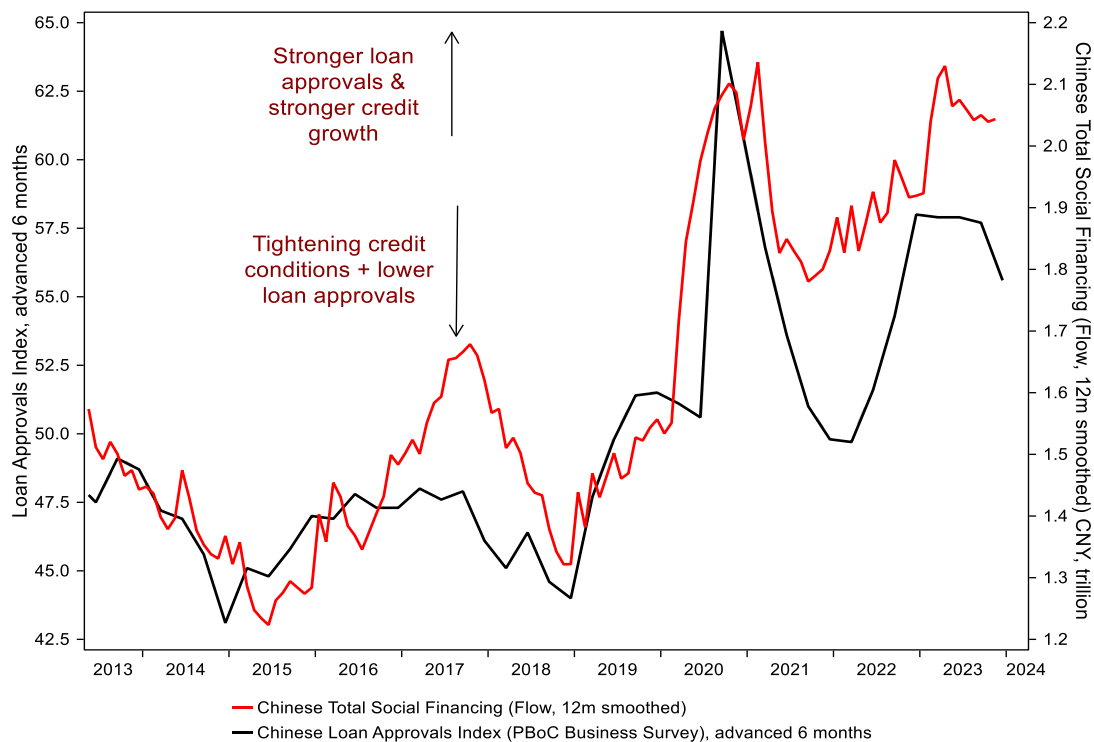


Source: Longview Economics, Macrobond

The key question, therefore, in the near term, is whether the authorities have provided enough stimulus to offset the initial fallout from the bursting of **China's housing bubble** (i.e. such that **China's credit** intensity of GDP can **return to 'normal' levels**). **Downside risks, in that respect, remain high.** In particular, despite high expectations, no new/significant policy measures were announced by Xi Jinping/other leaders at this week's annual economic work conference. Instead, it was clear that **'boosting domestic demand' is no longer the government's top priority** (e.g. see [HERE](#)). With that, and as **we've highlighted** in prior research, China has not meaningfully used its key policy tools in the past 12 – 18 months (RRR, interest rates, PBoC balance sheet expansion, etc.), compared to other times of crisis/stress. The relatively low level of total bond issuance in the Chinese economy is instructive in that sense (see fig 8g).

- Given that lack of stimulus, the outlook for credit growth is poor. **That's the message of several indicators which lead China's credit cycle.** Loan approvals, for example, have rolled over (pointing to weaker lending, fig 8d); money supply growth has decelerated (typical ahead of slower credit growth, fig 8i); **while, consistent with that, China's 'credit impulse' is trending down** (albeit with some volatility, see fig 8h). In other words, and while much of the newly created credit is currently used to support businesses in distress (see point 1), **there's little evidence that 'regular' lending, to support/drive economic activity, is about to reaccelerate.** That highlights the downside risks to Chinese growth.

Fig 8d: TSF credit growth (CNY, trillion) vs. loan approval index (6m advanced)



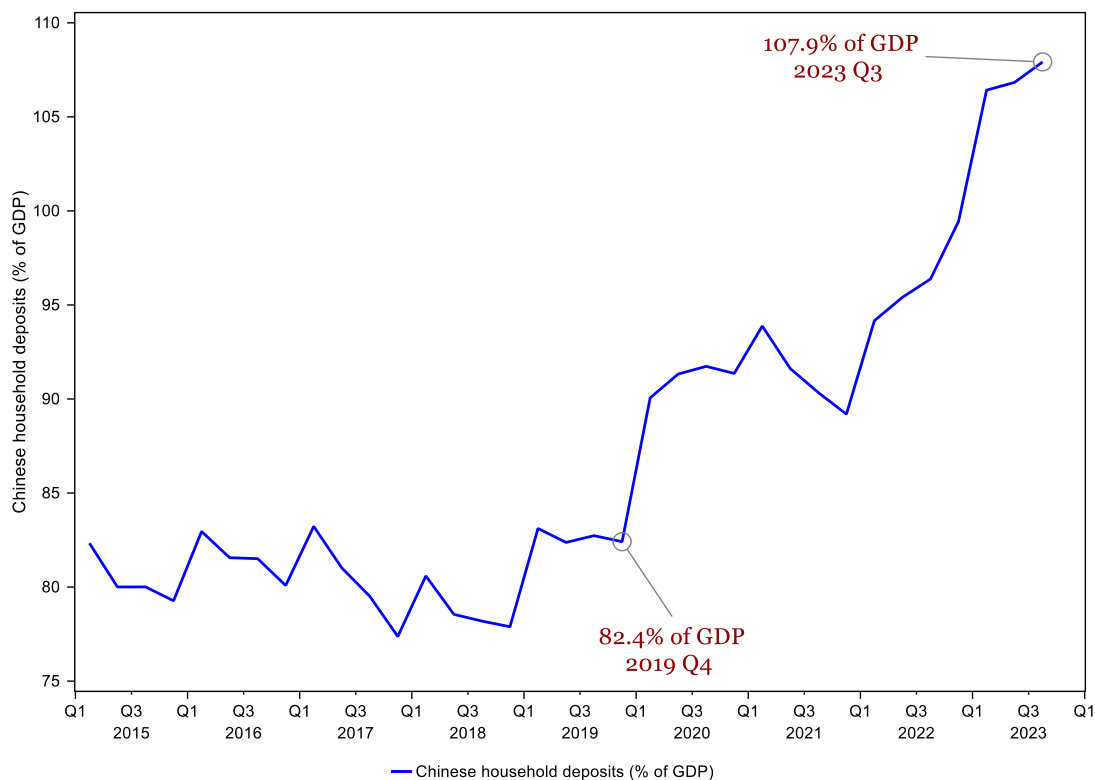
Source: Longview Economics, Macrobond

3. Households are not spending their cash.

In Western economies, consumers have been spending the excess savings they built up in the pandemic. That has mostly happened post lockdown/during economic reopening, and has been a key driver of strong economic growth. In China, the cash buffer is particularly large, with household deposits rising by 25pp. of GDP since late 2019 (fig 8e). Despite fully lifting lockdown restrictions about a year ago, though, those cash deposits have continued to grow in recent quarters, both in cash terms and as a share of GDP (albeit less quickly than in 2022).

That's consistent with (i) deeply depressed consumer sentiment (as highlighted above); and **(ii)** a dysfunctional housing market which is likely generating negative wealth effects and an increasing appetite for precautionary savings. Indeed, **while house prices haven't fallen** much in major cities, **they also aren't selling** (fig 8, i.e. the listed price is too high). Equally, average selling prices in certain Tier III & IV cities are significantly lower (by up to 50%) while consumer expectations for house prices are low & trending lower. Somewhat unsurprisingly, and arguably illustrating the power of housing wealth effects in China, consumers' **view on house prices** has become highly correlated with their views around whether to 'save' vs. 'spend' (i.e. with a current bias, therefore, in favour of saving more/consuming less, see fig 8f).

Fig 8e: Chinese household cash deposits (% of GDP)



Source: Longview Economics, Macrobond

Table 8a: Chinese traffic light indicators (updated December 2023)

Leading Indicators

Indicator	Status	Comment
LEI – OECD (trend restored)	GREEN	Growth rate elevated
Yield curve (10 yr less 2 yr)	AMBER/RED	Flattening trend in recent months
New export orders (PMI subcomponent)	RED	Below 50 (as per recent years)

Credit Indicators

Indicator	Status	Comment
RMB lending growth	AMBER	Stable growth rate on latest data
System wide lending growth	AMBER	Sideways trend in recent yrs.
M2 money supply	AMBER	Growth rate decelerating in past 6 months
SHIBOR (2 wk & 1 month)	AMBER	Mid-range vs. recent years

GDP indicators

Indicator	Status	Comment
Longview Li Keqiang Index	AMBER	Mid range relative to past 5 yrs
GDP (Y-o-Y & Q-o-Q)	GREEN	Strong growth rebound in Q1 & Q2

Trade

Indicator	Status	Comment
Exports	RED	Shrinking Y-o-Y
Imports	RED	Shrinking Y-o-Y
Cargo handled at ports	AMBER	Growth in range of recent years
Imports from Asia	RED	Shrinking Y-o-Y (albeit less so)
Imports of copper and iron ore	AMBER/RED	Trending sideways with little/no growth
Imports of oil	AMBER/RED	Sideways trend in recent years

Housing & Consumer

Indicator	Status	Comment
Vehicle sales	AMBER/RED	Broadly flat since 2016
House price growth (in 70 cities)	RED	Contracting Y-o-Y
Floor space started	RED	Trending lower
Retail sales	RED	Sideways trend (Y-o-Y distorted by lockdowns)
Longview Luxury Index	RED	At low levels relative to recent years
Longview Household Index	AMBER/RED	Volatile readings in recent yrs
Longview Personal Index	RED	At relatively low levels

Industry

Indicator	Status	Comment
Supplier deliveries (PMI)	AMBER/GREEN	Above 50 on latest data
Rail freight volumes	RED	Low growth rate Y-o-Y in recent months/yrs
Commercial vehicle sales	AMBER/GREEN	Growth rate starting to move higher
Industrial production	RED	Close to bottom of historical range
Longview production index	AMBER	Possibly trending higher (current trend unclear)
Electricity production	AMBER	Growth rate mid-range
Fixed Asset Investment	RED	Contracting Y-o-Y
Production of cement	RED	Shrinking on latest data (October)
Steel production	AMBER/RED	Rangebound in recent years/no growth
Manufacturing PMI (NBS data)	AMBER	Modestly above 50 on latest data
Manufacturing PMI (HSBC data)	AMBER	Modestly above 50 on latest data
Services PMI (NBS data)	AMBER/GREEN	Rolling over (but still above 50)
Services PMI (HSBC data)	AMBER/GREEN	Rolling over (but still above 50)
Manufacturing PMI (new orders)	RED	Below 50/trending down

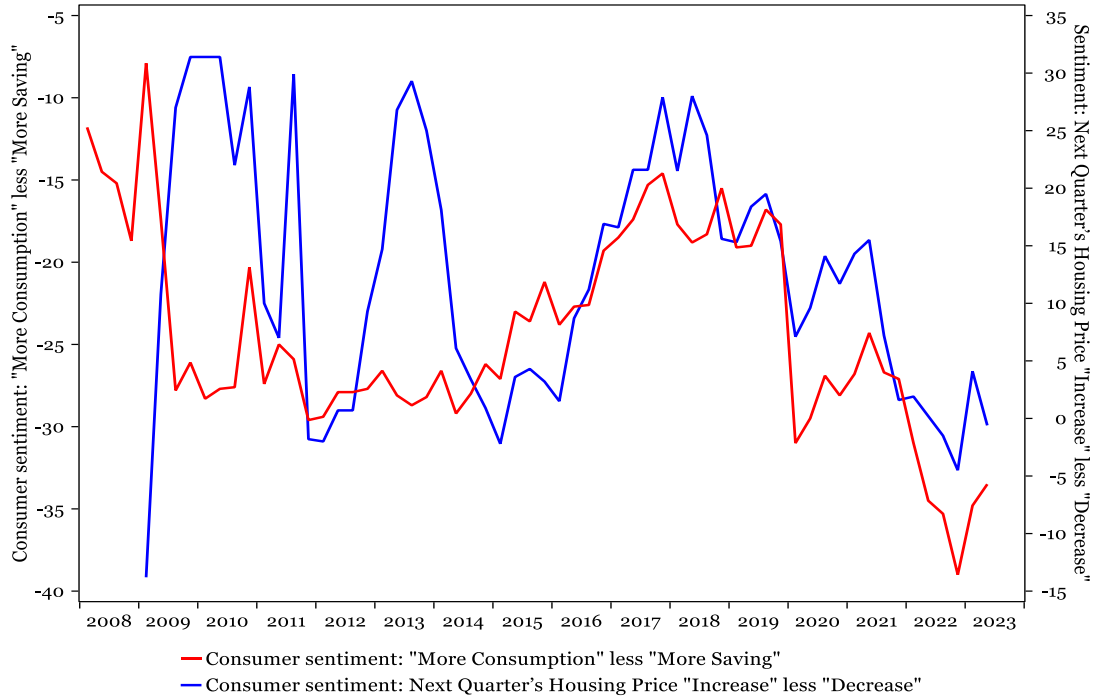
Public finances

Indicator	Status	Comment
Government revenues	GREEN	Sharp acceleration this year
Government spending	AMBER/RED	Rolling over/modest contraction on latest data

Source: Longview Economics

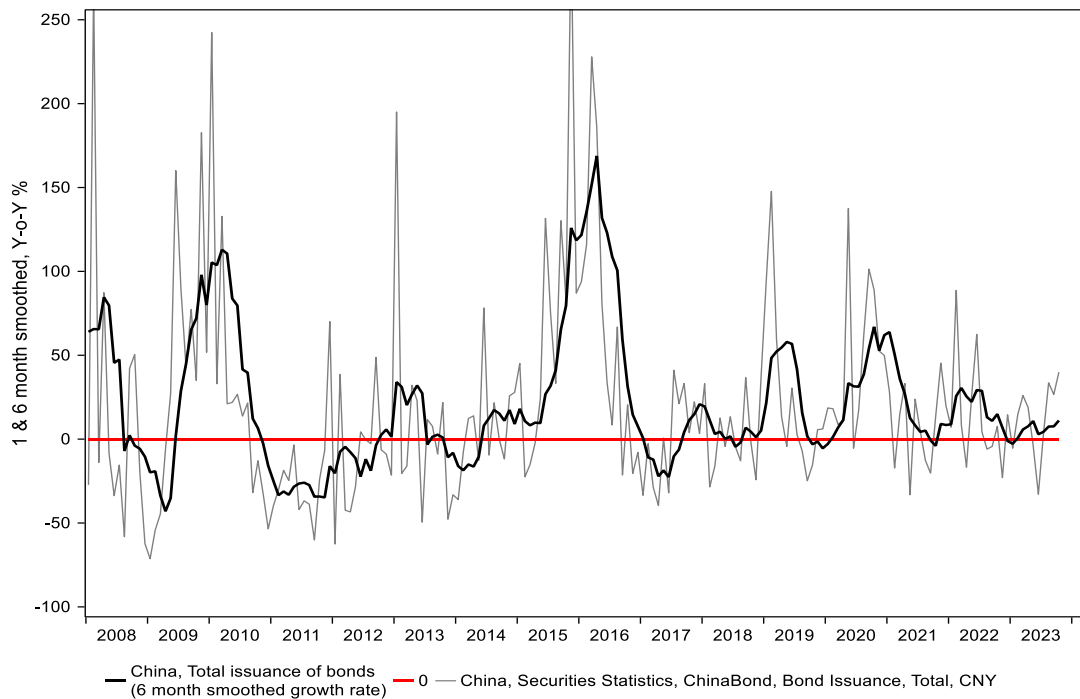
Key Charts

Fig 8f: Consumer outlook (“house price expectation” vs. “consume or save”)



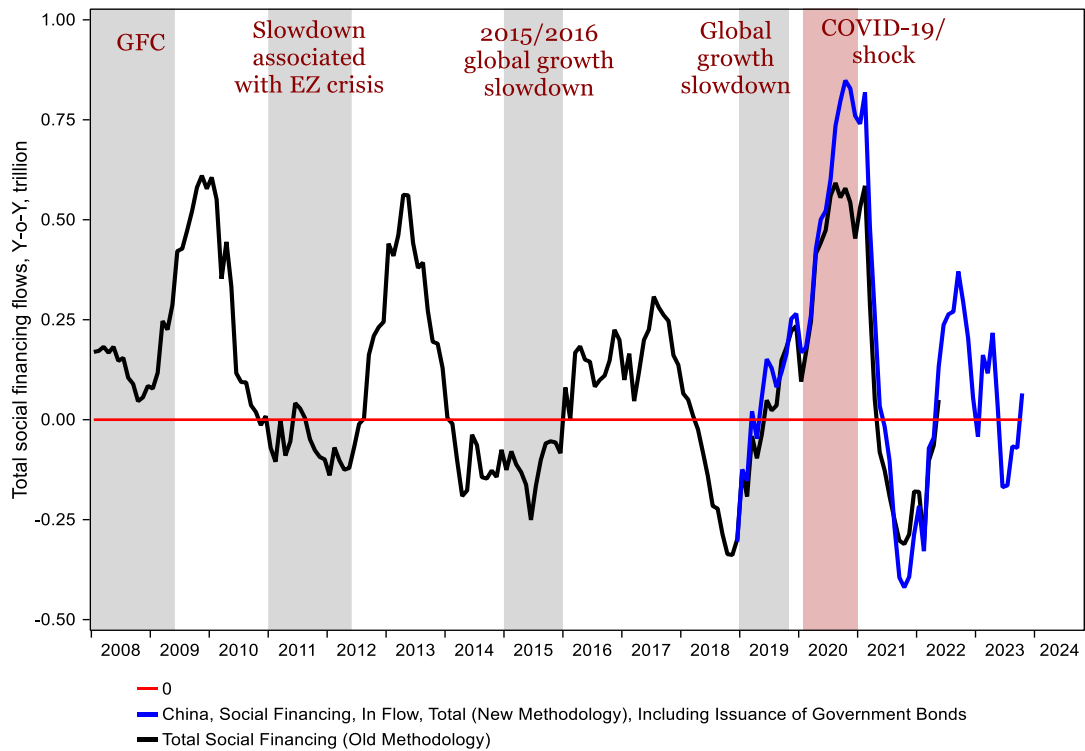
Source: Longview Economics, Macrobond

Fig 8g: Chinese total (economy wide) bond issuance (Y-o-Y %)



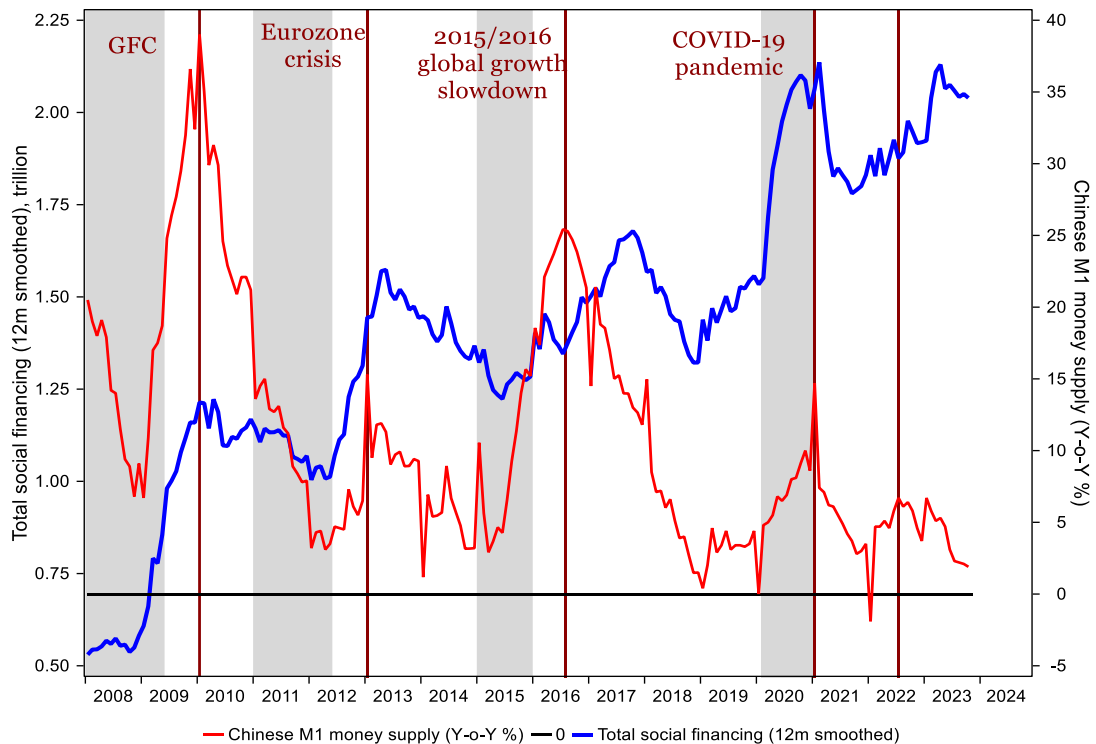
Source: Longview Economics, Macrobond

Fig 8h: Chinese credit impulse (TSF flows, Y-o-Y change in trillion CNY, 12m m.a.)



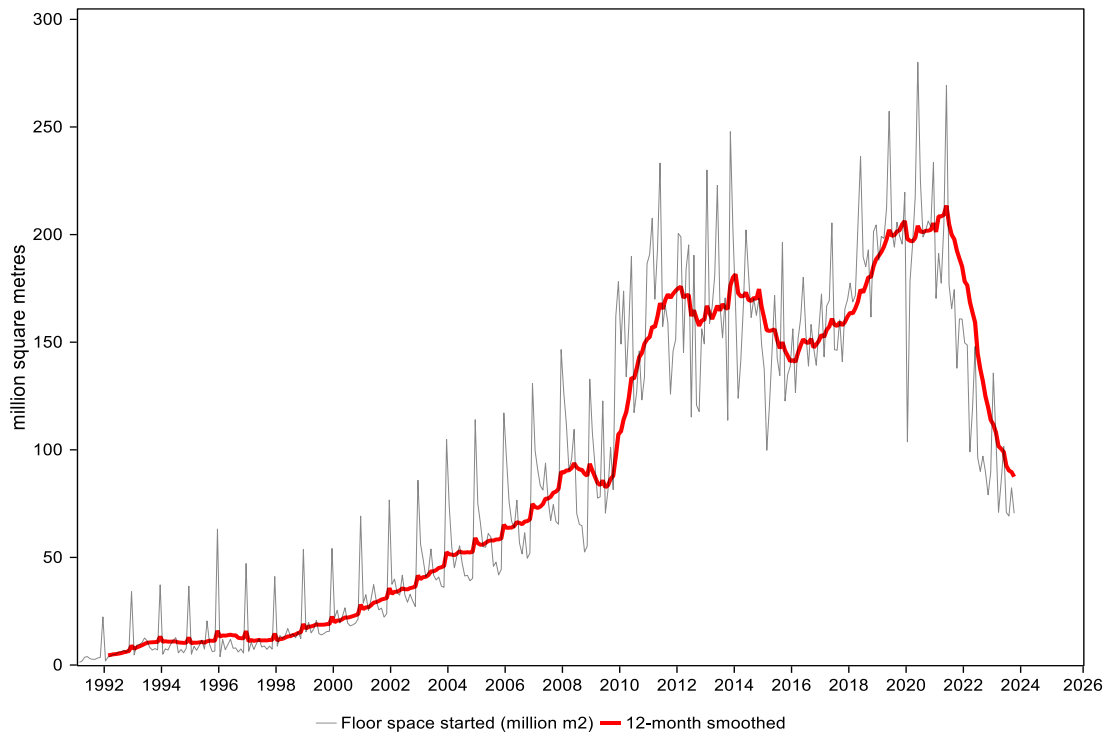
Source: Longview Economics, Macrobond

Fig 8i: Chinese M1 money supply (Y-o-Y %) vs. TSF (12 months smoothed)



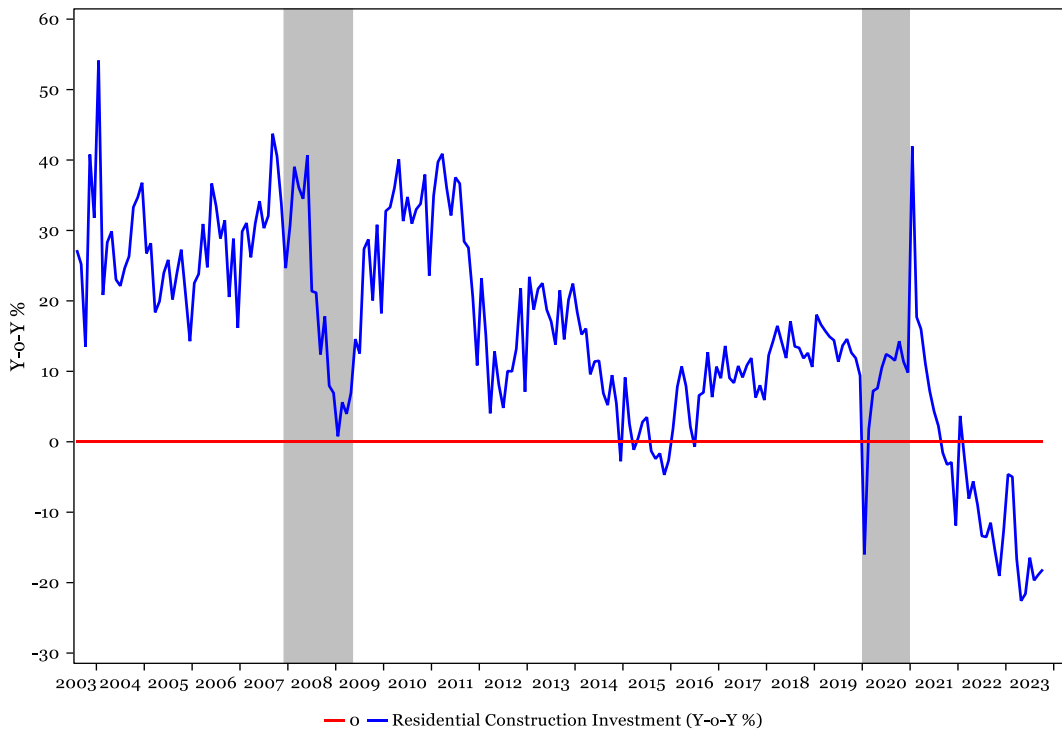
Source: Longview Economics, Macrobond

Fig 8j: Chinese floor space started (underlying with 12 month moving average)



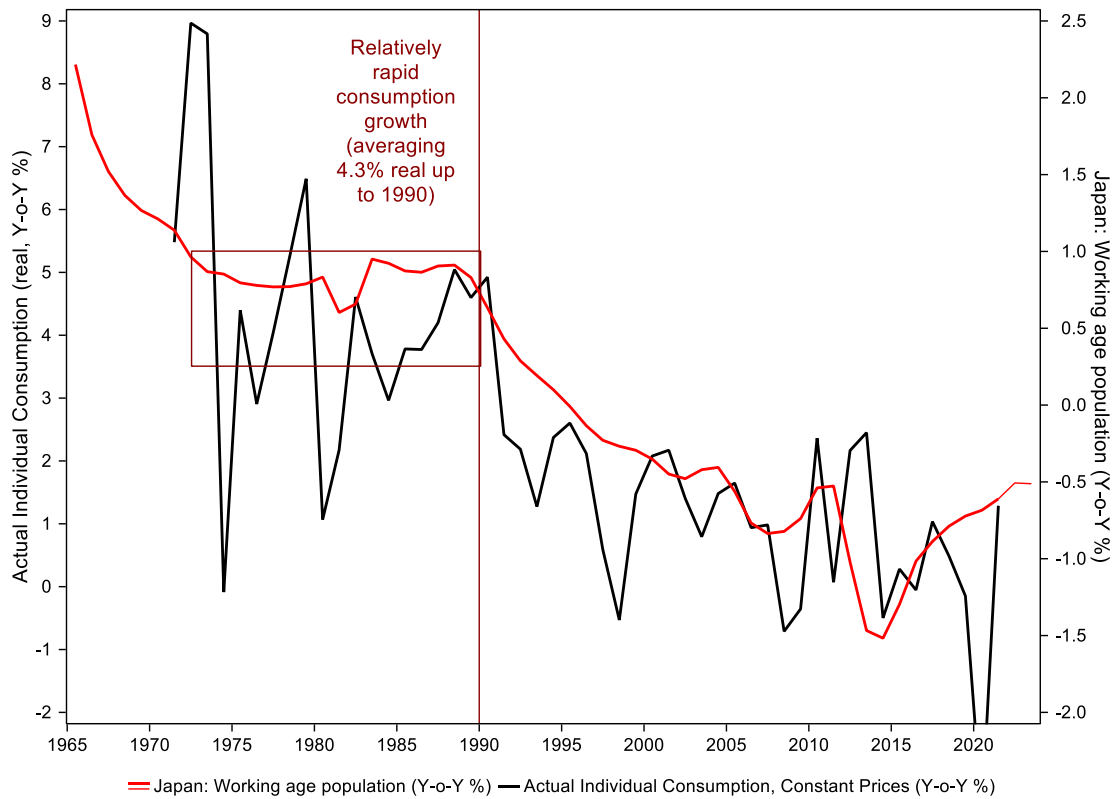
Source: Longview Economics, Macrobond

Fig 8k: Chinese residential construction investment (Y-o-Y %)



Source: Longview Economics, Macrobond

Fig 8I: Japanese consumption (Y-o-Y %) vs. working age population



Source: Longview Economics, Macrobond

Section 9: Global Valuation Chartbook 20th December 2023 Tech Overstretched: Changing of the Guard

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Section 9: Valuation Overview

While absolute valuation has limited use for timing cyclical bull and bear markets (see structural asset allocation no 14, May 2006: "Does Valuation Matter"), it does provide insights into market sensitivities to challenging (or indeed positive) economic environments. Added to that, relative valuation can be particularly useful – especially as a key building block for allocating between asset classes and geographies. This is why we dedicate a section of the quarterly global asset allocation to the analysis of valuation metrics.

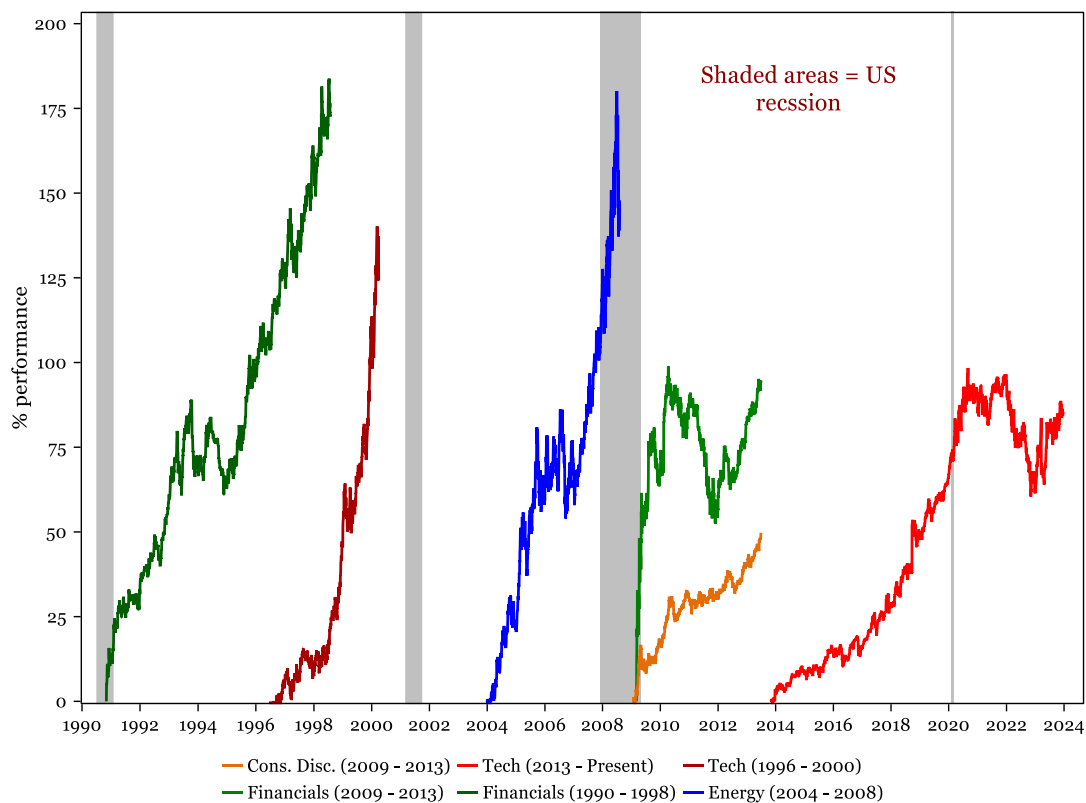
It's clear looking through history that markets have fashions. Every economic cycle has its distinctive characteristics in which different sectors take up leadership (as highlighted in prior research, e.g. 'Markets have Fashions' & 'The Bubble in Risk Free' – available [HERE](#) & [HERE](#)).

As we've stated previously:

"In the second half of the late 1990s, the market was TMT led; in the noughties (post 2000 – 2002 bear market) the market was led higher by energy, materials and banks; post GFC bust, the defensive sectors initially led the market through to 2015 (healthcare, consumer staples as well as consumer discretionary); while finally in recent years, it's been IT and growth stocks."

Source: 'Markets have Fashions', LV on Friday, 8th Jan 2022

Fig 9: S&P500 sector leadership (% performance of leading sectors)



Source: Longview Economics, Macrobond

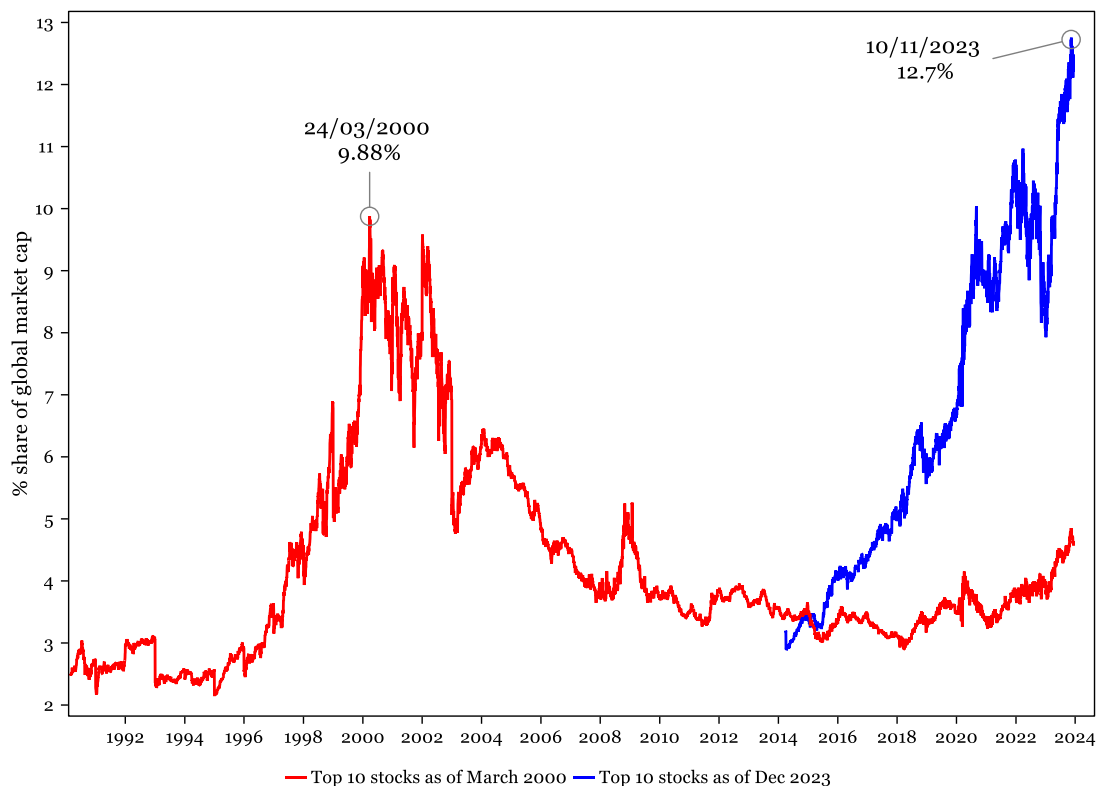
Tech has led equities higher since 2014, as highlighted in fig 9 above. But, with ‘fashions’ usually only lasting between 5 – 8 years, the key question is: For how long will the current fashion continue? Are we about to see another major shift in sector leadership?

Usually, fashions change when (i) a new macro theme emerges; and (ii) valuation discrepancies become extreme. Regarding (i), please see the front section of our quarterly asset allocation (due this week).

With respect to (ii), from a valuation perspective, three factors currently point to a forthcoming switch in leadership. All of which draw strong parallels between the current cycle and the 2000s dotcom bubble. In particular:

1. Both periods were dominated by tech sector outperformance, with tech stocks making up a significant share of global market cap (both then and now). **Today’s mega cap stocks, though, make up a larger share of the global market share than they did in the dotcom bubble.** In the early 2000s⁹, the top 10 stocks made up 9.9% of the global market cap (at their peak). Today, they make up 12.7%⁹ⁱ (fig 9i). In other words, the breadth of market leadership is narrower today than during the dotcom bubble (on that measure). On that basis, therefore, tech sector dominance has become overstretched, which is typical ahead of market leadership switches.

Fig 9i: Top 10 stocks (2000 & 2023) as a share of global market cap (%)



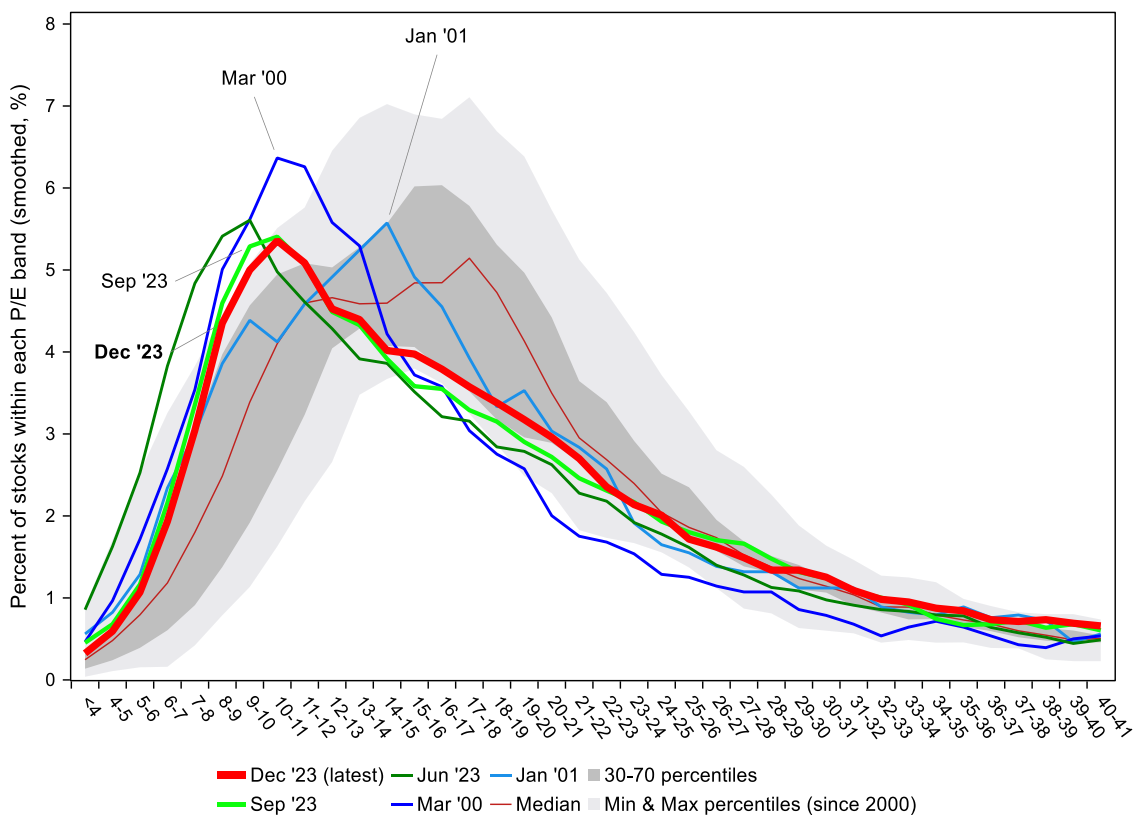
Source: Longview Economics, Macrobond

⁹ In 2000, the top 10 stocks by market cap were: General Electric, Microsoft, Cisco, Texas Instruments, Exxon Mobil, Procter & Gamble, Walmart, Oracle, IBM, Citigroup.

⁹ⁱ In 2023, the top 10 stocks by market cap were: Apple, Microsoft, Amazon, Google, Nvidia, Tesla, Berkshire Hathaway, Meta, Eli Lilly, Broadcom.

- The distribution of single-stock PEs model remains heavily skewed to the left (fig 9ii) as it was in early 2000. While the distribution has shifted somewhat to the right since our last update in September, it remains skewed to the left compared to the historic median. The distribution remains similar to the 2000s tech bubble. This chart below is therefore another way of showing that **America's rich valuation is** driven by a small number of mega-cap stocks (while most other stocks within the S&P500 remain cheap relative to history). Indeed, further supporting that, small cap equity indices are at 20-year low valuations relative to the S&P500 (see fig 9viii).

Fig 9ii: Distribution of individual underlying single stock PERs (US market)



Source: Longview Economics, Macrobond, FactSet

- Other key models point to a major shift in market leadership in coming months/quarters. The Longview proprietary valuation model, for example, is now generating its first **strong SELL** message since the bursting of the dotcom bubble in early 2000 (fig 9iii). Historically, this model has generated timely SELL/strong SELL signals ahead of many key market downturns/bear markets, including ahead of the 2000 – 02 and 2007 – 09 bear markets, as well as the '87 crash and the early '80s recession (i.e. major turning points in sector leadership). That further highlights the expensiveness of the US (which is dominated by tech stocks).

Consistent with that, various US ERP models have fallen sharply and are back at levels of the early 2000s (i.e. signalling that equities are expensive relative to real bond yields/cash rates, see figs 9iv & 9xii).

Overall, therefore, a change in market leadership seems likely in coming months and quarters. The question is: Which sectors, and therefore which country indices are likely to take up that leadership?

Please see the sections below for sector and regional equity valuation analysis.

Fig 9iii: Longview proprietary valuation model vs. S&P500 (log scale)

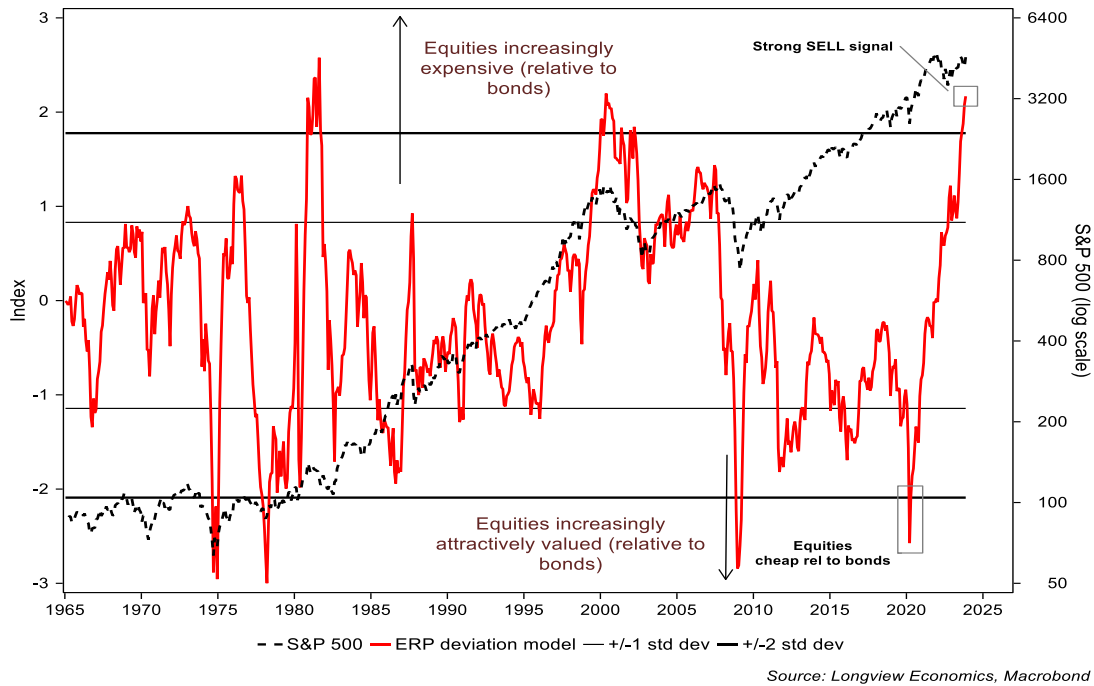
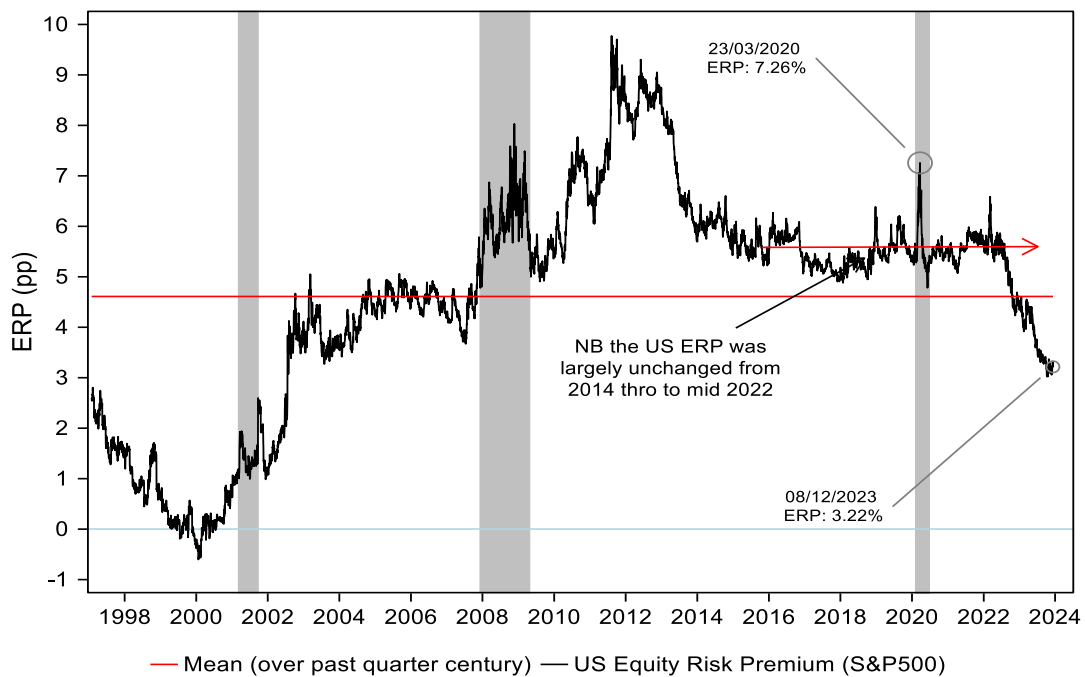


Fig 9iv: US equity risk premium (earnings yield less real bond rate)



Relative Sector Valuations

As highlighted above, and shown in fig 9ix, tech valuations are notably high on a standalone basis. Tech/growth stocks are also, though, over-stretched relative to other sectors and equity indices, from a valuation perspective.

In a general sense, for example, the valuation premium of US growth stocks relative to an (equally weighted) basket of (i) defensive; and (ii) cyclical sectors has become extreme (e.g. see fig 9v below). Equally, compared to both US & global equity indices, Tech's **valuation premium** recently reached a +1 std deviation (e.g. fig 9x).

Fig 9v: US tech valuation premium/discount relative to defensives (%)



Source: Longview Economics, Macrobond

The key question, therefore, becomes: Which sectors are attractive? Which sectors **could become the next ‘fashion’?**

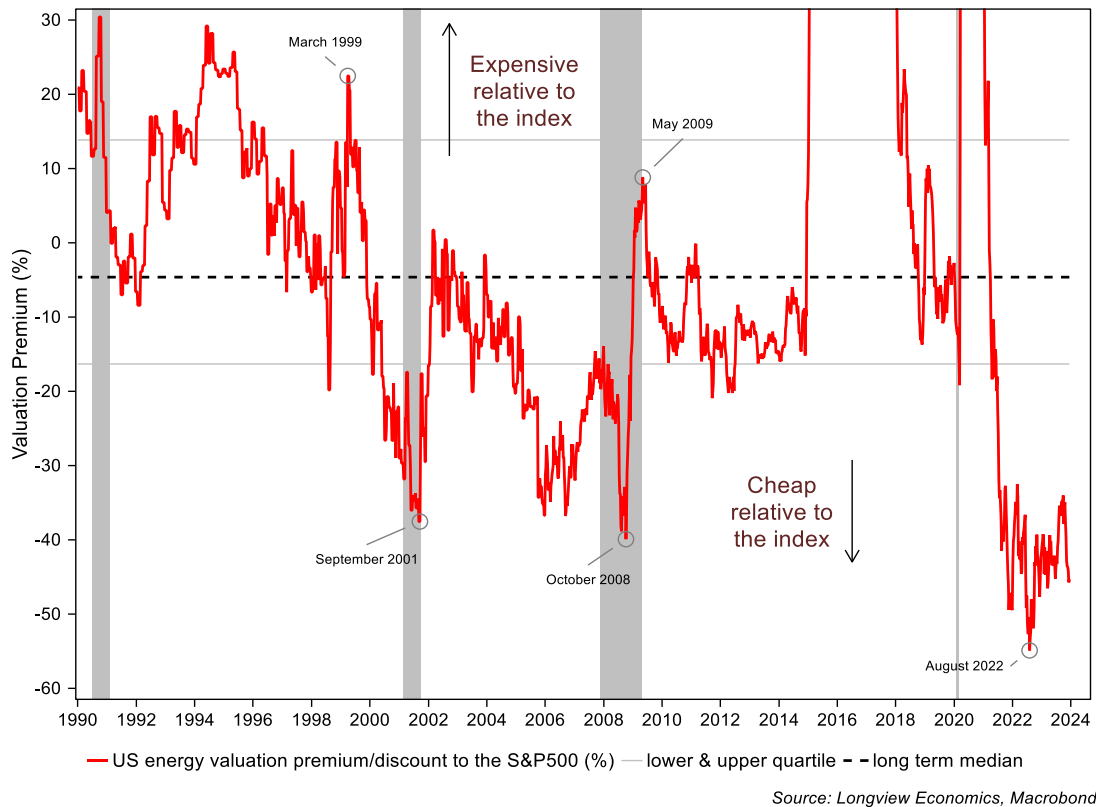
Energy, in particular, is the cheapest relative to other US sectors. As shown in the US sector heatmap below (fig 9xv), energy PERs are in their second percentile relative to history (vs. the S&P500 index). Indeed, energy is now trading at a deeper valuation discount than at the 2001 or 2008 lows (fig 9vi below). When compared to tech, the energy sector is at its lowest relative valuation since the early noughties (fig 9xi).

Added to which, from a fundamental perspective, **there’s a strong** case for higher energy prices and, more broadly, a commodity supercycle (as outlined [HERE](#) & [HERE](#)). Historically, chronic underinvestment in supply results in a

prolonged period of high commodity prices. That has been the case this past decade and supports the expectation that energy will **become the new ‘fashion’**. That, if it happened, would draw another parallel with the dotcom bubble (i.e. with energy taking up leadership in the early noughties, see fig 9).

From a global perspective, energy, consumer staples and financials are the cheapest sectors relative to the others (see the heatmap in fig 9aii).

Fig 9vi: US energy valuation premium/discount relative to the S&P500 (%)



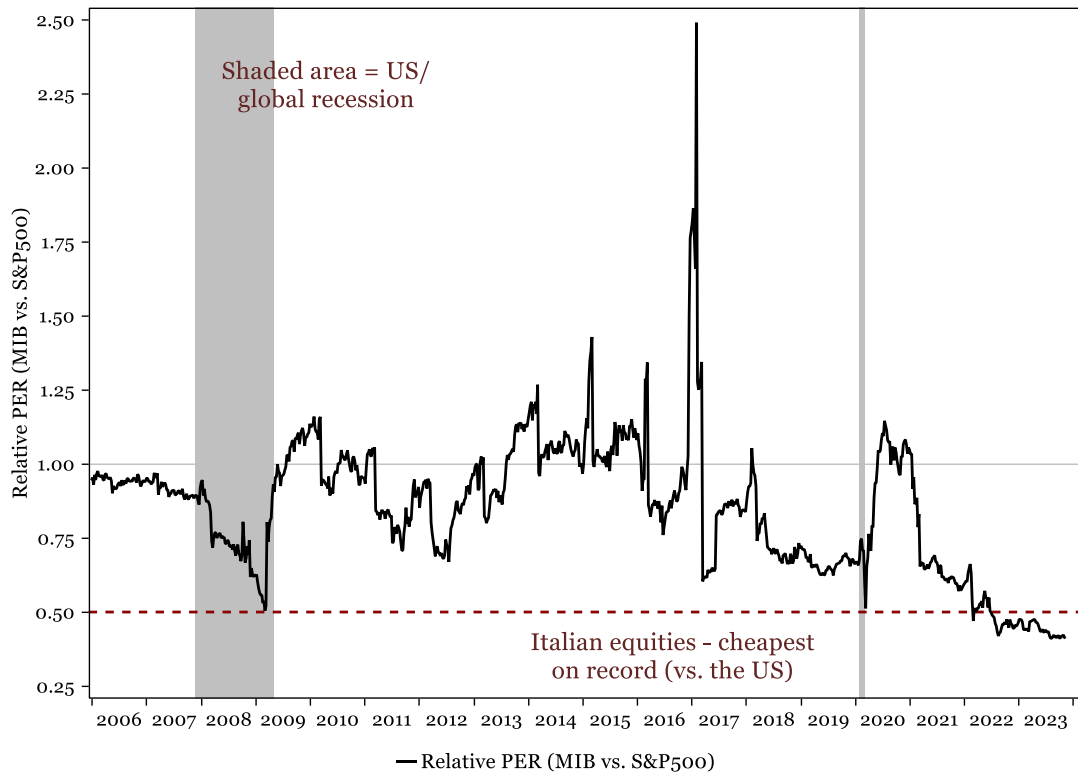
Relative Valuations (by Geography)

Consistent with extreme tech valuations (vs. other sectors), US equities are overstretched relative to other major global equity markets. The US is now the fourth most expensive market we track (relative to forty-two other major country stock markets, see fig 9ai). It is the second most expensive on a country-by-country relative PE basis (currently in its 83rd percentile on average, just behind India which is in its 90th percentile – see fig 9aii).

Consistent with that, Europe is extremely cheap (and has continued to derate this year, relative to US/global equities). European forward PEs have reached their lowest level since 1992 (relative to the global PER, fig 9cii). Within Europe, Spanish equities remain attractive (for various reasons, as highlighted earlier this month, see [HERE](#)). Italy, similarly, is also cheap on a relative valuation basis (e.g. relative to the US, see fig 9vii below, and other European indices, see figs 9ai & 9aii), while the UK is close to record cheap levels vs. the rest of the world (see fig 9xiii).

Elsewhere, emerging markets broadly remain mid-range on a relative PER basis (e.g. see figs 9cvi & 9gi – 9giii). Within that, though, several **countries/regions are relatively cheap**. Most notably, **China’s PER has sunk to its 16th percentile** when compared to the global PER (fig 9aii). In contrast, India is now the most expensive market we track (now in its 90th percentile on average relative to other major economies, see fig 9xiv).

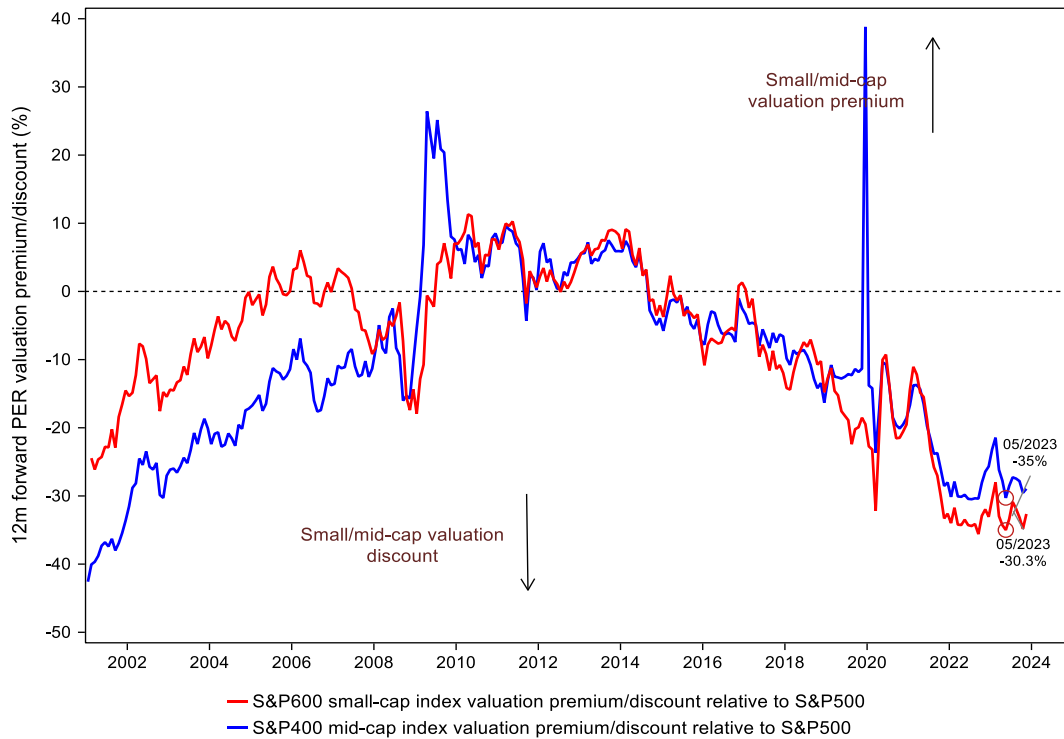
Fig 9vii: Italian forward PER relative to the US market (i.e. MIB vs. S&P500)



Source: Longview Economics, Macrobond

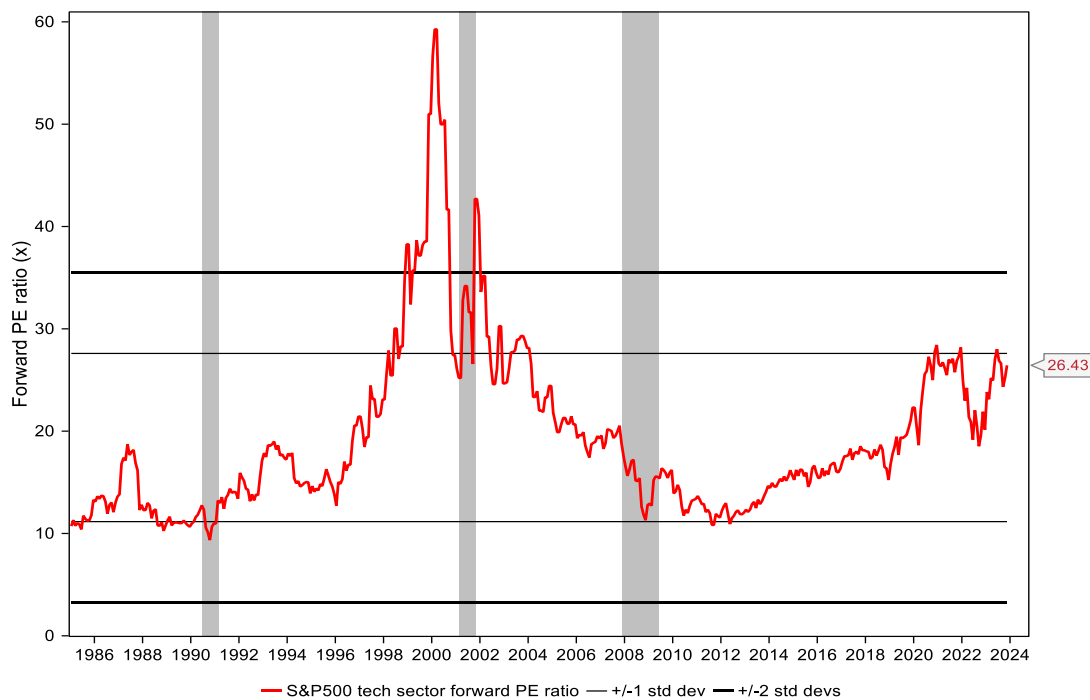
Key Charts

Fig 9viii: Small & mid-cap valuation premium/discount relative to index (S&P indices)



Source: Longview Economics, Macrobond, FactSet

Fig 9ix: US tech sector forward PE ratio (x)



Source: Longview Economics, Macrobond

Fig 9x: US tech valuation premium/discount relative to global PE (%)

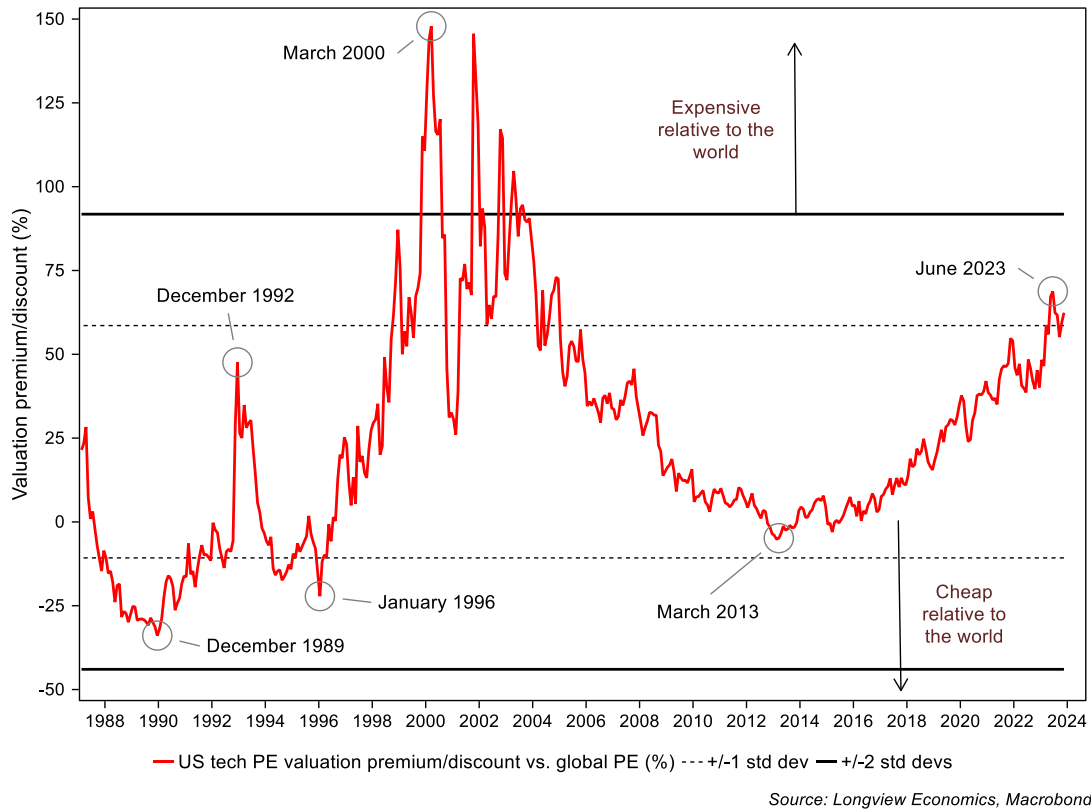


Fig 9xi: US energy valuation premium/discount relative to tech (%)

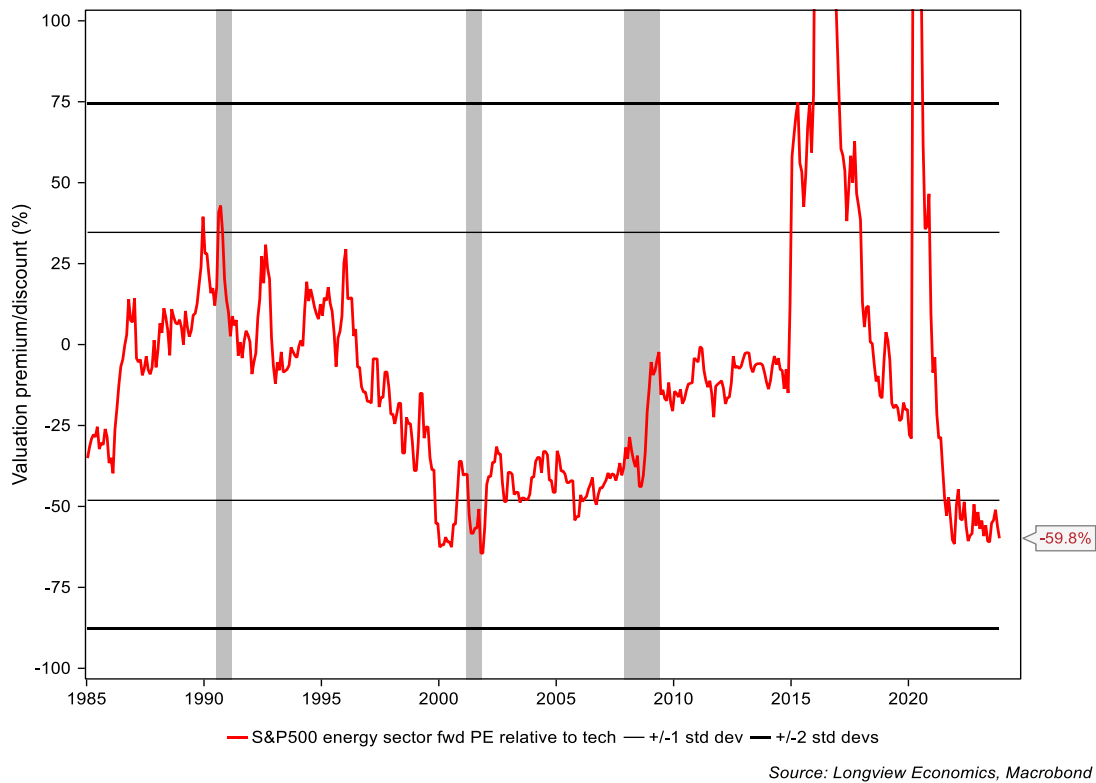
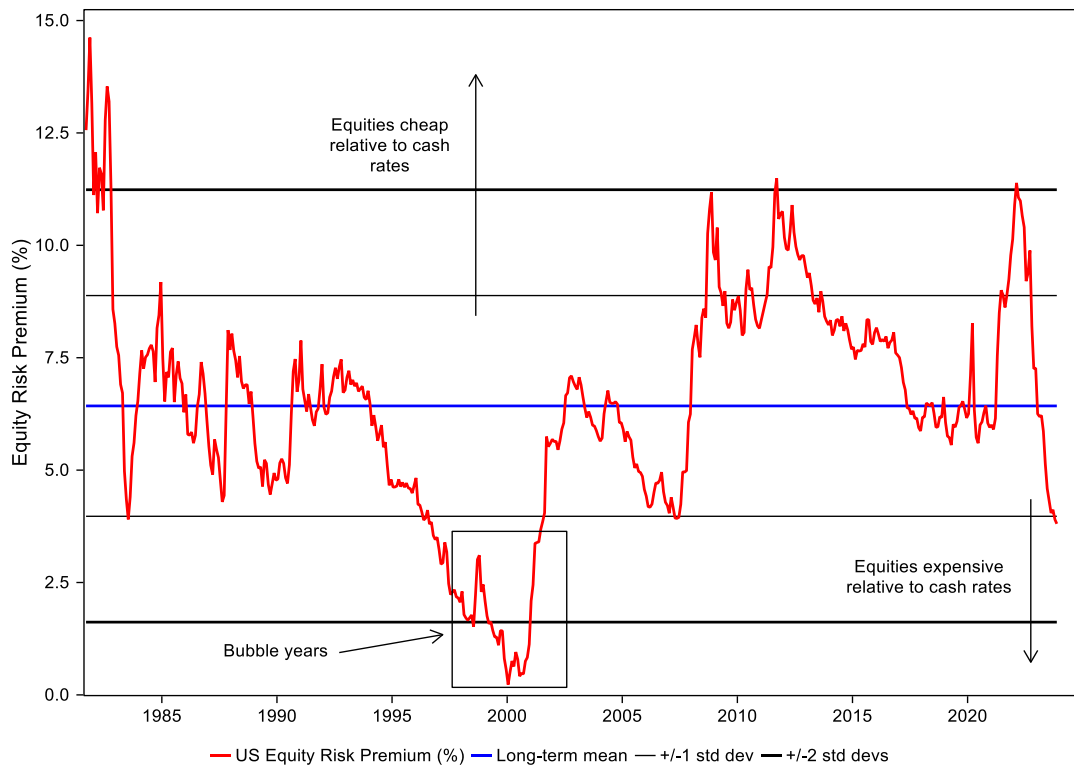
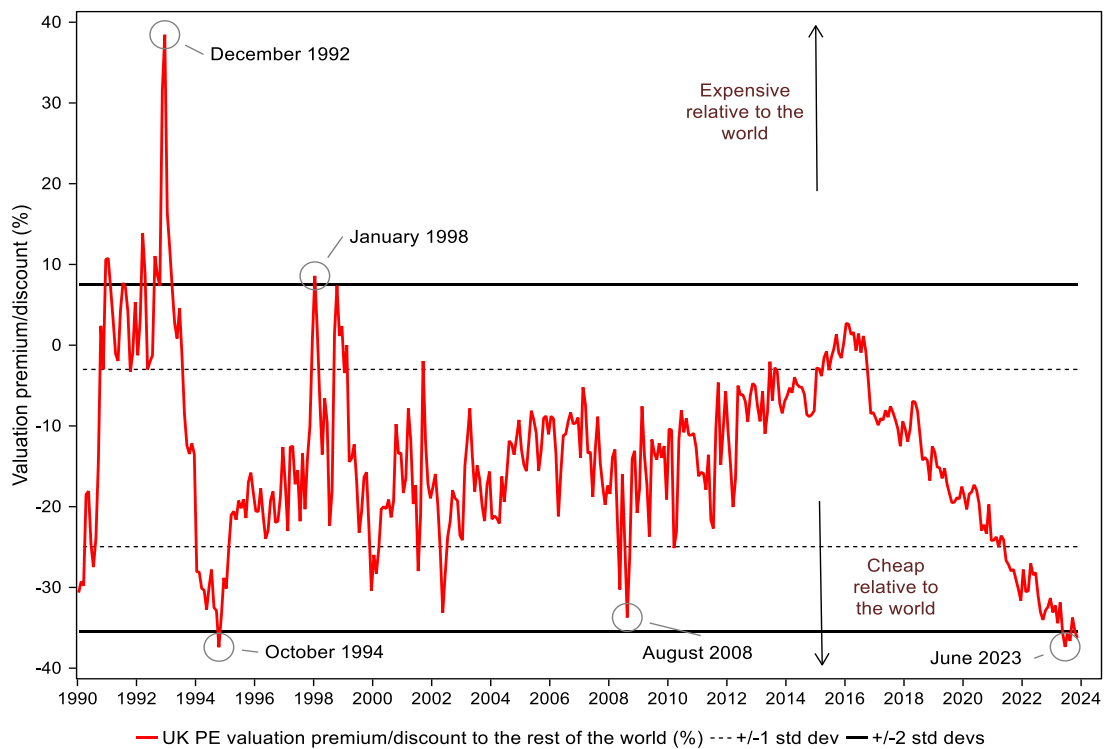


Fig 9xii: US Equity Risk Premium (earnings yield less [real cash rate](#))



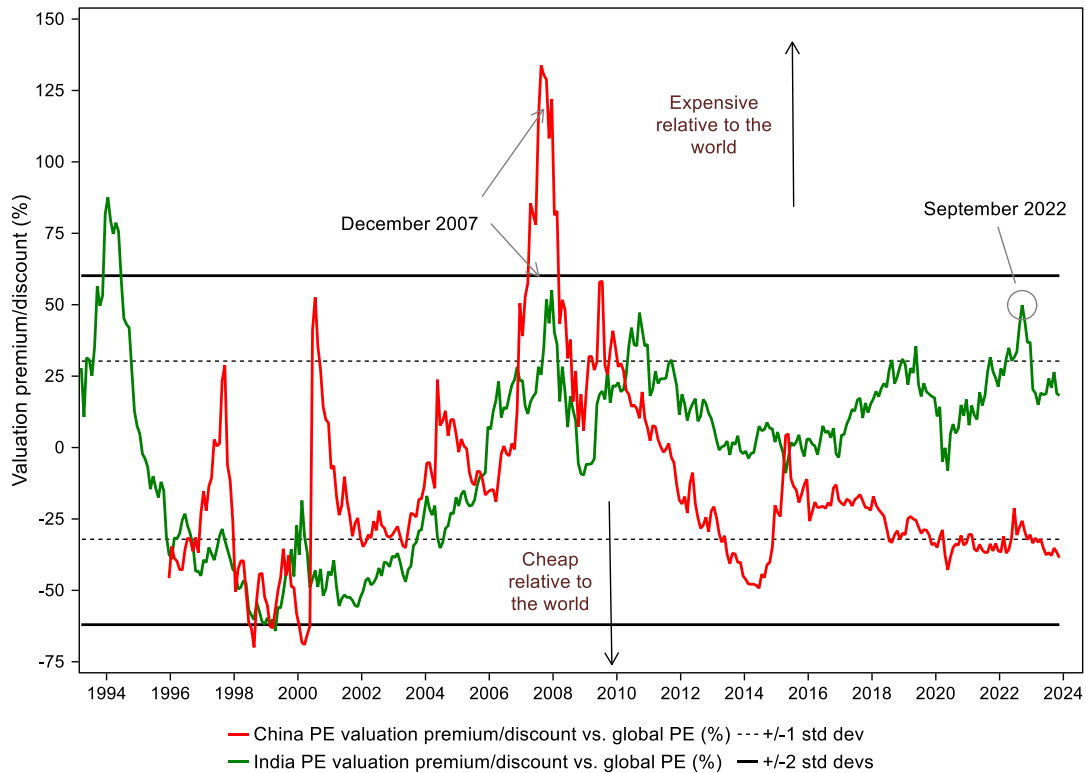
Source: Longview Economics, Macrobond

Fig 9xiii: UK valuation premium/discount relative to the world (%)



Source: Longview Economics, Macrobond

Fig 9xiv: China & India valuation premium/discount vs. global PE (%)



Source: Longview Economics, Macrobond

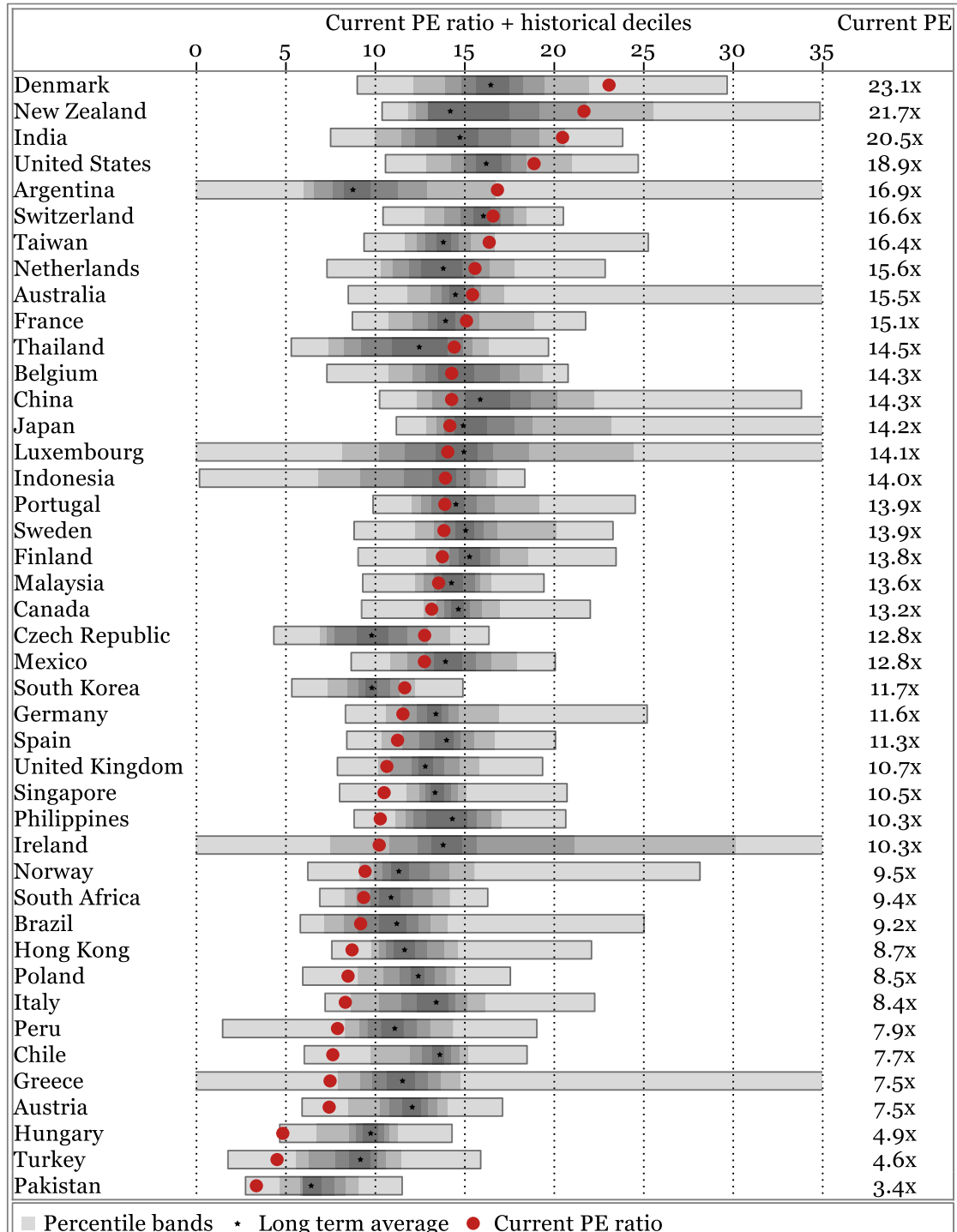
Fig 9xv: US sector PE heatmap

	Cons disc.	Cons. staples	Energy	Financials	Health care	Industrials	Info tech	Materials	Real Estate	Comms Services	Utilities	Index
Cons disc.		8	2	19	11	21	57	32	13	14	19	14
Cons. staples	93		6	91	64	89	90	91	34	65	58	94
Energy	99	95		98	93	98	98	100	83	95	94	99
Financials	82	10	3		31	67	82	77	5	30	49	68
Health care	90	37	8	70		81	93	81	8	63	54	83
Industrials	80	12	3	34	20		86	63	10	28	38	59
Info tech	44	11	3	19	8	15		27	1	13	21	18
Materials	69	10	1	24	20	38	74		1	29	30	42
Real Estate	88	67	18	96	93	91	100	100		95	28	99
Comms Services	87	36	6	71	38	73	88	72	6		71	79
Utilities	82	43	7	52	47	63	80	71	73	30		67
Index	87	7	2	33	18	42	83	59	2	22	34	

Source: Longview Economics

Section 9a: Headline Country PE ratios

Fig 9ai: Standalone broad index* PE ratios – various country indices (based on rolling 12m forward EPS)



Source: Longview Economics, Macrobond

* NB are broad indices created by Factset aiming to capture the whole investable universe of stocks.

Fig 9aii Cross-country PE heatmap

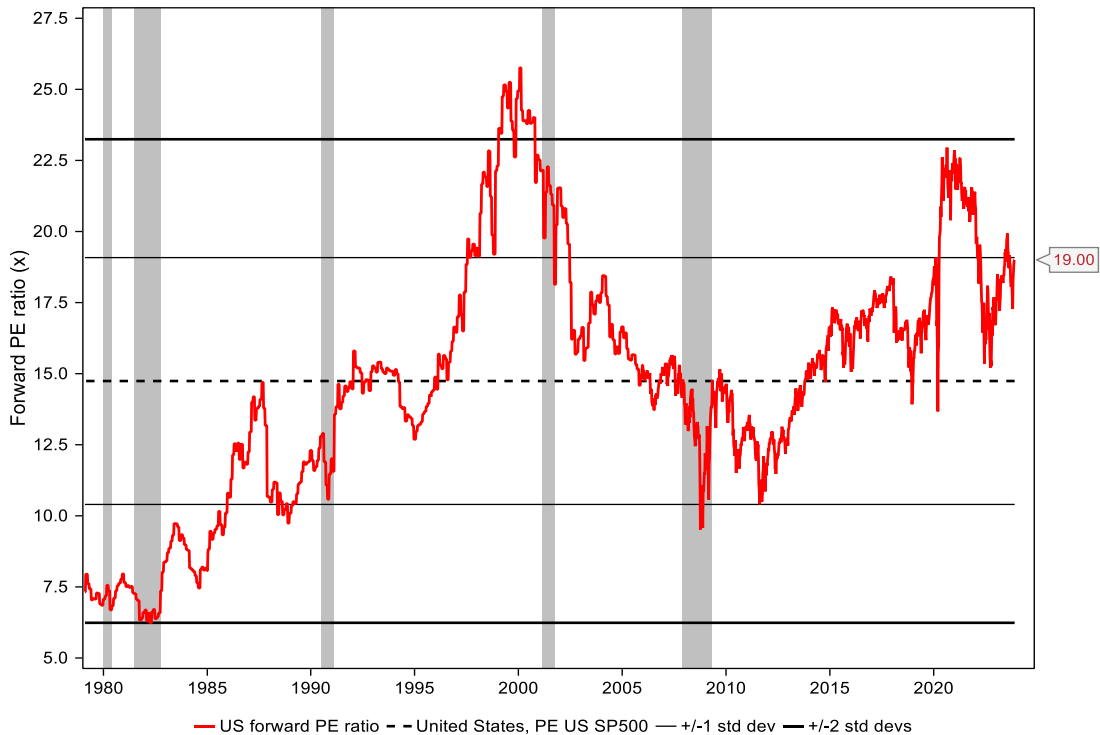
	Australia	Canada	France	Germany	Italy	Japan	Netherlands	Spain	Sweden	Switzerland	United Kingdom	United States	Brazil	China	India	Indonesia	Korea	Mexico	Russia	South Africa	Taiwan	Turkey	World	EM	BRIC	Asia Ex-Japan	LaiAm	Europe	EMU	Emerging Europe	Average
Australia		10	17	4	4	33	33	12	23	40	2	63	10	15	80	33	46	12	12	7	48	4	54	21	25	15	7	6	24	31	24
Canada	91		48	36	4	48	74	32	70	81	11	95	32	34	91	64	71	49	13	29	64	6	64	59	68	49	28	43	49	50	50
France	84	53		13	3	45	84	32	78	91	12	98	39	35	93	61	71	47	13	35	65	15	84	56	65	51	32	43	59	54	52
Germany	97	65	88		3	61	87	54	91	95	44	99	47	46	97	75	90	56	14	57	79	23	98	74	76	72	43	78	91	60	68
Italy	97	97	98	98		80	98	95	98	97	96	98	68	79	97	95	96	87	29	88	88	32	98	91	92	94	70	98	98	80	87
Japan	68	53	56	40	21		72	46	63	73	39	89	47	31	86	61	78	46	13	53	78	22	80	55	57	60	42	53	58	39	54
Netherlands	68	27	17	14	3	29		9	39	55	5	78	26	27	84	47	63	33	11	19	50	7	49	43	51	31	22	6	22	44	34
Spain	89	69	69	47	6	55	92		85	94	31	98	46	47	94	66	73	56	14	45	66	19	89	64	72	59	43	68	74	56	62
Sweden	78	31	23	10	3	38	62	16		68	11	81	34	26	90	52	64	35	11	26	58	12	62	44	55	33	26	17	25	39	39
Switzerland	61	20	10	6	4	28	46	7	33		4	73	25	16	84	41	54	26	12	16	45	6	41	28	39	14	14	7	11	30	28
United Kingdom	99	90	89	57	5	62	96	70	90	97		99	46	59	95	83	83	62	14	55	76	17	95	73	77	68	42	94	86	63	70
United States	38	6	3	2	3	12	23	3	20	28	2		26	12	67	30	36	26	10	18	39	5	4	20	29	10	19	2	2	17	18
Brazil	91	69	62	54	33	54	75	55	67	76	55	75		50	92	86	83	60	17	58	72	16	72	70	78	63	35	64	61	59	62
China	86	67	66	55	22	70	74	54	75	85	42	89	51		97	72	83	61	15	55	80	11	85	79	82	70	46	65	67	57	64
India	21	10	8	4	4	15	17	7	11	17	6	34	9	4		11	15	8	11	6	24	6	19	8	4	3	8	7	10	12	11
Indonesia	67	36	40	26	6	40	54	35	49	60	18	71	15	29	90		53	25	13	16	52	11	59	43	45	40	12	35	41	47	39
Korea	55	30	30	11	5	23	38	28	37	47	18	65	18	17	86	48		29	11	25	40	12	49	21	39	23	15	28	31	32	31
Mexico	89	52	54	45	14	55	68	45	66	75	39	75	41	40	93	76	72		17	43	62	8	68	59	65	51	21	55	55	49	54
Russia	89	88	88	87	72	88	90	87	90	89	87	91	84	86	90	88	90	84		86	91	45	89	88	88	88	82	88	89	81	86
South Africa	94	72	66	44	13	48	82	56	75	85	46	83	43	46	95	85	76	58	15		59	12	75	59	75	52	24	68	64	54	59
Taiwan	53	37	36	22	13	23	51	35	43	56	25	62	29	21	77	49	61	39	10	42		15	55	44	45	36	26	35	38	33	38
Turkey	97	95	86	78	69	79	94	82	89	95	84	96	85	90	95	90	89	93	56	89	86		93	90	93	86	84	87	86	88	87
World	47	37	17	3	3	21	52	12	39	60	6	97	29	16	82	42	52	33	12	26	46	8		25	39	14	24	13	10	28	31
EM	80	42	45	27	10	46	58	37	57	73	28	81	31	22	93	58	80	42	13	42	57	11	76		65	35	11	44	45	43	47
BRIC	76	33	36	25	9	44	50	29	46	62	24	72	23	19	97	56	62	36	13	26	56	8	62	36		31	11	33	38	32	39
Asia Ex-Japan	86	52	50	29	7	41	70	42	68	87	33	91	38	31	98	61	78	50	13	49	65	15	87	66	70		28	49	52	49	54
LaiAm	94	73	69	58	31	59	79	58	75	87	59	82	66	55	93	89	86	80	19	77	75	17	77	90	90	73		71	67	60	69
Europe	95	58	58	23	3	48	95	33	84	94	7	99	37	36	94	66	73	46	13	33	66	14	88	57	68	52	30		51	56	54
EMU	77	52	42	10	3	43	79	27	76	90	15	99	40	34	91	60	70	46	12	37	63	15	91	56	63	49	34	51		52	51
Emerging Europe	70	51	47	41	21	62	57	45	62	71	38	84	42	44	89	54	69	52	20	47	68	13	73	58	69	52	41	45	49		53
Average	77	51	49	33	14	47	67	39	62	73	31	83	39	37	90	62	70	47	15	42	63	14	70	54	62	47	32	47	50	48	

On a relative valuation basis (i.e. using forward PE ratios) compared with other indices since 1980 (data permitting) and then scored by percentile, Turkey is the world's cheapest major equity market. India is the most expensive by this metric. NB this table should be read as 'column header' relative to 'row header' - i.e. Australia is in its 91st most expensive percentile relative to Canada (compared to history).

Source: Longview Economics, Bloomberg

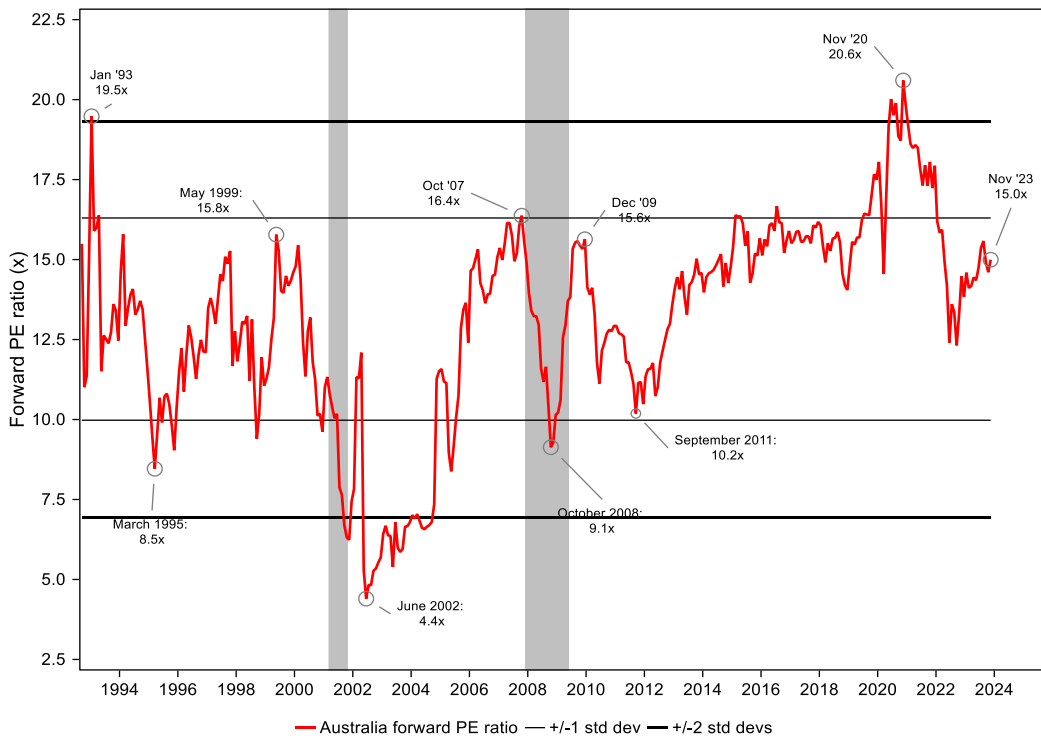
Section 9b: Standalone PE ratios of certain expensive/cheap countries

Fig 9bi: S&P500 12m forward PE ratios (based on rolling consensus EPS)



Source: Longview Economics, Macrobond

Fig 9bii: Australia forward PE ratio (based on rolling consensus EPS)



Source: Longview Economics, Macrobond

Fig 9biii: Chinese 12m forward PE ratios (based on rolling consensus EPS)

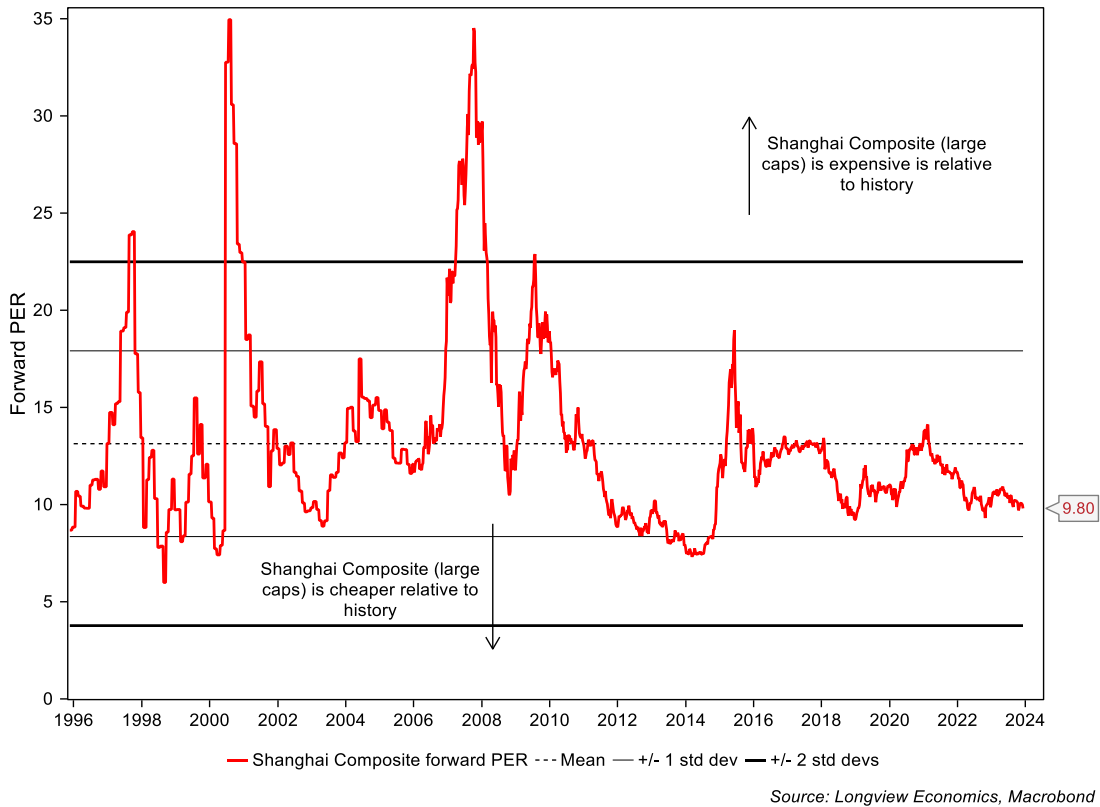
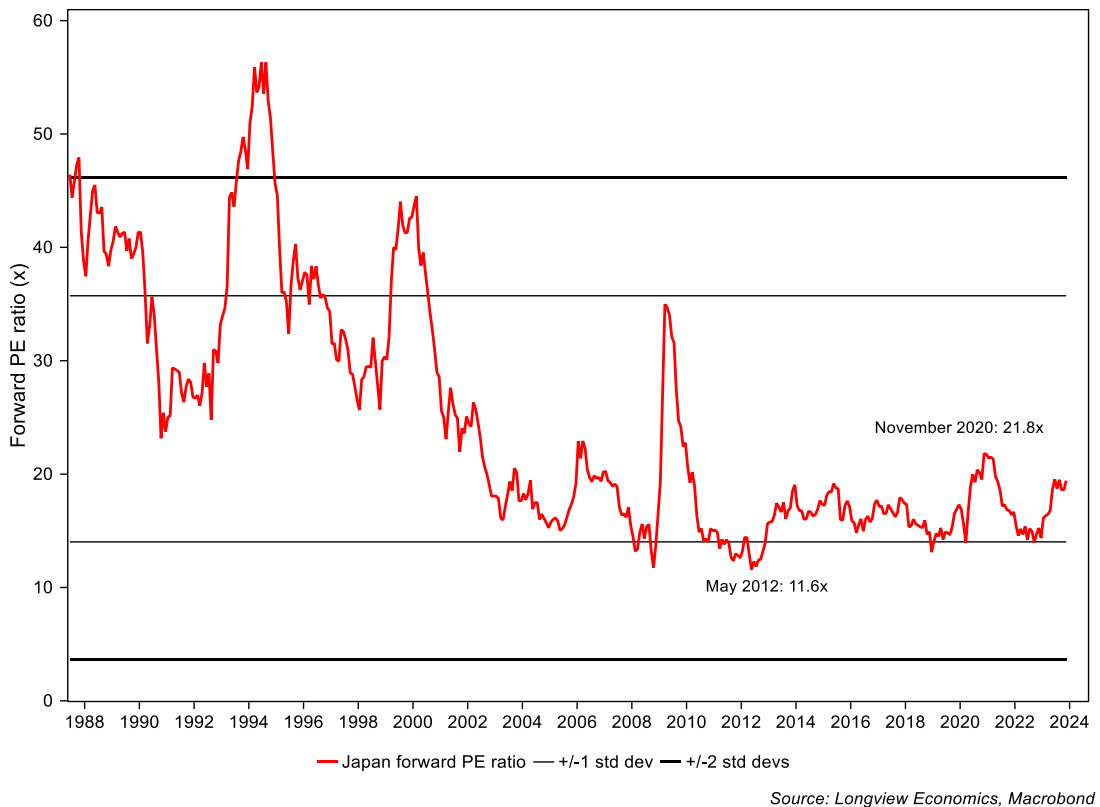
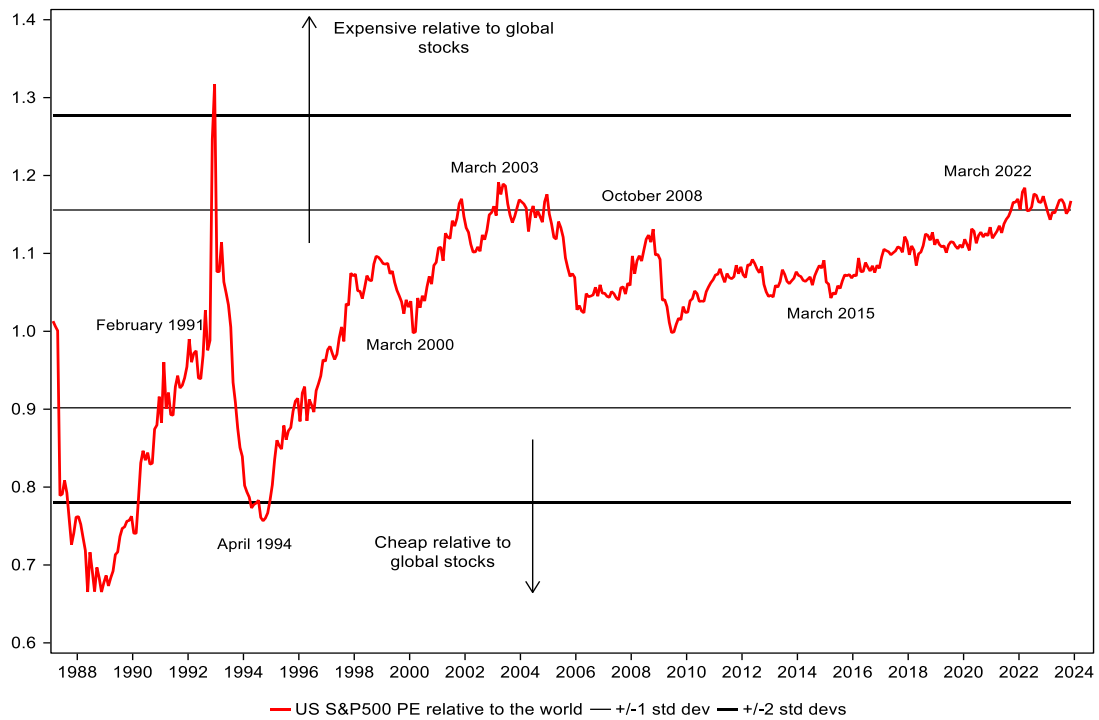


Fig 9biv: Japan 12m forward PE ratio (based on rolling consensus EPS)



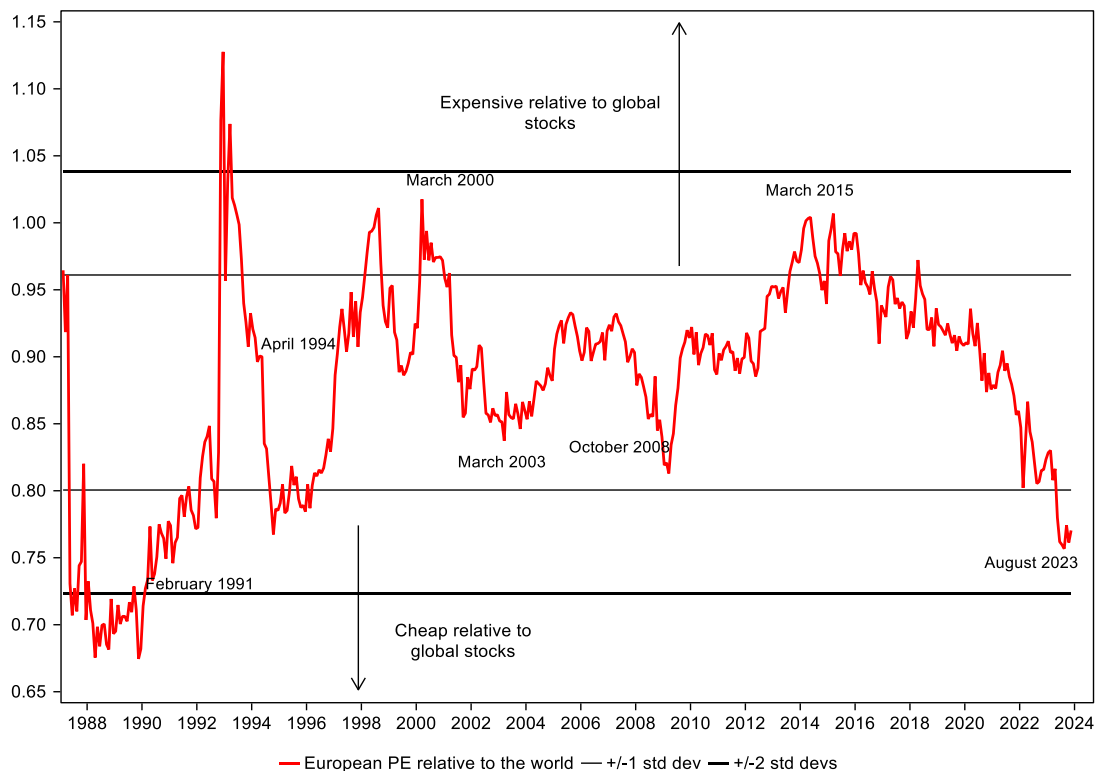
Section 9c: Various country PER relative to global PER (both on forward EPS)

Fig 9ci: US 12m forward PE relative to global 12m forward PE



Source: Longview Economics, Macrobond

Fig 9cii: European 12m forward PE relative to global 12m forward PE



Source: Longview Economics, Macrobond

Fig 9ciii: Chinese 12m forward PE relative to global 12m forward PE

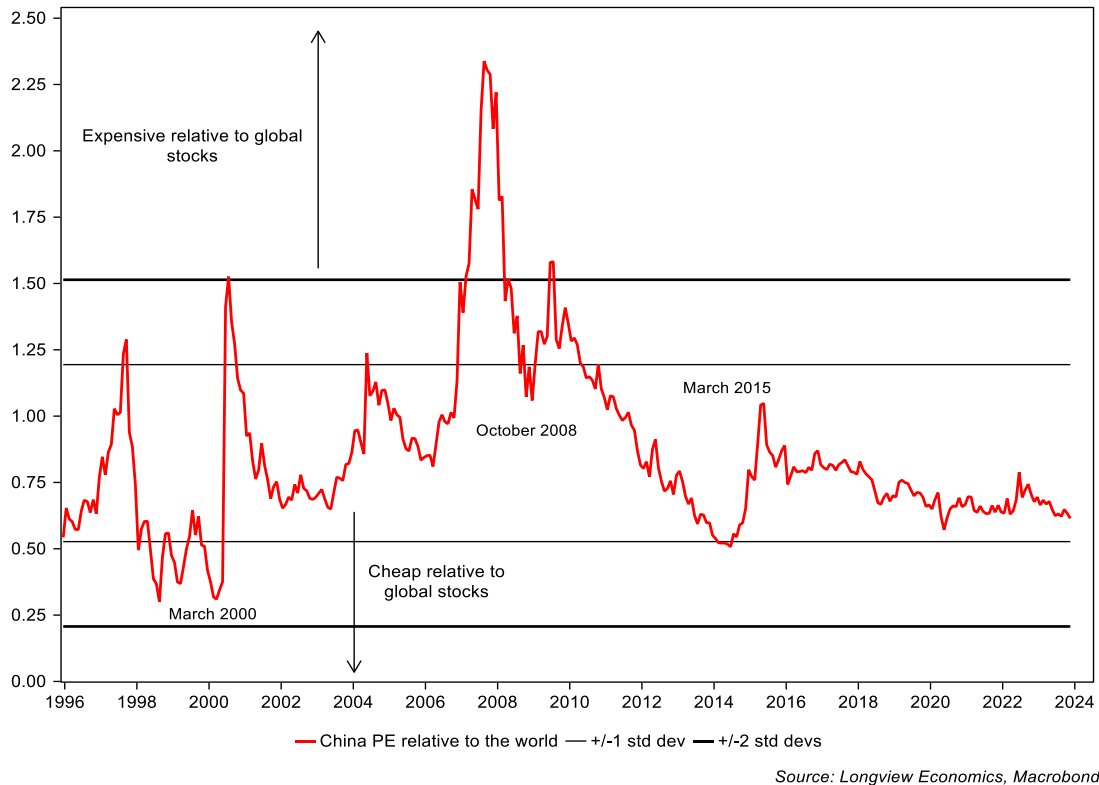


Fig 9civ: India 12m forward PE relative to global 12m forward PE

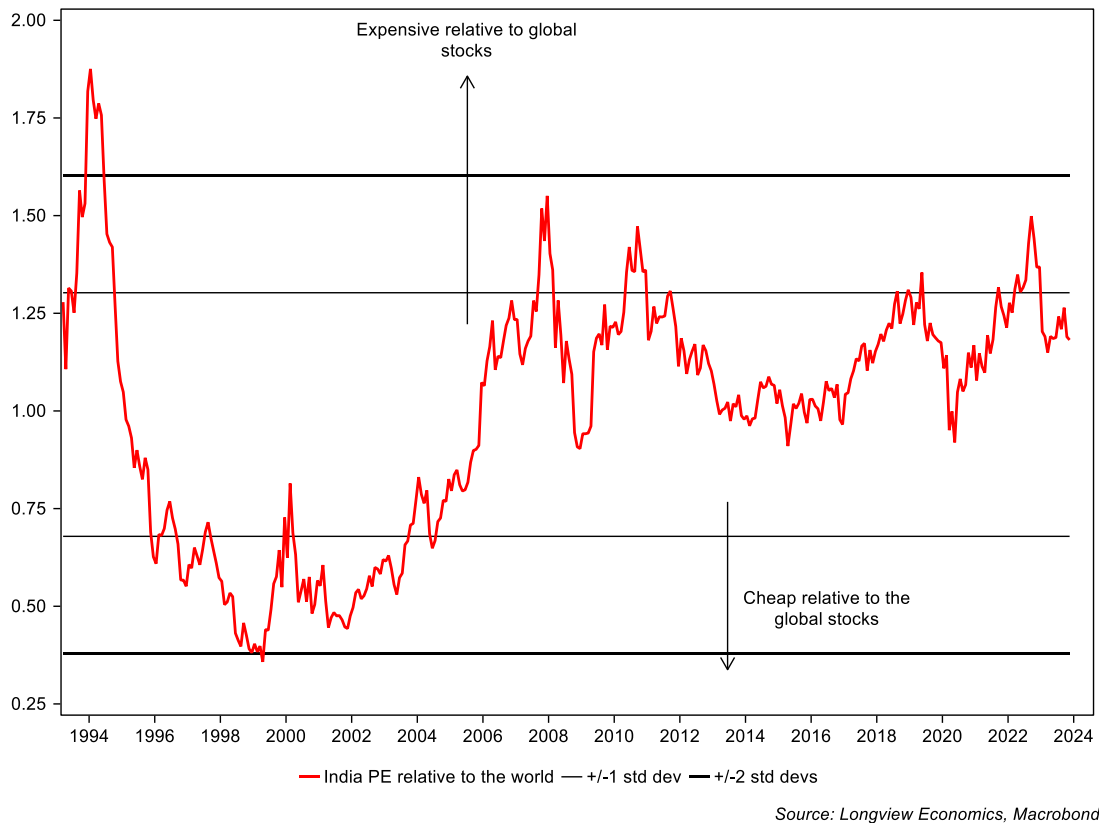


Fig 9cv: UK 12m forward PE relative to global 12m forward PE

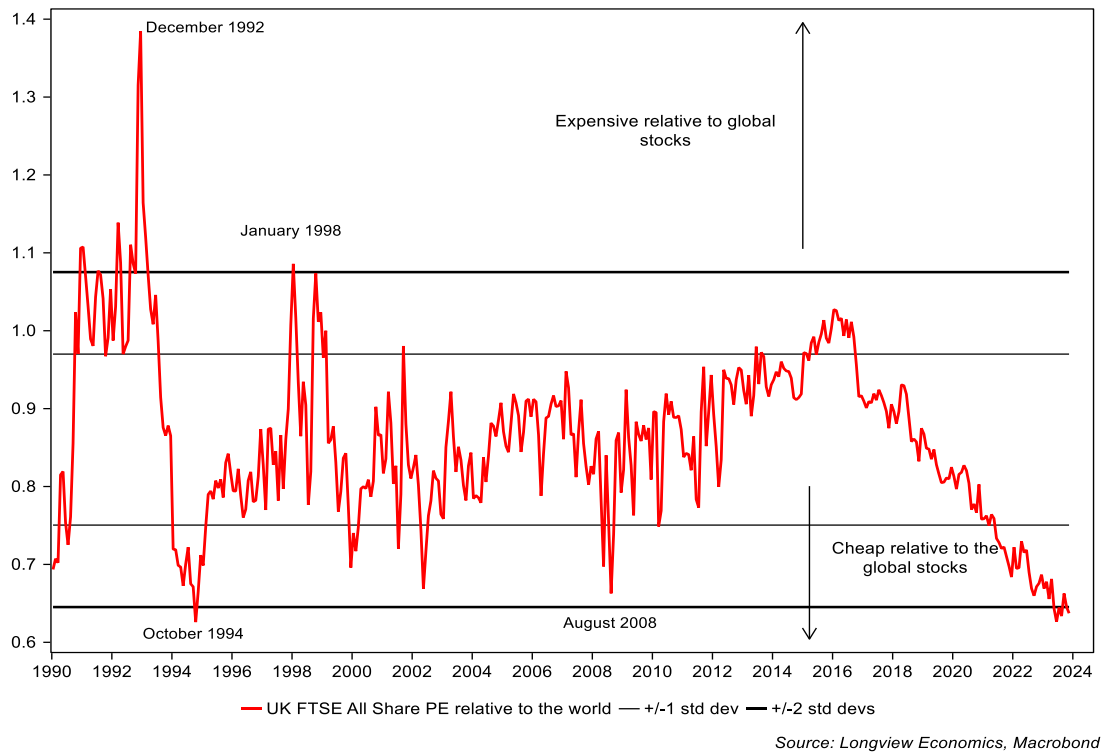
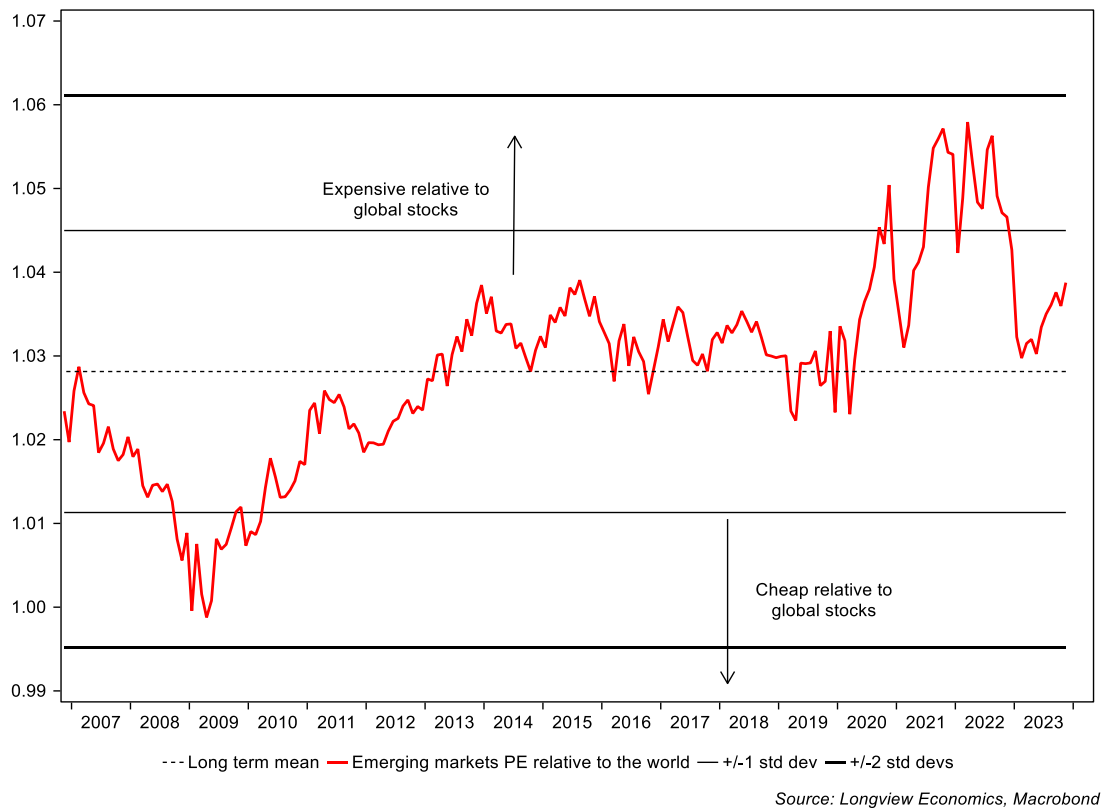
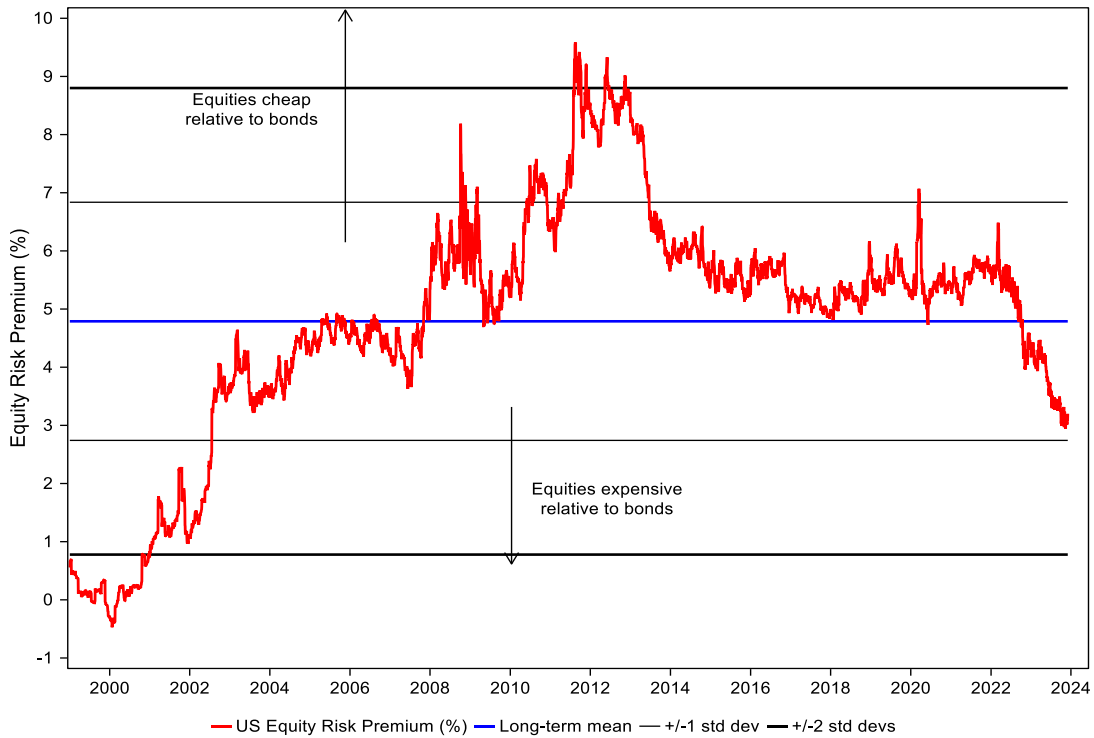


Fig 9cvi: EM 12m forward PE relative to global 12m forward PE



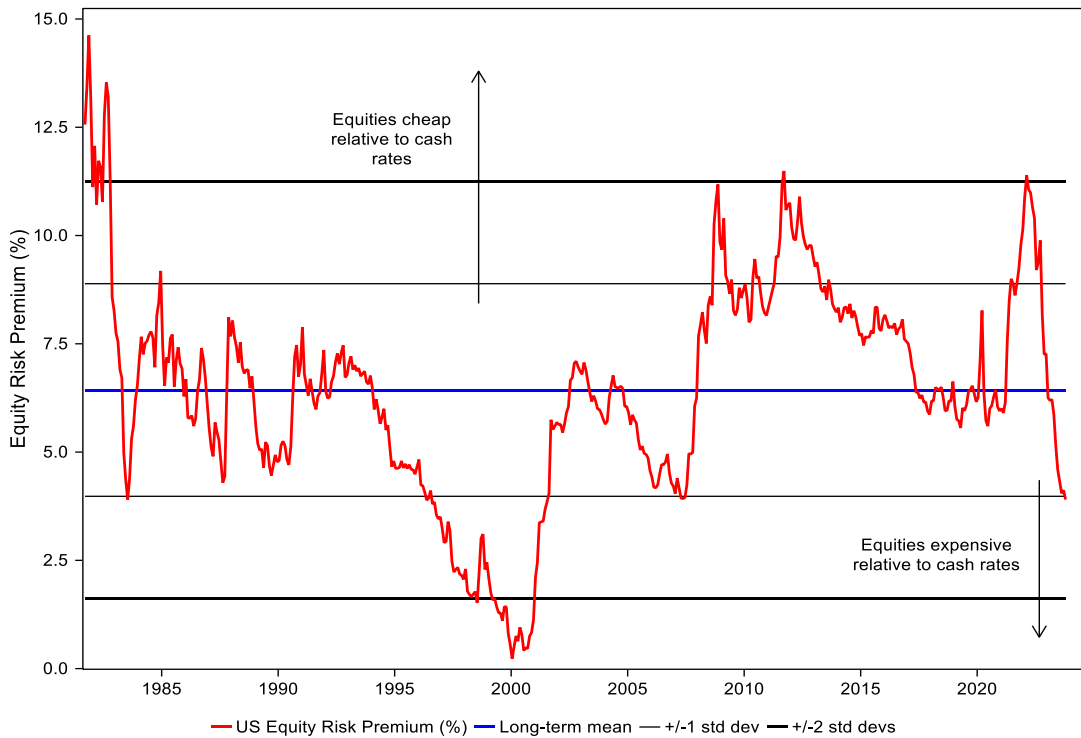
Section 9d: US Equity Risk Premia

Fig 9di: US Equity Risk Premium (earnings yield less **real bond yield**)



Source: Longview Economics, Macrobond

Fig 9dii: US Equity Risk Premium (earnings yield less **real cash rates**)



Source: Longview Economics, Macrobond

Fig 9diii: US Equity Risk Premium (earnings yield less IG corp bond yield)

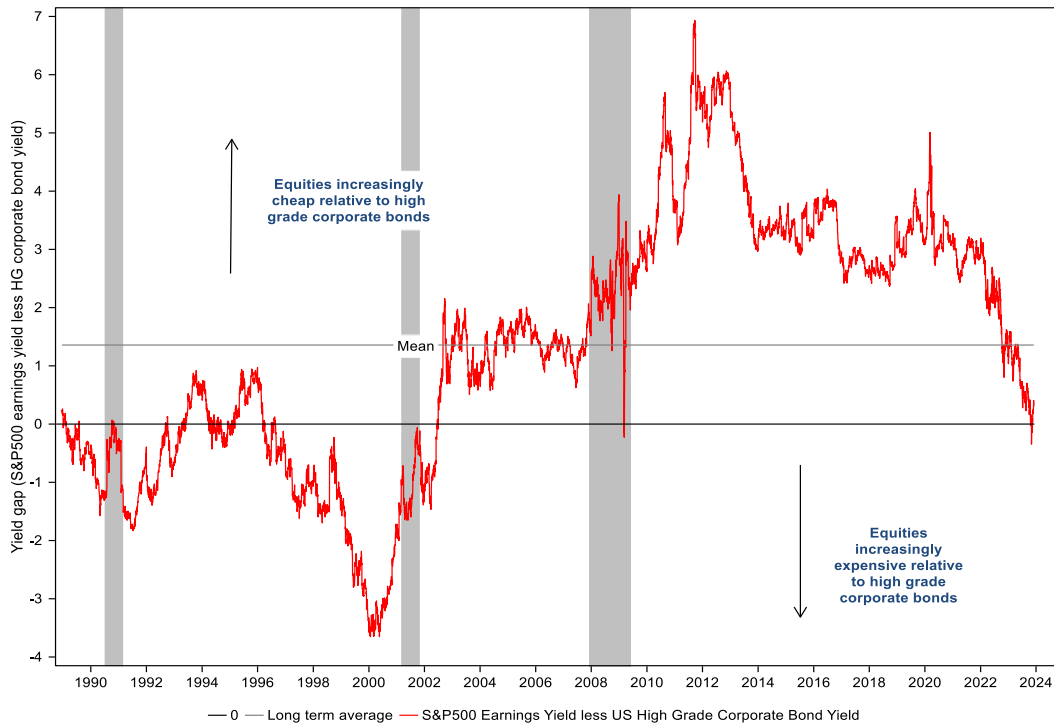
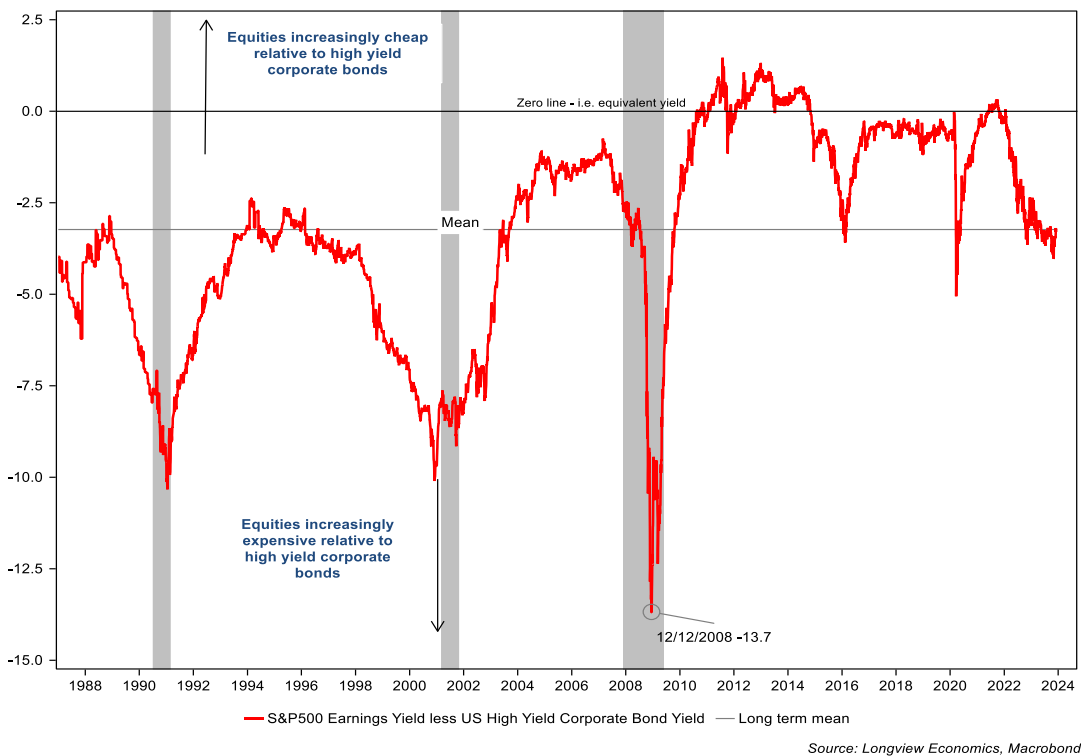


Fig 9div: US Equity Risk Premium (earnings yield less HY corp bond yield)



Section 9e: UK Equity Risk Premia

Fig 9ei: UK Equity Risk Premium (earnings yield less real bond yield)



Fig 9eii: UK Equity Risk Premium (earnings yield less real cash rates)

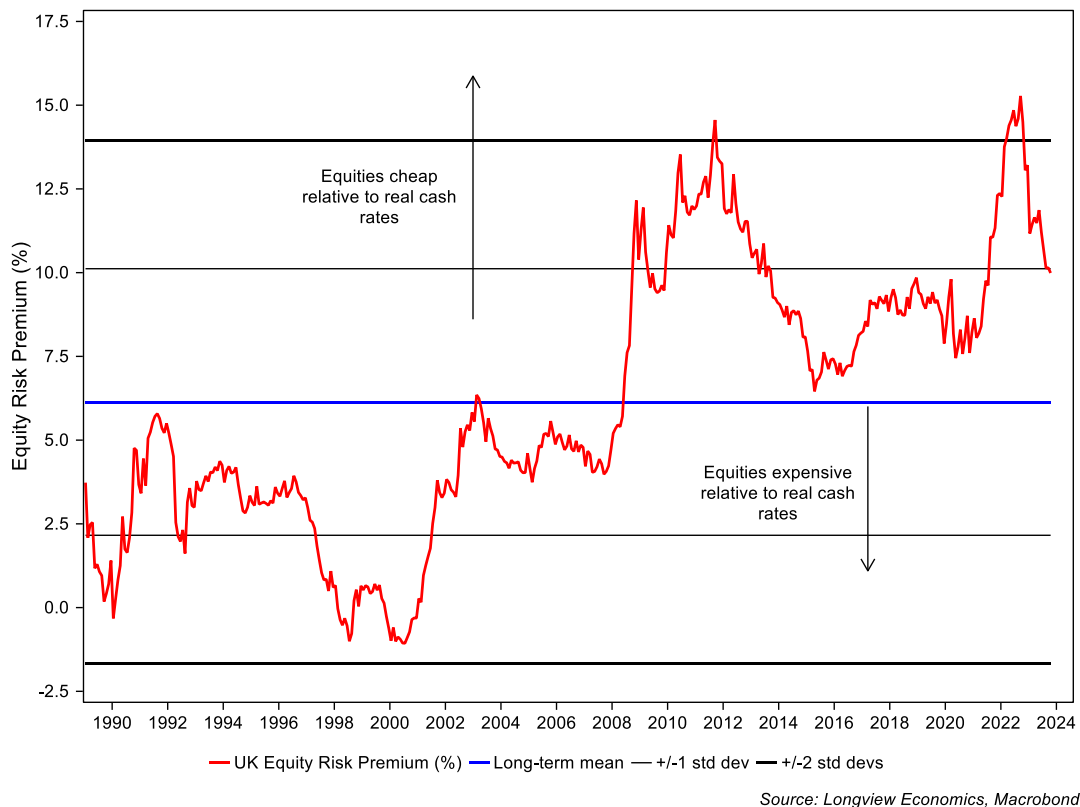
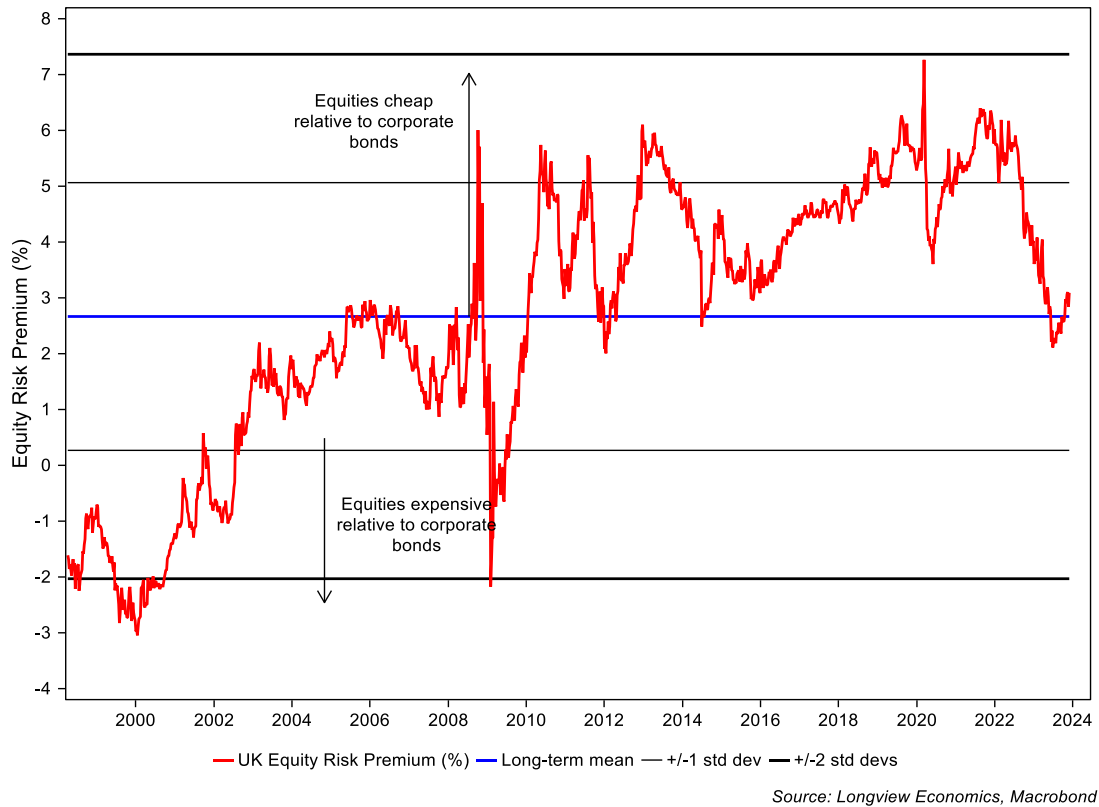


Fig 9eiii: UK Equity Risk Premium (earnings yield less **BBB corp bond yield**)



Section 9f: European Equity Risk Premia

Fig 9fi: European Equity Risk Premium (earnings yield less **real bond yield**)

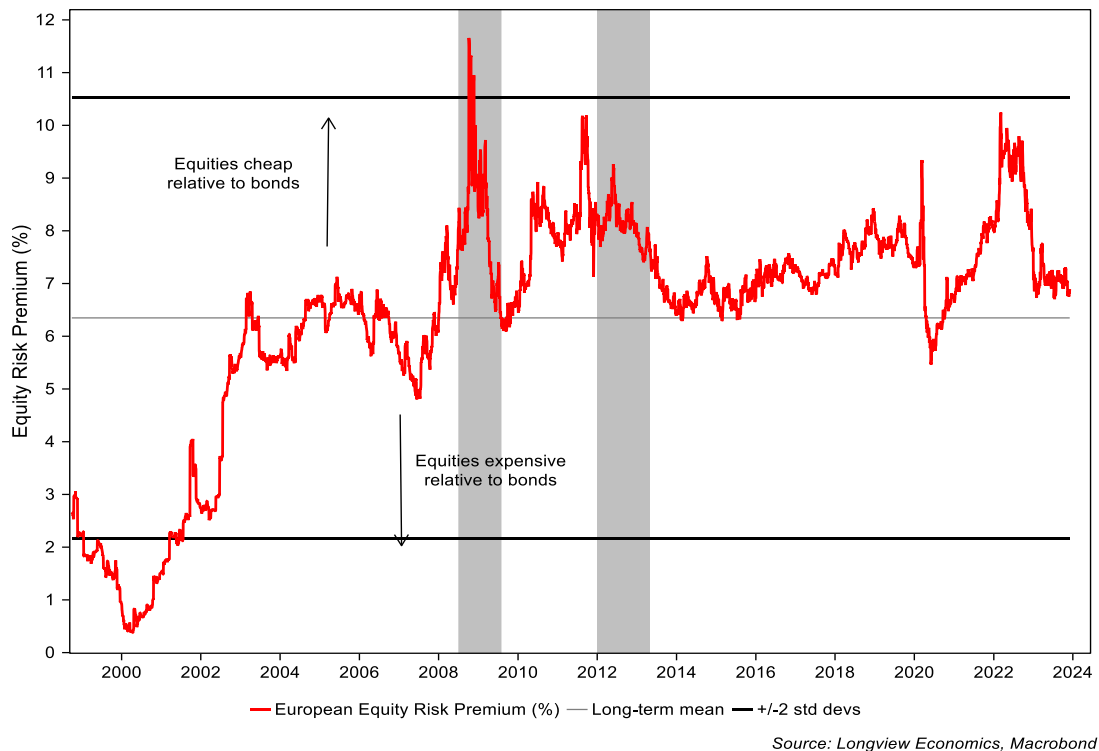


Fig 9fii: European Equity Risk Premium (earnings yield less [real cash rates](#))

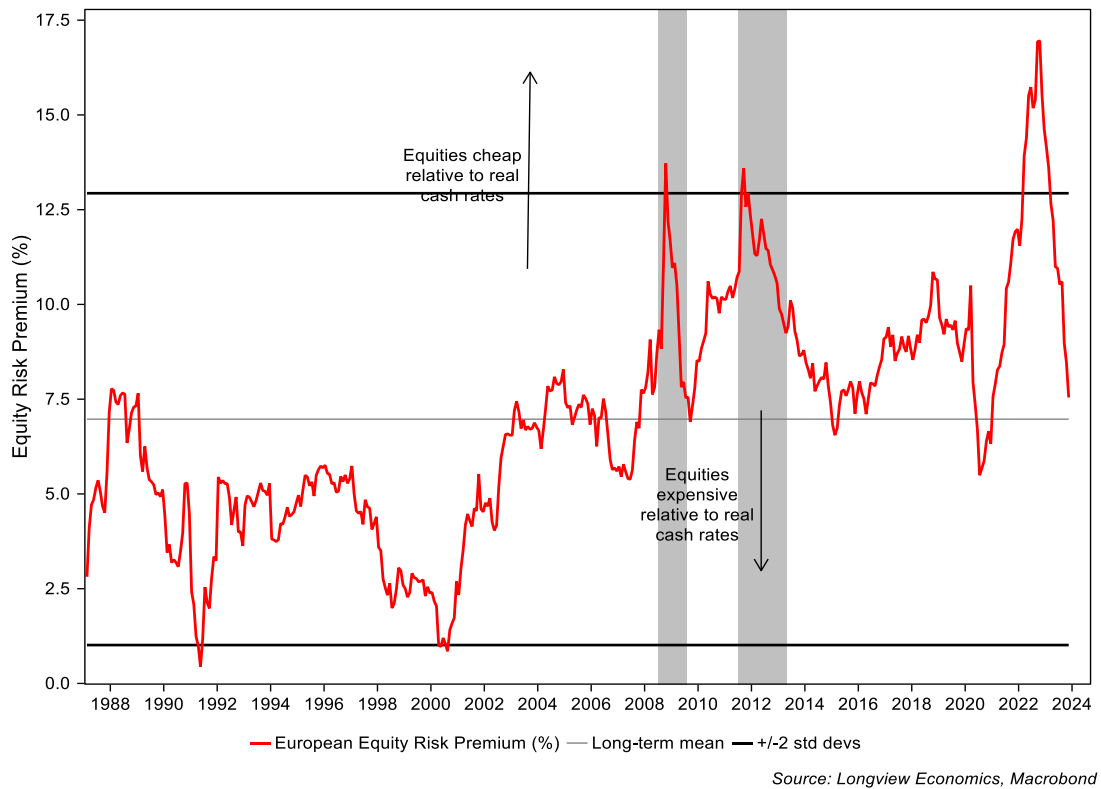
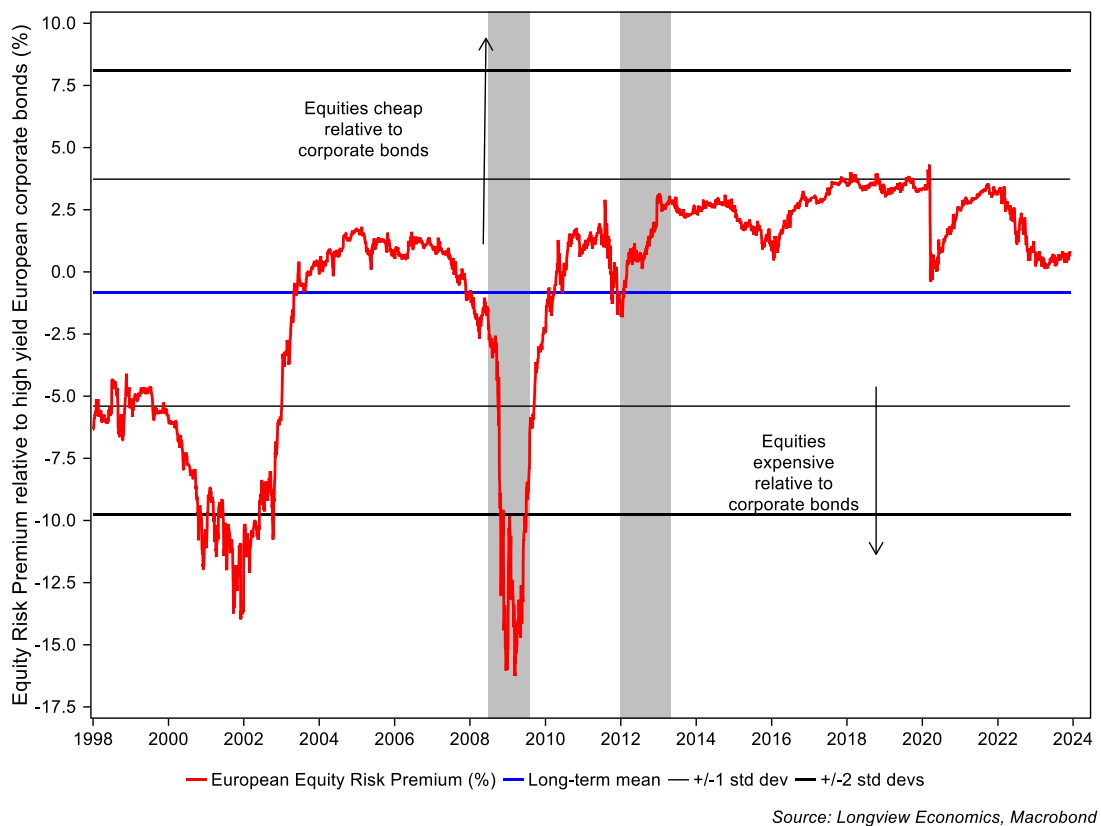


Fig 9fiii: European Equity Risk Premium (earnings yield less [HY corp yield](#))



Section 9g: EM Equity Risk Premia

Fig 9gi: EM Equity Risk Premium (earnings yield less **real bond yield**)

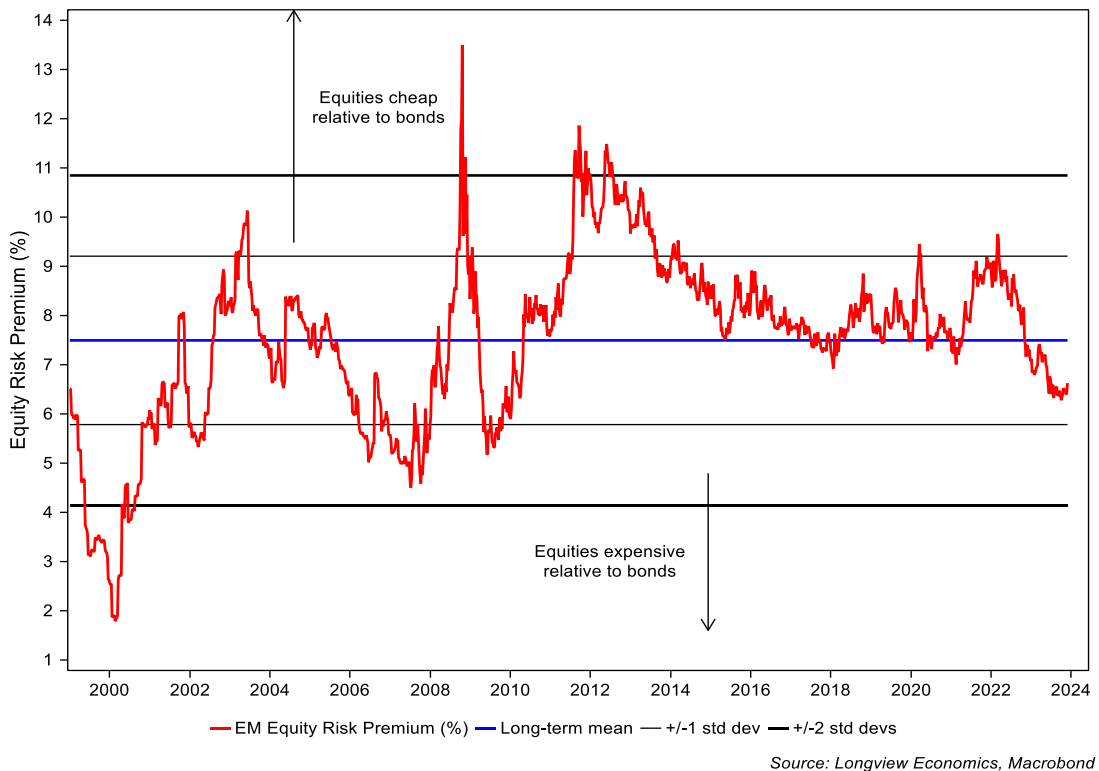


Fig 9gii: EM Equity Risk Premium (earnings yield less **real cash rate**)

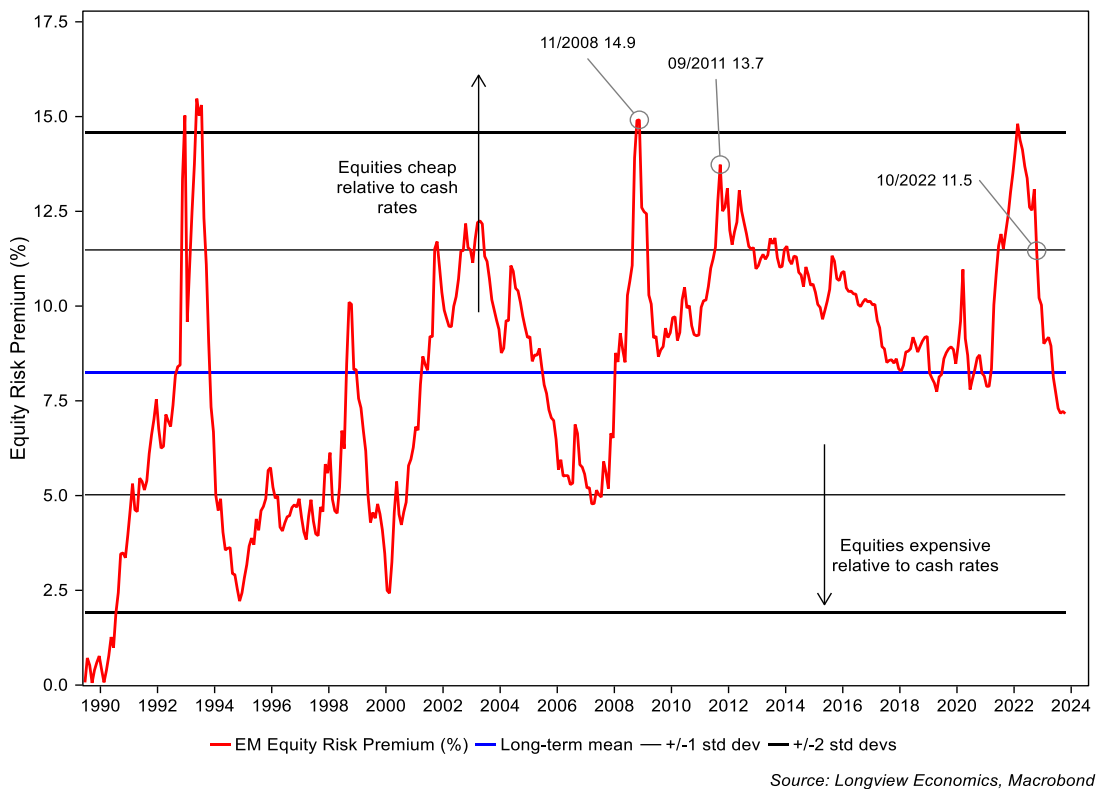
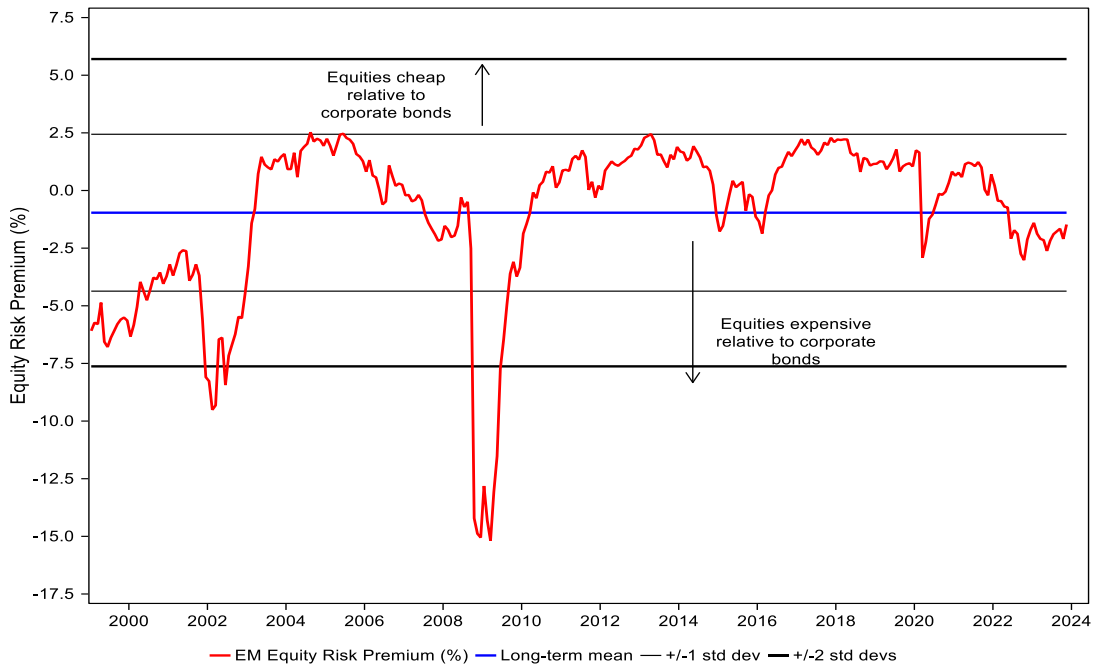


Fig 9giii: EM Equity Risk Premium (earnings yield less real corp bond yield)

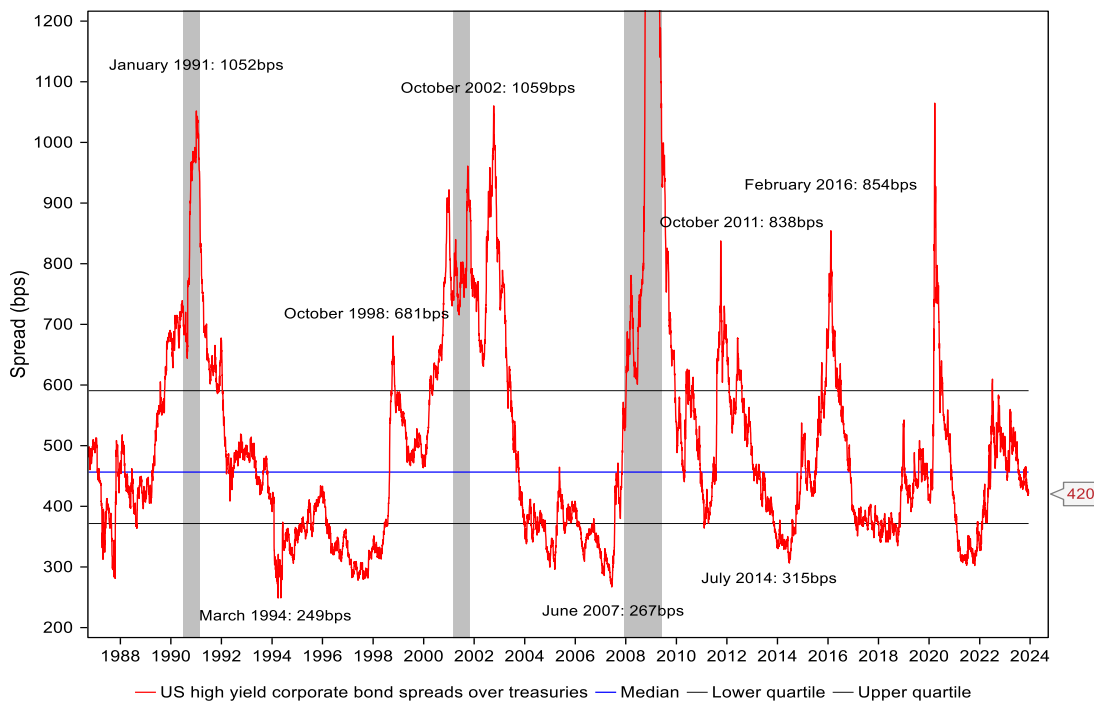


Source: Longview Economics, Macrobond

Section 9h: US Corporate Bond Spreads

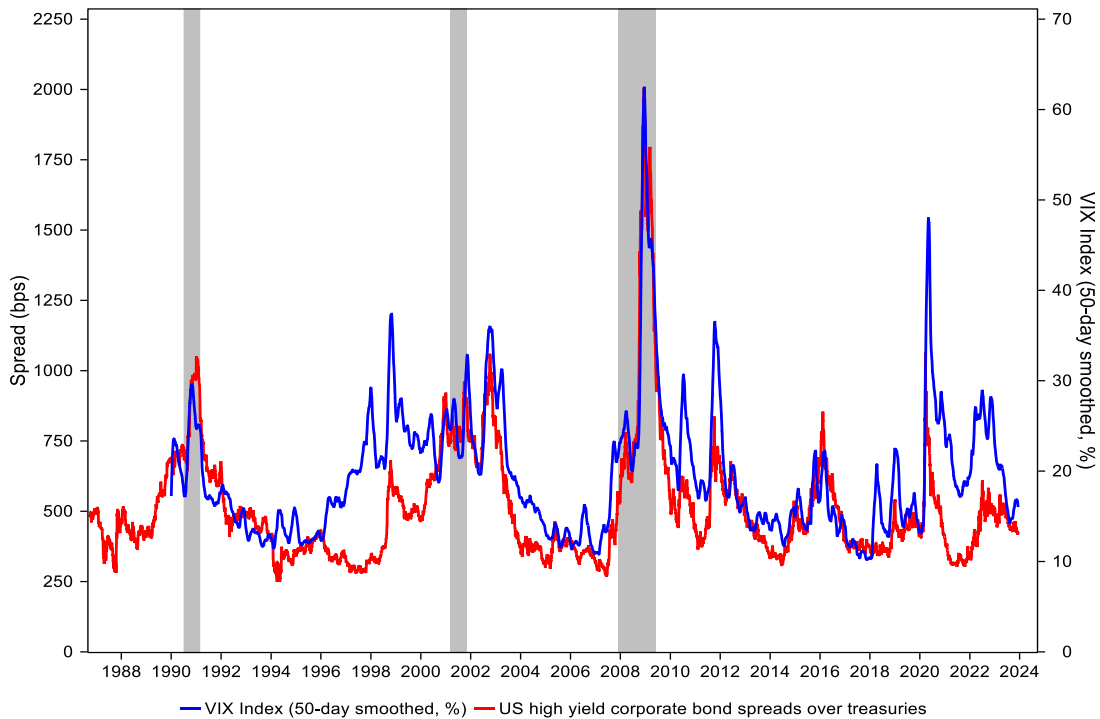
Due to the asymmetric nature of bond spread series, we have used a median & quartile analysis instead of mean & standard deviation analysis.

Fig 9hi: US high yield corporate bond spreads over treasuries (bps)



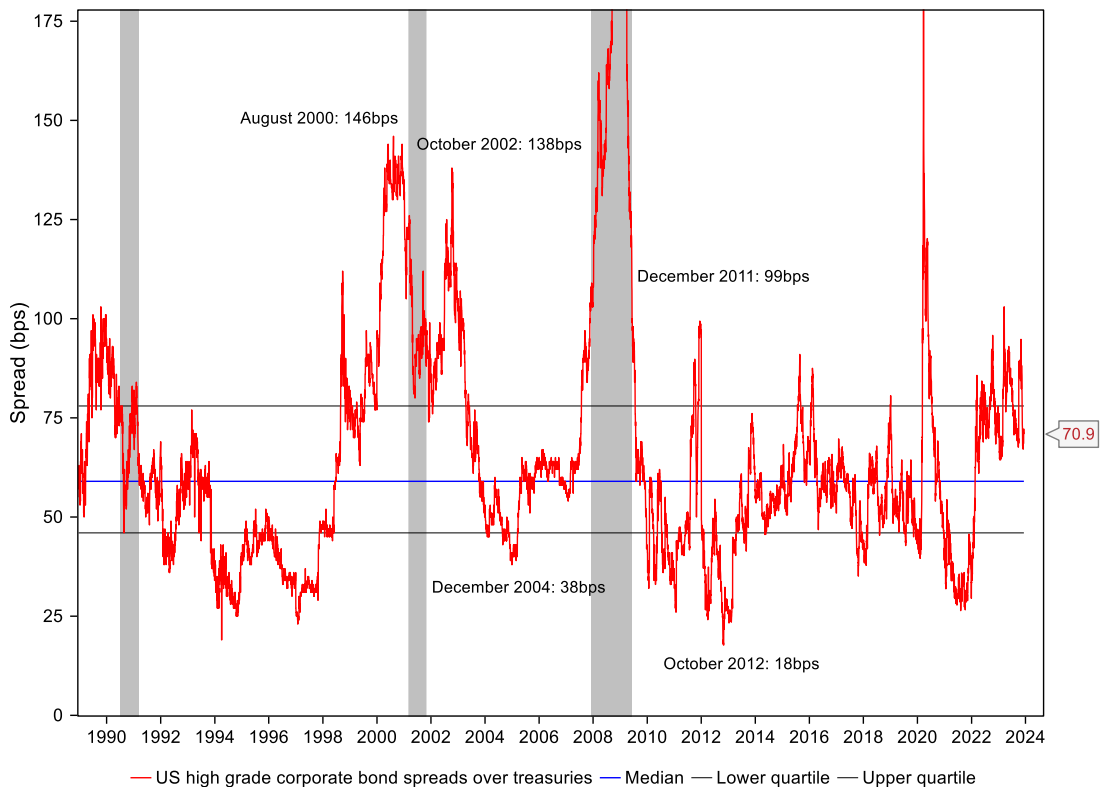
Source: Longview Economics, Macrobond

Fig 9hii: US high yield corporate bond spreads over treasuries (bps) vs. VIX



Source: Longview Economics, Macrobond

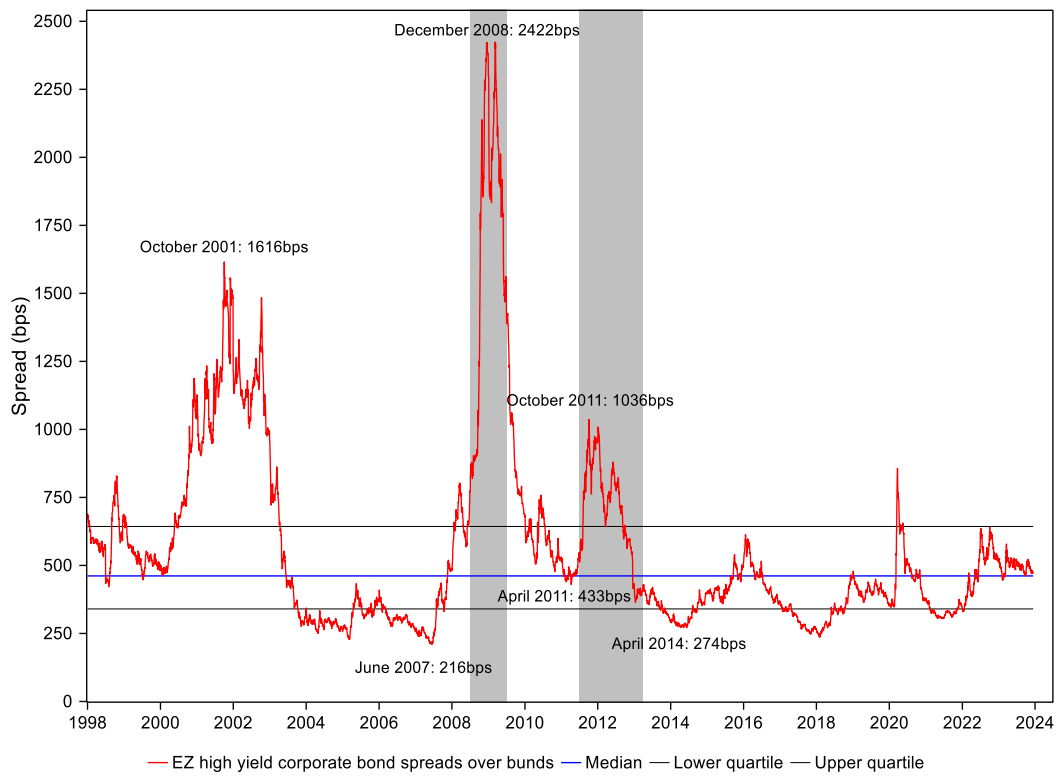
Fig 9hiii: US investment grade corporate bond spreads over treasuries (bps)



Source: Longview Economics, Macrobond

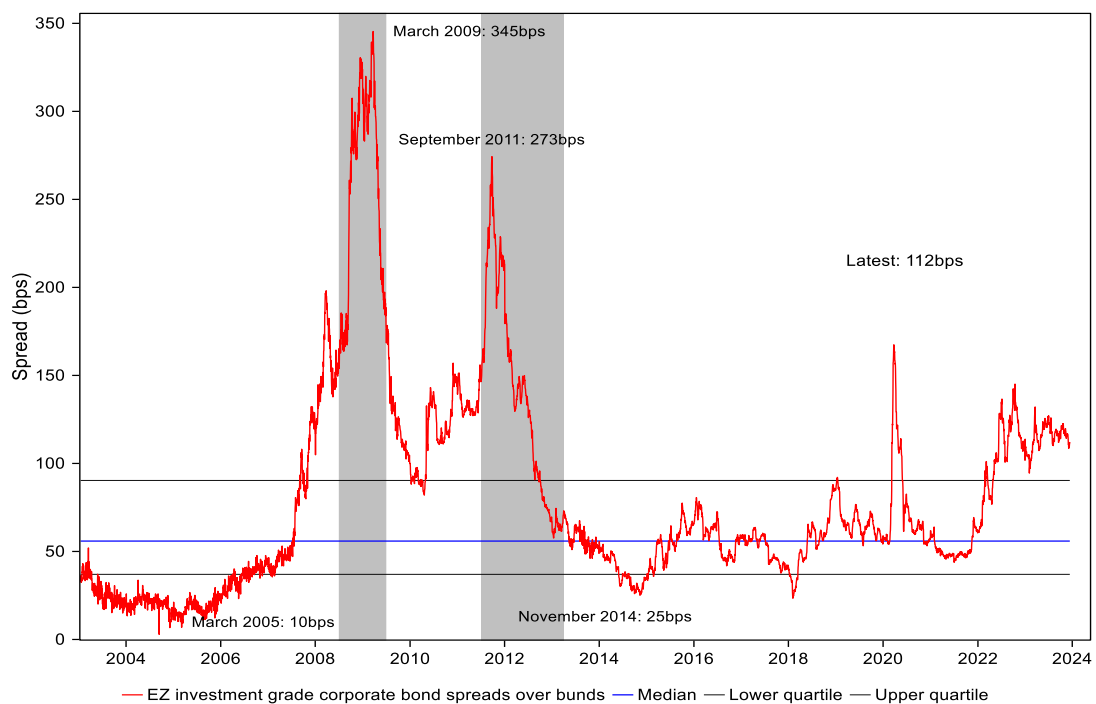
Section 9I: Euro Zone Corporate Bond Spreads

Fig 9I i: EZ high yield corporate bond spreads over bunds (bps)



Source: Longview Economics, Macrobond

Fig 9I ii: EZ investment grade corporate bond spreads over bunds (bps)



Source: Longview Economics, Macrobond

Section 9k: Emerging Market Bond Spreads

Fig 9ki: EM government bond spreads over treasuries (bps)

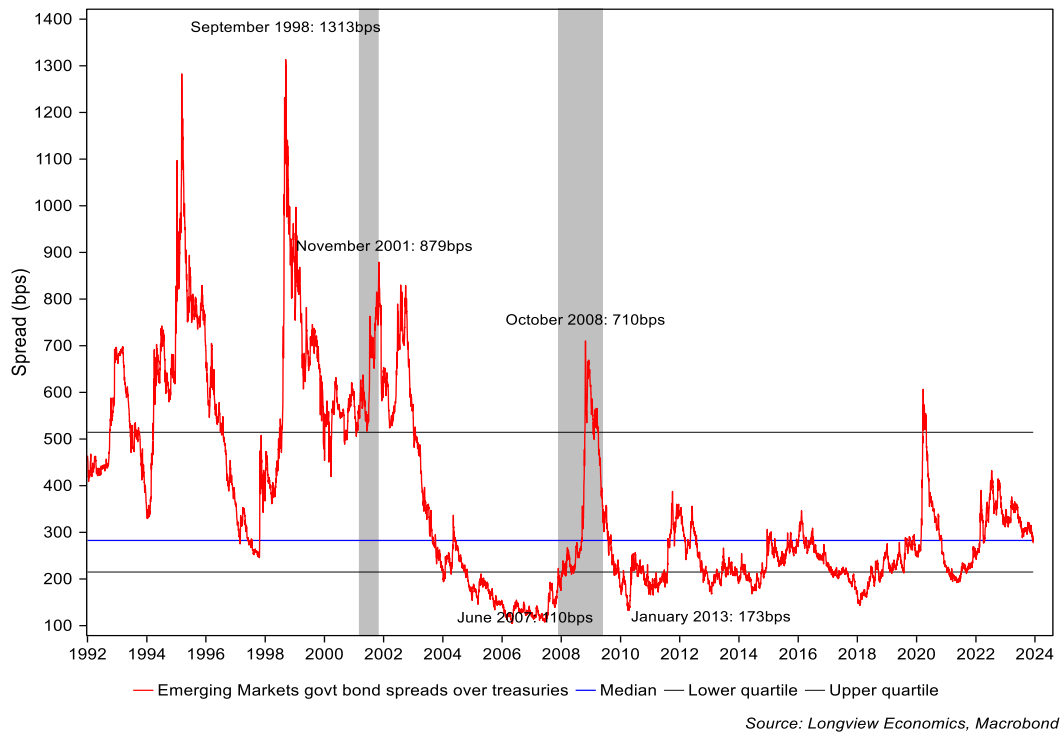
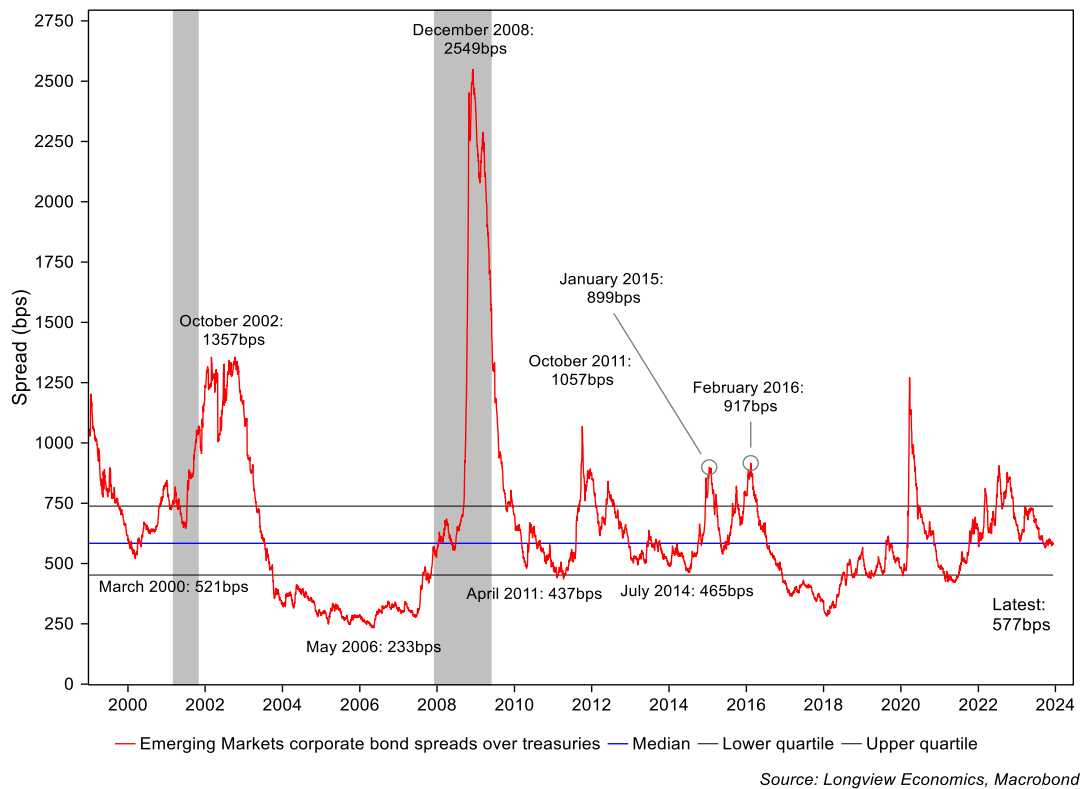
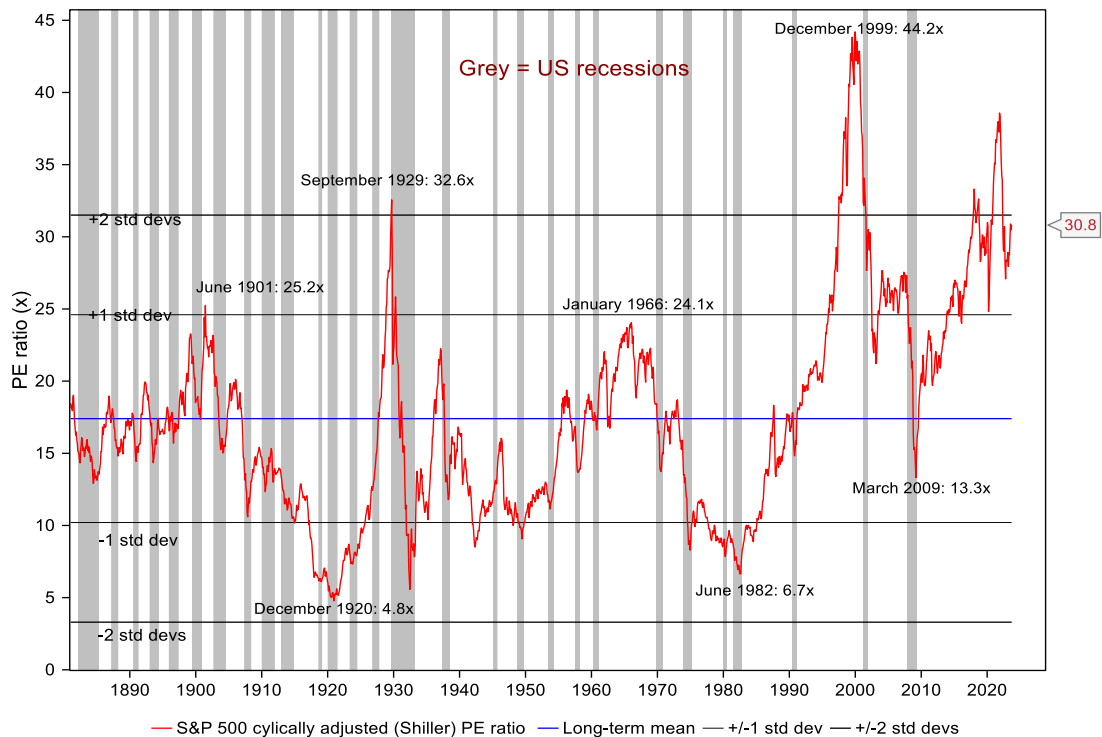


Fig 9kii: EM corporate bond spreads over treasuries (bps)



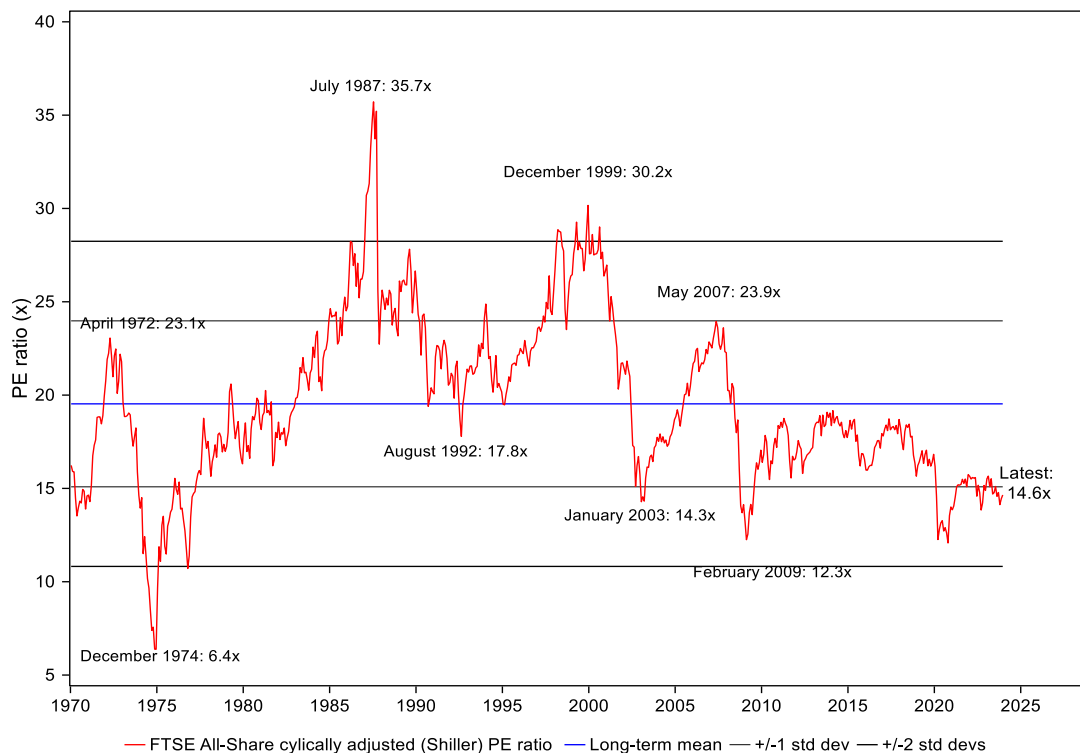
Section 9I: Shiller PE ratios

Fig 9Ii: Long term US S&P 500 cyclically adjusted (Shiller) PE ratio



Source: Longview Economics, Macrobond

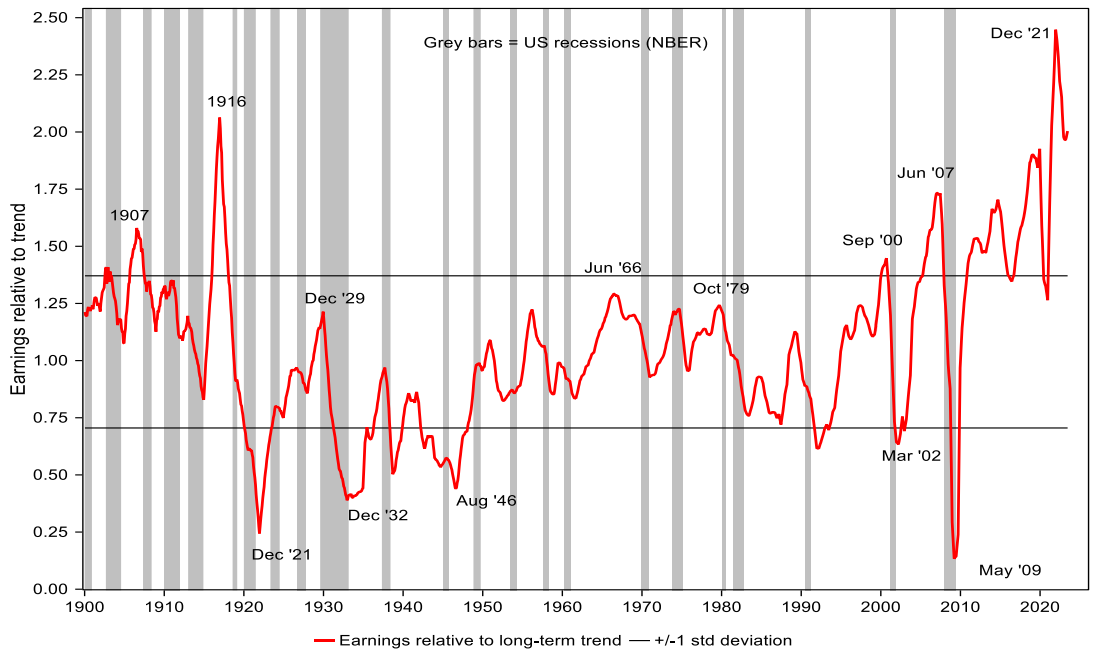
Fig 9Iii: Long term UK FTSE All-Share cyclically adjusted (Shiller) PE ratio



Source: Longview Economics, Macrobond

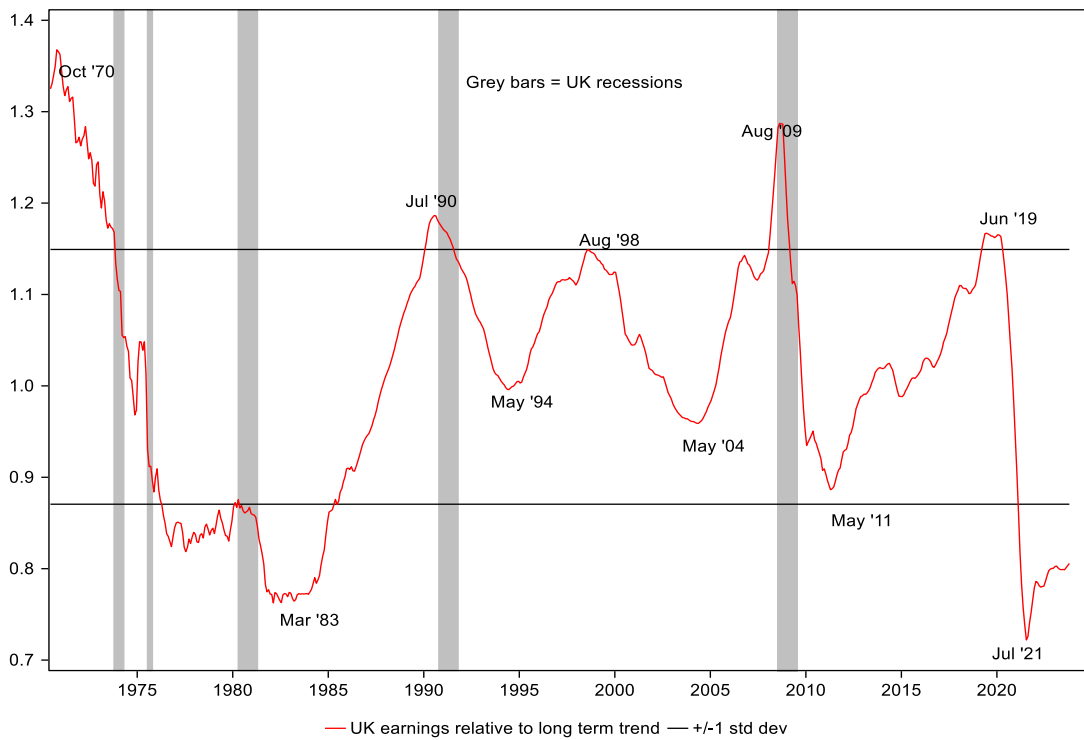
Section 9m: Earnings

Fig 9mi: US earnings (EPS) relative to long-term trend



Source: Longview Economics, Macrobond

Fig 9mii: UK earnings (EPS) relative to long-term trend



Source: Longview Economics, Macrobond

Section 9n: Global Sector Valuations

NB these tables are extracts from our global sector presentation. We also have presentations centric to US and UK markets. If you would like to be added to our monthly distribution list for any of these products, please let us know.

Fig 9ni: Global sector valuation heatmap*

11/12/2023	Cons disc.	Cons staples	Energy	Financials	Health Care	Industrials	Info tech	Materials	Comm. Services	Utilities	Index
Cons disc.		10	6	14	35	58	84	48	55	44	57
Cons staples	91		13	51	91	95	99	86	83	65	97
Energy	95	88		93	95	96	97	100	92	94	96
Financials	87	50	8		78	89	93	86	72	73	89
Healthcare	66	10	6	23		71	91	63	66	45	70
Industrials	43	6	5	12	30		84	44	48	39	37
Info tech	17	2	4	8	10	17		25	15	17	12
Materials	53	15	1	15	38	57	76		50	42	53
Comm. Services	46	18	9	29	35	53	86	51		31	52
Utilities	57	36	7	28	56	62	84	59	70		60
Index	44	4	5	12	31	64	89	48	49	41	

Source: Bloomberg Consensus Estimates, S&P, Longview Economics

* NB This table should be read as ‘columns versus rows’ – i.e. the sector name above, relative to the sector name to the left.

Fig 9nii: Global sector valuation metrics*

Name	Forward PE	Long Term Mean	Relative PE	Relative PE range	Over/Under Value*	Relative PE Percentile**	56-day RSI	56-day RSI Percentile
S&P GLOBAL 1200 INDEX	16.4	15.8	-	-	-	-	57.2	-
Energy	9.2	14.5	0.56	0.63-1.46	-39.1%	4	46.9	76
Materials	14.8	14.2	0.90	0.50-1.28	-1.1%	45	53.5	25
Industrials	17.8	16.5	1.08	0.77-1.42	39.9%	72	57.4	76
Consumer Discretionary	17.6	16.7	1.07	0.62-1.41	-5.5%	26	55.0	67
Consumer Staples	17.7	20.7	1.08	1.09-2.43	-16.7%	3	48.7	57
Healthcare	17.2	17.5	1.05	0.79-1.49	-5.1%	30	51.2	61
Financials	11.2	12.4	0.68	0.51-0.98	-14.1%	13	58.0	28
Info Tech	24.9	19.9	1.52	0.90-1.99	22.3%	89	59.5	61
Telecoms	16.3	16.1	1.00	0.61-1.79	-0.1%	51	55.2	21
Utilities	14.4	14.2	0.88	0.49-1.35	-4.2%	42	53.2	76

* This measures how expensive the sector is relative to the index, compared to its long term history (i.e. since 1987).

Fig 9niii: US sector valuation (PE) heatmap

S&P 500 Sector	fwd pe ratio (x)	vs. own history	vs. 1	vs. 2	vs. 3	vs. 4	vs. 5	vs. 6	vs. 7	vs. 8	vs. 9	vs. 10	vs. 11	vs. Index
1. Energy	10.7	23	0	6	7	10	11	7	3	19	14	38	4	
2. Materials	18.7	87	100	77	31	83	78	89	18	96	77	85	65	
3. Industrials	18.7	81	94	23	26	74	62	75	12	92	69	77	28	
4. Consumer Discretionary	25.4	88	93	69	74	86	77	85	28	85	84	88	75	
5. Consumer Staples	19.0	63	90	17	26	14	37	42	8	88	67	79	11	
6. Healthcare	17.4	81	89	22	38	23	63	52	9	95	72	81	28	
7. Financials	13.9	72	93	11	25	15	58	48	11	85	63	77	4	
8. IT	26.1	90	97	82	88	72	92	91	89	99	85	88	87	
9. Communications	16.7	34	81	4	8	15	12	5	15	1	29	59	3	
10. Utilities	15.9	62	86	23	31	16	33	28	37	15	71	77	23	
11. Real Estate	17.1	30	62	15	23	12	21	19	23	12	41	23	11	
Index	18.9	85	96	35	72	25	89	72	96	13	97	77	89	

These table should be read as the row header relative to the column header. Cells/Rows shaded red are more expensive on a percentile basis relative to history, while those shaded green are cheap on that relative basis.

Source: Longview Economics, Macrobond

Fig 9niv: US sector equity risk premium heatmap

S&P 500 Sector	fwd ERP (%)	vs. own history	vs. 1	vs. 2	vs. 3	vs. 4	vs. 5	vs. 6	vs. 7	vs. 8	vs. 9	vs. 10	vs. 11	vs. Index
1. Energy	7.4	65	100	97	99	89	88	95	98	86	89	74	99	
2. Materials	3.4	11	0	23	84	17	20	11	94	3	21	14	37	
3. Industrials	3.4	9	3	77	94	27	30	20	93	4	27	18	74	
4. Consumer Discretionary	1.9	5	1	16	6	5	8	4	76	2	8	6	6	
5. Consumer Staples	3.3	11	11	83	73	95	56	37	94	10	25	18	89	
6. Healthcare	3.7	16	12	80	70	92	44	35	97	5	26	19	79	
7. Financials	5.2	10	5	89	80	96	63	65	93	24	47	34	91	
8. IT	1.8	10	6	10	11	28	10	7	11	1	14	10	13	
9. Communications	4.0	18	14	97	96	98	90	95	76	99	67	44	99	
10. Utilities	4.3	7	11	79	73	92	75	74	53	90	33	31	81	
11. Real Estate	3.8	20	26	86	82	94	82	81	66	92	56	69	90	
Index	3.3	7	1	63	26	94	11	21	9	91	1	19	10	

ERP is the Equity Risk Premium (Earnings Yield less real bond yield)

These table should be read as the row header relative to the column header. Cells/Rows shaded red are have a lower risk premium on a percentile basis relative to history, while those shaded green have a higher ERP on that relative basis.

Source: Longview Economics, Macrobond

Fig 9nv: US sector dividend yield heatmap

S&P 500 Sector	fwd div yield (%)	vs. own history	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs. Index
			1	2	3	4	5	6	7	8	9	10	11		
1. Energy	3.4	82		84	88	90	65	78	68	80	89	78	71	89	
2. Materials	2.1	37	16		78	83	27	51	28	77	98	45	28	85	
3. Industrials	1.8	19	12	22		85	5	14	27	58	97	26	16	86	
4. Consumer Discretionary	0.8	12	10	17	15		8	9	19	51	79	18	17	23	
5. Consumer Staples	2.8	57	35	73	95	92		84	51	85	99	69	33	99	
6. Healthcare	1.8	38	22	49	86	91	16		48	60	98	33	22	91	
7. Financials	2.1	61	32	72	73	81	49	52		65	97	59	42	86	
8. IT	0.8	26	20	23	42	49	15	40	35		45	26	18	44	
9. Communications	0.8	5	11	2	3	21	1	2	3	55		1	3	3	
10. Utilities	3.7	41	22	55	74	82	31	67	41	74	99		27	88	
11. Real Estate	3.7	73	29	72	84	83	67	78	58	82	97	73		87	
Index	1.6	15	11	15	14	77	1	9	14	56	97	12	13		

These table should be read as the row header relative to the column header. Cells/Rows shaded red have a lower yield on a percentile basis relative to history, while those shaded green have a higher yield on that relative basis.
Source: Longview Economics, Macrobond

Fig 9nvi: US sector price to book heatmap

S&P 500 Sector	fwd pb ratio (x)	vs. own history	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs.	vs. Index
			1	2	3	4	5	6	7	8	9	10	11	
1. Energy	2.0	55		36	16	21	30	30	29	11	44	33	56	16
2. Materials	2.7	60	64		21	23	32	28	39	8	38	47	58	19
3. Industrials	4.8	91	84	79		26	90	74	68	7	89	96	97	70
4. Consumer Discretionary	7.3	80	79	77	74		80	76	68	27	73	86	89	70
5. Consumer Staples	4.9	71	70	68	10	20		25	39	4	49	72	81	27
6. Healthcare	4.2	76	70	72	26	24	75		46	8	72	80	91	28
7. Financials	1.8	68	71	61	32	32	61	54		9	63	72	78	29
8. IT	9.1	92	89	92	93	73	96	92	91		97	97	98	86
9. Communications	3.2	66	56	62	11	27	51	28	37	3		63	83	5
10. Utilities	1.8	60	67	53	4	14	28	20	28	3	37		67	21
11. Real Estate	2.9	48	44	42	3	11	19	9	22	2	17	33		4
Index	3.7	89	84	81	30	30	73	72	71	14	95	79	96	

These table should be read as the row header relative to the column header. Cells/Rows shaded red are more expensive on a percentile basis relative to history, while those shaded green are cheap on that relative basis.
Source: Longview Economics, Macrobond

Section 9o: Global Commodities Valuations

Fig 9oi: Commodities heatmap

Commodity	Data since	Price	vs. own history	vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs. vs.															
				1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Palladium	2/1/1968	1,140.0	84		53	88	75	68	75	83	86	89	72	89	76	77	47	74	84
2. Gold	31/1/1901	2,019.4	97	47		100	89	86	78	97	99	95	84	99	86	92	88	91	98
3. Platinum	31/1/1910	950.0	38	12	0		4	5	5	79	80	38	32	84	16	63	20	33	53
4. Silver	31/1/1910	23.9	89	25	11	96		74	45	94	98	78	70	98	67	83	82	81	89
5. Brent Oil	1/10/1985	76.9	66	32	14	95	26		76	70	79	93	39	76	41	46	58	54	81
6. WTI Oil	31/12/1900	71.4	84	25	22	95	55	24		90	93	85	57	92	46	79	61	52	80
7. Wheat	31/1/1901	6.8	12	17	3	21	6	30	10		58	37	11	81	11	25	69	53	75
8. Corn	31/1/1901	4.6	9	14	1	20	2	21	7	42		33	7	76	5	25	40	47	66
9. Natural Gas	29/12/1922	2.4	55	11	5	62	22	7	15	63	67		33	74	28	57	24	24	24
10. Cocoa	1/7/1959	4,244.0	61	28	16	68	30	61	43	89	93	67		95	47	61	94	96	99
11. Cotton	29/8/1902	0.8	5	11	1	16	2	24	8	19	24	26	5		6	14	32	49	39
12. Copper	2/7/1959	3.9	69	24	14	84	33	59	54	89	95	72	53	94		67	86	76	93
13. Sugar	31/1/1901	0.2	31	23	8	37	17	54	21	75	75	43	39	86	33		97	82	95
14. Tin	9/2/2012	24,982.0	27	53	12	80	18	42	39	31	60	76	6	68	14	3		60	51
15. Zinc	2/1/2004	2,536.8	26	26	9	67	19	46	48	47	53	76	4	51	24	18	40		51
16. Aluminium	27/8/1987	2,195.5	10	16	2	47	11	19	20	25	34	76	1	61	7	5	49	49	

These table should be read as the row header relative to the column header. Cells/Rows shaded red are more expensive on a percentile basis relative to history, while those shaded green are cheap on that relative basis. NB all relative metrics are adjusted for inflation.

Source: Longview Economics, Macrobond



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