LV **Longview Economics**

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Tactical Equity Asset Allocation No. 240, 3rd January 2024

(1 – 4 month outlook for risk assets)

Written by: Chris Watling, CEO & Chief Market Strategist, Longview Economics

Stay Tactically OW Equities (albeit risks rising)

a.k.a. Cyclical Bull Market Ongoing

Summary Extract:

- A wide variety of medium-term models have moved onto SELL. That includes our sentiment scoring system; our fast moving scoring system; as well as various technical models (all of which highlight that US equities are overextended to the upside).

- There is, however, no current evidence of euphoria in markets, which typically marks major local highs – while certain models are generating rare signals, suggesting that this cyclical bull market has more legs.

- We therefore recommend continuing with modest overweight equity positions for now, with more upside expected over the course of January (and potentially into February/March).

Table of Contents

Important disclosures are included at the end of this report

Stay Tactically OW Equities (albeit risks rising)

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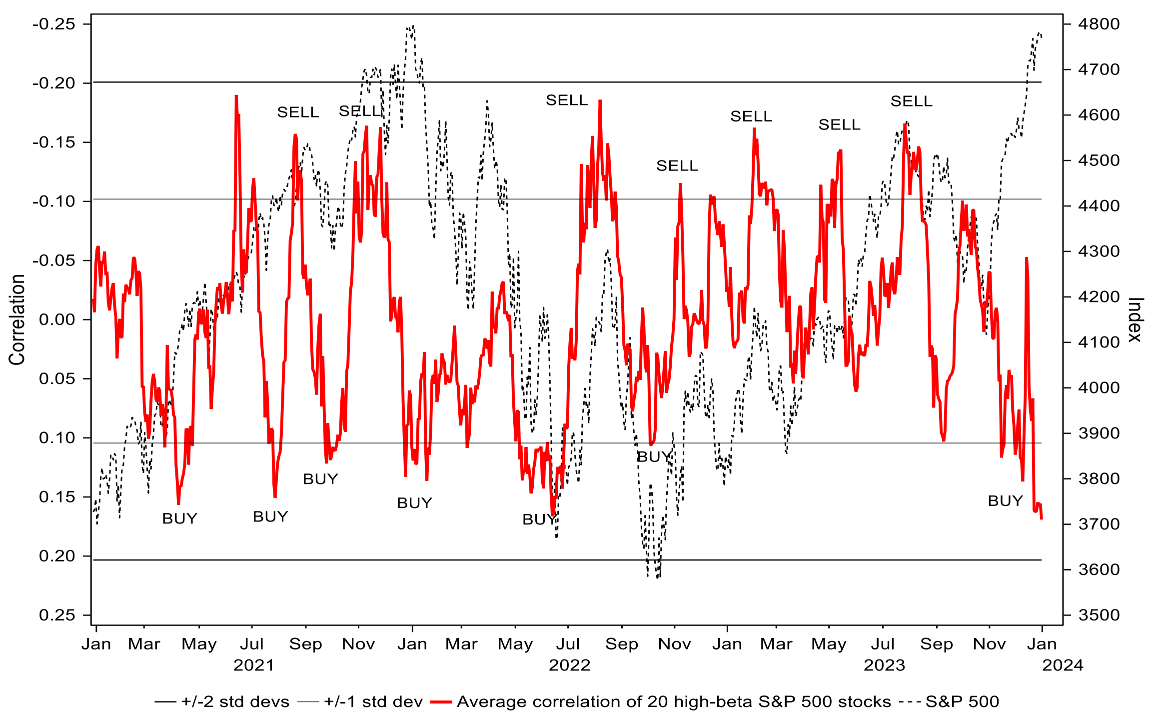
Section 1: Executive Summary

Since the late October lows, **US and global equity markets have moved sharply higher**, performing strongly in November and December. The S&P500, for example, having troughed on 27th October (at 4,103) has subsequently rallied 17%. The NASDAQ100, after its July to October 'summer swoon', reached a local low on 26th October and has since rallied around 20% (up to its end 2023 highs). Other global equity markets have behaved similarly.

That strength in equities, in such a short period of time, raises questions about **where to next?**

SELL Signals: In that respect **a wide variety of medium term models have moved onto SELL.** Our sentiment scoring system, for example, is back on SELL (at 1 standard deviation) for the first time since April 2021 (fig 1a); our fast moving scoring system is also back on SELL (fig 1b); along with various technical models, which measure how overextended the market is at an index, sector and single stock level (see figs 2 to 2e). Those models suggest some degree of caution is warranted at this current juncture.

Fig 1: Correlation model* (INVERTED) vs. S&P500



Source: Longview Economics, Macrobond

*NB this model measures the average cross correlation of the 20 highest beta stocks in the S&P500.

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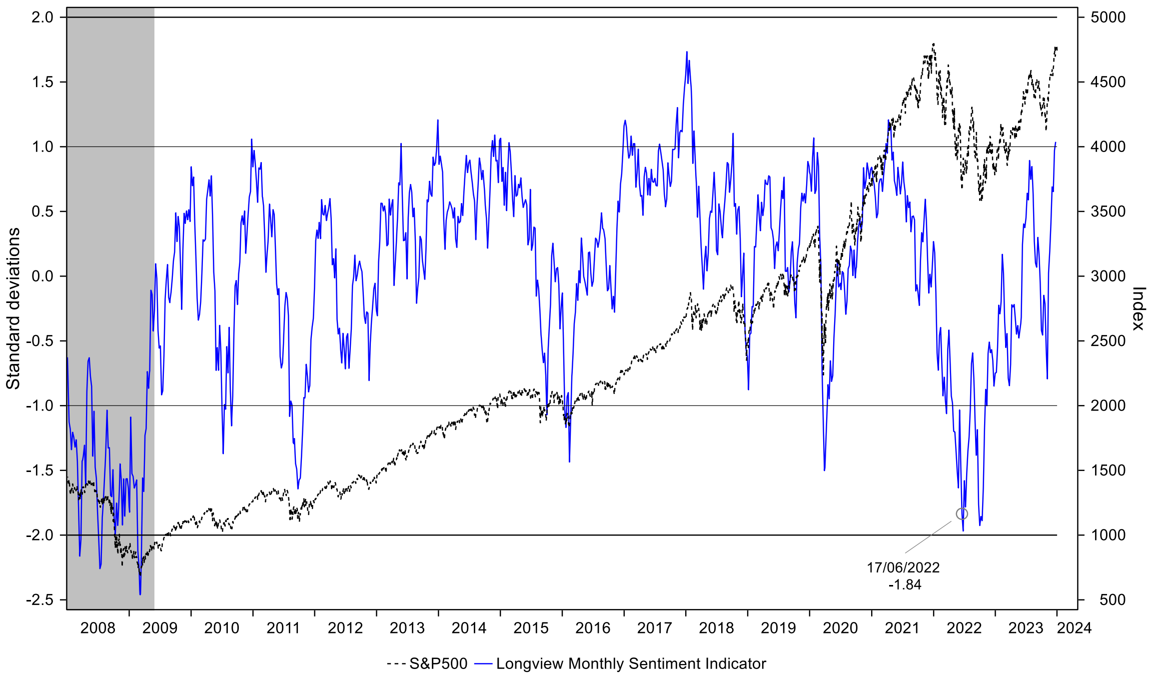
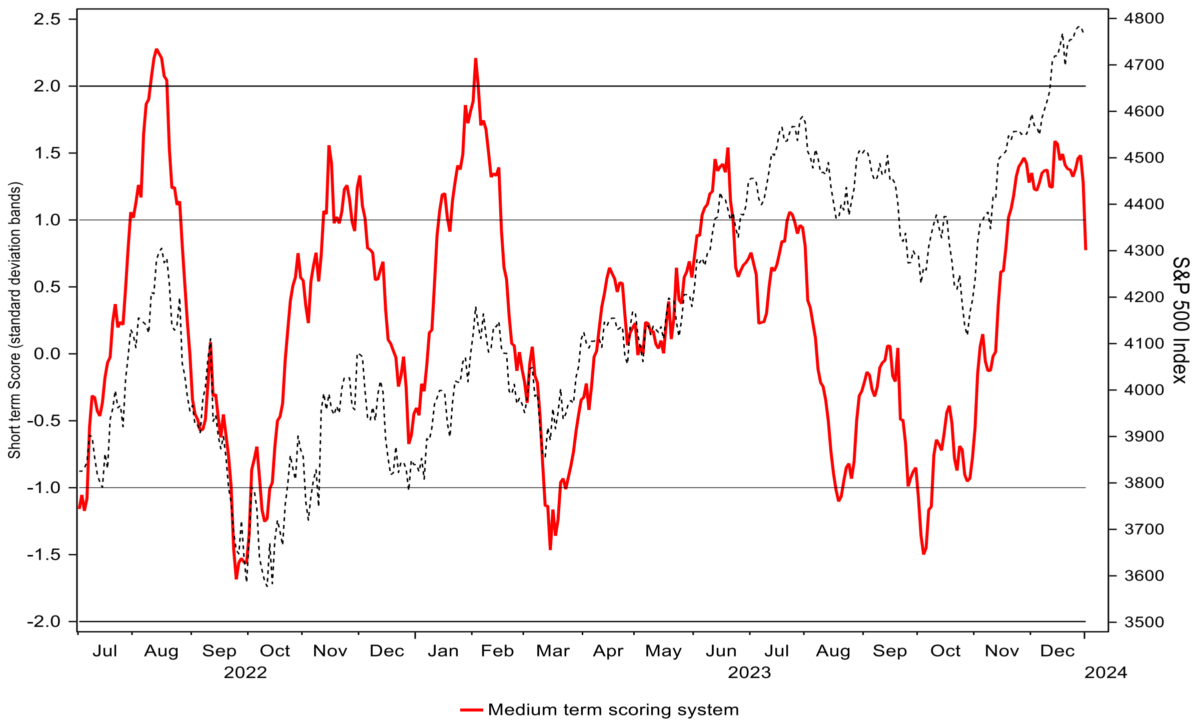
Fig 1a: Longview sentiment scoring system vs. S&P500



Source: Longview Economics, Macrobond

Fig 1b: Longview 'fast moving' TAA scoring system vs. S&P500



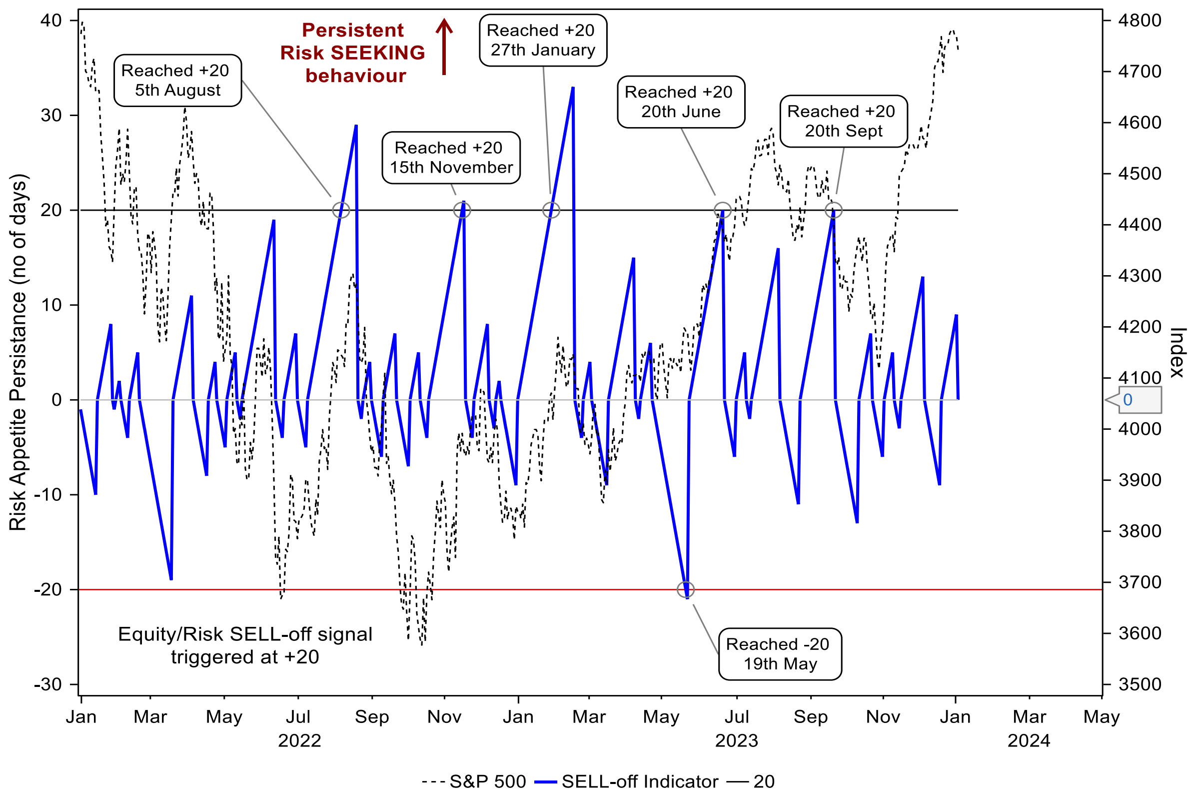
Source: Longview Economics, Macrobond

No Current Euphoria in Equity Markets

There is, however, **no current evidence of euphoria** in markets. Our SELL-off indicator, for example, which is designed to pick local highs and lows in a timely fashion, is not warning of an impending pullback/wave of risk aversion (currently it's on zero). As fig 1c shows, it typically generates a warning at major local highs (e.g. 20th June 2023, 14th February 2023).

Equally, the **medium term put to call ratio** is not at euphoric levels (i.e. not on SELL). That implies that there remains some, albeit a reduced, degree of downside protection in portfolios. This model, which often correlates with the AAII retail sentiment, is therefore not confirming the current SELL message of that model. Other signs that euphoria is not present (despite the strong rallies) include the **absence of high volumes of single stock call option buying**. This model had a brief spike higher in mid-December but hasn't seen any subsequent follow through/persistent buying (as it did in June/July 2023 & Jan/Feb 2023, prior to those pullbacks). Added to which, while volatility (VIX) is at low level, the steepness of the volatility curve is not signalling that markets are complacently priced. As such, whilst markets have rallied hard these past two months and various market timing models are back on SELL, they are not exhibiting 'euphoric price action' which is usually present at major local highs.

Fig 1c: Longview SELL-off Indicator vs. S&P500

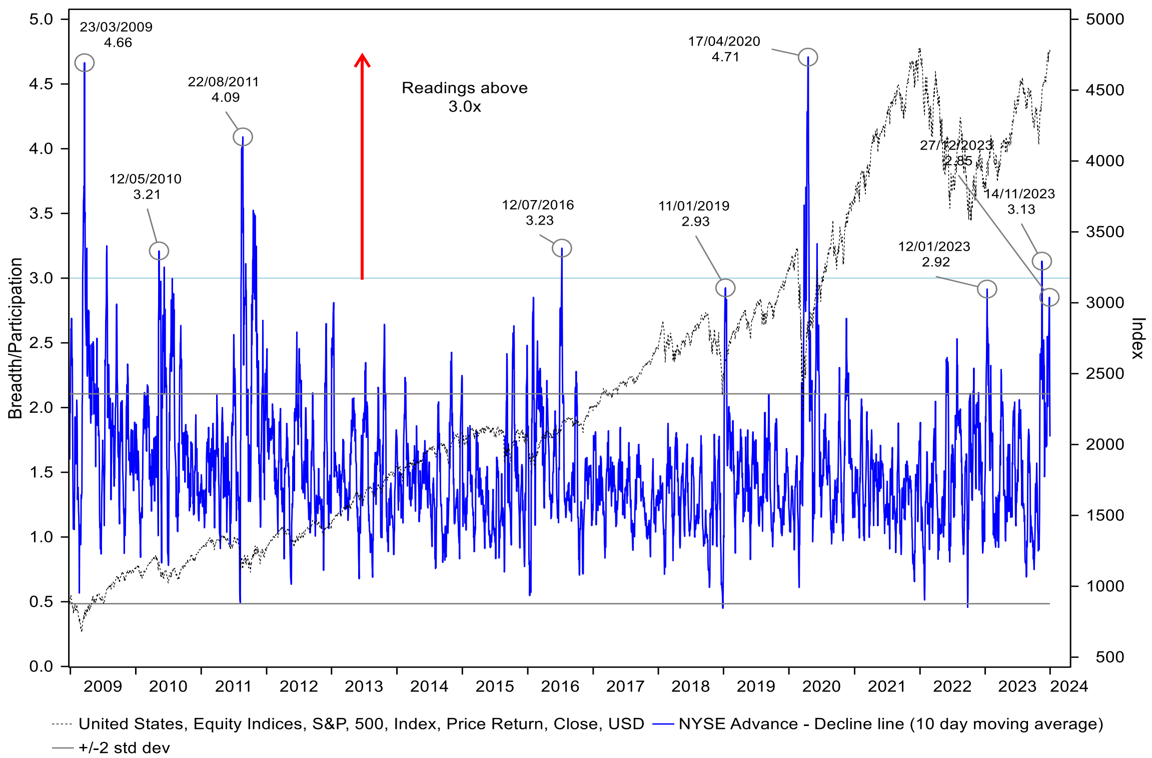


Source: Longview Economics, Macrobond

Evidence that a New Bull Market is Underway

Adding to that backdrop, and digging into the detail of the market's internal/technical behaviour, there is growing evidence that a new bull market is underway.

Fig 1d: NYSE smoothed advance-decline line (breadth thrust) vs. S&P500



Source: Longview Economics, Macrobond

In particular, there have been 'breadth thrust' signals, our bull-bear market models are now both signalling 'cyclical bull', whilst certain other key models are behaving in a manner consistent with the start of a new bull market. Added to which the latest BAML fund managers' survey highlights that while investors have been putting cash to work, cash levels remain reasonably high (i.e. at 4.5%, which is broadly the middle of the normal range). Furthermore, we have downgraded US recession risk for 2024, reflecting the Fed pivot, amongst other factors.

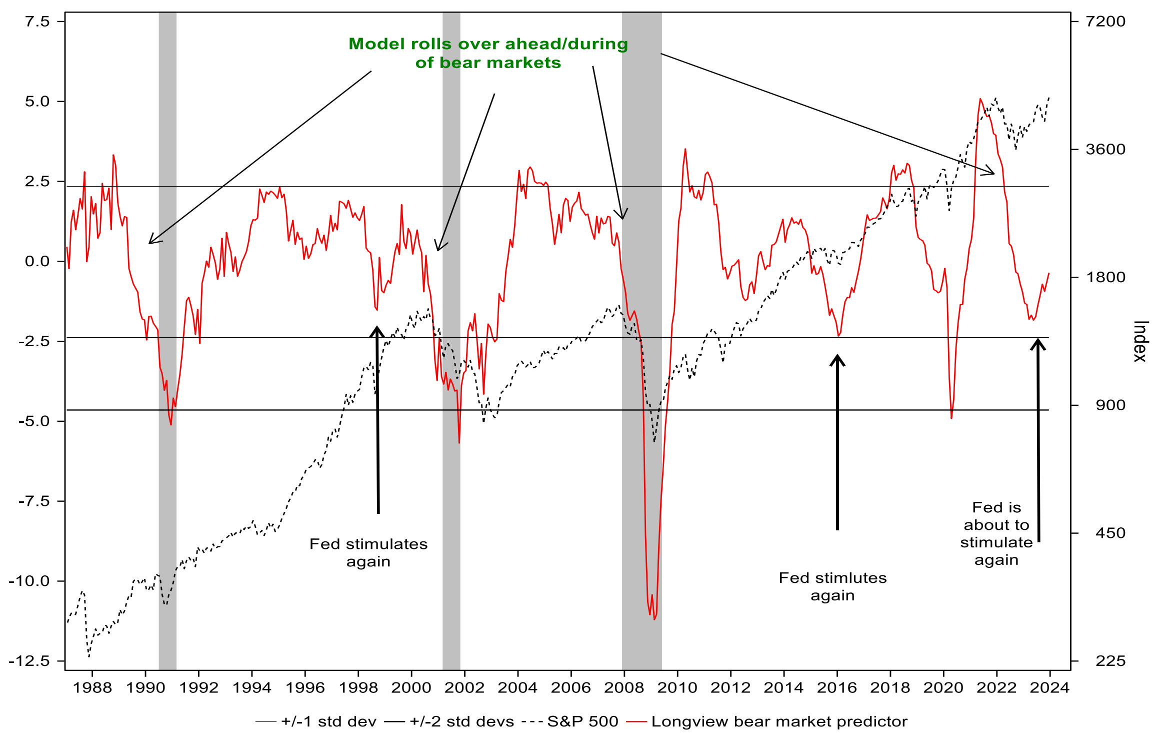
Those factors are outlined in detail below:

1. **Breadth in the equity market** has been especially high in recent months. The NYSE (10 day smoothed) advance-decline line, for example, generated a 'breadth thrust' signal on 14th November (which we highlighted in recent publications). When this model goes above +3 it signals broad single stock participation in the rally (encouraging confirmation by single stocks that the outlook is improving). Historically those signals above +3 have occurred as major multi-month (or even multi-year) bull runs in equities are getting going.

That high November breadth reading was subsequently replicated in late December (although not at quite such a high level). Consistent with that, there's also been a Mclelland summation signal (which is similar in composition but rarer). Breadth models are, therefore, signalling the start of a new bull run in equities**.

2. Our **stock market bull-bear models** are now both generating 'bull market' signals. The trend signal model generated a bullish signal in the middle of 2023, which has subsequently been confirmed more recently by the 'bull-bear market forecasting' model (a macro based indicator) which has been turning upwards (fig 1e).

Fig 1e: Longview 'bull-bear market' predictor (macro model)

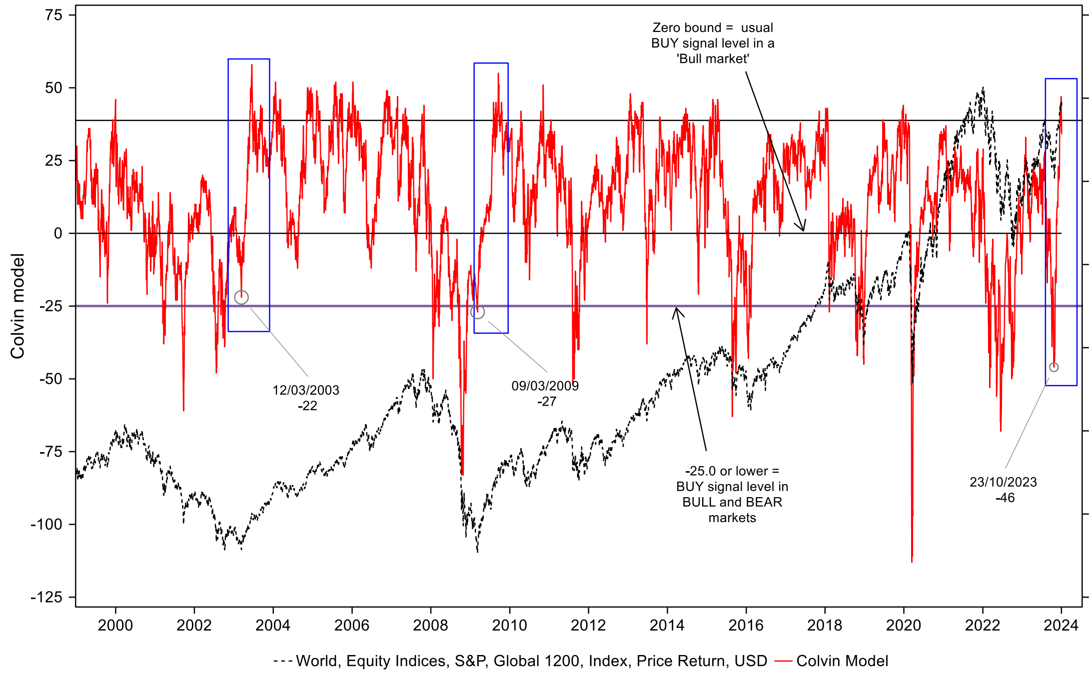


Source: Longview Economics, Macrobond

**albeit the bull run originally started in October 2023.

3. The **Colvin** model is behaving in a manner consistent with a new bull run in equity markets. Whilst it's a subtle point, it's notable how the speed of the move in the Colvin model from strong BUY through to strong SELL (since late October 2023), is notably similar to prior moves at the start of new bull markets. In 2003, for example, the model moved sharply, and quickly, from strong BUY to strong SELL. It behaved similarly in 2009 (after the end of the GFC). Whilst it has rallied sharply in other examples, it hasn't done it to such an extent (i.e. from BUY through to SELL in one movement, as it has typically stalled and slowed etc, e.g. see 2017). In that respect, this is similar to an unusually high RSI reading (i.e. around 90 or so) – which, rather than signalling that an asset is overbought, is more likely signalling the start of a new sustained bull run.

Fig 1f: Longview Colvin model*** shown with the S&P500



Source: Longview Economics, Macrobond

***NB The Colvin model is a Longview designed model to measure how overextended/oversold a range of global asset prices have become. It uses Bollinger bands and a scoring system to generate the final model reading.

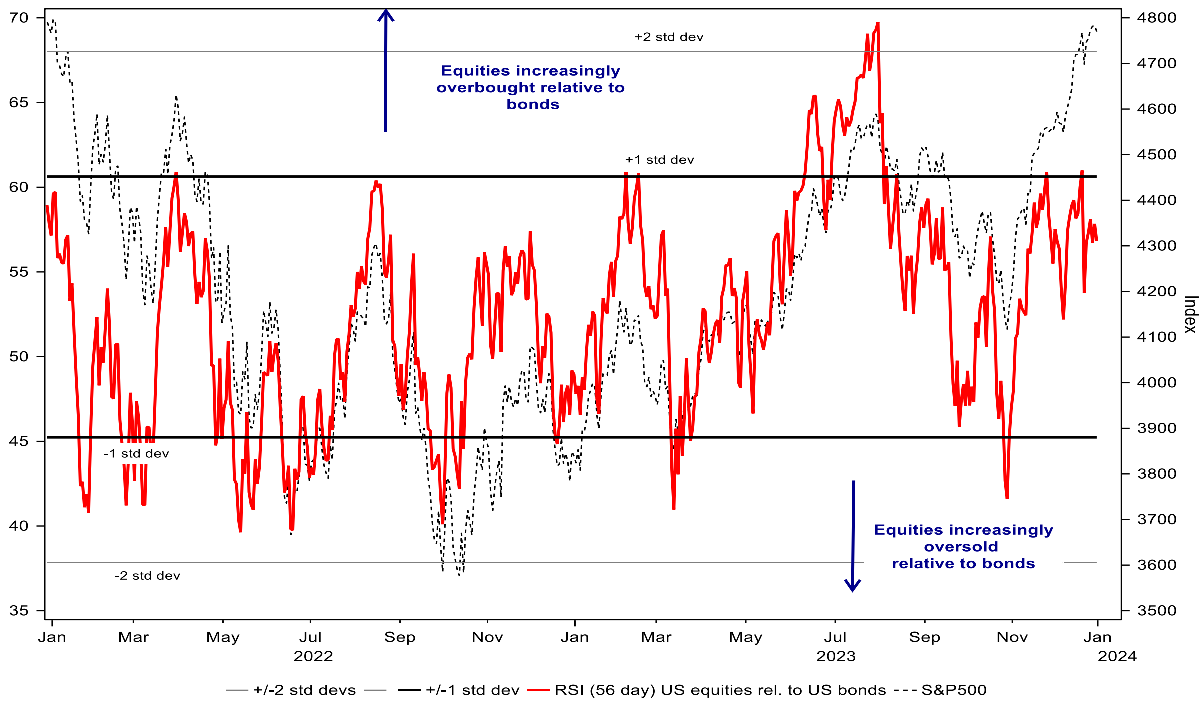
4. The **correlation model** is behaving like the Colvin indicator. That is, it's behaving in a manner consistent with the start of a new bull run. As fig 1 shows, the model typically ebbs and flows with the month by month market moves (i.e. it normally correlates with the equity market). Of late, though, the two lines have diverged significantly. This is highly unusual behaviour which is rarely replicated (and was last seen in mid-2003, after the start of that bull market). Its current high, positive correlation reading is consistent with a high breadth reading, and implies that lots of stocks are moving in the same direction (i.e. are rallying).

Conclusion: Whilst key medium term models are back on SELL and therefore encouraging a degree of caution, unlike other occasions in the past 3 years when those models have been on SELL, this is not a time to be underweight risk assets. In particular, there are no signs of euphoria, whilst there is also evidence that a new bull run is underway. As such, and in order to balance those conflicting signals, we recommend continuing with modest overweight equity positions for now, but expect to build on/increase the size of that overweight on weakness (if forthcoming). In other words, our central case is modest weakness (at this juncture/in the near term), with more upside over the course of January (into February).

Key risks, as always, are multiple and include the risk of an escalation of the Middle Eastern conflict (with Iran increasingly drawn into the regional conflict/and with associated oil price risks). Equally the liquidity signals, as highlighted last month, continue to be a concern. US quarterly earnings season also starts next Friday with the major banks reporting.

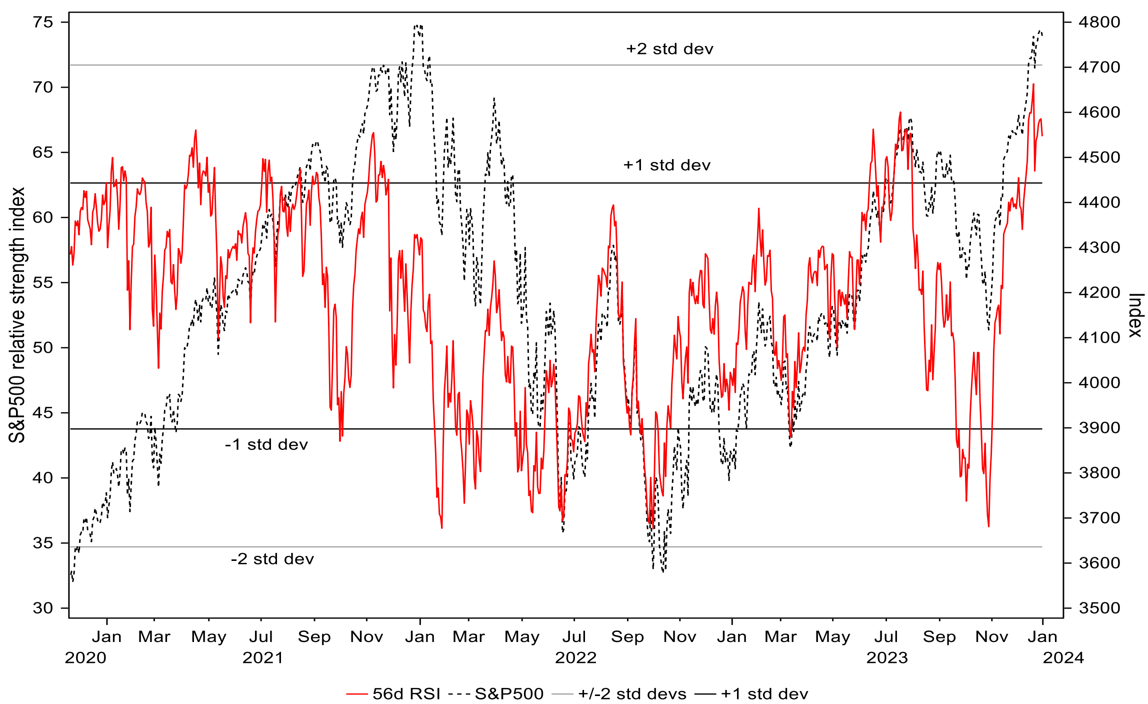
Section 2: Technical Market Timing Models – Index Models

Fig 2: RSI (equities relative to bonds) vs. S&P500



Source: Longview Economics, Macrobond

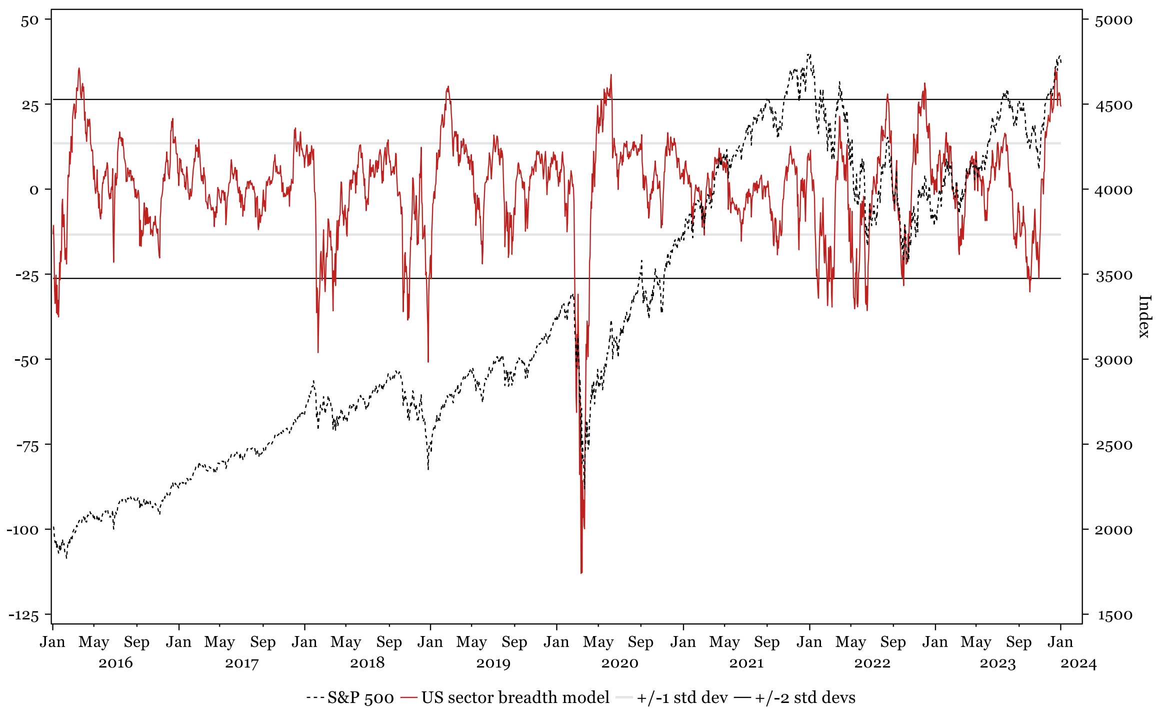
Fig 2a: Medium term RSI for equities (S&P500) vs. S&P500



Source: Longview Economics, Macrobond

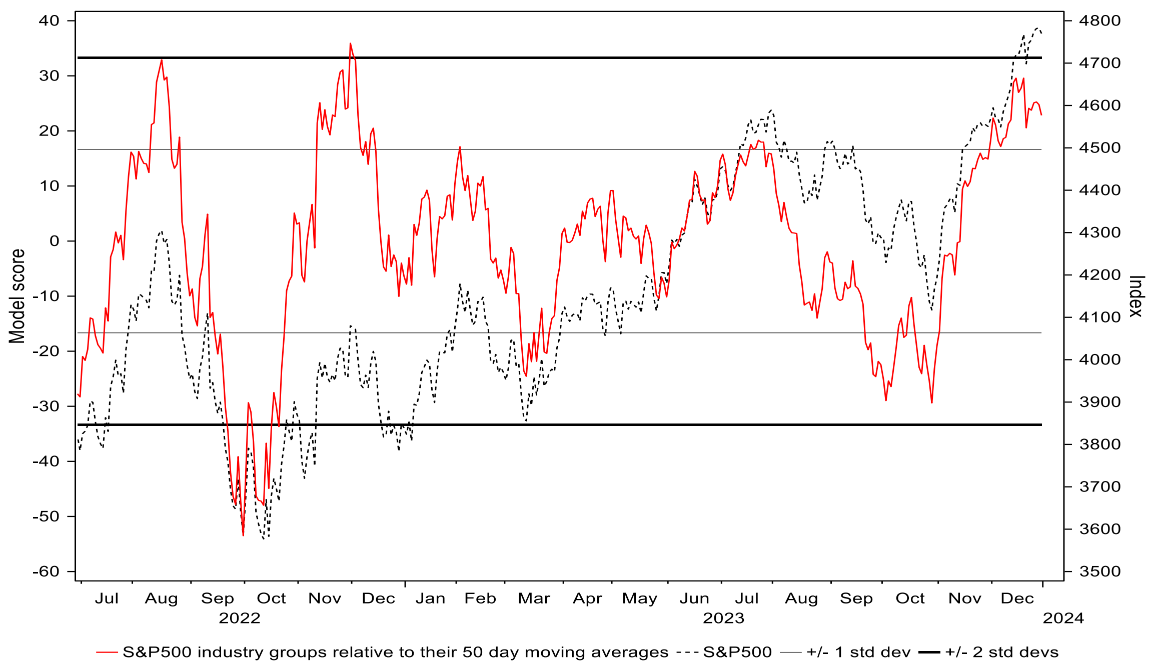
Section 2a: Technical Market Timing Models – Sector Models

Fig 2b: US sector breadth model vs. S&P500



Source: Longview Economics, Macrobond

Fig 2c: S&P500 industry group technical model vs. S&P500



Source: Longview Economics, Macrobond

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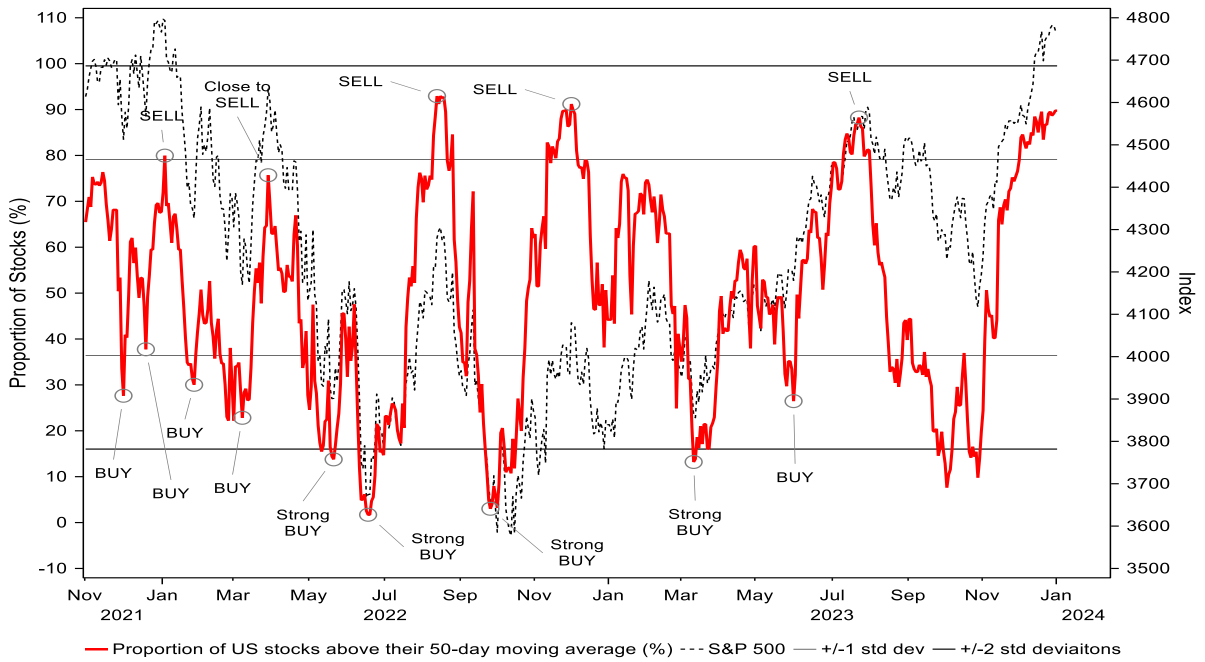
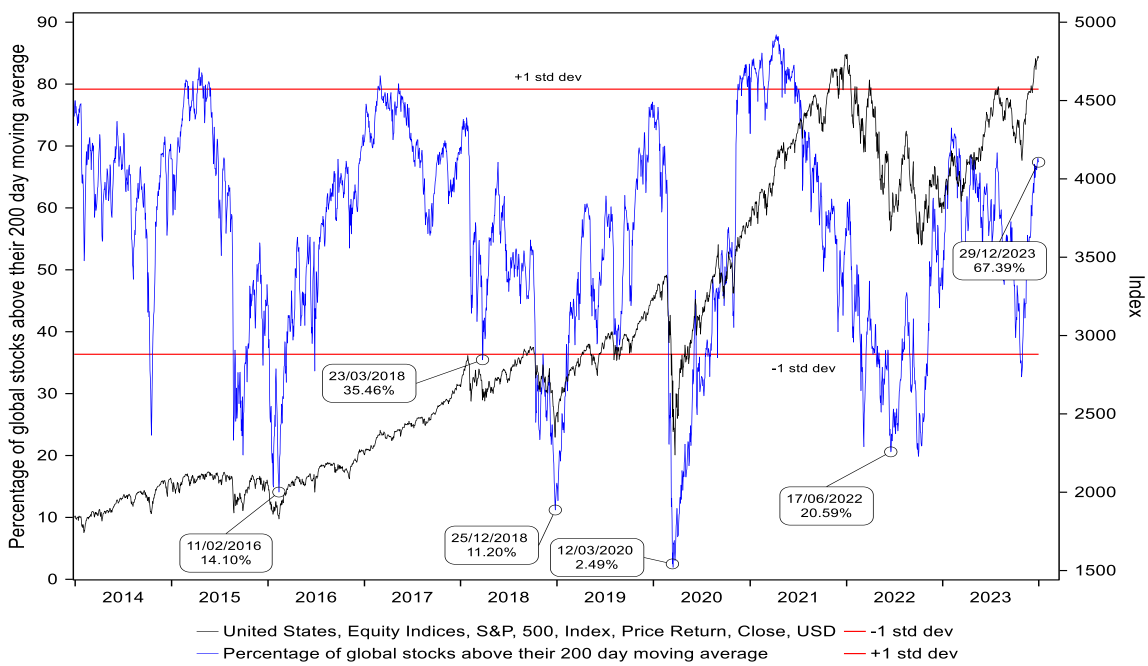
Section 2b: Technical Market Timing Models – Single Stock Models

Fig 2d: Proportion of US stocks above their 50 day moving averages



Source: Longview Economics, Macrobond

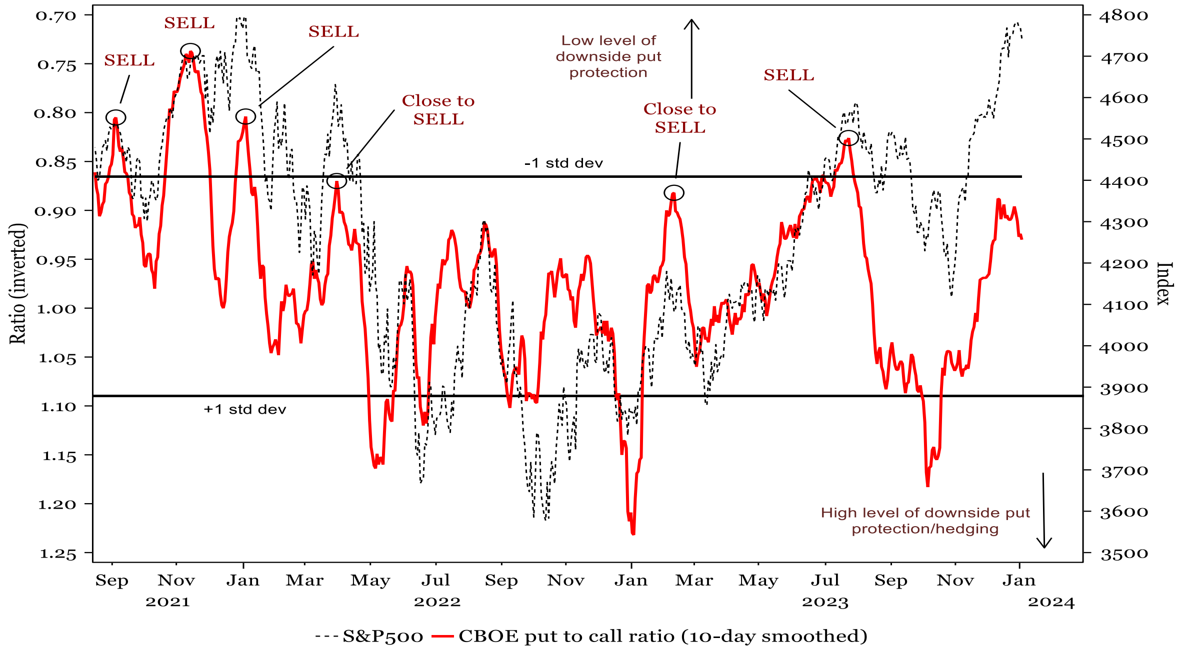
Fig 2e: Proportion of Western stocks above their 200 day moving averages vs. S&P500



Source: Longview Economics, Macrobond

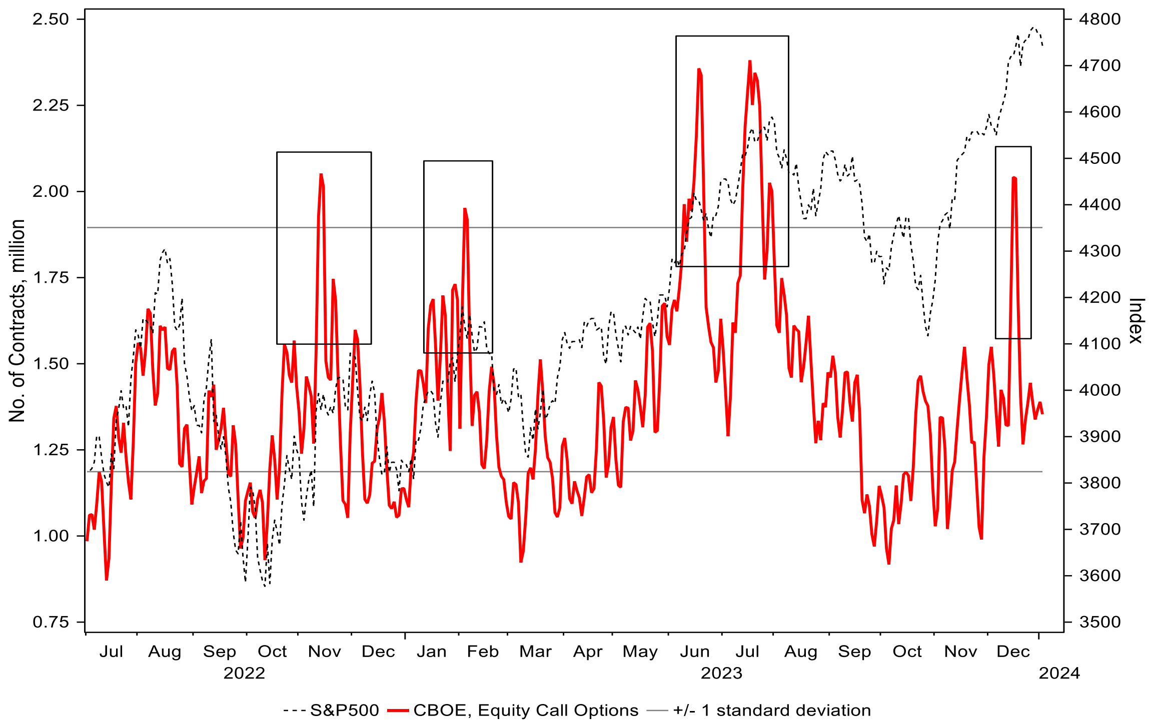
Section 2c: Market Euphoria Models

Fig 2f: CBOE 10 day smoothed put to call vs. S&P500



Source: Longview Economics, Macrobond

Fig 2g: Volume of CBOE 'single stock' call options (3d smoothed) vs. S&P500



Source: Longview Economics, Macrobond

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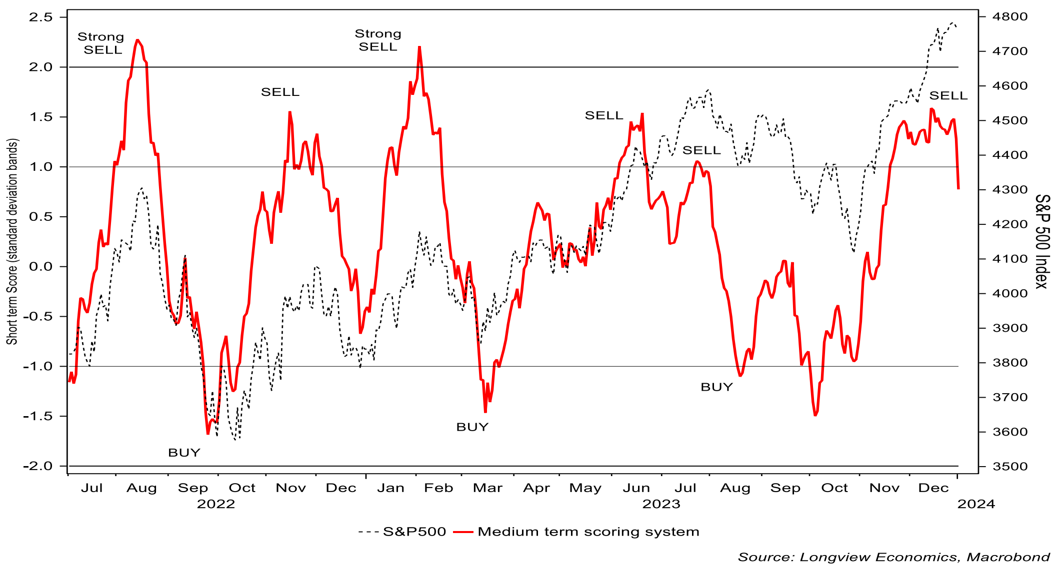
Section 3: Longview Scoring Systems

Methodology overview: In the short term (i.e. 1 – 4 months) the **trend in equity markets is driven by the ebb and flow** of **'greed and fear'** (i.e. positioning). That's why we rely heavily on our key models and scoring systems in determining our recommended monthly tactical asset allocation. The monthly tactical decision is approximately 60% models based and 40% discretion.

Our models are primarily price based/price related in their composition. They draw on a wide list of global inputs across all asset classes. There are 3 main model inputs into the monthly tactical asset allocation process. They are: i) The 'fast moving' TAA scoring system (fig 3); ii) The 'slow moving' market environment scoring system (fig 3a); & iii) the 'SELL-off' indicator (fig 3d). The 'fast moving' scoring system is timely and efficacious and helpful for pinpointing specific weeks for market timing moves. It relies primarily on risk appetite based indicators. The slow moving scoring system is designed to generate an overall picture of the general 'market environment' (including general sentiment, technical positioning, complacency measures and so on). It achieves this by incorporating a larger number and broader range of indicators than the fast moving model (e.g. including sentiment models, technical models, bond spreads and so on). We combine the message of all three model inputs (plus any other models that are of occasional interest) and couple that with judgment (and over a decade of experience using these models) to determine a recommended tactical asset allocation.

Models Summary: The Longview **'fast moving'** scoring system (fig 3) is (just) NEUTRAL while the **'slow moving'** market environment scoring system (fig 3a) is on SELL. Of the five subcomponent categories of the slow moving scoring system, the 'Bond Spreads' and 'Sentiment' components are generating SELL signals, the 'Technicals' component is generating a strong SELL signal, while the other two components are NEUTRAL.

Fig 3: Longview 'fast moving' TAA scoring system vs. S&P500

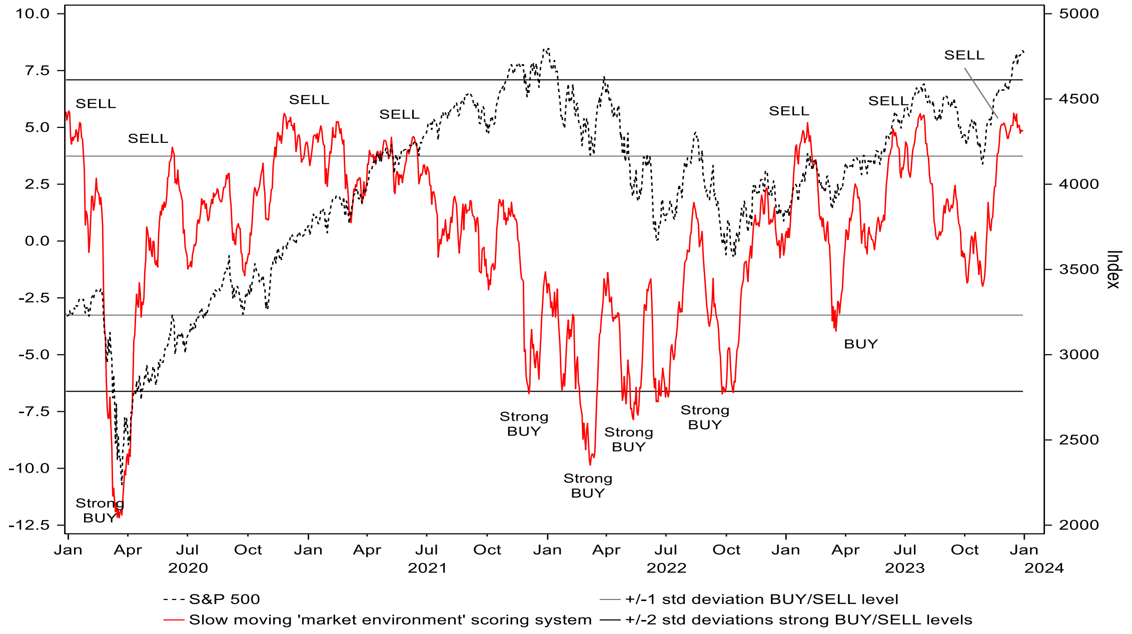


Our medium term 'fast moving' scoring system is NEUTRAL

This scoring system is comprised of eight models, with each scored daily and individually.

The Longview 'fast moving' scoring system generates more frequent signals aimed at shorter time frames than the 'slow moving' scoring system. It's more effective in picking turning points, especially local market highs. The choice of indicators is tighter (it includes only 8 models in total). We deliberately exclude slower moving models which often generate signals (especially SELL signals) significantly early, for example sentiment and overbought technical indicators. The key models are risk appetite based. Some models also measure over-exuberance (excessive risk taking).

Fig 3a: Longview 'slow moving' market environment scoring system vs. S&P500



Source: Longview Economics, Macrobond

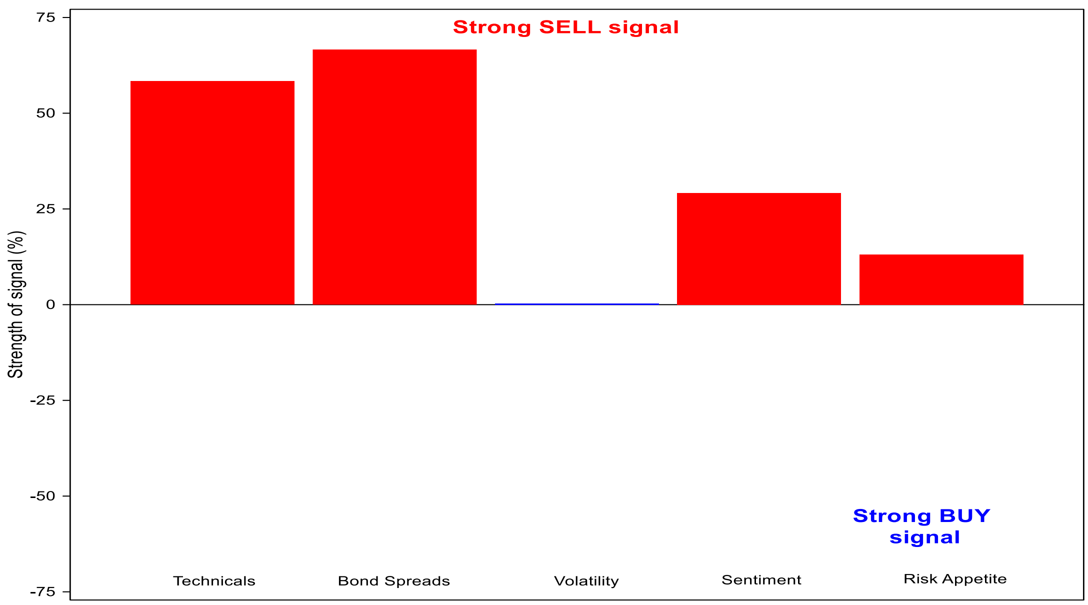
Our medium term 'slow moving' scoring system is on SELL

This scoring system is comprised of eight models, with each scored daily and individually.

Our slow moving 'market environment' scoring system (fig 3) aggregates a suite of models across a number of categories (namely: Technicals, Bond Spreads, Volatility, Risk Appetite & Sentiment). This scoring system is entirely mechanistic. Typically, a score of -3.5 (i.e. -1 std deviation) indicates a BUY signal (within a cyclical bull market) and +3.5 a SELL signal. The individual categories are scored and then aggregated to create the scoring system (see fig 3a). The 'fast moving' TAA scoring system (fig 3b) is an aggregation of 8 faster moving indicators, and is used to finesse entry points into medium term trades.

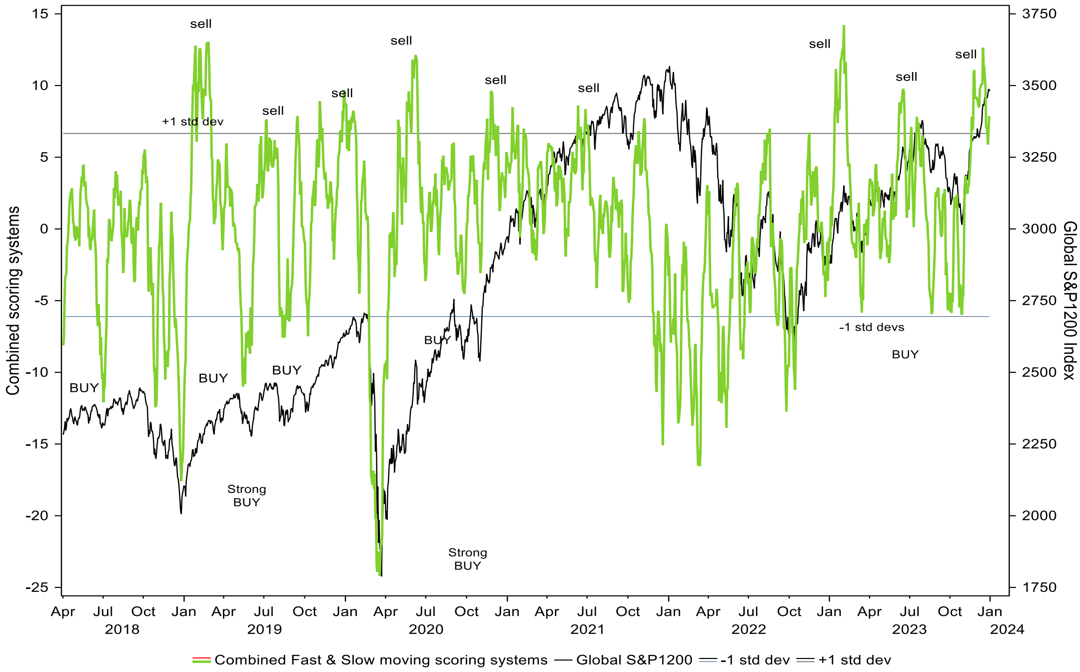
For further detail/explanation of any of the models within this section, please see 'models explanation' at the back of this publication, or contact us via email.

Fig 3b: Longview 'slow moving' Market Environment scoring system – key categories



Source: Longview Economics, Macrobond

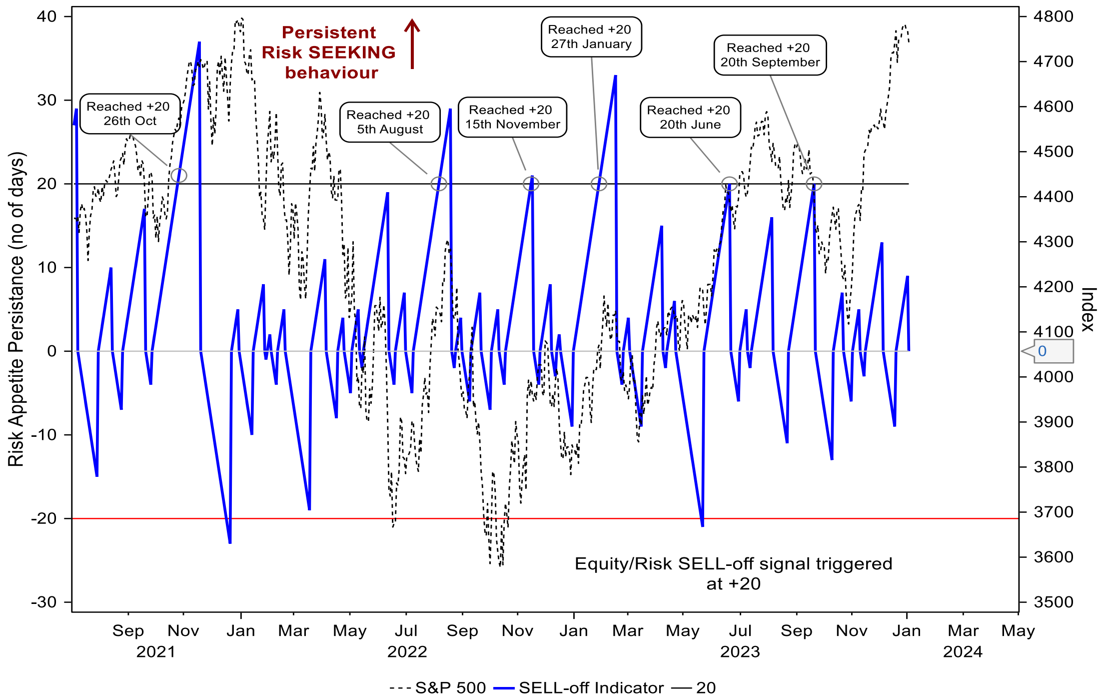
Fig 3c: Combined Slow Moving & Fast Moving Scoring systems vs. S&P500



Source: Longview Economics, Macrobond

The combined slow & fast moving scoring system is on SELL

Fig 3d: Longview SELL-off Indicator vs. S&P500



Source: Longview Economics, Macrobond

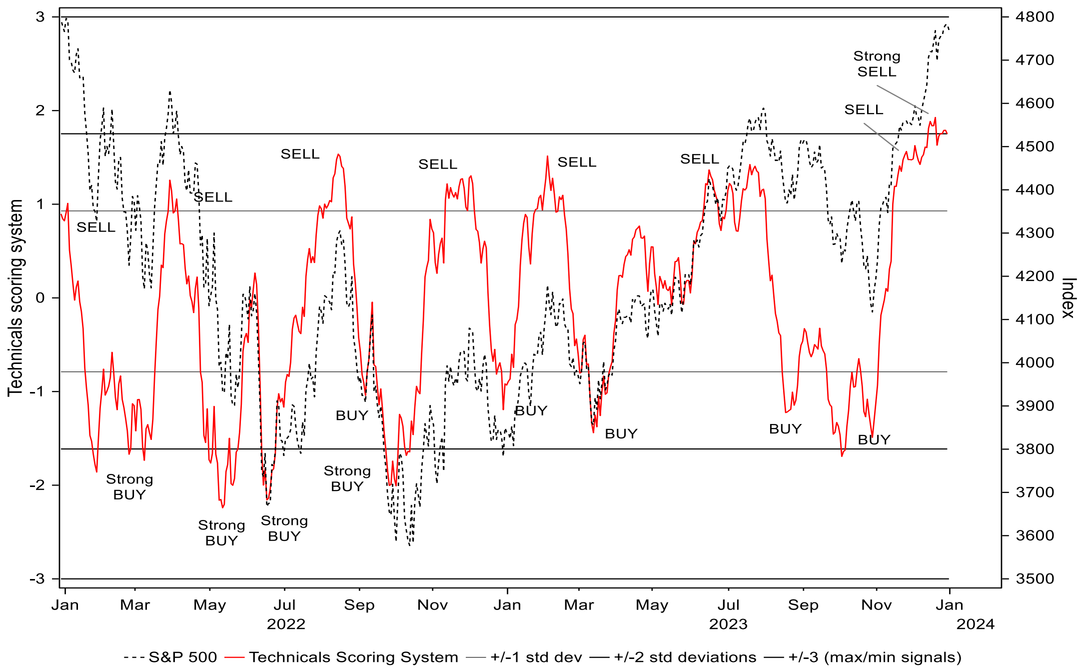
The Longview SELL-off indicator is currently NEUTRAL

(N.B. +20 is the SELL-off warning threshold).

The SELL-off indicator is an indicator derived from the Longview short term risk appetite model. It highlights phases of excessive greed in global financial markets – i.e. phases of overexuberance. It generates a signal when it reaches +20. At that time, the probability of a near term 5 – 10% pullback in the S&P500 is high.

Section 3i: Longview Scoring Systems – Key Sub Categories

Fig 3e: The 'Technicals*' scoring system vs. S&P500 index

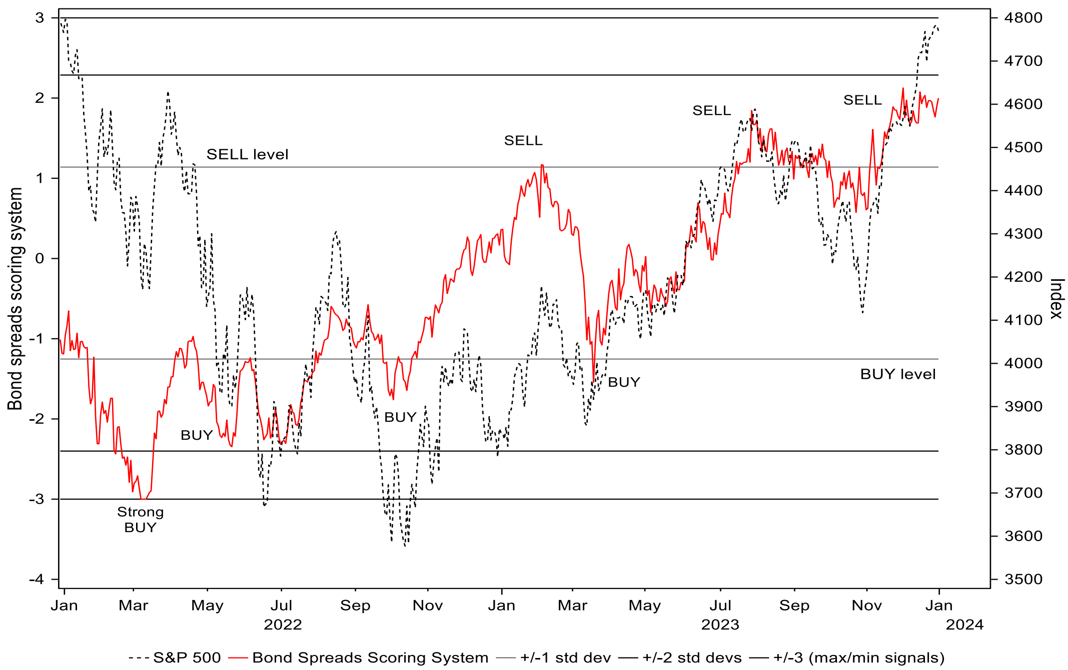


Technical factors summary: Technical models are on strong SELL (just)

Source: Longview Economics, Macrobond

*The 'technicals' scoring system scores and aggregates the signals from 9 different technical type indicators including overbought-oversold models, breadth models and put to call models

Fig 3f: 'Bond Spreads'* scoring system vs. S&P500 index

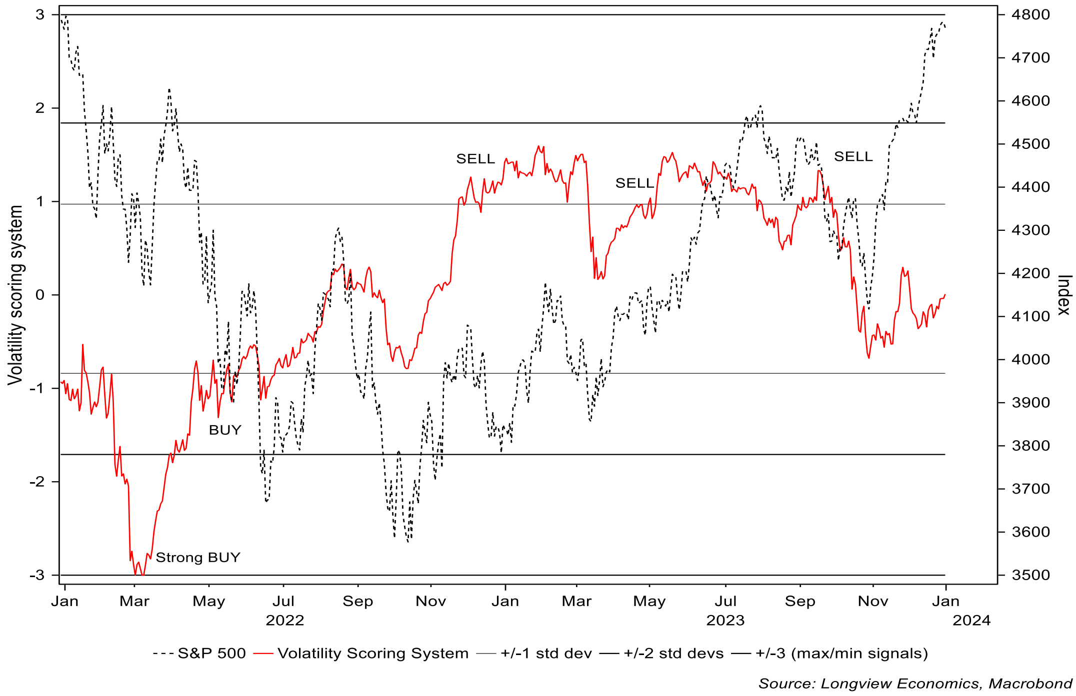


Bond Spreads Summary: This model is on SELL

Source: Longview Economics, Macrobond

*Bond spreads measures, scores and aggregates risk premium in the credit markets across corporates and EM debt

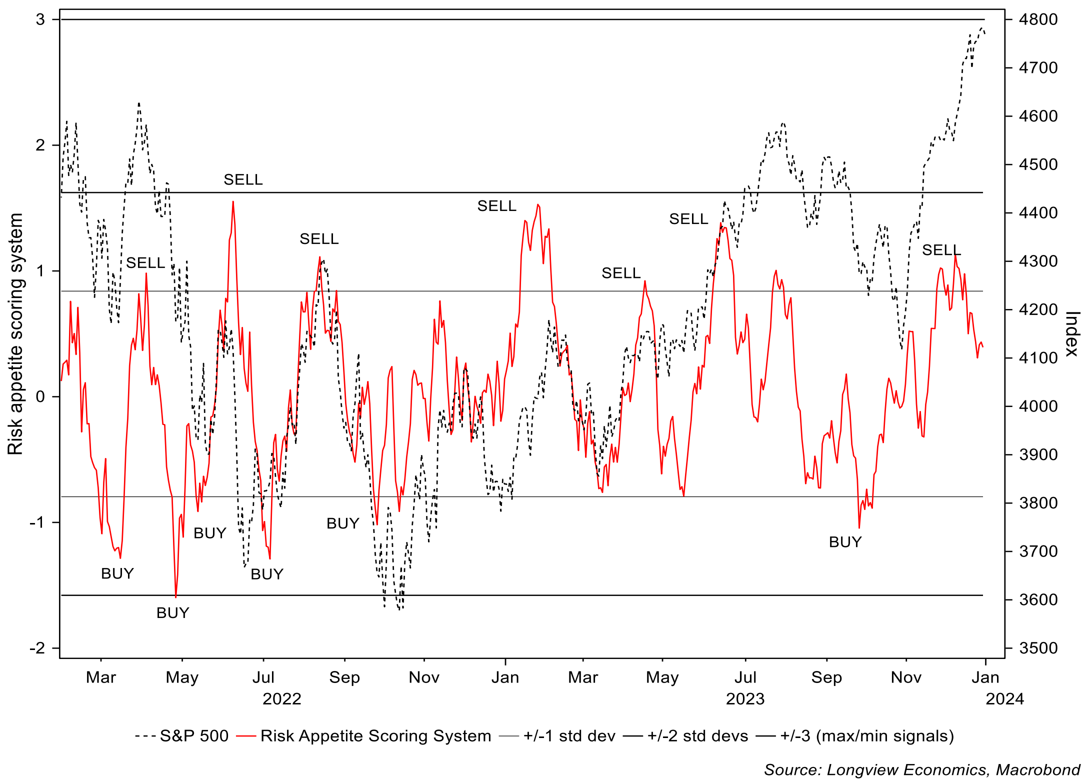
Fig 3g: 'Volatility' scoring system* vs. S&P500 index



Volatility summary: The volatility model is NEUTRAL

*The volatility scoring system aggregates the signals from a variety of volatility measures/models drawing upon a variety of types of financial assets across various geographies

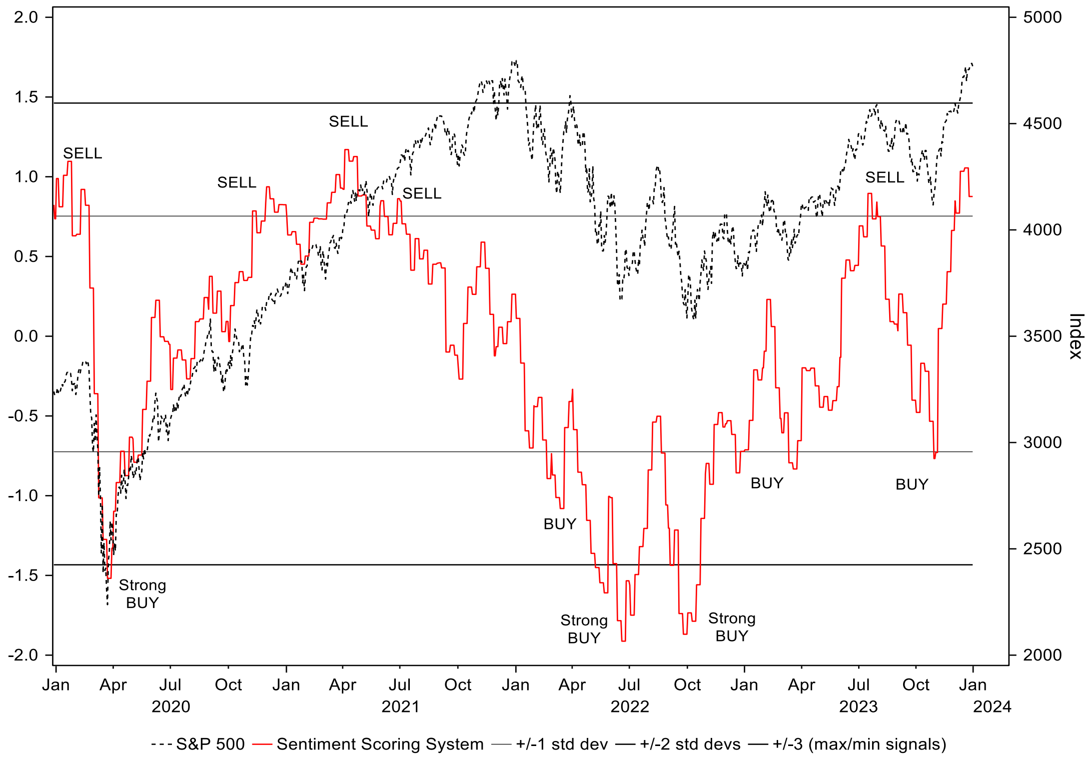
Fig 3h: 'Risk Appetite' scoring system* vs. S&P500 index



The risk appetite scoring system is NEUTRAL

*The risk appetite scoring system aggregates the scores of 3 Longview in-house medium term risk appetite models

Fig 3i: 'Sentiment' scoring system* vs. S&P500 index



Source: Longview Economics, Macrobond

The sentiment scoring system is on SELL

*This scoring system scores and aggregates the message from 4 sentiment indicators including: AAII retail sentiment, US Equity Advisory Optimism and Consensus Bullish Sentiment (which is based on market opinion published by brokerage houses and available at: http://www.consensus-inc.com/)

Appendix A: Equity Recommendation – for various portfolio strategies

Table A: Asset Allocation Recommendation **– for Tactical Asset Allocators**

	US Equities* (% weighting)	US government Bonds (% weighting)	Cash (% weighting)
Permitted Range	+/-10pp	+/-10pp	+/-10pp
Longview benchmark	45.0	45.0	10.0
Over-under weight	**+1.0**	**-**	**-1.0**
Current recommendation	**46.0**	**45.0**	**9.0**

Source: *Longview Economics*

We recommend staying (modestly) tactically overweight equities (and neutral bonds).

The tactical asset allocation (TAA) decision is between US equities*, government bonds & cash with a 1 – 6 month time frame. The aim is to mimic an institutional approach to US (mainstream) tactical asset allocation. That typically requires outperformance from a TAA overlay of between 20 – 50bps (and in some cases higher). For the purpose of performance measurement, the allocation is assumed to be implemented at the close of trading on the business day immediately prior to publication of the report. The permitted range on the allocation to each asset class is as in Table 1 above. Performance history is shown below on an annual basis and on a monthly basis.
*US equities are measured using an S&P500 total return index; US 10 year government bonds are measured using a JP Morgan total return 10 year government bond index. Cash is measured using US 3 month T Bills.

Table Ai: Equity Strategy for the Simulated Global Macro Fund Product

Equity Strategy for Simulated Global Macro Fund:	US Equities net (SHORT)/LONG
Permitted Range (aggressive)	-100% to +150%
Current recommendation (for global macro fund)	**+10%**

Source: *Longview Economics*

N.B. Table Ai used to be an Equity Long-Short recommendation. These have been changed as of 1st February 2017. These recommendations in Table Ai above will now be part of the simulated macro fund (and subsumed into that performance). The aim is to create a 1 – 4 month equity market weighting for a global macro hedge fund, thereby taking advantage of market pullbacks and market rallies (on a 1 – 4 month basis). Shorter term market movements (i.e. 1 – 2 weeks) are picked up in the Daily RAG product.

Table Aii: Top level Strategy Recommendation – **for LONG ONLY Equity Portfolios**

	Global Equities (S&P1200)	Global Cash
Range	85 – 100%	0 – 15%
Longview benchmark:	92.5%	7.5%
Over-under weight	+1.0pp.	-1.0pp.
Current recommendation	93.5%	6.5%
Sector split of Equity allocation:		
S&P1200 Cyclicals vs. Defensives*	S&P1200 Cyclical sectors	S&P1200 Defensive Sectors
Range	+/-10pp	+/-10pp
Longview benchmark:	72.0%	28.0%
Over-under weight	0.0	0.0
Current recommendation	67.3% (i.e. 72% of 93.5%)	26.2% (i.e. 28% of 93.5%)

Source: *Longview Economics, Standard & Poors*

The aim of the strategy recommendation for long only equity portfolios is to make the top level strategy call (not to make sector strategy recommendations). That top level call can primarily be captured in 2 key ways: i) cash levels within a portfolio; and ii) top level sector strategy asset allocation – i.e. defensives vs. cyclical sectors. Hence we show in this table both a recommended cash weighting (between 0 and 15%) as well as a split of the equity weighting between defensive and cyclical sectors. We use the S&P1200 global index as the basis for evaluation of our recommendations.

*The classification of **cyclical sectors** includes the following sectors: IT, Consumer Discretionary, Materials, Energy, Financials and Industrials. **Defensive sectors** are Telecoms; Utilities, Healthcare and Consumer Staples.

Table Aiii: Global S&P1200 sector heatmap****

02/01/2024	Cons disc.	Cons staples	Energy	Financials	Health Care	Industrials	Info tech	Materials	Comm. Services	Utilities	Index
Cons disc.		10	6	14	40	67	83	55	53	39	60
Cons staples	91		13	55	94	97	99	90	83	62	98
Energy	95	88		95	96	98	97	101	92	93	97
Financials	87	46	6		79	90	91	87	69	67	88
Healthcare	61	7	5	22		73	87	66	61	39	67
Industrials	34	4	3	11	28		82	43	42	32	24
Info tech	18	2	4	10	14	19		28	15	16	14
Materials	46	11	1	14	35	58	73		46	36	45
Comm. Services	48	18	9	32	40	59	86	55		31	57
Utilities	62	39	8	34	62	69	85	65	70		64
Index	41	3	4	13	34	77	87	56	44	37	

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

***re: Sector choices – please see Global sector heat map laid out above showing relative PE ratios of all sectors versus each other. Of note, relatively cheap sectors include financials, energy, and consumer staples. Relatively expensive sectors include IT, industrials & materials.
****NB this table should be read as 'columns versus rows' – i.e. the sector name above, relative to the sector name to the left.

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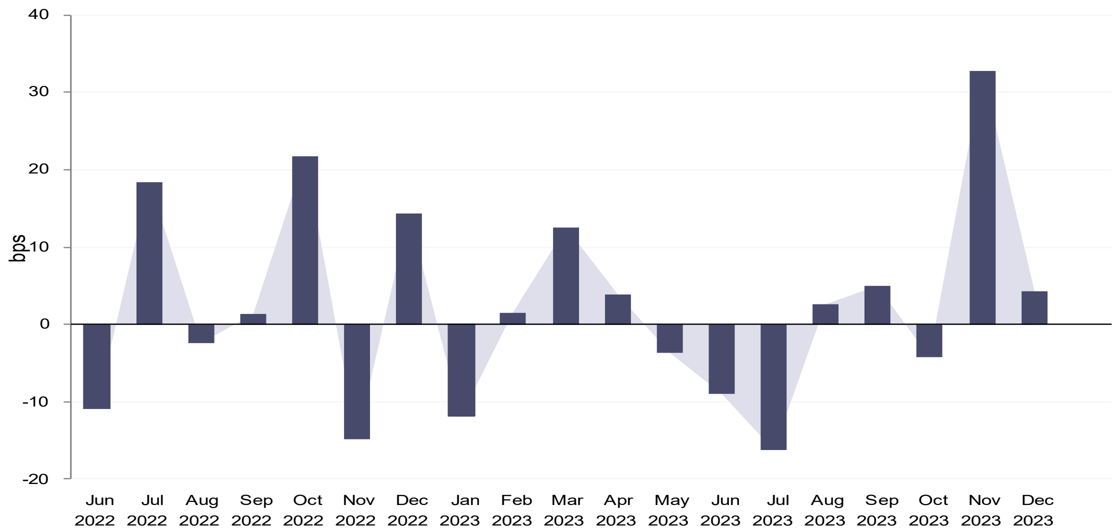
Appendix B: Historical Performance – Equity Recommendations

Fig B: Monthly performance of Longview TAA portfolio vs. benchmark (bps)



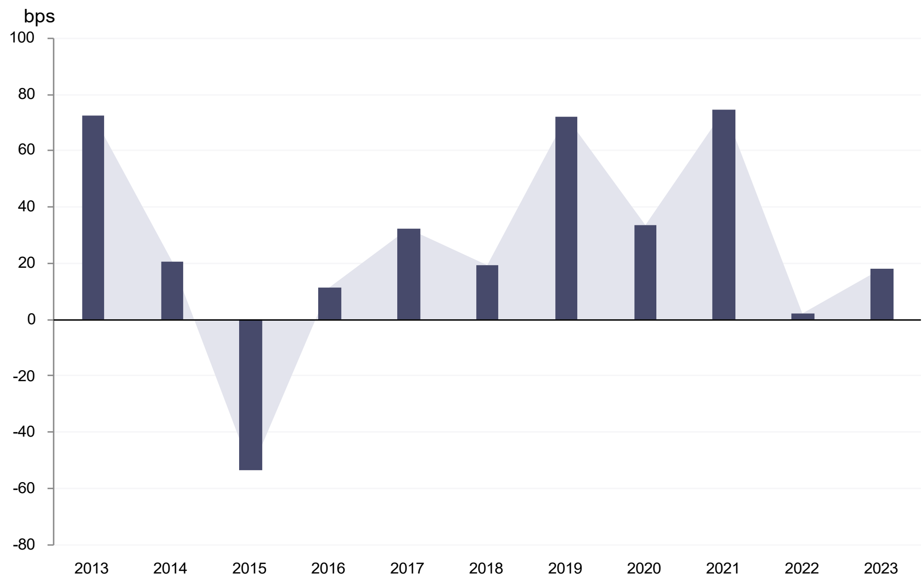
Source: *Longview Economics*

Table Bi: Historical performance* of Longview Economics' asset allocation recommendations

	2017 bps	2018 bps	2019 bps	2020 bps	2021 bps	2022 bps	2023 bps
Benchmark	1054	-145	1816	1502	1047	-1499	+1410
Longview absolute	1086	-125	1888	1536	1122	-1497	+1428
Longview rel. to benchmark	+32	+19	+72	+34	+75	+2	+18

** N.B. sums may not add due to rounding*
NB Longer history available on request (i.e. back to '04)

Fig Bii: Historical performance of Tactical Asset Allocation recommendations (last 11 yrs)



2023 performance was +18bps (just below target levels).

NB annual target is +20 – 50bps

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