Market update: 7th inning stretch

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7th inning stretch

- The big change since Jan 1: expelling a large producer of energy, industrial and agricultural commodities (Russia) when COVID, deglobalization and fiscal/monetary policy create unprecedented inflationary pressures

- Most of the stimulus driven surge in valuations has been completely reversed
- Markets pricing in meaningful likelihood of recession but not certainty
- Expect intermittent rallies due to buybacks and institutional rebalancing before a final leg down later this year as full consequence of monetary/fiscal reset are clearer
- Profits recession more likely than growth recession
- Selling now would require excellent market timing and market breadth to benefit
Global slowdown approaching

Leading indicators point to sharp drawdown in global manufacturing, Global PMI survey

In 19 of the 21 market corrections since 1950, leading indicators bottomed before markets rebounded.

Source: Piper Sandler, JPMAM. April 18, 2022.
CEOs can sense it, confidence approaching levels seen before prior recessions
Typically followed by sharp decline in capital spending and in profits

CEO confidence survey on economic conditions
Index, 50+ = positive outlook

Source: Conference Board, JPMAM. Q1 2022. Shaded areas = recessions.
Inspecting the damage
S&P decline already similar to some of the less damaging recessionary bear markets

S&P 500 drawdowns from peak to trough

% decline

COVID stimulus valuation premiums are gone

**P/E ratios: Megacap, Core, Growth and Value**

Price / consensus 12 month forward earnings per share

Source: Datastream, Bloomberg, JPMAM. May 30, 2022. Megacap 8 includes GOOGL, AMZN, AAPL, FB, MSFT, NFLX, NVDA, TSLA.
COVID stimulus valuation premiums are gone (continued)

P/E ratios: US by market cap and Europe
Price / consensus 12 month forward earnings per share

Aesop’s Fables: meme stocks, innovation ETFs, hydrogen, Bitcoin and SPACs

**Retail favorites vs S&P 500**

Index (100 = Jan 2019)

Source: Bloomberg, JPMAM. May 30, 2022

**The Tortoise and the Hare**

Index (100 = Dec 2016)

Source: Bloomberg, JPMAM. May 27, 2022.

**Performance of companies taken public via SPAC**

Equal weighted index (100 = Feb 2020)

Source: Bloomberg, JPMAM. May 31, 2022. Company returns included starting 7 days prior to merger close.

**Bitcoin vs relative performance of high Beta stocks**

Ratio

US$, thousands (log scale)


**Solactive Hydrogen Economy Index**

Index (100 = Jan 2019)


**Cryptocurrency market cap ex stablecoins**

US$, trillions

Growth stocks have been repriced, but only part of the way

Markets are still paying a high premium for growth
P/E ratio spread, growth - value

Source: JPMAM. May 2022.
Same with the NASDAQ 100: hard to describe current valuations as “distressed”

NASDAQ 100 Index price to sales ratio
Price to trailing 12 month sales ratio

Source: Bloomberg, JPMAM. May 27, 2022.
A lot more damage seen in smaller stocks within each universe

12 month drawdown of indices vs constituents

Market pessimism is nothing like the selloff in early 2020...

Market pricing of S&P 500 dividend growth
Percent, FY2 dividend growth vs FY1

Source: Bloomberg, JPMAM. May 27, 2022.
…when we noted in the Eye on the Market that equity markets were assuming a decade for earnings to recover. Typical recovery: around 3 years.

**March 2020: US earnings per share level implied by dividend futures, % of pre-virus level**

Time required to reattain prior earnings peak

Years required to regain prior peak

Date of trough earnings for all earnings declines > 15%

Venture Capital returns will come down to earth as well, eventually

Venture capital quarterly fund returns

Percent

-10%
-5%
0%
5%
10%
15%
20%
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021

Unrealized return
Realized return

The end of this journey was always going to be a rough one

**Lowest real yields on cash since 1830, other than during wartime, T-bill/Funds rate less inflation, 5-year average**

*Source: FRB, Robert Shiller, GFD, BLS, JPMAM. 2020.*

**US budget deficit**

US$, billions


**Fed balance sheet**

US$ trillions

*Source: Federal Reserve Board, Fitch Ratings. May 25, 2022.*
The market and the Fed have been wildly wrong on inflation so I take little comfort from the assumed terminal level of interest rates.

**Market implied December 2023 Fed Funds rate**

Percent

Tightest labor market on record

Largest worker shortage in the post war era
Job openings plus employment as % of labor force

Source: BLS, JPMAM. March 2022.

More jobs than workers
Wage-price dynamics are getting away from the Fed pretty quickly

Evidence of a wage-price spiral in low wage industries

% y/y change

Source: BLS, BEA, JPMAM. April 2022.
Supply chains are still a mess

**Time required for producers to acquire raw materials and intermediate inputs, Days**

Source: ISM, JPMAM. April 2022.
If real interest rates reset to traditionally positive territory, valuations may have further to fall

S&P 500 P/E vs real interest rates
Price / 12 month forward earnings               US real yield (inverted)

Other factors arguing against a quick V-shaped market rebound

- Highest food price inflation since the 1980’s
- Savings rates have plunged, and the US economy no longer benefits from unmet inventory demand
And of course housing is on the way down too

**US new single family home sales**
Annualized sales, millions

**Months supply of new single family homes**
Months, inventory / monthly sales

Now what?

• All things considered, a lot of the damage is priced in
• Probably another leg down sometime this year as the full impact of monetary and fiscal stimulus withdrawal kicks in
• Profits recession more likely than a growth recession (US Q2 GDP tracking 3%+ real growth)
• Beware of using economic and profit indicators as market timing indicators since they are usually lagging indicators
  • Business surveys like the PMI/ISM have historically been the best predictors of where the economy and the markets are headed
  • In 19 of the 21 market corrections since 1950, leading indicators bottomed before markets rebounded
Be careful trying to time the next stage of this selloff
Equity markets tend to bottom well before economic growth does

Equity markets also tend to bottom well before signs of an earnings rebound.
Business surveys are used for a reason

ISM manufacturing PMI vs S&P 500 performance

Source: Bloomberg, ISM, JPMAM. May 27, 2022.
Time capsule: 2000-2004 NASDAQ collapse and recovery
Stick with profitable companies and try to identify the ones which will become profitable

Average info tech returns
Index (100 = Jan 2000), includes stocks with market cap > $400mm

Source: Factset, JPMAM. 2022. Profitability measured as positive or negative net income in Q1 2000 and Q4 2004.
US and EM have taken a hit this year relative to Europe and Japan, but the ongoing benefits from overweighting them have barely been dented.

Overweight US & EM, underweight Europe & Japan
3-year rolling out (under) performance vs MSCI All World Index

Source: Bloomberg, JPMAM. May 2022. All equity portfolio, rebalanced quarterly. 10% OW to US, 10% UW to Europe, 5% OW to EM, 5% UW to Japan. Assumes no currency hedging.
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