Fiscal: Sisyphus or Hercules

Under-the-hood issues on tax receipts and job openings
Implied correlations extremely low
SOFR put-flies, USDCNH

Summary

- Fiscal: more Sisyphus than Hercules
- Tax receipts on production diverge vs GDP
- Job opening data worse than headline, distorted by labor hoarding…
- Warns of downside to EPS forecasts…
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- Pricing power weaker, removing another support for margins
- Inflation leading indicators are bottoming
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This monthly Macro Snapshot report blends the output from VP's key Tactical (1-3m), Cyclical (6-12m) and Structural (2-3y+) models. Clients can see our full Asset Allocation output on our portal as a dashboard (updated intra-month).

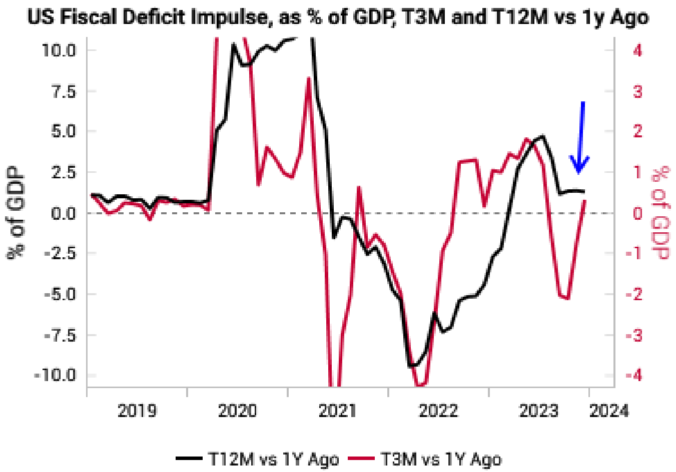
Fiscal: more Sisyphus than Hercules

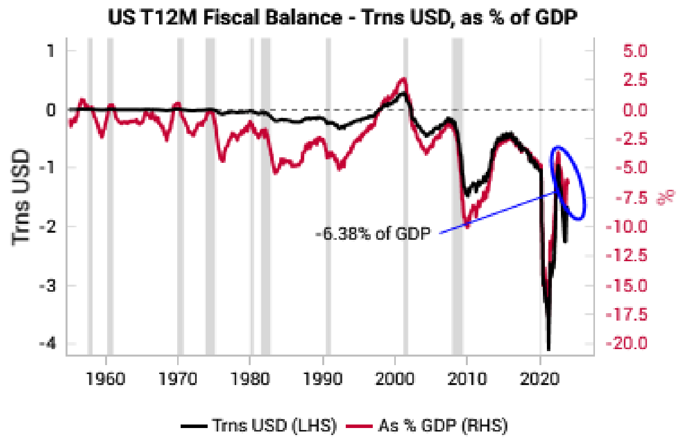
The **US fiscal impulse** is back to **neutral** again (top left chart), showing a **run rate of 6.4% of GDP deficit on T12M basis** (top right chart).

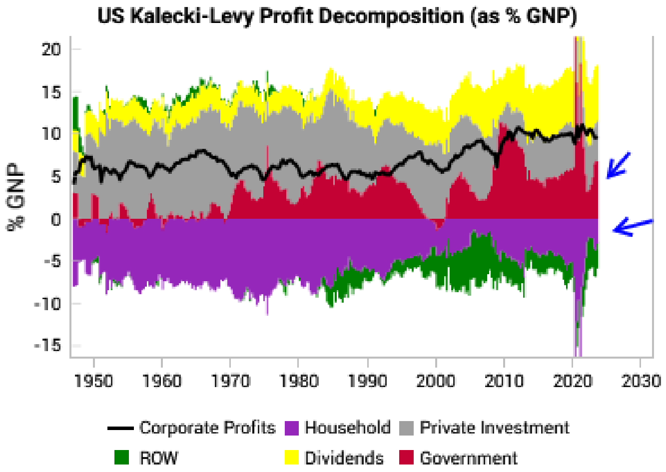
This ongoing **fiscal deficit**, alongside the **drawdown in household savings**, has been a **major support for corporate profits**. This can be shown using the Kalecki-Levy profit decomposition (bottom left chart). The red area in the chart shows the rising government deficit, while the purple area is household savings (negative as more household savings reduce corporate profits).

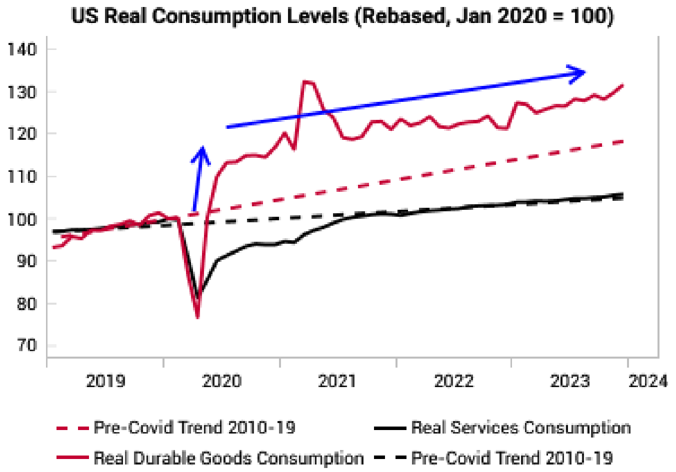
The **post-Covid** environment has been **rare in history**, with a **simultaneous drop in household savings and surge in fiscal deficits**. Historically fiscal deficits only surge in recessions when household savings are rising. Today's rare combo has enabled real durable goods consumption to stay elevated (bottom right chart).

The impact of fiscal has been obvious, but we see signs that suggest an elevated dependence on continued fiscal spending. **Like Sisyphus rolling the boulder up the hill, the US economy remains vulnerable to any drop off in fiscal spending.**









Source: S&P Global, Refinitiv, Macrobond and Variant Perception

Tax receipts on production diverge vs GDP

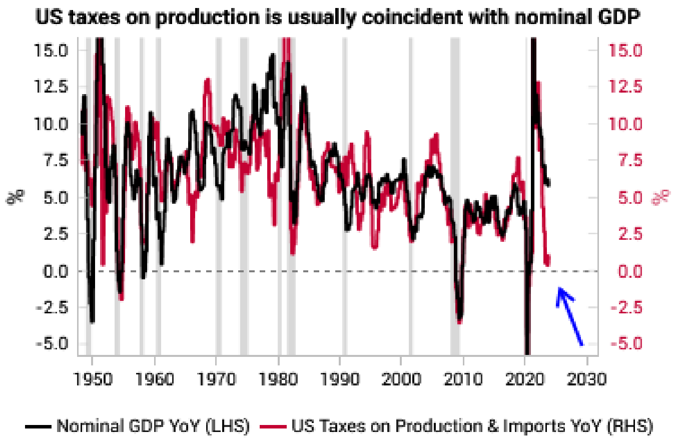
Historically there is a very good correlation between nominal GDP and taxes on production & imports (top left chart). **Today's situation of high nominal GDP growth vs barely growing tax receipts on production is rare.**

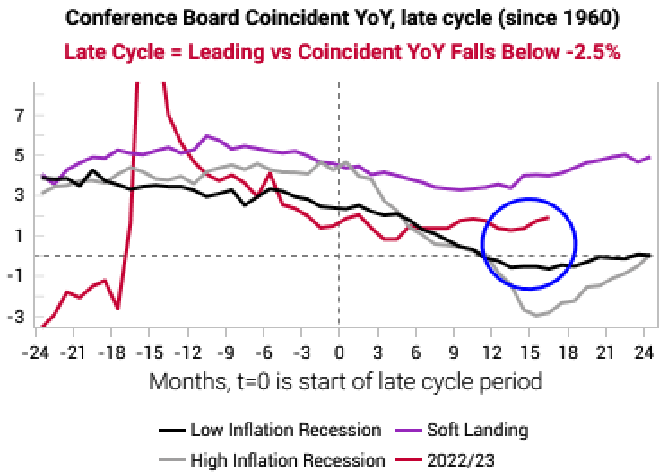
We have previously speculated that this gap is partly explained by generous green tax credits in the Inflation Reduction Act and partly explained by the economy being weaker than the headline nominal GDP suggests.

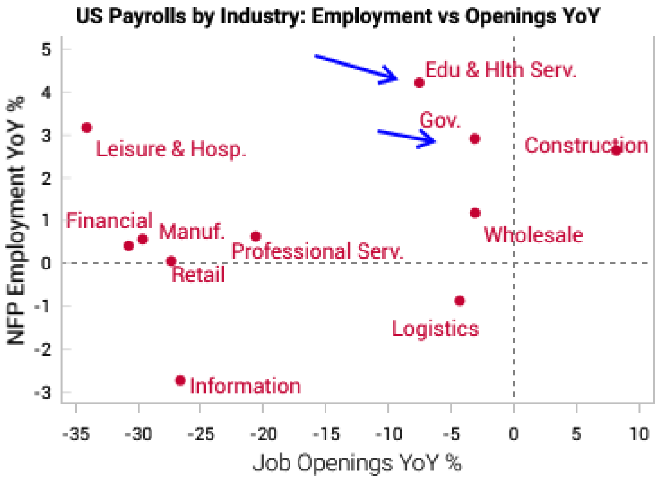
Overall, coincident growth data continues to track between a soft landing and hard landing (top right chart).

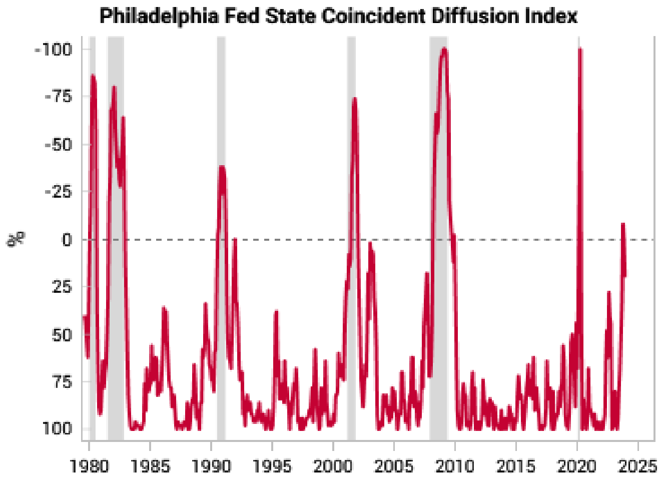
The government's impact is clear in the sector payroll data (bottom left chart). **Government** and **education / healthcare jobs** are seeing strong growth and muted falls in job openings. Other sectors are seeing big drops in openings, but employment has yet to react given labor hoarding/hiring difficulties that we have previously discussed.

The **diffusion of state coincident growth indices has also deteriorated**, which has usually occurred in recessions. This data is subject to revisions, but is another sign that the economy is not doing as well as headline GDP suggests.









Source: S&P Global, Refinitiv, Macrobond and Variant Perception

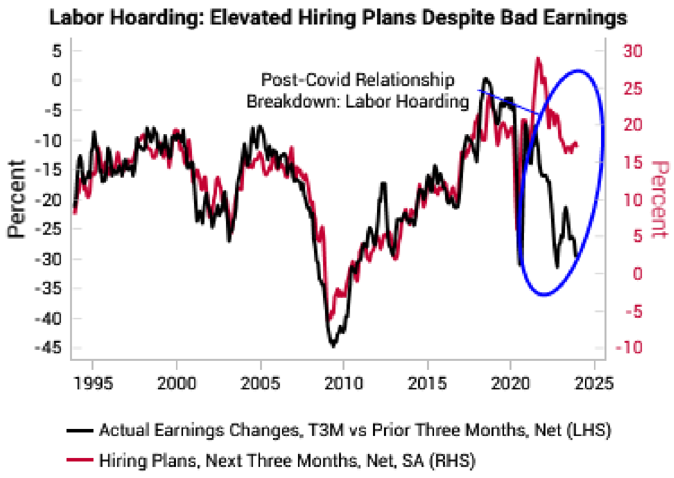
Job opening data worse than headline, distorted by labor hoarding…

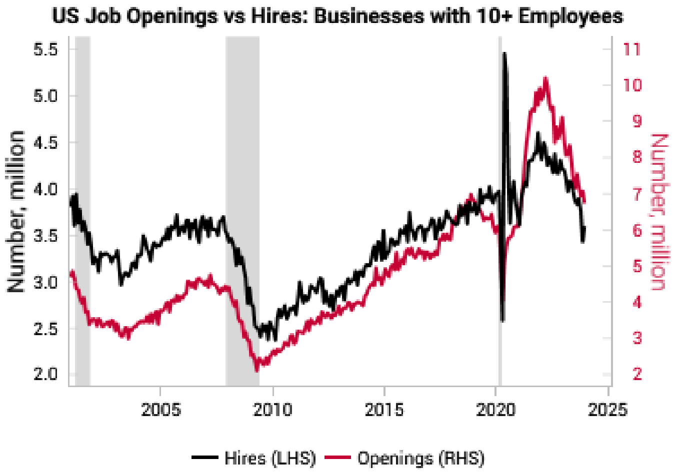
The overall **job opening** data is giving **too optimistic** a view of the economic conditions. Breaking out job openings by businesses with more than 10 employees vs less than 10 employees paints a much clearer picture.

Businesses with less than 10 employees have struggled in the post-Covid environment to hire workers, driving a large divergence between job openings and hires (top left chart).

This is a reflection of the **labor hoarding** issues we have been flagging, shown by the NFIB survey of elevated hiring intentions despite worse earnings (top right chart). The same survey shows that actual hires have been lower than intended, explaining the elevated total job openings for these micro-businesses.

In contrast, for **businesses with more than 10 employees, job openings and hires have dropped precipitously and are now below trend**. This is indicative of a worsening earnings outlook (see next slide).





Source: S&P Global, Refinitiv, Macrobond and Variant Perception

Warns of downside to EPS forecasts…

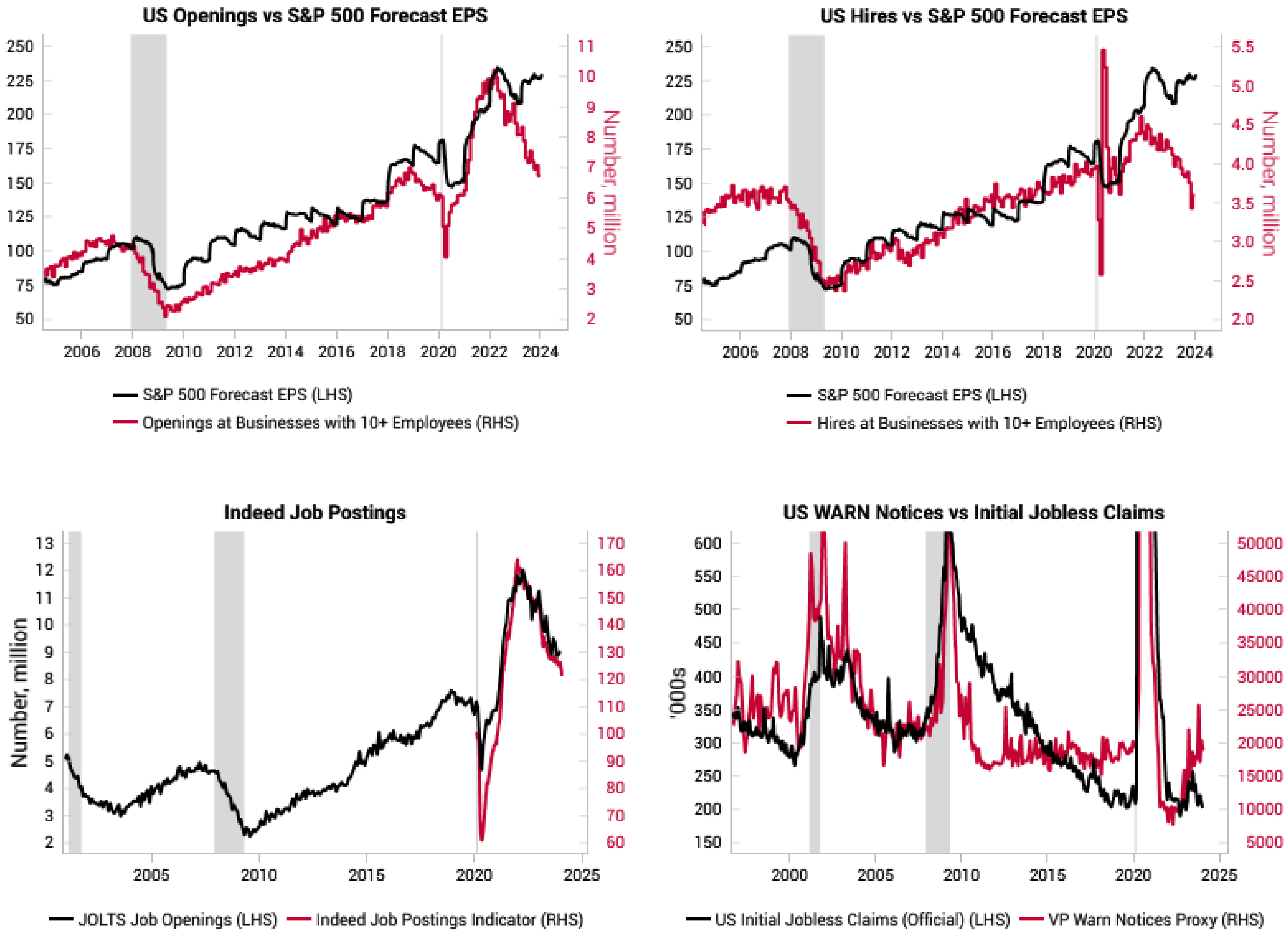
The **job openings and hires** data for businesses with more than 10 employees has usually been **correlated to S&P 500 EPS forecasts**. This is intuitive as future earning expectations should be reflected in business optimism in hiring or advertising for workers. Today there is a **large divergence** (top 2 charts).

Alternative data sources such as the Indeed job postings data also corroborate a continued fall in job openings (bottom left chart).

WARN notices are still trending higher, despite the very low initial claims (bottom right chart). **Big layoffs from non-Tech (e.g. UPS) companies are meaningful signposts to watch out for.**

In recent years, tech has been one of the most capital abundant sectors, which created room to cut costs to preserve profit margins.

In contrast, other sectors of the economy have less fat to cut, so more layoffs would be signs of more meaningful headwinds.



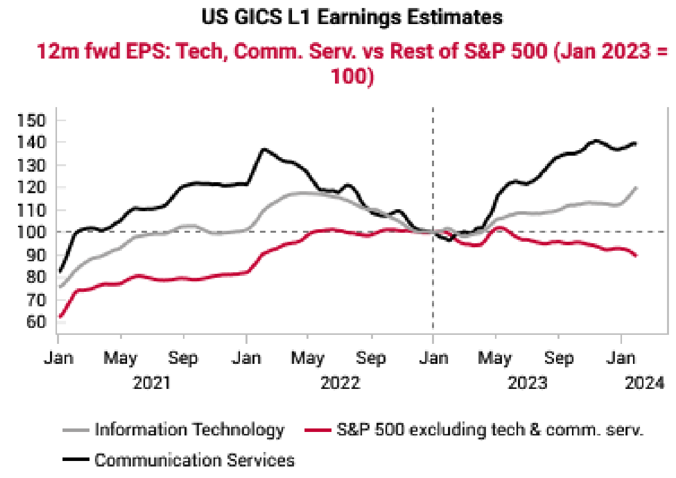
Source: S&P Global, Refinitiv, Macrobond and Variant Perception

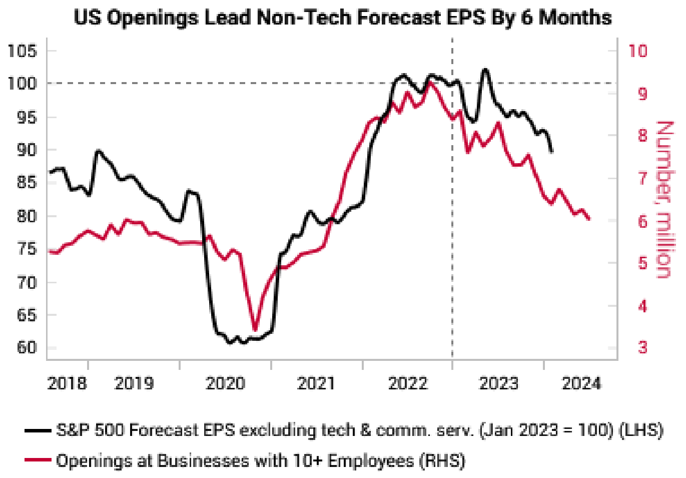
Even non-tech forecast EPS remains vulnerable

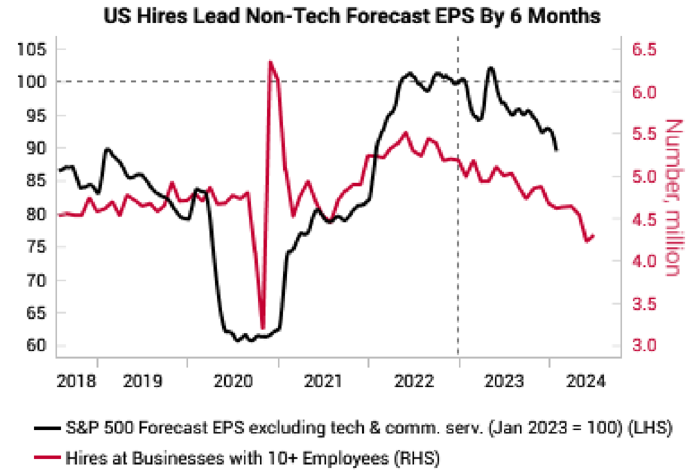
Given the divergence of tech outperformance, it is important to break out the forecast EPS for tech vs the rest of the index (top left chart). **Non-Tech forecast EPS has already peaked and been revised down.**

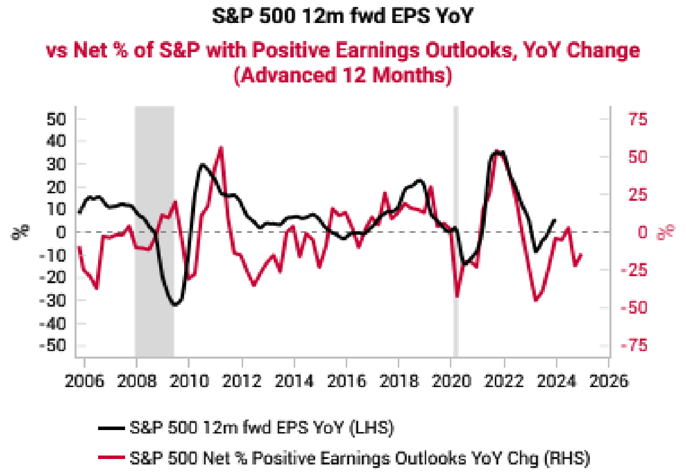
However, headwinds still remain. **Job openings and hires have led forecast EPS for non-Tech since Covid.**

Additionally, **the net % of positive earnings outlooks has also been weakening** (bottom right chart).









VARIANT PERCEPTION

Source: S&P Global, Refinitiv, Macrobond and Variant Perception

Pricing power weaker, removing another support for margins

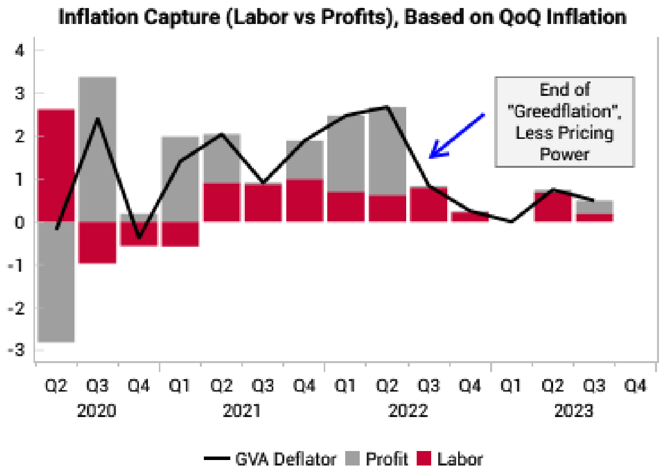
Our inflation capture work shows that pricing power (i.e. “greedflation”) has diminished since 2Q22. In aggregate US corporations no longer have the same pricing power as in the aftermath of Covid (top left chart).

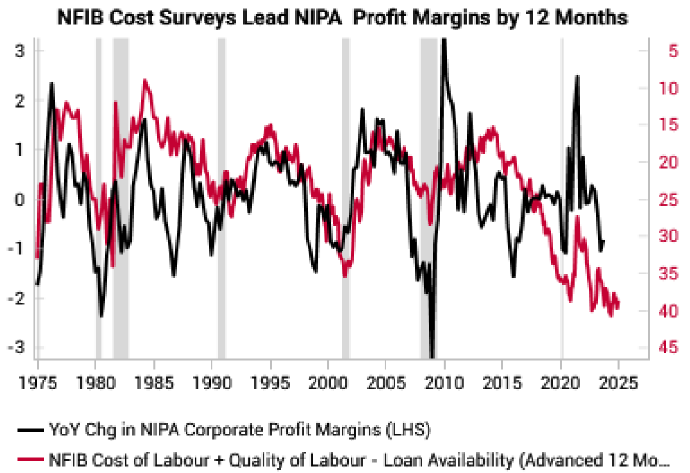
Non-discretionary business costs like labor & credit likely remain a headwind (top right chart). The **NFIB survey for cost of labor, quality of labor and loan availability still paint a picture of cost pressures** and usually lead profit margins by 12 months**.**

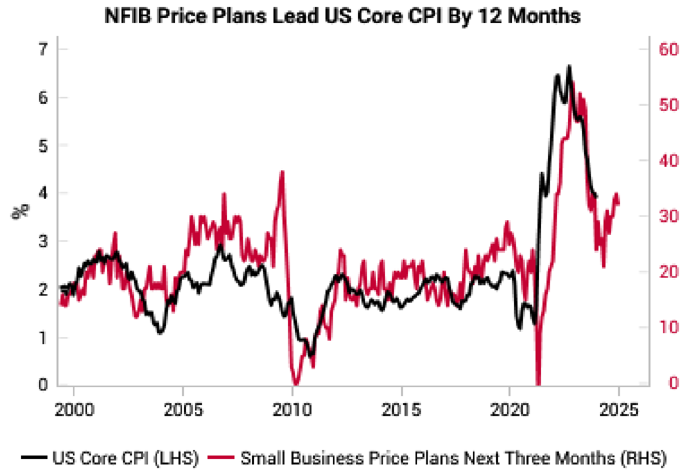
From the January Dallas Fed manufacturing survey: Food manufacturing – “*Stagflation, increased commodity costs, labor costs and benefits to retain talented staff, political upheaval, border failure and dysfunction at the regulatory level [are issues affecting our business].*"

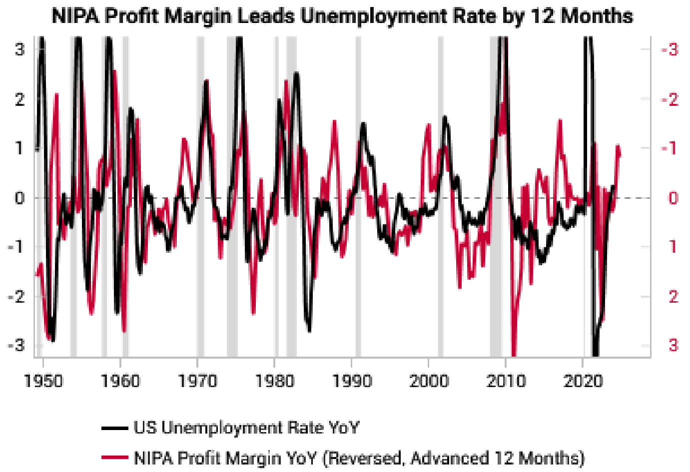
The NFIB price plan survey has started to turn up (bottom left chart). This is likely **a sign of businesses needing to raise prices to preserve profit margins**.

If pricing power is weaker now, then it is likely that profit margins will start to decline, which will then force layoffs to be made (bottom right chart).









VARIANT PERCEPTION

Source: S&P Global, Refinitiv, Macrobond and Variant Perception

Inflation leading indicators are bottoming

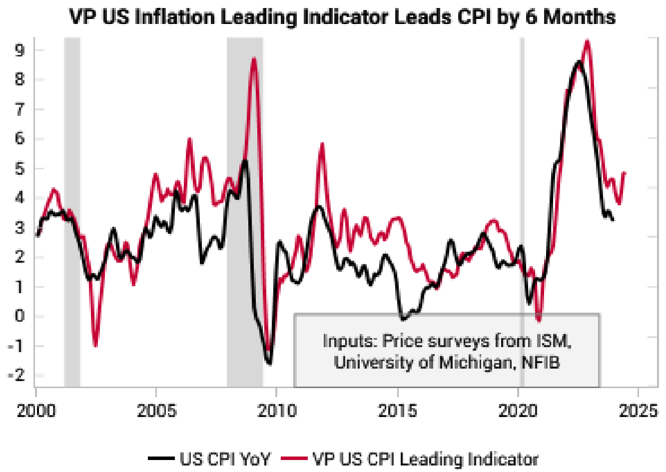
Our **US inflation leading indicator is starting to bottom** (top left), which is also **corroborated** in the top right chart **by the upturn in the diffusion of all our inflation inputs** (120 data series across all major DM/EM economies).

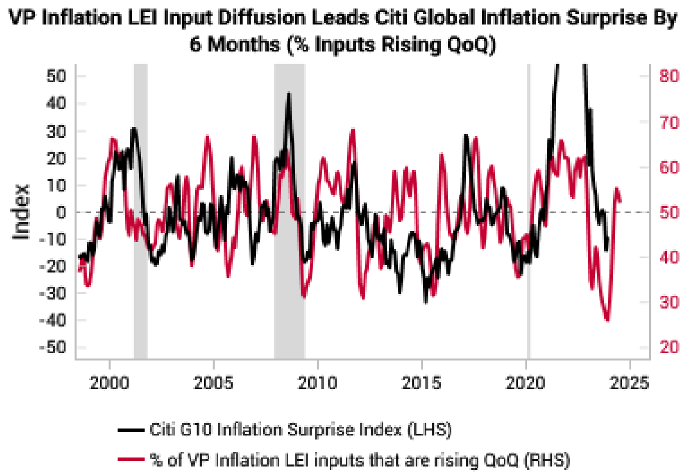
On a coincident basis, the **breadth of inflation components** rising more than 0.2% MoM is also now **starting to bottom** (bottom left chart).

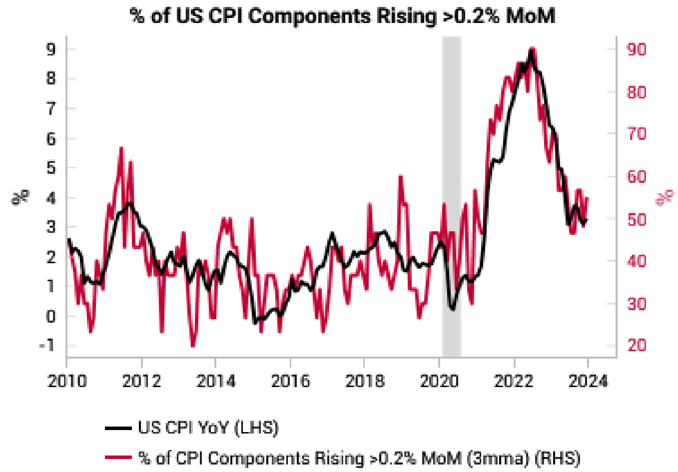
Of course, it is very possible that inflation collapses in a hard landing scenario, but in a soft landing the risks are to the upside for inflation.

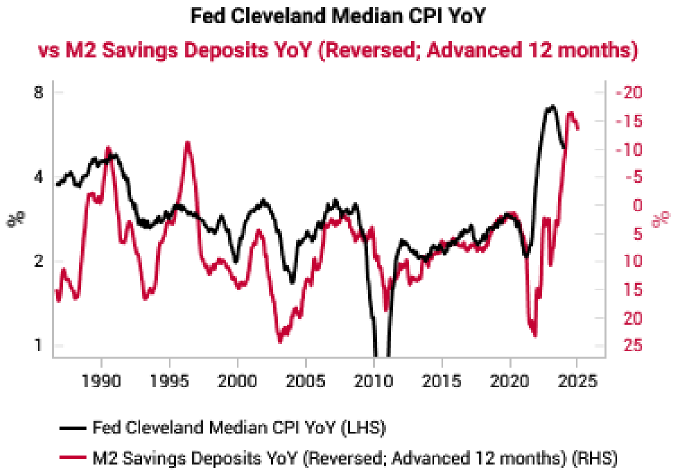
A **soft landing** would most likely result from continued fiscal easing and **draw down in savings** (facilitated by Fed cuts). In this scenario, the persistent fall in the savings deposit would likely create upward pressure on inflation again (bottom right chart).

Changes in savings deposits have historically offered a good lead on median CPI. Intuitively, changes in savings deposits reflect changes in spending intentions.









VARIANT PERCEPTION

Source: S&P Global, Refinitiv, Macrobond and Variant Perception

Moderate liquidity headwinds

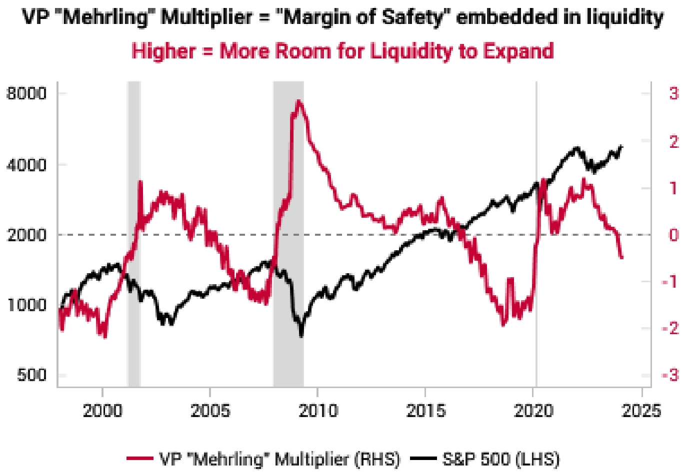
Our December thematic, [The Hierarchy of Money: towards a "general theory of liquidity" for practical investing](), laid out a first principles approach to understand **the margin of safety embedded in the monetary system.**

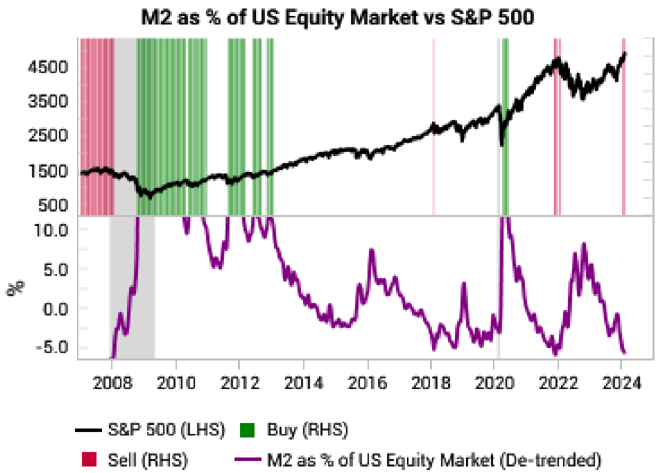
The **VP "Mehrling" Multiplier** measures the "level" of liquidity embedded in the monetary system (top left chart). This is now more negative indicating less room for the Hierarchy of Money to expand to support asset prices

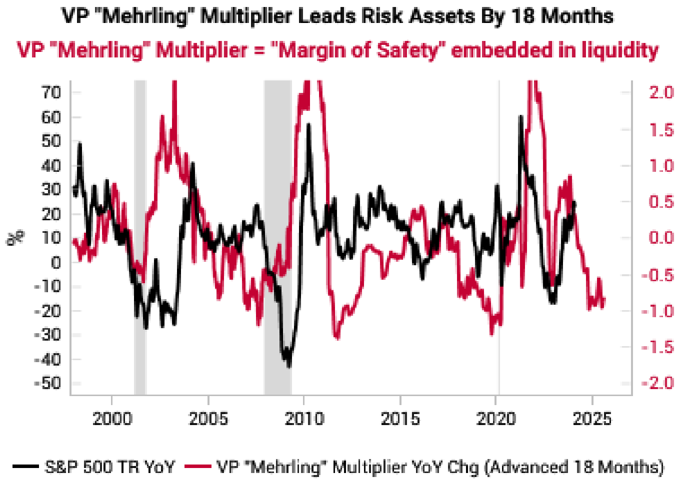
A **simpler way** to illustrate the same point is to show **the ratio of M2 vs the S&P 500 market cap** (top right chart). **When M2 is high vs the S&P market cap that is a green light for asset prices to rise and vice versa.**

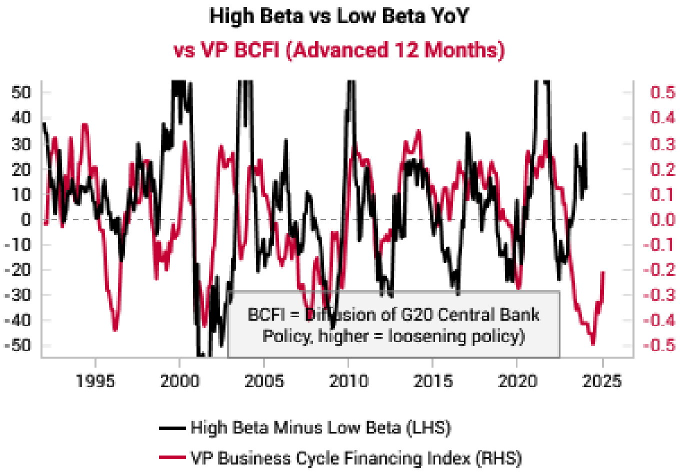
The main positive indicator among our liquidity indicators is that our BCFI (diffusion of G20 central bank policy) is starting to recover (showing more central banks moving to easing, bottom right chart).

Overall, we would characterize our liquidity indicators as showing moderate headwinds for risk assets.









VARIANT PERCEPTION

Source: S&P Global, Refinitiv, Macrobond and Variant Perception

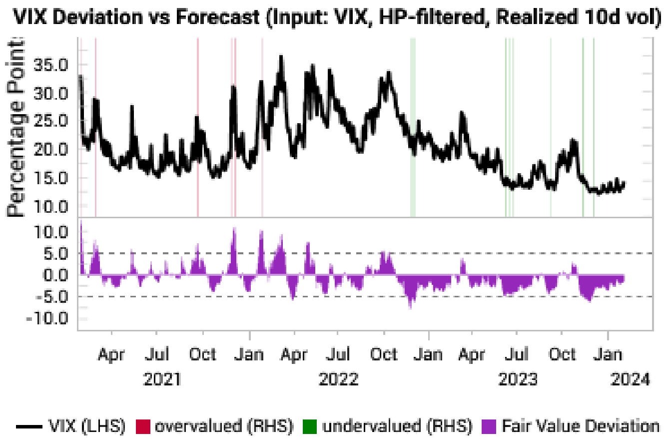
Time to look for long vol exposures again

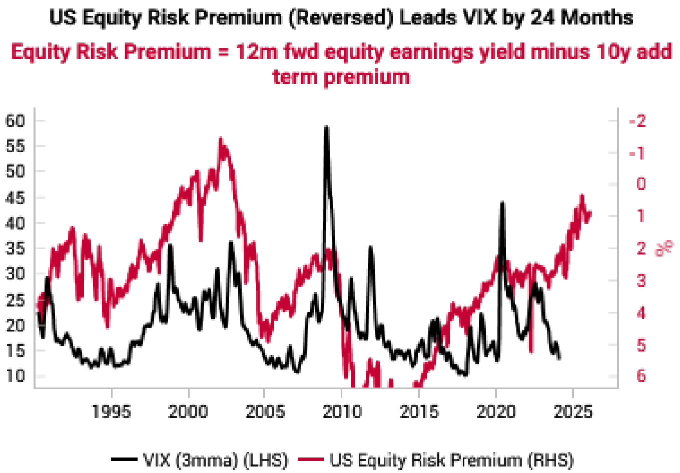
Our VIX fair value model continues to show the **VIX is undervalued** (top left chart), even as the **low equity risk premium** shows a **lack of margin of safety** embedded in the S&P 500 (top right chart).

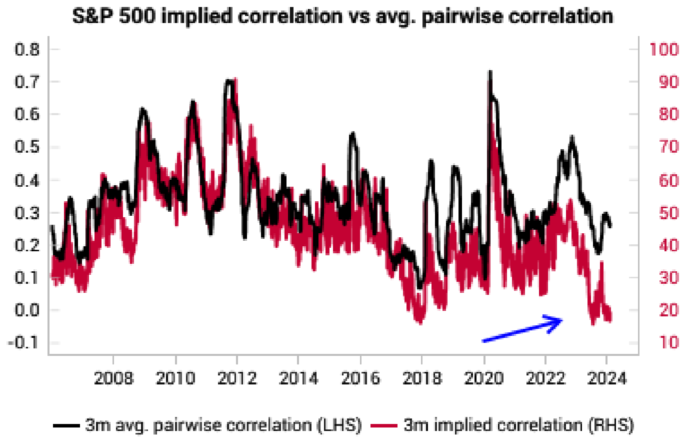
It is **particularly notable** that S&P **implied correlations have collapsed** again. This is true for **both 3 month** (bottom left chart) **and 1 year** (bottom right chart), where average realized pair-wise correlations are now very elevated vs implied correlations.

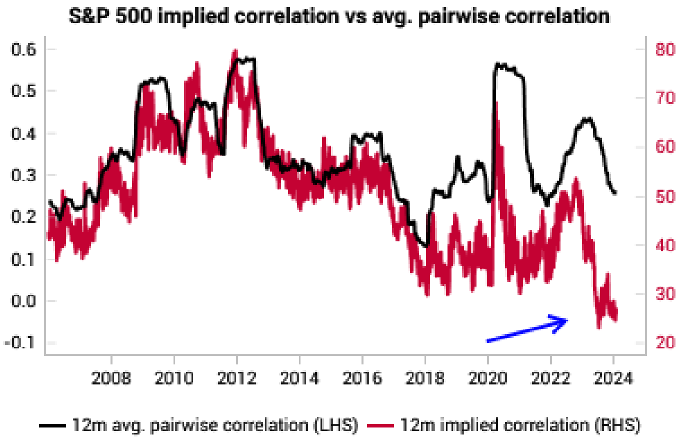
If dispersion trades are forced to unwind, that could allow index volatility to jump. Vol of vol (VVIX) also remains near multi-year lows.

We still think the cyclical regime still favors higher volatility (see [Volatility Cycle Turning - Trick or Treat Time – Oct 2023]).









Source: S&P Global, Refinitiv, Macrobond and Variant Perception

US fixed income: TIPS, MBS, SOFR put-flies

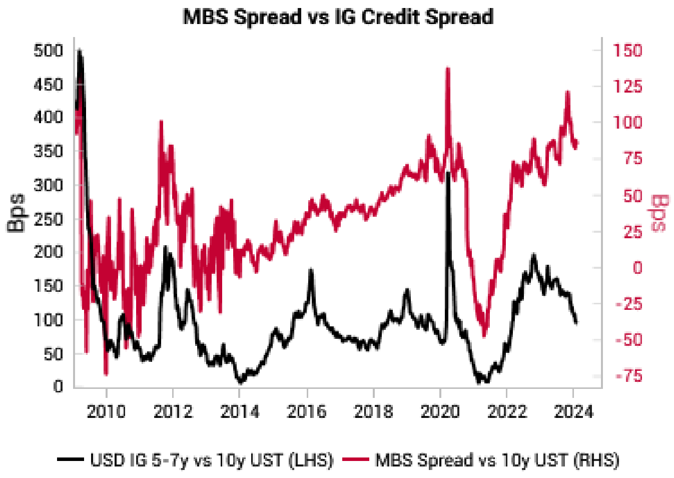
From an **allocation** point of view, we continue to see **attractive value in TIPS and MBS**.

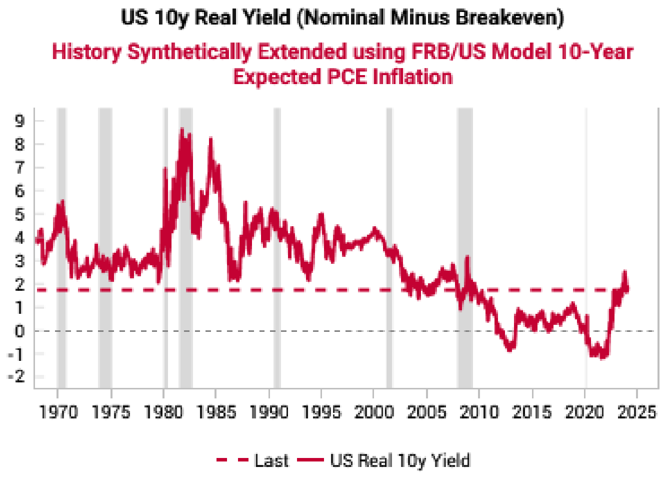
Our Fed easing model remains in the easing regime (bottom left chart), but we continue to think the STIR market has likely overshot, pricing in 6+ cuts by year-end.

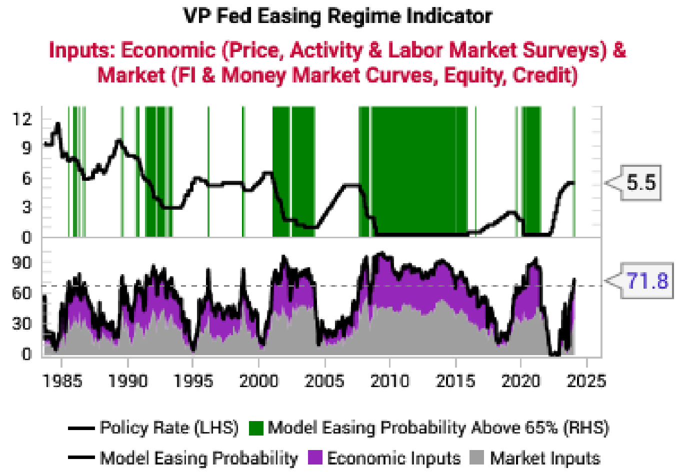
In our interpretation, **SOFR futures are trying to price 2 binary outcomes. Either we get a soft landing and the Fed only cuts say 3 times or we get a hard landing and the Fed will be forced to go big on cuts.**

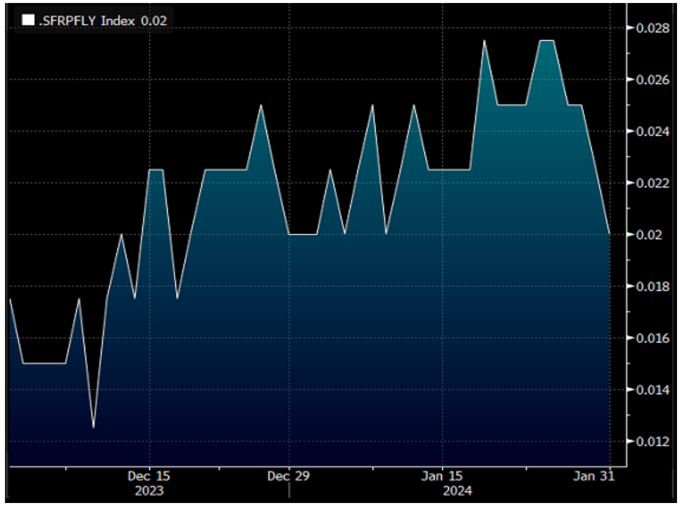
This is the **ideal set up for SOFR put-flies to leverage up the profit potential from the Fed cutting less scenario.** Given the polarized opinions on the US and Fed today, this kind of trade structure is very attractive.

Indicatively **one can get a 10:1 max pay-off with capped downside risk to buy a 96/95.75/95.5 SOFR Dec 24 Put Butterfly.** The bottom right chart shows the current price from Bloomberg is around 0.02 for a theoretical max pay-off of 0.25.









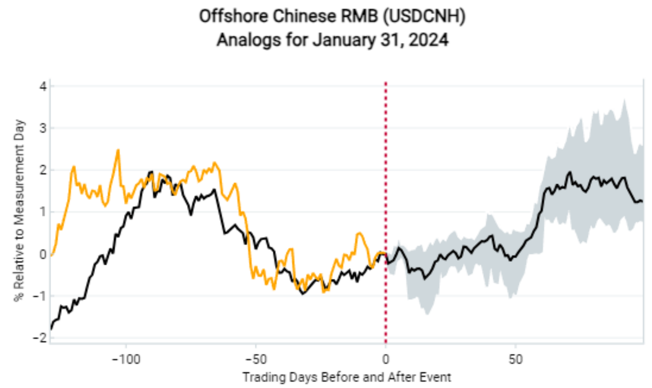
China: USDCNH upside

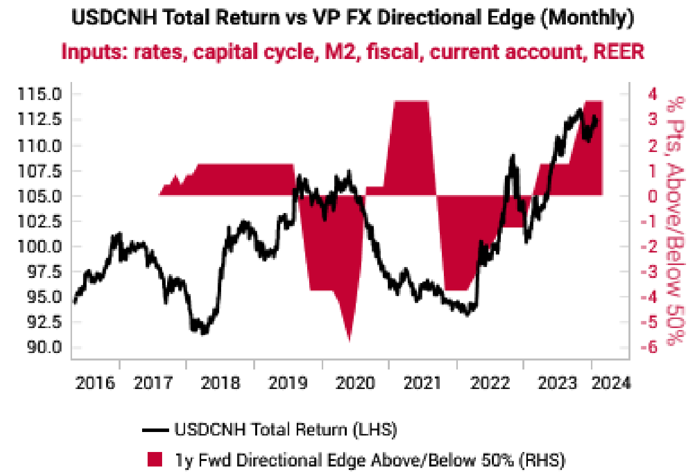
The VP **analog** model ([whitepaper]) is starting to flag **USDCNH upside** (top left chart). There are likely **some timing issues around Chinese New Year** (CNY) with exporter repatriations and PBOC liquidity injections, but our interpretation is to look for USDCNH upside.

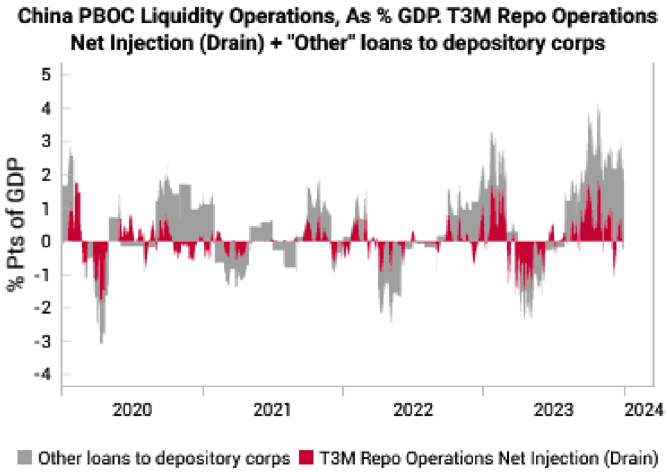
Our **12-month forward FX edge models** ([whitepaper]) also continue to **favor long USDCNH** (top right chart), indicating the cyclical picture is still aligned, adding conviction to the bullish analog indicator.

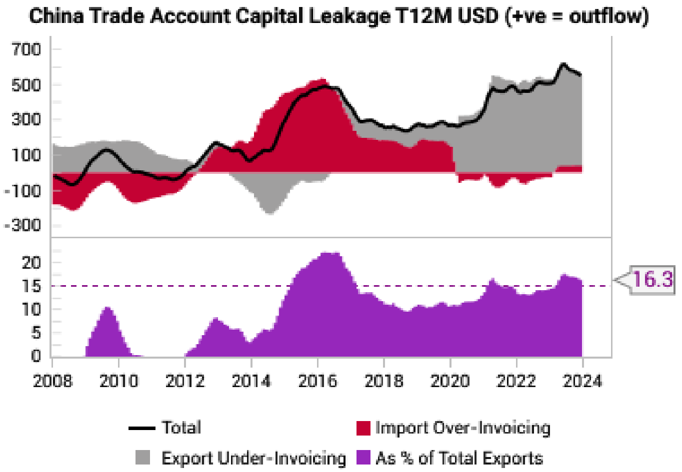
The **PBOC** has been **expanding** it's balance sheet with a jump in the **"other loans to depository corporations"**. The bottom left chart shows the T3M flow in "other" loans and open market operations as a % of GDP has been elevated.

Further easing by the PBOC into an economy that is still lacking in animal spirits is a recipe for more excess liquidity, which should contribute to depreciation pressures. **Capital leakage remains an issue** (bottom right chart), corroborating the structural depreciation pressures.









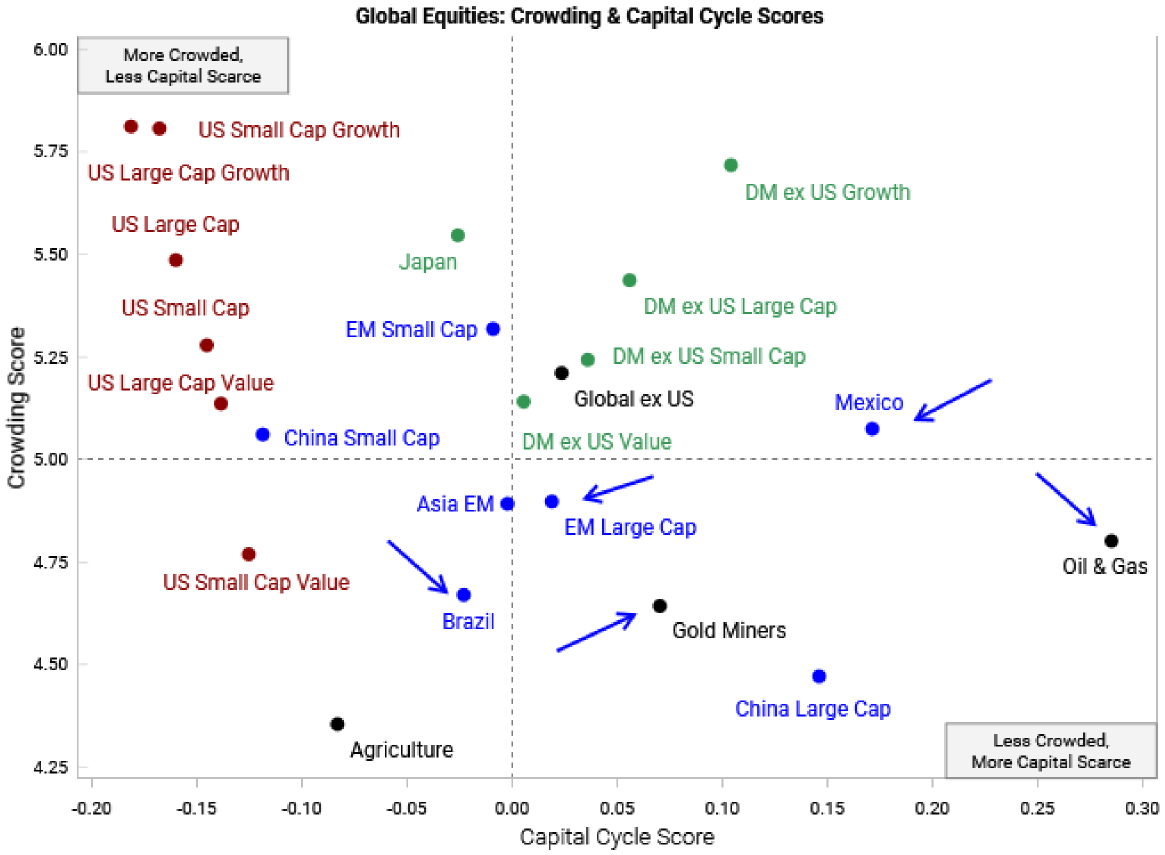
Global equity allocation: LatAm, energy, and goldminers

We consider **uncrowded equities** that are aligned with the longer-term **capital cycle** as the **best opportunities**.

LatAm (specifically **Mexico** and **Brazil**) remains our favorite long EM expression. We view China more as a trading market than an allocation market for now, given the idiosyncratic structural problems there are more of a feature, than a bug.

Energy remains **capital scarce** and underperformed in 2023. As we wrote in our 2024 themes, it is not unthinkable that this year sees a de-synced global recovery even as the US slows, which would be supportive of the oil & gas industry.

Goldminers remain capital scarce and uncrowded. We view goldminers as the best way to participate in an attractive structural backdrop for gold.



Source: S&P Global, Refinitiv, Macrobond and Variant Perception

VARIANT PERCEPTION

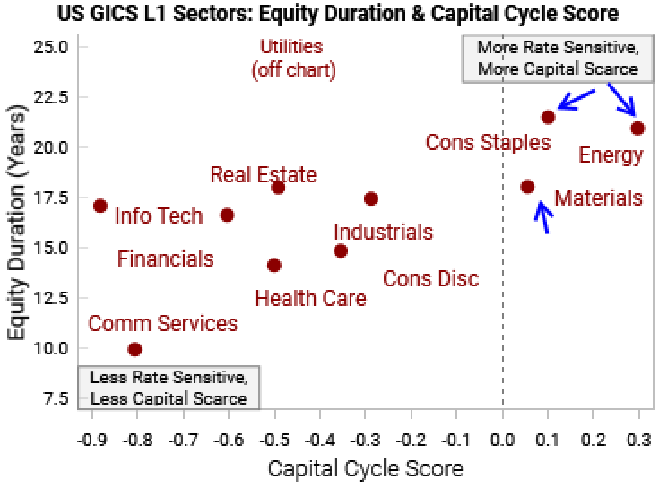
Sector equity allocation: energy, materials, staples

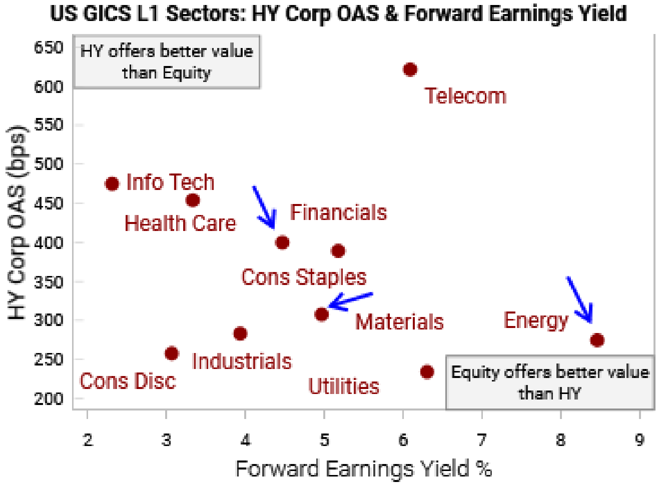
The Fed is set to cut rates this year, the question is how much and how political the Fed will be. We view **capital scarce** sectors with **high duration** as the best way to capture **upside** from a **cutting cycle** while staying **aligned** with core **structural** return **drivers.** This favors **energy, materials,** and **staples** (top left chart).

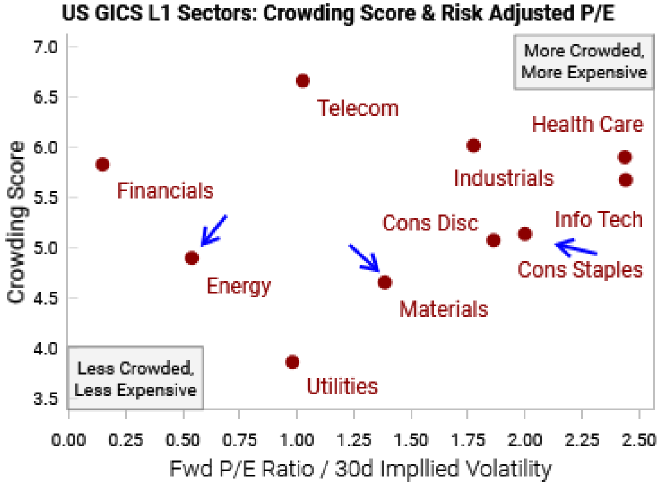
Looking at **high yield OAS** vs **earnings yields** helps flag **relative value** across sectors. **High earnings yields relative to spreads favors going long the equity** (top right chart).

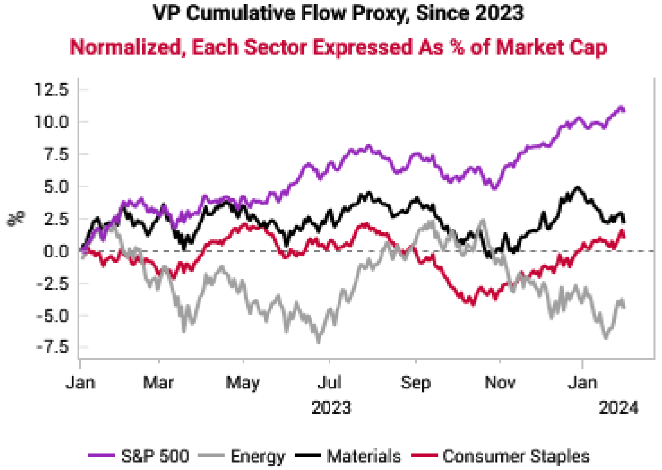
We can further screen for relative value by looking at crowding scores versus risk-adjusted P/E; **less crowded, less expensive** sectors have less risk priced in, creating **better upside/downside** capture (bottom left chart).

Our cumulative flow proxies shows the lack of inflows into these sectors relative to the S&P 500 (bottom right chart).









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