LV Longview Economics
Investments. Trades. Macro.

Tactical Equity Asset Allocation No. 219, 6th April 2022

('1 – 4' month outlook for risk assets)

Written by: Chris Watling, CEO, Chief Market Strategist

Tactical BUYing Opportunity

a.k.a. Stay OW Risk

Summary Extract:

"Equity markets therefore remain attractive on a tactical basis and vulnerable, given the positioning of the models, to positive newsflow. Over and above that the evidence for a recession, whilst growing, is not yet compelling, money is not clearly tight, and this is most likely a Phase II in a stylised bull market (accentuated by the war). With the Fed now hiking, and the Russian invasion risk largely priced in/fading, a renewal of the uptrend (Phase III) is expected…"

Table of Contents

Important disclosures are included at the end of this report

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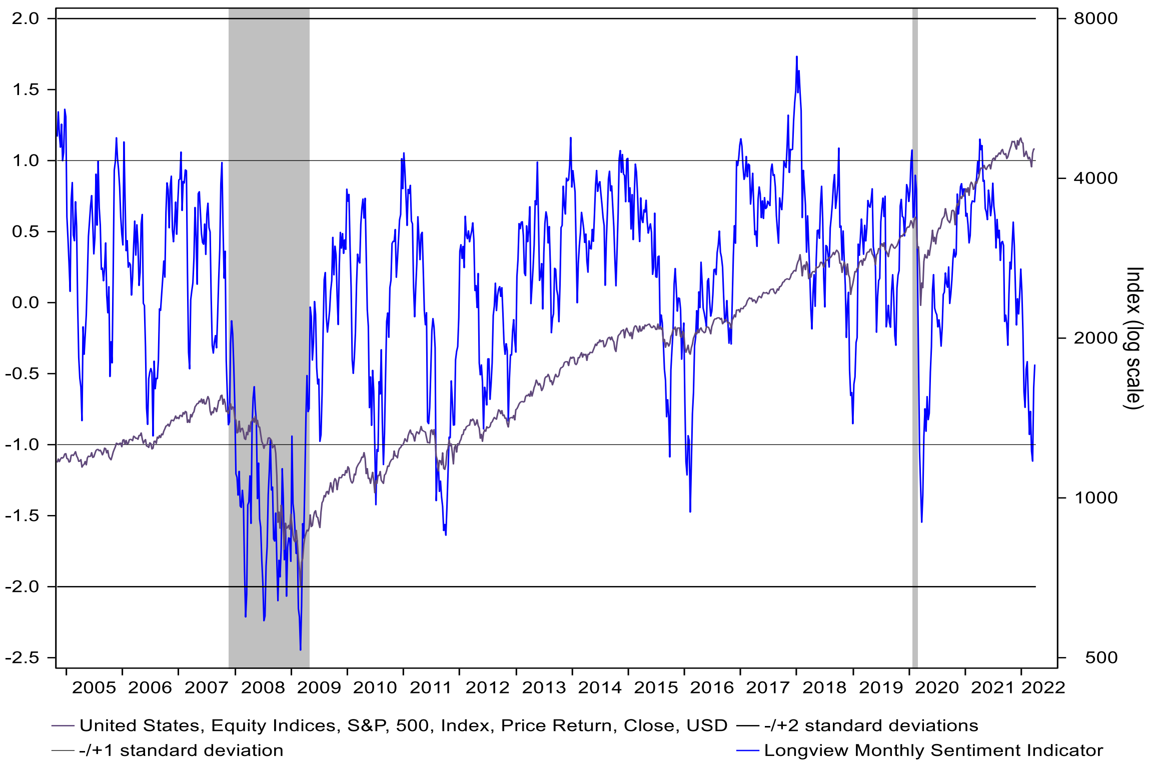
Section 1: Summary & Conclusion

The **key** driver of equity market direction on a '1 – 4' month timeframe is *predominantly* 'Fear and Greed', that is: Emotion, positioning and sentiment.

Overexuberance: Once or twice a year, equity investors become **overly exuberant,** and 'all in' on equities (in a short-term sense). At that moment, they are vulnerable to any negative news flow (and, therefore, quick to sell when a trigger comes along). Those times are typically highlighted (ahead of time) by indicators, like the SELL-off indicator*, which measure persistent and excessive appetite for risk by market participants over a prolonged period (see fig 3d & January 2007, Structural Asset Allocation Report: "Forecasting Waves of Risk Aversion" for detailed explanation).

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



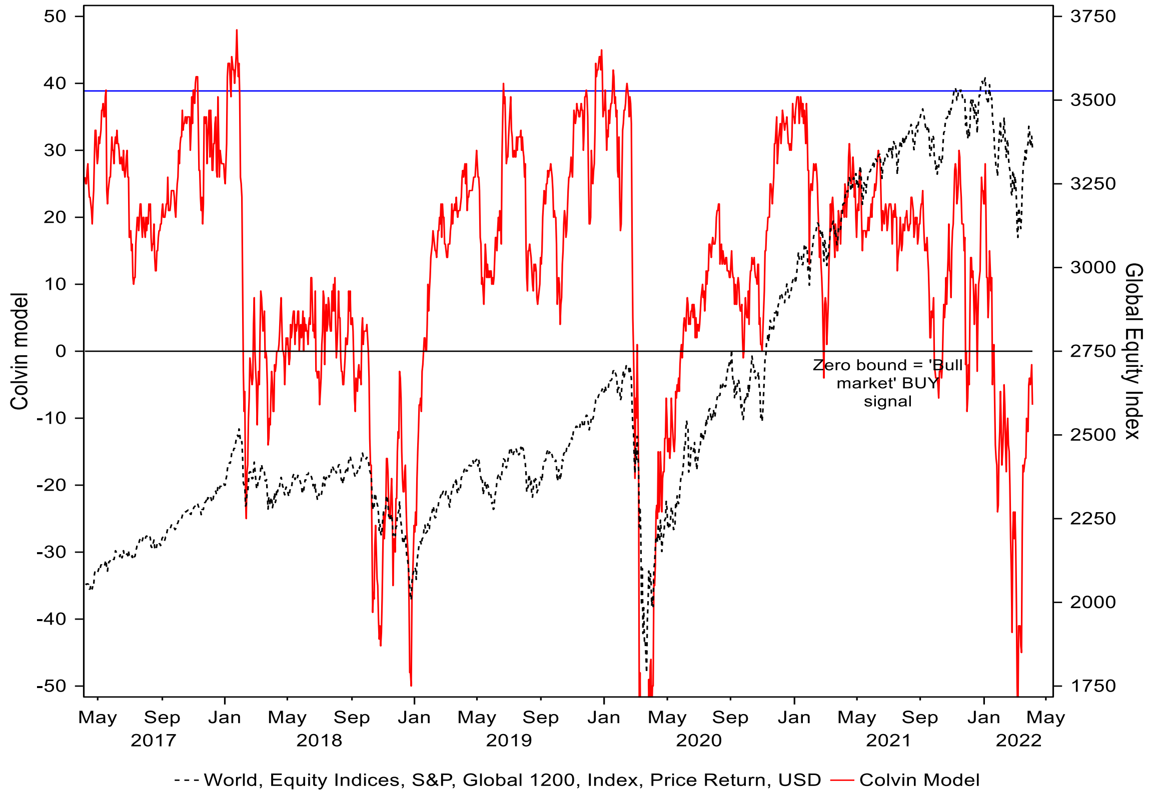
Source: Longview Economics, Macrobond

*NB this indicator measures what global investors 'actually' do on a risk adjusted basis across all key liquid global markets (as opposed to 'sentiment' indicators which measures 'how they feel').

Other models, like the single stock 'call option' volume model, will often confirm that message, while the price action in various equity markets can also be instructive (with some markets generating euphoric price action at the same time).

Fearfully Priced: Equally, on the other side of the equation, markets are sometimes fearfully priced, with high levels of uncertainty. At those times, markets are vulnerable to any positive/good newsflow (as a trigger). That is, **they have become overly fearful**.

Fig 1a: Longview Colvin model** vs. global equities (S&P1200)



Source: Longview Economics, Macrobond

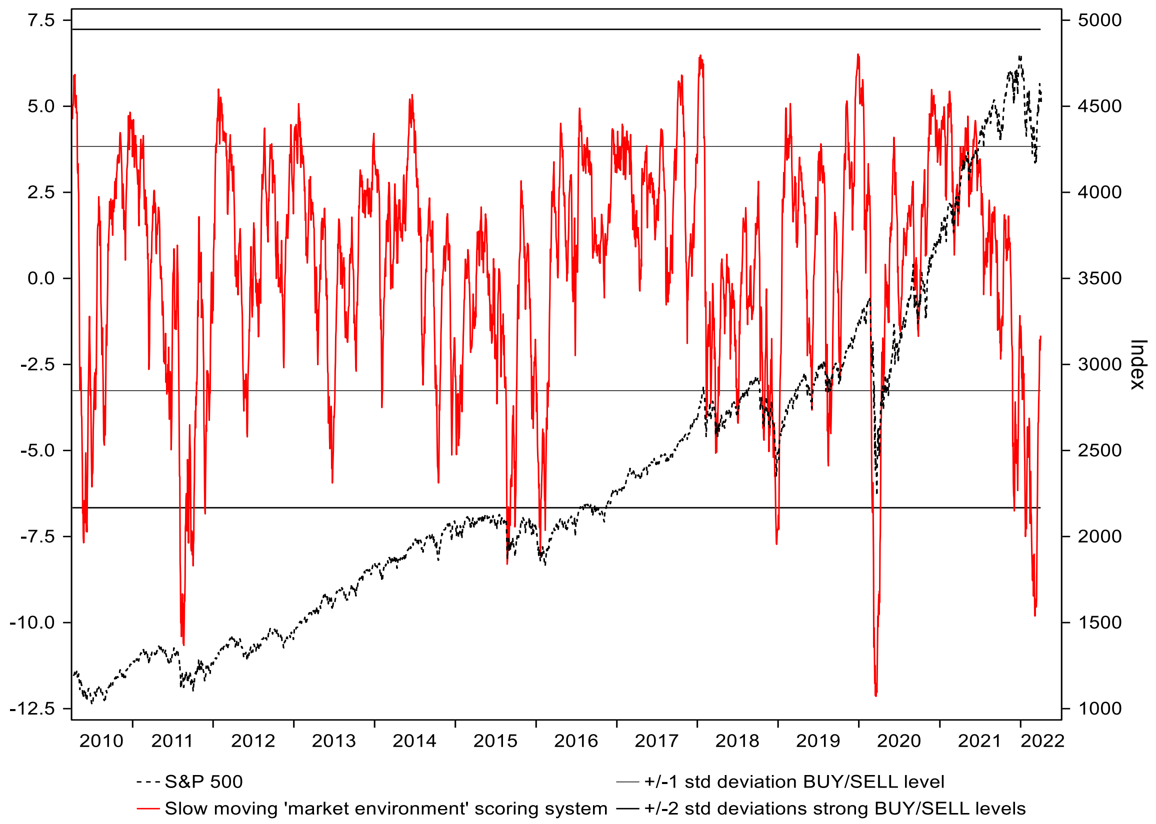
** The Colvin model measures global market breadth i.e. the strength of the advance (or decline) in global risk asset prices. Extreme deviations from trend reflect rapid advances/declines in asset prices thereby leading to and generating overbought/oversold signals.

Both extremes are rare, happening perhaps once or twice a year (in bull markets). Both also generate key contrarian entry/exit points for tactical investors.

This moment (and recent weeks) is likely one of those occasions.

In mid-March various key Longview indicators generated extreme fearful (strong BUY) readings. The 'slow-moving scoring system', the 'Colvin model', and the 'percentage of stocks above their 200 day moving averages' all generated extreme readings (figs 1a, 1b & 1e). The signal on the slow-moving scoring system has only been more extreme on three occasions in the past 15 years: i) the March 2020 pandemic SELL-off; ii) the depths of the Euro crisis; and iii) in October 2008. In all three there was the potential, until there was an aggressive policy response, for a global economic depression.

Fig 1b: Longview slow-moving 'market environment' scoring system vs. S&P500



Source: Longview Economics, Macrobond

Added to that, market sentiment has adjusted rapidly such that our sentiment scoring system has also recently generated a strong BUY signal. Absent a persistent cyclical bear market, this type of signal typically produces strong returns for several months after the signal (fig 1).

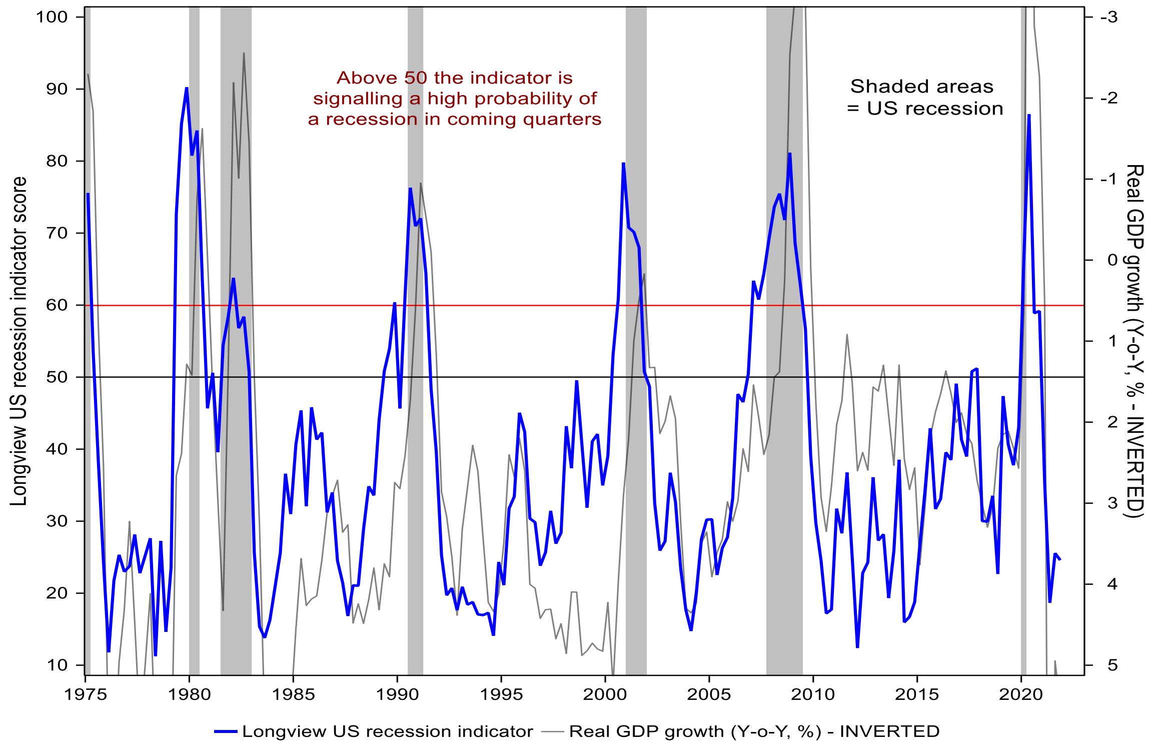
As such, either equities have entered a **cyclical bear market**, in which case recent strength is a bear market rally (although, even then, bear market rallies typically persist longer than two weeks) **or this is a significant 'multi month' buying opportunity**.

Cyclical bear markets, though, are generally about: i) pricing in forthcoming recessions; ii) tight/tightening money; and/or iii) shocks.

Clearly there has been a shock with the Russian invasion of Ukraine and its associated impact on energy prices (and, therefore, the inflation outlook). The **market, though, reached a point of maximum uncertainty on the outlook for the war in early March**. At that point, it was unclear how far Putin might go towards/into NATO territory, the reaction of the West/NATO was still unknown, and whether nuclear weapons would be used or an accident in a nuclear power plant would happen, was also unknown and so on. Now, whilst scientifically hard to illustrate, there's a clear sense that markets now understand those risks (and that the uncertainties have diminished relative to early March).

Recession Risk – How High? In terms of recession risks, whilst the probability is rising (given the signal of the yield curve inversion), it's not yet at a convincing level. We outlined our analysis/thinking on that in last week's Longview on Friday (1st April 2022, "Fully Assessing Recession Risk plus Latest Global Asset Allocation Recommendations"). Our US recession model is reproduced below and is generating a benign message (i.e. a low recession risk level).

Fig 1c: Longview recession indicator shown with US recessions



Source: Longview Economics, Macrobond

Key BUYing moment: More likely, therefore, this is one of those key buying moments (for equities). Indeed, the sentiment towards markets and risk assets, as outlined in the last month's 'Bank of America ML Fund Managers' Survey' illustrates the point:

"Russia/Ukraine drives FMS cash levels to highest since April '20 (COVID)" – and one of the highest levels since the 2000/02 bear market, fig 1d.

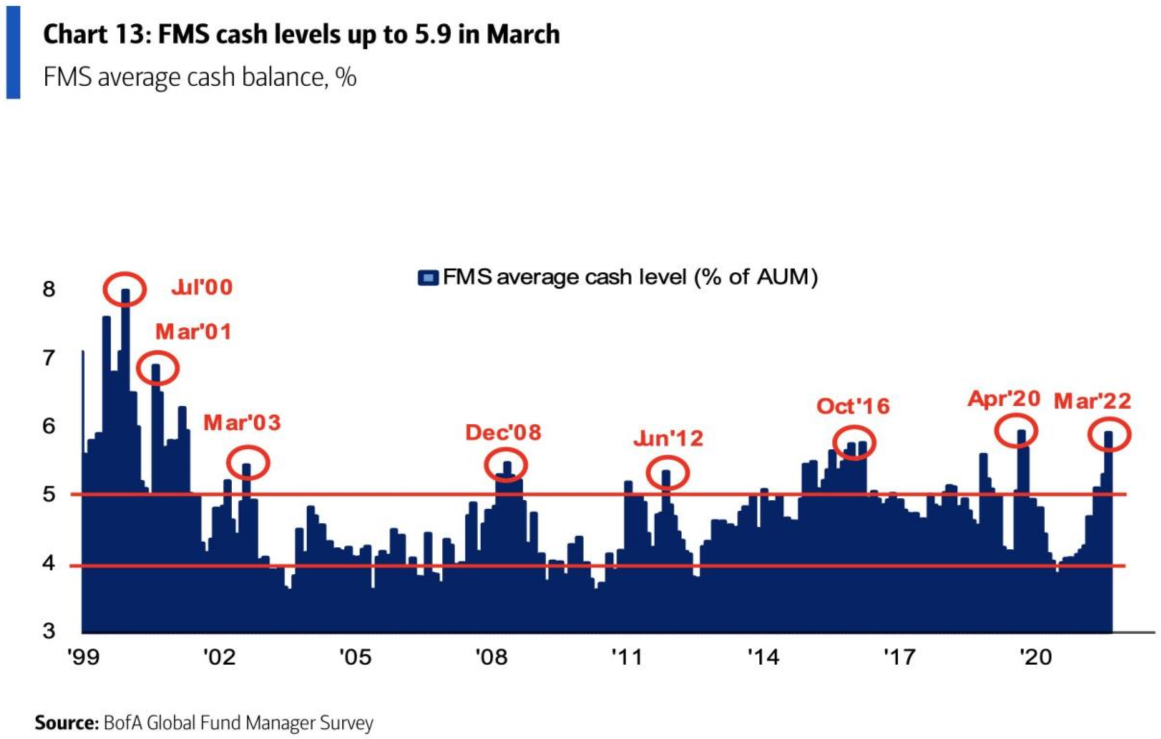
"global growth optimism lowest since June '08 (Lehman)".

"Hegde fund equity exposure lowest since April 2020" – and one of the lowest levels since the GFC.

"60% of investors now expect an equity bear market in 2022".

Source: BofAML Fund Managers' Survey March 2022.

Fig 1d: Cash levels according to the BofAML FMS (%)



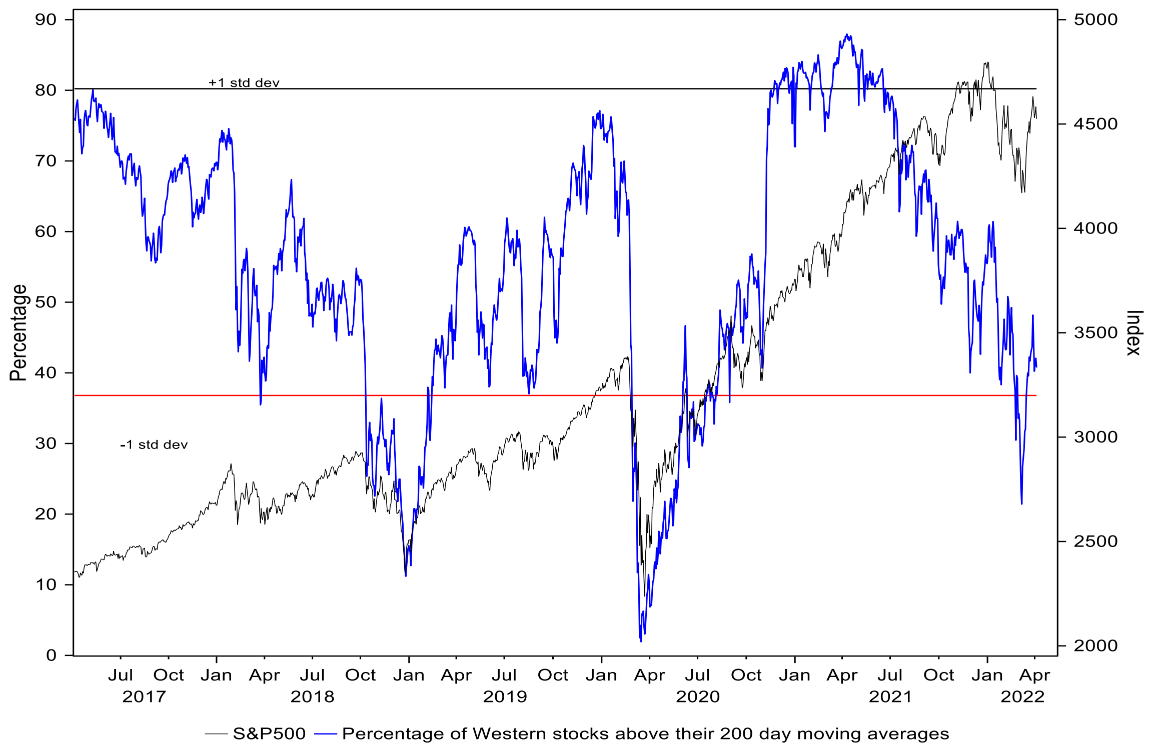
Added to the above, and despite Fed hawkishness and the market's expectations of sharply rising interest rates, liquidity models don't, currently, indicate that money is too tight (other than the yield curve): Indicators of stress in the commercial banking system are not elevated (e.g. see SOFR spreads, TED spreads, repo rates and the sizeable liquidity in the Fed's overnight RRP – fig 2a); real M1 money supply is still growing; & credit and financial conditions remain loose.

Equally the consensus still expects earnings growth in 2022 (& 2023). Naturally the rate of earnings growth is slower this year than last (given last year was a bounce-back from 2020/the pandemic). 2022 consensus earnings expectations are currently 225.6 (for the S&P500). That is still 9.4% earnings growth (which, given typical upwards earnings beats, will likely be higher). That also comes after earnings growth of 47.6% in 2021. Added to that, the S&P500 consensus earnings have been revised higher this year (so far), despite the SELL-off in the equity market and increased fed hawkishness**. In aggregate S&P500 estimates for 2022 are approx. 1% higher now than they were in January.**

Finally, there's also an argument, which has been outlined in prior research (see "Bulls, Bears & Phase IIs: Mapping the Cyclical and the Secular Cycles") that this recent pullback is simply a classic 'Phase II of a stylized cyclical bull market'. Phase II's occur as markets start to price in the removal of monetary accommodation and the return to normal monetary policy, like in 2004, 1994 and 1983/84. Arguably that's been a, if not the, key driver of equity markets in the past 6 months (with added downside impetus from the Russian-Ukrainian situation). As such, markets are just now entering Phase III (i.e. the renewal of the uptrend).

In conclusion, therefore, equity markets remain attractive on a tactical basis and vulnerable, given the positioning of the models, to positive newsflow. Over and above that the evidence for a recession, whilst growing, is not yet compelling, money is not clearly tight, and this is most likely a Phase II in a stylised bull market (accentuated by the war). With the Fed now hiking, and the Russian invasion risk largely priced in/fading, a renewal of the uptrend (Phase III) is expected. As such, we recommend staying tactically overweight equities. See Appendix A for detailed recommendations for various investing styles.

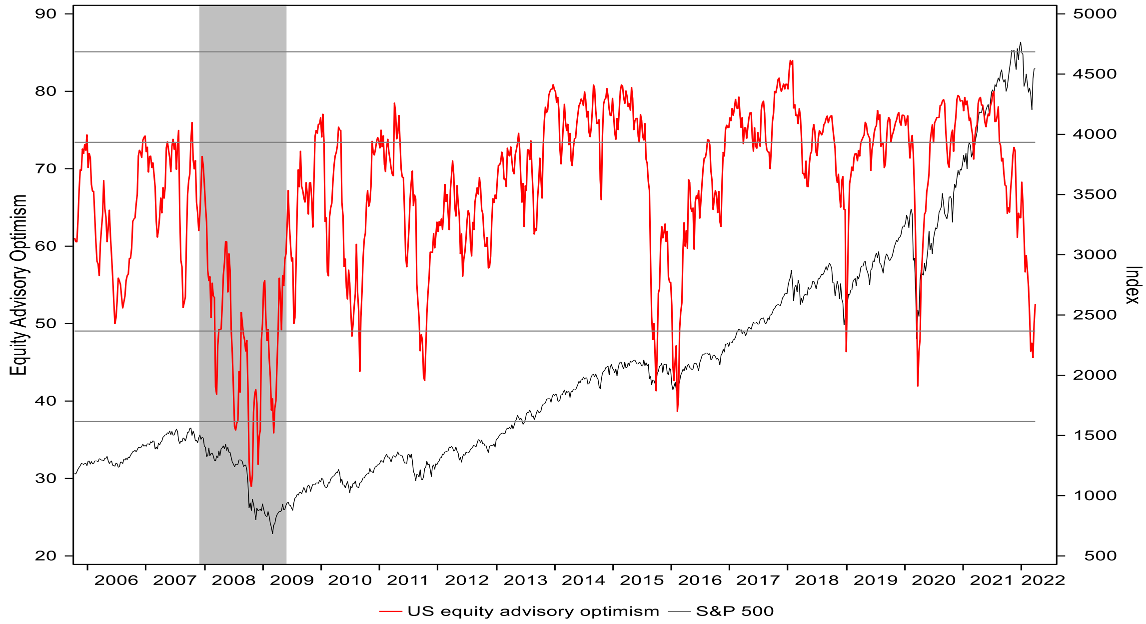
Fig 1e: Percentage of Western stocks above 200 day moving averages vs. S&P500



Source: Longview Economics, Macrobond

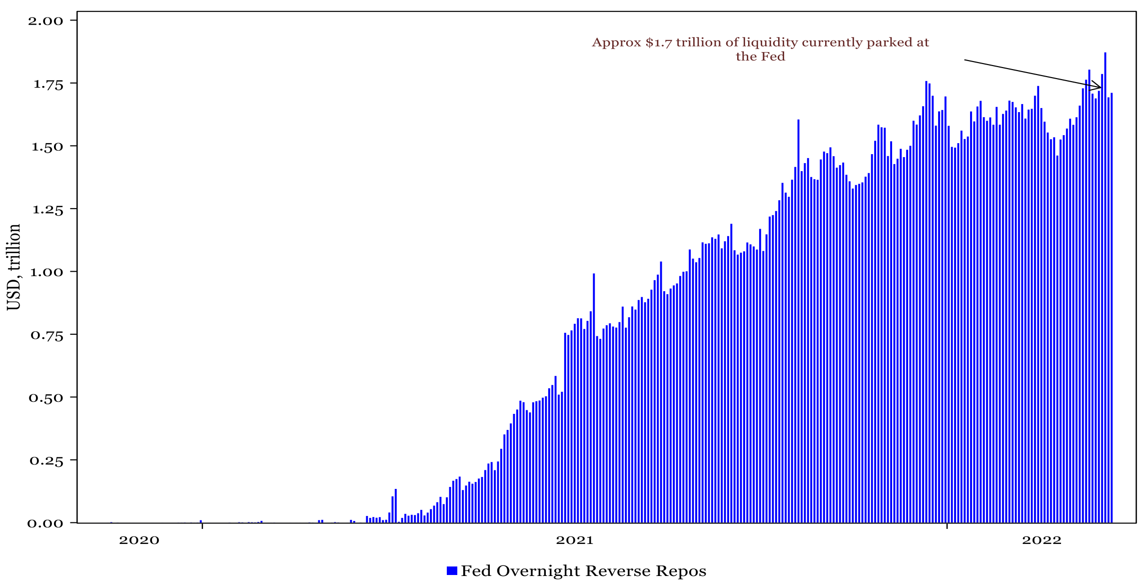
Section 2: Key Charts

Fig 2: US equity advisory optimism index vs. S&P500



Source: Longview Economics, Macrobond

Fig 2a: Funds parked at the Fed's Overnight Reverse Repo Program* ($tn, daily)



Source: Longview Economics, Macrobond

*The Fed's ON RRP (reverse repo program) was a new program introduced after the GFC. It's designed to help ensure the Fed's effective fed funds rate reaches the Fed's target level (as set at each FOMC meeting). Phases of QE create abundant liquidity, with those excess funds then needing to find a return. Excess liquidity can therefore push short term market rates below the Fed's target rate, and even into negative territory. In order to counter that pressure the Fed offers to accept the funds at an interest rate designed to create a floor for the effective fed funds (i.e. effectively soak up excess liquidity).

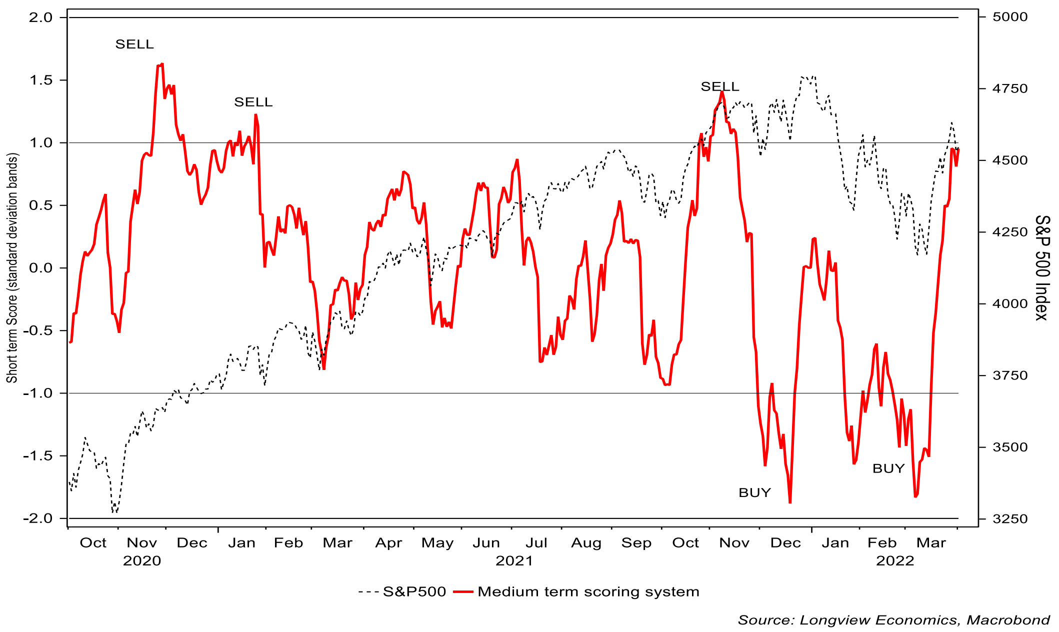
Section 3: Longview Scoring Systems

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: Both the Longview **'fast moving'** scoring system & the Longview **'slow moving'** market environment scoring system are NEUTRAL (figs 3 & 3a). One subcomponent ('Volatility') is currently on BUY, while the other four subcomponents (i.e. 'Bond Spreads', 'Risk Appetite", 'Technicals' and 'Sentiment') are NEUTRAL.

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

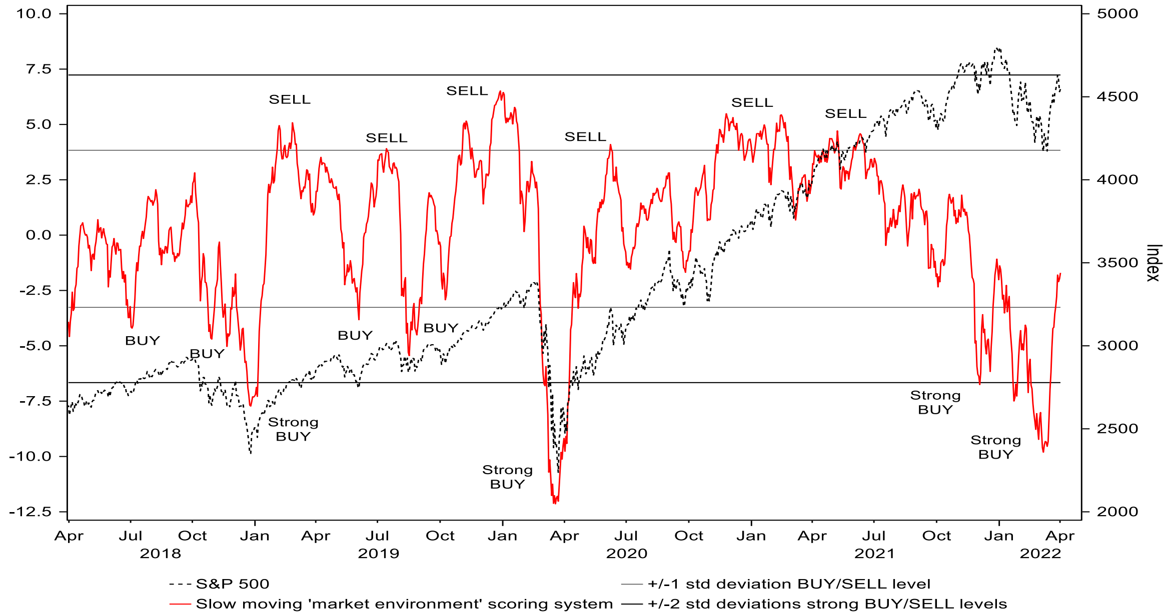


Our medium term 'fast moving' scoring system is NEUTRAL (just)

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).

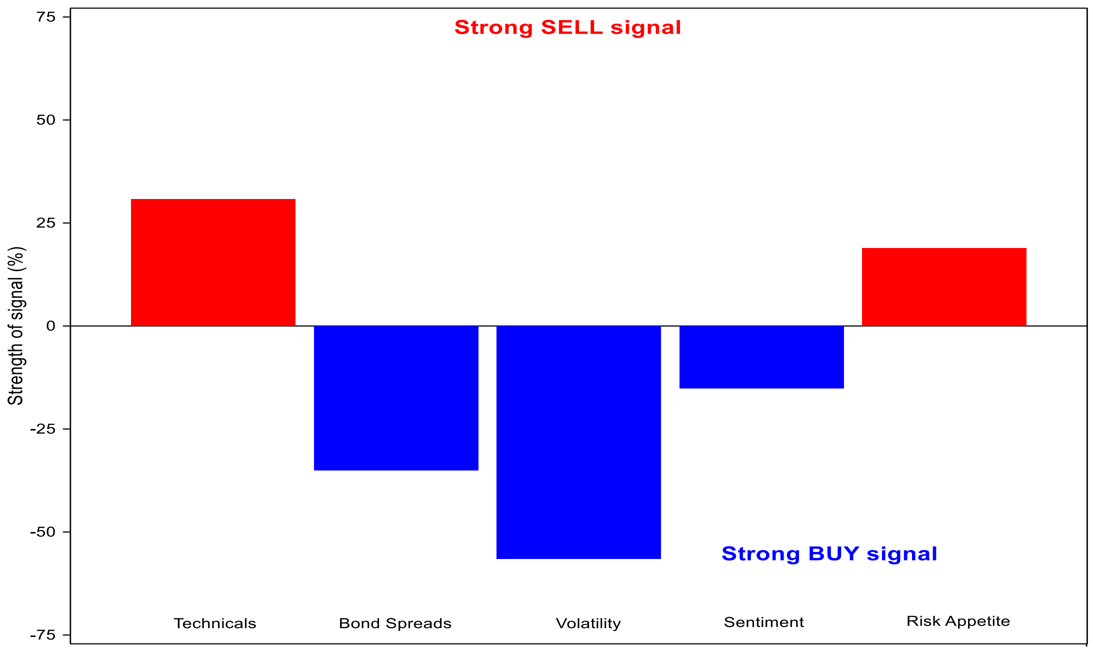
Fig 3a: Longview 'slow moving' market environment scoring system vs. S&P500



Source: Longview Economics, Macrobond

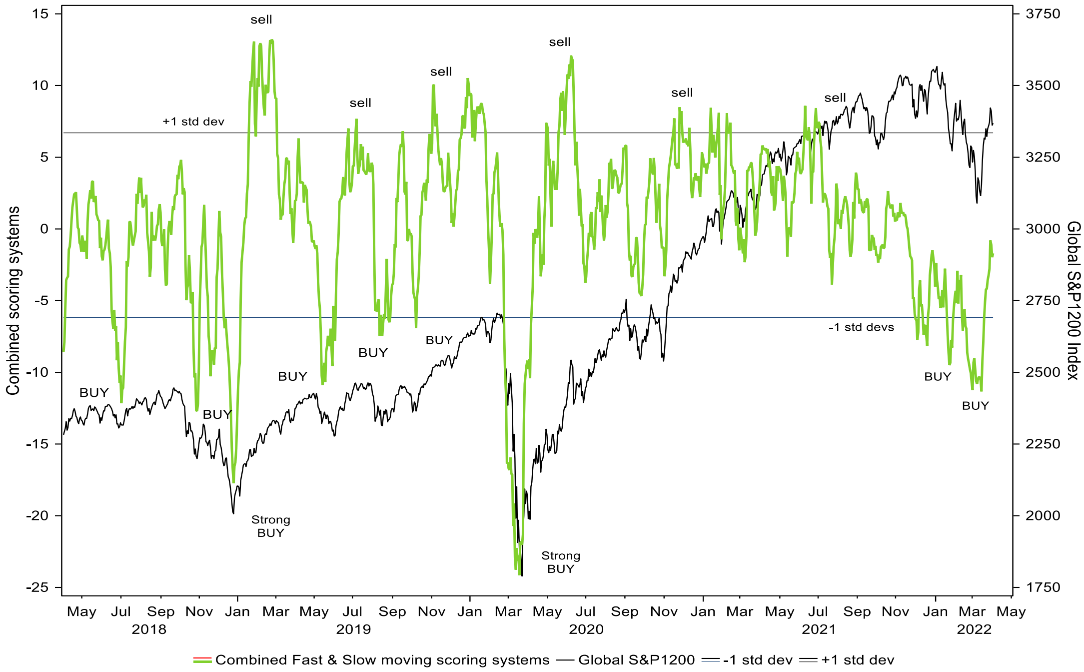
Our slow moving 'market environment' scoring system (fig 3) aggregates a suite of models across a number of categories (namely: Technicals, Bond Spreads, Volatility, Risk Appetite & Sentiment). This scoring system is entirely mechanistic. Typically, a score of -3.5 (i.e. -1 std deviation) indicates a 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

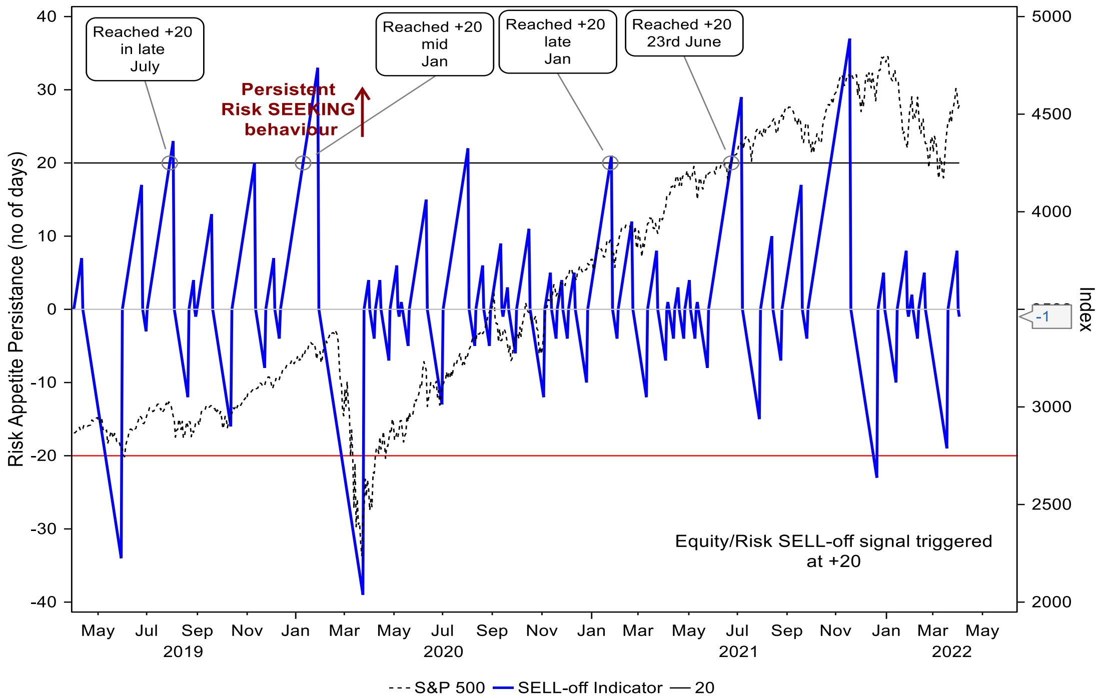
Fig 3c: Combined Slow Moving & Fast Moving Scoring systems vs. S&P500



Source: Longview Economics, Macrobond

The combined slow & fast moving scoring system is NEUTRAL

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



Source: Longview Economics, Macrobond

The Longview SELL-off indicator is 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.

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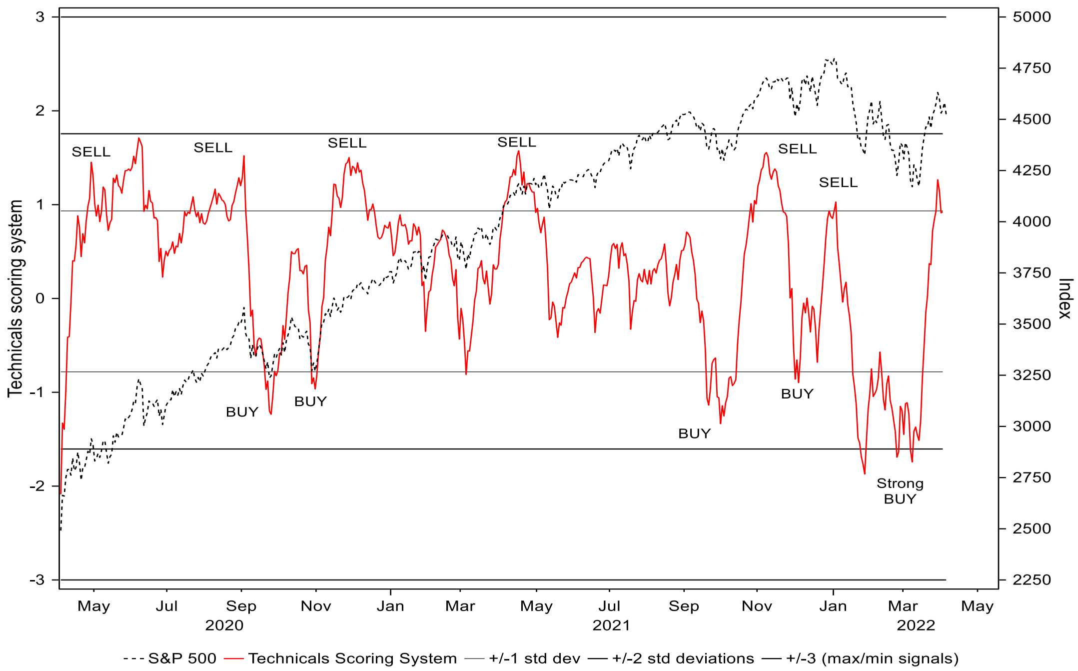
Section 3i: Longview Scoring Systems – Key Sub Categories

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

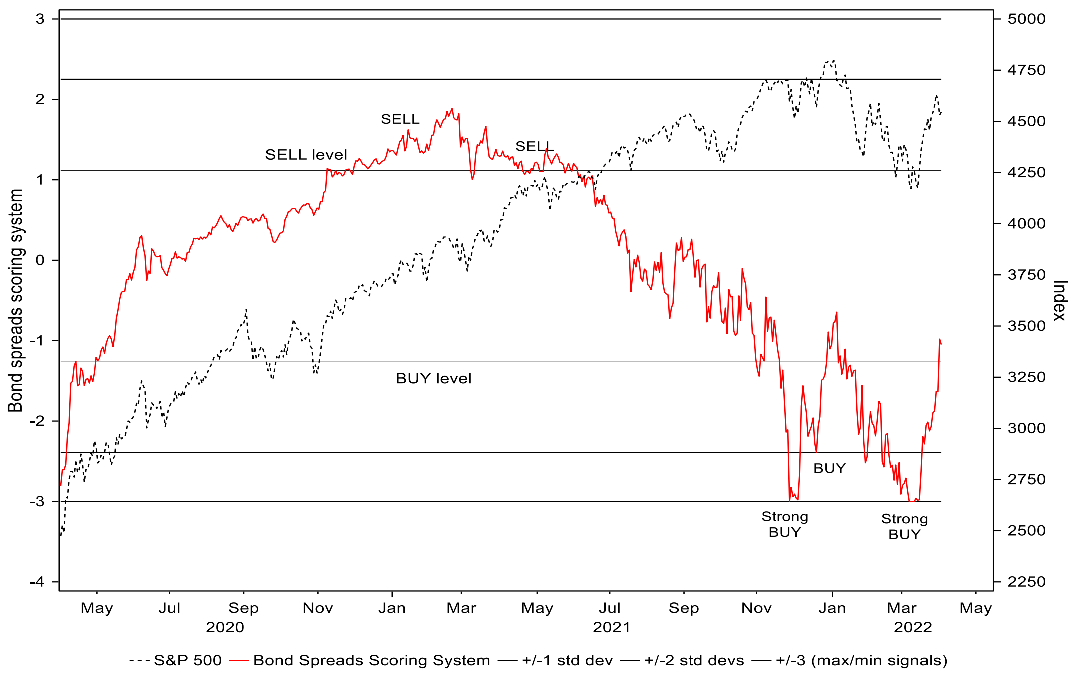


Source: Longview Economics, Macrobond

Technical factors summary: Technical models are NEUTRAL (just)

*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



Source: Longview Economics, Macrobond

Bond Spreads Summary: This model is NEUTRAL (just)

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

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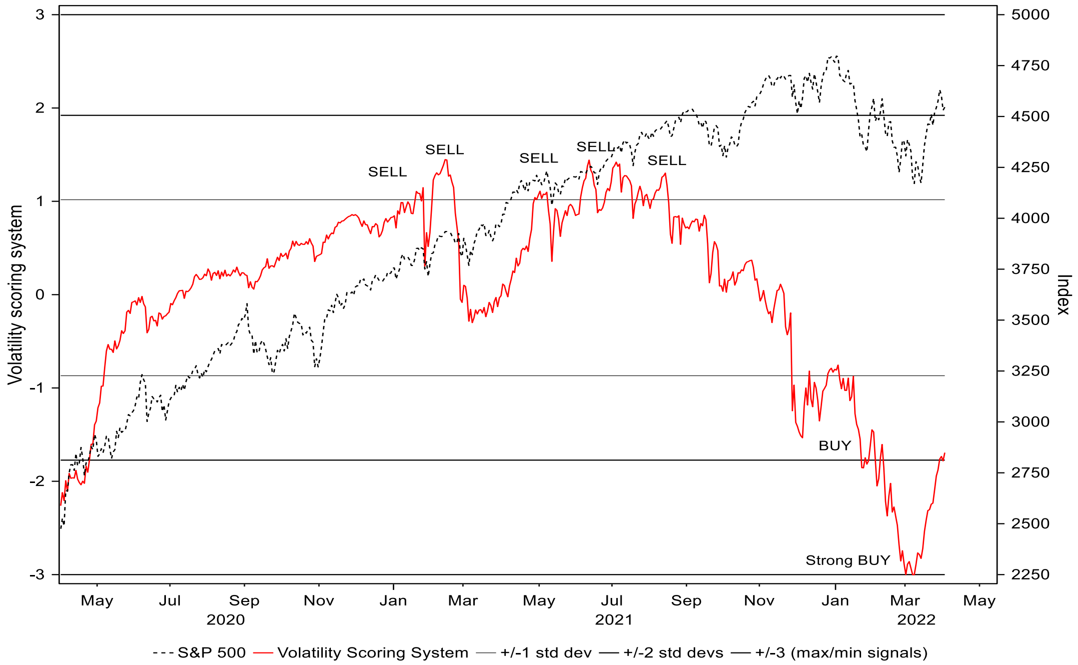
Fig 3g: 'Volatility' scoring system* vs. S&P500 index

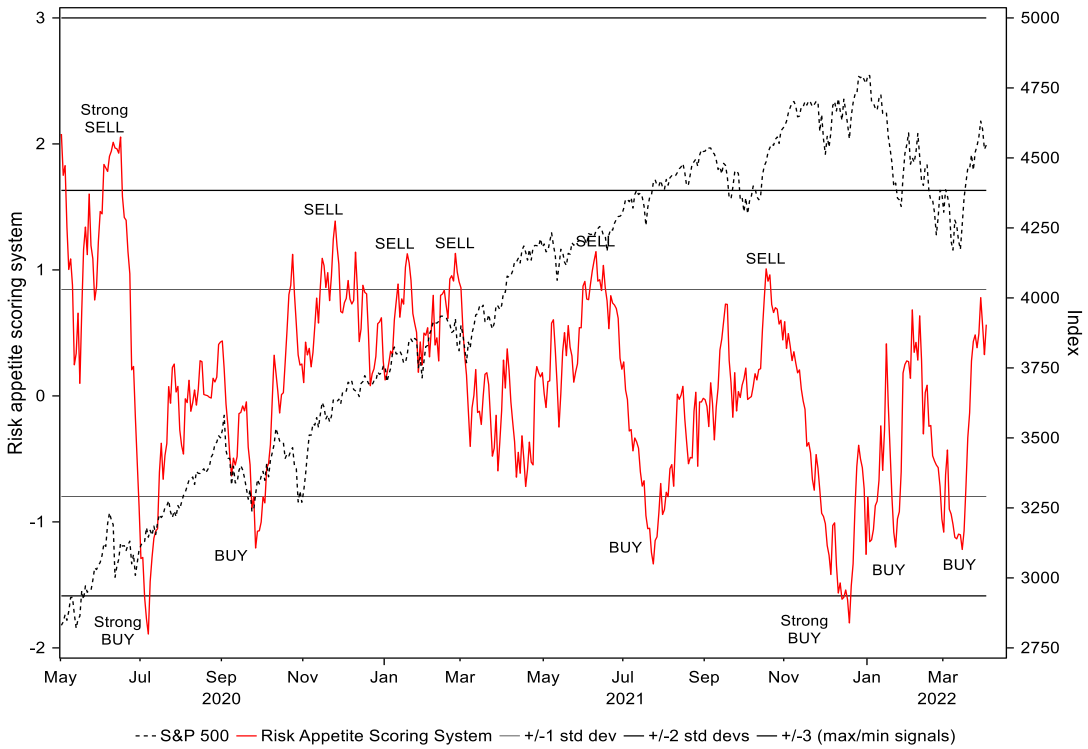


Source: Longview Economics, Macrobond

Volatility summary: Volatility model is on BUY

*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

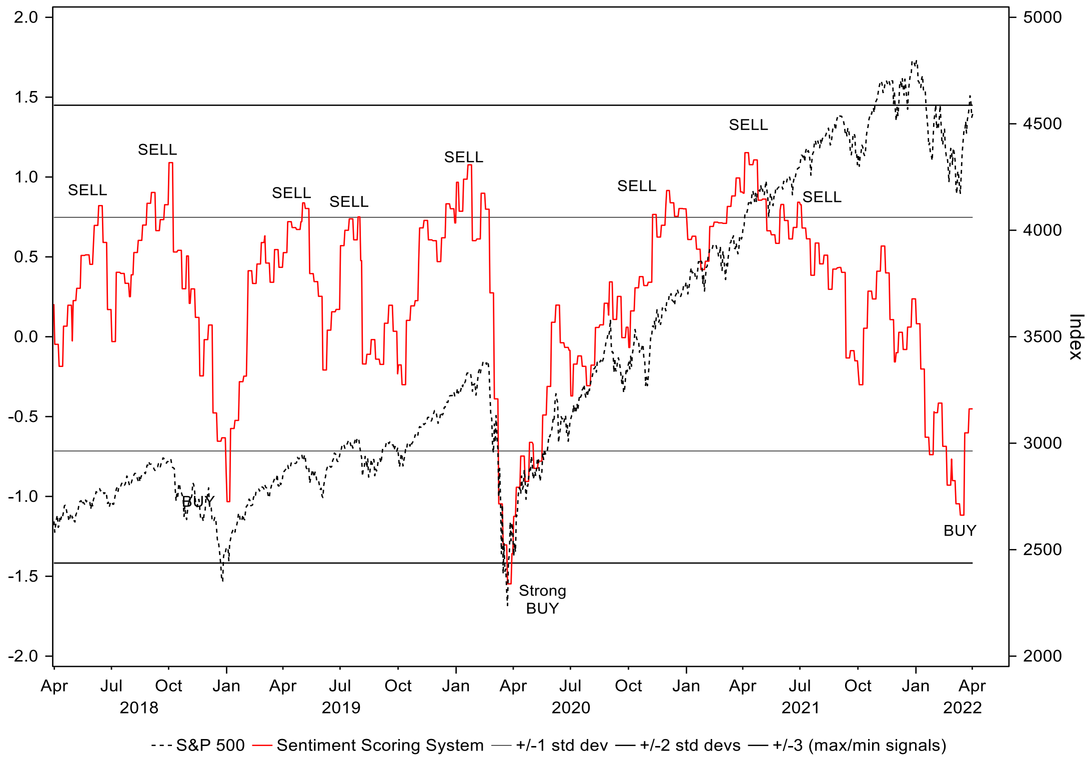


Source: Longview Economics, Macrobond

Risk appetite summary: 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

Sentiment models summary: The sentiment scoring system is NEUTRAL (& just above BUY)

*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	**+5.0**	**-**	**-5.0**
Current recommendation	**50.0**	**45.0**	**5.0**

Source: *Longview Economics*

We recommend retaining a tactical OW equity position and staying US cash.

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

	US Equities
Equity Strategy for Simulated Global Macro Fund:	net (SHORT)/LONG
Permitted Range (aggressive)	-100% to +150%
Current recommendation (for global macro fund)	**+50%**

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 forecast 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	+5.0	-5.0
Current recommendation	97.5%	2.5%
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	70.2% (i.e. 72% of 97.5%)	27.3% (i.e. 28% of 97.5%)

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****

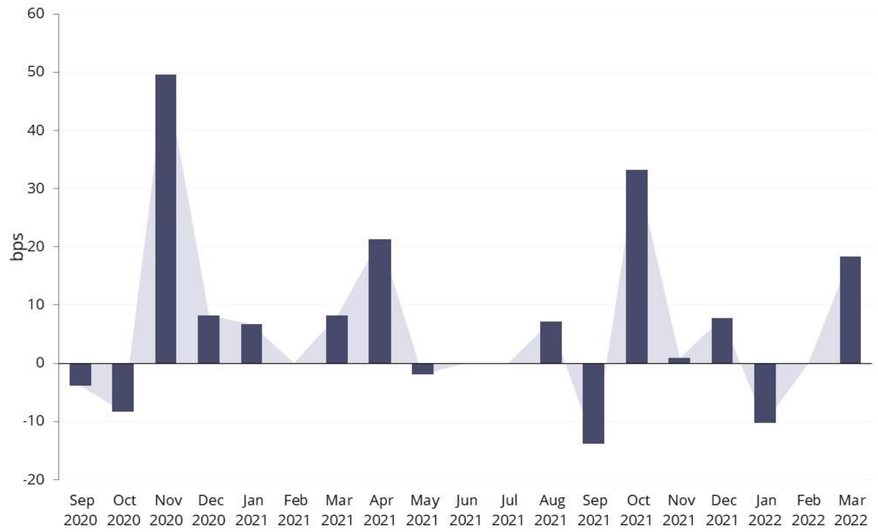
04/04/2022 15:12	Cons disc.	Cons staples	Energy	Financials	Healthcare	Industrials	Info tech	Materials	Comm. Services	Utilities	Index
Cons disc.		15	3	8	20	21	69	6	49	82	18
Cons staples	86		6	18	33	66	81	17	71	94	65
Energy	98	95		96	97	98	95	95	95	100	99
Financials	93	83	5		73	89	81	42	77	98	90
Healthcare	81	68	4	28		74	81	30	79	97	75
Industrials	80	35	3	12	27		73	7	61	90	42
Info tech	32	20	6	20	20	28		16	41	61	26
Materials	95	84	6	59	71	94	85		83	99	90
Comm. Services	52	30	6	24	22	40	60	18		72	35
Utilities	19	7	1	3	4	11	40	2	29		7
Index	83	36	2	11	26	59	75	11	66	94	

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, healthcare, consumer staples and industrials. Relatively expensive sectors include utilities, communication services. materials & IT.
****NB this table should be read as 'columns versus rows' – i.e. the sector name above, relative to the sector name to the left.

Appendix B: Historical Performance – Equity Recommendations

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



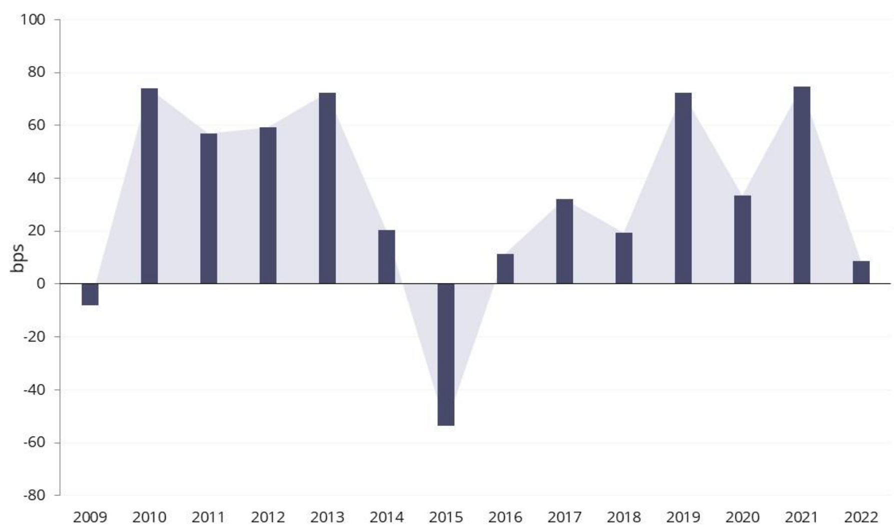
Source: *Longview Economics*

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

	2016 bps	2017 bps	2018 bps	2019 bps	2020 bps	2021 bps	2022 bps
Benchmark	552	1054	-145	1816	1502	1047	-498
Longview absolute	563	1086	-125	1888	1536	1122	-490
Longview rel. to benchmark	+12	+32	+19	+72	+34	+75	+9

** 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 13 yrs)



YTD performance is +9 bps.

NB annual target is +20 – 50bps

Source: *Longview Economics*