Blackshield Capital

December 2023 (11.12.23 – 17.12.23)

BLACKSHIELD WEEKLY INSIGHTS

Dynamics by key assets

Top charts of the week:

- significant easing of Fed policy
- market sentiment and fundamental data
- consumer credit tightening

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One of **the most important tasks of an investment firm is** to respond in a timely manner to the challenges of the economy and market conditions. While many risks of a geopolitical and financial nature cannot be predicted, it is worth staying informed to understand what is happening in a meaningful way.

Interest rates, the real estate market, employment and unemployment, inflation and corporate profits are just a few of the variety of factors affecting asset and security pricing.

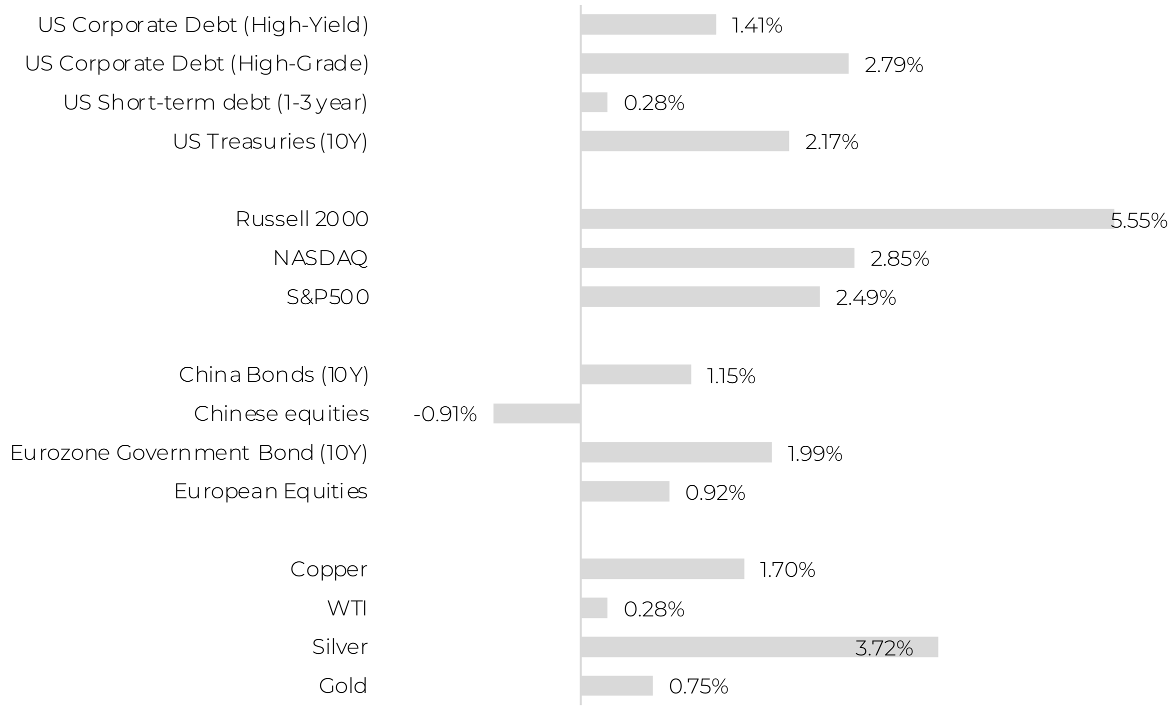
Our goal is to provide a deeper and clearer understanding of what is happening in the markets with an emphasis on illustrations, charts and visuals.

Weekly Insights will provide a more detailed look at industry specifics, delve into the nuances of price mechanics, and provide a more detailed understanding of our strategic vision offered in our quarterly strategic reports.

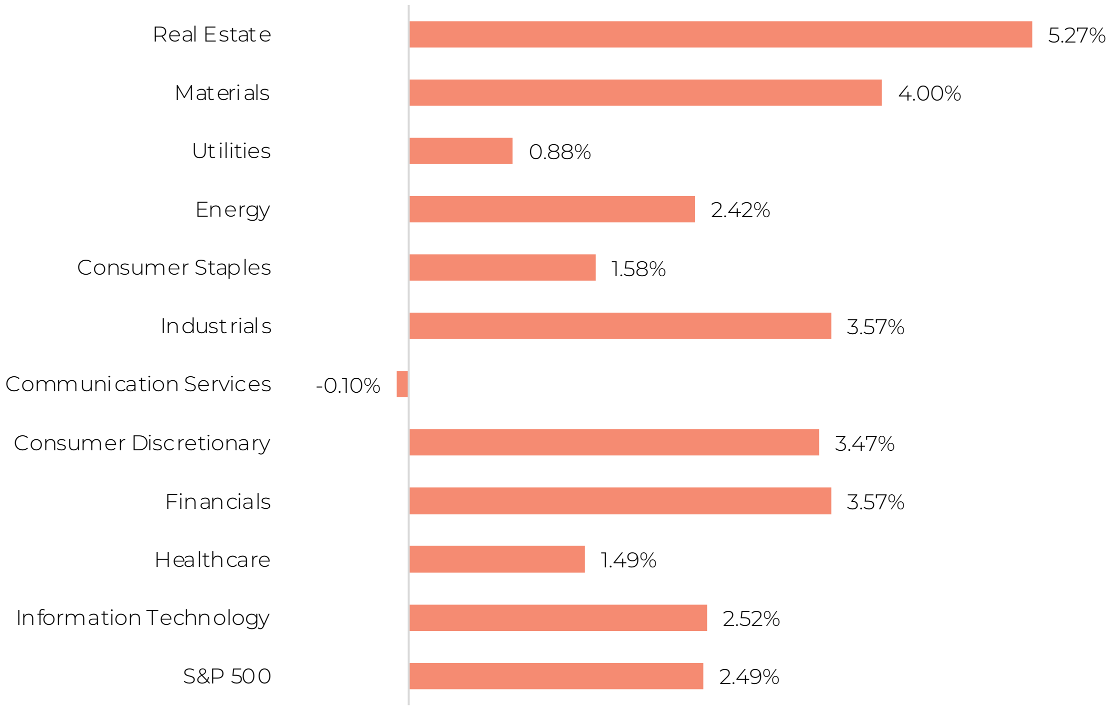
Dynamics by key assets

The previous week was positive for markets in terms of both economic data releases and market sentiment. Stock indices averaged 2%+ gains, while industrial and precious metals rallied mixed.

Dynamics by key assets for the week



S&P 500 index sectors dynamics for the week



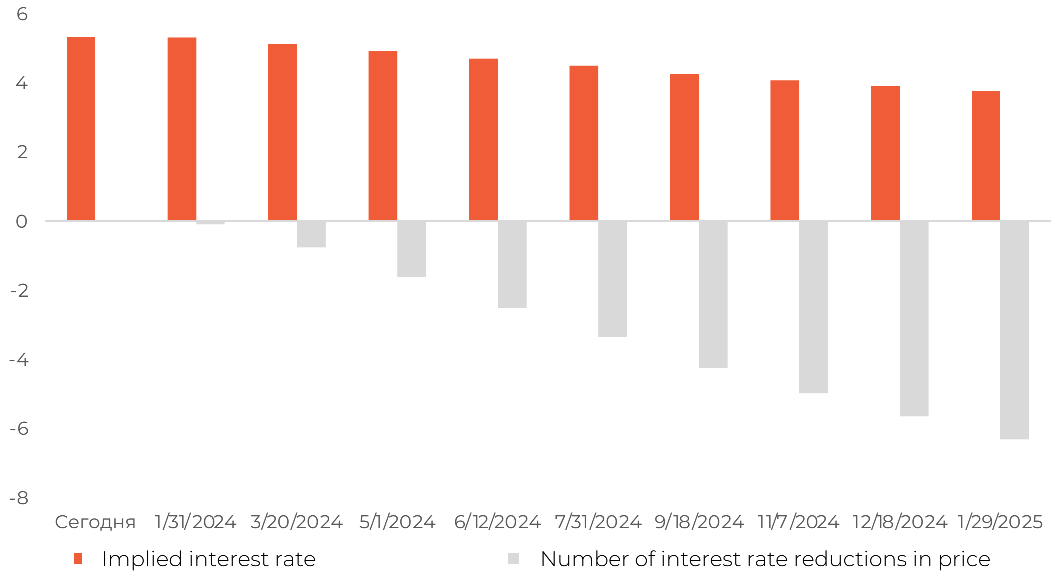
- Small-capitalization companies can be confidently called the leader of last week's growth, as the expected reduction in interest rates significantly relieves the debt burden on small businesses. This easing potentially opens up growth opportunities for companies whose only significant impediments to growth were expensive debt capital and excessive corporate debt.

- On a sectoral basis, the most active sub-sector is real estate, which is also benefiting significantly from the expected decline in interest rates. Many structured real estate funds use leverage to increase returns, and any reduction in the cost of borrowed capital proportionally increases the potential returns of this business sector.

Top charts of the week – significant easing of Fed policy

Softened inflation figures and the Fed's open announcement of a possible interest rate cut caused a surge of positivity among both bond and equity market investors. Consensus expects a rate cut as early as March.

Market's assessment of future interest rates



Average dynamics of the S&P 500 index before and after the first interest rate cut

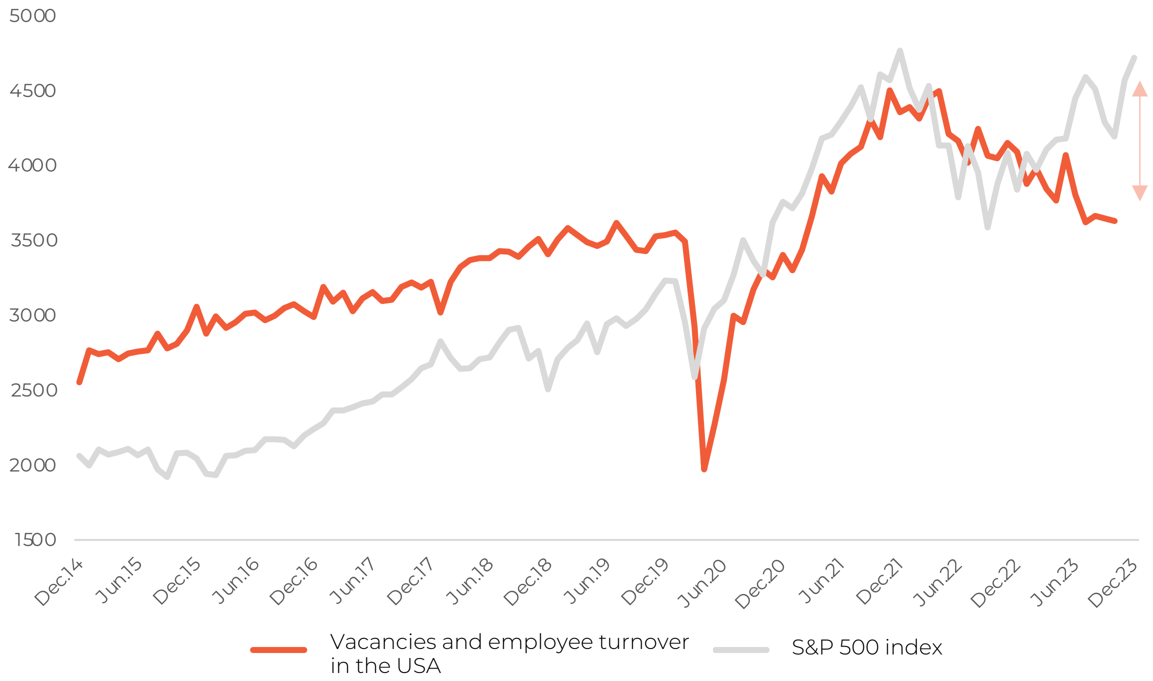
- For the most part, central banks have synchronized their interest rates as the topic of sustained and high inflation is yesterday's news. It is now important to understand how fast and how soon interest rates will be cut.
- The market was positive on the Fed's verbal confirmation that interest rates will be cut and it will happen soon, however, the inertia of the economy and the Fed's caution may cause rate cuts to happen later than expected.

- Over the past two years, investors have learned how to navigate a market with aggressive interest rate policy and a tight Fed stance. The upcoming major theme is how the markets will behave in a mirrored environment.
- On average, stock indices tend to rise before and after the first rate cut. But it is worth considering that there are also anomalous cases: similar economic conditions in 1989 and 1995 showed different trends, where in 1989 the market collapsed immediately after the rate cut, while in 1995 it showed a strong rise.

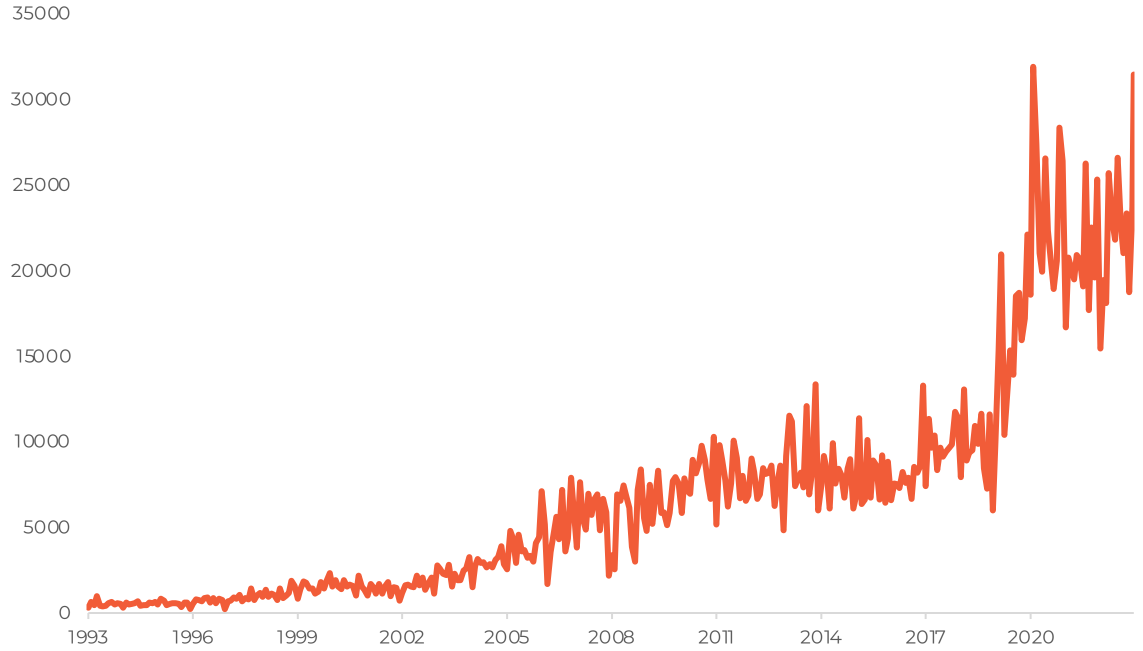
Top charts of the week – market sentiment and fundamental data

Against the backdrop of short-term optimism, the fundamental divergence between the market and the economy is also worth noting. One of the important indicators (besides sentiment) that institutional investors watch is the labor market.

S&P500 index and the labor market



Call options trading volumes, since 1993



- Among the leading indicators of the labor market (in addition to the direct indicators of employment and unemployment, including in the structural context), we can name the indicator of new vacancies and staff turnover. The fact is that a higher confidence in the possibility of finding a new job is reflected in a high turnover rate. If it decreases, it is one of the "red flags".
- Some divergence between the stock market and the labor market has developed recently, the release of updated data will be decisive.

- The derivatives market traditionally reflects investor sentiment and is a telling indicator of both trend and counter-trend. Recently, call options trading volume (reflecting bullish investor sentiment) has grown to levels close to historic highs.
- A similar spike in call option demand was seen in March 2020 and November 2021.

Top charts of the week – consumer credit tightening

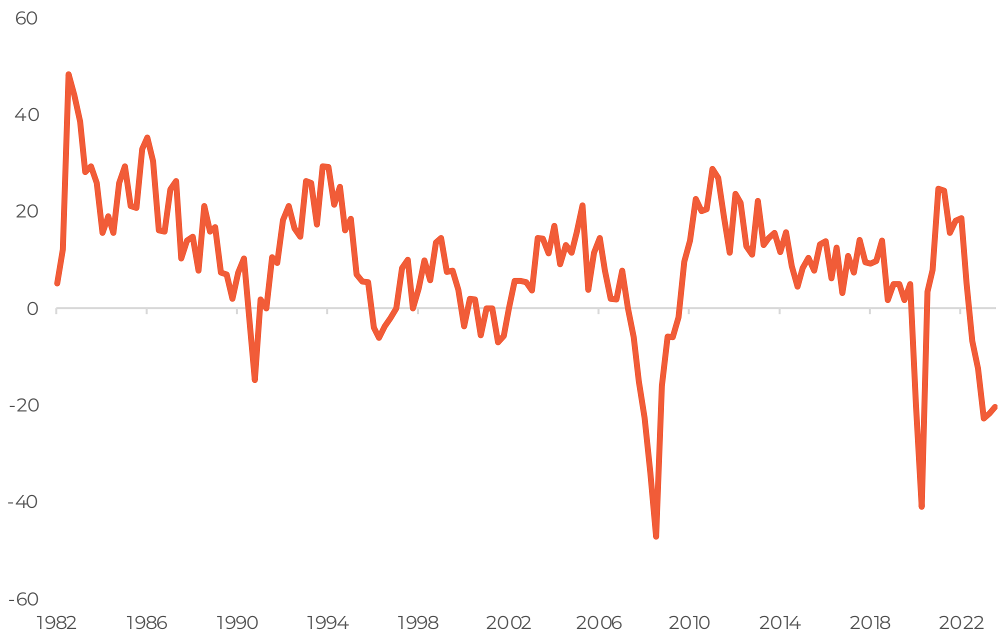
Continuing on to the point of divergence between the market and the economy, it would be logical to look at the main factor in causing a recession - credit tightening.

On average, it takes 10 quarters from the beginning of a Fed contraction to a recession

Fed Funds Initial Hike	1st Qtr. Of Recession	Qtrs. From Liftoff
3Q 1958	3Q 1960	8
4Q 1967	1Q 1970	9
2Q 1972	1Q 1974	7
2Q 1977	2Q 1980	12
4Q 1980	4Q 1981	4
4Q 1986	4Q 1990	16
2Q 1999	2Q 2001	8
3Q 2004	1Q 2008	14

10 quarters on average

Willingness of banks to provide consumer loans



- On average, it takes 10 quarters from the start of a monetary contractionary policy to the appearance of a recession (2008 - 14 quarters, 2001 - 8 quarters).
- In Q4 2023, it has already marked 7 quarters from the start of tightening. Currently, we are in the average historical time frame. As banks continue to tighten standards, there is a lagged effect from rising bond yields and inflation continues to restrain demand - there is every opportunity for a recession to find its start.

- One important factor worth noting is the willingness of banks to lend, as this instrument is a precursor to recessionary conditions.
- In particular, historically, any "hard landing" scenario has been marked by high levels of credit tightening. Whereas on only 3 occasions has a recession been mild - in 1966, 1985 and 1995 - when the level of willingness to lend was on a positive trajectory.

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LET US HELP YOU TO FOCUS **ON WHAT MATTERS MOST**

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