Blackshield Capital

01.01.2024 - 08.01.2024

BLACKSHIELD WEEKLY INSIGHTS

Dynamics by key assets

Top charts of the week:

- labour market
- anomalous values of SOFR and arbitrage
- the year of politics

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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.

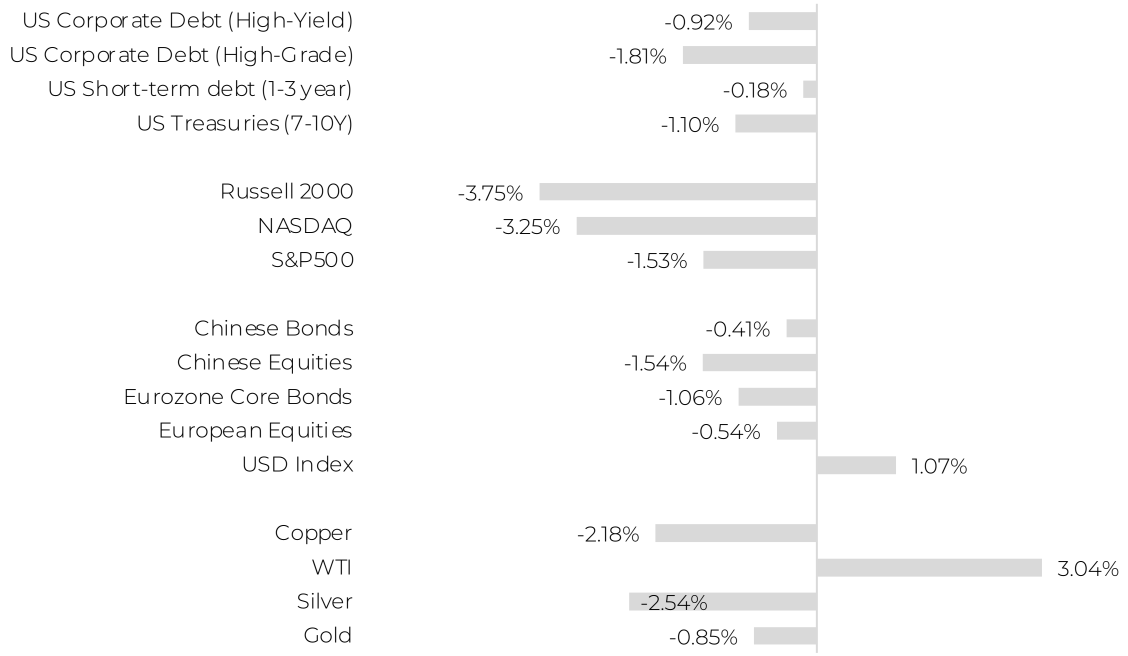
Our goal is to provide a deeper and clearer understanding of what is happening in the markets with an emphasis on illustrations, charts and visuals.

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.

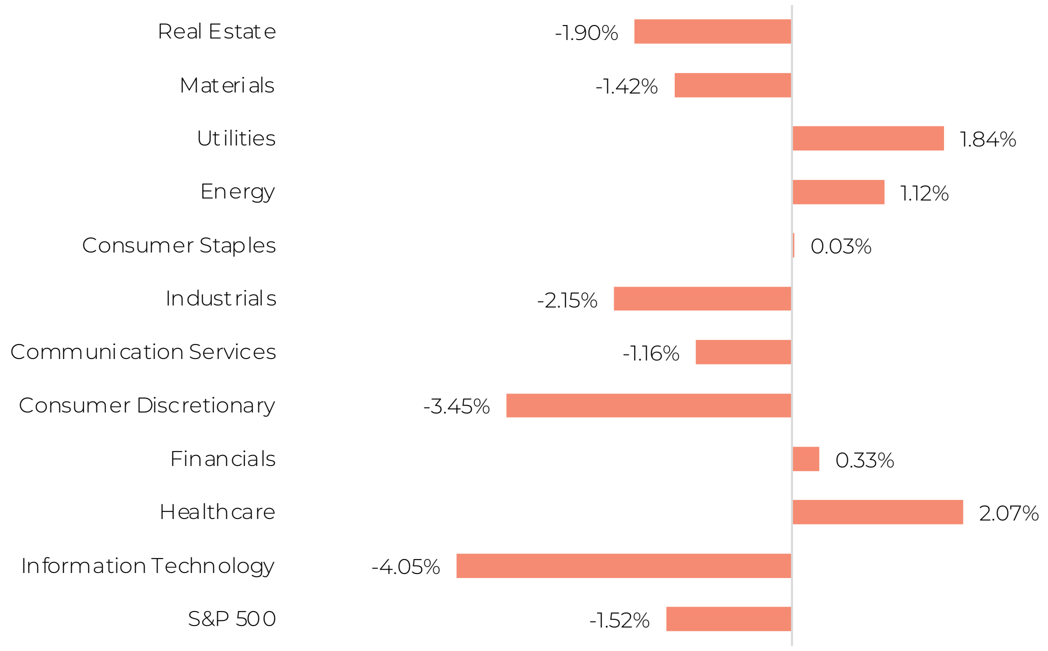
Key Assets Dynamics

The start to the year was negative for both major indices and bonds. Most risk assets fell, leaving investors to question the nature of January's decline - whether it was a strategic pullback or whether markets had reached a turning point.

Key assets dynamics for the week



S&P 500 index sectors dynamics for the week



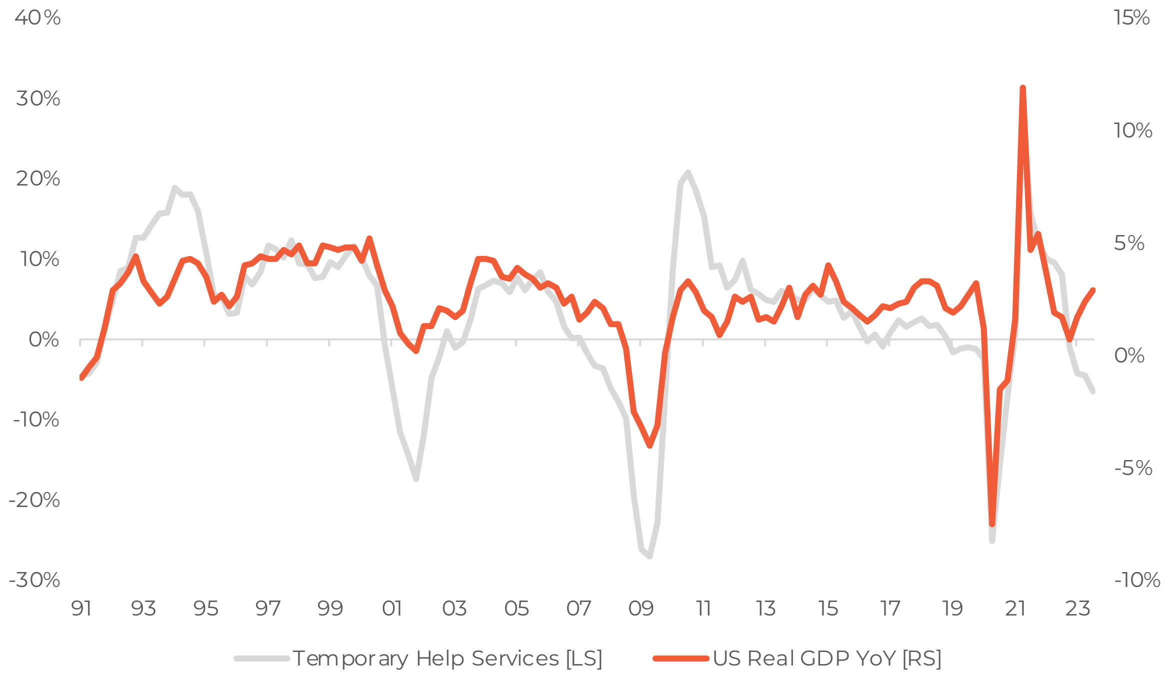
- It should be noted that the structure of the market correction mainly reflects the risk profile of assets, so this pullback can initially be seen as profit taking and hedge funds reducing their leverage.
- One of the smaller rallies last week was in the oil market (including the structure of the forward curve), largely due to the logistics issue in the Red Sea.

- In terms of the structure of the S&P 500, the weakest sectors were interest rate sensitive stocks, i.e. the recent growth leaders - information technology, consumer discretionary and real estate.
- In contrast to cyclicals, defensive companies were moderately positive, while financials were flat, largely due to valuations and the extremely overbought growth momentum of recent weeks.

Top charts of the week - labour market

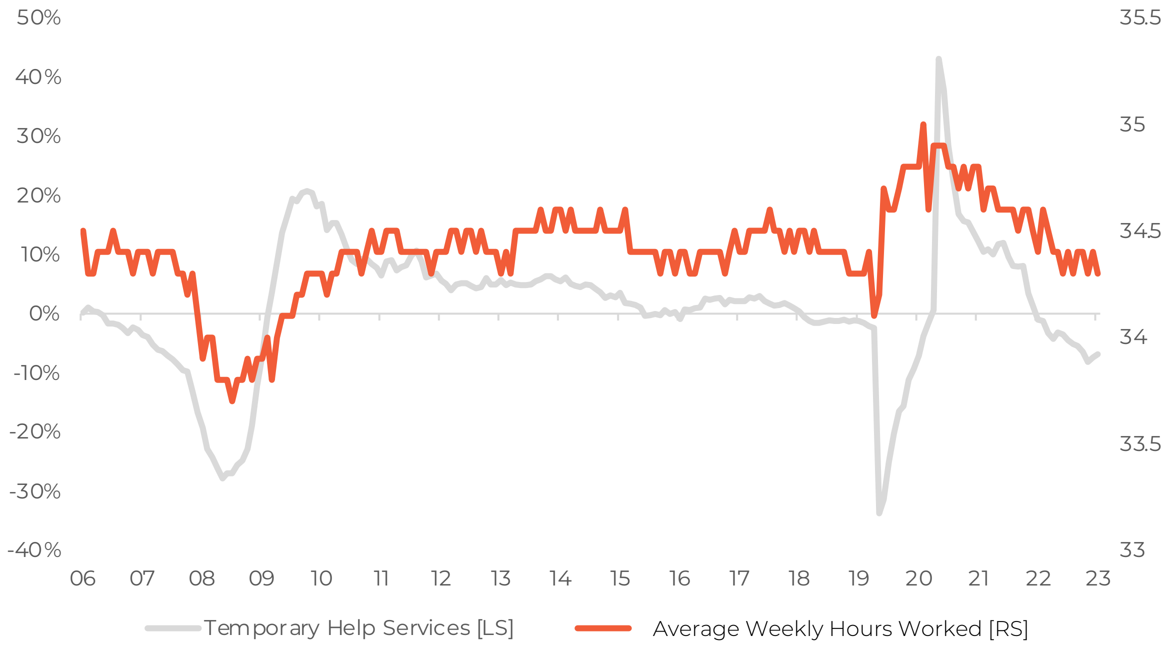
Despite the fairly unambiguous employment statistics at the moment (rising but low unemployment), some of the labour market data are sending conflicting signals.

Temporary employment in the labour market



- When the labour market was at its peak, the number of temporary workers was also at an all-time high. Previously, the explanation for this fact was the post-Brexit boom, when companies in all categories and sectors had a high need for temporary workers.
- Now, as the economy worsens, most companies do not even have a comparable need for excess labour, including temporary workers.

Temporary employment in the labour market and average weekly hours worked

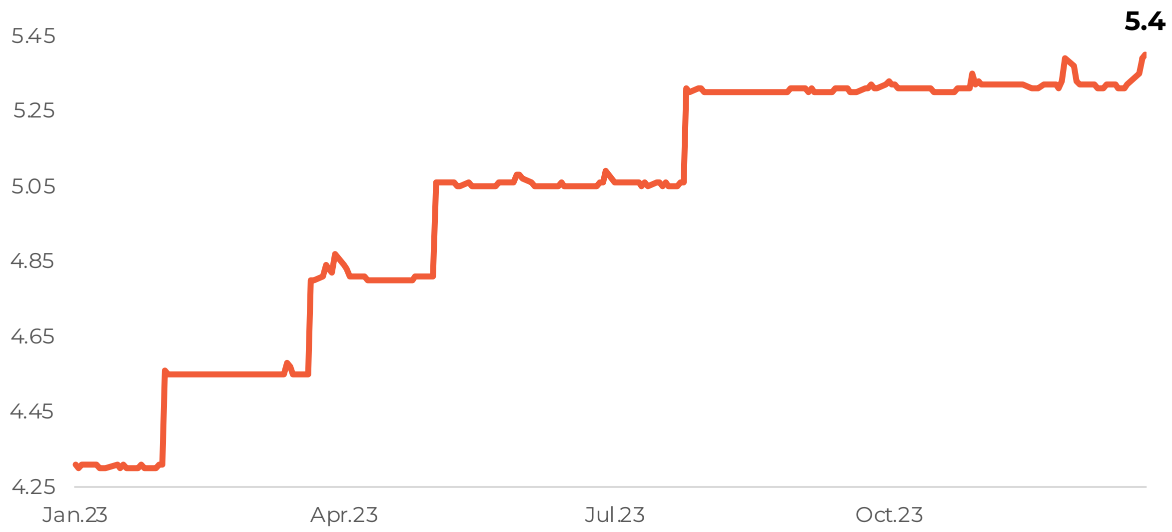


- Interesting to note that, given the growing importance of temporary employment over the past few decades, it was the decline in this type of employment that was a precursor to the last three recessions.
- This is not to say that a recession has already occurred, but in parallel with declining business activity, entrenched inflation and tight Fed policy, such statistics are one of the red flags of future economic problems.

Top charts of the week - anomalous values of SOFR and arbitrage

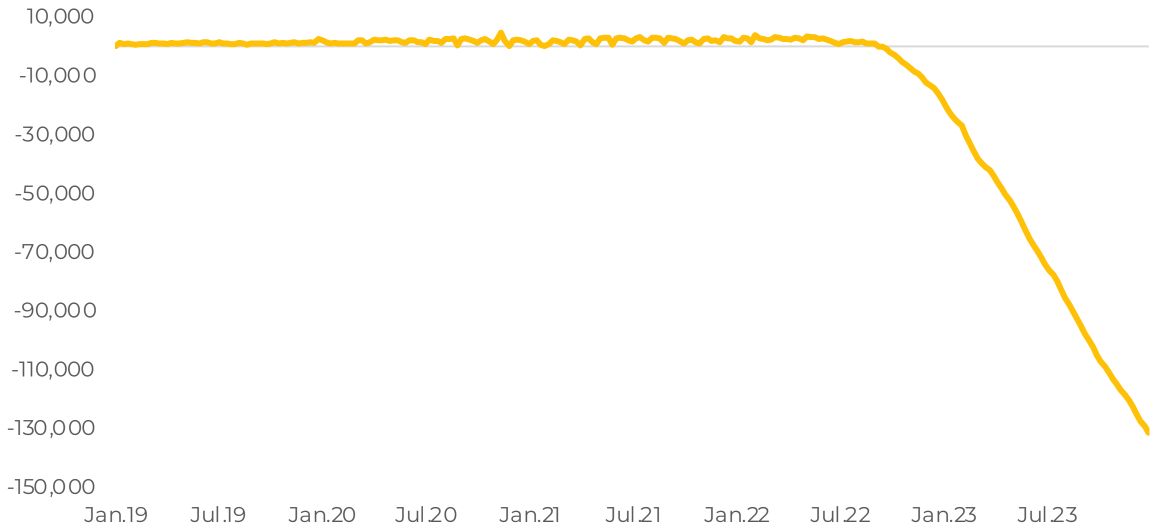
At the end of 2023 there was a spike in the price of repurchase agreements (where investors borrow against bonds). This was partly a consequence of the liquidity squeeze at the end of the year, and partly a liquidity imbalance, which created an arbitrage opportunity for institutional investors.

Dynamics of the short-term interest rate SOFR



- The Secured Overnight Financing Rate (SOFR) is a measure of the cost of borrowing overnight funds backed by government bonds. By the end of 2023, this rate had risen to a 5-year high of 5.4%.
- Interestingly, banks are increasingly borrowing from the central bank through the BTFP short-term bank funding programme (which was urgently created in March 2023 after the collapse of the SVB to prevent depositors' deposits from running out).

Reserve balance: transfers in favour of the US Treasury

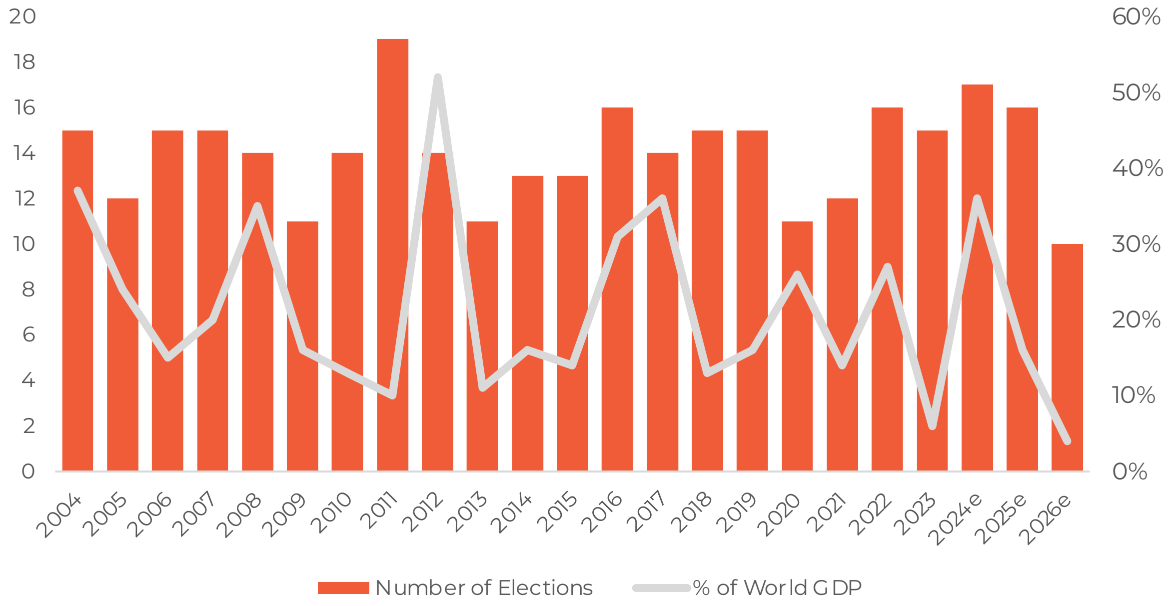


- The high probability of a decline in long-term rates led to a large spread between short-term and long-term rates, which, together with low liquidity at the end of the year, led to an increase in arbitrage: banks can borrow through the BTFP at an annualised rate of around 4.8% and use the funds received at an IORB rate (rate on reserves) of 5.3%, leaving a net arbitrage of 0.5%.
- The rise in ultra-short term rates, while beginning to normalise at the start of the year, has not reduced the level of institutional flows into ultra-short term funds and assets.
- This overlaps with the reallocation of assets and the Fed's balance sheet reduction, but in any case someone else always pays for the arbitrage.

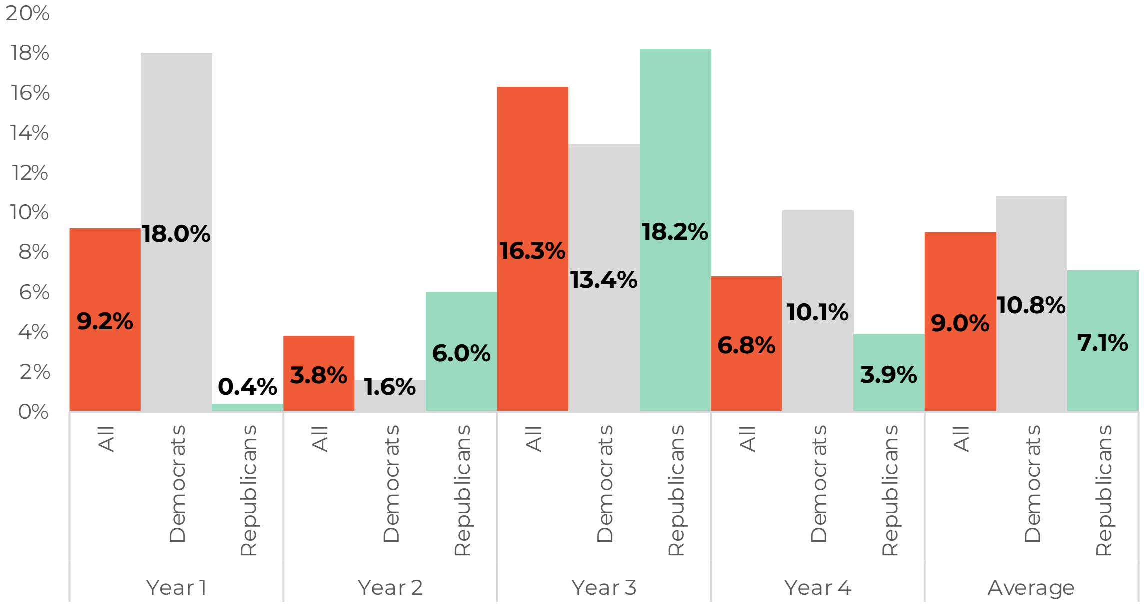
Top charts of the week - the year of politics

In the coming year, the outcome of elections, not only in the United States but also in other developed countries, will be important and will determine not only the political vector but also the economic content, while the global economy is on the verge of recession.

The level of GDP of the countries where the elections will be held



Stock market dynamics during elections



- As we can see from the chart above, 2024 is an election year in most of the world, particularly in the developed economies, which together account for around 40% of the world's total GDP.
- By this measure, the level of political uncertainty becomes quite high, leading to ambiguity not only in the political world but also in the economic world.

- There is a strong belief that markets grow strongly in the first year of a presidency and the year before the election. We have not found a clear pattern, except that the third year of the presidential cycle shows the highest growth rates.
- At the same time, certain policies can be a strong driver for certain sectors, as has been the case recently: injecting liquidity into the markets, fiscal spending on infrastructure, student loan relief, etc.

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

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