Blackshield Capital

FAQ

Is it possible for the U.S. to avoid a recession?

While the resilience of US consumers surprised us, about 80% of distributed consumer income is not participating in investing. Also, loan delinquencies are already rising to 2020 levels, signaling a deterioration in household alternative cash flow. That said, interest payments are still higher than distributed income in the private sector. In the corporate sector, there are certain problems in the structure of the labor market caused by the desire to cut costs, as well as risks of rising wage inflation. In such an environment, it will be difficult to avoid at least 1-2 quarters of lower GDP growth.

Markets are rising, why should the Fed cut interest rates at all and is it okay not to?

Interest rate policy is a cyclical process, as interest rate hikes are the central bank's response to rising inflation. As inflation falls, the Fed will have to lower interest rates because, first, if nominal rates do not fall in line with inflation, this will lead to a rise in real rates, which is equivalent to an uncontrolled tightening of monetary policy. Second, there is a theory about the "neutral interest rate," some balanced real interest rate at which the economy produces the most output at a high level of employment. This directly echoes the Fed's two main mandates of price stability and maximum employment

How quickly and by how much can central banks start cutting interest rates next year?

Looking beyond the US to the entire G10 group of countries, despite the steady decline in global inflation, the market implies a weighted average interest rate cut for 2024 of just 0.8-1%, well below the 3.2% average in the interest rate cut phase. And while global central banks appear synchronized, the largest economies are moving out of sync: while the US is teetering on the brink of recession, China is teetering on the brink of growth and is close to avoiding structural risks.

What does a "balanced portfolio" include in the current economic environment?

We expect scenarios in the coming months in which risk balance and global diversification play a major role. The prolonged period of low volatility and high concentration of stock indices does not favor active trend-following investing. That said, the current economic situation rhymes more with late 2021 than early 2020 and is less likely to be the start of a prolonged bull market. We expect at least 2 volatile rallies in the coming year in both the stock and bond markets, so timing and diversification are perhaps the two important success factors for a balanced portfolio next year.

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Are market expectations for rate cuts in 2024 realistic?

Our baseline scenario leans toward the market significantly overestimating the current prevailing inflation situation, which has more than halved since its 2022 peak. And the fastest rise in interest rates historically could be followed by the fastest decline. However, a rapid cut in rates while not reaching the inflation target could lead us into another round of price increases. This may remind us of the history of the 1970s, where the economy was twice in periods of high inflation. At the same time, it was negatively reflected in the stock market, which emphasizes the importance for the Fed to make the right decision in the current environment.

There is another argument related to the labor market. As long as the economy is close to the employment ceiling, wage inflation has limited room for growth, but it may accelerate following a decline in the labor market.

Are there any signs of a future decline in stock indices, given the high concentration of BigTech?

To answer this question, it would be worthwhile to delve into the prerequisites for the growth of large IT companies in the previous year. A clear growth factor was their significant financial stability due to strong balance sheets, excess cash and stable cash flow generation. These are characteristics that are important to investors when selecting companies in economically unstable times. At the same time, given the 30% share of all 7 large IT companies in the S&P500 (which is an all-time high), the high concentration encourages market participants to look for alternatives in search of diversification. This rather logical dynamic of investment capital creates one of the most important risks for the stock market.