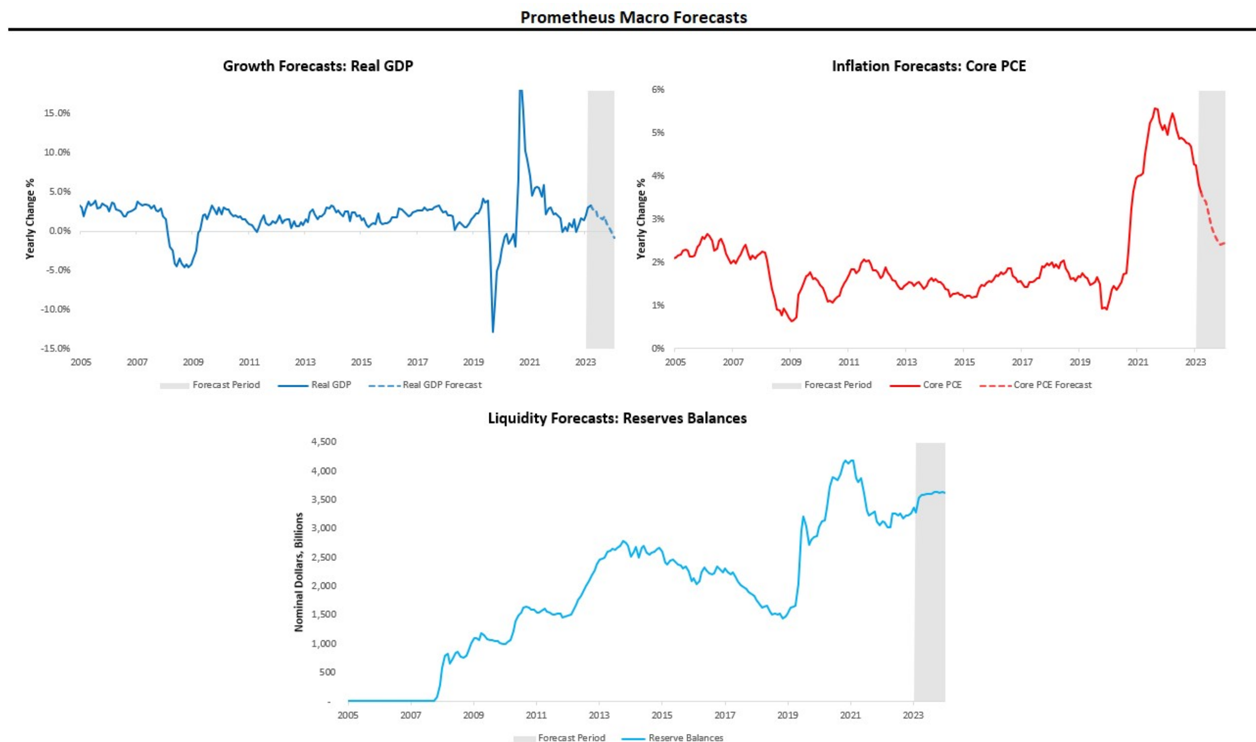
PROMETHEUS

Month In Macro

This note aims to share our research team's internal checkpoint process in evaluating the current state of the economy as it pertains to markets. The pages that follow will have familiar content for those who follow our work, but with the added benefit of our connecting the dots across all the economic and financial data our systems use to make portfolio decisions. Our primary takeaways are as follows:

- ***Nominal GDP contracted by -0.11% in October, with real GDP contracting by -0.24% with inflation rising by 0.13%. Meanwhile, despite ongoing QT, reserve balances in the financial systems have continued to expand, supporting liquidity conditions.***
- ***Cyclical dynamics and our outlook on nominal activity have begun to shift. While our expectations for real growth remain that they will soften, conditions are now aligning for inflationary pressures to abate, potentially pushing us out of an inflationary bear market.***
- ***We are at what resembles a turning point for treasury markets, with the amelioration of short-rate pressures and declining inflationary forces. The end of short-rate pressures are more apparent than decreasing inflationary forces.***
- ***After losses across positions last month, our Cycle Strategies are flat stocks & bonds and long commodities.***

We begin with our high-level assessment. We expect growth to trend lower, inflation to decelerate but remain above target, and liquidity to remain elevated. We show our forecasts for each below:



Our views on growth remain consistent, while our views on inflationary pressures. have moderated, and those on liquidity conditions have improved. The combination drives our positioning in our Cycle Strategies.

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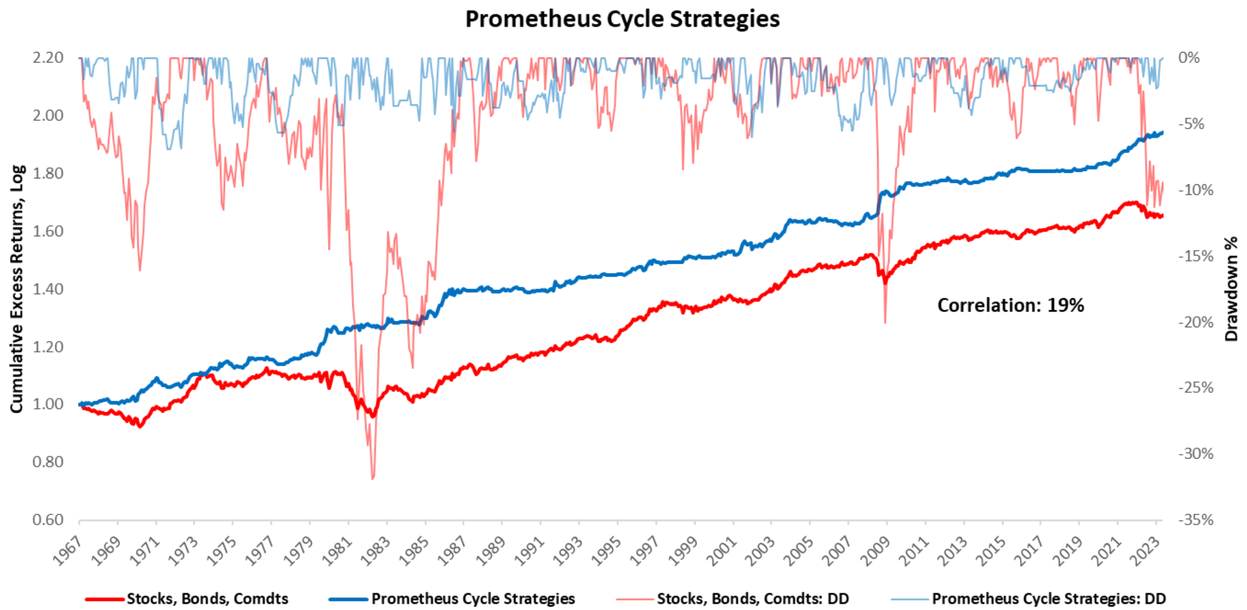
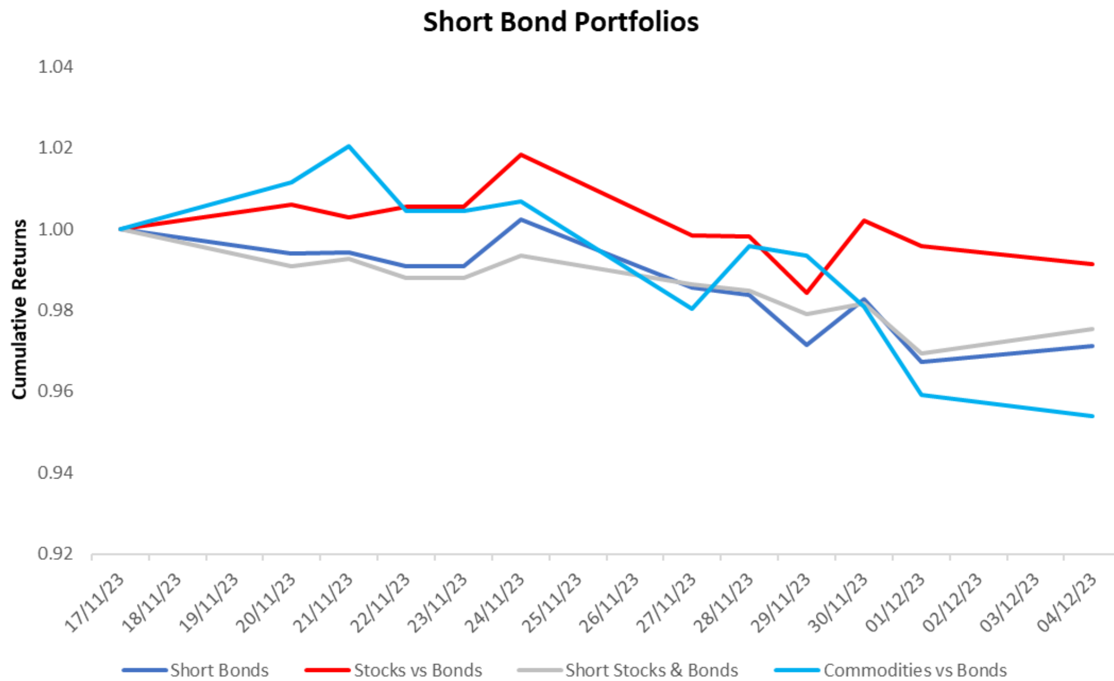
For reference, we show our Cycle Strategies below, which are 3% off their highs:



Above, we show the performance of our Cycle Strategies through November. A large part of the losses in the last months are driven by the shift in the short-bond dynamics visualized below:



As we can see above, bonds have potentially begun to stabilize as we approach the end of the tightening cycle. Whether this will continue will depend on the economy's path and what markets are pricing relative to this path. We discuss all this and more in the pages that follow.

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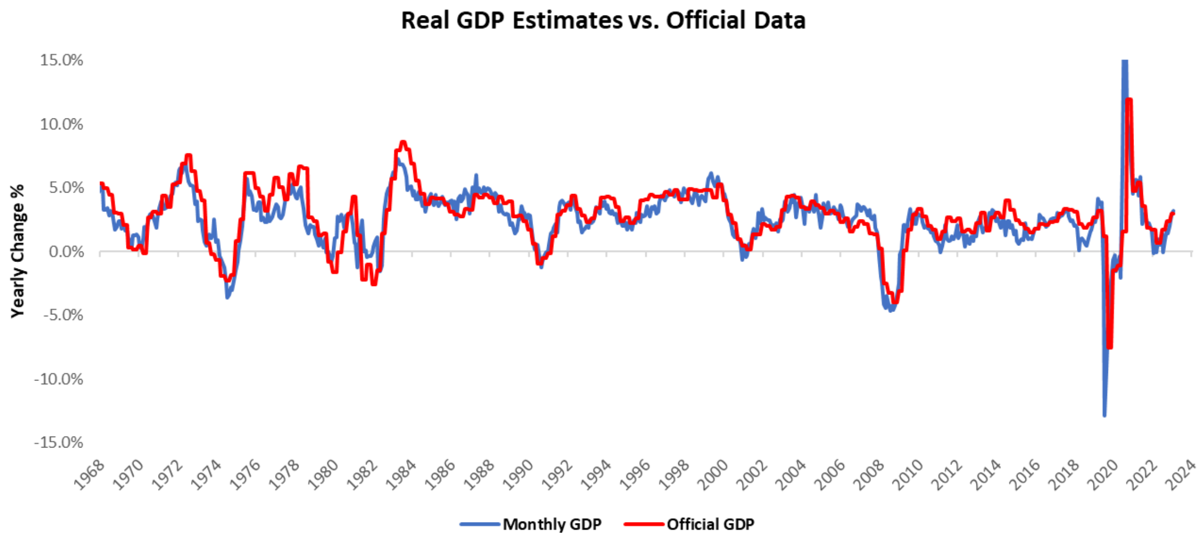
GDP: Resilient Nominal Activity

Before we dive deep, we think setting the stage for where we are is essential. For the latest data through October, our systems place Real GDP growth at 3.18% versus one year prior. Below, we show our monthly estimates of Real GDP relative to the official data:



In October, GDP came in at -0.24% versus the prior month. We decompose the most recent months' data into its major divers to better understand this increase. Below, we offer the contribution by sector to monthly GDP in the table:

Contributions To Monthly GDP Changes

	GDP	*C*	*I*	*G*	*X*	*M*
Nov 22	0.4%	-0.2%	-0.1%	0.0%	-0.1%	0.8%
Dec 22	-0.1%	0.1%	0.0%	0.0%	0.1%	-0.3%
Jan 23	0.9%	0.7%	0.2%	0.0%	0.5%	-0.5%
Feb 23	-0.1%	0.0%	0.0%	0.0%	-0.5%	0.3%
Mar 23	0.2%	-0.1%	-0.2%	0.0%	0.3%	0.2%
Apr 23	-0.5%	0.1%	0.2%	0.0%	-0.6%	-0.3%
May 23	0.8%	0.1%	0.1%	0.0%	0.2%	0.4%
Jun 23	0.5%	0.2%	0.1%	0.0%	0.1%	0.2%
Jul 23	0.4%	0.4%	0.1%	0.1%	0.2%	-0.3%
Aug 23	0.7%	0.0%	0.3%	0.0%	0.1%	0.3%
Sep 23	0.3%	0.2%	0.1%	0.0%	0.3%	-0.4%
Oct 23	-0.2%	0.1%	-0.2%	0.1%	-0.3%	0.1%
Cumulative	3.2%	1.5%	0.6%	0.4%	0.2%	0.4%

As we can see above, yearly GDP (cumulative, at the bottom of the table) has improved significantly, as investment has ramped up significantly after a difficult period during 2022. Additionally, consumption spending has remained resilient. Over the last month, however, we saw both investment and exports resume declines.

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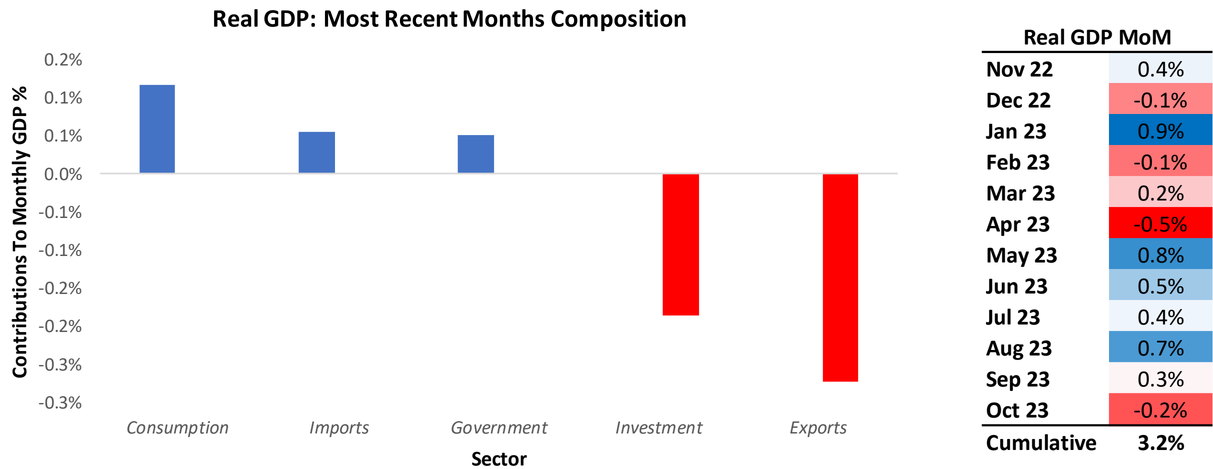
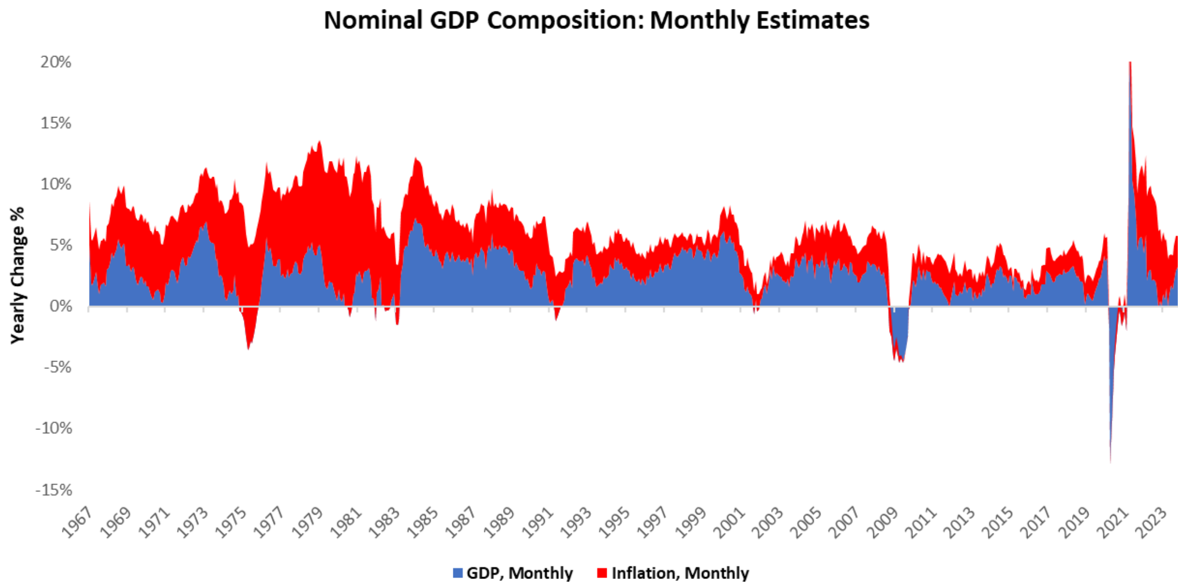
Below, we show the weighted contributions to the most recent one-month change in real GDP and the recent history of month-on-month GDP. Additionally, we offer the contribution by sector to monthly GDP in the table below:



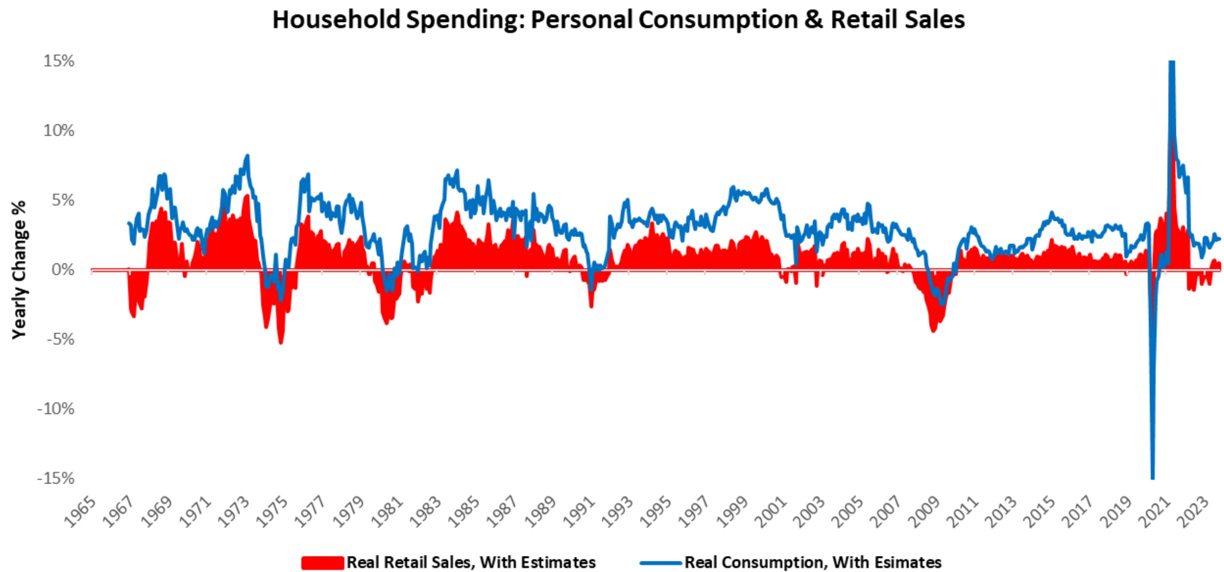
Real GDP MoM	
Nov 22	0.4%
Dec 22	-0.1%
Jan 23	0.9%
Feb 23	-0.1%
Mar 23	0.2%
Apr 23	-0.5%
May 23	0.8%
Jun 23	0.5%
Jul 23	0.4%
Aug 23	0.7%
Sep 23	0.3%
Oct 23	-0.2%
Cumulative	**3.2%**

Our latest estimates place nominal GDP at 5.72% versus one year prior. Nominal activity continues to remain elevated relative to recent history:

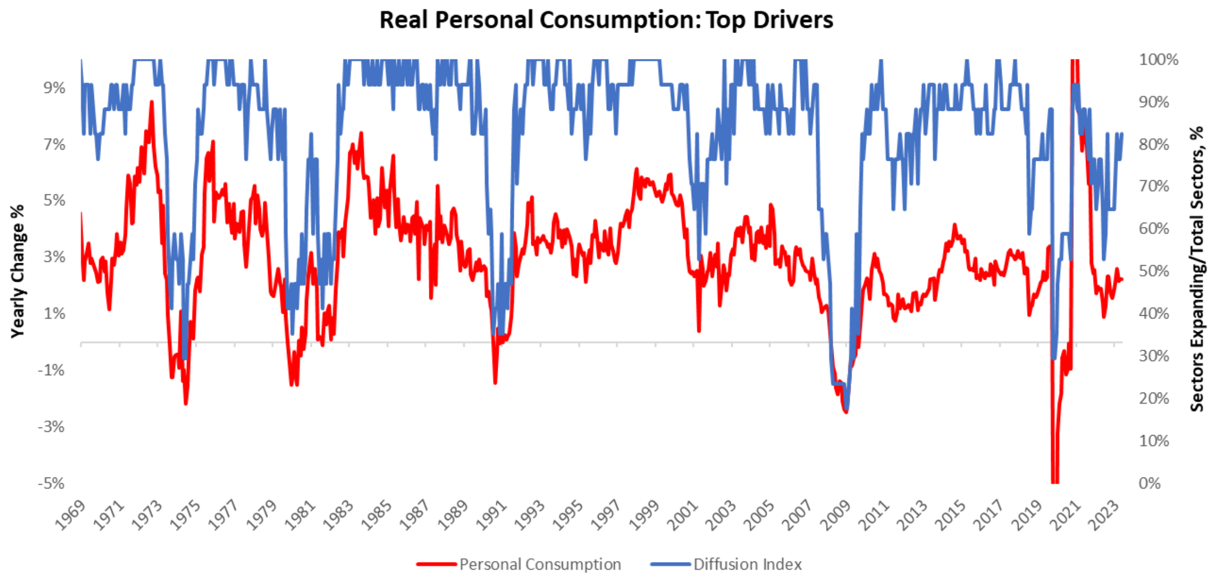


While the current trend in nominal GDP growth remains inconsistent with the Federal Reserve's inflation target, sequential developments align with these objectives. It remains to be seen whether these trends can extend themselves to 2024. Next, we turn back to real GDP to understand the composition of growth.

In October, real consumption spending increased by 0.12%. Over the last year, consumption has added 1.53% to GDP growth of 3.18%.



Personal consumption remains strong across the board, with 82% of industries showing increasing real spending over the last twelve months.



This strength in personal consumption reflects the strength of employment driven by strong nominal business activity. Furthermore, this strength in consumption relative to incomes has continued to flow back to corporate profits. We show this on the next page.

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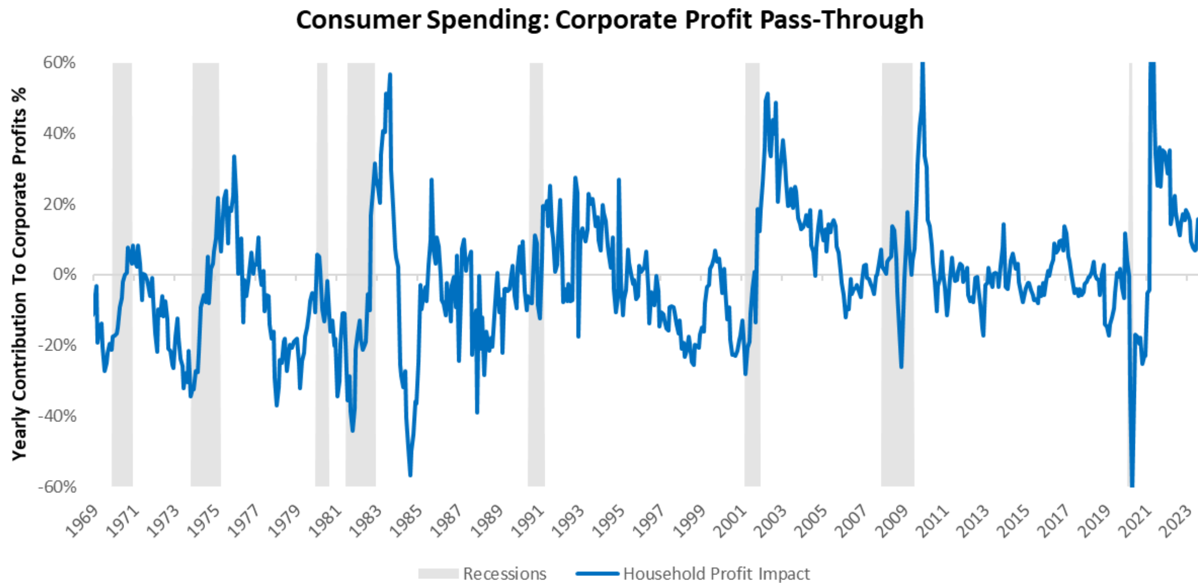
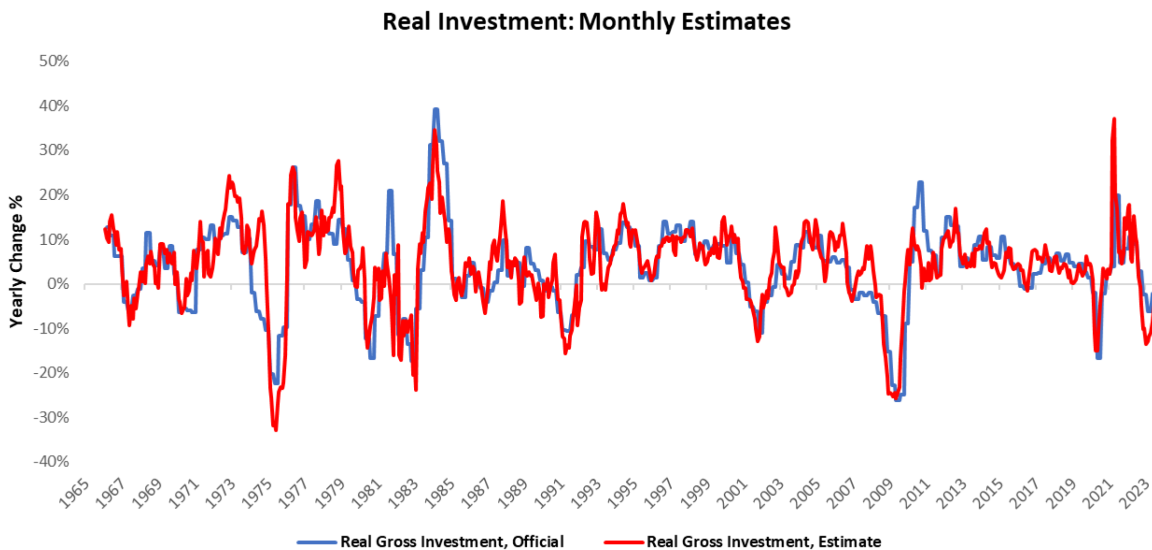
Below, we show how consumer spending has been the dominant driver of corporate profit resilience:



Alongside this sustained consumer spending, we have seen a trend higher in gross investment. In October, real gross investment decreased by -0.19%. Over the last year, investment has added 0.57% to GDP growth of 3.18%.



This improvement in investment has come with strong transportation sales, steady manufacturing construction, and improved residential construction. This increase in investment has occurred relative to a stable rate of capital consumption, boosting profits as well.

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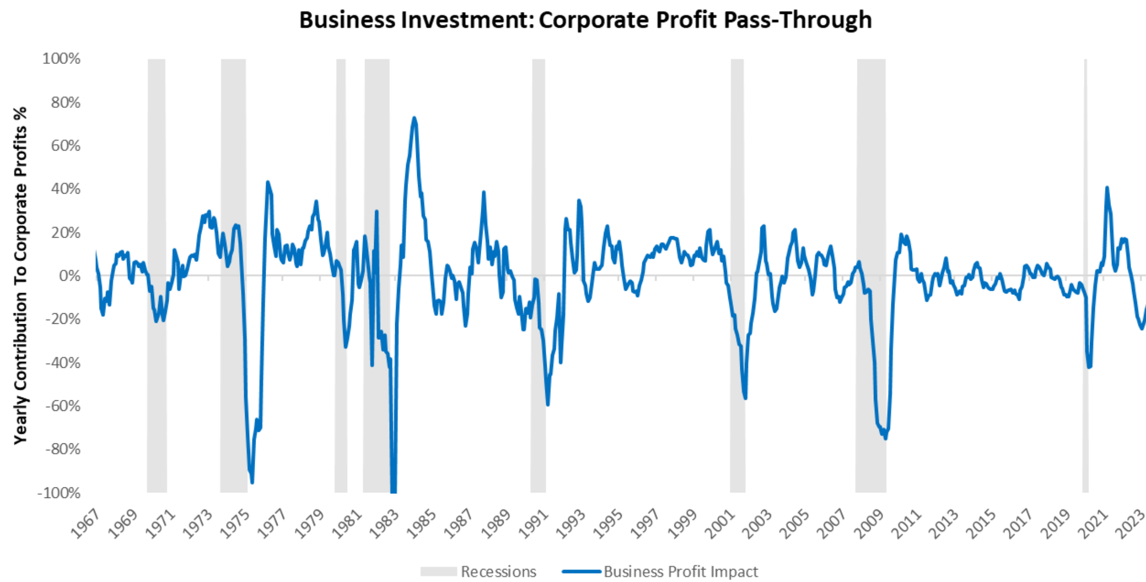
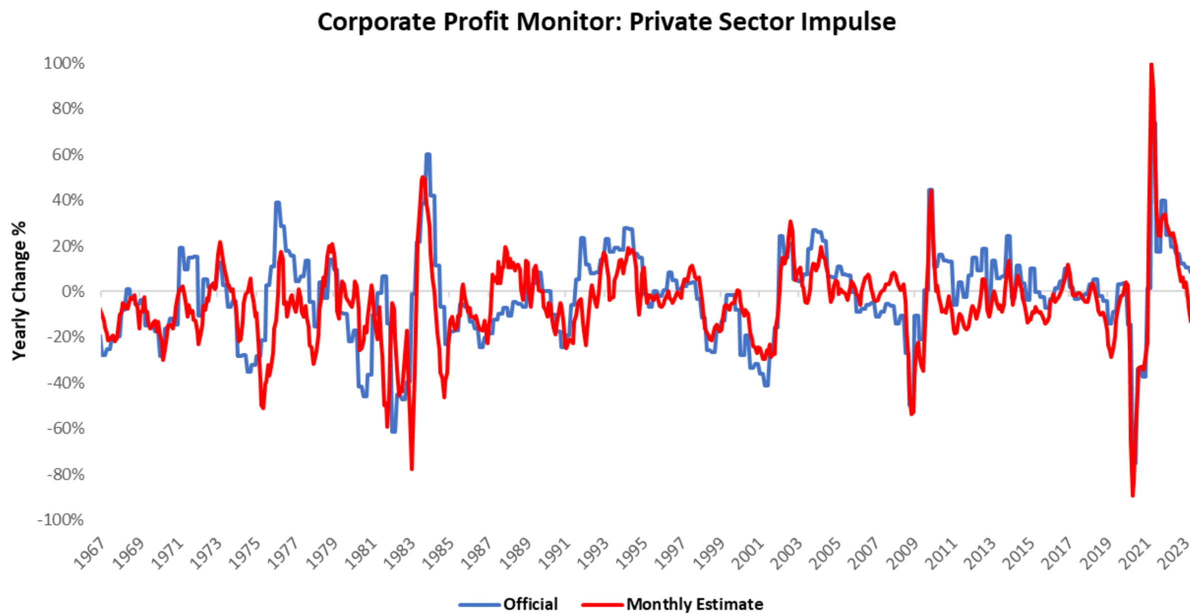
Below, we show our estimates for the pass-through from business investment to corporate profits:



As we can see above, the combination of these drivers has supported corporate profits coming from the private sector. We show the dynamic below:



Thus, the combination of high employment and reaccelerating investment has contirbuted to a reacceleration in both nominal GDP and supported corporate profits on a trending basis. However, sequential changes have marginally increased the odds of recessionary outcomes.

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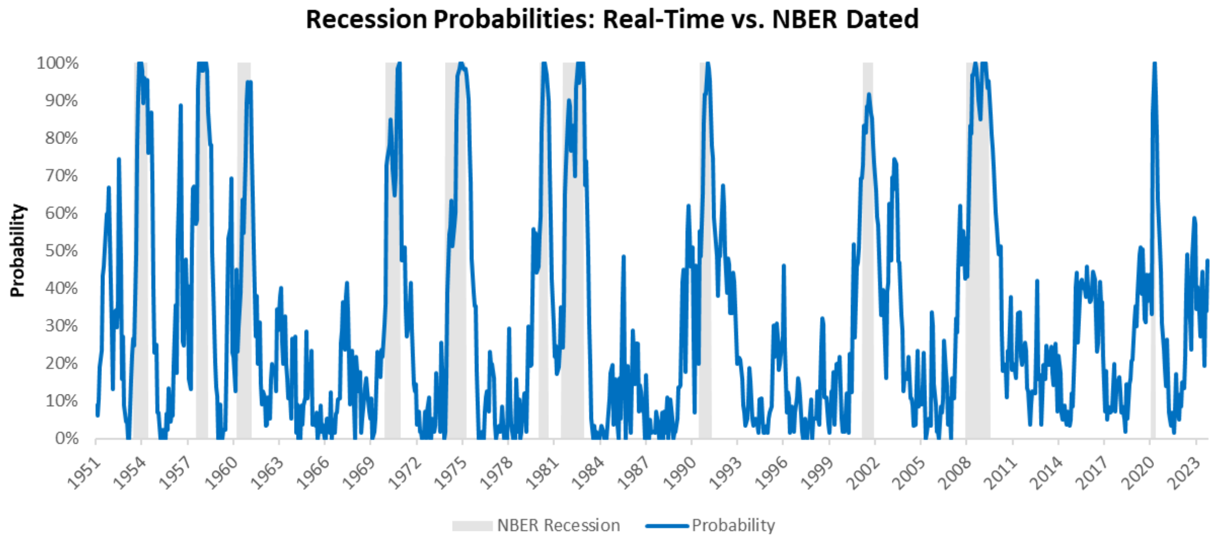
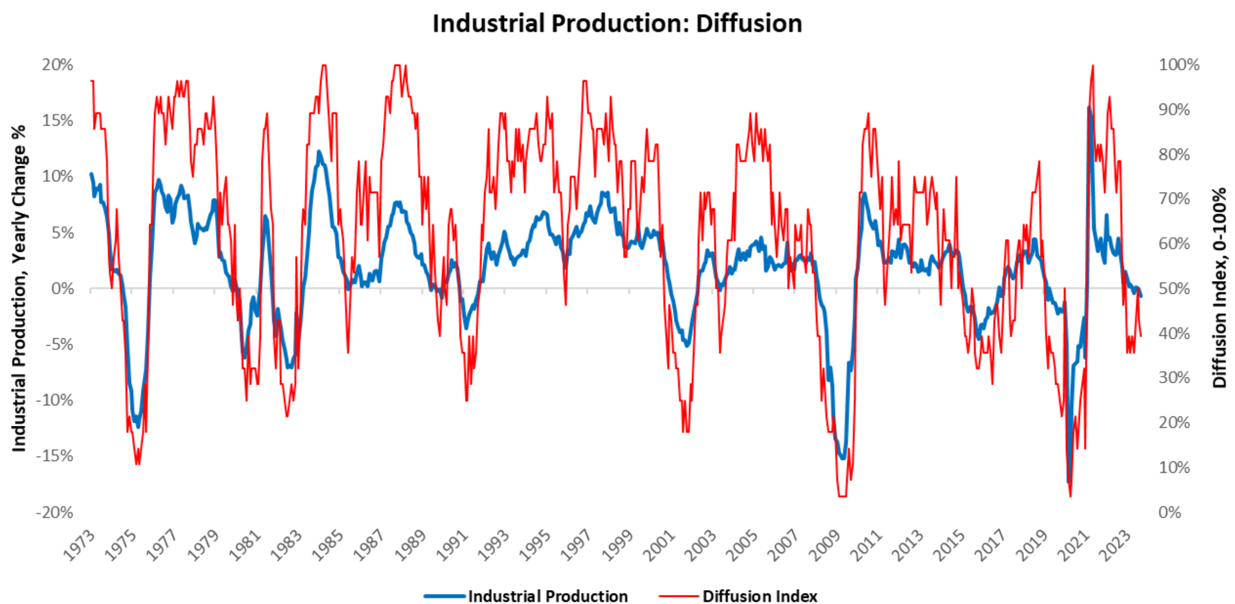
Below, we show our upgraded recession probability monitor, which has risen modestly in the recent past:



As we see above, recession probabilities greater than 50% have coincided with NBER-defined recessions. This measure has risen to a 47% probability, driven by weakness in the manufacturing sector. We show this below:



We think these declines in manufacturing and the elevation of recession probabilities are meaningful developments, especially relative to expectations of priced-in for equity markets (expanding earnings). We think a careful examination of cyclical activity is required at this junction to assess probable outcomes relative to market pricing better. We begin our assessment of cyclical conditions in the section.

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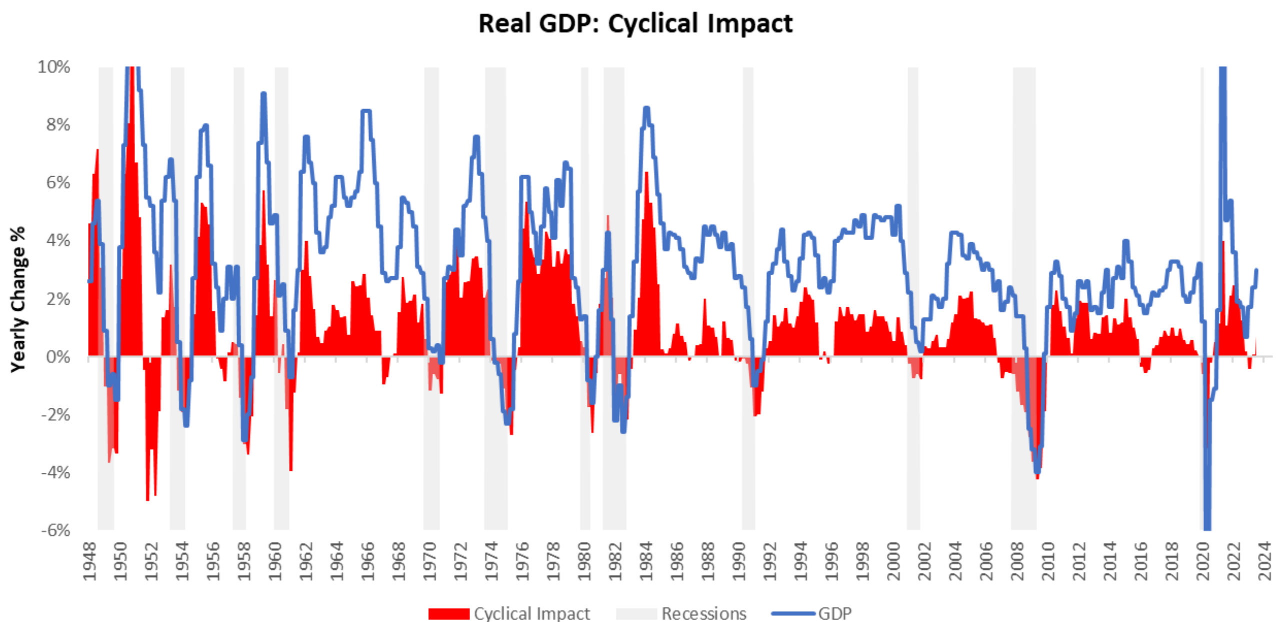
Assessing Recessionary Pressures: Cyclical Mechanics

Before diving into our assessment of cyclical conditions, we think it is important to outline our broad thoughts on what drives a recession. While real GDP is not what the NBER uses to define a recession, persistent downturns in GDP have been consistent with recession dating. This consistency is because real GDP is the most comprehensive measure of spending in the economy. Additionally, the measures the NBER uses largely correspond with the large muscle movements in GDP. As such, evaluating what drives GDP into contraction before and during a recession is essential to understanding the path to a prospective one. The path to a recession typically begins with the tightening of policy conditions, which results in less marginal borrowing, which impacts spending relative to existing interest burdens and hurts profitability, resulting in layoffs. When we reach the layoff phase, dynamics are typically self-reinforcing to the downside. Importantly, this chain of events begins with tightening, flowing through to sectors most sensitive to the cost of capital. It is these cyclical sectors that precipitate recessionary conditions. We show how this rationale has borne out over time:



Above, we show the GDP impact coming from cyclical components of the economy. As shown, these segments drive nearly all the downside variation in GDP. Therefore, to have an opinion on the potential for a recession, we need to understand these segments' drivers deeply. Currently, these drivers remain weak but well removed from recessionary territory. Principal among these leverage-sensitive sectors are construction, transportation, and manufacturing. We assess that transportation will likely remain resilient while construction will see moderation. Meanwhile, manufacturing will likely be under significant pressure. We discuss each in detail.

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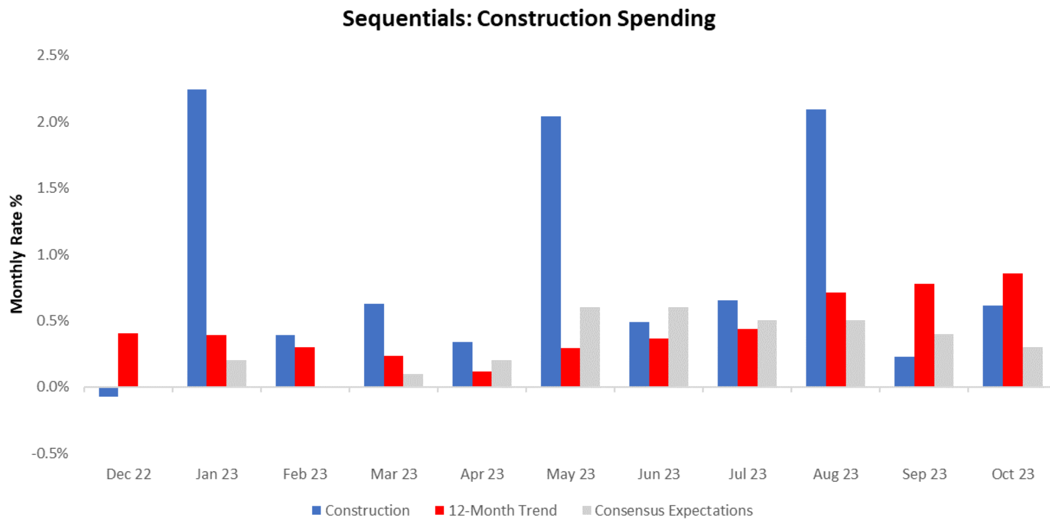
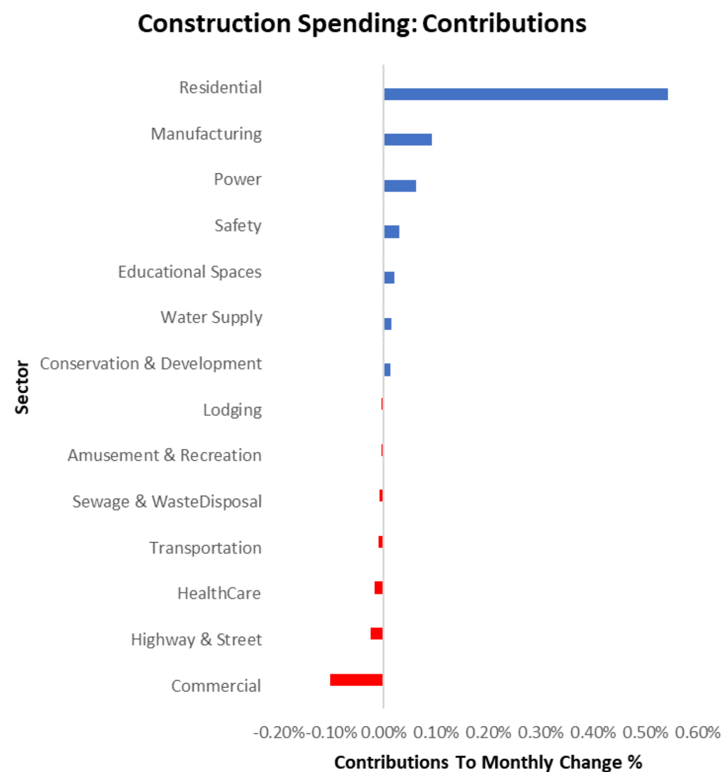
Construction: Nonresidential Offsetting Residential

We begin our assessment of construction activity with sequential data. The most recent data for October show construction spending increased by 0.61%, with 0.54% and 0.07% coming from residential and nonresidential spending, respectively. This data surprised consensus expectations of 0.3% and contributed to an acceleration in the twelve-month trend.



For further context, we show the composition of the most change in monthly construction spending. The strongest contributor to construction spending in October was Manufacturing, while the weakest was Religious construction spending:



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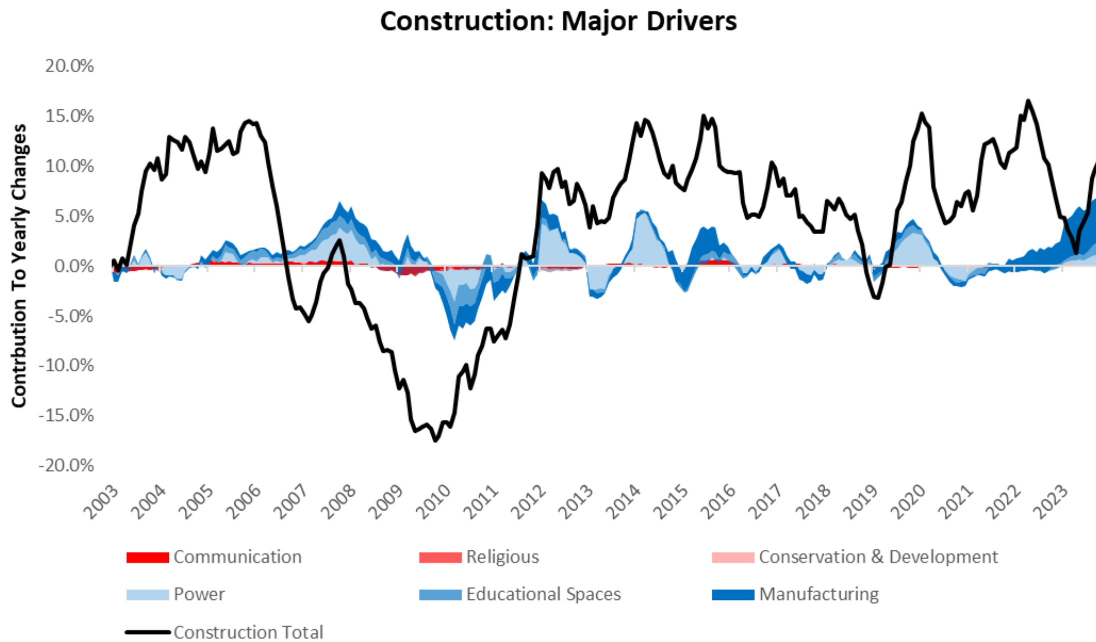
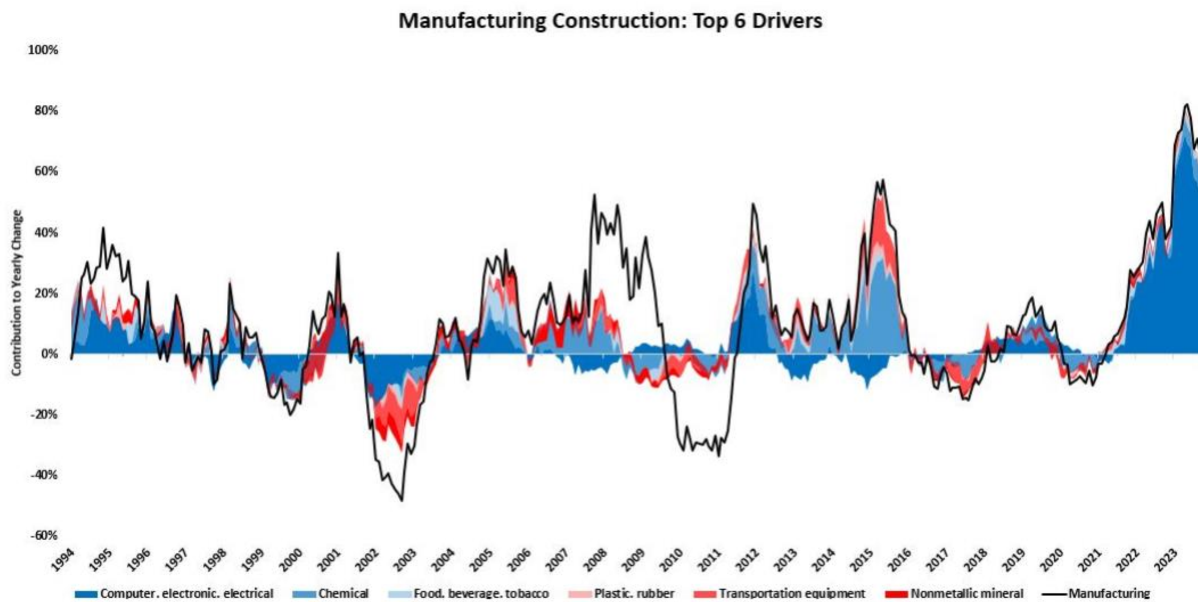
Zooming out, we show the evolution of construction spending over the last year, which rose by 10.74%%. This increase was driven by a 0.03% increase in residential spending and a 10.71% rise in nonresidential spending. Below, we drill down further to show the top 3 drivers of strength in blue (Manufacturing, Educational Spaces, and Power) and the top 3 drivers of weakness in red (Communication, Religious, and Conservation & Development):



As we can see above, the dominant force in aggregate construction has been the strength of manufacturing. As we have explained in prior notes, this is driven by large technology firms' expansion of semiconductor manufacturing facilities. We zoom into this growth below:



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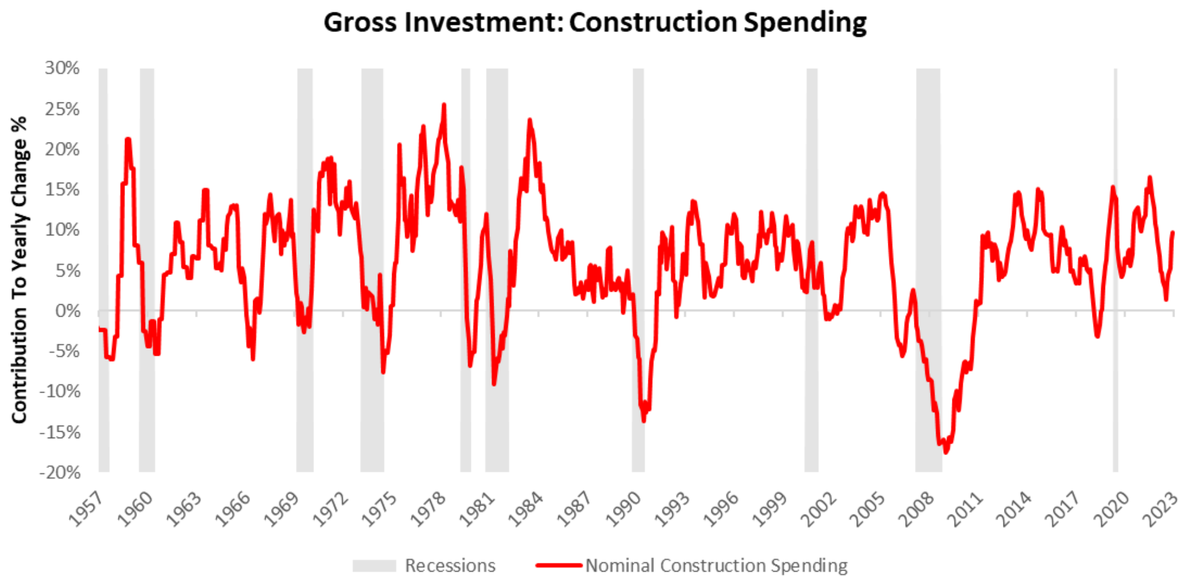
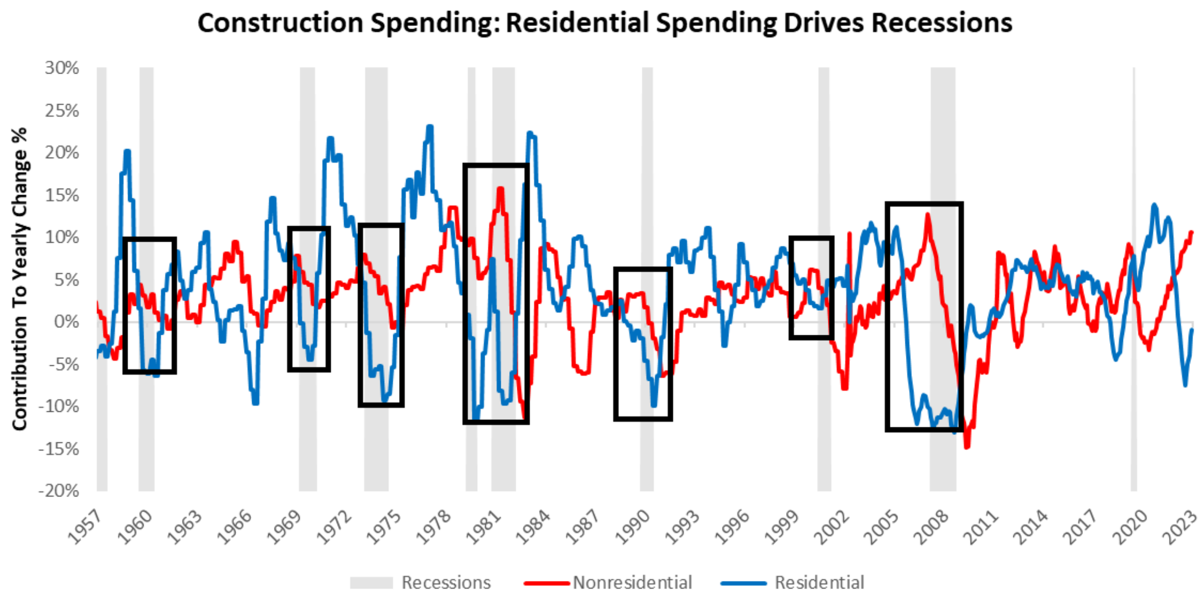
The combination of a weak but sequentially stronger residential market and a strong nonresidential market have kept nominal construction activity elevated:



Now, while this level of nominal spending remains inconsistent with recessionary conditions, we think it is crucial to recognize that these are largely driven by nonresidential investment. Importantly, nonresidential investment is rarely sensitive to recessionary conditions:



Above, we visualize the contributions to total construction coming from both residential and nonresidential construction. As highlighted in the boxes, nonresidential construction activity rises during recessionary periods. This divergence is largely due to a large share of activity coming from government spending, which remains somewhat neutral to economic conditions.

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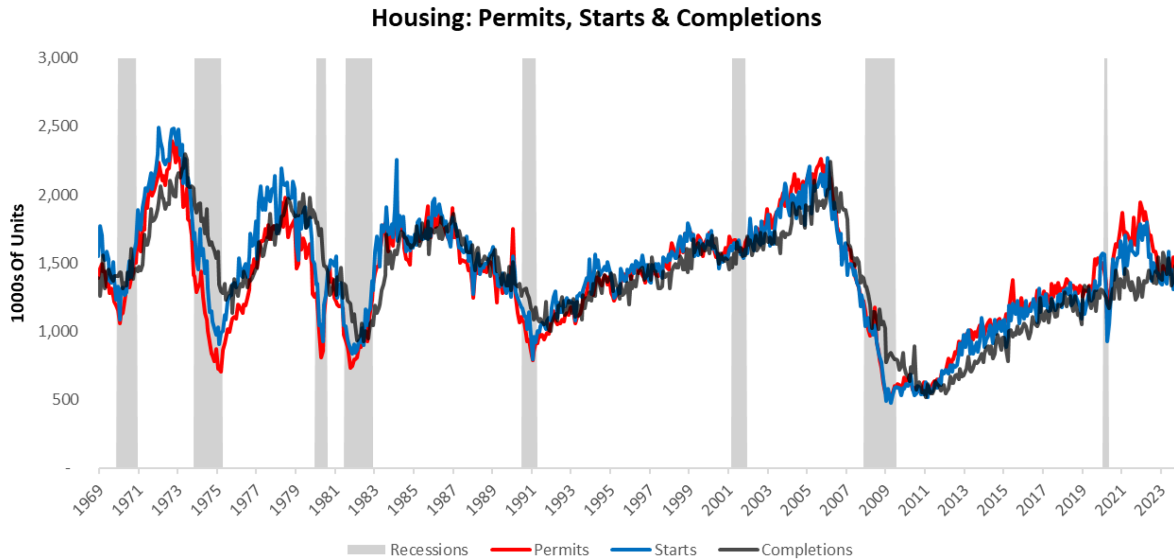
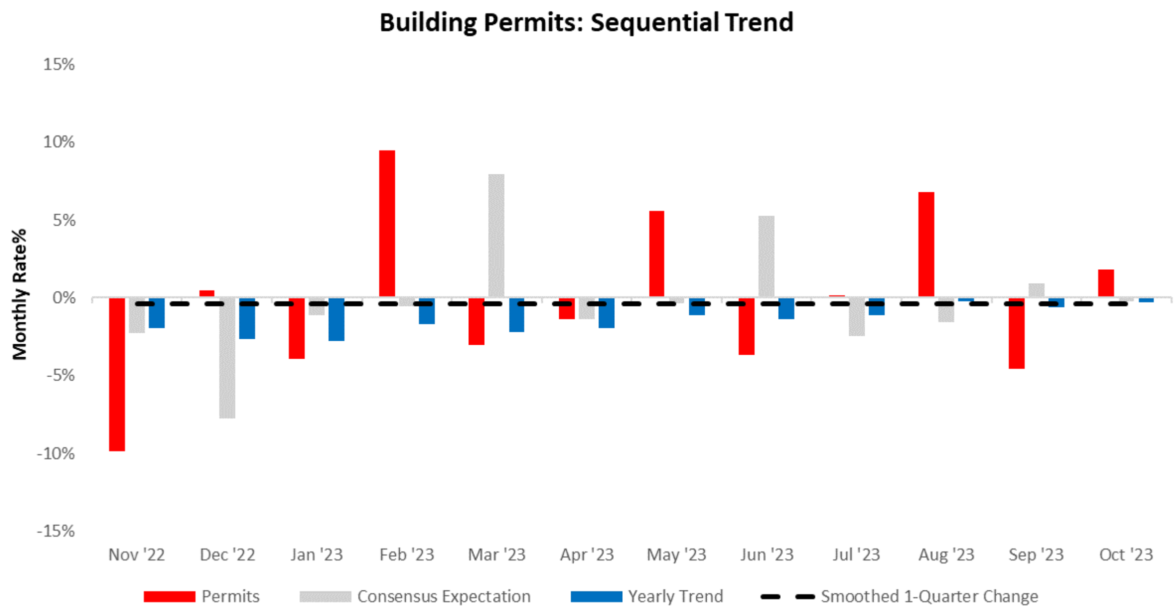
Therefore, while the state of the overall construction market will play an integral role in determining overall economic activity, we think the residential market will likely offer more insight into the pass-through of monetary tightening. We dive into our tracking of residential activity. The latest data for October showed housing permits increased by 1.84%, housing starts increased by 1.93%, and housing completions decreased by -4.6%. Below, we show the current levels for the same:

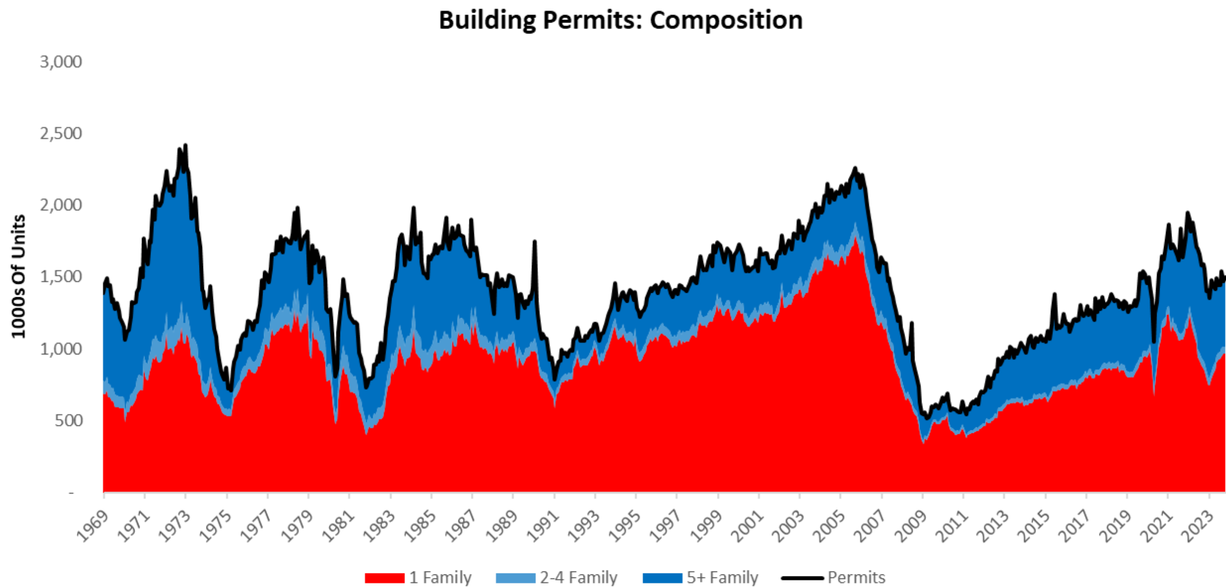


Zooming into the data, housing permits increased by 1.84%, surprising consensus expectations of -0.21%. Below, we show the sequential evolution of the data, along with the smoothed one-quarter change in the most recent data. We provide the smoothed version as monthly housing data contains significant noise.

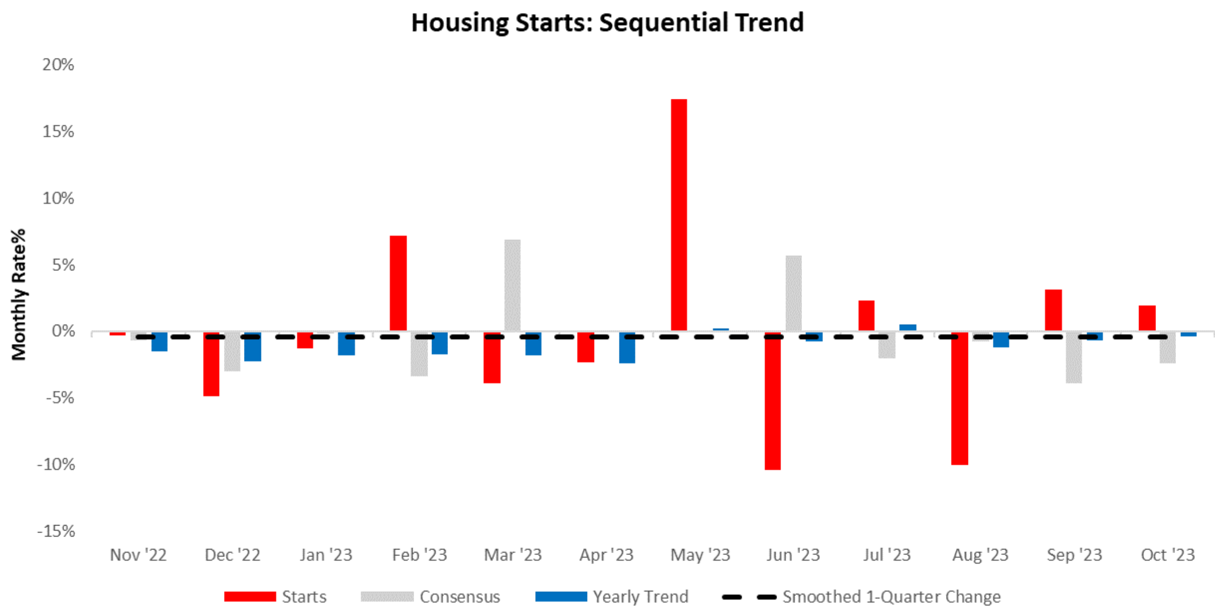


For informational purposes only.

For further context, we zoom out to show the contributions from single-family homes (119), two-family homes (-7), and multi-family homes (-169) to the fall (-57) in total permits over the last year:



Consistent with the permits data, housing starts data showed starts increased by 1.93%, surprising consensus expectations of -2.39%. Below, we show the sequential evolution of the data, along with the smoothed one-quarter change in the most recent data. We provide the smoothed version as monthly housing data contain significant noise.



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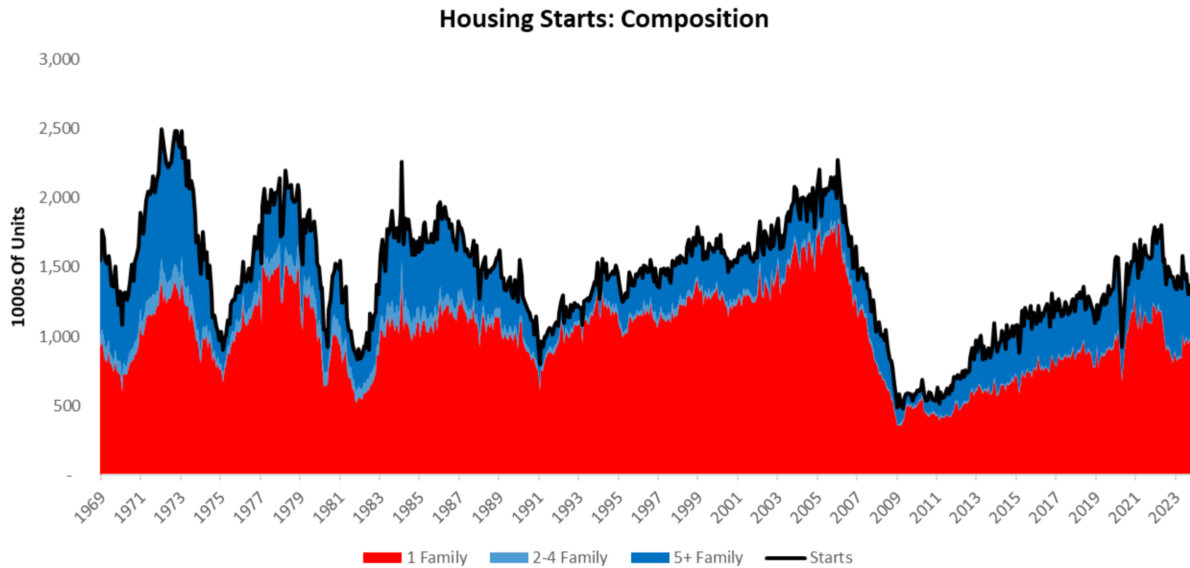
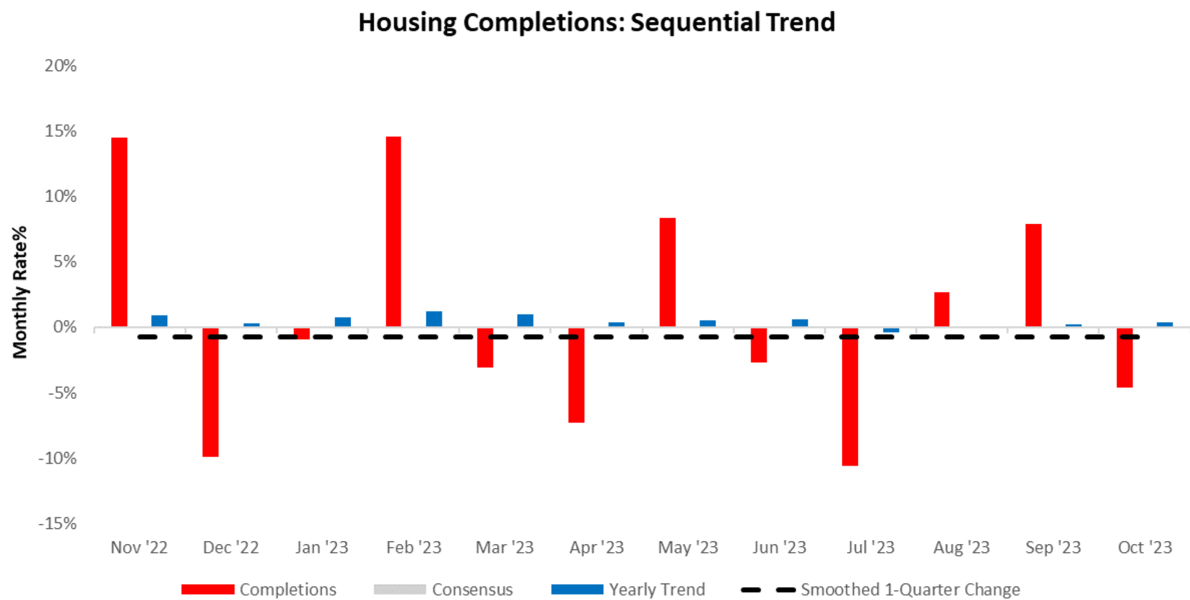
To illustrate the bigger picture, we show the contributions from single-family homes (2), two-family homes (6), and multi-family homes (-178) to the fall (-60) in total starts over the last year:



Last, in our sequential analysis, we turn to housing completions data, which showed completions decrease by -4.6%. Below, we show the sequential evolution of the data, along with the smoothed one-quarter change in the most recent data. We provide the smoothed version as monthly housing data contain significant noise.



We zoom out to show the bigger picture as well below.

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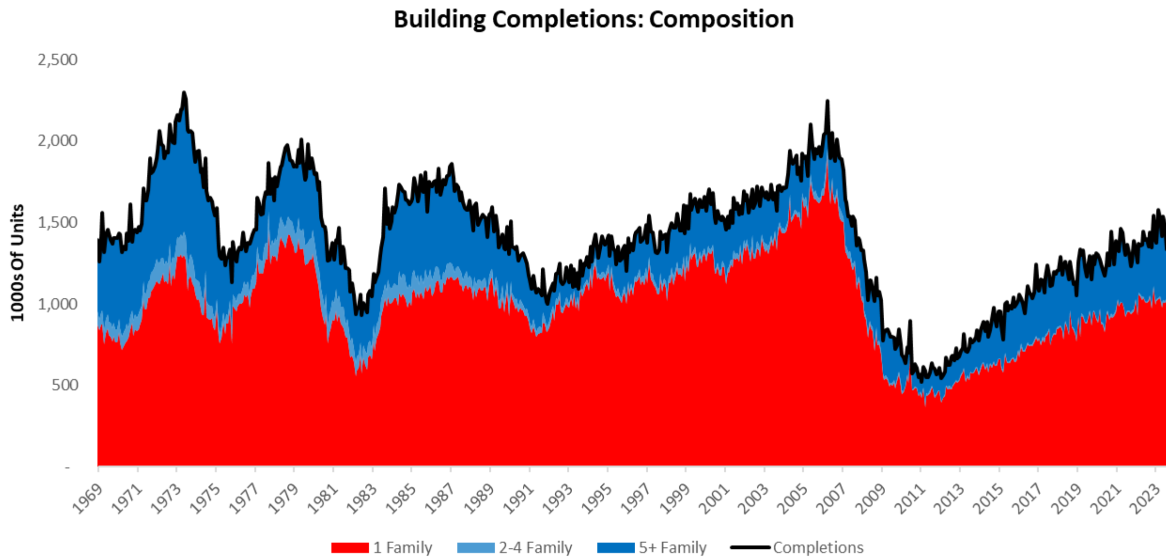
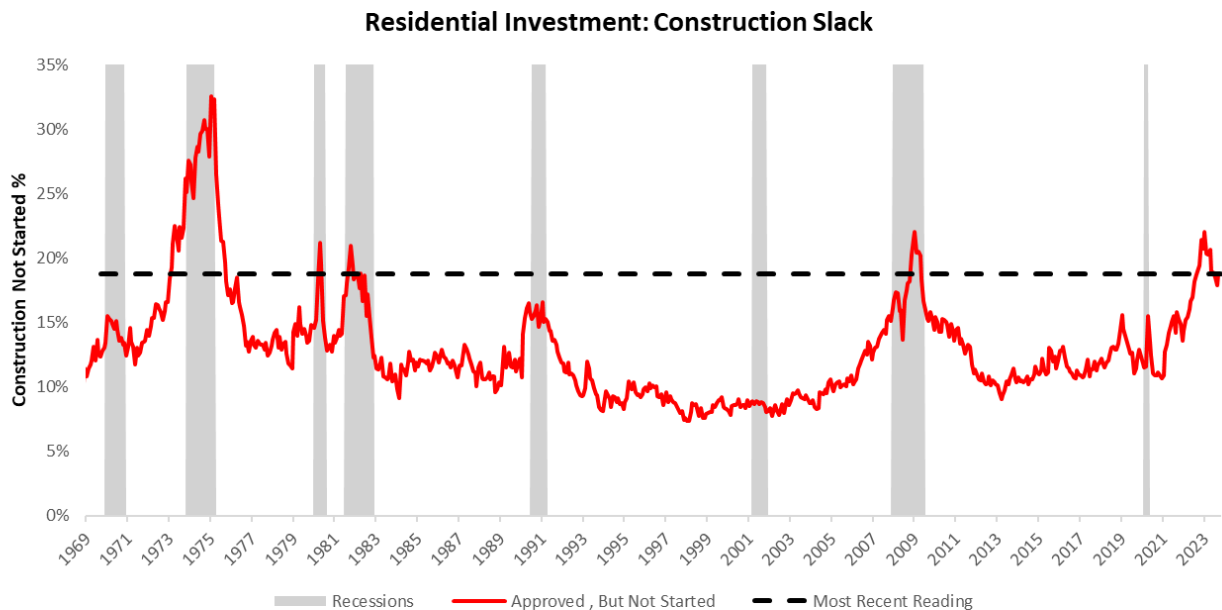
We show the contributions from single-family homes (-9), two-family homes (-8), and multi-family homes (51) to the rise (62) in total completions over the last year:



To get a better sense of where we are in the housing cycle, we examine how many construction projects have been approved but not yet started. According to the latest data, 19% of projects are yet to begin construction. Looking through history, housing-led recessions usually begin when this measure of construction slack is around 15%, suggesting that we are within the ballpark of a recession:



Now, while this rise in unstarted projects can often be a sign of weakness in perceived end demand, it can also be due to existing backlogs in construction.

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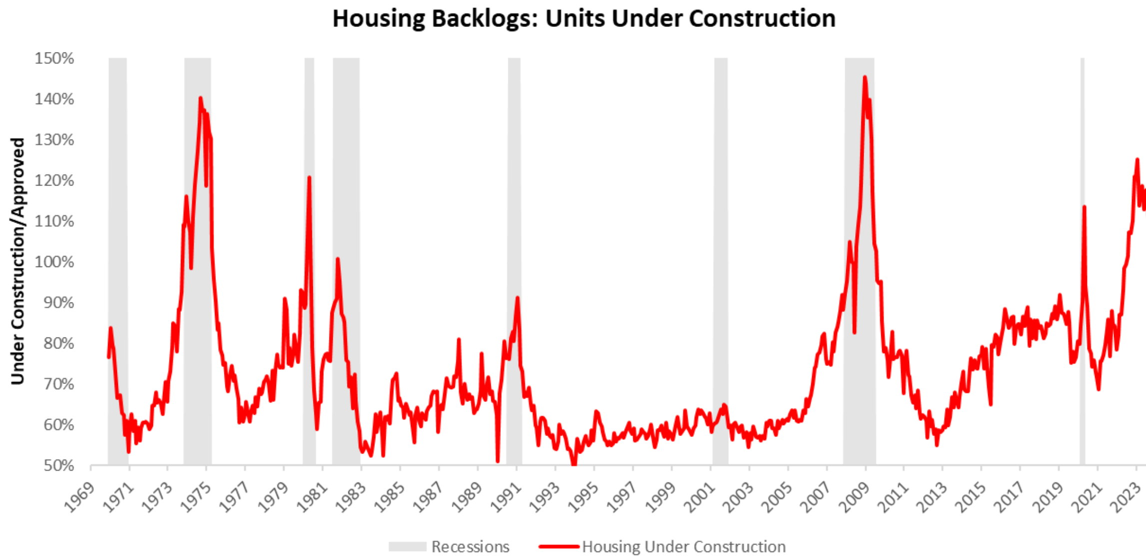
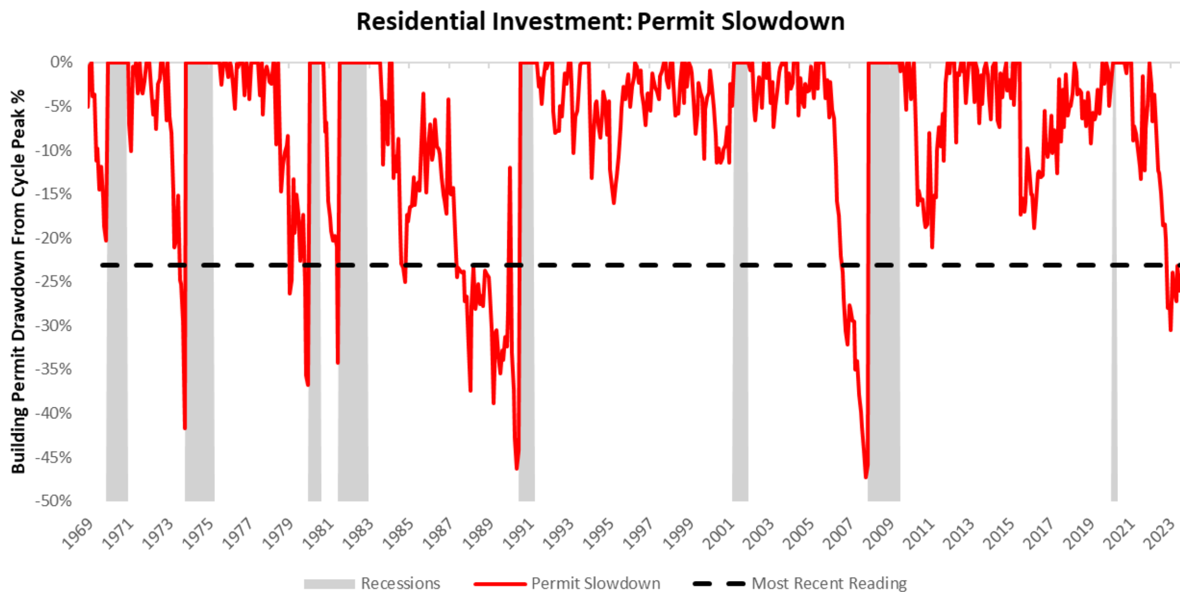
Below, we show a measure of these backlogs, which show the number of homes under construction relative to those under construction:



As shown above, the level of housing units under construction relative to those approved for construction is extremely elevated. This dynamic typically occurs when permits begin to contract. Below, we show another measure of housing weakness, i.e., permit slowdowns- which measures how much building permits have fallen from their cycle highs. Large drops in permits bode ill for the broader residential investment complex & GDP. The latest data shows that building permits are off their cycle highs by -23.1%. Housing-led recessions usually begin when this measure of cyclical weakness is around -35%, suggesting that we are well removed from outside recessionary territory.



Furthermore, while permits, sales, and completions have moderated somewhat, they do not translate into sales.

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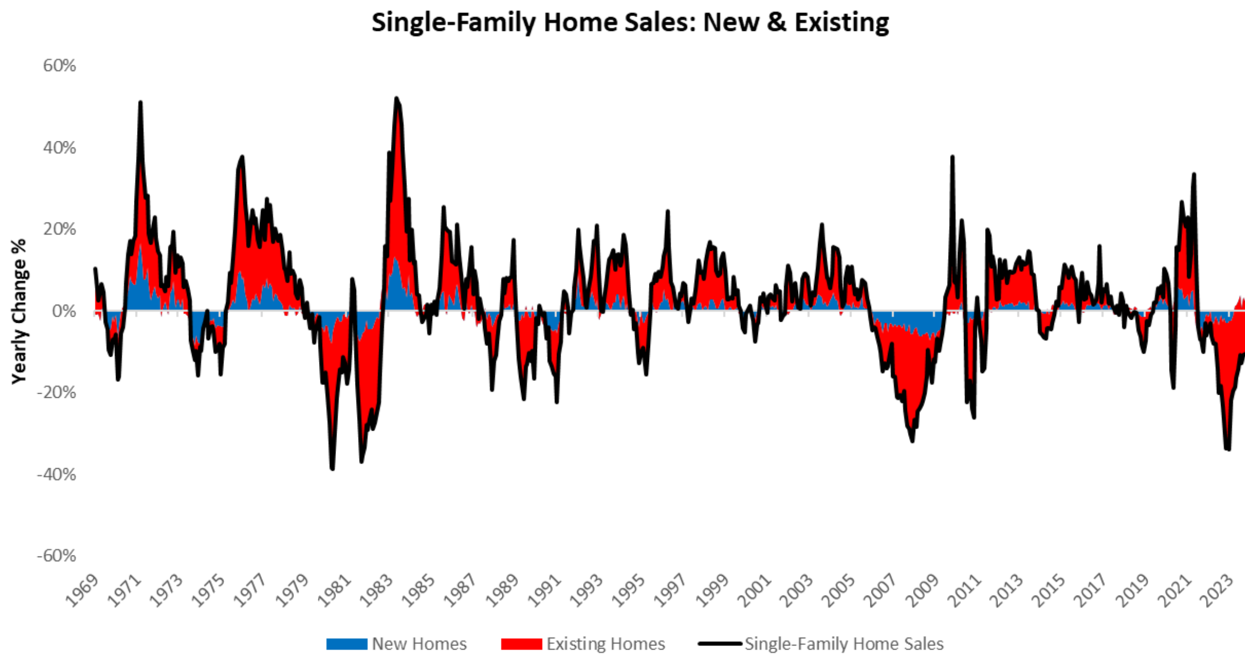
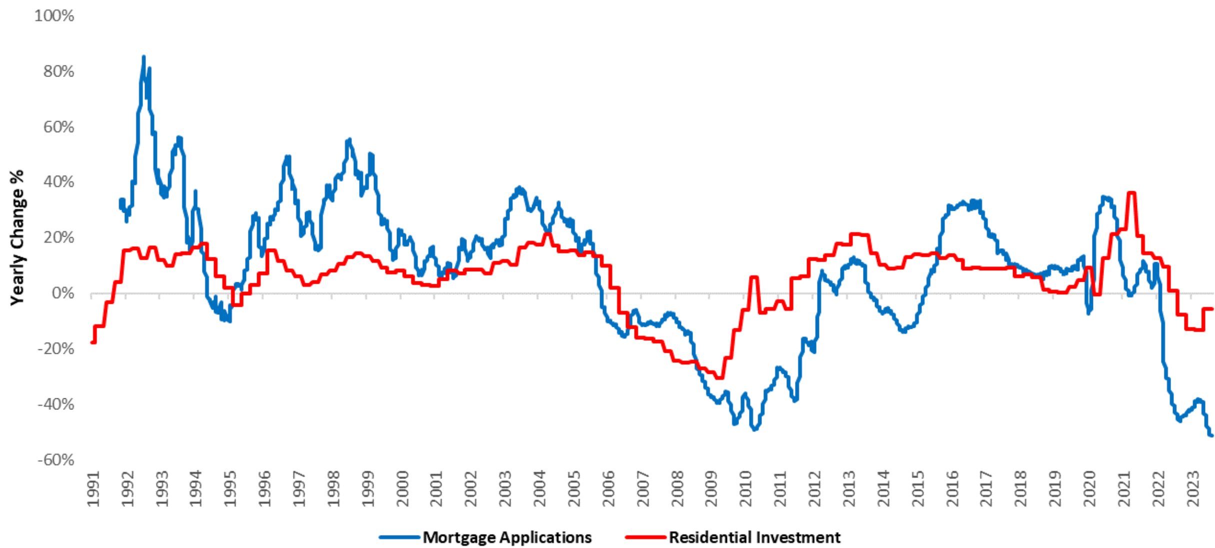
Below, we show home sales for single-family homes, which are the largest driver of home sales in the economy:



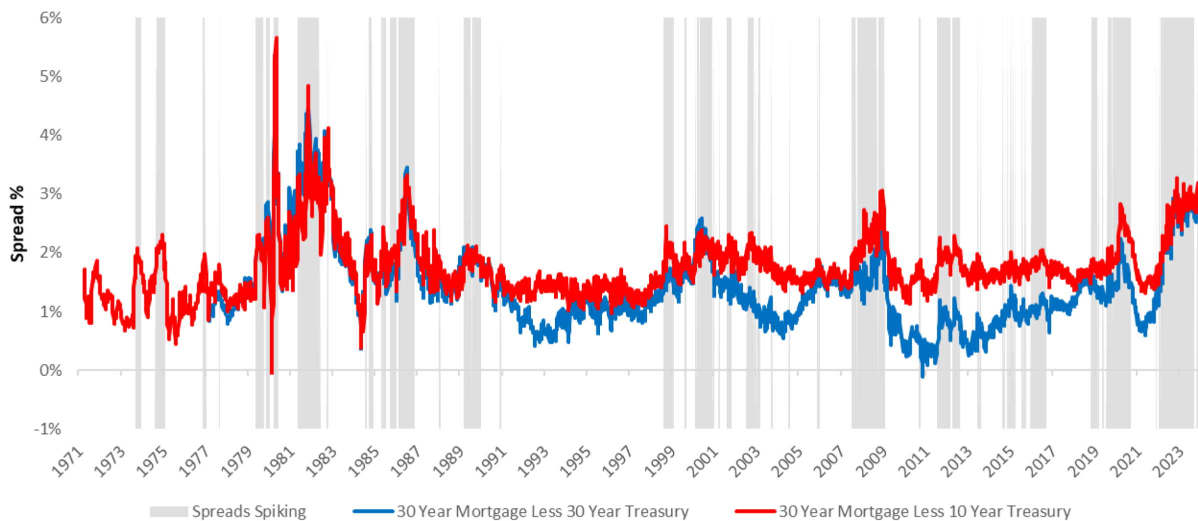
While the yearly data may be perceived as improving at surface value, it is critical to recognize that this improvement was driven by a one-off rise in existing home sales in February of 2023. Over the last year, home sales have been down for ten of twelve months. Additionally, they are down significantly over one, three, and six-month periods. Putting the picture together, we think it is important to recall that GDP accounting conventions call for recording construction activity rather than housing sales as a measure of investment activity. As such, even if home sales continue to decline but construction continues to build inventory, GDP data will reflect the construction. While we do not think it is worth contesting the validity of the methodology, we believe understanding this nuance allows us to better evaluate the residential complex's drivers. Currently, outcomes look great for builders (construction), while spending looks weak for consumers (sales). We think these forces will likely reconcile in the consumer's direction, i.e., a weaker residential complex. We look at factors driving the same next.

For informational purposes only.

The latest data shows a sequential weakening in our weekly tracking of mortgage applications. Our latest estimate suggests downward pressure on mortgage borrowing and residential investment. Our latest estimates show mortgage applications are down by 51.5% compared to one year prior. We present this information below:



To assess the borrowing conditions driving these changes in mortgage applications, we turn to mortgage spreads. According to our measures, mortgage spreads are rising. Spreads have begun to rise since October 2023. Since then, the 30-year mortgage yield relative to 10-year Treasury yields has increased by 0.07%. Below, we present the 30-Year Mortgages relative to 10 & 30-Year Treasuries:



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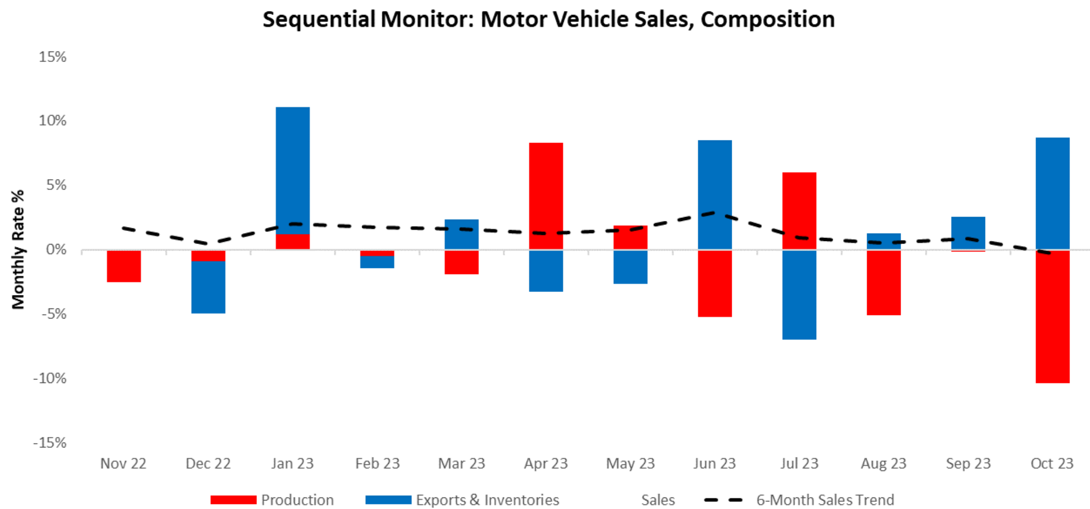
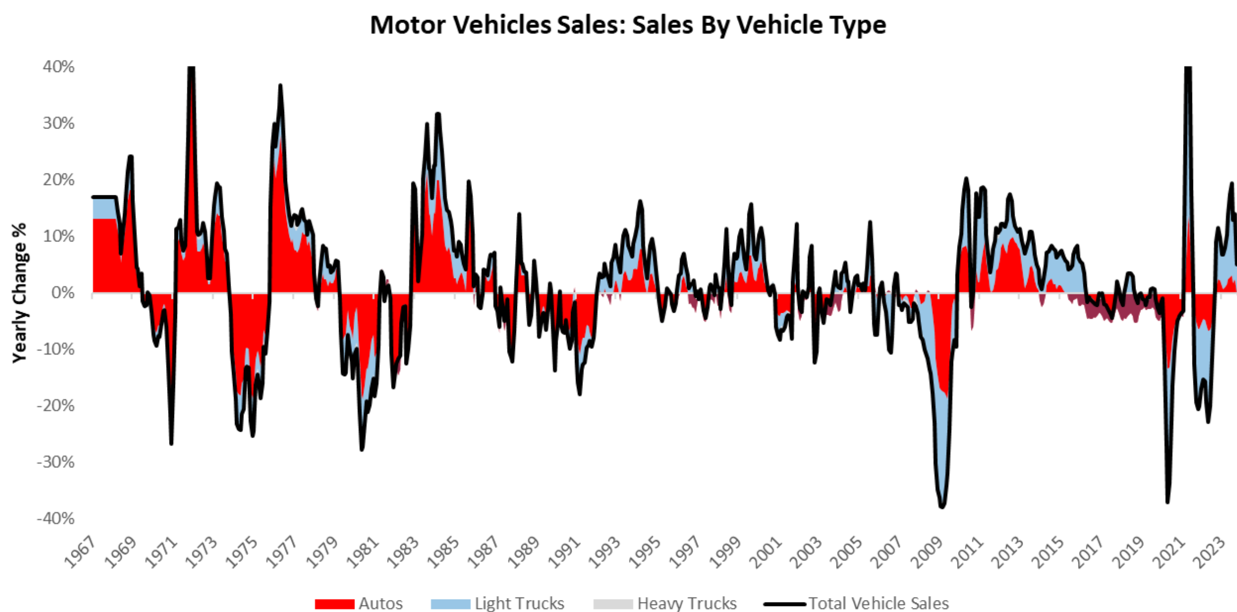
Transport: Weakening, But UAW A Potential Headfake

Much like construction, the purchase and production process of transportation (motor vehicles) tends to be leverage-sensitive and cyclical. Today, we are seeing the beginning of weakness. However, a significant complicating factor remains the UAW workers' strike, which pressures production and employment data. Therefore, weakness may be somewhat exaggerated today with the potential for a counter-trend reversal. In October, real motor vehicle sales declined by -1.69%.Below, we show the sequential evolution of the data, along with the composition driving these monthly changes:



Motor vehicle spending is directly reflected in GDP in the form of consumer motor vehicle purchases and business investment in motor vehicles. To better understand this spending, we look at the composition of total motor vehicle unit purchases by type of motor vehicle.



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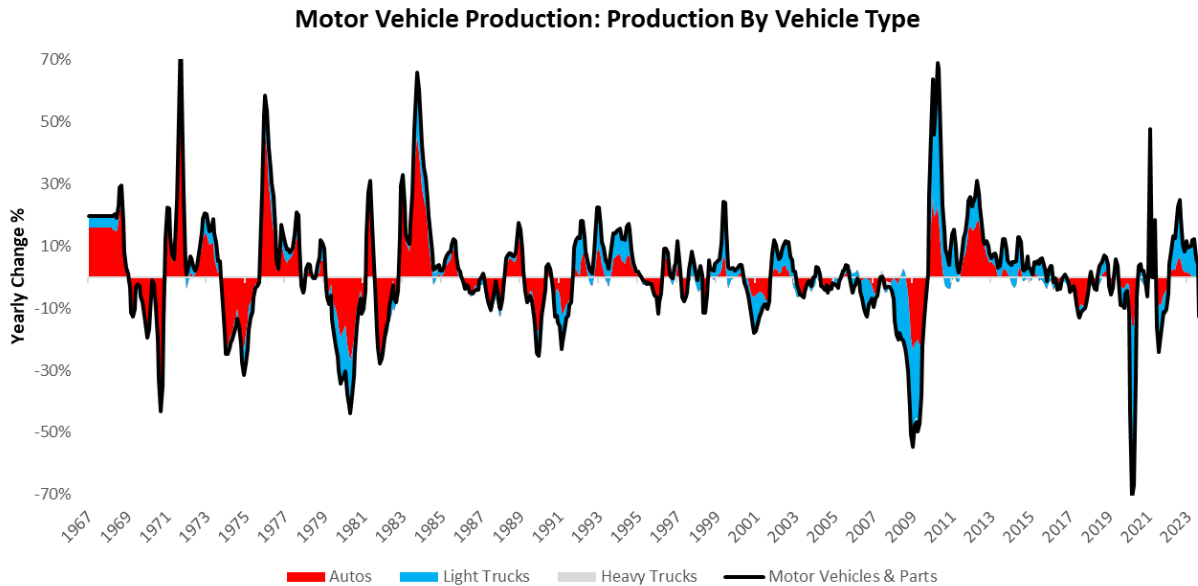
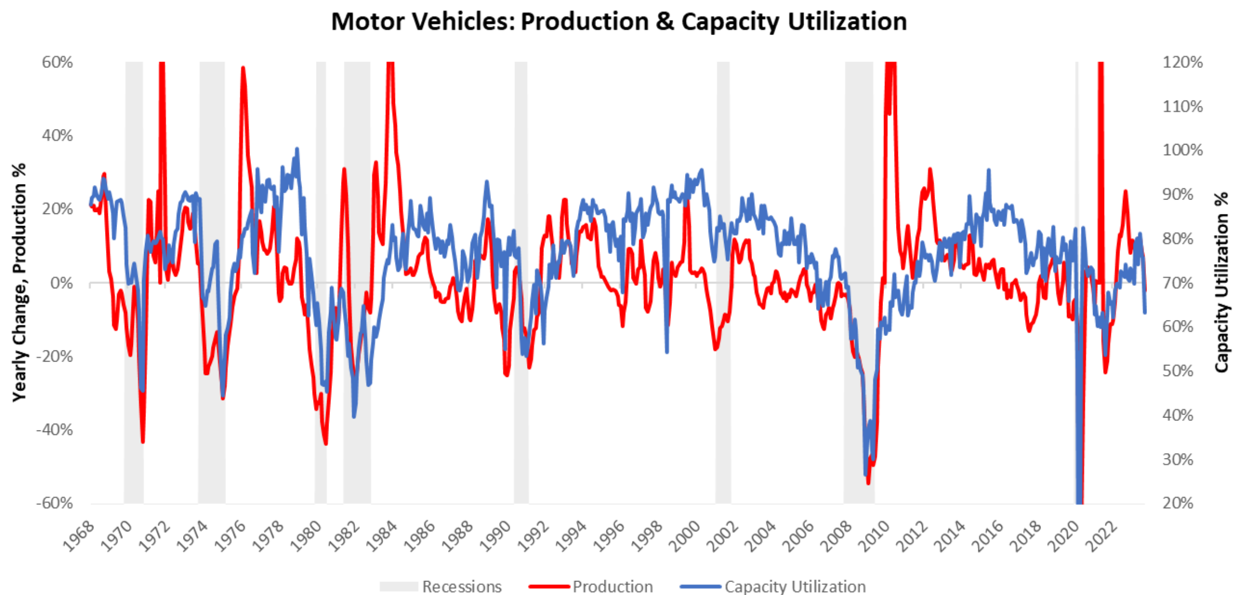
As shown, motor vehicle purchases have increased by 7.29% over the last year. This move in purchases was driven by Autos (-0.6%) ,Light Trucks (7.71%), & Heavy Trucks (0.17%).While real sales declined in October total motor vehicle production declined. Over the last year, motor vehicle production was driven by Autos (-0.6%) ,Light Trucks (7.71%), & Heavy Trucks (0.17%), falling by -12.77%:



Motor vehicle production and capacity utilization have typically been good indicators of cyclical conditions. Currently, motor vehicle production relative to capacity is consistent with a recession. According to our estimates, readings between 65% and 43% are consistent with recessionary activity:



Currently, we are seeing capacity utilization at 63%. While this is somewhat consistent with recessionary conditions, it may abate quickly with the UAW workers' strike dissipation.

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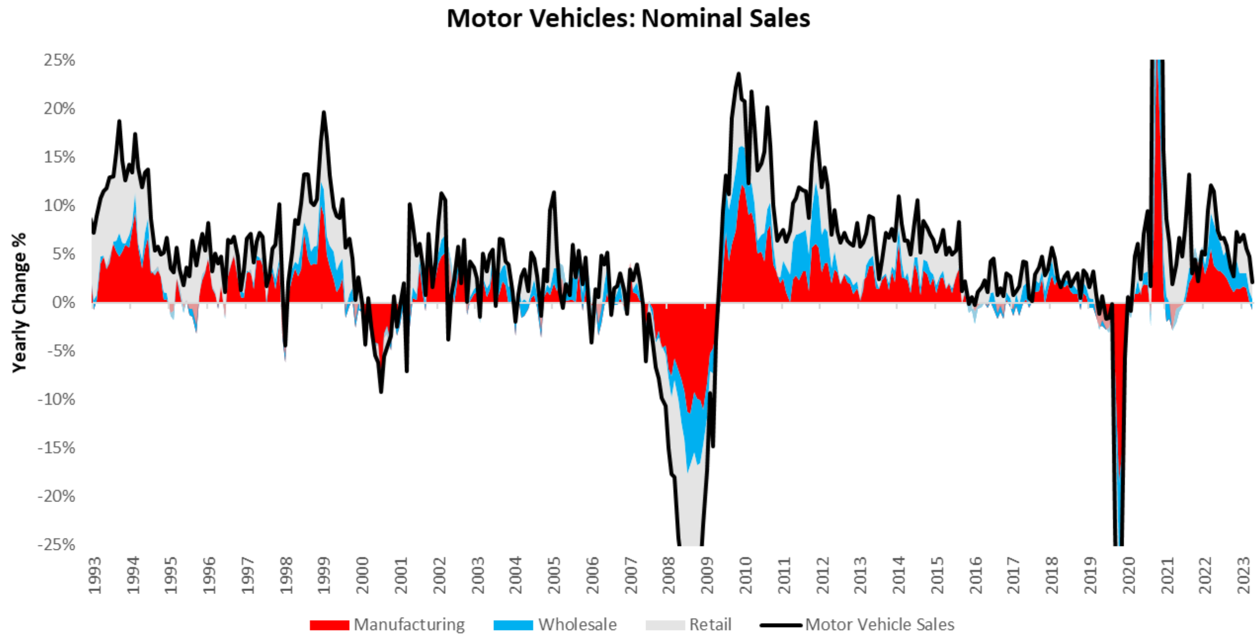
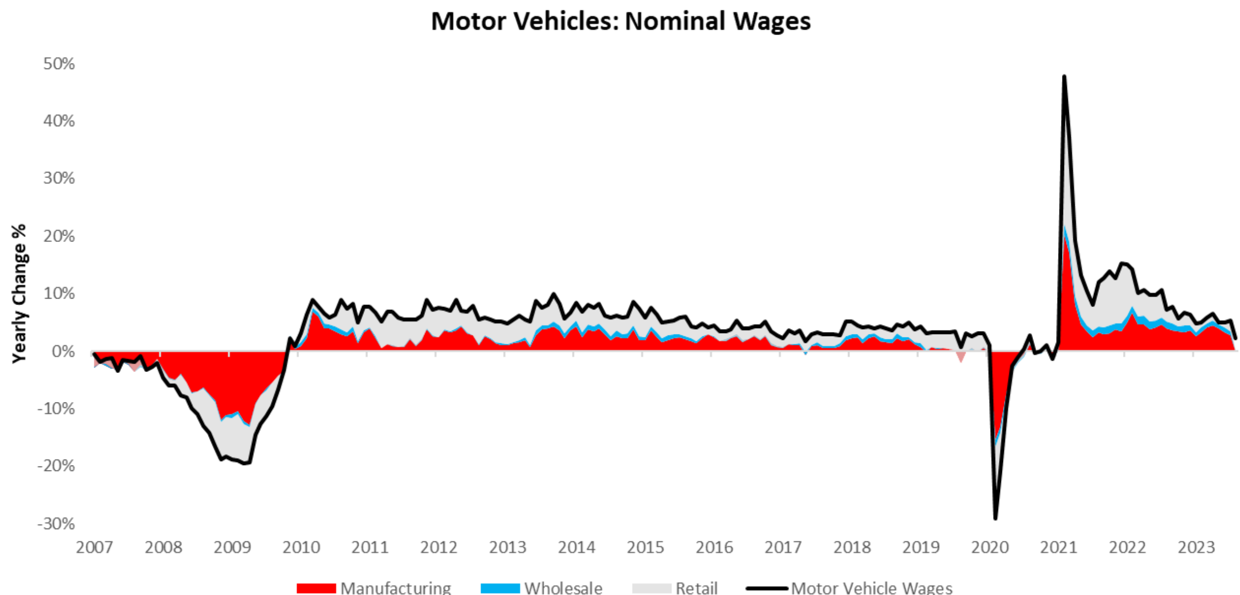
To better understand how this motor vehicle production has created spending and income, we now turn to nominal sales for automobiles across manufacturers, wholesalers, and retailers. Over the last year, our estimates of nominal sales showed nominal motor vehicle sales growth of 2.15%. We show the contributions coming from manufacturers (-0.71%), wholesalers (1.06%), and retailers (1.79%) below:



Now that we have examined the impact on business sales, we also examine how this is reflected in wages. Over the last year, our estimates of nominal wages showed nominal employee income growth of 2.31%. We show the contributions coming from manufacturers (0%), wholesalers (0%), and retailers (0%) below:



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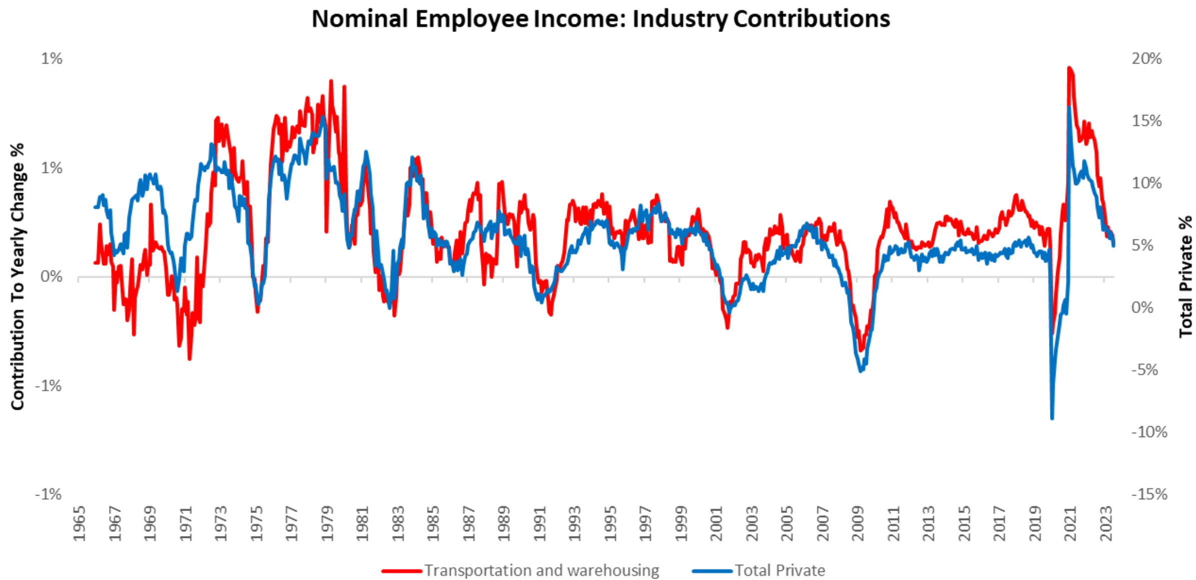
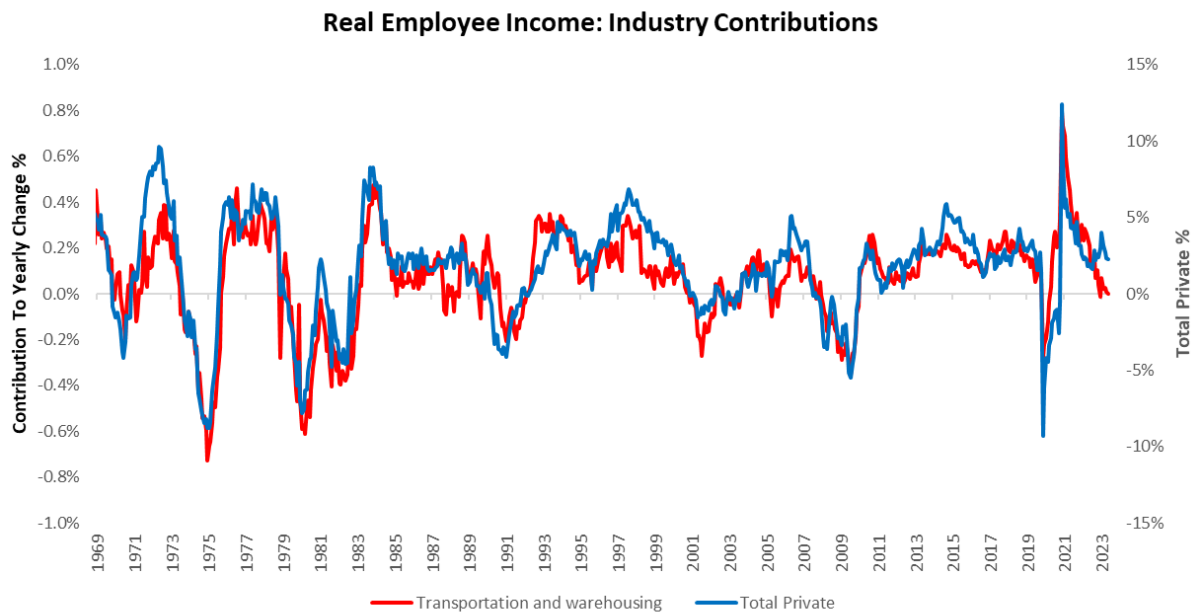
In addition to the direct impacts on motor vehicle production and sales, automobiles also create secondary demand via services. We are seeing a modest decline in nominal income in these areas, that are largely consistent with the overall slowing in wages:



However, real incomes have declined faster than overall real incomes, now close to a sustained contraction:



Therefore, while we see weakness in the production and sales of motor vehicles, we are currently only seeing the nascent stages of weakness in transportation services.

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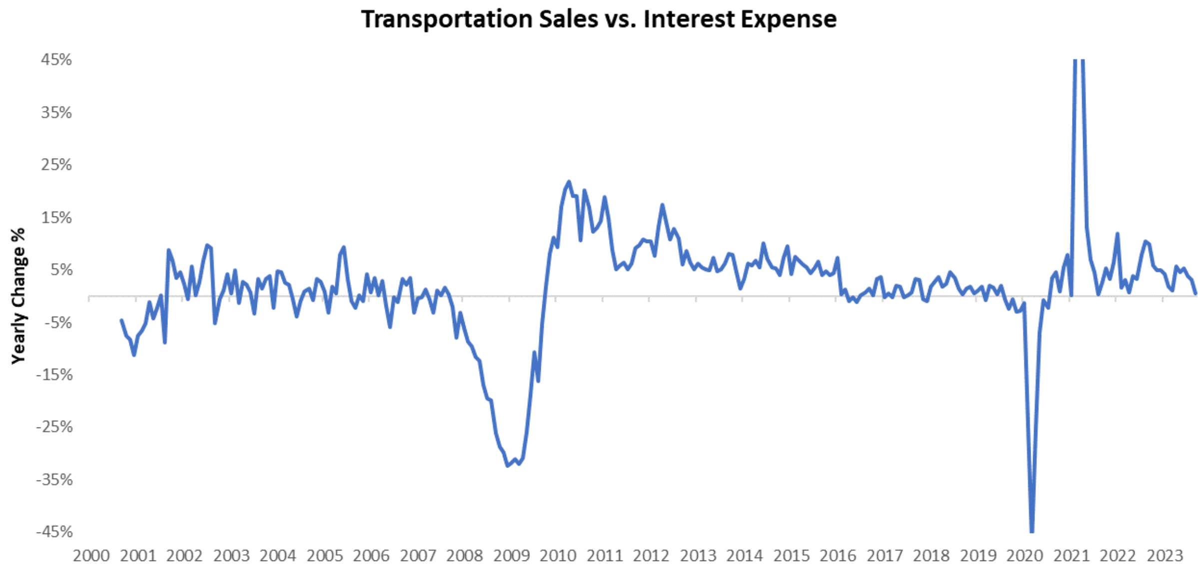
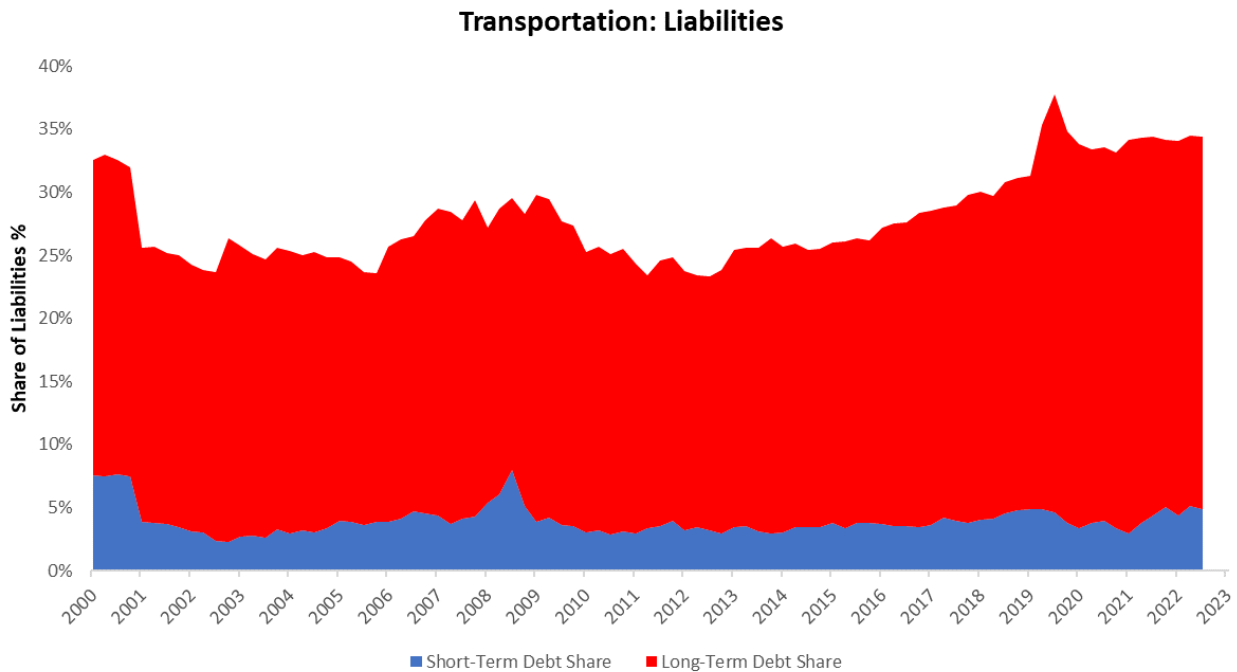
Furthermore, our estimates show nominal sales for transportation are still above interest expense, but the gap is closing quickly. Below, we visualize transportation sales relative to interest expense over time:



Thus, if we continue on the current trend in sales, even at the current level of interest expense, we will have margin pressures to develop soon. There is unlikely to be a shift in interest expense trends, as the majority of debt in the sector is long-term:



As we can see, there has been a rise in long-term debt as a share of total liabilities as well.

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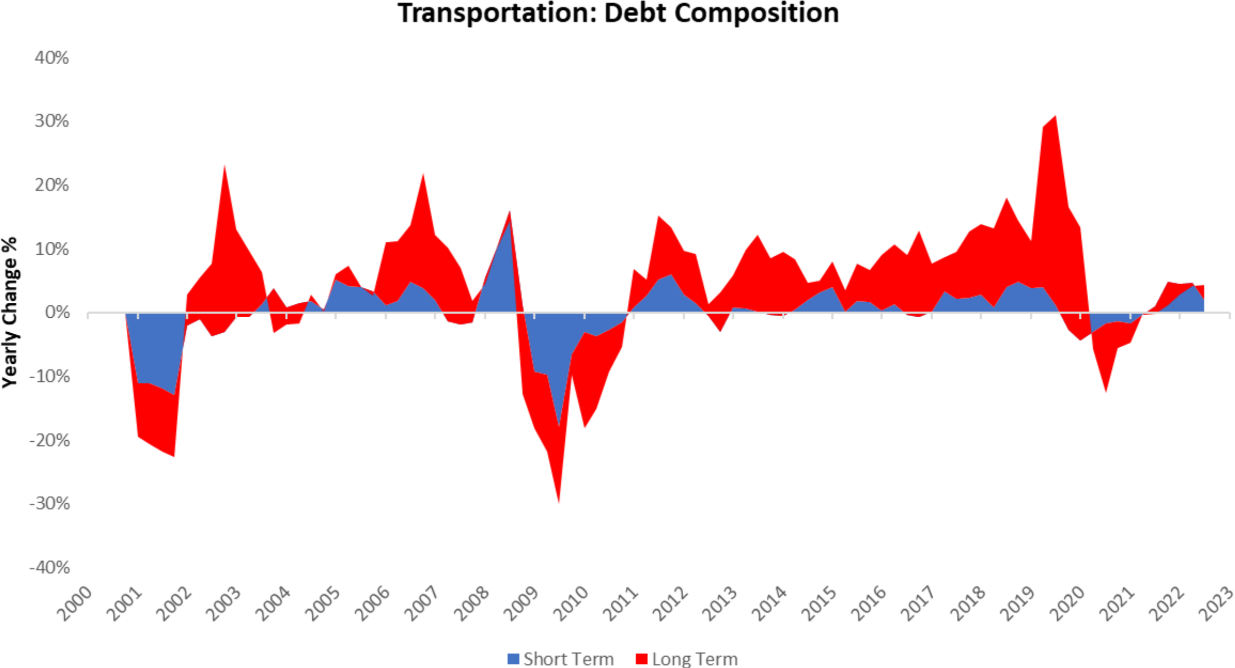
We offer the contributions to the changes in borrowing as well below:



Therefore, we expect the interest expense trend to remain roughly stable over the next six months, with sales being the dominant driver of margin pressures. Overall, the sector looks like it is witnessing the initial phases of tightening pressures, and UAW workers' strikes have likely overstated some of these pressures. However, if we stay on the current trajectory, we expect conditions to look significantly worse in 2024.

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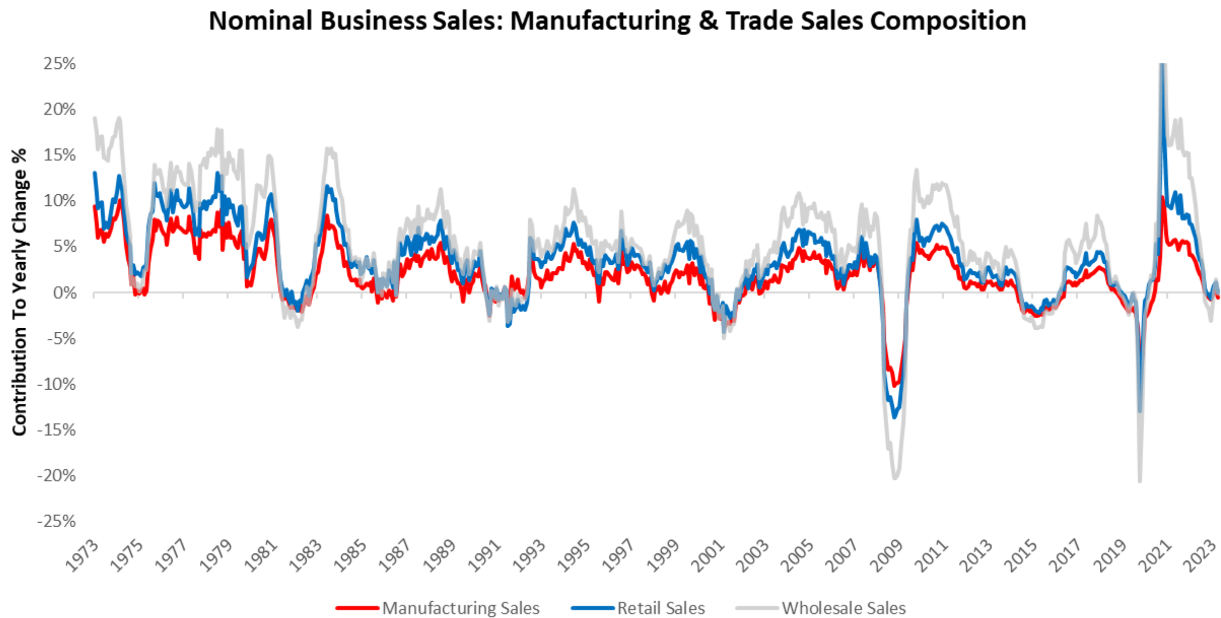
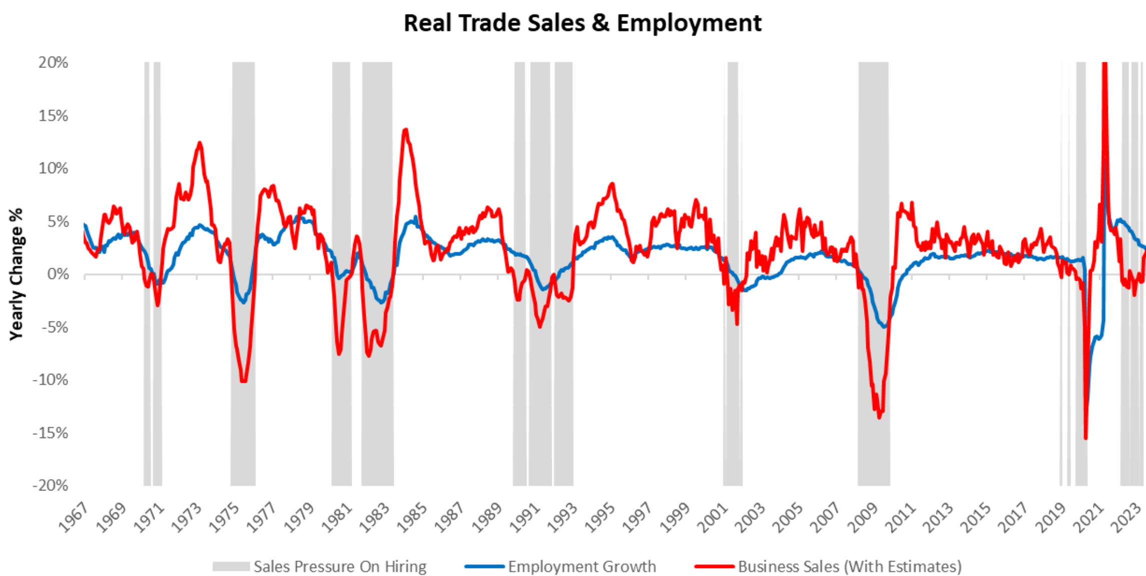
Manufacturing: Contracting & Like To Continue

As we have shared in recent editions of *The Observatory*, we see significant weakness in the manufacturing sector, starting from topline pressures and flowing through to employment. We begin by showing the overall state of trade sales by major component:



Above, we show trade sales broken into manufacturing, wholesale, and retail—these sales barometers to the overall health of the goods economy. Aggregating and adjusting these sales for inflation has typically offered insights into the pressures on broader employment:



As we can see, output remains under pressure, and after a brief period of amelioration, the pressure on employment has resumed.

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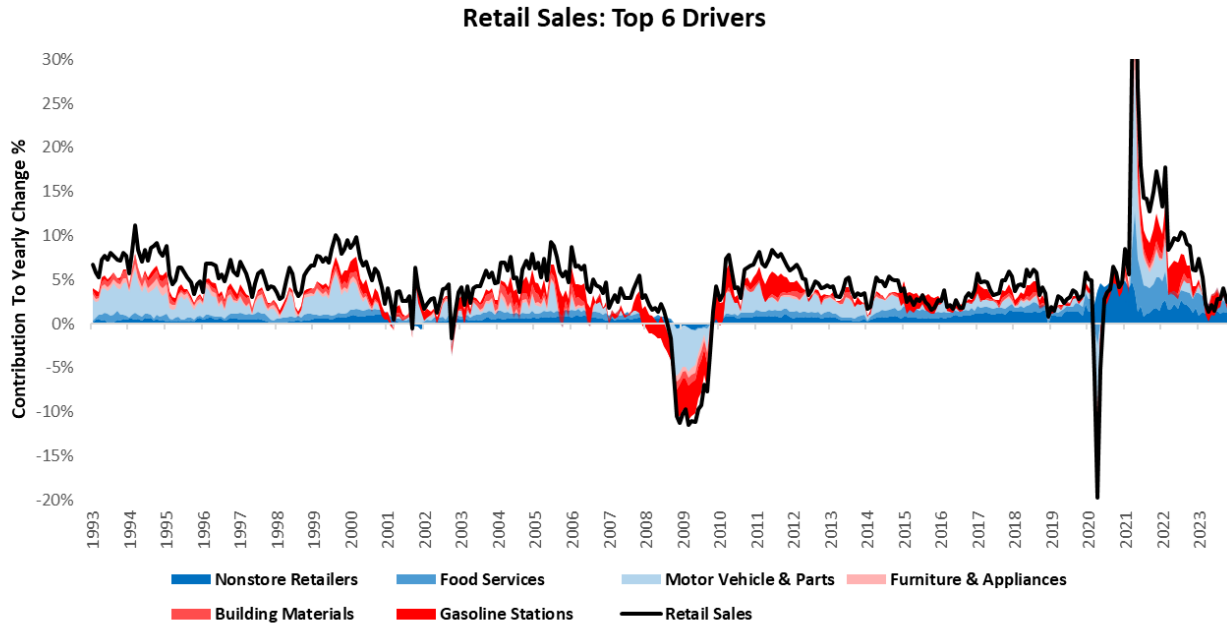
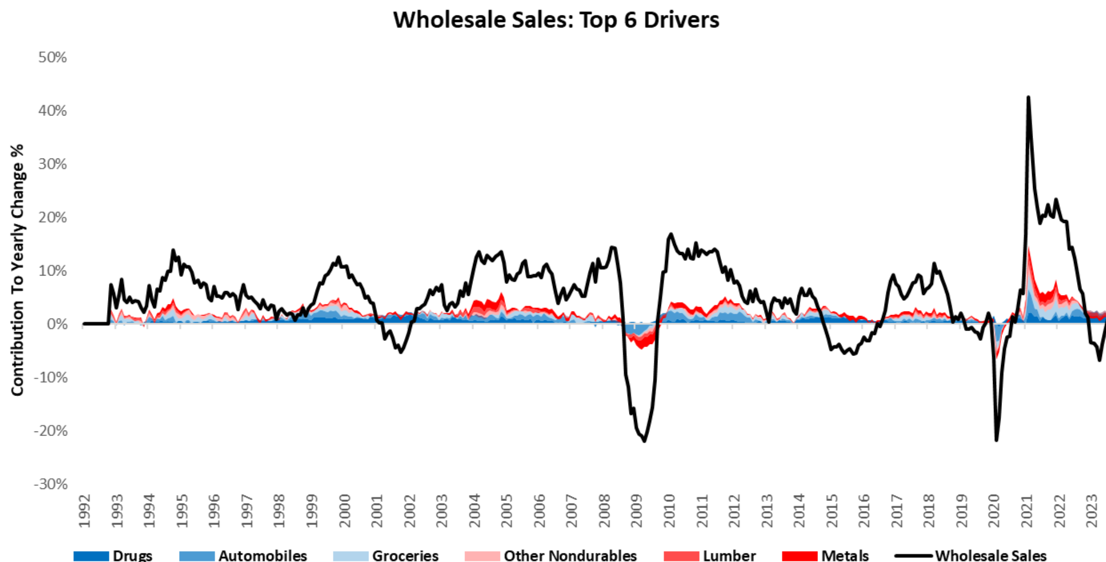
We now examine each area, beginning with nominal retail sales. Over the last year, retail sales have expanded by 2.48%. Below, we zoom out to show the six major drivers of strength in shades of blue (Nonstore Retailers, Food Services & Motor Vehicles and parts) and weakness in shades of red (Furniture and appliances, Building Materials & Gasoline Stations):



Retail sales have been the most resilient area of the goods economy due to their strong link to the consumer. Further up the supply chain, we see more weakness in wholesale activity:



Over the last year, wholesale sales have contracted by -0.41%. Above, we zoom out to show the six major drivers of strength in shades of blue (Drugs, Automobiles & Groceries) and weakness in shades of red (Other Nondurables, Lumber & Metals).

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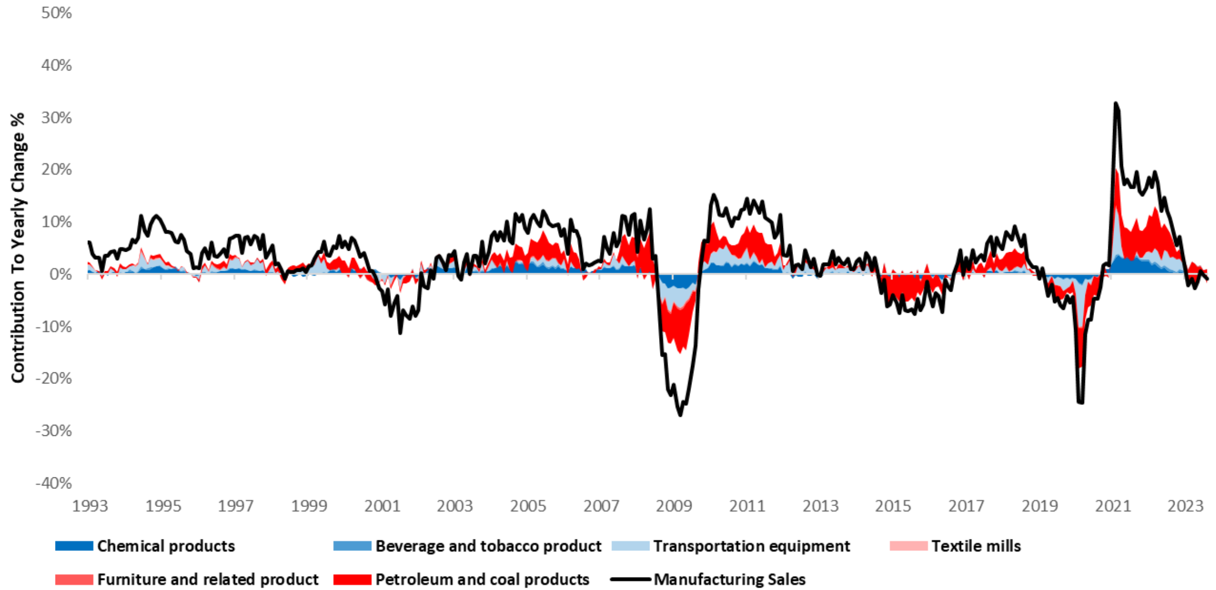
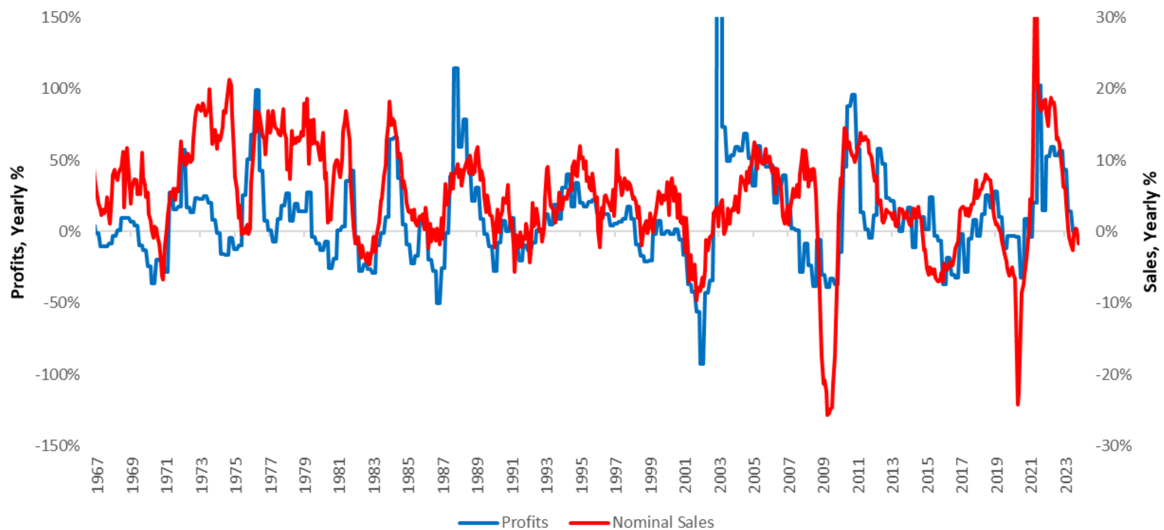
Now, while retail and wholesale activity has links to the manufacturing complex and are good barometers of good demand, they are supported by consumer spending and are less indicative of manufacturing activity. When we turn to manufacturers' sales, we see sustained weakness.



Over the last year, manufacturers' sales have contracted by -0.88%. Above, we zoom out to show the six major drivers of strength in shades of blue (Chemical products, Beverage and tobacco products, and Transportation equipment) and weakness in shades of red (Textile mills, Furniture and related products, and Petroleum and coal products). These declines in sales have flowed through to declines in profits:



Without an improvement in manufacturing sales, we are unlikely to see an improvement in profitability.

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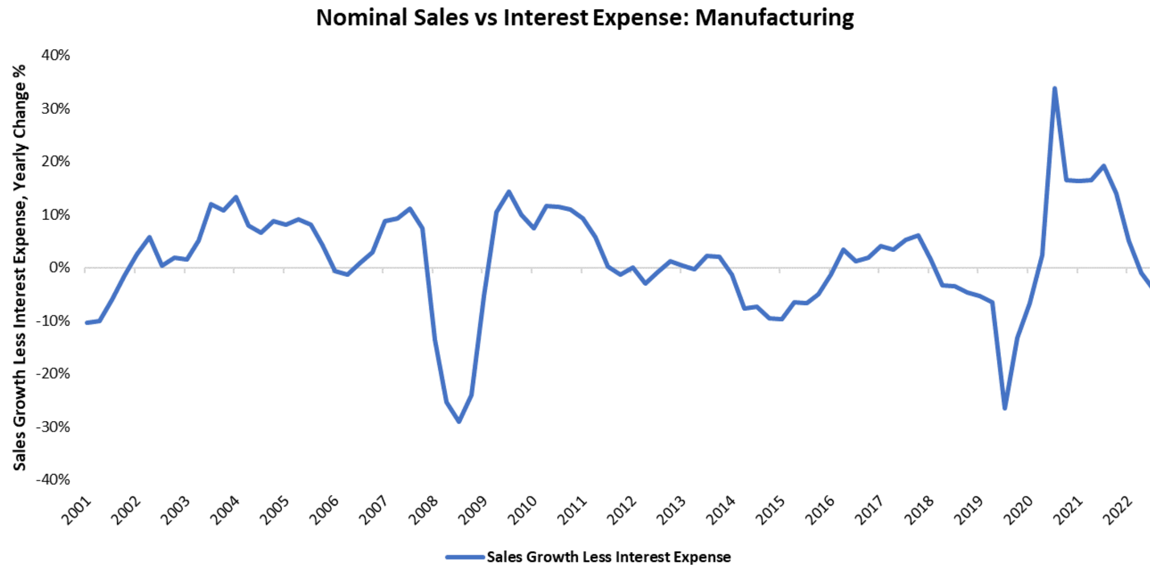
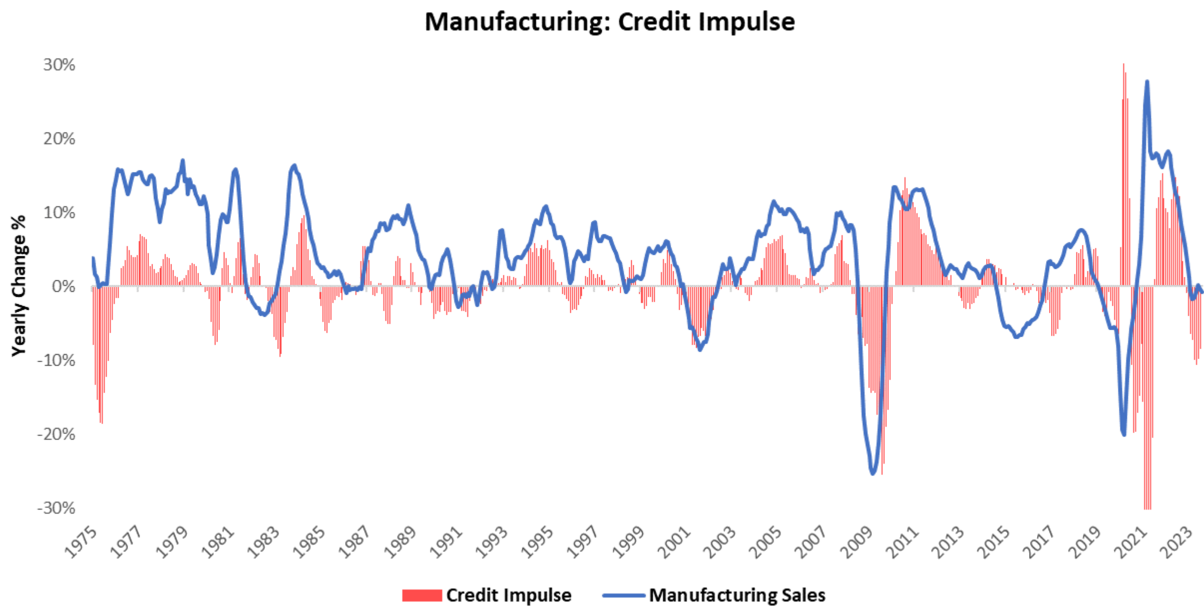
Furthermore, when we examine the state of these sales relative to existing interest expense, we see further pressure:



This dynamic has dampened the credit creation in the manufacturing sector:



As we can see above, borrowing by the manufacturing sector has slowed. Now while the pace of borrowing has slowed, the debt burden in likely to be persistent, given the large share of long-term debt obligations.

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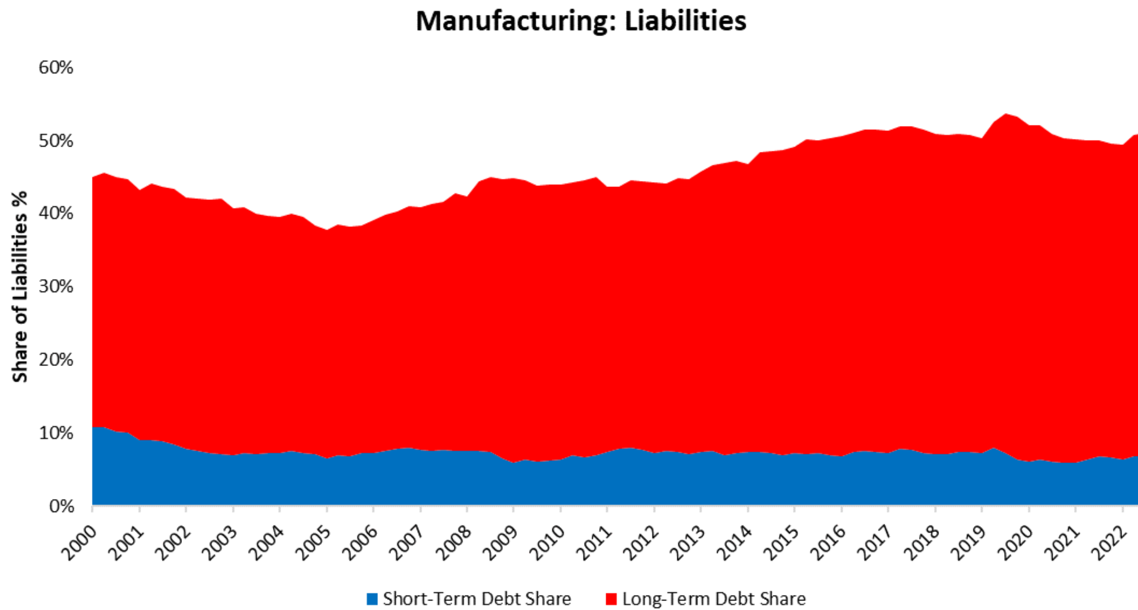
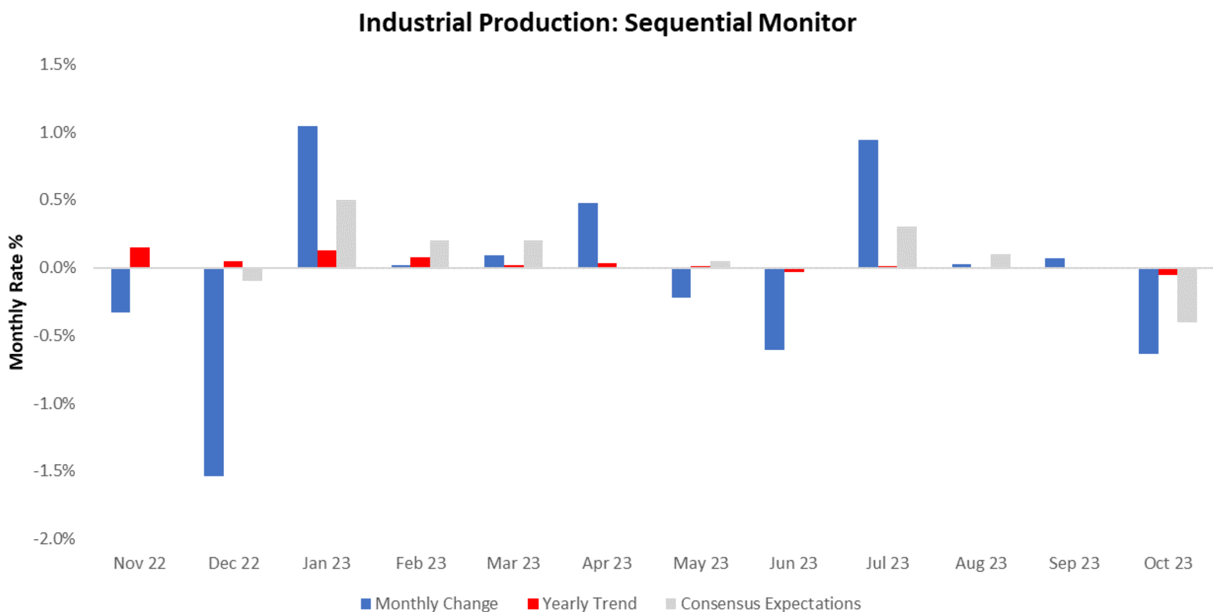
Below, we show how long-term debt occupies a large portion of manufacturing liabilities.



The combination of these dynamics has resulted in weak output. The latest data for October shows Industrial Production declined, coming in at -0.63%. This print disappointed consensus expectations of -0.4% and contributed to a deceleration in the three-month trend relative to the twelve-month trend. We show the sequential evolution of the data below:



This decline in output is consistent with the weakness we have seen in both sales and profits.

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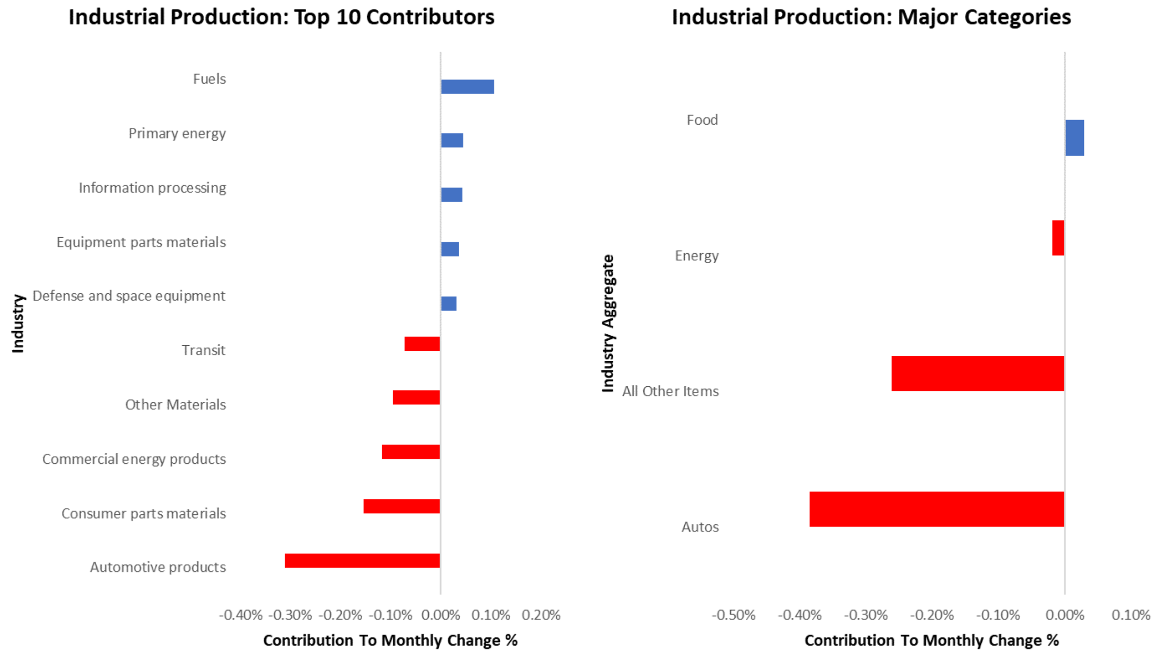
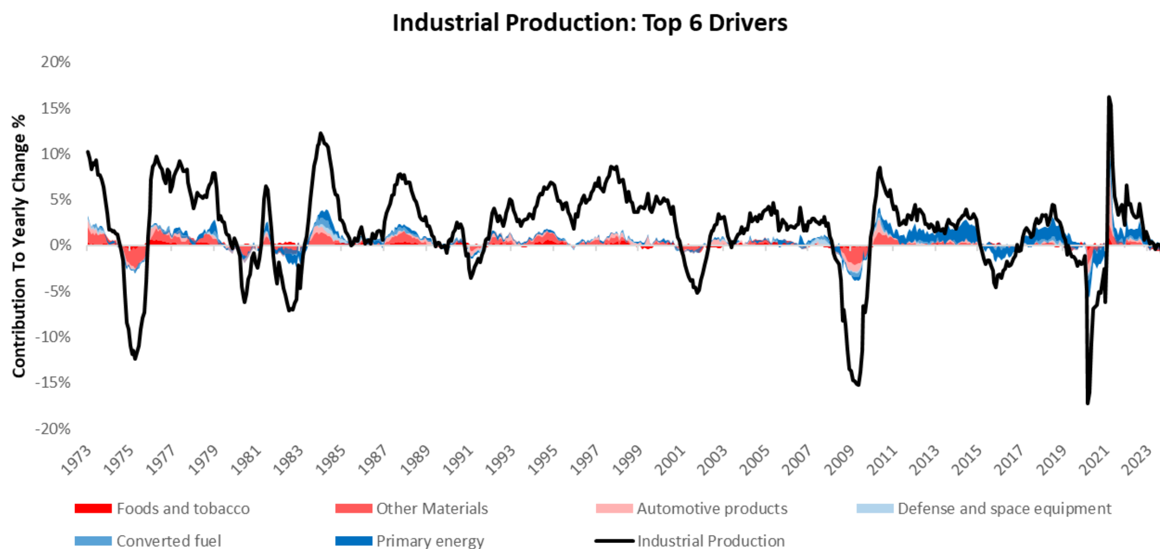
We break this print into its contributions from production coming from Food (0.03%), Energy (-0.02%), Autos (-0.38%), and All Other Items (-0.26%). Additionally, we also showcase the top 10 contributions by industry. The largest contributor this month was Fuels, and the largest detractor was Automotive products:



We zoom out to offer further context on the dynamics of industrial production. Over the last year, industrial production has contracted by -0.68%.



Above, we present the top six drivers of industrial production, with the three strongest industries highlighted in blue (Primary energy, Converted fuel, and Defense and space equipment) and the three weakest industries highlighted in red (Foods and tobacco, Other Materials, and Automotive products).

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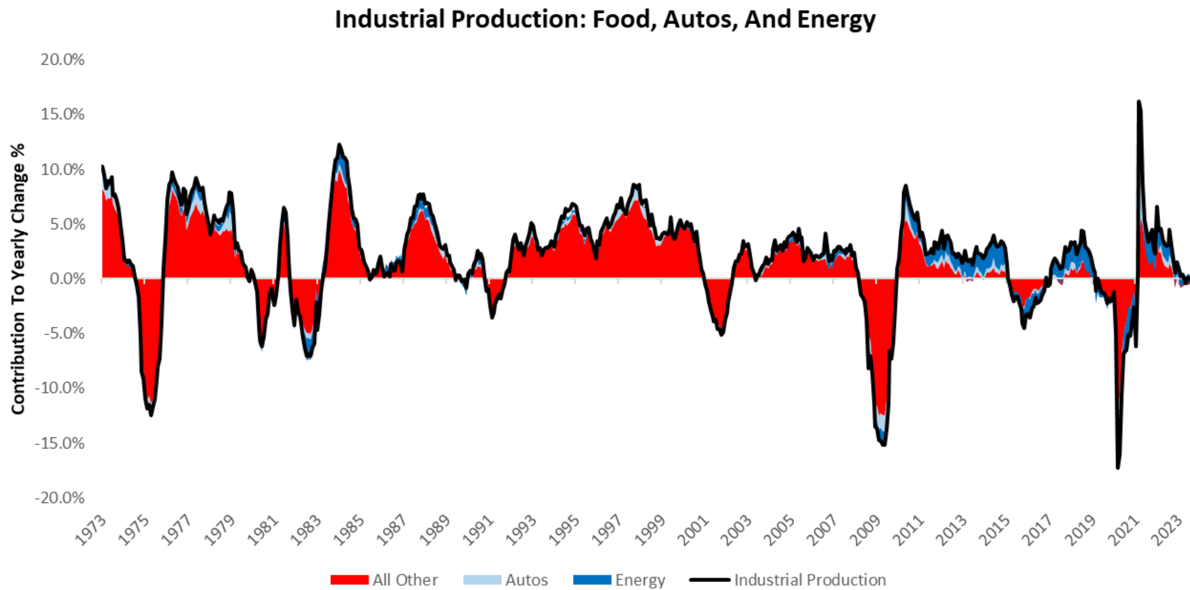
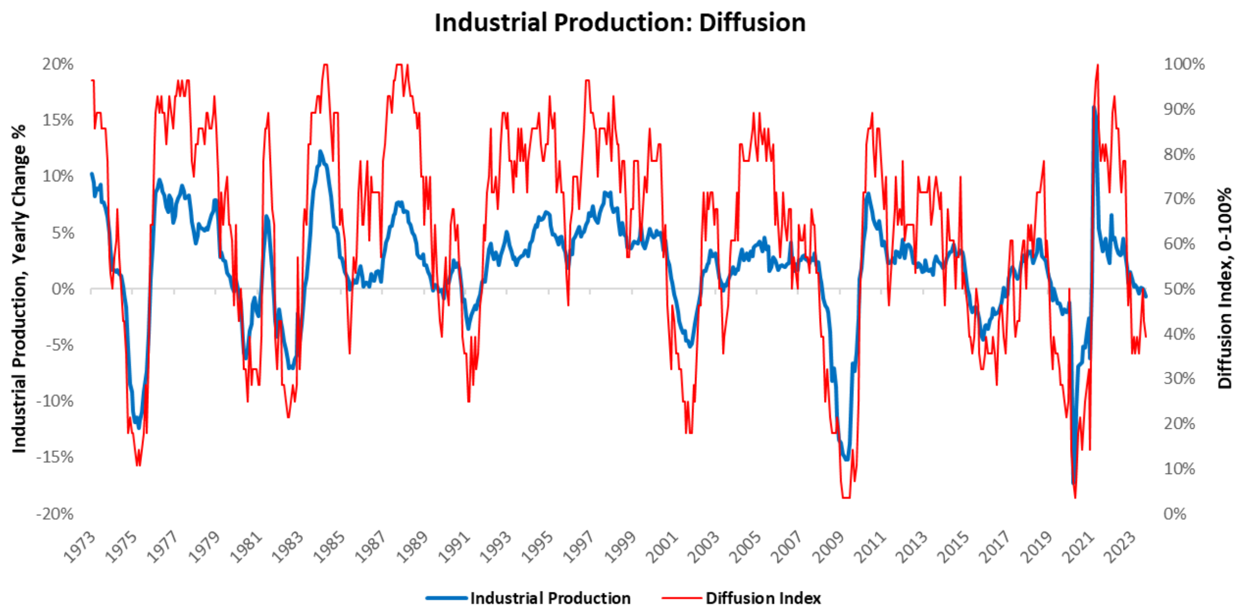
Over the last few decades, the importance of food, energy, and automobiles has risen, accounting for a significant amount of the variation in industrial production. Over the last year, food, energy, and automobiles have contributed -0.11% to the -0.68% change in industrial production. We show this impact below:



To further assess the health of the current contraction of industrial production, we examine the diffusion of the 28 subsectors we track. This involves examining the number of industries that are expanding versus the number of industries that are contracting. We find that 61% of industries are contracting.



As we can see, the weakness in production remains broad-based.

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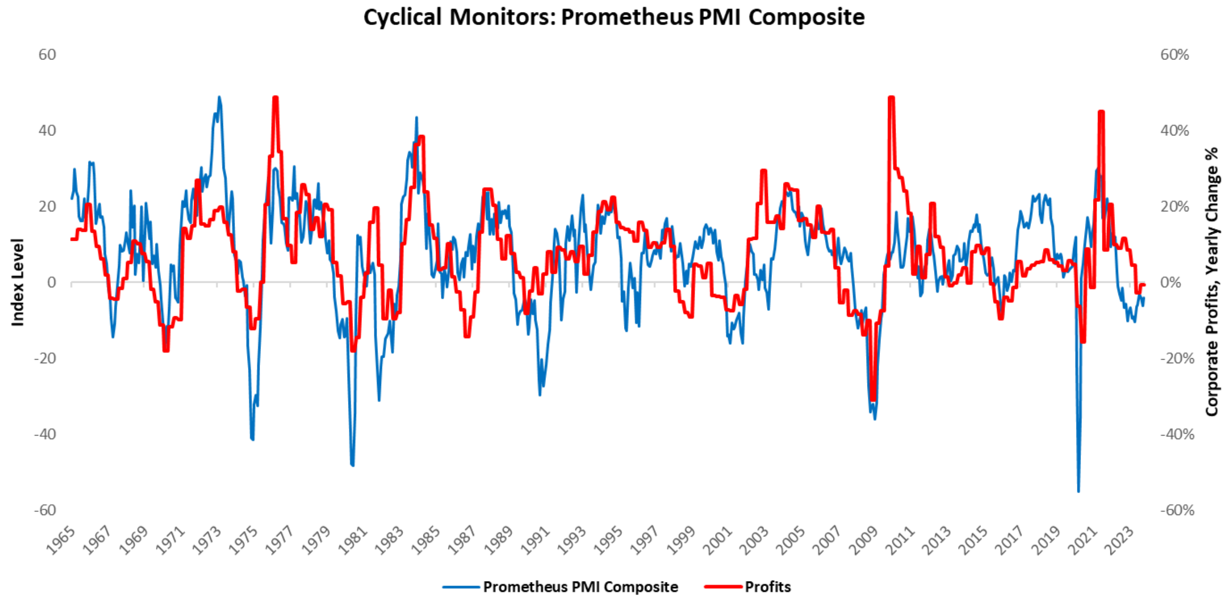
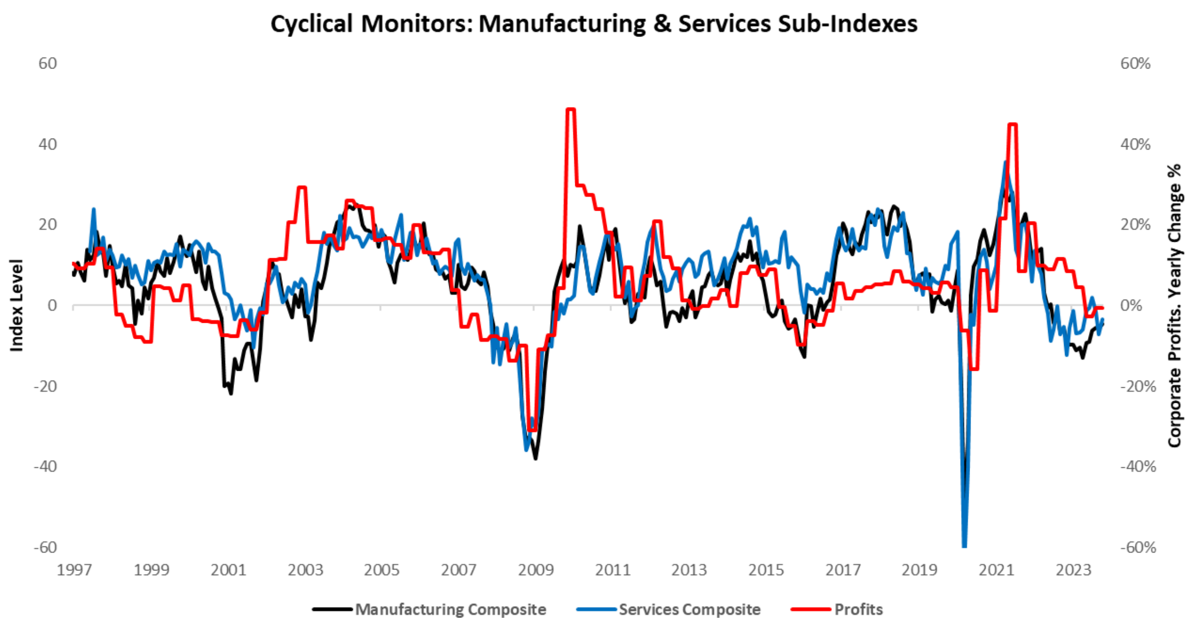
Finally, forward-looking measures of manufacturing remain weak. As of the latest available data, our PMI composite now shows a reading of -4.1. This was a sequential acceleration from one month prior and a decline in the three-month trend. PMIs are generally strong directional indicators of where we are in the profit cycle, as PMI respondents manage inventories and orders in response to their outlook on revenue and profitability. Below, we offer the latest readings of our PMI Composite, which offers us a sense of the pressures on profitability:



PMI indicators are typically biased toward the manufacturing sector. While this does indeed make sense since production is largely driven by the manufacturing sector, we think it is important to also separate these sub-indexes to understand the pervasiveness of the current trend in PMIs:



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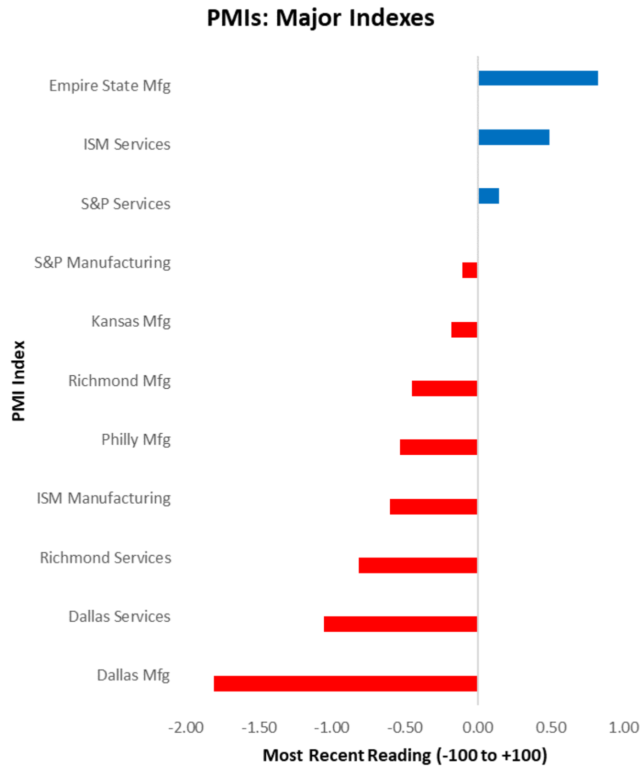
Currently, our Manufacturing and Services composites are sow readings of -4.5 & -3.4, respectively, signaling consistency within the current trend. Finally, we show the composition of the most recent prints in major PMI indices, standardized to allow for comparison. Empire State Mfg has been the strongest of the PMIs, while Dallas Mfg has been the weakest.



Overall, our assessment remains that activity in the manufacturing sector has begun to turn and is likely to persist on this path. Combining our assessment across cyclical components of the economy, we see a strong likelihood that the impacts of the tightening of monetary policy have begun to make their way through to the economy. This dynamic sets up an opportunity at odds with market pricing in the equity market. We turn to this in our next section.

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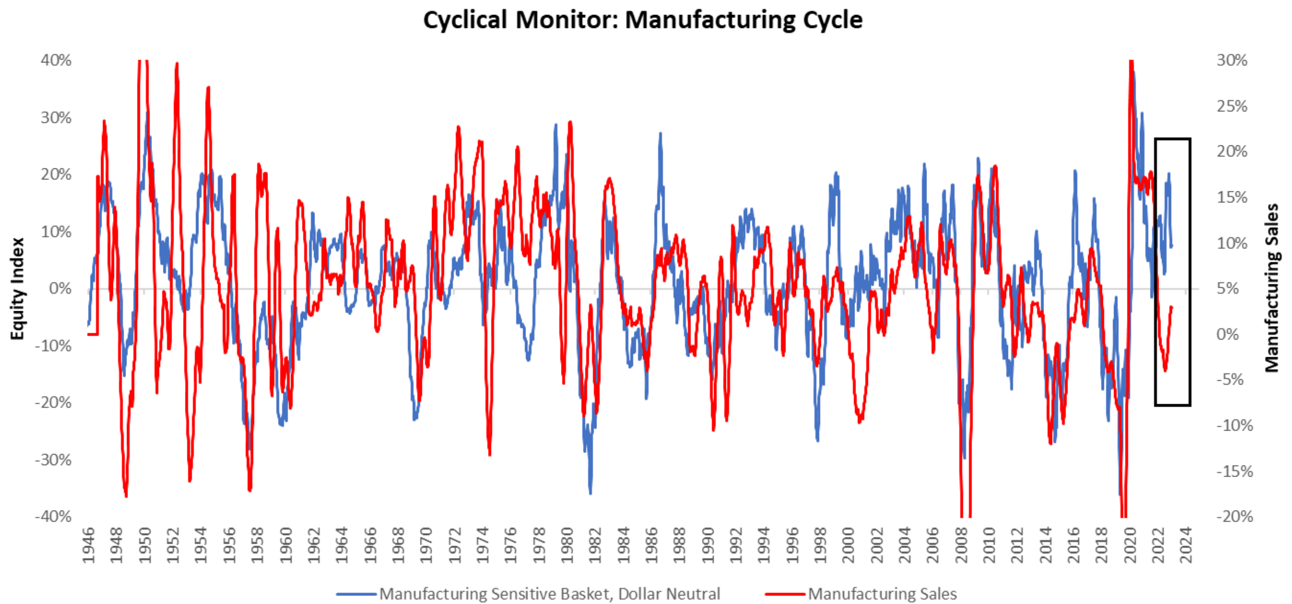
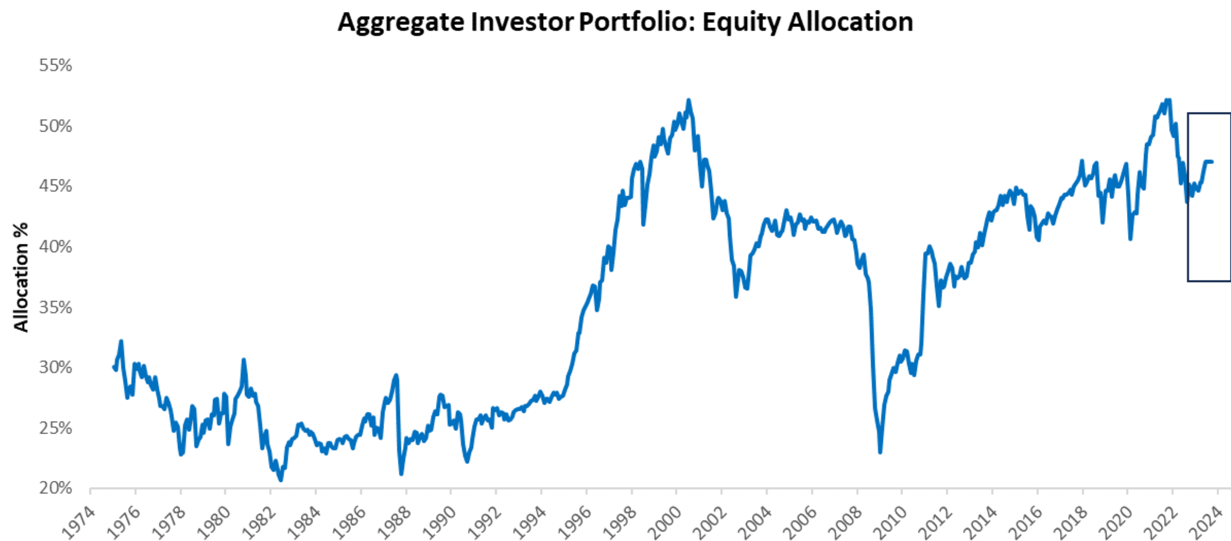
Equity Markets: Industrials & Beta Rich To Fundamentals

Now that we have examined the drivers of the economic cycle in detail, we now turn to how the prospective path compares relative to what is priced into markets. We see two potential opportunities. First, we see manufacturing-sensitive sectors (industrials, energy, and materials) vs. non-sensitive (healthcare and utilities) as overpriced relative to the economic environment we have discussed. Second, we think that market expectations for profitability remain stretched. The combination of these things will likely create relative value opportunities, which will expand to broader opportunities in the short beta. We begin by showing the gap between manufacturing activity and market pricing below:



As we can see above, the gap between current activity and that priced into the market remains significant. Additionally, we show our monitors for aggregate investor exposure to equities, which remains somewhat elevated:



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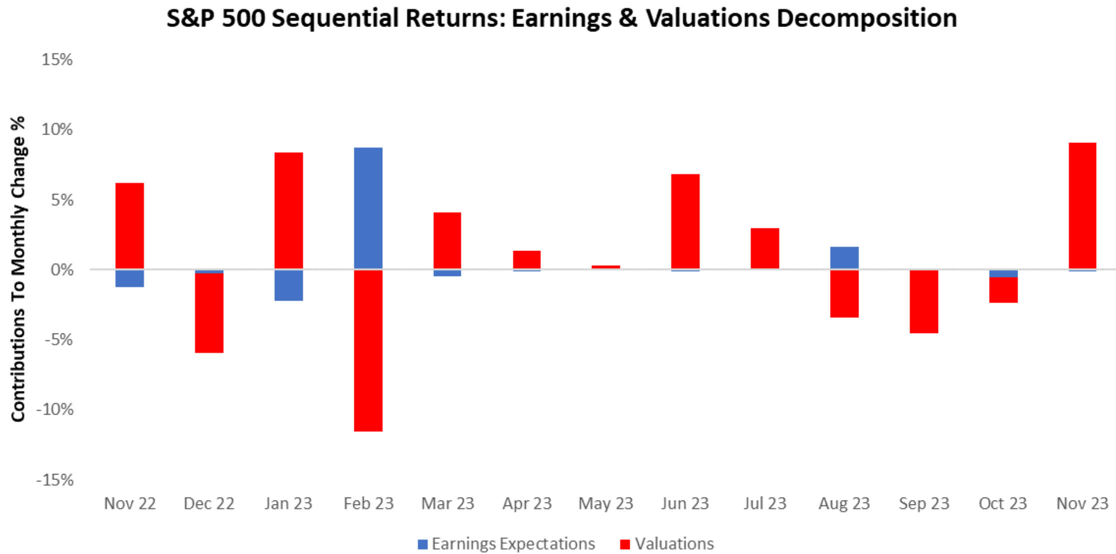
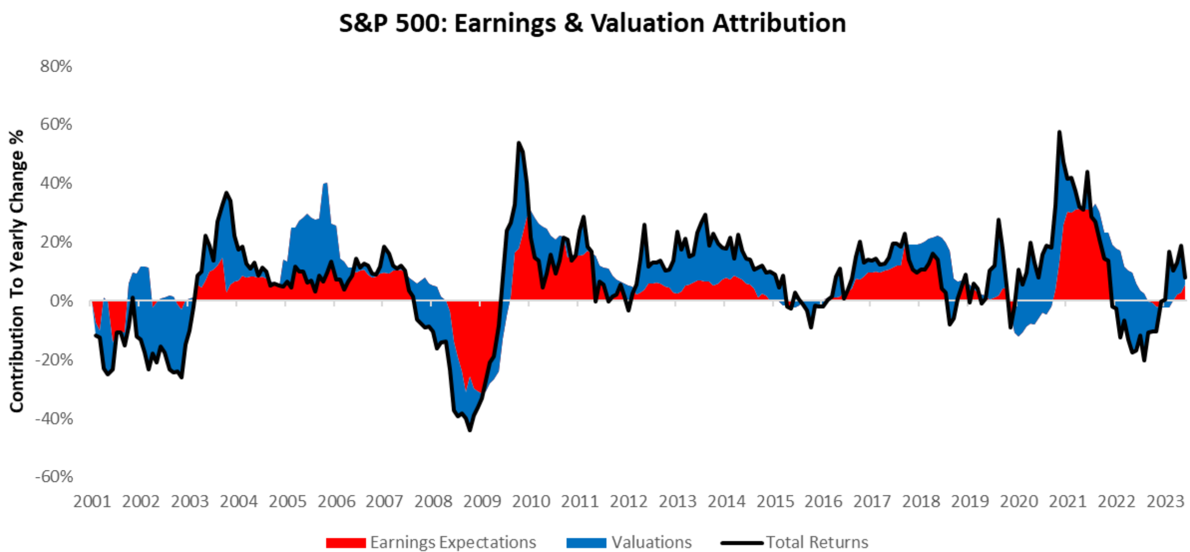
The combination of these dynamics leads us to believe that equities remain locally rich, particularly equities sensitive to manufacturing outcomes. This countercyclical expectation is consistent with the strong gains seen in equity markets. Over November, the S&P 500 fell 8.94%, primarily driven by valuations. Earnings expectations and valuations contributed -0.14% & 9.08% to the 8.94% rise in markets. Below, we show the sequential evolution of market prices, along with our decomposition of returns:



Over the last year, the S&P 500 has been dominantly driven by valuations, with total returns rising by 17.44%. We show cumulative returns on the S&P 500 over the last year, decomposed into earnings expectations (5.31%) and valuations (10.02%):



We further decompose these yearly returns into their sector contributions.

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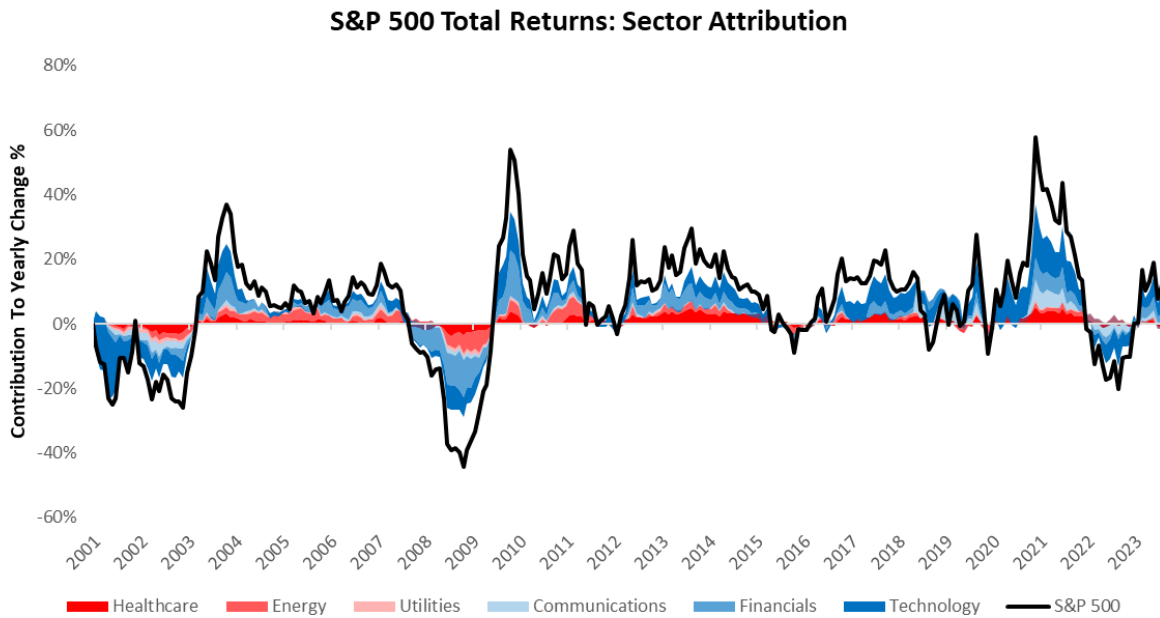
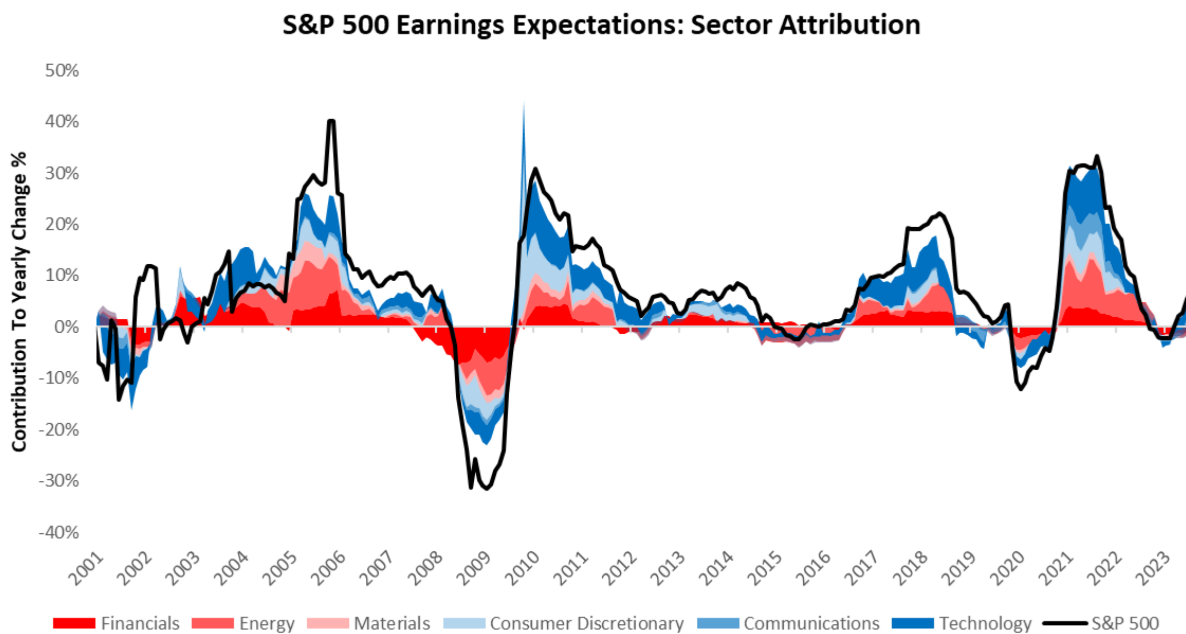
We begin by showing the primary drivers of the S&P 500. We show the top three drivers in blue (Technology, Financials, Communications) and the bottom three in red (Healthcare, Energy, Utilities):



We drill down into these total returns by isolating the changes in earnings expectations. We show the top three drivers in blue (Technology, Communications, Consumer Discretionary) and the bottom three in red (Financials, Energy, Materials):



Finally, we examine the contributions of sectors to valuation changes.

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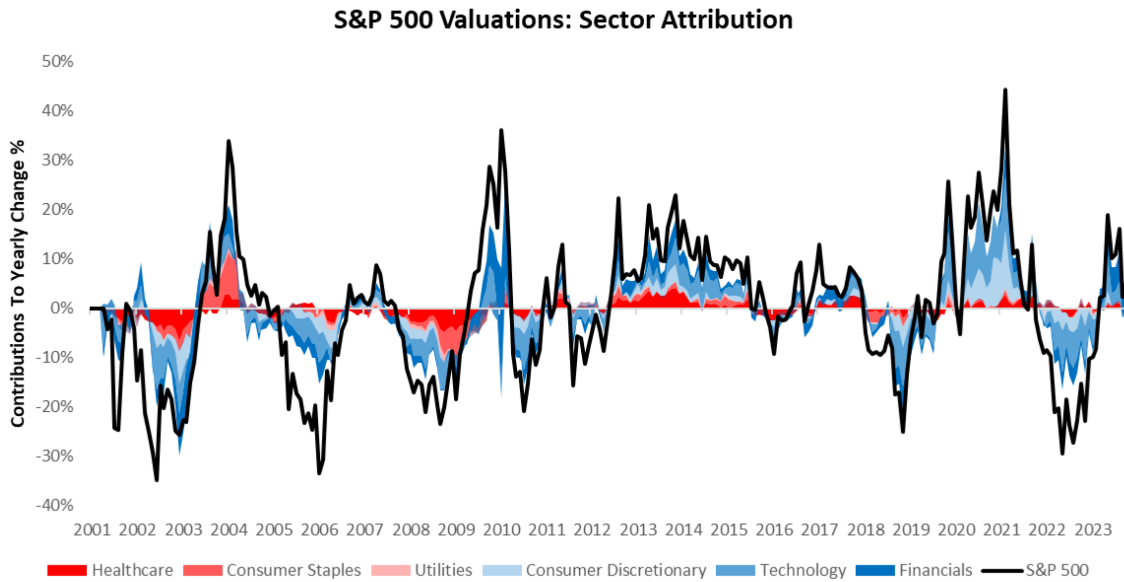
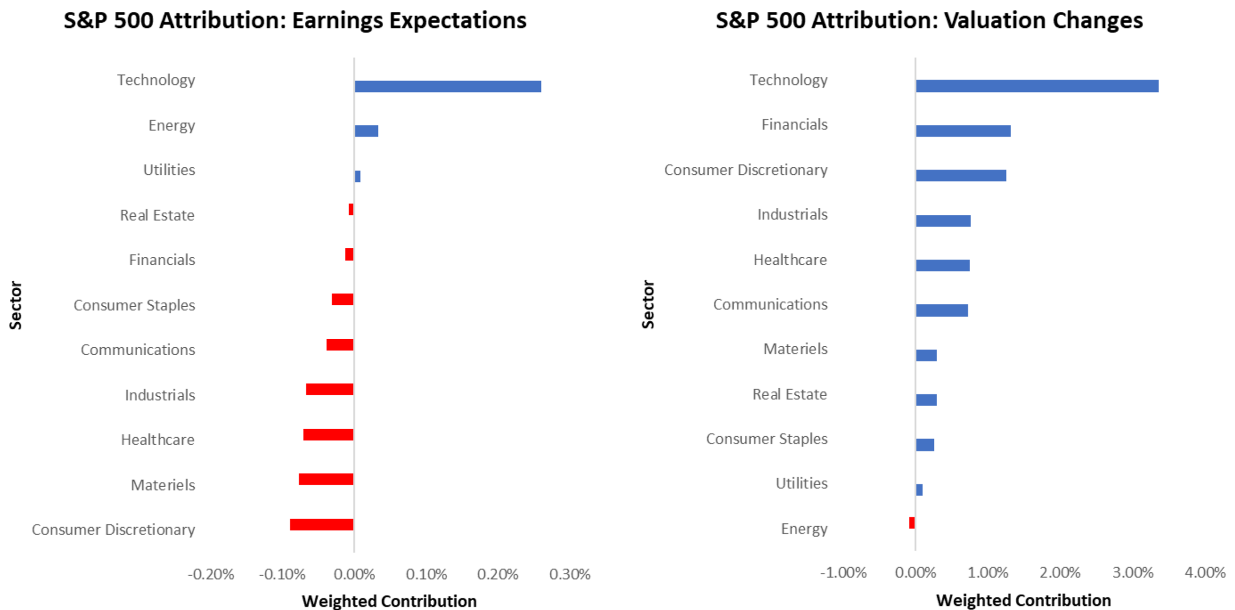
We show the top three drivers in blue (Financials, Technology, Consumer Discretionary) and the bottom three in red (Healthcare, Consumer Staples, Utilities):



Zooming back into the most recent month, we show the composition of the most recent weakness in equity markets. We show the sector-wise composition of the most recent months' returns, changes in earnings expectations, and changes in valuations below:



At a macroeconomic level, we can decompose equity returns into their constituent drivers of growth, inflation, liquidity, and discount rates using our proprietary measures.

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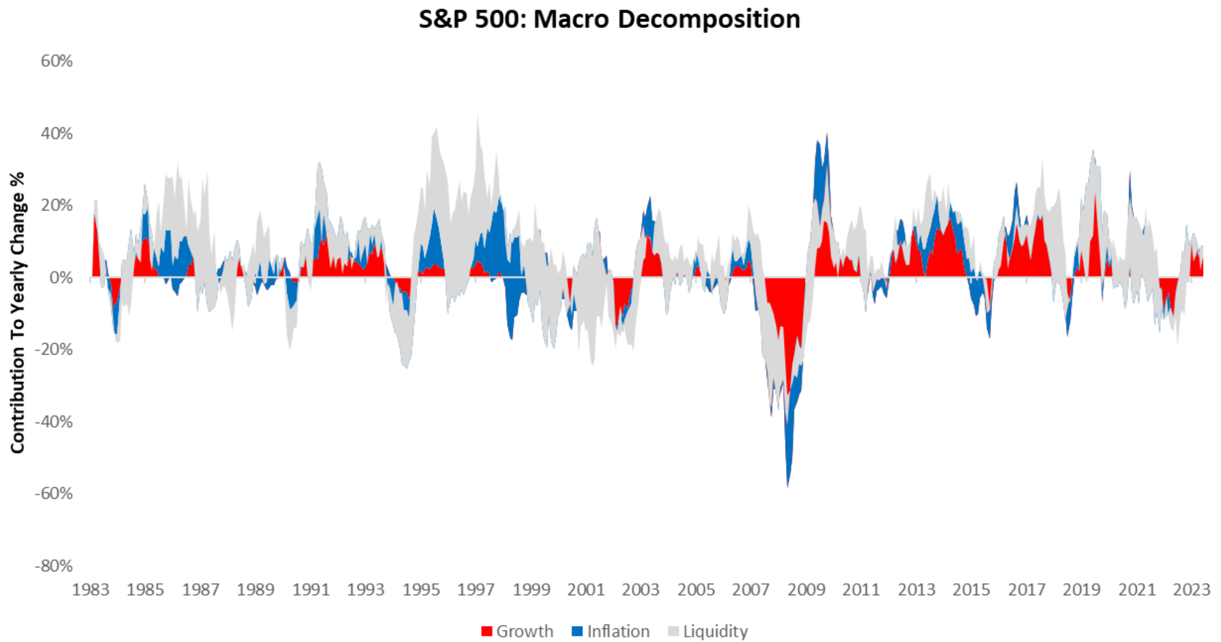
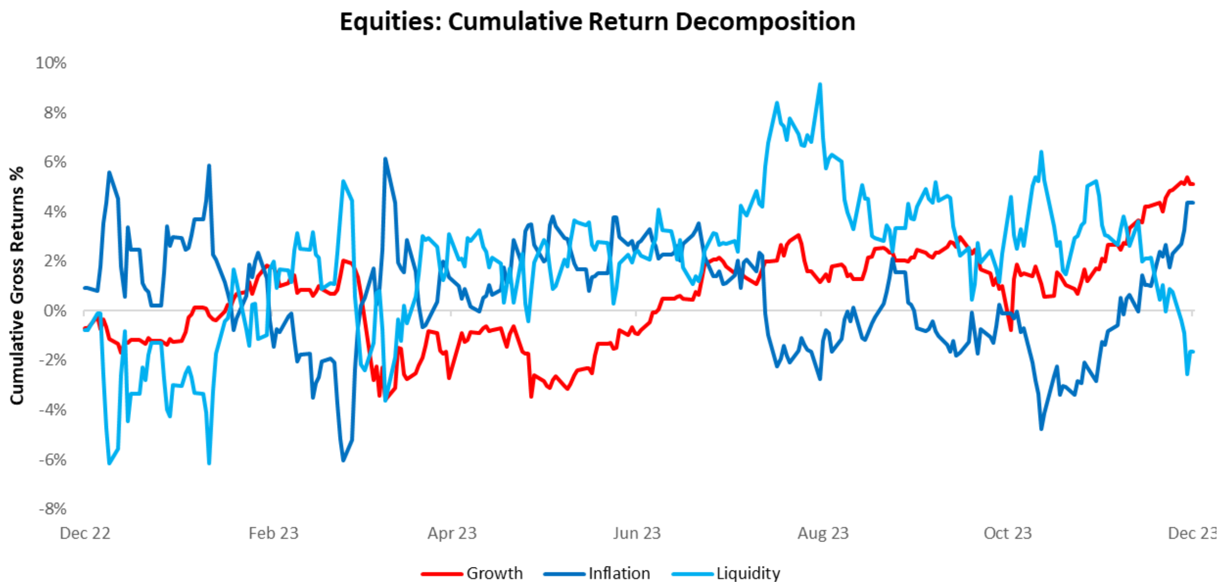
Over the last year, equities have been primarily driven by growth, with liquidity now dragging on returns:



For further contextualization of these returns, we show the cumulative returns attributable to our growth, inflation, liquidity, and discount rate factors. In the most recent month, growth, inflation, and liquidity have contributed 3.31%, 7.32%, & -6.62%, respectively. We show the cumulative contributions to total returns over the last year below:



As we can see above, recent disinflationary pricing and sustained strength in growth have powered equities ahead. Given our growth outlook, we think it is unlikely that this will continue.

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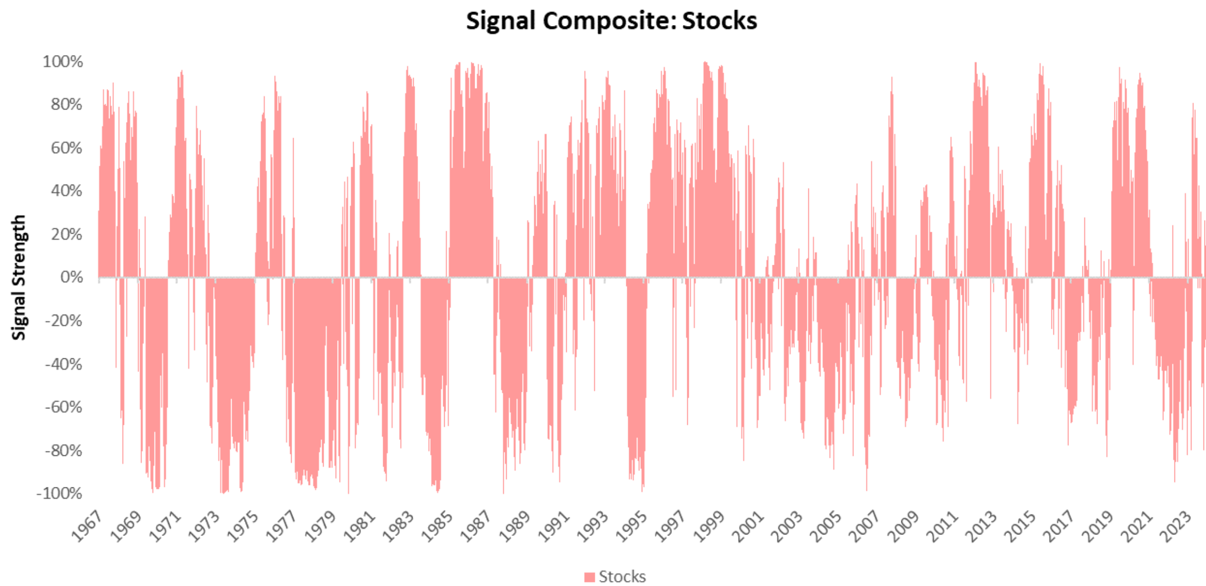
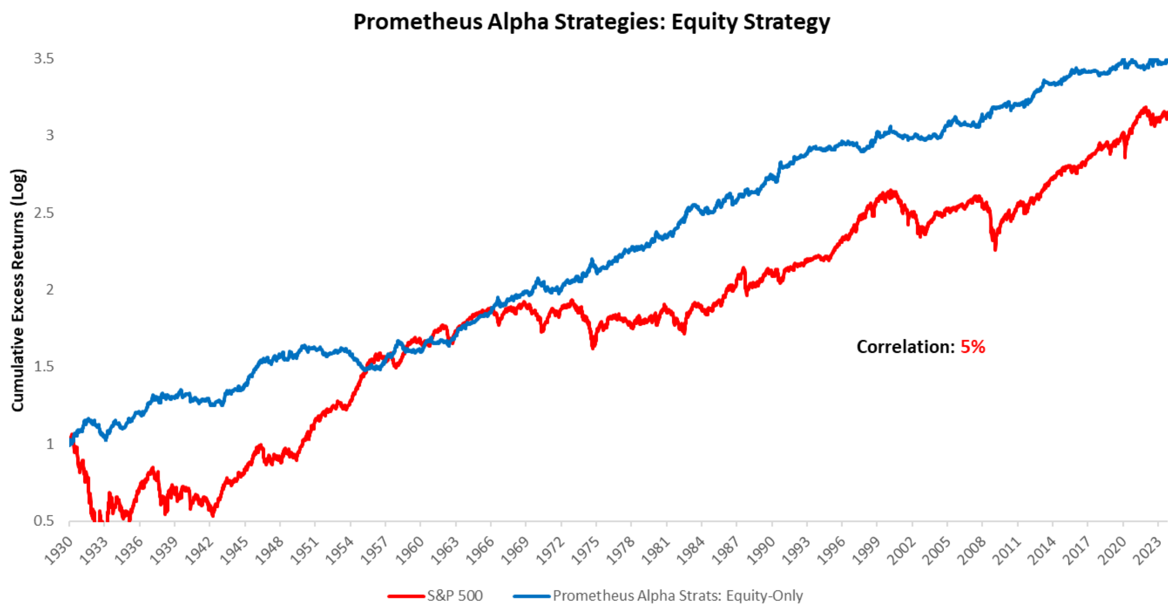
This observation is supported by the views coming from our ETF Portfolio alpha composites:



Overall, manufacturing-sensitive sectors offer a market-neutral short opportunity exposed to their current downward economic momentum. Over time, taking off the market-neutral component to have a broader beta short will likely prove attractive. We will release Prometheus Alpha Strategies next year to best express these bets and provide consistent coverage:



Stay tuned for more on this in 2024.

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Conclusions

We reiterate our expectations and our views on macro and risk.

- ***Nominal GDP contracted by -0.11% in October, with real GDP contracting by -0.24% with inflation rising by 0.13%. Meanwhile, despite ongoing QT, reserve balances in the financial systems have continued to expand, supporting liquidity conditions.***
- ***Cyclical dynamics and our outlook on nominal activity have begun to shift. While our expectations for real growth remain that they will soften, conditions are now aligning for inflationary pressures to abate, potentially pushing us out of an inflationary bear market.***
- ***We are at what resembles a turning point for treasury markets, with the amelioration of short-rate pressures and declining inflationary forces. The end of short-rate pressures are more apparent than decreasing inflationary forces.***
- ***After losses across positions last month, our Cycle Strategies are flat stocks & bonds and long commodities.***

We think the initial phases of the impacts of tightening have begun. Whether these sustain and metastasize remains a question and is subject to close monitoring. Manufacturing-sensitive sectors offer a market-neutral short opportunity exposed to their current downward economic momentum. Over time, taking off the market-neutral component to have a broader beta short will likely prove attractive. We will provide our updated thoughts on bond markets in the coming notes from *The Observatory*.

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