Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

Insights from Multi-Asset Solutions' Portfolio Managers

Quarter ending
MARCH | 2024

On the Radar Screen

1. **Following two years of little or no profit growth** (outside of mega-cap technology, anyway), earnings appear poised to push higher. As we move through the upcoming earnings reporting season, we will be listening for discussion of margin durability and potential expansion.
2. **Core CPI readings were disappointing in both January and February,** but we believe the broader trend toward lower rates of inflation remains intact. Further moderation in wage growth is a necessary precondition to such, and we turn to the Atlanta Fed's Wage Tracker as a barometer.
3. **Steady job gains, compensation increases and low rates on existing mortgages** have preserved strong household balance sheets, but deterioration is evident in some areas. We are keeping an eye on mounting delinquencies on auto loans and credit cards.
4. **Commercial real estate does not yet appear to be experiencing significant levels of distress** despite elevated interest rates, but this bears monitoring given their significance to community banks and the potential knock-on effects.

"A wise man changes his mind, a fool never." – Proverb

A pivot of our own. Reluctantly—extremely reluctantly—we've come to embrace the soft landing narrative. What's held our attention hostage for the past year or two has been a distressing set of indicators illustrating a potential Wile E. Coyote moment in the making for the U.S. and global economy: a deeply inverted Treasury curve, a collapse in the willingness of banks to extend credit, rising business bankruptcies and personal loan delinquencies, small business surveys at recession lows, and so forth. Many of these factors remain a concern today and indeed, have worsened in some instances. Nevertheless, in the totality, we must acknowledge that the economy is on an increasingly firmer footing. We capitulate even as Harriet Beecher Stowe's admonition rings in our ears: "Never give up, for that is just the place and time that the tide will turn." And yet we capitulate all the same.

What has changed? The facts on the ground. Inflation would be Exhibit A. There are some components of the consumer basket that show stubborn price increases, but the broad trend is quite favorable. With the supply chain tangles of the COVID-19 era now largely untangled, an influx of immigrants swelling the pool of available labor, technology-driven productivity gains coming more clearly into sight, and consumption patterns normalizing, businesses have managed to successfully protect their margins without the large price hikes that marked recent years. And with inflation now cooling accordingly, the Fed is poised to start taking the pressure off the brake.

Also showing notable improvement are the housing market and global manufacturing, both of which look to have bottomed after adapting to a higher rate environment. Consumer sentiment deserves a shout-out too, having climbed considerably off its 2022 lows. Fiscal policy may provide a further tailwind by way of the Wyden-Smith tax bill (possible passage), the Employee Retention Tax Credit and other levers available to the administration that are likely to be pulled in the lead-up to the election. And we would be remiss not to also recognize the rush to develop artificial intelligence (AI) infrastructure and the associated boom in business capital expenditures.

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"Progress is cumulative in science and engineering, but cyclical in finance." — James Grant. One might reasonably assume that, given our more benign assessment of economic conditions and the improved outlook for corporate earnings, we would be commensurately more optimistic in our expectations for the return on risk assets. We're not. The powerful rally we've been enjoying these past five months has driven equity price multiples to some heady levels and credit spreads atypically narrow. It's difficult to make the case that prices can continue to climb at this pace. The cyclical nature of finance implies some form of mean reversion that restores pricing to levels more consistent with historic norms. This could happen gradually with the market moving generally sideways for an extended period, while companies grow into the valuations that have been assigned them. Or it could happen more abruptly when something sparks a sharp correction resetting valuations. Not knowing what that "something" might be nor when it may arrive, our approach is to hold total equity and credit risk close to their benchmark weights and seek opportunities to add value within stock and bond markets rather than between them. If we do see a substantial pullback, however, we will not hesitate to lean aggressively into risk.

In terms of what parts of the market we favor, our current thinking includes: a stake in uranium miners as key upstream beneficiaries of the rising demand for power generation; a preference for digital infrastructure (data centers, towers, etc.) over more expensive hardware and software stocks that have already run; a tilt toward profitable businesses with high interest-coverage ratios over heavily indebted "zombie" companies that may struggle to meet their debt obligations; Japan over Europe; convertible bonds over bank loans on a volatility-weighted basis; and a modestly long-duration bias within our bond portfolios as we anticipate that Treasury yields will move lower with inflation.

"'Well now that we've seen each other,' said the Unicorn, 'if you'll believe in me, I'll believe in you.'" — extract from Lewis Carroll's *Through the Looking-Glass*. Whereas we have had a change of heart in regard to prospects for the economy, the same cannot be said of our opinion regarding cryptocurrency. Frankly, we don't understand their purpose. We've heard the phrase "a solution looking for a problem" applied to Bitcoin, and that sounds about right. As an asset, it's a mythical beast whose intrinsic value doesn't actually exist. That the price should have popped with the anticipated launch of a number of Bitcoin ETFs pulling in billions of dollars isn't particularly surprising, but can it continue to climb, or indeed even retain its current price? Time will tell, but you can color us skeptical. Some have made the argument that digital assets belong in client portfolios for diversification reasons, but we don't sit in that camp. Given a negative expected return (our expectation), better to park assets in cash if there is a need to reduce risk.

There is no assurance that the investment objectives will be met.

Past performance is no guarantee of future results, which will vary. All investments are subject to market risk and will fluctuate in value.

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About Risk

All investments are subject to market risk, including possible loss of principal.
Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.

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