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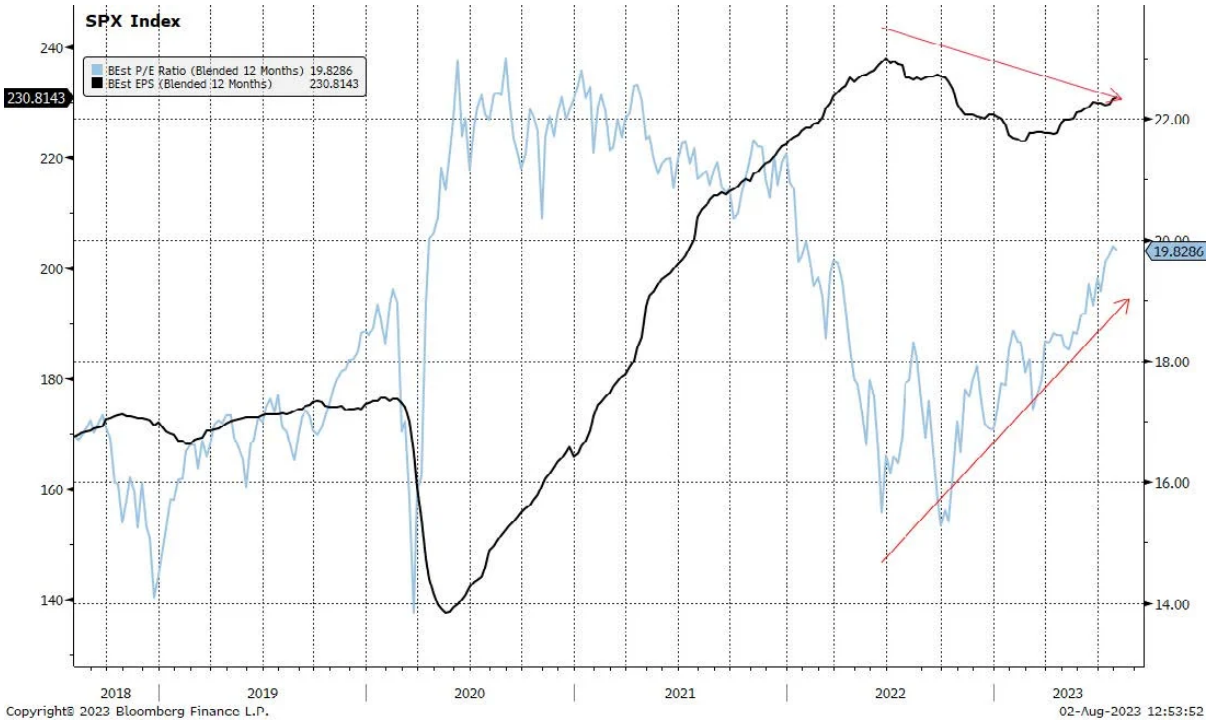
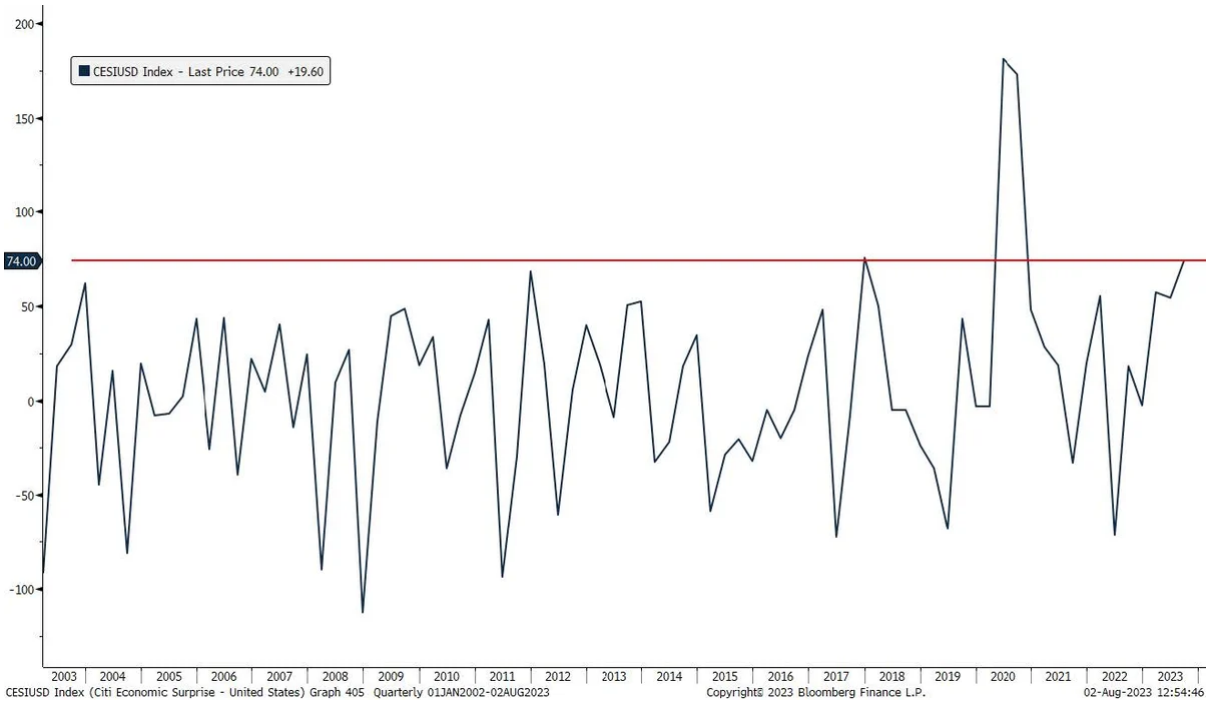
The beta chase has likely run it's course

The S&P500 is up +20% for the year and the 12mth fwd PE multiple is back at 20x - expanding aggressively as CPI / hard landing fears are priced out. At 20x we are at the 90th percentile of this valuation measure since 2003, notable when the risk free rate is 5.5%. What stands out in particular is the high beta variant of the S&P 500 i.e. the most cyclically geared stocks are +29% of the year (Invesco S&P 500 High Beta ETF – SPHB US Equity).
What matters more for equities are surprises to growth expectations rather than the level of prevailing growth itself. Equities hope for growth – and so that places emphasis on unexpected changes in economic growth which in turn influence the level of profit multiples.
With this in mind, four points on expectations going forward, which all suggest the hurdle for cyclical stock gains is now much higher:

- *Earnings expectations:* The rise in S&P500 12mth fwd earnings estimates remains lacklustre, not yet at the peak of last summer. If CPI is deemed yesterday's news, earnings now need to deliver for a market trading at 20x. There will be greater scrutiny on how much falling pricing power puts pressure on sales and in turn earnings, if margins have little room for improvement.

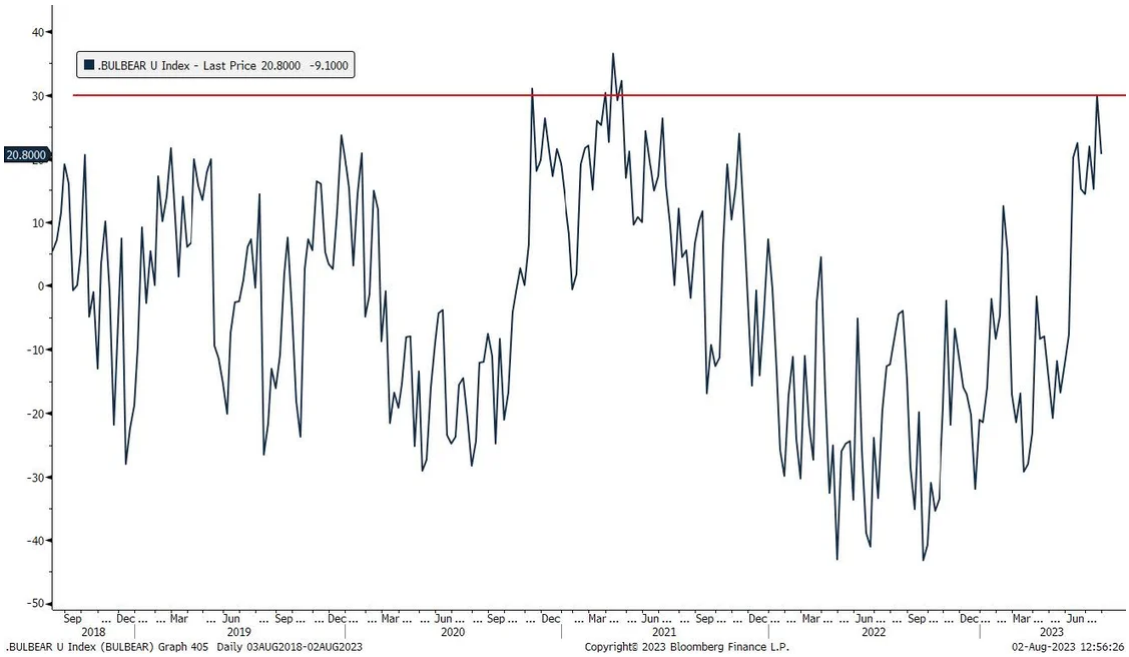


- *Growth expectations*: The Citi US economic surprise index which indicates whether data has been surprising to the upside or downside relative to consensus expectations is at long term range highs. What happens now is that forecasts get raised and so data surprises, given a higher bar, are likely to turn down. Indeed, on this basis, given the high correlation, our US GDP Growth Tracker basket (ask for more details) also looks short term at risk.

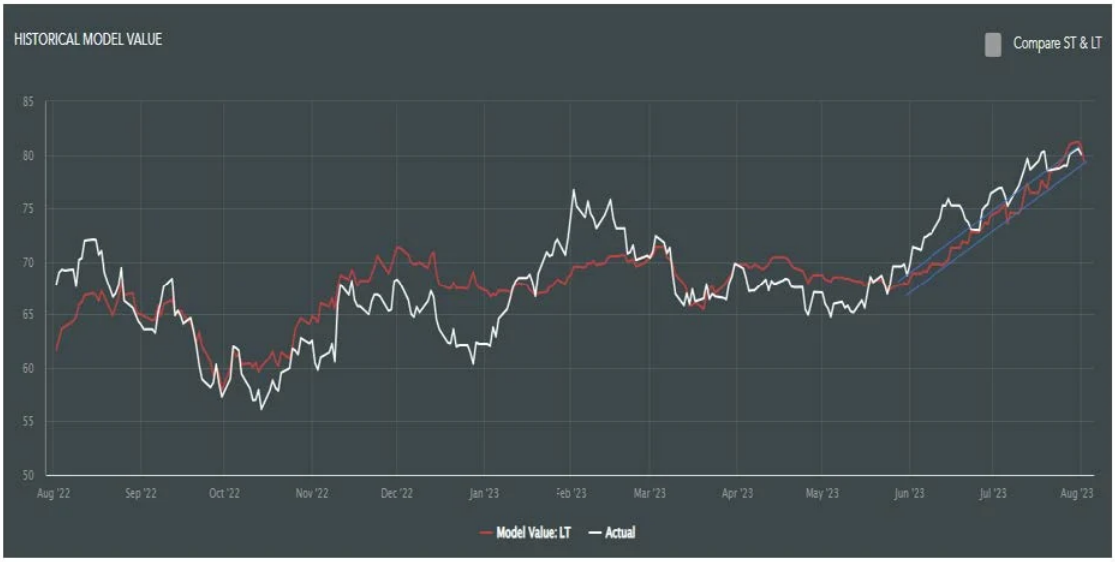


- *Financial conditions:* The Senior Loan Officers' survey on lending conditions was released this week. This continues to be one of the few data points to argue against a soft-landing narrative. The share of banks reporting tighter credit standards for commercial & industrial loans increased (from +46 to +51). The four times since the start of the survey in 1990 that have seen such tightening have all been associated with recessions. HY credit spreads remain one of the top driver's for Qi's model of the S&P500 and currently sitting at new 52wk lows. Clearly, the market is expecting a "this time is different" narrative but this backdrop is worth the reminder.

- *Risk Appetite*: The AAII Bulls less Bears gauge of investor sentiment looks to also be moderating from long term range highs. The high beta chase is reflected in a high RSI overbought reading for SPHB US Equity – again a more opportune time to be reducing cyclical risk than adding.



Qi's macro warranted fair value for the SPHB ETF is close to spot value – indeed model value had been rising until late July primarily driven by tighter credit spreads, the top driver. There are now tentative signs the trend higher in model value is coming under pressure – we watch this closely.



As highlighted in the recent Qi Insight Note ' *Don't fight the US consumer*', it is likely time to screen portfolio for cyclical exposure with high credit sensitivity.

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