Market Commentary
October 2023

English Version

The More Things Change, The More They Stay The Same

Quarterly Call Q4 | 2023

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insigneo

Ahmed Riesgo
Chief Investment Officer
Insigneo

Executive Summary

We envisioned an A-shaped trajectory for markets, with stocks performing well initially and facing challenges later as the lagged effects of monetary policy finally trickled down to the real economy.

The strength in US economic activity is attributable to the emergency interventions during the pandemic which placed a plethora of excess savings (over USD 2 trillion) into the pockets of US consumers that have seemingly delayed the connection between interest rate increases and noticeable economic deceleration.

While the onset of a recession has been more delayed than most anticipated, we maintain that it is deferred, not averted.

In the forthcoming six months, we estimate a 70% chance of avoiding a recession, a 25% probability of a mild recession, and a mere 5% likelihood of a severe one.

Within a year, the odds of a mild recession increase to 55%, the chances of avoiding a recession decrease to 35%, and the probability of a severe one slightly rises to 10%. In conclusion, we anticipate that the US is likely to experience a mild recession by mid-next year.

The countdown to a recession continues, suggesting an unfavorable risk/reward balance for risk assets through the remaining months of this year and the initial half of 2024.

Our rate forecast also implies that we perceive the US 10-year bond has surpassed its fair market value based on economic fundamentals, and that technical factors are unduly influencing it, such as the issuance of Treasury debt and growing concerns regarding fiscal deficits.

With long-term rates at current levels, the US is beginning to compromise its exceptional funding capability, and it is now incurring a notable term premium. This development tempers our stance on the current US Treasury 10-year yield of 4.5%, despite our fair value estimate of between 3.55% and 3.80%.

Given our anticipation of a US recession in the coming year, our recommendations will be centered around becoming more defensive in portfolio positioning over the fourth quarter.

Defensive sectors, Large Caps, and US equities should outperform as global growth begins to decelerate next year.

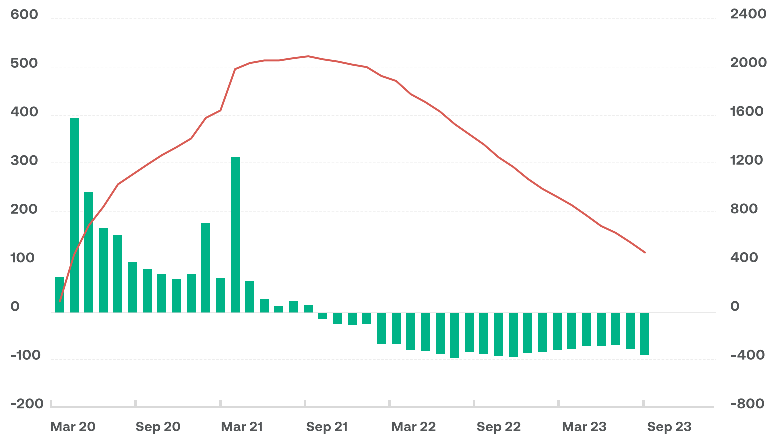
As has been our mantra since the middle of this year, we would favor Quality-factor equites over both Growth- and Value-factor equities.

US Excess Savings Now Sit at USD 400 Billion from USD 2.2 Trillion

At this burn rate, excess savings will be exhausted by Q1 2024

— Month-to-month change in excess savings, $B (Left)

— Cumulative excess household savings since March 2022, $B (Right)



Source: Pantheon

Is This Time Really Different?

We opened 2023 quite enthusiastically compared to the Wall Street consensus of a doom and gloom type of year. Our skepticism of the widespread predictions of a 2023 US recession and the prevalent expectation that the stock market would initially struggle before recovering in the latter half of the year was rooted in the underlying strength of the macroeconomic data. **Instead, we envisioned an A-shaped trajectory for markets, with stocks performing well initially and facing challenges later as the lagged effects of monetary policy finally trickled down to the real economy.** During the Summer months, as the markets churned higher, it seemed that even our own optimistic projections might have been understating the pace of growth. Perhaps, generative AI technologies were increasing productivity faster and accelerating profitability sooner than we anticipated. We held steady then and we are holding firm now as well as, quite honestly, not much has changed. In Bayesian terms, our posterior probabilities largely match our prior probabilities. In regular parlance, we have not really learned anything new over the calendar year, or to be more precise, we have no new data that makes us change our previous predictions. *Plus ça change, plus c'est la même chose.*

The more things change, the more they stay the same.

Yes, this is true for our market expectations. But I would be remiss if I failed to mention that we did change one major economic projection for the year – US real GDP growth. We increased this from 0.7% in January to 2% today. **The strength in US economic activity is attributable to the emergency interventions during the pandemic which placed a plethora of excess savings (over USD 2 trillion) into the pockets of US consumers that have seemingly delayed the connection between interest rate increases and noticeable economic deceleration. While the onset of a recession has been more delayed than most anticipated, we maintain that it is deferred, not averted.** A key consideration is understanding how the waning impact of pandemic-related policies will affect the economic landscape. The initial graph indicates about USD 400 billion in excess savings remaining from a high of over USD 2 trillion in late 2021. Projecting the monthly decrease in excess savings suggests depletion around the first quarter of 2024. There have been counterarguments indicating that these savings are primarily held by the higher income quintile, who are less likely to spend; however, we remain unconvinced by this viewpoint.

There's a legal principle called res *ipsa loquitur*, meaning "the thing speaks for itself" in Latin. This principle allows courts to deduce negligence from the inherent nature of an incident or injury when there is no direct evidence of a defendant's actions in tort cases. For instance, if a piano were to fall on someone walking below, it could be inferred that the owner, who placed it precariously, is liable for the damages, since pianos do not simply fall randomly from the sky without cause. This principle can be applied here, and it suggests that the ongoing consumer spending implies the narrative of concentrated savings may be exaggerated. The consistent spending and adjustment of savings by households indicate a continuation of stable consumption growth. According to the Federal Reserve's financial data, it seems the lower quintile may have depleted their excess savings by the end of 2022. However, we postulate that the middle-income segments of households still possess adequate financial reserves to sustain spending into the first quarter of 2024, aligning with the overall depiction in the aforementioned chart. Moreover, even with a significant increase in interest rates of 550 basis points, the actual impact on aggregate mortgage debt interest payments has been minimal due to the prevalence of 30-year fixed mortgages originally fixed at approximately 3%. In real terms, this represents the first time in over four decades that the effective interest rate on outstanding mortgages is substantially negative.

Similarly, for non-financial corporate entities, there was a surge in investment grade issuance following the onset of the pandemic. This was supported by the Federal Reserve's guarantee for corporate borrowers with ratings of BBB-minus or higher, leading to a flood of issuance throughout 2020 and 2021. Companies have generally been able to prolong debt maturities under very favorable financial conditions. While not as protected as homeowners with traditional mortgages, many investment grade bond issuers capitalized on opportune moments in 2020 and 2021 to term out their debt. In essence, non-financial corporate entities have had a level of insulation from rising interest rates during this rate hiking cycle, although this buffer is diminishing.

Timing the Next US Recession

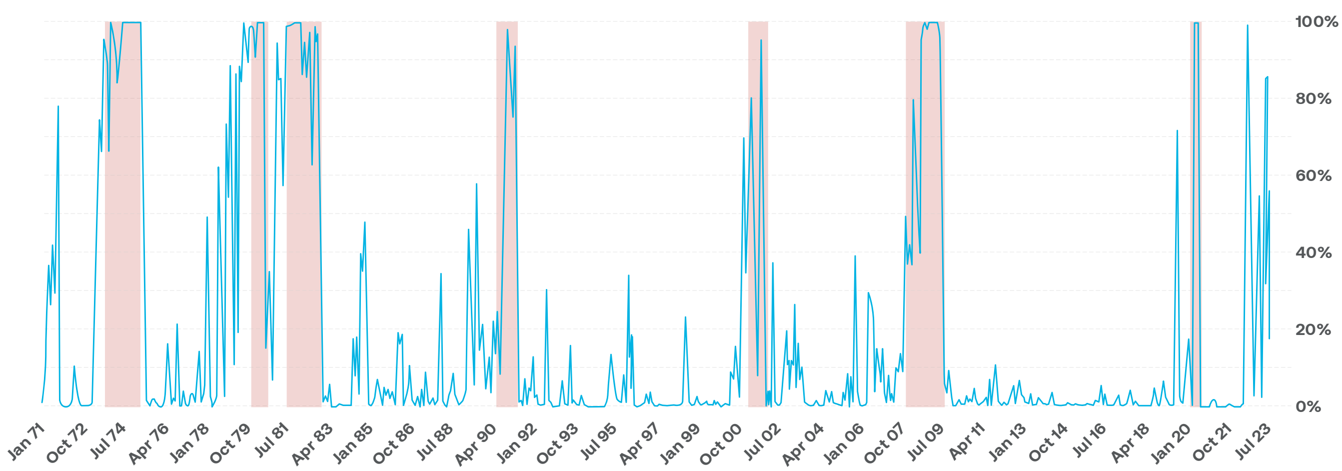
Until now, we have portrayed an American economy that has remained relatively shielded from the intensi-

Probability of a US Recession Usign our Probit Model

Source: Insigneo-Forefront Recessionary Indicator

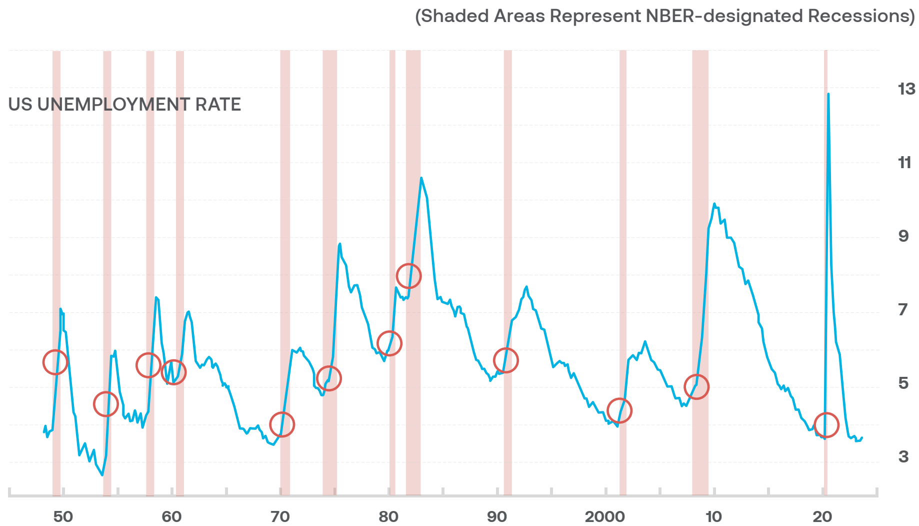
Over the Next 6 Months ~ 17% (Pseudo-R2 = 53.51%) | Over the Next 12 Months ~ 85% (Pseudo-R2 = 56.23%)

(Shaded Areas Represent NBER-designated Recessions)



Since WWII, US Unemployment Rate Has Never Risen More than a Third of a Percent Without a Recession

There has never been a case in the post-war era where the three-month moving average of the unemployment rate has risen by more than one-third of a percentage point whithout a recession taking place.

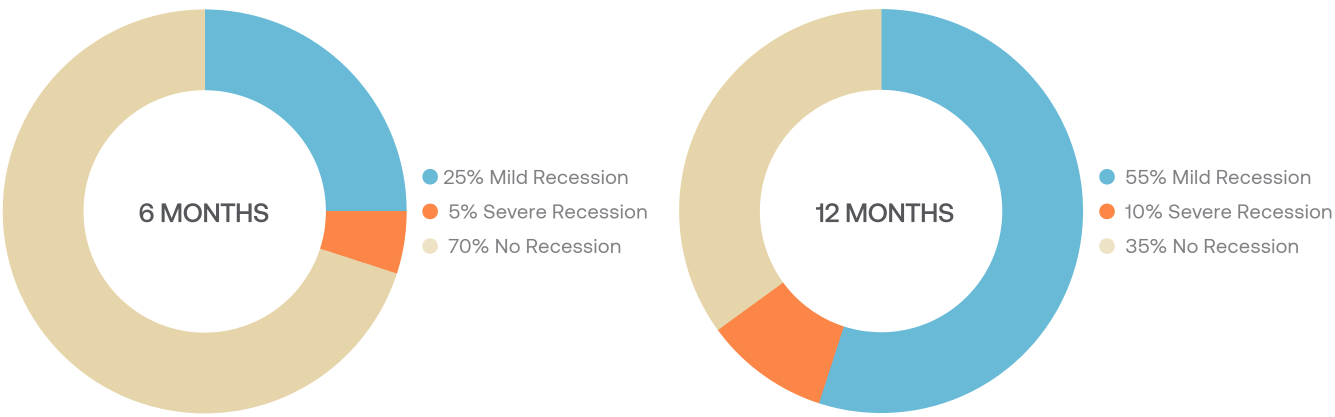


Source: BCA Research

fied cycle of rate increases initiated in 2022. However, economic principles must regain control eventually, correct? As Milton Friedman remarked, the influence of monetary policy is characterized by long and variable lags. So, an increase of 550 basis points in rates is bound to impact the US economy at some point, right? Yes, in due time. Predicting a recession is invariably challenging, but fortunately, we have numerous resources available, and even if no model is flawless, some can be advantageous. Our Insigneo-Forefront Recessionary Probit model indicates that, while a recession is not immediately on the horizon, it is highly probable within the next year. Presently, it projects a mere 17% likelihood of a recession in the upcoming six months but anticipates an 85% chance within twelve months, suggesting a commencement in the second or third quarter of 2024. A recent study by the Chicago Fed posits that the delayed consequences of elevated interest rates will diminish real GDP by an additional 3 percentage points in the succeeding five quarters compared to a situation where rates remained unchanged. This accounts for roughly a third of the total influence on output due to the Federal Reserve's tightening measures. The Chicago Fed speculates this would suffice to align inflation with the Federal Reserve's objectives by mid-2024 without inducing a recession, implying no further rate hikes are necessary. While we understand the perspective that a temporary stabilization is achievable, we question its sustainability. This skepticism arises because when an economy reaches full employment, factors accelerating growth can fuel inflation, whereas those decelerating growth can result in increased unemployment. Also, due to reinforcing cycles, once unemployment escalates, it tends to persist. The chart above illustrates that the unemployment rate typically decreases gradually but ascends more abruptly. The descent is gentle, but the ascent is rapid. Up like a rocket, but down as a feather. Integrating our recessionary probit model with decision trees that consider elements like policy errors and external shocks, we formulate our comprehensive subjective recessionary probability framework. **In the forthcoming six months, we estimate a 70% chance of avoiding a recession, a 25% probability of a mild recession, and a mere 5% likelihood of a severe one. Within a year, the odds of a mild recession increase to 55%, the chances of avoiding a recession decrease to 35%, and the probability of a severe one slightly rises to 10%. For clarification, we define a mild recession as a scenario where the U-3 Unemployment Rate exceeds 4% but stays below 6%. In conclusion, we anticipate that the US is likely to experience a mild**

Subjective Recessionary Probabilities Over 2-Quarters & 4-Quarters Incorporating All Factors

In our Decision Tree, a “Mild Recession” is defined as U-3 Unemployment Rate of 4% ≤ U3 ≤ 6%



Source: Insigneo-Forefront Recessionary Indicator

recession by mid-next year. We recognize the uncertainty surrounding the exact timing of the next US recession and the possibility that surplus household savings could prolong US growth beyond our optimistic projections. Nonetheless, monetary policy remains stringent in the US, and such a policy is strongly associated with recession onset within a relatively short period (typically within a year). **The countdown to a recession continues, suggesting an unfavorable risk/reward balance for risk assets through the remaining months of this year and the initial half of 2024.**

Market Implications

The table on the right illustrates that, historically, for the last five decades, stocks have typically reached their peak approximately six months before a recession commences. The longest duration between the S&P 500 peaking and the onset of a recession was thirteen months in 1970, while the shortest was in 1980, when the index plummeted just as the recession initiated. Collectively, our anticipation of a mid-2024 US recession suggests a confined window for equities to continue their ascent in the upcoming months. The next table presents a summary of some of our principal market predictions for 2023 and their evolution throughout the year. It is evident that our year-end forecast for the S&P 500 remains consistent, indicating our expectation for a relatively stable market in the fourth quarter, despite anticipated heightened volatility. **Our rate forecast also implies that we perceive the US 10-year bond has surpassed its fair market value**

For more than 50 years, US Equities Peak on Average Six Months Before a Recession Begins

RECESSIONS	S&P 500 PEAK* (MONTHS)	S&P 500 TROUGH* (MONTHS)	PEAK TO TROUGH* DECLINE (%)
DEC 69 - NOV 70	-13	+6	-36%
NOV 73 - MAR 75	-11	+10	-48%
JAN 80 - JUL 80	0	+2	-17%
JUL 81 - NOV 82	-8	+12	-27%
JUL 90 - MAR 91	-2	+3	-20%
MAR 01 - NOV 01	-7	+18	-49%
DEC 07 - JUN 09	-2	+14	-57%
AVERAGE	-6	+10	-36%

Source: BCA Research (*relative to start of NBER-designated recession)

Key US Market Forecasts & Early 2024 Outlook

Major Assumption: No New Fed Rate Hiking Cycle.

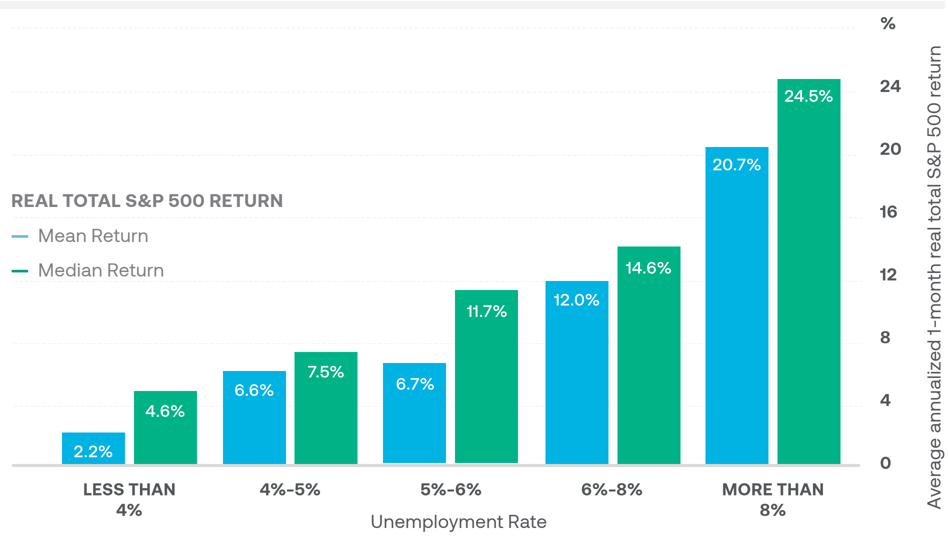
	2023 ESTIMATE (from 2022)	2023 ESTIMATE (Final)	EARLY 2024 (Early Estimate)
S&P 500	4100 to 4300	4100 to 4300	4900 to 5100
US 10-Year Treasury	3.4% to 3.65%	3.55% to 3.80%	3.0% to 3.5%

Source: Insigneo

based on economic fundamentals, and that technical factors are unduly influencing it, such as the issuance of Treasury debt and growing concerns regarding fiscal deficits. This point merits emphasis as concerns about a substantial US deficit arise while the economy is robust. Typically, the US government only runs deficits of this magnitude in extraordinary times such as war or fiscal emergencies (e.g., Covid, the Global Financial Crisis, etc.). The Congressional Budget Office estimates that the deficit equals 5.4% of GDP in 2023, and, astonishingly, that it will average 6.1% of GDP from 2024 through 2033. In fact, embedded within the CBO's assumptions for its projections is a 10-year Treasury note that yields 3.8% over that same time period. **With long-term rates at current levels, the US is beginning to compromise its exceptional funding capability, and it is now incurring a notable term premium. This plausible development tempers our stance on the current US Treasury 10-year yield of 4.5%, despite our fair value estimate of between 3.55% and 3.80%.** All these are contingent upon our belief that the Federal Reserve has concluded its tightening cycle. A resurgence in the Federal Reserve's rate hikes would adversely affect both government bonds and the stock market. As previously discussed, a well-established core disinflationary trend is evident, and a persistent rise in core inflation prompting renewed rate hikes by the Fed would be surprising. Incidentally, a single 25 basis points rate increase, if it materializes, would not constitute a new hiking cycle, in our opinion. Furthermore, we are introducing preliminary forecasts for the end of 2024, which will be refined as more data becomes available and finalized at our annual conference in January.

The following chart somewhat unexpectedly illustrates that a lower unemployment rate correlates with weaker equity market returns. Remember the illustration depicting the gradual decrease and rapid increase of the unemployment rate. Well, currently at 3.8%, the

Counterintuitively, a Low Unemployment Rate Implies Poor Equity Returns



Source: BCA Research

US unemployment rate is exceptionally low, leaving room for only one significant movement – upwards. Markets with high unemployment rates are more appealing as this indicates potential for a decrease, which generally lifts equities from their lowest points.

Despite discussions in the financial press about "higher for longer" rates, we foresee the global monetary policy tightening phase nearing its conclusion. In Q4, any last rate increases in developed economies will align with several reductions in emerging markets. As 2024 approaches and then gets underway, a phase of monetary easing will begin to prevail. By the same time next year, we expect the majority of major central banks globally, including the US Federal Reserve, to be reducing interest rates. The chart below provides a summary of our growth projections for major economic regions globally. Except for Europe, all other principal regions have experienced growth at or slightly above the trend this year. In the coming year, we anticipate all these regions to experience growth below their trend levels. The decision by the US Federal Reserve to maintain interest rates unchanged at its last meeting follows similar pauses in Australia, Canada, and New

Insigneo Macroeconomic Scorecard & Forecasts

Final Revisions for 2023 & Early 2024 Outlook. Strength in the US & Japan Outweighing Weakness in China & Europe; EM Growth Ex-China Looks Very Strong.

Source: Insigneo

COUNTRY REGION	2023 ESTIMATE (from Q3)	2023 ESTIMATE (Q3 final)	EARLY 2024 Estimate
US	1.4%	2.0% ↑ (Δ=0.6%)	1.0%
China	5.5%	5.1% ↓ (Δ=0.4%)	4.5%
Eurozone	0.4%	0.4% ↔	0.4%
Japan	1.3%	1.9% ↑ (Δ=0.6%)	0.9%
World	2.6%	2.8% ↑ (Δ=0.2%)	2.6%

Zealand. Meanwhile, several emerging market central banks, including those in China, Brazil, Chile, Hungary, and Poland, have initiated rate reductions. We project that the fourth quarter will signal a shift where rate increases are no longer predominant. Specifically, we are skeptical about further rate hikes by the Federal Reserve or the European Central Bank. We also expect emerging markets to continue reducing rates, with others joining the aforementioned list of early initiators of loosening cycles. Major developed markets may take time to join the easing cycle due to late starts and other factors such as rising oil prices. In contrast, the Bank of Japan is likely to exit negative rates next year and thus will not join the easing cycle immediately. Nevertheless, any remaining hikes by developed market central banks are expected to be outweighed by rate cuts elsewhere.

Given our anticipation of a US recession in the coming year, our recommendations will be centered around becoming more defensive in portfolio positioning over the fourth quarter. Defensive sectors, Large Caps, and US equities should outperform as global growth begins to decelerate next year. **As has been our mantra since the middle of this year, we would favor Quality-factor equites over both Growth- and Value-factor equities.** While there is some room for risk assets to outperform again here in the fourth quarter, especially if disinflationary trends persist or intensify causing a decline in bond yields, we will only advise the nimblest and volatility-tolerant investors to participate in what could be a narrow window of opportunity.

こんにちは (Kon'nichiwa), Japan!

There are mounting indications that the Japanese economy is performing exceptionally and entering a virtuous cycle of income gains and increased consumer consumption. In addition, numerous indicators suggest potential upward shifts in Japanese inflation. In Japan, a country battling deflation for thirty years, this is

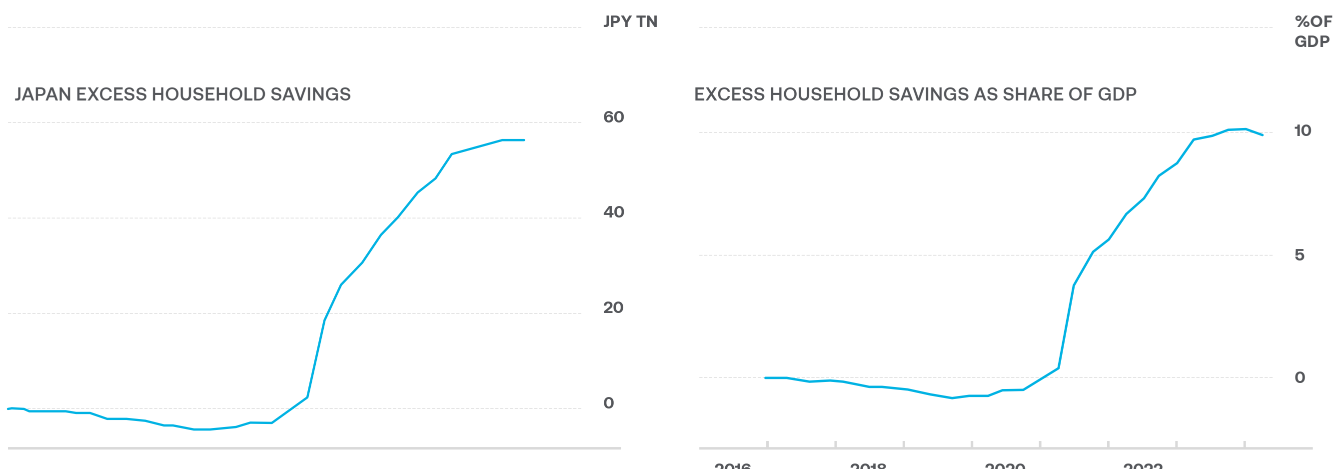
— "The key takeaway for investors is to **prioritize the Japanese Yen** while concurrently **minimizing exposure to Japanese government bonds."**

welcome news. This is likely to enhance interest-rate differentials, benefiting the Japanese Yen, especially given the currency's notable undervaluation. **On a Purchasing Power Parity basis, the Yen is undervalued by 40%. The key takeaway for investors is to prioritize the Japanese Yen while concurrently minimizing exposure to Japanese government bonds.** A suitable comparison can be drawn to the dynamics of the US Dollar and Treasuries in 2022, where it proved advantageous to invest in the US Dollar and divest from Treasuries. A parallel situation appears to be unfolding in Japan.

The key rationale behind this viewpoint is the substantial evidence suggesting upwardly revised economic surprises in the country. While the Bank of Japan has begun to unwind its Yield Curve Control program, this means that we can expect a more hawkish central bank in the near future. Japan's Q1 and Q2 2023 real GDP growth figures of 0.9% QoQ and 6.0% QoQ, respectively, reveals a nation that is experiencing high and accelerating growth. Particularly, since trend or potential growth in the island nation is only approximately 0.5% by the central bank's own estimates. The consumption activity index has returned to levels seen before the pandemic, despite a generally low propensity to consume in Japan. The country was among the last to lift travel restrictions, leading to cautious spending amid widespread economic uncertainty. As normalcy gradually resumes, accumulated demand is expected to bolster spending in Japan.

Governmental aid has also allowed households to accumulate significant savings. This graph indicates that excess savings in Japan presently constitute 10% of GDP, maintaining a robust position compared to the sharp decline in the US that we discussed earlier. The Japanese still have a lot of extra money in their pockets. Theoretically, this could enable Japanese consumers

Unlike the US, Japanese Excess Savings Remain Bouyant



Source: BCA Research

to drive economic growth at trend levels solely based on these excess savings for the upcoming five years, not including any income. Additionally, considerations are being made to extend support measures, such as fuel and gas subsidies. Signs of growing consumer confidence are becoming evident across various sectors including employment prospects, income growth, and purchasing intent for durable goods. In our view, only an exogenous shock could derail the Japanese economy at this moment. Some other risks include a deceleration in the pace of foreign machinery orders and machine tool orders. In addition, after a substantial surge over the previous two years, Japanese exports are experiencing a waning despite the currency's depreciation. However, given the substantial war chest of excess reserves amounting to 10% of GDP, Japanese consumers should be able to weather any storm quite well.

China's Taiwan Problem is Structural, Not Cyclical

While the prevailing sentiment among investors towards China is significantly bearish, mirroring the trends observed during 2015/16, apprehensions surrounding geopolitical conflicts, particularly Taiwan, have notably subsided. Presently, macroeconomic, and regulatory considerations are taking precedence over geopolitical risks, a shift we believe might be somewhat premature. **The forthcoming elections in Taiwan could play a pivotal role in determining the trajectory of cross-strait geopolitical tensions.** China possesses non-military alternatives that could have severe implications for the markets. Currently, investors should be wary of assuming that countries will overlook national security concerns or weaknesses in favor of economic progress and stability.

China, with its vast geographical core territories and highly-educated and rapidly-urbanizing population is

— "The forthcoming **elections in Taiwan** could play a **pivotal role** in determining the trajectory of cross-strait geopolitical tensions."

as a formidable global power. Just for comparison, the United States produced six hundred thousand PhDs in STEM fields last year. China produced four million. However, its natural constraints, including deserts, mountains, and distant islands, affect its control and access to the sea. Historical and current tensions with neighboring islands and nations have remained, especially with Taiwan, a potential launchpad for attacks on China's critical supply lines and ports. The inherent threat that Taiwan poses to China, and vice versa, remains, regardless of the peaceful intentions of their leaders. Contemporary events, such as Russia's invasion of Ukraine, underline that geopolitical concerns continue to shape nations' actions, despite advancements in globalization and democracy. Economic prosperity and integration do not necessarily overshadow national security objectives. The persistence of conventional warfare amongst affluent nations demonstrates that security interests often surpass economic ones.

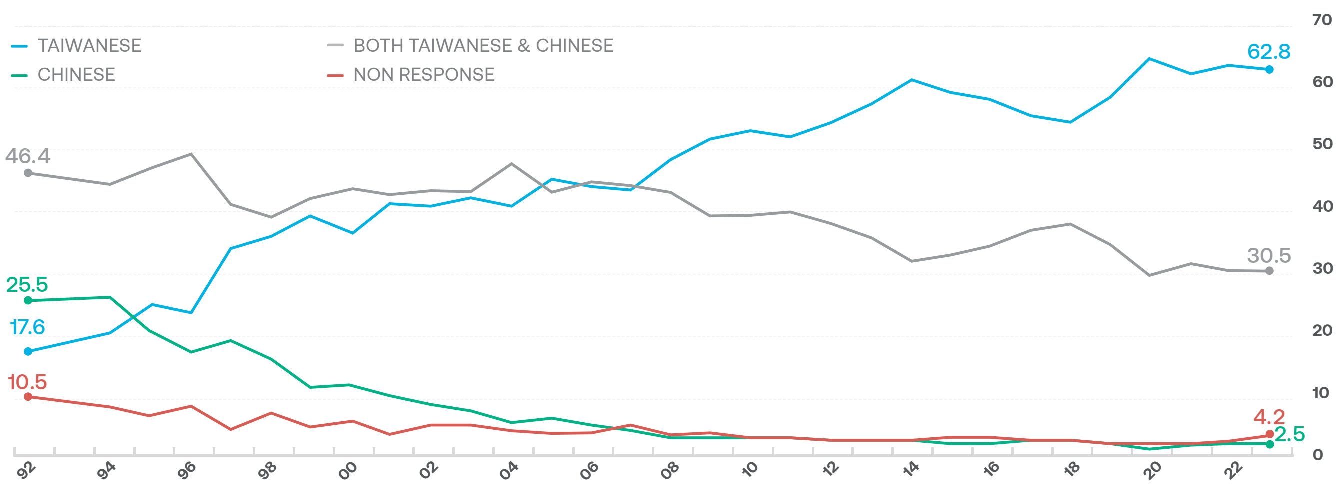
That means that the likelihood of China's Xi regime engaging in preemptive wars, risking economic and societal stability, remains uncertain. The domestic perception of national capabilities might concurrently underestimate the opposition from other nations. Strategic failures in deterrence have been highlighted by events like the Ukraine war and have implications for China, where the risks of erratic or aggressive national policies are elevated under Xi Jinping's consolidated rule. Currently, China's focus is on addressing domestic economic challenges, technological advancement, and preparing for potential conflicts, emphasizing a quest for self-sufficiency, and acknowledging vulnerability to external influences.

The challenges facing China in a potential invasion of Taiwan are considerably greater compared to Russia's invasion of Ukraine. Russia serves as a cautionary example, emphasizing restraint against engaging in direct conflicts with the West. Despite China's untested military capabilities, the efficacy of the US's strategic deterrence, particularly in minor or unconventional actions aimed at undermining Taiwan's resolve, remains questionable. China can employ a variety of non-military strategies to weaken Taiwan's economy and will. Meanwhile, the consensus within the US political system on countering China's influence and supporting Taiwan introduces additional complexities. The outcome of Taiwan's 2024 Election will significantly influence cross-strait relations, with different parties representing varied prospects for dialogue and strategic détente. A change in political power in Taiwan could alter Beijing's approach, favoring gradual integration over military conflict, especially given the strategic significance of Taiwan's prized technological assets – its high-end semiconductor foundries.

However, even if there is a change in political power in Taiwan, the potential for conflict persists eventually. The distinct Taiwanese identity and their unwillingness to compromise on freedom and security pose challenges to integration. This chart indicates **that approximately 63% of the population identifies exclusively as Taiwanese. This shift in identity, coupled with China's aggressive policies under Xi Jinping, has distanced the democratic Taiwanese further from the Mainland, limiting the concessions that could be made during negotiations.**

In anticipation of the upcoming elections, investors should brace for escalating policy uncertainties in both China and Taiwan. The election results will be instrumental in dictating whether tensions escalate or

Changes in the Taiwanese/Chinese Identity of Taiwanese as Tracked in Surveys by the Election Study Center, NCCU (1992-2023.06)



Source: Election Study Center, National Chengchi University de-escalate in the short-term. While a full-scale invasion by China is not imminent, in our view, a reelection of the Democratic Progressive Party could lead to intensified economic, cyber, and diplomatic pressure on Taiwan. Failing this, Beijing might explore other tactics, including asserting maritime authority, imposing embargoes, or employing hybrid military strategies against Taiwan's territories. All these actions would increase the geopolitical risk premium on East Asian risk assets.

Looking Ahead to the Seminal US 2024 Election

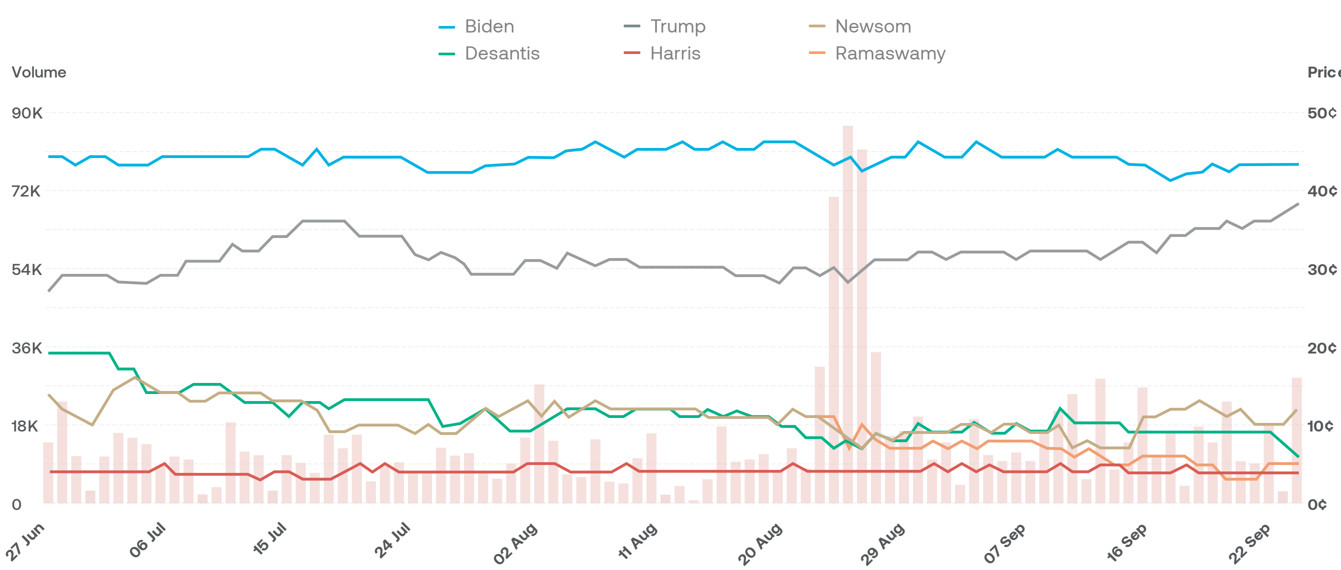
During the upcoming electoral frenzy, it is essential for investors to adopt a systematic, unbiased strategy towards US politics and policy, which is the goal of this section.

This chart Illustrates that the foremost candidates for the 2024 presidency – Biden and Trump – would both be in their second term and of advanced age, potentially resulting in a more assertive foreign policy. A candidate in their first term, such as someone following Trump's path like Governor Ron DeSantis of Florida, would likely face constraints if financial market instabilities jeopardized their chances for re-election. However, as the chart indicates, the prospect of a candidate other than the two front-runners, like DeSantis, is dwindling. Consequently, the likelihood of having second-term presidents in 2024 is high.

Biden's chances of re-election are somewhat uncertain compared to those of his party. This is not because he is less likely to secure a victory compared to another Democrat—historically, he has a better chance. Instead, uncertainties surrounding Biden's age and health are factors that need consideration. Vice President Kamala Harris, the most probable successor to Biden, would remain a strong contender provided no economic downturn occurs. Harris's perceived shortcomings are often exaggerated; she adequately represents the

US 2024 Presidential Elections Market

Source: PredictIt, September 25, 2023

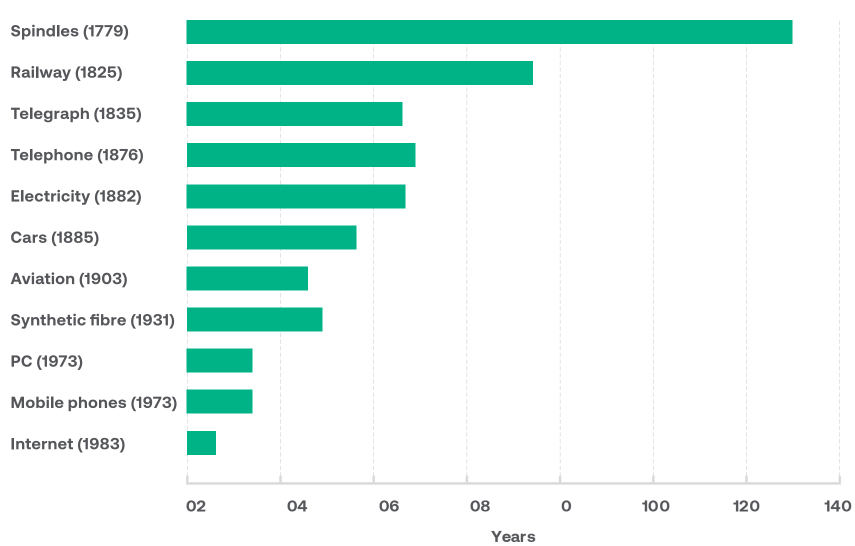


party. A non-recessionary election with her as the candidate would likely center around societal topics, primarily women's rights, such as abortion. Trump is expected to maintain support among Republicans unless he faces incarceration. Incarcerating him before the election would be challenging but feasible. Of all the cases open against him, the third round of indictments in Washington DC seems most likely to result in a conviction. Ultimately, political influence, rather than legal or ethical considerations, will shape the outcome of Trump's case, as almost every post-election scenario under a Republican administration would likely lead to a pardon. While imprisonment does not legally hinder Trump, it would politically, in our view. In such a scenario, the Republican National Committee might opt for a younger, more appealing candidate to consolidate the party. DeSantis serves as a suitable alternative to Trump, with his alleged flaws, like those of Harris, often overstated. In our opinion, the Republicans' chances of victory would increase behind a fresh face, like Vivek Ramaswamy, particularly if the US economy avoids a recession. If a combination of strict monetary policies and sluggish international growth causes a downturn in the labor market, then it makes Republicans the favorites. This holds even with Trump being the most likely nominee, and more so if another candidate represents the party. **In sum, it is important to remember that the most likely determinant of who will win a contest between Biden and Trump is the answer to the following question: Is the US in a recession by the middle of 2024? If the answer is yes, Trump is the most likely victor. If the answer is no, then Biden should prevail.**

Gauging AI's Economic and Market Impact

The financial media is abuzz with opinions on how AI is set to transform our lives, whether for good or ill. Numerous studies illustrate the benefits of AI on worker productivity within specific sectors or industries, such as a frequently mentioned Stanford-MIT study, which reported a 14% increase in productivity for call center workers following the integration of generative AI. However, the crucial factor for the macroeconomy is the impact on the productivity of the workforce as a whole. AI represents a novel form of capital, which inevitably influences productivity by increasing the capital available per worker. More significantly, AI is

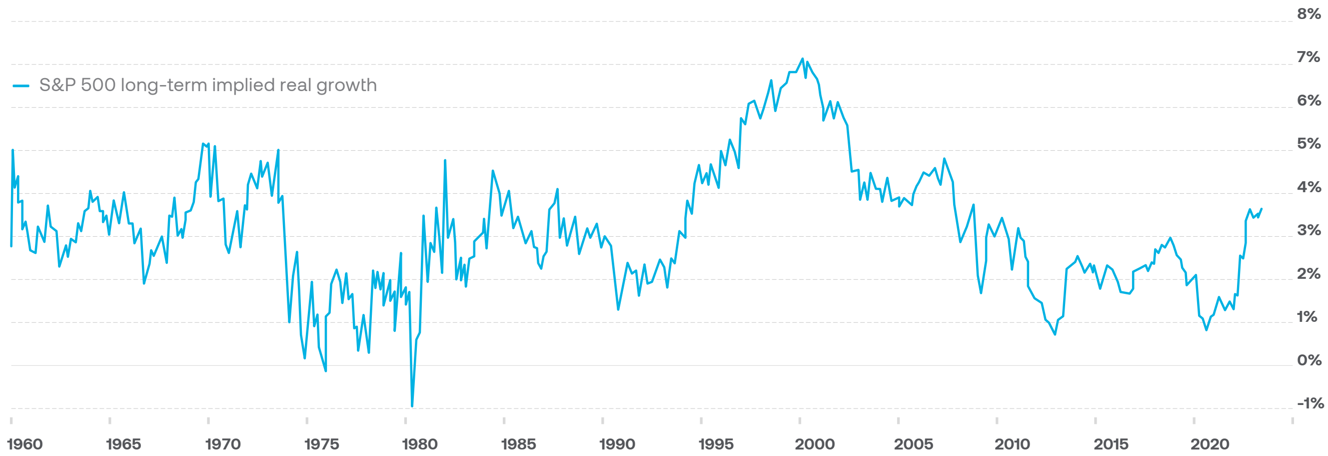
Lags in Technology Adoption (Years)



Source: Comin & Mestieri (2018)

Given Long-Term Implied Growth, S&P 500 is Neutral

Long-term implied real growth = ERP (4%) + 10-year yield – dividend yield – 10-year breakeven



Source: Datastream, Goldman Sachs Investment Research

expected to enhance "multi-factor productivity," a term economists use to describe the efficiency with which labor and capital are utilized to generate output. It is important to acknowledge that technological advancements and their accompanying productivity benefits do not materialize instantaneously. Adapting infrastructure and processes to leverage new technologies is a gradual process, although these adoption times are decreasing. The chart on the previous page indicates that while the telegraph, introduced in 1835, became widespread later in the 19th century, the adoption rate for technologies like mobile phones and the internet was much quicker. Investors seem keen on securing immediate investment rewards from a technology that is likely to gradually permeate through the economy for a few more years, at least. While AI may primarily impact the broader economy by the next decade, it is already a significant influencer of equity market performance this year as seen by extraordinary stock returns in names linked to it.

All this attention has sparked debates about its larger influence on equities, market leadership dynamics, and the possibility of another financial bubble. The aftermath of a burst bubble typically sees the rise of dominant enterprises within that sector and the technology's ripple effects across other industries. Presently, technology dominates the US market on a market cap basis, and there has been a notable increase in stock concentration, echoing past innovation trends. However, today's tech sector valuations are not as inflated as during past bubble eras, and the current frontrunners boast robust balance sheets and returns on equity. The chart above indicates that the S&P 500's valuation, based on its projected real growth rate, is not nearly as high as one might assume, especially when compared to past cyclical highs like the 1980s, the tech bubble of the early 2000s, or the 2006 real estate bubble. **We might be in the early phases of a technological revolution that could result in continued market dominance by these companies.** ■

House Views Matrix

	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
US Equities[1]	NEUTRAL	OVERWEIGHT
European Equities	NEUTRAL	NEUTRAL
Japanese Equities	NEUTRAL	OVERWEIGHT
Emerging Market Equities	NEUTRAL	UNDERWEIGHT
Chinese Equities	NEUTRAL	UNDERWEIGHT
US Treasuries[2]	NEUTRAL	OVERWEIGHT
Investment Grade Fixed Income	NEUTRAL	UNDERWEIGHT
High Yield Fixed Income	NEUTRAL	UNDERWEIGHT
Emerging Market Sovereign	OVERWEIGHT	NEUTRAL
US Dollar	NEUTRAL	OVERWEIGHT
Energy[3]	NEUTRAL	OVERWEIGHT
Precious Metals	UNDERWEIGHT	UNDERWEIGHT
Cash	OVERWEIGHT	OVERWEIGHT

[1] *Relative to global equities in USD*
[2] *Relative to aggregate fixed income markets in USD*
[3] *Relative to an overall commodity allocation*

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