Market Commentary
**July 2024**

English Version

# Hidden Vulnerabilities, Election Waves and the New Space Race:

An Investment Guide for the Remainder of 2024.

## Quarterly Call Q3 | 2024

Get guidance on investments, and the major structural factors behind your clients' portfolios.

insigneo

**Ahmed Riesgo**
Chief Investment Officer

## Executive Summary

The US economy is losing momentum, and the three main drivers of consumption (i.e., wage growth, savings, and credit availability) are diminishing.

A broad equity selloff is unlikely until there is clearer evidence of an impending recession, so it may take several months for earnings expectations to align with deteriorating economic reality.

Our overall subjective US recessionary probabilities including all factors over the next six and twelve months are 40% and 60%, respectively.

Recent stock market price increases have pushed equity valuations higher, and this suggests that stocks may be overpriced and vulnerable to a market correction even if our base case is wrong and a recession is avoided.

In fixed income, we expect bond yields to drop cyclically before eventually resuming their structural uptrend once the recession has abated.

Within equity portfolios, we recommend a defensive tilt by overweighting consumer staples, healthcare, and utilities.

The U.S. presidential election, a significant event risk this year, has garnered increasing attention recently.

Prediction markets have shown Trump widening his lead following Biden's poor performance in the first debate.

As of June 30th, the probabilities hover around the following levels: Trump 57%, Biden 21%, Newsome 7%, Obama 6%, Harris 5%, and RFK, Jr 1%.

Sweeping and/or large tariffs could cause an inflation spike, making the Federal Reserve less likely to cut rates even if the US economy finds itself in a mild recession as we expect.

Under a Republican sweep, significant policy changes should be expected, and a stronger U.S. dollar is the most plausible outcome; in this scenario, the two main risks are yields rising rapidly or a negative market reaction to unexpected tariff surprises.

While everyone in private investments is focused on AI, investors should look to Space as an incredibly attractive alternative; SpaceX's recent valuation of USD 180 billion in the private market, exceeds any IPO in history and highlights the sector's appeal.

Given that SpaceX is already a well-known investment opportunity that is priced on the higher end for similar companies, but offers superior growth prospects, we would urge investors to look for private investments among other private companies, particularly those that supply critical components for companies like SpaceX; buy the "picks and shovels" for the oncoming gold rush in Space.

## Introduction

Presently, global investors have developed an unwarranted confidence in the durability and resiliency of the US economy. So far, equity markets have managed signs of slowing US economic growth well, benignly interpreting them as harbingers of a more accommodating Federal Reserve and lower bond yields. Our concern is that growth could slow to the point where negative economic news negatively impacts stocks again. **We fear that we will soon move from a world where "bad news is good news" for risk assets to one where bad news is just that...bad news.**

Furthermore, the extraordinary returns of the largest companies are masking weaknesses in other segments of the market. For instance, the S&P 500 equal-weighted index has remained mostly flat over the past 2.5 years, and the Russell 2000 has been stagnant for even longer, despite 25% nominal GDP growth over the past three years. Similarly, only a small portion of S&P 500 companies have driven the earnings revisions for 2024 and 2025 EPS growth over the past year. The top 20 are +18% and +22%, while everyone else is -6% and -3%, respectively. Since Nvidia's earnings surprise in May 2023, six S&P 500 stocks related to large language models have accounted for 65% of the index's gains during this period and 75% year-to-date. For perspective, the market value of these LLM stocks is $15 trillion, equal to the combined market capitalizations of Germany, Japan, India, and Brazil.

This raises the question: **Will the US economy remain strong enough to allow more cyclically driven market sectors to catch up, or will it enter a recession, ensuring that more defensive, quality stocks continue to dominate?** We think the latter is much more likely. The US avoided a recession in 2023 due to the use of excess household savings and significant growth contributions from fiscal spending. However, the fiscal impulse is expected to be negative this year, and various measures of excess savings indicate they are already depleted.

Forward-looking indicators of the US labor market are suggesting rapidly declining demand for workers. Rising consumer loan delinquencies support the view that excess savings have been exhausted, business loan lending standards remain strict, and overall US credit growth is very weak. **In sum, the US economy is losing momentum, and the three main drivers of consumption (i.e., wage growth, savings, and credit availability) are diminishing.** Although inflation is likely to continue its downward trend, a return to target levels has been delayed. This delay, combined with investor expectations that the Fed funds rate will remain above the estimated neutral level even a year from now, suggests the Fed may be too late in its attempt to pivot.

**Now, a widespread equity selloff is unlikely until there is clearer evidence of an impending recession, prompting downward revisions of earnings estimates.** Since the economy can continue to slow gradually and recessions are only typically recognized after the fact, it may take several months for earnings expectations to align with deteriorating economic reality. **Nonetheless, an overvalued equity market, extreme investor bullish sentiment, and decreasing equity risk premia indicate elevated downside equity risk.** Therefore, we are hesitant to pursue higher market gains at this late stage of the economic cycle as current evidence suggests a US downturn by early 2025, with equities typically peaking, on average, six months before the onset.

## Macroeconomic Outlook

Surprisingly, our Insigneo-Forefront Recessionary Indicator has produced a lower recessionary reading over the next 6 months in the latest June update.

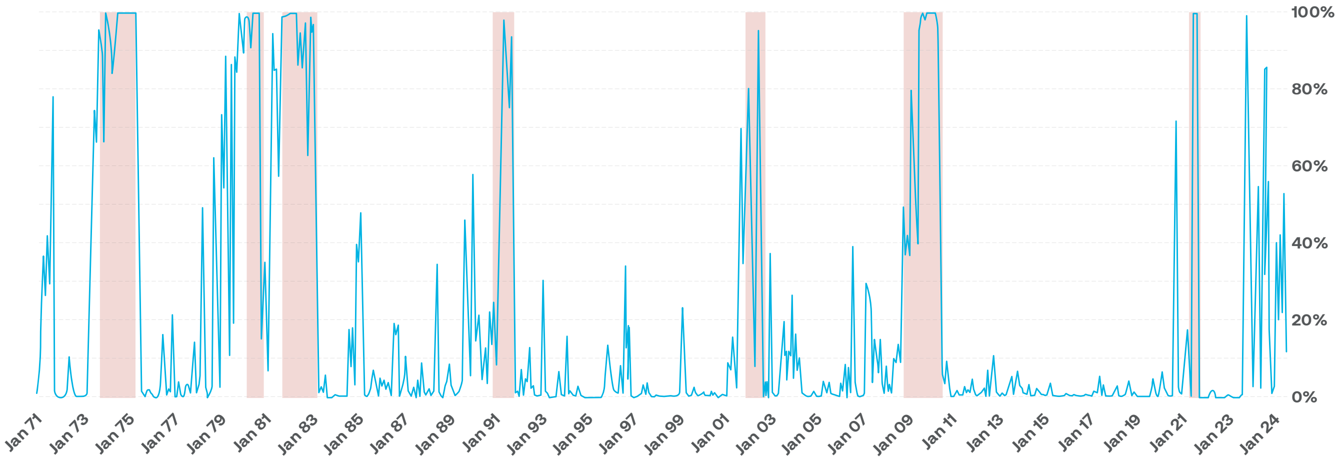
However, over a 12-month window it remains elevated

### 1. Probability of a US Recession Usign our Probit Model

Source: Insigneo-Forefront Recessionary Indicator

Over the Next 6 Months ~ 12% (Pseudo-$R^2$ = 52.08%) | Over the Next 12 Months ~ 64% (Pseudo-$R^2$ = 51.00%)

(Shaded Areas Represent NBER-designated Recessions)



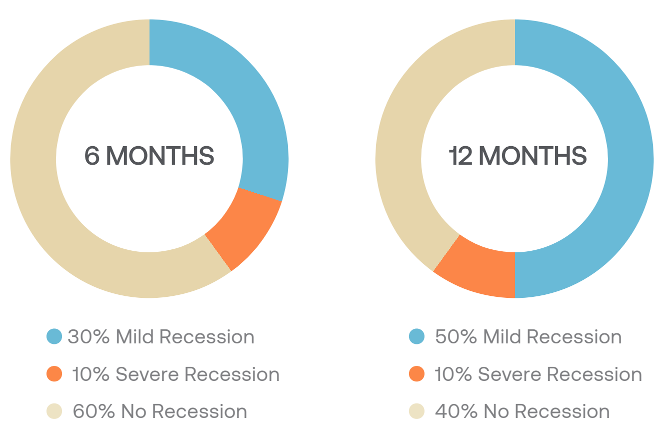

at ~64%. We use our model as one of several inputs into our decision-making process. Lately, it has become noisier, statistically-speaking, as evidenced by a slightly lower pseudo-$R^2$. To be sure, a pseudo-$R^2$ of 52.08% is still a strong signal and means that the model explains more than half of the variation in the dependent variable, which typically suggests a relatively good fit and reasonable predictive power for the model. But the uniqueness of the post-pandemic environment, in our opinion, has mildly diminished its signaling capability, and we have adjusted our overall subjective probabilities accordingly to adjust for this by including new variables.

**Our overall subjective recessionary probabilities including all factors over the next six and twelve months are 40% and 60%, respectively.**

Historically, recessions in the U.S. have typically begun about two years after the Federal Reserve starts raising interest rates, and they often begin suddenly and unexpectedly. We are now at 27 months. And despite

### 2. 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

### 3. Is This Time Really Different?

Long & Variable Lags in US Monetary Policy

Number of months between the first hike in fed funds rate and the start of a recession

--- MEDIAN (24 months)


Source: Federal Reserve, BCA

a current real GDP growth rate of 1.4%, this fact alone does not preclude a recession, as past data show a median GDP growth rate of 2.1% in the quarter before a recession begins.

Recessions occur abruptly due to the kinked Phillips curve, which shows a non-linear relationship between inflation and unemployment. When unemployment is high, companies can hire without raising wages, but once full employment is reached, hiring leads to higher wages and prices. This cycle is usually halted by reducing aggregate demand through tighter monetary policy. The kinked Phillips curve framework has been an especially useful predictive tool since the pandemic.

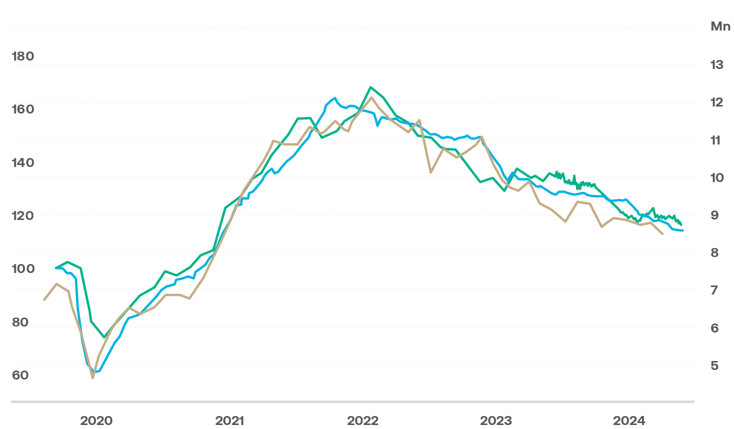
In 2022, it correctly predicted no recession when others expected one, and in 2023, it foresaw immaculate disinflation rather than significant economic pain. For 2024, it predicts a sudden recession by the end of the year or early 2025.

Because the labor supply curve was steep, we avoided a recession over the past two years. This led to lower wage growth and job openings when labor demand weakened. However, job openings have decreased significantly, and other labor market indicators also show softening. In addition, households no longer have significant excess savings. The Federal Reserve Bank of San Francisco, for example, estimates that they were

### 4. US Job Openings Are Trending Lower

Rebased to 2020

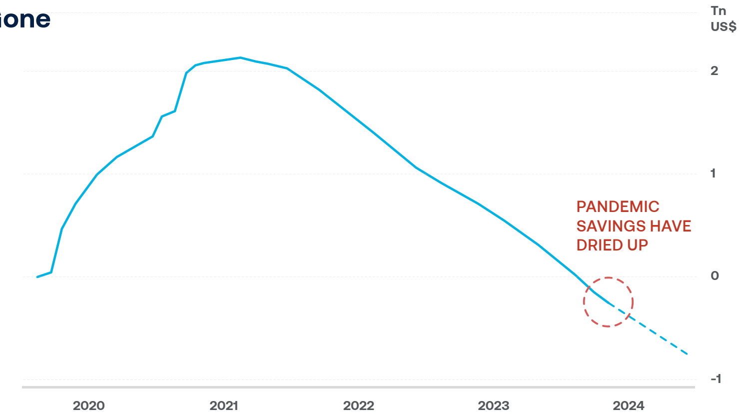
— INDEED (LS)
— LINKUP (LS)
— JOLTS (RD)




Source: BCA

## 5. US Pandemic-Related Excess Savings Are Gone

Estimated US excess household savings



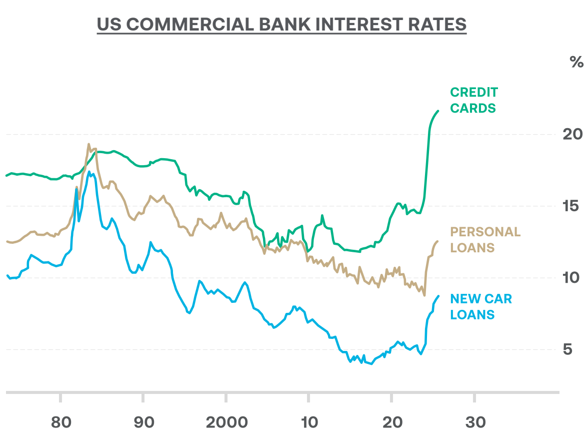

Source: Federal Reserve Bank of San Francisco

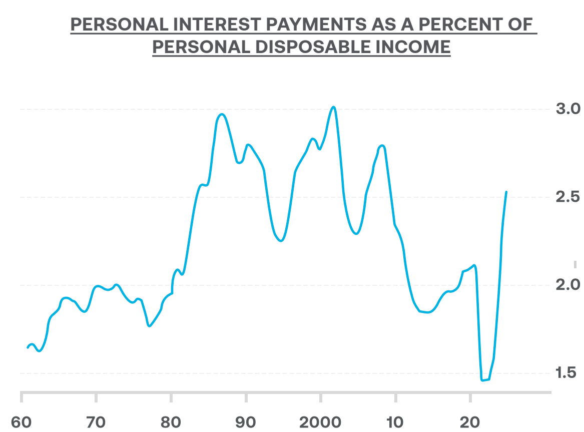
extinguished earlier this year in the US. Furthermore, borrowing against future income has become difficult with rising delinquency rates and tighter lending standards. In fact, **personal interest payments as a percentage of disposable income are back to where they were in 2010, a year in which the unemployment rate averaged 9.6%.** Credit cards, personal loans, and new car loans are also gapping higher. All this leads to reduced spending and higher unemployment, creating a negative feedback loop. Business investment is also expected to decline despite high stock market performance and enthusiasm over initiatives like AI investment and the CHIPS Act. Commercial construction starts are at a 12-year low, and weaker consumer demand will further reduce business expansion plans.

Even potential Fed rate cuts might not prevent a recession due to concerns over a second wave of inflation and the effective tightening of monetary policy. Remember, the interest rates paid by households and businesses, not just the Fed funds rate, are crucial for the economy and it takes a while for both hikes and cuts to percolate through the economy. Earlier, when discussing our overall recessionary probabilities, we mentioned that the odds of the US succumbing to a recession were 40% and 60% over a six- and twelve-month timeline. **The inverse, obviously, then is that the no recession outcome currently stands at 60%**

## 6. US Consumer Financial Picture is Getting Gloomy

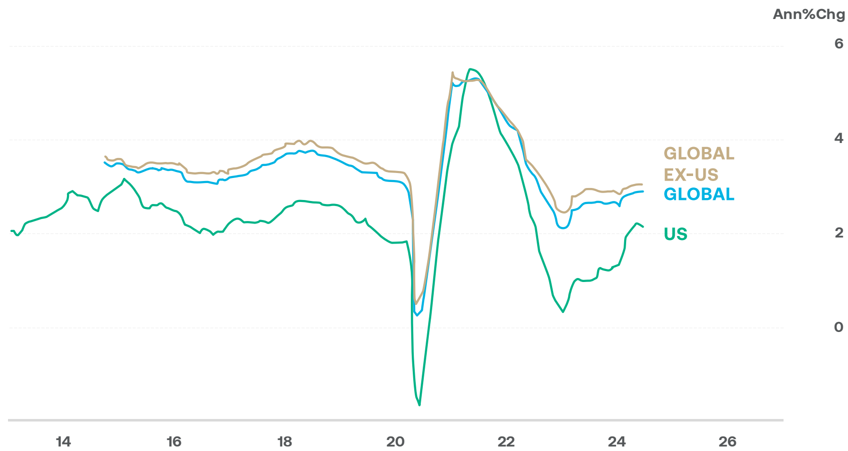
Source: Federal Reserve, BCA



## 7. Global Growth Expectations Heading Higher

1-Year Ahead Real GDP Growth Forecast




Source: Bloomberg, BCA

**and 40% over that same horizon, so it is not trivial and there is a possible and credible path to a soft landing in the US.** However, it requires several favorable conditions, such as a balanced labor market, stabilized cyclical spending, benign loan delinquency rates, inflation back to target, and improved global growth. It is a narrow path.

Indeed, global growth expectations outside the U.S. are rising, especially in Europe, where real wage growth has improved. European households, unlike their US counterparts, have substantial excess savings, indicating pent-up demand for durable goods. However, higher interest rates on consumer loans in Spain and Italy and tighter fiscal policy in Germany could weigh on spending. We doubt the European growth story would survive a US recession.

In China, the economy is split between a weak property market and a strong export sector. While export growth has accelerated, domestic demand remains subdued due to a weak housing market. We do not see any material improvement in the Chinese property market and believe that it will be a multi-year deleveraging cycle. Home prices are still high relative to rents, and a shrinking working-age population will reduce demand for new homes.

**In sum, because the US has been the largest driver of the global manufacturing cycle's stabilization and the Chinese economy is unlikely to compensate for receding US demand, we expect the US recession to morph into a global recession eventually.**

## Market Outlook

Given our views, it is prudent to underweight equities now. **Recent price increases have pushed equity valuations higher, and this suggests that stocks may be overpriced and vulnerable to a market correction even if our base case is wrong and a recession is avoided.** With inflation above the Fed's target and the economy not broken, the market has been viewing poor economic data as a positive sign, expecting less aggressive monetary tightening. However, we are nearing a point where negative economic data will negatively impact risk assets.

**Increased recession risk generally benefits bonds, so we advise investors to move proceeds from equities into cash and high-quality long-duration government bonds, such as U.S. Treasuries.** As central banks raised policy rates to curb inflation, real bond yields surged, leading to declines in equity risk premia. Declining ERP suggests that holding equity is becoming less attractive compared to bonds. Despite this, investor sentiment remains very bullish. High investor confidence combined with decreasing rewards for taking equity risks over bonds suggests increased downside risk for stocks. **Within equity portfolios, we recommend a defensive tilt by overweighting consumer staples, healthcare, and utilities.** We suggest underweighting consumer discretionary stocks, financials, and real estate, and downgrading energy, materials, and industrials if recession risks rise further.

— “In fixed income, we expect **bond yields to drop cyclically** before eventually resuming their structural uptrend once the recession has abated.”

The technology sector presents a dilemma. Without the top 20 largest companies, the S&P 500 would be trading around ~4700, or about 15% lower than levels as of June 30th. For this trend to continue, these companies must keep revising estimates higher to maintain price momentum, which is challenging given the high consensus earnings growth forecasts of 12% for the rest of this year and 14% for 2025. In other words, consensus estimates imply a double-digit growth rate despite a mature business cycle with slowing demand, peak margins, and diminishing buyback effects. While tech has performed well, it is time to look for opportunities elsewhere. Therefore, we would reduce our tech overweight to neutral, assuming the sector will struggle if a weakening economy dampens sentiment towards highly valued AI stocks. Nevertheless, their market dominance should not be challenged in the near term, though eventually it will be.

Of course, a recession would disproportionately harm smaller companies, many of which are highly cyclical and reliant on bank financing. However, small caps are trading at a significant discount to large caps, limiting relative downside risk.

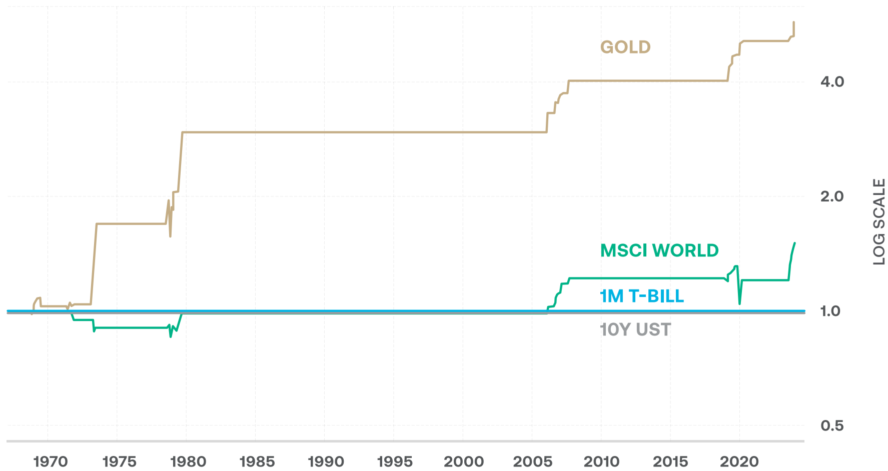
Typically, U.S. stocks outperform during recessions. While we expect U.S. stocks to outperform during the upcoming global recession, the margin of outperformance will likely be narrow because U.S. equities are expensive relative to non-U.S. stocks. **In fixed income, we expect bond yields to drop cyclically before eventually resuming their structural uptrend once the recession has abated.** We also advise underweighting corporate credit in fixed-income portfolios. The U.S. default rate has risen to 5.3% from 1.2% in February 2022, yet high-yield spreads have decreased, suggesting that the current level of spreads is unjustifiable.

Future U.S. dollar strength will depend on global growth trajectories. The dollar tends to strengthen when global growth weakens, so it may appreciate if a global recession occurs later this year. However, the dollar is overvalued by 20% relative to its purchasing power parity exchange rate, so significant appreciation is unlikely. **The Japanese yen would also function as a good hedge during a recession.** If other central banks cut rates sharply, the interest rate differential with Japan will narrow, boosting the yen.

Commodities are classic late-cycle investments, with oil prices often peaking after a recession starts, magnifying economic downturns. **Once a recession is apparent though, commodity prices will react negatively.** While the cyclical demand outlook for industrial metals remains challenging, the structural

### 8. Gold Outperforms All Others in Stagflation-like Environments

Asset class returns on logarithmic scale when current economic environments are similar




Source: Gavekal-IS, Macrobond

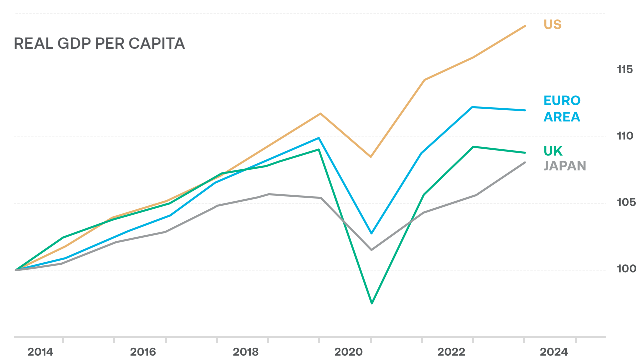
picture is brighter due to the growing EV market, the renewable energy transition, and the proliferation of data centers.

Gold prices typically fall when real interest rates rise and the dollar strengthens. Despite these factors, gold prices recently hit a record high. Emerging market central bank demand for gold has supported prices, with China's gold reserves increasing significantly from 1% in 2008 to 5% today. **In low growth and high inflation environments like the mid-to-late 1970s and early 1980s, gold has historically outperformed other assets.** Remember that Treasury Bills, Bonds, and gold are all competing forms of money. US government bonds and bills returned zero, the MSCI World index returned 9.7% a year, and gold returned 48.6% a year; by a wide margin, gold was the best performer.

Before we move on to our other topics and themes this quarter, I want to address a question we often get here at Insigneo: how long will US economic & market dominance last? **In our view, U.S. economic dominance should continue, but this alone will not necessarily translate into sustained stock market outperformance.** The U.S. economy has been the largest in the world since the 1870s and has consistently outperformed its peers in productivity and growth. In fact, in recent years, the U.S. is outpacing its developed market peers on both an absolute and relative basis. While other regions like China and Europe have potential, they face significant challenges that will prevent them from overtaking the U.S. in economic dominance. Overall, no other major economic bloc has the advantages the US does in terms of deep capital markets, an attractive immigration destination, elevated levels of R&D, and an entrepreneurial culture.

### 9. Real GDP Per Capita Growth in Developed Markets | Rebased to 2013

Source: IMF, BCA

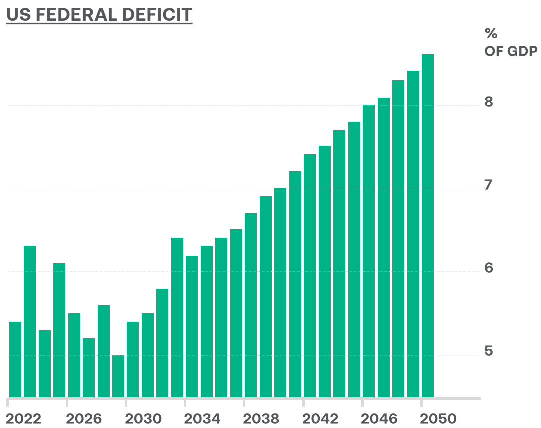


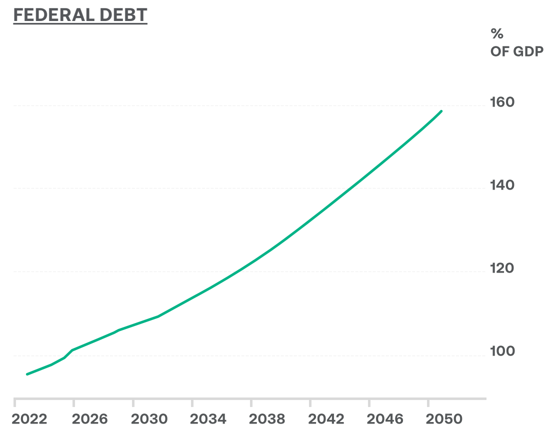

**The one significant shortcoming that could, in our view, upend US economic dominance is the precari-**

### 10. US Fiscal Trajectory is Alarming

CBO Projections Likely Understated With No Recessions Projected

Source: Congressional Budget Office




**ous state of American public finances.** The federal debt-to-GDP ratio is at a peacetime high near 100% and will continue to climb on current projections. In fact, if left unchecked it would approach 160% of GDP by 2050. If there is no fiscal consolidation, through a combination of decreased spending, higher taxes, or accelerating economic growth, then the debt spiral would only end when investors are no longer willing to buy U.S. Treasuries at yields the economy can withstand. We think this outcome is unlikely in the near future for a few reasons, three stand out above the rest (as the US is the undisputed global leader in each): rapid productivity growth from AI technologies, persistent immigration, and the rapid commercialization of space. For all these reasons, we think US economic dominance should be entrenched for the next few decades.

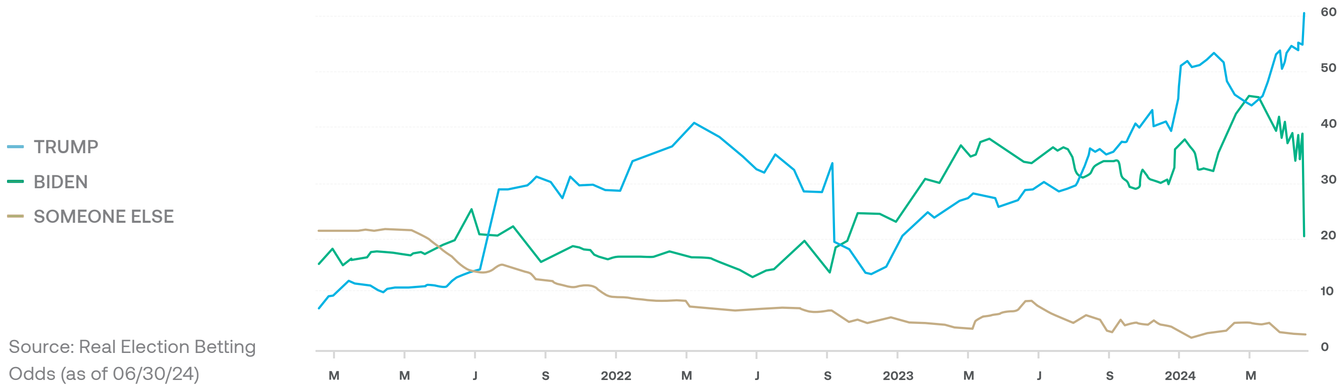
However, the other feature of American outperformance since the pandemic, equity market outperformance, may prove less resilient. Once the AI bubble inevitably bursts (perhaps months or years from now), the US stock market could significantly underperform its peers, which have not participated in this rally thus far. **In conclusion, U.S. assets should continue their run of dominance for now and into the coming recession. But on the other side of the cycle, investors should begin to reassess their regional allocations.**

## US Election Risks and Opportunities

**The U.S. presidential election, a significant event risk this year, has garnered increasing attention recently.** Unlike previous elections where the debate centered on which policies would benefit risk assets, current outcomes appear more neutral on average, but with the potential for greater significant negative outcomes (i.e., fatter left tail risk). A Biden win and a divided Congress (the most plausible scenario for incumbency at the moment) would likely result in policy continuity that would limit new disruptive policies. In contrast, **a Trump victory could lead to major substantive changes in trade policy, foreign policy, regulatory policy, and fiscal/tax policy.** Although election experts have identified seven battleground states—Arizona, Georgia, Michigan, Nevada, North Carolina, Pennsylvania, and

### 11. Probability of Winning the US Presidency in 2024

Trump ~ 60% - Biden ~20% - Someone Else ~ 20%




Source: Real Election Betting Odds (as of 06/30/24)

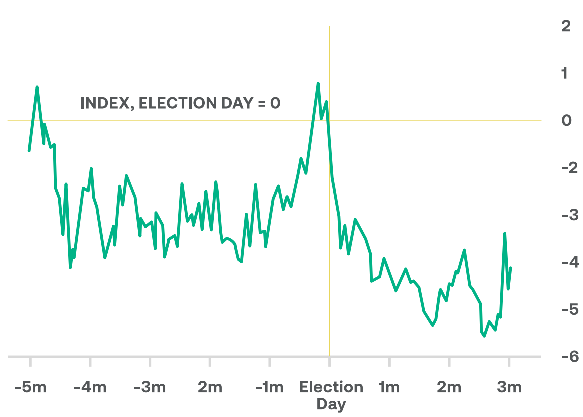
Wisconsin—where the victory margin is expected to be narrow, **prediction markets have shown Trump widening his lead following Biden's poor performance in the first debate. As of June 30th, in the wake of the now infamous first Presidential debate, the probabilities hover around the following levels: Trump 57%, Biden 21%, Newsom 7%, Obama 6%, Harris 5%, and RFK, Jr 1%.** Similarly, prediction markets assign a 38% probability to a Republican sweep of Congress, 12% for a Democratic sweep, and 50% chance of a divided Congress.

Historically, markets have priced in higher volatility one to two months before the election, traditionally aligning with the first debate. This year's earlier-than-typical debate increased uncertainty about the Democratic nominee, which could lead markets to discount election risks sooner than usual. Overall, we believe tariffs and their inflationary impact will be the most significant issue for financial markets in this US election cycle. **Sweeping and/or large tariffs could cause an inflation spike, making the Federal Reserve less likely to cut rates even if the US economy finds itself in a mild**

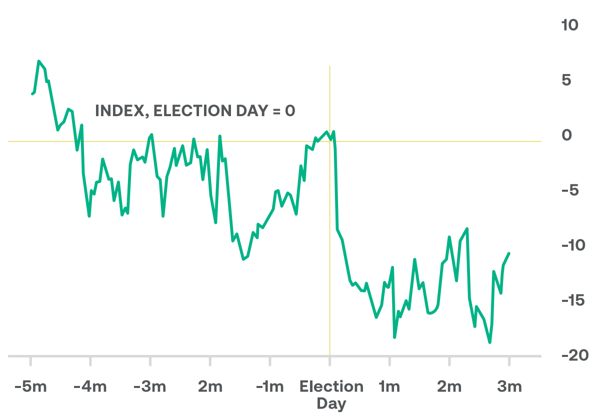
### 12. Equity & Rate Volatility Usually Begin to Appear 1 to 2 Months Before the Election

Source: Goldman Sachs

OPTION-IMPLIED US EQUITY VOLATILITY (VIX INDEX)

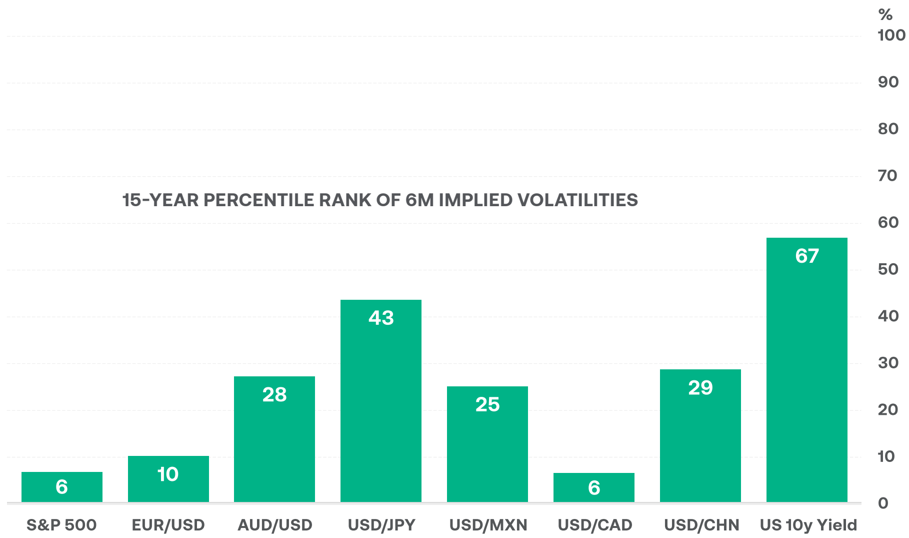



OPTION-IMPLIED US INTEREST RATE VOLATILITY (MOVE INDEX)



### 13. Implied Volatility Stemming From US Election

Only US Treasuries and JPY have Begun to Reflect Risks




Source: Goldman Sachs

**recession as we expect.** Beyond inflation, tariffs could also negatively impact companies with a high proportion of revenue driven by international sales.

Regardless of the Presidential outcome, a unified government (i.e., a blue or red sweep) would be the most bearish scenario for rate markets. **Unified government control is expected to create the most positive fiscal impulse, while divided government would lead to more fiscal restraint.** However, the fiscal impacts in all scenarios could be smaller than either 2016 or 2020 (given our dire current fiscal position). **A Trump victory, whether with a Republican or divided Congress, would be potentially the most equity bullish scenario given the potential for regulatory rollbacks, corporate, and personal tax relief.** Probably, Trump could adopt a tougher foreign policy stance, especially with China, using more Executive Orders on trade and investment. Focusing on regulatory changes, he may also reverse clean energy and environmental policies via Executive Orders as well. However, we expect a new Trump administration would include experienced politicians rather than first-term outsiders, featuring familiar, market-friendly names. On the other hand, Trump 2.0 could lead to more contentious European relations, potentially negatively affecting Ukraine's ability to continue in the conflict. The return of Mike Pompeo as Secretary of State, however, would assuage Ukrainian worries as he has recently criticized both congressional Republicans and the Biden White House as being too soft on Russia.

**Under a Republican sweep, significant policy changes should be expected, and a stronger U.S. dollar is the most plausible outcome. In this scenario, the two main risks are yields rising rapidly or a negative market reaction to unexpected tariff surprises.** Implied volatility across much of the equity complex and parts of the FX complex is still at the lower ends of its historical ranges. In other words, protection is still cheap so now is the time to initiate these hedges. U.S. dollar longs vs. G10 currencies also offer positive carry, mitigating the cost of holding positions for longer.

**At this stage, the implied moves among several asset classes under the four possible election outcomes are as follows: 1) a modest rally in equities, higher yields, and USD strength in a Republican sweep, 2) modest equity downside, moderately higher yields, and USD weakness in a Democratic sweep, 3) modest equity downside, slightly higher yields, and USD strength**

### 14. Potential Asset Price Returns Under Four Possible Election Scenarios

Baseline Estimates From Fiscal, Tax, and Trade Policy Shifts

| | R SWEEP | D SWEEP | TRUMP W/DIVIDED GOVT | BIDEN W/DIVIDED GOVT |
|---|---|---|---|---|
| **EQUITIES** | | | | |
| S&P 500 | ↑ | ↓ | ↓ | ↓ |
| **FX** | | | | |
| Euro | ↓ | ↑ | ↓ | ↑ |
| JPY | ↓ | ↑ | ↓ | ↑ |
| MXN | ↓ | ↑ | ↓ | ↑ |
| USD TWI | ↑ | ↓ | ↑ | ↓ |
| **RATES** | | | | |
| UST 10Y | ↑ | ↑ | ↑ | ↓ |

Source: Insigneo

in a Trump with divided government outcome, and 4) flattish equities, lower yields, and USD weakness in a Biden with divided government.

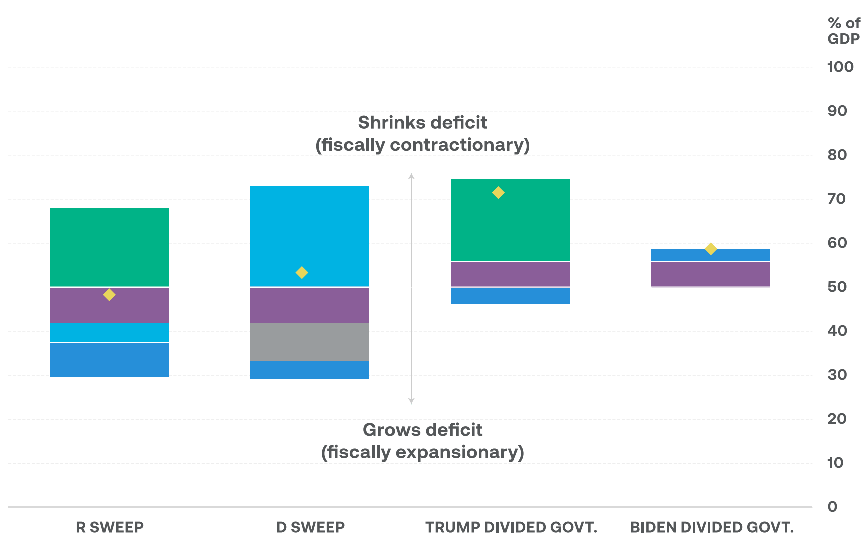
A few caveats and takeaways. First, investors should not anticipate a repeat of 2016, when a Republican sweep resulted in a broad-based risk-on rally. The macroeconomic environment today is vastly different from when Trump was first elected, with additional crosscurrents in play. Second, a stronger U.S. dollar is the most likely result of a Republican sweep because it is the most consistent response to escalating tariffs. Third, higher yields are more probable in either a Republican or Democratic sweep compared to a divided government. Fourth, we think a divided Congress appears to be the most neutral outcome, as it would limit changes to existing policies and prevent the implementation of new, potentially volatile ones. However, risks remain around unilateral executive or agency actions. Finally, for unrelated reasons, implied volatility remains low by historical standards, even as the October/November period approaches. This low volatility environment presents a very favorable opportunity to add portfolio hedges and buy insurance during the summer months.

Let us end by focusing on the fiscal and tax possibilities, considering that we just identified America's fiscal trajectory as perhaps the only barrier to sustaining longer-term US economic dominance. We begin by

### 15. US Fiscal Effects Under Four Possible Election Scenarios

Trump with a Divided Congress Produces Most Favorable Fiscal Outcome

- PERSONAL TAX
- CORPORATE TAX & SUBSIDIES
- BENEFITS
- GOVT. SPENDING
- TARIFFS
- TOTAL




Source: Goldman Sachs

evaluating the fiscal and tax agendas expected under the four main election outcomes. This reflects the hypothetical fiscal impacts, including potential tariff policies and the use of funds they generate. The most significant fiscal policy shifts occur in the two sweep scenarios, as substantial changes are difficult under divided government, though tariff policy mainly depends on presidential control.

— "Given our recessionary call, it just means that **yields will not fall by as much as we previously expected them to fall**. But they will still fall."

In a Republican sweep, fiscal changes stem from extending expiring tax cuts and introducing additional cuts that offset new tariff revenue. In a Democratic sweep, higher corporate taxes are initially offset by an expanded Child Tax Credit. It follows that a divided government would be the most favorable scenario for the U.S. fiscal position. A Trump victory with a divided Congress would likely reduce the U.S. fiscal deficit the most, while a Biden win with a divided Congress would also improve the balance sheet, but to a lesser extent. The only scenario where the U.S. fiscal deficit worsens is a Republican sweep, where tax cuts could negate all tariff revenue.

Regarding tariffs, their impact on risk assets should be less severe than during the previous China trade war under Trump 1.0. *Ceteris paribus*, yields are more likely to move higher than lower, given the current inflation and policy context. **Given our recessionary call, it just means that yields will not fall by as much as we previously expected them to fall.** But they will still fall. The direction will be the same, but the magnitude should be less.

One thing we can state with high conviction is that the market reaction to tariff proposals is the biggest potential swing factor in asset markets. **Finally, geopolitical risks or aggressive attempts to influence Fed policy strengthen the case for owning oil and gold.**

## Private Space Investments: Ready to Launch

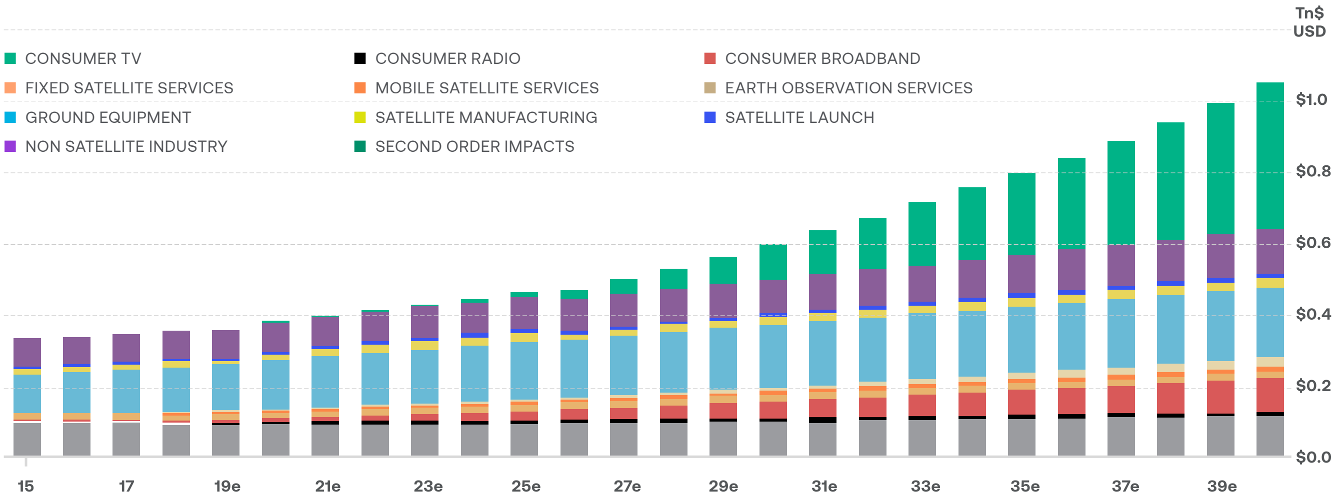
While everyone in private investments is focused on AI, investors should look to Aerospace & Space Technology as an incredibly attractive alternative.

In this sector, key positive factors include a growing market, alignment with future trends, innovation, interest from both the public and private sectors, resilience to economic fluctuations, and compatibility with existing technologies.

Enter the expanding space economic ecosystem. Commercialization, a crucial factor for investors, is now a reality in the space sector. In the U.S., the federal budget share for NASA's civil space activities has declined since the 1990s. This reduction has led to increased private sector investment and innovation in space exploration, highlighted by SpaceX's historic crewed mission in May 2020. The trend towards privatization and commercialization, along with the establishment of the U.S. Space Force in December 2019, underscores shifting priorities and the evolving role of private companies in space exploration. Global space tourism, worth $678 million in 2023, is projected to exceed $1.3 billion by 2033, with a 38% compound

## 16. Space Economy: Expanding Frontier

Source: Haver Analytics, Morgan Stanley, BCA

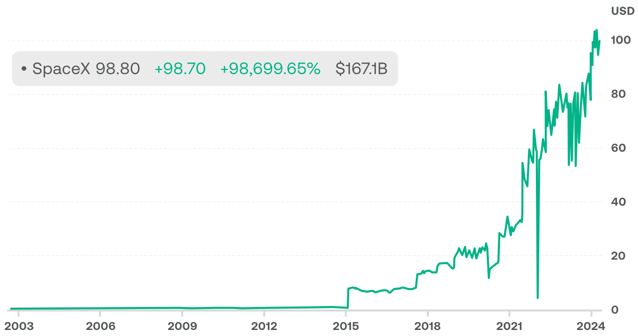



annual growth rate over the next decade. The sector's economic stability is further supported by consistent public sector funding through defense budgets, which strengthen government space programs. Despite numerous challenges, the field of Space Technology has relatively few competitors. According to Pitch-Book, there were over 170 early-stage deals in Space Technology in 2023, compared to over 4,800 deals in AI & ML. **SpaceX's December 2023 valuation of USD 180 billion in the private market, exceeds any IPO in history and highlights the sector's appeal.** It is arguably the best-known private company ever due to Musk's powerful combination of rapid technical advances, coupled with an unrivaled marketing and promoting strategy.

SpaceX is ready to launch. Indeed, its dominant role in the space industry and its high valuation would rank it among the top 50 most valuable companies in the S&P 500 if it were publicly traded today. SpaceX operates two main business lines: launch and Starlink. The launch segment provides payload delivery to orbit at 5 to 10 times lower cost per ton than any other company or government agency in the world, including NASA. Starlink has created the largest satellite network in the world, comprising about 60% of all operational satellites, and offering connectivity to anyone, anywhere. **With around 90% of the earth's surface currently without cell service and around 2.7 billion people without internet access, there is a major market opportunity for SpaceX as it is developing a new internet modality that is becoming a critical component of global communications infrastructure.**

Here are some key highlights for SpaceX gleamed from Morgan Stanley's financial model of the company: FY24 revenues of approximately $13bn, up ~54% YoY, Starlink has 2.6 million subscribers as of March '24, it is growing nearly 25k subs per week, the company turned a profit in 1Q23, it launched nearly 1 rocket every 3 days last year, it is the only private launch contractor to send astronauts to the International Space Station and it is a critical partner in NASA's Artemis mission to return astronauts to the moon for the first time since 1972. Morgan Stanley projects SpaceX's revenue to grow from around $13 billion in 2024 to over $100 billion by 2035. While SpaceX started with leading launch capabilities, Starlink is expected to be the primary driver of future growth and profitability.

### 17. SpaceX Price Per Share in Secondary Transactions




Source: notice.co

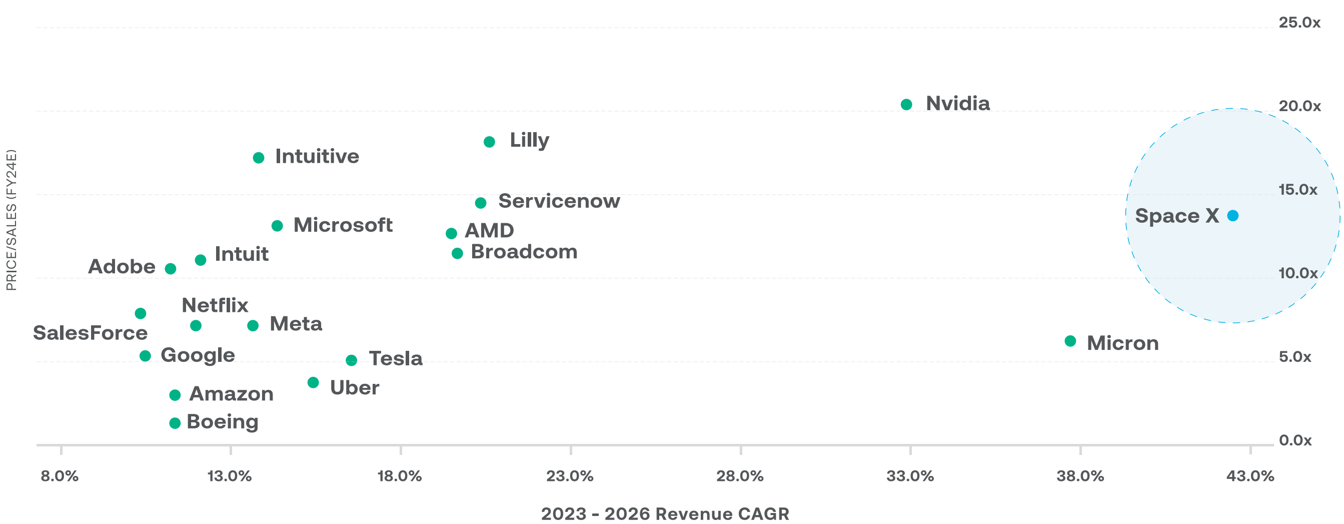
When comparing SpaceX to other large companies with high expected revenue growth, SpaceX is valued higher than its peers, with a Price/Sales ratio of nearly 14x compared to the average of 9x. However, its projected compound annual revenue growth rate of 43% over the next two years is the highest among its peers. SpaceX's valuation has remained strong in both primary and secondary markets, performing well alongside AI companies in recent funding rounds. Its current valuation surpasses companies like Intel, Uber, Pfizer, and Boeing. Over the past two decades, SpaceX's valuation has steadily increased through multiple equity offerings, growing from $27 million in 2002 to $180 billion in 2023. Elon Musk, who owns 42% of the company, has stated that no additional funding is needed for projects like Starship and Starlink, and SpaceX has not tapped primary markets since July 2022. It is supported by over 200 investors, including notable venture capital firms like Sequoia Capital and the Founders Fund, as well as major investors like Alphabet and Fidelity.

Given that SpaceX is already a well-known investment opportunity that is priced on the higher end for similar companies, but offers superior growth prospects, we would urge investors to look for private opportunities among other private Space and Aerospace companies, particularly those that supply critical components for companies like SpaceX. **It makes sense to buy the "picks and shovels" for the oncoming gold rush in Space.** ■

### 18. SpaceX vs. S&P 500 Stars

(>USD 100 billion + >10% Revenue Growth)

Source: Factset, Morgan Stanley



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## The Mineral Industry and Latin America

> Latin America plays a crucial role in the mineral complex due to its stance as a critical provider of some of the most important minerals needed for most blossoming new technologies.

> The region exhibits setbacks in infrastructure development and high operational risks, which undermine its production capacity and ease of access to all minerals.

> If leaders in Latam adopt policies that create a benign environment for producers, the region could be poised to be a meaningful beneficiary of the increased long-term demand for its products.

Minerals have always provided an important starting point for many of the goods we enjoy in our daily lives. Copper, iron ore, and nickel, among others, have been valuable building blocks of society for hundreds of years. After many years, some of these minerals lost some of their proverbial luster. However, new technologies such as electric vehicles and renewable energy, are rekindling the mineral complex's shine. These trends, propelled by the constant quest for greener, more sustainable fuels and materials, have led to the exponential growth of the importance of mineral production around the globe. This growth has brought Latin America to the forefront of many discussions on the subject, namely because of the region's stance as a critical provider of some of the most important minerals needed for these technologies. As such, we wanted to delve deeper into the importance of Latin America within the minerals complex and touch on some of the companies that could benefit from this industry's potential development.

From copper to lithium to nickel, Latin America is blessed with large concentrations of important minerals. A point that stands out is how rich the region is in copper and lithium. According to data from the Center on Global Energy Policy at Columbia University, Chile and Peru are the world's leading producers of the two minerals, accounting for close to 40% of global production. At the same time, Chile and Argentina are respon-

## 1. Latin America is home to some of the world's largest reserves of critical minerals

Global reserves ranking (and global percentage) of critical minerals by country

| LITHIUM | | COPPER | |
|---|---|---|---|
| #1 | Bolivia (21.9%) | #1 | Chile (19%) |
| #2 | Argentina (20.9%) | #2 | Peru (12%) |
| #4 | Chile (10.5%) | #6 | Mexico (5.3%) |
| #10 | Mexico (1.6%) | #12 | Argentina (2%) |
| #13 | Peru (1%) | #16 | Bolivia (1.3%) |
| | | #19 | Brazil (1%) |

| NICKEL | | RARE EARTHS | |
|---|---|---|---|
| #3 | Brazil (12.3%) | #3 | Brazil (18.2%) |
| #6 | Cuba (4.1%) | | |


Source: US Geological Survey; EIU

sible for 32% of global lithium supply. In fact, the Lithium Triangle, comprised by Chile, Argentina, and Bolivia, holds over 60% of the world's reserves of this mineral. These statistics should bode well for the region, considering that, according to data from the International Energy Agency (IEA), the demand for critical minerals is expected to increase by more than 6% per year, on average, through 2030.

However, not everything is as rosy as it seems. The region exhibits setbacks in infrastructure development and high operational risks, which undermine its preparedness to take advantage of its richness of critical minerals. Furthermore, and even if Latin America is home to almost three quarters of the world's reserves of lithium, more than a third of the world's copper reserves, and nearly one-fifth of nickel and rare-earth metals, its production capacity has decreased in recent years due to the lack of investment in mining projects.

Copper's attention is focused on this metal's importance within the clean energy ecosystem, especially because of the increased deployment of renewables and electric vehicles around the world. The region is home to two of the main suppliers of copper, Chile and Peru, with the former producing a quarter of the global supply, according to 2023 IEA figures. In its forecasted scenario, the Agency expects Chile to remain as the largest copper producer, as it continues to contribute about a quarter of the world's global supply through 2040, with production from its main mine, Escondida, which alone produces 5% of the world's copper supply. At the same time, Peru is highlighted as the world's second-largest copper supplier. However, it is expected to see its share of supply shrink due to increased influence from other producers such as Russia, Indonesia, and the current biggest supplier, the Democratic Republic of Congo, as well as the lack of viable projects and aging assets. Furthermore, some of Chile's main copper assets have had to close due to environmental concerns that are related to the country's efforts to move towards more sustainable mining, as well as ESG controversies. For example, in 2023, Codelco closed its Ventanas smelter due to an environmental incident that caused increased pollution which, in turn, left dozens of inhabitants suffering from symptoms of sulfur dioxide emission poisoning. Codelco's output remains at historical lows, with production coming in 6% below its target rate through May of this year. Its recent lithium production deal with SQM could help the company navigate its current downturn in copper production. Lead times to increase supply tend to be long in this industry; however, production is likely to rise over time in response to increased expected demand. This sentiment was echoed by Vale during its recent "Base Metals Asset Review" webinar, where it unveiled plans to increase production capacity through 2028 and beyond.

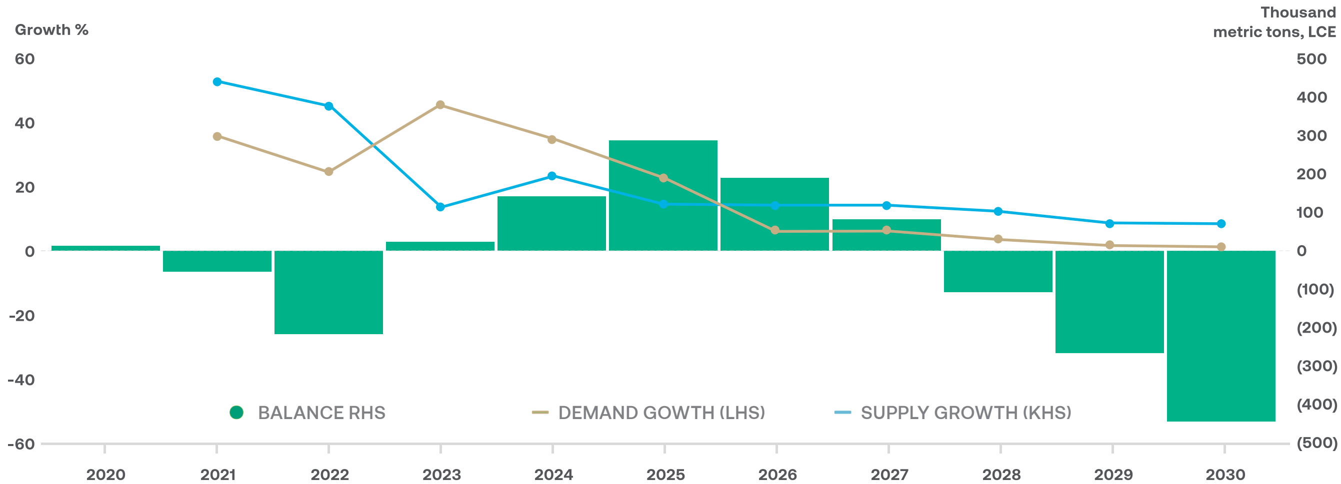
— "Copper has traditionally been the backbone of the mineral industry in Latin America. However, given the massive size and level of concentration of **lithium** reserves in the region, this commodity **has the potential to surpass copper...**"

Copper has traditionally been the backbone of the mineral industry in Latin America. However, given the massive size and level of concentration of lithium reserves in the region, this commodity has the potential to surpass copper as Latin America's most important mineral. As we highlighted above, the Lithium Triangle holds an outsized number of global reserves. However, the gap between the level of reserves and actual production varies widely on a country-by-country basis. For example, Bolivia accounts for approximately 24% of global lithium deposits, while Chile accounts for 11%. However, Bolivia accounted for a minimal amount of global lithium production, while Chile accounted for 25%. Why this discrepancy? Lithium can be hard and expensive to produce, particularly in regions requiring intensive mining. This could explain why certain countries, such as Mexico, are having limited success developing this industry. The United Nations Development Program believes that the cost of producing refined lithium will average $7,000/ton through 2036. This cost level poses significant limitations to the development of reserves in certain countries in the region.

Complicating matters further is the fact that lithium prices have plummeted from their highs of $80,000 in 2022. With prices near $15,000/metric ton, it is likely that we are close to the lows. However, with production costs currently ranging between $5,000 to $10,000/ton, increasing production at current prices is much less appealing than it was in 2022. Something else to consider is that many lithium producers still operate their budgets with price assumptions in the range of $20,000 to $25,000, which will likely need to be adjusted downwards. As a result, producers' cash flows could remain constrained in the short term. However, this may not be a bad outcome for the industry, as it would restrict the expansion of supply, likely setting a floor on the price of the commodity. Balancing production growth and cash flow preservation is going to be an important goal for lithium producers over the next few years. The demand for lithium also creates a high degree of uncertainty, since as we know, it has grown slower than expected. Over the long term, we believe that a possible increase in demand, coupled with limited supply, could stabilize the lithium markets and push prices upward, something that could potentially benefit producers like SQM, Albemarle, and Lithium Americas. In the short term, however, volatility is likely to remain present in the lithium markets.

## 2. Lithium Market Supply and Demand Dynamics

Source: Bloom




Latin America also displays a relative investment and development gap when it comes to rare earths. These minerals are critical in the creation of products like high-end consumer electronics, electric vehicles, and advanced weapon systems. A backdrop of tight environmental regulations that make accessing reserves a complicated task is not helping matters. However, taking into consideration the vast reserves that were discovered in the region between the states of Minas Gerais, Goiás, and Bahia, as well as its growing production and industrial capacity, Brazil could be well positioned to close the gap that China is expected to leave after 2025. Unfortunately, the country has seen its rare earths output decrease due to lack of continuous investment. As of the end of 2023, China was responsible for close to 70% of rare earths production. In stark contrast, Brazil was responsible for a mere 0.02% of global production, an insignificant amount compared to Chinese production. However, Brazil's reserves are about ¼ the size of China's reserves, highlighting the potential production growth inherent in the former country. Policies that would encourage investments in the mining and production of these minerals would go a long way in closing this gap.

Another important mineral in the region is nickel. As with rare earths, Brazil is also a relevant player when it comes to this metal. In fact, the country's mining institute estimates that Brazil could receive investments of as much as USD 4.4 billion over the next four years. If we take into consideration the rising demand for nickel in response to the need to build more efficient batteries, together with the observed increase in the price of the metal, Brazil's growing nickel output should bode well for the country's growing position as a meaningful supplier. In fact, according to estimates from the IEA, Brazil is poised to continue to gain market share form the top three main nickel producers in the globe, eroding their combined market share from 90% down to 81% by 2040.

Latin America is blessed with a vast treasure trove of mineral resources. If leaders in the region adopt policies that will create a benign environment for producers, the region could be poised to be a meaningful beneficiary of the increased long-term demand for its products. Finding a balance between business and government will be key. ■

# House Views Matrix

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