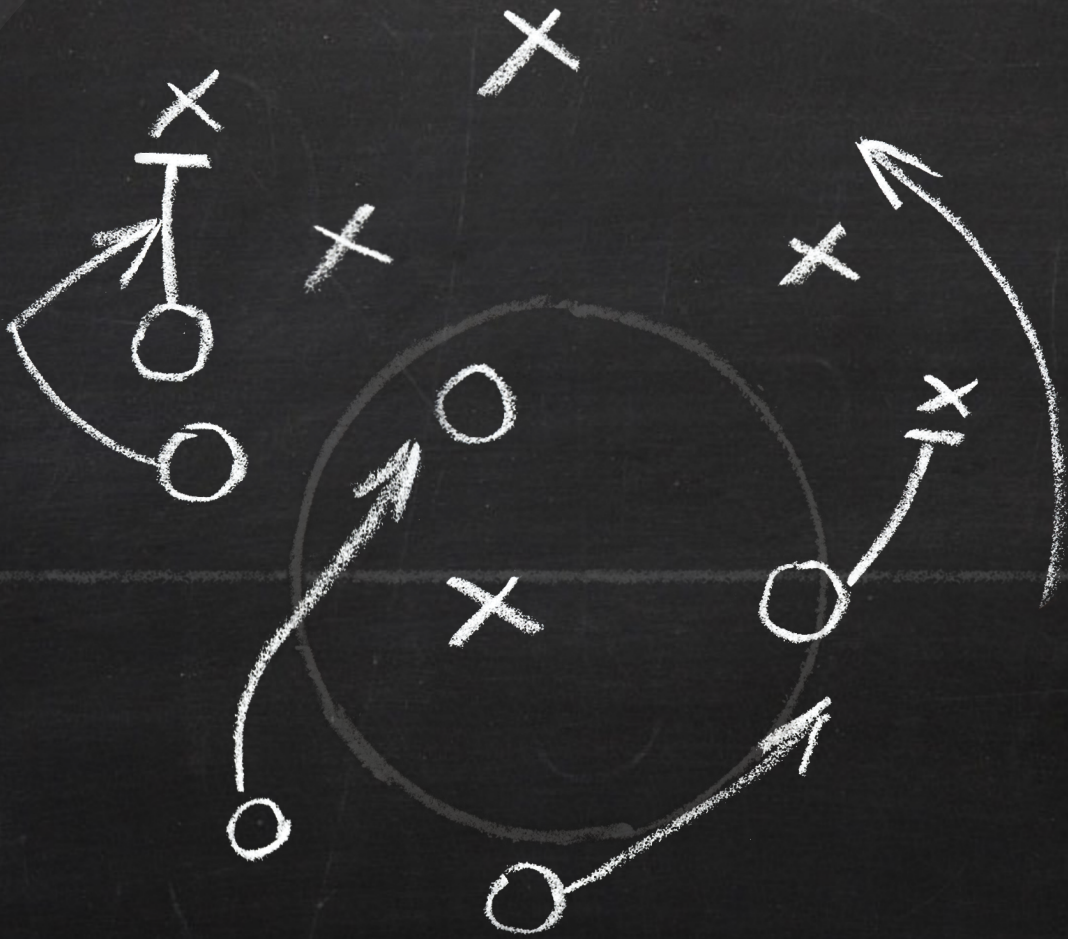




Insigneo Special
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English Version



NOTE FROM THE CIO

Recession Deferred But Not Cancelled

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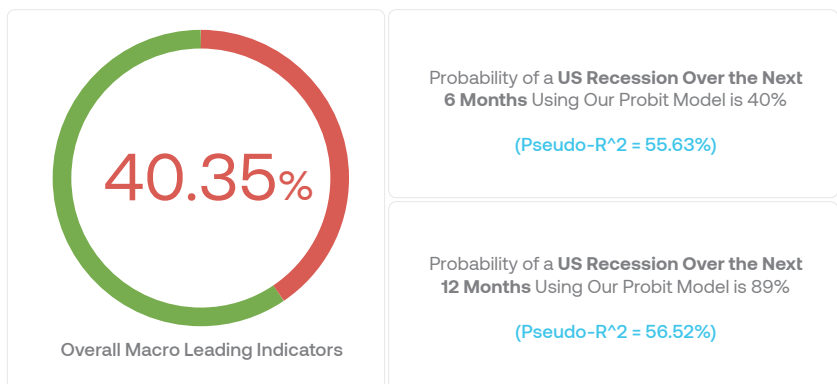


Ahmed Riesgo
 Chief Investment Officer
 Insigneo

Recession Deferred But Not Cancelled

- Recent US economic data suggest that growth remains buoyant as there is particular resilience in the labor market and strength in services. Unfortunately, stronger growth is simultaneously raising the odds of persistent inflation as the latest figures have come in higher than expected as well.
- In contrast, the feedback from companies during this current earnings season has been one of slowing growth and lower inflation. This has been reflected in weak aggregate guidance from management teams.
- So, which outlook are we to give greater credence?
- Our proprietary Insigneo-Forefront Recessionary Indicator (“IFRI”) is reflecting an approximately 40% chance that the US economy will experience a recession over the next 6-months. One can track the evolution of the IFRI over time, going all the way back to 1971 with the shaded areas demarcating official historical US recessions as designated by the National Bureau of Economic Research.

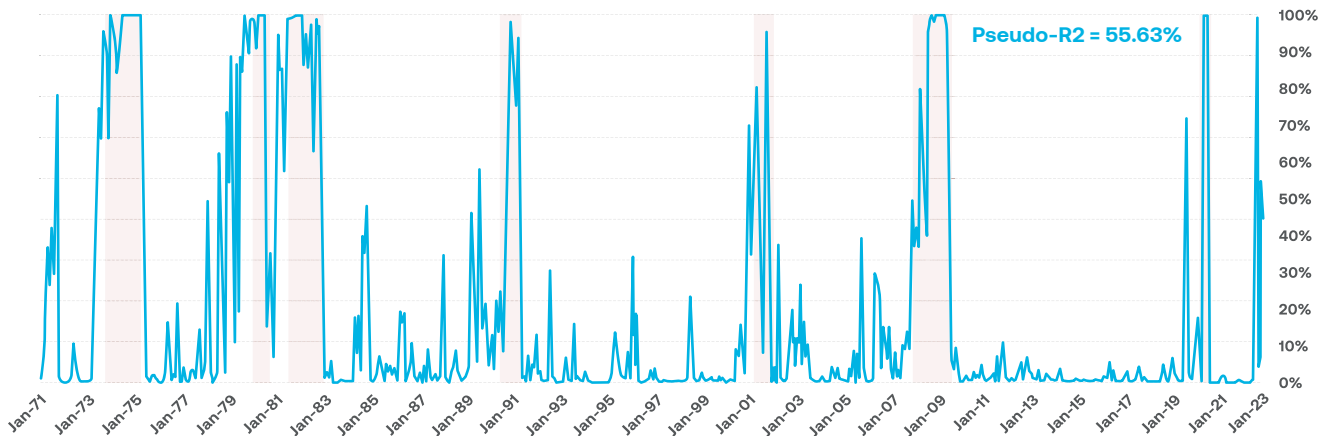
Probability of a US Recession according to IFRI



Source: Insigneo-Forefront Recessionary Indicator

Forecasted Recession Probability for 2-Quarter Forward Period Using All Macro Leading Indicators

January 1971 – February 2023



Source: Insigneo-Forefront Recessionary Indicator

- However, over the next 12-months, the IFRI is assigning 89% odds that the US economy will fall into a recession. Although there could be multiple inflection points along the way, we are fairly confident that the US economy will eventually succumb to, at a minimum, recession-like conditions, implying falling growth and inflation rates most likely by early to mid-2024.

- Our IFRI is a statistical probit model, and it is only one factor input into our overall framework of subjective recessionary probabilities. Some other factors include, but are not limited to, geopolitical risk assessment, monetary and fiscal policy evaluations, and domestic political appraisals (e.g., 2024 election considerations).

- Incorporating all factors, our subjective US recessionary probabilities currently are as follows:

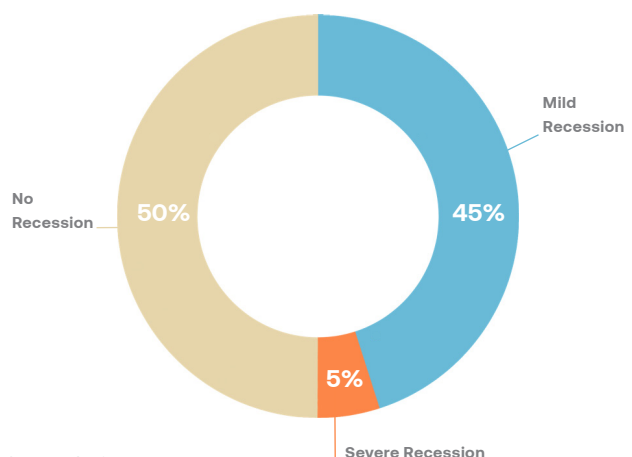
1) Over a six-month horizon, 50% chance of no recession, 45% chance of a mild recession, and 5% chance of a severe recession.

2) Over a twelve-month horizon, 75% chance of a

mild recession, 15% chance of a severe recession, and 10% chance of no recession.

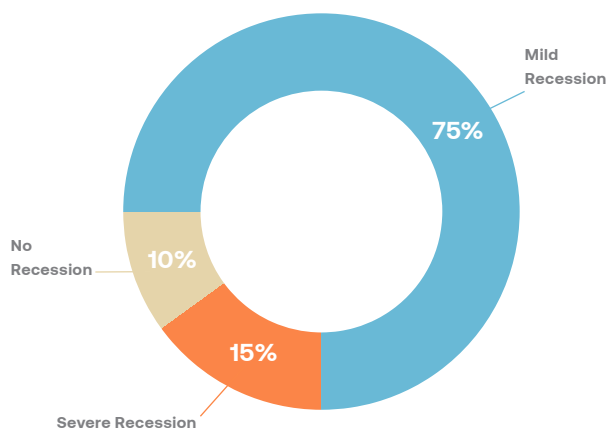
- There are two main takeaways from this assessment. First, a US recession has likely only been delayed rather

Subjective Recessionary Probabilities Over 2 Quarters Incorporating All Factors



Source: Insigneo

Subjective Recessionary Probabilities Over 4 Quarters Incorporating All Factors



Source: Insigneo

than averted. Second, the increased odds of a severe recession largely arise from the heightened risk of a Fed policy mistake stemming from overtightening financial conditions. Within our framework, a “severe recession” is defined as one where the US unemployment rate exceeds 6%.

Market Implications

- As previously mentioned, there are competing narratives stemming from recent economic data and earnings season. The former picture, which is one of stronger growth and higher inflation, suggests an environment where the Fed will continue hiking rates above current market expectations. This will be a challenging environment for both US rates and equities. The latter scenario, one of weaker growth and lower inflation, would be a tailwind for rates as it would imply rate cuts, or, at a minimum, a Fed pause would be forthcoming. The equity implications are

more nebulous, since it will largely depend on the effects on forward EPS estimates since the multiple contraction should cease.

- For now, we are maintaining our tactically neutral equity and rates asset allocation given the balance of risks.** Our fixed income preference for Investment Grade over High Yield continues to make sense as high quality bonds tend to outperform in an environment of diminishing growth and inflation. On the equity side, we continue to favor equities outside the US over their American counterparts. Chinese equities remain our top tactical conviction trade for the year.

- We will look to turn outright bearish on US equities should we a) get further evidence of a second inflationary wave developing, and/or b) reach our S&P 500 target levels of 4100/4300.

- In terms of selection preferences, we continue to believe that beta will be subsumed to alpha in this environment. **Stock and sector selection matter more than they have in the recent past.**

- Our inclination remains to be overweight under-valued and under-owned sectors of the US market like energy. On a style basis, we retain our bias to Value at the expense of Growth.

- The most prevalent sources of uncertainty continue to be the timing of the onset of the US recession, and an escalation of the Ukrainian conflict. Other relevant sources of risk are the ongoing Iranian Israeli proxy war, and the looming US debt ceiling showdown during the summer months.

- More defensive portfolio positioning will likely be necessary later this year. ■**

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