The Macro Investing Tool

from Raoul Pal and Julien Bittel

RV MIT Business Cycle Update – January 31, 2024

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Welcome back to the weekly newsletter of The Macro Investing Tool (MIT). This product aims to help you position your portfolio for the different ebbs and flows of the business cycle.

Just as a reminder, here's what you can expect from Raoul and Julien every month:

In the first two weeks of every month, you will receive a short weekly newsletter (like this one) where Raoul and Julien will go through the top macro and market charts on their radar for the given week. In the third week of every month, Raoul and Julien will write a publication around the updated model outputs to highlight where we are in the cycle and, based on the new data, help to identify the appropriate asset allocation. Finally, in the last week of every month, Julien will follow up with a video update (slide deck included) to discuss the key takeaways from the month.

We will also do regular AMAs with Raoul and Julien to ensure we answer all your questions.

Ok, let's dive right into this week's newsletter...

US C&I Loan Survey: Credit Standards

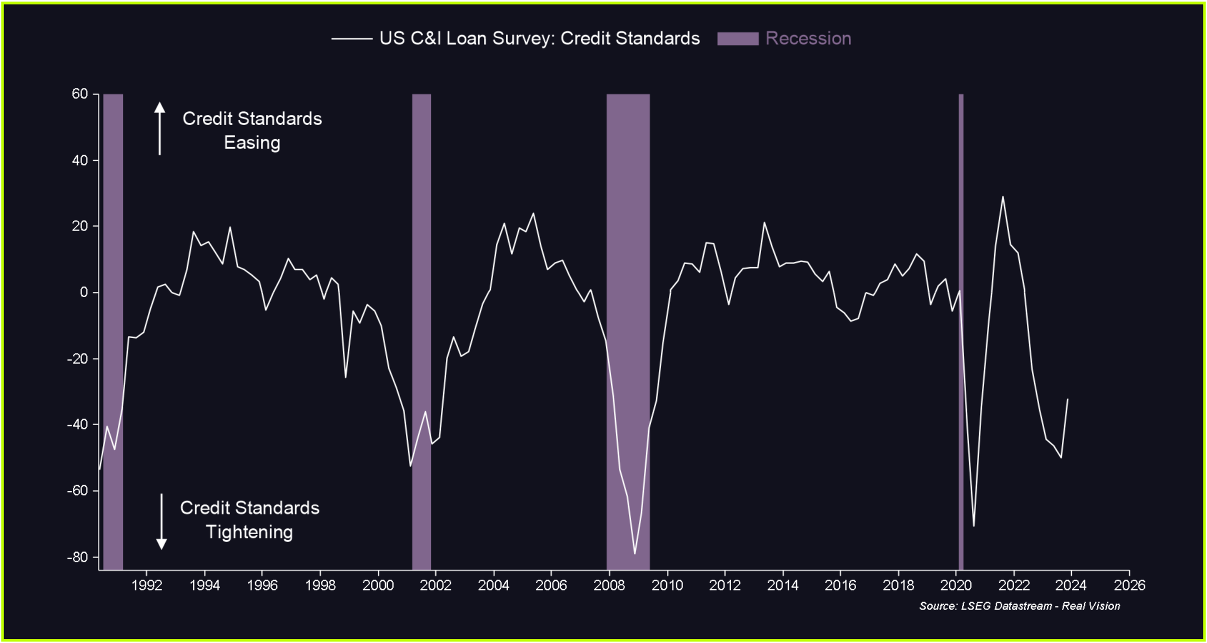
This week, we wanted to spearhead an extremely loud narrative on which we have a slightly different point of view to offer.

Last year, just about everyone in the macro bear camp had been calling for a "credit event" in Q4. This narrative seems to have spilled over into 2024, so we need to talk about it.

Additionally, I get the sense that there's still quite a lot of confusion around the topic, mainly due to interest rates still being so high. Let us talk you through why we've had a different view on this and continue to believe that the worst of the tightening in credit standards is already behind us, not ahead of us.

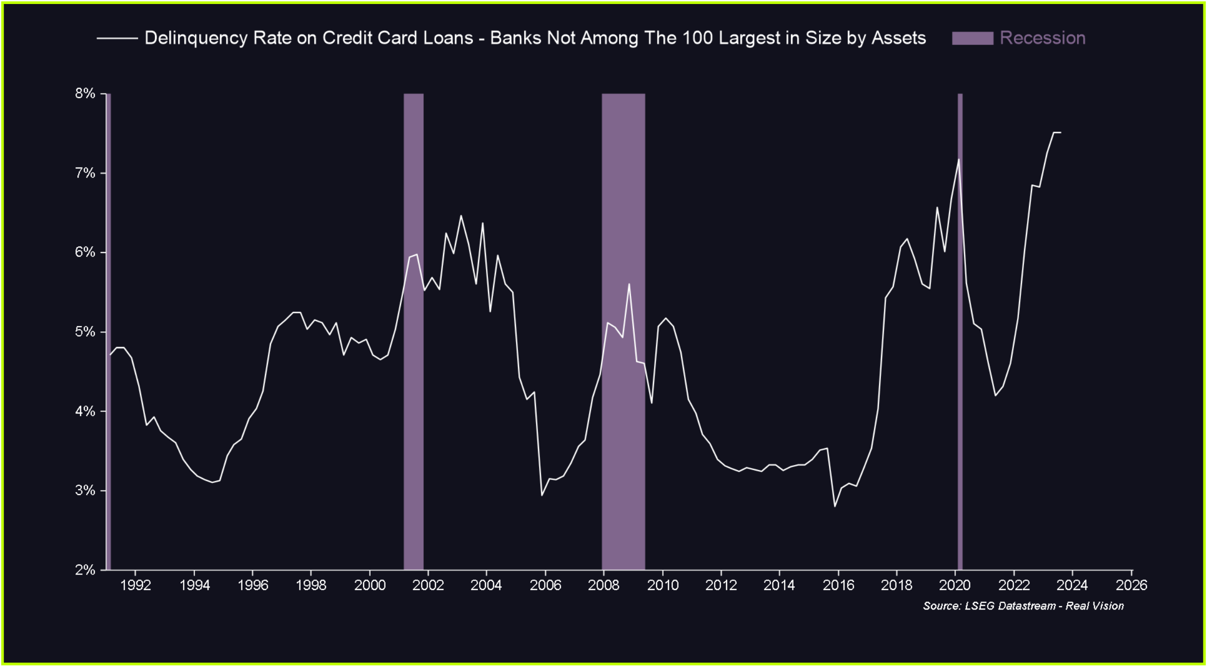
As always, let's run through some data...

Scary charts like the example below are what has prompted everyone to sound the alarm bells – bank lending standards for commercial and industrial loans have tightened to levels only seen during previous recessions...



Delinquency Rate on Credit Card Loans – Banks Not Among The 100 Largest in Size by Assets

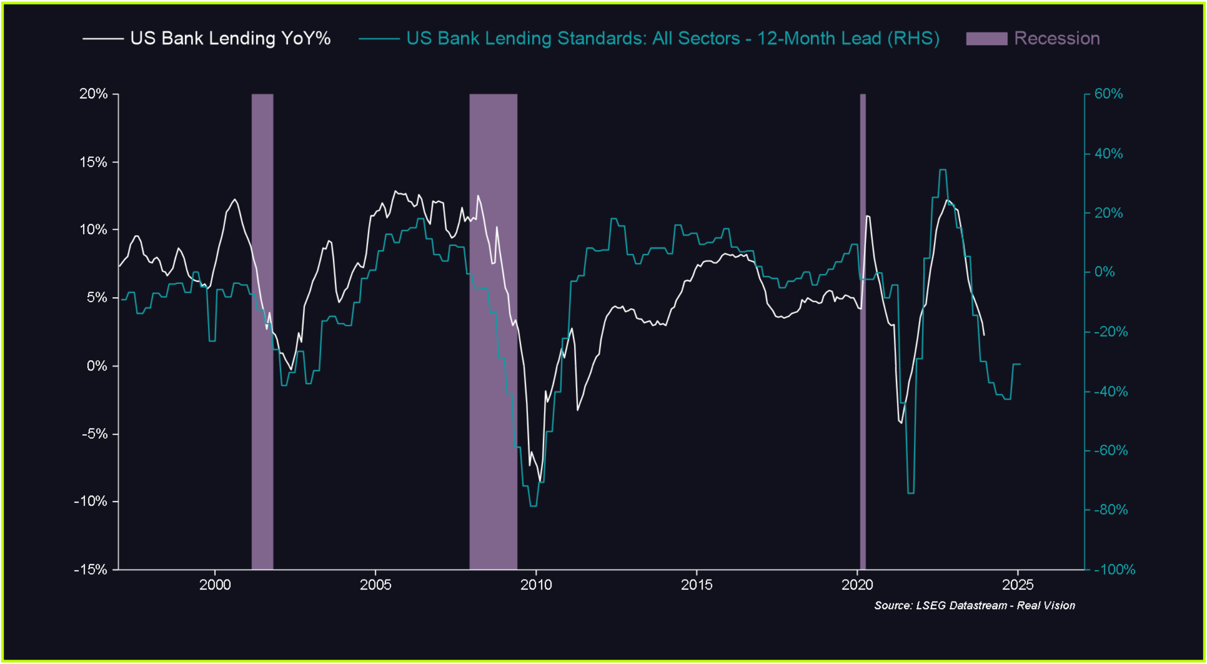
Credit card default rates from small lenders are at their highest levels on record. This is a truly shocking chart!



US Bank Lending YoY% vs. US Bank Lending Standards: All Sectors

If we then aggregate all the Fed data from the Senior Loan Officer Survey across all sectors, we get the following...

Et voila! This is what everyone is worried about – an outright contraction in bank lending.



US Bank Lending YoY% vs. ISM

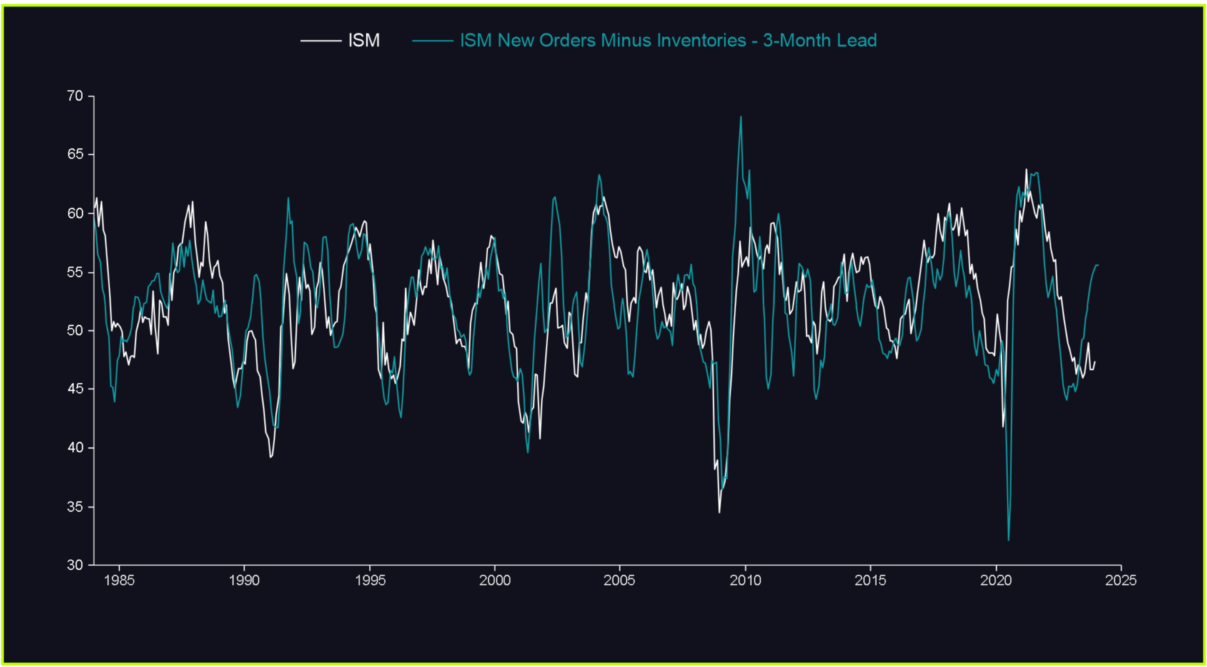
But here comes the doozy! Bank lending activity is not a leading indicator of the economy; it's a super-lagging indicator...

In fact, much like bank lending standards, bank lending activity lags the ISM by twelve months...

ISM vs. ISM New Orders Minus Inventories

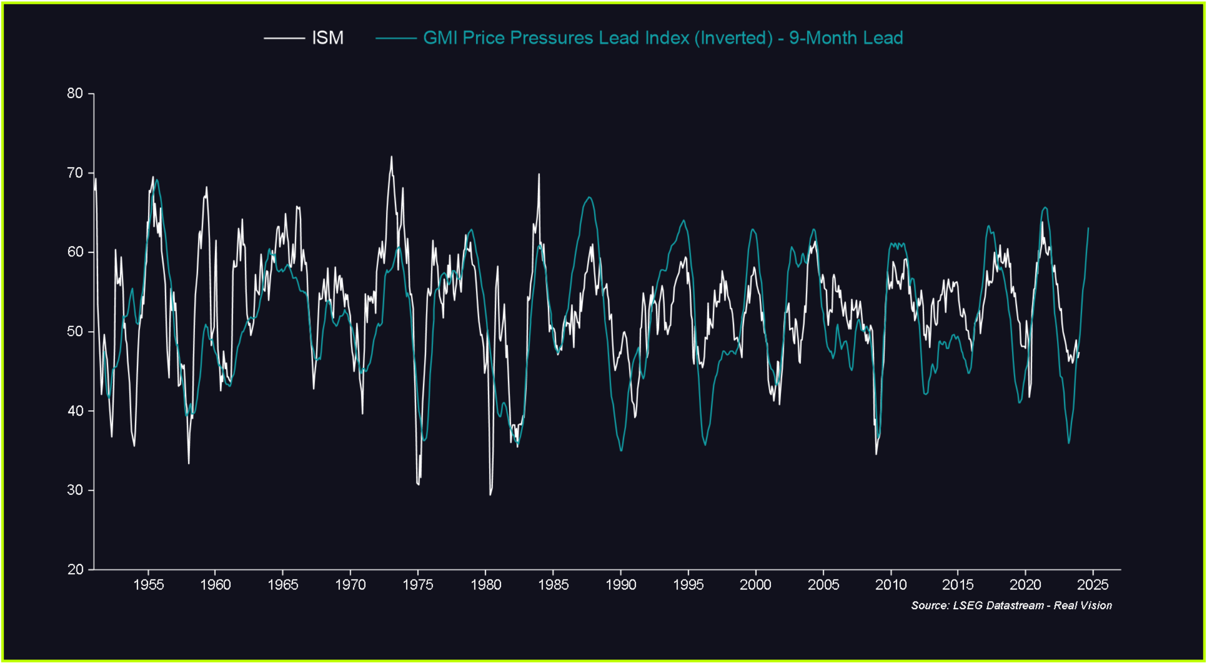
Thus, the ISM, if anything, is really what we should focus on here, not bank lending.

We also know that the trend in ISM New Orders Minus Inventories continues higher, and this is the discount window for equities (+3 months versus current ISM) ...



ISM vs. GMI Price Pressures Lead Index (Inverted)

… and longer leads over ISM (+9 months) have turned sharply higher…



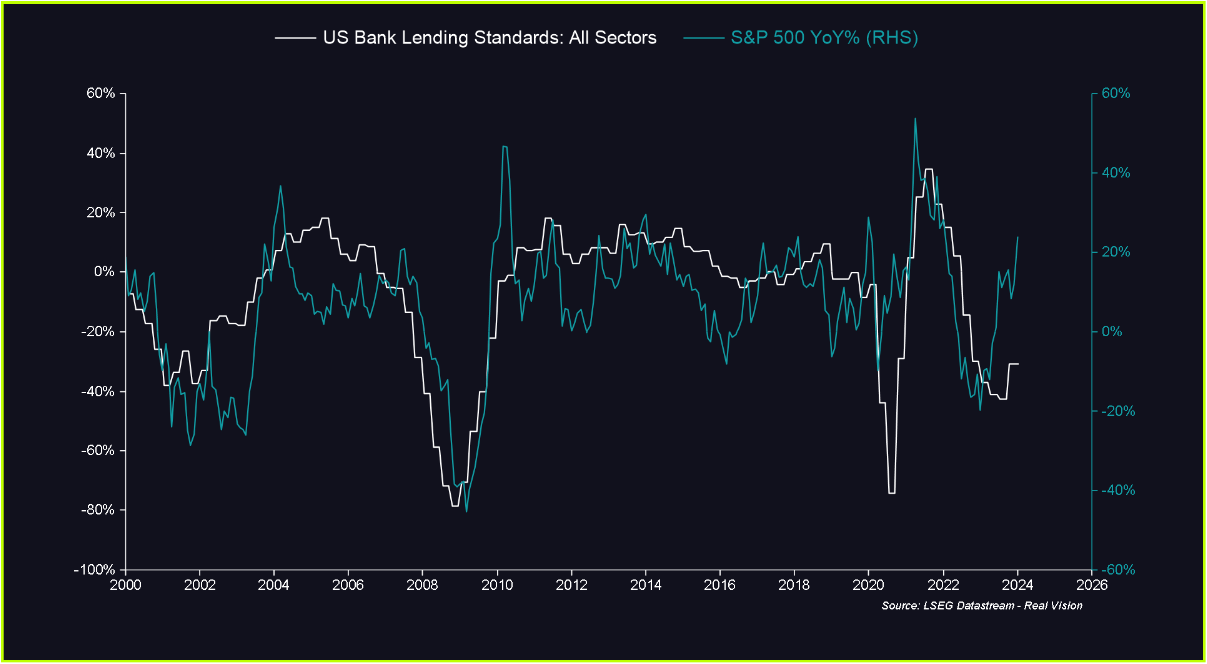
ISM: The Everything Code

The Everything Code also suggests that markets will remain perfectly cyclical. Therefore, the previous cycle's ISM predicts this cycle's ISM will go up only over time to a peak in H1 2025...

US Bank Lending Standards: All Sectors vs. S&P 500 YoY%

Don’t get me wrong, the credit crunch that people are talking about is coming. Bank lending growth can easily fall from its current 2.3% year-on-year growth rate in December to 0%, or perhaps even negative.

But our view all along at GMI was that the S&P 500 priced this all in back in Q4 2022 and has been anticipating a turn higher (i.e., an easing of credit conditions), moving in line with our lead indicators as you’d expect, given that stocks tend to be leading...



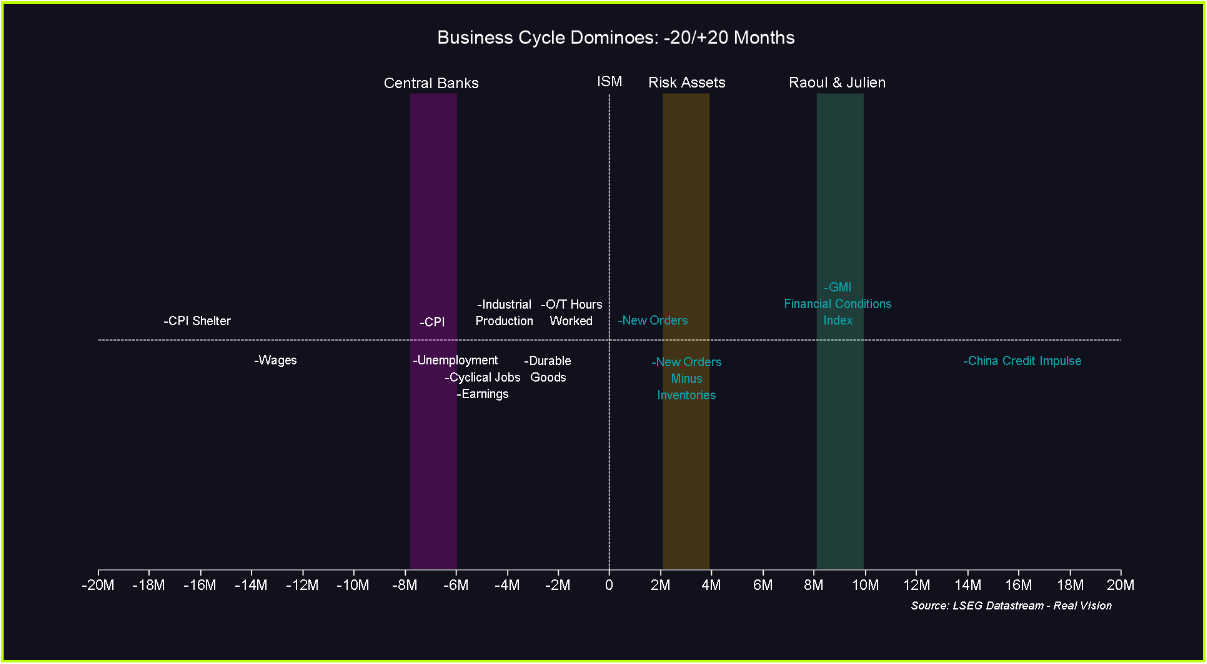
The MIT Big Picture

Here's this week's key takeaway:

While the market moves slightly in advance to the tightening in bank lending standards (+3 months), the market also tends to look completely through the actual contraction in bank lending activity because this data is so lagging in the business cycle.

We still hear a lot of people saying, "Respect the lag," speaking to the multi-quarter lag over which tighter lending conditions filter through into actual bank lending activity...

Understanding the credit transmission and how that impacts the real economy is one thing, but it's wrong to assume that this HAS to result in a bearish outcome for risk assets... markets are forward-looking, and it's all about *The Business Cycle Dominoes!*



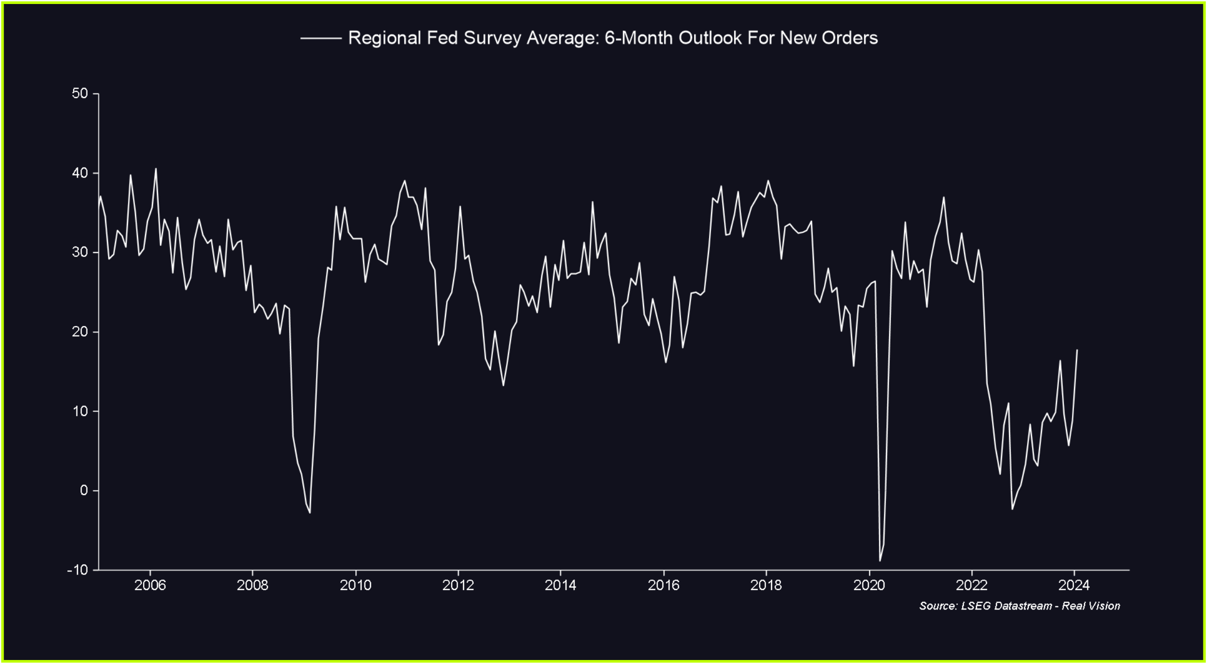
ISM vs. US Regional Fed Manufacturing Survey Composite

Finally, Regional Fed surveys almost across the board were weaker than expected in January, which means that we could see one final dip lower in ISM this month before working higher...

Regional Fed Survey Average: 6-Month Outlook For New Orders

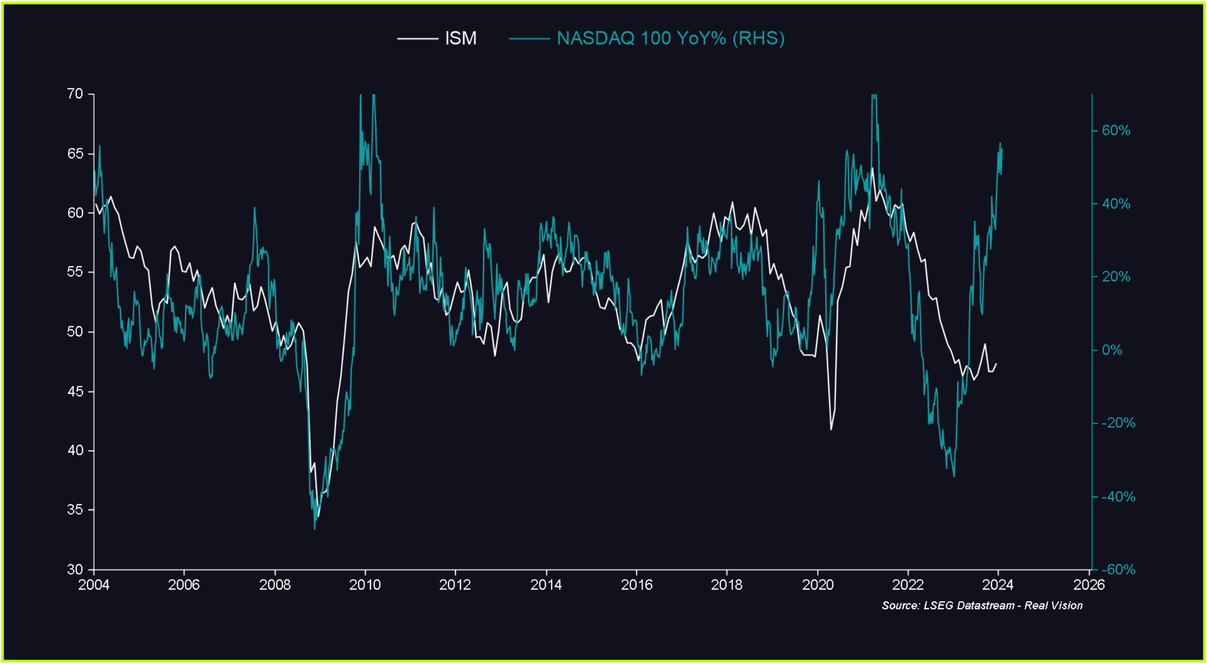
However, we have been much more focused on the outlook for future New Orders, as this part of the survey tends to be more forward-looking, and there we saw another big jump higher in January.

What's going on here is a case of today's economy still being weak but the future economy being stronger – something that we've discussed over the last couple of weeks in prior MIT reports...



ISM vs. NASDAQ 100 YoY%

It’s also important to remember that the NADASQ 100 priced in an ISM of 37.7 already in Q4 of 2022...



GMI Weekly Global Liquidity Index YoY% vs. ISM (Inverted)

So, even if the ISM makes one final push lower, we think it's already priced in...

Additionally, a weaker-than-expected headline ISM number in January, at this stage in the business cycle, can only mean one thing – MOAR COWBELL in 2024/2025!!!

That's all from us this week. Good luck out there, and see you all next week with another update.

Enjoy!

Raoul Pal – CEO, Founder - Global Macro Investor

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