

What a difference a year makes: leading indicators, profits and a Japan update; Eye on the Market mailbag (on AI, GLPs, China, housing, insomnia and Truth Social)

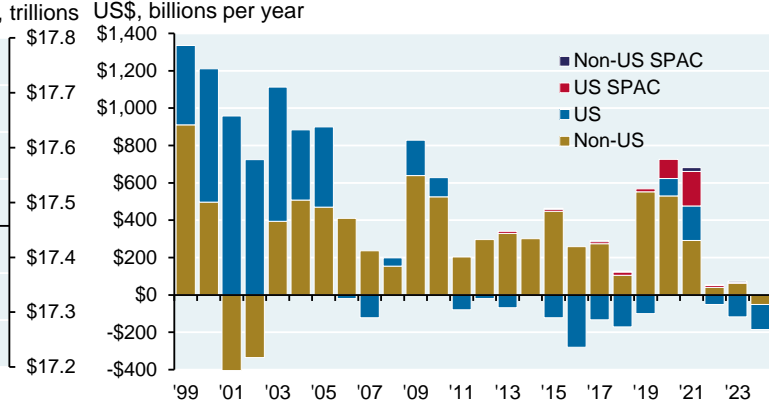
A year ago, US bank deposits fell sharply and bank stocks underperformed. An aggressive bailout package stopped the bleeding¹, leading to a recovery in bank deposits and bank stock performance. Something that hasn't changed over the last year: net equity supply, which has been very tight for three years in a row. It's a strange environment; despite a recovery in risk appetite and valuations, the new issue market is still extremely tight. In other words, buybacks exceed primary and secondary new equity issuance. Tight supply conditions are generally more favorable for market returns, indicating more investor scrutiny on new issues.

US commercial bank recovery



Source: Bloomberg, JPMAM, April 2, 2024

Net equity supply globally



Source: J.P. Morgan Global Markets Strategy, April 3, 2024

Something else that has changed since last year: substantial improvement in our leading indicator model on the US economy. There's a lot more green than there was last August.

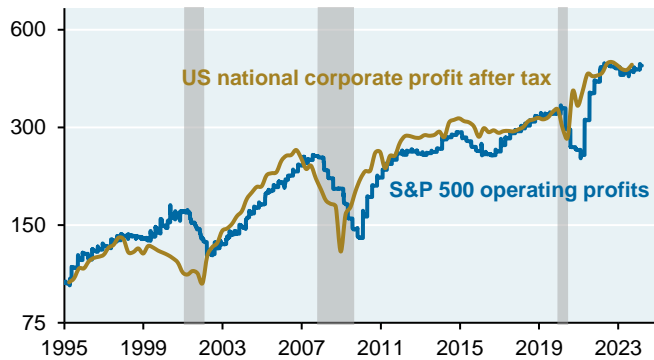
#	Category	Leading indicator...	Advanced by...	Predicts a worsening in...	Pulse 4/2024	Pulse 8/2023
1	Bankruptcy	Banks tightening C&I loans	6 months	Corporate bankruptcy filings	Green	Red
2	Capex	Banks tightening C&I loans	9 months	Non-residential capex	Green	Yellow
3	Capex	Earnings	3 months	Non-residential capex	Green	Yellow
4	Construction	Leading economic indicators	18 months	Construction activity	Green	Yellow
5	Economy	New orders less inventories in ISM survey	3 months	ISM manufacturing index	Green	Yellow
6	Economy	Interest rates and ISM prices paid	12 months	ISM manufacturing index	Green	Red
7	Economy	Interest rates, input prices, and US dollar	12 months	Global PMI manufacturing index	Green	Yellow
8	Employment	Single family home sales	18 months	US unemployment rate	Orange	Yellow
9	Inflation	ISM services, PPI service prices and job openings	9 months	CPI services inflation	Green	Yellow
10	Inflation	NFIB pricing plans	12 months	Median CPI	Green	Yellow
11	Inflation	Zillow observed rent index	12 months	CPI rent	Green	Yellow
12	Lending	Respondents reporting tighter credit standards	9 months	Bank lending	Green	Yellow
13	Production	Real inventory-to-sales ratio	4 months	US manufacturing production	Yellow	Green
14	Profits	Fed funds, corp. tax rate, unemployment & productivity	8 months	Economy-wide profits	Red	Red
15	Profits	Economic activity, business confidence, supplier deliveries, wages, inflation, cyclical GDP	12 months	S&P profits	Yellow	Yellow
16	Profits	US\$, PMI, cons. confidence, housing, spreads	12 months	S&P profits	Green	Yellow
17	Sales	NFIB pricing survey	4 months	S&P sales growth	Yellow	Yellow
18	Sales	Producer prices finished goods	4 months	S&P sales growth	Yellow	Yellow
19	Wages	Avg. growth in wages advertised in job postings	4 months	Corporate wage expense	Green	Yellow
20	Wages	Rehiring rate proxy	12 months	Corporate wage expense	Green	Yellow
21	Equities	China credit impulse	9 months	US high beta vs low beta stocks	Orange	Yellow

Source: Bloomberg, Morgan Stanley, Piper Sandler, JPMAM, April 2024. Weakness projection colors: red = substantial, orange = modest, yellow = slight

¹ **Federal Reserve:** for the first time, banks could post collateral at the Fed and borrow 100% of par value even if the security were worth less. **FDIC:** SVB depositors were bailed out despite it being a venture capital piggy bank. SVB deposits rose and fell with the IPO calendar; only 3% of its deposits were fully insured; it offered venture loans in exchange for deposit exclusivity; its average account balance was > \$1 mm; its average uninsured account balance was > \$4 mm; and its top ten depositors had \$13 billion in uninsured deposits, all of whom were bailed out despite the long history of losses imposed on uninsured depositors in FDIC resolutions.

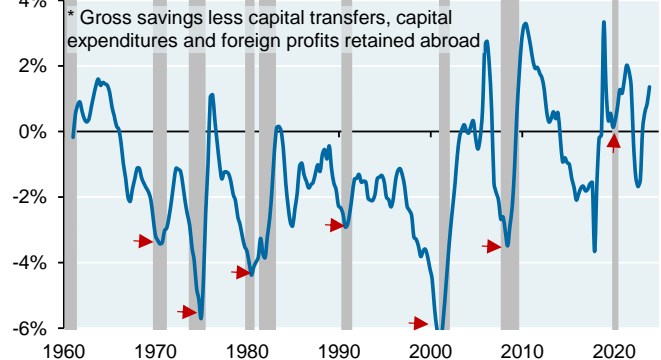
In addition to the improvement in leading indicators, we see limited signs of a large profits or capital spending decline that often coincides with recessions. We highlighted the second chart last year as we were formulating our “Pillow Talk” soft landing thesis. While the inverted US yield curve has a clear pattern of predicting recessions, **prior yield curve inversions were also accompanied by deeply negative corporate sector cash flow**. This time around, the story is different: the corporate sector is in surplus. For all the talk of an overextended tech-driven boom, the fourth chart shows a very modest increase in tech capital spending relative to cash flow. In other words, nowhere near the kind of excesses that took place twenty-four years ago².

US economy-wide profits and S&P 500 operating profits
Index (100 = January 1995)



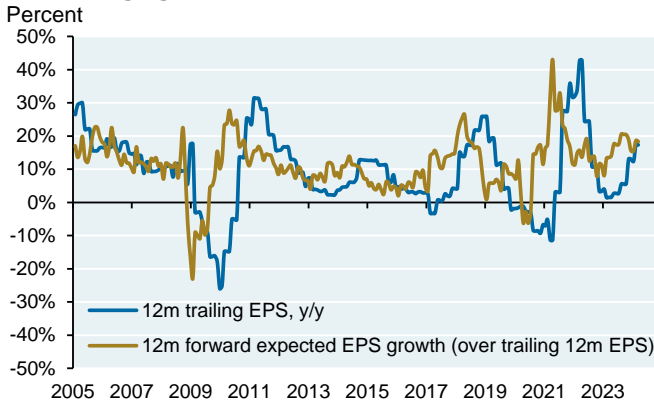
Source: Bloomberg, JPMAM, April 2024

US corporate sector financial balance
% of corporate gross value added, 4-quarter average



Source: Federal Reserve, BEA, JPMAM, Q4 2023

US earnings growth



Source: Bloomberg, JPMAM, March 2024

US tech capital cycle



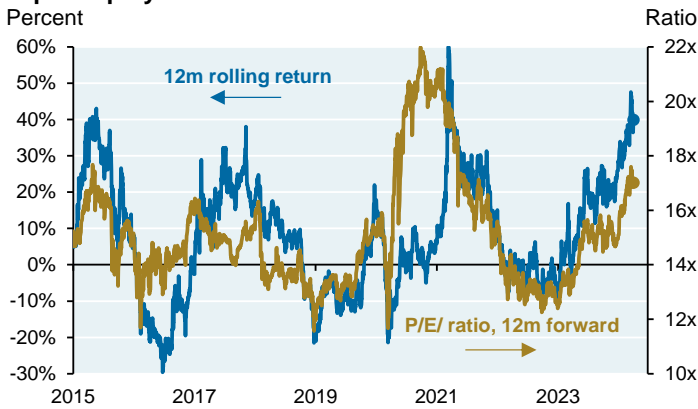
Source: Bloomberg, JPMAM, Q1 2024

² In 1999, the CEOs of TheGlobe.Com were invited to be the keynotes speakers at JP Morgan’s annual Managing Director meeting, the first one I was invited to. I checked my Bloomberg terminal to see what this company did, and it said “TheGlobe.Com has no publicly announced business model at this time”. I asked around and no one else had any idea what they did either. Their stock disintegrated over the next few months. A few months later, JP Morgan merged with Chase Bank. I do not see these two events are being completely unrelated.

Japan

Commentary

Japan equity returns vs valuation



Source: Bloomberg, JPMAM, April 5, 2024

Commentary

Investment deal activity in Japan



Source: Prequin, JPMorgan Private Investments, April 2024

Japanese deal making accelerates



Source: Bloomberg, February 2024

Here are the corporate governance changes that we mentioned last year in the Eye on the Market as signifying a meaningful improvement in Japan for equity investors.

- As shown in the table, there’s a lot of room for Japan to “equitize” further
- The exit from deflation has made cash less attractive vs equities for Japanese pensions and households (real short term interest rates are -2%)
- The Tokyo Stock Exchange has threatened to delist companies trading below book value unless they enact governance reforms
- There are over 50 activist funds in Japan which is unprecedented, and they’re pummeling the corporate sector with governance proposals
- The share of companies with more than 50% independent external directors has risen from 30% to 60%
- There are tax incentives for households to increase equity allocations, and there’s pressure on Japanese pensions to align equity allocations higher to match the Government Pension Investment Fund

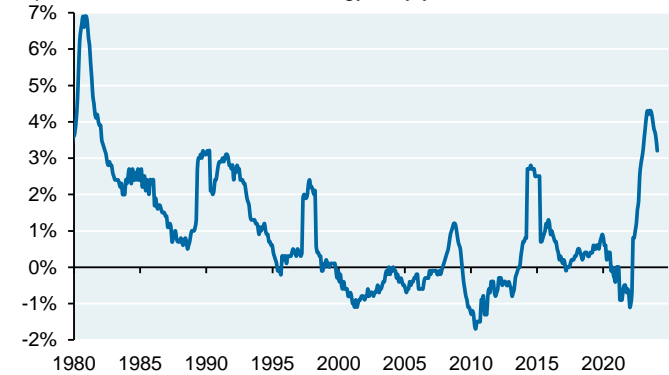
Room for Japan to "equitize"

	US	Japan
10 year dividend payout ratio	70%	30%
Cash % of market capitalization	7%	21%
Share of companies trading below book value	4%	50%
Corporate buybacks as % of market capitalization	2.0% - 3.5%	0.7% - 1.4%
Household equity allocation	40%	11%
Pension equity allocation	40%	25%
Household cash allocation	15%	55%

Source: Bridgewater, JPMAM, December 2023

Japan finally exits deflation

Japan CPI ex fresh food and energy, % y/y

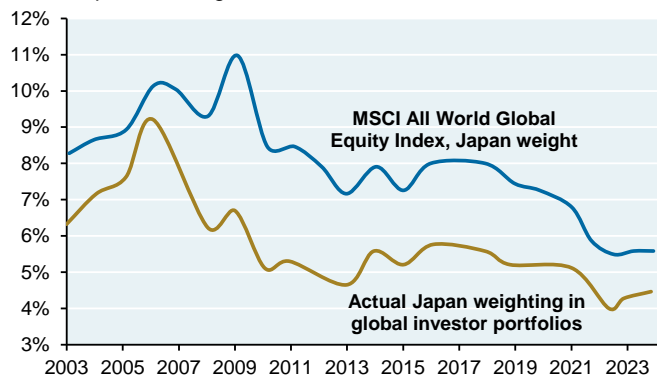


Source: Bloomberg, JPMAM, February 2024

To be clear, Japan is still a very slow-growing economy with a lot of demographic and competitive pressures. Growth in 2023 was still dominated by exports rather than by domestic consumption, real wage growth is still negative, its industrial production growth is no different than Europe, and China has now eclipsed Japan as the world’s largest auto exporter. According to the Bank of Japan, the country’s potential growth rate is still less than 1% due in large part to unfavorable demographics. **Our improved outlook for Japan equities is based on the exit from deflation combined with additional boosts from corporate governance and investment incentive policies. I doubt that will end up being a rationale that lasts for several years.**

Global investor underweight to Japanese stocks

Percent, portfolio weight



Source: JP Morgan Securities Japan, JPMAM, December 2023

Introducing the Eye on the Market mailbag!

Vaclav Smil sent me a note expressed his disappointing experience with AI. Vaclav asked GPT-4 how many GW of power a city of 1 million people would need. GPT-4’s response: 342 GW. That’s a very bad answer! The entire US has ~1,200 GW of installed capacity. What went wrong? GPT-4 did the energy math incorrectly when converting GWh to kWh, and should have responded with 0.342 GW. The bigger problem: GPT-4 had no way of checking its results to see if they made any sense. Vaclav’s conclusion: “It was off by three orders of magnitude. I hope nobody uses this AI for anything!”

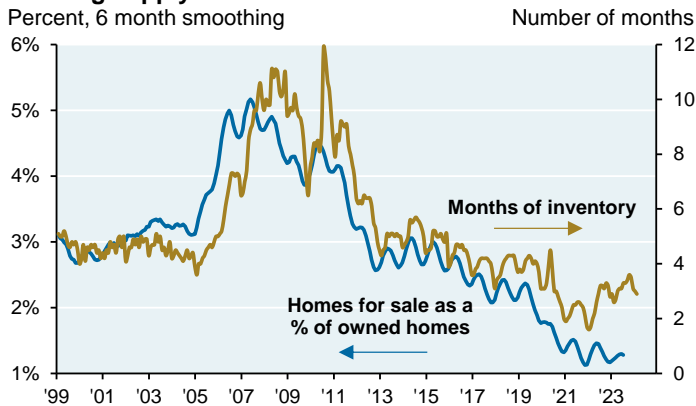
Eric G. from a California pension plan asked if there have been any notable developments regarding GLPs tested for conditions other than diabetes and obesity. As we wrote in the 2024 Outlook, one of the key valuation premises for GLP stocks is their eventual use for other conditions.

- GLPs appear to work via brain pathways to reduce inflammation. Some experts speculate that GLPs could be used to treat conditions that involve inflammation such as Alzheimer’s and Parkinson’s. A study of early Parkinson’s disease found no progression of motor symptoms for patients taking GLPs, compared to the placebo group which worsened by 3 points on a scale of 132 (not clinically meaningful)³. So, no major changes here
- More than half of patients with heart failure have preserved pump function (HFpEF). Previous studies have shown that GLPs can reduce the risk of HFpEF, but these studies excluded participants with Type 2 diabetes. A recent study of patients with Type 2 diabetes found that GLPs led to larger reductions in HFpEF related symptoms than the placebo group after 1 year⁴

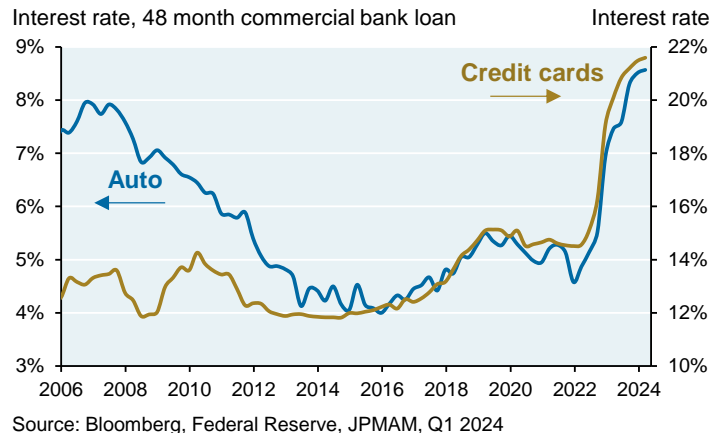
Rachel H who lives with me in Brooklyn writes, “why are housing pricing so stable despite the rise in interest rates?” Inventories are extremely tight whether measured against the pace of sales or against the housing stock. Research shows that home prices have usually only declined when the months of inventory rising above 6.0x; it is currently at 3.0x.

Joe F from a college endowment asks, “what keeps you up at night in terms of risks related to the US economy?” The major risk is the budget deficit/debt situation, for which we have created an online monitor (see link above). While a wide range of leading indicators have improved substantially (see page 1), I still think there could be some aftershocks from xxx.

Housing supply



Consumer interest rates



³ “Trial of Lixisenatide in Early Parkinson’s Disease” NEJM, Meissner et al, April 3, 2024

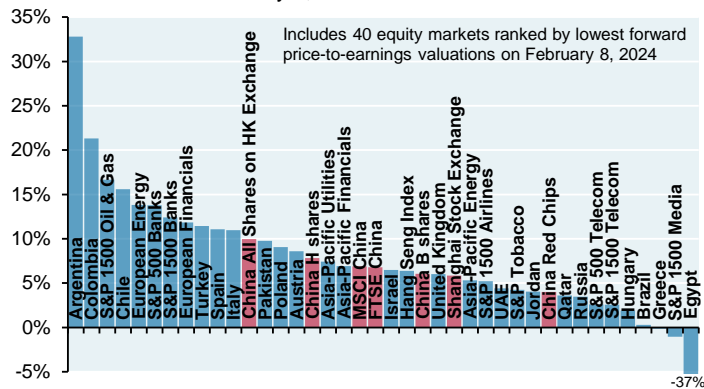
⁴ “Semaglutide in Patients with Obesity-Related Heart Failure and Type 2 Diabetes” NEJM, April 6, 2024

David F, a colleague who asks too many metaphorical questions with no apparent answer, did ask a concrete one regarding China. Two months ago, Dave wanted to know if a 10x P/E was enough of a discount to offer value on China equities for long term investors, and if we expected improvement in China’s economy.

- China’s economy is showing some signs of life; our China monitors⁵ have been rising a bit from very depressed levels. But the real estate situation is still in bad shape with many years of unsold supply and weakening demand; since a lot of government spending is done by local entities relying on land sales, fiscal policy hasn’t been very stimulative
- In the February EoTM we explained that while China was trading at a 10x P/E, there were a lot of equity markets trading at or below that level; China was not the only deep value market in town. As shown in the second chart, risk appetite has been rising globally. Since February 8, around half of the deep value equity markets have risen more than the MSCI China Index.

Returns of the cheapest equity markets

Price returns since February 8, 2024

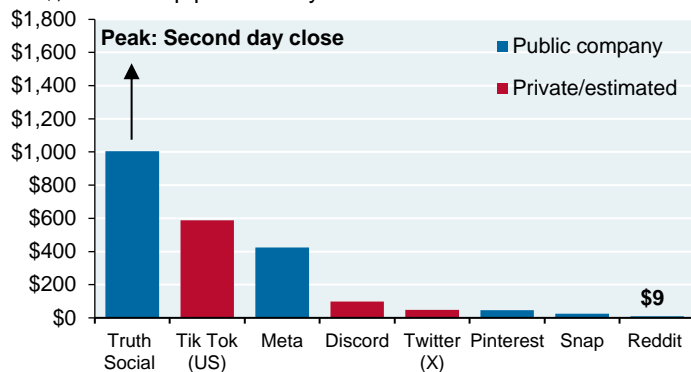


Source: Bloomberg, JPMAM, April 9, 2024

Alex W from MSNBC asked me what I thought of market valuation of Truth Social. My response:

Social media market cap per active user

US\$, Market cap per monthly active users



Source: Bloomberg, CNN, Nasdaq, Business of Apps, Axios, JPMAM,

Michael Cembalest, JP Morgan Asset Management

⁵ Monthly data used in our China activity monitor: exports, electricity consumption, industrial production, retail sales, corporate earnings, crude steel production, non-SOE fixed asset investment, residential construction starts and a credit impulse index

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