

The Leuthold Group

The Hunt For Red October

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Major Trend Index

September 22, 2023

Category	-	Reading	+ Comments
Valuation		◆◆◆◆	-Valuations on Large Cap stocks back to pre-COVID peaks
Cyclical		◆◆◆	-Tightening hitting everything (except unemployment claims!)
Sentiment		◆◆◆	-Excessive confidence in prospects for a soft landing
Technical		◆◆◆◆	-Breadth/leadership very uncharacteristic of new bull market
TOTAL		◆◆	-High Neutral, Neutral, or Low Neutral since mid-January

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(Low Neutral)

New Bull Market Signposts

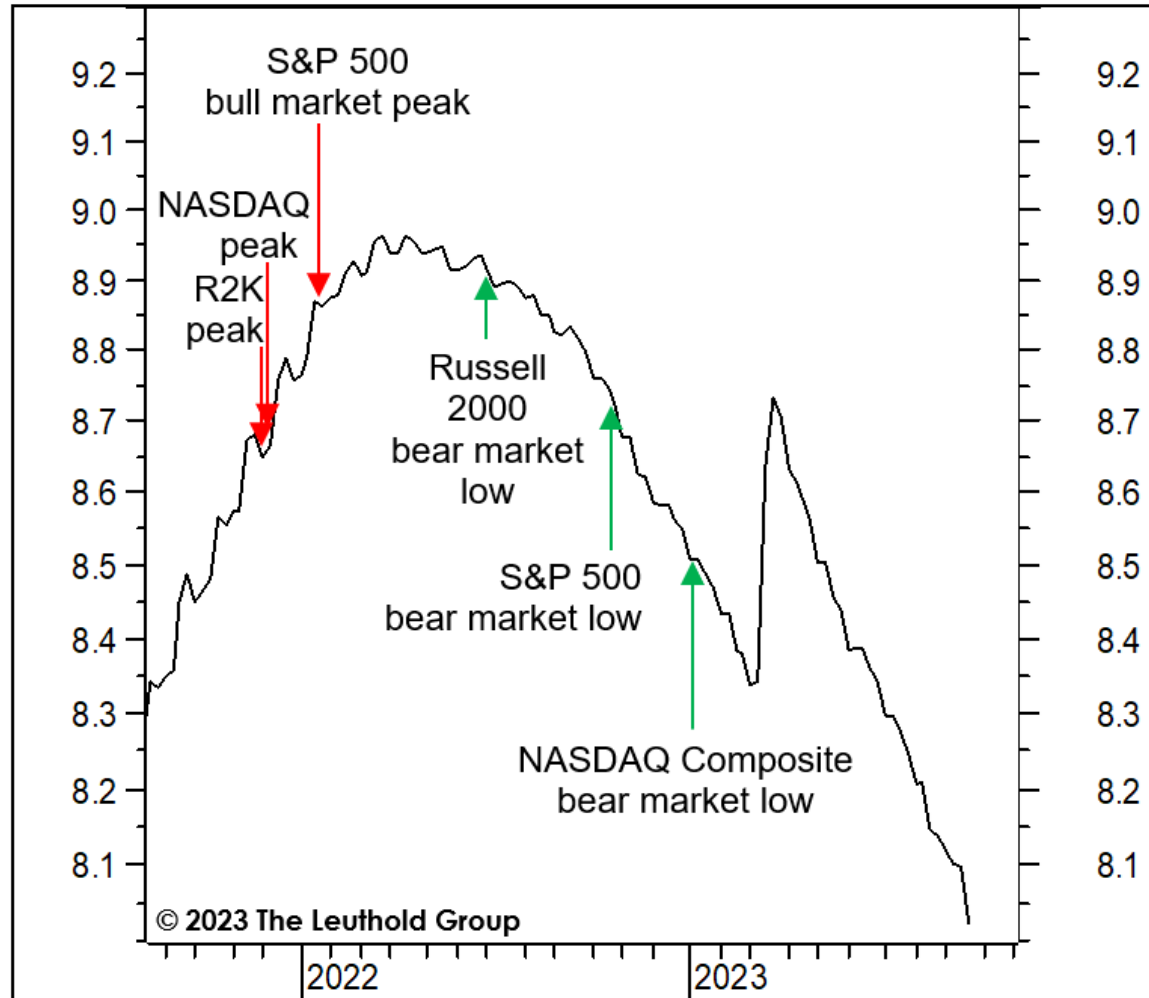
Economy	Economy emerging from recession Leading Economic Indicators rising sharply Super bullish readings in NOPE Index (ISM New Orders > Prices) Housing activity rebounding from depressed level Boom/Bust Barometer rising Federal deficit expanding rapidly	NO NO NOPE NO YES YES	(down for 17 consecutive months)
Inflation	Inflation declining from cyclical peak	YES	(peaked 15 months ago)
Monetary/Liquidity	Long campaign of Fed rate cuts Yield curve steepening rapidly Money supply growth far above GDP growth (excess liquidity)	NO NO NO	(most severe inversion on record) (reverse is true - and to a record degree)
Valuations	Emerging from average or below-average levels	NO	
Market Action	S&P 500 Stop-And-Reverse Model BUY % S&P 500 stocks above 50-day MA > 90 Moving Balance Indicator > 80 Zweig Breadth Thrust VLT Low-Risk BUY Signal on S&P 500 Weekly NYSE 52-Wk. Highs > 350 NYSE 10-Wk High/Logic Index Major BUY NASDAQ 10-Wk High/Logic Index Major BUY Outperformance by Small Caps & equal-weighted indexes Outperformance by Financial stocks Outperformance by Cyclical stocks	YES YES YES YES YES YES NO NO NO NO YES	(October 28, 2022) (November 30, 2022) (January 12, 2023) (March 31, 2023) (March 31, 2023) (for only one week - February 3, 2023)

Monetary
conditions:
From bad to
worse...

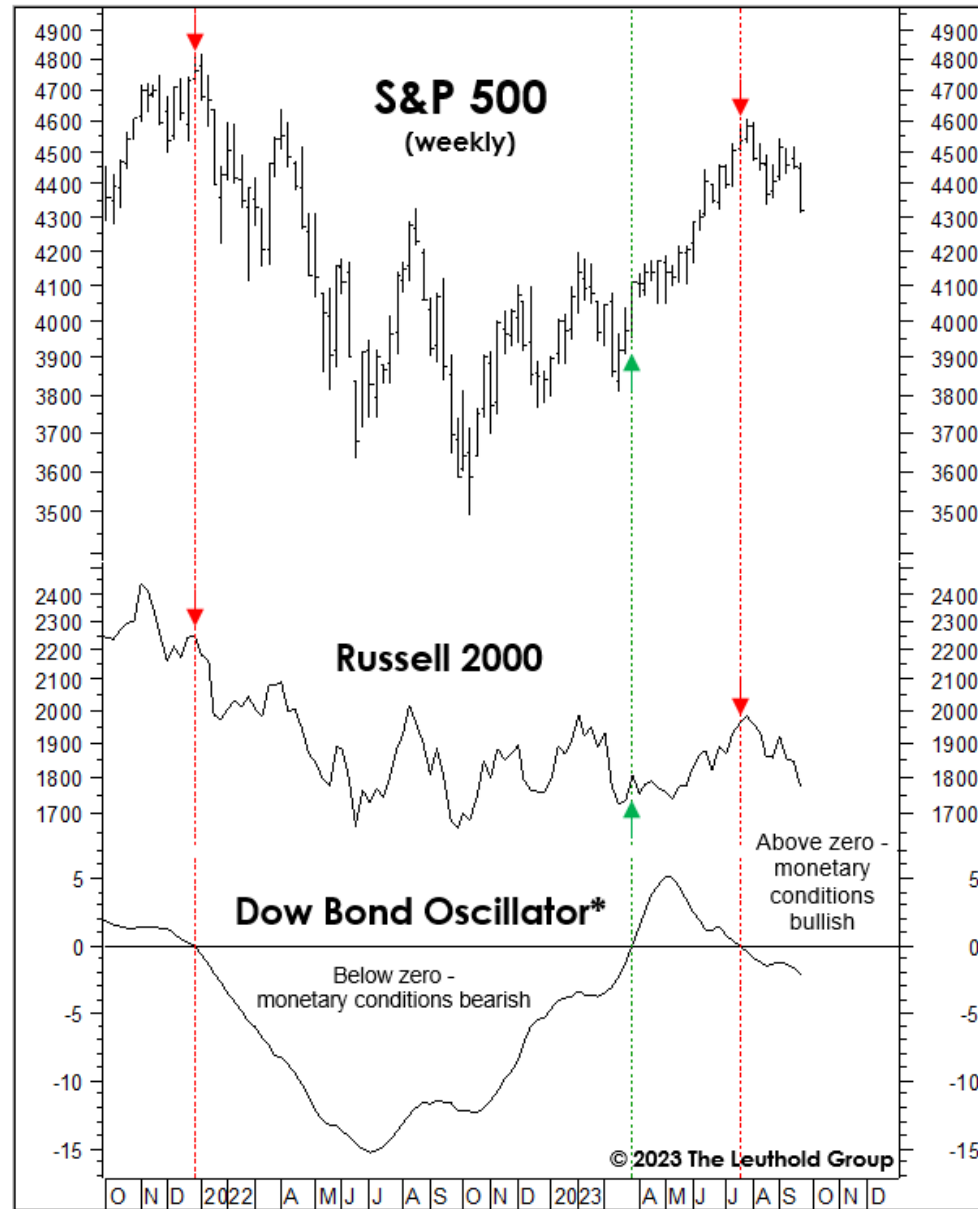
		- Reading +
Monetary/ Liquidity	M2 Money Supply Growth	◆◆◆◆◆◆◆◆◆◆
	Global M2 Growth	◆◆
	Marshallian K (M2 Minus GDP Growth)	◆◆◆◆◆◆◆◆◆◆
	Excess Liquidity (Real M2 Less Ind. Prod. Growth)	◆◆◆◆◆◆◆◆◆◆
	Fed Balance Sheet Expansion/Contraction	◆◆◆◆◆◆◆◆◆◆
	Treasury General Account Expansion(-)/Contraction(+)	◆◆◆
	Dow Bond Oscillator	▼◆◆◆◆◆◆◆◆◆◆
	Moody's BAA Momentum	◆◆◆◆◆◆◆◆◆◆
	10-Yr. Treasury Momentum	▼◆◆◆◆◆◆◆◆◆◆
	3/5-Yr. Treasury Momentum	▼ ◆◆◆
	Treasury Yield Curve (10-Yr. Minus 3-Mo.)	◆◆◆◆◆◆◆◆◆◆
	Near-Term Forward Spread	◆◆◆◆◆◆◆◆◆◆
	2s10s	◆◆◆◆◆◆◆◆◆◆
	2-Yr./Fed Funds	◆◆
	Loan Demand	◆◆
	Consumer Credit Demand	◆◆

QE/QT:
Not the timing
tool it used to be

Fed Balance Sheet (Total Assets of All Federal Reserve Banks - Tril \$)

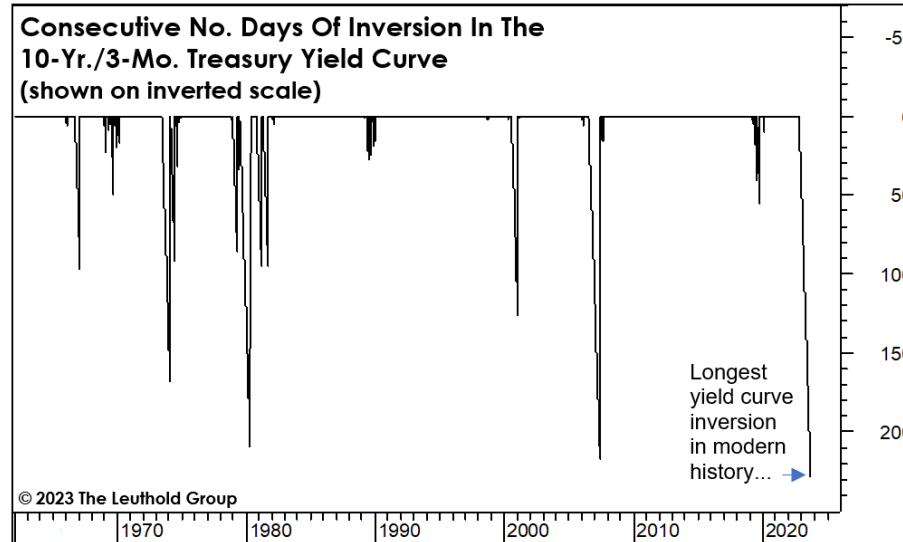


Liquidity
measure based
on bond prices
is negative
again

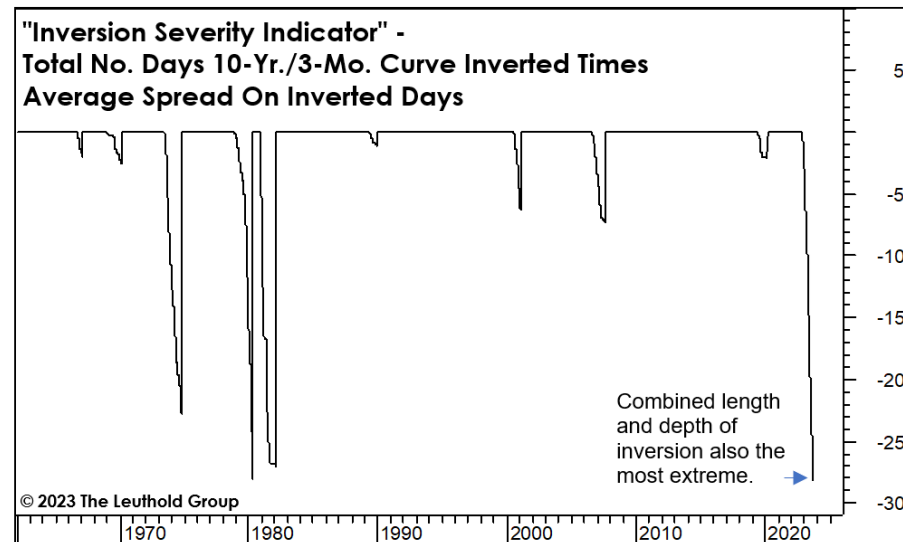


*10-wk. exponential moving average of the 26-wk. percentage change in the Dow Jones Corporate Bond Index.

The most pronounced curve inversion in history



*Secondary-market 3-mo. bill rate used until January 1982; constant-maturity rate used thereafter.



Stocks usually stage a “post-inversion, pre-recessionary” rally...

Making Money In The S&P 500 After The Yield Curve Inverts



Inversion occurs when 10-Yr./3-Mo. Treasury spread goes negative for 10 consecutive days. (Jim Bianco rule)

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Stats for previous “post- inversion” rallies

S&P 500 Performance From Inversion To Subsequent Highs & Lows

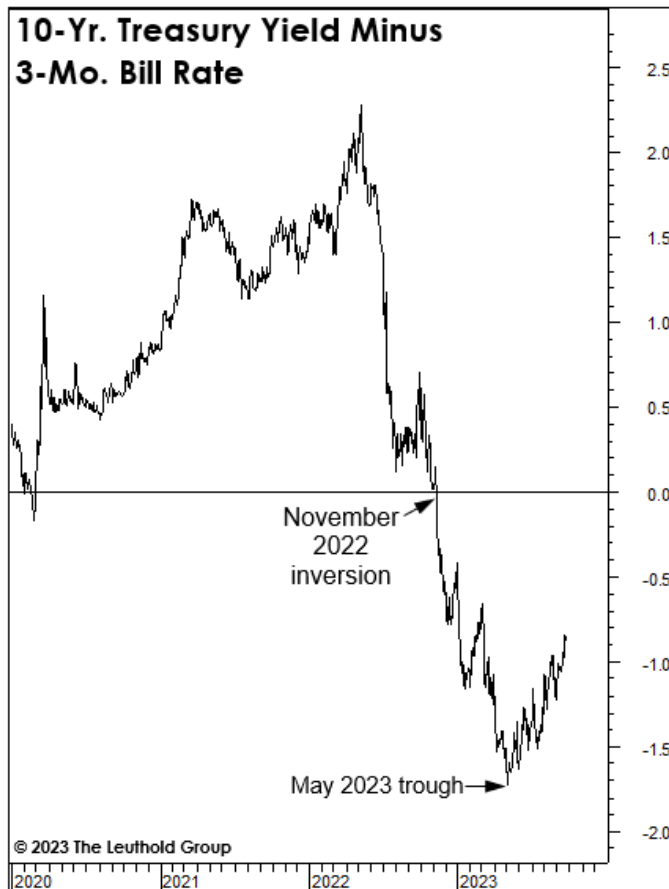


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10-Yr./3-Mo. Yield Curve Inverted For Ten Consecutive Days	Gain In S&P 500 To Next Peak	Days From Inversion To Next Peak	Gain/Loss In S&P 500 From Inversion To Final Low	Days From Inversion To Final Low	Loss In S&P 500 From Interim Peak To Final Low	Days From Interim Peak Final Low
January 13, 1969*	5.7	83	-31.0	343	-34.7	260
June 14, 1973*	4.7	84	-41.5	330	-44.1	246
December 29, 1978	23.3	284	2.2	316	-17.1	32
November 10, 1980	8.5	13	-20.9	443	-27.1	430
June 7, 1989	12.9	279	-9.6	341	-19.9	62
August 1, 2000*	5.7	23	-46.0	548	-48.9	525
August 1, 2006	23.1	299	-46.8	654	-56.8	355
June 6, 2019	19.1	177	-21.2	200	-33.9	23
November 7, 2022*	20.6 **	181	?	?	?	?
Average (ex. 2022-23)	12.9	155	-26.9	397	-35.3	242

*S&P 500 bull market high made before 10-Yr./3-Mo. curve inverted

**through S&P 500 July 31st rally high

Based on the yield curve's typical lead time, a business cycle peak is imminent



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 Recession warnings are triggered when this measure trades below zero for ten consecutive days (rule proposed by Jim Bianco).

Yield Curve Inversions & U.S. Recessions

First Month In Which 10-Yr./3-Mo. Spread Inverts For Ten Consecutive Days	Months To Business Cycle Peak
January 1969	11
June 1973	5
December 1978	13
November 1980	8
June 1989	13
August 2000	7
August 2006	16
June 2019	8
November 2022	?
Average Lead Time	10

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"Maximum Inversion" & Recessions

Month In Which 10-Yr/3-Mo. Spread Reaches Most Inverted Level For Cycle	Mos. To Bus. Cycle Peak
July 1969	5
September 1973	2
March 1980	-2
May 1981	2
June 1989	13
January 2001	2
February 2007	10
August 2019	6
May 2023	?
Average Lead Time	5

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A better mousetrap:
 The Near Term
 Forward Spread
 (NTFS)

**Which Versions Of The Treasury Yield Curve
 Best Forecast Future Economic Growth?**

© 2023 The Leuthold Group		Correlation* With 4-Qtr. Forward Real GDP Growth, 1978Q1-2022Q1	
		Reading on September 22	
best →	Near Term Forward Spread	0.48	-0.78
	5-Yr. Minus 3-Mo.	0.41	-0.99
	5-Yr. Minus 6-Mo.	0.35	-0.95
economists'	5-Yr. Minus 1-Yr.	0.34	-0.89
long-time	10-Yr. Minus 6-Mo.	0.33	-1.08
gold standard →	10-Yr. Minus 3-Mo.	0.30	-1.12
	10-Yr. Minus 1 Yr.	0.27	-1.02
bond investors'	5-Yr. Minus 2-Yr.	0.23	-0.53
favorite →	10-Yr. Minus 2-Yr.	0.17	-0.66
	5-Yr. Minus 3-Yr.	0.15	-0.23
	10-Yr. Minus 3-Yr.	0.13	-0.36

*Yield curves calculated as six-month averages of daily figures, which showed higher correlations with GDP growth than quarterly average and quarter-end figures.

NTFS lead times



Recession warnings are triggered when this measure remains below zero for ten

Inversions In The Near Term Forward Spread & U.S. Recessions

First Month In Which NTFS Inverts For Ten Consecutive Days	Mos. To Business Cycle Peak
November 1968	13
June 1973	5
December 1978	13
November 1980	8
June 1989	13
August 2000	7
August 2006	16
March 2019	11
November 2022	?
Average Lead Time	11

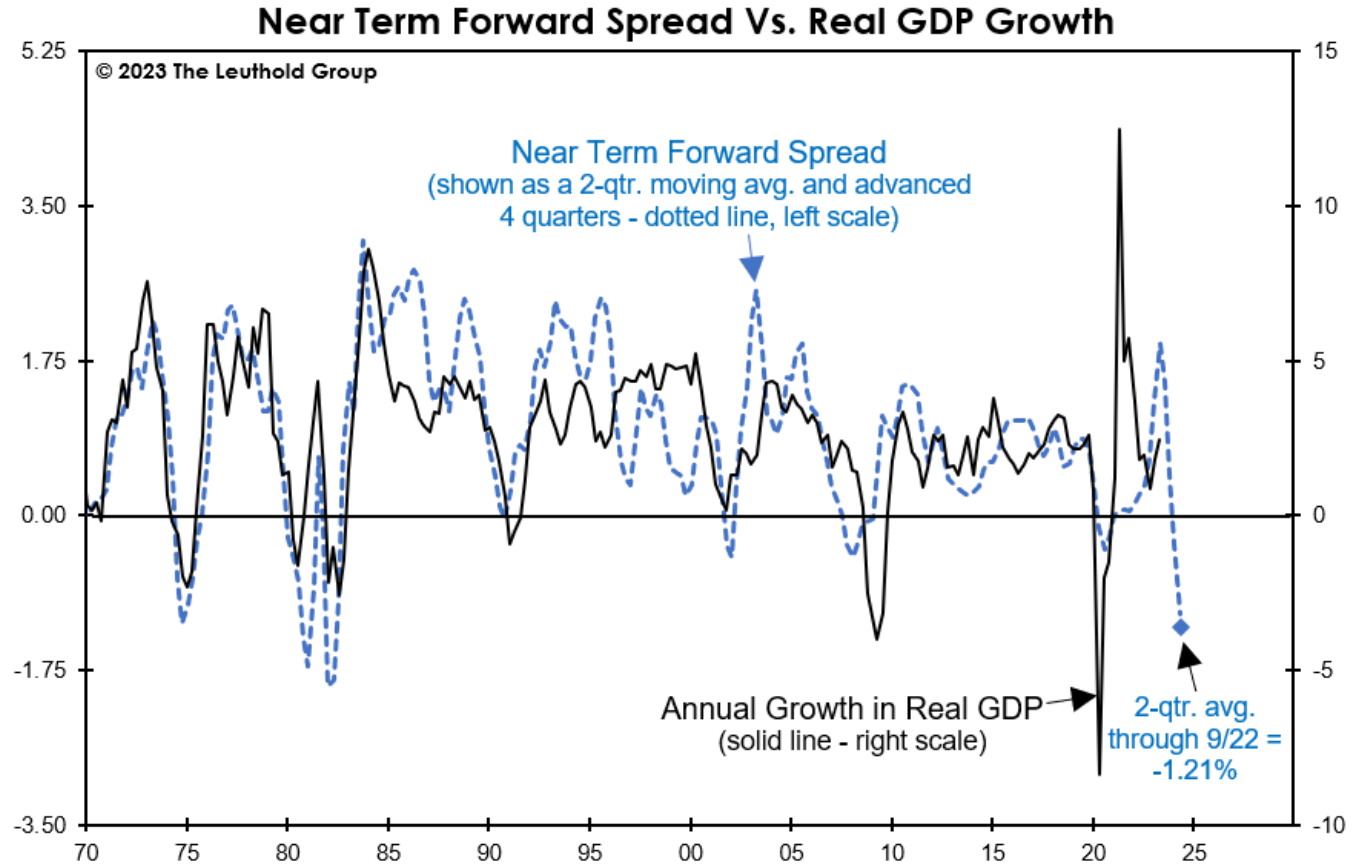
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"Maximum Inversion" In Near Term Forward Spread & U.S. Recessions

Month In Which NTFS Reaches Most Inverted Level For Cycle	Mos. To Bus. Cycle Peak
June 1969	6
September 1973	2
April 1980	-3
December 1980	7
July 1989	12
December 2000	3
January 2008	-1
September 2019	5
May 2023	?
Average Lead Time	4

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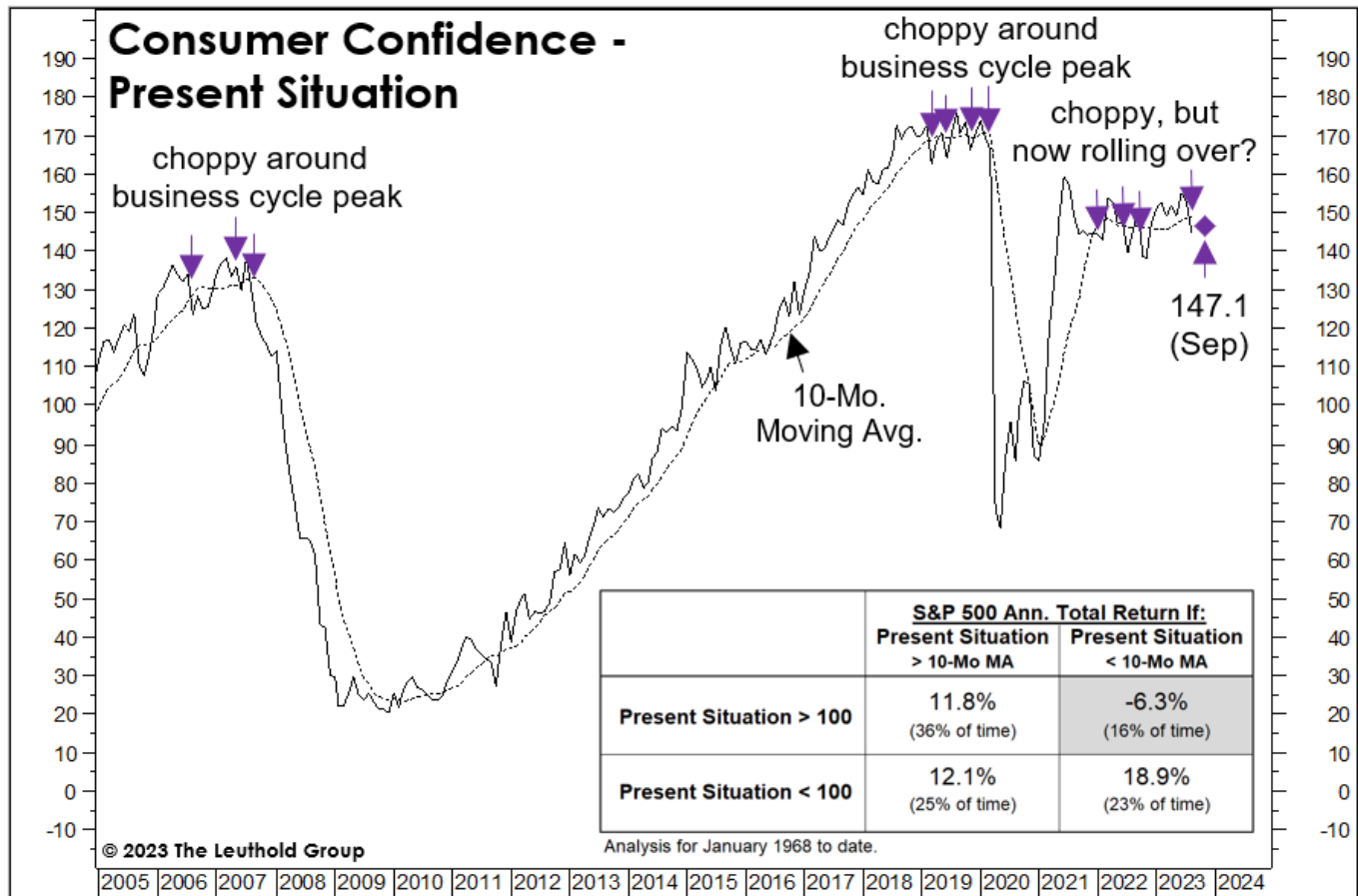
If the *depth* of the yield curve inversion matters, look out



Hunt For Red October?

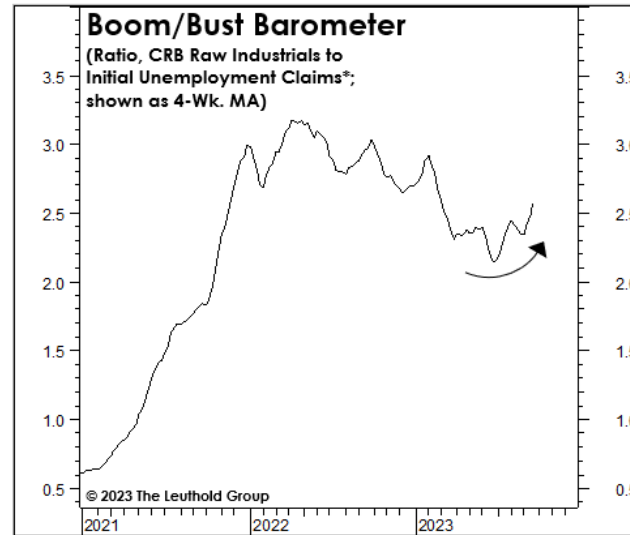
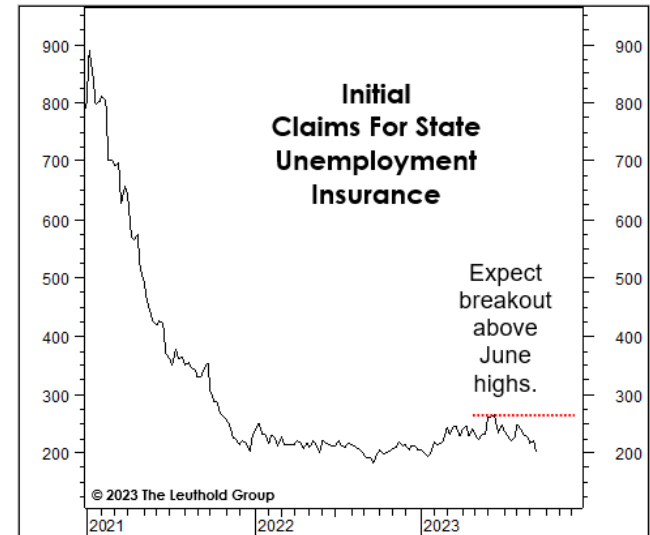
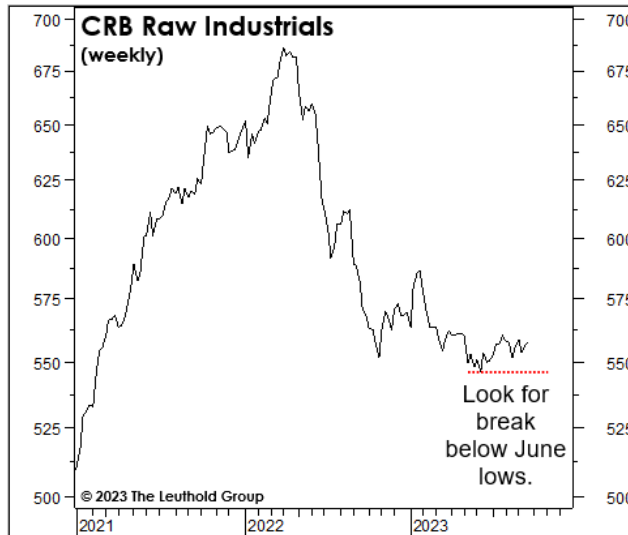
- Based on their average lead times from the last eight cycles, both the 10-Yr./3-Mo. Treasury spread and the Near Term Forward Spread (NTFS) project a business cycle peak in September or October
- Crude oil up 30-35% from summer lows
- Student loan repayments resuming in October
- UAW strikes hitting production & incomes on a short-term basis
- Stock market correction could be the straw that breaks the economy's back

Confidence has entered the “Twilight Zone!”



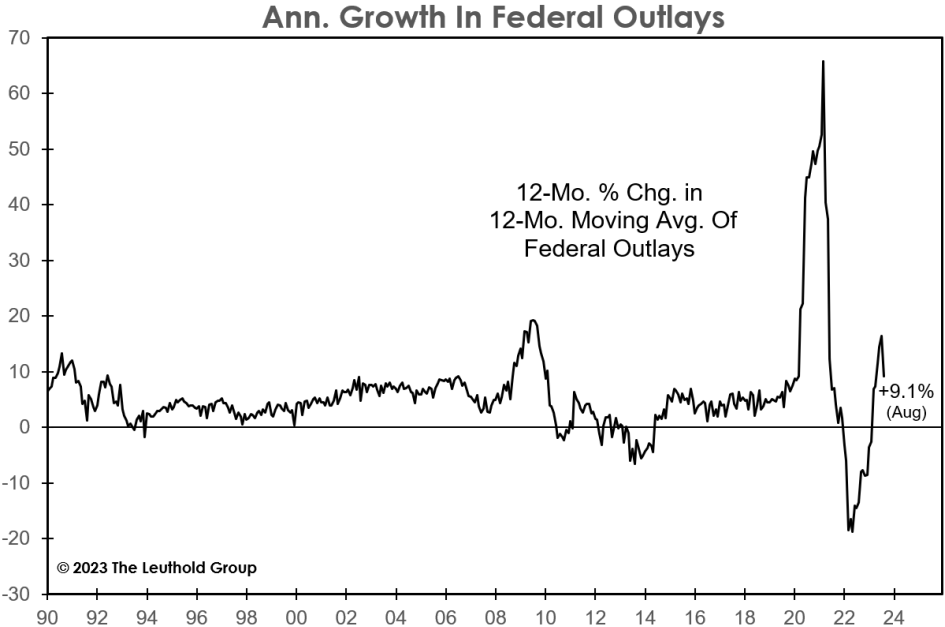
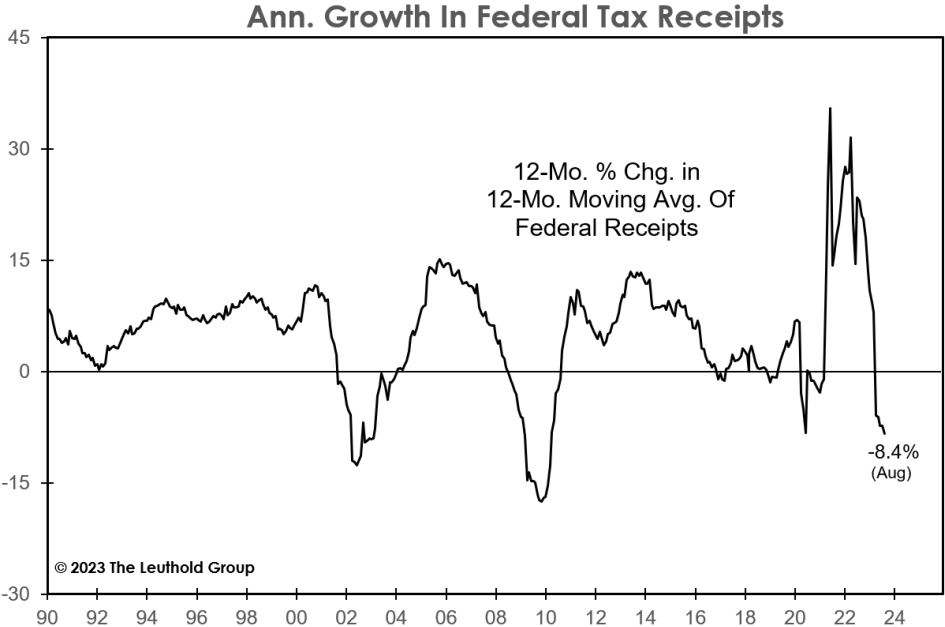
Source: Conference Board

Pieces of the puzzle that don't fit...



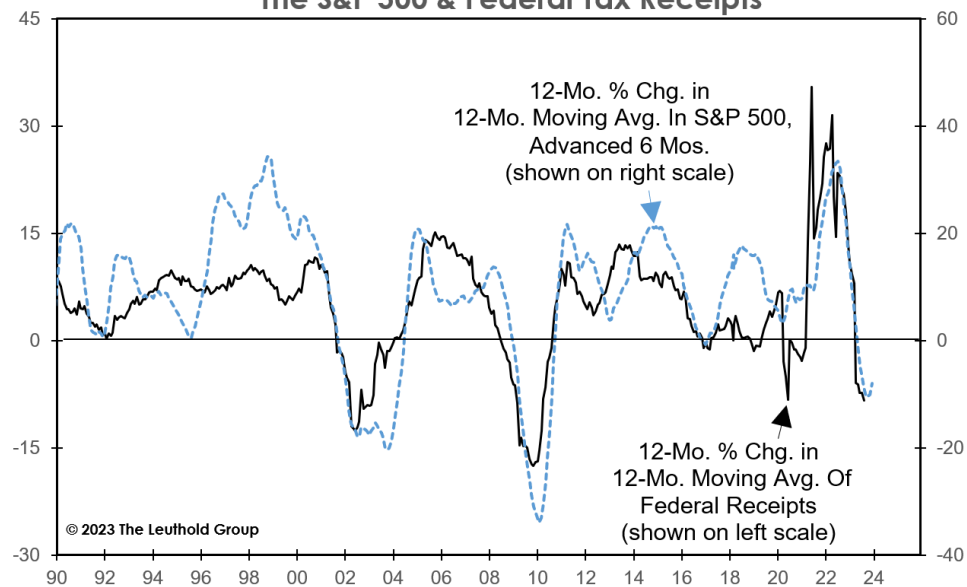
*Shown as a 4-wk. moving avg. Created by Ed Yardeni

Fiscal offset?

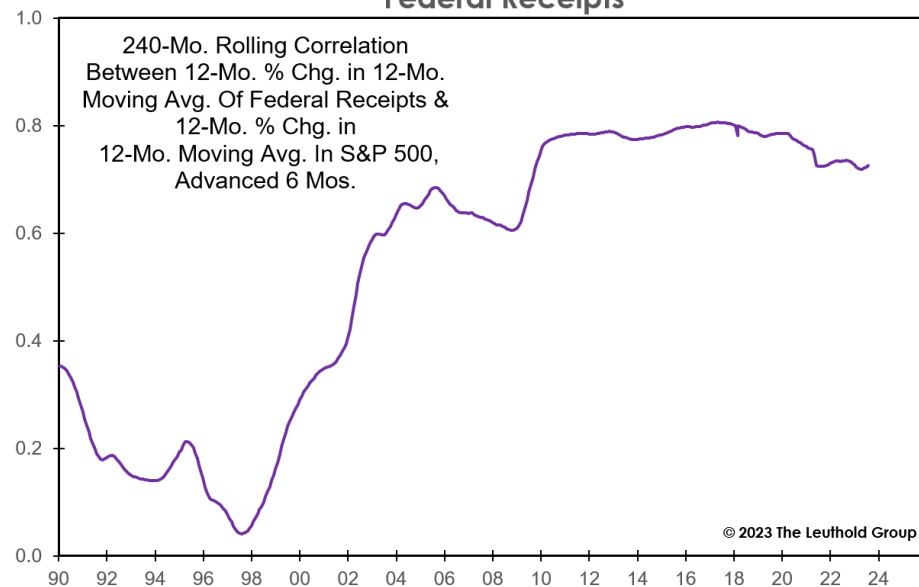


Blowout in deficit is largely result of *last year's* market decline

**The Tail Wags The Dog:
The S&P 500 & Federal Tax Receipts**



20-Yr. Rolling Correlation Between S&P 500 & Federal Receipts

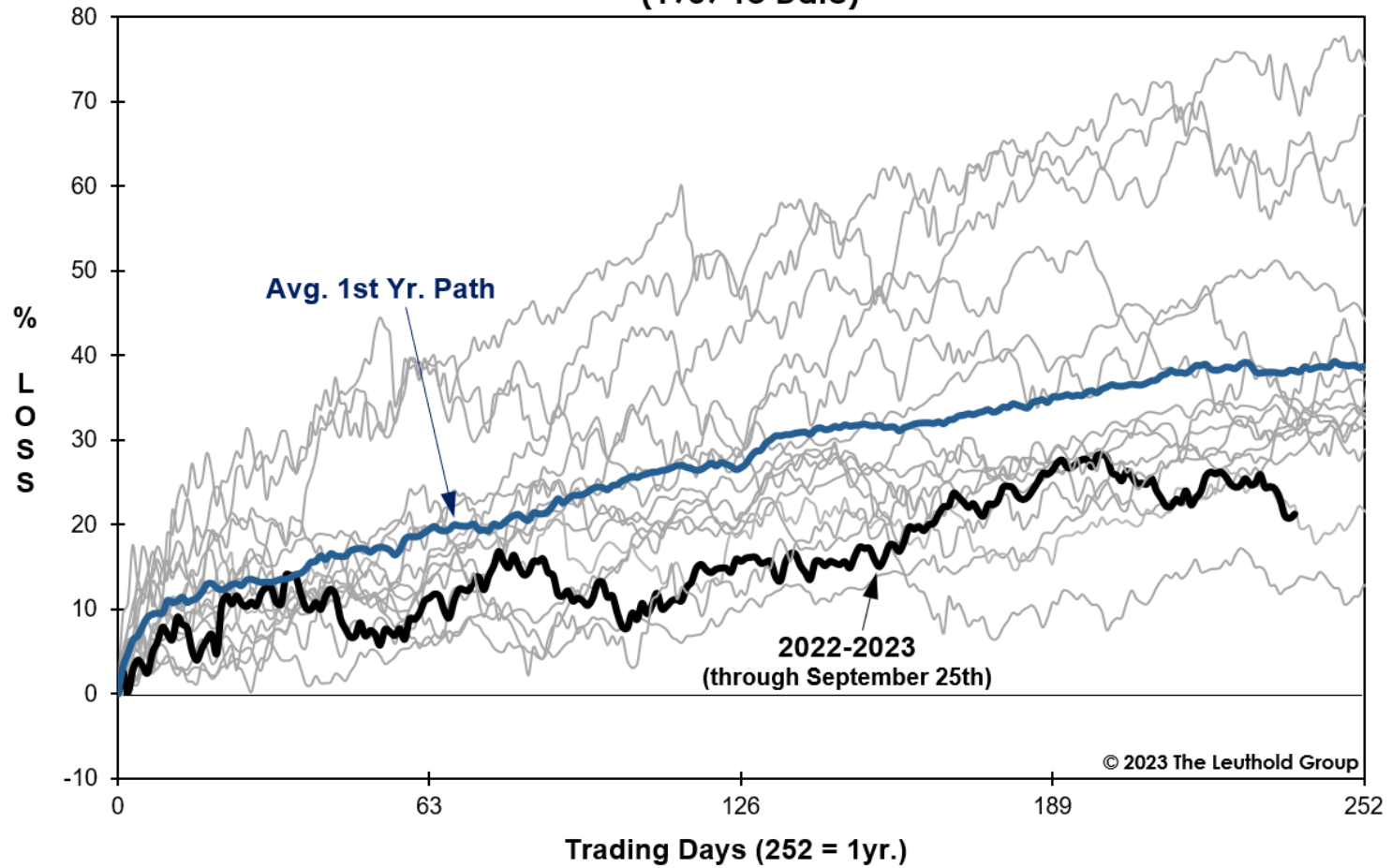


Major S&P 500 Advances* (1957 To Date)

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Date of Low	Date of High	Gain (%)	Duration (Mos.)	Followed Recession?
October 22, 1957	December 12, 1961	86.4	50.0	Yes
June 26, 1962	February 9, 1966	79.8	42.5	No
October 7, 1966	November 29, 1968	48.0	25.5	No
May 26, 1970	January 11, 1973	73.5	29.5	Yes
October 3, 1974	September 21, 1976	73.1	23.5	Yes
March 6, 1978	November 28, 1980	61.7	32.5	No
August 12, 1982	August 25, 1987	228.8	60.5	Yes
December 4, 1987	July 16, 1990	64.8	31.5	No
October 11, 1990	July 17, 1998	301.7	93.0	Yes
August 31, 1998	March 24, 2000	59.5	17.0	No
October 9, 2002	October 9, 2007	101.5	60.0	Yes
March 9, 2009	April 29, 2011	101.6	25.5	Yes
October 3, 2011	September 20, 2018	166.6	83.5	No
December 24, 2018	February 19, 2020	44.0	14.0	No
March 23, 2020	January 3, 2022	114.4	21.0	Yes
October 12, 2022	July 31, 2023	28.3	9.5	No
Average (ex. latest)		107.0	40.6	8 of 15 advances preceded by recessions
Average (ex. latest)		79.8	31.5	
Average (ex. latest) if:				
Advance preceded by recession		135.1	45.4	
Advance not preceded by recession		74.9	35.2	

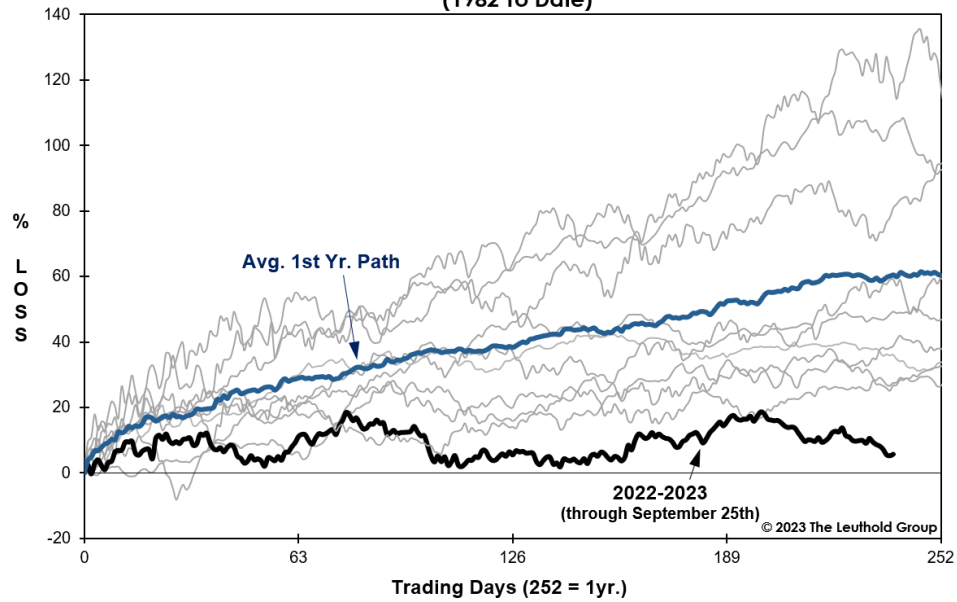
*A Major Advance is defined as an upswing in the S&P 500 not interrupted by a 19% drop (i.e., by a Major Decline)

Major S&P 500 Advances [Gains Not Interrupted By A 19% Decline] (1957 To Date)

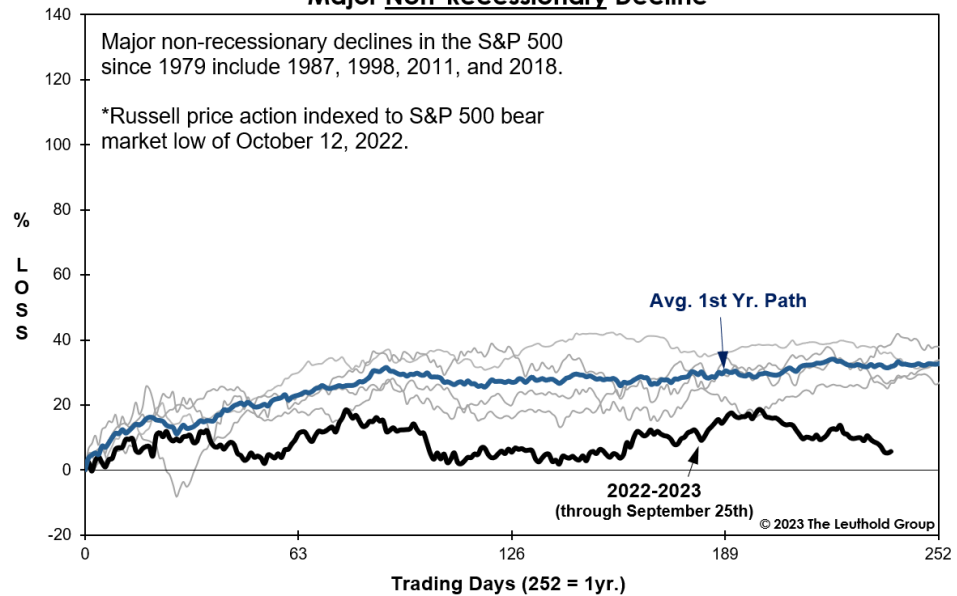


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**Russell 2000 In First Year Of A Major S&P 500 Advance
(1982 To Date)**

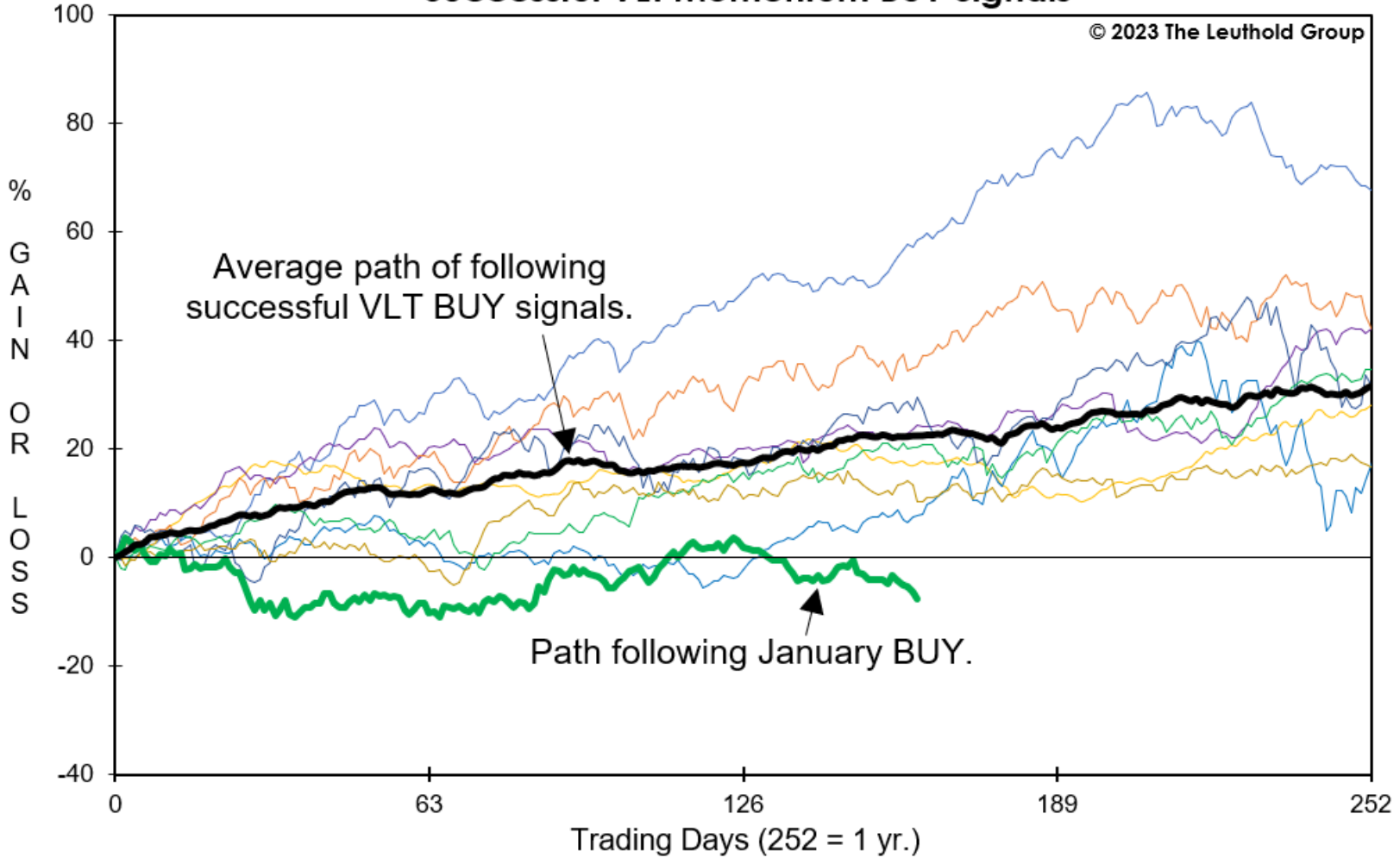


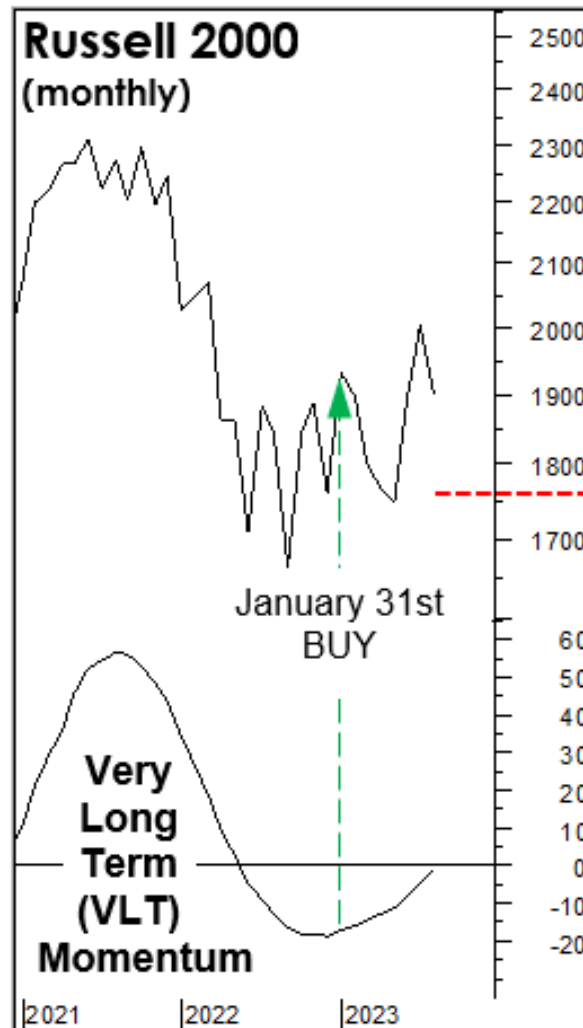
**Russell 2000 In First Year After A
Major Non-Recessionary Decline***



Russell 2000 In 12 Months Following Successful VLT Momentum BUY Signals

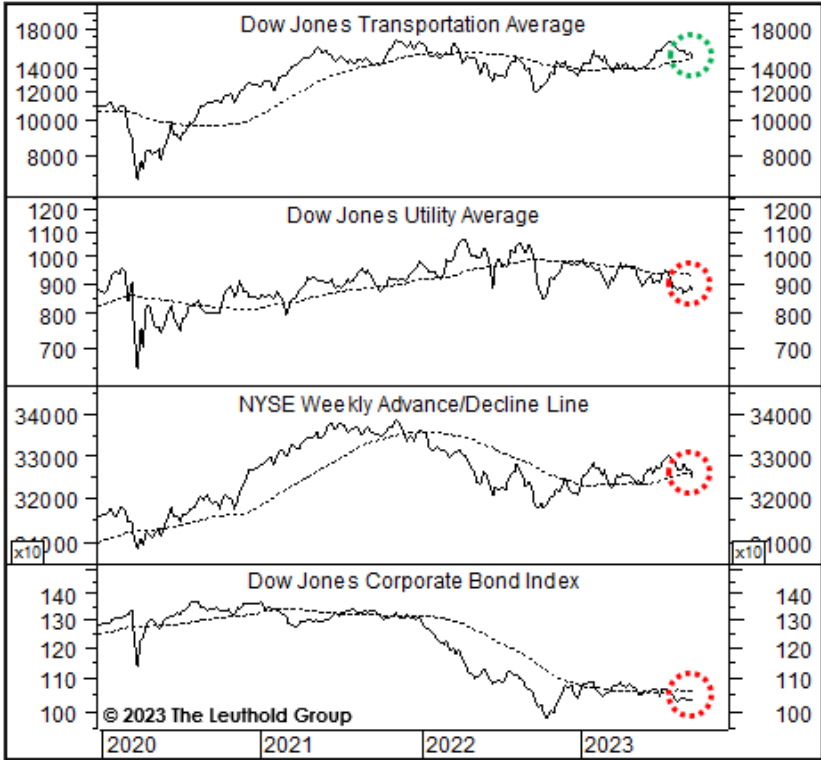
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VLT BUY signal will be rescinded if the Russell 2000 closes the month of September below 1761 (versus 1784 on Sept. 25th).

BUY signals occur when VLT turns up from below zero



All series shown with their 40-week moving averages.

Quattro Model Performance

Market Status	S&P 500 Ann. Gain	Pct. Of Time
Transports, Utilities, NYSE Breadth & Bonds above 40-wk moving avg.	15.0%	35%
Three of four series above 40-wk moving average	8.0%	22%
Two of four series above 40-wk moving average	6.8%	17%
One of four series above 40-wk moving average	-5.3%	11%
None of four series above 40-wk moving average	2.6%	15%

Results for period April 1941 to date.



Dots represent bear market lows.

Latest reading (September 22, 2023) = 25.9x (91st percentile)

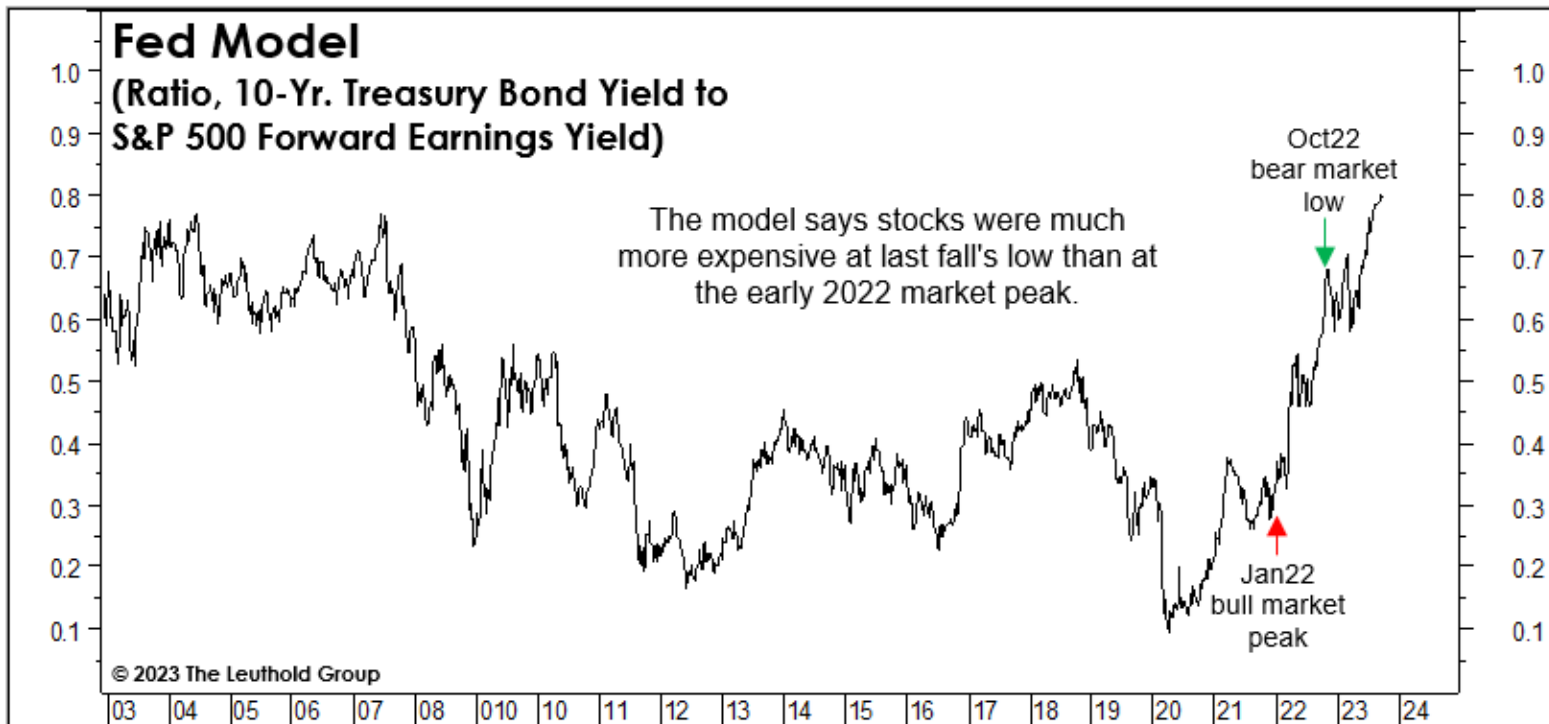
Reading at October 12, 2022 bear market low = 22.7x (80th percentile)

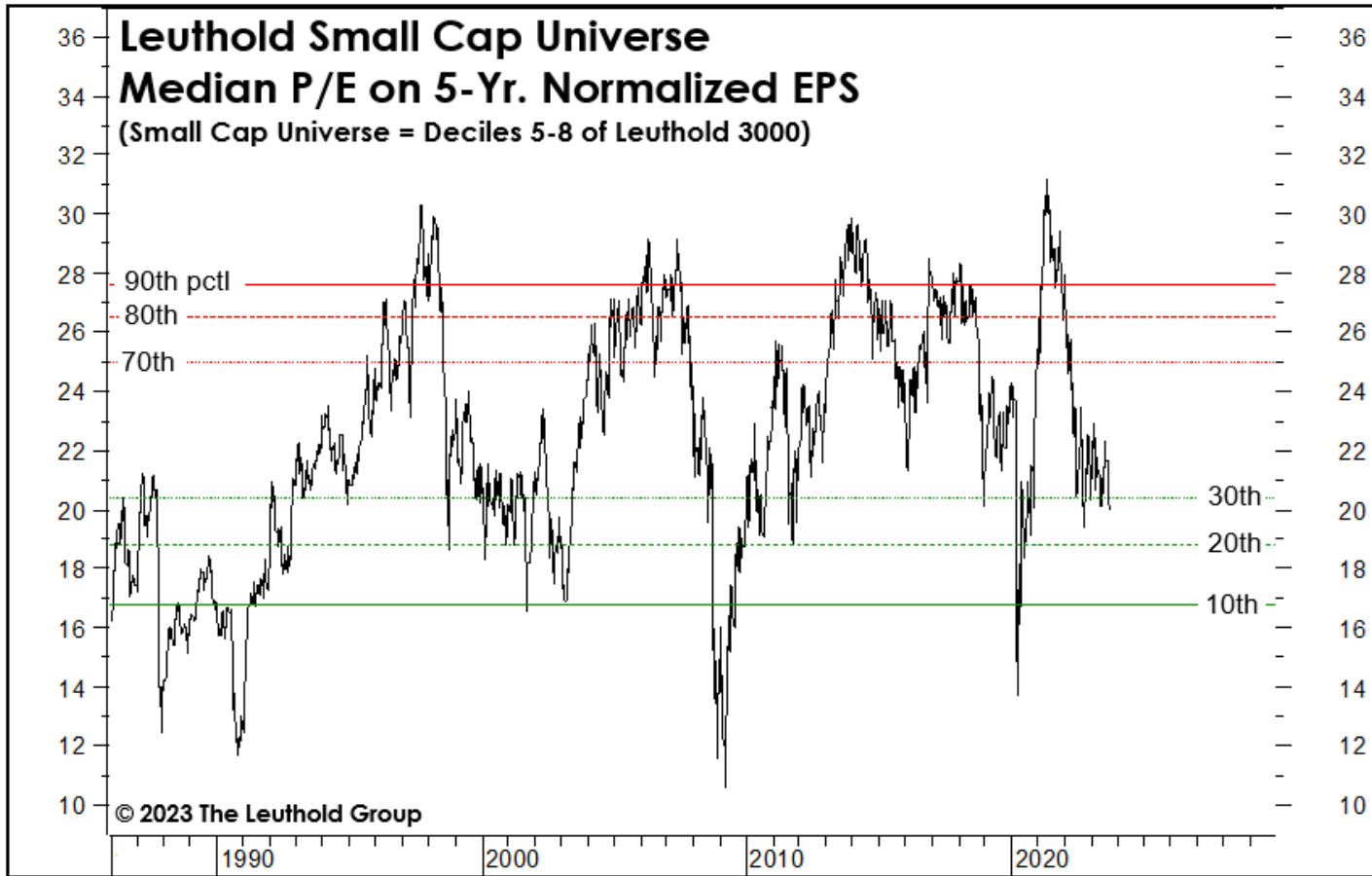
“What if???”

**S&P 500 Valuations:
Today Versus The Two Priciest Bear Market Lows In History**

© 2023 The Leuthold Group	Forward P/E	Peak P/E	Normalized P/E	Price/ Cash Flow*	Price/ Sales	Price-to- Book	Average Downside	Implied S&P Low
September 22, 2023	18.0	21.8	25.9	16.0	2.41	4.13		
October 9, 2002	13.5	14.4	17.0	11.4	1.09	2.36		
March 23, 2020	13.0	16.5	18.1	10.5	1.61	2.49		
Downside to Tech Wreck Low	-24.9	-34.0	-34.3	-28.7	-54.8	-43.0	-36.6	2715
Downside to COVID Low	-27.3	-24.4	-30.0	-34.2	-33.4	-39.8	-31.5	2933

*Data for MSCI United States Index





Leuthold Core Portfolio – Asset allocation as of September 25, 2023

