

# Eleon Capital Management Ltd.

- MARKET OUTLOOK -

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NET ASSESSMENT

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In a recent [video post by Ramin Nakisa of Pension Craft](#), he noted how the stock market rally of 2023 has been dominated primarily by eight tech stocks and noted the case for and against the market continuing its rally. The case supporting a market fall included:

- ◆ Weak fundamentals as companies reported falling YoY (year-over-year) earnings fall;
- ◆ High and sticky core inflation forcing the FED to continue rate hikes; High cost of borrowing; Tighter credit conditions; and
- ◆ High relative valuations, especially for the 'growth' stocks category.

In favour of a market rally was:

- ◆ The expectation of a soft economic landing (avoiding a recession) with robust employment and resilient consumer spending;
- ◆ An end to the FED's rate increases;
- ◆ The expectation of analysts that corporate earnings revert to growth; and
- ◆ US tech dominance.

Recently, in both [the Financial Times](#) and [The Guardian](#), there were articles that despite JP Morgan, the US's largest bank, having achieved robust Q2 profits, Chief Executive, Jamie Dimon, was

*"sounding warnings even when their business was growing."*

The article notes that total US debt has reached \$17tr, – a record high and has progressively been increasing over time. Further, the New York FED highlighted that credit card debt had reached a record high of \$1tr, but more worryingly, delinquencies were rising and back to pre-2019 levels. As a result, JP Morgan was increasing its loss reserves in anticipation of weakening consumer and corporate debt servicing abilities and increasing defaults. They noted how rising interest rates, high and sticky inflation, weakening economic growth, the return to normality of the credit cycle, and American consumers who were lush with pandemic stimulus cash (which, according to the San Francisco FED, is now primarily depleted as excess savings have dwindled to \$500bn from a peak of \$2.1tr in mid-2021) are having difficulties making payments.

JP Morgan's actions give us some sobering insights into the health of the US economy, which can largely be extrapolated globally. As Jamon Dimon said: "... while we cannot predict with any certainty how these factors will play out ..." nor should we, we can, in the framework of Howard Mark's "Mastering the Market Cycle", make certain deductions in terms of investor optimism, risk aversion and the availability of capital.

*In essence, when investor optimism is high, risk aversion low, and capital freely available with 'light' covenants, markets generally will be in the final stretch of a bull market, although they may take some time to get there and visa-versa.*

It is fair to say that, at present, conditions are not at extreme levels to warrant the case for a bull or bear market.

However, in terms of fundamentals, i.e.,:

- 1) free cash flow;
- 2) investment in growth opportunities;
- 3) the spread between Return on Invested Capital (ROIC) and the Cost of Capital (COC); and
- 4) the discount rate, i.e. COC (cost of capital),

The odds are more likely (despite analyst expectations to the contrary by and large) that there will be a deterioration as inflation, high debt servicing costs, weakening consumer and corporate financial conditions, geopolitics erode margins and growth rates.

With debt levels as high as they are and the cost to service that debt gradually increasing over time, investors need to be overly cautious, as debt amplifies the liquidity conditions and needs of many households and firms that would otherwise be able to ride out unfavourable economic environments. With both short and long-term treasury yields at historically higher levels, increasing oil prices, high and sticky inflation, high equity valuations will be challenging going forward.

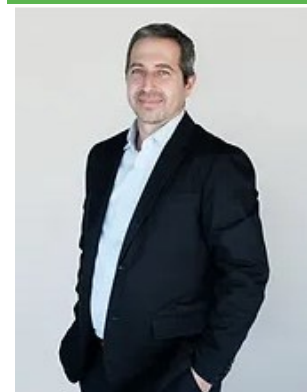
19 September 2023



*Strong Roots,  
Sustainable Growth*

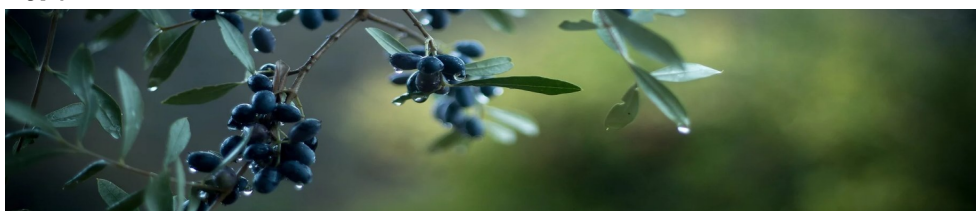
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