

2.15-3.00

## Investing In Equities Under A New Interest Rate Regime



**IRENE TUNKEL**

Chief US Equity Strategist  
BCA Research



# Agenda

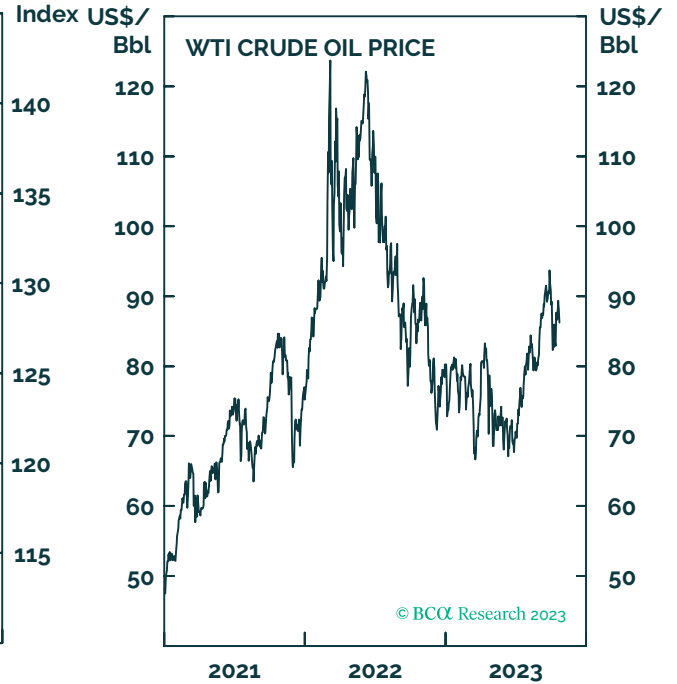
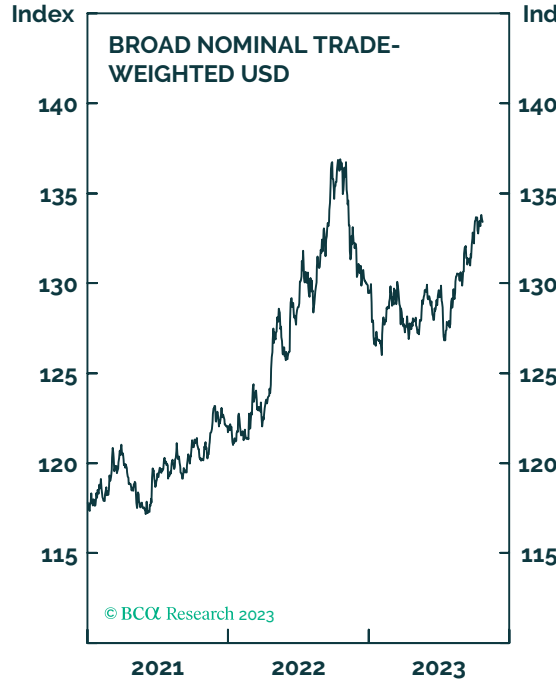
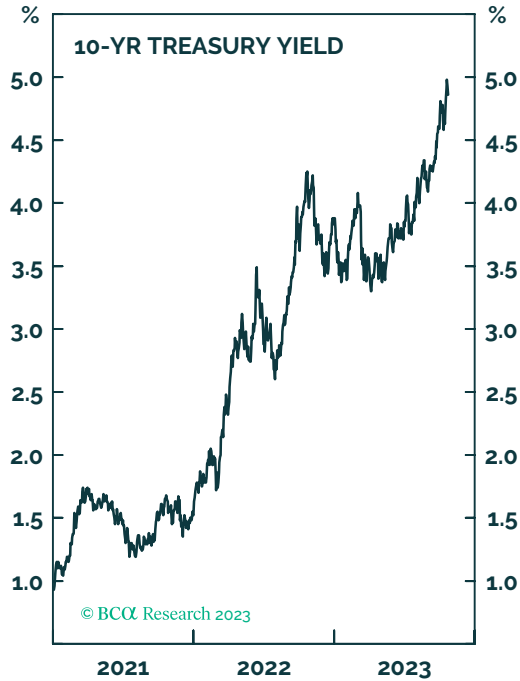
- **Macroeconomic Backdrop: Vicious Troika Of Rates, Energy, And USD**
- **Equity Fundamentals: What To Expect This Earnings Season**
- **Recap Of Investment Themes**



# **The Vicious Troika**

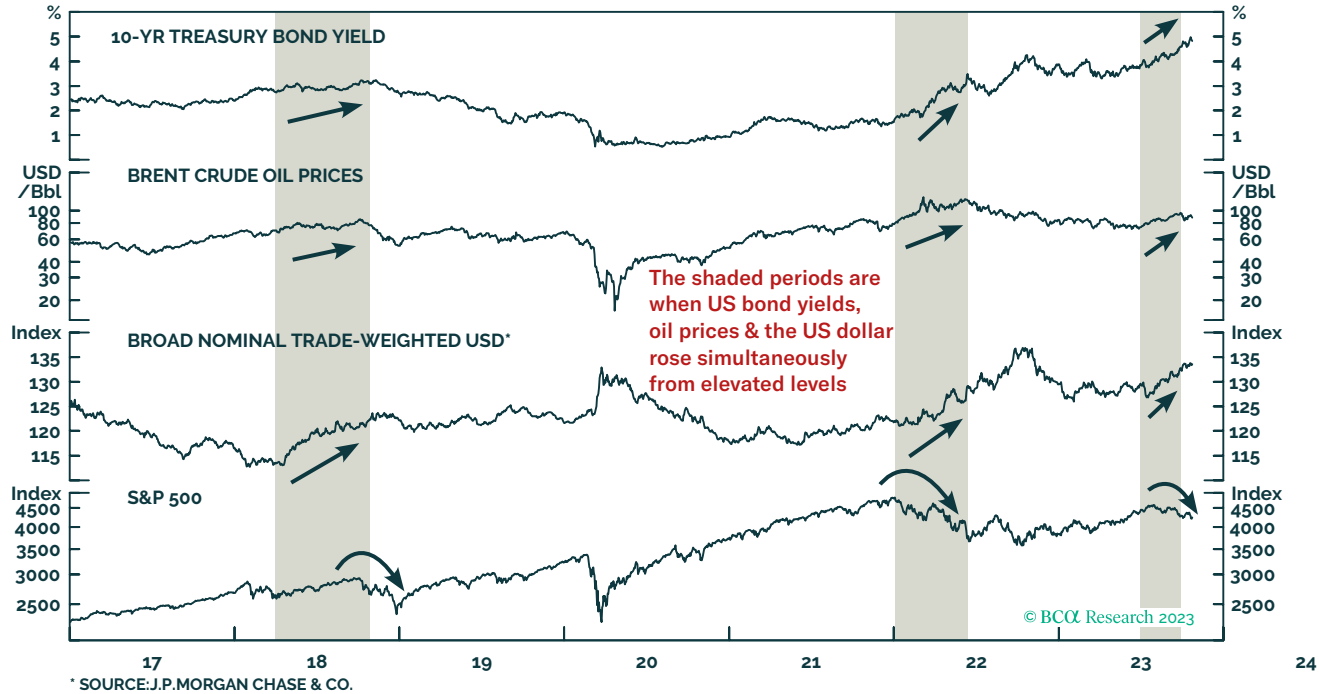
**Rising Rates, Dollar, And Energy Prices**

# Yields, Dollar and Energy Have Broken Out

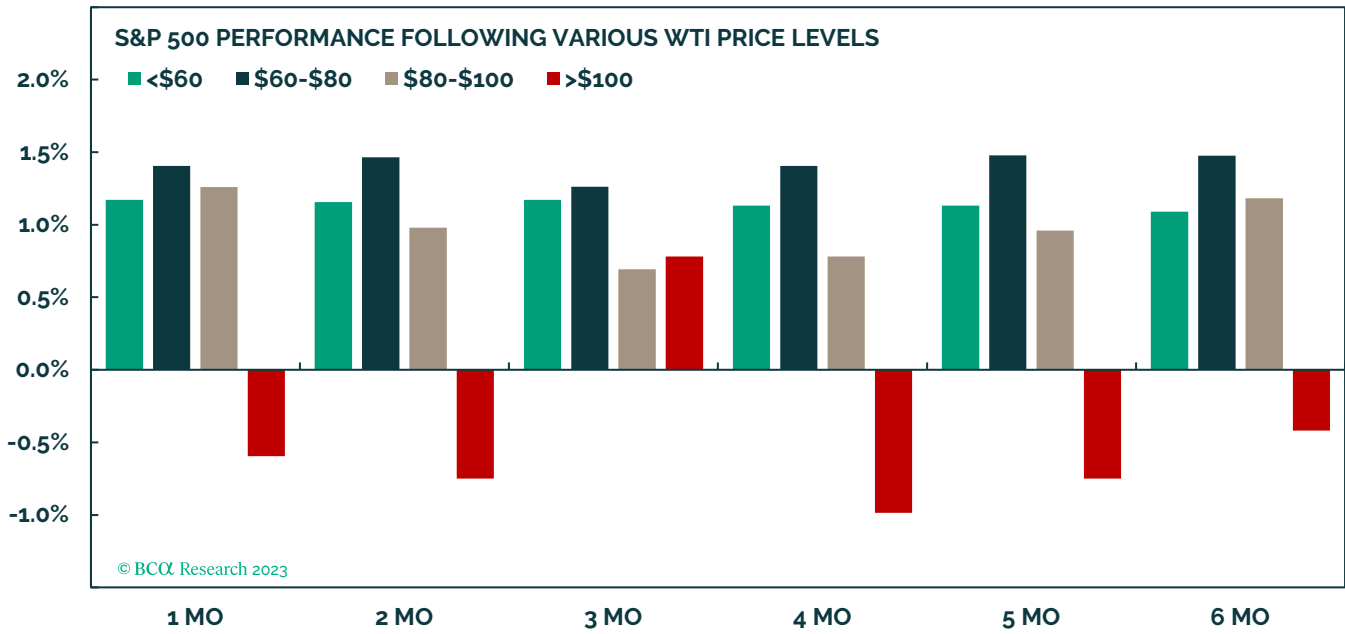


SOURCE: J.P. MORGAN CHASE & CO.

# Vicious Troika Is Bad For Equities

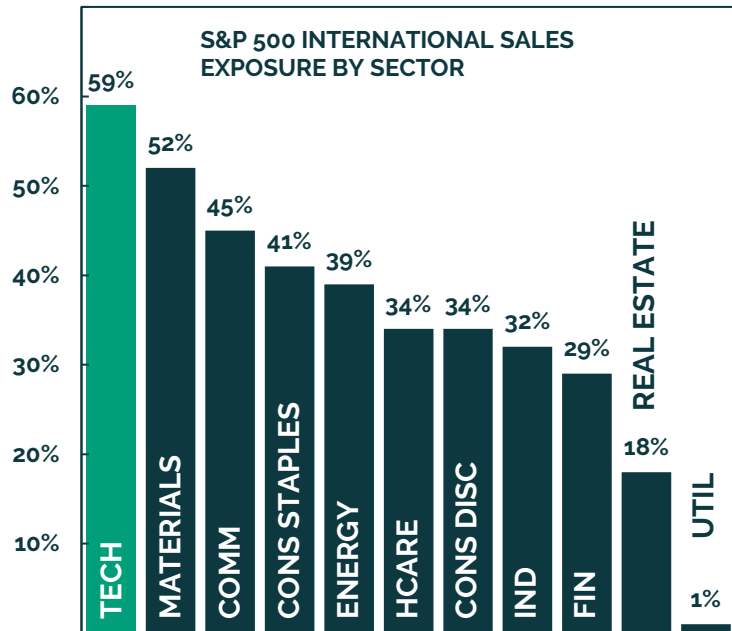


# Beware Of \$100 Oil



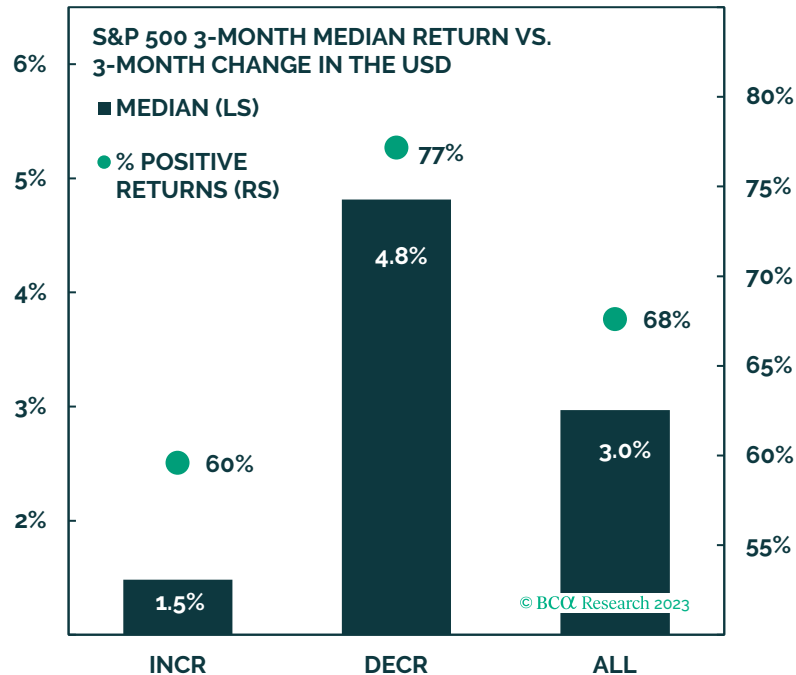
SOURCE: BCA CALCULATIONS.

# Strong Dollar Does Not Help Either



NOTE: AS OF Q3, 2023.  
SOURCE: FACTSET.

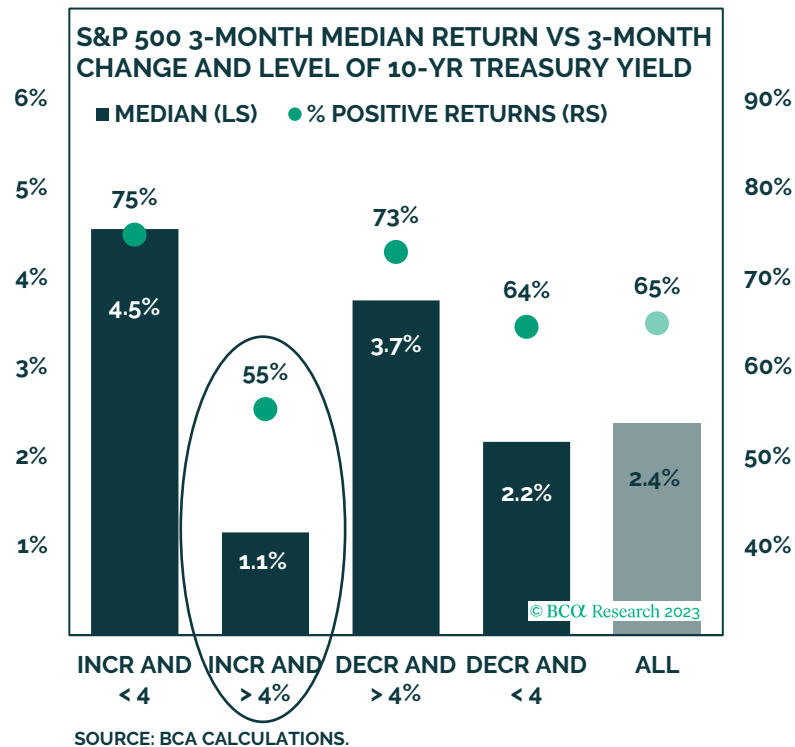
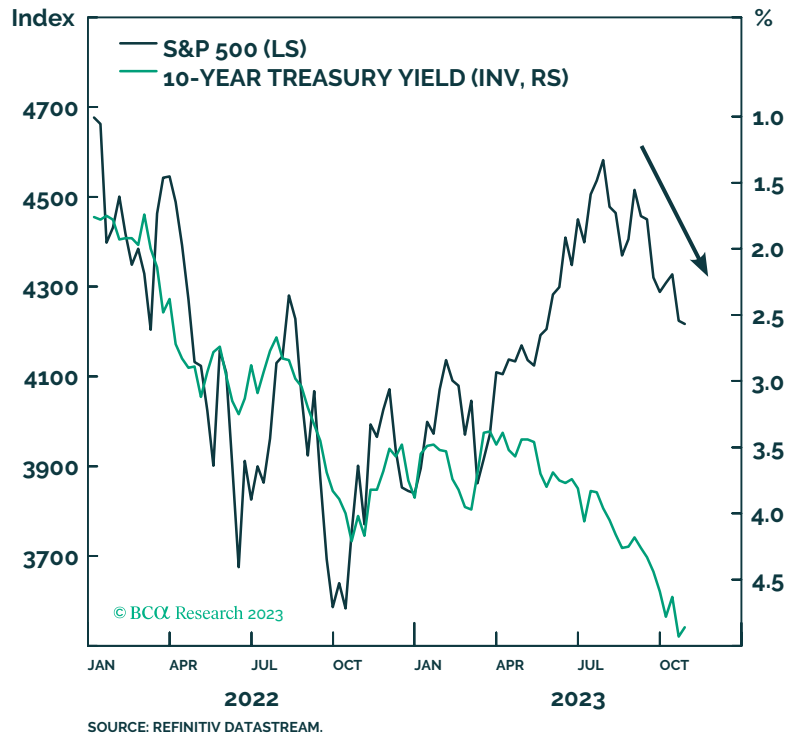
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SOURCE: BCA CALCULATIONS.

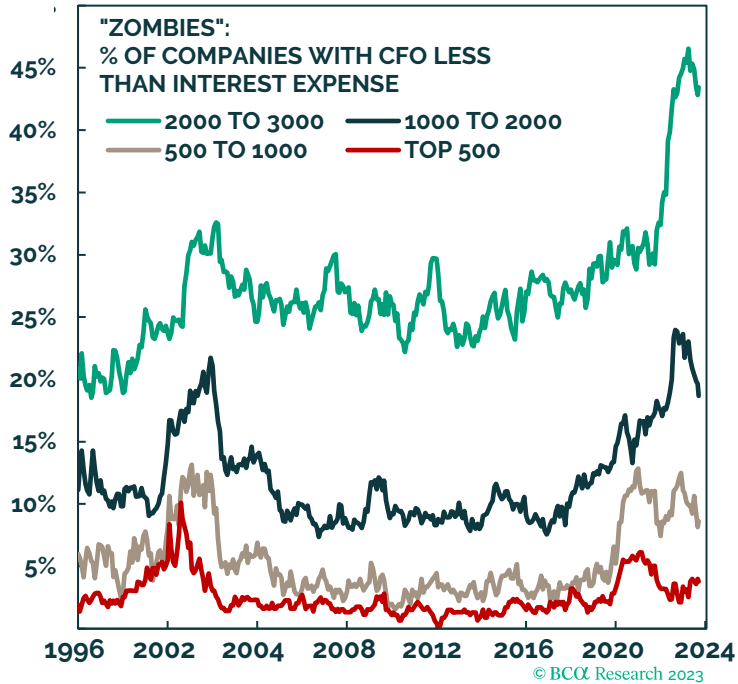
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# High And Rising Rates Are Also Unfavorable For Equities

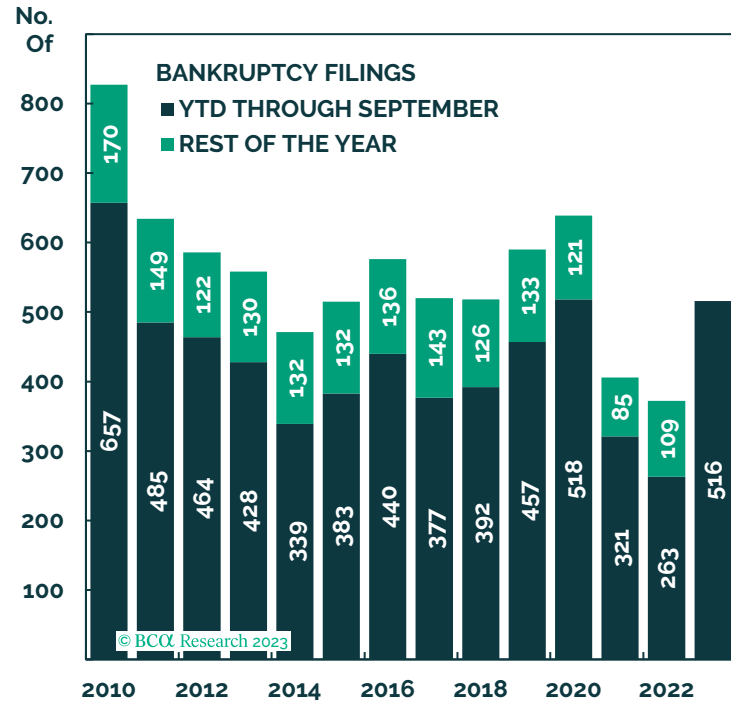




# “Higher For Much Longer” Will Kill “Zombie” Companies



SOURCE: S&P GLOBAL AND BCA CALCULATIONS.

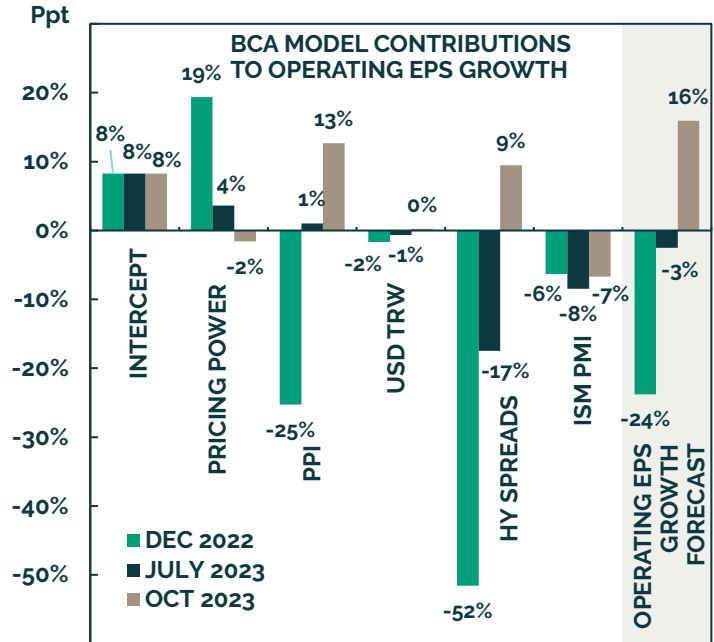


SOURCE: S&P GLOBAL MARKET INTELLIGENCE.

# Over A Longer Investment Horizon, Vicious Troika Will Weigh On Profitability

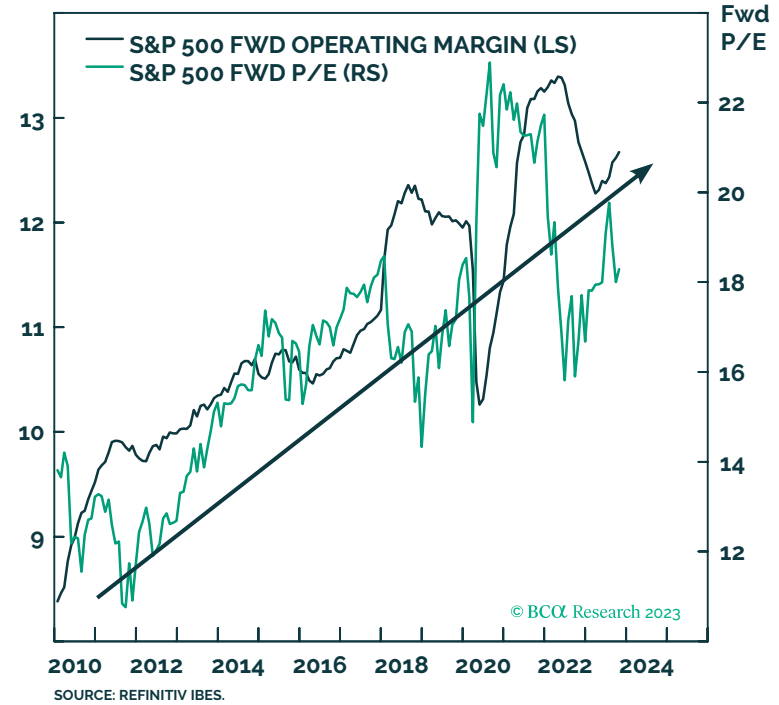
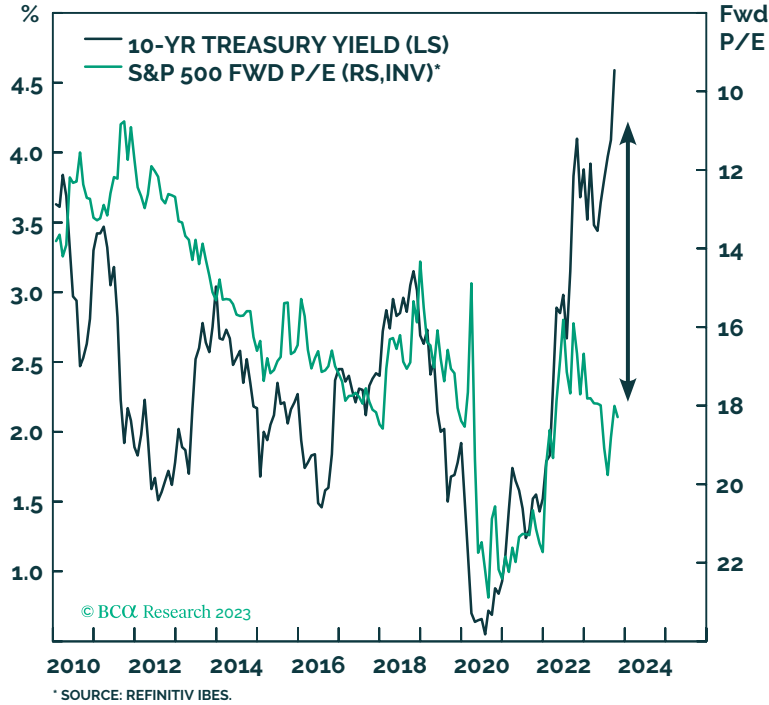
EARNINGS GROWTH MODEL REGRESSION				
FACTORS	ESTIMATE	SE	TSTAT	PVALUE
INTERCEPT	0.08	0.01	7.48	0.0%
PRICING POWER 3 MO LAG	1.84	0.62	2.95	0.3%
PPI 3MO LAG	-1.63	0.44	-3.69	0.0%
USD TRW YOY% 3MO LAG	-0.71	0.02	-9.77	0.0%
HY SPREADS YOY% 3 MO LAG	-0.19	0.19	-3.66	0.0%
ISM PMI YOY% 3 MO LAG	0.48	0.08	6.15	0.0%

NUMBER OF OBSERVATIONS: 250, ERROR DEGREES OF FREEDOM: 244  
 ROOT MEAN SQUARED ERROR: 0.124  
 R-SQUARED: 0.661, ADJUSTED R-SQUARED: 0.654  
 F-STASC VS. CONSTANT MODEL: 95.3, P-VALUE = 2.32E-55



SOURCE: S&P GLOBAL AND BCA RESEARCH.

# Higher Interest Rates And Lower Profitability Will Suppress Multiples

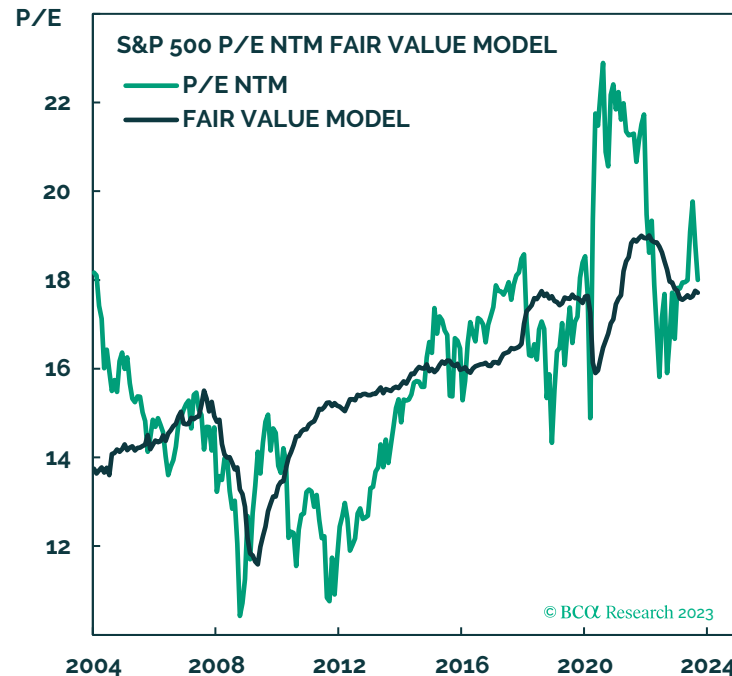


# ... Fair Value Of PE NTM For The S&P 500 Will Be Much Lower

2004-2023		FOR PE NTM		
STAT	ESTIMATE	SE	TSTAT	PVALUE
INTERCEPT	5.05	1.19	4.26	0%
10-YEAR TREASURY YIELD	-0.18	0.12	-1.45	15%
OPERATING MARGIN NTM	1.07	0.10	11.23	0%

NUMBER OF OBSERVATIONS: 236, ERROR DEGREES OF FREEDOM: 233  
 ROOT MEAN SQUARED ERROR: 1.97  
 R-SQUARED: 0.416, ADJUSTED R-SQUARED: 0.411  
 F-STATISTIC VS. CONSTANT MODEL: 83, P-VALUE = 6.11E-28

FV PE NTM	10- YEAR TREASURY YIELD			
OPERATING MARGIN NTM	4	4.25	4.75	5
<b>13.6</b>	18.9	18.8	18.7	18.6
<b>12.6</b>	17.8	17.8	17.7	17.6
<b>11.6</b>	16.8	16.7	16.6	16.6
<b>10.6</b>	15.7	15.6	15.6	15.5

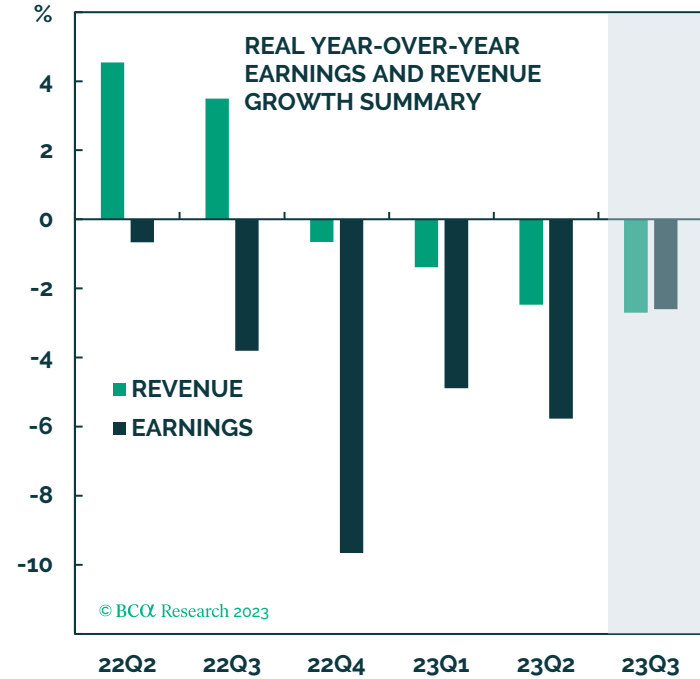
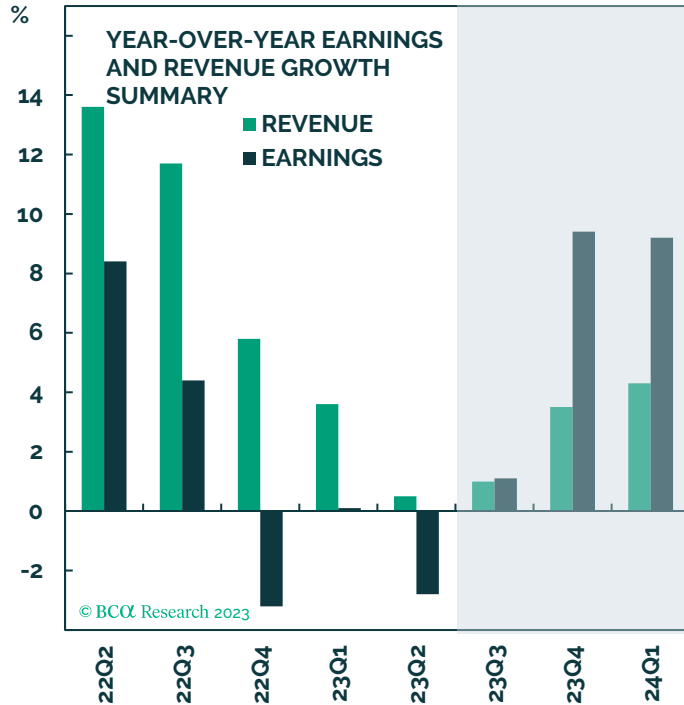


SOURCE: REFINITIV IBES AND BCA CALCULATIONS.



# Equity Fundamentals

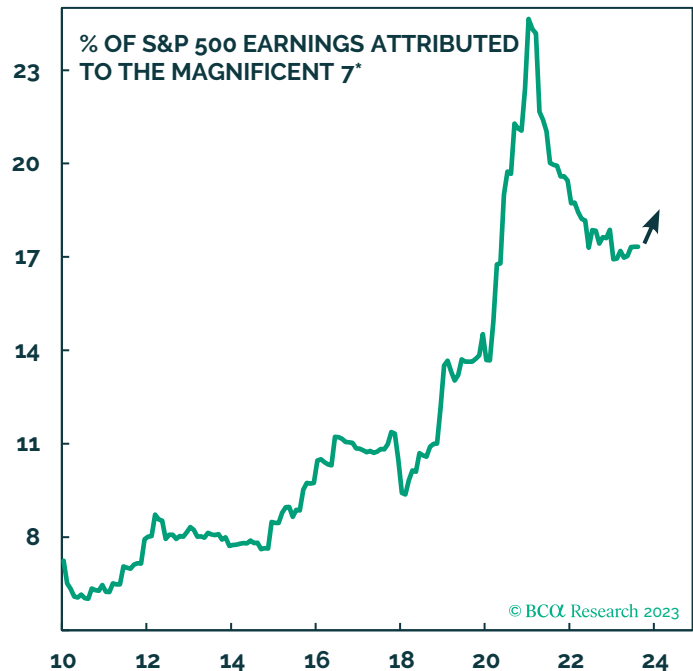
# Earnings Outlook More Optimistic For Q3-23 And Beyond



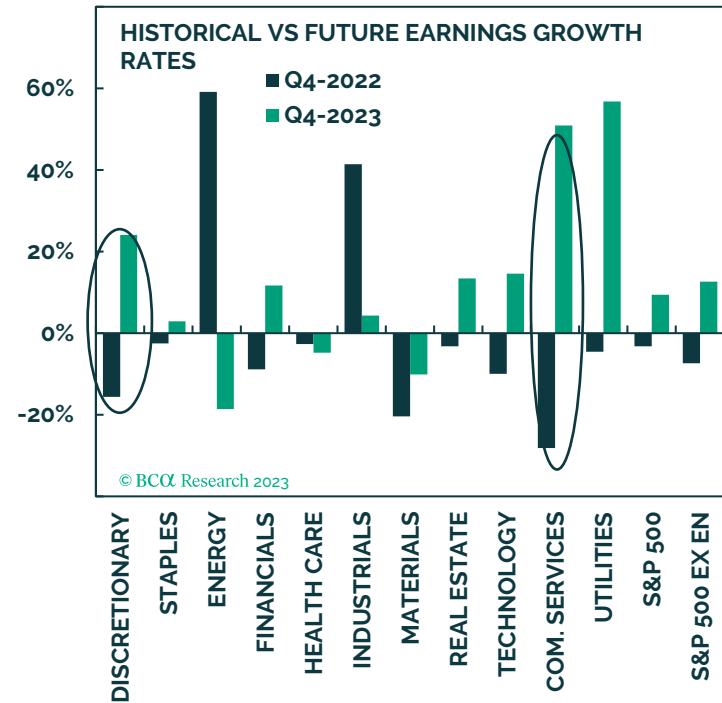
SOURCE: REFINITIV IBES.

SOURCE: REFINITIV IBES.

# ...Thanks To A Base Effect For The Magnificent Seven

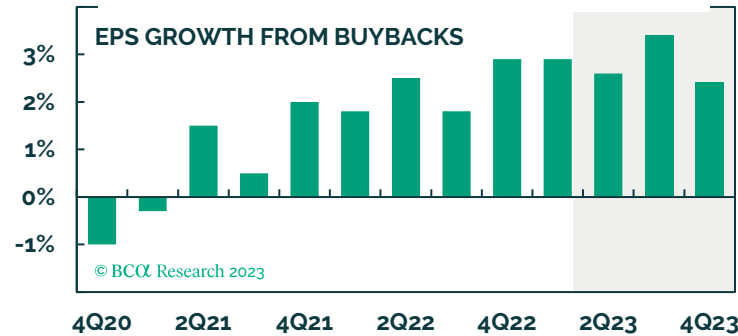
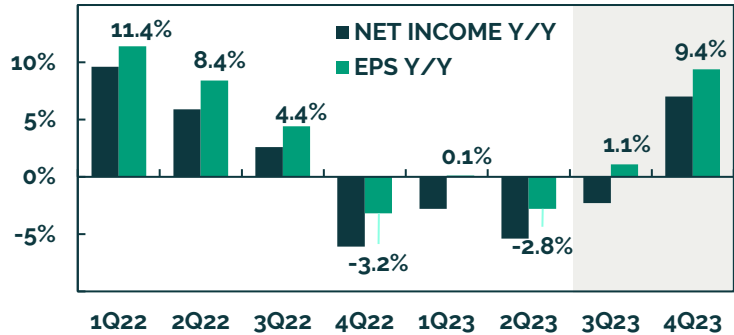


\* INCLUDES APPLE, ALPHABET, AMAZON, MICROSOFT, META, NVIDIA, AND TESLA.  
 SOURCE: S&P GLOBAL AND BCA CALCULATIONS

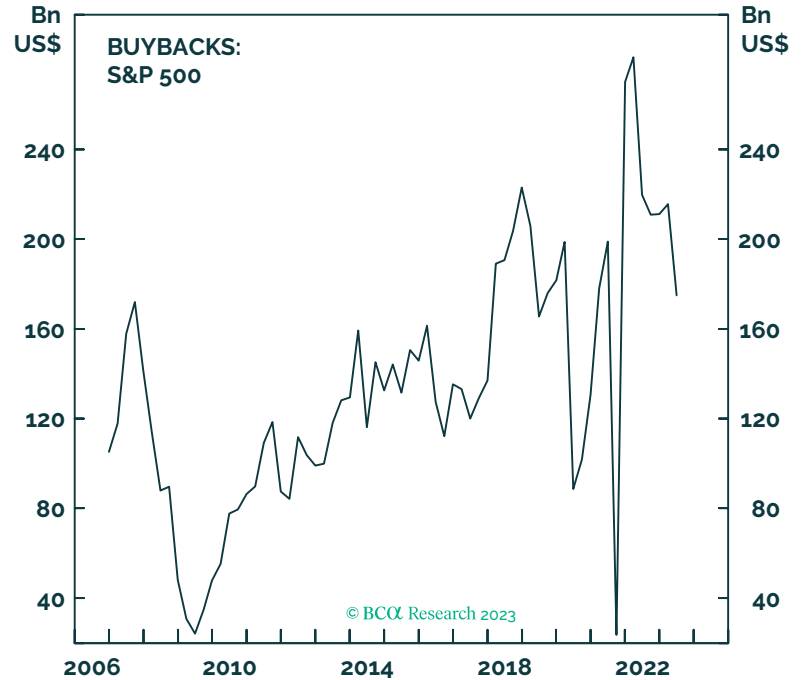


SOURCE: REFINITIV IBES.

# Quality Of Earnings Remains A Concern

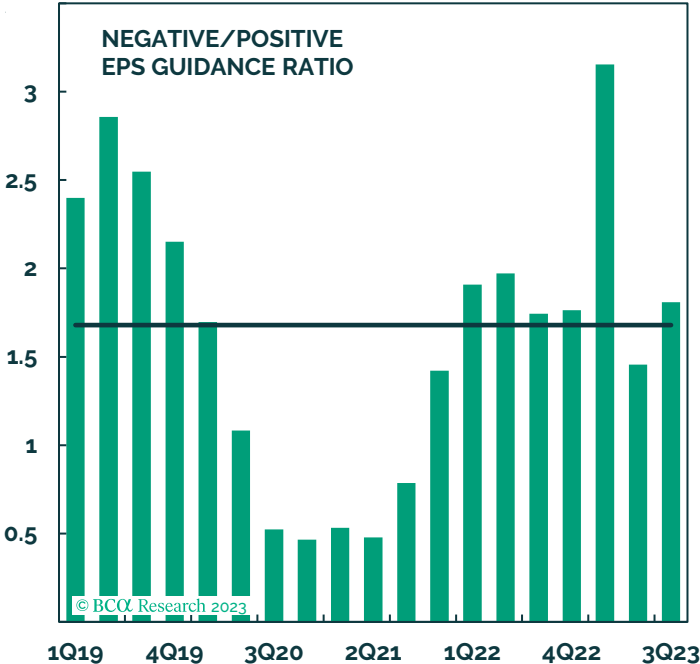


SOURCE: REFINITIV IBES.

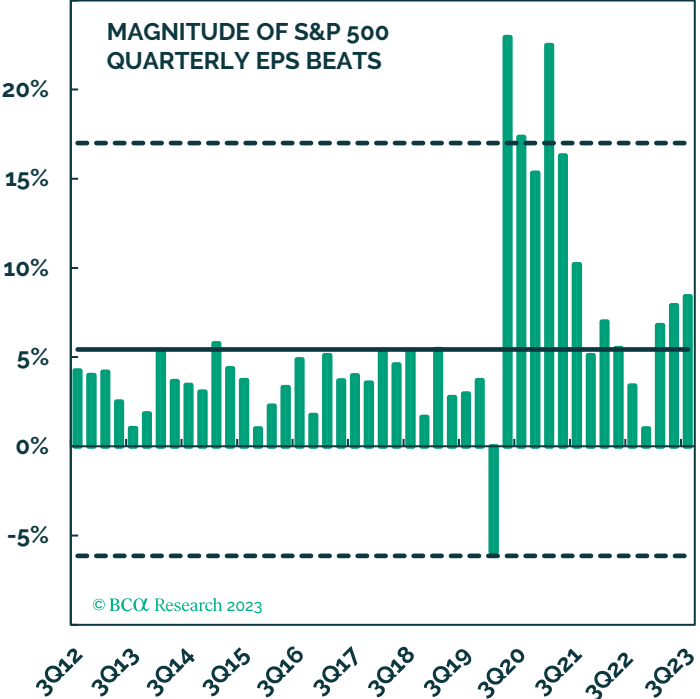




# Companies' Guidance Is Conservative: Surprises Are Likely

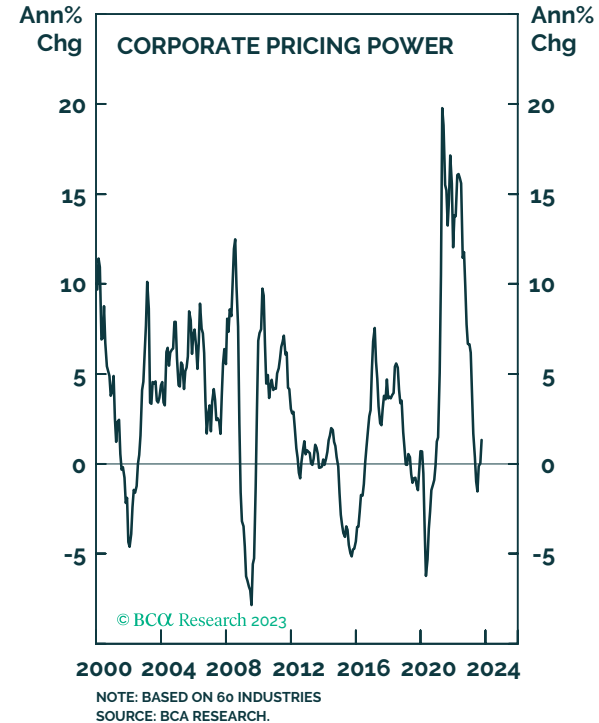
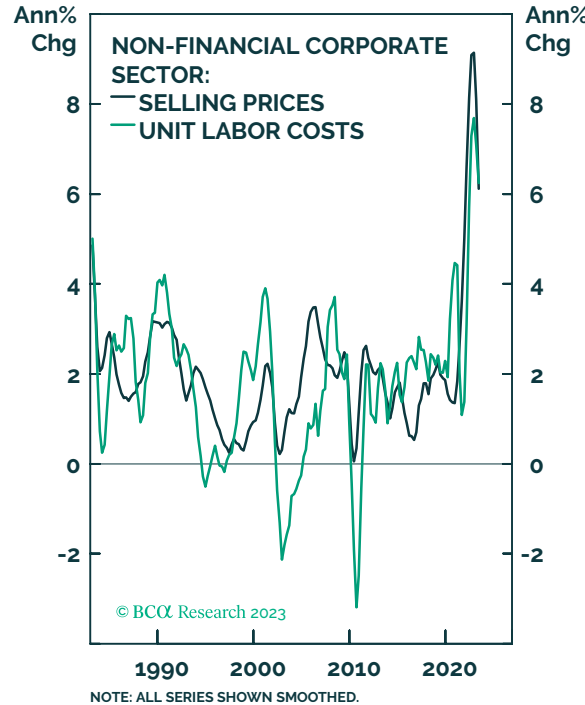
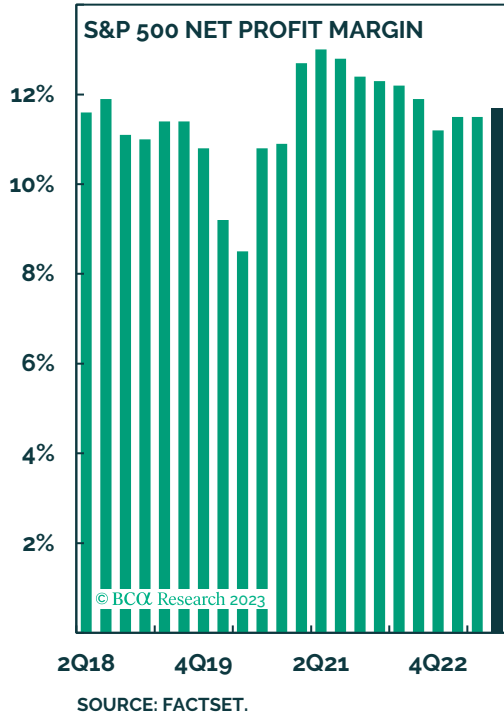


NOTE: LINE DENOTES LT AVERAGE = 1.68.  
SOURCE: FACTSET.



NOTE: SOLID LINE DENOTES SERIES MEAN; DASHED LINES DENOTE +/- 2 STANDARD DEVIATIONS FROM THE MEAN.  
SOURCE: REFINITIV IBES.

# Margins Are Holding Up And Pricing Power Is Rebounding



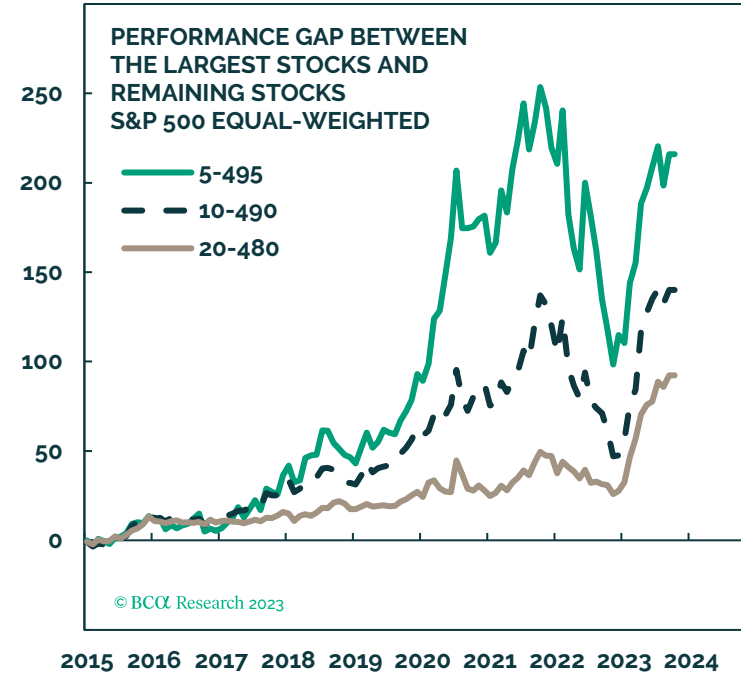
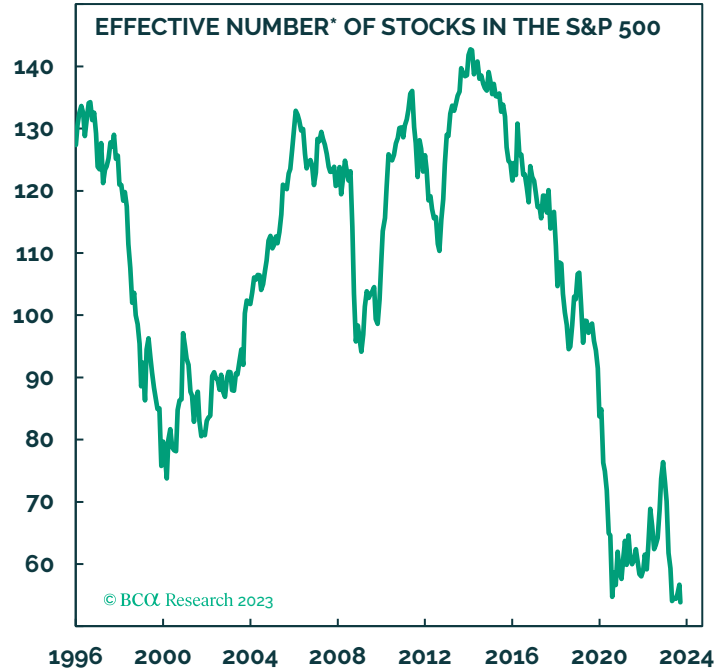
# What We Are Watching This Earnings Season

- **Effects of Troika**
- **Consumer Spending**
- **Pricing Power**
- **Restocking Cycle**



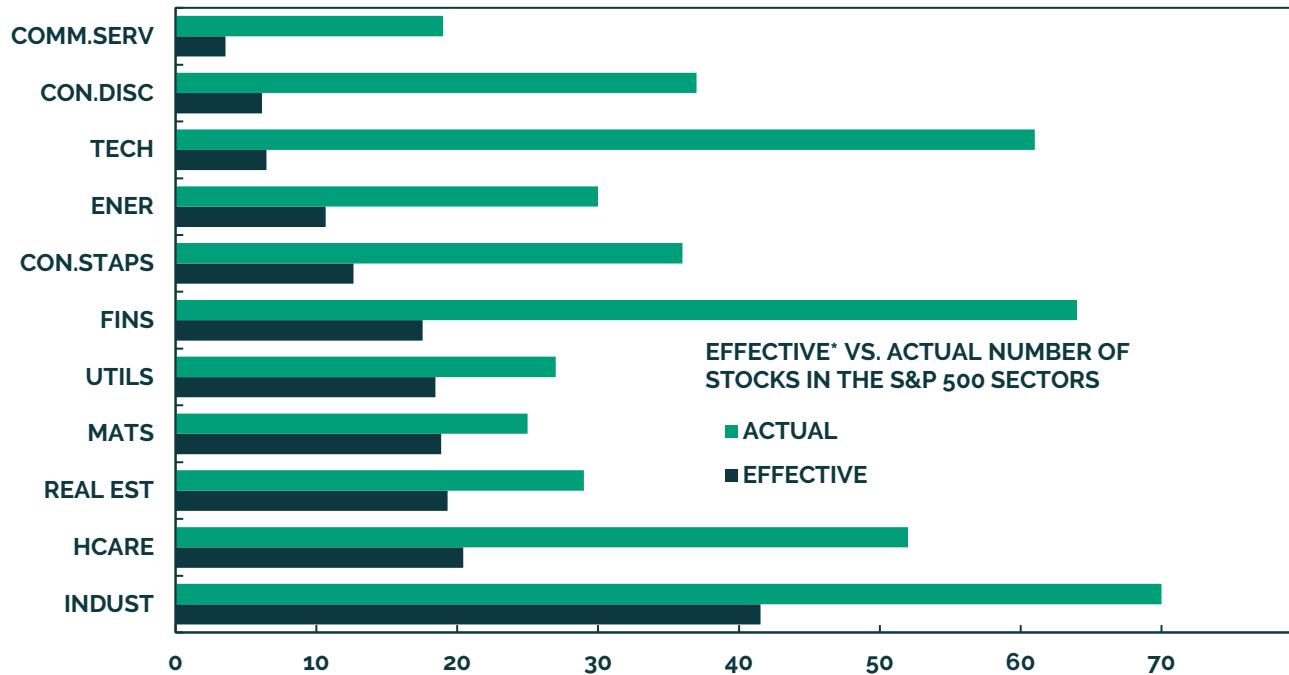
# Recap of Recent Investment Themes

# Market Is Unusually Concentrated



\* MEASURE BASED ON THE HERFINDAHL - HIRSCHMAN INDEX.  
SOURCE: S&P GLOBAL AND BCA CALCULATIONS.

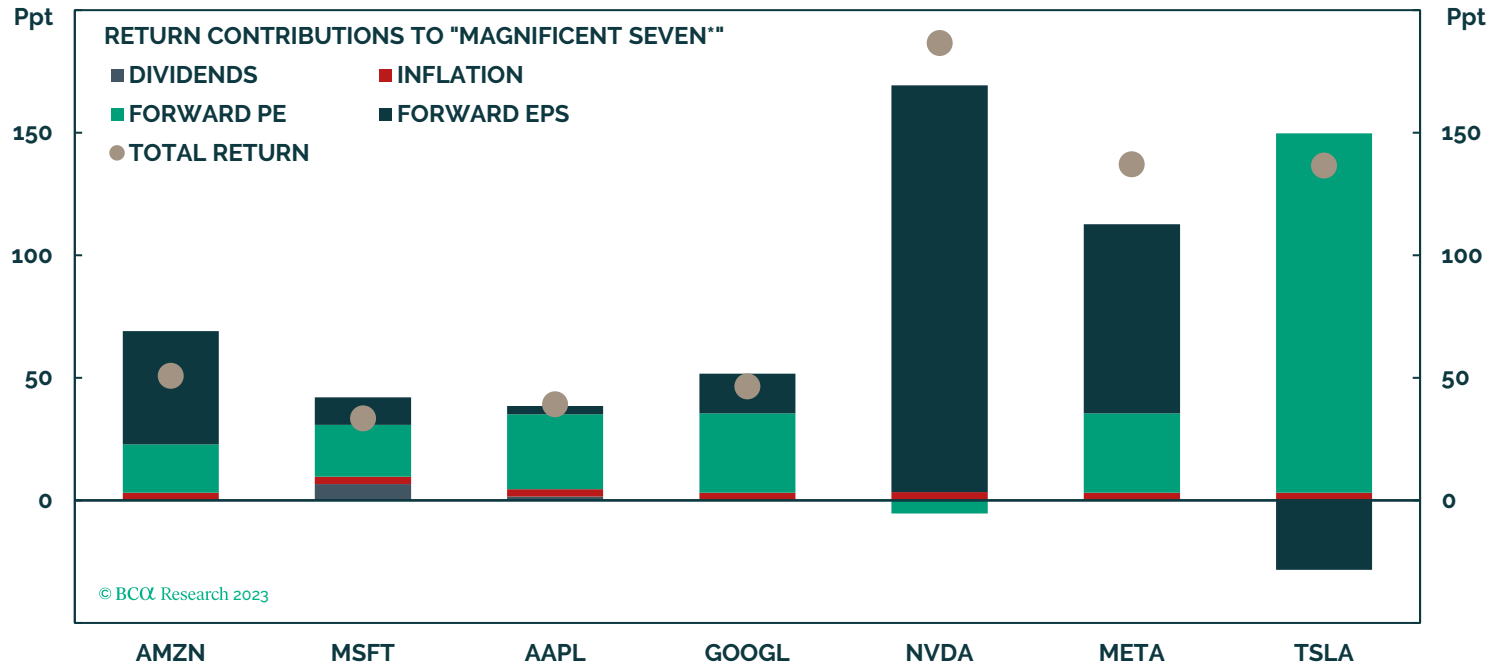
# Performance Of Many Sectors Is Driven By The Magnificent Seven ...



\* MEASURE BASED ON THE HERFINDAHL - HIRSCHMAN INDEX.  
SOURCE: S&P GLOBAL AND BCA CALCULATIONS.

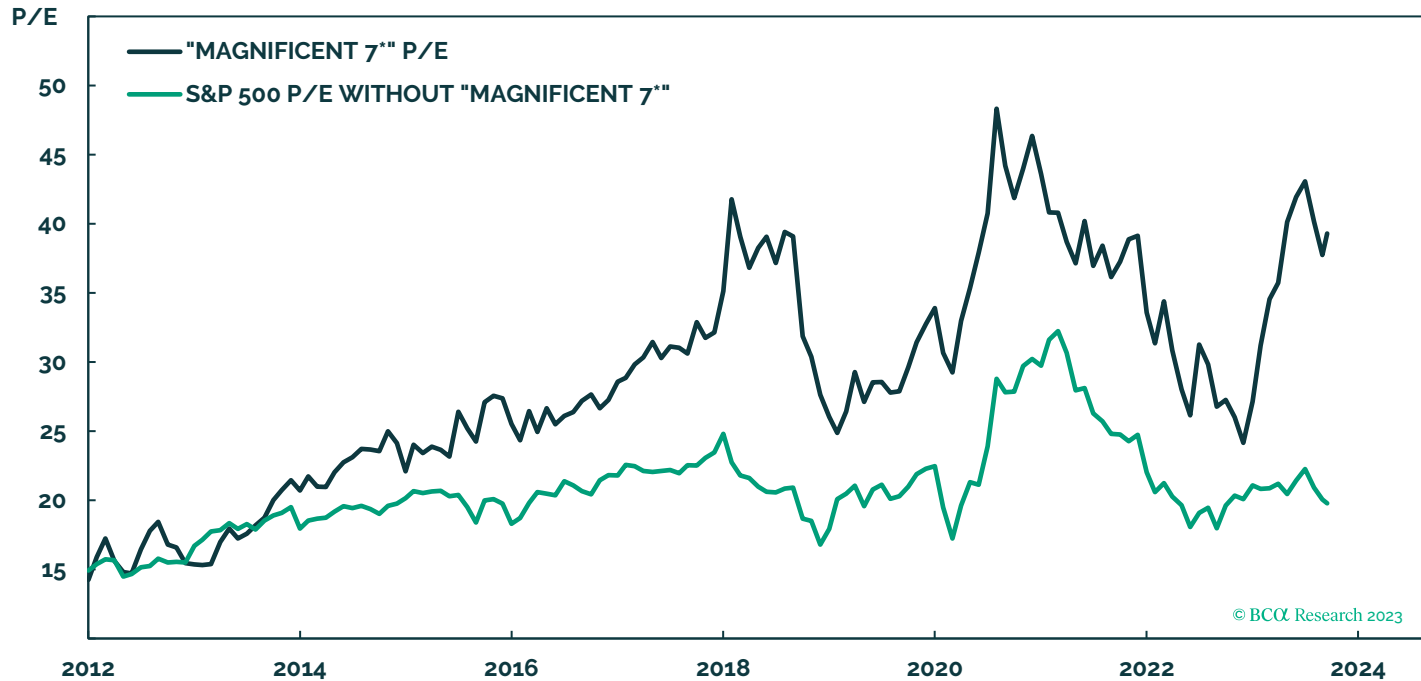
© BCQ Research 2023

# ... Which Enjoyed Multiples Expansion



\* INCLUDES APPLE, ALPHABET, AMAZON, MICROSOFT, META, NVIDIA, AND TESLA.  
 SOURCE: BLOOMBERG FINANCE L.P. AND BCA RESEARCH.

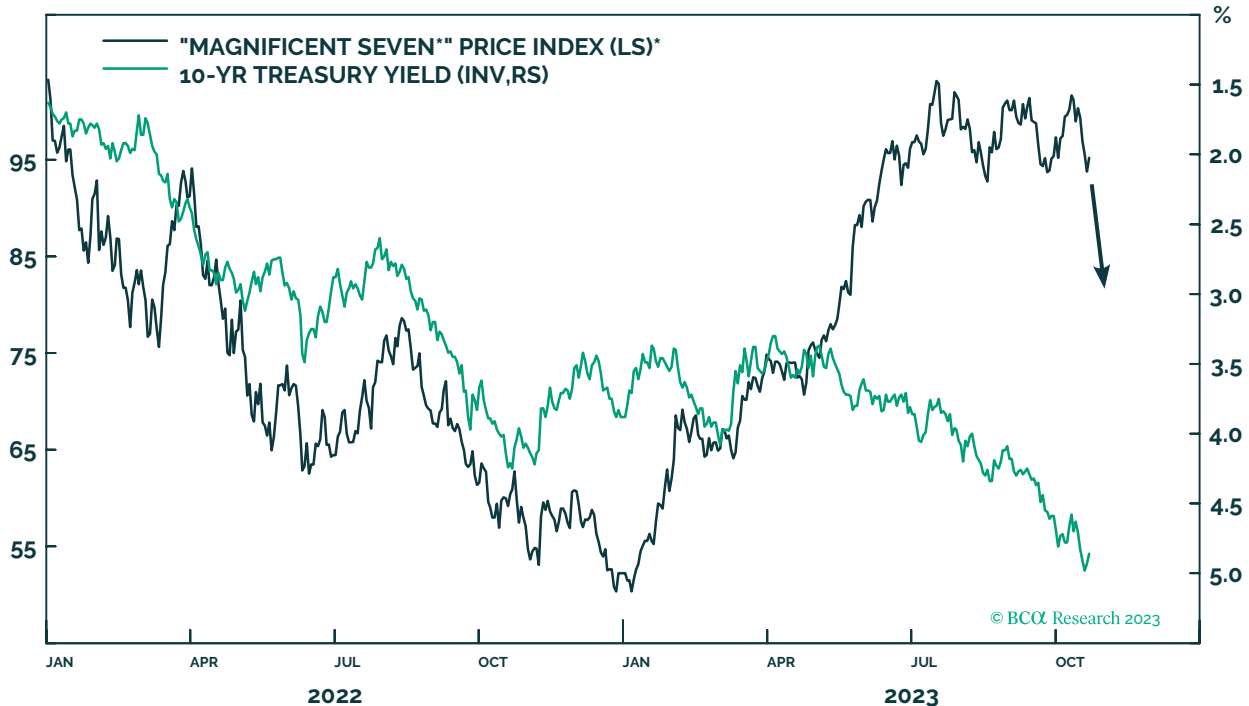
# The Magnificent Seven Inflated Valuations Of The S&P 500



\* INCLUDES APPLE, ALPHABET, AMAZON, MICROSOFT, META, NVIDIA, AND TESLA.  
SOURCE: S&P GLOBAL AND BCA CALCULATIONS.



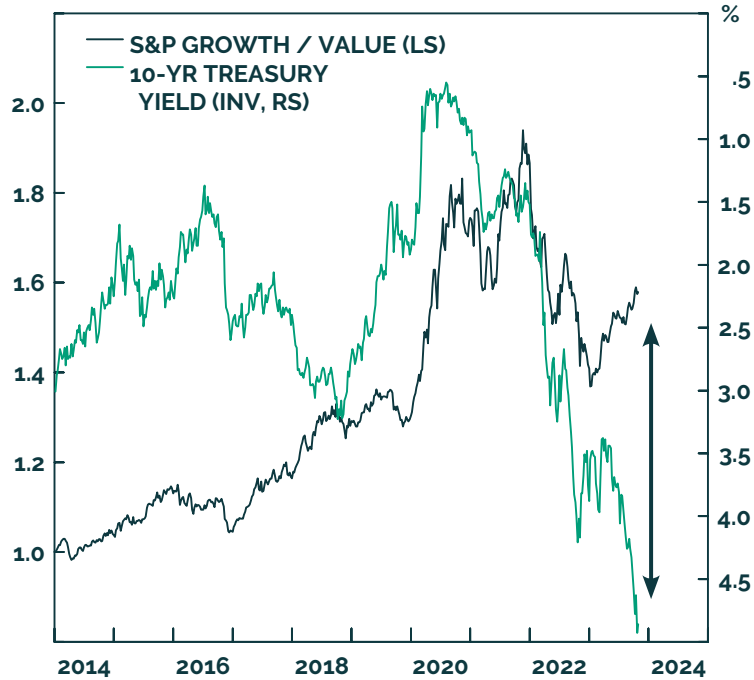
# The Magnificent Seven Are Likely To Recouple With Rates...



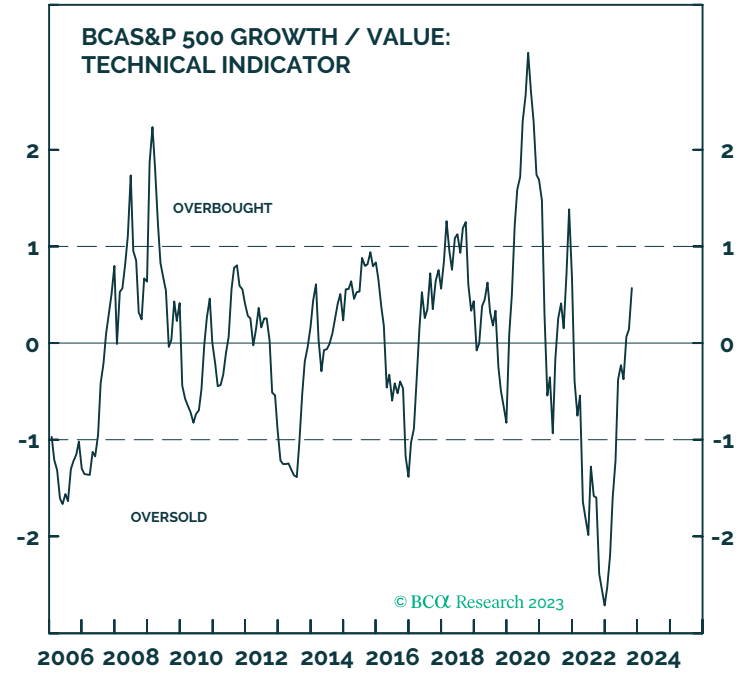
© BCO Research 2023

\* INCLUDES APPLE, ALPHABET, AMAZON, MICROSOFT, META, NVIDIA, AND TESLA.  
SOURCE: REFINITIV DATASTREAM.  
NOTE: PRICE INDEX REBASED TO JAN 1, 2022.

# Time To Underweight Growth And Overweight Value

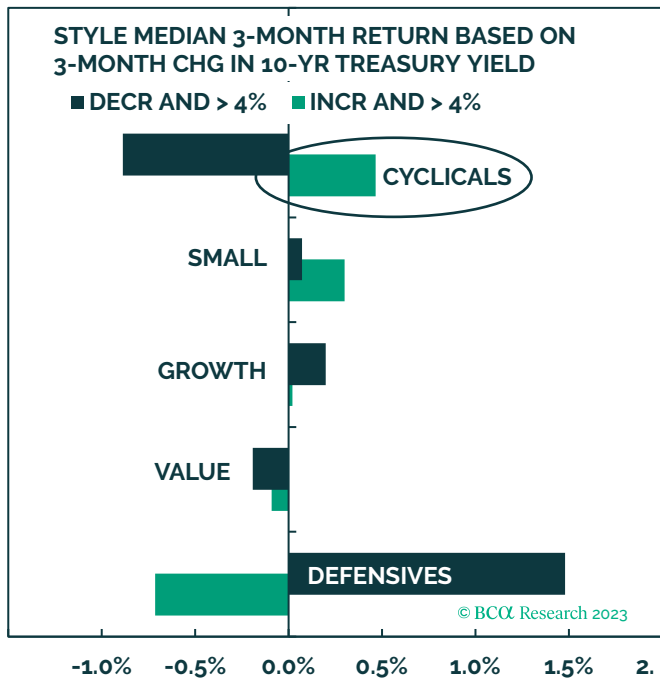


NOTE: SERIES REBASED TO JAN 1 2014  
SOURCE: REFINITIV DATASTREAM.

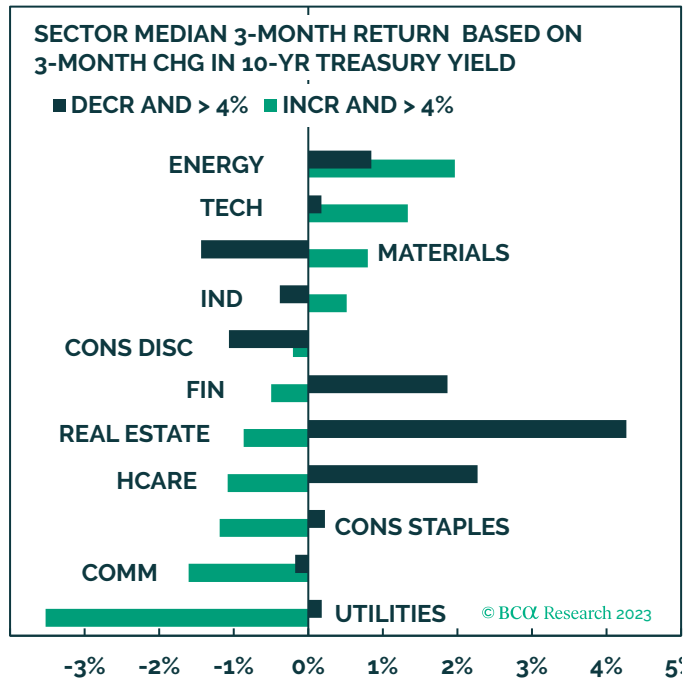


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# In A High Interest Rates Regime, Cyclical Outperform

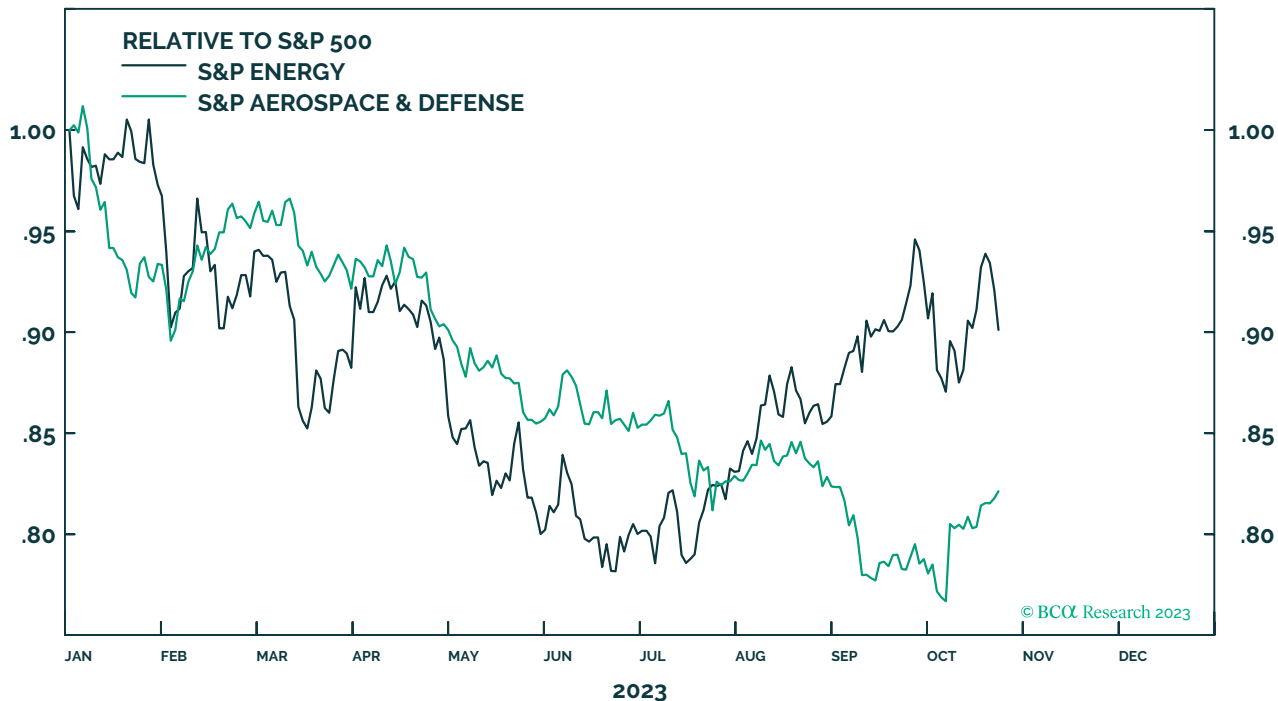


SOURCE: BCA CALCULATIONS.



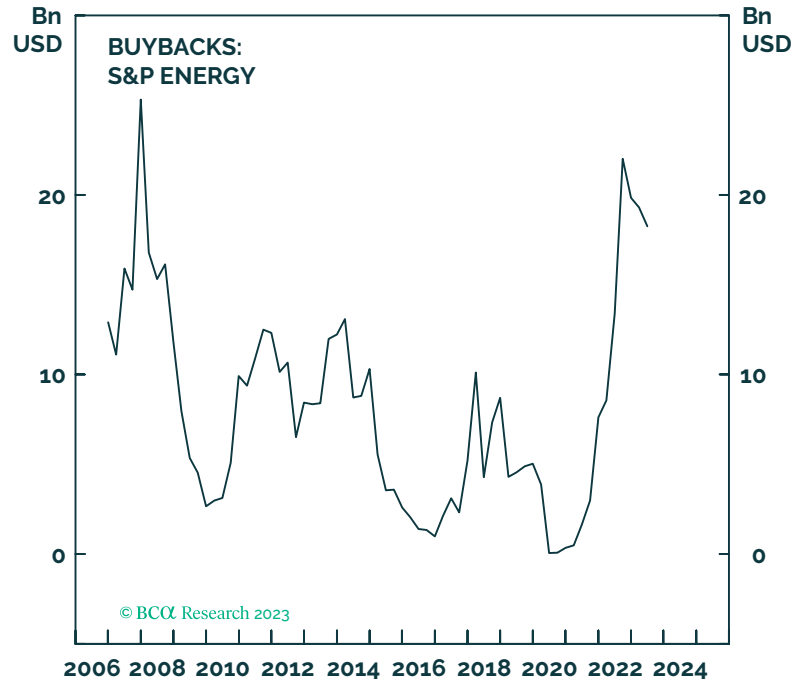
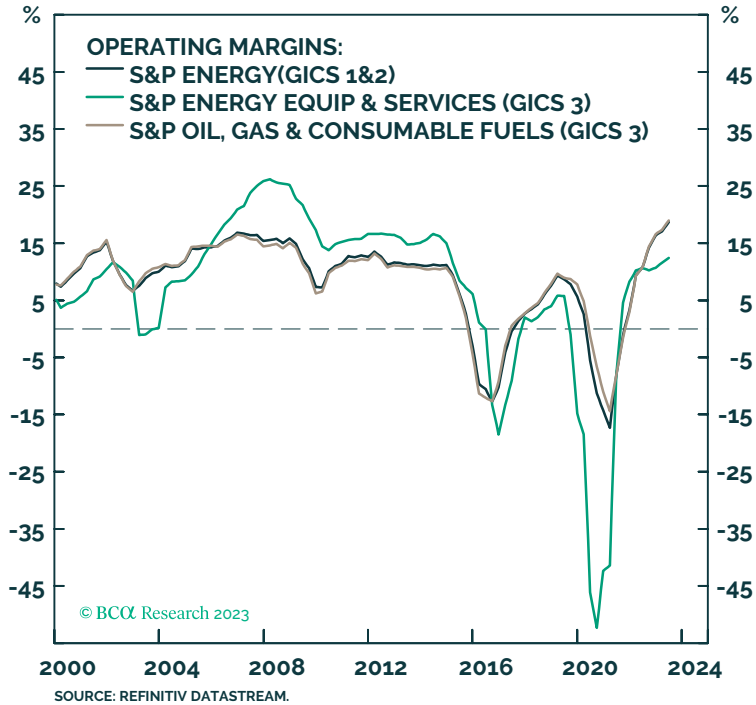
SOURCE: BCA CALCULATIONS.

# Overweight Energy And Aerospace And Defense

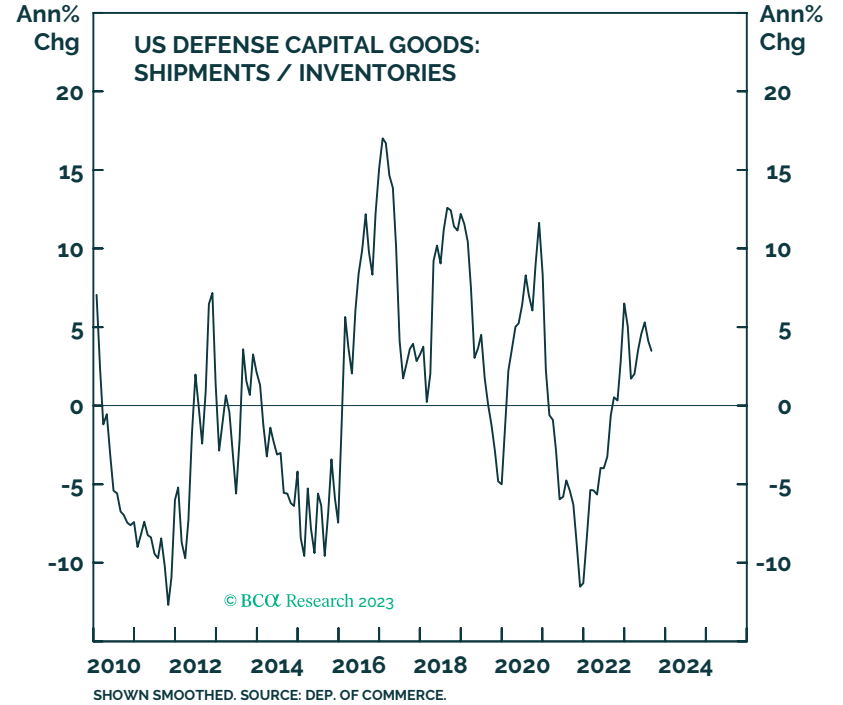
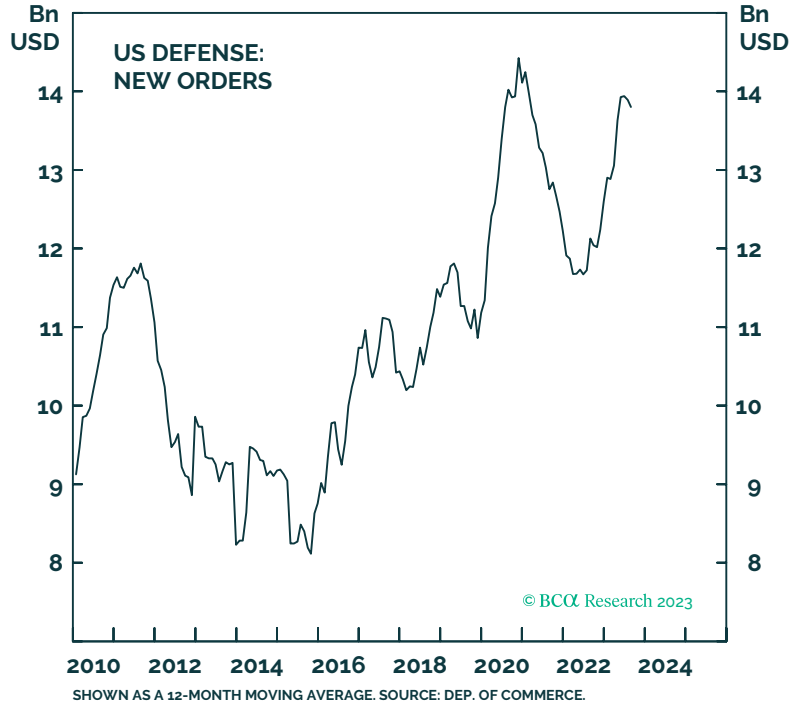


NOTE: SERIES REBASED TO 1 ON JAN 1, 2023.

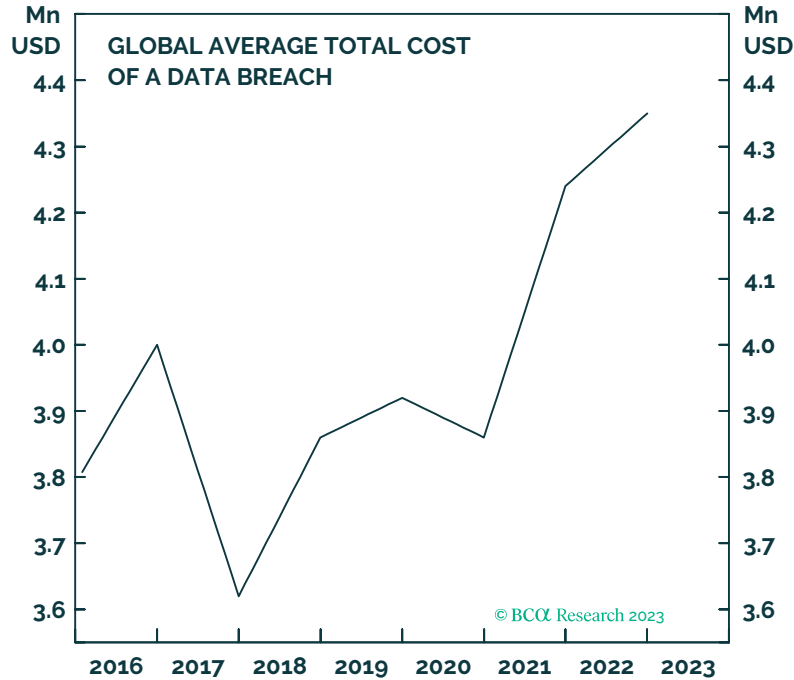
# Big Oil Is Profitable And Disciplined



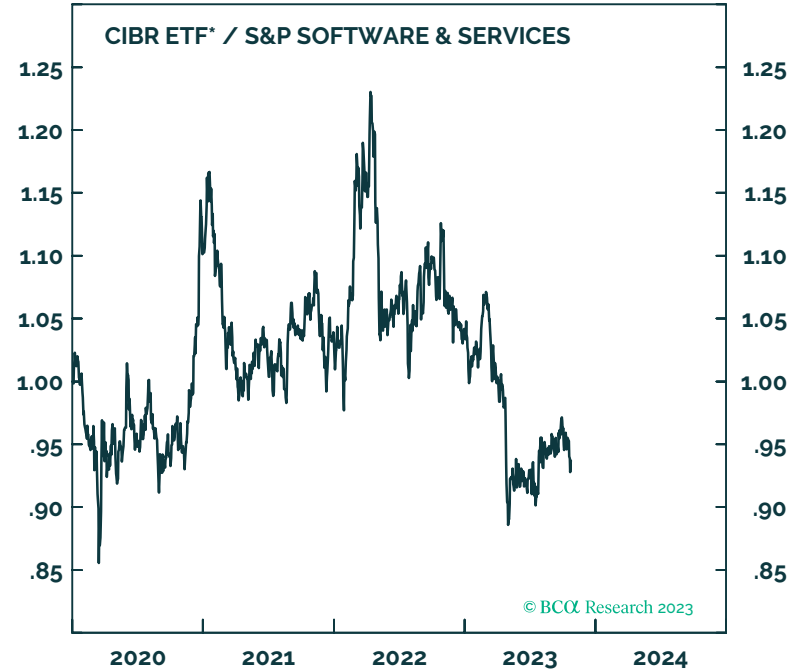
# Aerospace And Defense Benefits From A Strong Pipeline Of New Orders



# Cybersecurity Will Also Be Bolstered Because Of Global Tensions



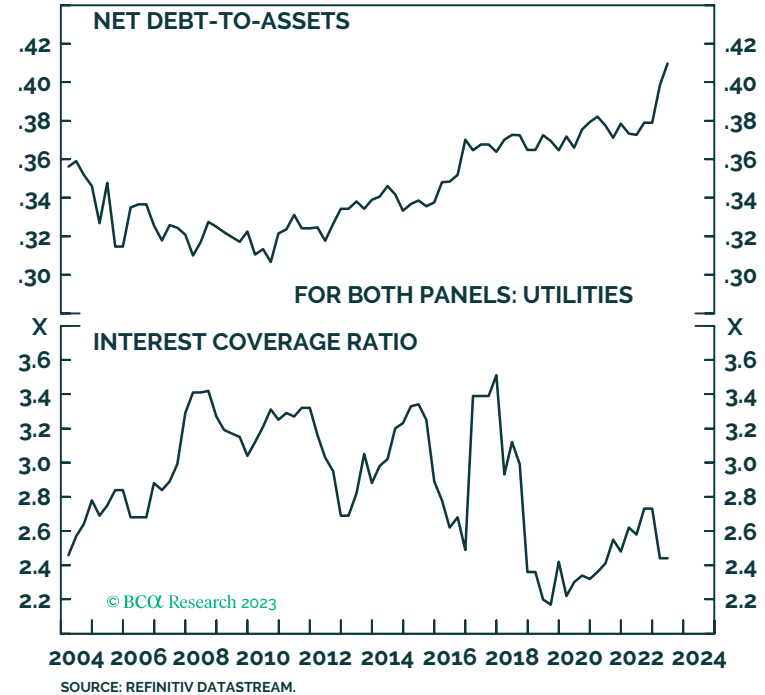
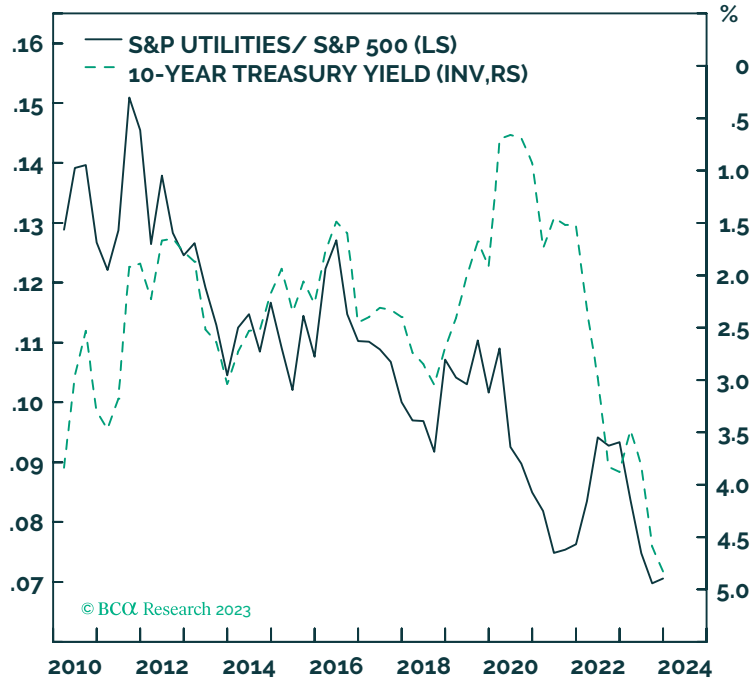
SOURCE: PONEMON INSTITUTE AND IBM SECURITY.



NOTE: REBASED TO JAN 1 2020.

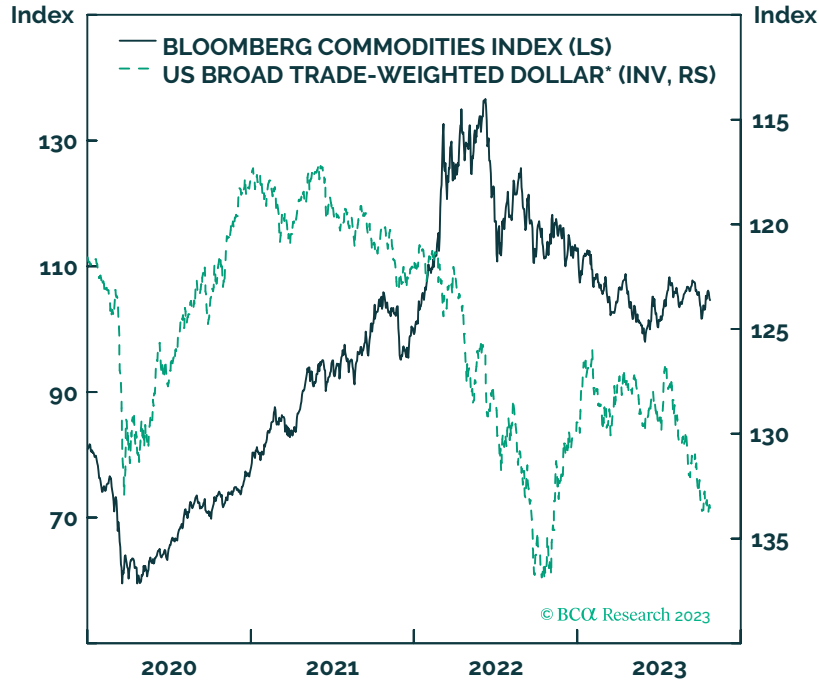
\* SOURCE: BLOOMBERG FINANCE L.P.

# Underweight Utilities As Bond Proxies

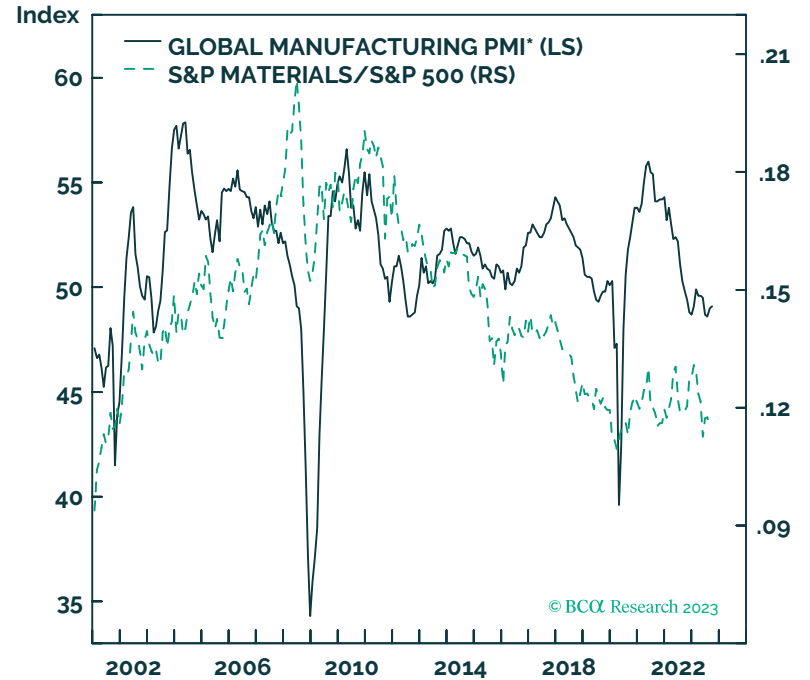




# Underweight Materials As A Play On A Dollar And Slowing Global Growth

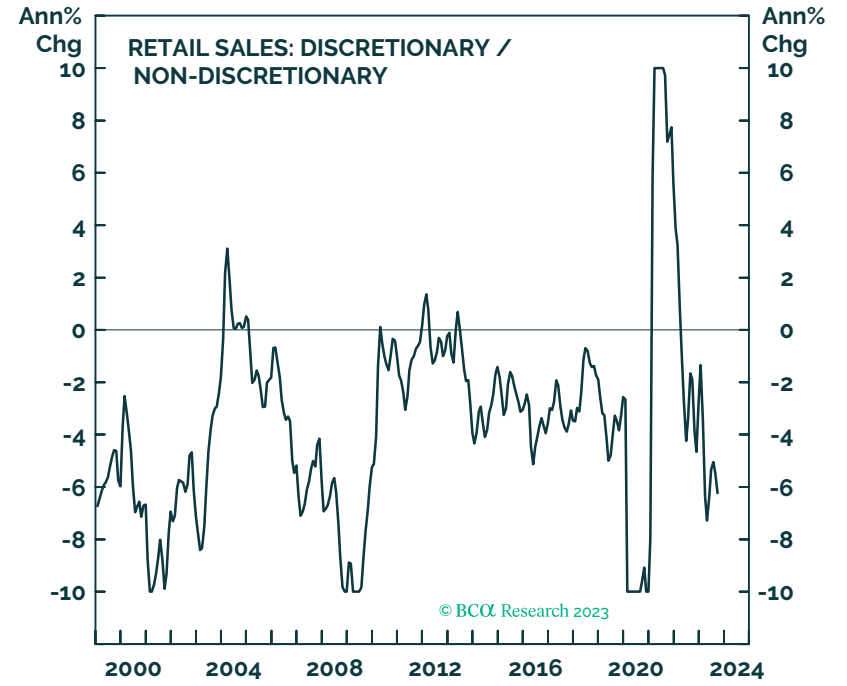
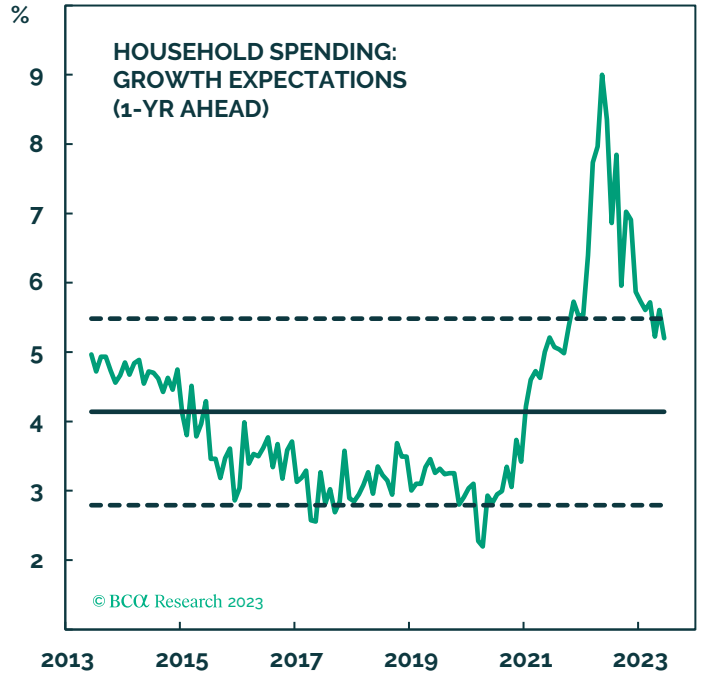


\* SOURCE: J.P.MORGAN CHASE & CO.



\* SOURCE: S&P GLOBAL.

# Underweight Consumer Discretionary: Spending Will Shift From “Want” To “Need” Again



SOURCE: NEW YORK FEDERAL RESERVE.

# Portfolio Positioning

## Overweight

- **Monetary Tightening:** Insurance, Banks
- **Geopolitics:** Energy, Aerospace & Defense, Cybersecurity
- **Pent-up Demand for Services:** Professional Business Services
- **Government Spending:** Construction and Engineering, Building Materials, Green and Clean, EV
- **Defensive Growth:** Software and IT Services, Health Care
- **Defensives:** Consumer Staples

## Underweight

- **Weak Demand For Goods:** Semiconductors
- **Slowing Global Growth:** Chemicals, Metals & Mining
- **“Higher For Longer”:** Utilities
- **Consumer Spending Slowdown:** Consumer Services, Retailing
- **Commercial Real Estate:** Retail REITs, Office REITs

S&P SECTORS & STYLE	-				+
GROWTH	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
VALUE	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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HOUSEHOLD & PERSONAL PRODUCTS	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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PHARMACEUTICALS, BIOTECHNOLOGY & LIFE SCIENCES	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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MEDIA & ENTERTAINMENT	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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UTILITIES	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

NOTE: ALLOCATION IS RELATIVE TO THE S&P 500.

CURRENT

# Conclusions

- **The vicious troika:** Surging rates, an appreciating dollar, and higher energy prices are a triple whammy for US equities and other risky assets going forward.
- **Earnings growth** is expected to rebound into the yearend. Looking further ahead, earnings growth will be under pressure should higher rates, energy, and the dollar persist.
- **S&P 500 is highly concentrated:** The Magnificent Seven continue to call the shots, but the bar is set high for these stocks – overweight Value vs. Growth.
- **Overweight** Energy, Aerospace & Defense, And Cybersecurity to protect portfolio from geopolitical tensions.
- **Underweight** Metals & Mining, and Consumer Discretionary as growth both in the US and abroad is to slow further.

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