NATIXIS INVESTMENT MANAGERS | SOLUTIONS

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PORTFOLIO ANALYSIS & CONSULTING

Charts and Smarts®

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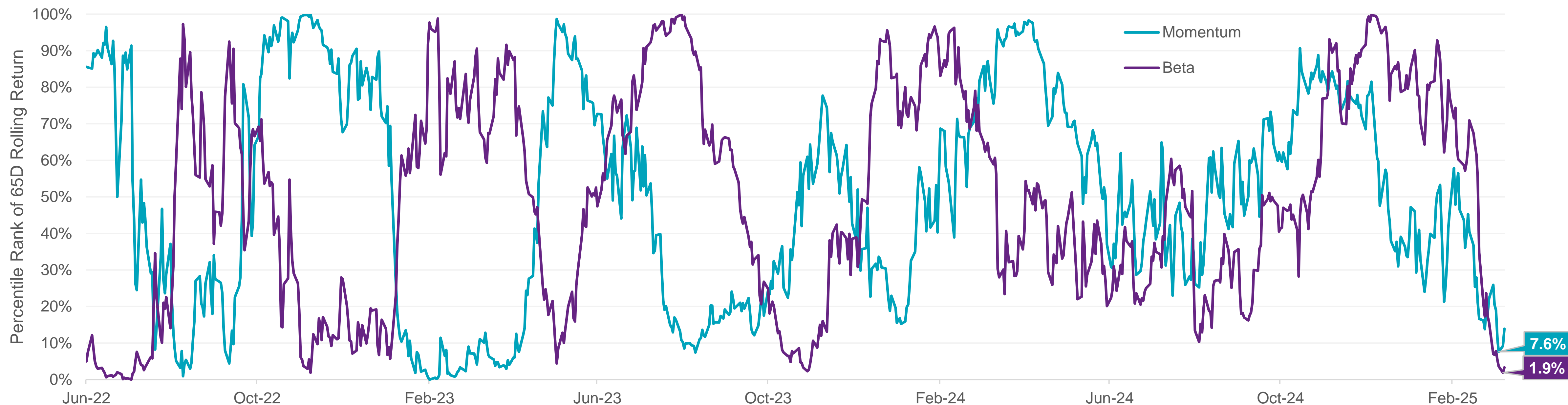
It Ain't Me Babe

Bloomberg Beta & Momentum High-Low Indices (6/2/22–3/11/25)



February was certainly a tale of two months as markets pushed higher through mid-month with the S&P 500® Index notching a new all-time high by February 19. Since that date, which oddly enough marked the market peak in 2020, it's been a very different story. Growing uncertainty, falling confidence and softer data have all combined to change the prevailing narrative. A common refrain we've heard through this vicious rotation and pullback is that equities are selling off as a result of slowing growth, thanks to dented confidence from elevated uncertainty. But that strikes us as off the mark for a few reasons. First, the slowing in growth that investors are slowly starting to appreciate isn't a function of an uncertainty overhang, which, to be sure, is yet another headwind, but rather a continuation of the cooling process that has been underway for some time. And second, resilience in cyclical sectors, particularly Financials, and relatively well-behaved credit spreads, suggests that growth fear simply isn't all that pervasive. Instead, the pullback has largely been a story of an aggressive unwind in crowded positioning within beta and momentum names. The washout has indeed been extreme as rolling 65-day returns for momentum plummeted from the 91st percentile in October, bottoming out in the 8th percentile, while beta fell from the 99th percentile in December to the 2nd. Although this washout suggests cleaner positioning moving forward, growth concerns are indeed increasing, and the pendulum hasn't swung far enough yet. That means the true growth scare is still lurking as markets and the Fed remain overly sanguine on growth and overly concerned with upside inflation risks. And while they will likely both come around, the market's overreaction function is likely to pivot before the Fed opens up the potential for another leg lower for equities.

Source: Portfolio Analysis & Consulting, Bloomberg. **Performance data shown represents past performance and is no guarantee of future results. The B**loomberg Momentum Index reflects the performance differential between stocks that have outperformed over the past year and those that have underperformed. **The B**loomberg Beta Index reflects the performance differential between stocks that exhibit a high beta, or high sensitivity relative to the broad market and those that exhibit a low beta.

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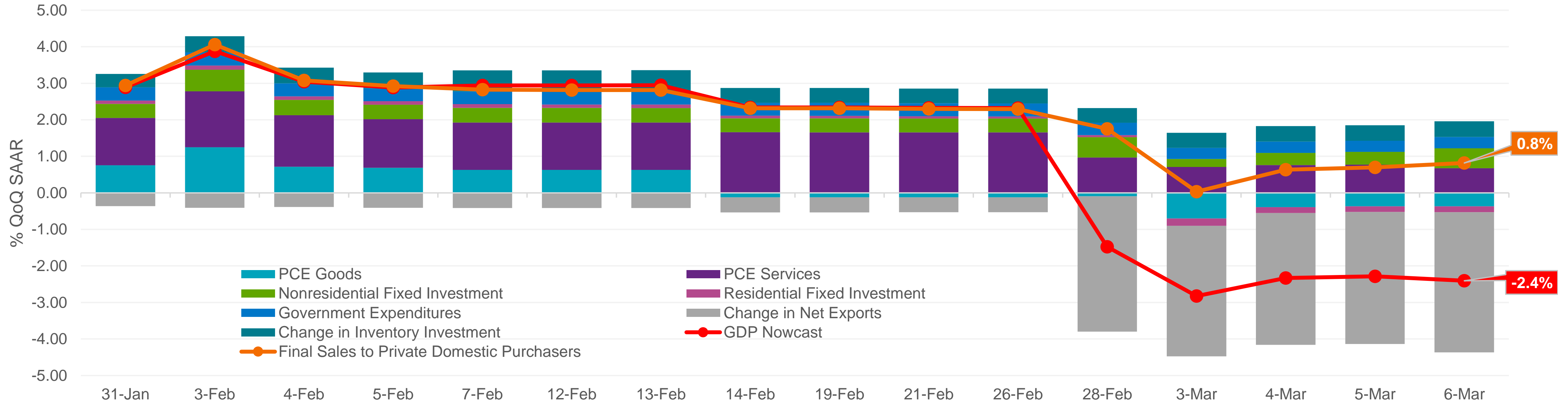
Like a Rolling Stone

Atlanta Fed GDPNow Q1 2025 Forecast (1/31/25–3/6/25)



While the growth scare may not be fully reflected in markets, there are certainly a growing number of data points that could help that concern metastasize further. Perhaps most visible of which is the Atlanta Fed's GDPNow model, which started the month tracking around 3%, now sits at a shocking -2.4% for Q1. There are a few reasons, however, to discount that figure. First and foremost, the model is not a true forecast, but rather an aggregator of inputs to GDP, and given that it's still very early in the quarter with respect to data, particularly after a few months that have seen severe weather and natural disasters, there's reason to be wary of distortions. Second, the model uses a combination of hard and soft data to triangulate its estimate, and there are plenty of reasons to be skeptical of the sentiment effects of uncertainty embedded in survey data, such as the Purchasing Managers' Indices. Finally, while the estimate had been grinding lower, the true force behind the massive decline into contractionary territory was the widening trade deficit in January, which wasn't as much a function of tariff front running as much as it was a massive increase in nonmonetary gold imports, which drove 60% of the widening of the goods trade deficit. Trade in nonmonetary gold, or gold that is not held as a reserve asset by a monetary authority, is GDP neutral and removing it leads to an upward revision of about 2% to the model. The bigger story, however, is that consumption, increasingly the lone provider of a growth impulse in the economy, appears to be slowing as evidenced by the more reliable measure of underlying economic momentum in final sales to private domestic purchasers. Yes, it's still early in the quarter, but from our perch, while growth isn't collapsing, it is certainly slowing as labor markets continue to cool and consumption moderates, and the narrative pendulum hasn't yet swung far enough to reflect the economic reality.

Source: Portfolio Analysis & Consulting, Federal Reserve Bank of Atlanta. GDP represents gross domestic product. PCE represents personal consumption expenditures.

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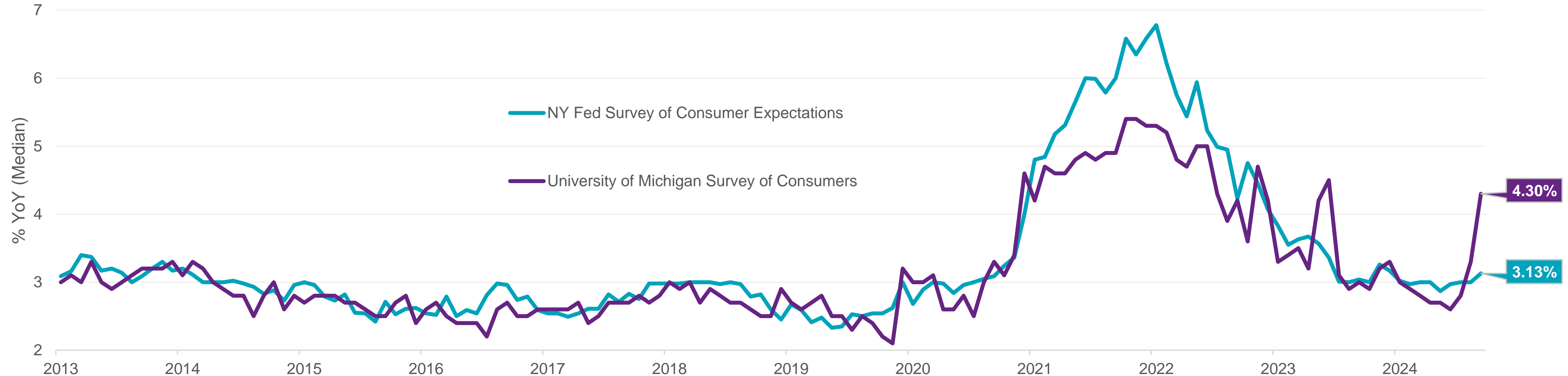
Blowin' in the Wind

One Year Ahead Inflation Expectations (6/30/13–2/28/25)

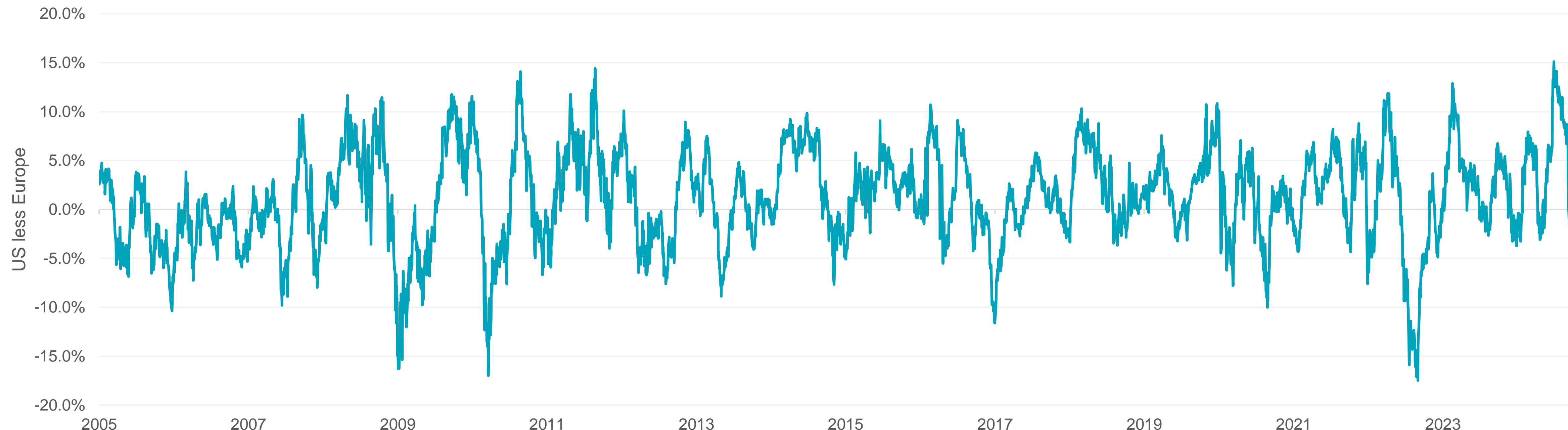


Whether it's a function of organic cooling or an uncertainty overhang, growth is certainly slowing. Given the slower growth backdrop and persistent tariff concerns, it should come as no surprise that rumblings of stagflation are once again on the rise. Those rumblings have only grown louder in the wake of the most recent University of Michigan Consumer Sentiment release. The Fed has been fairly consistent in expressing that they would look through tariff risks to the extent that inflation expectations remain anchored. At the surface, the latest release of the University of Michigan's Consumer Sentiment Survey has triggered concerns that those expectations are at risk of becoming unanchored, as the median expected inflation rate for the year ahead surged from 3.3% to 4.3% in February as 5-year expected inflation rose to 3.5%, its highest level in 30 years. Peeling back the layers, however, we can see the distortions that even the median can't rectify. As with the rest of the survey, it has largely become simply a reflection of political affiliation, as Republican respondents see 1-year forward inflation at -0.1% and 5-year inflation of just 1.3%, while Democrats see 5.4% and 4.4%, respectively. But to the extent that inflation expectations do, in fact, impact realized inflation via behaviors and decision making, the distribution of response should cast doubt on its reliability. The median figure is being increasingly distorted by the percentage of respondents marking unrealistically high round numbers in their responses, as 28% of respondents see inflation rising at a 10% or greater pace over the next year, and 23% citing that pace over the next 5 years, the latter of which is the highest since 1985. This stands in stark contrast to the findings of the New York Fed's Survey of Consumer Expectations which has a much larger sample size, surveys the same respondents from month to month, and frames the question to focus on inflation, rather than prices. The more reliable measure of inflation expectations by the Fed's own admission seems to be still well anchored. So much for stagflation.

Source: Portfolio Analysis & Consulting, Bloomberg.

Masters of War

US (SPY) vs Europe (VGK) 50-Day Performance Spread (5/20/05–3/7/25)



In December, we highlighted the potential for a European catch-up trade, despite continued structural headwinds given the extreme outperformance of US equities as markets priced in the second Trump term. To put that extreme in perspective, using ETFs to eliminate daily slippage from the different closing times of US versus European markets, the US outperformed Europe by over 15% at the wides in mid-November, the widest 50-day performance spread on record. Markets were primed for a mean reversion trade, and revert they did as the economic outlook began to look less bad. As we always like to highlight, markets love to overshoot and extremes rarely resolve to neutral - they tend to overshoot in the opposite direction. That is precisely where we find ourselves today as the US has now lagged Europe by 18.5% over the past 50 trading days, again the largest recorded performance differential in favor of Europe. The move has been sharp and swift and certainly much larger than even we had expected, leaving many investors scrambling just as they finished dusting off their Trump 1.0 playbooks. The question everyone is scrambling to answer: can this continue? From a tactical perspective, this move certainly seems to be long in the tooth and due for consolidation. And that seems particularly true given the bloc isn’t likely to have much immunity from the US catching a growth cold. But in the wake of a wild week in Germany which saw the incoming government announce plans to boost infrastructure and defense spending on the order of 3.0% to 3.5% of GDP, there’s more hope now than ever that Europe may finally be leaving its days of austerity behind and embracing a new regime of fiscal expansionism. Whether that comes to fruition remains to be seen.

Source: Portfolio Analysis & Consulting, Bloomberg. **Performance data shown represents past performance and is no guarantee of future results.** SPDR® S&P® 500 ETF Trust (SPY) and Vanguard FTSE Europe ETF (VGK) used for illustrative purposes only.

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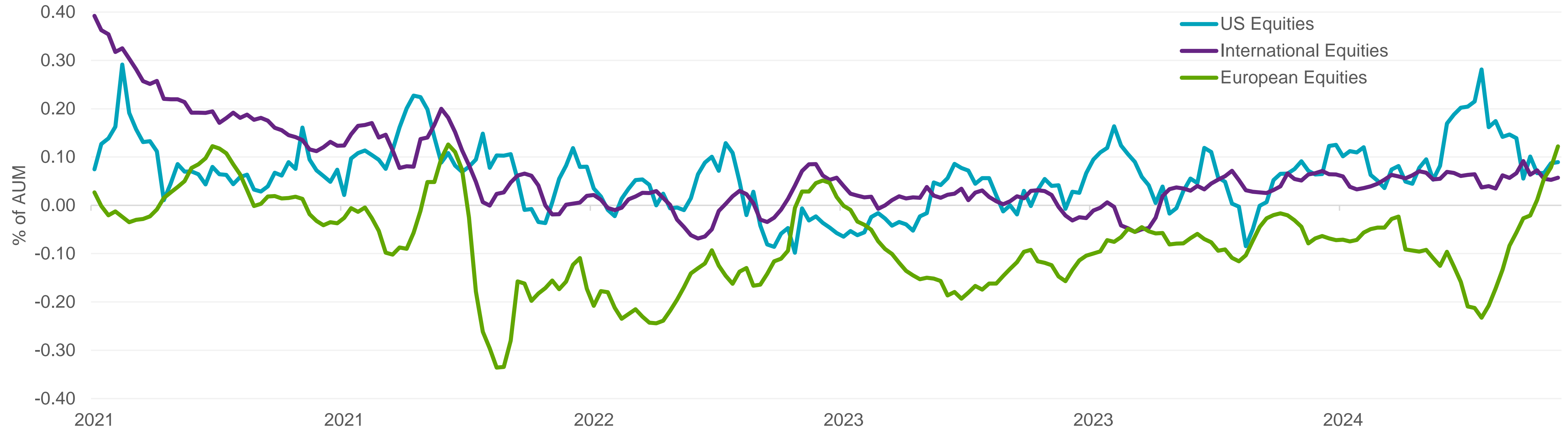
The Times They Are a-Changin’

Rolling 6-Week ETF and Long Only Flows (12/28/21–3/7/25)



The violent reversion in relative performance is shining through inflows as well. Over the past three years, flows have been decidedly one way as investors poured out of European equities hand over fist to the tune of $254B, with the region posting outflows in 144 of 156 weeks. A steady rotation out of Europe funding inflows into US equities of over $760B over that time. But the story has rapidly flipped with 6-week rolling net flows to ETFs and long only funds as a percentage of assets under management showing momentum has been steadily fading for US equities since mid-December as inflows to European equities have surged into positive territory for the first time since March 2023. There’s nothing like price to change sentiment, and the historic run of outperformance has certainly been a driving force behind the stark shift to inflows after a decade of outflows totaling $420B. What began as a story of less bad data clearing a low bar has evolved into an outright more optimistic growth outlook on the back of Germany’s fiscal shift. And while investors broadly remain underallocated to the region, the near-term risk appears to be another catch-up trade, or more accurately, a catch-down trade. With relative performance now historically stretched in favor of Europe and growth fears building in the US, the risk is for that slower US growth impulse to filter out into a global growth backdrop that already appears to be cooling. While the longer-term growth outlook may be growing brighter for the Eurozone’s largest economy, and perhaps for the bloc more broadly, downside risks to the near-term outlook appear to building. Watch for that narrative pendulum to start swinging back from yet another overshoot.

Source: Portfolio Analysis & Consulting, Bloomberg. AUM represents assets under management.

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