

A few thoughts & numbers on what's ahead in Q4 and the future

This is a quick note on what's ahead for Q4 2024 and how the outlook is unlikely to brighten up. It will cover thoughts and numbers on the US Presidential election, the UK tax hike, the US labour market, oil and US natural gas prices and the yield curve inversion and putting it into historic perspective. Once again, the current economic state of high government debt/GDP, high inequality, high migration as a result of wars, stock market speculation and an energy transition all happened before: In the 1920s. Investment horizons for equities hence should shorten and government bonds could be an attractive investment.

Historic parallels: 1920s v. 1970s vs. today

Parameter	1920s	1970s	Now
Auto sales	High auto sales amid shift toward combustion engine (from horses)	Falling sales & strikes	Low supply has met relatively strong demand, EV uptake weakens
Consumer sentiment	No data	Consumer sentiment fell to lows equivalent of 2008 in 1975 and 1980	Weakest since 2008/09
Credit spreads	20yr AAA vs. BAA rated corporate bonds yielded 6% vs. 8.2%	20yr AAA vs. BAA rated corporate bonds yielded 7.5% to 12% vs. 8.5% to 13.5%	20yr AAA vs. BAA rated corporate bonds yielded 4.7% vs. 5.5%
Geopolitics	World was split in two powers: France, UK, Russia vs. Germany, Austria-Hungary, Italy	Cold war was ongoing, Arab-Israel war led to indirect war of US vs. Soviet Union, which led to oil embargo. Iranian revolution in 1979 led to another spike in oil prices	Entering bi-polar world NATO vs. SCO, West vs. South
Globalisation	World was in globalisation mode, but WWI set the stage for de-globalisation	1970s were inflection point towards globalisation	Beginning of de-globalisation after strong globalisation in prior decades
Government debt/GDP	World leader (England) had excessive debt/GDP of over 130%	Below 40%	>100%
Housing market	Price hikes of as much as 14%	Mixed	Price hikes of as much as 20%, now abating
Inequality	High inequality, top 1% owning 12-19% share of total income	Inequality only started to shift from the late 70s	High inequality with top 1% owning 30% of all household wealth
Inflation	PPI was between 25-35% during WWI, then influenza kept inflation at 11%	PPI in region of 12-18% in 73/74 & 79/80	PPI in region of 10% and higher, now negative
Interest rates	Fed hiked from 4% to 7% within 8 months	73/74 Fed hiked from 5% to 12%, 78-81 Fed hiked from 8% to 18%	Fed hiked from 0% to 5.33% in <1.5 years
Inventories	Low inventories	JIT inventory approach was just taken on	Record lows, now climbing

Lending	Businesses borrowed excessively in light of soaring commodity prices	Grew normally	Consumer lending is picking up, businesses reduced borrowing
Orderbook	Large orderbooks	No data	Very high, now lower
Stock market	High speculation, lots of borrowing on margin	S&P 500 halved between 1973 and 1975, stable before	High speculation, lots of borrowing on margin
Taxation	Income tax and other taxes were introduced	UK had top rate of income tax on earned income was cut from 83% to 60% over the decade	Global minimum corporate tax to be introduced, general tax hikes
Unemployment	Low, frequent strikes for higher pay	Doubled from 4.6% to 9% and from 5.6% to 10.8% (73/73 & 79/80)	Record lows, now climbing
Yield curve	No data	73/74 & 79/80 yield curve inverted for nearly 2 year, rates kept rising overall	Inverted

Source: Multiple sources, James Grant's "The Forgotten Depression", etc. own estimates

The US Presidential elections

While President Trump is ahead according to betting markets, the US presidential elections are very tight. Kamala Harris has pledged to tax unrealised capital gains, while Trump pledged to cut corporate taxes further to 15%, at the same time as hiking tariffs for all imports to 10% and Chinese imports to a whopping 60%. I see a Kamala win as a disaster for equity markets, while a Trump win could raise a wedge between the US and Europe in a way similar to the 1920s when the US did very well economically, while Europe was struggling. The new Trump tariffs would resemble the 1922 Fordney-McCumber Tariff in this scenario (if nobody retaliates – also income taxes were reduced while trade tariffs were hiked, very similar to Trump's plan). However, it could also mean that the Trump tariffs would resemble the Smoot-Hawley Tariff Act of 1930 (if everyone retaliates), which could result in a global depression. I think the biggest mistake one can make is to underestimate Trump, but at the same time, hiking tariffs in such a weak economic environment would almost certainly result in a global depression. Hence, either outcome could be viewed as negative by the markets.

US Presidential Election Odds (Betfair)

16:43

75

betfair

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USA - Presidential Election 2024

Tue, 5 Nov, 11:00

Election Winner

Winning Party

Popular Vote Winner

Party of

Market Depth

P&L Table

Election Winner

Matched: £59,178,185

Back

Lay

Donald Trump

1.95

£13,478

1.96

£19,209

Kamala Harris

2.14

£28,300

2.16

£12,582

JD Vance

200

£121

210

£15

Nikki Haley

240

£159

260

£846

Michelle Obama

250

£15

300

£10

Tim Walz

330

£34

350

£12

Hillary Clinton

530

£16

610

£25

Robert F. Kennedy Jr

480

£10

530

£25

Gavin Newsom

900

£100

1000

£100

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Menu

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Sportsbook

Casino

Source: Betfair

The tax situation in the UK

Taxes are being raised all over the world, but the UK appears to be the frontrunner with this 30th October's budget to plug a £22bn blackhole. This blackhole is mostly the result of public pay hikes, of which there could be more to come. It will be a "Happy Halloween" budget that will likely be composed of the following¹:

¹ <https://x.com/AozoraStep/status/1828797626776690876>

1. Capital gains tax income was £15bn last year. If one were to adjust the 10-18% (basic taxpayer) and 20-24% (higher taxpayer) to income tax brackets, the additional income could potentially range from £10-15bn (up to 1.37% of total tax income)²
2. Inheritance tax income was £7.5bn last year and only counted for inheritance above £325k. If the 40% inheritance tax would be applied to everything, even below £325k and we assume 10% of deaths (60k) have £325k to pass on, £7.8bn could be raised³
3. Council tax on properties worth £1mio or more could be raised. With £44.7bn council tax makes up 5% of all tax income. There are 730k properties valued at £1mio or more. To raise £1bn, council tax payments would need to climb by £1,370 per >£1mio home⁴
4. Stamp duty on properties (1% or £13bn of tax revenue) and business rates on non-domestic properties (3% or £27bn of tax revenue) are also being discussed with the goal of changing this to land value rates compared to transactions and rents currently⁵
5. Corporate taxes currently generate 10% of all tax revenue (£100bn). Raising this rate by 5% to 30% could hence raise £20bn. Labour has dismissed this, but it could be used in the future to bring in more tax revenues⁶

While Labour indicated that they are not hiking corporate taxes, it would mean that they need to be quite aggressive on capital gains and inheritance taxes and possibly also hike council taxes and stamp duties. This could be the end of capitalism and trickle-down economics. It would become very hard to get rich quickly, although personally I think raising capital gains taxes and inheritance taxes is fair. Together with your partner you can invest £50k a year in tax-free ISA accounts. That means you need to earn over £90k of savings a year as a married couple, which compares to a median full-time employee gross salary of nearly £35k.⁷ I also think that inheritance does not make people happy – at least from the cases I have personally seen. And it's rightfully unfair to play Monopoly with a full bank account when the other players

² <https://www.gov.uk/government/statistics/capital-gains-tax-statistics/capital-gains-tax-commentary--2>

³ <https://www.gov.uk/inheritance-tax>

⁴ <https://www.savills.co.uk/insight-and-opinion/savills-news/339380-0/1-in-40-homes-now-valued-%C2%A31-million-or-more--according-to-savills>

⁵ <https://www.gov.uk/stamp-duty-land-tax/residential-property-rates>

⁶ <https://www.gov.uk/government/publications/the-growth-plan-2022-factsheet-on-corporation-tax/corporation-tax-rise-cancellation-factsheet#:~:text=According%20to%20OECD%202022%20figures,%2C%20Japan%2029.7%2C%20Germany%2029.8>

⁷

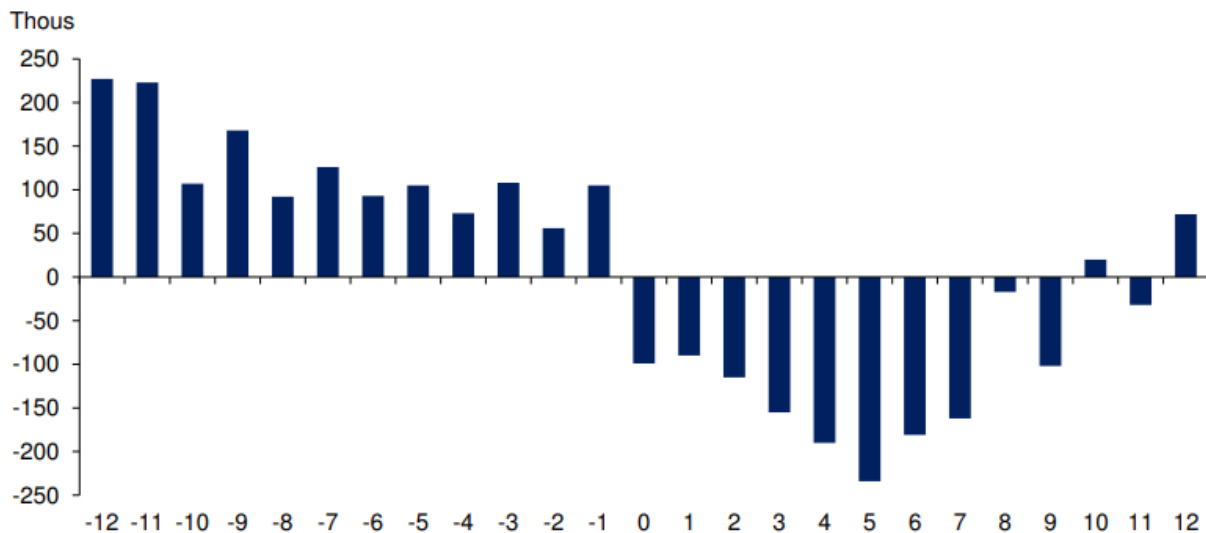
<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2023>

start with nothing, or perhaps even debt. However, I believe it would be much better to hike corporate taxes by 2% and increase capital gains taxes and inheritance taxes less drastic. In fact, this would be very logical, as other corporate taxes in Europe are mostly between 27%-30%⁸ compared to the UK's 25%. Despite Labour denying a corporate tax hike, it would surprise me if they try to plug this £22bn hole with more taxes on individuals – it would make working for the state comparatively too attractive!

The US labour market

Deutsche Bank sent out a very interesting chart today, which shows how nonfarm payrolls behave ahead of past recessions. The first meaningful drop usually comes 10 months ahead of a recession. From then, the next few months are varying between >100k+ changes and <100k monthly changes. If we look at the last 12 months of nonfarm payrolls, in April we had the first low print of just above 100k. This would indicate that we are now around 6 months away from a recession.

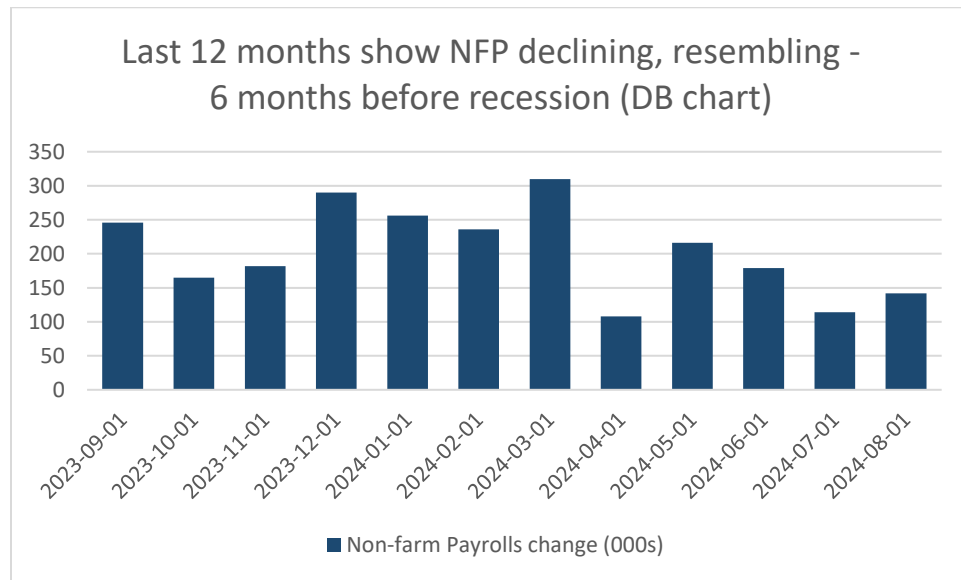
Figure 1: Median path for nonfarm payrolls growth in the 12 months around US recessions since 1945 (0 = first month of recession) - usually the first month of a recession sees a non-linear break to a negative payrolls print. So far in this cycle we haven't seen a sub 100k print.



Source : Haver Analytics, Deutsche Bank

Source: Deutsche Bank

⁸ <https://www.gov.uk/government/publications/the-growth-plan-2022-factsheet-on-corporation-tax/corporation-tax-rise-cancellation-factsheet#:~:text=According%20to%20OECD%202022%20figures,%2C%20Japan%2029.7%2C%20Germany%2029.8>

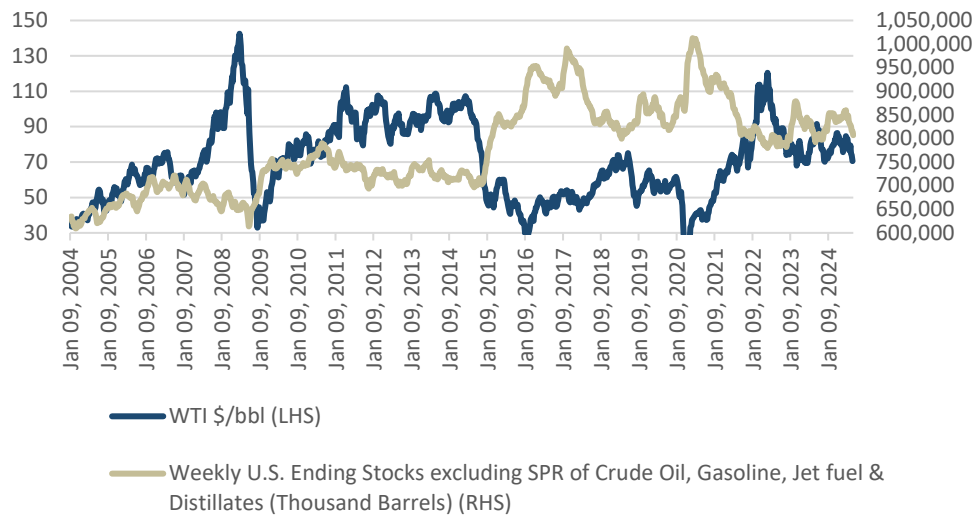


Source: FRED St. Louis

Oil vs. natural gas

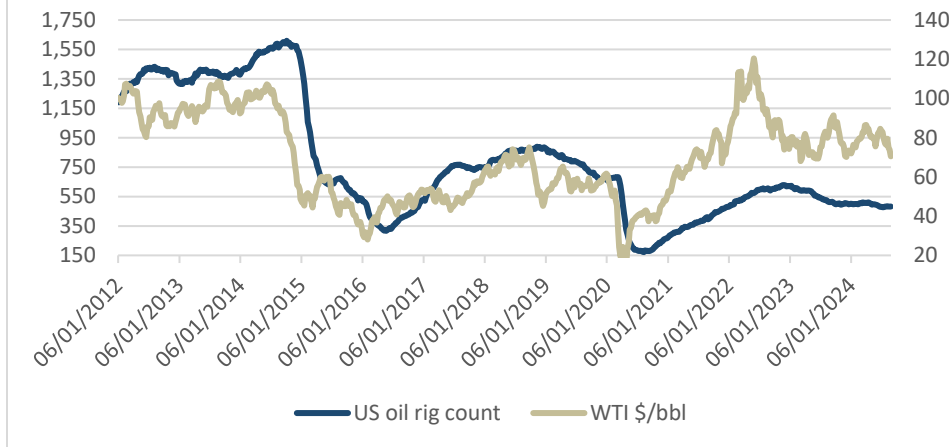
For over a year, we have seen oil prices and non-SPR US inventories stay in a range of \$70-90/bbl and 800-850mio barrels. However, in recent weeks we observed falling inventories while oil prices also fell, and the rig count declined slightly. This is very unusual and only occurred in 2011 and 2014 before, ahead of further oil price falls. This dynamic makes me cautious on oil prices. Gas prices, on the other hand, are near record low levels already and US production cuts have recently led to the slowest inventory build in August on record, with one week recording an inventory draw for the first time ever (in August). When oil prices drop further, we could also see oil production decline, which would also reduce gas production as it's a by-product. This overall makes the outlook for gas prices relatively positive.

Abnormal: In recent weeks US crude oil inventories fell while oil prices were also falling

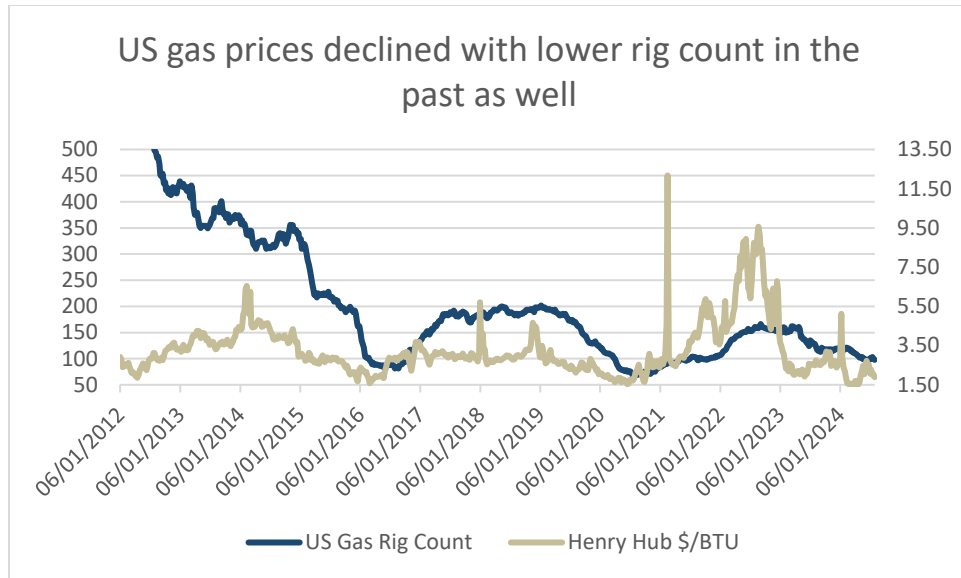


Source: FRED St Louis, EIA

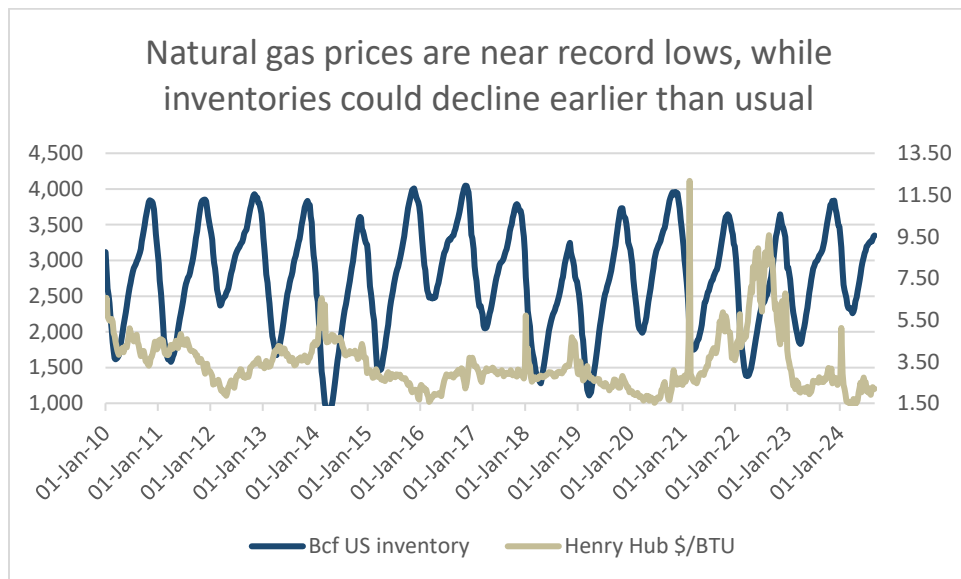
A rise in the rig count would indicate a risk to oil prices at this point



Source: FRED St Louis, Baker Hughes



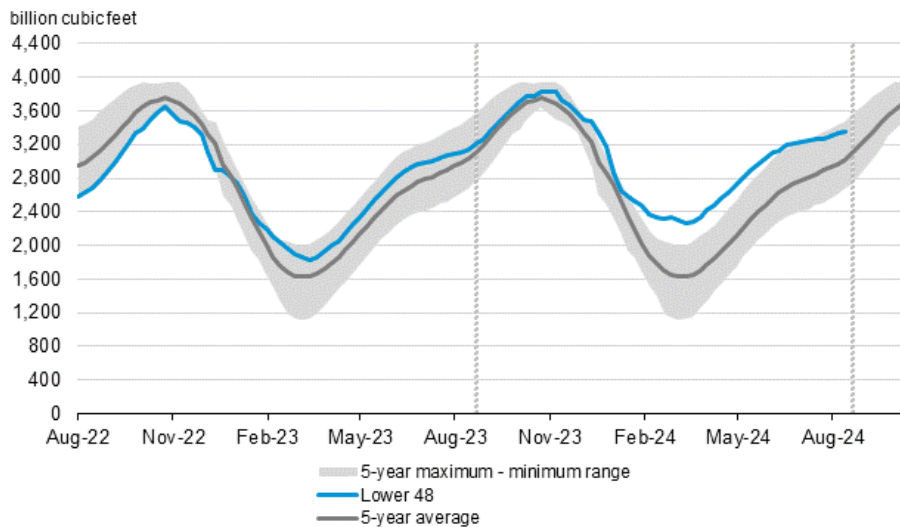
Source: FRED St Louis, Baker Hughes



Source: FRED St Louis, EIA

Current natural gas inventory growth is so slow, inventories could drop below 5-yr average in the winter

Working gas in underground storage compared with the 5-year maximum and minimum



Source: EIA

A historic comparison of 2s10s UST yield curve inversion

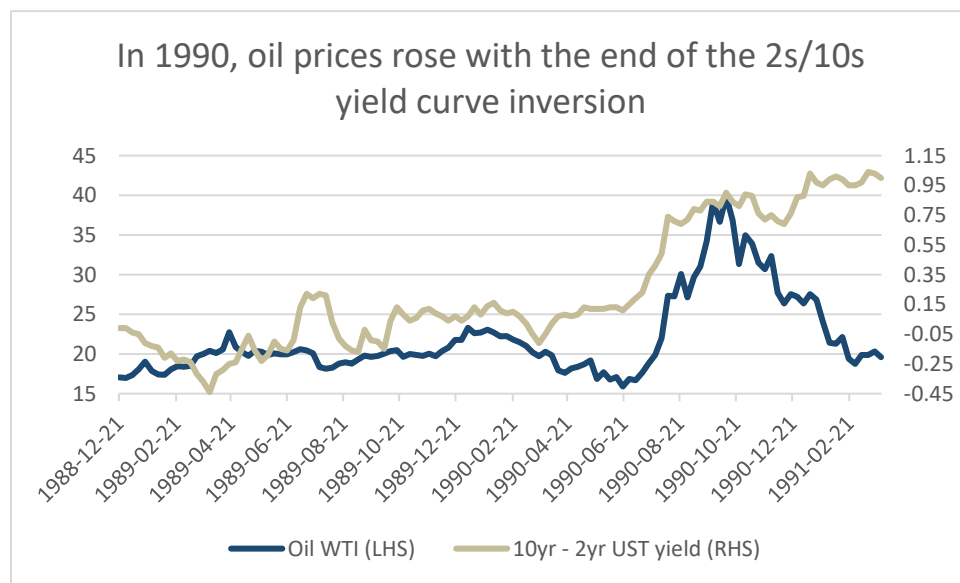
The 2s10s inversion did not occur very frequently historically. In fact, it only occurred three times over the last 50 years. In each case, the Federal Reserve cut rates by 50bps. The end of the inversion always led to higher oil prices, except in 1989, when oil prices were initially declining and only rose significantly with the Iraqi invasion of Kuwait a year later, which then caused the curve to steepen. In 2001 the rise in oil prices was also short-lived, as oil began declining again just one month after the first cut. The S&P 500 peaked between two weeks and four months after the first rate cut in all three prior instances. USD weakened ahead and (at least against the Euro) after the first rate cut in 2007, but USD strengthened in the other two instances, ahead of the first rate cut and then remained largely stable or weakened slightly afterwards. What stands out this time is that oil prices weakened significantly ahead of the first rate cut, as did the USD. The S&P 500, on the other hand, appears close to its peak, hence bets on higher equity valuations feel very risky to enter here. This time, the 2s10s inversion has also been longer and deeper than historically. The S&P 500 correlation to GBPUSD remains strong, and hence exposure to USD earnings should be beneficial if the market were to decline. In November 2006, OPEC also delayed oil output hikes

and like today, the SPR was being filled, but very different from back then is the transition to EVs and away from China.

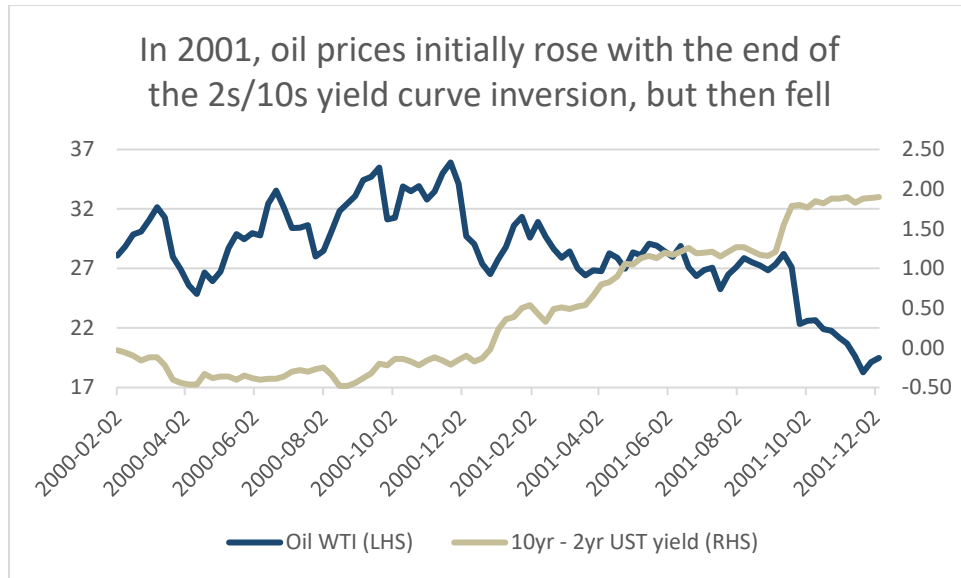
UST 2s10s inversion historic dates

Year	Peak 2s10s inversion	End of 2s10s inversion	First rate cut
1990	1989-03-29	1989-07-05	1989-06-14
2001	2000-08-23	2001-01-03	2001-01-03
2007	2006-11-22	2007-03-21	2007-08-15
2024	2023-06-30	2024-09-06	2024-09-18

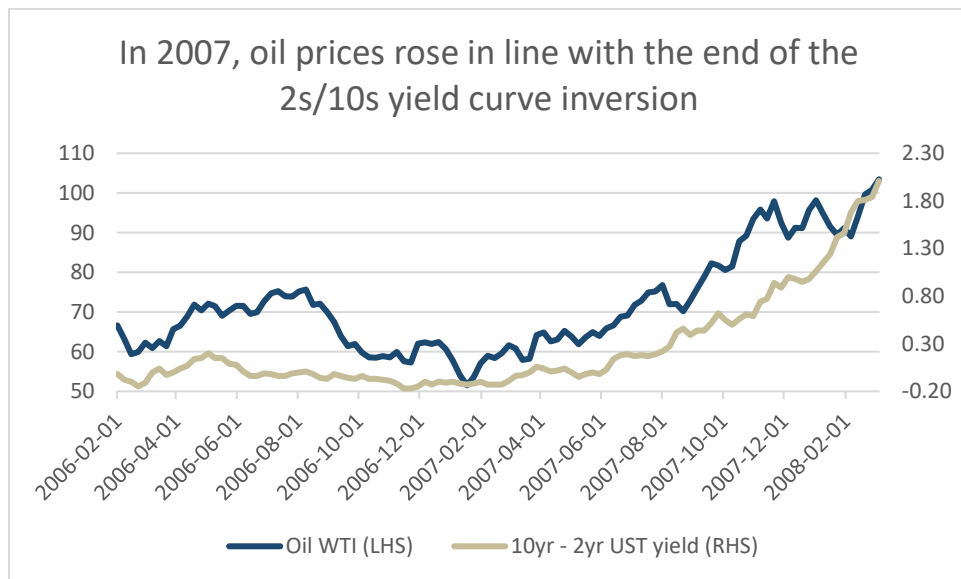
Source: FRED St. Louis



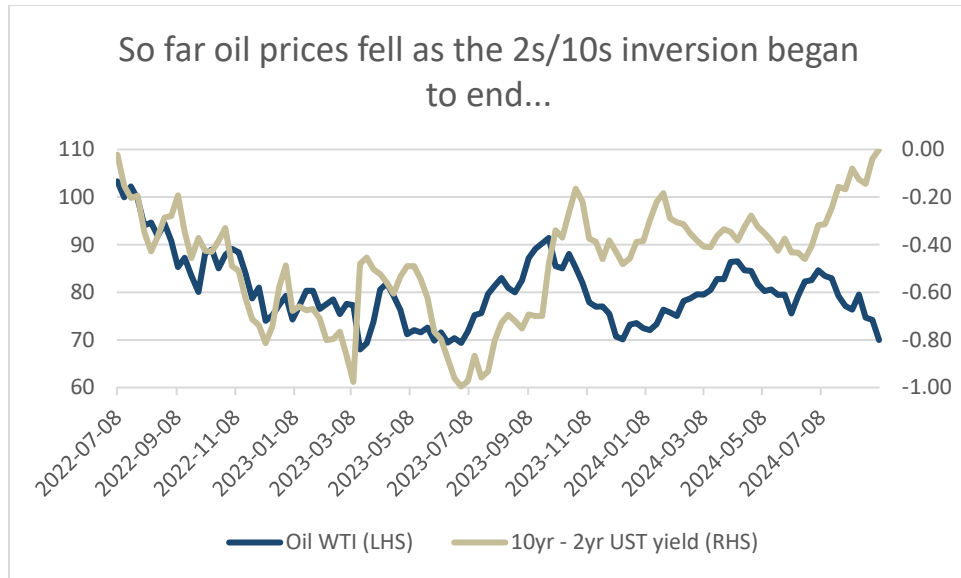
Source: FRED St. Louis



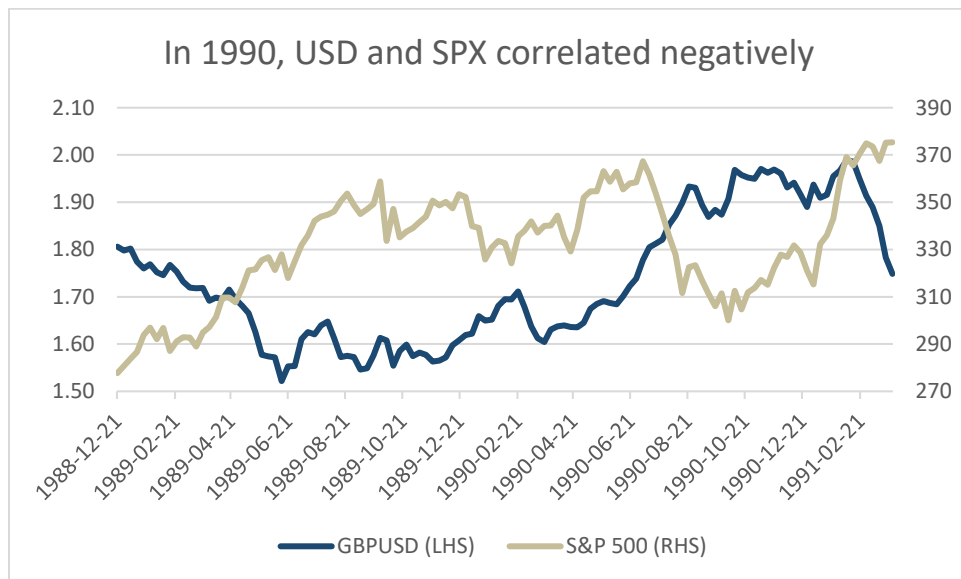
Source: FRED St. Louis



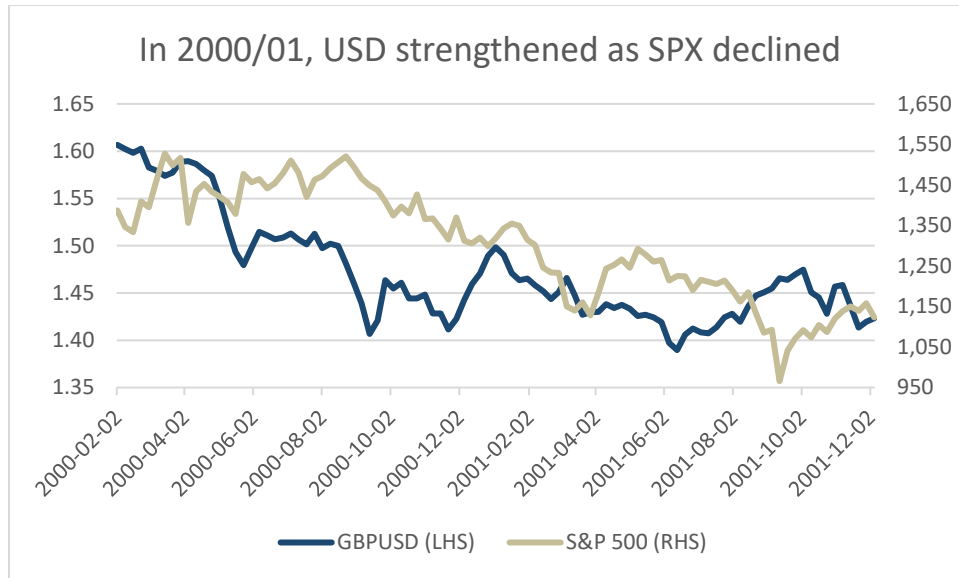
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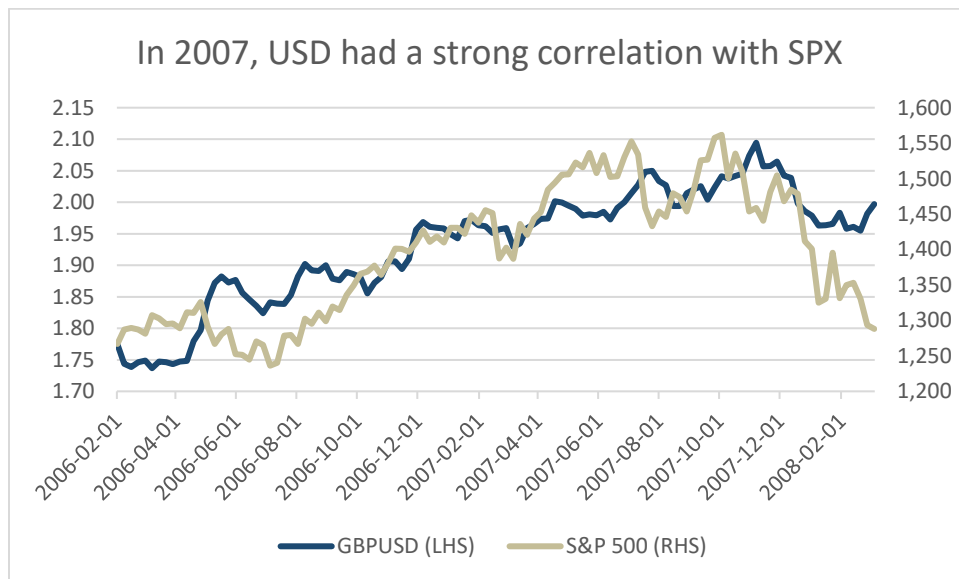
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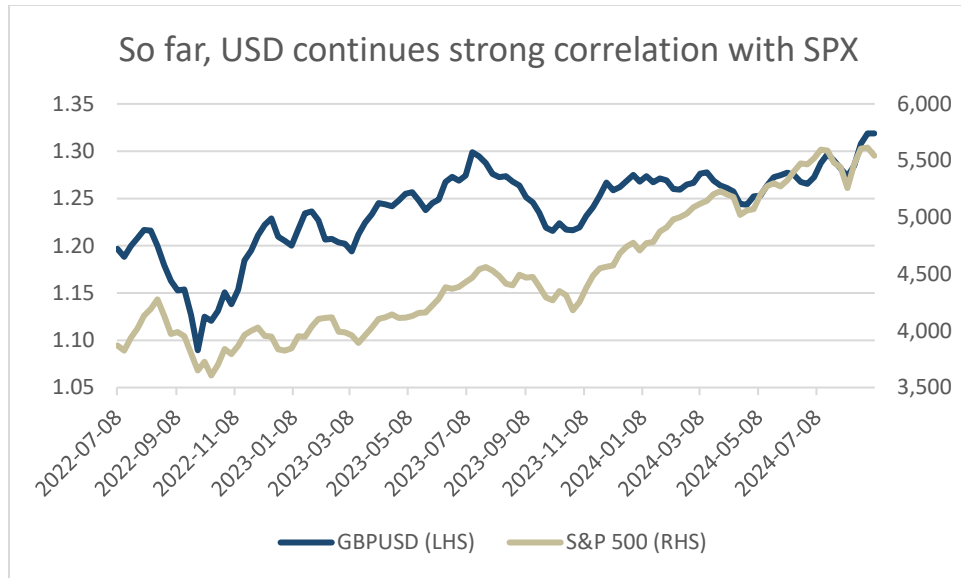
Source: FRED St. Louis



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