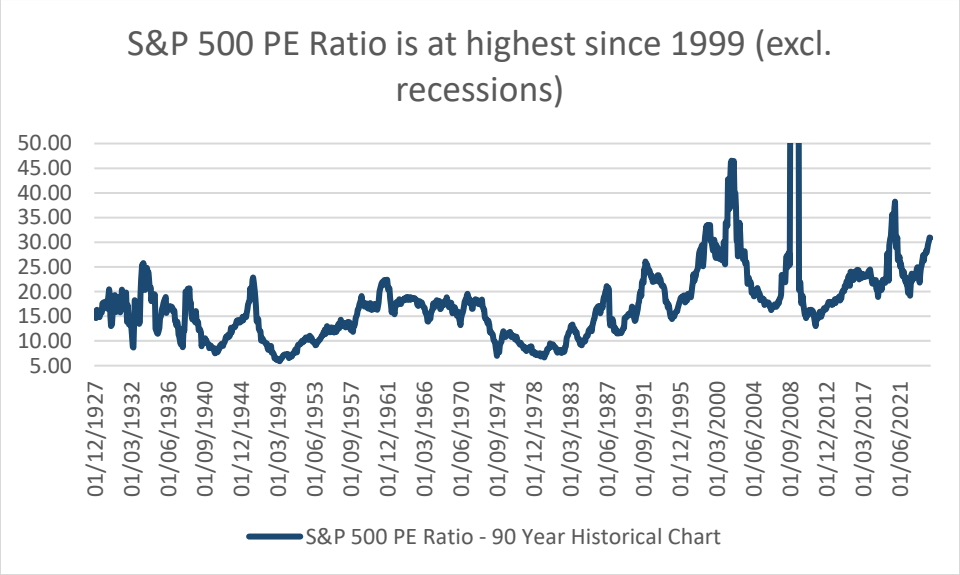
AozoraStep

24th January 2025

The key determinants of markets in 2025

US equity valuations

The current S&P 500 P/E ratio stands at 30.92 – the highest ratio since 1999 when you exclude the major recessions in 2002, 2009 and 2020[1]. This historic analogy (being 1999) is again similar to the conclusion I came to when looking at historic US yield curve inversions (here). I've been thinking for a while now what could cause the market to turn and compared the current environment to the 1920s (more below). However, I always felt that Trump's tariffs are implemented aggressively, but ultimately carefully, such that it doesn't cause a major recession as it did in 1929 with the USD appreciating accordingly. I also do not think that inflation is having a major comeback, as per LNG analysis below and due to tariff impact being eliminated with USD strength. Ultimately, these valuations cannot sustain themselves for very long periods and I think a trigger of change could come through a black swan event, like China invading Taiwan or an oil crisis in the Middle East, i.e. conflicts. The alternative would be monetary tightness from the Fed, similar to the dotcom bubble burst, market fear of tariffs due to de-globalisation, similar to 1929, or, and perhaps most likely, government spending cuts.



Source: Macrotrends (https://www.macrotrends.net/2577/sp-500-pe-ratio-price-to-earnings-chart)

[1] https://www.multpl.com/s-p-500-pe-ratio

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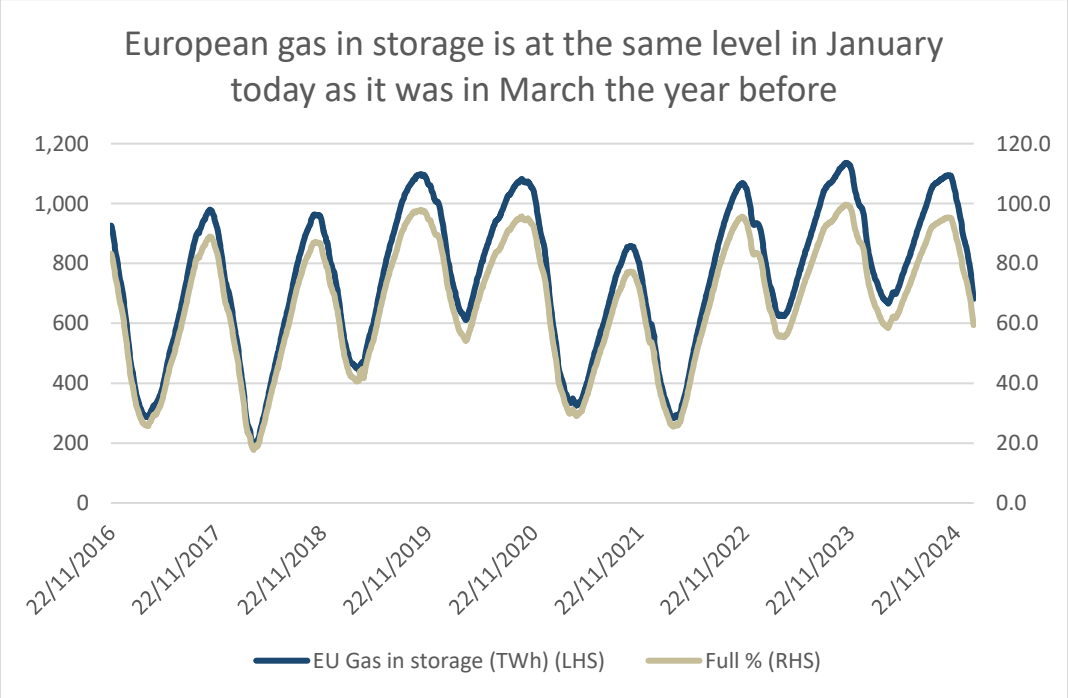
LNG and European gas in storage

As of 20th January 2025, European gas in storage is around 172TWh lower than last year at 59.4% full, which is the equivalent of where gas storage tanks were full by at the end of winter in 2024. Over the last 8 years, on average 23.4% or 260 TWh of gas in storage was drawn between 20th January and 31st March. This would put gas storage tanks full at 35.9% on 31st March 2025. However, a lot of new LNG supply is going to become available over the next few years. In 2025 alone, around 77mio tonnes[2] or 895TWh[3] annual LNG output is set to come online – more than enough to make up the annual difference, although it would take as much as two years to reach this output. Whilst in 2026, Qatar is bringing around 44bcm or 460TWh[4] annual output online, followed by 22bcm (230TWh) by 2027 and a final 22bcm (230TWh) by 2030[5]. This means that there will be more than enough LNG around to supply Europe and replace Russian natural gas. By 2030, a total of 2,283TWh is being added via LNG export facilities in North America and Qatar.



Source: AGSI (https://agsi.gie.eu/data-overview/eu)

[2] https://www.reuters.com/business/energy/venture-globals-lng-tanker-will-likely-head-germany-lseg-data-shows-2024-12-26/, https://lngir.cheniere.com/news-events/press-releases/detail/310/cheniere-achieves-first-lng-at-the-corpus-christi-stage-3, https://www.lngcanada.ca/who-we-are/about-lng-canada/
[3] https://www.unitjuggler.com/convert-energy-from-toe-to-TWh.html?val=77000000
[4] https://www.unitjuggler.com/convert-energy-from-GcmNG-to-TWh.html?val=64
[5] https://think.ing.com/articles/article-2-the-us-and-qatar-to-drive-lng-supply-growth-hold/

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Europe gas in storage is currently at the same level as it was at the end of drawing season in 2024

Date	Europe gas in storage in %
20/01/2017	48.7
20/01/2018	54.2
20/01/2019	60.2
20/01/2020	78.4
20/01/2021	58.4
20/01/2022	44.0
20/01/2023	78.9
20/01/2024	74.9
20/01/2025	59.4

Date	Europe gas in storage in %	Delta to 20th Jan
31/03/2017	25.8	- 22.9
31/03/2018	18.4	- 35.9
31/03/2019	41.3	- 18.9
31/03/2020	54.2	- 24.3
31/03/2021	30.1	- 28.4
31/03/2022	26.3	- 17.7
31/03/2023	55.7	- 23.2
31/03/2024	58.5	- 16.4
31/03/2025	35.9	- 23.4

Source: AGSI (https://agsi.gie.eu/data-overview/eu)

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North America's LNG export capacity is on track to more than double by 2028

This TIE was updated September 6, 2024 to clarify a data point.

Data source: U.S. Energy Information Administration, *Liquefaction Capacity File*, and trade press
Note: Export capacity shown is project's baseload capacity. Online dates of LNG export projects under construction are estimates based on trade press.
LNG=liquefied natural gas; FLNG=floating liquefied natural gas

New LNG export facilities schedule

LNG export terminal	Capacity (TWh)	Start date
Plaquemines	233	26-Dec-24
Corpus Christi Stage III	290	Dec-24
LNG Canada	81	mid-25
Fast LNG Altamira FLNG2	16	Q1 2026
Qatar I	460	early 2026
Energia Costa Azul	38	Q2 2026
Golden Pass	181	Q4 2026
Rio Grande	314	2027
Qatar II	230	2027
Woodfibre LNG	24	2027
Port Arthur	151	2027/2028
Cedar LNG	35	late 2028
Qatar III	230	2030

Source: Individual projects

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Fordney-McCumber and Smoot-Hawley tariffs in 1920s vs. Trump tariffs now

Last year, I have written a note on the Biden tariffs and compared the period to the 1920s (here). With Trump back in the Oval Office, ratcheting up tariffs across Canada, Mexico and China, there comes the question again whether this could lead to a breakdown of globalisation and the global trade order. Back in the 1920s, there were two large tariff reforms, the 1922 Fordney-McCumber Tariff and the 1930 Smoot-Hawley Tariff Act. The former did cause European government to retaliate, but did not stop US prosperity. The latter, however, did in part cause the Great Depression largely because it was a late-cycle economy in 1929 vs. an early cycle-economy in 1922[6]. Tariffs were used to protect the farmers and raise money for the government to reduce debt – roughly the same is valid today. Whilst the Biden tariffs were much more about protecting US auto manufacturers and others, Trump's tariffs will likely focus on generating income for the US government, as the tariffs are smaller (e.g. 10% tariff on Chinese imports). I like to compare the current period with the 1920s due to the many similarities listed below. This article (here) describes the economic power struggle of the 1920s extremely well. This economic power struggle is now happening between the US and China compared to Britain and the US in the 1920s. Very importantly, the world was on the gold standard in 1920s, which would not allow for exchange rate fluctuations, hence the USD could not appreciate. This is very different today. Therefore, Trump's careful approach of small tariff hikes will likely just lead to an equivalent appreciation of the USD. At the same time, China might lower its prices, as their economy is volume-, not profit-driven. Nonetheless, Trump promised tariffs of as much as 60% on China. What Trump might do is to increase these tariffs gradually, and there is a risk that at one point, similar to 1929, the reaction function might distort.

Influenza vs. Covid-19 waves

Influenza	Covid-19
1st wave: Early 1918	1st wave: Early 2020
2nd wave: Late 1918	2nd wave: Late 2020 (Alpha)
3rd wave: Early to mid-1919	3rd wave: Early & mid 2020 (Delta)
4th wave: Spring 1920	4th wave: Winter 2021/22 (Omicron)

Source: The Forgotten Depression by James Grant

[6] https://www.britannica.com/topic/Smoot-Hawley-Tariff-Act

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1918-20 vs. 2020-24: Economic timeline

1918-1920 and beyond	2020-2024
1918: Lockdowns were introduced to curb the virus	2020/21: Lockdowns were introduced to curb the virus
1919: 1 in 5 American was striking to achieve higher wages	2021: Record number of people left their jobs, resulting in labour shortages
1919/early 1920: Inflationary boom with commodity prices reaching all-time highs	2021: Inflationary boom with commodity prices reaching all-time highs
November 1919: Stock market peak, just as the Federal Reserve hiked rates from 4% to 4.75% to fight inflation and speculators, stocks slumped 12.8%	November 2021: Fed expected to announce tapering. Central banks around the world turn hawkish
January 1920: Fed raises rates to 6%, stock market didn't react	January 2022: Fed speeds up tapering and market starts pricing in 50bps rate hikes for March 22
April 1920: A Tokyo bank defaulted, prices of rice, cotton and silk dropped quickly, GM shares dropped 8%	March 2023: It took one year longer for first financial cracks to appear with SVB default
1920: Consumers changed to non-inflationary living, buying used clothes	2023: Non-branded products gained in popularity (e.g. McBride)
Spring 1920: Consumers stopped buying cars, strong demand disappeared. GM sold 52,000 vehicles a month in early summer, 13,000 in November and only 6,150 in January 1921	2024: Vehicle sales continue climbing, but the rate of growth begins to stall
April 1920: Weather was cold, wet and caused wheat and other agricultural goods to spike in price, farmers started borrowing more, but then were facing huge losses in 1921	Since the spike in 2022, wheat continues to decline
April 1920: Steel Corporation had luxury of 10.4mio tons of unfilled orders. This backlog dwindled to 5.8mio tons from April 1920 to March 1921	2024: Order books are being run down
June 1920: Fed raises rates to 7%	August 2023: Fed hikes rates to 5.33%
April 1922: Accumulated inventories were sold off for extremely low prices	Inventories have gradually been sold off

Source: The Forgotten Depression by James Grant

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1920s vs. Now: Superpower status

Parameter	1920s	Now
Superpower has high debt/GDP	The UK had government debt/GDP of 150-190%, while the US had government debt/GDP of 30%	The US has government debt/GDP of over 130%, while China has 77% debt/GDP
New Superpower leads new technology	The US produced 26.5x as many cars as the UK in 1924	China produced over 6mio EVs in 2022, 8x more than the US
Globalisation	The world slowly moved from globalisation towards de-globalisation	It appears like we have reached peak globalisation
Technology	Energy transition from the horse and firewood towards the combustion engine and coal	Energy transition from ICE vehicle and oil and gas to BEV and renewables
Inequality	Top 1% owned 12-19% of total share of income	Top 1% owns 30% of all household wealth
High speculation	Businesses and private individuals were borrowing excessively and bought stocks	High speculation, cryptocurrencies were worth over $3trn
Low interest rates	Interest rates stayed between 4-5% before declining during the Great Depression	Interest rates moved to 4-5% after a long period of near 0%
Pandemic	The Spanish Flu had 4 major waves	Covid also had 4 major waves (Beta, Alpha, Delta, Omicron)
Conflict	WWI followed by WWII	Ukraine war and potential conflicts in Israel/Middle East and Taiwan/China
Trade restrictions	The British insisted on free trade despite the US (& Germany) turning to high tariffs	China has high tariffs in place for many products, while the US insists on free trade

The US led the transition from the horse to ICE in the 1920s (motor vehicle production in 000s)

Country	1924	1928
USA	3,666	4,359
Canada	135	242
France	145	210
UK	138	212
Germany	18	90
Italy	35	55
Czechoslovakia	2	13
Russia	0	1

Source: XIII. The Roaring Twenties. Slouching Towards Utopia? The Economic History of the Twentieth Century by J. Bradford

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1920s vs. 1970s vs. now: Historic similarities and differences

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, now balanced
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 5.45% vs. 6.07%
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
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%
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, then 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 zero to 5.25%
Inventories	Low inventories	JIT inventory approach was just taken on	Record lows, no 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 declining
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
Yield curve	No data	73/74 & 79/80 yield curve inverted for nearly 2 years, rates kept rising overall	Inverted for 2 years, now coming out of inversion

Source: XIII. The Roaring Twenties. Slouching Towards Utopia? The Economic History of the Twentieth Century by J. Bradford, The Forgotten Depression by James Grant

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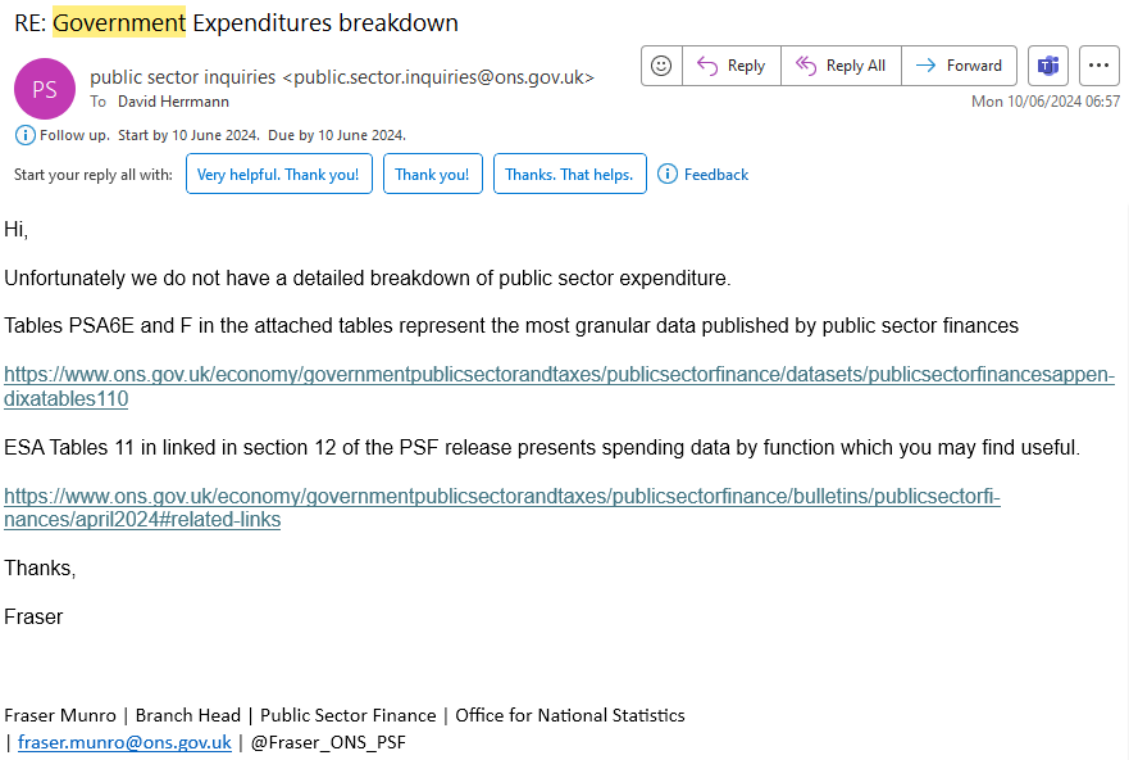
The UK government debt crisis

Since the early 2000s, the UK government began to have a constant budget deficit. The gap between receipts and expenditures then began to widen, and since the Covid crisis, this gap has remained stable, but wider than before. The UK government does not publish the exact details of its expenditures. However, what can be observed is that transfers to local governments declined as a % of overall expenditures from 20-22% between 1998 and 2012 to just 14% over the last few years. At the same time, net social benefits remained at around 30%. With the lack of details in the data it is very hard to pinpoint where the government spends too much money on. My guess based on the data below is that the UK is simply receiving too little tax income and has too high expenditures, which is driven by social benefits, such as social assistance and pension payments. The population is aging and the people coming to the UK are recently more often low-income earners. This is a structural problem, which requires reduced expenditures, because tax income as % of GDP is already at historic highs of 40%. The latest Budget requires lower interest rates. Unless this is achieved, government expenditures must come down.

The UK government does not publish details on its expenditures



RE: Government Expenditures breakdown

PS public sector inquiries <public.sector.inquiries@ons.gov.uk>
To David Herrmann

Reply | Reply All | Forward

Mon 10/06/2024 06:57

Follow up. Start by 10 June 2024. Due by 10 June 2024.

Start your reply all with: Very helpful. Thank you! | Thank you! | Thanks. That helps. | Feedback

Hi,

Unfortunately we do not have a detailed breakdown of public sector expenditure.

Tables PSA6E and F in the attached tables represent the most granular data published by public sector finances

https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/datasets/publicsectorfinancesappendixatables110

ESA Tables 11 in linked in section 12 of the PSF release presents spending data by function which you may find useful.

https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/april2024#related-links

Thanks,

Fraser

Fraser Munro | Branch Head | Public Sector Finance | Office for National Statistics
| fraser.munro@ons.gov.uk | @Fraser_ONS_PSF

Source: Email

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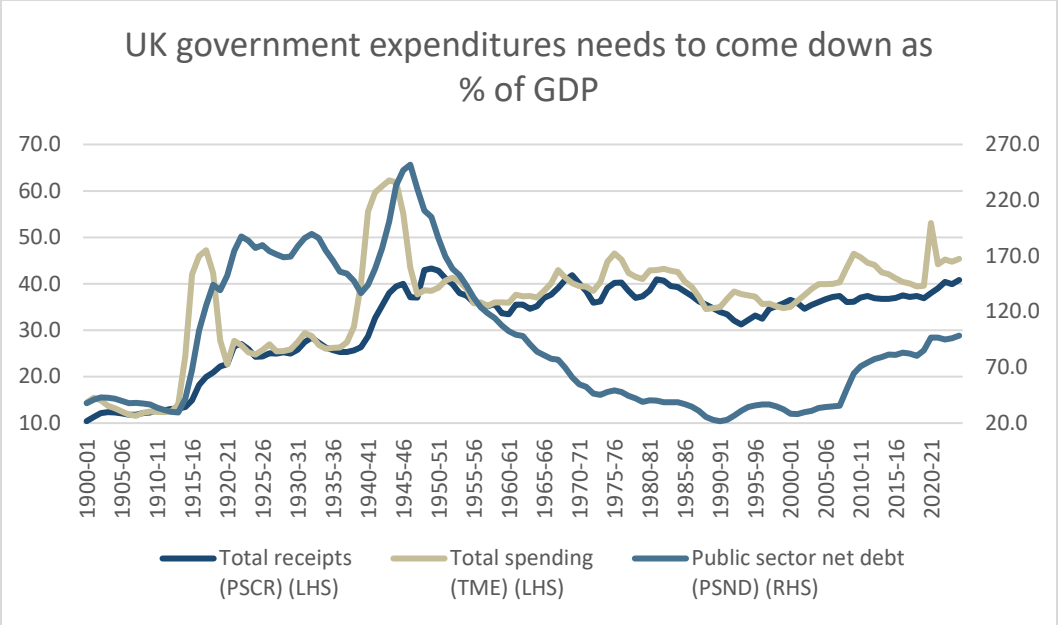
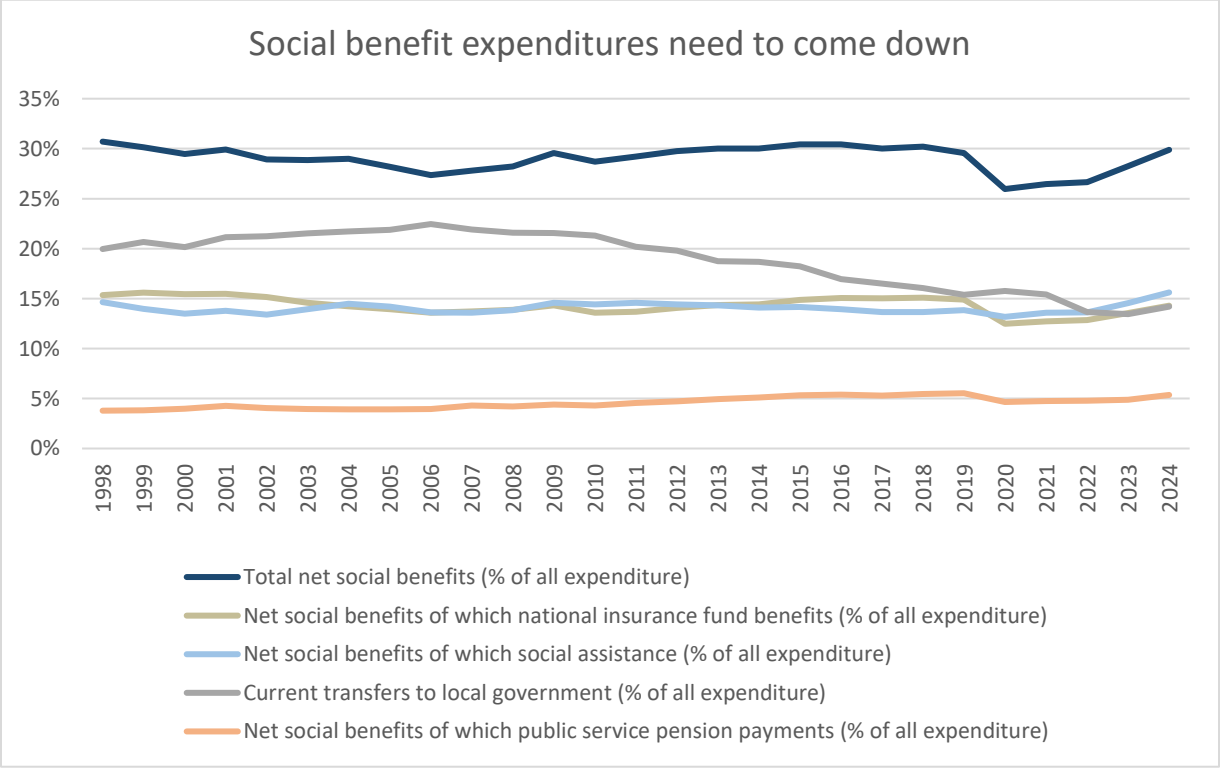


Source: OBR (https://obr.uk/data/)



Source: tab PSA6E_2

(https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/datasets/publicsectorfinancesappendixatables110)

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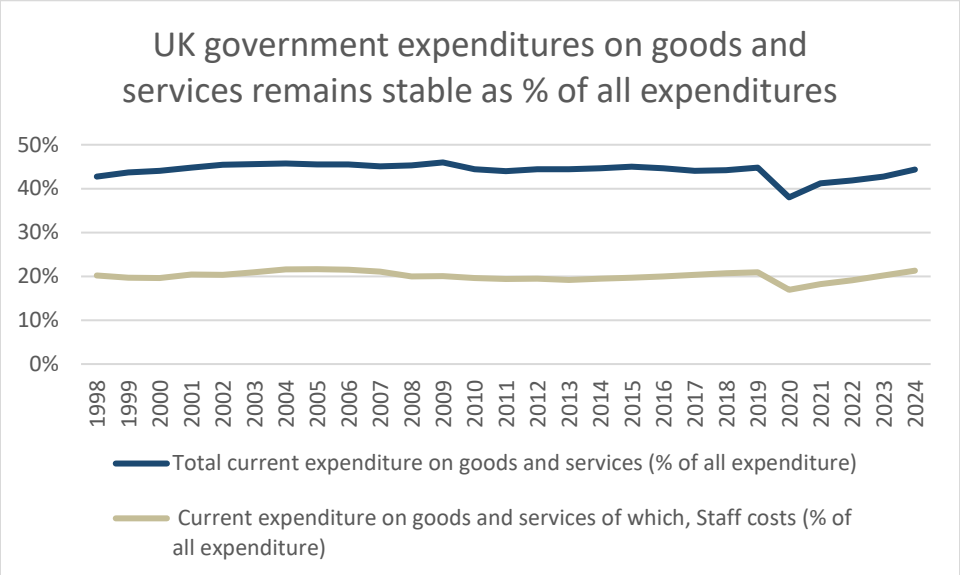
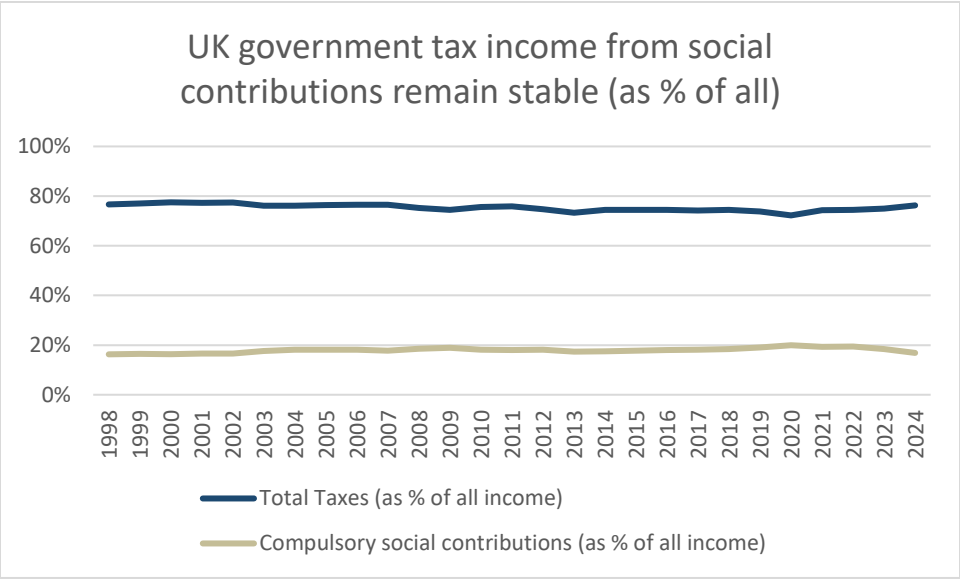


Source: tab PSA6E_1

(https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/datasets/publicsectorfinancesappendixatables110)



Source: tab PSA6D_4

(https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/datasets/publicsectorfinancesappendixatables110)

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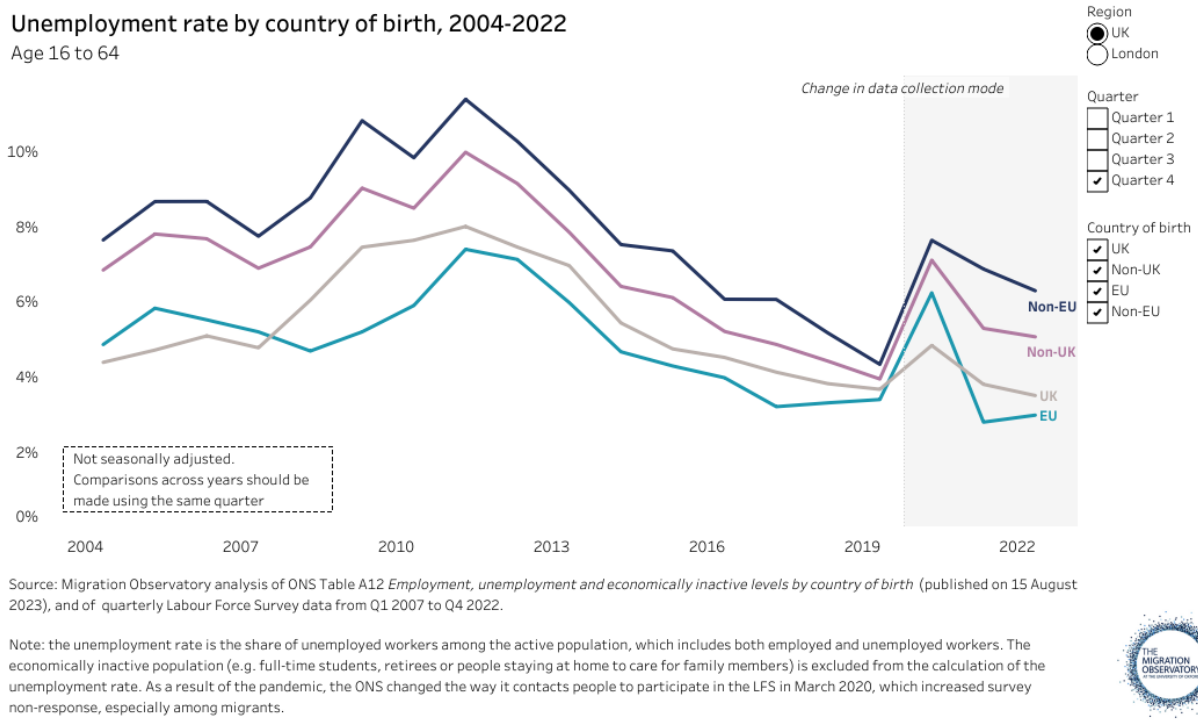
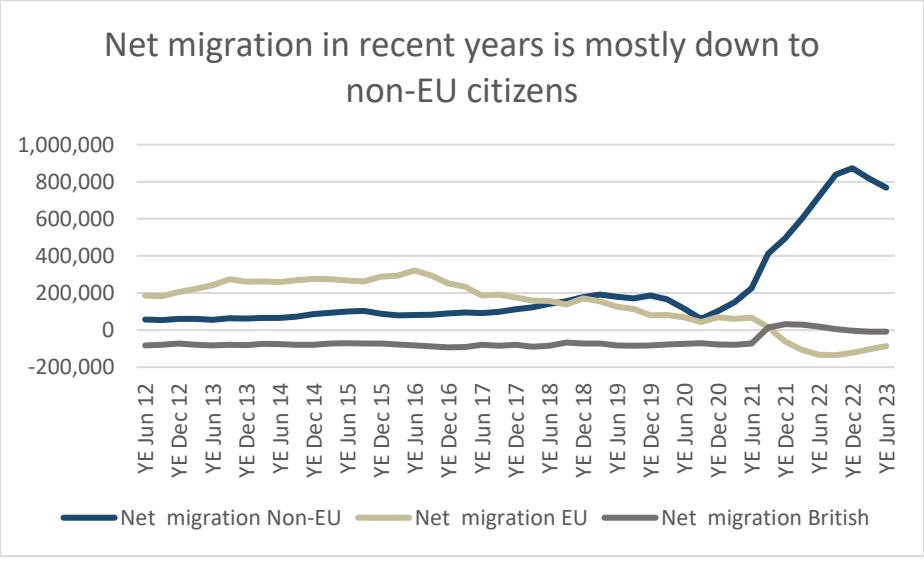


Source: Migration Observatory analysis of ONS Table A12 *Employment, unemployment and economically inactive levels by country of birth* (published on 15 August 2023), and of quarterly Labour Force Survey data from Q1 2007 to Q4 2022.

Note: the unemployment rate is the share of unemployed workers among the active population, which includes both employed and unemployed workers. The economically inactive population (e.g. full-time students, retirees or people staying at home to care for family members) is excluded from the calculation of the unemployment rate. As a result of the pandemic, the ONS changed the way it contacts people to participate in the LFS in March 2020, which increased survey non-response, especially among migrants.

Source: Migration Observatory (https://migrationobservatory.ox.ac.uk/resources/briefings/migrants-in-the-uk-labour-market-an-overview/)



Source: UK Home Office

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