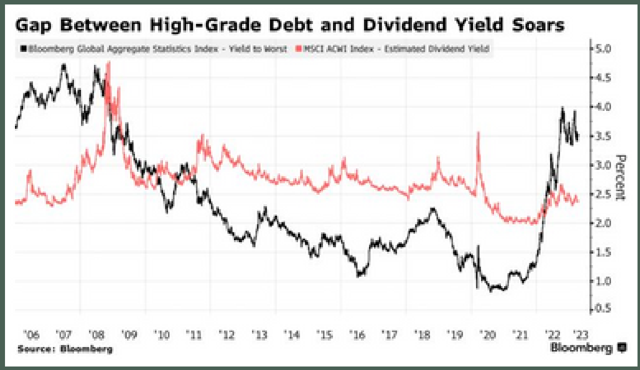
IvyLine Capital Group

Monday Market Update

LAST WEEK

May 08 - May 19, 2023

The Probability Of Recession Is Increasing



Despite inflation experiencing a downward trend and currently standing below the federal funds rate following the recent rate hike by the Federal Reserve, the looming threat of a recession has positioned debt securities as a safer investment option. In contrast, the stock market has yet to fully incorporate these risks into its pricing. Prominent fund managers from JP Morgan and Morgan Stanley have indicated that fixed-income instruments are expected to outperform equities in the event of an economic slowdown and if the Federal Reserve encounters challenges in achieving a smooth economic landing.

Several market indicators suggest a higher likelihood of a recession. Notably, the yield of high-grade dollar bonds has surpassed the dividend yields of the ACWI Index. This substantial gap, currently standing at approximately 90 basis points, is the widest it has been since the global financial crisis. This attractiveness of bonds lies in their ability to offer investors additional yield and potential capital gains in the event of a decline in interest rates. Meanwhile, equity valuations remain above their 12-month average, rendering them relatively expensive. Moreover, the decline in the regional banking sector has driven investors towards safer alternatives, such as bonds.

It is important to note, however, that bonds are not entirely devoid of risk. In an environment characterized by high interest rates, the likelihood of a recession increases, potentially leading to an uptick in corporate defaults. Nonetheless, if we consider the scenario of a recession, bonds are generally preferred over equities.

Another notable trend in the current market pertains to the investment choices made by money managers. Professional stock pickers are progressively shifting their allocations away from economically sensitive shares, particularly those related to banks, and redirecting capital towards stocks perceived as resilient during economic downturns. This shift is evident in the reduced exposure to cyclical holdings by hedge funds making both bullish and bearish wagers, marking the lowest levels since 2012 according to Bank of America. Similarly, long-only managers have also decreased their exposure to cyclical companies, nearing levels last seen in 2008.

Another trend involves the disparity between stock pickers and computer-driven strategies that utilize chart signals for asset allocation. Despite the heightened probability of a recession, systemic money managers, including trend followers and volatility-target funds, have chosen to increase their equity holdings in recent months. Quantitative funds, as highlighted by Deutsche Bank, have shown a notable inclination towards stocks, while discretionary investors have experienced a decline in their equity allocations, reaching the lower end of their one-year range.

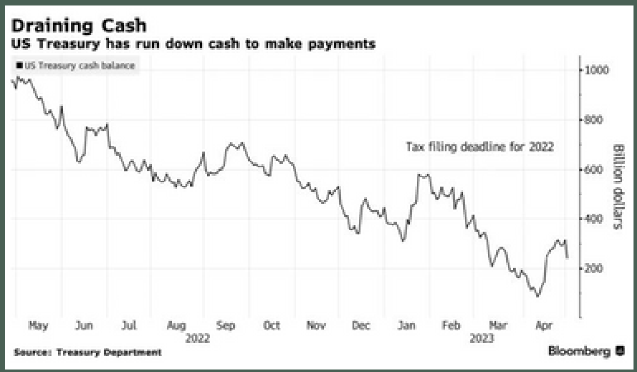
US Debt Ceiling (Continued)

The US Treasury has said it has just $88 billion left of authorized measures to prevent the government from running out of borrowing capacity. This is down from around $110 billion the previous week, leaving just over a quarter of the $333 billion authorized measures still available to prevent the government from exhausting its borrowing room under the debt limit. Treasury Secretary, Janet Yellen, has warned that her department could run out of cash as soon as June 1st and Treasury markets have already priced in a default premium for securities maturing around that date. The cost of insuring US debt against non-payment has also increased.

The US government needs to raise or suspend the debt ceiling before June 1st or face a potential default. If the deadline is indeed the first week of June, the practical deadline may be as early as May 26th, given that legislators will need time to review the bill before voting and Congress is scheduled to be out of session the week after Memorial Day.

Investors are monitoring the yield curve for bills and any dislocations that show up. Notable upward distortions in particular parts of the curve suggest increased concern among investors that that's the time when the US government might be at risk of default. Investors are also watching X-date predictions. While the administration has provided guidance that the government might fall short as soon as June, prognosticators across Wall Street have been running the numbers based on government cash flows and expectations around taxes and spending.

One other key area to watch for insight on debt-ceiling risks is credit-default swaps for the US government. Those instruments act as insurance for investors in cases of non-payment.



The cost to insure US debt is now higher than the bonds of Greece, Mexico, and Brazil. The US government's ability to pay its debts ultimately comes down to whether it has enough cash, so the amount sitting in its checking account is crucial. The figure fluctuates daily depending on spending, tax receipts, debt repayments, and the proceeds of new borrowing. If it gets too close to zero, it could be a problem.

Ultimately, any solution to prevent the US from defaulting will need to come from Washington. However, there are only a few days this month when both chambers of Congress are available, and President Biden is scheduled to be in the US capital, meaning there isn't a lot of time to waste before the X-date.

Last Week Summary

Recent economic indicators have provided valuable insights into the current state of the economy. The Consumer Price Index (CPI) and Core CPI for April met expectations precisely, both recording a growth rate of 0.4%. However, Crude Oil Inventories surprised on the downside, showing a much higher inventory of 2.951 million barrels compared to the expected decrease of 1.100 million barrels, indicating lower demand in the market. Additionally, the recently released WASDE report on commodities contains further details worth exploring. The Export and Import Price Indices aligned with expectations, reflecting stability in international trade prices. On the other hand, April's Producer Price Index (PPI) came in slightly below the forecasted figures.

Turning to the Treasury market, the yield curve continued to exhibit an inverted pattern. The week began with higher rates for long-term bonds, while the prices of the remaining Treasuries showed minimal change compared to the previous week. However, this trend shifted as the week progressed. Most of the treasuries experienced declines in rates, with the exception of the 1-month note, which witnessed a significant increase of 30 basis points during the week. This spike in rates can be attributed to the impact of the debt ceiling on the market.

Please refer to the table below for further economic data.

Indicator	Core CPI (MoM) (Apr)	CPI (MoM) (Apr)	Crude Oil Inventories	Initial Jobless Claims	PPI (MoM) (Apr)	WASDE Report	Export Price Index (MoM) (Apr)	Import Price Index (MoM) (Apr)
Actual	0.4%	0.4%	2.951M	264K	0.2%	- - -	0.2%	0.4%
Forecast	0.4%	0.4%	-1.100M	245K	0.3%	- - -	0.3%	0.3%

THIS WEEK

This week, the financial markets are eagerly awaiting the publication of several key reports that will provide valuable insights for investors. The early part of the week will bring the release of important data such as Retail Sales and Core Retail Sales figures for April. Projections indicate a slight decrease compared to the corresponding period last year. Wednesday will see the release of the Crude Oil Inventories report, with expectations pointing to a significant increase compared to the previous year. Furthermore, reports on April's Building Permits and Housing Starts will offer investors valuable insights into the real estate market.

As we progress through the latter part of the week, attention will turn to the weekly Initial Jobless Claims report, which is anticipated to show higher numbers compared to the trailing twelve months. Simultaneously, the Existing Home Sales Report will be published, providing additional information on the state of the housing market. Lastly, market participants will keenly listen to a speech by Federal Reserve Chair Jerome Powell, who will address monetary policy and the overall economy.

Please refer to the table on the right for a comprehensive list of the scheduled reports.

Source: Investing.com

Economic Calendar

Date	Economic Indicator	Expectation vs TTM
05 - 16	Core Retail Sales (MoM) (Apr)	0.4% vs 0.6%
05 - 16	Retail Sales (MoM) (Apr)	0.7% vs 0.9%
05 - 17	Building Permits (Apr)	1.430M vs 1.819M
05 - 17	Housing Starts (Apr)	1.400M vs 1.724M
05 -17	Crude Oil Inventories	-0.917M vs -3.394M
05 - 18	Initial Jobless Claims	254K vs 218K
05 - 18	Existing Home Sales (Apr)	4.30M vs 5.61M
05 - 19	Fed Chair Powell Speaks	- - -

Technicals & Terms

1. The MSCI All Country World Index (ACWI): a stock index designed to provide a broad measure of global equity market performance.
2. A quant fund is an investment fund whose securities are chosen based on numerical data compiled through quantitative analysis. These funds are considered non-traditional and passive.1 They are built with customized models using software programs to determine investments.
3. The term "X-date" refers to the date at which the United States government is projected to exhaust its borrowing capacity and reach the debt ceiling

Central Banks Rates

FED	ECB	BOE	BOJ	PBOC
5.25%	3.75%	4.50%	-0.10%	3.65%

S&P 500 @4,124.08 **7.41% YTD**

DJI @33,300.62 **0.46% YTD**

US2Y @ **3.98%**

As of May 12, 2023

Our Fund

The fund invests in macro related ETFs, individual equities, and certain hedged options strategies. Our single strategy utilizes distribution and variance metrics for the placement of options. The main factor that determines these decisions centers around Implied Volatility.

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Disclosure: The following results statement presents the performance of IvyLine Dynamic Growth LP account managed by the managing member of the General Partner and Advisor. The fund results are unaudited and is only to display an approximation of the performance for the timeframe above. The results were calculated by Perennial Fund Services, LLC. Results are net of fees calculations. Any questions should be directed to the manager of the fund. Past performance does not indicate future results.

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