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EQUITIESFIRST® Progressive Capital

NAVIGATING HIGHER-FOR-LONGER AND A LIQUIDITY DROUGHT

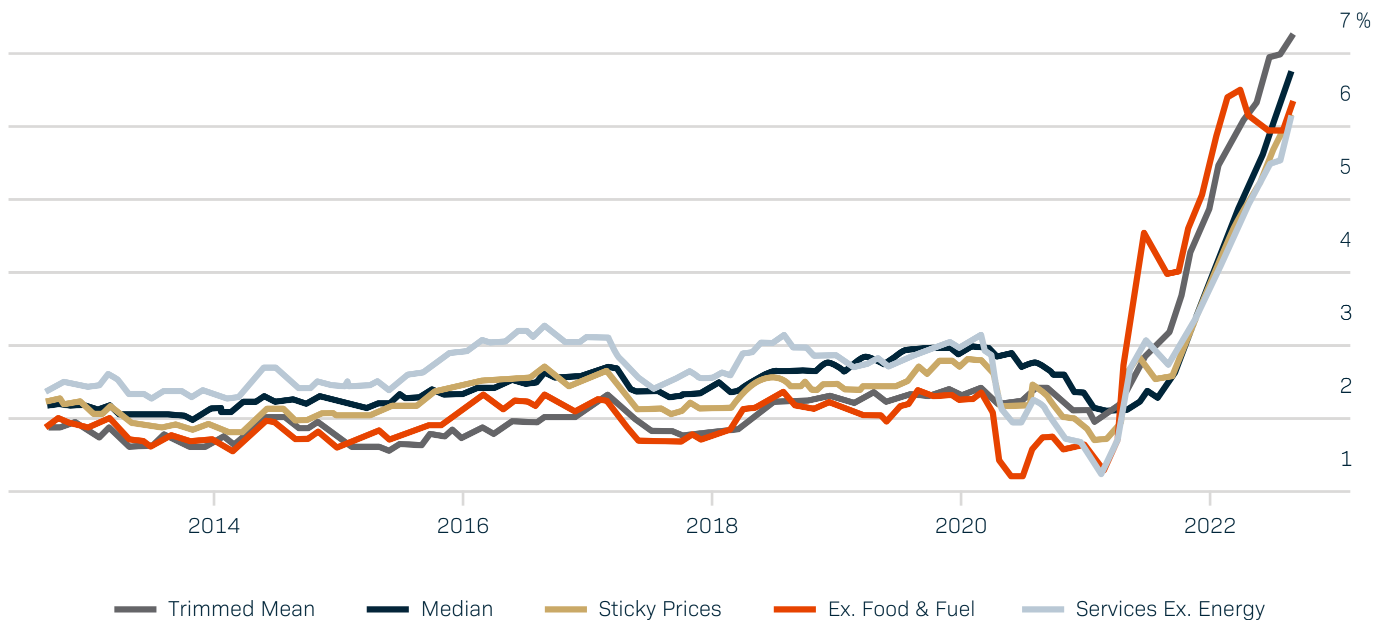
SUMMARY

Hopes that inflation would be short-lived have evaporated following the release of the latest US inflation data. This, in turn, has led the equity markets to accept that interest rates will likely remain elevated well into 2024, adding to already bearish sentiment. Selling equity positions in the current climate, however, may prove especially costly in light of an ongoing liquidity drought.

Poor market liquidity, coupled with little hope of improvement next year, is pushing investors to consider innovative solutions to raise capital to diversify their portfolios or pursue other opportunities, while maintaining the upside potential of their core holdings. Securities-based financing provides an ideal tool to do just that.

HOPES FOR TRANSITORY INFLATION HAVE VANISHED

US headline inflation came in higher than expected in August, up 8.3% year-on-year. Though the consumer price index (CPI) in August was up just 0.1% from July, analysts had expected a lower headline number, particularly since gasoline prices were down 10.6%. That puts paid to the previously widespread belief that inflation will be brought under control once energy prices start to decline. With a range of underlying inflation measures reaching fresh multi-decade highs in August, hopes that high inflation would prove transitory have been quashed.



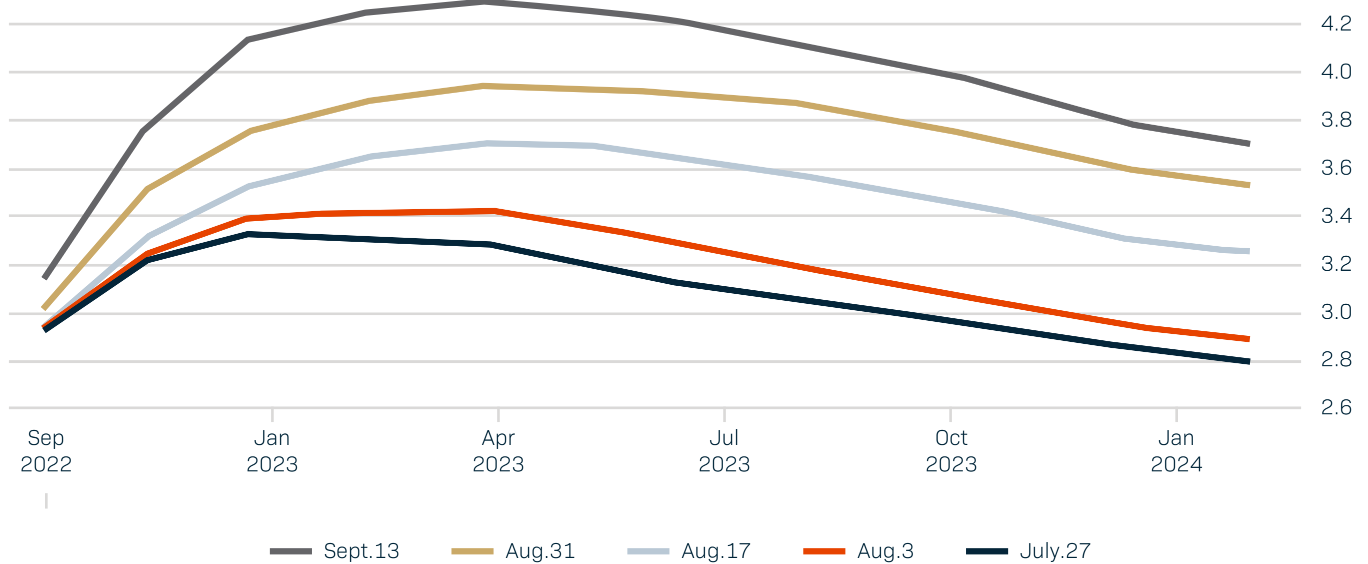
Source: Bloomberg, Bureau of Labor Statistics, Atlanta Fed, Cleveland Fed

EXPECTATIONS FOR SWIFT RATE CUTS HAVE EVAPORATED

It now appears inflation could be much more long-lived than many were expecting even a month ago. That, in turn, has raised expectations that central banks around the world, including the US Federal Reserve (Fed), will need to not only continue raising interest rates but also maintain higher rates for a longer period. After approving its third consecutive interest-rate rise of 0.75 percentage points on September 21st, the Fed signaled additional large increases were likely at upcoming meetings to tame inflation.[1]

As recently as the beginning of August, there was a general consensus that rates would peak at the end of 2022 and begin declining at the beginning of 2023, as reflected in Bloomberg's World Interest Rate Probabilities calculation. In light of recent inflation data, however, the latest expectation is for rates to continue rising to considerably higher levels and remain elevated throughout next year.

EXPECTATIONS FOR SIGNIFICANT RATE CUTS FROM EARLY NEXT YEAR HAVE EVAPORATED



HIGH INTEREST RATES RAISE THE PROBABILITY OF RECESSION

High interest rates work to curb inflation by cooling economic activity. Essentially, higher rates make money more expensive, reducing the ability and inclination of people and companies to borrow, invest and consume. The longer rates remain high, the more economic activity will slow, and the greater the odds of a recession.

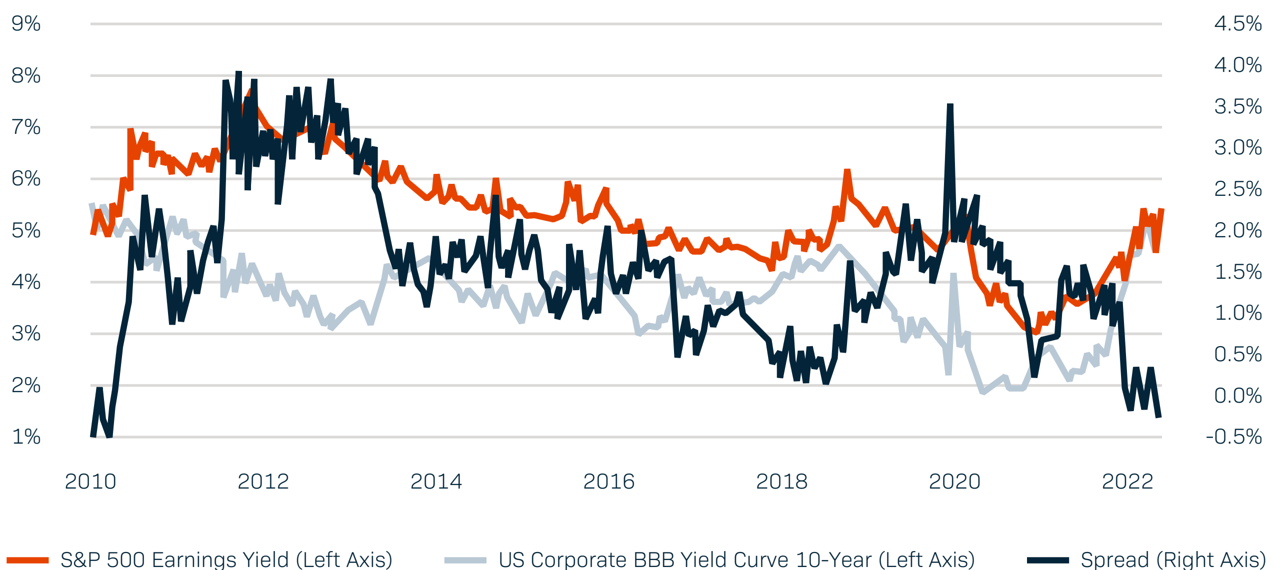
Bank of America Corp.'s monthly survey of global fund managers showed that expectations of a recession, which have been trending up since the middle of this year, rose even further in September.

Whereas Covid-19 had led to a spike in recession expectations in April 2020, a resurgence of the pandemic is now seen as a risk by just 1% of survey respondents. By far the biggest worry now is that persistent inflation will lead central banks to raise rates and keep them higher for longer, which is expected to result in significant declines in corporate profits.

Source:[1]https://www.cnbc.com/2022/09/20/stock-market-futures-open-to-close-newshtml.html , Bloomberg World Interest Rate Probabilities

BOND YIELD OVERTAKES EARNINGS YIELD

Even ahead of those lower profit figures being released, rising interest rates have resulted in the rate from a lower tier of 10-year investment-grade bonds surpassing the S&P 500's earnings yield for the first time in over a decade. This makes stocks even less attractive compared to corporate debt. The last time the spread between these yields was negative, in 2010, the S&P 500 went flat the following year, halting a two-year rally.[2]

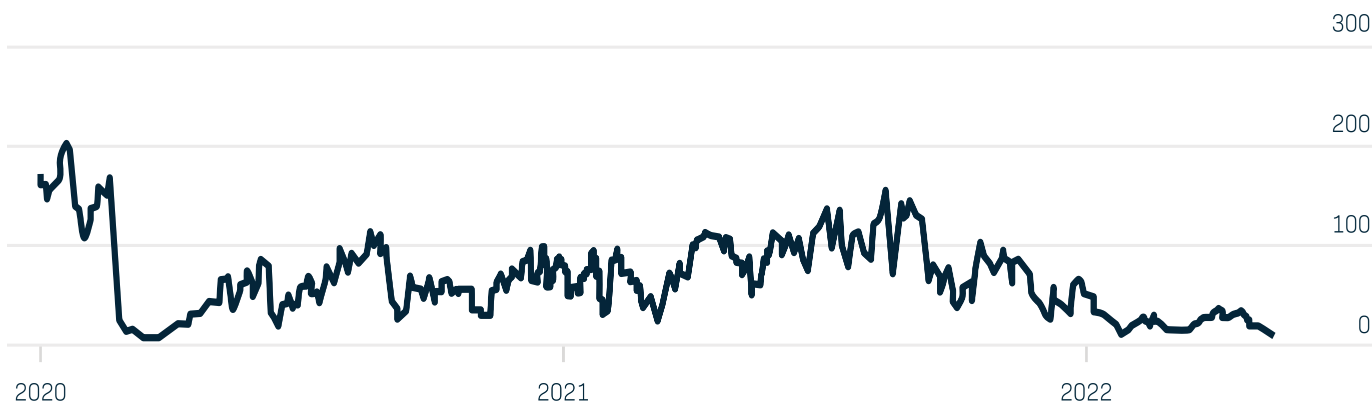


Source: Bofa Global Fund Manager Survey , Bloomberg

STAYING INVESTED DURING A LIQUIDITY DROUGHT

Although the outlook for equities has turned decidedly bearish, in past bear markets the best strategy for investors has generally been to take the long view and maintain their positions rather than sell and return to the market at some point in the future.[3] This is especially the case because markets have been plagued by a liquidity drought this year, making it expensive for investors to exit positions. Liquidity as gauged by bid/ask spreads on S&P 500 futures contracts in mid-2022 was as bad as during the first quarter of 2020, when markets were battered by the initial uncertainty surrounding Covid-19.

AVG. NUMBER OF S&P 500 CONTRACTS WITH THE TIGHTEST BID/ASK PRICES



HOW THE EFH SOLUTION HELPS

Ongoing weak sentiment has made it especially challenging for investors to access the liquidity they need to remain invested, go bargain hunting, diversify portfolios or for other purposes.

EquitiesFirst provides a compelling solution for investors to navigate the higher-for-longer interest-rate landscape in the form of securities-based lending, which allows investors to use their shares to access low-cost funding. EFH's solution enables borrowers to:

1. Access liquidity while maintaining upside potential of underlying positions

2. Use capital for any purpose, with no restrictions

3. Diversify risk and secure dry powder for bargain hunting

Accessing liquidity through a sale and repurchase agreement with EFH provides the following benefits:

- **Industry-leading loan-to-value (LTV) ratio**: With USD100 worth of collateral, the shareholder can borrow USD65-70

- **Non-recourse feature**: This limits the downside risk of the shareholder. In the worst-case scenarios, the shareholder has the option to walk away from the loan with no further liabilities (while keeping the loan proceeds)

- **Margin Call Advantage**: Our margin call threshold is calculated as 80% of the loan LTV. If the LTV is 65%, the margin call threshold would be 80% x 65% = 52%. This means the share price needs to drop from 100 to below 52 (for 3 consecutive days) before there would be a margin call

Source: [3]https://www.morganstanley.com/articles/top-5-investor-mistakes , JPMorgan Chase & Co.

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