Market review June 2023

In May, the reading of the economic cycle did not bring any clarity to the horizon. The debate continues between those who are banking on a recession and others who believe that the global economy should get through this slowdown without contracting. The Chinese economy, on which many hopes rest in order to avoid a global recession, does not seem to be delivering the expected recovery following its gradual reopening. The positive effects of this have been slow to make themselves felt, and many investors are becoming impatient. On the equity markets, the mood is one of grimace. For its 4th consecutive month of decline, the CSI300 index fell by almost 6% in May. Despite rising sharply in January, the index has posted a negative performance since the start of the year. Incidentally, Michael Burry, the famous hedge fund manager who inspired the director of the no less famous film 'The Big Short', recently increased his exposure to Chinese equities, including Alibaba. China's slower-than-expected economic recovery is also taking its toll on commodities, which have fallen sharply since the start of the year. While gold has benefited from its safe-haven status in recent months and is still posting a positive performance since the end of 2022, most industrial commodities that are dependent on the economic cycle, such as copper, silver and oil, have posted negative performances since the start of the year. The Bloomberg Commodity Index, which includes the main commodities, has just closed its 6th consecutive month of decline and is now close to its November 2021 levels. Although the consolidation could last until investors have a clearer view of the economic cycle, we remain convinced that demand for commodities will increase over the next few years and that supply will struggle to keep pace with demand for some of them, such as lithium and copper.

Still on the macro front, Germany reported its second consecutive quarter of negative GDP growth, synonymous with a technical recession. This did not prevent the Dax30, Germany's flagship stock index, from hitting an all-time high during the month. On the other hand, corporate results for the first quarter were on the whole better than expected and the word 'recession' was much less pronounced by chief financial officers (CFOs) than in previous quarters. In short, reading the economic cycle remains complicated.

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Market trends to end May 2023

	Equities in Local Currencies							
End of May	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	-1.25%	0.25%	-3.24%	-5.24%	-2.06%	-1.92%	-1.90%	-5.72%
Perf 3 Month	3.17%	5.28%	-0.48%	-2.33%	-3.67%	1.08%	-0.57%	-6.66%
Perf YTD	7.60%	8.86%	11.19%	9.65%	9.98%	4.55%	0.22%	-1.89%

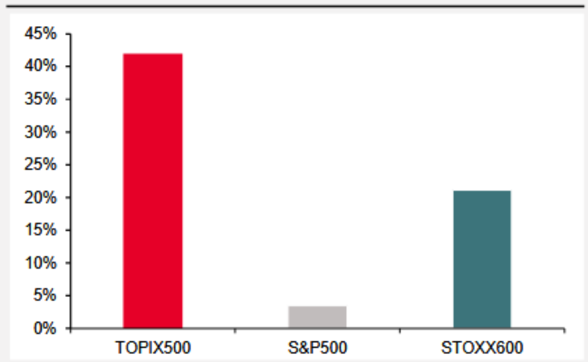
	Commodities				Currencies vs EUR			
End of May	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	-11.32%	-8.65%	-1.37%	-5.89%	3.09%	0.75%	2.06%	1.23%
Perf 3 Month	-11.63%	-13.39%	7.43%	-9.73%	-1.07%	-3.33%	2.37%	2.38%
Perf YTD	-15.16%	-15.42%	7.60%	-3.38%	0.15%	-5.73%	3.05%	1.66%

	Bloomberg Indices Bonds Total returns							
End of May	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	-1.95%	-1.09%	0.36%	-1.45%	0.03%	-1.86%	-1.15%	-0.75%
Perf 3 Month	1.59%	2.04%	2.50%	3.06%	3.94%	2.10%	0.40%	0.88%
Perf YTD	1.44%	2.46%	2.59%	2.88%	3.33%	2.60%	2.61%	1.78%

Source: Bloomberg 31/05/23.

The difficult discussions surrounding the US debt ceiling did not make investors' task any easier. Against this backdrop, equity markets tended to stall in May. With a few exceptions, most indices lost between 1% and 5%. The Nikkei, the Japanese stock index, was one of the exceptions. With a performance of more than 7% in local currency, the index, which is up by more than 18% since the start of the year, has passed its highest level for 33 years. This market, which has long been ignored by Western investors, seems to be back in the spotlight. After an extraordinary performance in the 1980s, Japanese equities were neglected for several decades, despite a few false starts. Anemic growth, declining demographics and excess debt in the private sector that the government had to absorb were the main causes of this long period in the wilderness. Today, Japanese equities are poorly valued. Most of them offer a relatively high dividend yield, stable and sustainable cash flow generation, and share buyback programmes are on the increase. In a world where liquidity is drying up and central banks are fighting inflation that is hovering above their targets, the Bank of Japan (BoJ) is maintaining an ultra-accommodative monetary policy, which is pushing the yen down and thus boosting exports.

Chart 27 – Percentage of listed stocks with a price-to-book below 1x



Source: SG Cross Asset Research/Global asset allocation, Bloomberg

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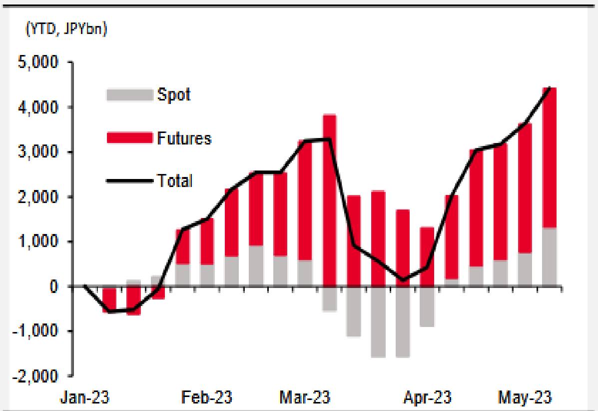
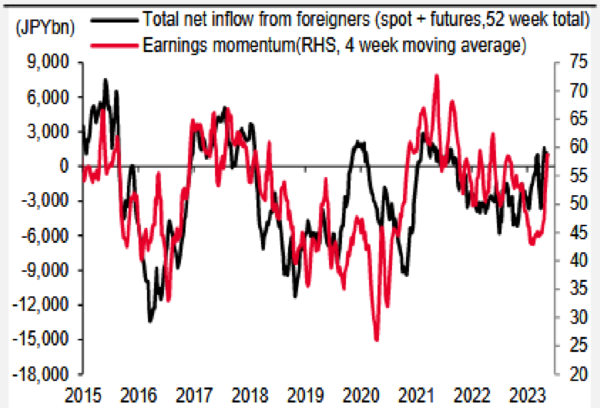
What's more, the country could be a serious alternative to China, which is subject to various sanctions from the West over the manufacture of semi-conductors. Several companies, such as Micron, have already announced plans for major investments in the land of the rising sun. And as if that wasn't enough, Warren Buffet recently travelled to Japan and told anyone who would listen how much he admired the region. This cocktail of good news has enabled the index to break through major thresholds. It is not impossible that, in the coming months, this market will be reconsidered in the asset allocations of Western portfolio managers. Beware, however, of the currency, which has tended to fall recently and could penalise the performance of investors who do not think in Yen.

Chart 17 – Net cumulative Japanese stock purchases by foreign investors



Source: SG Cross Asset Research/Global asset allocation, JPX

Chart 18 – Improved earnings momentum supports the inflow



Note: Earnings momentum indicates the numbers of stocks with earnings forecasts updated upwards divided by the total number of stocks earnings forecast revised.
Source: SG Cross Asset Research/Global asset allocation, Bloomberg, QUICK

The Nasdaq was the other equity index to perform brilliantly once again. It gained 8.4% in Mai, representing an increase of more than 30% since the start of the year. The index, which includes technology stocks, has recovered almost 2/3 of the decline it suffered between January and September 2022. Those who were predicting the death of the technology sector are now biting their fingers. However, this impressive performance should be treated with caution. Not all companies are benefiting in the same way. For this index of 100 companies, of the 1,008 points gained in May, 743 points were generated by 5 stocks, including 300 points by graphics card manufacturer Nvidia, which has the luxury of joining the very exclusive club of companies with a market capitalisation of over $1,000 billion. The sharp rise in this index is therefore mainly due to a buying frenzy on all stocks that have anything to do with artificial intelligence (AI). Admittedly, Nvidia has published solid results and an impressive outlook for the years ahead, but the movement on all the stocks in this theme is reminiscent of the FOMO (Fear Of Missing Out) phenomenon, which we saw, for example, in the hydrogen segment in 2020 or in metaverse companies in 2021. We are not saying that all these companies will give back their performances, but some of them will take a long time to generate revenues (and even longer to generate profits) from this activity. Nvidia, which we own in certain thematic products, is (and will be) clearly among the leaders in AI, as are Microsoft and Google (Alphabet), but the short-term frenzy seems hard to sustain. All the more so as many voices are being raised about the risks that AI represents for humanity. This could slow the growth of this segment, which nevertheless remains a secular theme to be implemented.

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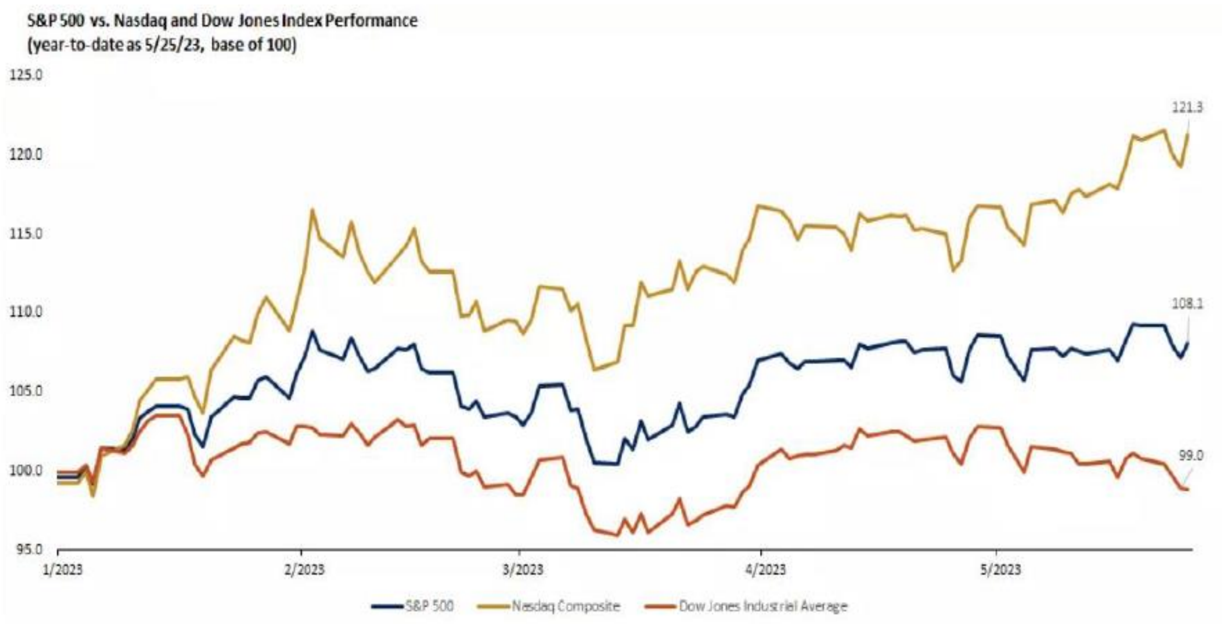
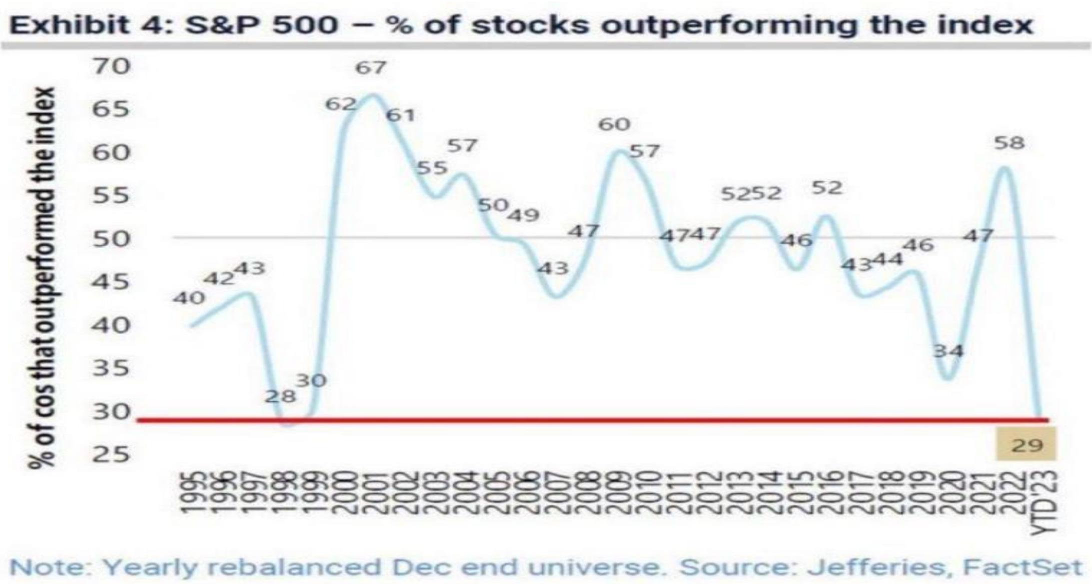


Source : Edward Jones

The fact that a handful of companies are driving the US indices higher is well known, and we have already mentioned it in the past. If we remove the contribution of a few large technology companies to the S&P500's performance, the latter would post a negative performance since the start of the year. This is usually seen as a negative indicator. For an uptrend to be solid and sustainable, the majority of stocks would have to contribute to the rise, which is not currently the case. The most optimistic would say that, at the start of an uptrend, the most important companies benefit first from this recovery and are likely to 'lead the way' for the rest of the market. So... is this time any different?



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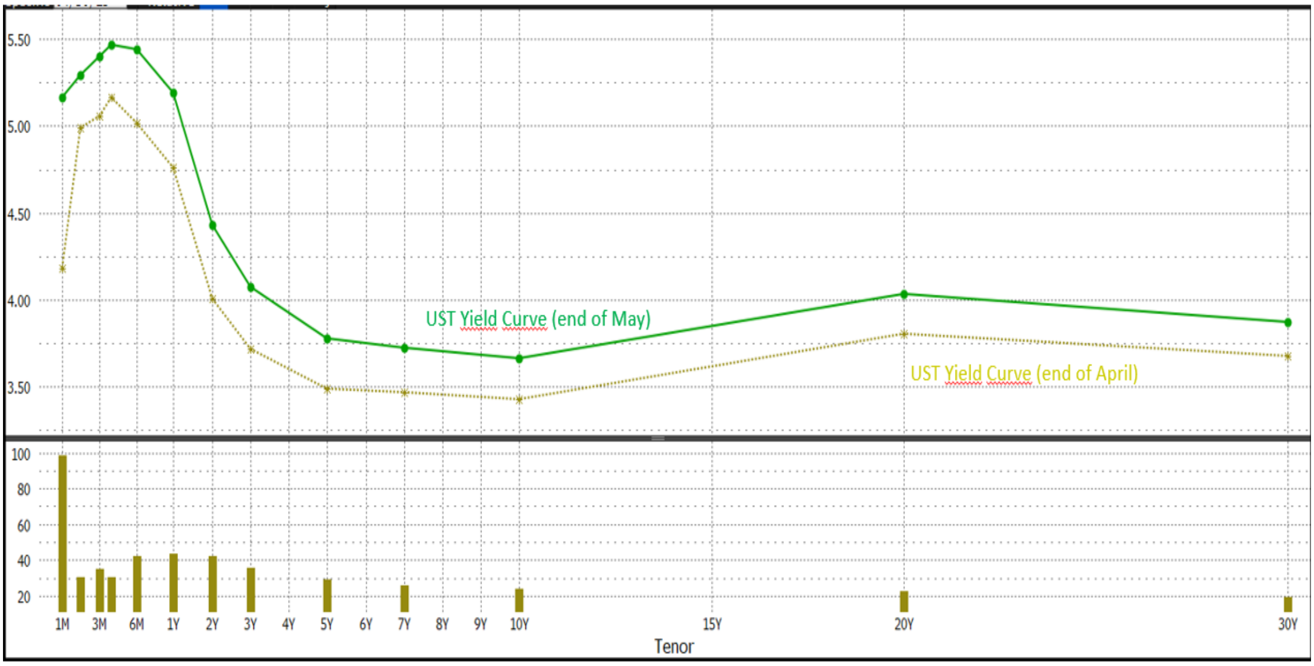
While German rates changed very little last month, US rates caught the eye. In fact, all maturities rose again, with a more marked movement in short-term rates. The 3-month yield rose by 36 basis points to reach a new high of 5.40%. The 2-year and 10-year yields rose by 39 and 23 basis points respectively, accentuating the inversion of the yield curve. At its last meeting, the FED hinted that a pause in its rate hike cycle could occur as early as June, but recent economic statistics have had an influence on investor expectations. For several months now, Mr Powell has been hammering home the message that rates will remain high for as long as is necessary to keep inflation under control. Less than a month ago, the investor consensus was expecting the first rate cuts before the end of 2023. It would appear that the consensus is increasingly leaning towards the FED's line and is now expecting, with a 65% probability, a further 0.25% rate cut by July at the latest. Core inflation is tending to fall more slowly than expected and household consumption is more resilient than expected, mainly because of continued upward pressure on wages, especially in the service sector. Let's not forget that until recently, most central banks claimed that inflation was "transitory".

Upward movement across the US curve



Source: Bloomberg, Weisshorn Asset Management

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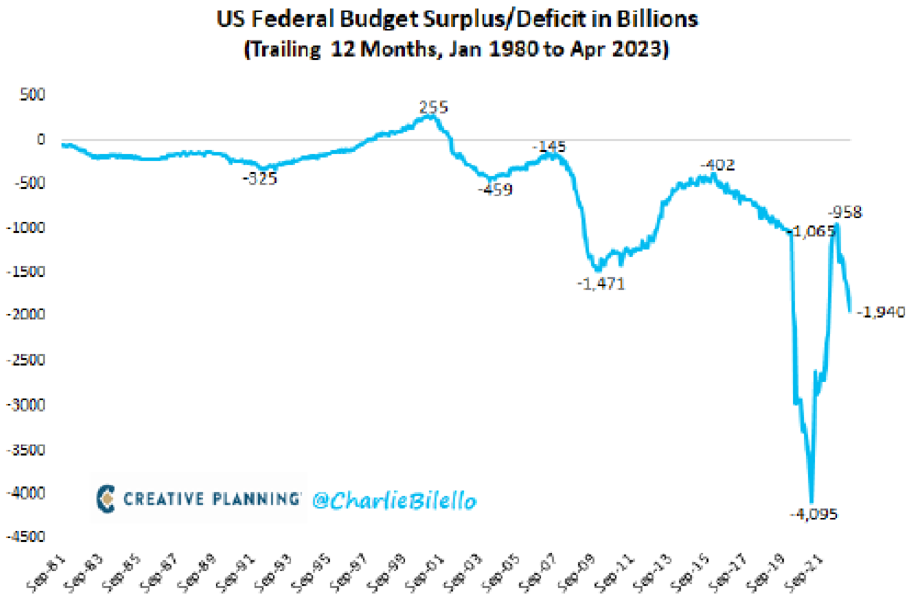
The lack of visibility around the debt ceiling is also likely to have pushed up short rates. The endless dithering between Democrats and Republicans is damaging the country's credibility. According to the latest estimates, the US government's liquidity level should fall below the minimum acceptable threshold for meeting its financial obligations (30 billion) by 5 June. Finally, the debt ceiling will be suspended until January 2025. This will not solve the problem of excessive government consumption, but it will only postpone it. The US budget deficit has been growing for several years. In-depth reform would therefore be necessary to stop this hemorrhaging and to enable the country to post healthier finances in the future. That still seems a long way off. Even if, once again, the risk of default by the USA is very low, this situation is unworthy of the world's largest economy and inevitably weighs on investor morale. This has not, however, caused the US dollar to lose its safe-haven status, appreciating by almost 3% in May to erase its losses since the start of the year.



Source: Charlie Bilello

We are fairly satisfied with the strong rebound in risky assets since the start of the year, even if the recovery in bonds is still a long way off. Some indices are performing almost indecently, given the lack of visibility over the economic cycle. The fact remains that equities remain an essential asset for protecting against inflation. Credit spreads, although not at stressed levels, tend to remain at neutral to high levels, as do risk-free interest rates. This situation complicates the recovery of the bond component of balanced portfolios. The latter therefore makes a marginal contribution to annual performance. As monetary policy normalises, we have seen that some alternative strategies are doing relatively well in the current environment. We still consider it useful to include this type of decorrelated strategy in a portfolio in order to diversify traditional investments.

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We remain at your disposal for any further information you may require on our investment philosophy, and wish you a pleasant summer.
The next monthly review will be published in August.

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