The Way We See It

May 2023
Issue 16

Goji Consulting Limited

enquiry@goji-consulting.com

Will the S&P 500 break 4200 and signal a new bull market phase?

INSIDE THIS ISSUE

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments
- Global Economies

Major economies in the world leading continued to grow, but at a relatively subdued pace. In G7 nations, goods prices have seen a welcome mild decline (even a cut in the OPEC oil supply was not successful at arresting the decline in oil prices). However, wages inflationary pressures in the low-skilled services sectors persisted, thus continuing to keep both headline and core inflation rates higher than desired. Hence, high interest rates remain.

Firstly, economic growth: solid employment and wage gains in the services sector continued to be the key driver of consumption, which, in turn, continued to drive GDP growth in the US and most other OECD economies. The latest Q1 GDP data in the US showed a paltry annualised 1.1% growth, boosted by domestic demand, but negated by inventories liquidation and weak government and investment spending.

China's growth was solid in Q1, but recent manufacturing leading indicators have started to fall again. The services sector was reported to have seen stronger growth.

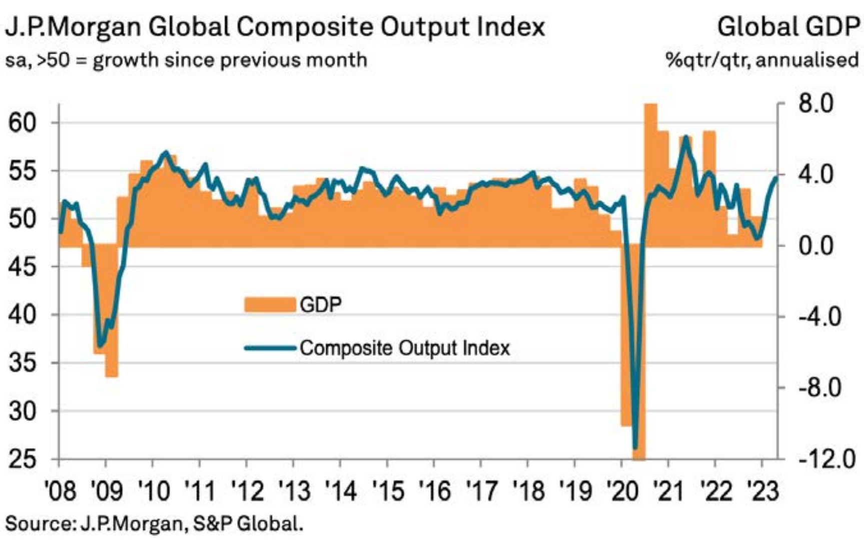
Negative newsflows include the recent turmoil in the U.S. and global banking sector, a threat which we consistently highlighted in our recent monthly reports, with the latest one being First Pacific Bank which was rescued by the FDIC authority, and then bought out by JP Morgan.

Secondly, inflation and monetary policy: Other adverse newsflows during the month include the continuing tightening of monetary policy by G10 nations, despite the threat of the pervasive global banking crisis and economic slowdown. It is interesting to note that while the US Fed and other OECD central banks continued to warn that core inflation remains far too high, which thus should have negated any hope of rate cuts this year, the market thinks differently: the latter continued to price in rate cuts, starting in Q4. They believe that the current threat of a US banking crisis, together with decelerating rate of headline inflation and a sub-par GDP growth rate, will force a change of direction by the Fed and its OECD counterparts by Q4 of this year.

Finally, let's not forget the global geopolitical risk: the continuing war between Russia and Ukraine, and the potentially damaging broadening of geopolitical and trade tensions in semiconductor chips between the US and its partners against China.

Negative newsflows overshadow but market thinks in a different way.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global

- Global Markets

The month of April recorded another positive result in US equities, helping to continue to boost the sentiment of investors in the US and Developed Markets. As a result, we saw a solid rally in the US and many other OECD economic-sensitive assets.

The containment of the US banking crisis, combined with the release of better-than-expected US Q1 corporate results and outlook statements (particularly in megacaps technology companies with AI products) boosted the overall sentiment of global equity investors. In addition, as volatility in the US stock market surprisingly fell, this has motivated quantitatively-driven funds to raise their equity exposure significantly. Another interesting feature is that it appears that long-only fundamental investors have been reducing theirs, as recession fears mounted.

Systematics Buying vs Discretionary Selling

Discretionary vs Systematic Equity Positioning
- Systematics Buying vs Discretionary Selling

*Wtd average of Z-scores for positioning indicators, weights based on explanatory power in regression of equity performance on indicators

Source: Deutsche Bank Asset Allocation

In Global Equities, the U.S. led, boosted by investors' renewed interest in the dependable high-growth Technology, Semiconductors and Social Media/ Internet sectors. The Emerging equity universe did not fare as well: the weakness of HK-China, caused by the deceleration of manufacturing and export growth, pulled down the whole sector.

Global Fixed Income markets rose slightly. They were supported by the fear of a recession in the US starting in Q4 of this year, plus the hope that the Fed and other G7 central banks are close to implementing a pause in their interest rate hiking cycle. Cash underperformed bonds.

Despite favourable GDP growth data coming out from China, the Commodities complex again ended lacklustre in April. Oil prices fell in the second half of April (affected by fears of recession and weakness in the global manufacturing and construction sectors).

The US Dollar fell slightly over the month. It was affected by the market perception that the Fed is close to a pause in its rate hiking cycle, and that it will cut rates in the second half.

Equities in April:
DM outperformed EM.

Near-term performance of various asset classes

as at 28/4/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	1.27%	1.80%	-1.11%
3 months	2.36%	2.54%	-4.68%
YTD	9.10%	9.82%	2.86%
FY 2022	-19.46%	-17.73%	-19.74%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	0.77%	0.54%	0.61%
3 months	0.28%	1.03%	0.49%
YTD	4.29%	3.56%	3.59%
FY 2022	-15.76%	-12.46%	-13.01%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	0.06%	0.44%	0.16%
3 months	0.06%	0.17%	-3.57%
YTD	3.15%	3.46%	-3.45%
FY 2022	-17.47%	-16.25%	19.53%

Asset Class	Asia ex Japan Equities	China Offshore	China A
Index	MSCI AC AxJ	MSCI China	MSCI China A Onshore
1 month	-2.07%	-5.16%	-2.07%
3 months	-5.54%	-11.16%	-5.90%
YTD	2.23%	-0.69%	3.88%
FY 2022	-19.35%	-21.80%	-27.09%

Source: GOJI, MSCI, Bloomberg

Market Outlook
- Global Economy

While there are both positive and negative factors operating in the US and the world economy, the potential growth positives are likely to narrowly win out, but not by much, in the first half of 2023. Unless there is a sudden change in the Fed's monetary policy, the second half may feel the adverse impact of past monetary tightenings and a potential normalisation of consumption to a more modest growth path.

Positives in the first half include: solid employment and nominal wage gains are likely to continue to support GDP growth in the US, together with modest increased spending by the government and corporates. In China, the re-opening of its economy, combined with a modest easing of fiscal and monetary policies should help to modestly boost its GDP from 3.5% in 2022 to about 5% this year. In addition, as the majority of countries have started to re-open and encouraged tourists and foreign workers to return, this will add to GDP growth and help to alleviate the shortage of labour in many countries.

On the negative ledger, the market consensus believes that the threat of a US recession developing in the second half remains high. This risk is compounded by the recent U.S. banking turmoil (regional banks and the commercial property sectors), continuing tight monetary policy, shortage of low-skilled workers in the services sector, and the escalation of trade tensions between the U.S. and allies against China (semiconductor chips, other technology-related sectors).

Our base case: world to grow at sub-par pace & remain fragile.

In brief, the US and world economy are expected to grow modestly in the first half of the year but may slow down more in the second. We attach a small probability to a deep US recession. In our base case, we expect that the world economy will continue to grow at a modest, ie, sub-par pace. Having said that, we are still somewhat concerned that, after a decade of almost zero interest rates and trillions of QE and fiscal pumping, the abrupt reversal of these super-easy monetary and fiscal policies has and is likely to continue to cause unexpected financial crises and/or recessionary conditions. Net, net, the world economy, in our opinion, remains fragile (financial accidents have and can continue to happen!).

The Way We See It
- Global Markets and Investment Thematics

The above economic, monetary, and geopolitically unbalanced backdrop is expected to prevail in the remaining of the year.

In the short-term, we continue to think that it would be sensible for investors to continue to adopt a neutral-risk strategy. This translates into a strong focus on quality and lowly-geared assets that can deliver predictable cash flows. In addition, until the U.S. banking and commercial property sectors are functioning healthily and that the Fed truly pivots from tight to pause/ease, investors could consider holding a mild overweighting in US-dollar-denominated Treasuries and Investment Grade corporate bonds.

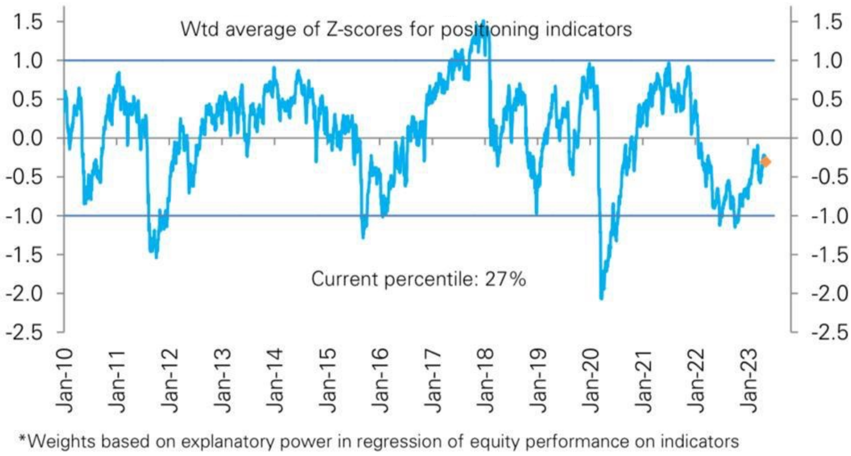
GOJI's view - sensible to adopt a neutral-risk and quality-focused strategy.

In terms of geographical diversification, it appears that it may pay to be neutral in the US versus other global equities. This is based on the differing growth and liquidity trends across the globe, which favour the rest of the world over the US.

From an investor's sentiment and positioning perspective, data seems to suggest that there has been interesting developments which created a divide between Systematic (Quantitative- and Algorithm-based) and Fundamental investors. The former has been consistently accumulating more equities as stock prices have been rising and equity volatility has been falling. The latter has been reducing theirs, on the basis of the consensus' continuing downgrade of economic growth and corporate profits, together with still high interest rates and expensive equity valuations. See chart *Consolidated Equity Positioning* on the next page.

Furthermore, it is interesting to note that in their latest annual general meeting, the two legendary investors, Warren Buffet and Charlie Munger, unusually sounded relatively downbeat in their outlook for their various business divisions. They also reportedly hold $US 130 billion in cash, seemingly unable to find large-scale attractive investment opportunities.

Consolidated Equity Positioning



Source: Deutsche Bank Asset Allocation

We wish to continue to share a technical chart of the leading risk index in the world, the US-based S&P 500 stocks index. It shows that the index has been gradually rising since October 2022, within a volatile upward-trending trading range.

Importantly, the 50-day moving average has crossed the 200-day counterpart on their upward trends, an event which is labelled a 'Golden Cross'. The latter is a positive signal (as long as they trend upwardly), suggesting higher prices ahead on a medium-term basis.

S&P 500 Stock Price Index

Source: MarketWatch.com

Technical: S&P500 "Golden Cross" intact since Feb'2023.

While the S&P 500 Index has achieved a Golden Cross signal, it has not been able to rise above the 4200 level, despite reaching it three times in 2023 year to date. To signal a new bullish phase, it needs to rise and stay above the 4200 level, on high trading volume. Whether this will occur or not is the continuing fight between bulls and bears. We err on the cautious side.

To summarise, it remains our strong belief that a sustainable bull market in equities and corporate bonds will return at some stage. But it would only occur when valuations fall further to reflect the US and global sluggish growth trend, and, more importantly, when the US Fed and other major central banks switch from the current tightening to a pause, or an easing mode. In the meantime, due to continuing macroeconomic uncertainties in the global economy, markets are likely to remain volatile. Consequently, a neutral-risk and quality-focused investment strategy should remain the foundation of risk-averse investors.

GOJI CONSULTING LIMITED

Level 34, Tower One, Times Square
1 Matheson Street, Causeway Bay, Hong Kong

www.goji-consulting.com

enquiry@goji-consulting.com

+852 3951 0359