The Way We See It

August 2024
Issue 32

Goji Consulting Limited

enquiry@goji-consulting.com

INSIDE THIS ISSUE

Is the U.S. economy on the precipice of a Recession? Markets appear to think so, while we do not agree.

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

On growth dynamics, the U.S. Q2 GDP's annualised 2.8% growth rate showed a modest rebound versus Q1's 1.4%. The Q2 GDP data was boosted by a large increase in inventories, and a more solid bounce in consumer spending. In addition, government spending also contributed positively.

Europe showed mixed results: the latest economic indicators of Germany showed an abrupt downturn again, while other tourism-intensive members of the Union appeared to have fared better.

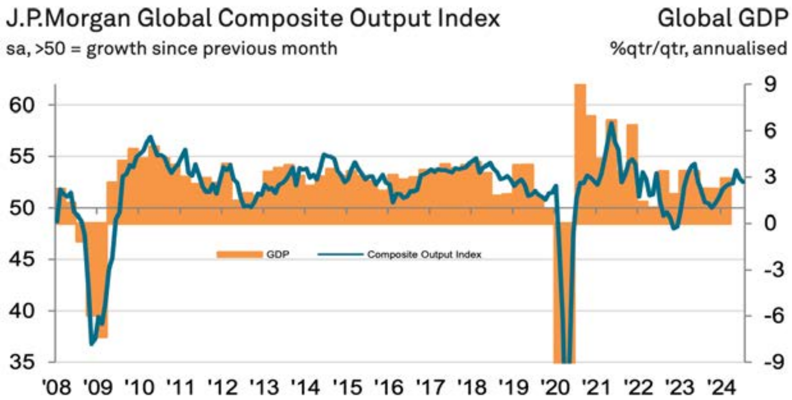
Despite the Chinese government's efforts to stimulate the domestic economy, China's growth recovery can best be described as volatile and modest.

On the global inflation front, in the case of Europe and other OECD countries, headline and core inflation indicators settled at a highish plateau, higher than the desired conventional annual 2% target set by major central banks. In the U.S., the inflationary trend has been more favourable. The last three core inflation monthly numbers have been lower or not worse than expected. This boosted investors' sentiment, who are now pricing in the scenario for two or more rate cuts in H2, not just one (as per the Fed's dot-plot).

Inflationary trend is favourable; market is pricing in 2+ rate cuts.

Finally, global geopolitical risks have not gone away, and, if anything, they have intensified: Russia vs Ukraine, Israel vs Hamas and Iran (heating up again this week). In addition, geopolitical and trade tensions between China and the U.S. remain high, particularly as the U.S. election is nearing.

J.P.Morgan Global Composite PMI™



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

- Global Markets

Following a positive month in Equities in the U.S. and other Developed Markets in the month of June and the June quarter, this favourable trend continued in July (although the first week of August was very volatile).

Positive Q2 continued in July.

- Positive factors include the continuing AI revolution in the U.S., global upgrades of economic and corporate earnings, together with hopes for an early rate cut by the Fed, and for the big-spending fiscal trend in the U.S. to continue, irrespective of who wins in November.

- Negative factors firstly include the disappointment in a number of key megacap corporates (investors' expectations were simply too high and valuations very elevated). In addition, there was a newly-emerging fear of a U.S. recession coming in the next 6-12 months, as employment and consumption indicators have slowed down more than expected.

The latest data on the equity positioning of fundamental and systematic investors during the month showed that both have been reducing (or "de-grossing") their exposure. The most favoured and thus "crowded" sectors, Semiconductors, the Magnificent 7 and other high growth stocks, which had performed strongly over the past 6 and 12 months, were under significant selling pressure.

As the growth in the U.S. employment and retail sectors disappointed, discretionary investors appear to discount a potential mistake by the Fed's reluctance to cut rates in the July FOMC. The former thus bought bonds and sold stocks aggressively in recent days. Rate cuts are being more aggressively priced in, with the first cut expected to occur in September.

Most asset classes continued to rise in July, except Offshore China & Commodity.

Near-term performance of various asset classes

Asset Class	US Equities	Global Equities	Global ex US Equities
Index	MSCI USA	MSCI World	MSCI World ex USD
1 month	1.26%	1.78%	3.15%
3 months	9.89%	8.60%	5.48%
YTD	16.32%	14.03%	8.69%
FY 2023	27.10%	24.42%	18.60%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	2.38%	2.19%	2.34%
3 months	4.96%	4.72%	5.06%
YTD	1.89%	1.31%	1.61%
FY 2023	8.52%	4.05%	5.53%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	3.18%	2.76%	-4.25%
3 months	3.99%	4.26%	-4.58%
YTD	-1.83%	-0.49%	5.42%
FY 2023	4.18%	5.71%	-5.01%

Asset Class	GEM Equities	Asia ex Japan Equities	China Offshore
Index	MSCI EM	MSCI AC AxJ	MSCI China
1 month	0.37%	-0.06%	-1.23%
3 months	5.01%	5.91%	-0.71%
YTD	8.08%	9.86%	3.53%
FY 2023	10.27%	6.34%	-11.04%

Source: GOJI, MSCI, Bloomberg; data as of 31/7/2024

Led by the U.S., the whole global equity universe, in USD terms, was up +1.78% in July. Excluding the U.S., the global equity universe rose by +3.15%, and the China A-share market posted a small gain of +0.73%.

Delayed expectations of early rate cuts in the U.S. continued to boost the value of USD. However, any sign of weaker than forecast inflation and/or growth data in the U.S. could reverse this uptrend.

U.S. Treasuries and other domestic and global fixed income markets finished the month with strong positive returns. The commodities complex fell, affected by fears of the U.S. slowdown and China's sputtering recovery.

Investors reduced exposure in crowded sectors in July.

Market Outlook

Consolidated Equity Positioning

*Weights based on explanatory power in regression of equity performance on indicators

Source: Deutsche Bank Asset Allocation, as of 31/7/2024

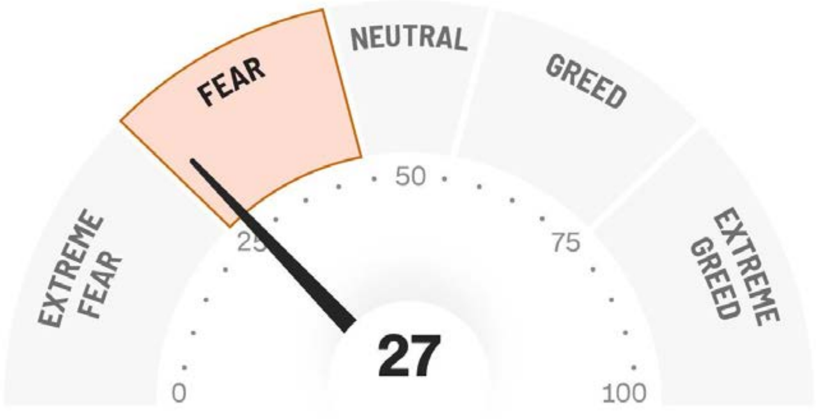
Discretionary vs Systematic Equity Positioning

*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, as of 31/7/2024

In the short-term, traders and investors' sentiment continued to oscillate between Fear and Extreme Fear. The CNN Fear and Greed index currently showed "Fear" *(as of end of July)*.

Fear & Greed Index
- What emotion is driving the market now?

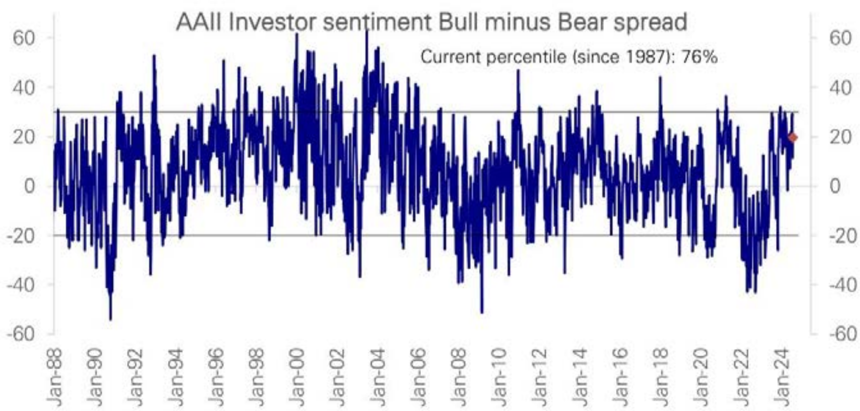


Source: CNN Business
Last update July 31 at 8:00:00 PM ET

Another sentiment indicator remained in the Neutral zone. This is exemplified by the fall of the latest Investors' Bulls minus Bears reading.

Less Bulls and/or more Bears - sentiment turned to [Extreme] Fear

Investor Sentiment
- Investor bull minus bear spread



Data as of 31 July 2024
Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

Despite historical highs being reached in the US and a number of other US-correlated markets, the rotation within the markets has been amplified by the substantial profit taking in NVIDIA, other Semis and

Technology stocks. Proceeds have been targeting the sectors of the market index which have been left in the dark over the past one to two years because of high interest rates, weakening domestic and slow earnings growth.

As a result, our view continues to stress prudence and efficient diversification in the next few months.

The Way We See It
- Global Markets and Investment Thematics

Thus, we, at GOJI, continue to prefer to adopt a risk-neutral investment strategy.

As outlined in our Global Investment Outlook for 2024 and in the two sections above, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and are prepared to pay up for a best-case scenario of slowing but not recessionary growth, falling inflation and lower interest rates. A Goldilocks scenario.

Despite the fact that we do not currently predict a recession in the U.S., our strategy recommendation continues to advocate a modest underweight exposure to expensive risky growth assets, and overweight cash and low-beta quality assets.

GOJI: stay diversified, with modest u/w in expensive growth assets, and o/w in cash & quality assets.

While the strategy didn't work in July, we continue to suggest a modest exposure to commodities.

Lastly, we think that the U.S. Dollar is more likely to consolidate, rather than continuing to steadily rise. Heavy overweight positions in the USD / HKD, which have worked well over the past 6 month, should be reduced.

Short-term Technical Analysis

Since the start of the year, U.S. and global equity indices, led by AI and Semiconductor stocks, have performed strongly. Recently, there has been some rotation away from the Tech towards non-Tech. As the weight of the megacaps in the S&P 500 Index is very high, the weakness of the Magnificent 7 has been pulling the overall Index down.

As the liquidation of equities by both Fundamental and Systematic investors appears to have only just started, unless the Fed panics and cuts rates unexpectedly, one needs to carefully monitor that this small correction does not cascade into a bear market.

GOJI: liquidation in risky exposure is NOT done yet.

S&P 500 Stock Price Index

Source: MarketWatch.com

As per GOJI's recommendation made in early June to long-term investors, we thought that it was sensible to pro-actively trim hyped-up Technology and other expensive High-Growth stocks. Proceeds were recommended to be spread to other cheaper and more defensive asset classes. This was outlined in the "Special-Topic Postscript" of GOJI's June and July monthly reports.

GOJI: continue to trim Tech & High Growth stocks.

We retain this recommendation for now.

Postscript #1
Wither Recession?

The start of the month of August was particularly volatile and rocky. Investors' sentiment turned from cautiously optimistic in July to panicky, just over four trading sessions in August. U.S. and global stock markets fell sharply. From their July peak (intraday) to the recent intraday bottom, the world leading equity benchmark index, the US-listed S&P 500, fell by -9.71%. The global leading technology index, the

NASDAQ 100, declined by -15.73%. The world leading AI stock, NVIDIA, fell by -33.39%. The global equity market, dominated by the U.S., fell by -9.20%.

	Intraday High (dd/mm)	Intraday Low (mm/dd)	Change %
SPX	5,669.67 (16/7)	5,119.26 (5/8)	-9.71%
NDX	20,690.97 (10/7)	17,435.39 (5/8)	-15.73%
NVDA	136.15 (11/7)	90.69 (5/8)	-33.39%
MSCI World	3,649.18 (17/7)	3,313.57 (5/8)	-9.20%

Source: Investing.com

Panic selling from mid July's highs to early August's lows.

What are the reasons for this panic selling?

There are several reasons. Unfortunately, we may never know for sure which is(are) the key one(s). The often-cited principal cause is that there were "clear" signs that the U.S. economy is already in, or about to, fall in a recession in coming months. Arguments put forward by the "Recession Bears" include the sudden jump in the unemployment rate, slowdown in the net new non-farm payrolls jobs created monthly, and the rise in the weekly unemployment numbers. Undoubtedly, the U.S. employment trend has been showing a deceleration for a period of time now. However, to jump to the conclusion that we are clearly heading towards a recession is somewhat exaggerated.

Fear of recession led to sell-off; Yen carry-trade added fuel to the fire.

The accelerated rate of price falls in August was exaggerated by the substantial and sudden liquidation of high-momentum markets (Japan's Nikkei) and stocks in the U.S. semiconductors and Magnificent 7 megacap tech stocks. What caused the abrupt sell-off was apparently attributed to the reversal of the Yen carry-trade which involved macro hedge fund managers buying back the Yen and selling long assets including the hot markets and stocks mentioned above. The significant price falls may have triggered stop/loss selling bull other Systematic funds, since the latter have to automatically unload their long positions in high-momentum markets and stocks when the implied volatility rises and prices fall. We have seen this phenomenon many times before. Markets' panic selling appeared to have stabilised as the Bank of Japan reassured investors that they will no longer raise interest rates when there is high volatility.

In an uncertain environment, stocks whose sales and earnings disappointed were harshly dealt with (Intel, Tesla, Microsoft).

Returning to the rationale backing the Recession Bears' case, we can make the following observations:

1. The Bears often quote the "Sahm rule", which goes something like this (*source: Barrons*):

- The Sahm Rule is named after its creator, Claudia Sahm, a former Federal Reserve and White House economist. It is considered by a number of economists as a reliable indicator that the economy is already in a recession (or about to fall in one).

- The rule indicates a recession has started (or will soon start) when the 3-month moving average of the US unemployment rate is 0.5 percentage points or more above its lowest during the previous 12 months. The threshold was crossed when the U.S. government data showed on Friday 1st August that the unemployment rate had hit 4.3% - its highest level since October 2021.

- A number of criticisms were levelled at this rule, including the fact that the unemployment rate appears to have risen as a result of a larger and broadening workforce rather than actual job losses. In addition, the Chairman of the Fed called it a "statistical regularity" rather than a trustworthy economic rule. Lastly, the creator of the Sahm rule, Ms. Claudia Sahm believes that her rule is unlikely to be accurate in predicting a recession in the current environment.

2. Another popular Recession financial indicator is the negative shape of the 2-10 bond yields' spread. The latter occurred some two years ago and has continued until now. Yet, there is no sign of distress of bank loans to small businesses or large corporations, or excessively high consumer leverage, or significant job losses. Perhaps there have been structural changes in the way consumers and corporates handle the higher interest rate regime.

In brief, GOJI believes that the above-outlined skepticism expressed towards a Recession scenario is justified. Consequently, we continue to advocate a "soft landing" economic scenario in which real economic growth remains modestly positive, and that inflation is expected to continue to gradually fall towards 2-2.50% pa.

As a result, we continue to offer our unchanged strategic recommendations to our clients based on our "soft landing" base case, and for the Fed to cut rates about 2-3 times from now until the end of December.

Postscript #2
Time to Buy Equities Again?

Recent releases of weaker than expected data relating to the U.S. employment situation, when combined with reluctance of the Fed to lower interest rates, caused fear in the trading community and a number of fundamental investors. Consequently, the growing consensus has rapidly swung from a cosy "soft" to "hard landing" scenario.

As elaborated in the Special Section 1 ("*Wither Recession?*"), the initial selling of risk assets and buying of bonds caused by the recession worries led to stop-loss liquidation by Systematic investors. This was amplified by the sudden increase in rates by the Bank of Japan which then caused a massive unwinding of the carry trade, the consequence of which was a significant and abrupt fall of the Nikkei and other popular high momentum sectors and stocks, including the mega-cap Magnificent 7.

The "throw the baby out with the bath water" phenomenon has, on our view, created a great opportunity for long-term investors to do some bargain hunting in risk assets.

We thus advocate to move from a "Neutral" to a moderately "Overweight Risk Assets" strategy.

This is our investment rationale:

1. Firstly, our U.S. and global economic monitoring

GOJI: panic sell-off created buying opportunities for LT investors.

Move to moderate o/w in equities.

suggests to us that the US economy is more likely to continue to grow moderately. It is very unlikely that the US will fall in a recession in the coming 6-9 months.

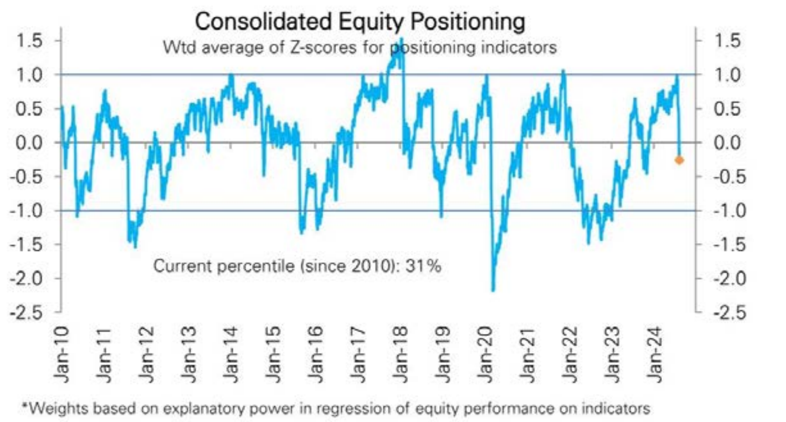
Reasons include: Still solid growth of fiscal expansion by the US government, still positive (albeit slowing) spending by consumers, and still growing (albeit slowing) CAPEX by corporates. Only global trade remains somewhat sluggish.

The above outlook is likely to provide a relatively favourable backdrop for corporates to continue to grow their sales and profits, albeit at a moderate pace.

2. Secondly, the Fed is about to launch itself into an easing phase, with many expected rate cuts in the pipeline, spread over the coming 6-18 months period. This will definitely provide some much-needed relief to small businesses, which have had to borrow at high cash-plus rates. In addition, long-term bond rates in US Treasuries have fallen dramatically over the past few months, helping to boost the valuation of long-duration stocks, particularly when many of the high-flying growth stocks have fallen by 20%+.

3. Thirdly, the crowded positioning of both Fundamental and Systematic investors has been reduced substantially in the recent stop-loss liquidation of risky assets. This is very good news, as, we, at GOJI, tend to guard ourselves against over-crowded consensus positions.

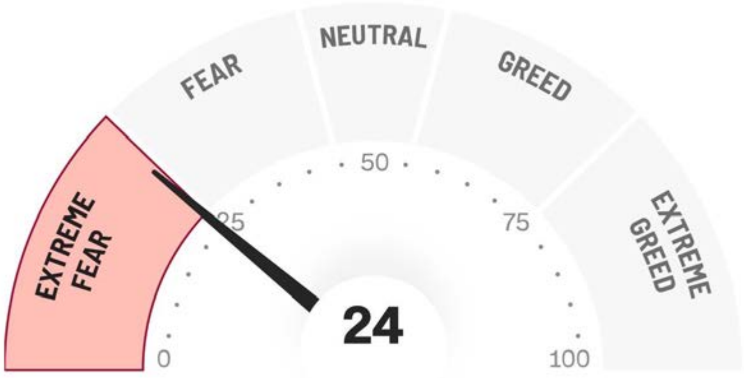
Consolidated Equity Positioning (latest)



Source: Deutsche Bank Asset Allocation, as of 9 August 2024

4. Fourthly, investors' sentiment towards risky assets has turned to cautious / fearful. This has tended to serve as a good contrarian indicator for long-term investors.

Fear & Greed Index (latest)
- What emotion is driving the market now?



Source: CNN Business
Last updated Aug 12 at 4:26:46 AM ET

Net, net, we recommend to our clients who wish to add to US or Japanese equities to do so now, taking advantage of this attractive "global sale".

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