The Way We See It

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Are we in a new sustainable bull equity market ?

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.

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Review of Developments
- Global Economies

With the exception of Germany and the Eurozone which entered a mild recession, most other major economies in the world continued to grow at a relatively subdued pace. In G7 nations, goods prices have seen a welcome mild decline. However, the global manufacturing re-shoring and new investment in green (rather than fossil fuels) energy, together with continuing wages inflationary pressures in the low-skilled services sector, continued to keep both headline and core inflation rates high. Hence, interest rates remained elevated, and continued to be raised in some countries (Canada and Australia just hiked again).

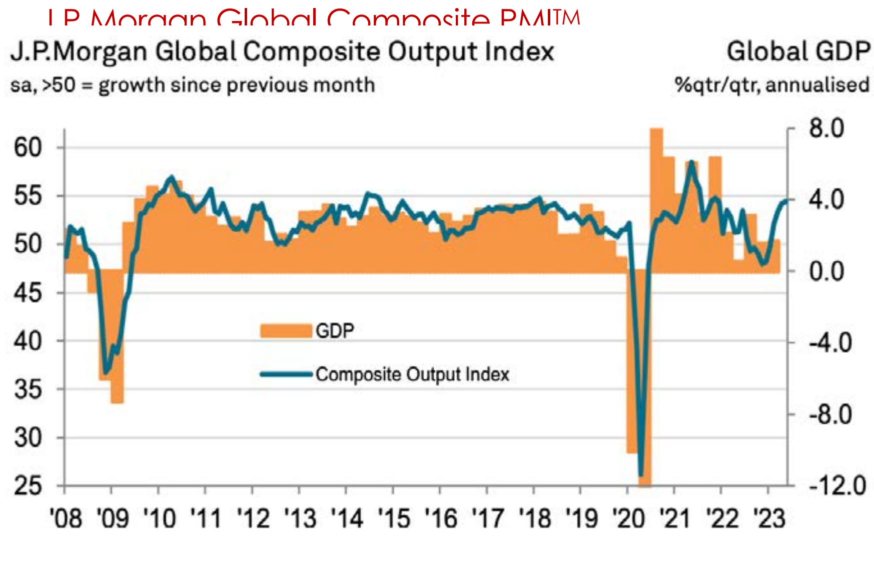
Firstly, economic growth: following the paltry annualised 1.1% growth in Q1 in the US, it was announced that the Eurozone fell in a mild recession. After a solid Q1, partial economic indicators in China are pointing to a rather sharp decline in economic activity. In brief, the world economy continued to grow at a worryingly low rate, weighed down by a higher cost of living, rising interest rates and slowing global trade.

The recent turmoil in the US and global banking sector appears to have stabilised for now. However, should the US Fed continue to maintain a tight monetary policy for another 12 months, troubles of the US banking sector could return.

As far as inflation and monetary policy trends are concerned, while there has been an easing of inflationary pressures, both headline and core inflation rates remain too high. This was the reason why the Fed and other OECD central banks continued to warn that interest rates may continue to be raised further and that the likelihood of rate cuts in 2023 is almost zero. Yet, the market thinks differently: the latter continued to price in rate cuts in the US, starting in November. 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. Experienced investors through cycles would be wise enough not to fight the Fed.

Almost unlikely to see rate cuts in 2023, but the market thinks differently.

Finally, about 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.



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

- Global Markets

With the exception of a small group of AI-fuelled stocks which rose euphorically, the month of May gave back some gains recorded in global bond and equity markets in April. The US equity market was blessed by the above AI development, as well as the compromised deal on the government debt ceiling.

The US and global bond markets weakness can be explained by the fact when investors realised that inflation and interest rates are likely to remain stubbornly high, they sold long-dated bonds, reduced duration and switched to cash-equivalent assets.

In terms of flow and positioning, both fundamental and quantitatively-driven funds were buying US equities. One noted that Quantitatively-based funds, driven by rising stock price momentum and falling stock volatility, are now overweight equities relative to past history. While long-only fundamental funds have also been buying (seems like a FOMO development), they remain underweight. As a result, US stock prices continued to rise and stocks' volatility continued to decline, inviting even more buying, particularly after the AI hype and the debt ceiling deal. A fortuitous virtuous cycle.

Lowering volatility invites more buying in US equity.

Discretionary vs Systematic Equity Positioning
- Systematics Buying vs Discretionary Selling

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 weakened for reasons elaborated above. Cash out-performed bonds.

The Commodities complex again ended lacklustre in May, as China is recently showing signs of severe slowdown, Europe tumbled and the US slowed.

The US Dollar rise slightly over the month, as investors changed their perception about the hope of a Fed easing cycle.

Near-term performance of various asset classes

as at 31/5/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	0.65%	-0.92%	-1.65%
3 months	5.55%	4.06%	0.24%
YTD	9.81%	8.81%	1.16%
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	-1.45%	-1.16%	-1.09%
3 months	2.07%	2.24%	2.04%
YTD	2.78%	2.35%	2.46%
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	-2.19%	-1.96%	-5.34%
3 months	1.48%	1.59%	-5.93%
YTD	0.88%	1.44%	-8.60%
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	-1.81%	-8.42%	-7.31%
3 months	-0.47%	-9.22%	-9.16%
YTD	0.38%	-9.05%	-3.72%
FY 2022	-19.35%	-21.80%	-27.09%

Source: GOJI, MSCI, Bloomberg

May gave back some gains recorded in April, but the AI hype kept US Equities above par.

Market Outlook
- Global Economy

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

Challenge remains in H2'23, unless sudden change in Fed's policy.

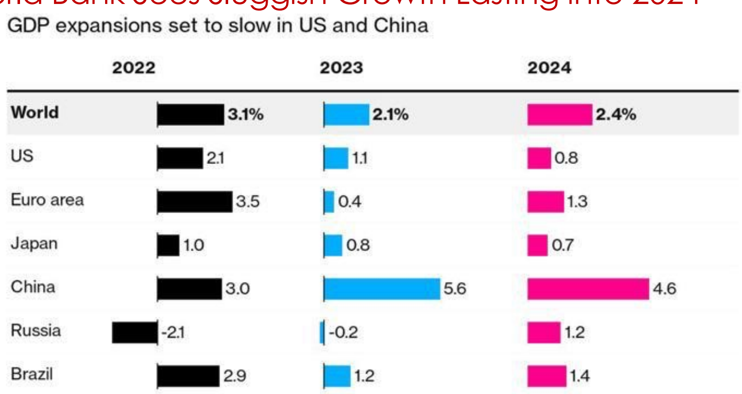
Positives in the first half include: solid employment and nominal wage gains are likely to continue to support GDP growth in the US, together with modest increased spending by the government's green industry and corporates.

In China, despite the re-opening of its economy, growth appears to be sputtering in the short-term, as illustrated by the recent sluggish exports and local consumption and production data. The two-year strict lockdown measures, combined with the US and its allies' trade restrictions vis-à-vis China, appeared to continue to adversely impact on both the domestic and overseas consumer of Chinese goods and services.

Consequently, we tend to agree with the World Bank's modest continuing downgrade of economic growth forecasts for this year (see table below). Their slightly more optimistic growth forecasts for next year depend very much on the taming of inflation (thus allowing monetary policy to be eased) and the turnaround of growth in the two largest economies, the US and China. Both conditions remain shrouded in uncertainty.

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

World Bank Sees Sluggish Growth Lasting into 2024



Source: Bloomberg, World Bank Global Economic Prospects report

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 only attach a small probability to a 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.

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

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.

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.

As we noted in our previous May monthly report, 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.

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 rising 50-day moving average has crossed the rising 200-day counterpart in Q1 of this year, an event which is known as 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

In the month of May, the S&P 500 Index was successful in crossing above the significant 4200 overhead resistance level, consistent with its Golden Cross signal (we did err on the side of caution, and were thus wrong). As we all know, this was boosted by the phenomenal rise of mega-caps in the semiconductor chips (NVIDIA) and other on-line and internet-linked stocks which are associated with the production and/or application of AI chips in the revolutionary ChatGPT software .

Technical: S&P500 crossed the 4200 resistance level in May.

Despite the above technical breakthrough in the short-term, we remain somewhat sceptical that the US equity market rally can be sustainably maintained. In other words, the potential for a correction and a break below the key 4200 level cannot be taken lightly.

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.

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