The Way We See It

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Second Half : Consolidation phase, or Rally to Continue?

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 the growth side, major OECD countries recovered modestly in Q2 and in early Q3, based on preliminary and partial data available in a number of countries.

On the strong side, preliminary guesstimates of Q3 GDP in the U.S. are pointing to a robust quarter. The latter is boosted by strong government-sponsored capital expenditure spending, a recovery in consumer durables (housing, cars) and a confident household and business sectors.

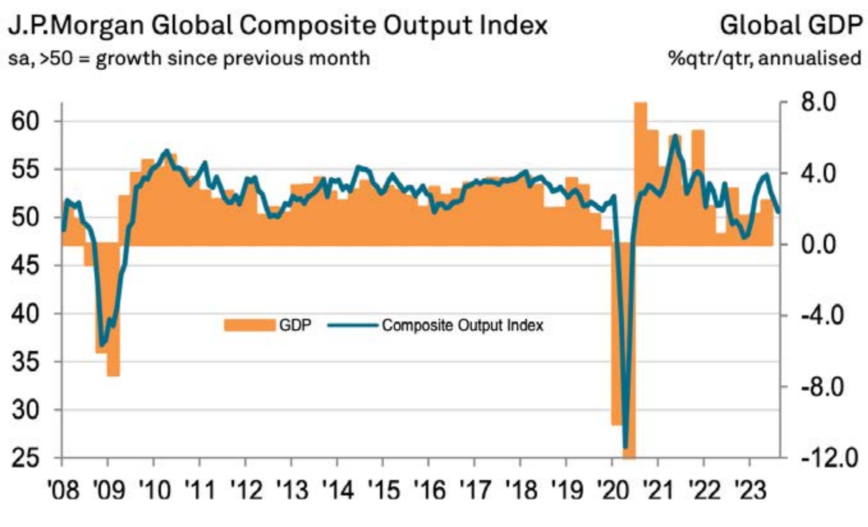
On the opposite end of the growth spectrum, early partial indicators in the Eurozone point to a sluggish trend. In the case of China, because of the government's relatively feeble attempt to boost its domestic economy, partial indicators reveal continuing weakness. Debt issues relating to the property sector, continuing fall in exports and a lack of confidence in both household and business surveys depressed the domestic recovery.

On the inflation front, in most developed economies, the favourable headline trend was halted by the bounce in energy prices. Core inflation measures remain elevated (structural factors including rising wages in low-skilled services, lower net immigration, green energy, manufacturing re-shoring, etc). The key message from the informal gathering of the top central banks at Jackson Hole continued to emphasise the need for a tight monetary policy. In the month of August, the ECB and BoE continued to tighten, while the Fed and the RBA were on hold. Reflecting the latest deflationary trend and a weak economy, China continued to ease monetary policy.

The need for tight monetary policy remains in most DM.

Finally, global geopolitical risks appear to intensify between Russia and Ukraine. In addition, the potentially damaging broadening of geopolitical and trade tensions beyond semiconductor chips between the US and its partners, against China, remains.

J.P.Morgan Global Composite PMI™



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

- Global Markets

Following a strong rally in equities in the month, quarter and year-to-date periods ending July, the month of August saw a correction, albeit modest for the major OECD markets. This was caused by the continuing hawkish messaging by the Fed, rising long bond yields and an overvalued IT sector. Cash, as a result, was the outstanding winner.

Within the global equities universe, the Chinese and the rest of the Emerging Markets bloc performed poorly. Investors were disappointed with the continuing poor growth in exports as well as domestic demand, and the feeble effort by the government to reflate.

Interestingly, the dominant seller of stocks in the month appeared to have come from fundamental investors. High interest rates seemed to have attract the attention of asset allocators.

August saw correction in risky assets, led by EM & especially China.

Near-term performance of various asset classes

as at 31/8/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	-1.69%	-2.35%	-6.13%
3 months	8.48%	7.10%	3.66%
YTD	19.12%	16.54%	4.86%
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	-0.08%	-0.03%	-0.08%
3 months	-0.02%	-1.61%	-1.06%
YTD	2.76%	0.70%	1.37%
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	-0.89%	-0.67%	-0.10%
3 months	-1.35%	-0.69%	11.05%
YTD	-0.48%	0.74%	1.50%
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	-6.39%	-8.95%	-8.05%
3 months	2.21%	4.99%	-3.36%
YTD	2.59%	-4.51%	-6.95%
FY 2022	-19.35%	-21.80%	-27.09%

Source: GOJI, MSCI, Bloomberg

The US and global bond markets continued to trade sluggishly. Cash outperformed bonds in all periods including the month, quarter and year to date to the end of August. The government bond market's weakness can be explained by the fact that there has been a large amount of new supply of US bonds hitting the market, particularly at a time when the Fed continued to withdraw liquidity via quantitative tightening and higher cash rates. In addition, while there has been some improvement in the headline inflation rate, central banks' number one priority is to continue to maintain a tight monetary policy to fight against a stubbornly high core inflation rate.

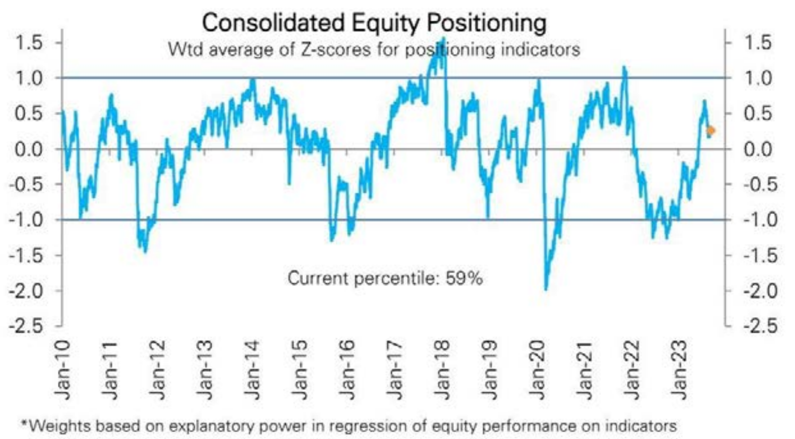
The US Dollar rebounded modestly in August, helped by the hawkishness of the Fed, and the lack of positive economic surprises from Europe and China.

The Commodities complex corrected along with other risk assets. The latest Chinese data (the ones which are still made available to the public), continued to denote a weak economy.

In terms of equities investment flows and positioning, both fundamental and quantitatively-driven funds remained overweight relative to their historical norm, with the latter modestly more.

Investors remained modestly overweight in equity positioning.

Consolidated Equity Positioning



Source: Deutsche Bank Asset Allocation

Discretionary vs Systematic Equity Positioning
- Systematics Buying vs Discretionary Selling

Source: Deutsche Bank Asset Allocation

Traders and investors appear to acknowledge that August and September have tended to be two seasonally negative months for markets. Hence the relatively thinner trading liquidity, which, as a result, exacerbated the intra-day and intra-week volatility of stocks and sectors.

Lastly, the consensus remains hopeful to see the resumption of the H1 bull market in the December quarter, based on their assumption that the Fed will be on hold until Q1 next year, following which the start of the monetary easing phase will occur.

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 continue to favour the U.S. over the rest of the world.

Europe is likely to be burdened by the lack of growth initiatives and the high interest rate regime. Thanks to its government's moderately easier policies, the Chinese economy may have bottomed, but the strength of its economic recovery is still clouded in uncertainty. The sputtering growth engine of China and the domestic-focused nature of the US economy are unlikely to help the rest of the world.

Chinese economy might have bottomed but yet to see growth recovery.

In brief, the US and world economy are expected to continue to grow, but at a sub-par rate. Having said that, we continue to attach a small probability to a mild US recession, possibly occurring in 2024. 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, particularly after a big rally in equities in H1. This translates into a strong focus on quality and lowly-geared assets that can deliver predictable cash flows. In addition, until the US banking and commercial property sectors are functioning healthily and that the Fed truly pivots from doubly tight (high cash rates and QT) to ease, investors could consider holding a mild overweighting in US-dollar-denominated Treasuries and Investment Grade corporate bonds.

GOJI's view remains - sensible to adopt a neutral-risk & 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, liquidity and valuation trends across the globe, which currently favour the rest of the world over the US.

Short-term Technical Analysis

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). The months of June and July saw a somewhat surprising acceleration of the bull trend, which took the Index by a further 10% or so.

Last month, we commented that "The market is now technically overbought, and we have started to see investors taking profits or being stopped-out. In addition, from euphoric levels, investors' sentiment have started to cool down in the short-term. It thus appears that a consolidation phase is coming in the near months".

As mentioned in our last report, we remain somewhat skeptical that the US equity market rally can be sustainably maintained. In other words, many are now predicting new highs for US equities by year end, which, in our opinion, appear excessively bullish.

We remain skeptical in sustainable rally in US; market appears to be excessively bullish.

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

Source: CNN Business

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.

Valuations matter.

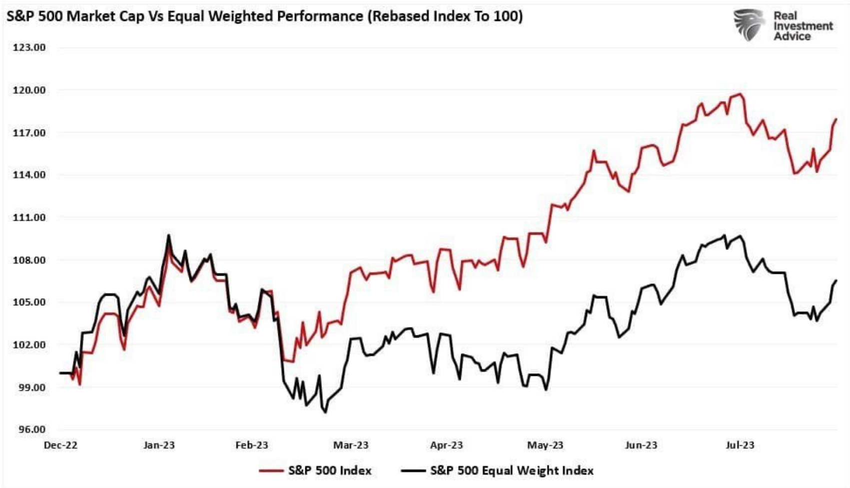
In the meantime, due to continuing macroeconomic uncertainties in the global economy, markets are likely to remain volatile. Consequently, in our opinion, a neutral-risk and quality-focused investment strategy should remain the foundation of risk-averse investors.

Post-Script

Performance of Market-Cap Weighted S&P 500 Index vs Equally-Weighted S&P 500 Index

The chart below (overpage) clearly shows the domination of the Top 10 stocks (by market cap) in the market-cap weighted S&P 500 index. YTD, it climbed strongly while the equally-weighted Index only rose slightly. As a result, the Top 10 mega-stocks are trading at a P/E of 27.7X, vs the remaining of the S&P 500 Index, which traded at 17.6X (a premium of 57.4%).

Mega-Cap Stocks Continue to Dominate – But For How Long?



Source: Investing.com

The implied message is whether the Top 10 can maintain this premium for long (it hasn't, if the past is of any guidance).

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