The Way We See It

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Goji Consulting Limited

enquiry@goji-consulting.com

INSIDE THIS ISSUE

Resolute Confirmation of Tight Monetary Policy: Will this change anything in our Outlook?

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

Review of Developments
- Global Economies

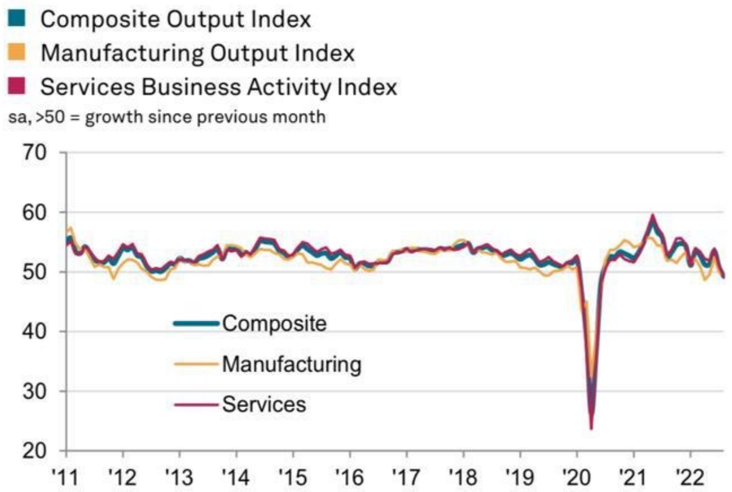
Over the month, the US data economic releases showed that the employment situation remains strong and that the economy appears to be growing at a moderate pace. While both headline and core inflation rates in the US have definitely shown signs of peaking (including further falls in gasoline and food prices recently), they remain excessively high relative to the Fed's target rate of 2% per annum. This underlined the Fed's Chairman's recent message at Jackson Hole that the Fed will unambiguously continue to raise interest rates and implement a more restrictive quantitative tightening program in the months ahead.

Across the other side of the Atlantic, Europe continued to be affected by the Russian energy crisis. In the Asia Pacific region, China continued to implement expansionary policies to try to boost its sluggish domestic economy, which continued to be affected by lockdowns in a number of major cities and the continuing crisis in its property market. Within the Emerging Markets universe, the risk of debt default continues to rise as a result of a very strong US Dollar, high US interest rates, and the reduced appetite of global investors to lend to weak and indebted nations.

We attach charts of the latest Global PMI trends. They reflect a continuation of the softening trend of real GDP growth.

J.P.Morgan Global Composite PMI™

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



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

GDP growth continue to soften globally.

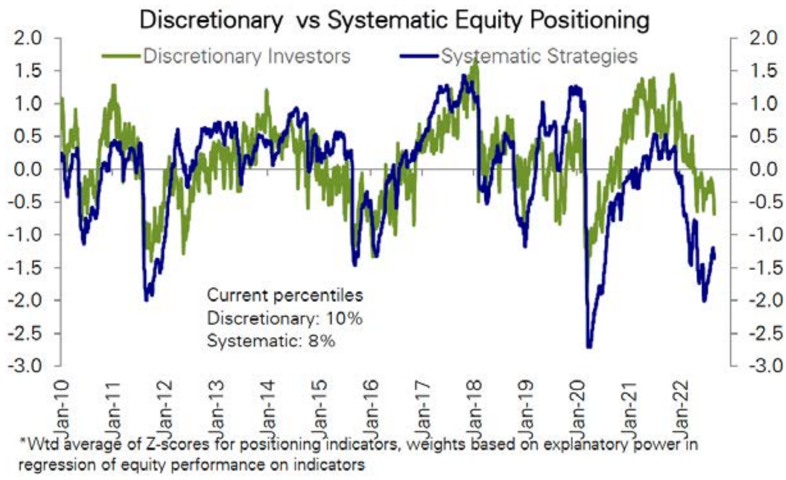
- Global Markets

The much-welcome relief rally of the US equity and bond markets, which started in mid-June, petered out in mid-August. It seems that short-term tradingorientated investors cannot resist the temptation to lock in some profits, while long-term investors became increasingly worried about the determined and uniform hawkishness of key members of the Fed Board to tighten monetary policy further. Investors are concerned that the Fed's blunt tool of tight monetary policy will, sooner or later, result in the US and global recession, and a fall in corporates' profitability.

Bear market rally in the summer months

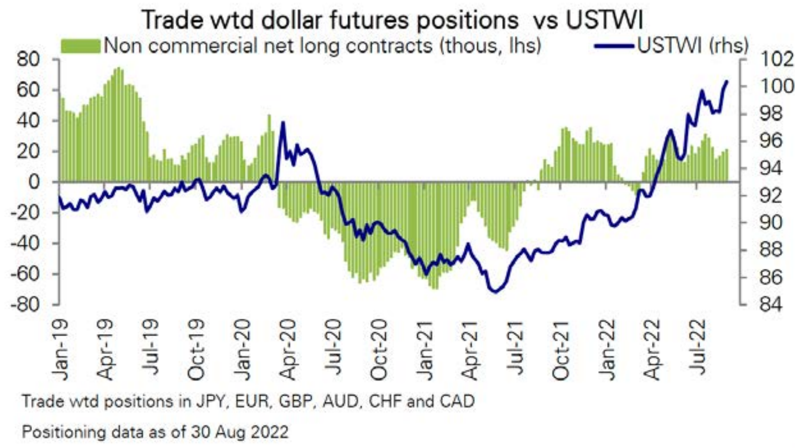
The out-performing risk assets, which led the rally from June to mid-August, witnessed a sharp reversal. Thus, long-dated government bonds, corporate high yield bonds, stocks, and economic-sensitive commodity prices and currencies all fell. The US once again led all other major equity and bond markets down.

Industry information suggests that long-only fundamental investors were reported to be the relatively more significant sellers of risk assets from mid-August to date, unlike the period from February to June, when Quantitative- and Algorithm-based investors dominated the selling. It appears that the former has begun substituting a soft landing for a recessionary scenario.



Source : CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation

The US Dollar remained strong over the period under review, helped by the aggressiveness of the Fed's tightening policy and the overall defensiveness of the global investment world.



Source : Deutsche Bank Asset Allocation, CFTC, Haver

Market Outlook
- Global Economies

While there are both positive and negative factors operating in the US and the world economy in the next few months, the potential growth positives are likely to be offset by negatives.

Positives are likely to be offset by negatives

Positives include: the likely gradual re-accumulation of inventories thus boosting GDP growth in the US, together with increased spending by the government and the potential corporate spending on CAPEX. In China, the gradual re-opening of its major commercial cities and easing of Covid rules, combined with a modest easing of fiscal and monetary policies should help to modestly boost its GDP in H2. 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. Having said that, should the Fed tighten too aggressively in order to tame inflation within a short time frame, the US economy may not escape a recession scenario in the coming 6-12 months. This scenario is gaining high credibility.

Other negative factors again rest with Inflation, Global Monetary Policy Tightening and Supply Bottleneck issues. First, regarding inflation, while the 3 rolling month inflation data appeared to have peaked, the more visible year-on-year inflation rate in major economies is expected to remain high. As a consequence, central banks in major OECD countries are almost certain to have to continue to raise rates until year-end. In addition, while supply-side bottlenecks appear to ease a little, the apparent complete suspension of gas exports from Russia through the Nordstream1 Pipeline would continue to hurt European economies. The US government has recently announced stricter measures regarding the export of sophisticated semiconductor A.I. chips to China. Lastly, the difficulty in finding workers to fill low-skilled services jobs in major economies and China's zero-Covid policy continued to cause unfavourable imbalances in demand and supply.

In brief, the world economy remains in a fragile phase at this juncture.

The Way We See It

- Global Markets and Investment Thematics

Our view remains unchanged - investors should stay defensive.

Against the above economic, monetary, and geopolitically unbalanced backdrop, in a not too dissimilar fashion through the first half of this year, our view remains unchanged - global financial markets are likely to trade within a wide range, in a volatile manner, with a downward bias.

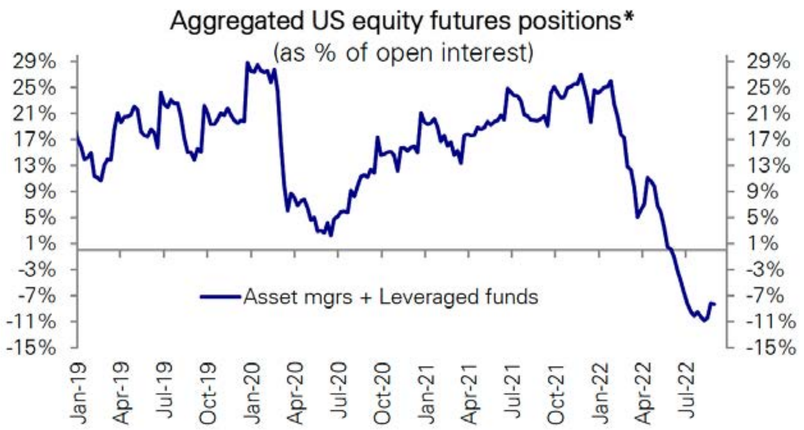
Consequently, we continue to advise that it would be sensible for investors to continue to adopt a defensive strategy in overall terms, consistent with our key message since November of last year. This translates into a strong focus on quality and lowly-geared assets that can deliver predictable cash flows, and USD cash.

In addition, as a number of growth stocks with a strong business franchise and good management have witnessed a substantial fall in their share prices, long-term investors should take advantage of these opportunities to selectively add to their equity and bond exposures.

From an investor's sentiment and positioning perspective, we noted in our Review section that both Quantitative- and Algorithm-focused and Fundamental investors appear to have to reduce their exposure to risky assets. We were not altogether surprised to see this, as we wrote in our July report:

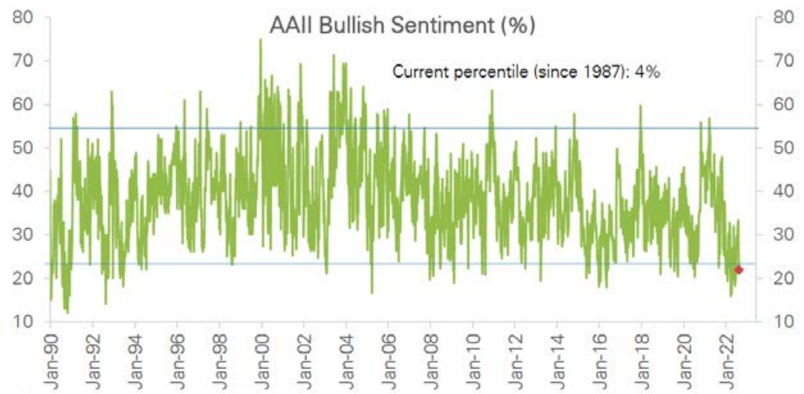
> *"Nevertheless, should stock prices fall and volatility rise again, the former is likely to liquidate their risky assets anew. Fundamental long-only investors may continue to reduce exposure to equities and low-quality corporate bonds, after a substantial buying binge last year and the first five months, should the recession newsflows worsen, and panic sets in."*

Finally, we highlight that Investors' sentiment is quite weak and investors' positioning in equities is relatively low at present. Any unexpected good news from the Fed's pivot in their current tight policy can cause equity and other risky asset classes to rise strongly and quickly.



*Based on futures positions in S&P 500, Russell 2000, NASDAQ 100, S&P 400 and DJIA
Positioning data as of 30 Aug 2022

Source : Deutsche Bank Asset Allocation, CFTC, Haver



Data as of 31-Aug-2022

Source : Deutsche Bank Asset Allocation, Barron's

In brief, it is our strong belief that a sustainable bull market in equities and corporate bonds will return at some stage, but only when valuations are lower and, more importantly, when the US Federal Reserve and other major central banks switch from the current tightening to a pause or an easing mode.

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