The Way We See It

August 2023
Issue 19

Goji Consulting Limited

enquiry@goji-consulting.com

INSIDE THIS ISSUE

1. Review of Developments
2. Market Outlook
3. The Way We See It
4. Post Script

Are we in a new sustainable bull equity market? Bull market still yes; Sustainable still uncertain.

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, following a relatively sluggish Q1. In the Asia-Pacific region, an opposite trend occurred: the Q2 data was slower than in Q1.

In particular, Q2 US GDP surprised on the upside: the US economy is estimated to grow at 2.4% pa, an increase from the 2% pa rate in Q1. Growth contributors include consumption, non-residential fixed asset investment and and private inventory increases. The Eurozone Q2 GDP rose by a more sluggish 1.2% pa, an improvement from the mild contraction in Q1. It was boosted by growth in France and Ireland. Excluding the latter two, the Eurozone Q2 GDP would have been flat. The Japanese economy is estimated to have increased by 1.3% pa in Q2. In China, its economy was reported to have grown by 3.2% pa in Q2, a deceleration versus the annualised 8.8% pace in Q1.

On the inflation front, in most developed economies,

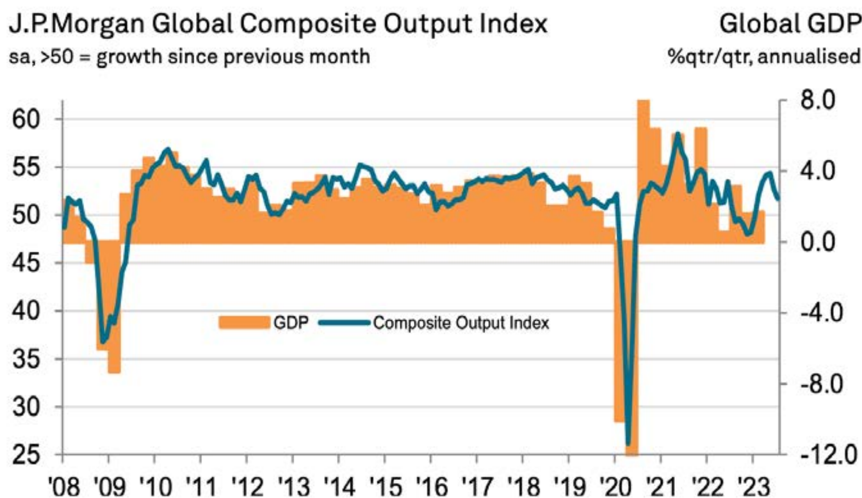
the trend continued to improve, with headline inflation decelerating faster (thanks to falling energy and food costs) than the core measure (structural factors including rising wages in low-skilled services, lower net immigration, green energy, manufacturing re-shoring, etc). This appeared to give central banks in key G7 countries some breathing room, since they have been aggressively raising rates over the past 18 months. In the month of July, led by the Fed and ECB, most G7 nations continued to raise rates. The Australian RBA decided to implement a "dovish pause" while China eased monetary policy to help to boost its sluggish domestic economy.

Decelerating headline inflation gives G7 central banks some breathing room.

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.

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 Intellidence

- Global Markets

The AI-fuelled equity rally in the US continued to broaden out to encompass all other sectors and other Developed and Emerging markets as well. Reversing a major downtrend since February, China bounced strongly, helped by expansionary measures implemented by its government.

In brief, it was another very good month for equities. It helped to boost the total return of global equities in the first seven months of the year to a strong 19.3%. Similar to last month, the largest buying of stocks appeared to come from fundamental investors: the latter were reported to continue to raise their equity exposure, driven by resilient economies and corporate earnings, hopes of peak inflation and interest rates, together with the fear of missing out on the powerful rally.

Another good month for equities. Some 20% return YTD in US & Global Equities.

Near-term performance of various asset classes

as at 31/7/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	3.44%	3.38%	6.29%
3 months	11.06%	8.67%	8.61%
YTD	21.16%	19.34%	11.71%
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	-0.36%	-0.84%	-0.63%
3 months	-1.40%	-2.72%	-2.07%
YTD	2.84%	0.74%	1.45%
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	-0.15%	-0.01%	7.70%
3 months	-2.65%	-1.97%	5.23%
YTD	0.42%	1.42%	1.60%
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	6.20%	10.86%	5.73%
3 months	7.20%	5.61%	-2.59%
YTD	9.59%	4.88%	1.19%
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 July. In July, Corporate bonds continued to slightly outperform their government counterparts.

Government bond markets' weakness can be explained by the fact that there was a large amount of new supply of US bonds hitting the market, particular 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.

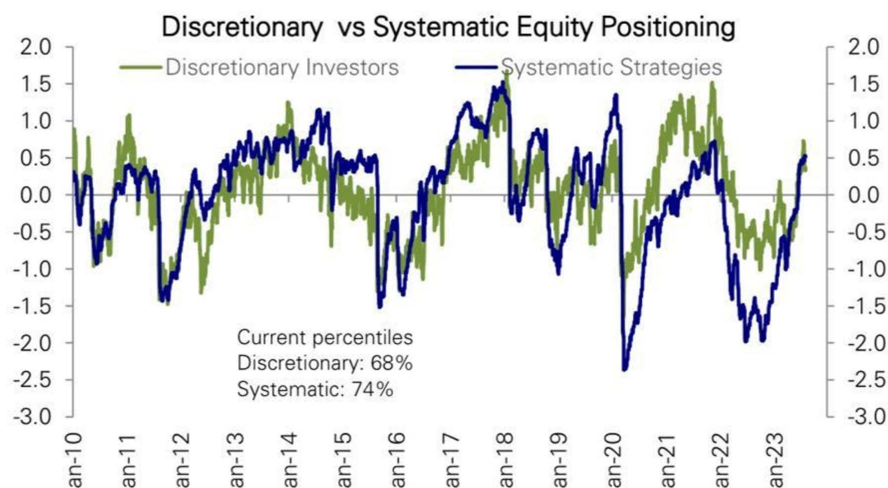
The US Dollar's fall accelerated in July, as investors began to price in the peak rate in the US, while other major central banks are expected to continue to do more tightening.

USD slipped in July as investors began to price in peak rate.

The Commodities complex rose strongly, boosted by a weak USD, China's stimulatory measures to boost its weak economy and Russia's renewed attack on exports of Ukranian grains.

In terms of flow and positioning, both fundamental and quantitatively-driven funds continued to buy US and foreign equities, with the former continuing to be the dominant party in July.

Discretionary vs Systematic Equity Positioning
- *Systematics Buying vs Discretionary Selling*



Source: Deutsche Bank Asset Allocation

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 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 tightening and a potential normalisation of consumption to a more modest growth path.

In China, the government's renewed concerted effort to ease both fiscal and monetary policies to shore up demand is likely to see a gradual modest recovery in the coming 6-12 months. Having said that, one of the past growth drivers of China, exports, may continue to face challenges as corporate and consumers around the world have been looking for alternative suppliers, and the on-shoring manufacturing process.

Export in China may face more challenges.

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, since 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 remains - sensible to adopt a neutral-risk & 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, 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.

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.

Market appears to be excessively bullish.

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 July report, we remain somewhat sceptical 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.

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.

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

China property market

Newsflows continued to point to a weak and challenging environment, particularly in 2nd tier cities and below. The near-bankruptcy status of many high profile and large property developers, together with unfinished flats, soured sentiment.

The Chinese government is well aware of these problems and are trying to fix them. However one cannot expect a quick resolution and return to health in this sector.

We share with you this headline which depicts the situation in the Chinese property market quite well:

PROPERTY

'Buy one floor, get one free': China's real estate slump deepens

Cooling of key growth engine brings risks of debt overhang into focus

An advertisement at a condominium project in the Tongling suburbs reads: "buy one floor, get one free." (Photo by Noriyuki Doi)

2) US NASDAQ and AI boom:

Like any other Tech boom which occurred over the past 40 years, there will be only a few winners and many losers. However, the current AI and online internet hype has been lifting all boats in the Tech

sector. The valuation of the latter has thus become very expensive. This, combined with high interest rates and a few disappointments in the latest Q2 results of the megacaps FAANG, have recently caused some profit-taking in the sector. It is challenging to predict how far the current correction in the NASDAQ and Internet / Tech stocks will go.

From a fundamental investor's viewpoint, the best strategy is to do their own discounted cash flow analysis of a minimum of the next 5-10 years' sales and profits of any Tech stock they are looking to invest in or liquidate. Another alternative is to calculate the implied long-term growth rate of the stock.

To illustrate, based on a rough analysis by Motley Fool, the champion winner of the AI theme, the advanced chips designer and manufacturer, Nvidia, is trading at a very demanding valuation. Here is what they wrote in June :

"With Nvidia trading at 41 times sales, it's nearly in the same boat as Zoom was in. Although the company projects an incredible 64% growth for the second quarter of fiscal 2024, it must continue that growth far beyond this year for the valuation to make sense.

Should Nvidia achieve the analyst's average revenue estimate for fiscal 2025 (ending in January 2025) of $54.5 billion, it would still trade at 19 times sales. Should Nvidia return to peak profitability of a 35% profit margin, that would price shares at 54 times earnings -- still an expensive valuation".

Lastly, history has clearly shown that when a Tech bubble bursts, the fall is not the usual 20%, but more like 50-70%. Hence, it is critical that the investor has to know exactly what they are buying.

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

Disclaimer

For your personal use and for reference only, not to be relied upon for any investment decisions or any other purposed. Not for further distribution. Neither Goji Consulting Limited nor its representatives are licensed with the Securities and Futures Commission of Hong Kong, nor is any of them holding out as such. No investment advice is offered. No solicitation made. Whilst information stated herein is based on independent third party sources we believe to be reliable, no warranty is hereby given and no responsibility is accepted.