SUNLINE

WEALTH MANAGEMENT

July 2023

June: Risk On

In June, the market decided to dismiss a faltering manufacturing sector and disappointing economic news out of China, and switch to a hope that this would allow central banks to shift their attention to growth, and thus avoid a recession. It also focused on good news on the inflation front, a steady services sector and a rate pause at the US Federal Reserve. The US equity market rally thus broadened beyond the companies linked to the A.I. craze in May, to include industrials, airlines, home builders, cruise lines and car manufacturers As a result, the S&P 500 moved up by 6.6% over the month, on par with the Nasdaq 100. The US thus partially closed its 2023 performance gap with continental Europe, up around 4.5% for the month. On its side, Japan had another sparkling month, with the TOPIX closing 7.5% higher.

July sees the start of the publication of companies' results for the second quarter, particularly for those in the US. Closely watched will be their ability to maintain their margins, along with any update to their outlook for the next couple of quarters: in aggregate, this should also give us an indication as to the timing and depth of a potential recession. We continue to think that the US could potentially enter one towards the end of the year, albeit a shallow one.

Perhaps even more spectacular, has been the repricing of where USD rates will be one year from now. As we have been writing for two months, the expectations that the US Federal Reserve would slash rates, starting in July of this year, by about 2% over the next 12 months or so, were far too optimistic. The resultant repricing means that rates are now expected to be at 5% in a year's time, up from 3.1% in early May. It does also include another rate hike of 25 bps at the end of July, versus a first rate cut, which is not now expected until January 2024. As a result, the curve inversion between the 3 months and the 10-year US bond reached an all-time high of 2%.

In currencies, a certain stability reigned in the majors, with the USD generally weaker against most others, except for the Japanese Yen. The governor of the Bank of Japan reiterated its policy of Yield Curve Control and economic stimulus, resulting in the currency losing over 3.5% versus the USD. On its side, the Chinese Yuan lost 2% against the USD, on the back of another flow of negative economic news. Of note, is the 5% rally of the Brazilian Real: the central bank could soon cut rates, which were hiked from roughly 2% to 14%, triggering large capital flows to its bond market.

The risk on mood was also present in fixed income markets: while the benchmark Global Aggregate was absolutely flat on the month and emerging markets, in hard currency, rallied 1.5%, while high yield indices gained between 1 and 1.5%.

A note on cryptocurrencies. Despite waves of negative news, between scandals and the regulatory clampdowns, the news that Blackrock and WisdomTree, amongst others, filed to issue ETFs linked to cryptocurrencies, was enough to send Bitcoin 17% higher in a matter of days.

In commodities, crude oil, (WTI), is stuck around the 70 level, as the market contends with renewed OPEC+ production cuts, with the likelihood of a recession.

Gold, after a negative month in May, lost over 2% in June, as USD rates expectations of another rate hike in July, along with 'higher rates for longer' outlook took its toll.

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Economy

The world cannot grow without China. We discussed extensively about China's economy in our last edition. Recent data has been even more worrying, with the real risk that the country could fall into outright deflation. Thus, expectations that the Politburo, at its meeting at the end of the month, will announce strong measures to support its economy, and, in particular, address its real estate sector, have greatly increased. As a reminder, the property sector, directly and indirectly, represents close to 35% of the Chinese economy, and is a large source of funding for many provinces and municipalities.

Last month, we talked about the potential for a K-shaped recovery in the US economy. We might have some signs that this is already the case, and that the rate increases are already impacting the US population in different ways, depending on the level of income and race, increasing the risk of a monetary policy mistake:

- Whilst US unemployment remained at a low 3.6%, the Black unemployment rate jumped to 6.4% from 4.4% in April. Hispanic unemployment rose to 4.3%, from 3.6% the previous month.
- Workforce participation of people without a college education is still far below pre-pandemic levels.
- The consumer has been sustaining the US economy. We acknowledge it is just an approximation. However, in 2022, and so far in 2023, US GDP growth matches the reduction in pandemic savings. The estimated excess savings during the pandemic, due to less spending and generous cheques from Washington, stood at 10% of GDP in early 2022 (Goldman Sachs). By April 2023 it stood at 6.5%. The US economy grew 2% in 2022, and currently grows at an annualized 1.8%: it's almost a perfect match! Lower, and middle, income consumers have already spent their excess savings and are now notably utilising their credit cards again. In Europe, by comparison, the situation is totally different: excess savings are estimated at 8%, (GS), and essentially nothing has been spent in 2022.
- The US consumer will also soon suffer a further blow. Following the Supreme court decision, student loans repayment will restart: an estimated US$10 billion a month.

In Europe, as commented on last month, the bifurcation is rather in the economies: manufacturing hubs, such as Germany and the Netherlands, are contracting, while the rest of Europe is growing, led by Portugal, Spain and Italy. This bifurcation should increase. Some countries, heavily dependent on tourism, published their May data: tourism increased between 5 and 9% over 2019 levels. Looking at the number of tourists currently flooding Europe, this trend should be confirmed throughout the summer. This means that most countries will avoid a recession in 2023, while, for the Eurozone as a whole, much will depend on how dire the situation in Germany is, and whether China will manage to kickstart its economy.

Equities: Why we stick to our European Overweight versus the US

Obviously, with the recent run up in US tech stocks, the question arises as to whether we should keep our overweight position in Europe versus the US.

As we wrote last month, we believe most of the rocket fuel of the A.I. craze has probably been burned, the S&P 500 went up only because of multiple expansion, whilst, as per FactSet, earnings are expected to contract by 6.5%.

The Magnificent Seven, as the street is now nicknaming Apple, Microsoft, Alphabet, Amazon, Meta, Tesla and Nvidia, are up, as an equal-weight basket, by close to 80% year-to-date, and are responsible for 12.2% of the 15% rise in the S&P 500 this year. The Magnificent Three alone, (Apple, Microsoft and Nvidia), are responsible for 7.5% of performance contribution. Without the Seven, the forward PE would also be at around a more palatable 17 times, rather than 20 right now. But even at 17 times, the US market is still trading at an historically high premium to the European continental market, at 13 times. Usually, investors look at the STOXX 600 as a gauge for Europe. In our case it doesn't work, as we are overexposed to European equities - ex UK, Scandinavia and Switzerland (which is a particularly expensive market). All together, these regions represent 50% of the index.

By buying the US market, you are obviously also purchasing those extremely elevated valuations.

We have talked about our overweight in Europe in the past, but let's look at other reasons as to why Europe:

- Higher interest rates in the US: the US market benefited more than Europe from lower rates because of its large share of technology stocks. But stands to suffer more from a 'higher for longer' rates scenario.
- As the Silicon Valley Bank and the Credit Suisse situation have shown, because of the regulatory framework and stress tests, European banks are much more resilient than US ones.
- Corporate tax rates have actually fallen for European companies.
- Assuming China kickstarts its, and therefore the world's, economy, European companies will benefit more than US ones: almost 60% of sales are done outside of Europe, compared to just 30% of US company sales being from outside the US.
- Share buybacks in Europe greatly increased, and now stand at a multiyear high.
- Takeovers and private equity activity has also notably increased.
- In the US, the profit share of GDP and profit margins are untenably high, both politically as well as economically. We are approaching a presidential election year, and this situation, along with deeply negative real wages increasing, will likely feed both parties with ideas as to how to redistribute the wealth inequality between companies and citizens.
- As a side note: despite the core and headline inflation falling, high frequency purchases in the US, such as groceries or electricity, are still 10 - 13% higher than in January of last year. A box of corn flakes is still 20% more expensive, despite the price of corn having fallen to its early 2022 level. The situation is different in Europe, where either various governments have asked the different actors in the supply chain to 'voluntarily' cut prices, or the supermarkets themselves have voluntarily lowered the prices on essential items, in order to show 'social responsibility': the inflation rate doesn't capture that, so the real inflation figure in Europe could actually be lower than the headline figure.

Strategy

In June, we didn't make any change to our asset allocation. In view of the above comments, we will monitor carefully any announcement coming from China, and, more broadly, review our exposure to Asia and Japan. Our current allocation to Japanese equities has drifted to a slight overweight position, mostly currency hedged. Our current positioning: slightly underweight equities, overweight Europe, and Asia, and underweight the US. The partial equity protection maturing in September on European equities is now almost worthless. We are long Gold.

Shortly after the meteorological phenomenon of La Niña ended, El Niño returned, with expected excessive rains in certain regions and droughts in others. It is very likely it will put upward pressure on agricultural commodities over the next 6 to 12 months. The investment committee is looking to capitalize on that view, and at ways to implement that view in our portfolios.

Positioning

Overall Exposure

We are slightly Underweight Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged.

Equity: Underweight

We have a very sizeable Underweight in US equities and a very sizeable Overweight to Continental Europe, Neutral UK, Neutral Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Cyclical Champions, Mega Trends, Emerging Markets Healthcare.

Fixed Income: Neutral

Underweight Sovereigns, Overweight Investment Grade USD and EUR Bonds.

Thematic Fixed Income

Long High Yield in EUR , Long US Municipal Infrastructure Bonds, Long Hybrids, Long Financial Credit and Long Asian Bonds.

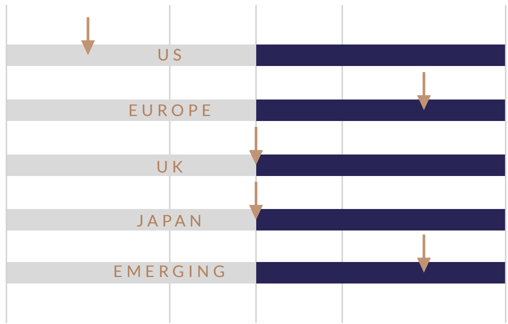
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

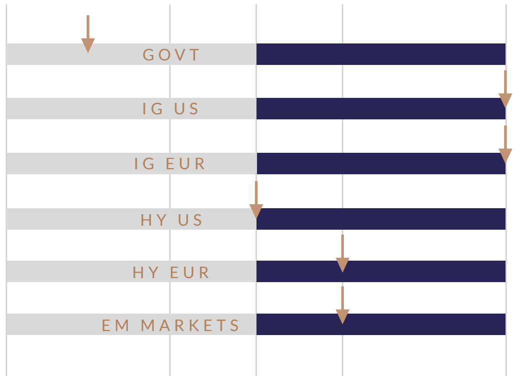
Long Gold.

Conviction thermometer

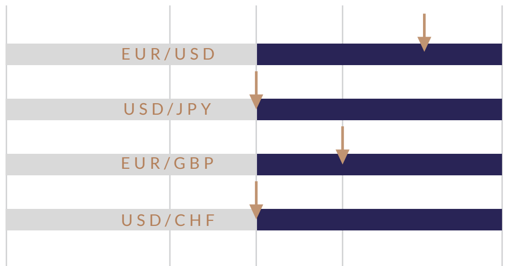
Equities



Bonds



Currencies



Commodities

Negative view Positive view

Market overview as of 30th June 2023

Equities (local ccies)	Level	5D	MTD	YTD	2022
MSCI WORLD	2 966,72	2,25%	6,09%	15,44%	-17,71%
US S&P500	4 450,38	2,36%	6,61%	16,88%	-18,13%
NASDAQ 100	15 179,21	1,94%	6,55%	39,35%	-32,38%
RUSSELL 2000	1 888,73	3,75%	8,13%	8,06%	-20,46%
EUROPE EURO STOXX 50	4 399,09	2,98%	4,35%	19,18%	-8,55%
GERMANY DAX	16 147,90	2,01%	3,09%	15,98%	-12,35%
FRANCE CAC40	7 400,06	3,31%	4,52%	17,41%	-6,71%
BELGIUM BEL20	3 543,18	0,56%	0,32%	-1,75%	-11,47%
SWISS MARKET INDEX	11 280,29	0,53%	0,58%	8,29%	-14,29%
UK FTSE100	7 531,53	0,95%	1,40%	3,11%	4,57%
JAPAN TOPIX	2 288,60	1,17%	7,54%	22,68%	-2,48%
MSCI EMERGING	989,48	-0,04%	3,83%	5,02%	-19,81%
BRAZIL IBOVESPA	118 087	-0,75%	9,00%	7,61%	4,69%
CHINA CSI 300	4 563,77	-0,22%	2,13%	0,45%	-19,83%
HS TECH	3 911,31	0,82%	7,89%	-5,03%	-26,66%
INDIA SENSEX	64 718,56	2,77%	3,58%	7,24%	5,77%
KOREA KOSPI	2 663,34	-0,22%	-0,49%	14,90%	-23,21%
HONG KONG HANG SENG	18 916,43	0,18%	4,49%	-2,76%	-12,56%
AUSTRALIA ALL-SHARE	4 096,26	1,07%	0,99%	2,50%	0,23%
SAUDI ARABIA TADAWUL	N.A.	N.A.	4,15%	11,29%	-4,96%

US: Sectors	Level	5D	MTD	YTD	2022
COMMUNICATION SVCS	216,08	0,37%	2,58%	36,24%	-39,89%
CONSUMER DISCRETIONARY	1 330,54	2,48%	12,07%	32,97%	-37,03%
CONSUMER STAPLES	778,82	0,58%	3,24%	1,28%	-0,62%
ENERGY	623,56	4,82%	6,65%	-5,55%	65,43%
FINANCIALS	561,11	2,96%	6,69%	-0,53%	-10,57%
HEALTH CARE	1 548,62	0,58%	4,36%	-1,48%	-1,95%
INDUSTRIALS	908,09	3,90%	11,29%	10,19%	-5,51%
INFORMATION TECHNOLOGY	3 085,84	2,93%	6,59%	42,77%	-28,19%
MATERIALS	521,93	4,04%	11,05%	7,74%	-12,28%
REAL ESTATE	236,67	5,14%	5,59%	3,72%	-26,21%
UTILITIES	332,80	0,69%	1,65%	-5,69%	1,56%

EUROPE: Sectors	Level	5D	MTD	YTD	2022
BASIC MATERIALS	2 761,96	2,04%	2,44%	-3,22%	-2,41%
CONSUMER GOODS	4 197,73	0,05%	0,60%	3,06%	-7,73%
CONSUMER SERVICES	1 564,89	3,23%	5,92%	25,33%	-15,22%
FINANCIALS	812,53	3,22%	4,54%	12,10%	-1,93%
HEALTH CARE	3 497,09	-0,14%	-0,77%	7,84%	-3,72%
INDUSTRIALS	3 459,14	2,34%	3,99%	19,25%	-18,88%
OIL & GAS	1 395,20	1,30%	2,47%	-1,81%	30,59%
TECHNOLOGY	1 633,45	3,65%	2,08%	28,50%	-25,49%
TELECOMS	525,79	1,99%	-2,26%	7,39%	-13,24%
UTILITIES	2 061,64	1,97%	2,81%	13,04%	-6,99%

Market overview as of 30th June 2023

Fixed Income	Level	5D	MTD	YTD	2022
Pan-Euro 3-5 yrs IG	195,01	-0,31%	-0,91%	1,20%	-11,37%
Euro Aggregate	226,55	-0,28%	-0,33%	2,25%	-17,18%
Pan-Euro HY Hedged Eur	388,71	-0,11%	0,41%	4,35%	-10,72%
Global Inflation hedged EUR	233,93	-0,24%	0,31%	0,36%	-18,94%
US Corp High Yield	2 264,90	0,83%	1,67%	5,38%	-11,19%
EM USD Aggregate TR	1 260,87	0,07%	1,49%	3,30%	-15,26%
EM Aggregate TR Local Ccy	139,19	-0,45%	0,11%	1,69%	-8,44%
EUR Banks CoCo Tier 1	129,45	0,75%	1,05%	-5,44%	-12,63%
EU GOVT HEDGED EUR	202,36	-0,28%	-0,29%	1,28%	-20,38%
Global Aggregate	2 554,99	-0,27%	-0,01%	1,43%	-16,25%

Commodities	Level	5D	MTD	YTD	2022
GOLD	1 919,35	-0,10%	-2,21%	5,23%	-3,64%
COPPER	374,10	-1,64%	2,86%	-1,82%	26,84%
OIL WTI	70,64	2,14%	3,75%	-11,99%	55,01%
OIL BRENT	74,90	1,42%	3,08%	-12,82%	50,15%

Currencies	Rate	5D	MTD	YTD	2022
EURUSD	1,09	0,14%	2,06%	1,91%	-6,93%
GBPUSD	1,27	-0,09%	2,11%	5,13%	-1,01%
USDJPY	144,31	0,42%	3,57%	10,06%	11,46%
USDCHF	0,90	-0,16%	-1,66%	-3,13%	3,13%
AUDUSD	0,67	-0,24%	2,48%	-2,19%	-5,60%
EURCHF	0,98	-0,06%	0,37%	-1,27%	-11,08%
USDCNY	7,25	0,19%	2,04%	5,15%	5,28%
USDKRW	1 318,40	1,04%	-0,60%	4,57%	4,22%
USDINR	81,43	0,01%	-0,83%	-0,84%	9,15%
USDIDR	N.A.	0,45%	0,48%	-3,26%	7,42%
USDBRL	4,79	0,07%	-5,30%	-9,43%	7,26%
USDTRY	26,01	3,08%	25,30%	39,04%	78,81%
BITCOIN	30 390,91	-1,74%	12,07%	83,31%	-64,30%

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