SUNLINE

WEALTH MANAGEMENT

August 2023

July: from recession fears to Goldilocks economy

Risk assets roared higher in July, as stronger economic growth and lower inflation prints in both Europe and the US led the markets to price a Goldilocks scenario: an economy that is neither too hot nor too cold. In the US, the subject that dominated media and economists' blogs, about an imminent recession, all but disappeared, as indicated by the San Francisco Fed daily news economic sentiment indicator.

In the Eurozone, we also had better growth and inflation numbers, despite Germany's notorious weakness. Here, as well, risks to the economic outlook are currently believed to be more balanced, despite the lack of traction from China, (see more below).

The earnings season has also been better than feared:

- In the US, 80% have beaten estimates on EPS, the best quarterly figure since the third quarter of 2021. The strongest EPS beats have been concentrated in growth sectors, while financials have lagged.
- In Europe, 58% of companies from the Stoxx 600 that published beat estimates. Overall, Earnings Per Share are contracting 5.7% year over year. However, that is primarily driven by the energy and mining sectors: Excluding them, profit growth is roughly 5%.

The result has been a rally in both equities and credit.

In US equities, the rally broadened beyond the 'Magnificent Seven' in July, as the S&P 500 equal weight slightly outperformed its 'big brother', rallying 3.5% versus 3.2%. Globally, midsized companies outperformed large capitalized companies.

The title of best monthly performance belongs to the Hang Seng TECH index: up 16%, on the heels of pinned hopes of real action to reanimate the Chinese economy after the Politburo meeting.

The rally extended to credit. As the benchmark global aggregate advanced 0.7%, to 2.1% for the year, the 'thematic' exposure in our portfolios overall added 'alpha', extending their outperformance year-to-date:

- European Investment Grade advanced 1.3% over the month and 3.5% for the year
- European High Yield also advanced 1.3%, bringing the 2023 performance to 6.1%
- Our Asian bond exposure added 0.8% on the month, bring the 2023 performance to 6%, (in USD)
- Corporate hybrids advanced 1.4%, for a 2023 result of 3.55%
- Subordinated financials added 1.4% on the month and 3.8% for the year, and our vehicle has now completely recovered from the Credit Suisse fall-out.

The US economy: another consumer shift in sight and the fiscal impulse

The US economy, but more globally the Western consumer, has been difficult to decipher post the reopening of the economies. After the spending binge on consumer goods, with the notorious supply chain issues driving prices higher, followed by the splurging in 'services', such as restaurants, Spas, travel and lodging and the explosion of the prices of such 'services', we are observing signs of 'fatigue' of paying exorbitant airline fares, and a possible return to a pre-pandemic spending pattern. In the US, airline fares plunged by 10% in July. At the same time, online platforms such as Amazon are reporting an uptick in consumer goods' orders. More normalcy ahead?

Many observers are surprised by the resiliency of the US economy, now facing the highest interest rates in 16 years. We probably must simply look at one number: fiscal spending. The various Biden's administration initiatives, Infrastructure Bill, Chips Act and Inflation Reduction Act have resulted in a monster budget deficit, and thus cash infusion into the economy, essentially crowding out the high interest rates. The United States is currently running a budget deficit of 8.5%, compared to 4.2% one year ago and pre-Covid, and the highest since the 08-09 crisis, except for the Covid crisis. In USD terms, it is on track to exceed 2.3 trillion USD this year, 1.3 trillion more than pre-Covid: it amounts to 5.2% of the 2022 GDP. Clearly this must be funded, and the market is already preparing for over 1 trillion extra-issuance by the US treasury starting in September, which is likely to flatten the US curve, as long-term yields are likely to face upside pressure, while short term yields will stay higher for longer: the market has now aligned with our view, and is now expecting the first rate cut some time during the second quarter of 2024.

China

After the hopes of decisive action by the Politburo to revive an economy that has continued to lose steam, and recently even fallen into deflation, domestic and foreign investors alike are still waiting on the sidelines, as nothing concrete has been actioned by the government. The only real action we have seen has been lowering interest rates. However, as we pointed out in the past, this is of no use if there is no demand for credit. Recent data indicate that demand for credit is now contracting for everything: from consumption to durable goods, to housing. Markets have been quick to react and undo part of the July rally in early August. Top political leaders pledged support for the troubled real estate sector and measures to boost domestic consumption, along with initiatives to stimulate private enterprises, (read here a proxy for the technology giants). But the government stopped short of handing out cash to families and offering tax breaks to businesses. Also, officials asked localities and provinces to stabilize the property market and fix the LGFV debt, (Local Government Financing Vehicle), without offering details. Instead, in the real estate sector we just had another flare up of issues with the ex-giant Evergrande. This week, we had news that government will pause publishing data on its soaring youth unemployment, which we have long highlighted as a key social issue, citing 'economic and social challenges': it will further fan fears about data transparency in the world's second-largest economy. We need more actions than words in China, and time is running out.

Clearly, we are monitoring the situation in China carefully, also thanks to our colleagues at our sister company in Singapore, who are nearer to the situation, as we do have some exposure to the country, which we didn't increase during the January hype of reopening, nor during the July rally.

Strategy

In July, we didn't make any changes 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 is slightly overweight, mostly currency hedged. Our current positioning is slightly underweight equities, overweight Europe, and Asia, and underweight the US. The partial equity protection maturing in September on European equities is now essentially worthless. We are long Gold.

As for our European equity exposure, we are currently reviewing our overweight in European equities, in light of the Chinese situation. As we highlighted in our July edition, China is only one of the factors for being long European equities. We remain convinced that China will be forced to take decisive action, in order to avoid a social meltdown. Although this is taking longer than we expected, we suspect targeted measures will be implemented. China renewing higher growth would be an extra kick for the European economy and its stocks.

On a side note, looking at the performance of the broader European STOXX 600 index is not ideal currently: 37% of the index is exposed to the UK and Switzerland, (the most expensive market in Europe). Both are widely underperforming global benchmarks.

As we highlighted recently, while we have a K-shaped economy for the US consumer, we have a K-shaped economy in Europe, with some economies doing much better than other ones, particularly Germany. We therefore have some sectors in Europe that do outperform the US broader market, such as materials or banks.

Briefly after the meteorological phenomenon of La Niña ended, El Niño returned, with expected excessive rains in certain regions and drought 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. A decision is pending.

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.

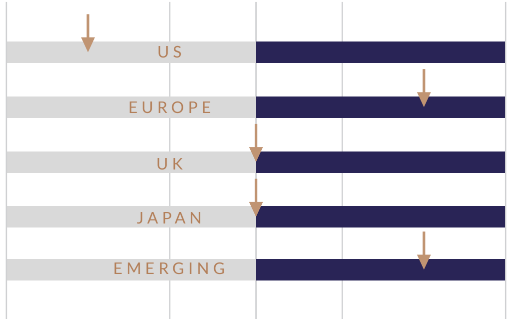
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

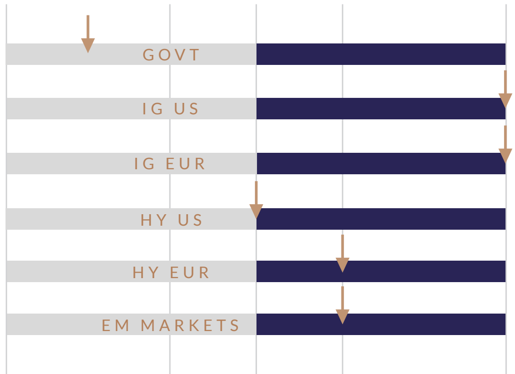
Long Gold.

Conviction thermometer

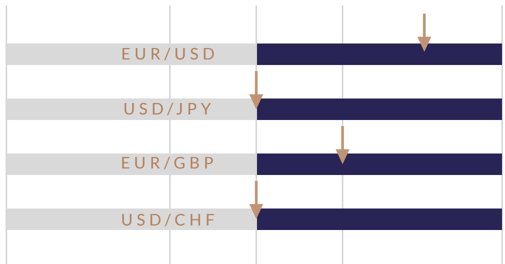
Equities



Bonds



Currencies



Commodities

Negative view   Positive view

Market overview as of 31st July 2023

Equities (local ccies)	Level	5D	MTD	YTD	2022
MSCI WORLD	3 064,30	0,91%	3,39%	19,35%	-17,71%
US S&P500	4 588,96	0,78%	3,21%	20,64%	-18,13%
NASDAQ 100	15 757,00	2,01%	3,84%	44,70%	-32,38%
RUSSELL 2000	2 003,18	1,92%	6,11%	14,67%	-20,46%
EUROPE EURO STOXX 50	4 471,31	2,01%	1,77%	21,29%	-8,55%
GERMANY DAX	16 446,83	1,58%	1,85%	18,12%	-12,35%
FRANCE CAC40	7 497,78	0,95%	1,36%	19,01%	-6,71%
BELGIUM BEL20	3 776,61	-0,29%	6,59%	4,73%	-11,47%
SWISS MARKET INDEX	11 309,25	1,18%	0,26%	8,56%	-14,29%
UK FTSE100	7 699,41	0,31%	2,35%	5,53%	4,57%
JAPAN TOPIX	2 322,56	1,82%	1,49%	24,52%	-2,48%
MSCI EMERGING	1 046,91	3,33%	6,28%	11,66%	-19,81%
BRAZIL IBOVESPA	121 943	0,50%	3,27%	11,13%	4,69%
CHINA CSI 300	4 563,77	5,57%	5,36%	5,83%	-19,83%
HS TECH	4 549,95	13,44%	16,54%	10,67%	-26,66%
INDIA SENSEX	66 527,67	0,23%	2,90%	10,34%	5,77%
KOREA KOSPI	2 663,34	0,15%	2,66%	18,27%	-23,21%
HONG KONG HANG SENG	20 078,94	7,58%	7,17%	4,22%	-12,56%
AUSTRALIA ALL-SHARE	4 198,02	0,29%	2,62%	5,19%	0,23%
SAUDI ARABIA TADAWUL	11 692,23	-0,84%	2,29%	13,85%	-4,96%

US: Sectors	Level	5D	MTD	YTD	2022
COMMUNICATION SVCS	230,64	6,32%	6,94%	45,70%	-39,89%
CONSUMER DISCRETIONARY	1 362,52	1,26%	2,44%	36,22%	-37,03%
CONSUMER STAPLES	794,32	-0,12%	2,14%	3,45%	-0,62%
ENERGY	668,98	2,09%	7,40%	1,43%	65,43%
FINANCIALS	587,50	-0,76%	4,85%	4,30%	-10,57%
HEALTH CARE	1 561,85	-1,36%	1,02%	-0,48%	-1,95%
INDUSTRIALS	934,02	0,56%	2,90%	13,38%	-5,51%
INFORMATION TECHNOLOGY	3 167,14	1,15%	2,68%	46,60%	-28,19%
MATERIALS	539,48	2,04%	3,41%	11,41%	-12,28%
REAL ESTATE	239,48	-2,07%	1,25%	5,02%	-26,21%
UTILITIES	340,62	-1,74%	2,47%	-3,36%	1,56%

EUROPE: Sectors	Level	5D	MTD	YTD	2022
BASIC MATERIALS	2 889,95	2,20%	4,63%	1,26%	-2,41%
CONSUMER GOODS	4 216,40	0,83%	0,67%	3,75%	-7,73%
CONSUMER SERVICES	1 564,38	1,73%	-0,01%	25,32%	-15,22%
FINANCIALS	846,58	1,11%	4,24%	16,86%	-1,93%
HEALTH CARE	3 558,02	1,00%	1,75%	9,73%	-3,72%
INDUSTRIALS	3 534,08	1,47%	2,21%	21,89%	-18,88%
OIL & GAS	1 441,94	-1,04%	3,46%	1,58%	30,59%
TECHNOLOGY	1 626,88	4,26%	-0,35%	28,04%	-25,49%
TELECOMS	520,34	-0,77%	-0,85%	6,47%	-13,24%
UTILITIES	2 022,80	-1,15%	-0,69%	12,27%	-6,99%

Market overview as of 31st July 2023

Fixed Income	Level	5D	MTD	YTD	2022
Pan-Euro 3-5 yrs IG	196,92	0,14%	0,98%	2,19%	-11,37%
Euro Aggregate	226,93	-0,23%	0,17%	2,42%	-17,18%
Pan-Euro HY Hedged Eur	393,49	0,40%	1,23%	5,63%	-10,72%
Global Inflation hedged EUR	233,72	-0,32%	-0,09%	0,27%	-18,94%
US Corp High Yield	2 264,90	0,21%	1,38%	6,83%	-11,19%
EM USD Aggregate TR	1 260,87	0,43%	1,18%	4,52%	-15,26%
EM Aggregate TR Local Ccy	142,57	0,37%	2,43%	4,17%	-8,44%
EUR Banks CoCo Tier 1	134,03	1,15%	3,54%	-2,09%	-12,63%
EU GOVT HEDGED EUR	202,43	-0,37%	0,03%	1,31%	-20,38%
Global Aggregate	2 554,99	-0,36%	0,69%	2,13%	-16,25%

Commodities	Level	5D	MTD	YTD	2022
GOLD	1 965,09	0,53%	2,38%	7,73%	-3,64%
COPPER	400,80	4,36%	7,14%	5,18%	26,84%
OIL WTI	81,80	3,89%	15,80%	1,92%	55,01%
OIL BRENT	85,56	3,41%	14,23%	-0,41%	50,15%

Currencies	Rate	5D	MTD	YTD	2022
EURUSD	1,0997	-0,61%	0,81%	2,73%	-6,93%
GBPUSD	1,2835	0,05%	1,04%	6,22%	-1,01%
USDJPY	142,2900	0,57%	-1,40%	8,52%	11,46%
USDCHF	0,8719	0,25%	-2,65%	-5,69%	3,13%
AUDUSD	0,6717	-0,33%	0,80%	-1,41%	-5,60%
EURCHF	0,9588	-0,36%	-1,86%	-3,11%	-11,08%
USDCNY	6,4583	-0,34%	-1,53%	3,54%	5,28%
USDKRW	1 106,85	-0,42%	-3,31%	1,11%	4,22%
USDINR	82,2525	0,52%	0,26%	-0,58%	9,13%
USDIDR	15 080,00	0,35%	0,09%	-3,17%	7,42%
USDBRL	4,7269	-0,06%	-1,27%	-10,58%	7,26%
USDTRY	26,9327	-0,11%	3,53%	43,95%	78,81%
BITCOIN	29 206,80	0,21%	-3,90%	76,17%	-64,30%