INVESTMENT COMMENT June 2023

- **Are The Bulls Back Or Is It Just a Trap?**

The S&P 500 is trading 20% above its recent lows last autumn. Even though this brought back some optimism, the rally that started last October was powered by out-sized gains of a few companies (Big Tech, Tesla, Nvidia) and the AI story. It was not broad-based.

Fed Chair Powell also hinted at continued rate hikes later this year despite having left rates unchanged in June – the first time after 10 continuous rate hikes in the last 15 months. Given favorable inflation numbers recently (May CPI down to 4%), the Fed is in less of a hurry. Important indicators to look out for are the softening of the labor market and the cost of housing.

The U.S. is ahead of Europe in this regard. After the initial euphoria over lower energy prices this past winter, Europe is still seeing persistently high inflation and is poised for more rate hikes in the coming months.

- **It Is Time To Rethink The Equity Allocation**

In May, 49% of professional asset managers had a lower-than-usual exposure to equities. Currently, they are most overweight in bonds since the global financial crisis 15 years ago. Assets held in money market funds – an alternative to cash – reached the highest levels in history, exceeding USD 5.5 trillion. However, equity markets do not peak when so much cash is waiting on the sidelines. Markets top when everyone is overweight equities, which is not the case today.

- **Japanese Equities Are Still a Buy**

The Nikkei index is up almost 30% year-to-date reaching its highest level since the early 1990's. Shareholder-friendly corporate governance reforms, record high share buybacks and dividends combined with attractive valuations, strong balance sheets and cash levels as well as the return of inflation could push the index over its 34-year old high. Given that global investors have been underweight Japanese equities since 2005, the rally still has legs. To get back to its all-time high set in December 1989, the Nikkei needs to appreciate another 17%.

- **China Remaining In The Doldrums**

After a spike in optimism in Q4/2022 when China announced it will lift its restrictive Covid-19 measures in early 2023, the Chinese markets have cooled down markedly. The only sector that continued to recover is domestic tourism. Youth unemployment remains stubbornly high at 20%+. Another class of 11 million graduates will be entering the job market this summer. Besides, both the most recent CPI and PPI numbers indicated minor declines. Another problem is the fledgling real estate market. While completions of real estate projects are picking up thanks to government support, new projects are nearly 60% below pre-Covid levels. The policy rate was recently cut by 10bps, the first time since August 2022, a reflection of the leadership's willingness to support the economy.

- **Asset Allocation**

We are moving equities to neutral (from underweight) and continue to hold predominantly short duration fixed income. Due to *higher rates for longer*, we see gold stuck in a sideways channel, but expect it to test new highs once the rate hiking cycle ends. Going into the traditionally slower summer months, we remain on the more cautious side.