GLOBAL EQUITY PERSPECTIVES 3 APRIL 2023

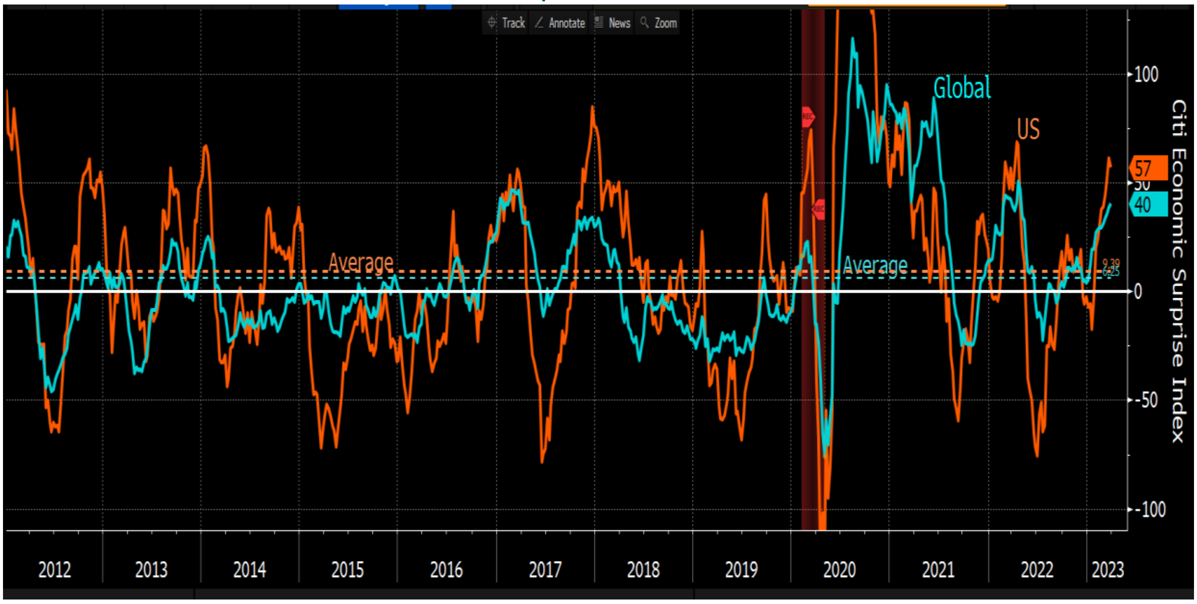
"If you don't have time to do it right, when will you have time to do it over?"

John Robert Wooden

1. ECONOMIC OUTLOOK

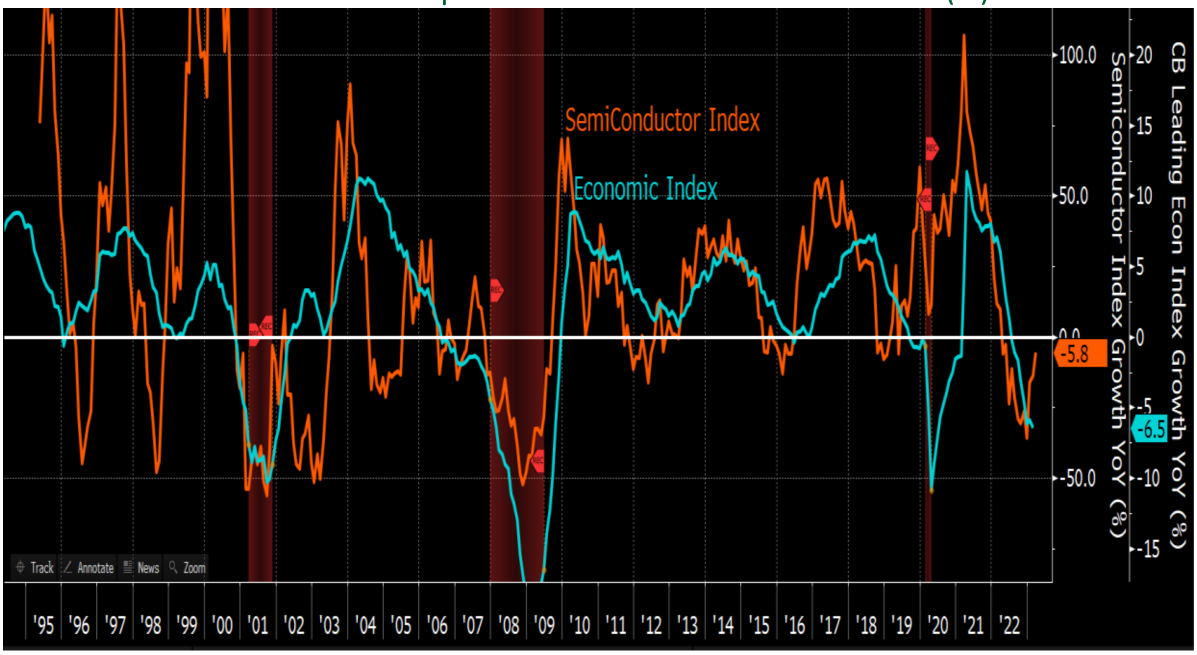
As we have written before, the possible upcoming US recession is by far the most anticipated one (should it materialize).

Citi Economic Surprise Index – US vs Global



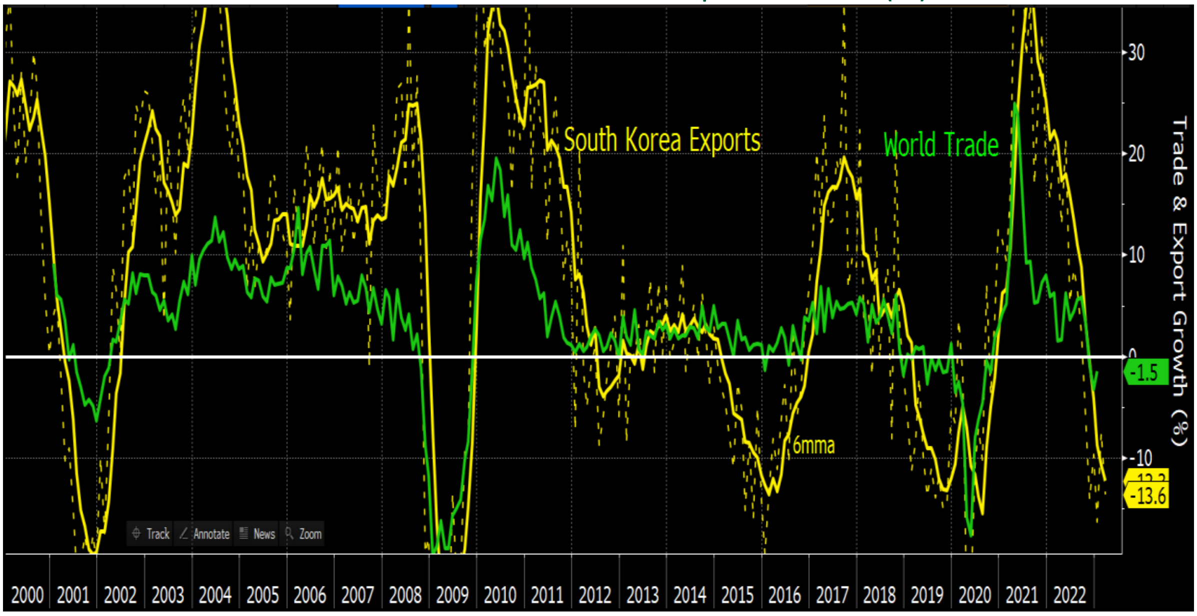
The above chart reflects US and Global Economic Surprise Indices against general expectations. Whilst off a low base, both indices are currently well above average, indicating how low expectations are, and that economies are in a better state than expected.

US – Philadelphia Semiconductor index vs Conference Board Leading Economic Index vs Philadelphia Semi-Conductor Index Growth (%)



The US Leading Economic Index in the preceding chart is currently in deep negative territory, having warned of an upcoming recession nine months ago. Historically, the Semiconductor Index in the chart led the Economic Index by a few months, and has recently turned for the better. On this basis, investors can expect the Economic Index to stabilize in the not-too-distant future.

World Trade vs South Korea Export Growth (%)



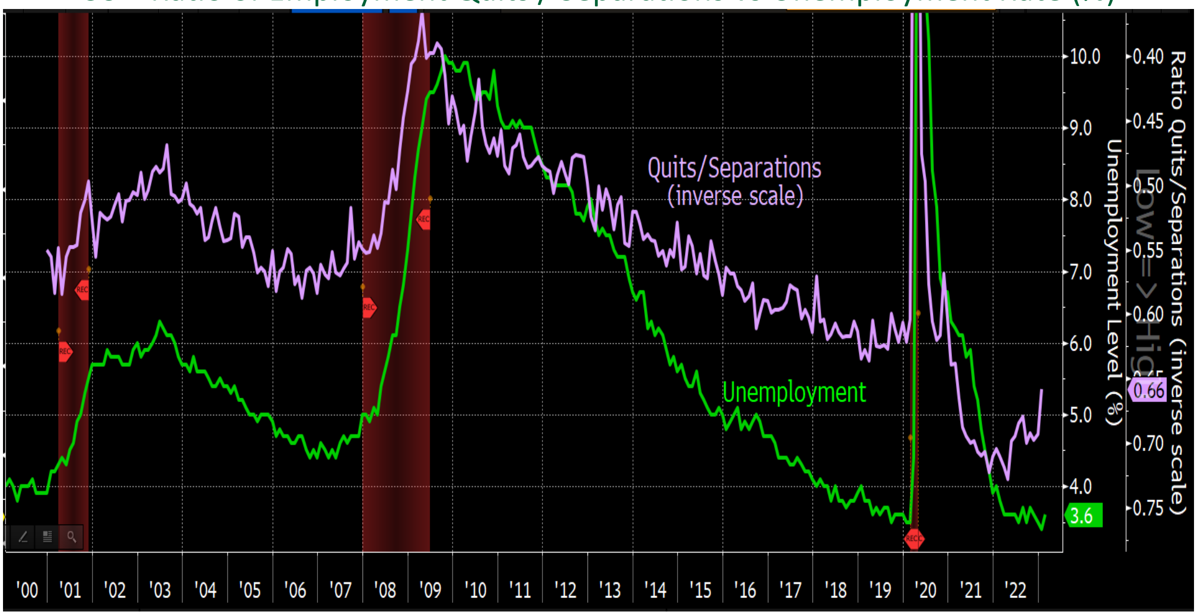
Because of the nature of South Korea's exports, it often leads world trade data. Their exports have shrunk to very low levels, while world trade is holding up relatively well. With China's economy reopening on their doorstep currently, we may not be overly surprised to see both indices stabilizing in the not too distant future.

All-in-all, signs are that the world economy is in a not overly concerning state and that investors have reason to stay positively tuned.

2. US EMPLOYMENT

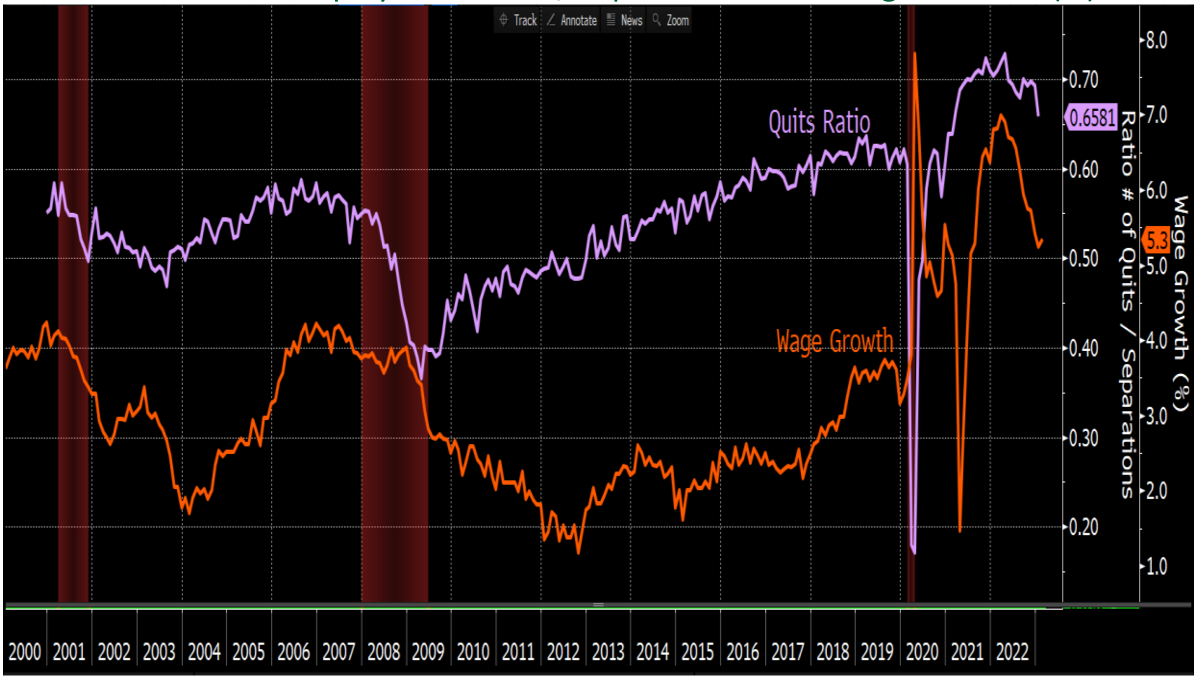
The Federal Reserve (Fed) dearly wants the US unemployment rate to be higher to contain wage growth and inflation. Whilst new employment numbers remain high, signs are that it may indeed start to rise:

US – Ratio of Employment Quits / Separations vs Unemployment Rate (%)



The ratio of employment quits against all separations (on an inverse scale in the preceding chart) is at a high level (two thirds), but the ratio has been dropping for a while. This is an indication that unemployment levels can turn higher off a historic low level.

US – Ratio of Employment Quits / Separations vs All Wages Growth (%)



The above chart reflects the same Quits Ratio, but along with wage growth this time. Logically, the former has historically led the latter. This is again in process of turning currently. Along with this, with the large layoffs happening in Silicon Valley, chances are that wage growth has more downside than upside potential from here, supporting the Fed in their task to contain inflation.

3. INTEREST RATES

The current mini banking crisis had an important side-effect of lowering US interest rates (over one percent on the shorter end).

US – 2- & 10-Year Treasury Yield and Yield Curve (%)

Whilst the banking issues tighten lending standards and may negatively affect economic activity, the lower yields can offset some of those effects. Furthermore, the yield curve (whilst still in inverted territory) steepened sharply from an extreme -1.08% level to -0.57% currently. This combination of lower rates and a steepening curve, along with lower inflation, supports investor sentiment and equity valuations.

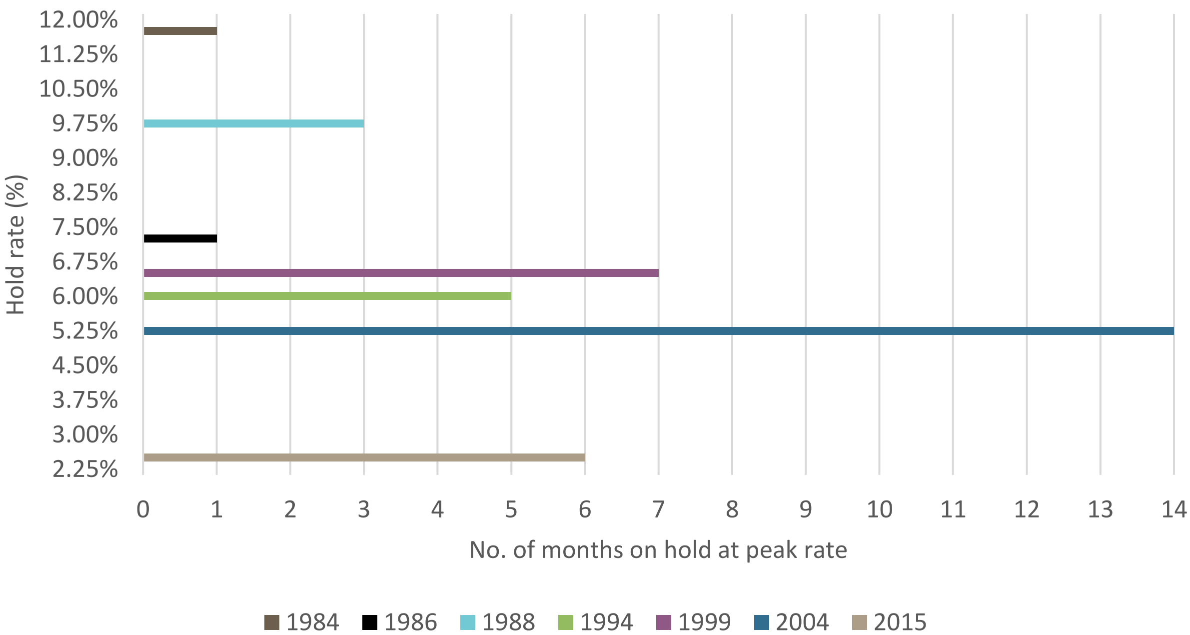
4. FED TASK

Investors are sensitive to further Fed actions during their current tightening task.

US – Fed Target Rate vs 2-Year Treasury Yield (%)

The preceding chart depicts their target rate along with the Treasury Yield, with the spread between the two (the bottom section of the chart). Historically, the Fed stopped tightening when the spread dropped into negative territory. It is currently already in quite deep negative territory.

Number of Months Fed Kept Peak Target Rate on Hold



The target rate, currently at 5.0%, is close to its peak 2004 level of 5.25%. At that time the Fed held it at that level for 14 months with the economy growing between two and three percent, and inflation hovering between three and four percent. We currently have materially reverse situations on both sides (much weaker economic circumstances and double inflation), which complicates the Fed's options materially.

US – Fed Funds Target Rate vs December 2023 Futures Rate (%)

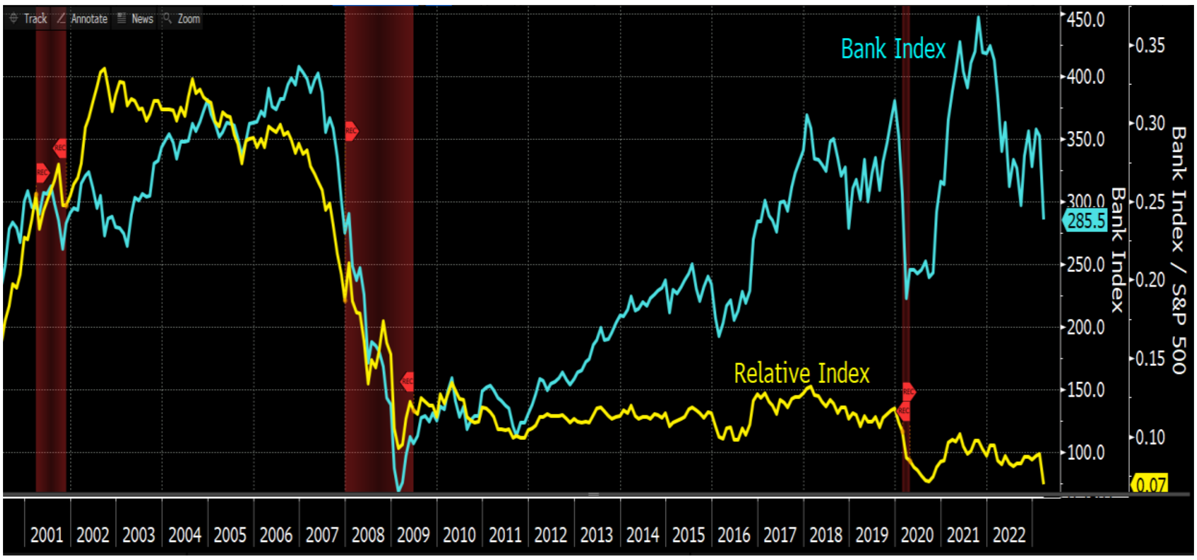
The above chart reflects market expectations of the target rate at the end of this year, clearly expecting the Fed to cut rates in the course of the year. We are of the opinion that the Fed will rather bide their time (with a possibility of actually raising another 0.25%). There may therefore be some negative market surprises on their way in this context.

All said, the Fed has been in the process of building a solid target rate level and can be in a good position to stimulate the US economy through rate cuts when necessary. The debate has solidly moved on to when the stimulation may start rather than damage the Fed may further cause.

5. BANK SIGNALS

We do not invest in banks. We believe they do not always manage or even understand their 'inventory' well - specifically bonds and derivative products - and have material risks of substantial losses. This has been our view for a long time. We feel we have been vindicated again in this context.

S&P Bank Index in Absolute and Relative Terms



The S&P Bank Index took 15 years to recover from its pre–Credit Crisis peak level. It has since lost -36% in absolute terms (the blue line in the above chart). It is currently at a record low on a relative level (the yellow line) - even lower than during the Credit Crisis. This is clearly not fertile ground for a quality equity mandate.

US – Banking TED Spread (%)

Clearly the banking sector, nevertheless, provides a wealth of information that can be utilized in investment decision making. The Interbank Lending Rate is a good indication of potential risks in the sector. The TED Spread (the difference between the Interbank Lending Rate and the associated maturity Treasury Yield) refines that risk even more precisely.

The Spread has recently (with the SVB disintegration) risen sharply, but not beyond its post-Credit Crisis levels and not remotely to the 2007/08 levels. It has since dropped from 0.63% to 0.54% - a welcome sign that the current banking crisis is not worsening.

US – Banking TED Spread (%) vs S&P 500

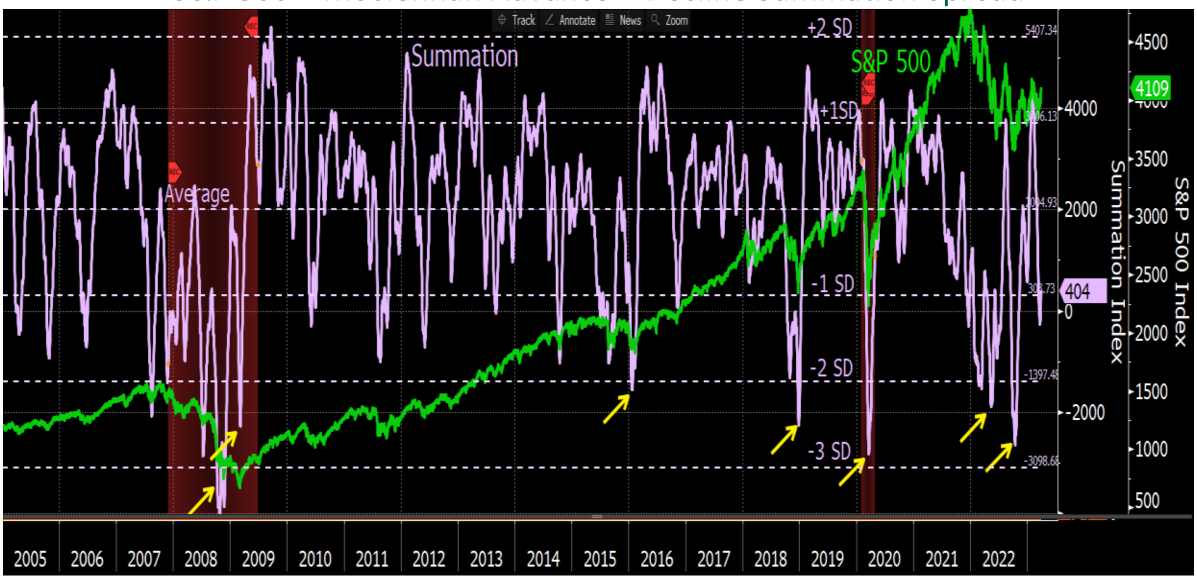
The above chart reflects the TED Spread (on an inverse scale) along with the S&P 500 Index. There is a clear (negative) correlation between the two series, and the S&P 500 has followed the recent drop in the Spread Index. We will keep following the TED Spread closely.

6. TECHNICAL PICTURE

S&P 500 – Price Index vs Moving Averages

The S&P 500 is currently in a healthy technical position – it remains above its Fibonacci level, it is above both its 50- and 200-day moving averages (the former is in a rising trend, the latter stable), and the recent Golden Cross remains intact.

S&P 500 – McClennan Advance – Decline Summation Spread



The above Summation Spread had an excellent Buy call in October last year (the arrow). It is currently at a -1 standard deviation level. It, therefore, remains more in Buying than in Selling territory.

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