Elgin asset management

investment commentary monthly

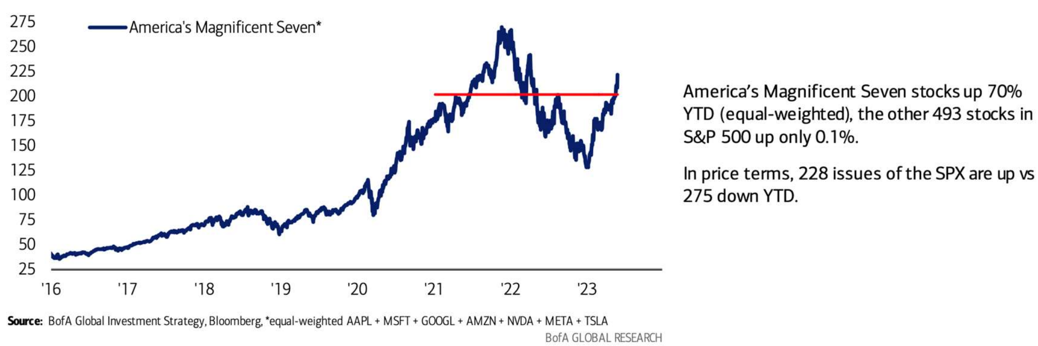
Monthly Commentary 6th June 2023

May was a truly bifurcated market, especially in US equities. While the S&P 500 was largely flat, the Dow Jones Industrial Average was down 2% and the Nasdaq rose 6%. Likewise, the FTSE 100 was down 5.4% while the Nikkei 225 in Japan was up 7%. Such moves were not limited to the equity market. UK Gilts were hammered and fell almost 4% but other government bonds fell only modestly. The USD was up a very strong 2.6%, with EUR taking the brunt of that by falling 3%. Crude oil tanked by 11% and contributed to a 5.3% drop in the broad commodity index, while Bitcoin fell 7%.

So, what is the market telling us?

Very mixed signals indeed. This is not surprising as globally services continue to grow at a healthy clip while manufacturing is hurting.

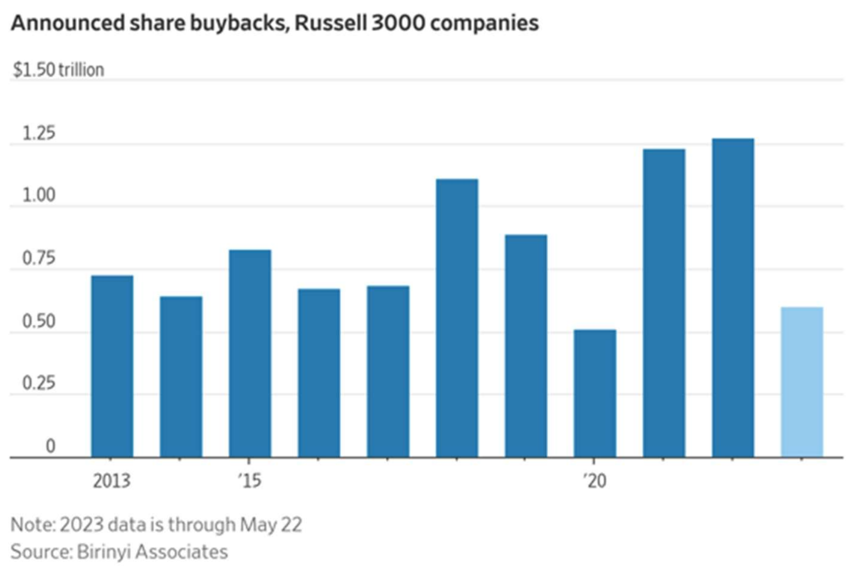
For equities in particular, it is Artificial Intelligence euphoria that has propelled what the markets believe to be the main beneficiaries – a few large tech stocks including Microsoft, Alphabet, Nvidia Apple, Amazon and Meta. In fact the following chart from Bank of America shows quite clearly that only 7 companies in the S&P 500 accounted for 97% of all the gains in the index so far this year.



When breadth is so narrow, it cannot be too healthy for the markets in general. An equally amazing statistic is that in May, the 10 largest companies in the S&P 500 gained 8.9% on average, while the remaining 490 lost 4.3% (according to the Bespoke Investment Group). In fact, Hedge funds and other speculative investors have built up a big bet that the S&P 500 will decline, **marking their most bearish positioning since 2007.** Of course, this does not mean they are right.

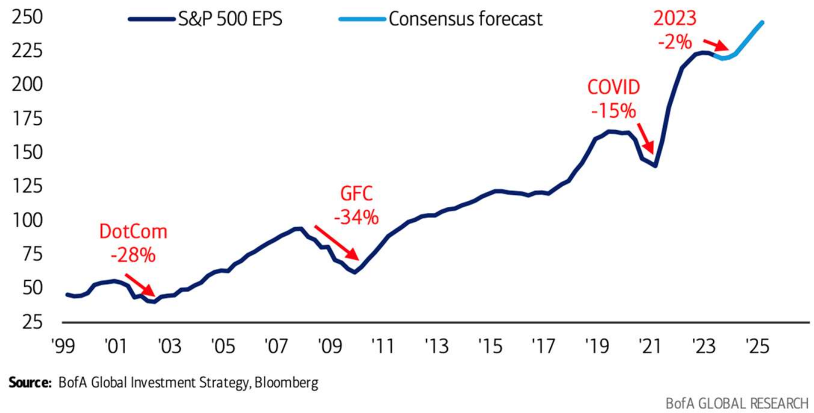
On the other hand, despite the negative sentiment there are reasons to be bullish. For example, mergers and acquisitions were very strong in April, with the value reaching $290B in the US alone. See graph on the next page. This indicates that companies' management feel that there is value out there.

Another bullish development is that year-to-date, announced share buybacks by corporations have been on course to surpass last year's record $1.25 trillion. Again, an indication there is value out there, and in the least, it is shareholder friendly.



Additionally, in May the US economy created a very healthy number of new jobs (339,000), while at the same time wage growth moderated. This is a Goldilocks scenario that shows a robust economy but not that "hot" to spur further gains in inflation. As a result, it will probably prevent the Federal Reserve from raising rates this month.

And one should always keep in mind the big picture. That is, earnings growth is the biggest driver of equity returns, and despite major setbacks in the last 25 years, the chart on the next page shows a clear trend. After all, corporations are in the business of growing their profits every year. This can only be good for markets.



In the end, it is certainly a very difficult environment to navigate for all investors. We shall stick to what we control. That is, investing in high quality.

The Elgin Analysts Team

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