Monthly Commentary 3rd July 2023

June was very strong for global stocks, with the MSCI World Index gaining 5.28%. The Nikkei 225 and the S&P 500 index were the biggest contributors as they were up 7.45% and 6.47% respectively. UK equities were the "laggards", up only 1%, and continued their anemic performance for the year. Global bonds were marginally lower as they are concerned about further policy tightening. In currencies, the USD Index which measures the USD vs a basket of currencies was down by 1.36%. Commodities as measured by the CRY Index was higher by 3.21% helped by crude oil while gold was among the laggards, down 2.21%. Finally, bitcoin continued its wild ride with a gain of 12.82% and a YTD gain of 84.97%!

The end of June marks the end of the first half of 2023. US Equities performed much better than most strategists had expected. This is largely due to the "magnificent seven". These 7 stocks accounted for 90% of the gains of the S&P500 this year (as of June 20). In technical terms we call this "bad breadth" as participation in the rally was not broad.

Bad breadth is often cited as sign of a weak market, but history shows that this has often been the case, and markets do not seem to suffer consequently as the participation often becomes broader.

At the same time, there are a lot of investors sitting on the sidelines, waiting for the right moment to re-enter the market. Barron's reported that Bank of America's survey of asset managers found that the average asset manager has about 6 percent of their portfolio in cash right now, up from 4 percent at the end of 2021. This is historically a high number, so this cash can propel equities higher.

Big tech stocks could be heading for long-term gains even if they take a breather. The reason? Fundamentals have been improving in the top line (i.e. sales/revenue) and bottom line (i.e. cost-cutting to enhance profitability).

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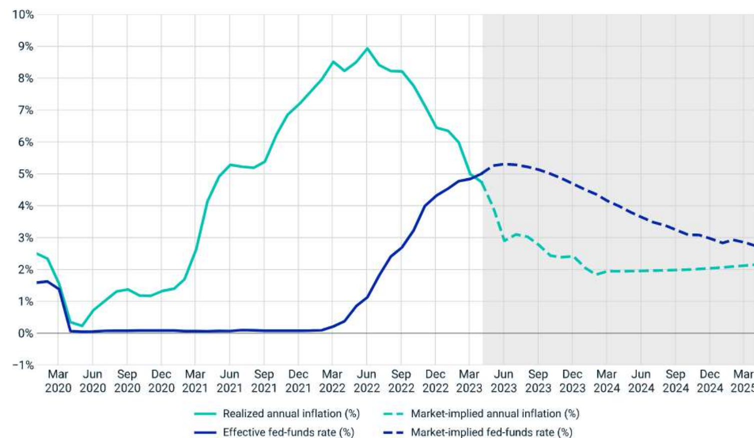
Growth rotation is also part of the story. The banking sector stress was a catalyst to move away from value stocks and back into growth stocks. Analysts expect double-digit earnings per share annualized growth for the group for the next several years for most of these big 7, thus justifying their high valuations.

It is good to report that 5 of the 7 companies feature prominently in Elgin's Best Ideas portfolios.

Today, markets are expecting the economy to bottom soon. The remaining impacts of higher rates are still working their way through the economy. For the moment the scenario that everybody wishes for or at least the one that policymakers are targeting, is a soft landing where interest rates remain high as inflation comes down in line with the Fed's expectation. Economic growth in the U.S. and eurozone is expected to weaken but to remain slightly positive. See below chart.



Market-implied expectations for the federal-funds rate and U.S. inflation are derived from the MSCI USD overnight-index-spread curve and MSCI USD breakeven-inflation curve, respectively. Data as of May 3, 2023.

Although this might not be played out as expected, other scenarios such as a hard landing or mild stagflation are also in the scenarios but less likely. As portfolio managers we are prepared for all scenarios through diversification and selection of quality stocks. Quality companies that can maintain their pricing power and profit margins in a macro environment of slowing inflation and growth are a good bet. On the fixed income side, US Treasuries and UK Gilts together with term deposits in the US and the UK offer an attractive tactical option within portfolios for the next 6 to 12 months. All the above together with our disciplined risk management approach will help us navigate through the next coming months.

The Elgin Team

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