The Way We See It

February 2024
Issue 26

Goji Consulting Limited

enquiry@goji-consulting.com

INSIDE THIS ISSUE

How long can investors fight the Fed ?

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments
- Global Economies

On growth dynamics, recently-released data continued to show significant growth divergences amongst key economies.

Again, on the relatively stronger side of the ledger, the recent Q4 2023 GDP data shows that the U.S. economy is in “rude health”, growing by a very strong 3.1% in 2023. Both households and government spending were robust. Capital expenditures also showed signs of picking up.

On the relatively weaker end of the growth spectrum, while the latest economic indicators of Eurozone and China continued to confirm a sluggish trend, at least it appears that the Eurozone has succeeded in avoiding another negative growth outcome in the latest Q4. In the case of China, thanks to a number of expansionary measures implemented by the government, the latest Q4 GDP showed that its domestic economy is stabilising.

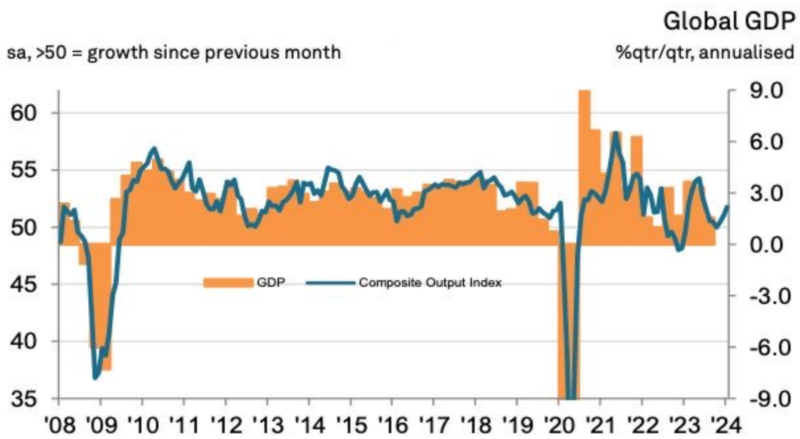
On the inflation front, thanks to the significant fall in energy prices (which we all know is volatile, caused by the uncertainties surrounding the supply from the OPEC bloc), the headline inflation trend continued to improve. Core inflation indicators also decelerated. In spite of this, central bankers in the OECD bloc remain wary about the volatility of energy prices and that the year-on-year core inflation rate remained somewhat too high relative to their 2% annual targets. Thus they are reluctant to cut rates in the short-term.

3 rate cuts starting in H2 2024.

The key message from the Fed, following its recent January FOMC meeting (in which rates remain on hold for a consecutive fourth month), emphasised the need to keep rates high for a while longer. This is based on their thinking that the road to achieving an annual 2% core inflation rate remains uncertain. Having said that, the Fed's Board appears be in unison on the scope for cutting rates 3 times, starting in H2. In the month of January, all other major OECD central banks remain on hold.

Finally, global geopolitical risks remain high: Russia and Ukraine, Gaza and Israel, plus geopolitical and trade tensions beyond semiconductor chips between the U.S. and its partners, against China.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global Market Intelligence

- Global Markets

The month of January saw some early profit-taking and stop-loss selling, but investors saw this as an opportunity to add to equities, particularly as corporate results released in the U.S. beat expectations and investors continued to hang on to hopes of 6 rate cuts. Many technology-related equity indices in the US and in the Developed Markets' universe closed the month at all-time high prices.

January saw some early profit-taking and stop-loss selling.

Once again, it was reported that both fundamental and quant-driven investors were moderate buyers of stocks. The former were positively motivated by the better-than-expected fall in all inflation indicators, as well as prospects of the Fed and other G20 countries to cut rates this year. The second type of buyers of the rally were driven by the positive momentum of rising prices, and falling volatility. This trend was established since early November to date.

Near-term performance of various asset classes

as at 31/1/2024

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	1.56%	1.22%	-4.63%
3 months	16.37%	16.24%	7.08%
YTD	1.56%	1.22%	-4.63%
FY 2023	27.10%	24.42%	10.27%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	-0.17%	-0.28%	-0.27%
3 months	10.38%	6.65%	8.23%
YTD	-0.17%	-0.28%	-0.27%
FY 2023	8.52%	4.05%	5.53%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	-1.87%	-1.38%	3.25%
3 months	7.41%	7.90%	-3.11%
YTD	-1.87%	-1.38%	3.25%
FY 2023	4.18%	5.71%	-5.01%

Asset Class	Asia ex Japan Equities	China Offshore	China A
Index	MSCI AC AxJ	MSCI China	MSCI China A Onshore
1 month	-5.44%	-10.61%	-10.14%
3 months	4.72%	-10.56%	-10.22%
YTD	-5.44%	-10.61%	-10.14%
FY 2023	6.34%	-11.04%	-11.46%

Source: GOJI, MSCI, Bloomberg

In other words, the Goldilocks soft-landing backdrop leads investors to either cover shorts and/or to start reducing their pile of cash in to re-invest in equity markets.

Within the global equity universe, other markets' performances, in USD terms, were negative to mixed. Again, the HK/Chinese and the rest of the Asian bloc performed more poorly. Investors were disappointed with the continuing poor growth in Chinese exports and domestic growth, as well as continuing debt issues in its property sector.

Equities: HK/China & rest of Asian bloc performed poorly.

Delayed expectations of early rate cuts in the U.S. in this month strengthened the US Dollar.

Bond markets, which have performed well in Q4 last year, encountered some resistance when the 10-year bond yield fell to 3.80% p.a.. They have since rose back up to above 4% p.a.

The Commodities complex rose modestly, helped by a slight bounce in energy prices. Gold was relatively stable.

The Crypto complex performed very strongly, ahead of a number of ETFs being launched soon.

In terms of equities investment flows and positioning, both are rising. At the end of January, both types of investors were reported to be moderately overweight.

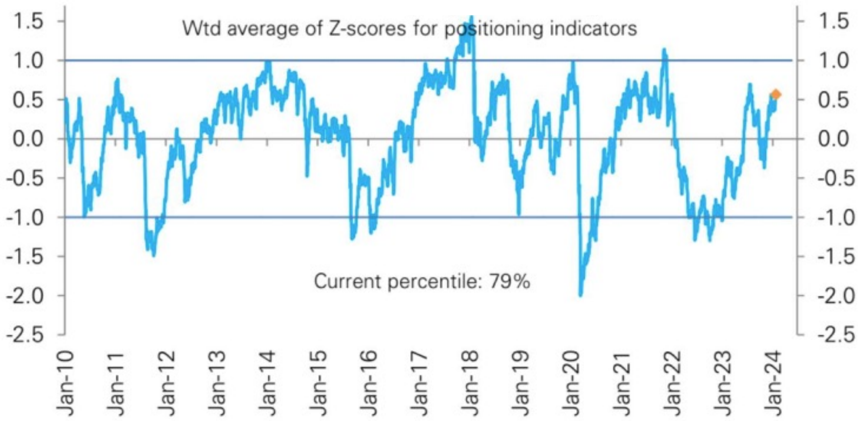
Market Outlook

The majority of investors (both fundamental and systematics) already appear to bullishly positioned for the continuation of a rally in G7 equities and bonds in 2024. Having said that, they can certainly buy quite a bit more in the future under the right circumstances, as their bullish positioning hasn't yet reached historical peaks. The enclosed chart (overpage) illustrates the above points.

Majority of investors still have room to buy more.

Their bullishness is based, firstly, on the soft landing economic scenario (slowing growth and falling inflation); secondly, corporate earnings recovery; and finally, the commencement of the monetary easing phase in the U.S. and other developed nations.

Consolidated Equity Positioning



*Weights based on explanatory power in regression of equity performance on indicators

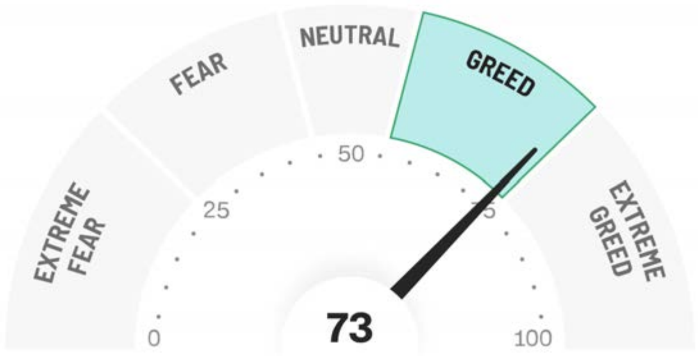
Source: Deutsche Bank Asset Allocation

Discretionary vs Systematic Equity Positioning

*Wtd average of Z-scores for positioning indicators, weights based on explanatory power in regression of equity performance on indicators

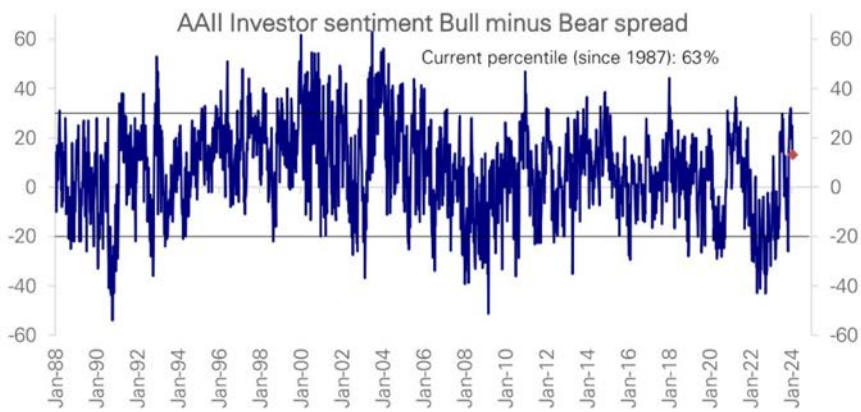
Consequently, both institutional and retail fundamental investors' risk appetite has been increasing significantly, thus pushing the CNN Fear and Greed index to "Greed / Extreme Greed" levels. The strong positive momentum in equity and bond markets has encouraged both fundamentally- and quant-driven investors to take risk and buy aggressively. The fear of making losses has been played down significantly.

Fear & Greed Index
- What emotion is driving the market now?



Source: CNN Business
Last update Feb 6 at 8:00:00 PM ET

Investor Sentiment
- Investor bull minus bear spread



Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

Strong momentum has encouraged way more Greed.

As outlined in our report last month, GOJI's own fundamental research continues to point to a scenario where growth is expected to be stronger in H1, and that inflation may make a surprise return. Hence, we only expect a modest easing of monetary policy of the U.S. Fed towards the end of the year. The European Central Bank, the ECB, is most likely to cut rates first, since its economy is so much weaker than that of the U.S.

GOJI: inflation may make a surprise return; expect modest easing towards y/e.

As a result, our view is more prudent in the next few months. In summary, we believe that there is a better entry point for risk asset set buyers.

The Way We See It
- Global Markets and Investment Thematics

As we discussed previously, to be a contrarian investor, i.e. adopting a more prudent investment stance at present, is definitely not a popular thing to do. Again, we, at GOJI, wish to stress that we do not propose a different view to the market consensus just for the sake of being contrarian.

As outlined in our Global Investment Outlook for 2024 and in the two sections above, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and and are prepare to pay up for a best case scenario of slowing but not recessionary growth, falling inflation and lower interest rates. A Goldilocks scenario.

GOJI: stay modestly u/w in risky assets; o/w cash & low-beta quality assets.

As a result, based on our perspective of stronger than consensus growth, more sticky inflation and interest rates, plus an overvalued US equity market, our strategy recommends to stay modestly underweight risky assets and overweight cash and low-beta quality assets.

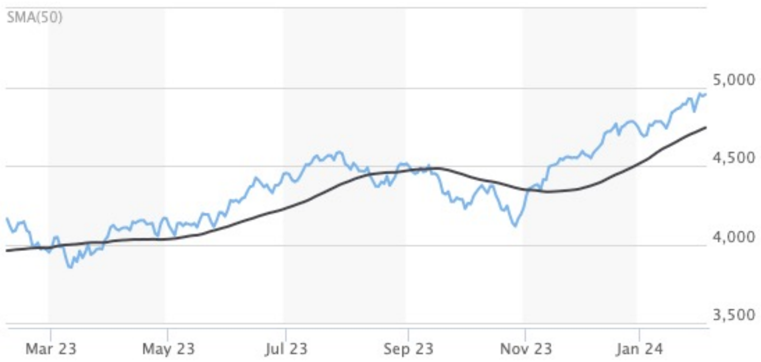
We would also suggest to build a modest exposure to commodities. Lastly, we think that the U.S. Dollar will continue to rebound in coming months against most liquid currencies.

Short-term Technical Analysis

After some early profit taking in the month of January, the wave of buying re-emerged, inspired by the Goldilocks scenario (depicted by hopes of falling inflation hence interest rate cuts, plus solid economic and earnings growth).

At the time of writing, US equity indices, led by Technology, recorded all time highs. Commentators in the financial social media labelled this positive technical development the start of a new bull market.

S&P 500 Stock Price Index



Source: MarketWatch.com

S&P 500 Index – 10 Year Historical Chart (log-scale)

Source: Macrotrends

New bull market vs Double top formation.

The above long-term chart of the SPX Index, plotted in log terms, shows that the market's rise has been dramatic. However, one should be somewhat wary about the double top formation at around the 4900 – 5000 index price levels.

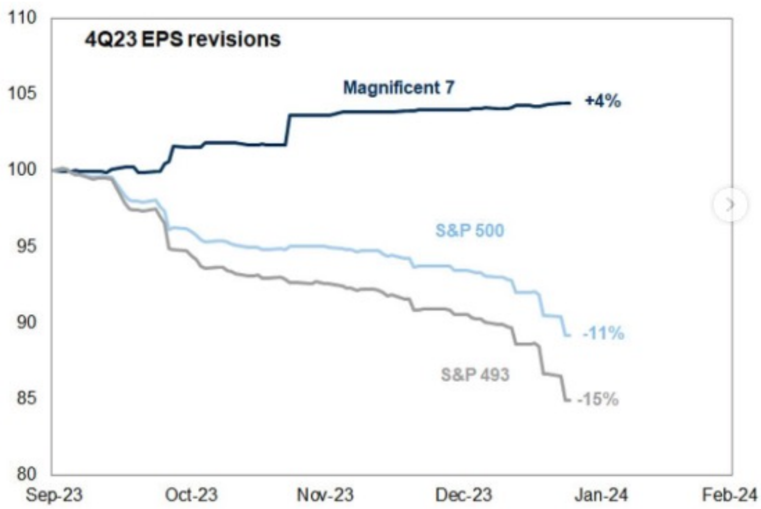
As outlined earlier in our report, we believe it's more to do with crowd FOMO buying, rather than one which is based on a positive change in fundamentals. If we are right, then we could see a few more new historical highs on key tech-orientated US equity indices. However, they may not last.

In other words, despite the semblance of a sustainable strong rally, we feel that the markets will revert back to fundamentals at some stage. This would then mean a correction, the size of which depends on how high and how euphoric the equity indices are.

Hence, our recommendation to long-term investors is not to chase this short-term rally. For those who can act based on short-term trends, some profit taking of expensive names would be a sensible tactic.

GOJI: LT investors not to chase ST rally.

EPS Revisions: Magnificent 7 Up, Rest of S&P 500 Down



Source: Instagram @market.radar

The chart above shows how the U.S. stockmarket, in general, continued to suffer from slowing sales and a narrowing of profit margins. On the other hand, the Magnificent 7, including ex-members of the celebrated FAANG, continued their upward march, boosted by the AI investment as well as recent cost cutting measures (p.s. it's ironic to think for one second that, in the Magnificent 7 movie, which inspired the creation of the Magnificent 7 mega-tech stocks, it ended with the disappearance of four members. In other words, only three of the seven survived).

Amusingly, which ones of the 7 Magnificent mega-stocks will survive in 10 years' time ?

GOJI CONSULTING LIMITED

Level 34, Tower One, Times Square
1 Matheson Street, Causeway Bay, Hong Kong

www.goji-consulting.com

enquiry@goji-consulting.com

+852 3951 0359