

The Way We See It

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Goji Consulting Limited

enquiry@goji-consulting.com

Is the July Bounce Sustainable?

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

Review of Developments

- Global Economies

Over the month, the US released its preliminary Q2 GDP statistics. Real GDP fell by an annualised 0.9% QoQ, marking the 2nd consecutive quarterly decline (Q1 showed an annualised -1.6% QoQ). This placed the US economy in a "technical recession" situation. Indeed, it is quite a surprising outcome, given the touted strength of the US labour market. The main negative components in the US data can be attributed to the running down of excessive inventories and a slowdown in government spending. In any case, neither the Fed, the government, nor investors seemed to care. Across the other side of the Atlantic, Europe managed to show a modest positive growth in Q2, boosted by a strong wave of tourist spending. China printed a negative real GDP number in Q2 (annualised -2.6% QoQ, and only +0.4% YoY), affected by lockdowns in a number of major cities and the steep decline in the property market.

Inflation remained high everywhere, particularly amongst industrialised nations. Annual rates of headline inflation of 7-9% in the major OECD economies are common (core inflation rates were

lower, but still high at 5-6% per annum). As a result, their central banks had to start and/or continue to raise interest rates and tighten excess liquidity, with the objective of taming wage expectations and slowing pent-up demand.

Towards the end of the month, there were emerging signs of an easing of price pressures from energy and agricultural commodity prices, as well as a reduction in supply bottlenecks. With a lag, this will likely reflect in lower petrol, food and manufacturing prices at the retail level.

- Global Markets

Following a poor first half, the bounce in the US and global equity and bond markets in the month brought about a much-welcome relief to investors.

The US once again led global markets, boosted by a significant decline in their long-duration bond yields, and a strong rebound in the Technology and other Growth stocks. Factors which are deemed to contribute to the rally include the perception that a fair amount of bad news has already been priced in (the Fed's 75bps rate hike, persistently high inflation, downgrades in GDP growth and corporate earnings, and the continuation of Russian war).

In addition, a number of large and influential investors, who were deemed to be very underweight or short long-dated bonds, equities and other risky asset classes, were reported to be the major buyer (including short-covering) in the July rally. Industry information suggests that the latter appear to belong to the Quant- and Algorithm-based investment category. Fundamental investors were reported to be modest net sellers in July, as the spectre of recession may have influenced their investment thinking.

One major market which did not join the global equity party was China. It was affected by a renewed bout of selling of the Technology mega-caps, as well as banks and property developers which suffer from excessively tight liquidity conditions. As China is a major component of the EM (Emerging Markets) universe, the net result is a small negative return of -0.16% in July.

July rally in most asset classes but Chinese equities (and dragged EM).

Table 1: July rally everywhere... except China

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 mth @ July	7.78%	7.97%	-0.16%
H1 2022	-21.11%	-20.29%	-17.47%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 mth @ July	3.24%	1.59%	2.44%
H1 2022	-14.39%	-9.14%	-10.35%

Asset Class	Global Govt Bonds	Global Aggregate	China Offshore
Index	FTSE WGBI	Bloomberg Global Agg	MSCI China
1 mth @ July	1.78%	2.13%	-6.80%
H1 2022	-14.79%	-13.92%	-11.19%

Source: GOJI, Bloomberg

The US Dollar remained strong over the period under review, helped by the aggressiveness of the Fed's tightening policy and the overall defensiveness of the global investment world.

Market Outlook

- Global Economies

While there are both positive and negative factors operating in the world economy in the next few months, the potential growth positives are likely to have more influence the US and world economy.

Positives include: the likely gradual re-accumulation of inventories thus boosting GDP growth in the US, together with increased spending by the government and the potential corporates spending on CAPEX. In China, the gradual re-opening of its major commercial cities and easing of Covid rules, combined with a modest easing of fiscal and monetary policies should help to boost its GDP in H2.

In addition, as the majority of countries have started to re-open and encouraged tourists and foreign workers to return, this will add to growth and help to alleviate the shortage of labour in many countries.

Having said that, should the Fed tighten too aggressively in order to tame inflation within a short time frame, the US economy may not escape a recession scenario in the coming 6-12 months.

Be mindful of Fed's rate hike "overdose"

Negative factors again rest with the Inflation, Monetary policy and Supply Bottleneck issues.

First, regarding inflation, while the 3-month rolling inflation data appeared to have peaked, the more visible year-on-year inflation rate in major economies is expected to remain high. As a consequence, central banks in major OECD countries are almost certain to have to continue to raise rates until year end.

In addition, while supply-side bottlenecks appear to ease a little (Ukrainians wheat started to be shipped out again), sanctions against Russian energy and agricultural exports, together with the difficulty in finding workers to fill low-skilled services jobs, and China's zero-Covid policy continued to cause imbalances in demand and supply.

In brief, the world economy remains in a fragile phase at this juncture.

The Way We See It

- Global Markets and Investment Thematics

Against the above economic, monetary, and geopolitically unbalanced backdrop, in a not too dissimilar fashion through the first half of this year, global financial markets are likely to trade within a wide range, in a volatile manner, with a downward bias.

Consequently, it would be sensible for investors to continue to adopt a defensive strategy in overall terms, an investment stance that we have advocated since November of last year. This translates into a strong focus on quality and lowly-gear assets that can deliver predictable cash flows, and USD cash.

In addition, as a number of growth stocks with a strong business franchise and good management have witnessed a substantial fall in their share prices, long-term investors should take advantage of these opportunities to selectively add to their equity and bond exposures.

Our recommendation for a defensive strategy remains.

From an investor's sentiment and positioning perspective, we noted in our Review section that quantitative- and algorithm-focused funds appear to have to modestly raise their exposure to risky assets. Nevertheless, should prices fall and volatility rise again, the former is likely to liquidate their risky assets anew. Fundamental long-only investors may continue to reduce exposure to equities and low-quality corporate bonds, after a substantial buying binge last year and the first five months, should the recession newsflows worsen, and panic sets in.

In brief, a sustainable bull market in equities and corporate bonds will return at some stage, but only when valuations are lower and, more importantly, when the US Federal Reserve and other major central banks switch from the current tightening to a pause or an easing mode.

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

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