BENDURA BANK
BENDURA BANK AG · LIECHTENSTEIN

INVESTMENT OUTLOOK
JUNE 2023

The month of May revolved around two main topics: the discussion surrounding the debt ceiling in the United States and the widespread excitement about Artificial Intelligence (AI), which contributed to the remarkable success of major tech companies. The performance of stock markets during this period varied, with European markets lagging behind the US, while Chinese and Hong Kong markets experienced declines and Japanese shares saw consistent growth for the fifth consecutive month. Despite the extensive coverage of the potential market disruption caused by the debt ceiling issue, investors appeared to concentrate on positive aspects such as increasing incomes and any developments related to AI.

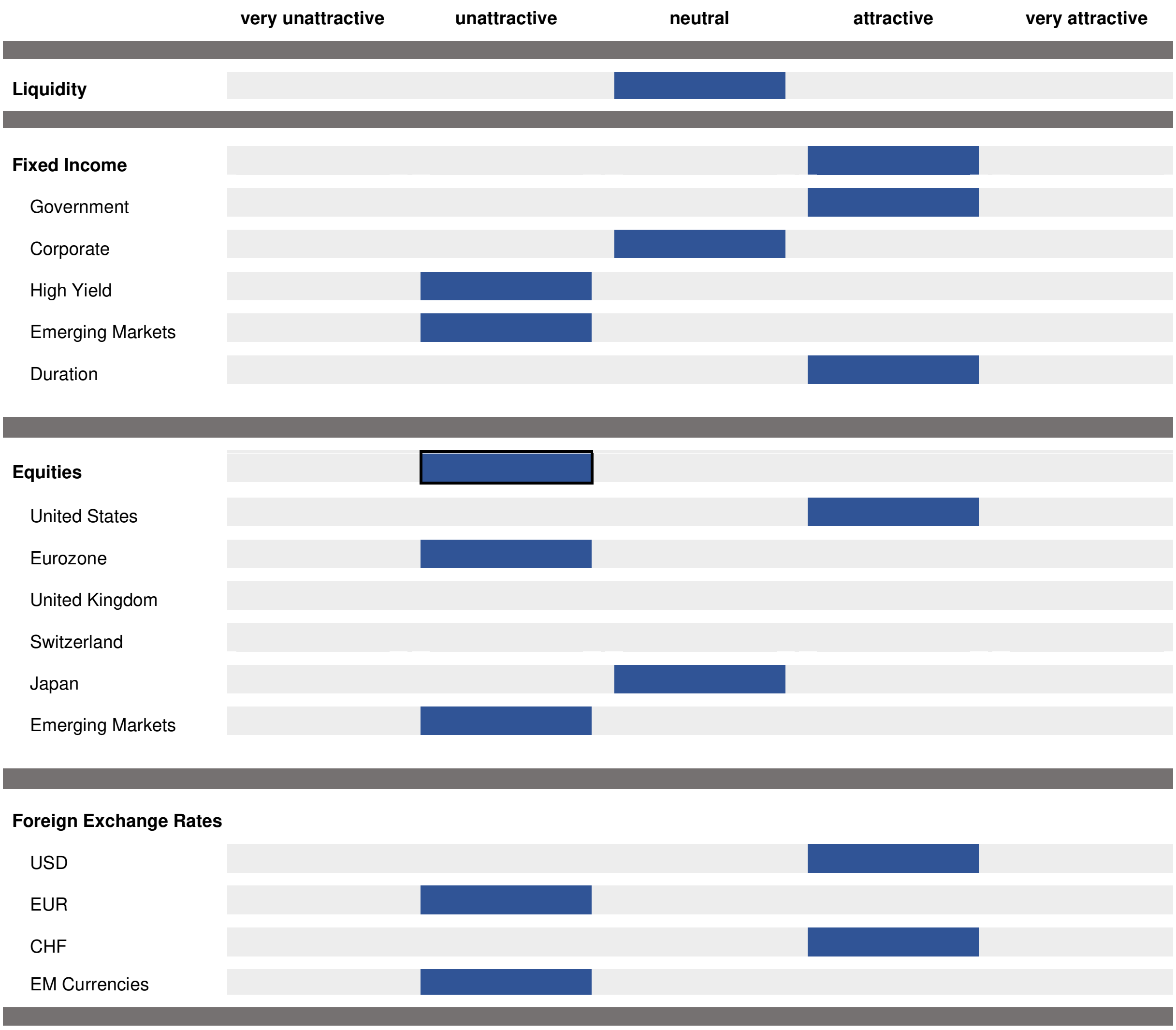
In recent months, stock markets have successfully navigated challenges such as banking stress, persistent inflation, and rising interest rates. Unlike last year when these issues frequently caused significant disruptions, they are currently being overlooked by the markets. Despite a multitude of concerns, global markets have continued to expand and maintain a sense of stability. An illustration of this is the S&P 500, which has experienced minimal fluctuations, with less than a 1% movement in either direction during 40 out of the past 50 trading sessions, marking the calmest 50-day period since December 2021. Additionally, the market heavily relies on a small number of stocks, which has presented some difficulties for investors.

However, the only scenario in which stocks and credit could demonstrate robust performance in the coming year is a rapid decrease in inflation without a recession. According to the remarks of Federal Reserve Chairman Jerome Powell, such a situation would go „against history".

Given the current conditions, where US inflation remains stubbornly high and economic growth is displaying indications of deceleration, we anticipate a continued economic slowdown that will exert downward pressure on equity prices.

Therefore, we continue to recommend a defensive stance with an overweight on government bonds and underweight on equities and credit.

BENDURA Market Views



The terms attractive / unattractive describe the return potential of the various asset classes. An asset class is considered attractive if its expected return is above the local cash rate. It is considered unattractive if the expected return is negative. Very attractive / very unattractive denote the highest conviction views of the BENDURA Investment Committee. The time horizon for these views is 3-6 months.

Global Economy

Based on the latest Labor report, the United States exceeded expectations in terms of job creation, but many aspects of the report indicated a declining trend. As a result, the unemployment rate increased from 3.4% to 3.7%. Although the rate of inflation has slowed down compared to its peak a year ago, there is still a persistent risk of elevated price pressures due to strong consumer demand and consistent business investment. Regarding this, the likelihood of a 25 basis point increase in the Federal Reserve (FED) interest rate by July has risen to 80%, indicating a potential additional weakening of the job market in the upcoming months.

After considerable deliberation, an agreement regarding the debt ceiling in the United States has been ultimately reached. The decision primarily stems from the recognition that none of the major political parties wishes to shoulder the blame for the potential crisis it could create. Market participants remained calm even as the possibility of default loomed, as historically, discussions surrounding the debt ceiling have never resulted in a default for the US.

Markets reflected a mixed picture in Europe, since the market was exposed to risks influenced by multiple factors that impacted performance. The boost from falling energy prices has lost its steam, which is also confirmed by the leading indicators, such as Ifo and ZEW. The debt ceiling talks in US also rattled through European markets. Again, inflationary pressures continued to persist in Europe, driven by factors such as increasing energy costs and disruptions in the supply chain. As a result, investors and central banks closely monitored these developments, recognizing their potential impact on the overall market.

Such situation indicates that European Central Bank (ECB) may raise interest rates once again during the summer. The expectation of the annual inflation rate in the euro area is projected to be 6.1% in May, down from 7.0% in April, yet still significantly higher than the central bank's target.

The momentum of China's reopening rally has significantly diminished. Due to limited fiscal resources, the government's ability to boost infrastructure spending remains constrained. Additionally, Chinese authorities have urged major banks to reduce their deposit rates in an effort to stimulate economic growth. Disappointing economic data, both in terms of soft indicators and tangible measures, has prompted corresponding reactions in the equity market. For instance, Hang Seng Index has experienced a decline of 14.90% over the past three months, erasing all the gains achieved during the beginning of the year. As a result, year-to-date returns currently stand at -2.68%.

Equities

From the first view, May appeared to be a strong month for US equities. The Nasdaq demonstrated an impressive increase of 5.8%, while the S&P 500 experienced a more modest rise of 0.25%. However, it is important to remember that non-technology sectors and indices faced notable losses, with the Dow Jones index falling 3.49% during May.

The market's overall surge was primarily driven by the outstanding performance of AI-related stocks, leading to substantial growth for technology companies like NVIDIA. NVIDIA's brief achievement of reaching a market capitalization of $1 trillion was a historic milestone, placing it alongside esteemed blue-chip companies such as Apple, Amazon, and Microsoft.

Nevertheless, it is worth highlighting that the financial benefits stemming from AI are not expected to generate significant revenues in the near future. Despite this, market participants remain optimistic and focused on the potential of AI-driven technologies.

Interestingly, an equal-weighted basket of just seven stocks, including Apple, Microsoft, Amazon, Nvidia, Meta, and Tesla, experienced a staggering 70% increase this year, while the remaining 493 stocks showed a mere 0.1% gain by the end of May. This indicates an unprecedented reliance on the top ten largest members of the indices throughout history. With only 28% of S&P 500 members reaching gains this month, and showing the weakest market breadth since 1990, it reinforces the notion that markets are strongest when there are broad positive returns, and weakest when they become narrowly focused on a few blue-chip names.

Therefore, we suggest our readers to stay cautious and positioned defensive on equity investments.

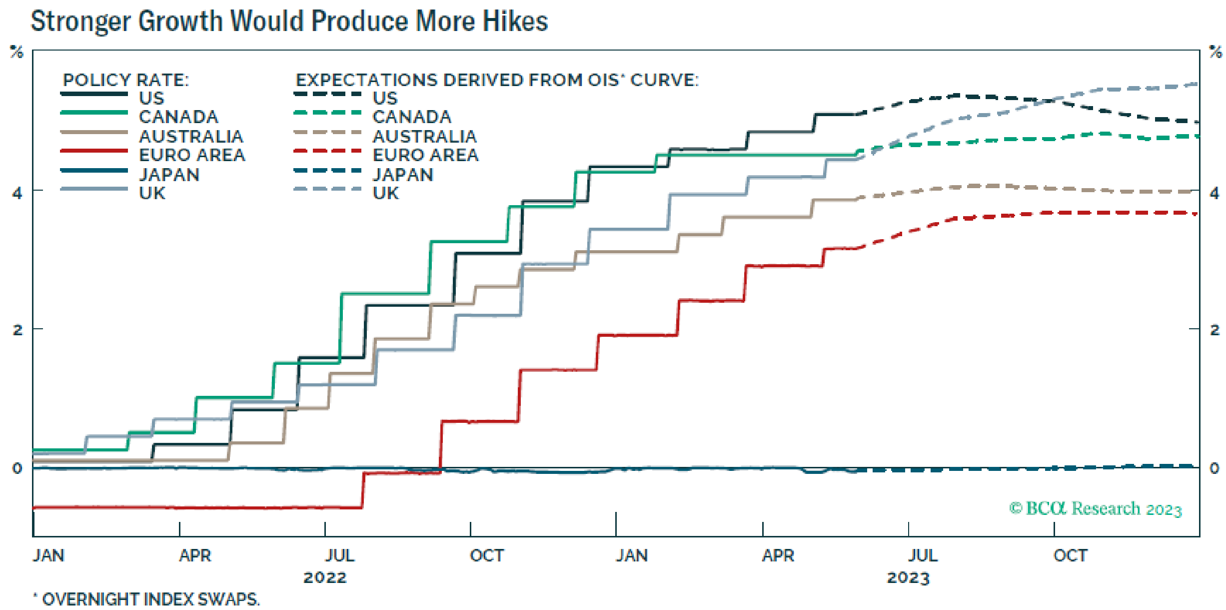


Chart 1: Current and expected development of interest rates. Source: BCA Research, www.bcaresearch.com

Fixed Income

In May, the US 10-year Treasury yield climbed from 3.35% to a peak of 3.82%. This increase was driven by the market adjusting its expectations and pricing out the possibility of Federal Reserve rate cuts for the year. With another interest rate hike anticipated in the summer, the likelihood of this adjustment becomes even more evident. Given this scenario and the potential for an upcoming recession towards the end of the year, we maintain an overweight position on US Treasuries.

Additionally, the credit market currently presents unattractive valuations, and there is a notable increase in defaults. In April, there were 11 defaults in the US corporate bond market, and it appears that the number will be considerably higher for May. Moreover, credit valuations are currently unattractive, suggesting that the market may not be offering favorable investment opportunities. This trend suggests a growing risk in the credit market, further supporting our preference for US Treasuries.

Fintech lenders, mortgage brokers, and other nonbank lenders are reducing their credit offerings due to facing limitations in their own borrowing capacity, which restricts their ability to extend credit to borrowers. Also, lenders are anticipating an increase in delinquencies, which prompts them to exercise caution in lending activities.

The rise in interest rates on credit cards and auto loans has had a negative impact on households. Higher interest rates mean increased borrowing costs for consumers, which strains their finances and potentially lead to difficulties in repayment. Similarly, elevated mortgage rates have stopped some individuals from pursuing home purchases.

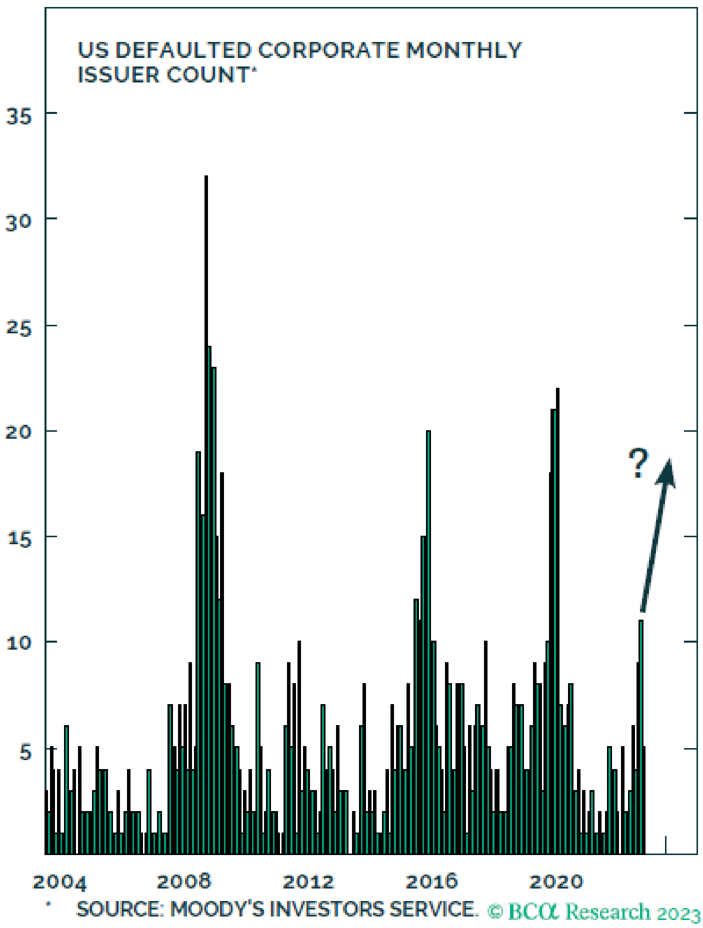


Chart 2: Monthly count of US defaulted corporates. Source: BCA Research, www.bcaresearch.com

Commodities and Currencies

Copper had a noticeable price development in May. The copper price has widened to its largest discount in almost twenty years. One reason for the drop in demand is China's stalled recovery. According to the London Metal Exchange (LME), the spread for copper has reached its highest level since 2006. The price fell by 11% over the month of May to almost 8,000 US dollars.

Another interesting commodity is lithium. In Portugal, the Environmental Protection Agency (APA) has approved the opening of the country's first lithium mine, which has the largest lithium reserves in Europe, crucial for the production of batteries and accumulators. The price of lithium rose by around 20% in May.

Due to the significant rally of gold as a safe haven asset since the beginning of the year, we are maintaining a neutral stance on its future price movements. In May, gold prices remained around the $1970 per Troy ounce mark, which is in proximity to historical highs. However, the attractiveness of gold as an investment is currently limited by the expectation of rising real interest rates. Consequently, we are adopting a cautious approach and refraining from taking active positions, considering the imminent interest rate hikes by the Federal Reserve (FED) and the European Central Bank (ECB).

The dollar has rallied in recent weeks – the DXY index rose 3% in May, reflecting weaker European growth prospects and the rise in U.S. interest rates described above. We believe that we are probably in the early stages of a dollar bear market, as the dollar is significantly overvalued against other major currencies, especially the euro. However, the dollar is a countercyclical currency and is likely to benefit in a recession. Our preferred currencies are the safe havens, the Japanese yen and the Swiss franc.

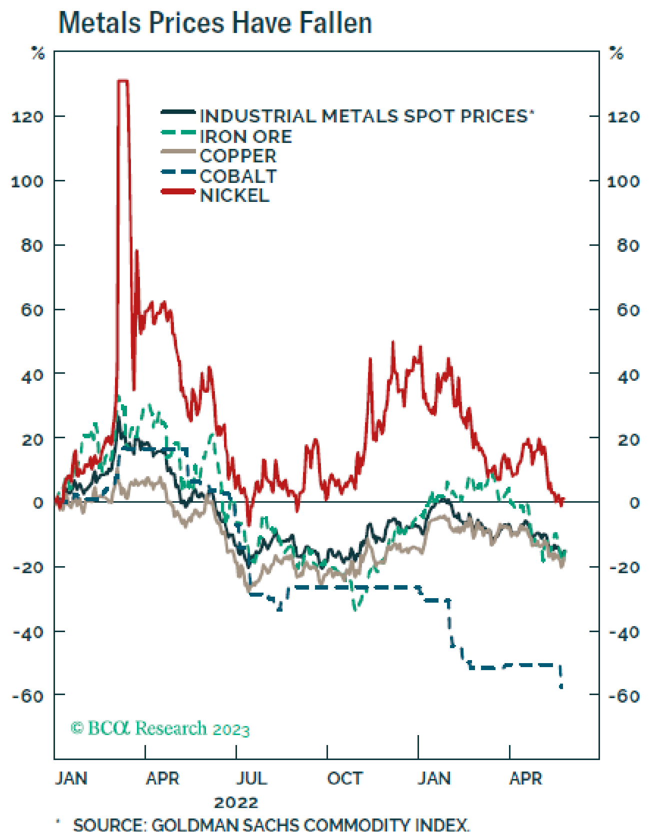


Chart 3: Sinking Industrial metals prices. Source: BCA Research, www.bcaresearch.com

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