BENDURA BANK
BENDURA BANK AG · LIECHTENSTEIN

INVESTMENT OUTLOOK
MAY 2023

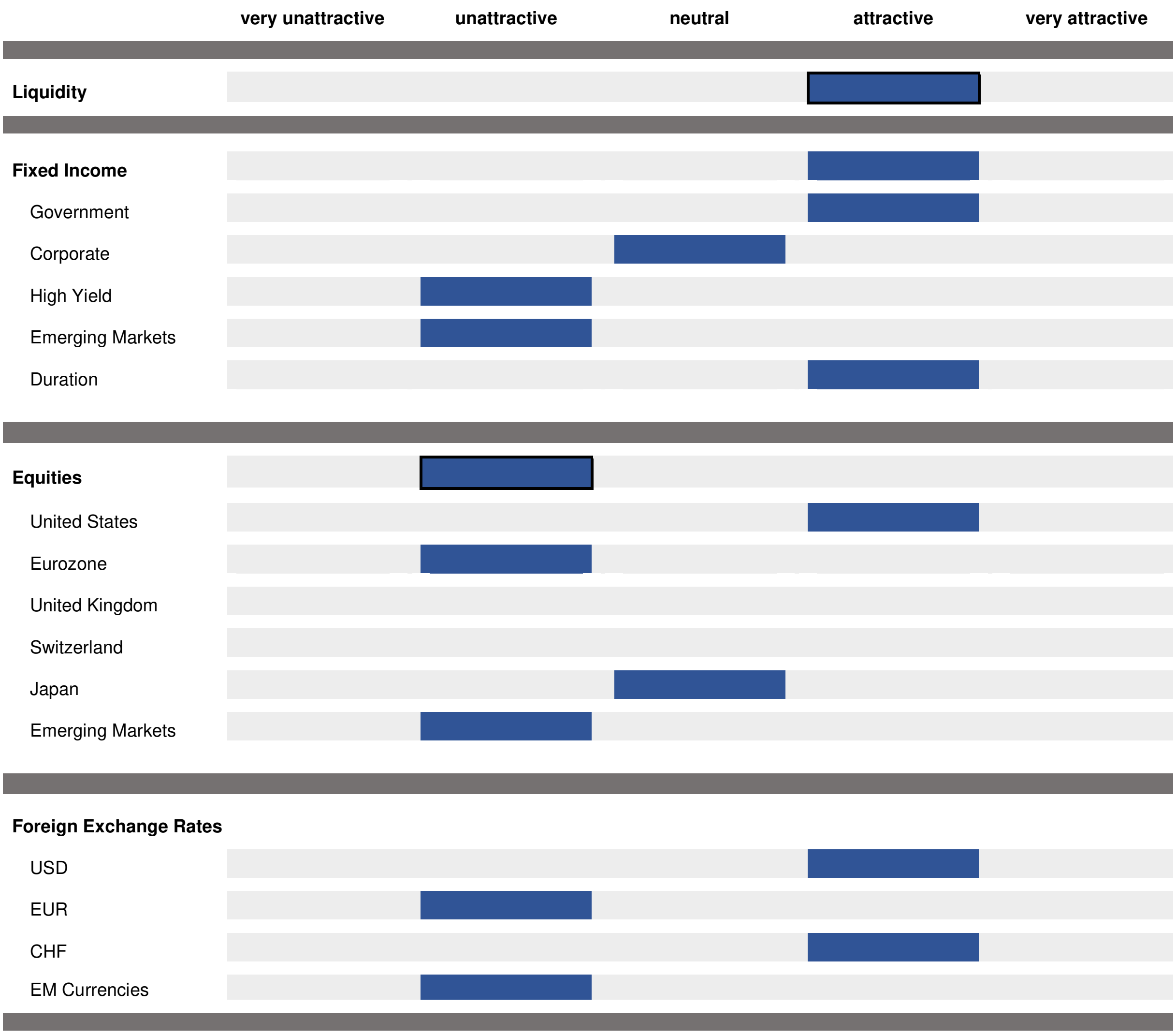
The past month has been eventful for stock market investors. With many factors affecting market trends, it has been a period of both excitement and worry. Even though we experienced headwinds from higher interest rates, renewed banking turmoil and the weakening macroeconomic numbers, the market stayed resilient. Such resilience is confirmed with better-than-expected earnings from the S&P 500 in the United States or DAX in Germany, although it showed decline in quarter-on-quarter earnings for the second consecutive quarter.

Since April was a positive month for most of the major world indices (except China), we return again to the famous phrase - Sell in May and go away? Statistically, since 1990 a six-month average S&P 500 return from November to April was around +7%, and about +2% for the May-October period. The same pattern was seen last year as well. Should we be worried today?

Taking into consideration worsening economic numbers in the US and Europe, smaller than expected impact from China’s reopening, sticky inflation, and higher interest rates, we reiterate our conservative stance regarding investments into equities and bonds. As the impact of higher interest rates may finally take a toll on the economic activity, the future could coincide with the ¨Sell in May and go away¨ theory.

In short, we repeat our message to investors from last month: stay cautious and stay defensive.

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

The resilience in the market shows a high-level of optimism from the market participants. The market has priced in all interest rate raises by the Federal Reserve Bank (FED) in the USA and is looking forward to potential interest rate cuts later this year. The last interest rate-raise in early May topped at the 5 – 5,25% range. According to the FED, more time is needed to assess the impact on the second fastest interest rate hike cycle in USA’s history, leading to a pause before any further changes in the interest rates are made. The economy seems to be resilient with Services PMI gradually rising to almost 54 in April, the highest level this year, meanwhile manufacturing data shows no optimism (50,2). Other problems caused by the higher interest rates are continuing to emerge - property prices are falling, banks’ lending has slowed down, increase in jobless claims, and Gross Domestic Product (GDP) growth less than the expected Q1 figures (annualized 1,1 percent).

The European Central Bank (ECB) still plans to tighten the policy further. Since energy prices cooled down, it is assumed that inflation has passed its peak and should slowly decline throughout the year. However, credit data suggests that monetary policy is firmly in restrictive territory and the economy will soon feel the pain of the higher interest rates. GDP deceleration is also expected due to restrictive policies and lower money flows. This is also weighing heavily on both small and large companies, which have to lower their capital expenditures.

However, the service sectors both in the US and EU will stay strong for longer, meaning their employment rate and wages will not be facing too many headwinds. This in turn motivates the FED and the ECB to remain hawkish.

In China, the recovery led to increased activity in the services sector, while improvements in industrial segments remained weak. The recent drop in commodity prices supports the view that China's industrial recovery will be disappointing. Exports from China also experienced the contraction in the recent period. Considering this, the global household demand for non-auto goods and corporate investment spending will continue to fall on the back of a slowdown in consumption due to the pandemic and higher borrowing costs. As a result, trade and production will continue to decline worldwide.

Equities

Equities experienced some volatility this month but did not have significant price fluctuations. We still see strong resilience to negative market news. Even though the FED raised interests once more and did not signal any upcoming rate cuts this year, US equities stayed optimistic. On the positive side, equities were supported with better-than-expected earnings results both in the US and Europe, although the growth rate was slower than the quarter before. However, it should be noted that the strength of US equities is based on just a handful of stocks - 80% of the S&P 500 8% YTD gain was achieved by just 7 big companies. In overall, only 32% of the stocks are outperforming the index, which brings us to a level not seen since 1999. Therefore, the strength of the market is being cushioned by a small number of stocks, implying possible downside risks in case the blue-chip companies fall.

Chinese shares have suffered a strong selloff in April even though they have reported higher than expected first-quarter GDP growth. It seems that the investors were not convinced about the sustainability of China's reopening plans, outlook on the economy and fears that the recovery after Beijing's disruptive zero-Covid policy could slow down in the coming months. Based on such recent movements, Hong Kong's index Hang Seng was left with just a slight positive return this year.

Taking into consideration worsening economic conditions, sticky inflation, and above-neutral level interest rates, we believe that the rebound in equity prices in the last few months is a classic bear-market rally. With economists forecasting recession, but analysts a rebound in Q3 earnings, one of the parties must be wrong. With a sign that the job's market, which is usually the last indicator to fall before the slowdown, is also starting to wobble, we continue to stay cautious in equities.

Thus, our message for equities is: stay defensive and underweight.

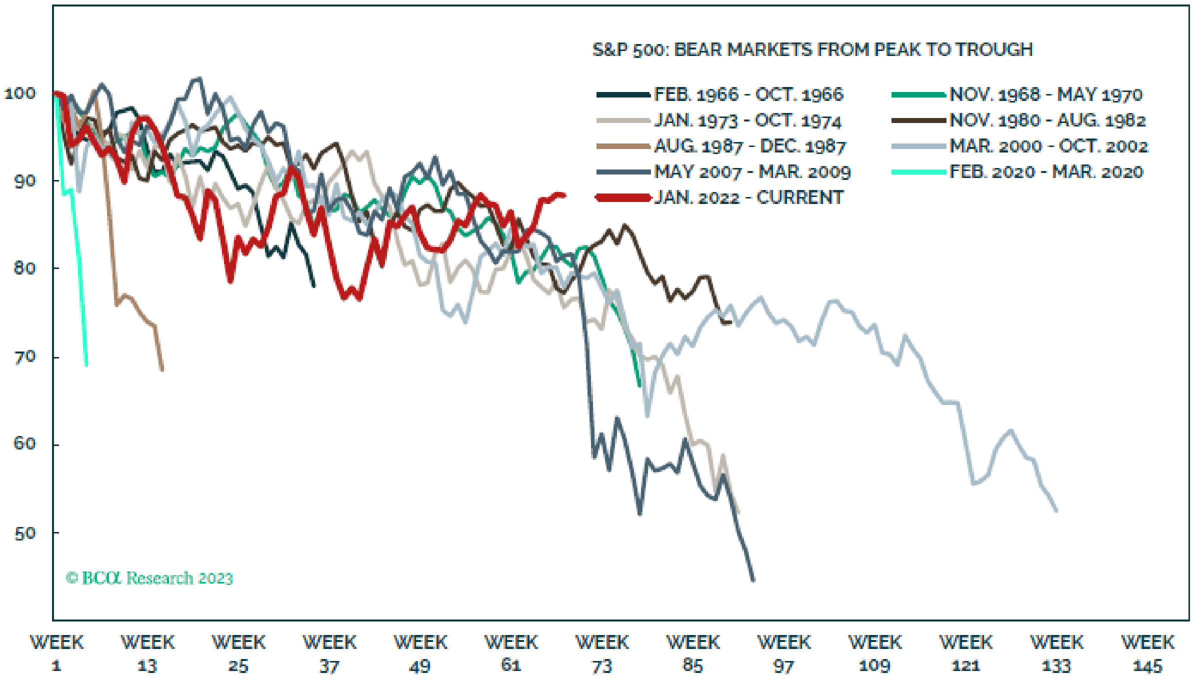


Chart 1: Bear market rallies are not unusual. Source: BCA Research, www.bcaresearch.com

Fixed Income

During the latest FED meeting, they have raised interest rates to the 5 – 5.25% range, followed by the ECB hike the next day. Jerome Powell announced that they are planning a pause on further policy changes to evaluate the impact on the economy after the second fastest tightening cycle in the US. The market still expects to see rate cuts before the end of this year, however from the current economic stand, this is highly unlikely.

The ECB has delivered another interest rate hike of 25 basis points to 3.25%, leaving the door open for further increases in the foreseeable future. With the leader of the ECB Christine Lagarde accepting the fact that credit activity is slowing in the euro area, we believe that European growth will remain weak in the upcoming months, although inflation seems to have reached the peak and should slowly decrease.

We tend to prefer government bonds over other fixed income investments due to higher safety during recessions. The Credit market is currently unattractive with investment-grade bond yields just over short-term rates. Still worsening lending capabilities and the rising risk of defaults makes high-yield strategies unattractive, leaving us underweight in both investment grade and high yield strategies.

Therefore, we stay overweight in government bonds and underweight in high yield and emerging markets debt.

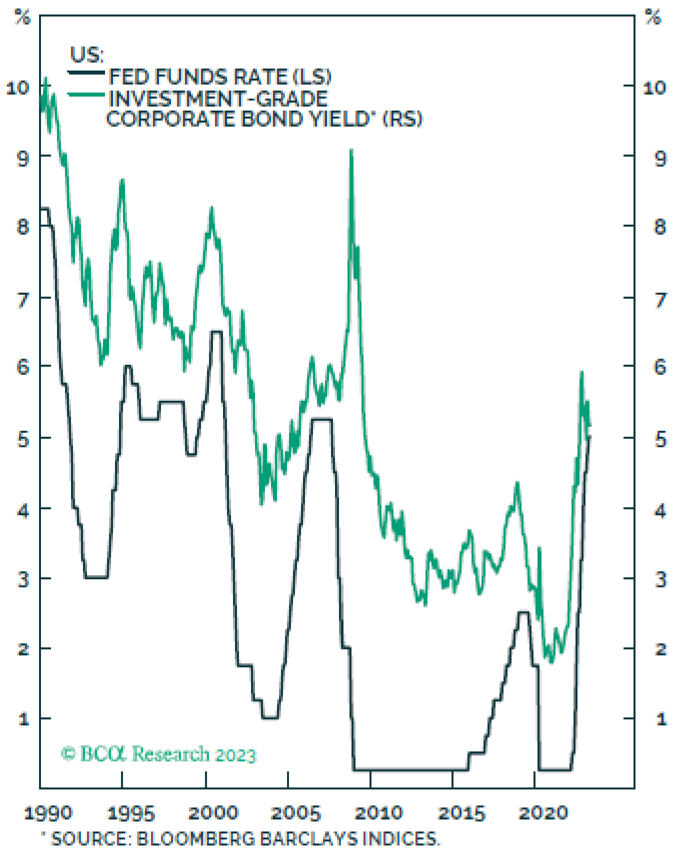


Chart 2: Corporate bonds yield no more than cash. Source: BCA Research, www.bcaresearch.com

Commodities and Currencies

Gold has held over 2000$ per ounce during the last month. It seems that investors do have a high interest in it, which is a good portfolio hedge against market uncertainties and has low correlation to other asset classes. However, current price levels of gold seem to be expensive and close to all-time highs and interest rates might hurt the commodity.

Metal prices are often determined by the demand in China. Though their stimulus is currently marginal as the government can easily meet its modest 5% GDP growth target on the back of post-Covid consumption recovery without increasing infrastructure spending. This suggests that the recovery in industrial projects might not take place soon but instead weakness in metal prices could continue.

The decline in oil prices has shaken the market over the last month, even though OPEC and Russia have announced the planned production cut. We expect oil prices to remain tight due to increased demand of around 1,5 million barrels a day, mostly due to the rebound in internal consumption and traveling both inside and outside of China.

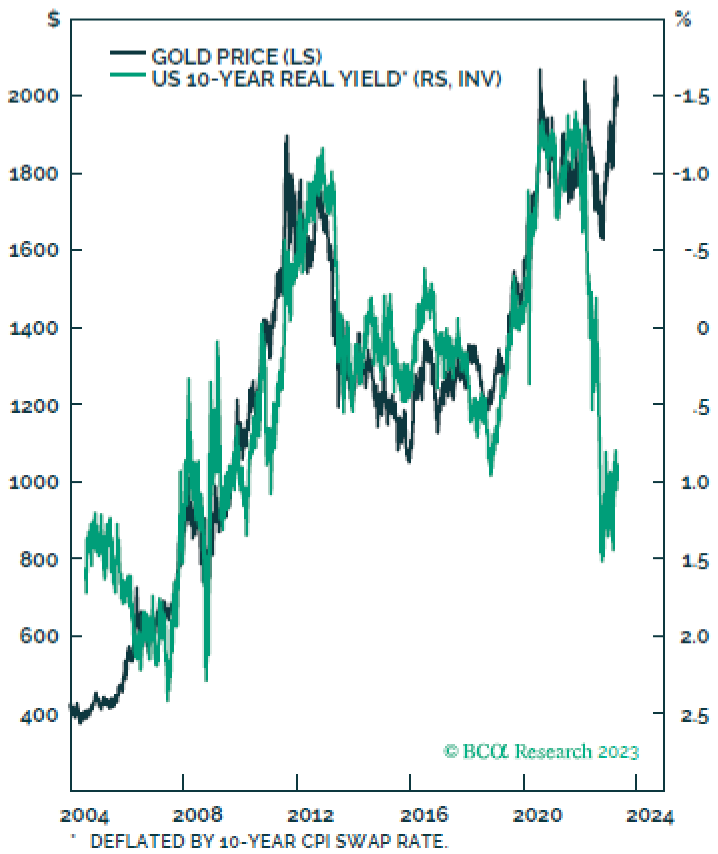


Chart 3: Gold has a risk of being hurt from high interest rates. Source: BCA Research, www.bcaresearch.com

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