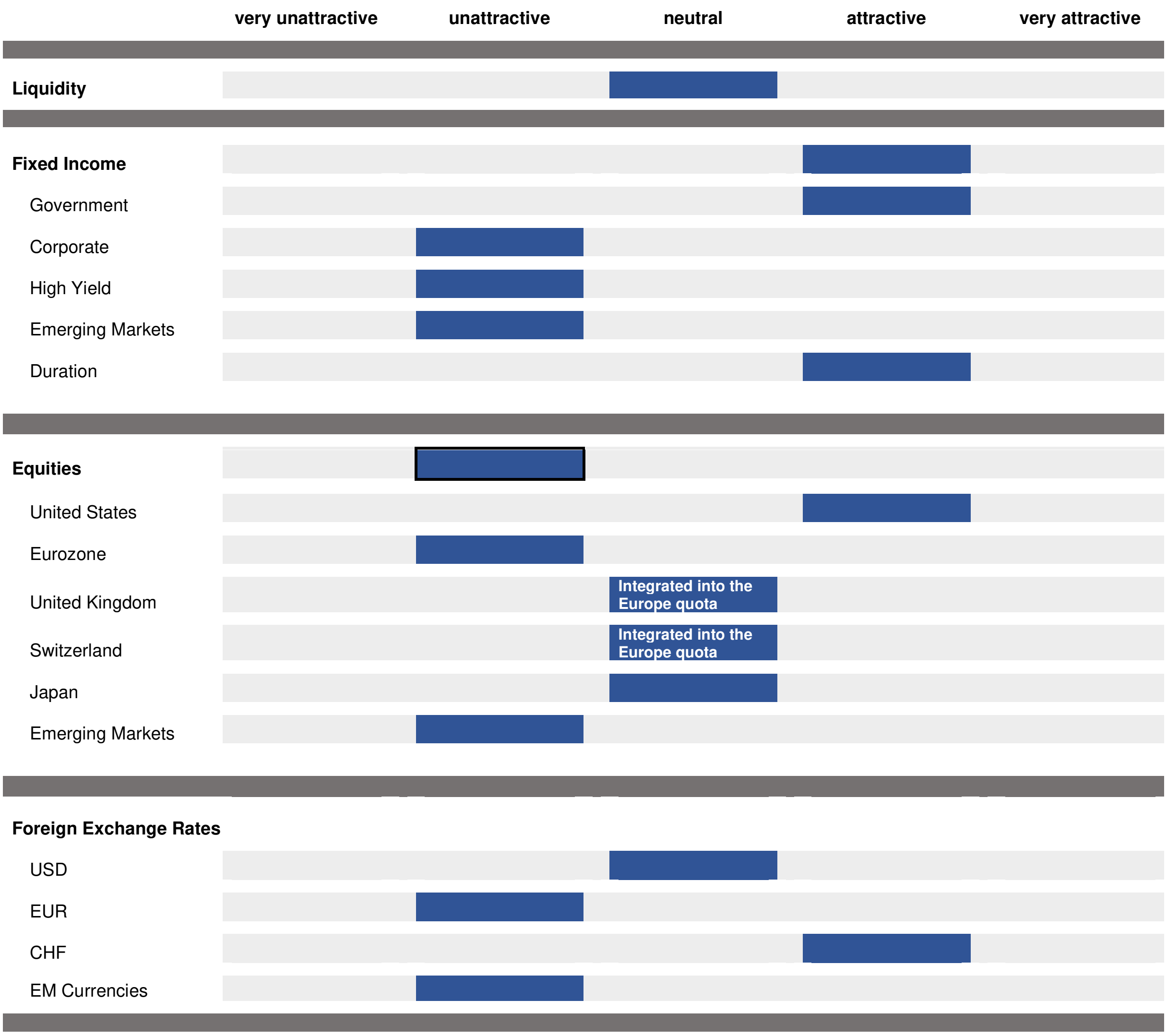
INVESTMENT OUTLOOK
OCTOBER 2023

Seasonality has taken its place as expected, and September has proven to be the least favorable month of the year thus far. Most global stock indices experienced declines, except for the UK FTSE. In general, the broader stock market rally has come to a halt since the end of July, partly due to stronger-than-anticipated economic data, which has raised concerns about the trajectory of interest rates. What has possibly changed in September is that investors have come to accept the reality of persistently high interest rates, primarily in the United States but also elsewhere. Although many investors might have inferred this from the robust economic data in the summer, the tipping point was likely the series of messages from major central banks at the end of September, all signaling a commitment to keeping rates at elevated levels for an extended period. As we look ahead, it appears that we'll continue to witness a similar scenario in the upcoming weeks, with investors grappling to come to terms with a new reality: Interest rates are likely to stay elevated for an extended period. The sentiment suggests that the market moves are likely to be on the downside, especially after many embraced the idea of a soft landing.

Since any kind of market timing is difficult, especially in the wake of recession, which is foreseen in the first half of 2024, staying positioned defensively is the base case. We are leaning towards a low-risk portfolio strategy, with a lower allocation to equities and credit, a higher allocation to government bonds, and maintaining a benchmark weighting in cash.

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 global economy starts showing signs of a slowdown, especially felt in Eurozone with PMI's falling further into contraction zone. The pain is felt both in economic data and in the prices of global equities. Global equities are down by 8% since July, and the equally weighted S&P 500 index, excluding the biggest seven AI-related companies is flat year-to-date. In September, yields and low-risk assets were the consistent top performers across different regions. Assets like oil, bitcoin, and the US dollar performed well, whereas US and European equities experienced the most significant declines. Japanese, emerging market, and Asian equities outperformed their counterparts. In terms of sectors, global energy, financials, and healthcare excelled, while durables, technology, and retail struggled the most.

Apart from other countries and regions of the world, US growth still seems to show resilience, which is mostly seen in services sector. However, the manufacturing continues to weaken and the bottom predicted a few months ago was broken down again. With the Government shutdown looming, markets seem to be abate again knowing the budged deal must be reached to finance the country further. Interestingly, historical data shows that during the five government shutdowns since 1995, the S&P 500 traded positively in each instance, with an average return of 3.2%. Even during the most recent and longest government shutdown in the last 30 years, the S&P 500 rose by more than 10%.

In Eurozone growth remains sluggish due to high interest rates and overall slowdown in the global economy. However, inflation has dropped to its lowest level in nearly two years, providing hope that the significant surge in consumer prices seen recently is fading. This could lead to the European Central Bank considering a halt to interest rate hikes and finish the cycle. Consumer prices in the Eurozone rose by 4.3% in the year to September, down from 5.2% in August, according to Eurostat, while both services and manufacturing PMI's remain under the neutral level of 50.

Chinese growth is still facing problems with the consumer confidence collapsing, yet authorities are not doing much regarding this case. However, the PMI's look doubtfully high (51.8 services and 51.0 manufacturing) meaning economy is in expansion. At the same time, the Yicai Economic Activity Index, including less manipulative data like air pollution, coal consumption or traffic congestion shows that economic activity should be in a downward spiral. In addition to the collapse of the real estate market, China's monetary and fiscal policy support was very weak, with overall growth in social financing and government spending at its lowest level in decades.

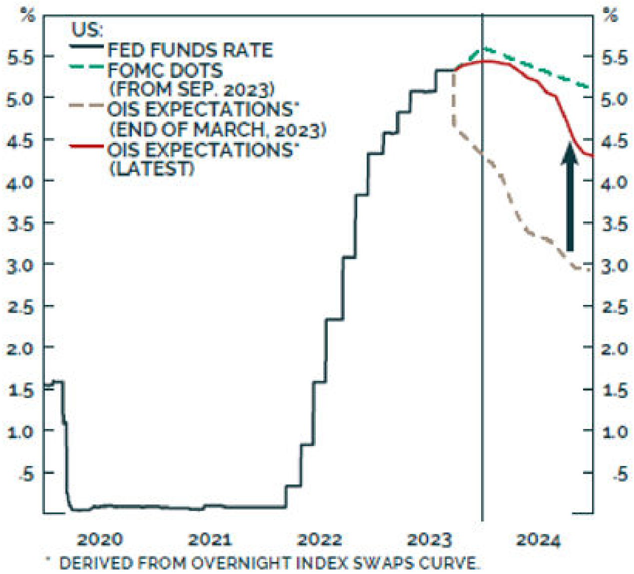


Chart 1: Markets now believe in ¨Higher for Longer. Source: BCA Research, www.bcaresearch.com.

Equities

In September, U.S. equities experienced a sell-off, with the S&P 500 suffering its most significant decline since December, dropping by 4.87%. This decline marked the index's first consecutive monthly drop in a year. The S&P 500 is currently trading at a three-month low due to surging oil prices, rising bond yields, and concerns about economic growth, causing investors to exit the market. Despite positive developments such as solid IPOs and robust M&A activity, rising yields have acted as a significant headwind. One important factor to consider is the impact of higher yields on technology stocks, which were significant drivers of the S&P 500's performance in the first half of the year. Many technology companies have high valuations, and rising interest rates can erode the perceived value of their future growth potential. The performance of the "Magnificent Seven" (Amazon, Apple, Alphabet, Meta, Microsoft, Nvidia and Tesla) stocks was mixed, where some had marginally weaker performance and others staying relatively stable to the broader market.

European equity markets ended lower, with the STOXX 600 reaching its lowest levels in six months. The main driver of this decline was a significant increase in bond yields as markets digested the prospect of higher rates for an extended period following a hawkish stance from the Federal Reserve and European central banks maintaining restrictive policies despite a slowdown in economic activity and softer inflation. On an index basis, the UK's FTSE 100 managed to outperform, gaining 2.27% in September, thanks in part to the strong performance of oil majors and the basic resources sector. However, it has only risen by 2.10% on a year-to-date basis. On the other hand, the worst-performing index was the German DAX, down by 3.51%, followed by the CAC 40, which lost 2.41%. The outlook for equities remains bearish for European markets, with investors adopting a cautious approach, favouring cash, bonds, and defensive assets. Some analysts see rays of optimism, believing that much of the bad news is already reflected in prices, and any positive developments could drive outperformance. However, the macroeconomic outlook remains gloomy, with weakening PMI data. There are concerns that ECB policy changes may affect corporate profit margins, even if there is a soft landing for GDP.

For investors, the current landscape suggests maintaining a cautious stance. It's not yet the time to become overly bullish, focusing on high-quality companies in the European and U.S. markets with strong operational leverage and solid balance sheets. While a crash isn't anticipated, localized corrections and sell-offs should be expected.

Fixed Income

A significant development occurred in the bond markets, where yields steadily rose throughout September. The US 2-year yield, for instance, increased from 3.8% in early May to its current level of 5.1%. Longer-term rates, not only in the US but also globally, saw an uptick too. The ten-year Treasury yield in the US reached a 16-year high of 4.5%, while the 10-year German Bund now yield 2.85%, the highest since 2011. The rise in yields is directly connected to the market expectations that higher interest rates will stay for longer. Additional pressure was put by the FED leaving a chance to raise interest rates on more time this year. Current environment creates a favourable entrance point to government bonds, where easing price pressures, rebalancing labor markets, and a deteriorating global environment should lift bond prices.

Even though high yield and investment grade corporate bonds had a slight uptick, weaker corporate fundamentals and tighter financial conditions have contributed to a wave of defaults in the corporate credit market. With the borrowing costs rising significantly, it seems to be little value in credit, particularly in the high-yield space.

Therefore, we do not change our stance in fixed income area. We suggest underweighting the credit due to rising defaults caused by higher interest rates and prefer government bonds as a good hedge against recession risks and a little downside given the fact that interest rates are nearing their cycle-peak.

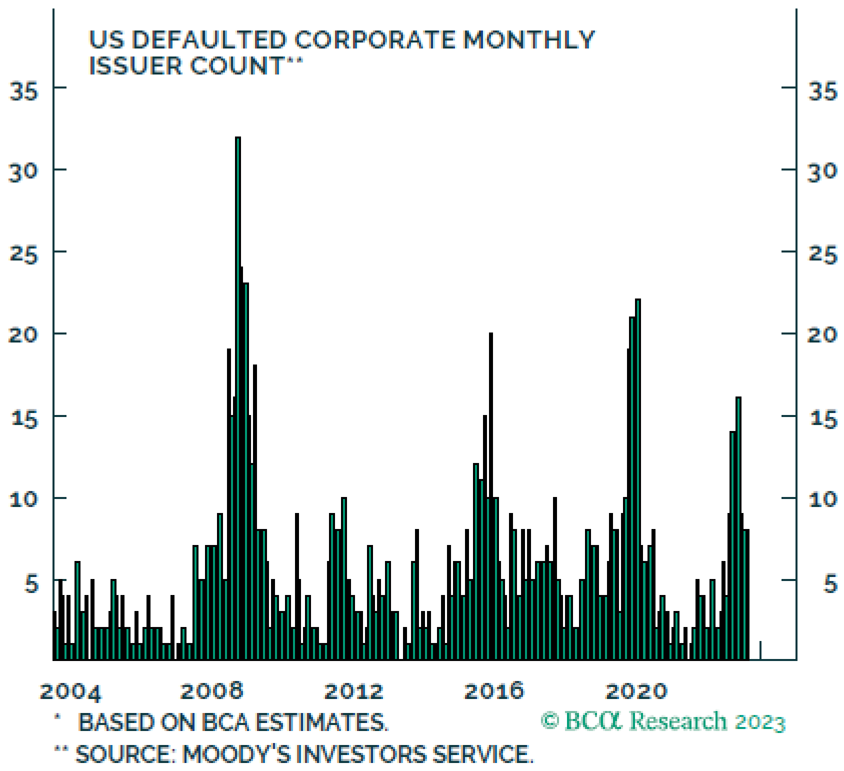


Chart 2: More companies are being pushed to default. Source: BCA Research, www.bcaresearch.com

Commodities and Currencies

Gold has experienced a 5% decline from its peak in April, largely due to a cooling inflation environment, surge in US bond yields that pressured non-yield bearing assets and reduction of geopolitical risks. While we consider gold to be a safe haven asset, it remains expensive against real interest rates.

On the other hand, we remain overweight on oil. The steepening backwardation in Brent oil futures price spreads suggests high current demand for oil, driven primarily by growing oil demand in China. On the supply side, both Saudi Arabia and Russia have confirmed the extension of production cuts, which will continue till the end of 2023. While the production decrease has been partially offset by a substantial increase in Iranian inflows, the combination of tight supply and growing demand is expected to prolong the deficit in the oil market.

On the currencies side, we remain neutral on USD. The price action over the past year suggests that we are in a structural dollar bear market: Even though the global manufacturing cycle is in deep contraction and most currencies outside of the US are in or near recession, the USD has not been able to clear last year's highs. Moreover, momentum – one of the most reliable indicators for the USD – has turned positive.

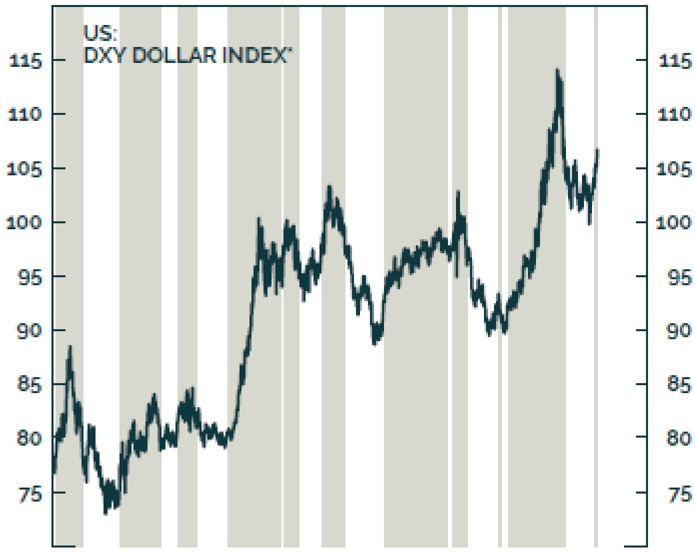


Chart 3: Stance to remain neutral on USD. Source: BCA Research, www.bcaresearch.com

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