APRICUS FINANCE

WEALTH MANAGEMENT

August 2024

Economic Blues and Summertime Volatility: Soft Landing still Ahead for the US

For most of the year, market concerns have shifted between growth and inflation.

We started the year worried about a recession and less about inflation, with the market expecting as much as 1.8% of rate cuts.

By the end of April, after the Q1 inflation bump, the market started to price almost no rate cuts for 2024, and even went as far as pricing some probability of a rate hike.

A couple of weeks ago, a set of weak US economic and employment data went as far as pushing the market to expect an emergency rate cut from the central bank ahead of its upcoming meeting in September. That was reversed just one week later:

- The weekly and volatile payroll number was better than expected by 7000, (and this in a country of 350 million people).
- The usually ignored Producer Price Index was more benign than expected, which was followed the next day by the more mainstream inflation index.
- Retail sales were better than expected, however, in areas that confirm the current weakness of the consumer and its focus on careful spending: sales were led by essential groceries and general merchandising, showing restraint in discretionary spending.

We believe the volatility that hit the market in early August is a confluence of events, rather than just a couple of US macroeconomic data, amidst very thin liquidity and further unwinding of crowded trades, (see last month's commentary):

- The Bank of Japan decision to hike rates and halve the amount of bond purchases: this led to a sudden YEN strengthening to below 142 from above 154 against the US dollar. The central bank one week later 'apologized' and sent a dovish signal mentioning that in the future it will take into consideration market conditions, before taking decisions: the Yen weakened to just below 150.
- The new shape of the US elections, with the entry into the race of Kamala Harris.
- The potential worsening of Middle East tensions, with fears of an Iranian retaliation on Israel.
- Ukraine's incursion into Russia.
- NORAD intercepting an unprecedented joint patrol of Russian and Chinese nuclear capable bombers off Alaska.

The large moves and the volatility that accompanied the markets over the last two weeks are nothing short of exceptional, absent an exogenous shock, and have hit almost all asset classes, including cryptos and crude oil:

- Japanese equities dropped 20% in two days, before recovering almost all their losses. The last time we observed such a move in Japanese equities was after the Fukushima incident in 2011.
- Bitcoin dropped from 66,000 to 49,000, before recovering.
- Crude oil lost over 6% before recovering.

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- The S&P 500 volatility index (VIX), rose by 42 points to above 65 in a single day, (it was at 16 at the end of July). The extraordinary move was likely fed by strategies systematically shorting volatility, such as dispersion notes, CTAs or ETFs.

- The 'Magnificent 7' lost over 8% before fully recovering their losses.

- The rotation into US small caps ended abruptly, as the Russel 2000 lost close to 10% in just two days.

- US two-year yields sank from 4.25% to 3.65%.

At the beginning of this paragraph, we said 'almost all asset classes', because credit, the Euro and Gold faired quite well:

- Credit spreads behaved quite well, whether Investment Grade or High Yield, widening only very marginally during the episode. They usually do 'participate' in any major sell off in risky assets.

- Gold only dipped 70 US dollars an ounce before quickly stabilizing near all-time highs.

The current outcome of this short but very whirly summer storm:

- US small caps largely underperformed large caps.

- The S&P 500 is back to where it was prior to the event.

- The return of mega caps.

- The market is still pricing in the possibility of an outsized rate cut (50 bps) at each of the next 5 meetings of the Federal Reserve. We believe the central bank will cut rates by 25 bps at least at the next three meetings, without the need to cut by 50 bps, which would, in all likelihood, send the market, at least in the short term, into panic mode.

That said, the earnings' season is nearly over, and while mega caps had mixed results, and the market is eagerly awaiting Nvidia results at the end of the month, on average, results have been quite decent: on average S&P 500 companies beat earnings' expectations by 4.6%.

We still believe in a soft economic landing in the US, with inflation trending lower (almost all sub-sectors are now deflationary except for 'shelter'), employment gradually worsening, and the US growing below trend for the next few quarters.

As such, and with the US Federal Reserve expected to follow suit and the European central bank cutting rates on a regular basis, we believe the current environment of moderate expansion should continue to be supportive for a multi-asset portfolio.

We admit there are obvious risks from economic data, from geopolitics, and from the potential economic program of a winning, clean-sweep, leftist Harris-Waltz ticket - she is clearly benefiting from the 'novelty' effect, with betting sites (which over the last ten years have proven more accurate than opinion polls, in the US and the UK) currently giving Kamal Harris a winning 54% of the votes and Donald Trump only 45%.

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Strategy

At the peak of the sell off, as the VIX index reached 65, we decided to exit half of our protective put. We reasoned that the volatility index would not stay that high for very long: at that level we were 'synthetically' hedging about 9% of equity exposure, (for a balanced portfolio). Also, another key input in our decision to de-hedge partially and consider the sell-off as short-lived or at least exaggerated, was the extreme stability of the all-important credit markets: credit is the piping of the economy. If it had joined the sell-off this would have caused the markets to go into crisis mode, and probably would have led to emergency rate cuts by major central banks.

We also decided to tactically reduce our Japanese exposure. While the key considerations for being positive this market, as explained in the past, continue to be valid, further 'mistakes' from the central bank can't be ruled out in the future. We thus reduced the allocation on the rebound. Recently, the decision by Japanese Prime Minister Kishida to not run for a second term could bring political instability in the country.

Also, Kishida's government and the central bank have sought to show a united front and restore calm to financial markets after the biggest stock plunge in more than three decades earlier this month triggered criticism of monetary policy tightening and cast a shadow over efforts to get households to invest their assets. That unity might not hold true with the next government.

We also decided, over the near term, to opportunistically reduce risk in our fixed income allocation, by reducing our exposure to European High Yield. One reason for this decision was the willingness to derisk portfolios a little post recent events, but also, while still attractive, the sub-asset class has changed since we increased it in May of last year. The asset class offers less convexity, as the average bond price within the index was 87.50 versus currently 94.70, while the average coupon moved from 4 to 4.8%. The average duration also stopped decreasing, and went from less than 3 years, to the current 3.15 years.

Equity

We keep an overweight in Eurozone equities versus the US broader market.

We continue to own, (a now reduced), partial put on US equities.

Fixed income

We continue to favor exposure to credit versus duration. We have exposure to investment grade credit, European high yield, hybrids, financials' subordinated debt, US municipal infrastructure and Asian hard currency debt.

Foreign Exchange

The Japanese YEN exposure is mostly hedged, and we maintain a 5% exposure to the US Dollar.

Gold

We continue to keep our allocation to Gold at about 5%. Whilst it doesn't provide any yield, it continues to be a good diversifier in a multi-asset portfolio. This year, it is the best relative contributor to the portfolios.

Conclusion

The backdrop of lower but positive economic growth and continuing disinflationary trends is supportive for equity markets, fixed income, and thus a balanced portfolio.

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Positioning

Overall Exposure

We are now Neutral Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged.

Equity: Neutral

We have a very sizeable Overweight to the Eurozone and a very sizeable Underweight in US equities, Slight Underweight US technology, Overweight Nasdaq 100 equal weight, Neutral UK, Neutral Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Champions.

Fixed Income: Neutral

Long 1 to 3 years US Treasury Notes. Long 20+ years US Treasuries.

Thematic Fixed Income

Overweight High Yield in EUR and Underweight in USD. Overweight Investment Grade EUR and USD Bonds, Underweight Sovereigns. Long US Municipal Infrastructure Bonds, Long Hybrids, Long Subordinated Financial Credit & Long Asian Bonds in hard currency.

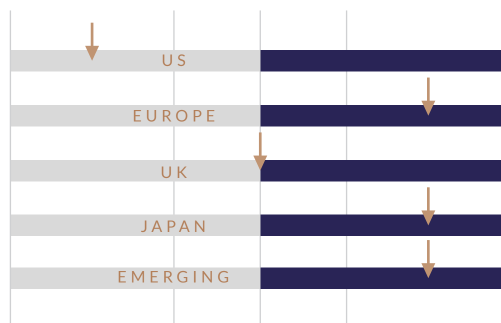
Currencies: Portfolios have a 5 % USD exposure.

Commodities: Overweight

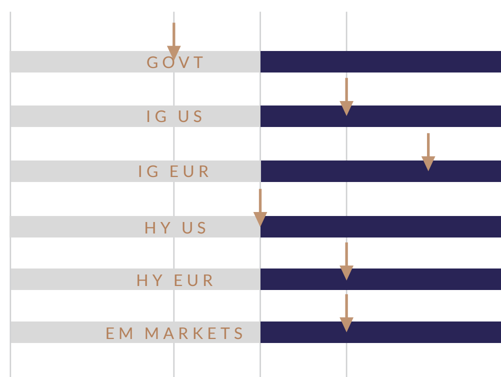
Long Gold.

Conviction thermometer

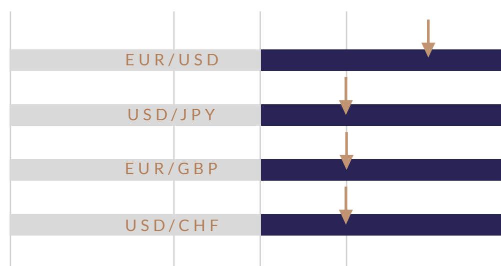
Equities



Bonds



Currencies



Commodities

Negative view Positive view

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Market overview as of 31st July 2024

Equities (local ccies)	Level	5D	MTD	YTD	2023
MSCI WORLD	3 571,58	1,60%	1,79%	14,05%	24,44%
US S&P500	5 522,30	1,77%	1,22%	16,69%	26,26%
NASDAQ 100	19 362,43	1,75%	-1,59%	15,60%	55,13%
RUSSELL 2000	2 254,48	2,70%	10,16%	12,06%	16,88%
EUROPE EURO STOXX 50	4 872,94	0,24%	-0,29%	10,83%	23,21%
GERMANY DAX	18 508,65	0,66%	1,50%	10,49%	20,31%
FRANCE CAC40	7 531,49	0,24%	0,77%	2,66%	20,10%
BELGIUM BEL20	4 130,20	2,05%	6,25%	14,22%	3,51%
SWISS MARKET INDEX	12 317,44	0,94%	2,70%	14,03%	7,06%
UK FTSE100	8 367,98	2,65%	2,53%	10,58%	7,68%
JAPAN TOPIX	2 794,26	0,05%	-0,54%	19,48%	28,28%
MSCI EMERGING	1 084,77	0,26%	0,36%	8,03%	10,20%
BRAZIL IBOVESPA	127 652	0,97%	3,02%	-4,87%	22,28%
CHINA CSI 300	3 442,08	0,87%	0,60%	2,67%	-9,14%
HS TECH	3 516,87	0,88%	-0,79%	-5,70%	-8,25%
INDIA SENSEX	81 741,34	2,00%	3,53%	14,20%	20,34%
KOREA KOSPI	2 770,69	0,44%	-0,97%	5,42%	20,52%
HONG KONG HANG SENG	17 344,60	0,22%	-1,04%	5,11%	-10,46%
AUSTRALIA ALL-SHARE	4 588,31	2,71%	3,13%	10,76%	7,70%
SAUDI ARABIA TADAWUL	11679.50	0,10%	3,76%	2,79%	18,10%

US: Sectors	Level	5D	MTD	YTD	2023
COMMUNICATION SVCS	297,29	1,34%	-4,01%	21,60%	55,80%
CONSUMER DISCRETIONARY	1 516,58	3,43%	1,66%	7,41%	42,30%
CONSUMER STAPLES	834,36	0,09%	1,93%	11,08%	0,52%
ENERGY	712,42	2,98%	2,11%	13,27%	-1,42%
FINANCIALS	727,47	2,60%	6,46%	17,28%	12,10%
HEALTH CARE	1 742,67	-0,15%	2,65%	10,67%	2,06%
INDUSTRIALS	1 081,94	3,78%	4,90%	13,03%	18,08%
INFORMATION TECHNOLOGY	4 249,09	1,27%	-2,09%	25,57%	57,84%
MATERIALS	580,51	2,82%	4,39%	8,61%	12,55%
REAL ESTATE	258,33	2,19%	7,22%	4,59%	12,35%
UTILITIES	369,64	2,38%	6,78%	16,86%	-7,08%

EUROPE: Sectors	Level	5D	MTD	YTD	2023
BASIC MATERIALS	2 932,35	1,01%	-1,53%	-0,01%	5,95%
CONSUMER GOODS	3 918,72	-0,07%	2,97%	2,39%	-2,46%
CONSUMER SERVICES	1 521,78	-0,88%	-3,12%	2,95%	21,53%
FINANCIALS	1 035,05	0,89%	3,66%	20,00%	25,42%
HEALTH CARE	4 114,07	3,02%	2,65%	19,26%	8,75%
INDUSTRIALS	4 052,51	1,86%	2,97%	11,96%	27,43%
OIL & GAS	1 577,18	1,92%	0,08%	6,62%	9,01%
TECHNOLOGY	1 977,41	0,22%	-6,52%	16,75%	34,72%
TELECOMS	568,28	1,70%	4,65%	12,26%	8,86%
UTILITIES	2 053,49	1,57%	7,07%	4,60%	14,75%

Market overview as of 31st July 2024

Fixed Income	Level	5D	MTD	YTD	2023
Pan-Euro 3-5 yrs IG	208,44	0,55%	1,50%	1,40%	6,68%
Euro Aggregate	239,41	0,88%	2,04%	0,80%	7,19%
Pan-Euro HY Hedged Eur	435,79	0,30%	1,21%	4,15%	12,32%
Global Inflation hedged EUR	238,24	1,23%	1,76%	0,18%	2,02%
US Corp High Yield	2 264,90	0,37%	1,94%	4,58%	13,45%
EM USD Aggregate TR	1 260,87	0,84%	1,85%	4,11%	9,09%
EM Aggregate TR Local Ccy	147,12	0,97%	1,81%	0,54%	6,91%
EUR Banks CoCo Tier 1	153,60	0,34%	1,90%	6,82%	5,04%
EU GOVT HEDGED EUR	212,33	1,06%	2,15%	-0,04%	6,31%
Global Aggregate	2 554,99	1,14%	2,76%	-0,49%	5,72%

Commodities	Level	5D	MTD	YTD	2023
GOLD	2 447,60	2,08%	7,06%	18,64%	13,10%
COPPER	417,65	1,89%	-8,50%	7,35%	2,10%
OIL WTI	77,91	0,41%	-4,91%	8,74%	-10,73%
OIL BRENT	80,72	-1,21%	-8,13%	4,78%	-10,32%

Currencies	Rate	5D	MTD	YTD	2023
EURUSD	1,0826	-0,13%	1,50%	-1,93%	3,12%
GBPUSD	1,2856	-0,40%	2,91%	0,98%	5,36%
USDJPY	149,9800	-2,54%	-4,96%	6,34%	7,57%
USDCHF	0,8780	-0,80%	-4,50%	4,35%	-8,99%
AUDUSD	0,6542	-0,59%	1,07%	-3,96%	-0,01%
EURCHF	0,9507	-0,92%	-3,06%	2,34%	-6,13%
USDCNY	7,2980	-0,51%	0,79%	2,79%	2,92%
USDKRW	1 382,10	-1.14%	2,58%	3,86%	1,79%
USDINR	83,7275	0,01%	0,35%	0,62%	0,57%
USDIDR	16 260,00	0,28%	0,00%	5,60%	-1,10%
USDBRL	4,8572	-0.08%	-1,27%	-7,55%	-8,01%
USDTRY	33,1438	0,97%	2,22%	12,25%	57,82%
BITCOIN	64 559,96	-2,25%	7,84%	53,95%	152,94%

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