

» *Fisch View*

Monthly Update – June 2023

As at 31 May 2023

Summary: Market breadth and liquidity decline dramatically

- We expect interest rate cuts by central banks only in the event of a recession, which we continue to anticipate for the US in the second half of the year.
- If, conversely, the economy and labour markets remain robust, there is a risk of a resurgence of inflation and therefore further increases in interest rates.
- Thus, in both scenarios, the fundamental and monetary environment for equity and high yield credit markets is difficult.
- The raising of the debt ceiling in the US will lead to massively higher issuance of US government bonds in the coming months. This will temporarily put upward pressure on long-term interest rates.
- Inflation is falling globally, but only slowly. From mid-year on, base effects will disappear and a further decline will thus become even more difficult.
- Valuations in equity and high-yield credit markets remain relatively rich. Investment-grade corporate bonds, on the other hand, offer interesting entry opportunities.
- Currently, the persistently strong decline in money supply, as well as a very low market breadth, are weighing on financial markets from a technical point of view. Positive factors are high short positions and relatively pessimistic market sentiment.

Significant changes compared to the previous month

- The high short-term government bond yields of 5% in the US and 3% in Europe, while dampening manufacturing and investment, paradoxically have a positive effect on consumers by generating high interest income on savings. This additional income is being spent on consumption, compensating for the drag. This dynamic is all the stronger at present because savings rose sharply during the Corona pandemic and interest rates have been raised by historically unprecedented magnitudes in recent months.
- Nevertheless, various important economic and labour market indicators (yield curves, Conference Board LEI, jobless claims) continue to weaken globally. The probability of recession according to the Cleveland Fed has now risen to 75% for the second half of the year. Moreover, Germany has already had slightly negative economic growth for two quarters. We also expect a recession to occur in the US in the second half of the year.

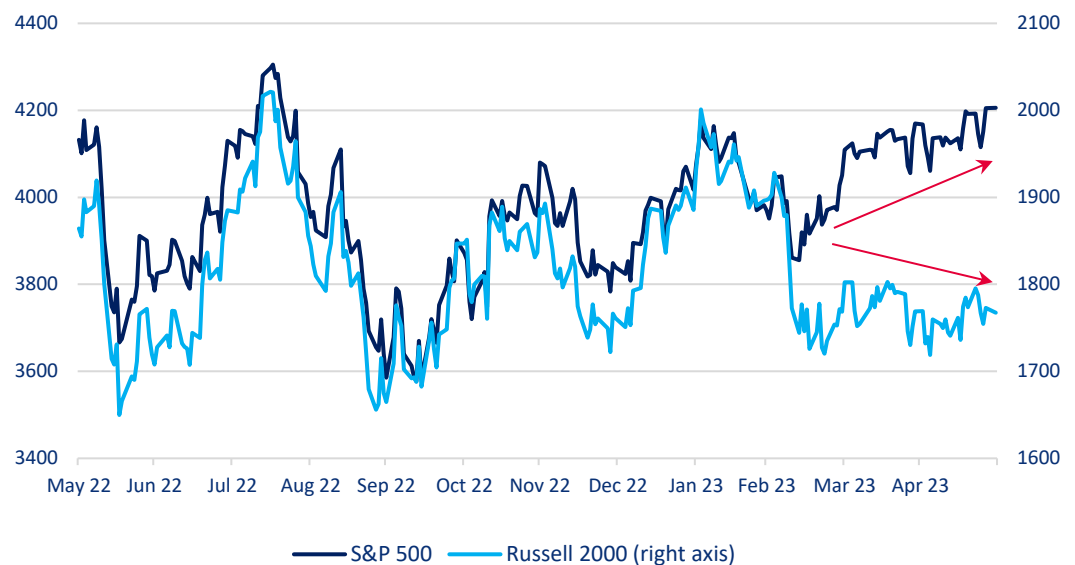
- Inflation rates are also continuing to fall, albeit relatively slowly, but still within a typical long-term pattern. Until we get to July, there are still relatively strong base effects, which should lower the inflation level by around 1.5% to 2% (to below 4% in the US).
- After that, however, inflation rates are likely to consolidate or even rise slightly. The reasons for this are, the disappearance of the aforementioned base effects and an already discernible pick-up in rental price inflation (especially in the US, but also to some extent in the eurozone). This is also confirmed by the latest, stubbornly high PCE inflation figures in the US, which are strongly influenced by rents.
- The raising of the US government debt ceiling will lead to a massive increase in government bond issuance in the coming months. While this reduces liquidity in financial markets, it boosts the economy and inflation.

Current situation and positioning

- Due to the aforementioned very solid global consumer spending (because of the currently high interest rates on savings), the danger of a resurgence of inflation and the soon-to-be-resumed increase in government spending (after the raising of the debt ceiling), a quick turnaround in monetary policy is not to be expected. Despite a slowly cooling economy, central banks are forced to continue withdrawing liquidity from the system.
- An additional liquidity-draining factor is a sharp decline in lending due to the still smouldering banking crisis in the US and the associated outflow of bank deposits. In addition, lending standards are being tightened considerably. In Europe, too, bank lending is declining. In particular, debtors with lower credit ratings are already feeling increasing headwinds in refinancing their debt.
- Persistently weak real estate markets in both the US and Europe as well as the sale of government bonds by the central banks (Fed, ECB) and the US Treasury, estimated at more than 900 billion US dollars in the coming months, are additionally intensifying the already strong liquidity withdrawal from financial markets. All of the above-mentioned liquidity-reducing factors were partially compensated for in the past months by special factors (emergency liquidity, reduction of the "Treasury General Account", private money creation). However, most of these compensatory effects are now disappearing, and a renewed increase of the impact of the restrictive monetary policy must be expected.
- Overall, this continues to create a difficult environment for equity and high yield markets. The combination of rapidly falling liquidity and a weakening of the economy and corporate earnings is providing strong headwinds here. At the same time, valuations are still relatively high. There is thus no risk buffer. A recession is not priced in.
- We therefore remain defensively positioned in our strategies with equity and high yield exposure. Market technical indicators (decreasing market breadth) confirm short-term risks are present. Long-term government bonds could come under pressure in the short term (because of high issuance due to the raising of the US debt ceiling) but then rise again. This also results in a neutral to slightly positive environment for investment grade corporate bonds, also in the emerging markets.

Topics “on the radar”

Chart: US equity market breadth is decreasing dramatically



Source Refinitiv Eikon, Fisch Asset Management

In US equity markets, market breadth is declining at a rate rarely seen in history. Since mid-March, the broad market, as measured by the Russell 2000 Index, has significantly underperformed the S&P 500, as the chart above impressively shows. That is, the vast majority of stocks have not made money since March. Of the 500 stocks in the S&P 500, only eight (!) have risen (Apple, Tesla, Microsoft, Nvidia, Facebook/Meta, Amazon, Netflix and Google/Alphabet). With all the others, however, investors lost money.

This is an indirect signal of rapidly dwindling financial market liquidity and is likely to weigh on investor sentiment in the foreseeable future. Many investors are in the red (even on an annual basis), despite highs in individual indices, and are therefore likely to become increasingly worried.

Declining market breadth can be metaphorically described as an army on the attack, in which only a few generals are still charging forward, but the troops are already retreating in the opposite direction. Such a battle is difficult to win. Accordingly, market breadth swings have always been good medium-term timing signals in the past. They are an expression of increasing tension between lifting forces and decreasing liquidity.

Summary of *FischView* model outputs

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Equities	-	-	+ ↑	o ↓	o	o
Government Bonds	o	o	o			
Credit IG	+ ↑	+ ↑		o ↓	o ↓	o ↓
Credit HY	-	-		o	o	o
Convertibles	-	-	o	o		

	PrecMet	InduMet	Energy
Commodities	o	-	-

Key:

- ++ Strong positive
- + Positive
- o Neutral
- Negative
- Strong negative

Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained [here](#). Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	<ul style="list-style-type: none"> CBs with positive yield Stocks with strong secular trends (renewables, healthcare) Defensive sectors (recession resilient) 	<ul style="list-style-type: none"> Weak credit quality & liquidity REITS Retail
Global IG Corporates	<ul style="list-style-type: none"> Energy, healthcare 5-10 year maturities 	<ul style="list-style-type: none"> Real estate Maturities >10 years
Global Corporates	<ul style="list-style-type: none"> Energy, healthcare Investment grade Developed markets 	<ul style="list-style-type: none"> Real estate, transport High yield Emerging markets
Global High Yield	<ul style="list-style-type: none"> Telecoms, energy Basic industry 	<ul style="list-style-type: none"> Retail Technology 'CCC' rating segment
Emerging Markets - Defensive	<ul style="list-style-type: none"> Indonesia, Malaysia, Middle East 'A' rating segment 	<ul style="list-style-type: none"> LatAm, Taiwan 'BBB' rating segment
Emerging Markets - Dynamic / Opportunistic	<ul style="list-style-type: none"> High yield energy, gold miners 3-5 maturity IG credits LatAm esp. Mexico, Indonesia 	<ul style="list-style-type: none"> Deeper credit B/CCC segment

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

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