Alpha Beta
PARTNERS

INVESTMENT UPDATE

JUNE 2023

FOR PROFESSIONAL INVESTORS ONLY

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Of course, appearances are often deceiving and beneath a seemingly quiet exterior, complications, dangers, and opportunities can lurk. This seems an appropriate way to describe the current market position. Let's lift the lid and peer inside.

One should never underestimate the power of the US consumer. After restrictions and self-denial inflicted by the pandemic, Americans continue to spend, particularly on experiences and travel. Airlines are so short of seats they are advising passengers to defer travel plans to the Autumn. Cruise ships have gone from half empty last year to being overbooked. Restaurant reservations are tricky to secure and shop windows are festooned with "We are hiring" signs. Economic activity rose to a 13-month high during May and a new qualifier for the illustrious "1 trillion-dollar club" was appointed following Nvidia's market capitalisation surging to all-time highs. So, all is well in the world's largest economy?

A collection of highly credible economic indicators point squarely to a slowdown or recession, whilst important commentators from major institutions offer fluent narratives supporting the data. Who does one believe? In some ways the answer rests with 3 people – Jerome Powell, Chairman of the Federal Reserve, Jamie Dimon, Chief Executive of JP Morgan Chase, and Joe Sixpack – the American equivalent of our man on the Clapham omnibus.

US rates may well have peaked last month and a period to assess the economic data and impact will determine whether more monetary cold water needs to be poured on the inflationary flames. Jerome Powell will announce the strategy from here, but the Federal Reserve does not enjoy the best reputation for delicate and sensitive handling. The quarter-one earnings season proved less painful than many forecast, although earnings per share growth is undeniably down -3% or thereabouts and may fall further during the year. Job lay-offs have grown and expansion plans in growth industries are holding back more than had been expected. JP Morgan Chase have been highly accommodative by hoovering-up failing regional banks and so a contagious collateral crisis has thus far been avoided. Joe Sixpack keeps spending despite the highest levels of inflation in 40 years, and tougher borrowing costs. Notwithstanding the prospects for cooling job openings, and a retreating real estate market, the US consumer's credit card persists.

Equity progress has benefitted those allocating passively, although breadth has been non-existent with 7 behemoth technology and communications stocks powering ahead, and mean reverting from 2022 as shown in the chart below. Excitement around miracle productivity gains courtesy of artificial intelligence breakthroughs being the catalyst. Valuations here are stratospheric. The US debt ceiling will be raised to $35 trillion and a drama in Congress is to hopefully be avoided. Quantitative tightening is ongoing at $95 billion per month.

S&P 500 Sector Annual Performance Ranking

as of May 25

2017	2018	2019	2020	2021	2022	2023 so far	+/- YTD perf
Information Technology 37 %	Health Care 4,7 %	Information Technology 48 %	Information Technology 42 %	Energy 48 %	Energy 59 %	Information Technology 30 %	↑
Materials 21 %	Utilities 0,46 %	Comm. Services 31 %	Consumer Discretionary 32 %	Real Estate 42 %	Utilities -1,4 %	Comm. Services 30 %	↑
Consumer Discretionary 21 %	Consumer Discretionary -0,49 %	Financials 29 %	Comm. Services 22 %	Information Technology 33 %	Consumer Staples -3,2 %	Consumer Discretionary 16 %	↑
Financials 20 %	Information Technology -1,6 %	Industrials 27 %	Materials 18 %	Financials 33 %	Health Care -3,6 %	Industrials -0,89 %	↓
Health Care 20 %	Real Estate -5,6 %	Consumer Discretionary 26 %	Health Care 11 %	Materials 25 %	Industrials -7,1 %	Consumer Staples -2,2 %	↓
Industrials 19 %	Consumer Staples -11 %	Real Estate 25 %	Industrials 9 %	Health Care 24 %	Financials -12 %	Materials -2,5 %	↓
Consumer Staples 10 %	Financials -15 %	Consumer Staples 24 %	Consumer Staples 7,6 %	Consumer Discretionary 24 %	Materials -14 %	Real Estate -4,9 %	↓
Utilities 8,3 %	Industrials -15 %	Utilities 22 %	Utilities -2,8 %	Comm. Services 21 %	Real Estate -28 %	Health Care -6,3 %	↓
Real Estate 7,2 %	Comm. Services -16 %	Materials 22 %	Financials -4,1 %	Industrials 19 %	Information Technology -29 %	Financials -7,2 %	↓
Energy -3,8 %	Materials -16 %	Health Care 19 %	Real Estate -5,2 %	Consumer Staples 16 %	Consumer Discretionary -38 %	Utilities -8,9 %	↓
Comm. Services -6 %	Energy -20 %	Energy 7,6 %	Energy -37 %	Utilities 14 %	Comm. Services -40 %	Energy -10 %	↓

Source: Steno Research, Bloomberg and Macrobond

Credible and hitherto reliable economic indicators point clearly to a slowdown / recession. Demand for copper has cooled (leading indicator) whilst Citi's Economic Surprise Indicator rests at zero. A shallow recession late in 2023 remains our central forecast for the United States.

Our allocation to Japan has proven to be well judged as the economy there picks up, in the ways forecast here a couple of months ago. How pleasing to see economic activity reminiscent of the 1990s for those of us that recall the era of the Sony Walkman. Stocks are up around 14% year-to-date in local currency terms.

Likewise, our enhanced allocation to Europe has profited from shrinking energy costs and lower valuations have allowed share prices to propel higher. Inflationary pressure continues to fall encouragingly here but the economy looks set to flip into recession at any time. At home, UK stocks benefitted from sector rotation and a commodity surge in 2022 and fixed income was impacted negatively by the unfunded Kwateng budget. So, those managers with a domestic bias to their equity allocation enjoyed a decent year and their marketing departments strive now to maximise the positive hangover from the transition which has already moved on. Inflation (as we can all attest) remains an embedded issue whilst profit inflation, or greed, is being practised by some retailers of staple goods. Government and larger employers must work hard to avoid a wage spiral. Yields on UK 10-year Gilts back above 4% inform us that Andrew Bailey and his team at the Bank of England have more heavy lifting to do and rates are set to go higher.

China and the emerging world have performed less well, so far, than we had hoped, despite the reopening of China's economy earlier in the year. The impact led by the US so-called onshoring, nearshoring and "friend shoring" has stemmed the surge in demand for Chinese manufacturing. As we write the oil price has slipped below $70, despite sanctions on Russian exports and an OPEC+ production cut. The Chinese Yuan may well be massaged lower to reduce costs of imports as we discussed here some months back, whilst the People's Bank of China remains accommodative.

Progress at portfolio level year-to-date remains credible. Our reduction in the US equity weighting proved timely, although continuing with our passive approach to equities here has enabled upside to be realised despite such narrow progress year-to-date. The allocation to short-dated fixed income will deliver benefits when rates begin to come down. Bolstering European equities has paid off and gains made from our enhanced Japan allocation have underlined our faith in the changes underway there. Longer duration strategies, both for fixed income and equity, remain on the watch list although conditions are not yet sufficiently attractive. We retain a healthy and profitable balance in money market funds which offer-up decent almost risk-free yields and cash holdings remain in position, allowing us to be nimble and place a growth seeking strategy when the moment arrives.

As ever, we thank clients for their support and warmly invite questions and feedback.

Written by the Alpha Beta Partners Investment Team

All sources Bloomberg unless otherwise stated.

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defaqto EXPERT RATED DFM MPS on Platform 2023

defaqto EXPERT RATED DFM MPS (Platform) Family 2023

The Five Diamond rating awarded on Alpha Beta's Core portfolio range.

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