ANALYST WEEKLY

Beginning of end for Fed

JULY 24.2023

Summary

Starting the Fed three-step

Set for July 26th Fed meeting interest rate peak. Focus to shift to pause length, and timing of cuts. S&P 500 historically +7% between last hike and first cut. Market fighting Fed, seeing aggressive six cuts in 2024 starting in March. A hawkish Powell press conference would stoke growth fear and help long-duration assets, like tech. This is closer to our view. A more dovish stance would hasten rotation to growth-sensitive small cap and commodities and hurt dollar. **See Page 4**

Tech results in the spotlight

Global markets ground up, from stocks to bonds and commodities. Dow Jones index saw a record-breaking 10-days of gains. Macro news saw UK inflation relief and China currency intervention. Whilst TSLA, NFLX, and TSMC results held back tech, and CFR dragged on luxury. MSFT was boosted by AI subscription plan ahead of big earnings week. See our Q3 Markets Outlook **HERE** and at twitter @laidler_ben. **See Page 2**

Pros and cons of the weaker dollar

Double-digit dollar plunge a relief for emerging markets, commodities, and US tech-led earnings, but headwind for open European and Asian markets and crucial US inflation fall. **See Page 2**

Company profit margins see timely relief

Producer prices fallen faster than consumer prices on both sides of Atlantic, giving timely relief to company profit margins, and helping offset weak top-line sales 'recession'. **See Page 2**

The stealth emerging markets rally

China weakness masked gains in rest of EM this year, led by eastern Europe and LatAm. Is deep-value contrarian play on weak dollar, improving tech cycle, and firming China growth. **See Page 2**

Silver's tech-led proxy rally

Silver price surged the past year and gold/silver ratio shows further value as solar and battery demand help keep market in deficit. **See Page 2**

Altcoins back in the spotlight

BTC held near the $30,000 level but focus was on altcoins, from SOL to ADA, which continued to bounce-back from the sharp underperformance after being named as 'securities' by SEC. XRP consolidated dramatic gains after partial SEC lawsuit win. 'FedNow' instant payments launch seen as a possible crypto competitor. **See Page 3**

Supply disruption drives ag prices further

Commodities led up by surging ag, with supply disruptions spreading. Grains boosted by Russia withdrawal from Black Sea deal. Cocoa by bad weather in dominant producer Ivory Coast. And rice as India put on export curbs. Natgas boosted by summer heatwave. Top gold producer NEM saw lower output and higher costs. **See Page 3**

The week ahead: Last Fed hike, peak earnings

1) Central banks in overdrive with last Fed hike (Wed), an ECB raise, and possible BoJ surprise. 2) Decisive earnings week as 50% S&P 500 report, w/ MSFT, GOOG, AMZN. 3) See cooling US, EU, UK, JP, AU PMIs (Mon). 4) Reaction to Spanish election and NASDAQ-100 rebalance. **See Page 3**

Our key views: A positive markets breather

Markets due a breather after the strong 1H, with weaker seasonality, low volatility, and coming growth slowdown. But fundamentally positive on lower inflation and coming rate cuts. Focus on defensive growth and long duration assets from healthcare to big tech. Cautious growth exposed cyclicals, commodities, and banks. **See Page 5**

Top Index Performance

	1 Week	1 Month	YTD
DJ30	2.08%	4.45%	6.28%
SPX500	0.69%	4.32%	18.15%
NASDAQ	-0.57%	4.00%	34.07%
UK100	3.08%	2.71%	2.84%
GER30	0.45%	2.19%	16.19%
JPN225	-0.27%	-1.46%	23.80%
HKG50	-1.74%	0.98%	-3.57%

*Data accurate as of 24/07/2023

Market Views

Tech results in the spotlight

- Global markets ground higher, from stocks to bonds and commodities. The Dow Jones index saw a record-breaking 10-days of gains. Macro news saw UK inflation relief and China currency intervention. Whilst TSLA, NFLX, and TSMC results held back tech, and CFR dragged on luxury. MSFT was boosted by its AI subscription plan ahead of huge earnings week. **See NEW Q3 Outlook HERE**. See Page 6 for resources and videos.

Pros and cons of the weaker dollar

- The US dollar index (DXY) recently fell below 100 level as lower US inflation cut interest rate hike expectations, and the global stocks rally eased safer-haven demand. The euro-heavy DXY is down 12% from its 20-year high September peak, whilst the broader trade-weighted index is off 9%.

- LatAm and East European FX led gains this year, given their early rate hikes, whilst Euro breached above 1.10. Japan's Yen and China's RMB been notable losers, as interest rate outliers. We see a modestly weaker dollar ahead, that supportive of risk assets, but with some costs for the most exposed European and Asia markets. See Page 2

Company profit margins see timely relief

- Stock market returns this year nearly all led by higher valuations. Puts spotlight on earnings to start providing some needed support. But weaker economic growth and lower inflation set to drive rare S&P 500 revenues recession this season. But being part offset by timely relief to company profit margins (see chart), as input prices have fallen faster than consumer prices.

- US profit margins remain over 11%, above average, and the 9% seen in Europe. This reflects the US's huge and high margin tech sector, alongside the 'reopening' cyclical sectors that are still rebounding from very depressed profitability. See Page 2

The stealth emerging market rally

- Emerging Markets been perennial laggard of global stock markets. Much driven by growing size, and underperformance, of China. It's a huge 30% weight in EM indices and suffered as GDP growth slowed and cracked down on its property and tech sectors.

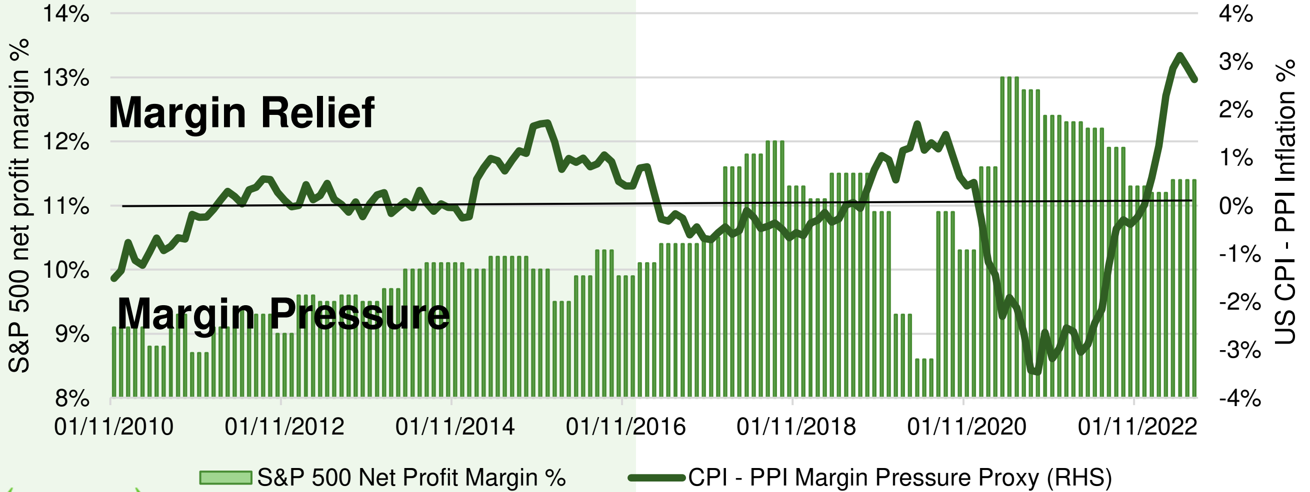
- This masked better performance from other EM's. Emerging Markets ex China stocks are up 13% this year, double the broader index, and versus China's 3% fall. Whilst EM's Greece, Czech, Hungary, and Mexico are the world's best performing markets. We see emerging market stocks, including China, as a deep-value contrarian play on a weaker dollar, improving tech cycle, and firming China growth. From @ChinaTech to @LatAmEconomy. See Page 2

Silver's tech-led proxy rally

- Silver led precious metals rally, up 33% in a year. Boosted by less US bond yields, easing competition for these non-yielding assets. And by a weaker US dollar, making commodities cheaper for overseas buyers. Silver especially helped by improving tech-led demand outlook, from solar to batteries.

- Alongside less mine output from 50% producer LatAm, is set for a widening deficit. Silver a lesser-known and 'cheap' tech rally proxy. See Wheaton (WPM) to Pan American (PAAS). See Page 2

S&P 500 profit margin pressure now easing



Source: Factset, Refinitiv. For illustration purposes only

Market Views

Altcoins back in the spotlight

- BTC price remained near $30,000, holding on to its dramatic gains this year which has seen crypto become the best performing asset class.
- But performance focus remains the catch-up rally from altcoins like SOL and ADA that had suffered after being named as 'securities' by the US SEC, therefore requiring tighter regulation.
- Similarly, XRP held on to its recent huge gains after partial win in its long-standing SEC lawsuit.
- 'FedNow' instant payment network live, with 35 banks supporting. Biggest upgrade since 1970s.

Supply disruption drives ag prices further

- Commodity markets held onto gains even as the US dollar regained some ground after recent sharp weakness. Agricultural markets again led strength on widespread supply disruptions.
- Wheat led big grains rally as Russia suspends role in Black Sea grain export deal and then bombed Ukraine ports. Supply disruptions continued as cocoa surged as dominant producer Ivory Coast saw heavy rains. Whilst India put export curbs on rice, where it is 40% of the world supply.
- US and EU natgas surge as temperatures set new all-time highs, stoking air conditioning demand.
- Top global gold miner NEM saw lower production and higher costs as works to close NCM.AX deal.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-0.64%	3.96%	41.27%
Healthcare	3.02%	2.96%	1.03%
C Cyclicals	-1.63%	4.00%	28.28%
Small Caps	1.51%	5.22%	11.30%
Value	2.21%	4.32%	3.55%
Bitcoin	0.33%	-0.58%	80.64%
Ethereum	-0.49%	1.13%	58.45%

Source: Refinitiv, MSCI, FTSE Russell

The week ahead: Last Fed hike and peak earnings

1. Central Banks go into overdrive with the potential last US Fed **interest rate** hike (Wed), to 5.25%, a further ECB move up (Thu), to 4.25%, and room for a BoJ yield curve control (YCC) surprise (Fri).
2. It's the decisive week of S&P 500 **earnings** season as near half of all stocks report. Led by tech giants MSFT, GOOG, AMZN, META, plus V, KO, PG, XOM. Consensus for 1% sales and 8% earnings fall YoY.
3. Economic focus will be on forward-looking **PMI** indicators (Mon) from US, EU, UK, JP, AU with manufacturing already in a recession and services now cooling. Also look for cooling price pressures.
4. Monday reaction to **Spanish election** as rightist parties gained and as holds presidency of Council of EU. Plus, **NASDAQ-100** index starts trading with lower big-tech weights after its 'special rebalance'.

Our key views: A positive markets breather

- Markets due a breather after very strong 1H, with weaker summer seasonality, too low volatility, and the still-coming GDP growth slowdown. But are fundamentally positive markets, with a stronger Q4 and 2024, as economies avoid recession, with lower inflation and coming interest rate cuts.
- Faster slowdown hurts earnings. But lower bond yields helps valuation. Focus on defensive growth and long duration assets, from healthcare to big tech. More cautious on assets most exposed to recession risk, like cyclicals, small caps, and commodities. Or with lower yields, like banks.

Fixed Income, Commodities, Currencies

	1 Week	1 Month	YTD
Commod*	1.53%	3.77%	-5.86%
Brent Oil	-0.80%	8.97%	-5.93%
Gold Spot	-0.06%	2.08%	7.31%
DXY USD	1.17%	-1.77%	-2.35%
EUR/USD	-0.92%	2.12%	3.95%
US 10Y Yld*	0.86	9.93	-3.87
VIX Vol.	1.95%	1.19%	-37.24%

Source: Refinitiv. * Broad Bloomberg index. * Basis points

Focus of Week: Beginning of the end for the Fed

Starting the Fed three interest rate step at this week's meeting – stop, pause, cut

The Fed is set for a final interest rate hike this week as headline inflation has plunged (see chart). This would mark the first in a three-step Fed dance. Focus will then shift to the second step, the length of the rate pause and resulting two-sided economic growth and earnings risks. This is ahead of the final third stage of the interest rate cuts that would underpin the next bull market. The S&P 500 has posted average gains of 7% between the last hike and first cut in the 8 rate cycles since 1980. We are bullish markets but see more modest gains ahead. Valuations have already rerated, driving markets higher. The focus is shifting to more support from earnings. This will take time, with the bulk of the economic slowdown ahead.

Market is still fighting the Fed and looking for early rate cuts

The market, as usual, has moved well-ahead of the Fed in pricing an interest rate peak and imminent decline. There is more risk to the pace than the direction. 3% headline inflation is nearing the Fed's 2% average target. But underlying core-PCE is at 4.8% and stuck there for months. The data-dependent Fed will want to keep its options open, with two more inflation and jobs reports before its September meeting, It's afraid of repeating the premature rate cuts of the 1970's. With 'long and variable' lags on the impact of the big interest rate hikes seen, the risk of a sharper economic slowdown in the months ahead remains.

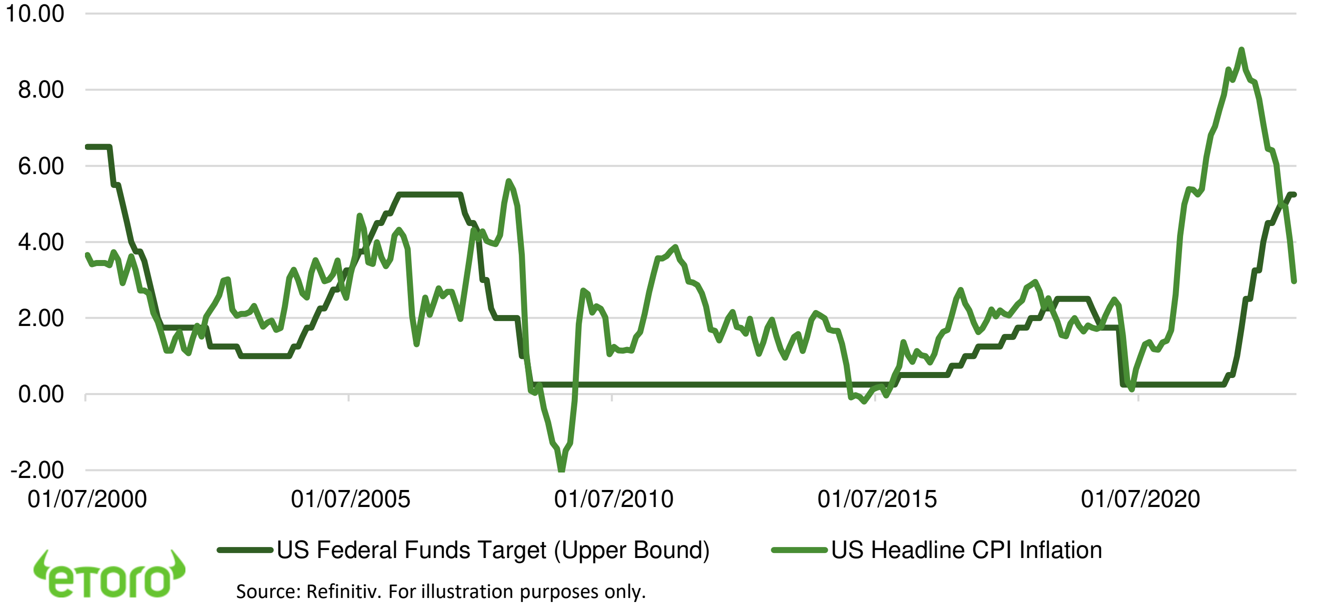
This weeks' Fed meeting marks the top of this dramatic rate cycle

The Fed is universally assumed to hike rates 0.25% at its July 26th meeting. This 11th hike may also mark the end of the Fed's shortest and sharpest hiking cycle in living memory that started only in March last year. There will be no updates to the 'dot plot' forecasts at this meeting. The focus will be on Chair Powell's press conference. He will likely lean against the market view of peaked rates now, and six cuts next year starting in May. With core inflation stuck at 5%, unemployment near generational lows, and peak 'dot plot' at 5.6%.

Focus will shift to sector rotation and the length of the pause

Powell forcefully leading against the 'dovish' market narrative and keeping his options open by signalling further possible hikes would raise economic growth and earnings risks. This would pull-down long-term bond yields, further invert the yield curve, and help long-duration and defensive assets, from tech to healthcare equities, and crypto. This is our base case. Whereas explicit language that the hiking cycle is over and/or inflation concerns easing would push investors to rotate into cheaper and more growth sensitive assets. From small caps to commodities. This would also likely further undermine the US dollar. We see this rotation coming, but later in the year. When core inflation is lower and labour markets cooler.

US Fed interest rate versus inflation (%), since 2000



Source: Refinitiv. For illustration purposes only.

Key Views

The eToro Market Strategy View

Global Overview	Aggressive and extended Fed interest rate hiking cycle and stubborn inflation accelerated our 2023 view. Of a coming GDP slowdown, but not recession, plus lower inflation, and a peaking Fed interest rate cycle. Will pressure earnings but also lower bond yields and take pressure off de-rated valuations. We are invested, believing Oct 2022 was the low, and focus on cheap and defensive assets for a faster 'V-shaped' market recovery. **See our Q3 Outlook HERE**

Traffic lights*	Equity Market Outlook
United States	World's largest equity market (60% of total) seeing slowing but resilient GDP and earnings growth. Valuations led the rebound this year and are supported high company profitability and peaked bond yields. Focus on cash-flows defensives, like healthcare and high dividend. And Big-tech supported by defensive growth, cost cutting, and AI. See gradual 'U-shaped' rebound as inflation slowly falls and de-risks market and boosts tech and crypto appetite.
Europe & UK	Favour defensive and cheap UK ('Economies not stock-markets') and continental European equities. Recession risk easing with lower natgas prices and reopening China with high 'buffers' of rising fiscal spending (defence and refugees) and weak Euro (50%+ sales overseas). Even as ECB hikes aggressively. Equities cushioned by lack of big tech sector and 30% cheaper valuations vs US. Banks better capitalised and regulated but loans/GDP much higher.
Emerging Markets (EM)	China, Korea, Taiwan dominate EM (60% wt.), and more tech-centric than US. Positive China as economy reopens, supports property sector, eases tech regulation pressure. Valuations 30% cheaper than US and markets out of favour. Recovery helps global sectors from luxury to materials. EM needs weaker USD and peak US rates catalyst.
Other International (JP, AUS, CN)	Canada and Australia have benefitted from strong equity market weight in commodities and financials, as global growth resilient and bond yields risen. Now could be becoming headwinds. Japanese equities among worlds cheapest with own and China-proxy growth and governance improving but threats of tighter monetary policy and stronger Yen.

Traffic lights*	Equity Sector & Themes Outlook
Tech	'Tech' sectors of IT, communications, consumer discretionary (Amazon, Tesla), dominate US and China. Expect better performance as 1) lower bond yields take pressure off valuations and 2) high profit margins and fortress balance sheets make defensive to recession risks. 2) Cost cuts and AI add to growth. 'Disruptive' tech much more vulnerable.
Defensives	More attractive as recession risks rising and bond yields have peaked. Consumer staples, utilities, (some) real estate attractive with defensive cash flows, less exposed to rising economic growth risks, and with robust dividends. Healthcare is the most attractive, with cheaper valuations, more growth, some rising cost protection.
Cyclicals	High risk cyclical sectors - like discretionary (autos, apparel, restaurants), industrials, energy, materials, and small caps - have cheap valuations, many with depressed earnings, and have been out-of-favour for many years. But they are significantly exposed to rising recession risks. Some especially cheap (energy) or see growth recovery (airlines).
Financials	Current stresses likely individual not systemic. Post GFC reforms boosted capital and size/speed of authority's response. But outlook for 1) less GDP growth, 2) lower bond yields and interest rates, and 3) valuation sensitivity after recent surprises, worsens outlook. Insurance and Diversifieds (like Berkshire Hathaway) more defensive.
Themes	Dividends and buyback themes attractive with resilient cash flows, rising pay-outs, and investor search for defensives. Power of compounding dividends under-estimated, at up to 1/2 of total long-term return. Small caps pressured by rising recession risk. Secular growth of Renewables and Disruptive Tech investment themes.

Traffic lights*	Other Assets
Currencies	USD 'wrecking ball' driven by Fed interest rates and 'safer-haven' bid. DM currencies hurt by still low interest rates and struggling growth. Strong USD hurt EM, commodities, US foreign earners like tech. But helps big EU and Japan exporters. See a stabler USD outlook in 2023 as near top of the Fed cycle and global risks remain high.
Fixed Income	US 10-yr bond yields supported around 4% by higher Fed rate hike and stickier inflation expectations. Set to ease as recession risks slowly build and inflation expectations gradually fall. US has widespread to other market bond yields, and headwinds of high debt, poor demographics, and low productivity. 5% bill yields an attractive cash alternative.
Commodities	Strong USD and rising recession fears hit commodities. But still above average prices helped by GDP growth, 'green' industry demand, supply under-investment, recovering China, Russia supply crisis. Oil helped by slow return of OPEC+. But commodities not to repeat their 2021 and 2022 performance leadership. Gold benefits from safer haven demand.
Crypto	Potential 'surpsise' after dramatic and early asset class sell-off and later specific risk events from Luna to FTX. See long term asset class development with small size $1 trillion, correlations low, regulation growing, development/catalysts continuing – Ethereum merge to proof-of-stake and coming BTC halving.

*Methodology:	Our guide to where we see better risk-adjusted outlook. Not investment advice.
Positive	Overall positive view and expected to outperform the asset class on a 12-month view.
Neutral	Overall neutral view, with elements of strength and weakness on a 12-month view.
Cautious	Overall cautious view, and expected to underperform the asset class on a 12-month view.

Source: eToro

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