

The biggest call in markets now

AUGUST.07.2023

Summary

To rotate to Value and cyclicals or not?

The investment style and sector rotation is the biggest investor decision in markets today. The gap between best and worst styles and sectors is already above average. Value stocks (VTV to EFV ETFs) are much cheaper, more cyclical and GDP exposed, and pay more dividends. We nibble at select Value ideas, from BEACH stocks to big pharma and EM, but any more needs PMI growth lead indicators to bottom. We think Growth and tech has still has more in the tank. [See Page 4](#)

Excuses for some profit taking

Stocks pulled back after their huge YTD gains as Fitch cut the US credit rating and US Treasury announced \$1 trillion debt issuance plans. The US dollar rose to a 4-week high and 10-yr yields broke 4%. Brazil became 2nd major central bank to cut rates. AMZN gave earnings relief, but AAPL less so. PYPL slumped. TUP became the latest meme phenomena. See Q3 Markets Outlook [HERE](#) and at twitter [@laidler_ben](#). [See Page 2](#)

Profiting from the summer doldrums

Path of markets least resistance remains up, and inevitable pullback to be bought. [August focus](#) is commodity rally risks, dovish inflation consensus, and Q2 earnings ending with a bang. [See Page 2](#)

Global interest rate cuts have started

Chile and Brazil leading LatAm off [rate cutting](#) starters block, with eastern Europe to follow, and US next year. Anticipation of cuts usually drives stocks, whilst FX focused on the coming growth pick up than lower rate differentials. [See Page 2](#)

Gasoline risks derailing goldilocks rally

20% [gasoline price](#) surge risks taking bite out of consumer spending and restoking inflation fears, two pillars of rally. Hopes are gasoline's unusual 50% price premium to oil narrows. [See Page 2](#)

Shadow banks 'dancing in the streets'

Hefty new US [capital proposals](#) latest headwind for underperforming banks. And boost to alt. lenders, APO to BX. See [@BigBanks](#). [See Page 2](#)

Crypto sits on the sidelines

BTC firm at \$29,000 with altcoins SOL to MATIC bearing brunt of stocks weakness. SHIBxM gained as moved to add digital IDs to projects, and LTC completed its halving. MARA extended its lead as largest listed miner, whilst Hong Kong awarded first new crypto regime license. GS see \$200bn AI investments by 2025. [See Page 3](#)

Commodity rally losses steam

US debt downgrade and stronger dollar stalled the recent commodity rebound, 7% up from its June lows. Brent oil held firm above \$85 as Saudi extended its voluntary 1mbpd supply cut. Whilst high-flying ag prices saw profit taking and a better supply outlook, led by grains. ALB raised lithium profits and pricing outlook. [See Page 3](#)

The week ahead: US inflation, Oil, and Disney

1) Headline US inflation fall to under 3% (Thu) versus China deflation (Wed). 2) UK flirting with recession (Fri) and house prices fall. 3) Latest OPEC market outlook (Wed) as rebounding prices threatening lower inflation outlook. 4) DIS to LLY earnings and NOVO to SONY. [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	-1.11%	3.94%	5.79%
SPX500	-2.27%	1.80%	16.63%
NASDAQ	-2.85%	1.82%	32.89%
UK100	-1.69%	4.24%	1.51%
GER30	-3.14%	2.23%	14.57%
JPN225	-1.73%	-0.60%	23.37%
HKG50	-1.89%	6.39%	-1.22%

*Data accurate as of 07/08/2023

Market Views

Excuses for some profit taking

- Stocks pulled back after their huge YTD gains as Fitch cut the US credit rating and US Treasury announced \$1 trillion debt issuance plans. The US dollar rose to a 4-week high and 10-yr yields broke 4%. Brazil became 2nd major central bank to cut rates. AAPL and AMZN reported relieving earnings. PYPL slumped. TUP became the latest e=meme phenomena. **See NEW Q3 Outlook HERE.** See [Page 6](#) for resources and videos.

Profiting from the summer doldrums

- The better outlook for inflation, interest rates, and growth drove latest stage of stocks rally, with capitulating investor sentiment adding extra fuel. The [path of least resistance](#) remains higher, with any inevitable pullback likely to be bought.
- August' peak summer is deceptively quiet. The commodities surge risks upsetting the inflation outlook. Dovish interest rate consensus tested by coming date and Jackson Hole. Seasonality is often some of year's worst. Focus long duration and defensive growth. Tech and crypto to bonds. But selective 'value-trap' cyclicals, small cap, commodities, with slowdown ahead. [See Page 2](#)

Global interest rate cuts have started

- The [global interest rate cycle](#) is turning down as inflation falls. Chile recently slashed interest rates by 1.0%. Brazil followed with 0.5% last week. They are the first major central banks to start cutting rates this cycle. This saw Investors endure an unprecedented 350 net rate hikes globally last year. Stocks typically rally into the first cut, then they see some temporary profit taking.

- Before stocks later recover as both valuations and earnings benefit from stronger growth and lower interest rate view. But sector leadership changes, with interest rate sensitives like real estate leading, and defensives, like staples lagging. [See Page 2](#)

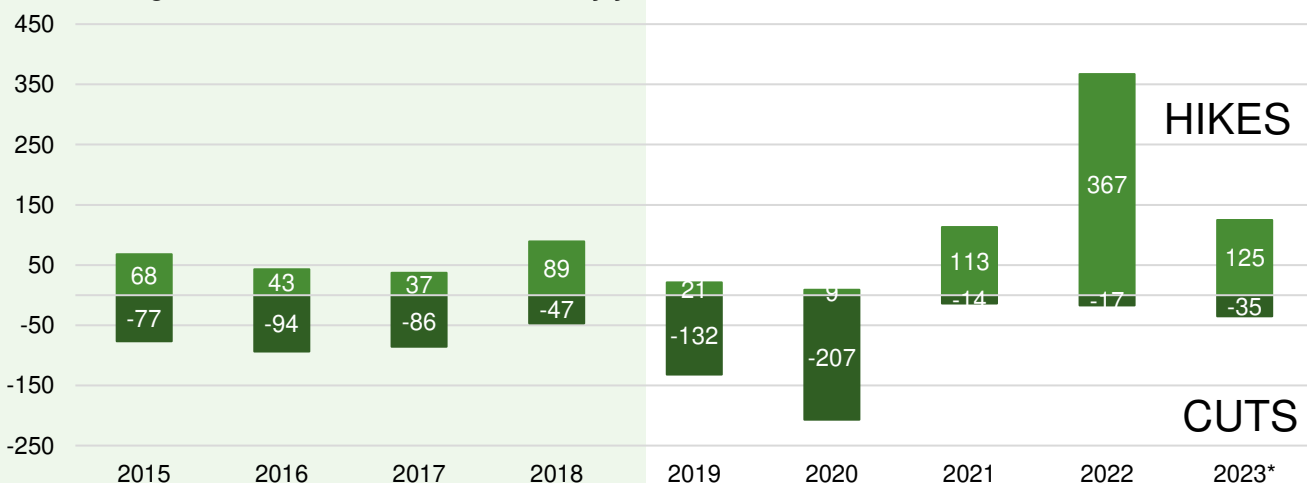
Gasoline risks derailing goldilocks outlook

- Gasoline [prices surged](#) 20% in past month, taking US pump prices to \$3.76/gallon. OPEC supply cuts, resilient economic growth, and China economic stimulus hopes boosted oil. Whilst summer driving season demand and tight supply has boosted the gasoline price premium to twice its average.
- Alongside rising agricultural commodities this is a growing tail-risk to the 'goldilocks' investor consensus of both falling inflation and a resilient consumer that has driven the recent big stocks rally. Every 10c. increase in gas pump prices is a \$25 billion annual cost to the consumer, equal to all Macy's (M) sales. Whilst gas prices closely track consumer inflation expectations. [See Page 2](#)

Shadow banks 'dancing in the streets'

- Financials 3rd biggest S&P 500 sector, 2nd cheapest (after energy) and 2nd worst performing this year (after real estate). With March's small banks scare, a slowing economy and commercial real estate, and now the prospect for tougher capital rules.
- These rules may keep pressuring highly regulated banks at [expense of 'shadow banks'](#). Seen likes of Apollo (APO) and Blackstone (BX) muscle in on banks' traditional business, 'dancing in the streets' according to JP Morgan' (JPM) Dimon. [See Page 2](#)

Number of global interest rate hikes vs cuts, by year



Market Views

Crypto remains on the sidelines

- BTC remained stuck below \$30,000 whilst altcoins SOL and MATIC bore the brunt of volatility seen in tech stock markets. Whilst meme-coin SHIBxM gained as adding digital ID to projects as steps up DeFi credentials. And LTC completed its 'halving'
- Industry news saw MARA extend its lead as the largest listed crypto miner with a 17.7 EH/s self-mining hash rate. Hong Kong awarded the first license under its new crypto regime.
- Goldman Sachs projects that generative AI investments could total \$200 billion by 2025, accounting for up to 4% of US GDP.

Commodities rally loses steam

- The recent commodity rally lost steam as the US's debt downgrade stoked slowdown fears and US dollar strengthened. Remains 7% off June lows.
- Brent crude oil prices were supported near 3-month highs as Saudi Arabia extended its big voluntary 1mbpd supply cut into September.
- Agricultural prices fell back after recent strong gains. Grains saw 10% losses on signs of better supplies coming from major producers US and Russia. Whilst soft commodities, from orange juice to sugar and cocoa saw some profit taking.
- Albemarle (ALB), world's largest lithium producer, raised its profits and growth outlook as sales doubled and prices are expected to rise 30%.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-3.68%	-0.04%	39.08%
Healthcare	-2.17%	0.13%	-1.92%
C Cyclical	-0.40%	0.82%	29.27%
Small Caps	-1.21%	3.20%	11.14%
Value	-1.71%	1.09%	2.18%
Bitcoin	-1.03%	-5.75%	75.40%
Ethereum	-2.39%	-5.71%	53.16%

Source: Refinitiv, MSCI, FTSE Russell



The week ahead: US inflation, Oil, and Disney

1. Focus is **inflation** with an est. further welcome US headline decline to under 3% (Thu). At same time as China (Wed) is set for deflation as global trade and local consumer weakness hold back prices.
2. The stagflationary **UK** is set to report June GDP growth (Fri) flirting with recession, as the Halifax house price index extends its -3% YoY fall. Comes the week after the BoE raised rates for a 14th time.
3. Spotlight on **oil prices**, with Brent at 3-month high over \$80/bbl., as Saudi extends its supply cut, and OPEC to publish latest update (Wed). Further gains could challenge the lower inflation view.
4. The Q2 US **earnings** season begins to wind down with entertainment giant DIS, healthcare LLY and logistics UPS, whilst international earnings remain in full swing from NOVO to SONY and BABA.

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*	-1.21%	3.94%	-6.09%
Brent Oil	2.21%	10.21%	0.19%
Gold Spot	0.99%	2.47%	8.09%
DXY USD	0.38%	-0.26%	-1.46%
EUR/USD	-0.06%	0.38%	2.89%
US 10Y Yld*	9.23	-2.18	16.64
VIX Vol.	28.28%	15.13%	-21.09%

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

Focus of Week: The biggest decision in markets today

The investment style and sector rotation is the biggest decision in markets today

The biggest decision in markets today is on investment styles and sectors, not its overall direction. We think markets are supported by falling inflation, the turning interest rate cycle, and coming growth soft landing. Capitulating investor sentiment is the technical icing on the cake. The bigger call is if, when and how to rotate out of the dramatic tech and Growth outperformance into cheaper and lagging Value and cyclicals. We see select opportunities there but think it's too early. The two key leading PMI and inflation expectations macro signals are still falling. Value is very cheap but the economic slowdown is still coming. This makes for only select opportunities today, from BEACH stocks, to big pharma, and emerging markets.

Styles and sectors performance gap is already running above average

The long term average annual performance gap between the best and worst performing S&P 500 sectors is 45% and between investment styles is 30%. Only seven months into the year and we are ahead of this divergence already. Technology has led utilities by 50%, whilst Growth has led high dividend yield by 32%.

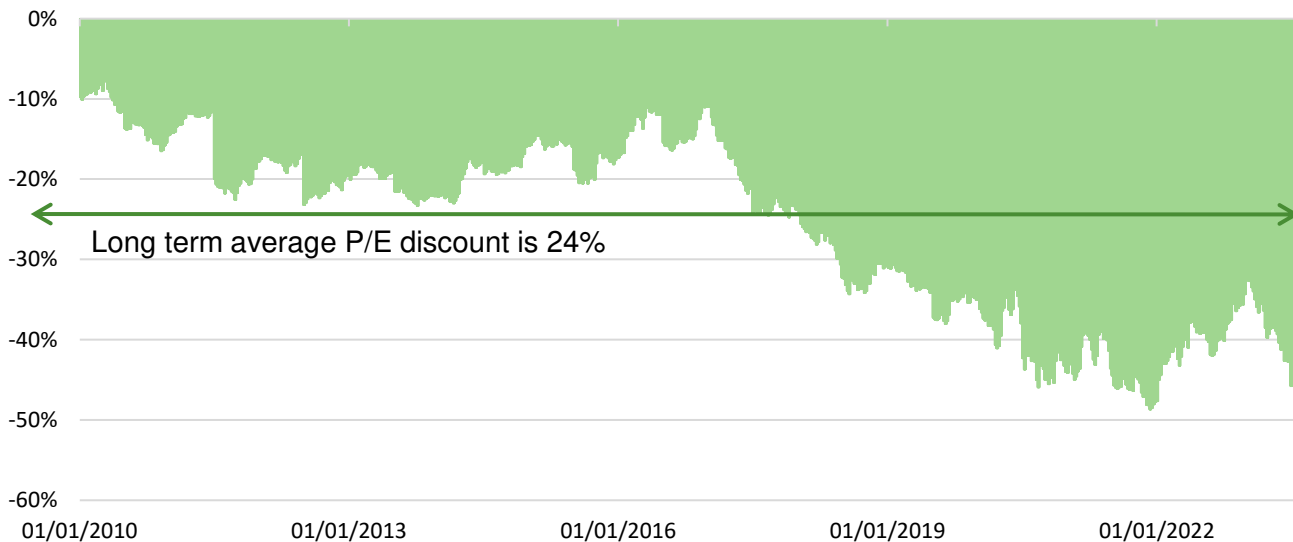
Value stocks are cheaper, often more cyclical and economically exposed, and pay more dividends

Value stocks tend to be cheaper, have slower underlying growth rates, and are often in more traditional industries that are more exposed to the economic cycle. They often pay more in dividends. Think financials, industrials and commodities but also parts of healthcare and tech. The largest holdings in the biggest Value ETF (VTV) for example are Berkshire Hathaway (BRK.B), United Health (UNH), and Exxon (XOM). And in its international equivalent (EFV) its Novartis (NVS), Shell (SHEL), and Toyota (TM). Some markets also have strong style characteristics. The US is dominated by tech stocks and therefore the Growth style. Europe and most of emerging markets by financials and industrials, and therefore Value.

Nibbling at select Value ideas, from BEACH to EM, but more needs PMI lead indicators to bottom

Value stocks have [dramatically lagged Growth](#) in recent years, seeing their most dramatic period of underperformance since WWII. This has hidden for many their strong longer term outperformance record. Tech has recently benefitted from low growth, low interest rates, and accelerating tech disruption. This has taken the valuation gap to near record levels. Value typically benefits from rising growth, boosting their more cyclical businesses and earnings. Higher inflation that their low valuations are defensive to, and Growth is especially hurt by. Tracking the two leading macro indicators is key. [Forward-looking PMI's](#) are weakening, with manufacturing in a recession. Whilst [market inflation expectations](#) are falling. The recent rotation to Value, driven by premature signs of bottoming inflation and stabilising manufacturing falls.

Forward Price/Earnings valuation discount of US Value stocks versus Growth (since 2010)



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 'surprise' 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.

Analyst Team

Global Analyst Team

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