ANALYST WEEKLY

Why a Pause not Pullback

AUGUST.21.2023

Summary

Healthy pause not a sinister correction

We see recent market weakness as a healthy and expected pause in the record-breaking recovery rally. Average years' see three 5% pullbacks. The two main sell-off drivers of higher bond yields and oil prices are likely nearing peaks. Whilst China concerns are far from new. We look ahead to stronger earnings growth and well-supported valuations. Bigger risk is being out of markets. We focus on 'defensive growth' tech, healthcare, bonds, crypto, and cautious Value. See Page 4

Stocks hit by triple-whammy

Stocks hit by a triple whammy of 15-year high US 10-yr bond yields, $85/bbl. oil, and renewed China growth and debt concern. US retail sales surged, taking Q3 GDP NOWCast to a huge 5.8%. UK saw one off inflation fall. Moody' cut US banks outlook. Largest retailer WMT beat results and upped outlook. Buffett' BRK buys homebuilders. Dutch payments giant ADYEN slumped after poor results. See our Q3 Markets Outlook HERE and at twitter @laidler_ben. See Page 2

Valuation worries but not panic

US stock valuations at a record premium to our fair-value, but we see coming support from lower bond yields, recovering earnings, and with plenty cheaper alternatives across markets. See Page 2

China's limited contagion risks

China is an economic giant but capital markets minnow. Opposite to super-sized US markets. Lessens contagion risk, whilst its policy flexibility and valuation are contrarian support. See Page 2

The oil rally may 'self-correct'

Oil prices in new and higher range but more gains will be harder and risk triggering demand fears or testing OPEC supply unity. See Page 2

A lot is riding on NVIDIA

Results (Wed) from the $1 trillion mkt. cap. Semis giant could give tech sector needed boost from strong-for-longer chip and AI growth. See Page 2

Crypto flash crash trigger by SpaceX sale

Sharp crypto weakness was triggered by SpaceX BTC sale report, but asset class also not immune to broader market weakness. Meme coins DOGE and SHIBxM led down. COIN saw rare regulatory good news on crypto futures approval. ARK Invest spot BTC decision delayed by SEC. The TON coin broke into top-20 largest. See Page 3

Commodities hit by China fears

China economic growth, property, and debt concerns hurt commodities. Led down by industrial metals and oil, with Brent below $85. Ag mixed as OJ surged on Florida supply concern, and coffee fell on good Brazil harvest progress. Bidding war broke out for US Steel (X), and STLAM.MI latest to invest in lithium. See Page 3

The week ahead: Jackson Hole, NVDA, Politics

1) Fed's Jackson Hole (Thu) meeting focus as global bond yields soar. 2) Semis and AI giant NVDA reports (Wed), with whole sector watching. 3) Global PMI macro health-check for US, EU, JP, UK, AU. 4) The first Republican primary TV debate kicks off 15-month presidential race. 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	-2.21%	-2.06%	4.08%
SPX500	-2.11%	-3.67%	13.81%
NASDAQ	-2.59%	-5.29%	26.98%
UK100	-3.48%	-5.24%	-2.54%
GER30	-1.63%	-3.73%	11.86%
JPN225	-3.15%	-2.64%	20.53%
HKG50	-5.89%	-5.89%	-9.25%

*Data accurate as of 21/08/2023

Market Views

Stocks hit by triple-whammy

- Stocks hit by a triple whammy of 15-year high US 10-yr bond yields, $85/bbl. oil, and renewed China growth and debt concern. US retail sales surged, taking Q3 GDP NOWCast to a huge 5.8%. UK one off inflation fall. Moody's cut US bank outlook. WMT beat results and raised outlook. BRK bought homebuilders. And Dutch payments giant ADYEN slumped after poor results. **See NEW Q3 Outlook** **HERE**. See **Page 6** for resources and videos.

Valuation worries but not panic

- Near all returns in US stocks this year came from rebounding valuations. This re-rating taken valuations above long-term averages (17.4x P/E) and made US world's priciest market. Higher bond yields now depressing 'present value of future cash flows'. Has opened a rarely seen 30% valuation chasm to our 'fair value' sanity check.

- Is a cause for concern but not panic. As we think 1) Bond yields should ease. 2) Earnings are set to recover. 3) And cheaper valuations are available under surface. Plus, history may be poorer guide, given changed nature of US stocks. **See Page 2**

China's limited contagion risks

- We see China GDP growth and debt concerns having limited impact on global markets. China is a economic giant but a relative markets minnow. Its stocks already some of world's cheapest, and foreign investors already underweight. Its GDP growth is disappointing, and structurally down-shifting, but will still be among world's strongest this year. Whilst US GDP growth outperformance has lessened its immediate global impact.

- China has policy flexibility to respond. From high real interest rates and domestic savings to capital controls, state banks, and overwhelmingly local debt. The response will likely be measured, but this may be enough for the brave with expectations so low. @ChinaTech and @ChinaCar. **See Page 2**

The oil rally may 'self-correct'

- Oil prices may have re-set to new and higher range. With OPEC+ cutting supply and global demand stronger than feared. These are great prices for oil stocks (XLE), well above cash flow break-evens, and as wide refining crack spreads further helping.

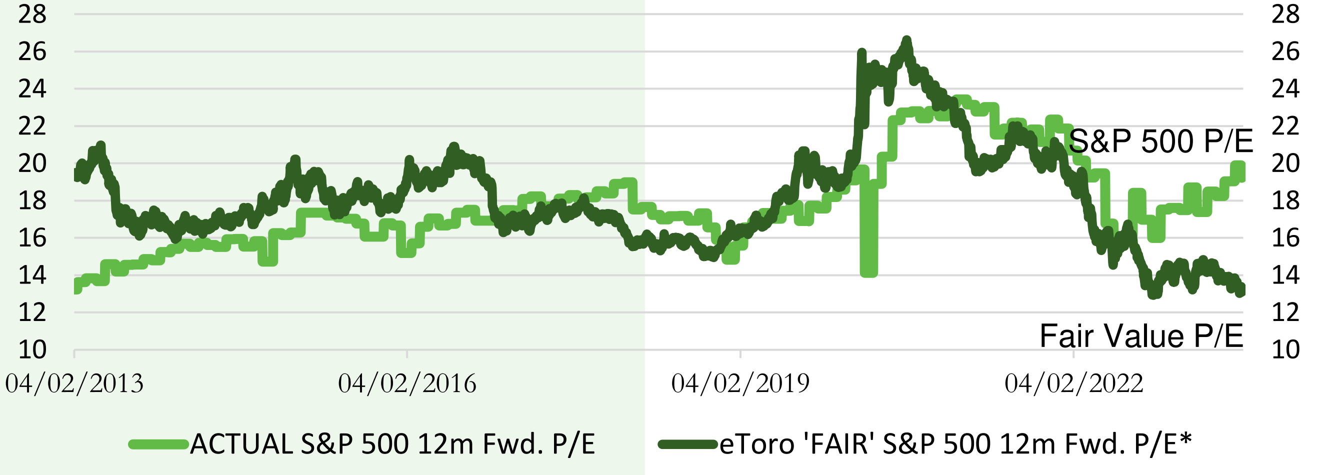
- The going will be tougher from here. Higher prices may 'self-correct' as trigger demand slowdown fear. And testing OPEC supply cutting resolve. Balancing this, forward curves are back-wardated, reflecting views of lower prices, but counter-intuitively help prices now. The world is watching, as higher oil would undermine goldilocks outlook for lower inflation and rates. @OilWorldWide. **See Page 2**

A lot is riding on NVIDIA

- Semis giant Nvidia (NVDA) the poster child for AI-led tech rally and best performing of 'magnificent seven' stocks. Makes its quarterly results (Wed), and $8 billion estimated data centre revenue crucial.

- This is now the 4th largest stock in the S&P 500 index and is larger than all crypto assets, for example. The whole tech sector would get a needed boost from the confirmation of stronger-for-longer chips and AI growth and validation of the big valuation surge seen this year. **See Page 2**

Valuation 'jaws': S&P 500 forward P/E vs 'Fair Value' P/E (10-Years)



Source: Refinitiv. For illustration purposes only

Market Views

Crypto flash crash trigger on SpaceX sale

- Major coins BTC and ETH weakened sharply along with global markets, pressured by higher bond yields and China growth concerns, and on reports Musk's SpaceX had sold its BTC holdings. Weakness led by meme-coins DOGE and SHIBxM. The latter was also hurt by teething problems of its Ethereum level-2 Shibarium launch.

- Exchange COIN saw some rare regulatory good news as its was approved for US crypto futures trading. Whilst a decision on the ARK Invest spot BTC ETF was delayed, as expected, by the SEC.

- The Open Network's TON coin broke into the top-20 market cap coins, following efforts to expand its global network and its entry into NFT sector.

Commodities hit by China growth fears

- Commodity prices fell sharply on China demand concerns and as strong US growth data triggered fears of more rate hikes, and boosted US dollar.

- Weak China retail sales and industrial production and concern on its huge property and shadow banks alarmed investors not calmed by it cutting interest rates. China centric metals, copper to nickel, led, and Brent knocked below $85/bbl.

- OJ rose 10% on Florida supply concerns, whilst coffee fell as the Brazil harvest progressed well.

- US steel giant X was bid for by CLF.US. STLAM.MI the latest automaker to invest in a lithium mine.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-1.40%	-7.42%	34.20%
Healthcare	-1.67%	0.07%	-1.59%
C Cyclicals	-3.95%	-6.12%	23.24%
Small Caps	-3.41%	-5.90%	5.57%
Value	-2.15%	-1.77%	0.23%
Bitcoin	-11.02%	-12.47%	57.89%
Ethereum	-9.82%	-12.54%	38.94%

Source: Refinitiv, MSCI, FTSE Russell

The week ahead: Jackson Hole, NVIDIA, Politics

1. Fed's 45th annual **Jackson Hole** symposium kicks off (Thu), entitled 'structural shifts in the global economy' as US bond yields soar with markets nervous risk of higher-for-longer interest rates.

2. Semis giant and AI leader **NVIDIA** reports earnings (Wed) with whole tech sector watching and focus on $8bn est. data centre revenues. Plus, Q2 reports from BHP, BIDU, LOW, ADI, and ZM.

3. August's **PMI** 'health-check' lead indicators on easing growth but stickly inflation from US, EU, JP, UK, and AU. With manufacturing in recession territory below 50, but services cooling but strong.

4. First **Republican primary TV debate** takes place (Wed) in Milwaukee, marking de-facto start of the US presidential race to Nov. 5th, 2024. Polls show Biden and Trump leading respective party polls.

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*	-1.27%	-1.84%	-7.59%
Brent Oil	-2.19%	4.87%	-1.35%
Gold Spot	-1.40%	-2.32%	4.82%
DXY USD	0.57%	2.34%	-0.09%
EUR/USD	-0.69%	-2.27%	1.59%
US 10Y Yld*	9.85	41.18	37.31
VIX Vol.	16.58%	27.21%	-20.17%

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

Focus of Week: Why a market pause not a pullback

We see recent market weakness as a healthy and expected pause in the recovery rally

The S&P 500 index has fallen 4% since its recent July high and is now below its 50-day moving average. Tech has led the recent fall, and the NASDAQ-100 is off 6%. These are rounding errors after the dramatic rally this year and in a historic context (see chart), but enough to unnerve many. Our long-awaited summer pause is upon us. The twin fundamental catalysts have been surging bond yields, pressuring valuations, and rising oil prices, re-stoking inflation concerns. This has been given a helping hand by a setup of well-below average volatility, weak summer seasonality, less-bearish investor sentiment, and the record-breaking YTD rally. We see fundamentals as secure, bond yield and oil price concerns to ease, and a strong Q4 as investors look ahead to double-digit earnings growth and Fed rate cuts next year.

The two main downside drivers of higher bond yields and oil prices are likely nearing peak levels

The drivers of this market weakness has not been renewed China growth fears or Fitch's US debt downgrade, but surging bond yields and oil prices, in our view. Both should ease. US 10-year bond yields surged to 15-year highs. Pressured by strong growth and rising oil, and technical from higher US issuance to Japan's yield curve control boost. Our copper/gold ratio is still rangebound, current 6% GDP NOWCast and 2% real bond yields historically high. Similarly, we think Brent oil prices much above current levels will be self-correcting. As renewed inflation and rate hike fears stimulate growth and oil demand fears, and high prices challenge OPEC unity. China has bene 70% of demand growth this year, and its struggling.

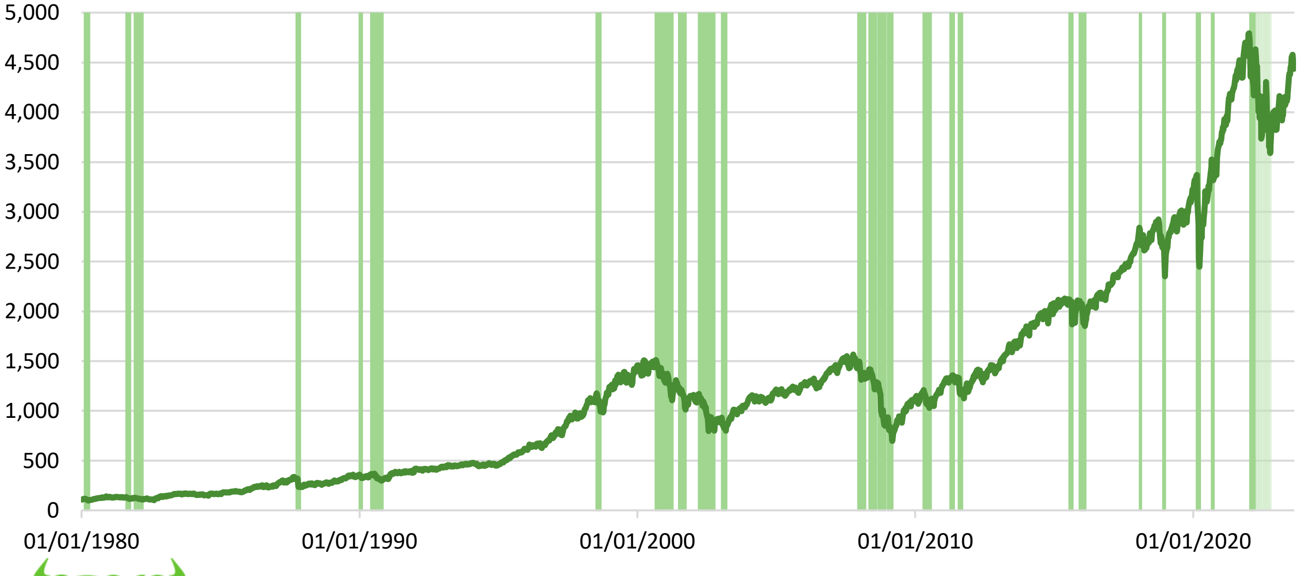
We look ahead to stronger earnings growth and well-supported valuations

The fundamental outlook has turned a lot less bad than feared coming into the year. Headline inflation has fallen sharply. The Fed likely paused its dramatic interest rate cycle. The resilient consumer kept the economy out of recession. This Q2 earnings season will likely be the trough, with earnings falling 3% year-over-year. We look to a seasonally stronger Q4 as investors look ahead to a 2024 with earnings recovering to double-digit growth pace, and a more dovish Fed that starts to cut rate and keep valuations high.

The bigger risk is being out of markets. We focus on tech and healthcare and are cautious Value

The latest bout of nerves may continue for a while. The stocks fall so far is a rounding error historically. September seasonality is typically the worst of the year. Volatility is still well below average. But we think the fundamentals are secure and the bigger risk is being out of markets not in them. We are still focused on defensive growth assets, with risks still above average and an economic slowdown ahead. We focus on big tech and healthcare, see contrarian entry points to long bonds, and are very selective on value stocks.

S&P 500 index 10%+ market 'corrections' (since 1980)



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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