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Summer 2023

CHATGPT

"Chief Investment Officer Quarterly Outlook – Q3 2023

Dear Investors,

We are pleased to present the Chief Investment Officer Quarterly Outlook for the third quarter of 2023. As we enter the second half of the year, global financial markets continue to navigate a complex landscape influenced by a multitude of factors. In this outlook, we will discuss key themes, risks, and opportunities that we believe will shape the investment landscape over the coming months.

1. Global Economic Outlook

The global economy remains on a path of gradual recovery, albeit with some divergences across regions. Advanced economies are experiencing a strong rebound supported by robust consumer spending and fiscal stimulus measures. Emerging markets face more varied conditions, with some countries benefiting from improving export demand, while others grapple with the challenges of managing inflationary pressures and structural issues.

2. Inflation and Central Bank Policies

Inflation concerns have become more pronounced, driven by factors such as supply chain disruptions, pent-up demand, and rising commodity prices. Central banks are closely monitoring these developments and are likely to adopt a more hawkish stance in response. Investors should expect a gradual tightening of monetary policy as central banks seek to balance inflation containment with supporting economic growth.

3. Technology and Innovation

The rapid pace of technological advancements continues to disrupt traditional industries and create new investment opportunities. Areas such as artificial intelligence, robotics, clean energy, and digital transformation remain key drivers of long-term growth. Investors should consider allocating capital to companies at the forefront of innovation to capture potential returns in this evolving landscape.

4. Geopolitical Risks

Geopolitical risks persist, and investors need to remain vigilant. Trade tensions, regional conflicts, and policy shifts can create volatility and uncertainty in markets. Key events to monitor include ongoing trade negotiations, geopolitical tensions, and regulatory changes that could impact various sectors and regions.

5. ESG Investing

Environmental, social, and governance (ESG) factors continue to gain prominence in the investment landscape. Investors are increasingly considering sustainable investment strategies that align with their values while seeking attractive returns. Companies with strong ESG practices and commitments are likely to be better positioned for long-term success.

In conclusion, the third quarter of 2023 brings both challenges and opportunities for investors. A vigilant approach to managing risks, embracing innovation, and seeking exposure to promising sectors can help navigate the evolving investment landscape. As always, it is important to maintain a long-term perspective and remain adaptable to changing market conditions.

We wish you a successful and rewarding quarter ahead."

Are you still awake?

Being a great believer in working smarter rather than harder, I thought about exploring what level of Artificial Intelligence ChatGPT can produce.

Artificial? Absolutely. From my perspective, it is evident that the above was written either by a machine or a dullard.

Intelligent? Perhaps on a surface level, but does it truly provide us with meaningful insights? No. The results are as bland as porridge with no salt, sugar or honey. Where is the wit, panache or out-of-the-box thinking and entertainment? Here is my version:

What condition my condition was in
"Yeah, yeah, oh-yeah
What condition my condition was in
I woke up this morning' with the sundown shinin' in
I found my mind in a brown paper bag and then
I tripped on a cloud and fell a eight miles high
I tore my mind on a jagged sky
I just dropped in, to see what condition my condition was in
I pushed my soul in a deep dark hole
And then I followed it in
I watched myself crawlin' out as I was crawlin' in
I got up so tight I couldn't unwind
I saw so much I broke my mind
I just dropped in, to see what condition my condition was in"

Just Dropped In – Kenny Rogers & The First Edition
Theme tune for the movie "*The big Lebowski*"

Markets and investors seem to have an unlimited appetite for making the same mistakes again and again especially when it comes to new technologies that could upend the very way that we do things. Another human trait is to worry about resulting job losses and completely ignore people's ability to adapt.

Whether we are talking about the industrial revolution, the invention of the motor car, aircraft, railroads etc., some industries become obsolete with resulting job losses, but new ones evolve to replace them. Just remember how in the 1990s many thought there were going to be huge job losses as a result of large advances in computing power. Instead, we actually saw growth in a new highly paid sector – the birth of the software engineer and IT consultant.

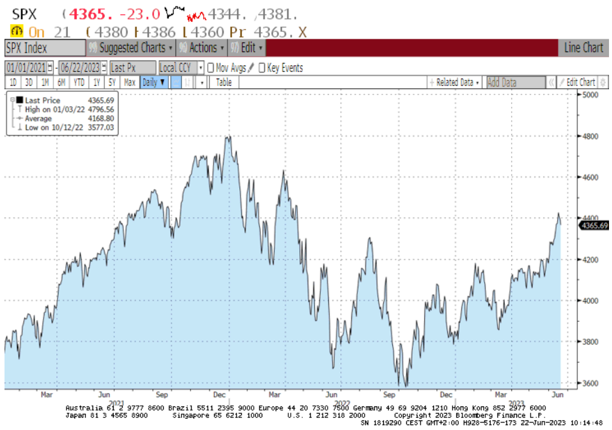
In these aforementioned examples, stocks related to the new industries were bid up to unsustainable levels only to eventually collapse and flatline for decades.

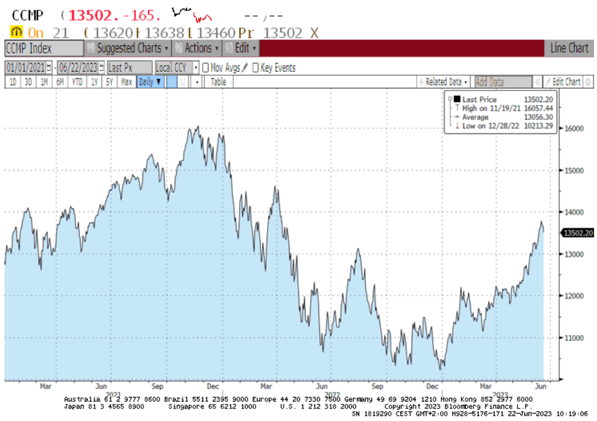
With AI, the impression is that some investors have just fallen in love with this new phenomenon rather than evaluating its potential rationally. Of course, the companies manufacturing, for example, the chips that power AI will benefit financially but perhaps normal companies deploying AI to increase efficiency, productivity and decrease costs will benefit more.

Whilst on the face of it everything seems to be going pretty well in terms of market indices with many in a technical bull market (a rise of 20% or more from the bottom), is all as rosy as it seems? We have no way to be sure that what we are witnessing is just not a vicious bear market rally.

We still have a way to go before we reach real new highs.

Nasdaq bear market rallies during the 2000s
Credit to Bloomberg Finance L.P. for the below SPX and CCMP Index graphs





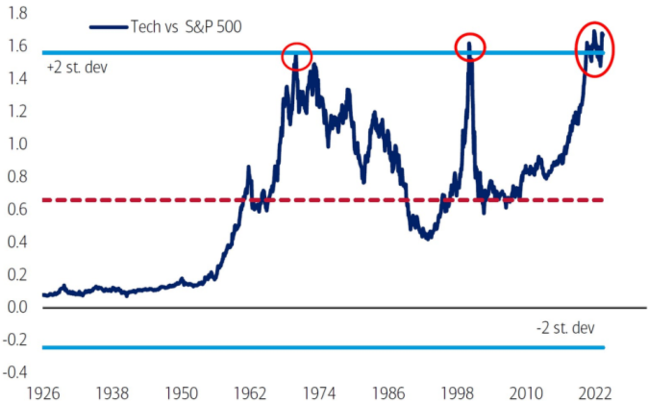
Nasdaq bear market rallies during the 2000s

Credit to Bloomberg Finance L.P. for the below NDX Index graph

Are we witnessing a rerun of the 2000s? Overall valuations on the Nasdaq are not at the nosebleed levels reached then; however, on a relative basis, things look eerily similar.

US tech vs S&P 500 back at Feb '00/ Jan '70 levels

Credit to BofA Global Investment Strategy, Bloomberg, Global Financial Data for the below graph



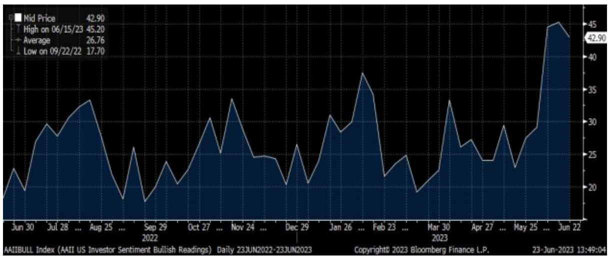
What happened to the Roaring Twenties scenario that everyone expected once we exited the pandemic? It seems to have become very localised. Just look at the prices for travel, how busy airports, hotels and restaurants and car dealerships are especially when compared to electronic stores.

A shot in the dark

How can we explain the recent volatility in markets, especially at the sector/style level? One major cause is simply the fact that investors are unsure about what to do and are changing their bets rapidly. Investors have become more bullish as the market has risen, suggesting that they are now chasing performance after missing out in the first quarter of this year.

AAII US Investor sentiment Bullish readings

Credit to Bloomberg Finance L.P. for the below graph

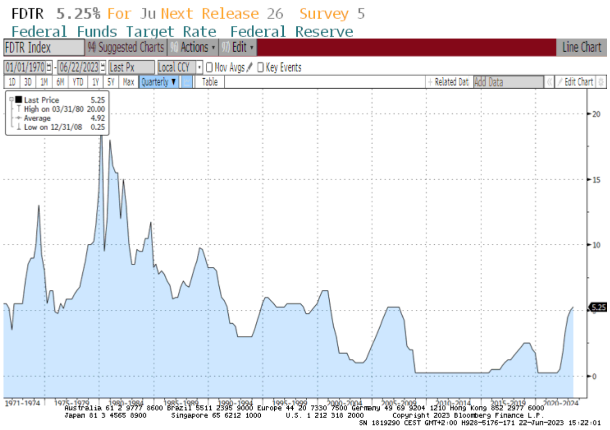


It is commonplace for investors to believe that the current interest rate and economic regime will remain permanently. However, as we have alluded to many times before, we believe that there has been a seismic change, and inflation and interest rates are likely to remain at elevated levels (compared to the recent past).

This is due to many factors such as climate change, greenification of the economy, employee pricing power, military conflicts, deglobalisation, etc.

Federal Funds Target Rate Federal Reserve

Credit to Bloomberg Finance L.P. for the below graph



On a longer-term basis, US interest rates are still slightly below their median level, and even if rates increase a bit further, it doesn't necessarily have to end in disaster. I don't recall a deep recession in the 90s despite rates being at similar levels. However, we are now outside the comfort zone of most investors who still believe that central banks will come to their rescue with interest rate cuts. We do not foresee this happening unless economies have very deep recessions, which is not our base case scenario.

Despite significant headwinds such as extremely high energy prices and inflation, the Eurozone economy had the very mildest of recessions last winter and is probably already returning to growth. With a tighter labour market in the USA and employees now having pricing power, we expect an even softer landing. After all, this is the segment of society that typically spends most of its income rather than saving it.

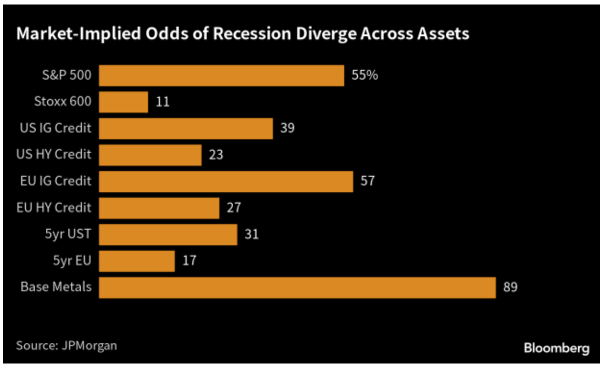
If our base case scenario of no recessions is correct, then cyclical stocks (economically sensitive) are badly mispriced at their current levels, and investors will have to significantly adjust their current positions, leading to even more volatility. We are likely to remain in this "Loki" (the Norse god of mischief) market until investors adapt to the new reality.

RTY Index

Credit to Bloomberg Finance L.P. for the below graph

Market-Implied Odds of Recession Diverge Across Assets Index

Source: JPMorgan - Credit to Bloomberg Finance L.P. for the below graph



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