

Quarterly Pulse – Monday, 3rd July 2023

Economic Outlook

Markets ended the second quarter and the first half of the year with solid gains supported mostly by the AI hype. Nasdaq rally marked the best start of the year for the tech since 1983, S&P 500 reached the highest since April 2022. Nonetheless, the combination of global political uncertainty, inflation, the hiking rates regime, the higher-than-average valuations and the lagged effect of tightening policy can slow the momentum and the strength of the next prints. Economists are expecting the U.S. economic data in the second half to worsen with earnings coming under pressure.

Tactical Asset Allocation

Liquidity	Neutral
Rates	Overweight
Credit	Neutral
Equities	Neutral
Alternative Investments	Neutral

Macroeconomics

Strong U.S. economic data has proven the resilience of the economy to the interest rates hikes. The banking crisis and debt ceiling discussions did not tighten credit as much as feared. The U.S. GDP growth rate was revised and increased from 1.4% to 2%. The consumption data came out strong, particularly for durables like cars, as supply normalized and falling prices supported the demand. Nonetheless, consumption is not a good indicator to predict recession, spending on durables was either flat or rose during last recessions and the current strength can only indicate that we are at the recession yet. With lagged effect of tightening and interest rates on car loans now above 7% can further slow the demand growth.

The peak in interest rates might be approaching but with core inflation remaining sticky in Europe and the USA, it will most probably stay higher for longer what implies also high borrowing cost pressure with lagging effect. It can take months for monetary to be fully felt, that is why it is early to estimate the full impact yet. In any scenario the economy does not show any sign for the cuts yet and Powell made a clear statement that more hikes are needed as anticipated before and rates will stay higher for longer even though market tries to defy that.

The Bank of England is still data dependent on how high to go on interest rates, it is hard for Central bankers to decide when to stop following the larger than expected latest hike.

In the meantime, Japan's economy is posed for a strong recovery from the pandemic with the confidence among businesses increasing and EPS growth forecast over the next two years. After decades of deflation, inflation is coming back. No recession in the US would support the boost. Bank of Japan is closely monitoring the weakening of yen and signaled the intervention.

On top of recovering from pandemic economy, Japan is planning to regain its leadership in semiconductors and triple domestic production of chips by 2030. Semiconductor materials business is becoming increasingly important for countries as a matter of national policy. The export controls on AI chips in the US and limitations of the exports of essential parts of the chips in Germany are currently under discussion. This measures and competition in AI and Semiconductors space along with high inventory levels that outpacing the sales growth put supply/demand dynamic in focus for investors.

The current market appears to be hyper focused on the recovery, hopes and trust of AI implications on future margins creating a bubble by pushing prices to irrationally high levels and investors to behavioural rather than rational investing.

Fixed Income

During the second quarter of 2023, interest rate markets experienced a period of relative stability. The main focus of investors was on the astonishingly solid development of the economy, which pushed recession fears further into the future. Once the debt ceiling discussions were out of the way, markets started to realize that the Fed is not done yet. Global bond markets had to readjust and therefore lost about 1 per cent in the quarter, after a 3 per cent gain in Q1.

In June, the Fed held its benchmark interest rate steady for the first time in more than a year, following 10 consecutive increases. But later, Fed-Chair Powell signalled to the Senate banking committee that the central bank could opt for two more hikes by the end of the year. The main reason for this is a sticky core inflation and a labour-market which still runs hot. The Treasury market is still indicating that interest rate increases will drive the US economy into recession as an inverted yield curve has preceded every recession in the past five decades. History tells us that an economic slowdown starts within 6 months to two years after a curve inversion. It's been a year now.

The resilience of the economy thus far appears to have pushed back the day where rates markets start to perform. Nevertheless, we think that current 10-year yield levels are

attractive. Central banks are restrictive and inflation seems to come down, although at a slower pace. We expect the long end to trade rangebound within 3.5-4% but the next bigger move in rates to be down. In the meantime you enjoy coupon-clipping.

We keep our overweight in rates, as we still think the peak in rates is near. But it is clear to us, that we need unambiguous signal from the macro data to be right.

Equities

We look back on an extremely exciting month for the equity markets in June, in which the S&P 500 broke out of a narrow range between 3800 and 4200 points, in which the stock market barometer has been largely trapped since April 2022. This breakout was met with follow-through buying, sending the index straight past the next resistance at 4400 points. Since the confirmed bottom in October 2022, the S&P 500 has now gained more than 20% and has thus "technically" entered a bull market. Same conclusion can be made for MSCI World or Nasdaq which formed its low last December.



Source: Bloomberg, Clarus Capital

While until recently seven technology-related stocks - also known as the "Magnificent Seven" in stock market jargon - were responsible for 88% of the annual performance of the S&P 500, this extremely thin market breadth has now begun to improve. Thus, the awakened optimism also spilled over to the S&P 400 (mid-cap companies), the Russell 2000 (small companies) or even the Russell Microcap Index in the recent weeks. Both are basically positive technical signals. Interestingly, this is playing out against a backdrop of persistently unconvincing macroeconomic data, a record inverted yield curve, an environment of higher real interest rates and an ongoing tightening of credit availability. This phenomenon under investors is called "climbing the wall of worry". With every further rise of stock market indices or all-time highs, the pain and fears of investors, who are not yet invested increase.

What also drove the recent equity markets is the Artificial Intelligence (AI) narrative in the U.S. And obviously investors

are questioning if this buzzword is creating a stock market bubble like we have experience it in the 2000 Dotcom area. But when we look at how the big indices, like the Nasdaq 100 and S&P 500, are being driven higher by the largest companies, we see that all of those are real businesses. They have revenues, cash flows and earnings. It is true that investors might look at a particular stock and think its multiple is too high for the growth they expect to see, like NVIDIA. Its chips exist, they are sold, and the company is the clear leader in providing the graphics processing units that allow AI to run. Compared to 1998 - 2000, the S&P 500 was hitting a forward P/E ratio of more than 55x. The initial run up was based on prices and euphoria. The second spike into the 50x range would have been from the quick drop in forward earnings expectations when the popping of the bubble was clear. The current valuation of the expected tech part of the S&P 500 is at 16.7x and is very close to the average over the full period. We agree, this is not cheap, but nor is it getting into the more expensive territory. What we want to say with this, is that a bubble is not just a bit expensive or kind of expensive, but rather represents a situation where prices have clearly gone far beyond fundamentals. Forcing ourselves back to a classic figure, the forward P/E ratio, we do not see evidence of that being the case.

Equity Indicators

Valuation	Neutral
Momentum	Positive
Seasonality	Negative
Macro-Economics	Neutral

The ratio is basically a function of the rate of growth and the monetary policy / liquidity environment. In simple words: the stronger the growth, the higher the P/E and the looser the monetary policy, the higher the P/E. Now let's go over and just ask ourselves the following questions: what happens to stocks if we are not going to see a recession, and at the same time the FED's tightening cycle is over? In that case, we should expect higher P/E's and continuing higher equity levels. In 1994, 1997 as well as 1999, the FED put its key interest rates on hold for the last time and raised them again later within the same calendar year. The S&P 500 performed in these particular years -1.5%, +31% and +19% respectively.

The new projections and statements by FED's Powell make it clear that the interest rate peak has not yet been reached. The markets therefore expect another rate hike at the end of July. However, that is likely to be as far as it goes. Finally, analysts expect a weakening of the economy in the coming

months, a cooling of the labour market and further progress on the inflation front. This should convince monetary watchdogs in mid-September that further tightening of monetary policy is no longer necessary – or is eventually already over.

We maintain our neutral stance in equities and clearly prefer U.S. over Europe despite its higher valuation. Since January we are overweight Tech and like the U.S. Small and Mid-Cap Exposure because the tightening cycle is almost over. In the last few weeks, the rotation to small and mid-caps has reaffirmed our decision. Overall, we are not that pessimistic like our competitors in equities and are confident for Q3 with solid returns.

Alternative Investments

Gold started the second quarter around USD 2'000 and declined within the quarter steadily to USD 1'900. Gold volatility has significantly reduced from 20% to 10% within the quarter. The newly won market expectations for higher interest rates for longer, made Gold trade range-bound. Robust economic data as well as hawkish comments from central banks are poisonous for higher Gold prices and might

continue to drag prices down. Elevated core inflation could add fuel to the bearish sentiment. Also technical indicators are now showing neutral to bearish sentiment. It seems that the safe haven effect of holding Gold is vanishing too looking at the price reaction despite of the geopolitical turmoils. We expect Gold to trade range-bound and having limited upside as well as downside: neutral stance.

Crude and Brent Oil lost both USD 6.- within the quarter to now USD 70.- respectively USD 74.40. Despite of a normally tighter month in July it will be challenging to see last quarters high of USD 80.- again. Supply cuts from Saudi Arabia, hopefully strong Chinese imports as well as the end of season in refinery should be supportive. A recessionary tendency in the US would further accelerate the decline in Oil prices. Historically, commodities especially Oil have been a hedge against inflation. However the environmental change as well as higher prices, made it easier for consumers to mitigate and supply has been supportive too. Do not count energy to be a good inflation hedge in the upcoming months. We expect Oil to slightly raise in one-digit within the next quarter.

Market Overview as of Monday, 3rd July 2023

Fixed Income

	Rate	Δ 1m	Δ 3m	Δ ytd		Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Overnight	5.06	0.00	0.25	0.74	USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD 1y Swap	5.67	0.30	0.64	0.55	USD Aggregate 1-3y	-0.3%	-0.5%	1.1%	1.1%
USD 3y Swap	4.68	0.50	0.71	0.33	USD Aggregate 3-5y	-0.6%	-1.3%	1.1%	1.3%
USD 5y Swap	4.22	0.38	0.59	0.20	USD Aggregate 5-7y	-0.5%	-1.5%	1.4%	1.7%
USD 10y Swap	3.86	0.18	0.40	0.02	USD Aggregate 7-10y	-0.1%	-1.4%	1.6%	2.1%
EUR Overnight	-0.51	-0.02	-0.01	-0.01	EUR Overnight	0.3%	0.8%	1.4%	1.4%
EUR 1y Swap	4.12	0.24	0.56	0.84	EUR Aggregate 1-3y	-0.4%	-0.2%	0.6%	0.7%
EUR 3y Swap	3.68	0.32	0.48	0.37	EUR Aggregate 3-5y	-0.7%	-0.5%	0.7%	1.2%
EUR 5y Swap	3.32	0.22	0.31	0.09	EUR Aggregate 5-7y	-0.7%	-0.4%	1.3%	2.1%
EUR 10y Swap	3.05	0.04	0.15	-0.15	EUR Aggregate 7-10y	-0.5%	-0.2%	1.9%	3.3%
CDX Xover 5y	4.33%	-0.20%	-0.36%	-0.51%	US Corp. HY	0.8%	1.4%	4.8%	5.4%
iTraxx Xover 5y	4.01%	-0.14%	-0.44%	-0.73%	EUR HY	0.3%	1.4%	4.2%	4.6%

Equity

	Price	P/E	D. Yield	FCF yield		Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	9'191	17.9	2.1%	4.3%	MSCI World	3.3%	6.4%	15.2%	15.1%
S&P 500	4'456	20.4	1.6%	3.9%	S&P 500	4.0%	8.0%	16.5%	16.0%
NASDAQ	15'209	28.8	0.7%	2.5%	NASDAQ	4.6%	15.7%	40.0%	39.0%
Euro Stoxx 50	4'398	12.6	3.5%	6.0%	Euro Stoxx 50	1.7%	2.0%	13.3%	15.9%
SMI	11'219	17.4	3.2%	4.7%	SMI	-2.0%	1.1%	2.2%	4.6%
FTSE 100	7'527	10.6	4.1%	9.9%	FTSE 100	-1.1%	-1.9%	-0.4%	1.0%
DAX	16'081	11.4	3.4%	5.5%	DAX	0.2%	3.2%	13.4%	15.5%
MSCI Asia Pacific	163	14.6	2.7%	4.1%	MSCI Asia Pacific	0.5%	0.2%	4.2%	4.8%
FTSE China A50	12'728	10.8	3.1%	6.3%	FTSE China A50	1.0%	-3.9%	-2.2%	-2.1%
MSCI Emerging Market	989	13.3	3.0%	6.2%	MSCI Emerging Market	0.5%	0.0%	2.8%	3.5%
PH Semiconductor	3'704	30.0	1.2%	2.1%	PH Semiconductor	5.8%	15.7%	48.1%	46.3%

Commodity

	Price	FCST 23	FCST 24	Δ Future		Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	1'929	1941	1970	0.2%	Gold	-1.2%	-2.8%	4.5%	5.6%
Silver	23.11	23.44	24.685	0.7%	Silver	-3.6%	-5.4%	-6.9%	-6.0%
Platinum	917	1032.5	1147	1.0%	Platinum	-9.2%	-8.6%	-16.6%	-15.9%
Palladium	1'236	1495	1513	2.3%	Palladium	-12.0%	-15.9%	-27.7%	-31.8%
Crude Oil	70.09	78	81	0.8%	Crude Oil	-2.4%	-12.0%	-8.5%	-11.7%
Brent Oil	74.95	81.47	85	-1.1%	Brent Oil	-1.3%	-10.1%	-6.7%	-9.8%

Foreign Exchange

	Price	FCST 23	FCST 24	Δ Spot		Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	1.0913	1.12	1.15	5.2%	EUR/USD	1.9%	0.1%	3.5%	1.9%
GBP/USD	1.2695	1.26	1.29	1.6%	GBP/USD	2.1%	2.3%	6.1%	5.1%
USD/CHF	0.8963	0.9	0.9	0.4%	USD/CHF	1.1%	1.8%	4.4%	3.1%
USD/JPY	144.66	132	125	-14.6%	USD/JPY	-3.5%	-8.4%	-9.4%	-9.4%
EUR/CHF	0.9782	0.99	1.03	5.2%	EUR/CHF	-0.7%	1.7%	0.9%	1.2%
USD/RUB	118.69	85	95	-22.3%					
EUR/RUB	97.46	95	107.28	9.6%					

Source: Clarus Capital Group, Bloomberg

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