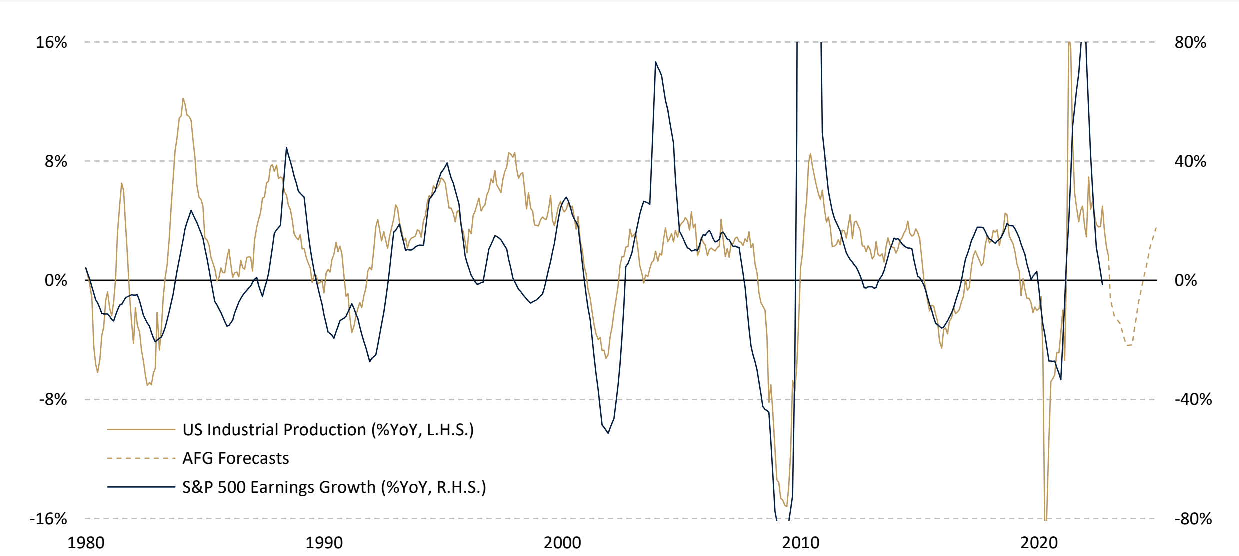
Weekly Investment Focus

13 February 2023

"BULL RUN OR BULL TRAP?"

- Bond investors deliver a message of recession
- Leading economic indicators point to a hard landing
- With corporate earnings and valuations set to fall...
- ... stock markets will struggle to extend their January rally

CHART OF THE WEEK: "Growth in output and corporate profits"



Source: Federal Reserve, R. Shiller, Atlantic Financial Group

FINANCIAL MARKET ANALYSIS

2023 kicks off with a bang. Does the future look bright for investors? Stock markets have performed very well in the first six trading weeks. The flagship US equity index, the S&P 500, has risen by +9%, its technology sibling, the Nasdaq, by +17%, while its European counterpart, the Euro Stoxx, has risen by +12%. Naturally, investors are wondering whether this is another bull run or a fourth bull trap. Looking at the signals sent by the bond market, the answer to this key question does not seem so hard (see Fig. 2).

Fig. 2 - Stock market vs. yield curve

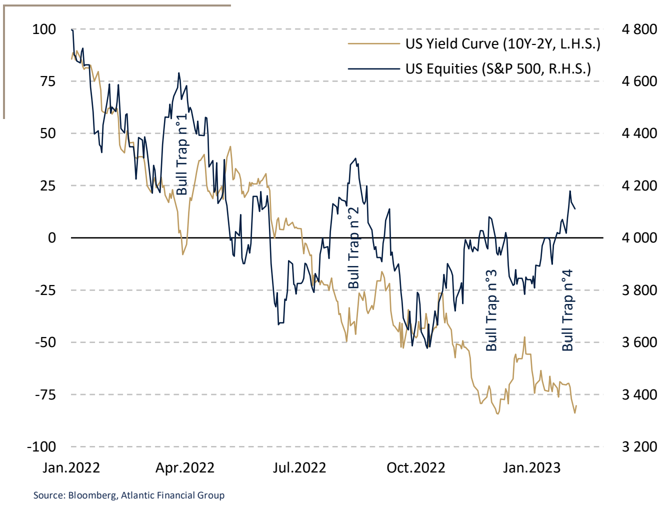
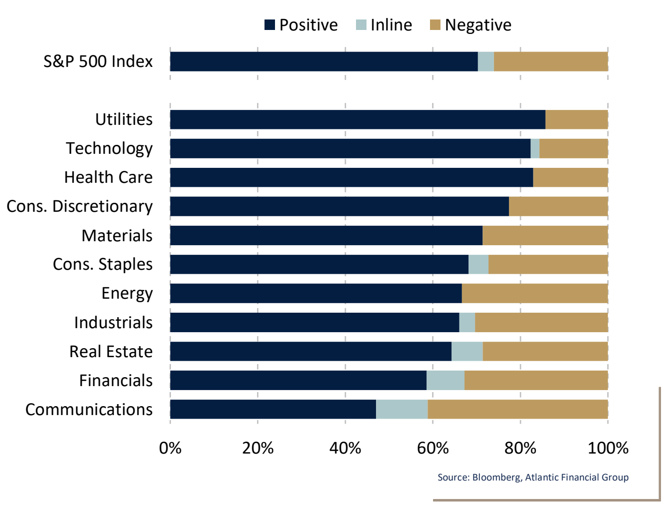


Fig. 3 - US earnings season, by sector



In the United States, **two-thirds of the companies** that make up the S&P 500 **have released their earnings for the fourth quarter of 2022.** 70% of them have beaten estimates (see Fig. 3). This may sound positive, but it is the weakest result since the Great Financial Crisis in 2008. **Their profits fell by -5.3% compared to last year.** They were affected not only by the poor results of communication companies and financials, but also of the major technology names such as Meta, Alphabet, Amazon, and Apple. Fortunately, not all of them were penalised. Meta, for example, which managed to beat earnings expectations and cut costs, jumped to its highest level in six months. At the other end of the spectrum, defensives like utilities and healthcare firms are doing well.

Fig. 4 - GDP = Employment + Productivity

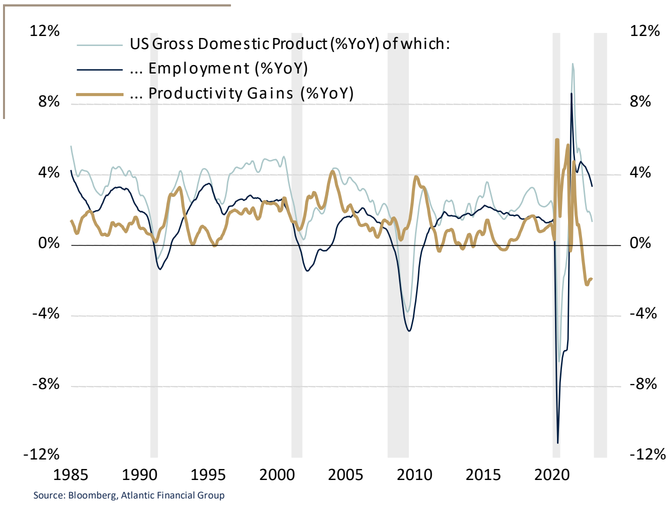
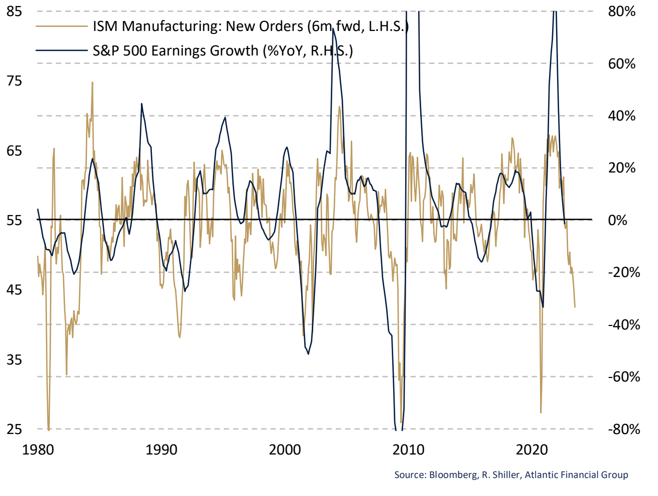


Fig. 5 - Company profits vs. order books



Globally, the next few quarters will not be any better. As earnings fluctuate with the economic cycle (see Chart of the Week), they will be negatively impacted by weak demand. Furthermore, companies have been hiring as their production has begun to weaken. In doing so, they have degraded their productivity (see Fig. 4), which will weigh more heavily than usual on future earnings.

In light of recent leading indicators, including weak new order books in industry (see Fig. 5), **listed companies' profits will contract further. Our econometric modelling estimates a low of -20% over the full year 2023** (see Chart of the Week), **a far cry from the consensus.** Analysts expect a modest earnings squeeze, with a decline in the first half and a rebound thereafter. Their estimates are based on a soft landing for the economy, which almost never happens. In the vast majority of cases, economies make hard landings. In the last 23 years, a decline in earnings has been expected only four times (2001, 2008, 2015, 2020). In each case, equity indices have experienced a bear market.

Fig. 6 - Equity valuation ratios

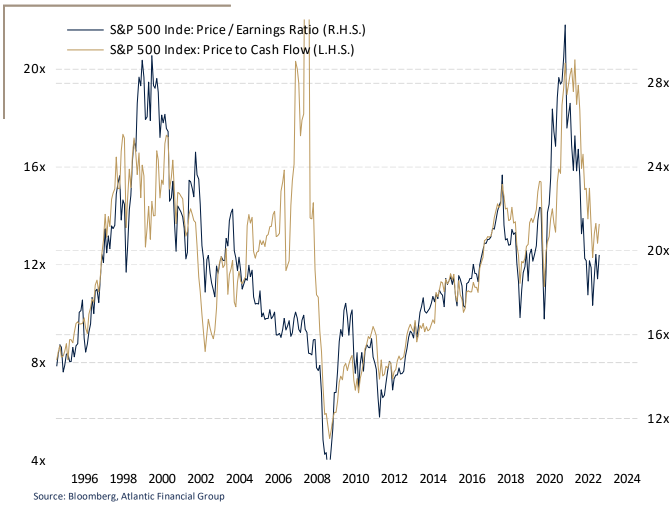
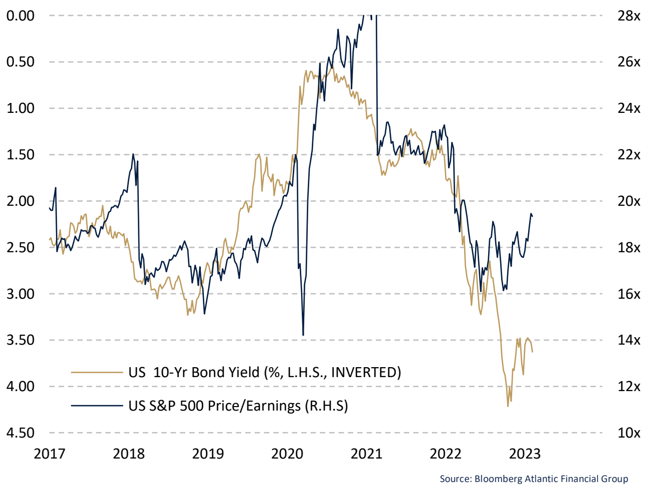


Fig. 7 - Equity valuation vs. 10-year yield



As stock markets have risen at the same time as earnings have fallen, valuations have risen. In other words, listed companies have become as "expensive" as they were at the beginning of last year before the stock market correction. Some may find them "cheap", but the ratios are well above their previous cycle lows: 1995, 2002, 2008, 2011 or 2020 (see Fig. 6). **Therefore, over the next 10 months, there is a real risk of a further valuation squeeze.** If bond investors are correct, a 14x earnings multiple would not be unrealistic (see Fig. 7).

2023 is the best start to a year for multi-asset portfolios since 1987. Equity markets were not the only positive contributors to performance. Bonds and gold gained 3% to 6% over the period. This is slightly less spectacular but just as notable, and, more importantly, the likelihood of an upcoming downturn in these assets is much lower.

Conclusion:

Past performance is no guarantee of future results. After six particularly rewarding weeks in 2023, this disclaimer has never been more appropriate for the stock markets' current situation. The leading indicators, and the implied economic scenario, leave little room for doubt: the recession will be severe in 2023. Corporate earnings will suffer, dragging stock market indices to new lows. It is too early to add risks.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2023 Year-to-Date (%)	2022 (%)	2021 (%)
Equities							
World (MSCI)	638.1	68.41	3.4%	1.5%	5.5%	-18.0%	19.0%
USA (S&P 500)	3 999	60.58	2.7%	-0.4%	4.2%	-18.1%	28.7%
USA (Dow Jones)	34 303	62.55	2.0%	0.6%	3.5%	-6.9%	20.9%
USA (Nasdaq)	11 079	59.76	4.8%	-1.5%	5.9%	-32.5%	22.2%
Euro Area (DJ EuroStoxx)	445.0	71.83	2.9%	4.2%	8.6%	-11.4%	23.5%
UK (FTSE 100)	7 844	74.63	1.9%	4.7%	5.3%	4.6%	18.4%
Switzerland (SMI)	11 291	62.53	1.3%	1.4%	5.2%	-14.3%	23.7%
Japan (Nikkei)	25 822	38.91	0.6%	-6.4%	0.1%	-7.4%	6.7%
Emerging (MSCI)	1 030	78.27	4.2%	6.8%	7.7%	-19.9%	-2.3%
Brasil (IBOVESPA)	110 916	55.80	1.8%	7.1%	1.1%	4.7%	-11.9%
Russia (MOEX)	2 219	63.21	2.3%	4.1%	2.4%	-36.9%	21.9%
India (SENSEX)	60 224	43.66	0.6%	-3.6%	-1.0%	5.8%	23.2%
China (CSI)	4 138	72.66	2.4%	3.4%	5.2%	-19.8%	-3.5%
Communication Serv. (MSCI World)	76.21	73.11	4.3%	4.3%	8.4%	-35.3%	10.9%
Consumer Discret. (MSCI World)	303.8	71.82	5.4%	3.1%	9.5%	-31.6%	9.2%
Consumer Staples (MSCI World)	273.0	61.38	0.5%	0.3%	2.2%	-6.0%	11.7%
Energy (MSCI World)	248.2	61.49	3.4%	3.9%	3.1%	34.5%	37.5%
Financials (MSCI World)	140.5	75.19	3.2%	5.3%	6.4%	-9.2%	25.1%
Health Care (MSCI World)	345.9	57.12	0.8%	-1.4%	1.1%	-5.7%	18.0%
Industrials (MSCI World)	298.7	69.50	2.9%	2.0%	5.3%	-12.7%	16.6%
Info. Tech. (MSCI World)	416.0	61.54	5.2%	-2.1%	6.0%	-30.9%	27.6%
Materials (MSCI World)	338.9	75.24	4.7%	4.6%	8.7%	-11.0%	15.4%
Real Estate (MSCI World)	183.9	67.71	4.1%	2.3%	6.8%	-24.0%	23.6%
Utilities (MSCI World)	155.4	61.69	1.5%	0.7%	2.6%	-3.8%	11.1%
Bonds (FTSE)							
USA (7-10 Yr)	3.50%	59.45	0.6%	-0.1%	2.8%	-14.5%	-2.4%
Euro Area (7-10 Yr)	2.79%	56.24	0.9%	-1.5%	4.0%	-19.4%	-2.9%
Germany (7-10 Yr)	2.16%	52.00	0.3%	-2.1%	2.8%	-17.8%	-2.7%
UK (7-10 Yr)	3.36%	57.63	1.0%	-0.1%	2.5%	-17.1%	-4.9%
Switzerland (7-10 Yr)	1.13%	62.76	1.8%	0.4%	4.1%	-12.5%	-2.3%
Japan (5-10 Yr)	0.53%	18.50	-0.7%	-2.1%	-0.7%	-2.8%	0.0%
Emerging (5-10 Yr)	7.74%	69.01	1.0%	1.1%	2.5%	-17.4%	-2.3%
USA (IG Corp.)	5.03%	66.07	1.0%	1.0%	3.4%	-15.8%	-1.0%
Euro Area (IG Corp.)	3.95%	61.07	0.7%	0.8%	2.1%	-13.6%	-1.0%
Emerging (IG Corp.)	7.33%	79.36	0.4%	1.8%	2.3%	-14.9%	-3.0%
USA (HY Corp.)	8.10%	75.13	1.0%	2.4%	3.8%	-11.2%	5.3%
Euro Area (HY Corp.)	7.35%	80.48	1.0%	2.2%	2.5%	-10.6%	3.4%
Emerging (HY Corp.)	10.48%	78.66	0.9%	2.9%	3.1%	-12.4%	-3.2%
World (Convertibles)	374.4	73.85	3.1%	2.3%	4.4%	-18.2%	2.4%
USA (Convertibles)	494.4	69.65	3.0%	1.5%	4.3%	-20.1%	3.1%
Euro Area (Convertibles)	3 523	45.80	-0.1%	-0.8%	n.a.	-14.2%	-0.3%
Switzerland (Convertibles)	175.3	65.92	0.9%	0.2%	1.9%	-7.5%	-0.5%
Japan (Convertibles)	198.9	59.23	0.8%	0.0%	0.5%	-1.3%	3.3%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	734	61.33	n.a.	0.1%	n.a	1.0%	8.2%
Distressed	924	51.58	n.a.	0.0%	n.a	-4.5%	12.5%
Event Driven	757	52.53	n.a.	-0.1%	n.a	-6.7%	12.9%
Fixed Income	390	52.96	n.a.	1.4%	n.a	-2.3%	5.2%
Global Macro	1396	65.53	n.a.	-1.1%	n.a	17.1%	9.6%
Long/Short	874	53.62	n.a.	0.2%	n.a	-5.9%	8.3%
CTA's	407	63.41	n.a.	1.0%	n.a	18.0%	8.2%
Market Neutral	295	59.85	n.a.	1.9%	n.a	-0.1%	6.2%
Multi-Strategy	706	59.18	n.a.	-0.5%	n.a	1.7%	7.0%
Volatility							
VIX	18.35	37.72	-13.2%	-18.6%	-15.3%	25.8%	-24.3%
VSTOXX	17.34	33.89	-6.2%	-14.9%	-17.0%	8.4%	-17.6%
Commodities							
Commodities (CRB)	559.5	n.a.	2.2%	0.1%	0.8%	-4.1%	30.3%
Gold (Troy Ounce)	1 917	72.75	2.4%	6.9%	5.1%	-0.3%	-3.6%
Oil (WTI, Barrel)	79.86	56.53	7.0%	5.9%	-0.5%	4.3%	58.7%
Oil (Brent, Barrel)	83.62	54.56	9.3%	5.5%	-0.7%	9.7%	51.4%
Currencies (vs USD)							
USD (Dollar Index)	102.17	33.72	-0.8%	-2.4%	-1.3%	8.2%	6.4%
EUR	1.0831	65.82	0.9%	2.3%	1.2%	-5.8%	-7.5%
JPY	127.92	69.80	3.1%	6.8%	2.5%	-12.2%	-10.2%
GBP	1.2229	58.48	0.4%	0.7%	1.2%	-10.7%	-1.0%
AUD	0.6977	64.59	0.9%	4.4%	2.4%	-6.2%	-5.6%
CAD	1.3393	57.73	0.0%	2.3%	1.2%	-6.8%	0.7%
CHF	0.9255	55.74	-0.5%	0.9%	-0.1%	-1.3%	-3.0%
CNY	6.7144	77.22	0.9%	3.9%	2.7%	-7.9%	2.7%
MXN	18.784	75.48	2.0%	5.3%	3.8%	5.3%	-3.0%
EM (Emerging Index)	1 702.2	87.61	2.0%	3.4%	2.5%	-4.3%	0.9%

Source: Bloomberg, Atlantic Financial Group — Total Return by asset class (Negative \ Positive Performance)

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