MERRION INVESTMENT MANAGERS | CANTOR Fitzgerald

Strategy & Outlook

MARKET UPDATE

JUNE 2023

MAY

Global equities rose by 2.5% in euro terms in May, very much flattered by a more than 3% rally in the US dollar against the euro. Apart from currency moves, returns were driven entirely by technology as the AI theme gained even more momentum, Nvidia, at the epicentre, up 36% for the month and bringing the year-to-date return to 159%. At a global level, the only sectors in positive territory for the month (absent FX moves) were technology (+8.0%) and communication services (+2.1% which was driven by Alphabet, Meta and Netflix). All other sectors were negative. Market breadth therefore is extraordinarily poor, and although market indices remain supported, it is by fewer and fewer stocks, only ~20% of US stocks beating the index over the last 3 months, the lowest level since 1999.

The month began with yet another bank failure as First Republic Bank was sold to JP Morgan, and whilst it appears that the banking sector stress has abated for now, deposits continue to flow from the banking system, lending conditions continue to tighten, and significant question marks remain over bank profitability.

The US debt ceiling was the focus of markets for much of the month, the bigger concern not being whether the US would default (a very low but non-zero probability outcome) but whether there would be swingeing cuts to federal spending as demanded by Republicans. In the end though, it amounted to nothing more than political theatre, a deal being done that doesn't change very much at all.

Aside from Washington theatrics, economic data was mixed. Evidence continues to mount that the US consumer faces significant headwinds, but continues spending nonetheless, ramping up short term (credit card) borrowing to support same. Manufacturing globally appears to be in a slump, which the Chinese recovery post-reopening remains a mirage. Central Banks continue their hawkish rhetoric, the Fed for example moving from what seemed like a pause to a skip, another rate hike in July now almost fully priced, whilst two more hikes are priced for the ECB.

Big questions remain after the debt ceiling resolution – Treasury Bill issuance is expected to increase substantially, with consensus estimates of around $1tln over the summer in terms of net issuance. Whether this issuance is funded via a liquidity-neutral fashion from money market funds (and hence from the Fed's overnight repo), or via a huge liquidity drain from bank deposits will have a large impact on market volatility over the summer, and such large issuance is bound to crowd-out investments in other asset classes.

Outlook

While the resolution to the debt ceiling is a positive in that it removes the possibility of an extremely negative event and does not come with significant fiscal austerity, we continue to remain concerned about the possibility of a volatile summer period. Interest rates in the US appear too restrictive or have certainly moved into restrictive territory far too quickly without due consideration of the lags inherent in monetary policy and the impact such moves could have on the banking system and its ability to provide credit to a modern economy. The ECB has kept pace with the Federal Reserve since they began raising rates last summer, as has the Bank of England. Further rate rises are expected, at a time when liquidity will be drained from the financial system (via Fed QT, ECB QT, US T-bill issuance). And market breadth is very poor.

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Positioning and Performance

As noted previously, we began the year with a very positive outlook for asset markets but the risks that we outlined some months ago increased dramatically towards the end of Q1, along with new risk in the shape of US banking sector turmoil.

Having reduced growth asset exposure in the funds towards a more neutral stance over the course of March, and reduced exposure further over the course of April towards the lower end of the asset allocation range, we have remained close to the lower end of the asset allocation range for growth assets. The cash raised in the defensive side of the funds is invested in European Treasury bills at yields above 3%. Given the potential volatility in markets ahead and the low price of index option protection, we have a higher-than-normal level of protection in place.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

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