
NG
NAHMANI GRUNDER
WEALTH MANAGEMENT & MULTI-FAMILY OFFICE

NG Market Insights

Executive Summary

Asset Allocation

- Carry/Interest income remains our focus as we are being paid to wait.
- Clear preference remains on Bonds over Equities.
- Risk/return around equities remains highly unfavorable with downside.
- Positive on Copper and Crude Oil, while Gold remains a core investment.
- Valuation reset in PE/VC has room to run into 2024.

Equities

- Developed Market equities show downside from here into 2024.
- S&P 500 range of outcomes: 3,750 – 3,950 by mid-2024 in a soft landing and a bottom of 2,800 - 3,000 in a US recession.
- EM equities trade at multi-year low valuations, especially due to China.
- Sectorally, emphasize Health care, segments of Consumer with strong pricing power, and Energy. We turn neutral on US Software after H1 performance.

Fixed Income

- Ongoing focus on short-dated USD/CHF/EUR sovereign bonds (up to 2 yrs).
- Key remains Coupon and Quality.
- Position in global IG credit, notably USD/EUR/CHF low A-to-BBB rated within the 3 - 5 year duration bracket. Too early to go longer.
- Stronger emphasis on credit analysis ahead of a potential default cycle.

Commodities

- Still positive on Crude Oil and «green» metals due to ESG-related lack of supply growth.
- Gold should continue to benefit from central bank purchases among BRICS countries in a period of increased de-globalization.

Currencies

- Deteriorating US fiscal position worries us, especially in a period of increased de-dollarization efforts.
- Among DM currencies, still prefer CHF and USD.
- Conceivable that BRICS currencies do better against USD in a soft landing scenario, especially those from commodity-exporting countries.

H1 2023 Review

Global Risk Radar: A surprisingly pleasant market for risk assets in H1 2023

GLOBAL EQUITIES	S&P 500	SMI	EuroStoxx 600	MSCI World	MSCI EM
30-Jun-23	4 450.4	11 280.3	461.9	2 966.7	989.5
30-Dec-22	3 839.5	10 729.4	424.9	2 602.7	956.4
% return, in local currency terms	**15.9%**	**5.1%**	**8.7%**	**14.0%**	**3.5%**
FX impact	*0%*	*3.2%*	*1.9%*		
in USD terms	**15.9%**	**8.5%**	**10.8%**	**14.0%**	**3.5%**

GLOBAL BONDS	BBG Global Credit TR	US BBB spread	US High Yield spread	10-year Treasury rates	US yield curve 2s/10s
30-Jun-23	252.6	1.70%	4.66%	3.84%	-1.06%
30-Dec-22	244.3	1.86%	5.09%	3.87%	-0.55%
% return (USD terms)	**3.4%**				
	10-year breakeven	**US Equity Risk Premium**	**10-year US REAL rates**	**US Financial conditions**	**Fed Funds rate, end-23e**
30-Jun-23	2.23%	0.67%	1.59%	99.56%	5.39%
30-Dec-22	2.30%	1.88%	1.58%	100.20%	4.65%

CURRENCIES	EURUSD	CHFUSD	GBPUSD	USDJPY	BTCUSD
30-Jun-23	1.0909	1.1165	1.2703	144.31	30 391
30-Dec-22	1.0705	1.0817	1.2083	131.12	16 579
% change	***1.9%***	***3.2%***	***5.1%***	***10.1%***	***83.3%***

COMMODITIES	Global BBG index	Gold	Copper	Iron ore	WTI Crude Oil
30-Jun-23	101.5	1929.4	8315.5	108.9	70.6
30-Dec-22	112.8	1826.2	8372.0	111.7	80.3
% change	-10.0%	5.7%	-0.7%	-2.5%	-12.0%

Source: Bloomberg, Nahmani Grunder.

- While our global rates outlook has been spot on, we have been wrong about equity market outcomes so far in 2023 due to the compression in risk premiums partially driven by the ongoing AI hype.

NG Market Insights July 2023

Growth/Inflation mix has not reached a state of equilibrium yet

Resilient US/Global economy: Below-trend growth but no recession so far

- We are nearing the end of one of the sharpest global hiking cycles in history which came after the onset of multi-decade high and sticky inflation. Since March 2022, the FED has increased the Fed Funds policy rate from zero to a target range of 5.00% - 5.25% by June 2023, after an 11-year period during which it averaged 0.5%. The European Central Bank (ECB) deposit rate went from -0.50% to +3.50% in the same 16-month period.

Central Bank	Current policy rate	Mar 2022
FED	5.08%	0%
ECB	3.50%	-0.50%
Bank of England (BoE)	5.00%	0.50%
SNB	1.75%	-0.75%
Bank of Japan (BoJ)	-0.10%	-0.10%

Source: Nahmani Grunder.

- Historically seen, such monetary tightening has resulted in an economic recession as households and enterprises react to higher borrowing costs by becoming more cost sensitive via curtailed spending budgets. As such, the end game has also always been a negative labor cycle with higher unemployment rates. However, the outcome so far in this current cycle has been quite different, with stubborn strength in the US/Global economy.

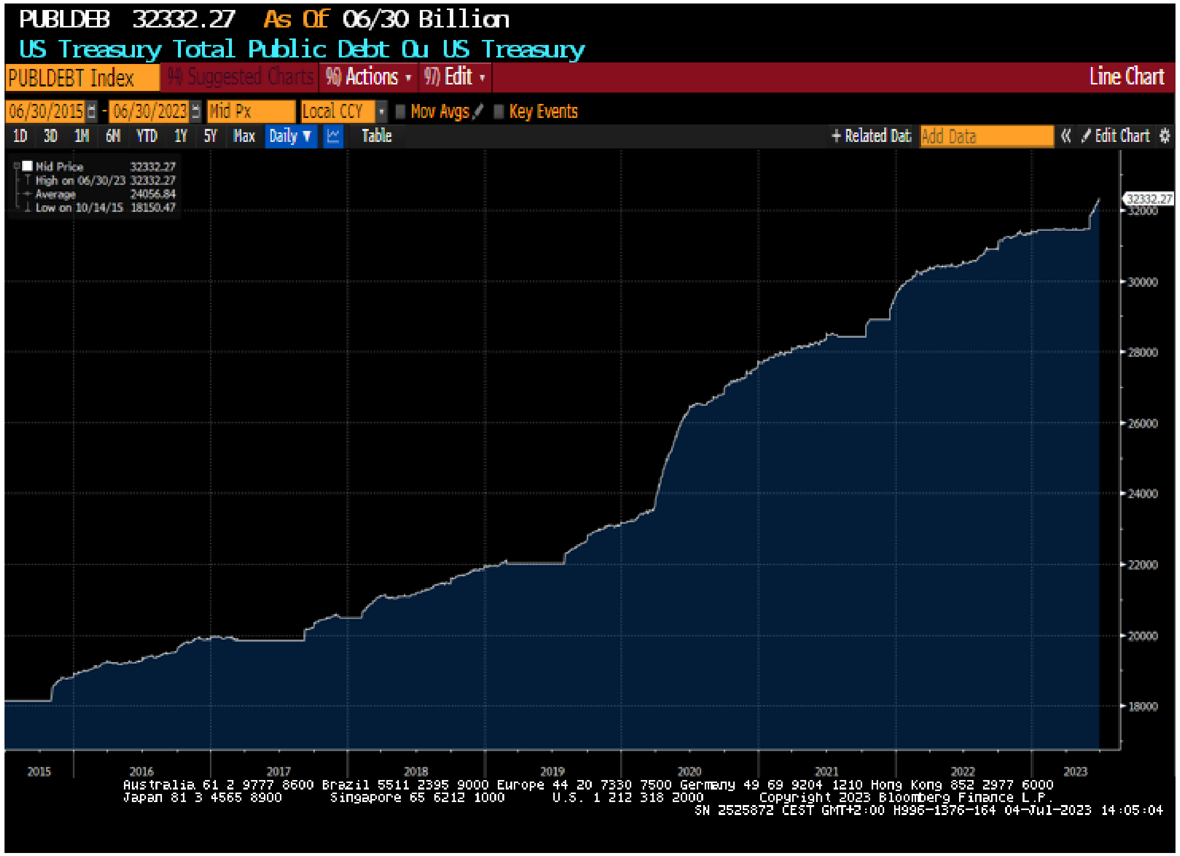
GLOBAL REAL GDP GROWTH MAP							
	2017a	**2018a**	**2019a**	**2020a**	**2021a**	**2022a**	**2023e**
US	2.2%	2.9%	2.2%	-3.4%	5.7%	1.1%	0.8%
Japan	1.7%	1.1%	0.7%	-4.6%	1.6%	1.2%	1.2%
Germany	2.5%	1.9%	0.6%	-4.9%	2.9%	1.9%	-0.3%
France	2.3%	1.6%	1.5%	-8.0%	7.0%	2.5%	0.5%
UK	1.7%	1.4%	1.3%	-9.7%	7.5%	3.9%	0.1%
Italy	1.5%	1.2%	0.6%	-9.0%	6.6%	3.8%	1.0%
Canada	3.0%	2.1%	1.5%	-5.3%	4.6%	3.4%	1.1%
G7-ex US	2.1%	1.5%	0.9%	-7.0%	4.9%	2.8%	0.6%
China	6.9%	6.7%	6.1%	2.3%	8.1%	3.0%	5.0%
Developed Mkts (DM)	2.3%	2.4%	1.7%	-5.0%	5.5%	2.1%	0.7%
Emerging Markets (EM)	4.7%	4.7%	4.2%	-1.9%	6.9%	3.6%	3.6%
Global GDP growth	**3.7%**	**3.7%**	**3.1%**	**-3.2%**	**6.3%**	**3.0%**	**2.4%**

Source: Nahmani Grunder.

We underestimated the near-term effect of US fiscal spending

- The amount of FED tightening has been much less impactful on US economic growth so far in 2023. In hindsight, massive Covid-era fiscal stimulus is most probably the key underlying reason, with the US government budget deficit totaling $ 6.7 trillion between 2020 - 2022. Specifically, the budget deficit was $ 2.6 trillion and $ 1.4 trillion in 2021 and 2022, respectively, and is expected to come in at $ 1.6 trillion in 2023, versus an average of $ 0.5 trillion per annum between 2000 – 2019. Government outlays also included monthly cheques to US households which bolstered overall savings rates.

- The consumer makes up a large 68% of US GDP. It is now clearer that, with US household (HH) balance sheets exiting the Covid pandemic extremely well capitalized and also a much higher propensity to spend following lockdowns, there has also been much less of a reaction to consumer spending patterns from higher rates in the interim. However, this excess cash should have been distributed by now with consumer credit increasing double-digit this year. This would imply that we are looking at an economic process that is unfolding more gradually than we originally anticipated. By waiving the US debt ceiling in early June, the recent move to higher fiscal policy can be sustained at least until end-2024.



** US federal debt has ballooned from $ 23.1 trillion at the end of 2019 to $ 32.3 trillion by 30 June 2023.*

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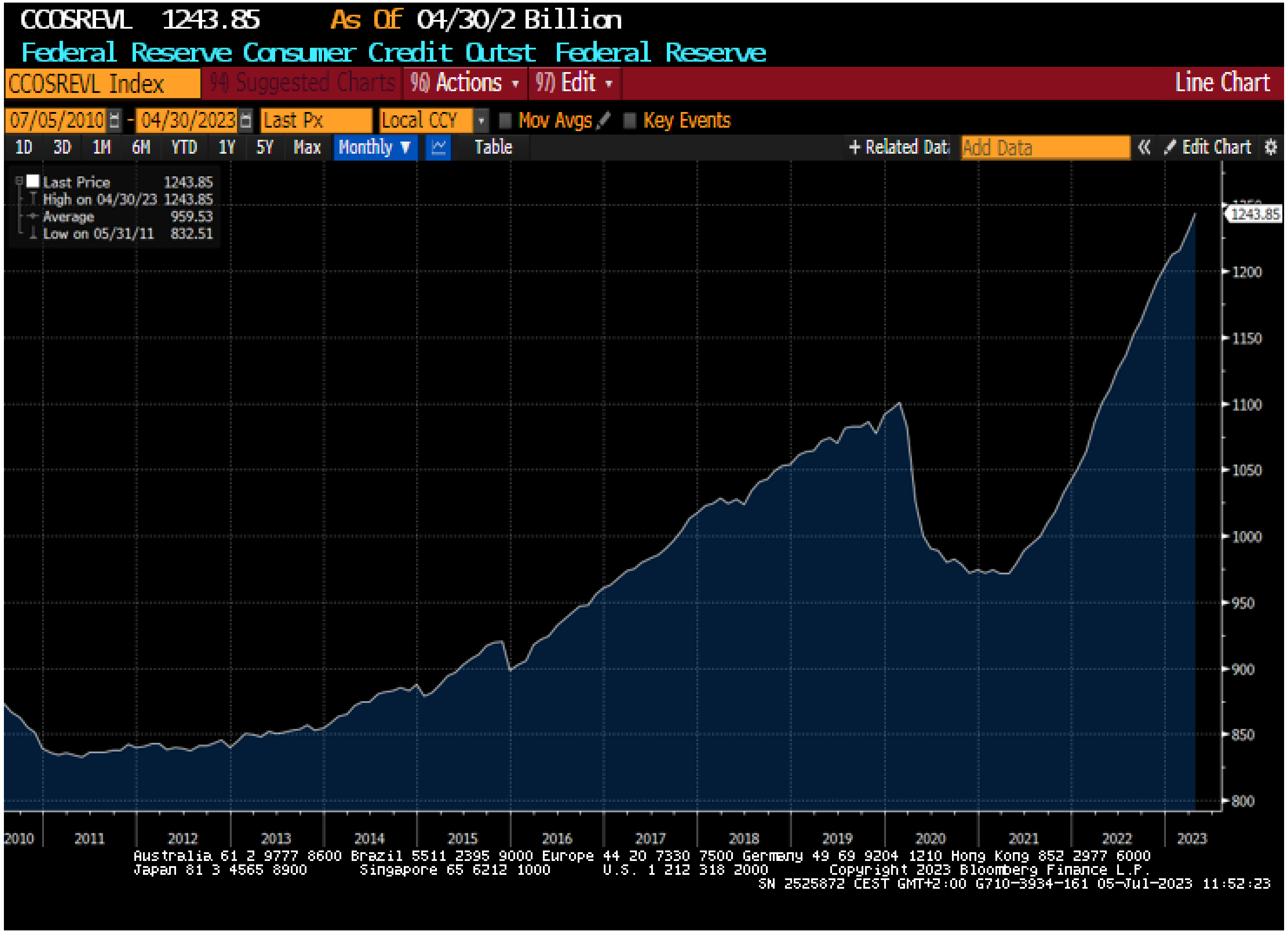
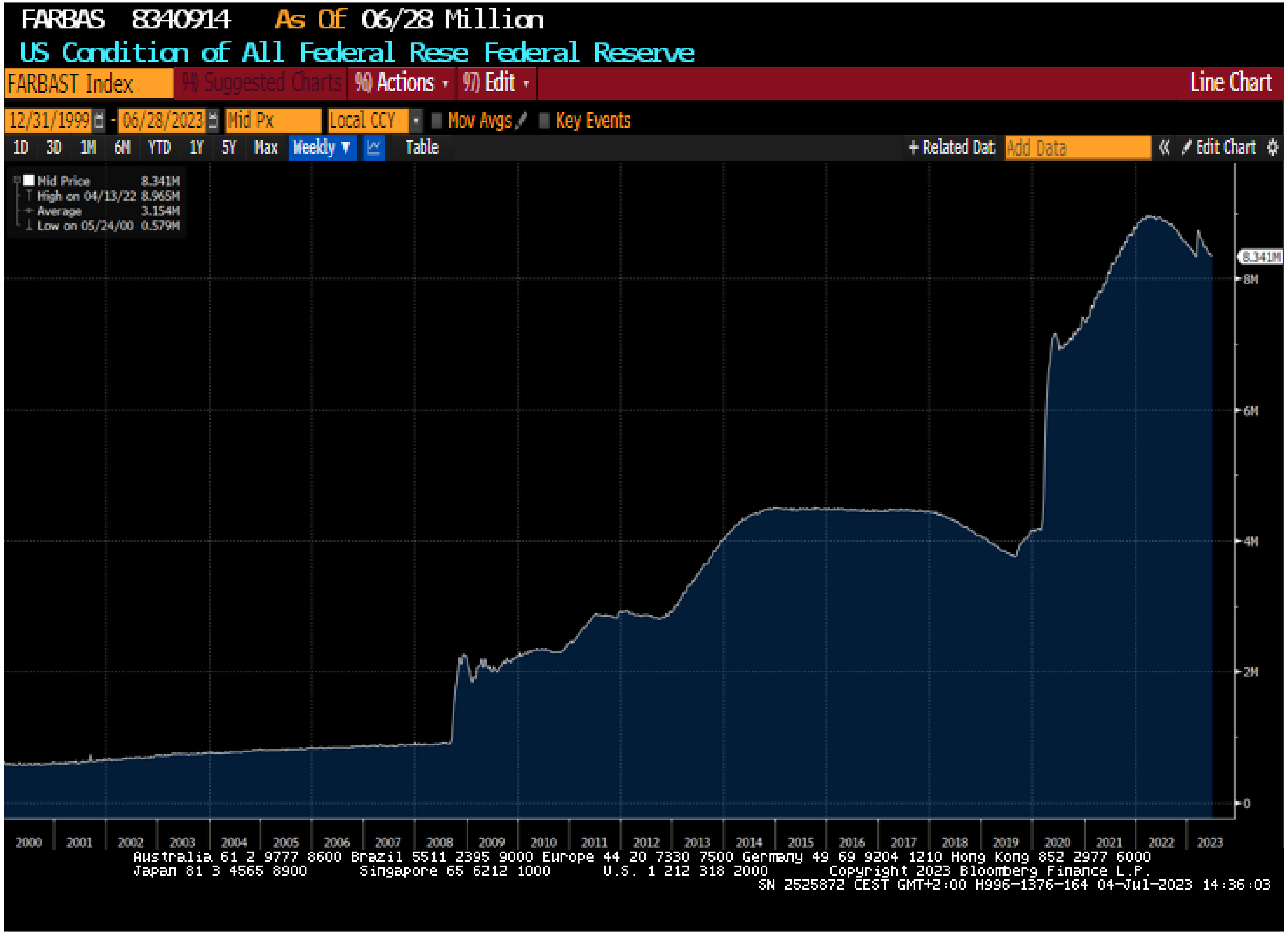
Total US revolving consumer credit up +13% year-on-year in April 2023

- Total outstanding US revolving consumer credit, which includes credit card (CC) balances, is back at an all-time high after briefly decreasing during the covid pandemic. Financing a higher degree of spending via short-term credit can't continue forever, especially as the interest rate on CC balances is now higher at 20% versus 14.6% in 2021. US consumer spending is a direct function of employment and health of HH balance sheets, both of which should see headwinds from here.



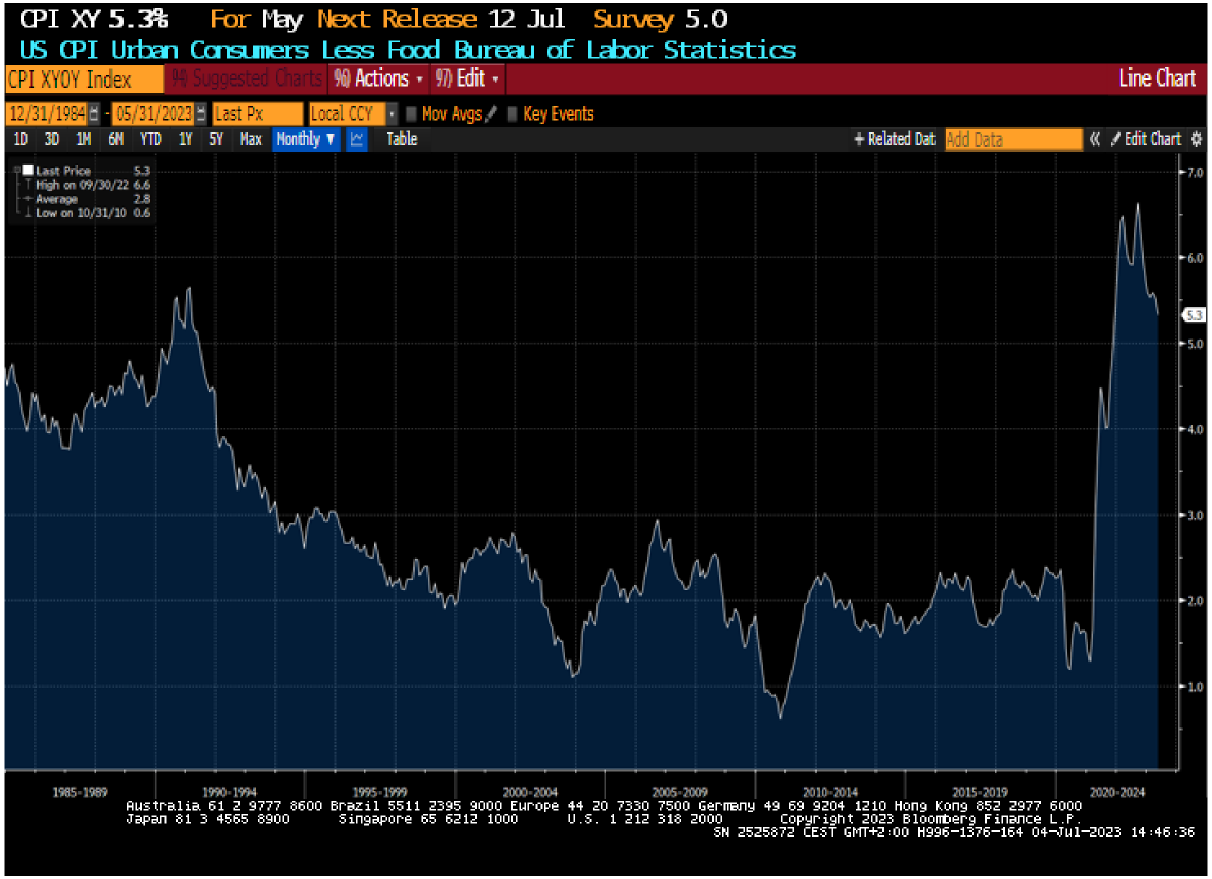
The FED has underwritten part of that budget deficit with its balance sheet

- Fiscal policy has replaced QE, and is proving to be more inflationary as experienced in the post-Covid period.



Inflation is still at a multi-decade high and remains sticky…

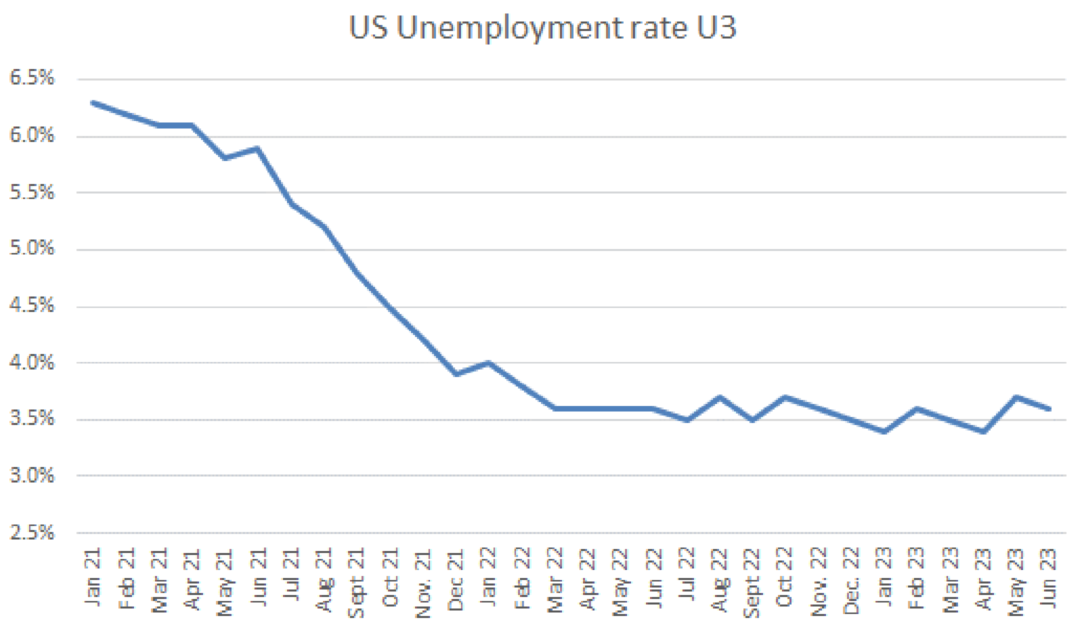
- We expect US core CPI to finish 2023 at 3.9%, still meaningfully above FED's medium target of 2.0% and average of 1.8% between 2010 – 2020.



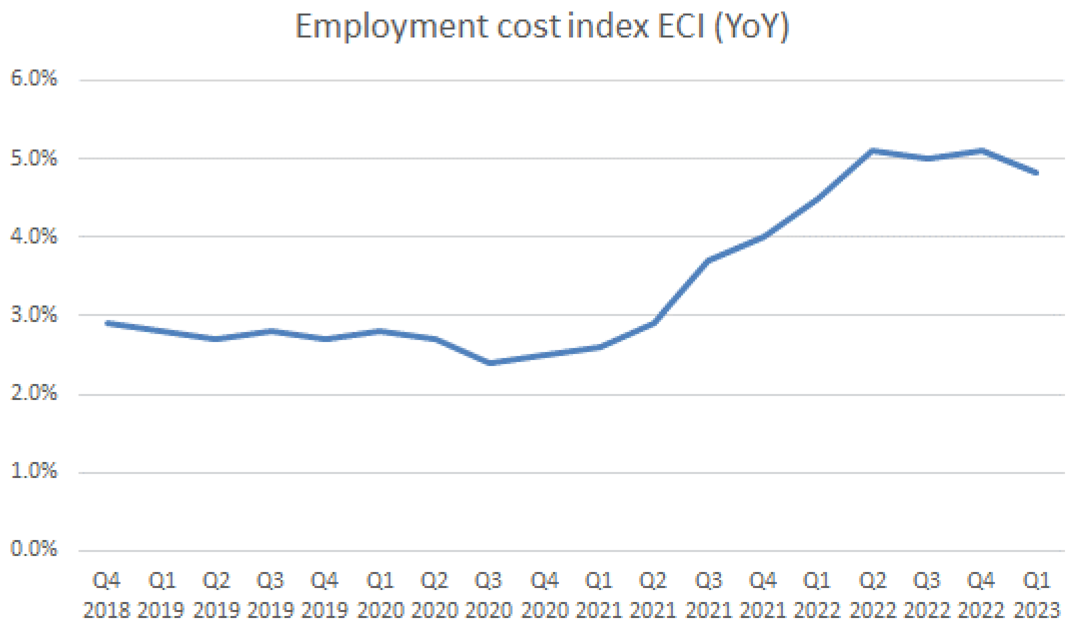
	May 22	Jun 22	Jul 22	Aug 22	Sept 22	Oct 22	Nov. 22	Dec. 22	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23e
MoM	0.63%	0.60%	0.31%	0.58%	0.57%	0.33%	0.31%	0.40%	0.43%	0.45%	0.35%	0.41%	0.43%	0.33%
YoY	**6.0%**	**5.9%**	**5.9%**	**6.3%**	**6.6%**	**6.3%**	**6.0%**	**5.7%**	**5.6%**	**5.5%**	**5.6%**	**5.5%**	**5.3%**	**5.0%**
Core CPI	101.9	102.5	102.8	103.4	104.0	104.4	104.7	105.1	105.6	106.0	106.4	106.8	107.3	107.7
Goods inflation (MoM)	0.7%	0.8%	0.1%	0.4%	0.0%	-0.1%	-0.2%	-0.1%	0.1%	0.0%	0.2%	0.6%	0.6%	0.4%
Services inflation (MoM)	0.6%	0.7%	0.4%	0.6%	0.8%	0.5%	0.5%	0.6%	0.5%	0.6%	0.4%	0.4%	0.4%	0.3%

Source: Nahmani Grunder, BLS.

...due to a tight US labor market where open-jobs-to-workers ratio stands at 1.6x



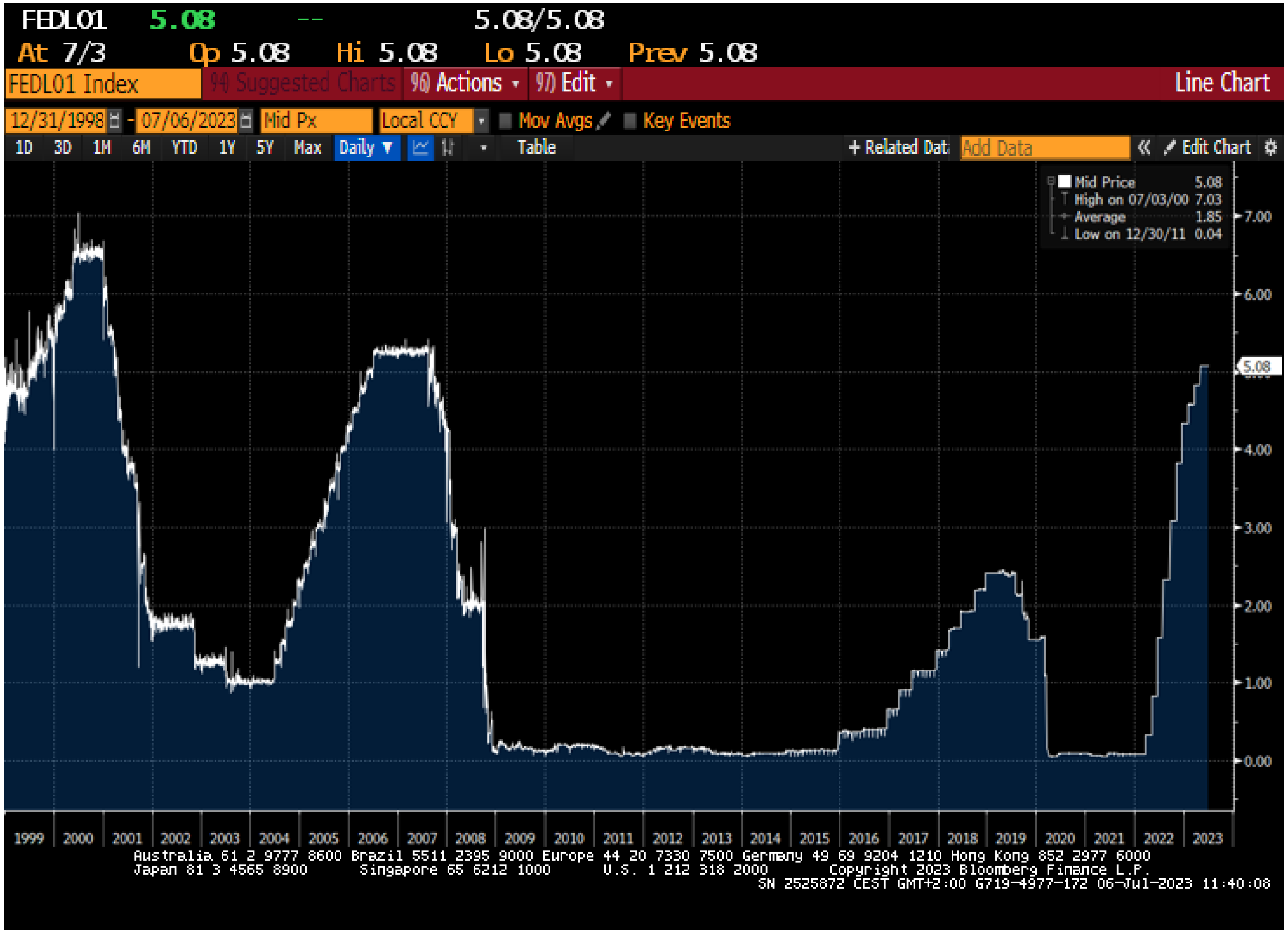
** No negative labor cycle yet, with unemployment rate staying flat around 3.5% despite the aggressive hiking cycle*



... with wage growth elevated around +5.0% YoY since Q1 2022

The FED currently runs a restrictive monetary policy

- The neutral Fed Funds rate is the short-dated FED policy rate which is neither restrictive nor stimulative. This is important as long-dated US rates drive valuations across all global asset classes, in a financial system with the USD as the world reserve currency. Our "estimate" of the neutral Fed Funds rate is 3.0%, higher than during 2010s due to rising demand for capital to finance the deficit as well as worsening demographic effects from retired baby-boomers.
- Our estimated neutral 10-year Treasury rate is thus 3.5% - 4.0%. We derive all global cross asset views from this benchmark line.



In our mind, the range of economic outcomes remains unchanged

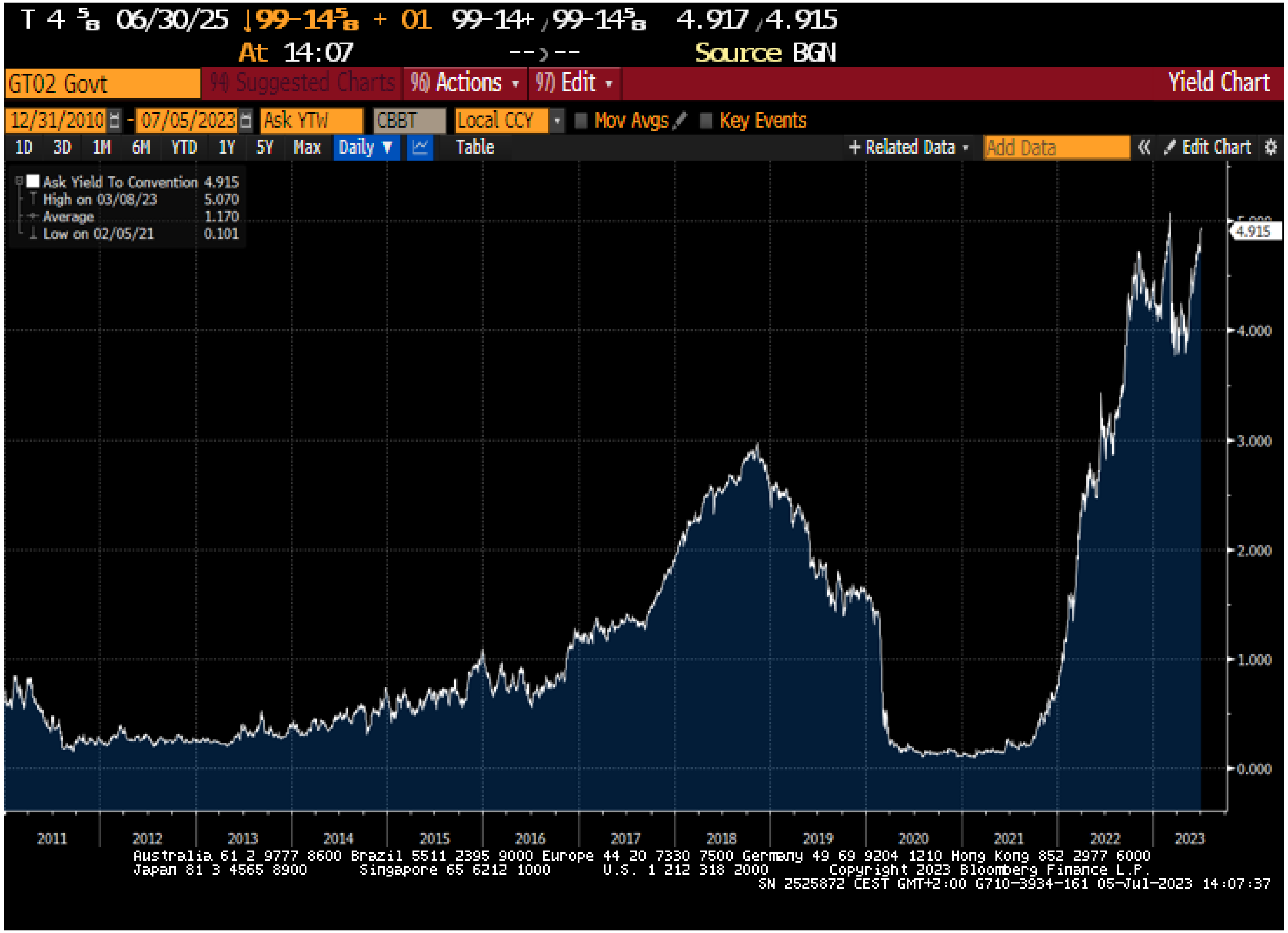
- The slower than anticipated unfolding of the economic process so far in 2023 does not change our view regarding the range of potential outcomes in terms of the coming growth/inflation mix. We are still in a state of disequilibrium.

- Scenario 1 is a soft landing with ongoing weak, below-trend economic growth, but also a higher mid-term (MT) inflation path. This higher inflation path would be based on the move towards sustained higher fiscal policy and the negative effects of de-globalization. We think de-globalization is set to be inflationary to the West, as global supply chains get dismantled with "friend-shoring" due to national security considerations (think TSMC and the semiconductor value chain). Net net, Scenario 1 would imply that we have entered a more inflationary environment in the intermediate term with inflation never reaching FED's 2% target.

- Scenario 2 is a severe recession outcome due to balance sheet stress on households and corporates from years of misallocation of capital in an environment in which cost of money was close to zero. Higher borrowing costs only hit debtors when such loans need to be refinanced, and this debt wall was still ahead of us during H1 2023. For example, based on the FED's G.19 report dated 7 June, we know that total outstanding US consumer credit totaled $ 4.86 trillion by the end of April 2023, $ 3.62 trillion of which was non-revolving (i.e. Fixed) in nature. Scenario 2 would also imply the US unemployment rate going above 5.0% (from 3.6% in June), loosening wage pressures and ultimately bringing back US inflation back down to 2% by 2024/2025.

- Net net, in our view, Scenario 1 would require the Fed Funds policy rate to remain high, above 4.0%, well into 2025, translating into 10-year nominal US Treasury rates at or above 4.0% for the foreseeable future. As such, significant rate cuts from here with a 10-year rates going back to 2.0% would only happen if we eventually get to a severe recession, or Scenario 2.

2-year US Treasury rate at 4.9% assumes limited rate cuts into 2025



** We have had massive short-dated rates volaility so far in 2023. However, we are back to pre-SVB highs of March 2023.*

2-year Treasuries are now pricing limited FED rate cuts into 2025, suggesting to us that it is betting on our Scenario 1. The 2-year is the most sensitive to FED policy.

… with US 10-year nominal rate at 3.9% consistent with Scenario 1

** US yield curve remains deeply inverted, with the 10-year Treasury rate at 3.9%*

The benchmark 10-year Treasury rate is consistent with a soft landing but higher inflation path.

- The US rates market is now assuming FED's policy rate remaining in restrictive territory for longer well into 2025, with the 10-year rate «normalizing» into a range consistent with the 2000 – 2007 period.

Premiums earned in Equities and Credit do not compensate for the extra risk

- Given the moves seen in markets so far in 2023, our key asset allocation conclusion is that the premium investors should normally be earning to hold equities or credit over risk-free rates has become even more unattractive during this year. And, this to such a point that we claim equity investors on an index level are now left with return-free risk. In credit, corporate credit spreads are now once again close to multi-decade lows.

- For equities, we think the best way to gauge the relative valuation versus rates is the equity risk premium (ERP). The US ERP is thus the difference between the prevailing earnings yield of the S&P 500 (the inverted P/E ratio) and the current 10-year nominal Treasury rate. The US ERP stood at only 0.67% at the end of June 2023, compared to a multi-year average of 3.2% between 2015 – 2019. In other words, flat-to-higher long-dated nominal and real rates have been accompanied this year by higher equity market valuation multiples, which is an unsustainable paradox.

- The US ERP is a relative metric between 2 variables, and can thus be brought back to historical norms by an adjustment in one and/or both variables. As such, the current P/E multiple of the S&P 500 at 22.2x would only be justified through an eventual swift re-pricing of the 10-year Treasury rate down to 2.0% and a continuation of the expected EPS recovery in H2 2023 and 2024. US equities are thus pricing a fairly quick fall in inflation/rates back to 2.0% together albeit with a soft landing in the economy. We assign a very low probability to such an outcome, which has not even been included in our 2 scenario framework.

Current ERP will normalize either via much lower rates or lower equity multiples

Implied Equity Risk Premium (ERP) for S&P 500				
	P/E	10-year Treasury	Implied ERP	10 Year Real rates
2011	12.8	1.88%	5.9%	-0.07%
2012	13.7	1.76%	5.5%	-0.67%
2013	16.8	3.03%	2.9%	0.80%
2014	17.6	2.17%	3.5%	0.49%
2015	17.3	2.27%	3.5%	0.73%
2016	18.8	2.45%	2.9%	0.55%
2017	20.1	2.41%	2.6%	0.44%
2018	15.4	2.69%	3.8%	0.98%
2019	19.6	1.92%	3.2%	0.15%
2020	26.0	0.91%	2.9%	-1.08%
2021	22.4	1.51%	2.9%	-1.04%
2022	17.4	3.87%	1.9%	1.58%
Current 2023	22.2	3.84%	0.7%	1.59%
Average 15 - 19	18.2		3.2%	0.43%

Source: Nahmani Grunder.

Strong ongoing preference on Rates over Equities and also Credit

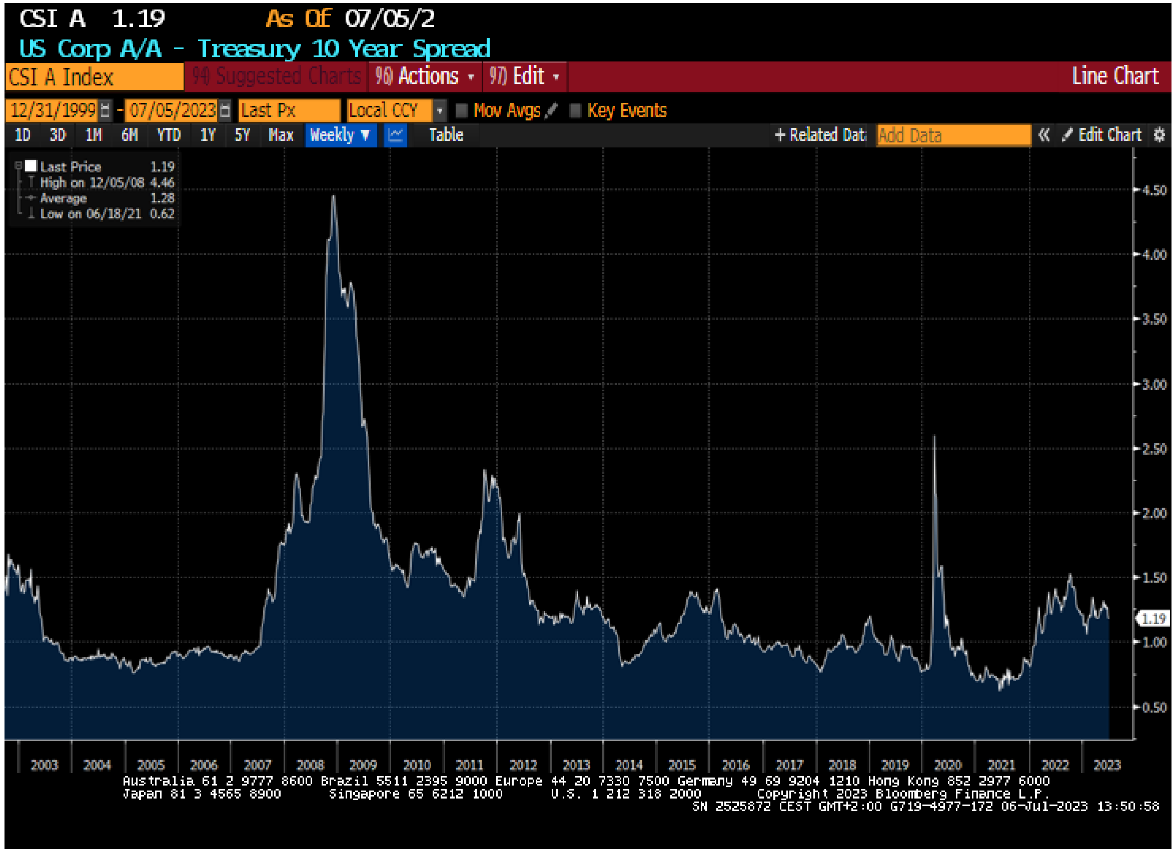
- This large inconsistency between rates and equity markets will need to resolved over the next 6 months, in our view, especially as the FED continues to have an asymmetric bias to even higher policy rates. As a reminder, we think rate cuts and a sizeable move in the 10-year Treasury towards 2.0% will only materialize on the back of the onset of a severe recession or a significant crisis in financial markets, both of which would be highly negative for equity and credit markets with much higher premiums versus Treasury rates.

- We reiterate our overall asset allocation view from January 2023 which put a strong preference on Rates over Equities and also Credit. With risk-free rates back to attractive levels, short-dated rates allow us to be paid to wait while the growth/inflation disequilibrium is sorted in the coming quarters. We are keeping our focus within the 2-year rate spectrum. Part of the current yield curve inversion would be reversed under Scenario 1.

- While rates are attractive under any scenario, we think overall equity indices are now in an even bigger “lose lose” constellation, regardless whether Scenario 1 or Scenario 2 materializes, with downside potential under both scenarios.

Risk/return in Credit not as favorable as in the rates market

- In credit, while we continue to keep our bias on IG within 3 – 5 year spectrum, the yield pick-up, i.e. credit spreads, is close to all-time lows. While credit should be fine under Scenario 1, a meaningful negative credit cycle with much higher default rates would ensue a possible Scenario 2 leading to widening spreads and mark-to-market losses. Accordingly, we spend more time than ever on credit analysis with a particular emphasis on debt maturity profiles, covenants and the volatility of free cash flow generation for any given issuer.



S&P 500 is back to March 2022 levels when the 10-year rate stood at 2.2%

**The S&P 500 is +16% so far in 2023 due to a 4.8 points increase in P/E multiple* and despite year-on-year declines in EPS in Q1 and Q2.

*Interestingly, Equal-weighted S&P 500 is up +6.0% only, with the **heavy-weight Tech stocks pushed higher by initial euphoria from GenAI.***

Nasdaq-100 up by +38.8% in the first half of 2023

Initial AI hype comes to the rescue

- MSCI World generated a return of +14.0% in the first half (H1) of 2023, with the US outperforming the rest of the world meaningfully on the back of the initial enthusiasm around generative AI (GenAI). MSCI Emerging Markets (EM) was up "only" +3.5% with China continuing to underperform despite multi-year low valuation multiples.

- While we are firm believers that GenAI will prove to be the next large computing platform transition, after the PC, Internet and Mobile platform shifts previously. However, we are also cognizant that such new technologies always carry an initial hype stage, before long-term winners start to appear with large valuation outcomes. The initial hype stage is driven by the "picks and shovel" companies delivering enabling hardware (in the case of GenAI, these are the likes of Nvidia/TSMC/ASML), the incremental earnings upside should be enough to move the needle for the EPS of major equity indices. In other words, we doubt a fast adoption of GenAI applications by consumers will be enough to create considerable EPS upside for the S&P 500 until 2026/2027.

**NYFANG index includes Apple, Microsoft, Alphabet, Amazon, Tesla, Meta, Nvidia, AMD and Snowflake, and was up +74.1% in H1 2023.*

Downside potential to S&P 500 into 2024

- Under Scenario 1, we see a fair value of 3,750 – 3,950 for the S&P 500 by mid-2024, using flat EPS of around $ 220 in 2023 and 2024, and a P/E 2024e multiple of 17x – 18x (10-year Treasury rate of 4.0% and ERP of 1.75%). Interestingly, an EPS of $ 220 for 2023 would require an earnings recovery in the second half of the year after declines in H1. This would also imply net margins of 11.3% for the S&P 500 in 2023, only 100bps lower than all the time high achieved in 2021.

- Under Scenario 2, we see a bottom of 2,800 – 3,000 for the S&P 500 in the downcycle, using an EPS of below $ 200 and a P/E 2024e multiple of 14x – 15x in line with previous valuations during a US recession.

S&P 500 P/E valuation, 2015a - 2023e

	2015a	2016a	2017a	2018a	2019a	2020a	2021a	2022a	2023e
Operating EPS	**118.2**	**119.1**	**133.0**	**162.9**	**164.6**	**144.6**	**212.5**	**220.6**	**200.8**
growth (YoY)		*0.7%*	*11.6%*	*22.5%*	*1.0%*	*-12.2%*	*47.0%*	*3.8%*	*-9.0%*
Price low	1867.6	1829.1	2257.8	2351.0	2447.9	2237.4	3700.7	3577.0	3808.1
Price high	2130.8	2271.7	2690.2	2930.8	3240.0	3756.1	4793.1	4796.6	4450.4
Price close	**2043.9**	**2238.8**	**2673.6**	**2506.9**	**3230.8**	**3756.1**	**4766.2**	**3839.5**	**4450.4**
P/E low	15.8	15.4	17.0	14.4	14.9	15.5	17.4	16.2	19.0
P/E high	18.0	19.1	20.2	18.0	19.7	26.0	22.6	21.7	22.2
P/E close	**17.3**	**18.8**	**20.1**	**15.4**	**19.6**	**26.0**	**22.4**	**17.4**	**22.2**
P/E range	**15.8 - 18.0**	**15.4 - 19.1**	**17.0 - 20.2**	**14.4 - 18.0**	**14.9 - 19.7**	**15.5 - 26.0**	**17.4 - 22.6**	**16.2 - 21.8**	**19.0 - 22.0**

Source: Nahmani Grunder.

AI pushed regional P/E multiple differentials further apart this year

- European equities, as measured by Dow Jones Stoxx 600 (SXXP), are now trading at a 37% discount to US equities (S&P 500, SPX). SPX is also now trading meaningfully above its 2015 – 2019 average of 18.2x, while both SXXP and MSCI EM are still below.

- MSCI EM (where China has a 34% weight) at a P/E multiple of 12x is still at multi-year lows. The question is whether Europe can continue to re-rate without a better backdrop in China. Both regions have historically been linked, although there has been some de-coupling so far in 2023.

Year-End P/E multiples for Major Equity Indices				
	S&P 500	Europe Stoxx 600	MSCI EM	Discount SXXP/SPX
2015	17.3	16.9	13.2	-2.3%
2016	18.8	17.0	12.8	-9.6%
2017	20.1	16.0	15.2	-20.4%
2018	15.4	12.9	12.9	-16.2%
2019	19.6	16.2	14.7	-17.3%
2020	26.0	22.4	21.2	-13.7%
2021	22.6	17.3	13.6	-23.2%
2021	22.4	16.1	13.2	-28.3%
2022	17.4	12.0	11.5	-31.0%
2023e	22.2	14.0	11.9	-36.7%
Average 15 - 19	18.2	15.8	13.8	-13.4%

Source: Nahmani Grunder.

- Our previous strong bias to US equities is no longer warranted.

Summary Outlook 2023

Asset Classes	Positive	Neutral	Negative
Fixed Income & Cash	Treasury (up to 2 years) Sov. EUR/CHF (up to 2 years) Global IG Corp (3 - 5 years)	US Treasuries Global IG long dated	EU Sov. Bonds EU HY Corp US HY Corp
Equities (sectoral view)	Healthcare Consumer Staples Energy	US Software Internet Telecom Semis Metals&Mining	Industrials Consumer Discretionary Chemicals Financials
Commodities	Copper Crude Oil	Gold Iron ore Nickel	

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