MWC MANENTIA WEALTH CONSULTING GROUP

Quarterly Market Overview
3Q 2023

<u>October 2023</u>
MWC Group
Anupam Agarwal, Portfolio Manager & Financial Advisor

"October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February."

- Mark Twain

Economics 101

Think of a bathtub with the taps open, filling the tub. At the same time, the drain has the stopper removed so that water is simultaneously running into and out of the tub. Whether the tub is slowly filling with water or slowly draining depends on the difference in the rates of water-in and water-out. The rate at which the water is flowing in can be regarded as the rate of creation of credit which is used to deliver and purchase goods and services. The rate at which it flows out is the cost of creation of that credit: interest rates, which act as a counterweight and a drag on economic activity. The net change in the level of water in the tub is then the change in Gross Domestic Product, GDP. One of the roles of a Central Bank is to manage that rate of change such that it engenders an environment of sustainable long-term economic growth.

The Markets

A summer of record-breaking temperatures is now over for most. In its place come not only shorter days and cooler evenings, but a return to reality. The bull market in equities and all things AI caught many by surprise. Similarly, the resilient robustness of the US economy has confounded consensus. Both may endure, but our sense is that they will also be accompanied by a growing realisation – a return to reality, if you will – that an era of low rates is not something investors should expect any time soon. This has clear investment implications.

In a complicated world, it's often helpful to have some simple rules, particularly since no market participant will ever be in a position to know everything. Against this background, it seems fair to contend that asset prices should rise when interest rates are falling and vice versa. However, it's never quite as simple as that. Even if they are imperfect, markets tend to be forward looking. Bubbles can also last for a long time. As John Maynard Keynes famously noted many years ago, "markets can stay irrational longer than you can stay solvent."

Mixed messages have been a large part of 2023's investment story. Sure, broad equity indices have rallied. However, dig below the headlines and a quite different story emerges. Recent data show that while the seven biggest companies within the S&P 500 Index have risen by an average of 50%+ year-to-date, the remaining 493 constituents have eked out a markedly less impressive sub-5% average gain. This perhaps explains why **fewer than a third of active managers in the US are outperforming their benchmark in the US**, the worst outcome in well over a decade (data per Goldman Sachs).

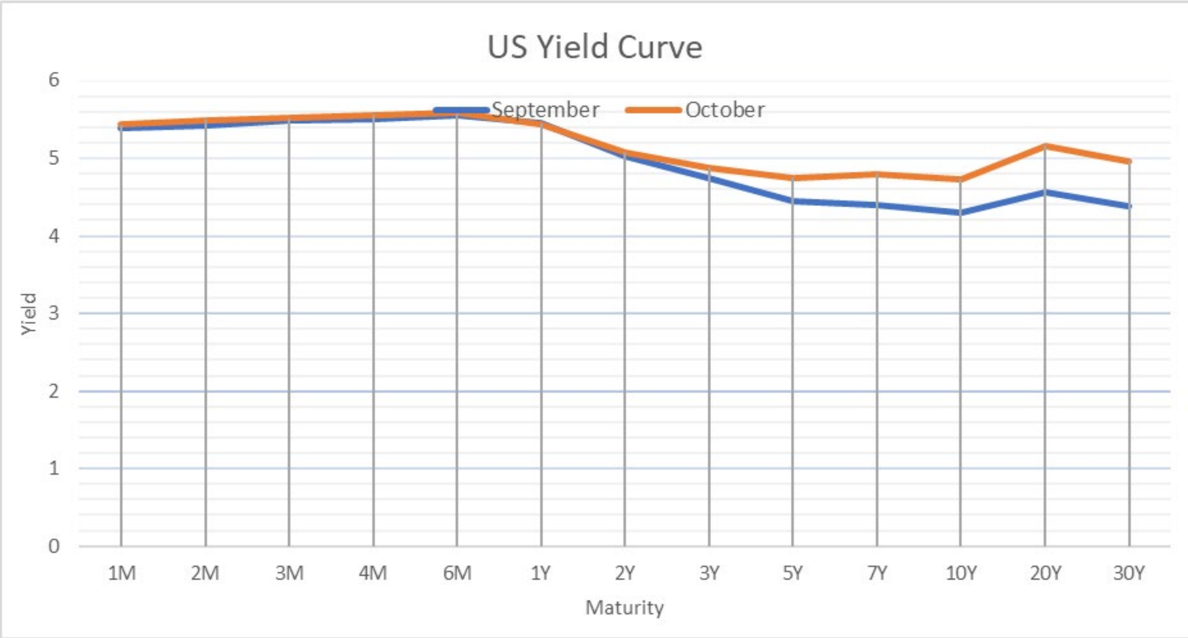
A similarly confusing picture may emerge from looking at bond markets. Yields (on 10-year US Treasury debt – as a proxy) looked as if they had peaked in October last year, at around the same time that equity markets appeared to have troughed. However, since then they have gone on something of a round trip: from 4.2% in October 2022 to 3.3% in March 2023, and recently briefly touched 4.8%. At the same time, a yield curve that was deeply inverted (i.e., with longer-term bonds yielding less than shorter-term debt instruments) at the start of the year seems in the early stages of reversing its inversion.

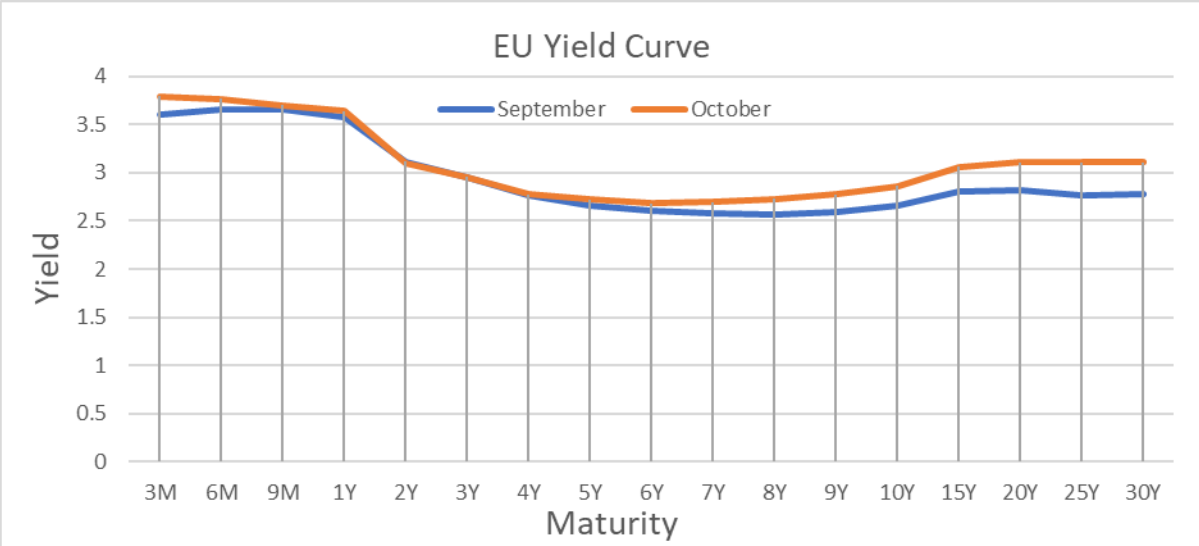
The markets appear to be finally pricing in the oft chanted, but scant heeded Central Bank mantra of "Higher for Longer". Until recently, the markets had been gradually pricing in a 'soft landing' scenario whereby the interest rate policy as applied by the Federal Reserve together with an economy appearing to be surprisingly resilient in the face of the rapid increases in these rates would lead to a manageable slowdown in economy without triggering a recession in the process. In theory, this should eventually lead to a fall in the rates of inflation to levels that justify a reduction in the rates of interest. Until recently, the markets had been pricing in that interest rates would start being reduced as early as 1H24 and could even be meaningfully lower by the end of 2024.

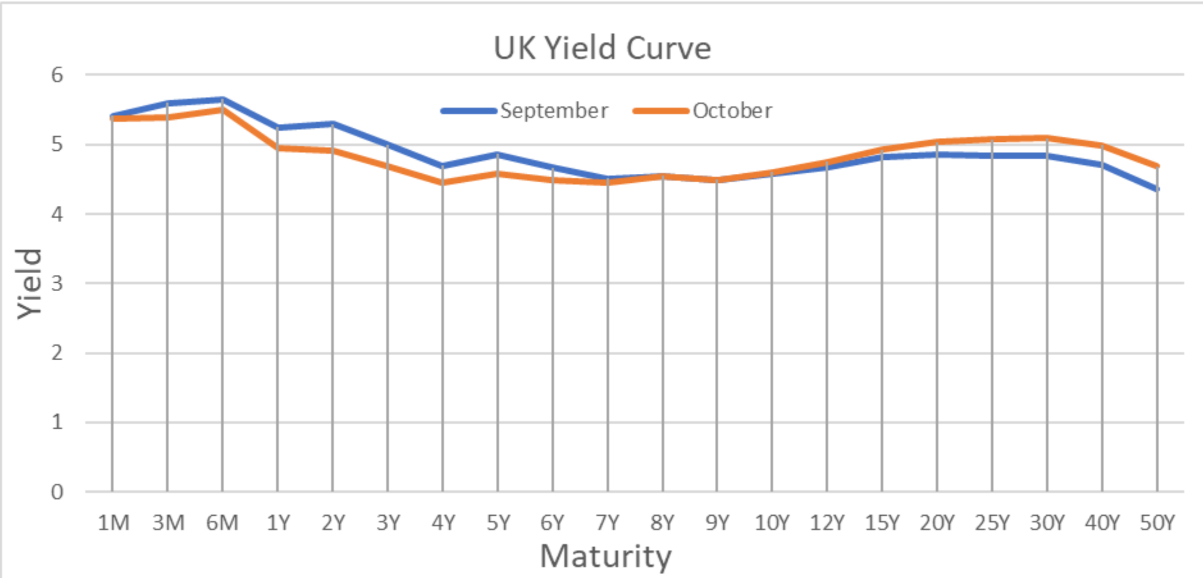
Now, the markets seem to 'get it'. As little as one month ago, and regardless of whether the FED raises rates one more time or not, the USD 2Yr, 5Yr and 10Yr Treasuries were yielding 5.031

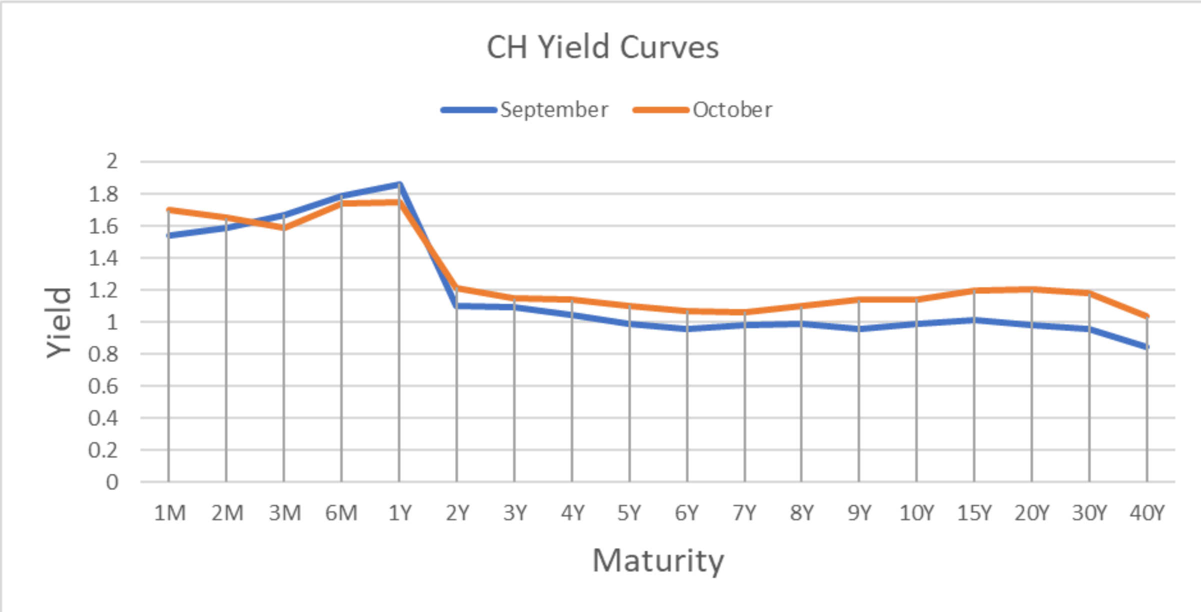
%, 4.447% and 4.302%. As of the time of writing, they are 5.081%, 4.751% & 4.732% respectively. This means that the markets now expect interest rates to remain much more 'elevated' than has been the experience for the last 15-odd years. Otherwise said to those hoping for a material reduction in their cost of borrowing is "0.43% reduction for the next 10 years and that's your lot!".

Of course, the markets can and usually do overshoot on both sides of the constant battle between greed and fear. What is depicted above is merely two snapshots in time of narrow data, but the message we are trying to convey is that market expectations change and when they do, that affects our investments. What we have seen since the end of 2021 is the unwinding of the historic and unsustainable low or zero interest rate policy. Until the end of 2021, it had been priced in that interest rates would remain at or close to zero for an extended period of time. As interest rates began to rise, bond prices fell as did the equity markets. The selling reached a climax around September/October 2022 at the height of pessimism with inflation sitting at around 10% and with Europe gripped in an energy crisis. For the next 9 months, the markets began to price in falling inflation and therefore when interest rates would/should/could start to fall with optimism peaking towards the end of 2Q23. The last three months, and particularly the last month have repriced interest rate expectations as in the snapshots above and in the graphs of interest rate curves in the 4 major currencies below.


US Yield Curve
September
October
Yield
6
5
4
3
2
1
0
1M
2M
3M
4M
6M
1Y
2Y
3Y
5Y
7Y
10Y
20Y
30Y
Maturity

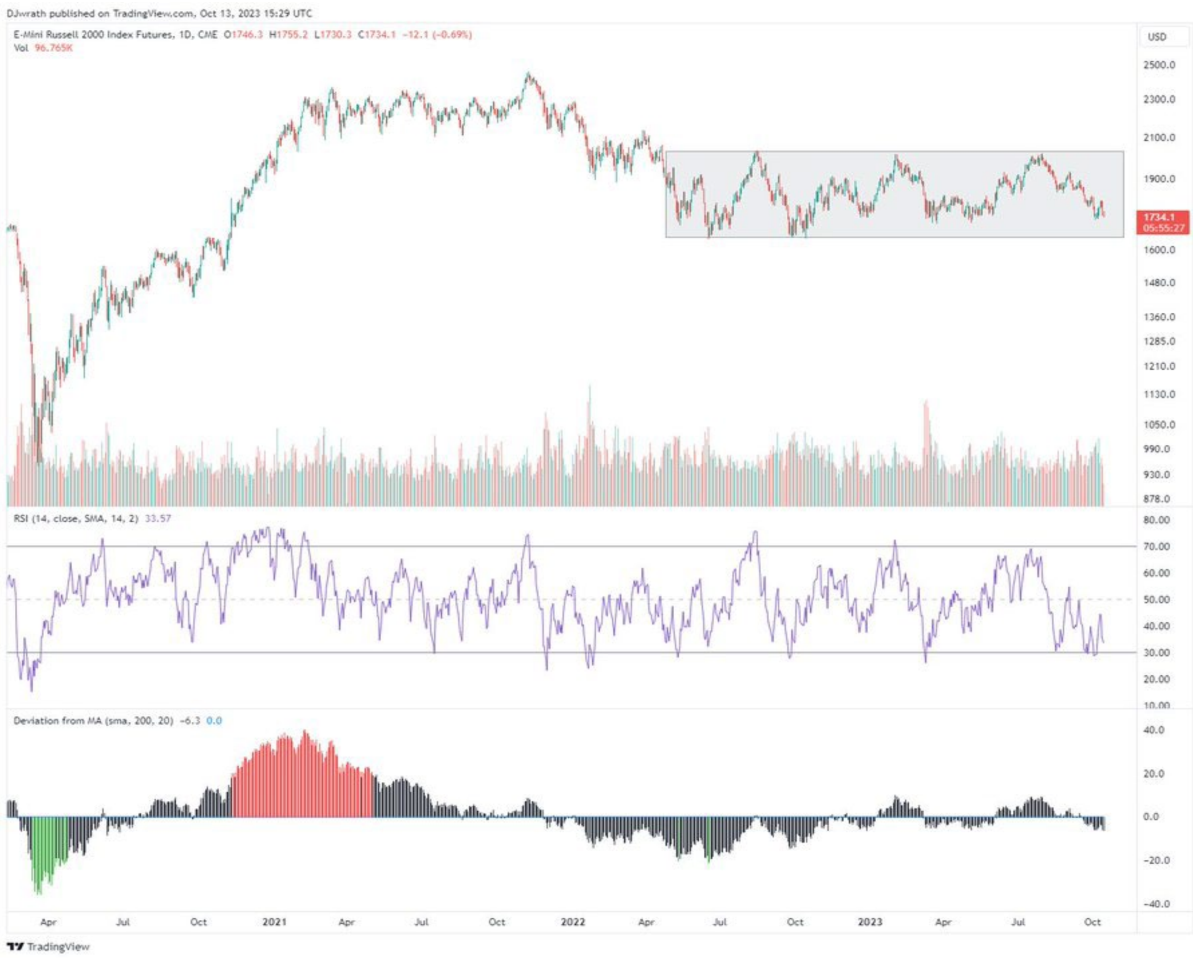

EU Yield Curve
September
October
Yield
4
3.5
3
2.5
2
1.5
1
0.5
0
3M
6M
9M
1Y
2Y
3Y
4Y
5Y
6Y
7Y
8Y
9Y
10Y
15Y
20Y
25Y
30Y
Maturity


UK Yield Curve
September
October
Yield
6
5
4
3
2
1
0
1M
3M
6M
1Y
2Y
3Y
4Y
5Y
6Y
7Y
8Y
9Y
10Y
12Y
15Y
20Y
25Y
30Y
40Y
50Y
Maturity



Equity markets have similarly fallen: with the expectation of higher costs of funding and for longer, discounting future cashflows at higher rates leads to a lower net present value.

Broadly speaking, since the end of 2021, we have seen the equity markets move sideways overall. Bear in mind that the MSCI All Country World Index is currently 10% down from the all-time high. In between, it has been down 26% and up 22% from there. Granted that these are large moves on both sides but if one zooms out a bit, the sideways move becomes more apparent, as in the case of the Russell 2000 Index Futures below.



With ongoing uncertainty as to what path inflation and interest rates will take, we expect that the equity markets will continue to move sideways until it becomes abundantly clear that inflation has been quashed and it is once again safe to let the children out to play. The Central bankers will likely not risk their credibility by cutting rates too early for fear that that may reignite the embers of inflation. We suspect that they will be hostage to the price of energy which is something that no Central Banker can do anything about. As energy is required for all aspects of all our lives, the amount we consume defines our standard of living. if energy becomes more expensive then we will either have to accept a lower standard of living if we can afford less, else somehow increase our income to be able to maintain the same standard. But we digress and that is a subject for another day.

Should we be concerned?

Without wanting to sit on the fence, the short answer is still ‘yes’ and ‘no’. Yes, we should be concerned as the higher cost of funding for many, particularly smaller, companies could pose an existential threat. Those companies that rely on high leverage to achieve their objectives may find it difficult, if not prohibitively expensive, to refinance their debt. Higher cost of funding leads to reduced profitability and therefore make these companies less attractive.

No, we should not be overly concerned as interest rate cycles are just that – cyclical. In time, interest rates will be reduced, and profitability will increase once again. However, we generally do not invest in those companies or sectors that require high leverage to operate. Those businesses in which we invest will not escape the relatively high interest-rate environment, but they will be much less affected. There are even those companies with large amounts of cash on their balance sheets who are receiving interest income in a manner that: a) was a thing from a seemingly bygone age and, b) delivers a meaningful impact on the overall profitability of the company.

In any case, the investment philosophy at MWC is to invest for the long-term in sectors that will retain their growth profiles regardless of what interest rates and inflation are doing. It is clear that these sectors will not be immune to the changes in broad market movements, but their fundamentals remain sound and, once the fog of uncertainty clears, they should recover and deliver the long-term returns that we expect of them. Nevertheless, we think the correct stance in the current environment is for investors to recalibrate their expectations, especially for equity returns in a higher rate environment.

Please refer to our separate fund commentary that discusses the prospects of some of the funds in which your monies are invested.

Summary

2023 is a year that has confounded most investors to-date. Equities may be up, but only a minority of active managers are outperforming. At the same time government bonds have been on a round trip, with the yield on US Treasuries now higher than a year ago. Both the resilience of the US economy and the boom in AI have caught many by surprise. Accompanying these dynamics is a growing realisation that there will be no return to the cheap money era of the 2010s any time soon. Put another way, even if much of the tough work on quashing inflation has now been done, investors may well have to live with a higher rate environment for longer than had been previously assumed. With the economy yet to feel the full pinch of tighter monetary policy, charting a path forward may be challenging. The timing of any Central Bank policy pivot also looks uncertain.

Economic Data Table

June 2023

Stock Markets	Month	Q3 23	YTD	GDP YoY	Interest Rates	Inflation Rate
United States	6.47%	8.30%	15.91%	1.80%	5.25%	4.00%
Euro Area	4.29%	1.95%	15.96%	1.00%	4.00%	5.50%
Germany	2.97%	0.34%	12.30%	-0.50%	4.00%	6.40%
France	4.25%	1.06%	14.31%	0.90%	4.00%	4.50%
Italy	8.37%	4.12%	19.08%	1.90%	4.00%	6.40%
Spain	6.00%	3.90%	16.57%	4.20%	4.00%	1.90%
Greece	4.92%	21.24%	37.52%	2.10%	4.00%	2.80%
Switzerland	0.56%	1.57%	5.13%	0.60%	1.75%	1.70%
United Kingdom	1.15%	-1.31%	1.07%	0.20%	5.00%	8.70%
Brazil	9.00%	15.91%	7.61%	4.00%	13.75%	3.94%
Russia	2.93%	14.15%	29.86%	-1.80%	7.50%	2.50%
India	3.35%	9.71%	6.37%	6.10%	6.50%	4.25%
China	1.16%	-5.15%	-0.75%	4.50%	3.55%	0.20%
Japan	7.45%	18.36%	27.19%	1.30%	-0.10%	3.20%
MSCI World Equity Index	5.64%	5.58%	12.80%			

Bond Indices	Monthly	Q3 23	YTD
Barclays Capital U.S. Aggregate Bond Index	-0.48%	-1.54%	1.18%
Barclays Global Aggregate ex-USD Float-Adjusted Index (Hedged)	-0.14%	-0.08%	3.06%
J.P. Morgan Government Bond Index Emerging Markets Global Core Index (Local Currency)	2.24%	1.23%	5.49%
Barclays Global Aggregate ex USD 10% Issuer Capped (Hedged) Index	0.18%	0.69%	3.66%
The Bloomberg Barclays Global Aggregate Bond Index	0.19%	0.00%	2.78%

Currencies	Monthly	Q3 23	YTD	Price
EUR/USD	2.08%	0.66%	1.94%	1.09
GBP/USD	2.15%	3.01%	5.02%	1.27
EUR/GBP	-0.06%	-2.29%	-2.93%	0.86
USD/CHF	-1.67%	-2.13%	-3.15%	0.90
EUR/CHF	0.38%	-1.49%	-1.26%	0.98
USD/JPY	3.57%	8.68%	10.08%	144.32
GBP/CHF	0.44%	0.82%	1.72%	1.14

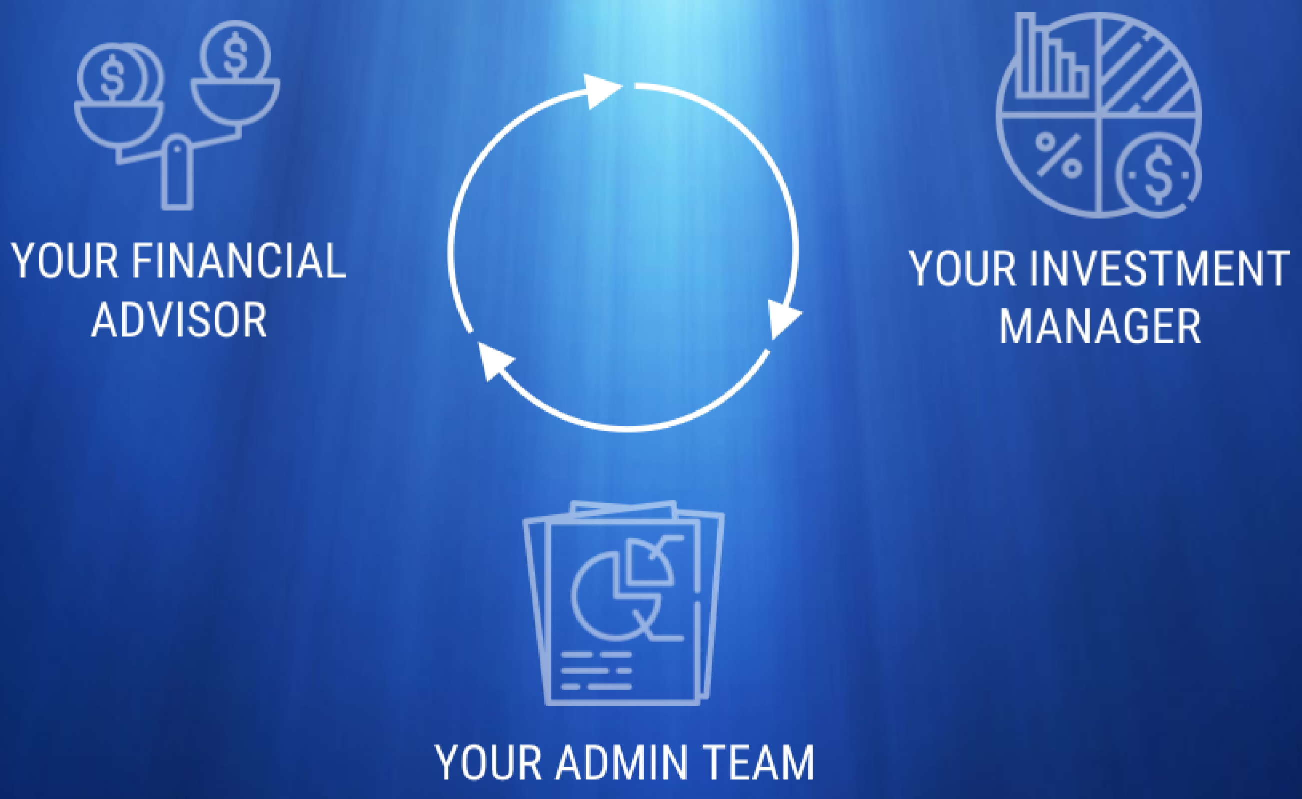
Commodities	Monthly	Q3 23	YTD	Price
Gold	-2.18%	-2.46%	5.22%	1919.57
Oil (WTI Crude, NYMEX)	3.87%	-6.88%	-12.64%	70.37

Disclaimer

The information provided in this Newsletter is being provided solely for educational and informational purposes and should not be construed as investment advice, advice concerning particular investments or investment decisions, or tax or legal advice. Similarly, any views or opinions expressed in this newsletter are not intended and should not be construed as being investment, tax or legal advice or recommendations.

Investment advice should always be based on the particular circumstances of the person to whom it is directed, which circumstances have not been taken into consideration by the persons expressing the views or opinions appearing in this newsletter. MWC Group has not verified and consequently neither warrants the accuracy nor the veracity of any information, views, or opinions appearing in this newsletter. You should always take professional investment advice in connection with, or independently research and verify, any information that you find or views or opinions which you read in our newsletter and wish to rely upon, whether for the purpose of making an investment decision or otherwise. MWC Group does not accept liability for losses suffered by persons as a result of information, views, or opinions appearing in this newsletter.

Manentia Wealth Consulting Group Limited (Reg. No. C 80087) is authorised and regulated by the Malta Financial Services Authority under the Investment Services Act (Cap. 370) to provide investment services and enrolled under the Insurance Distribution Act (Chapter 487) to act as an insurance brokers. Manentia Wealth Consulting Group Limited is owned by Manentia Wealth Consulting Group AG, registered in Switzerland (company registration number CH-170.4.010.039-7). Manentia Wealth Consulting Group AG is FINMA authorized (number 29575) and member of Polyreg (www.polyreg.ch).



Switzerland West Office:
Chemin de Blandonnet 2,
1214 Geneva, Switzerland

Switzerland East Office:
Etzelblickstrasse 1, 8834
Schindellegi, Switzerland

MWC | MANENTIA WEALTH CONSULTING GROUP

European Union Office:
229 Tower Road,
Apartment 11, Sliema SLM
1601 Malta