CROSSINVEST

Wealth & Asset Management
Private Equity & Venture Capital
Family Office Services
Since 1985

Q2 Quarterly & Outlook Q3 2023

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Artificial Intelligence

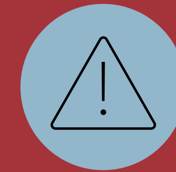
Three Key Market Drivers

Positioning

Investors who were overly bearish were caught offside as risk assets rallied despite consensus expectations for fixed income to outperform.

Inflation

Inflation has trended towards central banks' targets but remain a concern for market participants. We believe inflation and growth may surprise on to the downside.



Liquidity

The Federal Reserve engaged in de facto quantitative easing to prevent contagion as banks failed, supporting risk assets. Liquidity may fail to offer similar support for 2H2023.

Overview

Investors who were rushing out of equities to stay in cash came rushing back in as risk assets rallied against consensus expectations. Bank failures in the US were contained by regulators and the US debt ceiling eventually found bipartisan consensus. However, it was arguably greater levels of liquidity and optimism on artificial intelligence that drove market returns. While the adoption of artificial intelligence may indeed drive productivity gains, regulation and monetization remain unclear. We note that the nature of disruption is non-linear, and disruptors may themselves be disrupted. We avoid chasing the rally from here as certain beneficiaries look to be priced for much more even if the anticipated boom does come to pass. Valuation discipline is a core part of our portfolio construction process, and we shudder at positions priced at multiples of sales rather than earnings. Our preferred asset classes have outperformed year to date, as emerging market bonds outperformed their developed market peers while Japan equities hedged for FX outperformed their US counterparts. In addition, our dashboard of liquidity measures indicate that liquidity may be much less supportive from here.

Positioning

Equities have enjoyed a recovery as worries about bank failures and debt ceiling issues in the United States abated. A rebound in risk assets should have been a positive event for investors, but things are rarely that simple in markets. The rally in stocks came from unusually narrow market breadth in the US as returns were driven largely by technology companies perceived to be beneficiaries of the boom in artificial intelligence(AI). The S&P 500 excluding AI stocks only saw relatively muted returns. In addition, valuations became even more challenging as similarities with the dot-com bubble continue to reverberate.

This was further complicated by extreme bearish positioning of investors, who missed out on the rally. Recession risk became largely forgotten – or ignored – as asset managers became focused on fear of missing out and chased returns. The S&P 500 is now trading at levels last reached more than a year ago, where interest rates were more than 400 bps lower, the Federal Reserve's projections were much more optimistic and economic indicators in far more positive territory. The long and variable lags of monetary policy are now largely in the background as market participants load up on equities despite the environment remaining bearish for risk assets.

As students of economic history, the phenomenon of sharp rallies in bear markets is well known to us. Investors previously convinced of doomsday scenarios are now watching markets recover while missing out on returns. The contrast can be sharp and hence managers feel compelled to add risk, often reasoning that they will get out before the party is over and before everyone else does. The siren call to play a game of musical chairs with the market can be especially dangerous as exit windows for risk assets can close much more quickly than anticipated.

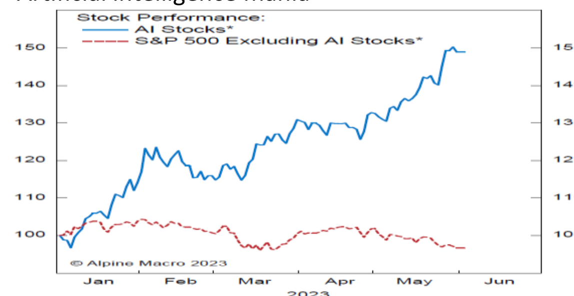
While we have remained underweight US equities, we have found more attractive assets in other parts of the world. We have been bulls in Japan since 2021 as we saw attractive valuations coupled with improving fundamentals from corporate reform. It was this year that Japan equities saw their strongest rally in decades as their merits finally saw recognition by market participants. This came after news broke that famed investor Warren Buffett was adding to positions in the land of the rising sun.

We have capitalized on the recent rally to realize double digit returns in several tactical positions while remaining defensive overall. As events in March proved, sentiment can turn quickly in an environment where the likelihood of financial accidents remain high. We remain on the outlook to build positions in assets we believe to be mispriced and would be keen on risk at more attractive levels.

Nasdaq 100 Index vs Russell 2000 Index

Source: State Street

Artificial intelligence mania



Source: Alpine Macro

Extreme bearish positioning

Source: Société Générale

Inflation

Inflation has come down from historical highs reached last year but concerns around their return to central banks' targets remain prevalent. Energy prices have almost halved from levels reached when Russia invaded Ukraine, contributing strongly to headline disinflation. Base effects also meant that inflation was unlikely to stay at levels reached last year even if energy prices remain unchanged.

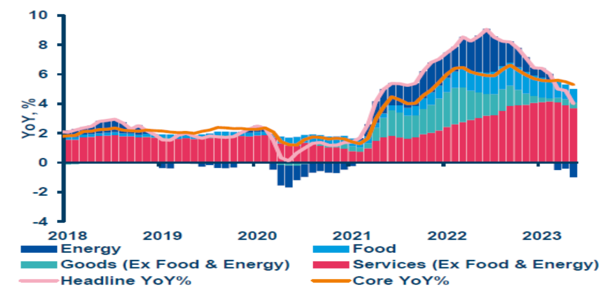
While disinflation has largely played out, investment grade fixed income has yet to rally as anticipated. This may be due to surprisingly resilient economic data as pandemic-induced economic distortions have yet to fully play out. Researchers at the San Francisco Fed estimate that consumers may still have $500 billion in excess savings. This may have accentuated the well-known "long and variable lags" of monetary policy as the effects of rate hikes take more time to percolate throughout the economy.

In addition, investor concerns are centering around core inflation. Fed Chair Jerome Powell himself has singled out core PCE services excluding housing – so called "supercore inflation" as a key area for concern. Several measures designed to track services inflation excluding housing on our inflation dashboard have given us room for optimism. The Atlanta Fed Core Sticky CPI excluding shelter 3-month annualized rate printed 2.5% in June's data release; not far from the Fed's target. Other measures of acyclical core inflation have also hit the 2% handle in recent prints. The Fed's aggressive interest rate hiking campaign, sharp contraction in money supply and anchored inflation expectations gives us cautious optimism that inflation is gradually returning to target.

This forms the basis for our positioning on high quality debt for both elevated yield relative to previous years and potential capital appreciation in a risk off environment. However, we place a much greater premium on agility and tactical trading in this volatile environment. We have tended to trade duration above the 4% handle and may add to long dated Treasuries if 10y yields break out.

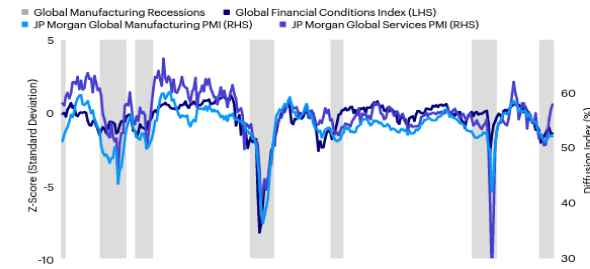
While we believe inflation may be trending down and are bullish on safe-haven assets, we do not share the same enthusiasm on risk assets nor optimism on the likelihood of a soft landing. The Fed has expressed its willingness to risk a recession over the possibility of inflation becoming entrenched. That their focus is on lagging indicators gives us pause as we contemplate the possibility that the Fed may continue to hike into a downward trend for inflation and inadvertently cause financial accidents. That we have already seen the first bank failures since the Global Financial Crisis engenders the view that this scenario is likely plausible rather than just possible.

Core inflation proves sticky



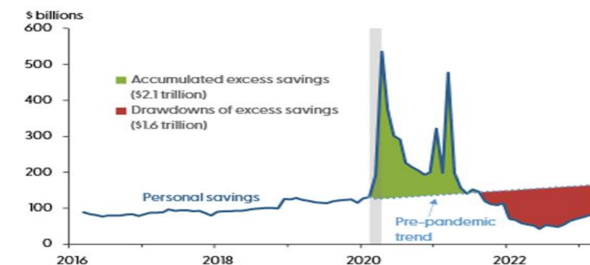
Source: Amundi

Services activity solid whilst goods slump



Source: Invesco

Aggregate personal savings vs pre-pandemic trend



Source: Federal Reserve Bank of San Francisco

Liquidity

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It has been said that everything has a price. Whether this holds definitively remains debatable, but interest rates are but the price of money. When interest rates are lower than they should have been, liquidity flows to speculative assets that do not deserve capital in the first place. Despite our progress in many areas of the human condition, liquidity-driven booms and busts have remain largely the same over time. When liquidity is abundant, risk control and grounding investment theses in numbers become forgotten or perceived as archaic as investors chase after a “New World”.

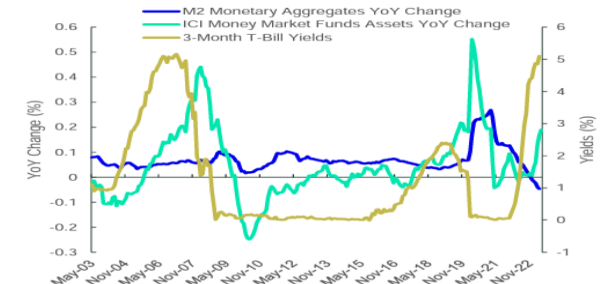
With the benefit of hindsight, supportive liquidity measures were kept in place for too much and too long. Year-over-year measures of M2 money supply reached a staggering 25% and massively boosted asset valuations. Akin to a sugar rush, euphoria was present across markets as asset prices inflated. Investors would be forgiven for experiencing an analogous sugar crash as money supply decelerates rapidly. Unproductive assets (unprofitable technology companies, cryptocurrencies, SPACs) that could not earn a sufficient return on capital may find that their exit from the marketplace is as abrupt as their entry.

The sharp sell-off across asset classes has caused gut wrenching volatility for market participants. While the emotions that may result from such an environment are unpleasant, investors can be rewarded in two ways. Firstly, your portfolio is now built upon much healthier fundamentals for future returns as froth is washed out. Secondly, extreme volatility tends to throw up mispricings for astute managers to exploit.

We managed to capture strong returns from energy, currencies and alternatives last year and have realized double digit gains from several positions in equities this year. This comes as investors get to enjoy yields from bonds in excess of 5% as we position for a recession, which may also lead to further capital gains. For comparison, interest rates were close to zero a little over a year ago.

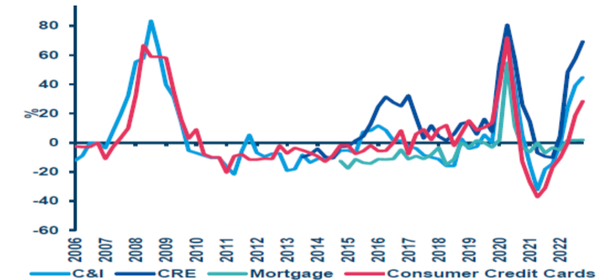
Liquidity conditions have been supportive of risk assets this year and has exacerbated the snapback from extreme bearish positioning among market participants. Optimistic expectations in artificial intelligence stocks also prompted asset managers to add risk and chase returns. Our strategy to navigate this volatile environment remains anchored amidst the shifting tides of sentiment and narrative. We remain defensively positioned, strive to be agile to capitalize on mispricings, while receiving income from bonds as we continue to position for a recession and probable financial accidents.

Money supply is decelerating rapidly



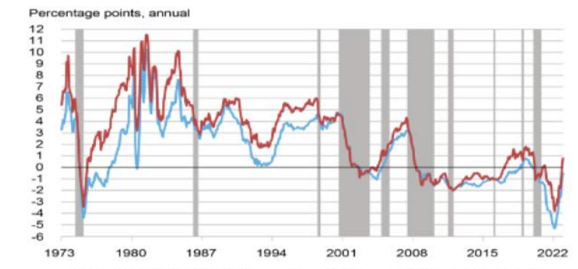
Source: State Street

Tightening in US lending conditions



Source: Amundi

Financial stress tends to occur when rates near R**



Source: Société Générale

Key Calls

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Looking Forward

We have taken profit on our tactical calls across several positions and are now overweight cash. Upward inflation surprises may incite further fears of unanticipated rate hikes, we believe it would offer us tactical opportunities on duration We remain bullish on emerging markets fixed income but stay away from countries dependent on China for trade.

- We are underweight equities and credit and are overweight cash.
- We are overweight bonds within the Emerging Markets space and prefer rates relative to credit.
- We remain bearish on China against consensus expectations as we believe they are likely mired in a liquidity trap.
- We have taken profit on the Growth factor within Japan equities and will look to express bullishness on Value.

Our current views are as follow

- United States: Underweight – We eschew rallies driven by multiple expansion, narratives and poor market breadth.
- Japan: Overweight – Japan is one of the few areas where we are overweight risk due to attractive fundamentals.
- Developed Europe: Overweight – We see better risk to reward in Europe relative to the US but remain highly selective.
- Asia ex Japan: Underweight – We think China is facing structural issues that monetary policy alone resolve.
- Emerging Markets: Overweight – We are cognizant of dispersion within EM and prefer fixed income over equities.
- USD Rates: Neutral – We are neutral on US duration as recession is likely, but valuations are only fair.
- DM IG Credit: Underweight – We are overweight quality securities but prefer duration risk over spread risk.
- DM HY Credit : Underweight – We have zero HY exposure in developed markets we believe default rates will rise.
- Cash: Overweight – We have taken profit and on risk assets and may look to deploy into fixed income if rates sell off.

Crossinvest (Asia)

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About Us

We are a privately-owned financial institution, with over 38 years of Swiss heritage that exemplifies the finest wealth & asset management traditions.

Our key business areas are asset & wealth management, private equity & venture capital and family office services. We work exclusively with high & ultra-high-net-worth individuals, families and institutions.

We have won over 24 industry awards for our portfolio performance, client servicing and proprietary technology. As an independent asset manager, we are keenly aware of the importance of considering the cross generational impact of investment and wealth-management decisions.

We appreciate that every client is unique, and every need is different. This leads us to create tailored solutions to meet our clients' goals while maintaining institutionalized processes of asset management.

Our Mission

Our clients' wealth is the result of the time they sacrificed away from their families to ensure their financial security; it is our mission to protect and build on this sacrifice.

We achieve this through

- Building long term value
- Our independence & open architecture
- Operating as a dedicated fiduciary advisor
- Our commitment to provide the best investment solutions & services
- Crafting the best solutions for our clients' individual needs

Recent Awards

2022

Best Client Service

Best Innovative Use Of Technology

Best Overall Digital Engagement

Most Effective Investment Service Offering – Highly Commended 2022

2021

Rising Star for Asia-Pacific

Best Multi-Family Office Singapore 2021

Best Independent Wealth Manager Singapore

2020

Best Asset Manager Serving Family Offices & Private Banks

Best Next – Generation Offering – Highly Commended 2020

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