



MARKET COMMENTARY

BERGOS
PRIVATE BANK



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As Bergos' Chief Equity Strategist, Frederik Carstensen leads the top-down equity strategy. He is a member of the investment committee and regularly comments on events in the international capital markets.

GLOBAL EQUITIES: JAPAN AND US GROWTH STOCKS OFFER FURTHER POTENTIAL

After the strong performance in the first half of the year, Frederik Carstensen, Chief Equity Strategist at Bergos, sees only limited opportunities for global equities for the rest of the year. However, there is still upside potential. US growth stocks have been a major performance driver in 2023 and remain in demand. In Europe, industrials have become more attractive. Investors are adding Japanese stocks to their portfolios again.

After a difficult year 2022, global equity markets rallied in the first six months of 2023. While US and European stocks posted double-digit gains, Japanese stocks performed especially well, rising by more than 20 percent in local currency terms. Emerging markets and China are lagging behind.

In contrast to 2022, growth stocks have performed better than value stocks so far this year. The US stock market was propelled by seven large cap growth stocks in particular. These stocks, known as the "Magnificent 7", are benefiting from advances in artificial intelligence-based technologies. All seven can be found in the technology, consumer discretionary, and communications sectors, and are listed in the Nasdaq 100. Having risen by almost 40 percent since the beginning of the year, this index has enjoyed the best first half in its history. The energy sector, which was triumphant in 2022, is among the losers so far in 2023.

Equity investors seem to have become used to rising interest rates

"Although issues such as the US banking crisis, Credit Suisse and the US debt ceiling debate have also moved equity markets in recent months, the key influencing factors that are causing the greatest uncertainty this year are interest rates and inflation," Carstensen said. Core inflation remains high in the United States and the US central bank has adopted a hawkish tone of late. Contrary to expectations, interest rates may not yet have peaked, given that a further hike is likely in the summer. The higher interest rates rise, and the longer they stay high, the likelier it is that economies eventually succumb to a meaningful slowdown.

Recent market performance suggests that investors have made their peace with the current situation considering that equity markets have rallied despite rising interest rates. "The US equity market has not seen a setback of more than 3 percent since early March. And the volatility index, the VIX, is at a very low level. This begs the question of whether market participants have become overly complacent with respect to interest rate and economic trends," Carstensen said. He regards the improved investor sentiment in the last few weeks as a contrarian indicator that calls for caution.

Time for a rebalancing

From a valuation perspective, equities have become less attractive. Share prices have risen, but earnings growth expectations are low. Consequently, PE ratios are now higher, meaning that equities have become more expensive. They have also become less attractive in comparison with bonds. The yield gap – defined as the earnings yield of equities minus the yield of 10-year government bonds – has fallen below its long-term average.

"Nevertheless, we still see further upside potential in the second half of the year, even if this is likely to be limited due to the already significant price gains in recent months," Carstensen said. He considers systematic investment strategies, which are still underinvested in equities but are forced to enter if volatility remains low, as a positive price driver. If, in addition, there are increasing signs that central banks are considering interest rate cuts and corporate earnings turn out better than expected, there may even be upside surprise potential in the markets. Against this background, equities are neutrally weighted in the Bergos portfolio. Carstensen: "After the strong share price gains in part, it is time for a rebalancing, taking profits from stocks that performed particularly well and returning these stocks to the target weighting."

Regions and sectors: USA, Japan, and European industrials

In terms of regions, Bergos maintains an overweight position in Japan and the US in the global equity portfolio. "In Japan, inflation is comparatively low and monetary policy is still expansive. This is supporting the equity markets. Valuations are attractive and net inflows to the Japanese market are picking up again," Carstensen explained. He sees greater opportunities in the United States than in Europe, which is neutrally weighted: "The interest rate cycle has progressed further in the United States. A central bank pivot could well happen earlier there. Growth stocks in particular usually stand to benefit from the prospect of interest rate cuts."

Bergos remains cautious with regard to emerging markets and especially China. "Here we see geopolitical risks: The tensions between China and the United States could escalate in the run-up to the US presidential election next year. That is likely to weigh on earnings and growth in China", Carstensen explained.

In terms of sectors, portfolios should be broadly diversified, in his opinion: "We see further potential for growth companies, for example from the technology, communications and consumer discretionary sectors. Our focus is primarily on quality growth companies that generate profits. At the same time, other parts of the market could catch up if investors bet on a broader economic recovery in the medium term." In Europe, Bergos has recently upgraded the industrial sector to an overweight. "This sector is benefiting from, among other things, the EU's Net Zero Industry Act and regulations that will accelerate the transition to renewable energy," Carstensen explained.



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