

Lotos Asset Management

Quarterly Investment View



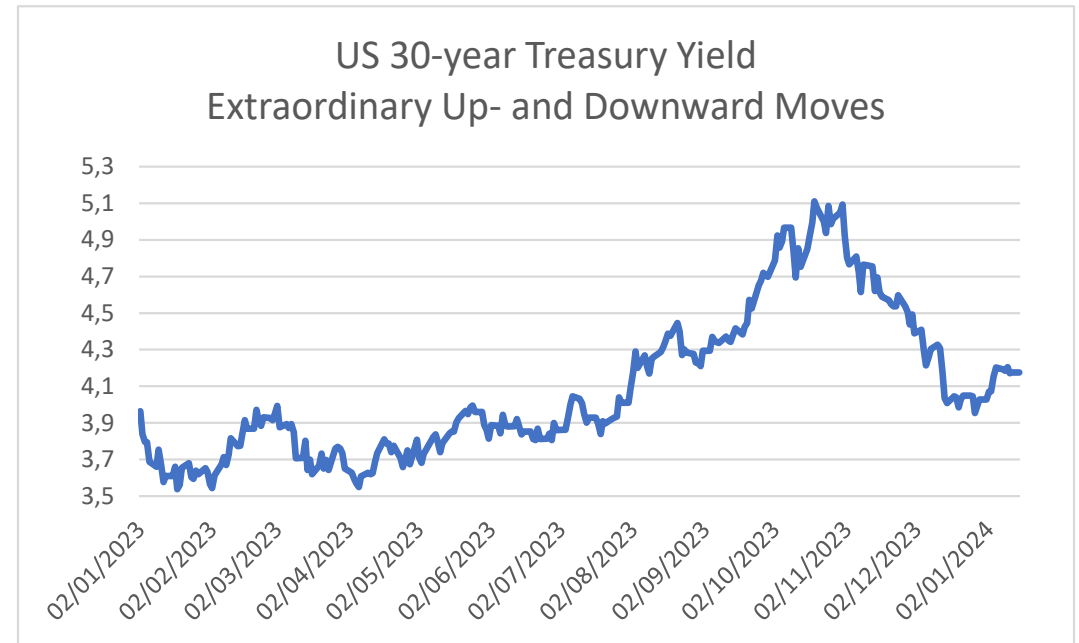
Should investors already look beyond a potential slowdown/recession?

Happy New Year!

2023 proved a much better investment year than many predicted. That – per se - was probably not very difficult as most forecasts were outright to slightly bearish and therefore totally to slightly wrong. We are delighted that in our managed portfolios the negative returns, which occurred in the annus horribilis 2022 have mostly been eradicated. The more risk-taking the strategy, the better the returns, which was particularly true for equity strategies. Over the timeframe 2022-2023 the latter even recorded positive double-digit returns.

But now that the new year has already started let's look forward. It strikes us to what extent market observers seem backward-looking. Previously, inflation was totally ignored, but afterwards nothing else seemed to count. Then came central bank policies and also now, this appears to be the main driver of all market moves. We consider that particularly equity investors should take a different approach: watch earnings, margins, cash flow and cost reduction potentials instead of trying to forecast timing and micro moves from central banks. Monetary policies are currently data-dependent and economic figures are not linear. Trends are key. Anyways, the most important central bank, the Federal Reserve (Fed), has already executed on its crucial mission – reigning in inflation. This takes risk out of the markets and offers a sound basis to walk forward. Admittedly, markets priced in an already quite aggressive approach to interest rates and may therefore be in a consolidation phase. Due to our assessment of the fundamentals, we remain overweight equities and equal weight bonds. As we are in a normalization phase, we have no exposure to alternatives – gold being the exception.

As always, it is interesting to find out, what is currently priced into markets. The consensus seems to forecast an economic soft-landing in the US with a significant reduction in inflation. On the right-side chart, we show the impressive moves up “higher rates for longer” to down “the Fed is done” interpretation of the bond market (US Generic 30 year Yield).



Source: US Treasury

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Equity investors have rapidly incorporated the potential for an economic soft-landing by buying into cyclical sectors, such as Consumer Discretionaries, Financials and Industrials. Defensive sectors, such as Utilities, Consumer Staples and Health Care continued to lag. The latter have been favorites for 2023 and – once again – are named as preferred segments for 2024 despite or because of their underperformance.

There seems to be a dichotomy between strategists and investors. In our opinion, many strategists are trapped in their negative convictions but have to face the market conditions. Should they continue to be cautious – risking to be wrong again or adapt? Some changes of opinion could already be observed late last year in light of the stock market rally. Investors that have to show performance apparently are quicker to adapt. They reacted to better-than-expected incoming economic data, to the fact the Fed signaled future rate cuts and to margins that held up surprisingly well (see next page).

But reflect these moves just a reaction or have markets already started to fulfil their role as a leading indicator? Typically, the start of monetary easing triggers a repositioning for a new cycle.



Source: Bloomberg

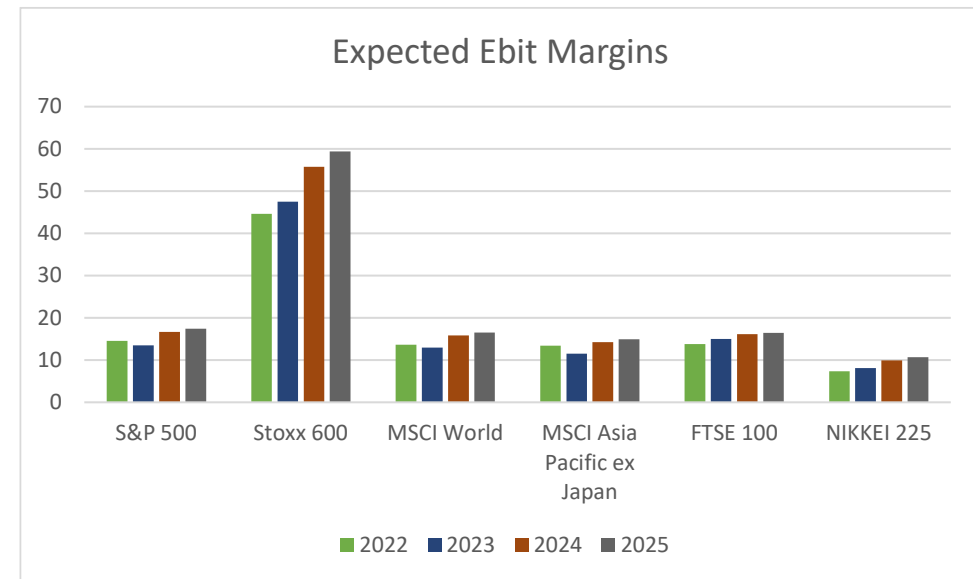
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As the chart below (left) shows, projected earnings growth varies widely by region. This is linked to the respective economic developments, index compositions, foreign trade and currency effects. In the most important equity market, the US (data for S&P 500), which represents roughly 70% of the MSCI World Index, we can observe, that earnings were slightly lower in 2023. This was much better than the deep earnings recession that was priced in by investors already in 2022 and explains partly the strong positive market reaction in 2023 despite weakish earnings growth. The other major factor was the looming change in monetary policy. For the current year, profit growth of approximately 11% is anticipated by the consensus. There are also signs of a recovery in margins (see chart to the right). Yet many investors are now skeptical if markets can keep the momentum after such a fabulous year. Looking back somewhat further, the current S&P 500 level corresponds to the one at the end of 2021. Earnings have, however, risen over 9% since then. That said, the Price/Earnings valuation ratio in 2021 of 24x has been quite rich.

Should future cuts in interest rates trigger an economic rebound, double-digit earnings growth seems feasible. Such a development will be factored in by investors well in advance of the facts. The most important growth drivers will continue to be technology, environmental policies and capital spending, in our opinion.



Source: Bloomberg Consensus



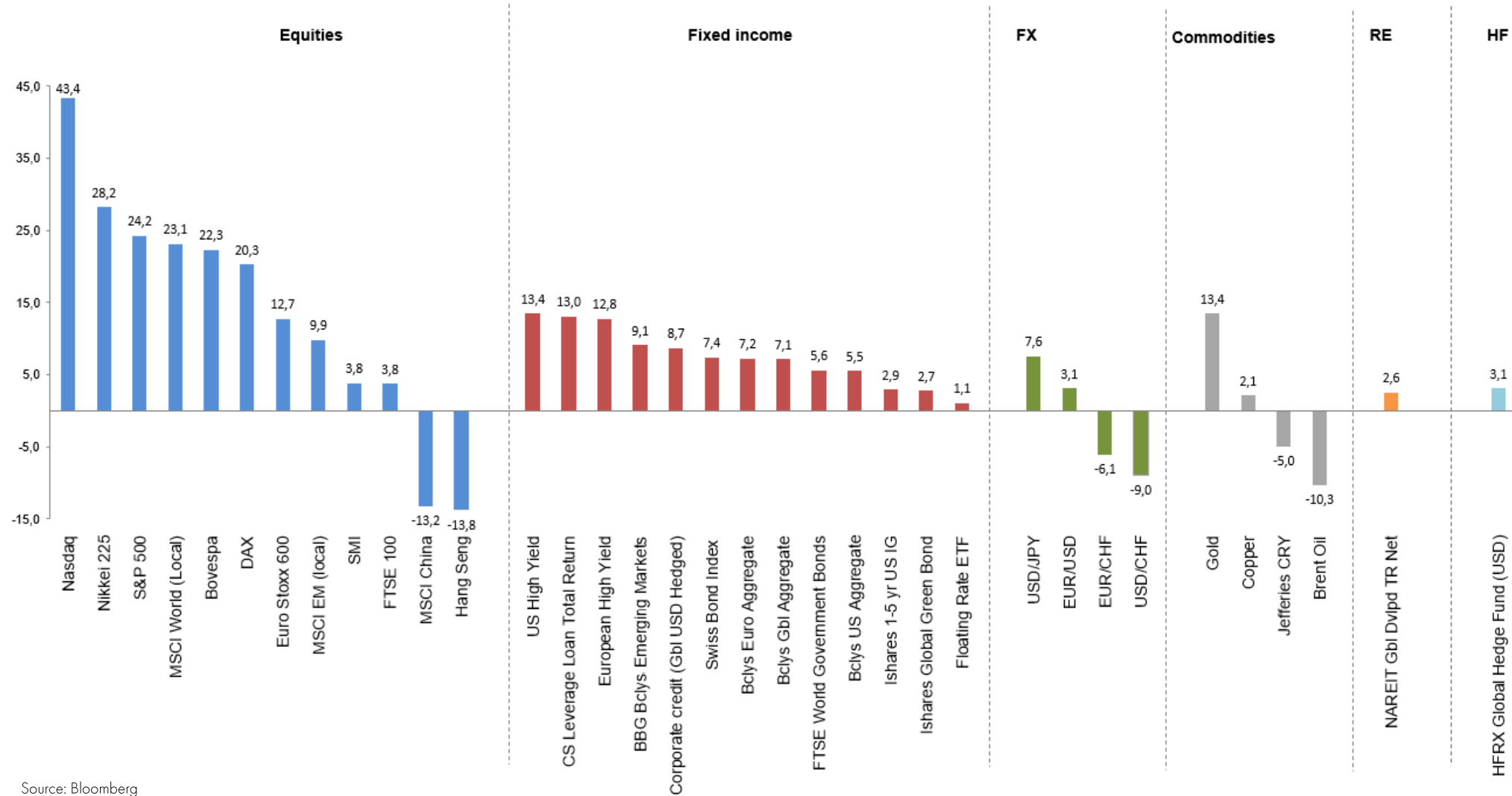
Source: Bloomberg Consensus

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Conclusion

- We expect investors to position for a new cycle after the current consolidation phase.
- We are still overweight the US as technology continues to be a major driver for the economy and markets.
- The earnings and margin trends in the US seem solid with less risk than in other geographies.
- We expect only a shallow economic slowdown in the US as corporations will be forced to implement Artificial Intelligence rather fast. One of the best leading indicators, the Philadelphia Fed Business Outlook, just showed a significant increase in the six-month outlook for capital spending.
- Infrastructure spending, military expenditures and investment needs due to de-globalization are not dependent on interest rates.
- Geopolitics and Elections in many parts of the world could temporarily increase volatility. We still believe in the sanity of humanity.
- China continues to be challenged on many fronts. The unpredictability and opacity of governance and data will continue to discourage investors from getting involved.
- Europe is confronted with its significant exposure to China and the end of the peace dividend. We remain underweight.
- Fixed Income Markets already anticipated interest rate cuts to a considerable extent.
- Investors that have not lengthened their duration in the portfolio should take advantage of the current correction phase and adjust.
- Fixed Income Markets will take longer to reallocate to a new cycle.

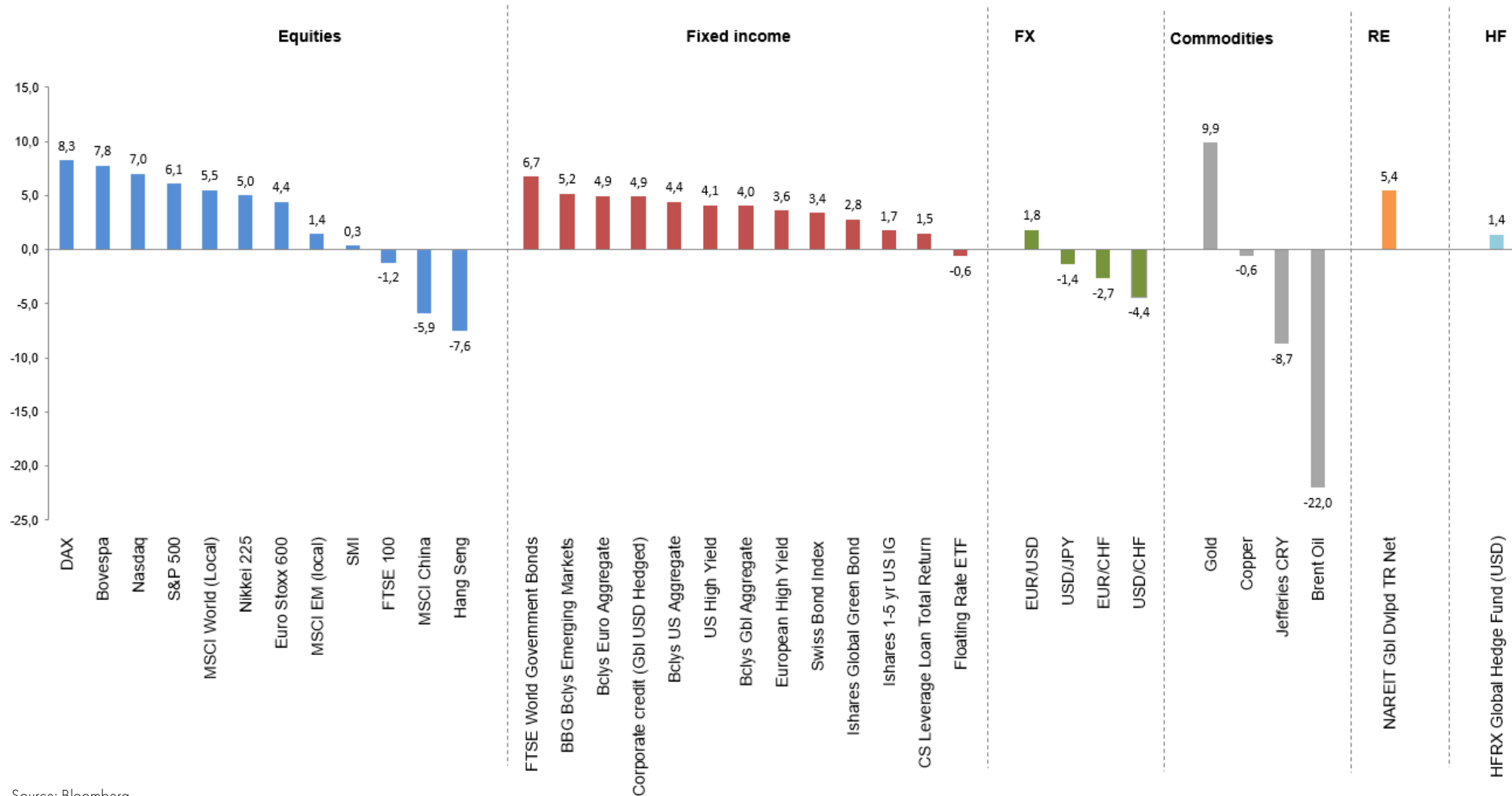
Performance major asset classes 2023 in local currencies



Source: Bloomberg



Performance major asset classes Q4 2023 in local currencies



Source: Bloomberg



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