ASAS CAPITAL
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Weekly Newsletter

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Musings

"The safe way to double your money is to fold it over once and put it in your pocket."

-Sir Kin Hubbard

Last week in the markets

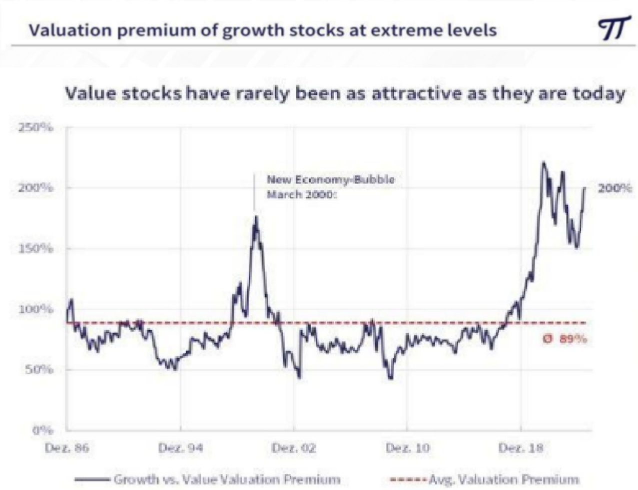
The stock market rally had a stellar week, as tame inflation reports eased Fed rate hike fears and sent Treasury yields and the dollar tumbling. The Dow Jones Industrial Average rose 2.3% in last week's stock market trading, hitting a 2023 high and just below a 52-week best. The S&P 500 index popped 2.4% and the Nasdaq composite leapt 3.3%, both setting fresh 52-week highs.

So, what's next?

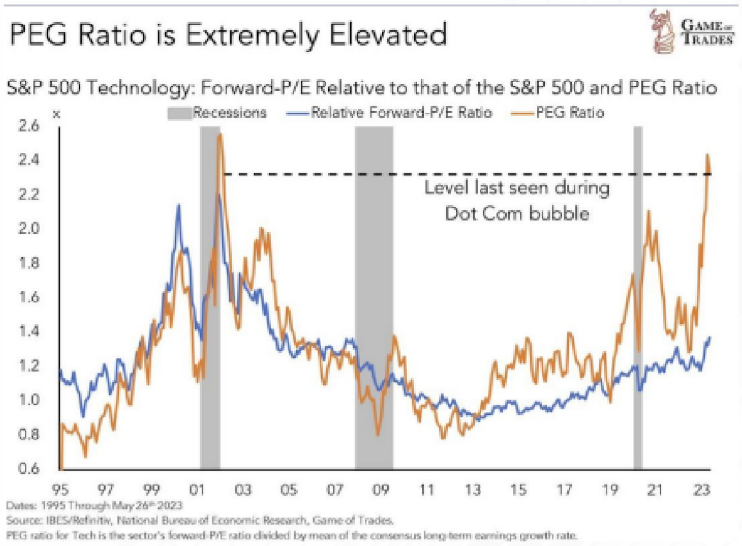
Growth stocks are reflecting extreme optimism.

Investors are apparently willing to pay more than 3x the valuation for growth stocks vs value stocks. This premium is over twice the long-term average. In an environment when sentiment is increasingly consensus bullish, valuations are stretched, and monetary conditions are getting tighter, we believe it is prudent to be cautious.

Growth stocks are currently significantly overvalued: Since 1986, global growth stocks have traded at an average premium of 89% compared to value stocks. Currently, investors are paying more than twice that premium. This means that growth stocks are even more expensive today than they were at the peak of the New Economy bubble in 2000. Following a long period of extremely low inflation rates and historically low interest rates, a paradigm shift seems more likely than ever, The reason: growth stocks disproportionately suffer from higher interest rates as the present value of profits in the far future decreases more strongly. The main beneficiaries will be undervalued value stocks, which have been disappointing for over 13 years.



Similar extreme behavior is visible in the technology sector, where PEG ratios are reaching levels last seen during the dot-com bubble in the beginning of this century. During the crash that followed and continued from 2000 to 2002, the Nasdaq dropped from 4,069.31 to 1,335.51, a drop of ~ 67%



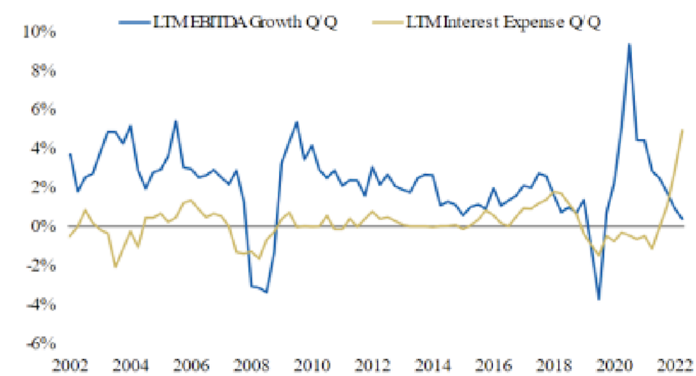
Investor sentiment has shifted towards optimism.

Market sentiment has turned decidedly bullish, as investors have shifted focus away from macroeconomic data towards the economic potential of new technologies.

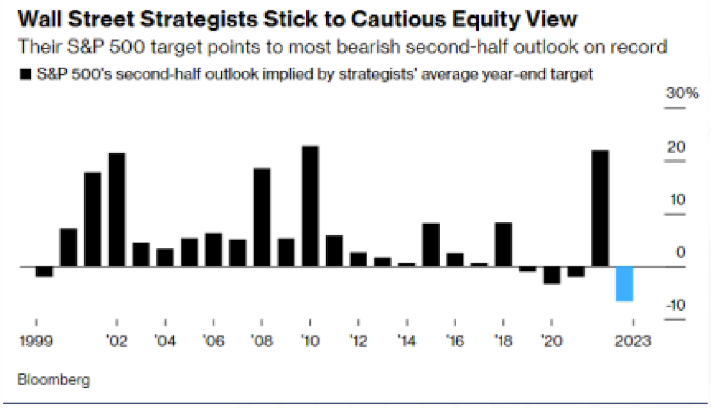
Higher interest rates are starting to erode profitability.

As expected, the rise in interest rates has started to push up financing costs for businesses and exerting downward pressure on profits. The full impact will be played out over the coming months as existing debts come up for renewal.

Exhibit 2: The gap between LTM interest expense (4.9%Q) and earnings growth (0.4%Q) reached a record high



It does not surprise us that most leading equity strategists on Wall Street are taking a cautious view of the market direction for the rest of 2023.



Banks reveal a mixed picture.

Friday's results showed that big banks like JPMorgan and Wells Fargo that have sprawling consumer franchises are performing well because they are able to charge more for their loans and benefit from a surge in credit-card borrowing by Americans who still have extra money.

But corporate clients are not providing as much of a lift, which is hurting the banks that rely more heavily on them. Goldman is expected to show an investment banking revenue decline of 32% from a year ago and a trading decline of 17%. Morgan Stanley is also expected to show a 4% drop in investment banking and a 19% decline in trading.

Even JPMorgan, which churned out massive profits in its consumer business, saw investment banking fees fall by 6% from a year ago.

Smaller banks could also show new challenges. State Street, which serves a lot of institutional clients, saw its net interest income, which measures the difference between what it earns from loans and pays out in deposits, falling 10% QoQ. That's largely because of rising deposit rates and a rotation by customers out of non-interest-bearing deposits as they seek higher yields.

Corporate earnings season about to pick up.

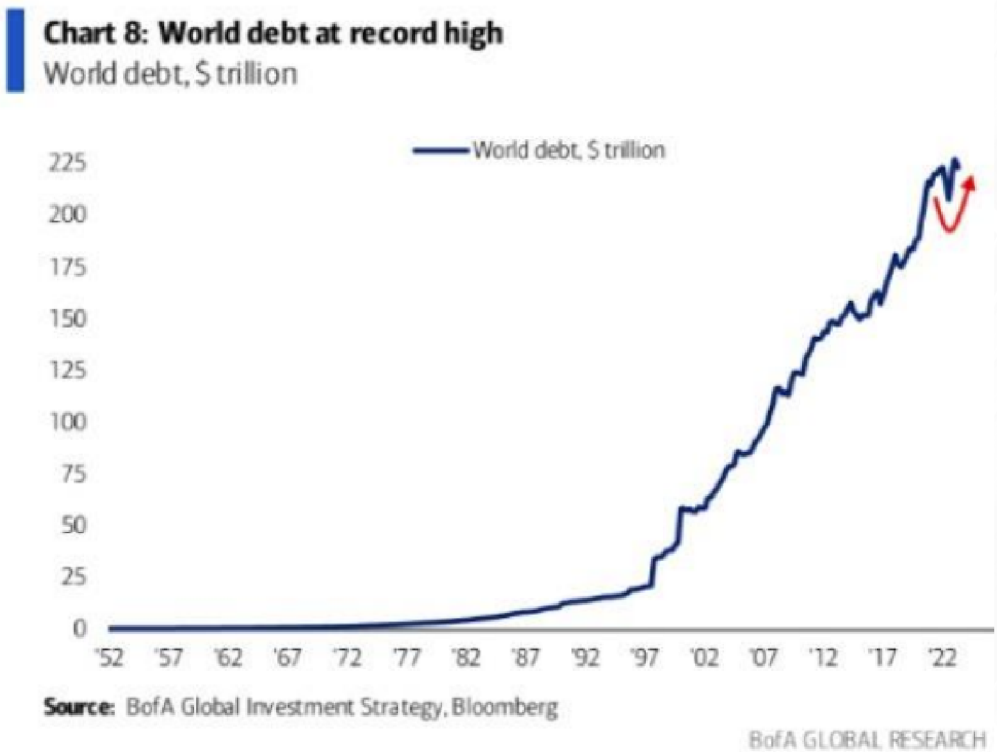
"Magnificent Seven" – the massive growth and technology names that have dominated the U.S. stock market in 2023 are set to report earnings in coming weeks, potentially determining the path for this year's equity rally. BofA Global Research projects they will increase earnings by an average of 19% over the next 12 months, more than double the 8% estimated rise for the rest of the S&P 500.

Nasdaq-100 will go through a special rebalance.

The Nasdaq is expected to spell out how a Nasdaq 100 special rebalance will adjust weights of its 100 components. The Magnificent Seven of Microsoft , Apple , Nvidia , Tesla , Google parent Alphabet , Meta Platforms and Amazon.com are set to see their outsized dominance lessened in the special rebalance that takes effect before the open on July 24.

Chart of the week

Global debt currently stands at $305 trillion, $45 trillion higher than before the COVID-19 pandemic. Of this, corporations account for $161.7 trillion (53 percent), governments owe $85.7 trillion (28 percent) and individuals comprise $57.6 trillion (19 percent).



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