Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

Main Events

13.06 – US CPI
The May CPI data will be released shortly before the FOMC meeting. However, only a significantly higher-than-expected reading could affect the Fed's decision

14.06 – FOMC MEETING
Stronger-than-expected data have put the possibility of a final hike back on the table, probably in July. Will the Fed confirm or downplay this expectation?

15.06 – ECB MEETING
The ECB is expected to raise rates and commit to at least one more hike, probably in July.

16.06 – U-MICH INFLAT. EXPECTATION
Another rise (after last month's unexpected one) in long-term inflation expectations could mean that they are becoming less anchored

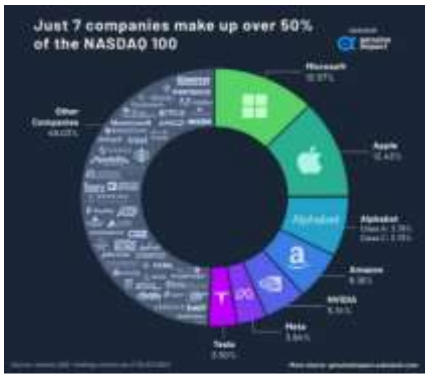
SPARKLING FAANGs

- **The FAANGs are solely responsible for the major world indices' positive performance since the beginning of the year**
- **The developments on the FAANGs over the past few weeks present some similarities to what happened in the final stages of the 2000 bubble**
- **The divergence in YTD performance suggests that caution is needed with respect to FAANGs, but it has also created pockets of undervaluation where good investment opportunities can be found**

Never has stock market performance been so polarized as this year, with a handful of stocks explaining the entire positive performance of the main indices.

With a remarkable increase of 70% since the beginning of the year, the FANG+ index (which consists of 10 stocks, among which the original FAANG - **F**acebook/Meta, **A**pple, **A**mazon, **N**etflix, **G**oogle/Alphabet), is solely responsible for the positive performance observed across various indices. In fact, the FANG+ account for more than 50% of the Nasdaq 100 index (+35% YTD), about a quarter of the S&P 500 (+14% YTD), and just under a fifth of the MSCI World (+13% YTD).

Source: Bloomberg



Source: Genuine Impact

(continued)

Source: Jim Bianco, Bianco Research LLC

Source: Bloomberg

The top left chart shows precisely how 8 stocks (the original FAANGs plus Microsoft, Nvidia and Tesla) are responsible for the entire positive performance of the S&P 500 from the beginning of the year to June 6. The other 492 stocks contributed zero to the index's performance. In other words, either one had these 8 stocks in the portfolio, or a diversified portfolio on the remaining stocks would be stuck at zero YTD.

However, it is crucial to question the extent to which this performance is supported by solid fundamentals. The higher valuation placed on growth stocks, particularly the FANG+ stocks, is often attributed to the anticipation of stronger earnings growth compared to the rest of the market. In the chart above on the right, the actual reported earnings per share (EPS) for the FANG+ index are depicted in green, while the EPS projected by analysts for the next 12 months are shown in purple.

Firstly, it is worth noting that earnings for the FANG+ have not only failed to rise significantly, but have actually declined nearly 38 percent in nominal terms from their peak one year ago, returning to the levels of two years ago. And this is despite the fact that CPI has risen cumulatively by more than 10 percent since then. Furthermore, despite the evidence of declining earnings, the EPS expectations continue to rise.

As of today, earnings for the next 12 months are expected to climb about 64 percent, or nearly ten times the average EPS growth experienced by equities over the very long term. The credibility of these assumptions is rather questionable, considering that the possibility of an economic slowdown or recession cannot yet be dismissed. It is important to note that we are not talking about small caps with limited revenues or companies with low margins. Nevertheless, the market seems to be focusing only on the EPS growth figure and getting excited about it.

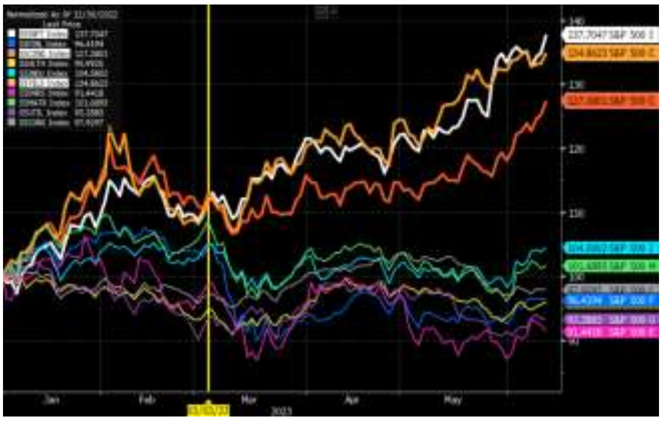
To avoid potential distortions caused by overly optimistic or pessimistic expectations, let's examine the Price-to-Earnings (P/E) ratio calculated using reported earnings. It becomes evident that the P/E ratio of the FANG+ stocks is rapidly escalating to levels typically associated with the formation of a market bubble. The P/E ratios of the Nasdaq and the S&P have also experienced significant increases, albeit to a lesser degree, primarily due to the influence of the FANG+ stocks within these indices. In contrast, the P/E ratio of the MSCI World ex-US, which does not include these stocks, has been gradually decreasing throughout this year.

These dynamics are possibly due to the liquidity injections of the past 4 months, owing to the debt ceiling and Fed interventions to support troubled banks, which had been discussed in previous report. This abundant liquidity likely triggered large inflows into the same stocks that had led the rally up to 2021 as investors, who typically have adaptive expectations (i.e., tend to project for the future the same dynamics experienced in the recent past), continue to view those stocks as the best ones, regardless of their valuations.

Source: Bloomberg

(continued)

Source: Bloomberg



Source: Bloomberg

A P/E of 56 corresponds to an implied return of 1.8% (=100/56). Even assuming a 65% earnings growth (10 times the historical average for the stock), the implied return after one year would only rise to 3% (1.8x1.65). Assuming two consecutive years of earnings growth at 10 times the historical average, this would result in an implied yield of 5%, which is still lower than 5.2% yield of 12-month T-Bills. Even assuming unreasonable growth rates from a historical point of view (and all the more so considering that these are some of the largest companies in the world), the implied returns of FANG+ still remain uncompetitive when considering current risk-free rates.

One of the most surprising dynamics is the lack of sensitivity to changes in interest rates. Risk-free rates have increased by 5 percent from last year. Everyone knows that growth stocks should be the most sensitive to interest rates. There has always been a strong inverse correlation between the Nasdaq P/E and real rates (shown on an inverted scale in the top left graph, since the correlation is inverse). [*Note: To avoid any confusion, the P/E ratio of the Nasdaq used in this chart is calculated based on forecasted earnings, expected to grow by approximately 20%, and not on reported earnings. This accounts for the difference in the P/E levels between this chart (26.8) and the previous one (32.6)*].

The gap between the Nasdaq P/E ratio and real rates has never been wider than it is currently. The difference has now expanded to nearly 40%, and in the past two months, the P/E ratio has risen despite the increase in real interest rates, approaching record levels.

Additionally, as mentioned earlier, the patterns we're observing right now resemble to those typically associated with a bubble. More specifically, some of these dynamics are similar to what happened in late 1999/early 2000. As depicted in the chart top right, since the US banking crisis began, only three sectors have soared: technology (including Microsoft, Apple, and Nvidia), telecoms (including Google/Alphabet and Facebook/Meta), and consumer discretionary (including Amazon and Tesla). All other sectors, in contrast, have been sold off and suffered losses of even more than 10 percent.

The first chart on the next page illustrates the evolution of the price-to-sales ratio of the constituents of the S&P 500, divided into deciles. The grouping is not based on sectors or investment styles, but solely on the absolute level of the P/S ratio. Over the past 40 years, it can be observed that all deciles have typically moved in sync, rising together, falling together, or remaining stable. The only exception is the period between late 1999 and 2005. During the parabolic surge in the final months, only stocks with the highest valuations (belonging to the first decile in terms of P/S ratio, and to a lesser extent the second decile) experienced increases, while all other deciles declined. In practice, people were selling underperforming stocks to invest exclusively in the few that were skyrocketing, disregarding fundamental factors.

When the bubble peaked in early 2000, this dynamic reversed: for a few years after the peak, stocks in the deciles with the highest valuations corrected significantly returning to more reasonable levels, while the other deciles, that had been sold off in the final phase of the bull market, posted positive performances.

How long can this divergence in performance last? Defining the timing of a reversal is always challenging, if not impossible. In this case, one might venture another historical analogy with the 2000 bubble.

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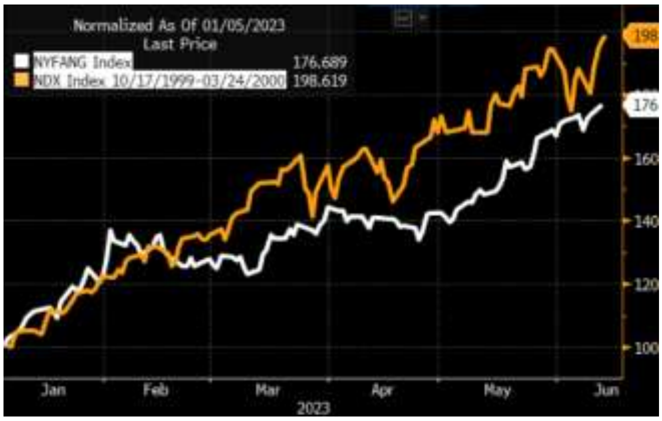
Source: www.hussmanfunds.com/comment/mc230221/



Source: Bloomberg

During that period, the hottest index was the Nasdaq, encompassing companies that were in the spotlight at the time, as the euphoria affected a large number of companies, unlike the current situation. Following a multi-year bull market, between October 18, 1999 and March 24, 2000 the Nasdaq made its last major surge, the most extended move that usually occurs at the end of a bubble, nearly doubling.

The top-right chart compares the Nasdaq during that period (in yellow) with the FANG+ index (in white) from its low on January 5, 2023. Interestingly, the duration of the two movements is virtually identical today (with a difference of only one day), while in percentage terms, the FANG+ index still falls short by 10% compared to the performance of the Nasdaq in 2000 (considering that the starting point is 176% and not 100%).

However, the aforementioned discussion does not imply a uniformly negative scenario for stocks. On the contrary, the recent divergence in performance has created pockets of undervaluation. For example, at just under 14 times earnings, the MSCI World ex-US offers an implied return of about 7 percent (=100/14).

Another, potentially more striking, example to illustrate some of the oddities that can currently be observed in the market is a comparison of FANG+ and European banks. Over the past 3 years, the earnings of European banks (in yellow in the two charts below) have grown faster than those of the FANG+ (in white), both considering actual reported earnings (left chart) and projected earnings for the next 12 months (right chart), but no one seems to be as excited about European banks as the FANG+. Moreover, European Banks are trading at 6.2 times current and projected earnings, or almost one-tenth of the current P/E of the FANG+.

Considering all the evidence presented thus far, we believe that a cautious stance is warranted regarding the FANG+ index, as the medium- and long-term risk/return profile appears quite unfavorable. Furthermore, these stocks are heavily overbought, increasing the risk of a short-term retracement that could occur at any time, particularly in the event of an unfavorable US inflation figure or a more hawkish stance by the Federal Reserve."

Source: Bloomberg

Source: Bloomberg

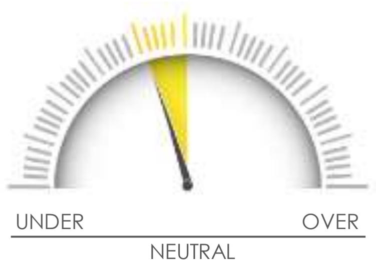
Asset Allocation View

	−	=	+
Equity			
Developed Markets	X		
Emerging Markets	X		
Fixed Income			
Developed Markets Sovereign			X
Developed Markets Corporate		X	
Emerging Markets		X	
Commodities			X
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

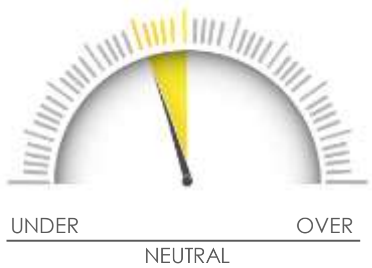
Developed Markets



We maintained our **Slightly Underweight** recommendation on Developed Markets Equities. High valuations and overbought conditions, primarily in the largest U.S. growth stocks, indicate that a cautious stance is justified. The current market movement appears to be driven mainly by momentum, as the recent rally in equity prices is taking place amidst a significant increase in risk-free rates. Additionally, we should start witnessing the impact of the liquidity drain resulting from Quantitative Tightening (QT) and the replenishment of the Treasury's general account (as discussed in the previous report), both of which are not favorable for equities. Considering the weak data in the EU, we are adopting a more cautious approach towards European stocks."

US	=	**Europe**	−	**Japan**	+

Emerging Markets



We kept our recommendation on Emerging Markets Equities unchanged at **Slightly Underweight**. Emerging markets continue to lag behind developed markets as the higher rates and the risk of a looming recession seem to be of importance only to developing countries. A more hawkish stance by the Fed at Wednesday's meeting could put additional pressure on emerging markets, while a dovish surprise could allow for a rebound given the deeply negative sentiment.

Asia ex-Japan	=	**EEMEA**	−	**LATAM**	+

Fixed Income

Developed Markets Sovereign

UNDER OVER
NEUTRAL

We kept our **Slightly Overweight** recommendation on Developed Markets Sovereign Bonds. Risk-free rates are on an upward trajectory due to central banks maintaining a hawkish stance. Some central banks, such as Australia and Canada, have resumed raising interest rates after a pause, as inflation proves to be more resilient than anticipated. In this week's meetings, the ECB is expected to continue with its 25 bps hikes, while the Fed is anticipated to stay firm and potentially raise rates in July, although a hike in June cannot be ruled out. If risk-free rates were to increase further, it would be advisable to consider lengthening portfolio duration.

EU Core	=	EU Periphery	=	US Treasury	=	Japanese JGB	=

Developed Markets Corporate

UNDER OVER
NEUTRAL

We maintained our **Neutral** recommendation on Developed Markets Corporates, as the end (or near end) of the US hiking cycle largely eliminates duration risk. We maintain a slightly more cautious stance on corporate bonds compared to government bonds, primarily due to relatively narrow spreads considering the increasing risks of a slowdown or recession. However, we do identify opportunities in subordinated and hybrid bonds. We still hold the view that high yield corporate bonds present the worst risk/return outlook.

IG Europe	+	IG US	+	HY Europe	−	HY US	−

Emerging Markets

UNDER OVER
NEUTRAL

We maintained our **Neutral** recommendation on Emerging Market bonds. The likely end (or near end) of the Fed's rate hiking cycle and the significant widening of spreads in recent months should offset the mounting recession risk globally.

Local Currency	+	Hard Currency IG	−	Hard Currency HY	−

Commodities

UNDER OVER
NEUTRAL

We maintained our **Slightly Overweight** recommendation on Commodities. The increase of the debt ceiling and the possibility of a further rate hike by the Federal Reserve have reduced the appeal of precious metals in the short term, but we continue to maintain a positive bias in view of the geopolitical risks and the challenging situation faced by the U.S. banking system. We remain more cautious on the other commodities.

Precious	+	Energy	=	Industrial	=	Agricultural	=

Currencies

The Committee has confirmed its **Neutral** view on the US Dollar. In recent weeks, the dollar has bounced back after the sharp depreciation of the previous months. In the short term, the fate of the greenback will depend mostly on what Powell will say after Wednesday's FOMC.

The view on the Euro is also **Neutral**. The recent weakness of the Euro can be explained by the soft macroeconomic data in Europe over the past few weeks. Further weakness might lie ahead if the ECB on Thursday opens the door to ending the current rate hike cycle earlier and at a lower level than expected, precisely because of the latest data.

The view on the **Chinese Renminbi** is **Neutral with a bearish bias** in consideration of the much weaker-than-expected economic data in China, which suggests that some monetary easing may be needed to support the economy.

On most of **other emerging market currencies** the view is **Neutral**, but we remain more constructive on Latin American currencies as they could benefit from some of the highest real rates in the world.

Euro	=	**USD**	=	**CNY**	=	**Other EM**	=