ARVEST

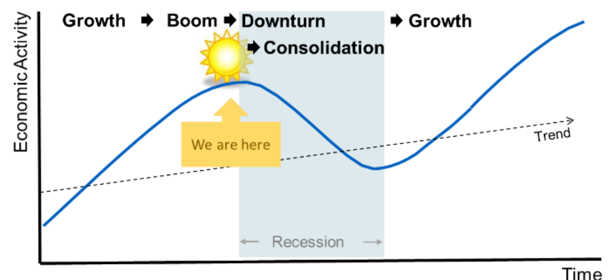
July 2023 | Issue no. 130

Briefing from the ARVEST Investment Committee

The global economy continued to grow moderately in the second quarter of the current year. This stability is mainly due to the surprisingly resilient labour market in the US and the strong services consumption. US households and businesses still have savings or unused credit lines from the pandemic, but these are also steadily declining. The risk of recession in the US remains very high, as the leading indicators for the next three to twelve months show. In contrast, the Chinese economy is gradually recovering from the pandemic, even if the pace has so far fallen short of expectations. Inflation is also declining worldwide, but remains high in the developed word, which is why the Fed and the ECB are maintaining their restrictive monetary policies.

In the first half of the year, the global equity market returned a healthy 11.6% in Swiss franc terms. A closer look at these figures shows that 8 companies alone contributed around 7.6%. The other 1192 companies together merely added around 4% to the total return. Thus, the world equity index does not really reflect a global picture, but rather a concentrated bull market of 8 large US technology companies.

For these companies, analysts' profit expectations for the next 12 months remained steadily positive, with only graphics processor manufacturer NVIDIA posting a sharp rise in forward earnings. The share price increases were thus mainly due to a widening of the price-earnings ratios. In other words, investors in these stocks were simply willing to pay more for earnings growth that lies in the distant future.



Two aspects are crucial for this optimism: First, during the bank failures in the spring, the Fed showed that it is quick to provide liquidity in the event of instability in the financial system, regardless of high inflation. This strengthened the confident bulls against the bears in the stock market. In boom phases, optimists tend to buy the same stocks that set the tone in the preceding growth phase, i.e. US big tech.

Secondly, we are currently experiencing a hype around artificial intelligence (AI) in the financial markets. The buzz has been building since the end of November 2022, after the company Open AI released the free app ChatGPT, which allows you to talk to a computer in natural language about any topic. Of course, AI has been researched in computer science for much longer. Even the author of these lines studied expert systems in the early 1990s as part of his diploma thesis in computer science. However, the underlying technology of ChatGPT is based on a modern type of neural network, the so-called Large Language Models (LLMs). The larger these LLMs are, the better the results. ChatGPT's LLM, for example, had to be machine-trained for months in huge data centres. So it is no coincidence that investors have mainly bought the shares of the large US technology groups and cloud providers.

We believe that this technology has the potential to change or reinvent many business models in virtually every sector of the economy over the next five to ten years, precisely because LLMs are not limited to the domain of speech. For LLMs, the last six months have shown that even smaller models, which can run on a normal computer or soon on a mobile phone, deliver excellent results if they have been carefully trained beforehand by the large LLMs. Running LLMs in-house is especially important for businesses and individuals who want to protect their valuable data.

The opportunities and risks will therefore not be concentrated to only a few companies. Companies that are agile and already at the forefront of digitalisation in their industry are likely to benefit the most. We expect some of these to already be in our investment universe. However, winners and losers are still difficult to predict today. Who would have thought when the first iPhone was released that it would turn the taxi and travel industry upside down?

Future Prospects

As mentioned at the beginning, we assume that the US economy will soon reach its growth peak before slipping into recession. However, this might not become apparent until late 2023 or early 2024. We are far from the only ones who see the danger of a recession, even if the stock markets seem to be ignoring this at the moment. We therefore remain vigilant as long as our most reliable leading indicators do not give a firm thumbs-up. Even a mild recession could lead to painful corrections in a concentrated and highly valued equity market.

We have already reduced the equity quota in the portfolios and are keeping it stable. For us, quality stocks with secure and sustainable dividends, as well as a truly global diversification of our investments, remain indispensable. Moreover, the economic cycle is more favourable in China and Japan than in the US or Europe. In our view, it is still too early for a "full" re-entry into the equity market. However, short- and medium-term bonds with low default risk seem attractive to us for the first time in well over 10 years.

10 July 2023
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG

This report represents opinions expressed by ARVEST Funds AG, is exclusively for informational purposes, is not an offer to invest in investment products and does not make any claims related to completeness. The investments or strategies mentioned in this report are subject to suitability testing and do not replace a competent advisor. Investments may include significant risks. The value of an investment may go up as well as down. Past performance is not indicative for future results. Units of investment funds mentioned in this report may be restricted with respect to certain jurisdictions. Investments in funds are made exclusively on the basis of the official fund documents. These may be downloaded at www.arvest.ch.