Eleon Capital Management Ltd.

- MARKET OUTLOOK -

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NET ASSESMENT

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*E*quity markets continue to defy the sceptics and to an extent fundamentals. All major equity indices year -to-date (YTD) are up, except for Brazil. All major sectors are up YTD except for Real Estate.

*D*espite higher interest rates, restrictive Central Bank actions, sticky inflation, two serious wars with significant repercussions, escalating geopolitical tensions and the reorganization of globalization, rising national debt levels, widening fiscal and current account deficits, polarized electorates, the increased prevalence of natural disasters and rising oil and natural gas prices, markets continue their upward trajectory. Ironically though Gold, an indicator to an extent of investor fears is also up – it is one of the best performing asset classes this year and the VIX index is below its long-term average. It is also worth noting that so far this equity rally is not concentrated to a handful of stocks (i.e. the spectacular performance of the Magnificent Seven last year).

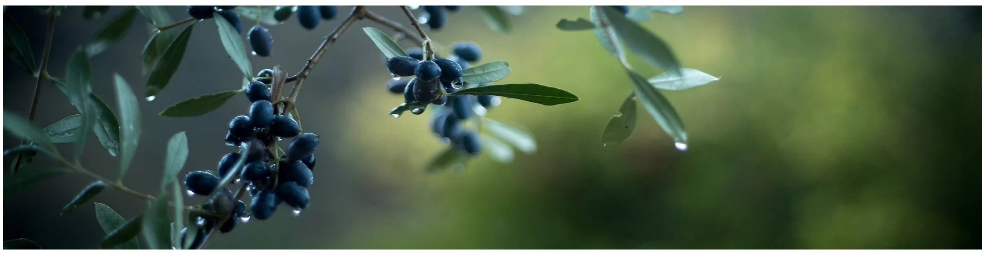
*I*n an FT article on the 18th May 2024 titled "How long can the good times keep rolling markets?" the author quoted an alternative asset manager as saying: "there's money everywhere" following a massive uptick in M&A deal values and global bond issuance this year prompting the author to ask: "So good times it seems. But all of this raises a question. We are seeing a turn downward in the interest rate cycle but without the usual painful economic correction that can accompany such pivots. Are we overdue a reckoning?"

The article went on to note that a prominent fund manager David Einhorn felt that due to the increased prevalence of passive index investing, the price discovery mechanism served by active participants in the equity markets was broken – "investors either don't care about valuation or cannot figure out valuation. The stock market is fundamentally broken." The truth is that the issues noted above should and do affect the valuation variables i.e. cash flows, growth rates, discount rates and ROIC. However, following the companies' Q1 earnings season, by and large earnings and growth rates showed a degree of resilience or just weren't as bad as expected. This is largely due to a phenomenon called "Greedflation" where companies have raised prices more than warranted by the underlying inflationary pressures prevalent and have therefore enhanced their profits and margins. Whether this affects demand significantly is still yet unclear. It appears therefore that markets are being driven by animal spirits, fundamentals and structural biases.

*H*owever, as Howard Marks in his Market Cycle notes, 'it is when risk aversion is low, risk tolerance high, underwriting standards are deteriorating, and liquidity is high and cheap that markets usually implode although the timing of which is not known.'

*I*n conclusion, the current state of the equity markets presents a paradox that challenges traditional economic theories. The resilience of the markets, despite numerous headwinds, suggests a new dynamic at play. Investors seem to be navigating through the noise, focusing on long-term growth prospects rather than short-term uncertainties. However, the concerns raised by prominent figures in the finance world remind us that this bullish sentiment may not fully account for underlying valuation issues. As markets continue to surge, it would be prudent for investors to remain vigilant, diversify their portfolios, and prepare for potential volatility ahead. The juxtaposition of rising asset classes alongside traditional safe havens like gold indicates a complex investor psyche, seeking both growth and security. Ultimately, the sustainability of this market rally may hinge on the unfolding economic data and geopolitical developments, which will either validate the current optimism or prompt a reevaluation of the risks involved. The coming months will be critical in determining whether the markets can maintain their defiance of the sceptics or if a correction is on the horizon.

25 May 2024



Strong Roots,
Sustainable Growth

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