SIGNIA INVEST

Signia Invest Insights

29 February 2024

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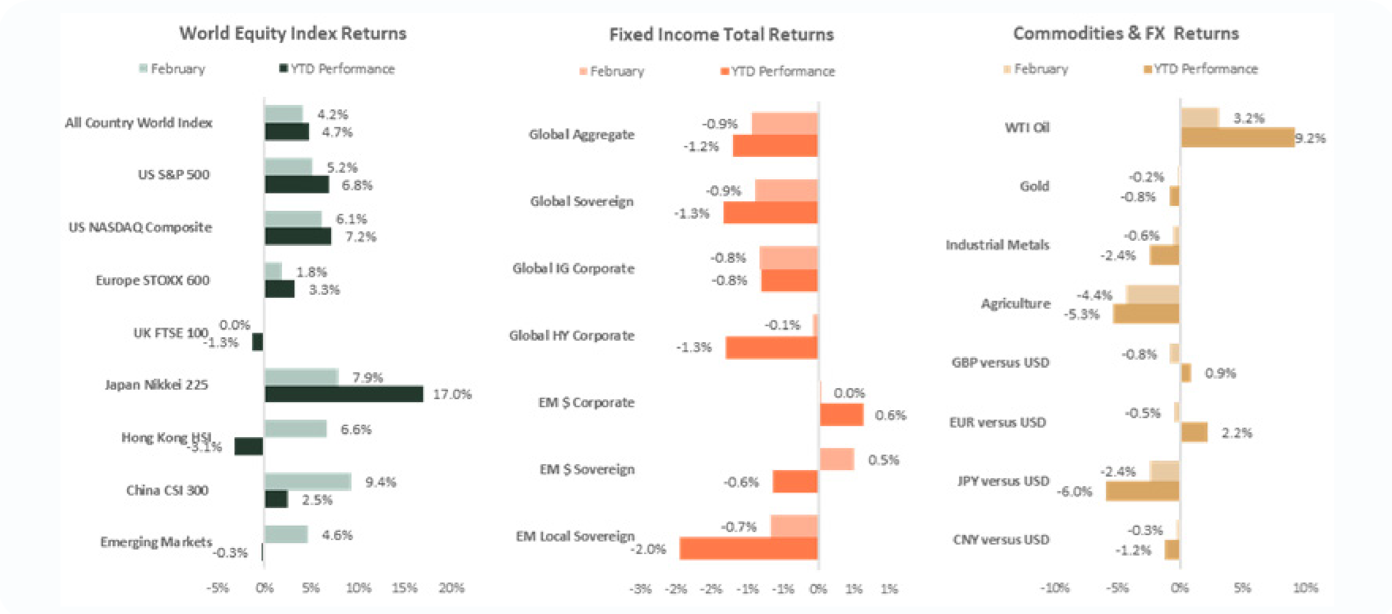
Market Review and Outlook

- February was another strong month for risk assets, with several major equity indices at record highs. That included the S&P 500 which surpassed the 5000 mark for the first time, Nasdaq 100 and Dow Jones indices which also hit new all-time highs, as well as the Nikkei 225 which surpassed its previous record from 1989. In part, that was because of continued excitement around AI, helping the Magnificent 7 (propelled by Nvidia) to post their best performance in 9 months. Nvidia added a record $277bn in market cap in one day following its Q4 results, surpassing the previous $197bn single session gain by Meta earlier in February. However, there was a fly in the ointment during the month, with US inflation still above the Fed's target and surprising on the upside in February, investors substantially pushed out and repriced their expectations of 2024 rate cuts from 6-7 25 basis point cuts starting in March, to 3-4 cuts starting in July, so a swift re-adoption of the 'higher for longer' Fed policy theme. In addition, US regional banks continued to struggle, as investor concerns persisted about the commercial real estate sector struggling under higher interest rates and tighter monetary policy.

- World equity markets rallied 4.2% during the month, led by the US, Japan, and China, yes even China! The CSI 300 index of Chinese onshore stocks jumped 9.4% following six consecutive monthly declines in response to the latest round of stimulative measures announced by policymakers. It remains to be seen whether this will have a lasting impact on the downward deflationary and household sentiment cycles weighing on the domestic economy. Fixed income markets struggled, with the global aggregate bond index declining -0.9%, with only emerging market dollar bonds bucking the trend posting a positive return of 0.5% in February as yields remained at attractive levels and spreads over US Treasuries remaining tight. In commodities, oil markets rallied 3.2% on continued tensions in the Middle East and as Houthi rebels stepped up their attacks on ships in the Red Sea, sinking the Rubymar, a British owned bulk carrier cargo ship. This is contributing to rising shipping costs and in particular 1-year inflation expectations, in turn pushing down real rates (nominal rates minus inflation). Historically, real rates are inversely correlated to gold prices, so if this trend continues alongside elevated geopolitical risks, we expect further upside for gold prices this year to new all-time highs. That said, it's worth noting that in inflation-adjusted real terms, gold is still some way beneath its other peaks in 1980, 2011 and 2020.

MARKET PERFORMANCE AS OF 29 FEBRUARY 2024:



Source: Bloomberg Finance L.P., Arbion Ltd

- The US jobs report for January highlighted the strength of the labour market, showing nonfarm payrolls up by +353k, along with positive revisions to the previous two months. Moreover, the ISM manufacturing print hit a 15-month high. But even as growth remained strong, there were further upside surprises on inflation, which raised fears that the path back to target was unlikely to be a smooth one, and raised questions as to whether the economy would face a “no landing”. In particular, the US core CPI print for January came in at a monthly +0.4%, which pushed the 3-month annualised rate for core CPI up to +4.0%, around twice as high as the Fed would be comfortable with before it considers embarking on a rate cutting cycle. However, looking at core PCE data, which is the Fed’s favoured inflation measure, this appears more aligned with rate cuts. CPI statistics have been boosted recently by strong gains in imputed rents, which should moderate going forward. Nevertheless, our view of the ‘higher for longer’ theme being around for longer, is still our base case for 2024. The FOMC is unlikely to start lowering interest rates until inflation data softens further, and from that standpoint, rate cuts are more likely in the second half of 2024, if they happen at all this year.

- The typical US household needed to pay $213 more a month in January to purchase the same goods and services it did one year ago because of inflation, according to Moody’s. Eating continues to cost more, even as overall inflation has eased. Prices at restaurants and other eateries were up 5.1% in January 2024 when compared to a year ago. Unfortunately, tangible consumer price relief is not likely to arrive soon. Restaurant and food company executives report they are still grappling with rising labour costs, and some ingredients, such as cocoa, are seeing a reacceleration in price inflation.

- Across the Atlantic, UK GDP data showed the UK in recession in the second half of 2023, adding to the determination from the Conservative Party to deliver tax cuts to stimulate activity and buy votes ahead of an election later this year. It is likely that tax cuts are funded by reductions in spending, scheduled to occur in the period after the election, at which point the Conservatives will almost certainly not be in office. Fiscal easing is also likely to lead to increased concerns with respect to the UK’s fiscal position, which an incoming Labour administration is likely to inherit. Thus, the risk of rising term premiums across the UK Gilt yield curve should therefore be a notable concern for bond investors over the coming years. Nevertheless, a tax boost can give a temporary sugar rush to the economy in growth terms, adding to recent activity data at the start of 2024, which appear somewhat firmer that what were recorded at the end of 2023.

- One powerful market force that does not seem to be getting the column inches it deserves is the substantial loosening in financial conditions since October last year, particularly in the fourth quarter as treasury yields declined, corporate bond yield spreads tightened, and the US Dollar depreciated. Loosening financial conditions tend to be negatively correlated to equity markets, and generally loose and stable financial conditions are a key precondition for a prolonged bull market, with the latter seemingly being the environment and market cycle that we are entering.

LOOSENING FINANCIAL CONDITIONS ARE HELPING TO PROPEL EQUITY MARKETS BUT ARE ALSO PROLONGING THE START OF FED RATE CUTS:

Goldman Sachs US Financial Conditions Index consists of a weighted average of the following components: Target Federal Funds Rate, 10-Year Treasury Yield, Corporate Bond Market Spread Index, S&P 500 Scaled by 10 Year Moving Average of Earnings and the Goldman Sachs Broad Trade-Weighted Exchange Rate Index.
Source: Bloomberg L.P., Arbion Ltd.

- With nearly all of S&P 500 companies having reported fourth quarter earnings, results have looked stellar. Earnings growth was nearly 8%, compared with expectations for a 1.2% rise before earnings season started. Nvidia's earnings were obviously the highlight. In fact, I have never witnessed a company's earnings release overshadow the release of the FOMC minutes, but this happened on 21 March! The company beat expectations and gave a solid future guidance that helped alleviate fears that AI growth might slow in the near term. The chipmaker also led the Magnificent Seven companies, whose earnings beats collectively lifted the S&P 500's overall results. However, whilst these seven companies saw their profits rise a staggering 59% in the fourth quarter, excluding them, the remainder of the index posted a disappointing 1.6% profit drop. Over in Europe, earnings are trailing Corporate America by the most in three years, where Europe Stoxx 600 profits are expected to drop 11% in the fourth quarter. That is largely down to the impact of key lackluster regional economies — with both Germany and the UK in recessions — and an underwhelming recovery in China, which is a sizable market for Europe's miners, automakers and luxury goods makers. While Europe boasts some AI beneficiaries such as ASML and BE Semiconductor Industries, their performance still notably trail Nvidia's.

- Not quite February but 5 March saw 'Super Tuesday' largely confirm the prospect of the 2024 race for the White House as Trump versus Biden. At this time, Trump continues to look the favorite to secure the Presidency, with the former President recording a solid lead in the six key swing states, which will decide the election. Clearly, plenty can still happen between now and November, but the legal challenge facing Trump may be fading. With a ruling not likely until June on Trump's appeal that he should enjoy immunity, it now appears that Trump is very unlikely to face a trial before September. Given how close this puts the date to this year's election, I suspect this means that the case may well be pushed back beyond polling day. In that instance, it may now seem that Trump will only be forced to take the stand should Biden emerge victorious. However, with Biden's current approval rating incredibly the lowest of any sitting President at this stage of his tenure, it looks like the Democrats face an uphill battle for the White House. Furthermore, were Biden to drop out of the race and be replaced by Kamala Harris or Gavin Newsom, indications are that Trump may be even more assured of claiming victory. Could the increasing likelihood of a second term in the Oval office for Donald Trump partly explain why the S&P 500 has returned a blistering +7.1% in only the first two months of the year, far outpacing the re-election year average?

Yes Trump is not short of surprises and controversial policies, but generally equity markets like a re-election year as it lessens the spectre of the unknown, and if Trump's first term is anything to go by then we know a period of financial market-friendly policies and tax cuts could well be on the cards again.

US EQUITY RETURNS HAVE TENDED TO BE STRONGER IN RE-ELECTION YEARS SINCE 1944:

Source: Bloomberg Finance L.P., Arbion Ltd

- We are indeed living in strange, fascinating and concerning times. In a world where geopolitical uncertainties and climate risks seemingly continue to rise with every passing year, I find myself with a growing sense of unease as I watch the financial markets rise in price and grow with resilience. Much of this is down to the exponential rise in support and resolve from global policymakers, both on the monetary, fiscal, and macroprudential fronts, to counter left-tail risks… but what about the right-tail risks? As we know, too much of a good thing for too long can also leave financial markets in tatters (dot com bubble, subprime housing bubble, etc). Could Nvidia mania be a catalyst for another right-tail bubble? We will only know in the fullness of time but I will leave you with this – the 1998 dot com analogue – where the Fed Funds Rate was cut from 5.5% (where we are today) to 4.75%, then subsequently raised six times between June 1999 and May 2000 to 6.5% during the tech bubble frenzy. If history were to repeat itself then rationale investors will be forced to address the dilemma: participate in the Nasdaq frenzy or work harder to find diversified sources of attractive risk-adjusted returns. Luckily, we are not yet at this juncture (if indeed we get there), but fortunately at Arbion we do the latter so it would be an easy choice!

ROBERT LEE

CO-HEAD OF MULTI-ASSET INVESTMENTS, HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, and Arbion's retail funds business. Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.

Robert is a Chartered Financial Analyst and a member of the Chartered Institute for Securities & Investment.

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