Signia Invest Insights

31 January 2024

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Market Review and Outlook

- January was a positive month overall for risk assets but on an intra-asset class basis it was a more mixed outcome for global financial markets, which displayed divergent performances. Developed market equities were positive (S&P 500 +1.6%) whilst emerging market equities were negative (EM Equities -4.7%). Emerging market dollar debt was up (+0.6%) whilst most other fixed income sectors ended down (global aggregate -0.3%).

- WTI Oil prices rallied strongly (+5.9%) whilst industrial metal prices declined (-1.9%). On the one hand, US economic data kept surprising on the upside for the most part, which meant equities continued their positive momentum from the fourth quarter of 2023, and the S&P 500 reached a new all-time high. However, on the other hand geopolitical concerns have persisted, particularly given attacks from Houthi rebels on commercial shipping in the Red Sea, which have caused shipping costs and freight rates to more than double recently.

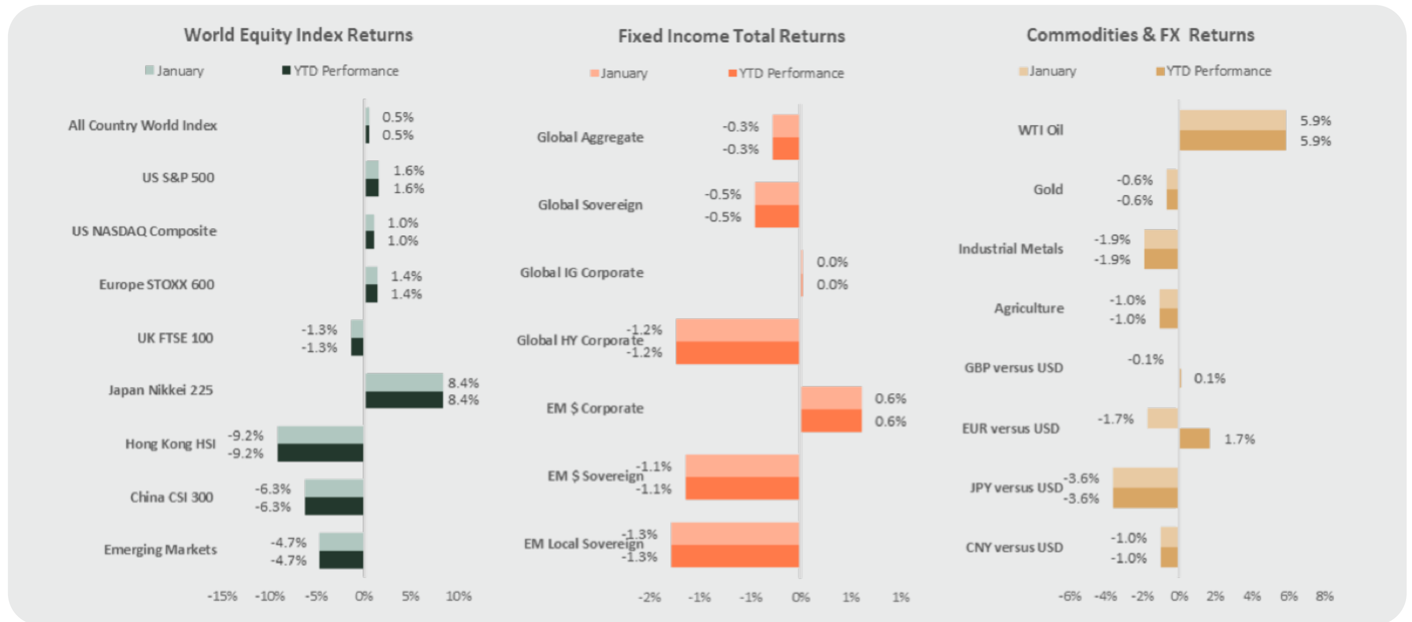
- Strong macro data and rising near term inflation expectations caused sovereign bonds to lose ground as investors dialled back the prospect of both rate cuts in the first quarter of this year and less cuts overall in 2024, following Chair Powell's suggestion in the Fed's January press conference that a cut by March was unlikely.

- Chinese stocks have been on a wild ride, albeit mostly on the downside, and weighing on emerging market indices. The offshore Hong Kong Hang Seng Index declined -9.2% whilst the Shanghai Shenzhen CSI 300 Index was down -6.3% in January, despite several attempts of relatively lacklustre intervention from policymakers to support the stock market. Whilst short-term technical market conditions look oversold in China, only comparing to 2008 where 75% of stocks traded at 52-week lows, it does not feel like the washout yet one would like to see in order to get more interested. There is still money chasing bear market rallies, only to get flushed out again in subsequent declines.

- Fundamentally, the market is not expensive, but earnings revisions are also still largely negative and the economy appears to be decelerating, ignoring whatever support package is being thrown at it. Considering the reputational risk for an investment manager and the diminishing benchmark pressure, it appears unlikely at this stage that international institutional money will feel an urgent pressure to return to Chinese equities.

- There has been some near-term stabilisation recently but the outlook for China's equity market, as with the domestic economy, remains bleak, with investors seemingly waiting for a more powerful and sustainable response from policymakers. They may kept waiting for some time if the value and stability of the Renminbi continues to remain the PBOC's priority, where large and substantial monetary policy easing has been absent.

MARKET PERFORMANCE AS OF 31 JANUARY 2024:

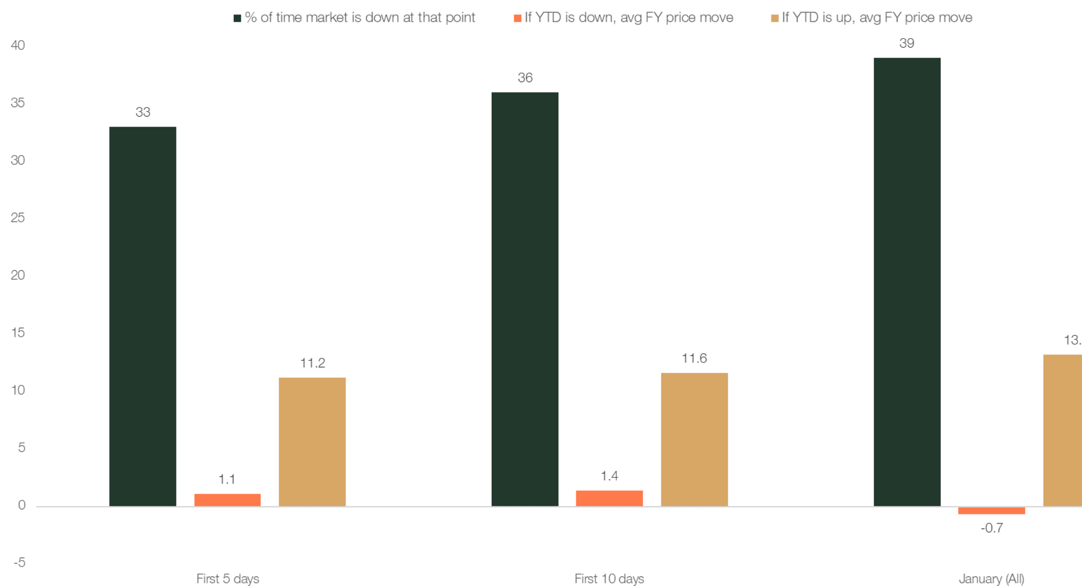


Source: Bloomberg Finance L.P., Arbion Ltd

- With January posting a third consecutive positive month for developed market equities, and the S&P 500 in particular after topping 5,000 last week for the first time, it is natural for investors to question the momentum of this bull market rally. Can it last and can 2024 be another healthy year for equity investors? Historically, the month of January tends to be positive for US equities more often than not, circa 60% of the time, and it is a similar case when looking at the first 5 and 10 days of the year.

- This January Effect, where seasonality and positive sentiment at the start of the year typically helps markets get off to a good start, has also tended to set the tone for performance over the course of the full year, statistically speaking. On average, the S&P 500 has returned over 13% in years where this has been the case, so a fairly substantial return and statistic that should not be ignored (nor on the other hand completely relied upon). A negative January, however, has on average resulted in a modest index decline over the full calendar year, so quite a stark difference.

JANUARY HAS HISTORICALLY SET THE TONE FOR S&P 500 PERFORMANCE IN A GIVEN CALENDAR YEAR:



.Source: Deutsche Bank

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- With the US now at 70% of broader world equity indices, international benchmarks look more and more correlated to the US and increasingly driven by the only story in town, technology. This tunnel view carries the risk of igniting a melt-up in a narrow set of stocks as many investments outside this group extend their relative underperformance to the frustration of their shareholders. To be clear, we are probably not there yet and although valuations are looking stretched in the near-term for many of the mega caps, they are not yet in the 'white-hot' danger zone.

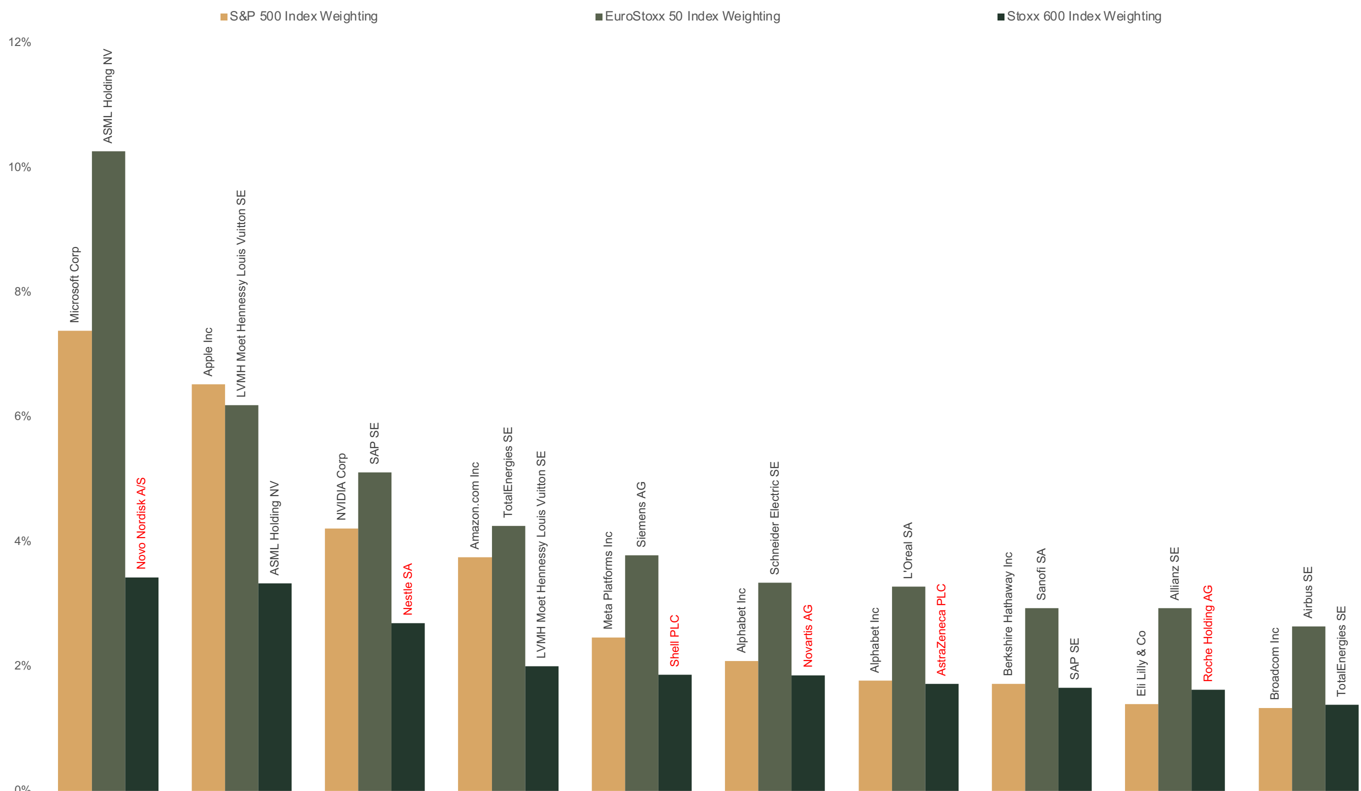
- Adding fuel to the mega cap tech fire was January's strong economic data, which culminated with the US payrolls report, driven by headline (+353k vs +185k expected) and private (+317k vs+170k expected) new jobs figures significantly beating expectations, alongside 126k of cumulative upward revisions to the prior two months. Adding to the robust jobs market data was average hourly earnings, which surprised to the upside both versus expectations and on an absolute month-on-month basis (+0.6% vs. +0.4% expected). Even the one inconsistent part of the report, a two-tenths drop in hours worked (34.1 vs. 34.3 expected), could be explained by bad weather having an adverse influence. Moreover, we are getting more data that indicate the potential for a re-acceleration of growth in the US: the Johnson Redbook same store retail sales are moving higher (+5.3% year-on-year), month-on-month growth in real consumer spending is increasing, capital spending intentions are inflecting higher, mortgage rates continue to decline leading to month-on-month pending home sales in December jumping to the highest value in nearly four years.

- Whilst this poses a conflict in the short term, we believe markets will continue to look at the bright side of things and interpret the stronger outlook as positive for risk assets, pushing aside for now the diminishing probabilities for a substantial number of rate cuts this year. As far as market breadth is concerned this could lead to a broader participation of sectors pushing higher and lowering the reliance on certain tech stocks to pull indices to new records. With the exception of technology and industrials, all other sectors are still substantially below their all-time highs which they hit, in some cases, many years ago. That same case can also be made for international stock markets, in emerging regions and Europe in particular, with several of them 30% or more away from their peak levels. A further supporting factor for these, as we have seen with Japan which is now almost back to its all-time high, are valuations which are not stretched in any way, compared to the US or versus their own history.

- Unfortunately, the wider economic picture in Europe looks far less rosy than in the US. To highlight just a few data points: the number of job seekers in France jumped substantially in December, new orders surveys in the UK for January reached a multi-year low while the number of corporate bankruptcies in the country reached an all-time high. Ifo sentiment surveys in Germany continue to trend lower and business confidence in France is struggling to stabilise at low levels as producer price inflation has reached deflationary levels again (-0.9% year-on-year in December). All of these are hardly indicating a return to a robust economic trajectory at this stage, and indeed look more akin to China than the US.

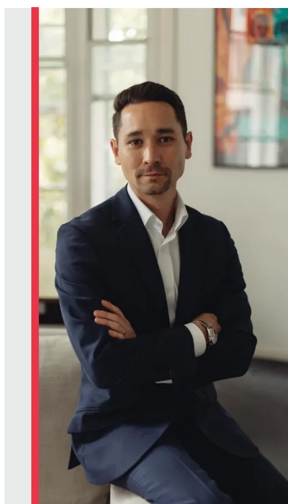
- Stock concentration risk is not just a growing US issue, it's also distorting the composition of the EuroStoxx 50, one of the most popular markets for European investors. Interestingly, here the AI and semiconductor chip rally has again been the main offender, causing ASML to reach its maximum 10% market cap limit in the index, something that no Magnificent 7 company has been able to achieve in the S&P 500 yet. That said, the EuroStoxx 50 index does suffer from a compositional methodology flaw, where some of Europe's largest companies by market cap such as Novo Nordisk, Nestle and Novartis, are omitted from the index based on their country. The EuroStoxx 50 only covers eight Eurozone countries: Belgium, Finland, France, Germany, Ireland, Italy, the Netherlands and Spain. Thus, European investors should tread carefully here and instead focus on the broader Stoxx Europe 600 market where concentration risks are more benign, and greater country diversification reduces volatility and widens the opportunity set.

TOP 10 STOCKS BY MARKET CAPITALISATION IN THE US AND EUROPE:



Source: Bloomberg Finance L.P., Arbion Ltd

- Finally, we continue to believe that the single-most important factor that is likely to drive this year's market performance is the US election in November in conjunction with a fiscal and monetary environment that should be supportive for the US economy. Therefore, we favour high investment levels and reasonable exposure to sectors that have been leading markets over the last quarters in combination with tactical downside protection. Unsurprisingly, within this current market context the VIX is now trading at notably low levels again, allowing for the purchase of cheap insurance in portfolios against the risk of the unexpected happening, which as we know from recent years is becoming an increasingly frequent phenomenon these days.



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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