# Monthly market update
## April 2024

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## 5 drivers of markets in March 2024

1. The sticky US inflation problem
2. Markets line up with what central banks are telling them
3. Japan raises interest rates in historic change
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**Outlook**

# Can Goldilocks avoid the bears?

March 2024 saw equity markets in many parts of the world reach new record highs. We saw major stock markets in the US, Europe, Japan and across the developed world scale new heights. Behind this stands a greater certainty that interest rate cuts are coming and probably only a matter of a few short months away[1].

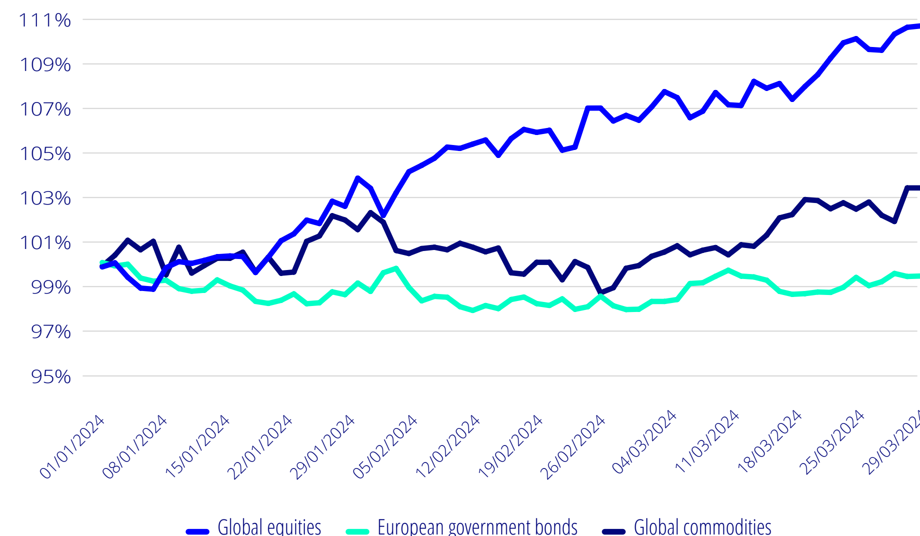
Also behind this is a growing belief that a "Goldilocks" economy looks more possible to achieve – a mildly slowing economy with only limited job losses – which is seen as supportive of risk assets' (equities for example) performances.

As a consequence, a renewed appetite for risk taking is increasingly in evidence in markets as fund managers and retail investors around the world take on more risk in their portfolios. Add in the continuing boom in all things artificial intelligence (AI) and we have a recipe that can support further gains in risk assets during the rest of 2024.

| | March 2024 | YTD 2024 | 2023 |
|---|---|---|---|
| Global equities | +3.3% | 10.7% | +18.1% |
| European government bonds | +1.0% | -0.6% | +7.2% |
| Commodities | +2.9% | +3.4% | -15.3% |

Source: Bloomberg, 02.04.24.

**Figure 1: Asset class performances to end March 2024**




Source: Bloomberg, 02.04.24.

Yet, the more these new records are broken, and the valuations of risk assets become ever more rarefied, the more alert to potential downside risks investors should become. There are some signs of a bubble starting to form, at least in parts of the market, and while these can last for considerable periods of time, history tells us to be that this Goldilocks' environment can also usher in some "bears".

*Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla
[1] Source: Bloomberg, 02.04.24.

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# 5 drivers of markets in March

## 1 The sticky US inflation problem

Inflation has been the most closely watched piece of economic data for the past two years. In March, the market focussed in on US inflation, with a concern too high a number would cause the US Federal Reserve (Fed) to hold interest rates at current elevated levels for longer.

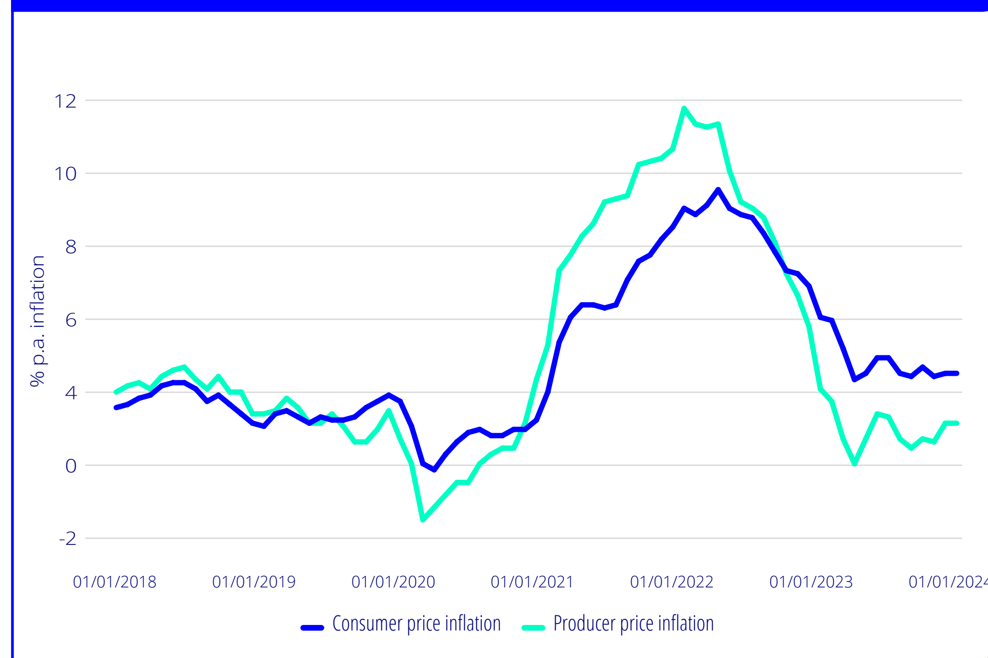
Headline inflation for February was reported at 3.2% (+0.1% on previous month) and core inflation, which excludes food and energy, came in at 3.8%[2]. Both numbers were higher than expected, which normally would have been bad news for markets. However, markets appeared to shrug this off and expectations for interest rate changes barely moved. There are a number of possible explanations for this:

1. There is evidence that consumer inflation is now largely contained to the services sector, with goods and energy no longer contributing.

2. Markets have noted that a good chunk of inflation comes from housing costs, which is both difficult to measure and arrives with a time lag. There are signs that these costs will continue to fall as rental inflation and owner's equivalent rent are both falling.

3. There were a number of other measures from which the market took some comfort re future inflation:
    - "Super-core inflation", which excludes the cost of shelter, energy, and food, spiked in January, and while it remained above 4%, it stabilised in February.
    - Similarly, the Atlanta Fed's measure of "sticky" inflation (which tracks prices that are difficult to move), was high at over 4% in February, but down from the 6% it reached in January. The same is true for the Cleveland Fed's "trimmed-mean inflation" measure which strips out the most extreme measures.
    - On 21.03.24, US producer prices, which are a measure of wholesale inflation, showed an increase of 0.6% for January, which was about twice as high as had been anticipated. The year-on-year (y/y) figure was expected to be 1.1%, but came in at 1.6%.

**Figure 2: US Consumer & Producer Price Inflation**




Source: Bloomberg/US Bureau of Labor Statistics 14.03.24

Interestingly, the US Fed appears to be quite optimistic about the recent sticky inflation data. In the comments that followed their March meeting, they signalled to markets that they were sticking to their plan in terms of interest rate cuts (meaning a mid-year start and three quarter per cent cuts to follow in 2024).

**Bottom line: Put together, this data paints a picture of US inflation that is still trending down, but at a frustratingly slower pace than might be hoped for. The Fed appears to be indicating that it can tolerate a very slightly higher level of inflation than its target to preserve the soft-landing in the wider US economy.**

[2] Source: Bloomberg, 02.04.24.

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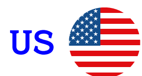
# 5 drivers of markets in March

## 2 Markets line up with what central banks are telling them

When it comes to both the Fed and the European Central Bank (ECB), the gap between what markets had thought would happen this year and what the central banks are actually doing was very wide when we began 2024. That gap has disappeared and market expectations are now much more aligned to what both key central banks are saying. If anything, market opinion is increasingly shifting to the other side of this debate, with an increased focussed on what "sticky" inflation may mean for the timing of interest rate cuts.

### US



- In their January meeting, the Fed's governors indicated that they wanted "greater confidence" that inflation was on a sustainable path to the 2% target. In the intervening weeks, they've been treated to higher than expected consumer price inflation and stronger than expected growth in the economy.
- Against that backdrop, Fed Governor Powell's US Senate March testimony was a predictable affair. Unsurprisingly, he indicated that incoming data would determine when they will start reducing interest rates and they would like to have greater confidence that inflation was heading towards 2% before taking action. He did suggest "It will likely be appropriate to begin dialling back policy restraint at some point this year". Commenting on the economic outlook, in this he noted that there was no reason to think the economy was "in or facing a significant near-term risk of recession." In an oblique reference to the Goldilocks economy being enjoyed by the US, he suggested that there are "risks to both cutting rates too early and too fast as well as too late or too little."
- Later in March, and much as the market had anticipated, the Fed left interest rates on hold. They also reiterated that three interest rate cuts was the likely path for 2024, but also hinted that 2025 might see a shallower path of cuts than previously thought.

### Euro area

- The position in Europe is slightly clearer at this point, with a more disinflationary environment in evidence for the euro area.
- ECB President Lagarde in a speech on 20.03.24 gave a strong indication that the first rate cut would happen in June this year. She also indicated that after the first rate cut there was no commitment about further reductions in borrowing costs, adding that the ECB believes they need to move further along the disinflationary path, as services inflation may remain elevated for most of the year. She outlined that they will be focussed on wage growth, profit margins and productivity growth when they are considering how many rate cuts will follow.
- The expectation she indicated that the ECB will, in all likelihood, reduce interest rates in June, is very much aligned to where markets view this.

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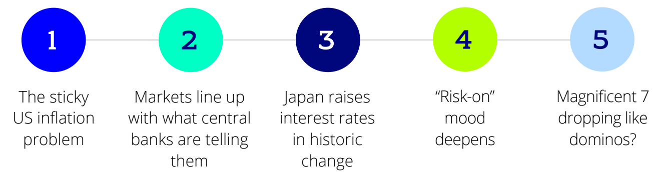
# 5 drivers of markets in March




## 2 Markets line up with what central banks are telling them (Cont'd)

### UK

- UK inflation fell more sharply than expected in February - rising by 3.4% compared to 4% in January and slightly lower than expected. Core inflation, excluding energy and food, came in at 6.1%. also slightly better than expected[3].
- Governor Bailey and his colleagues at the Bank of England may have weighed whether this was the right time to begin cutting rates, but they refrained and UK interest rates were held at the 16 year high of 5.25%.

**Bottom line: Interest rate cuts are coming and it is most likely that they will arrive in the euro area by June, with a greater than 1 in 2 chance the same will happen in the US. The market expects that this will be followed by another two cuts on both sides of the Atlantic before the year end. There is probably slightly more risk to this prediction in the US than in Europe, given the stickiness of inflation and stronger growth in the US.**

[3] Source: Bloomberg 20.03.24.

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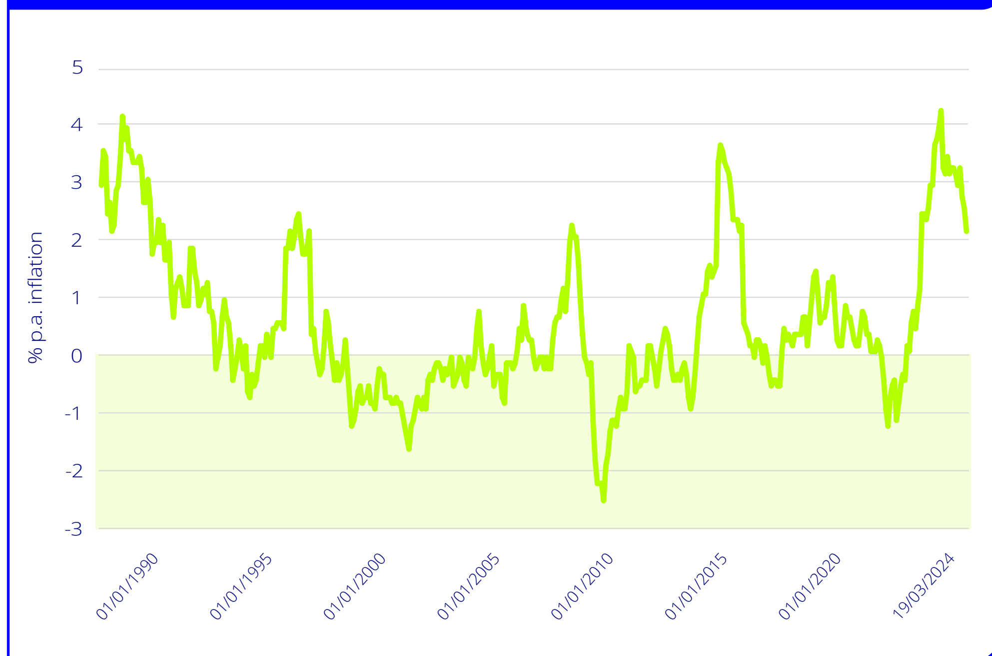
## 3 Japan raises interest rates in historic change

While the rest of the world wrestled with inflation, Japan, which has lamented its absence for large parts of the past three decades, was also dealing with its own resurgence, albeit from a very different starting point.

After a record bubble in both equities and property in the late 1980's, Japan has suffered sub-par growth and deflationary conditions for much of the past three decades. Despite enormous government spending and monetary policy measures by the Japanese authorities, little could propel Japan into the benign modest inflation that had been seen for decades in most western developed economies.




Source: Bloomberg 20.03.24

This was to change with the Covid-19 pandemic. It brought with it higher import costs and supply chain disruptions and suddenly inflation, albeit at lower levels than elsewhere in the world, was in evidence in virtually every sector of Japan's economy. By January 2023, inflation was over 4% its highest level since 1981. It has been dropping since then and remains above their 2% target (see Figure 3)[4].

Current Bank of Japan Governor Kazuo Ueda, speaking at the G20 finance meeting in late February this year, said it was too early to conclude that inflation was close to sustainably meeting the 2% target. However by mid-March, the Bank of Japan brought an end to Japan's negative interest rate era by raising rates. In so doing, Governor Ueda also gave a clear indication that they intended to remain accommodative, interest rates would be kept low, reflecting their caution as to whether inflation will stabilise near their 2% targets.

In cutting rates, the Bank of Japan set a new policy target range of 0% to 0.1% and scrapped the world's longest running negative interest rate policy and its complex bond yield control programme (a monetary policy tool used by central banks to manage interest rates). They did however indicate they intended to remain supportive, so expectations that there might be a series of rate increases in the short-term may prove misplaced. As a consequence, in the direct aftermath, the yen weakened against other major currencies. This may in part be down to a view that the Bank of Japan wants to limit the deflationary impact of a stronger yen to protect its economy and vital export business.

**Bottom line: The March interest rate cut is a seismic change in policy of the Bank of Japan and while its likely to be a long and not a short process, the weakness in the yen may continue to attract investor capital.**

[4] Source: Bloomberg 20.03.24.

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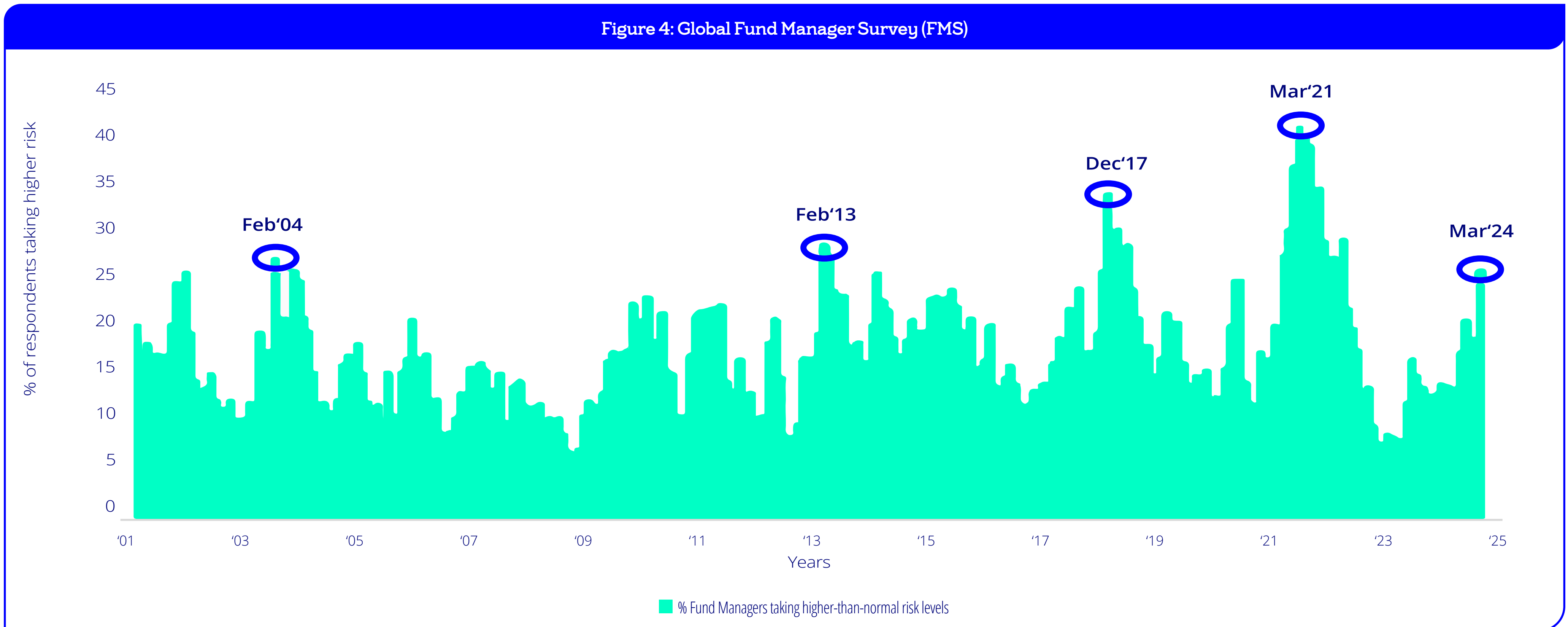
## 4 "Risk-on" mood deepens

2024 has seen the mood amongst the world's fund managers begin to shift to a more optimistic backdrop.

A recent Bank of America Global Fund Manager survey showed that large scale investors are beginning to take more risk in their portfolios with risk appetite at its highest level since November 2021 (see Figure 4).

Figure 4: Global Fund Manager Survey (FMS)




Source: Bank of America Global Fund Manager Survey, March 2024

Reflecting this more "risk-on" mood, March saw a number of record highs in major equity markets including from the US, the S&P 500 and NASDAQ 100 markets, from Europe, the Stoxx600, from Japan, the Nikkei 225 and from the UK, the FTSE100 (see Figure 5 overleaf).

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## 4 "Risk-on" mood deepens (Cont'd)

Figure 5: Major equity indices levels: 1986 to 2024

Source: Bloomberg 02.04.24

This shift in mood has also been reflected in assets that go hand in hand with higher levels of risk-taking.

- **Bitcoin** has seen another surge in values over the past few months. Early this year, with the authorisation in the US of a number of exchange traded funds[5], which track the performance of Bitcoin, prices rose to a new record high of over $74,000 by mid-March. True to the notoriously volatile path that cryptocurrencies take, Bitcoin fell heavily later in March, reaching a low below $64,000[6].

There is one other asset that has reached new record highs that perhaps, is sending a contradictory signal to which investors should be alert.

- **Gold**, sometimes used by fund managers as a protection in more lean times, has also seen record highs of over $2,200 per ounce during March, over 20% up on the lows of last October[7].

  In part, this has been caused by central bank buying, in particular by China. China has been seeking to diversify their balance sheet away from the US dollar. But it is also likely that some investors are choosing to buy gold as an insurance policy should events or indeed, investor sentiment, begin to take a different direction.

**Bottom line: One of the factors that can drive market returns is the flow of money and there is evidence that both institutional and retail investors are directing increased proportions of capital towards risk assets. If this continues, it will provide an additional support to this risk-on market.**

[5] Exchange Traded Funds (ETFs) are a type of investment fund that is traded on stock exchanges just like a share.
[6] Source: Bloomberg 02.04.24.
[7] Source: Bloomberg 02.04.24.

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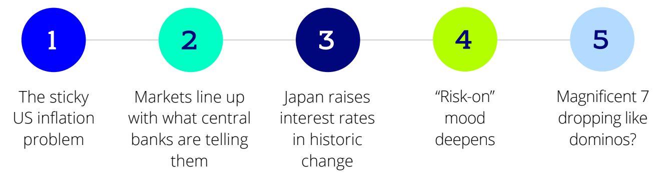



## 5 Magnificent 7 dropping like dominos?

Last year's "top story" was the performance of the so-called Magnificent 7 – the large cap US tech firms that stand to make the most from the revolution that AI is likely to unleash. The 7 comprise Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla.

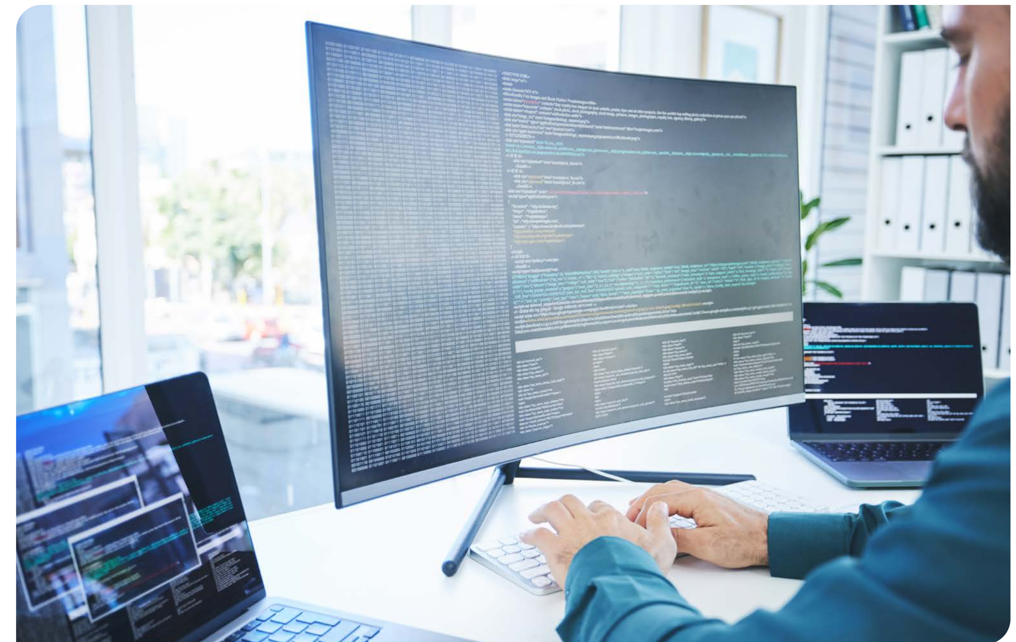
Combined, they grew in value last year by more than 100% in euro terms. This year, they have already added over 20% value in about 91 days, considerably more than the wider global equity market, which stands at +10.7% for the first quarter[8]. The question is can this continue?

### The case for:

- Those who advocate for these returns continuing argue that these companies are already well-established, highly profitable mega-cap companies; so this isn't about start-up innovation with loss-making companies, the way we saw in the 1999's tech bubble.
- In addition, they argue that the potential of AI is accelerating, and the Magnificent 7 are both enablers and long-term beneficiaries of it.

### The more cautious case:

- Those who argue that this is a bubble, point to the widening of valuations that apply to these companies when compared to the wider US market and the wider world. There are also some eye-popping statistics that inevitably raise some scepticism about whether this is sustainable.
- For example, these 7 stocks now make up over 31% of the value of the wider US market. Between just 4 of them, the Fab 4, they have contributed over 56% of the returns made by the S&P 500, the largest US market, so far this year – NVIDIA, Meta, Microsoft and Amazon, with NVIDIA alone accounting for almost a third (30%)[9].
- NVIDIA, which has made over 82% in euro terms in 2024 alone, is now the fourth largest company globally and is worth more than the entire US energy sector[10].
- Such levels of concentration are almost unprecedented and scepticism as to their durability should be the starting point for any investor at this point, with parallels to the late '90's popping up everywhere.



[8] Year to date performance of the Bloomberg Magnificent 7 index and the MSCI ACWI index total returns in euros to end March 2024.
[9] Source: Bloomberg 19.03.24.
[10] Source: Bloomberg 02.04.24.

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# 5 drivers of markets in March



## 5 Magnificent 7 dropping like dominos? (Cont'd)

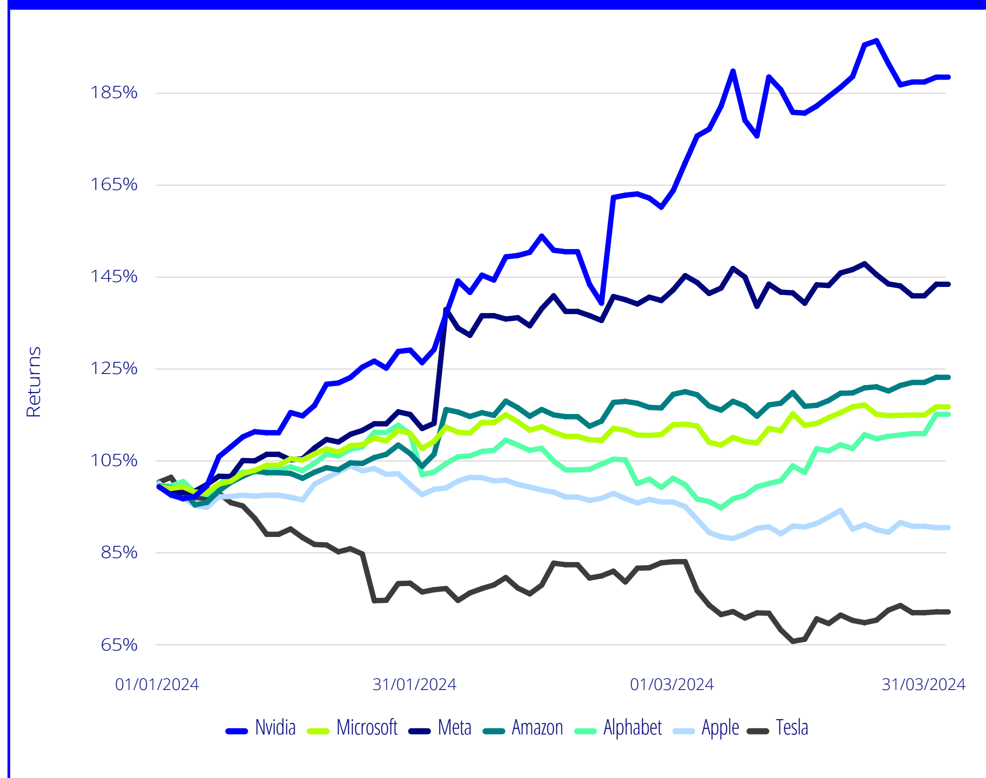
Sceptics will also point to three of the 7 who haven't done quite so well this year.

- **Apple's** most recent earnings report saw revenue rise for the first time in a number of quarters and it beat earnings expectations, but it also reported sales dropping in China. While it made 44% gains for investors in euro terms last year, it is down over 8% so far in 2024[11].
- Similarly, **Google (Alphabet** is its parent), which made 53% last year, also beat analyst expectations in terms of Q4 2023 earnings and revenue, but advertising revenue was below what was expected. Its share price growth is broadly in line with the market so far this year[12].
- Third on this list is **Tesla**, which has been the weakest of the seven. It saw revenue barely grow in Q4 2023, and was behind market expectations in earnings and guided that 2024 would be weaker. For Q1 2024, its investors have seen losses of 27.5%[13].

As shown in Figure 6, there has been a very considerable dispersion in outcomes in Q1 2024 amongst these 7 companies as far as their equity investors are concerned.

As to whether the Fab 4 continue to lead out the market? It seems possible for now at least, but investors should be wary when performance is as strong as it has been. We had a reminder of how fragile share prices can get once they reach such rarified territory with NVIDIA experiencing a drop of 7.5% in value in just 3 days during March[14].

**Figure 6: Dispersion of returns amongst the Magnificent 7 in 2024**




Source: Bloomberg 02.04.24

**Bottom line: The lesson from this is that these shares are "priced for perfection". They have to deliver what the market expects, and more, and any doubts about their future performance will be heavily penalised. Can the Fab 4 continue to deliver on the exceptional growth trajectory they've been on? It is very demanding but quite possible given the transformative nature of what AI will bring to so many industries. Tread slowly...**

[11] Source: Bloomberg: performance to 28.03.24, total returns in euros
[12] Source: Bloomberg: performance to 28.03.24, total returns in euros
[13] Source: Bloomberg: performance to 12.03.24, total returns in euros
[14] Source: Bloomberg: 07-11.03.24

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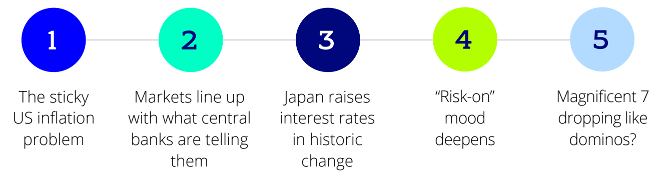
# Outlook




- Much of what unfolds for the rest of 2024 will be down to how the wider economy performs, especially the US, given how dominant its equity market has become. Better economic performance of the kind seen in recent months and, in turn, earnings growth, will support the wider market and hopefully see a broadening out of market returns beyond the small number of companies that have been so prominent to date.
- Equally, cuts in interest rates, anticipated from the middle of this year, will also serve to support the market making further gains.
- Obviously, if any slowdown is faster than expected or rate cuts get postponed, the path the market takes will be a very different one.
- What markets are expecting to see happening over the rest of 2024 and into next year is a so-called "soft-landing". In other words:
  - We avoid a recession (or if it happens its very mild and short-lived) and a slowdown in the wider economy results in only modest increases in unemployment. Indeed, to judge by the position taken by the Fed in March, it would appear they are trying to engineer just such an outcome in the US.
  - As a consequence, consumer confidence holds up and in turn, earnings will ultimately improve.
  - Add in the boom in AI and the assumed productivity gains it is due to deliver and risk assets can be expected to continue to make gains in the year ahead.
  - In this scenario, bond markets, especially short-dated bonds, will perform well as interest rate cuts are announced.
- However, two alternative outcomes should be considered by all investors.
  - Scenario I - **the "no-landing"** - the US economy, in particular, continues to generate robust growth and, as a consequence, inflation remains elevated and higher than expected. This could cause central banks to revise their plans on rate cuts. This outcome, while unlikely in our view, would be damaging to investors as it would be a considerable shock to see rate cuts put on hold.
  - Scenario II - **the "hard-landing"** - the global economy reaches a recession with a drop in consumer confidence, at a time when the last of the pandemic safety net savings have been depleted. In these circumstances, corporate earnings are hit and the current high valuation levels of risk assets won't be justified.
- Of the three scenarios, our view is that the **soft-landing remains the most likely** and is more in evidence at present. If this does play out as we anticipate, chances are that the current bull market in equities may continue for some time yet. However, the more we reach new highs in markets, and the more the "risk-on" mindset deepens and becomes driven by "FOMO" ("fear of missing out"), the more investors should be alert to the possibility of other less positive outcomes.

**As always, we encourage you to talk to an Advisor before making any change to your investment portfolio.**

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# Performance table

## Table 1: 5 year historic performances

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Global equities | 29.0% | 6.7% | 27.5% | -13.0% | 18.1% |
| US equities | 33.9% | 8.7% | 38.2% | -13.0% | 22.2% |
| European equities | 28.0% | -1.4% | 25.8% | -9.9% | 16.6% |
| Emerging market equities | 21.8% | 9.1% | 4.9% | -14.9% | 6.6% |
| Global bonds | 5.4% | 4.9% | -2.6% | -15.1% | 4.5% |
| US government bonds | 11.4% | 8.3% | -2.0% | -12.5% | 5.8% |
| European government bonds | 6.9% | 4.3% | -3.7% | -18.4% | 7.2% |
| Emerging market debt | 14.5% | -3.4% | 6.4% | -9.8% | 5.4% |
| Broad commodities | 7.9% | -13.1% | 37.0% | 20.7% | -10.9% |
| US corporate bonds | 11.2% | 7.8% | -1.9% | -17.1% | 5.8% |
| European corporate bonds | 6.3% | 2.4% | -1.2% | -14.0% | 8.4% |
| Japanese equities | 21.6% | 4.1% | 10.0% | -10.5% | 15.5% |
| NVIDIA | 80.5% | 104.2% | 142.1% | -47.1% | 228.2% |
| Bitcoin (against USD) | 89.4% | 328.5% | 58.1% | -66.2% | 155.2% |
| Gold | 18.1% | 25.1% | -5.1% | 0.2% | 14.1% |
| Microsoft | 60.7% | 30.9% | 63.7% | -23.5% | 53.10% |
| Alphabet | 30.7% | 20.2% | 77.5% | 16.9% | 53.20% |
| Meta | 59.7% | 22.2% | 32.2% | -48.9% | 184.70% |
| Tesla | 28.2% | 674.4% | 60.8% | -62.8% | 95.3% |
| Amazon | 25.5% | 61.9% | 9.9% | -39.7% | 75.10% |
| Apple | 92.7% | 67.5% | 44.6% | 16.2% | 44.20% |

Source: Investment Markets/Bloomberg, 03.04.2024.

For more information: Fund Centre boi.com/marketwatchupdates

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