Monthly market update
March 2024

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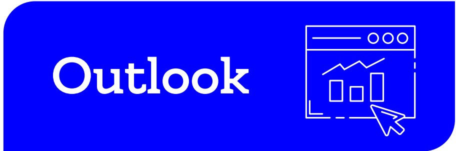
5 drivers in February

1. NVIDIA's earnings
2. A solid earnings season
3. US economy
4. Inflation's sticky last %
5. Changed interest rate expectations



Bubbling nicely?

February saw a continuation of the bull market in equities, with the themes seen in January continuing to dominate. Artificial intelligence (AI) was once again the main theme, with one stock in particular, NVIDIA, continuing its relentless upward movement.

In contrast, the bond market continued to hand back some of the gains seen in November and December as interest rate expectations came back in line with what the US Federal Reserve (Fed) and European Central Bank (ECB) have been saying for months.

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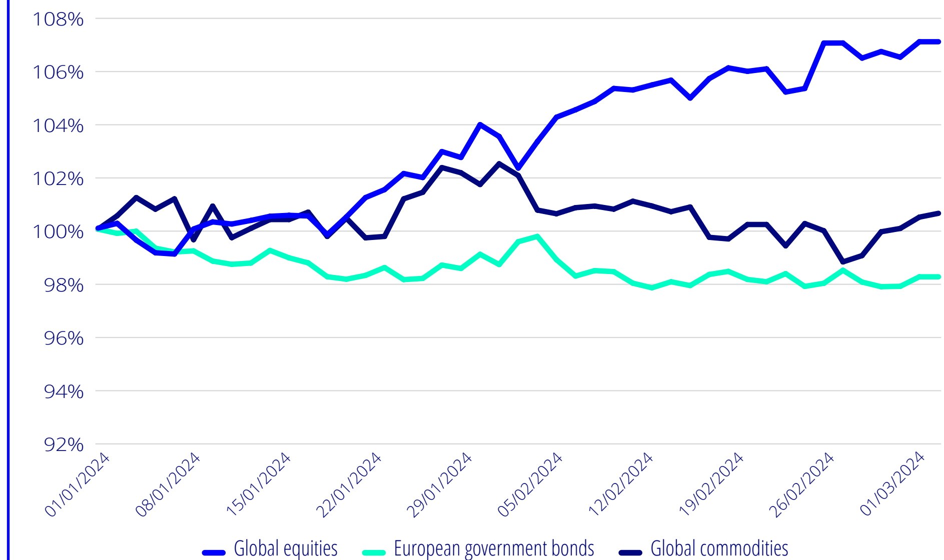
	February	YTD 2024	2023
Global Equities	+4.7%	6.7%	+18.1%
European government bonds	-1.2%	-1.9%	+7.2%
Commodities	-1.4%	-0.1%	-15.3%

Source: Bloomberg, 01.03.2024.



Source: Bloomberg, 01.03.2024.

February was another record for markets, with the US, Japanese, and European equity markets all hitting record highs. In the all-important US market, this rally was a very narrow one, dominated by the large technology firms. Inevitably, talk turned to whether this bull market was beginning to show some of the characteristics of a bubble, and with interest rate cuts possibly on the horizon, there is a chance that this may be happening.

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5 drivers of markets in February

1 We need to talk about NVIDIA

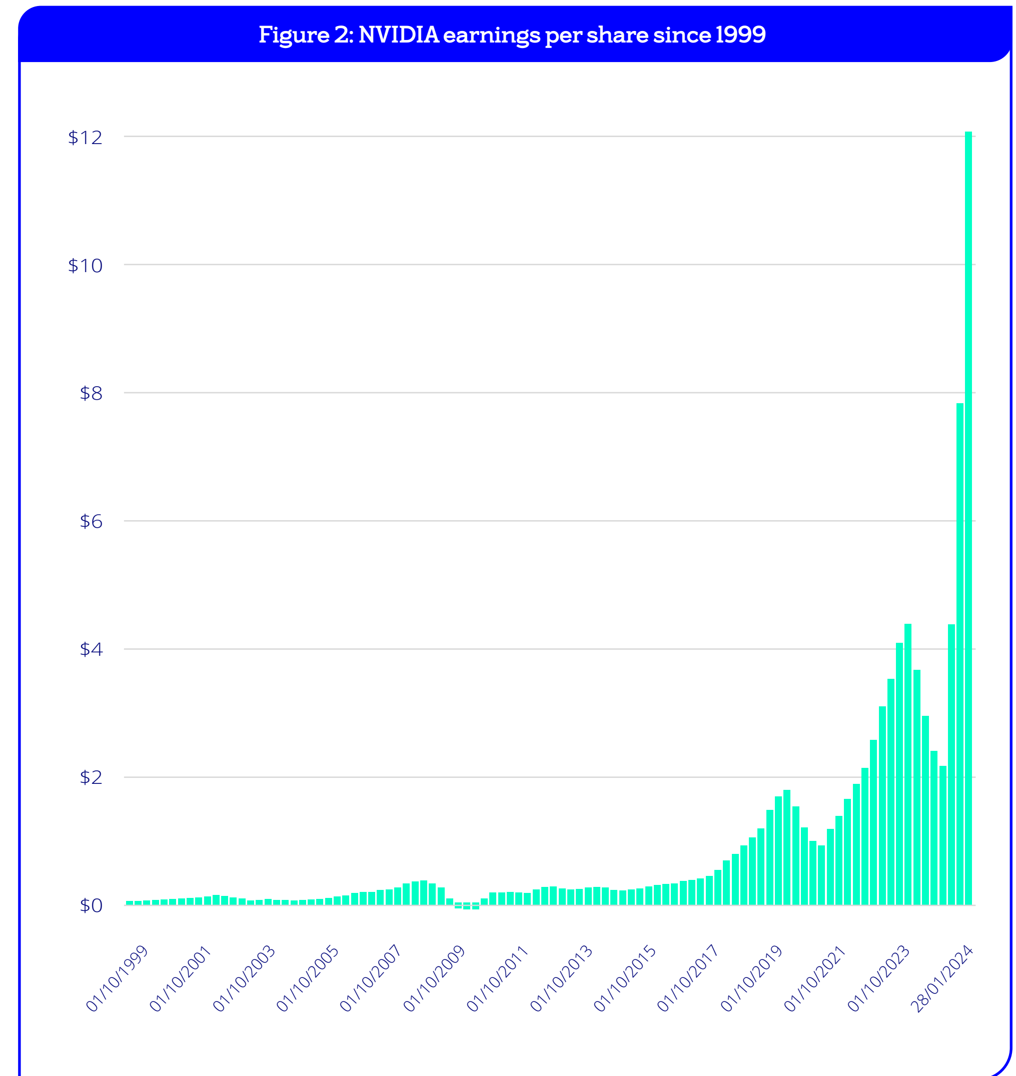
In the US, the big tech companies have been the dominant source of revenue and earnings growth. Earnings growth in the US stock market has been flattered by the performance of the top six tech companies[1], which are estimated to have reported 53.7% year-on-year (y/y) earnings growth in Q4 2023, compared with a 10.5% y/y earnings contraction for the remaining 494 companies[2].

Even among these six, one company stands out. Rarely has a single stock dominated the headlines as much as NVIDIA has in February. The trajectory of its reported earnings has been spectacular over the past year or more, and its Q4 2023 earnings report was one of the most anticipated announcements in financial markets so far this year. It didn't disappoint.

- NVIDIA's revenue tripled to $22.1 billion, well above the market forecast of $20.4 billion[3].
- Earnings per share of $5.16 per share also exceeded consensus estimates of $4.60 per share[3].
- Their forecast for even stronger revenue for Q1 2024 ($24 billion versus the previous estimate of $21.9 billion), illustrates just how strong the demand for AI technology is proving to be[3].

At the time of writing, the share price has seen returns of 63% in 2024 alone[4], contributing 29% of the US equity market gains in 2024[5]. The extent of the earnings growth is clearly illustrated in **Figure 2**.

Figure 2: NVIDIA earnings per share since 1999



Source: Bloomberg, 27.02.2024.

[1] Apple, Microsoft, Amazon, NVIDIA, Google and Meta.
[2] Source: BCA Research 27.02.2024.
[3] Source: Bloomberg 27.02.2024.
[4] Source: Bloomberg 27.02.2024.
[5] Source: Bloomberg 27.02.2024.

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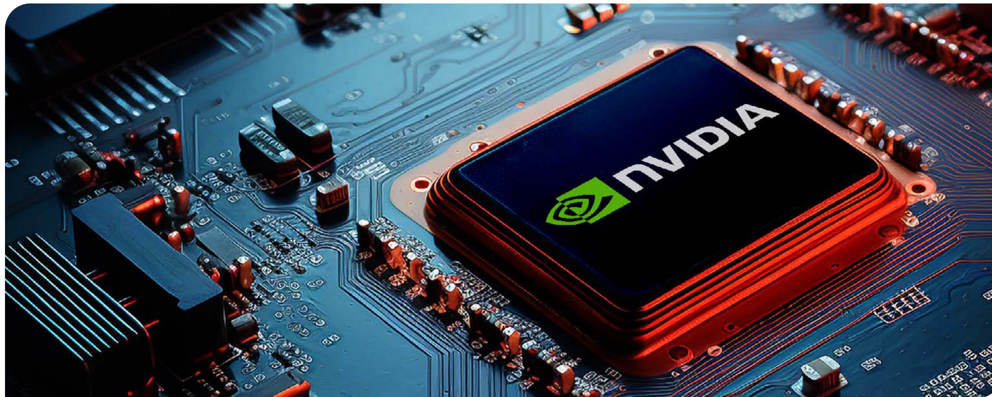
5 drivers of markets in February

1 We need to talk about NVIDIA (Cont'd)

The challenge for investors is the information shown in **Figure 3**. This chart shows both the trajectory of NVIDIA's share price and the company's price-earnings ratio (what is paid for each dollar of earnings). At the end of 2022, before the massive jump in the share price, NVIDIA was trading at 32 times forward price/earnings[6]. At the end of February 2024, it was trading at 32 times forward earnings[7]. So while it's expensive by the standards of the rest of the US market, its valuation hasn't moved much by its own recent standards, given the pace at which its earnings have grown.

At this point, NVIDIA is the third largest US company and is valued higher than the US energy sector, listed real estate sector, utilities sector, and materials sector. It is about 15% behind the value of the consumer staples sector[8].



Bottom line: NVIDIA is clearly at the forefront of the AI boom, and its stock price could continue to rise if it can continue to exceed market expectations as it has in recent quarters. Eventually, history tells us that this hurdle will prove too high and it cannot continue at this pace indefinitely.

Source: Bloomberg, 27.02.2024.

[6] "Forward price earnings" compares today's share price with expected earnings per share, in this case in 1 year's time.
[7] BOI Investments Markets/Bloomberg, 29.02.2024.
[8] BOI Investments Markets/Bloomberg, 29.02.2024.

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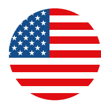
5 drivers of markets in February

2 Q4 earnings on a solid footing

In a sign that the economy remains on a solid footing, company earnings reported in Q4 2023 were generally better than expected, particularly in the US market.



In the US, earnings grew 10% y/y in Q4 2023. Excluding the energy sector, this growth rate increases to an impressive 13.6%. Revenue growth was more modest at 3.4%, or 4.9% excluding the energy sector. At the time of writing, 437 out of 500 companies have reported their earnings and 78.5% have beaten expectations, which is above the long-term average[9].

In Europe, the picture is a little less rosy. Q4 2023 earnings are expected to fall by 6.5% compared to the same period in 2022. Excluding the energy sector, the decrease is 1.3%. Revenue growth is expected to rise by 0.1% compared to Q4 2022, or by 4.6% when the energy sector is excluded. At the time of writing, 200 companies in the European equity market have reported Q4 2023 earnings, of which 53.5% beat analyst estimates, broadly in line with the long-term average[10].

Bottom line: US earnings expectations remain robust, and Europe is expected to emerge from its earning recession in the coming quarter. While we can expect some paring back of these expectations during the year, they look strong enough to support the equity market in the year ahead. However, with valuations already stretched in some markets, any disappointment is a risk.

Source: LSEG/I/B/E/S, 27.02.2024.

[9] Source: LSEG/I/B/E/S, 22.02.2024.
[10] Source: LSEG/I/B/E/S, 27.02.2024.

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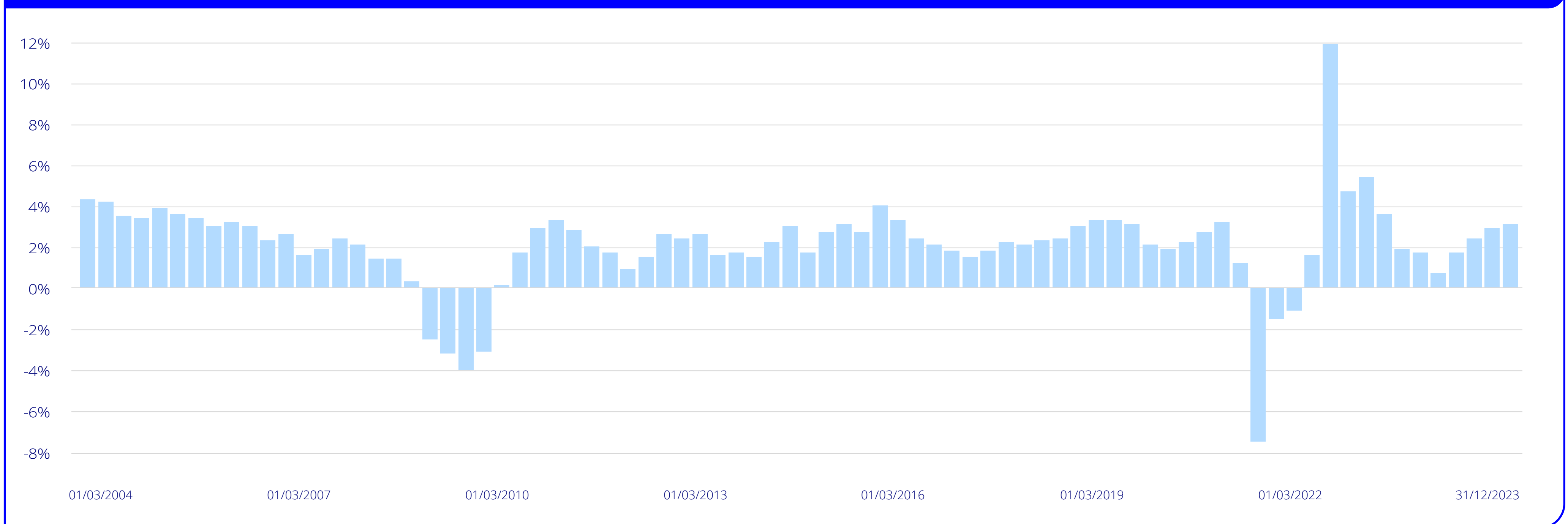
5 drivers of markets in February

3 Expectations about US economy continue to strengthen

In the near term, the US economy looks stronger than expected. According to a survey of forecasters conducted by the Federal Reserve Bank of Philadelphia, the US economy is expected to grow by 2.1% per annum (p.a.) in Q1 2024, up 1.3% from the previous prediction. For the full year, the survey suggests 2.4% growth in 2024, up 0.7% from the previous estimate[11].

In a separate survey, the February National Association for Business Economics (NABE) Outlook, which provides a consensus forecast from a panel of 41 professional forecasters, expects US inflation-adjusted economic growth to increase 2.2%, up from 1.3% forecasted in the December survey[12]. February's stronger growth forecasts for 2024 are the result of upward revisions to a number of economic sectors, including personal consumption, non-residential fixed investment, residential investment, and government consumption, expenditures, and investment.

Figure 5: US economic growth to end December 2023



Source: Bloomberg, 27.02.2024.

[11] Source: Federal Reserve Bank of Philadelphia 09.02.2024.
[12] Source: National Association of Business Economics, 26.02.2024.

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5 drivers of markets in February

3 Expectations about US economy continue to strengthen (Cont'd)

However, there are some areas for concern.

- The US housing market remains challenging, with sales of new and existing houses in 2023 at their lowest level since 2011, within which existing home sales are at a 30-year low[13].
- With very weak supply of new homes and existing housing stock, demand has outpaced supply and house prices continue to rise.

There has been little impact from higher interest rates to date as so much of the US mortgage market is fixed rate in nature. Combined with full employment, this has meant mortgage default rates remain subdued. However, the same can't be said for personal and credit card debt, where default levels have begun to rise, the first indication of the impact of higher interest rates[14].

The commercial real estate market is where monetary policy and any slowdown could be felt more acutely. According to Goldman Sachs, about $1.2 trillion in commercial mortgages will mature this year[15]. This is roughly a quarter of all US commercial mortgages and the highest level since 2008. With interest rates two to three times higher thanks to the Fed's rate increases over the past two years, a higher debt burden is likely to put some pressure on valuations next year.

On a global level, at a recent G20 finance meeting in Brazil finance chiefs indicate that the global economy has a growing chance of a soft landing, with faster than expected disinflation being one of the potential sources of upside[16]. This comes after the International Monetary Fund (IMF) raised its forecast for global growth in 2024 to 3.1%[17], citing better than expected US expansion and increased fiscal support in China.

Bottom line: Better-than-expected growth in the US economy will support earnings, but it may also keep the labour market tight, so wage growth could feed through to inflation. This, in turn, could keep central banks slow to reduce interest rates.

[13] Freddie Mac US Housing and mortgage market outlook, 27.02.2024.
[14] Source: Federal Reserve Bank of New York, "Credit card and auto loan delinquencies continue rising...", 06.02.2024.
[15] Source: Reuters, Bracing for the commercial real estate 'reckoning' By Jamie McGeever, 02.02.2024.
[16] Source: Bloomberg , "World economy has growing chance of soft landing G-20 says", 27.02.2024.
[17] IMF World Economic Outlook, 30.01.2024.

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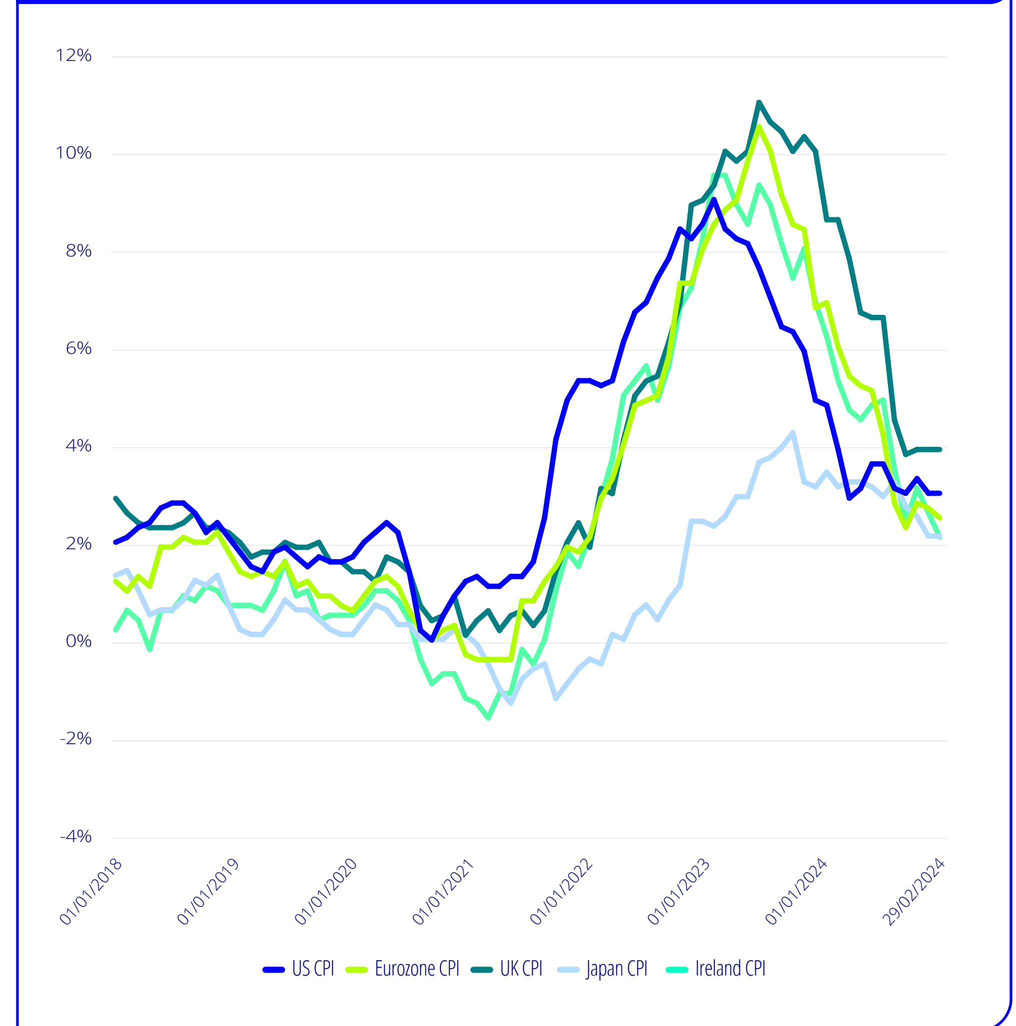
4 Inflation's sticky last 1%

At the beginning of 2024, inflation was no longer seen as the biggest threat to the global economy, at least as far as markets were concerned. Expectations were growing that inflation was on its way to the 2% target set by central banks in most developed economies, although many harboured belief that new factors could make the final stages of that journey more challenging:

- In the previous decade, China was essentially exporting deflation to the rest of the world, but with a richer China and a changed political landscape, it's possible that China could be less deflationary than in the past.
- Second, there was the fear that energy and food crises, such as we saw in 2022 with Russia's invasion of Ukraine, could be repeated.
- Third, there have been fears that Middle East politics would create a new source of inflation in the world's supply chains, and we have seen some evidence of this in the impact of the Red Sea crisis on shipping prices in recent weeks.
- And fourth, central banks have been quick to inject liquidity into markets when needed, such as we saw with the US banking crisis in 2023.

Figure 6: Headline consumer price inflation (CPI) in major economies



Source: Bloomberg, 27.02.2024.

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4 Inflation's sticky last 1% (Cont'd)

Despite these risks, there remains a widespread belief in markets that central banks have solved the inflation problem without causing a recession – an impressively executed balancing act if ever there was one.

- Despite better-than-expected economic growth, full employment and some sources of inflation on the rise (such as the costs of shelter and freight prices), as well as the ever-present risks of worsening geopolitical supply-side shocks, inflation could still be a risk to markets in 2024.
- While not reaching the levels of a couple of years ago, it's plausible that that we could see persistent inflation for a few more months, which could be enough to continue to cause central banks to stall on their interest rate cuts.

In February we got some evidence of this problem as US headline inflation came in at 3.1% for January, slightly higher than expected. Late in February, we saw the Fed's preferred inflation measure, Personal Consumption Expenditure (PCE) which measures the value of goods and services purchased by, or on behalf of, US residents, come in at 2.4% for January, in line with market expectations, while the core measure, which excludes food and energy came in at 2.8%[18].

In the eurozone, the month ended with headline inflation for February coming in at 2.6%, while core inflation, which excludes energy and food, came in at 3.1%, both slightly above expectations[19].

While the data is broadly heading in the right direction, it remains far enough away from policy targets to convince central banks that there remains a distance to travel.

Bottom line: There is enough evidence to suggest that inflation may get stuck above the policy target level, which may influence the timing of when interest rate cuts begin.

[18] Source: Bloomberg, 29.02.2024.
[19] Source: Bloomberg, 01.03.2024.

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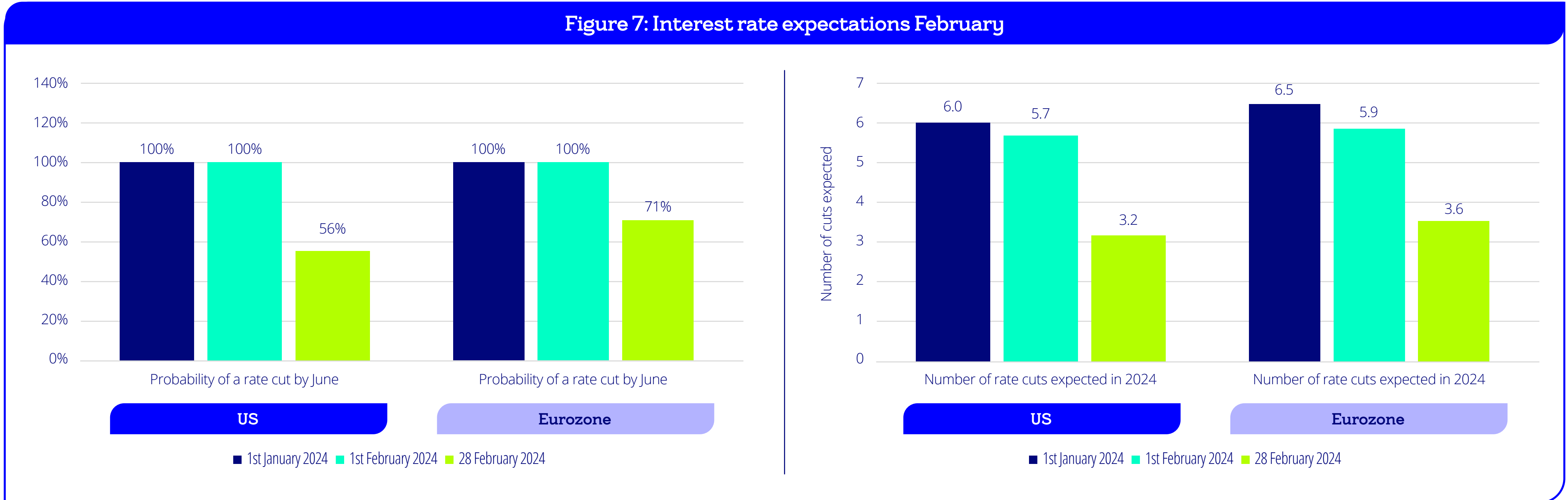
5 Interest rate expectations

The optimism in markets that we would see interest rate cuts beginning by March of this year has proven to be misplaced. Over the past two months, we have seen that expectation gradually erode, and by the end of February, market expectations have moved towards mid-year, and possibly later into 2024.

The continued strength of economic growth and persistent inflation have brought expectations more in line with what the major central banks have been saying for months. Currently, markets expect interest rate cuts to begin in May or June and for there to be 3 rate cuts in the US and possibly 3 to 4 in the eurozone.

Earlier this year there was a high degree of certainty that we'd have the first rate cuts before June and that they would continue from there. That has shifted significantly and there is now a much lower level of certainty about that and some concern that it could be pushed further out in 2024 if economic growth continues to be as strong as it has been.

Figure 7: Interest rate expectations February



Source: Bloomberg, 01.03.2024.

Bottom line: Overly optimistic expectations of when interest rate cuts might begin have been reined in and the market seems more in line with what central banks have been saying for some months.

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Outlook

With inflation falling, even to a sticky patch of 2-3%, interest rates still likely to fall by mid-year, and economic growth likely to remain at least lukewarm for most of 2024, the ingredients are in place for risk assets to continue to perform. But are we reaching a point where equities are overextended? Some history may help contextualise:

- If we were to hazard a guess as to when this equity bull market began, it was probably October 2022.
- Compared to previous bull markets, and by extension, bubbles, the 44% gains in the US market so far is modest by historical standards, especially when compared to the losses of the previous period.

Of course, this is not a broad-based bull market and, because it has been driven by technological innovation, it's inevitable that comparisons will be made to the internet bubble period of 1998-2000. As you can see from **Table 1**, that period was exceptionally exuberant by any standard, so the comparison to it may be somewhat flawed.

Nonetheless, if we compare what's been going on in the technology laden NASDAQ 100 index, this also shows that the current trajectory has been more modest in recent months. When you consider that in 1999, before the market crash in 2000 Qualcomm, the year's top-performing stock was up 2620%[20], even NVIDIA's extraordinary recent performance looks less mania-like.

Table 1: History of US bull markets since 1957

Bull Market Period	Duration	Total S&P 500 Return in $
October 1957 to December 1961	50 months	110.8%
June 1962 to February 1966	44 months	99.3%
October 1966 to November 1968	26 months	54.6%
May 1970 to January 1973	32 months	86.8%
October 1974 to November 1980	74 months	186.9%
August 1982 to August 1987	60 months	303.7%
December 1987 to March 2000	148 months	836.5%
September 2001 to January 2002	3 months	21.90%
October 2002 to October 2007	60 months	116.2%
March 2009 to February 2020	132 months	528.1%
March 2020 to January 2022	21 month	120.2%
October 2022 to present	16 months	44.6%

Source: Bloomberg/BOI Investment Markets, 28.02.2024. Returns are expressed in US dollars including reinvestment of dividends.

[20] Source: Bloomberg, 29.02.2024.

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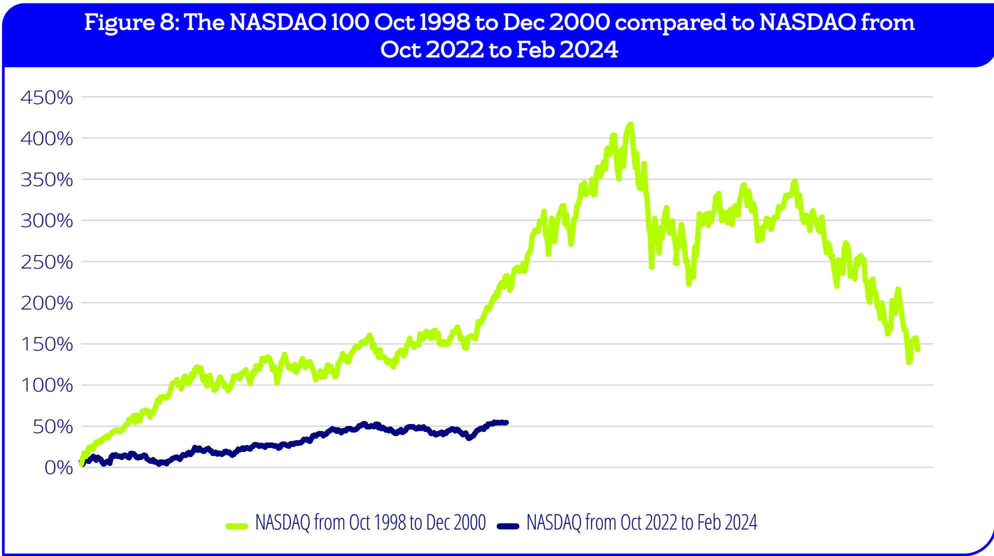
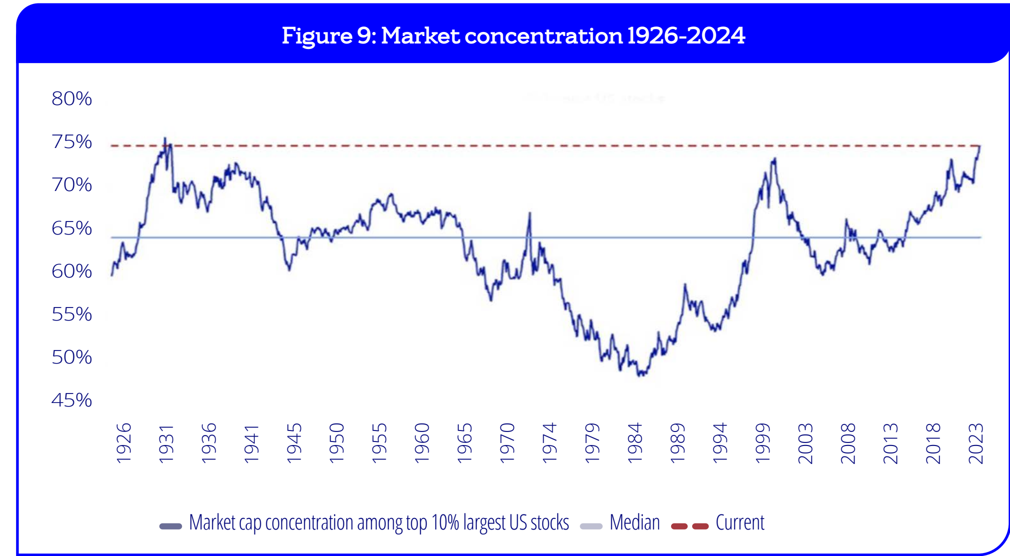
Outlook (Cont'd)

Figure 8: The NASDAQ 100 Oct 1998 to Dec 2000 compared to NASDAQ from Oct 2022 to Feb 2024



Source: Bloomberg/BOI Investment Markets, 28.02.2024.

Figure 9: Market concentration 1926-2024



Source: Kenneth R. French database, Deutsche Bank

What does distinguish this period is how concentrated the returns are in a small number of companies. The market has been driven by a handful of companies, and the largest companies now make up a greater portion of the market than they have in almost a century. This year alone, we've seen nearly 60% of the US equity market returns come from just 4 companies.

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

This is concerning and unsustainable in the long run, although that's not to say it won't continue, but the hurdle is getting higher every time. The fact that we have already seen at least three of the Magnificent Seven[21] fall behind this year illustrates how high the hurdle now stands for these companies. In fact, Apple and Tesla are the two largest contributors to index's losses so far in 2024[22].

The only time that US stocks were so top-heavy was in 1929, and that is an uncomfortable parallel. What is needed is to see a broadening of the sources of return from other sectors and regions of the market to make this more sustainable and balanced. However, if this small cohort of companies continue to deliver earnings above expectations, we could see more highly concentrated gains happening in the months ahead.

For investors, participating in markets like these is part of the journey and can be very rewarding, but there are dangers and while we believe this market has further to go, the risks are also rising.

[21] Apple, Alphabet, Amazon, Meta, Microsoft, NVIDIA, Tesla.
[22] Source: Bloomberg, 27.02.2024, measured by the drop in market capitalisation from 01.01.2024 to 27.02.2024.

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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%
Netflix	23.3%	53.5%	19.6%	-35.5	59.8%
Microsoft	60.7%	30.9%	63.7%	-23.5%	53.1%
Alphabet	30.7%	20.2%	77.5%	16.9%	53.2%
Meta	59.7%	22.2%	32.2%	-48.9%	184.7%
Apple	92.7%	67.5%	44.6%	16.2%	44.2%
Amazon	25.5%	61.9%	9.9%	-39.7%	75.1%

Source: BOI Investment Markets/Bloomberg, 01.03.2024.

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