SIGNIA INVEST

Signia Invest Insights

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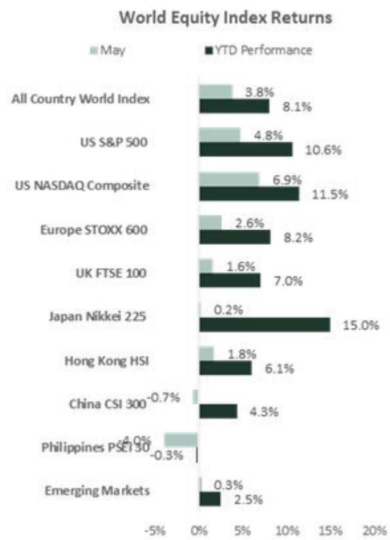
Market Review and Outlook

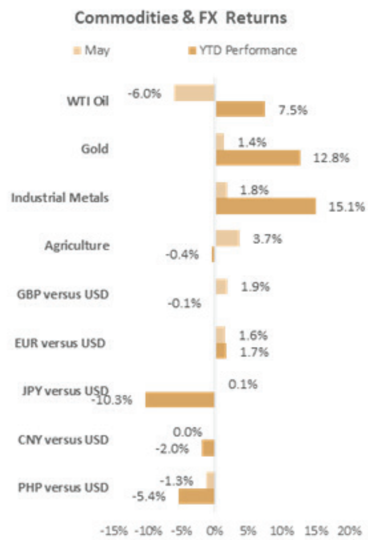
- Markets recovered their April losses in May, with the S&P 500 rising 4.8% and the STOXX 600 rising 2.6%, both climbing to new record highs. That came as US inflation eased slightly from its pace in Q1, which added to hopes that a prolonged 'Goldilocks' environment was still intact; that is, one where economic growth and inflation are neither too hot to force central banks into a more restrictive policy stance, nor too cold to raise the economic alarm over a recession.

- Consequently, the weaker inflation data coupled with some weaker-than-expected economic data in the US, caused the US Dollar to fall against most of its major peers. Moreover, the geopolitical situation was also calmer, which helped Brent crude oil prices to consolidate in May after four consecutive monthly gains.

- Nevertheless, even as risk assets did well for the most part, markets struggled again towards the end of the month. That came as global inflation data proved stickier than expected, leading to a fresh pullback for sovereign bonds across several major countries and yield curves. Indeed, there was a significant milestone in Japan, as the Japanese 10-year government bond yield closed above 1% for the first time since 2012, marking a potential exit from financial depression after 12 long years for domestic savers.

MARKET PERFORMANCE AS OF 31 MAY 2024:





Source: Bloomberg L.P., Arbion Ltd.

CAN ANYTHING STAND IN NVIDIA'S WAY?

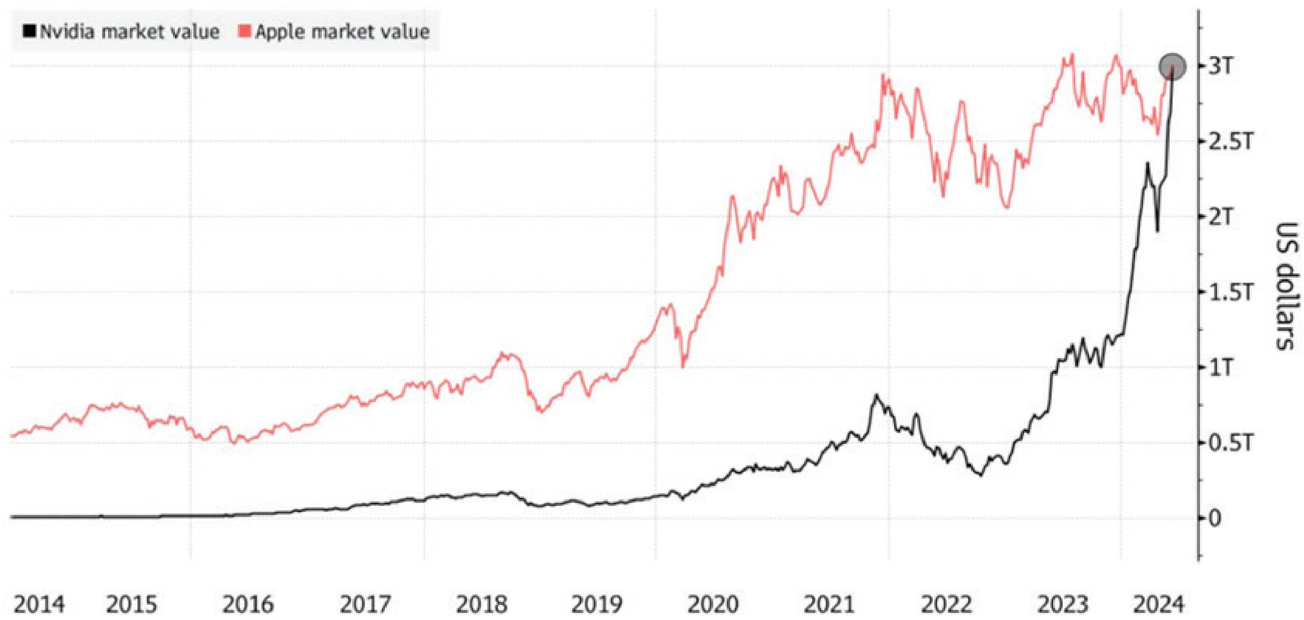
- Nvidia was already the world's most valuable semiconductor firm. Now, it's become the first computer-chip company ever to hit $3 trillion in market capitalization, overtaking Apple Inc. in the process. Nvidia's shares have rallied over 147% this year, adding about $1.8 trillion as the insatiable demand for its chips used to power artificial intelligence tasks skyrockets. The last time Nvidia was worth more than Apple was in 2002, five years before the first iPhone was released. At the time, both companies were worth less than $10 billion each!

- The company announced it expected second-quarter revenue to be about $28 billion, topping the already high bar of $26.8 billion set by analysts. Results in the fiscal first quarter, which ended April 28, also beat projections, lifted by growth in Nvidia's data-centre division where revenue growth accelerated yet again from 409% YoY in the preceding quarter to 427% YoY in the full year to Q1 (April). The company also announced a 10-for-1 stock split, with its shares gaining around +6% in after-hours trading and moving above the $1000 a share level.

- Whilst this meteoric rise in isolation is unsettling for many investors, and myself included, it is important to note that this is not the late 90s tech bubble, or at the very least, we are in the early innings of a somewhat unique cycle. Companies across industries and sectors are flush with cash, and spending on AI to highly profitable tech companies is expected to not just continue but to grow further and broaden out globally.

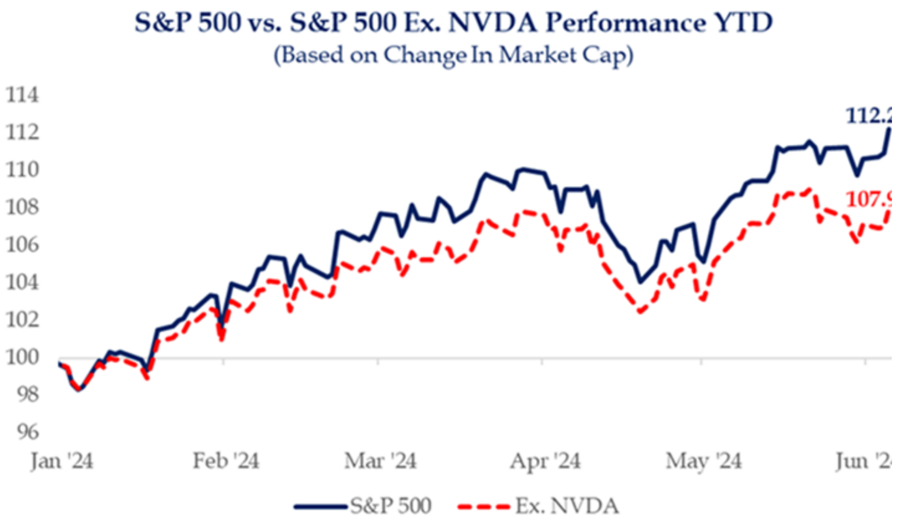
- The AI hype might take some time to subside, and with it take some valuation premium out of the more frothier stock prices in the long-run, but if an enduring structural change is underway, in the near-term it is difficult to see how solid earnings growth and cash flow generation within the context of a broadening bull market does not help propel the stock prices of the more profitable tech companies even higher.

APPLE'S MARKET CAPITALISATION WAS 2.5X GREATER THAN NVIDIA'S AT THE START OF 2024:



Source: Bloomberg L.P.

NO DENYING NVIDIA'S HEAVY AND GROWING STOCK CONCENTRATION INFLUENCE ON S&P RETURNS:



Source: Strategas

THE UK READIES ITSELF FOR ANOTHER LIKELY CHANGE OF PM

- If the polls are anything to go by then British voters are expected to vote in Labour leader, Kier Starmer, as their fourth Prime Minister in nearly five years, as Rishi Sunak called for an early election on 4th July. There's no precedent for a premier choosing to go to the polls when in this much political trouble. so why has he done it?

- His positive take was that headline inflation dropped to 2.3% in April and is almost back to the Bank of England's 2% target, which Sunak counts as a victory on one of his political goals. However, if Sunak really thought things were getting better, he should stick around for another six months, in the hope that further improvement would change voters' minds. Going to the country now only enforces a sense that he expects things to get worse in the second half of the year.

- Moreover, the inflation numbers were notably higher than forecasted, while the core number (excluding food, fuel, alcohol and tobacco) remains uncomfortably high at 3.9%, around double the BoE's target.

THERE HAVE BEEN SOME SIGNIFICANT ELECTION OUTCOMES RECENTLY

South Africa:

- The ANC lost its majority while, more worryingly, only 40% of the adult population participated in the election. The ANC's increasingly militant alignment with the BRICS and the rest of Africa as opposed to the West, did not go down well with voters, especially younger ones. The initial market reaction was negative but as it is likely that the ANC has to seek a coalition with the centrist DA, the damage is likely to be limited.

India:

- The market expected a large majority for incumbent Modi and rallied into the results. However, it then sold off as it turned out that he has to rule as part of a coalition which was seen as detrimental to the investment and infrastructure story. The reality is that coalition governments in India are not unusual and investment as a percentage of GDP in the country has been trending down ever since the financial crisis, despite the hype around the country over recent years. Subsequently, equities and the currency subsequently recovered their losses.

Mexico:

- The reaction to Claudia Sheinbaum's victory was worse and markets have not yet recovered yet. The peso and the local stock market sold off dramatically after the Morena candidate and climate scientist secured a landslide result. Rising minimum wages and improving welfare transfers in addition to a spending spree ahead of the elections were key reasons for Sheinbaum's victory but investors fear more radical constitutional changes coming and more pressure on the private sector to help fund the current budget deficit. It could take some time and require some evidence of market friendliness from the President elect before investors regain some of their lost confidence.

Europe:

- Macron has called for snap legislative elections which will take place in two rounds on June 30th and July 7th. This is after his party trailed with 15% in the European Parliamentary elections over the weekend with Le Pen's National Rally winning 32%. Although this was broadly in line with expectations, Macron is likely hoping to win back some momentum and hope a notable part of the European Parliamentary results were a protest vote as far right parties gained notable ground in other countries such as Germany. He will also be hoping that other centrist parties help by rallying round to limit the charge of Le Pen. So quite a gamble!

NOTABLE ECONOMIC DEVELOPMENTS

US:

- There are still no signs of the economy slowing down meaningfully. This resilience has been remarkable over the last quarters but is also relatively easily explained: Higher rates have only a limited effect on homeowners, for instance, as 40% of them in the US do not have a mortgage and 95% of mortgages are fixed for 30 years. Consumers have by now spent their excess savings accumulated from the pandemic, but higher interest rates also lead to higher incomes, supporting consumption and household balance sheets at a time when wages and savings income are also rising significantly.

- The latest US payroll data confirm these observations: May jobs data came in very strongly at +272k versus a forecast of +180k, where 204k jobs were created in the services sector alone, still driving the economy. Average hourly earnings grew by 4.1% versus a forecast of 3.9%, and the previous month's figure was revised up to 4.0%. This underlines the sticky aspect of inflation especially in services industries where wage inflation is the leading factor and the level of interest rates is somewhat less relevant than in more asset-heavy sectors.

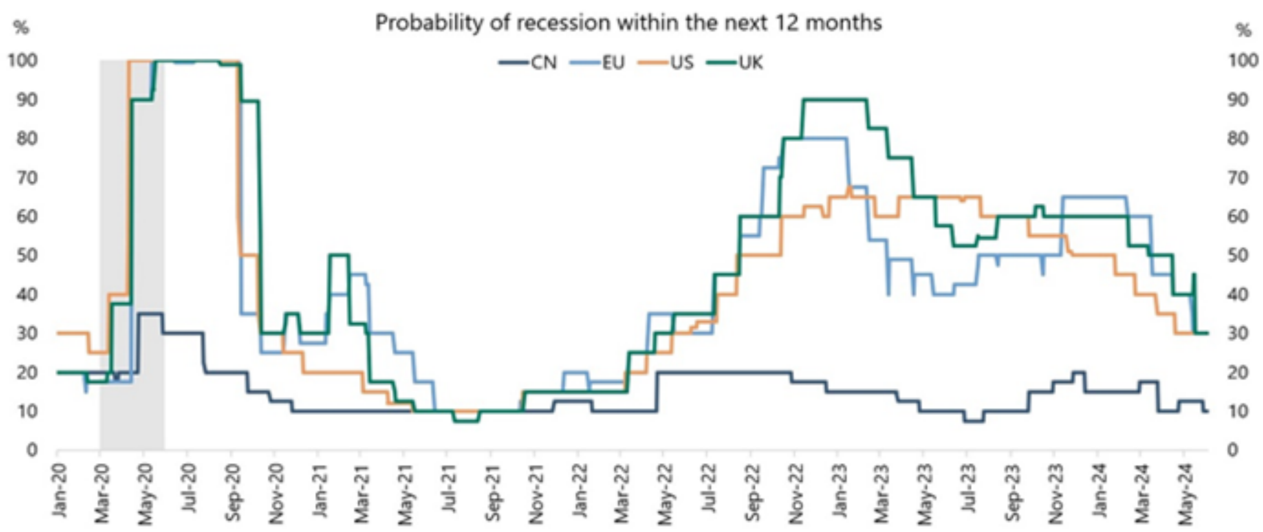
Eurozone:

- The economy returned to growth in the first quarter as GDP expanded by 0.3% from the previous quarter, following a contraction of 0.1% in Q4 of last year. The Q4 figure was revised down from 0.0%, meaning the bloc had been in a mild technical recession in the second half of 2023. However, the inflation story was a touch more concerning with the May flash HICP coming in above expectations at +2.6% YoY versus +2.5% expected, and the core number also surprised to the upside at +2.9% versus +2.7% expected.

- French bond markets declined after S&P ratings agency downgraded the country from AA to AA- due to the Government's failure to restrain the post-Covid budget deficit. This has undoubtedly had an impact the European Parliamentary elections with Le Pen's National Rally Party securing nearly twice as many votes than incumbent Macron's Renaissance Party.

- A picture of more robust world economy is developing: The consensus probabilities of recessions in the US, the eurozone, the UK and China have declined throughout this year and are now at 10% for China and 30% for the other major blocks. For comparison, this figure was 90% for the UK in early 2023.

THE CONSENSUS PROBABILITY OF A RECESSION IN EUROPE, THE US, AND UK HAS DECLINED SIGNIFICANTLY IN RECENT MONTHS:



Source: Apollo.

MORE G10 CENTRAL BANKS JOIN THE RATE CUTTING PARTY

- Swedish Riksbank became the second central bank with a G10 currency to cut rates in this cycle. The move was expected, but it was the first rate cut they'd delivered since 2016, so it was a big milestone, which took the policy rate down by 25 basis points to 3.75%. In addition, their statement signalled that more cuts were likely ahead, saying that if the inflation outlook held up, then they expected two more cuts in the second half of this year. It's also worth noting that they're in a better position than some other central banks, as their preferred measure of inflation (CPIF) was at 2.2% in March, so just above their 2% target. The Riksbank's decision follows the Swiss National Bank's cut back in March.

- Indeed, the debate around rate cuts is certainly becoming more interesting again. This is because Canada and the Eurozone have just cut their policy interest rates in early June for the first time in this cycle, despite not having to do so purely from a data point of view. In fact, the ECB simultaneously raised their inflation forecast for 2024 and 2025, stating that falling inflation trends have caused real rates (nominal interest rates minus inflation) to rise in the Eurozone, so an adjustment to nominal rates was deemed appropriate. The ECB cut its benchmark deposit facility rate by 25 basis points from 4.00% to 3.75%, though President Lagarde tried to maintain a hawkish language and was overall less clear on the outlook for monetary policy. It seems that central banks try to justify any action these days! The ECB's decision to cut rates is quite a novelty as this was the first time in their 25-year history that the European Central Bank reduced policy rates before the US in a new monetary cycle.

- The other milestone was the Bank of Canada, which pipped the ECB to the post to became the first G7 country to cut rates this cycle. They cut their interest rate by 25 basis points to 4.75% as expected, and there was a dovish tone from Governor Macklem, who explicitly mentioned additional cuts, saying it was "reasonable to expect further cuts" if inflation continued to ease. Macklem also mentioned the Bank of Canada does not "need to move in lockstep with the Federal Reserve", although "there are limits to divergence".

CURIOUS CASE OF THE JAPANESE YEN

- A $60 billion currency intervention. A boost from retreating US inflation expectations. Ten-year Japanese government bond yields above 1% for the first time in 12 years. And yet still, the Japanese Yen's decline continues. Its recent strengthening after officials stepped in didn't last long, exacerbating policymaker's concerns. That said, a frail currency is not all bad news for the Japanese economy as it benefits exporters and keeps tourists happy. But the persistence of such weaknesses raises the issue of how long the authorities can tolerate this without breaking something. Judging by recent market moves, the line in the sand used to be at 152 Yen per US Dollar but is now more like 160 Yen. Although a central bank can always print its currency, foreign reserve holdings are finite. Whether to sell a portion of foreign reserves is a separate issue from determining whether a weak currency poses an imminent threat to the economy. In Japan's case, the Ministry of Finance decides on the former, but addressing the latter involves coordination between the MOF, the BOJ, and sometimes other central banks. If Japan were to replicate recent interventions on the same scale, its $1.28 trillion of forex reserves (apparently no longer enough to buy a majority stake in Nvidia!) would likely be exhausted in little over a month.

MORE STIMULUS IN CHINA, BUT IS IT ENOUGH?

- China unveiled its most forceful attempt yet to boost the property market after prices dropped the most in a decade. It scrapped a minimum mortgage rate, cut down payments and told local governments to buy homes. Cumulatively, the quantum of support and stimulus from Chinese policymakers is now adding up, so much so that the International Monetary Fund recently increased its forecast for economic growth in China for both 2024 and 2025. It now expects the world's second largest economy to expand by 5% and 4.5% respectively, up from its previous forecasts of 4.6% and 4.1%. The housing market and with it household sentiment will no doubt take time to recover, but the 2024 upgrade is now in line with Beijing's own target of "around" 5%. However, the IMF warns of slower structural economic growth in years to come, predicting 3.3% by 2029 due to its ageing population and slower productivity growth.

With elections increasingly out of the way and the hope that various global conflicts are moving more into the background, and in the absence of inflation rearing its head once again in the second half of the year, the outlook for risk assets continues to be very supportive. Furthermore, as implied volatility levels are low, the cost of hedging equity portfolios is still very attractive and brings added comfort to running an overweight allocation to equities in this bull market. In a world where all other insurance prices seem to be going through the roof, equity put options certainly feel like a bargain!

ROBERT LEE

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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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