Market review February 2024

Even if the performance of stock market indices in January was not as extraordinary as in the last two months of 2023, investors were still in 'festive' mode. Indeed, there is something of an end-of-year rally hovering over the stock markets at the moment. Hopes of a "Goldilocks" scenario are motivating investors to favour growth stocks. The consensus expectation is that inflation will continue to fall towards the central banks' 2% target, while betting on economic activity that should enable developed countries to avoid recession. In this scenario, central bankers are likely to start cutting rates in the near future. The tensions in the Red Sea, which could raise the spectre of supply chain disruptions and thus put upward pressure on inflation in the short term, do not seem to have had much impact on investors. As a result, stock market indices gained between 1% and 3% over the month. The S&P500 even had the luxury of breaking through an all-time high. Some companies, such as Nvidia, which gained more than 24% in January after a 238% performance in 2023, and ASML, which gained more than 17% over the month, are already posting what we might call indecent performances. The big losers in the current environment are small and mid caps, which continue to underperform their larger peers. For example, the Russell 2000 contracted by almost 4%. The latter are more exposed to the consequences of a less dynamic economic cycle and restricted access to credit, which is cooling investors' appetite for this segment.

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On the Asian stock markets, the Nikkei 225 index, which includes Japan's main equities, soared by 8.4% to a level not seen since 1990, helped by its falling currency (down 4% against the US dollar). Conversely, despite a fresh attempt by the PBoC to stimulate the economy by cutting interest rates, the Chinese stock markets continued their descent into hell (down 10% over the month). As we pointed out in our previous letter, investors are waiting for positive signs to restore their confidence in this market, which has been racked by setbacks. The liquidation of Chinese property giant Evergrande by a Hong Kong court will not help to restore the confidence needed for a lasting recovery. The company, which has been in financial difficulties for more than three years, has not been able to put forward a convincing plan for restructuring its debt. It is too early to say whether this news will have a domino effect on other players in the sector, but it is clearly something to keep an eye on. It is also difficult to say whether the Taiwanese elections have had a negative impact on the Chinese market. The fact remains that, although his score was the lowest in the country's last three presidential elections, the pro-independence candidate won hands down, giving the Chinese authorities a hard time in their reunification plans. Not much to report from the major currencies, apart from the fall in the Japanese yen mentioned earlier and a tendency for the US dollar to appreciate, except against the Swiss franc (as usual…).

Market trends to end-January 2024

	Equities in Local Currencies							
End of January	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	1.14%	1.59%	2.81%	1.51%	-0.24%	1.76%	-4.68%	-6.29%
Perf 3 Month	15.77%	15.54%	14.46%	11.20%	11.76%	9.07%	6.62%	-10.00%
Perf YTD	1.14%	1.59%	2.81%	1.51%	-0.24%	1.76%	-4.68%	-6.29%

	Commodities				Currencies vs EUR			
End of January	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	5.86%	6.06%	-1.14%	0.58%	2.04%	-2.03%	1.67%	-0.32%
Perf 3 Month	-6.38%	-6.52%	2.80%	6.14%	-2.24%	0.92%	2.07%	3.32%
Perf YTD	5.86%	6.06%	-1.14%	0.58%	2.04%	-2.03%	1.67%	-0.32%

	Bloomberg Indices Bonds Total returns							
End of January	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	-1.38%	-0.27%	-0.33%	-0.15%	-1.81%	-0.70%	-0.19%	-0.56%
Perf 3 Month	7.90%	8.23%	5.79%	8.56%	11.62%	9.16%	9.39%	9.11%
Perf YTD	-1.38%	-0.27%	-0.33%	-0.15%	-1.81%	-0.70%	-0.19%	-0.56%

Source: Bloomberg 31/01/24.

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After a strong rally at the end of the year, bonds caught their breath in January. December's slightly better-than-expected inflation figures and the uncertain prospect of a first central bank rate cut were the main reasons for a rebound in yields across the curve. Admittedly, these movements are nothing like what we saw in 2022, but we have seen a slight rise in long-term yields, such as the US 10-year yield, which rose by 3 basis points. The same is true of its German cousin, which has recovered 14 basis points after falling by more than 80 points between November and December 2023. Despite tighter credit conditions for both individuals and businesses, credit spreads remain relatively stable.

As already mentioned, major refinancing needs should arise in 2024 and 2025, which could bring a touch of volatility to certain segments. In terms of commodities, uranium has emerged as the big winner from the inertia seen in the energy transition. While the solar and wind power sectors are getting their feet wet, uranium is enjoying its heyday. Uranium prices rose by a further 10% in January, for the 7ème consecutive month. New nuclear power station construction projects around the world, many of them in China, have contributed to this performance. As for digital assets, a historic decision has been taken. The SEC finally agreed to allow the issue of ETFs based on Bitcoin, but the latter, which ended January virtually unchanged, did not really benefit, despite peaking just after the announcement. This gives some legitimacy to this controversial asset class.

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Cumulative	Annualized
BTC 5,516%	SPX 12%	BTC 37%	BTC 119%	BTC 1,300%	AGG 0%	BTC 92%	BTC 302%	BTC 58%	CMT 20%	BTC 156%	BTC 315,678%	BTC 124%
SPX 26%	AGG 5%	AGG 0%	HY 17%	EM 35%	HY -2%	SPX 29%	Gold 24%	CMT 30%	Gold 1%	SPX 25%	SPX 226%	SPX 13%
HY 6%	HY 2%	SPX -1%	EM 15%	SPX 18%	Gold -3%	EM 21%	SPX 15%	SPX 29%	HY -11%	HY 12%	HY 64%	HY 5%
AGG -1%	EM 1%	HY -4%	CMT 14%	Gold 12%	SPX -7%	Gold 18%	EM 14%	HY 5%	AGG -12%	Gold 12%	EM 35%	EM 3%
EM -3%	Gold -3%	Gold -11%	SPX 11%	HY 7%	CMT -9%	HY 14%	AGG 7%	EM 0%	EM -18%	EM 9%	Gold 18%	Gold 2%
CMT -9%	CMT -18%	EM -14%	Gold 7%	CMT 6%	EM -15%	CMT 10%	HY 7%	AGG -1%	SPX -20%	AGG 5%	AGG 17%	AGG 2%
Gold -29%	BTC -58%	CMT -25%	AGG 2%	AGG 3%	BTC -73%	AGG 8%	CMT -3%	Gold -6%	BTC -65%	CMT -2%	CMT -4%	CMT 0%

BTC=Bitcoin; SPX=S&P500; HY=HighYield; EM=EmergingMarkets; AGG=AggregateBonds

As we said in the introduction, the tensions in the Red Sea do not seem to be worrying investors for the time being. However, the negative impact on risky assets could be significant if the situation were to flare up. For several weeks now, the Houthis, an armed Yemeni organisation backed by Iran, have been attempting to disrupt shipping bound for the Suez Canal, against a backdrop of missile and drone attacks on commercial cargo ships in response to Israeli bombardments of the Palestinian enclave of Gaza. The Suez Canal sees 20,000 ships pass through every year, representing almost 12% of the world's maritime traffic, and it would be hard to imagine any other means of transport for trade between China and Europe. For several weeks now, many shipping companies have been diverting their vessels.

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The option chosen by most carriers (which is quite simply the only possible alternative) is to bypass Africa and pass through the Cape of Good Hope, which drastically lengthens the distances involved. China, which is worried about its exports, is putting pressure on Israel by calling for a rapid end to the conflict in Gaza, which would help ease tensions in the Red Sea, but the Hebrew state does not seem to see it the same way...

Suez Canal vs. Cape of Good Hope shipping routes

Source: Global Maritime Hub, S&P Global Commodity Insights

To make matters worse, the Panama Canal, an essential link between the Pacific and Atlantic oceans, which handles around 5% of the world's shipping every year, is "running" slowly because of the drought, which means that water levels are insufficient to maintain normal traffic. There are usually 36 ships passing through the Panama Canal every day, compared with 24 at present. Once again, this is causing delays in the delivery of goods and long queues at the entrance to the canal. As you can imagine, these disruptions are having an impact. Even if we are still a long way from the levels reached after the confinements, this will inevitably have an impact on the prices of goods sold (upward impact on inflation?) or put pressure on companies' profit margins (if they bear the consequences of these additional costs, which seems unlikely). Oil and gas prices could also be highly volatile if the situation does not stabilise quickly.

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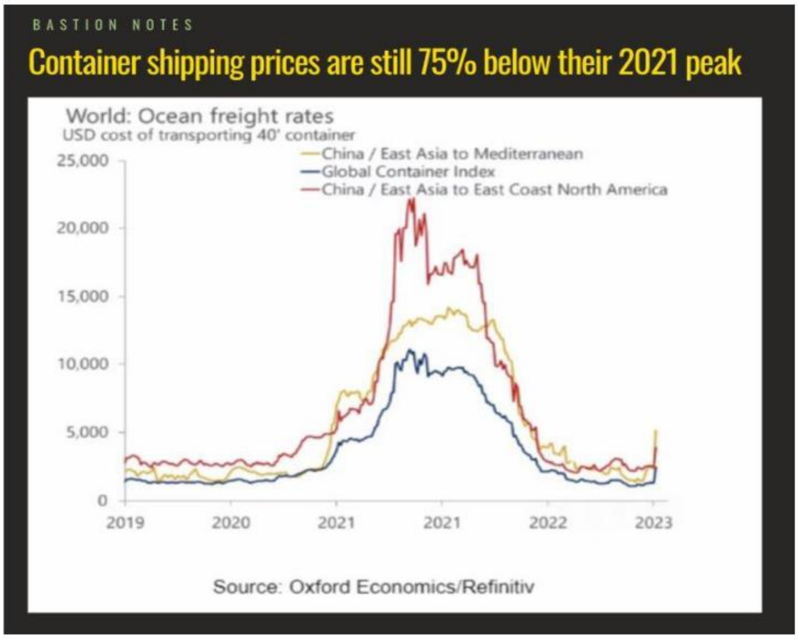
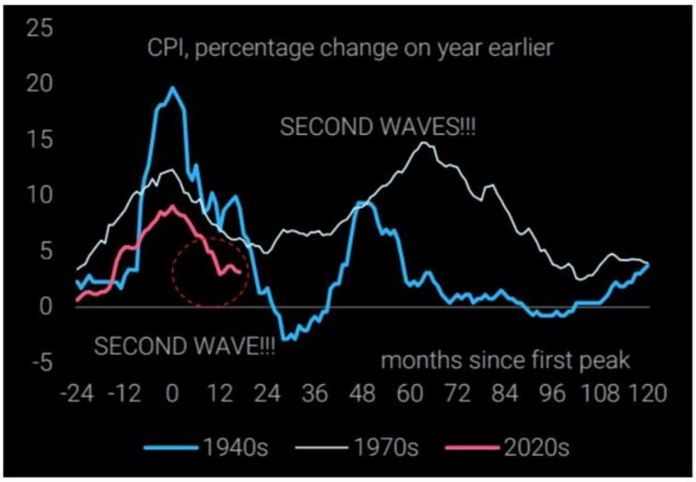


The risks of a "second wave" of inflation are therefore real. The problems mentioned above clearly represent a risk of unpleasant surprises at this level, especially as we have already seen a slight rise in inflation in the 4ème quarter of 2023, in both Europe and the United States. For the Americans, this rise is mainly due to base effects on energy products, as well as housing inflation, which accounts for around 35% of the reference basket. We know that following an inflationary shock such as we experienced between 2021 and 2022, inflation does not necessarily return in a linear fashion to its previous level, despite the efforts of the central bank. It is even doubtful that it will return to below 2% on a sustained basis, as it did then. As we have already mentioned, the consequences of the confinements have prompted companies and consumers to adopt new 'habits'. Deglobalisation will lead to higher structural inflation. This is not a real problem for equities, but investors need to start incorporating it into their valuation models.



Source: TS Lombard

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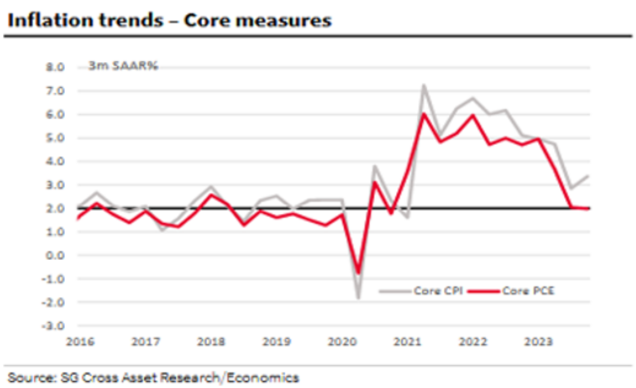
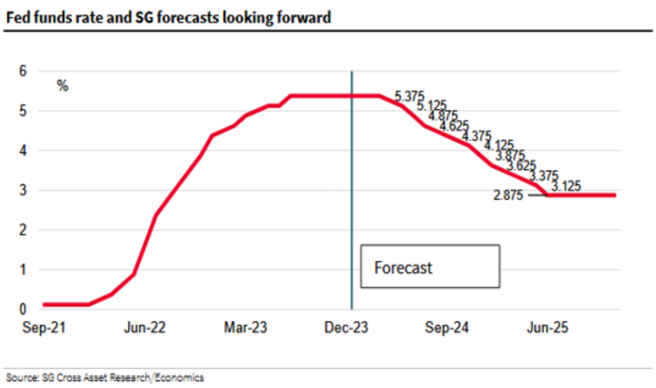
When we talk about inflation, we can't help but think of the central banks that are trying, as best they can, to control it so that it doesn't disrupt the functioning of the economy. Members of the ECB and the FED met at the very end of the month to discuss the monetary policy to be adopted. On the old continent first of all, Mrs Lagarde confirmed that the institution was dependent on economic data and that policy would evolve in line with the latter. Nothing new, you might say! On the other hand, she seems to have dashed the hopes of some investors who thought that the first rate cuts would come as early as April. Without giving any precise indication, it would seem that the first cut is expected this summer and that we should see 3 cuts in 2024. Of course, this remains hypothetical at this stage.
On the other side of the Atlantic, the message is virtually identical. While the likelihood of a rate-cutting cycle in the near future is high, the debate is raging over the timing of the first cut. Mr Powell hinted that the ECB would not move rates until it was certain that inflation was under control. For that to happen, there would have to be clear signs that the US labour market was easing. Before the meeting, the first falls expected by the consensus were in March, so it is not impossible that this forecast could be revised slightly. It would seem that the adage "higher for longer" has taken on its full meaning.





Some see similarities between the current situation and the internet bubble of 2000. Certainly, as we said earlier, some companies are trading at extreme and potentially worrying valuations that could trigger a correction. However, it is important to note that these companies are generating huge profits every quarter, unlike in 1999-2000. A contraction in earnings over the next few quarters cannot be ruled out, but we are a long way from the "house of cards" situation we witnessed between 2000 and 2002. To justify such a high valuation, these companies have no room for error. The slightest disappointment over margins or growth prospects will immediately be punished, as happened to Tesla, which lost 24% in January. It is for these reasons that we have been saying for several months now that we need to be more selective than ever when choosing companies, and avoid those that are unprofitable or overpriced. This is probably also why small- and mid-caps are out of favour at the moment... but that could change when the credit outlook brightens. Innovation and rising productivity should enable the best-performing companies to continue to attract new investors.

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We are entering an election year in the United States. While for the moment the flow of news has little influence on the markets, this could change as the months go by.
We wish you all a great start to the new year!

FIGURE 5 US president by party, real GDP, equity returns and US dollar

	Annualized Real S&P 500 Total Return (%)	Annualized Real GDP Growth (%)	Unemployment Rate At Start Of Term (%)	Annualized Real Trade Weighted Dollar Change (%)	Party	Term Start Date
Truman	9.7	4.7			D	04/12/45
Eisenhower	13.3	2.5	2.8		R	01/20/53
Kennedy	9.9	5.3	6.3		D	01/20/61
Johnson	7.9	5.1	5.5		D	11/22/63
Nixon/Ford	-2.1	2.7	3.4		R	01/20/69
Carter	1.3	3.2	7.8	-1.0	D	01/20/77
Reagan	9.4	3.6	7.4	0.1	R	01/20/81
Bush	11.0	2.2	5.3	-0.2	R	01/20/89
Clinton	14.2	3.8	7.4	2.2	D	01/20/93
Bush II	-5.3	1.9	3.9	-1.5	R	01/20/01
Obama	12.7	2.0	6.9	1.4	D	01/20/09
Trump	13.9	1.8	4.8	-1.5	R	01/20/17
Biden*	2.0	2.8	6.8	3.8	D	01/20/21
Weighted average						
Republican	5.5	2.5	5.8	-0.7		
Democrat	9.6	3.6	5.6	1.5		

*Biden figures are through Q2 2023.
Source: Haver Analytics through October 5, 2023. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. **Past performance is no guarantee of future results. Real results may vary.**

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