APRICUS FINANCE

WEALTH MANAGEMENT

June 2024

Do Not Try to Stop the Freight Train that is Tech Mega Caps, at Least Not Yet

May and early June saw equities reach new highs, getting impulse from (the much awaited) great results from 'newer', AI focused, technology companies, such as the giants Nvidia and Broadcom, (which is slowly approaching the 1 trillion-dollar market capitalization), but also 'older' names, such as Dell, Oracle or Adobe, that also benefited from spending in the sector.

At the beginning of the year, we highlighted that one of the risks to our broadly positive scenario for equities would be disappointing spending in AI infrastructure: just a slowdown in its dizzying growth would likely trigger a re-rating of the sector. That is clearly not the case yet, and the underexposure of many portfolio managers to these names, along with the rebalancing of the benchmarks and several very large ETFs towards those names, is forcing them to partially close the gap, therefore further fueling the rally.

We acknowledge that this is not sustainable long-term: revenue and earnings' growth cannot go on forever at those rates. However, currently there are no signs of tapering in AI spending, but rather signs of acceleration, as the AI adoption spreads to various sectors of the economy. Whether this is a new industrial revolution, only time will tell. But as a portfolio manager, trying to stand in front of the technology freight train might just prove very costly.

US Economy

Over the last few weeks, we have received further evidence that the economy is slowing down. At the same time the labor market, while still strong, has increasing signs that it is weakening. The figures, taken together, suggest that US growth peaked at the end of the first quarter.

1st quarter GDP was revised down yet again, to an annualized rate of 1.3 %, and PMI surveys of economic activity have been underwhelming. Household consumption, (retail sales control group), was negative in April. We expected a little rebound in May, as many retailers cut prices, ahead of the Memorial weekend, as consumers limit spending on discretionary goods: as a consequence, May inflation came in at zero, month on month.

This didn't happen: May retail sales (headline, just out), were a sluggish 0.1 % month on month, and the previous month's figure was revised downwards.

As we have pointed out in the past, low-income consumers continue to feel under strain. The mid-June University of Michigan survey showed a further deterioration in sentiment among low, and middle, income consumers, whose salaries didn't keep pace with the higher prices of every-day items.

As we pointed out in the past, low-income consumers account for only about 30 % of total household spending, so a pullback in spending by this group will not significantly affect aggregate spending. As previously commented, it is however an issue for Biden's re-election.

The US labor market gave weaker, but also contrasting, figures:

- Job openings are quickly returning to pre-pandemic levels.

- Small business hiring plans, (small business represents 70 % of the total jobs), are below pre-pandemic levels.
- The Quits rate, an indicator of how often a worker changes jobs, is below pre-pandemic levels.
- The unemployment rate increased to 4 %, while the participation rate dropped to 62.5 %.
- Continuing jobless claims have been rising.
- At the same time the creation of new jobs, as measured by non-farm payrolls, has been quite strong all along, including last month.

As pointed out by some colleagues at Goldman Sachs and Morgan Stanley, amongst others, the main reason for such a discrepancy between job creation and weak employment numbers is likely to be immigration, both legal and illegal. These people get absorbed by the job market without worsening significantly the main employment headlines. If this is the case, we could be at a tipping point: as Goldman says 'any further softness in demand for workers will hit jobs, not just job openings.'

If this is the case, the job market could then deteriorate quite quickly, just ahead of the election.

From there the market's attitude could also change: until recently, bad economic news was good news for financial markets. The rationale was that with bad news, it meant the central bank was successfully managing to slow down a red-hot economy, and thus could start cutting rates.

We already know we have a 'virtual rate cut' in June: the US Federal Reserve will start, more significantly than anticipated, the tapering of its Quantitative Tightening (slower reduction of its balance sheet with sales of bonds).

If the deceleration in the US economy continues, and, as we suspect, the labor market deteriorates markedly, a single rate cut in December for 2024, as indicated by the 'dot plot' from the latest FOMC meeting, will be too late. The US central bank will be, 'as usual', behind the curve. We therefore think that the central bank will cut twice, with the first cut slated for September.

Europe Economy

The Eurozone economy is improving. The final print for the Q1 GDP was confirmed at a non-annualized +0.3 %. The region is benefiting from the global upturn of cyclical activity, as the global technology and goods cycle is leading the trade recovery. This is especially supportive for European (and Asian) exporters.

The services sector is still expanding and leading GDP growth, further sustained by the swarm of tourists that have been invading the continent. However, the latest data indicate that the manufacturing sector bottomed out in Q3-Q4 of last year and is consistently improving.

We said in the past that we needed the consumer to come back and spend at least some of those extra pandemic savings: indicators of the propensity to consume and a supportive wage outlook, make us confident that they will be back soon.

As the disinflation process continues at a better pace than in the US, the European Central Bank was able to deliver a much-expected rate cut. We now expect that the ECB will deliver two more cuts this year, one in September, and the next one thereafter likely in December.

All of this is clearly positive for the Eurozone economy, pushing up traditionally lagging indicators in Germany. While they are still negative, the overall economy, such as the asset managers' ZEW survey or the IFO business managers' survey, is up from the recessionary levels at the beginning of the year.

China: is Quantitative Easing Coming?

China has had a difficult couple of years, between its ongoing real estate crisis and disappointing economic growth post its exit from its Zero Covid Policy.

Recently though, there has been better economic news, with the government actively buying equities and new regulatory measures in place, designed to strengthen China's capital markets. These have lifted the market from its depths.

On top of the recent steps announced to stabilize the property sector, one new instrument could be implemented: QE, the Chinese way.

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The PBOC could start conducting limited, targeted QE through its participation in a program that is now taking shape, under which, the PBOC will help finance state purchases of unsold homes to stabilize the property sector. This is something we have witnessed already after the market crash in the Summer of 2015, when the PBOC helped to finance shanty town renovations. The result was an expansion of its balance sheet.

For the next leg higher, the equity market will need an improvement in companies' earnings: industrial profits are still negative year on year but are recovering. As for policy delivery, we need the effective implementation of the policy easing regarding the housing market.

It is an Election Year, After All

As we pointed out in our 2024 outlook, this year it is the mother of all election years, bringing risks with it.

4 years ago, in the middle of the pandemic, Europe launched the first of its 'next' generation' EU funds, in a key moment of financial solidarity: for the first time ever it included fiscal transfers between EU states.

Last week, after the large gains for France's Rassemblement National party and for other Eurosceptic parties, future solidarity was thrown into doubt.

Following the surprise announcement by President Macron to call a snap parliamentary election for the end of June, early July, it triggered a market reaction, reflecting that fear, with the spread between the German Bund and the French OAT rising to a 5-year high, which in turn dragged Italian and Spanish spreads along with it. The domestic CAC index lost over 6 % for the week, and the Euro lost 1 % against the dollar.

French bank stocks were particularly badly hit, along with infrastructure stocks. We do understand the fears surrounding toll-road operators, as the Le Pen manifesto, during the 2022 election, spoke about nationalizing highways, but we understand less the sell-off, for example, in Europe's industrial 'launderette' Elis, which dropped 10 % over the week.

Concerning toll-road operators, according to many analysts, the French highways operations are already valued at zero, so even if Le Pen is in the position to do so, and proceeds to nationalize them, at current prices they are a bargain.

Even in the event of a supermajority of her party and affiliates in a couple of weeks' time, we doubt she will proceed with such radical decisions: she will likely 'realign' herself with Italy's Meloni. The market nevertheless is likely to stay nervous until the elections are over.

Whilst elections in India and Mexico delivered their dose of turmoil, due to their markets' size, in investments terms, they are of very marginal importance to global portfolios.

Where we are growing more wary is the US.

The likelihood that, in November, Trump manages a 'clean sweep', taking over the Presidency and both Houses, rose over the last couple of weeks.

In having unchecked political freedom, he will likely increase spending and cut taxes. Just think about his 2017 tax cuts and Jobs act: we could have a new version of them which could be much larger. As a minimum, in the short term, the result could be devastating for bonds: they will start to price a much higher level of fiscal profligacy, potentially sending 10-year yields back above 5 %, (currently they are at 4.2 %). The effects on a slowing economy will be much worse than in 2016, as back then yields were only 2.5 %, (they shot up 80 bps after the election).

A slowing economy with higher borrowing costs is a toxic cocktail: US Equities are unlikely to emerge unscathed and we would expect them at first to drop sharply, then recover in early 2025.

We have therefore decided to invest in a partial hedge on US equities, which matures at the end of the year.

Positioning

We continue to have a constructive view for the 'Balanced Portfolio' for the next 3 to 6 months. Bar an accident, we believe high nominal growth, peak rates and broadening earnings performance will continue to underpin equity market performance.

As noted above, we invested in a low delta protective put on US equities, which matures in December.

In terms of risk, we continue to focus on where the potential ones are to our positioning, and that we can, at least in part, control:

- Peak in companies' earnings due to margin compression.
- Lower capital expenditures in Artificial Intelligence, which has been a leading theme since last year, in many sectors outside of pure technology.
- A worsening of the global economic situation, with the biggest risk coming from China, (although the IMF just upgraded the world's GDP for 2024).
- A failure of the disinflationary trend to continue.

Strategy

During the month we didn't perform any asset allocation changes.

Equity

We keep an overweight in Eurozone equities versus the US broader market

We also keep an overweight in Japanese shares. Again, on top of its economy where policies are aimed at lifting the country from decades of deflation, for the first time in history, the government and the stock exchange are taking initiatives that are extremely shareholder friendly.

Fixed income

We continue to favor exposure to credit versus duration. We have exposure to investment grade credit, European high yield, hybrids, financials' subordinated debt, US municipal infrastructure and Asian hard currency debt.

Gold

We continue to keep our allocation to Gold at about 5 %: while it doesn't provide any yield, it continues to be a good diversifier in a multi-asset portfolio.

Conclusion

The backdrop of higher economic growth revisions and continuing disinflationary trends is supportive for equity markets, fixed income, and thus a balanced portfolio.

Positioning

Overall Exposure

We are now Neutral Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged.

Equity: Neutral

We have a very sizeable Overweight to the Eurozone and a very sizeable Underweight in US equities, Slight Underweight US technology, Overweight Nasdaq 100 equal weight, Neutral UK, Overweight Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Champions.

Fixed Income: Neutral

Long 1 to 3 years US Treasury Notes. Long 20+ years US Treasuries.

Thematic Fixed Income

Overweight High Yield in EUR and Underweight in USD. Overweight Investment Grade EUR and USD Bonds, Underweight Sovereigns. Long US Municipal Infrastructure Bonds, Long Hybrids, Long Subordinated Financial Credit & Long Asian Bonds in hard currency.

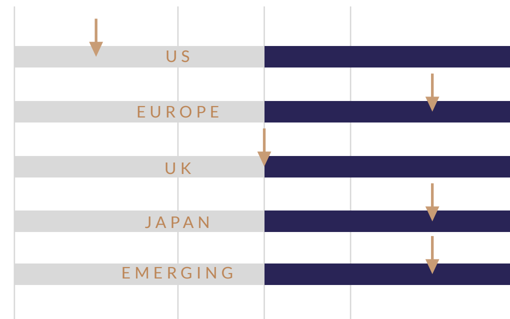
Currencies: Portfolios have a 5 % USD exposure.

Commodities: Overweight

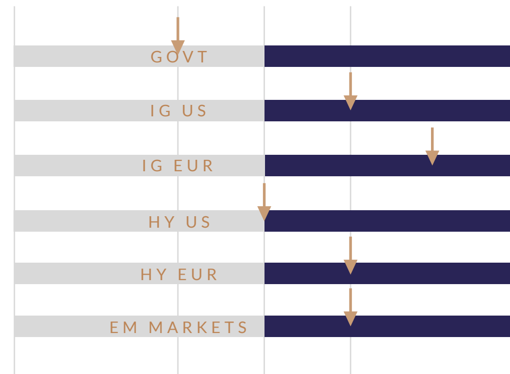
Long Gold.

Conviction thermometer

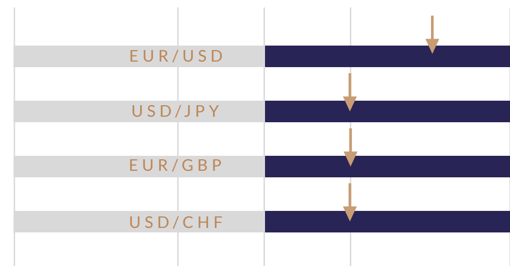
Equities



Bonds



Currencies



Commodities

Negative view   Positive view

Market overview as of 31st May 2024

Equities (local ccies)	Level	5D	MTD	YTD	2023
MSCI WORLD	3 445,17	-0,45%	4,53%	9,77%	24,44%
US S&P500	5 277,51	-0,49%	4,96%	11,30%	26,26%
NASDAQ 100	18 536,65	-1,43%	6,39%	10,54%	55,13%
RUSSELL 2000	2 070,13	0,04%	5,01%	2,68%	16,88%
EUROPE EURO STOXX 50	4 983,67	-0,90%	2,42%	13,09%	23,21%
GERMANY DAX	18 497,94	-1,05%	3,16%	10,42%	20,31%
FRANCE CAC40	7 992,87	-0,91%	1,57%	8,61%	20,10%
BELGIUM BEL20	3 918,09	-1,06%	2,46%	7,92%	3,51%
SWISS MARKET INDEX	12 000,86	0,58%	6,95%	11,08%	7,06%
UK FTSE100	8 275,38	-0,48%	2,03%	8,98%	7,68%
JAPAN TOPIX	2 772,49	1,10%	1,07%	18,40%	28,28%
MSCI EMERGING	1 048,96	-3,09%	0,59%	3,50%	10,20%
BRAZIL IBOVESPA	122 098	-1,78%	-3,04%	-9,01%	22,28%
CHINA CSI 300	3 579,92	-0,55%	-0,45%	4,70%	-9,14%
HS TECH	3 690,76	-2,85%	-0,17%	-1,54%	-8,25%
INDIA SENSEX	73 961,31	-1,81%	-0,29%	2,98%	20,34%
KOREA KOSPI	2 636,52	-1,90%	-2,06%	0,06%	20,52%
HONG KONG HANG SENG	18 079,61	-2,61%	2,54%	7,40%	-10,46%
AUSTRALIA ALL-SHARE	4 517,08	-0,42%	2,37%	8,64%	7,70%
SAUDI ARABIA TADAWUL	N.A.	-4,07%	-6,60%	-2,47%	18,10%

US: Sectors	Level	5D	MTD	YTD	2023
COMMUNICATION SVCS	296,23	-0,59%	6,58%	20,88%	55,80%
CONSUMER DISCRETIONARY	1 423,51	-0,26%	0,30%	0,73%	42,30%
CONSUMER STAPLES	824,23	0,11%	2,45%	9,18%	0,52%
ENERGY	708,04	2,04%	-0,39%	12,38%	-1,42%
FINANCIALS	691,28	0,08%	3,16%	11,15%	12,10%
HEALTH CARE	1 670,88	-0,58%	2,38%	5,78%	2,06%
INDUSTRIALS	1 042,88	-0,81%	1,65%	8,77%	18,08%
INFORMATION TECHNOLOGY	3 972,21	-1,45%	10,08%	17,31%	57,84%
MATERIALS	575,27	0,15%	3,22%	7,30%	12,55%
REAL ESTATE	238,00	1,82%	5,08%	-4,37%	12,35%
UTILITIES	367,47	1,69%	8,97%	15,82%	-7,08%

EUROPE: Sectors	Level	5D	MTD	YTD	2023
BASIC MATERIALS	3 090,39	-0,77%	1,47%	5,31%	5,95%
CONSUMER GOODS	3 890,81	0,33%	2,16%	1,41%	-2,46%
CONSUMER SERVICES	1 606,60	-0,76%	1,13%	8,51%	21,53%
FINANCIALS	1 026,71	0,41%	6,29%	18,90%	25,42%
HEALTH CARE	3 892,48	0,07%	2,85%	12,81%	8,75%
INDUSTRIALS	4 089,91	-1,07%	4,44%	12,80%	27,43%
OIL & GAS	1 618,76	0,95%	-0,97%	8,85%	9,01%
TECHNOLOGY	1 967,35	-3,50%	3,41%	16,02%	34,72%
TELECOMS	548,16	1,87%	5,90%	6,92%	8,86%
UTILITIES	2 008,07	0,76%	4,62%	0,25%	14,75%

Market overview as of 31st May 2024

Fixed Income	Level	5D	MTD	YTD	2023
Pan-Euro 3-5 yrs IG	203,87	0,02%	0,34%	-0,83%	6,68%
Euro Aggregate	233,83	-0,24%	0,04%	-1,55%	7,19%
Pan-Euro HY Hedged Eur	429,00	0,10%	0,98%	2,53%	12,32%
Global Inflation hedged EUR	233,60	0,11%	1,16%	-1,77%	2,02%
US Corp High Yield	2 264,90	-0,01%	1,10%	1,63%	13,45%
EM USD Aggregate TR	1 260,87	0,05%	1,72%	1,58%	9,09%
EM Aggregate TR Local Ccy	143,97	-0,43%	0,83%	-1,61%	6,91%
EUR Banks CoCo Tier 1	150,37	-0,11%	1,93%	4,58%	5,04%
EU GOVT HEDGED EUR	206,95	-0,31%	0,05%	-2,58%	6,31%
Global Aggregate	2 554,99	-0,08%	1,31%	-3,30%	5,72%

Commodities	Level	5D	MTD	YTD	2023
GOLD	2 327,33	-0,28%	1,80%	12,81%	13,10%
COPPER	460,20	-3,69%	0,82%	18,29%	2,10%
OIL WTI	76,99	-0,94%	-6,03%	7,45%	-10,73%
OIL BRENT	81,62	-0,61%	-7,10%	5,94%	-10,32%

Currencies	Rate	5D	MTD	YTD	2023
EURUSD	1,0848	0,01%	1,71%	-1,73%	3,12%
GBPUSD	1,2742	0,04%	2,00%	0,09%	5,36%
USDJPY	157,3100	0,20%	-0,31%	11,54%	7,57%
USDCHF	0,9023	-1,36%	-1,86%	7,24%	-8,99%
AUDUSD	0,6653	0,38%	2,78%	-2,33%	-0,01%
EURCHF	0,9789	-1,35%	-0,18%	5,39%	-6,13%
USDCNY	7,2980	-0,02%	0,79%	2,79%	2,92%
USDKRW	1 382,10	-1.14%	2,58%	3,86%	1,79%
USDINR	83,4650	0,44%	0,03%	0,31%	0,57%
USDIDR	16 250,00	N.A.	-0,06%	5,54%	-1,10%
USDBRL	4,8572	-0.08%	-1,27%	-7,55%	-8,01%
USDTRY	32,2480	0,06%	-0,54%	9,21%	57,82%
BITCOIN	67 630,41	-1,77%	12,96%	61,27%	152,94%

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