Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio

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Market Review

The release of Nvidia's earnings on February 21st was such a climactic event that in the preceding hours Goldman Sachs called the graphics chip giant the "the most important stock on planet earth". In fact, the anticipation was so high that options positioning was implying about a 11% move in either direction for the stock, with the potential to take the entire US equity market higher or lower with it. Nvidia did indeed "save" the broader market by delivering another blowout earnings report which saw revenues and net income rising by +265% and +769% YoY respectively. The stock rallied +16.40% on February 22nd, adding the largest valuation in a single day of any company, at 272 Bil USD. One day later, it joined Apple and Microsoft in the exclusive 2 trillion USD market cap club, the third company ever to pass that financial milestone. To put numbers in context, in October 2022, at the lows of the market, the company was worth 280 Bil USD.

Nvidia remains front and centre in a developing "Artificial Intelligence (AI) Mania". According to the Wall Street Journal (WSJ), in February alone traders spent 20+ Bil USD per week in options premium in the name. The GraniteShares 2x Long NVDA Daily, an ETF that provides investors with 200% of the daily performance of the stock, has seen its assets swell from 200 mil USD to 1 Bil USD since the beginning of the year. However, the frenzy has recently widened to other semiconductor names, as Super Micro Computer Inc. (SMCI) has become Wall Street's second most popular stock and has seen its valuation triple from 16 Bil USD to 48 Bil USD in just 2 months. At the end of February, the stock had reached the largest weight a company has ever had in the Russell 2000 index at 1.6% (from 0.52% at the end of December 2023), becoming eligible for inclusion in the S&P 500 at the next rebalancing of the benchmark on March 18th. The Asia Pacific region, which accounts for more than 90% of global semiconductor foundry revenues and 60% of global semiconductor sales, finally got a piece of the action during the month. Taiwan Semiconductor Manufacturing Company (TSMC), which holds a global near-monopoly on supplying the most advanced 5nm and 3nm chips, rallied to its highest level since January 2022, while in South Korea SK Hynix, the world's second-largest maker of memory chips, exploded to its highest level since December 2000.

According to the Semiconductor Industry Association (SIA), global semiconductor sales equalled 526.8 Bil USD in 2023, a decline of -8.2% compared to the industry's highest-ever annual total of 574.1 Bil USD recorded in 2022. They are forecast to increase at a compound annual growth rate (CAGR) of 7-8% in the next decade, comfortably surpassing 1 Trillion USD sometime between 2031 and 2033. However, in February two prominent technology titans made headlines as they called for a turbocharge and a "reshape" of this strategic sector. According to another article published by the WSJ, Sam Altman, the CEO of OpenAI, "is in talks with investors including the United Arab Emirates government to raise funds for a wildly ambitious tech initiative that would boost the world's chip-building capacity and expand its ability to power AI", a project that could require "as much as 5 Trillion to 7 Trillion USD". For his part, Masayoshi Son, the CEO of Softbank, which already owns 90% of the chip designer Arm, sent the stock of his company flying when he announced that he is looking to raise up to 100 Bil USD to build a chip venture that will rival Nvidia. Softbank would invest 30 Bil USD of its own money and source the other 70 Bil USD from Middle Eastern institutions to fund the new project dedicated to supplying semiconductors essential for AI.

The excitement about AI and how it will transform the global economy captured investors' imagination in February, overshadowing the astonishing comeback of the previous market darling, that is, blockchain. Powered by institutional inflows into ETFs newly launched by Fidelity, iShares (Blackrock) and Franklin Templeton, and by the countdown to the "halving" expected to happen on April 17th, Bitcoin jumped +39.44% in February, breaking past the 60,000 level for the first time since October 2021. Ethereum, the second largest cryptocurrency in terms of market cap, recorded its 9th best month ever, rising +44.15% breaking above the 3,000 mark for the first time since March 2022. According to data provided by the largest crypto exchanges, activity among retail traders has increased substantially, but not nearly to the extent of the last bull market experienced by digital assets back in 2021.

International Equities

US equities extended their winning streak to four consecutive months in February, as the Dow Jones Industrial (+2.22% in USD terms), the S&P 500 (+5.17%) and the Nasdaq 100 (+5.29%) all hit new all-time highs. Mega cap growth outperformed the general index despite the so-called "Magnificent Seven" group of tech stocks continuing to act more like "Magnificent Four", that is Microsoft, Nvidia, Meta (Facebook) and Amazon. Despite rebounding in February, Tesla remains one of the worst performers within the S&P 500 in 2024 due to cooling electric vehicles (EV) demand and mounting competition. Apple declined for a second month in a row on the back of a deepening slump in its China business. Alphabet (Google) bucked the trend after announcing that it was pausing the AI image generation feature of Gemini, its most advanced AI model launched at the end of December 2023. Users on social media had been complaining that the tool generates "historical" and "inaccurate" figures, for example the US Founding Fathers as people of colour, forcing the company to intervene to address the issue. The tech giant shed 80 Bil USD in market cap during the month owing to that error. Consumer discretionary, industrials and materials topped the list, while utilities, consumer staples and real estate lagged. The Philadelphia Stock Exchange Semiconductor Index posted double-digit gains for the third month out of the last four. The Russell 2000, the popular benchmark for smaller companies, outperformed the Russell 1000, while the S&P 500 High Beta TR bested the S&P 500 Low Volatility TR. REITs and regional banks continued to weigh on the S&P 500 High Dividend Index TR and the S&P 500 Equal Weight Index (+3.96%). US equities outperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) by the largest amount since May 2023. However, Asia ex. Japan was the best performing region, buoyed by South Korea, Taiwan and a resurgence in the Chinese stock market. On February 7th, China's Cabinet appointed markets veteran Wu Qing, the former chairman of the Shanghai Stock Exchange (SSE), to head the China Securities Regulatory Commission (CRSC), the main regulator of the securities industry. A few weeks later, the China Financial Futures Exchange (CFFEX) moved to tighten its scrutiny of high-frequency trading (HFT) and curb the activities of quant funds, deemed responsible for magnifying the drastic losses suffered by the market during the first weeks of the year. In Europe, the STOXX Europe Luxury 10 EUR TR which includes, among others, LVMH and Ferrari, recorded its 5th best month ever. Japan continued its relentless ascent higher powered by semiconductor-related stocks, with the Nikkei 225 breaking past the 40,000 mark for the first time ever and hitting new all-time highs after a 34-year wait. All in all, the MSCI AC World Daily TR was up +4.29% in USD terms and +5.91% in AUD terms.

Australian Equities

Australian equities could not keep up with their international peers in February, with the S&P/ASX 300 rising by a more modest +0.98%. Energy was the worst performing sector despite rising oil prices as Woodside Energy and Santos ended merger talks. Miners posted steep losses on the back of declining iron ore and copper prices. Healthcare dropped after index heavyweight CSL announced that the trial of its CSL112 drug failed to hit its primary endpoint. Technology and consumer discretionary topped the list on the back of strong results, with the so-called "WAAAX" group of stocks staging a comeback and recording its 5th best month ever. Mid-caps strongly outperformed smaller companies and the Top 20, with the latter group ending the month in the red. Finally, the MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR by the most since March 2020.

International Fixed Income

Every major global central bank that met in February left interest rates unchanged for the third consecutive month. Those include the Riskbank, Sweden's central bank, the Reserve Bank of New Zealand (RBNZ) and the Bank of England (BOE). Chairman Powell appeared on the CBS News show 60 Minutes on February 4th. During the (rare) interview, he confirmed that the FED is looking "to begin to reduce interest rates carefully", but that it "wants to see more evidence that inflation is moving sustainably down to 2%". He also took the possibility of a rate cut in March off the table by stating that it is "not likely" that the committee will reach the level of confidence required to cut in time for the next FOMC meeting. Only 2 of the 13 central banks across major emerging market economies that met during the month cut rates. Hungary and Czech Republic extended their easing cycle, while Poland, Indonesia, India, South Korea and Mexico all kept rates unchanged. For the first time in more than three years, no major emerging market central banks hiked. Global government bond yields rose sharply during the month, while spread in riskier credits, corporate high yield and emerging markets in particular, continued to tighten despite a deluge of new supply. The Bloomberg Barclays Global Aggregate Index hedged back to AUD was down -0.80% for the month.

Australian Fixed Income

On February 6th, the RBA held the cash rate at 4.35% and signalled that additional hikes "cannot be ruled out". In the accompanying statement, Governor Bullock admitted that "the economic outlook is uncertain" and that "while recent data indicates that inflation is easing, it remains high". However, the ABS monthly measure of consumer price inflation held steady in January at +3.4% YoY, positively surprising economists who were projecting an acceleration to +3.6% YoY. The cash futures moved to push out to September (from June) the first cut. The Australian yield curve transposed higher, with the 2, 5 and 10 year yields adding 12 Bps, 14 Bps and 12 Bps to 3.80%, 3.75% and 4.13% respectively. The Bloomberg AusBond Composite 0+ Yr was down -0.30% for the month, while the Australian Dollar softened vis-à-vis the US Dollar, ending January below 65 cents.

Global Property

Global property was down -0.63% in USD terms but up +0.91% in AUD terms in February. Australia was the best performing region, driven higher by Goodman Group, which rose double-digits on the back of the strong demands for its industrial properties, data centres in particular. Hong Kong outperformed the general index following the government's decision to lift certain stamp duty measures. Conversely, Europe lagged on deteriorating economic prospects.

Global Infrastructure

Global infrastructure was almost unchanged in USD terms (-0.11%), but positive in AUD terms (+1.45%) for the month. Telecom infrastructure and European renewables continued to exhibit weakness, while US electric utilities and railroads outperformed owing to a resilient macroeconomic environment.

Alternatives

Alternatives (+0.84%) rose for the fourth consecutive month in February, a feat last achieved by the group between April and July 2020. Returns were mostly positive across all strategic mandates, with Long/Short equities managers and CTA and managed futures leading the pack.

Market Outlook

The FED's dual mandate is to promote the goals of "maximum employment" and "stable prices", which in plain English means fostering economic growth while containing inflation. However, the central bank has (unofficially) added a third objective to its monetary policy in the wake of the 2007-2008 global financial crisis (GFC), that is, ensuring "financial stability". In an ideal world, the FED would look to achieve all three all the time but in reality exogenous factors constantly affect its reaction function, forcing it to prioritize a specific goal in certain circumstances. That was certainly the case in 2022 when surging inflation spooked the FED, prompting it to embark on its most aggressive tightening cycle in decades by simultaneously hiking rates and shrinking its balance sheet. "Financial stability" and "growth" took a backseat, with Chairman Powell going as far as declaring in August of that year that he was ready to bring "some pain to households and businesses", that is, a recession, to return to price stability. Financial assets took a beating, with equities and government bonds falling simultaneously for the first time in more than 40 years. Even property prices cooled off as the S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index declined -6.17% in H2-22. The so-called "wealth effect" turned negative and the highly financialized US economy contracted for two consecutive quarters from January to June. Then, in March 2023 three regional banks in US (Silvergate, Silicon Valley Bank, Signature Bank) and one global systemically important bank (G-SIB) in Switzerland (Credit Suisse) went under and the FED became concerned about "financial stability". As a result, it launched a new facility, the Bank Term Funding Program (BTFP), to provide liquidity to entities in need and prevent a full blown banking crisis from happening. Bank reserves, which had been declining for a year on the back of Quantitative Tightening (QT), started to rise again. In the end, the crisis was avoided, the much feared credit crunch did not materialize and the newly injected liquidity contributed to the torrid rise of the stock market, while US GDP growth boomed +1.2% QoQ in Q3-23.

However, US CPI troughed at +3% in June and started to move sideways, prompting the FED to shift its focus back to the "last leg" of the inflation fight and to adopt the "higher for longer" narrative. At the September FOMC meeting, the central bank announced that it was not done yet via the release of the Dot Plot, which projected one more hike before the end of the year and only 50 Bps of cuts in 2024. Government bond markets sold off sharply, with the US 10 year yield reaching 5% for the first time since July 2007, and the rout in fixed income dragged US stocks lower. At that point, the US Treasury became concerned about "financial stability", realizing that a supply and demand imbalance has developed in the Treasury markets, with investors unwilling to absorb the issuance of "coupons", that is, longer dated bonds, required to finance the massive fiscal largesse resulting from "Bidenomics". Consequently, US Treasury Secretary Yellen decided to flood the market with a deluge of short term bills to openly entice their purchase by money market funds (MMFs). Her plan succeeded. Interest rates made a U-turn, dropping 100 Bps in the space of two months, and the FED pivoted dovish with the stated intent of engineering a "soft landing". In other words, the central bank shifted its focus once again, this time from "inflation" to "growth", though it could be argued that, unofficially, its sudden change of heart was not spontaneous, but rather necessary to ratify the "financial stability" that ensued from the US Treasury intervention. Whatever the explanation, the decision reignited the "animal spirits", pushing US equities to new all-time highs. Not surprisingly, at the end of last year, US household net worth rose to 156.2 Trillion USD, above its previous peak reached in June 2023, and up +8.01% for the calendar year. While boomers are cashed up with stocks and properties, millennials have recently benefited from skyrocketing crypto currency prices, and both generations are eager to spend their gains on increased consumption. On top of that, the US government is refusing to turn off the spending tap during an election year, continuing to run a budget deficit equal to -6.5% of GDP.

The gist of the above excursus is that, in the past 12 months, every single time the FED has shifted its priority from "inflation" to "financial stability" or to "growth", it has (inadvertently) induced a massive wealth effect. As pointed out by an astute market commentator, the FED has de facto tightened "financing" conditions, that is, it has made more difficult and more expensive for borrowers to obtain or renew a loan. However, "financial" conditions have remained extremely loose on the back of rich asset valuations, burgeoning government outlays and sustained wage growth (+5% YoY according to the latest data published by the Atlanta FED). And because the current economic cycle has been primarily driven by income growth rather than credit growth, the positives of the wealth effect have always trumped the negatives of higher interest rates, preventing the US economy from entering a recession and inflation to soften to the 2% target. While the Rest of the World (RoW) has gone through some sort of economic adjustment in 2023 via slowdown, stagnation or "technical" recession, the US economy has uniquely remained in the so-called "late cycle" phase for an extended period of time.

The US unemployment has finally ticked up, increasing to 3.9% in February, its highest level since January 2022. That provides the FED with the cover to cut rates at the opportune time, as the disinflation impulse had been fading in recent months. In fact, the central bank has made it clear that it will cut rates "well before" the rate of inflation reaches 2% to secure the "soft landing". Thus, we continue to think that the FED will not be deterred from cutting interest rates in 2024. However, economic activity in the RoW is picking up, contributing to a revival in commodity prices, while in US the wealth effect and the fiscal impulse are alive and kicking. For those reasons, it is plausible that the easing cycle starts at a later date (currently futures markets see the first cut to be delivered at the FOMC meeting scheduled for July 30-31 with a 77.50% probability) and/or that it is conducted at a slower pace once initiated. Government bond markets may react quite negatively in such a scenario, and experience bouts of weakness.

Ultimately, our intention is to continue to accumulate duration, and more so if the FED finds itself constrained in its ability to loosen its monetary stance exactly at a time the economy is cracking and needs support. In fact, the central bank could potentially cut more than what is currently priced in when all things are said and done, but bond investors may have to go through a period of volatility in the meantime. For that reason, we will continue to normalize the duration of our portfolios after having been underweight for the past two years, favouring active managers to attain a fixed income exposure characterized by a duration comparable to that of the benchmark in aggregate, but tilted towards specific parts of the curve. Despite an almost universally bullish consensus on bonds, fixed income has underperformed equity since the beginning of the year, and we expect this dynamic to persist in the first half of 2024. Stock markets appear to be consolidating their gains after having gone almost vertical in the past 4 months, potentially presaging a broadening of the rally from mega caps growth to the biggest laggards of 2023, primarily emerging markets and interest rates sensitive sectors. Valuations and long positioning in US equities remain extreme, but the so-called "FED put" is operative again, and that should cushion any potential drawdown should volatility pick up going into spring. Finally, we maintain a positive stance on real assets and we will continue to add to our exposure in global infrastructure and/or global property, subject to the various risk constraints of each single model portfolio.

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E: invest@azsestante.com | www.azsestante.com

Important information

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ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.

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