Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio

As of 31/03/2024

Market Review

The UBS Magnificent 7 Index was up +75.71% in USD terms in 2023, while the S&P 500 Ex. Magnificent 7 Index, which tracks the performance of the remaining 493 stocks, rose a more modest +12.30%. The outperformance has persisted in Q1-24, but the gap has narrowed significantly (+13.42% Vs +8.88%). Nvidia, Meta (Facebook), Amazon and Microsoft have continued to propel the group higher, whereas Alphabet (Google) has posted gains inferior to that of the general index and Apple and Tesla have slumped, down -10.93% and -29.25% in USD terms respectively. As a result, according to a number of market strategists, the "Magnificent Seven" have shrunk to the "Fab Four". This is not the first time that it happens. A handful of "Big Tech" companies have dominated stock market returns for more than a decade, leading to increasing equity index concentration, however, the composition of the specific Wall Street label du jour has changed over time.

During an episode of "Mad Money" aired on CNBC on 5th February 2013, Jim Cramer uttered for the first time the acronym "FANG", which stands for Facebook, Amazon, Netflix and Google. The term, coined by Bob Lang, a regular contributor to the financial news TheStreet, became immensely popular and, according to its creator, "changed the way people look at stocks and investing as a whole". At that time, the concentration of the S&P 500 was at multi-year lows. The weight of the 10 largest stocks accounted for 18% of the index, down from the peak of 27% recorded in 2000, and Google had just broken through the upper echelon. The group of high-flying stocks was expanded by Jim Cramer in 2017 to include Apple and became known as "FAANG". In September of the same year, the Intercontinental Exchange, Inc. (ICE), the parent company of the New York Stock Exchange (NYSE), launched the "FANG+" future to provide exposure to a group of 10, equally-weighted, "highly-traded growth stocks of technology and tech-enabled companies", namely the 5 FAANG plus Tesla, Nvidia, Alibaba, Baidu and Twitter. The new acronym failed to capture investors' attention, but the FANG+ future still trades today, with the latest three stocks having been replaced by Microsoft, Broadcom and Snowflake. Also, being better suited for replication given its higher diversification, it led to the launch of few passive products around the world.

The FAANG continued to go from strength to strength, trouncing the rest of the market even during the sudden crash that occurred between February and April 2020 on the back of the COVID-19 pandemic. In the meantime, the concentration of the S&P 500 breached above the highs recorded in 2000, exploding from 24.8% at the end of 2019 to 31.6% at the end of June 2020. During the second half of that year, the group underwent a reshuffle, with Microsoft replacing Netflix, and a rebranding, as it became known as the "Fab Five". Eventually, the concentration of the S&P 500 peaked, together with the value of the index itself, in November 2021 at 32.4%. US equities fell hard in 2022, and the "Fab Five" dropped more than -40%, underperforming the major averages. However, in 2023 they got their mojo back and, with the addition of Tesla and Nvidia, became known as the "Magnificent Seven", before downsizing to "Fab Four" in Q1 2024. At the end of March, the latter group (4 stocks) accounted for 18.51% of the S&P 500, the former group (7 stocks) for 29.07% and the 10 largest stocks (which also include Berkshire Hathaway, Eli Lilly and Broadcom) for 32.48%. However, the concentration was even more extreme for the Nasdaq 100, with the "Fab Four" accounting for 25.37% of the index, the "Magnificent Seven" for 40.10% and the 10 largest stocks (which include Broadcom and Costco) for 46.97%.

As pointed out by several analysts, elevated market concentration is not a sign of downside risk per se, but it has to be examined in conjunction with the macroeconomic outlook. Historically, peak concentration has tended to mark the peak of a bull market when it has manifested during or ahead of a recession. Conversely, stocks have continued to rally sustainably at times of an economic recovery/acceleration. That said, the movements of a few heavyweights can have a disproportionate effect on the relative performance of various equity benchmarks, even major ones, in the short term. Such was the case in Q1 2024 with Apple and Tesla, whose negative returns weighed on the Nasdaq 100, causing it to underperform the S&P 500 during a positive quarter for the first time since Q1 2021. That is a rare event, only occurring in 14 instances out of 156 in the past 40 years.

International Equities

US equities extended their winning streak to five consecutive months in March, as the Dow Jones Industrial (+2.08% in USD terms), the S&P 500 (+3.10%) and the Nasdaq 100 (+1.17%) all hit new all-time highs. Mega cap growth underperformed the general index as Nvidia rose double-digits for the third month in a row and Alphabet (Google) caught a bid after a lacklustre start of the year, while the rest of the "Magnificent Seven" group of tech stocks underperformed the index (Amazon, Microsoft) or ended the month in the red (Apple, Meta (Facebook) and Tesla). Energy was the best performing sector, followed by utilities, materials, financials and consumer staples, while consumer discretionary, technology and real estate lagged. The Russell 2000, the popular benchmark for smaller companies, outperformed the Russell 1000. Similarly, the Nasdaq Next Generation 100, which tracks the performance of the largest 100 Nasdaq-listed companies outside of the Nasdaq 100, beat the latter for the second month in a row. The S&P 500 High Beta TR bested the S&P 500 Low Volatility TR while a rebound in regional banks and REITs lifted the S&P 500 High Dividend Index TR and the S&P 500 Equal Weight Index (+4.25%). At the end of March, the S&P 500 was up more than +20% in the space of just 5 months, a feat it last achieved between April and August 2020, and before that between March and July 2009, that is, at times of economic expansion subsequent to a cycle through. US equities performed in line with the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index). Europe was the best performing region on the back of improving business activity and continued progress on disinflation. Foreign investors lured by improving corporate earnings and a weakening Japanese Yen (JPY) continued to pile into Japan, driving the Nikkei 225 to another new all-time high. On March 15th, the country's largest union group announced the results of the so-called "shunto", the annual pay negotiations. Japan's largest companies agreed to raise wages by a stronger-than-expected +5.28% for 2024, the steepest increase since 1991. The hike should bring real wages growth into positive territory in Q2-24 and follows 24 consecutive months of decline. Emerging markets underperformed their developed peers as caution on the outlook for the Chinese economy returned, India consolidated its recent gains and Brazil fell. On the positive side, Taiwan and South Korea continued to benefit from renewed interest in artificial intelligence (AI) and battery stocks. All in all, the MSCI AC World Daily TR was up +3.14% in USD terms and +2.72% in AUD terms.

Australian Equities

Australian equities rallied smartly in the second half of March, ending the month with strong gains. The S&P/ASX 300 was up +3.26%, led higher by A-REITs, energy, insurance, utilities and materials. All sectors except telecommunication services ended the month in the black. Resources rose on the back of further increases in the price of oil (+6.27% in USD terms), copper (+4.50%) and gold (+9%, its best month since July 2020), which broke to new all-time highs. Conversely, lithium and iron ore remained under pressure, with the latter metal declining for the third month in a row. Consumer discretionary ended the quarter on a low note as they consolidated the strong returns generated in January and February. Mid-caps and smaller companies outperformed the Top 20, while value stocks bested growth stocks.

International Fixed Income

Six of the eight major global central banks that met during the month left interest rates unchanged. Those include the Bank of Canada (BOC), the European Central Bank (ECB), the FED, the Bank of England (BOE), the Norges Bank, Norway's central bank and the Riskbank, Sweden's central bank. On March 19th, the Bank of Japan (BOJ) hiked rates for the first time in 17 years, becoming the last major monetary authority to abandon a negative interest rates policy (NIRP) it first implemented back in 2016. The central bank increased the overnight lending rates to a range of 0-0.1%, from the previous band between -0.1% and 0%. In addition, it discontinued its yield curve control (YCC) policy, while pledging to keep buying long-term government bonds, as needed, and ended its purchase of exchange-traded funds (ETF). The latter program was started in 2010 as part of a stimulus programme deployed under former Governor Shirakawa, who chaired the BOJ from April 2008 to March 2013, and, over the years, has made the central bank the largest holder of Japanese shares with an accumulated 389 Bil USD in market value. Despite the hike, Governor Ueda committed to maintain accommodative financial conditions, pushing back against expectations of further tightening measures. As a result, the JPY softened against all major currencies, ending the month at its lowest level since December 2014 vis-à-vis the Australian Dollar. On March 21st, the Swiss National Bank (SNB) became the first major monetary authority to cut rates since November 2020. The central bank surprised markets by moving ahead of the FED and the ECB as it lowered its policy rate by 25 Bps, from 1.75% to 1.50%, prompting a sharp sell-off in the Swiss Franc (CHF). Headline inflation in Switzerland was +1.2% YoY at the end of February, having cooled below the +2% threshold since June 2023.

Global government bond yields were generally lower and credit spreads tighter during the month. The Bloomberg Barclays Global Aggregate Index hedged back to AUD was up +0.81% for the month.

Australian Fixed Income

On February 6th, the RBA held the cash rate at 4.35% and removed its tightening bias, a decision that was widely interpreted by market participants as dovish. In the accompanying statement, Governor Bullock concluded that "the board is not ruling anything in or out", suggesting that the central bank may have pivoted to a more neutral stance. Macroeconomic data were mixed, with the ABS monthly measure of consumer price inflation holding steady at +3.4% YoY and the unemployment rate unexpectedly dropping from 4.1% to 3.7% in February. GDP growth slowed down for the fourth consecutive quarter to +0.2% MoM and +1.5% YoY in Q4-23. The Australian yield curve flattened, with the 2, 5 and 10 year yield declining 4 Bps, 14 Bps and 17 Bps to 3.76%, 3.61% and 3.96% respectively. The Bloomberg AusBond Composite 0+ Yr was up +1.12% for the month, while the Australian Dollar strengthened vis-à-vis all major developed and emerging currencies.

Real Assets

Global property was up +3.68% in USD terms and +3.25% in AUD terms in March. Australia extended its outperforming streak to 5 months as Goodman Group rose double-digits for the second consecutive month. The stock benefited from its inclusion in the FTSE EPRA Nareit Global Real Estate index series with a weight of circa 248 Bps (8th largest constituents) effective March 15th.

Global infrastructure jumped +4.77% in USD terms and +4.33% in AUD terms for the month. Energy, primarily midstream, and US electric utilities were the best performing sectors while telecom infrastructure continued to exhibit weakness.

Alternatives

Alternatives (+1.15%) generated robust returns in March, led higher by CTA and managed futures, discretionary macro and Long/Short equities managers. The hedge fund industry recorded its best start of the year since Q1-19.

Market Outlook

The first three weeks of April have seen equities move lower worldwide and US yields, the US Dollar and gold rip higher in unison. On the surface, that unusual mix of correlations seems to be an aberration, however, on closer inspection, we think it may be symptomatic of the so-called "American exceptionalism" trend of 2023 having finally reached its natural limits. Last year the US economy remained resilient on the back of unprecedented fiscal stimulus and increased "coordination" in managing monetary affairs between the FED and the US Treasury, which artificially extended the cycle. In fact, the central bank hardened its monetary stance via higher interest rates and balance sheet reduction (QT), but the US government counteracted the tightening impulse by blowing up spending, with the budget deficit exploding to 8%+ of GDP at one time, and by financing the fiscal largesse primarily via the issuance of short term bills. Conversely, the Rest of the World (RoW) went through some sort of economic adjustment via slowdown, stagnation or a "technical" recession. As a result of the superior economic performance of the US vis-à-vis the RoW, capital flew into the former from the latter, buoying its stock market and keeping the US Dollar well bid for most of the year. In addition, the weakness of the global economy induced a steep decline in the Bloomberg Commodity Index but, in spite of that, inflation remained stubbornly high in the US. Fast forward to today, economic and inflation dynamics appear to be quite different between the two areas. The RoW has made steady progress on the disinflation front and it is "early cycle", whereas in US headline CPI bottomed at +3% in June 2023 and the country has remained "late cycle". There is a night and day difference between the two phases. The RoW is, in our opinion, poised to experience a "healthy" acceleration in GDP growth in 2024, one that should not lead to a commensurate increase in inflation. Having remained too hot for an extended period of time, the US is instead at risk of experiencing "inflationary" growth and that is precisely what we are observing at present with price pressures rebuilding in the system as the Atlanta Fed GDPNow GDP Forecast ticks higher.

It is not a coincidence that oil bottomed on 13th December 2023, exactly the day the FED pivoted, and it has rallied more than +20% since then, correctly presaging an acceleration in growth in the battered RoW in the first half of 2024. However, the recovery in the RoW, prompted by looser financial conditions, is also reverberating in the US, aggravating the inflation backdrop there. The US 10 year yield has started to respond accordingly, increasing by more than 70 Bps since the beginning of the year. Higher rates and the prospect of the FED cutting less and later than expected have strengthened the greenback, with the Dollar Index (DXY) appreciating by close to +5% over the same period of time. Eventually, that dangerous yield-currency combo has started to weigh on record stock market valuations, capping further appreciation at first, and then leading to the recent correction. The current predicament would not be too dissimilar to what transpired between August and October of last year, if it wasn't for gold. Back then it was falling, while today it is hitting new all-time highs. True, the shiny metal has been on a run lately on the back of the dramatic increase in geopolitical risk, however, government bond yields have been creeping higher since December without denting its allure, suggesting that the negative correlation between the two may have broken down. As stated above, we posit that the rise of the "barbarous relic" may portend a regime change from the "American Exceptionalism" of 2023. In our view, gold is acting as a relief valve and it is signalling that the policy mix of a tight FED and a loose US Treasury have become counterproductive for the global economy and the markets and it will have to be adjusted in due course. The US government has already spent 214 Bil USD in interest rate expenses in Q1-24, and that item alone accounts for almost 40% of its budget deficit. We may have reached the point whereby continuing to keep the excessive spending of "Bidenomics" going could impact the ability of the US Treasury to smoothly finance itself on the markets. The stress in treasuries is also having a ripple effect on stock markets, whose valuations have grown significantly compared to one year ago on expectations of a "soft landing", and on the US Dollar. Rising rates are mechanically strengthening the greenback at a time commodities are rallying on the back of a resurgent global economy. All those elements have started to tighten financial conditions and will continue to do so if left unchecked.

The RoW is not happy about the present state of affairs given the fact that its nascent (and fragile) recovery may be disproportionately affected by a spiralling higher US Dollar and it is becoming more vocal about that. On April 18th, the Finance Ministers of Japan and South Korea met Janet Yellen, and the trio released a conjunct statement acknowledging the "serious concerns" of those two countries "about the recent sharp depreciation of the Japanese yen and the Korean won". In plain English, Japan and South Korea, and the RoW in general, need a lower value of the greenback and that, in our view, can only be achieved via the US government reducing its spending, thus restoring the proper functioning of the Treasury market, or via the FED loosening its monetary stance. We suspect that rising gold prices are pointing to the latter being the tool of choice. The central bank has been talking hawkish lately, pushing back against rate cuts expectations and sort of "pivoting the pivot". John Williams, the President of the Federal Reserve Bank of New York, has even opened the door to rate hikes, a move which he "would obviously want to do" if economic data determine they are necessary to reach the central bank's inflation target. However, we continue to think that the FED will not be deterred from cutting interest rates in 2024 as the value of the greenback cannot be left unmanaged and the cost of funding of the US government is too elevated. We expect the unemployment rate to provide a plausible motive to reduce the target rate sometime in the second half of the year. Larry Fink, the CEO of BlackRock, the world's largest asset manager, nailed it when, on April 12th, he declared that, should we "get a stable inflation between 2.8% and 3%", "I'd call it a day and a win". We agree. The FED will tolerate higher inflation going forward if, as it is becoming clear, the "last mile" back to 2% proves to be too costly to achieve.

Government bonds have reacted negatively to the renewed hawkishness of the central bank, and ultimately we think that market volatility could have a potent, restraining effect on financial conditions should it persist for a few months. The US economy is highly financialized and so far it has been kept afloat by a positive wealth effect and public spending. The FED could potentially cut more than what is currently priced in should those two tailwinds fade or disappear. For that reason, we are taking steps towards normalizing the duration of our portfolios after having been underweight for the past two years. We favour 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. Our patience has paid off, and the moment has arrived to shift our overweight on Australian shorter maturities into traditional global fixed income, while being compensated with a higher yield in the process. Equity investors may have to endure more volatility in the short term, but the so-called “FED put” is operative again. We are looking for the extreme long positioning in US equities to gradually unwind and for capital to flow back into the biggest laggards of 2023, primarily emerging markets and interest rates sensitive sectors.

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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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