Amplia Monthly Investment Letter

A modestly positive start to the year

Most equity indices finished January in the positive territory, which was slightly surprising given the strength of the rally in November and December 2023.

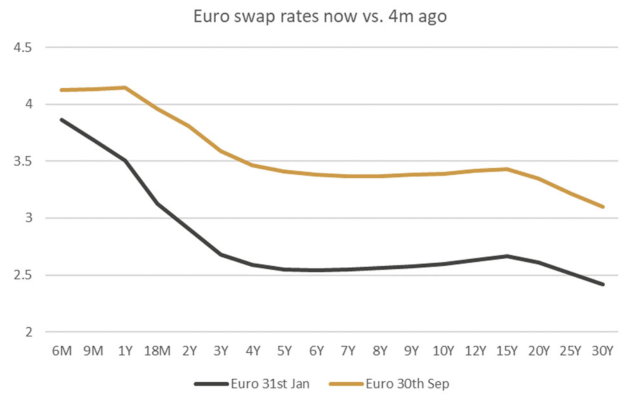
Northern American indices took again the lead, with the S&P 500 posting a total return of 1.68% and the NASDAQ 1.04%, respectively. The driving force was the tech sector where investors flocked to the big names, with hopes pinned on a positive earnings momentum and advances on the artificial intelligence side.

Elsewhere, the STOXX Europe 600 posted a total return of 1.49%, DAX 0.91% and FTSE 100 a loss of 1.27%, respectively.

Interest rates should give further tailwinds

Equity markets finished off 2023 on such a strong note that a near-term technical correction remains a possibility. However, they have room to run if the market consensus is even remotely right about the interest rate trajectory over the next 12 months.

The situation is much more prevalent on the bond markets where the large benchmark indices did not move as much as they could have done. The Bloomberg Euro Aggregate Total Return and US Aggregate Total Return indices, both widely accepted proxies of the respective investment-grade bond markets, gained last year 7.19% and 5.53% respectively, with all gains stemming from the rally in the final three months of the year. During the final quarter of 2023 the high-grade market interest rates declined significantly (see chart below). Considering the medium-long duration of these indices (US Aggregate 6.29, Euro Aggregate 6.39, respectively) and the accumulated coupons from the entire year, the gains could have been also stronger. One possible explanation are investment flows: despite all the chatter about institutions going into bonds, the central banks (ECB, Fed, and SNB in particular) trimmed their balance sheets which meant less demand for short-term issues, which again weighed on investment grade bond prices both in Europe and the US.



Decline in euro swap rates between 31st September 2023 – 31st January 2024. Source: Bloomberg, Amplia.

In any case, the speed of decline in rates has been remarkable. With many Eurozone economies such as Germany flirting with recession and the annual headline inflation having fallen from the peak of 10.6% to an estimated 2.8% only, it is obvious that the ECB will have to cut rates in the months ahead, no matter what Ms. Lagarde tells us. We would expect the first policy rate reductions to potentially come already in April, at latest in June. There are admittedly a few lagging indicators, such as collective wage deals and the core inflation that could warrant a slower tapering of the policy rate. However, the macroeconomic trends support a lower interest rate regime. The Euro area labour markets are not in a shape that would necessitate the current wage growth rates beyond 2024.

The decline we anticipate in euro area rates make euro-denominated investment-grade bonds a compelling investment for the moment, with considerable capital gain prospects, adequate coupon yield, low correlation to equities and good liquidity.

Our current asset allocation

We remain risk on. Investor focus will probably turn to the trade-political playbooks of the Republican and Democrat presidential frontrunners in the months ahead, with re-shoring, trade barriers and disputes taking the stage. For now however, one should enjoy the macroeconomic tailwinds of falling inflation, lower interest rates and booming labor market in the US. Listed equities have room to run higher, as have bonds.

As to equities, our long-standing (almost secular) overweight in the tech sector has been rewarded well lately. The earnings and the forward guidance from "The magnificent seven" stocks in the next two weeks may guide the entire market in the short-run, although it is pleasant to see the market gains becoming more broad-based. We overweight tech, parts of communication technology, high-end consumer discretionary and health care – with quality remaining the common denominator –as well as Asia and Emerging Europe as tactical investments.

In bonds, we overweight investment grade in all main currencies, with focus on medium-to long-term debt.

To seek protection and diversification from market gyrations in anticipation of the increasing political uncertainty, buying puts on main equity indices, especially the S&P 500, may be warranted thanks to the low levels of the key volatility indices such as VIX. Another way to seek protection would be to invest in Swiss franc or Japanese Yen terms, with especially the former now finally exhibiting a positive yield on short-term investments.

On 1st February 2024

Yours sincerely

Juho Kivioja