Amplia Monthly Investment Letter

Hiatus from interest rate obsession

February was the first month in a very long while when the markets moved in the same direction as the interest rates and inflation. In the US, the S&P 500 posted a total return of 5.34% and NASDAQ Composite 6.22% respectively. In Europe, the STOXX Europe 600 eked out a gain of 2% and DAX 4.58%, respectively. The gains were broad-based, with 321 of the S&P 500's components advancing and 182 declining. On the other hand, NVIDIA alone contributed for 28% of the total monthly advance.

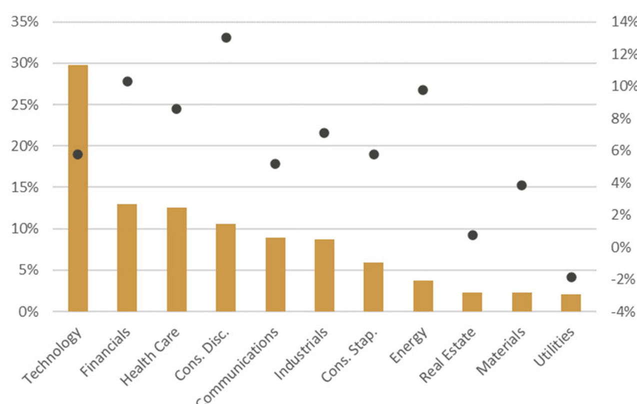
Meanwhile, all key interest rates edged up because of the incoming inflation data which fell more slowly than anticipated. In our view, the trend remains disinflatory nevertheless. Although the long-term structural deficits of aging populations and ballooning government deficits are likely to put upward pressure on the long-term yields, in the short term the improving supply and productivity will ensure the prices growth keeps slowing.

In European inflation, a big driver has been the food inflation, which enjoys the largest weight of all index components. In the US in turn, the cost of housing, *shelter costs*, has accounted for up to 70% of the total inflation over the past two years and is the largest basket component of the US consumer price index. European food inflation stood at an annualised 5.4% in January, having come down from 17.5% p.a. in March 2023. Similarly, the US housing costs increased 6.0% p.a. in January, after peaking at 8.16% p.a. in March 2023. The silver lining is that European food inflation was largely driven by increasing energy prices which now are coming down. Also, in the US the housing market experienced a very strong growth from May 2020 onwards, with almost two years of double-digit annual gains until October 2022. Such galloping house prices are bound to feed new construction projects, which will reverse the trend together with the present monetary policy.

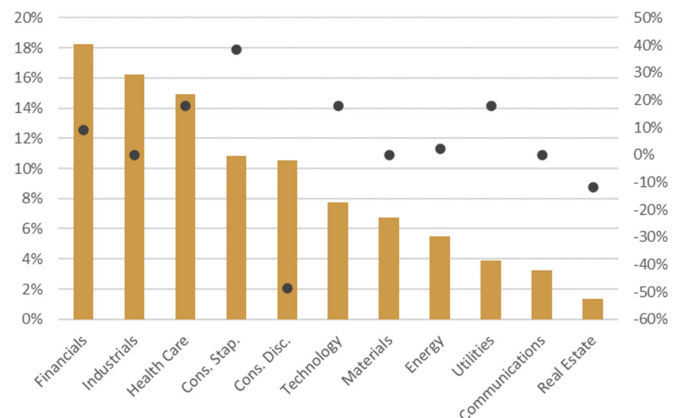
European earnings trailing American ones

As the current earnings season is gradually coming to an end, with 489 of the S&P 500's companies having reported, we conclude that earnings were positive enough to support the gains of the previous months.

30% of the S&P 500 consists of tech, followed by financials, health care, and consumer discretionary. The positive earnings surprises were concentrated in these weighty sectors, which helped lift the entire index considerably, as per below table.



In Europe the deviations between the sectors were much stronger with regards to living up to analyst expectations. Large sectors did not fare much better than the small ones, and generally the earnings season was poor. Of the 308 companies of the STOXX Europe 600 that have so far reported, only 46.4% beat their consensus forecast whilst 49.37% fell short of the consensus. The aggregate earnings surprise (aggregate realised / aggregate estimates – 1) was only 4.13% which is well below long-term averages.



Earnings outcome by sector of the S&P 500 (first diagram) and the STOXX Europe 600 (second diagram). Source: Bloomberg, Amplia.

The sector distributions also emphasise the different composition of the two broad indices: Europe remains a stronghold of financials and industrials, and in our view still lacks the dynamics of innovative technology and communications sectors.

Our current asset allocation

We keep our asset class preferences unchanged from the previous month. Equities remain at a neutral weight, with core holdings of tech, healthcare and select European industrials at overweight. For us, the recent AI developments are not a fad, and the earnings projections for the next two years are so immediate that comparisons to the IT bubble of the millennium shift are unfounded from a valuation perspective. We also continue to see intrinsic value in the pan-Asian stock markets and keep our tactical overweight there as well as the Emerging Europe unchanged.

We overweigh investment-grade bonds in developed market currencies in various maturities. We underweigh high yield bonds because the credit spreads have fallen so low that they do not compensate for the risk of any shocks to the markets at present.

Meanwhile, stock market implied volatility remains low, and considering the approaching US election cycle buying protection via puts may be warranted.

On 4th March 2024

Yours sincerely

Juho Kivioja

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