Amplia Monthly Investor Letter

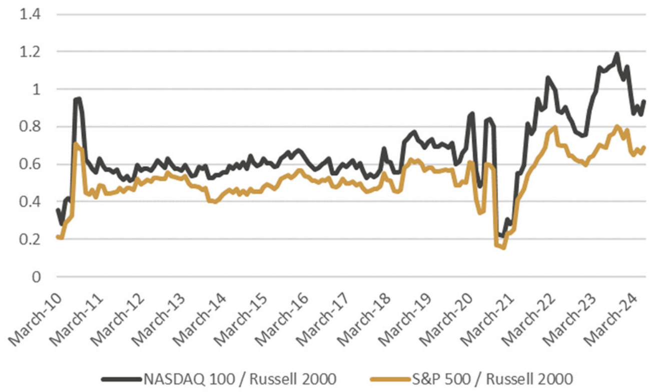
Modest correction on markets in July

The strong and long-lasting bull market of the NASDAQ came to an end in July, with the tech-heavy index losing 0.73%. The broader S&P 500 in turn gained 1.22%. In Europe, practically all main indices advanced cautiously, with the STOXX Europe 600 posting a total return of 1.43% and DAX 1.50%, respectively. The SMI lead the pack with a total return of 2.7%.

The US macro data continued their cooling, but no such negative surprise came about that could have justified the decline in NASDAQ. We attribute the modest sell-off to an accumulation of individual events that together triggered profit-taking. An assassination attempt of a former US president, the sitting president withdrawing his re-election bid and muted forward earnings guidance from a handful of mega-cap tech companies could all be listed as reasons behind the sell-off.

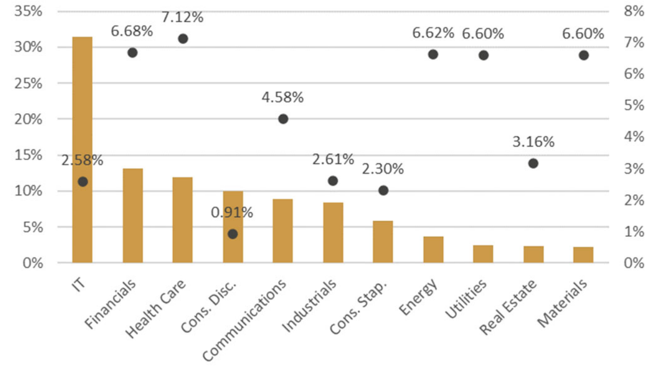
Sectoral rotation underway

Investors have not only dumped global large-caps in exchange for cash. For the first time in over a year, small-cap companies profited at the expense of their bigger counterparts. The leading US small-cap index, Russell 2000, advanced a whopping 10.16%. This rotation narrowed the valuation difference between the large- and small-caps that had grown historically wide in the past years, as the below chart of the relative price-to-earnings of the indices shows us. In other words, investors have recently been paying historically much for one dollar of net earnings of large cap companies compared to a dollar of net earnings from small cap companies, suggesting that the investors believe the large-caps, especially those of NASDAQ 100, to outgrow their smaller peers in the future.



The relative valuation of the large-cap indices NASDAQ 100 and S&P 500 to the American small-cap index Russell 2000 as measured by their price-to-earnings ratio. Source: Bloomberg, Amplia.

Meanwhile, the earnings season is in full swing. At the moment, 343 of 500 of the S&P 500's constituents have reported their second quarter results, with the least positive surprises coming from the consumer discretionary sector, and most positive surprises from health care companies. In the below chart the columns on the horizontal axis show the index weight of the S&P 500's 11 sectors whilst the dots show the aggregate earnings surprise in those sectors (the higher the plot, the bigger the actual earnings in relation to the street consensus estimates):

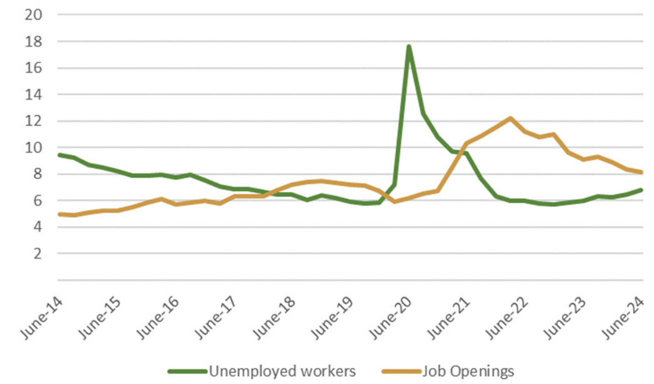


S&P 500 second quarter earnings data by sector. Source: Bloomberg, Amplia.

The earnings misses and cautiousness of future guidance from the consumer discretionary companies might be an omen of cooling consumer demand in the US. On the other hand, the earnings surprises have been positive for most sectors, signaling strength in the broad economy.

Taken together, we do not read too much into the earnings data yet. The rotation has solved some of the excessive valuation discrepancies of the previous months. Meanwhile, the growth prospects of the tech companies remain intact, as does the lead of the US over Europe and most parts of Asia.

The current US job market data speak a clear language: the higher interest rates are having an impact on the economic activity but with a considerable delay. This is because of the massive excess demand for workers that keeps supporting the job market. Many employers have searched for workers so long that they are willing to hire them even if the prospects of their business were starting to dim. Nevertheless, the job market is soon in balance, as evidenced in the below chart. We believe this will greatly improve the efficacy of the Federal Reserve's monetary policy and decrease the inflation pressure.



The total number of US Job Openings By Industry (amber) and total number of unemployed workers (green), both figures seasonally adjusted and in millions. Source: Bureau of Labor Statistics, Amplia.

Our current asset allocation

The macroeconomic backdrop is modestly cooling but remains supportive for risk assets. Combined with the recent tech stock market sell-off, we increase our equity weight slightly at the expense of cash or corporate bonds, depending on the strategy. This is a result not only of cheaper equities but also of lower cash yields. In Swiss francs and euros the interbank interest rates have fallen substantially, especially in tenors of two to five years.

We increase our tech and communication technology weighting with the proceeds from the money market and bond sales. The prospect of a further equity market correction before the US presidential election however looms large, so our equity allocation remains a slight underweight for the moment.

With the cash overweight neutralised, the only overweight we have are investment-grade corporate bonds. We consider these as a rate play that stands to profit from lower interest rates whilst earning a reasonable running yield, at least if compared to the average rates of the past 10 years.

We continue to favour the Swiss franc and the dollar over the euro.

On 1st August 2024

Yours sincerely

Juho Kivioja

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