

Amplia Monthly Investor Letter

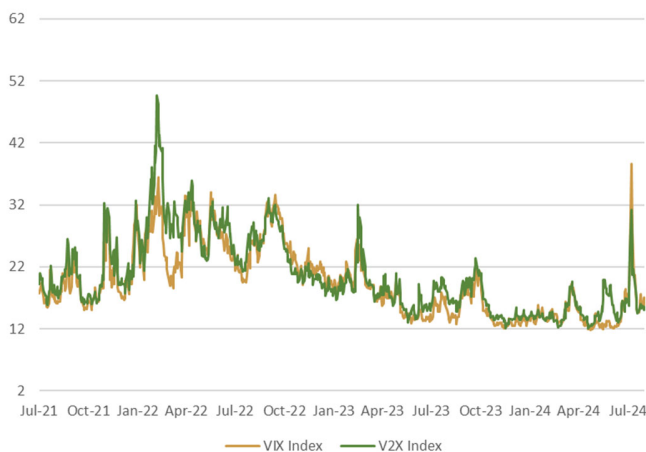


First sell-off over but for how long?

The start to August was historically weak on global trading venues. The most severe drop was witnessed in Nikkei 225 which fell 16% over two consecutive trading sessions in the first two days of the month. The unwinding of the Yen carry trade dragged down Western indices as well, with the NASDAQ 100 falling by 7.58% over the said two-day period. However, the sell-off disappeared as abruptly as it began, with investors – us included – using the dip to increase their equity exposure.

Ultimately, most of the main indices finished off in the positive territory. The S&P 500 gained 2.43%, NASDAQ 100 1.18%, and STOXX Europe 600 1.57%, respectively.

Whilst we had been arguing in the previous issues of this letter that the macro backdrop remained supportive and that some equity markets were ripe for a correction, the abruptness and magnitude of the sell-off left many questions unanswered. The gyrations beneath the surface were significant, as the below chart on the equity market volatility indices (VIX for S&P 500 and V2X for Euro STOXX 50) highlights: investor nervousity reached levels last time seen during the outbreak of the Russo-Ukrainian war:



Equity market implied volatility Indices August 2021 - August 2024. Source: Bloomberg, Amplia.

From a technical standpoint, imbalances remain. We would expect these to re-emerge as the US presidential election keeps nearing.

From sectoral to investor rotation

The explanation that investors unwound various carry trades during the August sell-off is plausible because it implies borrowed money left the stock market. However, the rumour that institutional investors would have reduced their stock market weight already earlier and left retail investors push up tech stock prices does not ring true.

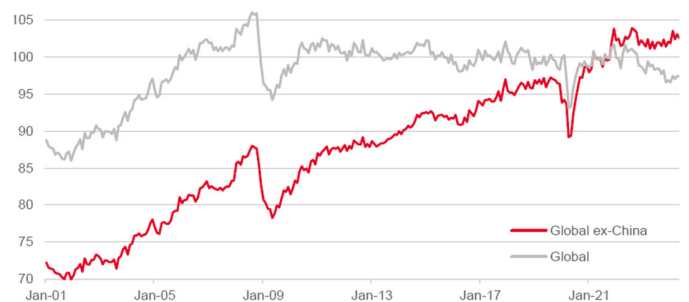
On the contrary, the amount of money market funds held by retail investors has increased 10.65% year-to-date, whilst that held by institutional investors has only gone up by 3.70%, as the data compiled by ICI show. Since the start of June, the total money market assets held by retail investors are up 4.18% and those held by institutional ones only 2.52%, respectively.

Although money market funds usually see inflows from Treasuries and other risk-free rate products aside of the stock market, it seems as if retail investors had "smelled" a change in market climate and front run the more sluggish

institutions. This happened last time in the covid spring of 2020 when the smallest of the retail investors amassed equities, resuscitating the global equity market and ushering in the post-covid rally long before the institutional money followed. The upcoming months will tell whether a similar investor rotation is on its way now.

Diverging fortunes in global trade

The French bank Société Generale argue in a study published in August that de-globalisation is a myth. According to them, a decline in global goods trade in 2023 was transitory following the above-trend growth of 2021 and 2022. Recent data indicate renewed growth but in more diverging patterns. Société Generale note that the ratio of global trade to global industrial production has declined for the past two years. However, this worrying trend is entirely driven by China where the ratio of exports and imports to production has fallen since the mid-2000's as a result of the country's economic ascend. When China is excluded from the data, the world trade-to-production ratio is not only continuing to progress but also intensifying. Examples of these include the recent free-trade agreements India signed with the EFTA states and the UK.



Ratio of global trade to global industrial production. Source: Société Generale.

If the French are right and the globalisation does continue, it has significant positive implications for the mid-term outlook of the global economy and risk assets. De-globalisation would clearly increase the risk of a global recession. Re-shoring, domestic production substituting for imports, would come at an extremely high cost simply because all Western economies currently exhibit a historically low unemployment. To tap the scarce workforce to render services and manufacture products of varying economic value where a country does enjoy a comparative advantage at present would push up nominal wages and inflation, raise real interest rates and diminish real wages. The result would be a lower real economic output and corporate earnings on a global scale.

Populism that nurtures these de-globalising, nationalistic and disconnecting ideals poses a threat to economic growth, just like major geopolitical shocks. If however, companies and individuals are left to operate without overwhelming government involvement, globalisation will evolve, keeping global inflation in check and lifting new countries and people out of poverty.

Our current asset allocation

We increased tech and communication technology weighting at the expense of bonds in our mandates in the days following the equity crash of the first days of August. Subsequently, we are neutral in our allocation across the liquid asset classes.

The neutral allocation reflects our balance act between a continuously benign macro environment and a combination of partly lofty equity valuations and investor nervousity that may start gyrating again before the US presidential election on 5th November.

In fixed income, we continue to favour investment grade over high yield and long maturities over short ones based on the cooling interest rate and inflation dynamics.

On 2nd September 2024

Yours sincerely

Juho Kivioja