Ampla Monthly Investor Letter

China firing with stimulus bazooka

In contrast to the normal September anomaly of negative returns, this year the September month was both positive and reasonably calm on the markets. The indices of S&P 500 and NASDAQ 100 posted a total return of 2.14% and 2.57%, respectively. In Europe, the STOXX Europe 600 ended practically flat at -0.32% whereas the Swiss SMI was one of the few decliners with a total return of -2.02%, in the wake of its strong rally during the summer months.

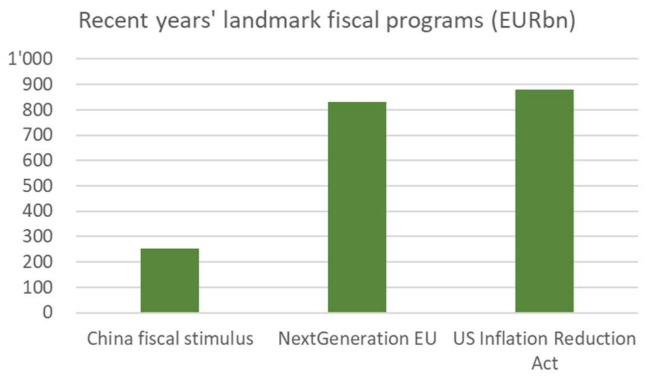
A big positive factor was the multi-pronged stimulus China unveiled last week. The Politburo pledged to accelerate efforts to revive growth, stabilise the country's battered property sector and introduce a range of stimulus measures to help the economy meet the government's growth targets. Whilst the Politburo did not publish details on fiscal spending yet, Reuters reported that the Ministry of Finance was planning to issue 2 trillion yuan, or EUR 254bn worth of special sovereign bonds this year. The funding would be evenly split between consumption stimulus and support for local governments to tackle their debt problems, according to Reuters. Of the totally rumoured amount, ca. EUR 102bn has been confirmed to be earmarked for boosting the local equity market, including loans to companies for share buy-backs.

The government's fiscal stimulus comes two days after the Chinese central bank, *People's Bank of China*, announced its biggest stimulus since the pandemic. The PBoC cut the banks' reserve requirement ratios, its main policy tool, by 50 basis points, freeing up around 1 trillion yuan for new lending operations. Aside of this, the central bank cut several benchmark interest rates, such as repo rates and loan prime rates by 20 - 25 basis points.

Little surprising, the Chinese equities finished off the month on a strong note, with Hang Seng posting a total return of 18.32% and CSI 300 of 21.11%, respectively. For the Hang Seng, the rally in the final week of September was its largest weekly gain since 1998.

Assessing impact of stimulus on risk assets

Alone the fiscal part of the fresh Chinese stimulus is comparable to the other two big stimulus programs of the recent past, the NextGeneration EU and US Inflation Reduction Act. Although these two vehicles, both meant to foster green transition alongside other objectives, are bigger in absolute terms than the present Chinese stimulus, so is their tenor longer: six years for NextGen EU and 10 years for IRA, respectively. The Chinese program in turn will probably have an almost immediate effect on security prices and the confidence of households and companies as the money will be released over a very short period of time.

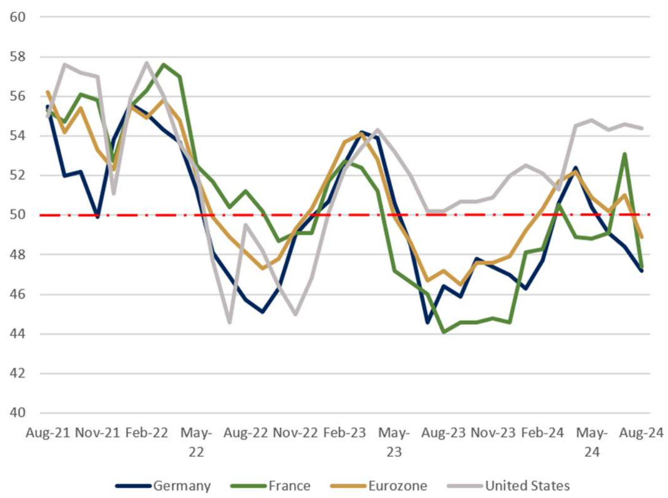


Landmark fiscal program sizes since the pandemic. Source: Reuters, Ampla.

We consider the combined effort of the Chinese fiscal and monetary stimuli a significant positive for both Asian and selective Western equities in the short-term. Although we doubt this will be enough to fend off the adverse dynamics of a secular downturn stemming from China's debt-fueled overcapacity in key sectors such as real estate and infrastructure in the medium-term, the short-term spillover effects from such a massive stimulus package will come handy to many a European consumer discretionary and industrial company. Amongst beneficiaries are the largest German carmakers, all of which (Volkswagen, Mercedes-Benz, BMW) derive over 30% of their revenues from China. Equally luxury good producers, industrials and materials companies such as miners will benefit from the brightening of the Chinese economic prospects.

European growth engine sputtering

The Chinese stimulus will benefit Europe indirectly. Up until May, the European growth outlook was recovering in lockstep with that of the US. Since then, the growth paths have diverged again. Looking at consumer and business confidence, retail sales or other metrics, the trend has been nose-diving or flatlining at best. Most so, the purchasing manager indices, PMI's, of the Old Continent depict a picture of a stagnating economic bloc. In the chart below, the PMI's of Germany, France and the Eurozone altogether have diverged significantly from their American counterpart since May. Readings below the dotted line at 50 mark stagnation and those above 50 growth, respectively.



European vs. US composite PMI's, all seasonally adjusted. Source: Bloomberg, Ampla.

Else, not much has changed in the recent weeks. Despite European growth worries, the monetary policy starts to be supportive for risk assets for the first time since early 2022. The Federal Reserve has clearly indicated that their focus has shifted from combating inflation to supporting economic growth. This will be a big positive for capital-heavy sectors in the short-term. Bonds, especially those of longer maturities, will keep benefiting from the trend as well. Banks will be worse off in relative terms, due to the decreasing net interest income.

Our current asset allocation

We keep evaluating the details and the final scope of the Chinese stimulus. Aside of Chinese equities, cyclical European stocks remain the largest single beneficiary of the trade. The share price of these cyclicals has already gone up, but we feel there is still room to go. Whether the upside is sufficient to warrant an increase in the affected sectors we will know soon. We have had an almost secular overweight in consumer discretionary for years – not least because of the sector nesting many quality companies with a strong brand and competitive position. This year however many European consumer discretionary companies have underperformed, and it is therefore delighting to see that phenomenon reversing.

We keep our asset allocation neutral across main asset classes. The macroeconomic picture has improved in a global context thanks to the Chinese stimulus, however the risk of a technical correction before the US presidential election on 5th November remains a not-so-distant possibility.

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 1st October 2024

Yours sincerely

Juho Kivioja