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Capicura Partners – Outlook 2nd Quarter 2024

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The music is getting softer, but it is still playing

- ***Semiconductors remain in the role of first violine***
- ***Inflation not under control yet***
- ***Swiss National Bank demonstrates its independence once again***
- ***How will markets react if US interest rate expectations are not fulfilled?***
- ***Gold completes sideways move, technical breakout lets the precious metal shine***
- ***Maintain asset allocation***

The 2023 year-end rally was cheered on by expectations of the FED cutting rates up to six times by a total of 150bp (1.5%) during 2024. In the first three months of the new year, however, inflation has proved more sticky due to elevated energy prices and the cost of shelter. Stronger core inflation readings make a near-term rate reduction by the FED very unlikely. The market has very quickly adjusted its expectations which led to a strong parallel shift (Fig. 1).

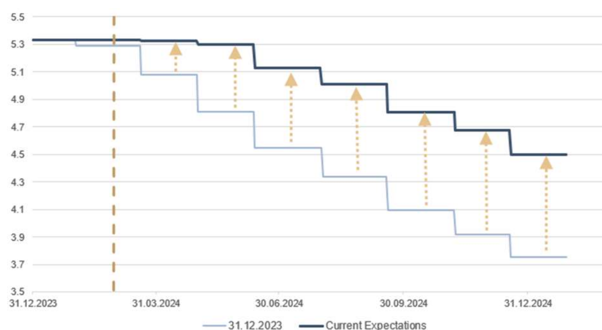

Fig. 1) Change in FED fund rate expectations today vs. 31.12.2023 *Data: Bloomberg / Chart Capicura Partners*

"What if interest rates are cut less or not at all in 2024?"

We acknowledge that the US job market is cooling but remind ourselves that the "last mile" of fighting inflation is the toughest. This should reduce future inflationary pressure from wage growth and prevent a wage-price spiral.

The FED seems to be in a dilemma: if they hold rates now, they risk needing to cut ahead of the presidential election in November. If they cut near-term, they may stimulate the economy and be forced to backtrack later. In such a case, the Fed would be forced to correct this at a later stage. A potential "policy mistake" can therefore not yet be ruled out. What if interest rates are cut much less than the FED's indicated 75bp this year, or ultimately not cut at all? The only central bank that is confronted with a completely different framework (inflation <2%) is the Swiss National Bank. Yesterday, it once again demonstrated that it is following its own course and contrary to expectations, cut interest rates by 25bp. What is becoming increasingly unlikely is a US recession. This has been priced into the markets. In Europe, the picture looks somewhat gloomier. In Germany, the question is when Europe's largest economy will emerge from the economic slump. However, there are increasing signs that European economic activity in the industrial sector is stabilizing at a low level. The Purchasing Managers' Index for the services sector even points to a tentative recovery.

«Semiconductors are leading the way»

All eyes remain on Artificial Intelligence (AI). One of the main winners is the semiconductor sector and Nvidia shares in particular. The semiconductor manufacturer is facing an almost insatiable demand for graphics processors. The US hardware manufacturer has now reached a market capitalization of around USD 2.2 trillion, which is roughly equivalent to the valuation of the entire German stock market (joint market capitalization of the DAX & MDAX)! Is this justified or are we seeing signs of an exaggeration? The past has taught us that such trends can last longer than one would like. We are therefore keeping a close eye on the semiconductor sector and expect it to remain an important leading indicator in the coming months. Momentarily, a simple "rule" seems to apply: if semiconductor companies are doing well, the market as a whole will continue to do well.

«The trend is your friend…»

Currently, nothing seems to be able to spoil the party in the equity markets. For more than 265 trading days without interruption, the MSCI World equity index (in CHF) has not seen a single day correction of more than 2%. Equity markets are still enjoying great momentum and technical resistance levels have been broken to the upside. In addition, many market participants are expecting, or rather hoping for, a pullback which would give them the opportunity to increase their equity exposure. Many investors (including us) have been too cautious since October 2022 and have underestimated the equity rally and in particular the bull market in technology stocks triggered by AI. Nevertheless, a short-term consolidation after the current "euphoria" would not just be healthy, but also very welcome. Until then, the old stock market adage remains valid: "The trend is your friend...until it ends" (Fig. 2).

Fig. 2) S&P500 breakout and uptrend intact
Data: Bloomberg / Chart: Capicura Partners

«What does gold know that we don't? »

Gold has broken out of its multi year sideways trading pattern (Fig. 3). This is despite the fact that fewer USD interest rate cuts are expected and the US-Dollar is gaining ground. These are factors which usually mean headwind for the price of gold. Furthermore, it is very rare for gold and stocks to push toward new peaks in unison. Since the 1970's it has happened only three times: during the inflationary spiral of the early 1980's, in the run-up to the Great Financial Crisis (GFC) and in 2020, the first year of the pandemic. With above in mind, the tandem rally in equities and gold could either be a speculative excess or gold is trying to indicate trouble ahead.

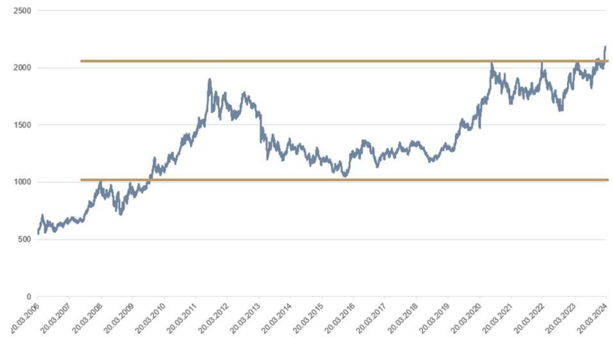

Fig. 3) Price of Gold in USD
Data: Bloomberg / Chart: Capicura Partners

Is a recession or a stagflationary environment looming after all? It remains to be seen. From a technical perspective, we see further upside potential. The precious metal remains a strategic position within our alternative allocation (ca. 4%).

«Positioning remains unchanged»

Despite equity markets looking attractive from a technical standpoint, we see little merit in increasing risk substantially after such a stellar Q1 and the US presidential election later in the year which historically calls for increased volatility. Still, our equity allocation has risen to around 47% within our balanced strategy during Q1, a level which seems justified on back of the above-mentioned momentum. Sector rotation and the expectation of a more challenging environment in the second half of the year, calls for a selective approach within this asset class (active management). Additionally, such a rotation bodes well for recovery potential in the energy, pharmaceutical and food space.

Asset Allocation	
Cash	8%
Fixed Income	25%
Equities	47%
Alternative Investments	20%

Fig. 4) *Suggested asset allocation for a Balanced Portfolio in Q2 2024*

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