MONTHLY UPDATE

Latest views from the investment team

Tech stocks bounce back

May saw a continuation of the theme of 2023 – that of a narrow set of (largely technology) stocks driving equity market performance, whilst the rest of the pack makes little progress. Stock market breadth is an important technical indicator in markets – suggesting that if more stocks are advancing than declining it is indicative of a more sustainable trend. We would like to see broader participation in equity market strength before feeling more comfortable that recessionary forces have abated.

Outside of the US, equity markets were broadly weaker in May. The US market eked out a gain of 0.8%, led by technology stocks (which saw a broad gain of around 8%).

As investors scramble to get a piece of the artificial intelligence (AI) boom, chipmaker Nvidia was the most prominent riser, becoming only the sixth public company to achieve a market capitalization of $1 trillion. In joining this club, it is amongst four other US tech firms; Microsoft, Apple, Amazon, and Alphabet (Google), alongside the Saudi state-controlled oil major, Aramco. Nvidia's 36% rise in May continued an astonishing near 180% rally so far this year. Similarly, Meta is up around 120% and Alphabet 40%, so far in 2023. The rally in technology stocks has surprised us. After a major rout in 2022, we thought technology stocks could stage a partial recovery – similar to the bear market rallies we saw during the tech bust of the early 2000's – but the rebound has been more sustained than we anticipated.

Since the end of 2022, we have made the conscious decision in portfolios to underweight the US market and, by proxy, the technology sector. This helped protect capital for investors last year, however, has meant a slight lag in returns this year. At this juncture, we do not believe chasing the recent rally in technology is sensible. The earnings momentum in the sector has stalled and valuations are looking stretched once again – meaning prices are moving more on hype, than fundamentals. We see much better value outside the US market, notably in Asia (including Japan) and broader emerging markets, for long-term investors.

Inflation appears to have peaked in the short-term and with that, markets are also expecting interest rates to be close to peaking. If central banks can navigate the narrow path of bringing down inflation, without inducing a harsh recession (caused by the tightening of financial conditions), then we believe the market rally can become more broad-based. There is an abundance of opportunities waiting in the wings to spring back to life if markets can get comfortable that a hard recession has been avoided. For example, small cap stocks currently trade on historic discounts to large caps. Their absolute and relative valuations are pricing in a particularly bleak environment ahead. This is most pronounced in the UK, where small caps are now the cheapest they have been since 2009.

Bottom Line

Despite recent successes, we remain nervous on the future path of US tech stocks. We see good value building in a number of equity regions/styles, such as Emerging markets and smaller companies. Our strategic real asset exposure to commodities, property and infrastructure assets also offers useful diversification and value. For portfolios that hold fixed income, we remain biased to quality and short duration bonds, which offer attractive yields between 5-7%.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↓	-5.23%
Europe	↓	-2.31%
US	↑	0.60%
Emerging Markets	↓	-0.99%
Japan	↑	4.52%
Bonds / Rates (* Absolute change (%))		
UK Base Rates	↑	0.25% / 4.5%
Fed Funds Rate	↑	0.25% / 5.25%
UK 10-Year Yield	↑	0.46% / 4.18%
US 10-Year Yield	↑	0.21% / 3.63%
Currencies		
GBP / USD	↓	-1.37% / $1.24
GBP / EUR	↑	2.10% / $1.16
DXY (USD Index)	↑	2.62% / 104.33%
Commodities		
Gold	↓	-1.37% / $1962.67
Oil (Brent)	↓	-8.65% / $72.66
Note worthy		
Nvidia	↑	36.34%

Q&A

What's on your mind?

Who are Nvidia, and how are they benefitting from artificial intelligence?

Nvidia is a technology company headquartered in Silicon Valley, with a primary focus on the development of graphics processing units (GPUs). With the growing adoption of artificial intelligence (AI) solutions by businesses, Nvidia has successfully capitalised on this surge and at the end of last month saw its market cap rise to the $1 trillion mark. This achievement can be attributed to the increasing demand for high-performance computing capabilities, particularly in the area of generative AI applications and cloud computing. In this domain, Nvidia's flagship H100 chip has emerged as an invaluable asset for individuals and organisations seeking to utilise the advantages associated with AI-driven productivity. This success, combined with the hype around AI has created the conditions for strong price rise this year.

What is the US Debt Ceiling and what unfolded over the course of May?

The US debt ceiling is essentially a cap on US government borrowing which needs to be increased by legislation, periodically, to allow government borrowing which funds both new and existing debt repayments. May saw the climax to negotiations between the Republicans and the Democrats to pass this bill. As with most political grandstanding, both sides were desperate not to appear as the loser of the negotiations and, with an increasingly divided US political system, the negotiations got closer to the deadline than many expected. Ultimately, they proved successful. Failure to reach an agreement would have caused serious volatility in financial markets as the US Government defaulted on its debt. This uncertainty led to a higher cost of borrowing and higher yields on government securities during May. Our relatively high allocation to short duration fixed income broadly protected us during this uncertainty.

Why are Japanese equities performing well?

Japanese equities posted a very strong May performance with the flagship indices returning to levels not seen since the early 90s. The Japanese markets have performed poorly since those highs. Economists still have disagreement about the causes of what is commonly referred to as "lost decades" for the country as the price level and GDP have barely expanded. Recently, however, there has been some GDP growth and inflation is high by historic standards. Japanese firms have even increased wages for the first time in decades. This, combined with a relatively weak yen (which benefits the exporting companies in Japan) and relatively cheap valuations have made the market attractive to foreign investors. Our portfolios have benefited due to our maintained overweight in Japanese equities as we look to benefit from the tailwinds previously mentioned alongside a future increase in Yen strength as Japanese monetary policy eventually tightens.

For more information, please contact your adviser.