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Market views and strategy

Ostrum ASSET MANAGEMENT

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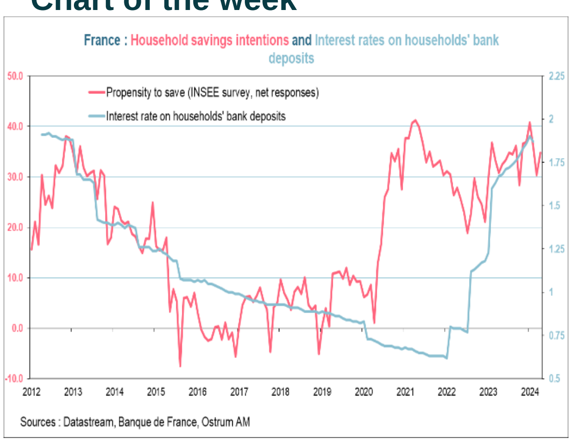
Topic of the week: US equities at the crossroads?

- **S&P 500 is down 5% quarter-to-date after a monster 28% rally since Waller signaled Fed cuts last fall;**
- **Powell's second thoughts on inflation could spell trouble for growth stocks that have led the market higher;**
- **Markets may require new catalysts to resume rising as most forecasts point to a flat equity market until the end of the year;**
- **M&A activity and share buybacks will continue to underpin valuations;**
- **Individual investors look fully invested whilst high rates should keep tons of money on the sidelines;**
- **Positioning, excessive optimism and the lack of a private equity bid could pose downside risk.**

Market review: Inflation or the pebble in the shoe

- **Core PCE inflation at 2.8% tests Powell's confidence in disinflation;**
- **Weaker-than-expected growth in the United States;**
- **T-note yields test 4.70% ahead of the FOMC and Treasury refinancing;**
- **Risk assets hold up thanks to buoyant earnings releases.**

Chart of the week



The French savings rate is among the highest in developed countries. The scenario of gradual recovery is partly based on the assumption of a reduction in household savings in France. The INSEE survey reveals a propensity to save close to record highs.

The increase in ECB rates since 2022 has strengthened the trend towards precautionary savings that emerged during the COVID crisis. The interest rate on bank deposits averages 1.87%, with many more lucrative alternatives such as money market funds.

Figure of the week

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Source : EIA

20%: the forecasted share of electric vehicles in global car sales in 2024 according to the EIA.

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Topic of the week

US equities at the crossroads?

Powell's second thoughts on inflation could change the Fed rate path and spell trouble for growth stocks as markets search for new catalysts. M&A activity could underpin valuations as sales come in on the soft side in 1Q 2024. Positioning, investor sentiment and somewhat pricey valuations leave little room for error.

S&P 500: Is there any juice left?

Equity markets are up 6.9% year-to-date in keeping with US economic strength (even as the first GDP print came in at just 1.6% in 1Q 2024). Jerome Powell's latest hawkish turn following a series of bad CPI releases ignited a repricing in the Fed rate path. Two-year note yields near 5% leave a lot of room to absorb potential bad news in bonds whilst higher interest rates could hurt stock valuations.

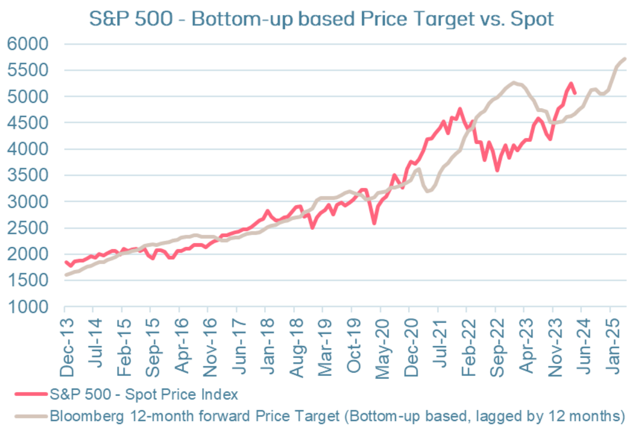
The Fed's second thoughts about the promised monetary easing has sparked a 5 % drawdown in the US equity market after a stellar start of year. Most bullish investors would view it as a healthy correction whilst bears may be increasingly wary of pricey growth stocks.

S&P 500	Index	% vs. Spot	EPS	PE Ratio
Spot	4 998	-	223	22.4
Forecasts (year-end 2024)				
Wells Fargo	$ 5 535	10.8%	$ 242	22.9
Oppenheimer	$ 5 500	10.0%	$ 250	22.0
Société Générale	$ 5 500	10.0%	$ 243	22.6
UBS	$ 5 400	8.0%	$ 240	22.5
RBC Capital Markets	$ 5 300	6.0%	$ 237	22.4
Ned Davis Research	$ 5 250	5.0%	$ 235	22.3
Fundstrat	$ 5 200	4.0%	$ 240	21.7
Goldman Sachs	$ 5 200	4.0%	$ 241	21.6
22V Research	$ 5 170	3.4%	$ 242	21.4
Deutsche Bank	$ 5 100	2.0%	$ 250	20.4
Evercore ISI	$ 4 750	-5.0%	$ 231	20.6
Stifel Nicolaus	$ 4 700	-6.0%	$ 223	21.1
Scotiabank	$ 4 600	-8.0%	$ 227	20.3
Morgan Stanley	$ 4 500	-10.0%	$ 229	19.7
JPMorgan	$ 4 200	-16.0%	$ 225	18.7
Average	$ 5 060	1.3%	$ 237	21.3

Source: Bloomberg, Ostrum AM

The S&P 500 peaked at the end of March at 5,254. Most sell-side analyst forecasts trailed the rally and point to a flat market until the end of the year. Their estimates range from 4,200 to 5,535 with a median forecast of 5,200. Price-earnings ratio assumptions range from 18.7x to 22.9x. It is important to note that the most bearish projection still expect the market to be priced above 18x.

The Bloomberg 12-month objective based bottom-up price targets suggests a year-end level of 5,122 and a further run-up to 5,714 in April 2025.



Source: Bloomberg, Ostrum AM

Roughly a third of companies have published their 1Q24 earnings. As always, close to 80% of EPS releases beat consensus numbers, which are usually marked down in the month prior to the publication. However, 1Q 2024 sales are marginally above estimates so far and only a small majority of companies were able to beat the consensus. The relative weakness in sales growth is hard to apprehend in the context of sustained growth and inflation in the US. Turnover is up around 4% from a year ago as earnings growth is close to 8%. By and large, corporate margins continue to surprise on the upside.

Having said that, most sectors in the S&P 500 trade at higher-than-average price-earnings ratio. At about 12x, Energy offers a discount to its 5-year PE average (17x) even after taking out the 2020 anomaly. Utilities and to a lesser extent consumer stocks appear slightly undervalued on this metric. The rest of the market is in line or slightly richer than it has been recently. A key question is whether relatively high multiples could accommodate negative surprises. EPS revisions for quarters ahead tend to be tilted to the downside.

Number of S&P 500 Companies with...	Q	Q+1	Q+2	Q+3	Q+4
Higher 4wk trailing earnings estimates	59	81	80	92	119
Lower 4wk trailing earnings estimates	63	132	120	118	108
Net	**-4**	**-51**	**-40**	**-26**	**11**
Average Net since 2018	-26.6	-25.1	-13.5	-3.4	-7.8
		Source: Bloomberg, Ostrum AM			

Looking under the hood

In this piece, we try to unveil what's really at play within the US equity market. The US stock market has been driven by powerful investment themes: artificial intelligence fueled by government investment programs including the IRA and the CHIPS Act, superior US domestic demand (benefitting domestic cyclicals) and more secondary trends like the blockbuster weight-loss drugs.

Beyond AI: the need for a new catalyst

Nvidia has been the obvious exposure to the AI theme, followed by other Tech behemoths. But there is no longer a cheap way into AI. Equity investors will have to find new ideas. There is no denying the earnings power of the likes of Nvidia, but price-earnings multiples above 30x do require sustained earnings growth with high visibility. There may now be a case for second or even third way to bet on AI, including bidding up companies that figured out how AI will enhance their existing businesses or parts of their value-chains.

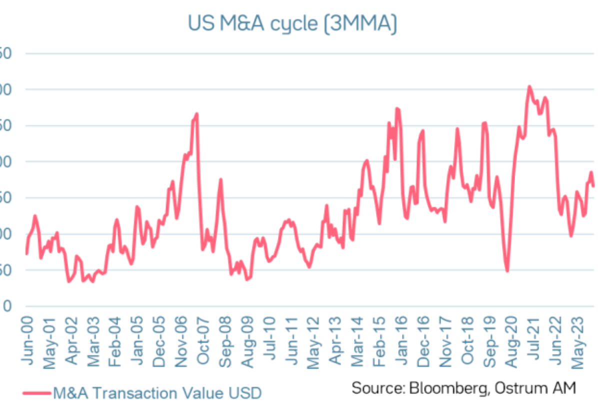
The outperformance of the Magnificent 7 group can be associated with the extreme concentration in AI investment spending: just 10 firms accounted for 29% of total capex and 54% of R&D in the S&P 500 in 2023. Amazon tops the list with $53 billion capex and $86 billion R&D expenses last year. The likes of Alphabet, Meta or Microsoft also invest in the tens of billions. At the macro level, US IT spending totaled $1.84 trillion or 6.7% of GDP last year, double the European figure.

2023	Capex		R&D	
Ticker	$ billion	% of S&P 500	$ billion	% of S&P 500
AMZN	53	6%	86	15%
MSFT	35	4%	28	5%
GOOGL	32	3%	45	8%
META	27	3%	38	7%
INTC	26	3%	16	3%
Top 10	279	29%	315	54%
		Source: Goldman Sachs, Ostrum AM		

Consistent with the solid growth environment, the US equity market has rewarded companies that invest instead of returning cash to shareholders. According to GS style indices, companies that return cash to shareholders underperform firms with high capex by about 2% this year.

M&A and cash return to shareholders

After three years of lackluster M&A activity, US firms may be more willing to deploy capital in 2024. In the first quarter, 8 deals worth over $10 billion were announced. Energy, Technology and Financials may consolidate further. However, demanding valuations and high interest rates imply that the cash component of deals is likely to diminish.

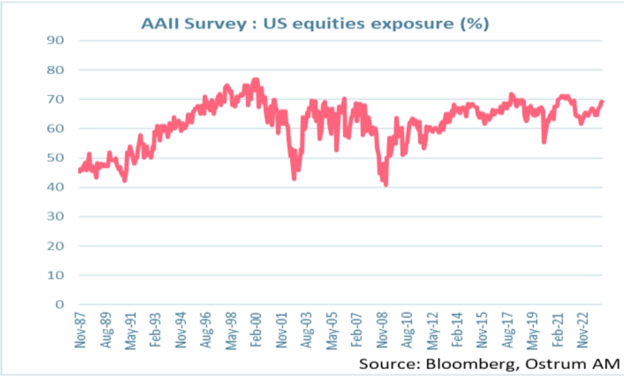


In turn, share repurchase programs worth $200-250 billion per quarter reduce stock market depth. Buybacks are quite concentrated at the top of the market capitalization spectrum. This underpins mega-cap valuations whilst reinforcing the oligopolistic structure of high-end technology.

Both M&A and buybacks contribute to the long-standing de-equitization trend. However, the private-equity bid has been missing for some time, which partly explains the sustained underperformance of small caps. Fed rate cuts could eventually revive the private equity bid.

Positioning and equity investor sentiment

Investor sentiment has been bullish. The AAII Asset Allocation Survey polls members monthly on their current holdings among the five asset categories. The equity exposure of individual investors is 69.3% in March at the 86th percentile of the range since November 1987. For what it is worth, US household margin debt on the equity market amounted to a whopping $743 billion at the end of February.



The CFTC data also hints at significant net long exposure on S&P futures from asset managers. In sum, there is scope for position trimming.

Micro positioning

Bullish positioning is echoed in portfolio by outsized exposure in leveraged account portfolios. The concentration of returns in the Mag7 subset has reinforced herding among investors. Chasing short-term (relative) performance may require owing overpriced stocks. Then, 'must-own' stocks are likely to be sold first in a market downturn. The concentration of fund holdings has been a topic. A group of stocks that matter most to hedge funds (from their top ten holdings) performed well in the first quarter but is now losing ground. The Goldman Sachs high hedge fund concentration basket consists of 20 stocks in the S&P 500 with the highest share of market capitalization owned by hedge funds. Since the March quarter close, hedge fund concentration has been a losing selection factor.

Conclusion

As the Fed's Waller hinted at rate cuts in late October, the S&P 500 bottomed out and started a 28% rally until then end of March. Since then, the S&P 500 has lost 5%. It looks like the market is searching for new themes as the AI and consumer strength investment ideas look exhausted. Earnings for 1Q 2024 are coming in better-than-expected but with surprising weakness in sales growth. M&A activity and continued support from share buybacks should mitigate the risk to stock valuations. However, private equity bids remain absent. High interest rates also keep money on the sidelines for now as individual investors are quite long equities.

Axel Botte

Market review

Inflation or the pebble in the shoe

Inflation is shaking up the Fed's scenario, but risky assets are resisting the rebound in rates.

The Fed seems trapped by its advanced communication. The scenario of 3 rate cuts, although reaffirmed in March, is moving away due to inflation. The private consumption deflator excluding volatile elements, close to 2% in the second half of 2023, suddenly recovered to 3.7% in annualized terms in the 1st quarter. The shift in service prices reflects long-lasting internal imbalances, particularly in the housing market. The markets are only factoring in a hypothetical drop in Fed funds at the end of the year. 10-year yields are tightening (4.70% on the T-note, 2.60% on the Bund), injecting a source of volatility into an equity market driven by quarterly publications. Profits, as often, surprise on the rise with some reservations on the slowdown in turnover. Publications from Microsoft or Alphabet ease the downward pressure on stocks. Long-term rates are rising, with astonishing passivity in breakeven inflation rates. The market still does not seem to be worried about a lasting slippage in inflation. However, oil is back at $2 this week. Credit like sovereign debt barely reacts to the rise in rates. The yen (157) remains weighed down by the BoJ's procrastination. The dollar is in slight decline in favor of the euro or the Australian dollar supported by inflation which is once again higher than expected.

The American economy seems to have slowed down over the first three months of the year. GDP stands at 1.6%. However, private internal demand is in line with expectations. The negative surprise concerns stocks and the external balance which subtract 0.4 pp and 0.9 pp respectively from growth. Prices increased by 2.6% in March, or even 2.8% according to the deflator excluding energy and food. Services inflation stands at 4%. The good news inferred from the drop in prices of imported goods in the fall is ancient history. The Fed is now being asked by the markets to position itself in relation to endemic inflation above the 2% objective. The Central Bank should nevertheless confirm the upcoming reduction in quantitative tightening, going against the bias displayed on rates. In the eurozone, the ECB, through Fabio Panetta, insists on the need to lower rates soon, despite the expected strengthening of activity and a probable extension of the Fed's status quo. The RBA is also facing a resurgence in inflation, which is giving rise to expectations of a tightening of monetary policy.

n the markets, the T-note traded above 4.70% before returning to around 4.65%. The slope is increasing while awaiting the announcement of Treasury issues for the period from May to July. The American 2-year bond at 5% is clearly attractive to the detriment of longer maturities. This justifies the use of optional strategies to cover a return of the T-note towards 5%. In the euro zone, sovereign spreads ignore tensions on the Bund and upcoming decisions by rating agencies. The 10-year OAT is trading below 50 bp. Pedro Sanchez's threat of resignation had no effect on the Spanish spread. The next BTP Valore issue supports the Italian spread around 140 bp. The primary nevertheless remains active (EU, RFGB). The Greek 30-year bond attracts a demand of €33 billion, or 11x the amount borrowed. It is appropriate to maintain exposure to inflation despite an apparent under-sensitivity to oil.

As for credit, technical flow factors in funds (ETFs or assets) keep spreads under wraps, ignoring the greater volatility of rates. The spread against swap is trading around 77 bp. New issues are placed at almost zero premiums, including over long maturities. High yield is tightening in parallel with a more active primary market which now sees 4 to 5 transactions every week. The balance of flows in funds has declined while remaining very favorable since the start of the year.

Equity markets rebounded by 1 to 2% after a difficult previous week. The first third of the publications is rather reassuring even if profits show a decline of 11% over one year. The second trimester will be better. Unlike performances since the start of the year, cyclicals have published less good results than defensives. Luxury and automobiles are penalized by disappointments. The market environment gives pride of place to discounted values as opposed to growth.

Axel Botte

Main market indicators

G4 Government Bonds	29-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	2.95%	-1	+11	+55
EUR Bunds 10y	2.53%	+4	+23	+50
EUR Bunds 2s10s	-43.2bp	+5	+12	-5
USD Treasuries 2y	4.97%	0	+35	+72
USD Treasuries 10y	4.62%	+1	+42	+74
USD Treasuries 2s10s	-35.1bp	+1	+7	+2
GBP Gilt 10y	4.3%	+9	+36	+76
JPY JGB 10y	0.89%	+0	+6	-21
€ Sovereign Spreads (10y)	**29-Apr-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
France	47bp	-2	-4	-6
Italy	133bp	-3	-5	-34
Spain	77bp	0	-9	-20
Inflation Break-evens (10y)	**29-Apr-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR 10y Inflation Swap	2.28%	+0	+4	+15
USD 10y Inflation Swap	2.64%	+3	+11	+23
GBP 10y Inflation Swap	3.77%	+2	+9	+24
EUR Credit Indices	**29-Apr-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR Corporate Credit OAS	112bp	-4	-3	-26
EUR Agencies OAS	59bp	-2	-2	-11
EUR Securitized - Covered OAS	63bp	-2	-2	-15
EUR Pan-European High Yield OAS	374bp	-5	+18	-25
EUR/USD CDS Indices 5y	**29-Apr-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
iTraxx IG	55bp	-4	+0	-4
iTraxx Crossover	313bp	-13	+16	-1
CDX IG	52bp	-3	+0	-5
CDX High Yield	347bp	-14	-24	-10
Emerging Markets	**29-Apr-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
JPM EMBI Global Div. Spread	342bp	-1	-3	-42
Currencies	**29-Apr-24**	**1wk (%)**	**1m (%)**	**2024 (%)**
EUR/USD	$1.070	0.498	-0.816	-3.1
GBP/USD	$1.252	1.361	-0.856	-1.7
USD/JPY	JPY 156	-0.674	-2.887	-9.5
Commodity Futures	**29-Apr-24**	**-1wk ($)**	**-1m ($)**	**2024 (%)**
Crude Brent	$88.9	$1.9	$1.9	16.0
Gold	$2 338.6	$8.6	$108.7	13.4
Equity Market Indices	**29-Apr-24**	**-1wk (%)**	**-1m (%)**	**2024 (%)**
S&P 500	5 100	2.67	-2.94	6.9
EuroStoxx 50	5 012	1.53	-1.40	10.9
CAC 40	8 109	0.85	-1.18	7.5
Nikkei 225	37 935	2.34	-6.03	13.4
Shanghai Composite	3 113	2.25	2.36	4.6
VIX - Implied Volatility Index	15.35	-9.39	17.99	23.3

Source: Bloomberg, Ostrum AM

Additional notes

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