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CREATING OPPORTUNITIES

Global Capital Markets
Quarterly Update
15 April 2024

Global Capital Markets – 2Q 2024 Update

Main Investment Themes:

Yields have increased in fixed income markets
1-year US Treasury yield has exceeded 5%, but is expected to fall gradually throughout 2024, which makes it an attractive investment today

Outlook for global tech stocks remains positive
As demand for Artificial Intelligence keeps rising, technology stocks are expected to benefit significantly both in the US as well as in Europe and Emerging Markets

Alternative assets have potential to diversify portfolio risk
Crypto currencies, gold, and other alternative asset classes provide diversification benefits due to low correlation with stocks and bonds

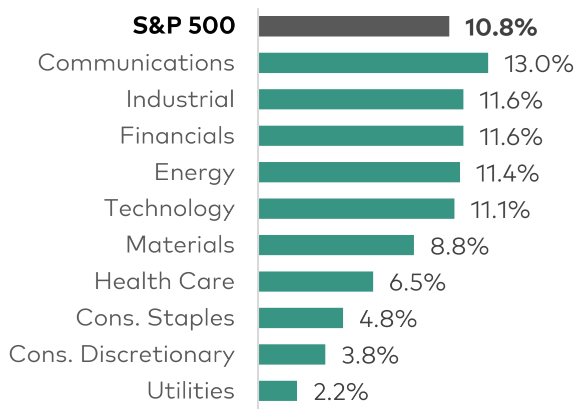
1. Summary

2024 started with strong gains in equity markets. Growth was observed in both developed and emerging markets, with US stocks outperforming their global peers. Similarly to 2023, mega-cap tech companies were the major contributors to a broad market rally. This positive dynamic was underlined by improved investor sentiment, partly fueled by a stronger than expected US economic performance (the US economy grew by 2.5% in 2023 and, according to IMF forecasts, is expected to grow by 2.7% in 2024).

Yields have increased considerably in the US fixed income markets. Due to a stronger than expected economic activity in the US, returning inflation to the target level of 2% is expected to take more time than previously expected (during the past four months, core inflation has only slowed from 3.9% to 3.8%). As a result, markets are now only pricing in two or three 25bps rate cuts from the US Federal Reserve in 2024.

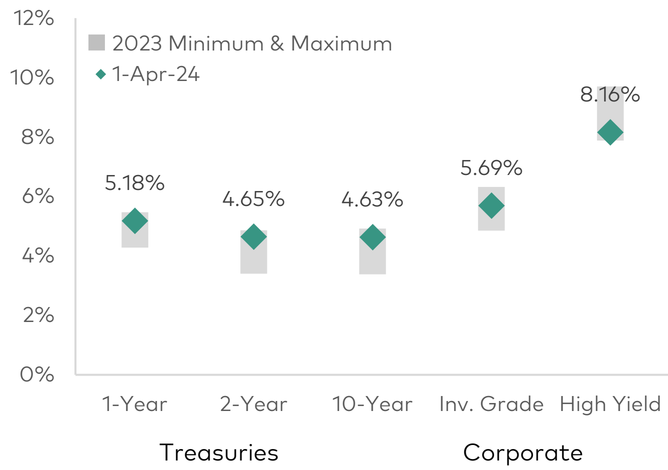
In the light of shifted expectations, yields have increased in fixed income markets and currently stand well above the 2023 minimum levels (see the graph to the right).

Performance of S&P 500 sectors in 1Q 2024



Source: Bloomberg

Yields in US fixed income



Source: Bloomberg
Corporate IG category corresponds a low-risk bond, while High Yield corresponds to a medium-risk bond

2. US Fixed Income

How did the expectations around Fed's future monetary policy change?

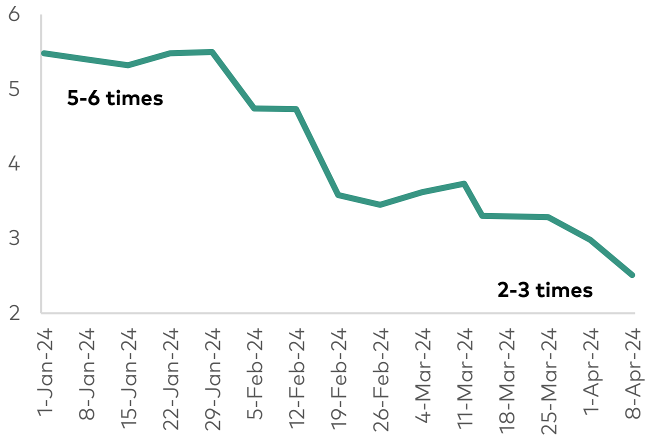
At the start of the year, markets expected Fed to cut rates from current 5.25%-5.50% to 4.0%-4.25% by the end of 2024 (i.e., five or six 25bps rate cuts). In contrast, markets are now only expecting two or three rate cuts by the end of the year, corresponding to the rate range of 4.0%-4.25%. The primary reason underlying this shift in expectations is the US inflation, which largely stopped declining in 2024 (a change in the trend of past two years when inflation was declining rapidly).

One of the main reasons for prevailing inflation dynamics is the strong labor market. During the past 12 months, the US added 240,000 new jobs every month, on average. However, it must also be noted that labor market participation has also strengthened, resulting in a slightly higher unemployment rate and, therefore, easing inflationary pressure on wages.

Which fixed income segments look the most attractive?

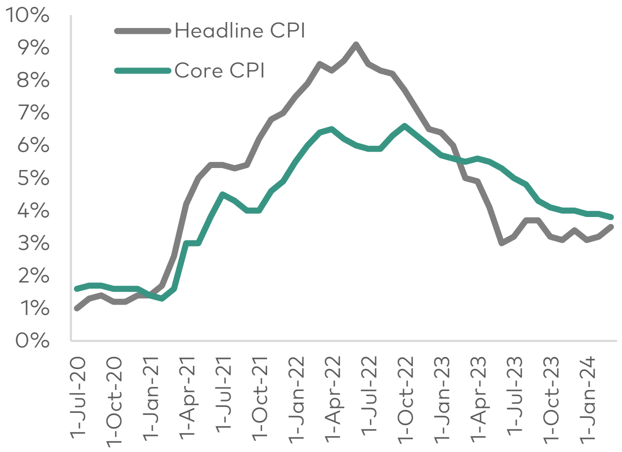
Currently, the fixed income yields are higher in the US than in Europe (the 2-year US Treasury yield stands at 4.93%, while a 2-year German Bund yields 2.90%). This, however, should not incentivize investors to invest solely in the US fixed income. Just as in case of equities, investors are better off by reducing risk through diversification. This means that, ideally, a fixed income portfolio should be composed of bonds from different regional markets, including the US, Europe, and Emerging Markets. Moreover, an optimal portfolio would also have diversification across quality and maturity as well. As compared to government fixed income, corporate bonds provide a higher yield in exchange for a higher credit risk. For instance, the average yield in the US on Investment Grade and High Yield corporate bonds are 5.76% and 8.29%, respectively.

Market-implied forecasts for number of 25bps Fed rate cuts in 2024



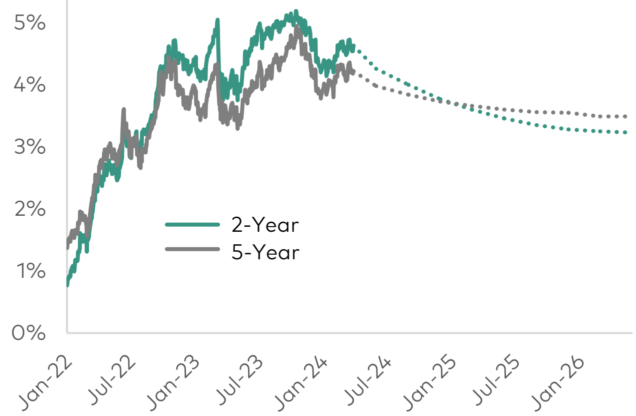
Note: 25 bps interest rate cuts are implied
Source: Bloomberg

Annual US inflation



Source: Bloomberg

Yields on US Treasuries (dotted lines represent forecasts)



Source: Bloomberg

3. Technology Sector Equities

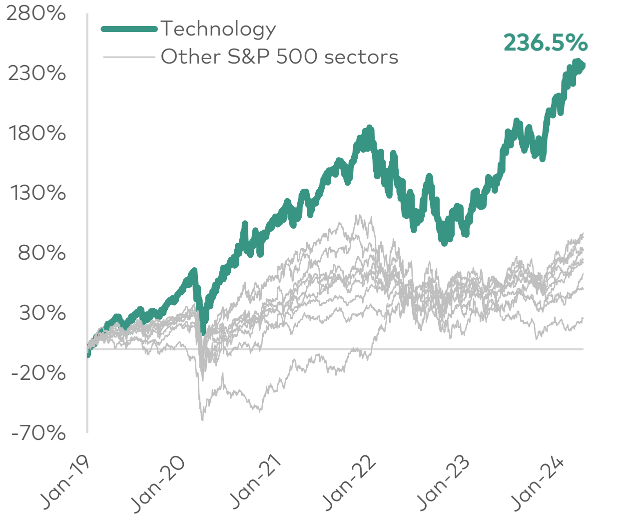
What is the outlook for technology stocks?

During past years, technology stocks have been growing by a significantly higher rate that their peers from other sectors. However, despite the already elevated price levels, analysts maintain a positive view on the sector. The primary reason for this is optimism around the theme of Artificial Intelligence. In 1Q 2024, similarly to 2023 full year, demand has been growing for AI technologies. The trend is observed both across sectors and regional markets (the US, Middle East, Sweden, Singapore, Japan, and Korea are examples of regions). According to the US Census Bureau, in 1Q 2023 somewhere from 3.7% to 4.5% of all American companies used AI technologies. It is expected that this range will increase to 6.6%-12.0% in the following six months.

What are the ways to invest in AI?

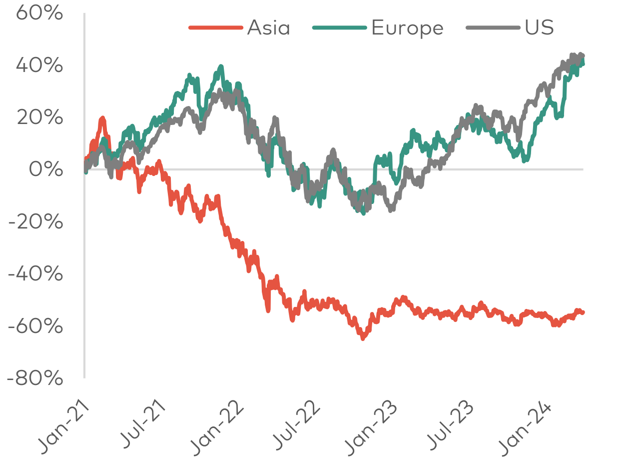
Investing in AI is possible through either single stocks or ETFs. In terms of single stocks, the large US tech companies are the most direct way to open exposure to AI. Examples of such stocks are NVIDIA (NVDA), Alphabet (GOOGL), Microsoft (MSFT), Amazon.com (AMZN) and Salesforce (CRM). However, it must be noted that the aforementioned stocks are already trading at elevated prices, which makes it risky to concentrate capital in them only. To achieve grater diversification, investors can also invest in sector ETFs that deploy AI technologies most intensively (or are expected to deploy them in the future). Other than Technologies, Health Care (XLV), Financials (XLF), and Communications (XLC) are examples of such sectors. Lastly, investors can address thematic ETFs that invest across sectors but specifically in AI-related stocks. Examples of such ETFs are Global X AI & Tech ETF (AIQ), iShares Robotics & AI Multisector ETF (IRBO) and First Trust Nasdaq AI & Robotics ETF (ROBT).

Performance of US technology sector vs other sectors (since 2019)



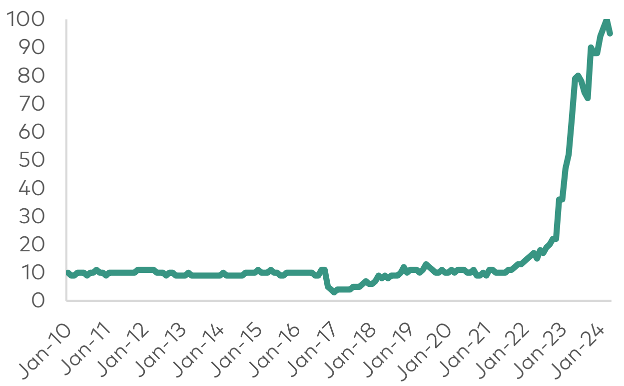
Source: Bloomberg

Performance of US, European, and Asian technology sectors (since 2021)



Source: Bloomberg

Popularity index of Google search for „Artificial Intelligence"



Source: Google Trends

4. Alternative Asset Classes

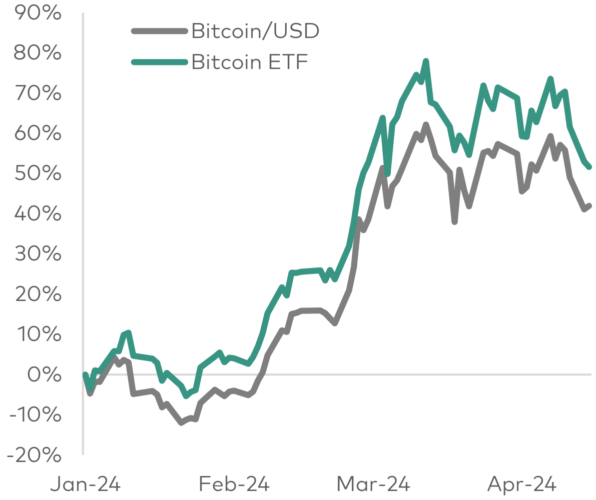
What is Bitcoin ETF and is it worth investing?

Bitcoin is the primary crypto currency, accounting for 52% of all crypto market capitalization. Bitcoin ETF is an exchange-traded fund, that invests in Bitcoin and, therefore, its value closely corresponds to the price of the underlying crypto currency. Generally, in world of investments, crypto currencies are viewed as purely speculative assets, as in contrast to stocks and bonds they have no associated cash flows. Despite this, crypto currencies can serve as a good risk diversifier in an investment portfolio (as performance of Bitcoin is less correlated with that of stocks and bonds). However, it must be noted that due to a very high volatility, it is not recommended to give large weight to crypto currencies in an investment portfolio.

What is Gold ETF and is it worth investing?

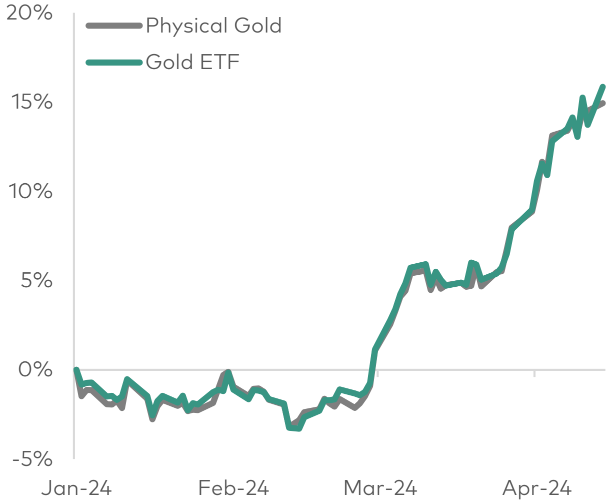
Gold ETF is an exchange-traded fund that invests in physical gold and, therefore, closely tracks the movements in gold price. Consequently, it gives investor the same exposure as would a direct purchase of gold. Similarly to Bitcoin, investing in gold increases portfolio's diversification and, therefore, reduces risk. However, in contrast to Bitcoin, gold is a low-risk asset. Holding gold is especially beneficial during the times of macroeconomic or geopolitical hardships, as investor demand for this safe haven asset strengthens, which increases the price. For example, when geopolitical tensions escalated in the Middle East in 1Q 2024, this had a positive impact on price of gold.

Performance of Bitcoin in 1Q 2024



Source: Bloomberg

Performance of gold in 1Q 2024



Source: Bloomberg

Forecasts for 2024

Fixed Income:

Analysts forecast a decline in yields throughout 2024, both in the US and in Europe. By the end-2024, a 2-year US Treasury yield is expected to reach 3.77% (down from current 4.93%), while a 2-year German bund yield is expected to fall to 1.89% (down from current 2.90%).

Equities:

According to BlackRock Investment Institute, the US and Japan equity markets should outperform other regional markets during the next 6 to 12 months. Meanwhile, the outlook is neutral for UK and Emerging Markets equities (including China) and negative for European stocks.

In terms of S&P 500 sectors, analysts expect Energy, Financials, and Materials to outperform the rest of the market. Meanwhile, Consumer Discretionary and Real Estate are forecasted to deliver weaker performance as compared to the index.

FIXED INCOME

Yield forecasts (%)

	Last	2Q24F	3Q24F	4Q24F	1Q25F
US treasuries					
30-year	4.74	4.23	4.14	4.11	4.06
10-year	4.63	4.03	3.93	3.87	3.82
5-year	4.65	4.34	3.98	3.84	3.73
2-year	4.93	4.26	4.00	3.77	3.60
SOFR*	5.30	5.31	5.08	4.82	4.44
German bunds					
10-year	2.43	2.18	2.10	2.11	2.09
2-year	2.90	2.32	2.07	1.89	1.84
EURIBOR*	3.89	3.65	3.34	3.03	2.81

Source: Bloomberg

EQUITIES

12-month outlook

S&P 500 Sectors	ETF	Outlook
Energy	XLE	Positive
Financials	XLF	Positive
Materials	XLB	Positive
Technology	XLE	Neutral
Consumer Staples	XLB	Neutral
Communications	XLK	Neutral
Utilities	XLV	Neutral
Industrials	XLP	Neutral
Health Care	XLRE	Neutral
Consumer Discretionary	XLI	Negative
Real Estate	XLU	Negative

Source: Bloomberg

6-12 month outlook

Regional Markets	ETF	Outlook
US	SPY	Positive
Japan	EWJ	Positive
UK	EWU	Neutral
Emerging Markets	EEM	Neutral
China	MCHI	Neutral
Europe	IEUR	Negative

Positive Neutral Negative

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