May 21, 2024

No Easy Bets Except Maybe in Tech

- **We still worry about US stagflation**
- **We remain positive on European equities - lower inflation helps**
- **Chinese equities challenged by weak data, but government action in the real estate sector provides support**
- **Japan disappoints on growth but equities helped by reform**
- **NVIDIA quarterly results likely to show that growth momentum maintained**
- **Old economy (Copper and utilities) ride the coat tails of tech**

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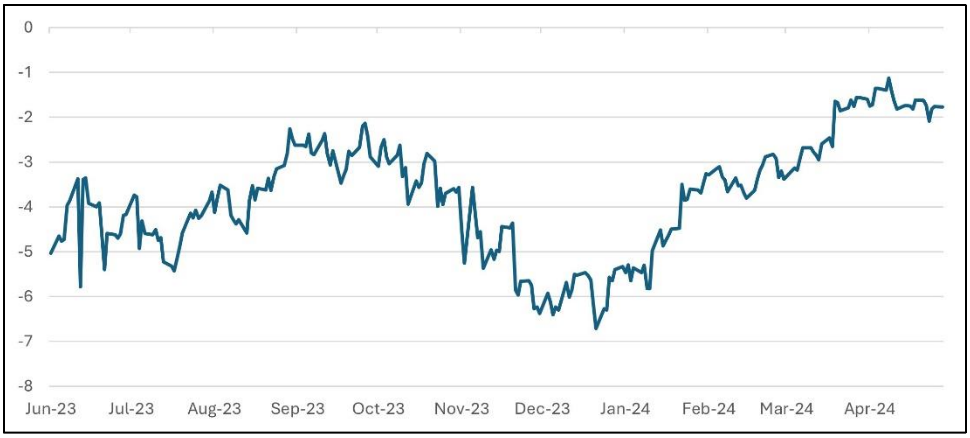
We still see prospects of stagflation despite a slightly better-than-expected US inflation data point. Amidst cooling domestic demand, the US consumer price inflation came in a touch lower than expected. The 'stag' of stagflation was more in evidence. April retail sales growth too fell short of expectations, and downward revisions to previous months' data added weight to the concerns surrounding consumers' spending power.

The consumer price inflation data for April was below expectations – the first number below market expectations in four months. Core CPI of 0.3% compared with market expectations of +0.4%. Other US inflation data points were not so good, if not downright ugly; import price inflation was +0.9% month-on-month compared with expectations of +0.3%, and export price inflation was +0.5% month-on-month compared with expectations of +0.2%.

The positive reaction from the equity market to the better-than-expected CPI seemed strange. At the end of the day, although the market moved to price two potential cuts to the Fed funds rate by the end of the year (Chart 1), such a rate cut, if at all it materialises, is quite modest relative to what the market had priced at the beginning of the year.

Chart 1: The market's pricing of the expected number of Fed funds rate cuts by year end

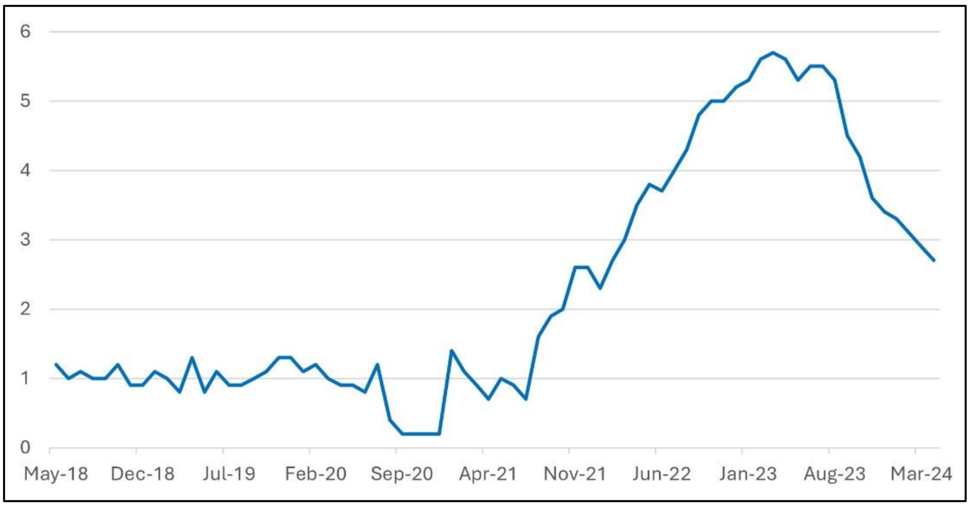


Source: Bloomberg

Over the past few months, we have argued about the value propositions that non-US equity markets offer. From the economic data standpoint alone, Europe, in our view, remains the better-founded equity bet. Last week's data confirmed solid GDP and employment growth. That GDP growth has been achieved with inflation still remaining on track to hit a level allowing the ECB to trim rates soon.

The second projections for the first-quarter Euro area GDP confirmed the flash estimate of +0.3% quarter-on-quarter growth. Core inflation in April will likely be confirmed at 2.7% year-on-year.

Chart 2: Eurozone core inflation headed in the right direction
% change year-on-year



Source: Bloomberg

Economic data from Japan and China needed to be more convincing, however. The lack of consumer confidence in both economies is keeping their respective policymakers on toes. In China, all the week's key economic activity data points were well below expectations. Retail sales were weak at -0.5% versus expectations of 1.2% month-on-month. Fixed investment at +3.6% year-on-year and industrial production at +6.7% year-on-year were good absolute numbers but were below expectations and implied a loss of momentum in the economy.

The good news for the market was that the Chinese authorities did announce some stimulus measures for the broader economy with specific plans to help the real estate market. As part of its plans to help the beleaguered real estate sector, the government announced measures to allow authorities to take some residential projects under state control as public housing. Also, the authorities will have the ability to buy land from developers who are struggling financially. As part of these measures, China's central bank will provide lending facilities to the state-owned enterprises. The PBoC also lowered the minimum down-payment for first-time homebuyers to 15% from 20% and said it would scrap minimum interest rates on mortgages.

Meanwhile, new trade tariffs announced by the US on Chinese products are likely to nullify the hopes of at least some in China of moving their trade to less contentious areas. The US and China have earlier locked horns on sensitive technology. The latest round of US tariffs quadrupled taxes on EVs while hitting the tech industry with a doubling of tariffs on semiconductors, amongst other increases.

Chart 3: Hang Seng mainland property sector index
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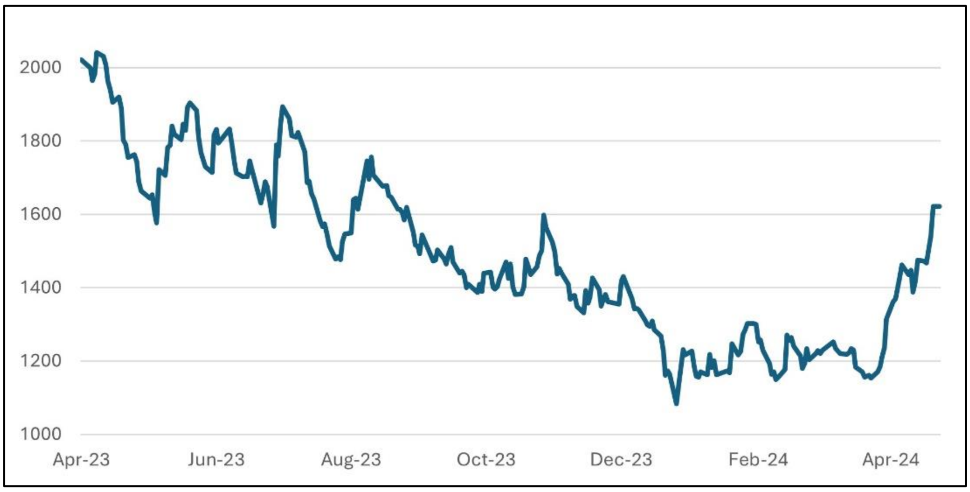

Source: Bloomberg

In Japan, the much weaker-than-expected GDP data challenged the hopes that the economy was on a path to consistent growth. First-quarter GDP fell 2.0% quarter-on-quarter, with the estimates for the fourth quarter of 2023 also revised down to 0% from 0.4%. Despite a good increase in household incomes, consumers still lack the confidence to spend. It was also unsettling to see a 3.2% quarter-on-quarter fall in capital investment, although this drop is after a very strong 7.4% increase in the fourth quarter.

The weaker-than-expected economic data is keeping the Bank of Japan from instituting tighter monetary policy conditions. The BoJ's reluctance to push on with tightening has led to further yen weakness, which only draws in a greater risk of inflation and squeezes real incomes. The yen's weakness, however, helps the exporters, which are a significant part of the stock market.

Nevertheless, we maintain our positive view on Japanese equities given the strong indication of ongoing reforms in the corporate sector. **However, we remain minded to hedge at least some of the currency risks (Chart 4).** The USD hedged version of the Japanese equity markets has proven to be the stellar performer of available share classes

Chart 4: Japan hedged equity index a better route to market
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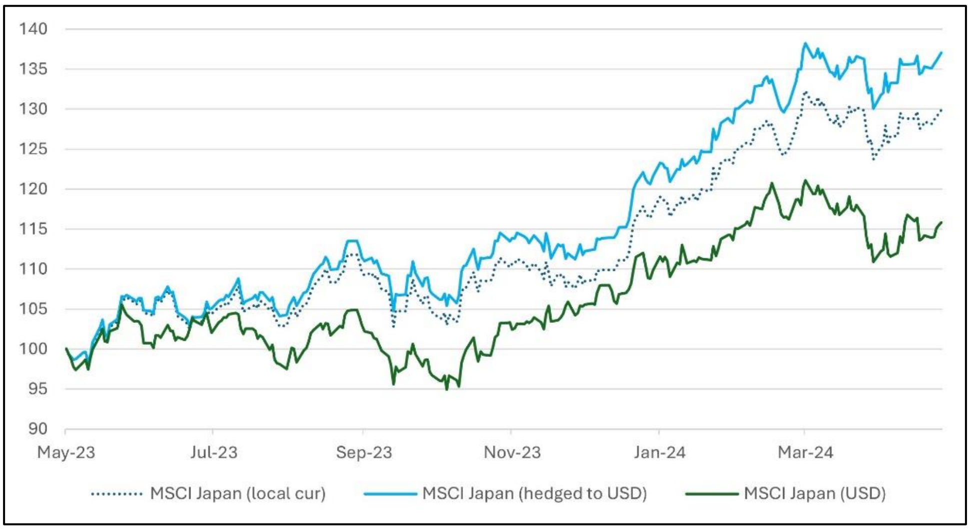

Source: Bloomberg

Notable Events This Week:

Speeches by Central Bankers: Keep an eye on upcoming speeches by central bankers, as their comments can impact market sentiment and financial strategies. Christian Lagarde is likely to reinforce the view that the ECB is committed to an early rate cut but unsure how the path of easing will develop beyond that. The Bank of England Chairman Andrew Bailey is likely to reiterate that the MPC needs greater confidence about the path of UK inflation before committing to its rate cut. The minutes of the last Fed meeting are likely to show the ongoing watch-and-see, data dependent attitude of the FOMC.

Nvidia Results: Nvidia ($924) is currently trading at an all-time high, with expected profits of $24.6 billion and earnings per share (EPS) of $5.53. Data centre revenue is projected to triple, while gaming revenue is expected to increase by 17%. The company continues to achieve very high gross margins at 77% and is anticipated to provide an upgrade to its guidance. Despite having a $2.27 trillion market cap and a 206% return over the past twelve months, Nvidia trades at a 'reasonable' forward price-to-earnings (P/E) ratio of 36x consensus forecast earnings.

NVIDIA played a different way - Utilities and Copper: Investors looking for growth opportunities in data centres beyond Nvidia have turned their attention to the utilities sector and copper. The US utilities sector recently experienced a record $700 million weekly inflow of retail money (source: Bank of America), as investors anticipate a sharp increase in electricity demand to power data centres. Copper, essential for electricity generation, has seen prices rise by 40% year-on-year due to various factors.

Chart 5: Copper price and US utilities index follow the path but not the absolute gains of NVIDIA

Price USD, yellow- Nvidia, White- Copper, Green- S&P Utilities TR Index

Source: Bloomberg

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