

July 18, 2024

BILBoard August 2024 – Stocks get that summer glow



Based on the Committee of 15th July 2024

Over the past few weeks, two important developments have played out for investors.

Firstly, **US inflation** was shown to have declined for a third consecutive month in June. The headline print came in below expectations at 3% YoY, and on a monthly basis, inflation actually declined (-0.1%) for the first time since May 2020. The all-important core CPI reading (which excludes volatile categories like food and energy) fell to 3.3%, the lowest level in over three years. Austan Goolsbee of the Chicago Fed concluded that “this is what the path to 2% inflation looks like”, while Jerome Powell has also expressed satisfaction with recent data. Can the trend continue? We think so. Global food and energy prices remain unthreatening, and a weakening

labour market is weighing on consumer sentiment, making a consumption slowdown likely in the months ahead. The upside of this is that it could lead to further alleviation in price pressures. These observations give greater confidence that the Fed will embark on a protracted easing cycle soon. Markets now see a September rate cut almost as a done deal and place a high probability of another cut in December. For many market participants, the risk that the Fed waits too long to cut, leading to a hard landing, has faded.

Secondly, the rally which has seen the S&P 500 hit 38 new highs this year, has started to **broaden out** beyond mega-cap stocks with an AI halo. As the prospect of Fed rate cuts becomes more tangible, smaller cap stocks have flourished. The small-cap Russell 2000, for example, has reached a two-and-a-half year high. To illustrate the extent of the small-fry comeback, the same index has enjoyed a five-day streak of gains of 1% or more for the first time since 1979. This represents a promising sign for the current bull market, as concentration risk – one of the prevailing sources of fear about the market rally in 2024 – is dissipating.

INVESTMENT STRATEGY

EQUITIES

In light of the aforementioned developments, we have **increased our exposure to US equities** in all eligible risk profiles, bringing our overall stance to a **slight overweight**. From an economic standpoint, we believe that the weak Q1 GDP print masks some underlying strength and Q2 could come in slightly stronger. Thereafter, we do envisage a slowdown throughout the course of the year, but without a recession materialising. On a more micro level, the earnings season is off to a good start. For example, Wall Street has posted its best quarter for investment banking in more than two years, in what bankers said were the early innings of a sustained recovery. Beyond that, momentum around the AI theme and technological progress is still going strong. Recent market action indicates that there remains a wall of money that's willing to buy, even if valuations are high.

In Europe, we maintain our base case for a weak recovery through end-2024, supported by a pick-up in consumption. PMIs pulled back in June, but this is perceived as a blip in the improving trend. In the services sector, firms are demonstrating a high degree of optimism about the future and domestic demand remains robust. In manufacturing, pricing power is very gradually returning to the market. In addition, manufacturing growth is seen in other parts of the world (US, UK, and India) and this global recovery provides a supportive backdrop for EZ manufacturers. We are holding fire for now with regard to topping up European equity exposure further, waiting for further clarity on the ECB's policy pathway. A record-low unemployment rate (6.4%), and ongoing collective bargaining (IG Metall and Verdi in Germany,

for example) could slow the disinflationary process this year, with meaningful progress towards 2% delayed until 2025. By closing some of our thematic positions, we have mechanically **reduced our European equity exposure, resulting in a slight underweight.**

Looking to the Pacific, we decided to **cut exposure to Japanese equities** in all eligible profiles. The yen has strongly depreciated and any turnaround in that trend would likely be unfavourable for Japanese equities. As of now, the BoJ is reportedly acting to prop up the currency. Meanwhile, Shunto annual wage negotiations have resulted in some of the largest pay hikes in 33 years, while economic surprises have turned positive. This paves the way for the BoJ to continue lifting rates, which would also boost the yen.

FIXED INCOME

In anticipating a less robust US macro landscape in the second half of the year, and with credit returning to extremely tight levels, we decided to lock in profits and **bring our US high-yield exposure back to neutral.**

In turn, we **slightly increased exposure to US Sovereigns.** While the bond market has had a mixed start to the year, with only credit being able to post positive returns, recent trends are encouraging for Treasuries (slowing inflation, some macro weakness, and a progressively dovish Fed). We position ourselves on the **intermediate part of the curve (3-7 years).** **More and more stakeholders are predicting a victory for Donald Trump and are beginning to discount the impact of his pro-business agenda,** which is expected to boost the economy and increase already-large fiscal deficits, thus potentially pushing up the long-end of the yield curve. Historically, Treasuries have performed well going into US elections, before selling off in the aftermath. This effect should be magnified if the Fed cuts in September or strongly suggests a November cut.

Otherwise, we remain **overweight European Investment Grade corporates,** where spreads still have some room left to tighten. European credit risk which resurfaced after the decision to call for snap elections in France was short lived, and spreads returned to previous levels once it became clear that no party at an extreme end of the political spectrum could secure a majority in parliament. Overall, the asset class remains in a sweet spot, with an economy that is neither too hot nor too cold.

CONCLUSION

It's the season when we recharge, to later return to the office sun-kissed and full of energy. Well, this summer, it seems the stock market is also getting a healthier glow about it. A thriving

market requires participation from multiple areas, whether it be across market caps, sectors, or styles. So far in 2024, this was not case with returns almost exclusively driven by large-cap tech stocks. But now rotation, the very lifeblood of a bull market, is playing out. If that wasn't enough, dovish notes are beginning to emanate from the US Federal Reserve, in another good omen for stocks. In light of these developments, we have increased US equity exposure. But one should always wear sunscreen: we balance out the additional risk by replacing a chunk of our high-yield exposure with US Sovereigns.



Lionel De Broux

Group Chief Investment Officer



Jade Bajai

Macro Strategist / Investment Communication Manager

Disclaimer

All financial data and/or economic information released by this Publication (the "Publication"); (the "Data" or the "Financial data and/or economic information"), are provided for information purposes only, without warranty of any kind, including without limitation the warranties of merchantability, fitness for a particular purpose or warranties and non-infringement of any patent, intellectual property or proprietary rights of any party, and are not intended for trading purposes. Banque Internationale à Luxembourg SA (the "Bank") does not guarantee expressly or impliedly, the sequence, accuracy, adequacy, legality, completeness, reliability, usefulness or timelessness of any Data. All Financial data and/or economic information provided may be delayed or may contain errors or be incomplete. This disclaimer applies to both isolated and aggregate uses of the Data. All Data is provided on an "as is" basis. None of the Financial data and/or economic information contained on this Publication constitutes a solicitation, offer, opinion, or recommendation, a guarantee of results, nor a solicitation by the Bank of an offer to buy or sell any security, products and services mentioned into it or to make investments. Moreover, none of the Financial data and/or economic information contained on this Publication provides legal, tax accounting, financial or investment advice or services regarding the profitability or suitability of any security or investment. This Publication has not been prepared with the aim to take an investor's particular investment objectives, financial position or needs into account. It is up to the investor himself to consider whether the Data contained herein this Publication is appropriate to his needs, financial position and objectives or to seek professional independent advice before making an investment decision based upon the Data. No investment decision whatsoever may result from solely reading this document. In order to read and understand the Financial data and/or economic information included in this document, you will need to have knowledge and experience of financial markets. If this is not the case, please contact your relationship manager. This Publication is prepared by the Bank and is based on data available to the public and upon information from sources believed to be reliable and accurate, taken from stock exchanges and third parties. The Bank, including its parent,- subsidiary or affiliate entities, agents, directors, officers, employees, representatives or suppliers, shall not, directly or indirectly, be liable, in any way, for any: inaccuracies or errors in or omissions from the Financial data and/or economic information, including but not limited to financial data regardless of the cause of such or for any investment decision made, action taken, or action not taken of whatever nature in reliance upon any Data provided herein, nor for any loss or damage, direct or indirect, special or consequential, arising from any use of this Publication or of its content. This Publication is only valid at the moment of its editing, unless otherwise specified. All Financial data and/or economic information contained herein can also quickly become out-of- date. All Data is subject to change without notice and may not be incorporated in any new version of this Publication. The Bank has no obligation to update this Publication upon the availability of new data, the occurrence of new events and/or other evolutions. Before making an investment decision, the investor must read carefully the terms and conditions of the documentation relating to the specific products or services. Past performance is no guarantee of future performance. Products or services described in this Publication may not be available in all countries and may be subject to restrictions in some persons or in some countries. No part of this Publication may be reproduced, distributed, modified, linked to or used for any public or commercial purpose without the prior written consent of the Bank. In any case, all Financial data and/or economic information provided on this Publication are not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law and/or regulation. If you have obtained this Publication from a source other than the Bank website, be aware that electronic documentation can be altered subsequent to original distribution.

As economic conditions are subject to change, the information and opinions presented in this outlook are current only as of the date indicated in the matrix or the publication date. This publication is based on data available to the public and upon information that is considered as reliable. Even if particular attention has been paid to its content, no guarantee, warranty or representation is given to the accuracy or completeness thereof. Banque Internationale à Luxembourg cannot be held liable or responsible with respect to the information expressed herein. This document has been prepared only for information purposes and does not constitute an offer or invitation to make investments. It is up to investors themselves to consider whether the information contained herein is appropriate to their needs and objectives or to seek advice before making an investment decision based upon this information. Banque Internationale à Luxembourg accepts no liability whatsoever for any investment decisions of whatever nature by the user of this publication, which are in any way based on this publication, nor for any loss or damage arising from any use of this publication or its content. This publication, prepared by Banque Internationale à Luxembourg (BIL), may not be copied or duplicated in any form whatsoever or redistributed without the prior written consent of BIL 69, route d'Esch | L-2953 Luxembourg | RCS Luxembourg B-6307 | Tel. +352 4590 6699 | www.bil.com.