Mt Fort Advisers
- Investment Strategy Update -

June 28th, 2024

Dear All,

We're pleased to present our latest investment strategy update, crafted with insights from our independent macro strategist, Prof. Michel Girardin. You can access it by directly clicking here and use **MtFort2024** as the password.

“Same players, shoot again”. The first half of 2024 marked the continued **dominance** of the **AI related tech stock** performance. US growth stocks returned over +24% in H1 2024, while value stocks generated a mere +5% gain over the same period. More specifically, the famous “**Magnificent Six**”, so called M6 (Apple, Amazon, Alphabet, Meta, Microsoft, and Nvidia) **outperformed** the broader market by 43 percentage points, generating gains of +48% compared to 5% for the S&P494. Zooming in further, NVDIA remained the star performer among the mega caps with a +150% gain in H1 2024. As a corollary of such a huge outperformance, the **concentration** of the M6 within the S&500 index **reached** an **unprecedented level**, representing 36% of the other 494 companies of the S&P500. Such a high concentration does expose the overall market indices to the destiny of the M6 performance, increasing therefore the overall market risk.
It is worth pointing out that the outperformance of the M6 is not driven by multiple expansion, which contracted from their highs in 2023, from over 60x PE in 2020 down to 40x in 2023 and around 35x now). It is predominantly the result of its **extraordinary earnings growth**. In the first quarter fiscal 2025, NVIDIA posted revenues amounting to $26.04 billion, a 262% increase to its $7.19 billion achieved in the same quarter the previous year. In the twelve months ending April 28, 2024, it posted revenues of $79.77bn, compared to $10.9bn in the twelve months ending January 2020, i.e. almost 8 times in 5 years. The company capitalization briefly topped $3tr outpacing Microsoft and Apple as the largest listed company in the world.

Financial markets enjoyed an unusual **steady first half of the year** with only **one** modest wave of **correction** in the semester during the month of April (-5.7%). The financial markets reacted to the ongoing **growth-inflation developments** and were spooked by the

data showing a strong labour market, resilient growth and renewed inflationary pressure. Those data fuelled the "**higher for longer**" rate narrative. As we have seen later in May and June, the most recent data showed: 1) a contracting economy with the Q1 2024 US GDP growing only at +1.3% compared to +3.4% in Q4 2023; 2) a labour market showing some signs of weakening with the unemployment rate moving north from 3.9% to 4% (compared to 3.7% last year); and 3) inflation data cooling down to 3.3% in May. Those data reassured the markets, which reversed their April losses and extended gains to the end of June pricing now **two to one rate cuts by the end of the year**. This is a stark contrast to the 5 or 6 cuts initially forecasted for 2024 at the end of last year, which did not prevent the financial markets to performance strongly during the semester with the S&P500 adding +15% and the MSCI World AC index +11% over the period.

After such a strong start in H1 2024, where does it lead us for the end of 2024? The questions raised in our investment paper last December are almost identical: 1) Will **inflation** continue to decelerate and reach the 2% Fed target? 2) Will the **labour market** start to cool down more significantly? 3) Will **interest rates** start **biting** into economic growth, and 4) Will the **Fed** finally **pivot** with one or two rate cuts as the market is now anticipating? And, is there still value in current markets trading at around 26x PE for US Equities compared to a long-term average around 17x and taking into account the current high concentration among only a few stocks driving the market performance?

As reported at the end of last year, many **macro aggregates** are at an **inflection** point. Prof. Michel Girardin is elaborating on some of his key proprietary indictors and points to the following facts: 1) global manufacturing activity is bottoming out, 2) the US labor market is cooling, 3) US consumer confidence is pointing to lower growth, 4) US consumer strength is due to abate, and 5) Inflation keeps rolling over but the hardest will be "the last mile" reaching the 2% FED inflation target.

In such a context, our base case for the end of the year and 2025, is constructed around a **normalising** macro environment with the **interest rate lagging effect fading** and tighter financial conditions starting to **bite economic growth** gradually. Excess savings post-pandemic has eroded. Income growth is muted in real terms. New credits are becoming harder to get. We would therefore expect a **deteriorating labour market**, and **weaker consumer confidence**, implying **lower consumption**. Inflation should keep receding, with shelter CPI cooling down with some delay, allowing the **FED to start its easing process** before the end of the year. We would keep a close eye though on oil and export prices, which could mitigate the current immaculate disinflation, due to potentially escalating overall geopolitical risks and increasing trade tariffs globally.

It is worth noting that a growing number of economists are foreseeing a potential **productivity boost** from the development of generative artificial intelligence, which could be reminiscent of the Internet boom in the late 90s and could provide further support to current equity markets. Although we appreciate the massive long-term benefits of GAI, those have been currently concentrated around **hardware players** and essentially chips producers such as Nvidia. We are questioning though how quickly the **software industry** can translate the hardware frenzy in real additional revenues. It might take longer for software applications to transpire through the economic system and be adopted at scale to bring significant revenues. Undoubtedly, this is only a matter of time, and we will see a second wave of strong returns for players able to **monetize on AI** related developments

and applications. In the shorter term, we are more concerned about the Nvidia & Co's capacity to keep growing their revenues exponentially for much longer.

Earnings will need to be monitored very closely in a potentially softer economic environment. Q1 2024 earnings growth was mildly positive +5.4% on a blended basis for the S&P500, but looking deeper, the Magnificent 5 (M7 excluding Apple and Tesla) cannibalised most of the growth, while the other S&P495 saw earnings growth contracting by about -2% for the quarter according to FactSet report. We reckon that the question is not if **growth stocks** can keep up with such a pace, but when should we expect some disappointments in this frenetic pace of growth. Amounts at stake are huge with an annual turnover soon to reach over $100bn for Nvidia. We should bear in mind that five companies are making over 50% of Nvidia's revenues. This is not a very diversified revenue base if some of the key clients are starting to produce their own chips or find alternatives at some stage.
According to our in-house indicators, **equities** are **approaching greed territory** (i.e. more than 30% outperformance of World Equities vs World Bonds). While we were still supporting an overweight exposure to growth stocks in H1 2024, we would rather be more cautions over the next semester and **reduce growth exposure** to turn more defensive in sectors such as health care, staples and utilities. Equally, on the asset allocation front, we would start **reducing the equity exposure** below neutral and go **long duration with bonds**. In a context of low volatility, relative high interest rate in USD, we are keen on building alternative equity exposure through protected equity instruments providing an upside potential on a range of underlying equities such as China, small caps, Italy, or utilities-AI energy consumption, while being immune against any potential downside. The asymmetric feature of those products is rather attractive in the current environment.

With **monetary policy** finally expected to **pivot** in the US, we would anticipate fair gains in the credit space by going long duration over the next few years. Although we appreciate that spreads remain very tight and debt servicing is still a constraint, it should become less of a burden with interest rates starting their descent. That should also put less stress on US regional banks exposed to commercial real estate and seating on significant marked-to-market losses on their long-term treasuries' exposure. The ECB, the BNS, the Riksbank and the Bank of Canda have already started cutting interest rates.

Along a slightly more cautious stance, we would keep a **long position in gold** supported by the current multi-polarisation of the world and a growing mistrust to the USD dominance. A surging US public deficit and debt servicing requirement could furthermore weight on the **USD**, despite its refuge characteristic and the fact that it remains by far the undisputed reserve currency for now.

The second half of the year will be rich in **political events** with the UK general elections on July 4th, the second round of the French legislative elections on July 7th and the US presidential election on November 5th. With a growing influence of **populism**, supported by social media, the increasing strength of far-right movements in Europe and the US, we should be mindful of potentially significant **policy shifts** that could affect certain sectors: marginalisation of green policies, tighter immigration, increase in protectionism and trade barriers, higher deficits,… Social tensions might escalate due to growing inequalities and decreasing purchase power. Not only domestic political risks are increasing, but **geopolitical risks** will remain high with possibly escalating trade tensions between the US

and China, if not more with the Taiwan situation, the Iranian developments, the war in Gaza, the ongoing Ukrainian conflict, skirmishes in the Red Sea affecting shipping traffic, …

In this environment, while we do not see strong signals at this stage supporting a dramatic shift to a risk off mode, we would keep a nimble approach using **tactical hedges** via bear put spreads to protect long exposure, while tactically reducing our risk exposure. Market sentiment, excluding the mega growth stocks, moved to a fear mode and together with a more accommodative Fed monetary policy, it should cushion an extended market weakness.

As always, we can only encourage investors to regularly review their **investment objectives** and ensure their portfolios are in adequation with their risk appetite and liquidity requirements factoring in any changes in their personal circumstances and perception of the overall environment. This is particularly sensitive considering the current economic inflection points, which could lead to a wide range of different scenarios, including upside surprises.

For a deeper dive into our strategies and Prof. Girardin's insights, you can access the full investment strategy update by clicking here.

We look forward to discussing these insights further and hearing your valuable thoughts.

In the meantime, the whole Mt Fort Advisers Team wishes you an enjoyable summer season, and for those in southern hemisphere, an excellent winter.

Thank you for your continued trust and support,

Your Research Team

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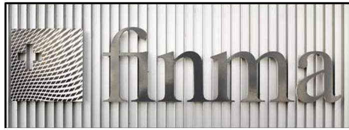

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