



Monthly Market Report

March 2024



With commentary from David Stevenson

Bubble time?

I'll kick off this month with two remarkable milestones, both about the runaway success of the US stock market. The first (as reported by SG strategist Albert Edwards) is that the value of the US tech sector once again comprises one-third of the US equity market. This just pips the previous all-time peak seen on 17 July 2000 at the height of the Nasdaq tech bubble. And that has been achieved with only three of the 'Magnificent-7' internet stocks actually being in the tech sector (Apple, Microsoft and Nvidia)! If you add in the market cap of Amazon, Meta (Facebook), Alphabet (Google) and Tesla, then the IT and 'internet' stocks dominate like never before.

The second milestone? Bloomberg reports that Chinese stocks have lost more than \$6.3 trillion in market value from a peak in February 2021. Over the same period, US equities have gained some \$5.3 trillion.

These astonishing numbers have prompted lots of very intelligent market observers to wonder if we're trapped in yet another bubble. Maybe the share price of Nvidia is stretched at a current 57 times earnings while Microsoft trades at 35 times forward earnings. But Alphabet is at around 21 times forecast earnings and Meta's not far off at 23 times. These valuations are certainly eye-brow-raising and probably above average, but they don't look extreme and totally unreasonable. The central point remains that large US corporations are making huge amounts of money, possibly because of inflated margins and price gouging. That much is increasingly obvious by looking at the current earnings season in the US. Here are some headlines as I write this on the current numbers:

- 32% of the S&P 500 (c.40% of the index's market cap) has reported so far and 185 issues have reported, with 140 beating operating estimates (for a 75.7% beat rate), as 124 of 182 (68.1%) have beaten on sales.
- Estimates call for a 0.7% increase over Q3 2023 and a 4.5% gain over Q4 2022.
- Sales are coming in strong, up 3.0% over Q3 2023 and up 4.6% over Q4 2022, and are expected to set a record quarter (surpassing USD 4 trillion for the first time) as well as the full-year 2023 (USD 15.6 trillion).
- Operating margins for Q4 2023 are expected to decline to 10.91% from 11.15% in Q3 2023 (the average since 1993 is 8.39%, and the record is 13.54% in Q2 2021).
- Sector wise, Staples (92%), Industrials (89%) and Materials (86%) have delivered the most beats per sector, while Real Estate (50%), Utilities (50%) and Communications (56%) have delivered the fewest.
- Without Nasdaq stocks, S&P 500 EPS would have been down for two years now. Similarly, excluding the AI-boom stocks, S&P 500 would be down 15% to 4,200

For 2023, earnings estimates call for a 7.8% increase, and the forward P/E is 22.8. For 2024,

earnings estimates call for a 12.6% increase, and the forward P/E is 20.3. Expensive, probably. Crazy? More debateable. Watch those cash earnings roll in !

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Headline Numbers

Global Liquidity is peaking

Investors like to fool themselves by thinking that what drives markets higher (and lower) is centred on valuation. I've increasingly come to a different view - what actually drives markets is liquidity, especially at the global level as determined by central banks. This focus on global liquidity is a concept a term borrowed from macroeconomics and implies the idea that when central banks flush extra liquidity into the global finance system, then risk assets - equities - tend to prosper. More money emerges in trading accounts which need to find a home in riskier assets that can increase markedly in price i.e shares in Nvidia and investments in Bitcoin.

The London research firm Cross Border Capital has built a strong track record of charting these global liquidity flows and boasts charts that show as global liquidity increases, equities surge ahead i.e. there is a very tight correlation. And vice versa - tighten credit and investors sell risky assets.

According to Cross Border Research, their latest weekly measures derived from Central Bank balance sheet data shows global liquidity growth expanding at a strong 14% 3m annualized clip. In nominal terms, global liquidity has hit a record US\$171.3tr. To put into context, the 2023 average was US\$166.6tr and the cycle-low in October 2022 was US\$158.8tr. Still, liquidity levels are still just 8% above that low. The liquidity cycle typically lasts 5-6 years from trough-to- trough and we are some 15 months into the current upturn. On this basis, we expect liquidity levels to rise through this year and next before peaking late on in 2025.

Is your lifecycle investing strategy working for you?

Asset allocation glide paths are to investment 101 what Bibles are to Christians - the bedrock of their faith and largely uncontested. The ideas are simple. As you get older, you take the risk levels down, and you start to conserve capital by switching to bonds before kicking into the final de-accumulation (or income drawdown) phase. That's the theory at least.

The logical consequence of this is that by your late 50s you should be moving into a capital preservation phase and starting to dial down equity exposure. Right? Maybe but I have long had my doubts. My first concern has been that increased longevity throws a spanner in that theory.

What happens if you are risk off in your late 50s but likely to live for another 30 years? Or maybe you will keep on working until your early seventies? My next concern is that its not immediately obvious that bond always provide quite the diversification you assume - especially non-government bonds ? Lastly I worry that if you go the safest route and switch exclusively into near risk free government bonds, will you be able to generate the returns you need?

If this kind of slightly pointy head stuff interests you - it does me - then it might be worth wading through all the equations and tables in an interesting academic paper called "Beyond the Status Quo: A Critical Assessment of Lifecycle Investment Advice" from late 2023 by Aizhan Anarkulova, Scott Cederburg, and Michael S. O'Doherty. You can [read the study here](#).

Here's the initial abstract:

We challenge two central tenets of lifecycle investing: (i) investors should diversify across stocks and bonds and (ii) the young should hold more stocks than the old. An even mix of 50% domestic stocks and 50% international stocks held throughout one's lifetime vastly outperform age-based, stock-bond strategies in building wealth, supporting retirement consumption, preserving capital, and generating bequests. These findings are based on a lifecycle model that features dynamic processes for labor earnings, Social Security benefits, and mortality and captures the salient time-series and cross-sectional properties of long-horizon asset class returns. Given the sheer magnitude of US retirement savings, we estimate that Americans could realize trillions of dollars in welfare gains by adopting the all-equity strategy.

And here's the academics conclusion?

Despite the dominance of Stocks/I in achieving retirement outcomes, investors and regulators may be uncomfortable with the tendency for larger intermediate drawdowns using the all-equity strategy. Drawdowns inflict psychological pain, and some investors may abandon their investments rather than stay the course. We are sympathetic to the discomfort and real costs of these bouts of poor short-run performance. In our opinion, however, reducing these short-run losses by adopting a QDIA strategy comes at too high a price because investors must forego the enormous economic gains from adopting the Stocks/I strategy (estimated to be hundreds of billions of dollars per year for US investors alone). Our findings suggest that financial advice and pension regulations should be revised to consider all-equity strategies as viable safe harbour alternatives; we call for alternative approaches to mitigate the costs of short-term losses, such as financial education on staying the course, retirement account reporting standards that emphasise long-term performance, and regulations that assist retirement savers with maintaining a long-term focus.

Measure	Values as of 11th January 2024	Values as of 9th February 2024
UK Government 10 year bond rate	3.80%	4.02%
GDP Growth rate YoY	0.30%	0.30%
CPI Core rate	3.90%	3.90%
RPI Inflation rate	5.30%	5.20%
Interest rate	5.25%	5.25%
Interbank rate 3 month	5.32%	5.33%
Government debt to GDP ratio	97.10%	97%
Manufacturing PMI	46.2	47

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Bank CDS options

Most of the banks in the table saw their swap rates marginally decline over the last month, though I wouldn't want to overegg those declines - they were mostly very marginal. A few banks did see their rates increase - Lloyds, Morgan Stanley and SocGen. But again, the increases were very marginal.

Bank	One Year	Five Year	Credit Rating (S&P)	Credit Rating (Moody's)	Credit Rating (Fitch)
Santander	46.62	17.59	A+	A2	A -
Barclays	74.35	43.68	BBB	BAA1	A
BNP Paribas	39.13	16.73	A+	Aa3	A+
Citigroup	63.33	30.28	BBB+	A3	A
Deutsche Bank	107.78	50.44	A-	A1	BBB+
Goldman Sachs	67.28	34.69	BBB+	A2	A
HSBC	41.18	22.09	A+	A1	AA-
Investec	n/a	n/a	n/a	A1	BBB+
JP Morgan	42.37	22.72	A-	A1	AA-
Lloyds Banking Group	42.6	17.14	BBB+	A3	A
Morgan Stanley	64.31	32.32	A-	A1	A+
Natixis	38.5	17	A	A1	A+
Nomura	78.3	19.63	BBB+	BAA1	A-
RBC	50.89	19.29	AA-	A1	AA-
Soc Gen	51.98	26.14	A	A1	A-
UBS	45.2	29.29	A-	Aa3	A+

Source: Tempo Issuer & Counterparty Scorecards ('TICS') 1st February 2024 www.tempo-sp.com

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Government Bonds

Fixed Income

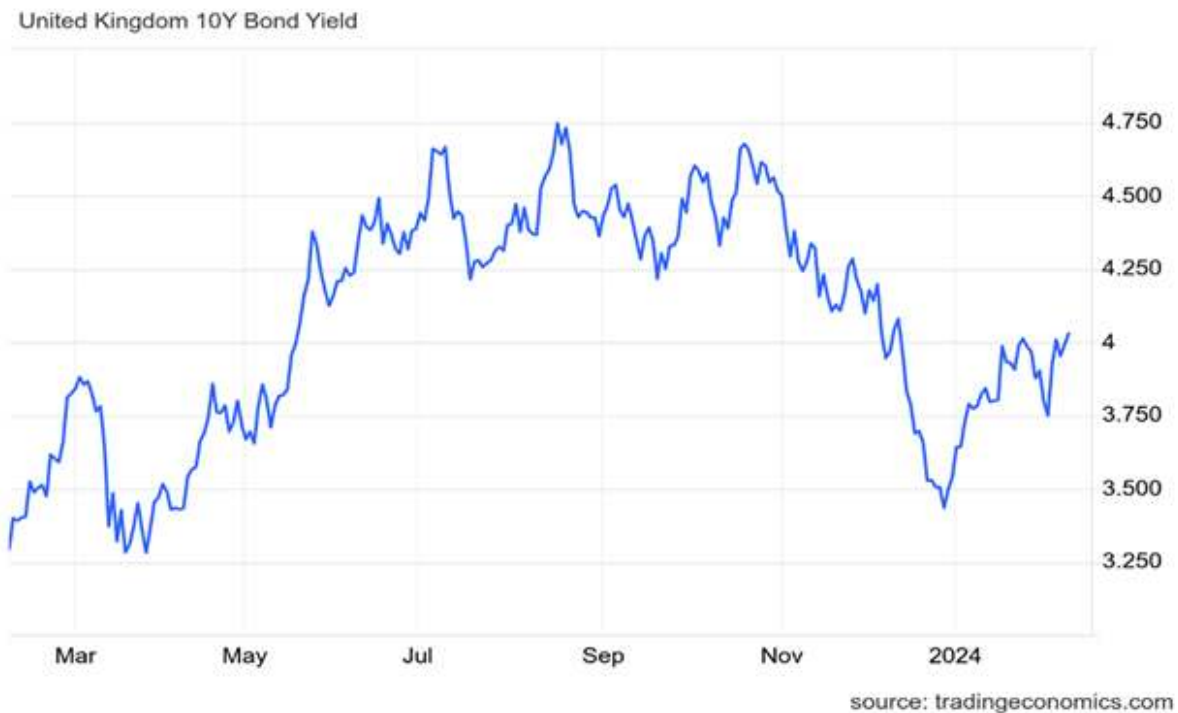
Two numbers are worth noting this month. The first is the less consequential - the spread between 10 year Greek government bond yields (at 3.36%) and German 10 year bond yields (2.35%) is now just 101 basis points and could break below 100 any day now. Remember that just over a year ago this spread was nearly double the current level.

As for government CDS rates, as you'd expect Switzerland is still regarded as the lowest risk in terms of government bond issuance with a 5-year CDS rate of just 7.46 basis points, closely

followed by Denmark, the Netherlands and Germany. What I find interesting is that Ireland has pricing for the 5 year swaps of just 23 basis points but the UK is up 32 basis points, 5 basis points ahead of the United States. The irony is that this above average pricing for swaps for the UK contrasts with its booming stock market and its optimistic consumer economy.

One last useful yardstick. Yields for Swiss 2 year bonds are currently just 1.17% whereas the US rate is 4.45%. The UK is even higher at 4.51%. The Swiss core inflation rate is just 1.70% whereas the UK core inflation rate is still at 5.1%.

UK Government Bonds 10-year Rate 4.02%



Source: <http://www.tradingeconomics.com/united-kingdom/government-bond-yield>

CDS Rates for Sovereign Debt

Country	Five Year
France	24
Germany	13.09
Japan	22.03
United Kingdom	32
Ireland	23.05
Italy	76
Portugal	39.84
Spain	42.88

Eurozone peripheral bond yields

Country	February 2024	January 2024	Spread over 10 year
Spain 10 year	3.27%	3.14%	92
Italy 10 year	3.92%	3.82%	164
Greece 10 year	3.36%	3.27%	101

	S&P Rating		Moody's Rating		Fitch Rating
Germany	AAA	Stable	AAA	Negative	AAA
United Kingdom	AAA	Negative	AA1	Stable	AA+
United States	AA+	Stable	AAA	Stable	AAA

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Equity Markets and Dividend Futures

The global equity markets finished January up 1.1% according to SocGen analysts, with Japan leading the way (+8.4%), and with the laggards China (-6.3%), Hong Kong (-9.2%) and US Smallcaps (-3.9%). In index terms, the S&P Global BMI gains stopped as the consolidated market posted a slight gain of 0.13%, after December's 5.16% gain and November's strong 9.05% turnaround (from October's -3.44% and September's -4.29%). However, absent the U.S. 1.02% gain, the 0.13% gain became a 1.20% fall.

Amidst this mixed bag of results, there were some fascinating winners. Who'd have guessed that in January, the most successful market was Egypt, which scored a 17% one-month gain, followed by Turkey, up 10.53% and Kuwait, up 7%. In Europe, the Netherlands produced the biggest gain, up 5.4% followed by Denmark up 4.89% and that great rebound story Greece up 4.83%. India notched up a 3% gain while the UK was down again, with a decline of 1.66%. At the bottom of the pack, China again with an 11% loss for January. Ouch!

I thought I would highlight the table below from S&P Dow Jones. I've ranked country markets by their 1-year returns (to the end of January). The big winner has been Egyptian shares again up 78% (who would have guessed it) followed by Hungary up 38% and Poland up 34%. Greece is up there again at a 34% gain, followed closely by India with a 32% gain.

			S&P Global Broad Market Index(BMI) Global				31/01/2024	
US MKT	%	%	BMI MEMBER	1-MONTH	YTD	3-MONTH	6-MONTH	1-YEAR
\$15	0.19%	0.02%	Egypt	17.12%	17.12%	31.44%	73.44%	78.08%
\$18	0.23%	0.02%	Hungary	3.00%	3.00%	19.01%	19.52%	38.30%
\$85	1.08%	0.11%	Poland	-2.49%	-2.49%	14.79%	6.91%	34.85%
\$46	0.58%	0.06%	Greece	4.83%	4.83%	17.61%	3.50%	34.50%
\$1,829	23.14%	2.34%	India	3.05%	3.05%	19.19%	16.71%	32.03%
\$623	0.89%	0.80%	Denmark	4.89%	4.89%	18.13%	17.95%	30.58%
\$198	0.28%	0.25%	Ireland	2.97%	2.97%	23.70%	6.11%	22.58%
\$21	0.26%	0.03%	Peru	-2.16%	-2.16%	25.75%	3.93%	18.14%
\$47,080	67.13%	60.33%	United States	1.02%	1.02%	16.05%	5.03%	17.29%
\$221	2.80%	0.28%	Mexico	-1.78%	-1.78%	22.51%	2.14%	15.34%
\$560	0.80%	0.72%	Italy	-0.22%	-0.22%	14.78%	2.95%	15.31%

Index	January 2024	February 2024	Reference Index Value	Level 6 Months Ago
Stoxx 50 Dec 23 contract	157.4	158.8	4718	143
FTSE 100 Dividend Dec 2023	311	311.5	7576	298

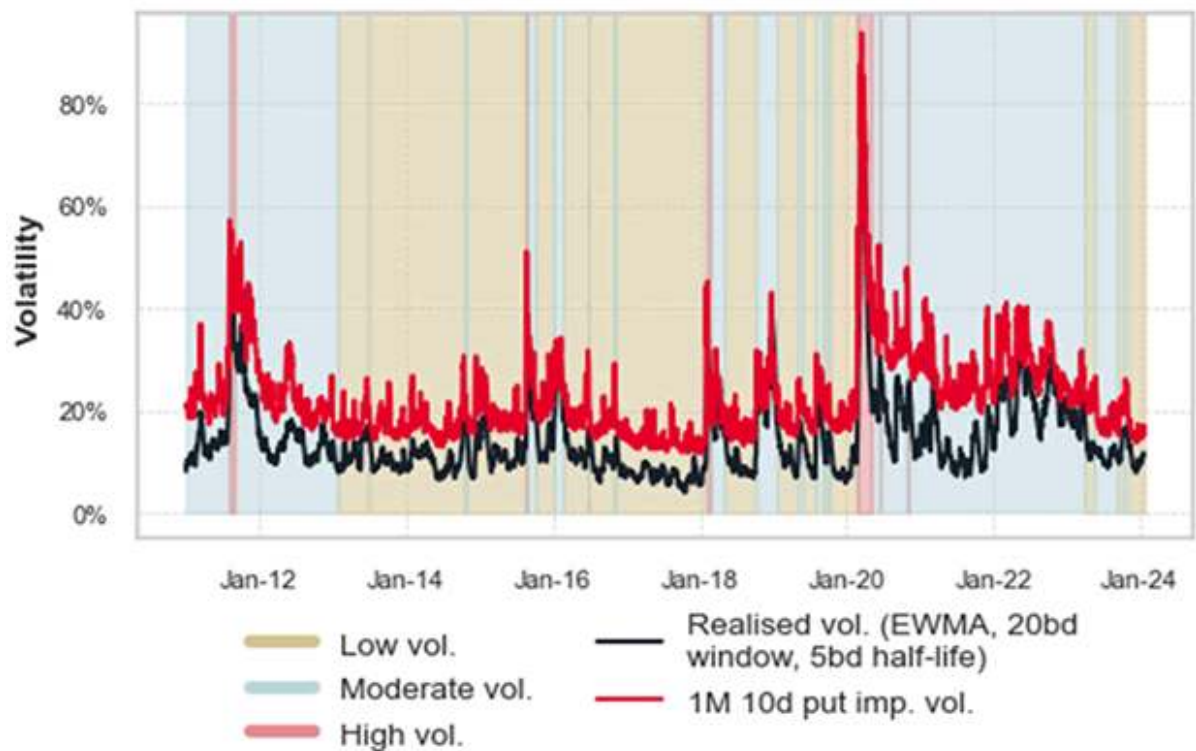
Note changed to Dec 2024 contracts

Name	Price % change						Close
	1 mth	3 mths	6 mths	1 yr	5 yr	6 yr	
FTSE 100	-1.01	2.9	1.18	-3.41	7.71	6.22	7616.4
S&P 500	4.86	14	11	21.3	84.5	93.5	4994.9
Gold Composite (Most Traded)	0.895	4.8	4.68	8.52	55.6	55.3	205170c
iShares FTSE UK All Stocks Gilt	-1.52	0.8	2.25	-4.66	-23.4	-20.5	1022.5p
VIX New Methodology	-1.91	-11.2	-19.8	-34.6	-18.4	-61.7	12.83

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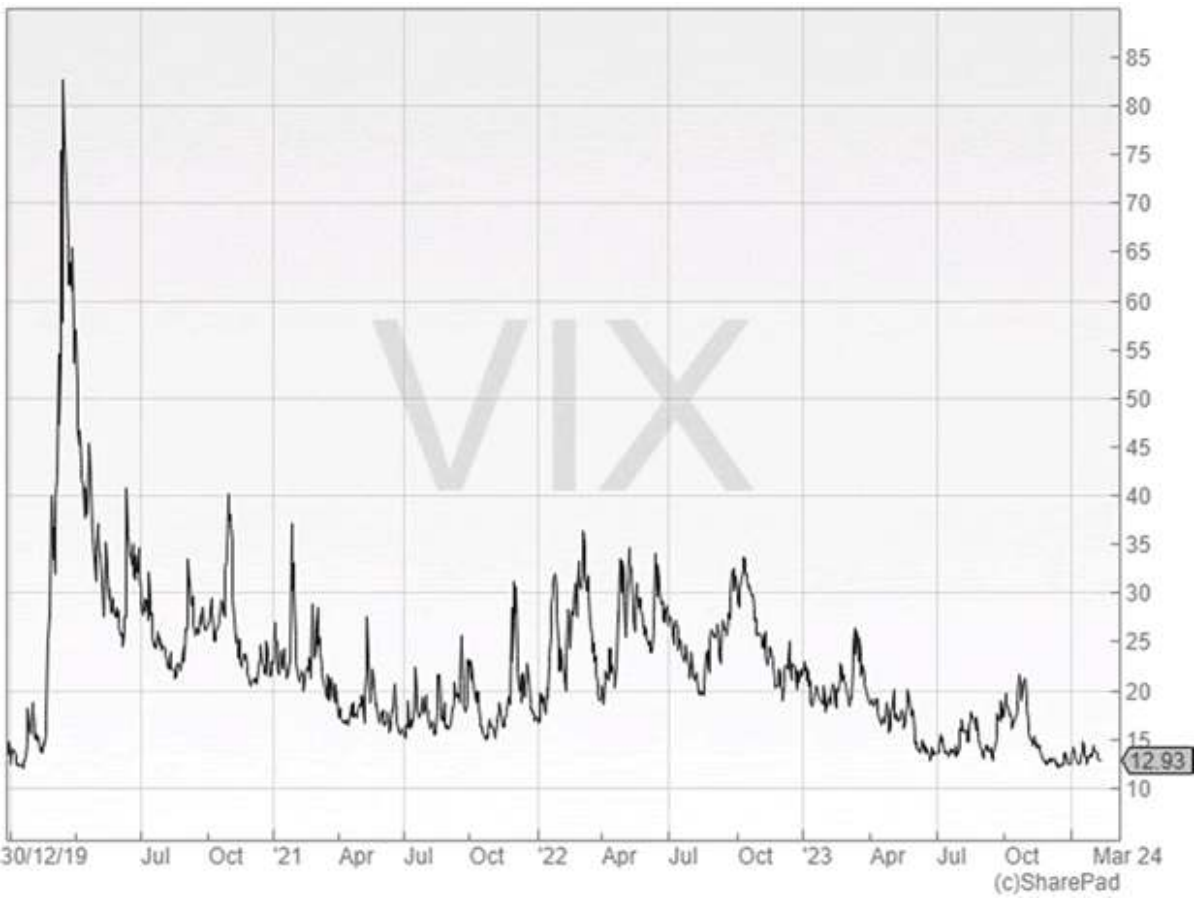
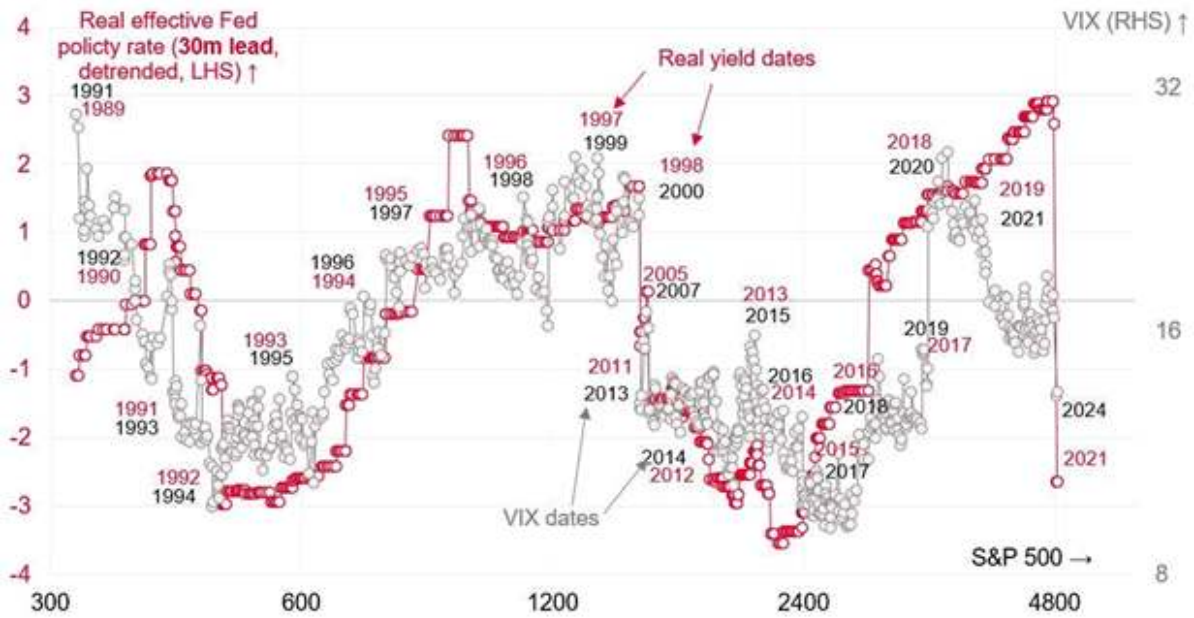
Volatility

I've consistently flagged the low levels of market volatility - the US markets, for instance, seem way too calm, which sets my alarm bells off! But maybe I'm being too cautious, and perhaps the current positive momentum has much further to run, restraining market volatility. Analysts at SocGen have been digging around inside the historical record for volatility measures and come to a surprising conclusion - volatility indices tend to move over medium-term cycles. According to SocGen's Kunal Thakkar markets have moved into a low-volatility regime after spending about three years in a moderate volatility one. (Beige, light blue and pink regions in the chart below indicate low-, moderate- and high-volatility regimes.) While the chart below is for the S&P 500, the SG analysts see a similar move into a low-volatility regime for the STOXX 50 as well.



The SG analyst reckons that markets will likely stay in this low-volatility regime for the foreseeable future, in our view. Recent signals from the SG Sentiment Indicator reinforce this view. The indicator stayed relatively high and in the 'risk-on' zone in 2023, like it did in other low-volatility, carry-friendly years such as 2017 and 2019. Its longest streak in the 'risk-off' zone in 2023 was 15 business days. To put this into context, we recorded 40- and 22-day risk-off streaks in the first half of 2022. The historical behaviour of volatility regimes also supports their benign view. The S&P 500 stayed in a low-volatility regime from early 2013 until about early 2020, with a few moves into moderate- (3Q15, early 2016, end-2018) and high-volatility regimes (February 2018, March 2020).

The SG team have also been crunching the numbers to try and figure out what drives these lower volatility regimes - the answer seems to be the real yield. Volatility tends to follow the real yield curve with a lag of 2-3 years. "Even a simple detrended real yield time-series seems to largely explain the trajectory of VIX when S&P500 is at all-time highs (chart below)!" The SG framework suggests that global equity volatility will bottom out in 2024 and inflect higher by the end of the year.



Measure	February Level	January Level	December Level	November Level
Vstox Volatility	13.62	13.92	13.21	15.93
VFTSE Volatility	12.93	12.69	12.63	14.17

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Summary of Pricing Impact on Structured Products

Pricing Parameter	Change	Impact on Structured Product Price
Interest Rates	Up	Down
Underlying Level	Up	Up (unless product offers inverse exposure to the underlying)
Underlying Volatility	Up	Down for capped return/fixed return/capital at risk products. Up for uncapped return/capital protected products.
Investment Term	Up	Down
Issuer Funding Spread	Up	Down
Dividend Yield of Underlying	Up	Down
Correlation (if multiple underlyings)	Up	Up (unless product offers exposure to the best performing underlyings only)

Source: UK Structured Products Association, January 2014

This information is provided for information purposes only, and the impact on a structured product price assumes all other pricing parameters remain constant.

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Explanation of Terms

CDS Spreads and Credit Ratings

A CDS effectively acts like an option insuring at a cost in basis points a bank or government bond in case of default. The higher the basis points, the riskier the market perceives that security. Crucially CDS options are dynamic and change in price all the time. A credit rating is issued by a credit rating firm and tells us how risky the issuer is viewed based on the concept that AAA (triple A) is the least risky and ratings at C and below are regarded as much riskier. CDS and ratings are useful for structured product buyers because they give us an indication of how financial risk is viewed by the market. Crucially a high CDS rate indicates that an issuer of a bond will probably have to pay a higher yield or coupon, which could be good for structured product buyers as bonds are usually a prime source of funding for a structured product. G8 government bonds issued by the likes of the UK and US Treasury are also sometimes used as collateral in some form of investments largely because they are viewed as being low risk. One last small note on credit ratings and CDS rates. A is clearly a good rating for a bond (and much better than B) but AA will be viewed as even safer with triple AAA the least risky. Terms of CDS rates anything much above 100 basis points (1%) would warrant some attention (implying the market has some, small, concern about the possibility of default) while anything above 250 would indicate that the market has major concerns on that day about default.

Why does the yield matter on a bond?

As we have already explained bonds are usually used as part of a structured product. The bonds yield or coupon helps fund the payout. All things being equal a higher bond yield means more

funding for the payout. But rising bond yields, especially for benchmark US and UK Treasury 10 year bonds also indicate that the markets expect interest rates to rise in the future. Rising interest rates are not usually a good sign for risky financial assets such as equities.

Volatility measures

Share prices move up and down, as do the indices (the 500 and FTSE100) that track them. This movement up and down in price is both regular and measurable and is called volatility. It is measured by stand alone indices such as the Vix (tracking the volatility of the 500), VStoxx (the Eurozone Dow Jones Eurostoxx 50 index) and VFtse (our own FTSE index). These indices in turn allow the wider market to price options such as puts and calls that pay out as markets become more volatile. In simple terms more volatility implies higher premiums for issuers of options. That can be useful to structured product issuers as these options are usually built into an investment, especially around the barrier level which is usually only ever broken after a spike in volatility. Again all things being equal an increase in volatility (implying something like the Vix moving above 20 in index terms) usually implies higher funding levels for issuers of structured products.

Dividend Futures

These options based contracts measure the likely total dividend payout from a major index such as the FTSE 100 or the Eurozone DJ Eurostoxx 50 index. In simple terms the contract looks at a specific year (say 2015) then examines the total dividend payout from all the companies in the index, adds up the likely payout, and then fixes it as a futures price usually in basis points. Structured product issuers make extensive use of dividend futures largely because they've based payouts on a benchmark index. That means the bank that is hedging the payout will want to be 'long' the index (in order to balance it's own book of risks) but will not want the dividends that come from investing in that benchmark index. They'll look to sell those future possible dividends via these options and then use the premium income generated to help fund their hedging position. In general terms the longer dated a dividend future (say more than a few years out) the lower the likely payout on the dividend future as the market cannot know dividends will keep on increasing in an uncertain future and must fix its price in some level of uncertainty.

Equity benchmarks

Most structured products use a mainstream well known index such as the FTSE 100 or 500 as a reference for the payout. For investors the key returns periods are 1 year (for most auto calls) and 5 and six years for most 'growth' products. During most though not all five and six year periods it is reasonable to expect an index to increase in value although there have been many periods where this hasn't been the case especially as we lurch into a recession. Risk measures such as the sharpe ratio effectively measure how much risk was taken for a return over a certain period (in our case the last five years using annualised returns). The higher the number the better the risk adjusted return with any value over 1 seen as very good.

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To find out more about UKSPA, please visit www.ukspassociation.co.uk.

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