ONE HERITAGE
CAPITAL MANAGEMENT
SINGAPORE

1H Strategy Snapshot

UNUSUAL S&P500 STRENGTH

March 2024

Global Equities	Price	YTD	1M	1-Year
MSCI World	3,437	8.5%	3.4%	27.1%
S&P500	5,248	10.0%	3.5%	32.2%
Nasdaq	16,400	9.2%	2.8%	40.0%
Dow Jones Industrial	39,760	5.5%	2.1%	22.7%
STOXX Europe 600	512	6.8%	3.5%	15.1%
FTSE 100	7,932	2.6%	4.0%	6.0%
Shanghai Composite	3,020	1.5%	2.1%	-6.9%
Shenzhen Composite	1,741	-5.3%	5.4%	-17.3%
Hang Seng	16,634	-2.4%	0.6%	-15.9%
Straits Times	3,231	-0.3%	2.3%	-0.2%
India Sensex	73,770	2.1%	2.0%	28.0%

S&P500 Sectors	Price	YTD	1M	1-Year
Technology	3,825	12.6%	3.2%	51.9%
Health Care	1,722	8.3%	1.4%	16.2%
Comm. Services	1,488	4.9%	1.1%	34.8%
Financials	697	11.3%	4.1%	33.4%
Comm. Services	285	15.9%	5.9%	54.3%
Industrials	1,066	10.5%	4.6%	28.2%
Consumer Staples	813	6.6%	2.7%	6.0%
Energy	713	11.5%	9.7%	15.2%
Utilities	331	2.8%	5.6%	-1.3%
Real Estate	246	-2.0%	1.3%	11.1%
Materials	584	8.2%	6.8%	19.1%

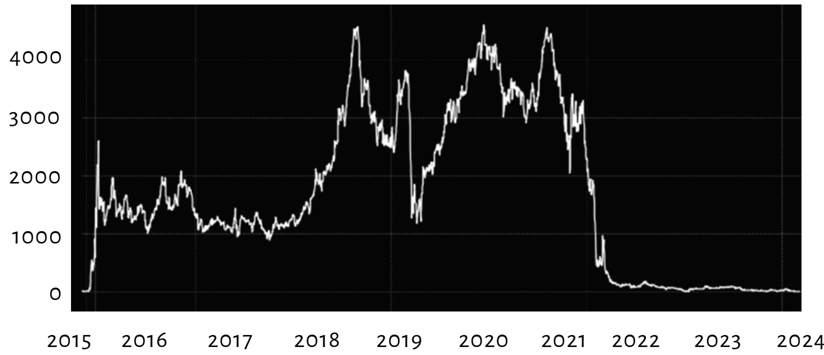
Hang Seng Sectors	Price	YTD	1M	1-Year
Commerce & Industry	9,284	0.5%	4.0%	-15.2%
Financials	28,087	-5.8%	-3.9%	-14.1%
Property	15,577	-15.0%	-5.1%	-36.8%
Utilities	33,521	2.0%	-3.3%	-6.2%

And there we have it. The end of negative yields for Japan - finally. The Bank of Japan has gone from negative interest rate policy to zero interest rate policy, or from NIRP to ZIRP. This is the first rate-hike in Japan for 17 years and it marks the end of negative interest rates globally, with Japan being the last hold-out on that front. The purpose of Japan's negative rate policy was to stoke inflation and it has finally happened – but it had little or nothing to do with interest rates. One may even argue that the policy was a waste of time.

Chart 1 is fascinating; it shows the number of individual bonds globally with negative yields going back to 2015. Before the Global Rate Hike Cycle began two years ago, there were over 4,000 bonds with negative yields! That number has now fallen to zero. Perhaps surprisingly, the yen weakened against the dollar after the BoJ's announcement on doubts around if or when there could be further tightening.

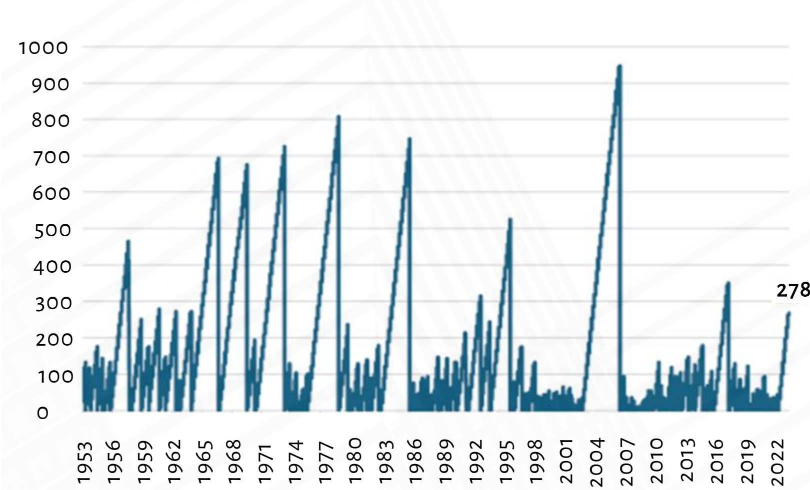
US stocks look increasingly overbought and are due for a pullback. Chart 2 shows the number of trading days that have gone by since there was a daily decline of -2% or more. 278 trading days, so over a full year. From the chart it appears that this is not an uncommon event. But if you look closely, the chart goes back to the 1950s. Over the past 25 years, there have only been two other instances of periods this long without a -2% down day. More remarkably, we have gone

Chart 1: Number of bonds with sub-zero yields



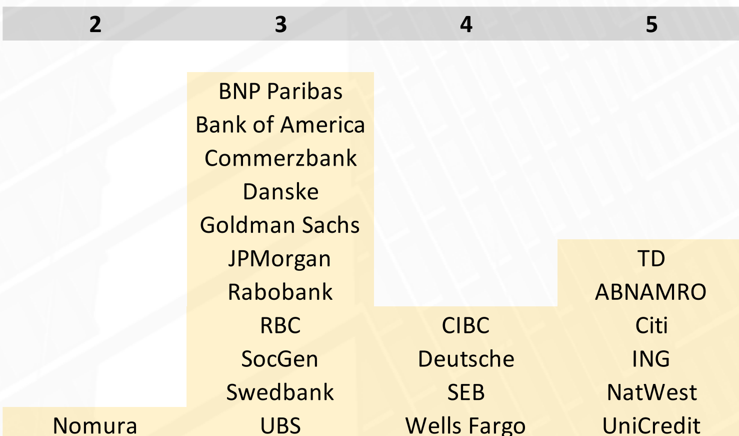
Source: Bloomberg

Chart 2: Trading days without a 2% pullback in US stocks



Source: Bespoke

Chart 3: Number of rate cuts expected in 2024 by banks



2	3	4	5
	BNP Paribas		
	Bank of America		
	Commerzbank		
	Danske		
	Goldman Sachs		
	JPMorgan		TD
	Rabobank		ABNAMRO
	RBC	CIBC	Citi
	SocGen	Deutsche	ING
	Swedbank	SEB	NatWest
Nomura	UBS	Wells Fargo	UniCredit

Source: ZeroHedge

through 106 trading days without the market falling more than -2% from its peak (source: Bespoke) – over any number of subsequent days. That is, the S&P500 has been making successive, new highs and not pulling back from them. While this is not a unique event, it is rare having only occurred on several other occasions over the past 50 years.

Earlier this month, the FOMC kept rates unchanged (as forecast), with a target range of 5.25% - 5.5%. Chart 3 shows the number of rate cuts expected by the Street in 2024. Half of them – eleven forecasters – expect three cuts, four forecasters expect four cuts, and six expect five cuts. Of those surveyed, only Nomura expects one rate cut which is entirely possible as the improbably strong US labor market refuses to buckle.

Just a few months ago, the futures market was pricing in a high chance of the first Fed interest rate cut by March or April. This has now been pushed back to June. Strategist forecasts at the big banks are also homing in on June. However, just last week, Vanguard, one of the world's largest asset managers, forecast no cuts this year! The next day, Atlanta Fed President Raphael Bostic opined that he is currently penning in just one cut due to lingering inflationary concerns.

The timing and size of cuts is a prime concern for markets. The US stock market has been particularly strong over the past few months, chalking up new highs much more often than usual. Some of this optimism, of course, is due to Tech Euphoria (do we never learn...?), but much of this strength is predicated on the 'soft landing' thesis for the US economy which – to our continued surprise and erroneous thinking – is thus far playing out. 'Higher for longer' rates will present a headwind to this soft-landing thesis. After all, the cost of money is over 500bps higher than it was just two years ago.

Chart 4: Cisco Systems – Performance since Inception

Source: Bloomberg, 1HCapital

Chart 5: Vanguard US Small Cap ETF – 5-Year Performance

Source: Bloomberg, 1HCapital

If you are thinking that risks in the equity market – and there is of course always a level of inherent risk – are larger than usual (rate cycle, recession threat, flat index EPS growth in 2023, AI euphoria, sky-high Bitcoin price even though most people who purchase it have no clue what it is and no way to use it), then how to allocate to equities? As we know, short-term predictions in the equity market are a fool's game; equity investors should have a minimum 3 to 5-year time horizon. But there are some broad portfolio tilts that can be considered.

The last 15 years was dominated by growth stocks, large-cap and now mega-cap, a class that did not exist ten years ago. Ironically, the academic research in portfolio management shows that, over the very long-term, value stocks have outperformed growth. This might seem puzzling when one considers the growthy Googles and Nvidias of the world with their multi trillion-dollar market caps, but for every Google there are 10 other growth stocks that have slowed or even stopped growing and their valuation consolidated / corrected / collapsed.

Take Cisco Systems (CSCO). At $50 a share, it is still $30 below its peak of March 2000. After the 2-year crash back down to earth after the Dot-com Bubble – and then a 10-year period of sideways consolidation - CSCO has been a solid stock over the past 15 years. It has also been consistently priced closer to value than growth in that period (it now trades at 15x EPS with a 3% yield).

The academic research also indicates that smaller capitalization stocks outperform mid and large-cap stocks over the long-term. Notably, small-cap stocks have gone through a period of underperformance over the past 5 years, returning +46.6% versus +84.5% for the S&P500. See Chart 5. Although this has been only a brief discussion, in our view, investors should consider the pros and cons at this time of a tilt towards both value and smaller-capitalization stocks.

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