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Markets in a Minute

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Guy Foster, Chief Strategist, discusses earnings results from the Magnificent Seven and how these microeconomic factors are affecting the markets.



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One topic dominated markets last week: Nvidia's earnings announcement. It was one of the most anticipated and celebrated events in the market this year.

The shares, which were cyclically depressed at the start of 2023, went to triple in value by the end of the year and have risen another 50% since then. In the week before announcing its profits, Nvidia's shares slid by nearly 9% as some investors feared that others were expecting too much. Memories of the technology stock market bubble of a quarter of a century ago loom large.

But Nvidia is far from the profitless companies offering jam tomorrow in the late 1990s. Nvidia's results revealed revenues rising 22% over the preceding quarter, and 200% from the same period last year, with profits up 8x.

As with all stocks, the controversy surrounds what will happen in the future. The pipeline for artificial intelligence-related sales remains very attractive, but unlike the technology bubble, those expectations are grounded in exceptional growth happening right now.

We believe semiconductors are in a cyclical upswing that forms part of a secular uptrend. Individual companies can be volatile, but the supply chain comprises a number of different types of company serving different parts of the value chain, whose long-term trajectory should be

positive, even while different factors move them in the shorter term.

Last week felt like Nvidia was singlehandedly pulling the market around, but what else was going on?

Back in the real world...

The purchasing managers indices (PMIs) offered an early snapshot of economic activity in February, painting a mixed picture.

In keeping with other data released so far this year, the US continues to look economically firm. The manufacturing and services sectors both seemed to expand at an accelerating pace. It makes sense to be a little wary of extrapolating the current trend too far. With unemployment so low there is limited room to expand employment, driving increased household income and spending. However, there still seems to be at least some scope because initial jobless claims for the last week declined. This leaves them very low, at levels consistent with a strong economy, although things can change fast.

Outside the US, PMIs were more mixed. European manufacturing remains in a slump and while France showed signs of early stages of recovery, Germany seemed to regress. Outside of these core economies, the peripheral eurozone members performed better – we just won't know how much better until the end of the month as they don't release provisional reports like the core countries.

Inflation benign?

Perhaps worryingly, selling price pressures rose during the month.

We can take some comfort from the fact that price data from PMIs don't correlate very well with consumer price indices. However, they suggest that for the services sector at least, the tight labour market is making it difficult to hold wages down. If other data backed these up, it could be difficult to cut interest rates as fast as the market has been hoping.

Interestingly, the price pressures are quite limited to services while disinflation seems to continue within manufactured goods. This is where we would expect to see the impact of higher freight rates emanating from the Red Sea (or, more accurately, from the Cape of Good Hope, around which Red Sea freight has been diverted). The Red Sea is an important transit route for Middle Eastern oil and Southeast Asian goods en route to Europe.

Freight rates are clearly continuing to rise but in Europe's biggest economies, impact is outweighed by weak demand. This partly reflects the fact that freight is often transported on long-term contracts, which are less vulnerable to movements in spot freight rates.

China stimulus

China and Europe have a substantial bilateral trade balance, but both are currently labouring some.

In China, decades of overinvestment in property, which had become the principal vehicle for the wealthy, has resulted in chronic oversupply. Bursting that bubble became a priority for Xi Jinping's Chinese Communist Party, but doing so has resulted in a persistent negative wealth effect (declines in the value of property make Chinese consumers feel poorer).

In an attempt to revive fortunes, China cut the loan prime rate for terms of greater than five years. This is essentially the rate which underpins mortgages and therefore serves as a stimulus for Chinese property. This morning's data from China's National Bureau of Statistics showed how important that could be, as property prices have continued to decline over the last month.

The slight green shoot of recovery that might be showing is the breadth of price declines may have narrowed. In December, 62 out of 70 cities saw prices for new properties decline, whereas in January that was just 56. Prices of existing properties fell in all 70 cities in December, whereas two saw an increase in January.

There is clearly a long way to go before this becomes a positive trend, and the risk remains that policy will not be able to turn around a sector so distorted by successive stimulus rounds and captive savings over decades. But at least policy is becoming more forceful in its attempt to support the sector.

Tax cuts

Finally, some good news came from UK public finances.

After strong tax receipts, it seems the government will borrow less than had been anticipated by the Office for Budgetary Responsibility. This means we can anticipate the unveiling of tax cuts potentially up to £10bn in the forthcoming budget. This is an enormous number that is difficult to put into context. It would be around half the tax cuts that took place at the beginning of this year after the autumn statement.

Recognising how much ten billion pounds is might also help to appreciate the scale of the market's response to Nvidia's earnings announcement. The company's market value rose by more than 20 times that much on the day (\$277bn, which is a record daily change in value for a single company)!

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