ATLANTIC
DERIVATIVES

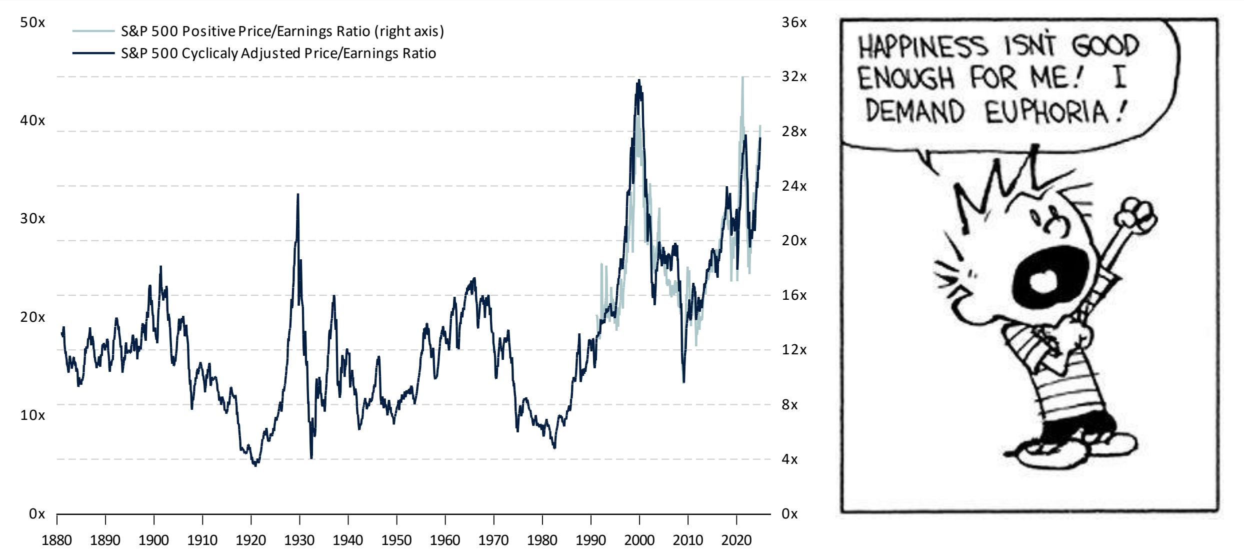
Weekly Investment Focus

Flexiweekly, 18 November 2024

"HAPPINESS IS NOT GOOD ENOUGH? DEMAND EUPHORIA!"

- U.S. equities are enjoying great success, propelling the S&P 500 from record to record
- This sequence serves as a reminder that portfolios should always be invested
- Only the 'tactical' part can be temporarily reduced in anticipation of a market correction
- This is the case at the moment, as it is whenever optimism turns to euphoria

CHART OF THE WEEK: "Stock market euphoria can easily be gauged"



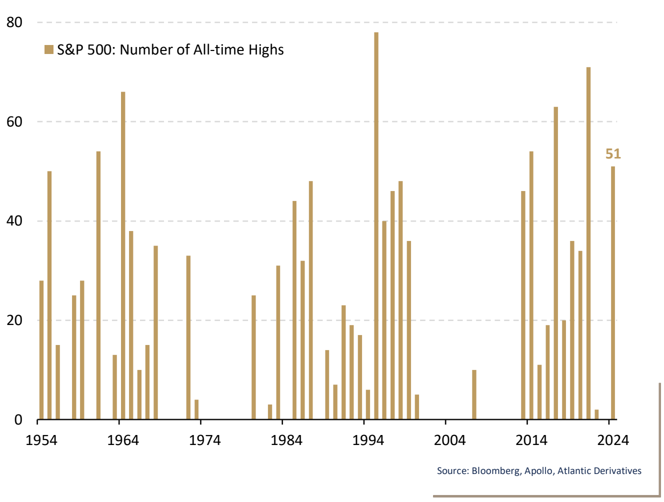
Source: Bloomberg, Bill Watterson, Atlantic Derivatives

FINANCIAL MARKET ANALYSIS

All eyes are on US equities, and for good reason. Not satisfied with rising faster and stronger than most international indices, **last Monday the S&P 500 broke through the symbolic 6,000-point.** By crossing the threshold, it set its 51st absolute record for the year. This is also the 51st of the bull market that began on 12 October 2022 (see Figs. 2 & 3). The first peak took 15 months to reach, on 19 January 2024. Since then, record highs have followed in quick succession: 22 in the first quarter, 9 in the second, 12 in the third, and now 8 in the current quarter.

Fig. 2 - New records posted by the S&P 500

Fig. 3 - Number of new high-water marks per year



This sequence serves as a reminder of two fundamental investment rules. The first is **to stay invested in the stock market at all times.** Since 1870, dividends reinvested, the US main index has delivered a positive trend performance of 9.3% a year. In real terms, i.e. adjusted for increases in the cost of living, the annual return is 7.0% (see Fig. 4). The second rule that follows from this, which is much less intuitive but just as relevant, is don't try to time the market. By missing the best trading days, an investor would considerably reduce his expected returns (see Fig. 5). **In both cases, staying away from the stock market for too long entails a performance risk for the investor.** With this in mind, investment professionals rely on a robust portfolio, whose static composition enables it to deliver positive trend returns.

Fig. 4 - Long-term equity performance

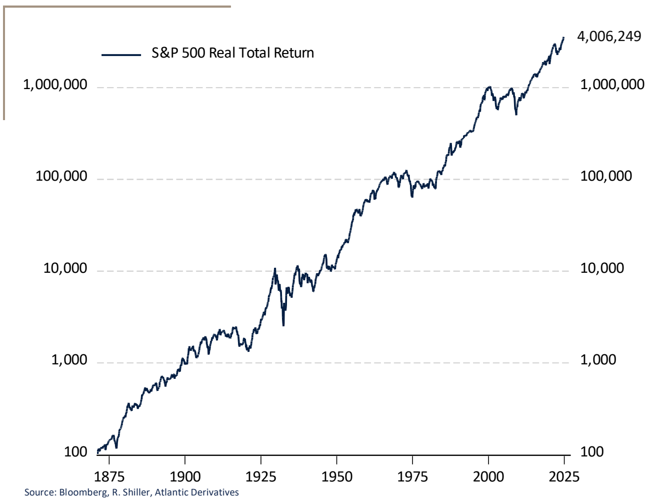
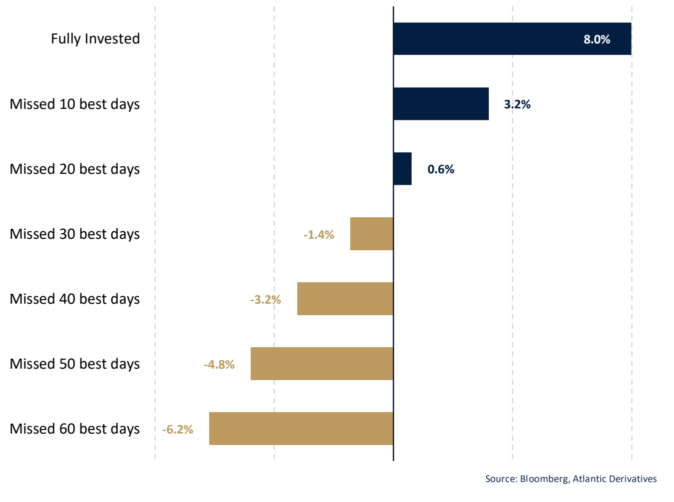


Fig. 5 - Performance by missing the best days



Around this 'strategic' portfolio, which drives long-term performance, revolves a 'tactical' portfolio designed to generate short-term performance. There are several ways of constructing these satellite allocations: using the economic cycle as a guide, analysing sectors and companies, applying technical analysis, etc. **One of them is to limit temporary losses.** While stock markets rise steadily over the long run, they can experience sharp corrections in a matter of days or months (see Fig. 6). It's a truism, but avoiding them means generating positive returns.

Fig. 6 - Proba. of losses according to holding period

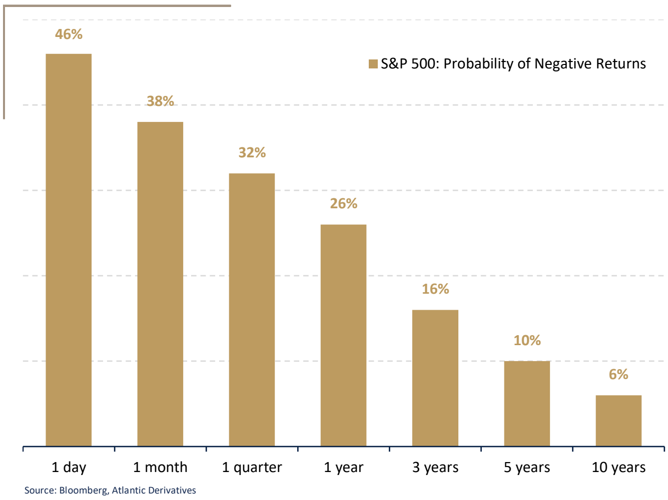
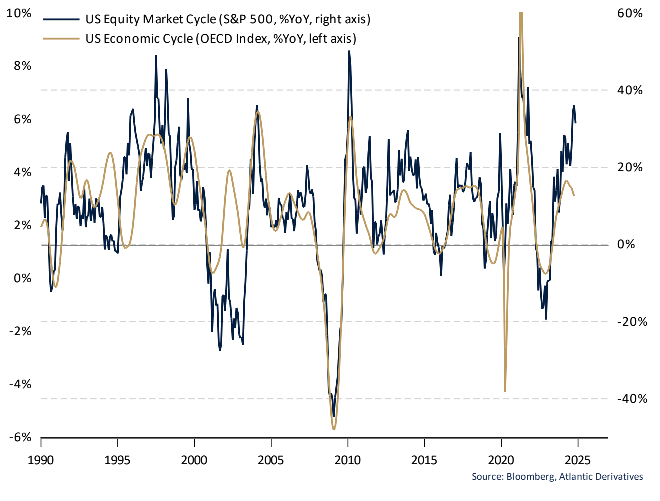


Fig. 7 - Stock market cycle and economic cycle



Equity markets usually shrink when economic activity slows (see Fig. 7). Faced with weak demand, companies announce poor, sometimes even negative, earnings growth. As a result, their market capitalisations fall, generating negative returns for investors. At present, leading indicators such as business and consumer confidence, as well as work started for dwellings and weekly hours worked, are pointing to sluggish growth. Given the historical correlation, the S&P 500's annual performance should be closer to 15% than 31%.

Contraction periods also occur when investor confidence has reached its peak. Either they have overestimated the earnings of listed companies, or they have allocated too many assets to the equity market. The two syndromes regularly go hand in hand. Eventually, demand for shares runs out of steam and can no longer absorb the supply offered by sellers. Share prices fall until a new equilibrium is found. **Today, investor confidence is close to euphoria.** Among professional investors, the gap between optimists (bulls) and pessimists (bears) is very wide (see Fig. 8). As a corollary, US households hold 42% of their portfolios in equities. This ratio rises to 70% for investors only (see Fig. 9). Whatever the group observed, the allocation to equities is far too high compared with the last 75 years.

The euphoria is such that US equities have reached stratospheric valuation levels: 28.4x earnings (38x average inflation-adjusted earnings over the previous 10 years - see Chart of the Week). The ratio between share prices and corporate earnings is as stretched as it was during the pandemic. At that time, it soared because some companies were shut down. This time it is because investors are anticipating solid growth in profits, and not just from the technology companies involved in the artificial intelligence revolution. The S&P 493, which excludes the Magnificent Seven, or the S&P 500 ex-TMT, are also trading at historically high valuation levels (25x and 27x).

Fig. 8 - Sentiment of equity investors

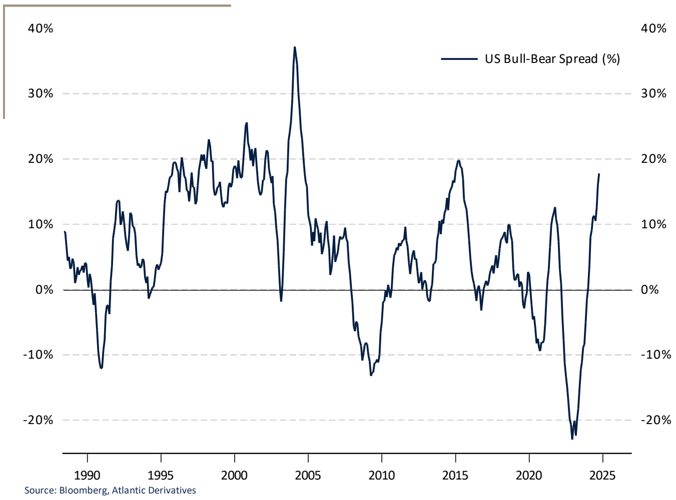
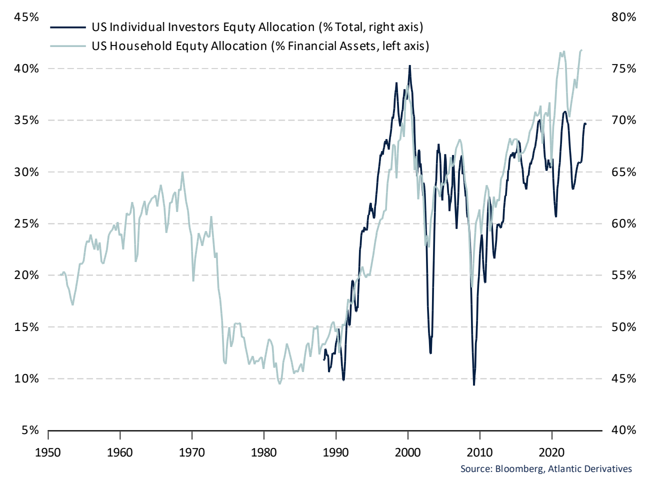


Fig. 9 - Weight of equities in portfolios



In the end, the only period that generated more euphoria among investors was that of the early 2000s, during the dotcom bubble. In the two years that followed, between September 2000 and October 2002, the markets contracted by 25% a year (see Fig. 10).

Fig. 10 - Equity performance by valuation

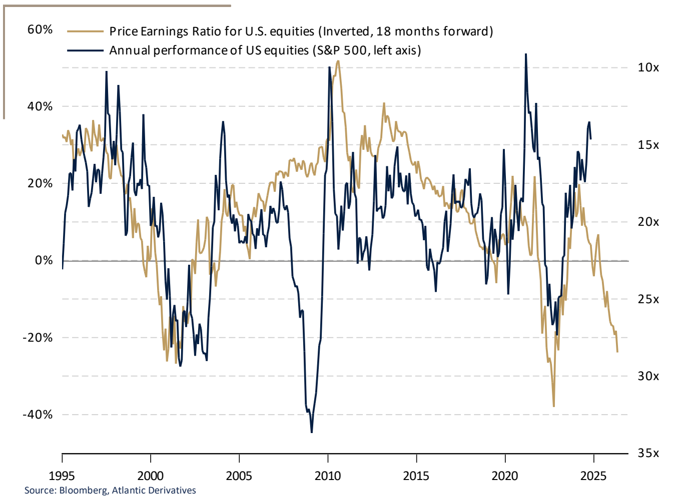
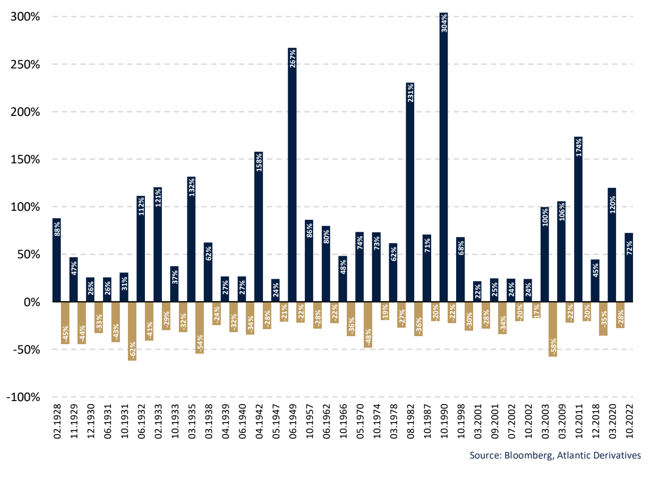


Fig. 11 - Succession of *bull* and *bear markets*



To the frustration of some investors, there is no rational element - be it economic, financial or even behavioural - for determining the precise end date of a bull market. The current phase of euphoria is further proof of this. Since 1928, 40% of bull markets have been larger than the current one (see Fig. 11).

Conclusion:

Although the milestones used to define the recent excesses in the US equity market are relevant, they are nonetheless useless for anticipating the date of the next correction phase. They do not allow investors to determine whether sentiment will continue to heat up, and therefore the direction that equities will take in the short term. However, the combination of "economic slowdown, generous valuations, high allocations and the size of the bull market" should rationally and tactically encourage investors to be cautious, i.e. to reduce their exposure to risky assets.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2024 Year-to-Date (%)	2023 (%)	2022 (%)
Equities							
World (MSCI)	842.6	44.73	-2.3%	-0.9%	18.0%	22.8%	-17.9%
USA (S&P 500)	5 871	52.05	-2.0%	1.0%	24.5%	26.3%	-18.1%
USA (Dow Jones)	43 445	56.59	-1.2%	1.8%	17.1%	16.2%	-6.9%
USA (Nasdaq)	18 680	50.64	-3.1%	2.0%	25.2%	44.7%	-32.5%
Euro Area (DJ EuroStoxx)	497.5	44.16	-0.2%	-2.7%	8.3%	19.5%	-11.4%
UK (FTSE 100)	8 064	39.14	0.0%	-1.9%	7.9%	7.7%	4.6%
Switzerland (SMI)	11 627	35.89	-1.4%	-4.8%	7.8%	7.1%	-14.3%
Japan (Nikkei)	38 196	48.51	-2.2%	-3.2%	17.3%	31.0%	-7.3%
Emerging (MSCI)	1 085	30.96	-4.4%	-5.6%	8.7%	10.2%	-19.8%
Brasil (IBOVESPA)	127 792	37.88	-1.5%	-2.5%	-4.8%	22.3%	4.7%
Mexico (IPC)	50 469	37.79	-2.5%	-3.3%	-9.9%	22.4%	-5.8%
India (SENSEX)	77 189	31.22	-2.4%	-5.2%	8.8%	20.3%	5.8%
China (CSI)	3 944	52.65	-3.3%	3.1%	19.1%	-9.1%	-19.8%
Com. Services (MSCI World)	120.20	49.61	-2.3%	1.0%	26.8%	38.1%	-35.3%
Cons. Discretionary (MSCI World)	402.2	54.95	-1.8%	3.1%	15.0%	29.5%	-31.5%
Cons. Staples (MSCI World)	275.9	30.35	-1.9%	-4.7%	5.5%	3.2%	-6.0%
Energy (MSCI World)	258.0	55.59	0.2%	1.7%	9.9%	6.0%	34.5%
Financials (MSCI World)	183.3	64.65	0.1%	3.1%	27.2%	16.4%	-9.2%
Health Care (MSCI World)	358.8	18.25	-5.4%	-8.4%	4.1%	4.1%	-5.7%
Industrials (MSCI World)	390.2	45.56	-2.6%	-1.6%	16.6%	22.5%	-12.6%
Info. Tech. (MSCI World)	748.7	47.50	-3.1%	-0.1%	28.2%	51.4%	-30.9%
Materials (MSCI World)	324.8	25.77	-4.8%	-7.2%	-2.3%	12.6%	-11.0%
Real Estate (MSCI World)	991.7	39.81	-2.4%	-4.0%	3.8%	5.3%	-26.6%
Utilities (MSCI World)	167.4	40.90	-0.6%	-4.0%	17.0%	1.6%	-3.8%
Bonds (Bloomberg)							
World (Aggregate)	3.68%	30.03	-1.3%	-2.6%	-1.2%	5.7%	-16.2%
USA (Sovereign)	4.41%	35.78	-0.7%	-1.8%	0.7%	4.1%	-12.5%
Euro Area (Sovereign)	2.74%	55.46	0.5%	-0.1%	1.6%	7.1%	-18.5%
Germany (Sovereign)	2.24%	52.10	0.3%	-0.3%	0.2%	5.6%	-17.8%
UK (Sovereign)	4.46%	39.56	-0.3%	-1.9%	-3.0%	5.6%	-17.1%
Switzerland (Sovereign)	0.57%	58.66	0.1%	0.6%	4.4%	7.9%	-12.5%
Japan (Sovereign)	0.84%	27.30	-0.5%	-0.7%	-1.9%	0.9%	-2.8%
Emerging (Sovereign)	7.03%	44.17	-0.9%	-0.9%	6.8%	11.0%	-17.4%
USA (IG Corp.)	5.25%	38.97	-1.1%	-1.6%	2.4%	8.5%	-15.8%
Euro Area (IG Corp.)	3.19%	59.74	0.0%	0.0%	4.3%	8.2%	-13.6%
Emerging (IG Corp.)	6.42%	42.51	-0.4%	-0.8%	7.2%	6.7%	-14.9%
USA (HY Corp.)	7.29%	54.78	-0.4%	0.0%	7.9%	13.4%	-11.2%
Euro Area (HY Corp.)	5.79%	82.64	0.1%	0.5%	7.3%	12.1%	-10.6%
Emerging (HY Corp.)	8.50%	57.83	-0.6%	0.3%	13.8%	13.1%	-12.4%
World (Convertibles)	441.3	55.52	-0.8%	0.8%	9.6%	12.3%	-18.2%
USA (Convertibles)	601.1	62.03	-0.2%	2.0%	10.6%	14.6%	-20.1%
Euro Area (Convertibles)	230	70.25	1.3%	2.6%	13.1%	7.3%	-11.1%
Switzerland (Convertibles)	258.9	39.72	-0.2%	-0.9%	-3.8%	5.8%	-19.1%
Hedge Funds (Bloomberg)							
Hedge Funds Industry	1 583	75.39	n.a.	-0.6%	9.2%	7.8%	-6.9%
Macro	1 322	63.82	n.a.	-1.7%	5.8%	1.6%	1.3%
Equity Long Only	2 225	68.75	n.a.	-1.4%	12.7%	15.9%	-16.4%
Equity Long/Short	1 659	75.73	n.a.	-0.1%	12.8%	7.7%	-10.7%
Event Driven	1 699	73.25	n.a.	-0.6%	7.1%	7.3%	-4.7%
Fundamental Equity Mkt Neutral	1 630	91.21	n.a.	1.0%	10.9%	6.6%	2.3%
Quantitative Equity Mkt Neutral	1 638	79.70	n.a.	-0.7%	8.1%	7.8%	-2.0%
Credit	1 580	86.25	n.a.	-0.1%	7.4%	8.1%	-5.0%
Credit Long/Short	1 602	89.66	n.a.	0.6%	8.0%	11.2%	-1.4%
Commodity	1 749	81.74	n.a.	1.8%	12.1%	7.3%	10.5%
Commodity Trading Advisors	1 314	51.99	n.a.	-3.2%	5.7%	-3.6%	5.3%
Volatility							
VIX	16.14	43.98	8.0%	-21.8%	29.6%	-42.5%	25.8%
VSTOXX	17.21	43.49	2.6%	-7.4%	26.8%	-35.0%	8.4%
Commodities							
Commodities (CRB)	534.9	n.a.	-0.2%	0.4%	4.8%	-8.0%	-4.1%
Gold (Troy Ounce)	2 585	n.a.	-1.3%	-5.0%	25.3%	13.1%	-0.3%
Silver (Troy Ounce)	31	n.a.	-0.1%	-9.1%	28.8%	-0.7%	2.8%
Oil (WTI, Barrel)	67.02	n.a.	-4.8%	-5.0%	-6.5%	-10.7%	4.2%
Oil (Brent, Barrel)	73.44	n.a.	-0.8%	-0.3%	-5.4%	-4.5%	5.5%
Currencies (vs USD)							
USD (Dollar Index)	106.65	72.82	1.0%	3.1%	5.2%	-2.1%	8.2%
EUR	1.0542	29.89	-1.1%	-3.0%	-4.5%	3.1%	-5.8%
JPY	154.40	41.15	-0.4%	-3.2%	-8.7%	-7.0%	-12.2%
GBP	1.2634	31.14	-1.8%	-3.2%	-0.8%	5.4%	-10.7%
AUD	0.6463	34.79	-1.7%	-3.6%	-5.1%	0.0%	-6.2%
CAD	1.4085	29.63	-1.1%	-2.0%	-6.0%	2.3%	-6.8%
CHF	0.8871	32.08	-0.7%	-2.5%	-5.2%	9.9%	-1.3%
CNY	7.2407	30.36	-0.4%	-1.9%	-1.9%	-2.8%	-7.9%
MXN	20.354	41.01	-0.1%	-2.3%	-16.6%	14.9%	5.3%
EM (Emerging Index)	1 746.6	32.24	-0.7%	-1.1%	0.4%	4.8%	-4.3%
XBT	90 907	n.a.	2.6%	32.9%	113.9%	157.0%	-64.3%

Source: Bloomberg, Atlantic Derivatives SA

Total Return by asset class (Negative \ Positive Performance)

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