Weekly Market Commentary (Week 8)

In a third party analysis of the main events on the financial markets last week, the latter explains why a record-breaking week for Japanese equities and the publication of fourth-quarter results by US technology company Nvidia made headlines.

In a normal week for financial markets, the minutes of the Federal Open Market Committee (FOMC) meeting would have been the main event. However, the FOMC was overshadowed by the outstanding results released by technology company Nvidia, which reported fourth-quarter sales of US$22.1 billion, a 265% increase in sales year-on-year, and is forecasting even higher sales for the current quarter of US$24 billion.

With global demand soaring, "accelerated computing and generative artificial intelligence have reached the tipping point," said CEO Jensen Huang in a statement. The chipmaker's share price jumped 16%, adding $277 billion to its market capitalization to bring it closer to $2,000 billion. By comparison, the total market capitalization of the German market is $2.3 trillion.

From a macroeconomic point of view, the advance of AI should lead to higher productivity and, by extension, higher trend growth and a higher neutral level for interest rates. From a regulatory and systemic risk perspective, however, the dominance of such a small number of companies on the US stock market is probably more worrying.

The five largest companies in terms of market capitalization (Microsoft, Apple, Alphabet, Amazon, Nvidia) today account for 25% of the market capitalization of the S&P 500 index. What's more, the top 10% of US companies in terms of market size account for 75% of the entire US stock market, levels of concentration that were only reached in 1929 and 2001 (see this week's chart).

FOMC: a little patience

The muted reaction to the minutes of the January FOMC meeting contrasts sharply with the reaction to the December minutes, which signaled the end of policy tightening and highlighted the risks to growth and the dangers of leaving rates too high for too long. The result was an aggressive repricing of policy rates.

In contrast, the minutes of the January meeting emphasized the risk of easing too soon, as many Federal Reserve (Fed) speakers have done in recent weeks. The minutes and the Fed speakers communicate a clear roadmap: interest rates will be lowered this year, as long as incoming data follows the expected trajectory. Patience is the key word - the Fed will need a little more data to confirm. The first 25bp cut is now scheduled for July.

This news was reflected in the markets, with government bond curves in Europe and the US flattening last week. This was due to the underperformance of the front end of the curve, as investors continued to dismiss the prospect of imminent monetary policy easing. At the end of the week, the overnight interest rate swap market was forecasting three 25bp cuts for Europe and the USA in 2024, a significant change from the six 25bp cuts expected at the start of the year.

Credit carry trade

Carry trade remained the best-performing strategy for credit investors, with high yield and emerging markets once again outperforming their peers. Commodity and currency markets moved up and down, as is often the case in the third week of the month, which tends to be low on macroeconomic data. Equity investors celebrated the Nikkei 225's achievement of a new all-time high (the previous record was set in 1989), and followed with curiosity the evolution of the Shanghai Stock Exchange, which has not been up to scratch for many months, closing the week up 4.85%.

China caught economists off guard by lowering its five-year prime lending rate by 25 basis points to 3.95%. The consensus forecast was for the key rate to remain unchanged. The five-year LPR is the key benchmark rate for home mortgages, and the easing was the largest one-off adjustment since its introduction in 2019.

For more general-purpose loans, the one-year LPR is the banks' preferred benchmark; a five basis point easing was expected, but the People's Bank of China left it unchanged at 3.45%. This seems in line with the administration's preferred strategy of "targeted policy", as it is currently more urgent to support the property market than general consumption. In January, property prices in China continued to fall - for both new and existing homes - but at a slower pace. At the same time, the number of cities with rising housing values increased for the first time in ten months, a first sign of price stabilization.

The Eurozone's composite purchasing managers' index rose to 48.9%, above the consensus of 48.4% and up from 47.9% in December. Overall, regional activity remains in contraction, but the report contains encouraging signs; the "services" component reached 50, allowing services to enter the expansion zone for the first time since last July.

On the inflation front, the European Central Bank's (ECB) consumer price survey showed that prices are expected to rise by 3.3% over the next 12 months, compared with 3.2% in December. Over the next three years, prices are expected to rise by 2.5% (unchanged from last month). At the margin, the data supports ECB members who are pressing for monetary policy easing to be postponed until the second quarter.

Top 10% of stocks by size versus the entire US stock market

Source: Kenneth R. French database, Deutsche Bank.

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