

2024

2nd QUARTER RESEARCH REPORT



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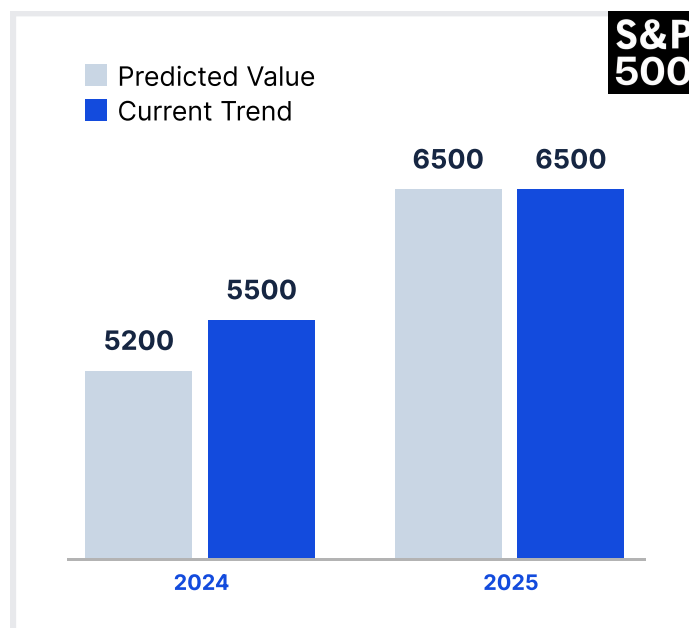
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Summary of Events

In our previous report, we forecasted a distinctive trajectory for the S&P 500, predicting it to reach 5,200 by the end of 2024 due to expansions in multiples, a departure from consensus expectations. Furthermore, we projected the index to continue its upward trend, reaching 6,500 by the conclusion of 2025. Our optimism was grounded in the belief that investors would fervently drive-up equity prices, reminiscent of the late 1990s internet boom, but this time fueled by the future potential of artificial intelligence (AI). As the S&P 500 has indeed experienced substantial gains in line with our projections, reflecting the growing influence of AI technologies on market sentiment and performance. As of close 1st of April, the S&P 500 was at 5258. The consensus earnings forecast for the S&P 500 for 2025 is 276 and with a current multiple of 23.55x and multiple expansions expected, we are looking at the S&P to be around 6500 by the end of 2025.



The assessment made last year regarding Chinese equity valuations remains relevant and has garnered increased attention from the markets. Stocks have indeed begun to climb, reflecting a growing acknowledgment of the undervaluation present in China's equity markets. The downbeat comparisons persist not only within China itself but also globally. Relative to both developed markets (DMs) and emerging markets (EMs), Chinese equities continue to demonstrate some of the lowest valuations seen in over a decade. This phenomenon cannot be solely attributed to elevated price-to-earnings (PE) ratios in the United States; rather, it represents a unique challenge specific to the Chinese market. As such, this ongoing undervaluation presents opportunities for astute investors to capitalize on the potential for significant future growth in Chinese equities as market dynamics evolve and valuations align more closely with fundamentals. Stocks such as JD, PDD, BABA and Luckin Coffee have been moving up very well due to their undervalued nature. The CCP will not hesitate to take any necessary measures to ensure the stabilization of the economy and, consequently, the markets.



Chinese Equities look very attractive and building positions in them for the next 2 years is essential.

Central Bank Forecast

It's essential to acknowledge when our predictions don't materialize as expected. Against our rate cut expectations, central banks have taken a different course due to sticky inflation and a stronger PMI. US Federal Reserve haven't initiated rate cuts as swiftly as we anticipated.

It's evident now that policy rates have maybe peaked in all developed markets (DMs), however we are in the camp of higher for longer. The Federal Reserve's approach has been more measured, with no indication of immediate rate cuts, contrary to our expectation of a cut as soon as March. Additionally, the market's anticipation of the start of a 125-bps rate cut in 2024 has not materialized. In light of these developments, it's crucial to reassess our strategies and predictions, remaining open to adjusting our viewpoints based on evolving economic conditions and central bank actions. With the influence of November elections in the US, we might see some additional dovishness by the Fed. Jerome Powell, in his last press conference, alluded to QT being reduced.

Even in the scenario where GDP growth shows signs of weakness and core PCE inflation remains subdued, our forecast anticipates the Federal Reserve implementing rate cuts totaling 75 basis points within this year, with the initial cut likely occurring in June. The recent manufacturing index numbers, GDP numbers and consumer confidence have been very strong which will keep the Fed on the fence for a while. Furthermore, we project an additional 75 basis points of cuts in 2025. Despite the prevailing economic conditions, our outlook suggests proactive measures by the Fed to stimulate economic activity and maintain stability in the face of evolving market dynamics.



The consensus earnings forecast for the S&P 500 for 2025 is 276 and with a current multiple of 23.55x, we are looking at the S&P to be around 6500 by the end of 2025.



This Quarter's Musings: Exploring Our Thoughts

What's on our mind this quarter

United States

Against a backdrop of rate decreases and growth forces, this succinct overview endeavours to shed light on the prevailing economic landscape shaping the trajectory of the US economy. From strong GDP growth to stubborn employment rates and the looming specter of inflation, we embark on an exploration of the realities confronting America's economic landscape.

Moreover, the dominance and influence of technology companies add another layer of complexity to the economic milieu. Amidst massive valuations and AI dominance, the role of tech giants in shaping markets and altering traditional business models cannot be understated.

Magnificent 7

The market capitalization of the Magnificent 7 stands as a monumental testament to their collective prowess and influence in the global economy. With a market cap of staggering proportions, if the Magnificent 7 were to be considered as a collective stock market entity, their formidable market cap would position them as the second-largest stock market in the world, rivaling even the economic might of entire countries. This realization underscores the immense scale and influence wielded by these conglomerates, accentuating their pivotal role in driving global economic activity and investment dynamics.

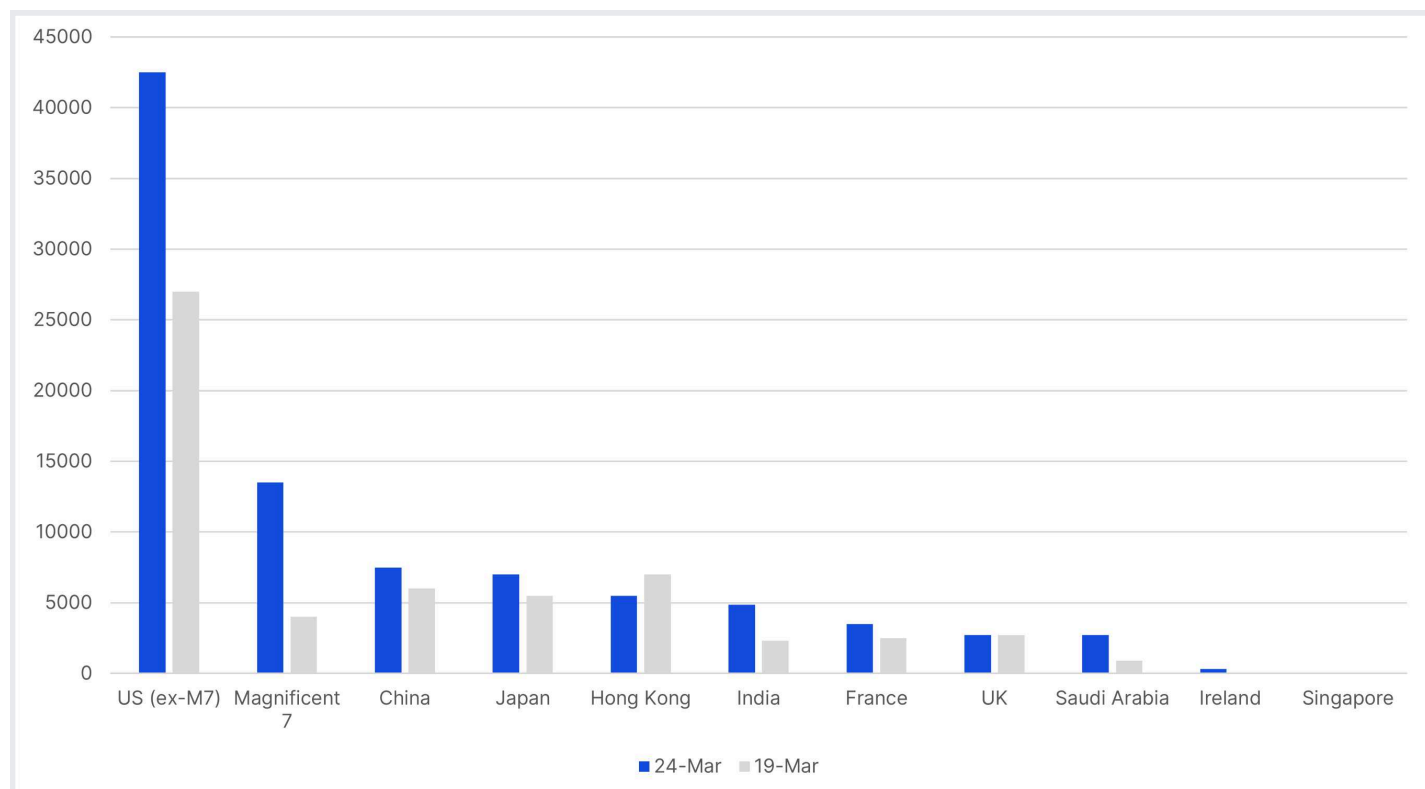
Here's a look at the companies ranked by their market capitalization on March 27, 2024, alongside their 5-year stock performance:



	28 March, 2019	Stock Price Today	Gain %	Market Cap (\$ bn)
AAPL	45.42	172.8	280.45%	2620
MSFT	111.3	419.3	276.73%	3133
GOOG	58.42	150.64	157.86%	1879
AMZN	88.67	178.4	101.20%	1852
NVDA	44.01	892.41	1927.74%	2314
META	165.37	490.76	196.76%	1264
TSLA	18.48	179.6	871.86%	565
Total				13,627

Source: Factset

What's on our mind this quarter



Source: Bloomberg and FactSet

US Large Cap vs. MidCap vs. Small Cap

Since 1989, in the United States, mid caps have consistently outpaced the returns of large caps, demonstrating the potential for significant growth and value creation in this segment of the market. Furthermore, Factset Data reveals that large-cap stocks are currently trading at historically high valuations, as indicated by their forward price-to-earnings (P/E) ratio surpassing its 10-year average. In contrast, the forward P/E ratios of small- and mid-cap stocks appear to offer a more attractive entry point for investors. This juxtaposition underscores the importance of careful analysis and a discerning approach to investment decisions, as opportunities may lie in areas of the market that present compelling value propositions for long-term growth and appreciation.

Higher Returns, Higher Volatility

What would a \$100 investment in small, mid, and large caps made in February 1989 be worth today?

The Trajectory of a \$100 Investment February 1989 to February 2024

Small Caps

\$2,162

Mid Caps

\$3,276

Large Caps

\$1,764

Since February 1989, small caps have returned **23%** more compared to large caps. Mid caps have returned **86%** more.

Yahoo Finance 03/05/2024. Large caps represented by the S&P 500. Mid caps represented by the S&P 400. Small caps represented by the S&P 600. Past performance is no guarantee of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece.

Small and mid caps earned a higher return historically, but experienced greater volatility.

Historical Annualized Volatility of Large Caps, Mid Caps, and Small Caps February 1989–2024



Yahoo Finance 03/05/2024. Large caps represented by the S&P 500. Mid caps represented by the S&P 400. Small caps represented by the S&P 600. Past performance is no guarantee of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece. Volatility, calculated as the annualized standard deviation of monthly returns, measures risk by quantifying the variation in returns. Past performance is no guarantee of future results.

Source: Yardeni Research (2024). Small caps, mid caps, and large caps are represented by the S&P 600, S&P 400, and S&P 500 respectively.



Smallcaps and midcaps are trading at a 29% discount and a 25% discount respectively to large caps.



What's on our mind this quarter

US Yield Curve Inversions and recession probability

The historical relationship between yield curve inversion and recessions is a well-documented phenomenon, with valuable insights for investors and policymakers alike. Typically, when the yield curve inverts—meaning short-term interest rates exceed long-term rates—a recession tends to follow. Historical data reveals that, on average, there is a median gap of approximately 12 months between yield curve inversion and the onset of a recession. However, the longest period between inversion and recession occurred in 2006-2007, spanning 22 months. Given that the yield curve inverted in July of 2022, we are currently running at 19 months since this pivotal event. This timeline serves as a sobering reminder of the potential economic headwinds ahead; however, we do not see a forthcoming recession in the economic data which is perplexing.

US Yield Curve Inversions & recession

Month of 10y-2y Inversion	Month of 10y-3m Inversion	Month Recession Starts?	Months between 10y-2y inversion & recession	Months between 10y-3m inversion & recession
Jan-66	Sep-66	N/A	N/A	N/A
Jun-69	Jan-69	Dec-69	6	11
Mar-73	Jun-73	Nov-73	8	5
Nov-78	Dec-78	Jan-80	14	13
Nov-80	Nov-80	Jul-81	8	8
Mar-89	N/A	Jul-90	16	N/A
Mar-00	Aug-00	Mar-01	12	7
Feb-06	Aug-06	Dec-07	22	16
N/A	Jun-19	Feb-20	N/A	8
Jul-22	Nov-22	N/A	N/A	N/A
		Median gap from inversion to recession (months):	12	8

Source: Refinitiv, NBER, Capital Economics

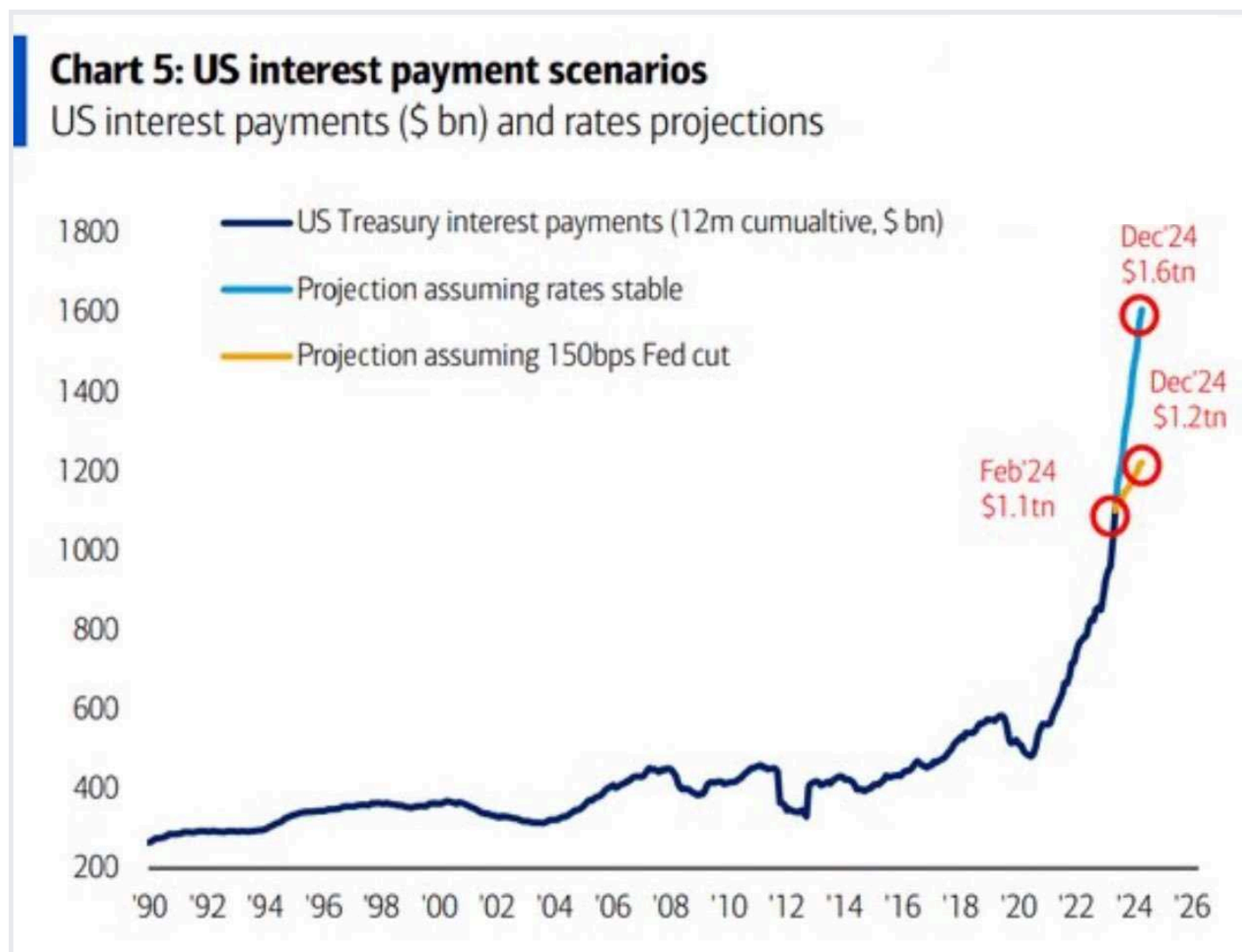
US Debt

The US National debt is rising by USD 1 trillion every 100 days and its set to hit USD 35 trillion in May 2024 and USD 37 trillion by US Election. The staggering figure of USD \$1.1 trillion per year in interest payments by the USA is a concerning indicator of the nation's fiscal health. Let's put that into perspective. That's almost USD 100 billion per month in interest payments alone. Such a substantial allocation of resources towards servicing debt reflects a significant burden on the government's budget, diverting funds away from critical areas such as infrastructure, education, and healthcare. Moreover, it highlights the long-term consequences of unsustainable borrowing practices and the accumulation of national debt. This persistent drain on financial resources poses challenges for future economic growth and stability, potentially necessitating difficult decisions regarding taxation, spending priorities, and debt management strategies. Addressing this issue requires a comprehensive approach that balances fiscal responsibility with policies aimed at promoting sustainable economic development and reducing reliance on borrowing. Failure to address the root causes of this escalating debt burden could have far-reaching implications for the nation's economic well-being and global standing.

What's on our mind this quarter

The public debt is the total outstanding debt that is owed by the federal government. This figure is comprised of debt owed to the public (for example, through bonds) and intragovernmental debt (debt owed to various governmental departments), such as Social Security.

As of February 2024, the United States government has a monthly interest rate of 3.2 percent on its debt, continuing an upward trend in interest rates that began at the beginning of 2024. In February 2024, U.S. debt reached USD 34.47 trillion almost two trillion more than in July 2023 when it was around USD 32.6 trillion.



Source: Bank Of America research report



United States interest payments to hit USD 1.6 Trillion by December 2024 if the Federal Reserve does not cut interest rates.



What's on our mind this quarter

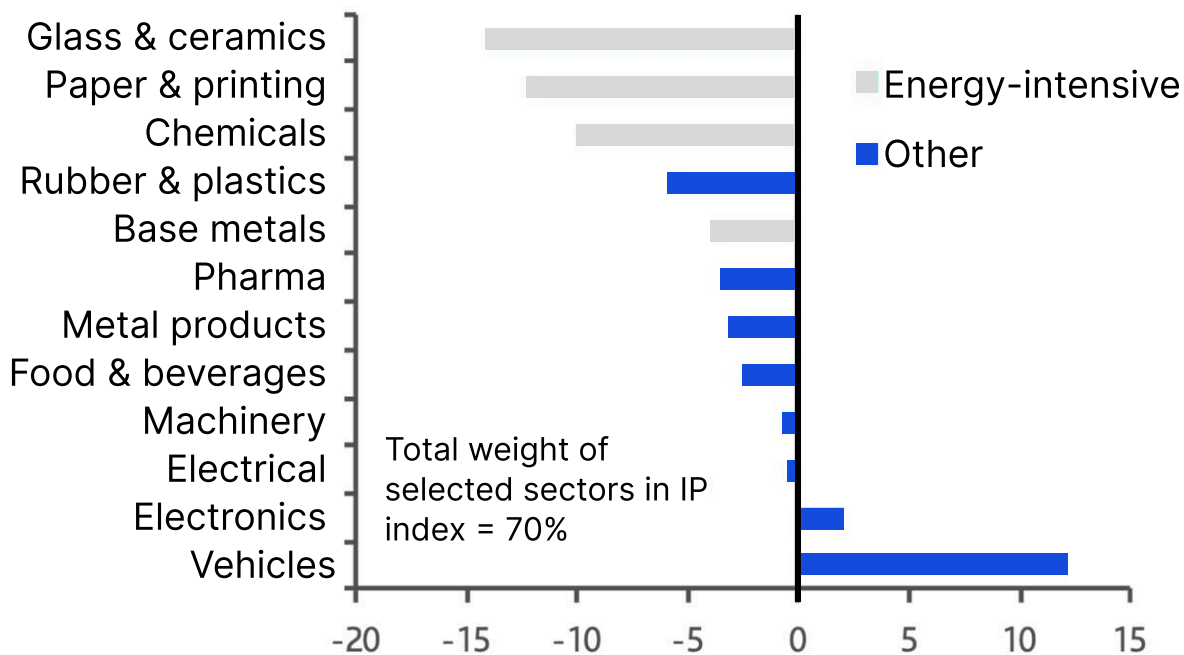
Eurozone

Against a backdrop of tepid growth, stable employment, and geopolitical tensions, the following thoughts seeks to illuminate the meandering course of the Eurozone economy. From the enigmatic fluctuations of Export falls of Germany to the enduring challenges of sovereign debt and political fragmentation, we decipher the rhythms of Europe's economic landscape.

Germany

The euro-zone is poised to remain mired in or near a recession during the first half of 2024 due to the ongoing impact of elevated interest rates, which continues to exert downward pressure on both household consumption and investment. Additionally, fiscal policy is set to tighten, exacerbating the economic challenges. Headline inflation has already experienced a significant decline and is anticipated to hover around the European Central Bank's (ECB) 2% target for the majority of 2024. Despite a still relatively tight labor market, signs of easing are emerging, with a reduction in the number of job vacancies from recent highs. This trend is expected to contribute to a downward trajectory in core inflation.

Germany Y/Y Change in Output in 12 Largest Industry Sectors in 2023 (%)



Source: Refinitiv, Capital Economics



ECB will start cutting interest rates in June as there is a notable slowdown in Eurozone Inflation

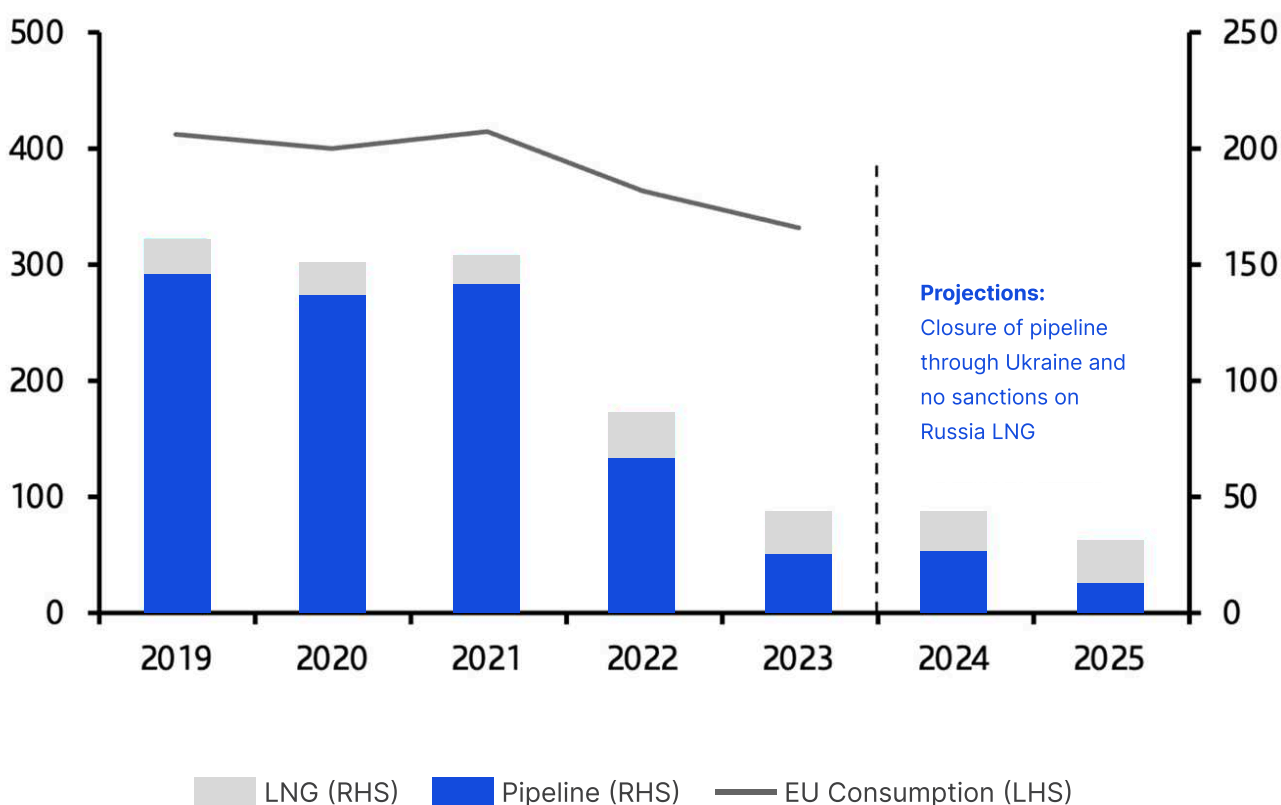


What's on our mind this quarter

EU dependency on Russian Gas is reducing at a phenomenal pace

The significant reduction in imports of Russian gas into the European Union underscores a notable shift in the region's energy dynamics. In 2019, Russian gas accounted for a substantial 40% of EU consumption, highlighting the significant reliance on this energy source. However, the current figure stands at a markedly lower 15%, reflecting a dramatic reduction over a relatively short period. This decline may be attributed to various factors, including efforts by EU member states to diversify energy sources, geopolitical tensions affecting trade relationships, and the advancement of renewable energy technologies.

EU Gas Consumption and Imports from Russia (Bn. Cubic Meters)



Note: Imports of Russian gas were equivalent to around 40% of EU consumption in 2019. This had fallen to around 15% in 2023.

Source: Refinitiv, Eurostat, European Commission, Capital Economics



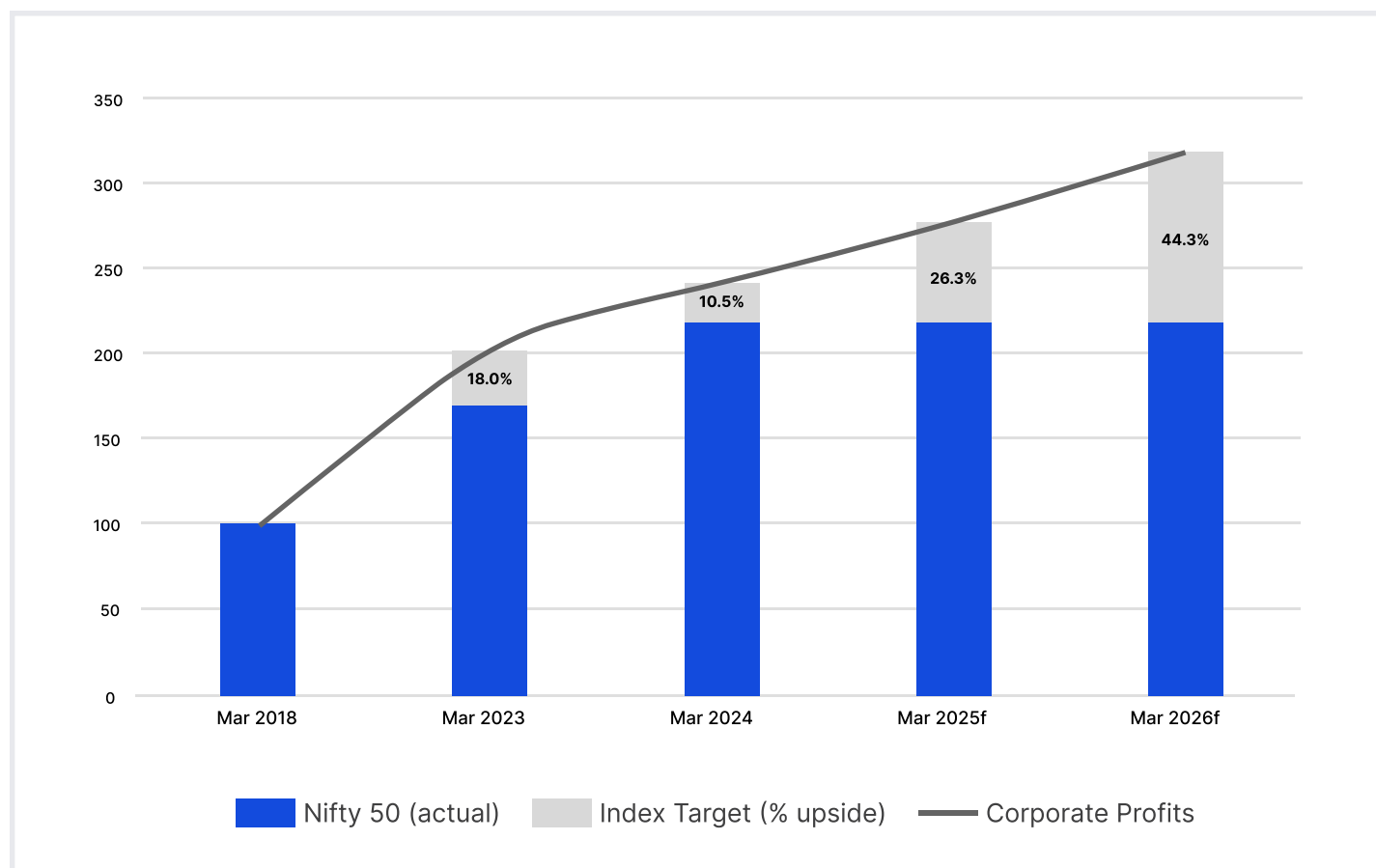
Russian gas accounted for 40% of EU consumption. The current figure stands at a markedly lower 15%



What's on our mind this quarter

India

Had the Nifty 50 Index kept pace with corporate profits since 2018, it would presently be 10.5% higher. The Index is currently playing catch-up with corporate profit growth, which from 2019 to 2024 achieved a compound annual growth rate (CAGR) of 16.0%, compared to the Index's CAGR of 14.1% during the same period. If this trend continues, we estimate that the Index could surge 26.3% by March 2025 and 44.3% by March 2026



Source: Factset



Buy Indian equities on every pullback for the next 2 years.

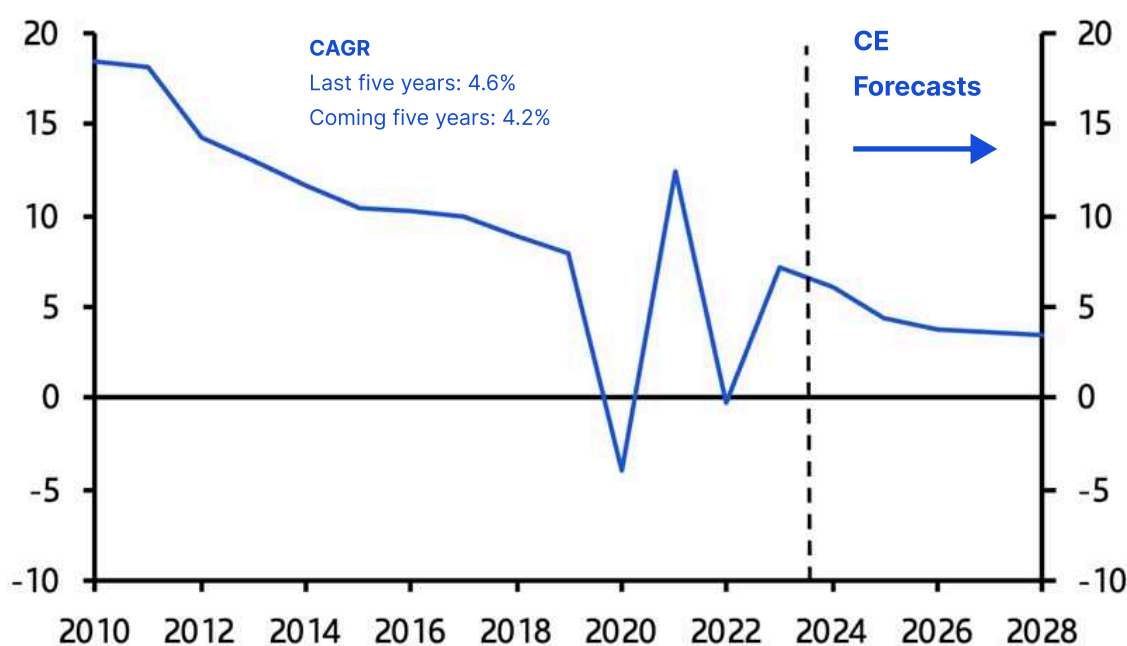


What's on our mind this quarter

China

As per a recent report from McKinsey & Co, China's economic landscape is gradually shifting towards a consumption-driven model, a trend we've been closely observing. Retail growth, encompassing both goods and services, is forecasted to surge by 5 percent this year, with consistent growth anticipated in the years ahead. This trajectory translates to an additional RMB 10 trillion in retail sales over the next five years, firmly establishing China as the premier growth market on a global scale.

China Retail Sales Values (% y/y, annual)



Source: CEIC, Capital Economics

Now this might seem to the naked eye a dramatic slowdown from 2010 number of 18% but we tend to forget the base number effect and that China's massive population. To put this expansion into perspective, it's essential to recognize that such robust growth in retail sales surpasses the retail sales of India, Indonesia, and South Korea COMBINED! These countries, it should be noted, possess significant economic influence and are not merely frontier nations.

Moreover, according to the same report, the projection for the proliferation of upper-middle and high-income households to reach 200 million by 2025 and 260 million by 2030 is truly remarkable. Additionally, the expected rise in high-income cities to 82 by 2025 and 93 by 2030 indicates a significant transformation in China's economic landscape. These statistics merit careful consideration and underline the profound implications of China's evolving consumer market for global investors and businesses alike.



Inflation and interest rates emerged as pivotal market influencers. The Fed's aggressive rate hikes to counter inflation demonstrated positive results. Looks like the Fed has landed the plane safely!

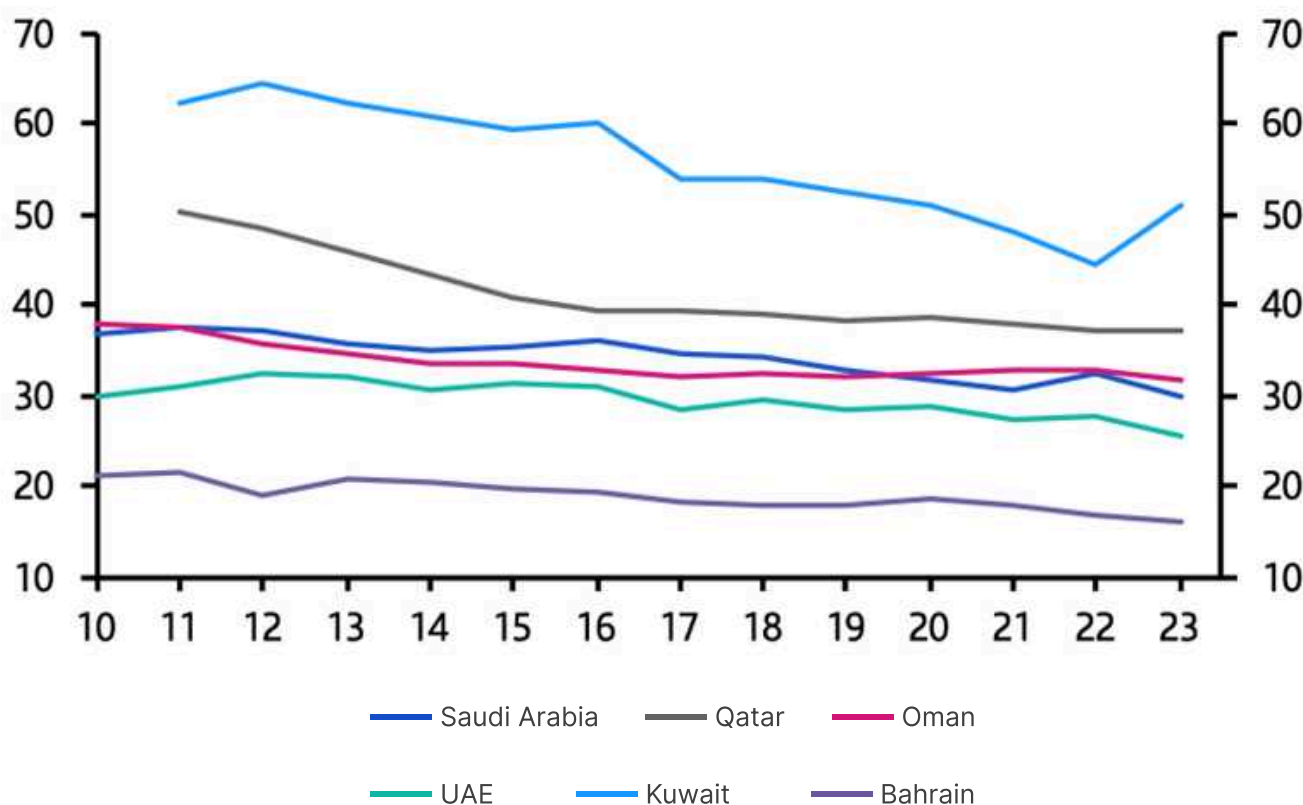


What's on our mind this quarter

GCC

Oil continues to play a pivotal role in the economies of Gulf Cooperation Council (GCC) countries, with its contribution to GDP remaining substantial over the years. Since 2010, data underscores the enduring significance of oil as a key asset in GCC economies. Despite efforts to diversify their revenue sources and reduce dependence on oil, the GCC nations continue to rely heavily on the oil sector to drive economic growth and development. This reliance is evident in the percentage of GDP attributed to oil-related activities, highlighting the crucial role that oil plays in shaping the economic landscape of the region. As such, fluctuations in oil prices and market dynamics continue to have profound implications for the overall economic performance of GCC countries.

Hydrocarbon GDP (% of Total GDP)



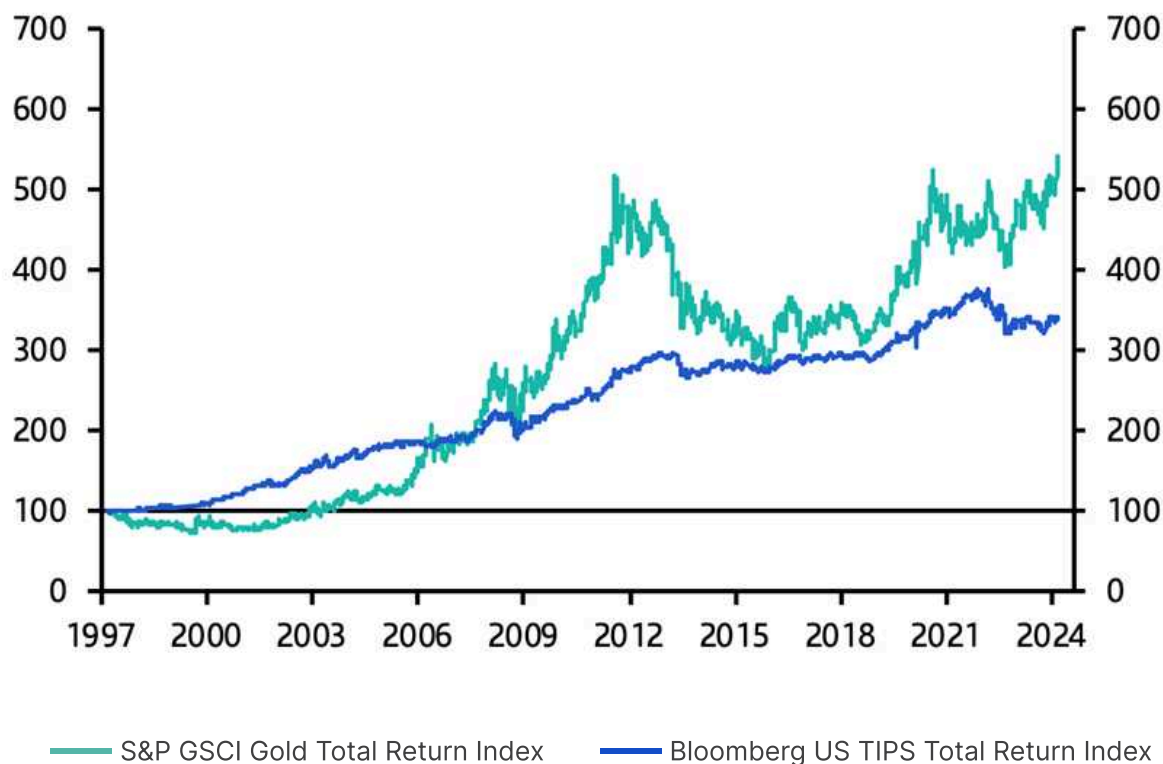
Source: CEIC, Capital Economics

Gold & TIPS

An analysis of TIPS (Treasury Inflation-Protected Securities) versus gold prices since 1997 reveals an intriguing pattern, particularly during times of crisis. Historically, gold prices have tended to deviate from TIPS prices whenever a crisis occurs, only to revert to TIPS levels within approximately a year. This phenomenon underscores gold's status as a traditional safe-haven asset, sought after by investors during periods of uncertainty. However, in the aftermath of the COVID-19 crisis, gold prices have continued to climb, defying the typical pattern observed in previous crises. This sustained upward trajectory suggests a persistent and substantial demand for the yellow metal, signaling ongoing investor preference for gold as a hedge against economic instability and inflationary pressures.

What's on our mind this quarter

Gold & TIPS Total Return Indices (31st Mar. 1997=100)



Source: Bloomberg, Refinitiv, S&P, Capital Economics

Gold Purchases by Central Banks

In recent months, we've witnessed a notable uptick in gold purchases by several central banks, signaling a concerted effort to bolster their reserves of the precious metal. Since the end of 2022, central banks in China, Singapore, Qatar, the Czech Republic, and Poland have collectively acquired a staggering 464 tonnes of gold, with China taking the lead by acquiring 225 tonnes alone. This significant increase of demand from central banks has served to establish a firm support level for gold prices, effectively putting a floor beneath its value. The strategic accumulation of gold reserves by these central banks reflects a broader trend of diversification away from traditional currency holdings and towards tangible assets with intrinsic value, reinforcing gold's status as a reliable store of wealth and a hedge against economic uncertainties. As such, this substantial increase in central bank purchases underscores the appeal of gold as a vital component of global monetary reserves.

Conclusion

In summary, we anticipate upward movements in the markets driven by growing earnings and the expansion of multiples. However, we foresee a potential correction of approximately 10% in April 2024, attributed to the quarterly rebalancing of portfolios. It's worth noting that the reduction in interest rates might occur gradually.

Nevertheless, there are key risks that could challenge our conclusion. A significant decline in inflation due to an economic slowdown or disruptions in the financial system resulting from higher interest rates could derail market expectations. These scenarios pose potential threats to the stability and trajectory of the markets, warranting careful monitoring and risk management strategies.



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Ahil Mansoor is a distinguished financial professional, brings over two decades of multifaceted experience to his role as CEO and CIO at Octave Asset Management. With expertise spanning asset management, private banking, venture capital, and financial consulting, Ahil is a strategic leader in the financial domain. Holding an MBA in Finance from the Thunderbird School of Global Management complemented by a Bachelor's degree in Engineering, Ahil is a seasoned professional with a strategic leadership approach. His industry proficiency is further underscored by designations including Certified Financial Planner (CFP), Chartered Investment Manager (CIM), and Fellow of the Canadian Securities Institute (FSCI), along with successful completion of CFA Level 2.



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