Blackshield Capital

November 2023 (13.11.23 - 19.11.23)

BLACKSHIELD WEEKLY INSIGHTS

Key asset classes performance

Top charts of the week:

- valuation of BigTech companies
- debt market spillovers
- inflation index and its structure

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One of **the most important tasks of an investment firm** is to respond in a timely manner to the challenges of the economy and market conditions. While many risks of a geopolitical and financial nature cannot be predicted, it is worth staying informed to understand what is happening in a meaningful way.

Interest rates, the real estate market, employment and unemployment, inflation and corporate profits are just a few of the variety of factors affecting asset and security pricing.

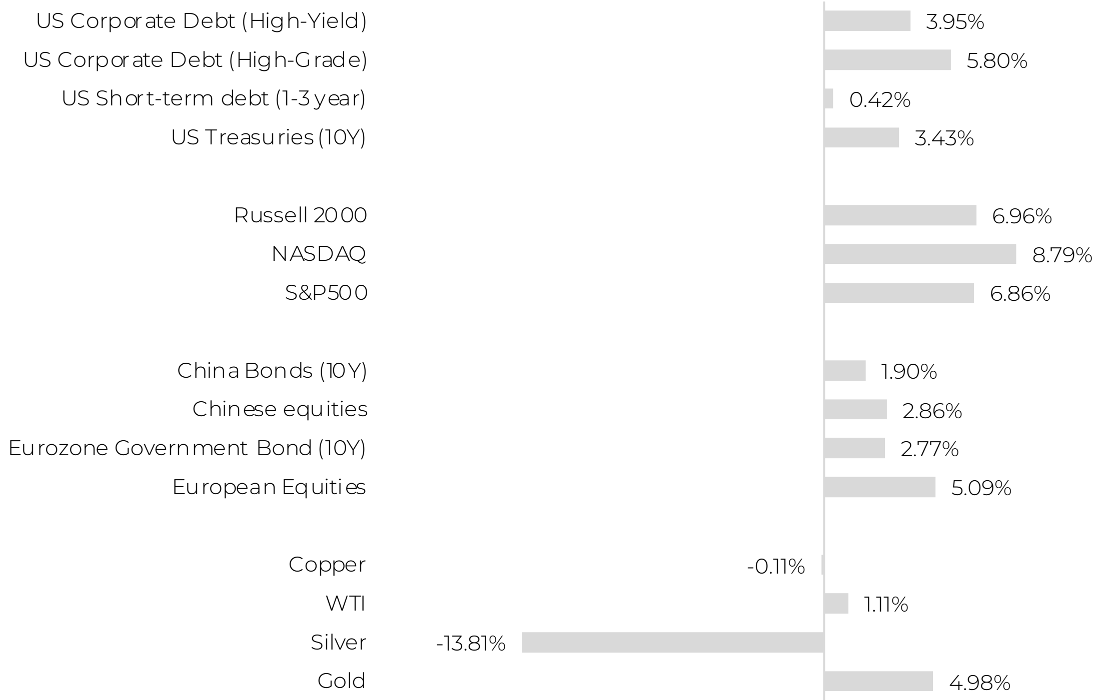
Our goal is to provide a deeper and clearer understanding of what is happening in the markets with an emphasis on illustrations, charts and visuals.

Weekly Insights will provide a more detailed look at industry specifics, delve into the nuances of price mechanics, and provide a more detailed understanding of our strategic vision offered in our quarterly strategic reports.

Dynamics of main assets

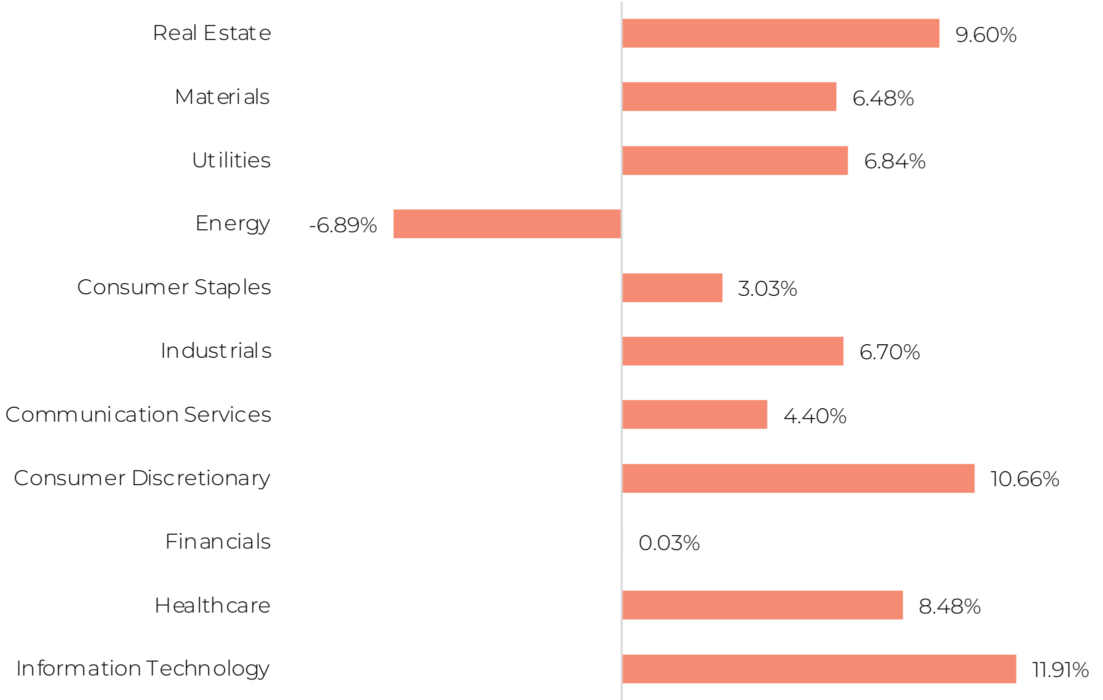
This week the markets showed strong optimism due to the positive reaction to the release of inflation data, which on the one hand set the trajectory towards the Fed's 2% target and on the other hand significantly reduced recessionary pessimism.

Dynamics by key assets, 1 month



- The obvious reason for the gains over the past week was the news of the inflation release, which came out more optimistic than the market had anticipated.
- This led to a rise in all assets on the market, in particular the most risky ones, among which we should mention the NASDAQ, the S&P500, as well as the debt market, which has been under pressure over the last months.

S&P500 sectors dynamics, 1 month



- In terms of sectoral breakdown, the most inflation-sensitive sectors of the economy, particularly IT, Consumer Discretionary and Utilities, reacted positively amidst the positive reaction to the release of inflation statistics.
- However, the positive market sentiment affected all sectors, in particular, the most recently sagging ones - Consumer Staples and Utilities.

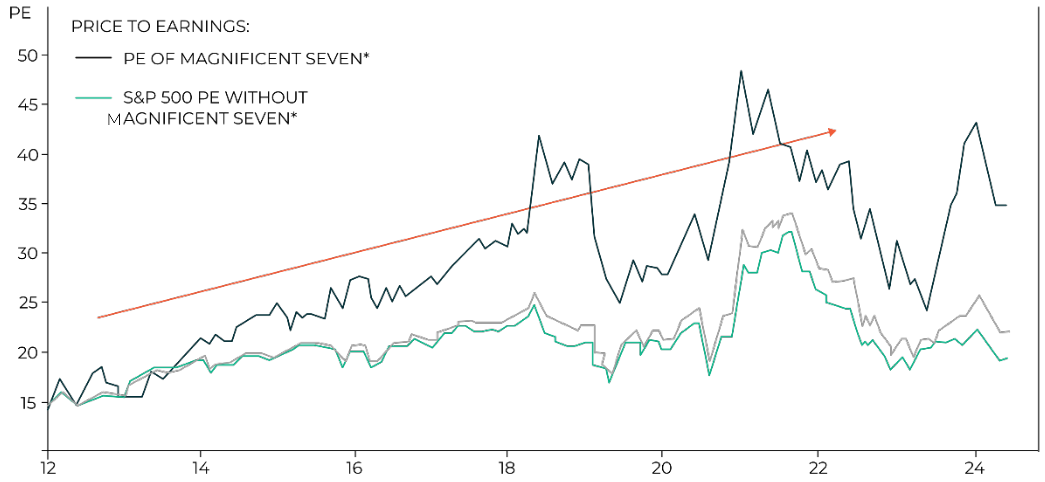
Top charts of the week – valuation of BigTech companies

In 2023, the most growing equity category was the so-called "BigTech", in particular companies whose business is directly related to the topic of artificial intelligence. However, the risks of concentration and downsizing of market leaders raise many questions about the sustainability of the future growth of such companies next year.

Operating profitability: BigTech premium vs. S&P500

- The company's current profitability gap is narrowing (from a 5-year peak of 12% to 4% in Q3 2023).
- This factor is mainly attributed to the post-Covid (2020-2021) boom in profit growth at IT companies, which organically declined in times of economic contraction.
- The level of development of companies is also an important factor: as companies become more mature, their profitability tends to stabilize.

BigTech valuation premium relative to S&P500

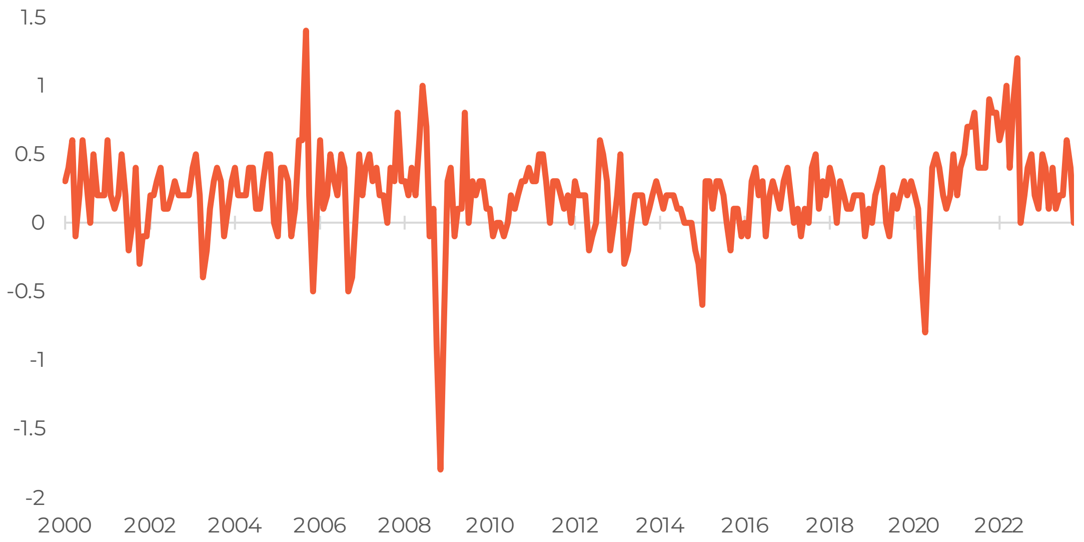


- Despite the narrowing profitability gap between BigTech and the rest of the S&P500, the company value gap remains above average over the past 3-5 years.
- This can be primarily attributed to both the strong demand for any IT services after 2020 and the fact that the largest BigTech companies have stable cash flows, the highest level of cash on the balance sheet (among S&P500 companies) and corporate debt with a much higher duration than smaller companies.

Top charts of the week – consumer price index and its structure

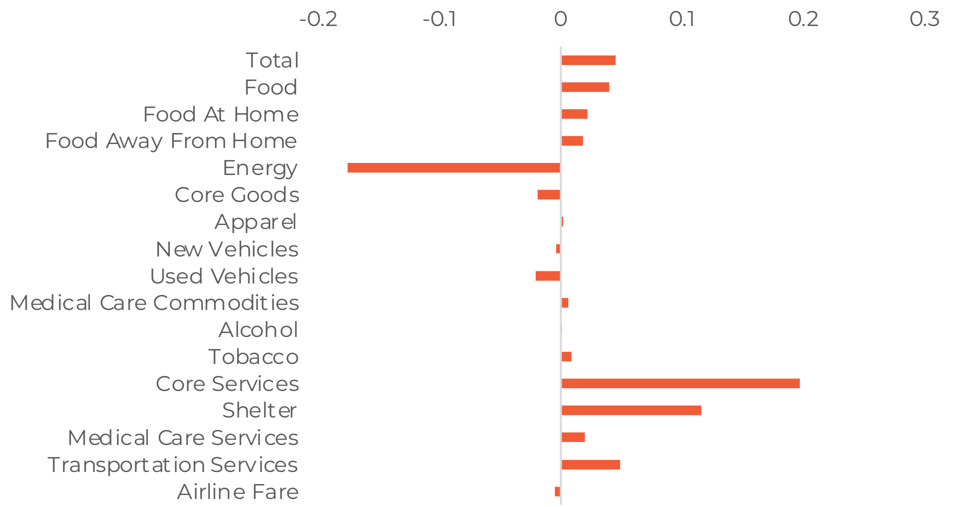
The decline in inflation is one of the bright events over the past week. The report for the previous month showed a decrease in the inflation growth rate, which was positively noted by the market.

Dynamics of consumer price index month-to-month



- The core consumer price index (CPI) rose 0.23% month-over-month, with a consensus of 0.3-0.4%. House prices continued to decline, while average rents rose by 0.4%.
- The most extreme growth was shown by the growth of prices of tobacco products and transportation services, meanwhile, the decrease in the inflation rate was mostly caused by the collapse of energy prices.
- The sharp decline in the CPI index in turn acted as a strong driver for the sharp rise in stock indices and bonds.

Structure of changes in consumer price index

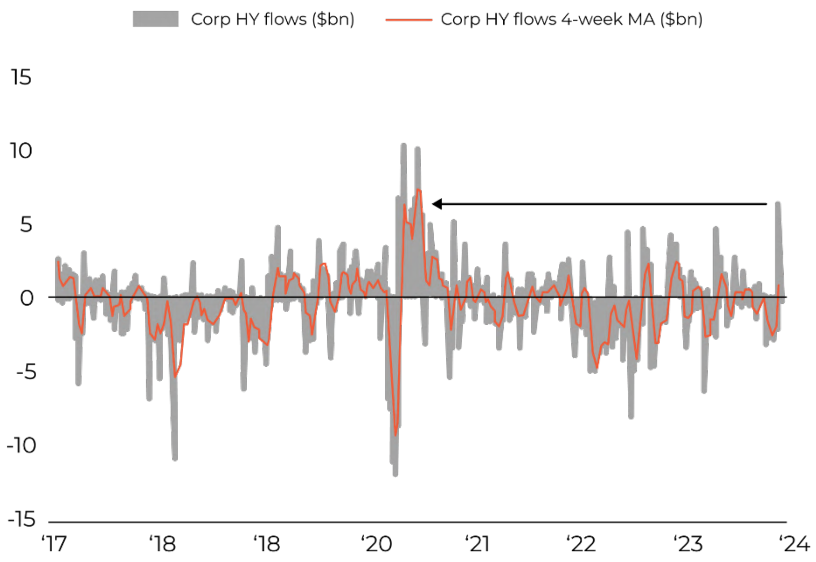


- With the potential increase in supply cuts at the next OPEC meeting (due to the large production inventories accumulated this year), as well as seasonal demand during the winter months, we are skeptical of a solid inflation trajectory to the Fed's 2% target rate.
- At the time the Fed put itself in a condition of dependence on market data, October inflation has very likely put an end to this cycle of interest rate hikes.

Top charts of the week – debt market spillovers

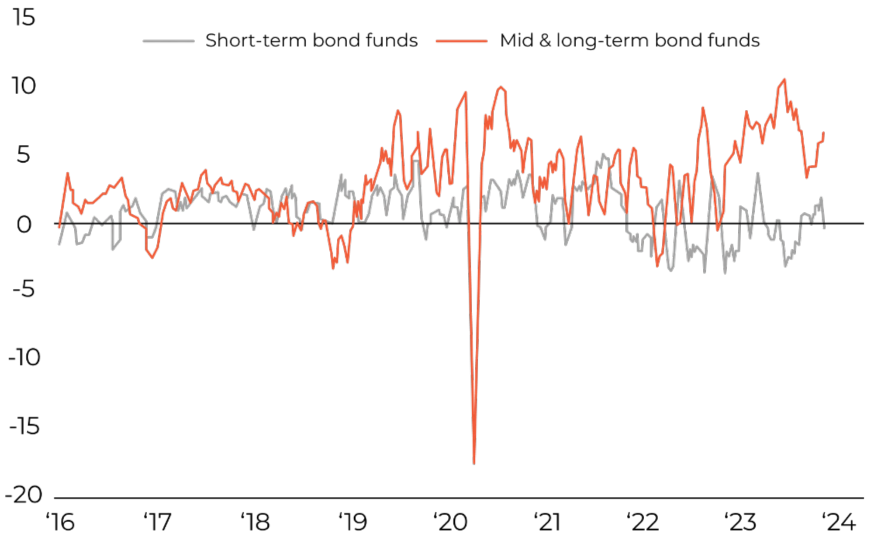
Tracking the flow of funds in the market is one of the important short-term indicators of market sentiment. An interesting movement in recent weeks is the spillover of money from more defensive to less defensive debt instruments.

Investors add to risk-positions: new inflows into High-Yield bonds



- The data on capital flows of institutional investors show a short-term inflow of assets into riskier debt instruments. On the one hand, this indicates market expectations of a relatively mild recessionary scenario. On the other hand, a potential peak in interest rates is a sign that new debt instruments will have declining coupons and thus a lower debt burden on businesses.
- The CPI inflation report also played a big role in the rise of risky bonds.

Investors are shifting money from short-term to medium and long-term bonds



- On the other hand, no less important point worthy of attention this week is the active shifting of investors into longer-term debt securities. Investors are interested in "fixing" the current high level of potential yields and coupons for a longer period.
- In turn, the next issues of short-term bonds and so-called T-Bills are likely to be conducted with lower yields, which will only accelerate the rally of medium-term securities.

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LET US HELP YOU TO FOCUS **ON WHAT MATTERS MOST**

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