Blackshield Capital

04.03.24 – 10.03.24

WEEKLY INSIGHTS

Increased tension in the financial market

Dynamics of key assets

Top charts of the week:
- growing optimism in the semiconductor industry
- decreasing investor confidence in the debt market
- labor market divergence

Have a question for the team? CONTACT US

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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.

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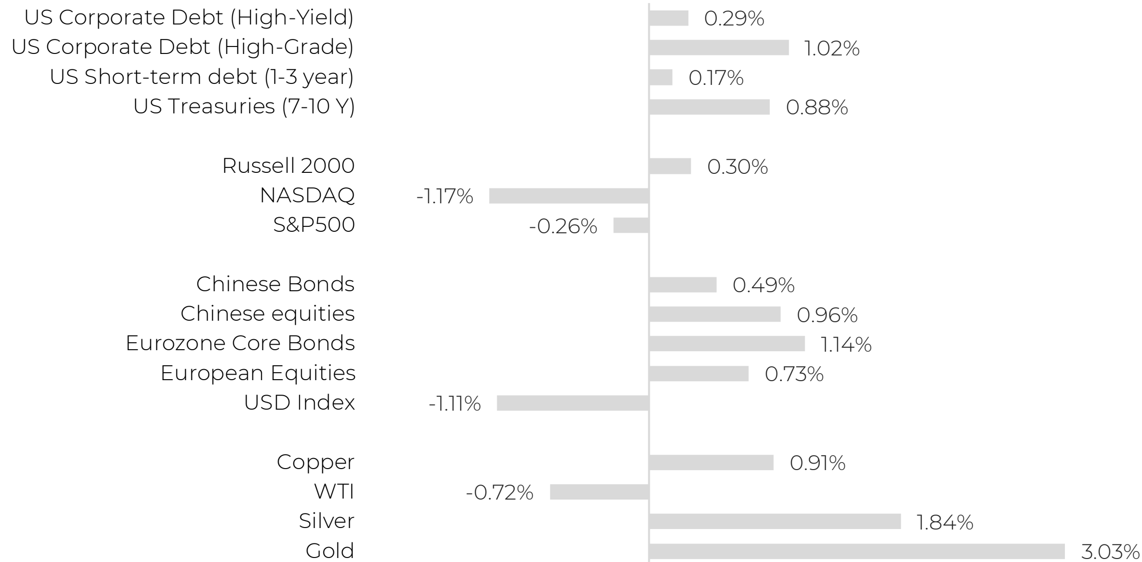
Dynamics of key assets

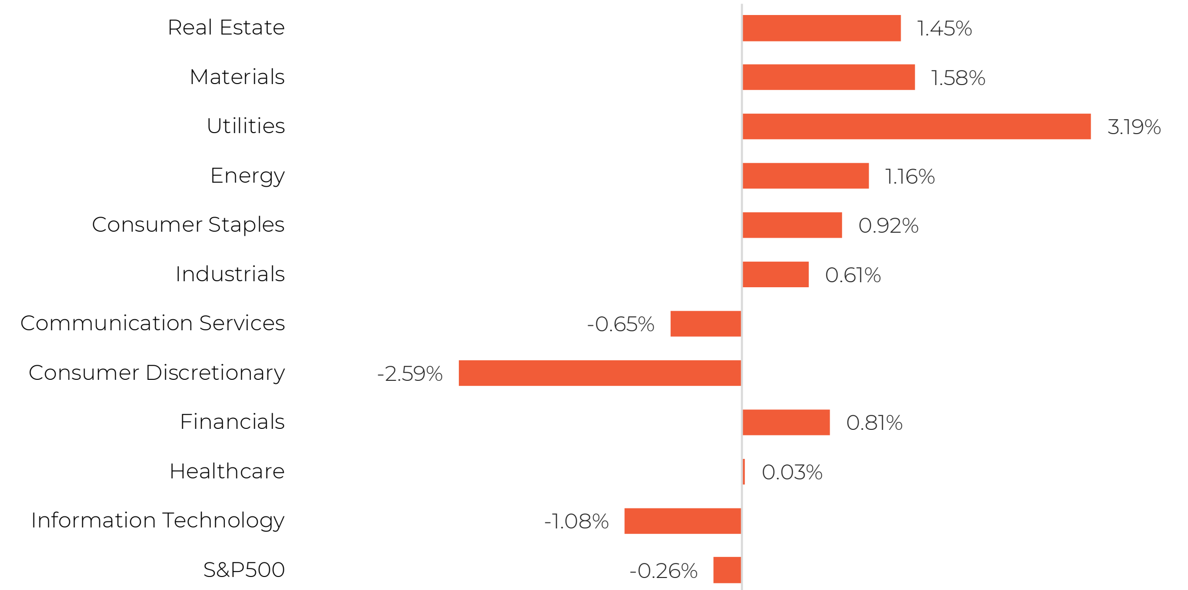
The week was marked by positive sentiment, given the Fed chairman's confirmatory rhetoric in the Senate, positive labor market data, and a general lack of negative macroeconomic news, although, for example, the US market closed in the red.

Dynamics by key assets for the week



- Last week was full of macroeconomic news that the market expected, which, on the one hand, built up expectations on the market regarding the stability of January inflation growth.
- At the same time, commodity assets, in particular gold, brought the highest returns, reaching historic highs amid expectations of lower rates and strong demand from central banks and Chinese investors.
- The United States stock market showed mixed dynamics, closing quotes in the negative due to lower valuation of the IT sector.

S&P 500 sector dynamics for the week



- Although most sectors showed growth, this did not affect the quotes of the overall S&P 500 index, based on the smaller share of sectors in the structure of the index itself.
- In particular, we have seen growth in pro-inflationary sectors such as materials, real estate, and energy. In turn, the most lagging sectors were consumer goods and communication services, where the largest share of companies from the so-called Magnificent 7 group is concentrated.
- In general, this picture indicates that investors are more ambivalent about the further growth of the stock market, which is currently at historic highs.

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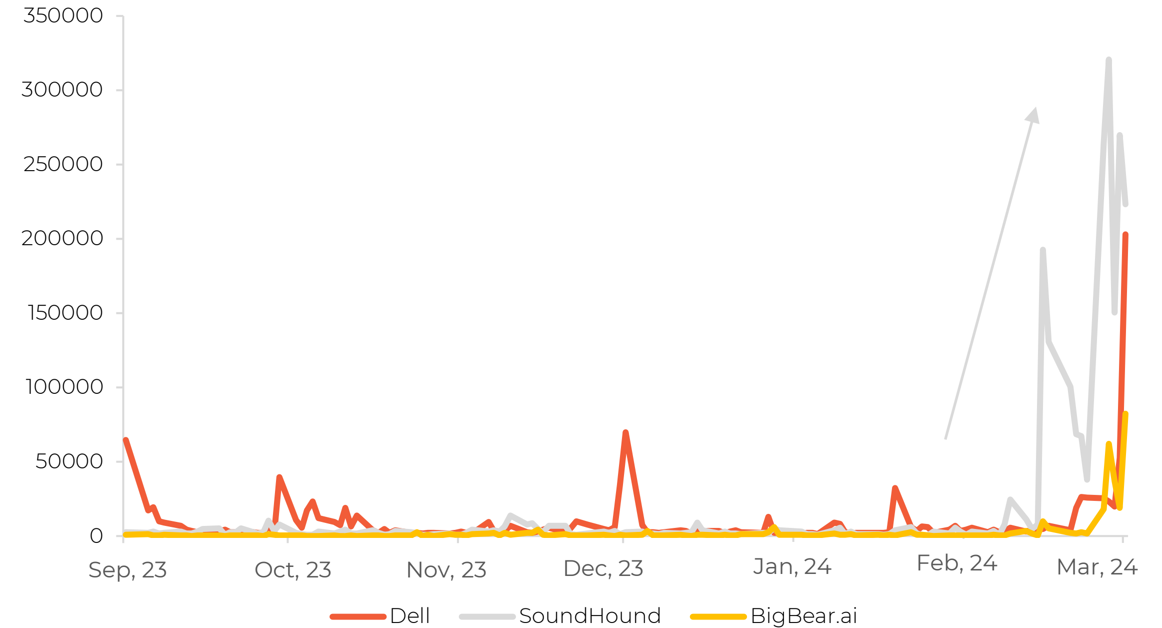
Top charts of the week – growing optimism in the semiconductor industry

The semiconductor sector has been attracting investors' attention for a long time, and optimism has continued to grow amid NVIDIA's reporting. Does this indicate an imminent reversal? Given that most players follow the trend, such demand may indicate that the industry is overheating.

The ratio of the semiconductor index to the S&P 500

- Trying to predict the peak of such euphoria is usually futile, as market participants adjust their year-end targets upward, amid the prevailing narrative of economic stability. Recent developments have led several banks to revise their year-end S&P 500 targets to 5,400-5,500, a forecast that seemed absurd a year ago.
- Although there are different views on this surge, the SOX/SPX ratio is almost back to its all-time high in March 2000. For more players, it is still difficult to go against the tide, but looking at the broader context, it is difficult to find market-balanced arguments that can support confidence in the future dynamics of this trend.

Trading volumes of call options on popular stocks are growing



- On the tech/SaaS/AI side, we clearly see a similar picture - an increase in demand for stocks and, more importantly, for options. Usually, the market has a balanced demand for so-called put and call options, which are the right to purchase shares of companies at a certain time at a certain price. However, over the past few months, the demand for call options has reached abnormally high levels for technology and semiconductor stocks.
- This is more true for mid-cap companies, which are the most prominently covered in the media, which is a kind of indicator of retail risk demand and a sign of temporary overheating in certain sectors, as was the case at the end of 2021. However, the economic environment then and now is different, in terms of inflation, interest rate expectations, and central bank strategy.

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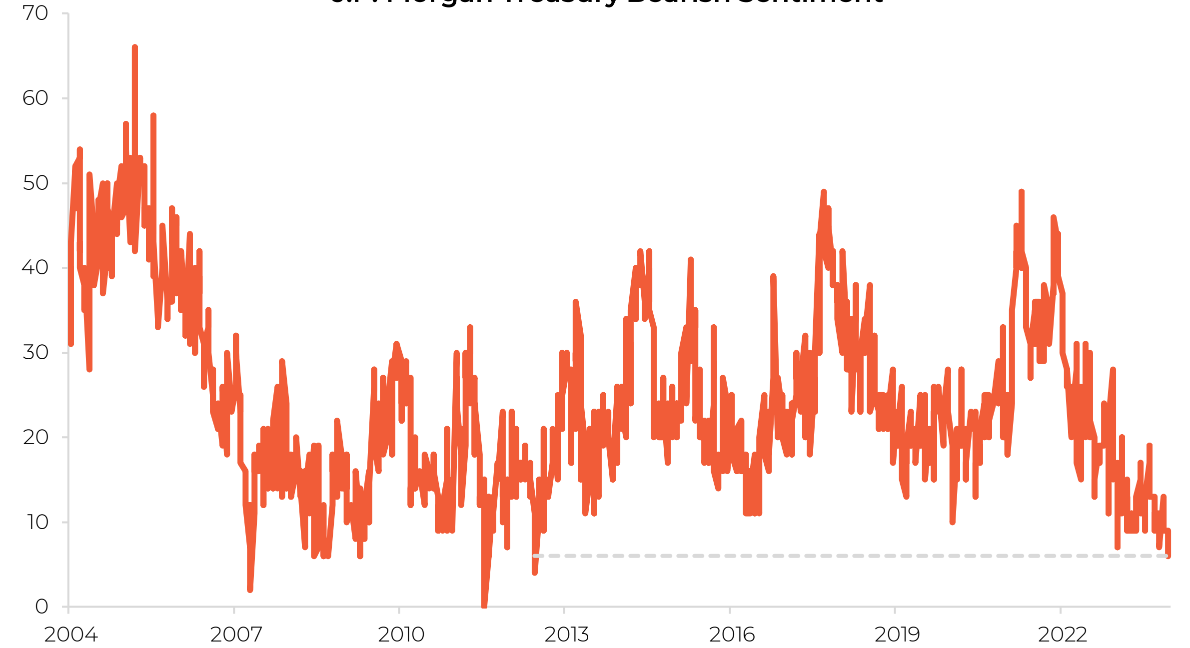
Top charts of the week – decreasing investor confidence in the debt market

The rise in bond yields indicates a decrease in debt appetite, which is influenced by the issuer's ability to repay the debt. The trend is supported by the unstable commercial real estate market, whose debt will be refinanced at potentially higher rates.

- The rise in bond yields is atypical as the Fed prepares to begin its easing cycle. Despite falling from its peak of 5.0% to 3.8% at the end of last year, the 10-year bond yield has recovered to 4.2% amid a reassessment of the economic situation.
- The key aspect is the trajectory of bond yields, which is the sum of expected future short rates over the life of the bond, together with the maturity premium. An analysis of the short-term interest rate futures market shows a change in market sentiment: initial expectations for a decline in interest rates have fallen to only 100 basis points. In addition, the projected terminal rate was revised upward to 3.5% from the previous estimate of 2.75%.



- In addition to this, only 6% of investors are bearish. According to the Mortgage Bankers Association (MBA), approximately $929 billion of commercial real estate debt matures in 2024, representing 20% of the total, and will need to be refinanced at potentially higher rates. MBA's 2024 forecast was significantly revised upward after several loans were extended.
- The problem is that the real estate sector is known for its high level of leverage. A significant decline in the value of the assets used as collateral for loans could cause significant financial stress throughout the system. Thus, there are legitimate reasons for concern at this time, especially given the extent of the price declines observed in certain regions.

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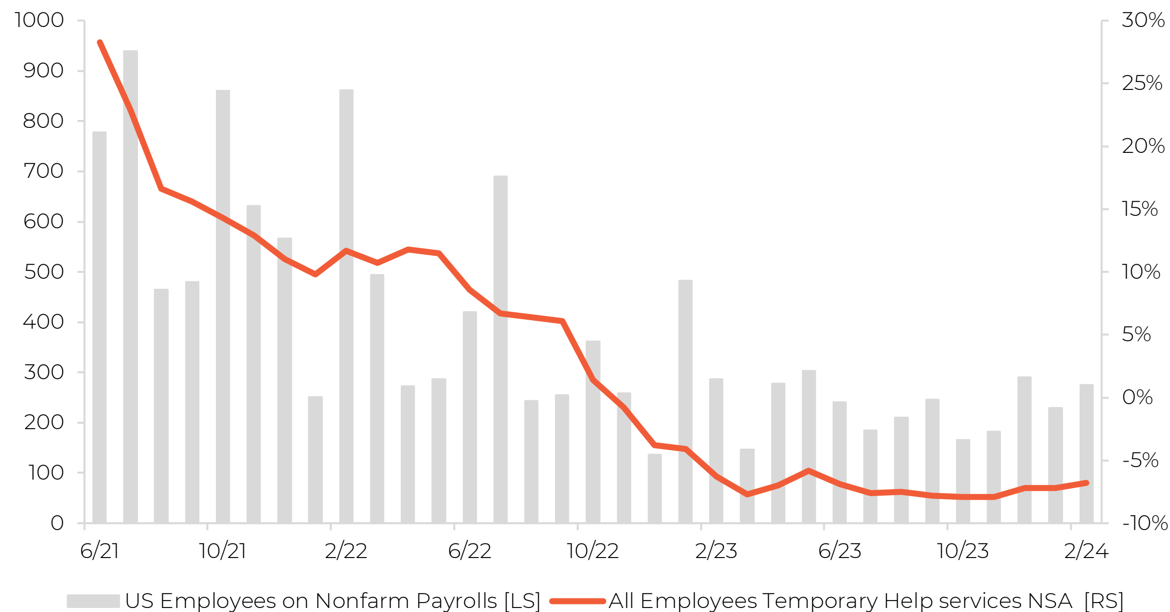
Top charts of the week – labor market divergence

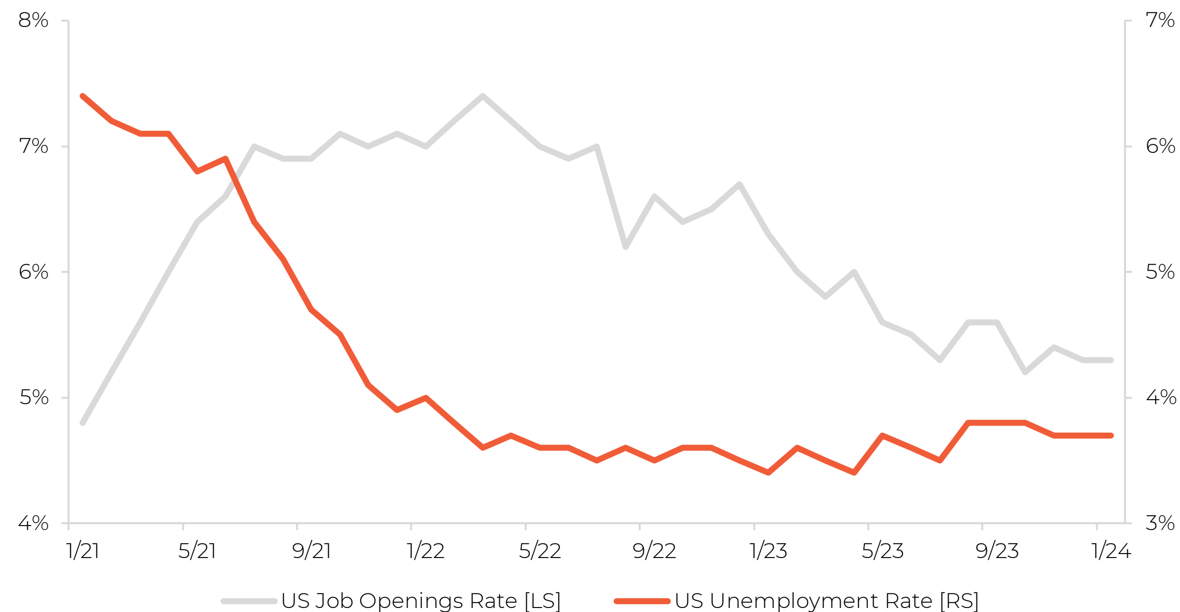
The latest data on nonfarm employment was positively received by the market, although, as we pointed out earlier, other indicators point to a certain deterioration in the situation. However, it is only a matter of time before this will translate into a real increase in unemployment.

Number of new employees in non-agricultural sectors of the economy



- The latest employment data showed an increase of 275 thousand new workers, which exceeded expectations by 75 thousand (market expectations were at 200 thousand the day before).
- This was positively received by the market, as this indicator indicates the direct creation of new jobs in the economy.
- However, there are several important points in the structure itself: the second most important factor in the growth of new jobs was the civil service, which is becoming a rather rare phenomenon. At the same time, the number of temporarily employed workers continues to decline, which is an early indicator of negative changes in the labor market.

Level of new vacancies in the economy



- In terms of the overall unemployment rate, the latest data showed an increase to 3.9% (from 3.7% in December 2023). Such fluctuations between 3.7% and 3.9% are already commonplace in the market, indicating a continued stable labor market.
- However, according to the theory of macroeconomic interdependencies, the unemployment rate tends to increase after a change in the level of new vacancies in the economy (the so-called Beveridge Curve rule).
- That is why we believe that the current unemployment rate has a direct opportunity to rise on the horizon in the coming quarters. Moreover, the 4.5% vacancy rate is a critical point at which, historically, unemployment growth has been more pronounced.

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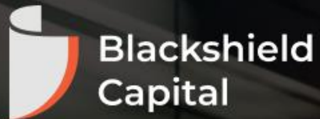

LET US HELP YOU TO FOCUS **ON WHAT MATTERS MOST**

hello@blackshield.capital

+41 43 456 25 92

Bahnhofstrasse 10, 8001
Zürich, Switzerland

Volodymyrska St, 4, 02000
Kyiv, Ukraine

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