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# Macro vs Micro

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For much of the time, the financial market narrative is dominated by “macro”, or “top down” factors. These can be things that are not specific to finance, such as geopolitics or, in extreme cases, forces of nature; more usually they relate to monetary and fiscal policy, with the direction of interest rates and currencies tending to be amongst the most important.

At the other end of the telescope, there is the "micro", or "bottom up". This refers more to the performance of individual companies. Confusingly, perhaps, "micro" extends all the way up to the "mega cap" companies, which today are exemplified by the "Magnificent 7" technology-related stocks that have led US equity indices higher over the last year. More on them later.

I don't think it would be an exaggeration to say that the macro has had the upper hand for most of this decade, starting with the pandemic, followed by extreme monetary and fiscal policy, extraordinary shifts in consumer behaviour, a multi-decade peak in inflation and an aggressive response from central banks. War in Ukraine and the current hostilities in the Middle East, along with the West's increasingly fractious relationship with China, are main courses, rather than just side dishes. Challenging demographics could be the dessert, although hardly the type that comes with a cherry on top.

The construction of clients' portfolios is approached from both ends. Strategic allocations to various core asset classes are directed by the amount of risk (for which read volatility and potential capital losses) one is willing to tolerate. We then apply a Tactical Asset Allocation (TAA) overlay to the strategic benchmark. The TAA is then populated by individual securities and funds.

We have just concluded the latest round of TAA process meetings, and the final reckoning was a mix between continued caution, a lack of certainty and the possibility of some light at the end of the tunnel. In American baseball parlance, there is no "fat pitch" waiting to be hit just now.

The caution is based upon the potential lagged effects of past interest rate rises. Companies and consumers are still having to refinance existing debts at higher rates, with the UK mortgage market a case in point as two-to-five year fixed rates roll off. There are still around 100,000 mortgages maturing every month. In the corporate world, a lot of bonds issued at very low rates in 2020 and 2021 will soon become due for refinancing. Governments find themselves in a similar predicament, with debt service costs rising on an expanding pile of debt.

Much of the uncertainty relates to the transmission mechanism of policy. It is already clear that rising interest rates have taken longer to bite than in the past. Then there is the ongoing debate about the level of "excess savings" built up by households during the pandemic. These are proving to be very hard to calculate precisely and it is equally difficult to predict consumer behaviour. Spending habits do appear to have evolved: in the pandemic it was all about buying "stuff"; now spending is being diverted towards experiences.

In addition to those uncertainties, we can add geopolitics, which is back on the radar in a big way. Moreover, elections in the US and (probably) UK will also be influential. The "binary" outcomes possible in the US, assuming that both President Biden and ex-President Trump stay the course (which is by no means guaranteed), only make the fog thicker.

The light at the end of the tunnel emanates from falling rates of inflation (although not price levels in aggregate) and the potential for lower interest rates. Futures markets are already pricing in the first rate cuts for April in Europe and for May in the UK and the US, with plenty more to come over the rest of the year. And while we would warn against taking futures prices too literally (because they represent the "mean" rather than the "mode" – i.e. there is a bit of tail-risk hedging priced in too), the direction of travel is pretty clear unless there is some sort of (positive) growth shock or inflation decisively turns up again.

In aggregate, that leaves us still recommending a small underweight to equities, but, as we have pointed out previously, that it still relative to benchmarks that will have substantial equity exposure. It is by no means a call to run for the hills. If anything, we would welcome a dip and greater clarity to increase our risk appetite.

Four times a year, the "micro" narrative gets top billing, and that is during the quarterly reporting seasons. We are currently getting into the meaty part of the latest one which covers performance in the last quarter (and financial year) of 2023. The good news here is that, in aggregate, the numbers are OK so far. We have the best data (as usual) from the US, where 124 of the companies in the S&P 500 have released their results. Of those, more than 90 have beaten expectations. However cynical we might be about the ability of companies to manipulate guidance to a level that can be easily beaten, there is no sign of a broad-based slowdown. That was especially visible in the results from the US Banking sector with limited reference to rising credit problems. Of course, we can always point to companies that have disappointed, but many of their travails can be traced to idiosyncratic problems.

Crucially, five of the leading US Magnificent 7 stocks report this week and the bar for them to clear looks pretty high. One of their number, Tesla, has already failed. Its shares are down 30% from their late-December peak, and they fell 14% last week as the company posted disappointing results. In the classic 1960 film, that would make Tesla Harry Luck, who was the first to die in the final shoot-out. He was played by the lesser known Brad Dexter, who, along with Horst Buchholz, tends to trip up pub quiz participants.

Meanwhile in Europe, there were well-received earnings reports from tech companies ASML and SAP, followed by results from LVMH that put paid to concerns about the bottom falling out of the Luxury Goods market. Over the course of the week, LVMH was +17%, ASML +16% and SAP +7.5%. The LVMH numbers also elicited something of a short squeeze elsewhere in consumer land. Diageo's shares rose 5% on Friday and Unilever's by 2.5%. Both companies have recently featured regularly in the "new 52-week lows" stock list. Our technical analysis expert points out that 17 of the top 20 performers in Europe on Friday were shares that had been in strong downward trends recently, supporting the short squeeze theory. Another big contributor to Europe's recent gains, Novo Nordisk, reports this week.

A timely article on Bloomberg pointed out that Europe's equity market suffers some of the same "narrow" traits as the US, although it uses a 50-stock index to illustrate this point rather than a 500 stock index. Since the post GFC lows of March 2009, half of the gains of the EuroStoxx 50 Index can be attributed to just five companies. These are microchip equipment manufacturer ASML (which only joined the index in 2012), LVMH (luxury goods), SAP (enterprise software), Siemens (engineering and manufacturing conglomerate) and Total (energy). In many ways they are a broader representation of the economy than the Magnificent 7 which are predominantly buoyed up on hopes for a fast and profitable adoption of technologies and services relating to Generative Artificial Intelligence.

However, despite finally clearing its pre-financial crisis high last week, it's still got another 18% to go before it gets back to its TMT-boom peak of March 2000. Just for fun I ran a total return calculation on Bloomberg from that date. The index has returned 89% with dividends accrued, but all those five stocks have done a lot better, with ASML managing a total return of 2222%. Who says stock-picking is dead?

That piqued my interest in the FTSE 100, thinking that there was little doubt that larger companies would dominate the index points gains. That turned out to be the case, but it was encouraging to see an even broader range of economic exposure across the Top 10. Yes, 2023 was a dull year in aggregate (+3.8% capital return, although you can add another 4% for dividends), but there were some humdingers in terms of individual performance. The top three delivered a combined 285 FTSE points against the index's actual return of 281.5, but here's the Top 10. HSBC (Bank), Shell (Energy), Rolls Royce (Aerospace), RELX (Business information and analytics), 3i (Private Equity), London Stock

Exchange (more about financial data and creating indices than trading shares these days), BAe Systems (Defence), CRH (Construction), Tesco (Food Retail) and Compass Group (Contract Catering).

For the record, the worst performers in terms of negative points contribution, were equally diverse: BAT (Tobacco), Diageo (Alcohol), Anglo American (Mining), Prudential (Life Insurance), Unilever (Food Manufacturing), Astra Zeneca (Pharmaceuticals), Glencore (Mining), Burberry (Luxury Goods), Croda (Speciality Chemicals) and St James's Place (Wealth Management). There are a few common threads in there (exposure to China being the key one), but its still quite a spread.

I'm going to have to go away and think about what this means. Maybe the FTSE 100 is just doomed to being dull in terms of capital performance, but you can continue to pick up a fat dividend yield to boost the total return.

# Economic Commentary

### FTSE 100 weekly winners

| Company | Change |
|---|---|
| Intermediate Capital Group plc | 14.4% |
| International Distributions Services plc | 13.1% |
| Ashtead Group plc | 9.0% |
| Prudential plc | 8.9% |
| Burberry Group plc | 8.8% |
| Croda International Plc | 8.0% |
| Antofagasta plc | 7.7% |

### FTSE 100 weekly losers

| Company | Change |
|---|---|
| SSE plc | -3.4% |
| J Sainsbury plc | -1.9% |
| Hikma Pharmaceuticals Plc | -1.8% |
| Abrdn plc | -1.8% |
| GSK plc | -1.7% |
| Lloyds Banking Group plc | -1.3% |
| Bunzl plc | -1.1% |

### FTSE 100 index, past 12 months

### EuroStoxx 600 index, past 12 months

### S&P 500 index, past 12 months

All data shown in GBP.

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