



Good fundamental macro and micro factors are lifting US equities higher, with investors differentiating between winners and losers, and speculation still at a relatively tame level. (UBS)

The outlook for risk assets remains positive

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Winter in the Northern Hemisphere is officially over in less than three weeks. It hasn't much mattered for the S&P 500. The index has gone up 16 of the last 18 weeks.

Cold days, sunny days, rainy days—it's all been the same for the market. Whether that continues or March comes in like a lamb but goes out like a lion will be determined by the data. As a guide, the following market observations inform the near- and medium-term outlooks. They support a relatively positive outlook for macro and micro reasons, and because investor euphoria isn't close to what it was in the late '90s. But as always, there are risks, some of which could materialize in the next few weeks.

- First, while investors fear sticky inflation, the markets have priced in a better growth outlook. The 25% rally in the S&P 500 since 27 October has preceded subsequent upward revisions to 2024 GDP growth forecasts, with consensus now at 2%. The 3% growth rate in 2023 is likely unsustainable, and recent data—January payrolls and retail sales, February ISM manufacturing index—have been mixed, but market pricing implies investors remain confident in the growth outlook.
- Second, equities have been much more immune to higher-for-longer rates this year compared to last fall, largely because of the better growth outlook. The S&P 500 rolled over in September and October when market pricing for the fed funds rate at the end of 2024 rose above 4.5%. But it has made a string of all-time highs this year when market pricing for the December fed funds rate repeated the same rise.
- Third, there are micro (idiosyncratic) and macro (systematic) factors driving the markets, and the relative influence of the former is higher than it's been in many years. This reflects the impact that AI is having on the markets. AI-related spending and adoption are not only driving equities higher but also contributing to extreme performance

differentiation. AI isn't the only story for the Magnificent 7, but their return dispersion this year is noteworthy, with four up and three down. Relatedly, there have been large and varied stock price reactions to 4Q earnings: Dell, Nvidia, Meta, and Netflix were all up at least 10% the day after their announcements, while Tesla, Snow, and Snap were all down more than 10%. Low correlations are a byproduct of high return dispersion, and for the S&P 500 it's about as low as it's been in many years.

- Fourth, a hallmark of the late 1990s bubble was the IPO frenzy and sky-high first-day returns, which is completely absent today. There was an IPO mania in 2020–21, with the highest average first-day returns since the dotcom era. But that ended once rates started to go up, and the IPO market has yet to really come back, resembling 2002–03 much more so than the late 1990s. This is also evident in an index of recent IPOs, which is about half of its 2021 peak, while the Magnificent 7 are above their 2022 peak. This divergence between mega-cap tech and small speculative companies didn't occur during the dotcom bubble and burst. The Nasdaq 100 and Amazon, a proxy for late 1990s IPOs, both had steep run-ups and 50% declines before and after 2000. The divergence today seems to reflect investors' willingness to pay up for high-quality companies with strong earnings potential, but not for those with far more uncertain futures.

The collective takeaway from these observations is that the outlook for risk assets remains positive. Good fundamental macro and micro factors are lifting US equities higher, with investors differentiating between winners and losers, and speculation still at a relatively tame level. A mathematical consequence of low correlations is that it drags down realized volatility at the S&P 500 index level. Thus, a VIX near 13 is consistent with stock prices moving for idiosyncratic or micro reasons, and it isn't necessarily an indication of macro risks being underpriced.

So, how could things go wrong? In the very near term, macro disappointment is the greatest risk, with growth not holding up as expected and/or inflation not coming down because hot CPI wasn't just a "January effect." The markets may give a pass to another month of disappointing inflation data, but not three. Some clarity on that will start to arrive this week, with February payrolls data released on Friday 8 March and CPI data out 12 March. Before then, Fed Chair Jay Powell will testify before Congress on monetary policy. But without knowing the data, he's likely to reiterate the same message that other Fed officials have given the past two weeks. The scope for near-term AI disappointment is much lower because it takes multiple quarters to change views on technology trends, versus only a few months for macro conditions.

The bottom line: The relentless climb higher for risk assets may slow and could well have some slip-ups in the near term as the weather turns warmer, but we still expect the direction of travel for the rest of the year to be higher. Generally positive macro conditions and AI micro tailwinds are a supportive combination. As for comparisons to the 1990s, between the path for the fed funds rate, IPO activity, technology developments, investor sentiment, and even valuations, it looks more like 1996 than 1999. The next two weeks should determine if the markets exit March like a lion after entering like a lamb. Even if they do, remember that April showers bring May flowers.

Main contributor – Jason Draho

Read the original report : [Rain or shine, 4 March 2024.](#)

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