

## WEEKLY VIEW

# Summer of small caps

29 July 2024

## “R” for rotation

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**SUMMARY**

Rotation gathers pace as small caps outperform

Fed meets with inflation closing in on target

With rocket attack, rail sabotage and tech outage, risks abound

**THE WEEK IN REVIEW**

Continuing a recent trend, US small caps and cyclical sectors outperformed large-cap indexes and noncyclical stocks last week. Thus, the Russell 2000<sup>i</sup> returned 3.5% (in USD), in sharp contrast with the Nasdaq's -2.1%<sup>ii</sup>. With the Q2 reporting season in high gear, lacklustre results from a couple of the 'Magnificent Seven' names weighed on the S&P 500<sup>iii</sup>, with the index returning -0.9% (in USD) over the week. Equity volatility remained considerably higher than just a couple of months ago. **Unexpected cuts to interest rates in China underlined the country's continued economic challenges** and failed to prevent the MSCI China<sup>iv</sup> from reporting a -2.3% fall on the week (in USD). Japan's TOPIX<sup>v</sup> dropped a notable 5.6% (in yen), in part due to the **yen's rebound as yen-funded carry trade strategies were unwound**. With a possible rate hike from the Bank of Japan this week, the yen surged 2.5% against the USD. Ramped-up bets on Fed rate cuts meant that the inversion of the US Treasury yield curve continued to unwind. While the Fed is unlikely to cut rates this week, there are even odds of a Bank of England cut.

**ELECTIONS**

In the first week of her White House bid, Vice President Kamala Harris raised USD200 m, energising Democrats. In Venezuela, the election authority declared incumbent Nicolas Maduro winner of Sunday's presidential vote.

**KEY DATA**

**Flash readings for S&P Global purchasing managing indexes (PMI) for July pointed to a listless euro area economy.** The composite PMI for the euro area dropped to 50.1 from 50.9 in June, only slightly above the 50 mark that separates expansion from contraction.

S&P Global's flash composite for the US rose to 55.0 in July from 54.8 in June. **The first estimate for Q2 GDP growth in the US accelerated to an annual 2.8% from 1.4% in Q1, with business investment rising 5.2%.** The Fed's favourite inflation gauge, the personal consumer expenditure index dropped to an annual rate of 2.5% in June from 2.6% in May.

**Consumer prices excluding fresh food rose at an annual 2.2% in the Tokyo region in July, up from 2.1% in June,** the third consecutive month that core CPI increased. But 'new core' inflation moderated to 1.5% from 1.8%.

**MARKET VIEW**

In the week that the Olympic Games opened, with breakdancing as a new category, data showed the US economy put in a stellar performance in Q2. This week, **we expect the Fed to set the scene for its first rate cut in September,** with GDP growth set to moderate in H2 to a below-trend pace.

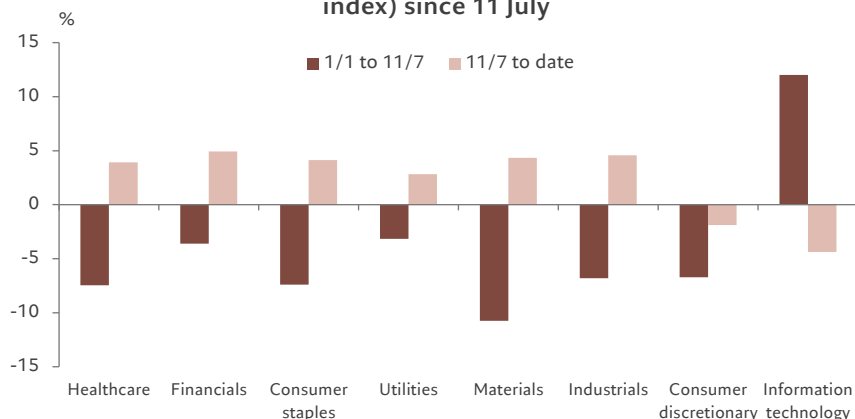
A rocket attack from Lebanon into Israeli-occupied territory served as a reminder of heightened geopolitical risks. Rail sabotage in France and a tech meltdown caused by a single software update enhanced the risk picture. **We like gold as a hedge against geopolitical risk.**

In markets, weak results in the luxury, autos and airlines sectors reinforce our theme of moving focus **from consumers to producers.** A Japanese carmaker's plan to buy back USD5.2 bn worth of its stock to unwind cross shareholdings chimes with our buyback theme in Japan. **We are overweight Japanese equities.** More broadly, for the rotation into small caps to persist, there needs to be upward earnings revisions, lower rates and decent growth.

## A rotation, not a correction

Since 11 July, there has been a significant market shift away from technology stocks to more cyclical segments of the market like small caps. This rotation continued last week after weak Q2 earnings reports from a couple of large-cap names. While there have been signs of a correction in the technology sector, the relative performance of other previously underperforming sectors has been positive and offer investors alternatives to the long tech trade.

Relative sector performance (versus the MSCI USA index) since 11 July



Source: Pictet Wealth Management, Bloomberg Finance L.P., as of 26.07.2024

## Asset class performance

Stock Markets	Last close	1 week change %	YTD%
Dow Jones*	40,589.34	0.75%	7.69%
S&P500*	5,459.10	-0.83%	14.45%
NASDAQ Comp*	17,357.88	-2.08%	15.63%
MSCI World Small Cap \$*	561.78	1.31%	6.28%
MSCI Europe*	171.84	0.55%	6.97%
MSCI EMU*	161.98	0.33%	6.09%
SMI*	12,241.49	0.56%	9.91%
MSCI China \$*	55.21	-2.31%	-0.46%
Nikkei*	37,667.41	-5.98%	12.56%
CBOE Volatility (VIX)*	16.39	-0.79%	31.65%

Currency, Commodity, Rates	Last close	1 week change %	YTD%
EURUS**	1.09	-0.32%	-1.72%
GBPUS**	1.29	-0.49%	0.83%
USDCHF**	0.88	-0.62%	4.91%
USDJPY**	153.54	-2.42%	8.91%
USDCNY**	7.25	-0.19%	2.27%
EURCHF**	0.96	-0.94%	3.11%
Gold**	2387.19	-0.57%	15.72%
Silver**	27.93	-4.44%	17.36%
Crude Oil**	78.58	-3.50%	9.31%
US Investment Grade	3289.12	0.16%	1.56%
US High Yield	1659.86	0.31%	4.39%
EU Investment Grade	282.41	0.40%	1.82%
EU High Yield	367.03	0.14%	4.14%
Swiss Bond Index	130.09	0.29%	2.21%

Source: Pictet as of 26.07.2024. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. This table may contain information about financial instruments or issuers but does not set out any direct or implied recommendation whatsoever (either general or personalized). YTD stands for year to date. \*measured on a non Total Return basis. \*\* showing mid price numbers.

### WHAT TO WATCH THIS WEEK?

#### MONDAY

US: Dallas Fed manufacturing business index (July)

#### TUESDAY

EU: GDP (Q2)  
 US: JOLTS job openings (June)  
 US: Conference board consumer confidence (July)

#### WEDNESDAY

Fed: interest rate decision  
 BoJ: interest rate decision  
 Euro area: CPI (July)  
 US: ADP employment (July) and employment cost index (Q2)  
 China: manufacturing PMI (July)

#### THURSDAY

BoE: interest rate decision  
 US: ISM manufacturing (July)  
 US: initial jobless claims  
 China: Caixin manufacturing PMI (July)  
 Euro area: unemployment rate (June)

#### FRIDAY

US: nonfarm payrolls and unemployment rate (July)  
 Switzerland: CPI (July)

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i) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, Russell 2000 (net 12-month return in USD): 2019, 25.5%; 2020, 20%; 2021, 14.8%; 2022, -20.4%; 2023, 16.9%.

ii) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, Nasdaq Composite (net 12-month return in USD): 2019, 36.7%; 2020, 44.9%; 2021, 22.2%; 2022, -32.5%; 2023, 44.6%.

iii) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, S&P 500 Composite (net 12-month return in USD): 2019, 31.5%; 2020, 18.4%; 2021, 28.7%; 2022, -18.1%; 2023, 26.3%.

iv) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, MSCI China (net 12-month return in USD): 2019, 23.7%; 2020, 29.7%; 2021, -21.6%; 2022, -21.8%; 2023, -11%.

v) Source: Pictet WM AA&MR, Thomson Reuters. Past performance, TOPIX (net 12-month return in JPY): 2019, 15.2%; 2020, 4.8%; 2021, 10.4%; 2022, -5.1%; 2023, 25.1%.