

Unusual Market Trends, the Role of AI and Commodities

Scanning through global equity markets reveals some incredible returns over the last two quarters. Daily we hear that inflation remains high and interest rates will be kept higher for longer to prevent it from running away again. Some economists are still forecasting recession or a slowdown, but they are kicking it down the road. Despite the economic negativity, hype around AI has caused companies related to this concept to deliver some excellent returns. We all want the Magnificent 7 in our portfolios, but have missed that GRANOLA at breakfast also helps with steady performance. Pre-occupied with this news, we have woken up to surge in commodity prices – potentially acting as a hedge against inflation. Furthermore, we must not forget that manufacturing is waking up as well



**Willie
Pelsler**

Global financial markets have performed surprisingly well so far this year. After Q1 24, equity markets have achieved consecutive quarterly gains of nearly 10%, a feat not seen in the past decade. However, the reasons behind this surge remain elusive. Despite widespread discussions about interest rates staying higher for longer, and meticulous analysis of inflation data, markets continue to defy expectations of a slowdown

or recession. Interestingly, it's not just a few US companies driving this momentum; non-US markets are also on the rise.

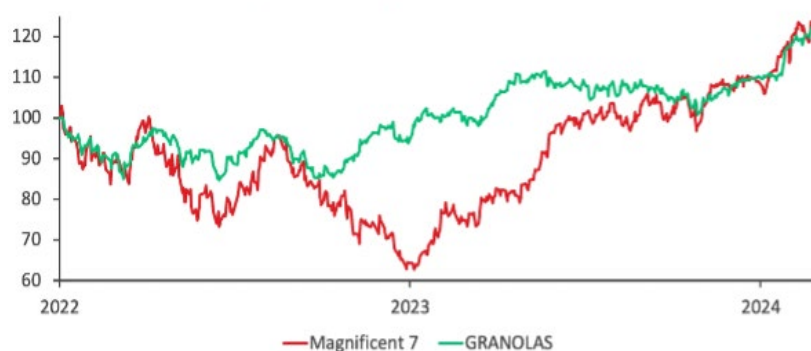
AI (Artificial Intelligence) is at the forefront of these market dynamics. The emergence of "The Magnificent 7," a group of AI-related companies - comprising Microsoft, Amazon, Meta Platforms (formerly Facebook), Apple, Alphabet (Google), Nvidia, and Tesla - has reshaped the landscape. The

SPEED READ

- Global equity markets have delivered two consecutive quarters of almost 10% returns, despite the concerns about stubborn inflation and higher-for-longer interest rates.
- Companies associated with artificial intelligence are performing phenomenally well. Consequently, everybody wants to be invested in the "Magnificent 7".
- Have you eaten your Granolas? This is another source of "energy" delivering good performance.
- Whilst markets were preoccupied with AI, commodity prices have surged. A recovery in manufacturing and a hedge against inflation sit behind the latest rally.

performance of this group of companies over the past two years reflects their growing importance.

MAGNIFIANT 7 VS "GRANOLAS"



Markets often get fixated on issues – AI is just one example. But that doesn't mean that other sectors are not producing solid returns."

Now, let's draw an analogy. Just as a good breakfast sets the tone for the day, diversification is essential in any financial market diet. While the Magnificent 7 have shone brightly, there's another, quieter force at work - the "Granolas." This group of European companies – including GSK, Roche, ASML, Nestle, Novartis, Novo Nordisk, L'Oréal, LVMH, AstraZeneca, SAP, and Sanofi – are arguably less sexy than the Magnificent 7, yet they contribute to stability and balance.

In summary, AI's impact is here to stay, potentially revolutionizing productivity and business practices. As we navigate these volatile markets, remember

that a healthy mix of both the Magnificent 7 and the Granolas, can help to keep your financial blood pressure in check.

Whilst markets were pre-occupied by every utterance from the Federal Reserve, inflation and whether one had sufficient exposure to the M7, the Granolas, or any other catchy acronym, commodities, like copper, gold and silver have surged to the top of the tables - and it almost feels like nobody has noticed. Despite the expectations of an economic slowdown, commodity prices have exhibited interesting behavior. We attribute this phenomenon to three key factors:



Whilst markets were pre-occupied with all things AI, commodity prices have surged.

- **Stalling Disinflation:** The prospect of stalling disinflation has sustained demand for commodities. Recent data, such as the higher-than-expected US CPI indicates that inflation isn't receding as rapidly as anticipated. Consequently, commodities are serving as a hedge against the persistent inflationary pressures experienced over the past two years.
- **Positive Macroeconomic Signals:** In March, macro data from developed economies surprised on the upside. Notably, the global manufacturing Purchasing Managers' Index (PMI) rose above 50, signalling an end to a 16-month industrial recession. Leading indicators, including South Korean semiconductor exports and Taiwanese exports, had already hinted at a trough in manufacturing activity in mid-2023. Additionally, the closely watched US ISM (Institute for Supply Management) index also crossed the 50 threshold, indicating a return to expansion.
- **Supply-Side Dynamics:** After years of destocking, supply-side issues appear to be resolving themselves. Notably, China has seen improvements. This has led to a return toward "hand-to-mouth" buying. However, risks persist due to lackluster mine supply, below-trend capital expenditures (capex), droughts, wage negotiations in Latin America, and electricity outages in South Africa. Geopolitical uncertainties related to Israel/Iran, the November US elections, and a potential Russian summer

offensive in Ukraine may also be impacting on commodity prices.

The movement of commodity prices, especially copper, has historically served as a reliable indicator of manufacturing recovery and overall economic growth. Understanding the significance of the global manufacturing sector is crucial - it contributes approximately 17% to total global GDP and forms the backbone of various other major industries worldwide.

When the COVID-19 pandemic struck, most industries faced significant disruptions. The manufacturing sector was hit hard, resulting in global supply chain shortages that continued to impact manufacturing industries even in 2023. Despite these challenges, there remains a sense of optimism among major manufacturing corporations. A recent KPMG report highlighted this positive outlook, with confidence now higher for growth over the next three years compared to the recent past. As we navigate these complexities, we hope that this marks the beginning of a new economic cycle. Perhaps in the coming months, we'll witness the emergence of new acronyms defining companies benefiting from manufacturing activity and rising commodity prices. While examples like ADHOC (Airbus, Deere & Co, Hoya, Otis, Cummings) or START (Stanvik, Toyota, Agilent, Rolls-Royce, Tenaris) are intriguing, remember that I used AI to generate these! They should not be treated as financial advice to invest in any of these companies without proper research.

I will end this article with some comments from Nvidia's CEO, Jensen Huang, highlighting that the new economy (AI) will have positive spinoffs on the traditional (or old school) economy. Speaking at last month's Nvidia technology conference, he said: "Whereas water was the raw material to generate electricity in the original industrial revolution, electricity is the means of generating data tokens in 'AI factories in the 21st century follow-up.'"

AI adoption is going to broaden exponentially. The International Energy Agency (IEA) has put out a forecast that they expect to see a 15% annual growth rate in these data factories in the coming years. This will result in more demand for various manufacturing requirements. For example, data centres processing AI algorithms require 4x the electricity than traditional data centres. This will underpin demand for copper - as Nvidia is already demonstrating. To mitigate the risk of power outages, the company has recently shifted from optical fibre to copper cables for their data centres, as they are more energy efficient, provide better cooling, and are cheaper. Furthermore, markets are already starting to think more broadly. Rising demand for electricity requires more power generation and improved national grids. It is an exciting new world, with many industries standing to benefit. Don't get sucked into believing that the only opportunity lies in the M7!



By the time of our next Insight seminar, our election will be out of the way. We will take the opportunity to review market performance for the first five months of the year, and look ahead to what the second half might hold.

Please note that we will be hosting both a morning and evening presentation in Cape Town. The venues will be communicated once finalised.



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Topic: **Taking Stock: Mid Year Update**

Natal Midlands

Date: 20 June, 2024
Venue: Christ Church Howick, 23 Mare Street, Howick
Morning Time: 10am for 10.30am
Evening Time: 5.30pm for 6pm

Johannesburg

Date: 11 June, 2024
Venue: Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time: 7am for 7.30am

Cape Town

Date: 13 June, 2024
Venue: ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time: 5.30pm for 6pm

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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