BELVÉDÈRE
Asset Management

March 2024

AI BOOM: IS THE BUBBLE ABOUT TO BURST?

MARKET INSIGHTS

AI BOOM: IS THE BUBBLE ABOUT TO BURST?

In March 2000, almost exactly 24 years ago, the so-called TMT boom reached its peak. TMT stood for Technology, Media and Telecoms. Investors' imagination was fuelled by the emerging spread of the Internet and mobile telephony, along with new media. Well-known names at the time were Cisco, Nokia and the media company EM.TV from Germany. Their share prices soared to heights practically unimaginable until the bubble burst. Today, a new technological revolution is on the horizon. Artificial Intelligence (AI) with the flagship company Nvidia. Quite a few market participants are warning of a bubble that could burst any moment. So, should investors be concerned?

Let's take a look at the similarities and differences between the two cycles. The most striking similarity is that in both cases an investment boom was triggered by new technologies. While in the 2000s it was networks and routers for the Internet, today it is AI processors for data centres. However, that's already where the similarities end. In macroeconomic terms, interest rate hikes by the US Federal Reserve sometimes put an end to a boom, whereas today interest rates have already peaked and interest rate cuts are expected. There are also differences in valuations. At the peak, a price/earnings ratio of over 100x was being paid for Cisco shares, while many other companies had yet to report any profits at all. Today, the valuations of Nvidia (32x), Microsoft (32x) and Google (20x) are also high, but not exorbitant. Furthermore, investor euphoria was greater 24 years ago and much wider circles of population engaged in the boom. Deutsche Telekom, the "people's stock" at the time, is a good example of this.

What does this mean for investors today? In the short term, there are hardly any apparent reasons for the AI boom to end. As shown, valuations are not (yet) going overboard, profits are rising and the transformation of data centres to AI is far from complete. For instance, the demand for Nvidia's processors still outstrips the supply. Nevertheless, there are some risks. Investments never evolve in a straight line and a temporary spell of negative growth would be nothing out of the ordinary. The long-term positive trend will not change, but there may be setbacks for these shares. Another cause for concern is the market concentration of the IT sector in the S&P 500, which is currently high at around 40%. This does not seem to be sustainable and will level off again sooner or later.

In a nutshell, investors are well-advised to hold on to their technology shares, but diversify their portfolio with an adequate exposure to defensive stocks. The Swiss market is a good place to start – currently, it is priced quite low compared to the US market.

Giorgio Saraco
CEO, Belvédère Asset Management

ECONOMY

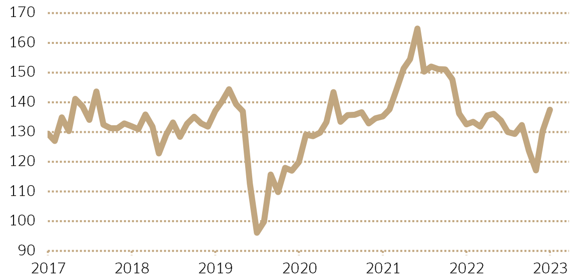
The US economy continues to hold up surprisingly well and is currently growing at around 3% (annualised, compared to the previous quarter). This is supported by the strong labour market with 353,000 new jobs created in January – significantly more than anticipated. We expect growth to continue over the coming months, but are not losing sight of the risks. These include falling savings rates along with rising credit card debt and depleting savings from the pandemic.

The economy in the euro zone is still stagnating. One positive aspect is the improvement in incoming orders for private residential construction, which should also prop up manufacturing in the coming months.

In China, the property market has not yet stabilised. As a result, the Chinese central bank eased the 5-year interest rates, which should also lead to lower mortgage rates. Meanwhile, consumption continues to lose momentum and the fall in inflation from -0.3% to -0.8% in January is giving rise to deflation fears. No significant improvement in the overall economy can be expected as long as the property market is ailing. China will therefore focus even more on exports and seek to position itself aggressively on the global markets.

Eurozone: Residential Building Permits

(indexed, 2015 = 100)



Source: Bloomberg

EQUITIES

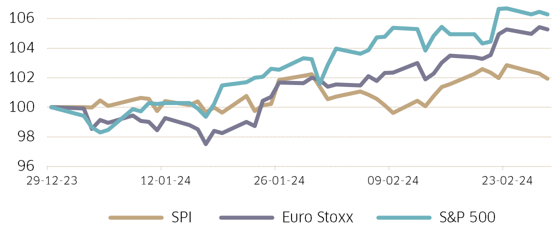
The market environment remained favourable for equities in February. Driven by the AI fantasy (see also lead article), the S&P 500 was among the champions with a performance of 4.8%, followed by the Euro Stoxx with +3.5%. As expected, the defensive SPI lagged behind with a gain of just over 0.5%. Small and medium-sized companies performed better (+1.3%). Stocks such as Swissquote (+8.1%) and Schindler (+8.7%) were in great demand.

We generally expect sentiment on the stock markets to remain positive and note that many investors are still viewing equities with a certain amount of caution. The pressure to invest is growing accordingly (FOMO: fear of missing out), as share prices continue to rise. In addition, around USD 6,000 billion are parked in money market funds in the USA. These funds could flow into equities quite quickly, notably if central banks should decide to cut interest rates.

Fundamentally, good earnings growth is wind under the wings of share prices. As a result, many companies are increasing their share buyback programmes, particularly in the US, but increasingly also in Europe. Examples include the car manufacturer Stellantis with EUR 3 billion and Novartis, which intends to buy back shares totalling USD 15 billion. Programmes like this provide welcome support in potentially more turbulent market cycles.

Stock Markets year to date

(total return, indexed, in local currencies)



Source: Bloomberg, BAM

INTEREST RATES

The last meeting of the US Federal Reserve showed that the committee is in no hurry to cut interest rates. This is easy to understand, as the economy is doing well and inflation – albeit losing ground – is still above target. Meanwhile, markets have also got this point and are now pricing in only three expected rate cuts by the Fed. The rise in interest rates continued at the long end. The further outlook is caught between a possible economic slowdown and the higher funding needs by the US, which could weigh on the market.

In our view, interest rates peaked at 5% last October. In Switzerland, January inflation was surprisingly positive at a mere 1.3%, which is also owing to the strong Swiss franc. On the other hand, this had an increasingly negative impact on the domestic economy. The lower inflation again allows the SNB to prevent a further strengthening of the CHF by intervening in the foreign exchange market. This means that the EUR/CHF and USD/CHF are well hedged to the downside.

Asset class	Assessment	Comment
Bonds		The market expectation of three rate cuts this year is now in line with the Fed's stance. At the long end, rates have peaked.
Government bonds		
Corporate bonds		
Equities		The market environment should remain favourable for equities, driven by a positive earnings trend and share buybacks. It would come as no surprise if the IT stocks that have been performing well were to take a break and defensive stocks were to take the lead for a change.
Switzerland		
Eurozone		
Great Britain		
US		
Emerging markets		
Real Estate		Property stocks have continued their recovery and remain interesting in view of impending interest rate cuts.
Switzerland		
Commodities		The oil price is moving up slowly. Supply shortages could make oil even more expensive. Gold is caught in a sideway drift.
Oil		
Gold		

unattractive attractive Current assessment

Matthias Wullschleger
Senior Investment Analyst

Imprint

Publisher: Belvédère Asset Management AG
Authors: Giorgio Saraco, Matthias Wullschleger
Stop press: 28.02.2024