Cantor Fitzgerald

Cantor Fitzgerald Strategy & Outlook

MARKET UPDATE

Commentary

Entering the second half of the year and the absolute and relative outperformance of our funds is notable. With political and central bank policy risks looming on the horizon and markets approaching some short-term valuation targets we feel prudence is the best stance as we enter the summer. We have therefore reduced exposure to risk assets and enter July below the mid-point of our asset allocation range. Although positioning and sentiment indicators are by no means stretched nor flashing red there is certainly a dark orange to some of them. Market breadth is particularly weak as fewer and fewer sectors participate in the recent rally.

Of the year-to-date market leaders, we've just ended a two-month run of AI led earnings calls, product releases and developer conferences which all exceeded expectations. The Sox index has rallied 30% in two months to reflect this incredible product cycle. A pause from here in the market leaders looks most likely. Diarmaid and I spent time in New York last month. We met over 40 companies and 20 analysts. The excitement and potential around AI from seasoned c-suite technology corporates was phenomenal with one CEO describing it as "*the biggest technology inflection of my lifetime*" and another hypothesising that the adoption of AI is more akin to the" *invention of calculus or electricity"* than to the start of the Internet.

The shorter-term message was clear on the economy. The consumer and corporates are solid and have withstood everything thrown at them in the last 2-3 years. However from here there is little room for error and monetary policy needs to take over from fiscal policy as the next economic catalyst. It's why the most recent Fed press conference and dot plot were worrying. Economic data in the US is stable but slowing. The unemployment rate has risen slowly for six months and is 50bps off record lows. Inflation data just hit a 3 year low. Despite this the most recent Fed press conference and dot plot were slightly hawkish. The Federal Reserve appears to be inching slowly to the brink of a policy error in the short term by pushing out rate cuts as they worry about a resurgence in inflation. After 2 years of falling inflation, it is deflation that is the threat from here.

Retailers have been talking about food price deflation worsening. Restaurants are talking about aggressive discounting. Corporates on the industrial side are beginning to talk about giving back pricing. Airlines have offered disappointing fare guidance. Goods price deflation in the US is at generational lows. The FT in the last few weeks finally acknowledged the energy glut we have in the west as LNG supply will double by end of the decade. Used car prices continue to fall month on month and are now 24% off their highs.

Geopolitics was flagged as a risk at the start of the year and in the last few weeks has come to the fore in the form of extreme cross asset volatility. Initially it was EM FX after Mexican and Indian elections. Emmanuel Macron's decision to call a snap election has caused a blow out in French-German spreads as the implications for fiscal policy and banking regulation of a far-left or far-right government in France come to the fore. On the 27th of June the first US election debate, 3 months earlier than usual, will kick start an elongated US election cycle. Historically US markets trend sideways in the couple of months leading up to the election, but this is an earlier start to a fraught campaign so perhaps that seasonality kicks in earlier.

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Biden making any progress in the polls from a positive showing in the debates would be taken unfavourably by a Wall Street that is convinced of Trump's victory and positive market reaction. Of particular concern is the disparity in corporate tax policy and subsequent earnings downgrades to come if Biden were to win. Over the following two weeks, the UK and France will go to the polls quickly followed by Trump's sentencing on the 11th of July and the RNC on the 14th of July. Some hope around China drawing a line in its housing crisis has been dampened as headline grabbing policies have failed to yield any tangible actions thus far.

The funds ended the first half below neutral having reduced exposures by taking profits in in financials, semiconductors, and miners. The factors listed above lean us towards thinking Q3 at the moment offers a poor risk reward for markets in general but with lots of trading opportunities thrown up around the growing cross asset volatility we are seeing. However, one should not lose sight of the potential for very strong Q4 as election uncertainty gives way at a time when seasonal inflation data allows the Fed to make the drastic rate cuts needed to kick start a broader market rally and economic recovery.

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WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

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