

Flash note
22/07/2024

Alex Fusté

[@AlexfusteAlex](#)

alex.fuste@andbank.com

Historic \$9.9B Inflows for Small Caps, But Longevity of Rotation in Question

Small-cap stocks attracted \$9.9 billion, **the second-largest weekly inflow in history**, driven by rotational dynamics. This rotational friction was exacerbated by:

1. **Chips Act:** A report suggesting that the United States is considering more onerous restrictions in its chip crackdown against China. (Trump's comments on Taiwan weighed on semiconductors).
2. **Imminent Seasonal Shift:** The first half of August is the fifth worst two-week period of the year, according to Goldman Sachs.
3. **Fed Pivot:** Powell's latest comments suggest that the Fed's dual mandate is much better balanced, and there is no need to wait for inflation to return to 2% to ease monetary policy, which added confidence.
4. **Macro Environment:** Economic growth remains above trend, with the Atlanta Fed's GDP-Now for the second quarter increasing to +2.7% from +2.0% last week.
5. **Big Bank Earnings Support First Quadrant Thesis:** With credit fairly stable, our first quadrant thesis is consolidated (controlled inflation with economic expansion, a historically favorable combination for equities).

Doubts: Despite the sell-off in some growth stocks, semiconductor fundamentals remain favorable, raising questions about the longevity of the rotation.

1. **TSMC** exceeding expectations, accompanied by the continued advance in AI capabilities.
2. **Cautious** readings from investors on **corporate updates** of retail stocks such as Five Below, Leslie's, Hugo Boss, and Burberry. Many retailers lagged despite the broad rotation.
3. Important industries (such as airlines) **still need to cut capacity**, as evidenced by United's weak third-quarter guidance.
4. Rotation in question after signs of **industrial weakness in guidance updates** from ABB, Atlas Copco, JB Hunt, PPG, and Autoliv.
5. **Doubts on whether China will support the rotation.** The conclusions of China's Third Plenum disappointed due to the absence of a commitment to aggressive fiscal stimulus. This suggests continued weakness in China's data, something that historically has not been favorable for small-cap companies.

Many may perceive that small caps are at historically low relative price levels, but...



... this is not the case. There have been moments (not too distant) when the underperformance of small caps was much more pronounced. These moments bear strong similarities to the current situation.



Best regards,