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When it rains, it pours

The recent surge in small caps, coupled with a sharp selloff in technology shares, is signaling a potential shift in market dynamics that’s catching investors off guard. As the old adage goes, “When it rains, it pours.” This seems particularly fitting for the current market situation where what began as a gradual rotation and broadening has quickly escalated into a significant correction for tech stocks.

Tech falls, small cap & value stocks rise

The Russell 2000, a benchmark for small-cap stocks, has outperformed major indices since the June CPI report release on July 11. This shift follows a long period of small caps lagging behind the so-called Magnificent Seven tech stocks that have dominated market gains. The Russell 2000 has surged 6.6% since the CPI announcement. In stark contrast, the Nasdaq 100 has plummeted 5.6% over the same period.

Market imbalance triggers correction

Concerns about the high concentration of Mega-Tech stocks in major indices have been mounting (see *Nasdaq 20,000*, June 24, 2024). At one point, the top 10 companies in the S&P 500 accounted for 36% of index’s value and contributed 77.8% of its year-to-date return. This concentration raised questions about potential market vulnerabilities. In fact, signs of exhaustion in big tech emerged even prior to the CPI report, with Nvidia shares falling as much as 16% from all-time highs in late June.

First cut expectation fuels rotation

The cooler inflation data bolstered expectations for Federal Reserve rate cuts. The prospect of lower borrowing costs has breathed new life into small-cap and value stocks, putting pressure on tech giants. At one point after the CPI announcement, while the Magnificent Seven was down, the other 493 stocks of the S&P 500 were performing well.

Angst over safety of Taiwan & global chip supply chain

The Biden administration's threat of severe restrictions on foreign chipmakers' exports to China sent semiconductor stocks into a tailspin. Worries over the global semiconductor supply chain caused the VanEck Semiconductor ETF to plummet 9.6% for the week, its steepest weekly decline since April 2024. Netherland’s ASML dropped 17.5% last week despite reporting robust earnings.

Former President Donald Trump’s remarks asking Taiwan to pay for defense costs further rattled the markets. Companies reliant on Taiwan Semiconductor Manufacturing Company (TSMC) felt the impact, as anxiety rose over the safety and stability of Taiwan, a critical hub in the global semiconductor supply chain. TSMC's American Depositary Receipts (ADRs) plunged 11.5% for the week.

Largest IT outage in history

As if these challenges weren't enough, the largest IT outage in history struck last Friday. A major technological glitch involving Microsoft and Crowdstrike brought global operations of banks, airlines, hospitals, and even the London Stock Exchange to a standstill. It appears that a botched software update from cybersecurity firm CrowdStrike crashed countless of Microsoft Windows computer systems worldwide. The incident highlighted the vulnerabilities of our digital world and further eroded investor sentiment in the tech sector.

Broadening to rotation to correction

The market chatter about rotation has morphed into reality, but with a vengeance. The tech sector, ripe for a correction, found itself facing a barrage of challenges. Soaring valuations, economic data hinting at lower interest rates, geopolitical tensions, trade wars, tariff threats, tech glitches and Trump’s assassination attempt all converged, creating a perfect storm. What we witnessed is not just a market broadening but a nasty rotation ending in a full-fledged correction fueled by this confluence of events.

Navigating Uncertain Waters

While a tech repricing was overdue, the speed and severity of the shift have surprised many. This shakeup, though unsettling in the short term, could pave the way for a more diversified market, offering investment opportunities across various sectors and countries worldwide. The question now remains: how long will this tech tide turn, and where will it lead the markets? Will Mega-Tech reclaim its throne, or will it take the back seat as it consolidates? Will he have a global bull market and a broadening where all countries and all sectors move up?

Neglected Markets Catch Up

Amidst all the volatility, there’s a ray of sunshine as shown by the Philippine stock market. The Philippine Stock Exchange Index (PSEi) gained 2.2% for the week, significantly outperforming both the Nasdaq 100 and S&P 500. The Philippine stock market was the only market in Asia that was up last Friday. It is up 10.3% from the June 19 low. The peso has also stabilized even with the prospect of lower interest rates by August. As tech-heavy counters struggled, there’s a rotation into neglected markets such as those in ASEAN nations, including the Philippines.