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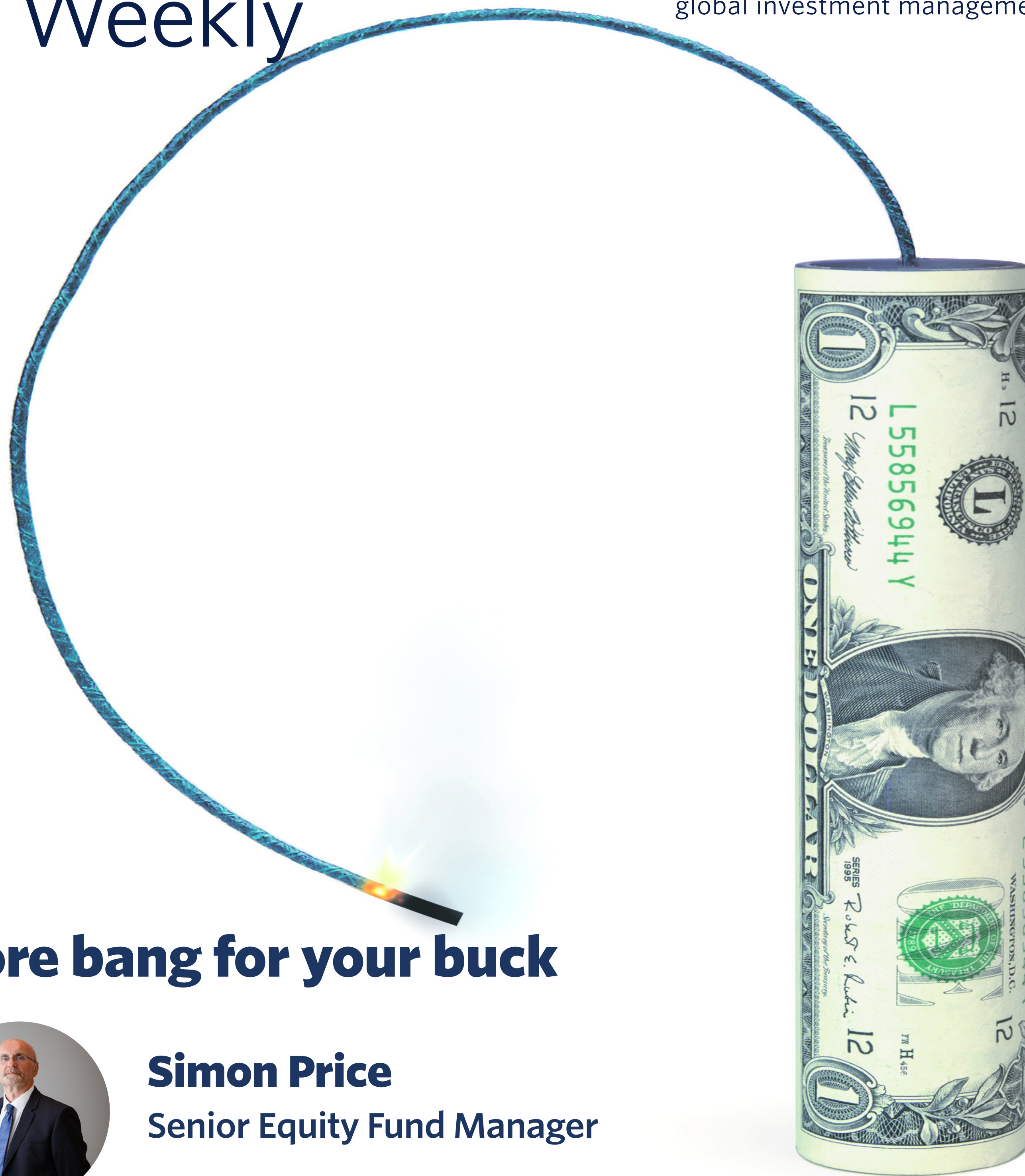

More bang for your buck

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Over the past several weeks, the tone of global equity markets has changed, with several breaking uptrends from last autumn. Many attribute this to a combination of restrictive policies of the Federal Reserve in the face of weakening jobs data, along with the technical unwind of the Japanese carry trade, where billions of dollars of leveraged exposure were hiding in plain sight but mostly ignored. While the Japanese equity markets bore the brunt of the unwind, many asset prices were likely inflated by this leverage. So, what now?

Financial markets invariably want to have their cake and eat it too. Recent US activity-based data, including the weaker-than-expected July US Employment report, has promoted recession concerns, albeit from a low base, generating calls for the Fed to ease policy, some even suggesting an emergency interest rate cut. This call was supported by the view that downward pressure on risky asset prices simply tightens financial conditions, thereby pressuring the real economy even further.

Markets have started to re-price that reality, telling the Fed they are too tight and need to cut more aggressively than what they have guided, with 2-year Treasury yields at some stage having fallen by around 50 basis points in the last month, almost 150 basis points below the Fed Funds rate. However, investors looking for signals might remember that the US Treasury and interest rate futures markets have been badly wrong in their expectations of Fed policy over the past few years. In January, markets were discounting as many as seven cuts in 2024. Now some are expecting cuts at the remaining three Federal Open Markets Committee (FOMC) meetings this year, starting with a 50-basis point cut next month.

The dilemma for the Fed and investors is that the next FOMC meeting is five weeks away, a lifetime for an impatient and at times volatile market. The case for an emergency Fed cut remains unconvincing, particularly when comparing current circumstances to other instances of inter-meeting policy rate reductions in 2020 and 2001. The Fed is not prone to over-reacting, as this is often counter-productive. An abruptly dovish move by the Fed may work against market stabilisation. Second, it is not clear that cutting rates will do much to change the economic data since bond markets have already done the cutting for the Fed this year to little avail. Mortgage rates have fallen 100 basis points, and housing activity has not improved.

In contrast, BoJ (Bank of Japan) monetary policy has been disproportionately accommodative for many years; both in terms of interest rate setting and the size of the BoJ's balance sheet. Escaping the zero-bound policy rate is less than straightforward, as demonstrated by previous attempts by the Fed. The sudden appreciation of the yen presents problems for Japanese equities and the economy, which was in a technical recession during the second half of 2023. The market reaction following the BoJ raising its policy rate to 25 basis points on July 31, as well as announcing the halving of its monthly bond purchases, has seemingly forced a policy pause. BoJ Deputy Governor Uchida Shinichi announced a pause on interest rate increases due to volatile financial markets. This would, therefore, imply no policy rate increase in September, when the Fed is expected to cut.

In conclusion, it looks like the broader US economy is decelerating but not in recession, as the tighter monetary policy of the past two years finally gains traction. The deceleration has taken longer than it normally does, probably due to the unusual nature of COVID-19 lockdowns and reopening, the massive amount of monetary stimulus pre-tightening, plus the unusual expansion of the federal budget deficit last year. US monetary policy will remain data-dependent, and the Fed will wait for more incoming data to formulate an appropriate response.

The start of the process of normalising Japanese monetary policy has come in seasonally poor liquid markets promoting volatility and questions over the stretched positioning in the yen carry trade. However, the yen carry trade involves a wide range of investors who have different risk appetites towards unhedged exchange rate exposure and, consequently, deploy varying risk management strategies. The US-Japanese interest rate differential will continue, an outcome that could sustain the yen carry trade, particularly if the BoJ decides to postpone further policy rate increases for a prolonged period.

Clearly, seasonality has generated increased volatility for markets with crowded trades and rich valuations. The question for investors is, are there cyclical factors also at play in this volatility increase and can central banks who are changing course, promote stability when some of their previous actions have created the conditions for that instability.

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Market Review - week ending 16 August 2024

- Global equities returned 4%
- All major global indices ended the week with positive returns
- Brent crude ended the week flat at $79.68 a barrel
- Gold rose 3.2% to $2508.01 per ounce

US

- US equities rose 4% after positive news on the inflation and growth fronts
- Federal Reserve member Mary Daly stated that she has 'more confidence' that inflation is under control and that it is time to consider adjusting borrowing costs, but the economy is 'not in an urgent place'
- Presidential nominee Kamala Harris leads Donald Trump by 49% to 45%, according to a major Washington Post / ABC News/ Ipsos survey
- The Commerce Department reported that retail sales surged 1.0% in July, their best performance in 18 months. Gains were strongest in the volatile auto sector, but increases were broad-based and included a 0.3% increase in sales at bars and restaurants, a sign of healthy discretionary spending
- The year-over-year increase in Consumer Price Index (CPI) fell below 3.0% for the first time in well over three years

UK

- European equities rose 2.5% as hopes grew for another round of interest rate cuts as early as September
- The eurozone economy expanded 0.3% sequentially in the Q2, the same rate as in Q1. GDP growth in France, Italy, and Spain offset an unexpected contraction in Germany

Europe

- UK equities rose 2.1%
- Headline inflation in the UK ticked up to 2.2% in July from 2.0% in June. However, growth in services prices slowed more than forecast, prompting financial markets to price in a higher likelihood of interest rate cuts later this year
- Average weekly earnings growth, excluding bonuses, rose 5.4% in the three months up to the end of June, compared with the same period last year—the lowest annual increase in almost two years

Rest of the World/Asia

- Global emerging market equities rose 2.9%
- Japanese equities rose 7.9%
- Chinese equities rose 1.7%
- Israel and Hamas have blamed each other for impeding a cease-fire and hostage deal. US Secretary of State Antony Blinken is due to meet Israel's PM Benjamin Netanyahu today for talks
- Japan's economy rebounded strongly in the second quarter of the year, expanding 0.8% quarter on quarter, ahead of estimates of 0.5% and reversing the first quarter's 0.6% contraction

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

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Market Performance - week ending 16 August 2024

Asset Class / Region	Currency	Cumulative returns: Week ending 16 August	Month to date	YTD 2024	12 months
Developed Markets Equities					
United States	USD	4.0%	0.6%	17.2%	27.4%
United Kingdom	GBP	2.1%	0.1%	10.7%	18.2%
Continental Europe	EUR	2.5%	-1.1%	8.2%	14.4%
Japan	JPY	7.9%	-4.1%	14.5%	21.2%
Asia Pacific (ex Japan)	USD	2.9%	0.7%	9.4%	15.9%
Australia	AUD	2.6%	-1.4%	7.0%	15.0%
Global	USD	4.0%	0.4%	14.2%	24.4%
Emerging Markets Equities					
Emerging Europe	USD	4.2%	-2.3%	12.9%	21.8%
Emerging Asia	USD	2.8%	0.7%	11.6%	16.8%
Emerging Latin America	USD	3.0%	5.6%	-10.0%	3.4%
BRICs	USD	1.5%	0.5%	7.9%	10.4%
China	USD	1.7%	1.2%	4.6%	-2.2%
MENA countries	USD	1.5%	-1.4%	-1.4%	1.5%
South Africa	USD	6.1%	2.5%	12.7%	22.0%
India	USD	0.9%	-1.6%	13.2%	26.6%
Global Emerging Markets	USD	2.9%	1.0%	8.8%	14.9%
Bonds					
US Treasuries	USD	0.4%	1.3%	2.7%	7.2%
US Treasuries (inflation protected)	USD	0.2%	0.3%	2.8%	6.7%
US Corporate (investment grade)	USD	0.9%	1.3%	3.8%	11.0%
US High Yield	USD	0.7%	0.7%	5.3%	12.4%
UK Gilts	GBP	0.3%	0.8%	-0.1%	9.3%
UK Corporate (investment grade)	GBP	0.3%	0.3%	2.2%	12.7%
Euro Government Bonds	EUR	0.0%	0.4%	0.7%	6.5%
Euro Corporate (investment grade)	EUR	0.0%	0.1%	2.4%	7.9%
Euro High Yield	EUR	0.5%	0.4%	4.9%	11.4%
Global Government Bonds	USD	0.3%	1.8%	0.4%	5.6%
Global Bonds	USD	0.5%	1.6%	1.4%	7.4%
Global Convertible Bonds	USD	1.1%	0.2%	0.9%	5.6%
Emerging Market Bonds	USD	1.0%	1.6%	5.0%	13.0%

Asset Class / Region	Currency	Cumulative returns: Week ending 16 August	Month to date	YTD 2024	12 months
Property					
US Property Securities	USD	0.3%	1.8%	7.3%	17.6%
Australian Property Securities	AUD	2.3%	-0.9%	14.4%	27.5%
Asia Property Securities	USD	1.9%	1.3%	-5.1%	0.2%
Global Property Securities	USD	1.0%	1.5%	5.1%	16.1%
Currencies					
Euro	USD	0.8%	1.8%	-0.5%	1.1%
UK Pound Sterling	USD	1.3%	0.7%	1.2%	1.5%
Japanese Yen	USD	-1.0%	1.7%	-4.8%	-1.4%
Australian Dollar	USD	1.2%	1.9%	-2.6%	3.5%
South African Rand	USD	2.4%	1.7%	2.1%	7.0%
Swiss Franc	USD	-0.4%	1.4%	-3.4%	1.3%
Chinese Yuan	USD	0.1%	0.8%	-0.8%	1.9%
Commodities & Alternatives					
Commodities	USD	0.0%	-0.7%	2.4%	0.4%
Agricultural Commodities	USD	-1.2%	-1.7%	-4.2%	-5.7%
Oil	USD	0.0%	-1.3%	3.4%	-4.5%
Gold	USD	3.2%	3.3%	21.6%	32.0%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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