Signia Invest Insights

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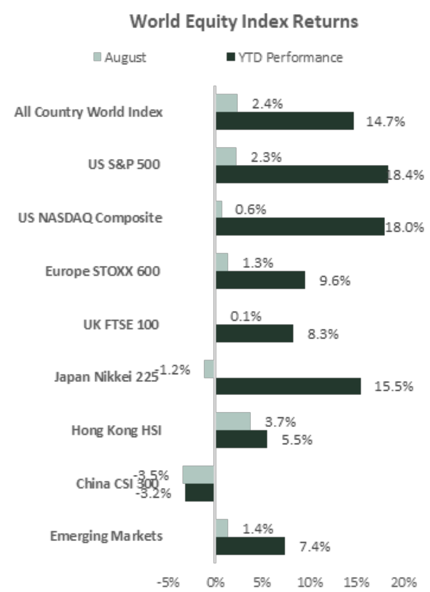
Market Review and Outlook

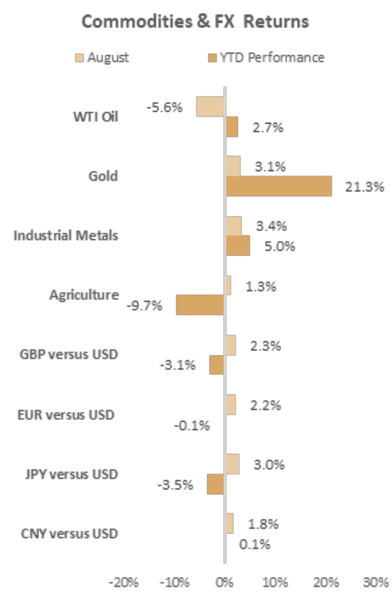
- Welcome to September. Although given the track record of recent years September tends to be the month that investors wish to avoid, as global equities have lost ground in each of the last four Septembers whilst global bonds are down in each of the last seven Septembers. So if we do manage to get some positivity this month, that would gladly fly in the face of recent history!

- August was an incredibly tumultuous month in financial markets with three violent and important re-pricings at the start of the month in the USD/JPY exchange rate, Trump election odds, and Fed policy expectations, causing large intra-month drawdowns in global equity markets and subsequent spike in the VIX index of equity volatility to levels not seen since the March 2020 Covid-19 market turmoil. Despite this, a sense of calm has since returned to markets and a buy-the-dips mentality has ensued, leaving August overall as a positive month in performance terms for most markets and sectors. For instance, both the S&P 500 and global aggregate bond indices advanced for a fourth consecutive month, rallying 2.3% and 1.1% in September, respectively. That said, there were points of weakness, namely in China A-shares, the oil markets, and the US Dollar index, with the latter having its worst month since last November as investors priced in even more rate cuts and an aggressive easing cycle from the Fed following a weak US jobs report in July.

- Other notable highlights during the month was the S&P 500 equally weighted index hitting an all-time high, and Berkshire Hathaway stock becoming the first US company that's not in the tech sector to achieve a $1 trillion market capitalisation, further evidencing a broadening out of this equity bull market.

MARKET PERFORMANCE AS OF 31 AUGUST 2024





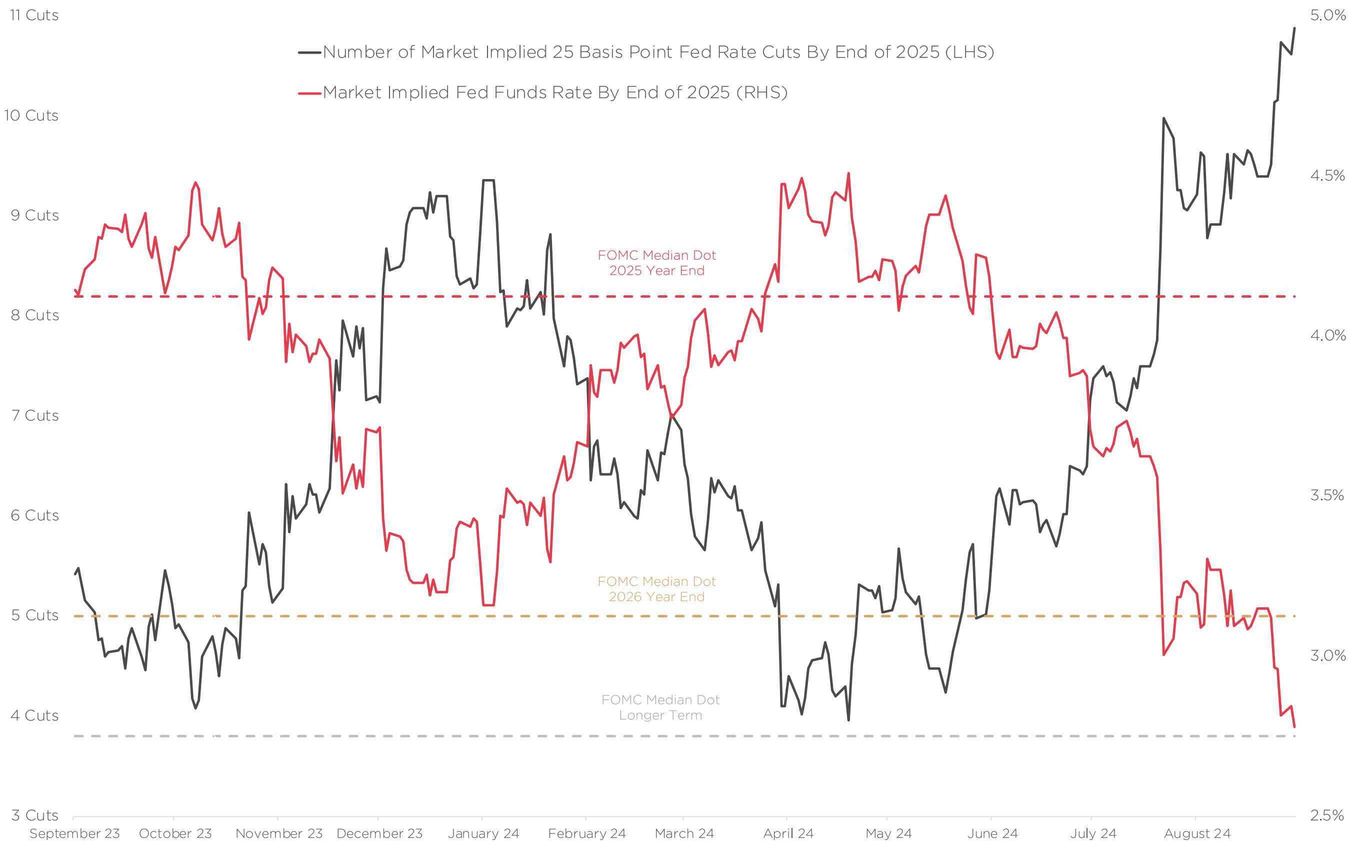
Source: Bloomberg L.P., Arbion Ltd.

US RATE MARKETS CELEBRATE THE RETURN OF THE FED PUT BUT HAVE TEMPORARILY DISCONNECTED FROM REALITY

- One of the reasons for the swift recovery of stock markets was the repricing of interest rates in the US from levels that were deemed too high and restrictive for the economy, and thus needed to be cut substantially. This perspective, which also prevailed at the end of 2023 and can be seen in the chart below, was rolled back somewhat during the first half of this year, but was then confirmed by Jerome Powell in his statement on 23 August at the Fed's annual Jackson Hole meeting: "The time has come for policy to adjust". This was a hugely significant event for markets as it not only signalled what investors have been wanting and waiting for – that a cycle of rate cuts and looser monetary policy was finally upon us – but also, and more importantly, that the negative tail risks of inflation have dissipated and are no longer a threat, and the implicit market support from the 'Fed Put' was now firmly back on the table.

- Underpinning this is a clear decline in inflation expectations recently, which has seen the US 10-year inflation swap close at just 2.2%, its lowest level since January 2021 before inflation risks began to spike higher in a serious way.

- The consequences of a live Fed Put have historically been substantial for the psychology of markets and investors, as it promotes a buy-the-dip mentality in the belief that the Fed will act as the ultimate backstop to support the economy (and therefore markets) if an economic slowdown or recession were to materialise. However, in the near term it seems that rate markets have again overpriced the reality of the Fed policy outlook, as Fed Fund Future contracts are now anticipating a whopping ten 25 basis point rate cuts by the end of 2025, equivalent to lowering US interest rates from between 5.25% and 5.5% today, to between 2.75% and 3% by the end of 2025. In contrast, the Fed's own rate projections via their quarterly dot plot publications expect rates to settle between 4% and 4.25% by the end of 2025. A notable disconnect!

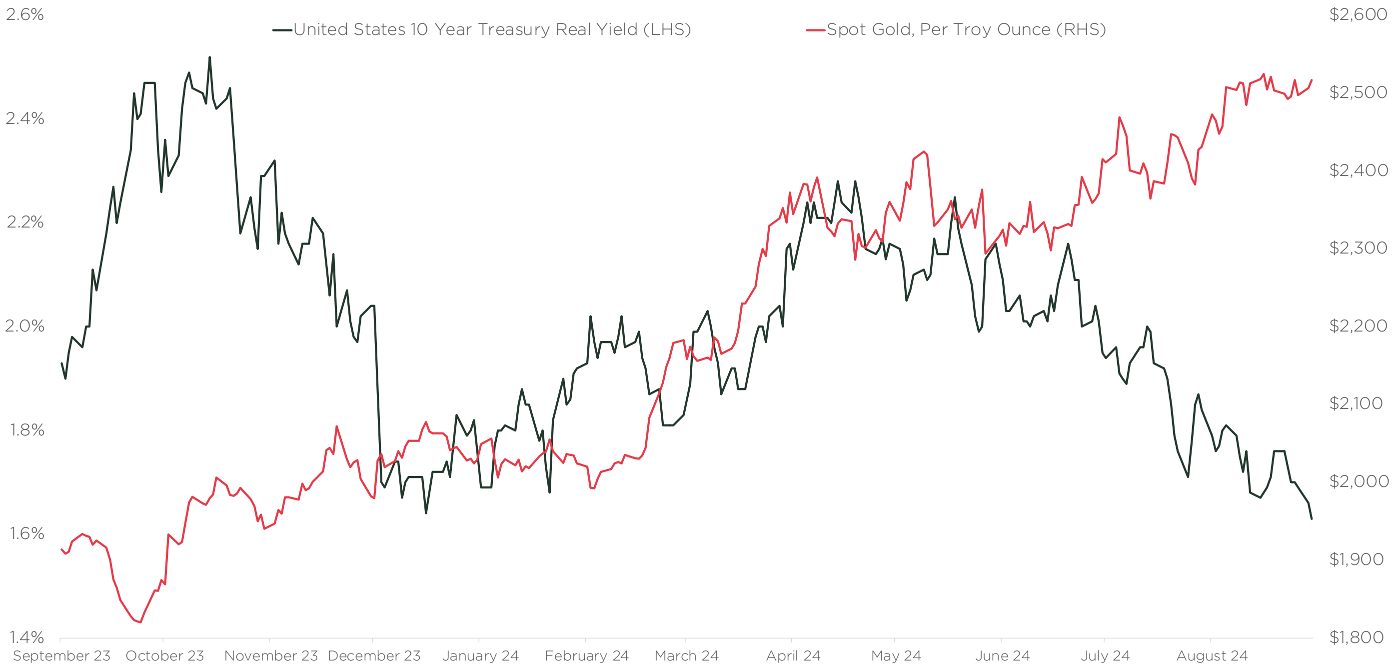


Source: Arbion Ltd, Bloomberg L.P.

GOLD'S IMPRESSIVE RALLY CONTINUES AS REAL RATES DECLINE FURTHER

- Declining real rates are typically positive for gold bullion as it is an asset that pays no interest. Hence, the opportunity cost of holding gold versus other interest bearing assets declines as interest rates decline. The recent moves of higher gold prices accompanied by lower interest rates signal that traditional macro drivers such as bond yields are returning to the fore. Earlier this year, gold advanced even as yields rose, an unusual pattern that surprised seasoned analysts. The decoupling at that point was largely due to strong central bank buying, particularly in emerging markets. That said, I have found over the years that gold usually finds a way to surprise investors as it is a multifaceted asset with many varying performance drivers making it somewhat difficult to value at the best of times!

- Meanwhile, another important driver of the price of gold – the US dollar – is at an all-time low against the yellow metal. For the first time, an ounce of gold costs more than $2,500, which means that a gold bar, typically weighing approximately 400 ounces, will now fetch more than $1 million.



Source: Arbion Ltd, Bloomberg L.P.

OTHER NOTABLE ECONOMIC AND MARKET DEVELOPMENTS

- **US:** The US economy grew by 3.0% annualised in the second quarter of 2024, higher than the previous official estimate of 2.8% and marking a significant acceleration from the 1.4% growth in the previous quarter. The increase was mainly fuelled by strong consumer spending and business investment. The Fed's preferred inflation target, the core PCE index (Personal Consumption Expenditures) printed a modest 0.16% in July, which brought down the 3-month annualised rate to 1.7%, below the Fed's long-term average target of 2.0%, whilst the year-on-year rate remained higher at +2.6% for a third consecutive month. US job payrolls rebounded in August to 142,000 versus 89,000 in July, and the unemployment rate declined from 4.3% to 4.2%. On the negative side, the previous couple of months saw payrolls revised meaningfully lower, and the 3-month average of payrolls growth is now at the lowest since the early days of the pandemic. On the corporate side, third-quarter earnings season was solid overall and did not result in major revisions of forward earnings-per-share growth.

- **UK:** Consumer price inflation rose slightly lower than expected at 2.2% year-on-year, whilst core CPI rose 3.3%. Encouragingly for the Bank of England, services inflation dramatically fell back, from 5.7% in June to 5.2% in July, in a clear sign of a reversal from the jump in the June CPI report.

- **Eurozone:** Eurozone annual inflation fell sharply to a three year low of 2.2% year-on-year in August, from 2.6% in July, raising expectations the European Central Bank will continue to cut interest rates. Core inflation, excluding energy, food, alcohol and tobacco, eased to 2.8% from 2.9%. Meanwhile, the closely watched Ifo Business Climate Index of business sentiment among companies in Germany, the Eurozone's largest economy, fell for the third consecutive month, as expectations became more pessimistic, reflecting declining orders and a weak investment outlook.

- **Japan:** Japan's economy rebounded to growth in the second quarter of the year on the back of an increase in private consumption, in a sign that a virtuous cycle long sought by the Bank of Japan linking rising incomes to increased spending may be starting to emerge. Japan will soon have a new prime minister who will face challenges from inflation, volatile financial markets, a worsening security environment and the transition to a new president in the US, the country's most important strategic ally.

- **China:** China's economy failed to pick up and unemployment rose for the first time since February, as slow consumption and disappointing investment dragged on growth. China's home price downturn abated in July, a sign that the government's most forceful effort yet to revive the housing market may be beginning to stabilise it, but this will still put pressure on the government's 5% economic growth target for 2024 and may put even more pressure on further fiscal policy easing.

- **Australia:** Australia's jobs growth surpassed all expectations in July while a swelling labour force pushed unemployment up only slightly, underscoring the resilience of the jobs market to elevated interest rates. Australia's bond yields dropped to a 13-month low amid growing speculation that the Reserve Bank of Australia is inching closer to the start of an interest rate cutting cycle, something that the central bank has thus far restrained from.

- **New Zealand:** the Reserve Bank of New Zealand slightly surprised markets by cutting its benchmark cash rate for the first time since March 2020 by 25 basis points to 5.25%, while flagging that more interest rate cuts are to come. During the press conference, the RBNZ Governor Adrian Orr mentioned he is confident with inflation back in its target band, and as such the central bank can commence re-normalising rates.

SUMMARY AND OUTLOOK

- A changing interest rate environment is likely to entail a change in leadership in the equity markets, although we would also not fully discount the possibility that the Fed could manage somehow to soft-land the economy as they did in the mid-1990's. But even during that period, sectorial leadership changed. We can already see that, recently, relative performance of technology sectors has suffered but rate-sensitive sectors such as REITs, homebuilders and related industries have performed strongly. After all, improving affordability for real estate could be a significant swing factor for economic growth in developed markets. In general, defensive sectors such as consumer staples, utilities, healthcare and real estate could also perform well in this new cycle, although it will likely take a prolonged period of underperformance from technology stocks to persuade investors of this.

- Looking forward, September is an important month in terms of positioning going into the end of the year. There is the all-important Fed meeting where the market is expecting a 25-50 basis point rate cut for the first time in this cycle, but really the unspoken elephant in the room is the September dot plot publication that will update the market on the Fed's 2025 outlook for US interest rates – a meaningful downward revision here some way towards the market's pricing of substantial policy easing next year would be a very positive reminder that the Fed Put is indeed back on the table. We also have the Bank of Japan meeting where a rate hike is likely to be announced, further supporting Yen strength over recent months. Needless to say, US job market figures will be closely watched for any signs of weakness creeping further into the economy.

- Overall, it appears that we are on the cusp of entering a different market regime where growth concerns are replacing inflation concerns as the dominant factor driving markets. Whilst this does not necessarily entail a negative outlook, it could mean somewhat higher volatility and more sector rotation than usual. As a result, we are positioned somewhat more defensively and sector-neutral, but would also be open-minded to take advantage of a number of tactical opportunities or oversold situations as this all comes at a seasonally difficult period of time for the market, where on average equities have historically struggled in the third quarter. Oh and there are, of course, the upcoming US elections... whilst this has fallen down the pecking order of market topics since Harris replaced Biden as the Democratic candidate, it is safe to say this will be dominating the headlines over the next two months in the absence of a clear frontrunner in the polls!

ROBERT LEE

CO-HEAD OF MULTI-ASSET INVESTMENTS, HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, and Arbion's retail funds business. Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.

Robert is a Chartered Financial Analyst and a member of the Chartered Institute for Securities & Investment.

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