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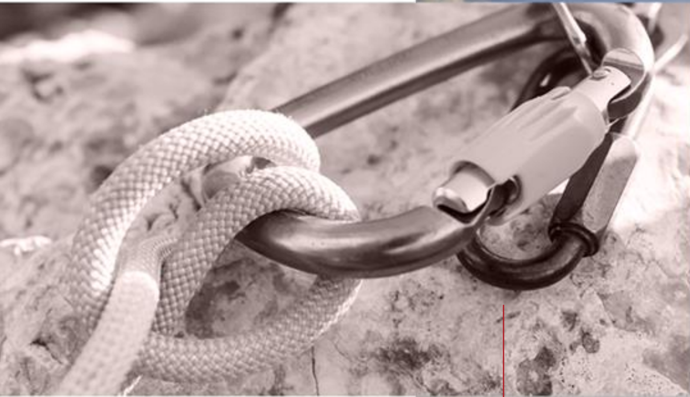
Newsletter: The Beginning Of Rate Cut Cycle / September 2024



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Key Take-Aways

- August saw positive returns in global equities and fixed income, alongside signals of upcoming U.S. interest rate cuts due to softening labor market conditions and moderating inflation.
- The U.S. labor market showed signs of weakening, with rising unemployment and a significant revision in job creation figures, influencing expectations for future monetary policy.
- Financial markets responded positively to the prospect of lower interest rates, though concerns remain about the sustainability of stock market highs amid potential recession risks and upcoming political uncertainties

- August ended on a positive note for the markets despite notable volatility, with major indices like the S&P, Dow Jones, and Nasdaq posting gains, driven by expectations of a new Fed rate cut cycle.
- While Nvidia's earnings disappointed, the broader uptrend in growth and tech sectors remains intact.
- The U.S. dollar is weakening due to anticipated Federal Reserve interest rate cuts, with further declines possible depending on the size of the cut and upcoming economic data.
- The EUR/USD is gaining amid divergent central bank policies, while lower-yielding currencies like the Swiss franc and Japanese yen are benefiting from dollar weakness and market uncertainty.

Review

August's overview

In August, markets experienced volatility, with a significant drawdown in the first ten days, followed by a strong rebound, leaving most indexes (as shown in the table) in positive territory. The two best performers were the S&P 500 and the EuroStoxx 50, with month-to-date (MTD) gains of 2.43% and 1.80%, respectively. The MSCI Emerging Markets index, boosted by the solid performance of TSMC, Tencent, and Alibaba, rose by 1.64%, closely followed by the Stoxx 600, which gained 1.57%. The Russell 2000 saw a correction after its impressive +10.16% rise in July. Meanwhile, the CSI 300 in China had another difficult month, erasing most of its gains since January 31, bringing the year-to-date (YTD) performance to -0.67%.

Despite a rough start, with a drop of 6.07% by August 6, the S&P 500 rebounded sharply, ending the month up 2.43%. The market is anticipating rate cuts in September and beyond, which benefited sectors like Consumer Staples (+5.94%), Real Estate (+5.79%), Healthcare (+5.10%), and Utilities (+4.86%) all of which are sensitive to yields and capital expenditures. However, the Energy sector (-1.70%) and Consumer Discretionary (-0.97%) underperformed last month.

Bonds had a strong August as market interest rates trended downward, driven by expectations of Federal Reserve rate cuts in September and beyond. This was reflected in the BBG Aggregate Treasuries Index Unhedged, which rose by 2.62%. The tightening of US High Yield spreads (-14 bps in August) gave a boost to the High Yield asset class, which returned 2.17% for the month and 7.49% YTD. US corporate bonds also benefited from the anticipated rate cuts, gaining 1.57%. Euro bonds were relatively flat, with slight gains of 42 bps and 30 bps for government and corporate bonds, respectively.

For the second consecutive month, the US Dollar Index weakened, falling by 2.30%. Both the EUR and GBP strengthened against the USD, with gains of 2.05% and 2.11%, respectively. The Swiss Franc made a strong comeback, pushing the USD/CHF pair below 0.85 and the EUR/CHF below 0.94. The USD/JPY seems to have found a new balance between 140 and 150. The JPM Emerging Forex Index struggled in the last five days of the month, bringing its YTD performance to -4.73%.

The BBG Commodities Index fell by 0.38% in the final days of August, bringing its YTD performance to -2.59%. WTI Crude Oil also had a tough month, posting a -5.60% return, largely impacted by China's slowing manufacturing activity. Meanwhile, gold prices continued to climb, ending the month at $2,503.4, pushing the YTD performance to +21.35%.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'648	1.02	0.27	2.43	3.67	19.52	20
Nasdaq	17'714	1.13	-0.91	0.74	0.00	18.58	25
Russell 2000	2'218	0.69	-0.01	-1.50	8.51	10.38	22
Euro Stoxx 50	4'958	-0.17	1.00	1.80	1.51	12.83	13
Stoxx 600 EUR	525	0.09	1.36	1.57	3.02	12.83	14
FTSE 100	8'377	-0.04	0.65	0.83	3.39	11.51	12
SMI	12'437	0.15	0.72	0.97	3.69	15.14	18
NIKKEI 225	38'648	0.74	0.81	-1.09	-2.29	16.57	19
CSI 300 China	3'321	1.33	-0.08	-3.25	-2.67	-0.67	11
MSCI EM Index	1'100	0.45	-0.05	1.64	2.01	9.80	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'648	1.02	0.27	2.43	3.67	19.52	20
UTILITIES	386	0.75	1.17	4.86	11.98	22.55	17
ENERGY	696	0.27	1.02	-1.70	0.38	11.35	12
TELECOM	301	0.83	-0.69	1.24	-2.82	23.11	17
CONS STAPLES	883	0.76	0.82	5.94	7.98	17.68	21
REAL ESTATE	273	0.99	0.36	5.79	13.42	10.65	20
CONS DISCRET	1'500	1.93	-0.17	-0.97	0.67	6.37	23
MATERIALS	593	1.08	1.67	2.39	6.89	11.21	20
HEALTH CARE	1'830	0.73	1.11	5.10	7.89	16.31	19
INFO TECH	4'299	1.06	-1.47	1.25	-0.86	27.14	27
FINANCIALS	759	0.97	2.96	4.51	11.26	22.57	16
INDUSTRIALS	1'111	1.14	1.71	2.86	7.90	16.26	21

Fixed Income - % Change	Price	5 days	MTD	QTD	YTD
BBG Global Agg Treasuries TR Index UNH $	204	-0.56	2.62	5.89	0.75
BBG Global Aggregate TR Index Value $	480	-0.53	2.37	5.19	1.86
BBG Global Aggregate Corporate TR $	294	-0.41	1.19	3.38	3.69
BBG Global High Yield $	1'636	0.12	2.17	4.18	7.49
BBG US Treasury TR Unhedged $	2'336	-0.50	1.28	3.50	2.60
BBG US Corporate TR Unhedged $	3'333	-0.59	1.57	3.99	3.49
BBG EuroAgg Government TR Index UNH €	240	-0.40	0.42	2.65	0.75
BBG EuroAgg Corporate TR Index UNH €	253	-0.13	0.30	2.02	2.57

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	101.698	0.35	0.97	-2.30	-3.94	0.36
EUR-USD	1.1048	-0.26	-1.29	2.05	3.13	0.08
USD-JPY	146.17	0.81	1.25	-2.54	-9.14	3.64
USD-CHF	0.8496	0.27	0.20	-3.23	-5.47	0.97
EUR-CHF	0.9390	0.04	-1.05	-1.22	-2.47	1.09
GBP-USD	1.3127	-0.31	-0.66	2.11	3.81	3.11
EUR-GBP	0.8415	0.03	-0.63	-0.07	-0.68	-2.93
JP EM FX Index	45.86	0.10	-0.75	0.00	-0.13	-4.73

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	96.1	-0.95	-0.38	-0.38	-4.86	-2.59
Gold Spot $/OZ	2'503.4	-0.71	-0.37	2.28	7.59	21.35
Crude Oil WTI	73.6	-3.11	-3.02	-5.60	-9.80	2.65

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	15.0	-0.65	-0.86	-1.36	20.58	2.55

Source: Bloomberg 30.08.2024

Macro & Rates
The Fed will cut rates in September.

Despite market turbulence earlier in the month, August provided not only positive returns in both global equities and fixed income but also a signal from the Fed about the beginning of the US interest rate cut cycle.

At their last meeting on July 31, the Fed reiterated that it wouldn't be appropriate to ease policy until policymakers gained greater confidence that inflation is moving sustainably toward their target. However, August data provided enough evidence for members of the FOMC to adjust their tone.

Indeed, some data suggested that the US labor market had finally softened. The unemployment rate rose to 4.3% with fewer-than-expected job creations. Additionally, the employment component of the ISM manufacturing survey dropped sharply to 43.4, the worst reading since June 2020. Excluding the COVID-19 period, this is the worst reading since 2009.

The biggest surprise came from the Bureau of Labor Statistics, which revised the number of jobs created over the year ending this past March downward by 818,000, roughly one-third of the previously announced figure. Softness in the labor market significantly changed the outlook for future monetary policy, with market participants now expecting 100 basis points (bps) of rate cuts by the end of the year and 120 bps by 2025.

On the inflation front, the data is consistent with a deceleration in inflation from the levels of the past few years. Headline year-on-year inflation stood at 2.9%, while the Core Personal Consumption Expenditure (PCE) Price Index came in slightly lower than expected at 2.6%, supporting the idea that inflation is slowly but surely decelerating.

Therefore, it was not a surprise when Jerome Powell's Jackson Hole speech confirmed what many already suspected: rate cuts will begin in September, thanks to the moderation of inflation and a shift in the Fed's emphasis toward the labor market.

For once, financial markets reacted rationally. Lower US Fed Funds rates generally imply lower overall rates, a steeper yield curve, a weaker dollar, higher gold prices, a boost to equities, and, last but not least, a lower correlation between equity and fixed income returns. This is exactly what occurred during the month.

Nevertheless, one question remains: The type of economy that might justify around 220 bps of easing by the end of next year might not be the same one that justifies a stock market near an all-time high, especially given the political uncertainty ahead of the US presidential election in November.

The deterioration of the US labor market is raising concerns. The Sahm rule, which states that when the three-month average U.S. unemployment rate rises by 0.50% or more from its 12-month low, a recession is likely underway, was triggered by the latest job report. This rule has served as a helpful guide for the Fed and has acted as an "early diagnosis" of possible recessions over the last 60 years.

For now, US equity markets are ignoring the recession risks suggested by developments in the job market and are instead focusing on the rate cuts and their positive impact on refinancing.

On the political front, US tax policy will be a key issue for the next president. It is a legitimate concern for the next administration, given the perilous state of federal government finances. Kamala Harris, who is leading the race for the Democrats, has proposed raising the corporate tax rate to 28% from 21%. Such a fiscal shift, if implemented, could impact the post-tax earnings of the current mega-cap companies in the S&P 500.

Fixed Income

Soft landing is base case scenario

August was another good month for fixed income. US 10-year Treasury yields fell from 4.46% to 3.87%, propelling the entire bond market higher. The move came on the back of US labour market data which showed that unemployment is rising at an accelerating rate.

The Sahm Recession Indicator signals the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.5% percentage points or more relative to its three-month average low during the previous 12 months. This signal was triggered during the month of July.

Meanwhile, US inflation continues to trend lower. While the less volatile supercore CPI YoY remains at 4.47% (vs. 6.48% in September 2022), US Urban Consumer CPI YoY has fallen to 2.9% (vs. 9.1% in June 2022) and is gradually reverting to the Fed's target rate.

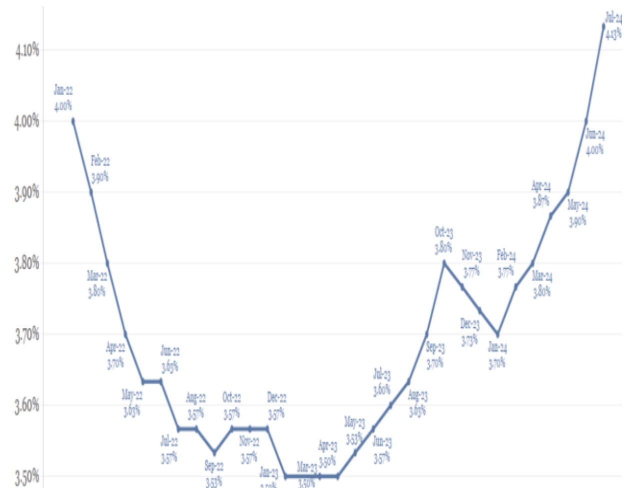
With the labour market cooling and inflation steadily approaching the Fed's target rate, investors have become more and more optimistic on the future path of market yields. A BoA study of fund managers shows that 59% expect lower bond yields. This is the third highest level since the question was asked 21 years ago.

2024 is already a good year for most types of fixed income, but we expect more of this to come. Indeed, the market is now pricing 4 rate cuts in the US before year-end and at five more in 2025. For the ECB, the expectation is for 2 to 3 more cuts in 2024 plus 3 more in 2025. This would bring the Fed funds rate to 4.25% and the ECB rate to 3% in December of this year.

US government bonds have already risen close to 3% and investment grade corporates have added 3.5% in USD and almost 2.5% in EUR. High-yielding bonds are up 6% in USD and 5.5% in EUR. Spreads have tightened throughout the summer months and credit isn't cheap any longer. However, taking on high-quality duration still makes sense in order to play the entire monetary policy easing cycle which has now clearly kicked off.

At Cité Gestion we believe that it is (still) time to be overweight in bonds. In a balanced profile, we have increased our allocation to bonds to 42.5% and have increased overall duration of portfolios to around 6 years. We prefer the pure-play of duration and therefore have the largest exposure to govies (14%), followed by investment grade corporate bonds (11%), Emerging Market hard (4%) and local (4%) currency bonds and high-yielding bonds (4.5%) in a balanced profile.

3-month average US unemployment rate

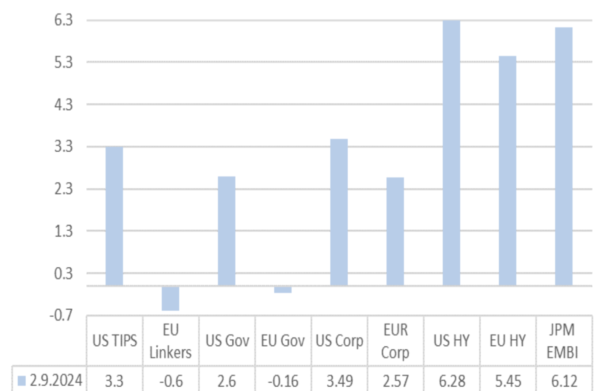


Source: Bianco Research LLC

% of FMS expecting lower long-term rates in the next 12 months

Source: BoA Blogal Fund Manager Survey

Bond YTD total returns as of 2.9.24



	US TIPS	EU Linkers	US Gov	EU Gov	US Corp	EUR Corp	US HY	EU HY	JPM EMBI
2.9.2024	3.3	-0.6	2.6	-0.16	3.49	2.57	6.28	5.45	6.12

Source: Bloomberg

Equity

Markets hold up despite the return of volatility

August ended on a positive note for the markets despite notable volatility, with major indices like the S&P, Dow Jones, and Nasdaq posting gains, driven by expectations of a new Fed rate cut cycle. While Nvidia's earnings disappointed, the broader uptrend in growth and tech sectors remains intact. However, short-term indicators suggest a potential pullback in September.

Positive month for the stock market

August was positive for the markets, even though volatility was significant. The S&P swung within a range exceeding 450 points, experiencing a drop of up to 7.3% during the month, while the VIX spiked to 65 points before closing the month down by 1.36 points (-8%) at 15 points. Similarly, the Nikkei experienced a sharp decline of 12% on Monday August 5 but ultimately ended the month with a modest loss of 1.2%. In August, the S&P, Dow Jones, Nasdaq, and Eurostoxx recorded gains of 2.3%, 1.8%, 0.7%, and 1.7%, respectively. This marks the fourth consecutive month of positive returns for the four ETFs that track major U.S. assets (TLT, LQD, SPY, and HYG), driven by expectations of a new cycle of Fed rate cuts. In the U.S. tech sector, hedge funds have trimmed their exposure to the "Magnificent 7," as GS data indicates, with these stocks now making up 18% of net long positions among HFs on their PB desk clients, down from 20.5% at the end of June. Additionally, they have reduced their holdings in semiconductors, maintaining a slight net long position in the sector.

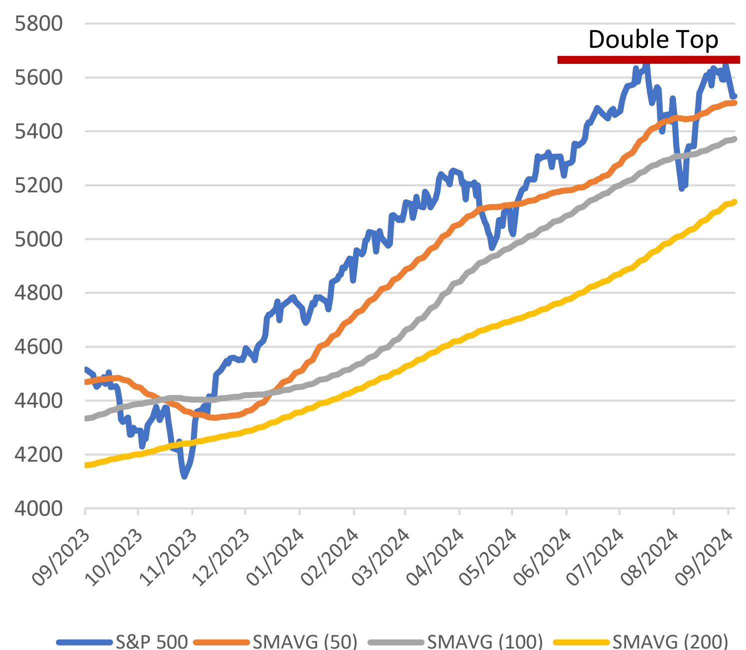
NVIDIA

Nvidia's response to its earnings report on Wednesday after-hours was anticipated as a key event but turned out to be disappointing, with the stock closing down 6.38%, its worst post-earnings performance since February 2022, prior to the launch of ChatGPT when the stock had dropped more than 7.50%). Nvidia was further impacted by concerns over its third-largest client, Super Micro Computer (SMCI US), which accounts for more and less 8% of its revenue. The company announced a delay in publishing its annual report, following a report by Hindenburg Research earlier in the week, which highlighted "flagrant accounting red flags, evidence of undisclosed transactions, control failures, and customer issues." On Friday after-market, SMCI's stock rose by 2.2% after the company indicated that their annual report was expected to align closely with the previously released annual and Q4 results from August 6th. The market’s reaction to Nvidia's earnings report is likely to be a key factor in shaping equity leadership trends as we move from Q3 into Q4. Unfortunately, it would appear that Nvidia is rather bearish and that the stock is currently looking for technical support.

Technical side

Technically speaking, short-term indicators have shifted from oversold conditions in early August to overbought levels by late August/early September, suggesting a potential pullback for the S&P and Nasdaq in September. However, unless there is a break below the August lows, the uptrends for most growth stocks driving these indices should remain intact. The growth vs. value trend continues to exhibit choppy trading behavior, with the early August oversold bounce now giving way to overbought conditions, showing signs of peaking. The August lows serve as essential support and stop-loss levels, and a decline below these points could indicate a significant shift away from growth stocks. As with the broader market, most growth stocks have rebounded sharply, leading short-term momentum indicators into overbought territory. Consequently, a short-term pause is likely, though the broader uptrend in growth, technology, and semiconductor sectors is expected to persist. The healthcare consumer staples and real estate sectors should also benefit from future rate cuts.

The S&P 500 Index failed to break the all-time high



Forex And Commodities

Change Of FX Regime : The End of USD Hegemony ?

As summer draws to a close, the U.S. dollar appears to be entering a new phase. The catalyst for this shift came in early August when macroeconomic events, triggered by a hawkish move from the Bank of Japan, set the stage for a weaker dollar. Despite a minor rebound at the end of August, the U.S. Dollar Index (DXY) had its worst month since the beginning of the year, dropping nearly 5.20%.

This decline has been largely driven by growing expectations that the Federal Reserve will implement its first rate cut by mid-September. While the downward trend is significant, it may not be over yet. The extent of this weakness hinges on whether the anticipated September rate cut will be 25 basis points (bps) or 50 bps. The market currently anticipates a 25 bps cut, but a 50 bps cut would be an unexpected move that could further weaken the greenback.

The September 6th U.S. jobs report will be a key indicator in determining the size of the rate cut. However, it may be premature to dismiss the dollar's strength entirely. The U.S. dollar remains a safe haven, and any deterioration in the geopolitical situation or signs of market stress could provide a favorable boost to the currency. Furthermore, the approaching U.S. election is adding to market uncertainty, which could translate into increased volatility for the dollar in the short term. From a technical perspective, the DXY has not yet broken below the key support level of 100.5, the lowest level of 2023. This could offer some short-term respite from the dollar's downward trend.

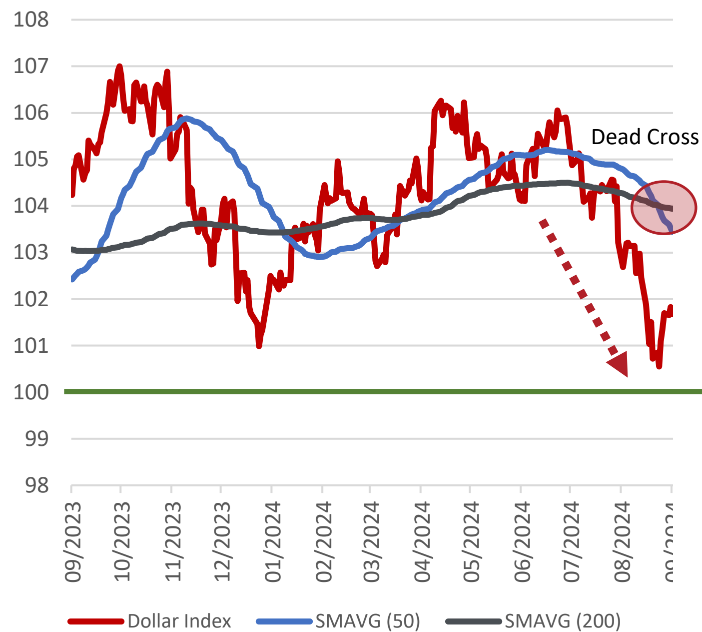
In summary, while the expected rate cut puts the dollar on a path for further decline in the medium to long term, potential headwinds could still trigger short-term rallies.

The EUR/USD pair recently broke through the key level of 1.10 but has yet to surpass the 2023 high of 1.1275. The divergence in policy approaches between the two central banks will weigh on the pair. As long as inflation remains under control and European growth doesn't falter significantly, the ECB is likely to maintain a more restrictive stance on its rate policy. In contrast, the Fed may have room to lower rates further in subsequent meetings, which could favor a stronger EUR/USD in the long run. Forex investors are increasingly positioning themselves as net long on the euro, driving sentiment to be more positive on the EUR/USD.

A weaker dollar is also likely to benefit lower-yielding currencies such as the Swiss franc (CHF) and the Japanese yen. The Fed's expected rate cut in September should weigh on USD/CHF, with the franc also likely to benefit from the uncertainty surrounding the U.S. election. August's price action pushed the USD/CHF pair below its key support level at 0.8550, triggering a further decline. A break below 0.8333 could maintain the negative momentum towards 0.80. Similarly, the EUR/CHF pair has been in a downtrend since May, and a mid-August death cross has opened the door for further declines. A break below 0.92 would confirm this negative momentum.

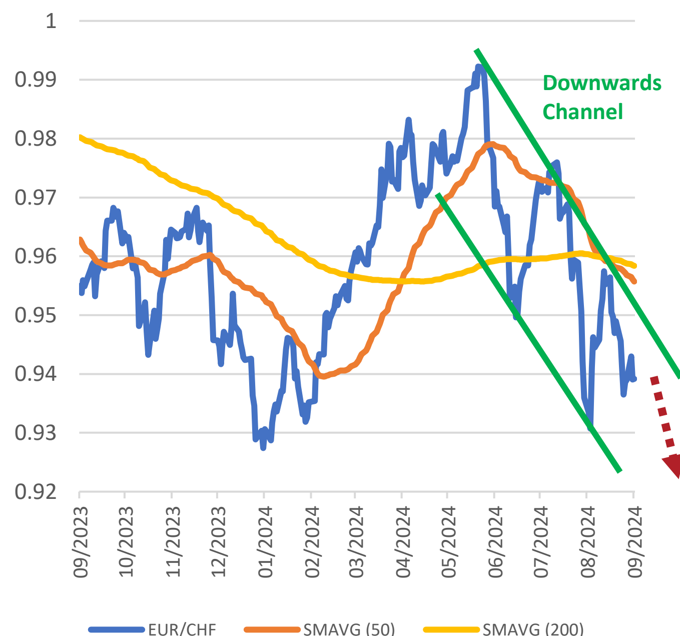
The Japanese yen was the biggest beneficiary of the Bank of Japan's surprise rate hike in August, with the USD/JPY pair losing nearly 11%. Although this move may have been overdone, it reflects a fairer value for the yen, and further gains are possible. The BoJ has indicated that short-term interest rates could rise further if inflation remains steady. Given a weaker dollar, the USD/JPY could now be testing the 140 level.

Could the DXY collapse below 100 ?



Source : Bloomberg

CHF Should Continue its Momentum.



Source : Bloomberg

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