Market Review August 2024

The summer vacations were challenging for the bulls. August (statistically one of the worst months of the year, along with September) got off to a flying start, with a sharp fall in equity indices and a rise in volatility. This sharp correction was mainly triggered by two factors. Firstly, weaker-than-expected employment figures. These could call into question the "soft landing" scenario anticipated by the vast majority of investors. At the time, the sharp revision in job creation published by the Bureau of Statistics (BLS), to which we'll return below, had not yet been unveiled. The second reason, which seems to us to be the main one, stems from the "carry trade" unwindings we mentioned last month. As a reminder, many hedge funds have, for years, tended to borrow in low-interest currencies (such as the Japanese yen) to invest in currencies offering higher yields (such as the US dollar), thereby cashing in on the yield differential. These investments can also be made in various asset classes, such as equities or bonds. The Japanese Central Bank (BoJ) recently tightened its monetary policy, causing the yen to rise sharply. Many Western investors were forced to cover their short positions in the Japanese currency, and consequently to sell their US dollar investments. Having already risen by 6.8% during July, the yen rose by over 6% between Thursday, August 1st and Monday, August 5. This movement triggered a sell-off in the Nikkei225 index of major Japanese equities (-18.5%) and sent a wave of panic through the world's indices for a few hours. As is often the case at such times, forced selling by leveraged speculators accentuated the downward movement and sent volatility soaring. After this "lightning clean-up", investors quickly came to their senses, which enabled most indices to end the month slightly up, except for the Nikkei, which still gave up 1.1%, a lesser harm after its historic decline during the first few days of the month. This episode is a perfect textbook case of the consequences of a stop-loss triggered runaway and margin calls when a very popular trade reverse.

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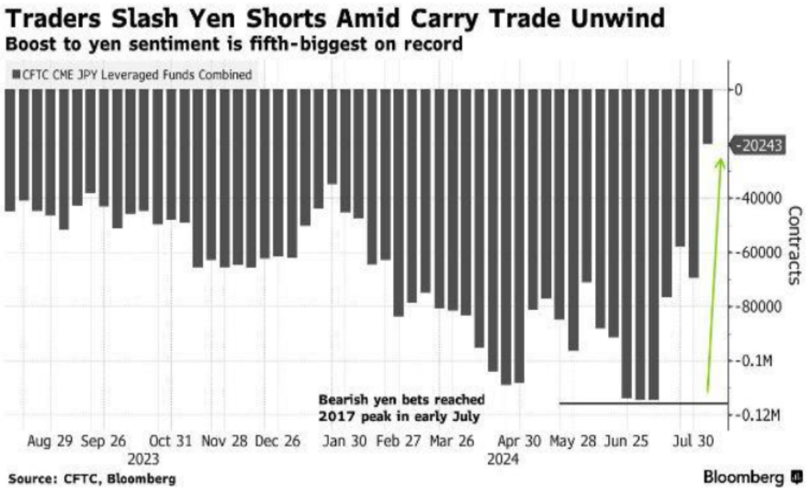

These "carry trade" unwindings had an impact on all asset classes, as well as currencies. The Dollar Index gave up more than 2% over the month to close in on its 100 support, its lowest level of the year. Unsurprisingly, safe-haven currencies such as the Swiss franc were in demand, while the yellow metal continued its ascent (+2.3%) to reach a new all-time high ($2,531 per ounce). The rest of the commodities market is still suffering the consequences of a slowing Chinese economy. Even oil continued to plummet (-2.5%), despite a geopolitical context as tense as ever.

In terms of interest rates, the trend has been downwards. Inflation pointing towards the central banks' 2% target, and an economic slowdown that seems to be slowly but surely taking hold, prompted investors to accumulate bonds in both US dollars and euros. The US 2-year yield contracted by 38 basis points over the month, while the 10-year yield gave up 19 basis points to return to the important 3.8% support level. This correction represents the fourth consecutive month of yield contraction. This movement has contributed to a steepening of the yield curve, bringing the differential between these two yields close to equilibrium, after having been in negative territory since July 2022. The same trend was observed on the Old Continent, but to a lesser extent, with German 10-year yields contracting slightly and fluctuating throughout the month in a narrow range between 2.20% and 2.30%.

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Market trends to end August 2024

End of August	Equities in Local Currencies							
	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	2.51%	2.28%	1.75%	1.32%	3.04%	0.97%	1.40%	-3.51%
Perf 3 Month	6.27%	7.03%	-0.52%	-4.53%	0.71%	3.63%	4.86%	-7.22%
Perf YTD	15.53%	18.42%	9.65%	1.16%	12.87%	11.66%	7.44%	-3.20%

End of August	Commodities				Currencies vs EUR			
	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	-5.60%	-2.38%	2.28%	0.11%	-2.01%	0.54%	0.06%	1.24%
Perf 3 Month	-4.47%	-3.46%	7.56%	-8.02%	-1.81%	5.65%	1.18%	4.25%
Perf YTD	2.65%	2.28%	21.35%	7.90%	-0.09%	-3.57%	3.01%	-1.08%

End of August	Bloomberg Indices Bonds Total returns							
	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	2.37%	1.44%	0.44%	1.42%	0.13%	2.01%	2.17%	2.10%
Perf 3 Month	5.34%	4.79%	2.83%	5.66%	5.16%	4.72%	4.59%	4.64%
Perf YTD	1.86%	3.07%	1.24%	2.71%	-2.21%	3.32%	7.49%	6.29%

Source: Bloomberg 31/08/24

On the political and geopolitical fronts, the sources of risk for financial markets remain active, prompting us to keep a close eye on their development. After an enchanted Olympic interlude, the political situation has not really improved in France, with President Macron yet to name a Prime Minister. In the United States, poll results remain tight between Mrs. Harris and Mr. Trump. We have learned that the Democratic candidate has chosen Mr. Tim Walz as her running mate. The current governor of Minnesota and former teacher is considered a progressive. This could be a handicap when it comes to winning back Republican voters who are still hesitating to vote for Mr. Trump. Americans are eagerly awaiting the televised debate between the two candidates scheduled for September 9, which is sure to influence the final outcome on November 5.

Unfortunately, there was no good news on the armed conflict front - quite the opposite in fact. In the Middle East, ceasefire talks are at a standstill, and even worse, the conflict is beginning to spread beyond Lebanon's borders. Hezbollah recently launched a drone attack in retaliation for the Israeli raid at the end of July, which killed a commander of the armed Islamist movement. This offensive was thwarted by the Israeli army, but we can see that the risks of the conflict spreading to the region are increasing. If Iran and the United States were to take a direct part in the confrontation, it could have catastrophic consequences for the whole world.

More than two years have passed since the Russian invasion of Ukraine and its impact on energy supplies. The month of August will certainly go down in history as an important date in the evolution of the conflict. Ukraine, which until now has been striving to defend itself and repel the invaders, seems to have gone on the offensive. At the beginning of August, the Ukrainian army made a surprise incursion into Russian territory in the Kursk region, claiming to control more than a thousand km². President Zelensky has remained tight-lipped about the reasons for this operation. Military specialists believe that the aim is to create a diversion and disperse Russian troops.

The territory could also be used as a "bargaining chip" in potential ceasefire talks. This event very probably marks a turning point in this conflict, which has been bogged down for several years and whose outcome seems hard to predict.

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While the most optimistic believe that this offensive could increase the chances of putting an end to the conflict, we must not overlook the image damage it is causing for President Putin and the (nuclear?) consequences that could ensue. As we have said on several occasions, we must consider and integrate these armed conflicts into our scenarios, but they must not be allowed to dominate the construction of our portfolios.

Offensive ukrainienne à Koursk, Russie - carte (mise à jour le 11 août).

Earlier, we mentioned a major revision of job creation statistics. Every month, the BLS (Bureau of Labor Statistics) publishes various statistics, including the number of jobs created in the USA, which are closely followed by investors and the US Central Bank. Indeed, along with the PCE (Personal Consumer Expenditure) price index, which reflects the evolution of US inflation, the number of jobs created represents one of the most important statistics for the FED and its ensuing monetary policy. As it turns out, the figure published monthly is an estimate. Indeed, given the amount of data to be collected, it is difficult to obtain a precise figure in such a short space of time. Once a year, in August, BLS publishes an annualized revision of the monthly statistics published between April of the previous year and March of the current year, in our case between April 2023 and March 2024. This revision is usually marginal, ranging between 100,000 and 200,000 jobs created over or under the twelve months under observation. On August 21, the BLS announced that 818,000 fewer jobs had actually been created over the period, i.e. an average of 174,000 jobs per month and not 242,000 as previously published.

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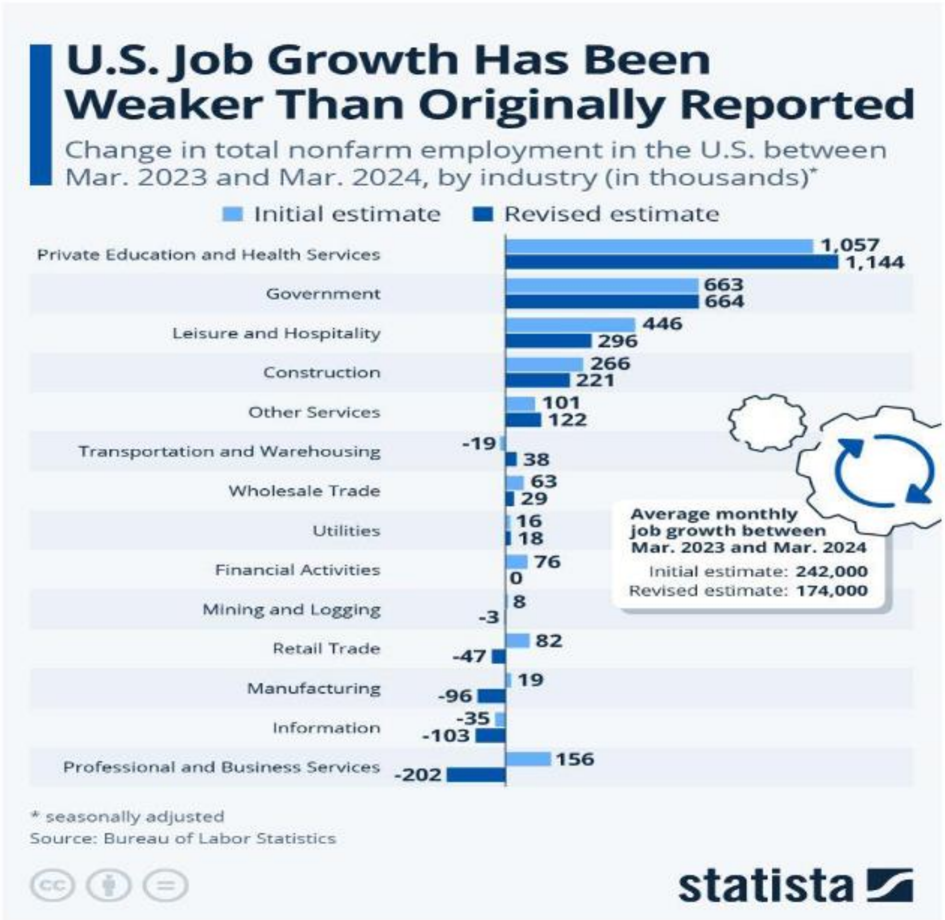
The icing on the cake was that, on the day of publication, the BLS seemed to have a technical problem and was therefore unable to publish the figure on time. A number of investment banks who follow these publications very closely and were surprised not to see the figure appear on their screens contacted BLS by telephone to find out what was going on. BLS confirmed the technical problem and took the liberty of communicating the revision by telephone as and when it received calls. This represents a serious breach of fairness in the transmission of information. "Can do better" for a service directly attached to the U.S. government...

There's no doubt that some heads are likely to roll in this department.



It would therefore appear that the US economy created far fewer jobs between April 2023 and March 2024 than the FED thought it would. Yet the FED has repeatedly justified its decision not to cut rates too quickly, precisely because of the strength of the labor market...an opinion heavily biased by this overestimation. It is therefore legitimate to ask whether the job market, and the US economy as a whole, are as robust as they seem...

At the same time, we learned that a leading indicator of recession has been triggered. It's hard to imagine you haven't heard of the "Sahm rule" in recent weeks. The work of economist Claudia Sahm was highlighted by the St. Louis Federal Reserve in 2019.

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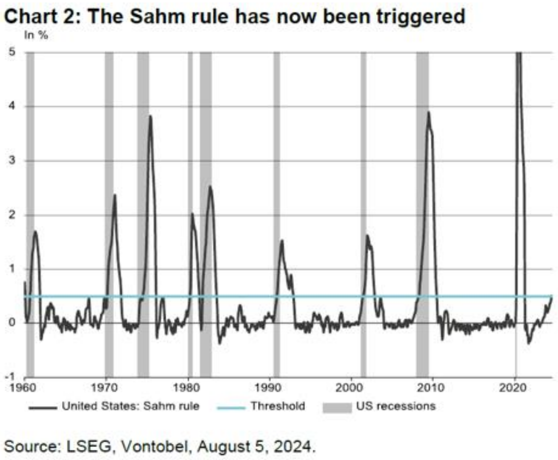
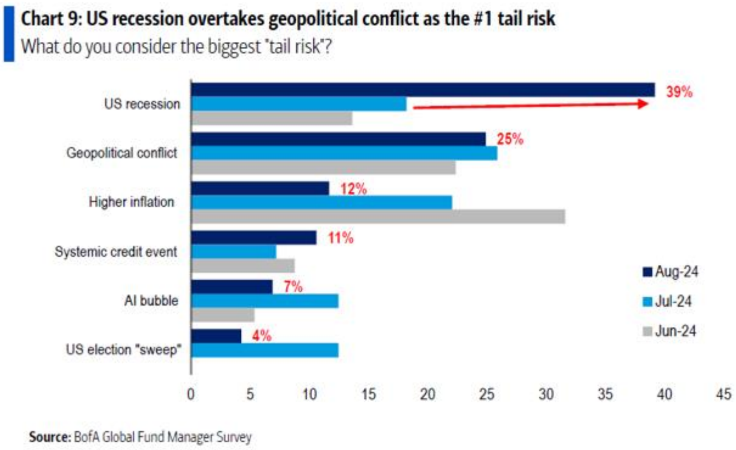
According to his study, when the three-month moving average of the US unemployment rate rises by more than 0.5% in the space of twelve months, this indicates that the US economy is on the verge of entering recession.

And this very signal has just been "triggered" by the unemployment rate statistic for July 2024. The "success rate" of this indicator has been quite high in previous recessions experienced by the US economy. Nevertheless, it is decried by many economists (and by Claudia Sahm herself!). Indeed, this model is based on a rise in the unemployment rate due to an acceleration in layoffs, and this is what has happened historically. Currently, there are indeed waves of layoffs in the US, but the rise in the unemployment rate is mainly justified by an excess supply of labor and a return of citizens who were inactive on the job market (mainly immigrants). What's more, when this indicator was triggered in the past and a recession ensued, household debt levels were also on the rise and investment was contracting, which is not really the case at present. Is "this time different? Perhaps... but the fact remains that this indicator confirms that the US economy is slowing down and that the FED will have to adapt its monetary policy.
That said, the recent upward revision of US GDP growth for the second quarter confirms that economic activity, driven mainly by private consumption, remains buoyant for the time being.





Mr. Powell understood this, and made it quite explicit in his speech at the annual summer meeting in Jackson Hole. He confirmed that "the time has come to adjust the monetary policy" of the institution he presides over, without however communicating a precise agenda. We can therefore expect the FED to start cutting rates at its next meeting on September 18, but data dependency remains an issue. Investor speculation is even pointing to a possible 50 basis point cut at this meeting, which could imply that the central bank has taken too long to act and is "behind the curve". Whereas in the autumn of 2023, the consensus was for seven rate cuts in 2024, by June of this year it was down to two. At the time of writing, the market is expecting four rate cuts between now and the end of December, but as you will have gathered, this could still change depending on future economic statistics.
The ECB, which cut its key interest rate for the first time in June, should logically repeat the operation at its next meeting on September 12.
At least, that's what the latest statistics suggest, and that's precisely what Sweden's Riskbank did when it cut rates from 3.75% to 3.50% in August.

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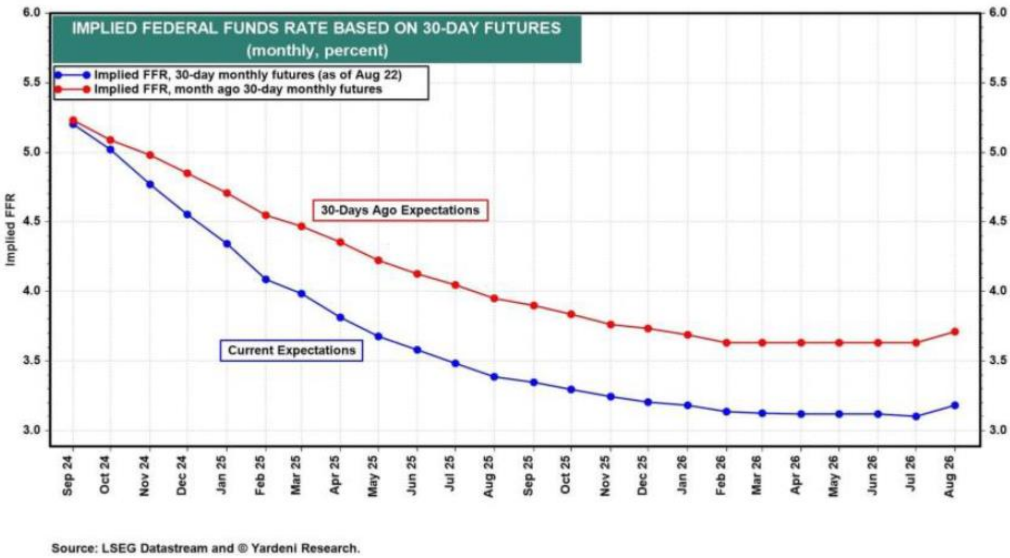
The SNB, which has already intervened twice since the start of the year, could soon make its third rate cut. One of the only central banks to adopt a restrictive monetary policy is the BoJ, whose country is in a different economic cycle, as mentioned above.



As you can see, a "soft landing" is taking place in Western countries. The major challenge for central banks will be to manage this slowdown, while preventing it from becoming too deep and triggering a recession ("hard landing").

Does the fact that most equity indices are trading at all-time highs imply that investors are being too complacent? In any case, current valuation levels (mainly in growth sectors) seem to us to be expecting "perfection", i.e. no nasty surprises. This is partly due to the good second-quarter results published by most companies. The current market equilibrium could be challenged by future economic statistics.
The vast majority of investors welcome the forthcoming rate cuts because they will give breathing space to heavily indebted companies and households. Rate cuts therefore tend to support equity markets, but if they fail to avoid a recession, an index correction seems likely. Current credit spread levels tend to reassure us that a recession can be avoided. Indeed, the spread between high-yield bonds and government bonds is hovering around 400 basis points, whereas in the past, when a recession was looming, the latter were hovering around 800 basis points.

We see no reason to panic, but we remain vigilant about macroeconomic developments. The US presidential elections are approaching, and could bring their share of "sketches" that could increase investor nervousness.

We wish you a beautiful and gentle end of summer.

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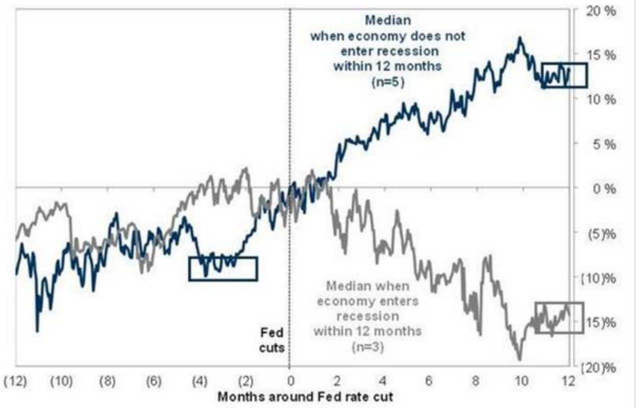
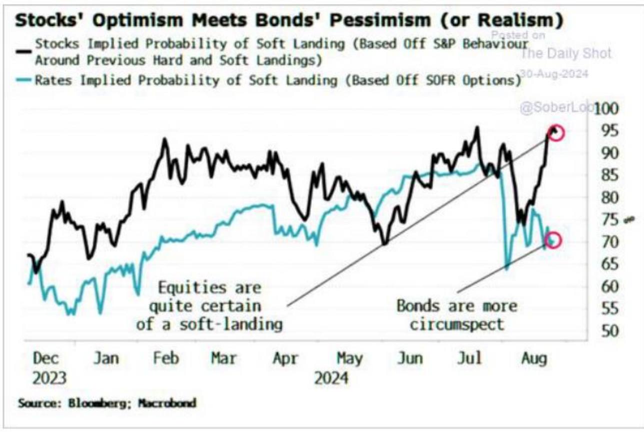
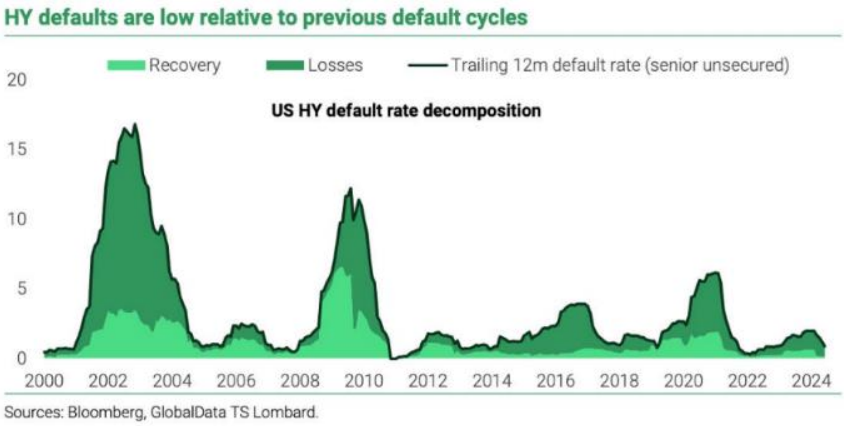
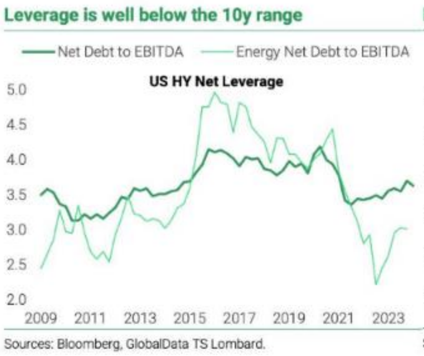
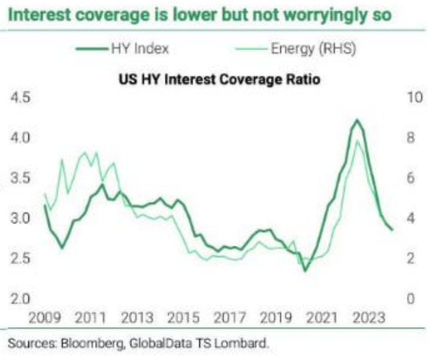
Bonus graphics :











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