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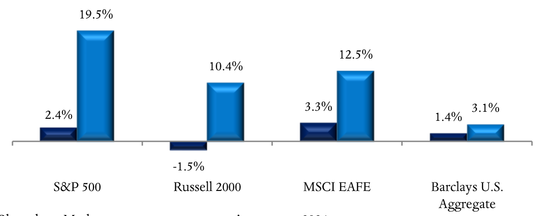
Markets

Investors witnessed a serious bout of volatility in August. The publication of US economic data that triggered fears of a recession, coupled with an initial interest rate hike by the Bank of Japan, sparked a sharp sell-off across global equity markets. Japan's TOPIX index was the hardest hit, tumbling 12% on August 5th, its biggest daily drop since Black Monday in 1987. Investors also took profit in US markets, as seen by the Nasdaq composite, which fell almost 6% over the course of three days. However, by month end, markets had rebounded as investors cheered the prospect of aggressive policy easing by the Federal Reserve as well as a solid Q2 earnings season. Finally, the S&P 500 finished August higher by +2.4% (+19.5% ytd), while the smaller capitalization Russell 2000 index declined by -1.5% (+10.4% ytd). Overseas, stocks in the MSCI EAFE index rallied +3.3% during the month (+12.5% ytd). In Europe, the Stoxx 600 index rose +1.6% (+12.8% ytd). Major Asian markets declined, with the Nikkei 225 index retreating -1.1% (+16.6% ytd), and the Shanghai composite dropping -3.1% (-1.9% ytd).

Interest rates fell and the yield curve continued to steepen throughout August. The 10-year US Treasury yield ended at 3.91% and the 2-year/10-year spread moved to nearly flat, after more than two years of inversion. On the heels of cooling inflation and labor market data, Fed Chair Powell delivered a speech at Jackson Hole, WY that indicated the prioritization of monetary policy focus shifted from inflation to labor. In this environment, the Bloomberg US Aggregate index ended the month higher by +1.4% (+3.1% ytd). Other interest rate sensitive assets classes, such as real estate, were also well supported and the Global REIT Index rose +6.2%.

Commodity markets were tempered by decelerating global growth and manufacturing weakness. WTI crude oil prices retreated -5.6% to $73.55/bbl on demand concerns, while iron ore prices dropped to a two-year low on the back of the real estate crisis in China. Overall, the broad S&P GSCI commodity index declined -2.7% in August; -4.6% ytd).



Source: Bloomberg Markets

Geopolitics

US elections are less than two months away, with Presidential and Vice Presidential debates scheduled for September 10 and October 1, respectively. Kamala Harris has secured endorsements from major labor unions. In addition, more than 200 Republicans have declared their endorsement for Harris, in an open letter. On the other side of the aisle, Donald Trump received endorsements from former presidential candidate Robert F. Kennedy Jr. and former Democratic Representative Tulsi Gabbard. Since Biden stepped down, Harris has raised more than $500mm and now leads Trump. Cash-in-bank was estimated to be $404mm for Harris and $295mm for Trump at end-August. The election will likely be decided in seven battleground states: Arizona (11 electoral votes); Georgia (16 electoral votes); Michigan (15 votes); Nevada (6 votes); North Carolina (16 votes); Pennsylvania (19 votes); and Wisconsin (10 votes). In terms of pathways to victory, Arizona, Georgia, Nevada, and North Carolina appear to be toss-ups (with less than 1% margins). Harris seems comfortably ahead in Michigan and Wisconsin, and marginally ahead in Pennsylvania. Trump will likely need to take Pennsylvania, which is leaning towards Harris, since previous scenarios had him winning both GA and NC. As a result, the betting odds have shifted in favor of the Democrats and away from a consensus Red Wave (Trump POTUS + Republican Congress). When looking at polls, as of September 9, Harris has a +2.8% lead, according to FiveThirtyEight, an aggregator which accounts for recency, sample size and house effects. Analyzing the underlying data, we note that surveys conducted in early September, including one by Morning Consult, favored Harris, while a more recent New York Times/Siena College poll favored Trump. Given that these studies typically exhibit a 2-3% margin of error, there is a high degree of uncertainty as to who will win.

With regard to the Senate race, there are 51 Democrats (including 3 Independents) and 49 Republicans. This election cycle has 34 seats up for election. Democrats hold 23 of the 34 seats up for election. In order to gain control of the Senate, the GOP will need a net gain of 2 seats. Sen. Manchin (D) is resigning from his seat in West Virginia and that is expected to flip Republican; in 2020, Trump won WV 68.6% to Biden's 29.7%. Based on the current poll data from The Hill, Democrats will need to win all their lean elections, both of the toss-up elections and one of the currently lean GOP elections for majority, indicating a 70% chance of GOP winning the Senate vs. 30% for the Democrats. The House of Representatives contains 435 members with every seat up for election. Currently, Republicans hold 218 seats and Democrats 213 seats. There are 4 seats vacant due to retirement.

A Trump presidential victory would open the possibility for significant change, especially if Republicans control both houses of Congress. A Harris victory would likely result in more checks and balances. Either scenario should be supportive of equities, with the caveat that Trump's corporate tax cuts may sunset in 2025.

United States

Economic activity in the manufacturing sector contracted in August for the fifth consecutive month and the 21st time in the last 22 months, according to the latest ISM manufacturing print of 47.2%. The underlying data indicated demand remains subdued on account of interest rate and election uncertainty. Employers added 142,000 jobs in August, continuing a decelerating trend of late. The unemployment rate did, however, edge down to 4.2% and wage growth was higher by 3.8% year-over-year, amid rising labor force participation, including a historic high for the women's prime age cohort. The US economy is seemingly on a slowing trajectory, driven by restrictive monetary policy, but there are no signs of a recession on the horizon. Employment and earnings continue to be positive (wage growth is well above pre-pandemic levels), consumer spending has re-accelerated as per recent retail sales data, while default rates and bankruptcies (which had spiked over the past year) have begun to trend down, GDP is expected to range between 1% and 2% over the next year, and S&P 500 corporate profit margins are near all-time highs.

August 2024 Economic Statistics

	Aug-24	Dec-23	Dec-22
Federal Funds Target Rate	*5.25 - 5.50%*	*5.25 - 5.50%*	*4.25 - 4.50%*
Consumer Confidence Index	*103.3*	*110.7*	*108.3*
Manufacturing PMI Index	*47.2%*	*47.4%*	*48.4%*
Unemployment Rate	*4.2%*	*3.7%*	*3.5%*
JPY/USD	*146.16*	*141.06*	*131.11*
USD/EUR	*1.1047*	*1.1036*	*1.0702*
Gold/oz.	*$2,503.03*	*$2,062.59*	*$1,824.40*
Oil (WTI)/bbl	*$73.55*	*$71.65*	*$80.26*

Sources: see disclosure *

Europe

Data showed that annual inflation in the eurozone was estimated at 2.2% in July, down from 2.6% in August. The drop in inflation towards the European Central Bank's 2% target now increases the likelihood that the ECB cuts interest rates at its September meeting, following a 25 bps cut in July.

The eurozone PMI ticked up to 51.0% in August, from 50.2% in July. The expansion was supported by the services sector, boosted by the Olympic Games in Paris, while manufacturing remained contractionary.

In the UK, Prime Minister Keir Starmer warned of a "painful" autumn budget amid an estimated £22 billion shortfall in public finances. He added that those with the "broadest shoulders" will bear the heaviest burden, sparking speculation around which taxes might be raised. Amid inflation of 2.2%, the Bank of England made its first rate cut in four years, by 25 basis points to 5.00%. Meanwhile, second quarter GDP growth decelerated to 0.9%.

Asia

Economic activity data in China remained subdued, on account of the domestic segment, which the Politburo has indicated is a priority for reflation. Loan growth ticked-down to 8.7%, as credit demand has stayed weak. Fixed asset investment saw a moderation in both manufacturing and infrastructure, while real estate remained in contraction. Industrial production growth softened to 5.1% in July, from 5.3% prior, led by construction-related sectors, while communication and other electronics were resilient. Retail sales did, however, see a slight sequential pickup. China's imbalanced strength on the external-front over the past year also appears to have peaked, as July exports slowed to 7.0% from 8.6%, amid easing global manufacturing activities.

The Bank of Japan's decision to increase its policy rate by 25 basis points, and Governor Ueda's subsequent hawkish tone, led to an abrupt unwinding of Japanese carry trades. These speculative positions relied on cheap Yen borrowing costs to buy other higher yielding assets, the reversal of which has led to the appreciation of the Yen, versus the US Dollar, by circa 12% over the past two months.

Outlook

Jerome Powell's recent speech at the Jackson Hole central bank symposium unveiled that the Fed has shifted its primary focus from inflation, which it believes is under control, to the labor market, which has cooled. Their fear is that rates may have remained elevated for too long of a time. While the pace of the Fed's rate cuts will depend on future data, investors interpreted the language as cementing a 25-50 basis point rate cut in September, with more to follow by year-end and in 2025. Fears of a US recession appear exaggerated given the resilience of the labor market, associated wage growth, and reaccelerating consumption. GDP growth is anticipated to slow from the 2.1% annualized pace in Q3 to a tepid pace of about 1% in Q4. However, growth should reaccelerate back to the 2% level by the end of 2025, reflecting achievement of the Fed's 2% inflation target, and lower interest rates.

With regard to equities, the outlook calls for the S&P 500 to increase profits by +15% in 2025, with rich valuations (20x 2025 earnings) supported by falling interest rates. In this scenario price appreciation should be commensurate with earnings growth, with the potential for a broadening of participation. Even with major indexes at record highs, we are seeing substantial stock specific opportunities. Further, as the Fed prepares for the first rate cut, the US dollar has begun to depreciate, discounting a narrowing interest rate differential, favoring multi-nationals. In a weak dollar environment, international diversification looks increasingly attractive, especially given the lower valuations currently available.

For fixed income investors, modestly extending maturities seems appropriate to maximize yield in a declining interest rate environment, while increasing portfolio resilience against volatility and potential growth shocks. Credit markets should continue to performed well, driven by attractive corporate earnings. Emerging market debt also stands to outperform, after nearly a decade of investor neglect, with a weaker US dollar providing a tailwind.

August's technically driven volatility is a reminder that financial markets are not always efficient. As such, we continue to recommend portfolios incorporating select hedge funds and non-market correlated investments that can take advantage of such opportunities. With interest rates in decline, we have originated several attractive real estate projects. In addition, select software equities, with an activist element, appear to be timely investments. We have also identified innovative private equity funds attempting to disrupt the education and healthcare industries.

*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.