



CIO OFFICE MORNING MARKET WRAP

02 September 2024

Last week was a relatively quiet conclusion to the tumultuous month of August. Weekly returns were around flat for global equities, and modestly negative for global bonds, with a +10bps increase in long dated US Treasury yields, to 3.7% for the 5-year and 3.9% for the 10-year. Global listed real estate gained +0.9%, continuing its impressive recovery to now +9% YTD, while gold, 2024's superstar, ended -0.4% lower at \$2,500 an ounce. The dollar rebounded against trade-weighted counterparts, with the yen weakening to 146. The price of Brent crude oil was steady at \$78.8 while bitcoin lost almost \$5,000 to just below \$60,000.

The week was relatively light in terms of events, with a few exceptions. On the macro side, the second estimate of US Q2 GDP growth was higher than the initial one, due to stronger consumption. This combined with a reassuring core PCE inflation measure for July, at +2.6% year-on-year, and with lower-than-expected weekly jobless claims to reinforce the "soft landing" scenario over imminent recession risks. It was, however, not strong enough to affect market expectations for the Fed which, in our view, are too dovish for 2024. Finally, NVidia, the "most important company on earth" as dubbed by Goldman Sachs, released their quarterly numbers and guidance. The former was undoubtedly great, as commented at length in our previous publications, with most metrics reaching or exceeding analysts' forecasts. The guidance was also very solid in absolute, but not spectacular compared to the most optimistic expectations. The stock price fell from \$126 to a low of \$117 before rebounding to \$119. Our take: the quarterly numbers confirm that AI spending continues, the guidance implies a ramp up of the latest chip but probably some manufacturing constraints in front of a buoying demand. Hardware is hard, as the Silicon Valley motto says. This is reassuring, even if it doesn't address the key question of the timing and magnitude of the payback of AI investments for Nvidia's clients.

We start the month of September with a global economy in reasonably good shape, with abundant signs of a soft landing in the US and a slow but so far unchallenged disinflation, which justifies more easing to come from Western central banks. The first issue for us is that according to Fed funds future contracts, markets are expecting US policy rates to be cut by -100 basis points between now and the end of the year. We think that the current backdrop justifies half of that unless the economy brutally deteriorates – in which case 100 bps may even not be enough. This is a first concern. Second is asset valuations. Earnings prospects are favorable under our scenario, which justifies the current relatively high equity multiples, but leaves little fundamental upside potential. Stocks are not outright expensive compared to bonds, but bonds are not cheap. A corner of the envelope calculation for the 10-year, with 2.5% inflation, 50bps of real rates and 100 bps of term premium leads to the same as our year-end fair value of 4%. We are at 3.9%. Of course, limited fundamental for the short-term is not a reason to be outright bearish: markets can overshoot, and protecting further for the short-term bears the risk of being wrong and compromising medium term returns. In summary, markets are priced for a supportive scenario which we believe will happen, but not without being questioned. Macroeconomic data, geopolitics and of course the US elections are potential detonators for volatility episodes, which would not necessarily be more significant than the brutal yet quickly healed August turmoil.

To that extent, the week ahead will provide crucial information on the macro picture, and precious data for the Fed, especially one of the most awaited monthly job reports in a while on Friday. The median forecast is currently for 165k jobs having been created, which wouldn't be a bad number at all – far from recession levels. We'll also have to look at any revision from the July (shocking) 114k... And keep in mind that the trust in these surveys has not improved after the massive revision of 12 months of data a few days ago. Still, the unemployment rate will also matter. At 4.3%, it stands 0.8% above its 2023 trough, which is not only embarrassing for the current US administration (especially given the abysmal fiscal stimulus) but also constitutes an explicit item of the Fed's mandate. In the meantime, we will also get the final monthly PMIs for all major regions, as well as their US ISM equivalents.

As always, it started with China on the last day of the month, ie Saturday: the August official manufacturing PMI came out at 49.1, failing to meet the median forecast of 49.5 after 49.4 in July. Services however at 50.3 fare better than July's 50.2 and slightly exceed expectations. An alternative measure, the Caixin, came out this morning a bit better at 50.4 for the manufacturing, while the Jibun Bank manufacturing PMI for Japan printed 49.8, just below neutral level and an improvement compared to July's 49.5. In essence, no game changer so far.

As we write this morning, Asian markets are overall cautious. Stocks are down -1.5% in Hong-Kong, -1% in China's domestic markets, and marginally up in Korea and Japan. US cash markets will be closed today for Labor Day holiday, so there is no trading of US Treasuries in Tokyo. Still, Future contracts on the S&P500 are down -0.1%. There is no major move in currencies, except maybe for the yuan weakening -0.2% against the dollar, confirming investors' fatigue with regards to the long wait for an economic rebound there. Both gold and oil prices are down, to respectively \$2,492 an ounce and \$76.3 for the Brent. Bitcoin and ether are -1/-2% lower as well.

Today we'll look at manufacturing PMIs for India, the Eurozone, and the UK, before the US tomorrow. Have a great week ahead.

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