

OCTOBER 2024

Editorial

This third quarter was undoubtedly volatile but ultimately quite buoyant in the end. After a good start to the month, the S&P first fell by a little more than 9% between July 15 and August 5 amid concerns about the American economy after a disappointing report on employment and a wave of profit-taking on certain technological stocks, notably those linked to AI. What's more, the surprise rise in interest rates in Japan raised some eyebrows. The Bank of Japan's decision to increase rates by 15 basis points - to 0.25% - disrupted the yen carry trade. This strategy, which involves borrowing at low interest rates in Japan to invest in higher-yielding assets internationally, was popular among investors looking to take advantage of the interest rate gap. However, rising Japanese rates, coupled with anticipation of cuts by the Federal Reserve, led to significant volatility in the yen and a sell-off in the stock market as traders faced margin calls. This confluence of factors highlighted the market's deep sensitivity to both domestic and international economic signals, leading to widespread declines in major stock indexes.

Fortunately, better macro data in August showing good resilience in the American economy, coupled with rather solid results from US companies and clearer expectations of future rate cuts from the Fed, allowed the S&P500 index to rebound vigorously to reach a double historic high around 5650 points. The decision of the American Federal Reserve to lower its key rates by 50 basis points on September 18, combined with skillful and reassuring communication, even allowed the American stock market to break its highs the next day, propelling US stocks as well as European stock markets to reach new heights.

Finally, the icing on the cake, an ambitious Chinese recovery plan was unveiled on September 24, contributing to a powerful rebound in Chinese stocks (which had been suffering for

3 years) and all emerging stock markets. A real shock of confidence which can be explained by the magnitude of the stimulus, both monetary with its rate cuts, financial with the measures to support the stock market through asset buyback programs, economic through the measures made to the real estate and tax sector through the support provided to households and businesses (more details in our Special Topic on page 4).

The S&P500 thus ended the quarter with an increase of 5.53%, compared to 2.17% for the Eurostoxx50 and an unexpected +7.79% on the MSCI Emerging Markets. Since the start of the year, the progressions are as follows: +20.81% for the S&P500, +10.59% for the Eurostoxx50 and +14.37% for the MSCI Emerging Markets.

In the current international context, what room can there be for the stock markets to progress after such increases? Let's already point out that the last time the US economy avoided a recession after aggressive Fed tightening was in the mid-1990s. The stakes are high. Markets are currently priced for a soft landing, so even a mild recession is likely to trigger a correction in stock prices. But for now, soft-landing seems to be the most likely outcome in the United States. The most recent macro data even show great resilience in this economy which has been accompanied in recent months by a drop in inflation, a moderation in wage growth and an easing of pressure on the job market. work. And the Federal Reserve, which is steering rather well and which began to ease before clear signs of economic stress appeared. This constitutes a rather positive environment for the markets. Historically, stocks tend to perform well in the months following the first rate cuts.

In Europe, the economic outlook is improving very slowly after having nearly hit recession in 2023. Germany, however, for once, appears to be the weak link, with an industrial sector that

	Q3 2024	YTD 2024	Close 30/09/24
DOW JONES	8.21%	12.31%	42,330.15
S&P 500	5.53%	20.81%	5,762.48
FTSE 100	0.89%	6.51%	8,236.95
EUROST.50	2.17%	10.59%	5,000.45
CAC 40	2.09%	1.23%	7,635.75
FTSE MIB	2.93%	12.43%	34,125.26
MSCI EM	7.79%	14.37%	1,170.85
CRUDE OIL	-16.40%	-4.86%	68.17
GOLD	13.23%	27.71%	2,634.58
EUR/USD			1.1135
EUR/CHF			0.9415
EUR/GBP			0.8325
EURIBOR 1M			3.353%

is struggling due to its dependence on China and an automotive sector in great difficulty in its phase of transition to electric vehicles. Many investments have been made by manufacturers to have wide ranges of electric cars available, but it is clear that sales are not there. Tesla and Chinese brands continue to take the lion's share. France is also worrying with a significant deficit of around 6% of GDP, high debt and a situation of political instability that has recently caused the OAT-Bund spread to rise to high levels. For once, it is rather the countries of the South (Spain, Italy) that are showing economic momentum.

In any case, the moderation of inflation (several countries have fallen below the 2% mark) now gives the European Central Bank free rein to reduce interest rates. In the United Kingdom, the economy is finally showing signs of recovery after stagnating since the end of the COVID-19 lockdowns. Consumer and business confidence are picking up, while the fall in inflation has allowed the Bank of England to start easing its monetary policy. If Europe and the United Kingdom maintain this momentum and manage to avoid recession, it is, like the United States, rather positive on paper for the stock markets.

Japan's economic performance remains uneven. The Bank of Japan seems to be bucking the trend of global central banks, and there is a risk that the country will tighten monetary



policy before long-term expectations for sustained inflation of 2% are truly anchored.

In China, the stimulus plan mentioned above is timely, in a context of slowing credit and consumer confidence close to its lowest levels in history. We will closely monitor the relevance and effectiveness of the Chinese plan in the coming months. In any case, the political will seems to be there, with a growth target raised to 5% after a year in 2023 when Chinese growth figures were among the weakest since the 1990s.

From a macroeconomic perspective, the environment therefore remains rather favorable to equities. And bonds should also perform well in this context of accommodative monetary policy on both sides of the Atlantic.

So where could the risks for the markets come from?

US elections? Let's not forget that the US democratic system, with its broad checks and balances between the executive, legislative and judicial branches, makes it difficult for winning candidates and their parties to implement extremely radical changes. As a result, and over several decades, the impact of politics on US markets has been relatively limited. US stocks have tended to rise regardless of the political party in power and 60/40 diversified portfolios have generated positive returns in most presidential election years, which we expect again for 2024.

However, we are keeping our eyes open on a few risks as the November elections approach. First, tariffs. Here, it is all about scale. A uniform 10% tariff on all US trading partners is probably something that traders can accept. We have already been in a limited trade war since 2018 and this has not yet been a systemic event for markets. However, 60% tariffs on all imports from China would have completely different consequences.

Second, corporate tax developments. Democratic presidential candidate Kamala Harris is proposing to raise the corporate tax rate from 21% to 28%, while Donald Trump is

proposing to cut it to 15%. Changes of this magnitude in corporate taxes could marginally affect S&P 500 earnings per share growth. It is important to note that tax issues are legislative matters, so it will be interesting to see whether the November vote results in one party winning both the presidency and control of Congress.

Third, challenges to the Fed's independence. Former Fed Chairman Alan Greenspan once noted that he had never met a president who did not want lower interest rates. Jerome Powell's term as Federal Reserve chairman is up for renewal in May 2026. A victorious Donald Trump might be tempted to push a candidate close to him on whom he could influence the magnitude of rate cuts, at the risk of restarting inflation.



No, the real risk for the markets at the beginning of autumn 2024 is more likely to lie in the geopolitical situation. And more particularly in the possible conflagration of the entire Middle East. The markets are cynical. The thousands of deaths in the Gaza Strip over the last 12 months have not kept operators awake or the stock markets from rising. A very localised conflict with no macroeconomic consequences. On the other hand, the acceleration of events in recent days has shifted us into a completely different environment. The experts who thought Israel was incapable of managing several fronts at once will be disappointed. The decapitation of the Hezbollah movement in southern Lebanon will have left its mark on people's minds due to the ingenuity of the procedures used and the precision of the intelligence. This has forced Iran, which until now had been advancing

hidden behind its proxies, to come out into the open. On Tuesday, October 1, Iran fired nearly 200 missiles at the Hebrew state in response to the assassination of the leaders of Lebanese Hezbollah and Palestinian Hamas, thus exposing itself to a large-scale Israeli response. The Netanyahu government has a historic window of opportunity to prevent Iran from finalizing its nuclear weapons. The problem is that Joe Biden, one month before the elections, does not seem very keen on supporting his Israeli ally in this approach. The risk is that Israel will then fall back on other "easier" targets such as Iranian oil infrastructure, which would have the advantage of hitting Tehran directly in the wallet. But this would not be without consequences and could generate some volatility in the price of a barrel of crude oil, which has risen sharply over the past two days. Plus, this would not at all be to the taste of China, the main customer of Iranian oil via ship-to-ship crude transfers. Nor even the United States, anxious to keep the barrel stable as the elections approach. It is estimated that a major Israeli strike on Iranian export capacities could remove 1.5 million barrels per day from the market. Fortunately, OPEC+ has the possibility of restoring 6 million barrels/day of capacity, which constitutes a brake on an overly sudden rise in the barrel. But the risk remains of a retaliation to the response and we cannot exclude at this time that Tehran, with the help of its Houthi allies in Yemen, will embark on destabilizing global trade, by putting pressure on international maritime routes, particularly around the Strait of Hormuz.

We are obviously keeping an eye on these risks, aware of the potentially recessive impact of an uncontrolled skid in energy prices. For the time being, our portfolios are ending the quarter with good performances, with all asset classes contributing to the increase. We are maintaining a high level of diversification on quality managers, capable of allowing us to get through crises with relative serenity.

Christophe Carrafang



Macro-economy

A slowing economy and decelerating inflation reassure central bankers

Price index : 2024 under the sign of disinflation.

- Inflation in Germany, Italy and France for September is well below the ECB target of 2%; +1.8%, +1.6% and +1.2% respectively.
- This gives a figure of +1.8% for the Euro Zone with a "core" indicator of +2.7%.
- In the United States, inflation fell in August to +2.5%. It is expected to be stable for the month of September. The decline in the price of oil and, more generally, in the cost of energy, favors an easing of prices.
- Japanese monetary authorities have warned of upcoming rate hikes; inflation at 3% has persisted for several months.
- Chinese inflation is not a subject, on the contrary, the authorities have launched a recovery plan which should stimulate it (+0.6% in August).

Job market : it still resists and continues.

- In the Euro Zone, despite still sluggish economic activity and sectors in difficulty (real estate, automobiles, etc.), the unemployment rate remains surprisingly low and even displays a historic record at 6.47%. However, it should, logically, rise again by the end of the year.
- In the United States, the employment figures for the month of September surprise and reassure; job creations are rebounding and the unemployment rate stands at 4.1%.
- In China, the sudden deterioration of the job market since May was one of the factors triggering the recovery plan.

Manufacturing activity: the few positive signs from spring have not been confirmed.

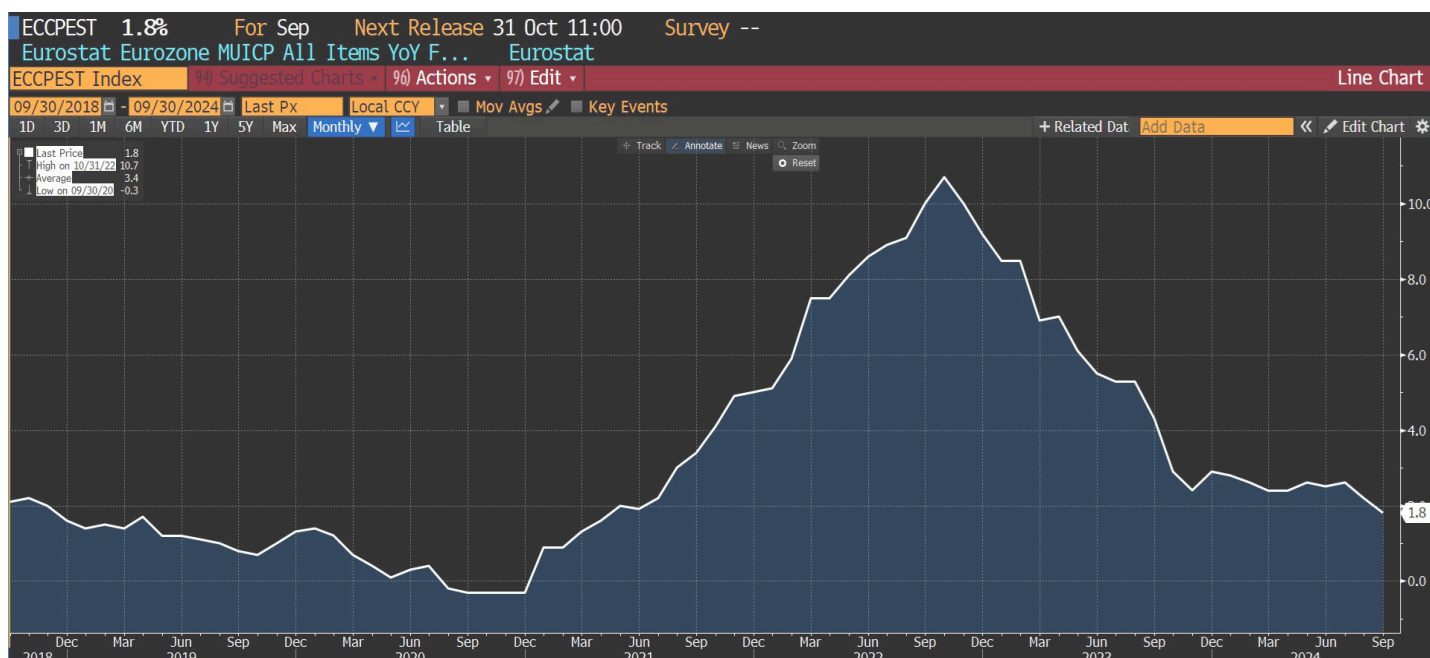
- After a few encouraging months, the overall indicator is back below 50; despite low stock levels, companies do not seem to want to replenish them immediately.
- Activity in the Euro Zone, little helped by an automobile sector in crisis, is deteriorating; the index is at its 2024 low at 44.8.
- In the USA, the indexes remain stable over the last three months (47.2).

Services activity: good resistance.

- The overall index fell slightly in September with different geographical dynamics.
- The Euro Zone slows to 51.4 with the three main countries lagging behind: France (49.6), Germany (50.6) and Italy at 50.5. Spain is an exception with a very well oriented index at 57.
- The Chinese slowdown is visible on the Caixin services indicator which lost 2 points over the quarter to 50.3.
- To the general surprise of observers, while services activity was expected to be stable at 51.7, the September figure came out at 54.9 with robust price and new orders components.

Damien Liegeois

Evolution of Inflation in the Eurozone





The Big Picture

What game is the ECB playing?

"Inflation is largely transitory."

We remember this phrase pronounced by Christine Lagarde during a speech in October 2021. We know the rest, inflation climbed to 10.6% in the euro zone. With no intention of throwing her under the bus, she did not foresee the war in Ukraine which accelerated the rise in prices.

For almost a year, inflation has been flirting with the ECB's target of 2% and even plunged below this target a few days ago, to settle at 1.8%. As on the outward journey, when inflation rises, the ECB takes all its time to react and absolutely does not seek to anticipate this disinflation, which has nevertheless been quite marked since last November.

So far, it has only lowered its key rates twice: once in June by -25bps and most recently in September by -25bps. Following this meeting, investors expected and hoped for clear indications on the future trajectory of Euro Zone rates. But they were once again disappointed and had to settle for yet another "we are data dependent".

The ECB is in no hurry to accelerate its rate cut cycle. Christine Lagarde's response contradicts the message sent by the market which anticipates a rate cut of -100bps by April 2025. This would imply rate cuts of -25bps during at least four of the next five meetings.

But the economic context is no longer the same. In Europe, we sense a slowdown in growth, particularly in Germany, where growth is expected to be 0 for 2024.

Jérôme Powell announced this summer: the Fed would start lowering its rates in September. As promised and due, it has actually lowered its rates by -50bps. This followed weak labor market data in the United States. It is worth remembering a fundamental difference between the Fed and the ECB:

The Fed has a triple mandate that allows it to provide maximum employment, stable prices and moderate long-term interest rates;

On the other hand, the ECB has a unique mandate which requires it to ensure price stability.

When we look at the evolution of inflation in Europe over recent months, disinflation seems clearly established and the fight against inflation won. In addition, some are starting to talk about a deflationary risk for the two largest economies in the Euro Zone: Germany's industrial slowdown and the budgetary crisis France is going through could impact growth in the coming months.

It is therefore difficult to imagine that the ECB will not accelerate its rate-cutting cycle in the coming months. We are comfortably exposed to a gradual decline in rates across the entire European curve in our portfolios today: both on the short and long sides, and both in Investment Grade and High Yield.

Damien Beasse

Special Topic

The Chinese Turnaround

It started with a rumor, continued with the conclusions of the meeting of the Chinese central bank (the PBOC), then the next day concluded with new announcements following a meeting of the Politburo, although this September meeting was not to be focused on economics. The idea was to make an impression and underline the determination of the authorities on the eve of the national holiday. If this is not at the level of the record stimulus of 2008, we are witnessing the most important recovery plan since that date. A sort of "Chinese whatever it takes" as analyzed by one of our managers specializing in emerging countries.

Why this urgency? Certainly the internal pressure which is growing strong with a rising discontent of the population on two central themes: the great difficulties of the real estate market which have persisted for too long, notably with the 15 million apartments not delivered but paid for; and the deterioration in recent months of the job market, especially among young graduates.



The recovery plan is therefore structured around three directions:

- 1) Monetary policy: The revival of activity by the reduction in interest rates already started continues from 1.7% to 1.5%, also a further reduction in the widely used bank reserve ratio to a level equivalent to that of 2008. The latter intervention allows the equivalent of 130 billion euros to be injected into the banking system. Further reductions should be implemented by the end of the year. The PBOC also requires banks to lower interest rates on existing mortgages by at least 0.3%, which will represent a drop of 0.5% when the rate cut is added.
- 2) Fiscal policy: Recovery through government spending with planned issuance of nearly \$300 billion in government bonds. Tax cuts are also being proposed. Many announcements are once again targeted at the real estate sector.
- 3) Equity market support policy: The idea is to restore investor confidence in a market which, according to many observers, was not the government's priority. Measures to promote access to markets: pledge facility, 300 billion yuan program

to finance share buybacks, project to establish a state support fund.

This recovery plan has been long awaited, but a certain number of investors are still skeptical about the real intention of the authorities and the scope of the measures announced, preferring to wait to see the actual impact that this will have on the economy. However, if the market starts to digest this, Chinese stock indexes could rise quickly, especially since valuations are historically low, particularly in a market that has been largely abandoned by international investors for 4 years. The last to position themselves could do so at their expense at much higher levels. Recent history shows us that "bull markets" on the Chinese market (flow market) generally do not last more than a year and deflate quickly thereafter; +70% between March 2020 and February 2021, or earlier +148% between July 2014 and June 2015. The longest, with China's entry into the WTO, between June 2006 and December 2007 advanced the index of +450%. For those who are already invested, this position could finally deliver performance, and for those who are not, the risk/return ratio deserves to be monitored closely.

Damien Liegeois

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