The Way We See It

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INSIDE THIS ISSUE

The Fed's easing cycle has started - "Soft-landers" rejoiced, "Hard-landers" still fret. We remain tactically bullish.

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments
- Global Economies

On growth dynamics, estimates for the U.S. Q3 GDP remain upbeat: an annualised growth rate of 3% is being forecast, following the final estimate of the Q2 growth annualised rate of 3%. Consumer and investment spending remain solid. Nevertheless, a number of recent economic reports have shown a mixed trend (particularly employment and manufacturing PMI survey). This has continued to raise the probability of a U.S. recession in the mind of a group of fundamental investors, and explained the large 50bps Fed Fund rate cut in the September FOMC meeting.

Europe showed mixed results: the latest economic indicators of Germany showed continuing weakness.

In spite of the above, some faint hope of recovery has emerged recently, based on China's stimulatory measures.

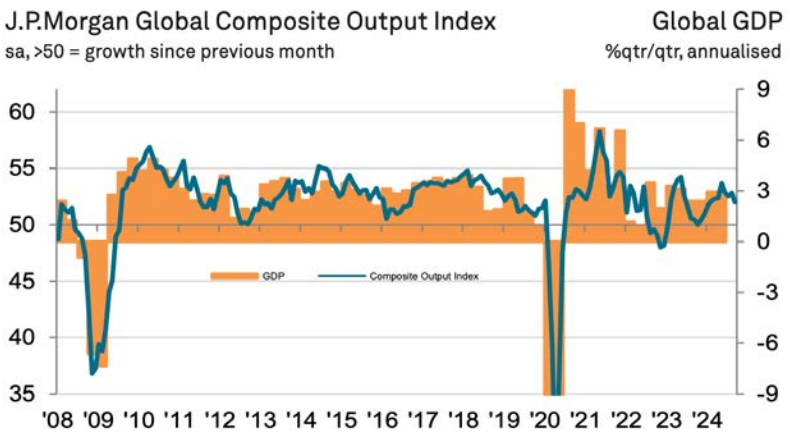
To the surprise and delight of many, the Chinese government recently implemented a much easier stance towards the property sector and its domestic stock markets. Large liquidity injections are being promised. Investors are now hoping that the government will follow up and execute a large fiscal spending program to help the weak domestic economy.

On the inflation front, in the case of Europe and other OECD countries, headline and core inflation indicators have visibly decelerated, thus raising expectations of further rate cuts from the ECB. In the U.S., the inflationary trend has also been favourable, but the core rate has not been able to break below the 2.5% pa as yet. This, when coupled with the recent surprise strengthening of the U.S. employment data, caused investors to re-price forthcoming rate reductions less aggressively. Only two 25bps cuts in the November and December FOMC meetings are being anticipated before year-end. Some even questioned whether there will be a cut in November.

Investors have re-priced forthcoming rate cuts less aggressively – 25bp x2 by year-end.

Finally, global geopolitical risks have not gone away, and, if anything, they have intensified: Russia vs Ukraine, Israel vs Hamas and Iran (heating up again after the killing of the Hezbollah leader and the retaliation of Iran). In addition, geopolitical and trade tensions between China and the U.S. remain high, particularly as the U.S. election is nearing.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global Market Intelligence

- Global Markets

Following a positive month in Equities in the U.S. and other Developed Markets in the month of August, the rally continued in September. The sectoral leadership has switched from Technology to the broader market. Nonetheless, markets' volatility remains high. Positive factors are expected to continue to be partially negated against adverse ones, resulting in a more volatile and thin trading environment.

- Positive factors include the continuing AI revolution in the U.S., global upgrades of economic and corporate earnings, hopes for a series of rate cuts following the larger-than-expected 50 bps cut by the Fed in September, and that the big-spending fiscal trend in the U.S. will continue, irrespective of who wins the election in November.

- Negative factors firstly include the somewhat expensive valuation of U.S. and other DM equity markets, together with the increasingly complacent sentiment of investors. In addition, there is uncertainty surrounding the U.S. election, wars and trade tensions, and the newly-emerging fear of a U.S. recession in the next 6-12 months.

Sectoral leadership has broadened from Technology; volatility will remain if not higher.

Near-term performance of various asset classes

Asset Class	US Equities	Global Equities	Global ex US Equities
Index	MSCI USA	MSCI World	MSCI World ex USD
1 month	2.15%	1.87%	1.15%
3 months	5.93%	6.46%	7.84%
YTD	21.69%	19.28%	13.63%
FY 2023	27.10%	24.42%	18.60%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	1.77%	1.20%	1.34%
3 months	5.84%	4.74%	5.20%
YTD	5.32%	3.84%	4.45%
FY 2023	8.52%	4.05%	5.53%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	1.81%	1.70%	2.86%
3 months	7.80%	6.98%	-1.90%
YTD	2.57%	3.60%	8.00%
FY 2023	4.18%	5.71%	-5.01%

Asset Class	GEM Equities	Asia ex Japan Equities	China Offshore
Index	MSCI EM	MSCI AC AxJ	MSCI China
1 month	6.72%	8.47%	23.93%
3 months	8.88%	10.55%	23.64%
YTD	17.24%	21.52%	29.60%
FY 2023	10.27%	6.34%	-11.04%

Source: GOJI, MSCI, Bloomberg; data as of 30/9/2024

Based on the recent stronger-than-expected U.S. economic growth data, the soft-landing economic scenario in the U.S. has gradually become the base case. Thus, in the month of September, Discretionary/ Fundamental investors appeared to have accumulated more equity exposure, at the expense of bonds (as the 10-year bond yield fell towards 3.50% pa).

The global equity universe, in USD terms, rose solidly in September, recording a +1.87% return. The U.S. did well (+2.15%), while the global equity universe (i.e. World ex U.S.) rose by +1.15%. Chinese equities was the outstanding outperformer in the month, as short-covering and strong buying by hedge funds sparked a substantial rally in China Offshore markets (+23.93%) and A shares (+23.09%).

China's support for stock market and easier monetary policy sparked a rally, but can it last?

U.S. Treasuries and other domestic and global fixed income markets finished the month with solid positive returns.

The Commodities complex bounced back after a weak couple of months, boosted by the surprisingly large easing of monetary policy by China, as well as the government's solid measures to alleviate bottlenecks in the property sector.

Market Outlook

Discretionary vs Systematic Equity Positioning

*Wtd average of Z-scores for positioning indicators, weights based on explanatory power in regression of equity performance on indicators

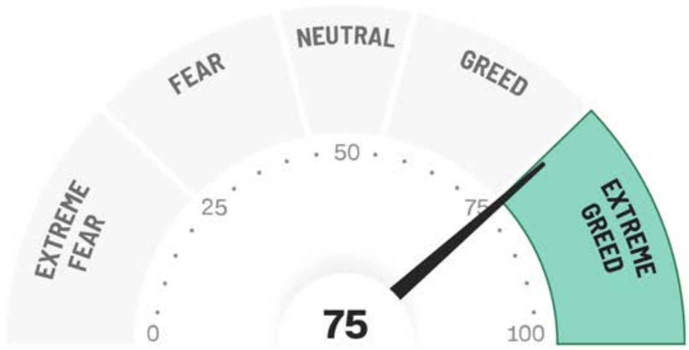
Source: Deutsche Bank Asset Allocation, as of 30/9/2024

The latest data on the equity positioning of Discretionary/ Fundamental and Systematic investors during the month showed that while Discretionary have been adding modestly, quant- and algo-driven Systematics have been more quiet. The latter remains wary of the high volatility in the U.S. stock market. This appeared to have been caused by increased hedging by investors ahead of the U.S. election, as well as the escalating war in the Middle East, the continuing investment tension between the Soft- versus Hard-landing camps, and lastly, the poor leadership of the Magnificent 7 mega caps in the U.S. stock market.

In the short-term, traders and investors' sentiment continued to oscillate between Greed and Extreme Greed.

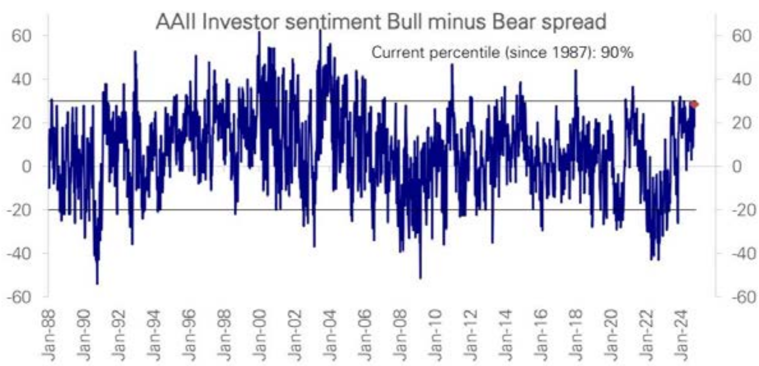
Market is driven by Greed (if not Extreme Greed).

Fear & Greed Index
- What emotion is driving the market now?



Source: CNN Business
Last update September 30 at 8:00:00 PM ET

Investor Sentiment
- Investor bull minus bear spread



Data as of 9 October 2024
Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

Short-term Technical Analysis

Since the start of the year, U.S. and global equity indices, led by AI and Semiconductor stocks, have performed strongly. Recently, there has been some rotation away from the Tech towards non-Tech.

Recently, as NVIDIA has been leading Semiconductor and other Technology stocks up, this has helped the overall market to record historical highs.

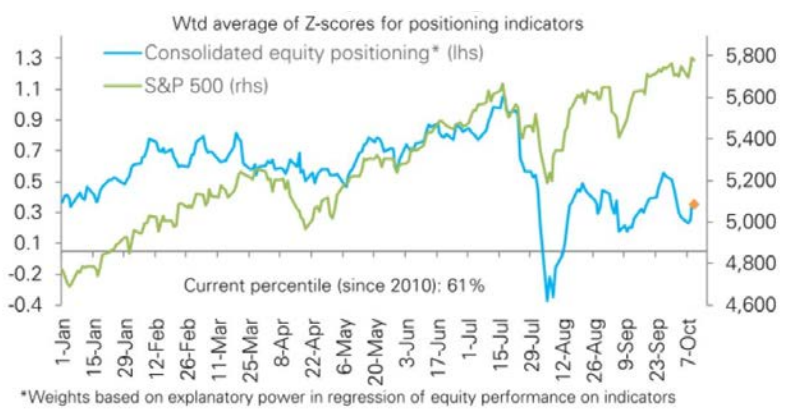
S&P 500 Stock Price Index

Source: MarketWatch.com

Similar to the trend recently established over the past few months, the sectoral leadership in equity markets has broadened out to include other countries and sectors than just the U.S. and U.S. Technology. This is a healthy sign as this serves to build a stronger foundation for the global equity bull market.

Market broadening out is healthy to build a strong foundation for global bull market.

Consolidated Equity Positioning vs S&P 500



Source: Bloomberg Finance LP, Deutsche Bank Asset Allocation

A number of investors and commentators found the above chart somewhat puzzling: it is indeed a rare occurrence when one observes that the S&P 500 Index is hitting all time highs, while the risk index VIX is trading at above 20 (normally, it should be lower, at 12-15). It is plausible that a number of investors are paying up for protection to hedge against the US electoral, escalating war risks and a more neutral/hawkish Fed.

As a result, our tactical asset allocation strategy continues to overweight global equities and underweight cash and fixed income.

GOJI: our TAA remains to o/w global equities & u/w bonds and cash.

The Way We See It

- Global Markets and Investment Thematics

At GOJI, we advocate a two-pronged strategy to invest in risk assets.

As outlined in the Special Section in our August report, following the massive liquidation by leveraged funds *(who borrowed cheap Yen to fund their equity exposure)*, **we advocated, from a Tactical viewpoint, to move from a Neutral to Moderately Overweight exposure to equities and other risky assets. Nonetheless, from a long-term strategic viewpoint, we retain our Risk-Neutral recommendation.**

GOJI: we retain a risk-neutral strategy for long-term SAA.

Long-term Risk-Neutral Strategy Rationale:

As outlined in our Global Investment Outlook for 2024 and our recent monthly reports, it is our belief that both fundamental and quant-driven investors have priced in, positioned for and have been prepared to pay up for a best-case scenario of slowing but not recessionary growth, falling inflation and lower interest rates.

A Goldilocks scenario, but with rather expensive valuations. Hence our hesitation to be overweight equities from a long-term strategic viewpoint.

Thus, our long-term strategy recommendation continues to advocate to hold a neutral exposure to risk assets, with a modest underweight exposure to ~~~

expensive risky growth assets, and overweight cash and less volatile quality assets.

In addition, while the strategy didn't work in July and August, we continue to suggest a modest exposure to in Commodities.

Lastly, now that the Fed has declared a change of their monetary policy direction from restrictive to easing, the U.S. Dollar is more likely to continue to fall modestly against all other currencies.

Tactical Moderately Overweight Strategy Rationale:

In early August, we took advantage of the massive fall of risky assets (caused by factors which are well known to all by now -please refer to GOJI's August Monthly issue-), to recommend to our clients to buy them, and build a moderate overweight exposure to risky assets.

As our research does not point to an imminent recession in the U.S., investors' positioning has not yet reached extreme overweight levels, China and the world are on a path of synchronised reflation, and that the Fed is much more likely to ensure that the U.S. economy continues to grow healthily by cutting rates and reduce the size of QT (particularly when inflation is no longer a big threat), we maintain our Tactical Bullish Risk Assets strategy.

We will monitor this tactical call carefully and will inform our readers when we wish to lock in profits

Postscript – Special Section

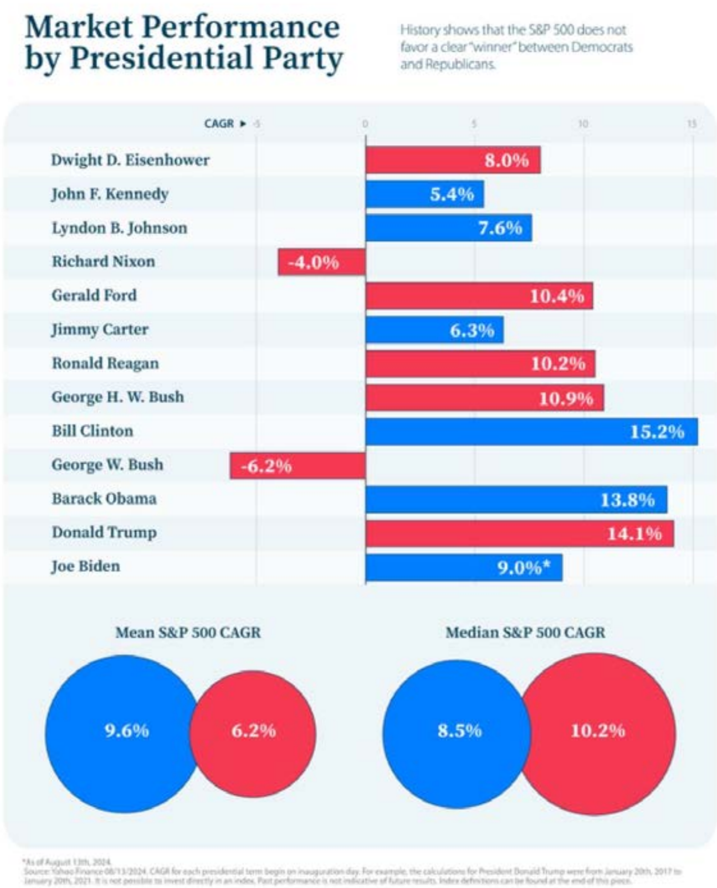
Does it matter for the U.S. equity market which party wins the election in November ?

In the long-term, it does not. American corporations have always very innovative and competitive, thus assuring a continuation of high labour and capital productivity and sustainable profits.

In the short-term, the market consensus often suggests that the Republicans have tended to be more pro-growth and friendly towards the private sector and thus the stock market.

U.S. election result won't matter for stock market, except it brings volatility in the short term.

The diagram which we include below does not particularly support this view. There are lots of other critical factors which impact of the direction of equity and other risky asset classes.



Source: www.visualcapitalist.com

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