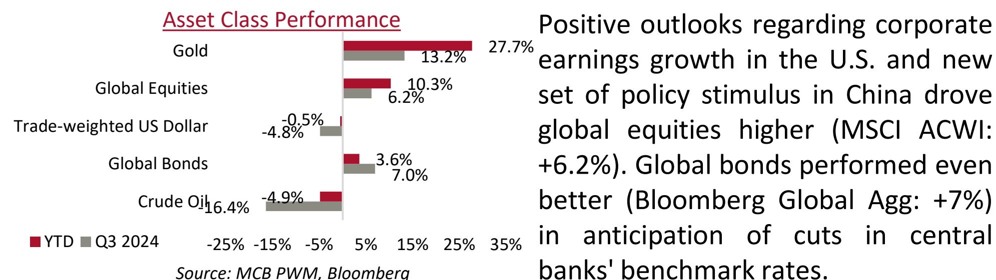
MCB

**Market Update**

*30 September 2024*

## ASSET CLASS OVERVIEW

Most asset classes recorded positive performances this quarter, despite considerable volatility at the beginning of August; triggered by events such as weaker-than-expected US unemployment figures, a rise in Japan's benchmark interest rates, profit-taking in tech companies, and the rapid appreciation of the Yen against the dollar—significantly exacerbated by a lack of liquidity.



*Source: MCB PWM, Bloomberg*

Positive outlooks regarding corporate earnings growth in the U.S. and new set of policy stimulus in China drove global equities higher (MSCI ACWI: +6.2%). Global bonds performed even better (Bloomberg Global Agg: +7%) in anticipation of cuts in central banks' benchmark rates.

Gold (+13.2%), an asset that does not yield interest nor dividends, also benefited from the rate decrease and continuing purchases by central banks in a context of heightened geopolitical risk, reaching historical highs at $2672/ounce at September-end.

Conversely, crude oil remained under pressure from weak Chinese growth and a lack of discipline among producing countries, although escalating tensions in the Middle East could potentially drive up prices. On the currency front, the US Dollar weakened against its peers as the US Dollar Index fell by 4.8% in Q3.

## MARKET OUTLOOK/PORTFOLIO POSITIONING

As we enter the final quarter of the year, our outlook on global equities remains cautiously positive overall. Whilst global growth is on a decelerating path, inflation which has been the bane of most central banks for the past 2 years now, seems to be moving towards target levels, finally allowing them to embark on an easing cycle. Furthermore, the recent broadening of the rally outside the US, notably driven by Chinese equities, if sustained, is another positive signal.

With many markets trading near all-time highs, we remain vigilant for market swings with potential triggers such as the upcoming US election, escalation in the Middle East, unexpected economic data and corporate earnings surprises.

**EQUITIES:** Our outlook on **US** equities remains positive, supported by recent and expected future Fed rate cuts, as well as the possibility of a US soft landing. Resilient earnings growth for the rest of 2024 should provide further support (with corporate earnings growth forecast of 4.2% and 14.6% for Q3 and Q4 respectively).

The broadening of the rally beyond the M-7 stocks began in Q3, a trend we expect to continue. The SP500 equal-weight (+9.5%) outperformed the SP500 (+5.2%), highlighting the strength in sectors outside of Tech and Communications. Our portfolio is well positioned to continue benefitting from this broader rally, as we maintain our underweight in Tech and Communications whilst being overweight in defensive and rate-sensitive sectors like Financials and Healthcare.

On **European** equities, we remain underweight, as the German economy continues to stagnate. Recent profit warnings from European automakers have further clouded the outlook. However, we continue to monitor for any positive impact from China's stimulus on sectors like luxury goods, materials, and industrials, which could present opportunities should conditions improve.

Despite recent market turbulence in the **Japanese** market, we maintain our overweight position, on the back of ongoing corporate governance reforms, expected strong corporate earnings and Japan's structural economic recovery. That said, uncertainty has recently emerged over the yen's appreciation. Newly appointed Premier Shigaru Ishiba's initial comments, stating that the economy is not ready for further rate hikes seems to conflict with the BOJ's willingness for gradual rate hikes. We shall continue to monitor this new dynamic closely.

We remain neutral **Chinese** equities despite the latest aggressive stimulus push. With those measures appearing to indicate a strong commitment by the authorities to prop up the country's GDP and address its ailing property market, Chinese stocks soared 25.1%, ending Q3 with gains of 16.1%. As such, for now we remain cautious about the sustainability of the stimulus rally.

**FIXED INCOME:** This quarter was a good one for fixed income in both developed and emerging markets as the Fed's and other central banks' decision to cut interest rates during the quarter provided a significant boost to bond prices.

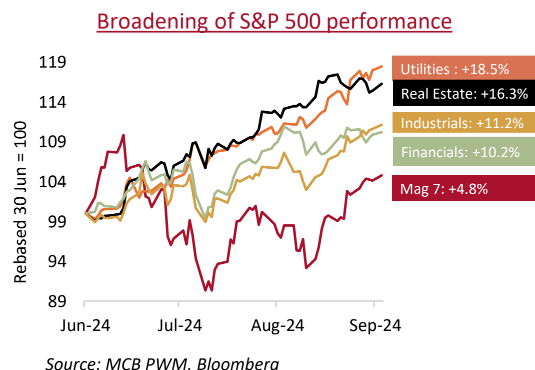
On our portfolio positioning, given that Q4 is expected to be marked by increased volatility, our stance remains cautious, prompting a preference for Investment Grade (IG) bonds over High Yield (HY) bonds as a more stable investment choice. Tactically, we maintain a strategy of extending duration of high-quality issuers for both EUR and USD as we navigate through monetary easing cycles across markets.

## GLOBAL EQUITIES

Extending the trend from last quarter, emerging markets (MSCI EM: +7.8%) continued to outperform developed markets (MSCI World: +6.0%) in Q3. The outperformance was largely driven by a strong rally in Hong Kong and China in late September (Hang Seng: +19.3%, MSCI China: +21.3%). Earlier in August, however, equity markets faced increased volatility due to concerns over weak US economic data along with a sharp appreciation of the Japanese Yen. This was followed by renewed optimism, driven by resilient corporate earnings.

US: In contrast to the first half of 2024, when performance was concentrated around the M-7 stocks, the broadening of the rally started to materialize this quarter, with a rotation from growth to value stocks. The SP500 hit several record highs, gaining +5.5% in Q3, as equities reacted favorably to the Fed's long-anticipated rate cut.

Broadening of S&P 500 performance




*Source: MCB PWM, Bloomberg*

| SP500 Sectors | Q3 2024 | YTD |
|---|---|---|
| Utilities | 18.5% | 27.4% |
| Real Estate | 16.3% | 11.5% |
| Industrials | 11.2% | 18.9% |
| Financials | 10.2% | 20.4% |
| Materials | 9.2% | 12.6% |
| Cons. Staples | 8.3% | 16.5% |
| Cons. Discretionary | 7.6% | 13.2% |
| Healthcare | 5.7% | 13.0% |
| Info. Tech | 1.4% | 29.6% |
| Comm. Services | 1.4% | 27.9% |
| Energy | -3.1% | 5.7% |

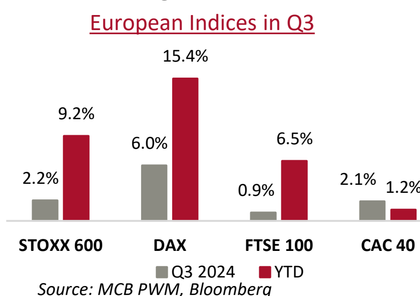
*Source: MCB PWM, Bloomberg*

The more interest-rate sensitive small caps responded more favorably, with the Russell 2000 posting a stronger gain of +8.9% over the quarter. Across sectors, Utilities led the way, as companies capitalized on strong demand for energy-intensive technologies like AI. In contrast, energy stocks underperformed, impacted by falling oil prices and weak demand from China.

Sector performance broadened beyond the tech-heavy sectors of IT and Communication services. Year-to-date, all S&P sectors have generated double-digit returns with the exception being energy.

Europe: Overall, equity markets posted more modest gains as economic data highlighted the Eurozone's sluggish recovery. However, performance diverged across the regional stock markets. The **Stoxx 600** rose +2.2%, amidst cautious investor sentiment driven by economic and political uncertainties. The Energy (-9.7%) and IT sectors (-9.9%) were the main detractors. France's **CAC 40** lagged slightly, rising just +2.1%, with its Consumer Discretionary sector (-7%) hit hardest due to weakening demand, particularly from China. The **FTSE 100** in the UK had an even weaker showing, gaining only +0.9% as its Energy sector disappointed (-14.5%). In Germany, automakers underperformed (Volkswagen, Mercedes and BMW all losing 10% in Q3) as they struggled with weak demand from China and the US, fiercer competition from domestic Chinese automakers, all worsening their outlook.

European Indices in Q3

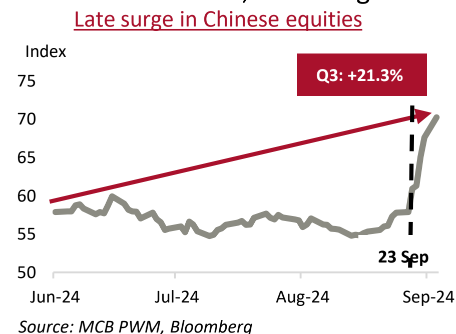



*Source: MCB PWM, Bloomberg*

However, other sectors led by a few stocks drove the **DAX** up +6.0%, outperforming its regional peers. Heavyweights Allianz (+13.7%), SAP (+7.8%) and Deutsche Telekom (+12.3%) accounted for over half of the quarter's performance. The index remains amongst the outperformers across major European markets YTD (+15.4%).

China: Chinese stocks had an impressive rally in late September on the back of stimulus measures, including interest rate cuts and fiscal support. The equity markets staged a remarkable recovery to end the quarter in positive territory (MSCI China: +16.4%), driven by optimism in consumer-driven sectors and the more supportive economic backdrop.

Late surge in Chinese equities




*Source: MCB PWM, Bloomberg*

Indian equities continued their uptrend in Q3 (Nifty 50: +7.0%) reaching new record levels along the way.

Japan: After hitting 38-year lows in Q2 the Japanese yen surged in Q3, gaining 10% against the USD. The sharp appreciation was fueled by the shrinking interest rates gap between Japan and the US, along with a sudden reversal of trades that had taken advantage of low borrowing costs in Japan. The Japanese equity market experienced extreme volatility, dropping over 20% in the first three days of August. Concerns over a US-led recession and fears that the BOJ's policy changes could hurt the profitability of Japanese exporters drove the initial decline. However, a more reassuring tone from BoJ officials helped stocks recover some of the losses, ending the quarter down (Topix: -5.8%).

## FIXED INCOME

During Q3, Global bond markets rallied by 7%, pushing the year-to-date performance into positive territory (+3.6%). Yields on US Treasuries fell during the quarter as the yield curve shifted downwards following the rate cut of 50 bps, reflecting a shift in market sentiment towards a more dovish Federal Reserve amid growing concerns about economic growth.

| PERFORMANCE OF GLOBAL BOND INDICES | | | | | |
|---|---|---|---|---|---|
| | YIELD | | TOTAL RETURNS | | DURATION |
| | 30 Sep 2024 | 28 Jun 2024 | YTD | Q3 2024 | years |
| Global Aggregate bonds | 3.3% | 3.9% | 3.6% | **7.0%** | 6.7 |
| U.S Treasury bonds | 3.8% | 4.6% | 3.8% | **4.7%** | 6.2 |
| U.S Investment Grade Corporate | 4.7% | 5.5% | 5.3% | **5.8%** | 7.3 |
| U.S High Yield Corporate | 7.0% | 7.9% | 8.0% | **5.3%** | 3.4 |
| Europe Investment Grade Corporate | 2.8% | 3.3% | 2.5% | **3.7%** | 6.5 |
| Europe High Yield Corporate | 5.9% | 6.7% | 6.3% | **3.3%** | 3.0 |
| Emerging Markets Aggregate | 6.3% | 7.2% | 8.2% | **5.8%** | 6.4 |

*Source: MCB PWM, Bloomberg*

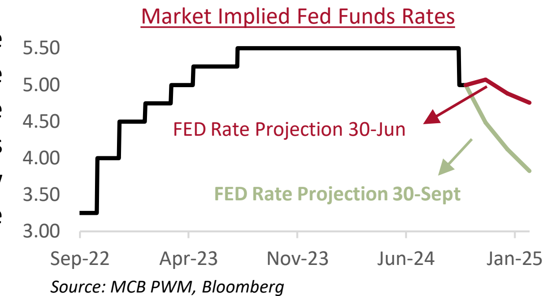
On the corporate front, IG bonds outperformed HY bonds in both EUR and USD as higher duration worked in their favor. Credit spreads of both IG and HY corporate bonds witnessed continued tightening with better-than-expected corporate earnings in Q2. Specifically, the average spread for the IG index hovered around 90 bps, just 10 bps above its lowest point in the cycle. Similarly, the average spread for the HY index stood at approximately 302 bps, with only a 40 bps difference from its cycle low. However, the total yield is still enticing at current levels.

Emerging Markets Aggregate bonds also delivered favorable returns driven mainly by the good performances of Argentina, Egypt and Kenya with more fiscal stability in those economies and improved situation in the debt and FX aspects.

## CENTRAL BANK ACTIONS

Significant decisions were made by central banks worldwide this quarter, reflecting the state of their respective economies. Notably, the Fed implemented a 50 bps rate cut in September to 4.75%-5% . In June, the dot plot indicated an expectation for a more gradual pace of interest rate cuts. In September, however, projections leaned toward a more aggressive easing cycle as the Fed sought to balance its dual mandate of price stability and maximum employment. This shift reflected concerns about a potential economic slowdown rising unemployment, particularly as inflationary pressures appeared to be abating.

Following the rate cut, the market expectation for the projected Fed Funds rate changed significantly from its June forecast. The market now expects the Fed to cut rates more aggressively going forward.



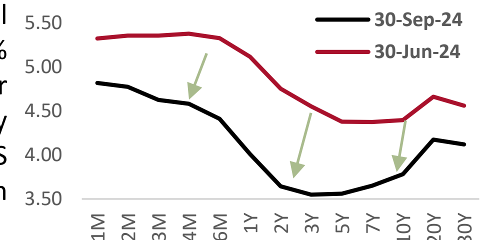
*Source: MCB PWM, Bloomberg*

The ECB responded by reducing rates by 25 bps to 3.5% in September. German and French 10-year government bond yields experienced a decline over the quarter, resulting in a corresponding price appreciation. Nonetheless, these securities underperformed their Spanish and Italian counterparts, with improved economic prospects and reduced credit concerns for Spain and Italy which emerged as the top performers within the European fixed-income market. The BOE executed a 25 bps interest rate cut in August but held rates steady in September citing persistent inflation, resulting in yields on UK gilts to rise. Investors now anticipate two additional interest rate cuts by the BOE before the year end.

In Japan, the BOJ initiated a marginal rate hike of 15 bps in July to around 0.25% but subsequently left rates unchanged in September. Japanese government bonds displayed mixed performances, with shorter-term yields declining amidst BOJ being more cautious, while longer-term yields rose due to inflationary concerns. Meanwhile, the People's Bank of China implemented a series of accommodative measures, including interest rate cuts and a reduction in the Reserve Requirement Ratio for banks. These actions contributed to a decline in Chinese government bond yields and supported the performance of the bonds.

## EVOLUTION OF US YIELD CURVE

In Q3, the 2yr and 10yr treasuries fell from 4.75% to 3.64% and from 4.40% to 3.78% respectively as the 2yr/10yr spread returned to positive territory ending the longest inversion of the US yield curve in history, spanning an astounding 793 days.



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