The Way We See It

September 2024
Issue 33

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Will the Fed's easing cycle arrive too slowly and too late?

INSIDE THIS ISSUE

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, the recently upwardly-revised annualised U.S. Q2 GDP of to 3% growth rate showed a robust rebound versus Q1's 1.4%. The Q2 GDP data was boosted by a large increase in inventories, and a more solid bounce in consumer spending. In addition, government spending also contributed positively. Nevertheless, recent economic reports have been disappointing (particularly employment and manufacturing PMI survey). This has raised the probability of a U.S. recession in the mind of a growing group of fundamental investors.

Europe showed mixed results: the latest economic indicators of Germany showed renewed weakness (probably caused by the significant fall of exports to China, which is slowing). Other tourism-intensive members of the Union appeared to have fared better.

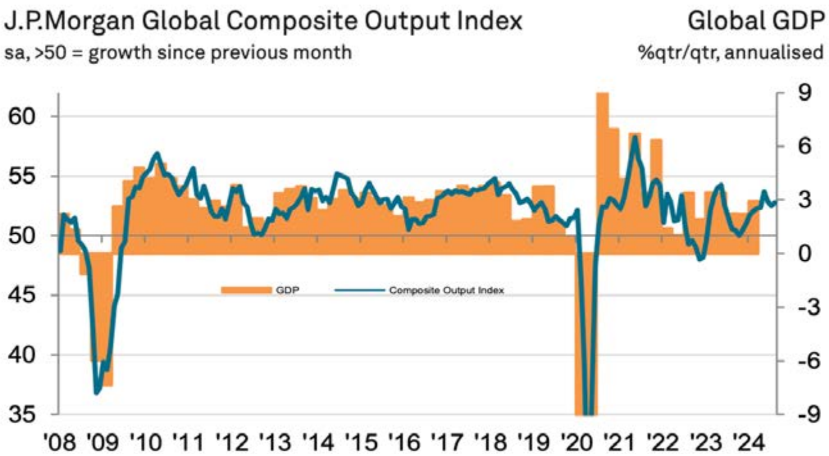
Despite the Chinese government's efforts to stimulate the domestic economy, China's growth recovery can best be described as volatile and modest. Domestic consumption and the housing sector remain quite sluggish.

On the inflation front, in the case of Europe and other OECD countries, headline and core inflation indicators decelerated, but settled at a slightly higher than the desired conventional annual 2% target set by major central banks. In the U.S., the inflationary trend has been more favourable, settling at 2.5% p.a. currently. The last three core inflation monthly numbers have been lower or not worse than expected. This, when coupled with the recent weakening of the U.S. employment sector, caused a number of investors to price in an aggressive four rate cuts (or 100bps) before Christmas.

Investors are now pricing in a 100bp Fed rate cut by Christmas.

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 this week). 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 July, the first week of August was particularly wobbly. Markets subsequently recovered, helping to produce another positive return in the month of August. Despite this, the U.S. equity market appeared to be quite unsettled in the recent weeks. Positive factors are fighting against negative 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 cut by the Fed starting this month, and that the big-spending fiscal trend in the U.S. will continue, irrespective of who wins in November.

- Negative factors firstly include the disappointment in a number of key mega-cap corporates' results and outlooks (investors' expectations were simply too high and valuations very elevated). In addition, there was a newly-emerging fear of a U.S. recession coming in the next 6-12 months, as employment and consumption indicators have slowed down more than expected.

Most asset classes rose in August, despite the "Black Monday" at the start of the month.

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	2.41%	2.68%	3.35%
3 months	7.41%	6.67%	4.87%
YTD	19.12%	17.09%	12.33%
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	1.57%	1.28%	1.44%
3 months	4.66%	4.54%	4.79%
YTD	3.49%	2.60%	3.07%
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	2.62%	2.37%	-0.39%
3 months	5.74%	5.34%	-4.53%
YTD	0.75%	1.86%	5.01%
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	1.65%	1.98%	1.01%
3 months	6.11%	6.32%	-2.07%
YTD	9.86%	12.03%	4.58%
FY 2023	10.27%	6.34%	-11.04%

Source: GOJI, MSCI, Bloomberg; data as of 31/7/2024

As the growth in the U.S. employment and retail sectors disappointed, discretionary investors have been pricing in a potential mistake by the Fed's reluctance to cut rates aggressively. They thus bought bonds and sold stocks in recent weeks. Starting from September, 100 bps rate cuts are being priced in by investors n the coming three months.

The whole global equity universe, in USD terms, was up +2.68% in August. Excluding the U.S., the global equity universe (i.e. World ex U.S.) rose by +3.35% and the China Offshore market posted a small gain of +1.01%, whereas China A saw a -1.90% loss.

The Fed chairman's announcement of an easier monetary stance at the Jackson Hole meeting caused the USD to continue to weaken.

U.S. Treasuries and other domestic and global fixed income markets finished the month with strong positive returns. The commodities complex fell, affected by fears of the U.S. slowdown and China's sputtering recovery.

Investors have been reducing exposure in risky assets.

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 31/7/2024

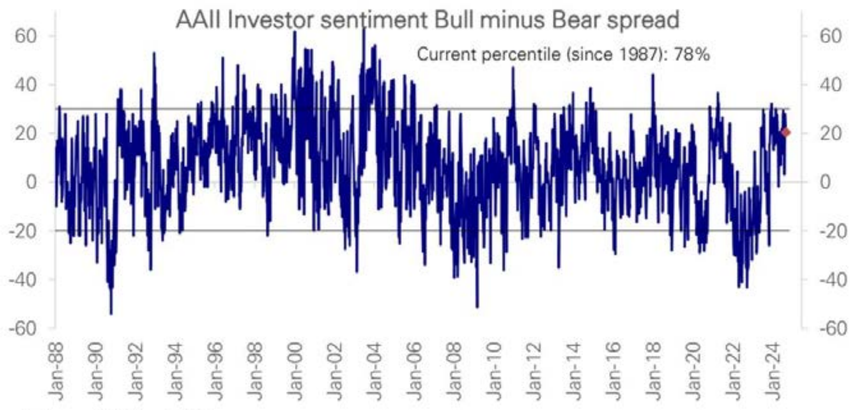
The latest data on the equity positioning of fundamental and systematic investors during the month showed that both have been reducing (or "de-grossing") their exposure. The most favoured and thus "crowded" sectors, Semiconductors, the Magnificent 7 and other high growth stocks, which had performed strongly over the past 6 and 12 months, were under significant selling pressure.

In the short-term, traders and investors' sentiment continued to oscillate between Fear and Extreme Fear. The CNN Fear and Greed index currently showed "Fear" (as of 10/9/2024), down from the "Greed" zone 10 days ago.

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

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

Investor Sentiment
- Investor bull minus bear spread



Data as of 4 September 2024
Source: Barron's, Haver Analytics, Deutsche Bank Asset Allocation

Despite historical highs being reached in the U.S. and a number of other U.S.-correlated markets, the rotation within the markets has been amplified by the substantial profit taking in NVIDIA, other Semis and Technology stocks. Proceeds have been targeting the sectors of the market index which have been left

Sentiment turned from Greed to Fear quickly in the first week of September.

in the dark over the past one to two years because of high interest rates, weakening domestic and slow earnings growth.

As a result, our view continues to stress prudence and efficient diversification in the next few months.

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 (we apologise for not emphasising this point in August), to move from a Neutral to Moderately Overweight exposure to equities and other risky assets (more on this in our Post-Script Special Section below). Nonetheless, from a long-term strategic viewpoint, we retain our Risk-Neutral recommendation.

GOJI: ST TAA to o/w moderately in equities & other risky assets; LT SAA to stay risk-neutral.

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 are prepared to pay up for a best-case scenario of slowing but not recessionary growth, falling inflation and lower interest rates. A Goldilocks scenario.

Despite the fact that we do not currently predict a recession in the U.S., our 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 lower-beta 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.

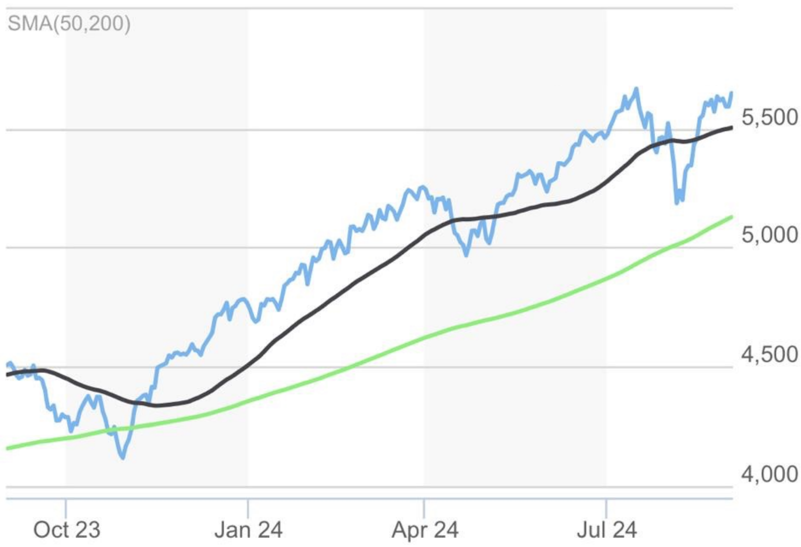
Short-term Technical Analysis

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. As the weight of the megacaps in the S&P 500 Index is very high, the weakness of the Magnificent 7 has been pulling the overall market down.

As the liquidation of equities by both Fundamental and Systematic investors appears to have only just started, unless the Fed panics a little and cuts rates aggressively, one needs to carefully monitor that this small correction does not cascade into a bear market.

Watch the Fed's policy announcements carefully.

S&P 500 Stock Price Index



Source: MarketWatch.com

Currently, from a pure technical charting viewpoint, the world leading equities' gauge, the S&P 500 Index, continues to trade in a long-term bull market.

As per GOJI's recommendation made in early June to long-term investors, we thought that it was sensible to pro-actively trim hyped-up Technology and other expensive High-Growth stocks. Proceeds were recommended to be spread to other cheaper and more defensive asset classes. This was outlined in the "Special-Topic Postscript" of GOJI's June and July monthly reports.

We retain this recommendation for now.

Postscript – Special Section

What to do with our call to "Tactical Buy Equities" last month ?

This is what we wrote in the August GOJI report:

"Recent releases of weaker than expected data relating to the U.S. employment situation, when combined with reluctance of the Fed to lower interest rates, caused fear in the trading community and a number of fundamental investors. Consequently, the growing consensus has rapidly swung from a cosy "soft" to "hard landing" scenario."

This caused an avalanche of fast and furious liquidation of assets by Yen-carry trade and other leveraged investors in the first week of August. This panicky selling created a buying opportunity for long-term investors.

We maintain our Tactical Bullish Risk Assets strategy for the time being.

Thus, in the 2nd week of August, we advocated to raise the Risk Assets' exposure from a "Neutral" to a "Modestly Overweight". GOJI's investment rationale is laid out in our August report.

Following our bullish call, risk assets bounced strongly for the rest of the month of August. But at the start of September, earlier recession and slow Fed concerns have returned, pulling the price of risk assets down again.

What to do ?

As our research does not point to an imminent recession in the U.S., and that we believe that the Fed is much more likely to ensure that the U.S. economy continues to grow healthily *(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.

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