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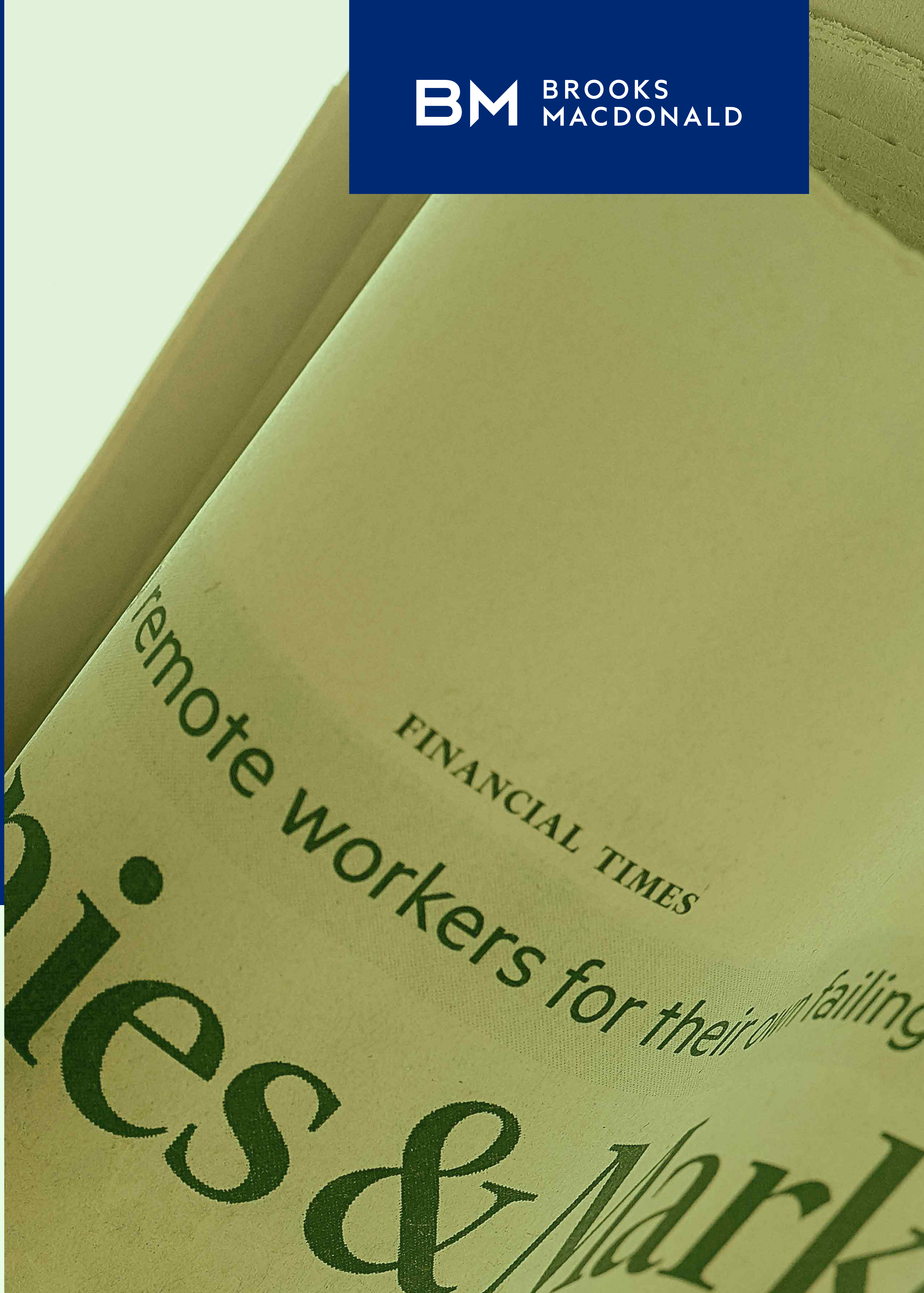
BROOKS MACDONALD

Weekly Market Commentary

5 August 2024



In summary

- Markets see some dramatic moves, as Japan endures another day of selling following last week’s surprise interest rate hike.
- We take a closer look at what is happening in Japan and why the weakness there could have an impact on assets around the world.
- US labour market data adds to a sense of economic fatigue as unemployment rises but recent hurricane ‘Beryl’ distorts the picture.
- Latest market volatility underscores the importance of seeking out asset allocation diversification in an uncertain world.

We are seeing some dramatic moves in markets coming into today. After a surprise Japan rate-hike last Wednesday triggered a degree of risk-off globally, markets were already on edge coming into last Friday.

On Friday, weaker than expected US payrolls employment data for July has proved to be a tipping-point for risk-appetite for investors, even if some of that latest labour data looks to have been heavily distorted by the recent US hurricane 'Beryl' weather impact. With worries about broader US economic fatigue overlapping the knock-on impact from Japan's rate hike last week, US S&P500 equity futures are this morning down between -2% and -3%, and UK and European markets are down a similar degree at time of writing. Looking forward to the week ahead, later today we are due to get the latest US Federal Reserve (Fed) Senior Loan Officer Survey, which will show whether or not the recent run of relative unwinding of tighter credit standards has continued. Then, on Tuesday, we have a rate decision due out from Australia's central bank alongside Eurozone retail sales data. Wednesday sees German industrial production numbers, and at the end of week we have the latest China inflation data due to land.

After the Bank of Japan caught markets by surprise with the timing of an interest rate hike last Wednesday, across Thursday and Friday last week combined, the Japanese TOPIX equity index posted its biggest 2-day decline (down -9.19% across Thursday and Friday) since the tsunami-earthquake disaster that hit the country back in 2011. That selling has extended into this week, and earlier today, the TOPIX index closed down -12.23%. According to data compiled by Bloomberg, on a 3-day-combined basis, the TOPIX index has just had its worst 3-day drop on record, on data going back to 1959. The Japan equity falls have not been helped by the stronger Japanese Yen, which has seen another move up versus the US dollar. The context here is that the Bank of Japan has made no secret of its wish to try to normalise monetary policy after decades of ultra-accommodation. Nonetheless, the timing of the interest rate hike last week caught markets by surprise. Arguably a decent part of the hitherto prior strength in Japanese equities in local currency terms has been down to the weakness in the Japanese Yen currency, which in early July was making the headlines by hitting 38-year record lows against the US dollar. With the recent significant strengthening in the Yen versus the US dollar, there is the risk of unintended consequences across other asset classes globally, as so-called 'carry trades' that had taken advantage of borrowing in Yen to invest in relatively higher yielding assets internationally, might now be forced to be unwound. Coming at a time when, for many, the traditional summer-holiday month August is often characterised by days of quieter trading volume activity, there is a particular near-term risk of heightening volatility which could amplify market moves.

It has been a little while since markets were really focused-in on US recession risks, with a so-called economic 'soft-landing' having moved into the mainstream consensus for investors in recent months. However, that view might change a little following the latest US labour data that came out last Friday. With the US unemployment rate for July rising to 4.3%, up from 4.1% the previous month (and versus 4.1% expected), it is the highest rate in almost three years, since October 2021. The latest data has also triggered the so-called 'Sahm rule' named after a former US Federal Reserve economist Claudia Sahm. The Sahm rule says that when the average jobless rate over three months is 0.5 percentage points above the 12-month low, a recession is coming. For context, it is worth noting that Claudia Sahm has pushed back on reading too much into her own rule recently. As Sahm said only last month in a 'Substack' written post, "a recession is not imminent, even though the Sahm Rule is close to triggering", and also that "the Sahm rule is likely overstating the labor market's weakening due to unusual shifts in labor supply caused by the pandemic and immigration".

The jump up in market volatility in the past few days comes at a time when markets have hitherto been riding high – indeed, the US S&P500 equity index was posting record highs less than a month ago. However, the latest market moves are a reminder of the importance that we place on diversification across our asset allocation. While much has been made of the high valuations in US equities for example, looking at the global ex-US equity markets, these in aggregate are trading almost exactly in-line with their two-decade-plus average. Furthermore, we are encouraged by a recent broadening out in performance across developed equity markets, which is supportive of our small & midcap exposures, including such exposures that we added to in the US earlier this year. Closer to home, we have kept our conviction around our maintained UK equity allocations against a relative UK equity reduction by our benchmark Personal Investment Management & Financial Advice Association (PIMFA) earlier this year; we believe that following a long period of relative equity underperformance, there is arguably ample 'runway' for a durable tailwind for UK equity relative outperformance going forwards. These are but a couple of examples, where we recognise that following a period of very strong broader equity index level performance, there is a risk of some consolidation, but our diversification means that we can still seek out and position for opportunities that we expect to add relative value.

Economic indicators (week beginning 29 July 2024)

Day	Data Release	Consensus	Prior	Actual
Mon	United Kingdom Mortgage Approvals Jun	60.3k	60.0k	60.0k
Tue	Japan Jobless Rate Jun	2.6%	2.6%	2.5%
	United States Conf. Board Consumer Confidence Jul	99.5	100.4	100.3
	Germany CPI YoY Jul P	2.2%	2.2%	2.3%
	Germany CPI MoM Jul P	0.3%	0.1%	0.3%
	Japan Job-To-Applicant Ratio Jun	1.24	1.24	1.23
	Australia Building Approvals MoM Jun	-2.3%	5.5%	-6.5%
	France GDP QoQ 2Q P	0.2%	0.2%	0.3%
	Italy GDP WDA QoQ 2Q P	0.2%	0.3%	0.2%
	Germany CPI EU Harmonized YoY Jul P	2.5%	2.5%	2.6%
Wed	Japan Industrial Production MoM Jun P	-4.5%	3.6%	-3.6%
	United States FOMC Rate Decision (Upper Bound) 11505	5.5%	5.5%	5.5%
	China Manufacturing PMI Jul	49.4	49.5	49.4
	France CPI YoY Jul P	2.4%	2.2%	2.3%
	Italy CPI EU Harmonized YoY Jul P	1.2%	0.9%	1.7%
	Australia CPI YoY 2Q	3.8%	3.6%	3.8%
	Italy CPI EU Harmonized MoM Jul P	-1.2%	0.2%	-0.8%
	United States ADP Employment Change Jul	149k	150k	122k
	Australia CPI QoQ 2Q	1.0%	1.0%	1.0%
	United States MBA Mortgage Applications 46204	--	-2.2%	-3.9%
	Australia Retail Sales MoM Jun	0.2%	0.6%	0.5%
	Japan BOJ Target Rate (Upper Bound) 11505	0.1%	0.1%	0.3%
	Germany Unemployment Change (000's) Jul	15.0k	19.0k	18.0k
	Canada GDP MoM May	0.1%	0.3%	0.2%
	United States MNI Chicago PMI Jul	44.5	47.4	45.3

Day	Data Release	Consensus	Prior	Actual
Thu	United Kingdom Bank of England Bank Rate 37104	5.0%	5.3%	5.0%
	United States Initial Jobless Claims 46569	236k	235k	249k
	France HCOB France Manufacturing PMI Jul F	44.1	44.1	44.0
	United States ISM Manufacturing Jul	48.8	48.5	46.8
	China Caixin China PMI Mfg Jul	51.5	51.8	49.8
	Japan Jibun Bank Japan PMI Mfg Jul F	--	49.2	49.1
	Italy HCOB Italy Manufacturing PMI Jul	46.0	45.7	47.4
	Germany HCOB Germany Manufacturing PMI Jul F	42.6	42.6	43.2
	United Kingdom S&P Global UK Manufacturing PMI Jul F	51.8	51.8	52.1
	Canada S&P Global Canada Manufacturing PMI Jul	--	49.3	47.8
	United States S&P Global US Manufacturing PMI Jul F	--	49.5	49.6
	United Kingdom Nationwide House PX MoM Jul	0.1%	0.2%	0.3%
	United Kingdom Nationwide House Px NSA YoY Jul	1.8%	1.5%	2.1%
	Australia Trade Balance Jun	A$5000m	A$5773m	A$5589m
Fri	United States Change in Nonfarm Payrolls Jul	178k	206k	114k
	United States Durable Goods Orders Jun F	-6.6%	-6.6%	-6.7%
	United States Unemployment Rate Jul	4.1%	4.1%	4.3%
	Italy Industrial Production MoM Jun	0.0%	0.5%	0.5%
	France Industrial Production MoM Jun	0.9%	-2.1%	0.8%
	United States Factory Orders Jun	-3.1%	-0.5%	-3.3%

Source: Bloomberg, data accessed 5 August 2024.

Economic indicators (Week beginning 5 August 2024)

Day	Data Release	Consensus	Prior
Mon	France HCOB France Services PMI Jul F	50.7	50.7
	France HCOB France Composite PMI Jul F	49.5	49.5
	United States ISM Services Index Jul	51.0	48.8
	Australia Melbourne Institute Inflation MoM Jul	--	0.3%
Tue	Australia RBA Cash Rate Target 38930	4.4%	4.4%
	Germany Factory Orders MoM Jun	0.5%	-1.6%
	United States Trade Balance Jun	-$72.5b	-$75.1b
Wed	United States MBA Mortgage Applications 37469	--	-3.9%
	Germany Industrial Production SA MoM Jun	1.0%	-2.5%
	China Trade Balance Jul	$98.20b	$99.05b
	China Exports YoY Jul	9.1%	8.6%
Thu	United States Initial Jobless Claims 37834	243k	249k
	Japan BoP Current Account Balance Jun	¥1865.0b	¥2849.9b
	United States Wholesale Inventories MoM Jun F	0.2%	0.2%
Fri	China CPI YoY Jul	0.3%	0.2%
	Italy CPI EU Harmonized YoY Jul F	1.7%	1.7%
	Germany CPI YoY Jul F	2.3%	2.3%
	Canada Unemployment Rate Jul	6.5%	6.4%
	China PPI YoY Jul	-0.9%	-0.8%
	Germany CPI MoM Jul F	0.3%	0.3%
	China Money Supply M2 YoY Jul	6.0%	6.2%
	Canada Net Change in Employment Jul	28.7k	-1.4k
	Germany CPI EU Harmonized YoY Jul F	2.6%	2.6%

Source: Bloomberg, data accessed 5 August 2024.

Asset market performance

		As at Friday close		YTD	
Index	Value	CR	TR	CR	TR
MSCI UK GBP	2338	-1.30%	-1.22%	5.54%	8.17%
MSCI USA USD	5082	-2.16%	-2.15%	11.63%	12.25%
MSCI Europe ex UK EUR	197	-3.08%	-3.06%	2.90%	4.95%
MSCI AC Asia ex JPN USD	554	-0.83%	-0.80%	4.69%	6.41%
MSCI Japan JPY	1562	-6.05%	-6.05%	7.88%	8.90%
MSCI Emerging Markets USD	1061	-1.03%	-1.00%	3.66%	5.48%
Barclays Sterling Gilts GBP	234		2.30%		0.12%
GOLD USD	2443	2.35%		18.43%	
WTI Oil USD	74	-4.72%		2.61%	
MSCI PIMFA Income		-0.30%	-0.27%	4.18%	5.69%
MSCI PIMFA Balanced		-0.66%	-0.63%	4.74%	6.21%
MSCI PIMFA Growth		-1.18%	-1.15%	6.06%	7.43%

Source: Bloomberg, MSCI: please see important information, data accessed 5 August 2024.
YTD denotes year to date, TR denotes total return and CR denotes capital return.

Important information