Parmenion

5TH SEPTEMBER 2024 | 3 MIN READ

August Market Update: Setbacks and safe havens

In a nutshell

1. Historic losses in Japan as the Yen strengthens
2. Bonds provide diversification
3. Nvidia beats expectations, but still disappoints

What's moving markets

August is usually a quiet month in the markets, with investors typically trading spreadsheets or sunshine, but this year markets had other ideas. The first half of the month delivered huge volatility, historic single-day losses, and plenty of chat about "carry trades". After the initial excitement, markets cooled off in the second half, and mid-risk portfolios finished the month pretty much flat.

But that flatness hides a lot of activity beneath the surface.

US labour market data came in weaker than expected at the start of the month, with unemployment ticking up to 4.3%. This triggered the 'Sahm rule', a real-time recession indicator that suggests if the three-month unemployment rate exceeds its 12-month low by more than 0.5%, you're in a recession.

There's been a fair bit of debate over whether the rule holds true given current labour market dynamics. However, the key takeaway is that the Fed is more likely to cut interest rates sooner, strongly suggested in subsequent comments from Fed Chair, Jerome Powell, and other members of the Federal Reserve. Anything other than a cut to US rates in September would be a big shock. 25bps or 50bps appears the only outstanding question.

The Bank of Japan are going in the opposite direction, raising rates from a 0-0.10% range to 0.25% - an important next step in their planned hiking cycle. This, in combination with the Fed's assumed rate cuts, had a big impact on the currency market. The Yen, which has been weakening for years, suddenly surged, creating ripple effects across the market.

Alot of investors using carry trades (borrowing in a low-cost currency and investing somewhere else, for a higher return) were forced to unwind them. Precise numbers are unclear, but consensus is 'a lot'. The Yen has provided the perfect vehicle for carry trades for a long time given the zero interest rates in Japan. It's hard to pinpoint exactly where the money was going, but Japanese stocks and US Tech are two key destinations.

Unwinding these positions led to forced sales of stocks. Combined with lower summertime liquidity, this caused a sharp negative reaction. The S&P500 was down 6% and the TOPIX (Tokyo Price index) fell 12% in a single day. The 20% total drawdown in the Japanese market is the third biggest on record, after the Great Financial Crisis and the Fukushima disaster.

A key reason the Japanese market reacted so strongly is the level of exporting companies in the index. A strengthening home currency reduces overseas revenue once it's translated back, reducing company margins and adding further selling pressure. Even so, the reaction felt disproportionate.

Nvidia reported their earnings at the end of the month. This is currently one of the most important quarterly events. Whether Nvidia beats expectations or not sets the tone for the wider market, as well as the fortunes of active fund managers. Interestingly, numbers were broadly positive and often ahead of analyst expectations, yet the stock was punished, falling more than 6% in aftermarket trading. It's a measure of current sentiment that it's not enough to just beat expectations, it needs a sizeable margin. "Priced for perfection" comes to mind.

Meanwhile, market and Central Bank interest feels like it has shifted from inflation to employment. This only holds so long as inflation behaves as expected. Reads this month from the US and UK were both there or thereabouts, at 2.9% and 2.2%, respectively.

Finally, Fixed Interest had a positive month and, importantly, went up in value when equities sold off. This is what we refer to as negative correlation and is a key aspect of multi asset investing. More specifically, it's the conditional correlation - how the asset class behaves during periods when equities go down in value - that's most critical. In that sense, Fixed Interest delivered as it should during the month.

Name	1m	3m	YTD	1yr	3yr
FTSE Actuaries UK Conventional Gilts All Stocks	0.52	3.56	-0.26	6.81	-22.31
ICE BofA Global Corporate	1.12	4.01	3.65	8.81	-6.12
ICE BofA Global High Yield	1.46	4.16	6.74	12.83	3.47
FTSE All Share	0.45	2.40	11.29	16.98	24.35
FTSE USA	0.16	4.13	15.40	22.19	32.54
FTSE World Europe ex UK	1.54	-0.06	8.84	15.78	18.68

Name	1m	3m	YTD	1yr	3yr
FTSE Japan	-1.76	2.39	9.10	14.44	16.19
FTSE Asia Pacific ex Japan	-0.12	2.89	7.63	12.66	0.31
FTSE Emerging	-0.37	2.42	7.73	11.89	0.00

Source: FE Analytics, GBP total return(%) to last month end

Author

Jasper Thornton-Boelman
Investment Director

Parmenion