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Market View
A look back at the quarter

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At a glance

- Market volatility and recovery: concerns over a slowing US economy and delayed Federal Reserve rate cuts coupled with Japan's rate hikes, initially shook markets, but strong fundamentals led to a quick rebound.
- Diverse rally and political shifts: the equity rally broadened beyond tech stocks, while political shifts saw momentum swing in the US election and Labour's landslide win in the UK.

- China's economic boost: China's aggressive stimulus measures significantly lifted its markets, with broader global benefits expected in commodities, raw materials, and luxury goods.

Equity markets experienced a shake-out over concerns the US economy may be stalling and concerns that the Federal Reserve was too late to cut rates. This was exacerbated when the Bank of Japan (BoJ) raised interest rates and guided towards more increases. Fortunately, fundamentals prevailed, and stocks quickly rebounded from their August lows.

We witnessed the central bank cutting cycle pick up steam when the Fed took the bold move of cutting rates by 0.50%, becoming the latest bank to lower rates in the global easing cycle. Both equities and bonds performed well during the quarter. The equity rally in particular was more broad-based, including a variety of sectors rather than just focus on the Magnificent 7 stocks. On the political front, two assassination attempts and a new candidate in the United States kept the headlines coming ahead of the November election. In the UK, Labour won the election by a landslide, though the new government's honeymoon period is proving to be short-lived.

Equity market returns broaden out

While most of the S&P 500's gains in the first half can be attributed to just a handful of technology stocks, August proved the importance of diversification. The BoJ raising rates for the second time this year led to a sharp rally in the Japanese yen and resulted in a sharp global equity market sell-off as investors reduced exposure to leveraged positions. Japanese equity markets suffered particularly with the Nikkei falling 12% on 5th August, finishing the quarter down 3.6%. However, as this sell-off was more driven by technical reasons and not fundamental causes, the market rebounded strongly from the lows of early August to hit new highs in recent weeks.

Despite growth concerns mounting, the S&P 500 finished the third quarter up 5.9%, compared with around 9% for both the S&P 500 Equal Weight and the Russell 2000 smaller caps index. Ten-year Treasury yields fell over 0.6% over the quarter, ending just below 3.8%.

Political swings

Republican candidate Donald Trump appeared to gain momentum in July following an assassination attempt, before tilting back towards Kamala Harris who became the Democratic nominee once President Joe Biden stepped out of the race. Harris has garnered support, particularly after she outshone Trump in a debate in September. Nonetheless, the November election remains too close to call and will come down to a few crucial swing states.

Meanwhile in the UK, euphoria around Labour's landslide victory was short-lived. Prime Minister Keir Starmer and his cabinet claim a £22 billion hole in public finances leaves them with no alternative but to raise taxes in the October budget.

Rate-cutting cycle starts

The global rate-cutting cycle picked up steam in the third quarter, with the Fed kick-starting its rate cutting cycle with a half-point reduction. Equities experienced some volatility leading up to the meeting, with expectations oscillating between whether the Fed would cut rates by 0.25% or 0.50%. The Fed's decision to go with the larger half-point reduction underlines their focus on the labour market as inflation concerns fade. The Fed's projections now indicate rates may fall by a total of 2% by December 2025, including September's reduction.

The Bank of England (BoE) also lowered interest rates in August to 5% from 5.25% while the European Central Bank (ECB) engaged in its second 0.25% rate cut this year to 3.5%. This saw the dollar fall versus other currencies, with sterling strengthening close to 6% over the quarter.

China's confidence drive

China's 5% GDP growth target seemed unachievable after a year of trivial returns and stagnant growth, leading many economists to downgrade their outlook for the region as a result. This prompted China's central bank and financial regulators to announce a series of daring policies that went beyond market expectations. With sentiment in the region at historic lows and the stock market trading at levels seen in 2019[1], the authorities needed to act to stabilise the economy and restore confidence.

The People's Bank of China (PBoC)'s economic policies include reducing short-term lending rates; cutting the amount of cash banks are required to hold; reducing both the average interest rates on existing mortgages and downpayments for second home purchases; and injecting over $100 billion to help bolster equity markets. These larger-than-expected policies had an immediate impact, with both the Hang Seng and Shanghai Composite surging, bringing their third quarter gains to 21.7% and 14.3%, respectively.[2]

The impact of this stimulus will go beyond the mainland's borders—China is a major market for commodities, raw materials, construction, automotive and luxury goods, so renewed interest in China will undoubtedly lift these sectors as well.

Oil prices remained in flux, due to potential additional supply from Libya and Saudi Arabia. Ongoing Middle Eastern tensions means a resolution in the region appears unlikely. Copper prices rose 9.8% in September, rebounding from losses earlier this year on the back of the recent news from China.

Outlook

Concerns remain over the US labour market, and it remains to be seen whether the Fed has engineered a soft landing. As the Fed's focus shifts from inflation to the labour market, inflation targets among other central banks will likely result in more measured cutting cycles.

We are cautiously optimistic about China and Asia more broadly, as China's recent policy measures should support the economy. We note there are plans for further policy measures.

The US election remains a global wildcard. As always, we continue to monitor geopolitical risks while constructing portfolios, but our focus remains on quality companies able to withstand political turbulence and deliver solid returns over the medium to long term.

[1] Bloomberg

[2] Bloomberg, Deutsche Bank