MONTHLY UPDATE

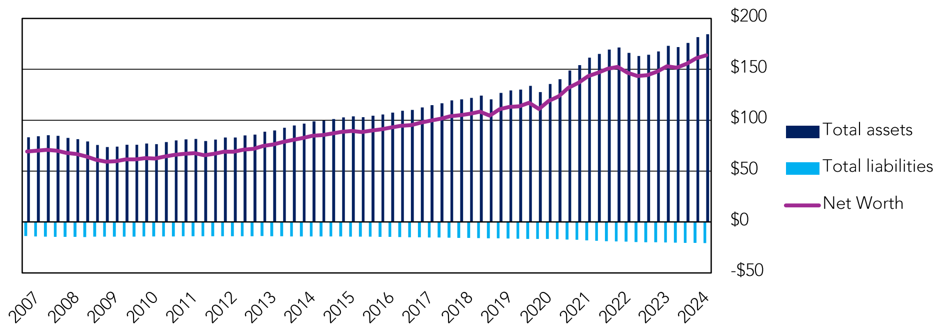
Latest views from the investment team

Don’t fight the Fed

Probably the biggest market event in September was the first US rate cut in over four years. At 0.5%, the size of the reduction was larger than many anticipated and has reinforced the Federal Reserve’s commitment to provide support and stimulus to the US Economy. Markets welcomed the move with US stocks hitting a new all-time high following the rate cut. Our flash update ‘The US goes large’ provides more detail.

The health of US households was much talked about in September due to the household savings rate, the proportion of a household’s income that is saved, declining. While this might imply households are struggling, it's important to also factor in overall household wealth, including assets like pension savings and home values. Therefore, the Federal Reserve’s quarterly report on household balance sheets, published in September, provides valuable information. This data showed that household wealth has risen yet again, driven by higher stock and bond prices, and indicates less need for households to build additional savings. It was the opposite situation in 2008 when household wealth declined for six consecutive quarters. This is demonstrated in the chart below and goes a long way to explaining why consumer spending remains strong.

Balance Sheet of US Households and Nonprofit Organisations, (USD tn)



This higher wealth, combined with the higher interest rates seen in recent years, has led to the demand for borrowing decreasing, leading to a decline in household debt. With rate cuts now underway and with more expected, mortgage rates are now substantially lower than a few months ago and, as a result, mortgage applications are picking up. Lower rates generally suggest that consumer activity should remain strong, and this is supportive for corporate earnings.

In the UK, the Bank of England left interest rates unchanged in September following an initial cut the previous month. This has boosted Sterling to its highest level against the US dollar since early 2022, as relatively higher UK interest rates attract investors to higher yielding UK deposit accounts. We expect rates to be reduced more gradually in the UK which should add further support for Sterling. Policymakers are closely monitoring UK wage growth, which is proving quite persistent, and is currently around 5%. In turn, this is leading to stickier inflation in the services sector. There has been only limited growth in worker availability post-Brexit, in contrast to the US where immigration has been large. Another UK rate cut is expected by year-end though, following the fall in inflation to date.

Month by numbers

Change in various markets over the month:

Asset		Change Value
Equities		
UK	↓	-1.77%
Europe	↓	-0.4%
US	↑	2.12%
Emerging Markets	↑	5.56%
Japan	↓	-2.33%
Bonds/Rates *Absolute change (%)		
UK Base Rates	-	0.00%
		5.00%
Fed Funds Rate	↓	0.50%
		5.00%
UK 10-Year Yield	↓	-0.01%
		4.01%
US 10-Year Yield	↓	-0.13%
		3.79%
Currencies		
GBP/USD	↑	2.05%
		1.34
GBP/EUR	↑	1.00%
		1.20
DXY (USD Index)	↓	-0.90%
		100.78
Commodities		
Gold	↑	5.25%
		$2,634.86
Oil (Brent)	↓	-8.92%
		$71.77
Noteworthy		
Chinese Equities	↑	20.97%

October 2024

As of 30 September 2024

Another notable event this month came in Japan where there was a leadership contest among the ruling LDP party following a resignation announcement from incumbent Prime Minister Kishida. Shigeru Ishiba unexpectedly proved victorious, triggering a negative reaction in Japanese stocks. Ishiba supports higher interest rates and has voiced concerns about the depreciation of the Japanese Yen (which has largely been a consequence of low Japanese interest rates). While he is popular amongst many individuals, who have endured higher prices on imported goods due to a weak currency, his appointment raises concerns about corporate profitability for exporters who benefit from more competitive prices when the Yen is weak.

Bottom line
Rate cuts encourage households and businesses to borrow more, increasing the money available for spending and investment. In the US, the Federal Reserve's decision to start with a 0.5% cut and their signal that further easing will come, sends a positive signal for stocks and corporate bonds, especially while the economy and the consumer remains strong.

Q&A

What's going on with Chinese stocks?

Chinese stocks have not recovered from the adverse impact of Covid-19 lockdowns and are in negative territory since early 2023 when its borders were reopened to international visitors. In comparison, global equities, in Sterling terms, are up around 30% since early 2023. While consumer confidence has rebounded in many economies since reopening, it remains very low in China, negatively impacting retail spending and company earnings. The property market is particularly weak due to an overhang of incomplete properties and high debt levels among developers. In response, Chinese authorities announced stimulus measures in September, including rate cuts, funding for share buybacks and pledges to increase government spending. The commencement of rate cuts in the US has enabled China to stimulate with less concern about currency weakness and associated investor outflows. The move is welcome, and Chinese stocks have outperformed sharply since the announcement.

Why has Brazil's central bank raised rates?

While the world has focused on the US rate cut, it is interesting to note that Brazil went the other way and increased interest rates last month. Rates were increased by 0.25% to 10.75% with more hikes signalled. Growth in Brazil is strong, and policymakers have expressed concern over rising prices, especially food and energy, and expectations for future inflation. Floods this year have pushed up food prices, weighing heavily on Brazil's low-income population. Inflation has been above 4% for the last three months, ahead of the 3% target. Brazil has a history of inflation problems and was among the first central bank to increase rates in early 2021 in response to rising prices. September's rate hike has helped to support the Brazilian Real, which has depreciated over 12% against the US Dollar this year; this should dampen the cost of imports and ease inflation pressure going forward.

For more information, please contact your adviser.