Allianz Global Investors

07/2024

Market Snapshot

Equity Snapshot

United States

In the US, the broad-based S&P 500 Index closed the month slightly higher while the tech-heavy Nasdaq Composite Index declined as technology companies, particularly AI-related ones, slumped. Among the mega-cap Magnificent Seven stocks, Meta, Alphabet and Microsoft entered correction territory, having fallen at least 10% from their peak in mid-July. Semiconductor stocks, including NVIDIA, also tumbled. In contrast, smaller companies surged, with the small-cap Russell 2000 Index outperforming the larger cap Russell 1000 Index by more than 8% over the month.

US economic news was mixed. US second-quarter GDP expanded by a stronger-than-expected 2.8% on an annualised basis in the second quarter. Job growth remained resilient, with the US economy adding 206,000 new positions in June. The flash estimate of the S&P Global US composite purchasing managers' index reached 55.0 in July, the highest level since April 2022, as services activity accelerated although manufacturing unexpectedly declined to 49.5. The University of Michigan consumer sentiment index dipped to an eight-month low of 66.4 in July, from 68.4 in June and the lowest level since November 2023, while retail sales were flat over June.

Headline inflation slowed to a one-year low of 3.0% in June. While the US central bank kept rates on hold at a 23-year high of 5.25%-5.5%, Federal Reserve chair Jay Powell signalled that rates could be cut in September, saying that the US economy is no longer "overheated" and the labour market is showing further signs of cooling.

Europe

Euro-zone equities closed July flat. At a sector level, information technology stocks fell sharply, with ASML hurt by reports the US may consider tougher restrictions on what semiconductor equipment can be sold to China. Luxury goods companies were also hit after LVMH reported slower-than-expected sales in the second quarter. At the other end of the scale, utilities companies were the strongest performers. In political news, the second round of France's parliamentary elections resulted in no outright majority for any party, although the far-right RN slumped to third place. France now needs to form a coalition government although the process will not commence until after the Paris Olympic Games.

The euro-zone economy grew 0.3% in the second quarter, slightly above forecasts and the same growth rate as in the first quarter. Growth appears to be stagnating in the second quarter. The HCOB euro-zone composite purchasing managers' index (PMI) fell to a five-month low of 50.1 in July. Services activity fell from 52.8 to 51.9, while the manufacturing index dropped from 45.8 to 45.6. Headline euro-zone inflation quickened to 2.6% in July, up from 2.5% in June. As widely expected, the European Central Bank (ECB) kept rates on hold as minutes of its rate-setting meeting in June showed that policymakers had been divided over whether to cut rates by 25 basis points given higher-than-expected wage growth. ECB president Christine Lagarde said another cut in September was "wide open" as she noted that "the risks to economic growth are tilted to the downside".

Asia

Equity markets in Asia were mixed in July. The tech-heavy markets of Taiwan and South Korea sold off, and China stocks retreated to five-month lows, undermined by ongoing concerns over the trajectory of the domestic economy. Growth data was weaker than expected in the second quarter, while inflation remained close to deflationary levels. India stocks continued their strong year-to-date performance, buoyed by domestic liquidity and despite the budget announcement of a hike in the capital gains tax. ASEAN markets generally rallied, supported by the weaker US dollar.

Bond

Global bonds rallied in July as hopes grew that the US Federal Reserve (Fed) would cut rates in September. The yield on the 10-year US Treasury bond declined to near a six-month low of 4.1%, while 10-year German Bund yields closed the month at 2.3%, a level last seen in early April. Yields on shorter dated bonds fell even more, causing yield curves to become less inverted. In contrast, Japanese bond yields rose slightly as investors priced in higher rates from the Bank of Japan.

Outlook

Whilst a soft landing (where inflation moderates and growth slows but a recession is avoided) remains the consensus view for the US economy, recent datapoints have led to a re-pricing of risk by market participants. The recent uptick in the US unemployment rate has spooked the market as some investors had completely discounted any threat of a US recession, evidenced by the recent lows in market volatility. Since the jobs report on the 2nd of August, the VIX index (a measure of volatility) has spiked to its highest level since 2022.

On the face of it, the latest US data supports rate cuts by the US Federal Reserve (Fed) – all things considered, a positive for markets. In an environment of heightened equity market expectation (especially in AI related stocks and semiconductors) any negative news is treated harshly. Markets are ignoring – at least for the moment – the potential for good news in the form of impending rate cuts and lower inflation risk. Even so, we will be watching any US data for confirmation that our soft-landing scenario remains in place and the probability of a recession is under control. While "micro" data on the US consumer is not especially good (travel, restaurants, etc), it is not dramatically poor. In fact, it fits rather well with a controlled slowdown of the US economy. Even with Friday's data (02/08), US unemployment remains at a very low level.

July saw a pause in the euphoria around Artificial Intelligence (AI) and perceived AI winners. This has been most clearly apparent with Nvidia, the leading designer of GPU chips used for AI calculations, whose share price has increased more than 130% so far this year. Despite apparent widespread adoption of AI by many companies in a range of applications – from replacing call centre staff to improving the productivity of software developers to image generation – some technology commentators are beginning to wonder where all the revenue is to justify the spend on AI equipment. Nvidia's results and outlook, to be communicated to the market at the end of August, will be even more closely watched as a signal of the traction and sustainability of the current AI trend.

After the political turmoil in June, July was a month of change and relative calm in the political landscape for a number of countries. In France, an alliance of left-wing parties won the greatest number of seats in the National Assembly, preventing control passing to the far-right National Rally party. This relatively benign outcome provided some reassurance for markets, which had been roiled by President Macron's decision to call a snap election in early June. In the UK, the Labour party won a commanding Parliamentary majority in the general election. This result was widely expected and had limited impact on financial markets. In the USA, President Biden announced he would not contest the forthcoming Presidential election, with Kamala Harris selected as the Democratic Party's candidate. Commentators now expect a much closer contest in November's election.

As we look ahead to the remainder of 2024, we are optimistic on the sentiment effects of rate cuts, as well as their technical effect on valuations. They are also valuable to unlock capex, with our companies across various industries relaying that customers are waiting for lower rates seemingly just around the corner. This could support our numerous industrial holdings, while our semiconductor leaders are projecting an excellent 2025 set to neutralise the current selloff. Meanwhile, M&A seems to be increasing with our cash generative companies, not beholden to interest rates, noting there are great opportunities at the current time. Fundamentals of the portfolio holdings generally remain strong and volatility can provide opportunity for stock pickers like ourselves. We believe that we are well positioned for a more optimistic environment for the remainder of the year.