Allianz Global Investors

08/2024

Market Snapshot

Equity Snapshot

United States

US stocks tumbled in early August as weaker-than-expected economic data, particularly job growth, sparked fears of a recession and caused the biggest sell-off in nearly two years amid thin trading. The correction proved short lived, however, with stocks subsequently rebounding sharply to more than recoup their earlier losses as later economic data proved more reassuring. In political news, Vice-President Kamala Harris secured the Democrat's nomination and continued to make ground versus Donald Trump in the opinion polls.

US non-farm payrolls grew 114,000 in July, far weaker than the expected 175,000 increase. Additionally, job growth for the 12 months to March 2024 was revised down by 818,000. However, other data metrics were more supportive. US second-quarter GDP growth was revised up an annualised expansion of 3.0%, compared with an initial estimate of 2.8%. The flash estimate of the S&P Global US composite purchasing managers' index came in at 54.1 in August: while manufacturing activity declined at its fastest rate in 14 months, services activity expanded slightly and remained solidly positive. US retail sales also increased 1% in July, the strongest monthly gain in 18 months, while the University of Michigan consumer sentiment index rose to 67.9 in August, a sharp jump from July's eight-month low of 66.4.

Headline inflation fell to 2.9 % in July, marking the first time it has been below 3% since March 2021. Federal Reserve chair Jay Powell signalled that the US central bank was likely to cut rates in September, declaring that "the time has come for policy to adjust" as he warned of rising downside risks to the labour market. As a result, investors started to price in multiple US rate cuts throughout the remainder of 2024, including the possibility of a 50-basis-point cut.

Europe

Euro-zone equities rose modestly over August, closing near record highs as they recovered from a sharp reversal early in the month when global stocks took fright over fears of an imminent US recession. At a sector level, real estate, health care and communication services rose the most, while energy companies were the weakest as oil prices weakened.

The HCOB euro-zone composite purchasing managers' index (PMI) rose to 51.2 in August, compared with a five-month low of 50.2 in July, as the Paris Olympics boosted the French economy. The euro-zone services sector expanded at the strongest pace since April, although manufacturing dropped to an eight-month low of 45.6. Euro-zone inflation slowed to 2.2% in July, its slowest pace in three years, opening the door for the European Central Bank (ECB) to follow its July cut with another reduction in September. Minutes of the ECB's July meeting showed policymakers had an "open mind" regarding September's meeting, despite concerns over wage growth.

Asia

The strongest performance in the region came from ASEAN markets such as Thailand, the Philippines, and Indonesia, which benefitted from the weaker US dollar. Taiwan was also a notable performer, with tech stocks bouncing back from the early month sell off as part of the broader unwinding of the yen carry trade. Conversely, South Korea lost ground, dragged lower by index heavyweight Samsung Electronics.

Bond

Global bonds gained as fears of a sharp slowdown in US economic activity boosted hopes that the US Federal Reserve (Fed) would cut rates multiple times in 2024, starting in September. The yield on the 10-year US Treasury bond closed the month back below 4%, having briefly touching an intraday low below 3.7% in early August . While bond yields also moved lower in Japan, long-dated European bond yields closed the month little changed although yields fell at the short end of curves.

Outlook

August was a volatile month for Global equities with the VIX index (a measure of volatility) reaching levels close to those of the 2020 pandemic and the 2008 Global Financial Crisis. The reported (02/08) uptick in the US unemployment rate led to a re-pricing of risk by market participants, who had previously discounted the threat of a recession in the world's largest economy. Whilst a soft landing (where inflation moderates and growth slows but a recession is avoided) remains the consensus view for the US, risks to the downside have increased modestly. The unexpected decision by the Bank of Japan to raise its key interest rate also had an impact on the market, with some investors borrowing cheaply in Yen to finance positions elsewhere. The subsequent unwinding of these trades due to the strengthening Yen added selling pressure to an increasingly nervous market.

At the time of writing, the data from the US supports a first rate cut by the US Federal Reserve (Fed) in September, with attention now focused on the magnitude of the first cut, and the subsequent speed of monetary loosening. A steady, controlled, interest rate descent should be good news for equity markets and jobs and inflation data will be watched closely in the coming months. 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 and while unemployment has increased, it remains at a very low level when compared to history.

The pause in the optimism surrounding Artificial Intelligence (AI) and perceived AI winners that began in July, continued into August. 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 reported quarterly numbers at the end of the month and subsequently fell 8% in after-market trading, amidst short term concerns regarding the product cycle of their next generation Blackwell chip and a forecast that was only slightly raised (in comparison to significant increases in previous quarters). There was a small margin decline (which was the first in 8 quarters) but it remains above 50%. The fact that such strong profitability was seen as a disappointment, highlights the sky-high expectations for the company.

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. Rate cuts are are also valuable to unlock capex, with our companies across various industries relaying that customers are waiting for the lower rates that are seemingly just around the corner. There has also been an uptick in M&A, with our cash generative companies, not beholden to interest rates, noting there are great opportunities at the current time. While the fundamentals of the portfolio holdings generally remain strong, there have been some tentative signs that the H2 acceleration in earnings that some were predicting may be more muted. By investing in high quality market leaders, we believe that we are well positioned to navigate any potential change in the macro environment and increased volatility may provide opportunity for stock pickers like ourselves.