Allianz Global Investors

10/2024

Market Snapshot

Equity Snapshot

United States

US stocks lost ground over October. Shares trended higher for much of the month, with the Nasdaq Composite Index hitting a fresh high as mega-cap tech stocks returned to favour, before slumping on the final trading day of the month as tech earnings highlighted the growing cost of investment in AI. US shares have started to price in a growing possibility that Donald Trump may win the US presidential election: the former President has vowed to cut taxes and lower regulation, moves that are seen as being positive for equities. While the race for the White House remains neck and neck, Trump appears to have a slight advantage in the seven swing states that will likely decide the election result.

US GDP expanded by an annualised 2.8% in the third quarter, driven by strong consumer spending. While this represented a slight slowdown from the 3.0% annualised growth rate recorded in the second quarter, it still indicated the economy was in good health. The flash estimate of the S&P Global US composite purchasing managers' index inched higher to 54.3 in October, with services activity remaining robust while the decline in manufacturing improved from September's 15-month low. Jobs growth picked up, with the US economy adding 254,000 new positions in September, the most in six months, while the University of Michigan index of consumer confidence rose to a six-month high of 70.5 in October.

Headline inflation eased to 2.4% in September, the lowest rate since February 2021, although core inflation accelerated slightly to 3.3%. With economic data continuing to indicate a soft landing for the US economy and a solid jobs market, expectations grew that Federal Reserve (Fed) would slow the pace of its rate cuts, especially after minutes of the Fed's September meeting showed policymakers had been divided over whether to cut rates by 50 basis points (bps). A 25-bps cut is now expected in November.

Europe

European equities retreated over October. Sentiment was knocked by the growing possibility that Donald Trump may win November's presidential election, with the former President vowing to impose a 20% tariff on imports from Europe. At a sector level, information technology, real estate and materials companies fell the most, while energy was the only sector in the MSCI Europe Index to deliver a positive return.

The euro-zone economy expanded by a stronger-than-expected 0.4% in the third quarter, marking the strongest growth rate in two years. The flash HCOB euro-zone composite purchasing managers' index (PMI) rose to 49.7 in October, marginally above September's seven-month low of 49.6. Growth in the services sector slowed slightly but remained positive, while the downturn in manufacturing softened. Headline euro-zone inflation accelerated to 2.0% in October – the uptick was mainly due to base effects. The European Central Bank cut rates by 25 basis points (bps), marking its third rate cut so far this year.

Asia

Asia ex Japan equities retreated over October. While Taiwan withstood the sell-off with a strong rally in index heavyweight Taiwan Semiconductor Manufacturing (TSMC), which reported a jump in profits and raised its earnings guidance, many of the region's other markets ended the month lower. A strong tone to the US dollar posed as a headwind for returns. Chinese equities lost ground as optimism over recent stimulus measures faded given the lack of hard details from authorities. Nevertheless, data releases hinted at some improvement in the domestic economy. India equities also suffered, with weaker returns stemming from a combination of profit taking, foreign investor outflows, and weak corporate earnings. On the positive side, India's manufacturing and services activity remained robust, along with local investor appetite for domestic equities. Meanwhile, ASEAN equity markets apart from Thailand closed the month lower, reflecting the stronger US dollar, general market concerns around US election results and the direction of the Federal Reserve's interest rate policy.

Bond

Global bonds sold off, with yields rising sharply in the US as polls indicated Donald Trump was likely to win November's presidential election. The former President has promised to hike import tariffs substantially while tax cuts are likely to further swell the fiscal deficit. The yield on the 10-year US Treasury bond rose 50 basis points over the month to close just below a four-month high of 4.3%. UK bonds sold off sharply after investors were unnerved by a sharp increase in UK government borrowing in Chancellor Rachel Reeves' budget. On a global basis, corporate bonds outperformed government debt, with high-yield debt faring better than investment-grade securities.

Outlook

After the first rate cut by the Federal Reserve in September, early November events in the US mean that the politics of the world's largest economy remain at the forefront of investors minds. At the end of a fiercely contested campaign, with the candidates polling neck and neck for the majority of the time, Donald Trump eased to a surprisingly comfortable victory. At the time of writing, a subsequent clean sweep of the Senate and the House of Representatives looks probable, providing the President elect with a powerful mandate to carry out his 'America First' policy aims. The initial market reaction saw the US market experience the largest post-election day move in history, led by industries linked to the so called 'Trump trade'. The likelihood of tax cuts, deregulation and tariffs on imports meant that US Banks soared, energy and materials advanced at the expense of renewables and smaller domestic focussed companies performed well.

It remains to be seen if the rhetoric of an election campaign feeds through to legislation, but the impact of policies will undoubtably be felt throughout the world. Fiscal largesse – together with higher tariffs, tougher immigration policy and looser regulations – tends to be inflationary. In response, the US Federal Reserve may moderate its easing cycle, potentially supporting the dollar. Mr Trump has also pledged to impose a 20% blanket levy on all US imports, plus a 60-100% tax on Chinese products. The assumption is that this is a negotiation tactic for better deals on US exports, and that the levels suggested will not be reached, but any tariff hikes that do materialise will likely trigger retaliation by other economies. We foresee more regional nearshoring and onshoring as companies diversify their manufacturing bases and supply chains – a move that could strain balance sheets. Higher tariffs could hit European and emerging market stocks, particularly those reliant on the US market, such as makers of luxury goods, cars, aircraft producers and steel companies. Navigating potentially wide disparities in performance between winners and losers within sectors and themes and between regions will require active investment management.

The geopolitical backdrop could shift markedly under Mr Trump. As well as a more aggressive approach to China, we anticipate a higher probability of a military confrontation with Iran and a potential escalation in the Middle East conflict. In contrast, there may be a quicker end to the Ukraine war if Mr Trump pushes for a deal with Russian president Vladimir Putin. An end to that conflict could lead to lower commodity prices if Russia officially re-enters the market. Europe would have to beef up its military spending, leading to higher debt and less productive fiscal expenditure.

We also expect more tensions with some European countries, with potential tax increases on imports which could weigh on European growth.

In the midst of the Q3 reporting season, results within the market have been mixed with technology and financials continuing to strongly outperform the more cyclical areas. Against this backdrop, the portfolio holdings have generally provided solid results. Expectations are lower than they have been, with full year growth projections downgraded for a number of companies and we are hopeful that our holdings that have pointed to a stronger second half can positively surprise. We see a strong story into 2025, where the impact of a lower interest rate will begin to be felt and the market may look beyond the dominant 2024 themes of artificial intelligence and higher for longer interest rates. Our companies have historically performed well when growth becomes more scarce and we remain convinced of our strategy that returns above-market earnings growth, compounding meaningfully over time. Ultimately this drives stock prices over the longer term.

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