CITĒ GESTION
PRIVATE BANK

Newsletter: Approaching US election / August 2024

Key Take-Aways

- Weak US economic data in late July, including disappointing ISM manufacturing survey results and payroll growth, has raised concerns about a potential abrupt economic slowdown.

- The US presidential election has already caused market volatility. The attempted assassination of Trump on 13 July impacted financial markets, boosting "Trump trades" like US equities, Mexican peso depreciation, and Bitcoin.

- Central banks displayed contrasting strategies in July, with the Bank of England and the Swiss National Bank cutting rates, while the Bank of Japan hiked rates significantly, reflecting differing economic outlooks.

- The bear-steepening of the US yield curve is driven by the likelihood of Donald Trump becoming President and potential Federal Reserve rate cuts. This reflects market expectations of inflationary policies resulting in a steeper yield curve.

- Despite the inverted 2yr-10yr yield curve suggesting recession, a soft landing is anticipated with favourable conditions for smaller firms due to expected rate cuts.

- Europe had a contrasted month, with the CAC 40 posting a positive performance, while the Euro Stoxx 50 posted a slightly negative performance.

- In the US, among fears of a recession, growth stocks struggled this month, and investors took refuge in value stocks. This caused the rotation seen between large caps and small & mid caps.

- The approaching US election is causing uncertainty, leading to a decline in the Dollar and potential further pressure if the Fed cuts interest rates in September.

- The EUR/USD is unlikely to rise above 1.10 due to interest rate differentials and weak German GDP. The Mexican Peso and Chinese Yuan might weaken under stricter US policies, while the Japanese Yen could strengthen with potential interventions. Gold reached a record high, driven by election uncertainty and geopolitical situation.

Review

July's overview

In July, the markets ended on a positive note overall, but it wasn't all plain sailing. With employment figures weaker than expected and inflation stabilising at around 3%, the markets anticipated a rate cut in September. This benefited small and mid caps, which are more sensitive to interest rates, as we can see from the Russell 2000 (+10.16%) and the possible profit-taking on Tech, which was at its peak during July (Nasdaq -0.73%). A less pronounced but similar phenomenon occurred in Europe with the Euro Stoxx 50 (-0.29%) and the Stoxx 600 EUR (+1.43). The Swiss and British markets had a good month, with performances of 2.70% and 2.53% respectively. The Nikkei 225 underperformed last month (-1.21%) but remains one of the best-performing markets YTD 17.86%.

The breakdown of S&P 500 performance by sector: there has been a reversal in sector performance. The sectors that drove the index as a whole have been declining in the last month. Telecommunications and Information Technology are down 4.01% and 2.09% respectively. They are still the best in class since the beginning of the year, with 21.60% for telecoms and 25.57% for IT. Real estate (+7.22%), utilities (6.78%) and financials (+6.46%) were the three best performers in July.

Bonds have gained significantly on all markets over the past five days. Lower yields due to market anticipation of cuts in interest rates had a positive effect on the sector. The BBG Glob. Agg. Treasuries index was up 3.18% in July. The corporate sector experienced the same effect, with a positive total return of 2.17% (BBG Glb Agg Corporate total return index), but the best performance since the beginning of the year remains the high yield sector with 5.20%.

The US dollar index weakened last month (-1.67%). This can be seen particularly across USD/JPY (-6.78%), USD/CHF (-2.31%), EUR/USD (+1.05%) and GBP/USD (+1.67) over the last five days. The JP Morgan EM index had a difficult end to the month (-2.64%), ending the MTD at -0.14%.

The BBG commo index fell by 4.50% last month, pushing annual performance into the red (-2.23%). With all these uncertainties, gold remained the safe-haven, which translated into a 5.19% MTD pushing the YTD to 18.64%.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'522	1.59	4.33	1.22	1.22	16.69	19
Nasdaq	17'599	2.64	4.12	-0.73	-0.73	17.71	24
Russell 2000	2'254	0.51	9.19	10.16	10.16	12.06	19
Euro Stoxx 50	4'873	0.66	-2.88	-0.29	-0.29	10.83	12
Stoxx 600 EUR	518	0.80	-0.06	1.43	1.43	11.09	13
FTSE 100	8'368	1.13	0.98	2.53	2.53	10.58	11
SMI	12'317	0.29	3.25	2.70	2.70	14.03	16
NIKKEI 225	39'102	1.49	1.28	-1.21	-1.21	17.86	16
CSI 300 China	3'442	2.16	-2.47	0.60	0.60	2.67	10
MSCI EM Index	1'085	1.24	1.15	0.36	0.36	8.03	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5'522.3	1.17	4.33	0.32	5.55	16.69	19.27
UTILITIES	369.6	1.27	2.60	6.78	6.78	16.86	16.38
ENERGY	712.4	0.46	2.85	2.11	2.11	13.27	11.12
TELECOM	297.3	1.29	-0.00	-4.01	-4.01	21.60	16.58
CONS STAPLES	834.4	-0.20	1.85	1.93	1.93	11.08	19.72
REAL ESTATE	258.3	-0.29	11.36	7.22	7.22	4.59	18.51
CONS DISCRET	1'516.6	1.79	6.36	1.66	1.66	7.41	21.12
MATERIALS	580.5	1.05	1.37	4.39	4.39	8.61	18.14
HEALTH CARE	1'742.7	-0.39	4.01	2.65	2.65	10.67	17.63
INFO TECH	4'249.1	3.96	5.48	-2.09	-2.09	25.57	24.32
FINANCIALS	727.5	-0.17	5.60	6.46	6.46	17.28	14.49
INDUSTRIALS	1'081.9	1.13	3.07	4.90	4.90	13.03	19.25

Fixed Income - % Change	Price	5 days	MTD	QTD	YTD
BBG Global Agg Treasuries TR Index UNH $	199	2.84	3.18	3.18	-1.83
BBG Global Aggregate TR Index Value $	469	2.83	2.76	2.76	-0.49
BBG Global Aggregate Corporate TR $	291	2.93	2.17	2.17	2.47
BBG Global High Yield $	1'601	2.47	1.96	1.96	5.20
BBG US Treasury TR Unhedged $	2'307	3.23	2.19	2.19	1.31
BBG US Corporate TR Unhedged $	3'282	3.13	2.38	2.38	1.89
BBG EuroAgg Government TR Index UNH €	239	2.13	2.21	2.21	0.32
BBG EuroAgg Corporate TR Index UNH €	252	2.31	1.72	1.72	2.27

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	104.096	-0.44	-0.60	-1.67	-1.67	2.73
EUR-USD	1.0826	0.10	-0.19	1.05	1.05	-1.93
USD-JPY	149.98	-1.83	-4.47	-6.78	-6.78	6.34
USD-CHF	0.8780	-0.53	-4.01	-2.31	-2.31	4.35
EUR-CHF	0.9507	-0.42	-4.19	-1.26	-1.26	2.34
GBP-USD	1.2856	0.16	0.93	1.67	1.67	0.98
EUR-GBP	0.8421	-0.06	-1.11	-0.61	-0.61	-2.86
JP EM FX Index	45.86	0.28	-2.65	-0.14	-0.14	-4.73

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	96.4	1.07	-8.17	-4.50	-4.50	-2.23
Gold Spot $/OZ	2'447.6	1.53	4.87	5.19	5.19	18.64
Crude Oil WTI	77.9	4.26	-1.05	-4.45	-4.45	8.74

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	16.4	-0.18	37.13	31.51	31.51	31.41

Source: Bloomberg 31.07.2024

Macro & Rates

Back to Macro and Politics.

Last month, we underlined the facts that politics will bring volatility and be a vector for financial markets with Elections in Europe in June and July being a kind of rehearsal for the US presidential election in November. July shows that the US election has already brought volatility with two significant unforeseen developments.

While there is a long and inglorious history of presidential shootings, the attempted assassination of Former President Donald Trump on 13 July was obviously unexpected. The immediate impact on Trump's election odds has been undeniable. Market wise, the initial reaction has been to pile into what seems to be the most obvious "Trump trades": the bear-steepening of the US curve on the theory that Trump will pursue more tax cuts and fiscal loosening, US equity market higher given the popular view of Trump's impact on the market, the Mexican peso depreciation based on Trumps' border rhetoric, Chinese markets lower ahead of Trump new trade war, a lower US dollar as Trump and even more his vice-president JD Vance hate the strong dollar, and naturally the Trump Media & Technology Group Corp higher… Because it is Trump! Interesting as well, the Bitcoin as Trump declared that he would establish "strategic Bitcoin stockpile" if he is elected.

Most of those "Trump trades" have done well since the assassination attempt. However, some of them are starting to fade after the second surprise of this US campaign.

Less than a week after the assassination attempt, the incumbent president Joe Biden has finally stood aside and stopped running for re-election. Biden's withdrawal from the presidential race came as anything but a surprise. Since the first TV debate, the question was more "when" rather than "if." As we are writing, vice-president Kamala Harris is shortlisted to take the job. It may change as the Democratic convention is not until 19 August. Whoever the candidate is, they should not move the needle. For sure, Biden's withdrawal has finally re-boosted the Democrat's odds, although Trump stays well ahead in the polls. Therefore, the market impact should be limited to the unwinding of the top performer "Trump trades".

Central Banks are not all playing the same game, The Bank of England (BoE) and the Swiss National Bank (SNB) cut rates in July meanwhile, in contrast, the Bank of Japan delivered a rate hike.

The big story was of course the Bank of Japan, which by its own standards was ultra-hawkish in delivering a 15-bp rate hike and unveiling a plan to halve its JGB purchases somewhat more quickly than expected. The contrast with the BoE and the SNB couldn't be more obvious, as both banks eased over the month. In the meantime, the Fed is widely, if not universally, expected to cut rates in September.

Until the very last days of July, the perspective of a soft landing scenario was seriously anchored. However, recent macro data raised concerns about the real state of the US economy.

The ISM manufacturing survey notably missed expectations (46.8 versus 48.8 expected) but the surprise came from the employment component at 43.4, way lower than the forecast 49.2 and the worst reading since June 2020. Outside of Covid, it's the worst reading since 2009. Weakness in the US labour market was confirmed by payroll growth, comfortably below expectations at 114k while the unemployment rate unexpectedly rose to 4.3%, its highest reading since October 2021. Suddenly, there are some concerns that the US economy is slowing a little too abruptly. The coming data will have to provide confidence that the economy is not slipping into recession.

Fixed Income

The recent bear-steepening of the US yield curve is due to the increasing likelihood of Donald Trump becoming the next President and the rising probability of the Federal Reserve cutting interest rates. Market participants expect Trump's policies to be inflationary, leading to higher long-term Treasury yields as investors demand compensation for anticipated inflation. Key factors contributing to this expectation include increased tariffs, immigration restrictions, tax cuts and a preference for lower Fed fund rates. Meanwhile, the short end of the curve, influenced by the Fed, is expected to become looser with rate cuts aimed at stimulating economic activity. This combination of rising long-term yields and lower short-term rates results in a steeper yield curve.

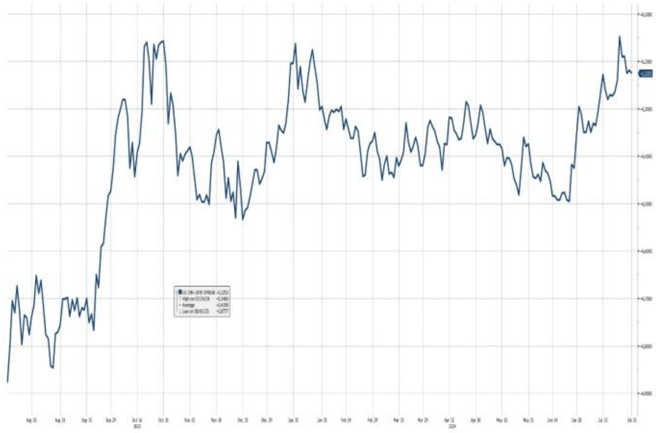
Despite July steepening, the 2yr-10yr part of the US curve remains between 10-year and 2-year bonds inverted. Historically, an inverted curve is an early sign of recession. However, after nearly 2 years of inversion, the US macro environment suggests that a soft landing appears as the most likely scenario for now.

Credit spreads for both Investment Grade and High Yield bonds remain low and stable, indicating a favourable credit environment. The expected soft landing of the economy, with moderate growth, no major downturn and softening inflation, is particularly advantageous for smaller firms. These companies, usually more affected by economic changes, are about to benefit from lower rate conditions and easier access to financing, which helps them operate and grow in a more stable market.

Taking into account recent macroeconomic data, market expectations regarding rate cuts have shifted, now anticipating two to three interventions of the Fed before the end of the year, the first one being most probably in September. This repricing suggests that investors foresee potential economic slowdowns and trending lower inflation, that would encourage the Fed to cut rates.

The last graph shows the expected rate cuts as predicted by the market. As mentioned above, a first cut is widely expected in September and a maximum of 2.75 cuts are expected by the end of the year, meaning a possible rate of just over 4.6% in December 2024.

31.07.24: US 2YR – 10YR Spread

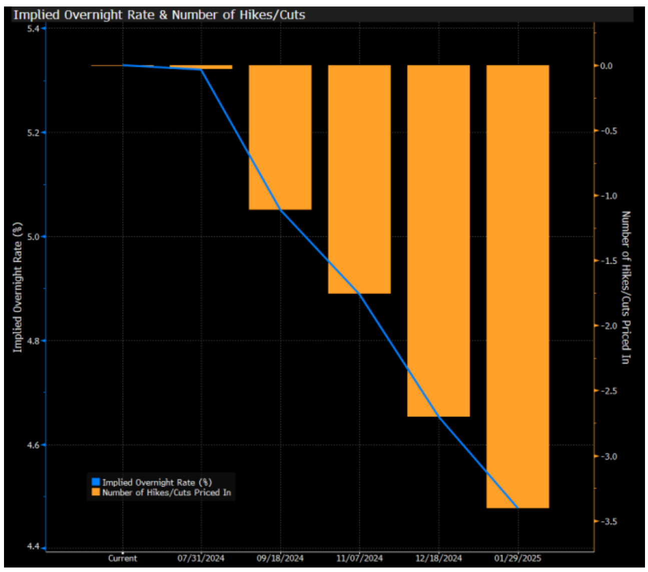


Source : Bloomberg

31.07.24: US High Yield Spread

Source : Bloomberg

31 .07.24: Expected Implied Overnight Rate and Number of Hikes/Cuts Priced in



Source: Bloomberg

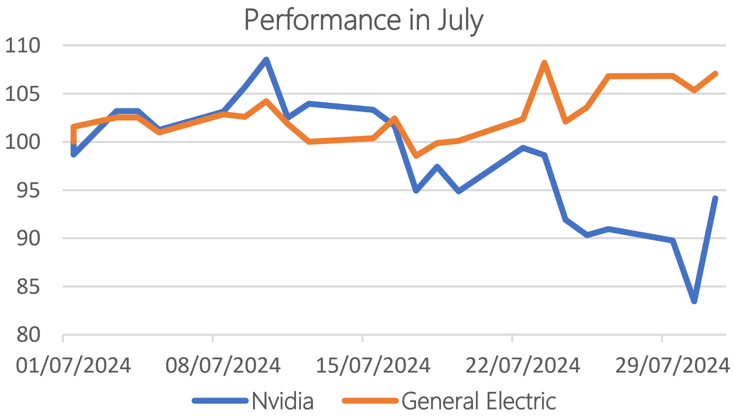
Equity

The Come-Back of Value

July saw a huge correction in the US Tech companies share prices, as well as the rotation from big to small & mid caps. The uncertainty regarding the US elections as well as tensions in the Middle East contributed to price changes in the Oil sector. Roche made a huge comeback and enabled the SMI to have a strong month.

Value outperforms Growth

The Russell 2000 Index reached its 52-week peak on 31 July at 2,300, whereas the Nasdaq Composite lost roughly 9% compared to its 11 July level, which was its all-time high. Fears of a looming recession caused investors to trim their exposure to growth stocks, taking profits from big tech companies such as Nvidia, which lost more than 15% from its peak. Despite this, the earnings season was generally not disappointing, with most companies meeting expectations. The Russell 2000 typically consists of small and mid-cap companies, belonging to the value component of the market, which benefited from this sector rotation. A clear example of this value trade is General Electric, a member of the Dow Jones Industrial Average, which reached USD 177.20 on 23 July and closed the month around USD 170, posting a positive performance of approximately 8%. The value trade was therefore very popular in the month of July, mainly due to the cheapness of these companies, with low multiples and high dividends, in clear contrast of growth stocks, which are deemed too expensive

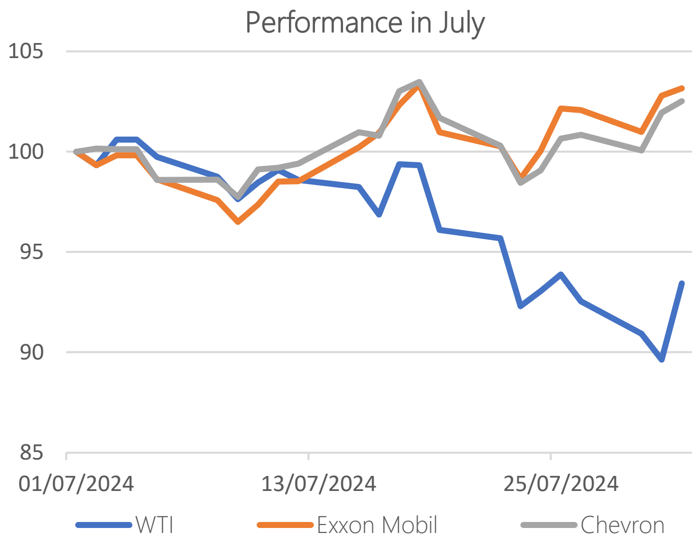


Europe flattish

The EuroStoxx 50 Index had its all-time high at the beginning of April, reaching at that time EUR 5,121. Since then, Europe saw a correction, but it started before the one happening now in the US. This month, it had a slightly negative performance of -0.29%. However, the CAC 40, despite the political uncertainty in France as the new government has not been chosen yet, posted a positive performance of 0.77%.

The impact of the US on Oil

In July, Exxon and Chevron, the two bellwethers of the oil sector, along with Shell and BP, all managed to show slightly positive performances, despite oil (WTI Index) performing poorly and posting a loss of approximately 6%. The increased likelihood of a potential recession in the US has more than offset the rising tensions in the Middle East, which typically lead to higher oil prices. For the oil sector, a Trump administration would be more favourable, allowing more supply to come onto the market and capping prices. In contrast, a Kamala Harris victory would probably hinder supply growth, with restrictions on oil expected, potentially causing higher prices.



Roche to the rescue of the SMI

The SMI had a good month in July, with a performance of 2.7%. However, this was hugely influenced by the excellent performance of Roche, which has a significant weight in the index. Roche had its best month in a long time, achieving a performance of 14.55%, after announcing very promising results regarding a new GLP-1 weight loss drug.

YTD Performance of Roche Holding AG (Source: Google)

Forex And Commodities

Would The Next US President Achieve A Weaker Dollar ?

As the US election approaches, its impact on the forex market is already noticeable, creating significant uncertainty around the US dollar. The downward move of the DXY (Dollar Index) observed in July exemplified how the election is affecting the forex market. Biden's withdrawal from the race, leaving Kamala Harris likely to face Trump, caused the DXY to fall below 1.05.

If former President Trump returns to the White House (he currently still has the highest odds), he will advocate for a policy favouring the devaluation of the US dollar. Trump's "America First" stance argues that today's strong dollar undermines American labour competitiveness. However, his policy also involves imposing import tariffs, which risk to maintain the USD at a strong level. As a matter of fact, these tariffs could support domestic production demand and push up consumer prices with a more expensive labour cost, creating inflationary pressure that tends to support the US dollar.

Therefore, downward pressure on the USD is not guaranteed if Trump becomes the next president. While Trump's presidency might limit the upside pressure on the dollar, it is not likely to remove it. In the short term, the uncertainty surrounding the presidential election and the anticipated US interest rate cuts in September could be the vectors that could exert downward pressure on the USD.

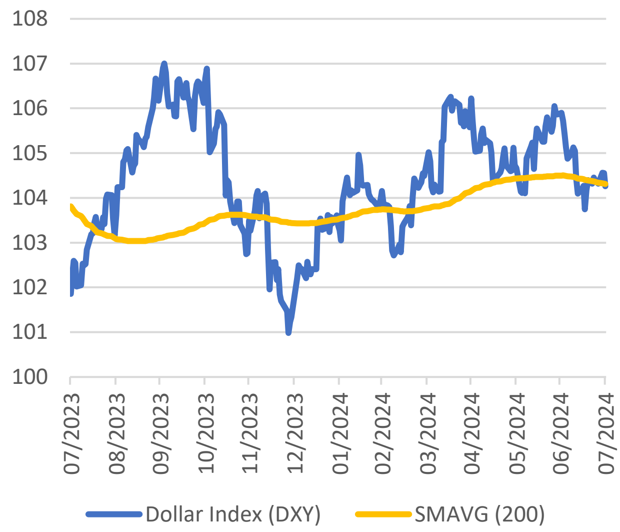
Despite this, it seems unlikely that the EUR/USD pair will witness a short-term comeback above the psychological level of 1.10. A slight comeback in July saw the pair rise above 1.09, but an interest rate differential still favours the USD. Additionally, the latest German GDP data showing contraction in Q2 could put downward pressure on the EUR/USD. At the time of writing, the pair is trading just below the 200-day SMA and above the 50-day SMA. A break below could consolidate the downward pressure and push the EUR/USD back to early July levels at 1.075. It is expected that the EUR/USD could maintain its range between 1.075 and 1.09 over the medium term.

Among currencies that could suffer the most under a new Trump presidency, the Mexican Peso and the Chinese Yuan are likely to be impacted by stricter US policies. The Peso, which peaked against the USD since 2014, might decline if Trump wins, potentially pushing the USD/MXN pair above 20.

After gaining significant momentum in July, the Japanese Yen skyrocketed above 150 vs USD, right above the 200-day SMA, still acting as key support. The significant currency intervention by the Japanese Government and the rise of interest rate to 0.25% by the Bank of Japan on 31 July have stemmed the Yen's strengthening. Opening the door, for more Yen appreciations in the short term. The 200-day SMA will be a critical level to watch; a break below it in the USD/JPY pair could lead to more JPY momentum paving the way to the next support at 146.

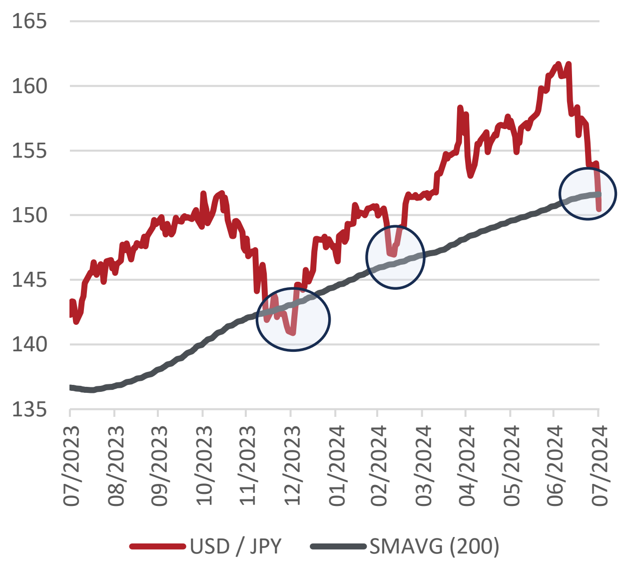
Finally, gold hit a record high in July at USD 2,483 per ounce. The US election and the Fed have been key drivers of this momentum. Gold is now touching its key support (50-day SMA at 2350). If this support holds and the election-related uncertainty continues, we could see further momentum in the coming months.

Could The Election Uncertainty Weight More On The Dollar ?



Source: Bloomberg

New Momentum for The Yen, Could it Consolidate Below The 200-Day SMA ?



Source: Bloomberg

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