FIRSTNEWS VOL 49, SEP 2024

EQUITIESFIRST® Progressive Capital

GLOBAL MARKET REACTIONS TO RECESSION CONCERNS

As global markets face heightened uncertainty and volatility in July and August, different regions and assets are experiencing varied impacts based on their economic policies, market conditions and investor sentiment.

Below is an overview of the current market situation in key regions and assets:

EXECUTIVE SUMMARY

- **Japan**: The recent sharp correction in Japan's Nikkei 225 Index was largely driven by the Bank of Japan's interest rate hike, which disrupted the carry trade strategy, leading to a rapid appreciation of the yen and a significant sell-off in Japanese equities.

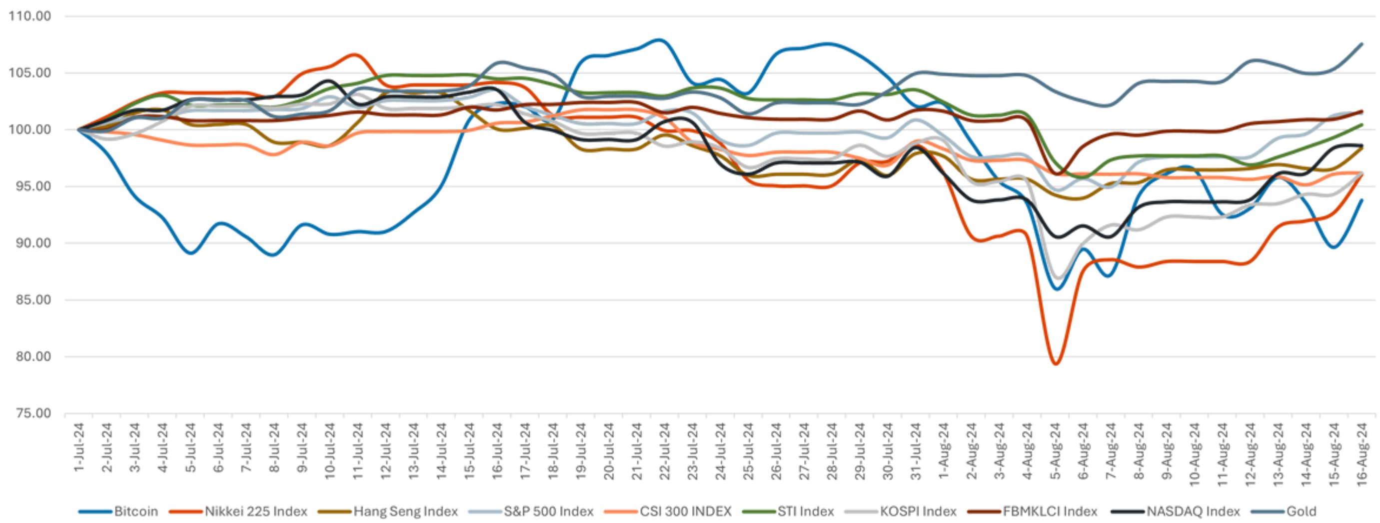
- **US**: In July 2024, the US labor market showed signs of slowing, with decreased job growth and rising unemployment. This contributed to heightened uncertainty, leading to significant corrections in US equity markets as fears of an economic slowdown intensified. However, Powell's speech at Jackson Hole, which hinted at the potential adjustment of monetary policy to include the interest rate cut, fueled market expectations.

- **Gold**: As global markets faced increased volatility and economic uncertainty, gold prices surged, reinforcing its role as a safe-haven asset. Investors shifted capital into gold, seeking protection from the instability in equities and other riskier assets.

- **Crypto**: The crypto market experienced significant declines, with Bitcoin and Ethereum suffering steep corrections due to broader market fears and risk aversion. The unwinding of carry trades and macroeconomic pressures further exacerbated these losses.

- **China**: Chinese stock markets, particularly the Hang Seng Index and CSI 300 Index, were relatively resilient compared to Japanese equities due to their already low valuations before the crisis, which cushioned them from steeper losses during the market downturn.

JULY - AUGUST 2024 ASSET PRICE PERFORMANCE (%) (REBASED)



JAPAN MARKET

NIKKEI 225 INDEX

The recent sharp correction in Japan's Nikkei 225 Index, which saw it drop from a high of 42,224 on July 11, 2024, to 31,458 on August 5, 2024, a staggering 25% decline within a month, was driven by several key factors.

One of the primary reasons for the Nikkei 225's downturn was the Bank of Japan's decision on July 31 to raise interest rates to 0.25% from a previous range of 0% to 0.1%, marking the second rate increase this year, following the central bank's decision on March 19 this year to lift its negative interest rate policy.

This policy shift led to a rapid appreciation of the Japanese yen, significantly impacting global financial markets, particularly the carry trade strategy.

Source: Bloomberg

CARRY TRADE

The carry trade is a popular investment strategy that investors borrow money in a currency with low interest rates, like the Japanese yen, and invest it in assets denominated in currencies with higher interest rates. The goal is to profit from the difference between the borrowing cost (low interest rate) and the returns from the invested assets (higher interest rate).

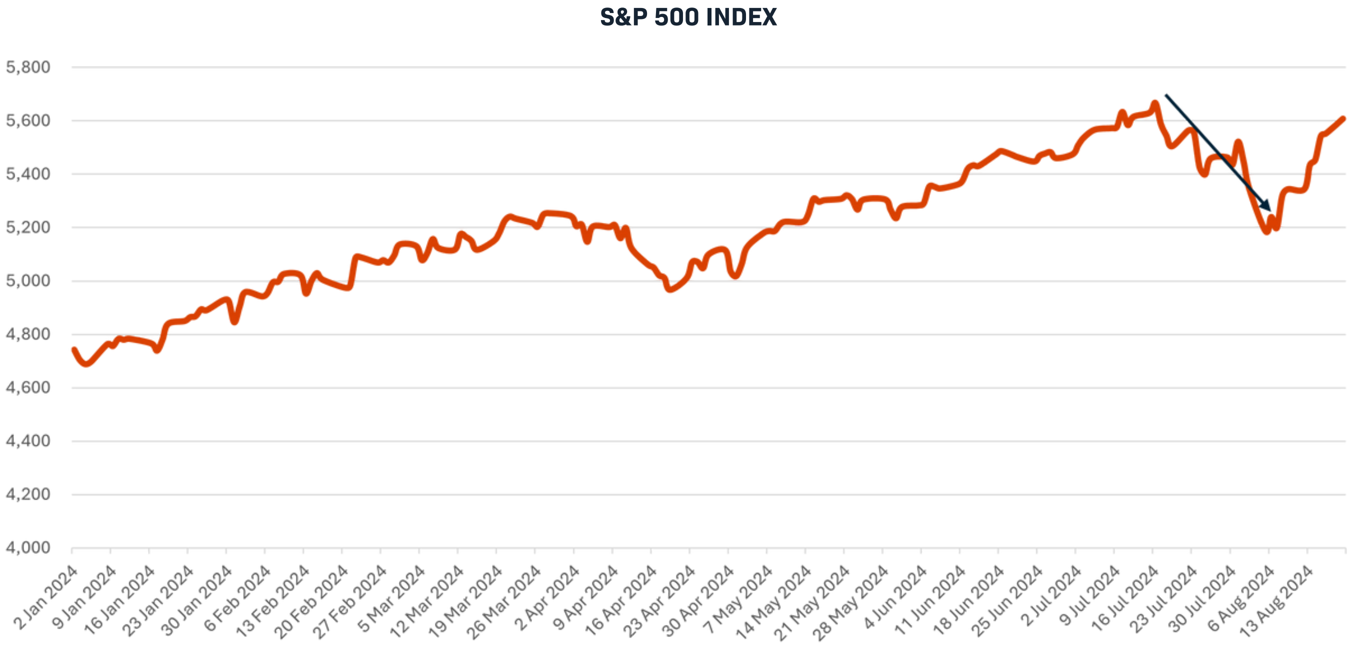
For years, Japan's low-interest environment made it a prime source for carry trades. Investors would borrow yen at minimal cost and then convert the funds into currencies like the US dollar to invest in bonds, stocks or other high-yielding assets in those countries. As long as the yen remained stable or depreciated, these trades were profitable.

However, the BoJ's rate hike disrupted this strategy. The yen appreciated sharply following the rate increase, which meant that when investors needed to convert their foreign assets back into yen to repay their loans, they faced potential losses. The stronger yen eroded the profits from these carry trades and, in some cases, turned them into losses.

To mitigate this, investors began unwinding their positions rapidly, selling off their investments and converting back to yen. This mass liquidation of assets created intense selling pressure, not only in Japan but also in other markets linked to these trades, contributing significantly to the sharp decline in Japanese equities.

In essence, the carry trade strategy is highly sensitive to currency movements and the sudden shift in Japan's monetary policy triggered a chain reaction that severely impacted the equity markets.

US MARKET



In July 2024, the US labor market showed signs of slowing, which had significant impacts across global financial markets. The Bureau of Labor Statistics reported that the US economy added 114,000 jobs during the month, a marked decrease from the previous month’s growth. This slowdown was coupled with an increase in the unemployment rate, which rose to 4.3% from 4.1% in June, marking its highest level since October 2021.

These indicators signaled that the labor market was cooling more rapidly than anticipated. The market interpreted this data as a potential indicator to economic downturns. Although the slowing job growth suggested that the Federal Reserve might ease its monetary policy by September, the immediate reaction in the markets was one of heightened uncertainty.

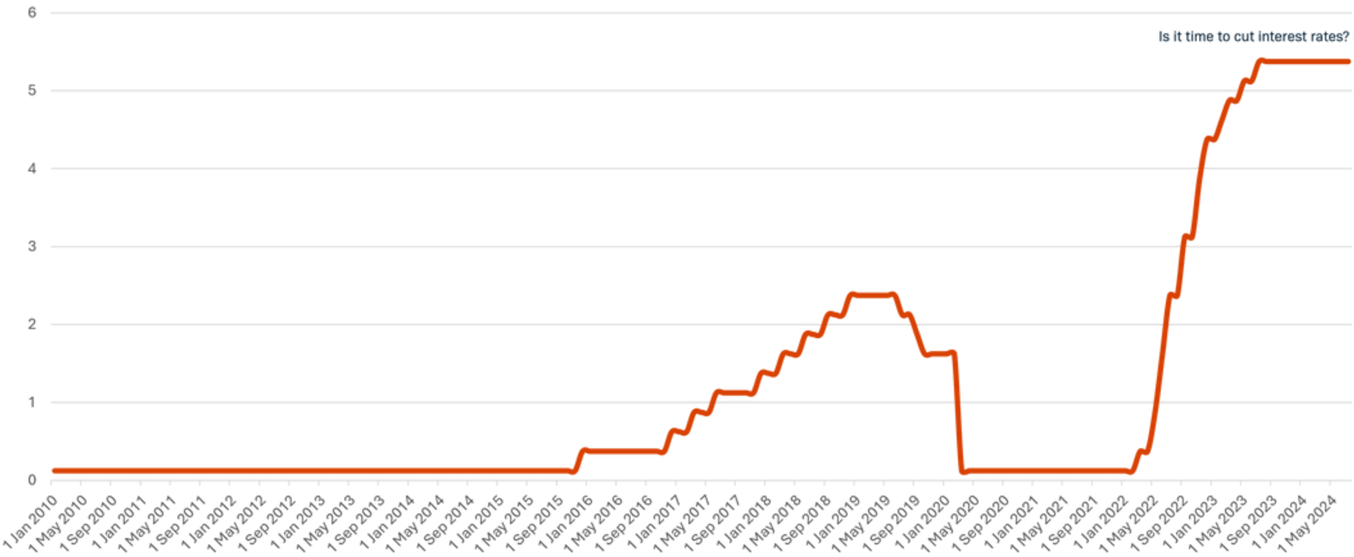
Fears of an economic slowdown led to widespread sell-off in the equity markets, with major indices in both the US and Japan suffering significant declines. The S&P 500 Index experienced a notable decline, dropping from 5,667 on July 16, 2024, to 5,186 by August 5, 2024, representing an 8% correction.

This combination of a cooling labor market and ongoing concerns about future economic growth created a perfect storm, leading to the sharp market corrections observed in July and August 2024.

Source: Bloomberg

FED POWELL'S JACKSON HOLE SPEECH

US FED TARGET RATE MID POINT OF RANGE (%)



The whole world was closely watching the speech delivered by Fed Chair, Powell, at Jackson Hole on August 23, 2024. The Jackson Hole Economic Symposium is crucial because it offers insights from global economic leaders, influencing market expectations and signaling potential shifts in monetary policy.

Powell highlighted significant progress since the pandemic, with inflation easing and the labor market stabilizing. He emphasized that the Fed's focus on returning inflation to the 2% target, acknowledging the need to balance inflation with unemployment risks.

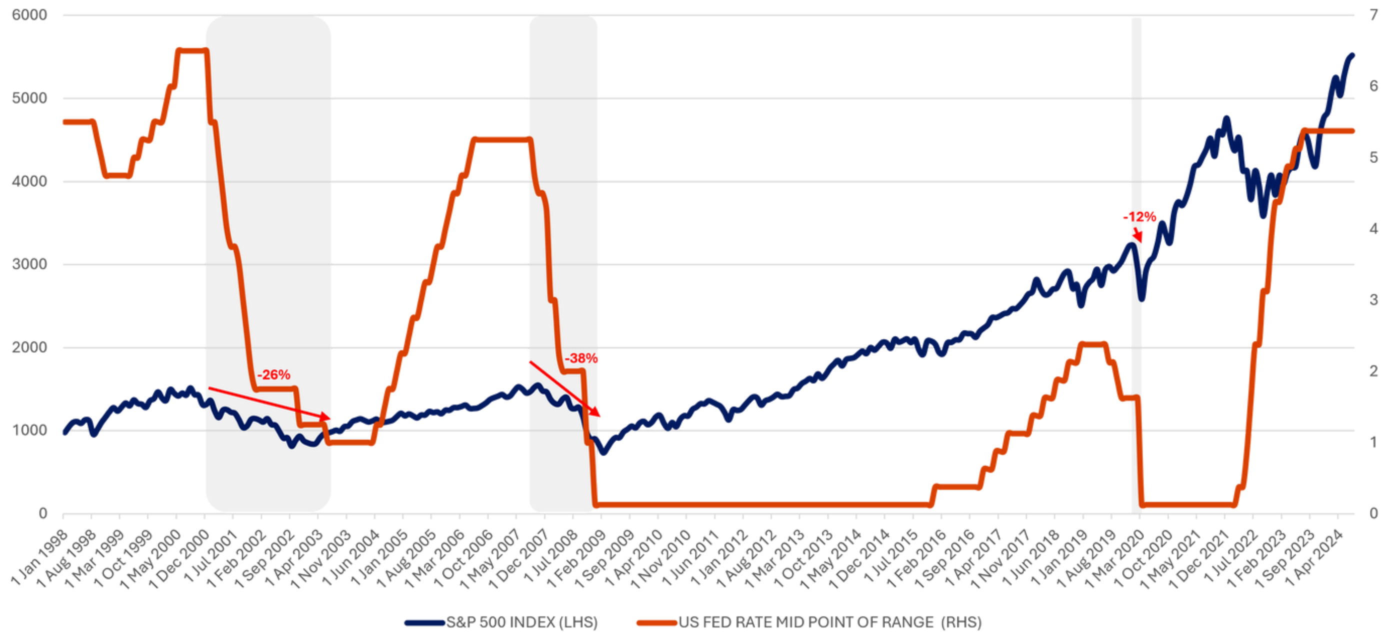
Powell reflected on the causes of the recent inflation surge, attributing it to supply chain disruptions, heightened consumer demand and global shocks like the Ukraine crisis. He explained how the Fed's shift from viewing inflation as transitory in the beginning to adopting more aggressive policies helped manage inflation without significantly raising unemployment rate.

Powell stressed the ongoing challenges and lessons learned from the pandemic, reaffirming the Fed's commitment to achieving price stability and maintaining a strong labor market. The Fed is ready to adjust its policies as needed.

The market is currently very bullish on Powell's statement: "The time has come for policy to adjust. The direction of travel is clear and the timing and pace of rate cuts will depend on incoming data, the evolving outlook and the balance of risks." The keyword here is "adjust". Powell explicitly indicated that the time is approaching to adjust the Fed's restrictive monetary policy, suggesting that interest rate cuts could begin in the coming quarters. As a result, the market consensus now expects a rate cut as early as September.

Source: Bloomberg

S&P 500 INDEX VS FED FUNDS RATE

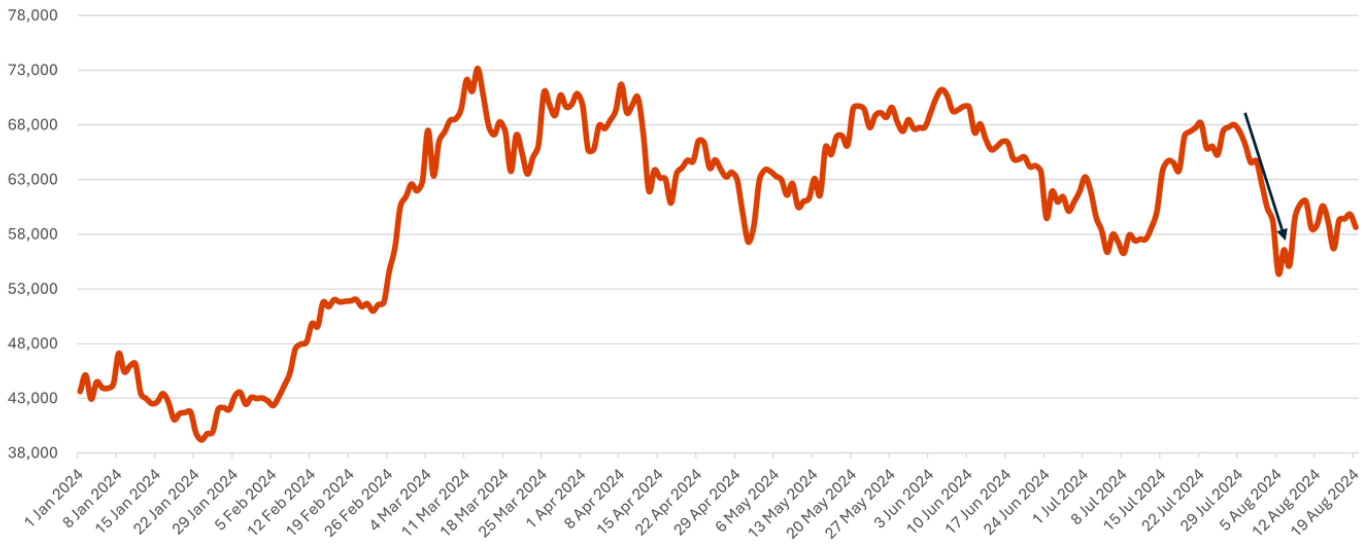


While an interest rate cut is generally seen as good news for the market, it is counterintuitive that US stock market often experiences short-term corrections when the Fed cuts rates. This pattern has been observed during historical rate cuts in 2000, 2007 and 2020, where market reactions were driven by fears of an impending economic recession. The last rate cut, during the COVID-19 crisis in 2020, also led to a short-term market correction before a strong bull market followed. The question now is, will this time be any different?

Source: Bloomberg

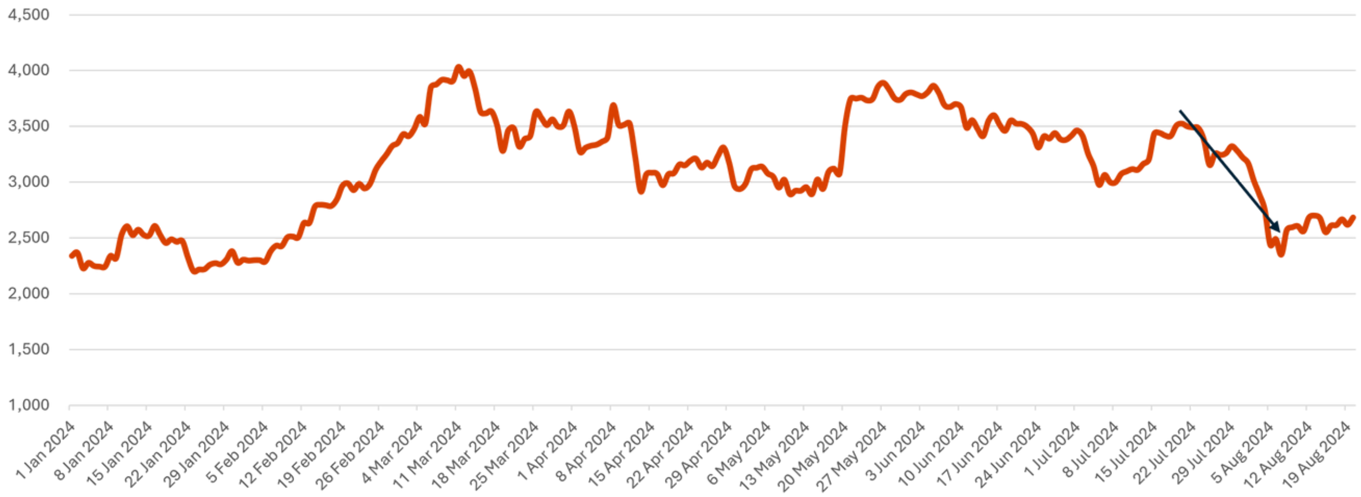
CRYPTO MARKET

BITCOIN



Bitcoin experienced a dramatic decline from $68,147 on July 22, 2024, to $54,395 on August 5, 2024, marking a 20% correction. As a high-beta asset, Bitcoin is highly sensitive to shifts in market sentiment, often magnifying the effects of broader market trends. In a risk-off environment, where investors become more cautious and retreat from riskier assets, Bitcoin tends to experience sharper declines compared to more traditional investments like equities or bonds.

ETHEREUM

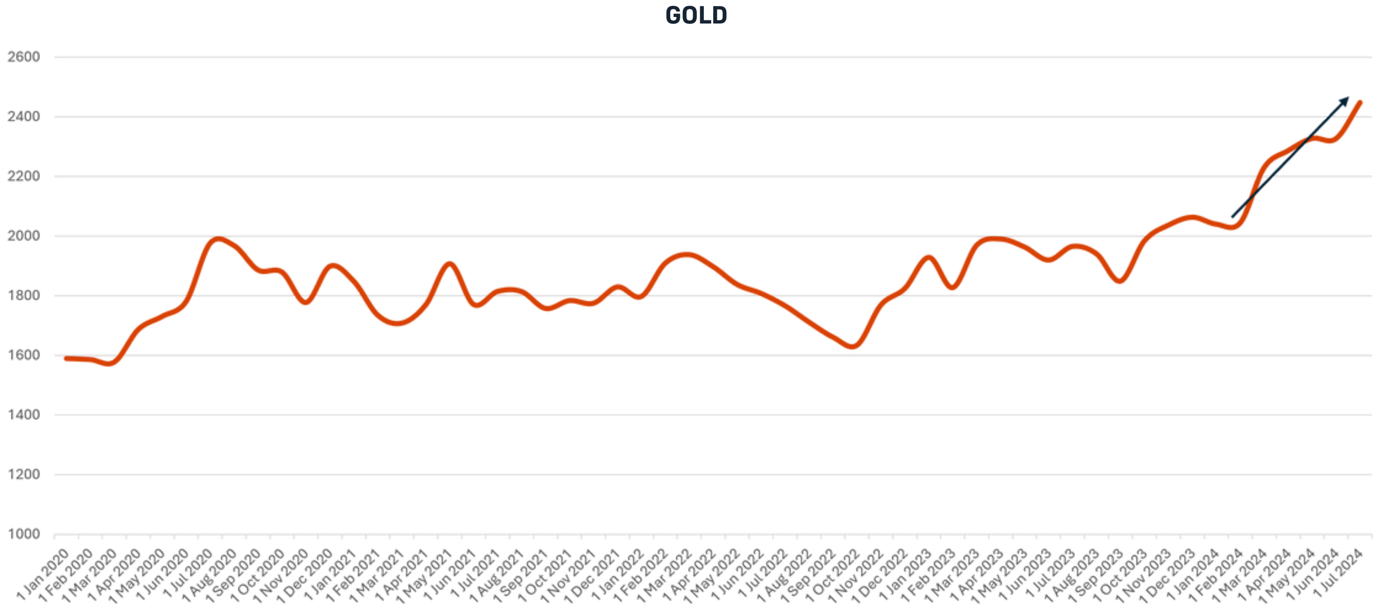


In July and August 2024, Ethereum witnessed a sharp decline in its price, dropping from $3,524 to around $2,349, a decrease of 33%. This decline was more pronounced than Bitcoin's, highlighting Ethereum's increased vulnerability to the negative market sentiment during this period. The downturn was driven by broader market corrections and growing investor caution. Despite its widespread use in decentralized applications, Ethereum struggled to maintain its value, reflecting the market's preference for safer assets in uncertain times. This period of underperformance underscores the challenges Ethereum faced in maintaining investor confidence amidst broader market correction in the short term.

The recent market turmoil, driven by factors such as market concerns of recession and a high-interest rate environment, led to widespread risk aversion. In such an environment, investors flocked to safer assets, leaving high-beta assets like crypto particularly vulnerable to significant sell-offs. This heightened volatility in crypto, exacerbated by the unwinding of carry trades and the impact of macroeconomic pressures, resulted in its substantial correction during this period.

Source: Bloomberg

GOLD

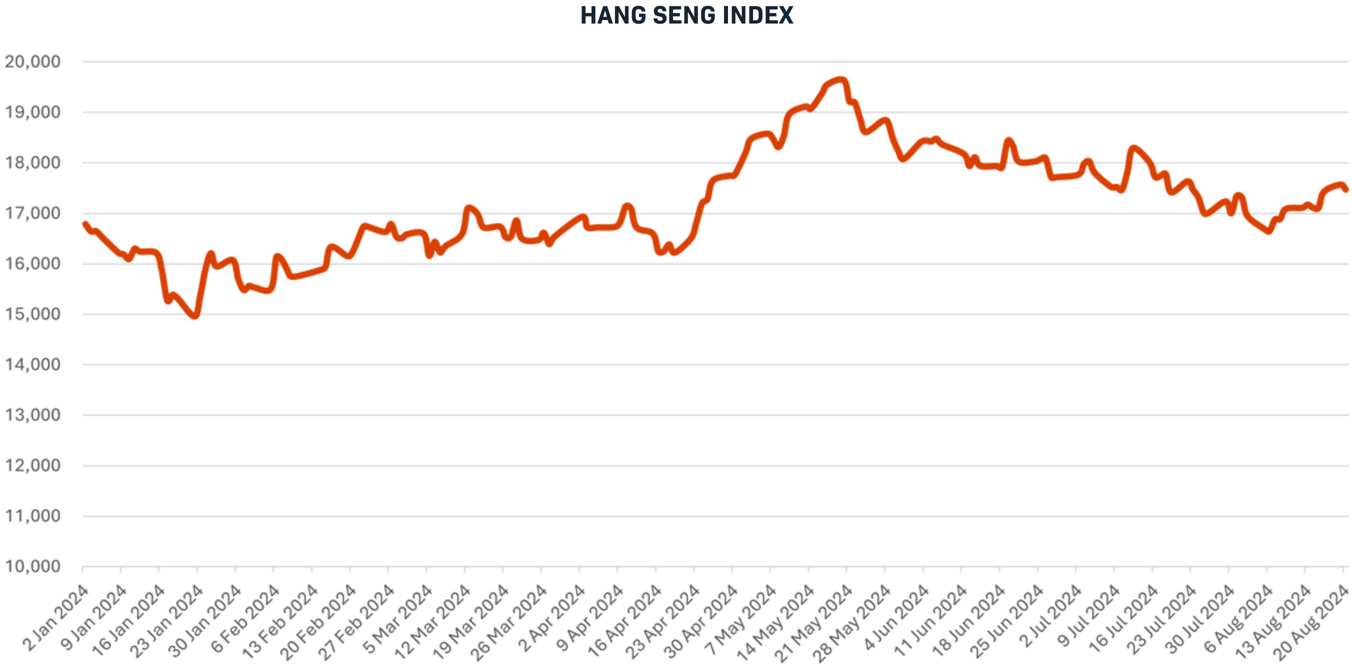


Gold's role as a safe-haven asset becomes particularly prominent during periods of heightened market volatility and economic uncertainty. Unlike high-risk assets, which are prone to sharp declines during turbulent times, gold tends to hold its value or even appreciate, making it a preferred choice for investors seeking to protect their wealth. Over the past two months, as global markets were roiled by factors such as fears of a potential recession, gold prices surged. Investors, wary of the instability in equities and other riskier assets, sold US and Japanese stocks and shifted their capital into gold, driving its strong performance.

This trend also reflects broader market sentiment during economic downturns. When recession fears intensify, investors often reallocate their portfolios to include more gold, anticipating its stability in comparison to more volatile assets. Gold's historical resilience in the face of economic slowdowns gives it a unique position in financial markets. It acts not only as a hedge against inflation but also as a buffer against economic contraction, offering a degree of security when other assets falter. As a result, gold remains a critical component in diversified investment strategies, particularly during uncertain economic periods.

Source: Bloomberg

CHINA MARKET



The Hang Seng Index and CSI 300 Index experienced relatively smaller declines compared to the broader global stock markets, including Japan. Hang Seng Index experienced a small decline from 18,293 on July 12, to 16,647 on August 6, marking a 9% drop, resilient in Asia, compared to the Japanese stock market.

One key factor behind this resilience is that the Chinese stock markets had already experienced significant downturns prior to the recent crisis, leaving them at lower valuations relative to their global peers. Specifically, the Hang Seng Index and CSI 300 Index were trading at 8.5x and 12x for 2024 P/E respectively, which are considerably lower than those of other major markets. As a result, their already discounted valuations helped cushion them from steeper losses during the global market downturn. This lower starting point meant there was less room for further declines, contributing to their comparatively resilient performance amidst the crisis.

To conclude, July and August have been months of significant market challenges, with recession fears driving volatility across the globe. Japan's rate hikes, a cooling US labor market and the heightened appeal of gold reflect the complex interplay of economic forces. Meanwhile, the crypto market has shown its vulnerability to these broader correction trends. As we move forward, these developments underscore the need for strategic asset allocation in an uncertain economic environment.

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Source: Bloomberg

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