Belvest

momentum
global investment management

GLOBAL MATTERS
MONTHLY VIEWPOINT

VOL #212|JULY2024

Contents

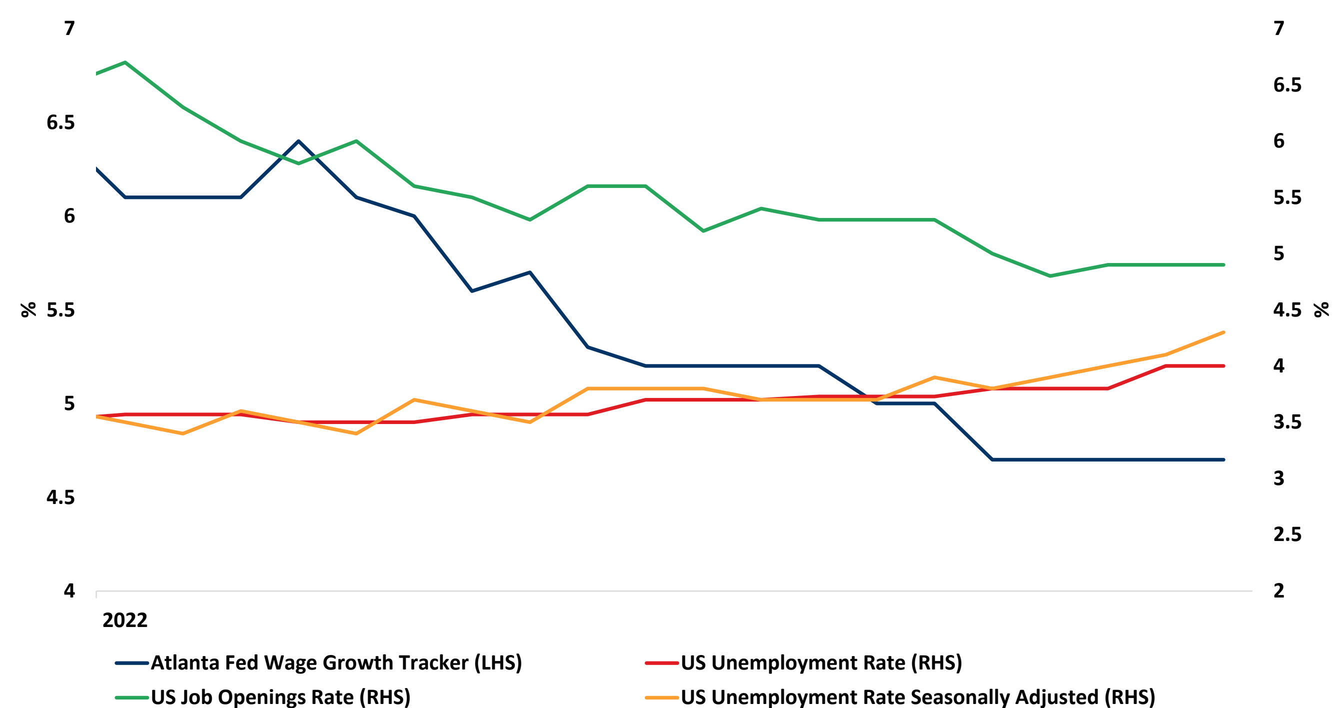
Global market review & outlook

On the surface, markets appear to have been uneventful in July, with few sizeable moves over the month - the S&P 500 index was up 1.2%, MSCI World index of developed markets +1.8%, emerging markets +0.3%, and US Treasuries +2.1%. The most notable moves were in currencies, with the yen +7.3%, a sharp reversal of its previous weakness, while gold continued to rise, +5.2%. Beneath the surface, however, there was a major change in the underlying market narrative, to an increasingly cautious view of the US economy, and a growing concern that the Fed has left policy easing too late to prevent a big slowdown. This was the trigger for a meaningful setback in markets from mid-month, after Wall Street had hit yet another all-time high on 16th July, weakness which escalated into a full-scale risk-off sell-off globally in early August. Given that these events have overtaken much of the news in July, we cover in this month's review the background to this particularly sharp and sudden correction in markets and how investors should interpret and react to the falls.

What caused the falls?

First and foremost, building evidence of slower growth in the US economy, particularly a weaker labour market, shifted the narrative. Job vacancies have been falling, unemployment rising, and wage rises pared. July data released on 2nd August showed weak job creation with the Non Farm Payrolls measure of employment increasing by 114,000 compared with a monthly average of 215,000 over the previous 12 months. The unemployment rate rose to 4.3% from 4.1% in June, and 3.5% a year ago, and average hourly earnings rose by 0.2%, bringing the year-on-year rate down to 3.6%, the lowest for over 3 years. With signs of weakness also evident in consumer spending and leading indicators of activity, the soft-landing consensus view shifted to growing concerns that the Fed has left policy easing too late to avoid a steep slowdown and possibly recession.

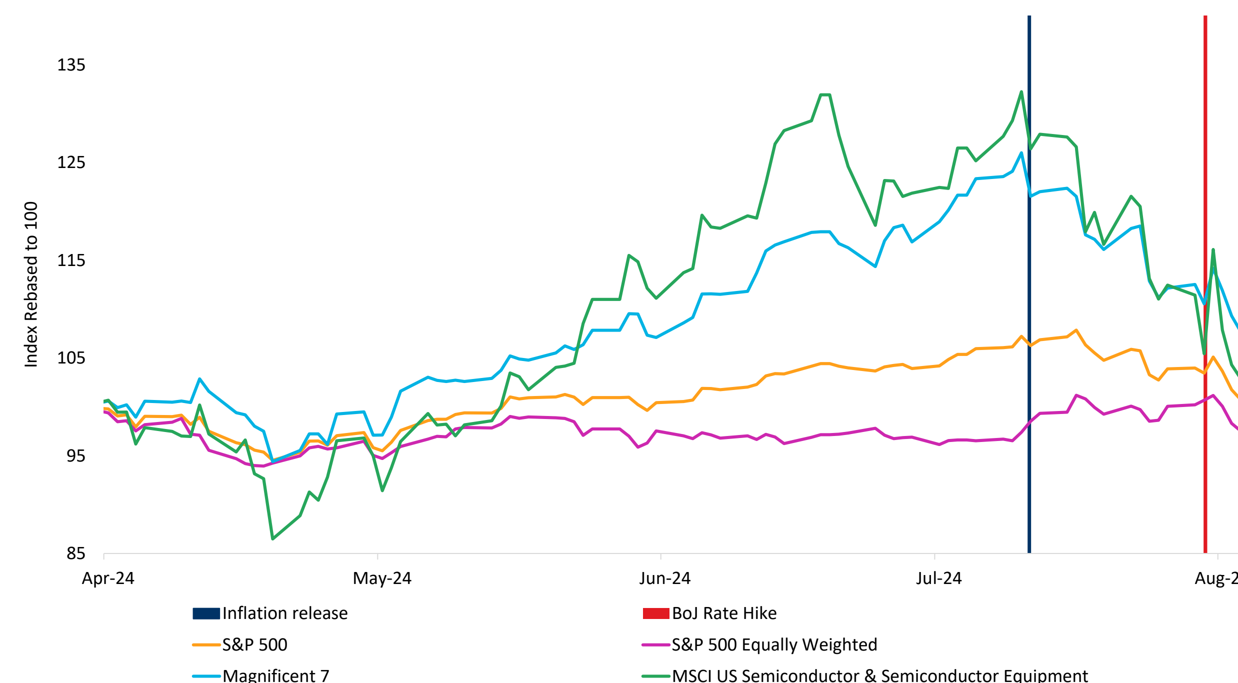
US labour market weakening



Source: Bloomberg Finance L.P. as at 31 July 2024.

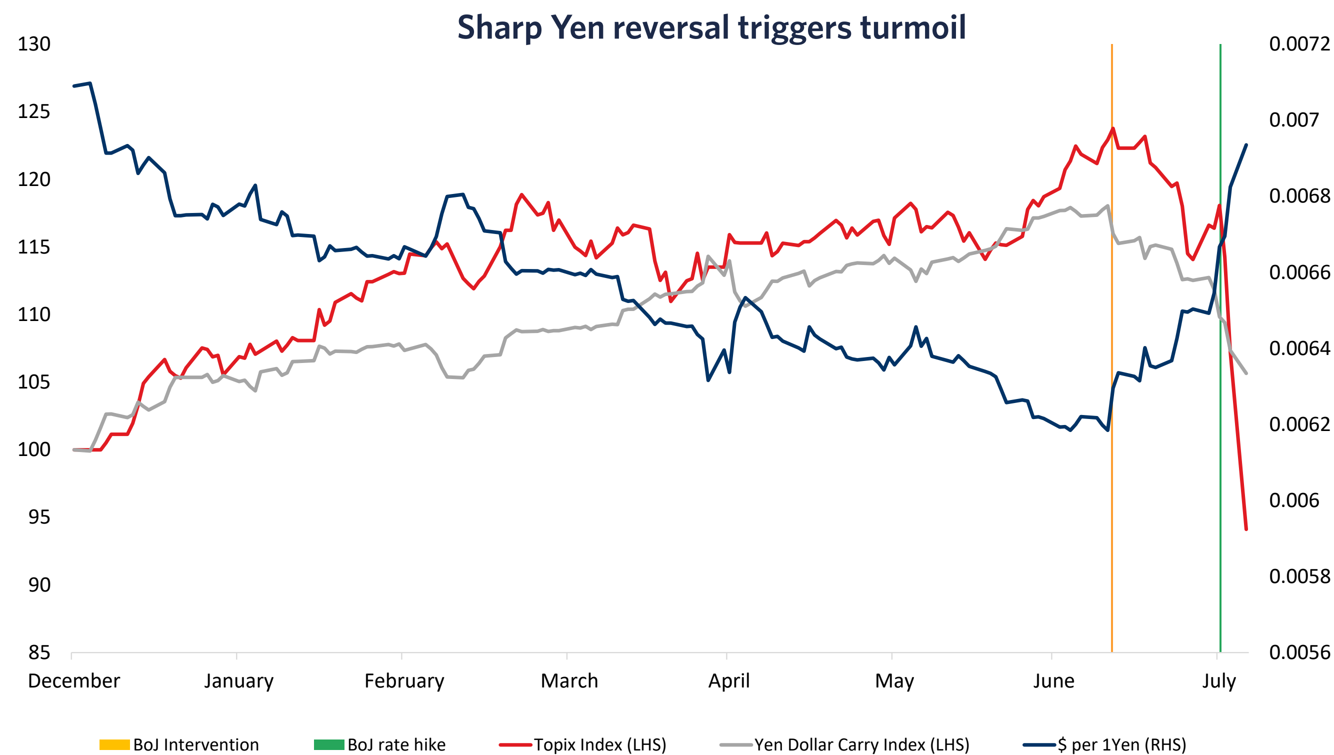
Second, cracks began to appear in some of the mega cap tech stocks in the US, the key drivers of the bull market in equities to date. Their steep rises and high valuations made these stocks increasingly vulnerable to profit-taking, accentuated by a series of either outright disappointing earnings releases or at least failure to live up to very high expectations. Investors increasingly questioned whether the massive investments in infrastructure to support the AI boom would pay off, and news of Warren Buffett halving Berkshire Hathaway's stake in Apple during the second quarter further dampened sentiment (although worth noting that Apple is still Berkshire's largest single holding). Rotation away from mega cap tech started with the better-than-expected CPI release on July 11th, which led to markets pricing in a rate cut in September and a shift by investors into more economically sensitive sectors, and the move continued through the turmoil in early August as defensive sectors outperformed substantially.

Big rotation away from mega cap tech stocks



Source: Bloomberg Finance L.P. as at 7 August 2024.

Third, the Bank of Japan tightened policy at its late July policy meeting, raising interest rates to 0.25% from a range of 0-0.1%, signalling further rate rises ahead, as well as significantly reducing its planned purchases of government bonds. While not wholly unexpected, the move triggered a sharp rise in the yen, which had already been rallying on intervention by the authorities earlier in July after it had fallen to 40-year lows. In a three-week period, the yen rallied by 12% against the dollar, exacerbated by rapid unwinding of the so called 'carry trade', widely used to sell yen to reinvest in higher yielding currencies. In turn, yen strength removed one of the pillars on which the strength of the local Japanese equity market had been based, weakening the competitiveness of the important export sector.



Yen carry index is the notional return on short yen/long USD.
Source: Bloomberg Finance L.P. as at 5 August 2024.

Fourth, but of less immediate consequence for investors, has been increased uncertainty around the outcome of the US Presidential election following Biden's withdrawal, and heightened concerns in the Middle East about an escalation following intensified attacks by Hezbollah on Israel and then Israel's response, potentially bringing Iran more directly into the conflict.

Finally, the technical situation in markets almost certainly exacerbated moves. August is traditionally one of the quietest months of the year, and liquidity is relatively tight. A scramble to deleverage and unwind trades that have turned sour inevitably has a much greater impact at this time of year.

How did markets react?

Equities sold off sharply, with the biggest falls in Japan, down by 24% between 11th July, when the authorities stepped in to support the yen, and 5th August, with much of that fall in just two days at the beginning of August, wiping out all of its gains this year. Wall Street fell 9% from its all-time high in mid-July to early August, but with a wide dispersion among sector performance, evidenced by the rapid rotation from big tech into small cap that started in mid July, a style shift that plays to our portfolio construction approach. The falls in European markets were more muted, while emerging markets saw big falls in Korea and Taiwan, with their high exposure to tech stocks. Defensive sectors such as consumer staples and healthcare held up well, as did interest rate sensitive sectors such as real estate and utilities, as bond yields fell. High-flying tech stocks saw sharp falls, with the Magnificent 7 and US semi-conductors indices down by 17% and 24% from their recent peaks to early August lows.

Outside Japan, arguably the most significant moves came in bond markets, where yields fell dramatically. The US Treasury 10 year yield fell by 66bps between end June and 5th August, to 3.78%, its lowest since mid-2023, while 2 year yields fell even more sharply, by 87bps to 3.88% by 5th August. The moves were driven not so much by a flight to safety but more because market expectations of rate cuts by the Fed changed substantially, with a cut of 25bps at the next meeting of the FOMC in September now all but certain, and a 50bps almost fully priced in, followed by two further cuts of 25bps by year end, taking the Fed Funds rate to 4.25%.

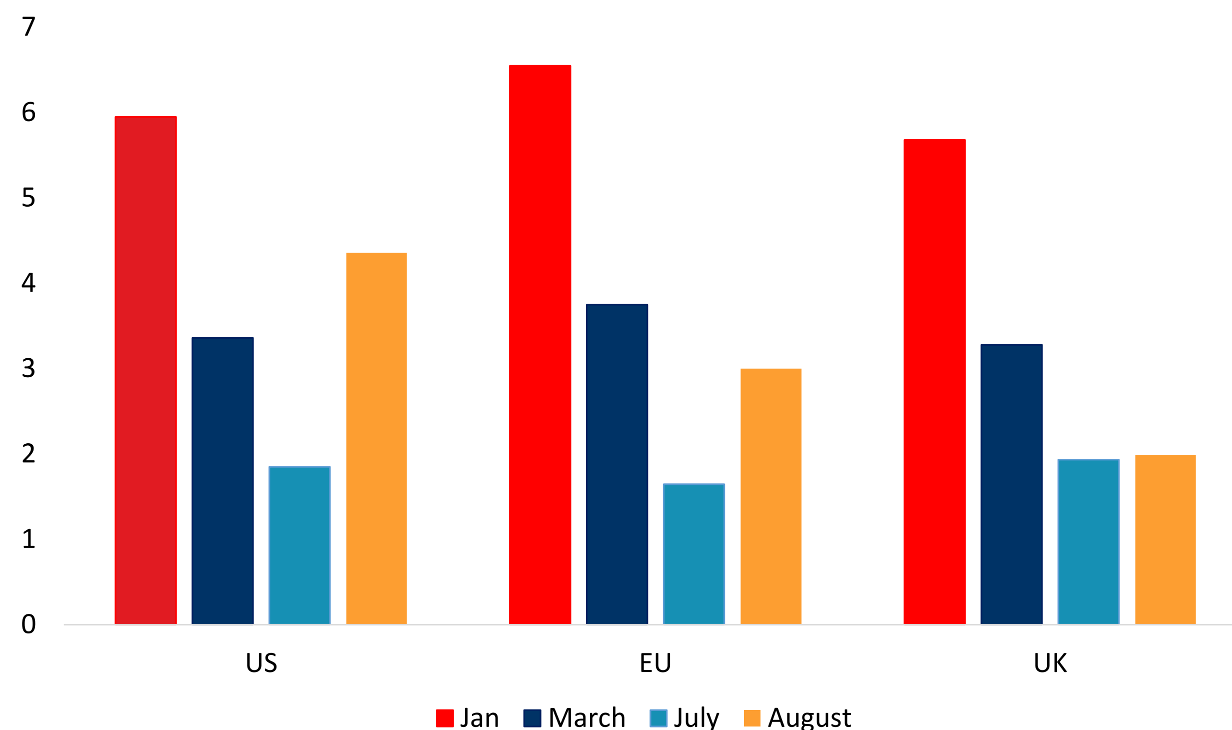
Credit spreads have widened, by around 50bps in the high yield sector, but from very low levels and by no means reflecting distress, while gold was remarkably resilient, suffering only very modest falls.

Currencies were dominated by the rise in the yen and sell-off in emerging market currencies which had been the beneficiaries of the carry trade. For example, the Mexican peso, a favourite of carry trade speculators, has fallen by some 10% since the yen started its rise.

What should investors do?

Don't panic: only very rarely is it right to do so, and this is not one of those times. The US economy is slowing and softer than previously thought, but we are not in conditions likely to cause a meaningful recession. The labour market has weakened but unemployment is still relatively low compared with previous cycles and wages are rising in real terms. Investment remains strong, helped by the various measures taken by the administration to support key initiatives. Inflation has fallen to levels which give the Fed ample room to start cutting rates, and the recent softening of the economy will only accelerate that programme.

We do not expect the Fed to over-react to the recent turmoil in markets by cutting rates mid-meetings, but we are confident that the rate cutting cycle will begin in September. While it is extremely unlikely to be as deep as that following the GFC, rates could well be 100bps lower by year end and potentially another 100bps lower by the end of 2025. This is not an environment which is bad for risk assets. We recognise the risk of policy error and the possibility of the economy weakening further, but the Fed has considerable room to ease and given its dual mandate which prioritises both inflation control and full employment, it will no doubt use its full armoury if necessary.



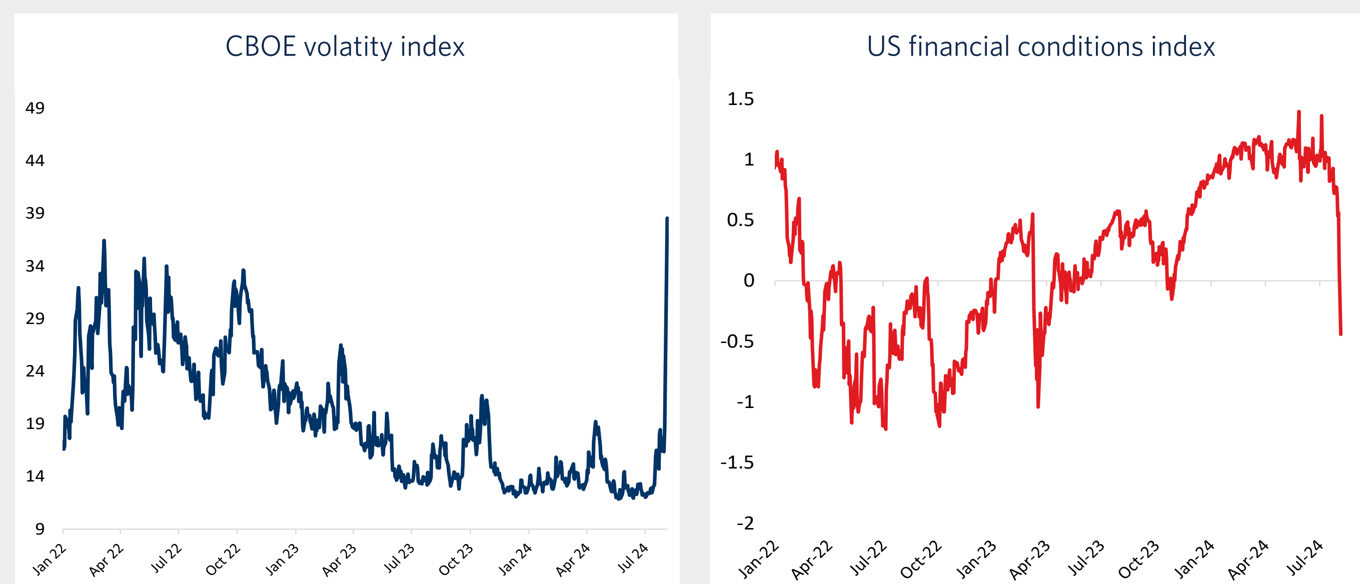
Source: Overnight index swaps as at 5 August 2024.

The moves we have seen, particularly in the yen, have triggered some deleveraging and rapid position closing; some pain and casualties among traders is likely given the speed and scale of the moves, and we might not yet have seen the end of this process. Volatility in markets has spiked and financial conditions have tightened abruptly, despite the big falls in bond yields. But this is not an event on a global scale which would raise widespread systemic risks. Critically, banks globally are in strong shape, and balance sheets are unrecognisable compared with the GFC, able to withstand very much bigger turmoil than currently seen.

We recognise the risks coming from geopolitics and US politics, and the increased uncertainty around economic growth. But markets have adjusted rapidly to the changed narrative; valuations of equities are now lower, in some cases materially, and while short term volatility could remain high as unwinding of extended positions might have further to run, systemic risks are minimal, corporate profits are generally holding up well, and the Fed's rate cutting cycle is about to begin.

We are therefore using this meaningful correction to add selectively to equity risk. We are more cautious in bond markets; having added to duration at higher yield levels we have taken some profits as the scale of the falls in yields appears to be discounting tougher economic conditions than seem likely. Gold, where we retain our positions, has again illustrated its considerable value as a portfolio diversifier and preserver of capital in market turmoil. Perhaps more than anything else, the events of recent days illustrate the vital importance of diversification, across asset classes, regions, and investment styles.

Volatility spikes higher, financial conditions tighten abruptly



Source: Bloomberg Finance L.P. as at 5 August 2024.

"We recognise the risks coming from geopolitics and US politics, and the increased uncertainty around economic growth. But markets have adjusted rapidly to the changed narrative"

Market performance - Global (local returns) as at 31 July 2024

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
Developed Markets Equities						
United States	S&P 500 NR	USD	1.2%	9.9%	16.4%	21.6%
United Kingdom	MSCI UK NR	GBP	2.6%	3.3%	10.8%	13.5%
Continental Europe	MSCI Europe ex UK NR	EUR	0.6%	3.1%	9.3%	12.0%
Japan	Topix TR	JPY	-0.5%	2.1%	19.5%	23.1%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	0.2%	6.0%	8.7%	7.1%
Global	MSCI World NR	USD	1.8%	8.5%	13.7%	18.3%
Emerging Markets Equities						
Emerging Europe	MSCI EM Europe NR	USD	0.3%	3.8%	15.6%	20.9%
Emerging Asia	MSCI EM Asia NR	USD	-0.3%	6.2%	10.7%	8.0%
Emerging Latin America	MSCI EM Latin America NR	USD	1.0%	-8.1%	-14.8%	-9.3%
China	MSCI EM China NR	USD	1.0%	3.3%	7.3%	1.9%
BRICs	MSCI BRIC NR	USD	-1.3%	-0.9%	3.3%	-12.4%
Global emerging markets	MSCI Emerging Markets NR	USD	0.3%	4.8%	7.8%	6.3%
Bonds						
US Treasuries	JP Morgan United States Government Bond TR	USD	2.1%	4.6%	1.3%	4.2%
US Treasuries (inflation protected)	BBgBarc US Government Inflation Linked TR	USD	1.8%	4.4%	2.5%	4.3%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	2.4%	5.0%	1.9%	6.8%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	1.9%	4.0%	4.6%	11.0%
UK Gilts	JP Morgan UK Government Bond TR	GBP	1.8%	4.0%	-0.9%	5.8%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.6%	3.4%	1.5%	9.2%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	2.3%	2.4%	0.3%	5.0%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.7%	2.7%	2.3%	7.1%
Euro High Yield	BBgBarc European HY 3% Constrained TR	EUR	1.2%	2.6%	4.1%	10.5%
Japanese Government	JP Morgan Japan Government Bond TR	JPY	-0.1%	-1.5%	-3.3%	-3.9%
Australian Government	JP Morgan Australia GBI TR	AUD	1.5%	2.6%	1.5%	4.3%
Global Government Bonds	JP Morgan Global GBI	USD	3.1%	4.2%	-1.6%	1.4%
Global Bonds	ICE BofAML Global Broad Market	USD	2.9%	4.5%	-0.5%	3.0%
Global Convertible Bonds	ICE BofAML Global Convertibles	USD	1.7%	4.4%	3.6%	4.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	2.0%	4.2%	4.5%	9.6%

Asset Class / Region	Index	Ccy	1 month	3 months	YTD	12 months
Property						
US Property Securities	MSCI US REIT NR	USD	6.2%	14.1%	5.3%	9.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	6.8%	7.9%	15.4%	23.3%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	5.8%	-1.6%	-6.4%	-7.7%
Global Property Securities	S&P Global Property USD TR	USD	6.0%	9.5%	3.5%	8.4%
Currencies						
Euro		USD	1.1%	1.5%	-1.9%	-1.6%
UK Pound Sterling		USD	1.7%	2.9%	1.0%	0.2%
Japanese Yen		USD	7.3%	5.2%	-6.0%	-5.1%
Australian Dollar		USD	-1.9%	1.1%	-4.0%	-2.6%
South African Rand		USD	-0.1%	3.2%	0.9%	-2.0%
Commodities & Alternatives						
Commodities	RICI TR	USD	-4.2%	-3.9%	3.1%	-2.1%
Agricultural Commodities	RICI Agriculture TR	USD	-2.8%	-5.7%	-2.6%	-6.2%
Oil	Brent Crude Oil	USD	-6.6%	-8.1%	4.8%	-5.7%
Gold	Gold Spot	USD	5.2%	7.1%	18.6%	24.6%

Interest Rates	Current Rate
United States	5.50%
United Kingdom	5.25%
Eurozone	4.25%
Japan	-0.10%
Australia	4.35%
South Africa	8.25%

Source: Bloomberg Finance L.P. , Momentum Global Investment Management. Past performance is not indicative of future returns. *estimate.

Market performance - UK (all returns GBP) as at 31 July 2024

Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
Equities						
UK - All Cap	MSCI UK NR	GBP	2.6%	3.3%	10.8%	13.5%
UK - Large Cap	MSCI UK Large Cap NR	GBP	2.4%	3.0%	11.8%	14.3%
UK - Mid Cap	MSCI UK Mid Cap NR	GBP	3.2%	4.5%	2.3%	5.8%
UK - Small Cap	MSCI Small Cap NR	GBP	7.0%	9.6%	11.4%	16.4%
United States	S&P 500 NR	USD	-0.3%	7.1%	15.7%	21.8%
Continental Europe	MSCI Europe ex UK NR	EUR	-0.1%	1.6%	6.2%	10.2%
Japan	Topix TR	JPY	4.6%	4.0%	11.1%	16.4%
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	-1.4%	3.3%	8.0%	7.2%
Global developed markets	MSCI World NR	USD	0.2%	5.7%	13.1%	18.5%
Global emerging markets	MSCI Emerging Markets NR	USD	-1.2%	2.1%	7.2%	6.4%
Bonds						
Gilts - All	ICE BofAML UK Gilt TR	GBP	1.9%	4.1%	-1.1%	5.8%
Gilts - Under 5 years	ICE BofAML UK Gilt TR 0-5 years	GBP	0.9%	2.1%	1.5%	5.9%
Gilts - 5 to 15 years	ICE BofAML UK Gilt TR 5-15 years	GBP	1.9%	4.2%	-0.6%	7.3%
Gilts - Over 15 years	ICE BofAML UK Gilt TR 15+ years	GBP	2.5%	5.7%	-3.9%	3.6%
Index Linked Gilts - All	ICE BofAML UK Gilt Inflation-Linked TR	GBP	2.0%	3.7%	-2.5%	1.6%
Index Linked Gilts - 5 to 15 years	ICE BofAML UK Gilt Inflation-Linked TR 5-15 years	GBP	1.7%	2.8%	-0.4%	4.8%
Index Linked Gilts - Over 15 years	ICE BofAML UK Gilt Inflation-Linked TR 15+ years	GBP	2.6%	5.0%	-5.1%	-1.8%
UK Corporate (investment grade)	ICE BofAML Sterling Non-Gilt TR	GBP	1.6%	3.4%	1.5%	9.2%
US Treasuries	JP Morgan US Government Bond TR	USD	0.5%	2.0%	0.6%	4.4%
US Corporate (investment grade)	BBgBarc US Corporate Investment Grade TR	USD	0.8%	2.3%	1.1%	6.9%
US High Yield	BBgBarc US High Yield 2% Issuer Cap TR	USD	1.9%	4.0%	4.6%	11.0%
Euro Government Bonds	ICE BofAML Euro Government TR	EUR	2.3%	2.4%	0.3%	5.0%
Euro Corporate (investment grade)	BBgBarc Euro Aggregate Corporate TR	EUR	1.7%	2.7%	2.3%	7.1%
Euro High Yield	BBgBarc European High Yield 3% Constrained TR	EUR	1.2%	2.6%	4.1%	10.5%
Global Government Bonds	JP Morgan Global GBI	GBP	1.6%	1.5%	-2.1%	1.6%
Global Bonds	ICE BofAML Global Broad Market	GBP	2.9%	4.5%	-0.5%	3.0%
Global Convertible Bonds	ICE BofAML Global Convertibles	GBP	1.7%	4.4%	3.6%	4.4%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	GBP	0.5%	1.5%	3.9%	9.8%

Asset Class / Region	Index	Local Ccy	1 month	3 months	YTD	12 months
Property						
Global Property Securities	S&P Global Property TR	GBP	4.4%	6.7%	2.9%	8.6%
Currencies						
Euro		GBP	-0.6%	-1.4%	-2.9%	-1.7%
US Dollar		GBP	-1.6%	-2.8%	-1.0%	-0.2%
Japanese Yen		GBP	5.5%	2.2%	-6.9%	-5.3%
Commodities & Alternatives						
Commodities	Rogers International Commodity (RICI) TR	GBP	-5.6%	-6.4%	2.5%	-1.9%
Agricultural Commodities	Rogers International Commodity (RICI) Agriculture TR	GBP	-4.3%	-8.1%	-3.2%	-6.1%
Oil	Brent Crude Oil	GBP	-8.0%	-10.5%	4.2%	-5.5%
Gold	Gold Spot	GBP	3.6%	4.3%	18.0%	24.8%

Interest Rates	Current Rate
United Kingdom	5.25%

Source: Bloomberg Finance L.P. , Momentum Global Investment Management. Past performance is not indicative of future returns.

JUNE 2024

Asset allocation views

Score	Change	---	--	-	/	+	++	+++
MAIN ASSET CLASSES	▲/▼/—							
Equities	—			■				
Fixed Income	—				■			
Alternatives	—					■		
Cash	—				■			

Overall View

We remain somewhat cautious on equity risk overall, mindful of the dominance of the US in the global equity context, and of the concentration within the US market. Our fixed income view remains largely constructive, more so in sovereign bonds which still offer attractive nominal and real yields, but we recognize risk premia on corporate credit are thin today. Alternative assets including gold remain a good diversifier of returns, proving useful as market volatility has increased. Cash provides optionality on any pullback as well as a decent yield, but increasingly we prefer to lock in medium term rates by extending duration.

Score	Change	---	--	-	/	+	++	+++
EQUITIES	▲/▼/—							
Developed Equities	—			■				
UK Equities	—						■	
European Equities	—				■			
US Equities	—			■				
Japanese Equities	—					■		
Emerging Market Equities	—					■		

UK equities remain the highest conviction valuation call with the UK remaining the cheapest developed market. The attractive earnings yields continue to draw in private and overseas buyers, and with the recent election behind us, sentiment finally appears more constructive. Japan remains attractive both on improving fundamentals and in valuation terms – more so after recent volatility saw prices correct sharply. The lack of breadth in US equities has started to play out through a sector and size rotation which should increasingly favour an active approach to stock selection. European equities have optically quite attractive valuations but mask some fundamental regional challenges. Emerging market equities remain cheap as China, the dominant index constituent, battles domestic growth concerns.

Score	Change	---	--	-	/	+	++	+++
FIXED INCOME	▲/▼/—							
Government	—					■		
Index-Linked	—				■			
Investment Grade Corporate	—				■			
High Yield Corporate	—			■				
Emerging Market Debt	—				■			
Convertible Bonds	—			■				

Global treasury yields still look attractive today, despite recent tightening, and we maintain our overweight government view. Inflation linked bonds offer reasonable real yields but are not particularly cheap today. Despite offering alluring all in yields, we think the spreads offered today on investment grade and riskier high yield corporate bonds do not compensate investors adequately for the underlying fundamental credit risk. Although defaults remain low, the growth outlook has moderated, and financial conditions remain somewhat tight today. We prefer shorter duration bonds in both developed and emerging markets, particularly higher quality credit.

Score	Change	---	--	-	/	+	++	+++
SPECIALIST ASSETS/ALTERNATIVES	▲/▼/—							
Commodities	—				■			
Property	—				■			
Infrastructure	—					■		
Liquid Alternatives	—			■				
Private Equity	—							■
Specialist Financial	—						■	

Commodity prices are likely to remain idiosyncratic supply and demand driven stories with price moves exacerbated by geopolitical risk which has taken gold to new highs. Industrial commodities remain exposed to a buoyant but perhaps softening global economy. Alternatives continue to offer diversification benefits but compete today with higher yielding cash and quality sovereign bonds. Increasing discounts in NAVs in listed private equity appear overly pessimistic, and we upgrade our view to take advantage. Infrastructure and specialist financials remain attractive. Our liquid alternatives continue to offer attractive diversification benefits during periods of market uncertainty, but the bar has been raised for the performance from this sector after the resetting higher of global rates in recent years.

Score	Change	---	--	-	/	+	++	+++
CURRENCIES vs. USD	▲/▼/—							
GBP	—					■		
EUR	—				■			
JPY	—					■		
Gold	—			■				

Against long term valuation metrics, the Yen remains cheap relative to the Dollar. The Bank of Japan's policy of yield curve control crushed the Yen in recent years, but their recent shift to a hiking bias has seen a rapid reappraisal as carry trades unwind. This should have further to run. The higher for longer narrative in the US has buoyed the dollar, but as rates look set to fall later this year its dominance may wane. Its safe haven status at a time of heightened geopolitical risk does however assure it a diversification premium. Gold's status as a haven asset means it remains a useful diversifier, but its recent run higher makes it look somewhat expensive as a non interest bearing asset today.

The asset allocation views are updated at the end of each quarter unless otherwise stated.

Belvest

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