Global Matters Weekly

23 September 2024

History doesn't repeat but it often rhymes

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Last week, the Federal Reserve delivered a highly anticipated decision, lowering interest rates and marking the beginning of a new monetary policy cycle. This shift provides an excellent opportunity to assess the current investment landscape and consider market expectations.

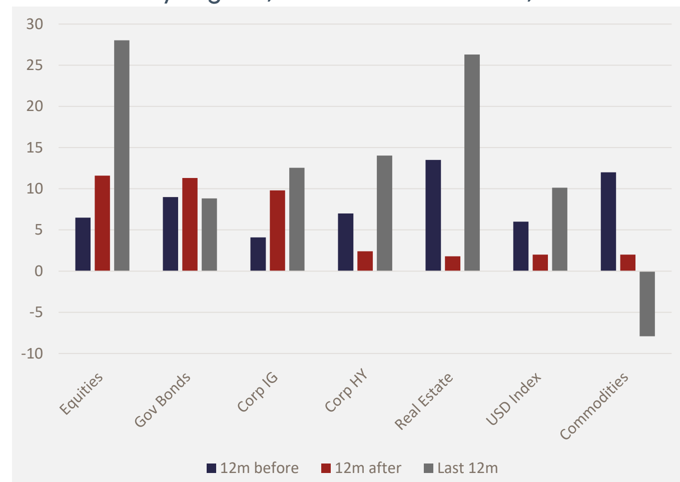
Historically, periods of changing monetary regimes have been associated with heightened price volatility across various US dollar-denominated asset classes. Transitions to a lower interest rate environment have often coincided with strong positive returns for traditional asset classes. The blue bars on the chart below represent the average returns of these asset classes over the past four decades. Notably, the grey bars, which depict returns from the past 12 months, show that many asset classes have exceeded expectations.

Below, we explore the main factors driving these surprises.

In the US equity market, the performance of the "Magnificent 7" companies has likely been a key contributor to the robust overall outperformance. Meanwhile, in corporate investment-grade and high-yield categories, strong returns have come amid a neutral to positive economic growth outlook, further bolstered by abundant liquidity in the system. In the real estate sector, the primary driver appears to be an upward correction from previously oversold conditions.

In the foreign exchange market, the US Dollar Index (DXY) outperformed, supported by the relative strength of the US economy and heightened geopolitical uncertainty.

Historical returns 12 months before and after the change in US monetary regime, and latest 12 months, %



Source: S&P Global, ICE, CAIM, January/September 2024.

Government bond returns were in line with historical data, while commodities underperformed. This underperformance can be attributed to growing concerns about the Chinese economy, which, as a global manufacturing powerhouse, is closely linked to demand for commodities.

Regarding the Fed's decision, most analysts were surprised by the 50 basis point rate cut, as a 25 basis point cut was expected. However, the bond market's reaction suggested otherwise, with yields remaining stable at the short end of the curve and selling pressure at the long end. This was partly explained

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by the Fed's updated projections, which indicated a slower pace of rate cuts going forward and slightly upward-adjusted terminal rate projections.

What should we expect for the returns of major asset classes in the coming months, and how will they compare to their four-decade averages? The year began with high market expectations, reflected through high valuations of many assets. Market observers will recall that asset returns over the past 12 months were far from evenly distributed.

Looking ahead, we expect similar volatility over the next 12 months, as the fundamental outlook raises more questions than answers. Economic growth may once again surprise to the upside, as could inflation.

From a technical perspective, many indicators are signaling overbought conditions, with positioning showing increased accumulation of high-risk assets.

In the government bond market, traditionally a safe-haven asset class, the market is still ahead of the Fed, pricing in a more aggressive rate path. Geopolitical factors will likely take center stage again, particularly with upcoming US elections and ongoing fiscal challenges.

Many investors will look to history for guidance on he future. The red bars in the chart show the historical performance of asset classes 12 months after the first interest rate cut. While history may not repeat itself exactly, it often rhymes, presenting plenty of investment opportunities.

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