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July 2024
Market Pulse

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MARKETS RALLY AMID EXPECTED RATE CUTS LATER IN 2024

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Global stock markets rallied in July as some weakness in the technology sector was more than offset by softer inflation data in the US, which supported the case for some monetary easing and bolstered equity-market sentiment. Government bond prices were higher as investors priced in further rate cuts in 2024. Global economic data was mixed, with some signs of slowing in the US, while Eurozone output showed improving trends. Inflation slowed in the US, leaving the potential for the Federal Reserve (Fed) to cut rates in the coming months, and Fed Chair Powell indicated as much at the central bank's July policy meeting. Meanwhile, political risk remained in focus in Europe, with elections in the UK and France. In the US, politics took a dramatic turn as there was an assassination attempt on Donald Trump, and President Joe Biden withdrew from the presidential race.

Macro

Global economic data was mixed in July, and this was reflected in purchasing managers' indices (PMIs). The composite index (manufacturing and services) for the US rose slightly as an improvement in services from June offset a decline in manufacturing. In contrast, the Eurozone composite PMI was down by more than forecast as Germany's PMI unexpectedly fell into contractionary territory.

Meanwhile, political risk remained in focus amid elections in France and the UK. The UK general election gave the Labour party a large majority, as expected. It won a landslide victory of some 409 parliamentary seats out of a total of 650. The French election results were less straightforward. The left wing New Popular Front bloc won the most seats, with 180, but was well short of the 289 needed for majority. President Emmanuel Macron's Ensemble alliance was second with 159 seats and the far-right National Rally underperformed expectations and won 143 seats. This is expected to lead to continued uncertainty around government formation, but a positive is the large presence of centrist parties, which could act as a control on fiscal spending by any government headed by the New Popular Front.

In addition, the US election campaign took a dramatic turn in July as there was an assassination attempt on Donald Trump. President Joe Biden withdrew from the presidential race and strongly endorsed Vice President Kamala Harris, who is expected to be formally nominated as the Democratic presidential candidate in August.

US

Data in the US showed mixed signals in July. Q2 US GDP rose by an annualised 2.8% quarter-on-quarter (q/q), above market expectations and double the growth rate in Q1. Economic activity was supported by strong household consumption. In addition, US labour market data for June showed more jobs added (206k non-farm payrolls) than expected (190k). However, unemployment ticked up marginally to 4.1%. The services sector, which accounts for 70-80% of the US economy, also exhibited a broad-based contraction in activity in June, with the ISM non-manufacturing index falling to its lowest level since May 2020. The fall was steeper than market expectations and indicated weakness across new orders, business activity and employment.

As part of the GDP release, inflation was shown to have decelerated in Q2. Core inflation fell to 2.9% year-on-year (y/y) from 3.7% in Q1. The Fed's preferred inflation measure (core PCE) also stayed at 2.6% y/y in June. Finally, the headline consumer price index was 3.0% y/y in June, a 12-month low and down from 3.3% in May. Core prices were up by 3.3%, lower than market expectations. Taken together, this suggested that inflation pressures were easing from earlier in the year and that a continuation of this trend to inflation nearer the Fed's 2% target should allow for rate cuts this year.

Indeed, Fed Chair Powell's comments to Congress and the Senate in early July were viewed as leaning towards this stance as he highlighted "unexpected weakening" in the labour market. This view was subsequently confirmed after the Fed's July meeting, at which the federal funds rate was left unchanged at a target range of 5.25-5.50%. In the press conference, Chair Powell stated that: "A reduction in our policy rate could be on the table as soon as the next meeting in September". He emphasised that inflation would need to show continued evidence of coming down before then, but also that the central bank was "attentive" to growth risks.

Europe

Eurozone Q2 GDP indicated that activity continues to recover, rising by 0.3% q/q, which was above market expectations and matched the Q1 number. This was driven by strength in Spain (0.8% q/q) and France (0.3%), and also helped by Ireland (1.2%). Activity in Germany declined by 0.1%, down from a 0.2% rise in Q1 amid falling investment. Meanwhile, unemployment in the region remained at the historical low of 6.4% in May, a full percentage point below the pre-pandemic level and indicative of a strong labour market. Finally, headline inflation accelerated marginally in July to 2.6% y/y, from 2.5% in June, while core inflation was unchanged at 2.9%.

Overall, this backdrop of healthy activity and somewhat sticky inflation is likely to keep the ECB cautious around further monetary easing in the coming months. Indeed, the ECB's June meeting minutes, at which it cut rates for the first time since 2019, suggested that the central bank remains concerned about upside risks to inflation. This was also reflected at its July meeting, at which policy rates were left unchanged. There was a focus on how data evolves broadly in the coming months, to assess the appropriate policy setting, in subsequent speeches by ECB President Lagarde and other Governing Council members.

MARKET ROUND-UP

Equities

Global stock markets rallied in July as some weakness in the technology sector was more than offset by softer inflation data in the US, which supported the case for some monetary easing and bolstered equity-market sentiment.

The MSCI All Country World index rose by 1.2% (0.7% in euros) over the month, with the MSCI USA rising by 1.3% (0.3% in euros) and European ex-UK equities up by 0.6% (in local and euro terms). Q2 corporate earnings from Google and Tesla were disappointing and this weighed on technology stocks in mid-July. The day after these results were announced, US indices were sharply lower, with the S&P 500 posting its worst daily loss (-2.3%) since December 2022. However, subsequent softer US inflation data and expectations for a rate cut from the Fed in September supported a rebound in technology stocks and the broader equity market into month-end.

Small cap stocks rallied strongly over the month, supported by lower bond yields given their higher leverage levels and larger share of variable rate borrowings. The MSCI World Small Cap index rose by 6.0% (5.8% in euros) in July.

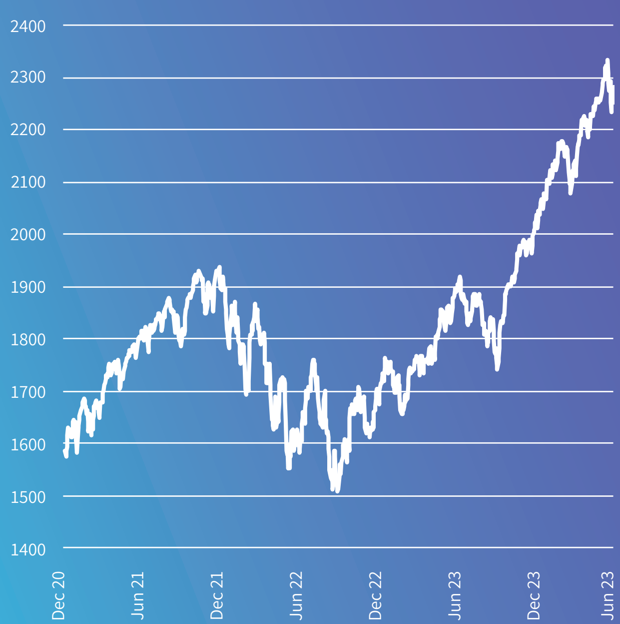
Bonds

Eurozone government bond prices were higher in July as investors priced in further rate cuts in 2024. The ICE BofA 5+ Year Euro Government bond index returned 3.0% amid falling yields, with the 10-year German bund yield down by 20bps to 2.30% in July. The equivalent US Treasury bond yield fell by 37bps to 4.03% over the month.

Corporate bonds were supported by falling yields. European investment grade (IG) corporate bonds returned 1.7% as yields fell by 31bps to 3.56%. Spreads narrowed by 8bps to 109bps. Global high yield bonds returned 1.8% as yields declined by 31bps to 6.62%.

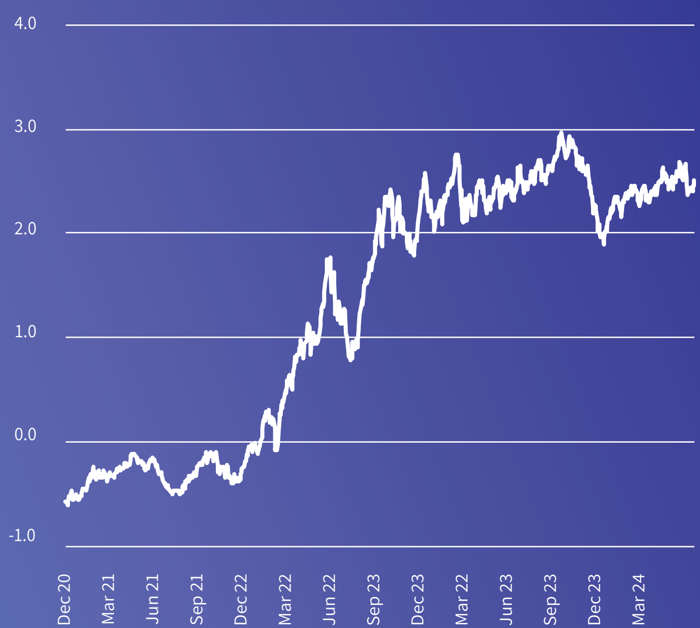
CHARTS OF THE MONTH

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 31 July 2024.

Bonds – German 10-year yield



Source: ILIM, Bloomberg. Data is accurate as at 31 July 2024.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2023 Return (%)
MSCI Ireland	9.4	30.1	20.6
MSCI United Kingdom	3.2	13.7	10.3
MSCI Europe ex UK	0.6	10.1	18.5
MSCI North America	0.4	18.3	22.3
MSCI Japan	4.8	15.0	16.7
MSCI EM (Emerging Markets)	-0.6	10.3	6.5
MSCI AC World	0.7	15.8	18.6
10-Year Yields	**Yield last month (%)**	**2023 Yield (%)**	**2022 Yield (%)**
US	4.03	3.88	3.87
Germany	2.30	2.02	2.57
UK	3.97	3.54	3.67
Japan	1.06	0.61	0.42
Ireland	2.70	2.38	3.13
Italy	3.65	3.69	4.70
Greece	3.32	3.06	4.62
Portugal	2.93	2.66	3.59
Spain	3.12	2.99	3.66
FX Rates	**End last month**	**2023 Rates**	**2022 Rates**
U.S. Dollar per Euro	1.08	1.10	1.07
British Pounds per Euro	0.84	0.87	0.89
U.S. Dollar per British Pounds	1.28	1.27	1.21
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2023 Return (%)**
Oil (Brent)	-6.6	4.8	-10.3
Gold (Oz)	4.3	17.6	13.1
S&P Goldman Sachs Commodity Index	-3.5	7.2	4.3

Source: ILIM, Bloomberg. Data is accurate as at 1 August 2024.

THE ILIM VIEW – LOOKING AHEAD

With inflation having fallen significantly and central banks now suggesting rates will be cut further in 2024, bond yields are expected to decline over the next 12 months. On a 12-month view, our base case is that German and US 10-year government bond yields fall from current levels of 2.30% and 4.03% to 1.75% and 3.75%, respectively. We believe fixed income offers a strong risk-reward profile at this stage in the cycle, with the potential to offer protection if the economy slows, and is attractive from an income perspective, while also providing potential for capital gains via falling yields. We believe that the risks of materially higher bond yields have reduced and, if the economy falters, major central banks will be able to cut rates to support growth. In that scenario we would expect bonds to outperform to a greater extent.

Global equities valuations are above long-term averages, trading on a 12-month forward price-to-earnings (P/E) multiple of 17.5x against a long-term average of 16.0x. Equities remain expensive against both bonds and cash given the high yields currently available on these assets. Despite equities appearing expensive on a relative valuation basis, however, the outlook on a 12-month view is positive. Central banks are likely to pivot towards looser policy in 2024 as inflation falls. An increasing probability of growth remaining firm, with a recession being avoided, contributing to a rebound in earnings in 2024 is supportive. Over the medium term, the rollout of artificial intelligence (AI) should boost efficiencies and earnings across the whole market and allow equities to trade at higher valuation levels. The ongoing green-related capex cycle could also boost earnings over the medium term. Any short-term volatility in markets is likely to be offset by the above factors, resulting in positive returns on a 12-month time frame.

THE MONTH AHEAD

AUGUST

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
				9 CN Inflation Rate YoY
	13 GB Unemployment Rate US PPI Mo	14 GB Inflation Rate YoY US Inflation Rate YoY	15 GB Inflation Rate YoY US Inflation Rate YoY	16 GB Inflation Rate YoY US Inflation Rate YoY
		21 GB Inflation Rate YoY US Inflation Rate YoY		23 JP Inflation Rate YoY
26 DE Ifo Business Climate Durable Goods Orders MoM		28 DE GfK Consumer Confidence	29 US GDP Growth Rate QoQ 2nd Est	30 EA Inflation Rate YoY Flash US Personal Spending MoM

Source: tradingeconomics.com

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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