MARKET VIEWS

Charts of the Week

August 13th,2024

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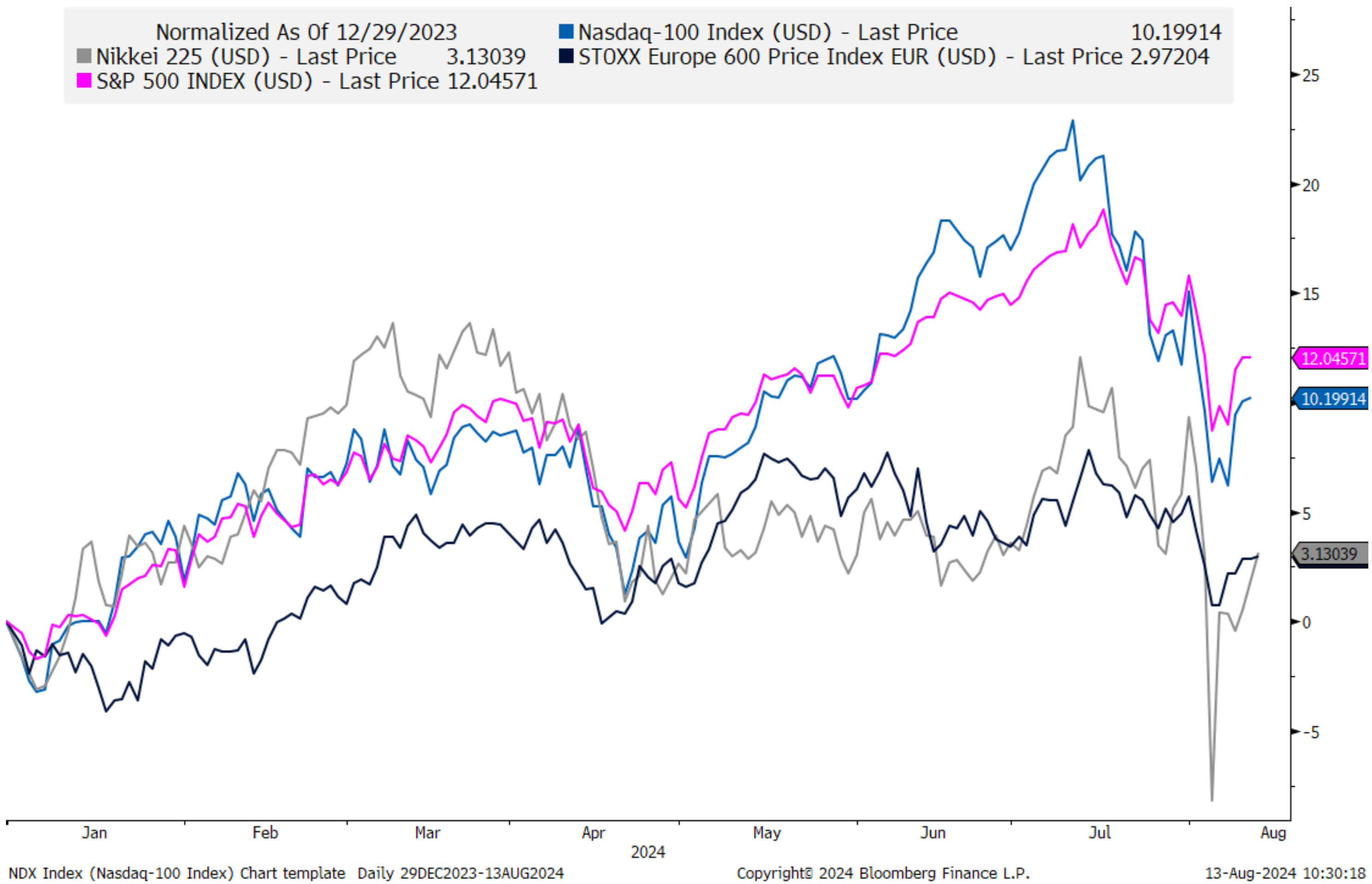
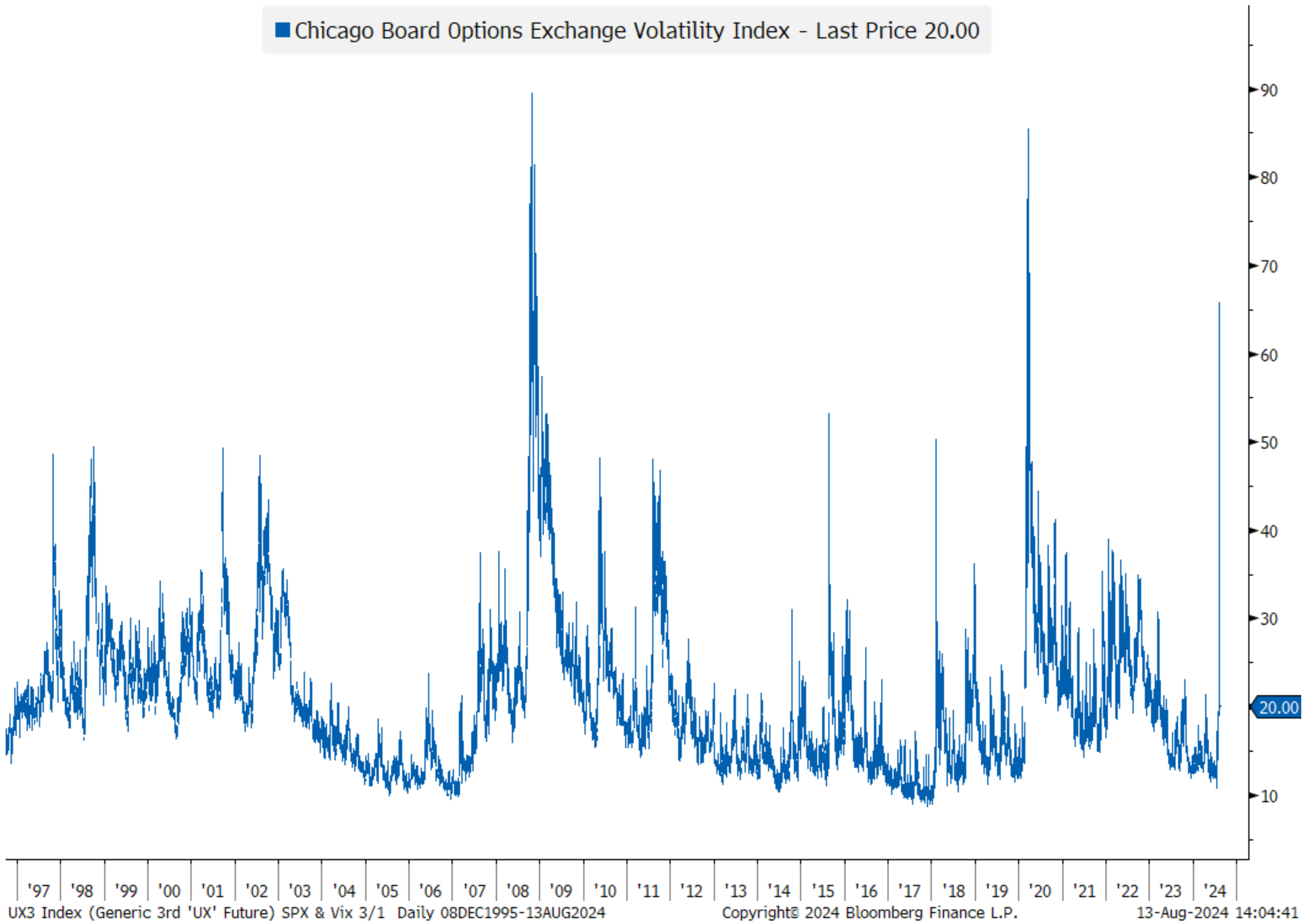
Violent crashes in global equity indices

Global equity indices went through major declines in early August, with the Nikkei crashing 12% in JPY terms, the biggest daily drop since 1987. This abrupt crash was triggered by a combination of weaker US economic data, which raised recession fears, and a rate hike in Japan, pushing the JPY sharply higher. This forced the unwind of the JPY carry trade, whereby investors borrowed JPY to buy various risk assets, exacerbating the declines.



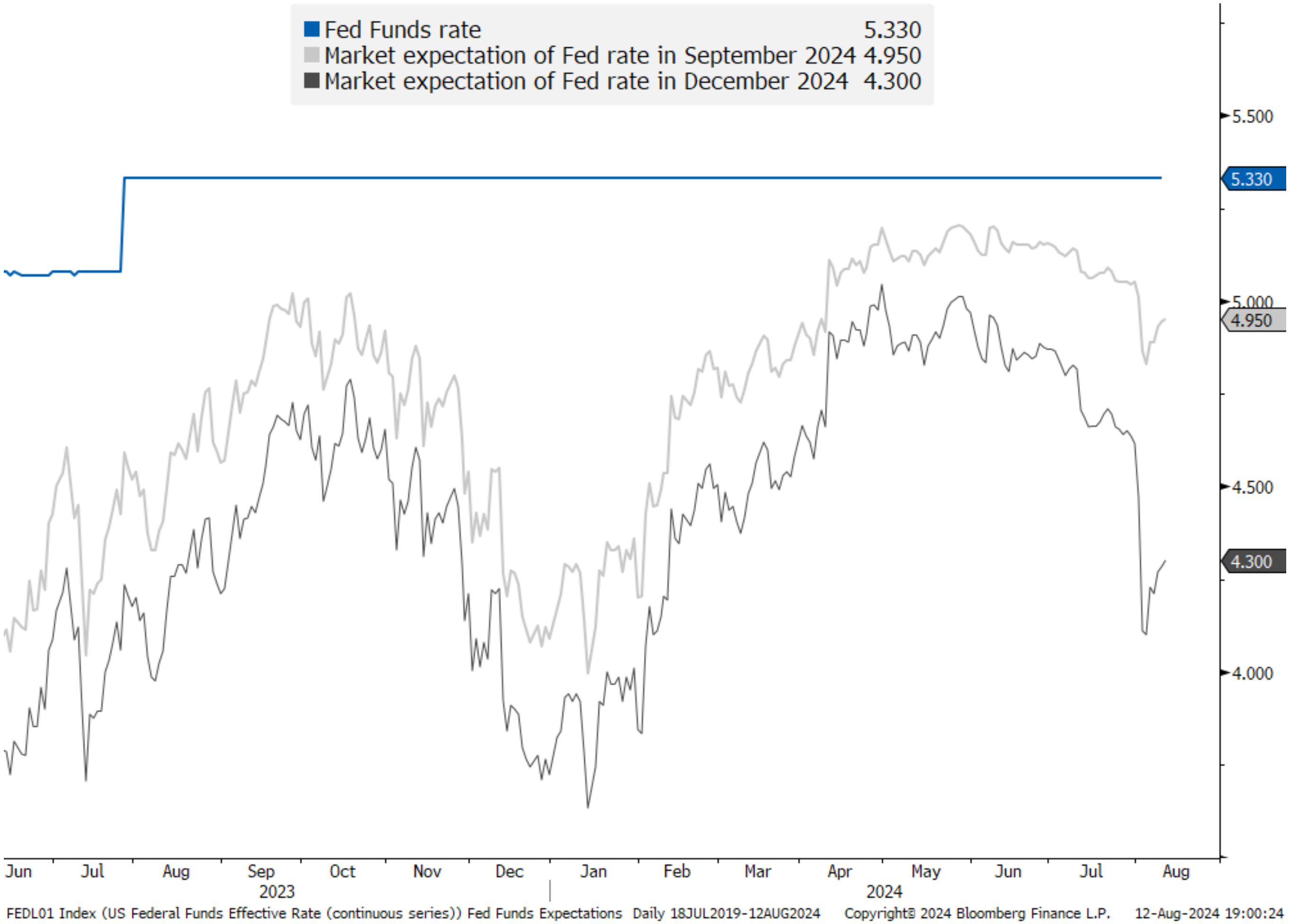
Volatility reached extremes seen in previous major panics

The US volatility index, effectively considered a “fear” gauge, spiked to an intraday high of 65; such extreme levels have historically been associated with major events such as the LTCM crisis, dotcom bust, GFC, COVID etc. Historically, such spikes in volatility and associated fall in equities take a few weeks to be digested before an uptrend can resume.



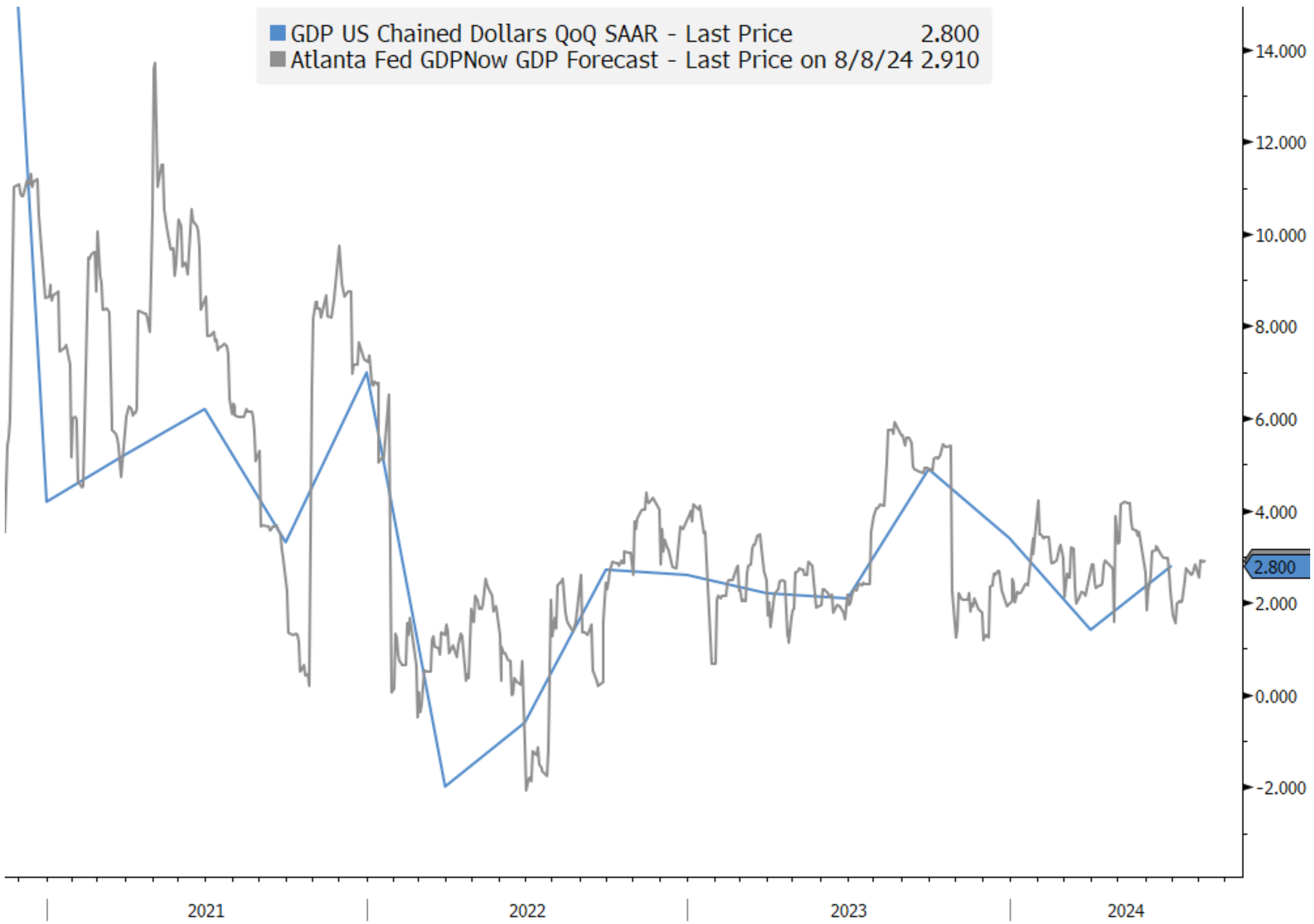
Pricing 1% of cuts by year-end?

At the peak of last week's panic, markets were pricing 150bps of cuts by the Fed by year-end, as the decline in markets reflexively raised recession fears. Current expectations have normalised but remain for 100bps of cuts by year-end, and 38bps of cuts in September. At this stage, such aggressive cuts appear unlikely.



The data does not support aggressive cuts for now

The US economy is indeed likely to decelerate but there is little sign of an imminent recession. The Atlanta Fed GDPNow forecast continues to oscillate between 2 and 3% real growth, which is above historical trend. Recent earnings also don't support the scenario of a recession (see next slide). This should be supportive of equities later this year, but does not preclude further short-term volatility.

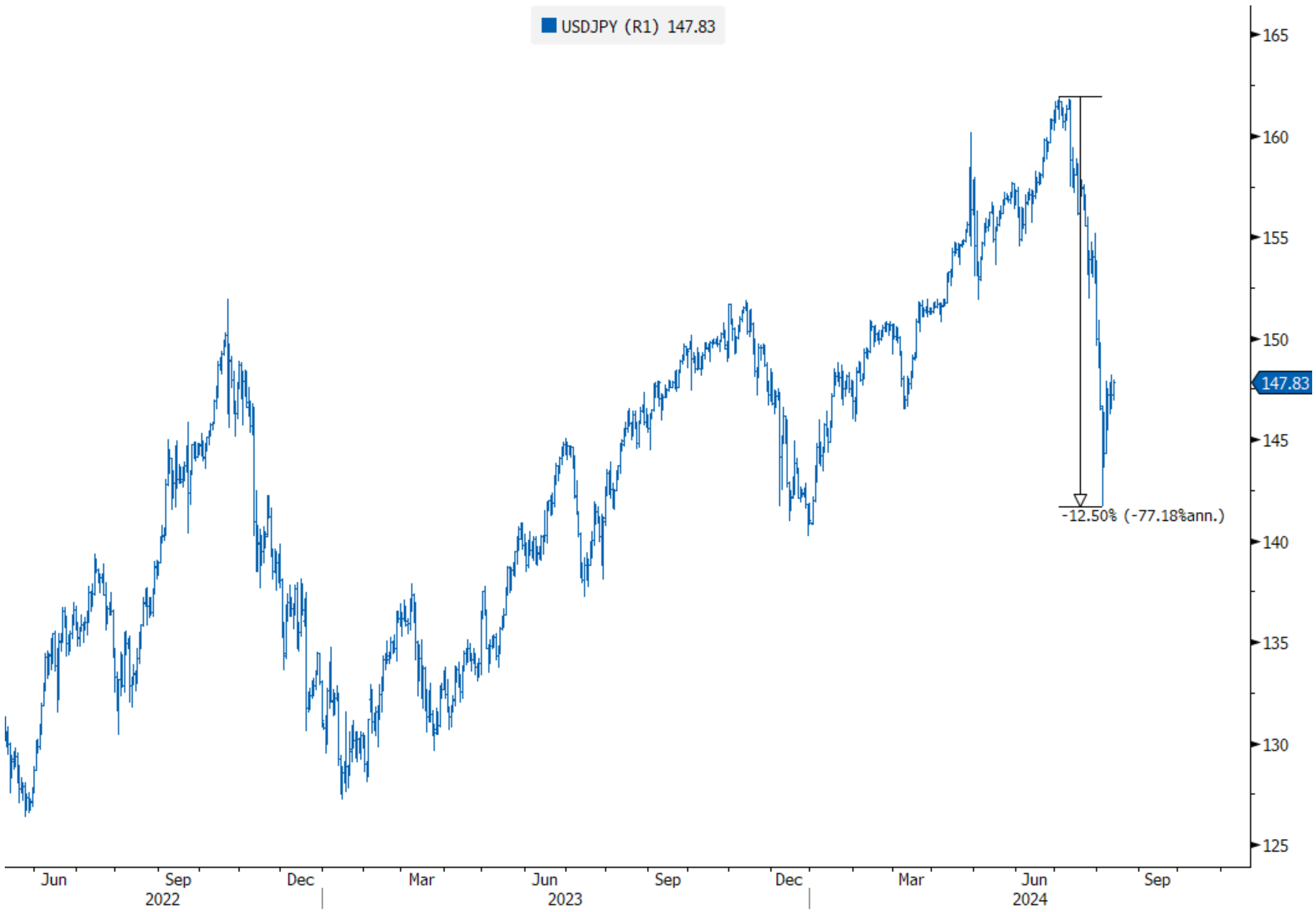


GDP CQOQ Index (GDP US Chained Dollars QoQ SAAR) US GDP and WEI Daily 15SEP2016-12AUG2024 Copyright© 2024 Bloomberg Finance L.P. 12-Aug-2024 19:49:58

Looking through the corporate earnings window

It might be more about the JPY’s trajectory in the short-term

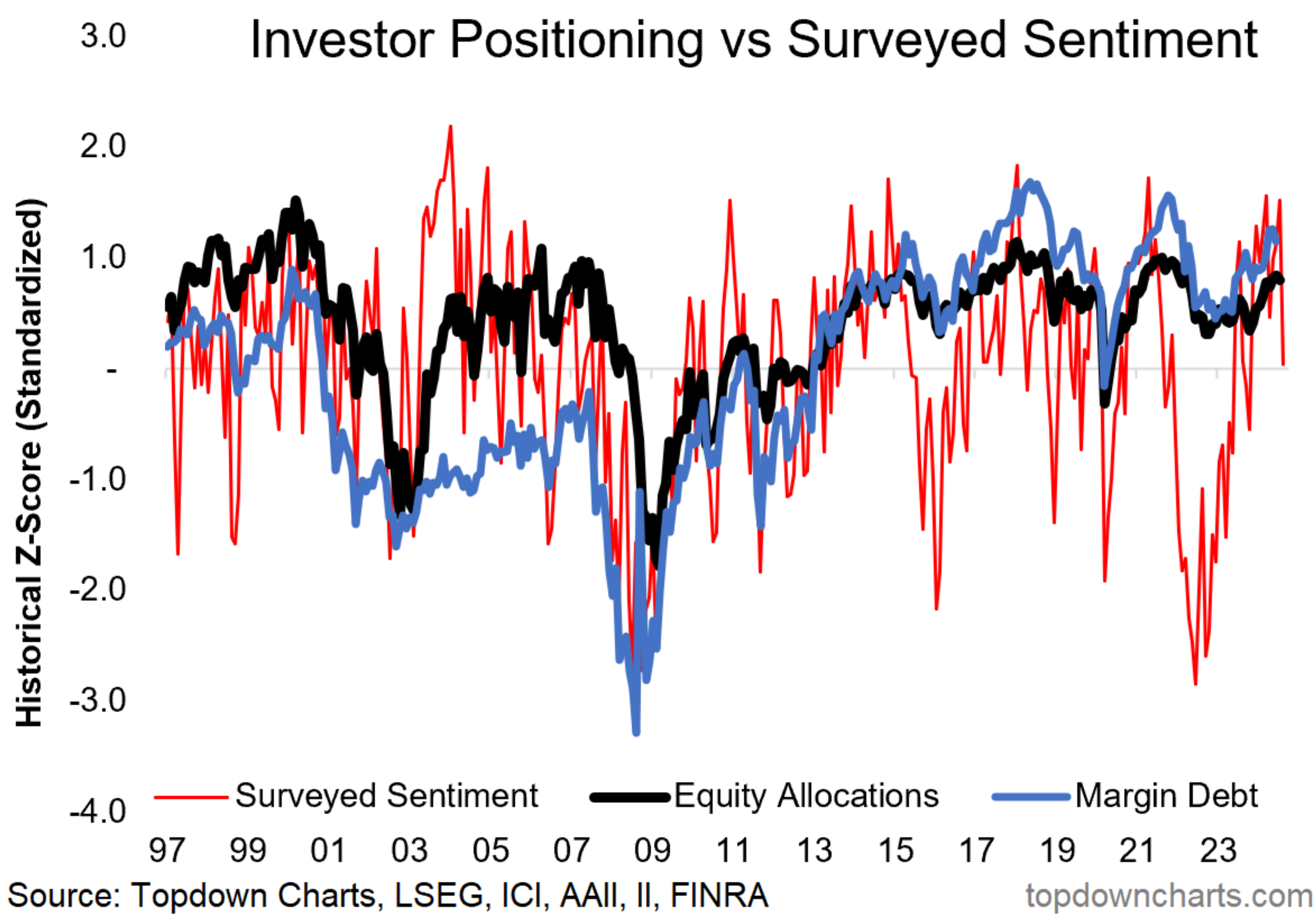
While the most speculative short positioning have likely been wiped out, the full extent of the JPY carry trade, i.e. the amount of borrowed yen financing investments or speculations, is impossible to reliably assess. This uncertainty suggests that further JPY appreciation could lead to another wave of selling for global assets. Building some long JPY exposure between 150 and 155 makes sense.



JPY Curncy (Japanese Yen Spot) JPY CFTC Spec pos Daily 14AUG2023-13AUG2024 Copyright© 2024 Bloomberg Finance L.P. 13-Aug-2024 14:12:11

Allocations and sentiment have not reset

Markets tend to digest crashes over a period of weeks before resuming their uptrend. Moreover, last week so significant buying from investors and speculators, suggesting that positioning could still be under pressure. At this stage, taking advantage of the rebound to trim exposure is sensible, particularly given the lingering JPY risk and the current poor seasonality.



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