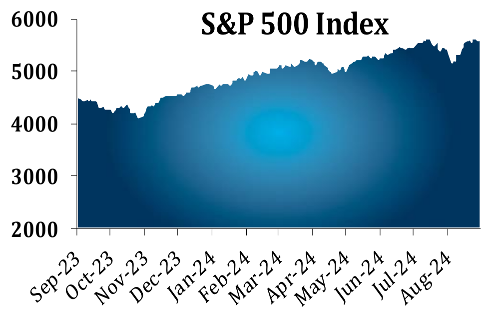
This Month in the Markets

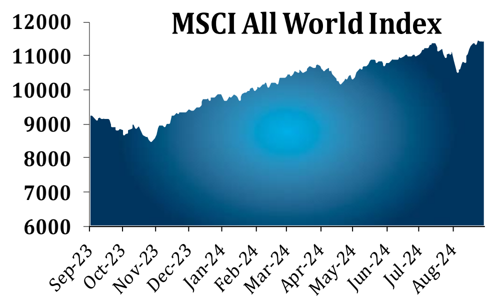
August 2024

Equity Commentary: Whipsaw

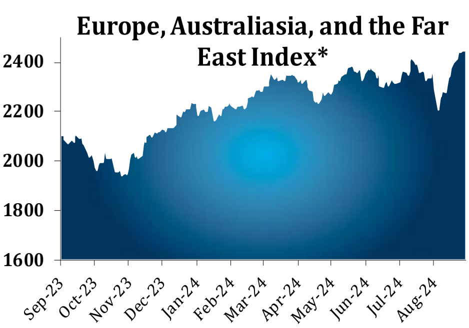
August continued with some equity volatility as the Japanese yen carry trade started to unravel, and interest rate cuts could be seen on the horizon due to slowing economic growth (see the Bond report for this month). As a result, the MSCI ACWI Index fell and then rose, ending the month up 2.6%. The MSCI Emerging Markets Index had a smaller gain of 1.6%. International shares again led the gains, with the S&P 500 Index rising 2.4% compared to the increase of 3.3% for the MSCI EAFE Index. Value marginally outperformed growth in terms of investment styles, with the MSCI All Country World Growth Index rising 2.4% while the MSCI ACWI Value Index was up 2.8%. The MSCI ACWI Health Care Sector was the biggest gainer, with a rally of 5.5%, driven mainly by a rebound in pharmaceutical names. Conversely, the MSCI ACWI Energy Sector Index declined by 0.3%, primarily due to the retreat in energy prices. The Bloomberg Commodities Index was flat in August.



MSCI ACWI tumbled by about 6% in the initial weeks of August. A dramatic pivot followed this; the market shifted and surged by over 9%. The whipsaw action underscores the uncertainty of the likely economic transition. The U.S. economy appears to be slowing on the margin, but the Federal Reserve has also begun aiding in the transition with interest rate relief. It's too early to confidently bet on how this will end – soft landing, hard landing, or no landing? Regardless of the outcome, we still believe several secular themes and company-specific factors can lead to constructive returns for various positions.



We had one sale in the month. We sold Danaher Corp ("DHR") as its recent rally brought it to the point of being fully valued. We also took advantage of the volatility to add three names. We established a position in Vertiv Holdings Co. ("VRT"). VRT makes cooling and power management systems that keep data centers running efficiently. While much news has revolved around Nvidia chips, the tech needed to run the data centers is where VRT excels. Its products include uninterruptible power supplies, cooling solutions, and circuit breakers, to name a few. We believe that data-intensive AI applications will require high investments in power and thermal management for some time to come.



*MSCI EAFE Index

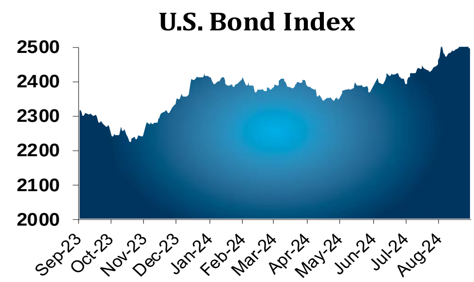
We also purchased First Citizens BancShares Inc. ('FCNCA") which has a reputation for growing through prudent acquisitions. When everyone was fleeing the regional banking sector in March of 2023, the North Carolina bank stepped in and used its strong balance sheet to buy Silicon Valley Bank from the Federal Deposit Insurance Corporation on very attractive terms. We also bought Elanco Animal Health Inc. ("ELAN"). ELAN is a pure animal health play that develops, manufactures, and markets products for both companion and food animals. The company benefits from two significant trends. Pet Health is a $15bn global industry. Growing pet ownership and the "humanization" of pets being viewed as part of the family is a worldwide trend and tailwind for Elanco. Many pet owners will spend almost anything for prevention and life-saving medication for their smaller companions. On the other hand, Farm Animals is a $23bn global industry in secular growth due to increased global protein demand driven by rising GDPs and expanding protein diets. Micron Technology Inc. ("MU") experienced the largest underperformance in August, with its stock falling 12.4%. Concerns over AI-related stocks continued to put pressure on the semiconductor sector. In contrast, MercadoLibre Inc. ("MELI") was the top performer, with its stock rising 23.5% after the South American e-commerce company reported second-quarter earnings per share that exceeded estimates by 26%.

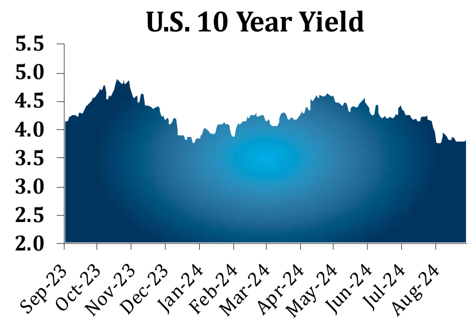
Fixed Income Commentary: Powell's Declaration

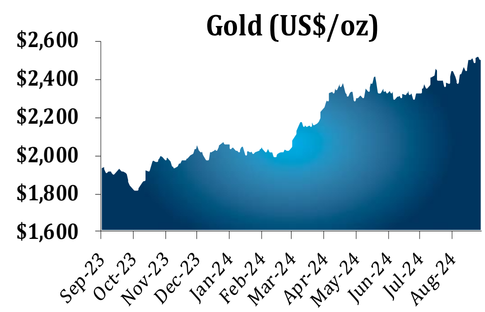
August began with a bang on the back of the Bank of Japan's (BOJ) surprise hawkish policy rate hike (from 0.10% to 0.25%) with guidance to further increase rates over time and to reduce the size of the balance sheet (purchase fewer Japan government bonds). The Japanese yen rallied strongly on the news. Over the past two years, while other central banks had raised interest rates to combat inflation, the BOJ left Japan's policy virtually unchanged. This resulted in a sizeable interest rate differential, which in turn led to the Japanese yen being the favoured currency for carry trades – investors borrow yen and use the proceeds to invest in higher yielding assets. When the BOJ surprised markets by hiking, the yen strengthened, thereby squeezing those investors who were short the currency, which in turn led to positions being closed and an intense knock-on effect in risk assets. Credit spreads widened sharply, equity prices declined, and volatility shot higher. This risk-off period didn't last long. However, it was a stark reminder that the potential for volatility still very much remains.

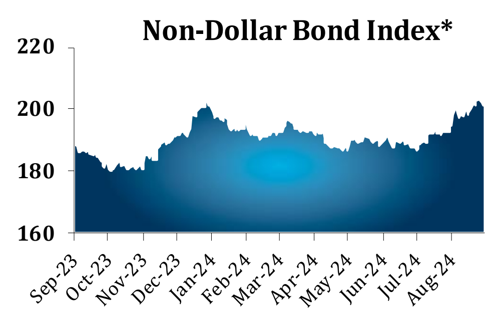
In late August Federal Reserve Chairman Jerome Powell gave his annual speech at the economic symposium in Jackson Hole, Wyoming. This setting has become an iconic setting for delivering historic and possibly market moving speeches by Fed Chair's including former Chairman Ben Bernanke's 2010 speech where he laid out the case for a second round of quantitative easing. While Jerome Powell's 2024 speech likely won't go down as historically important, he did set the table for the Fed to begin cutting rates at the Federal Open Market Committee's (next) September meeting: "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." In Chair Powell's speech he spoke of the Fed's dual mandate, inflation and employment, making it clear he sees the greater risk to the employment side of the mandate. The unemployment rate has risen from 3.7% to 4.3% in 2024. Importantly, this has been driven by an increase in workers and a slower pace of hiring as opposed to a rapid increase in lay-offs. Nonetheless, Chair Powell made his view clear - "We do not seek or welcome further cooling in labour market conditions."

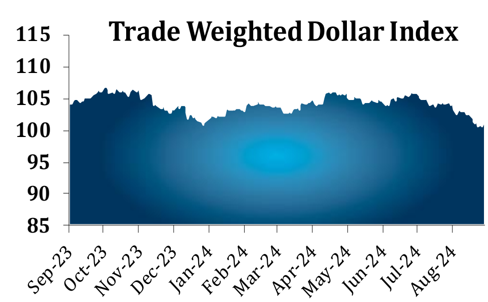
Chair Powell's confirmation that the rate cutting cycle will begin in September was a confirmation more than a dovish surprise. Coming into the meeting the market was already expecting a 0.25% rate cut in both the September and November meetings, as per fed fund futures. The majority of data released in July and August were suggestive of declining inflation and a cooling labour market - best signified by the huge negative payrolls revision in mid-August. In prior reviews we have noted that the shelter component of the consumer price index (CPI) is lagging and still elevated (5.0% YoY). However, excluding shelter, core CPI (which excludes food and energy) is just 1.8% YoY and -0.3% on a 3-month annualized basis. This supports Chair Powell's remarks and stance at Jackson Hole. Thus, we leave August with the Fed poised to kick-off the rate cutting cycle with the first of possibly four 0.25% expected cuts in 2024 per fed fund futures to occur in the September 18th meeting.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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