

# Monthly Market Review

Review of markets over April 2024

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## Higher, later, stronger, faster

A lot happened in the financial markets between the Easter egg hunt and the Labor Day holiday, which is celebrated in over 60 countries around the world. Investors continue to push back on their expectation of the Federal Reserve's (Fed's) first rate cut, because of strong job data and stubborn inflation. This led to high U.S. Treasury (UST) yields and corrections in equities. This also brought a stronger U.S. dollar (USD), with the Japanese yen (JPY) hitting its lowest point against the U.S. dollar since 1990. Equity valuation de-rating from higher yields is partly offset by respectable 1Q earnings. Meanwhile, Chinese equities are making a quiet comeback. Investors are still deciding on whether this is a tactical rebound, or a sustained trend for the long run.

### Higher inflation presses the Fed to cut later

The U.S. economy is still strong. The job market is hot. The unemployment rate has been below 4% for 29 consecutive months, but wage pressure is easing. March inflation data, whether the consumer price index (CPI) reading or the personal consumption expenditure deflator, all surprised on the upside. Instead of raising rates quickly from the current level of inflation, the Fed made it clear in the May Federal Open Market Committee (FOMC) meeting to opt for a status quo, and let the current level of interest rates slow down the economy gradually. Fed Chair Jay Powell echoed this view by saying inflation is taking longer than expected to hit the Fed's target. The current set of economic data means the Fed will not have the needed conditions to start the rate cut cycle until September at the earliest. If inflation and job data remain stubbornly firm through the summer, the first cut could get pushed all the way to the end of the year.

This has lifted the 10-year UST yield by 40 basis points (bps) and the 2-year UST yield by 35bps in April. This was challenging for fixed income investors, especially those in government bonds and investment grade corporate debt. It is important to stress that we think the current rate cut cycle is merely delayed, rather than canceled. This means the relative outperformance of cash versus high-quality fixed income should reverse once inflation in the U.S. resumes its falling trend. Moreover, government bonds and high-quality fixed income provide important protection to investors in case the global and U.S. economies decelerate rapidly.

Meanwhile, the impact on U.S. equities from rising yields has been limited. The 5.5% correction in the S&P 500 between the end of March and April 19 was the largest correction in 2024, but this magnitude is still small compared to the market corrections in previous years, and it quickly recovered half of the lost ground. This is partly helped by steady corporate earnings growth. By the end of April, over 230 companies, or 55% of the market capitalization, have reported their earnings, and earnings per share (EPS) growth for 1Q was 4.8% versus a year ago. Compared to 2023, S&P 500 earnings growth is less dependent on the "Magnificent 7". Companies are still able to protect their profit margins. Information technology and communication services have been the key contributors to earnings growth, while energy and financials have been subtractors.

## Faster dollar appreciation is hurting the Japanese yen

The rise in UST yields have also led to a stronger U.S. dollar. The USD index rose to its highest level (106.20) since October 2023. The Australian dollar bucked the trend with a small gain against the U.S. dollar due to the potential for higher rates from the Reserve Bank of Australia. Otherwise, all major and Asian currencies depreciated against the U.S. dollar in April.

Within this, the JPY underperformed both major and Asian currencies. It briefly broke above 160 against the U.S. dollar on April 29 for the first time since 1990. This was partly driven by thin liquidity as it was a market holiday in Japan. Nonetheless, the fundamental reason for JPY weakness was brought about by the combination of the delay in Fed rate cuts and the Bank of Japan's (BoJ's) reluctance to tighten monetary policy. It kept its policy rate unchanged in the April meeting and continued with its government bond purchases. Meanwhile the latest economic forecast from the policy board revised the FY2024 inflation forecast higher, but the gross domestic product (GDP) growth forecast lower. This implies that the central bank may opt to go slow with raising rates, and this disappointed the market.

A weaker JPY could challenge consumer spending given more expensive imports. Imported inflation threatens to offset faster nominal wage growth. It does help to enhance corporate earnings, as overseas revenue in USD would be worth more in JPY. However, it was far from clear that the JPY's depreciation so far has benefited Japanese equity returns. Since the March BoJ monetary meeting, the weakness of the JPY coincided with a sustained correction in Japanese equities. Again, we reiterate the investment case of Japanese equities is not about the gains from a weaker currency, but instead justified by steady earnings performance as well as the ongoing corporate governance improvement.

## Stronger Chinese equity performance brought by bargain hunters

Chinese equities were the surprise package in April, outperforming developed markets as well as a number of Asian markets. The CSI 300, in USD terms, rose 1.8% in April. The Hang Seng index was up 7.4%, compared with -4.2% for the S&P 500. For the first four months of 2024, on a USD basis, both the CSI 300 and the Hang Seng were just 1.5-2 percentage points behind the S&P 500, and outperformed the Nikkei 225.

Some may see this rebound driven by tactical, short-term investors taking advantage of cheap valuations. Although it is clear that the real estate market and private investment would need more time to recover, policy support is helping to limit the downside risk to economic growth. The latest Politburo meeting reiterated the effort to stabilize the economy by suggesting to promptly issue ultra-long government bonds to fund stimulus. The announcement of the third-party plenum to be held in July would also attract investor attention on additional short-term and long-term policy support to improve growth momentum. The key now would be whether the relatively strong performance in April will attract more international flows into the Chinese markets.

## Investment implications

We do acknowledge that a delay in Fed cuts could be challenging for fixed income in the near term, and investors should focus on short duration bonds. The fact that we see the rate cut cycle is merely delayed, and should begin later this year, still provides a strong case for staying invested in fixed income. Government bonds and high-quality corporate debt also have the added benefit of protecting portfolios from recession risk.

Meanwhile, the resilient economic backdrop is supportive to global equities. We continue to emphasize a broader contribution from S&P 500 companies to the index's performance. Growth and tech should still be the core, but high-quality cyclical companies should also benefit from solid consumption and well-protected profit margins. For Asia, Japan and tech-exporting markets such as Taiwan and South Korea, should still be taking the lead. Chinese equities deserve more attention, as a dial up in policy support could be the ticket for better investor confidence.

**Global economy:**

- U.S. March headline CPI came in stronger than expected at 0.4%, with shelter and gasoline contributing over half of the month-over-month increase. Core services inflation was sticky, especially transportation and health care. This prompted Chairman Powell to provide hawkish comments mid-month, as well as at the May FOMC meeting, on the lack of progress in disinflation. However, to the markets' relief, Powell's latest comments confirmed that a rate hike was not being considered, and the Fed was comfortable cutting once data permits. Futures markets are currently pricing only one rate cut in 2024. Even though the Bank of England and the European Central Bank maintained rather dovish rhetoric in comparison, markets are also pulling back slightly on the number of cuts expected from them in 2024. In Asia, the BoJ kept rates steady at 0-0.1% and did not change its bond-buying plans, but reiterated the conviction to hike rates once data confirms Japan's inflation momentum. (GTMA P. 22, 23, 31)
- In terms of growth, March global services purchasing manager's index (PMI) continued to expand at 52.5, but the global manufacturing PMI showed slow recovery at 50.6. In the Euro area, Germany and France remained in contractionary territory in March and April, but marginal improvements can be seen in Asia. China 1Q24 GDP beat expectations at 5.3% year-over-year growth, and along with the monthly activity data, continued to point to weak consumer sentiments and property sector. However, strong growth was observed in industrial production, advanced manufacturing and infrastructure investments, driven by earlier government stimulus. However, China's March CPI was softer than expected, although remained marginally positive at 0.1% year-over-year. In Japan, growth has been mixed, with industrial production beating expectations, but retail sales disappointed and core CPI rose only 1.6% year-over-year in April, versus consensus of 2.2%. (GTMA P. 5, 8, 14, 17)

**Equities:**

- After a stellar March performance, equities largely pulled back in April. The MSCI AC World fell 3.4% over the month. Sector wise, energy and utilities outperformed, rising 1% and 1.5%, respectively. While all the other sectors were in the red, rate-sensitive sectors like information technology and real estate were especially weak at -5.2% and -6.2%, respectively, in April.

- The S&P 500 fell 4.2% as markets recalibrated rate expectations, prompting yields to rise. The index stabilized in the second half of the month on the back of generally decent earnings results. Asia was a clear outperformer, with the MSCI Asia ex-Japan index up 1.1% in local currency terms. China saw an impressive rebound, driven by better-than-expected GDP print, support from state-backed funds and capital market reform policy announcements. Offshore, the MSCI China rose 6.5% and the Hang Seng Index was up 7.4%, both outshining onshore CSI 300's 1.9% return. (GTMA P. 33, 39)

**Fixed income:**

- The 10-year U.S. Treasury yield started the month at 4.3% but rose to a peak of 4.7% toward the end of the month, putting year-to-date (YTD) moves at +80bps. The 2-year yield breached 5% after U.S. employment cost data came in higher than expected. In contrast, China's 10-year yield was unchanged in April, despite a 10bps drop mid-month. The yield gap between China and other major markets continues to widen. (GTMA P. 57)
- The climb in government bond yields drove credit yields higher, while spreads stayed fairly stable. The Global Agg yield-to-worst (YTW) rose 32bps, totaling 57bps YTD. Emerging market debt in USD terms saw YTW rise as much as 78bps. Credit markets broadly fell, with Global Agg falling 2.54%. Such weakness was consistent across investment grade and high yield. (GTMA P. 52, 55)

**Other assets:**

- The U.S. dollar index strengthened a modest 1.6% in April, hitting 106, unseen since October 2023, putting YTD gains at 4.8%. Most currencies fell against the U.S. dollar, notably the JPY. The JPY hit a key level of 160 against the U.S. dollar after the BoJ kept policy rates unchanged and downplayed the importance of the currency. The JPY rebounded to end the month at 157 on evidence of state intervention and lower U.S. Treasury yields. (GTMA P. 68, 69)
- Brent crude hit a peak of USD 92.18 mid-month due to escalated tensions in the Middle East, but ended the month flat as tensions eased and Fed cuts were expected to be delayed. Gold continued its climb, returning 4.2% in April, reaching 11% gains YTD. Silver and copper returned 8.6% and 14.3%, respectively, as demand continues to grow from the energy transition. (GTMA P. 70, 71)

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