

# Monthly Market Review

Review of markets over March 2024

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## Not choosing to cut is still a choice

### In brief

- Developed market central banks are hesitating to cut rates given sticky inflation and the risk of wage growth rebounding. The Bank of Japan (BoJ) was an exception in raising rates, but it was a very cautious first step.
- Still, steady central bank policy was sufficient to drive equities' returns. Gains in the U.S. equity market have started to broaden out. Asian exporters outperformed in March.
- Fixed income returns were driven mainly by yields. We expect central banks' rate cuts later in the year should help to boost returns from falling risk-free rates.

Most central banks have opted to stay put in March, including the Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE) and Reserve Bank of Australia (RBA). Meanwhile, the BoJ finally exited its negative interest rate policy and yield curve control (YCC), but the words are louder than action here. As we have argued in the past six months, the end of the hiking cycle around the world should be sufficient in supporting risk assets. Indeed, most equity markets delivered positive returns in March, even the unloved Chinese markets. Fixed income returns have been driven broadly by income, but we expect the start of the rate cut cycles around the world to boost bond price returns in the months ahead.

### Let's just wait a bit more

Starting with the Fed, the market was worried that a string of strong economic data and relatively sticky inflation readings could jeopardize the 75 basis points (bps) rate cut forecasted in December. The Federal Open Market Committee (FOMC) did express increased confidence in economic growth, revising its growth forecasts for 2024, 2025 and 2026. While core personal consumption expenditure (PCE) inflation for the fourth quarter of 2024 was revised higher, unemployment rate forecasts were lowered for 2024 and 2026. To the market's relief, the median projection for the policy rate for the fourth quarter of 2024 remained unchanged at 4.6%. This is equivalent to a total of 75bps of cuts before year-end. By the end of March, the Overnight Index Swap market was pricing in the Fed's policy rate to be reduced by 70bps by the end of 2024, compared to a total of 90bps of cuts at the start of the month.

Inflation data in the U.S. has been steady. The month-over-month change in headline consumer price index (CPI) and PCE deflator stood at 0.4% and 0.3% respectively, which is in line with the trend in recent months. Ideally, this would be easing more in the months ahead. This view was also echoed by Fed Chair Jerome Powell recently. We believe that housing costs and inflation momentum from selected services, such as health care and auto insurance, should cool in the months ahead. Since the job market continues to be strong, this allows the Fed to opt for the status quo for longer.

The RBA and the BoE both kept their policy rates unchanged in their March meetings. The RBA is still watchful over the tight labor market, which could lead to wage inflation. For the BoE, the voting pattern of the Monetary Policy Committee (MPC) members is telling. In the February meeting, two MPC members voted for higher policy rates, while one voted for a cut. In March, the vote was 8-1, with one member voting for a cut.

Overall, we may see some central banks actually starting to cut rates in June, but the risk is for them to stay on the hawkish side and wait longer.

As for the BoJ, it ended negative interest rates, YCC on the Japanese Government Bond market and purchases of exchange traded funds and Japanese real estate investment trusts. On paper, these are historical steps to end its ultra-loose monetary policy and quantitative easing. Yet, upon looking more closely, the actual changes are less dramatic. This partly explains why the Japanese yen (JPY) weakened beyond 150 against the U.S. dollar after the announcement.

After all, the Japanese economy entered a slowdown late in 2023. While it avoided two consecutive quarters of gross domestic product (GDP) contraction, private consumption was still soft. This might be boosted by wage increases, but the central bank may want to tread carefully.

## Stocks thrived amid central bank inaction

Stability in monetary policy and interest rates meant investors have one fewer problem to worry about. They can focus on earnings performance and sectors that could deliver long-term returns.

The S&P 500 rose 3.1% in March, and the European markets also posted some decent performance with the Stoxx 600 up 3.7%. The rise in the S&P 500 is no longer as concentrated to a handful of tech stocks. Four big tech and artificial intelligence (AI) related companies were still leading the way in contributing to 47% of the index's year-to-date gain. We do see more support from other sectors including pharmaceuticals, financials and retailers. This is likely supported by resilient economic performance benefiting more cyclical stocks.

In Asia, Taiwan was the outperformer with the TWSE index up 7.2% in March, driven by the AI rally. South Korea also started to catch up from behind after a subdued start to the year, with a 4% gain in the KOSPI index. We continue to be upbeat on these tech export-oriented markets given the possible upturn in the consumer electronic cycle in the next few years. Japan's gain was relatively modest, up 1.2% in the month, after a stellar first two months of 2024.

In contrast, fixed income returns were largely driven by yield, rather than bond price appreciation. The 10-year U.S. Treasury yield ranged between 4.05% and 4.35% in March, but ended the month largely at the same point as it started at 4.2%. Steady economic performance in the U.S. has helped to tighten high yield corporate credit spreads further to below 350bps, pushing beyond the low end of the 15-year range. We continue to see returns from fixed income come mainly from yield and duration benefit from risk-free rates, rather than credit spread tightening.

Overall, the current economic trajectory continues to support our view that both equities and fixed income should outperform cash in the quarters ahead. While some investors may be worried about the valuations of selected U.S. sectors, there are still ample opportunities in global equities, especially in Asia. Bond yields have come off from multi-year highs, but are still attractive and could return to positive real yield later as inflation cools in the months ahead. An internationally diversified allocation remains key given the uneven distribution of economic growth, as well as various elections in the months ahead that could shape global trade in years to come.

**Global economy:**

- The Fed kept its policy rate unchanged as expected in its March FOMC meeting. Its forecast for rate cuts for 2024 was also left unchanged at 75bps, despite robust economic data and sticky inflation. The BoJ ended its negative interest rate policy, as well as YCC on the government bond market, even though it pledged to keep buying bonds at a similar pace as previous months to maintain yield stability. Central banks in the UK, eurozone and Australia all kept their policy rates unchanged and argued that more time is needed to decide on cutting rates. The Swiss National Bank surprised the market by cutting its policy rate by 25bps given low inflation. (GTMA P. 21, 22, 31)
- Global manufacturing momentum was largely stable, but uneven. Europe's manufacturing purchasing managers' index data remains below 50, but it was particularly weak in Germany, with the March data at 41.6. U.S. economic data remained resilient. The change in nonfarm payrolls remained above 200,000 for three consecutive months between December 2023 and February 2024, with hourly earnings rising by 4.3% year-over-year. 4Q GDP growth was also revised higher to 3.4%. Inflation was steady with headline CPI at 3.2%. Housing costs and services, such as health care and auto insurance, were keeping inflation sticky. China's export performance continues to improve, boosting industrial production to grow at 7% in the first two months of the year, the fastest since early 2022. However, the real estate sector remains sluggish. (GTMA P. 5, 17, 25)

**Equities:**

- March was another good month for global equities given steady central banks and economic data. The MSCI World Index was up 3%. The S&P 500 rose 3.1% in March, and the European markets also posted some decent performance with the Stoxx 600 up 3.7%. The U.S. market gain has been broadening, with health care and financial companies making greater contributions. As we approach the 1Q earnings season, analysts have been revising 2024 S&P 500 earnings modestly lower to 10%. Japan was one of the few markets that has received an earnings upgrade by analysts in the past three months. (GTMA P. 35, 39)

- Performance was mixed in Asia, with Taiwan leading the way as the TWSE index rose 7.2% in March, driven by the AI rally. This is also benefiting South Korea with 4% gain in the KOSPI index. Chinese stocks consolidated after a decent rebound in February as investors are still focusing more on tactical opportunities instead of long-term strategic trends. (GTMA P. 33)

**Fixed income:**

- The 10-year U.S. Treasury yield ranged between 4.05%-4.35% in March, but ended the month unchanged at 4.2%. A similar trend applied to the short end of the curve. 10-year government bond yields fell by more than 10bps in Europe, Australia and New Zealand, even though their central banks are still sticking to their "wait and see" approach in rate cut possibilities. (GTMA P. 53)
- Corporate credit spreads, especially for U.S. high yield bonds, narrowed further in March given robust economic data and the prospects of rate cuts by the Fed later in the year. This narrowed to 350bps, beyond the low end of the 15-year range. This also implies that returns from spread tightening are becoming increasingly challenging, and a bad run of economic data could be a risk for investors. (GTMA P. 52, 55)

**Other assets:**

- The U.S. dollar strengthened modestly in March, with the U.S. dollar index rising from 104 to 104.4. The JPY weakened beyond 150 to the U.S. dollar after the BoJ's policy action was milder than expected. Most Asian currencies also weakened against the U.S. dollar, led by the South Korean won and the Taiwanese dollar, tracking the JPY's weakness. (GTMA P. 68, 69)
- Oil prices rose almost 4% in March as Organization of the Petroleum Exporting Countries plus other oil-producing countries maintained its output cut along with prospects for stronger demand from China. Brent Crude rose to USD 87 per barrel. Gold pushed to its record high at USD 2254/oz on the back of prospects of lower rates later in the year around the world, as well as ongoing demand from Chinese investors and Indian consumers. We also expect emerging market central banks to continue to diversify part of their foreign exchange reserves into gold. (GTMA P. 70, 71)

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