

# Monthly Market Review

Review of markets over May 2024

## Author



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## Beware of the Mood Swing

### In brief

- Softer U.S. economic data in May rekindled market hopes for a September rate cut from the Federal Reserve (Fed). As the European Central Bank (ECB) prepares markets for a June rate cut, the hotter-than-expected May inflation data also introduced some uncertainty.
- Our asset allocation strategy is unchanged with a preference for equity over fixed income in the short term, if we are seeing delayed rate cuts.
- China is seeing a welcoming shift in government policy relating to the property sector, but geopolitics will continue to be an overhang.

Market sentiment improved in May as several key U.S. inflation and economic gauges suggest that rate cuts by the Fed before the end of the year are back on the table. Meanwhile, corporate earnings for 1Q24 in the U.S. have been respectable, which also facilitated the stock market recovery. However, it is important to stress that investors' expectations regarding the Fed's policy outlook are swinging from hawks to doves based on one month of data. We still see the risk of sticky inflation and a robust job market bringing back market volatility in the summer months.

### You see what you want to see

U.S. economic data in May gave some ammunition to the doves. April non-farm payroll data came in weaker at +175,000 versus the expectation of +240,000. March job growth numbers were also revised lower. April core consumer price index (CPI) (excluding food and energy) fell to 3.4% from 3.6%. Retail sales and the housing market also came in much weaker than expected. This helped rekindle market expectations for a September rate cut. The futures market was pricing in a 60% chance of a 25 basis points (bps) rate cut in the September Federal Open Market Committee (FOMC) meeting in mid-May, compared with just 30% at the end of April. This has since scaled back to around 45%.

While we believe that inflation is likely to gradually ease in the months ahead and high policy rates should start to have a greater impact on cooling the economy, we are also cautious about being swayed by one month of soft data. We still think the Fed could start cutting in September, but inflation and growth numbers need to ease consistently in the next 2-3 months, or else the first cut could get pushed back to December. This does not change our overall asset allocation strategy. Equities could get more tailwind in the short term relative to fixed income in a delayed rate cut scenario.

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Elsewhere, the ECB is preparing the market for a rate cut in its June 6 monetary policy meeting. Inflation has been cooling steadily, and its growth momentum deserves more monetary stimulus than the U.S. However, ECB officials are also careful to caution investors not to get carried away with rate cut expectations, especially after the stronger-than-expected May inflation data. Meanwhile, the Bank of Japan (BoJ) is still approaching the question of raising rates cautiously.

### **More policies to help the Chinese real estate market**

While there have been some upside surprises in recent Chinese economic data, the overall growth momentum is still weighed down by the real estate sector. Hence, the government, both at the central and local levels, continues to ease housing market restrictions to facilitate recovery. These include reducing the down payment ratios for mortgages and abolishing the floor level of commercial mortgage rates. Local governments can also purchase private housing projects and convert them into public housing.

Ultimately, these policies are supposed to make home purchases easier and more attractive, as well as reduce the inventory overhang in the market. We see these steps as moving in the right direction, but it will take time to restore buyers' confidence and reduce housing stock to a more sustainable level. Nonetheless, corporate earnings improvement should help maintain the recent positive momentum in China and Hong Kong markets.

One uncertainty facing investors is the potential for more trade and tariff policies ahead of the U.S. presidential and congressional elections in November. The Biden Administration announced plans to introduce or raise tariffs on a series of Chinese exports, including batteries, electric vehicles and medical and protective equipment. The direct impact of these new tariffs should be modest. However, this illustrates that presidential candidates are willing to deploy these strategies to gain voter support, which could exacerbate global supply chain reorganization or introduce more inflation into the economy.

**Global economy:**

- May saw signs of U.S. growth finally softening. 1Q24 U.S. gross domestic product (GDP) was revised down to 1.3% quarter-over-quarter, below consensus and the prior 1.6%, noting a slowdown in consumer spending, exports and government spending. Labor market data was also moderating, with initial jobless claims generally ahead of consensus or at least in line, and nonfarm payrolls growing at a pace below expectations. After three hotter-than-expected prints, the April CPI was softer than expected, with the core CPI annualized growth rate at 3.5%, the lowest since April 2021. Personal consumption expenditures (PCE) data was also largely in line with expectations. In early May, softer data prompted markets to expect an earlier rate cut from the Fed, but rate cut expectations were dialed back later in the month due to pushback from hawkish Fed speak. (GTMA P. 22, 23, 31)
- Across the Atlantic, European central banks will likely begin their rate cut cycles before the Fed, with relatively softer growth and stronger disinflation traction. While the ECB can likely start cutting rates in June as telegraphed, the Bank of England is still seeing sticky services inflation and stubborn wage growth, and will likely wait until later in the summer to start cutting. In Asia, the Reserve Bank of Australia kept cash rates unchanged at 4.35% as widely expected. Japan saw 1Q24 GDP contract 2.0% quarter-over-quarter annualized, to the market's disappointment, with private consumption continuing its previous decline. However, BoJ governor Kazuo Ueda seemed to look beyond this print and reiterated his unchanged assessment of Japan's economy. China's property market saw a welcoming shift in policy, with authorities turning their attention to reducing housing inventory and cities continuing to relax home purchase restrictions. Geopolitics has and will continue to be an overhang for China, with a notable hike in tariffs by Biden mid-May. (GTMA P. 5, 8, 14, 17)

**Equities:**

- Global equities rallied 3.8% in May, with developed markets outperforming emerging markets, returning 4.2% versus 0.3%. U.S. equities returned strongly, with the S&P 500 at 4.8% and NASDAQ at 6.9%. Most of the gains came in the first half of the month, from earnings beats and a rate reprieve following inflation prints that came out in line with expectations. Year-to-date, U.S. equity returns have seen a healthy contribution from both multiple expansion and EPS growth expectations. (GTMA P. 34)

- The Chinese rally lost some momentum in May, with onshore CSI 300 falling -0.7%, underperforming the Hang Seng Index, which returned 1.8%. A slowing rally was likely due to signs of profit-taking, geopolitical concerns and sluggish earnings revisions, among other things. The Japan rally also slowed in May, returning 1.3% in the month in USD terms. Year-to-date, MSCI Japan returned 6.2% in USD terms, much weaker than the 18.3% return in local currency terms, due to the sharp depreciation in the Japanese Yen (JPY). (GTMA P. 33)

**Fixed income:**

- The 10-year U.S. Treasury yield started the month at 4.68% and fell to a trough of 4.35% mid-month. Markets were relieved by cooling labor market data and benign inflation prints, but hawkish Fed speak and deficit concerns later pushed the 10-year U.S. Treasury yield back up to 4.5%, putting year-to-date moves at +61bps. Elsewhere, the UK, Australian and Chinese 10-year government bond yields were mostly unchanged, but Japan 10-year government bond (JGB) yields rose 20bps throughout the month. It hit 1% for the first time in 11 years, when the BoJ bought a smaller amount of JGB than previously, fueling expectations of further tightening of monetary policy. (GTMA P. 15, 57)
- The general fall in government bond yields, especially from the U.S., while spreads remained relatively steady, generated positive returns for most credit markets. In particular, the Bloomberg Global Aggregate Bond Index returned 1.3%, with investment grade slightly outperforming high yield. (GTMA P. 52, 55)

**Other assets:**

- After hitting 106 in April, the U.S. dollar index fell a modest 1.5% in May, as rates pulled back from softer economic data. Currency markets were relatively calm in May, with the Chinese yuan and the JPY ending the month relatively unchanged. The JPY has depreciated 10.3% year-to-date. (GTMA P. 68, 69)
- Brent crude prices fell 6% in May, due to surprisingly softer U.S. gasoline demand, creating an increase in gasoline inventories. Gold climbed modestly at 1.8% in May, outpaced by silver's 17.3% returns. Silver prices hit USD 32 per ounce in May, a 12-year high, driven by continued industrial demand such as from China's solar-panel manufacturing. (GTMA P. 70, 71)

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