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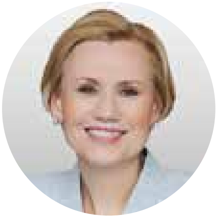
Market uncertainty ramps up around the world

Weekly Market Compass | October 29, 2024



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International Monetary Fund (IMF)

The IMF raised concerns about the accelerating risks of geopolitical conflicts, trade protectionism, and growing deficits.

Political surprise

The ruling coalition in Japan failed to secure a majority of seats in Japan's House of Representatives election.

Federal Reserve insights

Federal Reserve districts indicate that the US economy is holding up, although there are areas of weakness, such as manufacturing activity.

Rising government debt, US election uncertainty and political surprises in Japan have all contributed to a sense of angst in the markets, despite the continuation of positive surprises during earnings season. Here's what I'm watching closely now.

International Monetary Fund warns about public debt and other risks to growth

Last week, the International Monetary Fund (IMF) lowered its global growth forecast for 2025 while recognizing central banks' success in tamping down inflation and avoiding recession. The IMF's concerns about the accelerating risks of geopolitical conflicts, trade protectionism, and growing deficits led to the downward revision. Chief Economist Pierre-Olivier Gourinchas explained, "...downside risks are increasing, and now dominate the outlook."[1]

I was in Europe last week meeting with clients, and there was clearly concern about the potential for trade wars if former President Donald Trump were to win the US presidential election. And it's clear there's concern about an escalation in geopolitical tensions, especially in the Middle East — just look at the sigh of relief evidenced in the drop in the price of oil last week when Israel chose not to bomb oil production facilities in Iran.

But it's more than that. Last week, the IMF also raised concerns about global public debt, which is expected to reach $100 trillion, or 93% of world gross domestic product (GDP), by the end of the year.[2] So many countries are facing debt concerns. Take the UK, which is waiting with some trepidation for the release of the Autumn Budget this week. I expect looser fiscal policy, but nothing nearly as loose as the 2022 budget from the Truss government. This government continues to stress that it will be fiscally responsible and has pledged to decrease debt as a percentage of GDP (albeit using a different metric than previous governments). So we might get a mild spike in gilt yields, but I am confident we will not see the type of gilt crisis we saw in 2022. Even if we do, we know government entities stand ready to respond quickly, as they did two years ago.

Political surprises bring change to Japan

Last week also saw a surprise upset of the ruling coalition in Japan, which failed to secure a majority of seats in Japan's House of Representatives election. It was not in my bingo card for this year that Japan's political situation would look similar to that of France, with Japan's prime minister trying to form a new ruling coalition, just as Emmanuel Macron did earlier this year.

Coalition building to form a government will take place over the next several days (Japan's constitution requires that an extraordinary session of the Parliament convenes within 30 days of the election for the House of Representatives to elect a prime minister). There seem to be three possible scenarios for the new government involving different coalition combinations, two of which would enable Japan's new prime minister, Shigeru Ishiba, to remain in power while one scenario would mean the leader of the opposition party would become the next prime minister.

On the monetary policy front, conventional wisdom suggests that the election defeat for the ruling coalition may slow the policy tightening process by the Bank of Japan (BOJ) — even more so than Ishiba's win over Sanae Takaichi last month to lead the Liberal Democratic Party (LDP).

From an economic policy perspective, the new government's fiscal policy is likely to be more expansionary as the major opposition parties proposed tax cuts and increased spending for low-to-middle income people. This would likely result in greater overall government debt, which could force greater belt-tightening down the road. However, for now, it is expected that the Japanese economy's structural transformation toward sustained domestic demand growth is likely to be intact, given the continued tightness in Japan's labor market. This structural shift should continue to support Japan's equity market.

Bank of Canada makes its first 'jumbo cut' of this easing cycle

The Bank of Canada decided to cut rates by 50 basis points last week. This was its fourth consecutive decrease but its first jumbo cut of the cycle. Bank of Canada Governor Tiff Macklem declared, "Canadians can breathe a sigh of relief. It's a good news story. It's been a long fight against inflation, but it's worked, and we're coming out the other side." He was clear that the focus is now on supporting demand while maintaining low and stable inflation: "We need to stick the landing."[3] We could very well get one more rate cut this year from the Bank of Canada as it proceeds with its objectives. It is worth noting that the IMF anticipates a very significant pickup in growth for Canada in 2025, which is not the case for most other major developed economies (where expectations of modest increases are more the norm). It anticipates GDP growth of 1.3% this year, which accelerates to 2.4% next year.[4]

Takeaways from the Federal Reserve Beige Book

Also last week, the Federal Reserve Beige Book was released. My key takeaways are quite simple:

The US economy is holding up, although there are areas of weakness
Some districts are seeing weaker manufacturing activity. Consumer spending is mixed with continued signs of pressure for some consumers, who are buying less expensive alternatives.

Job growth was very modest but layoffs have also been very modest
It seems that employers continue to place importance on retaining employees, after having difficulty finding them for so long. The good news is that, while the labor market remains relatively tight, a number of districts noted wage growth has slowed.

The presidential election has created uncertainty for businesses and consumers
The most recent Beige Book is littered with references to the uncertainty created by the US presidential election, which is causing businesses to delay major decisions including investment plans and hiring, and also seems to be tamping down consumer spending, especially around major purchases. Even recent manufacturing weakness was blamed, at least

partially, on election uncertainty. I was encouraged to see some businesses expect a significant increase in activity in 2025 once election-related uncertainty is resolved and interest rates continue to ease; this is a view I have held for a while.

Learnings from earnings reports

Last week saw continued positive earnings reports. Thus far, 37% of S&P 500 companies have reported earnings. Of those companies, 75% have reported a positive earnings surprise while 59% have reported a positive revenue surprise.[5]

Some bellwether companies reported earnings last week, most notably UPS. As a shipping company, UPS can give us a sense of the strength of commerce, and last week it reported better earnings and revenue, which further supports the view that the US economy is doing relatively well despite areas of weakness.

Markets showed some fear last week

Last week, the 10-year US Treasury yield reached its highest level since July. On Sept. 16, right before Fed's super-sized rate cut, the 10-year US Treasury yield was slightly above 3.6%. At the end of last week, it closed slightly above 4.2%; that is a very significant rise in a relatively short period of time.[6]

However, rising yields have done little to dampen the stock market rally this year — until very recently. We did see US stocks fall last week, although this isn't surprising given that when yields rose quickly in both October 2022 and October 2023, US stocks fell.[6] A more modest stock sell-off occurred in April 2024 due to a rise in yields but lasted only briefly. Of course, it's not just the 10-year US Treasury yield. The 30-year Treasury yield has seen a similar runup, from a bottom of 3.936% on Sept. 16 to a close of 4.47% on Oct. 25.[6]

Investors may be worried about the prospect of higher US budget deficits in the future, which could be pushing yields higher. That is a common theme among many developed economies, several of which I discussed earlier. Having said that, I must give the caveat that trying to understand what is driving the 10-year US Treasury yield isn't simple — many factors impact it, including growth and inflation expectations. But I do suspect that bond vigilantes are at least part of the reason, given neither major US party is focused on fiscal prudence — and hasn't even tried to convey a message of fiscal restraint, unlike the current government in the UK.

Maybe it's no surprise that the AAII Investor Sentiment Indicator has seen a significant change in sentiment in the past month. On Sept. 18, bullish sentiment was 50.8%.[7] Since then, bullish sentiment has declined; the most recent reading, reported Oct. 23, show bullish sentiment at 37.7%.[7] There's substantial volatility in these numbers on a week-to-week basis, but the trend is clear. There's a lot of uncertainty in the air, which lends itself to worry about downside risks — including tariffs, wars, and government debt.

Looking ahead

I will be paying close attention to the release of the UK Autumn Budget on Oct. 30 — and the market reaction to it — as well as some key economic data releases including the US Personal Consumption Expenditures Index, US wage growth (from the Employment Situation Report), Eurozone Consumer Price Index, and the US Job Openings and Labor Turnover Survey (JOLTS) report. I think the Bank of Japan decision will be a non-event, although we may get some guidance on the future path of monetary policy, which would be welcome given the political surprise experienced last weekend.

In addition, earnings season will continue this week with some of the biggest mega-cap tech companies reporting.

In this time of unease and uncertainty, I would like to remind that most investors' timelines are far longer than a week, a few months, or even a US presidential term. In my view, it's important to maintain exposure to markets, be well diversified, and not react emotionally to data or developments.

With contributions from Tomo Kinoshita

Dates to watch

Dates	Reports	What it tells us
Oct. 28	Dallas Fed Manufacturing Business Index	Assesses Texas's manufacturing activity.
Oct. 29	Bank of England Consumer Credit	Tracks the volume of credit borrowed by UK consumers.
	S&P/Case Shiller Home Price Index	Indicates the health of the housing market.
	Conference Board Consumer Confidence	Details US consumer attitudes and expectations for inflation, stock prices, and interest rates.
	September US Job Openings and Labor Turnover Survey	Gathers data related to job openings, hires, and separations.
Oct. 30	Germany Unemployment	Indicates the health of the job market.
	Germany Gross Domestic Product	Measures a region's economic activity
	UK Autumn Forecast	Provides an update from the government on the state of the UK economy.
	Eurozone Consumer Confidence	Tracks sentiment among eurozone consumers.
	Eurozone Business Climate	Assesses the cyclical situation within the euro area.
	Eurozone Consumer Inflation Expectations	Tracks expectations for inflation among eurozone consumers.
	Eurozone Gross Domestic Product (preliminary)	Measures a region's economic activity
	Mexico Gross Domestic Product (preliminary)	Measures a region's economic activity

Dates	Reports	What it tells us
Oct. 30	US Personal Consumption Expenditures Price Index (preliminary)	Tracks the path of inflation.
	US Gross Domestic Product (preliminary)	Measures a region's economic activity
	Japan Retail Sales	Indicates the health of the retail sector.
	Japan Industrial Production	Indicates the economic health of the industrial sector.
	Australia Retail Sales	Indicates the health of the retail sector.
	China Purchasing Managers' Indexes	Indicates the economic health of the manufacturing and services sectors.
	Bank of Japan Monetary Policy Decision	Reveals the latest decision on the path of interest rates.
Oct. 31	Germany Retail Sales	Indicates the health of the retail sector.
	Eurozone Consumer Price Index	Tracks the path of inflation.
	Eurozone Unemployment Rate	Indicates the health of the job market.
	Brazil Unemployment Rate	Indicates the health of the job market.
	US Personal Consumption Expenditures Price Index	Tracks the path of inflation.
	US Employment Cost Index	Measures the change in the cost of labor for employers.
	US Personal Spending	Tracks personal spending in the US.
	Canada Gross Domestic Product	Measures a region's economic activity
	Japan Manufacturing Purchasing Managers' Index	Indicates the economic health of the manufacturing sector.
Nov. 1	UK Nationwide Home Price Index	Indicates the health of the job market.
	Mexico Unemployment Rate	Indicates the health of the job market.
	US Employment Situation Report	Indicates the health of the job market.
	US Purchasing Managers' Indexes	Indicates the economic health of the manufacturing and services sectors.

Notes

[1]Source: Eurasia Review, "As Inflation Recedes, Global Economy Needs Policy Triple Pivot – Analysis," Oct. 26, 2024

[2]Source: International Monetary Fund, October 2024

[3]Source: Reuters, "Bank of Canada slashes rates, says monetary policy has worked," Oct. 23, 2024

[4]Source: International Monetary Fund World Economic Outlook, October 2024

[5]Source: FactSet Earnings Insight, Oct. 25, 2024

[6]Source: Bloomberg, as of Oct. 25, 2024

[7]Source: AAII Sentiment Survey

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

The American Association of Individual Investors' AAII Sentiment Survey offers insight into the opinions of individual investors by asking them their thoughts on where the market is heading in the next six months.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

A basis point is one-hundredth of a percentage point.

The Summary of Commentary on Current Economic Conditions by Federal Reserve District (the Beige Book) is published eight times per year. Each Federal Reserve Bank gathers anecdotal information on current economic conditions in its district, and the Beige Book summarizes this information by district and sector.

Bond vigilantes is a name given to bond investors who sell bonds in protest against a monetary or fiscal policy they fear is inflationary.

The Consumer Price Index (CPI), which measures change in consumer prices, is a commonly cited measure of inflation.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

The Employment Situation Report is released by the US Bureau of Labor Statistics to monitor labor market data on a monthly basis.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

Gross domestic product (GDP) is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

Inflation is the rate at which the general price level for goods and services is increasing.

The International Monetary Fund is a global organization that supports economic policies that promote financial stability and monetary cooperation.

The Job Openings and Labor Turnover Survey (JOLTS) from the US Bureau of Labor Statistics produces data on job openings, hires, and separations.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual US household expenditures. Core PCE excludes food and energy prices.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Tightening monetary policy includes actions by a central bank to curb inflation.

UK gilts are bonds issued by the British government.

The opinions referenced above are those of the author as of **Oct. 28, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.