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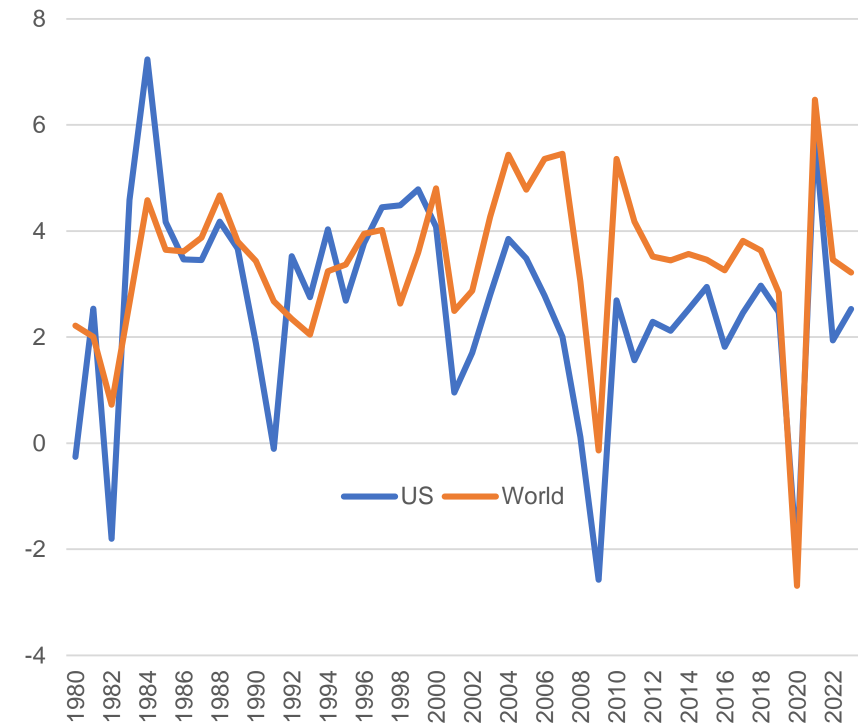
7 AUGUST 2024

Increasing concern about the US economy

Global equities experienced a significant downturn on Monday, August 5, 2024. Major indices saw notable declines: the S&P 500 fell by 3.0%, FTSE 100 by 2.0%, DAX by 1.8%, CAC by 1.4%, and Nikkei 225 suffered a sharp drop of 12.4%. Other regional markets also faced losses, with the STI down 4.0%, KOSPI plunging 8.8%, SET dropping 2.9%, JCI decreasing by 3.4%, and PSEi falling 2.6%. The Malaysian market was similarly affected, with the FBMKLCI index dropping 4.6% to 1,536.48 points.

The recent downturn in global markets is partly attributed to the unwinding of the Yen carry trade following the Bank of Japan's (BOJ) decision to raise its benchmark interest rate. On July 31, the BOJ increased the policy rate by 15 basis points to 0.25%. While the BOJ's actions are significant, the US Federal Reserve is expected to play a crucial role in the market's direction. Anticipation is building for significant interest rate cuts at the upcoming Federal Open Market Committee (FOMC) meeting on September 17-18, with a 50 basis point reduction being discussed as a likely starting point for easing. The possibility of an emergency FOMC meeting to accelerate rate cuts cannot be entirely dismissed.

Previously, there was a strong push for rate cuts due to concerns that high rates were increasing financing costs for borrowers. However, the narrative has shifted towards the need to prevent a potential recession in the US. As a result, markets are currently in risk-off mode. Given the global economy's close ties to the performance of the US economy, the current market weaknesses should be closely monitored, as equity markets often react before changes in the real economy become apparent.



Source: IMF

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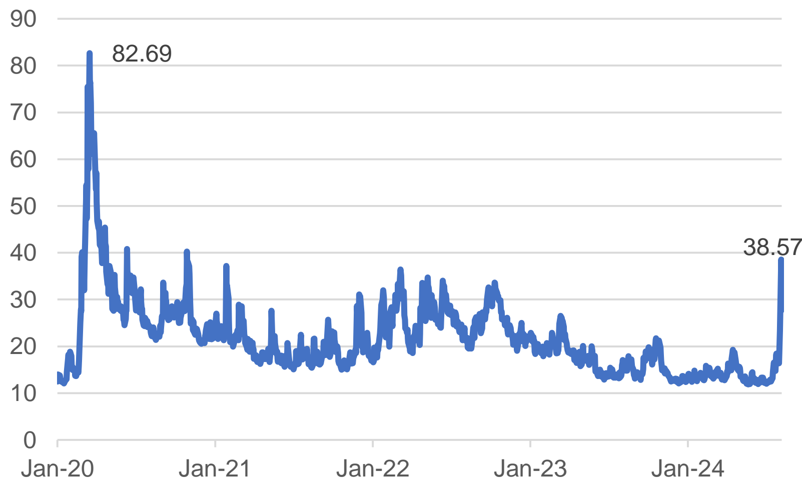
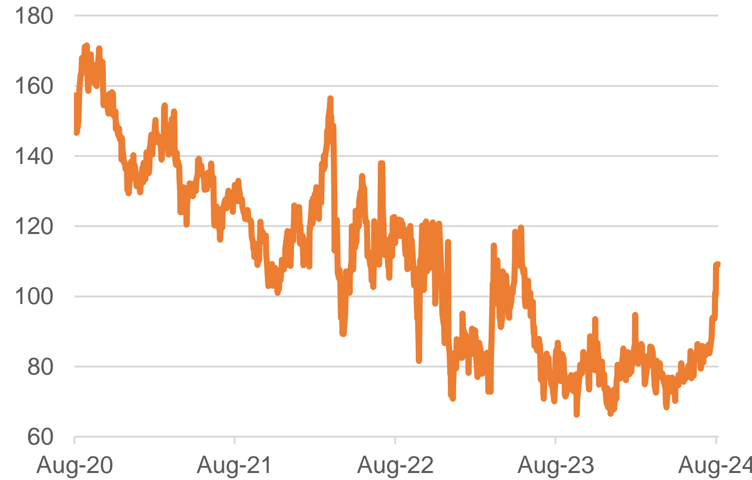
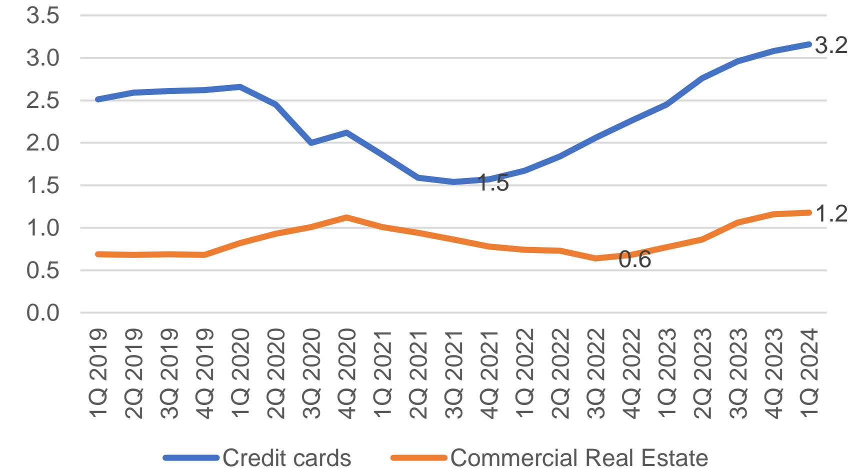
US jobs are weakening, what else?







Sources: US Federal Reserve Board, Bloomberg & CEIC

The CBOE Volatility Index (VIX), often referred to as the Fear Index, surged dramatically on Monday, reaching an intraday high of 65.73 points. This level is approaching the peak of 82.69 points seen during the COVID-19 crisis in March 2020. The VIX measures the implied volatility of S&P 500 options, typically rising during periods of economic uncertainty, such as the US subprime crisis in 2007-2008 and the COVID-19 pandemic in 2020. The worse-than-expected Nonfarm Payroll (NFP) report last Friday likely prompted traders to hedge their positions, driving the VIX to close at 38.57 points, well above the average of around 20 points, which is often used as a benchmark for market volatility. Additionally, credit markets are signaling distress among corporations and households. The corporate credit spread for Aaa bonds has risen to 109 basis points above the 10-year US Treasury yield. Meanwhile, delinquency rates for credit cards and commercial real estate have increased to 3.2% and 1.2%, respectively, in the first quarter of 2024, up from 2.5% and 0.8% in the same period last year. These indicators suggest that the restrictive monetary policy is putting pressure on the economy, as households and businesses struggle to meet their debt obligations.

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Stay vigilant everyone.

FOMC meeting dates	09-Jul-24	15-Jul-24	16-Jul-24	22-Jul-24	26-Jul-24	29-Jul-24	07-Aug-24
31 July, 2024	-4.50%	-4.50%	-8.50%	-4.50%	-6.5	-4.00%	n.a.
18 September, 2024	-75.50%	-94.50%	-105.50%	-95.50%	-105.50%	-109.90%	-179.10%
7 November, 2024	-42.20%	-64.70%	-65.70%	-60.50%	-65.70%	-66.50%	-118.20%
18 December, 2024	-79.90%	-91.30%	-92.30%	-86.80%	-91.40%	-95.20%	-125.70%
29 January, 2025	-61.30%	-71.50%	-72.50%	-67.20%	-67.40%	-68.90%	-84.40%

Source: Bloomberg

Economic shocks often catch everyone off guard, despite emerging warning signs. Some argue that the current situation may differ, especially in the post-COVID era where the services sector has become a major driver of the global economy, largely due to technological advancements. Notably, the rise of Artificial Intelligence (AI) has significantly impacted the global stock markets. AI algorithmic trading now accounts for 60% to 75% of total US stock trading, meaning trading decisions are increasingly based on mathematical models rather than human emotions, as seen in traditional investment strategies. This shift could explain the heightened volatility and rapid fluctuations observed in the markets.

It remains uncertain how these developments will benefit humanity as a whole, beyond providing superior returns to investors. However, the likelihood of a Federal Funds Rate (FFR) cut at the September meetings is increasing, with a 50 basis point reduction seeming plausible. This situation calls for policymakers, investors, businesses, and households to remain vigilant. While a lower interest rate environment might be welcomed, it could come at a cost. Easing monetary policy often signals anticyclical measures, indicating that policymakers are trying to mitigate the risks of a significant economic downturn. Therefore, a slowdown in global growth may be on the horizon, as evidenced by the actions of central banks worldwide.

Sources: *https://www.forbes.com/sites/forbesbooksauthors/2024/06/18/humans-vs-ai-in-the-stock-market-the-worst-trade-ever-made/#:~:text=The%20problem%20is%20becoming%20increasingly,volume%2C%20according%20to%20Quantified%20Strategies.

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