



FOUNDED IN

1988

EMPLOYEES

80+

LOCATED IN

10+
COUNTRIES

ASSETS DIRECTLY
UNDER MANAGEMENT

US\$1.6
BILLION

ASSETS INDIRECTLY
UNDER MANAGEMENT

US\$9.1
BILLION



ICM Monthly Outlook

OCTOBER 2024

Market Review

That's Q3 down, so let's check the scores on the board. For the nine months to September 2024, the S&P was up 20.8%, compared to 14.5% for the six months to the end of June 2024. In Q3, the Russell 2000 returned 8.9% versus 5.5% for the S&P.

You can't say you weren't told? In June, we said,

"Notwithstanding equity markets' high valuations, we see no reason for a significant pullback. We expect the second half of 2024 to be positive for markets, albeit at a lower rate of gain. We believe the broader market (the Russell 2000, for instance) will be dragged higher in the second half of the year by less restrictive monetary policy, which may come as soon as September in the US".

More broadly, risk assets had a positive return in Q3 despite the volatility in early August, which we explained last month. The Global High Yield index returned 6.2% in Q3. Year to date, the Global High Yield index has returned 8.5%. The US High Yield index returned 5.3% in Q3, and 8.0% year to date.

At the time of writing, we see no reason why this year's AI-infused everything rally won't continue through to year end. 6000 on the S&P would be another 4.5% in 2024, adding numerous new record highs to the 43 record highs this year already. The S&P is 5,792 at the time of writing.

The US' performance was pedestrian compared to the Chinese's. The Shanghai Stock Exchange Composite index skyrocketed 29% between 13 September – 8 October due to a range of stimulus measures by the Chinese Government to counteract slowing economic growth. Bloomberg's current GDP forecast for China is 4.8% in 2024 versus the Chinese Government's target of 5.0%.

The Chinese Communist Party (CCP) needed to stimulate its economy due to the property millstone weighing down the economy, and draining liquidity from local businesses and the broader economy. The Chinese authorities followed a playbook familiar to the Japanese, US, and Europeans. The People's Bank of China, China's equivalent of the Federal Reserve Bank, cut interest rates, making borrowing more affordable and reducing mortgage payments, thereby increasing liquidity.

The Chinese National Financial Regulatory Administration lowered the minimum capital requirements of Chinese banks by an aggregate of USD 150 billion. When banks are required to hold less regulatory capital, they can increase lending. Western regulators did not reduce capital requirements despite a robust argument to do so. The Chinese authorities need banks to re-engage in lending to businesses and consumers.

Market Review continued

The CCP cut the minimum deposit for homebuyers and introduced a help-to-buy scheme to support home buyers. These measures were designed to restore confidence in China's struggling property sector.

Furthermore, the CCP introduced measures to support the stock market by increasing liquidity and promoting mergers and acquisitions in key industries. The aim was to strengthen market confidence and stimulate consumer spending and investment, which appears to have worked so far based on the melt-up in equity markets.

The Chinese Government will soon learn that investors expect stimulus every time a new crisis arises, which is inevitable.

In recent months, we have mentioned reasons to be concerned around global trade, such as the possible introduction of tariffs by the next US President. This month, the European Commission imposed tariffs as high as 45% on electric vehicles from China due to state subvention for these industries. The Chinese Government protested their innocence and threatened to respond with tariffs on agriculture and European automobiles, much to the frustration of some member states who stand far worse from losing competitiveness in such a large market.

Market Outlook

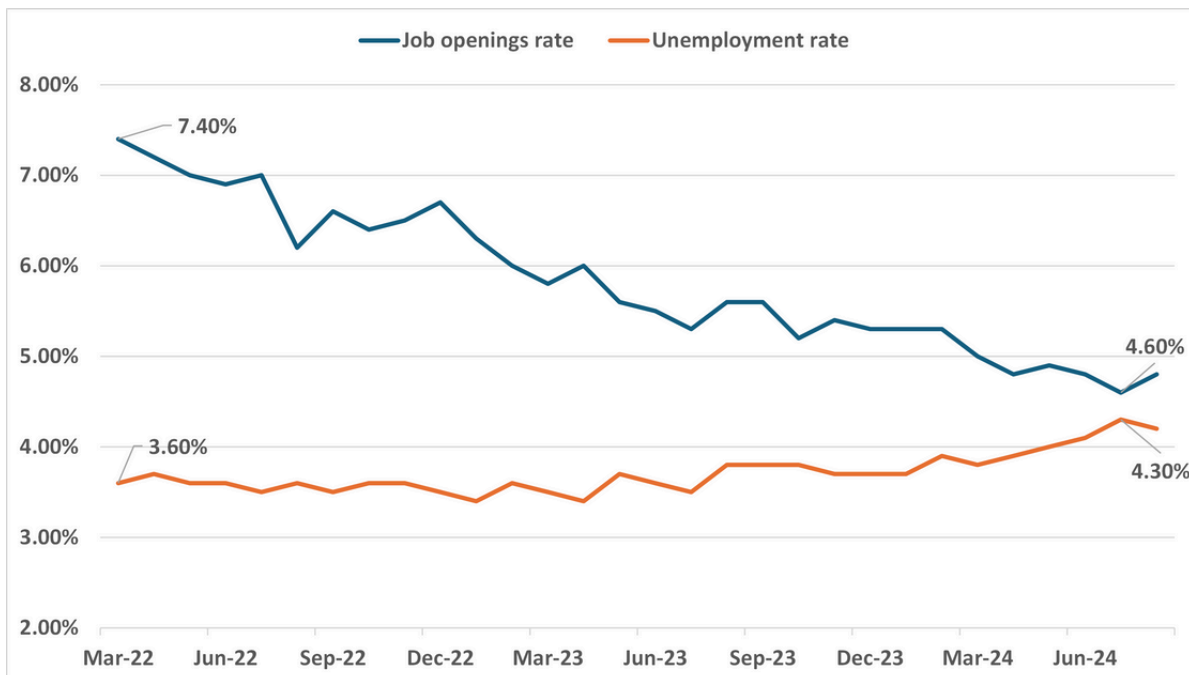
Interest rates

So, the US Federal Reserve Bank (FRB) surprised most investors when it cut rates by 50 basis points in September. JP Morgan was the only prominent proponent calling for 50 basis points last month. FRB interest rates are in the range of 4.75% to 5% now. (Thank God we didn't spend long debating that event - sarcasm alert for our US readers.)

Last month, we explained that the size of the FRB's cut would depend on their bias toward employment or inflation; employment won. Economic data between the Jackson Hole conference in August and the FRB meeting in September supported a strong start to the cuts.

In the press conference following the FRB meeting, Chairman Powell cited the Beveridge Curve to explain the bank's rationale for the 50 basis point cut. The Beveridge curve measures the relationship between the job openings rate and unemployment.

US Job Openings versus US Unemployment Rate



Before September 2024, the FRB felt that job openings were sufficiently elevated that they could fall a long way before hitting the part of the curve where lower job openings turned into higher unemployment and job loss. As of its September meeting, the FRB felt that the US labour market was very close to the point where a further decline in job openings would translate more directly into unemployment.

After the pandemic, the job opening rate peaked at 7.4% in March 2022 while the unemployment rate was 3.6%. A low unemployment rate (3.6%) and a high opening rate (7.4%) indicated a “tight” labour market and a growing economy.

Since then, the job opening rate has gradually fallen to 4.8%, while the unemployment rate rose to 4.2% in August 2024. As job openings fell, the unemployment rate has risen but only modestly. Since the start of this year, the unemployment rate has increased from 3.7% to 4.3% in July before falling back to 4.1% in September.¹ Chairman Powell said, “We’ve seen a lot of tightness come out of the labour market without it resulting in lower employment.”² While this is true, it is likely the FRB believes the economy is now at a point where unemployment will start to rise faster if job openings came down appreciably more than where they are currently.

Financial markets rallied hard after the 50 basis point cut. Some interpreted the strong action as an admission of tardiness by the FRB, suggesting it had fallen behind in executing a soft landing.

Skip forward to October’s nonfarm payroll (NFP) report, and the outlook for the US labour market is much improved. A much better than expected NFP figure on 4 October will have assuaged some of Chairman Powell’s concerns.

In September, the NFP increased by 254k, exceeding the Bloomberg median estimate of 150k and higher than the highest estimate of c.220k. In other words, no one saw 254k coming. Furthermore, The Bureau of Labour Statistics revised July’s NFP figure upwards by 55,000 to 144k, and August’s upward by 17k to 159k, an aggregate increase of 72k. The September NFP figure means the 2024 average is 232k versus the 261k average in 2023, when the labour market was tight, and 170k in 2019, the last pre-pandemic year.

The better employment data in September lessens the need for further aggressive (50 basis points) cuts. The market expects only two more 25 basis point rate cuts in 2024, down from three more 25 basis point cuts which was the expectation the day before the NFP report was released.

We anticipate possibly only one more 25 basis point cut in 2024.

The labour market is keeping pace with solid economic growth, which we expect will continue. The Sahm rule (see August’s newsletter) no longer suggests the US is in recession. Based on recent inflation data, the FRB may revert to inflation as its number one priority. The FRB probably would have cut by 25 basis points only in September had they been more focused on inflation based on the data at the time.

The FRB cannot afford a victory lap just yet. Inflation may regain top billing in the minds of board members. We expect inflation to continue trending lower slowly and the labour market to remain soft, resulting in a 25 basis point cut in either November or December. We feel that a year end target of 4.5% - 4.75% is well positioned to address either upside risks to inflation or downside risks to the labour market as we head into 2025. We expect layoffs will remain low and unemployment claims will be rangebound. Against this Goldilocks labour market, wage inflation should not re-emerge.

The volume of data and the extent of the debate about the US economy’s trajectory, including inflation, are equally weighty and persuasive on both sides of the argument. For example, the oil market faces an uncertain period ahead. Our favourite oil analyst, the excellent Jeff Currie, said, “global oil supplies face the highest risk in decades amid conflicts involving key producers Iran and Russia.” A higher oil price would clearly arrest short term disinflation. We believe the risk of an Israeli retaliation against Iran will only result in a short term spike. Hence, we think the oil price is an unlikely candidate for pushing the oil price higher over the medium to longer term. Notwithstanding Mr. Currie’s sentiment, we expect the oil price to remain rangebound between \$65 and \$85 over the medium term. In fact, there is a risk that prices could go lower, possibly into the \$50 range reflecting building production volumes coming out of North America shale fields. If the Saudis and OPEC+ decide to build their volume and compete for market share, this could be the outcome in 2025 which of course would allow inflation to fall further.

While not our central case, inflation could fall below 2%, forcing the FRB onto the front foot resulting in even more aggressive cuts. More generally, maintaining inflation at 2% is a massive challenge for Central Bankers. The challenge of holding such a narrow line may eventually give way to a broader range for inflation deemed suitable for price stability, say 1% to 3%. The FRB can't have forgotten the reputational damage it incurred when inflation ran hot in 2022 and 2023.

US Election

In 1992, Jim Carville, a strategist on President Clinton's campaign team, coined the phrase "It's the economy, stupid" when discussing the most important election issue. That year, President Clinton beat President H.W. Bush. Since then and before, the economy has persistently been the main election issue in the US and worldwide. This year's elections (US and Europe) feel different. Inequality is competing with the economy for the top spot of election issues.

Inequality has many guises, including racial, economic, gender, and even voting inequality.

In the US, the Republicans appear most focused on racial inequality, which can be oversimplified as white Americans versus The Rest. President Trump and JD Vance appear to be preying on the insecurities of white Americans, promising to Make America Great Again. One of the most publicised (and bogus) one liners in this year's election campaigns is President Trump's assertion that immigrants are eating people's pets. President Trump's pet assertion is analogous to outlandish conspiracy theories propagated by far right groups online,³ which also introduced the catchphrase, 'drain the swamp' in opposition to big government, aligning with Libertarian principles of free living; free living being a euphemism for paying less tax to the detriment of social welfare for many Americans.

The day before the dog eating quote, Trump made the assertion that "young American girls (are) being raped and sodomised and murdered by savage criminal aliens." President Trump has promised to deport entire nationalities from cities, even though the majority are legal and have not committed a crime. Of course, President Trump could never follow through with such a promise. Still, this sort of rhetoric wins over large swathes of the electorate who fear equality and who believe the haves and have nots are a state of nature rather than the result of oppression.

Cast your mind back to President Trump's 2016 election campaign, primarily based on tax cuts and promises of great riches, and building the wall.

On the other hand, the Democrats are more focused on economic inequality, notwithstanding nominating their third black candidate in the past five elections. Kamala Harris and Tim Walz want to reduce economic inequality. Kamala is a role model for ambitious non whites in the land of the free, and Walz is the common man, appealing to the struggling working classes. The Democrats are highlighting that over the last few decades, income inequality has surged, with the wealthiest 1% of Americans controlling an ever growing share of the nation's wealth while the bottom 50% (working class moderates) struggle to keep pace with rising costs of living, stagnant wages, and diminished job security. Simply put, we feel the Democrats are focusing on economics, 'stupid', which is why we believe Harris may just about do enough to win.

Beyond the election result

Voting inequality is not discussed much but is emblematic too. Tuesday voting began in the nineteenth century when most Americans were farmers and had to travel by horse and cart to count centres, often commuting for many hours. Tuesdays in November (after the harvest) allowed voters a day to commute to the vote centre, to queue up and vote and time to return home for market day on Wednesday without interfering with the Sabbath. Farmer labourers were not afforded the time or infrastructure to travel to the vote centre, thus eliminating their ability to vote. While farming is no longer the predominant occupation, and most Americans live in cities, Tuesday voting still curtails the voting power of lower income families struggling to juggle childcare, commutes, work, and then stand in line. A lack of time for voting is the number two reason for not voting, after dislike of the candidates, 48% versus 52%, respectively.⁴ Lower income voters have less flexibility during their working day. A few US states have reduced early and absentee voters to limit low income voting.

Contrast Tuesday voting with public holidays in the US, which have no political consequence. Most US public holidays fall on Mondays for the convenience of travelling and shopping, except Juneteenth, which is always the 19th, commemorating the ending of slavery in the United States. For centuries, a particular section of electorates globally has been taught that inequality is natural and not oppressive; it's just the order of things. Inequality has quietly existed in the US (and elsewhere) since its foundation. However, the level of inequality has increased and looks set to worsen, posing risks to the US and other countries.

You may ask what this all has to do with the outlook for financial markets. We fear the increasingly polarised opinions of public representatives can only have negative consequences for society and the uncertainty that brings. We expect and hope that the US Elections will take place peacefully and that the outcome will be accepted by both parties and their supporters. While this uncertainty may bring about short term market volatility around the election, we do not expect the elections or the election result to have a lasting effect on the direction of markets into 2025.

Investors may be sanguine about the election result thanks to the likelihood of a divided government, with Republicans taking the Senate and Democrats taking the Congress, which would shackle any radical shift in economic policy. US investors may also realise that the Federal Reserve Bank has far more sway over the economy than political policies, as we suggested in our letter last month.

Market Implications

There was no significant change from our thinking last month. We expect the Everything rally will continue with no reason to derisk. The latest US data reaffirms economic expansion in the US, while European growth continues to languish. Against this backdrop, we expect the rate cutting cycle and consumer and corporate spending will continue. We outlined earlier the extent of the Chinese stimulus that will support emerging markets. Expansive monetary policy and solid US economic growth will also benefit emerging markets.

Keep calm and carry on.

Conor Spencer

16 October, 2024

Source Data: ICM, Bloomberg as of 30 September, 2024.

[1] <https://data.bls.gov/timeseries/LNS14000000>

[2] <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20240918.pdf>

[3] <https://www.reuters.com/world/us/biden-says-attacks-haitian-immigrants-have-stop-2024-09-13/>

[4] <https://today.yougov.com/politics/articles/44434>

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