



FOUNDED IN

1988

EMPLOYEES

80+

LOCATED IN

10+
COUNTRIES

ASSETS DIRECTLY
UNDER MANAGEMENT

US\$1.6
BILLION

ASSETS INDIRECTLY
UNDER MANAGEMENT

US\$33.9
BILLION



ICM Monthly Outlook

SEPTEMBER 2024

Market Review

Uncertainty and volatility go hand in glove. Uncertainty refers to the lack of predictability of information, making investment outcomes harder to forecast. Volatility measures the dispersion of short-term shocks around a long-term mean. Volatility has risen since the start of July due to increased uncertainty. In the first two days of August, the S&P 500 fell 7.56%, its worst two days in over two years, during which the volatility index spiked to 65, the biggest intraday move on record. The S&P 500 followed a similar pattern in early September, albeit less severe at negative 4.3%. Encouragingly, normal service resumed quickly in both instances once investors assessed the situation. For August, the S&P 500 closed higher and within 1% of its all-time high. Year to date, the S&P 500 is up 18.42%. As we write, for September, the S&P is well along the road to recovery and within 50 basis points of the all-time high.

Weak job data in the US and a divergence in central bank policy expectations between the US and Japan brought on August's volatility and brought down the carry trade. A carry trade involves borrowing at low interest in one currency and investing in an asset that provides a higher rate of return, usually currencies and frequently highly leveraged. Carry trade investors rushed to reduce leverage in anticipation of the Japanese Central Bank raising rates and the US Federal Reserve Bank cutting sharply. The USD/JPY currency pair volatility was c.~5 standard deviations around that time.

Nvidia was blamed for September's volatility. It is unreasonable to criticise Nvidia's sell-off given that the company is a ripsnorter of a performer this year whose supersized returns have dragged the S&P 500 to all-time highs. Late revellers chased Nvidia and other tech stocks to a valuation they couldn't live up to for the time being. Over the past year, we have mentioned Nvidia's meteoric rise to riches. Fun facts abound about Nvidia's sell-off on the 3rd of September, which makes for excellent humble-bragging by shareholders. On the 3rd of September, Nvidia's market capitalisation suffered the largest value decline for one company in one day in history, falling by USD 280 billion. Over three days, USD 500 billion was wiped off Nvidia's market capitalisation. Nvidia is no longer more valuable than the entire European stock market; at its peak, it was valued at USD 3.33 trillion versus USD 2.6 trillion today. The CEO personally lost USD 10 billion of value on the 3rd of September. We also learned that 76% of Nvidia employees are millionaires, and 33% are worth over USD 20 million.¹ (1'm available.)

The same day as Nvidia was grabbing the headlines, the yield curve resumed an upward slope, or disinverted if you prefer. For the first time in 26 months, the US has an upward-sloping yield curve between 2 and 10 years. The delta started at a paltry two basis points, and it is nine basis points at the time of writing. The basis for the disinversion is the assumption that the Federal Reserve will cut rates by 2.5% (10 x 25 basis points) in the next 12 months to stave off a recession. Since April, the US 10-year Government bond yield has fallen to 3.6% from 4.6%. We would not be surprised if yields continued to fall, albeit slower, due to persistent concerns about a recession, which is not our central case.

Market Review continued

Other risk assets have endured increased volatility lately, as is typically the case at the start of Federal Reserve Bank easing cycles due to anxiety about growth and the possibility of a recession. The oil price has fallen c.12% since the start of August. The Commodity Research Board Metal's index is down c.7% since the middle of July. The Bloomberg Magnificent Seven Index is down 13% since its peak on the 10th of July 2024. However, year to date, the Magnificent Seven Index is up c.30%, so it's hardly a disaster.

We believe the market volatility since the end of July is mid-cycle skittishness rather than the prelude to a more severe end of cycle sell-off. In September, Goldman Sachs' chief economist lowered the probability of a recession to 20% from 25% earlier in the summer.

That said, we are not surprised that volatility has increased given the vulnerabilities festering over the last few months. Sooner or later, investors had to stop debating inflation and talk about something else. Sooner or later, some economic data release would reveal the prospect of slower growth. Sooner or later, the US Federal Reserve would call time to cut interest rates. Sooner or later, someone had to get ejected from that increasingly crowded one-way Nvidia/US equity trade. Sooner or later, expensive valuations based on optimistic earnings estimates would lure rotation into lower-risk assets, such as bonds. Sooner or later, higher rates would crimp demand and cause a growth scare.

Now, investors are debating all these interconnected economic factors, overlaid with rising political and geopolitical risks, to determine what will happen next. Investors are less endowed with certainty right now. There is no question that weak economic data spooked the market in early August, but we have no reason to believe this will worsen in the coming months. The latest economic data has been encouraging, with the unemployment data not as bad as feared and consumer confidence higher than expected.

Market Outlook

"The time has come for policy to adjust", said Chairman Powell during the press conference after the annual economic conference in Jackson Hole, Wyoming. The date will be September 18th.

We expect the Federal Reserve will cut by 25 basis points and wait for more economic data. That'll make it fourteen months since the end of the last tightening cycle, July 2023, and the joint longest period of rates on hold in over sixty years, tied with July 2006 to September 2007. As we said in May, we can't draw any parallels between the current economic outlook and the period that followed September 2007.

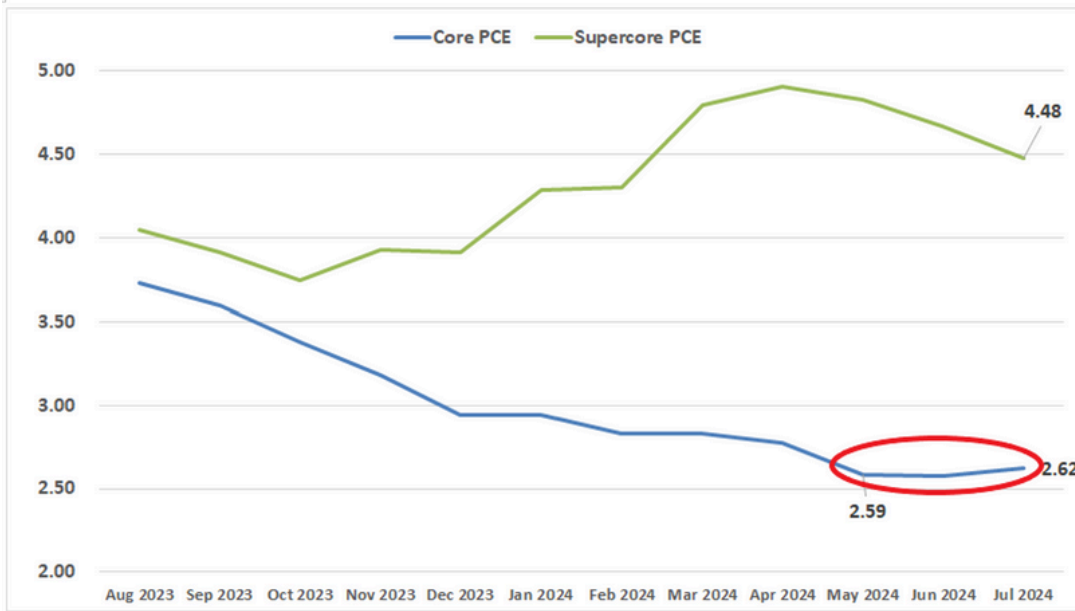
Plenty of analysts are calling on the Federal Reserve to cut by 50 basis points in September; typically, these are the same analysts calling for cuts long ago, who have already decreed that the Federal Reserve is wrong to have waited so long to cut rates and say that inaccurate data from government agencies means they were right all along. It's not a baseless argument and time will tell who is right.

Our basis for the more cautious 25 basis point cut in September relies on a few data points.

Inflation

One significant impediment to cutting more aggressively is the uncooperative trajectory of core PCE inflation over the past three months. Core PCE, the Federal Reserve's preferred gauge of inflation, is still above its target of 2%, having flatlined at 2.6% since May. The super core index, a subset of the core PCE less housing, remains well above target at 4.5%. While both figures remain lower on a long-term trajectory, we believe Chairman Powell will want to put the final nail in the coffin of above-target inflation. We believe the Chairman is naturally cautious and will want to wait for more evidence that inflation is still falling. For instance, food prices could be on the Federal Reserve's radar. Due to extreme weather and general climate change,² coffee prices are at their highest in five years due to adverse climatic conditions in critical regions. Cocoa prices have never been higher due to poor harvests from unfavourable weather conditions in West Africa. More generally, the mentions of the impact of climate change on companies' businesses in earnings and other regulatory filings rose to the highest on record in the consumer staples industry this year, according to Bloomberg.

US Personal Consumption Expenditure Core Price Index

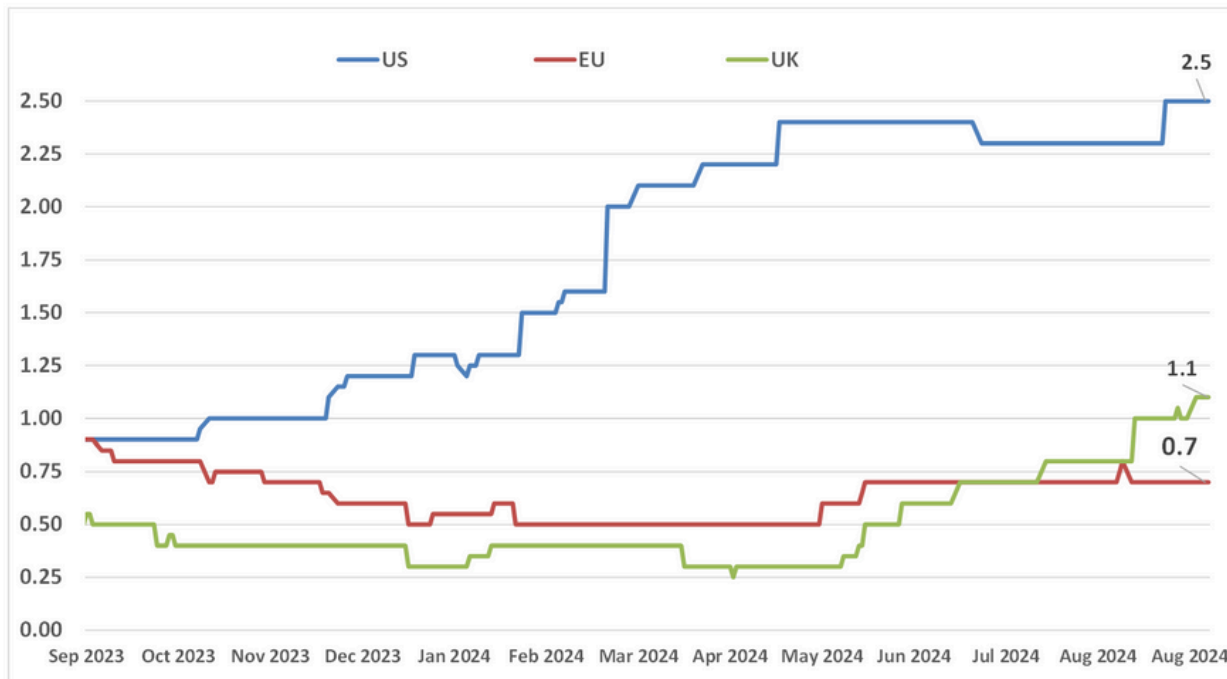


Source: Bureau of Economic Analysis³

Economic Growth in the US

The second factor impelling caution is the latest economic growth expectation for Q3 2024, suggesting the US economy does not need stimulation. The Atlanta Federal Reserve’s GDPNow model suggests 2.1% growth for Q3 2024, while the New York Federal Reserve’s equivalent estimate is 2.6% growth in Q3 2024. Both numbers indicate the US economy is relatively robust.

GDP Economic Forecast for 2024



Source: Bloomberg

Unemployment

The argument for a 50-basis point cut relies on a separate set of data points and would indicate a greater level of concern for the jobs market by the Federal Reserve Bank. At Jackson Hole, Chairman Powell said a further cooling in the job market would be unwelcome.

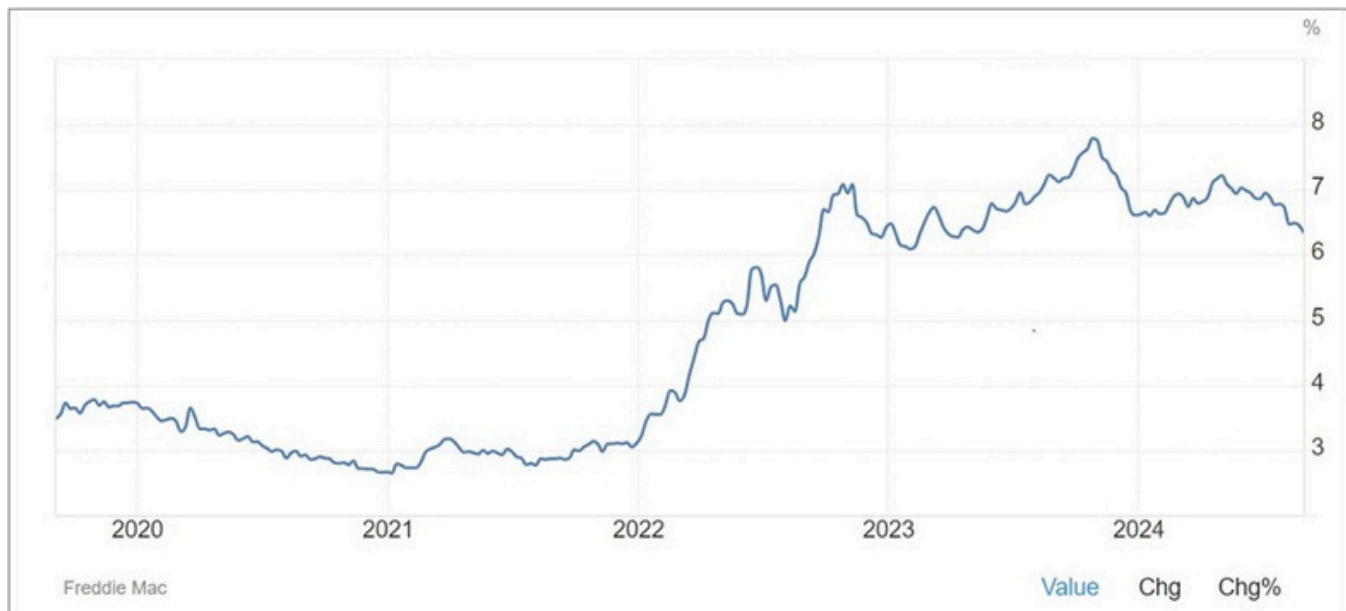
The deterioration in the labour market per the non-farm payroll report on 31st July started the outcry for a 50-basis-point cut. Investors' fears were soothed by better-than-expected retail sales in mid-August and assuaged further by a better-than-expected non-farm payroll report on 31st August.

Yes, the labour market is softer, but we believe the latest employment data lends itself to 25 basis points, not 50 basis points. US initial jobless claims 4-week moving average shows improvement as opposed to deterioration.⁴ It's too soon to determine if the recent deterioration is the start of a significant rise in unemployment or just mean-reversion in the labour markets. That said we know that jobs data is a lagging indicator, and it is quite normal for unemployment to be rising at this stage of the cycle. Hence, our central case expectation is that unemployment will rise but top out just under or around 5% over the next several quarters.

Housing

We are more concerned about the US housing market. It is a sore on the US economy that would love a 50-basis point cut dearly. Recent housing-related data⁵ gave us a window into an interest rate sensitive sector of the US economy that appears to be struggling, most likely due to restrictive monetary policy. On 15th August, the Housing Market Index⁶ fell for the fourth consecutive month to 39, the lowest level so far this year, from a downwardly revised 41 in July and below forecasts of 43. The composite index reading of 39 indicates unfavourable conditions in the housing market and is consistent with observations during recessions. Builder sentiment is weak, dampened down by a lack of affordability due to current interest rates and construction cost inflation pushing up home prices. According to the National Association of Home Builders, 33% of builders offered a discount in August compared to 31% in July and 29% in June. We also note the rise in consumer delinquency rates, suggesting financial strain in certain strata of the economy.

US 30-Year Mortgage Rate



Source: United States 30-Year Mortgage Rate⁷

Beyond September, based on the current economic outlook, we expect the Federal Reserve Bank will cut by another 50 basis points in 2024, equating to 75 basis points in aggregate before Christmas. Bloomberg's World Interest Rate Predictor model predicts 100 basis points (1%) of cuts before Christmas. Goldman Sachs expects 3 x 25 basis points cuts in 2024.

Europe

It was no surprise when the European Central Bank (ECB) cut by 25 basis points in September. The ECB's future path will also be data-dependent, with special emphasis on sticky core inflation that has flatlined at 2.75% since April 2024, mimicking the graph shown previously for the US. We believe the ECB will be even more cautious than the US and cut only once before the end of 2024. The Eurozone economy is heavily influenced by the US and the Federal Reserve Bank's decision. If the US sneezes, Europe catches a cold.

US Presidential Election

In our May newsletter, we suggested that a Trump victory would be a slam dunk if President Biden remained in the election. Disillusioned Democrats who couldn't bring themselves to vote for the crepuscular Biden can now heave behind Harris, as illustrated by substantial fundraising inflows to her campaign, largely from smaller donors.

Before the debate on 10th September, the betting market was 50:50 between the two candidates. Post-debate, it seems that Trump fared worse, and Harris has taken a small lead. There are still two months to go, so between now and election day, Trump, who has recovered from more scandals than anyone you'd care to mention, will undoubtedly rebound. We expect the voting intentions in the swing states will ebb and flow between both candidates, culminating in a close-run race in which, ultimately, we think Harris will win.

Kamala Harris' short lead time has worked to her advantage; no one is bored of her yet. Harris is new content in the age of bottomless mobile phone feeds. Also, as unbelievable as it sounds, we believe that Taylor Swift's endorsement of Harris shortly after the debate on 10th September will catalyse Harris to win the swing states. Young female voters will tip the scales in Harris' favour, barring a disaster for her campaign. Circa 400,000 people registered to vote since Miss Americana's Instagram message after the debate on September 10th. That is a lot of votes in such a close-run race. It remains to be seen if these voters show up in polls, but a decent amount will vote on the day. The bond market barely reacted to the debate. The bond market reacted far more meaningfully to the job data in July and August, which suggests that the outcome of the election is secondary in the minds of investors. For investors, there are only suboptimal outcomes from this election. Harris will introduce higher corporate taxes. Trump will bring tariffs and trade wars. Both will impact investors' returns. Ultimately, we believe the outcome of the US election is just one of numerous factors that will drive capital markets over the next six to eighteen months, with the Federal Reserve's action being more potent.

Market Implications

As mentioned earlier, we see no reason to believe that the recent increase in volatility suggests that we are at the end of the cycle for risk assets. We still expect a smooth transition to stable growth, not a recession in the US. We still believe we are in a bullish market for equities and bonds, albeit a slightly tired bull for the next few months that will be revived by the incoming tide of liquidity from central banks. In this environment, we expect consumer spending to hold its own and corporate earnings to hold up. Lower underlying yields will benefit corporate borrowers as much as consumers, and the corporate sector should benefit from lower refinance rates, supporting credit spreads. We prefer higher-quality, larger companies that will continue to scale up and out-muscle their smaller counterparts through acquisition or competition. We believe we are looking at the corporate equivalent of the rich getting richer at the expense of the poor, particularly in the technology sector. Similarly, emerging markets are set to benefit from expansionary monetary policy, stable US economic growth, and a shrinking valuation discount versus more expensive developed markets.

Conor Spencer

17 September, 2024

Source Data: ICM, Bloomberg as of 31 August, 2024.

[1] Bloomberg, "Nvidia Rally Mints Millionaires Too Busy to Bask in New Wealth", <https://www.bloomberg.com/news/articles/2024-08-26/what-s-it-like-working-at-nvidia-you-may-get-rich-but-work-remains-stressful>

[2] Coffee, cocoa, and orange juice prices have risen significantly lately, +31%, +141%, and 50%, respectively. Commodities - Live Quote Price Trading Data (tradingeconomics.com)

[3] Bureau of Economic Analysis, <https://www.bea.gov/data/personal-consumption-expenditures-price-index>

[4] Department of Labour, U.S. Initial Jobless Claims track the number of people who filed jobless claims for the first time during a specific period. News Release ([dol.gov](https://www.dol.gov))

[5] The National Association of Home Builders/Wells Fargo Housing Market Index and the U.S. Census Bureau's release on housing starts. NAHB/Wells Fargo Housing Market Index (HMI) | NAHB; New Residential Construction Press Release ([census.gov](https://www.census.gov))

[6] The house market index is a composite measure incorporating current sales, anticipated activity in the next six months, and traffic on prospective buyers. United States Nahb Housing Market Index (tradingeconomics.com)

[7] United States 30-Year Mortgage Rate, <https://tradingeconomics.com/united-states/30-year-mortgage-rate>

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