Allianz Global Investors

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The Week Ahead

Time to loosen up

Just as loose summer attire in the northern hemisphere is slowly giving way to autumnal jumpers and jackets, sentiment among investors might still be described as relaxed and carefree. The leading US index, the **S&P 500**, has surged to fresh all-time highs, while Germany's foremost equity benchmark, the **DAX**, has topped the 19,000 point milestone for the first time ever – despite a challenging domestic economic backdrop. Even bond investors have had reason to celebrate recent price gains.

The main impetus for this easing has come from the US central bank, the Federal Reserve (**Fed**), which finally embarked on a long-awaited interest rate cutting cycle. And it did not disappoint, slashing rates by a massive 50 basis points. Fed policymakers emphasised that this jumbo-sized cut was intended as a precautionary step to prevent the labour market from cooling off too quickly, rather than a belated response to an inexorable slowdown in the economy. In this sense, the Fed is seeking to shore up confidence among market participants in its primary objective of bringing inflation back towards the 2% target by achieving a "soft landing" for the economy. So far, most investors appear to view this as a credible outcome.

Stefan Rondorf
Senior Investment Strategist, Global Economics & Strategy

By ushering in an easing cycle, the Fed, which sets the tone for the rest of the world, has in turn opened the door for many other central banks to loosen their monetary policies without unilaterally devaluing their own currencies. The central banks of Indonesia, Mexico and South Africa, for instance, have already availed themselves of this opportunity.

Above all, however, the Fed seems to have emboldened **China's** economic policymakers into doing more to support its flagging domestic economy. With growth having previously slowed, increasingly jeopardising the government's 5 percent target for this year, the need for additional measures to bolster consumer spending and support the ailing property market became more pressing in the second half of September. These include steps to ease monetary policy by reducing prime rates and mortgage rates or lowering minimum reserve requirements for banks, as well as regulatory initiatives such as reducing downpayment ratios for purchasing second homes. In a separate announcement, Chinese economic officials also held out the prospect of **fiscal policy measures**, including cash injections to recapitalise banks, to stimulate consumption and to enable the central government to assume debts of regional governments. As this shock-and-awe package of measures exceeded all expectations, Chinese equity markets have seen an epic rally after a protracted dry spell.

Publications

→ Navigating Rates
A highly anticipated rate cut by the US Federal Reserve has finally arrived. We think the current more proactive rate-cutting cycle looks very favourable for bond investors.

→ Dividends: Stability in an era of disruption
Be it deglobalisation, digitalisation, demographics or decarbonisation, disruption is in full swing wherever you look. It is also a long-term, structural phenomenon. These drivers of transformation are also likely to have an impact in 2024. Then there are the current (geo)political, macroeconomic and monetary policy developments. Taken together, this makes the question as to how equities can provide stability in a portfolio all the more pressing. Welcome to our new white paper on dividends.

→ China's central bank surprises
In a major package of stimulus measures, China's central bank on Tuesday announced a 20 bps cut to the seven-day reverse repo rate from 1.7% to 1.5%.

All indications are pointing to further monetary easing in the euro area as well, with a mix of falling inflation rates and softening economic data likely to spur the **European Central Bank** (ECB) into at least giving more serious consideration to a further rate cut in October.

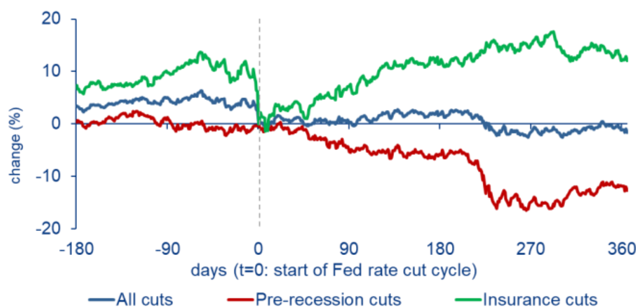
Investors have also been relatively relaxed when it comes to the most consequential political event of the year: the presidential election in the **United States**. So far, there has been no sign of the uncertainty often exhibited by equity investors in the weeks leading up to the election, although it would not be unusual to see a few temporary setbacks in October.

In a nutshell, monetary easing in the world's largest economy, the USA, and simultaneous and long sought after fiscal stimulus in the second-largest economy, China, would appear to be propping up investors' hopes going forward – at least for now.

Wishing you a loose month ahead

Yours,
Stefan Rondorf

S&P 500 return vs cash around the start of Fed rate cut cycles: it all depends on the economic path thereafter



Source: Allianz Global Investors Global Economics & Strategy, Bloomberg.

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UPCOMING POLITICAL EVENTS 2024

17 Oct	EZ	ECB Governing Council meeting
23 Oct	CA	Bank of Canada Meeting
25–27 Oct	IMF	IMF and World Bank annual meetings
31 Oct	JN	Bank of Japan meeting

→ Overview political events 2024 (click here)

The prevailing environment of monetary easing would suggest the following **tactical allocation for equities and bonds,** as well as **currencies**:

- **Equity investors** still firmly believe that the US economy is headed for a soft landing; with other words, that the now finished monetary policy tightening will not trigger a recession. This belief is reflected by elevated valuations and profit expectations that err on the optimistic side. However, this does not completely rule out any rapid and self-reinforcing deterioration on the labour market.
- Yet, by kicking off the cycle with a heft interest rate cut, the Fed has signalled that it is keeping a watchful eye on downside risks for the economy. As inflation declines, the central bank **safety net** for equity markets has become somewhat more entrenched. Consequently, opportunities for equities are likely to predominate for the time being.
- Beyond the United States, investors are faced with a diverse range of macroeconomic conditions. While downside risks pervade the **euro area**, events in **China** are raising hopes of an improvement. In **Japan**, the economy would appear sufficiently resilient, with the performance of the yen currently dominating activity on the markets.
- The US equity market has regained a more balanced footing, with performance no longer driven by just a handful of tech companies. This creates opportunities for active stock selection.
- Compared to equity markets, **government bond markets** are more receptive to downside economic risks. They price in rapid cuts in key interest rates to slightly below levels at which central banks such as the Fed and the ECB consider their respective neutral equilibrium rates to be. This means that opportunities for further price gains are most likely to arise in the risk scenario of a recession.
- In contrast, default risk premiums for **corporate bonds** are very low, indicating that this market segment reflects an optimistic economic scenario.
- Following a weak phase, the **US dollar** may be poised for a moderate appreciation against currencies such as the euro. Overall, the US economy appears more buoyant than in most other regions. Elsewhere, central banks may cut their key rates more quickly.

Investment topic:
Monetary policy turnaround

- The monetary policy turnaround has finally arrived. The US central bank, the Federal Reserve (Fed), and the European Central Bank (ECB) have made their first moves – and they are not alone.
- With the exception of the Bank of Japan (BoJ), which is supposed to walk a different path, a large number of other central banks are in the process of pushing their own key rates lower. This has been made possible by declining inflation rates.
- This is good for the economy – not, however, for savers as falling key rates mean interest rates on bank deposits will also (continue to) fall. What is more, this trend has only just started. When inflation is factored in as well, there is not much interest income left. So, it is time to act. The question is, where should you put your money?
- While past performance never repeats itself in the same way, previous rate cutting cycles and how various asset classes have reacted to them can nonetheless provide valuable insights.
- To analyse this, we examined the US Fed's last nine interest rate cutting cycles all the way back to 1981 and calculated which asset class responded over the whole period from the first to the last interest rate cut as an alternative investment to the money market.
- What emerged from our analysis is that (US) government bonds, but also those from emerging markets and corporate bonds, generated a positive additional return over money market yields. Equities, on the other hand, displayed a worse performance.
- The picture becomes more interesting when breaking down the cycles into those that resulted in a recession and those in which a recession was averted. In the latter scenario, **both** equities and bonds outperformed the money market.
- For those banking on a "soft landing" scenario (with no resulting recession), both bonds and equities may be attractive investments because, as interest rates fall, investors should decide: Do they just want to sit by and watch their returns dwindle or seek out alternatives?

Market overview as of 01.10.2024

Equity Indices		
DAX		19,213
Euro Stoxx 50		4,948
S&P 500		5,709
Nasdaq		17,815
Nikkei 225		37,809
Interest Rates %		
USA	3 Months	4.85
	2 Years	3.68
	10 Years	3.78
Euroland	3 Months	3.28
	2 Years	2.32
	10 Years	2.06
Japan	3 Months	0.45
	2 Years	0.35
	10 Years	0.87
FX		
USD/EUR		1.109
Raw Materials		
Oil (Brent, USD/Barrel)		74.6

Calendar Week 41

Monday			Consensus	Previous
GE	Industrial Orders MM	Aug	--	2.9%
GE	Manufacturing O/P Cur Price SA	Aug	--	4.5%
GE	Consumer Goods SA	Aug	--	98.8
UK	Halifax House Prices MM	Sep	--	0.3%
UK	Halifax House Prices YY	Sep	--	4.30%
EC	Sentix Index	Oct	--	-15.4
EC	Retail Sales MM	Aug	--	0.1%
EC	Retail Sales YY	Aug	--	-0.1%
US	Consumer Credit	Aug	--	25.45B
Tuesday				
JN	All Household Spending YY	Aug	--	0.1%
JN	All Household Spending MM	Aug	--	-1.7%
JN	Current Account NSA JPY	Aug	--	3,193.0B
JN	Current Account Bal SA	Aug	--	2,802,900M
JN	Trade Bal Cust Basis SA	Aug	--	-392.690,00M
GE	Industrial Output MM	Aug	--	-2.4%
GE	Industrial Production YY SA	Aug	--	-5.29%
US	International Trade $	Aug	--	-78.8B
Wednesday				
JN	Reuters Tankan N-Man Idx	Oct	--	23
GE	Exports MM SA	Aug	--	1.7%
GE	Imports MM SA	Aug	--	5.4%
GE	Trade Balance, EUR, SA	Aug	--	16.8B
US	Wholesale Invt(y), R MM	Aug	--	0.2%
Thursday				
UK	RICS Housing Survey	Sep	--	1
JN	Corp Goods Price MM	Sep	--	-0.2%
JN	Corp Goods Price YY	Sep	--	2.5%
US	Core CPI MM, SA	Sep	0.2%	0.3%
US	Core CPI YY, NSA	Sep	--	3.2%
US	CPI MM, SA	Sep	0.1%	0.2%
US	CPI YY, NSA	Sep	--	2.5%
US	CPI Wage Earner	Sep	--	308.640
US	Initial Jobless Clm	30 Sep, w/e	--	--
US	Cont Jobless Clm	23 Sep, w/e	--	--
CN	M2 Money Supply YY	Sep	--	6.3%
Friday				
JN	M2 Money Supply	Sep	--	1,252.2T
JN	Broad Money	Sep	--	2,172.5T
GE	CPI Final MM	Sep	--	--
GE	CPI Final YY	Sep	--	--
GE	HICP Final MM	Sep	--	--
GE	HICP Final YY	Sep	--	--
UK	GDP Est 3M/3M	Aug	--	0.5%
UK	GDP Estimate MM	Aug	--	0.0%
UK	GDP Estimate YY	Aug	--	1.2%
UK	Services MM	Aug	--	0.1%
UK	Services YY	Aug	--	1.7%
UK	Industrial Output MM	Aug	--	-0.8%
UK	Industrial Output YY	Aug	--	-1.2%
UK	Manufacturing Output MM	Aug	--	-1.0%
UK	Manufacturing Output YY	Aug	--	-1.3%
UK	Goods Trade Balance GBP	Aug	--	-20.003B
US	PPI Machine Manuf'ing	Sep	--	185.1
US	PPI Final Demand YY	Sep	--	1.7%
US	PPI Final Demand MM	Sep	0.1%	0.2%
US	PPI exFood/Energy YY	Sep	--	2.4%
US	PPI exFood/Energy MM	Sep	0.2%	0.3%
US	U Mich Sentiment Prelim	Oct	--	70.1

The calendar data for the current week comes directly from Bloomberg. They are published in the week in which “The Week Ahead” appears. These are economic data that come from official sources. Where available, the previous figure is collected together with the consensus estimate. The consensus estimate is collected by Bloomberg through a survey of analysts and economists. It is the average of all estimates submitted.

If not mentioned otherwise data and information sources are from LSEG Datastream.

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