Allianz Global Investors

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Capital Markets Monthly

Cutting through the noise

Besides the usual flow of corporate, macroeconomic and central bank news for investors, the last couple of weeks have seen a remarkable slew of political headlines hit the markets as well. How much of this has just been "noise" and which of them could have a genuinely lasting impact on capital markets?

In the **United States**, with the Democrats having replaced the top of their ticket and following an assassination attempt on the GOP's presidential candidate Donald Trump, the race for the Oval Office still appears to be wide open. Until recently, polling had suggested that Trump was ahead in six key states where the result of the election is expected to be very close (the so-called "swing states"). However, according to opinion polls published in the last few days, momentum at least seems to be shifting in favour of the Democrats and their new presumptive nominee Kamala Harris.

Stefan Rondorf
Senior Investment Strategist, Global Economics & Strategy

A key point is not just what is in each party's platform but what the chances are that either party could actually realise its policy proposals, considering that the most likely scenario, **divided government** (in which the House of Representatives and the Senate are controlled by different parties), would probably result in significant horse trading between both sides. Essentially, though, a second Trump administration can be expected to bring about a more pronounced change in the market environment as the overall direction of US policy would potentially diverge to a much greater extent from what we have seen over the last four years. On the basis of publicly available information, a handover of power in the United States may have a negative effect on non-US equity markets in the medium term (due to the likelihood of a more aggressive, US-centric trade policy) and a positive effect on gold (given the potential undermining of the independence of the US central bank, the Federal Reserve, or Fed).

The aftermath of **elections to the French National Assembly** has left the complex task of forming a government, which will presumably result in some kind of coalition. This is an unfamiliar situation and something of an experiment for the French political system and one that is not likely to result in a stable government with a clearly defined policy agenda. The bond markets, in particular, will be focusing on the public spending policies of any potential alliance while the EU has already launched an excessive deficit procedure against France. The resulting uncertainty has been reflected in higher spreads between French and German government bond yields, which have reached around 70 basis points in the 10-year segment (as of beginning of August). For the time being, there is not expected to be any rapid decline to levels seen before the snap election was called.

Publications

→ Shifting World Order – why investors should pay attention
Geopolitical dynamics are shifting and investors should pay attention.

→ Healthcare: how to live better
Many of us embrace the idea of living to a ripe old age. Yet the resources required to sustain longer lifespans are a growing financial burden.

→ Multi Asset: The comeback
The aim behind "multi asset" is to improve the risk/return profile of an investment by allocating capital across a multitude of assets. This approach to investment struggled during the phase of low and negative returns. Meanwhile, it may be poised for a comeback.

Meanwhile, the conflict in the **Middle East** remains tense and there is no ruling out any direct or indirect confrontation between Israel and Iran. The latter would likely result in a spike in energy prices. Since reaching a temporary peak in April of this year, the oil price has been on a volatile and slightly downward trajectory. As such, it does not currently reflect any heightened anxiety.

The **fundamental picture** is what matters, and this suggests that a soft landing for the US economy is becoming the most probable scenario. While US economic growth appears to be easing off somewhat, it remains within a normal capacity utilisation range and thus adequate. Inflation continues to trend lower; the economy seems to have left a temporary uptick in price growth in the first quarter of the year behind it. This provides the **Fed** with the chance to give more serious consideration to making its first interest rate cuts.

A similar situation applies to the European Central Bank (**ECB**), which has already made its first move in cutting rates. However, in contrast to the United States, it faces a much gloomier outlook for economic growth. Indeed, the economic rebound anticipated by the ECB and many observers seems unfortunately to be weaker than initially projected – at least for the time being. On the flipside, this has increased the probability of a further reduction in interest rates.

Cutting through the noise of the news flow, the picture for higher-risk asset classes can generally be described as sufficiently positive. Taking a closer look at equity markets, the strong performance of a small number of companies contrasts with a whole host of stocks that have recently turned in modest gains. The more optimistic the prospects for the (US) economy may be (which appears doubtful in the short term) and the greater number of interest rate cuts the disinflationary environment enables central banks to make, the more likely it would seem that a **broadening** of equity performance to additional market segments will ensue.

Do not allow yourself to be distracted by the noise.
Yours,

Stefan Rondorf

Taking a step back from the noise of the news flow, the current picture would suggest the following tactical allocation for equities and bonds:

- Global **equity markets** should fare well in the event of a soft landing for the US economy. However, this favourable scenario seems to be the baseline scenario for most investors, so there is little potential for positive surprises. There is no ruling out some disappointments, though.
- Thus far, the second-quarter **earnings season** can be best described as mixed, with advance expectations having been slightly higher than usual. In the US, muted revenue growth was somewhat negative, although in many cases companies were able to defend or even expand their high profit margins. Companies with disappointing earnings or outlooks have met with a comparatively harsh response by markets.
- A **broadening of market performance** would be beneficial for equity markets, especially in the United States. There is every reason to presume that stronger cyclical growth and (dis)inflation-driven interest rate cuts could be seen as especially helpful for small caps and other overlooked segments such as cyclicals. The driver of interest rate cuts is likely to have greater potential in the short term than the driver of economic recovery.
- On **bond markets**, the yield curve has become noticeably steeper and is now less inverted. In the medium term, a further normalisation of curves on both sides of the Atlantic would seem likely, primarily due to a fall in yields at the short end. At the long end, however, the potential for a continuation of falling yields appears limited.
- The **EUR/USD exchange rate** has recently been trending sideways. In terms of interest rate differentials, this sideways movement could continue, possibly with a tendency towards a weaker euro. However, political factors may override this trend at any time.

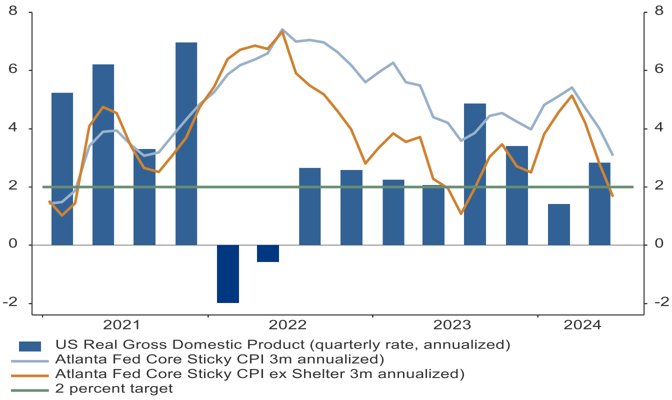
UPCOMING POLITICAL EVENTS 2024

01 Aug	GB	BoE announcement and minutes
04 Sep	CA	Meeting of the Bank of Canada
10 Sep	UN	UN General Assembly
12 Sep	EZ	ECB Governing Council meeting

→ Overview political events 2024 (click here)

The US economy seems approaching a „soft landing“

Growth close to potential, underlying inflation aims at 2% again



Source: LSEG Datastream, AllianzGI Economics & Strategy 07/31/2024

Past performance, or any prediction, projection or forecast, is not indicative of future performance.

Investment topic:
Never put all your eggs in one basket

While equities are likely to remain an indispensable factor in accumulating private wealth from a strategic/long-term allocation, an old adage is gaining new-found relevance in turbulent times: "Never put all your eggs in one basket".

Spreading assets across a range of investment opportunities ("multi asset") enhances diversification and stabilises the portfolio.

An interesting point here is that, following the period of low and negative interest rates, the correlation between the two major asset classes of equities and bonds has normalised again. It would appear that the previous phase in which they were in lockstep with one another has come to an end.

Crucially, monetary policy, which had been in crisis mode and which had lifted equites and bonds alike, has now returned to business as usual. Overall, this suggests that their correlation may remain low and even turn negative in the near future. As a result, there should be nothing standing in the way of a multi asset comeback.

Market overview as of 26.07.2024

Equity Indices		
DAX		18.418
Euro Stoxx 50		4.853
S&P 500		5.459
Nasdaq		17.358
Nikkei 225		38.469
Interest Rates %		
USA	3 Months	5,52
	2 Years	4,53
	10 Years	4,25
Euroland	3 Months	3,69
	2 Years	2,86
	10 Years	2,36
Japan	3 Months	0,36
	2 Years	0,38
	10 Years	1,04
FX		
USD/EUR		1,086
Raw Materials		
Oil (Brent, USD/Barrel)		80,5

Calendar Week 32

Monday			Consensus	Previous
CH	Caixin Composite PMI	Jul	--	52.8
CH	Caixin Services PMI	Jul	51.0	51.2
EC	Sentix Investor Confidence	Aug	--	-7.3
EC	PPI YoY	Jun	--	-4.2%
US	ISM Services Index	Jul	51.0	48.8
Tuesday				
EC	Retail Sales YoY	Jun	--	0.3%
GE	Factory Orders YoY	Jun	--	-8.6%
GE	HCOB Germany Construction PMI	Jul	--	39.7
JN	Labor Cash Earnings YoY	Jun	--	1.9%
UK	S&P Global UK Construction PMI	Jul	--	52.2
US	Trade Balance	Jun	-$72.3b	-$75.1b
Wednesday				
CH	Exports YoY	Jul	--	8.6%
CH	Imports YoY	Jul	--	-2.3%
CH	Trade Balance	Jul	--	$99.05b
CH	Foreign Reserves	Jul	--	$3222.36b
GE	Exports SA MoM	Jun	--	-3.6%
GE	Imports SA MoM	Jun	--	-6.6%
JN	Leading Index	Jun P	--	111.2
JN	Coincident Index	Jun P	--	117.1
US	Consumer Credit	Jun	$10.000b	$11.354b
Thursday				
GE	Industrial Production YoY	Jun	--	-6.7%
JN	BoP Current Account Balance	Jun	--	¥2849.9b
JN	Trade Balance BoP Basis	Jun	--	-¥1108.9b
US	Initial Jobless Claims	Aug 03	--	--
US	Continuing Claims	Jul 27	--	--
Friday				
CH	PPI YoY	Jul	--	-0.8%
CH	CPI YoY	Jul	--	0.2%
CH	BoP Current Account Balance	2Q P	--	$39.2b
JN	Money Stock M2 YoY	Jul	--	1.5%
JN	Money Stock M3 YoY	Jul	--	1.0%

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.

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