

Monthly market update

October 2024



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September 2024 snapshot - Equities reach record highs but risks abound

5 drivers of markets

- 1 The US Federal Reserve begins to cut interest rates
- 2 The US economy keeps on trucking
- 3 China goes "all in"
- 4 Rising tensions in the Middle East
- 5 European inflation falls below 2%



Executive summary

This month we discuss five measures and events that influenced (and continue to influence) the direction markets took in September, including:

1. The US Federal Reserve's first interest rate cut and what rate cuts can mean for markets; as well as the direction other central banks are taking;
2. More on the US economy and how it is holding up, including strong employment numbers;
3. The People's Bank of China's recent announcements and whether these will resolve the challenges faced by the Chinese economy;
4. What rising tensions in the Middle East might mean for markets, and
5. How eurozone inflation falls below the 2% target, as the economy remains weak.

Equities reach record highs but risks abound

The past two months have seen global stock markets reach new highs despite a volatile “W-shaped” pattern over the same period.

September began on a weak footing as markets continued to worry about each and every US economic data release that might hint at a forthcoming recession. However, optimists regained the upper hand as the month progressed as we saw better than expected economic data, interest rate cuts and other central bank measures announced.

Performance to 30.09.24

	September 2024	YTD 2024	2023
Global equities	1.5%	17.5%	18.1%
European government bonds	1.1%	2.7%	4.5%
Global Commodities	3.5%	1.0%	15.3%

Source: Bloomberg 04.10.24

5 drivers of markets in September 2024

1

The US Federal Reserve begins to cut interest rates

2

The US economy keeps on trucking

3

China goes “all in”

4

Rising tensions in the Middle East

5

European inflation falls below 2%

Figure 1: Asset class performances to end September 2024



Source: Bloomberg 04.10.24

Warning: Past performance is not a reliable guide to future performance.

1 The US Federal Reserve begins to cut interest rates

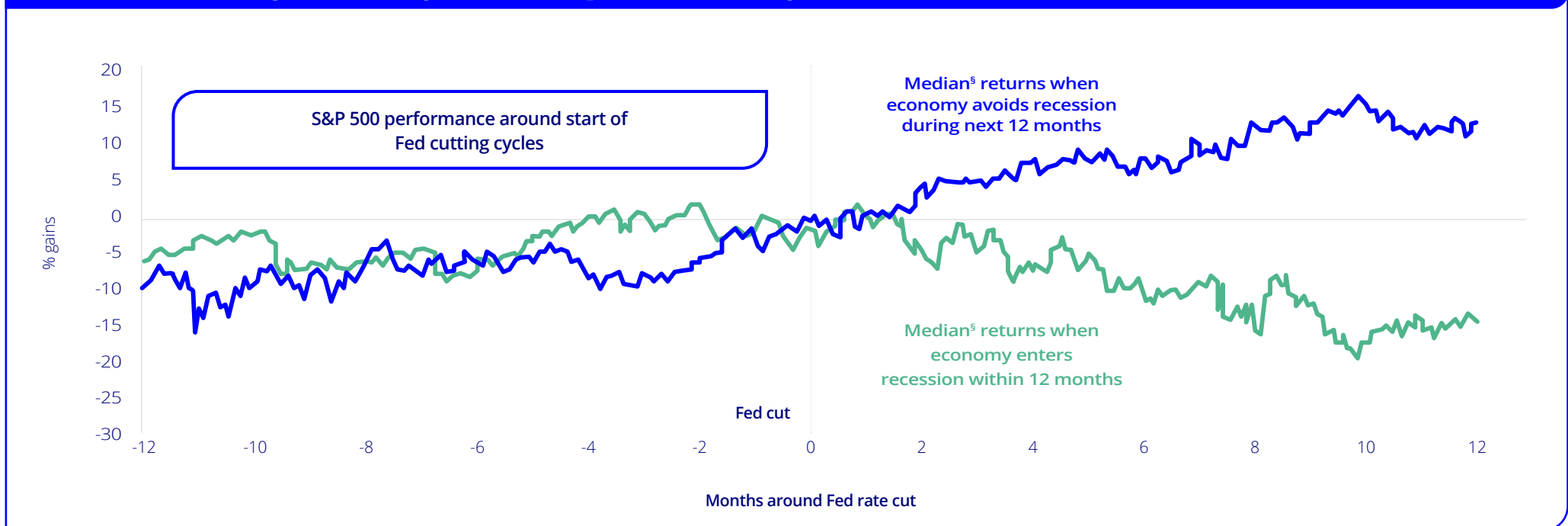
Except for the fact that the US Federal Reserve (Fed) decided to begin with a 0.5% cut in interest rates, there was little surprise that the US saw its first rate cut in September.

Against a backdrop of strength in the US economy, Fed Governor Powell explained the cut as the beginning of a process of normalisation of interest rates given their increased confidence that inflation is now fading towards their 2% target. August's inflation reading (using the Personal Consumption Expenditure (PCE) index, the Fed's favoured measure of inflation) showed it had fallen to 2.2% on a 12 month basis¹.

Rate cuts & equity & bond markets

Much is often made about rate cuts being good for equities and bonds, but the historical path is actually more complex and interesting. From a pure asset valuation perspective, a lower interest rate means higher valuation of assets. But it is what happens in the wider economy that tends to be more important for equities and bonds (see Figure 2).

Figure 2: History shows that equities tend to rally after a first Fed cut in the absence of recession



Source: Goldman Sachs Global Investment Research, September 2024. The S&P 500 is a measure of the returns of the 500 largest stocks in the US.

¹ Source: Bloomberg/Bureau of economic analysis 04.10.24

[§] Median is the value in the middle of a dataset, meaning half the outcomes are higher and half are lower.

1 The US Federal Reserve begins to cut interest rates (Cont'd)

Figure 2 suggests that what matters most when interest rate cuts begin is the direction that the economy then takes.

- If we see a decline into recession then equity markets are likely to take a downturn.
- If we see continued economic growth, even at a slower level, history suggests equity markets continue to make gains.

Research from Bank of America Merrill Lynch presents a similar story (Table 2). Using the 12 instances since 1970 when the Fed began cutting rates, they illustrate that three scenarios can emerge – a “hard-landing”, a “soft-landing” and in a “crash/credit event”.

What we can conclude from this is that while interest rate cuts are important, it is the economy’s overall performance that will determine future investment returns.

Elsewhere

September saw a number of the major central banks also cutting interest rates with the European Central Bank (ECB) adding its second 0.25% cut, and similar cuts in Canada, Switzerland, and Sweden while the Bank of England held rates steady.

Amongst developing economies, seven delivered rate cuts including Indonesia, Mexico, South Africa, Czech Republic, Hungary, Chile and Colombia while Russia and Brazil raised interest rates².

Table 2: What has happened in the US economy after the Fed begins to cut rates (12 instances since 1970 to date)

Scenario	Date first rate cut began for each scenario	Did a recession follow?	Average S&P 500 performance (3 months later)	Average S&P 500 performance (6 months later)
Soft-landing	02-Oct-84	No	+2.7%	+10%
	06-Jul-95	No		
	31-Jul-19	No		
Hard-landing	03-Sep-73	Yes	-6.2%	-3.00%
	01-Jul-74	Yes		
	01-Apr-80	Yes		
	01-Jun-81	Yes		
	05-Jun-89	Yes		
	03-Jan-01	Yes		
	19-Sep-07	Yes		
Crash/Credit event	19-Oct-87	No	+14.6%	+19.8%
	29-Sep-98	No		

Source: Bank of America Merrill Lynch 01.08.24.

² Source: Reuters 03.10.24

September in review

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- 3 China goes "all in"
- 4 Rising tensions in the Middle East
- 5 European inflation falls below 2%

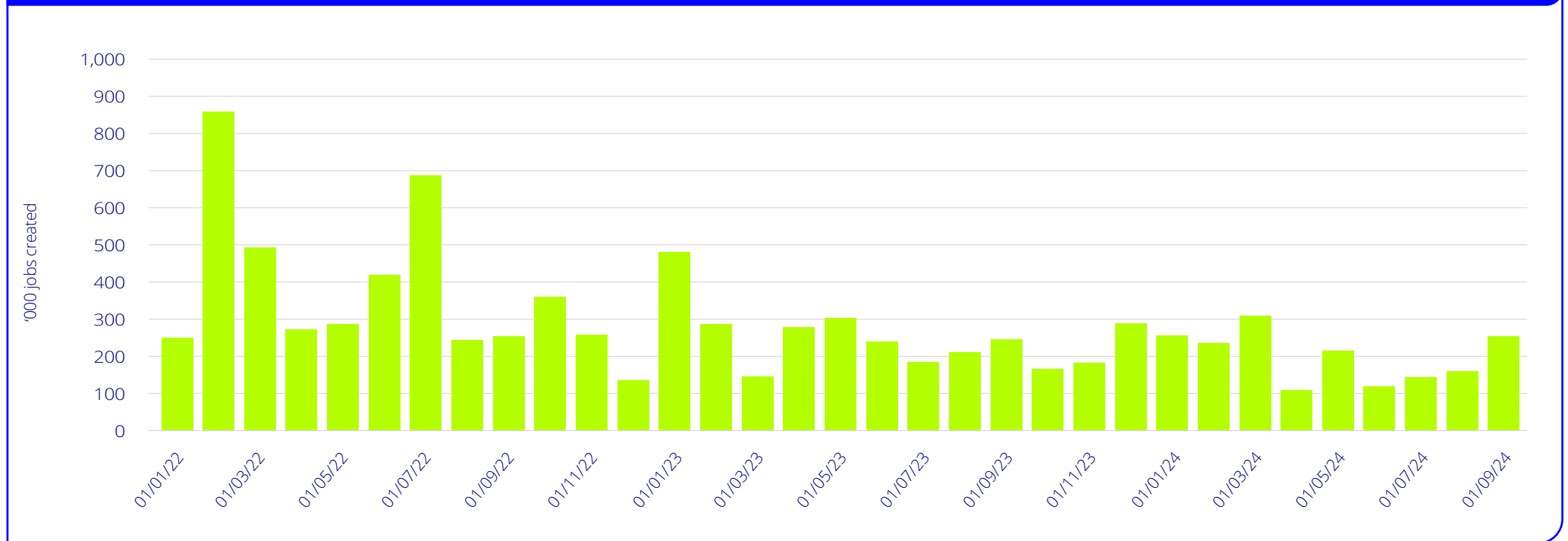
2 The US economy keeps on trucking

The US economy has surprised many with how robust it has remained. Economic growth for Q2 showed the economy expanded again, with real growth (growth after inflation) of 3% per annum (p.a.). That's an acceleration on the 1.6% growth rate from Q1 (and notably the previous quarter estimates were upgraded from the initial estimate of 1.4%).

Obviously, this is a measure for a number of months back, but current estimates suggest that Q3 continued in a broadly similar fashion. The Atlanta Fed GDPNow tracker, a forecast of economic growth, currently projects the US economy is pacing for annualised growth of 2.5% for Q3³.

Fears arose towards the end of September that a dockers' strike was going to cripple supply lines in half of US ports. However, the strike was ended after three days when an agreement was reached to extend negotiations on a long term agreement.

Figure 3: US labour market - non-farm payrolls



Source: Bloomberg 04.10.24

³ Source: Atlanta Federal Reserve 04.10.24

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2 The US economy keeps on trucking (Cont'd)

Data for the US labour market released in early October (Figure 3) showed that employment continued to grow at a faster pace than anticipated.

- The US non-farm payrolls, which measures the change in jobs in the US economy over the previous month but does not include farm workers, increased by 254,000 in September. This was the highest level in six months while unemployment fell to 4.1%, with hourly earnings up 4% from a year ago.
- While business in the southeast of the US will have been impacted by Hurricane Helene and Hurricane Milton, the broader picture looks very supportive of the view that the US can achieve a soft-landing.
- Despite the "still-sturdy" economy, market expectations of US interest rates continue to point to a downward trajectory over the 12 months.

Figure 4: Expected US interest rate trajectory over the next 12 months



Source: Bloomberg 04.10.24

3 China goes "all in"

China's economy has faced numerous challenges in the post Covid-19 pandemic era. Economic growth has been slowing, deflation has been a worry, its property market has been mired in difficulty for some time and its stock market has underperformed.

At the start of October, the People's Bank of China (PBOC) had its equivalent to previous ECB President Mario Draghi's famous "Whatever it takes" moment, with a slew of measures announced aimed at stimulating the economy. It may well be that the Beijing authorities saw the beginning of the US interest rate cuts as a moment to boost their economy without having to worry too much about the impact on the value of the Yen. Their actions had three components:

1. Rate cuts

- The 1 year interest rate was reduced by the most on record.
- The medium-term lending facility was cut from 2.3% to 2%, the biggest cut since it became the rate by which the market is guided in 2016.
- The reserve requirement ratio, the portion of assets that banks must hold on to rather than invest or lend, was lowered from 10% to 9.5%, to boost bank liquidity and increase lending.
- The 7-day reverse repo rate, the interest rate that banks borrow money from the central bank, was cut by 0.2% (following a 0.1% cut to the 14-day rate).

2. Housing

- Borrowing costs on existing mortgages were cut by an average of 0.5%.
- Downpayment requirements for second home purchases were eased from 25% to a historical low of 15%

3. Support for the stock market

- A swap facility, where two parties exchange cash flows or liabilities from two different financial instruments, was announced to give non-bank financial institutions access to RMB500 billion of funding support to invest in the domestic stock market.
- A RMB300 million lending programme was set up to allow companies listed on the stock market to borrow for share buybacks.

The measures also seem to be signalling a shift from Beijing's focus on the "real" economy i.e. manufacturing, to support capital markets, technology and real estate.

3 China goes "all in" (Cont'd)

Reaction

Equities

The reaction in Chinese equities has been dramatic with gains, in local currency terms, of 38.4%⁴ in Hong Kong-listed Chinese shares since mid-September. 7% of gains came in the aftermath of the main policy announcements (Figure 5). Bloomberg reports that hedge funds have increased their interest in the companies listed on the Hong Kong stock market that are likely to benefit from the Chinese measures in a very short space of time⁵. At time of writing, the boom was beginning to look more fragile as this same index fell by over 10% in a single day (08.10.24), in response to an apparent lack of government spending stimulus to follow the initial package of measures from China⁶.

Bonds

The Chinese bond market also responded with sharp falls in China's main bonds as yields, a measure of the return that an investor will be paid for investing in bonds, increased in the immediate aftermath of the policy announcements. The moves brought the Chinese 10 year yield to 2.2% from a low of 2.03%, as demand fell, in mid-September reflecting the enthusiasm that the policy package would re-ignite economic growth. Chinese equities look more likely to benefit from the announcements.

Some might argue that solving a structural problem in the property market by stimulating the capital market may not produce the desired longer term results, but it is certainly creating a near-term boom in Chinese shares that will have a bearing on performances more broadly this year.

Figure 5: Hang Seng China 100 Index in 2024



Source: Bloomberg 04.10.24

⁴ Source: Bloomberg measured by Hang Seng China (HK Listed) 100 Index, returns in euros from 11.09.24 to 04.10.24

⁵ Source: Bloomberg 02.10.24

⁶ Source: Hang Seng Chinese Enterprises index measured in local currency from 7.10.24 to 8.10.24

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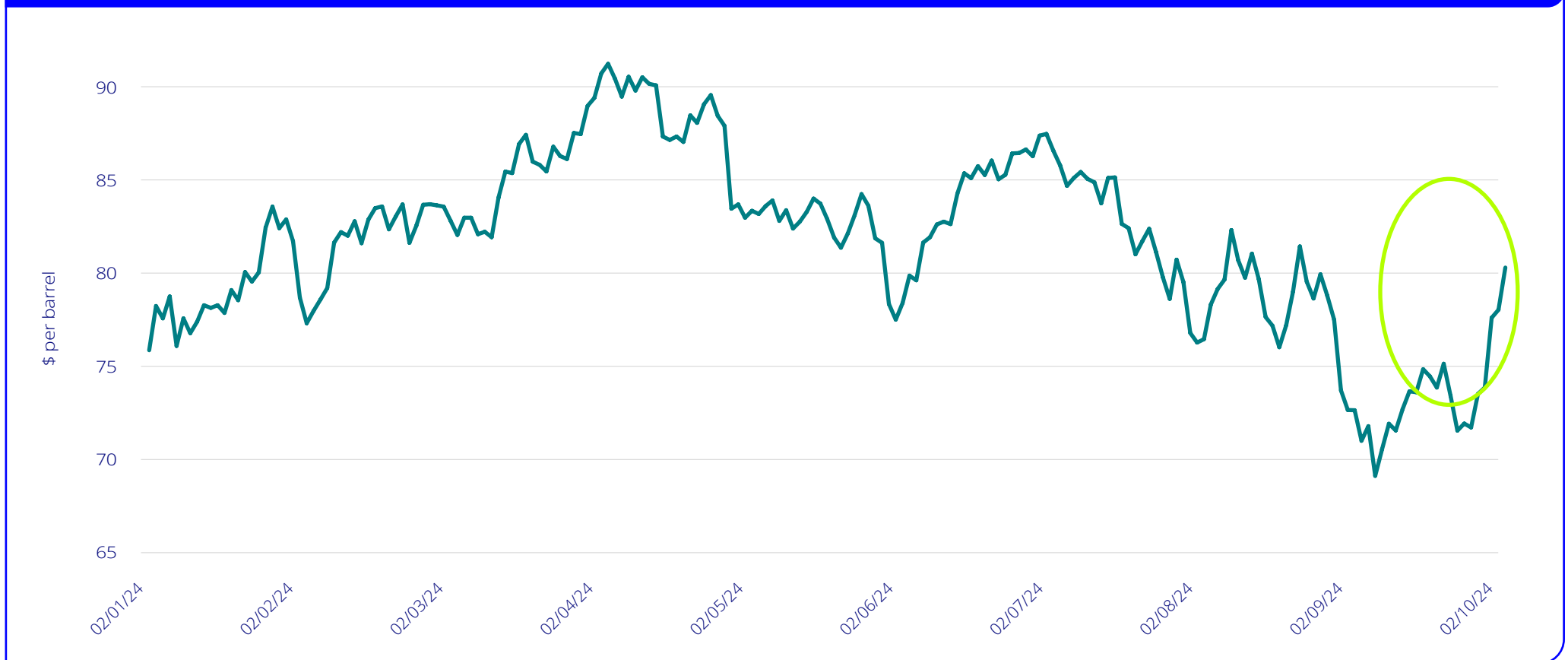
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4 Rising tensions in the Middle East

The escalation of tensions in the Middle East is certainly on every investment risk radar around the world right now.

With Iran and Israel trading threats and missiles, many investors are worrying that we will see a further escalation in the Middle East. Might Israel respond by targeting energy production in Iran or might Iran respond by blocking access to key territories and thereby choking-off the global oil supply?

Figure 6: Oil prices \$ per barrel in 2024 to date



Source: Bloomberg 04.10.24

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4 Rising tensions in the Middle East (Cont'd)

At time of writing, the US administration appeared to have green-lighted retaliation by Israel against Iran's energy infrastructure but not its nuclear installations. Perhaps the US calculation is that with Iran supplying little more than 3-4% of global oil, and most of this going to China, that the impact on western economies can be contained. Equally they are probably relying upon the fact that OPEC (Organisation of the Petroleum Exporting Countries) has capacity to replace Iranian oil supply if this did arise.

Oil prices have increased by 13% to \$80 a barrel by 07.10.24 and there are clearly risks that this will go higher in the near-term (Figure 6).

Echoes of 1973?

For investors, increased risks of conflict always prompt memories of the impact of the 1973-4 Israeli-Arab War.

During this conflict, OPEC imposed an embargo against the US and some of its allies for its decision to provide emergency aid to Israel. An increasingly oil-import dependent US economy saw an upward spiral in oil prices with the price of oil quadrupling. Europe and Japan increasingly became dependent on US help to secure new energy supplies, while the US itself became more reliant on imported oil than ever before as its reserves dwindled.

The peace talks to end this war faced complex negotiation - 1) with the Arab OPEC nations to end the embargo and increase oil production, while 2) also arranging an Israeli withdrawal from territories.

Today

While the risks of escalation of the current conflict are considerable, the probability of embargoes of the kind seen in the 1970's seems more remote given the very changed geopolitical relationships now in place.

In addition, in terms of economic policy reaction in the 1970's, this was seen as a supply shock that created inflation. The consensus amongst policymakers back then was that monetary policy, such as cutting interest rates, could do little to impact inflation. Clearly, as we have seen in the wake of the Russian invasion of Ukraine, this opinion no longer holds and interest rates etc. can play a role if crisis conditions emerge.

So while the risk of escalation of tensions in the Middle East may well prove to be the next source of volatility in markets, it seems less likely to have the impact of the magnitude it did in the 1970's.

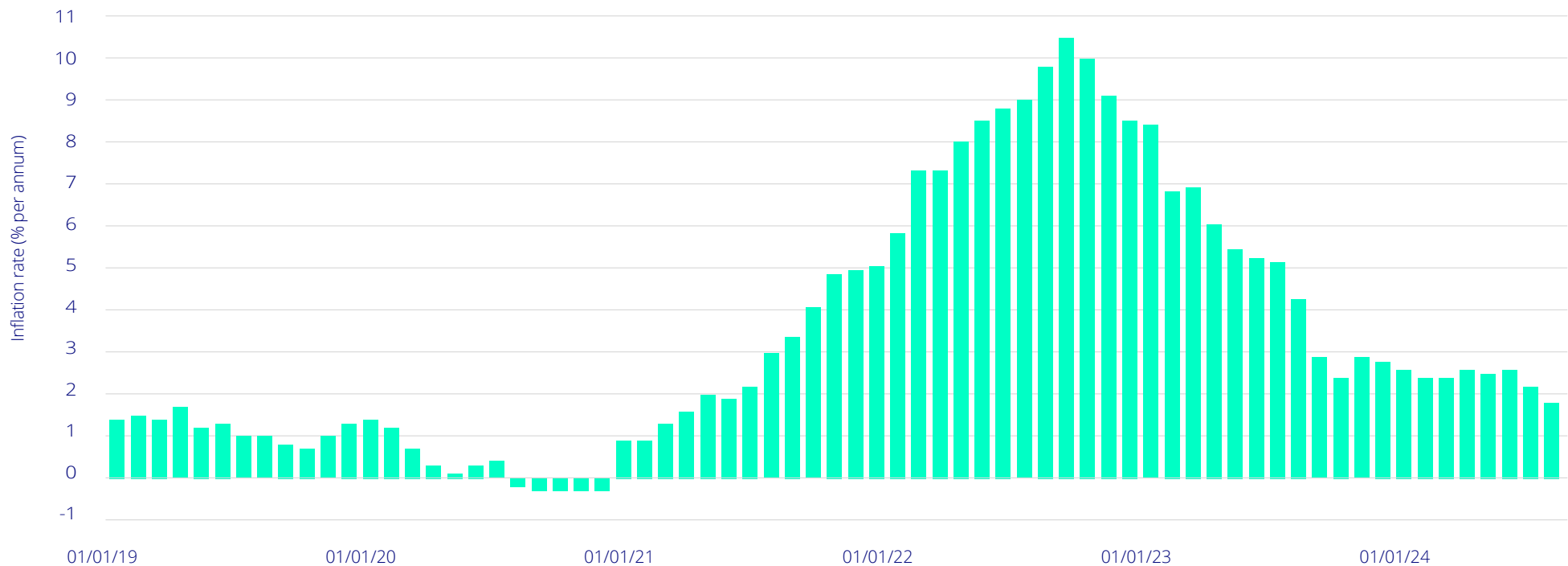


5 European inflation falls below 2%

Eurozone inflation fell below the ECB's target of 2% for the first time in September (Figure 7), with data showing headline inflation at 1.8% per annum.

The impact of this may be that the ECB will be able to cut interest rates faster than anticipated. President Lagarde indicated on 30.09.24, that the ECB will take this into account for their next decision. Headline numbers are impacted by energy costs, so it is likely that headline inflation may increase again in Q4 if Middle East tension feeds through into higher oil prices, in particular. Furthermore, services inflation only fell marginally and this remains a factor that may cause policymakers to go slowly with the pace of rate cuts.

Figure 7: Eurozone inflation over past 5 years



Source: Bloomberg 04.10.24


Markets have grown confident that the ECB will cut twice before year end, with an expectation of at least a cumulative 0.5% cut by December. By end of 2025, markets currently believe that the ECB will bring rates down to closer to 2% from the current 3.5%.

The past two months have brought an intensive news flow for markets to consider.

From a positive perspective

 **US** - We continue to see the US economy delivering solid growth and surprisingly, unemployment has fallen, according to the most recent data. Allied to a 0.5% jumpstart to interest rate cuts and this alone presents a continuation of a "goldilocks economy" (not too hot and not too cold) that has supported risk asset values so generously in the past two years.

The argument made by the Fed's Governor Powell that rate cuts were about returning to a normal monetary regime, and that they are now focussed on ensuring unemployment doesn't rise, looks to have gotten off to a good start.

 **Eurozone** - The eurozone has also seen its second interest rate cut, however growth remains weak, in particular in Germany, where the economy may well be in a technical recession already.

 **Elsewhere** - We have seen the Chinese act decisively to address their beleaguered property market that has ignited a boom in the Chinese equity market, at least for now.

More cautious view

It remains difficult to ignore the fact that the all-important US consumer has probably depleted their Covid-19 pandemic surplus savings and may already have gone "all-in" on their credit cards, which does point to a slow down ahead. Add to this was a drop in US consumer confidence in September, falling by the largest level in the past three years⁷.

For investors the extent of this slowdown will be critical. If it can be turned into a soft-landing, investors can once again look forward to a positive year to follow. That's leaving aside the impact of November's US election, which may yet bring some surprises to bear.

Adding the rising risk of a wider conflict in the Middle East draws one into the realm of speculation. Yet it is a real risk that the current conflict becomes more widespread and prolonged, with the possibility that energy markets will be impacted in some fashion.

Set against a backdrop of continued growth and falling interest rates, it looks like an environment in which the path of least resistance for equity markets remains up. But the risk of events overtaking this has made the risk-reward trade off more challenging for investors today and a conservative stance is probably called for over the months ahead.

As always, we encourage you to talk to an Advisor before making any change to your investment portfolio.

⁷ Source: Conference Board, September 2024



Performance table

Table 1: 5 year historic performances

	2019	2020	2021	2022	2023
Global equities	29.00%	6.70%	27.50%	-13.00%	18.10%
US equities (S&P 500)	33.90%	8.70%	38.20%	-13.00%	22.20%
European equities (Stoxx 600)	28.00%	-1.40%	25.80%	-9.90%	16.60%
Emerging market equities	21.80%	9.10%	4.90%	-14.90%	6.60%
Global bonds	5.40%	4.90%	-2.60%	-15.10%	4.50%
US government bonds	11.40%	8.30%	-2.00%	-12.50%	5.80%
European government bonds	6.90%	4.30%	-3.70%	-18.40%	7.20%
Emerging market debt	14.50%	-3.40%	6.40%	-9.80%	5.40%
Broad commodities	7.90%	-13.10%	37.00%	20.70%	-10.90%
US corporate bonds	11.20%	7.80%	-1.90%	-17.10%	5.80%
European corporate bonds	6.30%	2.40%	-1.20%	-14.00%	8.40%
Russell 2000	28.90%	9.80%	26.30%	-17.00%	13.20%
Magnificent 7	57.70%	102.20%	62.70%	-41.90%	100.40%
Hang Seng China 100 index (HK listed)	15.00%	-5.90%	-15.80%	-14.90%	-17.40%
NVIDIA	80.5%	104.2%	142.1%	-47.1%	228.2%

Source: Investment Markets/Bloomberg, 04.10.24.



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October 2024

