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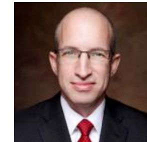
WEEKLY MARKET RECAP

22 April 2024

Summary for the week ending on Friday, 19 April 2024

MULTI-ASSET SOLUTIONS EMEA & LATAM



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ECONOMIC AND POLITICAL BACKDROP

The US

The trading week started off on a strong note driven by relief that Iran's well-telegraphed retaliatory strike on Israel did not result in worst-case scenarios, with nearly all missiles fired into the country intercepted by air defences. However, hopes that Israel would carry out a measured response faded alongside stock prices as reports surfaced that the Israeli war cabinet had decided to retaliate "clearly and forcefully." On Friday, stocks headed lower again, after Israel conducted strikes on air defence facilities within Iran, as well as on Iran-backed groups in Iran and Iraq.

Some strong economic data appeared to increase worries that the Federal Reserve (Fed) would push back any interest rates cuts to the fall, if not to 2025. On Monday, the Commerce Department reported that retail sales rose 0.7% in March, well above consensus expectations of around 0.3%, while February's gain was revised upward to 0.9%. Rising gas prices were partly at work (the data are not adjusted for inflation), but the strength was broad-based and included healthy gains in discretionary categories, such as restaurants and bars and online retailers.

Conversely, downward surprises in housing market data may have furthered inflation fears by auguring continued supply tightness. Housing starts and permits in March came in well below expectations and declined from February, with the former falling to the lowest level in seven months. Existing home sales also declined, although largely in line with expectations, as the average 30-year mortgage rate climbed above 7% for the first time since December.

As was the case the previous week, Fed officials expressed their concern with recent economic data. On Tuesday, Fed Chair Jerome Powell stated at an economic conference that "recent data have clearly not given us greater confidence and instead indicate that it's likely to take longer than expected to achieve that confidence." On Thursday, New York Fed President John Williams warned that a rate hike is not the baseline, but that one is possible if the data warrants. Atlanta Fed President Raphael Bostic said that policymakers would not be in a position to cut rates until the end of the year.

Europe

A slew of European Central Bank (ECB) policymakers at the annual meeting of the International Monetary Fund (IMF) reiterated that June was the likely target date for lowering borrowing costs, barring unexpected economic shocks. ECB President Christine Lagarde declined to say whether there might be more than one reduction in rates. In an interview with CNBC, she argued that policy should still depend on incoming economic data, given high levels of uncertainty. She added that the ECB would monitor oil prices "very closely" amid worries about conflict in the Middle East. In an interview with Bloomberg, Governing Council member Martins Kazaks also highlighted the uncertainty but added that the three to four rate cuts this year priced in by markets were in line with the bank's economic outlook.

The UK

Consumer prices in the UK grew an annual 3.2% in March, down from 3.4% in February. Although the inflation rate fell to its lowest level in two and a half years, the decline was slightly less than forecast by analysts and the Bank of England

(BoE) due to elevated price growth in fuel and communication goods. Services inflation – a measure of underlying price pressures that is watched closely by the BoE – remained high but slowed to 6.0% from 6.1%.

Wage growth also slowed less than expected in the three months through February. Excluding bonuses, pay increased 6% year over year, down from 6.1% in the preceding period. The unemployment rate rose sharply to 4.2% in February from 3.9%. Job vacancies continued to decline in the first quarter.

Higher oil prices and the somewhat sticky inflation data prompted financial markets to push out expectations for a first cut in UK interest rates from June to sometime in the fall. In contrast, BoE Governor David Bailey sounded more upbeat. “In the UK, we're disinflating at what I call full employment,” he said at the IMF’s meeting. “I see, you know, strong evidence now that that process is working its way through.”

Japan

Japan’s exports rose 7.3% year on year in March, slightly slower than the 7.8% gain registered in February. The data print nevertheless marked the fourth consecutive month of growth in exports, attributable to the boost provided to Japan’s exporters by historic weakness in the yen. Signs of a pickup in Chinese demand also lent support.

In other economic data releases, the core consumer price index (CPI), a leading indicator of nationwide trends, was 2.6% higher year on year in March, slightly lower than had been expected and down from a revised 2.8% in February. While suggesting that price pressures could be easing somewhat, data showing that Japan’s inbound tourism grew solidly in March, driven by an increase in visitors from South Korea and China, is likely to support services inflation.

China

China’s GDP expanded an above-consensus 5.3% in the first quarter from a year ago, accelerating slightly from the 5.2% growth in last year’s fourth quarter. On a quarterly basis, the economy grew 1.6%, rising from the fourth quarter’s 1.4% expansion.

However, other data provided a mixed snapshot of the economy. Industrial production rose a lower-than-expected 4.5% in March from a year earlier, down from 7% growth in the January to February period. March retail sales grew a lower-than-expected 3.1% from a year ago as catering and auto revenue slowed after the Chinese New Year Holiday. Meanwhile, fixed asset investment rose more than forecast in the first quarter from a year ago, although property investment fell -9.5% year on year. The urban unemployment rate eased slightly to 5.2%, while the youth jobless rate stayed at 15.3% in March, unchanged from February.

On the monetary policy front, the People’s Bank of China injected RMB 100 billion into the banking system via its medium-term lending facility compared with RMB 170 billion in maturing loans and left the lending rate unchanged, as expected. The operation resulted in a net withdrawal of RMB 70 billion from the banking system, marking the second cash extraction this year.

China’s new home prices fell -0.3% in March, matching February’s -0.3% drop and extending losses for the ninth consecutive month, according to the statistics bureau. Authorities have ramped up efforts to revive the troubled sector by relaxing homebuying restrictions and directing state-owned banks to step up lending to indebted property developers. However, analysts said the data showed that China's housing slump had not yet bottomed and remained a significant drag on the economy.

Australia

Australia labour data gave back some of February’s strength. Employment fell -7,000 in March, below the market consensus of 10,000 gain. Alongside the weakness, the unemployment rate ticked up to 3.8% from 3.7%. However, the average monthly employment gain of 41,000 in the first quarter is still quite strong. Moreover, the job losses were entirely in part-time as full-time workers rose solidly by 28,000. While data looks volatile, the labour market remains tight for now.

EQUITY MARKETS

Last week, the MSCI All Country World Index (MSCI ACWI) lost -2.9% (2.8% YTD).

In the US, the S&P 500 Index moved -3.0% lower (4.6% YTD), recording its third consecutive week of broad losses, as concerns over tensions in the Middle East and the possibility of US interest rates remaining "higher for longer" appeared to weigh on sentiment. Mega-cap technology shares lagged as rising rates placed a higher theoretical discount on future earnings. A first-quarter revenue miss from advanced chipmaker supplier ASML Holdings also seemed to weigh on the sector and on general optimism toward companies with artificial intelligence (AI)-related earnings.

Growth stocks fell more than value shares. While holding up better than large-caps, small-caps continued to struggle, pushing the small-cap Russell 2000 Index further into negative territory for the year-to-date period. The Russell 1000 Growth Index returned -4.9% (4.6% YTD), the Russell 1000 Value Index -0.7% (3.8% YTD) and the Russell 2000 Index -2.8% (-3.5% YTD). The technology-heavy Nasdaq Composite tumbled -5.5% (2.0% YTD).

In Europe, the MSCI Europe ex UK Index gave up -1.0% (5.2% YTD) as tensions rose in the Middle East. Major stock indexes were mixed. Germany's DAX Index declined -1.1% (5.9% YTD), France's CAC 40 Index added 0.2% (6.7% YTD) and Italy's FTSE MIB Index gained 0.5% (12.4% YTD). Switzerland's SMI Index slid -0.5% (3.4% YTD). The euro appreciated versus the US dollar, ending the week at USD 1.07 for EUR, up from 1.06.

In the UK, the FTSE 100 Index decreased -1.2% (3.5% YTD) and the FTSE 250 Index lost -1.6% (-0.6% YTD). The British pound weakened versus the US dollar, ending the week at USD 1.24 for GBP, down from 1.25.

Amid an escalation in tensions in the Middle East, Japan's stock markets suffered sizable losses over the week. The TOPIX Index tumbled -4.8% (12.0% YTD) and the TOPIX Small Index fell -4.1% (7.0% YTD). An additional factor weighing on the markets was some concern about waning AI-related demand.

The yen, perceived as a safe-haven currency especially in times of geopolitical turmoil, strengthened on the final trading day of the week. It nevertheless continued to hover around 34-year lows, finishing the week at 154.6 against the US dollar, from 153.2 at the end of the previous week.

While speculation continued about Japanese authorities potentially intervening in the currency markets to prop up the yen, no such move was forthcoming. However, US, Japanese and South Korean leaders met to discuss current conditions in the foreign exchange markets, focusing on the recent sharp depreciation of the Japanese yen and the South Korean won.

In Australia, the S&P ASX 200 Index retreated -2.8% (1.4% YTD) amid weaker labour market data, more hawkish rhetoric from Fed members and the escalating conflict between Israel and Iran. Australian government bond yields remained largely unchanged. The Australian dollar weakened against the US dollar by -0.9% due to speculation of fewer Fed cuts and a flight to safety.

Emerging markets and other markets

MSCI Emerging Markets Index closed -3.6% lower (-1.3% YTD), with a positive contribution to performance from the stock market of China and a negative contribution from those of India, Taiwan, South Korea and Brazil.

Chinese equities rose after the economy expanded more than expected in the first quarter. The Shanghai Composite Index was up 1.5% (3.1% YTD) and the blue-chip CSI 300 Index added 1.9% (3.2% YTD). In Hong Kong, the benchmark Hang Seng Index dropped -3.0% (-4.3% YTD) as escalating geopolitical tensions in the Middle East hurt investor sentiment.

In the Middle East, over the previous weekend Iran launched a wave of 300 drones and missiles at Israel, nearly all of which were shot down before entering Israeli airspace with the help of British, American and Jordanian air forces.

According to T. Rowe Price credit analysts Razan Nasser and Peter Botoucharov, this attack marks a significant escalation in tensions between Israel and Iran, as this is the first time that Iran launched a direct attack on Israel rather than using its proxies. The Iranian attack came in response to an Israeli strike on a diplomatic facility in Damascus, which led to the killing

of several senior Iranian Revolutionary Guard members. Iran viewed the Damascus strike as a hit to its sovereign territory and vowed to respond. They felt the need to reestablish deterrence as well as play to domestic pressures to look strong. The attack, however, was telegraphed well in advance and did not use advanced weapons. In a letter to the United Nations, Iran said that it now considered this matter over and would not conduct another strike unless Israel choses to retaliate.

Early Friday morning local time, Israel carried out a reprisal strike on an Iranian airbase in the city of Isfahan. The attack appears to be limited in nature – at least according to Israeli and local Iranian news – and both sides have downplayed the retaliation, indicating little or no damage. T. Rowe Price analysts believe that this week's attacks seem to be signalling actions about Iranian and Israeli military capabilities rather than an attempt to escalate the situation.

In Türkiye, the central bank governor, Fatih Karahan, spoke on Tuesday at a Council on Foreign Relations event focusing on central bank governance in emerging markets. As reported by Bloomberg, Karahan – facing the choice between rebuilding Türkiye's foreign exchange reserves and fighting inflation – has decidedly favoured the latter. She was quoted as saying, "Our…utmost priority is disinflation, and we will accumulate reserves as much as we can, depending on market conditions."

On Wednesday, in response to journalists' questions, Turkish Labour Minister Vedat Isikhan said that the government did not intend to raise the minimum wage in July. This is a reversal from his stance back in January, when he pushed for a higher-than-expected minimum wage hike, against Minister of Treasury and Finance Mehmet Simsek's recommendation. According to T. Rowe Price portfolio manager and credit analyst Ulle Adamson, the proliferation of this message over time should help set disinflation expectations throughout Turkish society. She believes that another minimum wage hike in July would have nullified any chance of inflation approaching the central bank's inflation target by the end of the year.

FIXED INCOME MARKETS

Last week, the Bloomberg Global Aggregate Index (hedged to USD) returned -0.5% (-1.4% YTD), Bloomberg Global High Yield Index (hedged to USD) -0.5% (1.4% YTD) and Bloomberg Emerging Markets Hard Currency Aggregate Index -0.5% (-0.5% YTD).

The retail sales data helped push the yield on the benchmark 10-year US Treasury note to its highest intraday level since early November. Over the week, the 10-year Treasury yield increased 10 basis points (bp) to 4.62% from 4.52% (up 74bp YTD). The 2-year Treasury yield increased 9bp to 4.99% from 4.90% (up 74bp YTD).

European government bond yields broadly climbed. Over the week, the 10-year German bund yield rose 14bp, ending the week at 2.50% from 2.36% (up 48bp YTD).

The 10-year gilt yield rose 9bp, ending the week at 4.23% from 4.14% (up 70bp YTD).

The yield on the 10-year Japanese government bond closed the week at 0.85%, broadly unchanged from the prior week. Bank of Japan Governor Kazuo Ueda echoed previous comments in stating that if weakness in the yen exerts significant upward pressure on inflation a rate hike may be warranted.

In the US investment-grade corporate bond market, issuance was relatively light but met expectations, and most issues were oversubscribed. However, the higher-for-longer rates narrative and geopolitical tensions weighed on the high yield bond market and trade volumes were somewhat above average as more sellers appeared to be active and high yield funds industrywide reported negative flows.

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YTD is year to date. GDP is gross domestic product.

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