

# MONTHLY MARKET VIEWPOINT



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## THE RISE AND FALL

- The broad rally in equity markets that started in September has splintered; prospects of a soft landing power US indices while investors perceive rising growth risks in Europe.
- Expectations are high for US tech stock earnings, but so far actual results have justified the optimism. Another season of earnings beats could provide the next positive catalyst for the market.
- Investors are still assessing how far the Chinese government is willing to go in the short term to boost growth, but the medium-term challenges remain significant.



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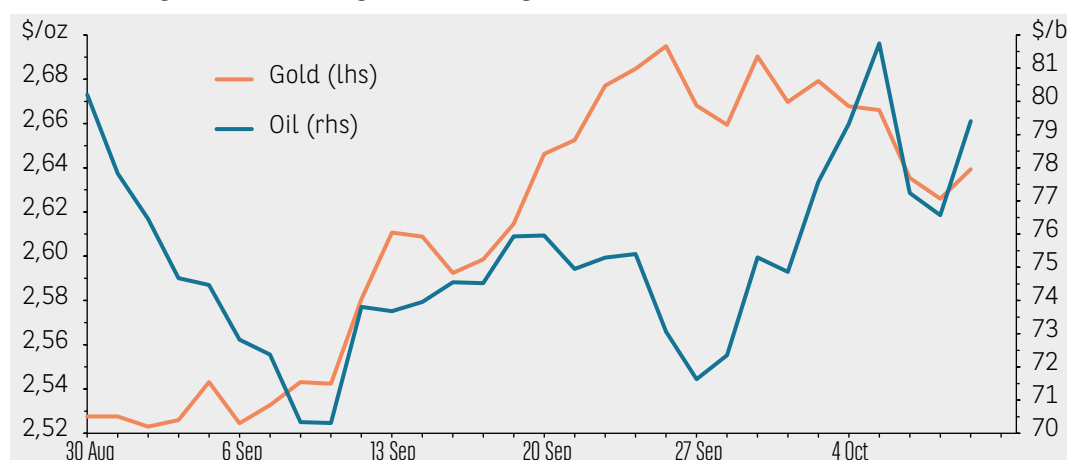
The broad recovery in equity indices that started in September has faltered, with greater differentiation between markets. As tech stocks move ahead, Europe and value indices are struggling.

The latest rally in equity markets that began with September's bigger-than-expected reduction in the fed funds rate has wavered recently. Disappointing economic data out of Europe and rising geopolitical worries have made investors marginally more cautious.

Particularly acute are worries of an escalation of the conflict in the Middle East. A consequent spike in oil prices could reverse the trend of declining headline inflation and dent consumer confidence. The recent jump in oil prices, though, still leaves it below its level at the end of August (see Exhibit 1), and Saudi Arabia's plans to raise output should keep prices contained in the medium term.

### Exhibit 1

Both oil and gold prices have gained due to geopolitical risks



Data as at 10 October 2024. Sources: FactSet, BNP Paribas Asset Management.

The comparatively disappointing data in Europe was principally from lower purchasing managers' index (PMI) readings in September versus August, and levels below 50 (indicating contraction) in manufacturing. The picture is not uniform, however, with the indices for Spain and the UK far better than those in Germany, France or Italy (see Exhibit 2).

### Exhibit 2

Purchasing managers' indices mostly lower in September

Sector	Country	Sep-24	1mo chg
SERVICES	US ISM*	54.9	3.4
	US PMI	55.2	-0.6
	Germany	50.6	-0.6
	France	49.6	-0.4
	Italy	50.5	-0.9
	Spain	57.0	2.5
	UK	52.4	-1.4
	Japan	53.1	-0.6
MANUFACTURED	China	50.1	-0.8
	US ISM*	47.2	0.4
	US PMI	47.3	-0.6
	Germany	40.6	-1.8
	France	44.6	0.7
	Italy	48.3	-1.1
	Spain	53.0	2.5
	UK	51.5	-1.0
	Japan	49.7	-0.1
	China	49.6	-0.2

Data as at 3 October 2024. Note: France services PMI change is versus July. US manufacturing ISM is for August. Sources: FactSet, BNP Paribas Asset Management.

The European Central Bank has already begun cutting policy rates and is expected to continue at its next meeting. The question is whether this has happened soon enough, and whether it will go far and fast enough to pull the region out of its comparative slump. Germany may well be in a recession this year.

Fortunately, there's been better news for Europe on the inflation front, where, after several months of high monthly inflation, core inflation fell back sharply in September.

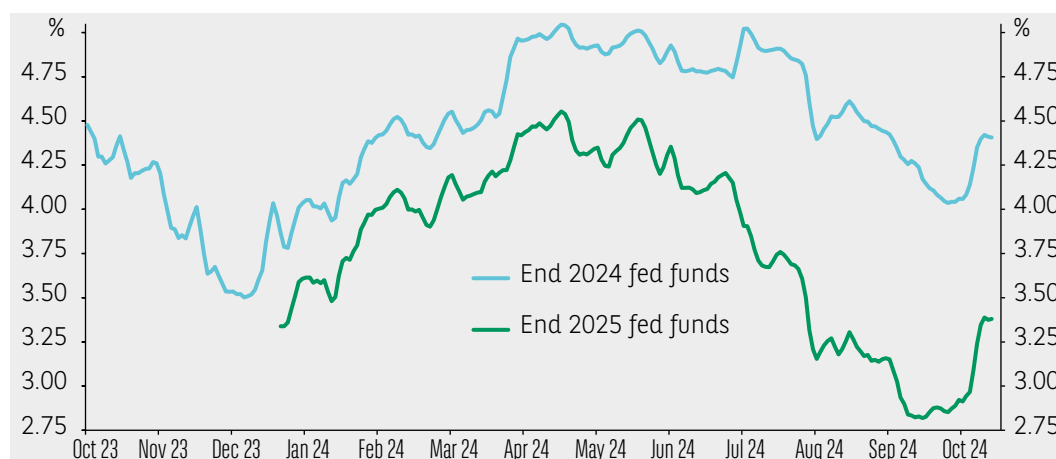
### US macro: jobs market looking better

In the US, it was beginning to feel like déjà vu, with markets again expecting a significant reduction in the fed funds rate this year. Recall that in January, markets were forecasting that the key policy rate would drop to 3.5% by the end of 2024, only to see it move back up to 5% a few months later when inflation reaccelerated (see Exhibit 3).

More recently, we had seen expectations that the fed funds rate would drop to 4% this year (and to 2.75% for the end of 2025), when the August non-farm payrolls data suggested the normalisation of the US labour market had gone further and was pointing to a recession. Citations of the Sahm Rule<sup>1</sup> skyrocketed.

### Exhibit 3

#### Stronger-than-expected US labour market data has pushed up forecasts for the fed funds rate



Data as at 11 October 2024. Sources: Bloomberg, BNP Paribas Asset Management.

Since then, the data (and the markets) have reversed. The September private non-farm payrolls data showed a much higher rate of job creation (223,000 jobs), than the average over the prior three months (103,000). The unemployment rate dropped to 4.1%, meaning the Sahm Rule no longer applied. Forecasts for the future level of fed funds have moved up sharply.

PMI data also points to a steady expansion of the economy, at least in the services sector. Manufacturing, by contrast, is weak – as it is in many places. On the one hand, this could be dismissed as simply reflecting global difficulties. On the other, expectations were certainly high that the subsidies and incentives of the Inflation Reduction Act would lead to much more activity.

Aside from the better growth data forcing a rethink of the outlook for policy rates, inflation expectations have shifted. The Atlanta Federal Reserve's GDPNow model has been forecasting third quarter GDP would rise by 3.2% (seasonally adjusted annual rate), an acceleration compared to the 3% posted in the second quarter.

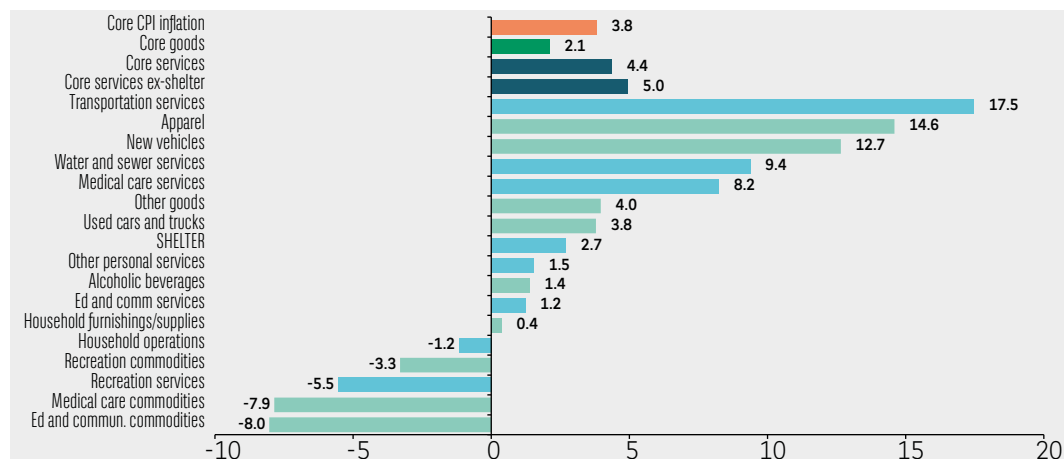
<sup>1</sup> "The Sahm Rule identifies signals related to the start of a recession when the three-month moving average of the national unemployment rate ... rises by 0.50 percentage points or more relative to its low during the previous 12 months." Federal Reserve of St. Louis. This occurred in August.

The markets should therefore perhaps have had higher expectations for inflation ahead of September's Consumer Price Index (CPI) release. Consensus estimates were for a 0.2% gain month on month (2.4% at an annualised rate). The actual figure was 0.3% (3.8% annualised; see Exhibit 4).

#### Exhibit 4

##### Services inflation is still elevated and goods inflation is higher

Monthly change (annualised) in US core Consumer Price Index (CPI) inflation



Data as at 11 October 2024. Note: light green bars are goods subindices; light blue are services. Sources: FactSet, BNP Paribas Asset Management.

Worryingly, goods inflation was comparatively strong at 2.1%, when it had been negative on average since January. Even worse was services inflation, running at a 4.4% annual rate, and in contrast to the prior month, this was not solely due to higher shelter prices.

The Fed's preferred inflation measure is not CPI, however, but the Personal Consumption Expenditures (PCE) index. It is not certain that the higher CPI inflation rate will be repeated in the PCE measure. There was a large difference between the two in August, when monthly CPI inflation was 3.4%, while the PCE rate was only 1.6%.

Either way, investors will need to consider the risk that inflation will not move quite as quickly or as easily to the Fed's target as they had hoped, and as a result, that the fed funds rate, too, may be higher.

#### Earnings season preview

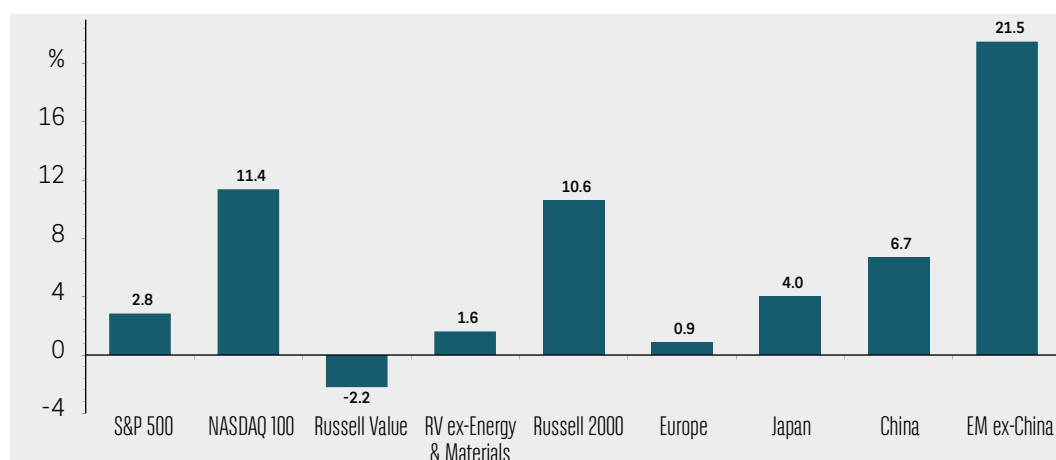
Investors will be looking to the upcoming third quarter earnings season for signs of any weakening in consumer activity. There have been anecdotal stories of lower-end consumers struggling to maintain previous levels of demand, though the decline in energy prices and mortgage rates should provide some support.

Earnings growth expectations for the major global indices are varied. The headline figure for the S&P 500 of just 2.8% year-on-year masks a wide divergence between earnings for growth/technology stocks and value stocks.

Companies making up the NASDAQ 100 are expected to see gains of 11.4% in aggregate, while the Russell Value index may see a decline of 2.2% (see Exhibit 5). Much of the drop in profits for the value index is linked to commodity sectors. Excluding the energy and materials sectors, earnings growth is positive, but only 1.6%.

**Exhibit 5****Earnings expectations highest for tech and semiconductor-exposed indices**

Consensus estimates for year-on-year 3q 2024 earnings growth



Data as at 11 October 2024. Sources: FactSet, BNP Paribas Asset Management

The value orientation of the MSCI Europe index also helps explain why expectations for growth are quite modest, at 0.9%. Emerging markets ex-China and US small cap stocks are the standouts. As it is for the NASDAQ 100, the semiconductor industry is driving much of the increase in emerging markets.

We anticipate that at least for US growth, earnings should come in better than expected (as they typically do), which should sustain the gains in markets we have already had this year. Expectations have certainly risen sharply this year, but actual results have so far justified that optimism.

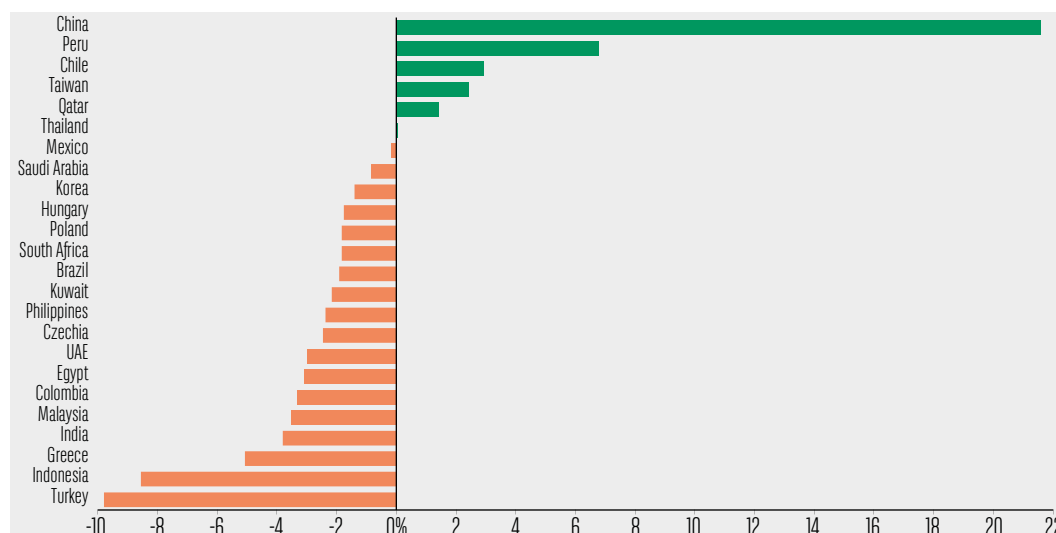
**China: was the recent stimulus enough?**

The unexpected announcement by China's government of a massive stimulus package for the economy a few weeks ago led to significant outperformance for the equity market. It is notable, though, that the euphoria has not spread far beyond China (see Exhibit 6).

Prior to the Covid pandemic, China was viewed as the world's economic growth engine. One would expect a renewed revving of the motor to have global repercussions, with greater China demand lifting commodity prices and pulling in imports from abroad.

**Exhibit 6****China's gains have not been widely shared across other emerging markets**

Price return in USD since 23 September 2024



Data as at 11 October 2024. Sources: FactSet, BNP Paribas Asset Management.

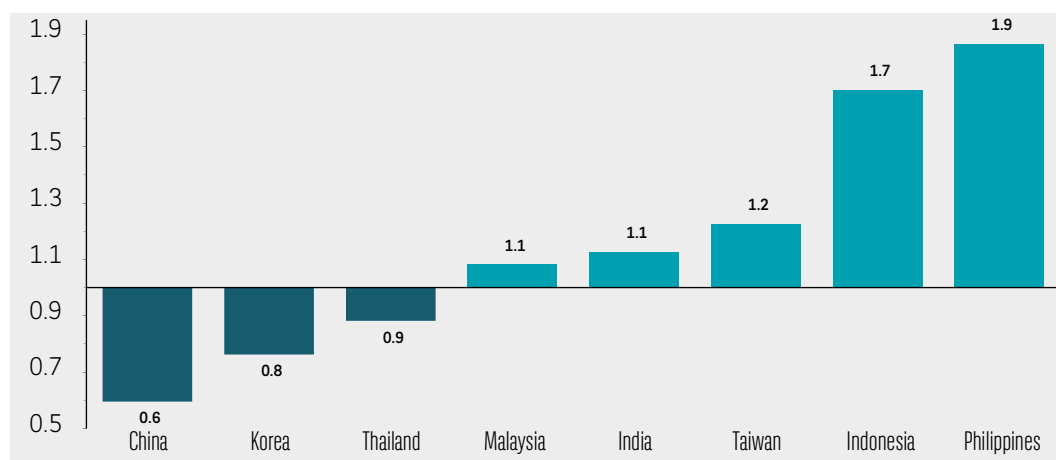
The divergence between the outsized returns for China's market and less positive or negative returns elsewhere suggests that the drivers for the gains in China were the very negative sentiment of institutional investors and the short positions of hedge funds. Data from Goldman Sachs showed China equity exposure was previously at five-year lows. Valuations were also very depressed. The rebound has been so strong that the forward price-earnings ratio for the MSCI index went from 8.7x, nearly 30% below the long-run average, to 10.7x as of 10 October, 11% below average.

The recovery in valuations suggests that further gains will also need to be driven by positive earnings growth. Over the last several months, analyst expectations have fallen rather than risen for companies making up the MSCI China index. The ratio of positive to negative estimate revisions for 2025 stands at just 0.6, the lowest of all the emerging markets in Asia (see Exhibit 7).

#### Exhibit 7

##### Earnings revisions for China worse than in the rest of Asia

Ratio of upward to downward revisions for 2025 EPS over the last 75 days



Data as at 11 October 2024. Sources: FactSet, BNP Paribas Asset Management.

It is likely that this tendency will improve thanks to the latest announcements. The more fundamental question is whether the improvement in the outlook will be sustained. Chinese equity markets have previously seen significant rallies that eventually reversed once markets determined the measures were not sufficient to improve the underlying trend. This has already happened to some degree.

China faces significant near- and long-term structural challenges. The property market remains depressed. Without a recovery, consumer sentiment is unlikely to improve, given the significant share of household wealth that property represents in China.

Longer term, the government does not appear to want to develop a consumption-driven economy like the US or Europe. Consumer demand represents 68% of GDP in the US and 54% in Europe according to FactSet, versus 35% in China.

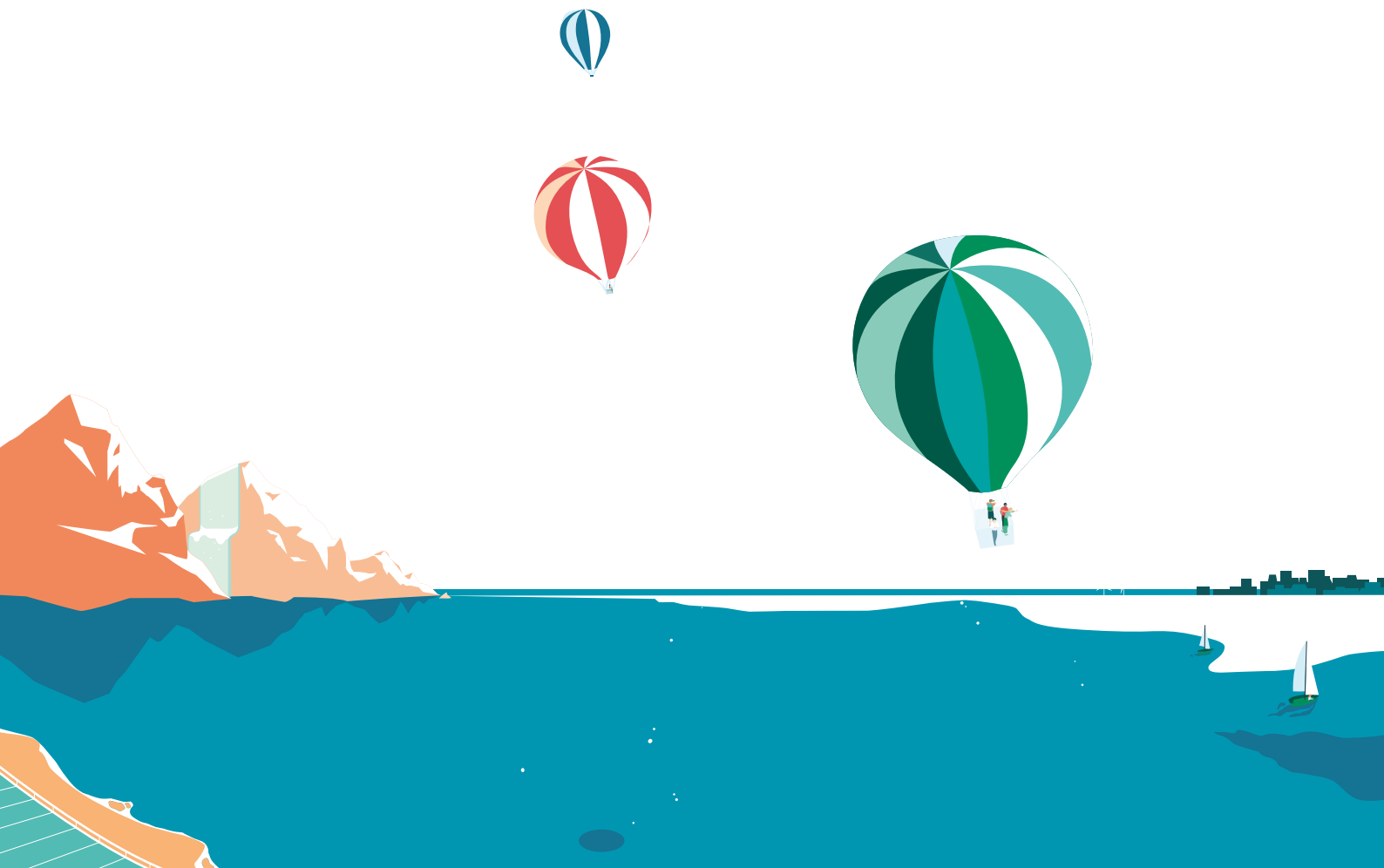
Development of a consumer economy in China would require a much stronger social safety net (unemployment insurance, health insurance, pensions) than is currently the case. Lacking them, household savings are likely to remain high as people believe they have to rely on their own resources in case of difficulty.

Instead of consumer demand to drive growth, the government is looking to investment and exports, which have driven China's growth historically. Investment in the future, though, will be in newly emerging industries instead of property and infrastructure. It is not clear, however, that these industries will be able to generate the rate of growth for the broad economy the government is targeting. Finally, it is unlikely exports can be a sustainable motor of growth given rising protectionism globally.

There is likely more stimulus to come, though China will need to sustain its easing efforts for a while longer to turn around both investor sentiment and the economy. For a more detailed analysis, please see [China's recovery, is it for real this time?](#)

## MULTI ASSET CLASS VIEWS

- As the Fed finally begins its monetary easing cycle, the overall decline in inflation coupled with the normalisation of the labour market and the stabilisation of consumer confidence at high levels confirms our scenario of soft landing for the US economy
- We maintain a slightly positive stance on equities amid uncertainties related to the US elections and the upcoming earnings season. We favour US technology stocks which, despite high valuations, display high levels of profitability and still-favourable earnings growth prospects
- While our duration exposure is slightly long, our conviction remains high on euro investment grade credit, which continues to benefit from solid company fundamentals and strong technical support
- Precious metals, and more specifically gold, remains our strongest conviction in a context of declining real rates, steady appetite from emerging market central banks, and geopolitical uncertainties.



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