

INFLATION DIPS; RALLY BROADENS; THIRD PLENUM STARTS

Market Review:

The observant among you may notice the list of indices covered by our graphic has crept up over the last couple of weeks. Now, including the FTSE 250 mid-cap and the Russell 2000, an index of US small-cap companies. Although it is very early days, there is a distinct possibility that the bull market has begun to broaden out from large cap. Last week, we saw that the R2000 and the F250 outperformed the usual primary indices. We shall see if it lasts; elsewhere, it was a good week for global equity indices, with intra-week highs from all the US Indices (even the Dow Jones) and the Nikkei. All regions made progress, and in Europe, we saw a tentative recovery after the stalemate from the French election. Gold was up, and bond yields dipped slightly as we got a good inflation number from the US.

US - Reasons to be Cheerful

On Thursday, we got news that US inflation cooled broadly in June to the slowest pace since 2021, driven by a long-awaited slowdown in housing costs. This development sends the strongest signal yet that the Federal Reserve may soon cut interest rates. The core consumer price index, which excludes food and energy

costs, rose by just 0.1% from May, marking the smallest increase in three years. The overall measure fell for the first time since the onset of the pandemic, largely due to cheaper gasoline

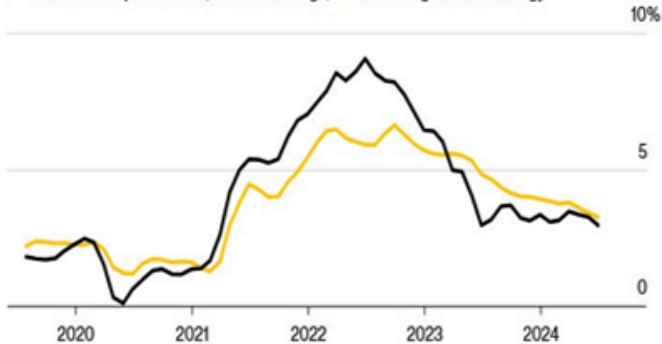
Equity Indices	1 wk %	
Russell 2000 TR in US	6.01	
MSCI China TR	3.08	
FTSE 250 TR in GB	2.03	
MSCI AC Asia ex Japan TR	1.79	
MSCI Emerging Markets TR	1.66	
MSCI Europe ex UK TR	1.62	
S&P 500 TR in US	0.88	
Nikkei 225 in JP	0.68	
FTSE 100 TR in GB	0.60	
MSCI India TR	0.57	
Bonds/Currency/Commod	05.07.2024	12.07.2024
Bond: UK 10 Year Yield	4.137	4.122
Bond: US 10 Year Yield	4.277	4.186
Currency : GBP/USD	1.2808	1.2992
OIL: WTI \$	83.44	82.18
Gold \$	2399.80	2416.00

Source - Bloomberg - 14/07/2024

US Core Inflation Cools to Slowest Pace Since 2021

Deceleration boosts odds of a Federal Reserve rate cut in September

US consumer price index (12-month change) / Excluding food and energy

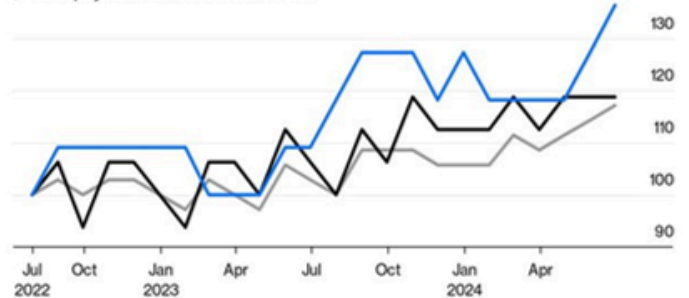


Source: US Bureau of Labor Statistics

Tight Market

Unemployment rises as workers take longer to find jobs

Unemployed 15 Weeks or Longer / Job Losers and Persons who Completed Temporary Jobs / Unemployment Rate Total in Labor Force



Source: BLS, Bloomberg Economics
Note: 2022-07-31 = 100

Bloomberg Opinion

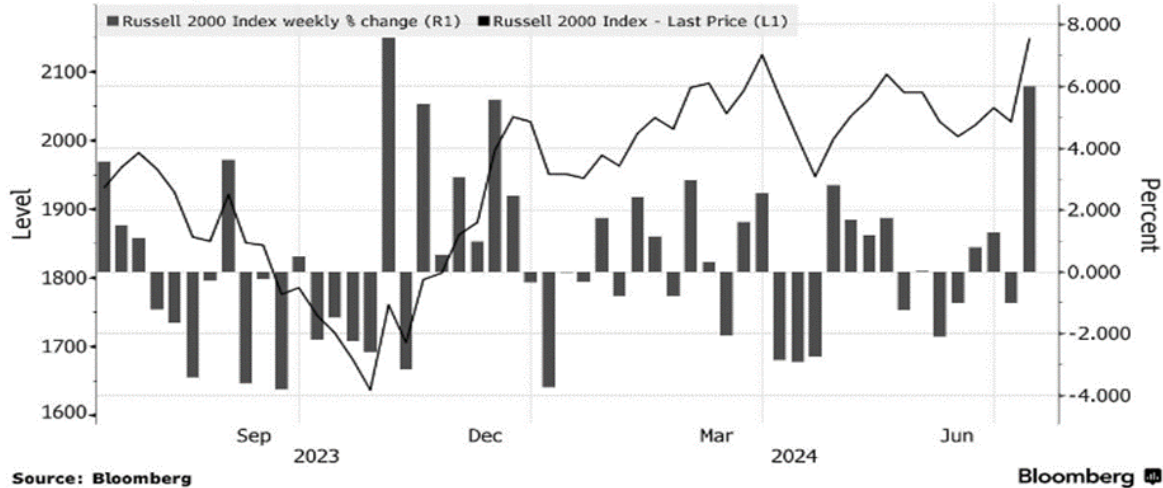
In his testimony before lawmakers last week, Powell refrained from indicating the timing of potential rate cuts, emphasising that incoming data will guide policy decisions. So, if you combine this latest inflation report with the last jobs data, which showed unemployment on an upward trend, you can see why investors have become near certain of a Fed rate cut in September. For this to happen, we will need to see the trends confirmed in the following sets of employment and inflation data, and then we will finally get the cut we have been hoping for.

Breadth in the Market is Typically Next Phase of a Bull Market

Since June, the stock market has been in a slow-motion melt-up. Economic indicators have been weaker than expected, raising the odds of Fed rate cuts. Thursday's CPI further fuelled rate-cut euphoria and the stock market melt-up, but not in an obvious way, as the S&P 500 fell the most in months, but the small-cap Russell 2000 surged higher.

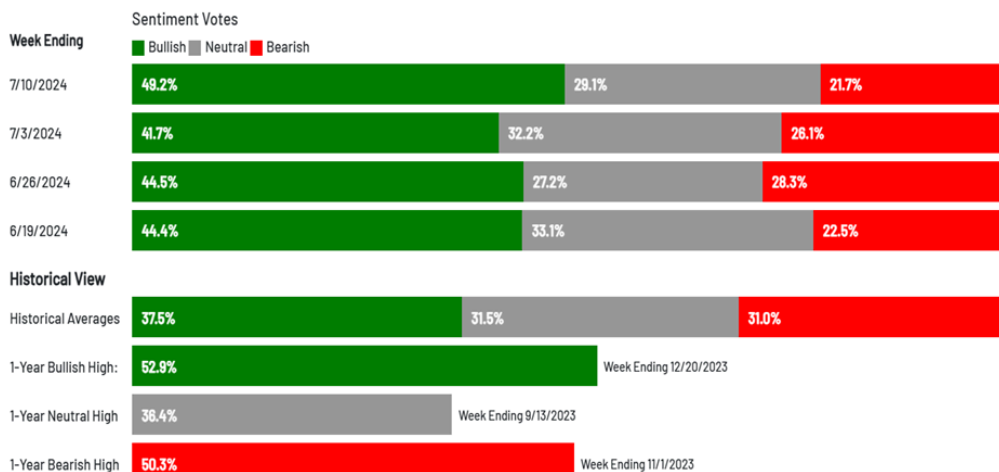
Source - Bloomberg - 14/07/24

Big Week for Small Caps Russell 2000 posts best week since November



Despite the headline drop in the S&P 500, the theme across these moves is clear: risk-on. Nearly 400 of the S&P 500 constituents were flat or up on the day. Many commentators have challenged the notion that this is a proper bull market as the advance has been very narrow, led by Nvidia and the other tech monsters. But even excluding the MegaCap-7, it's still been a bull market for the remaining S&P '493'. Last week could be the start of a shift; active managers might even be able to outperform the index again, and the move could be accentuated if we get better-than-expected Q2 earnings across other sectors. We all know the massive spending going into AI; perhaps as we move forward, we will hear more from 'non-tech' company management on how they are using AI to cut costs and increase productivity, and that is, after all, why they have been investing so heavily in it.

One final note: I am not sure if it is one of caution or another reason to be cheerful: investment sentiment indices have become very bullish, typically a contrarian indication that the market may be in overbought territory. These are dangerous words, but 'this time might be different' given that so much money is parked in short-term money market instruments and bank deposits. If the Fed does lower interest rates, that could unleash plenty more irrational exuberance!



China - The Third Plenum

The Third Plenum, or the third plenary session of the Central Committee of the Chinese Communist Party (CCP), has started, and it is as significant a meeting as you get in China. Held every five years, it typically focuses on major economic and political reforms. It is often seen as a platform for the Party to outline its mid-term agenda and strategies. Historically, such meetings have led to significant economic reforms, such as the 1978 opening to foreign businesses, the 1993 liberalization of the yuan and the socialist market economy. The upcoming plenum aims to make China attractive to investors again amidst mixed expectations, political changes, and economic challenges, including a prolonged property crisis and a \$2 trillion stock market sell-off due to regulatory crackdowns and strained US relations.

While China has so far refrained from deploying a 'policy bazooka', having observed the debt and inflationary consequences of loose monetary policies in Western countries post-COVID, incremental policy support has still been provided.

'The Third Plenum, will offer investors insights into future policy directions'. President Xi stated, 'We are planning and implementing a series of significant measures to comprehensively deepen reform'.

Although I still don't expect a bazooka, there could be further moves to improve national income distribution. Maybe more tax reforms would support indebted local governments and the expansion of the welfare net, which would encourage more household spending. The Chinese are actually natural savers. Investors are particularly interested in how the plenum will address the private sector's role. While state-owned enterprises have thrived post-pandemic, recent rhetoric suggests a more supportive stance towards entrepreneurs. In May, Xi sought opinions on optimizing the private business environment and questioned the decline in billion-dollar startups. If Xi delivers on his promises, this year's Third Plenum could be as transformative as those in 1978 and 1993, marking a significant turning point in China's economic and political landscape.

Japan

Japan deserves a quick word as the Nikkei set a new high last week above 42,000 before retreating towards the end of the week. Since the beginning of 2023, Japanese equities have shown impressive performance, delivering approximately a 55% total return in local currency, exceeding the S&P 500. However, when considering Yen depreciation, you can see from the graph the average returns from the GBP Japanese Sector, which are only broadly in line with our own FTSE 100.

Source - FE Analytics - Data Period 20/12/2022 - 12/07/2024



Before the recent surge, global recession fears negatively impacted Japanese stocks in 2022 despite an 8% year-over-year net profit growth that year, setting the scene for the rebound. Key events like the Bank of Japan signalling an end to deflation, Warren Buffett's significant investments in Japanese trading companies and the Tokyo Stock Exchange's push for better returns on equity provided the catalyst.

The 55% total return since early 2023 is higher than the 20% earnings growth, meaning the market has become more expensive. Still, current valuations remain reasonable, with a forward PE ratio slightly under 16x and over 40% of stocks in the MSCI Japan benchmark having a forward PE of less than 15x. Unlike in the US, the market cap increase has been broad-based, encompassing various sectors such as financials, autos, trading companies, machinery, services, and chemicals. Corporate reforms should continue to provide opportunities for structural earnings growth, with a consensus forecast of 12% net profit growth for the current fiscal year and growing dividend payments. These data points suggest that Japan still has room to run, and solid double-digit local currency returns would be a fair guess over the next year.

A key concern is the Yen, which touched 162 against the dollar last week before suspicious activity in the currency markets (the Yen strengthened suddenly during the week that inflation numbers came out in the US). The BOJ might be drawing a line in the sand with the Yen at 162 to the USD, and with a tighter rate policy likely, that may mark peak weakness. At some stage, we can expect Yen strength, which could enhance the returns for sterling investors.

Next Week

Things to look out for include the intensifying pressure on Joe Biden - will he stay or go of his own volition? - or will he be ousted? Introducing Zelensky as Putin at the NATO summit last week didn't strengthen his cause. Next week, we are at the floodgates of US earnings results - Tesla, Netflix, IBM, BOA, and J&J, to name but a few. We also get UK CPI data and Retail Sales.

Q2 : FactSet Earnings Scorecard so far...

On Friday, we heard that JP Morgan and Citibank delivered beats, and Wells Fargo was punished for lower net interest income. However, guidance is needed to improve here, and all the bank management teams expect Fed rate cuts. For Q2 2024 (with 5% of S&P 500 companies reporting actual results), 81% of S&P 500 companies have reported a positive EPS surprise, and 56% of S&P 500 companies have reported a positive revenue surprise.

Postscript - Trump shooting

Since writing the initial draft, news has broken of an attempt on Donald Trump's life as an assailant attempted to kill him by firing shots from a nearby barn's roof. Mr Trump sustained an ear injury and was swiftly moved to safety. However, the attack resulted in the death of one Trump supporter and severe injuries to two others. The gunman, identified as a young white male, was shot dead by security forces. This incident has drawn widespread condemnation, including from President Joe Biden and leaders across the political spectrum.

What will the effect of the attempt on Mr Trump's life be on America's election? I am sure that Mr Trump's popularity will now rise even higher. The assassination attempt will probably have other consequences, though these are hard to predict. It may distract from Mr Biden's immediate troubles, and he may find it easier now to ignore his critics. On the other hand, this may be the sort of shocking event that helps to concentrate minds in the White House and encourages a frank conversation with the president about his weakness as a candidate—especially if Mr Trump is now even more energised.



**TOM
MCGRATH**

**Chief Investment Officer &
Portfolio Manager**