BNY

iFlow WEEK AHEAD

August 4, 2024

Non-Linear

’We evolved to make sense of this non-linear and unpredictable world with stories. These stories are often very powerful.” - Dominic Cummings
"Life isn't a linear journey. Sometimes it's one step backwards, two steps forward and then a jump out to the side. It's kind of like the “Time Warp”, when you think about it. Life follows many directions and hopefully, eventually, your mind and body and life and love, all catch up with each other” - Karina Halle

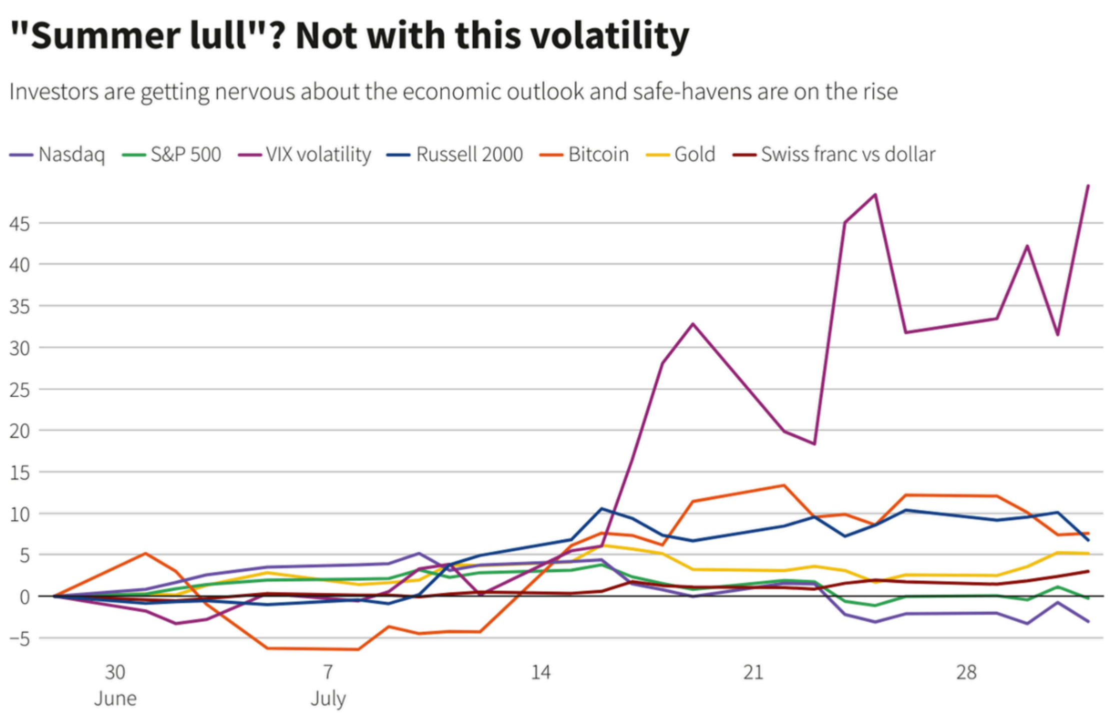
Summary:

August arrives and the markets have given up on a quiet summer with volatility rising not failing even as vacations and the calendar in the week ahead makes clear less news may not be better for investors still trying to understand the turn of events that are forcing a new narrative as technical lines breakdown, and as economic models flash red driving expectations for 50bps easing from the Fed in September. If the Fed is behind the employment curve as many claim, the risk of a non-linear decline in the economy rises, with negative spirals between consumers and corporate profits. The week ahead will test this new storyline along with the wisdom of forward guidance from the RBA, RBI and Banxico. The focus outside of the US will be significant with geopolitics every present, along with concerns about growth in China and Europe – particularly Germany. The global PMI reports and China CPI will be used as barometers as well as the US polls to determine if there is any return for Trump trades. The weaker USD has delivered far less relief to markets than many expected and correlations across asset classes are breaking adding to concerns of a larger volatility shock ahead.

Themes for the week ahead:

- **Soft to Hard Landing Fears** - Investors now price in 116bps of easing for US FOMC in 2024 with more in 2025 and many expecting a recession from a Fed policy mistake Bets in the futures markets on Friday suggested growing unease about the economy. Fed fund futures reflected pricing an over-70% chance of a 50-basis point cut at the central bank's September meeting, compared to 22% the day before. The Sahm rule is in play with US July unemployment report from last Friday at 4.3% - 50bps from the low - driving recession talk. The hope for a soft-landing rests on the 2Q 2.8% GDP, weather related noise in the jobs report and the ongoing earnings from 2Q bearing expectations with momentum for companies to continue to invest in the future, while the consumer may face down selling as prices continue to matter. Inflation improvement continues to look important. The problem is when assets are "priced to perfection", it does not take much for disappointment to set in. And thin summer markets often mean more volatility. Weaker readings of U.S. business activity and employment have prompted investors to rethink whether rate cuts are a reflection of an economy that is weaker than they first though and so take some money off the table.
- **Geopolitical worries** - The ongoing tensions between Israel and Iran have left many analysts discussing the risk of escalation and with that the threat to oil supply and ongoing global shipping. The risk of Ukraine and Russia war continuing without a deal is also in play Increasingly, reports mix the role of Russia and Iran working together. As global conflicts continue to hang over markets there is a tension over energy prices with supply fears matched for now by demand risks. The rise in gold prices continues to highlight safe-haven demand as well, with some eyes to liquidation of such to get liquidity. Watching the demand for cash to cover margin calls will be part of the week ahead.
- **More than a healthy correction? Safe Havens and Fed puts -** The question for August is whether the FOMC rate cuts priced are sufficient to flip risk back on for equities and other assets The difference between a bear market and a healthy correction is essential, and more than the 10% difference between the return lines. Futures priced a total of 116 basis points in rate cuts in 2024, compared to just over 60 basis points priced in on Wednesday. Broader markets also showed signs of unease. The Volatility index (VIX) - known as Wall Street's fear gauge - hit its highest since March 2023 at 28% on Friday as

demand for options protection against a stock market selloff rose. Meanwhile, investors have rushed into safe haven bonds and other defensive areas of the market. US10-year yields - which move inversely to bond prices - on Friday dropped as low as 3.79%, the lowest since December. Sectors that are often popular during times of economic uncertainty are also drawing investors. The healthcare sector is up 4% in the past month, while utilities, are up over 9%. By contrast, the Philadelphia SE Semiconductor index, is down nearly 17% in that period amid sharp losses in investor favorites such as Nvidia and Broadcom. Some investors said the data could just be a reason to lock in profits after the market's overall strong run in 2024.



Note: Rebased to 0 as of June 30
Source: LSEG/Reuters - Amanda Cooper
Reuters Graphics

What are we watching:

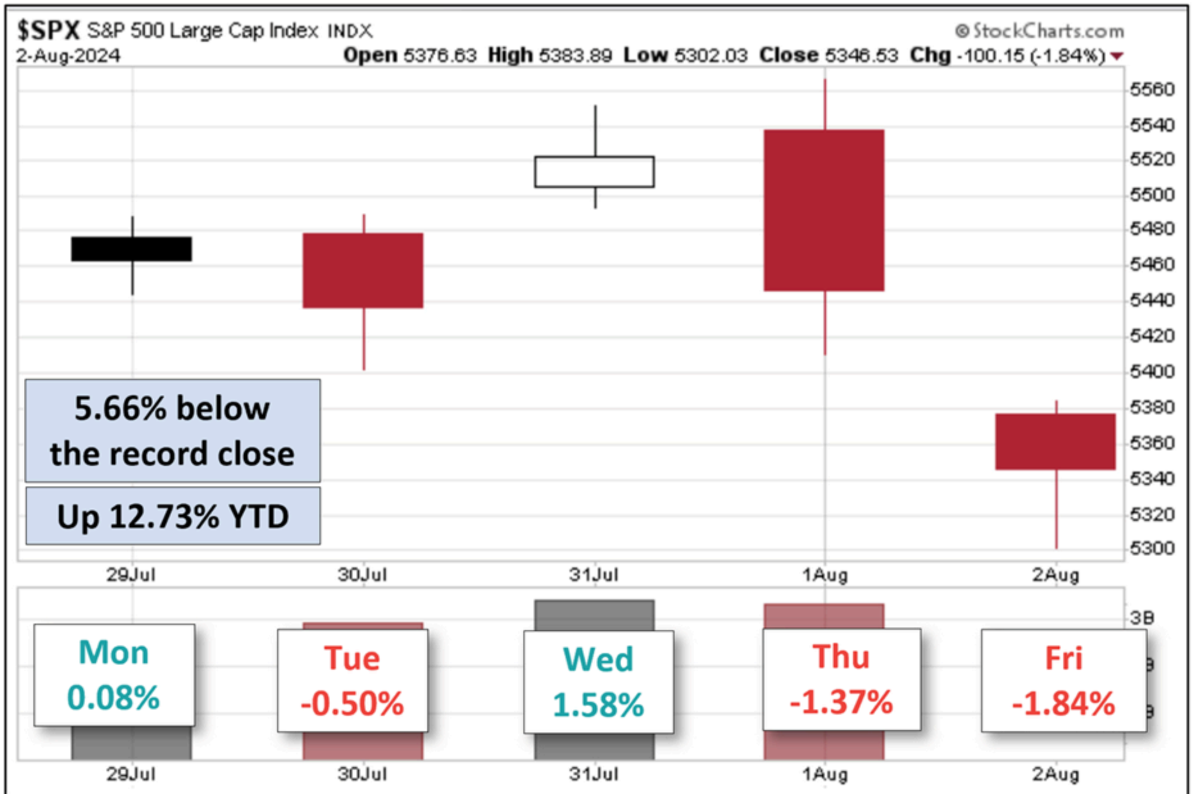
- **Economic Releases: Monday** – Global Service PMIs, Turkey CPI, EU PPI, US Service ISM, Fed Senior Loan Officers Survey; **Tuesday** – Japan household spending, Taiwan CPI, German factory orders, EU construction PMI, retail sales, US trade balance; **Wednesday** –NZ unemployment, German trade, US consumer credit; **Thursday** –China trade, Taiwan trade, Mexico CPI, US weekly claims**: Friday** – China CPI, PPI, C/A, Sweden household consumption, Turkey industrial production, Brazil CPI, Mexico Industrial Production, Canada unemployment.

- **Central Banks: Monday** – Fed Daly; **Tuesday** – RBA decision; **Wednesday** – BOC minutes; **Thursday** – BOJ minutes; RBI decision, Banxico decision, Peru BCRP decision,
- **Issuance**: **Eurozone supply estimated at E7.5bn** from Germany and Austria this week putting cash flow negative -E23.8bn. Tuesday – Austria sells E1.5bn of 10Y and 16Y RAGB and Germany sells E4bn in 5Y BOBL; Wednesday – Germany sells E0.5bn in 14Y Bund and E1.5bn in 17Y Bunds. **UK Supply seen at GBP6bn** and cash flow -GBP6bn with Tuesday – 19Y Gilt sale for GBP2bn and Wednesday sale of GBP4bn for 5Y Gilts**. US supply is $125bn** with positive +$86.1bn cash flow as $211.1bn August 15 coupons and redemptions hit –Tuesday brings $58bn in 3Y notes, Wednesday - $42bn in 10Y notes and Thursday - $25bn in 30Y bonds.

What changed this week:

- **US shares fell for third week -** The S&P 500 fell for a third straight week and dropped to its lowest close in almost two months on Friday. The index is currently 5.66% off its record high from July 16th, 2024, and is now up 12.73% year to date. Largest losses were in Japan where the Nikkei fell -4.7% but on the month off -11% while Italy MIB fell -5.3% on the week but is off just 5.5% on the month.

Exhibit #1: S&P500 off for 3rd week

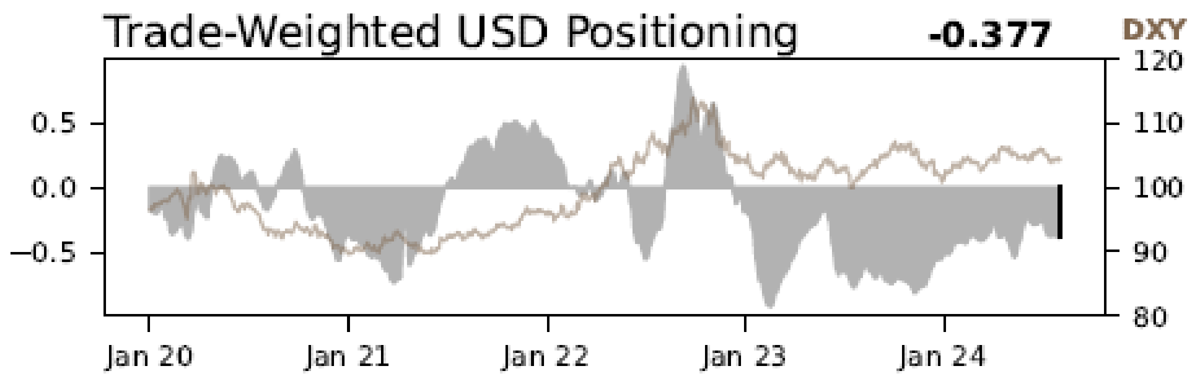


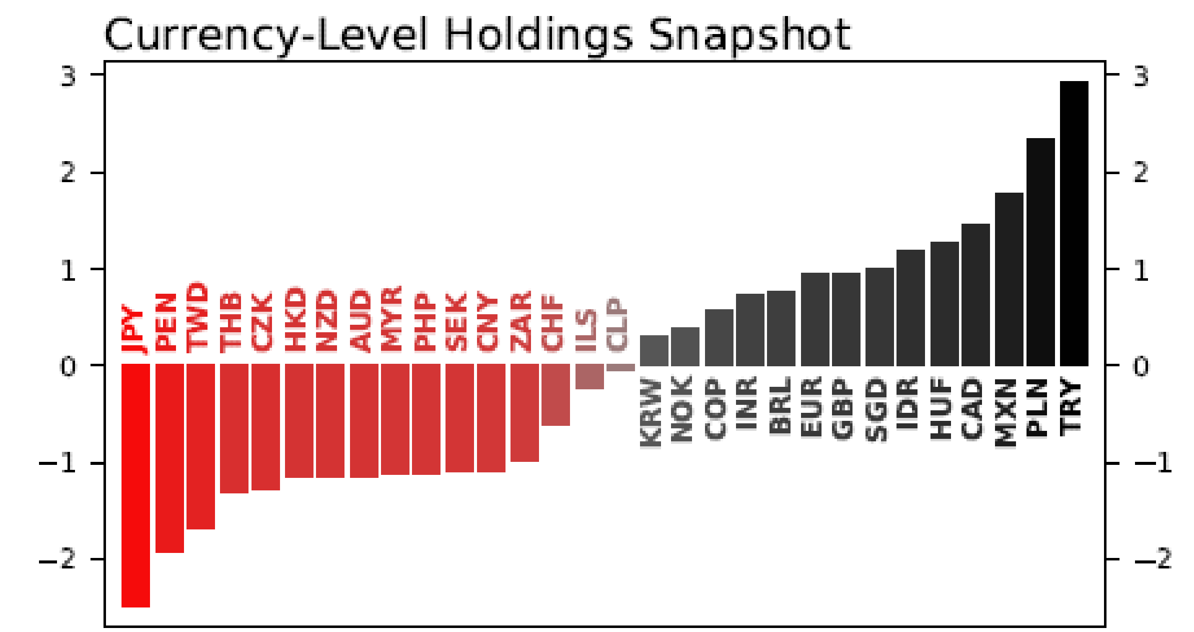
Source: Bloomberg, BNY

- **Bonds continued to rally globally despite BOJ rate hike.** The US curve re-inverted with 10Y back to 3.79%. The FOMC made clear jobs matter and September rate cut was likely. The rest of the world was also buying debt - with notable moves in Turkey, Poland.

- **FX markets sold the USD off 1% on the week** while JPY gained 4% and MXN fell 1%. The EUR rose 1% and GBP 0.5% even with the BOE rate cut.. The iFLow data highlighted that TRY, PLN, MXN and HUF remain overheld while the JPY, TWD and AUD lead the short holdings. The carry factor and trend both lost ground.

Exhibit #2: FX USD holdings, JPY and MXN still focus





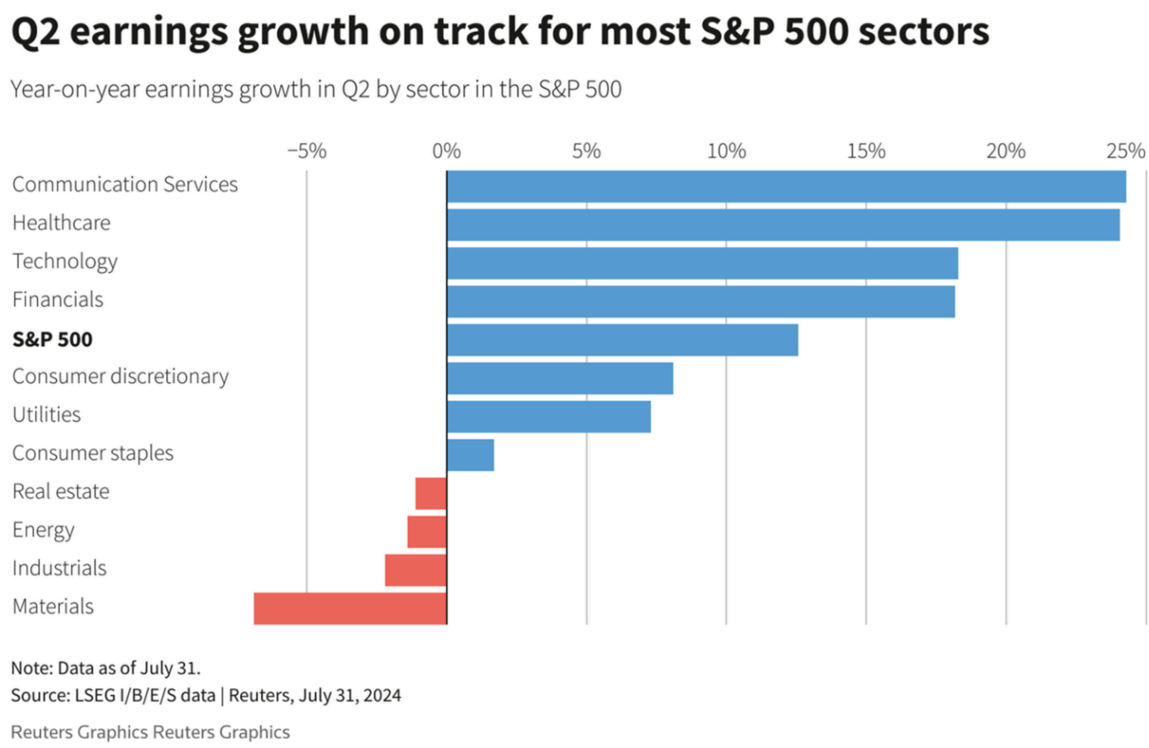
Source: iFlow, BNY

News Agenda and Weekly Themes –

It will be a relatively quiet week in the United States, with only the ISM Services PMI and the trade balance report of significance. Additionally, the earnings season for big companies is slowly wrapping up, featuring results from Amgen, Caterpillar, Uber, Airbnb, Walt Disney, Eli Lilly, SoftBank, and Siemens. Over in China, the Caixin Services PMI, the balance of trade, and producer and consumer inflation figures will be closely monitored. Australia RBA, India RBI and Mexico Banxico will announce their interest rate decisions while inflation rates will be reported for Turkey, the Philippines, Mexico, Brazil, and Russia. Germany will release data on its balance of trade, factory orders, and industrial production while the Euro Area will update retail sales figures. Also, balance of trade reports will come from Canada and Brazil and Services PMIs for Spain, Italy, and Brazil. Finally, GDP growth rates will be announced for the Philippines, Indonesia, and Russia.

1. 2Q Earnings - Better and Worse - With 75% of S&P 500 companies having already reported, second-quarter earnings are on pace to have climbed 11.5% from a year earlier, according to fact set. That is better than the 10.6% increase expected for the period on July 1.so far, 78% of companies have topped analyst estimates for earnings, nearly the same beat rate as in the prior four quarters. While most of the megacaps companies will have reported already, other important results are expected in the days ahead. Those include industrial bellwether Caterpillar, media and entertainment giant Walt Disney, weight-loss drugmaker Eli Lilly, and Super Micro Computer, which is at the center of the market's artificial intelligence excitement. The key point about 2Q earnings is that they aren't bad, nor are 3Q outlooks. During the month of July, analysts lowered EPS estimates for the third quarter at average levels. The Q3 bottom-up EPS estimate (which is an aggregation of the median EPS estimates for Q3 for all the companies in the index) decreased by 1.8% (to $62.09 from $63.20) from June 30 to July 31. What better explains the drop in US shares in 2Q is that the misses matter more and that revenue lags even as EPS beats. Revenue is at 59% above estimates - below the 5Y average. Companies that have reported positive earnings surprises for Q2 2024 have seen an average price increase of +1.2% two days before the earnings release through two days after the earnings release. This percentage increase is larger than the 5-year average price increase of +1.0% during this same window for companies reporting positive earnings surprises. Companies that have reported negative earnings surprises for Q2 2024 have seen an average price decrease of -2.5% two days before the earnings release through two days after the earnings. This percentage decrease is larger than the 5-year average price decrease of -2.3% during this same window for companies reporting negative earnings surprises.

Exhibit #3: 2Q earnings better than market prices?



Source: Reuters, BNY

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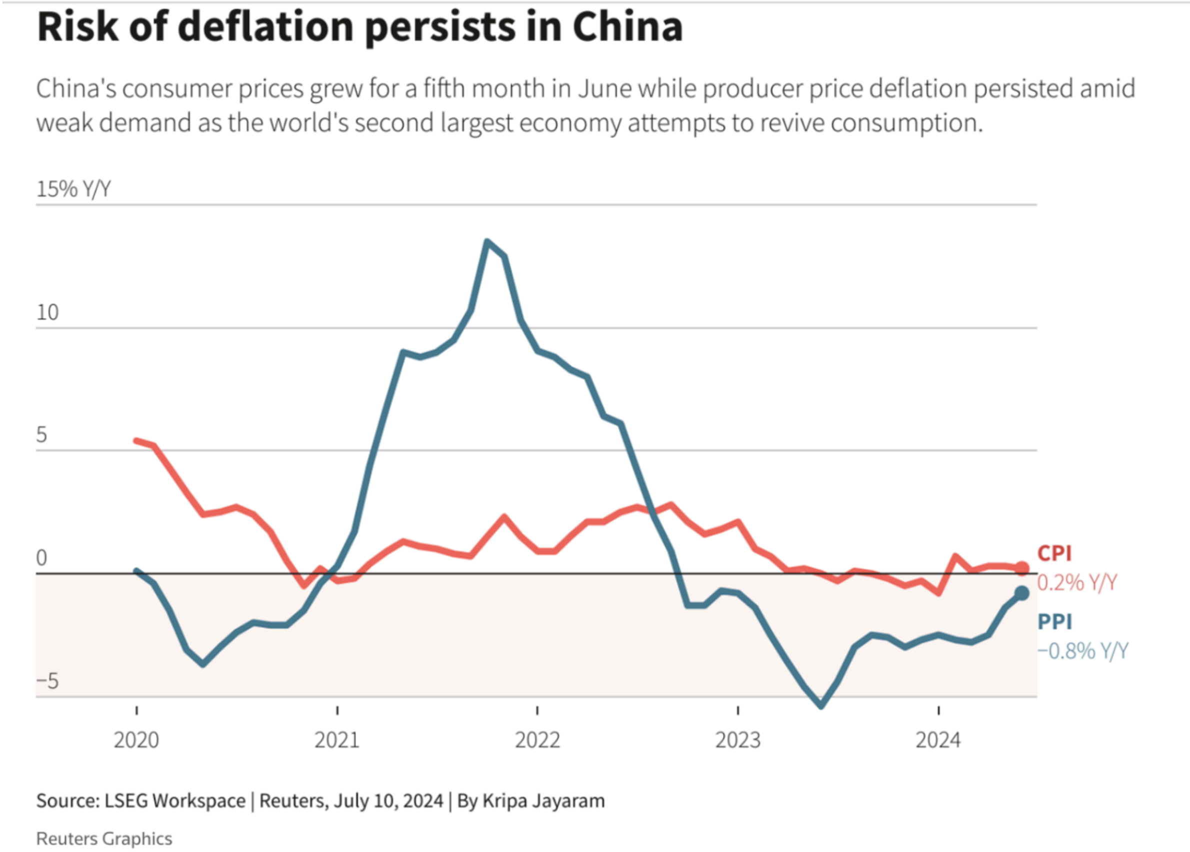
2. China and the PBOC conundrum with bond yields and recovery - A slew of economic releases from China will reveal how its shaky recovery is taking shape in the second half of the year and chances are, the picture still is not going to be particularly rosy. The week begins with a private-sector survey on services activity, followed by trade data on Wednesday and a reading on consumer prices to round off the week. Main focus will be on the PBOC and the 10Y rates with the break of 2.25% yields a problem but one that may lead to shifts in 5-7Y rates becoming the speculative tool for further rate moves.

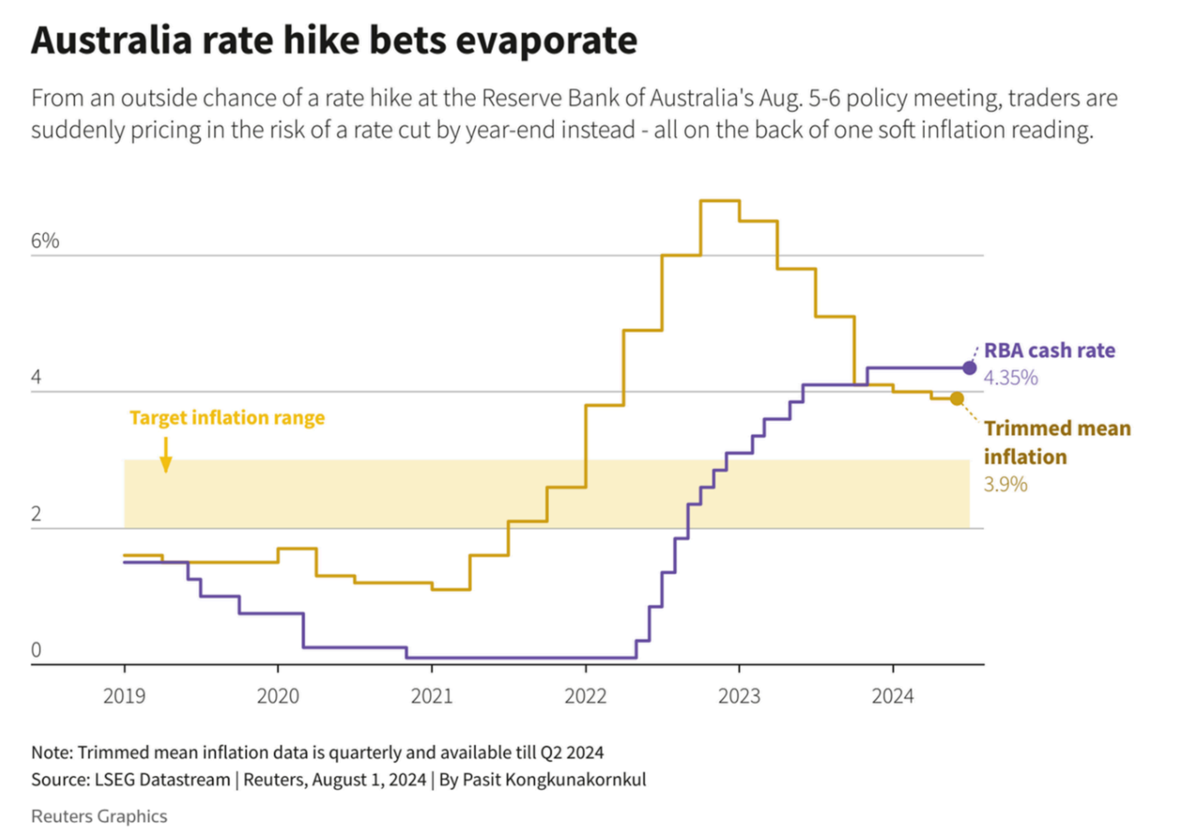
Exhibit #4: China CPI will be key for rates



Source: Reuters, BNY

3. RBA flips from hawk to dove - what does this mean for AUD? From an outside chance of a rate hike at the Reserve Bank of Australia's Aug. 5-6 policy meeting, traders switched to pricing in the risk of a rate cut by year-end instead - all because of one soft inflation reading. The Aussie dollar skidded to a three-month low and stocks surged to a record high, after core inflation unexpectedly slowed to a two-year low. This will be very welcome news at the central bank, which would have been very reluctant to raise rates already at a 12-year high amid flatlining economic growth, moribund consumer spending and a weakening labour market. Traders now put the odds of a rate cut at a coin toss for November, much sooner than the RBA's assumed timing of possible easing - around the middle of next year should inflation continue to slow as desired.

Exhibit #5 RBA and forward guidance risks



Source: Reuters, BNY

Weekly Calendar – August 5-Aug 9

Central Bank Decisions

- **Australia RBA (Tuesday, August 6) –** We expect the RBA to remain on hold but the market is now expecting a good chance of a pivot towards easing by year-end due to the recent drop in inflation numbers. The shift in Fed expectations would have compounded the effect. Even so, we believe the RBA remains one of the least dovish G10 central banks and there is no clear sign of weakness in wage growth. Encouraging a weaker AUD through policy transmission may also prove counterproductive as tradables inflation is rising, indicating pass-through risk remains high.
- **India RBI (Thursday, August 8) –** There had been increasing dovish shift within RBI with 2 members voted for 25bp rate cut at June meeting vs only 1

dissent in February and April 2024 meeting. That said, we expect RBI to keep repurchase rate unchanged at 6.5%. Headline CPI is within 4.0-6.0% band, but not sufficient to call for a cut. Our view is that the RBI will maintain positive real interest rates for the time being until inflation reaches its 4% target, refraining from a pre-emptive move.

- **Mexico Banxico (Thursday, August 8) –** Banxico is expected to cut rates by 25bp to 10.75%, though the market is not unanimous in the is view given current volatility is not conducive to MXN performance and may cause incremental pass-through risk. Although pricing of the Fed towards more aggressive easing will provide some additional room for Banxico, a weakening US economy will not be conducive to MXN in any way and markets will be looking for more aggressive pricing of cuts in Mexico as well as real rates would need to decline from current mid-single digits level.
- **Peru BCRP (Thursday, August 8) –** We expect most LatAm central banks to continue facing a balancing act between the need to lower interest rates while limiting pass-through. Changes in Fed pricing will have an impact on Peru as well but with local inflation continuing to normalise and a more challenging regional outlook, there will be some room to act if the dollar follows yields rather than push higher due to simple risk-aversion. On the other hand, LatAm remains vulnerable to an unwind in carry positions, so BCRP won't be in a position to signal a more conservative path.

Key data/releases

Date	BST	EDT	Country	Event	Period	Cons.	Prior
08/05/24	08:00	03:00	TU	CPI YoY	Jul	62.02%	71.60%
08/06/24	02:00	*21:00	PH	CPI YoY 2018=100	Jul	4.00%	3.70%
08/06/24	***05:30***	***00:30***	***AU***	***RBA Cash Rate Target***	***Aug-06***	***4.35%***	***4.35%***
08/06/24	23:45	18:45	NZ	Unemployment Rate	2Q	4.70%	4.30%
08/07/24	07:00	02:00	GE	Industrial Production SA MoM	Jun	1.00%	-2.50%
08/07/24	08:00	03:00	SZ	Foreign Currency Reserves	Jul	--	711.5b
08/07/24	12:00	07:00	US	MBA Mortgage Applications	Aug-02	--	-3.90%
08/08/24	00:50	*19:50	JN	BoP Current Account Balance	Jun	¥1863.0b	¥2849.9b
08/08/24	03:00	*22:00	PH	GDP YoY	2Q	6.20%	5.70%
08/08/24	***05:30***	***00:30***	***IN***	***RBI Repurchase Rate***	***Aug-08***	***6.50%***	***6.50%***
08/08/24	07:30	02:30	HU	CPI YoY	Jul	3.90%	3.70%
08/08/24	12:00	07:00	SA	Manufacturing Prod NSA YoY	Jun	-0.80%	-0.60%
08/08/24	13:30	08:30	US	Initial Jobless Claims	Aug-03	--	249k
08/08/24	***20:00***	***15:00***	***MX***	***Overnight Rate***	***Aug-08***	***10.75%***	***11.00%***
08/09/24	02:30	*21:30	CH	PPI YoY	Jul	-0.90%	-0.80%
08/09/24	02:30	*21:30	CH	CPI YoY	Jul	0.30%	0.20%
08/09/24	07:00	02:00	NO	CPI MoM	Jul	--	0.20%
08/09/24	07:00	02:00	NO	CPI YoY	Jul	--	2.60%
08/09/24	07:00	02:00	GE	CPI YoY	Jul F	2.30%	2.30%
08/09/24	07:00	02:00	GE	CPI MoM	Jul F	0.30%	0.30%
08/09/24	13:00	08:00	BZ	IBGE Inflation IPCA YoY	Jul	--	4.23%
08/09/24	13:00	08:00	BZ	IBGE Inflation IPCA MoM	Jul	--	0.21%
08/09/24	13:30	08:30	CA	Unemployment Rate	Jul	--	6.40%
08/09/24	***00:00***	****19:00***	***PE***	***Reference Rate***	***Aug-08***	***--***	***5.75%***

Key Events

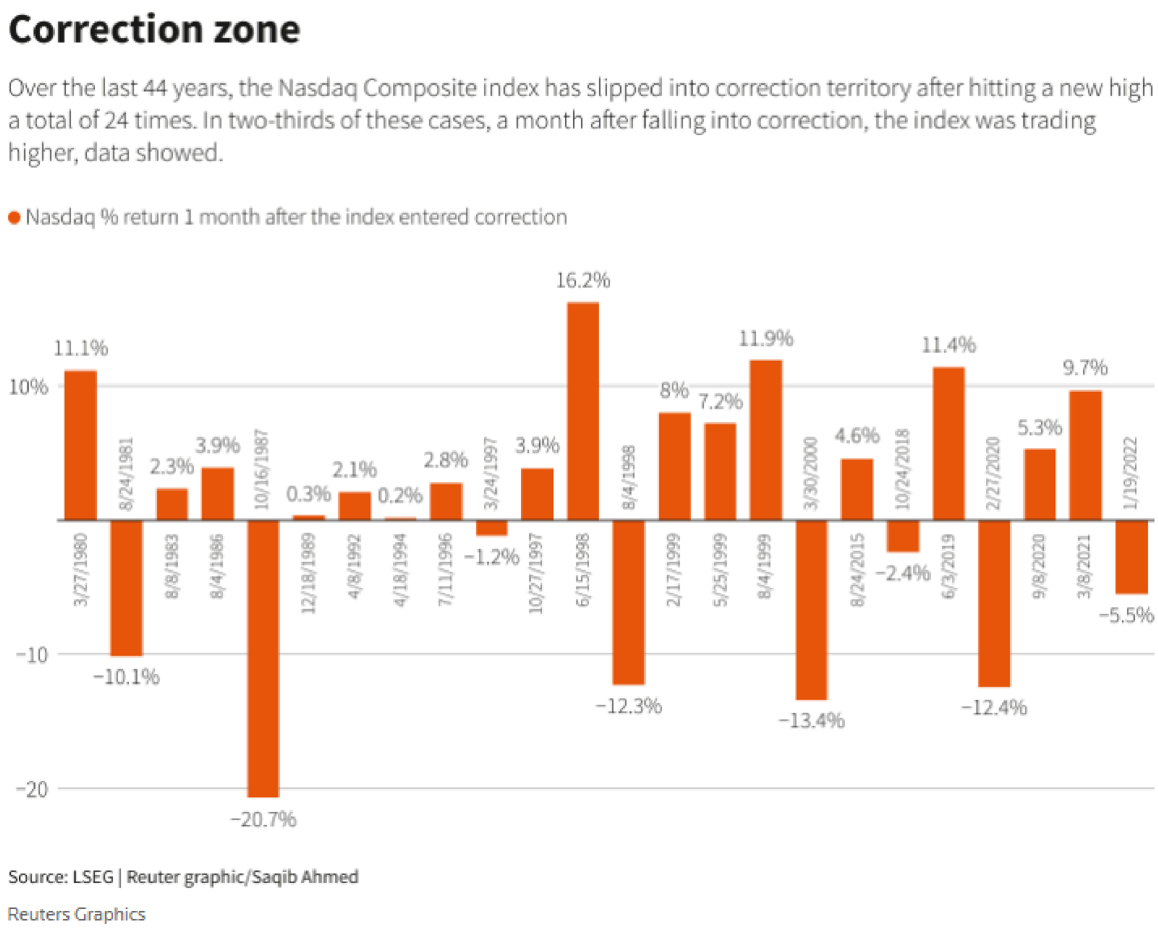
Date	BST	EDT	Country	Event
08/03/24	01:30	*20:30	US	Fed's Barkin Appears on Carolina Business Review
08/05/24	00:50	*19:50	JN	BOJ Minutes of June Meeting
08/05/24	13:30	08:30	US	Fed's Goolsbee on CNBC
08/05/24	19:00	14:00	US	Senior Loan Officer Opinion Survey on Bank Lending Practices
08/05/24	22:00	17:00	US	Fed's Daly Speaks in Moderated Discussion
08/05/24	23:00	18:00	CO	Colombia Monetary Policy Minutes
08/06/24	05:30	00:30	AU	RBA-Statement on Monetary Policy
08/06/24	06:30	01:30	AU	***RBA Governor Michele Bullock Media Conference***
08/06/24	12:00	07:00	UK	BOE releases report on APF
08/07/24	00:00	*19:00	AU	RBA's Hunter-Testimony
08/07/24	18:30	13:30	CA	Bank of Canada Releases Summary of Deliberations
08/08/24	00:50	*19:50	JN	BOJ Summary of Opinions (July MPM)
08/08/24	03:40	22:40	AU	Speech by Michele Bullock, Governor
08/08/24	20:00	15:00	US	Fed's Barkin Speaks in Fireside Chat

Conclusions: Where is the Fed S&P500 put?

The simple answer is lower still. Finding the right level for Fed Funds opens the debate about the FOMC policy mandates and the risk of a third rail - financial stability. The drop in US shares last week and the ongoing slowing in economic data drive the debate. As the FT warns recession isn’t off the table for the US. Some argue that rate cuts would only encourage an asset bubble. The prospect of rate cuts may in part support equities, but the S&P 500’s relentless upward march has recently wobbled as investors begin to question whether AI can deliver the revenues needed to cover the hefty capital investment currently being committed. That has happened even though rates cuts are coming into view. The biggest fear for the week ahead is in the VAR shock risks - where markets touch levels that force further selling. Leverage in markets usually makes such unwinding risks larger. There is a balancing act for financial conditions to matter to the real economy. The split of wealth vs. income becomes important at such times where investors suffer more than working-class as long as the cycle doesn't't’ destroy jobs. The key point for the US data watching in the week ahead will be around further signs of job weakness and determining just how weak the reports from Friday proved to be for the whole economy.

Bottom Line: US markets are in a liquidity matters stage where the FINRA shows that there is record margin use and still more room to borrow. The drop in shares so far has not forced many to give up positions and until we have capitulation, it's not clear that this is "safe market." Determining if the USD weakness or if rate guidance elsewhere helps or calms markets will be part of the story, as will how events play out in geopolitics. Until there is some certainty, volatility will remain. USD selling isn't solving problems yet, so expect other markets have to catch up..

Exhibit #6: Will politics or peace be better than the Fed put?



Source Reuters, BNY

Please direct questions or comments to: iFlow@BNY.com

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HEAD OF MARKETS STRATEGY AND INSIGHTS

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