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iFlow

MACRO REVIEW

August 2024

Key Themes

Rebalancing: JPY recovery flow likely due to August sales and equity weakness

US Equity Styles: Clear sign of cyclical downturn due to early-August volatility

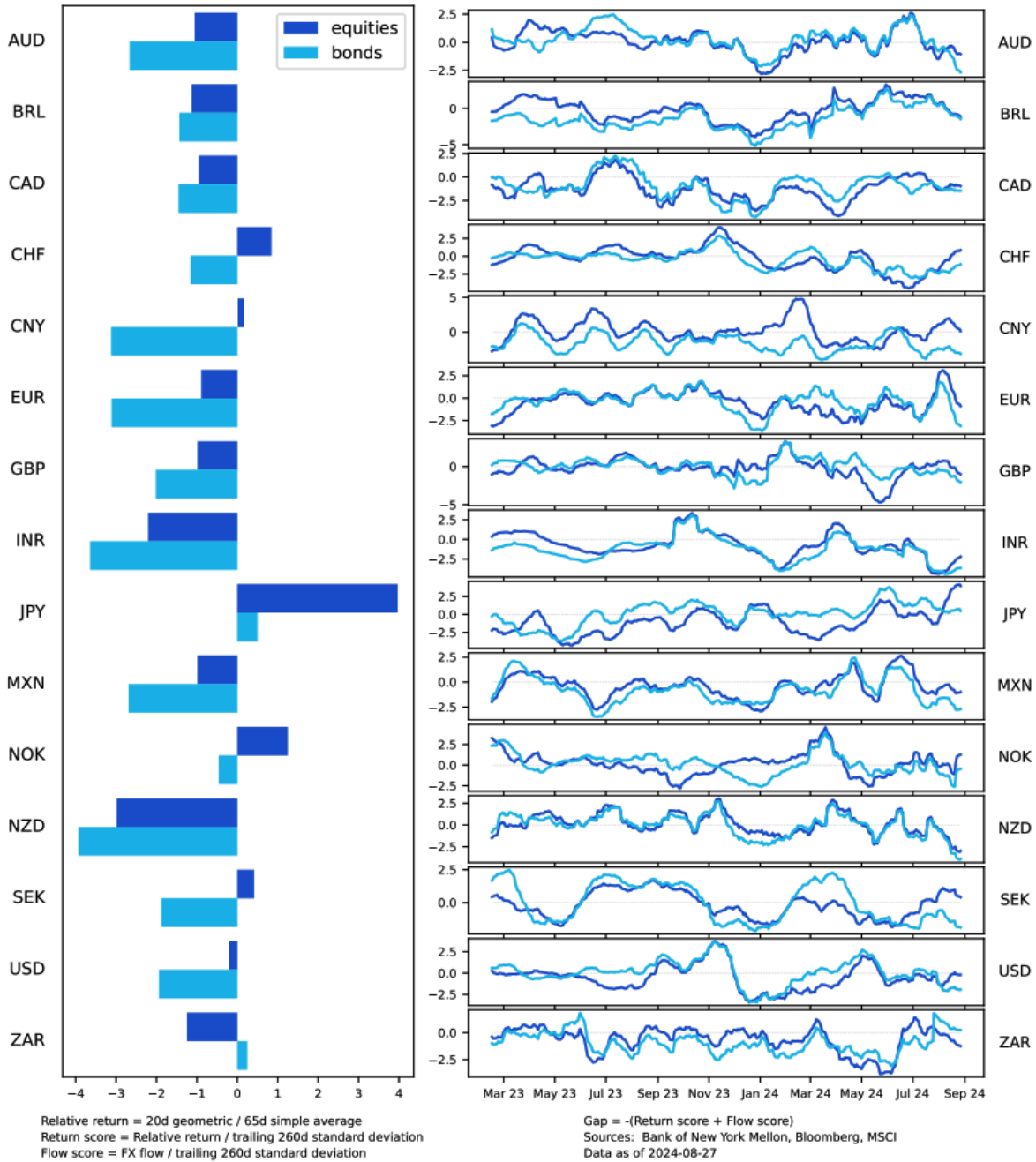
International Equity Styles: Growth exposures fall negative as sentiment turns

iFlow Green: Negative alignment finally ends as EM ESG factors recover

Click on the image below to launch a PDF with all graphics.*

Rebalancing Report

Aggregate month-end rebalancing gap between equity or bond price movements & FX flows



Source: BNY

Rebalancing Update

As the dust settles on August trading, market participants would be forgiven for wondering how calm most asset classes are after the volatility seen at the beginning of the month, where some key markets registered one-day moves unseen in decades. Ultimately, due to the lack of net movements as of month-end, there is a rather 'risk-on' feel to the flow rankings, with the JPY still the underperformer, whereas high-yielders both in EM and G10 registered some of the best flow figures, including MXN, INR and NZD. The dollar also ended the month net bought despite the weakness in spot and the Fed pivot, suggesting that there

is still significant concern over risk exposures and liquidity preference is strong – we have highlighted already how dollar-denominated cash flow has totally turned around and saw strong interest, defying normal sensitivity to yields. Much of the rebalancing need therefore will be generated by asset market developments.

It should come as no surprise that Japan is the main outlier in August equity performance. Even though local indices had been attempting to recover after the initial severe drops, it is evident that new financial conditions are in place and this required a material recalibration of equity indices. Subsequently, a discount is in place, and it was highly unlikely for Japanese equities to revisit previous highs, especially if the JPY is now expected to continue strengthening on a structural basis. However, there is the matter of tactical versus strategic rebalancing, and the latter may limit the extent of total return exposure to Japan over the medium term. These decisions will take time to come through, so assuming that benchmarks are in place for now, the material underperformance in August of Japanese indices on a marginal basis alone would require purchases of JPY to offset. Meanwhile, high-beta markets such as South Africa, Brazil and India all performed well and could result in some FX realignment through hedging, though we acknowledge that in a Fed easing environment, costs of hedging EM FX exposures will begin to rise, and this could also affect mandates over the medium term.

Consequently, by some distance, the biggest rebalancing need in equities is in the JPY. The selling in the currency for much of the month and poor equity returns require aggressive rebalancing, assuming benchmarks remain largely unchanged for reasons stated above. There are no other currencies which have any net purchase need through equity rebalancing. On the selling side, INR selling is required again as the currency was as the only rebalancing signal we identified in equities in July. The NZD also requires some selling flow, though this was mostly due to the currency's strong marginal performance. Meanwhile, poor Eurozone equity performance managed to offset the euro's strong purchases.

Fixed income performance was strong throughout August globally. Although equity markets recovered well and overall risk sentiment has ended the month on a positive note, inflation expectations have structurally de-rated, led by the turn in the Fed which was confirmed on Friday by Chair Powell. Understandably, where the Fed leads the rest of the world would follow. During the severe bouts of risk aversion at the beginning of the month, global demand for sovereign paper was extremely strong across all asset markets as inflation expectations fell across the board. Even emerging markets benefited, as the weaker dollar means much of the developing world faces far lower pass-through risk. As such, the top three markets were

all in EM, though we acknowledge that China's deflationary risk has allowed it to lead FI performance for much of the year. Meanwhile, Japanese fixed income has performed the worst, even with a positive abnormal return score, due to the direction of travel for the BoJ. Overall, the fixed income performance globally would have generated significant selling needs in FX, with pressures most pronounced on currencies which were net bought through the month.

Even though we do not have a strong dollar buying signal (the FI figure was close to significant), this would largely reflect the need to sell dollars to rebalance by cross-border investors. However, as the marginal mover of global hedging flow is still with USD-based investors, the selling needs in other currencies will be materially beneficial to the greenback. In EM, INR, CNY and MXN will face strong rebalancing needs – all selling – due to their strong performances in FI. South Africa and Brazil also had good FI performance on the month, but ZAR and BRL were already sold. EUR, AUD and NZD meanwhile require selling flow – the NZD and EUR due to the currencies' good performance on top of FI gains, while AUD was also a good G10 performer in FI.

iFlow Equities 2.0 Style Indices - Flows of Significance

1. US Equity Styles

- Mostly due to the volatility generated at the beginning of the month, cyclicals are struggling and we expect this trend to continue given the outlook for the economy
- The trend for growth outperformance relative to value is positive but volatility is high, with frequent drops back down to neutral
- Inflation interest is also relatively tame, in line with current policy guidance

2. International Equity Styles

- Cyclical flows continue to deteriorate – in Developed EMEA cyclical performance relative to defensives is now at its lowest point since 2020
- Cyclical flows are also soft across APAC, though Developed Markets in the region are under greater pressure
- Growth flows are flat relatively to value across international markets but momentum is weak

3. iFlow Green

- On an aggregate basis, ESG flow alignment is no longer near uniformly-negative, especially within EM where several factors have improved markedly, such as ESG-

Governance and UN Global Compact-Labour Rights. EM EMEA is performing particularly well, with most factors flat or positive, except for UN Global Compact-Human Rights

- Developed market flow alignment continues to see divergence between Americas flow and other areas. ESG-Governance is particularly strong in DM Americas.

***iFlow Macro Review PDF contains the following:**

- Monthly Rebalancing index, based on marginal equity and fixed income returns, offset against marginal FX flow scores generated by iFlow.
- US Equity Styles, detailing US equity purchases across different style indices.
- International Equity Flows, assessing asset allocation preferences across developed and developing markets on a regional basis.
- iFlow Green, assessing alignment between ESG factor flows and general equity flows.

Disclaimer & Disclosures

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