BNY

iFlow

MACRO REVIEW

September 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

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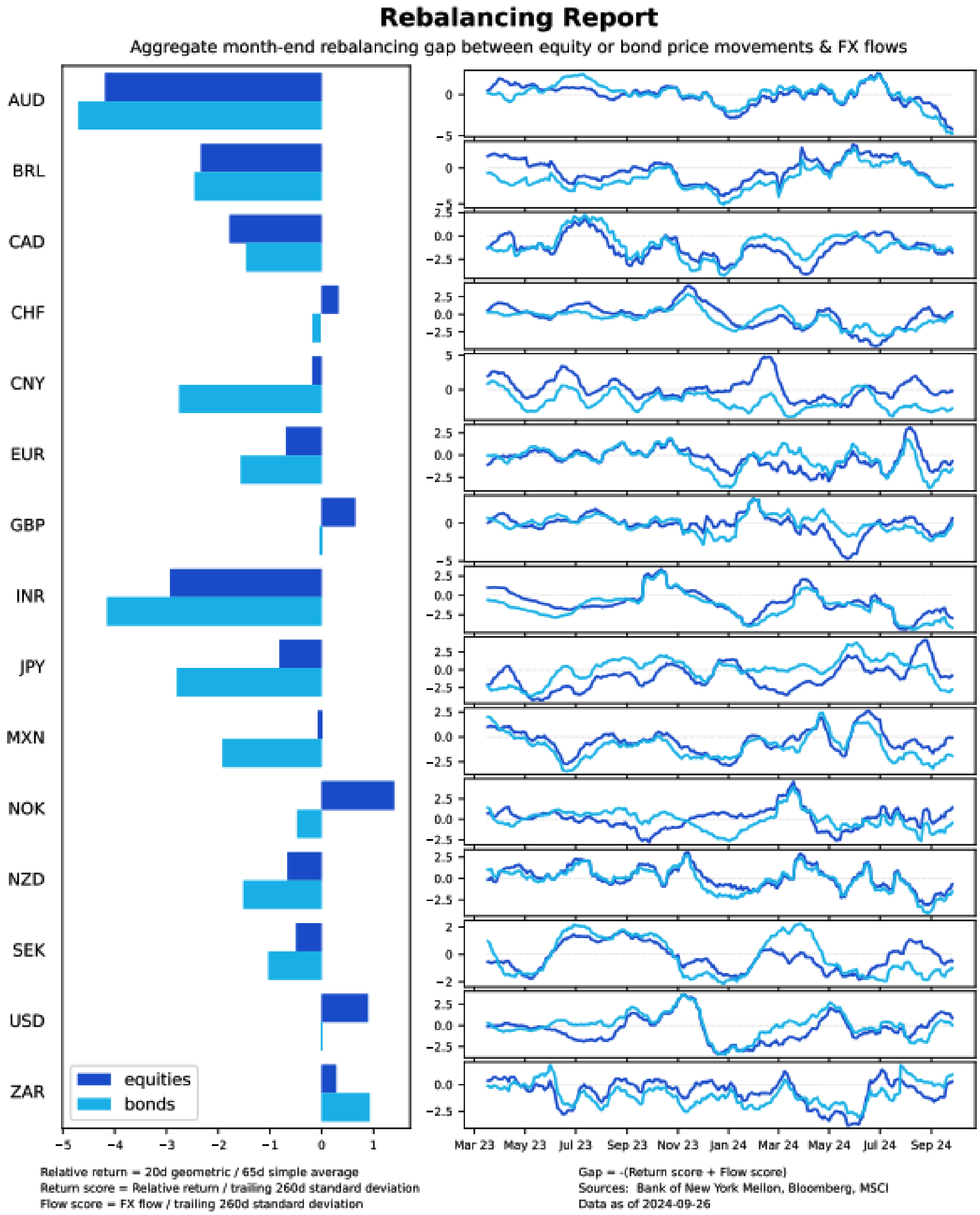

Source: BNY

Rebalancing Update

Suffice it to say that despite all of the event risk in September, risk appetite looks set to end the month on a very positive note. The Fed was more dovish than expected but curtailed fears of a hard landing, while month-end stimulus from China was indeed forceful enough to generate material changes in equity market outcomes, though we do question whether month-end rebalancing is already too late in the planning and execution stages to be affected by the changes in equity markets, especially where there is a high China growth/demand exposure. Even without taking into account month-end flows, the risk-on tone in APAC and commodities is already clear. AUD, INR and BRL are in the top five in absolute terms while the JPY also ends the month on a solid note, though here the purchases are probably more to do with its own policy changes and valuation pressures. It also wouldn't come as a surprise to see the dollar materially underperforming on the month. The Fed's 50bp cut will have material consequences for hedges, which are highly sensitive to rate differentials. Given that the ECB, BOJ and BOE were seen as having different shades of hawkishness or at least a lack of dovishness, the dollar's aggregate flow was bound to suffer. This means, however, that month-end rebalancing would be dominated by potential dollar strength or a reduction of exposures in risk, which also appears to be a sound strategy as event risk will continue through Q4 and the US election looms large. On a marginal basis the purchases in AUD and selling USD have been amplified, while there is limited change in the rankings for all the currencies we track. This suggests that the AUD has gone through a poor period of flows, and this is probably more in line with the market's view on China and potential growth tailwinds for the rest of the world. Meanwhile, the RBA itself was also hawkish, which generated demand for front-end paper, and the Fed's cut may have supported the return of long positions. Meanwhile, the dollar's large marginal net selling figure also underscores the recovery flow it had seen over the last quarter, even though the market had been pricing in Fed easing during the process. In hindsight, this was a sign that Fed easing was being seen in a "risk off" or US hard landing context, where the safety properties of the dollar smile could assert themselves.

Equity returns on a marginal basis were broadly positive through the month and this was a continuation of August trends. Also similar to August, Japan was not a strong performer, but we can see that China is by far the weakest. The data do not include the additional market reaction seen on September 26 after more stimulus was announced, but we note that even before the last week of September, the local market was still in a state of weak performance, and this was still undermining the marginal flow figures. As stated above, we think that the equity returns may have come a bit too late to generate significant rebalancing flows, but the effect will start to show in the coming weeks, assuming the effect is sustained, which is clearly the intent of the authorities. Fixed income once again was very well supported through the month, with almost every economy we track having a decent marginal return score of 1.0 or higher. This is more of a Fed-based view, especially for advanced economies but EM's outlook is significant as well. Disinflation in China is continuing to generate strong demand for duration, and markets may feel that this is going to be exported regionally or even globally. Meanwhile, South Africa and Mexico also saw rate cuts in their policy decisions, and both were in line with market pricing, which had probably generated strong duration interest throughout the month. However, Brazil faced rate hikes, and this has been reflected in its poor performance, especially relative to other EM bond markets.

Combining asset flow and FX, we find that the bulk of the rebalancing is taking place with a "risk-off" tone as markets reduce exposures in currencies that were well bought, while underlying asset performance was also strong. In equities, BRL, INR and AUD all face outflows, mostly as a reflection of their FX purchases through the month, but equity performance was also positive for all three. In contrast, although Canada did very well in equities the currency faced offsetting flows. Again, we stress that the signal from CNY is not sufficiently strong for now, but for the sake of argument if the last 72 hours of equity performance is taken into account with the equity flow situation, we would expect CNY sales to come through as well. In fixed income, all markets will be under rebalancing pressure due to duration's performance. In addition to AUD, INR and BRL, we note that CNY and JPY may also face some downside risk. For the former, easing from the central bank and subsequent duration strength should lead to more hedging coming through. We note that CNY underheld positions are declining quite sharply so mean reversion flows are supportive. JPY will need to rely on the carry trade returning after a strong run in August and September, though for now we don't see the LDP leadership vote changing the currency's risk exposures materially.

iFlow Equities 2.0 Style Indices – Flows of Significance

1. US Equity Styles

- There is no clear sign of the Fed cut initiating a new cycle yet as Cyclical vs. Defensive flows are volatile and look set to end the month flat, even though industrial trends remain worrying.
- Growth and leverage are showing signs of outperformance, which is the expected response to any easing in financial conditions.
- Inflation interest continues to come down, fully in line with the Fed's outlook and it appears the market is willing to support their current policy guidance.

2. International Equity Styles

- Cyclical rebounded sharply in EM EMEA, though they remain at their lows in DM EMEA – such divergence will be hard to sustain given the supply chain links and we expect the former to converge to the latter.
- Cyclical and defensive flows remain soft across Asia as it is too early for the China stimulus news to have had an effect.
- Growth flows are flat relative to value across international markets, but momentum is weak

3. iFlow Green

- On an aggregate basis, ESG flow alignment is continuing to improve, with the environment factor on a headline level now strongly positive, led by similar improvements globally. Only DM APAC and EM AMER are slightly negative. There is no factor or region with uniform flow alignment, though EM EMEA continues to outperform, with only UN Global Compact – Human Rights showing negative factor alignment.
- EM is continuing to underperform DM strongly, with ESG-Governance and UN Global Compact – Labor Rights the only two factors with positive flow alignment, and only mildly so.

***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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