iFlow MACRO REVIEW

July 2024

Key Themes

Rebalancing: Limited signs of risk aversion, but EM FX under pressure from bond rebalancing

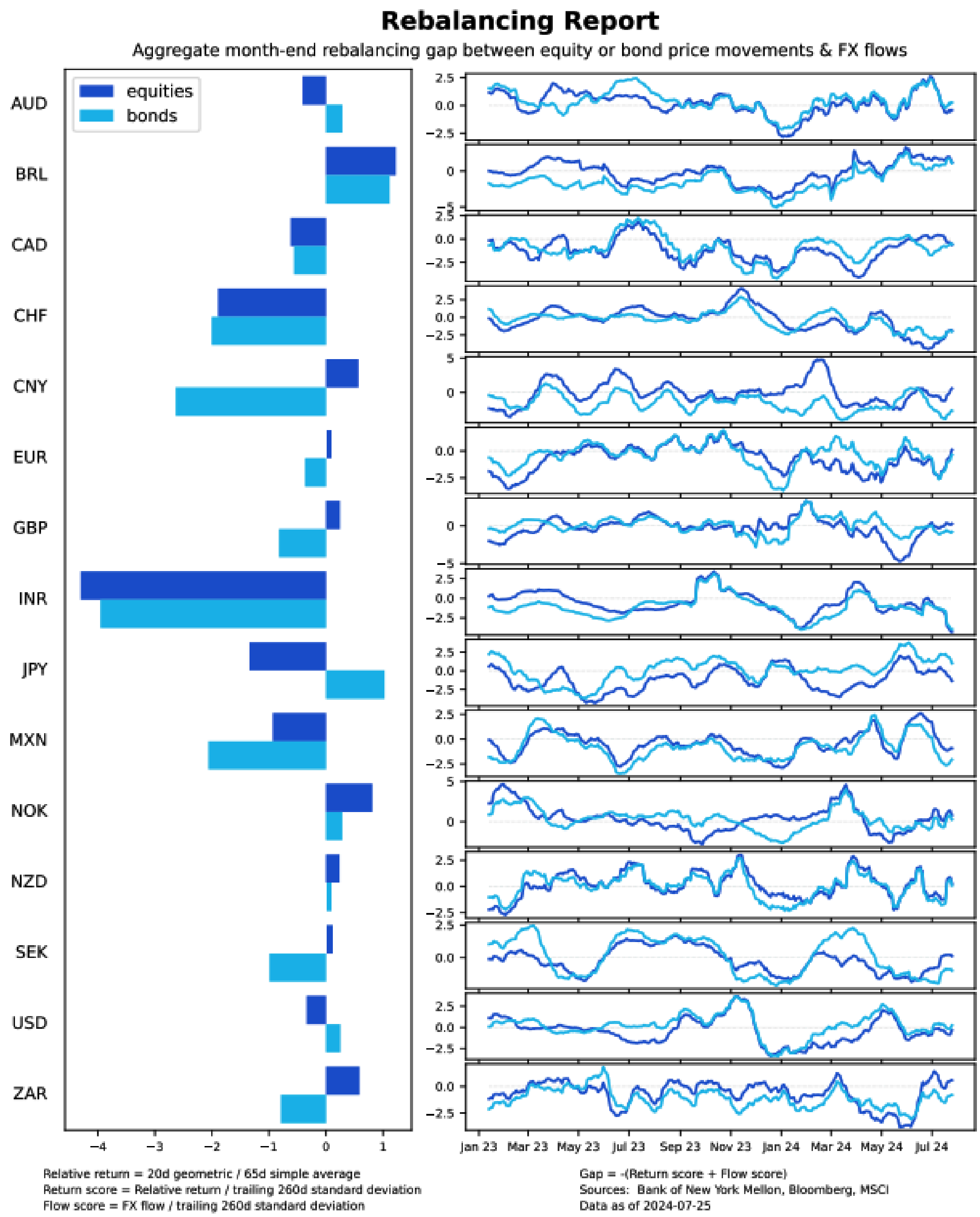
US Equity Styles: Cyclicals beginning to struggle relative to defensive flow, inflation flows weaken further

International Equity Styles: Growth exposures continue to weaken across all regions

iFlow Green: ESG-Governance turning positive globally, EM Americas showing best positive factor flow alignment

---

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



Source: BNY

Rebalancing Update

Risk aversion continued through much of July. Political risk remains in place as growth is also starting to buckle and markets even looked to price in the risk of an earlier Fed cut. However, this time the interpretation was far from favorable for risk appetite as recession risks only increased, so there was no guarantee that high yielders – which are already quite strongly held – would see good inflows. The dollar did struggle a bit but there is no broader theme coming through. MXN, CHF and INR stood out on the purchase side, and we suspect the two EM names' purchases had much to do with mean reversion from June. The only well-bought currency that looks like a safety flow was CHF, and JPY purchases arrived late as the market reverted to form and started to look at BoJ tightening again. ZAR, however, continues to struggle, but there are indications the flows were due to hedges of underlying assets being put on.

Equity markets have clearly faced difficult conditions throughout July, but in the context of the past quarter, through which we calculate marginal flow changes, performance remains manageable. Japan and the US have managed to hold on to the bulk of their quarterly gains. Consequently, the need for rebalancing is not a strong as price action may indicate. However, general interest has started to falter and as the strong weeks of equity momentum from Q2 begin to roll off and the volatility through June and July starts to exert itself, the outlook could prove more challenging, subject to impending policy decisions. Some markets are weakening. For example, equity return scores are negative for the Eurozone, the UK, China and Mexico. Downsides in these markets have generally been in line with the growth and sentiment narrative. China's performance is particularly weak and underscores the need for additional action, as specified in the recent plenum. The only two equity markets that face some rebalancing need – both through potential currency sales – are Switzerland and India. Both currencies performed well, but the latter was the best-performing equity market on a marginal basis and pushed FX flow demand through high thresholds. In contrast, Japan, the US and South Africa all saw their currencies face reductions in exposure through the month, which suggests that hedging took place throughout the month. In many respects, Japanese equity performance depends on keeping JPY exposures light, but selling is running out of steam. Aggregating the flow gaps, our analysis shows that for the second month in a row, CHF selling in equity rebalancing was material, but for July the signal was just shy of our usual criteria. Even though Swiss equities did well and the franc was also bought, there was no marginal change in momentum for either. Meanwhile, INR's selling signal was very strong on account of large total interest coming through due to the top ranking of the INR and Indian equities in their respective performance categories. There were no strong signals for purchases: South African equity purchases were sufficiently hedged by ZAR selling already.

Due to a combination of data weakness and month-end risk aversion, fixed income performed extremely well throughout the month, though the individual rankings underscore different themes in markets. For example, India was the outlier with a very strong marginal recovery, though much of this was probably due to the mean reversion from the previous month, when election results generated outflows throughout much of EM fixed income. Its performance also complements the equity recovery in the country. In contrast and perhaps surprisingly, JGBs also performed strongly, which goes somewhat against the BoJ normalization narrative – of which lower bond purchase levels are a key component – which has been supporting yen strength. On the other hand, JPY strength itself would encourage disinflation and help improve Japanese real yields and boost performance. Finally, although we remain concerned about the fiscal narrative in the US, broader risk aversion is driving flows back into US duration and investors are focusing on rotation out of equities rather than inflation risks and term premia. Meanwhile, Chinese bond markets have continued their good run, undoubtedly helped by long-end issuance and surprise rate cuts toward month-end. CNY selling from good duration performance is almost a default position in month-end rebalancing. Ultimately, we find that all the rebalancing signals were on the selling side for currencies. INR again requires material selling flow due to INR purchases and Indian government bonds ranking highly in total returns. As the franc continued to strengthen, Swiss bonds evidently also would outperform as disinflation risks in Switzerland picked up, along with expectations for further SNB easing. MXN and CNY also face selling. The former due to the strong FX ranking and moderate outperformance by Mexican bonds, which would be following the Fed in seeing some room for further rate cuts as real rates fell. Meanwhile, Chinese bonds again benefited from additional rounds of easing after the plenum, but the CNY did not struggle through July, whereas in previous months CNY sales had been able to offset good performance in bonds.

iFlow Equities 2.0 Style Indices - Flows of Significance

1. US Equity Styles

- Unsurprisingly, equity flow styles in the US point to a clear shift in growth sentiment this month. Cyclicals are again struggling to strongly outperform defensive flows and are now heavily divergent from the ongoing weakness in manufacturing ISM.
- Inflation-related flows have fallen quite aggressively, which is consistent with data prints that have indicated softer price pressures and support calls for a Fed cut this quarter.
- Growth continues to outperform value while leveraged flows have also been recovering, which suggests that markets are not fully entertaining rotation yet.

2. International Equity Styles

- The deterioration in growth factors is very clear across all international equity styles. In EMEA, developed cyclicals are now entering their worst period of performance relative to defensive flow since early 2022, and in EM EMEA there is very little differentiation between the two.

- In both APAC and EMEA, growth underperformed value very strongly over the past month, reflecting the clear shift in data and sentiment this month.

3. iFlow Green

- On an aggregate basis, ESG flow alignment has improved strongly over the past quarter. EM remains challenging, but this is largely due to weak APAC flows. In contrast, EM EMEA is showing positive flow alignment with all factors apart from UNGC-Human Rights, while EM Americas' alignment with UNGC-Human rights and UNGC-Labor Rights is strongly positive.
- Developed market flow alignment is mixed. Governance flows are very strong, led by the Americas, where flow alignment with ESG factors is generally turning positive.

***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

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

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF

This message was sent from an unmonitored email box. Please do not reply to this message.

.