



CIO OFFICE MORNING MARKET WRAP

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10 seconds summary (long one today): A tech rout in the US, positive flash PMIs, increasingly dovish expectations for the Fed, rate cuts in Canada and China, sharp rally for the yen, Asia in the red, US Q2 GDP report later today and earnings season in full swing.

US stocks suffered their worst day in 18 months yesterday, led by everything tech/AI related, following the previous night's disappointing results from Alphabet and Tesla in particular. The S&P fell -2.3% and the Nasdaq -3.6%, dragging the global DM index to -1.8%. Stocks from emerging regions were down -0.4% as Asia, which is 80% of the market cap, closed before the US rout. The fixed income asset class was resilient. US Treasury yields were steady on durations above 5 years but lower on 12-month, to 4.84%, and 2-year, shedding 5 basis points to 4.43% on more dovish Fed expectations. The dollar was weaker, mostly against a booming yen. Gold dropped -0.5% to below \$2,400 and the price of Brent crude oil was steady at \$81.7.

Tesla lost -12%, Nvidia -7%, Meta -6% and Google -5%, in a day. This illustrates the fact that when valuations reflect a perfect scenario for the long-term, there is no margin of safety for adverse events in the short-term. Last week was tough for tech, between trade restrictions on semiconductors and a giant IT outage, and the first quarterly earnings from two of the Magnificent 7 were not good enough to restore enthusiasm. Tech is not alone: UPS, LVMH, Ford last night and even Visa to some extent disappointed on their quarterly reports, while the uncertainties from US politics add to risk-aversion. At this stage, this is not a fundamental shift, but a logical outcome: perfect valuation and unanimous positioning hit by doubts from events and numbers. Still, the AI complex didn't suddenly become cheap, and it still requires good news, especially from the five other magnificent 7, to stay the course. The combination of rich valuations with expected volatility is, again, precisely the reason why we cut our overweight equities to neutral earlier in July in our mid-year review. It's neutral, not underweight, as the fundamental backdrop remains supportive.

To that extent, it is not deteriorating. Yesterday's flash PMIs were overall supportive. At the composite level, 52.6 for Japan, 61.4 for India, 52.7 for the UK, even 50.1 for the Eurozone, and finally an impressive 55 for the US are all more than decent. Yes, they highlight regional imbalances and a come-back of US exceptionalism, but the details do not suggest an imminent reversal in the US disinflation trend, and for sure, no imminent recession risk. At the same time, expectations for the Fed are slowly turning more dovish: Fed funds futures price in a cumulative 2.6 cuts (of 25bps each) for the end of the year, and Bill Dudley, former President of the New York Fed, now calls for action as early as next week. The Bank of Canada is leading the charge on easing, with a second rate cut last night for a second consecutive monthly meeting. The weakness of the Eurozone economy also clearly supports another ECB cut in September.

Now switching to Asia, starting with central banks. China's PBOC just unexpectedly cut their one-year policy rate by 20 basis points, after having also surprised with a cut on a shorter-term instrument on Monday. This confirms the fact that if the Third Plenum was not a catalyst by itself, the absence of complacency in the communique was an indication that the authorities have no intention to give up. In their strategic wisdom, they will certainly not do anything big on the fiscal side before knowing the name of the next US President. They start with monetary easing. The other Asian giant is obviously Japan where markets are increasingly expecting the BoJ to hike interest rates next week. The consequence is a dramatic appreciation of the yen, which literally jumped from almost 162 for a dollar less than two weeks ago to 152.4 as we write today – with more than half of this +6% move happening in the last 72 hours, and +1% just today. There are two drivers. The first one is simply fundamental: between a more dovish Fed and a more hawkish BoJ, the rate differential is getting less favorable. The second is about positioning and risk-aversion: the yen carry trade, i.e. borrowing in yen to invest in dollar, is massive and suddenly becoming perilous, hence an accelerated unwinding. The yen looks undervalued on a fundamental basis for the long-run, however the magnitude of the current move is brutal. Let's hope that it doesn't turn into outright panic with consequences for "carry traders", including Japanese banks.

All Asian stock markets are unsurprisingly in the red as we write this morning. The Nikkei is down almost -3%, as a strong yen amplifies the overall risk aversion mood. Stocks are down -1.5% in Hong-Kong and Korea, -0.7% in India and -0.5% in onshore China. Bonds are sought after. In Tokyo trading, the US 10-year is down -2 basis points to 4.26% and the 5-year is -4bps lower at 4.13%. The dollar is weaker (again, mostly due to the yen), but gold sees profit taking, down -1% to \$2,374, and major crypto are suffering with bitcoin at \$64k and ether down -6% to \$3,160. Finally, the barrel of Brent trades down -0.8% at just \$81.

Today we'll have the first estimate of US Q2 GDP, a quarterly report that also includes personal consumption and core PCE. The earnings season will continue, with big pharma in particular (Abbvie, Astra, Roche), as well as Hermes in luxury (interesting to compare with LVMH) or Nestle in staples (will they be as good as Coca Cola?).

Have a great day!

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