Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio

As of 31/10/2024

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Market Review

Historically, October has been the most volatile month of the year for the stock market, followed by November, and then March. The average standard deviation of the Dow Jones Industrial in October is 34% higher than the average across all twelve months, going back to the inception of the benchmark, in 1896. 2024 was no exception to the rule, with the caveat that volatility manifested not only in equities, but also in fixed income. In fact, both the VIX Index, the measure which estimates the expected volatility of the S&P 500, and the MOVE Index, which calculates the future volatility in US Treasury yields implied by the option market, recorded their highest monthly closes since October 2022 and May 2023, at 23.16 and 135.18 respectively. The heightened volatility was primarily caused by politics. It turned out that the much anticipated "October surprise" was, in the end, the unexpected skewing of election odds in Trump's favour observed in polls and betting markets during the month. Whether the renewed momentum for the former 45th president was due to a genuine resurgence in his support or to the fading of the initial enthusiasm aroused by the candidacy of Harris, mainstream media outlets acknowledged the trend, with multiple reports of "confidence" growing among Republicans and "panic" spreading among Democrats.

According to the polling aggregator RealClearPolling, at the end of October Trump was marginally leading the race 48.4% Vs. 48.1%, having mounted a comeback from 47.3% Vs. 49.1% recorded one month before. Prediction markets were exhibiting an even higher advantage, with PredictIt at 55% Vs. 49% (from 49% Vs. 55% at the end of September) and Polymarket at 62.4% Vs. 37.6% (from 49% Vs. 49.7%). However, on October 18th, the Wall Street Journal ran an article positing that Trump's gains on the latter, crypto-based platform, might have been a "mirage" manufactured by a single, large bettor wagering that Trump would win the presidency, the popular vote and the so-called "blue wall" swing states of Pennsylvania, Michigan and Wisconsin. One week later, Polymarket identified the "Trump whale", whose "directional position" on the election had in the meantime swelled to 45 million USD, as a French trader with "extensive trading experience and a financial services background" acting "on personal views" and not attempting to manipulate the exchange. Polymarket has not been accessible to US based users since 2022, but it appears that the ban may be circumvented using virtual private networks (VPNs). Nonetheless, financial markets took those probabilities at face value, embracing the "Trump trade" and the prospects of a "Republican clean sweep" with abandon. Investors propelled gold to new all-time highs and Bitcoin above 70,000 USD. The Dollar Index (DXY) jumped the most since September 2022 as US breakeven inflation rates, calculated as the difference between the yield of a nominal bond and that of inflation-linked bond of the same maturity, shot up across the curve.

If the pressure coming from the (concrete) possibility of Trump retaking the White House was not enough, fixed income markets had also to contend with the first Autumn budget delivered by the newly elected UK's Labour government. On October 30th, the Chancellor of the Exchequer Rachel Reeves unveiled 40 billion GBP in tax rises per year, pledging to "rebuild Britain". However, she also announced plans to borrow an additional 70 billion GBP, that is, just over 2% of economic output, over the next 5 years to "invest, invest, invest". As a result, the UK Debt Management Office (UK DMO) revised the country's financing needs for the coming 2024/25 financial year up by 23 billion GBP from the Spring budget, equivalent to 5.7% of GDP. Sales of government bonds were projected to reach their second-highest level on record at roughly 300 billion GBP, only behind the pandemic peak of 2020/21, and almost double the average issuance seen in non-crisis years over the past two decades. In order to avoid a repeat of the "mini-budget" disaster that occurred in September 2022, the Office for Budget Responsibility (OBR) independently assessed the economic plan in advance and released a detailed forecast report about it. However, the public body concluded that the "large, sustained increase in spending, tax and borrowing" is likely to result in an unchanged trajectory of economic growth in the medium term, coupled with slightly higher inflation and lower wages. Investors balked at the prospects of such little value for money and voted with their feet by selling UK debt, prompting a spike in UK government bond yields and a decline in the Pound Sterling.

International Equities.

US equities ended October modestly in the red. The S&P 500 (-0.99%) and the Dow Jones Industrial (-1.34%) gave back gains after having broken to new all-time highs in the first half of the month, while the Nasdaq 100 (-0.85%) continued to hover around the 20,000 level. The "Magnificent Seven" curbed losses, outperforming the rest of the market for the second month in a row on the back of the explosive move higher in Tesla and the solid returns posted by Nvidia and Alphabet. The S&P 500 Low Volatility TR bested the S&P 500 High Beta as the latter was dragged lower by semiconductor stocks. The "Trump trade" was noticeable even in the context of a generally "risk-off" tone across markets. Investors rotated away from defensives and rushed into cyclicals. Financials were the main beneficiaries, with regional banks propelling the sector higher, although real estate fell sharply. Communication services and energy bucked the trend, while consumer staples and healthcare bore the brunt of the selloff.

The "American exceptionalism" theme regained steam as US equities strongly outperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the month. All major regions were up in AUD terms in October, with the only exception being Europe. Within the Old Continent, the "periphery" outperformed the "core" both financially and economically. Volkswagen revealed that it plans to close three factories in Germany, a move unprecedented in the brand's history and potentially leading to tens of thousands of layoffs. Taiwan was the best performing emerging market in October, buoyed by Taiwan Semiconductor Manufacturing Company (TSMC). Conversely, Chinese stocks slid as optimism faded; in addition, the European Union (EU) approved additional tariffs of up to 35% on imports of electric vehicles from the country, on top of the EU's standard 10% car import duty. The Japanese Yen (JPY) fell vis-à-vis the greenback by the most since April 2022 after the longtime ruling LDP-Komeito coalition lost its majority in the Lower House, jeopardizing Ishiba's hold on power. The newly elected Prime Minister himself had called for a snap election but will now have to win allies to secure his position. All in all, the MSCI AC World Daily TR was down -2.24% in USD terms, but up +3.28% in AUD terms.

Australian Equities

Australian equities strongly underperformed their international peers in October in AUD terms, with the MSCI Daily TR Net Australia lagging the MSCI AC World Daily TR by almost 500 Bps, the largest gap since February 2024. The S&P/ASX 200 notched another all-time high mid-month, before succumbing to global uncertainty. The S&P/ASX 300 shed -1.30%, with most sectors suffering steep losses ranging from -4% to -7%. Utilities, consumer staples, resources, technology and consumer discretionary tumbled, while financials, healthcare and telecom bucked the trend. Banks rallied smartly despite expectations of muted results, as the rotation to resources occurred in September on the back of China's stimulus package petered out and reversed. Miners tracked iron ore and copper lower. Index heavyweights AUB Group and QBE Insurance boosted returns for insurance, while Goodman Group weighed on A-REITs. The Top 20 outperformed mid-caps, but trailed smaller companies, while value stocks bested growth stocks.

International Fixed Income

Global central banks cut by a cumulative 125 Bps during the month. On October 9th, the Reserve Bank of New Zealand (RBNZ) lowered its Official Cash Rate (OCR) by 50 Bps, from 5.25% to 4.75%. The widely anticipated decision marks a step-up in the pace of the easing cycle following its kick-off in August. Inflation had decelerated to +2.2% at the end of Q3 and several economists expect it to undershoot below the 2% midpoint as the domestic economy stalls on the back of rising unemployment and falling housing prices. On October 17th, the European Central Bank (ECB) lowered its policy interest rate for the third time, from 3.50% to 3.25%. The European Union Harmonised Indices of Consumer Prices (EU HICP) came out at +1.7% YoY for September, helped by falling energy prices, but it is expected to accelerate over the coming quarter on base effects. On October 23rd, the Bank of Canada (BOC) slashed its benchmark overnight rate by 50 Bps from 4.25% to 3.75%, its first jumbo cut since March 2020, and the fourth consecutive reduction since June. Governor Tiff Macklem declared the end of the post-pandemic, high price increases era and stated that the focus of the central bank will now be on maintaining “low, stable inflation” to “stick the landing”. Among major global central banks that met during the month, only the Bank of Japan (BOJ) left interest rates unchanged.

Global yields rose sharply in October, as bond markets digested the 50 Bps cut administered by the FED in September and its potential positive ramifications for growth, the increased odds of a Trump victory and the bloated financing needs of the UK government. The movement was partly compensated by spreads on US investment-grade bonds reaching their tightest level since 2005. The Bloomberg Barclays Global Aggregate Index hedged back to AUD dropped the most since April, down -1.51% for the month.

Australian Fixed Income

On October 8th, the RBA released the minutes of the meeting it held back in September. They revealed that, on that occasion, the central bank did not consider a rate hike due to weak economic growth and the risk that households may save most of their gains from government tax cuts. On October 17th, the Australian Bureau of Statistics (ABS) reported that the unemployment rate had remained steady at +4.1% in September, missing market estimates of an increase to +4.2%. The labour market continued to exhibit strength as the domestic economy added more jobs than expected, the participation rate reached a new record, and hours worked soared. The Australian yield curve bear steepened, with the 2-, 5- and 10-year yields jumping 40 Bps, 54 Bps and 53 Bps to 4.04%, 4.12% and 4.50% respectively. At the end of the month, the cash futures had moved to push out to Q2 2025 the first cut. The Bloomberg AusBond Composite 0+ Yr fell -1.88% for the month, but it was still in positive territory since the beginning of the year. The Australian Dollar weakened across the board, dropping vis-à-vis the greenback by the most since September 2022.

Real Assets

Global property tumbled -4.86% in USD terms but added +0.53% in AUD terms in October. The US was the only region to outperform the general index on the back of healthy earnings and despite the rate for a 30-year US home fixed mortgage jumping 60 Bps above 7%. Sector-wise, the positive momentum in data centres and healthcare persisted.

Global infrastructure declined -1.06% in USD terms but rose +4.55% in AUD terms for the month. Energy infrastructure, mid-stream in particular, was the best performing segment while communication infrastructure, UK utilities and transportation stocks lagged. During the month, Google and California’s Kairos Power signed a landmark deal to develop a fleet of small modular nuclear reactors to meet the power needs of AI.

Alternatives

Alternatives (-0.77%) declined in October, with performance dispersion decreasing during the month. Losses were widespread across strategic mandates. CTA and managed futures were hammered by their ill-timed long bond positions and reversed to short.

Market Outlook

Trump won the 2024 election with 312 electoral votes and 50.1% of the national popular vote at the time of writing of this note (November 19th), beating Kamala Harris decisively on both fronts. In a race that was projected to be extremely close, she earned close to 7 million fewer votes than Biden in 2020, securing only 226 electoral votes and 48.3% of the national popular vote. In the end, it was a Red Sweep. Trump managed to succeed in all 7 so-called “swing states”, Republicans regained control of the Senate and maintained the majority in the House. The response of US equities has been euphoric, with all major averages breaking to new all-time highs. According to State Street Global Advisors, a “monumental” 22 billion USD flowed into US-listed ETFs on November 6th, “shattering” the previous 4 billion USD record inflow seen in 2020 on the day after Biden was elected. Amidst the volatility, US yields appear to have settled on levels 10-20 Bps higher than those prevailing at the beginning of November. The Dollar Index (DXY) has shot up to the same heights it reached back in October 2023, at the peak of the bond hysteria ignited by the “higher for longer” narrative. Since election day, investors have been pulling money from the Rest of the World (RoW), prompting assets denominated in currencies other than the USD to post outright losses and massively underperform vis-à-vis the US. It is speculated that the election of Trump will bring back the “Roaring 20s” for US stocks and that the “American Exceptionalism” that characterized the 2010s will extend into the 2030s. If that thesis is correct, the US will continue to attract capital from all over the world on the back of superior economic growth induced by procylical deficit spending, tax cuts and deregulation, superior earnings growth, higher interest rates and a strong greenback.

In our opinion, the market movements that followed the election primarily reflect the unwind of hedges against political risk and a (potential) short-term improvement in fundamentals, and not necessarily the long-term ramifications of a “Trump 2.0” administration. In fact, consensus had it that the winner would have not been known for days after the polls closed; in addition, the possibility of another contested election was not insignificant. Instead, results were timely and unequivocal, triggering a wash-out of “risk-off” positions, with both the VIX and the MOVE indices shedding one-third of their values in a few sessions. The “volatility crush” ignited a powerful rally as traders mechanically chased the market higher. Moreover, the election of Trump removed the uncertainty surrounding the impending renewal of the Tax Cuts and Jobs Act (TCJA) that he enacted during his first presidency and that is due to expire in 2025. Industry analysts now expect those “temporary” tax breaks to be made permanent, and the corporate tax rate to be further reduced from 21% to 15%. Those measures alone could be worth a 5-6% increase in the operating earnings of the S&P 500 in both 2025 and 2026, translating to a further 5-10% upside for the benchmark, all things equal. In other words, the stock market ebullience appears to be backed by numbers and not to be just a sigh of relief. On the economic side, the victory of Trump builds on the commitment to preserve and prolong the expansion announced by the FED in September, offering more reassurance that the US economy will not enter a recession soon. As a result, the repricing of the yield curve initiated by the jumbo 50 Bps cut persisted, bringing the 10-year yield to 4.5%. We think that the latter level is consistent with an economy that was growing at +4.9% YoY in nominal terms at the end of Q3, and that will continue to do so in the future as both the central bank and the new president provide support via the monetary and the fiscal channels. When the 10-year yield reached 3.60% ahead of the penultimate FOMC meeting, we thought that it was fully pricing in a “soft landing”, and that a more serious deterioration of the economy was required to bring it lower. Fast forward to today, we think that 4.5%-5% is appropriate for an economy maintaining the current rate of growth and inflation, even assuming that, as it seems more and more likely, the US CPI will not return back to its 2% target.

In short, while US markets do not appear to have overreacted to the news, lots of positives are already in the prices. In the fixed income space, recession hedges have been lifted. In the equity space, investors have positioned for increased productivity and record profits. The US Dollar, which had softened during the summer, has reversed its course and it is almost 7% higher than it was just 2 months ago. Which begs the question: where do we go from here? One widely held view that finds us unconvinced is that of Trump fuelling the fire of inflation by significantly increasing the budget deficit. We certainly expect him to be a big spender, but we caution that conditions today are vastly different from 2017, when he was first inaugurated. Back then, the US economy was emerging from what, in hindsight, became known as the “austerity of the Obama years”. Federal spending, which had ballooned to around 24% of GDP in 2009 following the GFC, was steadily reduced between 2010 and 2016 and brought back to 20%, its historical norm. In practical terms, the budget deficit was cut from a peak of 1.4 trillion USD to 587.3 billion USD (-58.1%), and government outlays rose only marginally, from 3.6 trillion USD to 3.8 trillion USD (+5.5%) over that period of time. In plain English, the so-called “fiscal impulse” was negative for most of the Obama’s presidency, and when Trump was elected, he reversed that situation by breaking with tradition and starting to procyclically (that is, outside of a recession) stimulate the economy.

Biden and the Democrats stole his playbook in 2020 and took it to its extremes with the aim of running the economy hot to keep unemployment low. Government outlays jumped to 6.5 trillion USD in 2020 (under Trump) following the pandemic, equal to 30% of GDP, but never got back to 20% as “Bidenomics” kicked in, providing generous funding and subsidies for investments in American infrastructure and advanced industries. The price to pay for such largesse was a sustained increase in the cost of living. At the end of September, government outlays totalled 6.7 trillion USD, equivalent to 23% of GDP, and the budget deficit was 1.8 trillion USD, one-third larger than it was back in 2022.

Considering the current, exorbitant level of public spending and the fact that, according to multiple surveys, high prices cost the Democrats the election, we deem unlikely that the “second coming” of Trump will have the same impact as the first one. If anything, we suspect that, in 2025, we may experience a negative fiscal impulse once again, that is, a budget deficit that remains elevated, but it is marginally lower than that of the year before. If the ideal scenario for Trump is that tariffs on trade partners and the increased productivity resulting from deregulation will pay for tax cuts, the only way he can try to normalize the size of the US government relative to GDP is by reducing spending. In fact, the positive effects of those reforms (if any) will take time to manifest. Putting it all together, the risk/reward for equities going into the back end of the year seems less compelling to us, although we do not see particular reasons to reduce our exposure to growth assets too far ahead of time. We are comfortable maintaining a fixed income exposure characterized by a duration comparable to that of the benchmark. The carry remains attractive, and more so after the recent, significant boost. Besides, we expect the FED to cut by another cumulative 50 Bps and bring its target rate to a range of 4.00%-4.25% by March 2025. While the outlook for growth has improved, it may not have to the extent projected; conversely, we contend that the inflation risk has not materially increased, and that markets may be overestimating it, at least at the current juncture.

AZ Sestante

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Important information

The Morningstar Historical Corporate Sustainability Score is a weighted average of the trailing 12 months of Morningstar Portfolio Corporate Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, more-recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.

ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.