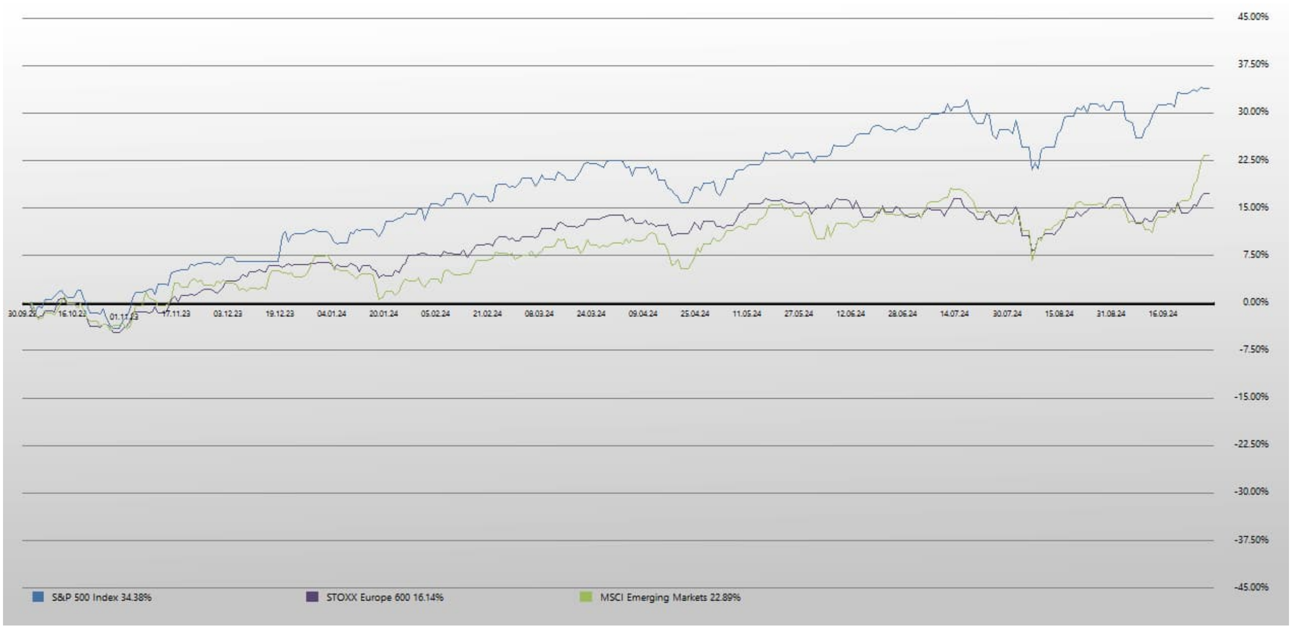
Kestrel
Wealth Management

Quarterly Financial Market Update, September 2024

Financial assets did well in the third quarter of the year. Overall, the markets presented similar characteristics to the second quarter, i.e. asset prices ending the quarter higher, though with brief intense risk-off periods from investors. Over the next months, we believe this kind of steep rollercoaster ride will continue, tilted upward thanks to more accommodating monetary policies from central banks, such as the US Federal Reserve.

In this context, global equities gained 6.21% in the third quarter (3Q). For once, emerging markets (up 7.79%) were the best performers after the release of supportive economic measures from the Chinese government and from the People's Bank of China. Elsewhere in the world, the S&P 500 Index increased 5.53%, whilst the STOXX Europe 600 Index rose by 2.24%.

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

Our investment strategy remains as is. On the equity side we are keeping our overweighted positioning. On the bond side, we are maintaining our neutral stance, focusing on Investment Grade debtors amid a weakening macroeconomic environment. Thus, we avoid the High Yield segment, i.e. the low quality debtors. The risks to our strategy are mainly linked to the state of the US economy, the evolution of the wars in Ukraine and in the Middle East and to a lesser extent, the US presidential election.

Regarding the latter, as said in the past, we do not believe a new government could change the underlying fundamentals of the US economy, unless there is a tsunami from a party overwhelming all US institutions. A new government could change the US foreign policy though, which in turn could alter the evolution of the wars for example.

On that particular matter, geopolitical tensions and open conflicts have not evolved for the better unfortunately. In Eastern Europe, Ukraine has launched an incursion into Russian territory in the Kursk region in order to start a new front in an attempt to remove some of the pressure from its troops elsewhere and to drive Mr. Putin to offer terms.
In the Middle East, Tzahal continued its bombing of the Gaza strip vs. Hamas and started also in Lebanon vs. Hezbollah. Furthermore, as we write these lines, Iran attacked Israel with missiles in response to the killing of political leaders, opening the door now to severe retaliation measures from Israel.

As we are not experts in geopolitics, we will not develop on any potential evolution of these conflicts and what kind of new world order (if any) will emerge from them. However, as they do not seem to be ending anytime soon, we advise investors to have diversified portfolios in terms of sectors and geographies, but also to build defensive pockets through Investment Grade bonds, where the investment strategy allows it.
Stay invested though. Indeed, as long as these wars do not affect something vital for the world's economy, such as oil supply or trade routes, we believe the global environment remains supportive for risky assets, such as equities. Gold could also be seen as a hedge. However, trading above USD 2'600.-/oz. we do not advise to chase the precious metal. Gold price increased 13.23% in the third quarter.

The US economy continued to weaken during the quarter. For example, the ISM Manufacturing Index remained firmly below the 50-level, at 47.2, thus indicating an economic contraction. Furthermore, the labour market showed lower-than-expected readings, igniting periods of significant weakness in stock prices in early August and early September. Indeed, a weakening employment increased investors' fears over a hard-landing of the US economy, before being reassured by the release of more positive data, such as an inflation rate remaining on a downtrend, for example. All taken into account, a soft-landing of the US economy remains the most likely scenario going forward.

Importantly, this environment comforted the US Federal Reserve (the Fed) to become more accommodating, lowering by 50 bps its benchmark interest rate. The Fed cut the upper bound from 5.50% to 5.00% and the lower bound from 5.25% to 4.75%. This surpassed expectations calling for a 25 bps-reduction. In addition, Jerome Powell's speech accompanying the press release also hinted at further rate cuts in the future, reducing the likelihood of a severe recession in the US.

This move has not only supported the equity markets, but also bond prices during the quarter. On a global basis, bond prices moved up by 6.98%. Lower benchmark rates led to fast-declining short-term interest rates in the US. It should continue and ultimately end up with a normalisation of the yield curve, i.e. with long-term interest rates higher than short-term ones. This process has started with, for example, the yield on the 2-years US government bond declining 111 bps to 3.64% vs. the yield on the 10-years US government bond declining 61 bps to 3.78%.

The lower interest rates and the concerns over the economy weakened the US dollar in 3Q against other major currencies. The US Dollar Index, a measure that indicates the general international value of the USD, lost 4.81%. This was particularly true vs. the Swiss franc, against which the greenback lost close to 6%, as investors sought a strong currency.

In today's world where so many variables on the economic, politics and geopolitics fronts are at play, we believe it is paramount to remain focused on what is quantifiable and what can be reasonably expected. Although easier said than done, emotions should be removed as much as possible from the investment rationale, allowing to climb over the wall of worry.