Perspectives

Flash Comment

Swiss Life Asset Managers

7 August 2024

Summer storm on financial markets

What has happened?

- After a positive July, financial market sentiment reversed abruptly at the beginning of August.
- What started with a correction on the Japanese equity market on 1 August ended up engulfing global financial markets.
- Although no single event triggered this correction, the combination of weaker-than-expected US labour market data, uninspiring earnings and outlooks by US companies and the unexpected policy rate increase in Japan rattled investors and led to a sharp correction on equity markets, wider credit spreads and a significant fall in bond yields.

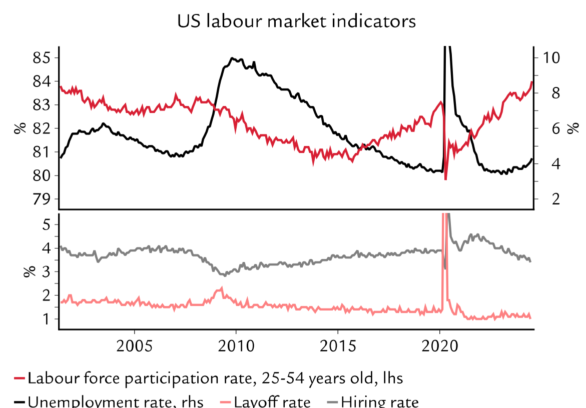
Our economic assessment

- The unexpected increase in the US unemployment rate from 4.1% in June to 4.3% in July led to worries that the US economy is on the brink of recession.
- A moderation of the excessively high US consumption growth and a looser labour market have always been part of our base case scenario for 2024. So it is not rising unemployment per se that is concerning, but rather the recent speed at which it has increased.
- Encouragingly, it is not increased "firing" that is pushing up unemployment, but reduced hiring amid a surge in labour force participation (see chart). The latter is not necessarily a bad sign for the economy. Furthermore, negative effects from Hurricane Beryl might have impacted the July data.
- Also, the unemployment rate is currently the only indicator showing pronounced weakness. The payrolls survey indicated that the US economy was adding jobs in July, although at a slow pace. Meanwhile, purchasing managers' indices suggest that the services sector was still doing fine in July.
- The biggest risk is that the "recession scare" might start to weigh on consumer and corporate sentiment and thus initiate a negative economic feedback loop. Monetary policy easing is key to alleviate these concerns. We expect the US central bank to start a policy rate cutting cycle in September.

Our market assessment

- The ongoing correction has potentially been amplified by the seasonal thin market liquidity, implying that we could see a rebound in the short term. However, the fundamentals remain weak, as the moves were insufficient to correct the high valuation of equities and credits.
- We therefore expect continued volatility on financial markets. Equity markets are likely to continue their rotation in favour of cheaper regions, sectors, and market segments. Corporate bonds and high yield spreads might widen further. Yield levels are likely to fall slightly, although the significant drop over the last days might limit the downside potential. On the currency front, we see limits to a further appreciation of CHF relative to EUR and USD, as the SNB might intervene. After the move up, we see no further upside potential for EUR/USD as lower rates in USD will likely be matched by lower EUR rates.
- The market's focus on the risk of an economic slowdown led to a modest decline in oil prices, despite the risk of a further escalation in the Middle East. Any such escalation would introduce an additional element of volatility that would, in our view, hurt European markets in particular.

US labour market: less hiring amid rising participation



Sources: Macrobond, Swiss Life Asset Managers. Last data point: 07/2024

Swiss Life Asset Managers

José Antonio Blanco
CIO Third Party Asset Management
Head Multi Asset
joseantonio.blanco@swisslife-am.com

Damian Künzi
Head Macroeconomic Research
damian.kuenzi@swisslife-am.com
@kunzi_damian

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please send an email to: info@swisslife-am.com.
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