Market Commentary

Dart Capital

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Most equity markets enjoyed a positive month, with particularly strong gains from small- and mid-cap indices, with US large-cap stocks the only major laggard.

Market dynamics

Having been dominated by US technology stocks over the prior six weeks, July saw a rotation in equity market leadership, with small- and mid-cap stocks in particular outperforming in both the US and UK, aided by the prospect of interest rate cuts which helped bolster sentiment. In contrast, the technology sector lagged amidst growing questions about the likely profitability of the huge capex on data centres and graphics chips by these mega-cap technology companies.

UK

The election at the start of the month saw, as most expected, Labour gain a large majority in the General Election, with domestic asset markets generally reacting positively to the prospect of greater stability, particularly when compared to the political upheaval in the US and several of the major economies in the Eurozone. UK inflation was slightly above economist expectations, with the annual rate remaining at 2% in the 12 months to the end of June.[1] This was in large part due to services sector inflation remaining elevated at 5.6% year-on-year[1], again largely due to price increases in the hospitality & entertainment sector. Cost pressure has remained elevated in this sector, and companies have retained power to raise prices amidst resilient consumer demand. Following the end of the month, the Bank of England's meeting on the first day of August saw the Monetary Policy Committee vote 5-4 in favour of a 25 bps cut in the base rate to 5%.[2] However, the minutes from the meeting and Governor Andrew Bailey's comments indicate that they're in no rush to cut rates aggressively, with the Committee remaining sensitive to the, aforementioned, elevated inflation in the services sector.

UK equities performed well amidst the rotation towards cyclical sectors, with MSCI UK All-Cap gaining 3.1% in price return terms.[3]

US

The run-up to the US election has been nothing but eventful so far, with incumbent President Joe Biden withdrawing from the race and current Vice President Kamala Harris set to be the Democrat candidate to face Donald Trump, who suffered an assassination attempt over the month. As Trump is the current favourite, economists have been warily eyeing up his plans for significant increases in tariffs, which would be detrimental for global growth and supressing US inflation. The Federal Reserve's monetary policy committee, the FOMC, took place on the last day of the month and saw the minutes of the meeting refer to the weakening of the labour market, and removed references to the strong economy, with this change in language seen as setting the scene for an interest rate cut at the next meeting in mid-September.

The outperformance of smaller companies was the most marked in the US market, with the smaller companies Russell 2000 index, gaining c.11% over the month in price return US Dollar terms, whereas the large-cap S&P 500 was only up 1% on the same basis.[3]

Europe

The French election of early July saw neither of the three major parties gain a majority, with the country now expected to have a period of policy paralysis until the 2027 Presidential election. The German economy has continued to struggle, with its important manufacturing sector struggling with cheap Chinese competition in key industries, such as car manufacturing. The initial estimate for Eurozone inflation was above economist expectations, with inflation in the 12 months to July reported as 2.6%, up from 2.5% in the prior month.[4] European equities, as represented by MSCI Europe ex-UK gaining 0.5% in local currency terms.[3]

Asia

The Bank of Japan's surprise decision to raise the base rate in their meeting caused significant market upheaval late in the month, with the Yen initially rallying strongly, a move which in turn forced leveraged currency speculators who had been short the Yen to close their positions, which then drove further gains in the Japanese currency. The Yen gained 6.5% against the US Dollar over the month,[3] with the rally in the currency causing a drag on the equity market, with MSCI Japan ending the month down 1% in local currency terms.[3] The start of August has seen a continued rally in the Yen, as the unwind of short positions against the Yen has continued. The Third Plenum of the Chinese government failed to deliver significant support for markets, with few concrete policy proposals which will help support the economy. This weighed on Chinese stocks, with MSCI China H ending the month down 5.5% in local currency terms.[3]

August's moves

Having made good progress over July, global equity markets saw significant upheaval over the first few trading days of August, with a sharp sell-off across global markets, before rebounding somewhat over the second half of the week following supportive comments from the Japanese Central Bank. US economic data played a role in unsettling markets, with the very weak data - released at the start of the month - from the manufacturing sector and labour market particularly notable, with the latter seeing a sharp slowing of new hiring.

The other factor has been the large rally in the Japanese Yen, which has continued following the Bank of Japan's decision to raise interest rates at the end of July. As noted above, the move in the Yen is notable because many traders have been borrowing in Yen and investing in higher yielding currencies and assets, with the rally in the Yen causing them to close these positions and sell holdings in other assets, in particular equities. The rally in the Yen has since moderated, as the Governor of the Bank of Japan publicly noting that they will not raise interest rates further during periods of market upheaval.

1.. *Office of National Statistics (ONS)*
2: *Bank of England*
3. *FE Analytics*
4. *Eurostat*
5. *Thomson Reuters*