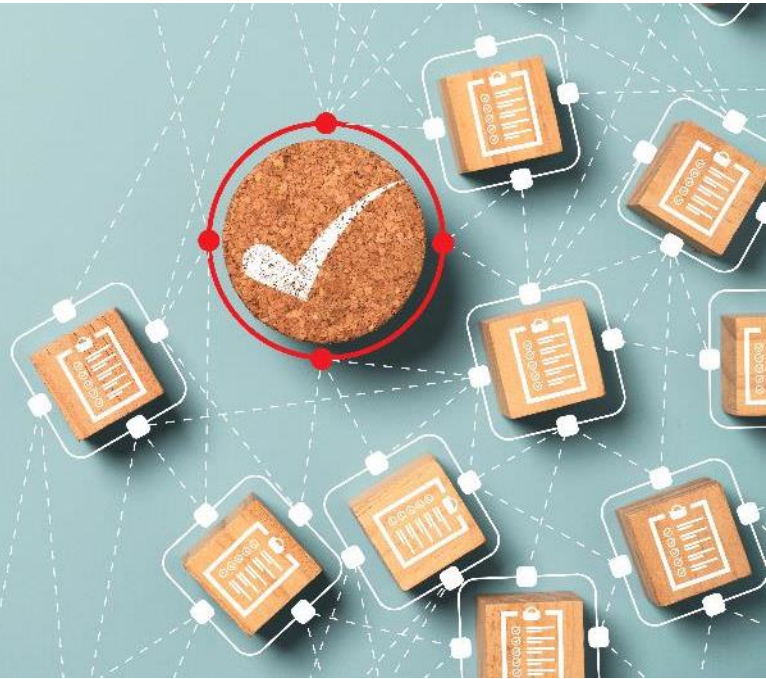


## FUNDAMENTAL FLASH

# Three Questions After the August Selloff

Prepared by AHAM Asset Management



### What Happened?

Following the torrid meltdown that marred the beginning of August, a sense of calm has returned to markets.

The sharp pullback on 5 August, which will be ominously remembered as another “Black Monday” was largely driven by the unwinding of the Japanese yen carry trade, where investors had placed heavy bets on a weaker yen.

This had caused severe dislocation in financial markets and battered global stocks as investors ditched their short yen positions.

However, the worst now appears to be over. According to research by JP Morgan, approximately 75% of these global carry trades have been unwound.

While the first leg of the pullback appears to have run its course, the second leg which is the risk of a US recession remains more difficult to predict.

The US economy continues to expand, but the pace has slowed which has fuelled concerns about a potential downturn.

One of the key indicators we are watching closely is the US labour market, especially weekly unemployment claim. In our view, this data point is timely and less prone to noise which makes it a reliable gauge. A sustained rise in unemployment claims could signal a weakening economy and heighten risks of a recession..

### Flashpoints

- The sharp pullback in early August was largely driven by the unwinding of the Japanese yen carry trade. However, research shows that the bulk of the short yen positions has been unwound.
- While the US economy is still growing, the pace has slowed, raising concerns about a potential recession
- The bond market is expecting a 50 bps rate cut by the Fed in September, with easing inflation paving the way for potential rate reductions.
- Any weakness in Asian equities due to a US recession is likely to be short-lived, with a weaker US dollar potentially supporting domestic economies and consumption.
- Upcoming US Presidential election could pose volatility, but the ongoing trend of trade diversification away from China is expected to continue.

**What's Next?**

All eyes are now on the US Federal Reserve (Fed) next move in its upcoming FOMC meeting in September. Though expectations have been tempered, bond markets are pencilling in a 50 bps rate cut by the Fed.

Easing inflation as reflected by recent Consumer Price Index (CPI) prints would help clear the path for the Fed to cut interest rates. This would lead to lower borrowing costs that would also provide some relief for US corporates and consumers.

While a US recession could have the potential to drag down exports and impact key sectors in Asia, we believe that any potential weakness in Asian equities would be short-lived.

Falling interest rates often leads to a weaker US dollar that could act as a countervailing force to pressure seen in Asian markets by bolstering domestic economies across the region. For instance, a weaker US dollar could lead to lower import costs for Asian countries and support domestic consumption.

While, we cannot rule-out the risk of a hard landing, this isn't our base-case. Labour data including unemployment rates as well as other real economic indicators suggest that US economic growth will soften, but not rapidly plummet. There may be pockets of weakness in more vulnerable household segments, but default rates remain low compared to levels seen during the 2008-GFC.

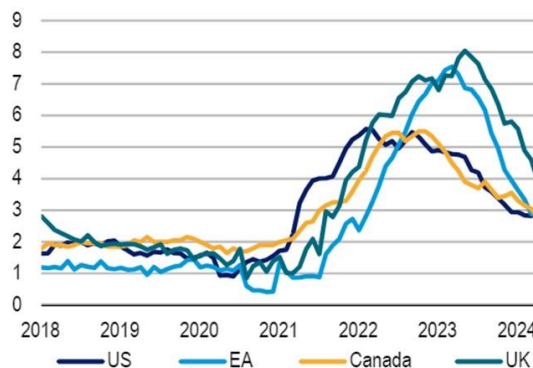
Other flashpoints in the 2H'24 include the possibility of a major escalation in the Middle East should the conflict spread to the rest of the region. This could lead to a disruption of global oil supply, causing a spike in energy prices and stoke inflationary pressures.

In addition, the upcoming US Presidential election in November may pose uncertainty. The election outcome will have far-reaching implications in terms of trade and foreign policy, particularly for Asia.

A second Trump presidency may bring more short-term gyrations for markets based on the former president's history of using aggressive rhetoric as negotiation tactics. However, with the benefit of experience, we can also anticipate that while his statements may generate noise, his actual policy actions tend to be more moderate in nature as he slowly back-pedals on policies.

Nonetheless, whether Trump or Harris wins the election, we expect the ongoing trade diversion theme to continue as global MNCs seek to diversify their supply chains and reduce their dependence on China. Countries such as India, Japan, Taiwan as well as ASEAN countries such as Malaysia are poised to benefit from this trend and may see investment flows.

**US core PCE, Euro area, Canada, UK core CPI (% , yoy)**  
Inflation is much closer to target after falling more than expected last year



Source: Bank of America Research, as of 24 May 2024

**What Investors Can Do?**

By now, last Monday’s selloff that rattled markets may seem more like a tremor as global equities regain back its footing.

It’s important to remember that market selloffs, though often unsettling, can present opportunities especially for investors with a long-term perspective. History has shown that downturns, while challenging in the moment, have the potential to reward disciplined investors who stay the course.

One effective approach during periods of volatility is to gradually average into the market through regular investments over time, regardless of market conditions. By consistently investing, particularly during downturns, investors can take advantage of market dips and lower the purchase price of their investments.

Market volatility is a natural part of the investment journey, and reacting impulsively to short-term market movements often leads to suboptimal decisions. While selling during a downturn can staunch the bleeding in a portfolio, it would also mean crystallising losses which prevents investors from making any future gains when markets recover.

Instead, investors should stick to their investment plan and only invest money they will not need for several years. By maintaining a well-diversified portfolio, investors can ride out the turbulence and stay on track to reach their financial goals.



| Event                   | Market Decline | Subsequent Market Rebound |
|-------------------------|----------------|---------------------------|
| SARS                    | 31%            | 139%                      |
| Global Financial Crisis | -59%           | 78%                       |
| European Debt Crisis    | -16%           | 72%                       |
| Oil Glut                | -18%           | 53%                       |
| COVID-19                | -33%           | 102%                      |

Source: Bloomberg Period: 1 January 2002 until 31 December 2021.

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