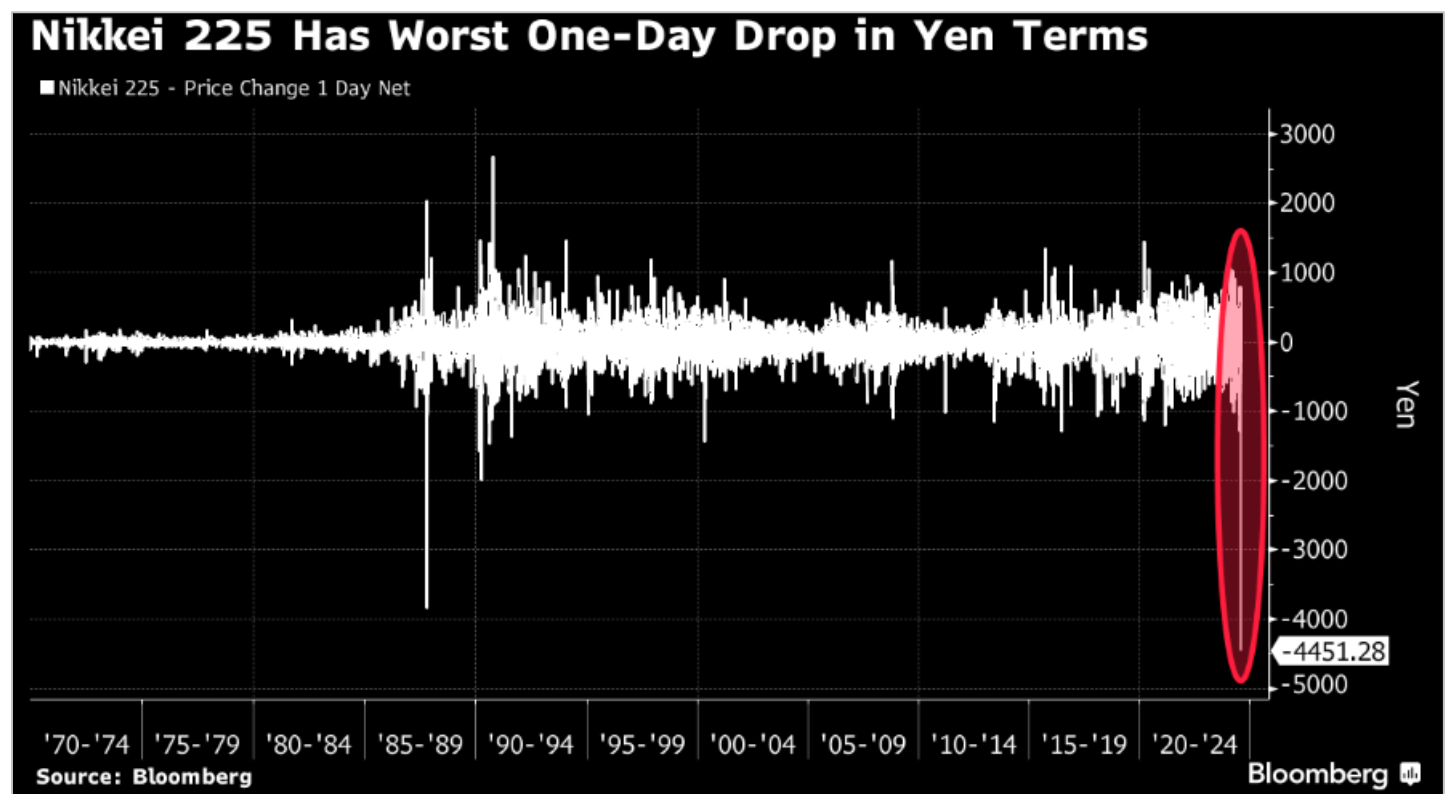


8/5/2024

The week of August 5, 2024, begins with a major global market sell-off following the Bank of Japan's decision to tighten monetary policy for the first time in three decades. As investors brace for the volatility tsunami impacting a cross-section of risky assets (stocks, credit, commodities), greater investor unease and a slowing U.S. economy could be enough to prompt the Federal Reserve to adopt a more aggressive schedule for cutting interest rates and loosening monetary policy. As such, investors may be given a narrow window to add on market risk if financial contagion doesn't spread nor does the global economy fall into recession.

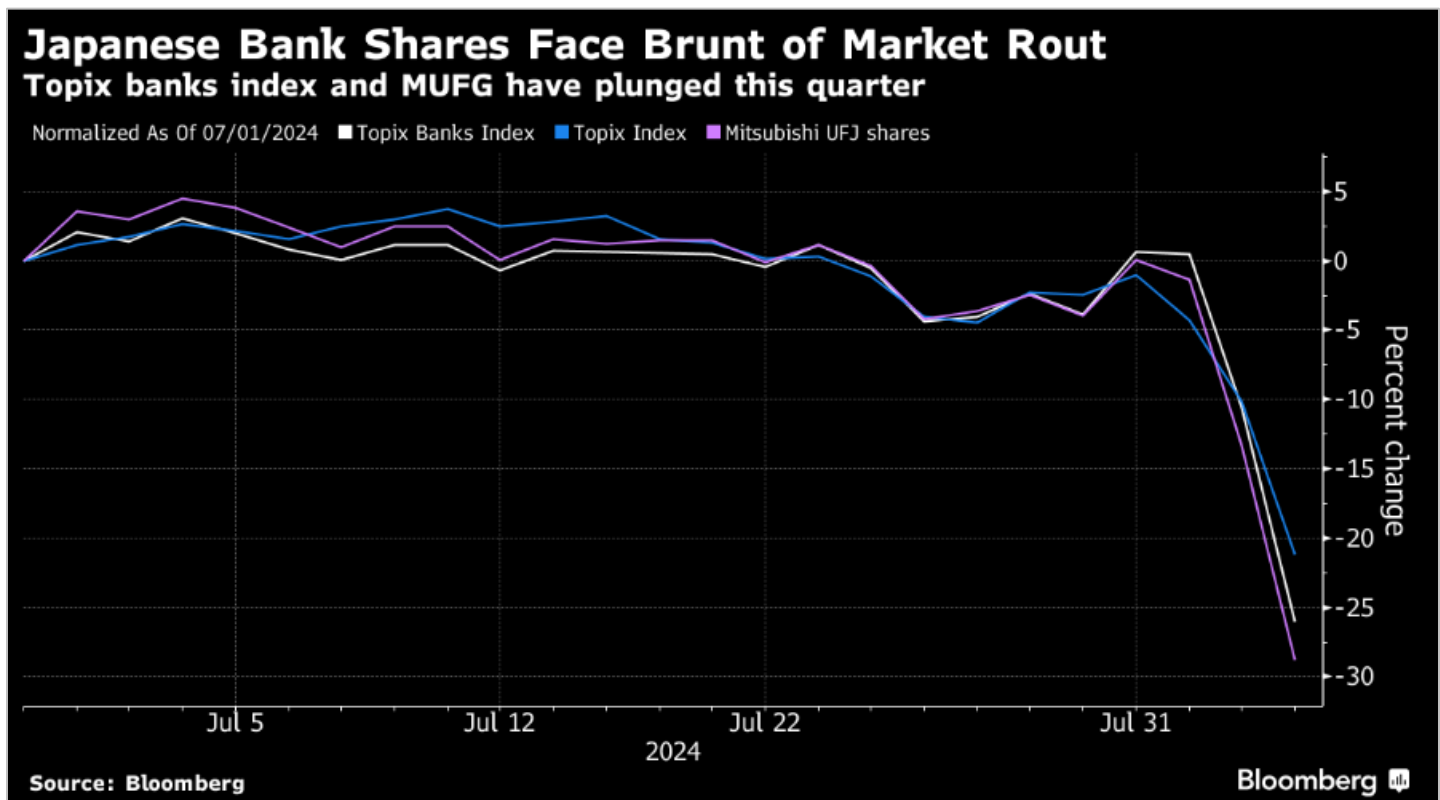
Japan's Stock Market Enters Bear Market Following Bank of Japan Policy Tightening

At the time of this writing, Japan's Topix index fell 24% from its recent high, and the Nikkei 225 had its worst single day drop in yen terms, signaling a bear market amid collapsing investor confidence. The market plunge was driven by a strong yen, tighter monetary policy, and a bleak U.S. economic outlook. The yen's surge, coupled with the Bank of Japan's interest rate hike, caused significant losses for tech companies and banks, with the Topix suffering its largest three-day drop since 1959.



Investors' mass deleveraging and panic selling intensified the market's decline, with all 33 Topix industry groups falling. Previously popular yen-funded carry trades became unprofitable, exacerbating the sell-off. Foreign investors significantly reduced their Japanese equity holdings, further pressuring the market.

Japanese bank and insurer stocks were hit particularly hard, raising concerns that the equity sell-off could threaten financial stability.¹ Japan's largest financial group, Mitsubishi UFJ Financial Group (MUFG), experienced a record 18% drop in share value, leading a dramatic \$85 billion loss across Japanese banks.² The Topix Banks Index plummeted 16%, marking its worst day since 2011.



The BOJ's decision to raise interest rates for the first time in years, intended to combat inflation and stabilize the yen, backfired as it caused the yen to surge. This surge, coupled with the unwinding of yen-funded carry trades, pressured Japanese banks heavily reliant on low-interest rates. MUFG and other major banks like Sumitomo Mitsui Financial Group and Mizuho Financial Group saw their shares dive as a result.

Market analysts express uncertainty and caution, noting that the Japanese market faces unprecedented challenges due to both domestic policy shifts and global economic conditions. The rapid sell-off reflects broader concerns about global economic health, particularly in the U.S., and suggests a potential reset in expectations for Japanese equities for the remainder of the year.

Investor sentiment was further dampened by weak U.S. economic data, including disappointing job growth figures and an unexpected rise in unemployment, which intensified fears of a global economic slowdown.












¹ ["Japan's Bank Stocks Log Worst Day Since 2008 After Rate Hike,"](#) Bloomberg, 8/2/2024

² ["MUFG Drops by Record as Japan Banks Lose \\$85 Billion in Value,"](#) Bloomberg 8/5/2024

Market Sell-Off Another Reminder of Interconnectedness of Global Markets

The interconnectedness of global financial markets means that Japan's financial turmoil could have ripple effects worldwide and exacerbate tightening financial conditions that would impact the funding sources of risk-on position-taking. The sell-off is not only impacting global equities, particularly markets with high yielding currencies funded in the so-called carry trade such as Australia, New Zealand, and Latin America, but also corporate credit risk and commodities.

First, unlike prior risk-off regimes that saw a flight to the U.S. dollar, investors are seeking the safe havens of Japanese Yen (YEN), Swiss Franc (CHF), and Hong Kong Dollar (HKD), a proxy for Chinese Yuan (CNY). The strength of non-U.S. safe haven currencies, suggest that much of the selling pressure is coming from overseas as financial institutions seek to repatriate capital to home markets.

Basket: Majors		Last Price		Rate: 1 Month		Date: 08/05/24		Fixing Time: Local Time			
Source: BGN		% Change		Outrights		Points		Heat Map			
Spot		Forward		Fixing							
											
	USD	EUR	JPY	GBP	CHF	CAD	AUD	NZD	HKD	NOK	SEK
SEK	10.547	11.570	.07430	13.466	12.456	7.6157	6.8067	6.2601	1.3569	.95557	
NOK	11.037	12.108	.07775	14.092	13.035	7.9698	7.1232	6.5512	1.4200		1.0465
HKD	7.7729	8.5269	.05476	9.9239	9.1798	5.6126	5.0164	4.6136		.70424	.73698
NZD	1.6848	1.8482	.01187	2.1510	1.9897	1.2165	1.0873		.21675	.15264	.15974
AUD	1.5495	1.6998	.01092	1.9783	1.8300	1.1189		.91970	.19935	.14039	.14691
CAD	1.3849	1.5192	.00976	1.7681	1.6356		.89377	.82201	.17817	.12547	.13131
CHF	.84674	.92887	.00596	1.0811		.61141	.54646	.50258	.10893	.07672	.08028
GBP	.78325	.85922	.00552		.92502	.56556	.50549	.46490	.10077	.07096	.07426
JPY	141.95	155.72		181.24	167.65	102.50	91.613	84.257	18.263	12.861	13.459
EUR	.91158		.00642	1.1638	1.0766	.65823	.58831	.54107	.11728	.08259	.08643
USD		1.0970	.00704	1.2767	1.1810	.72208	.64537	.59355	.12865	.09060	.09481

% Change on Day Range						
Below -2.5%	-0.5% to -2.00%	-0.05% to -0.05%	-0.05% to 0.00%	0.05% to 0.5%	0.5% to 2.5%	Above 2.5%

Rates are from Composite where Bloomberg BGN is not available.

Source: Bloomberg

Global Market Sell-Off Following Tightened Japan Monetary Policy

The sell-off in Japanese equities is spilling over to other equity markets as well as corporate credit risk and commodities. The 10-Year U.S. Treasury Yield has dropped to near 3.7%, a 2024 YTD low. The North American High Yield CDX index, a market proxy for corporate credit risk expressed in spreads to U.S. Treasury rates, spiked although the index remains well below 400 (or 4% spread to Treasuries) and below prior post-pandemic spikes.



Source: Bloomberg

Global Market Sell-Off Following Tightened Japan Monetary Policy

Commodities have also felt the selling pressures, even gold prices which had recently rallied over the prospects of aggressive Fed easing following the weaker-than-expected employment releases. Interestingly, industrial metals (iron ore, steel) most closely associated with Chinese industrial activity are up this morning, perhaps catching the tailwinds of CNY strength.

Commodity	2Day	Price	Norm Chg	%Chg	Δ AVAT	Time	%YTD	%YTDCur
Energy								
NYM WTI Crude		72.33	-1.19	-1.62%	+156.69%	07:04	+0.95%	+0.95%
ICE Brent Crude		75.70	-1.11	-1.45%	+77.68%	07:04	-1.74%	-1.74%
ICE ARA Gasoil		700.50	-12.25	-1.72%	-12.87%	07:03	-6.69%	-6.69%
NYM NYH Gasoline		227.53	-4.23	-1.83%	-5.38%	07:04	+8.21%	+8.21%
NYM NYH Heating Oil		228.14	-3.71	-1.60%	+30.73%	07:04	-10.64%	-10.64%
NYM HH Nat Gas		1.91	-0.05	-2.69%	+39.30%	07:04	-23.87%	-23.87%
ICE TTF Nat Gas		34.98	-1.67	-4.57%	+65.46%	07:04	+8.11%	+7.30%
Metals								
LME Aluminum		2,263.50	-32.50	-1.42%	--	08/02/24	-5.05%	-5.05%
LME Copper		9,055.50	+3.00	+0.03%	--	08/02/24	+5.80%	+5.80%
LME Nickel		16,273.00	-9.00	-0.06%	--	08/02/24	-1.99%	-1.99%
DCE Iron Ore		774.00	+12.50	+1.64%	-92.69%	08/05/24	-24.40%	-24.66%
SHF Steel Rebar		3,366.00	+13.00	+0.39%	-79.23%	08/05/24	-25.32%	-25.57%
Spot Gold		2,406.91	-36.33	-1.49%	--	07:14	+16.67%	+16.67%
Spot Silver		27.10	-1.45	-5.09%	--	07:14	+13.91%	+13.91%
Agriculture								
CME Live Cattle		182.07	-1.65	-0.90%	+46.63%	08/02/24	+6.00%	+6.00%
ICE Coffee		225.15	-5.35	-2.32%	+23.09%	07:04	+19.57%	+19.57%
CBT Corn		400.00	-3.25	-0.81%	-9.58%	07:04	-18.73%	-18.73%
ICE Cotton		67.26	-0.99	-1.45%	+11.11%	07:04	-18.75%	-18.75%
CBT Soybeans		1,025.00	-2.25	-0.22%	-99.96%	07:02	-19.60%	-19.60%
ICE Sugar		17.84	-0.26	-1.44%	+95.27%	07:03	-13.31%	-13.31%
CBT SRW Wheat		529.25	-9.75	-1.81%	+19.14%	07:04	-15.72%	-15.72%

Source: Bloomberg

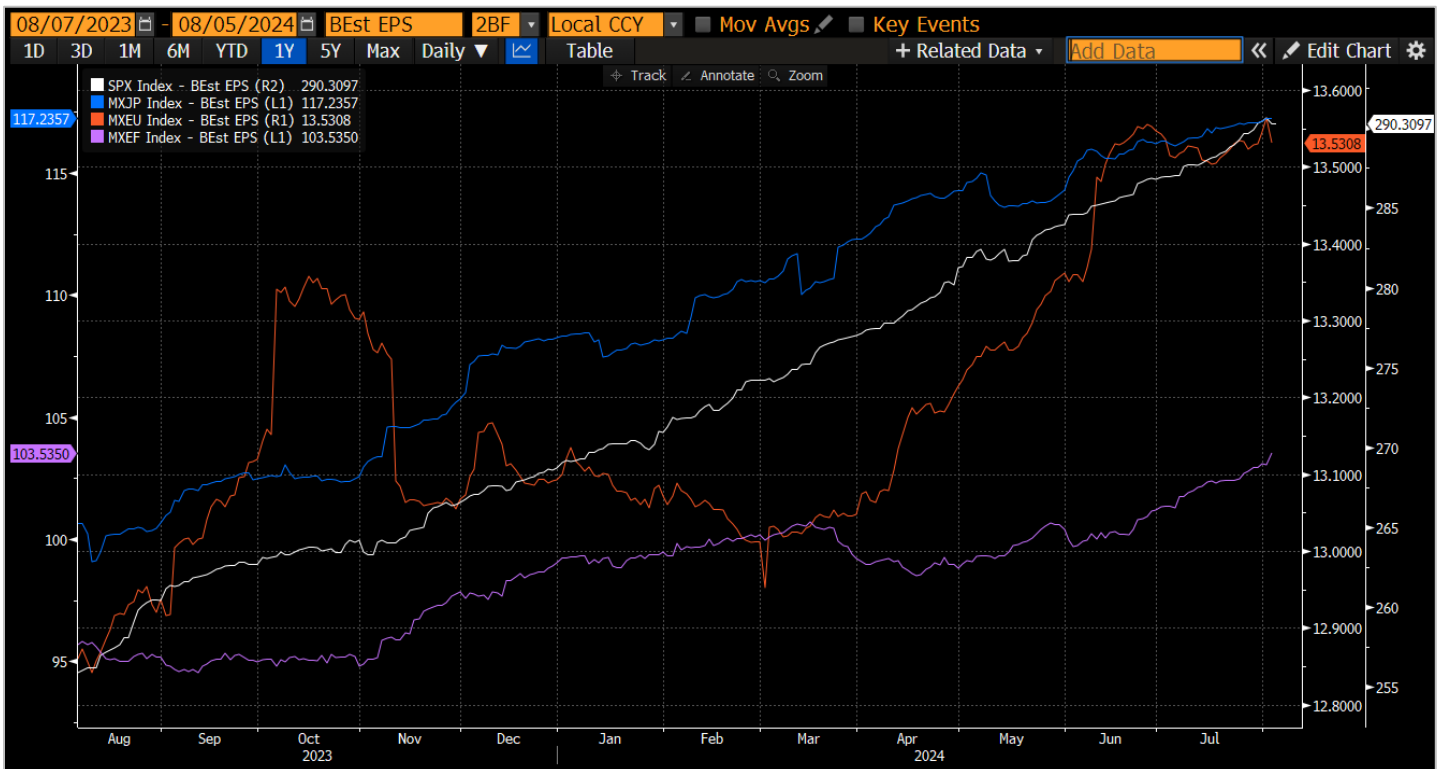
Global Market Sell-Off Following Tightened Japan Monetary Policy

Fed Funds Futures now fully price in two rate cuts (50 bps) at the September FOMC and six rate cuts by the January 2025 FOMC, a sharp revision of earlier expectations that the Fed would only cut incrementally.

Region: United States »			Instrument: Fed Funds Futures »			
Target Rate	5.50		Pricing Date	08/05/2024		
Effective Rate	5.33		Cur. Imp. O/N Rate	5.256		
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.	
09/18/2024	-2.179	-217.9%	-0.545	4.712	0.250	
11/07/2024	-3.847	-166.8%	-0.962	4.294	0.250	
12/18/2024	-5.098	-125.1%	-1.275	3.982	0.250	
01/29/2025	-6.055	-95.7%	-1.514	3.743	0.250	

Source: Bloomberg World Interest Rate Probability (WIRP)

Despite the recent pullback and selling pressures, the analyst community remains sanguine over earnings prospects, not just for U.S. companies, but for global markets as well. Earnings are expected to grow over the next two years for the major markets (U.S., Japan, Europe, and Emerging Markets) even if that growth trajectory starts to slow down. Near-term liquidity-driven selling could eventually give way to long-term earnings growth reality.



Source: Bloomberg

The recent global market sell-off following the Bank of Japan's decision to tighten monetary policy underscores the interconnectedness of financial markets and the delicate balance of global economic health. As Japan's stock market entered a bear market, driven by a strong yen and investor panic, the ripple effects were felt worldwide, impacting equities, corporate credit risk, and commodities. This turmoil serves as a stark reminder of the importance of staying informed and vigilant in the face of rapid market changes.

At Freedom Investment Management, we emphasize the importance of maintaining a disciplined investment strategy rather than attempting to time the market. While the recent shifts may require adjustments to keep allocations in line with one's investment program, even if no immediate action is necessary, understanding these developments can provide valuable insights. As the Federal Reserve considers its response to the slowing U.S. economy and potential financial contagion, investors should stay informed and be prepared to act prudently. Despite the current volatility, the long-term outlook for earnings growth remains positive, suggesting that short-term market disruptions may eventually give way to sustained growth.

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Except as otherwise specifically stated, all information is as of August 5, 2024.