SIB Standard Investment Bank

Regulated by the Capital Markets Authority

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GLOBAL MARKETS COMMENTARY

Q3 2024 MANSA^{X} MARKETS REVIEW & Q4 2024 OUTLOOK

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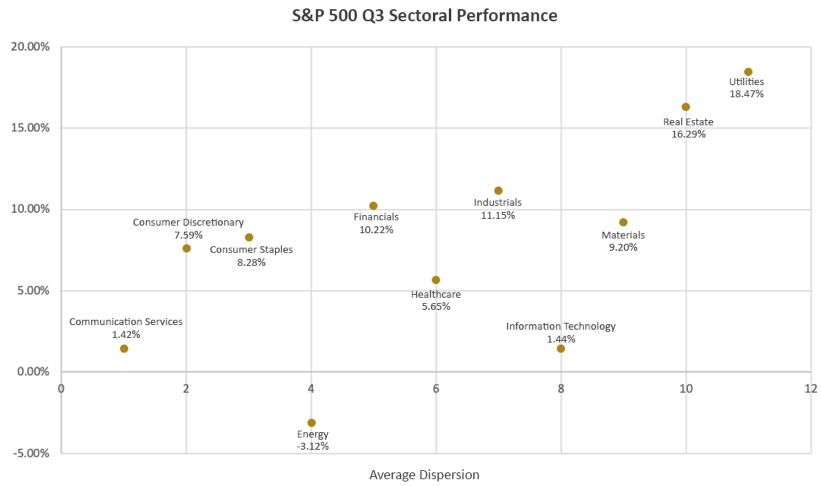
Volatility Makes a Comeback

The S&P 500 has seen a blistering upward momentum since rebounding from the lows of the Fed induced 2022 bear market in October of the same year. Since then, the U.S. flagship equity benchmark has finished higher in seven of eight quarters, including its current run of four consecutive in the green. Over the prior four quarters, it has a total return of 33.6%, which in the last 20 years has only happened when the stock market was rebounding off the 2020 covid lows and 2009 GFC lows. Through the end of Q3, the S&P 500 has had its best YTD gain through three quarters since 1997.



Through the end of Q3, the S&P 500 has had its best YTD gain through three quarters since 1997.

The ongoing bull market flies in the face of one of the steepest rate hiking cycles in modern times, and accordingly, there have been many cynics along the way doubting the health and sustainability of the trend. Admittedly, despite corporate earnings growth rebounding sharply heading into 2024, investors and analysts were deeply concerned that the majority of stocks were underperforming their cap-weighted benchmarks as major indexes were extracting most of the gains from a very narrow range of stocks colloquially referred to as The Magnificent Seven and this remained true for almost the entirety of the first half of the year.

However, this trend reversed in the third quarter with the Magnificent Seven contingent of mega-cap technology stocks not shining as brightly as they once did, with five of the seven stocks now lagging behind the S&P 500. That healthy sector rotation was evident during the quarter as the best performing sectors were Utilities (+18.47%), Real Estate (+16.29%) and Industrials (+11.15%) while major equity benchmarks were led by the small cap Russell 2000 (+8.9%), the blue-chip Dow Jones Industrials (+8.21%) and the S&P 500 (+5.53%) while the tech-focused Nasdaq 100 lagged further behind with a 1.92% gain during the quarter.

The "Magnificent Seven" stocks shone less brightly in Q3 with 5 out of 7 stocks lagging behind the S&P 500

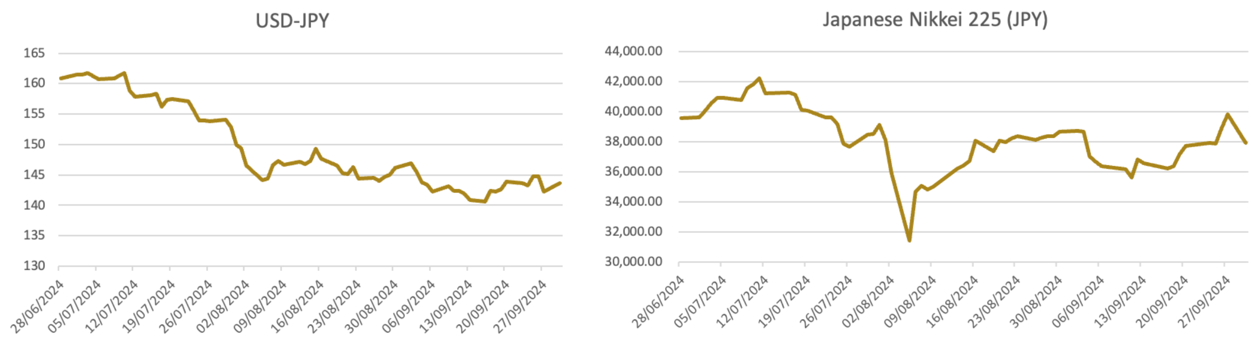
"Everything in moderation, including moderation," goes a line varyingly attributed to Socrates, Voltaire, Benjamin Franklin, and Oscar Wilde. No matter who said it, the quote is apt. For months, moderation ruled. Bad economic news was good news for stock and bond investors, who appeared to have their cake and eat it, too.

Inflation was falling and economic strength with it, but not so much as to raise immoderate alarm bells. A soft landing was the near-consensus call on Wall Street as investors went into the third quarter waiting for the all-clear sign on inflation, which would let the Fed finally cut interest rates. The economic data quickly turned in that direction, with soft readings on employment and inflation data suggesting price pressures were at last meaningfully abating. However, panic can quickly sweep through a flight cabin, and we saw something similar happen at the onset of August when higher-than-hoped-for unemployment numbers sent the S&P 500 on its worst two-day decline since the Silicon Valley Bank collapse in March 2023. Blowing air on the flame, we then immediately learned that Warren Buffett dumped half of his Apple exposure and despite Apple still being 30% of Berkshire's equity portfolio, this raised questions about whether he is souring on the outlook for the stock market and economy as his total cash holdings sharply grew to a record $277 billion. The gripe amongst economic observers became that Fed Chair Jerome Powell and his crew at the U.S. central bank have pitched the plane toward a possible recession by keeping interest rates high for too long and not initiating the cutting cycle in July.

The straw that broke the camel's back happened almost immediately thereafter in Japan when their central bank hiked interest rates. This metamorphosed the campfire into a wildfire as for years, many hedge funds and asset managers snapped up riskier assets, such as U.S. technology stocks, and funded those trades with the Japanese yen, thanks to ultralow interest rates in Japan. Known as the Yen carry trade, this involves borrowing in Japanese Yen and exchanging it for Dollars, then taking that cash and buying something else—hoping to earn more from the asset purchase than it costs to borrow in Japan. This has been a fine strategy that has yielded money for investors for years as interest rates in Japan have been at 0% or negative since 2010 while the Yen has also weakened significantly in recent years. But now, with the BoJ raising interest rates for the second time in 17 years to its highest level since 2008, the normally docile yen rallied 7.6% against the USD in less than a week, eating away much of the potential profit.

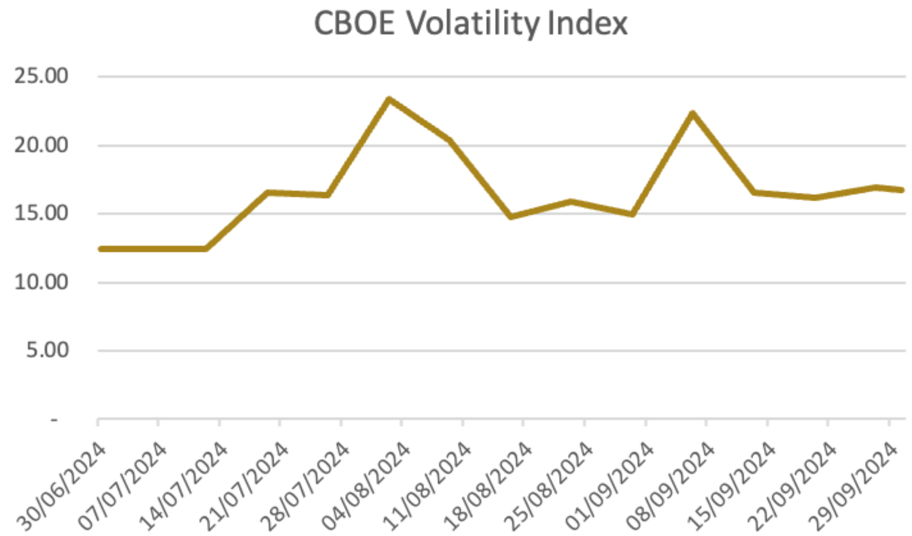
The key risk with any trade involving a large amount of borrowing is that the investors using leverage might lose so much money that they can't pay back their lenders, especially as rapid moves in asset values in the wrong direction equal large, unexpected losses. Remember the adage: If you owe the bank a million dollars, you have a problem. But if you owe the bank a billion dollars, the bank has a problem. From what we gather, the latter problem was a serious possibility as it is likely multiple hedge funds and asset managers were getting tapped on the shoulder with a margin call.

A global stock selloff swiftly followed slamming everything starting with the Japanese Nikkei which was up 18% on the year through the end of July. After three days of trading in August, the index was now down 6.1% on the year after posting its second-largest single session drop ever outside of Black Monday back in 1987. This is because when investors need to raise cash to reduce risk, they sell assets. Any unwinding of a large global trade such as the yen carry trade creates a negative feedback loop. Losses require sales to meet margin calls. Sales result in more losses, resulting in more sales to meet more margin calls. All this put consequential pressure on equity markets which comprise a significant part of portfolios.



The Bank of Japan raised interest rates to its highest level since 2008. As a result, the Yen rallied 7.6% against the USD, interrupting the Yen carry trade and triggering a global stock selloff that slammed everything, including the Japanese Nikkei

The confluence of these factors coming together at once stoked market turbulence causing investors to reach for the motion-sickness pills known as the 'CBOE Volatility Index' (VIX), which spiked 220% in three trading days to its third highest ever level only being topped by the volatility at the peak of the Global financial crisis in 2008 and the onset of global Covid-induced lockdowns in 2020. For a while this quarter, it looked like the bull market in stocks could be in trouble. However, the mayhem quickly subsided and despite concerns about aftershocks still lingering amongst market participants, the VIX quickly plunged marking its fastest-ever retreat. The record reversal showcased a jumpy market, easily swinging between quick bursts of optimism and swift collapses due to thin summer liquidity.



Within the quarter, the CBOE Volatility Index' (VIX), spiked 220% in three trading days but quickly plunged marking its fastest-ever retreat

"Wake me up when September ends," sang the band Green Day—and many investors will feel the tune was written for them. The ninth month of the year is notoriously unkind to markets with the S&P 500 having lost ground in each of the last four Septembers, and in seven of the last 10 years. So, it wasn't much of a surprise when the month began ominously with a near 5% decline during its first week due to worries about China's weakening economy, a continued pullback in the U.S. manufacturing sector, and concerns that highflying tech and artificial intelligence stocks like Nvidia had run too far too fast. However, help was on the way via lower rates. And the upcoming September rate cut was likely to be the first of many. The only question at this point was whether the fed takes its typical approach of trimming rates by a quarter-percentage point or opts to be more aggressive with a half-point cut.

On 18th September, The Federal Reserve voted to lower interest rates by a half-percentage point, opting for a bolder start in making its first reduction since 2020. The long-anticipated pivot followed an all-out fight against inflation that the central bank launched over two years ago. Quarterly projections released Wednesday showed a narrow majority of officials pencilled in cuts that would bring the federal funds rate to 4.4% by December 2024 and 3.4% by December 2025. The decrease should provide some immediate relief to consumers with credit-card balances and to businesses with variable-rate debt. Long-term borrowing costs—on everything from mortgages to corporate debt—have already been declining in anticipation of a series of further rate cuts around the corner.

The fed has long been haunted by the spectre of the 1970s, in which they took insufficient steps to constrain demand and allowed expectations of higher prices to become self-fulfilling. But inflation has fallen over the past year, assisted by healed supply chains and a steady influx of workers to the job market. That suggests the downturn many economists once thought might be needed to tame inflation would now be overkill. However, prior to the Federal Reserves decision to cut interest rates, The US Bureau of Labor Statistics' preliminary annual benchmark review of employment data suggests that there were 818,000 fewer jobs in the twelve months to March of this year than were initially reported. This report indicated that job growth during much of the past year was significantly weaker than initially estimated.

The 50-basis point cut is an unusually large move in the context of the economic data and given little stress in financial markets which suggests the Fed is worried about the labour market. This decision likely reflected so-called risk-management concerns in which officials weigh the risks of various economic hazards, such as high inflation or rising joblessness, and navigate accordingly. "It buys the fed a little bit of insurance against a further unexpected weakness in the labour market", said Loretta Mester, who retired in June as president of the Cleveland Fed. The Fed was criticized for being too slow to start raising rates. Naturally, it doesn't want to be criticized again for being too late. It really is focused on achieving the soft landing. This view was re-enforced recently by Chair Jerome Powell at the National Association for Business Economics stating "Overall, the economy is in solid shape. We intend to use our tools to keep it there."

Eurozone

Eurozone shares, as measured by the Euro Stoxx 50 index, made moderate gains (+2.44%) in Q3. The advance was led by the real estate, utilities and healthcare sectors as the prospect of lower interest rates saw investors re-assess some previously out-of-favour parts of the market. Energy and information technology sectors were the main laggards, delivering negative returns for the quarter in-line with the trends seen in US markets.

The European Central Bank (ECB) kept interest rates on hold at its July meeting but then cut by 25 bps in September. Data indicated a softening of inflation over the period, with annual inflation falling from 2.6% in July to 2.2% in August and 1.8% in September. However, economic data reinforced the sluggish nature of the eurozone recovery so far this year, with Germany's reliance on manufacturing acting as a particular drag amid both weak demand from China and rising competition from cheaper Chinese exports. The weaker data, combined with the softer inflation readings, bolstered expectations of further imminent rate cuts from the ECB.

Over in the UK, equities moved slightly higher over the quarter as a landslide Labour general election win at the start of the period fuelled hopes for a sustained recovery in the domestic economy. This occurred as expectations also built for a cut in UK interest rates, which the Bank of England (BoE) delivered in August, making its first cut in four years. The positive sentiment was somewhat offset by the new UK Prime Minister (PM) Keir Starmer warning of a "painful" autumn budget. He signalled potential tax increases and spending cuts due to an estimated £22 billion shortfall in public finances. The PM added those with the "broadest shoulders" will bear the heaviest burden, sparking speculation around which taxes might rise. Economic data in the country has generally been more upbeat so far in 2024, although consumer confidence did fall in September in advance of October's UK budget announcement.

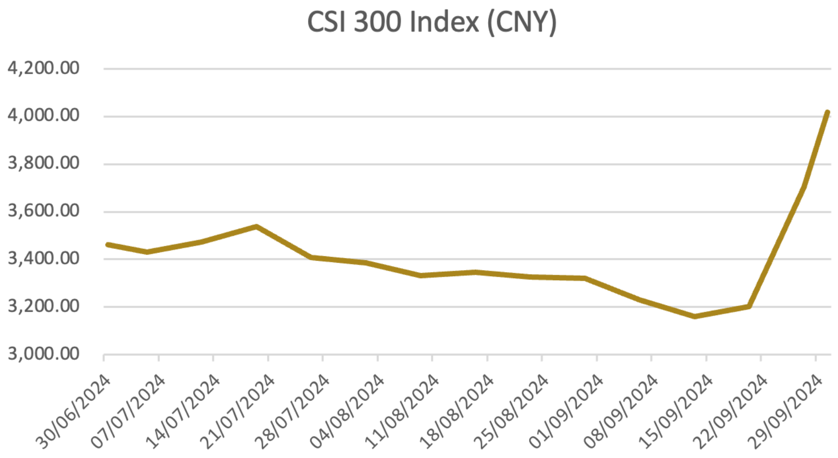
The Bank of England's governor Andrew Bailey promised to move ahead cautiously with further interest rate cuts. Meanwhile, the deputy governor Clare Lombardelli added that the Bank's base case for inflation is benign, but risks remain of an "alternative world" in which inflation moves higher again. The consumer staples, financials and consumer discretionary sectors were the top performers over the period. Energy was a significant detractor.

Europe has not escaped the volatility that was evident in global markets during the quarter. French bond risk has exploded to its highest level since the euro zone crisis after gains by the far right has caused major headaches for French President Emmanuel Macron prompting his dissolution of the National Assembly and triggering a snap parliamentary election. As a result, investors are now demanding a higher interest rate to buy 5-year French debt than they do from Greece, the country that was at the centre of the euro zone crisis. The euro has also fallen against European peers like Britain's pound and the Swiss franc. Distressed debt specialist fund Gramercy said the rise in French government bond yields which also includes the Franco-German yield differential topping 80bps had prompted comparisons to the "Liz Truss moment" that the UK gilt market endured two years ago.

Asian Markets

In equity markets, Asia was the top performing region this quarter. Despite having treaded water for much of the quarter, Asian stocks rallied strongly towards the end of September after Chinese policymakers turned on the economic stimulus taps. After a long period of hesitation, Chinese leadership has decided to counter the deflationary economic trends with various monetary and fiscal policy measures. The main aim is to stimulate consumer spending and improve the willingness to borrow and invest.

While many of these measures have been seen in isolation over the last year, such as cuts to interest rates or reduced down-payment requirements for home purchases, the coordinated nature of September's announcement was the clearest signal yet that Beijing stands ready to support the Chinese economy and markets. The surprising nature of this announcement meant the impact on Chinese equities was immediately noticeable. The CSI 300, which is a capitalization-weighted stock market index designed to replicate the performance of the top 300 stocks traded on the Shanghai Stock Exchange and the Shenzhen Stock Exchange, posted its strongest week since 1996 rallying almost 24% in the last 5 trading days of the quarter.



The CSI 300 posted its strongest week since 1996, rallying almost 24% in the last 5 trading days of the quarter.

Japanese stocks found themselves at the other end of the rankings, falling by 4.9%. The Bank of Japan's July rate hike and comments from Governor Ueda that guided towards further rate hikes ahead meant that a narrowing of interest rate differentials between the US and Japan was now firmly on the cards. The Japanese yen appreciated sharply alongside an abrupt unwind of many "carry trades" that were reliant on cheap Japanese borrowing costs. A more reassuring tone from BoJ officials later helped Japanese stocks to pare losses, but the market still ended the third quarter in the red.

Elsewhere in Asia, South Korea and Taiwan ended the quarter in negative territory, due to the sell-off in technology stocks during the quarter, with investors starting to question how the expansion in artificial intelligence (AI) will benefit revenue. However, despite the poor quarterly performance Taiwan remains the best-performing index market in the year-to-date period.

Fixed Income

The third quarter saw the start of the interest rate cutting cycle in many major economies. The cut and expectations of faster monetary policy easing by the Fed led to a weaker dollar against major currencies. In the bond market, US Treasuries have enjoyed their longest monthly winning run in three years gaining for five straight months as yields fell substantially over the quarter with 2-year yields leading the way, falling 111 bps. Meanwhile, the 10-year Treasury yield ended Q3 at 3.81%—more than a full percentage point below its current peak in October 2023. Subsequently, the 10-year yield rose above the 2-year, ending the long-standing yield curve inversion. Yields across the curve followed this downward trend for the first time in almost two years.

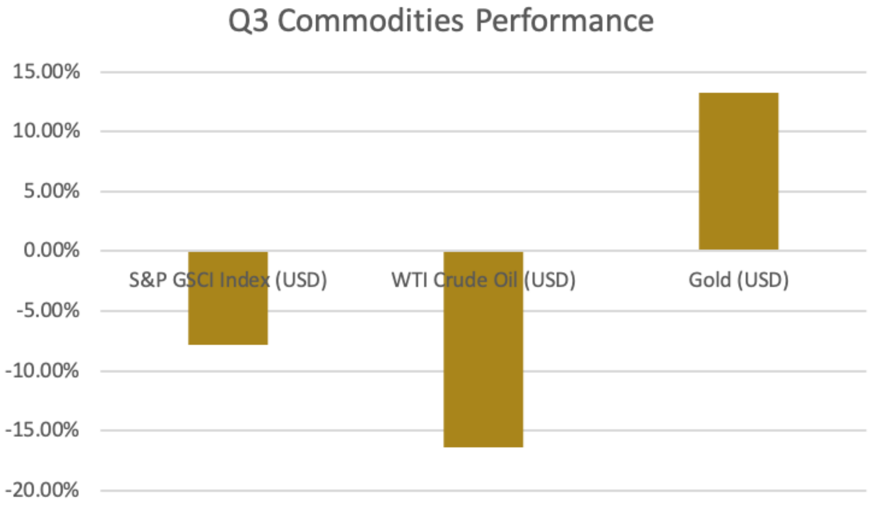
US Treasuries gained for five straight months as yields fell substantially over the quarter with 2-year yields leading the way, falling 111 bps.

Over in the UK, yields remained largely unchanged as the election result had been priced in by the market. The BoE announced a 25-bps rate cut in August, which was the first modification since the onset of the Covid-19 pandemic, but kept rates on hold in September. UK gilts rallied over the quarter, fuelled by the government's promise to kick start economic growth, with investors increasing their bets on two more BoE interest rate cuts before the end of the year.

German and French 10-year government bond yields declined over the quarter but underperformed relative to Italy and Spain, which were the strongest performers in Europe as the ECB also cut interest rates by 25 bps during the quarter.

Commodities

The S&P GSCI Index fell in the third quarter despite strong performance from precious metals. Energy was the biggest drag on the commodity index with the big Q3 shift being the 17% slide in oil which despite escalating conflict in the Middle East where Israel's bombings have now spread to Lebanon as growing concerns around the health of the global economy put downward pressure on prices.



The S&P GSCI Index fell in Q3; conversely, the precious metals component was sharply higher

In agriculture, the price of coffee, cocoa, and sugar rose significantly in Q3, while soybeans and wheat prices were modestly lower. Within industrial metals, aluminium, zinc, and copper achieved modest gains, while the price of lead declined.

The precious metals component was sharply higher in Q3, with a weaker dollar and strong buying by Western investors and global central banks having helped gold to set new record highs and posting its strongest quarter since 2016. Despite the People's Bank of China having seemingly held back on buying gold for its reserves in recent months, other central banks have stepped up as Poland recently became the joint biggest gold buyer amongst central banks, tying with India, according to the World Gold Council. Central bank demand for gold has surged in recent years, with this seemingly relentless appetite being due to safe-haven demand driven by geopolitical and economic uncertainty which has become ever-more important to gold's underlying bull run. However, all that glitters isn't just gold—it's also silver which has outpaced gold in its year-to-date performance. Demand for silver has been strong, mostly as a store of value and demand from industrial uses has been growing rapidly, in large part thanks to solar-panel manufacturing, where silver is integral. The Silver Institute, an industry association, estimates that demand for silver has been outrunning supply for the past three years and this trend is only likely to continue further for the next few years as most industrial uses of silver don't have viable substitutes.

The price of coffee, cocoa, and sugar rose significantly in Q3, while soybeans and wheat prices were modestly lower

Nairobi Securities Exchange

NSE Q3 Performance
- N10: +0.7%q/q
- NSE 20: +7.2%q/q
- NSE 25: +1.3%q/q

- NASI: -2.2%q/q

The bourse closed 3Q24 on a mixed note with the N10, NSE 20, and NSE 25 gaining 0.7%q/q, 7.2%q/q, and 1.3%q/q, respectively while the NASI retreated by 2.2%q/q. Worth noting, September was the best month in the quarter with all indices closing in the green – offsetting, in part, the mixed performance registered in July and August.

From a q/q vantage point, 3Q24 performance was better than 2Q24, albeit trailing the 1Q24 relief rally. Foreign net flows for the quarter turned negative (USD 4.83m in outflows) vis-à-vis USD 22.69m inflows in 2Q24. We expect to see a rise in inflows in 4Q24 with the current (and expectation of further) rate cuts in key developed markets reducing opportunity costs exposure for investments in frontier markets even as valuations better on lower cost of equity and cost of debt.

From a corporate action viewpoint, the banking sector exhibited remarkable resilience in 1H24 with lenders in our coverage reporting profit growth (at varying intensities) in the face of a persistently high-interest rate regime which has not only raised the cost of funds but also raised overall asset quality deterioration. Looking ahead, we are optimistic about the performance of the banking sector in the second half of 2024. We view ongoing revenue diversification strategies, continued implementation of risk-based pricing, support from regional subsidiaries, regional trade deals, cost containment initiatives, and digital transformation as tailwinds to the sector. Additionally, potential rate cuts (both internationally and locally) as inflation eases are expected to stimulate private-sector credit demand, reducing the crowding-out effect.

We believe MSCI move to include DTB, Kenya Re, KenGen, and BAT to the MSCI Frontier Markets Small Cap index, as well as the addition of Cooperative Bank of Kenya and KCB Group to the MSCI Frontier Markets index will provide stock visibility and reorient foreign investor interest into frontier and emerging markets – a move that should benefit the market as a whole, and fuel a potential bull run in the final quarter of the year.

Looking Ahead

The economy is not the stock market. And that's good news. Recent bouts of market volatility tested investor conviction, but fundamentals prevailed and stocks quickly rebounded. Q3 volatility was at least partly rooted in concerns over a slowing economy and whether the Fed was behind the curve in addressing it. We believe it had little to do with the fundamentals underlying the stock market, and this is an important distinction. Sometimes that realization comes faster than others. This illustrates the importance of active selection and knowing deeply what you own, which can provide conviction when markets are on edge. Markets are a forward-looking anticipatory mechanism and attempt to predict recessions, with historically mixed results. When the economy is in a slowdown, markets can struggle to discern a midcycle slowdown from a recession — stoking volatility. While the economy has struggled to recalibrate post-COVID, spiralling into a series of "mini rolling recessions" — we find that the stock market, and the companies that comprise it, have managed to adapt to what we see as a return to more "normal" conditions.

But there's no chance of a quiet end to the year, with the fourth quarter set to be dominated by the forthcoming U.S. presidential election which is another event drawing interest among investors and could become one of those potential volatility-inducing moments. The shake-up in July at the top of the Democratic ticket in the campaign alters the race dynamics and introduces some uncertainty. Current polls show a close battle with no obvious frontrunner developing as we approach Election Day. Hold your hats, folks; the ride could get bumpy! At the end of 2023 which delivered significant returns for investors, many market commentators had mostly dismissed the possibility of a repeat performance especially in an election year. The S&P 500 has averaged a 7% gain during U.S. presidential election years since 1952. While a 7% gain is far from disastrous, it is also well short of the 17% average S&P 500 gain in the year prior to an election year. Heading into Q4, the S&P has just posted its best ever 9-month performance in an election year. So, did anyone see this coming? Few saw it coming as the future forever remains unwritten.

Although the temporary commotion of an election can be distracting, keep your eyes on long-term investment objectives

Every election cycle it feels like the stakes are exceptionally high, or even higher than the previous contest as media is quick to dub the race of the day as the most consequential of our lifetime, but the data just doesn't support that. You can turn on any news channel or look at any financial website and see our point reinforced. Thus, investors naturally feel strongly about the way political events turn out. Here is where we might find some solace, though; history has shown that the president is a small part of several elements affecting the market over time. Actually, regardless of which party is in charge, stocks have not deviated from the path it was on. Although the temporary commotion of an election can be distracting, we should keep our eyes on long-term objectives and see things from the long run. Continuing to invest, regardless of which political party is in control, is a well-trodden path. The point is this — the markets and global economy are far larger than any one political party or candidate can influence.

Also likely to influence market sentiment in Q4 are Federal Reserve rhetoric and rate cuts. Equity markets generally perform well on Fed easing, particularly when rate cuts are not accompanied by a recession. While the outcome for stocks can look different in an environment of recessionary rate cuts, history does reveal some patterns: Large caps generally lead small caps and high quality and low beta tend to outperform in the year after the onset of cutting, with or without a recession. The pattern holds two and three years after the first cut, though value stocks also join the "winners" in these time periods.

The wild card for the markets in Q4 is a broadly more complex set of geopolitical risks with the current escalation of the war between Israel and Iran and its allies' harbors great uncertainty regarding the consequences for regional political stability and the economic impact on the global economy. The two countries have been on a collision course of a potentially costly and prolonged conflict. Iran recently launched a barrage of missiles into Israel with Benjamin Netanyahu promising that Iran "will pay" for its actions, and President Joe Biden said he's discussing the possibility of Israeli strikes on Iran's oil infrastructure. This has already led to a shake-up in the oil market as oil has recently spiked beyond $70. However, beyond Crude Oil, financial markets aren't reacting like you'd expect them to considering the threat of higher oil prices negatively affecting the progress on inflation. We also expect the escalating conflict in the middle east shall have a limited impact on financial markets unless Gulf countries such as Saudi Arabia or the United Arab Emirates get involved directly. Our reasoning for this is due to the feel-good factor amongst investors as amidst a lower interest rate environment, analysts also expect recent quarter earnings for S&P 500 companies, in aggregate, will rise 4.1% year over year and another double-digit earnings growth for the full year 2025 at a hotter pace than 2024's expected earnings growth of 10.7%.

As we have seen, Q4 brings some key issues for investors to contemplate, which could further stoke the flames of market turbulence. While volatility gets a bad rap, it's important to remember that it entails ups as well as downs — and that context and circumstances are critical variables. When it comes to inevitable market angst, consider that Volatility is normal and can be considered healthy for markets. Market resets do provide opportunities for us to establish or increase exposure to assets in which we have high conviction — and at a discounted price. This is particularly true in cases where volatility is driven by sentiment or technical factors (such as extended/crowded positioning or light trading as is common in summer months) rather than fundamentals (like company earnings growth and financial fortitude).

This year has also reinforced the need to be unemotional while making investment decisions. We have had two separate downturns in 2024 that, in the moment, felt painful, but will absolutely be forgotten with time. Turbulence in the market is not uncommon with there always existing a reason to sit in the sidelines if you listen to TV & social media talking heads. Corrections of 10% or more have happened in 20 of the last 35 years, with the average drawdown in that timeframe at 14% while drawdowns of 5% or more have happened in each year except for 1995 & 2017. And yet the S&P 500 returned an average 11% per year (more than 4,000% on a cumulative basis) in that time. Investors who stay the course through bouts of volatility can be rewarded — sometimes quickly as was the case this past quarter. The period of moderation following the Global Financial Crisis (GFC) was unusual for many reasons — muted volatility among them. The VIX historically has experienced more dramatic gyrations than was the case post-GFC, particularly in the relatively subdued 2012-2019. We see a return to a more normal environment where the VIX may experience more pronounced spikes, driven by such factors as central bank policies, geopolitical tensions and a general proliferation of information and social media dissemination that can arguably make investors superfluously anxious and markets less efficient.

The world is a complicated place; it always has been and probably always will be. The remarkable thing is that we always eventually find a way forward. The exact same tenets hold true for the economy and markets. Allowing fear to influence our investment decision-making, rather than following prudent investment fundamentals is a failed strategy nearly all of the time. Over the long run, we still believe a well-diversified investment strategy can weather any storm and put us in position to benefit the portfolio. We're happy to report the markets are currently cooperating, but that can change just as quickly as a Deputy President can be impeached. Understanding and appropriately participating in the markets, while knowing this is how the seasons ebb and flow, allows for a much more enjoyable and vibrant experience. The information above strongly suggests continuing to give the bullish case the benefit of the doubt even as nothing is guaranteed in the markets. Patience is a virtue and we wouldn't have it any other way.

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