GlobalData. TS Lombard

Macro Strategy

CHINA RALLY: NOT TOO LATE TO GET INVOLVED

Andrea Cicione / Daniel von Ahlen

- China's stimulus may have limited impact due to its small size and likely low multiplier
- But rising EPS, cheap valuations and investor underexposure => equity rally continues
- Whether it becomes a bull market depends on further fiscal stimulus and banks recap
- We add longs on AUD vs CHF and JPY in light of Chinese stimulus and a hawkish RBA

Will China's "whatever it takes" moment turn into a "bazooka in your pocket" one? China's stimulus announcements last week signalled a sea change in Beijing's attempt to stabilize the economy and financial markets. The fundamental difference between this latest effort and the unsuccessful ones earlier this year is the level of commitment the administration is demonstrating. Last week was arguably China's "whatever it takes" moment: while the announcements were light on detail, they were heavy on determination. The market responded to the news with understandable enthusiasm. But the question at the top of investors' minds now is: can the rally continue? The answer is "probably", but the outcome depends ultimately on whether the "whatever it takes" moment turns into a "bazooka in your pocket" one.

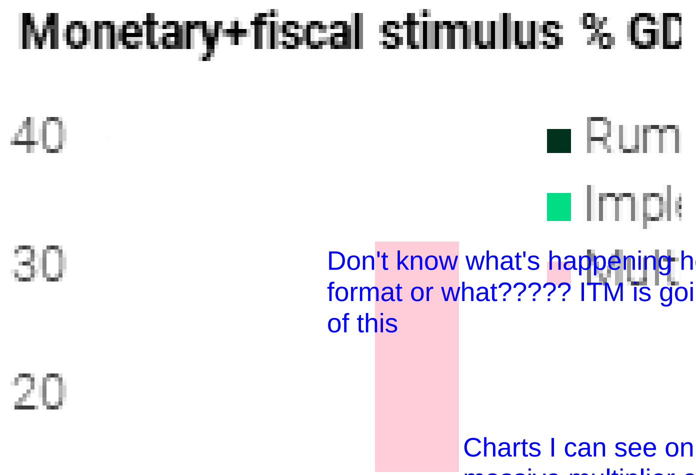
Balance sheets need fixing first. As has been the case in the past, the stimulus consists of a broad range of measures. Some are directly aimed at triggering an equity market response, which they certainly did. But looking beyond the near-term sentiment boost, the effectiveness of the measures could fade unless some fundamental issues are addressed. The key one is fixing damaged balance sheets – especially those of the banks. Until that happens, any attempts to boost borrowing and leveraged risk-taking are likely to fail.

Stimulus: this time is different. Past stimuli have been effective for two reasons. First, they were large – 13% of GDP in 2008 and 9% of GDP in 2015-16. Second, and perhaps more important,

In the big scheme of things, a 25% rally is still just a blip

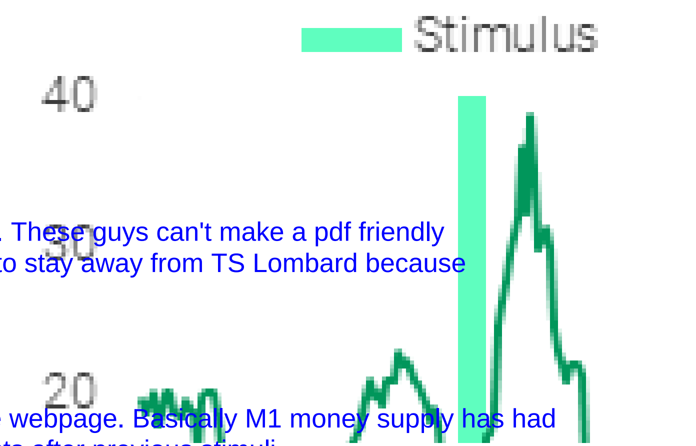
Source: Bloomberg, GlobalData TS Lombard.

Current stimulus small, multiplier doubtful



Sources: GlobalData TS Lombard

How much will M1 rebound on latest stimulus?



Sources: Bloomberg, GlobalData TS Lombard.

Don't know what's happening here. These guys can't make a pdf friendly format or what????? ITM is going to stay away from TS Lombard because of this

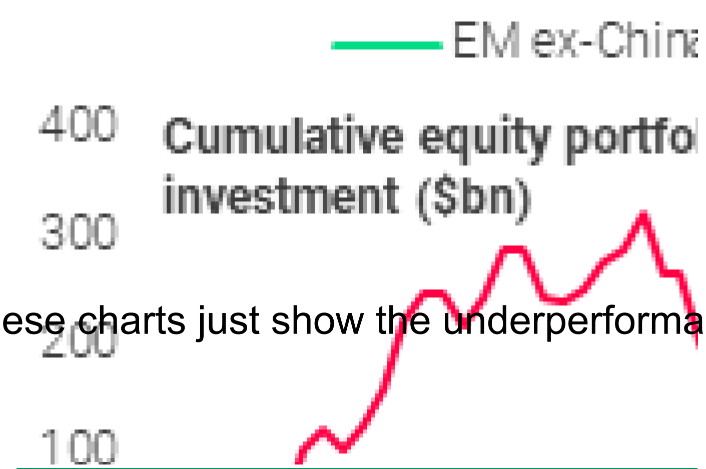
Charts I can see on the webpage. Basically M1 money supply has had massive multiplier effects after previous stimuli

they triggered an economic and financial response that amplified the impact of direct measures. Looking at M1 as a proxy, the total impulse was 32% of GDP in 2008 and 22% of GDP in 2015-16. By contrast, the measures announced this year are just 1.5% of GDP. Even adding an extra rumoured 2.4%, current measures pale in comparison with what Beijing has done before. Additionally, the spillovers are unlikely to be large this time, owing to an already overleveraged economy and increased emphasis on boosting consumption over infrastructure spending.

The timing is right. That said, the authorities have picked a very good time to unleash new stimulus. Sentiment on the economy and the stock market was extremely bearish and, as a result, a lot of investors were underweight China. The need to reduce underexposure and, in some cases, good old FOMO (fear of missing out) created a fertile ground for a rally. And Chinese corporate earnings appeared to have bottomed and valuations were cheap, making the market ready for a bounce once the right conditions emerged.

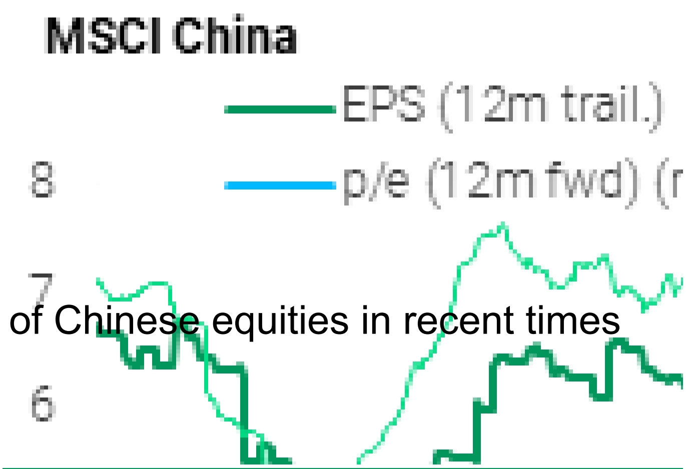
A tradeable rally that could turn into a bull market on further fiscal measures. While the size of the measures announced so far seems insufficient to correct the structural issues of the Chinese economy, the signalling effect of Beijing's changed stance cannot be overstated. Corporate fundamentals seemingly improving, cheap valuations and underweight investors, coupled with global monetary policy easing, should be powerful enough to sustain the rally for some time. But for the rally to turn into a bull market, more will fiscal impulse be needed and banks will have to

Equity investors are underweight China



Source: Bloomberg.

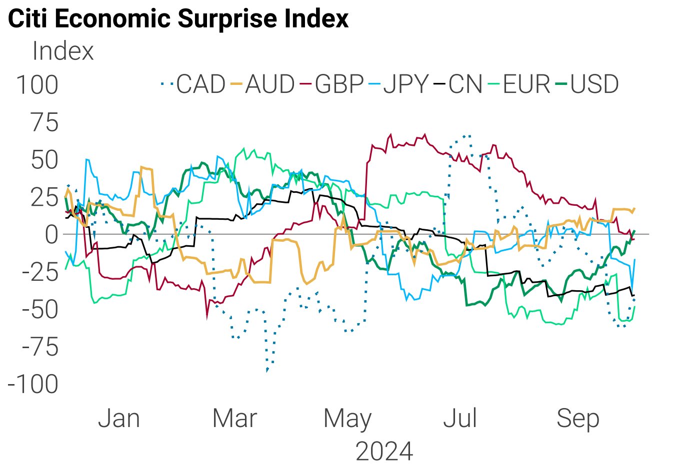
China EPS are rising and valuations are cheap



Source: Bloomberg.

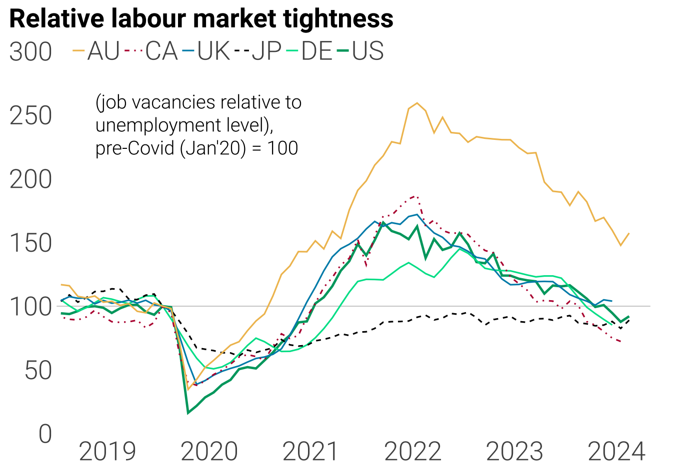
These charts just show the underperformance of Chinese equities in recent times

Australian econ surprises are steadily improving



Sources: Macrobond, GlobalData TS Lombard.

Australian job vacancies have yet to fully normalize



Sources: Macrobond, GlobalData TS Lombard.

be recapitalized. And, of course, the US election in November remains a serious risk. For now, however, Chinese equities are likely to continue to rise.

Long AUD vs CHF and JPY. Our positive view on the Australian dollar in recent months has worked out well, with AUD returning roughly 4.5%vs the USD since we upgraded it to +1 in our Asset Allocation report back in August. More recently, we got stopped out of our long AUD/CAD trade and we chose not to re-enter at the time as the apparent reluctance of Chinese policymakers to underpin the economy dampened our risk appetite. That has changed now, and we re-enter a tactical long AUD funded vs CHF and JPY. **The combination of Fed rate cuts into a strong economy to keep it strong alongside soaring EPS growth globally is an unusual combination and should help buoy risk sentiment**, which is an important factor for AUD.

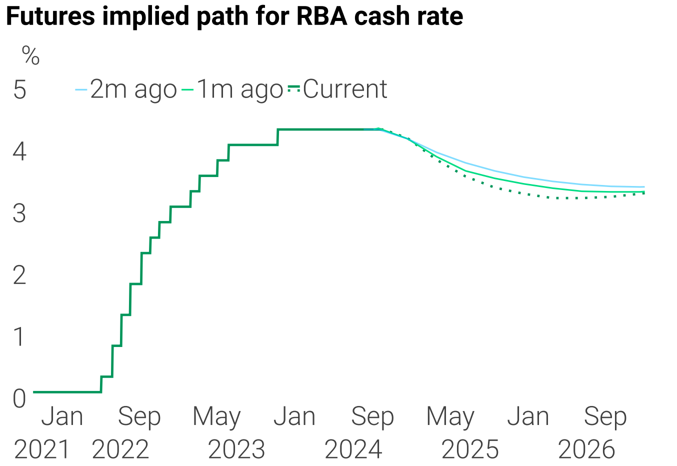
More cuts from the SNB are coming and new dovish signals from Japan's policymakers favour CHF and JPY shorts, especially as Fed Chair Powell hinted on Monday that the FOMC is not in a hurry to cut rates quickly, dampening market expectations of another 50bp cut. Moreover, the willingness of Chinese authorities to put a floor under the country's economic malaise should also be positive for AUD, given the close trade ties.

yo someone on the same page as me finally.

The ratcheting up of tensions between Iran and Israel is a risk factor, although we believe Iran has no incentive to severely escalate the war. Iran is placing considerably more strategic weight on developing its nuclear programme as the best means of ensuring the regime's existence. Israel does not possess the airpower needed to materially degrade the Iranian oil industry. The US alone has that power; and while White House National Security Advisor Jake Sullivan has made statements today that could be read as indicating US readiness to join offensive operations against Iran, there are reasons to be very sceptical about that – especially in the run-up to the US election. That said, we put a tight stop on the trade.

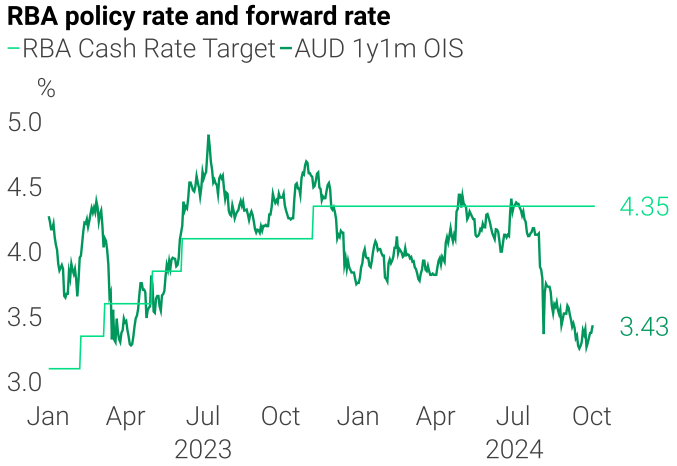
No cuts from the RBA this year. The RBA is still bucking the trend of the global easing cycle and remains one of the most hawkish G10 central banks. **We reiterate that the RBA will not cut rates this year as the country is still grappling with the brisk growth of unit labour costs, elevated job openings and soaring rental inflation at a time when underlying inflation is still around 4% y/y and economic surprises are positive and tending upwards**. The confidence that inflation will sustainably move into the RBA's target range of 1-3% looks beyond reach this year. We think the market probability of a cut this year – which currently stands at c 70% – will fade as the year progresses, lending more support to AUD alongside Chinese stimulus.

Rates path for RBA has become more dovish



Sources: Macrobond, GlobalData TS Lombard.

A lot is priced in, despite tight labour market



Sources: Bloomberg, GlobalData TS Lombard.

CHF ZIRP 2.0 incoming? The SNB cut its policy rate by another 25bp last week and massively revised its inflation forecasts lower – to as low as 0.5% next year raising the spectre of another round of ZIRP/NIRP. The current strength of the franc adds to the woes of many Swiss exporters amid the structural challenges in key export markets such as Germany. This should put renewed focus on FX intervention, even if new Governor Martin Schlegel has recently dodged journalists' questions about the valuation of the currency.

Portfolio update

We raise the stops on our equity and credit trades ahead of the US NFP report on Friday, which could trigger a sell-off in the event of another downside surprise, especially as the JOLTS report yesterday did not assuage investors' concerns about the health of the labour market.

We still like our long carry, short trend factor trade (expressed via long $EMHY vs a basket of CTA ETFs), which we opened post Jackson Hole. A Fed that cuts aggressively into a strong economy should dampen volatility and this is bad news for CTAs, which typically thrive on market and macro volatility as trends form. On the flipside, Chinese stimulus should buoy risk sentiment in EM credit markets. The trade has returned roughly 5% and we expect more gains over the coming weeks.

SNB dropped a major dovish surprise with its new inflation projection last week

Sources: Macrobond, Bloomberg, GlobalData TS Lombard.

Macro Strategy

	Ticker-Proxy	Opened	Entry	Last	P&L	Target	Stop	Original rationale / comment
US soft landing								
Long equal weight S&P 500	RSP US Equity	07-Aug-24			9.50%		7.50%	Soft landing & cuts = > contained correction
Long US HY Credit	HYG US Equity	26-Jun-24			5.20%		2.50%	HY is well suited for the expansion stage of the cycle
interesting **Long US CCC Credit**	XCCC US Equity	07-Aug-24			8.80%		5.00%	All in yield is attractive and spreads have room for compression
Fed reaction function								
Long Carry, Short Trend	EMHY vs (CTA, DBMF, KMLM, WTMF)	28-Aug-24			4.80%		-2.00%	Fed put is creeping back "in the money" => bad for trend
Long Stocks, Short Bonds	ACWI vs TLT	25-Sep-24			1.50%		-2.50%	Aggressive cuts into a strong economy
Global easing cycle								
Long 2y Gilt		10-Jan-24	4.24	3.76	48		45bp	2024 cuts and flat-lining of growth
Long AUD vs CHF & JPY		02-Oct-24					-3.00%	RBA bucking the global easing cycle
Policy mispricing								
Long DXY		22-Aug-24	101.2	101.5	0.40%		-2.00%	Fed pricing looks stretched relative to other DM central banks

Bold indicates new trades or changes made this week. (*) Opening today. As of October 2, 2024

Macro Strategy	Ticker-Proxy	Opened	Entry	Last	P&L	Target	Stop	Original rationale / comment
US soft landing								
Long equal weight S&P 500	RSP US Equity	07-Aug-24			9.5%		**7.5%**	Soft landing & cuts = > contained correction
Long US HY Credit	HYG US Equity	26-Jun-24			5.2%		2.5%	HY is well suited for the expansion stage of the cycle
Long US CCC Credit	XCCC US Equity	07-Aug-24			8.8%		**5.0%**	All in yield is attractive and spreads have room for compression
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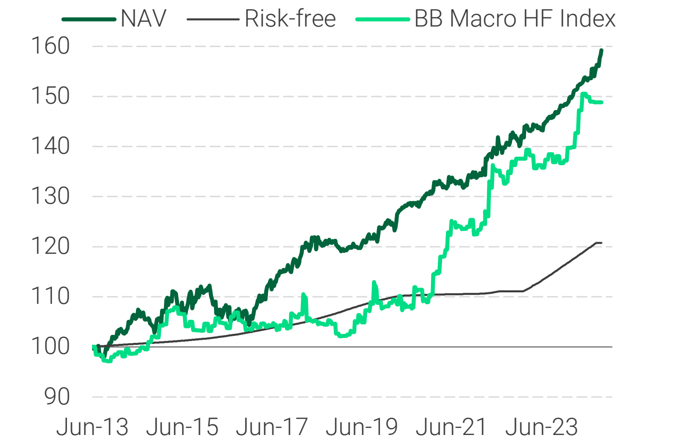
EM Trade Recommendations

Asset	Asset class	Long/ Short	Date Opened	Units	Open Level	Current Level	Total Return ($)
Brazil	Equity	Long	8-Jul-24		1,455	1,490	+2.4%
EM ex-China	Local debt	Long	12-Aug-24		145.6	151.3	+3.9%
USD/IDR	Currency	Short	27-Aug-24		15,495	15,258	+1.8%
MX credit vs USD/MXN	Credit vs FX	Long	2-Sep-24		100.00	100.86	+0.9%
EM HY vs EM equity	Credit vs Equity	Long	23-Sep-24		106.54	105.66	-0.8%

Date/time 2-Oct-24 07:56

Source: Bloomberg, GlobalData TS Lombard.

Model portfolio performance



Sources: Bloomberg, GlobalData TS Lombard

Model portfolio metrics since inception

Since inception return	
Annual return	
2020	
2021	
2022	
2023	
YTD	
12m return	
Max drawdown (12m)	

* Calculated using excess returr

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