

Data and opinions as of August 31, 2024

NEI perspectives

Market recovers from carry-trade selloff driven by strong economic data from the U.S., especially retail sales, boosting investor confidence. Macro data suggests a soft landing is increasingly likely, with potential lower recession risk. With corporate earnings growth remaining strong, and inflation moderation allowing for rate cuts, a bullish positioning with a focus on high-quality investments is still warranted.

Chairman Powell's dovish comments at Jackson Hole marked a shift of focus from inflation to labour market weakness, increasing market expectations of rate cuts and shifted the debate to whether the September rate cut will be 25 or 50 bps. Investors shouldn't shy away from fixed income in this environment. In previous easing cycles, fixed income investments outperformed equities, while interest rate-sensitive investments fared better than equities.

Nvidia's earnings report reflects investor skepticism. The continuing artificial intelligence (AI) boom is fueling significant capital expenditures from tech giants, with Nvidia at the forefront. Despite Nvidia's impressive Q2 earnings, investors were skeptical on the sustainability of their gross margins and whether they can consistently meet high expectations. Investors may soon begin to shift their attention from foundational providers like Nvidia to beneficiaries of AI adopters and users. Investors need to stay vigilant to look beyond quarterly results and consider how the AI landscape is rapidly evolving, especially as new winners emerge and competition intensifies.

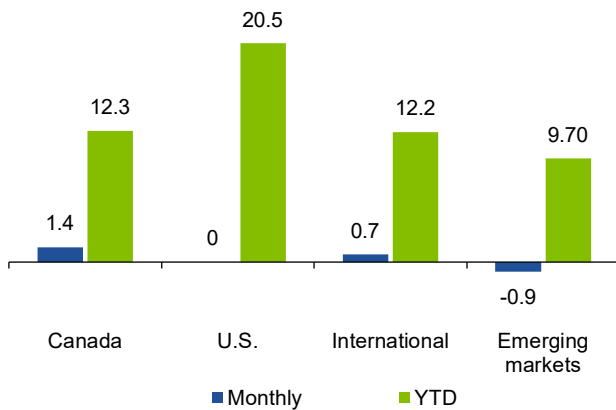
Bottom line: *Despite recent market volatility, the outlook for equities remains positive. We expect broadening of price performance outside of mega-cap companies driving the AI narrative, and into areas with better valuations such as defensive sectors. The U.S. Federal Reserve's (Fed) dovish stance also supports growth. Potential rate cuts could enhance the appeal of interest rate-sensitive investments, but market rotation may cause volatility.*

– NEI Asset Allocation team

From dips to dazzle: V-shaped recovery on shift in sentiment

The market faced a sharp decline at the beginning of August, driven by the rewinding of yen carry trade, exacerbated by fears that the U.S. economy was slipping into recession, after a higher-than-expected unemployment rate of 4.3%. Following the initial downturn, a series of encouraging economic indicators as well as Fed Chairman's comments at Jackson Hole signaling a shift in focus towards a more accommodative monetary policy, led to a significant boost in market sentiment, buoying major indices closer to their all-time highs. The recovery was led by technology, after previously being hit hard in the pullback.

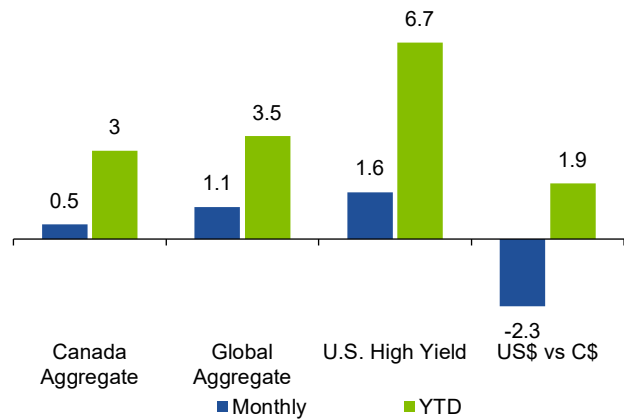
Equity returns (in C\$)



Canada: MSCI Canada Index TR; **U.S.:** MSCI USA Index TR
International: MSCI EAFE Index TR; **Emerging markets:** MSCI Emerging Markets Index TR.

Source: Morningstar Direct.

Fixed income and currency returns (in C\$)



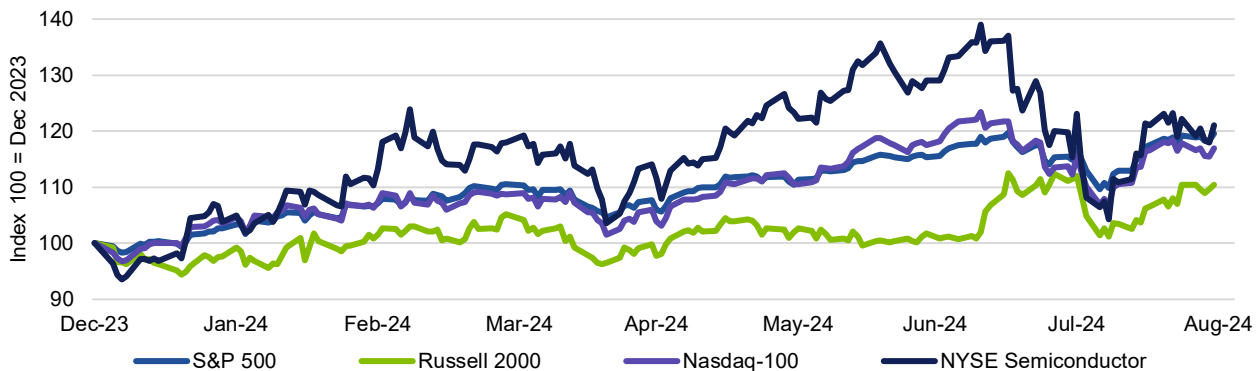
Canada Aggregate: Bloomberg Barclays Canada Aggregate Bond Index; **Global Aggregate:** Bloomberg Barclays Global Aggregate Bond Index; **U.S. High Yield:** Bloomberg Barclays U.S. High Yield Index.

Source: Morningstar Direct.

V-shaped comeback & global market resilience

The sharp selloff in early August was followed by a notable recovery in global markets driven by positive economic data releases in the U.S. that restored investor confidence. In the U.S., unexpected strength in retail sales and resilient consumer spending alleviated recession fears, while in Europe GDP growth also bolstered confidence. This recovery has coincided with a sector rotation toward value and small-cap stocks, which stand to benefit from anticipated rate cuts by the Fed. Additionally, supportive monetary policies from central banks worldwide have created a favourable environment for market stabilization.

Year-to-date performance



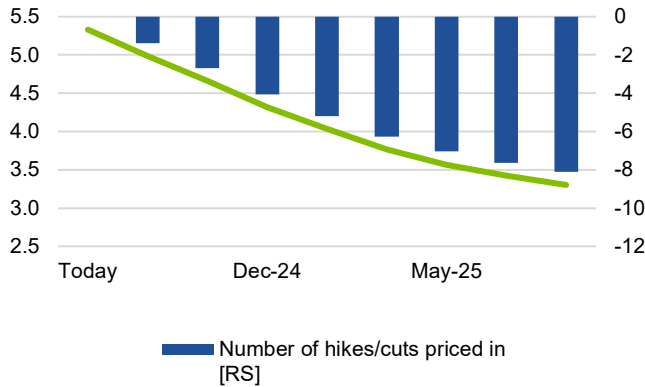
Source: Bloomberg.

In this sell-off, the magnitude of the drawdowns varied greatly by sectors and factors. As bond yields drifted lower, defensive sectors stood out as safe havens relative to the cyclical sectors. Low valuation held up better than companies that are rich on valuation, and large-cap companies outperformed small-cap companies. Importantly, bonds fulfilled their traditional risk-mitigating role as higher bond prices offset stock price weakness in a balanced portfolio. While most asset classes recovered from the bout of market volatility unscathed, these recent events demonstrate that investors are trading carefully amid market uncertainty and elevated market valuations. This speaks to the need for investors to avoid making quick decisions based on short-term volatility.

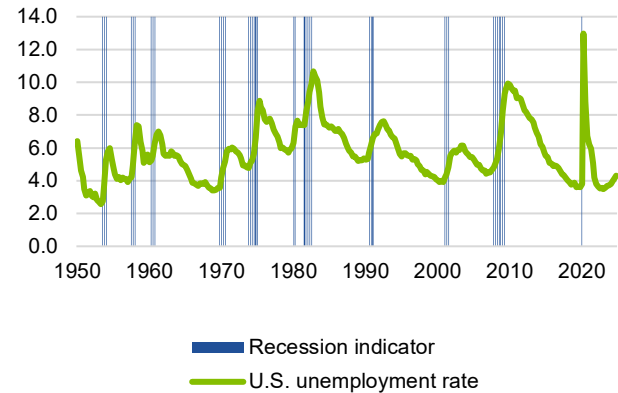
Dovish pivot at Jackson Hole

In his recent Jackson Hole speech, Fed Chair Jerome Powell signaled a notable pivot in the Fed's tone, shifting from a primary focus on taming inflation, to concerns about the labor market. This suggests that the central bank could be adopting a dovish stance and becoming more attentive to employment dynamics as unemployment rates rise, which could lead to potential rate cuts in the near future. Market reactions have already begun to reflect this outlook, with investors pricing in four rate cuts by the end of the year in the U.S.

U.S. rate cuts priced in & implied overnight rate



U.S. unemployment rate



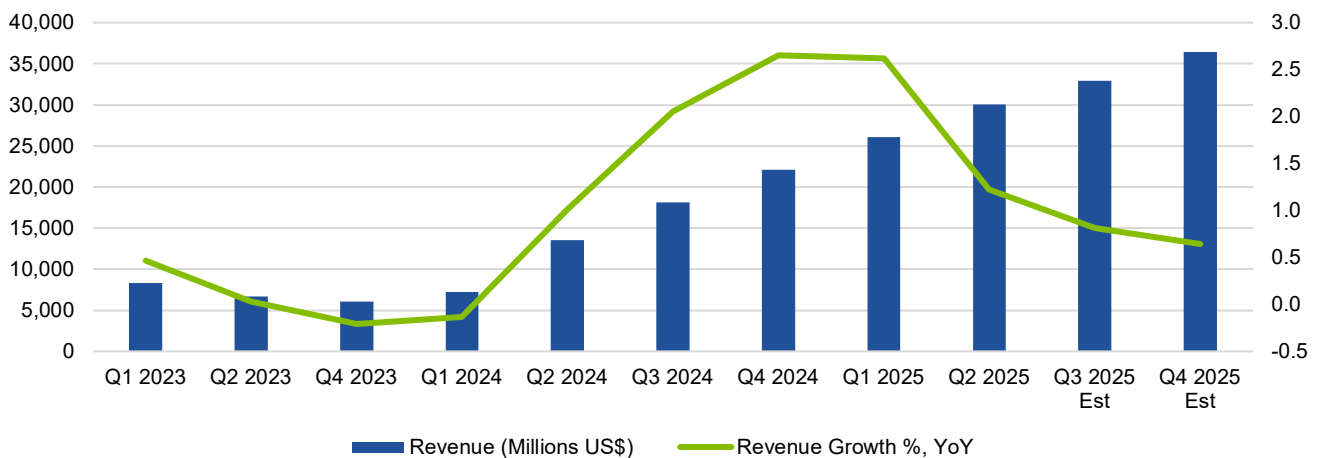
Source: Bloomberg, NEI Investments.

As the narrative evolves, the implications for the broader market are significant; a focus on labour market stability rather than inflation could foster a more supportive environment for equities, particularly in sectors sensitive to interest rates. As central banks begin the easing cycle, the yield curve tends to steepen, which also tends to give way to positive returns in fixed-income investments.

Nvidia's earnings highlight AI growth skepticism

The recent surge in AI investment is exemplified by Nvidia's (NVDA) impressive Q2 earnings, which featured a remarkable 122% year-over-year revenue increase, reaching \$30.0 billion. Data centre revenue, a key metric for Nvidia, saw a 154% increase to \$26.3 billion, highlighting the broader implications for capital expenditure on technology infrastructure as firms enhance their AI capabilities. However, Nvidia's next-generation Blackwell AI chips have faced delays, raising caution among investors. Despite beating Wall Street expectations, Nvidia's shares fell over 3% in after-hours trading following the earnings release, prompting a re-evaluation of whether its growth rates justify its current valuation.

NVDA Revenue growth expected to moderate in 2025



Source: Bloomberg.

While Nvidia is still a key indicator of AI demand, caution is warranted; the focus is not just on the chipmaker but on the broader implications for capital expenditure on technology infrastructure. As major firms ramp up their AI capabilities, investors may soon begin to shift their attention from foundational providers such as Nvidia to beneficiaries of AI adopters and users. Investors need to stay vigilant to look beyond quarterly results and consider how the AI landscape is rapidly evolving, especially as new winners emerge and competition intensifies.

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