J. Safra Sarasin
Cross-Asset Weekly

16 August 2024

The yen rebound is slowing but not over yet

After the fast unwind of the crowded yen carry trade, the explosive yen rally has come to a halt for now. The gap between the dollar-yen exchange rate and interest rates differentials has narrowed considerably in the process, however, it has not yet fully closed, suggesting that there is further upside for the yen. In our view, the yen's pace of appreciation will be more gradual from here, given that recent data indicate that most speculative short positions are cleared by now. Consequently, we expect USD-JPY to trade around its current level in the near term, but expect the pair to gravitate towards 140 by year-end.

In the rates space, we note that diverging central bank policies are leading to phase shifts in the cyclical behaviour of corresponding long-term government bond yields. Although long-term bond yields seem to follow a synchronised global interest rate cycle, subtle differences are emerging. Japan is still at a relatively early stage, while Switzerland is already far advanced in the current interest rate cycle, with other countries lined up in between.

We also review Q2 earnings which have comfortably beaten elevated pre-season consensus expectations. Sales were somewhat softer than earnings. Yet they still managed to grow at a solid pace as compared to previous quarters. From a sectoral perspective, consumer discretionary represented a pocket of weakness. Excluding the heavyweights Amazon and Tesla, the sector recorded its first yoy drop in EPS since early 2021. The deterioration in earnings has been corroborated in earnings calls. A broad set of firms, ranging from travel and home improvement to auto, consumer durables and fast food mentioned a restraint by consumers, which was most notable in the lower income segments.

This week's highlights

Japanese yen 2
Yen appreciation to be gradual from here

Global fixed income 4
Phase shifts in developed markets rate cycles

US equities 6
Q2 earnings review: Strong numbers, softer talk

Economic Calendar 9
Week of 19/08 – 23/08/2024

Market Performance 10
Global Markets in Local Currencies

Contacts

Dr. Karsten Junius, CFA
Chief Economist
karsten.junius@jsafrasarasin.com
+41 58 317 32 79

Raphael Olszyna-Marzys
International Economist
raphael.olszyna-marzys@jsafrasarasin.com
+41 58 317 32 69

Mali Chivakul
Emerging Markets Economist
mali.chivakul@jsafrasarasin.com
+41 58 317 33 01

Alex Rohner
Fixed Income Strategist
alex.rohner@jsafrasarasin.com
+41 58 317 32 24

Dr. Claudio Wewel
FX Strategist
claudio.wewel@jsafrasarasin.com
+41 58 317 32 26

Wolf von Rotberg
Equity Strategist
wolf.vonrotberg@jsafrasarasin.com
+41 58 317 30 20

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Japanese yen

Yen appreciation to be gradual from here

Dr. Claudio Wewel
FX Strategist
claudio.wewel@jsafrasarasin.com
+41 58 317 32 26

The Japanese yen has weakened slightly after its rally came to a halt last week, prompting the question where it will head next. While the recent USD-JPY slide has narrowed the FX-yield gap considerably, it is not closed fully, suggesting that there is further upside for the yen. In our view, the yen's pace of appreciation will be more gradual from here, given that recent data indicate that most speculative short positions are cleared by now. Hence we expect USD-JPY to trade at around its current level near term, while we expect the pair to gravitate to 140 as the year ends.

Japanese yen has weakened slightly after its rally came to a halt last week

Last week, the Japanese yen's sharp rally came to a halt. Yet the currency has retreated somewhat from last week's highs, calling for a reassessment of the yen's drivers to evaluate the currency's likely direction in the months ahead.

A series of events triggered the yen's rally:

1. **A weaker-than-expected US June CPI**
2. **FX intervention augmented initial move**
3. **Hawkish BoJ July meeting**
4. **Disappointing US manufacturing and labour market data**

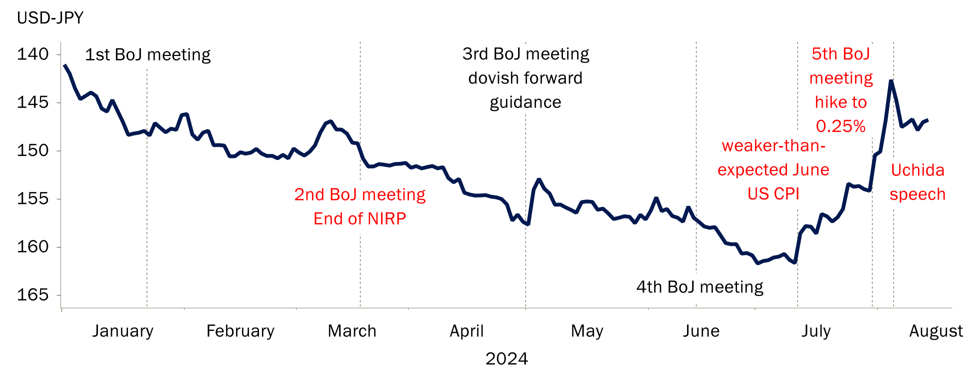
As we opined three weeks ago (see «Likely past its trough»), the weaker-than-expected June CPI print in combination with the BoJ's FX interventions, marked the beginning of an extended yen upward trend. The move gained further traction following the BoJ's decision to hike its policy rate to 0.25% and to start tapering its JGB purchases (Exhibit 1). BoJ Governor Ueda's surprisingly hawkish comments in the press conference following the meeting provided additional tailwind. Ueda noted that there was «still quite some distance» between the current policy rate and its neutral level that is believed to be somewhere between 1 and 1.5%. In essence, this would argue for further policy tightening before the end of this year. Disappointing US manufacturing and labour market data eventually pushed USD-JPY towards its January levels.

Resilient US services and comments from BoJ's Uchida halted the yen's rally

Given the degree of market turbulence, BoJ Deputy Governor Uchida backtracked Ueda's comments at the beginning of last week, noting that market developments could change the BoJ's rate hike path in case they affected the achievement of the bank's 2% inflation target and that it was «necessary to maintain current levels of monetary easing for the time being». Along with resilient US services data, Uchida's comments eventually halted the yen's rally and USD-JPY started to rebound from its lows. Over the past days, the pair held fairly steady at around 147, begging the question of where we should expect the yen to head in coming months.

As we have repeatedly voiced before (here, here and here), softer US data were pivotal for the yen's rebound

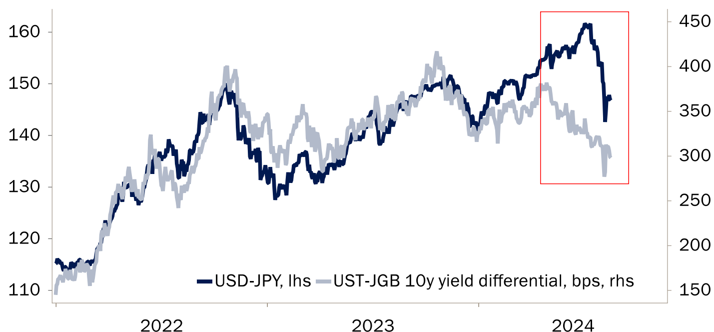
Exhibit 1: Apart from the BoJ's end to NIRP, a weaker June US CPI stopped the yen's decline



Source: Macrobond, Bank J. Safra Sarasin, 15.08.2024

Exhibit 2: Gap between USD-JPY and yields has narrowed markedly

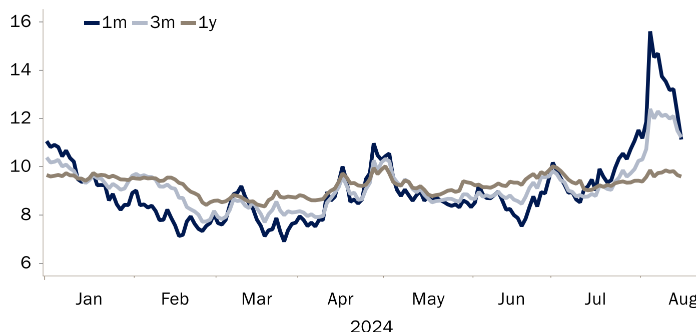
USD-JPY vs 10y yield differential



Source: Macrobond, Bank J. Safra Sarasin, 15.08.2024

Exhibit 3: Option-implied yen volatility on its way down

USD-JPY option-implied volatility



Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

FX-yield gap is not fully closed, suggesting that yen upside remains

Perhaps most importantly, the yen's sharp rally triggered what might have been the biggest yen-funded carry trade unwind in two decades. While the unwind narrowed the gap between USD-JPY and yields quite substantially, it is not entirely closed, suggesting that there still is further upside for the yen (Exhibit 2).

Yet the pace of yen appreciation is likely to be more gradual from here, given that most speculative shorts have been cleared

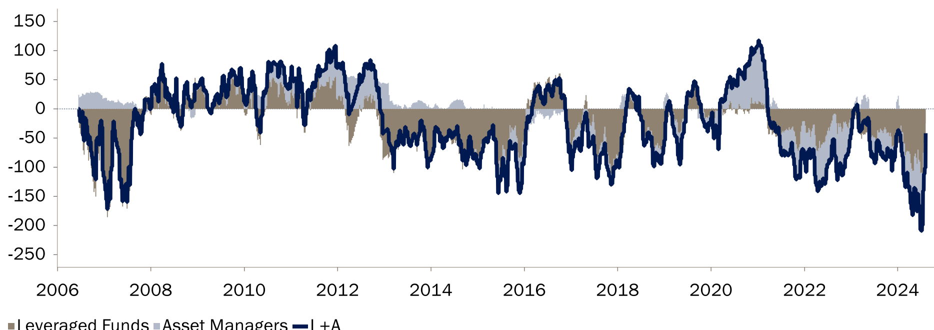
We expect the pace of yen appreciation to be more gradual from here. FX-option implied yen volatility has started to come down following the recent rout (Exhibit 3) and according to last Friday's CFTC TFF report, more than 80% of net speculative short positions have been cleared (Exhibit 4), such that the unwind of remaining positions is unlikely to have a substantial impact on the currency's dynamics. Hence we expect the yen's moves to be again more closely aligned to relative macro and yield dynamics.

Near term, the yen should trade at around current levels, while we expect USD-JPY to grind towards 140 towards year end

In our view, the dynamics of the dollar-yen yield differential should remain primarily US-driven. But given the current resilience of the US cycle, we think there is limited scope for a further narrowing. We also note that since late July, US yields have dropped by almost 50 basis points across the curve, which should constrain their downside potential. This means that the yen will likely trade at around current levels in the near term, while USD-JPY should grind towards 140 by the end of this year.

Exhibit 4: Past weeks likely saw the largest yen short position unwind in two decades

CFTC TFF Report, JPY net speculative positions, in thousand futures contracts



Source: Macrobond, Bank J. Safra Sarasin, 15.08.2024

J. Safra Sarasin
Cross-Asset Weekly

16 August 2024

Global fixed income

Phase shifts in developed markets rate cycles

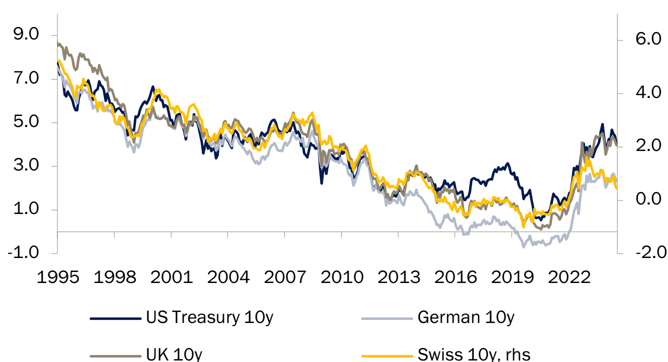
Alex Rohner
Fixed Income Strategist
alex.rohner@jsafrasarasin.com
+41 58 317 32 24

Long-term global bond yields tend to be highly correlated and largely move in common cycles. However, diverging local central bank policies can lead to differences in the cyclical behaviour of rates structures, in particular around turning points for long-term bond yields. The current price action is a perfect example for these phase shifts. Although long-term government bond yields seem to follow a synchronised global interest rate cycle at first sight, subtle differences are emerging. Japan is at a relatively early stage, while Switzerland is already far advanced in the current rate cycle, with other currency spaces lined up in between

Long-term global bond yields are highly correlated and largely move in global cycles

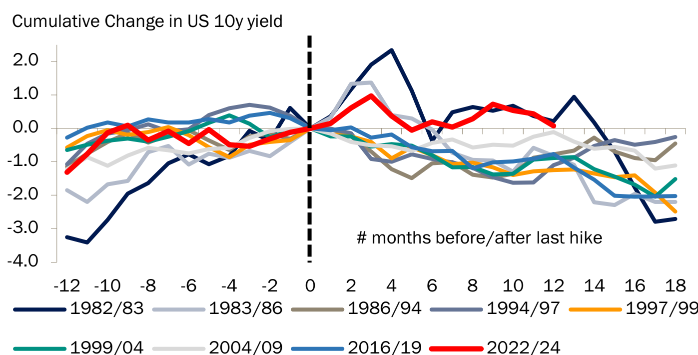
Global long-term bond yields have historically exhibited a high degree of correlation. A long-term bond yield can essentially be thought of as the average expected real short-term rate and inflation over the maturity of the bond plus a premium for taking on additional interest rate (as well as credit and liquidity) risk. Or to put it slightly differently, a bond yield is mainly a reflection of longer-term growth and inflation expectations for the respective interest rate space. The global economy and the global monetary system are highly interconnected. Economic weakness in one part of the global economy will tend to have negative effects on the other participants, affecting their economic outlook and expected policy rate trajectory. The same applies to the global monetary system: A problem in one part of the global (banking) system can quickly affect the whole system and can lead to coincident risk-off moves across all markets. It therefore makes sense that global long-term bond yields should exhibit significant correlation and hence largely move in global cycles (Exhibit 1).

Exhibit 1: Long-term government yields are highly correlated



Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 2: Long-term bond yields usually peak around the last hike



Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Local central bank policy divergences account for the imperfect correlation

Of course, the correlation is far from perfect. Diverging central bank policies do matter. Their monetary policy actions get passed through to the whole local interest term structure, though with a decreasing effect for longer maturities, and can lead to important divergences between bond yields. An example is the Fed's tightening cycle in 2018, that was not matched by other central banks and led to a sharp temporary increase of US long-term yields relative to their European counterparts. Divergences in central bank policies are instrumental in explaining differences in cyclical behaviour of rates structures, in particular with regard to turning points for long-term bond yields. The current price action is a perfect example for phase shifts created by divergent central bank policies. Let's see first how central banks help determine turning points for long-term bond yields:

J. Safra Sarasin

Cross-Asset Weekly

16 August 2024

Long-term bond yields usually peak around the last central bank rate hike

Long-term bond yields usually peak around the last central bank rate hike, that is, once policy makers realise that monetary policy is restrictive enough to achieve their objectives. As the evidence of economic headwinds due to monetary tightening starts to become visible, the danger for substantial mark-to-market losses even on longer-term bonds starts to diminish substantially, and investors feel more comfortable owning duration. Consequently, yields stop rising and start to form a top. This topping-out process can be very volatile and last for many months, but it ultimately paves the way to lower bond yields as central banks lower policy rates to provide monetary support (Exhibit 2).

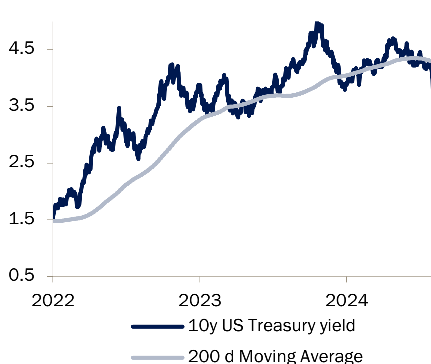
This topping-out process is currently playing out, with clearly visible phase shifts

This topping-out process is currently playing out with clearly visible phase shifts. The trend for 10-year JGB yields is likely still up as there is little conviction that the last hike by the Bank of Japan is already in (Exhibit 3). On the other side, The Fed and the Reserve Bank of Australia are done hiking rates and are eying their first rate cuts. Their long-term bond yields are well advanced in the process of forming a top (Exhibits 4 and 5). The euro area and the UK are already at a slightly more advanced stage. Their topping-out process is likely complete as both central banks have already cut rates and are eying further cuts (Exhibits 6 and 7). Finally, Swiss yields are at the most advanced stage and are already in an extensive sharp downward move (Exhibit 8).

Exhibit 3: BoJ likely not yet done with hikes, no firm top in place yet

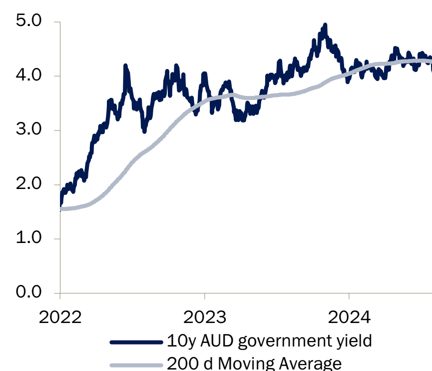
Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 4: Last Fed hike is in, Treasury yields well advanced in the process of topping out...



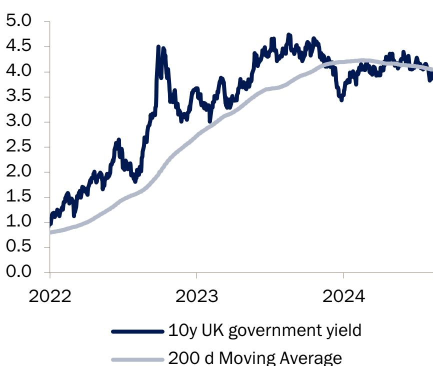
Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 5: ...a very similar story is unfolding in Australia



Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 6: BoE has already cut, more to come, top in Gilt yields likely complete

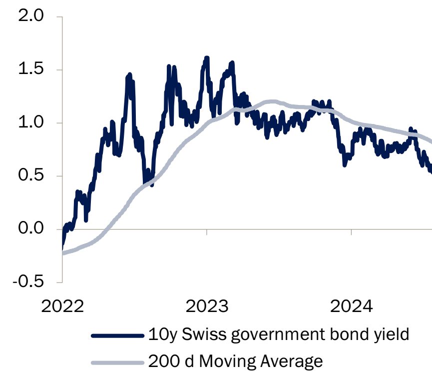


Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 7: ECB has already cut, more to come, top in euro area yields likely complete

Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

Exhibit 8: SNB has cut twice, more to come, bond yields already in advanced down move



Source: Bloomberg, Bank J. Safra Sarasin, 15.08.2024

J. Safra Sarasin

Cross-Asset Weekly

16 August 2024

US equities

Q2 earnings review: Strong numbers, softer talk

Wolf von Rotberg
Equity Strategist
wolf.vonrotberg@jsafrasarasin.com
+41 58 317 30 20

The US earnings season is coming to an end. Despite elevated consensus expectations going into the season, 77% of companies still managed to beat on earnings. Sales beats were at a more moderate 57%, but sales growth at 7% for the S&P 500 was still the strongest since Q4 2022. Those numbers provide little reason to be worried, even though they are once again predominantly driven by the «Magnificent 7». The one pocket of the market that has been notably weaker is consumer discretionary. Removing the heavyweights Amazon and Tesla from the consumer discretionary aggregate, the sector recorded the first year-over-year drop in EPS since early 2021. The soft numbers have been accentuated by management communication, which has in many cases flagged a waning of consumer demand, driven by the low end of the income distribution. More specific areas of weakness have been travel, home improvement, auto, durables and fast food, where a noticeable restraint by consumers has been mentioned, weighing on Q2 results.

Strong earnings beats as the Q2 earnings season is closing in

The US Q2 earnings season is coming to an end. Of the 86% of companies which have reported so far, 77% have beaten pre-season earnings expectations (Exhibit 1). This is not only above the 5-year average of 76%, but it also marks the highest earnings beat rate since Q4 2021. At 12%, year-over-year EPS growth has also registered the highest rate since Q1 2022. Yet despite the strong data, market performance has been soft since the season started in mid-July. The S&P 500 has lost 3.5% since 15 July as positive earnings surprises gained less than usual while negative surprises lost more.

Earnings beats did not translate into performance as other factors have outweighed results

Companies that have surprised positively have seen an average price increase of 0.8% two days before the earnings release through two days after the earnings release. This is below the 5-year average price increase of 1.0%. At the same time, companies which have reported negative earnings surprises saw an average price decrease of 3.8% two days before through two days after the earnings release. This is larger than the 5-year average price decrease of 2.3%.

Some notable observations

The reason for the market's softness certainly goes beyond reported Q2 earnings and has to do with wider concerns about the US cycle. Yet the underlying data and message from the earnings season was also less positive than the headline numbers are suggesting. We think three observations are worth mentioning in this regard.

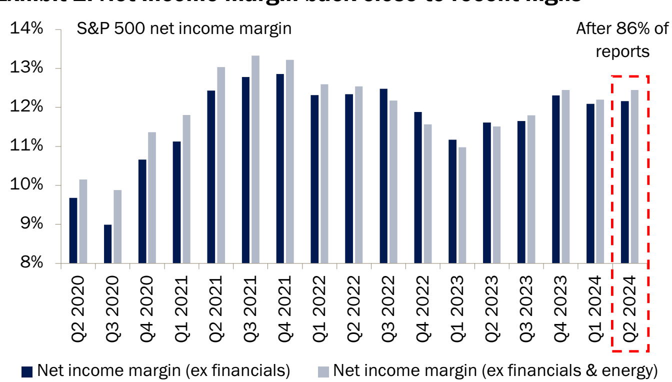
Sales have been softer than earnings

i) Sales have been softer than earnings
While 77% of companies have managed to beat earnings expectations, only 57% of companies reported better than expected sales numbers (Exhibit 1). The yoy sales growth rate at 7% has also been well short of the EPS growth rate at 12%. Earnings growth has thus come to a large extent from solid net income margins, which have risen back above 12%, on par with the peaks seen over the past two years (Exhibit 2). Is this a reason to worry? Probably not. Although weaker than earnings growth, sales growth at 7% yoy still marks the highest rate since Q4 2022, indicating that companies were able to raise their margins on the back of solid top-line growth, most likely via continued pricing power and strong cost discipline.

Exhibit 1: Strong earnings beats, sales much softer

Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

Exhibit 2: Net income margin back close to recent highs



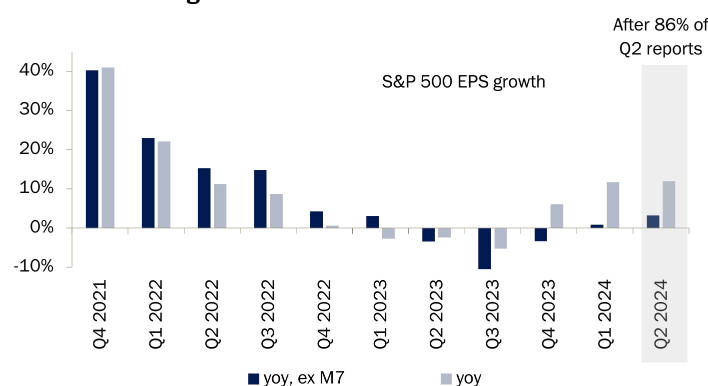
Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

The «Magnificent 7» remain the biggest game in town, but not the only one

ii) **The «Magnificent 7» remain the most important growth driver**

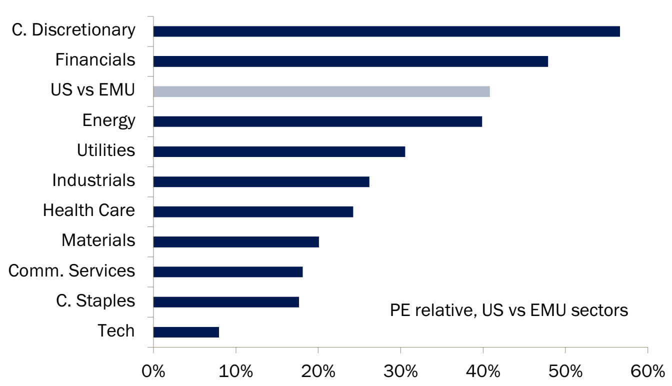
The Magnificent 7 have once again delivered the majority of EPS growth in the S&P 500. Even though NVIDIA yet has to report its Q2 numbers (28 August), it is clear that the Magnificent 7 have once again contributed to the majority of EPS growth. Removing them from the S&P 500 aggregate, yoy EPS growth for the index drops from 12% to 3.2%, which would still be the highest growth rate since Q4 2022, but markedly lower than the double-digit number if all S&P 500 constituents are included (Exhibit 3). On a positive note, the broadening of the earnings recovery is definitely visible in Q2 data. On a more negative note, underlying earnings growth still looks very sluggish. This begs the question whether the large valuation premium of US sectors vs other regions is justified, in particular given that other regions are producing similar earnings growth rates outside tech (Exhibit 4).

Exhibit 3: The «Magnificent 7» remain the main EPS driver



Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

Exhibit 4: US sector valuations remain well above EMU valuations



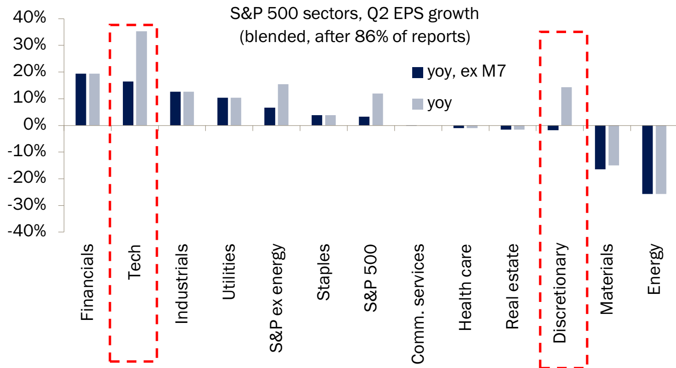
Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

Most worrying is the reported softening of consumer demand

iii) **The low-income consumer shows signs of cracking**

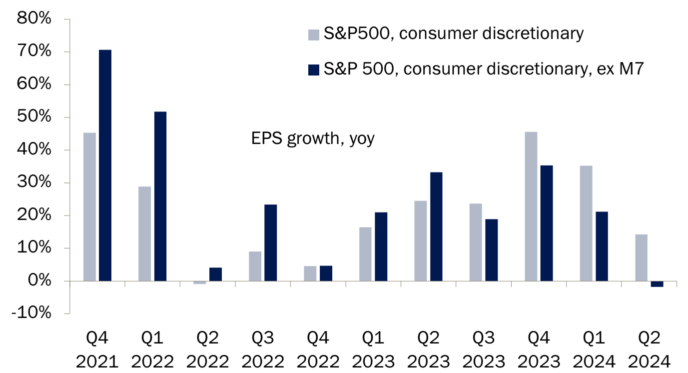
A broad set of companies, ranging from travel & leisure to apparel, retail, home improvement, fast food chains and autos are reporting a fade in demand and an increasingly exhausted consumer, in particular in the lower half of the income distribution. Consumers are starting to cut back their discretionary spending and this is becoming more visible in reported earnings. The consumer discretionary sector is naturally the most exposed to slowing demand. Once the two heavyweights Amazon and Tesla are removed from the sector, consumer discretionary has seen the first decline in reported earnings since the beginning of 2021 (Exhibits 5 & 6).

Exhibit 5: Consumer discretionary and tech boosted by M7



Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

Exhibit 6: Ex M7, discretionary earnings growth is negative



Source: Refinitiv, Bank J. Safra Sarasin, 13.08.2024

A strong season with some caveats

In conclusion, the Q2 earnings season has been strong in terms of beats and earnings growth rates. The most concerning feature, however, is what companies have to say about the low-income US consumer. Some companies may benefit, as the combination of a cooling labour market, easing price pressures and lower funding costs helps margins. Yet if demand were to slow more aggressively, the hit to top-line growth would likely outweigh the positive impact from cost reductions.

Exhibit 7: Our Q2 earnings season dashboard

S&P 500 earnings dashboard Q2 2024	Reported				Blended (reported + consensus)		Net income margin	
Sector	**% reported**	**EPS yoy**	**Sales yoy**	**EPS beats**	**EPS yoy**	**Sales yoy**	**Consensus Q2**	**5-year avg**
Energy	96%	-26%	2%	71%	-26%	2%	9%	7%
Basic materials	100%	-15%	-6%	78%	-15%	-6%	12%	13%
Industrials	89%	17%	6%	88%	13%	5%	13%	12%
Consumer discretionary	72%	25%	13%	80%	16%	9%	6%	5%
Consumer staples	69%	6%	9%	72%	4%	8%	6%	6%
Health care	91%	-1%	8%	92%	-1%	9%	11%	13%
Financials	95%	19%	10%	75%	19%	10%	16%	16%
Technology	73%	32%	13%	77%	35%	14%	27%	24%
Communication services	88%	14%	3%	86%	0%	-8%	16%	14%
Utilities	100%	10%	-17%	41%	10%	-17%	14%	13%
Real estate	100%	-2%	4%	68%	-2%	5%	18%	19%
S&P 500	**87%**	**12%**	**7%**	**77%**	**12%**	**6%**	13%	12%
S&P ex energy & financials	84%	15%	7%	78%	15%	6%	12%	12%
S&P ex energy	86%	16%	8%	78%	16%	7%	13%	12%
S&P ex financials	85%	11%	7%	78%	11%	6%	**12%**	**12%**
S&P cyclicals	84%	16%	9%	84%	12%	7%	9%	8%

Source: Refinitiv, Bank J. Safra Sarasin, 14.08.2024

Economic Calendar

Week of 19/08 – 23/08/2024

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 19.08.2024						
US	16:00	Conference Board Leading Index	Jul	mom	-0.30%	-0.20%
Tuesday, 20.08.2024						
US	14:30	Philly Fed Non-Mfg Activity	Jul	Index	--	-19.10
Wednesday, 21.08.2024						
US	14:30	MBA Mortgage Applications	Aug16	wow	--	16.80%
UK	20:00	FOMC Meeting Minutes				
Thursday, 22.08.2024						
GE	09:30	HCOB Germany Mfg PMI	Aug	Index	--	43.20
EU	10:00	HCOB Eurozone Mfg PMI	Aug	Index	--	45.80
UK	10:30	UK Mfg PMI	Aug	Index	--	52.10
US	14:30	Chicago Fed Nat Activity Index	Jul	Index	--	0.05
	14:30	Initial Jobless Claims	Aug17	1'000		--
UK	15:45	US Mfg PMI	Aug	Index	--	52.10
US	16:00	Existing Home Sales	Jul	mn	3.90m	3.89m
	17:00	Kansas City Fed Manf. Activity	Aug	Index	--	-13.00
Friday, 23.08.2024						
JN	01:30	Natl CPI Ex Food, Energy YoY	Jul	yoy	2.00%	2.20%
EU	10:00	ECB 1 Year CPI Expectations	Jul	%	--	2.80%
	10:00	ECB 3 Year CPI Expectations	Jul	%	--	2.30%
US	16:00	New Home Sales	Aug	1'000	634k	617k
	17:00	Kansas City Fed Services Activity	Aug	Index	--	-4.00

Source: Bloomberg, J. Safra Sarasin as of 15.08.2024

J. Safra Sarasin

Cross-Asset Weekly

16 August 2024

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W (bp)	Δ YTD (bp)	TR YTD in %
Swiss Eidgenosse 10 year (%)	0.46	2	-25	2.4
German Bund 10 year (%)	2.26	4	24	-0.2
UK Gilt 10 year (%)	3.92	-3	39	-0.1
US Treasury 10 year (%)	3.90	-4	2	2.6
French OAT - Bund, spread (bp)	72	-2	19	
Italian BTP - Bund, spread (bp)	137	-5	-31	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	12'150	18.7	2.7	12.5
DAX - Germany	18'183	13.3	2.8	8.5
MSCI Italy	1'042	8.9	1.9	8.7
IBEX - Spain	10'886	10.5	3.1	11.3
DJ Euro Stoxx 50 - Eurozone	4'808	13.5	3.0	9.4
MSCI UK	2'389	12.2	2.9	11.1
S&P 500 - USA	5'543	23.2	4.3	17.2
Nasdaq 100 - USA	19'490	30.1	5.9	16.4
MSCI Emerging Markets	1'076	12.9	2.9	7.3

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.87	7.6	0.7	3.6
EUR-CHF	0.96	6.5	1.3	3.0
GBP-CHF	1.12	7.8	1.6	4.7
EUR-USD	1.10	6.0	0.6	-0.5
GBP-USD	1.29	6.8	0.9	1.2
USD-JPY	149.0	10.6	1.6	5.7
EUR-GBP	0.85	4.8	-0.3	-1.6
EUR-SEK	11.56	6.9	0.6	3.8
EUR-NOK	11.79	8.8	-0.1	5.0

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	96	11.0	1.1	-2.9
Brent crude oil - USD / barrel	84	28.7	4.5	8.4
Gold bullion - USD / Troy ounce	2'455	15.9	1.1	19.0

Source: J. Safra Sarasin, Bloomberg as of 15.08.2024

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