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# PHILEQUITY CORNER

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## Cut, cut, cut

In our recent articles, we noted that the most important catalyst for capital markets is a peak in interest rates (see *Some good news*, November 13, 2023, and *Good tidings*, November 27, 2023). This became clearer after Federal Reserve (Fed) Chair Jerome Powell made a dovish speech last Thursday. Based on the Fed's latest dot plot, there will be no rate hikes forthcoming and the Fed expects three rate cuts amounting to 75 basis points next year.

## Pivot party

Market sentiment improved as bonds, stocks, commodities, and global currencies soared after the Fed meeting. Investors refer to this as the everything rally. The yield on the 10-year US Treasury fell from a 16-year high of 5.02% in October 23 to 3.91% last Friday. The Dow closed at a record high of 37,305 while the S&P 500 notched a 23-month high of 4,719. This year's rally was primarily led by tech heavyweights, as seen in the Nasdaq's 41.5% year-to-date return. The Dow, S&P 500, and Nasdaq are now up 15.4%, 15%, and 18.1%, respectively, from their October lows.

## The great monetary pivot

In his speech, Powell added the word "any" to highlight the Fed's view that interest rates are at or near the peak. Powell finally bared that the Fed is considering rate cuts. Powell's latest remarks surprised investors because he was still hawkish in his December 1 speech when he warned that talks of rate cuts were premature. Below are some quotes from Powell's policy statement.

- "Inflation has eased from its highs, and this has come without a significant increase in unemployment."
- "Our actions have moved our policy rate well into restrictive territory."
- "We will make decisions about the extent of **any** additional policy firming and how long policy will remain restrictive based on the totality of the incoming data, the evolving outlook, and the balance of risks."
- "So we added the word **"any"** as an acknowledgement that we believe that we are likely **at or near the peak** rate for this cycle."
- "People generally think that we're at or near that and think it's not likely that we will hike, although we don't take that possibility off the table."

Powell's latest speech may be signaling the start of the Fed's pivot from tightening to easing. This comes after the Fed's unprecedented tightening cycle which entailed 11 rate hikes in 17 months amounting to 525 basis points.

## Three cuts in 2024

Powell noted the shift in the Fed's dot plot which now point to three rate cuts that would amount to 75 basis points next year.

- "If the economy evolves as projected, the median participant projects that the appropriate level of the federal funds rate will be 4.6 percent at the end of 2024, 3.6 percent at the end of 2025, and 2.9 percent at the end of 2026, still above the median longer-term rate."

## Central banks pause from tightening

Aside from the Fed, there were other central banks that held their policy meetings and paused from tightening. The European Central Bank (ECB) said last week that "policy rates will be set at sufficiently restrictive levels for as long as necessary." The Bank of England (BOE) stated that "monetary policy is likely to need to be restrictive for an extended period of time." Bangko Sentral ng Pilipinas (BSP) Governor Eli Remolona said that the BSP "is hawkish for the time being" as "we're not so convinced yet the trend will hold so we need more data." Though their statements were not as dovish, the ECB, BOE, and BSP followed the Fed's lead by keeping their policy rates unchanged. The People's Bank of China (PBOC) injected $112b of additional liquidity to support the financial system and the slowing Chinese economy.

## Monitor the risks

While global markets surged amid signs of a Fed pivot, there are still risks that can upset the rally and alter the outlook. After the surge in stock prices, the market is now overbought and probably needs a correction. Also, the market may be getting ahead of itself as investors expect six to seven rate cuts next year. It remains to be seen if there would be a deep recession caused by overtightening of monetary policy. An escalation of the US-China trade war and the ongoing deflation in China may dampen global growth. The rise of authoritarian regimes, the 2024 US election, and a potential Trump comeback may destabilize the global economy. Meanwhile, the heightened encounters in the South China Sea between the Philippines and China may become the trigger for a bigger armed conflict involving China, the US, and its allies. There are also geopolitical risks emanating from the potential escalation of the war in Ukraine and tensions in the Middle East.

## Broadening

The primary market catalyst that we discussed in our recent articles has already materialized. Powell's speech last week may be the beginning of the Fed's policy shift from tightening to easing amid clearer signs that inflation is on a downtrend. This has resulted in seven weeks of gains for the S&P 500 (the longest in six years), the biggest weekly gain for US Treasuries since March 2020, and the best trading day for financial assets since 2009.

We explained in our recent articles that market strength has broadened to other sectors and will lift emerging market counters such as the PSEi. This played-out as the All-Country World Index ETF (ACWI) is now up 14.3% from its October low while the MSCI Emerging Index Fund (EEM) has gained 9.9%. The PSEi closed at 6,478 last week after rebounding by 9.4% from its recent low of 5,920 in October 31.