MARCH 25, 2024

PHILEQUITY CORNER

By Wilson Sy

PhilEquity MANAGEMENT INC.

Dovish Powell lifts markets to historic highs

Last week, US equities reached new all-time highs, thereby lifting global stock markets. This came on the back of Federal Reserve (Fed) Chair Jerome Powell's dovish policy statement. In that speech, Powell touted considerable progress in bringing down inflation, notwithstanding the bumps in the road toward the 2% target.

Story has not changed

In its policy meeting last week, the Fed kept its policy rate unchanged at 5.25-5.50%. The 2024 dot plot was likewise unchanged at 4.6%, implying three rate cuts for this year. When he was asked about higher-than-expected inflation in January and February, Powell replied that "they (two months of recent inflation data) haven't really changed the overall story, which is that of inflation moving down gradually on a sometimes bumpy road toward 2%." Powell added that "we're not going to overreact to these two months of data, nor are we going to ignore them."

"Peak for this tightening cycle"

Powell further clarified his stance in his speech. His comments showed that the Fed is willing to cut rates but it is patiently waiting for the right time to do so. Below are quotes from Powell's policy statement last week that caused markets to move higher.

- "As labor market tightness has eased and progress on inflation has continued, the risks to achieving our employment and inflation goals are coming into better balance."
- "We believe that our policy rate is likely at its peak for this tightening cycle and that, if the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year."
- "We know that reducing policy restraint too soon or too much could result in a reversal of the progress we have seen on inflation and ultimately require even tighter policy to get inflation back to 2 percent."
- "At the same time, reducing policy restraint too late or too little could unduly weaken economic activity and employment."
- "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably down toward 2 percent."
- "Of course, we are committed to both sides of our dual mandate, and an unexpected weakening in the labor market could also warrant a policy response."

Dollar strengthens against global currencies

The strong US economy and the US-led bull market in stocks caused the US dollar to strengthen despite Powell's dovish statements. Below, we discuss the move of three major currencies that weakened against the US dollar last week.

1. **Swiss franc.** The Swiss National Bank last week cut interest rates amid expectations of easing inflation and modest economic growth. The SNB became the first major central bank to cut rates, thereby causing the Swiss franc to weaken against the dollar.

2. **Chinese yuan**. The USDCNY rate broke above the 7.20 threshold as the People's Bank of China (PBOC) signaled that it would tolerate a wider trading band. The PBOC said that it has room to lower its reserve requirement ratio in order to boost liquidity. China also has room to cut interest rates in order to support and stimulate its economy.

3. **Japanese yen**. The Bank of Japan implemented its first rate hike in 17 years, thereby ending its negative interest rate regime. With the normalization of interest rates in Japan, the yen should have strengthened. However, the interest rate differential remains wide and the yen weakened as the USDJPY rate breached $150.

Since European and Asian economies are weaker than the US, then the Fed has more leeway to delay rate cuts and the US dollar has more room to strengthen.

The Nvidia effect

Aside from the Fed, another major catalyst behind the current bull market is the surge of investments in AI. Nvidia (NVDA) is leading the AI charge, and it is up 90% year-to-date after gaining by 239% in 2023. It is on track for its best quarterly performance since 2001.

Last week, Nvidia announced the arrival of its new Blackwell platform. During its launch, several CEOs from important tech companies described their business relationships with Nvidia. They also emphasized the transformative nature of Nvidia's new platform and how it can completely change how their businesses run.

In an interview with CNBC's Jim Cramer, Nvidia's President and CEO Jensen Huang said that "we're in the beginning of the accelerated computing ramp. It's going to last a few years." In describing the significance of the ongoing AI industrial revolution, Cramer said, "I think AI's bigger than the loom or the steam engine or the jet engine or the mainframe or the microprocessor, perhaps all rolled into one."

Fed and AI powered bull market

Global markets are being boosted by the Fed pause, the strong US economy, the possibility of rate cuts, the dawn of the AI era, and Nvidia in particular. US stock indices reached new record highs, consequently driving global indices to new all-time highs as well. The S&P 500 is up 27% since October and it is on track to deliver its best performance since 1970. The MSCI All Country-World Index ETF (ACWI) reached an all-time high of 110.37 last week. Meanwhile, the PSEi is up 16.2% from its October low and is 6.7% higher year-to-date. Market sentiment was lifted by Powell's dovish speech and the dot plot which showed that the Fed is still on course to deliver three rate cuts this year. Barring a major negative event, the move of the market will continue to be powered by the Fed and US megatech companies that are contributors and beneficiaries of the AI value chain.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email ask@philequity.net.