

QUARTERLY TRADING REPORT



Q3 2024

THE BIG ROTATION AND THE BIG CUT



RESEARCH

The big rotation and the big cut

U.S. equity-market leadership reversed course during the third quarter of 2024, with small cap stocks outperforming their large cap counterparts and the value factor beating the growth factor. This marked a significant change from the first two quarters of the year, when market returns were far and away dominated by U.S. large cap growth stocks—particularly the Magnificent Seven group of stocks.

Fixed income markets were mainly driven by expectations for U.S. Federal Reserve (Fed) rate cuts, which caused yields to fall throughout most of the quarter in anticipation of the onset of the rate-cutting cycle. Following the Fed's supersized 50-basis-point (bps) rate cut, however, rates ticked upward again as traders bet on a slower pace of easing moving forward. In foreign exchange markets, the decrease in rates led to an uptick in volatility.

At Russell Investments, our 87 years of experience executing trades for a broad range of institutional clients gives us valuable and differentiated insights into the latest market trends and insights. We trade approximately \$2.3 trillion annually through our multi-venue trading platform, and maintain a 24-hour global trading desk with access to over 100 countries across all asset classes. Here are our key observations from the third quarter of 2024 and insights into the months ahead.

EQUITIES

Overview

The third quarter of 2024 was a rollercoaster ride for global equity markets, marked by significant volatility and mixed performances across regions and sectors.

The MSCI All Country World Index (ACWI) posted a modest gain of 0.5%, reflecting a quarter of ups and downs. Early in the period, concerns over the global economic outlook and high valuations in tech stocks led to a market slump. However, a batch of positive economic data and a 0.5-percentage-point interest rate cut by the Fed sparked a sharp turnaround late in the quarter. The recovery was further bolstered by China's aggressive stimulus measures, which included rate cuts and fiscal support.

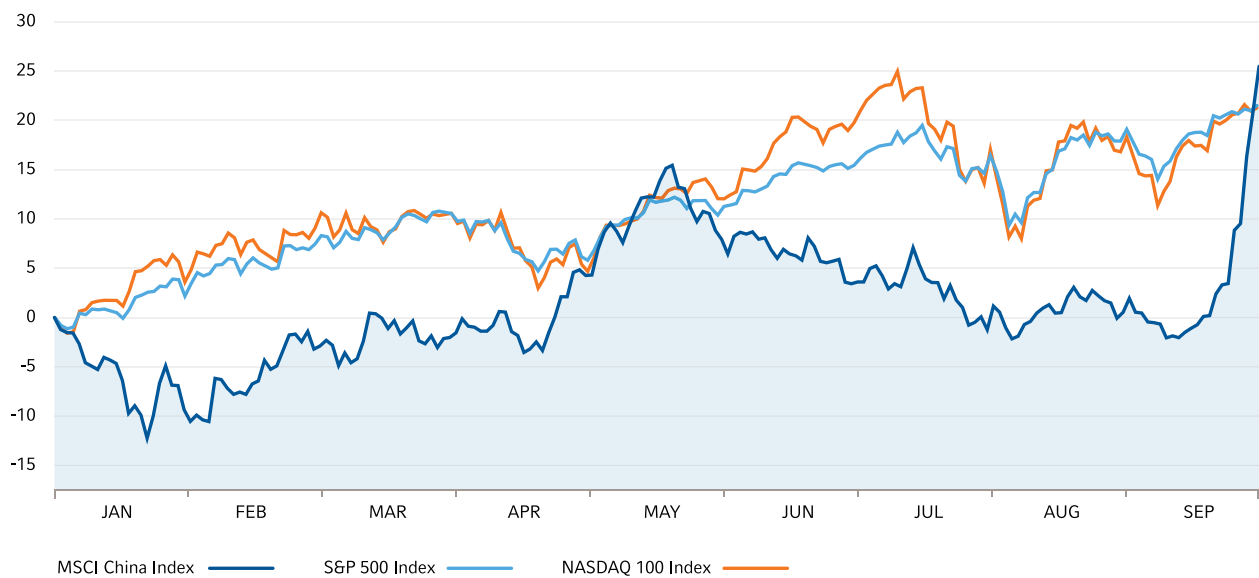
Chinese equities were the standout performers during the quarter, with the MSCI China Index surging 16.4% due to the large-scale stimulus measures aimed at reviving economic growth. In contrast, the Nasdaq 100 Index fell by 4.3% as investors grew wary of high valuations in U.S. tech stocks. European markets showed resilience, with the Euro Stoxx 50 gaining 2.1%, driven by strong corporate earnings and easing inflation concerns.

Investment trends in the U.S.

From Q2 to Q3, there was little change in U.S. average daily turnover, with \$578.8 billion in Q3—compared to \$581.5 billion in Q2. Sept. 20 saw elevated closing volumes due to quarterly index rebalances in both major U.S. and global indexes.

Perhaps most significantly, the third quarter was marked by a stark shift in investor focus from high-flying tech stocks to more traditional sectors. Small cap and value stocks outperformed large cap and growth stocks, benefiting from the broader market rotation. Additionally, utility stocks gained traction, driven by increased investments in energy infrastructure to support the growing demand from AI (artificial intelligence) and data centers. After a year-plus of narrow market leadership fueled by the strength of the Magnificent Seven, the broadening of the rally served as a good reminder of the value of portfolio diversification.

PERFORMANCE OF CHINESE STOCKS VS. U.S. INDEXES, Q1–Q3 2023



Source: MSCI China Index, S&P 500 Index, NASDAQ Index

FIXED INCOME

The third quarter kicked off with all eyes on the U.S. labor market and the Fed. The U.S. Treasury market saw rates continuing to fall from the highs set earlier this year (rates peaked in the 4.7%-5.0% range in April), and a disinversion in the yield curve followed suit, with the spread between the 10-year yield and the 2-year yield breaking off its -50 bps low in June and rising to a high of +20 bps in September.

Price action stemmed from a multitude of factors—primarily the Fed rate cut in September—and further cuts anticipated going into year-end (markets are pricing in approximately 45 bps of easing by the end of 2024). Positioning has been long all year, but has since eroded in light of a red-hot September U.S. jobs report (254,000 new jobs were added, compared to estimates for 150,000). This caused rates to rise across the board, with the 10-year U.S. government bond yield topping 4% and the spread between the 10-year and 2-year notes re-flattening to around 3 bps.

In credit, primary markets remained very active, with September hitting a record high of \$208 billion in issuance—and the third quarter logging \$476 billion in issuance overall. While September historically is the most active calendar month for bond issuance, this was further magnified in 2024 by the onset of the easing cycle and a firm demand backdrop from investors (new issues tightened, on average, by about 1.5 bps in Q3 and have tightened by about 4.6 bps year-to-date). The spread environment remained well supported by technicals, with investment-grade credit tightening by approximately 3 bps to an option-adjusted spread (OAS) of 90—nearing May's level of 85 bps. Moving forward, credit markets will continue to monitor Fed rhetoric as a soft landing increasingly gets priced in, with labor and inflation reports remaining the focal point for the rest of the year.

Other notable watchpoints for fixed income markets are the U.S. elections in November, rising tensions in the Middle East, the recently announced stimulus measures in China, and Q4 central bank meetings. Both the Bank of England (BoE) and the European Central Bank (ECB) have signaled further cuts by year-end, while the Bank of Japan (BoJ) is expected to hold off on rate hikes for a bit.

While new Japanese Prime Minister Shigeru Ishiba is seen as a monetary policy hawk, he has lately softened his tone on rates and appears more aligned with the BoJ. Volatility around the Japanese yen will also be a key watchpoint for markets moving forward, given the systematic carry trades that were unwound in July and August.

FOREIGN EXCHANGE

The foreign exchange (FX) market was influenced by a blend of monetary policy adjustments and geopolitical uncertainties during the third quarter, with the actions of central banks playing a key role.

The U.S. dollar (USD) exhibited a gradual weakening against other currencies, as reflected by the U.S. Dollar Index (DXY), which fell from 105.90 in early July to 100.77 at the end of September. This decline occurred as the Fed maintained high interest rates for longer than expected. The beginning of the Fed easing cycle in mid-September triggered heightened volatility in FX markets, with ongoing discussions about the timing and extent of future rate cuts further fueling uncertainty.

The EUR/USD (euro vs. U.S. dollar) exchange rate remained relatively stable during the quarter, fluctuating between 1.08 and 1.12. By the end of September, it stood at 1.11, slightly stronger than its mid-quarter low. The GBP/USD (British pound to U.S. dollar) exchange rate followed a similar trend, with the pound trading between 1.27 and 1.33, closing near the higher end of that range as the quarter wound to a close.

The Japanese yen (JPY) experienced major fluctuations during Q3 as market participants reacted to the prospect of rising interest rates in Japan, which coincided with signs of weakness in the U.S. economy. This perfect storm led to a significant selloff in global equities in early August. Changes in the USD/JPY (U.S. dollar vs. Japanese yen) exchange rate reflected these shifting market dynamics. Earlier in the year, the yen was under pressure due to the BoJ's prolonged ultra-loose monetary policy. However, as speculation about potential interest rate hikes in Japan increased at the start of Q3, the yen began to strengthen against the dollar.

USD TO JPY EXCHANGE RATE DURING Q3 2024



Source: LSEG Datastream

Another currency in focus this past quarter was the Chinese yuan (CNH). The yuan showed signs of appreciation throughout the quarter, strengthening against the USD from 7.27 in early July to 7.00 by the end of September. This appreciation was driven by China's large-scale stimulus announcement. Optimism around these new stimulus measures led to capital inflows into China, contributing to the yuan's strength despite a raft of global uncertainties.

Looking ahead, several developments are likely to inject further volatility into the FX market in the final months of the year, including the upcoming U.S. elections, the health of China's economy, and rising geopolitical tensions in the Middle East.

DERIVATIVES TRADING

On Sept. 22, as the third quarter drew to a close, the U.S. Congress passed a spending bill to keep the government funded through Dec. 20. Despite market volatility in early August, equities remained near all-time highs during the September equity futures roll cycle. As observed in prior quarters, equity index futures continued to trade at premiums to fair value.

Interest rates were an important consideration during this cycle as monetary policy by the Fed and other central banks was a critical catalyst for equity markets. Equity index futures continued to trade at elevated premiums relative to historical averages but were roughly in line with the previous roll cycle. Anticipation of the policy shift was a major driver through the roll, even though the Fed cut occurred after most of the open interest had rolled to December. The persistent premium witnessed in equity index futures over the last few years has been caused by strong demand for long equity exposure and balance sheet restrictions by dealers, which limited their ability to provide supply to the market.

In Europe, equity index futures rolled at a premium to fair value but were below their prior 12-month average. Similar to the U.S., monetary policy took center stage, with the ECB and BoE meetings occurring during the roll cycle. Japan's Topix Index traded cheaper than the last two roll cycles due to material long liquidation and increased short positioning as part of the yen carry trade unwind, which saw the Topix decline over 20% from Aug. 1-5. While the index rebounded from those lows as the quarter progressed, open interest in the Topix still declined around 7% versus the prior roll cycle.

THE BOTTOM LINE

Changes in market environments can transpire quickly, as the rotation toward small cap stocks and the rising uncertainty in FX markets after the Fed rate cut both illustrate. This is why it's critical for investors to have access to the latest market trends—and to work with a provider that can leverage these insights to deliver scalable solutions that meet the trading and execution needs of asset owners and asset managers alike.

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