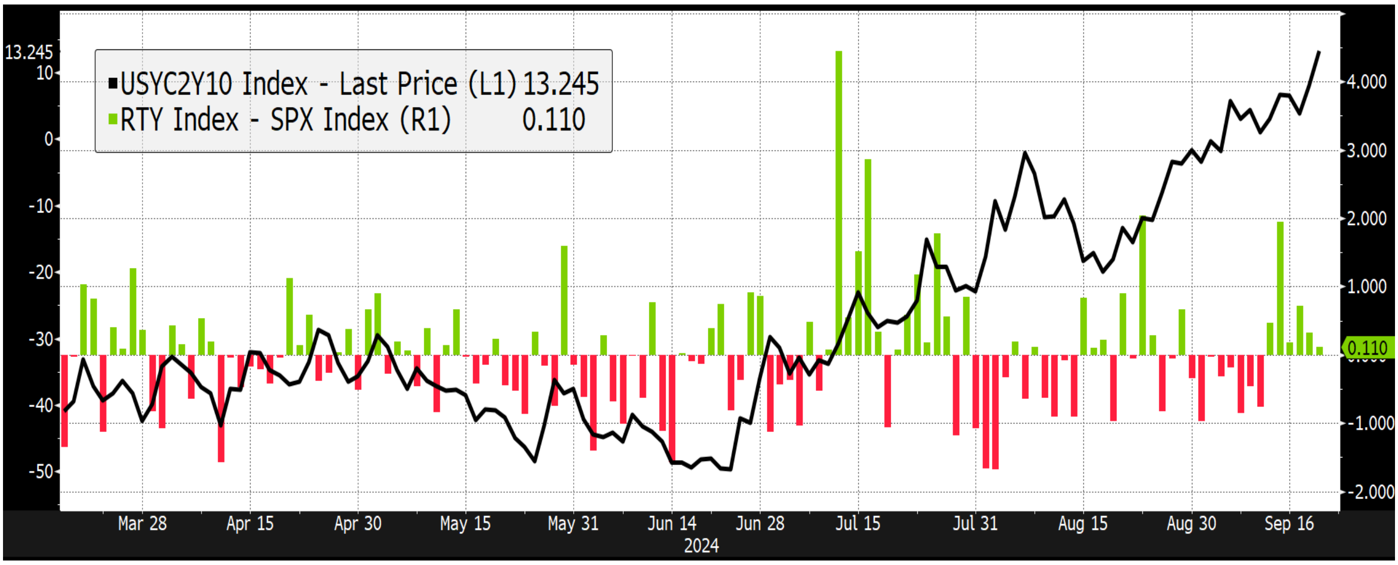
MACRO MARKET LENS– The US cuts interest rates

Last week, the Federal Reserve delivered a rate cut of 50 basis points for the first time in 4 years. The move signalled a dovish stance to cuts in the cycle, while the FOMC suggested the labour market is now a bigger problem than inflation. The reaction was greeted with a steepening of the US yield curve in 2s10s into positive territory. The curve had been inverted for over 2 years, which was the longest period of inversion in US history. The path for steepening is now in play and could potentially go another 20bp higher in the near term, then 30bp more over time. The technical double bottom target is +60bp.

Stock markets printed new highs in the major US indices, with the S&P 500 making its 39th new record high this year. It is now +19.55% ytd, surpassing our bull target for 2024 of 5,693. Meanwhile Gold is +27.09% ytd, making new all-time highs also on a weaker US Dollar narrative, and silver is even better at +31.02% ytd. **We mentioned in past Laser Focus editions that small caps should out-perform in the run-up to a rate cut and thereafter. So far, this has played out in the last 3-4 months** with the Russell 2000 outperforming the S&P 500. We remain bullish on this sector of the market going forwards.

Russell tops S&P500 as Fed cuts 50bps (chart source: Bloomberg)

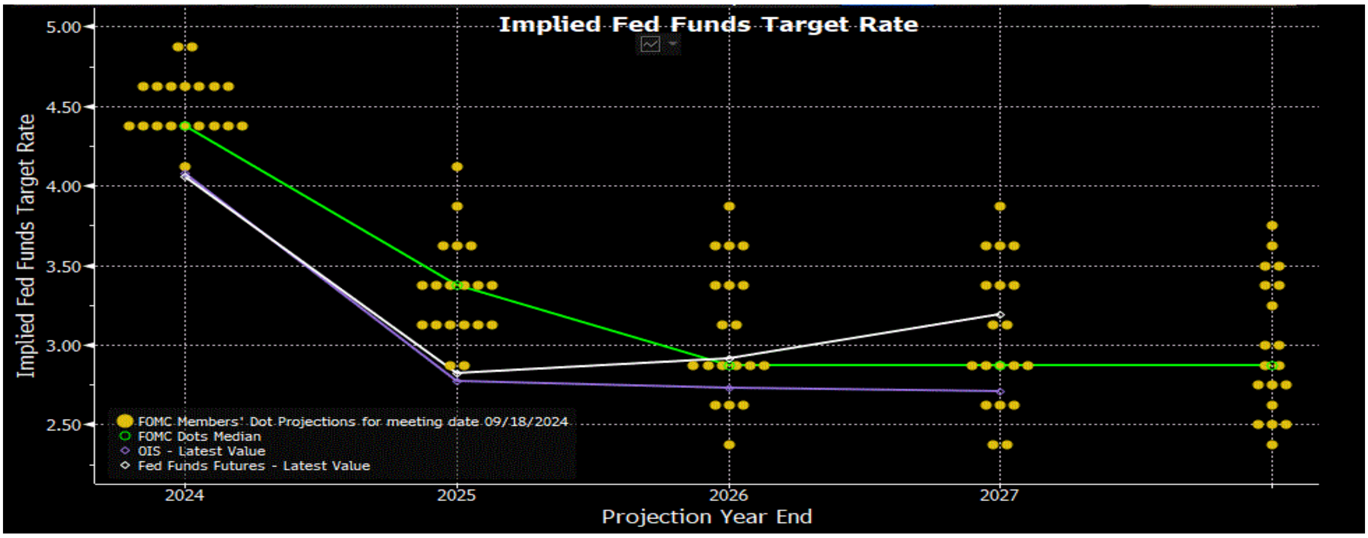


In its updated Summary of Economic Projections, the Fed marginally revised its forecasts. Economic growth for the current year was lowered to 2%, down from 2.1% in June, while projections for 2025 and 2026 were unchanged. Inflation projections saw downward revisions for both 2024 and 2025, while the unemployment rate was revised upwards across 2024, 2025 and 2026. **"The Committee has gained greater confidence that inflation is moving sustainably toward 2 percent,"** the FOMC statement said.

	2024	2025	2026	2027
Fed's unemployment projections	4.0%	4.2%	4.1%	
Core PCE Inflation	2.6%	2.1%	2.0%	2.0%

The DOT PLOT

The updated quarterly Dot Plot — a tool used by the FOMC to signal its future policy intentions — indicates a more aggressive path for rate cuts than previously projected.



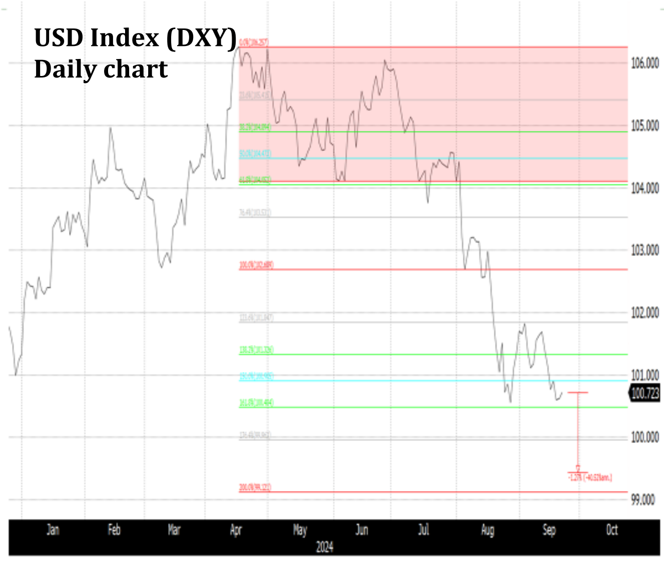
The September median projection now points to 100 basis points of cuts in 2024, with the federal funds rate expected to fall to a midpoint of 4.4% by the end of this year. **This suggests the Fed could enact 25 basis-point cuts at both the November and December meetings.**

Further into the future, the Dot Plot signals the Fed funds rate will drop to between 3.25% and 3.5% by the end of 2025, implying an additional 100 basis points of cuts. By the end of 2026 and in the newly introduced projections for 2027, interest rates are expected to fall to 2.9%.

This outlook marks a significant shift from the Fed's June projections, which anticipated only one rate cut in 2024, followed by 100 basis points of cuts in both 2025 and 2026. The bottom line is that this keeps the chances of a "soft landing" in play, avoiding a recession for now. But the unemployment component will be keenly watched, as historically 5.5% unemployment has been the level where the US has tipped into recession.

The US Dollar weakens further

The USD Index (DXY) which is heavily weighted in Euros and other G10 currencies, made fresh lows for the year last week following the Fed announcement. The USD fell -5.42% from its highest point earlier this year. It's worth highlighting that the British pound has been the best performing G10 currency this year +4.63% vs the USD. It broke through the 1.3300 handle last week as the Bank of England left rates unchanged and signalled it's not likely to cut until November – a vastly different path compared to both the Fed and the ECB. We see USD weakness continuing until the US election result in November, which means such pairings can extend their gains further. However, in the UK context, many are wary of the October budget and implications for tax and investor confidence. This is most evident from data last week showing retail sales higher than expected in the UK but consumer confidence down the most in 30 months. **The USD could weaken another -1.26% in coming weeks** to 99.46 in the USD Index, (see chart). This should be supportive for cryptocurrencies, Gold and for major G10 currencies, most notably JPY.



Japan is on a different rate path to the US as it continues to hike rates, which in turn has been helping the USD/JPY move lower. A stronger JPY can continue for some time, so consider 135.00/125.00 as themed targets. The Bank of Japan (BoJ) last week left rates unchanged, but it kept the path open for further rate hikes. On Sep 27th Japan's Liberal Democratic Party chooses a new leader to take the role of Prime Minister, which will keep the BoJ out of the spotlight. It's unlikely to raise rates in October, as there's a possibility of a national vote in Japan just before the US election outcome in November. Most analysts expect the BoJ to hike in December or January. Either way, the JPY in time should push lower vs the US Dollar and also vs the GBP and EUR crosses.

It's worth noting that last Friday, Japan's Minister of State for Financial Services Junichi Kanda met Samson Mow (founder of JAN3) to discuss Bitcoin adoption and cryptocurrencies in general. A coalition of major Japanese firms including Sony, Nippon Toyota and others are calling on the Financial Service Authority (FSA) to relax restrictions on the crypto industry. Japan was one of the first to implement exchange rules in 2017, and a stablecoin framework in 2022. But these achievements are overshadowed by heavy restrictions. The FSA is currently looking to overhaul crypto taxes which can be as high as 55% for individuals.

Fixed Income

The Federal Reserve is the seventh G10 central bank to cut rates this year. Norway is not expected to cut until 2025. So, the focus will now be on the Reserve Bank of Australia (RBA), which meets this week. The RBA has been pushing back against market speculation of a rate cut this year, and the market has gradually pared back its expectations. The Swiss and Swedish central banks also meet over the coming week. Both will most likely deliver their third quarter-point cut this year. It's worth remembering that cutting interest rates is typically associated with a weaker currency impact thereafter. With this in mind, consider EUR/CHF higher to 0.9700/50 over time.

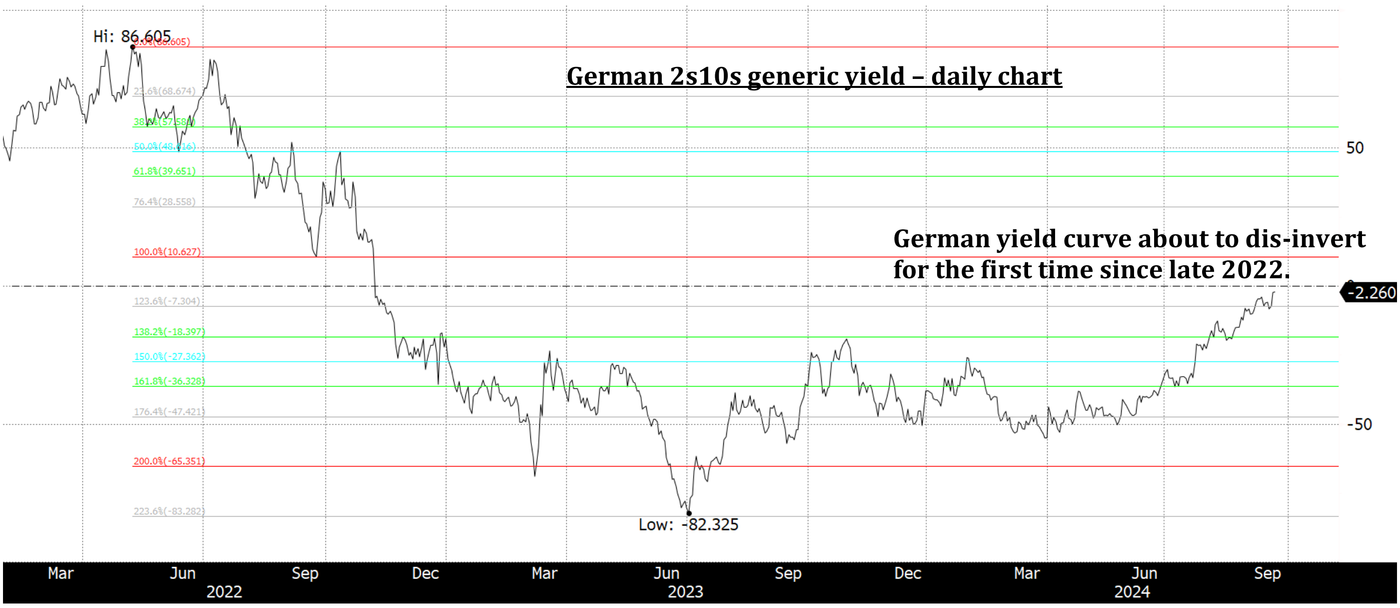
Let's take a look at what typically happens 1 week after a 50bp rate cut, compared to 1 month after for US yields:

1 week following a 50bp FFR cut the 10-year UST falls -5bp and 2s10s steepens +8bp
1 month after, the average result is the 10-year UST falls -3bp and steepens an additional +19bp in 2s10s

The recent low in US 10s has been 3.59% and may offer a stall to lower yields for now. But in time as 3.40%/3.21% attracts. This means a potential trade of interest might be to buy long dated Gilts over Treasuries based on Central Bank rate cycle ambitions, with the US going more aggressively than the UK on the cutting cycle.

Eurozone

It's 50/50 whether the ECB cuts rates next month on October 17th based on swaps pricing, and a 60% chance of a 50bp increase by the end of the year. The ECB is still watching data awaiting the preliminary PMI and other surveys out in the coming days. We think, however, some of the lending figures associated with the money supply release on September 26th may be of some interest. The market is pricing in 125-150 bps of cuts by the middle of next year. German 2-year yields are currently near 2.23% and the bias is to break below 2.0% and lower. Thus, we see the curve in 2s10s dis-inverting which will be the first time it's been positive since late 2022.



Equities - can the rally continue?

Equities	Price	1M	3M	6M	12M	YTD	QTD
MSCI World (USD)	3,676	+0.75%	+4.82%	+7.26%	+27.67%	+16.02%	+4.70%
MSCI EM (USD)	1,106	+0.52%	+1.79%	+6.46%	+14.75%	+8.08%	+1.86%
S&P 500	5,702	+1.21%	+4.35%	+8.95%	+32.00%	+19.55%	+4.43%
Nasdaq Comp	19,791	+0.36%	+0.46%	+7.92%	+34.63%	+17.62%	+0.55%
Russell 2000	2,227	+0.41%	+10.18%	+7.52%	+25.41%	+9.91%	+8.80%
Euro STOXX 50	4,871	-0.77%	-0.73%	-3.17%	+15.79%	+7.74%	-0.46%
DAX	18,720	+0.47%	+3.06%	+2.82%	+20.33%	+11.75%	+2.66%

The question is how much longer the equity rally can continue for. With record highs achieved again last week for major indices, corporate profits in the US are likely to continue to benefit from a rate cutting cycle. Profit growth is a function of economic growth, and this current cutting cycle is not a knee jerk reaction to being in a recession. Seasonally, the months of September and October are regarded as weaker months in an election cycle. But the S&P 500 forward earnings per share looks encouraging for further gains. The estimated YoY earnings growth rate for Q3 2024 is 4.6%. If 4.6% is the actual growth rate for the quarter, it will mark the 5th straight quarter of YoY earnings growth for the index.

In valuation terms, the 12-month forward P/E ratio for the S&P 500 is 21.4. This P/E ratio is above the 5-year average (19.5) and above the 10-year average (18.0). We are nearing the start of the 4th quarter, and we can judge the markets' expectations based on ratings.

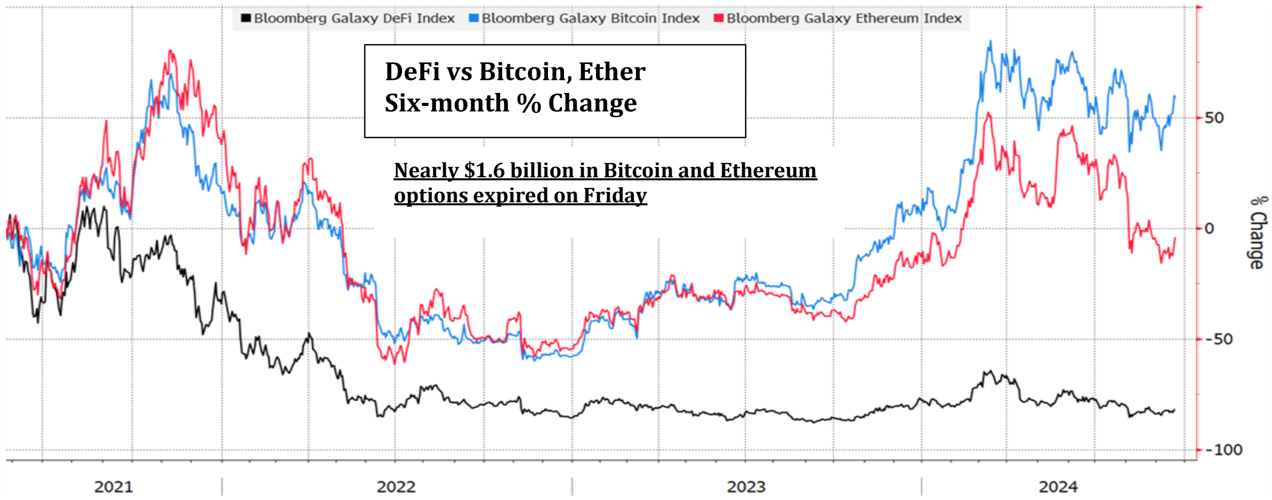
8-out-of -11 sectors are expected to report YoY growth. Three are forecast to have double digit growth, namely Information Technology, Healthcare, and Communication services. Energy is the sector that is declining. Overall, we see healthcare and communication services holding up well and the implementation of AI over time boosting those sectors further in the medium term.

As the S&P 500 makes new highs past 5,700, it leaves the technical potential to 5,981- the 150% Fibonacci projection as seen in the weekly cash chart below with a 31-week cycle that we see dominating this index. **If it plays out, it will be another +5.60% of gains, and in turn will be crypto supportive.**

The bottom line is the uptrend for stocks remains intact, and new highs are technically bullish for equities near to medium term. But we expect volatility through the 5th of November US elections, with a preference for small cap companies as the group most positively levered to an easing cycle. That's because easing the cost of capital is a boost to industrials, financials and biotech which is 49% of the Russell 2000. M&A would also be small cap positive.

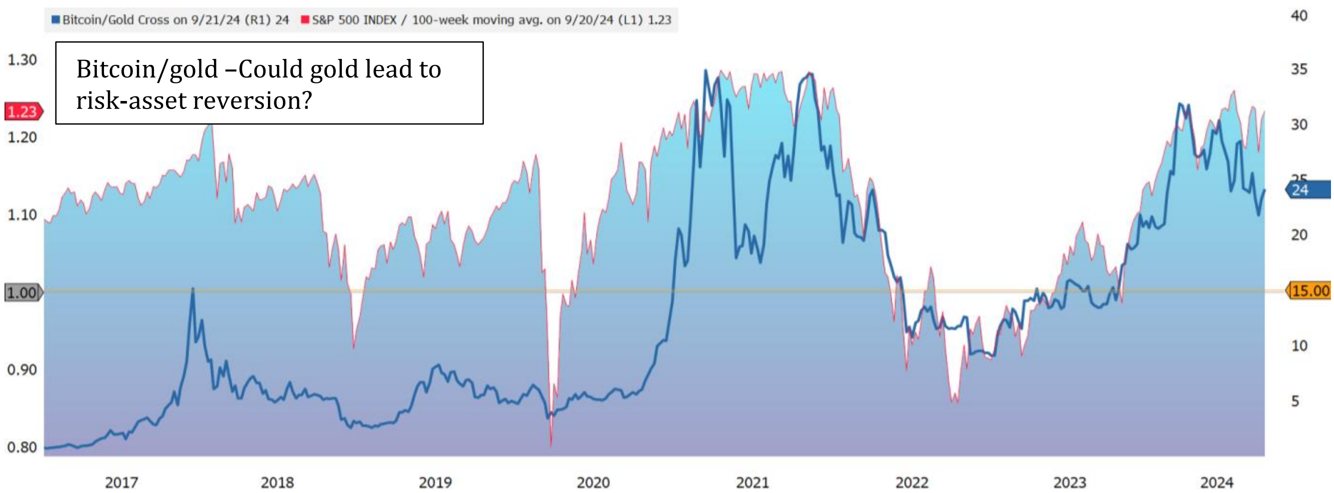
Rebound seen in the Bloomberg Galaxy DeFi Index of digital coins this week.

Those involved in decentralized finance rose 1.4%. The index rose to 693 as of Friday, up from 684 a week earlier. The Bloomberg Galaxy Bitcoin Index gained 5.2% during the same period, while the Bloomberg Galaxy Ethereum Index gained 5.1%. The DeFi Index tracks the prices of cryptocurrencies and associated apps engaged in financial activities such as automated market-making and lending. Members include Uniswap, Aave and MakerDao. Crypto assets are rebounding as the stock markets rebound after the Fed 50bp cut, proving that a rising tide lifts all boats.



Bitcoin vs Gold

The ounces of gold equal to a Bitcoin was at 24x on Sep 20th. This could push back to a pivotal 15x. The graph shows how normal such a decline would be for crypto vs gold, and would be a backfill in beta. Typically, the Bitcoin/gold cross often peaks ahead of the S&P 500 and the stock index's move is now at a 20% premium above its 100-week moving average (it hit the 5,693-target set for 2024 last week). Bitcoin/gold set its high at 37x back in July 2021. The question after last weeks' big moves is, is it a buy on dips? Or an indication of beta mean reversion? The key is to look at what fueled the highs. In 2021 post-Covid, the biggest stimulus in history led to the most stretched S&P 500 vs its 100-week average since 1999 and a Bitcoin/gold peak. The launch of US Bitcoin ETFs in Q1 might have similar topping implications as seen in 2017, and the next few weeks should answer that question.



Source: Bloomberg

It's worth noting that Friday's quarterly "triple witching" witnessed roughly $5.1 trillion of derivatives contracts related to stocks, index options and futures mature with another $250 billion in index trades going through. This historically has created some volatility, as traders roll-over their existing positions or open new ones. With stocks making new highs, the market is pricing in about 18% of earnings growth for the S&P 500 by the end of next year. It's a bullish scenario, and if correct, should be supportive for cryptocurrencies too.

TECHNICALS

Bitcoin – two weeks ago formed a shaven bottom candlestick in that the start two weeks ago was the low of the week. This is a bullish signal, and the net result is a bull engulfing candlestick week two weeks ago. This suggests a rebound was looming from a technical chart perspective. Last week then produced a range that held mostly above the 39-week moving average, breaking $62,757.76 Fibonacci resistance is at the 1.618% level. Sustained gains if seen from here leave $67,015 as the next focus level, the 176.4% Fibonacci projection. We know the Fibonacci measures are a useful measure since the all-time highs stalled exactly at 200% projection of the measures used since Dec 2022 lows to Dec 2023 highs as the impulse measure. Support now should surface against pullbacks near $55,875, another Fib level (138.2%).

BITCOIN – weekly chart with 39 week moving average and Fibonacci projections

Source: Bloomberg

Seasonality – the best times historically in recent years for Bitcoin have been Feb, Apr, and October, and December is typically a month that sees a strong Bitcoin performance.

Ethereum - Overall from June to August witnessed a -46.73% decline in the value of the currency, but the last 3 weeks have seen a bounce from the lows of about +18.73%. There's still a long way to go to recover the $4,000 handle seen mid-year which has been a major resistance hurdle for 2024, marking the 200% Fibonacci projection measure since June 2022 lows. The key test of resistance at $2,816 (123.6% Fib projection) is needed now to encourage gains building towards the 39-week moving average region of $3,022.50. Seasonally many are aware September is typically a poor month for crypto performance, but we have just had a historic 50bp rate cut from the Fed and new all-time highs in stocks, so this time it's different. The S&P 500 registered its 39th new record high for this year. As for Bitcoin, September is historically the worst month for price action with a mean September loss of -5.9% in the 13 years since 2011.

ETHEREUM – weekly chart with 39 week moving average and Fibonacci projections

Source: Bloomberg

The US election and crypto

Crypto has had its sceptics -including Donald Trump- in the past. But soon it might have a champion in the White House. Donald Trump this week launched a new crypto business with his family, World Liberty Financial. He also made pledges to block a Federal Reserve-backed digital currency, establish a "strategic national bitcoin stockpile", and remove Gary Gensler as head of the SEC. Meanwhile, his presidential rival Kamala Harris spoke publicly about crypto for the first time at the weekend. Attending a fundraiser in Manhattan, Harris vowed to to encourage investment in artificial intelligence and digital assets.

It's hard to ascertain how much of an impact these moves will have on voters. There's an argument that wealthier and influential voters may prefer a president who is "crypto friendly". Trump's campaign has raised millions of dollars in cryptocurrencies. Cameron and Tyler Winklevoss, the founders of the crypto exchange Gemini, each gave Trump $1 million towards his campaign, as did Jesse Powell, the founder of the Kraken exchange. But most of the crypto war chest is focused on the congressional races, with crypto companies making up nearly 50% of all corporate contributions to nonpartisan PACs. This is according to Public Citizen, a non-profit consumer advocacy group.

It's worth remembering that Trump appointed Howard Lutnick, the Chairman and CEO of Cantor Fitgerald, as co-chair of his transition team. Lutnick had spoken back in July with Trump at the Bitcoin conference in Nashville before he was appointed and is probably one of cryptos biggest supporters on Wall Street. Lutnick has led his company to build an estimated $2 billion facility to lend against Bitcoin collateral. Cantor also manages Tether's portfolio of US Treasuries. Tether's main product is the world's most used stablecoin, USDT, which functions as an unregulated digital dollar with $119 billion in circulation.

The outcome of the US presidential election poses an uncertain future for Bitcoin. Both potential administrations are expected to maintain or even accelerate fiscal spending, which could result in further quantitative easing. This monetary policy, aimed at stimulating the economy, may inadvertently create a favourable environment for risk-on assets like Bitcoin. However, the impact could dampen investor confidence if either administration adopts anti-business policies. Should Kamala Harris retain Gary Gensler as Securities and Exchange Commission (SEC) Chair or align closely with the Elizabeth Warren wing of the Democratic Party, the digital asset sector may face a tightening regulatory framework.

Despite these potential challenges, a Harris presidency could benefit Bitcoin in the long run. That's because a more regulated environment may bring greater clarity and legitimacy to the cryptocurrency space than a deregulated approach coming from Trump.

Regardless of who wins the presidency, the trend for rising government debt is now at over $35.4T, and escalating budget deficits are likely to continue. Such activity typically weakens the US dollar, creating a macroeconomic landscape in which BTC has historically thrived. Additionally, the 50bp cut from the Fed last week now sets in play a dovish cutting cycle, implying further US dollar weakness which is supportive to gold and crypto.

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