Signal Through the Noise

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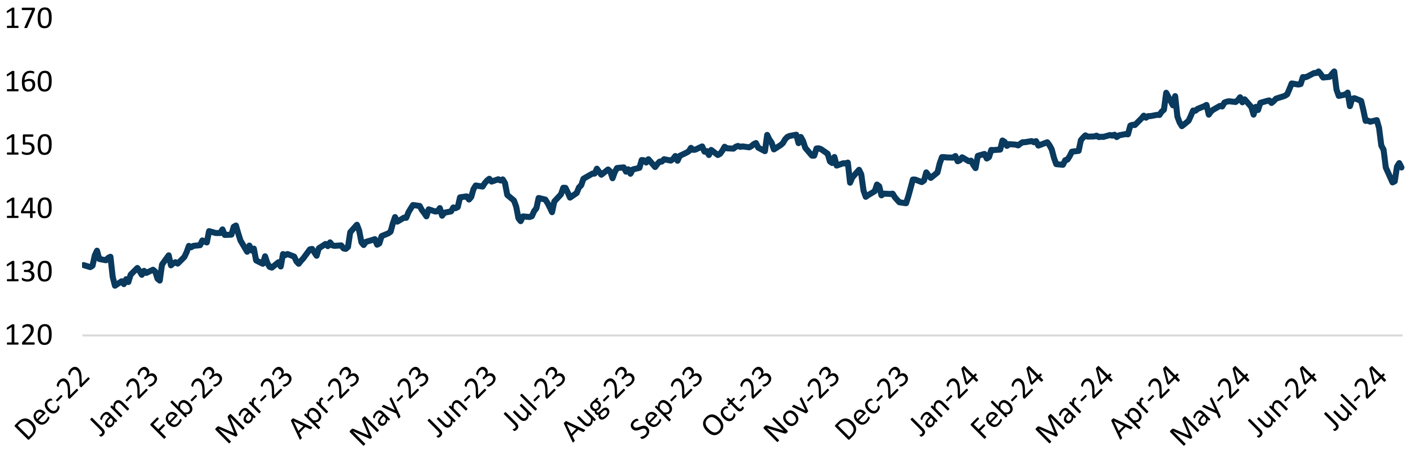
The unwind of the yen carry trade on the morning of August 5th injected a level of volatility in markets reserved only for crisis periods. The carry trade involved investors borrowing yen to buy riskier assets, which is effectively a short position on the yen. This strategy had worked well in 2024 as the yen weakened during the year through July.

The Bank of Japan's rate hike on July 31st and the US dollar sell-off (following the US labor market data release on August 2nd) resulted in a sharply stronger yen going into the weekend, which saw borrowers of the yen under stress. It seemed like much of the short base liquidated its position en masse on Monday, August 5th.

JPY/USD

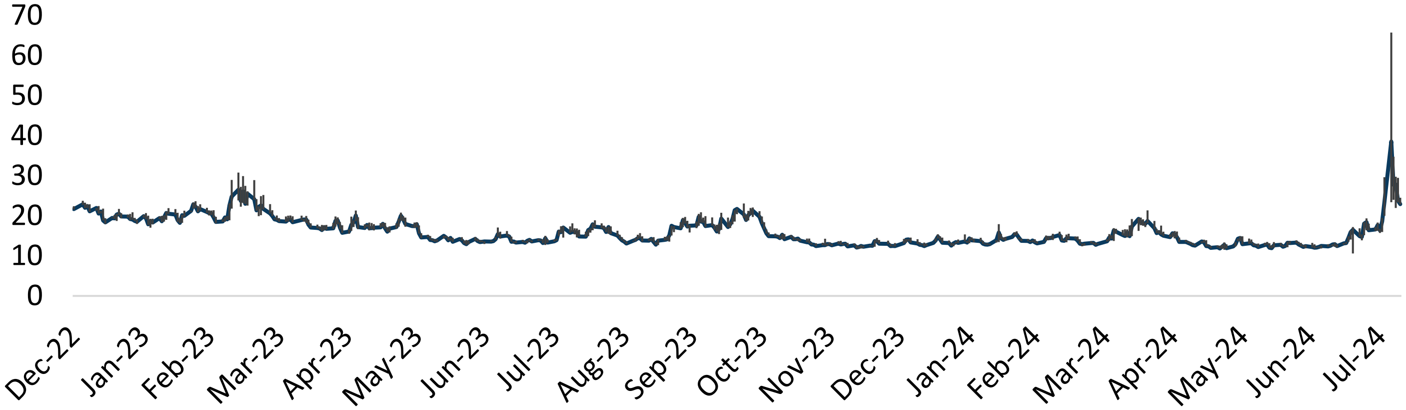
Source: Sage, Bloomberg



The shock to markets proved to be technical in nature as markets stepped back from the precipice of a meltdown into a more normal market environment throughout the week. The VIX Index, a measure of equity implied volatility and a common measure of market-wide uncertainty, jumped from 23 on Friday, August 2nd, to over 65 at one point. It has since largely calmed to below where it was on August 2nd.

VIX Index, Daily Range

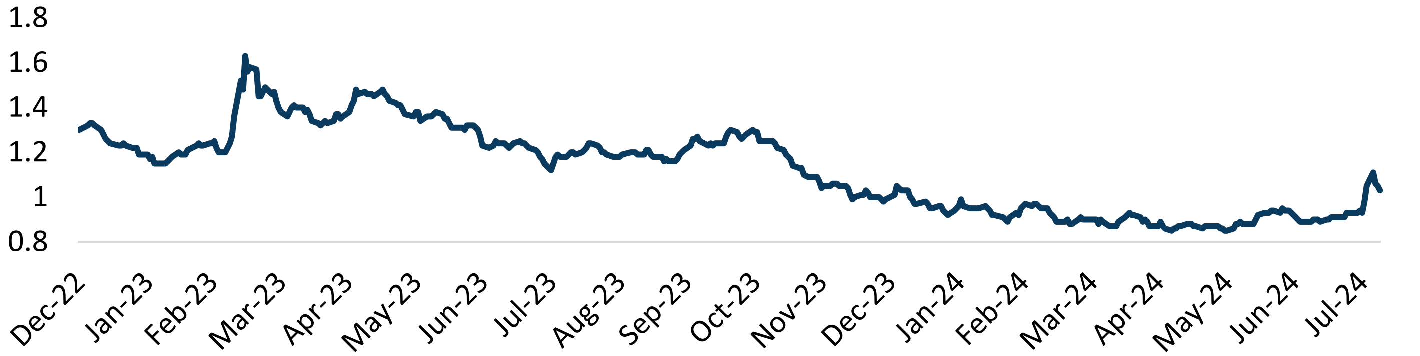
Source: Sage, Bloomberg



Credit spreads, which we see as a key barometer for market stress, widened but remained low by historical standards. The lack of response by credit is a good sign that the current period of market volatility is not systemic in nature.

IG Corporate Credit Spread

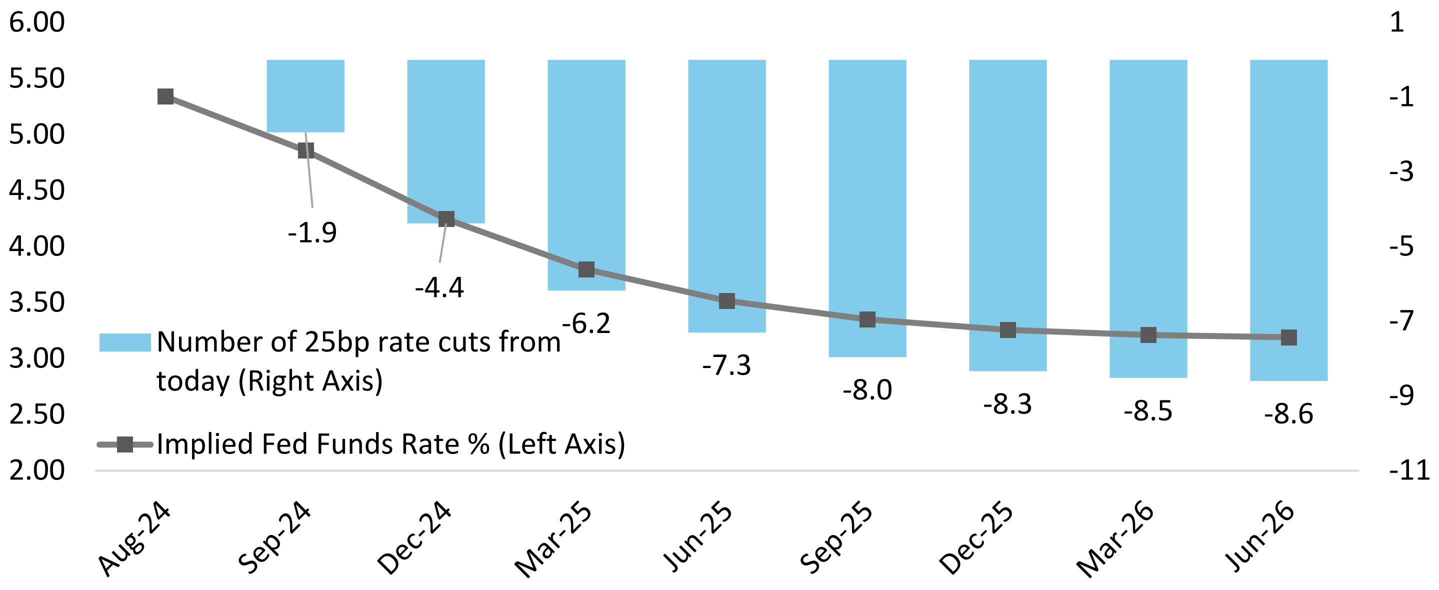
Source: Sage, Bloomberg



Expectations for Fed Policy have normalized from the levels on August 5th, with interest rate derivatives pricing in 100 basis points of cuts for the remainder of 2024. This includes a 50 bps cut at the September meeting and 25 bps at each of the November and December meetings. We believe that the Fed will commence interest rate cuts in September starting with a 25 bps cut, as economic data would have to continue to disappoint to the downside to warrant a 50 bps cut. The Fed holds its annual Jackson Hole Symposium in September, and it will be a key moment for Chair Powell to signal the Fed's intentions.

Market Implied Fed Path

Source: Sage, Bloomberg



The low level of "summer liquidity" gave way to highly volatile markets to start August, but the signal beyond the noise is clear: markets are now hyper-focused on slowing growth rather than high inflation as the main threat to the US economy. As we wrote last week in our Notes from the Desk, we believe that this focus on growth preservation rather than inflation fighting should present a good environment for fixed income, leading to lower yields and a return to being a diversifying asset versus equities.