The Global Edge
Financial Insights from WisdomTree

"Easing" Into Global Central Bank Policy Discussion

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Authors

An empowering blend of global financial research and analysis, insights and macro commentary on a breadth of today's most compelling economic and investing developments, from an international team of WisdomTree thought leaders.

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“Easing” into Global Central Bank Policy Discussion

Heading into 2024, the prevailing mindset seemed to be centered around the next phase for global central bank policy, i.e., easing. Typically, the more well-known aspect of this part of the monetary policy equation involves rate cuts, but as we’ve seen from the responses beginning with the financial crisis and carried through to the COVID-19 period, central bank balance sheets have also become an active tool for policy makers.

As financial markets prepare for this potential next phase of monetary policy, they are discovering that it is not a “one-size-fits-all” dynamic. While rate cuts may still be on the radar for a variety of the major developed market central banks, expectations for the timing and magnitude of any potential move have certainly undergone some visible transformations through the first five months of the year. Against this backdrop, we are going to take a deeper dive into this easing discussion to see where the key global monetary policy outlooks may now be headed.

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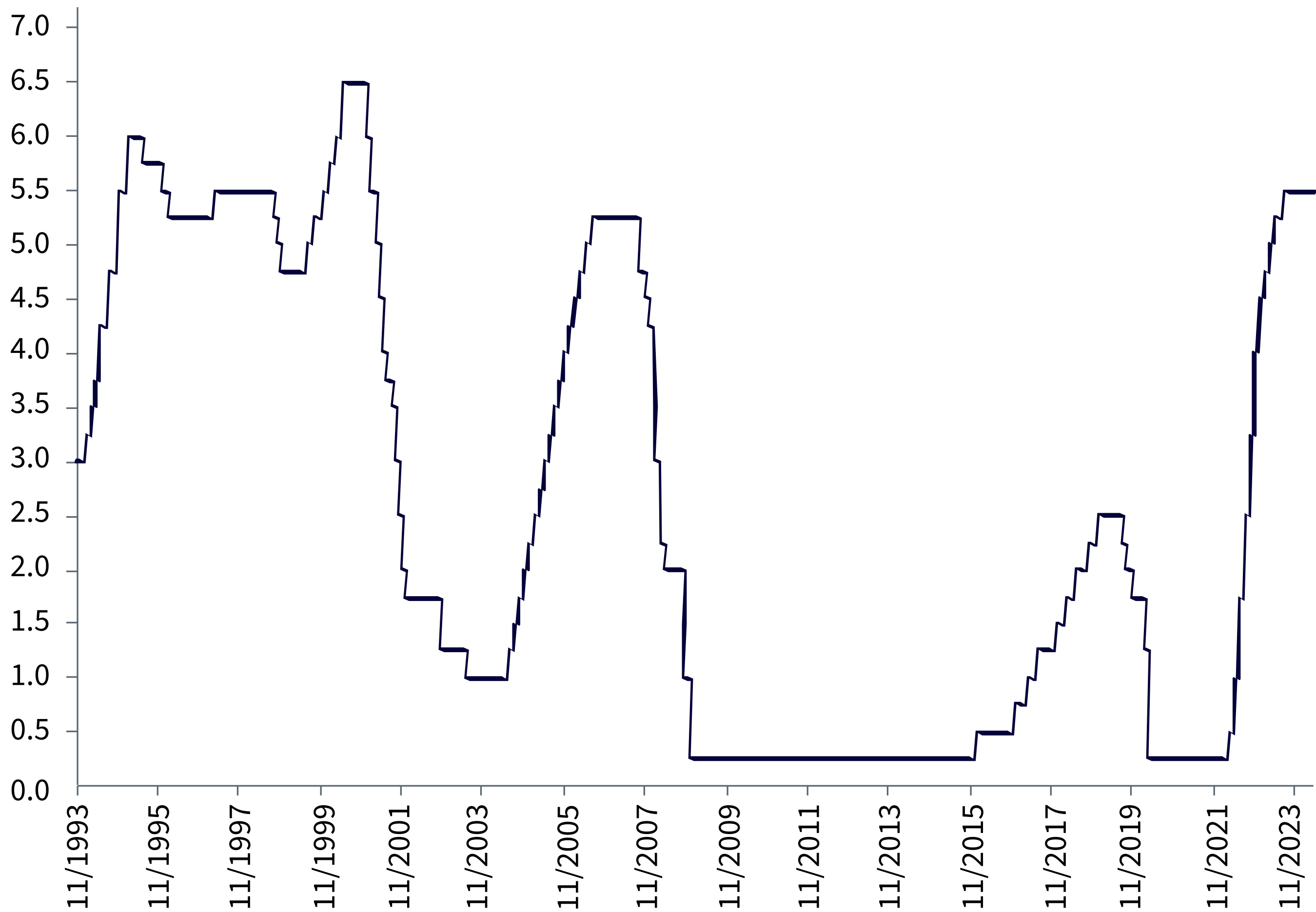
U.S. Fed Watch

In our prior Global Edge publication, we referred to the central bank that is arguably considered to be the “leader of the pack”: the U.S. Federal Reserve (Fed). Certainly, during the historical rate hike period of 2022–2023, the Fed did seem to be leading the charge among the major developed central banks. However, on the “other side of that trade”—rate cuts—the markets could potentially see a new leader on this policy front.

Figure 1: Fed Funds Target Rate - Upper Bound



Source: Bloomberg, as of April 29, 2024. **Historical performance is not an indication of future performance.**

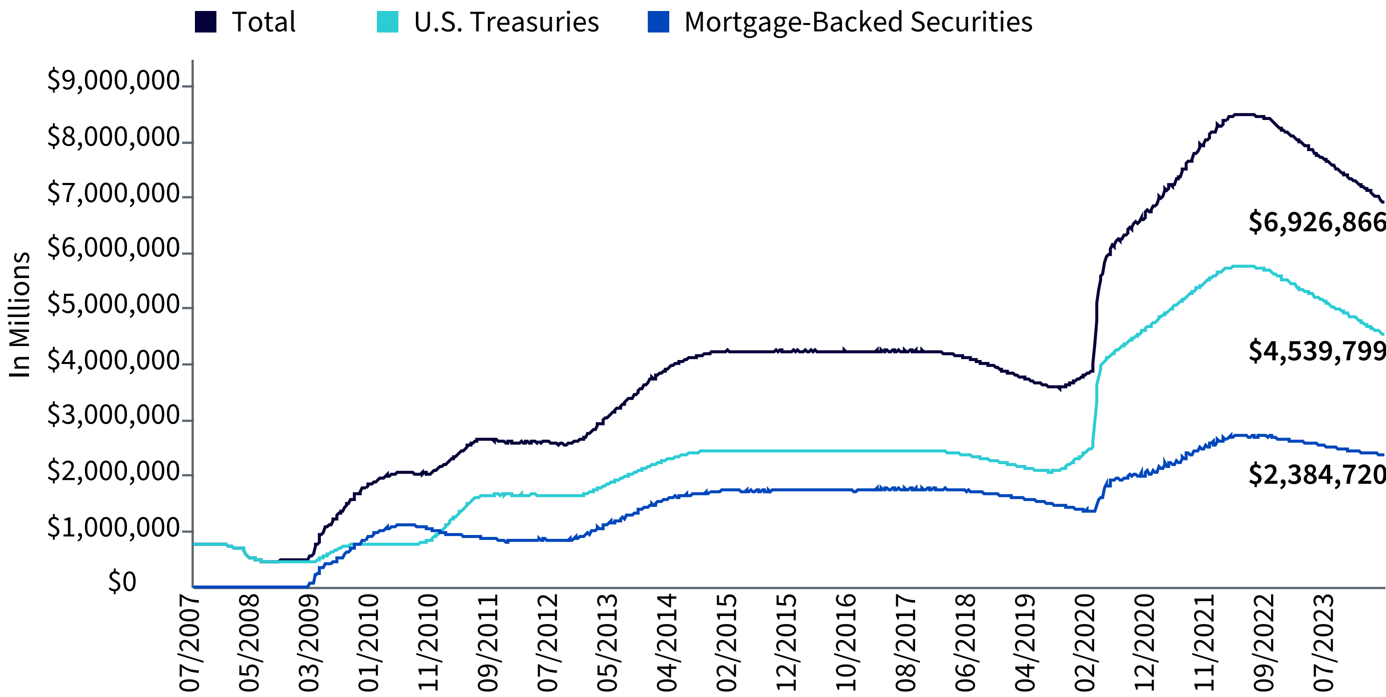
Once again, the Fed kept rates unchanged at the recently concluded May Federal Open Market Committee (FOMC) meeting. As a result, the Fed Funds trading range remains in the 5.25%–5.50% band that was introduced in July of last year and still resides at a more than 20-year high watermark. Despite economic and inflation data that has challenged rate cut expectations up to this point, Powell & Co. still seem to be on the page that a rate cut will more than likely occur sometime later this year. However, what investors are finding out is that this potential easing move keeps getting pushed back, and increasing uncertainty has now entered into the equation as to what this potential rate-cutting episode could eventually look like.

The monetary policy outlook in the U.S. has been turned on its head thus far in 2024. Just a few short months ago, the money and bond markets were looking for six rate cuts this year, but as of this writing, the implied probability for Fed Funds Futures is priced for less than two rate cuts. It is truly amazing to see how rate cut expectations went from double the Fed's dot plot to now being actually less than the three moves the Fed is forecasting. In addition, the initial easing move has gone from March, to June, and now maybe September.

Against this backdrop, investors have been left trying to ascertain what exactly Powell & Co. will do at the remaining five FOMC meetings this year. Obviously, the policy maker's data dependence remains on full display. Certainly, the labor market and inflation data have not only provided the Fed with no urgency to consider easing monetary policy anytime soon, but as we have seen recently, it has also called into question whether any rate cuts are needed in 2024.

Looking ahead, though, you get the sense that Chairman Powell does seem to be itching to cut rates, but the data needs to lead him there. What does that mean exactly? In our opinion, renewed progress on inflation is a necessary ingredient in this process, and, of course, some softening in labor market conditions would also help the Fed chairman get there.

Figure 2: Securities Held Outright by the Fed



Source: Federal Reserve, as of April 29, 2024.

As we mentioned in our introduction, there is another aspect of Fed policy decision-making that has been flying under the radar, and that involves their balance sheet. When talking about the Fed's balance sheet, the specific reference is to the Securities Held Outright line items, also known as the System Open Market Account (SOMA). The reader is probably more familiar with the terms "quantitative easing" (QE) and "quantitative tightening" (QT) when addressing the Fed's balance sheet.

Recall that while the policy maker was busy implementing historic rate hikes during 2022–2023, it was also reducing its holdings of Treasuries and mortgage-backed securities (MBS) that had ballooned in size as a result of the COVID-19-related QE program. This latter portion of monetary policy tightening was QT. As

announced at the May policy gathering, the FOMC is ready to start paring back the pace of QT, even if it is not ready to start implementing rate cuts.

Let's look at the Fed's securities holdings to get some perspective on how the current QT program has been working. At its peak, SOMA reached as high as $8.5 trillion in May 2022, and since QT went into effect in June of that year, total holdings have dropped more than $1.5 trillion to $6.93 trillion as of this writing. This reduction is the result of the Fed's present plan to let its Treasury and MBS positions roll off by a combined $95 billion per month. Remember, the Fed is not outright selling any securities; it is just not reinvesting the total amount of holdings that are maturing or being redeemed.

As expected, the Fed did announce it will begin paring back the pace of QT beginning in June. In addition, the policy maker announced it will only reduce the pace of QT that includes the Treasuries portion of its overall holdings, not MBS.

Interestingly, several Fed officials have gone on record that the ultimate goal would be to have only Treasury securities on its balance sheet. However, this could take quite some time, as the Fed's balance sheet is holding nearly $2.4 trillion in MBS, and the current pace of the run-off here is $35 billion per month.

The Bottom Line

What should investors look for going forward in terms of U.S. monetary policy? If history is any guide, the Fed will not just begin cutting rates without any guidance on that front. At this point in time, a reasonable case scenario would be to start with the Fed's dot plot and conclude that less than those three rate cuts seem likely, but stay tuned—as we've seen, things can change quickly.

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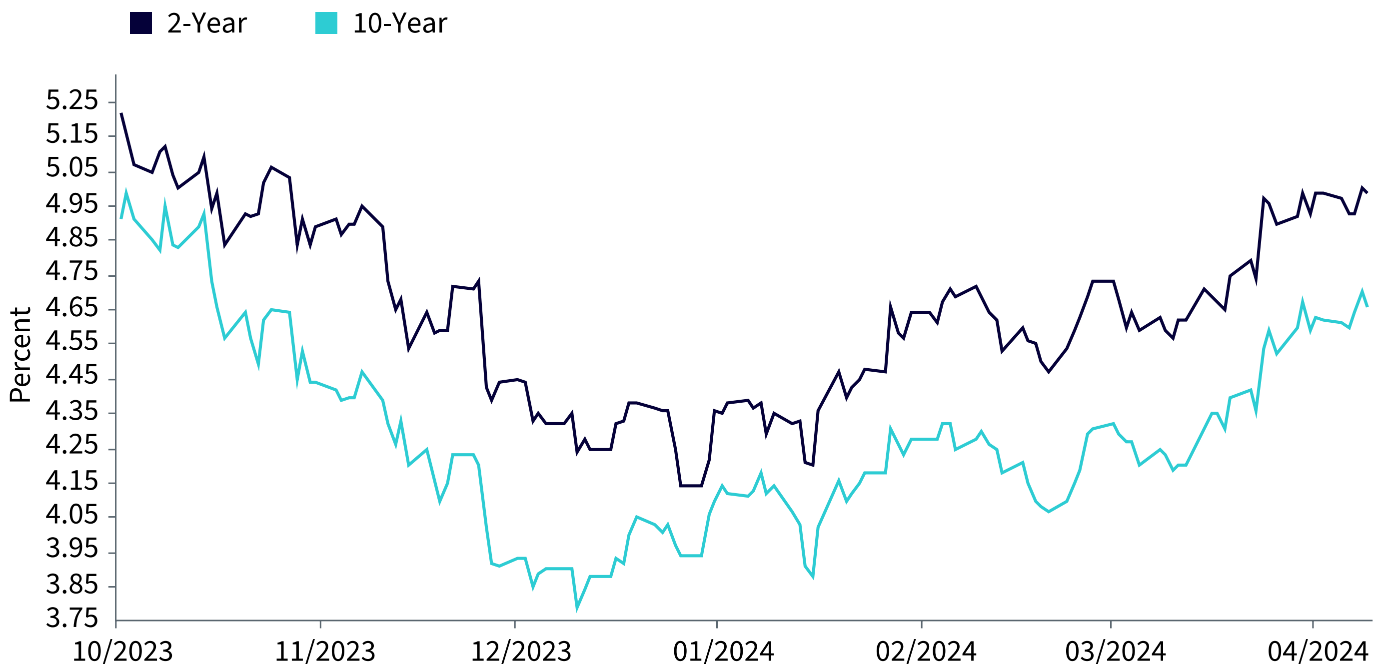
U.S. Bond Rate Outlook

The optimism that gripped the bond market heading into 2024 quickly evaporated. Indeed, the U.S. Treasury (UST) arena produced a rally for the ages to end last year, but as we get ready to enter the second half of this year, a far less favorable tone is now hanging over the market. During the Q4 rally, we noted on numerous occasions that in order for UST yields to remain at, or below, the levels that were being registered, validation needed to occur, and what we've been discovering up to now is that the bond market rally was not validated.

For those who may not be as familiar with the inner workings of the UST arena, price action is often based on what is being anticipated for the months ahead. This "discounting" mechanism can be a powerful force, as we witnessed firsthand from about mid-October through the beginning of this year. The key underpinnings were the expectations that disinflation would continue to work its magic and the economy, specifically the labor market, would finally begin to "buckle" from the historic Fed rate hikes. These two forces would not only combine in a pivot to monetary policy but ultimately end up with Powell & Co. cutting rates sooner rather than later, and by a sizeable amount.

Figure 3: U.S. Treasury Yields



Source: Bloomberg, as of April 29, 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

In hindsight, the markets now know these presumptions were far too optimistic from an interest rate point of view. The labor market data is not showing any signs of "buckling" as yet, and this point has been underscored by the historically low level of weekly jobless claims, a leading economic indicator. In addition, the disinflation trend that was witnessed throughout 2023 is showing potential signs that the

"last mile" to the Fed's 2% target could be a more challenging task than the improvement that occurred from the 2022 peak in price pressures.

As we outlined previously, the Fed rate cut outlook has changed in a rather noticeable fashion as a result, pushing the yields on the UST 2-Year and 10-Year notes to retrace roughly 75% of the decline in Q4 of last year, as of this writing.

Against this backdrop, investors have a whole new dynamic to consider. The rise in U.S. bond yields is arguably a positive development from an investor's perspective because it returns fixed income to its more traditional role in the asset allocation process.

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U.S. Equities Face Inflation and Rate Challenges

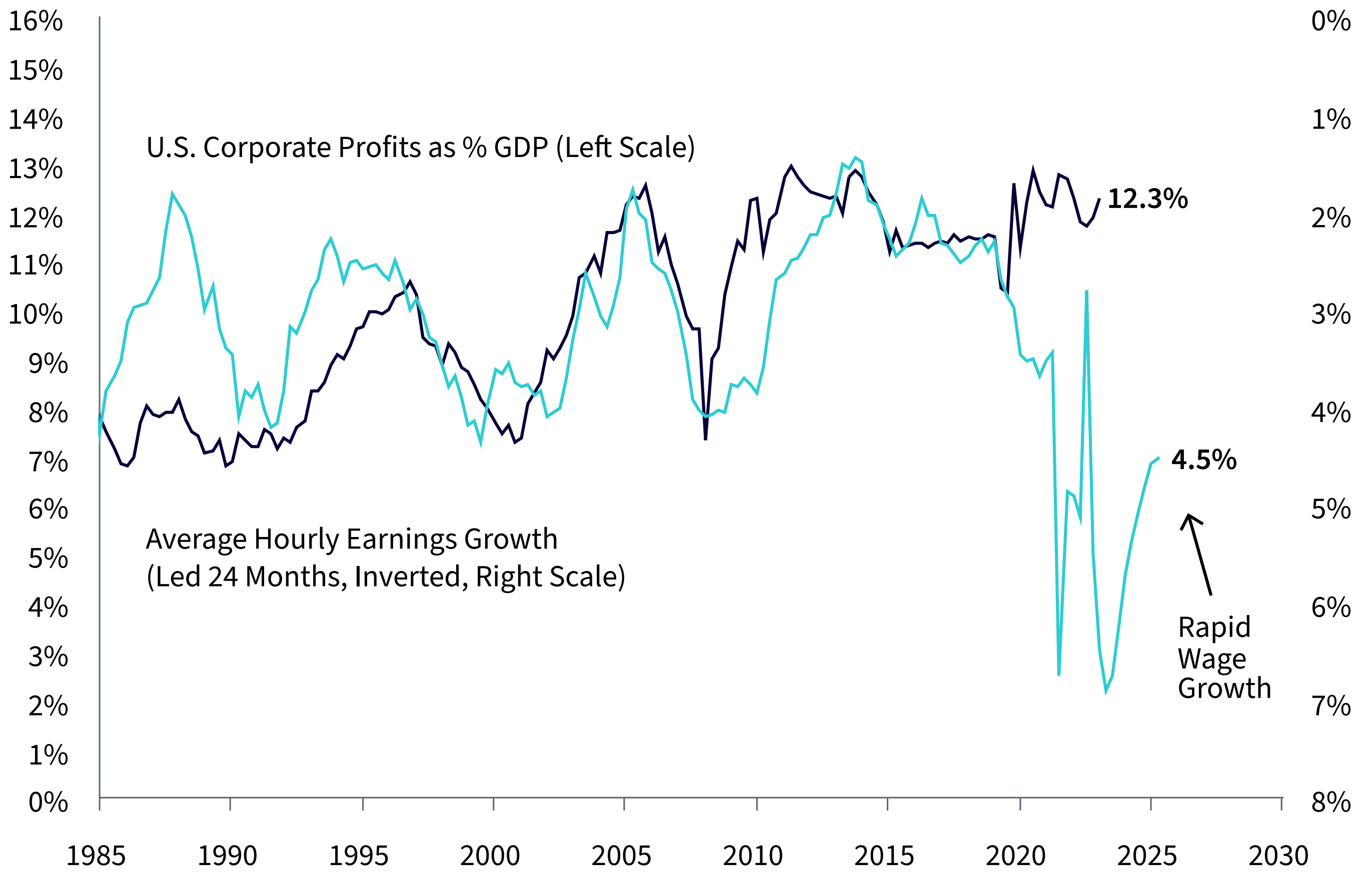
The higher inflation and interest rate regime amounts to a twofold hit to corporate profits. The first comes with a lag, as old corporate bond obligations that were financed in the negative interest rate world reach maturity and are replaced with new debt at more onerous rates.

The second comes in the form of wage costs hitting profit margins. Average hourly earnings grew at an annualized rate north of 5% from Q3 2021 until Q2 2023 before falling into the 4's in recent quarters. Even at current growth rates, this is still a level of wage inflation that is generally alien to the experience of virtually all of modern-day corporate America's executives (figure 4). The good news, as we explain later, is that employers' wage woes may soon wane, which could be supportive of corporate profits in the out years. The bad news: the catalyst for wage softness may well be people losing their jobs.

In the meantime, while wages remain robust, we anticipate that NIPA (National Income and Product Accounts) corporate profits, which currently amount to 12.3% of the gross domestic product (GDP), could take a hit as 2024 progresses, owing to the rates-and-wages-induced profit margin pinch.

Companies operating with thin margins, or thin profits for that matter, are among the most vulnerable to an ugly situation, such as that August junk clear-out we tend to see every other summer. You know the one: the CBOE Volatility Index® (VIX®) goes spiking, junky stocks get pummeled, and liquidity thins because half the industry is on vacation.

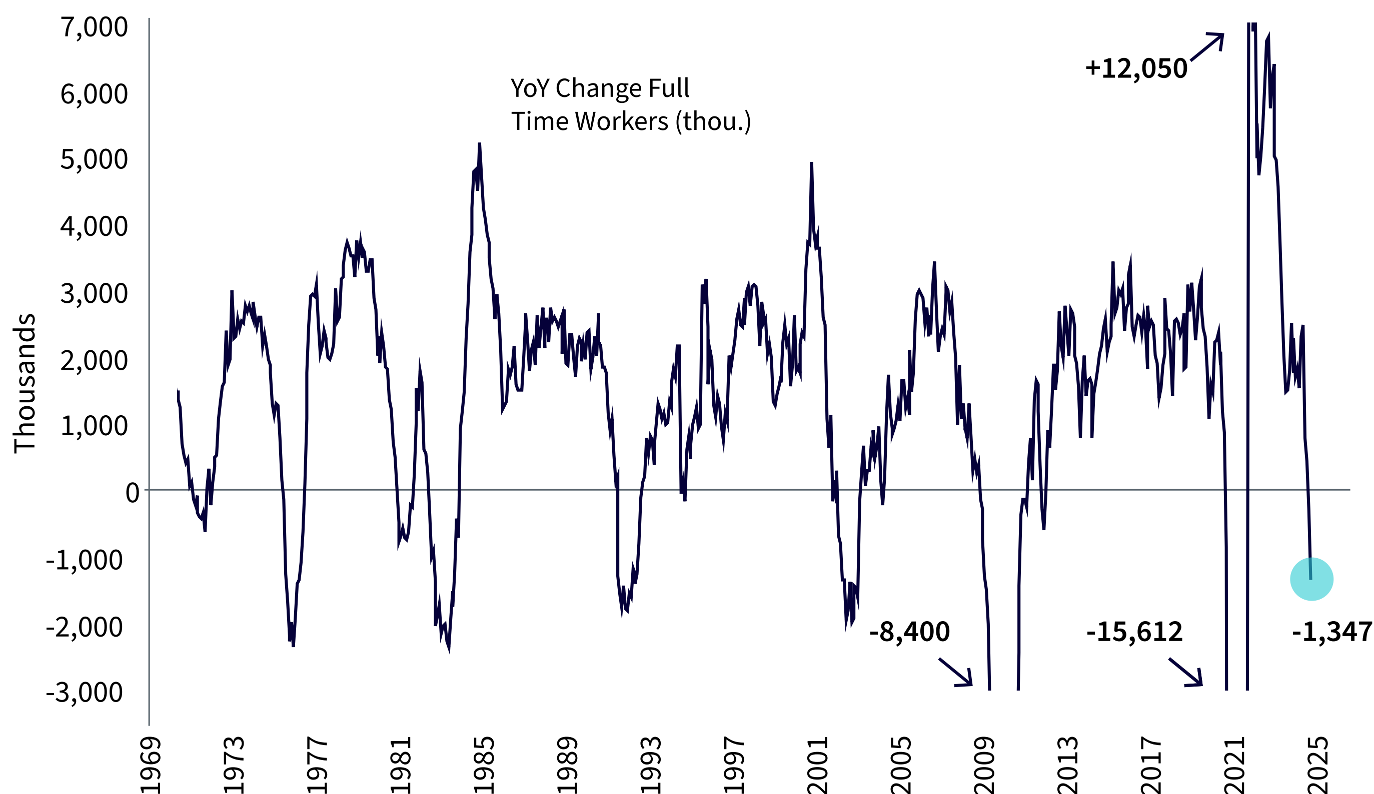
Figure 4: Wage Inflation Poses a Profit Risk



Sources: BEA, U.S. Department of Commerce, BLS, Department of Labor, as of Q1 2024. **Historical performance is not an indication of future performance.**

Nevertheless, robust wage growth means workers finally have some bargaining power. However, consider that wage growth considerably lags general labor market conditions. The count of full-time workers has fallen by 1.3 million over the last year (figure 5). Not shown in the chart is an area of growth you don't want to see: part-time jobs, which are up 2.0 million in that time. Though the unemployment rate is undeniably low at 3.8%, and initial claims remain nothing short of resilient, we are becoming troubled with this labor market's optics.

Figure 5: The U.S. Economy Has Lost 1.3 Million Full-Time Jobs in the Last Year



Sources: Refinitiv, BLS, DOL, as of March 2024.

Sector-wise, Consumer Discretionary is the group most vulnerable to an adverse employment surprise, especially since it is priced for perfection. Of the 10 largest Consumer Discretionary components, each trades for at least 20x last year's earnings per share. The median among those 10 is 29x; the average is 34.5. It's not much more appealing from a forward-looking P/E perspective either; an investor needs to pony up 24x earnings to own it. Glance back at the full-time job chart. It's not good.

Energy is a sector that is intriguing, not so much because we have special insight on its propensity to outperform, but because of its rising status as a bond market diversifier. Year to date, it has been the market's leader, thriving in a tentative bull market that has witnessed several of the Magnificent Seven fall out of favor.

Critically, Energy is showing something of an anti-correlation with fixed income. Because the primary worry—at least for the time being—is inflation's stickiness, our minds are on the inability of the "40" in a 60/40 equity/fixed income portfolio to offer the diversifying benefit that we witnessed for most of our careers.

To the extent that there is a bigger question mark on bonds, that question mark rests almost entirely on a foundation of structural inflation worry. Energy thus steps up as the incremental portfolio diversifier to

the extent it is over-weighted. The 2024 action through April is a case in point: fixed income is in the red once again, the collective is in agreement that the reason for that predicament is stubborn inflation, and Energy shouts at us that it is holding the reins.

Across broad equities, strategies emphasizing companies that have demonstrated an ability to pay dividends and engage in buybacks are the types of firms that typically have durable business models that can withstand an economic shock that could be caused by the Fed's unwillingness to ease.

Japan: Case in Point on 2024 Bull Catalysts

The world's fourth-largest economy's setup involves a currency decline that we feel comfortable labeling a collapse. Relative to the U.S. dollar, the Japanese yen was as strong as ¥103 as recently as 2021; now, the market chatter is that ¥160 was the line in the sand that panicked the Ministry of Finance (MoF) into selling dollars in late April. For all we know, the MoF intervening could become thematic if Chairman Powell continues to hold the line north of five.

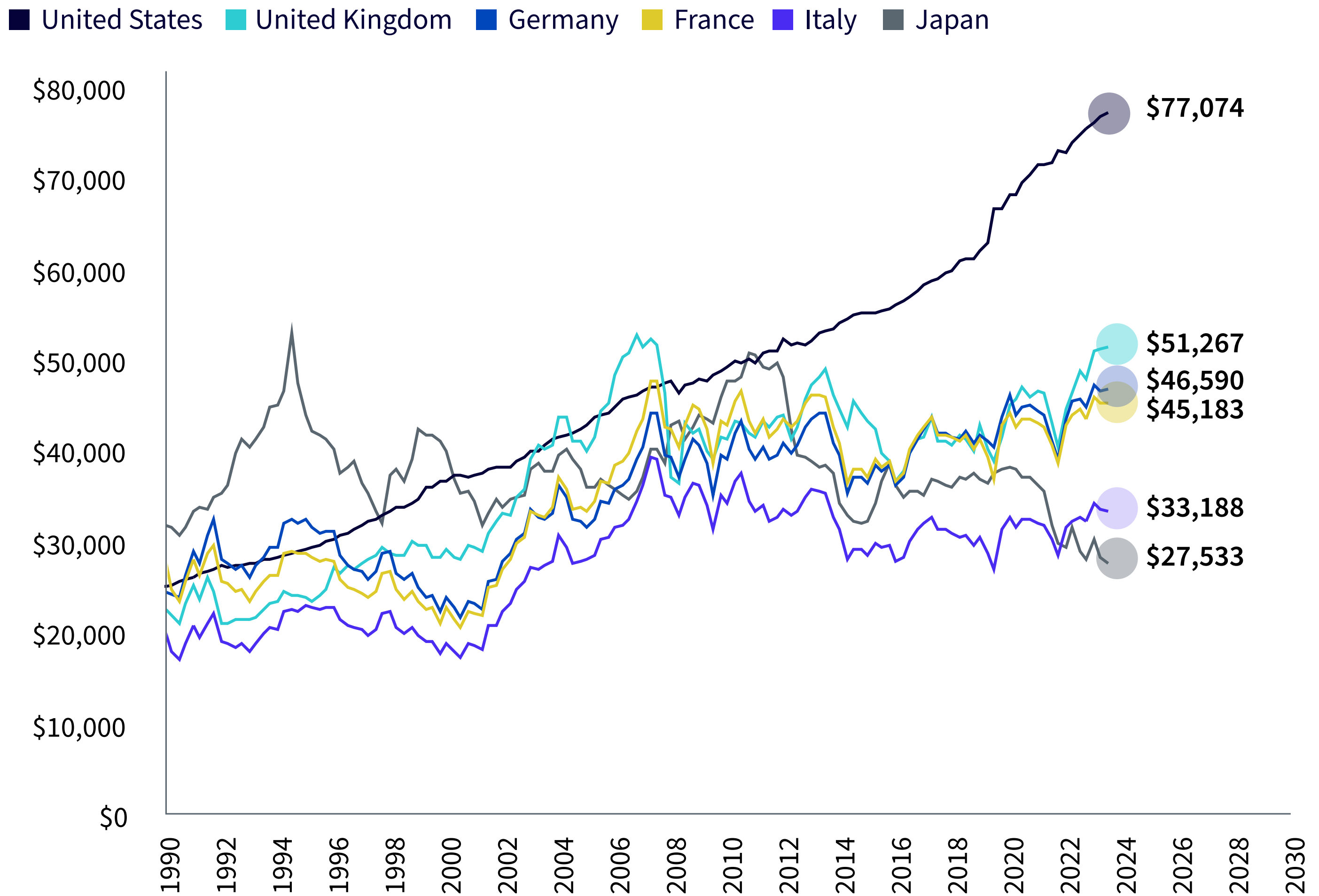
The question of whether the yen's next move is up or down betrays what we think should be the focus: whether the currency is at ¥150, ¥160 or ¥170 to the dollar will not materially change the cold reality that you can now drive a truck through the wage gap that has opened between U.S. and Japanese workers.

The Organization for Economic Cooperation and Development (OECD) tabulates average wages by country. We wish they used medians, but alas, we have to work with averages. In USD terms, American and Japanese workers were at wage parity as recently as the turn of the century. Now, Americans earn triple the compensation of their Japanese counterparts ($77,074 vs. $27,533).

How did that happen? Give one country a quarter-century to compound wages at 2% or 3% per year while the other country's wages go nowhere. Next, sprinkle in a currency collapse for the country whose wages chopped sideways. When you do the arithmetic in dollar terms, the result is figure 6. The European countries have a similar wage competitiveness setup, but nothing is quite as bold as Japan's situation.

If we have it right about the wobbly U.S. labor market, we should put ourselves in the shoes of the C-suite at MultinationalCo. Time for layoffs. Who to get rid of, the office workers in Tokyo or their peers who they Zoom with in San Francisco? It's obvious.

Figure 6: Average Annual Wage (USD Terms)



Sources: Refinitiv, OECD, as of Q2 2024, with currency conversion as of the exchange rate on April 30, 2024. **Historical performance is not an indication of future performance.**

In equities themselves, the Tokyo Stock Exchange has found success pushing listed firms to disclose their "Action to Implement Management that is Conscious of Cost of Capital and Stock Price." Though that is a mouthful, it is a specific program. For more than a year, Japanese firms have been strong-armed into disclosing explicit plans to boost profitability measures and their valuations.

The initiative seems to have worked, as indicators such as return on equity (ROE) are finally ticking up in the country. Also heartening are indications, at least to us, that we will witness copycat corporate governance reform out of Korea and China. With three countries in the region now actively engaged in shareholder-friendly reform, there is the prospect of a proverbial "arms race" occurring between them, whereby each country attempts to outdo the others on matters such as shareholder rights and profit maximization.

Promising Growth Outlook for India

Some of the most robust earnings growth prospects this year and next should materialize in India. Many on the Street are pricing in earnings growth of 15% for both 2024 and 2025. Granted, it is hard to declare the country cheap; few among us would argue that it doesn't need to grow into its 24x forward earnings multiple.

Nevertheless, we think the country has several multi-year catalysts. For one, there will likely continue to be a buzz between now and 2027, when India's Finance Ministry projects the country will jump into third place in the GDP pecking order behind the U.S. and China. The anticipation of that event is something that we believe will shower the headlines, raising awareness among plenty of investors whose exposure to the country is zero.

Additionally, the fixed income side of the business is preparing for India's inclusion in key emerging market indexes, namely those tabulated by industry giant J.P. Morgan. There is also the possibility that other index houses, such as Bloomberg, may sharpen their pencils for more India exposures in their fixed income indexes sometime thereafter. This is bullish for general India equity research and fund management. After all, fixed income and equity teams exchange ideas around the water cooler.

Another catalyst is the prospect of India becoming perhaps the largest member country in indexes such as MSCI Emerging Markets and FTSE Emerging Markets on the equity side. Unlike in fixed income, that possibility won't come at the hands of index committees. Instead, the country may simply surpass China's market capitalization. As that portent rises in the collective consciousness, we think India will gain more attention. The reality, and we all know it, is the financial news media's stock market coverage in the emerging world is Sinocentric. Sooner or later, someone in the newsroom asks why they don't have a correspondent in Mumbai.

Eurozone: Periphery Continues to Outperform the Core

The eurozone economy is expanding again, leaving behind the stagnation witnessed in H2 2023. The improvement in growth was driven by net exports, services consumption and stronger construction activity aided by a mild winter. Peripheral countries in the eurozone have been doing the heavy lifting in terms of growth, while the underperformance of core countries continues as industry and export-dependent countries like Germany continue to bear the brunt of the manufacturing slump. However, improved services activity in the core countries is helping to narrow the gap. We expect rising real incomes and a solid labor market to support domestic consumption over H2 2024, thereby allowing the eurozone to enjoy a sustained rebound in growth over 2024.

Disinflation in the Eurozone Remains on Track

The eurozone Harmonized Index of Consumer Price (HICP) inflation continues to trend lower at 2.4% year-over-year in April alongside core inflation, which edged down further to 2.7%[1]. Energy and goods inflation continued to be a drag on inflation. Services inflation is expected to moderate further, supported by further falls in wage growth. The cooling in inflation is likely to be sufficient for the European Central Bank to go ahead with its first rate cut at the June Governing Council meeting.

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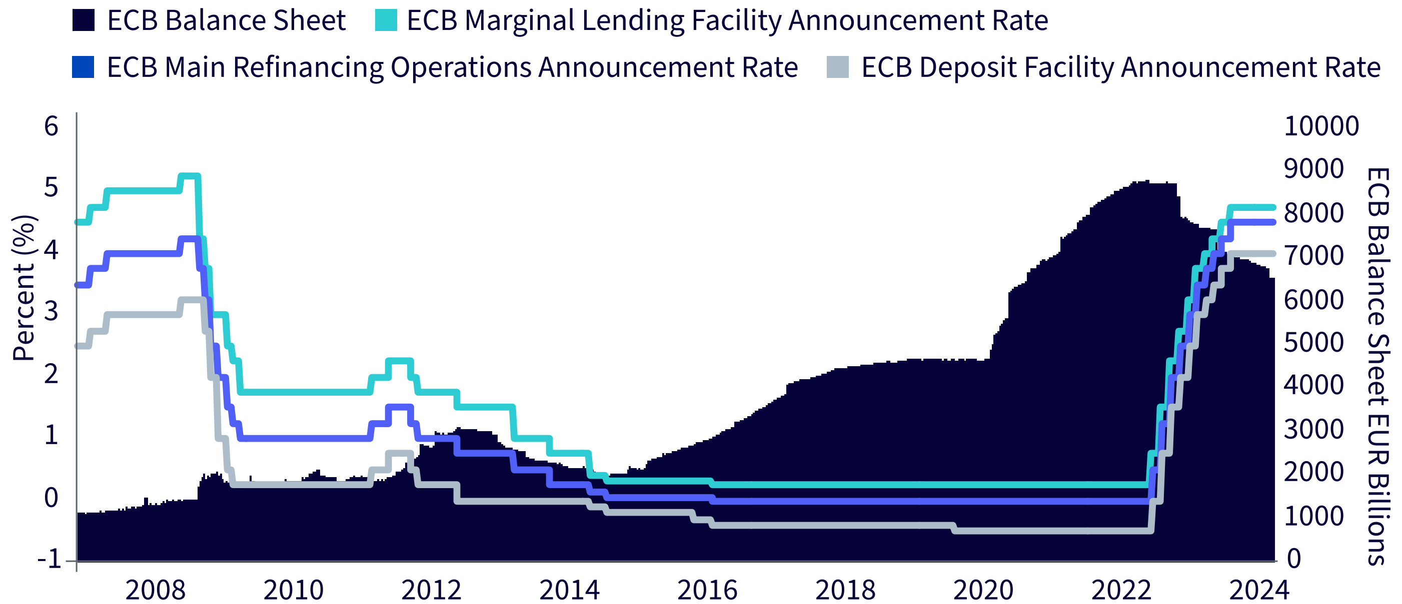
Door Remains Open to a June Cut

The key debate at the European Central Bank (ECB) now appears to be whether it should follow up with a consecutive rate cut in July or wait until September for the second rate cut. As long as the eurozone economy's recovery remains on a gradual path and the risk of inflation reaccelerating remains on the table, the ECB will adopt only a mild loosening of its restrictive stance. The postponement of the first Fed rate cut could also offset some of the easing in euro area financial conditions. The ECB holds assets worth a combined €4.6 trillion under its asset purchase programme (APP) and pandemic emergency purchase programme (PEPP). The ECB is unwinding its APP only gradually. The portfolio is expected to shrink at a slow pace of about €0.3 trillion until the end of the year. Maturing bonds under the APP will not be reinvested. The ECB also intends to start reducing the PEPP volume by €7.5 billion per month in H2 2024 and then stop reinvestment altogether[2].

[1] Bloomberg, as of April 30, 2024.

[2] European Central Bank, as of March 31, 2024.

Figure 7: European Central Bank - Key Policy Rates and Balance Sheet



Sources: European Central Bank, Bloomberg, WisdomTree, as of April 19, 2024. **Historical performance is not an indication of future performance.**

A Reversal for European Small-Cap Equities on the Horizon

European small caps have faced a notable setback, trailing behind European large caps by more than 25% since the COVID-19 pandemic, in part due to their lower exposure to sectors that benefited from rising rates, such as Financials and Energy. The decline in interest rates could act as a catalyst for European small-cap stocks, especially given their heightened sensitivity to tightening credit conditions. European small-cap earnings have been outperforming those of large caps since mid-2023. In lockstep, European small caps are becoming more attractive in terms of valuation (as the price-to-earnings (P/E) ratio gap with large caps is at its highest level since 2003)[3]. The combination of favorable valuations with positive earnings growth creates a ripe environment for a reversal in the performance of European small caps versus their larger counterparts.

The Far-Right Threat Is Real in European Elections

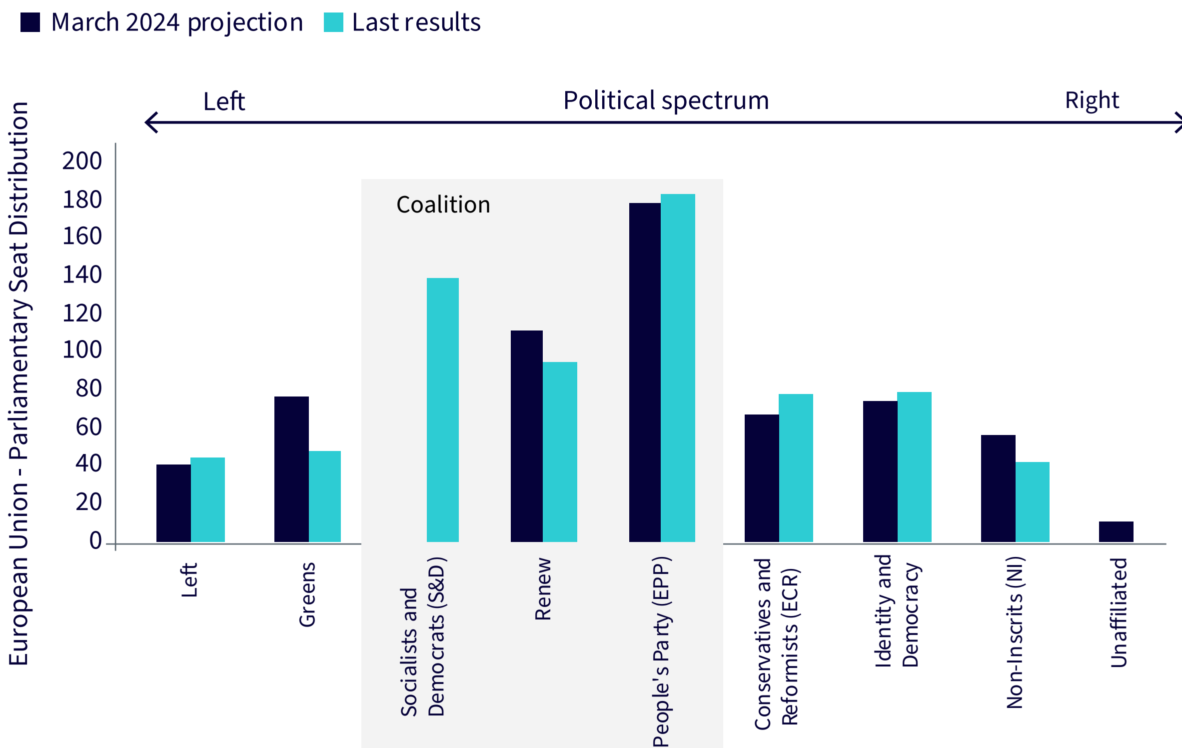
At stake in the European Parliamentary elections in June will be everything that defines the modern European Union (EU). There is currently a strong backlash against the kind of policies the Von der Leyen Commission represents. Polls indicate that far-right parties will make substantial gains, owing to

[3] FactSet, as of March 31, 2024.

dissatisfaction with the latest wave of illegal immigrants[4]. In addition, we are seeing a strong pushback against the Green Agenda. The radical-right Identity and Democracy (ID) group is likely to gain significant seats, emerging as the third-largest group in Parliament.

The two main political groups in Parliament—the European People's Party (EPP) and the Socialists and Democrats (S&D)—will likely continue to lose seats. Despite this, the EPP is expected to remain the largest group in Parliament and, therefore, maintain the most agenda-setting power. This is likely to influence the EU's policy stance on issues such as immigration, climate change and EU enlargement. The EPP is likely to cooperate more often with the right side of the political spectrum, particularly on issues where voting margins are thin.

Figure 8: Right Wing Parties Set to Gain in European Elections



Sources: EuropeElects, WisdomTree, as of March 31, 2024.

Climate Change and Migration Remain in the Limelight

However, the biggest policy implications of the 2024 elections are likely to concern environmental policy. The significant shift to the right in the new Parliament would imply that an "anti-climate policy action" coalition is likely to dominate. This would significantly undermine the EU's Green Deal framework and

[4] ECFR.

the adoption and enforcement of common policies to meet the EU's net zero targets. The majority of the new Parliament will probably advocate for a more gradual transition alongside a more restrictive stance on immigration policies. The next Parliament could also push for a tougher stance on issues key for other areas of EU sovereignty, including migration, enlargement and support for Ukraine.

The implications of the June 2024 elections are far-reaching for the geopolitical direction of the Council of the European EU and the Commission. Recently, the European Commission decided to boost the defence industry and provide adequate support to Ukraine. Thus, the European Parliament is, and probably will remain, in favor of supporting Ukraine.

> The majority of the new Parliament will probably advocate for a more gradual transition alongside a more restrictive stance on immigration policies.

The second most significant election in Europe in 2024 will be in the UK, where anti-incumbency sentiment remains strong. Voters are expected to bring a Labour Party government back to power. The Conservative Party has been in office for almost 14 years, but the opposition Labour Party is leading in the polls by a huge margin. Even if Labour's lead shrinks over the course of 2024 as the economy stabilises and inflation edges down, the Labour Party is expected to secure a working majority.

Encouraging Signs Don't Mean Rate Cuts Are around the Corner for the UK

The improving trajectory of inflation has altered sentiment on Threadneedle Street. While the Bank of England (BOE) kept rates on hold at 5.25% at its March meeting, two of its most hawkish members on the Monetary Policy Committee (MPC) voted to hold rates rather than raise them. The rise in the unemployment rate to 4.2% and the slowdown in wage growth to 6% in February have allowed the bank to remove its hiking bias.

It seems clear the BOE wants to cut and has been persistently dovish in the face of improving data. However, the issue for the UK is that services inflation remains high and sticky. On a medium-term horizon, it's still hard for the UK to bring down services inflation to sub-4% and core inflation to sub-3% by year-end. Private sector earnings excluding bonuses remain a bit above the Bank's forecast of 5.7% for March with one month to go. In addition, the committee is likely to take into consideration the recent rise in energy prices owing to the rise in geopolitical risks and its impact on UK inflation. This makes it

challenging for the UK to initiate its rate-cutting cycle before August. We expect the BOE to be the last of the major central banks to start cutting rates and probably move slowly, at least compared to the ECB.

Gold Propelled to New Highs on the Back of Geopolitical Risks

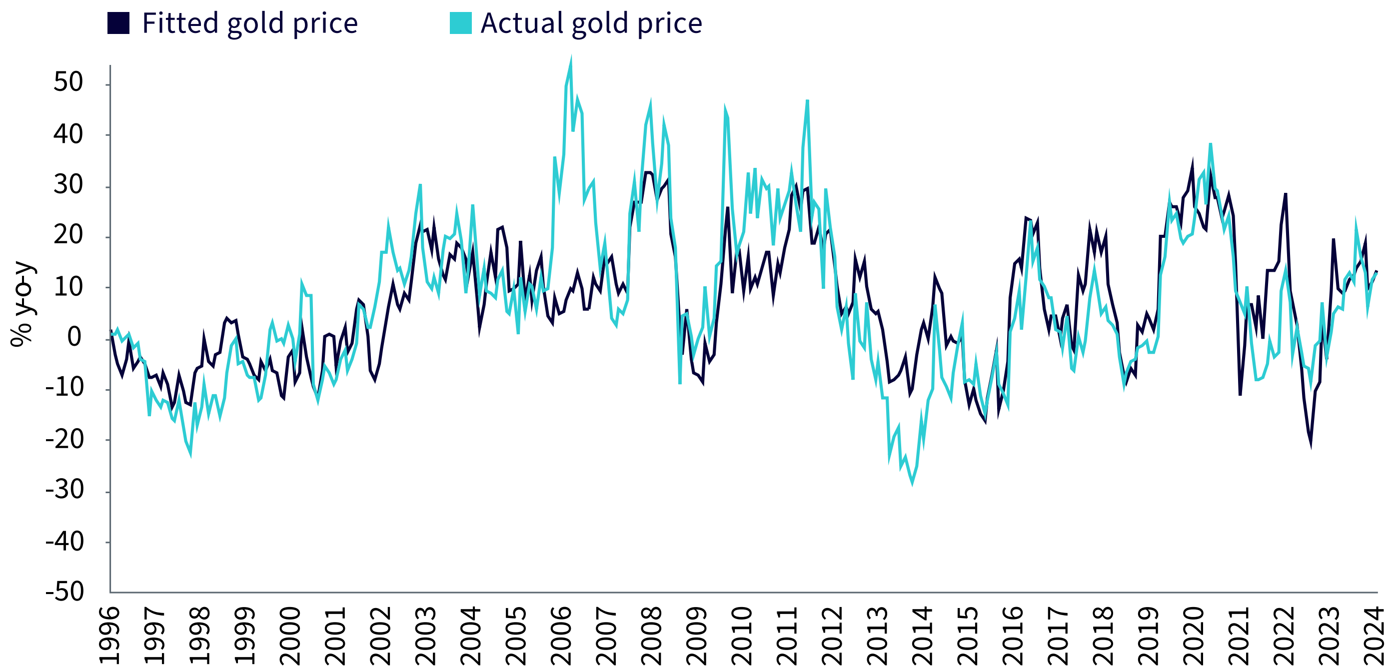
Gold reached a fresh high of $2,402/oz on Friday, 12 April (figure 9), as geopolitical risks escalated when Israel and its allies were preparing for an attack from Iran, and official U.S. inflation was running hot. Gold eased back to $2,330/oz by 29 April, as higher bond yields, a stronger U.S. dollar and market perceptions of an easing of geopolitical tensions took some of the upward pressure off the metal.

As discussed in earlier sections, markets have shifted their expectations of U.S. rate cuts towards the end of the year, driving the U.S. dollar and bond yields higher. These are normally gold-negative events. However, WisdomTree's model approach to explaining gold price behaviour[5] indicates that the price increases appear in line with gold's fundamentals (figure 9). Our model indicates that at the end of March 2024, gold should have increased by 13.4% year-on-year, basically matching the 13.2% year-on-year increase we actually saw. Higher-than-expected inflation was gold price supportive, countering the bond sell-off and U.S. dollar appreciation. Moreover, the elevated geopolitical risks, reflected in the higher speculative position in the metal, are a key driver of performance.

Higher-than-expected inflation was gold price supportive, countering the bond sell-off and U.S. dollar appreciation.

[5] See our model described in "Gold: how we value the precious metal."

Figure 9: WisdomTree Gold Model



Sources: Bloomberg, WisdomTree price model, data as of April 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

While global investment in gold has been very slow (in fact, we have seen net outflows from exchange-traded products (ETPs) and a marked slowdown in retail buying in key markets like India), Chinese buying has been strong.

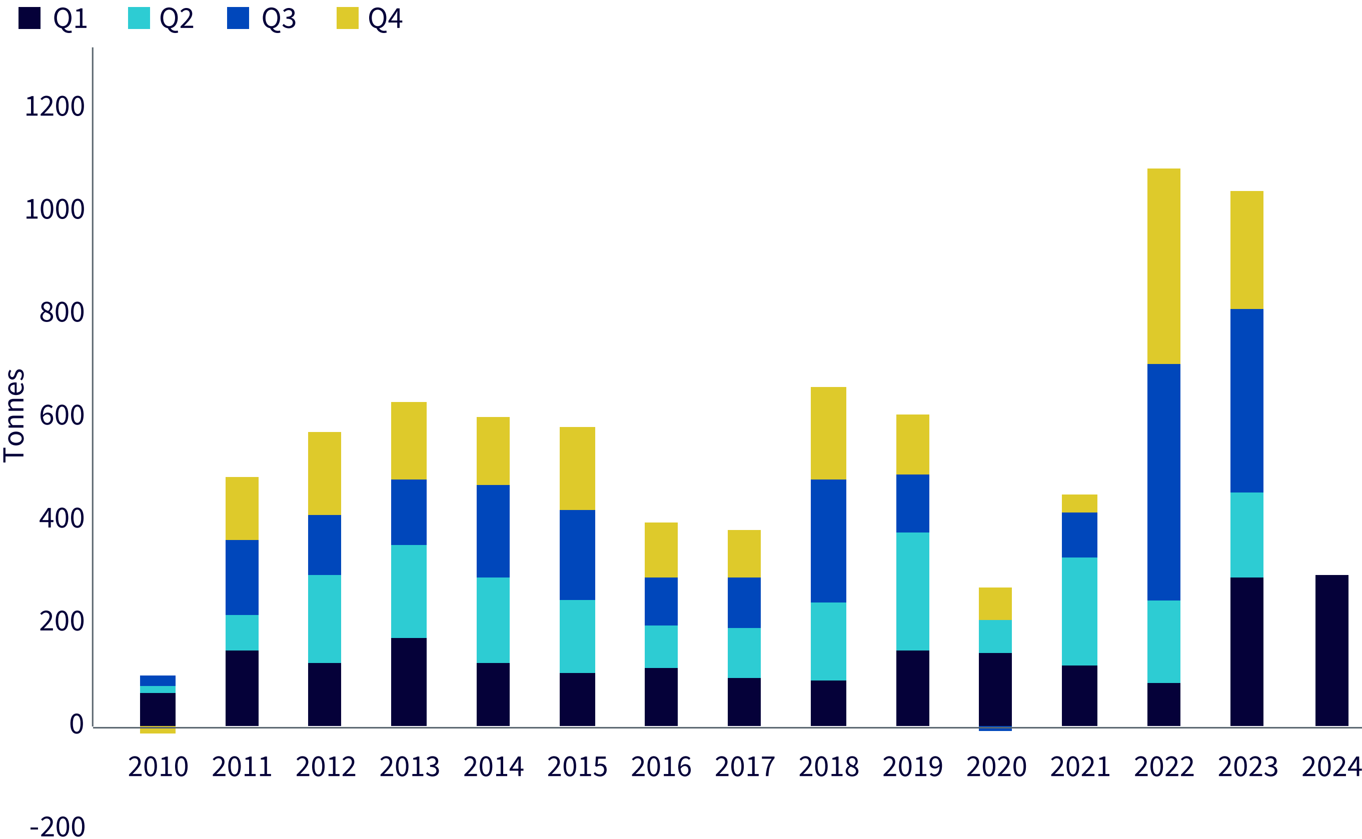
Chinese ETPs attracted inflows, adding RMB1.2 billion (US$164 million) in March and pushing total assets under management (AUM) to another record high of RMB35 billion (US$5 billion). Chinese gold withdrawals from the Shanghai Gold Exchange totalled 522 tonnes during the first quarter, 57 tonnes higher year-over-year and the highest Q1 since 2019. Furthermore, withdrawals stand 43 tonnes above the 10-year average. Despite a weaker-than-usual March, the strongest January on record and the above-average February shored up Q1 wholesale demand. Active retailer replenishment ahead of the Chinese New Year, healthy consumption in early 2024 and elevated investment demand throughout Q1 were key contributors.

Central Banks Are Lapping up Gold

Central banks have been buying gold at a record pace in recent years (figure 10). The catalyst was the reaction of G7 countries to the Ukraine war. When Russia's assets in G7 currencies were frozen, it spooked many central banks around the world. Falling on the wrong side of the G7 could have detrimental effects. To mitigate the risk, the solution that central banks have resorted to is to accumulate a currency that no

other central bank controls: gold. In 2022, central bank gold buying hit its highest on record (data goes back to 1970). In 2023, central bank purchases only moderated marginally. In 2024, we have seen the highest first-quarter buying by central banks on record. Central banks are less price sensitive than retail or institutional investors as they are trying to fulfil a policy objective.

Figure 10: Central Bank Demand for Gold



Sources: WisdomTree, World Gold Council, Q1 2010 to Q1 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

The largest central bank buyer in 2023 was China's central bank, the People's Bank of China (PBoC), accumulating 225 tonnes. The PBoC has reported 17 consecutive months of purchases and shows no sign of slowing. The PBoC has bought 27 tonnes in Q1 2024. China has the largest foreign exchange reserves in the world and more than double the next largest country (Japan). Replacing all of its foreign exchange (FX) with gold is an impossible task. Even to get to a similar gold-to-FX reserve ratio as the U.S., Italy, Germany and France have (in the region of 60%–70%) is impossible. But increasing the ratio from the current level of just over 4% on an ongoing basis seems like a reasonable strategy. We thus believe that the gold purchases of 225 tonnes (approximately $32 billion) we saw from China in 2023 could be repeated for decades to come.

In 2023, we saw some very large-scale purchases by central banks that have not been that active in many years. Poland, for example, bought 130 tonnes, and Singapore bought 76 tonnes. It’s less clear if these central banks intend to maintain that level of buying going forward.

On the other hand, Turkey, usually one of the largest gold buyers[6], sold 2 tonnes in 2023. Facing economic turmoil, earthquakes and a government embargo on gold imports, Turkey’s central bank was selling gold to domestic buyers in a period of high gold demand in Q2 2023 (132 tonnes), but it resumed buying once the embargo was lifted and began replenishing lost ounces to become broadly flat by the end of the year. In Q1 2024, Turkey has accumulated a further 30 tonnes.

We believe that given elevated geopolitical risks and aversion to ‘import’ G7 monetary policy, central banks across many developing countries (and a few developed ones, too) will continue to buy gold at levels higher than the pre-2022 norm.

China’s Surprising GDP Print Belies Ongoing Fragility, with Further Stimulus Needed by the PBoC

China’s Q1 2024 economic growth came in at 5.3%, beating even the most bullish forecasts[7]. An economy beleaguered with a real estate market implosion, an equity market rut and no sign of a bazooka stimulus programme has surprised to the upside with this GDP print.

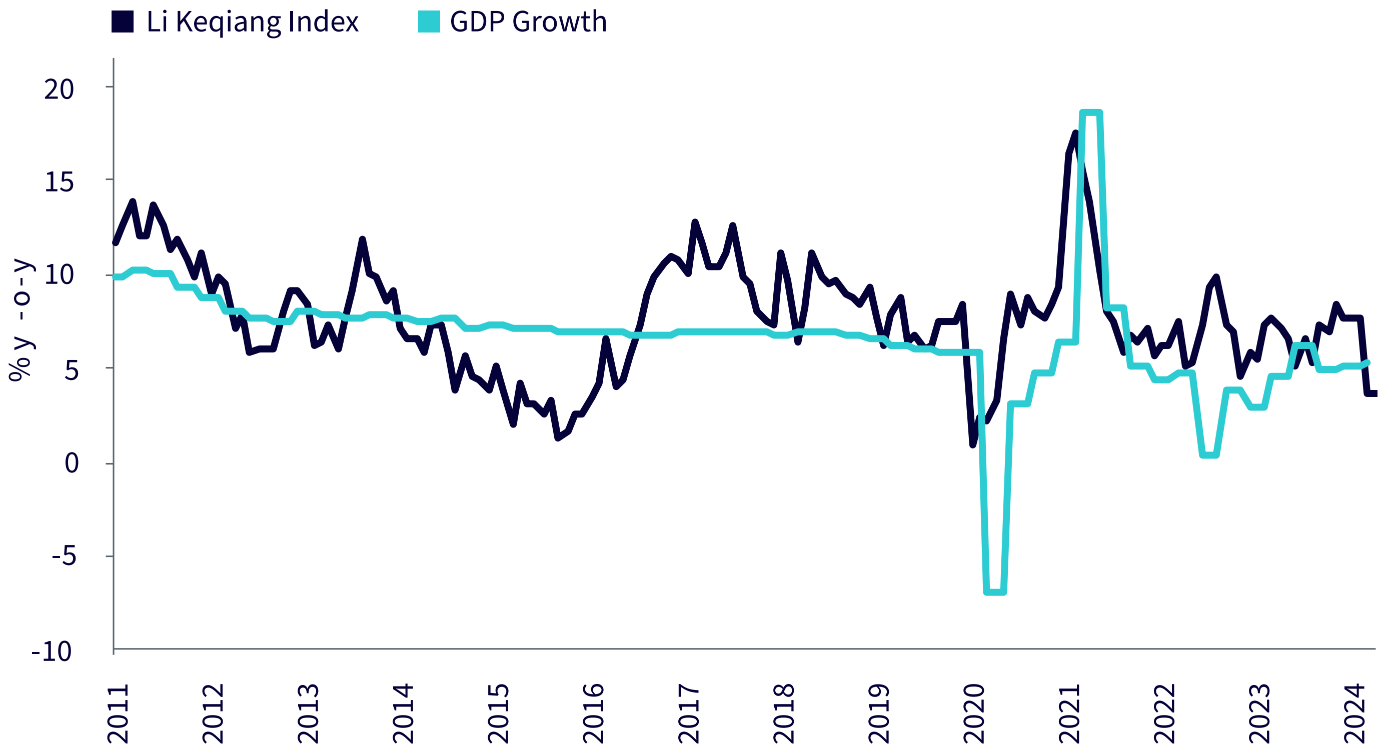
It could be tentative signs that the piecemeal stimulus, i.e., a series of stimuli that has rarely been headline-worthy but in accumulation has been potent, is bearing fruit.

However, the print does sit at odds with GDP proxies. The late Li Keqiang, the Chinese premier from 2013 to 2023, once remarked to a U.S. diplomat that China’s GDP data was ‘man-made’. To track growth, he preferred to look at changes in bank lending, rail freight, and electricity consumption. Thus was born the famous Li Keqiang index, a GDP proxy which applies a 40% weight to bank lending, 40% weight to rail freight and 20% weight to electricity production. As figure 11 shows, this proxy has dipped in recent months in contrast to official GDP figures. Deflationary pressure may be contributing to the disconnect between the official data and proxies. Deflationary pressure is, however, a worrying trait that we believe the central bank needs to address.

[6] 86 tonnes in 2017, 51 tonnes in 2018, 126 tonnes in 2019, 16 tonnes in 2020, 0 tonnes in 2021 and 148 tonnes in 2022.

[7] Bloomberg Survey, April 2024. Highest forecast in the survey was 5.2%.

Figure 11: China GDP and GDP Proxy



Sources: WisdomTree, Bloomberg January 2011 – March 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

We believe that to maintain the 5% growth target for this year, China will need to stimulate further. The PBoC is, however, reluctant to cut interest rates in a broad fashion until the U.S. cuts rates. It fears currency depreciation would result. The PBoC had cut key mortgage rates in February 2024. The 0.25% cut to the benchmark five-year loan prime rate was the largest since it was introduced in 2019. The PBoC also cut the reserve requirement ratio (RRR) in January by 0.5%, the largest in two years. The RRR is a non-interest rate monetary tool which determines the amount of cash banks have to keep in reserve with the PBoC. The lower the reserve requirement, the looser credit conditions by commercial banks.

The PBoC is, however, reluctant to cut interest rates in a broad fashion until the U.S. cuts rates.

Until we get rate cuts elsewhere, we expect the PBoC to continue to make infrequent adjustments with periphery tools, with more meaningful monetary stimulus at the end of the year.

The Chinese government has chosen an economic strategy focused on promoting solar cells, lithium batteries and electric vehicles. The so-called “New Three” (“xin san yang”) is designed to counteract the downturn in real estate domestically and outpace the export markets of the “Old Three—textiles, furniture and consumer electronics.

The risk China faces is renewed protectionism, especially from the U.S., given the election year. That could lead to China needing to pivot its economic strategies once again.

Additionally, fiscal support for equipment upgrades and durables trade-ins will help fixed-asset investment. The programme announced in March by the National People’s Congress (NPC) promotes:

1. Equipment upgrades covering industrial sectors, construction, utilities and transportation, as well as equipment for education, healthcare, entertainment and others.
2. Trade-in programs, with auto, home appliances and home decoration as three major areas.
3. Recycling: The plan pledged to promote “trade-in and recycling” of used goods, such as cars and electronics.

The NPC also reintroduced an energy intensity target, with an energy consumption per unit of GDP of around 2.5% in 2024. Having more efficient equipment helps this goal and generally moves the country to greater electrification.

Glossary

60/40 portfolio: A portfolio of 60% equities and 40% fixed income.

Asset allocation: An investment strategy that involves dividing an investment portfolio among different asset classes to balance risk and reward.

Asset purchase programme (APP): A monetary policy instrument used by central banks to buy securities from the corporate and private sectors, as well as government bonds.

Balance sheet: Refers to the cash and cash equivalents part of the current assets on a firm's balance sheet and cash available for purchasing new positions.

Beta: A measure of the volatility of a security or portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Bond yield: Refers to the interest received from a bond and is usually expressed annually as a percentage based on its current market value.

Bull market: A market in which share prices are rising, encouraging buying.

Buyback: Also known as a share repurchase, this is when a company uses excess cash to buy back its own shares from the stock market, canceling them and reducing the number of shares outstanding.

CBOE Volatility Index® (VIX®): A key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. It is the premier benchmark for U.S. stock market volatility.

Central bank: An institution that manages the currency and monetary policy of a state or formal monetary union and oversees its commercial banking system.

Disinflation: Term used to describe instances of slowing inflation. It's different from deflation in that price levels are still increasing overall, just at a slower rate.

Dot plot: A chart based on the economic projections of the Federal Reserve board members that illustrates their views on the appropriate pace of policy firming and provides a target range or target level for the Federal Funds Rate.

Earnings growth: The annual compound annual growth rate of earnings from investments.

Earnings per share (EPS): Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

Emerging market (EM): Characterized by greater market access and less potential for operational risks when compared to frontier markets, which leads to a larger base of potentially eligible investors.

Eurozone Harmonized Index of Consumer Price (HICP): A measure of inflation in the euro area that compares the average change in prices paid for a basket of goods and services over time.

Exchange-traded products (ETPs): Financial instruments that are traded on stock exchanges throughout the day, similar to stocks.

Federal Reserve balance sheet: Also known as the Fed's H.4.1 statement, this is a financial statement that shows the U.S. central bank's assets, liabilities and capital accounts.

Federal Funds (Fed Funds): Excess reserves that commercial banks and other financial institutions deposit at regional Federal Reserve banks.

Fed Funds Futures: Financial contracts that represent the market opinion of where the daily official Federal Funds Rate will be at the time of the contract expiry. The futures contracts are traded on the Chicago Mercantile Exchange (CME) and are cash settled on the last business day of every month. Fed Fund Futures can be traded every month as far out as 36 months.

Fed Funds Rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Federal Open Market Committee (FOMC): The branch of the Federal Reserve Board that determines the direction of monetary policy.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the U.S.

Forward earnings: An estimate of the next period's earnings of a company, usually until the completion of the current fiscal year and sometimes to the following fiscal year.

Forward multiple: A valuation ratio that reflects a company's value on the basis of an estimated financial metric, i.e., forecasted earnings performance.

Forward price-to-earnings: Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

FTSE Emerging Markets Index: Provides investors with a comprehensive means of measuring the performance of the most liquid large- and mid-cap companies in the emerging markets.

G7: An informal gathering of seven of the world's most advanced economies: Canada, France, Germany, Italy, Japan, the United Kingdom and the U.S.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Magnificent Seven: Refers to a group of high-performing U.S. stocks that includes Microsoft (MSFT), Amazon (AMZN), Meta (META), Apple (AAPL), Google parent Alphabet (GOOGL), Nvidia (NVDA) and Tesla (TSLA).

Market capitalization: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Mortgage-backed securities (MBS): A type of asset-backed security that is secured by a mortgage or collection of mortgages.

MSCI Emerging Markets Index: A free-float weighted equity index that captures large- and mid-cap representation across emerging markets (EM).

National income and products accounts (NIPA): One of the main sources of data on general economic activity in the U.S.

Organization for Economic Co-operation and Development (OECD): The Organization for Economic Co-operation and Development aims to promote policies that will improve the economic and social well-being of people around the world.

Pandemic emergency purchase programme (PEPP): A temporary program launched by the European Central Bank in March 2020 to buy public and private sector securities in response to the COVID-19 crisis.

Price-to-earnings (P/E) ratio: Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Quality dividend growth screen: A process of filtering, or removing, companies that are eligible for an investment process based on certain parameters.

Quantitative easing (QE): A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Quantitative tightening (QT): The reverse process of quantitative easing whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Reserve requirement ratio (RRR): The percentage of deposits that a commercial bank must keep in reserve.

Return on equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

System Open Market Account (SOMA): An account that is managed by the Federal Reserve Bank containing assets acquired through operations in the open market. The assets in SOMA serve as a management tool for the Federal Reserve's assets, a store of liquidity to be used in an emergency event where the need for liquidity arises and as collateral for the liabilities on the Federal Reserve's balance sheet such as U.S. dollars in circulation.

t-note: A debt obligation issued by the U.S. government that matures in less than 30 years.

U.S. Treasury (UST): UST is the abbreviation for the U.S. Treasury, the federal government division that manages U.S. finances. UST is commonly used to reference debt that is issued by the U.S.

Valuations: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Yield: The income return on an investment. Refers to the interest or dividends received from a security typically expressed annually as a percentage of the market or face value.

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