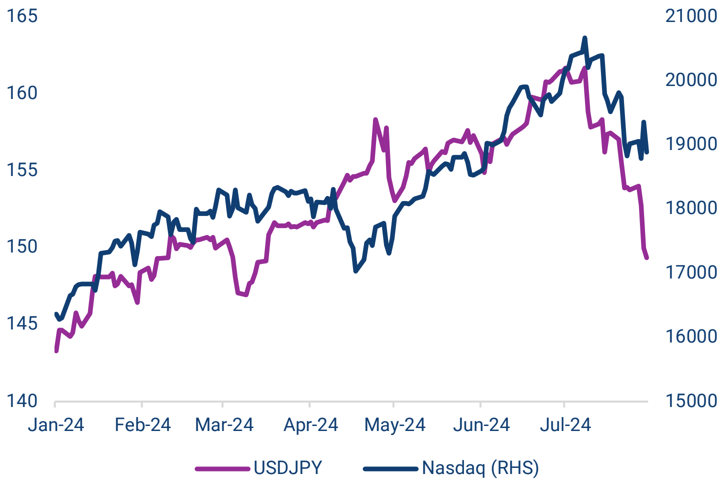
10X Global Connect – July 2024

Unwind of the Yen carry trade

USDJPY vs Nasdaq Index - YTD 2024



Source: 10X Investments Bloomberg

After many years of suppressing interest rates, the yen has become the primary funding currency for carry trades, depreciating by 45% in the three years leading up to June 2024.

In July the BOJ delivered its second-rate hike of 2024 at a time when rate cut expectations have increased in the US on the back of softer inflation and employment data.

The divergent path of Japanese monetary policy drove the yen to strengthen 7% July, triggering an unwind of carry trades.

The bull market in US mega-cap tech shares was a beneficiary of this carry trade and now faces headwinds from this drain of liquidity at a time when earnings are disappointing and valuations are high.

Valuation expansion has driven S&P 500 returns

Real return decomposition of US equity indices July 2014 -July 2024

	S&P 500	S&P 500 Equal Weight	S&P 500 Dividend Aristocrats
Real Return	10.3%	7.9%	8.4%
Dividend	1.8%	2.0%	2.5%
Real EPS	4.0%	4.8%	4.4%
Valuation	4.5%	1.1%	1.5%

Source: 10X Investments, Bloomberg

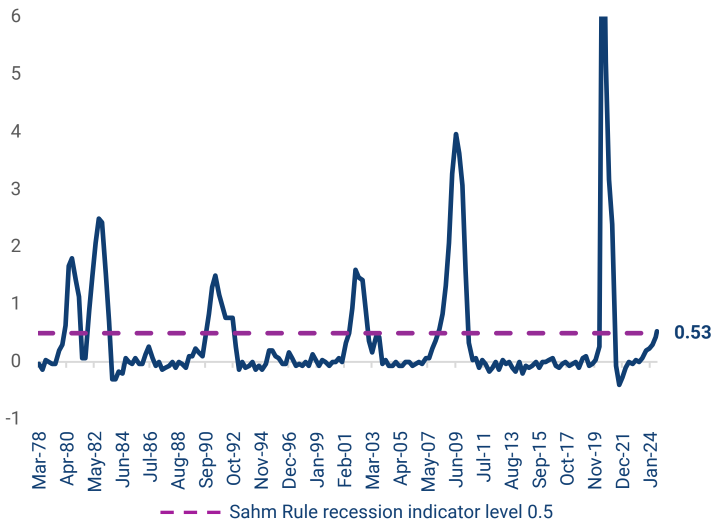
The S&P 500 has been one of the best-performing indices over the last decade, primarily driven by a valuation rerating, which has contributed 4.5% to its real return of 10.3%.

In contrast, more diversified and less tech-heavy indices like the S&P 500 Equal Weight and S&P 500 Dividend Aristocrats have shown stronger earnings growth, with real EPS increases of 4.8% and 4.4%, respectively, despite underperforming the S&P 500 over the same period.

Earnings expectations have driven the valuation premium for the S&P 500, and with signs that these expectations are not being met, the rerating tailwind could easily turn into a headwind.

Sahm rule triggered

Sahm rule reccession indicator - 1978 - 2024



Source: 10X Investments, Bloomberg

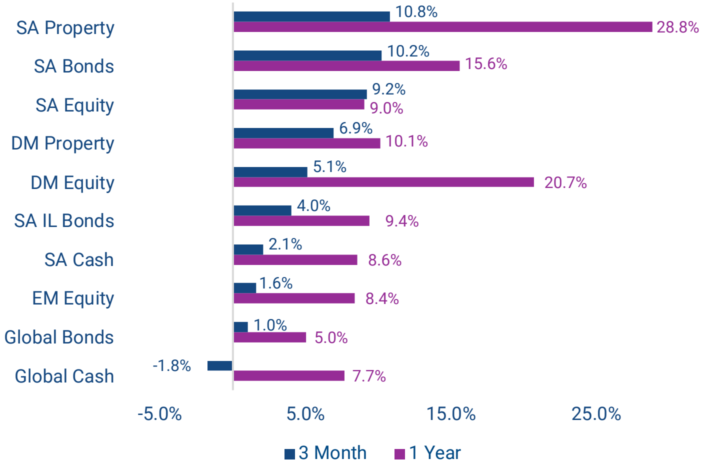
The US labour market continues to soften, with July's unemployment rate at 4.3% triggering the Sahm Rule, an early recession indicator measuring the acceleration of unemployment. Historically, a recession has followed each time this indicator has been triggered since 1960.

The Sahm Rule was created as an early warning for policymakers to stabilise an economy heading for recession. This data indicates a quickly deteriorating labour market, raising questions about the Fed's restrictive monetary policy.

As a result, there was a significant rally in US Treasuries, led by the short end, with the market now discounting nearly 1.5% of rate cuts by the end of January 2025.

Asset class returns to 31 July 2024

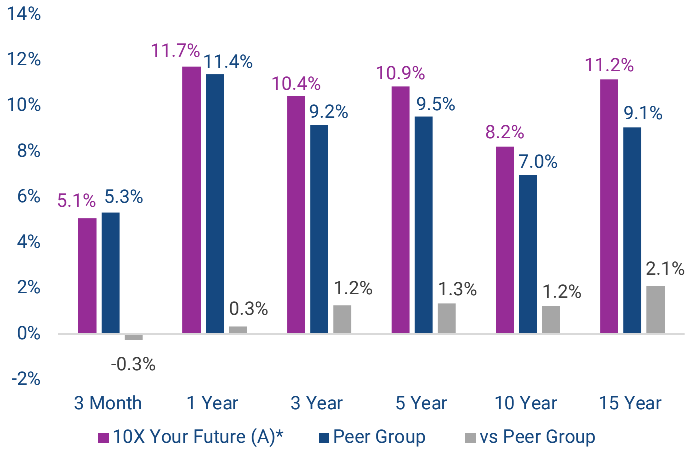
SA assets outperforming



Source: 10X Investments Bloomberg

Portfolio returns to 31 July 2024

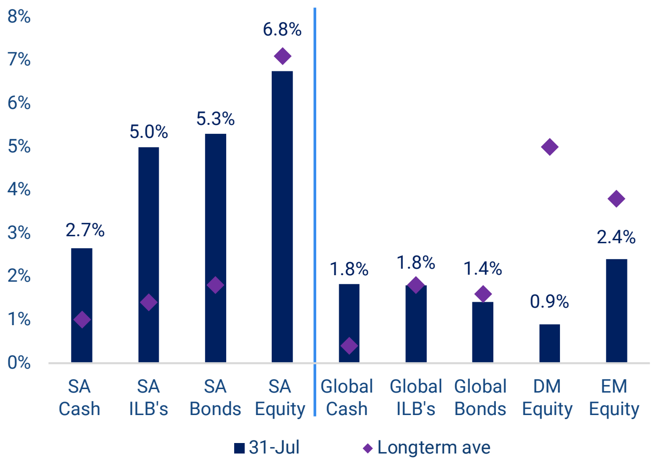
Strong long-term outperformance



Source: 10X Investments Morningstar; * returns prior to March 2019 are those of 10X Umbrella Pension Fund adjusted for Class A fee

5-10 year expected asset class return

31 July 2024



Source: 10X Investments, Bloomberg

Real (after-inflation) return expectations

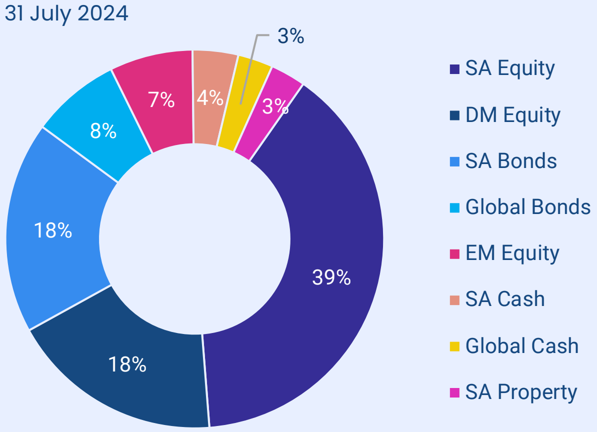
South African nominal bonds continued to rally in July, supported by a drop in market-implied inflation expectations. The 10-year breakeven inflation rate has fallen by 1.6% since its peak in April, while the 10-year real yield remains unchanged.

This has significantly improved the relative attractiveness of inflation-linked bonds, as their return outlook is unchanged, whereas the real return outlook for nominal bonds has dropped from 7% to closer to 5% over this period.

The outlook for growth asset classes remains challenging compared to defensive asset classes, with developed market equities standing out as the least attractive.

10X Your Future Fund Asset Allocation

31 July 2024



Source: 10X Investment

Asset Allocation

Following the decrease in expected returns from South African nominal bonds, we allocated 4% of nominal bond exposure to South African inflation-linked bonds, bringing the nominal/linker split to 50/50.

Given the continued concerns around both valuations and concentration risk, we continue to allocate our DM equity market cap exposure into more defensive, dividend-paying companies with greater diversification.

The portfolio remains defensively positioned, with 67% allocated to growth assets.

Anton Eser
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Disclaimer