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PHILEQUITY CORNER

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The cut is near

US inflation's broad-based cooling in June to its slowest pace since 2021 ramped up bets that a Federal Reserve rate cut is near. This triggered a market rotation away from the "Magnificent Seven" tech giants that have driven the current bull market in stocks. The prospect of lower borrowing costs is breathing life into small-caps, mid-caps and value stocks as investors dial back their exposure to big tech safe havens.

First Cut is the deepest

Expectations of the Fed's First Cut are having the deepest, most significant effect on global capital markets. It is driving substantial moves in the US dollar and significantly impacting currencies, bonds, and equity markets. The effect of the first cut is far-reaching. It is not confined to US asset markets alone. It extends to emerging market stocks and currencies, including the Philippine stock market and the peso. The last time the Fed first cut rates after a tightening cycle was in July 2019.

US CPI boosts odds of September cut

US Consumer Price Index (CPI) fell 0.1% for the month of June, falling short of consensus estimates and decelerating to 3.0% year-on-year from May's 3.3%. This softer-than-expected inflation reading combined with recent unemployment trends suggests economic cooling. This bolsters market expectations for Fed rate cuts as early as September.

Fed may not wait for 2% inflation

Fed Chairman Jerome Powell, in his congressional testimony last week, indicated that the risks to the economy are now more evenly balanced between inflation and recession. In a notable dovish shift, Powell suggested that the Fed may not need to see inflation hit its 2% target before considering rate cuts. The June inflation report may provide the final piece of evidence the Fed needs to justify a pivot to cut rates.

Pivot towards more cuts

The First Cut by the Federal Reserve is being viewed as a pivotal signal, marking a transition from the higher-for-longer stance to a more accommodative Fed. This potential move goes beyond the current pause in rate hikes, suggesting the start of more cuts in the future.

Rotation from big-tech to small caps

Investors are rotating from Big Tech safe havens to riskier assets. The Russell 2000 index of small-caps surged 6.11% for the week, while the tech-heavy Nasdaq 100 edged down 0.27%, underscoring a broadening of market participation.

US yields down, US dollar weakens

The “First Cut” effect reverberated across asset classes, with U.S. Treasury yields across 1-year, 2-year, and 10-year maturities all sinking 10-15 basis points to multi-month lows. This extended to the currency markets, where the U.S. Dollar Index (DXY) pared back 0.75% last week. Notably, the Japanese yen recovered nearly 2% from its 38-year lows against the dollar for the week.

ASEAN currencies also recovered, with the Thai baht, Indonesian rupiah and the Malaysian ringgit gaining 1.07%, 0.87% and 0.80% for the week, respectively. The Singapore dollar rose 0.47% over the same period.

Peso jumps to strongest level in 6 weeks

The Fed cuts, the weakening US dollar, combined with improving local economic data, are creating a supportive environment for Philippine assets. The Philippine peso continues to stabilize, jumping to its strongest level since June. It closed at 58.40 against the US dollar on Friday. The nation’s trade gap narrowed to $4.6 billion in May from $4.73 billion in April, providing fundamental support for the peso.

BSP may cut rates in August

BSP Governor Remolona said that the BSP will not wait too long to cut rates to avoid “unnecessary” loss of economic output due to tight financial conditions. He hinted that the better-than-expected Philippine June inflation gives the central bank more scope for possible easing in August. The weakening dollar could be an opportune time for the BSP to cut rates ahead of the Fed.

PSEi surges on rate-cut optimism

The prospect of BSP rate cutsis emerging as a key driver for local stocks, with market participants adjusting their positions accordingly. The Philippine Stock Exchange Index (PSEi) climbed for a third consecutive week on optimism over Fed rate cuts. The index advanced 2.39% last week and closed at 6,648 on Friday, extending its total gains to 8% since bottoming at 6,157 on June 20.

Capital rotation boosts Philippine equities

This may be an early sign of rotation into Philippine equities as global investors shift from U.S. tech giants to value stocks and emerging markets. The trend signals a broader rotation away from tech-heavy markets like the U.S., South Korea, and Taiwan. Lower U.S. rates will likely weaken the dollar, boosting the appeal of emerging markets. The shift is expected to broaden investment across sectors and countries, potentially benefiting previously neglected markets such as those in ASEAN nations, including the Philippines. Additionally, the reallocation of capital from Philippine fixed income to equities could further fuel the Philippine stock market’s rally.