Monthly Macro

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What were the biggest drivers of markets in February?

- All eyes continue to be on inflation figures. On the last day of the month, the personal consumption expenditures (PCE) data, the Federal Reserve's preferred inflation metric, read in line with expectations, with January's year-on-year core and headline numbers coming in at 2.8% and 2.4%, respectively. Both figures were slightly lower than the previous month, while the three- and six-month annualised numbers came in around the Fed's 2% inflation target.
- Amid fears that we would see a reacceleration in inflation following a higher than expected CPI reading earlier in the month, this has eased bond market fears. Europe also saw improving inflation news with German CPI down at 2.7%, compared to 3.1% the previous month.
- We saw a positive move in the yen thanks to a Bank of Japan board member commenting that Japan's inflation target is "finally in sight". The expectation is for Japan's negative interest rate policy to come to an end this year. This would be the most significant monetary policy event for Japan in eight years.
- Increasing comfort with growth in the US and, to a lesser extent, the rest of the world was the main dynamic in February. Stronger US services data, robust growth and continued strong employment meant that equity markets were strong and bonds weaker.
- When expectations for rate cuts in the US are being pushed out due to robust growth without a material inflation problem, then there is scope for such negative equity/bond correlation. This is in sharp contrast for much of the past two years, in which near term inflation problems and 'higher for longer' rate discussions have driven positive correlation across assets.
- February's supportive environment for equities in general was strengthened by earnings announcements in AI-related stocks. Some signs of softening US consumer spending, ongoing global real estate stress and geopolitical threats were largely shrugged off by markets.
- In Asia, Chinese stock markets were strong against a backdrop of support from policy makers and outperformed most other regions. A technical recession in Japan did little to impact the ongoing gains in that stock market.

What will you be looking out for in March?

- At the start of the year, investors expected the Fed to start cutting rates in March. Since then, stronger than expected economic data and the loosening of financial conditions has seen markets' expectations scaled back significantly. Bond markets are now expecting the first cuts in June.
- Real yields are hovering at around 2%, which is typically negative for risk assets and can result in increased volatility; real yields pushing through the 2% mark will be something to watch out for.
- Most equity and bond investors have enjoyed the journey since October and there is relative comfort with most types of risks today. This is reflected in US Treasuries, where implied rates suggest faith that neither upward inflationary pressures nor a material growth decline are major risks (a 'Goldilocks' scenario).
- Growth optimism is also illustrated by tight credit spreads and strong recent equity gains. Given that it has been only a few months since 'higher for longer' fears dominated, we'll see if current comfort proves to be fragile.

Key dates for the month ahead:

12 Mar : US core inflation rate **19 Mar:** BoJ interest rate decision **20 March :** UK inflation YoY, Fed interest rate decision **21 March :** BoE interest rate decision

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