

2024

# 3rd QUARTER RESEARCH REPORT

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# 2024 Mid-Year Review

As we approach the midpoint of 2024, the global economic landscape has been shaped by a mix of surprising outcomes and resilient markets. This commentary reflects on our earlier predictions and assesses the current state across key regions and commodities.

## United States

The S&P 500 index has already exceeded our ambitious target of 5,200 points by the end of 2024, reflecting robust economic fundamentals and investor confidence. Our forecast of two 75 bps rate cuts by the end of 2025 may need reassessment, given the Federal Reserve's cautious approach with only a 25-bps cut anticipated by November 2024. The correction anticipated in April 2024 was milder than expected, with the index rebounding swiftly, underscoring its resilience.

## Eurozone

In the Eurozone, the DAX index surged faster than anticipated, driven by strong corporate performance and supportive monetary policies. The German bund yield experienced volatility, peaking in May 2024 before retreating, highlighting the uncertainty in global bond markets. The European Central Bank's (ECB) gradual rate cuts suggest a measured response amid economic challenges, aligning somewhat with our forecasts.

## India

India's Nifty 50 index has outpaced our growth projection, reaching 24,011 points by mid-2024, supported by positive market sentiment and domestic policy reforms. Our optimism regarding Prime Minister Modi's reelection has borne out, contributing to a stable investment climate despite global volatility.

## Commodities

In commodities, gold and copper prices have outperformed expectations, reflecting heightened investor interest amid geopolitical tensions and inflation concerns. Gold has surged beyond our forecasted price, buoyed by safe-haven demand, while copper's robust gains underscore its essential role in global industrial production.

## Summary

As we navigate the second half of 2024, it is evident that while some predictions have been surpassed, others require adjustment amidst evolving economic conditions. The overarching themes of resilience in equity markets, cautious monetary policy adjustments, and the strategic role of commodities underscore the need for a dynamic investment strategy. Investors should remain vigilant, monitoring central bank actions, geopolitical developments, and sector-specific dynamics to capitalize on emerging opportunities and mitigate risks effectively.



# Forecasting Capital Market Trends: H2 2024

Predicting market leaders involves both art and science, and currently, we're closely monitoring potential shifts that may redirect the spotlight from the U.S. to international and emerging markets.

Here's a look at three pivotal trends we believe could be the next big market shakers:

- 1 **A U.S. Dollar Bear Market:** Envision the U.S. dollar embarking on a significant slimming journey.
- 2 **A Commodity Bull Market:** Imagine commodities surging as if they've had a triple espresso shot.
- 3 **A Shake-Up in U.S. Tech/Growth Earnings:** Consider potential regulatory tightening's impacting major tech firms.



## The Dollar's Great Diet Plan

Historically, a declining U.S. dollar correlates with robust growth in international and emerging markets. The late '80s and the early 2000s experienced significant non-U.S. bull markets when the dollar was weakening. A lighter dollar tends to reroute capital towards more attractive international pastures, often leading to booming markets outside the U.S.

## Commodities: The Next Big Thing

Commodities, generally priced in dollars, become more affordable in other currencies as the dollar weakens. This price drop spurs increased demand and drives prices up, benefiting sectors prevalent in non-U.S. indices, especially those in resource-rich emerging markets.

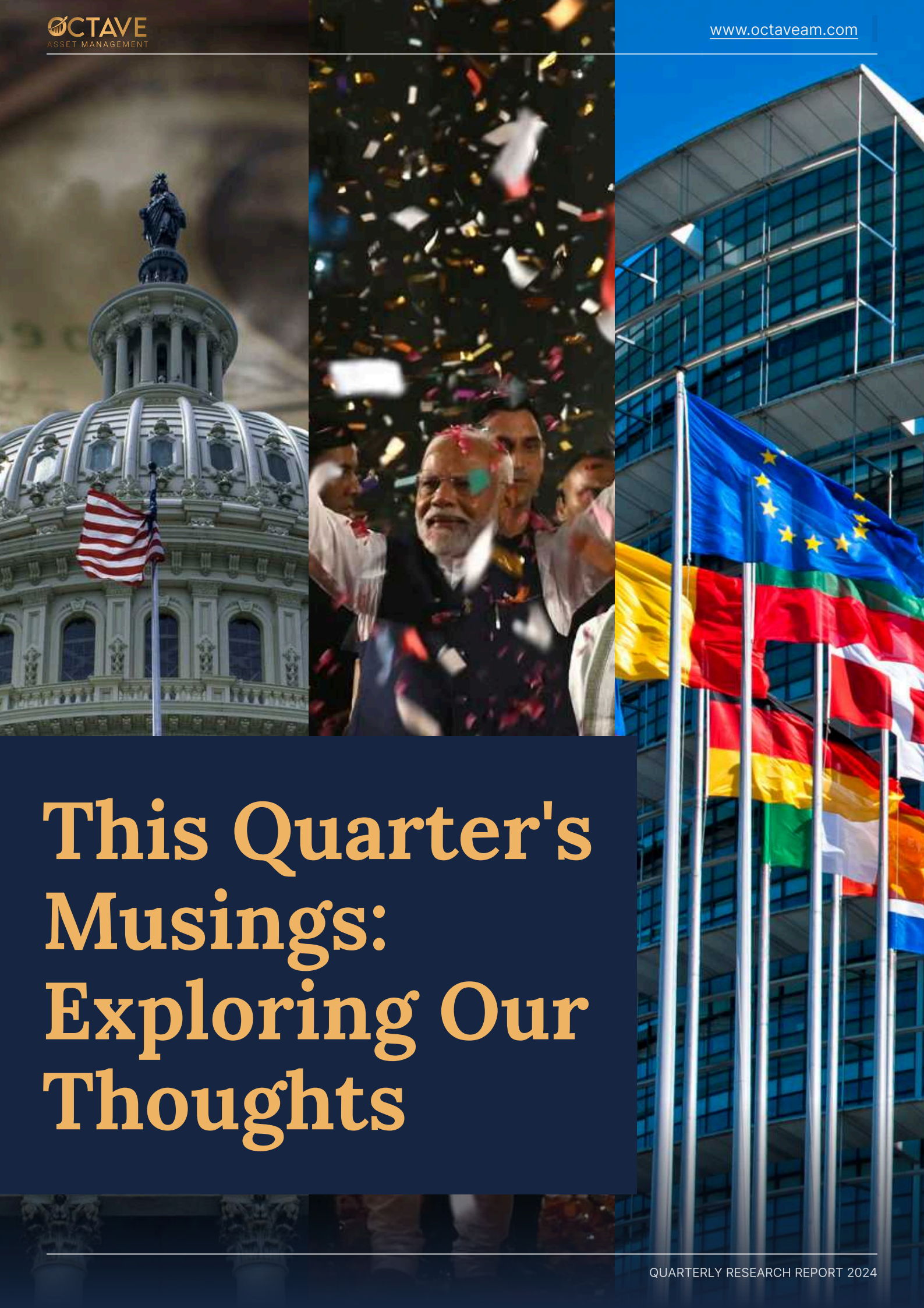
## Tech Titans on a Tighter Leash

The U.S. market's significant growth has been largely fueled by tech giants. However, increased regulatory and anti-trust measures could temper this growth, affecting profit margins and valuations. This scenario may drive investors to seek opportunities in markets less affected by regulatory issues.

## All Together Now: A Perfect Storm

The combination of a weakening dollar and a booming commodity market could create an ideal environment for international and emerging markets to outperform their American counterparts. At Octave, we remain vigilant, ready to leverage these shifts to benefit our clients through a flexible and proactive investment strategy.





# This Quarter's Musings: Exploring Our Thoughts

# Market Expectations: Inflation, Interest Rates, and US Protectionism

Current market expectations are heavily influenced by inflation trends and interest rate forecasts. With the U.S. adopting more protectionist policies, international trade dynamics could shift, potentially increasing costs and impacting global supply chains. Investors should monitor these developments closely as they can influence both market volatility and investment opportunities.

## US Protectionism

The recent US decision to hike tariffs on Chinese imports has intensified concerns about escalating trade tensions and potential retaliatory measures between the two economic giants. Last month, the Biden administration increased tariffs on \$18 billion worth of Chinese imports, targeting critical sectors such as steel, aluminum, semiconductors, solar cells, electric vehicles, and batteries, citing "unfair trade practices."

Beijing sharply criticized the move, calling it "typical bullying behavior" aimed at "suppressing China's normal economic, trade, and technological activities."

From the US perspective, these tariffs signal dissatisfaction with Beijing's "predatory" trade policy, including theft of intellectual property, industrial espionage, support of fentanyl production targeting the US, and belligerence in the South China Sea. The White House statement also accused China of "flooding global markets with artificially low-priced exports" and "forced technology transfers," posing significant risks to US supply chains and economic security.

China's dominance in solar panel manufacturing, where it controls over 80% of the market, is a key target of the new tariffs. However, this is unlikely to slow US solar farm development or rooftop solar installations.

In the electric vehicle (EV) sector, competition is heating up. Chinese automaker BYD has outpaced US-based Tesla in global sales, producing over 3 million vehicles in 2023 compared to Tesla's 1.84 million. An International Energy Agency (IEA) report noted that growing Chinese EV exports, which accounted for more than half of all electric car sales in 2023, could drive down global prices.

The US semiconductor industry is also under pressure, with domestic manufacturing capacity falling to just 12% of global production. The CHIPS and Science Act, signed by President Biden in August 2022, aims to boost this capacity and address supply chain vulnerabilities with a \$52.7 billion investment.

The Biden administration's actions build on former President Trump's 2018 tariffs on steel and aluminum, seen as protectionist measures that sparked a trade war with China. A recent S&P Global report indicates China's share of steel and aluminum exports to the US is minimal, but these sectors remain focal points in the trade dispute.

The US is also seeking European support against China. Treasury Secretary Janet Yellen recently called for a united front, warning that China's industrial overcapacity threatens both American and European businesses. This issue will be a key topic at the upcoming G7 summit in Italy.

In response, China is unlikely to remain passive. It may diversify its import sources, develop new productive forces, and potentially impose export restrictions on the US. Specifically, China could target Tesla by implementing similar protectionist policies, challenging the US automaker's market position in China.

As these economic titans continue their trade skirmish, the global market remains on edge, watching for the next move in this high-stakes game of economic chess.



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## Watch the US 2Y-10Y Yield Curve

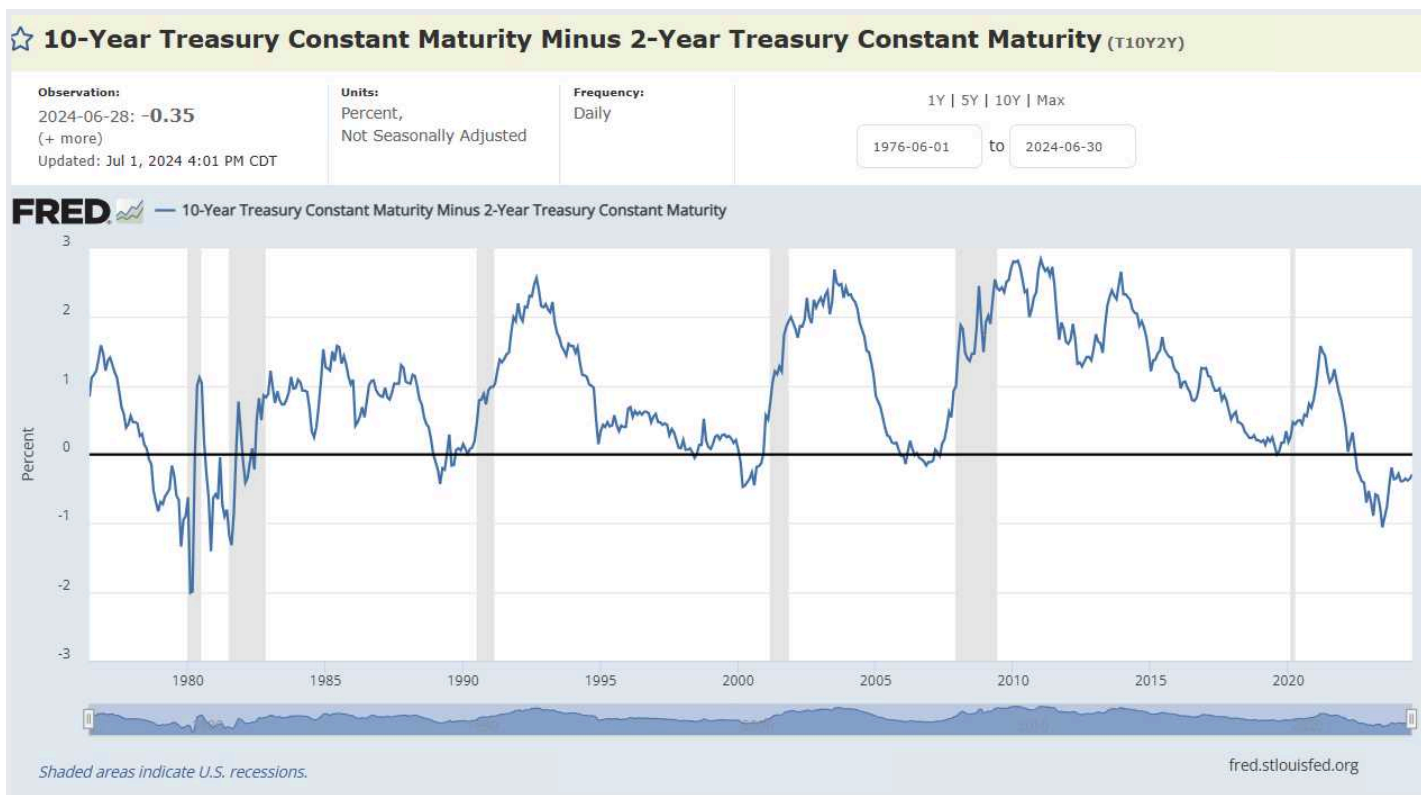
The U.S. Treasury yield curve, particularly the spread between the 2-year and 10-year yields, remains one of the most scrutinized indicators of economic expectations and financial market sentiment. This spread offers invaluable insights into the anticipated direction of the economy, primarily because it reflects investor perceptions of future economic growth and inflation.

When we observe a flattening of this yield curve, it signals that investors expect slower economic growth. An inversion, where short-term yields exceed long-term yields, has historically been a reliable predictor of economic recessions. This phenomenon occurs because investors, anticipating economic downturns, seek the safety of long-term bonds, driving their yields down relative to short-term bonds.

Historically, every time the 2-year/10-year spread has turned negative, it has been followed by a recession. This spread turned negative on July 5th, 2022, and has remained so, which is a noteworthy signal given the historical precedent. Nearly two years have passed without a recession, which is longer than typical lag times seen in previous cycles.

Given this historical context, it is prudent to anticipate a recession in the near future. This expectation is further compounded by the current economic conditions, including slowing global growth, persistent inflationary pressures, and tightening financial conditions. A recession would likely compel the Federal Reserve to shift its policy stance from tightening to easing, potentially initiating a series of interest rate cuts to stimulate economic activity and support financial markets.

As we move forward, monitoring the yield curve and the 2-year/10-year spread will be essential for investors and policymakers alike. It provides a forward-looking gauge of economic health, signaling potential turning points in the market and guiding strategic decision-making in an increasingly uncertain economic landscape.



Source: Federal Reserve Bank of St. Louis



## Eurozone: Impact of Elections in France on Bond Markets

Recent elections in France could significantly impact the Eurozone's political and economic landscape. Changes in leadership and policy direction often lead to volatility in bond markets, as investors reassess risk and return profiles across European government debt.

As we approach the French parliamentary elections, our attention is drawn to the potential for significant market volatility that could extend well into the coming weeks. The first round of voting is slated for this Sunday, culminating in the decisive second round on July 7.

Current polling from respected sources like Harris Interactive, Ifop, Elabe, Ipsos, Odoxa, OpinionWay, and Cluster17 places Marine Le Pen's National Rally (RN) in the forefront with 35.4% of the projected vote. This is closely followed by the New Popular Front (NFP) at 28.1%, with President Emmanuel Macron's Renaissance party trailing at 20.8%. The fiscal implications of an RN-led administration could see persistent deficits exceeding 6%, a significant consideration for market observers.

The scenario of an NFP-led government is even more pronounced, potentially driving the deficit near 8%. According to market analyst Renoult, this would set the trajectory of government debt on an unsustainable path. Such fiscal dynamics are crucial for understanding the potential impacts on the bond markets.

Our analysis, echoing sentiments from financial institutions like ABN Amro, suggests that the OAT-Bund spread is likely to remain wide. Clarity on the election outcomes and the subsequent policy directions will be critical in determining the next phases of market adjustments.

This underperformance hints at a potential reclassification of France as a "crossover peripheral," akin to lower-rated nations. Adding to the complexity, the European Commission has placed France under its Excessive Deficit Procedure. This designation prevents the European Central Bank (ECB) from employing its Transmission Protection Instrument to counteract sovereign credit risk in France. Consequently, Frankfurt faces the necessity of crafting an alternative emergency program to prevent further fragmentation risks within the Eurozone.



From the lens of bond market performance, the uncertainty surrounding the elections has already left a mark. French bonds have underperformed notably since the election announcement.



# India

With all of India's 640 million votes counted after the six-week-long election, the world's largest democratic exercise has produced some significant surprises.

The governing Bharatiya Janata Party (BJP), led by Prime Minister Narendra Modi, won 240 seats, falling short of the 272 required for a majority in the Lok Sabha, the lower house of India's Parliament, which has a total of 543 seats. However, with its allies, the BJP has secured a majority, achieving a combined total of 293 seats. The opposition INDIA alliance, headed by the Indian National Congress party, won 232 seats.

These figures contrast sharply with the 2019 results, when the BJP-led National Democratic Alliance (NDA) won 353 seats, with the BJP alone securing 303 of those seats.

The impact of a strong opposition on the economy and policy-making can be multifaceted. On one hand, increased scrutiny from I.N.D.I.A can enhance the quality of legislation by subjecting government policies to rigorous examination. This scrutiny can lead to more thoughtful and well-crafted reforms by the BJP-led NDA. However, it can also cause significant delays in implementing essential economic reforms due to prolonged debates and potential political deadlocks.

A well-functioning I.N.D.I.A can bolster investor confidence by ensuring government policies are balanced and predictable, thus providing stability. Conversely, if the opposition is perceived as overly obstructive, it can lead to political instability and uncertainty, deterring investment.

Furthermore, fiscal responsibility may improve with a strong opposition as it can hold the NDA government accountable, potentially resulting in better fiscal management and reduced corruption. However, the competition for voter support might drive both the ruling BJP and the opposition to adopt populist measures, which can lead to unsustainable fiscal policies.

The Indian stock market also responds to the presence of a strong opposition, with market sentiment being a critical factor. Positive investor sentiment can arise if the opposition ensures a balanced policy-making process. On the other hand, political tussles can generate uncertainty about future economic policies, negatively impacting market sentiment.

Additionally, specific sectors might experience varied impacts based on opposition policies. Regulation-heavy sectors such as finance, healthcare, and energy could see significant changes depending on the opposition's stance compared to the ruling government. Public sector companies, particularly those dependent on government contracts or subsidies, could be vulnerable to policy shifts driven by opposition pressures.



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## China

Three months ago, we posed a crucial question: Is this the year for EM equities, especially China? At the time, our analysis pointed to a potential resurgence in Chinese stocks, even though the sentiment around investing in China was lukewarm at best.

Fast forward to today, and the data provides an encouraging picture:

Alibaba (BABA) experienced a rise of around 15% Pinduoduo (PDD) increased by more than 12% JD.com (JD) saw a significant uptick of 20%

These gains support our earlier forecast and highlight the potential of strategic, data-driven investment decisions. While the broader market remained cautious, we identified key opportunities in China's transitioning economy and consumer market growth.

Our previous post highlighted how China's shift towards a consumption-oriented model, combined with significant growth in retail sales and an expanding upper-middle and high-income demographic, positioned the country for a robust recovery. The McKinsey report reinforced our perspective, projecting a RMB 10 trillion increase in retail sales over the next five years.

Investing in Chinese equities wasn't the most popular choice back then, but it was grounded in solid economic indicators and valuation metrics. Chinese equities were trading at a significant discount compared to their US counterparts—9-10 times next year's earnings versus 21 times for US equities. And they continue to present value opportunities.

## Strong Start to the Year: Global Gold Demand Reaches New Heights

The World Gold Council's Q1 2024 Gold Demand Trends report highlights a robust start to the year, with total global gold demand, including OTC purchases, rising by 3% year-on-year to 1,238 tonnes. This marks the strongest first quarter since 2016. However, excluding OTC purchases, demand saw a slight dip of 5% to 1,102 tonnes compared to Q1 2023.

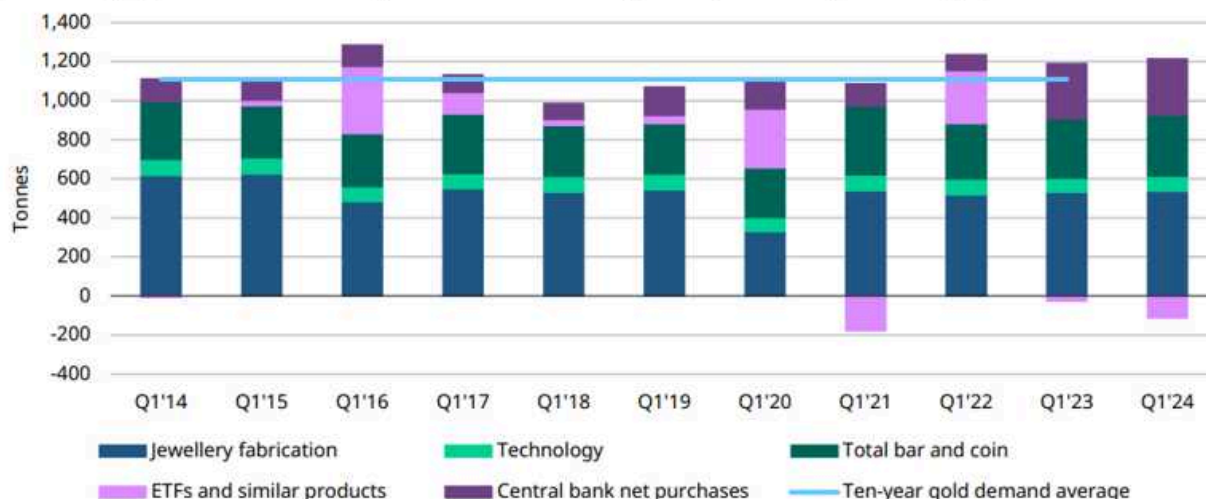
### Key Drivers of Gold Demand

The increase in gold demand was fueled by healthy investment from the OTC market, persistent central bank buying, and higher demand from Asian buyers. These factors propelled the gold price to a record Q1'24 quarterly average of \$2,070 per ounce—up 10% year-on-year and 5% quarter-on-quarter.

### Central Banks Lead the Charge

Central banks continued their vigorous gold buying, adding 290 tonnes to official global holdings during Q1'24. These substantial purchases underscore gold's critical role in international reserve portfolios amidst market volatility and heightened risk.

Quarterly gold demand by sector and 10-year quarterly average, tonnes\*



Source: Refinitiv, Capital Economics



## Investment Trends

Investment demand saw a mixed picture. Bar and coin investment rose by 3% from Q1 2023 to Q1 2024, maintaining the same levels as Q4 2023 at 312 tonnes. Meanwhile, gold ETFs experienced outflows, with global holdings dropping by 114 tonnes. This decline was driven by North American and European funds, partially offset by inflows into Asian-listed products. China was a significant contributor to this increase, driven by renewed investor interest due to a weakening local currency and underperforming domestic equity markets.

## Commodities: The Next Big Thing

Global jewelry demand remained resilient despite record-high prices, falling only 2% year-on-year. Strong demand in Asia helped offset declines in Europe and North America. Additionally, gold demand in technology saw a 10% from Q1 2023 to Q1 2024 recovery, driven by the AI boom in the electronics sector.

## Supply Dynamics

On the supply side, mine production rose by 4% year-on-year to 893 tonnes, setting a record for the first quarter. Recycling also surged, reaching its highest level since Q3 2020, with a 12% from Q1 2023 to Q1 2024 increase to 351 tonnes. Higher prices provided an opportunity for many to sell their old gold jewelry.



## Conclusion

The first quarter of 2024 has set a promising tone for the year with strong gold demand across various sectors and regions. The continued interest from central banks and investors, combined with robust supply growth, indicates a dynamic and resilient gold market moving forward.



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Ahil Mansoor is a distinguished financial professional, brings over two decades of multifaceted experience to his role as CEO and CIO at Octave Asset Management. With expertise spanning asset management, private banking, venture capital, and financial consulting, Ahil is a strategic leader in the financial domain. Holding an MBA in Finance from the Thunderbird School of Global Management complemented by a Bachelor's degree in Engineering, Ahil is a seasoned professional with a strategic leadership approach. His industry proficiency is further underscored by designations including Certified Financial Planner (CFP), Chartered Investment Manager (CIM), and Fellow of the Canadian Securities Institute (FSCI), along with successful completion of CFA Level 2.



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