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iFlow

MACRO REVIEW

December 2024

Key Themes

Rebalancing: USD selling and BRL buying the strongest candidates for rebalancing flows

US Equity Styles: Growth and leverage interest deteriorating

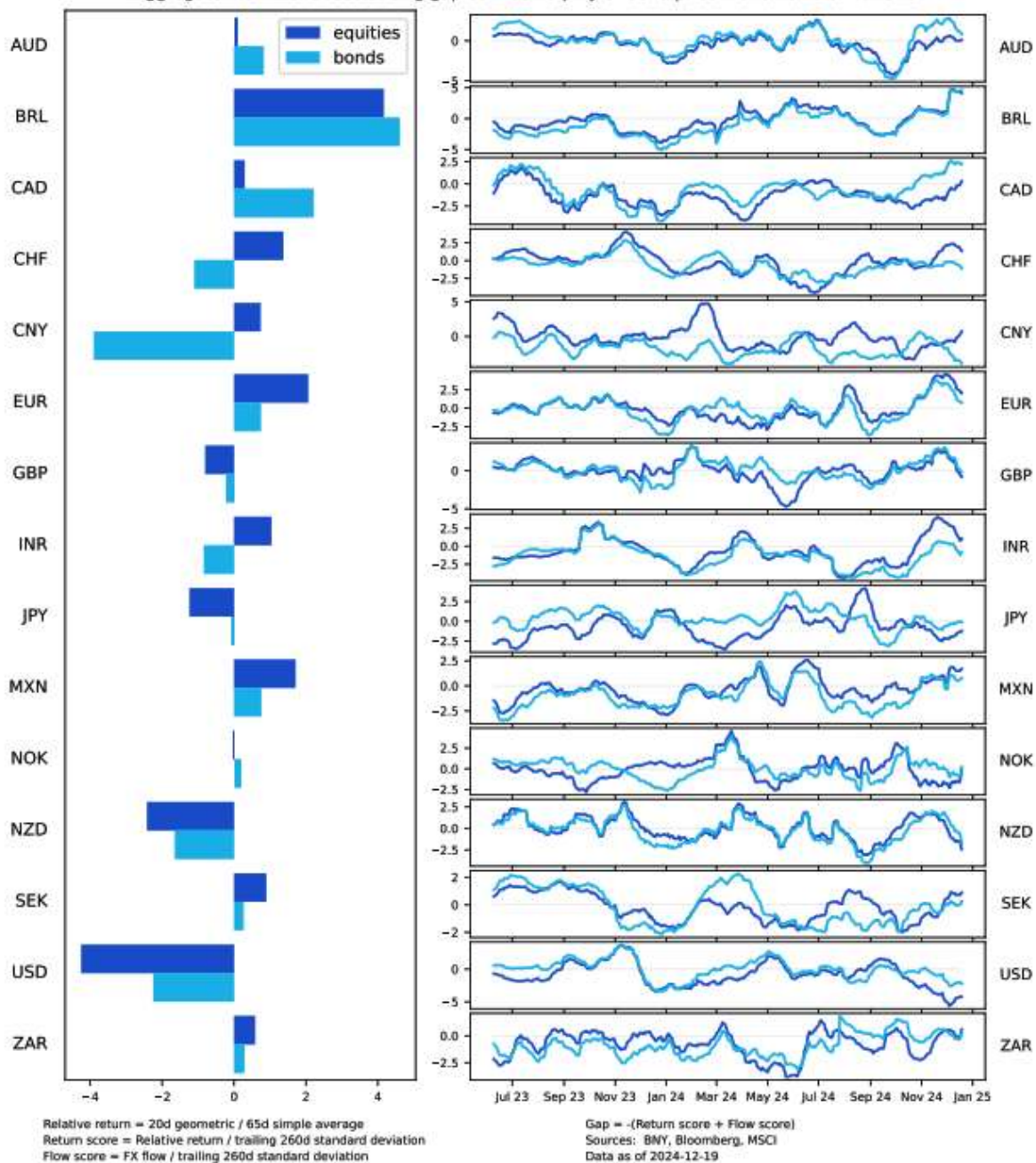
International Equity Styles: Cyclical performance also clear globally

iFlow Green: Most regions showing positive alignment; EM Americas is the outlier

To enlarge the charts, please click the image below.

Rebalancing Report

Aggregate month-end rebalancing gap between equity or bond price movements & FX flows



Source: BNY

Rebalancing Update

Although month- and quarter-end are both nearly two trading weeks away, rebalancing flows normally take place early due to the holiday season. Year-end volatility can never be ruled, especially with risk events still looming, such as a potential government shutdown in the US. However, activity levels will probably remain light and, where applicable, strong rebalancing signals will be actioned over the coming trading sessions.

The first two weeks of December were largely a continuation of the flows we have seen since November, and surge flows in dollar, mostly at the euro's expense, were the core feature in markets. As we highlighted in the run-up to the December FOMC decision, which generated the bulk of the activity in December, the prospect of the Fed becoming less dovish up ahead – broadly realized – only served to consolidate dollar flows and the currency looks set to end the month as the best-performing major currency.

We anticipated strong rebalancing flows against the dollar toward the end of November, but this did not materialize as the market clearly thought that US exceptionalism had more to run. Furthermore, as both US equity and fixed income markets have struggled in total return terms so far this month, there is an element of self-offsetting coming through. Even so, we still see USD flows and holdings as so extreme that additional rebalancing will be necessary, and investors may wish to enter the new year in a lighter dollar position.

Elsewhere, the only notable rebalancing flow we anticipate is in BRL. Largely for idiosyncratic reasons, the country's assets have struggled over the past few weeks. BRL is also performing very poorly in iFlow, and coupled with the poor total returns in equities and fixed income, there will, in theory, be strong buying need. However, despite very aggressive rate hikes, there is no clear sign of a speedy resolution to the country's domestic issues, so we remain somewhat cautious ahead of rebalancing flows. The volatility in the currency will also feature in conversations, and in an iFlow context, any buying of BRL will probably only reflect the removal of hedges after asset liquidation.

Otherwise, there aren't any currencies with significant potential for inflows across both equities and fixed income. The only standout single-asset signal is in CNY, as the country's fixed income market has performed extremely strongly over the past few weeks with bond yields falling to record lows. We expect hedging in CNY to rise strongly, if anything to capture much more favorable rate differentials versus the dollar.

iFlow Equities 2.0 Style Indices – flows of significance:

1. US Equity Styles

- The outperformance in cyclical flows has managed to improve slightly in December, though the recent adjustment to the downside after the Fed decision could have some residual impact on flows toward year-end. Given the uncertainty surrounding the current US economic cycle, we expect some caution in allocations for related sectors, especially as data remains soft.
- In contrast, growth is now underperforming value for the first time in over six months and there is also some deterioration in leverage. This is perhaps a sign of end-cycle behavior coming through, but such flows are also quite tentative for now. Leverage interest could also be affected by the pullback in Fed easing expectations.
- Inflation-related flows remain positive but there is very little change compared to November. While the market is moving away from disinflation pricing and the current inflation outlook is uncomfortable, for now there are no expectations of a new round of strong inflation akin to what was observed in 2022 and 2023.

2. International Equity Styles

- In both DM EMEA and DM APAC, the November rise in cyclical performance relative to defensive stocks has held but not strengthened. Given the weakness in global growth expectations and fears over tariffs against the US' key trading partners, this is probably the best position developed-market international equities can attain heading into year-end
- There is divergence between EM markets as only EM APAC cyclical flows performed well so far this month, having lifted itself from very depressed levels in Q3. However, growth flows are not outperforming their value counterparts in major equity markets.

3. iFlow Green

- After significant improvement in flow alignment between equities and ESG factors last month, most regions globally have managed to consolidate these gains. Except for

United Nations Global Compact – Labour Rights, all factors are showing clearly positive flow alignment, indicating that ESG exposures are improving

- EM Americas is still a clear outlier, led by very weak flow alignment in the ESG-Environment factor. Its ESG-Governance performance is similarly poor, and the two crucial factors have driven general weak performance in the region and is impacting global flows as well in the corresponding factors.

Please direct questions or comments to: iFlow@bny.com

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