

# U.S. recession fears overdone

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Global risk-off sentiment has intensified, with Japan's Topix down 20% since last Thursday in its biggest three-day rout ever. U.S. stocks slid further but have trimmed losses today. Recession fears are driving some of this. We think those fears are overblown and see opportunities.

Recession fears were triggered when last Friday's U.S. jobs report for July showed a rise in the unemployment rate to 4.3% from 4.1% and much weaker-than-expected monthly job creation. Those fears have exacerbated a global risk-asset selloff that began last month, driven by concerns over tech valuations and heightened geopolitical risks. Another exacerbating factor? A stronger yen – now up about 14% from its 38-year low against the U.S. dollar hit last month. That has led to the rapid unwinding of carry trades, or positions funded by using low-yielding yen to buy higher-yielding currencies and other assets.

We think the July U.S. jobs report is more in line with a slowdown than a recession. The unemployment rate is rising, but unlike ahead of past recessions, the main driver is not layoffs – it is an immigration-driven increase in labor supply. Job creation is slowing, but averaged a robust 170,000 over the past three months. Consumer spending, while cooling, remains relatively healthy and Q2 corporate earnings have so far topped expectations, with S&P 500 earnings growth projected at about 13%, above the 9% expected at the start of the season, LSEG Datastream data show. We think risk assets can recover as recession fears ease and the rapid unwinding of carry trades stabilizes. We keep our overweight to U.S. equities, driven by the AI mega force, and see the selloff presenting buying opportunities. We think growth will be supportive of risk assets and believe markets are pricing in too many Fed rate cuts.

Yet Japan's Topix has fared even worse than in the 2008 global financial crisis. This outsized response versus past instances of carry trades being quickly unwound suggests there is more at play in Japan than U.S. recession fears – with potential global ramifications if it continues. We think the BOJ's policy framework shift – alongside its rate hike last week – is part of it: the BOJ flagged yen weakness as something it wanted to address. While the importance of yen carry trades to the funding of global risk assets means a more persistent selloff cannot be ruled out, markets now see the BOJ walking back this hawkish shift. We think the BOJ will readjust and believe technical and sentiment drivers are behind these market moves more than deteriorating corporate earnings. That keeps us overweight Japanese stocks on a currency-unhedged basis – on which basis they are down only about 8% from their all-time high.

## Key views

**Recession fears, worries over tech valuations and the rapid unwind of yen-funded trades are hurting global stocks.**

**Risk assets could recover as recession fears are alleviated.**

**We stay overweight U.S. equities, driven by the AI mega force, and Japanese stocks.**

## Bulletin

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