



CIO OFFICE MORNING MARKET WRAP

28 October 2024

In the Asian session the yen is weakening following the ruling party's coalition failure to win a majority in parliament, raising concern that political uncertainty would impact the future trajectory of monetary policy. And oil slumped after the confrontation between Israel and Iran turned out to be less dramatic than expected. A gamble by Prime Minister Ishida to call a snap election backfired, the yen is falling as much as 1%, while the Topix is up 1.6% as of the time of writing. The BOJ is expected to keep its policy unchanged at the Thursday meeting, with the next move either in December or most likely in January as per consensus. WTI crude plunged by more than 5% in early trading, while gold edged lower. Chinese shares were weaker after profits at industrial firms dropped sharply in September, a sign deflationary pressures are sapping corporate finances. Investors are readying for a barrage of forthcoming data, from the Eurozone and US growth print, to the all-important payrolls report. Earnings will be dominated by five of the Magnificent 7 companies reporting. In China the official PMI is unlikely to be a source of major positive surprises.

The week was dominated by rising yields, improving odds of Donald Trump becoming president, and risk-off sentiment as investors further adjusted their assessment of expected Fed policy. Economic releases did not play a big role in setting narratives, if not to confirm that US growth is resilient, while Europe kept on struggling. Meanwhile, the IMF cut its global growth forecast for next year, on rising risks of wars and protectionism. The BRICS+ meeting in Kazan featured the so-called Global South as an alternative pole to the Western-centric world. The S&P 500 fell 1%, outperforming other developed markets (-2%), as well as MSCI EM (-1.8%). Large did better than small caps (-3%), and growth (+0.1%) than value (-2.7%). Tesla showed the relevance of the Magnificent 7's earnings for the entire market, rising 22% after announcing results. The whole Treasury yield curve shifted higher. Yields saw 15bps-plus gains both at the short and the long end on Trump's tariff rhetoric. The dollar (+0.7%) rose for the fourth consecutive week, gold (+1%) recorded new all-time highs, while Brent crude (+4.1%) rebounded strongly.

Stocks were weighed down by rising Treasury yields. In one month, the yield on the 10-year note rose from a low of 3.59% to hit 4.25%, while the 2-year from 3.57% to 4.10%. The resilient US economy forced investors to revise their way too optimistic assessment of the future path of policy rates. The expected number of Fed cuts now is actually falling a bit short of the official projections shared at the latest FOMC meeting. This repricing worked at the short end of the curve, as well as at the long end. But what spooked the market the most, was the rising odds of a Trump presidency as per the latest betting odds, alongside louder rhetoric about the benefits of very punitive tariffs. Historical precedents show that higher system-wide tariffs on imports are inflationary. Term premia did rise, exerting upward pressure at the longer end of the curve. Volatility on Treasuries touched the highs for the year, reflecting growing uncertainty about where yields would land in the future. If Donald Trump is elected, investors will demand higher compensation for holding long bonds, and eventually the equity rally would be curbed by higher yields and inflation. Unless tariffs are mostly a bargaining chip!

The equity rally has broadened beyond tech, yet there are few signs that that is related to earnings growth as well. Although in Q3 IT stocks lagged the broader market, it is estimated that they still account for the whole of the market's earnings growth. Without IT, bottom-line growth remains muted according to consensus estimates. And all the more so for the Magnificent 7 as against all other stocks. And Tesla did not fail to impress either. Its gross margin surprised to the upside, and the announcement of the launch of a cheaper EV thrilled investors. Five of the Magnificent 7 - Alphabet, Meta, Amazon, Apple, and Microsoft - are slated to report results this week. With earnings expected to slow, the rest of the market had better take up the slack soon, if the equity rally is to get more breathing room.

Tech dominance amongst sectors still goes hand in hand with US exceptionalism in the economy on the global stage. Business confidence beat expectations across manufacturing, services, and the composite in the advance US PMI October report, with the services sector firmly leading. On the other hand, the Composite PMI in Europe confirmed stagnation, with building slack and moderating price pressures not boding well. At the same time, ECB officials remain split about whether a 50bps cut is appropriate. In the UK, the Composite PMI pointed to a slowdown reinforcing the case for a November cut by the BOE. And in its just released global economic outlook the IMF has not seen any reason for much enthusiasm either. Global growth was cut slightly for next year. And while shorter term the ongoing disinflation process was deemed to be a tailwind, longer term spreading wars and the threat of protectionism were considered crippling events.

Have a good day!

Chief Investment Office
Wealth Management,
Emirates NBD.

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