



CIO OFFICE MORNING MARKET WRAP

10 January 2025

Yesterday it was a federal holiday in the United States with stock markets closed for a National Day of Mourning for late President Jimmy Carter. US futures slipped in thin trading. Traders are now concerned by the challenging backdrop posed by yields that have been rising for a month, pressuring valuations. The unemployment rate, probably the most relevant datapoint for the Fed, is expected to be rising for a third straight month later today. Several Fed officials confirmed yesterday that the central bank will likely hold interest rates at current levels for an extended period, only cutting when inflation meaningfully cools. Without extended policy support it remains difficult to see how markets could score significant gains from current levels given rich valuations. The yield on the 10-year note retraced all of the intraday losses to close unchanged, in a sign that yield upside may not be exhausted. Elsewhere, the UK was again in crisis mode, with investors dumping the pound and gilts at the same time, the former losing 1% for the week and the latter 1.6%. Bond vigilantes cast heavy doubts on the Chancellor of the Exchequer's ability to fund its policies that rely heavily on public interventions given the country's prospect of higher inflation and lower growth. Eurozone equities on the other hand closed almost 0.5% higher despite weaker-than-expected retail sales. Investors are probably betting that easier policy will put the common area economy back on track. On Wednesday Governing Council member Villeroy said that in the presence of disinflation the policy rate should reach its neutral level, that in Europe would be 2%. Yesterday Brent crude closed 0.9% higher, while the US dollar and gold made modest gains.

In the UK the pound at one point fell 1%, the lowest level in over a year, even as gilt yields did rise, with the 30-year gilt yield surging to the highest since 1998, while the 10-year reached levels last seen in 2008. Investors were unnerved by the government's escalating debt burden, alongside persistently high inflation for months, wondering how Labour will keep the deficit in check. With a global bond sell off gathering pace this week, UK assets led global Treasuries lower. It is unusual for a currency to fall when yields rise, and this occurrence is pointing to investors losing faith in UK assets in a sign of capital flights. Comparisons to Liz Truss's 2022 mini budget are being drawn, and the Treasury's chief secretary rushed to reassure that the gilt market has continued to function in an "orderly way". Although gilts retraced their losses in the afternoon and the pound trimmed its drop to 0.5%, options markets point to further turmoil ahead. Chancellor Reeve's challenge is how to steer the country away from a worst-case mix of high price pressures, surging government debt and lacklustre economic growth. Issuance is going to be heavy globally this year and gilts will have to compete for capital. Eventually, should the rout continue Rachel Reeves in her drive to prioritise fiscal responsibility might have to opt for unpopular cuts to public spending. The stagflationary scenario in the end is government self-inflicted. Higher taxes and a rise in the minimum wage underlying the autumn budget presented last year by the Chancellor of the Exchequer depressed animal spirits and raised the general level of prices. It will also be the BOE's predicament how to tackle a stagflationary scenario that poses unpleasant trade-offs. Bond vigilantes have a lot to work on!

Markets this morning:

Asian equities and US futures were in the red ahead of today's US employment report and following a bond rout in the UK yesterday. Shares in Japan and Australia slipped, while Hong Kong fluctuated. Contracts for the S&P 500 fell for a second day. While US Treasuries advanced, Chinese yields rose as the PBOC said it would temporarily halt its buying of government bonds. It was a surprise move spurred by benchmark yields slumping to a record low.

Upcoming Key events/data:

The US employment report and the University of Michigan consumer sentiment survey are the main highlights for today.

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