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US Market Wrap

18th October 2023: Haven demand favours Buck and Gold as stocks and bonds dip

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW**: Mixed US housing data; Strong Chinese activity data; Bullish US energy inventories; Decent 20yr auction; Fed's Waller in "wait and see" mode, Williams repeats that restrictive monetary policy needed 'for a while'; PG earnings beat; Weak UAL guidance; MS miss on wealth management revenue and NII.
- **COMING UP**: **Data**: Japanese Trade Balance, Australian Employment, US IJC, Philadelphia Fed, Existing Home Sales & Leading Index **Speakers**: Fed's Powell, Jefferson, Goolsbee, Barr, Bostic, Harker & Logan **Supply**: France & Spain **Earnings**: Roche, Nestle; Pernod Ricard, Renault, L'Oréal; Philip Morris, AT&T.

MARKET WRAP

Stocks dipped through the session Wednesday in lack of an obvious catalyst other than ongoing geopolitical angst, even though there was no material worsening of the situation in Israel. The weakness was led by the small-cap Russell 2k index, reversing Tuesday's outperformance; the VIX hit highs above the 20 handle; the NQ future flirted beneath 15k. One can point to the sell-off in Treasuries if they wish, where the curve bear-steepened into the 20yr auction, which ultimately went okay, but yields remained near highs, and stocks continued to fall afterwards despite the relief of there not being a repeat of last Thursday's 20yr auction bloodbath. Data was mixed with above forecast building permits and beneath forecast housing starts. Earnings were also a mixed bag, with positive investor reception to reports from Abbott (ABT) and Proctor & Gamble (PG), and negative reactions to Morgan Stanley (MS) and United Airlines (UAL). Elsewhere, the Dollar benefitted from a haven bid as high-beta FX was a wantaway ahead of Chair Powell on Thursday. Fed's Waller (voter, hawk) today confirmed his wait-and-see approach, all but confirming no hike at the November 1st FOMC. Williams (voter, dovish) gave some evergreen remarks too. The Fed's Beige Book saw little change in economic activity since September; labour market tightness continued to ease; wage growth remained modest to moderate; prices continued to increase at a modest pace. And in commodities, oil prices were firmer amid the fluid Israel situation, strong China data, and bullish US inventory data. Previous metals held onto a haven bid.

GLOBAL

BEIGE BOOK: In one line, the Fed's October Beige Book saw little change in economic activity since September, a continued easing of labour market tightness, modest to moderate wage growth, and prices continuing to increase at a modest pace. The near-term outlook for the economy was generally described as stable or having slightly weaker growth, with current consumer spending described as mixed. On employment, several Districts reported improvements in hiring and retention as candidate pools have expanded and those receiving offers have been less inclined to negotiate terms of employment, although most reported ongoing challenges in recruiting and hiring skilled tradespeople. Contacts across many Districts reported less pushback from candidates on wage offers. And on prices, sales prices increased at a slower rate than input prices, as businesses struggled to pass along cost pressures because consumers had grown more sensitive to prices, impacting profit margins. Firms expect prices to increase over the next few quarters, but at a slower rate than the previous few quarters, while several Districts reported decreases in the number of firms expecting significant price increases moving forward.

US BUILDING PERMITS/HOUSING STARTS: Building permits fell 4.4% in September to 1.473mln (prev. 1.541mln), above the expected 1.45mln, while Housing starts rose 7% to 1.358mln (prev. 1.269mln), but short of the consensus 1.38 mln. Oxford Economics notes, “Higher mortgage rates and deteriorating homebuilder sentiment will weigh on single-family starts, although the need for inventory may provide some cushion for the downside.” Nonetheless, OxEco thinks the multi-family sector, where supply is more plentiful, will see relatively greater weakness, as builders in that sector are also facing a more severe tightening of lending standards.

WILLIAMS (voter): Speaking at a Queens College New York event, he repeated his view from late September that the Fed needs restrictive monetary policy "for a while" to cool inflation. He didn't acknowledge whether or not the Fed would have to hike again (he said back in September that the Fed is at or near the peak rate), nor did he comment on the recent tightening of financial conditions and whether that would do the Fed's job for it; he simply said the path of policy is dependent on the data. Williams noted inflation had come down quite a bit, but there is still a ways to go to get it back

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down to target, saying the Fed would "stick at it". The NY Fed official said that at some point it would make sense to lower rates. He also reaffirmed his view that he's not convinced yet that the neutral interest rate has risen, expecting rates to move down over time to lower levels.

WALLER (voter): Said it is too soon to tell if more policy rate action is needed and they can wait, watch, and see before making definitive moves on the policy path, although further action on policy rate would be needed if demand and economic activity keep up the recent pace. Governor Waller added the increase in medium and longer-term interest rates over the past several months should weigh on both household and business spending, and should the real side of the economy soften, the Fed will have more room to wait on any further rate hikes and let the recent run-up on longer-term rates do some of its work – a view that is in fitting with most of his colleagues. Looking ahead, he said the the Fed still has one rate hike pencilled in and will be totally driven by the data if it happens, or when. Overall, hawk Waller is all but confirming no hike at the November FOMC here, confirming market-based expectations and showing no appetite to proactively hike after the recent hot-leaning CPI, retail sales, and IP data prints.

ISRAEL: In wake of the Gaza hospital attack on Tuesday, US President Biden said that based on information the US has seen, it appeared to have been a result of an errant rocket fired by "terrorist group" and caused by the "other side". Prior to this, the President said the US will ensure that Israel has what it requires to defend itself. Moreover, shortly after Biden met the Israeli war cabinet Israeli officials announced it will allow the entry of humanitarian aid to Gaza from Egypt. Prior to this, Egyptian security source, in response to Israel's refusal to open the crossing, said they will not allow the evacuation of foreigners in Gaza and escalation will be met with escalation.

FIXED INCOME

T-NOTE (Z3) FUTURES SETTLED 11 TICKS LOWER AT 105-28

Treasuries ultimately bear-steepened with initial haven demand unwound into the US 20yr auction, which went well. 2s +0.6bps at 5.220%, 3s +3.4bps at 5.046%, 5s +5.4bps at 4.928%, 7s +5.8bps at 4.952%, 10s +6.4bps at 4.911%, 20s +5.9bps at 5.236%, 30s +5.2bps at 5.003%.

INFLATION BREAKEVENS: 5yr BEI +2.2bps at 2.460%, 10yr BEI +2.0bps at 2.437%, 30yr BEI +2.2bps at 2.495%.

THE DAY: Treasuries entered the NY session Wednesday in a mild bull-steepener in thinner trade conditions in the aftermath of the Gaza hospital attack. T-Notes were little changed during APAC trade, with Tuesday's 106-03+ low initially holding as support. However, a wave of selling pressure in the London morning, accentuated by Gilt pressure from the hot-leaning UK CPI data, saw new lows of 106-03 printed. However, contracts recovered gradually but steadily into the NY handover with T-Notes peaking at 106-15+, aided by some 4k block buys in both 10yr and Ultra 10yr T-Notes, with the front end leading the strength.

Weakness, led by the long end, crept in as US trade got underway, despite mixed housing starts/permits data, with participants making way for the 20yr auction with heightened alert after the bloodbath at last Thursday's 30yr auction. T-Notes bottomed at 105-24 later in the NY morning, coinciding with a massive 29.7k ZTZ3/27.6k ZFZ3 block steepener, with the cash 10yr yield marking a new cycle peak of 4.93%, the 30yr yield peaked at 5.03%, respecting its Oct 6th peak of 5.05%, while the 2yr yield again came close but ultimately failed to clip 5.25%. A cautious Fed's Waller (voter, hawk) speech, who affirmed his view for Fed patience, catalysed a paring of yields from highs - from the front end - ahead of the auction; chunky Nov FF futures buying was observed. And the 1.4bp stop-through at the 20yr reopening alleviated fears of an auction failure, seeing the whole curve jump, seeing T-Notes hit resistance at 106-02+, although contracts (and mainly in the belly) gradually gravitated lower again into the futures settlement.

20YR AUCTION: A mixed USD 13bln 20yr bond reopening from the Treasury, but on the face of it, should quell the nerves from the awful 30yr auction last Thursday. The auction stopped at 5.245%, 65bps of yield pick up over last month's auction, which marked a 1.2bp stop-through the When Issued yield, better than the prior stop-through of 0.3bps and the six-auction average stop-through of 0.4bps. However, the bid-to-cover ratio was on the light side at 2.59x and Dealers (forced surplus buyers) were left with 11.9%, up from the prior 9.3% and the six-auction average 10.1%.

STIRS:

- SR3Z3 +0.5bps at 94.515, H4 flat at 94.575, M4 flat at 94.750, U4 -0.5bps at 94.965, Z4 -2bps at 95.19, H5 -3.5 bps at 95.40, M5 -4.5bps at 95.535, U5 -6bps at 95.605, Z5 -7bps at 95.635, Z6 -8bps at 95.65, Z7 -7bps at 95.56.
- SOFR flat at 5.31% as of Oct 17th, volumes fall to USD 1.427tln from 1.45tln.
- NY Fed RRP op demand at USD 1.151tln (prev. 1.082tln) across 108 counterparties (prev. 94).
- EFFR flat at 5.33% as of Oct 17th, volumes fall to USD 93bln from 96bln.

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- US sold USD 56bln of 17-week bills at 5.355%, covered 3.27x.

CRUDE

WTI (Z3) SETTLED USD 1.83 HIGHER AT 87.27/BBL; BRENT (Z3) SETTLED USD 1.60 HIGHER AT 91.50/BBL

Oil prices were firmer Wednesday but well off their highs amid the fluid Israel situation, strong China data, and bullish US inventories. WTI and Brent front-month contracts hit peaks of USD 89.88/bbl and 93.00/bbl, respectively, late in the European morning, with the geopolitical risk accentuated by the strong Chinese activity data. Chinese data also saw the country's oil refinery throughput in September hitting a record daily rate (+12% Y/Y at 15.48mln BPD) amid improving manufacturing demand and ramped travel for Golden Week. However, oil prices pared gains significantly through the NY morning, seeing WTI and Brent bottom at USD 87.20/bbl and 90.60/bbl, respectively, with further downside capped after the weekly US energy inventory data saw chunky draws across crude (-4.5mln bbls) and the products (gasoline -2.4mln and distillates -3.2mln). However, the market struggled with a more meaningful recovery after President Biden stated that the Gaza hospital attack appears to have resulted from an errant rocket fired by a "terrorist group".

EQUITIES

CLOSES: SPX -1.34% at 4,314, NDX -1.41% at 14,909, DJIA -0.98% at 33,665, RUT -2.11% at 1,728.

SECTORS: Materials -2.58%, Industrials -2.43%, Consumer Discretionary -2.33%, Real Estate -2.18%, Financials -1.7%, Communication Services -1.59%, Technology -1.23%, Utilities -0.94%, Health -0.9%, Consumer Staples +0.39%, Energy +0.93%.

EUROPEAN CLOSES: DAX -1.03% at 15,094.91, FTSE 100 -1.14% at 7,588.00, CAC 40 -0.91% at 6,965.99, Euro Stoxx 50 -1.11% at 4,106.15, IBEX 35 -0.92% at 9,212.70, FTSE MIB -0.82% at 28,135.79, SMI -1.35% at 10,668.20.

EARNINGS: **Procter & Gamble (PG)** earnings beat and affirmed FY24 guidance. CEO said every category grew in sales in the quarter and set up well to deliver towards the high end of FY24 guidance. **United Airlines (UAL)** top and bottom-line beat, but next quarter guidance was very weak, weighed on by the Tel Aviv flight ban alongside higher fuel, labour costs, and supply chain issues. **Morgan Stanley (MS)** profit and revenue beat but missed on NII and wealth management revenue, weighing on shares. **Abbott Laboratories (ABT)** surpassed expectations on the top and bottom line alongside lifting its FY EPS guidance range. **ASML (ASML)** missed on revenue and bookings, while noting customers continue to be uncertain about the shape of the demand recovery in the industry. **J B Hunt Transport Services (JBHT)** EPS and revenue missed. **Travelers (TRV)** revenue and net premiums written topped Wall St. expectations, while EPS missed, with larger catastrophe losses than expected. **Elevance Health (ELV)** profit beat and raised FY23 guidance. **Citizens Financial Group (CFG)** EPS, revenue, and NII missed. Q4 NII view -2% Q/Q.

STOCK SPECIFICS: Following Tuesday’s news that the US is to tighten curbs on China’s access to advanced chip tech, **Nvidia (NVDA)** saw its price target lowered at Citi and Morgan Stanley to USD 575 (prev. 630) and USD 600 (prev. 630), respectively. **Spirit AeroSystems (SPR)** entered into a new agreement with **Boeing (BA)** that “enables greater collaboration to achieve improved quality and higher deliveries in the future”. SPR said the changes will boost revenue by USD 60mln in 2023 and by ~USD 400mln over the course of 2024 and 2025 while sales will be trimmed in 2026-2033. In addition to this, SPR preannounced weaker than expected prelim Q3 results.

US FX WRAP

The Dollar was firmer on Wednesday, with the index printing a high of 106.630, vs a 106.010 trough, on broader risk aversion sentiment and a haven play as participants sought safety from the geopolitical risk. On the day, mixed housing data and Fed’s latest Beige Book failed to garner any reaction out of the Greenback, where to summarise the latter, it saw little change in economic activity since September, a continued easing of labour market tightness, modest to moderate wage growth, and prices continuing to increase at a modest pace. Meanwhile, Fed’s Williams (voter) repeated his view from late September that the Fed needs restrictive monetary policy "for a while" to cool inflation, and Waller (voter) all but confirmed no hike at the November FOMC here, confirming market-based expectations and showing no appetite to proactively hike after the recent hot-leaning CPI, retail sales, and IP data prints. Looking ahead, all attention will be on Fed Chair Powell speaking on Thursday at the Economic Club of New York, as well as a slew of other Fed Speak, and the latest regional bank survey (Philly Fed).

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Activity currencies, NZD, CAD, AUD, and GBP, all saw losses on the resurging Greenback and risk-off sentiment. AUD/USD and NZD/USD reversed from highs of 0.6393 and 0.5919, respectively, to lows of 0.6329 and 0.5852 as Aussie watchers await the jobs report Thursday. USD/CAD traded between 1.3618-3711, and currently sitting around highs despite better-than-expected Canadian housing starts or underlying strength in oil. Cable lost further touch with 1.2200 and even retreated below 1.2150 in wake of the firmer Dollar. On the day, UK inflation data was slightly hotter than expected at 6.7% (exp. 6.6%), matching the prior pace while the All Services print accelerated to 6.9% from 6.8%; the M/M print was in line at 0.5%. Core CPI was also marginally above expectations at 6.1% but it did ease from the prior 6.2% while the M/M was in line at 0.5% too. Analysts at ING note that given the surprise is not huge, and some of it can be put down to the volatile package holiday prices, "we don't think there's enough here to tempt the Bank of England into resuming its rate hike cycle in early November".

CHF and **JPY** saw mild gains and losses against the Dollar, respectively, with the Swissy garnering some demand through the European morning but couldn’t stave off the Buck bid as USD/CHF breached 0.9000 to a high of 0.9008, against an earlier low of 0.8955. USD/JPY was between 149.50-96 and currently towards the peak of that range with attention focusing on if there is any Japanese jawboning overnight considering the cross is inching close to the ‘line-in-the-sand’ 150. Prior to all this, with the recent reports suggesting the BoJ could increase its inflation forecasts, Rabobank notes the market will likely infer from this that the chances of further policy normalisation may be increased in the coming months. Rabobank sees another tweak to policy as likely being on the cards in the months ahead due to "the potential issues involved with maintaining its yield curve policy at current settings and the risk that JPY weakness would accentuate any further strength in oil price".

SEK and **NOK** both saw losses in excess of a percent vs. the Greenback, as risk-off positioning pulled the recovery rug from under the respective currencies, even from the NOK as Brent saw decent gains.

EMFX was almost exclusively lower on the Dollar haven bid, and aforementioned themes. The TRY slumped in the face of rampant crude. ZAR decoupled from Gold and handed back some of its recent gains. CNH could not maintain any lasting impetus from what should have been bullish Chinese data and various banks upping their 2023 GDP estimates given heightened concerns about default following a missed Country Garden coupon payment. On the former, GDP QQ, IP, and retail sales all topped expected. MXN was hardly helped by Banxico Board member Mejia saying Mexico's balance of risks for inflation has not deteriorated and the Bank will have to discuss the pace of rate cuts when appropriate inflation conditions are achieved. For the BRL, retail sales M/M was not as weak as feared, which was later followed by Chief Neto saying in terms of monetary policy, all eyes are now in the pricing of US yield curve and part of core inflation in Brazil has been a positive surprise. On rates, he never said anything regarding the probability of future rate cuts being higher or lower and still sees 50bps rate cuts as the appropriate pace.

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