US Market Wrap

19th October 2023: Bonds steepen on Powell but stocks slump and crude jumps on geopolitics

- **SNAPSHOT**: Equities down, Treasuries steepened, Crude up, Dollar down.
- **REAR VIEW**: Powell gives nod to higher bond yields doing the Fed's work but is prepared to do more if needed; Escalating geopolitical reports; Mixed Philly Fed; Hot initial jobless claims; Better-than-feared housing data; TSLA numbers miss; NFLX earnings impress with subscriptions better-than-expected; Stellar T report.
- **COMING UP**: **Data**: Japanese CPI, German Producer Prices, UK Retail Sales **Ratings**: Moody's on France & UK; S&P on UK, Italy, Greece & Netherlands' **Speakers**: Fed's Harker & Mester **Earnings**: Kering, Schlumberger & American Express.

MARKET WRAP

Markets meandered as they awaited Fed Chair Powell's speech with the hot jobless claims, mixed Philly Fed, and better-than-feared housing data having little impact. The initial reaction to Fed Chair Powell's speech was a dovish one where he noted the Fed is proceeding carefully and is attentive to the move higher in bond yields, albeit he did also suggest if there is more evidence of above-trend growth, or the labour market is no longer easing, it could warrant further action. The discussion saw more two-way price action with a hawkish move seen on remarks that he believes, and evidence says, that policy is not too tight. However, once he noted that the move in yields is being driven by term premiums (something Logan previously suggested means the Fed won't have to do more on policy), which is tightening financial conditions, a dovish reaction was observed. Nonetheless, heading into the APAC session geopolitical developments were rife with reports the Israeli military received the green light to enter Gaza, while a US warship intercepted Houthi missiles that were not aimed at the ship, but there were some suggestions they were aimed at Israel targets. Meanwhile, there were further drone attacks on the Iraq Al Asad airbase that houses US troops. The geopolitical developments saw stocks push to fresh session lows, with the VIX closing at the highest level since March, while crude prices surged post-settlement. The Treasury curve ultimately steepened after Powell's mixed messaging, with the front-end bid and long-end offered. Meanwhile, earnings saw Tesla (TSLA) plummet after EPS and revenue missed but Netflix (NFLX) surged after profit and streaming paid net additions surpassed expectations.

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CHAIR POWELL: Fed Chair Powell's opening remarks to the Economic Club of New York noted that the policy setting committee is proceeding carefully, stating that a significant tightening in financial conditions with higher bond yields can have implications for Fed policy and that they remain attentive to these developments. Powell also repeated that the policy stance is "restrictive" but more evidence of above-trend growth, or that of the labour market no longer easing, could warrant further monetary policy tightening. However, the extent of additional policy firming and how long to keep policy restrictive will depend on the data, outlook and balance of risks. On recent data the Fed Chair noted it shows ongoing progress towards inflation and its employment goals, adding the lower summer inflation readings were very favourable, but the September data was somewhat less encouraging, nonetheless Powell repeated that inflation is still too high. Within the discussion, Powell highlighted the strength of the economy but added we should be seeing the effects of monetary policy arriving, noting they have slowed on rates to give policy time to work. Powell noted he does not know where monetary policy will settle, but he did note it does not feel like policy is too tight and evidence says it is not. He also spoke on the move in bond yields, saying it is being driven by term premiums which is tightening financial conditions, whilst he noted the move is not principally about expectations of the Fed doing more. He did caveat however that it is not clear the bond yield rise will be persistent, noting markets are volatile. Powell said the Fed will let the yield rise play out and the Fed will watch it, but for now it is clearly a tightening of financial conditions. Powell concluded that there are many signs that the labour market is getting back into balance; wage increases are moderating, job openings weakening and the labour market is gradually cooling.

JOBLESS CLAIMS: Initial Jobless Claims were hot falling to 198k from a revised 211k (from 209k) despite expectations of a rise to 212k, continuing the recent trend of jobless claims hovering around the 200k handle, showing any labour market slowdown is not being led by job losses with the latest print the lowest since March. The Continued claims, for the prior week, rose once again to 1.734mln from 1.702mln, above the 1.71mln forecast, showing those who are unemployed may be struggling to return to the labour market. The 198k initial claim print in the latest week took the 4wk average down to 205.75k from 206.75k. Note, that the seasonal factors had expected a 6.8k decline with the unadjusted number falling 18.5k to 181k. Overall, this is another hot economic print, adding to the hot September NFP, CPI, PPI and retail sales reports, and the August JOLTS. Nonetheless, the Fed is more than likely to skip a hike in November, and perhaps December too as they "proceed carefully" whilst they assess the impact of higher long-term rates onto the economy but both Powell and Waller did suggest that if the economy does not slow, it could warrant further tightening.

PHILLY FED: Philly Fed increased in October to -9.0 (prev. -13.5) but printed below the expected -6.6 and remained negative for the 15th consecutive reading. Internally, employment and new orders rose back into positive territory printing 4.0 (prev. -5.7) and 4.4 (prev. -10.2), respectively. Meanwhile, CapEx sank to -4.8 (prev. 7.5), while prices paid encouragingly dipped to 23.1 from 25.7. Looking ahead, the 6-month index fell to 9.2 from 11.1. Overall, in summary, responses suggest mixed regional manufacturing conditions this month. The indicator for current activity remained negative, while the new orders and shipments indexes were positive. The firms indicated mostly steady employment, and the current price indexes continue to suggest increases in prices on balance. The survey’s broad indicators for future activity declined but continued to suggest respondents expect growth over the next six months.

EXISTING HOME SALES: Existing home sales fell 2% in September to 3.96mln (prev. 4.04mln) but surpassed the consensus of 3.89mln, while supply marginally rose to 3.4 months (prev. 3.3mnths). Oxford Economics note that the latter likely reflects homes sitting on the market a bit longer in the face of higher mortgage rates. Nonetheless, OxEco does not expect a sharp increase in inventory, as higher rates will keep both home buyers and sellers on the sidelines. Looking ahead, the consultancy expects existing home sales to come under more pressure over the course of the year as higher mortgage rates price further buyers out of the market. Supporting this, the headline reflects contracts signed a month or two prior, and mortgage rates have risen another 50bps since the end of August. Lastly, regarding prices, the median home price fell M/M but rose Y/Y, and while weaker demand will put some downward pressure on prices as the year winds down, the consultancy anticipates that tight supply will continue to limit the downside potential for prices.

GEOPOLITICS

The Israeli military reportedly received the 'green light' to move into Gaza, according to ABC citing an Israeli official, a move which has been expected in the prior days. Following this, according to CNN citing officials, a US Navy warship near Yemen reportedly intercepted multiple missiles, and one of the officials added the missiles were fired by Iranian-backed Houthi militants, who are engaged in an ongoing conflict in Yemen. The report added it was unclear what the missiles were targeting and it is possible the missiles were fired at the USS Carney or launched towards another target. Responding to these reports, the Pentagon said it cannot say for certain where the missiles were targeting, but potentially towards targets in Israel, while Israeli press noted that Israel estimates that the missiles launched from Yemen were aimed at Israeli territory. Further heightening the geopolitical angst, Reuters sources said drones and rockets attacked Iraq's Ain Al-Asad airbase, with multiple blasts heard inside the base. Note, on Wednesday US military forces in Iraq were targeted in two separate drone attacks, which houses US troops.

FIXED INCOME

T-NOTE (Z3) FUTURES SETTLED 14+ TICKS LOWER AT 105-13+

Treasuries steepened after Powell's mixed messaging, with the front end bid and long end offered. At settlement, 2s -5.7bps at 5.161%, 3s -3.4bps at 5.012%, 5s +2.3bps at 4.948%, 7s +5.7bps at 5.004%, 10s +7.5bps at 4.977%, 20s +10.1bps at 5.330%, 30s +10.4bps at 5.098%.

INFLATION BREAKEVENS: 5yr BEI +5.6bps at 2.516%, 10yr BEI +5.7bps at 2.496%, 30yr BEI +6.3bps at 2.561%.

THE DAY: The renewed Treasury selling pressures late on Wednesday continued into the APAC Thursday session. The Australian job report was on the soft side, although there was attention on a China Securities Journal article that said China's Q4 GDP growth is expected to reach more than 5%. There was also some angst around the latest TIC flows data, which saw Chinese investors sell the most US bonds and stocks in four years. The belly-led weakness continued into the London morning to see T-Notes trough at 105-12+, which held through the NY morning, with the sub-200k initial jobless claims figures offset by a disappointing Philly Fed manufacturing survey.

Fed Chair Powell's speech release at the Economic Club of NY saw T-Notes climb to 108-21+, with the Fed Chair affirming the "proceed carefully" stance and that higher yields can impact policy decisions in his prepared remarks, with front-end yields leading the drop. However, T-Notes began drifting lower again as his Q&A began, particularly after his comment that he does not feel like policy is too tight, which saw contracts hit session lows of 107-25. But, the UST losses began to pare as the dust settled, and as Powell spoke about higher bond yields and how they can offset the need for further Fed hikes. As Powell's appearance concluded, the curve remained steeper, with 2yr yields hovering near lows (5.16% vs pre-Powell 5.21%), while long-end yields remained higher vs pre-Powell levels.

5YR TIPS AUCTION: The USD 22bln 5yr TIPS auction saw lacklustre demand, tailing 2bps vs the six-auction average stop through of 2bps. The bid-to-cover ratio came in at 2.36x, which was also on the soft side of average. Dealers were left holding 9.2%, a bit beneath average.

NEXT WEEK'S AUCTIONS: US to sell USD 51bln of 2yr notes on Oct 24th, USD 52bln of 5yr notes on Oct 25th, and USD 38bln of 7yr notes on Oct 26th; all to settle on Oct 31st. US to sell USD 26bln of 2yr FRNs on Oct 25th, to settle on Oct 31st.

STIRS:

- SR3Z3 +3.5bps at 94.555, H4 +5.5bps at 94.635, M4 +7.5bps at 94.830, U4 +8.0bps at 95.050, Z4 +7.0bps at 95.265, H5 +6.0bps at 95.465, M5 +4.0bps at 95.575, U5 +2.0bps at 95.625, Z5 +0.0bps at 95.630, Z6 -8.5bps at 95.565. Z7 -11.0bps at 95.450.
- SOFR fell to 5.30% as of Oct 18th from 5.31%, volumes fell to USD 1.396tln from 1.427tln.
- NY Fed RRP op demand at USD 1.114tln (prev. 1.151tln) across 97 counterparties (prev. 108).
- EFFR flat at 5.33% as of Oct 18th, volumes fall to USD 89bln from 93bln.
- US sold USD 96bln of 4-week bills at 5.305%, covered 2.98x; sold USD 86bln of 8-week bills at 5.325%, covered 2.63x.
- US leaves 6-, 13-, and 26-week bill sizes unchanged at USD 75bln, 75bln, and 68bln, respectively; 13- and 26-week sold on Oct 23rd and 6-week sold on Oct 24th; all to settle on Oct 26th.

CRUDE

WTI (Z3) SETTLED USD 1.10 HIGHER AT 88.37/BBL; BRENT (Z3) SETTLED USD 0.88 HIGHER AT 92.38/BBL

The crude complex extended on the week's gains on Thursday and firmed through the duration of the US session to settle at highs and pare losses seen in the European morning. Crude-specific newsflow was light, and attention continues to lie on the known themes, such as geopolitical warfare, US/Venezuela, and central bank speak. Nonetheless, as mentioned, WTI and Brent were contained through the EU morning as participants digested the US easing sanctions on Venezuelan oil to allow more oil to flow globally, against the continuing concerns of escalations in the Middle East conflict. On the former, according to Reuters sources, OPEC+ sees no major impact from Venezuela sanctions easing. Meanwhile, the Dollar was ultimately weaker in wake of Fed Chair Powell which also gave a helping hand to the crude space. Looking ahead, Fed speak (ahead of the blackout period) and Baker Hughes rig count are the only things of note on Friday, as traders continue to digest the aforementioned risk themes.

NAT GAS: US nat gas saw notable downside on Thursday in wake of the weekly EIA data, which saw a bigger-than-expected storage build, record output, and forecasts for mild weather and less heating demand though early November.

EQUITIES

CLOSES: SPX -0.85% at 4,277, NDX -0.85% at 14,783, DJIA -0.75% at 33,414, RUT -1.51% at 1,702.

SECTORS: Real Estate -2.44%, Consumer Discretionary -2.2%, Financials -1.25%, Materials -1.08%, Health -0.96%, Utilities -0.93%, Industrials -0.9%, Consumer Staples -0.78%, Technology -0.44%, Energy -0.13%, Communication Services +0.32%.

EUROPEAN CLOSES: DAX -0.33% at 15,045.23, FTSE 100 -1.17% at 7,499.53, CAC 40 -0.64% at 6,921.37, Euro Stoxx 50 -0.39% at 4,090.05, IBEX 35 -0.72% at 9,146.80, FTSE MIB -1.38% at 27,746.82, SMI -2.15% at 10,445.60.

STOCK SPECIFICS: **Tesla (TSLA)** earnings missed while Cybertruck deliveries are scheduled to begin on November 30th; CEO said there will be challenges in reaching volume production and making it cash flow positive, adding he wants to temper expectations. Following earnings, several brokerages lowered their price target. **Netflix (NFLX)** profit and streaming paid net additions beat alongside raising its buyback authorisation by USD 10bln. On prices, it is boosting some in the US, UK and France. **AT&T (T)** EPS, revenue, and US wireless postpaid phone net additions all beat; raised FY FCF and adj. EBITDA view. **Discover Financial Services (DFS)** Q3 profit numbers missed estimates due to higher bad loan provisions. Net interest margin and net income also fell short, but revenue, NII, and deposits beat. **Las Vegas Sands (LVS)** EPS was in line, revenue beat and authorised a USD 2bln stock repurchase programme. **American**

Airlines (AAL) EPS beat, while revenue fell short. In commentary, CEO said booking trends for holidays are stronger than last year, and feel very solid on where demand is going, but it did lower FY adj. EPS view and has some headwinds on salaries and benefits in 2024. **KeyCorp (KEY)** surpassed Wall St. expectations on the top and bottom line, alongside raising Q4 net interest income guidance. **Philip Morris International (PM)** had a mixed report; EPS topped, while revenue fell short. For the FY, raised profit view and reaffirmed revenue growth. **TSMC (TSM)** net profit, gross margin, and revenue were strong while next quarter top-line guidance surpassed consensus. Profits were lower due to demand hit for chips as well as coming off a high base last year. **Union Pacific (UNP)** beat on EPS while revenue was light; FY23 outlook remained "relatively unchanged". **Zions (ZION)** fell short on EPS, total deposits, NII, and noted loan demand weakened in Q3 but is pleased with growth in customer deposits which increased 5% sequentially. Beijing weighs delaying approval of USD 69bln **Broadcom (AVGO)-VMware (VMW)** deal.

US FX WRAP

The Dollar was ultimately lower on Thursday despite a hot jobless claims print with focus on remarks from Fed Chair Powell, who also acknowledged the move in bond yields is tightening financial conditions, thus implying the Fed may not have to do as much, which saw the DXY hit session lows of 105.94. Nonetheless, markets were then choppy in reaction to Powell's discussion with Dollar upside seen when he noted evidence that policy is not too tight, but then sold off once he spoke on the move in bond yields being driven by term premiums. Post-Powell the Buck did move off lows on a slew of geopolitical updates, with ABC reporting the Israel military has the green light to move into Gaza, while CNN reported a US Navy warship near Yemen intercepted multiple missiles fired from the Iranian back Houthi militants. Meanwhile, the Iraq Al Asad airbase, where US troops are located, came under fire once again from drone attacks.

The Euro was supported by the weaker dollar with EUR/USD rising above 1.06 in response to Powell's speech but pared off highs heading into APAC trade amid souring risk sentiment with stocks taking a hit. Although risk sentiment soured into the close, the Yen saw little benefit and hovered just sub 150.00 again with traders reluctant to tolerate a move much higher than 150 given the suspected intervention earlier in the month (although we are yet to see any official confirmation). Although the Yen was flat vs the buck, the Swissy outperformed, however, with CHF hitting its best levels of the day amid the aforementioned geopolitical updates.

Cyclical currencies were relatively flat with a marginal outperformance in GBP which at one point attempted to reclaim 1.22 but ultimately failed before paring back to c. 1.2150. Similar price action was seen in the AUD and NZD with the run up in stocks ahead of Powell but the turnaround in risk sentiment post Powell and on the geopolitical developments saw the antipodes move off highs. AUD/NZD was flat, but of note for Aussie, the APAC session saw jobs data come in weaker than expected led by a decline in full time jobs but the overall unemployment rate edged lower. CAD was eventually flat on the day with USD/CAD moving from highs as oil rebounded post settlement following weakness since the cooler-than-expected CPI report on Tuesday.

EMFX was mixed. BRL was firmer after Finance Minister Haddad said they are preparing currency hedging tools this year to attract long-term foreign investments. CLP saw marginal gains, tracking the slight gains in copper. MXN saw mild weakness. KRW was ultimately mildly weaker vs the dollar after the BoK left rates unchanged at 3.5% as expected; noting it will maintain restrictive policy for a considerable time while it monitors inflation slowdown, financial stability and economic downside risks. Governor Rhee noted one member on the board said the policy raid should remain flexible both ways, but five said they remain open for a future rate hike if needed.