Weekly Market Summary

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Just When You Thought the Financial World Was Moving to a Better Place!!

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Back in August 2019, bond investors/traders – driven by deteriorating global economic fundamentals, a bullish technical outlook for fixed-income prices, idiotic presidential tweets, dovish central banks' talk and a never-ending Brexit saga – madly piled into government bonds on bets the era of ultra-loose monetary policy would extend unabated, forever. At that time, the main triggers for the relentless and irrational bond price ascent that drove 10-year US bond yields to a low of 1.41% and 30-year US bond yields to a record low of 1.91% were: 1- Failure by Jerome Powell to comfort markets that the July 31st enacted 25 bps cut was the beginning of a long series of rate cuts (which is effectively what equity and bond investors wanted to hear from the Fed Chair) & 2- The imposition of new tariffs on Chinese goods by the Trump administration (taxing $300 billion of new Chinese imports at 10%, in addition to the existing 25% tariffs on $250 billion in Chinese products). And whilst the narrative supporting the move was exhilarating at times (extra focus on a tiny and brief inversion of the US yield curve "2s-10s" amongst other things), many market players kept buying bonds solely on the calculation that they would soon be able to sell to someone else for an even higher price – the classic condition of a speculative frenzy as set out many years back by MIT economist Charles Kindle Berger in "*Manias, Panics and Crashes*".

Since then, positive steps toward a U.S.-China trade deal and a light at the end of the Brexit tunnel have exerted major downward pressure on bond prices (higher yields), and that despite a weakening global economic landscape (as confirmed by the IMF in its latest Word Economic Outlook report). UK Gilts, German Bunds and US Treasury yields took flight in past weeks on hints of a US-China trade pact and as prospects for a deal between the U.K. and European Union look firmer. With the case for G-7 government bonds largely hinging on these two major political dilemmas, a re-emergence of credible progress on both was seen as enough to catch bond bulls seriously offside and possibly derail a market on track for its best annual return since 2011. Indeed, if a worst-case scenario is no longer in play, global growth could improve, the Federal Reserve could be less inclined to ease and yields in major government bond markets would have more scope to rise. At least that is how the herd thinking went!

So, what have we really learned in past days and is it truly safe to assume that the financial world is now in a better place?

- **A well telegraphed 25 bps cut by the Federal Reserve:** The US Federal Open Market Committee ("FOMC") met last Wednesday and opted for a 25bps cut in the overnight fed funds rate (1.50% - 1.75%), the third quarter-percentage point decrease this year. It also signalled a pause in further cuts unless the economic outlook changes materially. The FOMC also altered language in its accompanying statement, dropping its pledge to "*act as appropriate to sustain the expansion*," whilst adding a promise to monitor data as it "*assesses the appropriate path of the target range for the federal funds rate*." "*We believe monetary policy is in a good place*," Fed Chair Jerome Powell told a news conference following the decision. "*We see the current stance of policy as likely to remain appropriate as long as incoming information about the economy remains broadly consistent with our outlook*." Additionally, Powell noted that the risks associated with the trade tensions and Brexit show signs of improving. As with the past two cuts, Kansas City Fed President Esther George and Boston's Eric Rosengren dissented, preferring to keep rates unchanged. Markets now price a small 23% probability that the US central bank reduces short-term rates by a final 25 bps before year-end.

- **China says it doubts a long-term trade deal is possible with Trump?!** Chinese officials are casting doubts about reaching a comprehensive long-term trade deal with the U.S. even as the two sides remain close to signing a "*phase one*" agreement (Trump lately tweeted that China and the USA are working on selecting a new site for signing of Phase One of the Trade Agreement, about 60% of total deal, after APEC in Chile was cancelled due to unrelated circumstances). In private conversations, Chinese officials have warned they won't budge on the thorniest issues, according to people familiar with the matter. They remain concerned about President Donald

Trump's impulsive nature and the risk he may back out of even the limited deal both sides say they want to sign soon. Chinese officials have also relayed low expectations that future negotiations could result in anything meaningful unless the U.S. is willing to roll back more of the tariffs (that includes withdrawing tariffs in place on some $360 billion in imports from China and cancelling a new wave of import taxes due to take effect on December 15th) and urged American visitors to carry that very message back to Washington, the people said.

- **The EU agrees to extend the October 31st Brexit deadline:** Earlier this week**,** the European Union agreed a three-month extension to the October 31st Brexit deadline, in a boost to Boris Johnson's hopes of forcing a general election. EU27 ambassadors approved an extension to January 31st, 2020 in a 20 minutes meeting in Brussels on Monday morning. The plan allows the "*flextension*" to end early if the deal is ratified by the House of Commons and European Parliament, meaning Brexit Day could be 11:00 pm on Saturday, November 30th, Tuesday, December 31st or Friday, January 31st. The British government has accepted the EU's extension and called for early elections on December 12th. Prime Minister Boris Johnson's claim to voters now is that parliament blocked his attempts to deliver Brexit, and only a comfortable majority will enable him to deliver it! But Brexit has blurred loyalties among voters and MPs, since there are pro and anti-Brexit MPs in each party. Labour has pursued creative ambiguity to enlist support of both camps, and favours holding another EU referendum. The outcome of the next election is by no means certain to produce a clear majority, with the Liberal Democrats being the only party that wants to cancel Brexit. The election result, and the party or parties who will form the next government, will determine the fate of Brexit. Hopes remain now that it will happen by the new January 31st deadline, though history clearly shows that the agreement with Brussels could get further delayed and renegotiated*, or that another referendum could be held to seek people's approval on the terms of Brexit outlined in the agreement.

New Definition of **Brexiting: Saying **Goodbye** to everyone at a party and then proceeding to **Stick Around.** Q: What's up with Boris, I thought he was **Leaving?!** A: Apparently, he is just **Brexiting!** ☺☺*

This afternoon brings the release of the all-important US payroll data**. Bloomberg consensus is for October payrolls to have risen by a small 85,000 (following a 136,000 jump in NFP for the month of September), largely reflecting the impact of 46,000 striking GM workers as well as related effects from any idling at the company's suppliers and contractors. It will also be worth keeping a close eye on the other important elements of the report, namely the unemployment rate (expected to tic higher by one-tenth to 3.6%), average hourly earnings (likely to rise by a healthy +0.3% mom & +3.0% yoy), the participation rate (expected unchanged at 63.2%) and average weekly hours (also projected to stay unchanged at 34.4 hours). A sharp weakening of the labour market over the coming weeks would increase the chances of seeing a 25bps cut at the December 11th FOMC meeting.

The sharp bond rally over the last 48 hours (10-year UST yields last at 1.69%, after trading to a high of 1.86% on Monday morning) suggest some market scepticism over Fed Chairman Jerome Powell's remark that U.S. monetary policy is now in a "*good place*" - an assurance that may have been partly overshadowed by China casting doubts about the possibility of a comprehensive long-term trade deal with the U.S. One has to wonder whether this afternoon's US payroll release (and later in the day US ISM Manufacturing data) brings back markets closer to a "*healthier place*" or otherwise trigger the next wave of risk-off trading and large move lower in government bond yields?

***If the Fed was looking for evidence that they should pause on rate cuts for the remainder of this year, the October payrolls numbers were a solid step in that direction. Everything about the report was better than it looks in the 128K jobs gain, which was held back to the tune of 42,000 jobs "lost" due to the GM strike. Add those back, and NFP would have risen to a 170,000 print. Moreover, the prior two months were revised sharply higher, by a collective 95K (Sept is now at 180,000). The jobless rate moved up a tick due to a rise in the participation rate, and the 0.2% rise in average hourly wages is reasonably good given that there were high wage factory workers missing from the count. Hours worked are up at an annualized 1.8% pace in the last three months. This latest economic news helped the USD and stocks rally, whilst bonds sold off (higher yields).*

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