Weekly Market Summary

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Could Markets Be Witnessing The Final Calm Before the Storm?! President Trump Seems to Believe So!!

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Late on Sunday (US time), shooting by Stephen Paddock - a “lone wolf and gambler” (in other words, no ties to “radical Islam” terrorism! ☹) - at a packed music festival on the famous Vegas strip resulted in the most lethal mass shooting in modern US history - with the death-toll reaching at least 58 people and the number of people injured in excess of 500, according to police. The US president called the incident an “*act of pure evil*” and told victims’ families that “*we are here for you and we ask God to help see you through this very dark period*”. Still, US stocks hit fresh all-time record highs on Monday as fourth quarter trading got underway. The S&P 500 rose as much as 0.3% to an intraday high of 2,528 - led by a 0.8% rally in the materials sector and about a 0.7% advance in both the financial and healthcare sectors, whilst the Dow Jones Industrial Average surged as much as 0.6% to 22,538. Markets appeared to be unfazed by the deadly Las Vegas shooting, focusing instead on data that showed that US manufacturing activity in September grew at its fastest pace in more than 13 years, and adding to optimism on the US economic growth outlook. Moreover, risk appetite had benefitted in recent weeks, amid expectations that the Republican tax plan could, if approved by Congress, unleash stronger economic growth. Federal Reserve chair Janet Yellen’s remarks last week also helped, when she struck an optimistic tone on the health of the US economy.

Earlier on that same Sunday October 1st, the Spanish region of Catalonia held a much-contested referendum on independence from Spain. The Spanish government had long ago declared any such vote illegal and unconstitutional, and worked for weeks to try and shut it down. As many Catalan voters tried to go to the banned polling stations, they were met by national police officers in riot gear. Hundreds were injured as police smashed, dragged, and fired rubber bullets at would-be voters. Of more than five million eligible Catalan voters, only 42% voted - with 90% of the votes cast being pro-independence - according to Catalan officials. On Wednesday - two days after holding this chaotic independence referendum - the Spanish region of Catalonia shut down in a one-day general strike to protest violence by national police during the poll. Catalan leaders have appealed to the EU to help mediate with the government in Madrid, a sign that it is holding back from an early declaration of independence, whilst Spain’s King Felipe VI has voiced harsh criticism of the “*irresponsible*” Catalan government for its independence campaign. Unsurprisingly, Spanish markets have been hit hard by the turmoil: Investors are selling Spain’s government debt and moving out of its stock market, keeping the country out of a steadier showing for wider European markets: The yield on Spain’s benchmark 10-year debt was last at 1.71%, after trading to a 6-month high of 1.78% on Wednesday morning (up from 1.58% before the weekend vote). Investors have also pulled more money out of Spanish equity funds in the past week than in any since November 2014, as the violent push for Catalan independence weighs on confidence in the market. Some companies have already decided to move their headquarters out of Catalonia and the Ibex 35, Spain’s main equity index, took its losses since a May high to more than 10% this week!

Elsewhere, senior US administration officials are pushing to harden Iran policy without destroying a historic nuclear deal with Iran that US president Donald Trump has called an “*embarrassment*” and threatened to scrap. Mr Trump has until October 15th to announce whether he will recertify the 2015 deal, in which Iran agreed to curb its nuclear programme in exchange for limited sanctions relief. The deal was signed by seven countries and endorsed by the UN Security Council. Before meeting US military chiefs yesterday, Mr Trump said “*We must put an end to Iran’s continued aggression and nuclear ambitions. They have not lived up to the spirit of the agreement*.” He later told reporters “*maybe it’s the calm before the storm*”, without making it clear if he was talking about Iran (or possibly North Korea!). A senior administration official told the Financial Times that despite Mr Trump’s disdain for the deal, he still retains some hope he can fix the agreement without getting out of it, and that no decision on how to handle the upcoming certification deadline has been made. Should Mr. Trump opt to decertify (withdraw his approval for) the deal, Congress would have 60 days to re-impose sanctions, a move that would probably destroy the signed agreement and see Iran resume its nuclear programme unfettered.

In the UK, Grant Shapps - former Conservative chairman - has emerged as a ringleader of the plot to oust Theresa May, saying that Tory MPs were "*perfectly within their rights*" to urge the UK prime minister to quit. Mr Shapps said up to 30 Conservative MPs supported the move but that no current cabinet ministers were involved, as the party reacted to Mrs May's disastrous party conference this week. Under party rules, a contest can be triggered if 15% of Conservative MPs write to the chairman of the 1922 Committee saying they no longer have confidence in the leader. Mr. Shapps' move would therefore need the backing of at least 47 of the party's 316 MPs. In the meantime, the British pound is headed for its worst week in a year, falling this morning to a low of $ 1.3052 and taking its weekly decline to 2.5%. "*The double whammy of negative economics and politics continues to weigh on the pound,*" said Neil Jones, London-based head of FX sales at Mizuho Bank Ltd. "*Domestic disarray and uncertainty are at the helm, and with or without May the pound is destined for lower still*."

If all the above uncertainties weren't enough to shake market confidence, one would also hope that the next Fed Chair appointment - in coming weeks - would go unnoticed! So far President Trump has met with current Fed Chair Janet Yellen, National Economic Council Director Gary Cohn, Fed Board Governor Jerome Powell and former Governor Kevin Warsh as he considers his choice to head the U.S. central bank. Stanford University economist John Taylor is also on the list of recommendations put together by Trump's advisers. There is no clear front-runner and outlier candidates haven't been ruled out (Jeffrey Gundlach, the famous money manager who predicted the presidential election of Donald Trump when few saw it coming, now believes Neel Kashkari – the very dovish president of the Federal Reserve Bank of Minneapolis – will be the next Chairman of the Fed!). Trump has said he expects to make a decision on the Fed-chair search this month, and that would kick off a months-long process of Senate confirmation before Yellen's current term expires in February 2018.

Yesterday night, US stocks hit their sixth consecutive closing high for the first time in more than 20 years, fuelled by additional signs of economic strength in the form of a narrowing trade deficit, rising US exports, lower unemployment claims for the week and a stellar US Services survey reading (in addition to the renewed optimism over tax cuts). The S&P 500 closed 0.6% up at 2,552.07, to mark the benchmark index's longest such streak since June 1997, according to Thomson Reuters data. It has more than doubled in the decade since its pre-crisis peak of October 2007, and is **up 350%** from the low it set in March 2009. President Donald Trump, whose administration has faced a string of legislative failures, was quick to note the gains, tweeting yesterday: "*Stock Market hits an ALL-TIME high! Unemployment lowest in 16 years! Business and manufacturing enthusiasm at highest level in decades!*" The CBOE VIX volatility index, which measures the short-term volatility implied by S&P 500 option prices, closed at 9.19, its lowest level since 1990. And yet, despite all this positive news, betting against bonds (bond prices are "logically" inversely related to equity prices, as yields rise / bond prices fall when stocks rally!) has probably been the ultimate "*pain trade*" in markets in recent years despite a chorus of warnings from so-called experts that record low interest rates and yields have nowhere to go except higher. However, a widely followed JPMorgan Chase client survey for the week ended October 2nd has found that sentiment toward U.S. Treasuries is more negative now than any time since 2005. If those clients are right (their logic is that the Federal Reserve transition to shrinking its balance sheet and continuing to raise its benchmark rate - coupled with the Trump administration's tax-cut plans and a change at the Fed leadership – are valid reasons for markets to be very worried!) and the bond market takes a tumble, it is likely that borrowing costs for companies and consumers will rise as well! The timing of such move remains the million dollar question!

Last, traders will focus later this afternoon on the all-important US payroll release**. Bloomberg consensus is for September payrolls to rise by a small 80,000 (versus the August print of 156,000), with the data reflecting the impact of adverse weather. Whilst a weak number may be discarded as caused by one-time factors related to Hurricane Harvey, a beat would surely see momentum investors adding to the dollar rally and recent bond selloff, as chances of tighter Federal Reserve policy – at the Fed's December 13th meeting – get a boost (markets are currently pricing a 76% probability for a final 25 bps rise in the Fed funds rate for the remainder of 2017). As always, it will also be worth keeping a close eye on the other important elements of the report, namely the unemployment rate (expected to remain unchanged at 4.4%) average hourly earnings (+0.3% mom /+2.5% yoy), the participation rate (last at 62.9%) and average weekly hours (expected unchanged at 34.4 hours).

** *Hurricanes did take a toll on hiring in September, as payrolls registered their first decline since late 2010. The headline number showed a decline of 33,000, with broad-based weakness due to Irma and Harvey. That being said, the unemployment rate did fall two ticks to 4.2%, on an extremely strong gain in the household survey of employment. Looking through some of the noise on job creation, wages were up a robust 0.5% month-on-month and 2.9% year-on-year* (The Bureau of Labour & Statistics "BLS" says that some of that *could be attributable to the hurricanes, but part of the strength in the year-over-year figure was due to an upward revision for August where hurricanes shouldn't have affected the number). Overall, the hurricanes impacts will make it difficult for markets to find a clear message, but the strong wage data and low unemployment rate should tip the scales towards a stronger dollar and higher yields. EUR/USD and USD/JPY last at 1.1690 and 113.40 respectively. 10-year UST yields last at 2.40%*

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