بنك الإمارات دبي الوطني
Emirates NBD

CIO Office Morning Notes

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On Thursday, risk-off sentiment prevailed after seemingly endless optimism about AI investments in the previous sessions with a modest bid to be seen only for the energy sector. That President Trump signed a bill providing provisional funding for the government did not help. Was it about growing uncertainty about rate cuts due to lower visibility on macroeconomic data following the shutdown? After all, with delayed labor reports, that could eventually be stronger than expected once published, the Fed might be tempted to err on the side of caution in December. But we doubt that to be the only factor at play. Nowadays, plentiful private surveys help extrapolate missing data points for tier 1 reports, so we can't really say the Fed to be as blind as reported by the media. It is also likely that there is AI investment fatigue as already mentioned in this publication. The so-called hyperscalers are changing the nature of their business with continued investments in data centers, shifting from a cash-richer, lower-debt, and lower-capital-intensity profile to a cash-poorer, higher-debt, and a higher-capital-intensity one. They must invest for survival, to avoid being left behind in the AI revolution. So, they are damned if they don't invest, and they are if they do as well, as they will end up shifting their business to a more leveraged and pro-cyclical one, that markets eventually will punish given the current elevated valuations. In this respect, their interests and the ones of their shareholders are no longer fully aligned. We hold the view investors would be better off looking for opportunities in the 'picks and shovels' of AI, that is the companies that help build the data centers and the AI infrastructure. That is, they should be looking further downstream in the AI supply chain. Yesterday, losses were to be seen across the board, for the S&P 500 (-1.7%), the Nasdaq Composite (-2.3%), and the smaller companies (-2.8%). All sectors closed in the red, with the exception of Energy (+0.3%). Treasuries closed in negative territory as well, with some Fed officials expressing doubts about the opportunity of cutting rates given inflation uncertainty. Yields were higher across the curve, while odds of a market-implied rate cut slipped below 50%. The 30-year bond led the sell off with an auction pointing to soft demand. Treasury implied volatility shot up from very depressed levels, the yield on the 10-year note settled at 4.12%, the 30-year at 4.71%, both about five basis points above previous day's settlement. Fed's Musalem mentioned he sees a resilient economy above potential next year, Kashkari that inflation is too high, and Hammack that rates should be held steady. The dollar fell 0.4% despite potentially favorable Fedspeak, Brent crude rebounded, while gold slipped.

Markets this morning:

Stocks extended losses across Asian markets following yesterday's risk-off session as stretched technology valuations weighed on sentiment. Less conviction about a December rate cut by the Fed may have played a role, though the end of Quantitative Tightening is already planned for December 1 this year and on its own would be equivalent to well more than one single policy rate reduction. Asian shares fell 1.2%, with IT companies such as SK Hynix leading losses. Bitcoin traded below 100,000, down more than 20% from its peak. Brent crude jumped over 2% on news that military officials briefed President Trump on the possibility of strikes inside Venezuela. That would come alongside the effects of recent sanctions against the country's largest oil companies. Treasuries and the Dollar Index steadied as comments from Fed officials cast doubts on a December rate cut, while gold advanced. Also, the October unemployment report would be released without the unemployment rate as the households survey was not run during the shutdown. Investor jitters were not allayed by President Trump's readying tariff cuts to address high food prices and a series of new trade deals aimed at addressing voter concerns over the cost of goods. The initiative would be following electoral victories for Democrats last week. Trade deals with Latin American countries unveiled yesterday would see the US reduce tariffs on common grocery items. Attention was also on the British pound that fell after the Financial Times said Chancellor Reeves would be ditching a planned income tax rise, pointing to the Chancellor's thinning options on the fiscal side.

China's economic activity slowed down more than expected at the start of the fourth quarter, with a sizeable slump in investment and slower growth in industrial output. Industrial production climbed 4.9% last month on a year-over-year basis, down from the September's rate, and fixed-asset investment shrank 1.7% in the first 10 months of the year. Retail sales gained 2.9%, slowing for the fifth straight month. The economy is facing challenges in the external environment and pressures from economic restructuring within the country. The market had a muted reaction, with the yuan and government bonds trading little changed. The CSI 300 Index of stocks was down 0.7%, after a 1.2% advance on Thursday. Chinese social media leader Tencent fell 2.3% after reporting Q3 results that beat estimates across operations, from gaming to advertising.

Upcoming key events/data:

The retail sales and the PPI reports may be delayed by the government shutdown in the United States. Euro area trade data is due out today.

Have a good day!

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