



CIO OFFICE MORNING MARKET WRAP – 17th October, 2021. ALSO AVAILABLE ON ALEXA.

Stocks recorded their best week in nearly three months, as strong earnings offset inflation concerns, and investors bid up the most cyclical sectors. The S&P 500 gained 2% over the past five days, led higher by materials, financials and industrials, and long-dated Treasuries rallied as well, with 10-year yields ending the week at 1.57%, in spite of hawkish Fed minutes and a positive retail-sales surprise. Industrial metals accelerated higher, copper broke above \$10,000 a ton and the copper-to-gold ratio, often indicative of US yield direction, reached levels last seen in 2014. Brent rose to reach close to \$85, while the US dollar edged lower.

Corporate earnings and the Fed minutes, alongside the CPI release, were in the limelight and affected market direction. In the September minutes the Fed assessed that the tapering of asset purchases should end by the middle of next year and could be started as early as in November or December, unexpectedly pulling forward the timeline for the beginning of the unwinding process. Fed officials acknowledged the existence of sustained price pressures, tied to the post-pandemic supply bottlenecks, as “they might have more persistent effects on prices and wages” than initially thought. The September CPI print at 5.4% compared to a year ago, released on Wednesday as the FOMC minutes, was well above expectations and matched the largest annual gain since 2008. It pointed to price pressures broadening beyond the reopening categories of the economy. Yet, markets took both the hawkish-leaning minutes and the inflation reading in their stride, with stocks buoyed by earnings and the Treasury yield curve bear-flattening. Market-implied measures of the terminal rate, the Fed policy rate expected in the longer term, moved higher for the year, but remained still subdued, as did measures of

longer-term expected inflation. Overall, investors still believe in the Fed capability of managing inflation. Should Powell step too late up to the plate with delayed hikes in spite of persistent price pressures, yields at the longer end could become unanchored with fading Fed credibility.

US large-cap banks dominated the first week of the third-quarter reporting season, with all four of the major banks delivering 20% EPS or more above consensus, although the four stocks averaged a low single-digit negative return for the week. Positive results were a combination of solid balance sheets, banks releasing provisions for bad loans, strong advisory revenue, but only muted loan growth. In a year where the bank sector is up more than 30%, investors need to find new reasons to remain interested. In the end, deal making will have to hand the baton over to the lending business, although it is not clear when this will happen. But when it does, banks with more deposits, like for instance Bank of America, will be able to put more money to work and continue to boost their bottom line. For now, the overall sector still boasts a forward price-to-earnings ratio which is only 50% of the S&P 500, an appealing enough valuation while awaiting the arrival of the loan growth wave.

Although concerns about the current soft patch in the global economy continue, the US and the UK have started to surprise to the upside, as per the respective Citigroup Economic Surprise indices. September US retail sales beat expectations, with an upside surprise at the headline index level, mostly due to motor vehicles, and small upward revisions for the previous two months. This improvement was not matched by one in consumer sentiment, as the University of Michigan consumer sentiment declined, which could reflect low purchasing power from recent price increases. The UK labor market remained strong in the August/September data, with employment now slightly above pre-pandemic levels.

In one of the busiest weeks for the earnings season, big names in finance, industrials and technology are scheduled to release earnings. China will release its Q3 GDP on Oct. 18. Investors will be looking for signs of the impact of the Evergrande crisis and the government crackdown on different sectors. In the US, housing starts and permits data will be out on Oct. 19, and the Conference Board leading index on Oct. 21. Flash PMI indices for some major DM countries will be released on Oct. 22.

Stay safe.

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