



CIO OFFICE MORNING MARKET WRAP – Sunday September 19th, 2021. ALSO AVAILABLE ON ALEXA

Stagflation concerns weighed on market sentiment, with equities in negative territory across the board, US stocks outperforming, and long-duration assets selling off as investors did not welcome higher yields and the forthcoming tapering decision by the Fed. Also, the regulatory crackdown in China continued, coupled with more negative news flow on the macro front, while the discussion of Joe Biden's proposal for higher taxes did not help either. The largely followed S&P 500 US equity benchmark closed below the 50-day moving average, a support level that has limited the downside since March this year. Investors will have to wait the return to normal of trading conditions on Monday, following last Friday's simultaneous option expiries, to better gauge market direction. US stocks lost more than half of a percentage, and emerging markets more than 2%, with Chinese equities recording losses in the mid-single digits on continued regulatory tightening and fears related to a possible collapse of China Evergrande group. The yield on the 10-year note rose 2bps, gold lost 2%, Brent crude and the US dollar advanced.

US macroeconomic releases took center stage, as investors looked for clues on the inflation-growth outlook. The August US CPI decelerated for the second straight month, though the annual gauge, at 5.3%, lingered close to decade-high levels. Details of the report show that virus concerns played a role in the softer reading, with lower price pressures in traveling and restaurants, but also continuation of supply bottlenecks, which translated in higher prices for consumer categories. Retail sales printed above expectations, and confirmed the picture of an economy marked by supply disruptions and Covid-related uncertainty. Consumer sentiment took a hit in the University of Michigan report, with poor buying conditions a consequence of shortages and high prices. Overall, this is unlikely to change the Fed's expected schedule for a tapering announcement at latest in November, followed soon after by its implementation. Next week's Fed policy meeting will be closely watched for further insights.

More prominent investors have expressed doubts about the temporary effects of supply-side constraints on inflation. Mohammed El Erian, ex CEO of PIMCO, mentioned in a recent article on the Financial Times that "supply side troubles ... could last for one or two years, if not more." Jeffrey Grundlach, CEO of Doubleline Investments, said that inventories remain at a "very, very low level" and "this is not supportive of inflation being transitory". The US Treasury market seems for now to be in agreement with these assessments, as the yield on the 10-year note continued to stabilize, rather than sink, on the negative news flow of the latest softer labour and CPI reports. Also, in the last couple of months gold has undershot its fair value based on where the US 10-year real yield has been trading, another confirmation that investors are looking through weaker data, in the expectation that either the soft patch won't last long, or inflation will be picking up.

China continued to foster apprehension during the week, both for macroeconomic releases and the relentless regulatory offensive on private corporations. Retail sales growth slowed sharply to 2.5% on the stringent measures to curb Covid outbreaks, industrial production decelerated to 5.3%, while fixed asset investments rose in the high-single digits in line with projections. This has lately spurred the authorities to revive infrastructure projects through new issuance of local government bonds, in an attempt to boost flagging internal demand. Also, monetary policy turned from tight to neutral and one more cut to the Reserve Requirement Ratio, translating into loans to Small and Medium Enterprises, is expected by year-end. If visibility on the macro initiatives is high and can be a source of comfort, we cannot say the same of the regulatory offensive aimed at implementing the new "common prosperity" model. Last week Beijing unveiled a new round of measures on the gambling sector, that wiped out almost \$20bn in market value. Regulatory risk is by some analysts deemed

to stay high until the 20th Party Congress in October 2022, with political leaders keen to build their populist credentials.

In the week ahead the OECD will be releasing its interim outlook with updated forecasts for the major global economies, and the US Housing Starts, Building Permits and the Current Account Balance on Tuesday; the Fed will be issuing its rate decision and publishing updated economic forecasts, the euro area releasing its Consumer Confidence gauge on Wednesday; the US will be releasing Jobless Claims and the Leading Index on Thursday; Germany the IFO business climate and the US New Home Sales on Friday. Stay safe.

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