



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

Asian stocks are advancing this morning as investors look forward to the forthcoming earnings releases and entertain expectations for more Chinese stimulus. The gap between 5- and 30-year Treasury yields narrowed on growing conviction the Fed may lift policy rates as soon as next year. Yesterday US stocks reversed early losses to extend the prior week gains on a whipsaw in energy prices, which relieved pressure related to stagflation concerns on the market. The S&P 500 added 0.3%, the Nasdaq 0.8%, while global equities closed in the red. The yield on the 10-year Treasury note climbed to 1.59% and UK yields surged as the Bank of England warned that it would respond to price pressures. Brent crude reached a five-year high and then retreated to end the session at \$84, the US dollar was little changed.

The relentless rise of oil futures has been stoking worries about price spikes, as crude pricing feeds straight into the inflation basket. Europe's self-inflicted energy crisis causing a gas-to-oil switch and the deepening power crunch in China and India are all but compounding the problem. With the cold season approaching any colder-than normal temperature would be further straining the overly-tight energy markets and sending prices soaring further. Yet, one should not hope that OPEC+ will come to the rescue, as the cartel seems to be looking through the current imbalances to expect a supply surplus sometime in 2022 with demand projected to drop significantly. Such calculations would be based on each member country being able to meet its current production quota, adding up to 400,000 barrels per day of overall additional supply, which cannot be the case according to some analysts. Many countries are already failing to achieve their production targets and the Iran deal is not on the radar, so its

production coming on stream is not either. The next OPEC+ meeting on Nov. 4 is likely to see some pressure from consumers, but its member countries might not be inclined to respond.

Higher energy prices and supply bottlenecks not going away overnight are working in the direction of making price pressures more persistent. Central banks' willingness to consider such inflation in the end "transitory" and refrain from tightening policy will be put to the test next year. Equity bulls should perversely hope that the economy slows down substantially more than forecast so that monetary policy is left unchanged, while at the same time that the soft patch remains within the confines of a soft landing as well. According to BlackRock strategists, markets are pricing too much of a Fed response and they think that "the Fed's rate hike path will be shallower", with liftoff taking place not before 2023. And the Fed's staff, the army of hundreds of PhDs tasked with churning out projections, has forecast that inflation will be under 2% in 2022 as per the September FOMC minutes. However hard it is to divine the future trajectory of the economy, the Fed's staff forecasts have consistently beaten consensus.

Downward pressure on the China economy was stark in Q3 GDP and in September activity data. Industrial production fell sharply and the rebound in consumption was not enough to offset that weakness. Given the downside risk from property and Covid, Beijing should be shifting to an easier fiscal and monetary stance by year-end. In that case, infrastructure investment and total credit would be bottoming soon, and local equity markets could be already in the process of discounting that. The big question mark is whether the authorities will manage to engineer the kind of sustainable and significant turnarounds witnessed in the past, otherwise market rallies would have limited scope.

Stay safe.

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