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China's Stimulus, A Strong US Economy, and Counterparty Risk Drive "Bipolar" Markets

In the last month, and in particular during the last couple of weeks, we have observed an unusual combination in price action, with a rise in equity and sovereign yields and at the same time an increase in gold and oil prices, thus breaking historical correlations and preparing the ground for an inevitable correction.

Let's start with *equity markets*. If we look at the performance of the major indices in the last month, the MSCI World Index has gained 5.11%, around a third of the 16.7% growth it has recorded year-to-date. The S&P 500 has gained 6.3%, which is about a third of its 20.6% gain since the beginning of the year, while the Eurostoxx 50 has gained 4.6%, half of the 9.6% it has gained since January 2024. But the real stars of the last month have been the Chinese indices. Hong Kong's Hang Seng has gained 30.3% in a month, making up almost the totality of the 33.4% increase it has recorded since January. In mainland China, the Shanghai stock index has managed to reverse its previous decline: a 20.6% increase in the last month has brought its yearly performance into positive territory, with a 12.5% gain year-to-date.

As equity indices were rising, *sovereign bond yields also rose*. When, in mid-September, the Fed decided to cut the benchmark Fed funds rate by 50bps, surprising the market to the upside, yields initially fell: the 2-year US Treasury yield dropped from 4.00% to 3.50%, while the 10y UST yield initially fell before rising back up in consideration of the reduced risk to growth (and potentially the higher risk to inflation) deriving from the move. But in the last couple of weeks, the 2y UST yield has been rising more markedly, reaching 3.92% on Friday, after the higher than expected Non-Farm-Payroll figure for September. Meanwhile, the 10y UST yield has also reached 3.97% over the same period.

In the *commodity space*, gold has continued to beat all previous records. One year ago the gold bullion was just over $2000, and one month ago it was $2500. In late September it reached $2706, and is now trading at $2673. This movement represents a rupture to the historical norm (or more simply correlation) that sees a rise in UST yields associated with a fall in gold prices (as gold does not pay interest and does not guarantee a return). Meanwhile, Brent oil prices have increased from $69 per barrel in early July, and is now trading at $79.

The most interesting question is what is behind this bipolar – one could say schizophrenic – behaviour of markets, which on the one hand exhibit the typical risk-on features (higher equity and oil prices and bond yields) and on the other hand shows a record-high level of risk aversion? There are several factors at play here, which can explain this unusual combination of price actions.

First, the US economy, which seemed on the verge of a recession until the summer, is actually proving much stronger than expected, as testified by the 354K increase in NFP in September, much higher than the 140K consensus or the previous reading of 159K. This has served to dissipate the doubts that the Fed had cut rates by more than expected in September as a sign of panic for the rapidly deteriorating economy. By the way, the larger-than-expected cut (and the consequent decline in bond yields) did provide a boost to risky asset prices.

Second, the massive monetary stimulus introduced by Chinese authorities in the two weeks preceding the country's October 1st National Day celebration (which opens up the so-called golden week) helped push Chinese equity markets up, and boost all other equity indices, driven by an expected improvement in the Chinese economy as well as a much-needed kick to the luxury sector in developed economies.

On the other hand, in the commodity space, the rise in gold prices signals the increased risk aversion by investors, which observe a combination of nasty geopolitical developments, with no end in sight, in both the Middle East and Ukraine, as well as the risk of higher inflation, as well as deflation, ahead. Gold is traditionally considered a good hedge against inflation, but offers even better protection in case of deflation, being an asset with no corresponding liability (as in the case of equities or bonds), and therefore offering protection against counterparty risk.

The rise in oil prices can be explained by a combination of two opposing forces conjoining to send them higher. On the one hand, stronger than expected global demand (from both US and China) incentivise oil production and consumption. On the other hand, rising geopolitical tensions, especially in the Middle East, lead to higher oil prices, as people expect reduced supply, in particular possibly from Iran.

Looking Ahead

The Week Ahead: Headline Inflation To Fall In US And Germany; Retail Sales To Rise In EZ

In the US, in September, headline inflation rate is expected to ease off to 2.3% y-o-y (*p*: 2.5%). On a monthly basis, inflation is also likely to cool off to 0.1% (*p:* 0.2%). In October, Michigan Consumer Sentiment is seen remaining at 70.1.

In the EZ, in August, retail sales are expected to rise by 0.2% m-o-m (*p:* 0.1%).

Among the largest EZ economies, headline inflation rate is seen easing off to 1.6% y-o-y (*p*: 1.9%) in Germany.

In the UK, in August, IP is expected to rise by 0.2% m-o-m (*p:* -0.8%).

The Quarter Ahead: Iran Awaits Retaliation from Israel; EU Approves 45% tax on Chinese Electric Cars

Oil prices spiked over fears that escalating conflict in the Middle East could disrupt global crude supplies. Concerns center on Israel possibly targeting Iran's oil infrastructure, which could provoke retaliation. When asked about Israel striking Iran's facilities, President Biden said discussions are ongoing, but no action is imminent. While OPEC has enough capacity to offset a full loss of Iranian oil, it would struggle if Iran retaliates against Gulf neighbors' installations.

The EU approved tariffs of up to 45% on Chinese electric vehicles to counter Beijing's subsidies, despite opposition from Germany. Von der Leyen emphasized the importance of the EV sector for Europe's competitiveness. However, German automakers like Mercedes-Benz and BMW criticized the decision, warning of negative consequences and calling for continued talks with China.

Last Week's Review

Real Economy: Strong NFP Figures in the US, EZ Inflation Falls; UK GDP decelerates

In the US, in September, unemployment rate edged down to 4.1% (*c:* 4.2%; *p:* 4.2%). NFPs rose by 254K (*c:* 140K; *p:* 159K). In September, S&P Global Manufacturing and Services PMI declined to 47.3 (*c:* 47; *p:* 47.9) and 55.2 (*c:* 55.4; *p*: 55.7). Composite PMI declined to 54.0 (*c*: 54.4; *p*: 54.6).

In the EZ, in September headline and core inflation rate fell to 1.8% y-o-y (*c:* 1.9%; *p:* 2.2%) and at 2.7% y-o-y (*c:* 2.8%; *p:* 2.8%). In August, unemployment rate stayed unchanged at 6.4% as expected. In September HCOB Manufacturing and Services PMI decreased to 45.0 (*c*: 44.8; *p:* 45.8) and to 51.4 (*c:* 50.5; *p*: 52.9). Composite PMI declined as well to 49.6 (*c:* 48.9; *p*: 51.0).

Among the largest EZ economies, according to the preliminary estimates, inflation rate: *i)* fell to 0.7% y-o-y (*c:* 0.8%; *p:* 1.1%) in Italy; *ii)* eased off further to 1.6% y-o-y (*c:* 1.7%; *p:* 1.9%) in Germany.

In the UK, in Q1, GDP growth rate decelerated to 0.5% q-o-q (*c:* 0.6%; *p:* 0.7%) and advanced by 0.7% y-o-y (*c:* 0.9%; *p:* 0.3%). In September, S&P Global Manufacturing and Services PMI decreased to 51.5 (*c*: 51.5; *p*: 52.5) and 52.4 (*c*: 52.8; *p*: 53.7). Composite PMI fell to 52.6 (*c:* 52.9; *p*: 53.8).

Financial Markets: Stock Prices Are Mixed; Yields Edged Up; Dollar Increased; Oil And Gold Prices Increased

Market Drivers: Surprise job gains boosted stocks in the US, overcoming Middle East tensions. However, in Europe, major stocks fell amid investor caution as a result of the escalations of conflicts in the Middle East. US Treasury yields reached a two-month peak, after a stronger-than-expected job market changed expectations for future rate cuts.

Global Equities: Decreased *w-o-w* (MSCI ACWI, -0.6%, to 847.40). The US S&P 500 index rose (+0.2% w-o-w, to 5,751.97). In the EZ, share prices decreased (Eurostoxx 50, -2.2% w-o-w, to 5,068.55). In EMs, equity increased (MSCI EMs, +0.4%, to 1,179.34). Volatility decreased rose marginally to 20.40 (VIX S&P 500, 52w avg.: 14.6; 10y avg.: 18.1).

Fixed Income: *w-o-*w, the 10-year US Treasury yields rose (22 bps to 3.97%). The 2-year US Treasury yields edged up (+36 bps to 3.92%). The German 10-year bund yields increased (+7 bps to 2.21%).

FX: *w-o-w,* the US Dollar Index increased (DXY, +2.1%, to 102.52; EUR/USD -1.7%, to 1.10). In EMs, currencies declined (MSCI EM Currency Index, -0.5% w-o-w, to 1,780.90).

Commodities: *w-o-w,* oil prices jumped (Brent, +9.2% to 78.14 USD/b). Gold prices increased w-o-w (+0.2% to 2,673.20 USD/Oz).

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The picture in the first page has been taken by this website.

Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	M5S	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year