

Six key themes impacting markets today



Kristina Hooper
Chief Global Market Strategist



Geopolitical risk

Global stocks didn't experience the big sell-off many feared would occur last week, despite the rise in geopolitical risk since Hamas' attack of Israel.

Monetary policy

There is still uncertainty about the path of monetary policy, with the focus on when US Federal Reserve rate cuts will begin and how many we will get in 2024.

Chinese economy

The Chinese economy continues to show mixed results, with weakness in parts such as the property sector but resilience in other parts.

Weekly Market Compass | October 16, 2023

After another week headlined by uncertainty, confusion, and chaos, I thought it would be helpful to take a step back and think about the key themes affecting economies and markets today. Below, I discuss six of these themes.

1. Markets are becoming somewhat desensitized to geopolitical risk

Global stocks didn't experience the big sell-off many feared would occur last week,¹ despite the rise in geopolitical risk since Hamas' attack of Israel. Just as markets have become desensitized to US government shutdowns, they have become somewhat desensitized to geopolitical conflicts.

That's not to say that geopolitical risks have no impact on markets. There has been an increased preference for perceived "safe haven" asset classes as concerns persist that the Israel-Hamas war will not remain contained and that other countries will get involved.

Demand for US Treasuries caused prices to rise and yields to fall, with the yield on the 10-year US Treasury dropping to 4.629% over the course of last week.² In addition, the price of gold has risen by nearly \$100 since the attack.²

And it goes without saying that geopolitical risks are exacerbated by the lack of a Speaker in the US House of Representatives. Kevin McCarthy was removed from that position on Oct. 3 — the first time in history that the House has voted to remove a Speaker — and the debate over his replacement continues.

2. Central banks are still driving markets

Central banks, especially the US Federal Reserve (Fed), have been driving markets for years — and that still continues today. Perhaps that's a good thing right now since it means we're unlikely to see market destabilization caused by geopolitical risk. But we also have to hope that central banks won't destabilize markets themselves with words and dot plots...

The good news is that "Fedspeak" in the past week has been more dovish. More Federal Open Market Committee (FOMC) members have echoed the words of San Francisco Fed President Mary Daly, who said that tightening financial conditions are doing much of the Fed's work for it (meaning further rate hikes shouldn't be necessary to control inflation).

However, there is still uncertainty about the path of monetary policy — with the focus on when Fed rate cuts will begin and how many we will get in 2024. That's because the minutes from the September FOMC meeting have made it clear that the Fed remains very data dependent: "All participants agreed that the Committee was in a position to proceed carefully and that policy decisions at every meeting would continue to be based on the totality of incoming information and its implications for the economic outlook as well as the balance of risks."³

Stocks and bonds are likely to continue trading in a range — albeit rather wide — until we get clarity on Fed policy going forward.

3. The US economy continues to show resilience

The International Monetary Fund (IMF) upgraded its forecast for US economic growth to 2.1% in 2023 and 1.5% in 2024 (a substantial upward revision from the 1% it forecasted in July).⁴

But perhaps because of the resilience of the US economy, fears of inflation resurgence are still alive and well. The US Consumer Price Index (CPI) reading for September⁵ was slightly higher than expected. Headline CPI rose 0.4% month over month and 3.7% year over year. Core CPI, which excludes food and energy prices, rose 0.3% month over month and 4.1% year over year.

As I have cautioned before, not every inflation-related data point will be perfect. However, in my opinion, the trend is clear: Inflation readings are improving, and the disinflationary process continues. Some areas of inflation will be stickier than others. However, concerns over the September inflation print drove US dollar strength later in the week. For example, inflation hawks are focused on the stickiness of “supercore” inflation, which excludes housing prices as well as prices for food and energy. I think these inflation hawks may be missing the forest for the trees. In taking a step back, I see a US economy that is on solid footing but slowing and bringing inflation along with it.

4. The economy remains a mixed bag in China

The Chinese economy continues to show mixed results, with weakness in parts such as the property sector but resilience in other parts.

For September, Chinese monthly exports and total social financing flows beat expectations, but consumer prices were flat from a year ago while producer prices dropped 2.5% year over year, suggesting weakened demand.⁶ And there continue to be significant concerns about the property sector given missed debt payments by real estate developers.

Market sentiment could start to improve as policymakers continue to offer targeted policies to stabilize the markets, such as the recent China state wealth fund purchase of shares in four major banks and the potential rollout of a Stabilization Fund. Last week, the IMF downwardly revised its forecasts for Chinese economic growth — but it is still at a solid 5% for 2023 (and 4.2% in 2024).⁷

5. An interesting dynamic emerges with oil prices

Both elevated valuations and uncertainty about the global economy are likely to prevent energy prices from rising much more in the short term. In addition, signs emerged weeks ago that higher oil prices have led to some reduction in demand:

“Supply fears gave way to deteriorating macroeconomic indicators and signs of demand destruction in the United States, where gasoline deliveries plunged to two-decade lows. Demand destruction has hurt emerging markets even harder, as currency effects and the removal of subsidies have amplified the rise in fuel prices.”⁸

I assume these pressures will result in some volatility around a relatively elevated price level; the key takeaway is that there is likely to be a ceiling on oil prices.

6. US earnings season is off to a solid start

S&P 500 blended earnings growth (actual earnings and estimated earnings for those companies that have not yet reported) for the third quarter has improved slightly since the end of September thanks to a good start to earnings season. At the end of September, the estimated earnings growth rate for the S&P 500 for the third quarter was -0.3%.⁹ As of last Friday, the blended earnings growth rate had improved to 0.4%.⁹

It's important to keep in mind that only 6% of companies have actually reported earnings thus far, but 84% of those have reported better-than-expected earnings (largely from the financials sector).⁹ We will get a better sense of third quarter earnings this week, as there are more than 50 S&P 500 companies expected to report including more companies from the financials sector, some major airlines, and Tesla, Schlumberger, and Netflix.

Dates to watch

Looking ahead, I will be focused on ZEW Economic Sentiment indexes for Germany and the Eurozone. Inflation readings from Canada, the eurozone, the UK, and Japan will be very important for their monetary policy implications. In the US, I will be paying attention to retail sales, industrial production and existing home sales. It's a big week for China, with gross domestic product (GDP), unemployment, and industrial production to be released. I will also be very interested in the anecdotal information provided in the Federal Reserve Beige Book — I can often glean important insights from this publication.

With contributions from David Chao and Andras Vig

| Date | Report | What it tells us |
|---------|---------------------------------|--|
| Oct. 17 | German ZEW Economic Sentiment | Measures opinions on the direction of the economy for the next six months. |
| Oct. 17 | Eurozone ZEW Economic Sentiment | Measures opinions on the direction of the economy for the next six months. |
| Oct. 17 | Canada CPI | Tracks the path of inflation. |
| Oct. 18 | Eurozone CPI | Tracks the path of inflation. |
| Oct. 18 | UK CPI | Tracks the path of inflation. |
| Oct. 19 | Japan CPI | Tracks the path of inflation. |
| Oct. 17 | US retail sales | Measures consumer demand. |
| Oct. 17 | US industrial production | Indicates the economic health of the industrial sector. |
| Oct. 19 | US existing home sales | Indicates the health of the housing market. |
| Oct. 17 | China GDP | Measures a region's economic activity. |
| Oct. 17 | China unemployment | Indicates the health of the job market. |
| Oct. 17 | China industrial production | Indicates the economic health of the industrial sector. |
| Oct. 18 | Federal Reserve Beige Book | Summarizes anecdotal information on current economic conditions in each of the Fed's 12 districts. |

Notes

¹Source: Refinitiv Datastream and the Invesco Global Market Strategy Office

²Source: Bloomberg, as of Oct. 13, 2023

³Source: September FOMC Meeting minutes

⁴Source: International Monetary Fund World Economic Outlook, October 10, 2023

⁵Source: US Bureau of Labor Statistics, as of October 12, 2023

⁶Source: China National Bureau of Statistics, October 13, 2023

⁷Source: International Monetary Fund World Economic Outlook, October 10, 2023

⁸Source: International Energy Agency monthly report

⁹Source: Factset Earnings Insight, October 13, 2023

Important information

Past performance is not a guarantee of future results.

There is no guarantee that forecasts/estimates will come to pass.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

The Federal Reserve's "dot plot" is a chart that the central bank uses to illustrate its outlook for the path of interest rates.

An earnings estimate (or estimated earnings) is an analyst's forecast for a public company's future quarterly or annual earnings per share (EPS).

The Eurozone (also known as the euro area or euroland) is an economic and monetary union of 18 European Union member states that have adopted the euro (€) as their common currency.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

Inflation is the rate at which the general price level for goods and services is increasing.

The International Monetary Fund (IMF) is an international organization that promotes global economic growth and financial stability, encourages international trade, and reduces poverty.

Headline inflation is the raw inflation figure reported through the Consumer Price Index (CPI) that is released monthly by the Bureau of Labor Statistics.

Core inflation is the change in the costs of goods and services, but it does not include those from the food and energy sectors. This measure of inflation excludes these items because their prices are much more volatile.

Dovish refers to an economic outlook which generally supports low interest rates as a means of encouraging growth within the economy.

GDP (Gross domestic product) is a broad indicator of a region's economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

Safe havens are investments that are expected to hold or increase their value in volatile markets.

Tightening monetary policy includes actions by a central bank to curb inflation.

The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity.

The opinions referenced above are those of the author as of October 16, 2023. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.