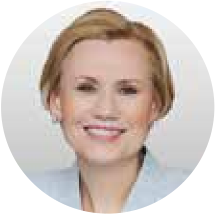
Global market roundup: Manufacturing, earnings season, inflation, and more

Weekly Market Compass | October 30, 2023



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Manufacturing weakness

Purchasing Managers' Indexes painted a weaker picture for manufacturing in Japan, the eurozone and the UK.

Treasury yields

The 10-year US Treasury yield continued its roller coaster ride as a wide range of factors contributed to big swings in this key data point.

Earnings season

So far, companies who beat 3Q earnings expectations have not generally been rewarded by markets, but earnings misses have been punished.

Data reports came in fast and furious last week. In some cases they provided clarity, and in other cases, they simply contributed to mixed signals. Landing on the side of clarity: Purchasing Managers' Indexes painted a weaker picture for manufacturing in Japan, the eurozone, and the UK. In terms of mixed signals, the 10-year US Treasury yield continued its roller coaster ride as a wide range of factors contributed to big swings in this key data point. I also discuss earnings season, fiscal policy in China, US inflation, and, of course, central banks.

Manufacturing looks weaker in Japan, the eurozone and the UK

We got a flurry of Purchasing Managers' Index (PMI) readings last week for a variety of different economies. I'm always interested in PMI surveys because they give us a snapshot on the state of an economy.

- **Japan.** Japan's flash PMI readings[1] for October showed us a bifurcated economy where the services sector is stronger than the manufacturing sector. Manufacturing PMI clocked in at 47.6, which is in contraction territory. Services PMI was 51.1, which is down from last month's reading of 53.8 but is still in expansion territory, no doubt helped by fiscal stimulus and the accommodative monetary policy environment.
- **Eurozone.** The eurozone economy is under significant pressure, with flash composite PMI[2] at a 35-month low. There is greater weakness in the manufacturing PMI at 43.1. Services PMI is better at 47.8, but remains in contraction territory. Of particular note is the extreme weakness in Germany's manufacturing PMI, which clocked in at 41.4. Dr. Cyrus de la Rubia, Chief Economist for the Hamburg Commercial Bank, which conducts the PMI survey, explained: "In the Eurozone, things are moving from bad to worse. Manufacturing has been in a slump for sixteen months, services for three, and both PMI headline indices just took another hit. In addition, all subindices point very consistently downwards, too, with only a few exceptions." He said he wouldn't be surprised to see a "mild recession" in the eurozone in the second half of this year.
- **UK.** The weaker manufacturing picture can also be seen in the UK, where manufacturing PMI was 45.3 while services PMI was 49.2.[3] Both are in contraction territory, but manufacturing is in much worse shape — although it seems to be becoming an increasingly challenging environment for the UK consumer.

10-year US Treasury yield continues its roller coaster ride

The 10-year US Treasury yield[4] rose to 5.02% early on Oct. 23, but closed the day significantly lower. On Oct. 26, the yield again moved higher, only to finish the week at 4.83%, likely on increased demand for Treasuries as a "safe haven" asset class with the Israel-Hamas war intensifying. It's likely to continue moving in a wide range given the many different factors impacting the 10-year yield and the lack of clarity from the US Federal Reserve (Fed) on monetary policy.

Markets seem to be ignoring better-than-expected earnings

Third-quarter earnings season[5] is in full swing. In the US, 78% of S&P 500 companies have reported a positive earnings-per-share surprise and 62% have reported a positive revenue surprise (49% of S&P 500 companies have reported earnings thus far).

In Europe, 57% of Stoxx600 companies have beaten earnings estimates so far, while in Japan, 58% of Topix companies have beaten earnings estimates. There are still more companies yet to report, but the key takeaway thus far is that, in general, companies that beat earnings expectations are not being rewarded by markets, but earnings misses are being punished.

China plans to boost fiscal spending targets

Chinese policymakers have announced a significant increase in debt to fund targeted fiscal spending.[6] We don't have a lot of specifics, but we can assume that this signals a focus on accelerating economic growth despite it already seeming to be on track to meet the government's 5% gross domestic product (GDP) growth objective. Just as targeted fiscal spending thus far has been positive for consumer sentiment and spending, I expect this should do the same but even more substantially.

US inflation tame but economy shows strength while inflation expectations rise significantly

There were no surprises with the Fed's most watched gauge of inflation, core Personal Consumption Expenditures. It rose 0.3% month-over-month for September, which was in line with expectations, and 3.7% year-over-year.[7] This enabled markets to heave a sigh of relief, as this print did not conflict with the thesis that the disinflation process remains underway.

However, there were a few flies in the ointment last week. The third quarter GDP print showed a robust economy powered by the American consumer. However, that reflects consumer spending before the reinstatement of student loan payments. We are starting to see signs that the consumer is weakening on the margins — for example, auto loan delinquencies are on the rise — and that should result in some softening of demand going forward.

Then came the University of Michigan consumer inflation expectations reading for October, which showed that inflation expectations have risen dramatically for the one-year ahead period and modestly for the five-years ahead period.[8] Short-term inflation expectations are typically more volatile and are often driven by energy prices. We saw a similar spike in one-year ahead inflation expectations from March to April 2023, when there also was a major increase in the price of crude oil.

It's important to note that the Fed pays close attention to inflation expectations, although it is focused on ensuring that longer-term inflation expectations (rather than shorter-term ones such as the one-year reading) are "well anchored." Given its focus on the longer-term data, I would not expect the Fed to hike rates at its November meeting despite the higher inflation expectations print.

Central banks keep rates steady in Canada and Europe

Last week, the Bank of Canada and then the European Central Bank (ECB) decided to keep policy rates static. For Europe, this comes after 10 consecutive rate hikes. ECB President Christine Lagarde recognized that the risks to economic growth lean to the downside (but she was quick to note that any discussion on rate cuts is very premature).

Over the last several years, the Bank of Canada has been at the vanguard of monetary policy moves, so it seems fitting that its decision last week to keep rates steady for two meetings in a row following 10 rate hikes preceded a similar decision from the ECB — and I believe it's likely to foreshadow a similar decision from the Fed this week. The Bank of England and Bank of Japan also meet this week.

An important life lesson

I would be remiss if I didn't note the passing of veteran strategist Byron Wien last week. I was lucky enough to be in his company a few times over the last three decades, and I was struck by his wisdom, his humor, and his commitment to mentoring. I am particularly inspired by this piece of wisdom from his 20 Life Lessons: "When your children are grown or if you have no children, always find someone younger to mentor. It is very satisfying to help someone steer through life's obstacles, and you'll be surprised at how much you will learn in the process."

Dates to watch

The data reports aren't slowing down. See below for a list of what I'm watching. And on Nov. 1, join me on X, formerly known as Twitter, as I share my real time views of the Federal Open Market Committee interest rate decision and key takeaways from Fed Chair Jay Powell's press conference as it happens.

Date	Report	What it tells us
Oct. 31	Eurozone CPI	Tracks the path of inflation.
Oct. 31	Eurozone GDP	Measures a region's economic activity.
Oct. 31	US Employment Cost Index	Measures the change in total employee compensation each quarter.
Oct. 31	Canada GDP	Measures a region's economic activity.
Oct. 31	US S&P CoreLogic Case-Shiller Home Price Index	Measures US residential home prices.
Oct. 31	Bank of Japan monetary policy decision	Reveals the latest decision on the path of interest rates.
Nov. 1	US PMIs (ISM)	Indicates the economic health of the manufacturing and services sectors.
Nov. 1	US Job Openings and Labor Turnover Survey (JOLTS) Report	Gathers data related to job openings, hires, and separations.
Nov. 1	Federal Open Market Committee (FOMC) meeting	Reveals the latest decision by the US Federal Reserve on the path of interest rates.
Nov. 2	Bank of England monetary policy decision	Reveals the latest decision on the path of interest rates.
Nov. 3	US jobs report	Indicates the health of the job market.

Date	Report	What it tells us
Nov. 3	Canada jobs report	Indicates the health of the job market.
Nov. 3	US PMIs (S&P Global)	Indicates the economic health of the manufacturing and services sectors.
	Earnings season continues…	

Notes

[1]Source for all Japan PMI data: S&P Global / AuJibun

[2]Source for all eurozone and German PMI data and quotes: S&P Global/HCOB

[3]Source: S&P Global

[4]Source for all US Treasury yield information: Bloomberg, L.P., as of Oct. 26, 2023

[5]Source for all earnings season information: Factset Earnings Insight, JP Morgan Earnings Season Tracker

[6]Source: Reuters

[7]Source: US Bureau of Economic Analysis

[8]Source: University of Michigan Survey of Consumers, October 2023

Important information

Past performance is not a guarantee of future results.

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.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

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

A basis point is one hundredth of a percentage point.

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.

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

Purchasing Managers' Indexes (PMI) are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Expenditures included in the index are actual U.S. household expenditures.

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.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

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

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 S&P CoreLogic Case-Shiller Home Price Indices are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate nationally.

Stoxx600 is an index that measures the performance of 600 large, mid, and small-capitalization companies from 17 countries in Europe: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

The Tokyo Price Index — commonly referred to as TOPIX — is a metric for stock prices on the Tokyo Stock Exchange (TSE).

The opinions referenced above are those of the author as of October 30, 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.