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Melting Up!

Macro Overview

US

With the Fed all but calling an end to their historic rate hike cycle and forecasting more rate cuts in 2024 than previously expected, US stocks extended their gains to close higher for the 7th week in a row. Laggards, small-cap Russell 2000 and the mid-cap S&P 400 led the gains for pretty much the whole week, underpinning the broadening of the rally beyond just big Tech. Both the Dow Jones Average and the Nasdaq 100 hit record highs. In terms of flows, money-market funds had their first outflow since October in the week ended Dec. 13, while equities had their largest eight-week inflows since March 2022, according to EPFR Global data cited by Bank of America Corp. Fed chair Jerome Powell said in a prepared statement that interest rate policy is "at or near peak," a pivot that fuelled the rally.

Thursday's Fed FOMC gave us the following takeaways:

- They are estimating 3 rate cuts in 2024 from 2 previously – [presumably 25 bps each for a total of 75 bps]
- They estimate inflation which is currently at 3.1% (headline CPI) to end under 3% by year's end and falling to 2.4%, 2.1% and 2.0% respectively in 2024, 2025 and 2026
- GDP is expected at 2.6% for 2023, 1.4% in 2024, 1.8% in 2025 and 1.9% in 2026.
- They expect the unemployment rate to rise from 3.7% currently to 4.1% in 2024/2025.

In other words, no recession is expected but a soft landing is their base case. However, in contrast across the Pond, the ECB and the BOE held rates unchanged with no language alluding to cuts just yet.

Still, a minority of Fed-speak cautioned against "premature" thinking about a rate cut in March (NY's Williams) whilst Atlanta's Bostic said he expects two rate cuts next year, but not starting until the 3rd quarter.

The economy's resilience this week came in the form of stronger than expected retail sales gaining 0.3% MoM against estimates for -0.1% and jobless claims, which fell more than expected by -19,000 to 202,000.

Earlier in the week, CPI showed that inflation continues to ease although the decline does seem to be slowing. Core MoM CPI ticked up slightly to 0.3% from 0.2% whilst the YoY data remained unchanged at 4.0%.

PPI which came in the next day was notably lower across the board. In the final week ahead of Christmas, we have key PCE Deflator reports, GDP revisions, personal spending U. of Mich. Inflation and sentiment expectations. Load up on your Put bullets soon.

Bitcoin posted its steepest drop in almost four months as traders moved to lock in profits following a more than 150% rally this year, triggering large liquidations of bullish bets. "Market leverage had risen materially," reported an analyst, "The current fall looks like a market deleveraging as opposed to any fundamental news catalyst." Ether was also lower trading just below $2,300.

EUROPE

European markets closed slightly higher on Friday, rounding out a positive week after a series of key policy decisions from major central banks. The pan-European Stoxx index ended up 0.1%, having given back earlier gains of around 0.5%. Mining stocks climbed 1.3% while telecoms dropped 0.8%. It gained 0.91% on the week in its 5th consecutive week of gains.

Last week's flash PMI disappointed, falling 0.6pt to 47.0, signalling a 7th consecutive monthly reduction in business activity across the euro area. Manufacturing continued to lead the downturn, accompanied by a steepening stop in service sector output.

Separately, Euro Area industrial production was down 0.7% m/m and manufacturing was down 0.5% m/m.

The ECB kept rates unchanged at 4% and maintained its data dependent approach to future meetings. Even though the press conference focused mainly on expectations around rate cuts but President Lagarde had pushed back on market pricing by highlighting the importance of wage developments in 1H24 and cautioning against claiming victory against inflation.

What changed during the ECB meeting was the forward guidance on PEPP reinvestments. It will continue in full in the first half of 2024 while the second half of 2024 the PEPP portfolio will be reduced on average by 7.5billion euro per month, amounting to an average of 50% decline in reinvestments during that time. All the reinvestments will end by 2024.

The projections for growth came in line with expectations, with 2024 revised down to 0.8% and 2025 remained unchanged at 1.5%. The inflation forecast is down for 2024 (headline and core at 2.7%), on the back of weaker-than-expected data until November. But headline inflation for 2025 was kept unchanged and above target (2.1%), with core (2.3%), stronger than in September.

ASIA

Asia markets closed the week higher MSCI Asia ex Japan was up 3%! Risk sentiment improved as the week wore on after the US Fed signalled as many as three rate cuts next year. China's CSI 300 however continued its pullback, down 1.7%, taking YTD numbers to -13.24% as worries of the health of the Chinese economy dragged sentiments. Chinese economic data had tilted to the downside with November's retail sales missing forecasts, adding to a deflationary headline CPI, and, while industrial output data was encouraging, construction and property investment was weakened. House prices in November also fell again on a m/m basis. China credit data came softer than expected with slower M1 growth furthered widening the gap vs M2. To support the economy, the PBOC injected a record amount of cash into the financial system Friday, helping property stocks to surge and send the Hang Seng significantly higher.

Chinese leaders agreed at an annual meeting on the economy last week to run a budget deficit of 3% of gross domestic product in 2024. The deficit figure is lower than this year's revised 3.8% target, suggesting Beijing wants to maintain fiscal discipline and is not considering a big fiscal bazooka next year. The leaders agreed to a proactive fiscal policy for 2024 and also look to spur domestic demand. China plans a new round of fiscal and tax reforms and the government is looking to improve the structure of fiscal spending to support strategic tasks, state media said, without giving details.

China's government advisers have told Reuters that they would recommend economic growth targets for 2024 ranging from 4.5% to 5.5%, with the majority favouring a target of around 5% - the same as this year. Fitch Ratings said it has neutral outlook on China's economy in 2024, expecting a growth rate of 4.6%, down from 5.3% this year, while flagging persistent property sector woes.

The Bank of Japan's December Tankan Survey showed strong corporate momentum for both manufacturers and nonmanufacturers, with all firms' business sentiment rising 3pts to 13, marking the highest level since 4Q18.

This reflects higher unit labour costs down the road because of stronger wages and lower productivity, a view of the world that might reflect fear of upside risks for inflation and raises the stakes for early rates cuts.

Similarly, ***BoE kept rate on hold as well at 5.25%,*** with the vote split at 6:3 where 6 members voted for a no change while 3 members voted to increase the rate to 5.5%, which was unchanged from November. The forward guidance remained unchanged. In the minutes, it said that rates would need to stay higher "for sufficiently long" to return inflation to 2% which contrasts with the FOMC which suggested that interest rates could fall significantly next year.

While the December MPC came broadly in line with expectations, the UK duration rally had been remarkable over the past week, supported by weaker-than-expected economic data and a dovish FOMC.

This week will be seeing HICP final final together with preliminary consumer confidence data in Europe.

Japan core machinery orders unexpectedly rose, marking a positive start to Q4. The Bank of Japan (BOJ) will begin to unwind its ultra-loose monetary settings as early as January, according to expectations by economists in a Reuters poll, heightening expectations the controversial policy era is near an end.

South Korea will provide 38 trillion won ($29 billion) in financing to strengthen its battery industry over the next five years, as global competition to secure battery supply chains remains fierce.

South Korean battery firms like LG Energy Solution, Samsung SDI and SK On, a unit of SK Innovation, held a 49 per cent share of the global battery market excluding China as of 2022. The country plans tax incentives and loan support for South Korean firms investing overseas to secure mining rights. It also plans to increase financial support such as loans, guarantees and insurance from institutions like the Export-Import Bank of Korea to battery industry firms, including those investing in North America to meet the terms for tax allowances under of the U.S. Inflation Reduction Act (IRA).

The BOK said today said it would keep its restrictive stance for a 'considerable' time. Korea's employment decreased by 0.3%m/m in November, reversing about half of its gains over the prior three months. The Philippines central bank last week kept rates on hold but warned of upside risks to consumer prices. Philippines exports shrank again while imports also fell but at a reduced rate than in recent months. Australian employment growth beat forecasts, but the jobless rate rose by more than expected. New Zealand Q3 GDP unexpectedly contracted, reinforcing a dovish rate outlook there. India wholesale inflation rose by more than expected and rebounded from a contraction in October. India's November CPI climbed less than expected to 5.6%. Malaysia industrial output bounced back by more than expected but retail sales growth fell to an almost two-year low. Indonesia Nov trade surplus narrowed as oil imports rose.

GeoPolitics

Israel: Visiting Tel Aviv, US National Security Advisor Jake Sullivan has reportedly told Prime Minister Netanyahu that Israel's war in Gaza needs to "transition to the next lower intensity phase in a matter of weeks, not months." Netanyahu says he told Sullivan that Israeli troops will fight "until full victory." Separately, Israel war cabinet minister tells Blinken they will need to remove threat of Hezbollah to the north. Many in Israel see Hezbollah as a greater threat than Hamas and consider a new war in Lebanon to be inevitable.

China – Vietnam: Chinese leader Xi Jinping made a trip to Vietnam last week. He will be seeking closer relations with his neighbour to the south—just as the US tries to nudge itself between the two. That trip took Washington's relations with Hanoi up a notch, which is just what Xi is trying to do through upgraded railroad links and other infrastructure incentives. ***China and Vietnam signed 37 agreements, including Beijing funding a cross-border railway link and holding joint maritime patrols.*** Xi's trip comes just weeks after US president Joe Biden's visit to Vietnam in September. Beijing and Washington are both competing for influence in the country. ***Vietnam's job is to thread the needle, staying in the good graces of both the US and China while maintaining sovereignty over its own affairs.*** That geopolitical love triangle will be difficult to maintain.

US – China: Treasury Secretary Janet Yellen said she plans to visit China again in 2024 to deepen cooperation and improve communication with Beijing while focusing on "difficult areas of concern". Yellen reiterated Washington to continue with export controls and investment restrictions while engaging China to prevent wider crises.

Nvidia CEO visited Vietnam affirming the company's desire to develop Vietnam's semiconductor ecosystem, and Fitch upgraded Vietnam rating from 'BB' to 'BB+' with a stable outlook. Vietnam's equities are now on track to end 2023 in positive territory, and the performance is likely to carry forward to next year based on its monetary policy, historical performance, and growing significance in the globe.

Credit/Treasuries

The 5-30 US Treasury yield curve is now almost normalized.

GV Ask/Chg					
2Y	4.441	-0.003	7Y	3.950	+0.012
3Y	4.123	+0.004	10Y	3.930	+0.020
4Y	4.013	+0.003	20Y	4.215	+0.024
5Y	3.917	+0.009	30Y	4.032	+0.024

Latest October PCE Core Deflator, favorite Fed inflation indicator, printed on the 30th of November at 3.50% YoY. It means that current real yield, using current mid-Fed fund of 5.375%, currently stands at 1.875%. Based on latest Fed SEP's announced last week, the Fed believes that PCE Core will end up at 2.40% at the end of next year. If the Fed is targeting a stable real yield for short term interest rates moving forward, the Fed might have to cut Fed Fund rates by 4.1x next year, but based on the Dot Plots announced last week, they currently forecast 3 rate cut of 25bps each for next year. The market is currently pricing about 5.7 rate cuts for next year. Market expectations were slightly above 6 cuts in 2024, right after the FOMC mid-last week, but expectations came down a little after the better-than-expected November Retail Sales as well as the better initial jobless claims and continuing claims.

After falling for most part of last week, interest rates and especially the 2years US Treasury yield, rebounded slightly last Friday after New York Fed President John Williams said it's too early for officials to begin thinking about lowering borrowing cost. So, following this very last busy week of the year, except the big BOJ meeting tomorrow, ***the US Treasury curve shape remained mostly unchanged even though all points on the curve moved drastically lower following the more dovish FOMC last week.*** The 2year yield lost 27bps, 5years lost 34bps, 10years & 30years lost 32bps.

Risk was well supported as IG & HY US credit spreads tightened by respectively 4bps & 33bps. US HY credit spreads are now trading at +367bps, their tightest level since March 2022 or when the Fed started tightening their monetary policy. It seems that the market is currently pricing a goldilocks scenario of an immaculate soft landing, which was very seldom achieved in the past when tightening and speed of that magnitude happened. The alignment of dovish Fed rhetoric's combined with market optimism supported very strong performances of fixed income assets last week, with IG gaining 3.20% over the week, HY gained almost 2% and leverage loans gained 40bps. So, in a way, Christmas came early for financial markets this year.

FX

DXY USD Index fell 1.4% to close the week at 102.55, driven by a dovish Fed.

The FED left rates unchanged, but the latest dot plot indicated a 75 bps rate cuts in 2024, compared to 50 bps back in Sep. Powell confirmed in the press conference that participants no longer expected further hikes, although they did not want to take the possibility off the table. Further, he stated that a "preliminary" discussion around rate cuts took place at the December meeting and offered no direct pushback when asked about recent market pricing. Data wise, US CPI came in largely as expected, while retail sales unexpectedly rose 0.3% (C: -0.1%). Immediate support level at 102 / 101.50. Resistance level at 103.50 / 104.

EURUSD rose 1.23% to close the week at 1.0895, driven by a much dovish stance from the Fed. ECB kept rates on hold at 4% as widely expected, and announced that they would reduce the PEPP portfolio by €7.5bn per month on average over H2 2024, and discontinue reinvestments under PEPP by year-end 2024. Rate cuts were not discussed at all by ECB, in contrast to the Fed meeting. Resistance level in EURUSD at 1.095/1.10. Support level at 1.085/1.08.

GBPUSD rose 1.05% to close the week at 1.2681, driven by a much dovish stance from the Fed. BoE held rates at 5.25%, with three of the nine members on the committee were still in favour of another 25bp hike. The statement also said that monetary policy would need to be sufficiently restrictive for sufficiently long. . Governor Bailey pushed back on market expectations of rate cuts in 2024, saying that "we are more cautious because we need to see those more persistent elements of inflation".

USDJPY fell 1.93% to close the week at 142.15, driven by a dovish FED and as a result, a decline in US Treasury yields. US 2 years treasury yield fell 27 bps for the week. Data wise, core machine orders in Japan unexpectedly advanced +0.7% m/m in October (C: -0.4%, P: +1.4%). PPI inflation came in a bit stronger than expected in November, with yoy at +0.3% (C: +0.1%). Bloomberg reported that BoJ officials saw little need to end their negative interest rate policy tomorrow. Market pricing has continued to dial down the likelihood of a shift as a result, and overnight index swaps are now pricing in just a 9% likelihood of an end to negative interest rates.

Oil & Commodities

Crude Oil halted its consecutive weekly decline, with WTI and Brent rising 0.28% and 0.94% to close the week at 71.43 and 76.55 respectively, supported by a dovish FOMC. This was despite a higher estimate of US oil production this year and a jump in shipments of Russian crude adding to oversupply concerns. Support levels on WTI and Brent are at 70 and 75 respectively.

Gold rose 0.75% to close the week at 2019.62, driven by a dovish FED and a decline in US real yield. Immediate support level at 1985 / 2000.

Economic News This Week

- **Tuesday** – NZ Trade Balance/ Biz Confid., AU RBA Mins, JP BOJ Rate Decision, EU/CA CPI, US Housing Starts/ Building Permits
- **Wednesday** – JP Trade Balance, CH LPR, UK CPI/PPI, US Mortg. App./ Existing Home Sales/ Cons. Confid., EU Cons. Confid.
- **Thursday** – US GDP/ Personal Cons./ Initial Jobless Claims/ Leading Index, CA Retail Sales
- **Friday** – JP CPI, UK Retail Sales/ GDP, CA GDP, US Personal Income/ Personal Spending/ Durable Goods/ New Home Sales/ Mich. Sentiment

Key Market Moves

15 December, 2023

Name	WTD	MTD	YTD	Last px
MSCI ACWI Index	2.60%	2.14%	17.16%	709.27
S&P 500 Index	2.49%	3.05%	22.60%	4,707.09
Dow Jones Industrial Average	2.92%	3.17%	11.90%	37,090.24
NASDAQ Composite Index	2.85%	3.57%	40.77%	14,733.96
EURO STOXX 50 Price EUR	0.58%	3.37%	19.42%	4,530.19
STOXX Europe 600 Price Index EUR	0.92%	2.35%	11.20%	472.46
Nikkei 225	2.05%	-2.39%	25.26%	32,686.25
Tokyo Stock Exchange Tokyo Price Index TOPIX	0.34%	-2.26%	22.71%	2,321.35
MSCI AC Asia Pacific Index	2.81%	-0.48%	3.67%	161.45
MSCI AC Asia Pacific Excluding Japan Index	3.00%	-1.15%	-1.05%	500.33
MSCI Emerging Markets Index	2.65%	-1.38%	1.79%	973.47
Shanghai Shenzhen CSI 300 Index	-1.70%	-3.92%	-13.24%	3,359.02
Hang Seng Index	2.80%	-3.91%	-17.21%	16,376.17
India NSE Nifty 50 Index	2.32%	5.14%	16.92%	21,167.95
Taiwan Stock Exchange Index	1.67%	1.26%	24.87%	17.653.11
Korea KOSPI Index	1.82%	0.16%	13.55%	2,539.44
Singapore Straits Times Index STI	0.19%	1.66%	-3.91%	3,124.12
Thailand SET Index	0.73%	-0.36%	-17.59%	1,375.16
Jakarta Stock Exchange Composite Index	0.44%	1.20%	4.60%	7,165.70
Philippines Stock Exchange PSEI Index	3.91%	2.88%	-2.49%	6,403.21
Vietnam Ho Chi Minh Stock Index / VN-Index	-1.97%	1.94%	10.75%	1,115.37

Source: Bloomberg

Name	WTD	MTD	YTD	Last px
US Generic Govt 10 Year Yield	(0.07)	(0.08)	0.02	3.97
Euro Generic Govt Bond 10 Year	(0.11)	(0.11)	(0.15)	2.17
Japan Generic Govt 10Y Yield	(0.09)	0.01	0.60	0.68
MARKIT CDX.NA.HY.32 06/24	-8.63%	-9.31%	-24.58%	365.00
MARKIT CDX.NA.IG.32 06/24	-6.57%	-10.99%	-32.27%	55.55
MARKIT CDX.EM.31 06/24	-7.07%	-7.69%	-27.47%	173.05
EUR-USD X-RATE	1.23%	0.12%	1.83%	1.09
GBP-USD X-RATE	1.05%	0.13%	4.61%	1.26
CHF-USD X-RATE	1.09%	0.77%	6.44%	1.15
USD-JPY X-RATE	-1.93%	-4.49%	7.95%	141.54
USD-CNY X-RATE	-0.68%	-0.02%	3.40%	7.13
USD-HKD X RATE	-0.07%	-0.04%	0.07%	7.81
USD-INR X-RATE	-0.46%	-0.06%	0.74%	83.35
NYMEX Light Sweet Crude Oil	0.28%	-8.16%	-13.08%	69.76
ICE Brent Crude Oil Future	0.94%	-9.88%	-13.11%	74.65
VIX Index	-0.57%	-5.65%	-43.75%	12.19
Gold Spot	0.75%	-0.02%	11.62%	2,035.91
Silver Spot	3.72%	-5.45%	-0.25%	23.89
Palladium Spot	24.33%	-0.64%	-44.05%	1,003.04
Bitcoin/USD	-4.39%	14.05%	160.30%	43,052.90
Etherum/USD	-5.20%	11.28%	89.83%	2,276.81

Sources – Various news outlets including Bloomberg, Reuters, Financial Times, FactSet, Associated Press