

Another Volatile Week
By Nan Wang, CFA

Global equity markets had a tumultuous few days last week, triggered by rising Treasury rates and trade war concerns. On Friday, the U.S. equity markets and emerging markets pared some losses as trade tensions eased. The U.S. market was also boosted by solid earnings from the banking sector. The S&P index and the MSCI world index both ended the week down about 4%.

Last Tuesday, the benchmark 10-year Treasury yield continued the climb from the prior week, to 3.26%, the highest level in seven years. The Treasury yield curve steepened modestly after years of flattening. The rising yield in government debt added to the selloff force of equity markets, as investors worried that higher borrowing cost would hurt corporate profits, which would likely slow economic growth. Also, higher bonds yields make stock investing generally less attractive as conservative investors shift to the safer asset class. Fed Chairman Jerome Powell commented that the Fed Funds rate is still far below the neutral rate. The Fed consensus of the neutral Fed Fund rate is 3%, while the current range is 2% to 2.25%. Traders are expecting one more rate hike by the end of this year, with two to three more hikes in 2019.

Last Thursday, the U.S. September consumer price index (CPI) report showed soft inflation data. Headline CPI increased 0.1%, below consensus of 0.2%. Despite rebounds in apparel prices and medical care cost, core CPI was dragged by sharp declines in auto prices. Core CPI slowed down moving into year-end, signaling that Fed's preferred gauge of inflation, the core PCE will likely drop below 2% in the coming months. The relatively stable inflation data proves that no upward price pressure from trade tariffs has been reflected so far.

On Friday, the market viewed the trade dispute between the world's two largest economies as making some progress with China and the US set to meet at the G20 summit in November. The U.S. Treasury department also announced that China isn't manipulating its currency. Strong trade data from China relieved some anxieties regarding the impact of tariffs. Despite heightened tensions with the U.S., China's trade surplus with the U.S. grew to a record \$34 billion last month. Both exports to and imports from the U.S. rose, with export growing at a faster pace. Given high domestic and global demand, trade data has been showing steady growth so far this year.

The three banks that reported earnings last Fridays, JPMorgan Chase, Citigroup and Wells Fargo all posted quarter-over-quarter profit increases, largely due to a pickup in income from consumer lending and spending. Despite higher rates, credit card debt continued to increase, but the default rate improved in the third quarter. On the other hand, the pace of new mortgage generation has slowed down for all banks due largely to higher mortgage rates. According to Federal Reserve data, U.S. households are paying out under 10% of their disposable income on interest payments, lower than the 13% level pre-financial crisis.

As we enter into third quarter earnings season, financial reports from major companies will be key market movers for next week. Investors will be assessing whether the massive tax cut from earlier this year still has lasting impact on corporate profits. Specifically, rate impact on earnings of Goldman Sachs, Bank of America and Morgan Stanley will be under the spotlight.

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Stock Market Performance

	10/15/18	W-o-W	M-o-M	Y-o-Y
DJIA	25,340	-4.2%	-2.5%	10.9%
S&P 500	2,767	-4.1%	-4.2%	8.5%
MSCI World	2,063	-4.1%	-4.1%	2.0%
S&P/TSX	15,414	-3.3%	-4.0%	-2.1%
BSX	2,935	2.1%	2.6%	36.9%
FTSE100	6,996	-4.4%	-4.3%	-7.4%
DAX	11,524	-4.9%	-4.2%	-11.2%
CAC	5,096	-4.9%	-4.4%	-4.9%
Nikkei	22,695	-4.6%	0.4%	8.3%
Hang Seng	25,801	-2.9%	-2.1%	-9.3%
Shanghai	2,607	-7.6%	-1.9%	-23.0%

Key Rates and Prices

Currencies	10/15/18	Month ago	Year ago
EUR	\$1.16	\$1.16	\$1.18
GBP	\$1.32	\$1.30	\$1.33
JPY	¥112.21	¥111.26	¥112.28
CAD	\$0.77	\$0.77	\$0.80
CHF	\$1.01	\$1.03	\$1.03
AUD	\$0.71	\$0.72	\$0.78

Fixed Income

3M LIBOR	2.44	2.33	1.36
3M Treasury Bill	2.27	2.14	1.08
2Yr Treasury Note	2.86	2.75	1.52
10Yr Treasury Note	3.16	2.96	2.32
Fed Funds Rate	2.25	2.00	1.25

Commodities

Gold/oz.	1,217.95	1,206.28	1,293.70
Silver/oz.	14.61	14.26	17.25
Copper/lb.	2.86	2.72	3.12
Oil	71.34	70.37	50.60

Global Economic Calendar (October 15th — October 19th)

Mon: Retail Sales (US)

Wed: FOMC Minutes (US); CPI (GB)

Thurs: Jobless Claims (US); GDP (CN); CPI (JP)

Fri: CPI (CA)

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