Wealth Management
Weekly Market Update

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Market Update

US stocks rose by +0.3% last week, reacting strongly to job market data. At the start of the week, US stocks sold off after job opening data was stronger than expected. Then, at the end of the week, a blowout non-farm payrolls report caused an initial sell-off in futures, which turned into a rally after markets opened, as traders digested the finer details of the report. In both cases, good news was viewed as bad news, as strong job growth was seen as a sign that the Federal Reserve may need to hike again, while weaker wage growth was seen as a sign that inflation is cooling. The yield on 10-year US treasuries continued to reach new highs, rising to 4.8%, a level not seen since 2007. Stocks in other regions fared worse as central bank fears and the 'bear steepening' of the US yield curve weighted on market sentiment. Oil prices fell by 9% over the week, on optimism around a deal between Saudi Arabia and Israel. This sentiment was swiftly reversed over the weekend however, after the news broke of an attack on Israel carried out by the Palestinian Islamist group Hamas.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼ -1.5%	▲ +0.3%	▼ -1.3%	▼ -0.5%	▼ -1.8%	▼ -2.7%	▼ -1.3%	▲ +0.3%

all returns in GBP to Friday close

Macro News

- The surprise offensive carried out in Israel by Hamas at the end of last week marked a spike in geopolitical tensions across the Middle East in the midst of a deal between Saudi Arabia and Israel that would improve relations across the region. Oil prices, which had eased in recent weeks on deal discussions, jumped sharply higher on Monday, up over +3%. These tensions threaten both further oil price hikes and a further wave of supply side inflation across developed economies.
- Global manufacturing conditions improved slightly in September, as indicated by PMI data, thanks primarily to a rebound in US manufacturing conditions driven by output growth. However, services continue to trend down in most developed economies, as the US teeters on the edge of services growth, while PMI figures for Europe and the UK now lie within contraction territory, indicating a slowdown in economic activity.

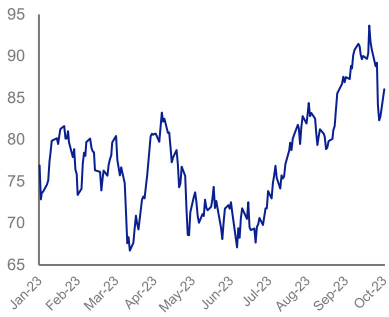
The Week Ahead

- The world will be keeping a close eye on how the situation in Israel develops, as the response and comments made from the Israeli government and other important political figures across the Middle East is likely to have sizeable and wide-reaching implications.

Week in Charts

Geopolitics unhinging oil prices?

WTI Crude oil price, spot, $

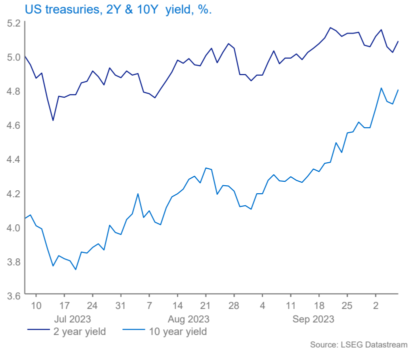


Source: Bloomberg

Geopolitics are once again having a material impact on oil prices. The Hamas offensive that unfolded at the end of last week has caused oil prices to surge again, jeopardising a deal between Israel and Saudi Arabia and threatening a resurgence of supply side inflation.

A bear steepener in bond markets

US treasuries, 2Y & 10Y yield, %.



The yield curve appears to be on the path to normalisation, although perhaps not in the way that was widely anticipated. Long-dated government debt yields are rising, while shorter-dated debt yields remain anchored just above 5%. This phenomenon, known as a bear steepener, widely reflects higher long-term inflation expectations.

View From the Desk

Last week provided two key pieces of information: A robust (ish) US labour market, and a flare-up of tensions in the Middle East. Both of these are important for portfolio holders, especially those with a large allocation in bonds, especially long-dated bonds.

Let's take things from the top. On Friday, the US announced a large jump in payrolls, which indicates that the labour market, and thus the economy, is strong. This is ostensibly bad news for those who hoped that the Fed would cut interest rates soon. Instead, markets may get another hike, although markets remain divided. In terms of the bigger picture, it doesn't matter. The Fed has communicated that it plans to keep rates higher for longer. The question is not 'When is the last rate hike', but rather 'how long is 'longer''.

Adding to the issue is the conflict between Palestinians and Israelis. While it is tempting to classify this weekend's incident as 'one of those things', it really isn't. For one, we need to consider that global geopolitical entropy is increasing, leading to an unbalanced world. Incidents which were isolated may now have wider and unexpected repercussions. Second, if Ukraine has taught us anything, it is that the wish for a 'short war' often clashes with reality, especially if both adversaries prove to be intransigent. Third, this is the worst escalation of the conflict in years. Both sides are digging in for what is likely to be a prolonged clash. The longer it lasts, experience shows, the more likely other parties could get dragged in, either militarily or diplomatically, making a resolution even harder.

Needless to say that the timing of this escalation is likely to mean that any rumoured deal between Saudi Arabia and Israel will be impacted. After the weekend's developments, it is safe to say that it is difficult for the deal to go ahead. Oil prices rose again.

This is not bad news for bondholders, per se. Many are locking in high yields, especially at the shorter-end, as the yield curve has been inverted (short-term bonds yielding higher than long-term bonds). Many are also locking in high yields over the longer-term, hoping for not just the yield (they can get it higher at the shorter end), but also capital appreciation if yields fall (and prices rise).

The beauty of bonds is that they promise an exact return if held to maturity. But those who buy with thoughts of capital appreciation must be very careful. They need to remember, that the central bank is now a seller, not a buyer. They face a hawkish Fed and unpredictable inflation. The yield they get is hard-earned. Investors need to be prepared to hold the long bond to maturity, 10 or even 30 years, to get the return promised and hope that inflation will not diminish them.

George Lagarias – Chief Economist

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