J. Safra Sarasin

Cross-Asset Weekly

29 September 2023

The Fed has got its message across

Fixed income markets in particular have finally got the message that the Fed actually means what it says: interest rates will stay high as long as necessary for inflation to come down sustainably to its 2% target. So far, a normalisation of supply conditions appears to have been behind most of the disinflation. Now, demand will need to soften sufficiently in order to bring the economy into better balance and reduce price pressures. The long end of the US Treasury market (and other developed government bond markets) has been the prime victim of the recent upward shift in the expected Fed Funds rate two years out and beyond. In fact, markets now price an average Fed Funds policy rate of roughly 4.5% over the next 10 years. We suspect that substantial lagged effects on the real economy from monetary policy tightening are now skewing the market's perception for the neutral policy rate to the upside. While the current sell-off still may have a bit further to go, we expect intermediate maturities (5 to 10y) to do well over the next 6 to 12 months.

Higher Treasury yields and oil prices are usually challenging conditions for weaker Emerging Markets economies, because of capital outflows and stickier inflation. However, currencies with high carry will likely be supported over the next 3-6 months, in particular Latin American FX such as the Brazilian real, the Colombian peso and the Mexican peso.

Despite equity market losses, the drop in valuations has been relatively moderate as risk premiums have not widened meaningfully. Growth in the US has been supported by the large increase in the fiscal deficit and incentives related to the CHIPS Act and Inflation Reduction Act. This is unlikely to be sustained and would have to be offset by other growth drivers in order to guarantee the equity market's resilience in the months ahead.

This week's highlights

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US macro

‘Higher for longer’ means weaker demand

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There has been a reckoning in financial markets over the past week that the Fed actually means what it says: interest rates will stay high as long as necessary for inflation to come down sustainably to its 2% target. So far, a normalisation of supply conditions appears to have been behind most of the disinflation. This is unlikely to be repeated. Demand will therefore need to soften sufficiently in order to bring the economy into better balance and reduce price pressures.

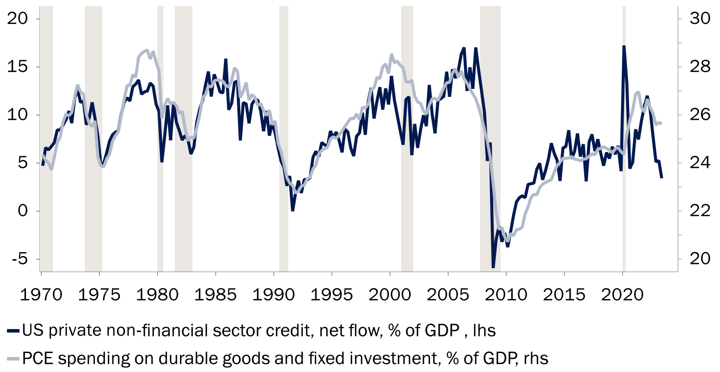
Fed’s higher-for-longer message is sinking in

Chair Powell’s hawkish message last week, as well as the upward revision to the policy path implied in the Fed’s new dot plot, led to another sharp increase in longer-term real bond yields as investors appear to be realising that a more prolonged period of higher rates may be needed to cool the economy. The drop in risk assets over the past week also suggests that the disinflationary process might not be as painless as financial markets had previously anticipated, a point that we have been making repeatedly.

The business cycle has been behaving differently, raising hopes that ‘this time could be different’

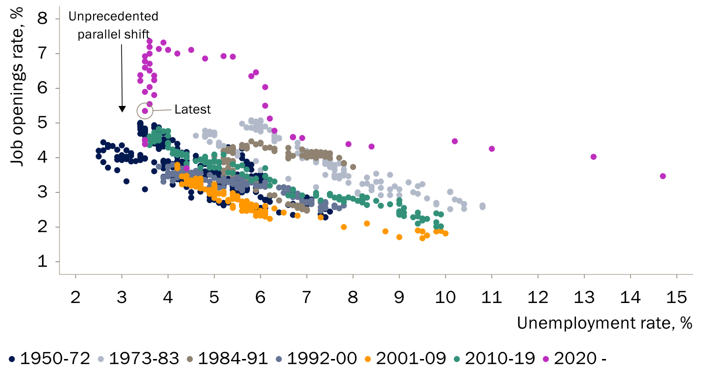
This business cycle has been surprising in many ways. For example, while credit flows have weakened as monetary policy has tightened, demand has remained surprisingly resilient. This in part reflects a normalisation in consumer behaviour, with spending shifting away from goods to services. But even credit-sensitive spending, particularly household consumption of durable goods and private investment, has not fallen in line with the deterioration in credit flows (Exhibit 1). In addition, the labour market is also behaving unusually. The Beveridge curve – the relationship between job vacancies and unemployment – has shifted downwards. In other words, the vacancy rate has dropped without any rise in the unemployment rate—this is unprecedented in US post-war history (Exhibit 2). As a result, some heat has been taken out of the labour market, reducing wage growth in a ‘painless’ fashion. This has raised hopes over the past few months that economic growth can remain strong and the labour market can maintain full employment, while the disinflationary process continues.

Exhibit 1: Demand has been more resilient than expected



Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

Exhibit 2: Openings have fallen without higher unemployment



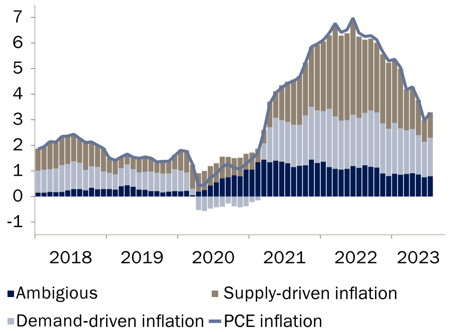
Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

The drop in inflation over the past year has largely been driven by a pick-up in supply. This is unlikely to be repeated, at least to the same extent

Fed officials’ higher-for-longer projections have poured some cold water on this idea. First, the Fed doesn’t appear to believe (a view that we share) that the ‘painless’ drop in inflation in the past three months should necessarily be extrapolated into the future. Indeed, its own work shows that most of the disinflation has been driven by normalising supply conditions (Exhibit 3). Looking ahead, we doubt that the supply side of the economy will be able to weigh much further on inflation. Supply chains are now operating normally – the NY Fed Global supply chain pressures index is around its historical lows – and most of the increase in the labour force participation rate so far has been driven by prime-age workers (Exhibits 4-5). Yet the participation rate of this group is already above its pre-pandemic level, suggesting that there is limited further upside. Another meaningful pick-up in the size of the labour force would need to be driven by older workers (55+), though so far, they have shown little willingness in re-joining the labour market (Exhibit 5).

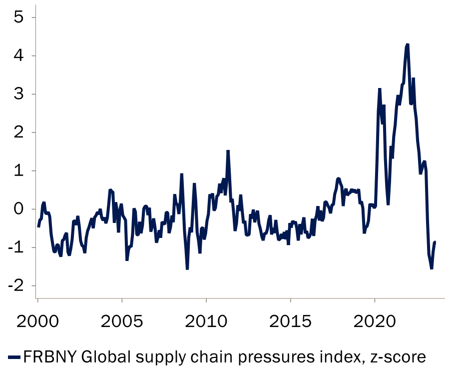
Exhibit 3: Supply-driven disinflation

PCE inflation and contributions, yoy% / pp



Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

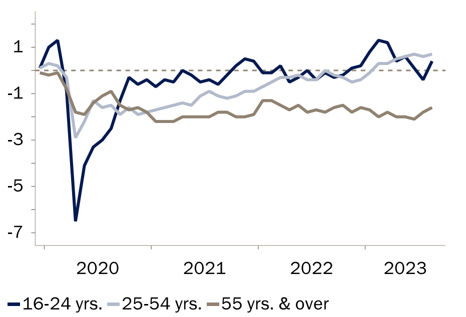
Exhibit 4: No more supply chain constraints



Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

Exhibit 5: 55+ participation remains low

Change in labour force participation rate by age group since Dec. 2019, %pts



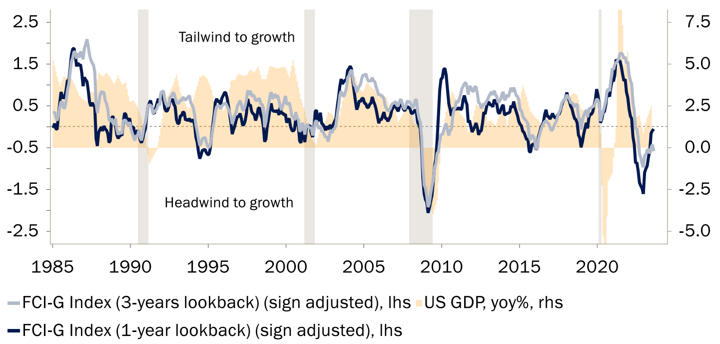
Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

The Fed will keep interest rates elevated as long as needed to cool demand and bring inflation back on track to its 2% target

At the same time, the renewed rise in house prices, resilient demand for goods, labour strikes and the sharp rise in the oil price over the past few weeks suggest that the economy is still facing important inflationary forces. The Fed has therefore no other choice but to signal that it will maintain rates elevated as long as necessary in order to maintain tight financing conditions. The Fed's new indices, which attempt to measure the cumulative effect on GDP growth over the next 12 months from current and past changes in financial variables over the past 1 and 3 years, suggest that conditions have in fact become less tight this year as equity and house prices have risen. Its main index, which uses the 3-year backward looking window, still points to tight conditions (Exhibits 6-7). But as Jerome Powell mentioned in the press conference last week, Fed officials don't really know how tight policy truly is. They will only know once the data confirm that demand is softening sufficiently to reduce price pressures. Whether the Fed can soft land the economy rests on its ability to read the signals early and be nimble enough to calibrate its policy stance so that it doesn't depress demand excessively.

Exhibit 6: Financing conditions appear to have become less tight ...

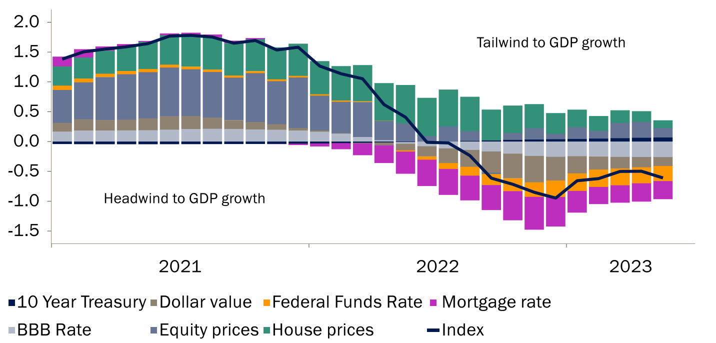
Contribution to GDP growth over the next year, percentage points



Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

Exhibit 7: ... reflecting higher equity and house prices

Fed Financial Conditions Impulse on Growth (3-years lookback) and components



Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

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Emerging Markets

EM FX: Carry is king

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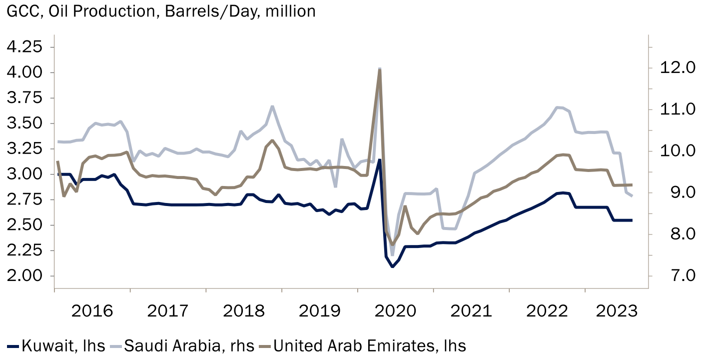
Since July, we have seen two changes in the global environment: the US Fed's "higher for longer" and higher oil prices. The former usually means capital outflows from EM and weaker EM FX. The latter puts pressure on EM oil importers' FX, and could keep EM inflation stickier. Currencies with high carry are likely the ones that will be supported in the next 3-6 months, in particular Latin American FX such as the Brazilian real, the Colombian peso and the Mexican peso.

New in 2H: Higher oil prices and "higher-for-longer" US interest rates

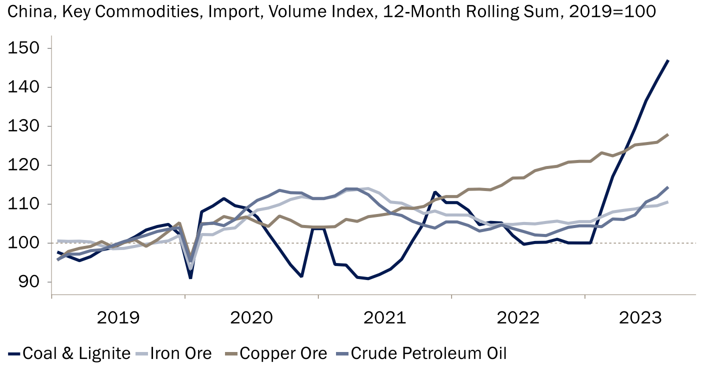
Since mid-July, we have seen a few changes in the global environment. First, the US Federal Reserve has confirmed that it will keep the policy rate elevated for longer. While the "higher for longer" narrative has gathered steam over the last few months, Chair Powell only mentioned it explicitly at the last FOMC meeting. Second, energy prices have increased significantly in the last two months. Brent oil price now trades at $97 instead of around $80 per barrel in mid-July. The price increase has been due to significant supply cuts by Russia and Saudi Arabia, while demand from the US and China has been resilient (Exhibit 1 and 2). Higher for longer has pushed up 10-year US treasury yields to the highest level in many years and the US dollar index has edged higher after hitting its 2023 low in mid-July (Exhibits 3 and 4). This in general is not supportive for EM FX.

Exhibit 1: Saudi Arabia's supply cuts have pushed oil prices higher



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

Exhibit 2: Stronger China's demand for key commodities



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

Higher for longer usually means weak EM FX

The last time the US Federal Reserve held its policy rate for a prolonged period was in the late 1990s. Many major Emerging Markets (EM) economies experienced balance of payments crises as capital flowed out of EMs. Today, major EM economies are much less vulnerable on the external front. They borrow more domestically, are not entirely dependent on external borrowing, and their exchange rate regimes have become more flexible. The tight spreads on US dollar sovereign credit for investment grade EM issuers attest to their resilience (Exhibit 5). Frontier EM economies, however, will likely continue to suffer in this environment. Egypt (which we wrote about last year), for example, continues to face external funding risks.

Higher oil prices could slow down the pace of the EM rate cut cycle

Higher oil prices, together with some regional food price increases (such as in India), have already fed into some EM headline inflation (Exhibit 6). Higher oil prices could also keep inflation expectations higher for longer, and put downward pressures on EM oil importers' trade balances. Indeed, 12-month-ahead inflation expectations in selected EMs show that expected inflation remains above the official inflation targets in most countries in the sample (Exhibit 7 with 4% target for South Africa, 2% target for Czech Republic, Peru and Thailand and 3% target for the rest). On balance, higher for longer and higher oil prices could keep EM central banks more vigilant and slow the pace of rate cuts in some EMs.

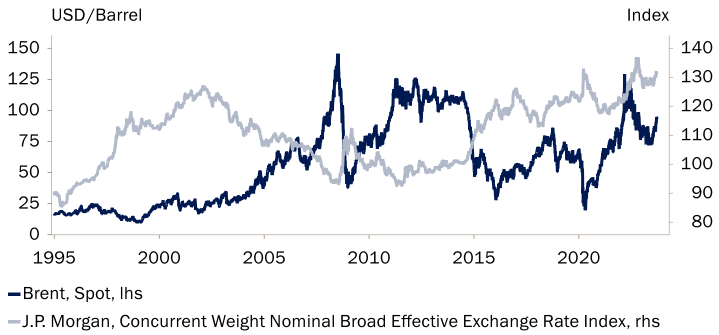
Exhibit 3: 10-year US treasury yield has risen to 4.5%

United States, Federal Reserve, Interest Rates, %

Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

Exhibit 4: US dollar has strengthened since mid-July

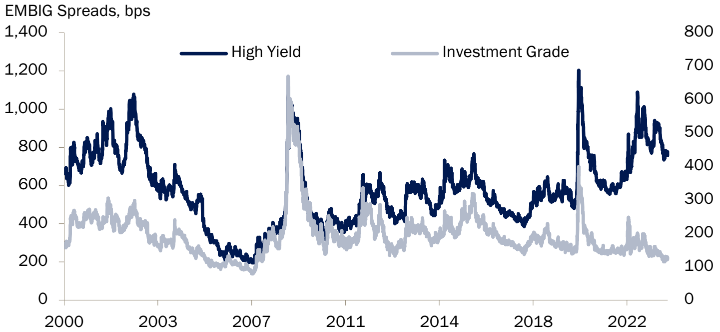
Brent Oil Price and US Dollar Index



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

Exhibit 5: IG EM issuers continue to see tight spreads

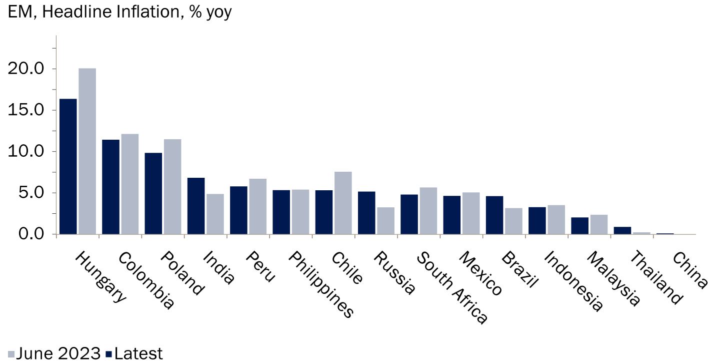
EMBIG Spreads, bps



Source: Bloomberg, Bank J. Safra Sarasin, 25.09.2023

Exhibit 6: A recent pick-up in inflation in parts of Asia

EM, Headline Inflation, % yoy



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

High-carry EM FX to be supported

In this environment, our view is that EM FX with high carry will be well-supported. A number of EM central banks with high policy rates have already started their rate cut cycle as inflation subsides and growth concerns mount (Exhibit 8). As rate cuts erode carry further next year, EM FX will likely be less supported. We outline our regional views for the next 3-6 months below.

Latin American FX should fare better given high carry

Latin American FX should fare best in general due to higher carry. We continue to prefer the Brazilian real (BRL), the Colombian peso (COP) and the Mexican peso (MXN). While the central bank in Brazil has already cut rates by 100bp so far, BRL real yields remain the highest among major EMs. We expect the Banco de Mexico (Banxico) to hold its policy rate for much longer. In both cases, fiscal risks could be a reason for both central banks to go slow. For Brazil, the risk is that the 2024 fiscal target will be loosened and that could lead to a sell-off. In Mexico, a large fiscal expansion is coming in 2024, which will keep Banxico more hawkish. In Colombia, there have been increasing calls from the business community to cut its policy rate. In our view, the central bank will likely start loosening policy in the next couple of months once the inflation dynamic looks better. Still, real policy rates (using 12-month inflation expectations) remain high at around 7%.

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Higher for longer and higher oil prices will keep Asian central banks mostly on hold until the Fed's first cut

Higher for longer and higher oil prices are particularly tricky for Asian EM economies which are mostly oil importers with low interest rates. Low yielding Asian currencies (CNY, KRW, MYR and THB) will likely see continued pressure from capital outflows. A relatively weak Chinese economy and a dovish People's Bank of China also add to the pressure. The Thai baht could turn around at the end of the year due to the seasonal tourism factor. Due to the changed global environment, we expect Asian central banks to remain on hold for longer in 2024 even if inflation has already come back to target in many countries (Indonesia, Thailand). Among the higher yielders within Asia, the Indonesian rupiah (IDR) and the Indian rupee (INR) should be better supported. Beyond relatively higher rate differentials, Indonesia should still be supported by a strong current account and policymakers that remained focused on stabilising the currency. While India is also affected by higher oil prices, portfolio inflows and the central bank's intervention have supported the INR. The recent announcement of India's inclusion into JP Morgan's EM local currency bond index (starting next June) should also help support the INR.

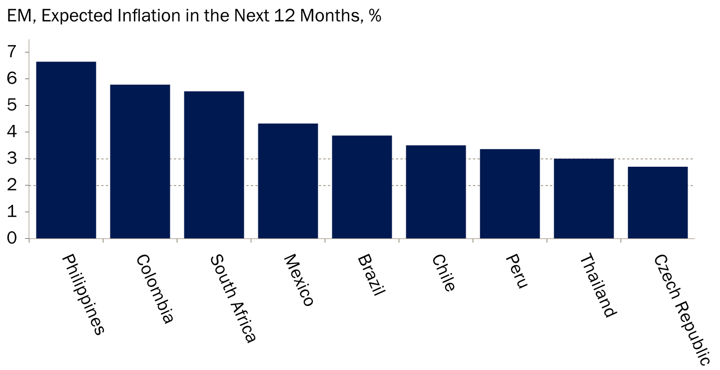
CEE currencies to be under pressure as growth concerns dominate

For Central and Eastern European central banks (CEE), growth concerns have become front and centre as the German economy is probably falling into recession, despite still-elevated headline inflation. Poland's surprised rate cut earlier this month was an example. Given that these countries are also oil importers, there is also FX pressure coming from worsening trade balances. Further policy rate cuts will likely put more pressure on CEE FX.

We still see some downside risks for ZAR and TRY although larger-than-expected rate hikes in Turkey should help stabilise TRY

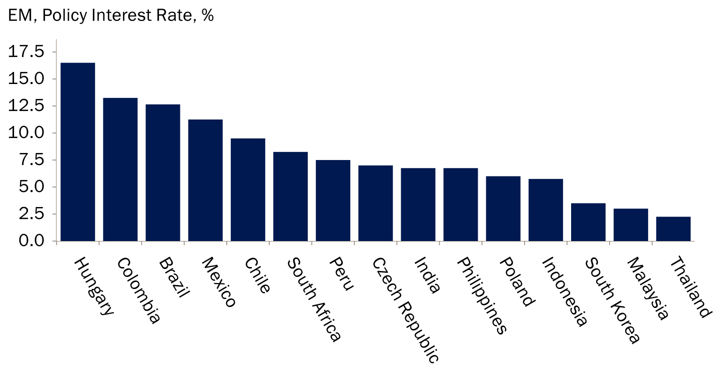
While carry is relatively high in South Africa, we are concerned about the risk of electricity outages as well as worsened trade balances (as an oil importer), which could keep the rand under pressure. In Turkey, the latest commitment to orthodox monetary policy has signalled that the country could be on the right policy path, which will help bring FX inflows. More FDI inflows from the Gulf countries should help beef up net international reserves, but Turkey will also suffer from higher oil prices and the real policy rate remains deeply negative. The market is only pricing the policy rate in 12 months at 38%, while 12-month inflation expectations are at 45% (today's policy rate is 30% and August inflation was at 59%). Given the hawkishness of the last monetary policy statement, the monetary stance could approach restrictive territory faster than the market expected. While we still see some downside risks for the Turkish lira for the next 3-6 months, a more restrictive stance should help stabilise the lira.

Exhibit 7: 12-month ahead inflation expectations are still elevated



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

Exhibit 8: Generally, high-carry FX should be supported



Source: Macrobond, Bank J. Safra Sarasin, 25.09.2023

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US fixed income

Market prices 'higher for much longer'

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Markets currently price an average Fed Funds policy rate of roughly 4.5% over the next 10 years, which suggests that they expect the US economy to be able to tolerate much higher real rates than before the pandemic. We believe that substantial lag effects on the real economy from monetary policy tightening skew the market's perception for the neutral rate to the upside. While the current sell-off may have some way to go, we expect intermediate maturities (5 to 10y) to do well over the next 6 to 12 months.

Markets have sold off significantly in August and September

US bond markets sold off significantly in August and September. Longer-term yields have now risen by about 70 to 80bp over the past 3 months, all of it coming from the real rate side. The yield curve steepened by 55bp (to -45bp) in the 2y/10y segment, retracing more than half the inversion. The apparent resilience of the US economy to higher (real) rates so far has led markets to price a higher expected policy rate path beyond 12 months, while short-term expectations remained largely unchanged. The result was a "bear steepening", an upward shift of the yield curve with long-term yields rising more that short-term yields.

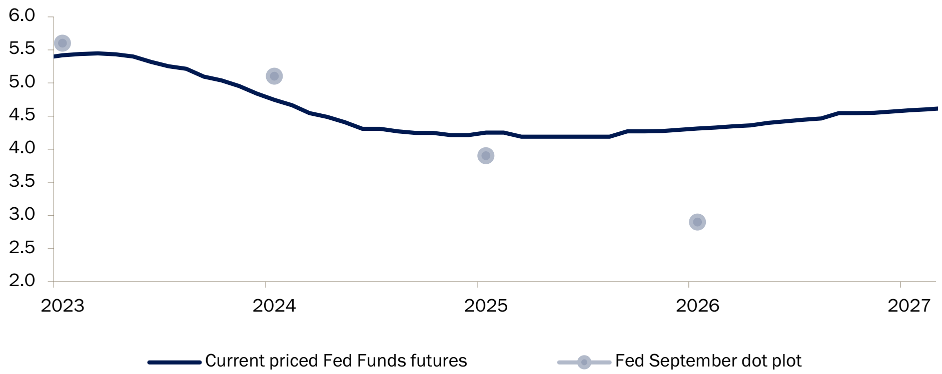
Bear steepenings usually occur at the end of a rate hike cycle

While phases of bear steepening are much less frequent during tightening cycles compared to other rate regimes, they do happen. They usually occur towards the end of a rate hike cycle. The reason is quite intuitive: as the tightening cycle becomes more advanced, markets increasingly price the cumulative effects from monetary tightening into their expectations for the trajectory of future policy rates. As monetary policy can work with very long lags on the real economy, markets can temporarily reprice overly optimistic rate expectations to the upside. For example, this happened in 2000, 2006 and 2007. Usually, these instances last only a few weeks, and are limited in magnitude. At -100bp for the 2y/10y segment, the curve was deeply inverted as we approached peak policy rates in this cycle, which is why the magnitude is higher this time and more difficult to predict.

Market pricing for Fed Funds diverges significantly from the Fed's September dots beyond 2024

Market expectations for the future trajectory of Fed policy rates have shifted even further over the past two months compared to the Fed's more hawkish September dot plot. While the market still prices Fed Funds 40bp below the hawkish Fed's end-2024 dot, the trajectories diverge meaningfully thereafter. While the Fed expects the Funds rate to converge towards its longer-term neutral policy rate of around 2.5% to 3%, markets expects a trough in Fed Funds at around 4.25% in 2025, and a rise thereafter towards 4.5% (Exhibit 1).

Exhibit 1: Market pricing for the Funds rate diverges from the Fed's dots beyond 2024

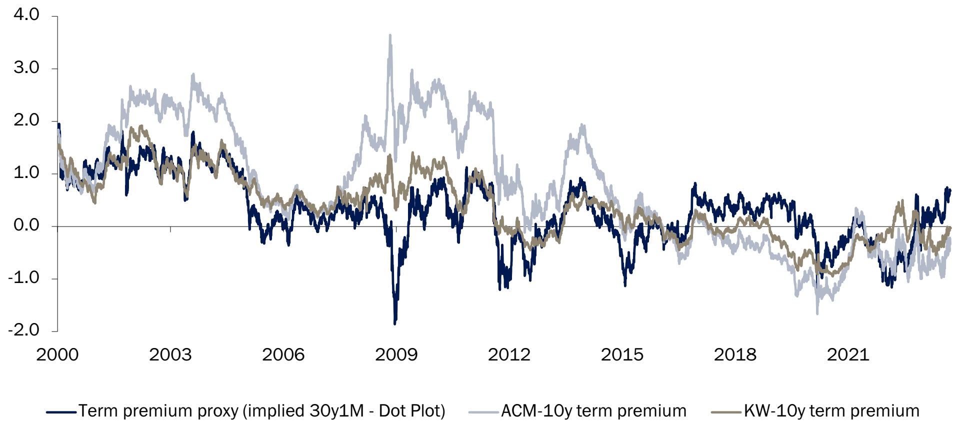


Source: Macrobond, Bank J. Safra Sarasin, 28.09.2023

Markets price a meaningfully higher neutral rate

The obvious conclusion is that the market now prices a significantly higher average equilibrium rate of interest than most estimates currently assume, that is, the rate at which the economy neither decelerates nor accelerates. This would mean that the US economy is able to tolerate much higher real rates than before the pandemic and would be consistent with the soft-landing scenario that credit markets currently price. In fact, credit spreads of Investment Grade and High Yield bonds trade below the historical medians and hence do not reflect the risk of a substantial economic slowdown, let alone a recession. Importantly, this would also imply that the term premium on long-term Treasury bonds is still close to zero (with potential further upside), as some term premium models would suggest (Adrian, Crump and Moench, ACM; Kim & Wright, KW) (Exhibit 2).

Exhibit 2: Standard term premium models imply no risk premium in Treasury bonds



Source: Bloomberg, Bank J. Safra Sarasin, 28.09.2023

Current market pricing likely due to substantial lag effects from monetary tightening

We suspect that a significant part of the current elevated market pricing is likely due to the substantial lag effects on the real economy from monetary policy tightening. The larger than expected fiscal impulse in 2023 and relatively healthy private-sector balance sheets seem to extend the lags even more, suggesting a stronger resilience of the US economy to higher real rates. This currently skews the market's perception for the neutral rate up.

Our term premium proxy suggests a more meaningful build-up of risk premium

The Fed's quarterly Survey of Market Participants (SMP) gathers an average estimate of the long-term neutral rate for the US economy, which currently sits at around 3%. This estimate is consistent with the New York Fed's estimate of the real neutral rate (two-sided real neutral rate from Holsten, Laubach and Williams) of 1.1%, which would suggest a nominal neutral policy rate of slightly above 3% as well. We can approximate the risk premium embedded in the Treasury market by comparing the long-run policy rate currently implied by the Treasury yield curve with the SMP estimates. It correlates well with the KW term premium estimates, however, contrary to the standard term premium models, it suggests a more meaningful build-up of risk premium (Exhibit 2).

Intermediate maturities should do well over the next 6 to 12 months

We expect the cumulative effects of monetary tightening to be increasingly felt in the US real economy (including the sharp real rate increase over the past two months). We expect lower nominal yields over the next 6 to 12 months, with a more benign steepening of the yield curve, hence intermediate maturities (5 to 10y) should do well.

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US equities

Cyclical support has not yet fully faded

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Equities have recently given up some of the gains they had made in 2023, following the Fed's hawkish hold in September and a sharp rise in real rates. Despite these losses, the drop in valuations has been relatively moderate as risk premia have not reacted. The High Yield spread in the US for example remains well supported by a gradually recovering manufacturing sector. In general, growth in the US has been well supported by strong fiscal spending. This is unlikely to be sustained and would have to be offset by other growth drivers in order to guarantee the equity market's resilience in the months and quarters ahead.

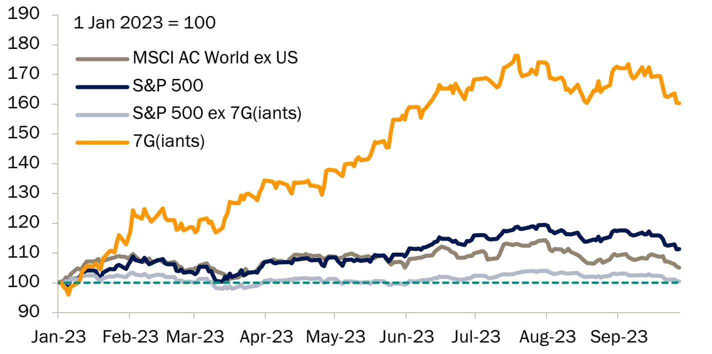
Equities are 6% off their 2023 highs after the recent rise in real yields

Equity markets have come under renewed pressure over recent weeks. The S&P 500 in the US has retreated more than 6% from its 2023 peak in late July and has fallen back to levels it first breached in June 2021 (Exhibit 1). Notably, excluding the seven major stocks in the S&P 500, the index has given up all of its 2023 performance and is flat year-to-date (Exhibit 2).

Exhibit 1: US equities have retreated from their 2023 highs

Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 2: The S&P 500 ex the 7 G(iants) is flat year-to-date



*7G(iants) = Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla

Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

The Fed has firmed its inflation fight, triggering a sharp rise in US real yields

Rather than some sort of macro shock, the rise in rates was instrumental in the recent equity market decline. The Fed's firm message after the last FOMC, reiterating their commitment to fight inflation, led markets to reprice expectations for the Fed Funds rate over coming years and triggered a surge in US real yields. Equity valuations, which have been remarkably immune against higher rates in recent months, reacted accordingly. The S&P500's 12-month forward PE dropped to 17.9x, a level it had last seen in March. Yet considering that the US real rate was about 100bps below today's level back then, one could argue that equities have still been very resilient in light of rising rates (Exhibit 3).

US High Yield spreads have been remarkably resilient compared to equity valuations

One reason for this resilience of equity markets surely is the depressed valuation premium across risk markets, most visible in the US High Yield spread. This has actually continued to contract over the past three months (Exhibit 4) – in contrast with falling equity valuations - and is currently at the lowest level since June 2022.

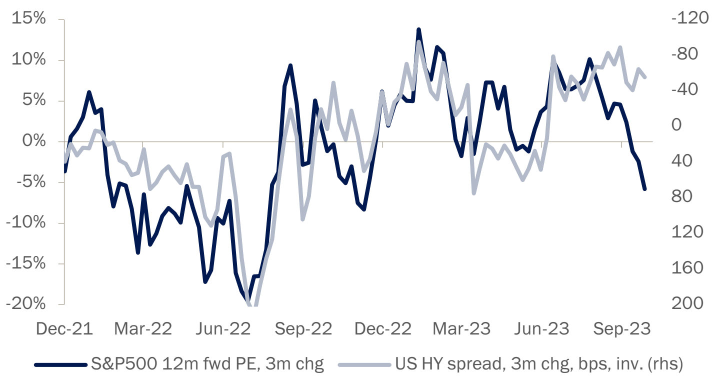
High Yield spreads have benefited from higher oil prices and firmer manufacturing data

High-yield spreads have been rather well behaved as their two most important macro drivers have been rather supportive lately (Exhibit 5): i) Brent oil prices have risen back to the highest level since November 2022, and ii) the manufacturing ISM in the US has started to recover slightly after touching a post-pandemic low in June (Exhibit 6).

Exhibit 3: Equity valuations have fallen as real yields have soared

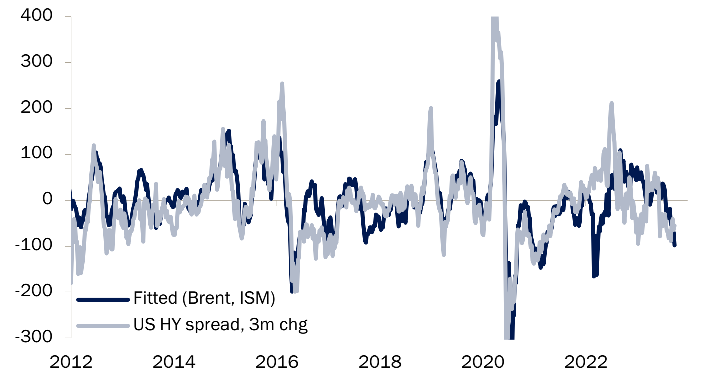
Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 4: The HY spread has not moved despite the drop in PEs



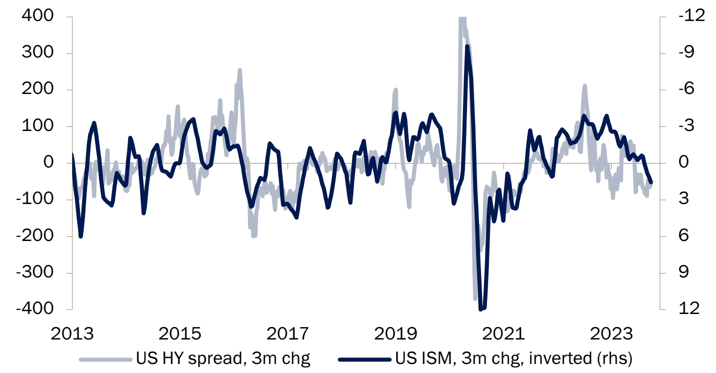
Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 5: HY spread supported by oil prices and manufacturing data



Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 6: US manufacturing data has bottomed lately



Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

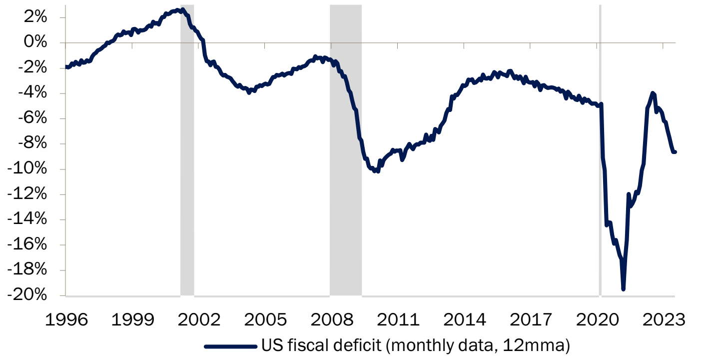
Fiscal stabilisers have supported the cycle much more strongly than expected in 2023

Once again, the outlook for the equity market boils down to the question whether the US cycle can recover in the months ahead or if the recent stabilisation in the manufacturing data should be regarded as an anomaly in a generally slowing cycle? We would argue for the latter. While the impact of Fed hikes has yet to hit and consumers are gradually drawing down their pandemic savings, another factor which is set to turn from tail- to headwind, is fiscal support. The first half of 2023 saw a sharp rise in the US fiscal deficit, driven by both, falling revenues and rising outlays. Paradoxically, last year's equity market sell-off is a key reason for the drop in federal tax receipts in the first half of this year, as capital gains tax revenues are lagging private portfolio returns. The economy was thus supported by an automatic fiscal stabiliser, which it would typically only receive during or right after a recession. In addition to this decline in tax revenues, social benefit payments adjusted for higher inflation and various discretionary programs (e.g. CHIPS act, IRA) were added to government expenses. To put that into numbers, the fiscal deficit rose to 8% of GDP by mid-2023 (12-month rolling based on monthly data), a level typically only seen in recessions (Exhibit 7).

The fiscal impulse has risen to levels only observed during recessions before

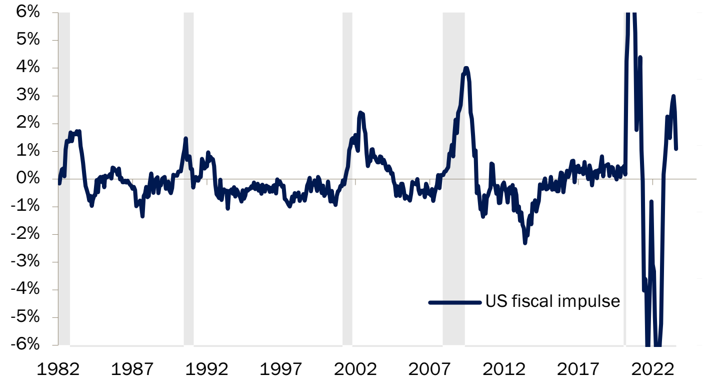
More important for economic growth than the deficit itself, is the change in the deficit (the fiscal impulse), which has also risen to levels only observed during recessions (Exhibit 8). While this does not translate into growth one-for-one (due to multiplier effects and as some components of the deficit have little relevance for growth, e.g. interest payments), the fiscal stance in the first half of 2023 has likely been remarkably supportive for an economy which is not in recession.

Exhibit 7: The US fiscal deficit has risen to recession levels in 2023



Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 8: Fiscal support is at the highest outside a recession

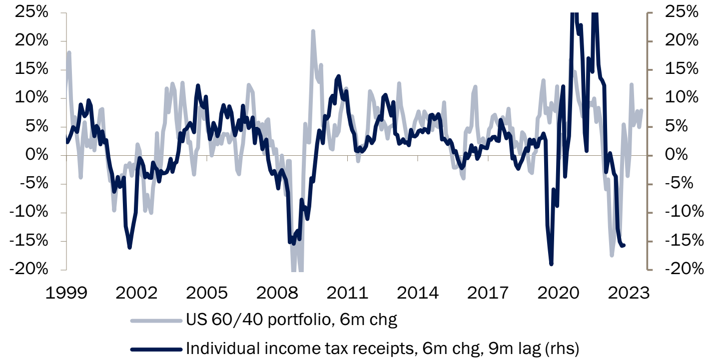


Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Sustaining this level of fiscal support is a difficult task in the coming quarters

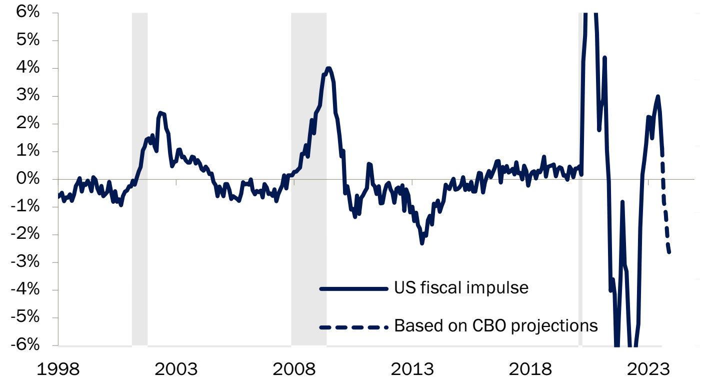
Yet looking ahead, this degree of fiscal support is unlikely to be sustained. Providing additional stimulus in the coming quarters would require the fiscal deficit to rise from current levels. However, income tax receipts are unlikely to drop once again as employment has continued to be strong and capital gains tax revenues tend to follow a typical 60/40 portfolio with a 9-month lag (Exhibit 9). But even if the monthly deficit does not shrink (which is unlikely), the fiscal impulse would fade quickly. The best projection for US fiscal data is the Congressional Budget Office numbers. These suggest that the fiscal impulse turns negative into the end of this year and the beginning of next year. This may only change if either mandatory (non-discretionary) spending and revenues deviate due to changes in the macro assumptions (as did income tax revenues in 2023), or if a new discretionary spending programme is implemented. As this would have to pass Congress, it does not appear within reach right now.

Exhibit 9: US (capital) income tax revenues follow markets with a lag



Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

Exhibit 10: The fiscal impulse is set to turn negative



Source: Refinitiv, Bank J. Safra Sarasin, 28.09.2023

The cycle will likely suffer without additional fiscal support. This may also lead to widening risk premia

Bottom-line, the remarkable strength in the US cycle this year has kept risk premia in check and shielded equity valuations against the drag from higher real rates. The fiscal impulse has been a key driver of US growth in 2023, yet is likely to fade as a support factor over coming quarters. If other drivers of the cycle fail to compensate for fading fiscal support, risk premia should widen as well and valuations should converge further towards levels implied by real yields.

Economic Calendar

Week of 02/10 – 06/10/2023

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 02.10.2023						
JN	01:50	Tankan Large Mfg Index	3q	Index	6.00	5.00
	01:50	Tankan Large Non-Mfg Index	3q	Index	24.00	23.00
US	16:00	ISM Manufacturing PMI	Sep	Index	47.70	47.60
	16:00	ISM New Orders	Sep	Index	--	46.80
Tuesday, 03.10.2023						
US	16:00	Jolts Job Openings	Aug	1'000	8900k	8827k
Wednesday, 04.10.2023						
EU	11:00	PPI MoM	Aug	mom	--	-0.50%
	11:00	PPI YoY	Aug	yoy	--	-7.60%
US	13:00	MBA Mortgage Applications	Sep29	wow	--	-1.30%
	14:15	ADP Employment Change	Sep	1'000	145k	177k
	16:00	ISM Services Index	Sep	Index	53.50	54.50
Thursday, 05.10.2023						
US	14:30	Initial Jobless Claims	Sep30	1'000	--	204k
Friday, 06.10.2023						
JN	07:00	Leading Index CI	Aug P	Index	--	108.20
US	14:30	Change in Non-Farm Payrolls	Sep	1'000	160k	187k
	14:30	Change in Mfg Payrolls	Sep	1'000	10k	16k
	14:30	Unemployment Rate	Sep	%	3.70%	3.80%

Source: Bloomberg, J. Safra Sarasin as of 28.09.2023

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W (bp)	Δ YTD (bp)	TR YTD in %
Swiss Eidgenosse 10 year (%)	1.16	9	-46	4.0
German Bund 10 year (%)	2.90	16	33	-1.5
UK Gilt 10 year (%)	4.48	27	81	-2.9
US Treasury 10 year (%)	4.57	13	69	-2.9
French OAT - Bund, spread (bp)	56	1	2	
Italian BTP - Bund, spread (bp)	195	9	-20	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	10'918	17.1	-1.5	4.9
DAX - Germany	15'324	11.1	-1.6	10.1
MSCI Italy	894	7.6	-1.9	18.7
IBEX - Spain	9'427	9.6	-1.3	18.3
DJ Euro Stoxx 50 - Eurozone	4'162	11.8	-1.2	13.1
MSCI UK	2'179	10.7	-0.7	5.0
S&P 500 - USA	4'300	19.8	-0.7	13.4
Nasdaq 100 - USA	14'703	26.4	0.1	35.3
MSCI Emerging Markets	944	13.2	-1.2	1.1

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.91	7.5	0.7	-1.3
EUR-CHF	0.97	5.1	0.0	-2.4
GBP-CHF	1.12	6.6	0.6	-0.1
EUR-USD	1.06	7.2	-0.7	-1.1
GBP-USD	1.22	8.2	0.0	1.3
USD-JPY	149.1	9.4	0.5	13.7
EUR-GBP	0.86	5.2	-0.6	-2.3
EUR-SEK	11.52	7.2	-2.8	3.2
EUR-NOK	11.28	8.7	-1.3	7.5

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	106	6.4	-0.9	-5.7
Brent crude oil - USD / barrel	98	19.6	3.1	20.2
Gold bullion - USD / Troy ounce	1'869	8.3	-2.7	2.4

Source: J. Safra Sarasin, Bloomberg as of 28.09.2023

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