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Market Weekly Insights

21st November 2023

Global Outlook

S&P 500	$4,538.19 -0.20%
DJIA	$35,088.29 -0.18%
NASDAQ	$14,199.98 -0.59%
Russell 2000	$1,783.26 -1.32%
FTSE 100	$7,481.99 -0.19%
Nikkei 225	$33,354.14 -0.10%
WTI Crude	$77.81 -0.03%
10-yr Treasury	4.4%

India's Inflation Eases to Four-Month Low, Nearing Central Bank's Target

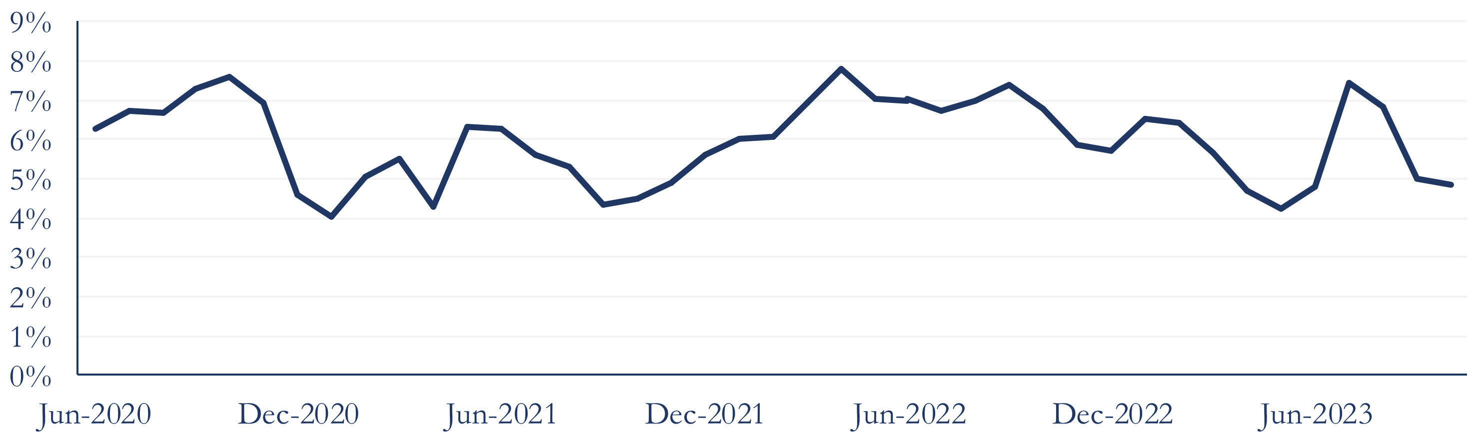
India witnessed a notable decline in retail inflation, marking a four-month low and moving it in proximity to the Reserve Bank of India's (RBI) targeted 4%. This crucial development positions the economy favorably for potential rate cuts. The annual retail inflation rate receded to 4.87%, a decrease from the preceding month's 5.02%, aligning with the consensus expectations outlined in a Reuters poll of economists.

The decline in overall inflation was attributed to lower core inflation, which excludes volatile food and energy prices. Despite remaining relatively stable at 6.61% in October, food inflation, constituting nearly half of the consumer price basket, remains a critical factor in India's inflation dynamics. Vegetable, milk, and cereal prices, known for their volatility, have been identified as the country's inflation drivers.

The RBI, maintaining a steady key lending rate for the fourth consecutive policy meeting, underscores its commitment to bringing inflation closer to the 4% target.

However, RBI Governor Shaktikanta Das has highlighted the risks associated with potential spikes in food prices, emphasizing India's vulnerability to recurring and overlapping food price shocks. Economists suggest a cautious approach, noting the need for vigilance despite the positive trend in inflation. Analysts forecast a climb in Consumer Price Index (CPI) inflation to 5.6% by December 2023, with a 4.9-5.6% range for the following two quarters.

AVERAGE RETAIL INFLATION RATE IN INDIA (in %)



Sources: Reuters, Forbes, Yahoo Finance

America This Week

Moody's Downgrades US Credit Outlook to Negative

Last Friday, Moody's Investor Services revised its assessment of the U.S. government's credit outlook, shifting from stable to negative. Despite this adjustment, the agency retained the highest credit rating (AAA) for the United States' sovereign debt. Notably, Moody's is the last among the three leading credit rating agencies to make such a modification, as both Fitch and S&P have lowered their second-tier credit ratings for the U.S. at AA+ since August 2023 and August 2011, respectively.

All three agencies have cited continued governmental instability as a primary driver. In 2011, S&P noted its concern over the American government's ability to "[tackle] the structural issues required to address the rising U.S. public debt burden effectively". The theme has appeared to prevail, with Fitch stating in August 2021 that "repeated debt-limit political standoffs and last-minute resolutions have eroded confidence in fiscal management". Moody's similarly has raised flags over the U.S.'s large fiscal deficit and "continued political polarization within U.S. Congress" that threatens the government's ability to slow the growth of the nation's debt.

Escalating interest rates have acted as a catalyst, diminishing debt affordability. The United States' sovereign debt is susceptible to the repercussions of the Federal Reserve's ongoing rate hikes. Average interest rates on the nation's debt have surged from 1.61% in 2021 to 2.97% in 2023. This surge has yielded significant consequences, as evidenced by the U.S. government's net interest costs reaching $659 billion in fiscal year 2023, marking a substantial 39% increase from the levels observed in 2022. Regardless, Moody's cited three factors supporting the U.S.'s AAA rating: long-term economic excellence, the effectiveness of strong monetary and macroeconomic policy; and the dominant roles of the U.S. dollar and Treasury securities in the global market.

Climate Change Costing the US $150 Billion Each Year

The most recent release of the U.S. National Climate Assessment underscores a trend revealing that frequent extreme weather events cause damages exceeding $1 billion dollars every three weeks. These events cost the U.S. economy nearly $150 billion annually, disproportionately affecting marginalized communities. The latest installment of the U.S. National Climate Assessment reveals that the country is now experiencing extreme weather events causing damages in excess of $1 billion dollars every three weeks, compared to every four months in the 1980s when adjusted for inflation. These events cost the U.S. nearly $150 billion annually, disproportionately affecting marginalized communities. The report emphasizes that the economic impacts of climate change will intensify without increased investment in clean energy and adaptive measures to rising temperatures and sea levels. Sectors like agriculture, tourism, and fisheries face heightened risks, disrupting food and water supplies. Coastal communities, housing 40% of the population, are particularly vulnerable.

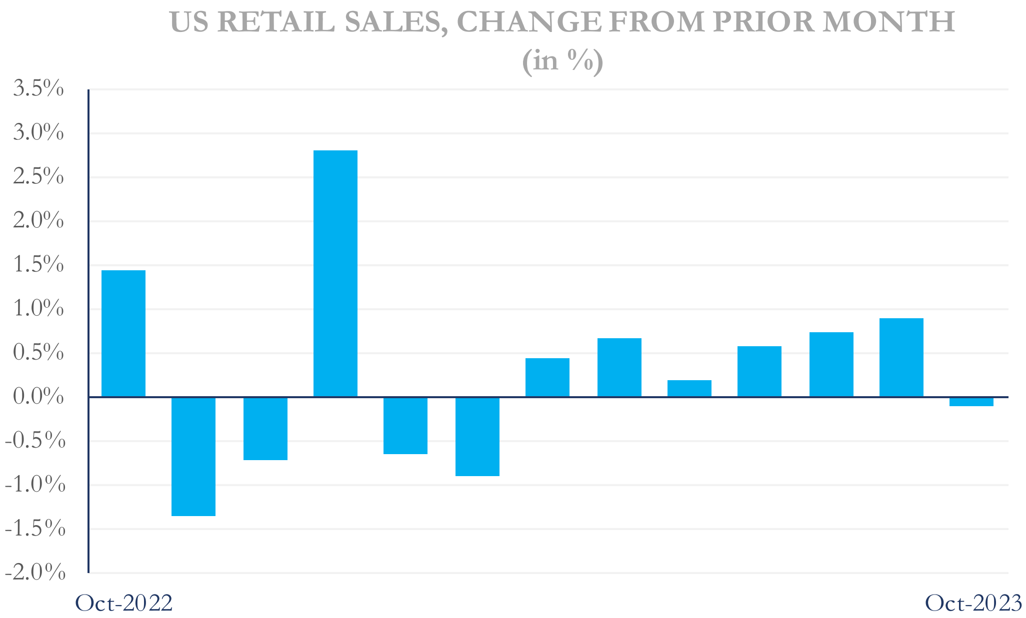
The report stresses the urgency of accelerating emissions reductions to combat climate change effectively, and to address these challenges, the Energy Department offers $3.9 billion for power grid upgrades aligning with the Biden administration's focus on clean energy projects. However, despite a recent decline in U.S. emissions, the current pace falls short of meeting crucial climate goals.

On a positive note, the assessment also highlights economic opportunities that may arise from transitioning from fossil fuels. The potential losses in fossil fuel-related jobs may be offset by creating new roles in the clean energy sector, following the administration's strategy of transforming the climate crisis into an economic opportunity.

Sources: CNBC, Wall Street Journal

US Retail Sales Fall

U.S. retail sales experienced a 0.1% decline in October, marking the first decline since March, following a 0.9% increase in September. Consumers scaled back spending across various sectors, including stores, dealerships, and gas stations. This is primarily attributed to households grappling with economic challenges, notably elevated interest rates and the resumption of student loan payments.



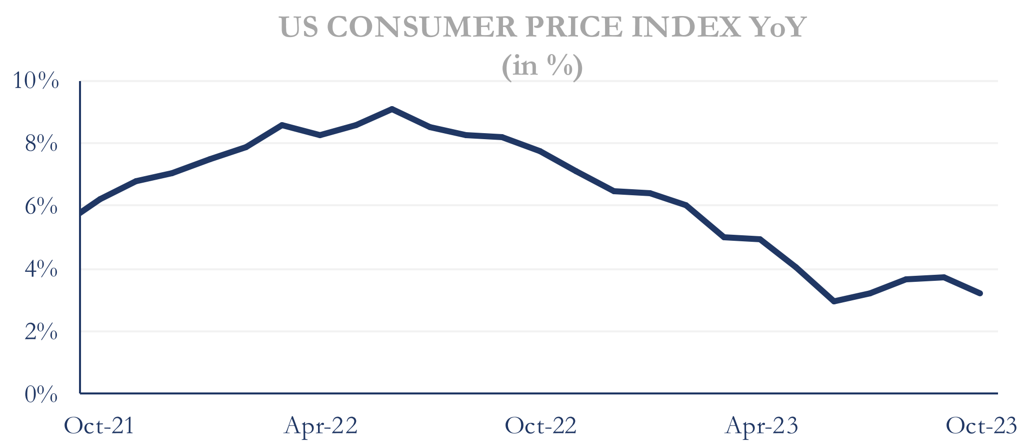
Major retailers like Target and Home Depot are witnessing their sales fall 3-4% as consumers exercise caution in discretionary spending, constituting a significant portion of their annual revenue. Economists from S&P Global Market Intelligence anticipate an overall easing of economic growth in the final months, projecting a 1% growth rate in the fourth quarter. As the holiday season approaches, analysts predict a spending increase of around 4% compared to last year.

Macro Highlights

October Inflation Report: Signs of a Fed Pause and the Pursuit of a Soft Landing

In October, a broad slowdown in inflation was observed, likely marking the end of the Federal Reserve's historic interest-rate increases. Consumer prices remained flat, with a 3.2% year-over-year increase, slower than in September. Core prices, excluding volatile items, rose modestly by 0.2% monthly and 4% annually, the slightest change since September 2021. This slowdown was influenced by lower car and airfare prices and milder growth in housing costs. Investors responded with stock and bond market rallies, anticipating that the Fed had concluded rate hikes.

The October report indicates five consecutive months of more relaxed core price increases, aligning with the Fed's criteria for reconsidering rate hikes. With core inflation at a 2.8% annual rate for the five months ending in October, the Fed paused rate increases for the first time since March 2022.



Sources: Wall Street Journal, US Census Bureau via St. Louis Fed, Bureau of Labor Statistics

The market shifted expectations, with investors no longer betting on further rate hikes but instead anticipating a possible rate cut in May. Fed officials focusing on inflation are encouraged by the substantial slowdown in the 12-month inflation rate, possibly the largest in four decades.

Despite predictions from private-sector forecasters and certain Federal Reserve officials anticipating stronger core inflation, the unexpected report indicates that the journey to curb inflation may encounter some unexpected challenges. Fed Chair, Jerome Powell, acknowledges challenges in lowering inflation to the 2% goal. The Fed aims for a soft landing, reducing inflation without triggering a recession, a goal that currently seems achievable as inflation slows and the overall economy remains robust. However, concerns persist about a potential pullback in consumer spending due to the impact of rate increases on jobs and wage growth.

Waning Low-Wage Surge Threatens Consumers

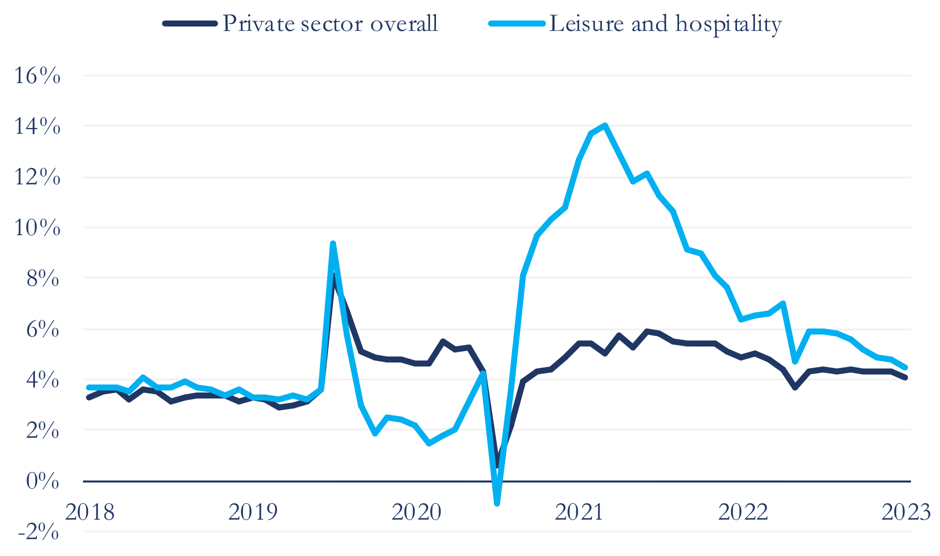
Over the past few years, low-wage workers have experienced significant benefits, including pay raises, ample job opportunities, and government relief during the pandemic. However, as the economy grapples with the Federal Reserve's efforts to curb inflation, wage growth, especially for low-wage workers, has decelerated noticeably. This slowdown has led low-income consumers to curtail retail spending, witnessing a decline in wage rises from 7.2% in January to 5.9% in October.

Economists frequently use the leisure and hospitality industry as a gauge for low-wage workers, where wages have risen by 4.5% from last year, a notable drop from the 7% at the beginning of the year.
During the pandemic, employers consistently sought low-wage workers, but the current scenario has shifted, with employers now inundated with resumes. Consequently, there's a reduction in incentives, such as sign-on bonuses, to attract workers.

Looking ahead, low-income households, having depleted their savings, will increasingly rely on income growth and borrowing to sustain spending. Notably, U.S. credit card debt surged by $154 billion in Q3 compared to the same period last year, marking the largest increase since 1999. The delinquency rate, with users 30+ days behind on at least one account, is higher than the pre-pandemic average, particularly in low-income zip codes.

Several companies, including McDonald's, Foot Locker, Gap, and budget airlines, have observed a spending slowdown among low-income consumers.

US RETAIL SALES, CHANGE FROM PRIOR MONTH (in %)

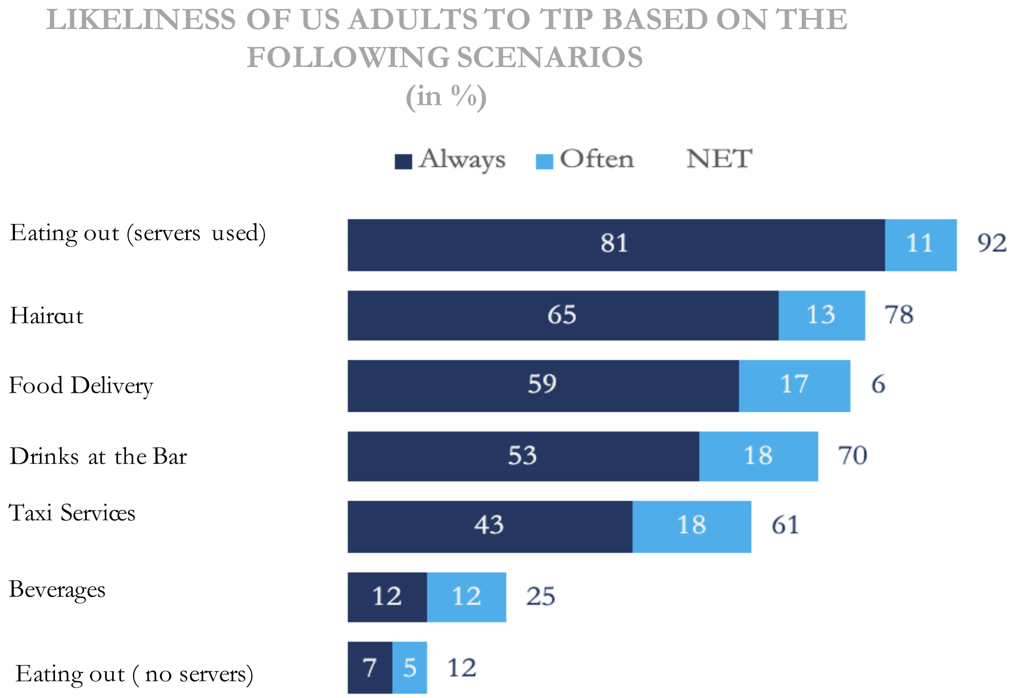


However, the most significant change lies in the standard of living. While wage growth diminishes for low-income individuals, inflation is decreasing at a faster rate, providing some relief as they still manage to outpace inflation. Despite this, the impacts of the Federal Reserve's measures are most keenly felt by low-income consumers, who, lacking sufficient savings, are constrained in their spending capacity.

Sources: Wall Street Journal

Tipflation: Navigating the Evolving Landscape of Tipping Culture in America

Americans find themselves increasingly prompted to tip service workers, a trend dubbed "tipflation." A striking 72% of U.S. adults note that tipping has become more prevalent in the last five years. Negotiating when and how much to tip has become a challenge, balancing courtesy with avoiding exploitation. About 29% of Americans feel an obligation to tip, while 21% consider it optional. The remaining 50% believe it depends on the service, reflecting a lack of standardized expectations.



As tipping becomes more routine, there's a shift towards lower percentages. Many now tip 15% or less at sit-down restaurants. However, 77% emphasize that their tipping amount is influenced by the service quality, rather than a predetermined figure.

The landscape of tipping is undergoing significant changes in structure and technology. While tipping has long been a practice with mixed sentiments, the post-COVID era introduces digital platforms encouraging tipping alongside a surge in mandatory service charges.

Industry News

Landmark Ruling Disrupts Real Estate Commission Norms

On October 31, a Missouri judge ruled the National Association of Realtors ("NAR") and several real estate brokerages were guilty of anticompetitive conspiracy, finding that they colluded to artificially inflate commissions on home sales. Around 500,000 home sellers in Missouri are expected to receive a portion of the judge's ordered $1.8 billion payout. That amount is subject to rise to nearly $5 billion.

The ruling last month sent waves through the residential real estate market, disrupting the industry's standard 5-6% commission. Typically paid for by the home seller, the commission is split between the buyer's and seller's agents and offers home seller's access to an industry-wide property database, the Multiple Listings Service. The lawsuit argued that real estate brokerages utilized anti-competitive practices by forcing sellers to pay a non-negotiable commission rate to gain visibility on their property listing and enable them to find a seller.

Companies such as Zillow, an online real estate marketplace, have seen their shares prices fall following the verdict. The dissolution of the industry's commission standard threatens to destabilize a revenue stream for the company - advertising for buyer agents. Americans pay around $100 billion in real estate commissions annually. This number could drop by up to 30% as home sellers gain more power to negotiate rates and agents lower prices to remain competitive.

Sources: Pew Research, Washington Post

The verdict comes at a time when the US housing market is already taking a battering from high interest rates. Progressive rate hikes from the Federal Reserve have lofted 30-year mortgage rates to 7.64%, making new house purchases less affordable for many Americans. With no clear sign from the Federal Reserve on when rates may start to fall, high costs of borrowing may continue to depress the market.

Dubai's $50 Billion Boeing Boost

Dubai-based carriers made a significant impact on the aviation industry last Monday by placing orders exceeding $50 billion for Boeing jets. Emirates and its sister airline, flyDubai, jointly acquired 125 Boeing wide-body jets, including a substantial order for 90 777x planes. This development marks a substantial boost for Boeing's 777x program, which has been grappling with years of delays.

The timing of these orders is notable, given the current high international demand for long-haul jets coupled with a limited supply. Dubai's airlines, alongside others, are making strategic bets on long-term demand from future travelers. This commitment comes at a time when travel in the region has been affected by geopolitical events, such as the Israel-Hamas conflict.

In response to the order placements and a Bloomberg report suggesting a potential pause in Chinese 737 orders following a meeting between Joe Biden and Chinese President Xi, Boeing experienced a positive market reaction. Boeing shares saw a 4.4% increase, indicating investor confidence in the company's prospects.

While medium-haul planes are crucial for driving profits for plane makers and suppliers, the Gulf region stands out as the largest purchaser of wide-body jets. Dubai's substantial orders raise the competitive stakes for other countries in the region seeking to establish a comparable footprint. Saudi Arabia, Turkey, and India are among those striving to keep pace with Dubai's influence, and it is anticipated that they may place additional orders for long-haul planes.

Industry insiders estimate that airlines globally are currently in negotiations for the purchase of 700-800 new jets. This surge is attributed to a re-prioritization of replacement plans that were deferred during the pandemic. However, concerns linger about tight supply chains, with a significant number of ordered jets not slated for delivery until 2030. The aviation industry is experiencing a substantial influx of orders, and manufacturers are facing challenges in keeping up with the demand.

OpenAI investor Inks $3 Billion Fundraising to Allocate to Startups

Khosla Ventures, a prominent investor in OpenAI, is on the verge of finalizing a remarkable $3 billion venture capital fund, showcasing the resilience and optimism prevalent among Silicon Valley investors. This substantial deal, the largest venture firm fundraising effort in 2023, stands out against the backdrop of challenges faced by many startups and their current low valuations.

OpenAI, a beneficiary of Khosla Ventures' investment, has articulated plans to allocate these funds towards supporting startups engaged in research-intensive domains, notably nuclear fusion, humanoid robots, and artificial intelligence. Recognizing a dwindling competitive landscape, OpenAI envisions this as an opportune moment to empower startups focused on revolutionizing traditional industries such as healthcare, transportation, and infrastructure.

Sources: Wall Street Journal, Reuters

In a market where high-interest rates have led many investors to curtail funding for startups, Khosla Ventures stands out as an exception. The firm is earmarking $500 million for startups and a substantial $1.6 billion for those in early-stage development, emphasizing its commitment to fostering innovation.

Khosla Ventures is renowned for its non-traditional investment approach, acknowledging significant losses in recent years. However, given the foresight exhibited in early-stage investments, the firm continues to demonstrate resilience and success. Adopting a long-term perspective, Khosla anticipates a market boom to reach new heights by 2030, underscoring the strategic patience embedded in the firm's investment philosophy.

Looking Ahead

Analyst Outlook – Rahul Kapur

Throughout 2023, the unemployment rate has been sitting around 3.5-3.8%, signaling an economy that remains vigorous despite other factors, including mass layoffs and high-interest rates. Going into the first quarter of 2024, some analysts are predicting unemployment to rise to upwards of 5%, mainly attributed to the Federal Reserve raising interest rates, which they have done 11 times since March 2022. 2024 will be a crucial year for the health of the U.S. economy, and I expect the unemployment rate to stay around 4-4.5%, with interest rates not being cut before Q2 of 2024. What remains most important as we go into the new year is the Fed focusing on lowering interest rates, maintaining a strong labor market, as well as putting more money in the pockets of Americans.

Analyst Outlook – Jack Miller

Stocks finished higher this week; however, data suggests the economy is slowing down. Retail sales and producer prices saw their largest decrease since March 2023 and April 2020, respectively. This indicates that the federal reserve may not only be done raising rates, but they may even begin to cut rates in 2024.

Moreover, a soft landing is still in question as financial conditions eased towards the end of rate hikes. The recent drop in Treasury yields and a stock market rally pose challenges for the Fed's goal of tightening financial conditions. With the delicate task of managing a slowing economy without triggering a recession, the Fed faces uncertainties in achieving both rate cuts and economic stability.

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Sources: Yahoo Finance