Market Weekly Insights

23rd October 2023

Global Outlook

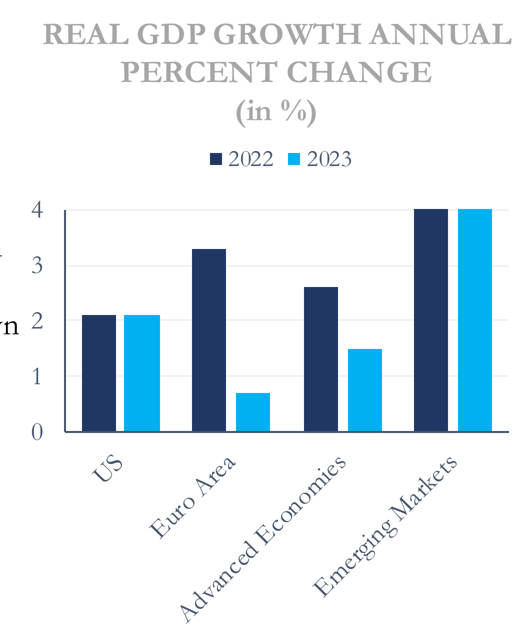
S&P 500	$4,224.16 -1.26%
DJIA	$33,127.28 -0.86%
NASDAQ	$12,983.81 -1.53%
Russell 2000	$1,680.79 -1.29%
FTSE 100	$7,402.14 -1.30%
Nikkei 225	$31,259.36 -0.54%
WTI Crude	$88.30 +0.25%
10-yr Treasury	4.9%

Global Economic Concerns Mount Amidst US Economic Adjustments, Escalating Geopolitical Tensions, and Slowing Trade

The surge in confidence within the US economy has triggered concerns in global markets, particularly concerning the ripple effects of higher US interest rates and the resultant strengthening of the USD, which have the potential to disrupt international trade dynamics and impact the stability of economies worldwide.

The ongoing conflict within the Gaza territory has further exacerbated the existing market volatility stemming from Russia's invasion of Ukraine. “Geopolitical tensions are the real economic risks now and we are all aware of that,” said French Finance Minister Bruno Le Maire. “Any escalation in the region would, of course, have a significant impact on global growth.”

Market uncertainty became clear as global trade is on track to grow by only 0.9% this year, a sharp decline from 5.1% last year. The IMF is concerned that this slowdown may provoke nations to focus their economic policies on national security rather than economic growth. Supply disruptions have also slowed growth while turning away investors. The IMF has boosted their inflation forecast to 5.8% for 2024, up from 5.2% in 2023, and they do not expect many countries to return to their price growth target until 2025.



Given that many foreign goods and commodities are priced in USD, when the USD strengthens, it is more expensive for other countries to buy foreign goods. "Because inflation has been more persistent than we thought, we are going to have to keep policy rates higher,” said Lesetja Kganyago, the governor of South Africa’s central bank. The challenge posed by elevated US rates to emerging markets is a shared concern among central bankers who hope to see a slowdown in US inflation. A new wave of debt may disperse across the world, as it will soon be very challenging for countries in emerging markets to pay their USD debt.

Global Implications and Economic Risks of the Israel – Hamas Conflict

The Israel-Hamas conflict, with its potential to escalate and draw in other countries, carries significant global implications. One of the immediate concerns is its impact on the world economy. The conflict raises fears of disruptions in oil supply.

Sources: Wall Street Journal, International Monetary Fund, Yahoo Finance

If the conflict expands, there is a significant risk of soaring oil prices, potentially reaching up to $150 per barrel. The spike in oil prices could lead to a global recession, slashing about $1 trillion off world output. There are concerns that the situation might lead to a proxy war between Israel and Iran, involving countries like Lebanon and Syria. Such an escalation could strain international relations and increase the risk of further conflicts in the Middle East. The severity and duration of the Israel-Hamas conflict will dictate its global impact. Oil prices are predicted to rise by $4 per barrel in the case of a confined war with minor market disruption.

In a proxy war involving Gaza, the West Bank, Lebanon, and Syria, oil is expected to increase by $8 per barrel, market volatility will rise by 8 points, and a 0.3% global economic decline is anticipated. In a direct Israel-Iran war, oil prices are projected to skyrocket by $64 per barrel, market volatility is forecasted to rise by 16 points, global GDP is expected to drop by 1.0%, and inflation is set to surge by 1.2%. Moreover, the conflict's geopolitical implications could lead to deglobalization.

Scenario	Impact on oil prices and market volatility	Impact on global GDP and inflation
Confined war	Oil: +$4/barrel Market volatility: no Impact	GDP: -0.1 ppts. Inflation: +0.1 ppts.
Proxy war	Oil: +$8/barrel Market volatility: +8 points	GDP: -0.3 ppts. Inflation: +0.2 ppts.
Direct war	Oil: +$64/barrel Market volatility: +16 points	GDP: -1.0 ppts. Inflation: +1.2 ppts.

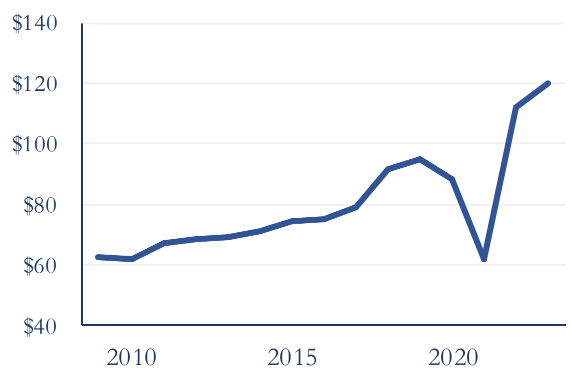
If trade relations between prominent economic actors deteriorate, it could result in reduced trade cooperation, less information sharing, and decreased financial-market linkages. Deglobalization could ultimately lead to inflationary pressures, causing prices to rise and potentially prompting tighter monetary policies globally.

America This Week

"Funflation" is Hurting Americans

Ticket prices for live entertainment events including concerts, sports, and theme parks have increased significantly. While some fans are willing to pay regardless of price, others can't. In a recent survey, nearly 60% of Americans said they have had to cut back spending on live entertainment this year because of the rising costs. Live music ticket prices have surged with the average ticket price in North America being $120.11, a 7.4% increase since last year. This rise in cost is mainly due to social media marketing for artists like Taylor Swift, Bad Bunny, and Blackpink, who are selling out at stadiums nationwide. The average price for Swift tickets was $1,095 with the best seats going for thousands of dollars. Other artists like Elton John and Ed Sheeran racked up more than $100 million in sold-ticket revenue during the first half of 2023.

AVERAGE TICKET PRICE FOR TOP 100 NORTH AMERICAN TOURS (in $)



Sources: CNN, Bloomberg, Wall Street Journal

Consumers have also seen rising costs at theme parks such as Disney, whose ticket prices are now $194 for a single-day visit, up 8% from last year. Disney has added new features for consumers such as passes to skip the line, but they come with a hefty cost. Other venues, like the San Diego Zoo, have raised ticket prices to cover wage inflation and material costs. According to the Bureau of Labor Statistics, the price for these events has risen faster than the food and gasoline prices in 2022. In August, Americans were on track to spend $175 billion this year on tickets alone.

With significantly rising costs, consumers are faced with questions as to whether they want to see a live entertainment event or put food on the table. The decrease in disposable income forces consumers to make more tradeoffs in their purchasing choices.

Rite Aid Files for Bankruptcy

Rite Aid, one of America's top drugstores founded in 1962, has taken a strategic step by filing for Chapter 11 bankruptcy protection, allowing the company to continue its operations while reevaluating and restructuring its financial obligations. The drugstore has grappled with multiple challenges including slowing sales, lawsuits, and significant debt burden. Competing against industry leaders like CVS and Walgreens, which have shifted their focus towards healthcare and made substantial investments in the sector, has proved to be a difficult battle for Rite Aid. Following the second quarter end, the company reported a significant revenue decline of $410 million with net losses of $306.7 million, compared to a $110.2 million loss in the same period last year.

Earlier this year, the Department of Justice took legal action against Rite Aid, accusing the company of dispensing thousands of illicit prescriptions, including substances such as Fentanyl and Oxycodone. Rite Aid has responded by seeking a dismissal of the case and concurrently announcing plans to shutter underperforming storefronts.

The implications of this legal battle extend beyond Rite Aid's financial stability. Millions of Americans who depend on Rite Aid for both their essential medications and employment could face significant repercussions should the company fail to achieve financial stability and be found guilty in this case. The outcome of this legal proceeding carries the potential to impact both healthcare access and the livelihoods of many across the nation.

Macro Highlights

U.S. Retail Prevails Amidst Bond Yield Surge

In September, U.S. government bond yields reached the highest levels over a decade, spurred by robust economic data. A stronger-than-expected 0.7% increase in retail sales, including spending online, in stores, and at restaurants, contributed to these concerns. The 10-year bond yield rose to 4.8%, its highest point since July 2007. Despite increased yields, American consumers continued spending, supporting the economy. Upbeat economic indicators have led bond traders to revise their expectations regarding the Federal Reserve's monetary policy, anticipating a more extended period of elevated interest rates.

The retail sector showed remarkable resilience. Retail sales, excluding gasoline stations, car dealers, building-materials stores, and food services (considered the control group for tracking consumer spending), rose by 0.6%. Inflation, a key factor, remained under control, especially in goods sold at stores. While overall consumer prices increased by 0.9% in the third quarter, goods prices rose more modestly at 0.6%. Some goods even experienced price declines, such as appliances (-0.9%) and furniture and bedding (-1.7%). As wages continued to rise, Americans' inflation-adjusted spending power increased, boosting retailers.

Despite concerns about rising bond yields, the positive momentum in consumer spending and the retail sector suggests a relatively strong outlook for the holiday shopping season. However, the impact of geopolitical events, such as the Israel-Hamas conflict, and evolving economic factors remain essential variables in the market landscape.

Sources: NBC, Wall Street Journal, Forbes

Industry News

AI's Potential to Transform the Work Environment and Boost Productivity: A Goldman Sachs Perspective

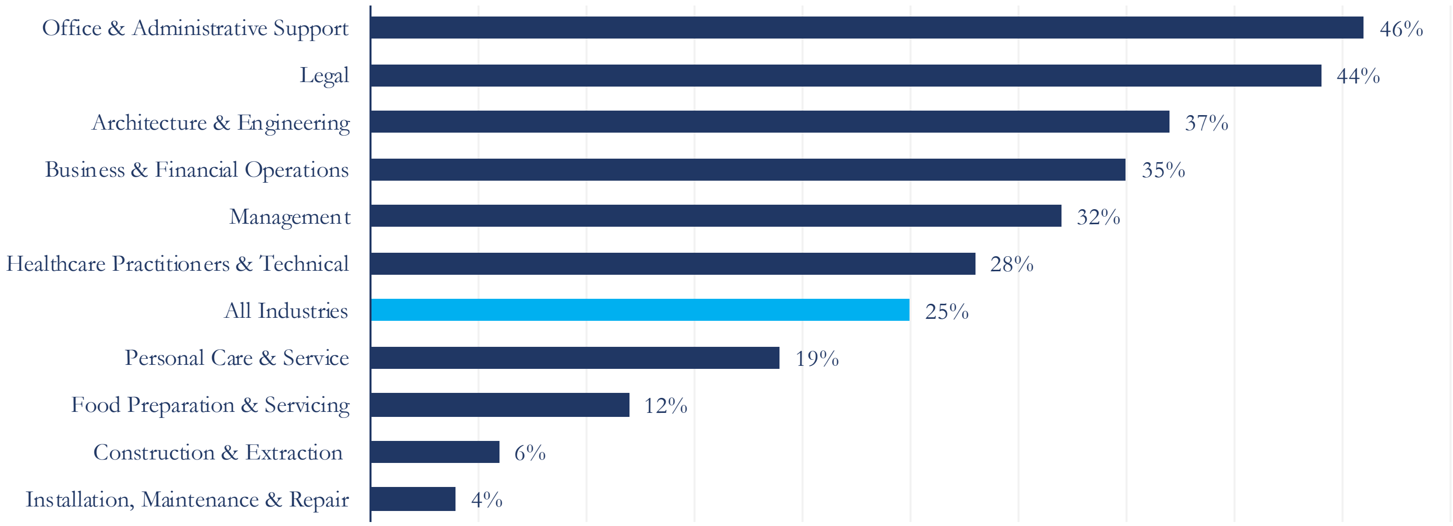
Artificial intelligence possesses the transformative potential to reshape the workplace, paving the way for imminent economic expansion while concurrently boosting productivity and overall output. As technology continues to advance and becomes increasingly accessible, the onus falls on companies to harness its full potential, extracting the maximum value it can offer.

Economists from Goldman Sachs predicted that within the 10 years after generative AI is widely adopted, it will boost annual US productivity by 1.5%. This would double the average productivity growth rate from 2007, yet it is challenging to predict when the wide adoption of generative AI will occur.

In the past, new technology has not made an instant impact on any field because the rest of the business must adapt along with the technology. For example, companies will soon need to hire specialists who are also proficient with their innovative technology, and that technology is not always available to the public. Some fields, on the other hand, have hit the ground running with their new AI technology. Call centers have seen a 14% increase in productivity, as generative AI has helped low skill workers specifically.

Goldman Sachs' analysis indicates that around 25% of tasks will soon be automated, specifically administrative and legal work. Physically demanding jobs, such as construction and maintenance, are not heavily affected by automation. It is more probable that AI changes the tasks of many people, rather than replacing them completely. However, jobs may be at risk if a company falls behind on technology used in their field, as more advanced companies will take their market share and root them out.

US EMPLOYMENT EXPOSED TO AUTOMATION BY ARTIFICIAL INTELLIGENCE
(in %)



Sources: Wall Street Journal

Challenges in Commercial Real Estate

Potential losses in commercial real estate were a top cited concern amongst respondents to a recent Fed survey. Data reported by MSCI Real Assets indicated that nearly half of outstanding distress (40.8%) was attributable to office buildings at $21.2 billion. This sector contributed 93% of additions to the distressed balance, a worryingly large signal of weakness. Another segment of CRE, retail, stood second at $21.2 billion or 26.6%.

The instability in this industry is largely attributed to a slow return to in-person work as rising interest rates squeezed the US commercial real estate market. Properties tied to floating rate loans run a huge risk and largely impact banks. According to the Fed, some banks will be faced with large declines in the fair value of their assets, promoting worries that, following the collapse of Silicon Valley bank, high levels of unrealized losses will topple more institutions.

Low office occupancy rates are another pain point for office building landlords. Kastle Systems, a leading security solutions company, recorded that average return rates barely scraped above 50% of 2019 levels in 10 US cities. In cities where return rates are highest, such as Houston, Dallas and Austin, vacancy levels are still soaring. In Q3'23, 25% of available office space wasn't leased due to excessive supply.

Biden Administration Further Restricts US Chip Exports to China

Regulations set forth by the Biden Administration in October of last year are currently undergoing revisions, with the updated measures set to take effect within the next 30 days. One of the significant changes involves the suspension of shipments of advanced semiconductor chips, including those from Nvidia, to China. This move is a strategic effort to prevent Beijing from leveraging US technology to bolster its military capabilities. Semiconductor chips are instrumental in powering artificial intelligence and advanced computer systems, technologies that play a pivotal role in various military applications.

These new rules will restrict advanced chips and chipmaking tools from going to many countries including Iran and Russia while blacklisting Chinese chip designers Moore Threads and Biren from the US. The US Commerce Department Secretary states that the restrictions are not meant to hurt China's economy, but a spokesperson from the Chinese embassy states they firmly oppose the new restrictions, and they violate the market economy and fair competition.

Nvidia said that it will comply with the new regulations and doesn't foresee a meaningful hit to their near-term results. When last year's rules were imposed, Nvidia and Intel made chips specifically for the Chinese market that limited communications speeds, but they were still better than other alternatives in the market. Their business has continued to thrive and Nvidia is still selling almost every chip it produces globally. Right now, demand is far exceeding supply. However, these restrictions may hurt US chipmakers in the long run if Chinese firms find another alternative.

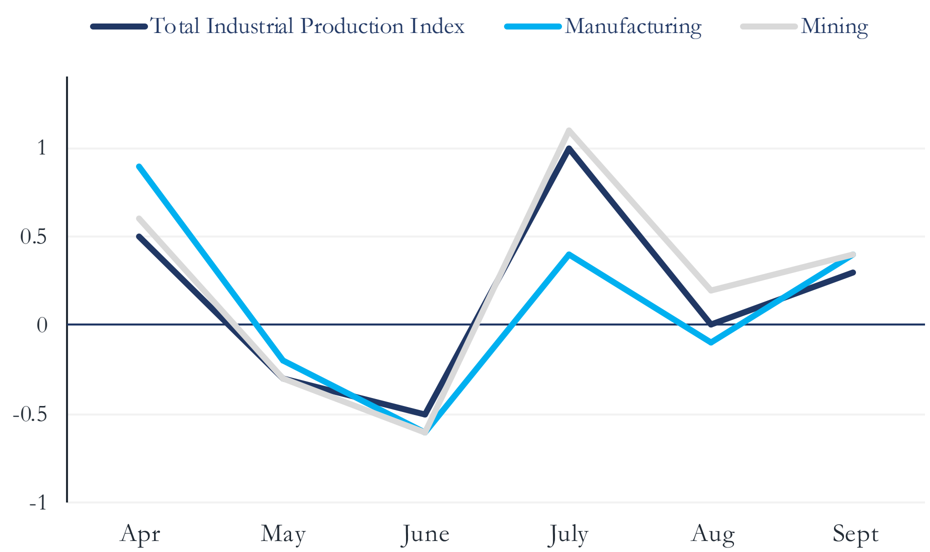
Sources: Barrons, Wall Street Journal, Reuters

US Industrial Output for September Surpasses Expectations

Despite slight headwinds from US auto strikes, the Fed reported on Tuesday that industrial production rose above expectations, up 0.3% since August rather than an anticipated increase of 0.1%. Numbers from prior months were also revised with August numbers now sitting at 0.0%. Of the major industrial groups, manufacturing and mining trended upwards, both sitting at 0.4%, up from -0.1% and 0.2% respectively from the month before. Within the manufacturing segment, wood products, primary metals, plastics, and rubber products grew by more than 1% whilst apparel, leather, printing, and support declined by more than 1%. Amidst the ongoing UAW strike on the US's Big Three automobile manufacturers, General Motors, Ford, and Chrysler September growth in motor vehicles manufacturing was subdued, clocking in at only 0.3%.

Overall, industrial growth for September higher than expected but the industry is likely to face interest rate headwinds in October and the coming months as borrowing costs rise.

PERCENT CHANGE IN INDUSTRIAL PRODUCTION



Market Insights Team

					
Momo Hassan	Jade Chan	Varun Jhamvar	Rahul Kapur	Jack Miller	Alyssa Nguyen
Director	Associate	Analyst	Analyst	Analyst	Analyst
Wellington Management	Northeastern University	Northeastern University	Fidelity Investments	Northeastern University	Northeastern University

Sources: Reuters, Board of Governors of the Federal Reserve