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Markets in a Minute

Guy Foster, Chief Strategist, discusses fresh U.S. economic data and the prospect of a soft landing. Plus, Janet Mui, Head of Market Analysis, analyses inflation data and the likelihood of interest rate cuts in Europe and the UK.

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New highs for U.S. stocks

Global markets are buoyant, with the S&P 500 index and Dow Jones Industrial Average reaching new record highs last week.

Despite mixed corporate earnings results, sentiment is broadly supported by good news on inflation, better-than-expected U.S. economic data, and the backdrop of interest rate cuts.

As is the case in every earnings season, there is stock-specific volatility related to the earnings outlook guidance (a company's public estimates of its current quarter and future earnings), which tends to have read-across implications for the sector.

Standout positive performance this quarter came from U.S. banks. Key players including Goldman Sachs, Morgan Stanley, JP Morgan, Citi, and Bank of America delivered strong earnings that handsomely beat analysts' expectations, resulting in a boost to their share prices.

Revenues were boosted by trading activities and deal-making, thanks to volatile markets over the summer and investor sentiment becoming more bullish as interest rates come down. The resilience in net interest margins is a relief to bank analysts, and the improvement in capital market activity is likely to be a more dominant driver of returns going forward.

In addition, commentary from bank CEOs on U.S. consumers is reassuring, which is music to investors' ears. Indeed, last week's U.S. economic data related to consumers and the labour market provided more reasons to be cheerful. For instance, U.S. retail sales expanded at a healthy pace in September and initial jobless claims dropped after a spike induced by Hurricane Milton.

Earnings season: The haves and have-nots

Things don't look as good in the Eurozone. Not only did economic data weaken, but the area's top stocks were threatened by external concerns. The Louis Vuitton Moët Hennessy (LVMH) stock price plunged, as the company reported a 5% fall in its key leather and goods division in the third quarter. LVMH has also flagged the strength of the Japanese yen as one of the main reasons it suffered lower sales.

The luxury sector is the crown jewel of the European equity market, but it faces tougher times when its biggest customers (Chinese consumers) are struggling economically, and wild currency fluctuations are working against it. Chinese stimulus is seen as a ray of hope for the luxury sector, but the real impact will take time, and aspirational consumers of luxury goods are likely to remain cautious. The near-term outlook for LVMH remains cloudy but it's a well-diversified luxury behemoth with irreplaceable brands.

The haves (true luxury) and the have-nots (affordable luxury) of luxury brands may see more differentiated outlooks, with consumers preferring to spend their tighter budgets on true luxury brands that tend to hold value in the second-hand market.

Last week, we saw a tale of the haves and have-nots in the semiconductor industry too. ASML, the Dutch chip equipment maker, saw its share prices plunge more than 20% after issuing highly disappointing 2025 revenue guidance that was less than half of what the market was expecting. As it holds a monopoly on the machines for chip foundries like TSMC, Samsung, and Intel, the disappointing results naturally raise concerns for the sector given the close-knit nature of the supply chain.

There are some company-specific issues. It's tougher when one of your most important customers (again, China) is facing export restrictions to the point you can't sell your most profitable gear to them anymore. A lot of sales to China were frontloaded, meaning an influx was made at the start of the period, which will not be repeated in 2025. But ASML's results also highlight the stark contrast in artificial intelligence (AI) versus non-AI chip demand. ASML CEO Christophe Fouquet said, "Today, without AI, the market would be very sad, if you ask me".

After ASML's disappointing results, which helped wipe billions off the chip sector's market capitalisation, TSMC's robust outlook guidance on AI demand came to the rescue. TSMC is the best-positioned foundry to benefit from the surge in AI chip making, thanks to its advanced technology and global expansion plans. Its shares bounced 13% on the day and lifted other AI-beneficiary chip stocks like Nvidia, Micron and Applied Materials.

When Chinese officials talk, the world listens

The latest Chinese economic data, including inflation, loan growth and export data, disappointed. Third quarter gross domestic product (GDP) slowed from 4.7% to 4.6%, putting China's 5% growth target at risk. On the bright side, retail sales, industrial production, and fixed asset investments all came in better than expected. However, investors are unlikely to be satisfied with the pace of recovery in China.

Officials are desperate to be seen as working around the clock to support the economy. It's not common for officials to host press conferences every other week, or even days. Overall, the latest stimulus updates have underwhelmed, as there are no new details on stimuli on the consumer side. Also, there were no specifics on the debt and deficit increase.

On the positive side, there's certainly willingness and room to do more. The key focus areas of the briefing, including housing market support, replenishing bank capital, and local government funding, are the right ones to tackle. It's clear the budget deficit will increase and more borrowing at state and local government levels will be needed. Capital injection into state banks is essentially the state underwriting credit risk to allow banks to lend to riskier areas, allowing capital to flow into the real economy.

We're hopeful that more stimuli will be coming. We think policy is heading in the right direction, but implementation is key. China's housing market can't be fixed in a short period of time. At the very least, the economy should stabilise, and the incremental benefit of the stimulus package should be felt more beyond 2025.

Markets are likely to remain volatile in China due to its retail-driven nature and understandable scepticism amongst international investors. We're giving the Chinese market the benefit of the doubt this time, as valuations remain low, which acts as a buffer.

Falling inflation gives green light to rate cuts

The European Central Bank (ECB) cut interest rates for the third time this year. The markets' reaction was relatively muted, as it was widely expected and fully priced in by the bond market.

The ECB refrained from outright dovish communication, as wage growth figures remain higher than desired. But the markets' interpretation is that another cut in December is highly likely, as the ECB sounded slightly concerned about growth while stating the disinflationary process is well on track.

We knew prior to the meeting that inflation in key Eurozone economies has weakened notably. We also saw economic data worsening in the two largest economies in the area. As the ECB now has a more constructive view on inflation reaching its 2% target, we believe the ECB will continue to have an easing bias, even though it hasn't changed its official forward guidance.

We believe the ECB will continue to deliver a series of rate cuts through to at least mid-2025, as growth concerns rather than inflation will dominate. In fact, markets are increasing bets that the ECB may cut by half a percentage point in December 2024.

Further rate cuts by the ECB are helpful to equities in the region, but the near-term outlook is more dependent on earnings results and details on Chinese stimulus measures.

Turning to the UK, where inflation pressure is perceived to be stickier and hence more of a constraint

for the Bank of England (BoE) to cut aggressively, the latest inflation and wage data supports another rate cut as soon as November.

UK consumer price index (CPI) inflation fell to 1.7% in September, below analysts' expected 1.9%, and well below the BoE's Monetary Policy Committee's forecast of 2.1% made back in August.

Core CPI inflation, which excludes energy, food, alcohol and tobacco, rose by 3.2% in September, lower than estimates of 3.4%. Although weaker air fares were a big driver of the decline, there is a broader story of weak inflation in these numbers that will encourage the BoE to cut interest rates.

Ignoring the biggest individual categories of inflation, the better news was that the median inflation category only saw prices increase by 0.2%, the lowest since 2021. Meanwhile, UK average weekly earnings ex-bonus growth slowed to 4.9% from 5.1% year-on-year.

All in all, the latest data would allow BoE Governor Andrew Bailey to be more aggressive with interest rate cuts, as he suggested in a recent interview. This probably means increasing the cadence of interest rate cuts rather than making a U.S.-style 0.5% cut. This supports our current stance of being overweight in UK gilts, as the markets' pricing of rate cuts in the UK has the potential to be more aligned with the pricing of rate cuts in the U.S.

For major Western central banks, the bias has clearly shifted to supporting growth rather than fighting inflation. Easier monetary policy is the key economic theme going into 2025 that should support consumer, business and investor sentiment.

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