THE GLOBAL CIO OFFICE

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It's Just Not That Easy

- **Markets pause as the bullish view sobers up**
- **Fed speakers reiterate their intention to keep tightening**
- **Data shows US household debt accumulation as consumers use credit cards to maintain spending power**
- **Asia has the opportunity – and ability – to outperform but meaningful collective policy making is still absent**
- **The bullish dollar positioning looks exaggerated**

After the recent good US consumer and producer price inflation reports, it was easy to conclude that there are much better times ahead in the asset markets. Since the equity market low in September, the markets have rallied strongly on the back of good inflation data. However, in our view, it just won't be that easy. Other data points last week suggest other significant challenges for the Federal Reserve that should make them think twice about pulling back on their tightening monetary policy.

After the previous week's investor euphoria, hawkish comments from the Federal Reserve speakers unnerved investors. St. Louis Fed president James Bullard's view that more hikes were needed to get to sufficiently restrictive levels, and Minneapolis Fed president Neel Kashkari's assertion that it was an "open question" about how high rates would be raised took the steam out of the rally. The benchmark S&P 500 fell in three out of five sessions, eventually ending the week down 0.69%.

Data released last week shows that US households have become much more concerned about the inflation outlook. Somewhat paradoxically, though, they are trying to maintain their living standards by aggressive credit card spends. According to a New York Fed survey of consumers, inflation expectations for 2023 have risen to 5.9%, half a percentage point higher than that recorded in September. Longer-term inflation expectations have also edged up. The three-year and five-year expectations for inflation increased to 3.1% and 2.4%, respectively.

Due to the higher cost of living, Americans are depleting their savings and retirement accounts. Many are turning to credit cards and other forms of loan options to pay for goods and services in a vain attempt to maintain their standard of living.

According to the Federal Reserve, household debt in the US recently rose at its fastest pace in 15 years. Outstanding balances on credit cards grew to more than 15% year-on-year, the highest increase in more than 20 years. The total amount of American household debt reached $351 billion for the third quarter, the most significant jump in debt since 2007. The total debt owed in the US is a record $16.5 trillion. The most significant contributors to debt originated from mortgage and credit card balances, which rose to $11.7 trillion and $930 billion, respectively.

Member states of the Asia Pacific Economic Cooperation (APEC) met in the Thai capital Bangkok on 18-19 November. It is easy to forget that APEC accounts for nearly 40% of the world's population and almost half of the world trade. As an organisation, it has been a bystander to some of the biggest issues facing the global economy: the war in Ukraine and the US Fed's monetary policy, to name a few. However, it has been at the receiving end of significant consequences. As Associated Press put it, "much of APEC's work is technical and incremental…covering areas such as trade, tourism, forestry, health, food, security, small and medium-size enterprises, and women's empowerment." While the organisation is dominated geopolitically by the US, China, and Russia, it provides a platform for the rest of Asia to set a global agenda.

The ASEAN region has an opportunity to be more proactive in setting up a global agenda and to encourage greater participations from countries for a constructive and rapid solution to such pressing problems as climate change and international peace. The IMF forecasts that the ASEAN-5 region will have GDP growth of 4.9% in 2023, almost five times that of the developed world (1.1%). In our view, the only reason that ASEAN equities will not outperform in 2023 could be a significantly tighter US monetary policy that surprises the market and/or Russia and China causing further geopolitical angst.

Chart 1: MSCI ASEAN equity market index relative to MSCI World

Index rebased to November 2012=100

Source: Bloomberg

We return to our tactical perspective. A recent Bank of America survey of institutional investors highlights the most favoured long positions of institutional investors. Those investors have received a big jolt as the trade-weighted dollar has receded around 5% from its recent peak (although it is still up 11% year-to-date). Last week's speeches from some of the Fed's voting members highlight that Fed policy could remain quite hawkish and hence supportive of the dollar. The BofA survey also highlights that the consensus is not always right. For dollar bulls, losing one quarter of the gain for the year in a matter of weeks is a wake-up call to the potential extreme of the previous dollar strength. As a good offset to the risk of downside to the dollar, the recent reawakening of the gold price has put the metal back on the list of relevant asset classes in the current circumstances.

Chart 2: Gold price rallies as trade-weighted dollar dives

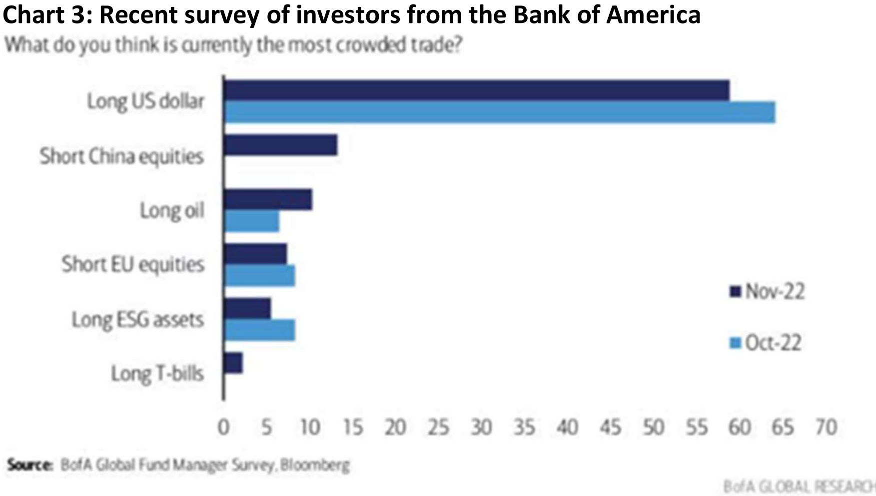
Gold price and USD trade-weighted index rebased to November 2021=100

Source: Bloomberg

We would take issue with the short Chinese equities trade, certainly as a tactical trade. As we saw from the recent action in the market, any good news can spark a sharp rally after such prolonged absolute and relative poor performance. The recent G20 and APEC meetings have suggested that China is trying to work on its global image. The apparent shift to more explicitly opposing Russia's ambitions in Ukraine will help.

We agree with the long oil view, although there may be some further room for profit taking in the coming weeks. Some of the near-term supply pressures appear to have waned. Near-term contracts in the oil market are trading below longer-dated contracts and reversal of recent price levels. Our medium-term bullish view on oil is supported by the constraints on supply. OPEC+ has cut production by 2mn barrels per day. The US has tried to fill this void by selling oil from its strategic reserves. However, the US's ability to reduce its strategic reserves further is limited by its already depleted levels – the lowest since 1984. Supply will also be constrained by the EU embargo on Russian oil from December 5th.

Chart 3: Recent survey of investors from the Bank of America



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