



**Philequity Corner (November 14, 2022)**

**By Wilson Sy**

### **Rally resumes on easing inflation**

Last Thursday, the comeback rally of financial markets resumed following reports that US inflation came in less than expected. Investor sentiment strengthened after some Fed officials made dovish comments. US stock indices notched their biggest one-day gains since the start of the pandemic in 2020. Bond prices recovered sharply as bond yields fell. Global currencies rebounded as the US dollar posted its biggest one-day drop since 2009.

### **US inflation dips to lowest since January**

US headline inflation came in at 0.4% MoM and 7.7% YoY in October, below consensus expectations of 0.6% MoM and 7.9% YoY. Headline inflation decelerated from 8.2% in September and was the lowest since January. Though October inflation was still way above the Fed's 2% target, the slowdown in inflation fueled investor hopes that inflation has peaked.

### **Dovish Fed speak signals slower rate hikes**

While most policymakers still favor raising rates, some Fed officials have made dovish comments and appear to be contemplating slower rate hikes. Below, we list comments made by some Fed officials in response to lower-than-expected October inflation.

- Philadelphia Fed Chair Patrick Harker said, "In the upcoming months, in light of the cumulative tightening we have achieved, I expect we will slow the pace of our rate hikes as we approach a sufficiently restrictive stance."
- Dallas Fed President Lorie Logan said, "I believe it may soon be appropriate to slow the pace of rate increases so we can better assess how financial and economic conditions are evolving."
- San Francisco Fed Chair Mary Daly explained that "Stepping down is an appropriate thing to think about. Pausing is not the discussion, the discussion is stepping down."
- Kansas City Fed chief Esther George said, "A more measured approach to rate increases may be particularly useful as policymakers judge the economy's response to higher rates. Already, the Federal Open Market Committee's policy actions have led to a sharp tightening of financial conditions."
- Boston Fed President Susan Collins noted that the risks of overtightening have risen after a series of jumbo Fed rate hikes.

### **Biggest one-day gains since pandemic**

Amid fears that an ultra-hawkish Fed will induce a painful global recession, markets sizzled following reports of lower-than-expected US inflation. This raised the prospect of slower Fed rate hikes, possibly starting December. The Dow went up by 1,201 points, S&P 500 jumped 5.5%, and Nasdaq advanced by 7.4%. These were the best single-day returns of the major US stock indices since March/April 2020 when markets rebounded from the fear of the COVID-19 contagion.

Last Thursday's move was led by the spectacular rebound of big cap / megatech corporations such as Amazon (+12.2%), Meta (+10.3%), Apple (+8.9%), and Microsoft (+8.2%). The PSEi joined the global market rally and rose 1.9% last Friday. In addition, bond prices recovered as the 10-year and 2-year US

Treasury yields pulled back by about 30bps last Thursday. The yield on the 10-year US Treasuries fell below 4% and is now at 3.85% while the 2-year yield dropped to 4.35%.

### **US dollar posts biggest drop since 2009**

Driven by hopes for a slowdown in Fed rate hikes, the US dollar index (DXY) fell 2.3% last Thursday. This was the US dollar's biggest single-day drop since March 2009. The dollar was down 3.9% for the week, its biggest weekly drop since the start of the pandemic. DXY is now at 106.42, falling 7.3% from its 20-year intraday high of 114.78 in late-September. The US dollar's sharp drawdown sparked a strong rebound in all global currencies. The Japanese yen surged 3.7% last Thursday and posted a weekly return of 5.4%. Likewise, the euro gained 2% in a single-day and was up 4% last week. The Philippine peso joined the reversal of global currencies. The peso strengthened 3% to 57.19 from its recent high of 59. We recently wrote about a potential peak in the US dollar (see *Peak dollar?*, October 31, 2022), and this may coincide with a marked peak in inflation and a slowdown in Fed rate hikes.

### **China eases COVID-zero policy**

The positive market sentiment was bolstered by China's decision to ease its highly restrictive COVID-zero policy. China cut the quarantine time for international travelers from seven days to five days. China also scrapped the imposition of temporary suspensions on airlines that carry COVID-19 positive passengers. These positive developments for the Chinese economy would have favorable repercussions for Asia and the rest of the world. China is behind the curve in easing its COVID-19 policies, but investors believe that recent developments are precursors to further easing and more actions. Xi Jinping and Joe Biden will meet today at the G20 summit in Indonesia, and investors are hoping that something good will come out of their face-to-face meeting.

### **Monitoring inflation as Fed-watching continues**

The revival of the rally and the historic moves in equities, bonds, and currencies illustrate how important inflation is to financial markets. It would therefore be crucial to monitor how the US inflation picture evolves. This would determine the next course of Fed actions which would consequently drive the direction of financial markets and the trajectory of the global economy. The Fed is expected to continue hiking rates and maintain a restrictive policy for longer because inflation is still too high. As such, one of the main risks for financial markets is a sharp economic slowdown resulting from Fed overtightening. Considering these, we maintain our core thesis that it is essential for investors to closely watch not only macroeconomic numbers, but also the words and actions of the Fed and other central banks.

*Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit [www.philequity.net](http://www.philequity.net) to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email [ask@philequity.net](mailto:ask@philequity.net).*