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2022 October Market Wrap Thursday 2 November 2022

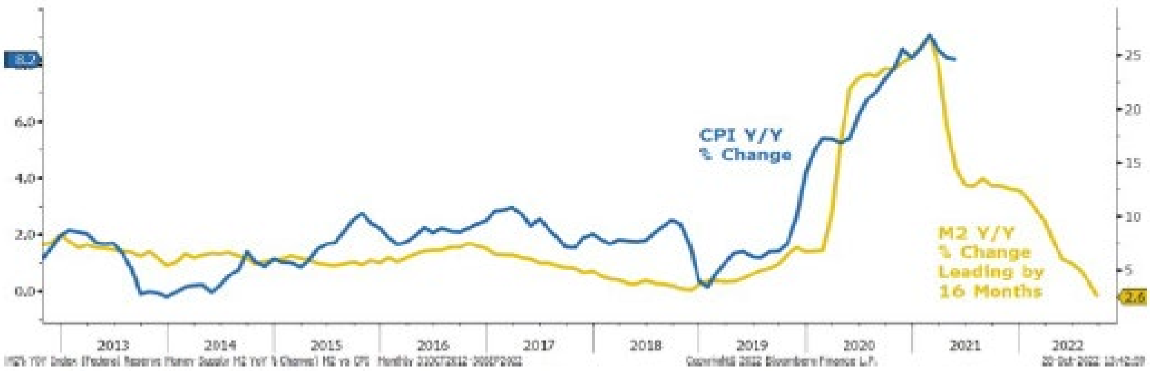
Another big month for market with a noted pick up in market sentiment last week despite the big sell off in mega-cap tech names. With good monthly gain across all market bar China and Hong Kong. The Equity risk premiums for offshore-listed Chinese equities rose following President Xi Jinping's consolidation of power at the National Party Congress last week. Hopes that the meeting might signal an inflection in policies such as Covid-zero appear to have been dashed. Entrenched support for Xi may signal further development of the current policy direction. This suggests no near-term policy relief for property markets. Growth stimulus may be used more sparingly and surgically going forward. Geopolitical risk has also increased. As a result, the market-implied equity risk premium for Chinese equities is at levels not seen since 2008, according to research firm CLSA.

Australian Inflation hit a 32 year high the Consumer price Index (CPI) – rose by 1.8 per cent in the September quarter (consensus: 1.6 per cent). The annual rate of the CPI rose from 6.1% to 7.3% the highest annual rate in 32 years (since June quarter 1990). Inflation is forecast to hit just below 8 per cent next quarter. The 64-dollar question is where to for rates? Prediction for increases range from 50bpts to 1.25%, with cash rate peaking at 3.1% - 3.85%. The key here is consumer inflation expectation and the RBA credibility. Taming the inflation beast is un popular and short term pain is required for long term gain. The slower the hikes the longer rates remain higher to bring inflation back to the target of 2 to 3 per cent.

Comment from Morgan Stanley that had a well-established bearish view on fundamentals:
"Two weeks ago the S&P 500 turned tactically bullish the technical picture became more supportive after the historic reversal two weeks ago on another higher-than-expected CPI reading for September. More specifically, the S&P 500 gapped lower that Thursday morning, only to reverse 6% and close at the highs. Then, on Friday, stocks had a terrible day, with the S&P 500 trading down 2.4% and closing on the lows. When we studied this price action over the following weekend, we found that Friday's pullback was a 61.8% Fibonacci retracement of Thursday's rally that stopped right at the 200-week moving average. The combination of these technical oddities was too much to ignore. Hence, our tactical/technical rally call.

From a fundamental standpoint there are some supportive factors too. First, (US) CPI is coming down. Granted, it is one of the most backward-looking data series; it says very little about the future and can be misleading about present conditions. Think back to what CPI was telling us at the end of March 2021. The index sat at 2.6%Y after the government had delivered more than $3 trillion in fiscal stimulus during 1Q21. As a result, the money supply (M2) was growing by 27%Y. Never in the history of these data (70+ years) had M2 grown at even half that rate. Given that inflation is always and everywhere a monetary phenomenon, it was crystal clear that 2.6%Y inflation was likely to explode higher. Fast forward to today and CPI stands at 8.2%Y, a 40-year high and marginally below its peak of 9.1%Y in June. However, M2 is now growing at just 2.5%Y and falling fast. Given the leading properties of M2 for inflation, the seeds have been sown for a sharp fall next year. This has implications for Fed policy and rates. Indeed, part of our call for a rally assumes we are closer to a pause/pivot in the Fed's tightening campaign, and while we don't expect to see a dramatic shift at next week's meeting, the markets have a way of getting in front of Fed shifts".

Exhibit 1: If inflation is a monetary phenomenon always and everywhere, look out below...



Source: Bloomberg, Morgan Stanley Research

"Bottom line, inflation has peaked and is likely to fall faster than most expect, based on M2 growth. This could provide some relief to stocks in the short term as rates fall in anticipation of the change."

If you have any questions do not hesitate to contact me.

Summary of Major share indices

Index	1 Month	52 Weeks	YTD
DJIA	+10.99%	-8.86%	-9.92%
Nasdaq	+1.60%	-29.54%	-29.77%
S&P 500	+5.26%	-16.08%	-18.76%
Russel 2000	+8.07%	-21.68%	-17.75%
Europe 600 Index	+5.47%	-13.92%	-15.50%
UK FTSE 100 Index	+2.69%	-2.66%	-3.93%
Hong Kong Hang Seng	-14.01%	-41.61%	-37.23%
Japan Nikkei 225	+5.23%	-6.95%	-4.18%
China Shanghai Composite	-4.33%	-18.37%	-20.50%
India S&P BSE Sensex	+6.97%	+1.01%	+4.28%
ASX 200 (Australia)	+6.30%	-6.88%	-7.81%

Australian Dollar

	Close	52-week Range
AUD	0.6397%	0.6170-0.7662%

Government Bonds

	Close	52-week Range

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US 3 Month Bill	4.173%	0.035-4.173%
US 10 Years Note	4.018%	1.341 – 4.325%
US 30 Years Bond	4.201%	1.665 – 4.424%
Australia 10 years	3.828%	1.543-4.256%

Source: Wall Street Journal.