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Macroeconomic & Market Update

November 14, 2022

Latest Macroeconomic Data Giving Investors Much to Consider

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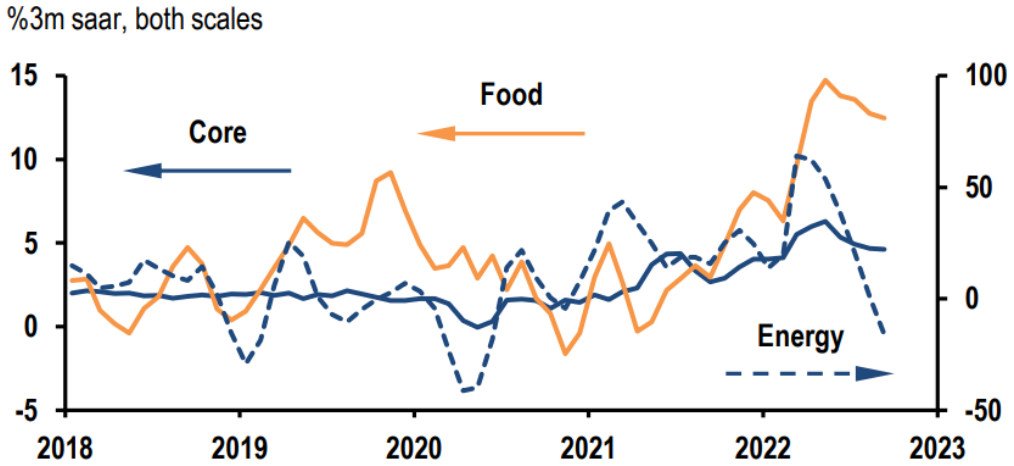
- **Some Notable Positives in Latest Inflation Data**
  - Significant downside surprise in US CPI report for October
  - Easing in global bottlenecks and declining manufacturing output prices
  - Commodity prices and Europe's natural gas prices down from recent peaks

- **Important Caveats Also Continue to Overhang Inflation Outlook**
  - Need sequential monthly slowing for convincing disinflationary signal
  - DM wage increases not yet comparable with central banks' inflation targets
  - Europe's expected 2023 disinflation subject to weather and geopolitics

- **Macro Headwinds Remain**
  - Tight financial conditions
  - PMIs suggest slowing
  - Regional/country recessions

- **Global Slowing More Likely than Collapse**
  - Employment strong
  - Balance sheets solid
  - Goods prices declining

Global CPI



Source: National sources, J.P. Morgan. Excludes Turkey and Argentina

Latest Global Manufacturing Survey / Consumer Data Mixed

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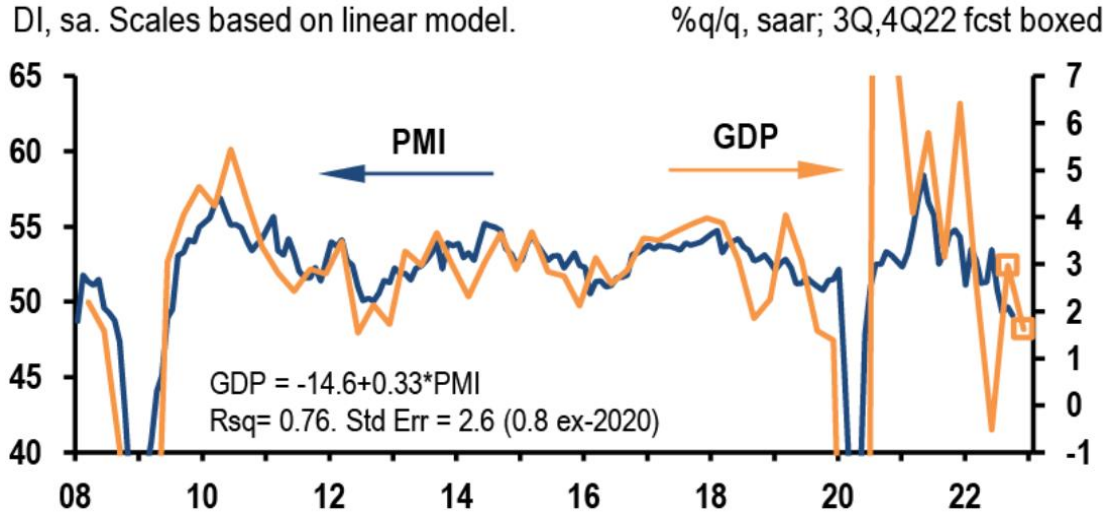
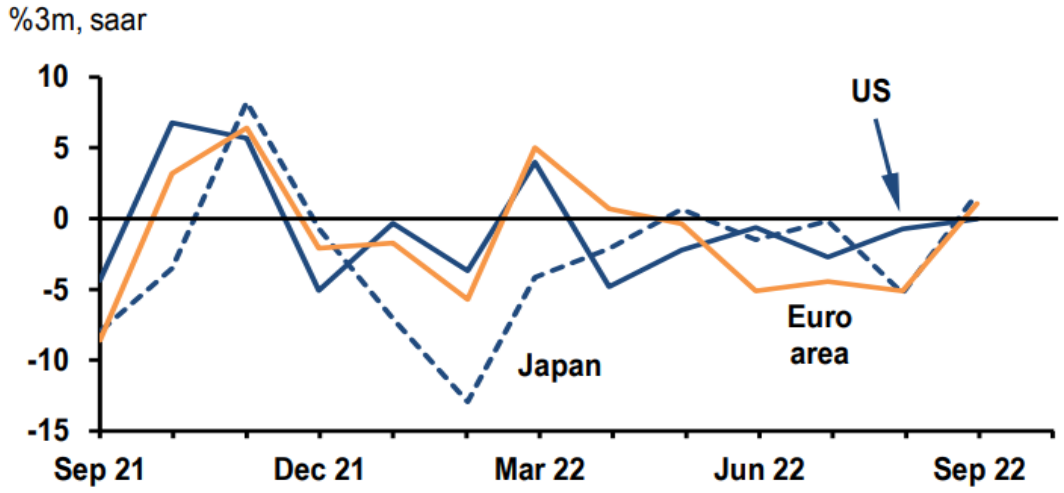
Global Mfg. PMI & GDP



- Global all-industry PMI at 49 in October, lowest level outside of recessions in history of series
- Consistent with below-trend 1.6% global GDP growth in current quarter

Real Consumer Spending



- Global retail sales[1] rebounded 0.5% m/m in September reversing earlier weakness
- Moderation in goods price increases and continuing employment gains seemingly supporting consumer spending

1. Data based on retail sales for 85% of the GDP weighted global composite monitored by JPM

Source: S&P Global, JPM, National Sources

Latest Wage Trends / Manufacturing Output Prices Mixed Messages

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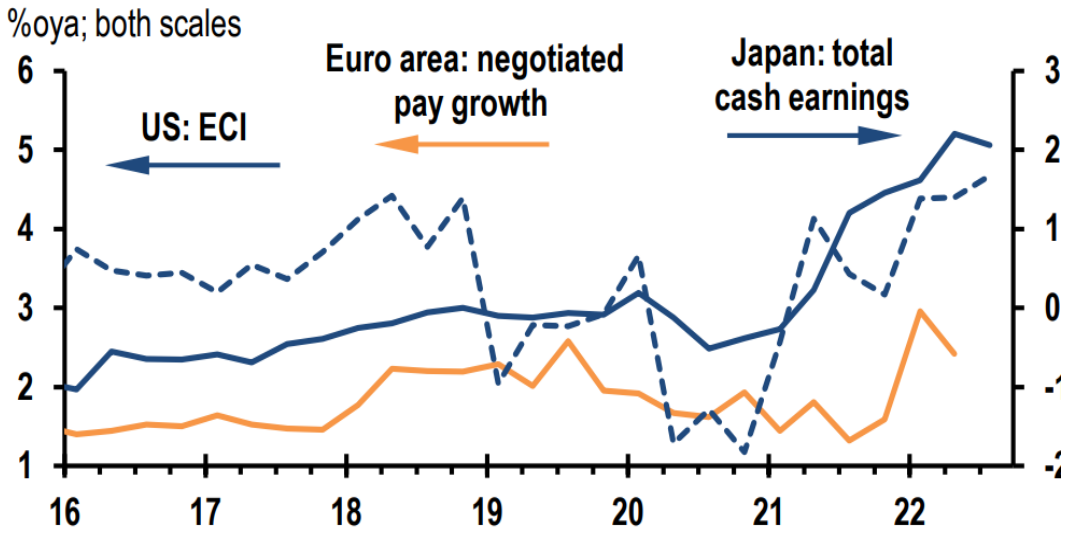
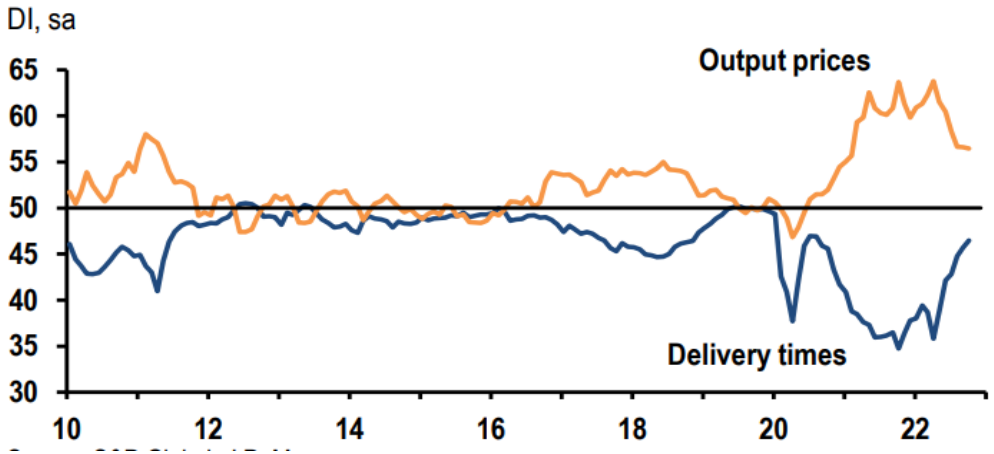
DM Wage Trends



- Recent wage trends in major DMs (ex. Japan) not compatible with central banks' inflation targets
- US employment cost index below recent peak but increasing at ~5% yoy. Euro area's negotiated pay growth still contained but real-time job posting data more concerning[1]

Global Manufacturing: Prices / Delivery Times



- Global manufacturing output prices continued to edge down in October, while improving delivery times indicate that supply-chain bottlenecks are fading

1. Based on real job posting data for six leading Euro area economies, median posted wages were up 5.2% yoy in October vs. 4.2% in June and 1.9% in 2019, "Eurozone wage growth stirs inflation fears", D. Strauss et al, FT, 10 November 2022.

Source: BLS, ECB, MHLW, S&P Global, JPM

US CPI: Some Signs of Relief

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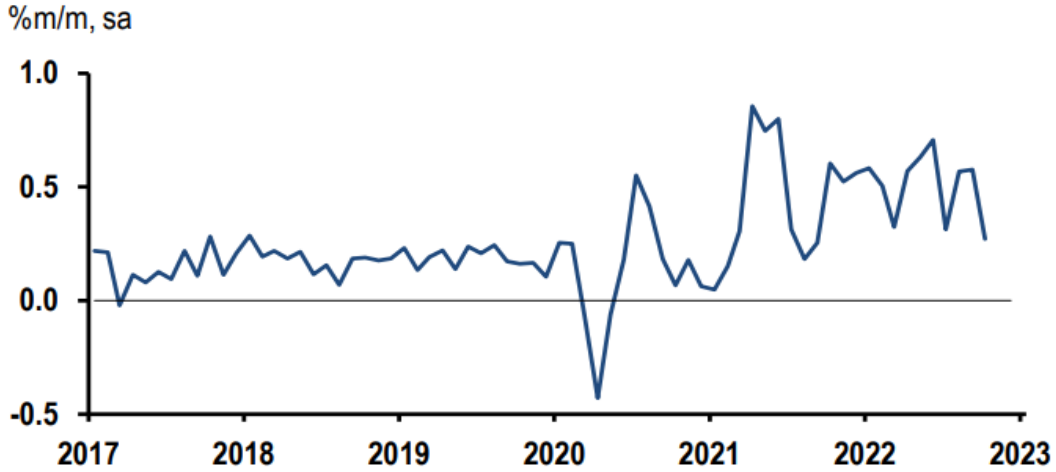
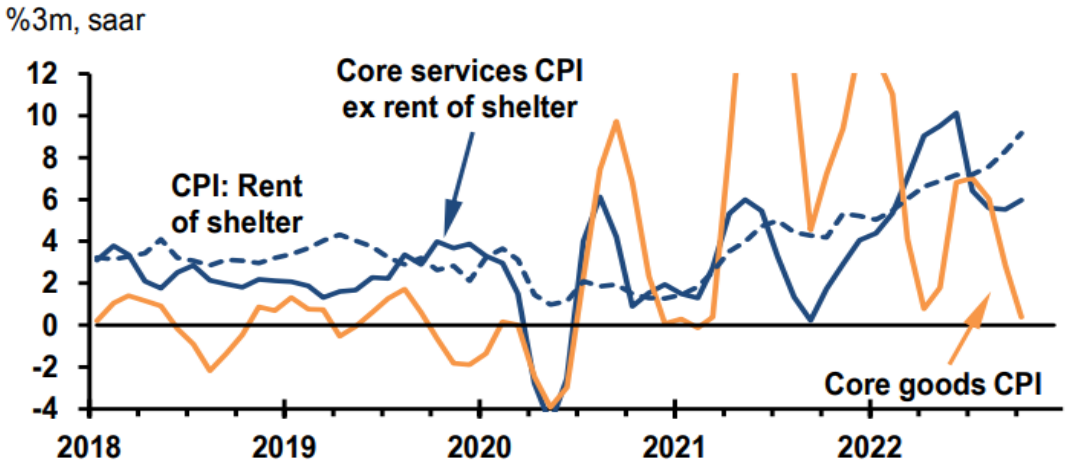
Core CPI



Core CPI Decomposition



- US core CPI was up less than expected in October – 6.3% oya and 0.3% in the month
- Although the volatility of month-to-month data calls for caution, the latest report buoyed US equity and bond markets

- In fact, the details of the report were somewhat reassuring
- Core goods prices led by a 0.9% decline in motor vehicle prices fell 0.4% in the month, while core services excluding shelter rose just 0.2%

Source: BLS, Haver, JPM

Country/Regional Briefs

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- **US: Latest Data/Reports Reassuring But Recession Can't be Ruled Out**
  - Better than expected CPI in October: Headline and core below expectations
  - Employment growth strong but moderating[1]
  - Wage growth ~4.5% yoy below recent peak yet still far too high[2]
  - Powell: Stepdown possible with higher terminal rate but not ready for pause
  - Midterms: Divided government expected but material change in policy unlikely
  - Case for relative optimism: Underpinnings of moderate increases in consumer spending in place [3]
  - Still considerable headwinds: Tightening financial conditions / home prices down ~15%

- **Euro Area: GDP Increased at 0.7% Rate in Q3, Weaker Q4 Expected**
  - Labor market still strong/unemployment rate historically low 6.6%
  - Inflation accelerated to 10.7% yoy in October
  - Economy still supported by consumer saving and fiscal stimulus…
    - Doing relatively well thus far in view of energy-price shock
  - ECB increased policy rate 75 bps in October but accompanying rhetoric viewed as dovish[4]
  - Composite PMI 47.1 in October pointing to mild Q4 weakness

1. Nonfarm employment increased 261K in October, down from 407K per month average thus far in '22 and 562K monthly average in '21. Source: BLS
2. Composite average-adjusted hourly earnings increases monitored by GS have slowed from 7% in July '21 to 4.5% in October on 6-month annualized basis.
3. GS economists: Consumer saving and wage increases expected to support continuing moderate spending growth in '23. Inflation on downward path. 35% probability of recession in next 12 months, well below Wall Street consensus of 63% but double unconditional probability. "Another Step on the Narrow Path", GS, November 2022
4. ECB in post-meeting statement did not commit to hiking after December and pivoted to data dependent stance. ECB president subsequently stated that a mild recession may not be enough to tame inflation JPM Global Data Watch, 3 November 2022

Country/Regional Briefs – cont'd

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- **UK: GDP Contracted at 0.7% Annual Rate in 3Q**
  - New PM expected to put renewed emphasis on fiscal discipline
  - BoE raised policy rate 75bps/ accompanying statement noted:
    - "Further increases in Bank Rate may be required…albeit rate expected to peak lower than priced into financial markets"[5]
  - Composite PMI (48.5) for October consistent with GDP contracting in Q4

- **China: Growth Restrained by Property Sector, Covid Policies and Soft Global Demand**
  - 2022 growth still projected at subpar ~3%
  - Gingerly moving to balance Covid policies with need to sustain economic growth
  - Open question whether new slightly less restrictive Covid policies will have material impact
  - On Friday, however, central bank and top banking regulator issued wide-ranging series of measures…
    - Aimed at bolstering housing demand and supply

5. Alan Monks, JPM Global Data Watch, 28 October 2022

Japan: Debt Level / Yield Curve Control[1] & Inevitable Exit

- **SECOR's Recent Debt Paper[2]**
  - Japan's government-debt-to-GDP ratio is 235%
    - Double OECD average / highest among 130 countries Institute of International Statistics monitors
  - Low cost of capital in Japan mitigates debt burden
    - Yield on 10-year JGB maintained at ~ 25 bps by YCC (yield curve control)
    - Bank of Japan owns 40% of outstanding JGBs / and domestic investors own most of balance
    - Artificially low rates implicit tax on domestic savers / foster non-productive investment
- **Exit From YCC Inevitable But Probably Not Imminent**
  - ***Mohamed El-Erian: BoJ needs to prepare investors for pivot[3]***
  - Longer Japan sticks with YCC costs of supporting yen & protracted fixed rate regime distortions build
    - Spent $62bn to support yen since September/Expect rates to jump when YCC removed
  - Domestic investors who assumed interest rate cap would remain and…
    - Leveraged their holdings to increase returns particularly vulnerable
  - Need to encourage pre-emptive orderly deleveraging before exit

1. YCC is a monetary regime introduced in Japan in 2016. Central bank targets a specific longer term interest rate and then buys as many bands as necessary to hit that target
2. "Near-Record Sovereign Debt: Cyclical Savior and Potential Risks", SECOR, November 2022
3. "Risk looms from bank of Japan's inevitable pivot," Mohamed El-Erian, FT, 1 November 2022

Debt Level / Yield Curve Control & Inevitable Exit- cont'd

- **BoJ Governor Kuroda: Need to end deflation to exit YCC4**
  - Current global price surge has raised goods inflation to 3% but…
  - After two decades of believing prices could only go down…
    - For lasting change of "deflation mindset" need higher wages
- **Shunto wage negotiations in spring provide potentially interesting opportunity**
  - Trade Union Confederation seeking 5% wage increase
  - Weaker yen has increased profits sourced overseas
  - Japanese companies currently in relatively solid position to absorb higher wages
- **Kuroda: If 2% inflation and wage hikes come into sight…**
  - "…a review of monetary policy will of course become necessary."

1. "Japan's central bank raises the stakes", Leo Lewis et al, FT, 6 November 2022

USD / Japanese Yen Differentials & Recent Interventions

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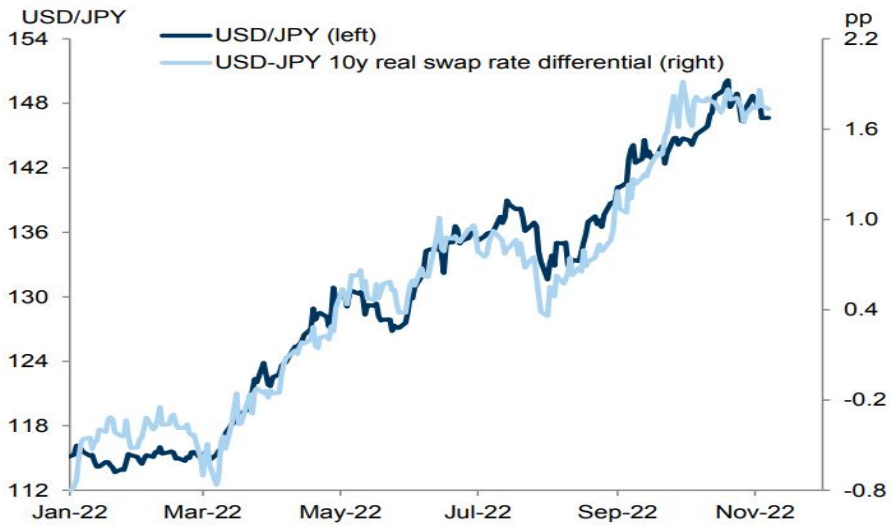
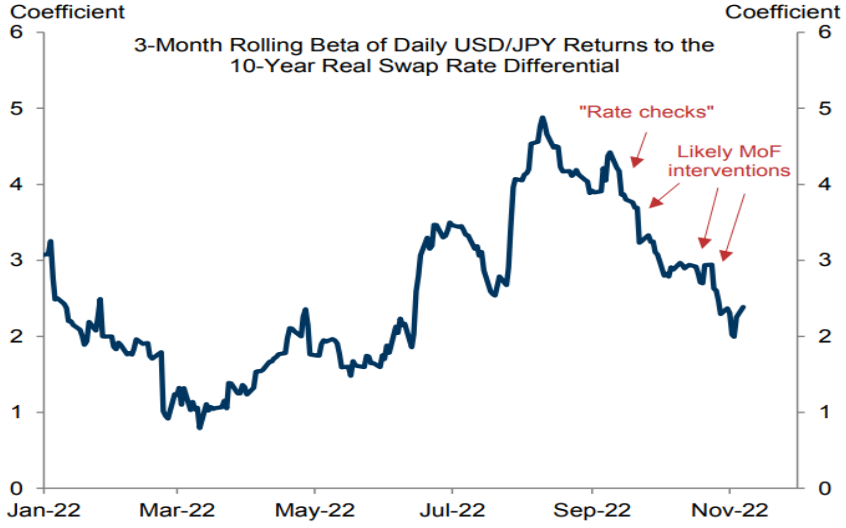
Yield / FX Differentials



- Main driver of USD strength vs. JPY this year has been the widening real rate differential
- Fed's tightening policies have raised US rates, while BoJs YCC (yield curve control) policy has kept yield on 10-year JGB anchored at ~ 25 bps.

Recent Interventions



- Over the past six weeks the MOF (Ministry of Finance) has intervened repeatedly and reduced USD/JPY FX sensitivity to US yields
- While divergence between FX and monetary policy is unsustainable over the longer term, GS economists contend it will persist well into 2023[1]

1. "Path forward for USD/JPY", Karen Fishman, GS, November 2022

Source: MOF, Datastream, GS

Possible Equity Technical – M2 / CPI Relationship

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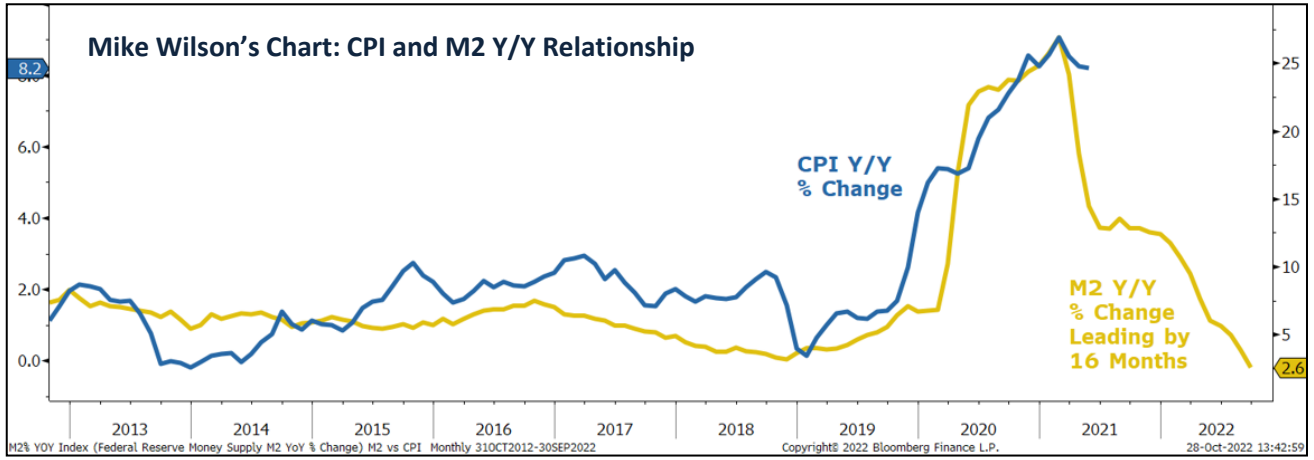
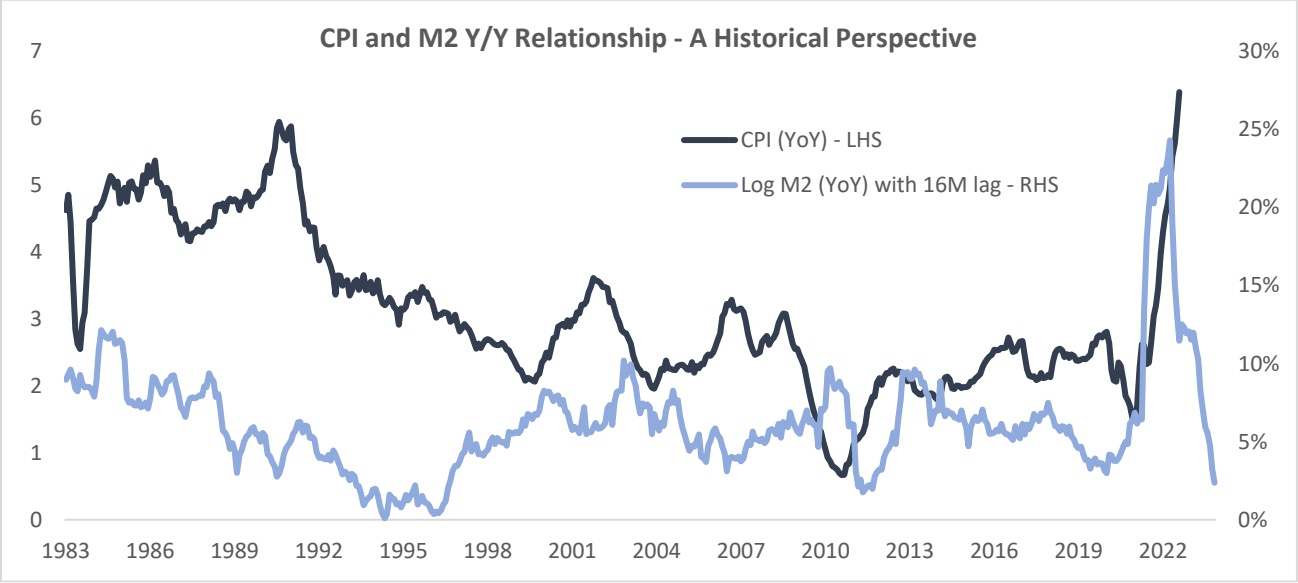
- **Mike Wilson (Morgan Stanley) turned "tactically" bullish on US equities in mid-October which he attributed to…**
  - Technical factors including the CPI /M2 relation
  - M2 is used as a leading indicator for inflation
  - M2 includes cash and short-term deposits

- **However, this short-term leading relationship is not stable**
  - M2 has not been a reliable leading indicator for CPI in the short term
  - While M2 no doubt is related to inflation, we cannot assign a high degree of confidence to short-term equity market calls based on this relationship





Market Performance Through to 11 November

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(USD)	Since 11/4	YTD	2021	2020	2019
Equities					
MSCI ACWI	6.59%	-16.75%	18.54%	16.26%	26.60%
MSCI EAFE	8.42%	-15.73%	11.26%	7.82%	22.01%
MSCI EM	5.74%	-22.12%	-2.54%	18.31%	18.42%
MSCI US	6.08%	-16.57%	26.45%	20.73%	30.88%
Fixed Income					
BarCap Global Agg Total Return (Hedged)	1.60%	-11.37%	-1.39%	5.58%	8.22%
Citi US 10+ Govt Bond Index	4.14%	-31.03%	-4.63%	17.72%	14.89%
BarCap US High Yield Total Return (Unhedged)	1.19%	-12.19%	5.26%	7.05%	14.32%
Oil					
WTI Crude	-3.94%	24.32%	54.09%	-10.28%	0.43%
Brent Crude	-2.62%	29.18%	48.83%	-12.31%	-2.72%
Currency					
USD/EUR	-4.17%	10.16%	7.57%	-8.25%	1.86%
USD/GBP	-4.19%	15.05%	0.86%	-3.07%	-3.76%
USD/JPY	-5.55%	20.78%	11.52%	-4.99%	-1.00%
USD/CNH	-1.51%	11.39%	-2.11%	-6.73%	1.38%
USD/TRY	-0.44%	39.33%	78.97%	24.88%	11.93%
USD/ARS	1.55%	56.43%	22.11%	40.55%	58.95%
USD/RUB	-2.39%	-19.14%	1.35%	19.10%	-10.48%

Source: Bloomberg

Sovereign Bond Yields

Source: Bloomberg

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