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Macro View

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Halloween, All Saint's Day, All Soul's Day and St-Hubert's Feast Day Hit a Grand Slam:

Stocks kicked off an eventful Halloween week with big gains across the board from day1, all 11 sectors of the S&P 500 having closed in positive territory. The rally took the benchmark above its 200-day moving average. What was particularly interesting, however, was that the US Treasury announced its estimated marketable borrowing needs for Q4 ($776 billion) and Q1 ($816 billion), following 1.01 trillion in Q3 while the US Fed delivered a hawkish pause: yet the bond market did not flinch: it bounced, suggesting a Treasury yield around 5.00% is high enough to attract private buyers even though fiscal policy is out of control and the Treasury lost China and the Fed as big buyers.

Meanwhile, in contrast to what one would have anticipated, the 2-year Treasury yield, which moves with interest rate expectations, fell to 4.84%; the 5-year Treasury yield, a reliable representative of the neutral rate, decreased to 4.50%; and the 10-year yield, which reflects growth and inflation expectations, declined to 4.57%. All are lower than they were 2 weeks ago. Arguably, neither the Treasury nor the Fed want the surge and volatility in long-date yields to carry on. Nonetheless, one can expect that next week the Fedspeaks will show determination that the inflation-job is not finished, which I define as posturing. Bloomberg's John Authers made an astute observation suggesting that central bankers' denials that they were thinking of cutting rates could be taken either way. A move in either direction is a big signal, and policymakers would rather not move if they don't have to.

What is important is that pressure is building on governments to start paying attention to their deteriorating deficits. The Treasury Borrowing Advisory Committee, which includes Citigroup, JP Morgan, Blackrock and Pimco warned the government that domestic and international buyers have not kept pace with the increased supply of debt. Tiff Macklem told a Canadian Senate committee that if our own government's spending plans are not changed, they will interfere with getting inflation back to target.

Meanwhile, corporate and mortgage borrowers are postponing or cancelling their debt financing plans. First, Macro Strategy Partnerships reported in a note that October saw at least 13 transactions shelved. Indeed, year-to-date there have been 67 debt deals scrapped globally, most of which have been bond sales. Closer to home, Costco said: "Refinancing existing debt at the current rates makes no sense and neither does new projects." The company intends to repay its debt with cash and won't buy back any debt ahead of maturity. Second, the never-ending affordability crisis in the housing market has killed the demand for mortgages. Perhaps the monetary authorities are right to keep market

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rates near current levels and let them do the rest of their work for them, leaving the economy in a better place than otherwise.

In this regard, it appears that 5% interest rates are proving to be a ceiling for the 10-year Treasury yield, giving stock operators a reason to take a shot at breaking the S&P 500 losing streak, returning it above the 4200 support level for "All Saints' Day", pushing it further to 4318 on All Souls' Day and ending the week on St-Hubert Feast Day at 4358 for a " Grand Slam" weekly gain of 6.4%.

Technically, the benchmark may have found some backing because its uptrend line is connecting the lows of March 23, 2020 to October 12, 2022. This is constructive, given that institutions have stashed away a lot of cash. I hear through the grapevine that buying volume has exceeded selling volume lately, suggesting short-covering. This is how a mid-term rally usually starts. Incidentally, Robert Armstrong pointed out in the FT that, going back to 1984, traders who have correctly called the top of the rate cycle have been well rewarded. Isn't this obvious? Yes, but there is a message here.

There is bullish evidence that falling inflation will continue albeit at a slower pace while growth will continue, albeit at a lower rate. Contributing to the strong rally were weaker than expected manufacturing activity, according to the Institute of Supply Managers' survey and lower private sector payrolls according to an ADP report, without any attrition in the amount of job openings. Thus, the Atlanta Fed's NowCasting model is projecting a growth factor of 1.2% for Q4, while Unit Labour Costs fell - yes, fell - 0.7% in Q3, up 1.9% from a year ago - on target. On top of all this, average hourly earnings rose only 0.2% m/m in October, producing a y/y increase of 4.1% versus 4.3% in the previous month. Claudia Sahm, the architect of a trusted recession indicator, pointed out that the direction of the unemployment rate, rising from a low of 3.4% to 3.9% , is living proof that the labour market is cooling.

The New Normal Is 5%: 2.5% for inflation and 2.5% for Growth:

One may find it remarkable that the US economy has the power and the capacity to to keep on trucking, but it has the reserves of strength. Its engine is generating a productivity boom, making the recession and soft landing calls less likely than pundits earlier believed. I've changed my mind about the long-term state of the U.S. economy because facts about it have changed. Those of you who read my weekly comments know that I've always been in the camp that believed that the economy was in a "2 plus 2" configuration: that is 2% for inflation and 2% for growth. I think that has changed to 2.5% for inflation and 2.5% for growth.

A New Era of Productivity has Emerged:

The aforementioned change may not seem much on the surface in the way of a major shift. Yet it is because contrary to past experience the potential growth has shifted from employment to efficiency and continues to do so. . The economy's odometer proves it. Since the end of the second quarter of 2022, labour productivity rose from -3.5% to

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+4.7% in Q3 of 2023 for a 4-quarter average annual rate of 2.5%. Outside of recessions, when productivity normally spikes, this sort of rise is historically very fast. The last time we saw this in action was in the late 1990s.

Many are sceptical that the economy has entered into a virtuous cycle of growth. I'm not. Executives aren't stupid. Businesses are incentivised to substitute more capital in their domestic production process for labour, globalisation and foreign imports. For example, Starbucks admitted that what drove their profits in Q3 was a burst in productivity, this in spite of a 20% increase in take-home pay for workers. Indeed, surveys are pointing out that the diffusion and implementation of digitalisation, artificial intelligence, robotics, cloud services and internet applications have only started. Incidentally, this phenomenon explains the reluctance of companies to let go of workers because they are getting more out of them as the investment in long-term training programs is paying off.

I intend to expand on this productivity-theme over the next few weeks. It's just too important to overlook, I cannot overstate its importance. It's a cure-all recipe that heals political divisions, reduces tensions between capital and workers, benefits consumers and producers, and re-distributes the fruits of growth equitably. There is no better social contract than this one. There is no need for bull-shit cry-outs, either. If governments want to accelerate this process, they just need to raise the depreciation rate on capital investments to 100% per year.

Whoever does this first will win big time.

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