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A World of Contrasts

12th December 2023

- US economic data regains strength after recent loss of momentum
- Fed meets this week but is unlikely to move policy or alter its messaging to the markets
- European economic data is weak and gives ECB room to make an earlier-than-expected cut in interest rates
- El Nino creates potentially large problems for the normal operation of the Panama Canal – a potential problem for the US economy

After a few weeks of disappointment, US economic data changed trajectory for the better, challenging the market view that US growth was rolling over and the Fed should resort to interest rate cuts sooner.

Both the US employment numbers and the US consumer confidence survey came in better than expected.
The November US employment report showed non-farm employment growth of 190,000, which was more substantial than expected. Hours worked per week and wage growth were stronger, too.

The sharp increase in the University of Michigan's Consumer Confidence Index to 69.4 (against consensus of 62.0) suggests that the recent drop in inflation and long-term interest rates may have prompted consumers to feel more confident about life. As we have been emphasising in recent CIO weeklies, aggregate monetary conditions have loosened significantly with the drop in long-term interest rates and the sharp rally in the equity market. Consumers will also note that the average gas price has dropped, which is a sign that consumer spending could reaccelerate from here. At 69.4, the headline level of confidence was way above expectations. The confidence level is still low by historical standards but has recovered from the lows seen during the middle of last year.

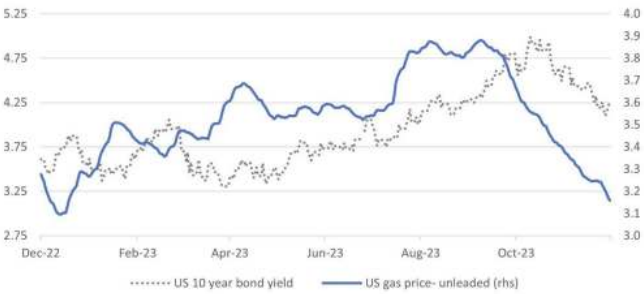

Chart 1: Consumer sentiment helped by drop in fuel bill and long-term interest rates
Source: Bloomberg

It's worth noting here that US economic data had been on a downtrend even until last week. The US Citigroup economic surprise index, for instance, had weakened to an index level of 11.7 from 80 before it rebounded to 20 last week.
The strong absolute gains in the US equity market look even more extraordinary in the context of such a weakening of the economy.

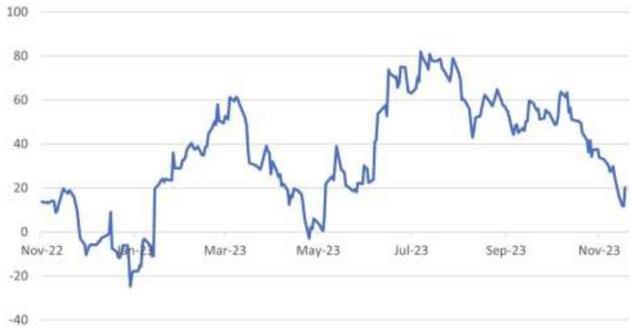

Chart 2: US CESI Economic Surprise Index
Source: Bloomberg

The Federal Reserve's monetary committee meets this week. The market, though, is not expecting any fireworks, with no change in policy seen. However, the market will scrutinise every word of the statement and the press conference that follows. While any firework is ruled out, the market will likely be hoping for a messaging that at least helps keep the current rally intact. Nevertheless, we struggle to see how the Fed could endorse such a move higher in bonds and equities when the medium-term strength of economic data is unclear.

We will get another part of the puzzle of how the markets will close out the year with this week's US CPI report. Core inflation ex food and energy is expected to remain unchanged at 4.0% year-on-year. The bias of risks is probably to the downside given the softness of product prices around the world and lower than expected CPI reports from China and Europe. However even a surprise to the downside is priced into long bonds.

Eurozone's Weakness – ECB To Act Early?

The strength in US economic data is in stark contrast with the weakness in the eurozone. Unlike the Fed, the ECB may have fewer choices and may need to act early. Such a move, if it materialises, will help selective sectors in the market, such as consumer stocks. Last week's eurozone GDP report was in line with expectations, showing a contraction of 0.1% quarter-on-quarter of the economy.

Earlier in the week, the retail sales report missed expectations, showing further contraction in retail sales. However, many economists expect eurozone retail sales to improve as persistent real wage growth supports a recovery in consumer spending. The weak GDP data may also prompt an earlier move by the ECB to cut rates. The market prices a likelihood of five rate cuts by the end of next year.

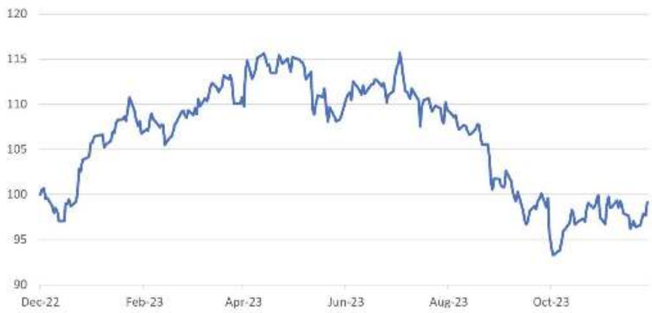

Chart 3: The relative performance of European consumer durables relative to European equities rebased to Dec 2022=100
Source: Bloomberg

Logistical Challenges: We Have Had COVID And Wars And Now We Have Canals At Risk

We note that analysts are increasingly concerned about the potential disruptions to the two vital links in the world of global logistics – the Panama and Suez canals.

The Panama Canal, a crucial conduit for international maritime trade, faces significant challenges because of fluctuating water levels. The impact of El Niño, the worst on record, has been so severe that it has led to the lowest water level in the canal since 1951.

The authorities have for the first time reduced the number of crossings. Month-to-date passages are down 30% with further reductions expected in the coming months. The problem is not just the number of ships that can pass through the canal per day but also the need for these vessels to carry comparatively lighter loads. On average, the ships are operating with at least 40% truncated capacity. That is quite a lot considering 40% of all US container traffic passes through the canal every year. While the Suez Canal does offer an alternative, there are concerns that the Yemeni Houthis will attack shipping in the Red Sea. Israeli shipping has been particularly at risk.


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