

## Market Weekly Insights

30<sup>th</sup> October 2023

## Global Outlook

*Budget Divergence: Europe's Fiscal Discipline in Contrast to America's Deficit Challenge*

In the wake of the Covid-19 pandemic and geopolitical crises, the United States and Europe resorted to heavy borrowing. However, a notable divergence has emerged recently. While the U.S. continues to run large deficits, Europe is on track to reduce its budget shortfalls significantly. This shift is in stark contrast to the situation a decade ago when some European countries faced default due to soaring deficits following the global financial crisis.

Discipline and fiscal responsibility are now shaping Europe's approach to economic management, thanks in part to the lessons learned from past crises and the existence of stringent eurozone rules. The U.K., for example, has raised taxes to counter its debt challenges. Meanwhile, the U.S. grapples with an expanding deficit and political disagreements, hindering narrow efforts. The Biden administration's proposed tax increases face resistance, while Republicans seek spending cuts that the administration opposes. The U.S. government reported a deficit of \$1.7 trillion, accounting for 6.3% of GDP, with projections indicating a continuing rise. In contrast, Europe is set to decrease its combined deficits to 3.4% of GDP in 2023.

Moreover, European countries that faced crises a decade ago, including Greece, Portugal, and Ireland, are now on the path to smaller budget gaps. Europe's experiences from the financial crisis have left a lasting impact on its approach to deficits, emphasizing the need for prudence in fiscal policy. In the U.S., bridging the deficit gap remains a significant challenge, making it crucial to find common ground in managing government finances.

*TSX Hits a New 52-Week Low*

This past Tuesday, Canada's primary stock index closed below 19,000 for the first time in a year triggered by declines in energy, utilities, and technology, coupled with interest rate uncertainty. Since then, the index has continued to trend lower. On Friday, the S&P/TSX Composite index was down 378 points (1.98%) from the beginning of the week to close at 18,737.39.

A downturn in the energy industry was a major contributor to the index's overall decline, with SPPTEN falling 50 bps on the week alongside a decline in fall of 1.72% by GSPTTUT, the S&P/TSX Capped Utilities Index. Technology was another impactful sector this week with the release of third quarter earnings reports from top firms. Both Alphabet (GOOG) and Meta (META) fell in share price despite exceeding profit expectations.

Sources: Wall Street Journal, Reuters, International Monetary Fund, Yahoo Finance

S&amp;P 500

\$4,117.37  
-0.48%

DJIA

\$32,417.59  
-1.12%

NASDAQ

\$12,643.01  
+0.38%

Russell 2000

\$1,636.94  
-1.21%

FTSE 100

\$7,291.28  
-0.86%

Nikkei 225

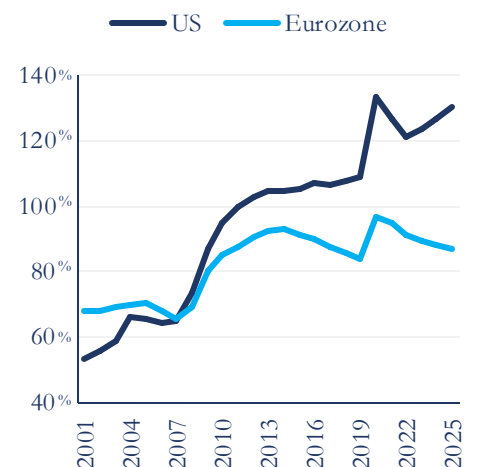
\$30,991.69  
+1.27%

WTI Crude

\$85.16  
+2.34%

10-yr Treasury

4.8%

GENERAL GOVERNMENT  
GROSS DEBT  
(as a % of GDP)

Investors instead expressed concern over commentary from management indicating a softening in advertising, a significant revenue driver for both tech giants.

With growing expectations that both the Federal Reserve and the Bank of Canada will maintain higher interest rates for the foreseeable next few months, both the S&P and TSX have reacted negatively to heightened borrowing costs. As certainty grows regarding the Fed's future actions, TSX will surely feel the ripple effects, highlighting the impact of US monetary policy on the rest of the world's markets.

## America This Week

### *The Implications of Rising Treasury Yields on the U.S Economy*

The U.S. 10-year Treasury note yield has reached 5%, a figure unseen in 16 years, driven by a rapid increase in recent weeks. This rapid yield surge carries significant concerns, potentially unsettling the nation's economic stability. One immediate consequence is the impact on government finances; higher yields increase the government's borrowing costs, potentially exacerbating the federal budget deficit. This, in turn, restricts the government's ability to invest in essential public services. Additionally, consumers and businesses are bracing for the impact. Rising Treasury yields translate into higher interest rates on mortgages, credit cards, and business loans. For consumers, this means increased monthly payments, while businesses find their borrowing capacity constrained, potentially leading to reduced investments and slower economic growth.

US 10-YEAR TREASURY NOTE  
(in %)



Financial markets quickly respond to these changes and investors may shift their portfolios from stocks to bonds in pursuit of higher returns, causing market volatility. The housing market, already facing challenges, takes another blow as mortgage rates climb. Higher rates make homeownership less attainable, potentially stifling the real estate market and affecting related construction-related industries. Moreover, the surge in Treasury yields could strengthen the U.S. dollar, making American exports more expensive for international buyers, possibly leading to trade imbalances and escalating trade tensions.

## Macro Highlights

### *US GDP Growth Blows Past Expectations in Third Quarter*

In a surprising turnaround last Thursday, the Commerce Department released its advance estimates for third quarter GDP growth to be clocked in at 4.9%. This significantly outpaced the prior quarter's growth of 2.1% and exceeded economists' expectations of 4.3%. Consumer spending was a primary driver of growth, demonstrating an acceleration up to 4% this past quarter compared to 0.8% in the second. This additional spending added nearly 2.7 points to the overall US GDP, highlighting the impact of consumer spending on the American economy.

Furthermore, average Americans enjoyed increased purchasing power with wages growing at a faster rate than inflation. Wages grew 1.7% after being adjusted for inflation. With more money in their wallets, Americans were better equipped to make substantial purchases of goods and services. Despite this outstanding performance in the last quarter, economists and US Treasury Secretary Janet Yellen concede that this level of growth is unsustainable in future quarters. Consumer spending is expected to face major headwinds, particularly from the resumption of student loan payments. This restart comes after a three and a half year pause and will likely reduce discretionary spending. The resilience of the American economy will further be put to the test in the face of Federal Reserve policies, which appear poised to maintain high rates and yields for the coming months.

## Industry News

### *Apple's China Dilemmas: The Foxconn-Taiwan Link and Implications*

Apple has navigated a series of challenges stemming from its operations in China, spanning from counterfeit stores and factory protests, to censorship and app regulations. Now, Apple finds itself entangled in the complex web of U.S.-China relations, with a new issue surfacing regarding the future of Taiwan.

Foxconn, a prominent Taiwanese contract manufacturer and a major supplier for Apple, has found itself under the scrutiny of Chinese authorities due to its founder, Terry Gou, venturing into presidential pursuits. This has prompted investigations that could have far-reaching consequences for Apple, given Foxconn's integral role in its supply chain.

Apple's CEO, Tim Cook, has been exploring alternative manufacturing hubs, as potential disruptions within Foxconn's operations could pose a threat to the tech giant's production. Historically, Foxconn has maintained a presence in both Taiwan and China, leveraging the latter for cost-effective labor. Over time, they became the primary assembler of iPhones for Apple, with a substantial portion of their revenue originating from China. Some observers speculate that these investigations are a means for Beijing to express concerns about Foxconn's potential involvement in diversifying away from Apple.

Furthermore, it's worth noting that Foxconn contributed significantly to China's exports in 2022, accounting for 3.5%. Thus, the probes and their potential repercussions may inadvertently harm China's economy, underscoring the intricate and interconnected nature of global technology supply chains.

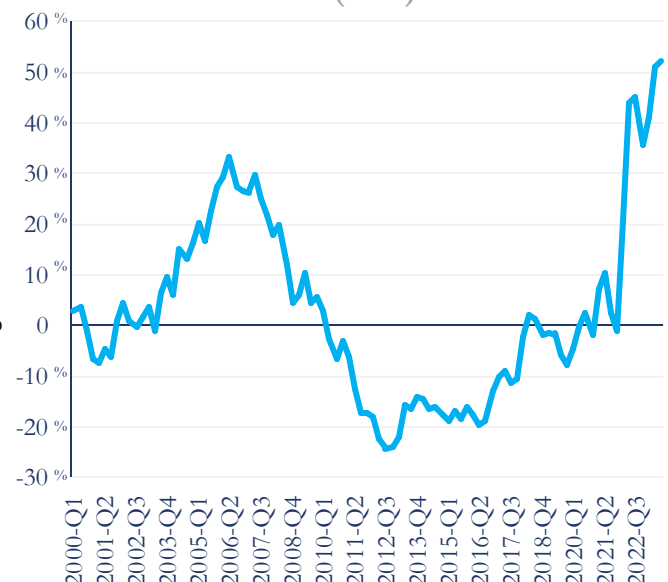
### *Buying Has Become Worse Than Renting*

In a recent study conducted by Coldwell Banker Richard Ellis, the average monthly cost of a new mortgage payment has surged to a level 52% higher than the average apartment rent. This disparity in housing expenses has now reached a level unmatched since the 2008 housing crisis and has not been this pronounced since 1996.

Historically, buying and renting costs were more closely aligned, but a combination of soaring mortgage rates, rising house prices, and a shortage of affordable down payment options have now created a significant gap. To illustrate, someone taking out a 30-year mortgage today for a \$430,000 home with a 10% down payment would face a monthly repayment that is a staggering 60% higher than if they had purchased the same house just three years ago.

However, despite the increased financial burden on homeowners, a complete collapse in house prices appears unlikely. This is due to the fact that a substantial 80% of outstanding U.S. mortgages carry interest rates below 5%. Unfortunately, homeowners find themselves unable to capitalize on this favorable interest rate environment and downsize due to record-high house prices and surging mortgage rates.

**PREMIUM/DISCOUNT TO BUY A  
US HOME VS. RENT**  
(in %)



### Chevron Buys Hess Corporation

Chevron has entered a significant \$53 billion all-stock deal to acquire Hess, strategically expanding its presence in the United States and gaining a share in Exxon Mobil's promising Guyana oil discoveries. This move, coupled with Exxon's recent \$60 billion purchase of Pioneer Natural Resources, will boost oil and gas production for the leading U.S. producers, including a substantial share from shale extraction.

Chevron's acquisition of Hess, along with previous purchases of PDC Energy and Noble Energy, is expected to increase its daily oil and gas output to approximately 3.7 million barrels, marking a 40% expansion in shale production. Chevron will also secure a valuable 30% stake in the Exxon and CNOOC Stabroek oil block in the rapidly growing oil-rich region of Guyana.

While regulatory reviews are underway, antitrust concerns are not anticipated, highlighting the companies' commitment to compliance. Chevron and Hess project cost synergies of around \$1 billion within a year, contributing to robust profit margins. Nonetheless, this deal has sparked concerns among environmentalists, as it underscores a continued emphasis on fossil fuels over renewable energy sources. The deal is expected to be finalized by Q2 of 2024, marking a significant milestone in the energy industry's evolution.

### GM Abandoning Goal of 400k EVs by Mid-2024

General Motors (GM) is abandoning its goal of building 400K electric vehicles by 2024. Despite the UAW strike that has been costing GM about \$200M each week in profit, the automaker has reported a healthy third-quarter profit. This positive performance makes the abandonment of GM's goal even more surprising as GM is relying on this EV technology for its future, anticipating a phase out of gasoline-powered vehicles by 2035.

Other EV producing rivals such as Tesla and Ford Motor have raised concerns over whether buyers will be willing to pay a premium for EV's. Ford Motor also pushed back its EV production target in July and Elon Musk was “gloomy” about the outlook for EVs last week. Many companies have been forced to offer discounts on EVs with Tesla significantly cutting the price of its most popular vehicles, the Model Y and Model 3. According to a GM Chief Executive, these pullbacks are hiccups in the process of reaching an EV dominated future rather than a signal of GM going back on its goal. There are many contributing factors to this production slowdown including rising interest rates and reduced “excitement” surrounding EVs, but GM remains committed to its coal of “an all-electric future”

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Sources: Wall Street Journal