Weekly round up (Week 44)

October was anything but easy for investors. As reflected in our favorite market sentiment index, the VIX, volatility jumped to 25 during the month, its highest level since Liberation Day. Investors faced a series of challenges, including the ongoing standoff between China and the US ahead of the planned meeting in South Korea, as well as concerns about the health of the US small and mid-cap banking sector following several unexpected defaults by well-known institutions. Investors also had to navigate the markets without a government safety net: Japan started the month without a prime minister, France seemed to be in chaos and unable to form a stable coalition government, while the US government remained paralyzed.

On the equity side, optimists were waiting for third-quarter results and new announcements on AI. It is impressive to note that AI-related stocks have accounted for 75% of the S&P 500's returns, 80% of earnings growth, and 90% of capital expenditure growth since the launch of ChatGPT in November 2022.

And as we close out October, all is well!

In October, most major sovereign bond curves experienced a slight bull-flattening move, with price data showing no signs of acceleration. Global activity remained robust, with third-quarter growth exceeding estimates in both China and the eurozone, and central bank monetary policy decisions broadly in line with expectations. The notable exception was the UK, where gilt yields fell by 20-30 basis points across the curve, with the long end outperforming. The catalyst was an unexpected drop in core inflation to 3.5%, prompting investors to reassess the likelihood of a Bank of England rate cut in December.

Meanwhile, eurozone HICP (harmonized index of consumer prices) inflation slowed to 2.1% year-on-year in October from 2.2% in September, reinforcing the consensus view that tariffs are proving disinflationary outside the US. In contrast, the expected rise in US inflation due to tariffs has not materialized.

One of the few notable data releases showed that both headline and core inflation in the US came in at 3.0% year-on-year, below expectations. With four months of hindsight since the implementation of the “liberation tariffs,” evidence consistently indicates that for every US$1 increase in tariff costs, businesses have passed on only about US$0.26 to consumers.

Given that basic goods account for 18% of headline inflation and 23% of the core inflation basket, the temporary effect of tariffs on inflation—assuming an average tariff rate of 17.9% and a 26% pass-through—is equivalent to a 0.86% increase in headline inflation and a 1.08% increase in core inflation. This suggests that once these one-off effects are removed from the index next year, US inflation should move closer to the Federal Open Market Committee's (FOMC) 2% target.

Of the three major central bank meetings this week—the Bank of Japan, the ECB, and the FOMC—it was the Federal Reserve that generated the most excitement. Although the Committee's decisions were in line with expectations, the FOMC lowered the target range for the federal funds rate by 25 basis points to 3.75%–4.00% and effectively ended quantitative tightening (QT) by announcing that it would stop reducing its balance sheet as of December 1.

The surprise came during the press conference, when Chairman Powell adopted a particularly aggressive tone, stating that "another rate cut at the December meeting is not a foregone conclusion." He was optimistic about economic growth, confident about the labor market, and noted that the impact of tariffs on PCE (personal consumption expenditure) inflation appears to be between 0.5% and 0.6%, which is lower than initial forecasts. 4

Overall, Powell's comments were aimed more at preserving monetary policy flexibility than at indicating a predetermined course, particularly in a context of increased uncertainty due to the scarcity of economic data caused by the government shutdown. In response, the overnight interest rate market revised down the probability of a further rate cut in December from 98% to 60%.

Corporate credit had a solid month, with all sub-asset classes (US, European, and emerging market credit) generating positive total returns. Emerging market credit stood out in particular, outperforming in both the investment grade and high yield segments. Emerging markets regained investor favor, supported by steady capital inflows since the summer, totaling $16.6 billion since the beginning of the year. Easing global financial conditions, combined with a series of positive geopolitical developments, prompted investors to review their positioning: the outperformance of emerging market credit relative to its US and European counterparts increased the urgency to fill any underweight positions.

October was also rich in positive geopolitical events. Japan appointed a new prime minister, Sanae Takaichi, who is expected to pursue a policy inspired by Abenomics, focused on monetary easing, fiscal stimulus, and structural reforms. In Argentina, President Javier Milei's libertarian party won a major victory in the midterm legislative elections, giving new momentum to his liberal economic reform agenda.

However, it was President Trump who dominated the headlines and buoyed market sentiment in October. He first secured a ceasefire agreement between Israel and Hamas, which came into effect on October 10. He then made a dramatic shift away from Russia, imposing new sanctions on Russian oil giants Rosneft and Lukoil, citing Moscow's lack of sincere commitment to peace in Ukraine.

The next step on the US agenda was the APEC Summit in South Korea, where President Trump announced a series of major trade and investment agreements with Japan and South Korea.

These agreements resulted in Japan's commitment to invest up to $550 billion in the US through government-related funds, while South Korea committed to $350 billion, including $150 billion for shipbuilding and $200 billion in a broader investment framework. In return, the United States agreed to reduce reciprocal tariff rates to 15% for both countries.

The highlight of the month was the highly anticipated meeting between President Trump and President Xi, their first face-to-face meeting in six years. According to all observers, the meeting went very well.

The meeting concluded with a comprehensive trade agreement, in which the United States agreed to halve tariffs on Chinese products related to fentanyl, with immediate effect, bringing the overall tariff rate on China back to 20%, its pre-Liberation Day level. In return, China committed to resuming its massive purchases of U.S. soybeans, promising a minimum of 25 million tons per year for three years, and to suspending its licensing regime for rare earths for at least one year. In addition, the two leaders agreed to strengthen their cooperation on issues related to Ukraine.

Currency and commodity markets reacted accordingly. The US dollar appreciated against major global currencies, buoyed by the central bank's unexpected comments and optimism over recent trade agreements, which are expected to attract significant foreign direct investment to the US. The Japanese yen, meanwhile, underperformed, weakening broadly in line with the new prime minister's “Abenomics”-style program.

Energy prices ended the month slightly lower, as growing signs of oversupply heading into 2026 offset the impact of sanctions on Russian suppliers. Metals, on the other hand, continued their rally: precious metals benefited from a rebound in demand (palladium rose 14% over the month), while industrial metals rose due to supply constraints, led by copper, which was up 6%.

Finally, equity markets extended their melt-up in October, with the Bloomberg World Large & Mid Cap Index rising 2%, buoyed by strong performances in

Asian markets. The Nikkei 225 gained more than 14%, but was outperformed by South Korea's KOSPI index, which jumped 15.7%. In the United States, technology stocks continued to lead the way, with the Nasdaq rising more than 4%.

With regard to artificial intelligence, at the APEC summit, NVIDIA CEO Jensen Huang emphasized that continuous improvements in AI models are driving investment in this technology, creating a “virtuous circle” of innovation and growth. He said that we are at the beginning of a decade of building a new technological era.