NOVEMBER EUPHORIA

The markets throughout 2023 have accustomed us to major and sudden changes of direction. It has almost always been the inflation expectations and thus the future trend of interest rates that have tickled fears and fuelled bets. It could not be otherwise, since 2022 the explosion of inflation and the central banks' firm decision to bring it back to the 2% target have been, and still are, the dominant themes of monetary policy. Historical experience and economic logic teach that when interest rates rise quickly, inflation falls. The price to pay is often a sharp drop in demand that leads to unemployment and possibly even recession. The markets have therefore been hanging on every single piece of data, every single word from every single exponent of the issuing institutions, in the hope of guessing the path on which to move. Last year, in the midst of the difficulty, there was one unquestionable certainty: financial asset prices had to be quickly recalculated. The future profits of companies were discounted practically regardless of the financial cost, given the near-zero or even negative rates. Thus the stock market collapsed and at the same time the bond market did too. The transition from a world centred on the fear of deflation to one suddenly obliged to fight inflation, to turbo-normalise interest rates, could not be painless. In the course of 2023, there was no lack of warnings: the US banking crisis in March, then the Credit Suisse crisis and now the bankruptcy of Signa, the company of real estate prodigy René Benko. Even the first inflation trigger, the war in Ukraine, has ended up habituating the markets. The war between Israel and Hamas has now been downgraded to a local phenomenon. And the problems of the Chinese economy, which impact world growth, are of less concern because they curb, the markets hope, geopolitical aims.

November 2023 will go down in history for the power with which the financial markets celebrated themselves. The index of world stock exchanges (MSCI World) rose 8.9%, the Nasdaq even 10.7%, the Stoxx 600 6.4% and Switzerland 4.4% (MSCI). The data that triggered the bodacious exuberance was that on core inflation in the US, which rose in October by 0.2% instead of the expected 0.3%: a small

surprise that was enough to convince financial operators of the imminent end of the rate hike cycle. The Federal Reserve, which had been accused of waiting too long in normalising its monetary policy, has now regained credibility in the eyes of dazed investors. This new confidence was not without immediate consequences. Those who were betting on the downside immediately ran to close their positions by buying back shares on the market with full force. Then it was the turn of the investment funds and big investors to step in, frightened by the idea of missing the performance train. Indeed, even employment growth had eased in October (+150'000 non farm payroll, the lowest increase since June), while unemployment rose to a two-year high (3.9%), indicating that the strong demand for workers was beginning to cool. Nevertheless, the US economy grew by 5.2% (annualised GDP) in the third quarter, instead of the expected 4.9%, as companies filled warehouses and stockpiled machinery. The markets' dream of a soft landing in 2024, such that consumption does not collapse causing a recession, seems within reach. The Federal Reserve - the markets think - is preparing for the reversal: once the rate hikes are over, it will move on to their rapid reduction, all fuel for the economy, admittedly slowed down but not stunned. The probability of a recession in the United States, the driving force behind the world economy, or at least the western economy, has risen to 46% over the next twelve months against the 70% imagined during the summer, according to the New York Federal Reserve.

Traders have even positioned themselves for five rate cuts of 0.25% each, the first, with a 40% probability, as early as March next year. Quite a change of narrative compared to July, when the end of the upward phase was imagined, but remaining at the crest of the peak for a long time. In the Eurozone, the preliminary inflation estimate for November stood at 2.4% (2.8% expected). It is inevitable to hope that the European Central Bank (ECB) will start cutting as early as next April. This new environment drove bonds: the yield on 10-year Treasuries fell from 5% to 4.2%, dragging up yields on riskier (high yield) bonds as well. The optimism bordering on euphoria has given new impetus to the buy-back mechanism, the repurchase of shares by companies which, according to Goldman Sachs, will continue at the rate of 5 billion a day until

8 December, when the regulated suspension period will come to an end.

What does the November euphoria mean in a longer-term plan? And, above all, is it destined to continue into 2024?

While it is true that markets act within their financial logics, it is equally true that there are moments in history when politics may deliberately decide to alter them. These are risky operations because markets, as George Soros writes, are essentially reflexive: the risks implicit in political decisions are only partially predictable, especially when they encroach on geopolitics. The war in Ukraine has turned into a battleground between the United States and its Western allies (Europeans, Japanese and Australians) against those realities, with China at the centre, that want a downsizing of Washington and the dollar. The new cold war was triggered by Russia. Joe Biden, the octogenarian president, has interpreted it as a call for his country to consolidate its role as a hegemonic power. It is also about destroying those perceptions, heightened after the 2008 financial crisis, that the US is a power in decline. The financial consequence of this approach is that inflation must be harnessed precisely to demonstrate the strength and consistency of the international dollar. The Federal Reserve has therefore proceeded to raise rates powerfully and quickly, projecting the dollar upwards and putting many economies in trouble. At the same time, politics, which had been in abeyance for the last thirty years, regained control of the economy under Biden by financing domestic reindustrialisation (reshoring) and digitalisation. High rates and the strength of American companies, such as Microsoft, Meta, Apple, Amazon, Alphabet, NVIDIA, have been able to catalyse attention on the artificial intelligence revolution, keeping the flows on the dollar and into the US. The management of US oil has contributed in no small measure to containing inflation at the expense of countries such as Saudi Arabia, which would have liked to reap some rich benefits. The Cold War climate has put the US's main antagonist, China, in a difficult position. Financial flows to this country, already opposed by Donald Trump, have come to a halt, confirming that Wall Street's hegemony also affects the Middle Country.

For now, 'bidenomics' seems to be a success to which the markets

enthusiastically toasted in November. But the price is high: US debt has exploded, with the budget deficit growing by 23% in 2023, compared to the previous year (6.3% of GDP). A Cold War climate has now set in, fuelled by politicians who have the age and experience to be influenced by it, fuelling a confrontation that is becoming ideological. In the United States there is a growing feeling, at least among the powerful on Wall Street, that neither Joe Biden nor Donald Trump are adequate to lead the country in the next four years. The Democrat Jamie Dimon, head of JP Morgan, has been very explicit: better to vote for the 50-year old Republican Nikki Haley rather than Biden (Dimon himself could be presidential). Ray Dalio, founder of Bridgewater, the fifth most important private company in the United States, and considered by *Fortune* to be one of the hundred most influential people in the world, is also along the same lines. American captains of industry share the change of tone towards China and the firmness in international relations. However, they do not want a cold war that shuts down markets and growth possibilities: rather, they are for a new form of international coexistence that will create global business opportunities also in the context of the energy and digital transition. The markets next year will be very careful and will be easily spooked if they do not see constructive assumptions in the governance of the country. They will, however, be ready to get excited if they see new leaders capable of motivating them.

This will be a volatility factor that will be amplified in movements, both downward and upward, by the liquidity that is still plentiful. Central bank balance sheets, swollen by years of monetary easing and supportive policies to overcome the Covid emergency, are unlikely to be reduced quickly in a rich election year, not just for the US, but for more than half the world's population. The market in November may have exaggerated in anticipating the speed of interest rate cuts. The fact remains, however, that the work of central banks is at its pivot, its turning point. Now the Federal Reserve, and by extension the other major central banks, will only have to temper exaggerations to contain inflationary escapes. The operational introduction of artificial intelligence dynamics can also quickly contribute to productivity growth and thus to cost containment.

The conditions for a positive 2024 are there, but so are the dangers. It will still be a volatile year waiting for new leaders capable of opening a new page of modernity. In the meantime, the markets are enjoying November's results and are beginning to take into account a tactical correction perhaps around 12 December, when the update on November's inflation figure arrives and, the day after, the Fed meeting.

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