What a Fire!

Last week we wrote the "We Didn't Start the Fire" remake. It was meant to be a quick (and hopefully mildly entertaining) way to highlight just how many things are affecting markets and the global economy (geopolitically, internationally, and domestically). The list of issues facing us is long, and certainly helped create the "wall of worry" that Wall Street managed to climb this week.

The Geopolitical Front

While there were many headlines this week, nothing much has changed from our previous view that the risk of escalation remains real, and that we'll have difficulty forming a domestic policy that keeps everyone happy.

We tackled the Middle East in this week's webinar. The replay runs just under an hour but it's a fantastic way to keep up to date on the many moving parts in the region along with some global issues. Beyond the military aspects, we explore supply chain issues, energy policy, and even the roles of various international organizations. Rachel Washburn, who was embedded with special forces in Afghanistan as an Army Intelligence officer, moderated the conversation and did a great job of including many questions that the audience was peppering her with from the get-go. Generals (Ret.) Deptula and Robeson brought a wealth of relevant information, perspective, and thoughts on where this could go. General Deptula, a retired Air Force general, was able to provide some deep insight into the air campaign, while General Robeson's Marine Corps career was extremely relevant to the discussion around the fighting on the ground. I highly recommend watching the replay.

As a backdrop, prior to the webinar and last weekend's Billy Joel tribute, you can find:

- Multiple SITREPS on the events in the region. Each SITREP is a reaction to events as they occur in real time. They are driven by the expertise of Academy's Geopolitical Intelligence Group, and are a key tool in our efforts to keep clients informed of what the events mean and what the reactions and consequences are likely to be.
- On the more "macro" front, there is not much of a change following our two prior pieces:
    - A Difficult Week outlined several scenarios and risks for the global economy. It also included our initial podcast on the war.
    - Increasing the Risk Assessment. Basically, where we still are.

We will continue to do our best to provide insights that hopefully help you navigate this on many levels, as it is a complex, treacherous, and highly emotional situation that is constantly evolving (or devolving, as the case may be).

The Market Dumpster Fire

Ok, we had the exact opposite of a dumpster fire in markets last week, unless you were short or owned puts. **Stock indices were up around 6% for the week!** If we want to nitpick, the Russell 2000 was up almost 8%!

Credit spreads tightened, though the CDX indices heavily outperformed the actual bond market (the CDX indices tend to correlate much more to equities than actual bonds). The rally in high yield bonds was impressive, but very much in line with what would be expected given the rally in bond yields and equities.

But the market that's "truly on fire" (or at least the market that sparked the flames) **was the Treasury**

market.

On October 23rd, the 10-year breached 5%. It almost did it again on the 26th, and it briefly traded below 4.5% on Friday! **A move between 40 bps and 50 bps in just over a week is extreme by any standard** and drove markets. WIRP (and the probability of Fed actions) has almost completely ruled out a hike and we now have an almost 30% chance of a cut at the March meeting! **What a difference a week makes!**

While the move is quite large, it is completely understandable:

- The Fed's refunding was not as bad as feared (or priced in) especially at the long end. In D.C. Has Done The Fed's Job, we expressed several reasons why the fear about supply, while likely correct longer-term, was overdone.
- We suspected that Powell would try to sound hawkish, but include many caveats (especially surrounding the moves in the yield curve and real yields). He couldn't be as hawkish as many were positioned for (The Game is Slipping Away).
- Our assessment of the Fed meeting (The Fed & Treasury Behind Us) was bullish with the caveats that the Middle East could disrupt the "everything rally" (it hasn't yet) and that the economic data could be bad enough to bring recession chatter back to the headlines (not yet).
- The Jobs Report Was Universally Weak. One thing that I learned quickly was that when you send out a report titled "weak report" and you only glance at the replies, your first reaction is to think that the comments were calling my report weak ☹. In any case, this report was weak enough to keep the "everything rally" going.

But all that is history, where are we going?

Bottom Line

The "easy" part of the Treasury rally is over. We could bounce around, but I am looking for more weakness on the data side to push us below 4.3% on the 10-year. After the recent rally, we might drift higher in yields first and see some shorts get put on, but I think that we'll see 4.3% before 4.75%.

The Treasury market moves will be mainly expressed 5 years and out as the Fed will be in no rush to cut rates. This implies that a bet on more negative curves is the direction to lean towards.

On credit spreads, I like credit spreads a lot here, especially for high quality IG.

- Cash credit spreads have some room to move tighter, given the move in CDX spreads and other risk assets.
- The calendar should start to slow as we head towards Thanksgiving.
- With all the noise still coming out of D.C., I keep thinking that investors should be overweight high-quality corporates as opposed to government securities. These corporates have good governance, global businesses, and every intention to pay back every dollar that they owe, when they owe it. I am still toying with the idea of what the "new safe asset" is, and it isn't super important today, but it is a "hypothetical" question worth exploring and high-quality corporates keep coming to mind.

Stocks will likely follow earnings, yields, and may try to rally some more as we're about to be bombarded with "seasonal" effects (or at least the reporting will focus on seasonal effects). I like stocks

until we get to 4.3% on the 10-year, and then would be extremely nervous as we won't get there without greater recession concerns!

We should expect some consolidation, but I continue to favor more of the "everything" rally.

Hope you enjoyed the extra hour of sleep, though the cost of it getting dark so early doesn't seem to be worth the price.

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