OBSERVATIONS

- Taiwan Semiconductor (TSMC), the world's largest contract semiconductor manufacturer experienced its largest decline in nearly 30 years after the U.S. again tightened controls over chip exports to China. TSMC generates roughly 10% of its revenues from China-based customers by supplying the likes of Apple, Qualcomm, and Nvidia.[1]
- Small Business Optimism Index rose modestly in September to 92.1 but remains below its nearly 50-year average of 98.0. Nine in ten small business owners reported few or no qualified workers and three in ten reported rising prices (inflation) was their number one business problem. [2]
- The US Producer Price Index rose 0.4% in September from August and stood at 8.5% year-over-year (YoY). Core-PPI—which excludes food, energy and trade services—was 5.6% YoY in September, unchanged from the August figure.[1]
- The September CPI report came in hotter than expected and core inflation reached the highest levels since 1982.[1] Core inflation moved up to 6.6% YoY versus 6.3% YoY in August—consensus estimates were for 6.5%—and headline inflation fell only marginally to 8.2% YoY from August's 8.3% figure.

EXPECTATIONS

- The minutes from the most recent Fed meeting showed that the Fed was well aware that its monetary tightening has negatively impacted the US housing market as well as businesses' plans for fixed asset investment, the group was determined to err on the side of hawkishness. They noted "that a period of real GDP growth below its trend rate, very likely accompanied by some softening in labor market conditions, was required" in order to combat the current high levels of inflation.[3]
- Q3 earnings season began last Friday with JP Morgan, Wells Fargo, Morgan Stanley and Citigroup all reporting. Overall, the numbers were mixed and guidance was negative as most began to set aside reserves in anticipation of weaker US economy and the potential for non-performing loans.[4]
- China began its 20th Communist Party Congress over the weekend, which will conclude later this week with Chinese President Xi Jinping receiving an unprecedented third 5-year term in office along with close Xi supporters being named to the Communist Party Politburo—the Party's highest governing body.[5] This congress will make Xi the most powerful Chinese leader since its revolutionary war-hero, Chairman Mao.
- Ukrainian forces continue to grind out gains both in the south near to Kherson as well as in the east moving towards the village of Svatove. Meanwhile, Russia continues to pummel civilian infrastructure across Ukraine with long-range missiles.[6]

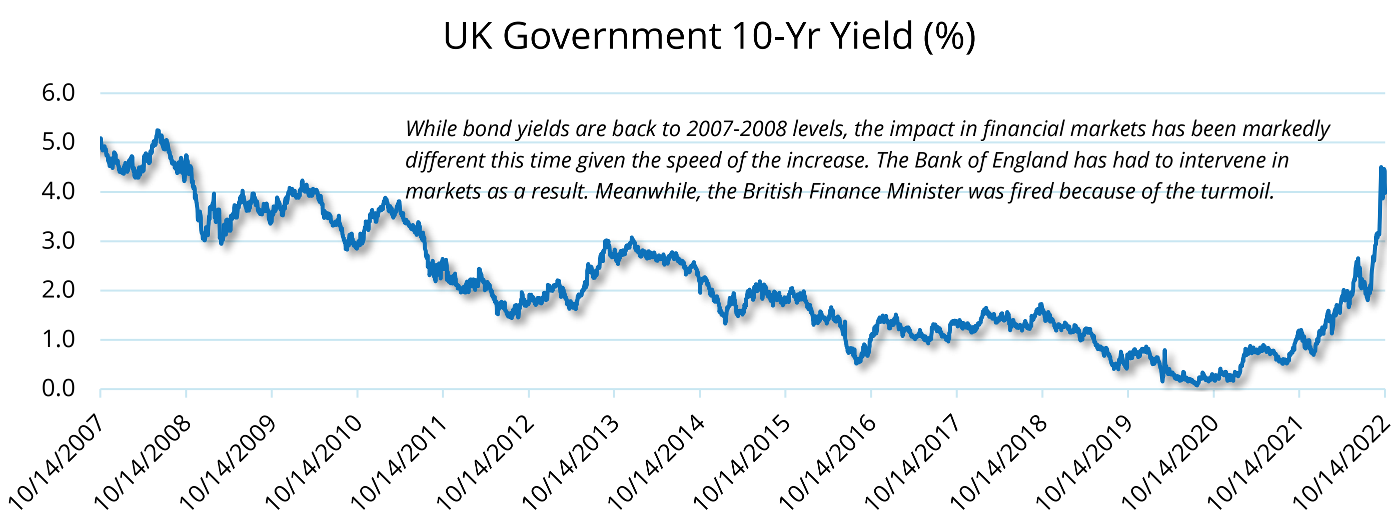
ONE MORE THOUGHT: *Financial System fragility on display*[7]

A decade of near zero to negative interest rates shoved risk into a broad part of the system best characterized as being 'non-bank' in nature. Over this period banks were constrained by regulatory regimes and the scars of the Great Financial Crisis remained. As a result, non-banks—entities that can be described as public and private asset

[1] Bloomberg LP
[2] https://www.nfib.com/surveys/small-business-economic-trends/
[3] https://www.federalreserve.gov/monetarypolicy/fomcminutes20220921.htm
[4] https://www.wsj.com/livecoverage/stock-market-news-today-2022-10-14/card/your-guide-to-third-quarter-bank-earnings-kAO6BRSwHk0blOpeMVFh
[5] https://www.ft.com/content/e60a61b3-f043-43c2-a840-b3d3fba3237f
[6] https://www.understandingwar.org/backgrounder/russian-offensive-campaign-assessment-october-13
[7] Bloomberg LP, CNCB.com

managers, pension funds and other asset owners—have in part supported much of the funding mechanisms that banks had traditionally provided. Now, as central banks around the globe continue to fight inflation by lifting interest rates, they risk setting off a potential chain reaction of a different variety. There is a link between stable monetary policy and financial stability, and the rapid pace of global central bank tightening is having consequences in numerous parts of the global financial system. In the UK, the government's 10-Yr bond yield has risen from 1.8% in early August to last week's high of 4.5%. The Bank of England (BOE) had just begun to implement its quantitative tightening measures—stopping new bond purchases and shrinking its balance sheet—but was forced to reverse course and once again to intervene in the country's bond markets noting that "dysfunction in this market, and the prospect of self-reinforcing 'fire sale' dynamics pose a material risk to the UK financial stability." The comments were pointed towards financial market leverage and certain pension fund investment strategies, specific to the UK. Meanwhile, in Japan after 20 years of quantitative easing, it is dealing with its own monetary policy challenges as it owns nearly half of outstanding Japanese government bonds. The ownership of securities has added to the illiquidity in Japanese markets, so much so that the Japanese 10-Yr bond did not trade for a third consecutive day last week—a stretch not seen since 1999. The point here is that as central banks reverse decades of quantitative easing, the unintended consequences of the past decade of financial repression—keeping interest rates artificially at or near zero—may prove to be more painful than many policy makers anticipate.

CHART OF THE WEEK



Source: Bloomberg LP, Clearstead, as of 10/12/2022

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