Week in review and ahead (vol37.)

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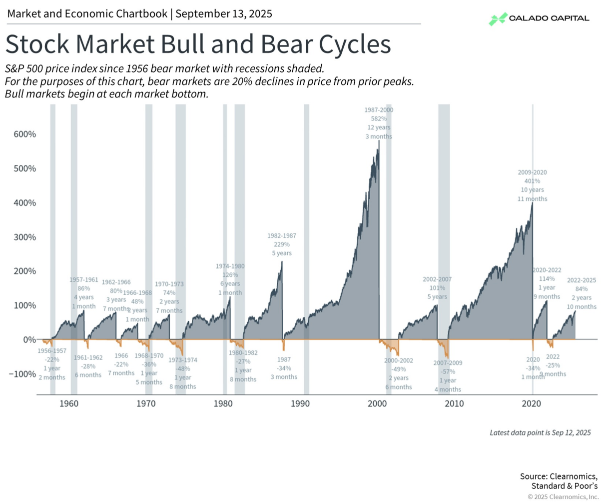
September 13, 2025

The equity markets rallied strong this past week, domestically and internationally alike, as a rate cut in the US of at least 25 basis points ('bps') is all but a certainty (and priced in). With markets focused on updated US inflation data, which surprised markets for being in line or better, reports of a weaker labor market with revisions to the previous year eliminating nearly 1M of jobs (from Apr'24-Mar'25), and a sudden spike in initial jobless claims to 260K, the Fed has been given exactly what it needs to cut rates at the next FOMC market following the announced pivot to focus on full employment in the US. Going into the week, I anticipated that the Fed's pivot would be tested, but the data on inflation and employment, both somewhat surprising and unexpected in my opinion, came in exactly in support of the pivot to ease monetary policy.

All major indices rallied for the week in anticipation of the Fed's pivot with the S&P500, Nasdaq Composite and Dow Jones advancing 1.6%, 2%, and 1%, respectively, setting numerous new all time high records throughout the week. The Russell 2000 closed the week up 0.3%. Internationally, all major global indices advances, including France's CAC-40, despite a lost vote of confidence for now ousted prime minister Bayro earlier in the week. With technicals in the market signaling oversold, institutional and hedge funds stepped in to buy the dip, and the newly appointed premier, Sebastian Lecornu, likely to maintain the fiscal discipline demonstrated by its predecessor (albeit initial announcements dont appear to support it and which lead to Fitch downgrading France's credit rating by a notch to A+). Japan and Hong Kong registered once again the largest weekly gains, advancing 4.1% and 3.6%, respectively. Germany's DAX advanced 0.4% amidst continued weakening macro environment.

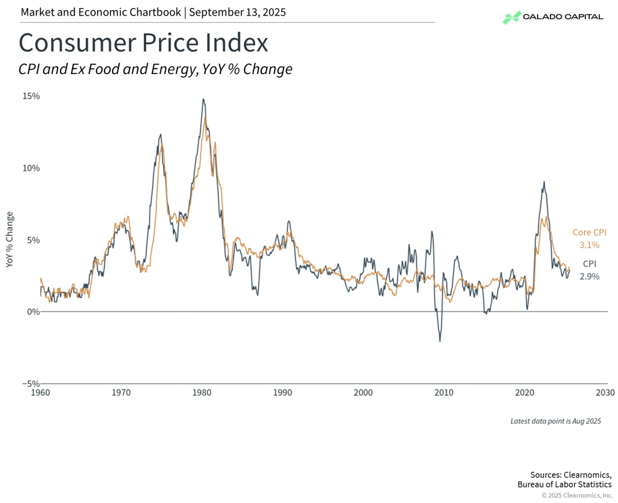
With monetary policy set to ease, many expect the current bull market in equities to continue, notwithstanding a pullback in the near term given the elevated valuations and signals of equities being overbought. While a pivot in monetary policy may be viewed favorably for equities, a deterioration in (real economic) growth amidst elevated inflation may risk stagflation that would put downward pressure on risk assets as growth in revenues and earnings may compress. Similarly, bond markets continued their rally this past week with yields along with all maturities declining; however, stagflation fears set in after the CPI report, despite being in line with expectations, which saw yields rise. The 10-yer treasury yield that had dipped briefly below 4%, rebounded to close the week at 4.07%.



With the inflation reports in focus, the PPI report on Wednesday surprised markets and helped lift (the S&P500 and Nasdaq) markets to new all-time highs at the opening and the rally that ensued after the CPI report on Thursday.

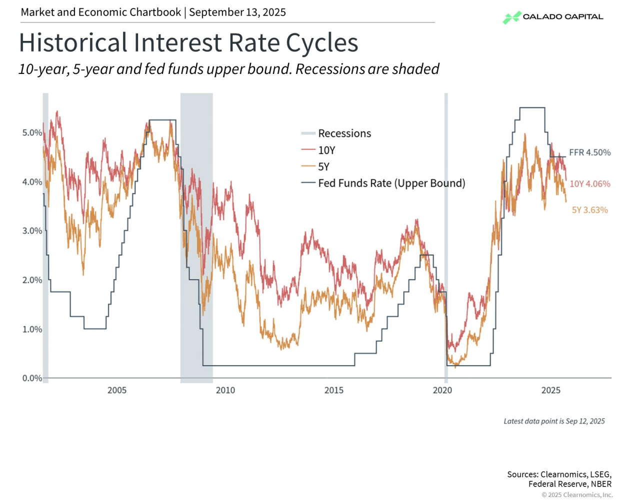
The producer price index (PPI), or wholesale inflation, for August expected to increase 0.3% month-over-month ('MoM') and 3.5% year-over-year ('YoY'), were -0.1% MoM and 2.6% YoY, not only missing (favorably) by a wide margin and surprising markets, but sequentially much improved with MoM and YoY readings for July being 0.7% and 3.1%, respectively. Similarly, core PPI, excluding volatile food and energy, in August of 0.3% MoM and 2.8% YoY, were overall better than expectations of 0.3% MoM and 3.5% YoY. Sequentially, however, the August report did not exceed the July report by wide margin (of 0.6% MoM) and in fact increased marginally on a YoY basis from the 2.7% reported previously. On the retail side, CPI headline and core CPI were in-line with expectations on a YoY basis of 2.9% and 3.1%, respectively, but higher sequentially, both by 0.2%-points. Regardless, with initial jobless claims spiking to 263K for the previous week, well above expectations of 236K and the 237K reported previously, markets quickly reasoned that a weakening labor market and somewhat "stable" inflationary pressures (albeit elevated) would be enough to see the Fed pivot and cut rates next week. Interestingly, given the data, speculation that the Fed may cut by more than 25bps (also known as a "jumbo cut") began to emerge immediately that saw yields drop but subsequently recover to close the week above key levels on the 10-year of 4%.

Besides inflation, consumer credit in July spiked unexpectedly to $16B from 9.6B in June and was well above the expected 10.5B, indicating that consumer spending may remain resilient. However, the week concluded with weaker consumer sentiment as measured preliminarily for September dropping to a reading of 55.4 from an expected 58.1 and a final reading of 58.2 in July.



For the week ahead, markets' focus lies squarely on the Fed's FOMC meeting and its announcement on monetary policy. Independent if the Fed decides to cut 25bps or proceeds with a jumbo cut, the narrative by Fed chair Powell will be closely watched for any indications of additional cuts yet in 2025. Some fear that the announcement may lead to a "sell the news" event, particularly if markets sense that the pivot may be done somewhat reluctantly and that upside inflationary risks continue to weigh on the Fed's decision making. After all, the monthly CPI and core CPI did advance at a faster rate and further from the Fed's target. Similarly, should the Fed decide on a jumbo cut, some expect it may trigger concerns or add focus to decelerating economic growth, fueling fears of possible stagflation. Regardless, volatility will heighten on Wednesday on the announcement itself and the subsequent press conference by Fed chair Powell as it does more often than not.

Besides the Fed's announcement, markets will get an update on the state of the consumer, with retail sales for August scheduled to be reported on Tuesday, and the housing market with home builder confidence and housing start and building permits due to report before the Fed's announcement. With the spike in initial jobless claims, markets will look to Thursday for any indications if this is the beginning of a longer trend, or subject to sector-specific, seasonality driven layoffs that does not necessarily reflect broader labor market weakness per Goldman Sachs, expecting downward adjustments to substantiate it. After all, continuing claims last week improved marginally to 1.939M, continuing a declining trend since August 21st.



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