

Week in review and ahead (vol.41)



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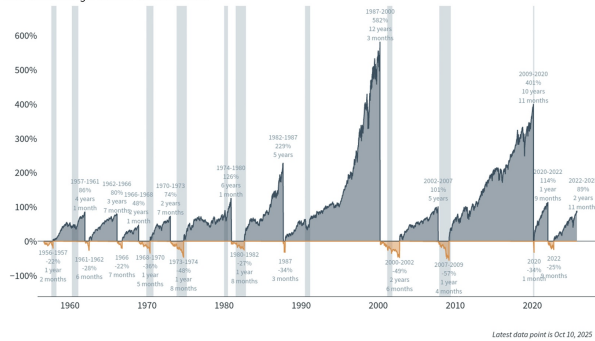
In preparation for the weekly newsletter, key macroeconomic, financial markets, and even geopolitical (albeit I try to avoid including those) data points are observed and noted throughout the week to write and finalize the newsletter highlighting key events that moved markets during the week that concluded and looking at what may move markets. With the governmental shutdown continuing and key macroeconomic datapoints not reporting as a consequence, this week's newsletter was slated to have the following introduction:

"The bull market is concluding (officially) its 3rd anniversary (on Oct 12th) and continues undeterred despite many acknowledging that valuations likely are elevated. Further, the governmental shutdown that has de facto halted reporting (m)any critical datapoints on the state and prospects of the US economy has been mostly ignored."

Well, so much for that introduction to this week's newsletter. With many discussions focusing on "if we are in for a 'dotcom' repeat or not and why," almost everyone had some type of a premonition as to what could eventually derail this bull run. Generally, elevated valuations on the face of it do not trigger corrections in markets. The causes for market corrections generally are triggered by macroeconomics or geopolitical events that elevates risks or even threatens any type of status quo for an economy or society.

Stock Market Bull and Bear Cycles

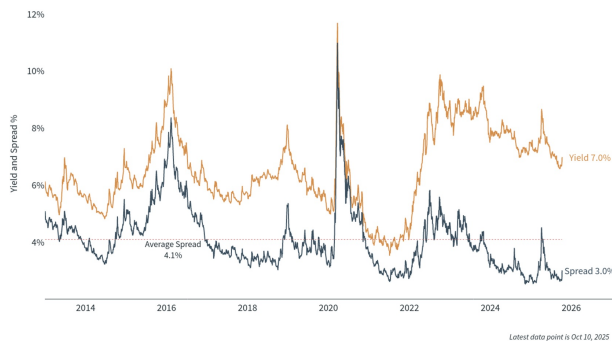
S&P 500 price index since 1956 bear market with recessions shaded.
For the purposes of this chart, bear markets are 20% declines in price from prior peaks.
Bull markets begin at each market bottom.



Sources: Clearnomics,
Standard & Poor's
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ironically include investment allocations from regulated banks. After all, corporate high yield credit spreads have remained relatively narrow from a historical perspective for some time now as initial fears of an economic slowdown or even stagnation (that lead to a spike in yields) faded quickly. The spread reflects the extra return investors' demand for taking on higher (credit) risks.

U.S. High Yield



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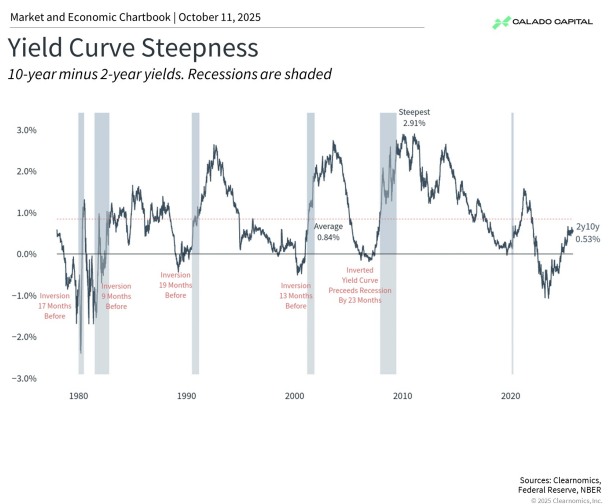
Some were concerned about the increased significance and raise of private credit in the US economy today. This is undoubtedly one of the reasons why news coverage of the First Brand bankruptcy filing a few weeks ago, that caught many of the largest asset managers that provided funds to structure these private loans off guard, is getting this strong of news coverage, which otherwise it would not. The coverage may ultimately center on asserting if this could be the beginning of a possible contagion to financial markets. This notion merits some level of validity as large asset managers in search of higher returns have increasingly allocated investments towards it, which

With this bull run's anniversary approaching, financial markets were reminded quickly (by the instance of a post by POTUS at 11am EST) that US trade relations are all but resolved. Despite having "term sheets" with key trade partners in place, the "path to a trade deal" between the US and its third largest trading partner China appears to unravel. With this administration taking a "corporate dealmaking" approach to trade policy, and doing so quite publicly, trading partners appear to quietly adjust to this strategy and likely trigger structural changes to the US economy that may go mostly unnoticed, even by financial

markets. After all, few details about these trade "term sheets" or "trade pacts" are known.

By taking this approach, China is silently influencing markets in the US. Regardless, if the approach is to decouple from the US (which may or may not violate recent trade discussions) or otherwise try to gain (negotiation) leverage, it will have wide reaching ramifications. In targeting the supply of US (semiconductor) chips into China, adding restrictions on Chinese exports of critical rare earths, or by halting their orders for US soybeans (in its entirety) during 2025, immediate impact on markets are to be expected and risks an all-out trade war triggering POTUS' announcements on Friday. With US agricultural producers now forfeiting billions of US dollars, POTUS is considering providing farmers' subsidies, however, considering that billions in US dollars of tariffs are deemed illegal, subject to an appeal before the US supreme court, the US debt levels risk widening

significantly. Eventually, this should bring out the 'bond vigilantes' out of 'hibernation' risking further steepening of the yield curve and which could elevate recession risks for the US, particularly given the Fed's recent pivot of prioritizing full employment over inflation.



With POTUS' announcement midday Friday, markets were reminded that tariff policy remains unsettled and that may have wide ranging implications for US sectors and growth prospects, markets sold off sharply with the tech-heavy Nasdaq leading the declines, dropping by more than -3.5%. The S&P500 and Dow Jones dropped by -2.7% and -1.9%, respectively, on Friday alone, while the small cap Russell 2000 index declined by -3% for the day. But for the sell-off on Friday, the Nasdaq, S&P500 and the Dow Jones were on pace to close the week up higher. Instead, all US indices declined on the week, with the Russell 2000 retreating

by the highest with -3.3% on the week, followed by the Dow Jones, Nasdaq, and S&P500 declining for the week by -2.7%, -2.5%, and -2.4%, respectively. In turn CBOE's VIX, which spiked on Friday amid the uncertainty, ended the week at 21.7, or 30% higher.

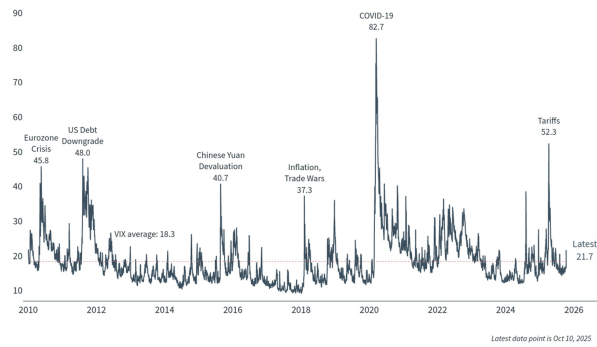
Internationally, most European markets closed down on the week led by France's Cac-40, down -2% for the week, on fallout from yet another prime minister resigning, albeit as of writing this report, Lecornu had been re-appointed. In Asia, Japan's Nikkei Index closed the week higher by 5.1%, rallying on Sanae Takaichi's ruling party's leadership election victory that sets the path for her to become Japan's very first female prime minister. Other markets in Asia were more subdued with China gaining +0.4% on the holiday shortened trade week, while Hong Kong declined by -3.1%.

With the government shutdown expected to continue all next week, markets stand to once again not get critical datapoints on the US' labor market, by way of the initial jobless claims for the third straight week, besides missing the non-farm payroll report for September previously, the state of the US consumer, by way of retail sales, and wholesale inventory, the PPI. Markets are hopeful, however, that the government may yet provide the important CPI report for September, given the critical nature to determine the cost-of-living adjustment for future social security benefits and other fixed incomes.

Focus, however, will remain on the flare-up of trade tensions among and between the US and China. The Chinese equity markets will open first on Sunday evening and a similar reaction to that of US markets can be expected, unless affirmation of a possible meeting between the two largest economies' leaders may yet proceed as intended during the upcoming APEC meeting.

Stock Market Volatility

CBOE VIX Index



Sources: Clearnomics,
CBOE
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If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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