

Novum Partners: Market Update

Tightening Into an Energy Shock: Rates, France and a First Crack in US Jobs

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Last 3 weeks performance

World Equity Indices

	% TR USD	% TR Local
MSCI World	-1.7%	-1.7%
S&P 500	0.5%	0.5%
S&P 500 Equal Weighted	-4.2%	-4.2%
Mag 7 Index	4.9%	4.9%
Russell 2000	-4.2%	-4.2%
Euro Stoxx 50	-5.0%	-2.1%
CSI 300 Index	-4.0%	-4.0%
Hang Seng Index	-6.4%	-6.3%
Nikkei 225	4.6%	5.6%
MSCI Asia	-0.4%	-0.4%
MSCI Latam	-4.4%	-4.4%
MSCI EM	-0.8%	-0.8%

S&P 500 Sectors

	% TR USD
S&P 500 Info Tech	6.1%
S&P 500 Comm. Serv	3.3%
S&P 500 Health Care	-2.6%
S&P 500 Financials	-7.4%
S&P 500 Cons Discr.	-3.0%
S&P 500 Energy	-1.8%
S&P 500 Real Estate	-5.3%
S&P 500 Materials	-5.0%
S&P 500 Industrials	-3.0%
S&P 500 Cons Staples	-3.0%
S&P 500 Utilities	-6.3%

Key Thematic Indices

	% TR USD	% TR Local
ARK Innovation ETF	5.5%	5.5%
Software ETF	4.6%	4.6%
Memory ETF	4.3%	4.3%
Semiconductors ETF	14.5%	14.5%
Momentum ETF	2.9%	2.9%
GS Cyclical	-5.9%	-5.9%
BBG Defensive Sectors	-2.84%	-2.84%

Fixed Income

	% TR or bps
LQD (High Grade)	-2.4%
HYG (High Yield)	-2.0%
US Treasuries Index	-1.9%
TSY 2 year (bps)	42
TSY 10 year (bps)	43
Bund 10 year (bps)	12
SOFR March 27 rate (bps)	27

FX & Commodities

	% TR USD
US Dollar Index	2.6%
Bitcoin	7.8%
BBG Precious Metals	-6.4%
BBG Energy	8.4%

Data as of 2nd October

Executive Summary

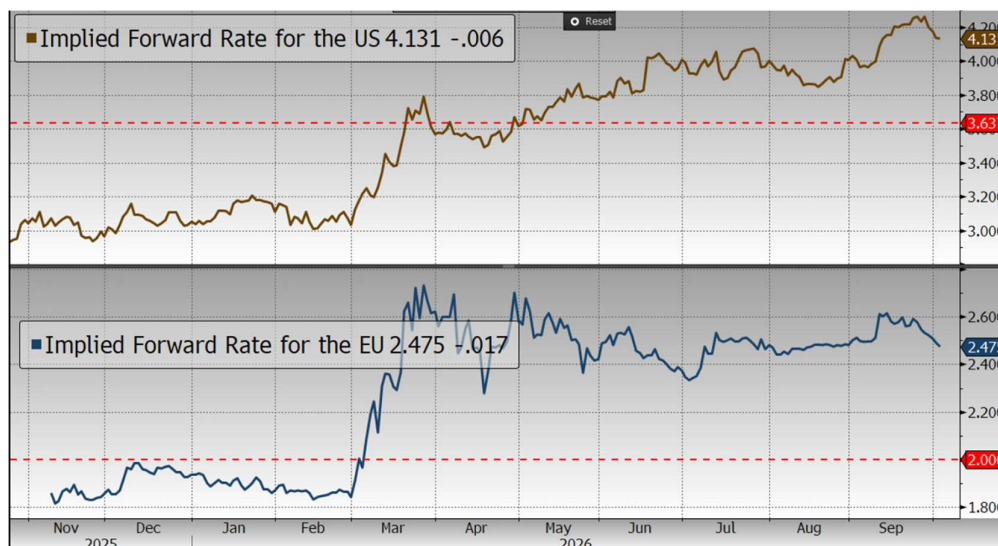
- Central banks tightened in sync. In mid-September the Fed, the ECB and the BoJ all raised rates within the same fortnight, a rare event. The Fed's first hike since 2023 came with a hawkish dot plot: 16 of 18 officials expect further tightening this year.
- A global bond sell-off defined the period. The 10yr Treasury yield rose +43bps over three weeks and touched 5.34% on 1 October, its highest level since 2002. The 10yr Bund broke above its 2011 euro-crisis peak. Real yields, not inflation expectations, drove the move.
- France became the epicentre of European stress. The OAT-Bund 10yr spread widened from 85bps at the start of September to 127bps on 30 September, a level last seen in June 2012. On 1 October it posted its largest daily jump since March 2020, with contagion to Italy, the banks and the euro.

- Oil, more than the Fed, remains the key risk. Brent peaked above \$109/bbl and stayed above \$100/bbl for most of the period as US-Iran talks over the Strait of Hormuz stalled. Futures price high prices well into 2027.
- Today's September payrolls disappointed: +29k vs. +84k expected, unemployment up to 4.2%, and 60k of downward revisions. Together with softer PCE revisions, the print lowers the urgency of a further Fed hike.
- Equities were narrow and AI-driven. The S&P 500 rose +0.5% over three weeks, but the equal-weighted index fell -4.2%. Semiconductors rose +14.5% while financials fell -7.4% and utilities -6.3%. Europe lagged (Euro Stoxx 50 -5.0% in USD) and the dollar gained +2.6%.

Economy & Monetary Policy

- ECB. On 11 September the ECB hiked by 25bps to 2.50%, its second move of the cycle, with hawkish guidance and higher growth and inflation forecasts.
- BoJ. The BoJ raised rates to 1.25%, the highest level since 1995, although two dissents made the outcome more dovish than expected.
- Fed. The FOMC unanimously raised rates by 25bps to 3.75-4.00%. Chair Warsh described the move as removing "a dose of accommodation", not a one-off, and prioritised a "timelier return" to 2% inflation. Late in the month, markets priced up to 93bps of further hikes by June 2027, and the odds of an October hike peaked above 70%.
- Other central banks. The BoE held at 3.75% but scaled back its quantitative tightening programme. The RBA hiked to 4.60%.

The hawkish momentum faded at the end of September. NY Fed President Williams saw "no urgency" for the next move, and Vice Chair Jefferson and Governor Bowman struck a similar tone. Downward revisions to US inflation data then cut October hike odds to around 30%. In Europe, the 1 October market stress pushed a further ECB hike by December below full pricing.



Our concern: tightening into a supply shock

Rate hikes do not add a barrel of oil to the market. The current inflation impulse comes from energy supply, not overheating demand. On our estimates, the US gasoline and diesel bill will rise by about \$274bn this year, close to 1% of GDP. Consumers have absorbed this so far by drawing down savings, but the savings rate is now only around 3%. Further tightening beyond what is priced would add a second, self-inflicted drag. Europe illustrates the risk: since the war began, the Euro Stoxx 50 has underperformed the S&P 500 by 11%.



US growth: resilient, then a first crack

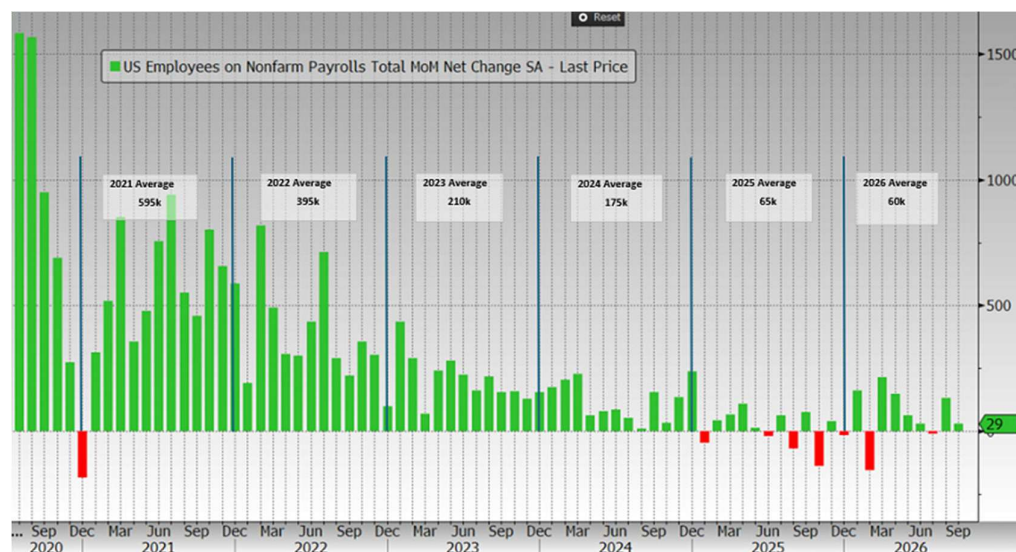
Activity data stayed strong through most of September:

- the flash composite PMI hit a 5-year high of 58.4;
- initial jobless claims fell to 197k and continuing claims to a three-and-a-half-year low;
- the Atlanta Fed GDPNow tracks Q3 growth near 5%;
- the ISM manufacturing index held at 54.5, but its prices-paid component jumped to 77.9.

The September jobs report was a clear downside surprise:

- nonfarm payrolls rose just +29k, below every Bloomberg estimate (consensus +84k);
- unemployment rose to 4.2%;
- July and August were revised down by a combined 60k jobs;
- wage growth slowed.

The detail is less negative than the headline. The participation rate rose to a four-month high of 61.8%, which explains part of the rise in unemployment. Layoffs also remain low, so the weakness reflects hiring restraint rather than job cuts. Still, after August's +162k surprise, the reversal suggests employers are becoming more cautious as costs rise. It strengthens the case for the Fed to pause, although the participation uptick argues against an outright dovish reading.



Inflation: US relief, European surprises

In the US, revisions lowered the inflation profile. Core PCE is now +3.0% y/y (vs. +3.3% expected), and its 3-month annualised pace is +2.05%, the softest since mid-2024. In Europe, September flash CPI surprised to the upside: Germany +3.3%, France +3.4% and Italy +4.1%. Euro Area headline inflation is tracking near +3.8%.

Geopolitics

- Tanker attacks, the temporary shutdown of Saudi Arabia's East-West pipeline, Houthi activity in the Red Sea and direct US-Iran naval clashes pushed Brent above \$109/bbl in mid-September. Talks around the UN General Assembly raised hopes of a phased deal to reopen the Strait of Hormuz, but Trump rejected Iran's latest proposal and Tehran refused to soften its demands. Trump's remark that he could "possibly" resume bombing after the midterms, and an additional US carrier deployed to the Gulf, point to a prolonged standoff. Partial relief came from the restart of about half the Saudi pipeline flows and a final 40m-barrel US SPR release.
- European politics. In Germany, the AfD won a record 44% in Saxony-Anhalt, the CDU failed to enter the Mecklenburg-Western Pomerania parliament, and Die Linke came first in Berlin. The political centre continues to erode, although federal policy continuity is not in question for now. France is presenting its 2027 budget amid protests and a record €340bn borrowing plan.

Markets

Equities: an AI-only market

Over the three weeks to 2 October, the headline indices hid a weak underlying picture. The S&P 500 gained +0.5%, but the equal-weighted index and the Russell 2000 both fell -4.2%. MSCI World lost -1.7%.

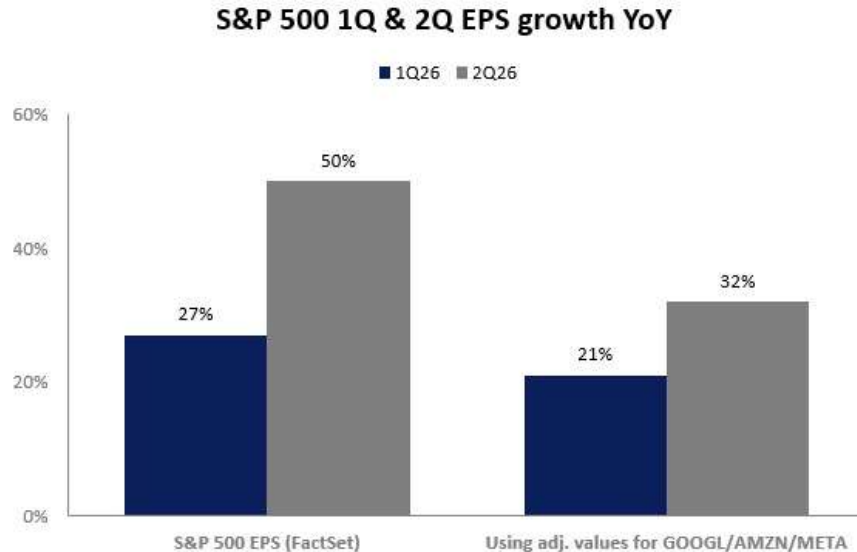
Gains were concentrated in AI-related technology:

- Semiconductors ETF +14.5%, Info Tech +6.1%, Communication Services +3.3%, Magnificent 7 +4.9%;
- drivers included Meta's AI agent, AMD crossing a \$1trn valuation and Micron's results;
- the Nasdaq set repeated record highs after recovering from a mid-September "AI doomerism" sell-off.

Almost everything else fell, consistent with a rates shock:

- Financials were the worst sector (-7.4%), hit by fears that AI erodes fees and margins, wider credit spreads and, at the end, European bank contagion;
- rate-sensitive sectors suffered: Utilities -6.3%, Real Estate -5.3%, Materials -5.0%;
- defensives offered no protection (BBG Defensive Sectors -2.8%), and cyclicals were weaker still (GS Cyclicals -5.9%);
- even the Energy sector fell (-1.8%) while energy commodities rose +8.4%, a sign that equity investors are not extrapolating current oil prices.

Fundamentals remain supportive. Q2 S&P 500 earnings grew +50% (with a sharp contribution from 3 hyperscalers) and the forward P/E has compressed by around 16% this year. Yet, expectations for Q3 season are for a healthy 26% YoY growth.

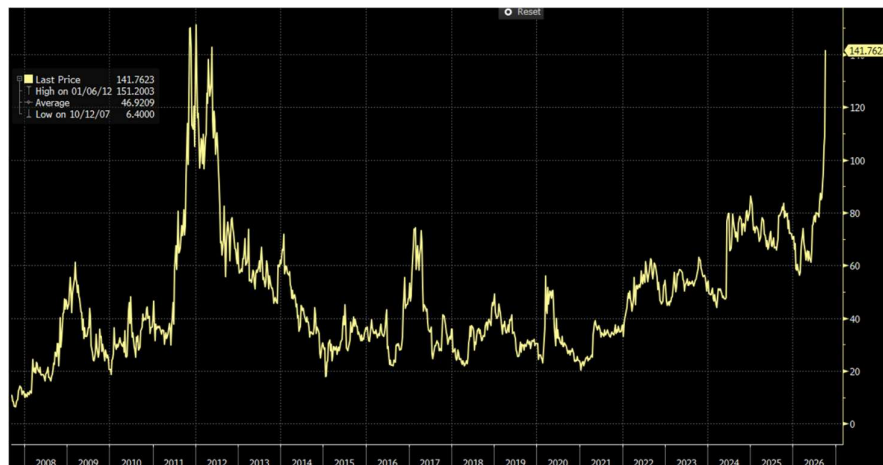


Focus: France, from slow grind to contagion

The French spread widened gradually, then fast:

- 85bps at the start of September;
- above 100bps on 18 September, for the first time since 2012;
- 118bps on 29 September, when the debt agency announced a record €340bn borrowing plan for 2027;
- 127bps on 30 September, a level last seen weeks before Draghi's "whatever it takes";

- a further +14bps on 1 October, the largest daily move since March 2020, on the day Lagarde said the ECB is "not here to close spreads".



About half of the widening since July reflects the global sell-off. The rest is French:

- the deficit target was raised from 5.0% to 5.4% of GDP;
- debt is around 119% of GDP, and the cost of borrowing (about 4.9%) now exceeds nominal growth (about 2%);
- support is eroding for Édouard Philippe, the only centrist presidential candidate markets know well.

At current yields, French debt trades more like a BBB- credit than its AA- rating.

Until late September the market treated France as an isolated case. That changed on 1 October: the Italian spread jumped +16bps, banks sold off and the euro had its worst day since June.

The ECB toolkit: a real backstop, with strings attached

- *OMT (2012): unlimited purchases, but only under an ESM programme with full conditionality. It is politically very costly for France.*
- *PEPP (2020): flexible QE, but reinvestments ended in 2024, so there is no pool of funds that could quietly be redirected towards France.*
- *TPI (2022): an anti-fragmentation tool with no ex-ante limit and no spread trigger. It can only be activated if three conditions are met:*

1. *The widening must be "unwarranted and disorderly" and threaten policy transmission across the euro area, not just reflect national fiscal risk. The contagion of 1 October moved the market closer to this point.*
2. *France must remain broadly compliant with EU fiscal rules and keep its debt on a sustainable path. This is the main hurdle: the ECB protects countries from the market only if they make a reasonable effort not to need protection.*
3. *Intervention must be proportionate. In a hiking cycle, TPI cannot become stealth QE.*

Lagarde's comment confirms that the ECB will not act on spread levels alone. The burden is on Paris: the credibility of the 2027 budget will decide whether France remains a fiscal story or becomes a euro-area transmission problem.