Novum Partners: Market Update

Self-Correcting Inflation, Self-Correcting Markets

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Last 2 weeks performance

World Equity Indices

	% TR USD	% TR Local
MSCI World	-0.2%	-0.2%
S&P 500	0.1%	0.1%
S&P 500 Equal Weighted	1.1%	1.1%
Mag 7 Index	0.2%	0.2%
Russell 2000	-2.6%	-2.6%
Euro Stoxx 50	-1.5%	-1.0%
CSI 300 Index	-4.2%	-4.4%
Hang Seng Index	0.5%	0.5%
Nikkei 225	-5.9%	-5.7%
MSCI Asia	-2.6%	-2.6%
MSCI Latam	7.9%	7.9%
MSCI EM	-2.9%	-2.9%

S&P 500 Sectors

	% TR USD
S&P 500 Info Tech	-4.6%
S&P 500 Comm. Serv	1.9%
S&P 500 Health Care	7.5%
S&P 500 Financials	2.8%
S&P 500 Cons Discr.	2.2%
S&P 500 Energy	6.6%
S&P 500 Real Estate	2.4%
S&P 500 Materials	3.3%
S&P 500 Industrials	-1.7%
S&P 500 Cons Staples	8.8%
S&P 500 Utilities	4.3%

Key Thematic Indices

	% TR USD	% TR Local
ARK Innovation ETF	-6.2%	-6.2%
Software ETF	0.1%	0.1%
Memory ETF	-21.4%	-21.4%
Semiconductors ETF	-13.8%	-13.8%
Momentum ETF	-6.4%	-6.4%
GS Cyclicals	0.6%	0.6%
BBG Defensive Sectors	5.46%	5.46%

Fixed Income

	% TR or bps
LQD (High Grade)	1.6%
HYG (High Yield)	0.2%
US Treasuries Index	0.6%
TSY 2 year (bps)	-6
TSY 10 year (bps)	-18
Bund 10 year (bps)	-6
SOFR March 27 rate (bps)	1

FX & Commodities

	% TR USD
US Dollar Index	0.2%
Bitcoin	-2.8%
BBG Precious Metals	-0.6%
BBG Energy	5.1%

Data as of 16 October

Executive Summary

- France and inflation set the tone. The French-German 10-year spread had its biggest weekly widening since at least 1990, peaking at 160bp. In the U.S., September CPI rose to 3.7% and PPI also beat forecasts.
- The AI trade came under pressure. Debt-funded AI names were hit hard: CoreWeave's CDS rose above 11% and Oracle fell almost 9% in one day. Over two weeks, semiconductors lost 14.1% and memory chip stocks 23.5%.
- The rotation was sharp. Global equities were flat overall (MSCI World -0.2%), but money moved into defensive sectors: staples +10.0%, health care +7.4%, utilities +4.8%. Latin America led (+7.9%) after the Brazilian election.
- Inflation is self-correcting. Higher energy prices and stagnant real incomes are weakening demand, and weaker demand limits further price increases. We see slower growth, not runaway inflation, as the main risk.

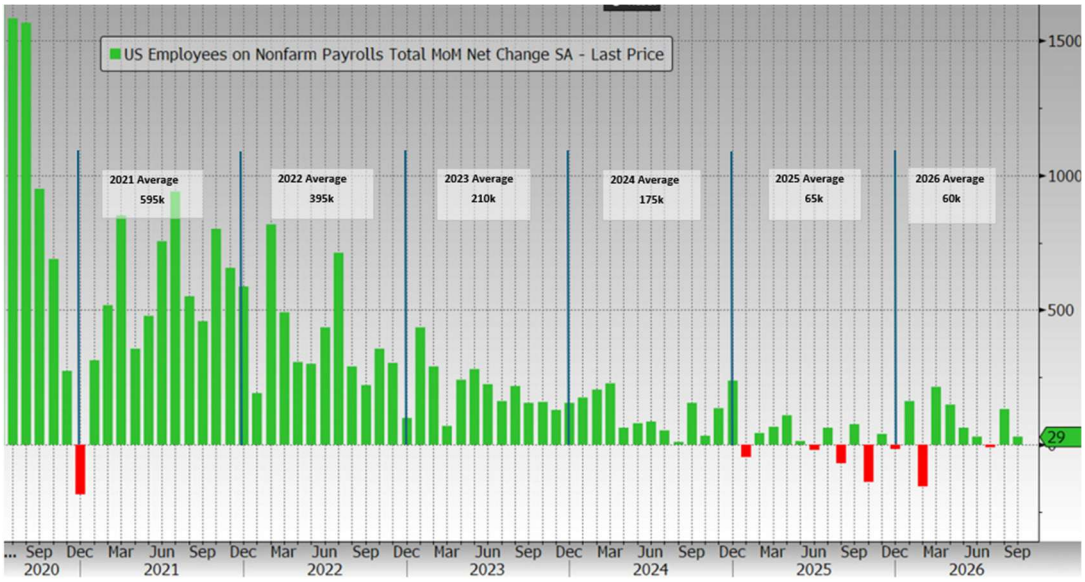
- Bonds are doing their job again. Treasuries rallied despite hot inflation data, with the 10-year yield down 23bp. We keep a positive stance on bonds, including our structured note linked to the 10-year Treasury yield, and expect balanced and risk-parity portfolios to benefit as bonds regain their protective role.

Economy and Central Banks

The past two weeks were dominated by a tug of war between inflation and financial stress.

In Europe, the main story was France. In the first week of October, the spread between French and German 10-year yields widened by 32 basis points to 141bp. That was its biggest weekly jump since at least 1990, and at one point it reached 160bp. The pressure eased after Marine Le Pen, who leads the polls for next spring's presidential election, promised to bring the deficit below 3% by 2028. But the calm did not last, and the spread is back near its recent highs. The Bank of France said the conditions for an ECB intervention are not met today. ECB President Lagarde, however, told euro area finance ministers that the ECB has the tools to deal with disorderly markets. Spain added to the political noise by calling an early election for 29 November. Markets have scaled back ECB rate hike expectations, as tighter financial conditions are already doing part of the job.

In the U.S., the data sent mixed signals. September payrolls were weak, with only 29,000 new jobs against 133,000 expected and almost no wage growth. Yet jobless claims fell to their lowest level since 2022, and the minutes of the September Fed meeting showed many officials in favour of further hikes.



Inflation then surprised to the upside. Headline CPI rose to 3.7% year-on-year, and core inflation was also stronger than expected, at 2.6%. Producer prices also beat forecasts. The odds of a Fed hike on 28 October jumped from about 20% to almost 60% after the CPI release, before falling back below 30% as the AI sell-off took hold.

The Q3 earnings season has started, and expectations are high. Analysts expect S&P 500 earnings growth of close to 30% year-on-year. U.S. banks opened the season with mixed results.

Geopolitics

Energy remains the main channel through which geopolitics reaches markets. In the Middle East, Houthi militants struck Riyadh's main airport several times, causing casualties. Attacks on tankers in the Strait of Hormuz also continued. Reports that the White House had asked the Pentagon for strike options against Iran briefly pushed oil higher. President Trump then said the U.S. would not attack Iran before the 3 November midterms and that talks with Tehran were "productive". Brent crude traded between USD 100 and 106 per barrel. More telling, oil prices one year ahead reached their highest level since 2022, a sign that markets expect high energy prices to last. European gas prices also hit a post-2022 high.

On Russia and Ukraine, President Trump announced an "energy ceasefire" and a temporary waiver allowing Russian diesel back onto world markets. The ceasefire looks fragile: strikes on energy facilities continued, and Ukraine has said it will resume attacks on Russian refineries.

Elsewhere, Brazil delivered a positive surprise. Flávio Bolsonaro, seen as the more market-friendly candidate, came first in the first round of the presidential election, ahead of President Lula. The run-off is on 25 October. Brazilian equities rose almost 12% in USD terms on the day after the vote.

Finally, the EU and China reached a deal to cap Chinese hybrid car exports to Europe, easing trade tensions ahead of this week's EU summit.

Markets

On the surface, global equities hardly moved over the two weeks. The MSCI World lost 0.2% and the S&P 500 0.3%. Underneath, however, there was a sharp rotation.

The AI trade came under heavy pressure. Three things triggered the sell-off: news of progress by Chinese memory chipmaker CXMT, a report that OpenAI's revenue is lower than previously thought, and growing concern about debt-funded data center projects. Memory chip stocks fell 23.5%, semiconductors 14.1% and the S&P 500 technology sector 5.7%. Asian markets with heavy tech exposure were hit hard, with the Nikkei down 5.5% and MSCI Asia down 2.6%. The Mag 7 index held up better (-0.6%), while momentum stocks lost 6.9%.

Money moved into defensive sectors. Consumer staples rose 10.0%, health care 7.4% and utilities 4.8%, while energy gained 6.6% on higher oil prices. The equal-weighted S&P 500 (+1.1%) outperformed the main index. Small caps were weak, with the Russell 2000 down 3.6%. In Europe, the Euro Stoxx 50 lost 1.9% in USD, with French stocks and European banks under pressure. The best performer by far was Latin America, with MSCI Latam up 7.9% thanks to Brazil.

In fixed income, government bonds finally did their job. The 10-year U.S. Treasury yield fell by 23bp and the 2-year by 14bp, while the 10-year Bund yield fell by 10bp. Investment grade credit gained 1.6%. High yield was flat, and U.S. high yield spreads widened to their highest level since March.

Bonds Are Doing Their Job Again

This has been a revealing week for markets. On Wednesday, U.S. consumer prices for September came in above expectations, with headline CPI rising to 3.7% year-on-year. On Thursday, producer prices (PPI) also surprised strongly to the upside.

On paper, two hot inflation prints in a row should have been bad news for bonds. Instead, Treasuries rallied on both days. Over the week, the 10-year U.S. Treasury yield has fallen by about 25 basis points.

Two forces were at work at the same time.

1. Growing stress in the AI sector

The first is the pressure building on the companies most exposed to AI spending. These firms need huge amounts of capital, and credit investors are watching their debt levels closely. CoreWeave is the clearest case. On Tuesday, the cost of insuring its debt against default (5-year CDS) rose above 10% a year for the first time. On Wednesday it rose further, to 11.2%, and the share price fell more than 15% in a single day.



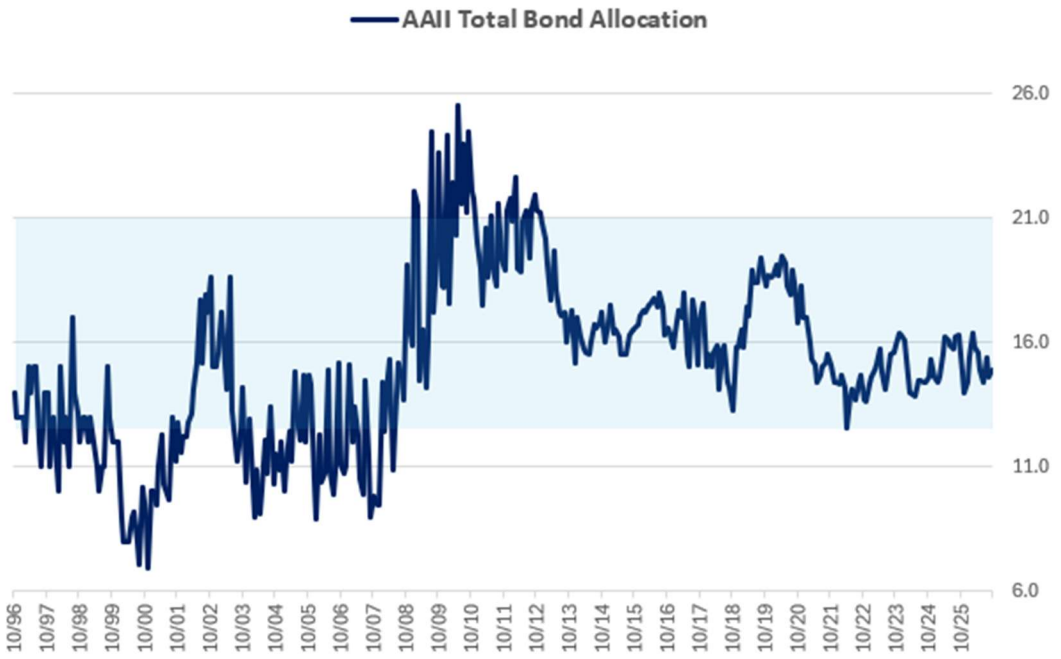
The stress then spread to other names with large investment needs. Oracle fell almost 9%, its worst day since June, and Broadcom's CDS also widened. The Philadelphia Semiconductor index fell for a sixth day in a row, its longest losing streak in over a year, and is now down almost 12% over that period. As equity investors became more nervous, money moved into government bonds.

2. Inflation that limits itself

The second force is the market's reading of inflation. When bonds rally on bad inflation news, the market is telling us it does not believe today's inflation will last. We agree. The latest rise in prices is driven mainly by energy, not by a strong economy, and this kind of inflation tends to correct itself.

Since early 2025, U.S. real incomes have barely grown. Wages are rising slowly, while households pay much more for fuel, heating and transport. Every extra dollar spent on energy is a dollar not spent elsewhere. To keep spending, people have to take on extra work, save less, or draw on their savings. None of these can last for long. High energy prices and weak wage gains are therefore slowly weakening demand. That makes it harder for companies to raise prices outside energy. The real risk is slower growth, not runaway prices, and that is a good environment for bonds.

Positioning added to the move: many investors were short duration and had to cover as yields fell.



After years of very low rates, bonds now offer real income again. At today's yields, that income cushions the impact of any further rise in rates, while a fall in yields brings meaningful capital gains, as this week has shown. Markets are still pricing

several further rate hikes from the Fed. If demand keeps softening, or if stress in the AI sector spreads, those expectations could be scaled back quickly.

How we are positioned

This is why we have kept a positive stance on bonds. We recently added a structured note linked to the U.S. 10-year Treasury yield. It pays a 10.25% annual coupon in USD as long as the 10-year yield stays at or below 5.75%, with coupons paid when the note is redeemed. Lower yields make these coupons more likely and support the value of the note.

More broadly, the past few years have been difficult for balanced and risk-parity approaches, because bonds failed to offset equity risk. If inflation fades as demand weakens, bonds can play their traditional role again: providing income and protecting portfolios when growth slows. With equity markets so concentrated in AI-related names, that protection matters more than ever.

One week does not make a trend, and energy prices remain a risk to watch. But the message from the bond market is clear: bonds are not broken.