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Sam Grobart, Host

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Sam Grobart: With recession risks abating but inflation remaining unpredictable, how are institutional investors thinking about all this? This is The Markets.

Hi, I'm Sam Grobart. Today I'm joined by Oscar Ostlund, head of Market Analytics and Data Science at Marquee, our digital platform in Global Banking & Markets. Oscar, you publish the monthly Marquee quick poll, which surveys more than 1,000 institutional investors. The latest poll just dropped. What's the big takeaway from the results?

Oscar Ostlund: Well, what we found is that institutional investors are actually expecting a decoupling between the US on the one side and Europe and China on the other. In the US, soft landing has become the very broad consensus.

We see a majority of participants expect a fast drop in inflation and the US consumer to stay relatively resilient throughout the year. But to some extent, that was already in the price. And we saw that last month, it being really the dominant consensus.

But the bigger news is maybe that investors are starting to internalize the slowdown in China, as well as in Europe.

Sam Grobart: So, as far as the US is concerned, if the risks of recession are receding, what kind of risks rise in its place?

Oscar Ostlund: Well, as we've seen, the consensus has strengthened here. And what we worry about is that the market as a whole has become somewhat too complacent. In the US, the market will expect both inflation to abate significantly throughout the year and into year end, as well as a resilient US consumer.

So, that just sets a relatively high bar for data in the US. And to some extent, the price action this week confirms that. We've had relatively okay data. And yet, the market hasn't really moved.

What makes us more cautious is that we're entering into a period where we know inflation will be a bit more volatile. Both from a technical perspective with changes in methodologies, as well as with oil hitting new highs.

Sam Grobart: And what about Europe and China?

Oscar Ostlund: In Europe and China, on the other hand, the consensus has shifted the other way. And while we agree with it, you always want to be a bit worried about the consensus being too strong and not having enough contrarians in the market.

Sam Grobart: So, we've been talking about risk and the feelings about that within participants in the poll. Where are you seeing the most bullish sentiment?

Oscar Ostlund: When we ask our investors about their views on asset classes, quite interesting where they continue to be very bullish is on the fixed income complex in general. We have seen a relatively big move in duration, as we say, or long term rates. But in general, I think investors feel relatively comfortable at this point owning that asset class.

Where we see a lot of disagreement is the direction for equities. And we see a very strong correlation between sentiment and what we discussed earlier, the outlook for the US economy and the valuation for equities. In other words, you really have a cohort that thinks that we're going to see a cycle extension in the US, meaning that we're going through a soft landing and the US growth will continue to be positive in the quarters and year to come. And another one that thinks that we're potentially hitting a soft patch and we will see the Fed cut rates more aggressively than what is priced. We're hitting the beginning of next year maybe a bit more difficult for us from an economic perspective.

Sam Grobart: Let's tie that sentiment to some news this week, which were the CPI numbers. If market participants increasingly believe a soft landing is possible, yet they also believe inflation is the biggest risk, how are they interpreting those numbers?

Oscar Ostlund: I think the CPI number earlier this week and the retail sales data today, as well as GPI data were, in general, a bit of a mixed bag. And there was enough for everybody to continue to believe in what they believed in.

Sam Grobart: They found evidence to support their position.

Oscar Ostlund: Exactly. And so, in general, the inflation data was a bit firmer than what the market expected. But certain key categories such as rent or owner's equivalent rent were a bit more on the softer, and so, positive side for people that want to see inflation come down.

And as we said at the beginning, I think what the soft-landing cohort expects is for inflation to abate, but also for the consumer to stay resilient. And to some extent, not having inflation fall too fast is a sign that the consumer continues to stay resilient and give that cohort hopes that we're going to power through the end of the year and into next year on a relatively stable footing.

Sam Grobart: You were talking earlier about Europe and China. I want to just focus in on that a little bit. What is the investor sentiment right now around the economic outlook for those countries and regions?

Oscar Ostlund: In China, what we have witnessed this year is a quite dramatic, 180-degree shift from the beginning of the year when investors really expected continuation of the reopening trade. And for China to really drive global growth. To a relatively bearish view on the economy regarding China.

It is no surprise to institutional investors that China is going through a structural readjustment of its economic model. And that leads to slower growth and there are a certain number of challenges, such as, obviously, a relatively large real estate sector, relatively subdued internal consumption. And so, there are a certain number of macro economic policy challenges that policymakers are having to deal with.

But the tactical view was that we were going to see this pick up this year due to the reopening. We didn't see that. And so, I think investors are going back to the more long-term strategic challenges. And those point to a weaker currency, to slower growth, and to a certain number of challenges with over-levered players onshore.

Sam Grobart: And what about in Europe? What's the view there?

Oscar Ostlund: In Europe, I think that the shift hasn't been as dramatic given that investors weren't as optimistic on Europe. But Europe continues to see challenges with both inflation that has proven to be relatively sticky, and probably even stickier than in the US, with the, like, economic powerhouse of Europe, i.e. Germany, continuously slowing down and being quite severely exposed to two major, I would say, shocks of this year, which are higher energy prices and a slower economy. That is hurting Germany quite significantly.

So, we're seeing, I would say, more apathy towards Europe. We see virtually no one picking the SX5E, which is the main European equity index as their favorite index. Whereas the US crowd tend to really like the S&P and the Asian investor community sees a lot of value in indices like the Japanese indices or other EM indices.

Sam Grobart: What does all of this mean for global currencies compared to the dollar?

Oscar Ostlund: Well, at the very beginning of the year, the consensus among the community was that the dollar was going to weaken. But as US hard-landing fears dissipated, the soft-landing view became prevalent. While other major blocks, such as China, Europe, but even I would say emerging markets as a whole have faced slightly slower growth, I think that the view on the dollar has somewhat shifted.

Versus China, we're seeing, view that the renminbi will continue to weaken versus the dollar. And between the euro and the US dollar, we continue to see some divergence in the sentiment or hawkishness of the central banks, which in the short term could support the dollar.

Sam Grobart: Oscar, last question. What are you going to be watching for next week?

Oscar Ostlund: Well, obviously, next week we have the September FOMC meeting. And while they're relatively widely expected to not hike, their forward guidance, in the various forms it will take, whether it's through the statement, through dots, through the press conference, are going to be really watched by everybody in the markets as there is still a lot of, I would say, uncertainty as to what the path will look like going into the end of the year. And maybe even more importantly, how we should think about next year.

Sam Grobart: Oscar, thanks again. Great to see you.

Oscar Ostlund: Thanks very much for having me.

Sam Grobart: That does it for another episode of The Markets. Be sure to subscribe on Apple Podcasts, Spotify, or wherever you get your podcasts.

I'm Sam Grobart. Thanks so much for listening.