CIO OFFICE DAILY OUTLOOK

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Disinflation. Markets are flagging this as a risk while the public narrative remains focused on inflation, dominated by Kevin Warsh's hawkish stance at the latest FOMC meeting. Yesterday, on this publication, as to signs of market-implied disinflation, we pointed to the rise of US real rates at the front end of the curve, of the US dollar, to the recent outperformance of Treasuries against commodities. Today, we would highlight the fall in basic materials stocks, and the unnoticed bull-run of the funding-costs-sensitive biotechnology sector. Disinflation is not a risk if real rates come down, and at the front-end of the curve they are not. Markets are telling us that if central banks intend to deal with supply shocks via higher rates, they will actually constrain growth first and foremost. Warsh was nominated by Trump 30 January and the 10s2s yield curve started to invert in early February, not by chance. High real rates can seem to be fine if the economy remains very strong, though this assumption can be questionable against the backdrop of high government debt levels and a highly financialized economy. It may be that Warsh's stance could create the conditions for him to turn dovish down the road, but we shall see. In this sense, the US jobs report, to be released on Thursday in this holiday-shortened week, will be highly relevant. In the last three months on average 188,000 new monthly payrolls were created, a hot number. And a strong labor market would affirm the Fed's tightening bias. We are shifting to a regime where good news is bad news, and a bit of bad news is read as good news.

Yesterday's session bucked the previous week's trend. Large cap stocks (+1.2%) got a boost from discretionaries (+2.7%), the Magnificent 7 (+2.6%) that rebounded strongly, and semiconductors (+3.8%) that led markets. Amidst a dearth of top-tier data in the United States it was Korea that took center stage, announcing a massive spending plan on chips and data centers. The bulk of the spending worth about USD 880bn, 5% of the country's GDP and deemed essential to survive the AI era, would be made across an extended period of time by Samsung Electronics (+2.1%) and SK Hynix (+1%), the two biggest drags on the local index yesterday. Investors will have plenty of time to decide whether the money is spent wisely. Undoubtedly, such outlays continue to make the current AI race inflationary, and some major countries are somehow more likely than not to want to maintain AI sovereignty, contributing to the price pressures. The Treasury market was calm yesterday, taking in its stride the Supreme Court's decision that US Presidents cannot fire Fed members without evidence of wrongdoing. Governor Lisa Cook would remain in her post, while fighting Trump's attempts to oust her. Elsewhere, the US dollar and gold slipped, while Brent crude was little changed. The Japanese yen continued to weaken, recording its lowest levels against the dollar since 1986. The government seems to be out of options to stem the steady loss of value, that after all represents the only way for investors to express their view on the country's crippling debt levels.

The ECB Forum on Central Baking was kickstarted in Sintra, Portugal, by ECB President Lagarde's opening speech. She focused on Europe's resilience to shocks and defended the recent rate hike to fight inflation.

Markets this morning

In the Asian session equities rose, adding to the regional benchmark's biggest quarterly gain in almost two decades, as technology stocks resumed their rally on optimism over the AI trade. The yen extended recent losses. The MSCI Asia Pacific Index climbed almost 1% following a tech-led rally on Wall Street. Global equities are on track for their best quarter in almost six years as investors piled into companies seen as key AI beneficiaries, from chipmakers to upstream suppliers. Investors will now turn their focus to June US payrolls data on Thursday. US equity futures were little changed. Elsewhere, Brent crude slipped ahead of the expected talks in Doha between parties to the local conflict. Gold slipped below $4,000/oz.

Upcoming key events/data

Today focus will be on The Conference Board consumer confidence and the JOLTS report release in the United States. The latter will provide insights in the current balance of labour market supply and demand. In Europe, the CPI is published, a key datapoint for future ECB decisions. Nike will be reporting.

Have a great day.

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