



CIO OFFICE MORNING MARKET WRAP – 5th April, 2022. ALSO AVAILABLE ON ALEXA.

Stocks in Asia are mixed this morning and crude climbed as investors gauge the prospect for new sanctions on Russia, while US and European futures are fluctuating. The rally from the late-February lows continued yesterday, with US markets led higher by technology, consumer discretionary stocks and some idiosyncratic news flow; Elon Musk took an almost 10% stake in Twitter, which jumped +27%, and Chinese companies listed in the US were boosted by the removal of a hurdle to US authorities having full access to the audits. The Arkk Innovation Fund and the biotechnology sector, both pummelled heavily in the previous quarter, came back quite strongly. Treasuries slipped lower, the US dollar and gold advanced, while crude oil rebounded.

The market reaction suggests that the direction of the pain trade can for the time being still be higher. The booming US labor market is supporting investor confidence that the economy is overall resilient, in spite of purchasing power being hit by rising price pressures and Mohamed El-Erian warning about a “cost-of-living” crisis. Markets are also ignoring the deteriorating outlook in Europe and the protracted soft patch in China, where anyway more stimulus in pipeline in the end should finally help. And the rebound helps deflect the attention from more of the same that we keep on getting about the Ukraine war, where additional sanctions, further accusations and denials chase each other with increasing intensity. There is allegations of war

crimes that the Russians not only deny, but also claim they are fabricated. It is difficult to see how the conflict could stop amidst relentless efforts to produce new tough measures against Russia by the day. Even conquering just the separatist republics will take time, so the easing of stagflationary pressures remains for now wishful thinking. And this is the reason why a growing number of strategists is becoming uncomfortable with the tail risks looming larger. The United States took the unprecedented step of halting dollar debt payments from Russian government accounts with US institutions. Hence, Russia will have to use dollar reserves held in the country itself, spend the revenue it collects to execute payments, or default. The decision was taken as a major payment was due Monday, in order to further ratchet up pressure. As tensions mount, the odds of unintended consequences rise sharply. The Europeans themselves will have to walk a very fine line, invoking more sanctions while trying to avoid recessionary impacts. Or, maybe, the euro area leaders won't mind facing the risks, in spite of German executives and politicians warning of dire consequences if Russian energy supplies are cut off. A noteworthy initiative was taken by the Arab countries, whereby the Arab League Secretary General and some foreign ministers are planning meetings with Russia and Ukraine in an attempt to deescalate.

Investors are looking forward to the release of the March FOMC minutes on Wednesday, hoping to gain insights about the shrinking of the balance sheet expected to start in a few months. The bulk of the planned hikes has now been discounted by money markets. Fed's Williams said that policy rates should be raised to more neutral levels, "whatever that means". El-Erian echoed his remarks by saying that no one can claim with confidence where neutral is. Yet, ex Treasury Secretary Larry Summers, known for much less nuanced statements, recently explained that the Fed should simply hike rates by as much as inflation has been rising, and by the way that would be an awful lot, in order to at least keep the real policy rate from falling. In principle, it does not seem to be so difficult to gauge what neutral means. JPMorgan's Dimon is forecasting way more hikes than the market expects. The ECB will be releasing its minutes on Thursday, possibly offering insights on the timing of future hikes.

The oil market remains overly tight, or only just less so, as backwardation, a gauge of tightness, has come down to pre-war levels. Yet Vitol, the leading oil trader, sees prices as still too low to reflect current supply risks. Russia's output dropped in March for the first time in seven months, and revamping the nuclear deal, even amidst its bizarre ups and downs, wouldn't tip the balance. A major shift in US shale production would, but that would also be dampening the ever-louder ESG noise a tad too much than currently tolerated. A significant pullback in crude prices for now already seems to be a scenario bordering on the optimistic.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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