



## CIO OFFICE MORNING MARKET WRAP – 6th June, 2022.

Stocks in Asia and US futures are rising this morning, with Beijing's reopening soothing investors' fragile mood weighed down by rates and inflation concerns. Japanese equities erased losses, and IT shares jumped in Hong Kong.

Last week market action was dominated by apprehensions about the effects of the removal of stimulus. Stocks surrendered part of the previous week's gains and bonds weakened as strong economic reports showed that the Fed will have to continue to tighten to rein in inflation, and corporate America warned about the economy. US equities lost about 1% underperforming other major benchmarks, while the emerging markets posted a third weekly gain, up 1.7%. The US 10y yield closed 20 basis points higher, the US dollar rebounded, crude approached its all-time highs and gold was little changed.

The Fed will be kept under pressure, this is the main take away from Friday's jobs report, reinforcing the view that good news eventually is bad news until the bulk of the tightening is behind us. Employers added 390,000 nonfarm jobs in May, above consensus expectations of about 320,000, while wage gains held firm. Job gains were broad across sectors with the exception of retail, not a sign of an economy slowing down. Yes, there is a slow reversal towards trend and wages were no longer growing

at a torrid pace, but “the economy is still running too hot to convincingly drive inflation back to target”, according to BMO Capital Markets’ senior economist. Treasuries extended losses and stocks fell following the release. Business confidence reports were also upbeat. The manufacturing survey earlier in the week was above expectations at 56.1 in May, showing solid demand and continued input strains, and the services one below forecasts due to distortions from some easing bottlenecks but overall pointing to still strong and normalising business activity. The vibrant releases poured cold water on hopes the Fed would consider pausing tightening in September, and vice chair Brainard dispelled doubts remarking that it is “very hard to see the case for a pause”.

In spite of the strong figures corporate America was unusually vocal in issuing warnings on the business cycle. JPMorgan’s Dimon told investors that they should brace themselves for a “hurricane”, Elon Musk said he has “a super-bad feeling” about the economy and as per furniture retailer RH’s Gary Friedman “you must be prepared for anything right now”, with reference to rates being raised to fight inflation. Businessmen recognise the growing chances of a policy mistake, perhaps something not so forthcoming as more of a late 2023 or early 2024 event, as highlighted by the rising probability of a US recession by mainstream models two years down the line.

Currently the outlook for the US consumer remains more than reasonable, which is not going to resonate with the Fed as implied by ex-NY Fed’s president Bill Dudley’s commentary on Bloomberg. He observed that ‘financial conditions are the means by which higher short-term rates work to slow economic growth’, meaning in plain English that the slowdown is achieved by pushing markets lower and the dollar higher alongside policy rates. But he unequivocally added that ‘the Fed’s job is far from complete’, that investors ‘underestimate the level of short-term rates’ necessary to bring inflation back to target, and that the ‘risks of a hard landing’ are ‘understated’. Even worse, should financial conditions start to ease again, meaning in plain English that the economy would still be resilient, and markets would continue to rebound, Fed officials would have to push policy rates ‘higher than currently anticipated’. In summary, any strong equity rebound should be on borrowed time, as it would be undoing the tightening the Fed is aiming to achieve.

If in the West the focus remains on liquidity getting tighter, in China the exact opposite is happening. The Shanghai government issued an action plan aimed at spurring the recovery after the Covid-19 related lockdowns, largely based on fiscal measures. According to the PMI report factories continued to contract, but at a slower pace in May, as many Covid restrictions were lifted in some areas. The better than expected PMIs and the partial relaxation of restrictions provided some support to market sentiment leading to the Shanghai Composite outperforming, with 2.1% gains for the week. More sustained rallies would require that lockdowns are definitely lifted, and stimulus is maintained.

The West-Russia confrontation becomes bitterer and more entrenched by the day. The euro area adopted new sanctions with a significant ban on seaborne oil from Russia and more measures on people and entities related to Russia and Belarus. Putin made inroads in the Donbas region, with the 'special operation' set to continue until Russia's goals are met. Both bits of news are dampening the outlook for lower oil prices, and Brent crude indeed closed just below \$120 on Friday. Russia is now back on default countdown as coupon payments worth about \$100ml have yet to make it through to foreign investors' accounts, triggering a 30-day grace period as of Friday.

Week ahead. Wednesday: Germany Industrial Production MoM - Thursday: ECB decision and inflation forecast update; China exports - Friday: US CPI and University of Michigan Consumer Sentiment (preliminary); China CPI YoY and PPI YoY. June 9-15: China aggregate financing.

Stay safe.

Chief Investment Office  
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