



CIO OFFICE MORNING MARKET WRAP – 10th May, 2022.

US futures are climbing as of the time of writing following the paring of early losses in China with no obvious catalyst, although the other main Asia markets remain mostly in the red. Long-dated treasuries are trying to follow through on yesterday's rebound, while the oil market is still slumping.

Stocks got pummelled yet again on Monday, in a crescendo where all news is bad news and nothing seems to be even sparking a silver lining. The week got off to a bad start - with concerns about China kickstarted by the premier's warns on jobs and by bad trade data - and continued with more jitters about a de-anchoring of inflation expectations in the United States. And the latter brought investors back to the mother of all questions on whether the Fed would manage to reverse price pressures without killing the economy. The S&P 500 closed for the first time below 4,000 since March 2021 and the yield curve steepened, a reflection of peak Fed hawkishness and prevailing uncertainty about inflation. Crude tumbled, gold came close to recording new lows for the week and bitcoin losses at a point extended in the low double digits.

The pandemic-era darlings were thrashed, still far from being rid of their premium versus the broader market. The Ark Innovation Fund made a 52-week low yesterday, with Cathy Wood undeterred reiterating that the outlook for the innovation space remains one of significant price appreciation five years out. One portfolio manager remarked that disruptive investments turned out to be more rate-sensitive than one had initially realized. Actually any long-duration

investment, not only technology stocks, fared very badly following the transition from a Goldilocks regime to a more brutal reality of higher inflation and more volatile growth. But yesterday energy stocks, this year's investor darlings, were the worst performers with losses in the high single-digits, a sign that liquidation is now reaching every corner of the market.

Inflation worries surfaced in the steepening of the yield curve as well. While investors scaled down expectations for a sharper Fed's tightening, triggering a rebound in shorter-dated Treasuries, they continued to demand term premia for inflation protection, pushing longer-dated yields to new highs. Bank of America is anyway betting that the curve will again invert by year-end, as the Fed manages to engineer the coveted slowdown. We could not agree more, having a fair value for the 10-year Treasury yield below the current levels, at 2.8%. Price pressures must have been top of mind for chair Jay Powell as well, following the New York Fed consumer survey reporting higher inflation expectations three year out. Will expectations about future prices become unanchored and induce a price-wage spiral? Probably not, if real inflation starts to fall on base effects as projected for the CPI release due out Wednesday. As usual, a big if.

Inflation shocks come from far afield, as Beijing insists with zero-tolerance Covid policies and implements lockdowns in key economic areas causing supply bottlenecks reverberating across the globe. In spite of premier Li Keqiang's warning on the "grave" jobs situation as Beijing and Shanghai tighten Covid-containment measures, President Xi is not expected to change stance until his confirmation for a third term later this year. The dire economic situation transpired from April trade data, with an abrupt slowdown in exports, from the mentioned supply chain issues, and zero import growth, a sign of deteriorating demand. Copper extended a slump in London as investors see China woes as a source of concern for base metal demand, China being the primary importer, and global growth in general. And worries about the country's slowdown caused a slide in the yuan, expected to lose further ground against the dollar as policy divergence between Beijing and Washington grows larger with the respective central banks proceeding in opposite directions.

History turns out to be no source for comfort, when one goes down the rabbit hole of trying to find past episodes shedding light on the current shortages. Today's supply-chain slowdowns are reminiscent of the 50s, 60s and 70s, pointing both to a possible structural break with the more recent past and to prolonged supply constraints inducing harsh slowdowns or recessions. Which this time is which we will get to know in less than two years, when the next US recession is projected to occur.

Stay safe.

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