



CIO OFFICE MORNING MARKET WRAP – 14th July, 2021. ALSO AVAILABLE ON ALEXA.

Asian shares are lower today after the modest losses on Wall Street following the CPI release. Equities fell from record levels and Treasury yields headed higher after inflation surprised to the upside, with the IT and pharma sectors holding up well and the deep cyclicals selling off. The dollar strengthened, gold was little changed and oil rallied. The mood on cryptocurrencies continued to sour, as volume on bitcoin dropped yet again amidst lacklustre price action.

The US inflation report topped all estimates, with the Consumer Price Index surging the most since 2008. The CPI jumped to 5.4% on a yearly basis and the Core CPI recorded the largest advance since 1991. The categories associated with the reopening of the economy, like hotel stays, car rentals and airfares, drove the rebound. Although the market is still going by the Fed's narrative of temporary price pressures, increases are "faster and for longer". Apart from putting pressure on Fed officials, the jump in prices can challenge the approval of more fiscal spending, as Republicans say that the new measures heighten inflation. Treasury yields and market-implied inflation measures recovered, while the yield curve unwound a bit of the recent flattening and the US dollar gained. Jay Powell is starting today a two-day testimony before Congress and will be hard put to dismiss the price changes as transient.

Although JPMorgan and Goldman Sachs results easily beat expectations, they both fell by more than 1% as investors wondered what could keep their earnings going. The pandemic-time trends which boosted their bottom line are now waning. Revenue from trading activity was down by 30% on a yearly basis at JPMorgan and by 33% at Goldman, with trading in decline since the Great Financial Crisis and inflated one-off by the forced lockdowns. Earnings were helped by extraordinary items, like the release by JPMorgan of \$3bn in loan-loss reserves built up the previous year. The key question for the sector is whether loan activity is going to grow consistently, which is not at all clear since consumers are awash with cash and still paying down debt rather than releveraging, unusual in a post-recession environment. This will also be crucial for economic growth to become self-sustained, rather than fizzle out once the most obvious stimulus effects fade.

Oil stocks, although still the best performers for the year, have lagged the performance of oil prices in term of their usual sensitivity to rising crude, especially since late spring when Brent accelerated higher towards the \$80/bbl mark. Oil demand has consistently exceeded supply, both on the strength of the recovery and the production curbs enacted by OPEC+, yet the energy sector has been uninspiring at best of late, currently trading in line with the levels last seen in early March this year. One reason could be the extreme backwardation reached by the oil curve, signaling short-term market tightness, whereby shorter-dated futures trade at higher prices versus the longer term ones. Historically very high levels of backwardation have pointed to market vulnerability, and can be linked to disappointing earnings, driven by lower crude ahead as indicated by the curve. For energy companies to get the attention of investors again oil should drop, which would help relieve the backwardation and possibly shift the curve towards a condition of so-called contango, where spot prices trade below longer-dated futures. Yet again, this makes oil stocks unappealing as of today.

Stay safe.

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