



CIO OFFICE MORNING MARKET WRAP – 15th July, 2022.

The US earnings season kick-started with disappointments by economic bellwether JP Morgan followed by Morgan Stanley. Both the banks disappointed with their earnings that missed the estimates, probably setting a trend that could be hard to shake off for Citi Group and Wells Fargo today. JPM missed the estimates by -4.3%, while MS missed the forecast by -8.3%. JPM also additionally suspended share buyback to boost its CET1 ratios, which the regulators require a minimum of 12.5% for the bank due to the systemic importance of the bank. The stop in buybacks will help the bank comfortably cross the CET1 ratio of 13%+. While banks missing estimates is not great news, the silver lining could be that the bank chiefs seemed pretty confident in navigating any upcoming slowdowns. JPM also indicated no debt repayment problems and raised its estimate for Net Interest Income. This is a good pointer to what we had been saying all along: in these incredible turbulent times, bank balance sheets are much stronger than in any other modern financial crisis.

Markets continued to be whipsawed by sentiments yesterday. The S&P 500 almost erased a slide that topped 2%. These significant intraday moves indicate a market trying hard to find its footing. Developed market equities were down -0.93%, while emerging market equities were down -0.48%. According to a recent Bloomberg research, Retail capitulation has started with average equity allocations gathering pace to the downside, matching the downward trend in the Bloomberg US Stock exchange sentiment. Gold had dropped below \$1,700 last night before recovering to \$1,709 at the end of US trading hours. Similarly, Brent crude temporarily went below \$95 during intraday trading to recover above \$100 in late-hours trading.

There was some tempering of the inversion trade on Thursday when the 2-year yield moved back to within 17 basis points of the 10-year note after Fed Governor Christopher Waller and St. Louis Fed President James Bullard both backed a three-quarter point hike this month. Waller said he could support more aggressive action if warranted by upcoming retail sales and housing data. To put the current inversion in historical context, in 2000, 10-year yields dipped as much as 56 basis points below those on 2-year notes. In 1980, the gap widened to as much as minus 2.4 percentage points as Volcker tried to break the inflation cycle.

Complicating the math are changing equations in the primary issuance market for high yield issuers. Goldman Sachs revised its full-year HY bond issuance down to \$135 Bn, which is only 30% of the 2020 and 2021 figures. Even the Leveraged Loans space, which typically has institutional investors, is under stress with the worst year on record for Europe's leveraged loan prices, a market that isn't quick to react to sentiment. These two factors warn of how difficult it has become for companies to raise cash and that the credit crunch is not far away.

Political upheavals continue to muddy the waters as Italian President Mario Draghi offered his resignation to the president, who rejected it. Italian 10-year BTPs went by 11 bps while Euro again traded below the Dollar briefly. Draghi will address parliament early next week, which could be followed by a confidence vote. Belarus officially defaulted as sanctions led the nation to miss a payment on its dollar bonds. Moody's said Belarus defaulted by failing to make a \$22.9 million coupon payment on \$600 million in dollar bonds due 2027 before the end of a grace period on July 13. This follows Russia, which defaulted on its debt obligations for the first time this century yesterday due to forced sanctions.

China's economy grew at the slowest pace since the initial 2020 coronavirus outbreak in Wuhan. Gross domestic product rose 0.4% from a year earlier, missing Bloomberg estimates of 1.2% growth. June numbers indicate some stabilization post the opening of the economy, which a recent surge in Covid cases could threaten. On the jobs front, the surveyed jobless rate eased to 5.5% from May's 5.9%. But for those aged 16-24, the jobless rate reached a new record of 19.3%. PBOC refrained from injecting fresh funds into the banking system while keeping the interest rate on its one-year policy loans unchanged at 2.85%. Chinese property prices continued to crash as they decreased for a record straight 10th month across the cities.

At the time of writing, Asian Markets trade divergently. Japan is up +0.59%, while the Hong Kong stock exchange is down by -1.21% due to the growing scrutiny on the tech names. Executives from Alibaba Group's cloud division have been summoned for talks by authorities in Shanghai in connection with the theft of a vast police database, one of the nation's most significant cybersecurity breaches. Chinese local stock market is holding up well despite the disappointing GDP data as traders expect the PBOC to turn up the tap of easing. Gold and Brent Crude are trading above key psychological levels of \$1,700 and \$100. Bitcoin remains steady above \$20,000 while Ether has crossed \$1,200.

We will see Consensus sees US retail sales advancing 0.9% month on month in June, reversing from a slight decline in May. In a testament to the strong retail performance, Amazon's Prime Day sales event bolstered confidence in the strength of the consumer. The company sold more than 300 million items over two days, more than any prior Prime Day. But worries are surfacing as the US personal savings rate is near a five-year low since pandemic fiscal stimulus savings run dry. The danger is that consumer spending, which drives some 70% of GDP, could soon be tapped out. Lower spending, and lower earnings with lower economic growth, while inflation is still hot, set the stage for a classic stagflation scenario.

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