



CIO OFFICE MORNING MARKET WRAP – Thursday February 17, 2022. ALSO AVAILABLE ON ALEXA

US equity futures are little changed as of the time of writing, and Asian stocks are mixed to positive in the morning session. Oil is gapping lower amidst signs that an Iranian nuclear deal may be more likely. Equities managed to stage a late-session rebound Wednesday, as investors mulled geopolitical risks and inflation, and assessed the minutes of the Fed's latest meeting. Commodity, industrial and retail companies outperformed the technology sector, the dollar fell, oil and gold climbed. US treasuries rebounded, while the yield curve steepened somewhat after continued flattening since the January FOMC meeting.

Geopolitical concerns resurfaced, after American officials rejected Russia's claim that it has begun to withdraw troops from the Ukraine border. Although Russia called US warnings about an invasion 'hysteria', according to Washington the Kremlin actually

added as many as 7,000 troops to the area, which should count 150,000 personnel, as well as tanks, artillery and other equipment. Vice President Kamala Harris will travel to Europe with a US delegation, to join Secretary of State Antony Blinken and numerous other officials at the Munich Security Conference. She is also scheduled to meet NATO's Stoltenberg, the leaders of the neighbouring Baltic republics, and engage with the Ukraine's President, the German PM and hold talks with three dozen other head of states. Ukraine represents the worst security crisis in decades and remains very hard to defuse amidst Kremlin claims about NATO's continued expansion and its possible arms deployment in the country. Market sentiment has been heavily affected with gold pushing to the upper end of its range, as a full-blown confrontation would send energy prices soaring, exacerbating global inflationary pressures.

The minutes of the latest Fed meeting suggest so far little inclination towards a shock and awe approach to contain the highest inflationary pressures in four decades, implying that Fed officials remain cognizant of the ongoing slowdown phase and still expect price gains to be eventually contained. A reactive, rather than proactive approach prevailed, as 'most' on the committee are ready to remove accommodation more quickly in case inflation is stickier than expected. Consensus within the Fed seems to gravitate around the view that economic data warrants four or five 25-basis-point rate hikes this year, to be started soon in March, but well short of hiking at every meeting. So, the hawkish tones ahead of the January FOMC must be considered more of a tool to tighten via language-based guidance, with a gradual rate hike path still preferable to the balance of the participants. For the time being markets may then have reached peak hawkishness, with more than six hikes discounted in the next twelve months. Indeed, the curve steepened a bit and two-year yields slipped following the release of the minutes, while the longer-end barely moved. The inflation and retail sales figures since January have been stronger than expected, but probably more might be necessary to shift consensus within the Fed, in the eyes of the market now more likely than ever to fall further behind the curve. No further detail was provided about the reduction of the size of the balance sheet, but the judgement that asset price vulnerabilities remain elevated could suggest the willingness to further sacrifice markets, if need be.

Although gold has a checkered track record as an effective hedge during times of geopolitical turmoil, the combination of a Federal Reserve falling behind the curve and investors discounting spiking price pressures in case of a Ukraine invasion could send the yellow metal towards \$2,000/oz, which should eventually be unsustainable in a year of tightening. Our year-end fair value of \$1,700 was taking into account a more proactive Fed and not the black swan of an unravelling security crisis.

Retail sales rose beyond expectations in the month of January, 3.8% as against the 2% forecast. The surge was driven by solid demand for durable goods, like autos and furniture, though the details point to a broader slowdown in purchases, as discretionary categories like electronics and clothing failed to rebound strongly following the previous month sharp declines. Retail spending will anyway have to normalise to lower levels this year, with stimulus payments coming to an end. Also, spending on goods will slow down with the shift towards services as the covid situation continues to improve. Stay safe.

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