



## CIO OFFICE MORNING MARKET WRAP – May 18th, 2021. ALSO AVAILABLE ON ALEXA.

Asian equity benchmarks are firmly in positive territory this morning, including Japan in spite of some grim economic data. Oil is rising, Treasuries are steady while the US dollar is weakening.

Little changed across asset classes. This would be an appropriate summary for yesterday's session, which is what one could expect after heightened volatility the previous week, the only exception being gold, at a 3-month high, which is not really surprising with 10-year real yields at a 3-month low. A casual look at charts gives the impression that Brent crude is coiling in a tighter range to continue to the upside. Yet, a good lesson is that one should never trust charts only. So, scratching below the surface and observing that the premium between the nearest-month contract and the next one has widened to the point that there is backwardation, an indication of a tight market, gives comfort to the chart pattern that should not be taken at face value on its own. Also, if gold is pushing higher on depressed real yields, one should think that euro could follow suit, as oftentimes they tend to move in the same direction, though calling currencies is never an easy task. Maybe a burst of euro confidence ahead of the flash PMI release on Friday? What is not 100% comforting is persistent weakness in bitcoin, which could be taken to be a hint of lack of liquidity, pointing maybe to more of the same to come across other, less speculative, asset classes.

Nowadays both professional investors and amateurs share lots of charts on social media, and a recurrent one is the short-term rolling correlation between the S&P 500 and 10-year Treasuries, so US equities and long-dated bonds, which has now spiked to the highest levels since the dot-com bubble. The usual complaint, never mind the sophistication of the investor, is that now bonds offer little diversification moving more in line with equities. This is true, but is actually also a truism, meaning that it is obvious in itself. What is more relevant, is that regime shifts can underlie correlation shifts, which in common parlance means that in a reflationary regime, where price pressures and economic growth rates tend to move together and be persistently positive, bonds and equities take notice and what is good for one, slow-moving inflation, is also good for the other. This is less of a truism but should be more revealing. So, as long as these high correlations persist, they are a sign of a reflationary environment taking hold, a novelty versus the deflationary one which has persisted since the Great Financial Crises. Which kind of correlation Fed officials prefer, who are not even managing portfolios by the way, is easy to guess.

The latest release in China pointed to a two-sided economy, with Industrial Production and Fixed Asset Investments in line with expectations and driven by exports and a solid real estate market respectively, while Retails Sales lagged projections. The country, being the first one to go through the pandemic and recover, is now in slowdown mode with growth that most likely peaked in Q1 this year. The softening phase seems set to continue, with authorities bent on curbing excesses rather than supporting expansion rates at all costs. As US growth dips after Q3, according to consensus estimates, investors will again be looking to EM countries for new opportunities, rather than focusing on the well-known and waning US exceptionalism. By the way, the Shanghai Shenzhen 300 Index shrugged off the signs of weaker domestic demand, led higher by Consumer Discretionaries, second best performers after Materials.

Stay safe.

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