



CIO OFFICE MORNING MARKET WRAP – Wednesday May 19th, 2021. ALSO AVAILABLE ON ALEXA

Asian shares are sliding this morning, following in the footsteps of Wall Street's lackluster performance the day before. Australia and Japan are the underperformers amongst the major markets. An upside breakout in the making in crude was upended by the possibility of more supply from Iran.

In engineering jargon yesterday's session had high noise and low signal, in humbler trader's parlance it was volatile and lacked direction, with US stocks a tad weaker, oil and gold little changed, yields stuck in their rut and the dollar headed south again. More action now seems to be taking place in the Bitcoin market, where the digital currency continues to trade at close to three-month lows. If oftentimes the crypto-community fantasises about the market cap of Bitcoin reaching that of gold, today they are much more concerned about China's ban on cryptocurrencies for its financial and payment institutions. Limited supply and portability is not the only argument that can be invoked to justify any kind of future astronomical price for an asset, with regulatory constraints playing much more of a role. The capital controls the Chinese

authorities want to maintain are incompatible with the secrecy and ease of money transfer achieved in the digital world, hence the only acceptable digital money in China is the Central Bank Digital Currency, that the government is strongly committed to. Should there be one day incentives for other countries to enforce capital controls, then the financial crypto-world as we know it today could be seriously disrupted. It is still early days, but exploding debts, capital flights and capital controls can occur in logical fashion, as already remarked by some very insightful investors.

It should be no surprise that when the world most powerful government distributes lots of money to the most spendthrift consumers consumption skyrockets. Indeed, the impressive Q1 reporting season of key US retailers confirmed the strength of the post-pandemic recovery through very solid spending patterns. Walmart, Home Depot and Macy's results were well above estimates. For Home Depot one could wonder whether the recent Do-It-Yourself trends could last that much longer now that the economy is set to reopen, while Walmart, though more of a staple retailer, is still benefitting from the desire of consumers to "get out and shop". Macy's, as the most discretionary of the three chains, should be best geared to the cycle and able to benefit from significant operational leverage.

A hallmark of the post-Great-Financial-Crisis recoveries has been the exponential rise of credit driven by ever increasing central bank liquidity and the Covid one has been no exception, seeing actually the Fed directly intervene in corporate bond markets to support their orderly functioning. Maybe it should come as no surprise that calls about the best days for the asset class being behind us are multiplying, which in layman's language means that the odds are more skewed to the downside and one should tread those waters very carefully. Also, such calls are in and of themselves somewhat obvious, since credit spreads are highly mean reverting and they are now sitting at their tightest ever, so reversion can only imply spreads widening rather than tightening. Morgan Stanley strategists have just downgraded their outlook to neutral citing valuations and "slower balance sheet repair". Yet, spreads can stay tight for long and drive extended cycles of complacency. Investors should in any case be mindful that sometime next year the historical liquidity impulse that lifted all boats is expected to reverse and even drop dangerously close to negative territory. Those looking to buy the dip then had better go for a larger one. Stay safe.

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