INSPIRING WHAT'S NEXT

CIO OFFICE MORNING MARKET WRAP – May 20th, 2021. ALSO AVAILABLE ON ALEXA.

Equities fluctuated as investors digested Fed language interpreted to be unexpectedly hawkish in the April's FOMC minutes. At one point US stocks lost more than 1% to close little changed, real yields shot higher, the dollar strengthened and gold froze off its three-month high. In a spectacular episode of volatility Bitcoin crashed to rebound 30% from the day's lows and this morning digital currencies are again weak in Asia.

Once upon a time the dreaded word upending rallies was starting with R, for recession, now it seems to be starting with T, for tapering. It is natural to think that recessions would reverse bull markets, after all growth is what matters for risk assets. Well, due to persistent lack of growth following the Great Financial Crisis liquidity is all that has mattered; hence it is now the withdrawal of accommodative conditions to affect financial assets just as badly. We are not really there yet, after all as per the latest FOMC minutes some Fed officials only suggested that reducing bond-buying efforts should be considered "at some point in upcoming meetings" if the economy continues to strengthen at the recent pace. Yet, widespread addiction to stimulus is measured by the very fact that when investors just start to think about thinking of the possibility of the reduction of policy support markets end into a tailspin. Ex Treasury Secretary Larry Summers once used the mouthful 'iatrogenic volatility' to signify that policy makers, whose role is to stabilise markets, actually destabilise them with their actions.

The term was coined by Summers himself after 'iatrogenic illness', an infection you catch when you go into a hospital. The plummeting of breakeven inflation following the release of the April minutes suggests that investors consider the reduction of bond purchases to be strongly at odds with the Fed's goal of achieving sustainable inflation, if not an outright policy mistake. Two local Fed governors said that it is not yet time to move policy and, of course, dip-buyers stepped readily in.

Brent crude weakened to close in the middle of its $62-72/bbl range, with the prospect of the US and Iran reaching a deal looming larger just as OPEC+ is gradually loosening its grip on supply. Oil has traded in a holding pattern since march this year caught in the tug of war between rising infections in Asia and still robust purchases from China. JPMorgan and Goldman Sachs remain convinced about their commodity super cycle thesis, actually claiming that both Iranian oil and additional shale supply are eventually needed to address the chronic supply shortfall envisaged until 2025. The argument hinges on the fact that, though more than enough crude exists underground, investments have plummeted and will not be able to keep up with rising demand due to the rising trend of decarbonisation and increased corporate focus on dividends and debt reduction. If indeed corporate behaviour has changed and the economy remains strong, they will be proven right, though markets appear far from convinced as highlighted by the substantial underperformance of energy equities versus oil since last year lows. Completely at odds, investment houses see a true economic recovery, investors still a false one in energy stocks.

The blowout Q1 earnings season has been humorously depicted as the "road to nowhere", following the muted performance of companies that overall reported bottom line growth of more than 50% from the same time a year ago. This should be a little surprising, considering that results jumped twice as fast as Wall Street initially expected and that guidance was also strong. Or maybe not, putting data into perspective by comparing historical index performance and earnings progression. Ned Davis Research did the diligent homework, comparing the S&P 500 12-month ahead gains with year-over-year reported earnings growth. It turns out that it is exactly the blowout numbers, growth north of 20%, that elicit the slimmest of market gains, a meagre 2.5% as per statistics. With hindsight, and a bit of appropriate number-crunching, everything becomes so obvious, as markets are indeed forward-looking and must not like a growth cliff portending much less than blowout earnings ahead. Although not many love math, in the end it is the second derivative which counts.

Stay safe.

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