



CIO OFFICE MORNING MARKET WRAP – 20th July, 2022.

North America futures are up and stocks in Asia are extending a rally that yesterday saw the US indices end the session at the top-end of a four-week-long consolidation pattern. Overall, markets were fully risk on amidst speculation that a worsening earnings outlook may be priced in. Global equities gained 2.4%, the S&P 500 was up 2.8%, the Nasdaq outperformed, +3.1%, and the EURO STOXX 600 closed +2% higher. All eleven S&P 500 industry groups were in the green, with communication services and materials leading. Bitcoin rose by 7.8% reaching a two-month high. US treasuries edged higher at the short end, with the 10y3m curve flattening further, euro area bonds ended mostly lower on speculation the ECB may raise rates by 50 basis points on Thursday, the dollar weakened against all major peers, oil advanced and gold was little changed.

Netflix delivered mixed earnings results, that anyway investors welcomed. The company saw its subscribers plunge by nearly a million, although the drop was half of what it had previously forecast, sales missed analyst targets and third-quarter projections were worse than expected, but meant a return to customer growth. The stock closed the session 5.6% higher and surged post market. Johnson & Johnson reported earnings just ahead of expectations, but lowered guidance warning about the strength of the dollar and ended the session in the red. At the other end of the spectrum, oil services giant Halliburton's profit jumped, in spite of winding down assets in Russia, as the CEO predicted "multiple years" of increased drilling activity.

The euro surged as much as 1.2% to 1.0269, a two-week high, as markets bet on a bigger ECB hike at tomorrow's policy meeting. The ECB may consider a 50-basis-point hike rather than a quarter-point one as signalled in June. If the Fed is trailing in the fight against inflation, the ECB is just starting and it is doubtful that it will be able to go the full tightening cycle, with manufacturing in the euro area already in recession and the prospect of a Russian gas supply cutoff not helping either. It may not be so much a matter of euro strength, as of broader dollar weakness in the shorter term, with long dollar positioning very stretched and the tightening momentum letting up after the Fed July meeting.

According to Bank of America's widely followed Global Fund Manager Survey investors are in "full capitulation", with the outlook for profits and growth at all-time lows, cash levels extremely high and equity allocations at the lowest since the Lehman collapse. Recession anticipation is the highest since May 2020. Most crowded trades are long commodities and the US dollar. In conclusion, going by the survey it would make sense to hold contrarian tactical longs in equities, in particular in growth stocks, and shorts in the Dollar Index. Respite in the dollar would in turn give some relief to EM assets and gold as well.

Although Joe Biden is touting as his economic priority the fight against inflation, Washington's actions are nowhere near where the mouth is. The US is not raising oil production as one of the currently few spare supplier countries and following the failure of Biden's climate change legislation in Congress, there is talk the President will announce executive action to address climate change today, still falling short of declaring a climate emergency. He should propel clean-energy construction, restrict oil drilling and curb fossil fuel use. On top of this, Janet Yellen yesterday supported the notion of "friend-shoring", a happy-sounding label for a less friendly world, whereby supply chains would be made more robust by spreading manufacturing mainly across friendly countries. In practice, it would imply localisation, loss of efficiency, hence higher costs and lower economic growth. As much inflation is a hated word nowadays, US policies are likely to make it more entrenched in the end.

Chinese returns this morning remain muted on covid and property-sector challenges. The loan boycott that started with homebuyers is starting to spread, with some suppliers to real estate developers refusing to repay bank loans because of unpaid bills owed to them, amongst others by Evergrande Group. The sector needs a fix, much more than a quick one, and therein lies President Xi's dilemma. Giving in to demands for support could strain public finances, while ignoring them could trigger contagion effects.

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