



CIO OFFICE MORNING MARKET WRAP – 21st July, 2022.

It looks like this time there is scope for a somewhat more durable rebound, as investors did not fade Tuesday's broad rally. The S&P 500 advanced by 0.6%, the Nasdaq outperformed closing 1.6% up, and the Russell 2000 of small cap stocks added to gains, while European equities slipped. The breadth of gains was again very high, with 491 components of the S&P 500 advancing. Bitcoin was little changed, and an on-chain research firm cautioned that there is absence of whale-wallet activity behind the latest move, referring to money of larger entities. Longer-dated yields edged higher, the dollar was steady and gold recorded new lows for the year.

The debate about the "full capitulation" of investors is not over. And while the day before Bank of America had provided support for that view, yesterday Bernstein begged to differ, saying that equity flows have not been weak enough for markets to have bottomed, but also that we may "have seen capitulation from bond funds". We would have sympathy for that view. We have recently raised our year-end fair value for the 10-year yield to 3.2%, which implies very limited upside from current levels. As activity slows down, since yields do not operate in a vacuum, they cannot keep on rising. We would tend to side more with Bernstein on equities as well, as it seems too early in the tightening cycle to sound the all-clear, although some of our tactical indicators point to the continuation of the current rebound. Also, it is difficult to see pressures on record margins ease beyond the quarter with a stronger dollar and higher input costs.

In a much-awaited release Tesla beat profit estimates, but with the first sequential profit decline since 2020. It made progress in getting production back on track amidst shortages and China lockdowns, and the target of 50% annual expansion rate on a “multiyear horizon” was left unchanged. This is key for a growth company in a cutting-edge sector with a 12-month forward P/E of 51, although the consensus of analysts is much less sanguine with an estimated long-term EPS growth of 37%. Analysts will keep a close eye on the company’s ability to ramp up production of its mass-market Model-Y SUV and soon introduce the Cybertruck pickup. Much to the disappointment of crypto enthusiasts, the company sold most of its bitcoin holdings and an impairment hurt the quarter’s profitability. Elon Musk is a practical-minded entrepreneur, not a long-term HODLer. Semiconductor stocks rallied as the Senate moved closer to giving the green light to more than \$50bn for US-based chip manufacturing. The sector has underperformed year-to-date, as record sales of recent years could lead to a supply glut once pandemic-related shortages ease. Customers may have double- or triple-ordered during the pandemic and now payback time is due. ASML Holding, the Dutch semiconductor equipment producer that has Intel, Samsung and TSMC as key clients, cut its revenue growth guidance in half for the year, as fast-track shipping of its machines led to delayed sales recognition. Despite the very “strong demand” in automotive, the company sees a slowdown in PCs and smartphones.

Russian President Putin signalled that Europe will get gas flows after the Nord Stream 1 pipeline is restarted, as long as a turbine for maintenance in Canada is returned to Russia. Otherwise, gas flows to Europe could drop to only 20% of capacity versus the previous 40%. Should flows be cut completely, the euro area would plunge into a recession, the common currency would fall below parity and Germany be in danger of losing almost 5% of its economic output according to the IMF. European Commission President Van der Leyen warned that a full disruption of Russian gas “is a likely scenario”, as she outlined a proposal for countries to cut gas consumption by 15%. Russia is also looking to annex more occupied territories this year, by calling votes on joining Russia and forcing residents to apply for citizenship. And it will extend its aims beyond the separatist republics, following the collapse of peace talks in spring and since the West continues to supply Ukraine with advanced weaponry constituting a threat for Russia.

European consumer confidence dropped to its lowest level on record as consumers brace for a recession amidst record inflation and energy shortages related to the neighbouring conflict. And the ECB is set to start a tightening cycle today which many doubt will be completed as planned. The Central Bank is not new to belated and mistimed rate hikes, the notable ones in July 2008, at the peak of the Great Financial Crisis, and in April and July 2011, the year of the European debt crisis. The superstitious would say that July is not a good month for rate hikes in Europe

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