



CIO OFFICE MORNING MARKET WRAP – 22nd July, 2022.

Asian shares are mixed this morning, S&P 500 futures and European contracts are rising, as investors weigh mixed earnings news and gains in Chinese tech shares. Equities extended gains for a third day led higher by the tech and consumer discretionary sectors yesterday, in spite of some key reports showing weakness in the US economy and the ECB embarking on a tightening cycle. Snaps shares plummeted on slumping advertising demand, while Tesla outperformed following previous day's results. Treasuries were well bid with the 10-year yield closing below 2.9%, gold rebounded off a two-year low and crude oil dropped.

The European Central Bank surprised markets with a sizeable 50 basis-point hike, raising policy rates for the first time in 11 years to quell decade-high inflation even as the economy has been showing signs of slowing down. Forward guidance was dropped for September to "a meeting-by-meeting" approach and the new Transmission Protection Instrument was announced. The TPI was designed to contain rising borrowing costs for vulnerable countries on mounting price pressures. The ECB said that normalisation of rates will be appropriate at upcoming meetings, prompting bets of more 50-basis-point moves to come then downshifting to 25-basis-point hikes by year end, with a 1.75% terminal rate to be reached as early as in Q1 next year according to some forecasts. But Christine Lagarde is facing more challenges than most, having to coordinate policy for 19 diverse economies and face the threat of a recession on rising fuel and food costs due to the war in neighbouring Ukraine. Germany, with lower supplies of natural gas, is particularly at economic risk being more dependent on

Russian energy. The latest cherry on the cake is political turmoil in Italy, with PM Draghi's resignation. Many expect that the current tightening cycle will not proceed as planned, as it happened in 2008 and 2011 when the ECB had to turn back as growth slumped. Borrowing costs for the weakest member countries have been rising fast of late and the TPI was introduced to tackle such episodes. It is unlimited in size and subject to eligibility criteria, but its activation is at the full discretion of the Governing Council. Market participants are likely to test the ECB's resolve to anchor sovereign credit sooner rather than later, especially with rising uncertainty in Italy.

The euro initially popped on the ECB's announcement, but later trimmed its gains against the dollar to trade at 1.019 as of the time of writing. Likewise, the 10-year treasury yield spiked to subsequently succumb to the negative news flow on the US economy to end the day below 2.9%. Gold closed 1.3% up, more sensitive to underwhelming US releases than the ECB joining in in the tightening push.

Mario Draghi resigned as Italy's prime minister, triggering the dissolution of parliament and pushing the country into snap elections to be held on September 25. Draghi quit on Thursday as his government failed to get the necessary support from a confidence vote. His exit comes at a time of acute economic crisis for Italy and the ambitious schedule of reforms agreed with the EU could now be at risk. The sell-off in Italian debt intensified following the resignation and the yield on Rome's 10-year government bond settled at 3.5% later in the day. Will Draghi's exit represent a setback to the Western alliance against Russia's invasion of Ukraine? But first and foremost, will turnout at the forthcoming elections be once more miserable, going a long way to point Italian voters' full disaffection with politics, irrespective of whom holds power?

Shares in social media app Snapchat lost about one quarter of its value in late trading after parent company Snap posted bleak second-quarter results. Revenue was just shy of analysts' estimates, but net losses widened by 178 percent compared with the same period last year, well beyond expectations. Snap is funded primarily through advertising, being slashed in the slowdown phase, and suffered from Apple's privacy changes in mobile devices and new entrants like Chinese-owned TikTok taking market share. The company announced plans to "substantially reduce hiring" and shake up its strategy.

Yesterday's releases showed that the US economy is on track to slow down significantly. The Conference Board US Leading Index, a composite of 10 economic indicators, fell 0.8% in June, with the most negative contributions coming from consumer expectations and the labor market. Excluding the month of February, the indicator has been falling back-to-back from its peak in April 2021 at 12.3 to the current level of 1.4, not far from negative territory where the economy is likely to contract. The senior director of economic research at the Conference Board said that "A US recession at the end of this year and early next is now likely". And the Philadelphia Fed Factory Outlook, a measure of business conditions six months from now, showed its worst reading since 1979, pointing to worsening manufacturing conditions.

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