



CIO OFFICE MORNING MARKET WRAP – 28th January, 2022. ALSO AVAILABLE ON ALEXA.

Asian stocks are mixed this morning, while US futures are climbing, supported by strong after-market earnings from Apple helping the Nasdaq 100 outperform the S&P 500 futures. The impact of Powell's words have reverberated across asset classes following the January policy meeting. Yesterday equity rebounds continued to be sold, long-dated yields retreated, IG corporate spreads widened, the dollar gained alongside shorter rates, and gold was pounded. Tech stocks still underperformed, with semiconductors leading losses, and retail traders' darling Tesla down in the high single-digits. The pullback in 10-year yields and the sharp flattening of the curve point to a potential negative impact on growth from tighter policy. Worries about credit defaults surfaced, as IG corporate default swaps reached the highest levels in two years. The combined effects of a stronger dollar and the outlook for prolonged tightening more than wiped out gold's modest gains in 2022.

Apple rallied in late trading after trouncing estimates. Sales grew 11% to record levels in the final fiscal quarter in spite of still-significant supply-chain hurdles, with guidance of double-digit growth in the quarter through March. The company benefitted from a flood of new products, including the iPhone 13, Apple Watch Series 7 and updated Macs. Earnings ended at \$2.1 per share, well above the \$1.9 estimate.

It is the day after 'the day after', after the Fed communicated its monetary policy plan on Wednesday, so as per playbook we should be breathing a sigh of relief as now we know what lies ahead, in other words some visibility has been restored. Has it really? Let's run some checks to see where we stand. The December minutes expressed some concern about excessive yield curve flattening induced by

policy normalisation, so it would be preferable to remove accommodation by “relying more on balance sheet reduction”. In other words, via balance sheet reduction longer-dated yields should be supported, offsetting the rise at the shorter-end of the curve due to rate hikes, so the curve would supposedly not flatten too much. The 10-minus-2-year treasury yield spread lingered for some time at about 80 basis points before the January FOMC meeting, and it is now at almost 60, so the yield curve is much flatter, and the Fed has hardly done anything so far. Furthermore, in late 2018 the Fed dared implement three layers of tightening as it will try again this year, with rate hikes, the winding down of asset purchases and shrinking of the balance sheet. That time it did not end well, as the Fed drained too much liquidity, money markets dried up and an intervention to restore orderly conditions was necessary. Fed officials must have learned their lessons, yet, the plan is now to proceed at an even faster pace. It is not clear at all that they will succeed. In summary, the road taking the Fed to its goal of removing the mammoth liquidity is long and winding, and it is far from assured that they will be able to complete the process without accidents. So, their incomplete visibility is our very limited visibility, still.

An additional twist to how long and winding the road ahead for the Fed is, has been added by Goldman Sachs president John Waldron, who said that “we might need to bring back Paul Volcker” to stay the course irrespective of what “exactly is going on in the markets”, in a not so concealed critical remark at the current Fed leadership. The reference is to the Fed chairman who in the early 80s first contained and then reversed very high inflation levels. It is not a coincidence that more commentators now write about a ‘lower Fed put’, representing the tolerance level at which further equity downside won’t be tolerated.

The US 4Q GDP came in stronger than expected, though masking weaker details, as the composition of growth was more in keeping with the economy hitting the brakes. GDP advanced 6.9%, versus a consensus estimate of 5.5%, and two thirds of it was inventory accumulation. The downside surprises were government spending and capital expenditure.

Stay safe.

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