CIO OFFICE MORNING MARKET WRAP – 29th July, 2022.

Thursday delivered positive returns across all asset classes, on the back of a much lower than forecast US Q2 GDP number. Global stocks didn't give back Wednesday's gains: they rose +0.8% in developed markets, led by the US at +1.2%, and +0.5% in emerging regions. Interest rates fell across all maturities with, interestingly, a bull flattening pattern that is worth detailing: the 2-year fell -14 basis points to 2.86%, the 5-year lost -15 basis points to 2.7%, while the 10-year shed -11 basis points to 2.67% and the 30-year only -4 basis points to 3.02%. The price of Brent crude oil didn't care about recession risk, gaining +1% to $107.6. But the dollar did: in trade-weighted terms, it moved down -0.6%.

It has been and still is a mega week – some would say a crazy one, and yesterday was no exception with both major macro and micro economic events. Let's start with the former. In yesterday's daily note, we suspected that the consensus could be too optimistic for US GDP: a bad Q2 could have been one of the reasons behind a less hawkish than expected FOMC. Well, Q2 was really bad: while the consensus was for a +0.5% year on year annualized GDP expansion, the number released yesterday was a -0.9% contraction. It followed -1.6% in the first quarter of 2022. In most countries, two consecutive quarters of contraction would be called a recession, but not in the US, where a dedicated administration is the only one who can declare it. Looking at details, the change in inventories, a somewhat "technical" measure, was the most important negative contributor. But it's worth noting that some highly interest-rates sensitive sectors were also falling, showing that tightening financial conditions have an impact:

residential construction tumbled -14% at annualized rate, while capital expenditures and durable goods spending fell around -2.5%. By contrast, net exports gained +1.4% and services spending was very strong at +4.4%. Simultaneously, personal consumption was actually not far from expectations at +1%. Bottom-line, consumers keep on consuming, not that much durable goods but services, while corporates are much more conservative. On the inflation front, the core PCE price growth continued to ease, although not drastically: after +5.2% in Q1, the Q2 number was +4.4%. Is it a recession? The debate will rage, with the Biden administration in one camp and the Dr Dooms of this world in the other. We simply highlight that with over 1 million new jobs being created in the US in Q2 alone, it's certainly not economic devastation and not even a typical recession. Bottom-line, both growth and inflation are slowing, which is consistent with what markets care the most about for the time being: a less hawkish Fed. The situation is different in Europe: as per yesterday's data releases, consumer sentiment collapsed to -27 while inflation -in Germany- accelerated to +8.5%. This puts the ECB in an impossible situation, especially as the key contributor to inflation is out of their reach: the energy crisis, linked to the war in Ukraine or more precisely its consequences in the context of European sanctions. Regional nuances matter, as also illustrated by Tokyo CPI just released this morning: a very reasonable +2.5% year on year.

This is normally our typical transition to Asian markets, but before that we'll have a word on earnings, as more than 40% of companies have reported their numbers between the US and Europe. Starting with the former, so far so good: 75% of companies exceeded EPS forecast with an average 3% surprise. Year-on-year earnings growth is not phenomenal, around +1%, but sales growth is an impressive +9%, obviously reflecting higher prices. In Europe, only 60% of companies exceeded EPS forecast, with an average 2% beat. Year on year EPS growth is around 3% there and revenue growth is at a spectacular +12%: inflation of course, but also a positive impact from weaker currencies. Now let's be more specific on last night: both Amazon and Apple delighted investors with both strong Q2 numbers and, most importantly, upbeat comments: Amazon's sales forecast was a positive surprise to analysts, and Apple expects an acceleration in revenue this quarter, especially driven by China.

This is where we have a look at markets in Asia, which are mixed. While stocks in Japan and Korea are modestly up, reflecting optimism from the West, they are down -2% in Hong-Kong and -1% in onshore China. A Politburo meeting didn't give any indication of central government support to the real estate endless turmoil, which remains a major drag on markets and on the economy. In addition, a call between President Xi and President Biden underlined tensions, especially on Taiwan. US Treasury yields continued to trend marginally lower in Tokyo trading, with the 10-year now at 2.66%. Gold and oil are unchanged, while major crypto currencies are slightly in the red. Interestingly, future contracts on US stock markets are up another +0.5% following overnight earnings releases.

Today will provide the first estimate of GDP growth in the Eurozone, expected at +3.4%, as well as various national CPI measures. In the US, focus will be on June personal income and spending. We are in the busiest part of the earnings season with today Procter &Gamble, Exxon, AstraZeneca, BNP Paribas, Hermes, Exxon and Chevron coming on tape among others. However, we won't comment them next Monday: our daily investment notes are taking a month-long break in August. Our weekly publications will continue. We wish our distinguished audience all the best for what will be another fascinating -and volatile- month.

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