# US Market Wrap

## 11th May 2022: Markets whipsaw to CPI bombshell as stock rout continues but Bonds hold strength

- **SNAPSHOT**: Equities down, Treasuries up, Crude up, Dollar flat.
- **REAR VIEW**: Worrying pick-up in Core US CPI, China inflation data also hot; Fed's Bullard says 75bps not his base case; Dallas Fed names NY Fed's Lorie Logan as new Kaplan successor; ECB sources see rates above 0% by year-end, while Lagarde hints at July hike; No progress on EU Russia oil sanctions; Large crude stock build a result of SPR release, products draw.
- **COMING UP**: **Data**: UK GDP, Swedish CPIF, US IJC, PPI **Events**: Banxico; IEA OMR & OPEC OMR **Supply**: US & Italy **Earnings**: Nexi, Siemens, Allianz; BT.

## MARKET WRAP

Stocks indices were lower Wednesday as the riskier sectors lead the declines (NDX -3%, RUT -2.5%, SPX -1.6%, DJIA -1%) that accumulated into the close. It was a very choppy session with the tape action seemingly a primary factor of technicals (positioning/flow/light liquidity) than a barometer for fundamentals. Both stocks and bonds dived in a knee-jerk reaction to the stronger rise than expected in the US Core CPI M/M in the US premarket, before swiftly unwinding the moves not long after - clearly that was a red herring for stocks but bonds held onto their recovery. The Treasuries curve flattened (2s20s -12bps) as the front-end remained pressured post-CPI amid more front-loaded Fed hike pricing, while aggressive curve flattening bets saw longer yields fall; the disappointing 10yr auction had little follow-through price action. Fed speak was limited post-CPI with just Bostic in hours acknowledging that action is needed (without going into many further details), while post-close comments from Bullard saw the Fed's token hawk suggest the inflation print, while hot, wasn't too surprising (perhaps indicative of little appetite to alter his position further) and affirmed his view that 75bps is not a base case scenario. Elsewhere, the DXY spiked to highs of 104.13 post-CPI but quickly pared and trended lower for the majority of the session, returning to unchanged levels at the close. Oil rallied through the session with "half-a-city COVID-free Shanghai" the go-to catalyst for the paring of recent losses, while chunky weekly US crude stock builds were caveated against the SPR release and large product draws.

## US

**US CPI**: Inflation metrics were hotter than expected on both headline and core, although the headline did ease from the prior but it was the core M/M that raised alarm bells. Headline CPI rose 8.3% Y/Y (exp. 8.1%, prev. 8.5%), and M/M saw a 0.3% gain (exp. 0.2%, prev. 1.2%), meanwhile the core numbers saw an acceleration M/M by 0.6% (exp. 0.4%, prev. 0.3%), while the core Y/Y rose 6.2% (exp. 6.0%, prev. 6.5%). Although Y/Y inflation cooled, it was still hotter than expected which implies inflation is not going away as fast as hoped and the Fed will want to see more evidence that inflation is slowing. The Core M/M acceleration, driven by big increases in airfares and vehicle prices, reversed the slowing in March core CPI, which printed 0.3% from the 0.5% in February. Services ex-energy rose to a new recent peak of +0.7% M/M from +0.6% M/M, which the Fed will be particularly wary of given the need for services inflation to stay contained as goods prices recede if overall inflation is to fall. Analysts point to the lagging, but important (>30% of CPI) rent of residences sector starting to pick up in the April numbers, with rents +0.6% M/M and owners equivalent rents +0.5% M/M, a big factor in the overall April numbers. Capital Economics suggests the data will strengthen the Fed's case to continue hikes at 50bps increments at the next couple of meetings and could also result in renewed speculation on a 75bps move, or even an inter-meeting move. However, CapEco adds that "with goods shortages tentatively easing and signs that wage growth is set to cool, we still think a more pronounced drop back in inflation will allow officials to slow the pace of tightening in the second half of the year." At pixel time, Fed Funds futures imply a year-end Fed rate at c. 2.76%, that compares to the pre-CPI 2.72%.

**FED**: On the closing bell, **Bullard (2022 voter, hawk)** spoke where he said the Fed has teed up 50bps hikes for future meetings while reiterating that he feels the goal should be to get Fed Funds to 3.5% by year end. He also said that 75bps is not his base case, while on the April inflation data, he noted it was hot but not far from what was expected and some of the numbers are transitory, but a big chunk is likely persistent which will need a policy response. He also stressed he will not emphasise a single inflation report too much, but he warned inflation is broader and more persistent than many thought. Bullard does not think the risk of recession is high in the US right now. **Bostic (2024 voter)** reiterated the Fed understands inflation is too high and it will act to bring it down. Bostic continued, if supply-demand gaps narrow then price pressures will ease, but he will support moving rates more if inflation persists. Moreover, the Atlanta President said moves in market yields is a sign the Fed still has credibility, and does not think the Fed is behind the curve. Elsewhere, the Dallas Fed named NY Fed's **Lorie Logan** as its new President, replacing former Dallas Fed President Kaplan, who retired in 2021.

## GEOPOLITICS

**RUSSIA/UKRAINE**: Russian Foreign Minister Lavrov said Russia does not want war with Europe, but the West is always saying Russia must be defeated. Moreover, the Kremlin, when asked about possibility of the Kherson region in Ukraine joining Russia, said that the residents must decide their own fate and such decisions need clear legal basis, as was the case with Crimea. Kremlin said this after pro-Russian authorities in the Kherson region were planning to ask President Putin to admit the region to Russia. Furthermore, the Kremlin reiterated the special military operation is going according to plan, while they are very closely watching anything that can affect NATO configuration near Russian borders. This comes after UK PM Johnson is to visit Sweden and Finland as they consider joining the NATO defence alliance, which comes after Johnson signed a security declaration with Sweden and is expected to do the same with Finland, pledging UK support should its military come under attack. On this, Russia has warned there will be consequences if they (Finland/Sweden) join NATO, whose members see an attack on one as an attack on all. However, US Defense Secretary Austin said he does not believe Russia President Putin wants to take on NATO. Lastly, as expected, the US House voted 368-57 to pass the USD 40bln Ukraine aid bill to send it to the Senate, although the Senate may not vote on the plan until next week.

**US/ASIA**: US Indo-Pacific Coordinator Campbell said what has happened in Ukraine must not be allowed to happen in Asia, and it is accurate to say that the US does not support Taiwan independence. Campbell continued saying the US is increasingly troubled by the steps in Hong Kong to pressure and eliminate civil society, and on communications the US is prepared for any kind of diplomacy or engagement with North Korea.

## FIXED INCOME

**T-NOTE (M2) FUTURES SETTLED 15+ TICKS HIGHER AT 119-08+**

**Treasuries flattened Wednesday with the front-end pressured post-CPI, while duration unwound all of its losses into the NY afternoon. Futures volumes well above recent averages**. 2s +1.4bps at 2.637%, 3s -1.7bps at 2.818%, 5s -3.6bps at 2.882%, 7s -5.9bps at 2.939%, 10s -7.4bps at 2.919%, 20s -8.5bps at 3.256%, 30s -9.2bps at 3.037%.

**THE DAY**: T-Notes entered the session on the front foot out of Europe, with curve flattening. The contracts made session highs at 119-13 at the London/NY handover before some measures paring was seen ahead of CPI. The big 0.6% rise in the core M/M CPI was enough to see bids evaporate across the curve as T-Notes fell nearly a whole point from 119-00 to session lows of 118-03+ (cash 10yr yield session high made at just beneath 3.08%). However, duration soon saw better bidding that carried right through into the NY afternoon, as T-notes unwound their whole knee-jerk lower; a 5.3k Ultra Bond block buy accentuated the bid. IFR noted on the composition of the bid, "Hedge funds stayed sellers all session, but real money added to curve flattening bets and scooped up above 3.0% yields in 5s, 10s and bonds, with algo sell programs sputtering when yields held support". The 10yr auction, which was weak, saw little follow-through price action, with traders now looking to Thursday's 30yr auction.

**10YR AUCTION**: A disappointing demand reception was seen at the 10yr new issue. The 2.943% high yield provided primary market participants more than 20bps more yield than April's reopening, but the auction still tailed by 1.4bps. That was better than the prior 3bps but worse than the six-auction avg. 0.5bps. The internals were more promising. The 2.49x B/C was just above avg. and better than the prior 2.43x, while Dealers (forced buyers) took 11.5%, better than the prior 18.7% and avg. 14.2%, with above avg. participation from both Directs and Indirects.

**STIRS**:

- Eurodollars flattened with whites (1st four quarterly contracts) sold as more front-loaded Fed action was priced in wake of CPI, but curve flattening bets saw the rest of the strip bid.
- EDM2 -1.5bps at 98.16, U2 -4.0bps at 97.375, Z2 -4.0bps at 96.90, H3 -1.5bps at 96.72, M3 +1.5bps at 96.615, U3 +2.0bps at 96.685, Z3 +2.5bps at 96.77, H4 +3.5bps at 96.855, M4 +4.5bps at 96.905, Z4 +6.0bps at 96.955, Z5 +8.0bps at 97.05.
- NY Fed RRP op demand at USD 1.876tln across 91 bidders (prev. USD 1.864tln across 87 bidders on Tuesday).
- SOFR (day-lagged) unchanged at 78bps.

## CRUDE

**WTI (M2) SETTLED USD 5.95 HIGHER AT 105.71/BBL; BRENT (N2) SETTLED USD 5.05 HIGHER AT 107.51/BBL**

**Oil prices rose through the Wednesday session in a stately manner with "half-a-city COVID-free Shanghai" the go-to catalyst for the paring of recent losses, while weekly US crude stock builds were offset by SPR release and product draws.** One could also sight the lack of a deal collapse in the EU's pending Russian oil embargo, although the Hungarian Foreign Minister said today the only way it would agree to an oil embargo is if it solely relates to maritime shipments, while pipeline shipments should be fully exempted. WSJ also reported no progress was made today. The to-and-froing of Russian supply and China's COVID situation will likely continue to be cited for the erratic price action in the energy space for the near future. For full analysis on EU Russian oil embargo, please click here.

**US INVENTORY DATA**: In the week ending May 6th, Crude stocks rose a chunky 8.5mln bbls against the consensus estimate for a 0.5mln draw, and more bearish than the 1.5mln build reported in the private data on Tuesday; desks point to the near 7mln bbl release from the SPR. Meanwhile, the products saw Distillates draw 0.9mln bbls and Gasoline draw 3.6mln, which on net marked a larger draw than anticipated, and brings product inventories further beneath long-term averages. Elsewhere in the report, crude oil production fell to 11.8mln BPD from 11.9mln, while refinery utilisation rose 1.6% (exp. +0.3%).

**UKRAINE GAS DISPUTE**: Ukraine's Naftogaz said "we could be talking about USD 1bln a month" when assessing the value of the gas allegedly stolen by Russia. That comes after no reported progress so far on a resolution after Ukraine halted the gas flow from Russia through the Donbas region on Tuesday, with Gazprom holding out in not agreeing to redirect flows to other Ukrainian territories. Germany and Slovakia said their gas supplies remain undisturbed for now.

## EQUITIES

**CLOSES**: SPX -1.65% at 3,935, NDX -3.06% at 11,968, DJIA -1.02% at 31,834, RUT -2.48% at 1,718.

**SECTORS**: Consumer Discretionary -3.57%, Technology -3.30%, Communication Svs -1.51%, Financials -1.00% Industrials -0.93%, Health Care -0.64%, Consumer Staples -0.34%, Real Estate -0.16%, Materials +0.03%, Utilities +0.77%, Energy +1.37%.

**EUROPEAN CLOSES**: Euro Stoxx 50 +2.62% at 3,647; FTSE 100 +1.44% at 7,347; DAX +2.17% at 13,828; CAC 40 +2.50% at 6,269; IBEX 35 +2.13% at 8,312; FTSE MIB +2.84% at 23,724; SMI +0.14% at 11,558.

**EARNINGS**: **Coinbase (COIN)** tumbled after an overall poor report, where COIN broadly missed expectations. EPS posted a surprise loss per share, whilst revenue, MTUs, and trading volume all fell short of expectations. Looking ahead, FY22 guidance was left "largely unchanged". **Unity Software (U)** lost roughly a third of its value after it provided soft guidance where FY22 and Q2 outlook were light of the expected. **Electronic Arts (EA)** saw gains after it beat on EPS and boosted Q dividend to USD 0.19/shr (prev. USD 0.17/shr). Although, missed on net bookings while Q1 and FY23 view also disappointed. However, MoffettNathanson recommended EA shares due to the Cos. stable foundation to weather market volatility ahead. **Occidental Petroleum (OXY)** surpassed Wall St. expectations, where the Co. was helped by surging oil prices. CEO said OXY is to extend buyback programme and expects to launch in Q2. **Wynn (WYNN)** posted a deeper loss per share than expected and missed on revenue. Looking ahead, WYNN said in Macau, they "remain confident that the market will benefit from the return of visitation when travel restrictions subside." **Krispy Kreme (DNUT)** issued a strong report where it exceeded analyst expectations on EPS and revenue; "sales per hub" metric rose 49.2% for international markets and 19.4% for the US and Canada. **Wendy's (WEN)** slumped 10% following misses on top and bottom line. WEN said it is seeing a negative impact from higher costs for supplies and labour. Backs FY22 adj. EPS view.

**STOCK SPECIFICS**: **Toyota (TM)** warned that "unprecedented" hikes in raw material costs could slice 20% off FY profit, a clear sign sales can no longer shrug off the supply-chain crunch that has roiled the global industry. TM added, it would work with suppliers to come up with alternative materials and other ways to reduce expenses. A **Boeing (BA)** executive stated wiring connectors are slowing 737 productions down, and the Co. will be a "little bit down" on defense business and top line for the year. On healthcare, President Biden reiterated he wants to give Medicare power to negotiate drug prices to lower costs for Americans. **Southwest Airlines (LUV)** announced USD 2bln plan to transform customer experience such as faster Wi-Fi, in-seat power, and larger overhead storage. **Tesla's (TSLA)** Shanghai unit exported its first batch of EVs after work resumption, according to Global Times. **Phillips 66 (PSX)** raised quarterly dividend 5.4% to USD 0.97/shr (prev. USD 0.92/shr). **Switch (SWCH)** is to be taken private by **DigitalBridge (DBRG)** and IFM for USD 34.25/shr, which values the transaction at roughly USD 11bln including debt. Quebecor, Canadian telecom operator, seen as a credible buyer for **Shaw Communications' (SJR)** freedom mobile unit, according to Reuters government source, which would help clear the way for the **Rogers (RCI)** and Shaw merger. **Google (GOOGL)**

announced the launch of its new Pixel 6A starting from USD 449, while it also teased the Pixel 7 and Pixel 7 Pro for a launch in the autumn/fall. It also announced Pixel Buds Pro to be available later this year. On **solar names (FSLR, SPWR)**, US Commerce Secretary Raimondo said they are moving as fast as possible on the solar tariff probe, adding a 200% tariff on solar imports would be an extreme case and was exceedingly unlikely. **Shopify (SHOP)** executives are to follow the CEO in buying the dip in SHOP stock after the CEO announced a buy of USD 10mln worth. **Abbott (ABT)** could restart baby formula production in two week if FDA approves, but take six to eight weeks before it is available in stores. **American Airlines (AAL)** CEO said we are worried about inflationary elements like fuel, but added travel demand from small and medium size businesses is above 2019 levels. AAL has also grounded 150 jets due to a lack of pilots.

## FX WRAP

**The Dollar** was very volatile Wednesday in wake of the April CPI report which came in hotter than expected in the headline, albeit down from the prior, but the Core M/M accelerated more than expected, offsetting the easing seen in the March data and adding to concerns that inflation may not be slowing. The kneejerk reaction saw the Dollar rally to highs of 104.13 although the move quickly pared and the buck traded lower for the majority of the session, before returning to relatively unchanged levels. Stocks and Bonds were also volatile, as index selling continued not long after the NYSE open, while duration caught a bid in bonds while the front-end remained pressured as front-loaded Fed hikes were priced.

**The Euro** was unchanged against the buck and mixed against other currencies, although EUR/USD was extremely choppy around the CPI release. There was a lot of ECB speak coupled with more source reports. ECB's Muller said it was appropriate for rates to be in positive territory from year-end and that moves should be in 25bp increments, while Elderson, de Guindos and President Lagarde also gave a nod to a July lift-off - Vasle supports further and faster action. The commentary was followed by Bloomberg sources that officials increasingly see rates rising above zero this year. Despite the hawkish shift from Lagarde, it was more her moving in line with her colleagues at the ECB, seeing the single currency unchanged against the greenback, which was marginally softer on the session. There are still ongoing concerns with Russia/Ukraine and its impact on the Eurozone economy, while the US CPI report supported the need for 50bps hikes from the Fed, emphasising the policy divergence between the two which offset any ECB speak hawkish rhetoric on Wednesday, although the decline in US yields seemingly did little to support the Euro.

**The Yen** was an outperformer after it welcomed the move back lower in Treasury yields as the CPI dust settled. The knee jerk reaction to the US CPI saw USDJPY hit a high of 130.81 as yields spiked, although the gradual pairing throughout the session saw the cross hit a low of USD 129.46, while there may have also been some haven demand as the equity rout continued. **Gold** prices were also bid, as was the **Swissy**.

**Cyclical currencies** managed to find some strength after the immediate downside post US CPI despite the risk-off tone in markets with AUD and NZD in the black while CAD outperformed. GBP, however, was weaker against both the buck and Euro with Brexit concerns back around the Northern Ireland protocol while the cost of living crisis in the UK is a key topic among the government and Chancellor Sunak is reportedly preparing a fresh wave of support for UK households. AUD/USD saw lows of 0.6929 from highs of 0.7053 before hovering around 0.6950 while similar price action was seen in NZD/USD, hitting lows of 0.6282 from 0.6380 highs, before paring to the 0.6300 area. Note, Australian Westpac Consumer Confidence data fell 5.6%. CAD was an FX outperformer in general thanks to the gains in crude prices.

**CNH**: Chinese CPI in April was hotter than expected rising 0.4% M/M (exp. 0.2%) from a prior 0.0% in March, seeing a Y/Y rise of 2.1% and a PPI rise of 8%, both above expectations. The hot print supported the Yuan to see the onshore Yuan (CNY) settle firmer against the greenback, but in wake of the US CPI, offshore Yuan (CNH) weakened against it. Elsewhere, in China, there was some optimism on COVID with the Global Times reporting the transmission risk of the latest outbreak in Shanghai has been effectively curbed and the Shanghai local government said there is basically no COVID spread in eight districts.

**EMFX** was mixed, MXN firmed while ZAR was bid thanks to gains in gold prices. BRL was flat against the buck. Brazil's Economy Ministry announced the government has zeroed tariffs on imports of beef, chicken meat, wheat, wheat flour, crackers, biscuits and other bakery products until year end and it also reduced the import tax on steel rebar to 4% from 10.8%. Meanwhile, April inflation data was only marginally above expectations with the Y/Y accelerating from the prior, but M/M cooled somewhat. TRY was weaker on the higher oil prices meanwhile the White House is reportedly seeking congressional approval for a proposed sale of missiles and equipment upgrades to Turkey.

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