



US Market Wrap

1st June 2022: Yields and Dollar surge on strong ISM and BoC hike, weighing on stocks

- **SNAPSHOT:** Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW:** Strong ISM, prices ease and employment slips; BoC hikes 50bps with hawkish statement; Fed speakers stick to script, but Daly nods to potential pause; Fed Beige Book shows some growth slowing; US to send long-range weapons to Ukraine; FB COO Sandberg to step down, Strong CRM earnings, AAPL to move iPad production from China to Vietnam.
- **COMING UP: Data:** Swiss CPI, US Challenger, ADP, IJC & Factory Orders **Event:** JMMC & OPEC+ **Speakers:** Fed's Mester, NY Fed's Logan **Supply:** Spain & France **Holiday:** UK Spring Bank Holiday

MARKET WRAP

Stocks were lower (SPX -0.75%, NDX -0.75%, R2K -1%, DJIA -0.5%) Wednesday after the strong US data weighed on valuations amid yields and the Dollar spiking. US indices had initially looked to trade on the front foot, with a tech bias in wake of the stellar Salesforce (CRM) report and guidance, while luxury names were also set to outperform as the likes of Capri (CPRI) and Victoria's Secret (VSCO) showed no signs of slowing high-end demand. However, all faded somewhat as stocks more broadly struggled in wake of the US ISM Mfg. data and BoC 'hawkish rate hike' sending macro tremors. Treasuries saw pronounced bear-flattening as a result (2yr +12bps, 10yr +9bps, 30yr +4bps), while Fed speak from Bullard, Daly, and Barkin provided little new to the discourse in NY trade, although late Tuesday comments from Bostic saying he by no means meant to imply any form of a Fed put hit expectations of any impending Fed relief (the 'Bostic Fed Pause' that has gained momentum lately). In FX, the Dollar surged after the data, while the Yen saw acute underperformance, aided by dovish BoJ commentary. Oil prices rallied into the NY session amid continued China reopening momentum, but faded with stocks as the Dollar surged.

GLOBAL

US ISM: The ISM manufacturing headline rose to 56.1 in May from 55.4; analysts had expected a decline to 54.5. Supplier delivery times fell to 65.7 from 67.2, which Capital Economics explains is an indication of a slightly shorter lead time; "despite the press release suggesting that the recent lockdowns in China were causing some disruption, goods shortages seem to be easing gradually," it wrote, "while the inventories index rebounded to a six-month high". The employment sub-index, however, was disappointing, falling beneath the 50.0 neutral mark to 49.6 (prev. 50.9). CapEco said this will add some weight to the view the May jobs report on Friday will continue to see headline payrolls growth slow in May (Newsquawk's NFP preview can be [accessed here](#)). "The press release also suggested that manufacturers are having a slightly easier time finding workers, which is another reason to think the worst may now be past for inflation." In terms of the implications for the prospects of the US economy in the months ahead, CapEco doubts that the rise seen in the manufacturing report signals the start of a sustained recovery, and expects manufacturing output will weaken from current levels. "Although the latest PMIs from China suggest the factory sector there is beginning to recover as virus containment measures ease, they are still consistent with the ISM index falling further over the coming months," it writes. "the likely hit to export demand from the stronger dollar, and the slowdown in domestic consumer goods demand, also suggest the outlook for the manufacturing sector is darkening."

BOC: The Bank of Canada hiked rates by 50bps to 1.75% and announced it is continuing with its QT process, as expected. Note, there had been some outside risk of a 75bps hike from the BoC, although this was not the base case. However, there was a hawkish tilt in the statement as it added it is "prepared to act more forcefully if needed" to meet its inflation target. The word forceful is new in the statement but it is something BoC Governor Macklem has suggested before, but nonetheless opens the door to potential 75bps moves in the future if it is required. Nonetheless, RBC is still calling for 50bps moves in July to take the Overnight Target Rate to the lower bound of the neutral rate (neutral is estimated between 2-3%), before turning to 25bp moves in September & October to reach a terminal rate of 2.5%. Meanwhile, ING expects a 50bp move in both July and September, before reaching a terminal rate of 3.5%, above the top end of the estimate for neutral. The BoC's tone on inflation was also hawkish as it noted the risk of elevated inflation becoming entrenched has risen, inflation continues to broaden and inflation is persisting well above target and is expected to move higher in the near term. However, it was encouraged by the activity noting economic activity in Canada is strong and it is clearly operating in excess demand, suggesting it is not concerned about a cooling economy



as a result of their normalisation. On risks, the BoC noted the invasion of Ukraine, China lockdowns and supply disruptions are all weighing on activity and boosting inflation - which could perhaps keep the Bank from shifting to a more aggressive 75bp move. On housing, it noted that activity is coming off exceptionally high levels, but this is a welcome sign for the BoC as the impact of its normalisation process starts to take effect. Analysts at RBC highlight that the BoC passed on several opportunities in Wednesday's statement and instead put focus on the many arguments for further tightening.

GEOPOLITICS: US President Biden wrote an op-ed where he spoke about America's role in the Ukraine conflict, he decided that the US will provide Ukraine with more advanced rocket systems and munitions, and the US would continue providing Ukraine with advanced weaponry, including Javelin anti-tank missiles, Stinger anti-aircraft missiles, artillery and precision rocket systems, radars, unmanned aerial vehicles, Mi-17 helicopters and ammunition. He also later confirmed they will be sending more financial assistance, with this latest package worth USD 700mln. Sources later suggested the US plans to sell four long-range, armed Gray Eagle drones to Ukraine, according to Reuters, who notes this would put an advanced reusable US system capable of multiple deep strikes on the battlefield against Russia for the first time. However, Secretary of State Blinken earlier noted they have assurances from Ukraine they would not use long-range weapons systems against targets on Russian territory.

FED

BEIGE BOOK: The Fed's June Beige Book (across 12 Districts) saw some regions note slowing growth, while price hikes were reported to be not as strong as the prior update, albeit still sizeable. In the labour market, "One District explicitly reported that the pace of job growth had slowed, but some firms in most of the coastal Districts noted hiring freezes or other signs that market tightness had begun to ease." Otherwise, most reported continued tight labour markets. On growth, "Eight Districts reported that expectations of future growth among their contacts had diminished; contacts in three Districts specifically expressed concerns about a recession." On wages/prices, a few Districts reported a levelling off of wage growth, while there were varied assessments on inflation with most reporting strong price increases, albeit some noted moderation. However, half of the Districts cited some customer pushback to price increases exhibited in smaller volume purchases or substitution to cheaper brands.

COMMENTARY: Daly (2024 voter) towed the Fed line where she sees a couple of 50bps hikes and they need to get rates to neutral expeditiously. Daly wants to be at 2.5% by year-end but she is not forecasting beyond a couple of meetings due to uncertainty around economic data. She is open to pulling the reigns back on the economy, but it is too early to proclaim what the Fed will do, and while she hopes inflation has peaked, she does not want to declare victory just yet. Daly said she is prepared to do what it takes to lower inflation but is also prepared to stop raising rates if needed (Daly is the only other Fed member to suggest a pause in hiking rates, while the latest minutes also suggested the Fed will assess later this year what further adjustments are needed). **Bullard** (2022 voter) spoke numerous times, reiterating he sees the neutral rate at 2% but he wants inflation at 3.5% before potential cuts in late 2023 or early 2024. He warned inflation expectations could become unanchored without credible Fed action but added it is not advisable to move too quickly in central banking but the 50bps path per meeting is a good place for now. He sees the 1-3year inflation expectations as concerning and that they need to get them under control. Bullard also believes it is too early to say if we have seen a peak in inflation and we need more than a few tenths to make a judgement. **Barkin** (2024 voter) said you cannot find a recession in the data or actions of business executives and he is perfectly comfortable with the rate path of hikes for the next couple of meetings. To change the pace of rate hikes, he says inflation expectations would have to change. Barkin is hearing very strong consumer demand at the high end and he is not concerned about consumer spending.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 30+ TICKS LOWER AT 127-17

Treasuries saw pronounced bear-flattening as the front-end tumbled in wake of strong data and a hawkishly tilted BoC rate hike. 2s +12.0bps at 2.660%, 3s +12.8bps at 2.839%, 5s +12.1bps at 2.930%, 7s +10.9bps at 2.974%, 10s +8.9bps at 2.933%, 20s +4.6bps at 3.313%, 30s +3.6bps at 3.093%. Inflation breakevens: 5yr BEI +3.1bps at 2.986%, 10yr BEI +0.7bps at 2.627%, 30yr BEI +2.3bps at 2.433%.

THE DAY: T-Notes had been leaking slightly lower into the APAC Wednesday session, and then again at the London open. However, the contracts attempted to pare losses into the NY morning with IFR noting real money and tech-based buying/short-covering. T-Notes made session highs of 128-21 ahead of the ISMs, JOLTS, and BoC decision. But, amid all three catalysts released at the same time (10:00ET) – beat on ISM Mfg., high job openings, and a 50bps BoC rate hike with hawkish guidance – Treasuries legged lower, with the front-end leading. T-Notes eventually bottomed out at 127-09 (cash 10yr yield high at 2.95%, highest since May 18th) around noon in NY, and with many UK participants off



for the rest of the week ("Platty Jubs" bank holidays) the related book squaring subsided. T-Notes then hovered near lows into the settlement. Fed's Bullard, Daly, and Barkin were all on wires, but all provided little new.

AHEAD: On the data front, ADP, productivity, jobless claims, and factory orders Thursday come ahead of NFP on Friday, while Fed Speak Thursday sees Logan's closing remarks at NY Fed and Mester on the economic outlook. Rates traders also have an eye on next week's 3s, 10s, and 30s auctions with the announcement due Thursday (larger net supply with the Fed trimming its reinvestments now).

STIRS:

- EDM2 -0.3bps at 98.233, U2 -5.0bps at 97.365, Z2 -9.0bps at 96.815, H3 -14.0bps at 96.625, M3 -17.5bps at 96.57, U3 -17.5bps at 96.67, Z3 -16.5bps at 96.775, H4 -15.5bps at 96.85, Z4 -13.5bps at 96.98, Z5 -11.5bps at 97.035.
- Noteworthy options: 20k EDZ2 97.25/97.00 put spread block for 17; 20k June'23 SOFR 95.875/95.75 put spread block for 2.5, targeting 4.00-4.25% FFR vs current 3.00-3.25% priced.
- US sold USD 30bln of 119-day CMBs at 1.390%, covered 3.09x.
- NY Fed RRP op demand at USD 1.965tln across 93 bidders (prev. USD 1.979tln across 101 bidders).

CRUDE

WTI (N2) SETTLED USD 0.59 HIGHER AT 115.26/BBL; BRENT (Q2) SETTLED USD 0.69 HIGHER AT 116.29/BBL

Oil prices rallied on Wednesday amid continued China reopening but faded into the settlement with stocks. Highs were made for WTI (N2) at USD 117.87/bbl and Brent (Q2) at 118.57/bbl in the NY morning, before fading with risk assets later on. Traders now look to the weekly US inventory data with the private release due later Wednesday ahead of the EIA print on Thursday (delayed a day due to holiday Monday). Current expectations (bbls): Crude -1.4mln, Gasoline +0.5mln, Distillate +1.0mln.

OPEC: Reuters reported the OPEC+ JTC meeting did not discuss exempting Russia from the oil supply deal, coming after the suggestions on Tuesday that pressure the benchmarks lower. Note the JMMC and OPEC+ meetings are due Thursday, to read our full preview please [click here](#). Elsewhere, Bloomberg reported Kazakhstan is to cut June oil output to 6.6mln tons due to maintenance, and then raise it back to 7.3mln tonnes of production in July.

US PRODUCTION: Chevron (CVX) CEO said a gov't restriction to fuel exports would be "unwise", but this cannot be ruled out. Chevron also said that Permian production can be maintained at 700k BPD for decades without M&A. On renewables, Reuters reported the Biden admin. is likely to raise ethanol blending volumes for 2021 biofuel mandates to as high as 13.9bln gallons from 13.3bln. The reports saw traded renewable fuel credits rally.

EQUITIES

CLOSES: SPX -0.75% at 4,101, NDX -0.74% at 12,548, DJIA -0.54% at 32,813, RUT -0.49% at 1,854.

SECTORS: Financials -1.67%, Health Care -1.42%, Consumer Staples -1.31%, Real Estate -1.1%, Materials -1.03%, Consumer Discretionary -0.84%, Communication Services -0.69%, Industrials -0.62%, Technology -0.33%, Utilities -0.16%, Energy +1.76%.

EUROPEAN CLOSES: Euro Stoxx 50 -0.80% at 3,759; FTSE 100 -1.01% at 7,531; DAX -0.33% at 14,340; CAC 40 -0.77% at 6,419; IBEX 35 -1.18% at 8,747; FTSE MIB -1.01% at 26,499; SMI -1.04% at 11,490.

STOCK SPECIFICS: **Salesforce (CRM)** beat on EPS and revenue and raised its FY EPS forecast above expectations, although FY revenue view was light. **HP Inc. (HPQ)** beat on EPS and revenue and raised EPS guidance above expectations. **Meta's (FB)** COO Sheryl Sandberg is stepping down from the co., and Javier Olivan is set to replace her. **Apple Inc. (AAPL)** is reportedly moving some iPad production out of China and shifting it to Vietnam after strict COVID lockdowns in and around Shanghai led to months of supply chain disruptions, according to Nikkei. The US FTC has reportedly revamped its antitrust probe into **Amazon (AMZN)**, according to Bloomberg citing sources. **Delta Airlines (DAL)** announced it expects strong Q2 2022 results with adj. total revenue fully restored to 2019 levels. **Humana (HUM)** reaffirmed its FY adj. EPS view at 24.50, beneath the 24.65 consensus, while adding the guidance contemplates an explicit COVID-19 related headwind of USD 1.00 per diluted common share. **S&P Global (SPGI)** suspended FY22 guidance due to extraordinarily weak market conditions for its rating business, while noting debt issuance volumes have been extraordinarily weak YTD; it expects to reintroduce in its Q2 earnings results. **Capri Holdings (CPRI)** beat on EPS and revenue but cut its FY23 revenue view, although raised its EPS forecast above expectations. **Victoria Secret**



(VSCO) saw a strong quarter, beating on EPS and revenue although Q2 EPS guidance was slightly light of expectations. **Weibo (WB)** beat on EPS and Revenue and had solid Daily and Monthly active users. **General Motors (GM)** is slashing prices for the Chevy Bolt amid high demand for electric vehicles, according to The Verge. **Morgan Stanley (MS)** said investment banking fees are being led by fixed income. **Coty (COTY)** saw Kim Kardashian launch SKKN by KIM in partnership with the Co.

FX WRAP

The Dollar surged Wednesday, primarily catching its bid in wake of the better than expected ISM data, although it did show that employment slipped sub 50 ahead of NFP on Friday. Price pressures had slowed somewhat, but still remained elevated. The ISM data triggered a spike higher in US yields which weighed on the Euro and Yen, in turn propelling the Dollar even higher. Fed speak saw Bullard reiterate his case for 3.5% rates before cutting in late 2023 or 2024 while Daly walked a fine line suggesting they can do more if required, but also suggested they can pause if necessary. Barkin is also happy with the current rate path. **The Euro** was hit by yield differentials between the US and EZ after the US ISM release although the S&P Global PMI in the Eurozone was marginally better than expected, aside from Italy. EUR/USD rose to 1.0738 in wake of commentary from ECB's Holzmann who said record Eurozone inflation prints back the need for a 50bps hike although session lows were hit as the Dollar and Treasury yields rallied.

Yen was the underperforming currency due to the leg higher in US yields to see USD/JPY hit a session high of 130.18 and holding above 130.00 through the latter part of the session while the BoJ Deputy Governor Wakatabe noted the central bank must maintain powerful monetary easing and dismissing the idea of widening the range on its 10yr JGB target, emphasising the policy divergence between the BoJ and Fed. **CHF** was weaker against the buck but firmer against Euro and Yen ahead of Swiss CPI on Thursday. **Gold** prices were bid throughout the session to see a high of USD 1,850/oz which coincides with the 10dma while it spend the majority of the afternoon trapped between the 200dma at USD 1,841/oz while the 21dma at USD 1,846 also acted as support.

Activity currencies were mixed, **AUD** firmed against the greenback thanks to better than expected Q1 GDP although it failed to hold its bid above 0.7200 while NZD, CAD and GBP were weaker against the buck. **USD/CAD** attempted to breach 1.2600 to the downside in wake of the BoC but fell short at 1.2610 as the strong US Manufacturing ISM headline provided a bid to the Dollar, defending 1.2600 while the sell-off in equities in wake of the data also hampered the CAD despite a hawkish BoC which although hiked by 50bps as expected, added language to the statement that it is prepared to act more forcefully if required while its commentary on inflation was rather bleak. Meanwhile, the **Kiwi** lost a grip of 0.6500 ahead of NZ terms of trade, import and export prices for Q1 while the NY session downside in stocks and bid in the Dollar only added to the currency's downside. **GBP** was weaker against the Dollar and Euro ahead of the Platinum Jubilee weekend where reduced GBP volatility is expected. Analysts at ING expect some GBP weakness ahead due to the growth outlook but they do not expect to see a downtrend morphing into a collapse. BoE Deputy Governor Cunliffe spoke in the evening, where he said rates may well have to rise further but he does not think the bank is heading back towards the interest rates of the 1990s.

EMFX was predominantly weaker but the ZAR outperformed thanks to the bid into gold while CLP was slightly firmer against the buck thanks to the gains in Copper, which helped offset a disappointing economic growth print of 6.9%, beneath the 7.7% consensus. Other EM's were hit by the stronger greenback. Nonetheless, several Banxico members spoke where Governor Rodriguez said future hikes could be larger than recent hikes, while 75bp dissenter Espinosa said a larger hike is needed due to upward CPI revisions and there could be an unanchoring of inflation expectations. Meanwhile, Esquivel suggested a 75bp hike is a possibility for the next meeting, but nothing has been decided. In Brazil, BCB Chief Neto said that "it is better to take the risk of doing more and run a little beyond our mandate".

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