US Market Wrap

2nd June 2022: Dollar slides and stocks rally on eve of NFP

- **SNAPSHOT**: Equities up, Treasuries up, Crude up, Dollar down.
- **REAR VIEW**: Brainard puts brakes on a pause in September talk; Mester wants 50bps hike at next two meetings then to assess further action; OPEC+ agrees to hike output by 648k BPD in July & August; US ADP misses expectations; IJC marginally declines; MSFT cuts Q4 guidance; EU approves partial Russian oil ban; BoC Dep. Gov. leans hawkish; Saudi reportedly willing to make up for lost oil production from Russia if needed; Bullish inventory report.
- **COMING UP**: **Data**: Australian, US and EZ Final PMIs, German Trade Balance, EZ Retail Sales, US Labour Market Report, ISM Services PMI **Speakers**: Fed's Brainard **Holidays**: China & UK.

MARKET WRAP

Equities rallied from lows seen at the open and continued throughout the afternoon into the close. The initial downside at the open came in wake of Microsoft (MSFT) cutting its Q2 guidance due to FX headwinds given the rise in the Dollar since Q1, although still an issue, the guidance cut was not due to lack of demand or consumer behavioural changes. However, the Dollar sold off heavily on Thursday, paring the gains seen on Wednesday as the ADP jobs figure disappointed expectations ahead of the NFP release on Friday, although the correlation between the two is not always so strong. Nonetheless, Microsoft (MSFT) managed to trim its losses and close in the green. The downside in the Dollar and upside in equities came despite some hawkish commentary from Fed's Brainard who said it is hard to make the case for a September pause while Mester reiterated its difficult to predict how high rates will need to go but she agrees with 50bps hikes at the next two meetings before considering the appropriate pace. Crude prices eventually were bid, paring morning weakness as participants question whether OPEC will be able to handle the increased production quotas over July and August, given they have been undershooting production quotas at the initial 432k BPD monthly output hikes, while Russia is also still apart of the production pact, despite sources earlier in the week. Treasuries were choppy but ultimately steepened by settlement in wake of a disappointing ADP jobs report, higher unit labour costs, a hawkish Brainard, and a choppy risk environment with volumes much lighter on account for the UK bank holiday. All eyes turn to NFP on Friday, particularly the wages metrics.

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FED: **Vice-Chair Brainard** took a more hawkish view, as she said it is hard to see the case for a pause in rate hikes. The Vice Chair added policy is not on a pre-set course, while QT could be worth another two-three rate hikes. On the QT remark, it is worth recalling that Powell has previously said analysts suggest the impact of QT could be 25bp over a year, while Waller had this as being between 25-50bp. Additionally, Brainard said if we see risks to the upside, we may need to move a little faster. Elsewhere, **Mester (2022, 2024 voter)** said they need ongoing rate increases, including 50bps rate hikes at next two Fed meetings; then, Fed will be well-positioned to consider appropriate pace for further rate hikes and assess how high rates need to go. Furthermore, Mester added, policy rate probably needs to go above 2.5%, but cannot make that call today, depending on how much demand moderates and what happens with supply. On this, if by September she sees more compelling evidence that inflation is moving down, the Fed can slow rate hikes but if it has failed to moderate, a faster pace could be needed. Furthermore, Mester said the risk of recession has risen, but a good case can be made that a sharp slowdown can be avoided, and lastly declared she cannot say if we will need to pause at neutral or not until we see what the data is, adding we may have to go beyond.

NFP PREVIEW: Headline measures of payroll additions are expected to continue moderating in May. The jobless rate likely fell back to pre-pandemic levels, while the participation rate may inch upwards, which would be an encouraging development. However, the focus will be on wages to see how employment compensation is faring amid surging consumer prices; the expectation is that the annual rates of pay growth eased, but the monthly rate may pick-up relative to April's data. The May jobs data will only have a limited impact on near-term Fed policy, given that the central bank is widely expected to lift rates by 50bps in both June and July, but any signs of moderation in wages may support the argument that the Fed could slow the increments of rate rises in September. To download the full Newsquawk preview, please click here.

ADP: US ADP national employment fell to 128k from the revised 202k, beneath the expected 300k. Looking into the release, Pantheon Macroeconomics noted, 'the consensus always looked too high but this is below even our bottom-of-the- market estimate.' As such, the consultancy adds, ' we are sticking with our Homebase-driven forecast that May payrolls rose by about 250K. That's a clear slowing from the pace in recent months, likely due in part, at least, to the energy price shock triggered by the Ukraine War, but it is not a disaster.' Moreover, it is worth adding, some analysts have complained that the ADP is not a reliable indicator of the official payroll numbers.

JOBLESS CLAIMS: Initial jobless claims declined to 200k, from the expected 210k, and the prior 211k, while continuing claims also dipped to 1.309mln (prev. 1.343mln, exp. 1.325mln). Pantheon Macroeconomics adds, 'the trend in initial jobless claims has been rising slowly since the mid-March low, though we think those readings were flattered by favorable seasonals.' Furthermore, looking ahead the consultancy expects claims to rise to about 220K over the coming weeks, and then anticipates a time of volatility through early August amid seasonal adjustment problems due to the annual automakers' retooling shutdowns. On this, Pantheon states, 'they happen every year, but the timing and extent varies.'

FIXED INCOME

T-NOTES (U2) SETTLED 7 TICKS HIGHER AT 118-27+

Treasuries bull steepened in wake of a disappointing ADP jobs report, higher unit labour costs, a hawkish Brainard, and a choppy risk environment with volumes much lighter on account for the UK bank holiday. At settlement, 2s -2.0bps at 2.644%, 3s -2.2bps at 2.828%, 5s -2.4bps at 2.916%, 7s -2.2bps at 2.955%, 10s -0.9bps at 2.922%, 20s +0.3bps at 3.302%, 30s +0.8bps at 3.085%. 5yr TIPS -2.7bps at -0.061%, 10yr TIPS -2.2bps at 0.251%, 30yr TIPS -3.1bps at 0.636%. Breakevens: 5yr BEI +2.6bps at 2.998%, 10yr BEI +2.8bps at 2.644%, 30yr BEI +5.2bps at 2.476%.

THE DAY: Treasury's were choppy in thin volumes where a disappointing ADP jobs report helped Treasuries find a bid before the revisions higher to Q1 Unit Labour Costs saw the ADP reaction unwind before Microsoft (MSFT) cut its guidance, taking indices lower and providing another bid into Treasuries to see the 10yr T-Note reach a high of 118-31. Fed speak and OPEC were also in focus, Brainard pared the bid in the front end of the curve as the Vice-Chair, who normally leans dovish, stated it is hard to make a case for a September pause. Meanwhile, OPEC increased production in the near term by pulling forward production hike plans for July, August & September, to just over July and August. However, given OPEC has been undershooting their production quotas, participants question whether they have the capacity to produce even more - which resulted in a bid in crude prices, adding some inflationary concerns. Meanwhile, little reaction was seen as the Treasury announced the sizes of next week's 3, 10 and 30yr auction as expected at USD 44bln, 33bln and 19bln, respectively. IFR also highlighted that sell programmes were triggered in the 30yr bond as the 30yr yield slipped back below 3.1%. Attention now turns to tomorrow's NFP report, with particular eye on the wages component given inflation is the Fed's number 1 priority, as well as the revision high to today's unit labour costs.

STIRS:

- US Sold USD 38bln in 4wk bills at 0.86%; B/C 3.07x. Sold USD 33bln in 8wk bills at 1.04%; B/C 3.23x.
- NY Fed RRP op demand at USD 1.985tln across 97 bidders (prev. USD 1.965tln across 93 bidders).
- EDM2 +0.5bps at 98.238, U2 -1.5bps at 97.350, Z2 -2.0bps at 96.795, H3 -1.5bps at 96.610, M3 +0.0bps at 96.570, U3 +1.5bps at 96.685, Z3 +2.5bps at 96.795, H4 +3.0bps at 96.875, M4 +3.5bps at 96.950, U4 +3.5bps at 96.990, Z4 +3.5bps at 97.010, Z5 +3.5bps at 97.070.

CRUDE

WTI (N2) SETTLED USD 1.61 HIGHER AT 116.87/BBL; BRENT (Q2) SETTLED USD 1.32 HIGHER AT 117.61/BBL

Crude prices were choppy throughout the day from overnight reports that Saudi would be willing to make up for any lost production from Russia in wake of sanctions while OPEC agreed to bring forward production hikes. As sources suggested an increase in production, WTI and Brent hit lows of USD 111.20 and 112.45/bbl, respectively, adding to the overnight weakness on the Saudi/Russia reports. However, the move was short-lived and prices reversed course, catching a bid and extending to gains after OPEC confirmed its decision to bring forward production hikes, while showing that Russia was not exempt from the production deal, dismissing source reports earlier in the week. Approval of the EU partial oil ban on Russia, a bullish inventory report, a rebound in broad risk sentiment and a weaker dollar were also supportive, helping benchmarks hit highs of USD 117.56 & 118.24/bbl in WTI & Brent respectively.

OPEC: OPEC agreed it would increase monthly output quotas to 648k BPD in July and August from 432k BPD in June. Although they are upping production in the short term, it is still the same amount that was expected until September, it is pulling forward the planned September increase across both July and August. Importantly, the decision showed that

Russia was still included in part of the deal despite source reports earlier in the week that they could be exempt from OPEC+ quotas, which would have paved the way for more production from Saudi and the UAE. Alongside Russia remaining as part of the deal, the meeting was a quick one, showing unity and no objections or friction from other members, while we were also left in the dark about the future after the OPEC+ deal ends, where real output will come into focus which has been heavily undershooting the agreed upon quotas, which are all reasons behind the upside in crude prices, alongside risk sentiment and a weaker dollar. Citi writes the "increase will be allocated on a pro-rata basis to all members, which suggests the actual volume of additional supply may only be about half as large. Russia , in particular, will simply pump what it can sell, and that's likely to be well below its OPEC+ allocation". The OPEC decision to raise output was welcomed by both the US and EU - Reuters sources had also suggested a potential visit by US President Biden to the Middle East in June, which could see him in the same room with the Saudi Crown Prince.

INVENTORIES: The EIA inventory report was bullish, showing a 5mln bbl draw in headline crude stocks, larger than both the private survey Wednesday night and the consensus. Products also saw draws, with gasoline drawing 711k, despite expectations for a c. 500k build, but not quite matching the 900k draw in the private report. Distillates also saw a surprise draw of 530k despite the 990k bbl build expected and seen in the private survey. Cushing saw a slight 250k build from the priors 1mln+ draw, while production was unchanged at 11.9mln bbls.

EQUITIES

CLOSES: SPX +1.84% at 4,176, NDX +2.75% at 12,892, DJIA +1.33% at 33,248, RUT +1.84% at 1,897.

SECTORS: Consumer Discretionary +3.03%, Materials +2.68%, Communication Services +2.58%, Technology +2.44%, Industrials +1.89%, Real Estate +1.47%, Financials +1.41%, Consumer Staples +1.37%, Health +0.78%, Utilities +0.6%, Energy -0.3%.

EUROPEAN CLOSES: Euro Stoxx 50 +0.95% at 3,795; DAX +1.01% at 14,485; CAC 40 +1.27% at 6,500; IBEX 35 -0.04% at 8,744; FTSE MIB +0.59% at 24,426; SMI +0.49% at 11,550.

STOCK SPECIFICS: **Microsoft (MSFT)** cut Q4 guidance, with both revenue and EPS view lowered due to unfavourable FX movements. **Oracle (ORCL)** announced that all required antitrust approvals have been obtained for its proposed acquisition of **Cerner (CERN)**. **Anthem (ANTM)** affirmed FY22 adjusted EPS view greater than USD 28.40 (exp. USD 28.63), similarly to **Humana (HUM)** on Wednesday. **Blue Apron (APRN)** gained following the announcement that it had launched a new offering at **Walmart (WMT)**, where consumers can purchase meal kits without a subscription. **Goldman Sachs (GS)** targets medium-term ROE 14-16% and targets medium-term efficiency ratio about 60%; targets 2024 transaction banking revenue of USD 750mln. Targets medium-term ROTE 15-17%. Kerrisdale Capital shorted **Lightwave Logic (LWLG)** and said it has been stuck in the "development stage" for 30 years, and will probably never come out. **Toyota (TM)** unveiled a new home battery pack to provide residential backup, a product that is going to compete with **Tesla (TSLA)** Powerwall, according to Electrek. **Block (SQ)** announced plans to bring tap to pay on iPhone to Square sellers. **Meta (FB)** announced Vice President for AI Jerome Pesenit will depart the co. in mid-June. **McDonald's (MCD)** will have an option to buy back its Russian restaurants in 15 years, according to Russia's anti-monopoly service. **Visa (V)** CFO stated inflation is not having an obvious impact on consumer spending.

EARNINGS: **Designer Brands (DBI)** topped on EPS and revenue alongside raising FY22 adj. EPS view. **Ciena (CIEN)** missed on EPS and revenue. Co. said demand remains strong, but supply chain challenges are resulting in increased uncertainty. **Hewlett Packard (HPE)** missed on top and bottom line while next Q EPS guidance was also weak. However, do note, raised FY EPS forecast. HPE said its profit margins are holding up well in the face of inflation and supply chain disruptions. **MongoDB (MDB)** posted a surprise profit per share and beat on revenue. Looking ahead, Q2 EPS view disappointed expectations but FY22 adj. EPS view topped. Sales surged 57% compared with a year earlier. **Chewy (CHWY)** posted a surprise profit per share and also surpassed on revenue. **PVH (PVH)** reported a strong report, highlighted by top and bottom line beats. Co. said it was negatively impacted by supply chain and logistics disruptions as well as Covid-related lockdowns in China.

FX WRAP

The Dollar was weaker on Thursday, and fell to lows of 101.730 due to the wavering demand for the Buck amid the risk-on tone of trade. Heading into the NY session the Greenback was already losing momentum amidst relative stability and consolidation in USTs following a hawkish reaction to Wednesday's stronger than expected headline manufacturing ISM, but retreated further in early EU trade when the Franc rallied on a Swiss CPI beat. Following this, along with the aforementioned risk tone the poor ADP report hindered the DXY recovery which comes ahead of the NFP report on Friday, as analysts note DXY will need more yield support from it as well as ISM services reports to expand this week's rebound. Moreover, Fed speak came from Brainard and Mester, where the former noted market pricing for 50bp hikes in

June and July seems like a reasonable path, but it is hard to make the case for a pause in September. Mester stated the need for ongoing rate increases, including 50bps rate hikes at next two Fed meetings; then, Fed will be well-positioned to consider the appropriate pace for further rate hikes and assess how high rates need to go.

Activity currencies were the outperformers with antipodes AUD and NZD seeing the greatest gains, in excess of a percent against the greenback, but the CAD and GBP still saw notable firmness against the Buck. In general, the aforementioned currencies benefitted from overall risk sentiment improving throughout the session highlighted by the rise in equities. For the antipodes, the Kiwi and Aussie, against the Buck, managed to pass through pivotal levels, respectively, to highs of 0.6564 and 0.7269, despite some mixed trade data overnight. Additionally, surging metals prices such as copper and iron ore have helped prop-up the antipodes as well as better Chinese demand prospects after a dismal start to the year. Elsewhere, Cable hit a high of 1.2581 broadly tracking firmer risk tone, but analysts note the cross remained mired in a range between 1.2330 and 1.2650 delineated by May's triple tops and bottoms, and could remain stuck there until mid-month Fed and BoE meetings. Note, UK participants are away as it is a UK bank holiday Thursday and Friday.

The Loonie hit highs of 1.2565 against the buck and strengthened throughout the NY afternoon following comments from BoC Deputy Governor Beaudry, who remarked there is an increasing likelihood that the policy rate will need to be raised to 3% or above (neutral is estimated between 2-3%) and the risk is greater now that inflation expectations could rise and high inflation could become entrenched. Moreover, he added interest rate increases will take time to have their full impact and the rebound in the economy, especially in employment, has been much faster than the Bank anticipated. Moreover, aiding the Loonie was the rebound in the crude complex following the OPEC+ decision, as WTI and Brent gained in excess of USD 1.50/bbl on the session.

Safe-havens, CHF and JPY, were the G10 underperformers, albeit still in the green against the Greenback, but less favourable due to the risk-on trade and haven properties as Swissy and the Yen were undermined by an upturn in UST yields that offset the forecast-beating Swiss inflation data. In turn, both crosses were in fairly tight ranges in comparison to other FX crosses, highlighted by USD/CHF trading between 0.9636-0.9576, and USD/JPY 130.23-129.52.

EUR saw strong gains on Thursday amid another ramp in EGB yields and more ECB guidance for policy normalisation given too strong and broad inflation pressures, this time via Villeroy, as the cross hit a high of 1.0748. Additionally, analysts note Wednesday's low attracted buyers by the 38.2% Fibo of May's sharp recovery and as 2-year Bund-Treasury yield spreads climbed to their highest since February. Moreover, aiding the single-currency on, analysts add, is record euro zone inflation in May which is fanning ECB rate hike expectations, with nearly five 25bps rate hikes now priced in by year-end and another 100bps for next year. Nonetheless, technicians note, EUR/USD faces key resistance from Monday's recovery high and key Fib of this year's slide at 1.0787, and as such Friday's US NFP and ISM services data will need to be solid to keep EUR/USD below there and other nearby tech hurdles.

EMs were mixed, with TRY and RUB seeing losses and underperforming, whilst the ZAR outperformed. TRY remains on track to depreciate further and another worrying rise in Turkish CPI on Friday may be the final straw, as it gleaned no real comfort from the CBRT stating that it expects the disinflation process to start on the back of strengthened measures for sustainable price and financial stability. On the flip-side, the CNH and CNY were encouraged by a pledge by the PBoC Vice Governor to use various policy tools to increase liquidity injections to maintain ample liquidity, adding that monetary policy will stabilise economic growth, employment and prices, while the ZAR latched on to Gold's advance towards USD 1870/oz.