US Market Wrap

30th June 2022: S&P 500 posts worst half-year since 1970 as recession fears mount

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar down
- **REAR VIEW**: Rate of core PCE eases, headline PCE rises, Personal Income in line, Consumption misses; Atlanta Fed GDPNow tracks Q2 contraction, signalling potential technical recession
- **COMING UP**: **Data**: Japanese Tankan Survey, EZ/UK/US/Chinese Final Manufacturing PMIs, EZ CPI, US ISM Manufacturing PMI **Speakers**: ECB's Panetta

MARKET WRAP

Stock indices are ending H1 nursing its worst H1 performance since 1970. Traders continued to cite growth concerns, which were exacerbated further on Thursday after data showed weak consumer spending dynamics in May; that resulted in the Atlanta Fed GDPnow model tracking an economic contraction of 1.0% in Q2 – if confirmed in official data later in July, it would imply a US "technical" recession of two consecutive quarters of negative real GDP growth. Some analysts have explained that this is probably not the best measure to gauge whether a recession has occurred, and this is a line that is likely to be emphasised by officials, who have recently noted significant strength in the labour market, for instance–something which runs contrary to recession concerns. Elsewhere, the rate of core PCE slowed in May, although the monthly pace of headline PCE accelerated. In aggregate, the PCE data is unlikely to shift the narrative around the July FOMC too much, given that inflation remains at elevated levels and the Fed wants to see sequential progress of these metrics. After the release of the data, money markets pared back implied probabilities of a 75bps increment rate rise, although as the dust settled, probabilities returned to pre-announced levels (75bps rate rise is priced with around 70% certainty, according to money market pricing). The Treasury curve saw yields narrow aggressively, with T-Note futures gradually bid throughout the session; analysts were attributing month-end factors as another reason for the bid in addition to a cautious risk environment. Elsewhere, despite tight fundamentals, energy markets tumbled amid risk-off trading conditions, underpinned by concerns around the demand side. OPEC+ rubber stamped the 648k BPD easing of its supply curbs, as expected, although it gave no indication about September policy. Ahead, trader's will be focussing on Friday's release of the Manufacturing ISM report to gauge the pulse of activity in the sector.

US

US PCE, PERSONAL INCOME, SPENDING: Headline PCE prices rose +0.6% M/M (prev. 0.2%), but the annual measure was unchanged at 6.3%; the core measure of PCE prices rose +0.3% M/M (exp. +0.4%, prev. +0.3%), and the annual core measure eased to +4.7% Y/Y (exp. 4.8%, prev. 4.9%). Although the core measures eased, it will likely do little to alter the Fed's thinking into the July FOMC, given Chair Powell has already placed a great deal of emphasis on headline measures of inflation. Indeed, while money market implied probability of a 75bps rate hike at the July 27th FOMC pared back slightly after the data release, it has returned to around 70%, where it was pre-data release. Meanwhile, US Personal Income rose +0.5% M/M (exp. +0.5%, prev. +0.5%), while consumption rose by just +0.2% M/M (exp. +0.4%, prev. +0.6%); these measures feed into GDP data, and when combined with the final Q1 GDP data (some of the components are used to model next quarter data, like export levels, inventories, investment, etc), the Atlanta Fed's famous GDPnow growth model is tracking growth at -1.0%. Analysts note that if this was realised, the US would see a technical recession in Q2, given the -1.6% growth in Q1. Note: there are many definitions of a technical recession, however, a commonly accepted measure is two consecutive quarters of negative real GDP growth, despite this posing some problems).

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 32+ TICKS HIGHER AT 118-17

Treasuries rallied as recession fears mount and amid the month/quarter/half-year end rebalancing, while Core PCE cools but headline PCE picks-up, and consumption misses expectations. 2s -12.8bps at 2.925%, 3s -14.5bps at 2.983%, 5s -14.4bps at 3.009%, 7s -13.5bps at 3.035%, 10s -11.3bps at 2.980%, 20s -7.5bps at 3.388%, 30s -7.9bps at 3.133%.

THE DAY: Treasuries rallied across the curve on growth concerns and on the final day of the month/quarter and half year. The PCE/Consumption data was mixed, with Core PCE cooler than expected but the M/M headline saw a decent rise while although income was in line with expectations, consumption missed – sparking growth concerns given consumption is a key unit of GDP. In wake of the data, the Atlanta Fed GDPnow estimate was revised lower in Q2, to -1% from +0.3%, only adding to the growth worries. Money market pricing still implies 70%+ chance of a 75bps rate hike in July, but traders will look to commentary from Fed speakers over coming weeks to gauge their views on how normalisation will progress, particularly if growth starts to tilt negative. The upside in Treasuries across the curve was met with heavy selling pressures in stocks as participants took a flight to quality approach while the front end and belly led the gains with Eurodollars starting to price in rate cuts from 2023.

STIRS

- EDU2 +6.5bps at 96.795, Z2 +14.0bps at 96.310, H3 +19.5bps at 96.385, M3 +22.0bps at 96.570, U3 +21.0bps at 96.755, Z3 +20.0bps at 96.900, H4 +20.5bps at 97.015, M4 +20.5bps at 97.105, U4 +20.0bps at 97.150, Z4 +19.5bps at 97.160, Z5 +15.5bps at 97.080.
- NY Fed overnight RRP sees 108 counterparties take USD 2.33trln (vs prev. 2.227trln, 98 bidders)
- US sold USD 38bln in 4wk bills at 1.240%; B/C 2.97x. Sold USD 33bln in 8wk bills at 1.650%; B/C 2.89x.

CRUDE

WTI (Q2) SETTLED USD 4.02 LOWER AT 105.76/BBL; BRENT (U2) SETTLES USD 3.42 LOWER AT 109.03/BBL

Despite tight market fundamentals, energy markets tumbled amid risk-off trading conditions, underpinned by concerns on the growth outlook, which are weighing the demand side of the equation. Analysts also note that futures of Brent (for August), heating oil (for July), and RBOB (for July) all expired today, which may have contributed to the volatile price action.

NATGAS: Gas prices continued to remain under pressure on Thursday after the DoE inventory data for the week reported a surprise build in stockpiles. The downside pressure was exacerbated on Thursday, with analysts saying that the shutdown of Freeport's LNG export plant resulted in a higher NatGas inventory build than was expected in the week (build of 82 BCF vs an expected 74 BCF, EIA said). After the report, the US Pipeline and Hazardous Materials Safety Administration said Freeport LNG pipes were damaged and needed repair following the June 8th blast; the regulator said a restart could not happen before September at least, Reuters reported; Freeport had previously suggested that it could be partially restored in September, with full restoration by the end of this year.

OPEC+: As was widely telegraphed, the group agreed to ease supply curbs by 648k BPD in August, lifting targets back to pre-COVID levels. Analysts who were looking for clues on what the group intended to do in September were left disappointed, however, with no decision made on output policy beyond August, according to Reuters sources. US President Biden said he hopes that Gulf states he will be meeting with next month see that it was in their own interests to increase oil production, CNN reported, though the President added that he would not be making an individual request to Saudi Arabia to increase oil production when he visits the nation July 15-16th.

RUSSIAN SUPPLY: Citi's analysts said "the market has learned to be sceptical of the target levels as actual production has lagged well behind," adding that "there's some market talk that output may only rise by about half the paper increase, leaving the market tight." The bank also notes recent comments from the Russian Deputy Prime Minister, who said Russian output in June was almost back to February levels, which would indicate that sanctions imposed on Russia's energy sector have failed to yield Allies' intended results.

GAS PRICES: President Biden was asked how long is fair to ask Americans to pay a premium at the pump for the war in Ukraine, to which the President replied "as long as it takes so Russia cannot in fact defeat Ukraine and move beyond Ukraine. This is a critical, critical position for the world," CNBC reported.

GREENHOUSE GASSES: The US Supreme Court ruled in favour of challengers seeking to curb federal authority to regulate carbon emissions from power plants, in a blow to the Biden administration's climate change agenda. The White House said it will study the SCOTUS ruling, and will find ways to move forward under Federal law.

EQUITIES

CLOSES: SPX -0.88% at 3,785, NDX -1.33% at 11,504, DJIA -0.82% at 30,775, RUT -0.66% at 1,708.

SECTORS: Energy -2.04%, Communication Svs -1.55%, Consumer Discretionary -1.54%, Technology -1.33%, Materials -1.23%, Financials -0.88%, Health Care -0.33%, Consumer Staples -0.06%, Real Estate +0.03%, Industrials +0.28%, Utilities +1.1%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.72% at 3,454; FTSE 100 -1.88% at 7,175; DAX -1.64% at 12,791; CAC 40 -2.02% at 5,909; IBEX 35 -1.02% at 8,105; FTSE MIB -2.31% at 23,325; SMI -0.66% at 10,740

STOCK SPECIFICS: The office of the inspector general of the US Transportation Department will audit the FAA's oversight of **Boeing (BA)** 737 and 787 production, according to Reuters. **United Health Services (UHS)** cut guidance due to lower than expected volumes, revenue and income at acute care hospitals after a significant decline in COVID-related patients vs Q1 22. **RH (RH)** also cut its revenue forecasts. **Walgreens (WBA)** beat on EPS and revenue although comp sales were softer than expected and it maintained guidance. **Constellation Brands (STZ)** beat on EPS and revenue while forecasts were also above expectations. It also announced it is eliminating Class B stock. **Xerox (XRX)** CEO passed away from complications with an ongoing illness. COO named interim CEO. **Spirit Airlines (SAVE)** adjourned Thursday's shareholder meeting to continue talks with **Frontier (ULCC)** and **JetBlue (JBLU)**. Wedbush analyst Daniel Ives notes **Tesla (TSLA)** Q2 deliveries will be impacted by China COVID lockdowns and expects the loss of China output will wipe out 70k units. Ives adds the June delivery numbers will be ugly but says to focus on the trajectory for the latter half of the year. TF International Securities says demand for **Apple (AAPL)** iPhone 14 in the Chinese market may be stronger than that of the iPhone 13 from the viewpoints of distributors, retailers, and scalpers. **Meta Platforms (META)** internal memo reportedly says headwinds are "fierce" in H2; company must operate "leaner" and "prioritise ruthlessly". **General Motors (GM)** called off plans to sell its India plant to Great Wall Motor; will explore new options for the sale. GM is also reportedly slowly ramping up Electric Hummer production but is making about 12 a day, trailing the pace of similar offerings from **Ford (F)** and **Rivian (RIVN)**, according to WSJ. FDA announced a recall of **Medtronic (MDT)** heatware ventricular assist device system due to battery performance issues.

FX WRAP

The Dollar Index saw a high of 105.54 before paring heavily to 104.71 in quite the turnaround as risk assets recovered in the afternoon as we pass through the month, quarter and half-year end; the sell-off came amid a choppy risk environment. Core PCE metrics were cooler than expected for both M/M and Y/Y, although the headline M/M saw a notable pickup from the prior. Meanwhile personal income rose in line with expectations but consumption disappointed, resulting in a downgrade to the Atlanta Fed GDPNow tracker, which is tracking a contraction in Q2; growth concerns remain at the front of traders minds, and how it will impact the Fed's reaction function as it aims to bring inflation back to target, and this updated tracking estimate alludes to a technical recession.

The Euro was supported by the weaker greenback. EUR/USD rose back above 1.0450 although it failed to touch upon 1.0500. Sources revealed some details about the ECB's PEPP reinvestments–not to be confused with fragmentation tool–which will reportedly divide the Eurozone in to "donors, recipients and neutrals" where Italy, Spain, Portugal and Greece will be the recipients, and donors will include Germany, France and the Netherlands. The list will be reviewed on a monthly basis.

The Yen was bid on Thursday as USD/JPY backed further away from 137.00, primarily driven by lower US Treasury yields helping to narrow the Treasury-JGB spread. The strength in the Yen was seen despite a much weaker than expected Industrial production report overnight, which declined 7.2% vs exp. -0.3%. Looking ahead, Japanese CPI, Jobs and the Q2 Tankan survey will be released overnight to help paint a clearer picture of Japan's economy.

Cyclical currencies were stronger by the end of Thursday supported by a weaker Dollar. Meanwhile the encouraging China PMI services data overnight helped the Aussie; gains in NZD outpaced the Aussie, but AUD/NZD failed to hold beneath 1.1050. The Pound rebounded strongly, having initially declined through 1.2100, before reversing to highs of 1.2188 as cyclical currencies drew encouragement from their US counterpart’s loss of upside momentum. Sterling also turned the tables against the Euro as the cross pulled back towards 0.8550 at the lows from 0.8620 following what seems to have been a false break beyond Fib resistance on Wednesday, although had stabilized around 0.8600 in later trade. CAD saw mild gains against the buck as the steep losses in oil offset the weakness in the buck.

SEK was weaker against the Euro and flat against the buck while NOK was flat against the Euro and stronger against the Dollar. The SEK was weighed on by the predominantly soured risk tone although the 50bps Riksbank rate hike saw EUR/SEK hit marginal new lows, but the downbeat risk tone in the morning offset any gains. The Riksbank signalled that rates will be raised further, and will be close to 2% by the start of 2023. **NOK** managed to outperform the SEK despite the tumbling Brent crude prices while the latest Norwegian Central Bank currency purchases stood at NOK 1.5bln for July.

EMFX was weaker against the softer Dollar, with notable softness in RUB, while TRY was undermined by a wider Turkish trade deficit. BRL saw weakness despite the jobless rate falling under 10%. MXN saw slight weakness against the greenback while ZAR also saw selling pressure.