



US Market Wrap

2nd August 2022: Stocks hit on US/China tensions and hawkish Fed speak

- **SNAPSHOT:** Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW:** Pelosi arrives in Taiwan; Hawkish Fed rhetoric from Mester, Daly and Evans; Taiwan say 21 PLA aircrafts entered southwest ADIZ; CATL reportedly pauses North American battery plant; China PLA to conduct military drills 4-7th August; UBER cash flow positive for the first time; US Jolts fell more than expected
- **COMING UP: Data:** Chinese Caixin Services PMI, EZ, UK & US Composite/Services PMI, German Trade Balance, Swiss CPI, EZ Retail Sales, US Factory Orders & ISM Services PMI **Event:** OPEC+ **Speakers:** Fed's Barkin, Harker & Kashkari **Supply:** Germany **Earnings:** BMW, SocGen, Commerzbank, Infineon; Hiscox, Taylor Wimpey; Moderna.

MARKET WRAP

Markets were choppy throughout the APAC, European and US sessions with the anticipated Pelosi trip to Taiwan initially hitting risk assets and supporting havens but her safe arrival saw a brief unwind of the selling pressures in equities to see stocks go positive in the afternoon. Nonetheless, China started to react by implementing military drills around Taiwan while 21 PLA jets entered the southwest ADIZ. Stocks ultimately finished lower with the geopolitical tensions weighing as China starts to respond to the visit and is starting to have domestic impacts. Chinese battery giant CATL is reportedly pausing its North American battery plant announcement due to the Taiwan trip. The factory was meant to supply auto giants Ford (F) and Tesla (TSLA). Meanwhile, Fed speak has been hawkish where 2022 voter Mester stated she is seeing no signs of inflation easing and that it is not going to come down quickly while reiterating the Fed's commitment to bringing inflation under control, something that Daly also said early in the morning while Evans believes 50bps is reasonable for September but said 75bps remains a possibility, similar to Kashkari Friday night. Bonds sold off hard throughout the afternoon on the hawkish Fed speak but also on heavy corporate supply with Intel (INTC) issuing a USD 6bn 5-parter after Apple's (AAPL) issuance on Monday. The Dollar was bid on its haven demand and supported by a weaker Euro from the impact on the EZ economy on a potential fallout with China. Oil prices primarily tracked risk ahead of the OPEC+ meeting on Wednesday where they are reportedly considering either a modest increase in oil production or maintaining output at current levels. Attention overnight will be heavily on any further US/Taiwan/China updates and China economic data.

GLOBAL

TAIWAN: US House Speaker Pelosi safely landed in Taiwan earlier this morning despite warnings from China who note the arrival goes against its One China policy, something that Russia agrees with noting the visit to Taiwan is a clear provocation and China has the right to take measures to protect its sovereignty. In response to the arrival, China announced it will definitely take all necessary measures to resolutely safeguard sovereignty and territorial integrity. China also announced military drills will be conducted from the 4-7th August around Taiwan, while the Eastern Military Command noted joint operations will commence around Taiwan from August 2nd in response to the visit. Taiwan then announced 21 PLA jets then entered the Southwest ADIZ while Chinese press reported exercises have started in three areas around Taiwan. The visit has intensified relations between China and the US, Global Times Editor Huxijin noted it has opened an era of high-intensity competition between China and the US. We are now also starting to see a follow on effect after reports that battery giant CATL is pausing its North American battery plant plans due to the Taiwan trip. The battery plant was set to supply batteries to Ford (F) and Tesla (TSLA) at a time when supply shortages are rife within the auto industry. White House's Kirby spoke in the evening where he noted the US is monitoring Pelosi's travel and has taken measures to ensure her safety, Kirby added China has positioned itself to take further steps and the White House expects China to react beyond Pelosi's trip, including by scheduling live fire exercises while other steps by China could include economic coercion. Kirby also noted the US will continue to operate in seas and skies of Western Pacific. House Speaker Pelosi is to meet with the Taiwan President Tsai at 22:30EDT Tuesday night/03:30BST Wednesday morning. Attention now lies on any potential further escalations from China.

FED: Daly (2024 voter) stated work on inflation is nowhere near almost done, and there is still a long way to go on that task. Meanwhile, Daly added she is looking at incoming data to decide if we can downshift rate hikes or continue at the current pace. On rates, Daly's modal outlook is we raise interest rates and hold them there for a while. Furthermore, on knockoff effects, she does not see a large increase in the unemployment rate coming up, but does note there are some layoffs as the economy rebalances. **Evans (2023 voter/departing)** said a 50bps rate hike is a reasonable assessment



for the September meeting, and 75bps is a possibility too if inflation does not improve. Moreover, Evans is still hopeful for 50bps in September and 25bps from there until Q2 2023. Further on rate, it sees a policy rate between 3.75-4% in 2023, which is in line with Fed's median view of 3.8% for 2023, but was above Powell's suggestion of 3-3.5%. Looking ahead, Evans added if we don't see an improvement in inflation over the next few months, we may have to rethink the rate path a little higher. **Mester (2022 voter)** stated she does not believe we are in a recession as we don't have a slowdown in labour markets. Regarding inflation, Mester said there is more work to do as she has not seen a turn in inflation and has not seen it cool at all. Continuing, she added she hasn't seen anything that suggests inflation is even levelling off yet and it is not going to come down quickly. Lastly, pockets of commodity prices are coming down but other parts of inflation, such as rents, are not good; might see inflation remain high in the services side of the economy. Overall, after the dovish reaction seen last week in wake of the July FOMC, the FOMC have been quite vocal and all are leaning towards a more hawkish outcome, including Kashkari on Friday night who was surprised by the markets reaction and also said a 75bp move again is possible, but he thinks 50bps would be reasonable, in fitting with Evans.

US JOLTS: US JOLTS for June fell for the third straight month to 10.698mln from the revised higher 11.303mln, and also printed beneath the expected 11.0mln. Oxford Economics note the labour market stayed extremely tight with layoffs holding steady at very low levels and quits held at 2.8%, 0.4ppt above its pre-COVID level. Further on the report, the ratio of job openings per unemployed - a key gauge of labour market tightness and one of the Fed's new favourite labour market indicators - declined to 1.8 but remained highly elevated. Elsewhere on the report, OxEco states, the openings rate pointed to cooler demand for labour as it fell to 6.6% (prev. 6.9%), but remained well above its pre-pandemic rate of 4.4%. As such, the easing in labour demand was broad-based across most industries though information, finance and insurance, education, and healthcare recorded higher job openings rates." Looking ahead, OxEco notes, labour market data in H2 '22 is expected to point to cooler employment dynamics. Oxford Economics looks "for the July employment [on Friday] data to show signs of easing labor market conditions". The consultancy expects a payroll gain of 260k jobs and the unemployment rate to remain steady at 3.6%. Finally, the consultancy adds "hot inflation, tighter financial conditions, downbeat business surveys and softer spending will weaken demand for labor."

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 1 POINT 7+ TICKS LOWER AT 120-04

Treasuries reversed lower as Pelosi landed safely, Daly affirms hawkishness, and corporate supply continues ahead of quarterly refunding. 2s +15.8bps at 3.067%, 3s +19.7bps at 3.022%, 5s +18.0bps at 2.848%, 7s +15.8bps at 2.817%, 10s +13.6bps at 2.741%, 20s +9.3bps at 3.211%, 30s +7.0bps at 2.995%. 5yr BEI -2.1bps at 2.783%, 10yr BEI -2.3bps at 2.480%, 30yr BEI -2.4bps at 2.217%.

THE DAY: Treasuries had been advancing into the APAC Tuesday session, seeing T-Notes hit session highs of 122-02 in the Tokyo morning, then hovering a few ticks beneath into the London session with a spree of 5yr future block buys keeping support. Selling picked up in the NY morning with a fresh slew of corporate IG supply being announced, including a five-part Intel (INTC) deal, hitting Treasuries due to rate-lock-related flows. The moves extended further after Fed's Daly (non-voter) pushed back on expectations of a Fed pivot, not to mention some sizeable put blocks in the belly adding flow-related pressure. The pick-up in risk assets as Pelosi landed safely in Taiwan hit bonds too as haven bids unwound; a chunky 2yr/Ultra 10yr steepener was blocked. T-Notes broke through Monday's lows of 120-27 as Europe closed shop, extending further into the NY afternoon to print a session low of 120-01+. Participants now look to Wednesday's quarterly refunding alongside ISM Services and Durable Goods/Factory Orders, no to mention Fed's Harker, Barkin, and Kashkari all on the schedule.

STIRS:

- EDU2 -5.0bps at 96.640, Z2 -12.5bps at 96.230, H3 -17.5bps at 96.340, M3 -20.5bps at 96.510, U3 -20.5bps at 96.720, Z3 -21.5bps at 96.860, H4 -23.0bps at 97.005, M4 -24.0bps at 97.140, U4 -24.5bps at 97.235, Z4 -24.5bps at 97.300, Z5 -19.5bps at 97.420.
- NY Fed RRP op. demand at USD 2.156tln (prev. 2.162tln) across 105 bidders (prev. 103).

CRUDE

WTI (U2) SETTLED USD 0.53 HIGHER AT 94.42/BBL; BRENT (V2) SETTLED USD 0.51 HIGHER AT 100.54/BBL

Oil prices were firmer Tuesday after bouncing with risk assets as Pelosi landed in Taiwan without incident. Meanwhile, the OPEC+ confab has got going after the JTC (technical committee) met Tuesday: reports suggested the JTC did not discuss production policy although the group forecasted the supply surplus on the global oil market in 2022 will be 0.8mln BPD, -200k BPD from the prior forecast. Participants now await the official OPEC+ meeting on



Wednesday ([full preview here](#)). On the topic, Bloomberg reported Tuesday that OPEC+ watchers doubt US President Biden's call for more oil will be fulfilled - not too surprising given the struggles of OPEC to ramp production, despite its efforts/quotas. More imminently, the private weekly US inventory data is due later Tuesday ahead of the EIA official print on Wednesday. On this, US Private Inventory Expectations (bbls): Crude -0.6mln, Distillates +1.0mln and Gasoline -1.6 mln.

RUSSIAN OIL: The G7 released a statement saying that nations are looking at a comprehensive prohibition of all services that enable transportation of Russian seaborne oil and petroleum products globally unless purchased at or below a price to be agreed by international partners. Said they would also consider mitigation measures alongside restrictive measures to ensure the most vulnerable and impacted nations maintain access to energy markets, including from Russia.

COMMENTARY: Marathon Petroleum (MPC) CEO said (post-earnings) that gasoline demand remained very resilient through the quarter in part due to the beginning of the summer driving season. The Co. noted that diesel demand, after a strong start to the year, softened a bit in Q2 due to lower trucking volumes. Noted that jet fuel demand continued its recovery, up nearly 20% Y/Y. Meanwhile, Williams Companies (WMB) said it is seeing record nat gas demand even with the Freeport shutdown.

EQUITIES

CLOSES: SPX -0.67% at 4,091, NDX -0.30% at 12,901, DJIA -1.23% at 32,396, RUT +0.18% at 1,886.

SECTORS: Real Estate -1.3%, Financials -1.07%, Industrials -1.05%, Materials -1.01%, Consumer Staples -0.74%, Consumer Discretionary -0.7%, Technology -0.69%, Health -0.37%, Utilities -0.22%, Energy -0.21%, Communication Services -0.18%.

EUROPEAN CLOSES: Euro Stoxx 50 -0.58% at 3,685; FTSE 100 -0.06% at 7,409; DAX -0.23% at 13,449; CAC 40 -0.42% at 6,409; IBEX 35 +0.15% at 8,096; FTSE MIB -0.35% at 22,351; SMI -0.32% at 11,109.

EARNINGS: **Caterpillar (CAT)** was lower after it beat on EPS but missed on revenue, as the co. noted sales were hurt by its exit from Russia, supply chain issues, and elevated costs. **Uber (UBER)** surged after it beat on revenue and announced it was cash flow positive for the first time. Although, UBER posted a much deeper loss per share than expected. **Pinterest (PINS)** surged after revenue marginally beat alongside MAUs also surpassing expectations. Moreover, it was confirmed that activist investor Elliott Management is now the cos. largest shareholder. Note, PINS fell short on EPS expectations. **Idexx Laboratories (IDXX)** was choppy on Tuesday following misses on the top and bottom line, alongside FY guidance way short of the expected. **Marriott (MAR)** saw slight gains after it surpassed St. consensus on EPS and revenue, alongside being optimistic about the financial outlook and strong cash generation. MAR expects to return over USD 2.2bln to shareholders through dividends and share repurchases. **Cummins (CMI)** firmed following beats on profit and revenue while it maintained FY22 guidance. **Marathon Petroleum (MPC)** was in the green in the wake of a very strong report, helped by the rise in oil prices. MPC also approved a 5bln share buyback programme. **Avis Budget (CAR)** topped St. consensus on profit and revenue as the co. said it benefited from strong demand and "stringent" cost controls. **Arista Networks (ANET)** gained following stellar earnings, highlighted by a beat on EPS and revenue alongside raising Q3 revenue view.

STOCK SPECIFICS: **Cowen (COWN)** is to be acquired by TD Bank for USD 39/shr in cash, according to Bloomberg. Note, COWN closed Monday at 35.49/shr. The US FAA adopted a new airworthiness directive for all **Boeing (BA) 777** craft, citing unsafe conditions on some products. **Tesla (TSLA)** is said to build its own recruiting software in a push to cut outside providers, according to The Information. **Unity (U)** is in talks to spin off its China unit to fuel its China expansion, according to Reuters sources; U has sought investors to join it in a business valued at USD 1bln. CATL reportedly paused its North American plant announcement due to Pelosi's Taiwan trip; the plant was up to USD 5bln and was going to supply **Ford (F)** and **Tesla (TSLA)**, according to Bloomberg. **Amazon (AMZN)** warehouses face expanded probes into safety hazards as investigators visit three more sites, according to CNBC.

FX WRAP

The Dollar rallied on haven demand in wake of the ongoing US/China tensions to see DXY rise from lows of 105.03 to highs of 106.25, while hawkish commentary from the Fed was also supportive. US House Speaker Pelosi arrived in Taiwan this morning which has intensified relations between the US and China as China believes it violates their One China policy. Meanwhile, Fed speak was hawkish. Mester (2022 voter) said she has not seen any signs that suggest inflation is even levelling off yet and inflation is not going to come down quickly. Daly (2024 voter) said the work on inflation is nowhere near almost done and there is still a ways to go on that task. Evans (2023 voter, retiring early 2023)



sees the policy rate between 3.75-4% in 2023 but warned if there is not an improvement in inflation within the next few months, they may have to rethink the rate path a little higher. He also believes 50bps is reasonable for September, but 75bps is also a possibility. However, he is still hopeful for 50bps in September before slowing to 25bps moves until Q2 23. Looking ahead, market participants eye further US/China rhetoric and NFP on Friday.

On Pelosi's visit, Desks note of potential haven flows into the Buck amid Pelosi's risky trip, with ING warning of potential shockwaves across FX markets: "The dollar, the yen (which may break below 130.00 already today) and CHF should be the main beneficiaries, while CNY and China-sensitive currencies (along with high-beta currencies in general) could come under pressure. Here, AUD and NZD appear mostly vulnerable in G10", ING says.

The Euro sold off to fall beneath 1.02 on the overnight risk concerns but it failed to rebound the initial equity bounce after the cash open. ING highlight that "any unwelcome development in China-US relationships would put pressure on EUR/USD, both because the safe-haven demand for the dollar would rise, and because the eurozone's export machine is highly reliant on China's demand."

Yen traded within a wide range with USD/JPY at 130.42 at the lows overnight as the Yen was initially bid on the intensified tensions but it did ease throughout the afternoon as Treasuries sold off heavily on hawkish Fed speak which resulted in JPY selling, particularly against the buck on the rate differentials. Gold prices were also choppy on the geopolitical risk matched with hawkish Fed speak with gold trading between USD 1,762/oz and USD 1,787/oz. CHF was bid against the Euro but not the Dollar while attention turns to Swiss CPI Wednesday morning, particularly in wake of last week's announcement that the SNB may take monetary policy measures at any time between regular assessment dates if it is required.

Activity currencies fell victim to the stronger buck, particularly the antipodes on their exposure to China on the rising US/China tensions to see AUD underperform. Aside from geopolitics, the RBA overnight hiked rates by 50bps as was expected while it also noted it is not on a pre-set course. Rabo Bank summarise "it would appear that the market has concluded that the move was a 'dovish hike' and that the tone of the RBA's guidance was less hawkish than expected." However, Rabo notes AUD has been one of the best performing currencies in recent weeks so a move lower in wake of the decision suggests a sell the fact reaction or a wave of profit taking. GBP was softer against the Dollar but firmed against the Euro while CAD was relatively flat against the stronger Dollar.

EMFX is generally weaker against the rising Dollar although CNH firmed both onshore and offshore despite the ramped up tensions between the US and China as relief was seen after Pelosi landed in Taiwan but did not result in an immediate response, although since then the PLA has started to conduct military drills. Elsewhere, LatAm FX was hit on the increased geopolitical tensions while BRL was also hit by disappointing industrial production numbers. ZAR also saw similar weakness to its EM peers while RUB firmed, even with Russia siding with China on Pelosi's visit.

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