US Market Wrap

18th August 2022: Dollar surges vs Euro and Pound after strong US data and Schnabel's warning for Europe

- **SNAPSHOT**: Equities up, Treasuries up, Crude up, Dollar up.
- **REAR VIEW**: Goldilocks Philly Fed and fall in jobless claims; Daly states 50 or 75bps reasonable for September while Bullard is leaning towards 75bps; ECB's Schnabel noted several indicators point to a de-anchoring of expectations; Putin hinted he could meet with Zelenskiy; German Chancellor Scholz said they intend to lower sales tax on gas to 7% (prev. 9%); KSS cuts FY EPS view; Strong EL report; QCOM plotting a return to the server market; US touted to provide Iran concessions.
- **COMING UP**: **Data**: UK Retail Sales **Speakers**: Fed's Barkin **Earnings**: Deere.

MARKET WRAP

Stocks were modestly firmer with a bias towards cyclical/value sectors amid a strong Philly Fed August survey and a surprise fall in initial jobless claims. That contrasted to Europe, where growth inflation pessimism was exacerbated by ECB's Schnabel noting inflation expectations are showing signs they could become unanchored and that even a recession might not stop inflation. The Dollar rallied particularly against the Euro and Pound despite the selling in EGBs and Gilts, with the currencies breaking through some key support levels. USTs ultimately bull-steepened (2s -9bps, 30s -1.5bps) in a choppy session with mixed Fed speak - Bullard, George, Daly, and Kashkari all spoke - further spreading the skew of Fed expectations to become more balanced, which already began after the FOMC minutes. In broad strokes, the Fed is establishing a framework to decide on what will warrant a decline in the degree of its tightening to get to a stage where it no longer needs to hike and can keep rates elevated "for some time", while markets appear to be getting ahead of themselves to focus on if/when rate cuts will occur, a notion that officials are trying to push back on whilst also laying the groundwork into the former. A tricky communications task.

US DATA

PHILLY FED: The Philly Fed was a stellar report, and also provided a positive contrast to the abysmal NY Fed survey earlier in the week. The headline index rose to +6.2 (exp. -5.0, prev. -12.3), marking the first positive print in three months, while prices paid fell to 43.6 (prev. 52.2) and prices received dropped to 23.3 (prev. 30.3). Highlighting the strength of the dataset, new orders rose to -5.1 (prev. -24.8), albeit still in negative territory but a marked improvement and employment jumped to 24.1 (prev. 19.4). Lastly, the looking ahead 6month index rose to -10.6 from -18.6. Pantheon Macroeconomics note, “the index is volatile, like all the subindexes, so we need to see further gains before we can be confident that the turnaround is real, but this is a welcome big move in the right direction.” Lastly, participants will be encouraged by the improved growth/employment metrics against reductions in both prices paid and prices received, unlike the Empire Fed which saw prices received remain stubbornly high.

JOBLESS CLAIMS: US initial jobless claims saw a surprise fall to 250k from the prior, revised lower, 252k; expectations were for another rise to 265k. Meanwhile, continued claims printed 1.437mln from 1.430mln, but more-or-less in line with the expected 1.438mln. Delving into the report, Oxford Economics notes, “the downside surprise is an encouraging signal that fears of broad-based layoffs have yet to materialize, but claims will continue to face upside risks through the rest of the year.” Furthermore, looking ahead, OxEco adds, “still, we doubt claims will accelerate sharply as labor demand remains well ahead of labor supply, while the outlook for the economy remains relatively positive despite elevated uncertainty regarding inflation and growth.”

EXISTING HOME SALES: US existing home sales fell in July to 4.81mln from 5.11mln, now at the slowest pace since May 2020, and beneath the expected 4.89mln. Looking at the inventory, the months' worth of supply rose to 3.3 from 2.9 in June. However, desks still anticipate further declines in sales given the degree to which mortgage rates have climbed. The speed at which the housing market continues to tumble will be something the Fed has on its radar, and it will be mindful not to create too fast a crash, something that could add to the pros in the debate for dialling down its hike increments.

FED

VOTERS: **Bullard (2022 voter)** stated he is leaning towards 75bps in September, and front-loading hikes in 2022 gives the Fed options in 2023. St. Louis President reiterated 3.75-4% year-end Fed rate call, via WSJ interview, and reiterated his view for an 18-month process of getting price pressures back to the Fed's 2% target (the Fed's median view in the June SEPs saw Core PCE troughing at 2.3% at 2024-end, while 2023-end median was seen at 2.7%, and the lowest 2023 estimate was 2.5%). **George (2022 voter)** noted the inflation number last month was "encouraging" but not time for a victory lap, while adding the easing of financial conditions may have been based on optimism that the Fed would slow down but that does not reflect how the Fed is thinking about policy. On rates, Kansas City President declared the case for rising rates remains strong and the pace will continue to be a matter of debate. As such, it is not clear where the stopping point for rate hikes will be, but the Fed will need to be "completely convinced" inflation is coming down.

NON-VOTERS: **Daly (2024 voter)** said it is way too early to declare victory on inflation, while on rates said 50bps or 75bp is reasonable for September but do need to get a little above 3.0% by end-2022, via CNN. Furthermore, Daly added the market has a lack of understanding, but consumers understand that rates won't go down right after going up, as if we raise, and hold, the strategy pays off. Lastly, San Fran President said she does not want to overdo policy and find we have tightened more than necessary (echoing the FOMC minutes), and does not want an unforced error. **Kashkari (2023 voter)** said we are getting some help on inflation from the supply side, and the Fed knows how to get inflation in check, but the question is can it do it without a recession. On a recession, Kashkari added he is not sure if the Fed can avoid a recession.

FIXED INCOME

T-NOTE (U2) FUTURES SETTLED 2+ TICKS HIGHER AT 118-27

Treasuries ultimately bull-steepened in a choppy session amid mixed Fed speak, strong US data, and dust settling from the FOMC minutes. 2s -6.6bps at 3.229%, 3s -3.6bps at 3.241%, 5s -2.0bps at 3.029%, 7s -1.7bps at 2.971%, 10s -1.3bps at 2.882%, 20s -1.5bps at 3.363%, 30s -0.5bps at 3.141%. Inflation breakevens: 5yr BEI +4.8bps at 2.798%, 10yr BEI +5.3bps at 2.529%, 30yr BEI +7.2bps at 2.323%.

TOKYO/LONDON: T-Notes were bid into the APAC Thursday session, but couldn't hold their own above 119-00, in follow through from the FOMC minutes Wednesday. Citi's rates desk said it saw bidding emerge on US-China-Taiwan tensions and a weaker than expected Australian jobs report. On an aside, it's worth highlighting that the latest Japanese MoF data saw the key market cohort's 4-week average flow flip to net buying for the first time since early this year. Anyway, as the London session got going better selling was seen in wake of ECB's Schnabel who warned of inflation expectations potentially becoming unanchored and that a recession alone was not enough to stop inflation. In sympathy from EGB selling, T-Notes made session lows of 118-18 before recovering through the European morning.

NEW YORK: Bull steepening developed into the NY handover with desk citing continued momentum to the balanced Fed minutes. The buying sustained into the US data to see T-Notes hit session highs of 119-07+. Selling began after the Goldilocks Philly Fed report (offsetting the dismal Empire survey earlier this week) and the fall in initial jobless claims. The pullback was accentuated by block sales in the 2yr and ultra 10yr futures. But the downside was capped as Fed's Daly spoke soon after, giving mixed comments, simultaneously pushing back on any Fed easing expectations whilst also expressing caution not to overtighten (similar to the FOMC minutes). It wasn't until Europe started to depart that Treasury selling could resume, bringing T-Notes gradually back towards session lows ahead of settlement, no doubt taking some cues from the crescendo in oil prices. The super-strong 30yr TIPS auction had little broader impact.

REFUNDING: US to sell USD 44bln of 2yr notes on Aug 23rd; USD 45bln of 5yr notes on Aug 24th; USD 37bln of 7yr notes on Aug 25th; all to settle on Aug 31st. Also to sell USD 22bln in 2yr FRN reopening on Aug 24th, settling on Aug 26th.

STIRS:

- EDU2 -0.3bps at 96.66, Z2 +3bps at 96.105, H3 +4.5bps at 96.09, M3 +4.5bps at 96.17, U3 +4.5bps at 96.365, Z3 +4bps at 96.535, H4 +3.5bps at 96.71, M4 +2.5bps at 96.850, Z4 +1.5bps at 97.06, Z5 +0.5bps at 97.31.
- Options flow was much more muted Thursday after the heavy put closing earlier this week, although Wednesday's open interest report saw a c. 10k SR3Z3 93.00/94.00/95.00 put fly opened, which targets 6% Fed rate by Dec'23.
- US sold USD 58bln of 1-month bills at 2.150%, covered 2.53x; sold USD 53bln of 2-month bills at 2.490%, covered 2.77x.
- NY Fed RRP op. demand rises to USD 2.218tln from 2.199tln.

CRUDE

WTI (U2) SETTLED USD 2.39 HIGHER AT 90.50/BBL; BRENT (V2) SETTLED USD 2.94 HIGHER AT 96.59/BBL

Oil prices climbed through the session Thursday amid a cocktail of geopolitical/supply risk, strong US data, and OPEC jawboning, despite the big bid for the Dollar. The upside momentum in oil began in the European session, aided by geopolitical tension around a potential incident at the Zaporizhzhia nuclear plant in Ukraine, but also on the demand side after Chinese President Xi gave rhetoric around China's efforts to open up the domestic economy. The upside was all the more impressive given the ascent in the Dollar index. Meanwhile, bullish reaffirmations by the OPEC Sec-Gen added support, noting fears of a Chinese slowdown have been taken out of proportion and that physical demand is robust. The strong Philly Fed survey only supported the demand side. Meanwhile, supply risk was exacerbated amid Shell (SHEL LN) announcing it had reduced production at its Rhineland facility due to too low water levels on the river Rhine.

EQUITIES

CLOSES: SPX +0.26% at 4,285, NDX +0.26% at 13,505, DJIA +0.06% at 34,000, RUT +0.44% at 1,996.

SECTORS: Energy +2.53%, Technology +0.49%, Utilities +0.34%, Industrials +0.33%, Materials +0.26%, Consumer Staples +0.25%, Financials +0.13%, Communication Services -0.04%, Consumer Discretionary -0.04%, Health -0.43%, Real Estate -0.75%.

EUROPEAN CLOSES: Euro Stoxx 50 +0.57% at 3,777; FTSE 100 +0.35% at 7,541; DAX +0.52% at 13,697; CAC 40 +0.45% at 6,557; IBEX 35 -0.05% at 8,430; FTSE MIB +1.00% at 22,985; SMI +0.35% at 11,167

EARNINGS: **Cisco (CSCO)** was firmer after it beat on EPS and revenue, while next Q revenue view also surpassed expectations as supply chain issues ease. Moreover, CEO noted FY product orders and backlog are at record highs. **NetEase (NTES)** beat on profit and revenue, alongside raising quarterly dividend to 0.36/shr. **Synopsys (SNPS)** topped on EPS and revenue, while looking ahead, Q4 guidance topped expectations alongside raising FY outlook. **Estee Lauder (EL)** surpassed St. consensus on the top and bottom line, but Q1 guidance was light. The co. noted it enters its fiscal year during a volatile period of record inflation, supply chain disruptions, strengthening dollar, risk of a slowdown in many markets globally, and with a strong headwind from the August 2022 COVID-19 restrictions in Hainan. **Keysight Technologies (KEYS)** gained following a strong report, highlighted by beating on EPS and revenue alongside raising Q4 guidance. **Kohl's (KSS)** fell after it significantly cut its FY adj. EPS view due to higher costs. Additionally, the co. noted results were impacted by a weakening macro environment, high inflation, and dampened consumer spending, which pressured middle-income customers. Note, it did beat on EPS and revenue. **Wolfspeed (WOLF)** surged after it posted a shallower loss per share than expected and beat on revenue. Also, next Q EPS and revenue view topped expected and it sees its longer-term 2026 revenue outlook up 30-40% from the prior forecast.

STOCK SPECIFICS: **Phillips 66 (PSX)** offered to acquire the public units of **DCP Midstream (DCP)** for USD 34.75/shr in a deal that would value the pipeline operator at USD 7.2bln deal and bulk up Phillip's natural gas liquids business. Ryan Cohen's RC Ventures filed to sell its entire 11.8% stake of 7.78mln shares in **Bed Bath & Beyond (BBBY)**, according to a filing. **Snapchat (SNAP)** ceased development of Pixy flying selfie camera, according to WSJ. **Qualcomm (QCOM)** plots a return to the server market with a new chip, according to Bloomberg sources. White House is planning for an end to its practice of paying for COVID-19 shots and treatments, shifting more control of pricing and coverage to the healthcare industry, according to WSJ. **Tesla (TSLA)** confirmed its plan to launch an electricity retail business in Texas, according to Electrek.

FX WRAP

The Dollar was firmer on Thursday and sustained upside in the NY afternoon to print highs of 107.570 as there appeared no stopping Dollar bulls. This came as participants leant towards a "there is no alternative" stance to the US currency's high rates, safety, and liquidity, even as the aggressiveness of further Fed tightening has become more data-dependent. Additionally, after key levels in EUR/USD and Cable were breached Dollar buying ensued. Nonetheless, the Greenback got a lift from goldilocks US data, which consisted of a stellar Philly Fed report, highlighted by the headline index residing in positive territory for the first time in three months, and also provided a positive contrast to the abysmal NY Fed survey earlier in the week, as well as a lower than forecast initial jobless claims. Additionally, there was a slew of Fed speak, with highlights from Bullard (2022 voter) who said he is leaning towards 75bps in September and reiterated that it's an 18-month process of getting price pressures back to the Fed's 2% target. Kashkari, Daly, and George all spoke as well. Looking ahead, there is little on the calendar for Friday aside from Fed's Barkin (2024 voter) .

GBP and **EUR** were the G10 underperformers, as both were hindered after key levels were breached in their respective crosses on the back of the Dollar strength. On this, EUR/USD breached two key levels, firstly, a key fib and July 28th low at 1.0112 and then 1.0095 to lows of 1.0081, while Cable printed a fresh session low of 1.1924, and saw one-way traffic after it broke under July 25th low of 1.1962. As such, techs note the next support is July 21st low of 1.1891, with bears eyeing 2022 low of 1.1761. The Pound appeared to slide as the gains seen in the crude complex exacerbate global inflation and recession fears, which the UK appears highly exposed to currently, ahead of UK consumer confidence and retail sales on Friday. Meanwhile, the single-currency was hindered as EGBs continued to reflect on hawkish ECB rhetoric, mainly from Schnabel, who said concerns over inflation have not changed since July's policy meeting and several indicators point to a de-anchoring of expectations. Schnabel also warned that a recession would likely not be enough to stop inflation. The losses came despite the improved yield differentials (vs the Buck) for the Pound and Euro, with concerns over growth/inflation seemingly in the driving seat.

Safe-havens, CHF and JPY, saw losses against the Buck and faltered on the back of Dollar strength, as opposed to anything currency specific. USD/JPY grinded higher throughout the NY afternoon to a high of 135.90, but the Yen defended 136.00. For the Swissy, USD/CHF breached the pivotal 0.9550 mark, to a peak of 0.9571 which comes ahead of Japanese inflation data and Swiss industrial production, respectively.

Activity currencies, CAD, AUD, and NZD, all saw similar losses and were unable to resist the broader Dollar strength. The Loonie came off lows, aided by the rebound in oil prices, whilst for the antipodeans, a recovery in broad risk sentiment rather than anything specific helped the Aussie and Kiwi regain some poise after heavy losses in wake of a conflicting labour market report and RBNZ policy meeting that should have impacted in theory. However, whilst AUD /USD and NZD/USD rebounded well off lows, heading into the close the antipodeans trundled back towards them as Dollar bull momentum sustained. Looking ahead, the New Zealand trade data and Canadian retail sales loom on Friday.

EMFX was predominantly lower vs the Buck, aside from the RUB which was the notable outperformer. Elsewhere, TRY saw losses after the CBRT unexpectedly cut rates by 100bps in the face of 80% inflation, which and Goldman Sachs now sees rising to over 90% before falling to over 75% by year-end amid base effects, but stressed substantial upside risk to its inflation forecast in Turkey. ZAR was hit, while local press suggested South Africa's Finance Minister Godongwana will step aside if he is charged. Meanwhile, the BRL was not helped by BCB chief Neto declaring that the Bank's work is nearly done in contrast to the CNH/CNY that pared some losses from lows after reports of property loan probes and speculation that the PBoC may trim LPRs to shore up the troubled sector.