US Market Wrap

7th September 2022: Stocks and bonds bounce while Dollar falls in relief risk rally

- **SNAPSHOT**: Equities up, Treasuries up, Crude down, Dollar down.
- **REAR VIEW**: WSJ's Timiraos gives nod to 75bps Fed hike; Fed's Brainard, Mester, Barr, and Collins all stick to script; EU announces Russian gas price cap proposals; BoC hikes 75bps as expected; soft trade data for both the US and China .
- **COMING UP**: Data: Japanese Final GDP, Australian Trade Balance, US IJC. Events: ECB Announcement. Speakers: RBA's Lowe, ECB's Lagarde, Fed's Powell, Evans, Kashkari, BoC's Rogers.

MARKET WRAP

Stocks rallied through the NY session on Wednesday in a lack of major catalysts. There was a bias to the higher risk stocks with the Nasdaq-100 and Russell 2k outperforming. Tech stocks were aided by the bounce back in Treasuries (10yr yield -7bps) while the export-sensitive small cap index enjoyed the broad selling of the Dollar - note international trade data saw a big deficit decline as expected. Energy was the only sector in the red, with oil prices making fresh post-Ukraine lows in the backdrop of fresh EU price cap proposals and China lockdowns, despite the softer buck and risk asset bounce. Airlines prospered on the cheaper oil price outlook whilst also benefitting from some positive commentary from United (UAL) and American Airlines (AAL). Fed's Brainard, Mester, Barr, and Collins all spoke, although all avoided giving specifics on the rate path, saying they won't make a decision on the hike increment until the meeting. Money markets ramped their implied pricing of a 75bps September hike to 80%, particularly after WSJ's Timiraos, an in-the-know, penned an article saying a 75bps hike appears most likely. Meanwhile, the BoC hiked 75bps as expected, signalling more hikes to come. Euro saw gains ahead of the ECB decision Thursday, while Sterling was flat amid a lack of take-up on 75bps hike talk (for next week) from BoE speakers today.

FED

Vice Chair Brainard noted rates will need to rise further and policy will need to be restrictive for some time. She needs to see several months of low inflation readings to be confident inflation is moving down to 2% but how long it takes to get back to target will depend on a combination of continued easing in supply constraints, slower demand growth, and lower markups, against the backdrop of anchored expectations. She added a higher policy rate and balance sheet reduction should help bring demand into alignment with supply. On the economy, she said labour demand continues to show considerable strength and says that is hard to reconcile with the downbeat tone of economic activity. Looking ahead she suggested it may take some time for the full effect of tighter financial conditions to work through the economy, and at some point in the tightening cycle, risks will become more two-sided. Brainard also warned the speed of the tightening cycle and its global nature, as well as uncertainty around the pace at which tighter financial conditions are working through demand, create risks associated with overtightening.

Mester (2022 voter) repeated what she said last week but also spoke on the August jobs report, where she said they are beginning to see some moderations but labour market conditions remain strong. She noted it is better for markets to focus on the path of interest rates rather than one particular meeting and she will decide her preferred magnitude of hikes at the September meeting. On inflation, she is not convinced inflation has peaked yet and wage growth is still above what is consistent with 2% inflation. On the balance sheet, she reiterated her call to contemplate selling MBS and she is more focused on whether balance sheet reduction will impact liquidity in markets rather than the impact on the FFR.

Collins (2022 voter) said inflation is "simply too high"; it is premature to predict the Fed's policy decision ahead of the September FOMC. She added the Fed has raised rates significantly, and there is more to do.

Vice-Chair of Supervision Barr said the Fed is conducting a "holistic" review of capital tools and will inform adjustments, if any, to the supplementary leverage ratio, countercyclical capital buffer, and stress tests.

BoC

The Bank of Canada hiked rates by 75bps as expected (down from its max hiking pace of 100bps) taking its overnight rate to 3.25%, above the BoC's estimate of neutral between 2-3%. The guidance saw little changes where it reiterated that further hikes will be necessary to bring inflation to target, implying the BoC is not done yet and will move even further into restrictive territory. There was little reaction to the rate decision and markets still imply a terminal rate of around 3.8% (implying an overnight rate of either 3.75% or 4.00%). The Canadian central bank was quite vague with its guidance and just noted that future rate moves will be assessed by how much more is needed to bring inflation to target - most likely implying a data-dependent approach on a meeting-by-meeting basis. Analysts at RBC expect one more 25bp hike in October but noted today's meeting suggests there is upside risk to its call for peak rates at 3.50%. Meanwhile, ING is expecting the policy rate to hit 4% by year-end, more aggressive than current market pricing but they are also looking for rate cuts in late 2023 as the economy slows, meanwhile RBC expect a mild recession in 2023. On inflation, the BoC acknowledged the rise higher in the July Core CPI measures while noting surveys suggest short-term inflation expectations remain high, and the longer this remains high, the larger risk of elevated inflation becomes entrenched. It also recognised the drop in headline CPI was primarily due to gas prices and data indicated a further broadening of price pressures, particularly in services. Growth in the Canadian economy was somewhat weaker than the BoC expected but it highlighted that indicators of domestic demand were very strong. Looking ahead, it continues to expect the economy to moderate in H2 22 as global demand weakens and tighter policy in Canada starts to bring demand more in line with supply. On housing, it also acknowledged the housing market is starting to pull back as expected.

ECB Preview

Up until a few weeks ago, expectations for the September meeting had been coalescing around the prospect of an additional 50bps hike by the ECB, taking the deposit rate to 0.5%. However, a source report on 26th August revealed that some policymakers wish to discuss a 75bps rate rise due to the deterioration in the inflation outlook, with the prospect of a looming recession not a justification for slowing or halting policy normalisation. Thereafter, a speech by Germany's Schnabel reinforced the Governing Council's tightening ambitions by noting that both the likelihood and the cost of current high inflation becoming entrenched in expectations are uncomfortably high, and she added that central banks need to act forcefully in this environment. August HICP data saw the headline rate climb to 9.1% Y/Y from 8.9%, and the super-core metric advance to 4.3% Y/Y from 4.0%, prompting concerns that second-round effects from energy inflation are making their way through the economy. Accordingly, the likes of Goldman Sachs, Credit Suisse, BofA, JPM and several others adjusted their calls in favour of a 75bps move, an outcome that markets are currently assigning with an approximate 95% probability. Looking further ahead, markets are pricing just under 175bps of tightening by year-end (including September). Elsewhere, aspects of the Q&A will likely focus on the ECB's plans for its APP reinvestments after reports suggested that it could begin discussing ending reinvestments, albeit a decision is not expected to be forthcoming with rates viewed as the preferred tool for tightening. The accompanying staff economic forecasts will likely see upward revisions to the 2022 and 2023 inflation projections of 6.8% and 3.5% respectively, with Morgan Stanley pencilling in an upgrade to the 2024 forecast of 2.1% to 2.2%. From a growth perspective, 2022 GDP is expected to forecast trivially higher at 2.9% vs. 2.8% in June, with 2023 growth expected to be cut to 0.4% from 2.1%. To download the full report, please click here.

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 18+ TICKS HIGHER AT 116-05+

Treasuries pared recent losses on Wednesday in sympathy with EGBs/Gilts, with oil sold, ahead of Powell's speech Thursday. 2s -5.6bps at 3.445%, 3s -7.1bps at 3.497%, 5s -7.8bps at 3.365%, 7s -7.4bps at 3.350%, 10s -6.9 bps at 3.271%, 20s -7.9bps at 3.670%, 30s -6.8bps at 3.415%. Inflation breakevens: 5yr BEI -5bps at 2.622%, 10yr BEI -2.7bps at 2.462%, 30yr BEI -1.3bps at 2.387%.

THE DAY: T-Notes were rangebound through the APAC Wednesday session with softer than expected Chinese trade balance for August the highlight in the region. There was a bid out of EGBs and Gilts in the London morning that spilt over to Treasuries, seeing a slew of block buys in the T-Note (Z2) contract. The bidding extended to new highs as US players arrived. Data was on the thin side with the decline in the US trade deficit in July the highlight, although the large fall was expected. Meanwhile, there was some chop after Nick Timiraos at the WSJ noted a 75bps hike looks likely ahead of the September FOMC, although the bid for Treasuries extended, bolstered by the tumble in oil prices to new post-Ukraine lows. There was no follow-through after the BoC hiked 75bps, as expected, while neither Fed's Mester, Barr, Collins, or Brainard rocked the boat with their remarks either. T-Notes ultimately printed session highs in late trade at 116-07+.

STIRS:

- EDU2 -0.5bps at 96.58, Z2 flat at 95.865, H3 +3.5bps at 95.865, M3 +6.5bps at 95.94, U3 +7.5bps at 96.11, Z3 +8.5bps at 96.28, H4 +9bps at 96.46, M4 +9bps at 96.595, Z4 +9.5bps at 96.745, Z5 +10bps at 96.84.
- There was a massive amount of October Fed Funds traded on the WSJ Timiraos article, with 75bps now 80% priced vs 50% before this week.
- US sold USD 30bln of 119-day CMBs at 3.195%, covered 3.63x.
- NY Fed RRP op. demand at USD 2.207tln (prev. 2.189tln).

CRUDE

WTI (V2) SETTLED USD 4.94 LOWER AT 81.94/BBL; BRENT (X2) SETTLED USD 4.83 LOWER AT 88.00/BBL

Oil prices extended lower to fresh post-Ukraine lows on Wednesday in the backdrop of fresh EU price cap proposals and China lockdowns, despite a softer Dollar and risk asset bounce. Desks continue to point to overarching concerns over global growth, accentuated by ongoing China COVID restrictions and Europe's woes, despite the OPEC+ production cut announcements earlier this week. Note that there was a brief bounce in the benchmarks earlier in the session amid Russian President Putin threatening to cut off all energy products, abandoning current contracts, in the event the EU adopts a price cap on Russian gas, although that soon unwound. Traders now look to the weekly inventory data with the private release due later Wednesday ahead of the day-delayed EIA figures on Thursday. Current expectations (bbls): Crude -0.3mln, Distillates +0.5mln, Gasoline -1.7mln.

EU CAP: An EU statement announced impending proposals for a mandatory target for lower electricity use at peak hours, caps on Russian gas, caps on revenues for companies producing electricity at low costs. The touted proposals also include a "solidarity contribution" from fossil fuels companies. Meanwhile, they will provide liquidity support for energy utility companies and update the temporary framework to enable state guarantees to be delivered rapidly. There is naturally scepticism on the implementation of these measures, highlighted by Reuters noting Italy is proposing any price caps on gas should be applied to all transaction switch delivery at EU hubs and not just to imports from Russia. This all comes ahead of the energy minister summit on Friday.

US PRODUCTION: Chevron (CVX) believes oil demand will be "pretty good" going forward, despite short-term challenges in China and Europe. Oilfield services major, Schlumberger (SLB), said international oil and gas activity growth could outpace North America going forward, but said North American oil activity is growing at a faster pace than expected. It said customers are more worried about securing capacity and operational performance than recession. Pioneer (PXD) said total US oil production is less than people are expecting.

OPEC+: Nigeria's Oil Minister said the country is looking at increasing gas supplies to Europe, adding that Nigeria has a lot of reserves and wants to take advantage of the high prices in Europe. The official also does not believe oil prices are too high but said USD 80/bbl is optimal. Elsewhere, Saudi Energy Minister, when asked about an oil price range by Energy Intel, said OPEC+ does not target prices or price ranges and its aim is to support market stability.

EQUITIES

CLOSES: SPX +1.84% at 3,980, NDX +2.07% at 12,259, DJIA +1.40% at 31,581, RUT +1.66% at 1,822.

SECTORS: Utilities +3.14%, Cons Disc +3.08%, Materials +2.73%, Communication Svs +2.05%, Financials +2.02%, Real Estate +1.92%, Cons Stpl +1.77%, Health +1.67%, Industrials +1.63%, Technology +1.59%, Energy -1.16%.

EUROPEAN CLOSES: EURO STOXX 50 +0.06% at 3,502, FTSE 100 -0.86% at 7,238, DAX 40 +0.35% at 12,916, CAC 40 +0.02% at 6,106, FTSE MIB +0.04% at 21,489, IBEX 35 +0.17% at 7,856, SMI -0.27% at 10,805.

APPLE EVENT: As expected, Apple (AAPL) announced the new iPhone 14, Apple Watch Series 8 and the 2nd Generation Air Pods pro. It also announced a satellite feature on its new iPhone and partnered with Globalstar (GSAT) - as was touted last week by TF International Securities Analyst Ming-Chi Kuo. For a full summary of the event, please click here.

AIRLINES: United Continental Holdings (UAL) stated capacity is trending higher than expected; adj. operating margin is expected to improve to 10.5% in Q3 2022 vs Q3 2019. It is seeing strong demand in September; considering retirement plans for its oldest widebodies. Expect to continue to see strength in demand in Q4 and next year. Corporate bookings are down vs 2019, revenue is actually in line or higher than 2019 as yield has gotten stronger. American Airlines (AAL) announced its guidance in Q2 still holds today. Added that as we get past Labor Day, leisure bookings still remain strong. Their transatlantic revenue performance exceeded 2019 levels and business bookings remain strong. IATA announced the passenger recovery is gaining momentum; jet oil prices are still very elevated and will put pressure on the airline cost base for the rest of the year. Also said China saw strong M/M improvement vs June.

STOCK SPECIFICS: **Intel Corp. (INTC)** announced there are no current plans to establish a manufacturing presence in India. **Meta's (META)** Instagram intends to drastically scale back its shopping features as it refocuses its efforts on features that directly drive advertising, according to The Information. **Tesla (TSLA)** shortened its delivery waiting time for its Model 3 and Model Y in China. **Netflix (NFLX)** is targeting cost cuts across the Co., imposing more financial discipline as subscriber growth stagnates, according to WSJ. **Chevron (CVX)** CEO said its USD 15bln share buyback can be sustained for multiple years; the intent is for excess balance sheet cash to be returned to shareholders. **Newell Brands (NWL)** lowered its outlook; Exec said it experienced a significantly greater than expected pullback in retailer orders and continued inflationary pressures on the consumer, and adjusted its expectations accordingly. **Apple (AAPL)** suppliers have been caught up in the Chengdu COVID lockdown extension, according to Nikkei. **Coupa Software (COUP)** beat on EPS and revenue and announced a USD 100mln buyback while EPS guidance was above expectations and its revenue outlook was more or less in line. **Nio (NIO)** posted a deeper loss per share than expected but revenue was marginally above expectations, although guidance was weak. **Peloton (PTON)** announced it received notice from the CPSC that agency staff believe the co. failed to meet statutory obligations under the consumer product safety act, with potential fines to be expected. **Lockheed Martin (LMT)** F-35 deliveries were temporarily halted over China alloy concerns, according to Bloomberg citing the Pentagon. **Kohl's (KSS)** expects supply chain issues centred around footwear to continue to improve in the back half of the year but not normalised until the beginning of 2023. The **Spotify (SPOT)** CEO is calling on the EU to speed up its antitrust case against **Apple (AAPL)**, according to FT. **Snapchat (SNAP)** CEO memo said Co. aims to grow user base by 30% to 450mln by 2023-end; aims to boost revenue by 20% to USD 6bln by 2023 (exp. 5.26bln), The Verge reported.

FX WRAP

The Dollar was sold Wednesday from its peaks alongside the fall in Treasury yields and recovery in risk appetite. The DXY had actually printed a new high of 110.79 in the European session, with risk assets struggling earlier on, only to reverse lower as the US session got going and Treasury strength extended while risks assets also staged a strong revival. There was little data, with US international trade the 'highlight', which saw a big trade deficit decline as expected. Meanwhile, Fed pricing for a 75bps September hike moved to 80% implied probability (vs 50% entering the week) after WSJ Timiraos noted a 75bps hike looks likely. Fed speak Wednesday saw Brainard, Mester, Barr, and Collins, although all avoided giving specifics on the rate path, saying they won't make a decision on the hike increment until the meeting. Powell is up next on Thursday.

The Euro was ultimately firmer amid the broader Dollar sell-off, with the currency benefitting from the risk appetite and fall in oil prices. EUR/USD was initially hesitant to bounce too far from its Tuesday cycle trough of 0.9862, although as the buck selling gained momentum, strength saw the cross bounce to highs at parity. The moves come ahead of the ECB rate decision Thursday (full preview here), while the EU Commission has announced proposals for price caps on Russian gas and restrictions on energy usage in the bloc ahead of the energy minister summit on Friday.

The Yen was sold to new lows against the buck despite the bounce higher in USTs and official jawboning. USD/JPY made a new peak of 144.98, just shy of the big round figure that has elicited speculation on whether it's guarded by official FX intervention. The cross pared somewhat into the latter session as the Dollar pared. Note former MoF FX chief Watanabe said there is no need for Japan to intervene in the currency market as current moves are driven by broad Dollar strength (of course that looks past the increasingly isolated/dovish policy stance of the BoJ).

The Swissy made some ground amid the buck sell-off, seeing USD/CHF trough at 0.9769, failing to run past Tuesday's low of 0.9763. The decline in European gas prices likely supported the currency also. Note Swiss unemployment data is due Thursday with the adj. August rate expected to remain unchanged at 2.2%.

The Antipodeans were supported on the improved risk tone with stocks rallying while the Dollar pared off recent YTD highs. Both AUD and NZD saw similar gains vs the buck with AUD/NZD flat on the session. Australian GDP data was mixed, with the Q/Q rising 0.9%, a touch beneath the 1% expectation but acceleration from the prior 0.8% while the Y/Y metric rose 3.6%, above the 3.5% expectation and the prior 3.3% - Attention now turns to commentary from RBA Governor Lowe Thursday. AUD/USD tested 0.6700 to the downside before rebounding, similar to NZD/USD on the 0.6000 handle ahead of NZ manufacturing sales Thursday for some independent impetus.

The Loonie was relatively unchanged vs the Dollar after the latest Bank of Canada rate decision, which overall was hawkish by hiking rates by 75bps as expected and signalling more rate hikes are to come, taking rates deeper into restrictive territory while acknowledging a broadening of price pressures and the upside in core inflation while the cooling headline CPI was led by declines in gasoline prices. Markets still imply a terminal rate of around 3.75% from the BoC while analysts at ING expect rates to peak at 4.00% before cutting next year. USD/CAD tested a double top around 1.3205-08 before rejecting the level several times on Wednesday.

The Pound was also flat vs the Dollar but much weaker vs the Euro. Cable did briefly hit multi-decade lows at 1.14 before a rebound in risk appetite throughout the UK afternoon and evening helped take Cable off lows back to c. 1.1500. The downside in GBP beforehand was led by several BoE speakers who dialled back hawkish rate hike expectations with no one alluding to a 75bp hike next week, even Mann didn't after earlier commentary during the week suggesting it is an important consideration.

The Scandis were weaker vs the Euro, but NOK underperformed on tumbling Brent prices while SEK found some support after Nordea announced they expect Riksbank to hike by 75bps in September and November.

EMFX was mixed: Real was flat vs the Dollar while the Peso firmed. In Mexico, Banxico's Espinosa spoke where she said the bank will watch the Fed in the coming months but does not mechanically follow the Fed rate. CLP saw gains despite the deficit in its trade balance and slowing copper exports as it benefitted from the risk tone and the backdrop of optimism from earlier in the week after voters rejected the new constitution, which would have been a sharp shift from its market-friendly constitution. The Lira was flat while the Ran saw mild gains, in fitting with gold prices which reclaimed USD 1700/oz. CNH was flat while CNY was softer vs the Dollar on ongoing COVID concerns on further lockdowns in Chinese cities while China trade data disappointed, posting a narrower surplus than expected with both slower than expected imports and exports.