US Market Wrap

3rd October 2022: Stocks and Bonds rally as aggressive Fed hike bets pare after soft data

- **SNAPSHOT**: Equities up, Treasuries up, Crude up, Dollar down.
- **REAR VIEW**: Weak ISM manufacturing data; UK Government will not move forward with abolishing the 45p top tax rate; Credit Suisse woes; OPEC sources say OPEC+ considering cuts in excess of 1mln BPD; Fed's Williams repeated inflation is too high & job is not done; TSLA Q3 deliveries short of expected.
- **WEEK AHEAD PREVIEW**: Highlights include: RBNZ, RBA, OPEC+, US and Canadian Jobs Reports. To download the report, please click here.
- **CENTRAL BANK WEEKLY**: Previewing RBA, RBNZ, ECB Minutes. To download the report, please click here.
- **COMING UP**: **Data**: US Factory Orders **Event**: RBA Policy Announcement **Speakers**: Fed's Williams, Logan, Daly, Mester, Jefferson; ECB's Lagarde, UK Chancellor Kwarteng **Holiday**: China **Supply**: UK & Germany.

MARKET WRAP

Stocks and bonds were bid on Monday after the September decimation for both assets, perhaps on oversold conditions but there are also murmurings of investors bracing for a Fed pivot - although this is very speculative, but the US data on Monday was also weaker than expected. Fed speakers have noted they are keeping an eye on events abroad and the potential impact it has on the US, although Fed Vice Chair Brainard on Friday did stress she is committed to avoiding pulling back prematurely while Williams noted inflation is far too high and the Fed's job is not done. The talk of a Credit Suisse collapse has led to a jump in the Credit Suisse CDS and a tumbling share price, exacerbating these concerns despite pushback from management but nonetheless adding to woes about financial stability. Meanwhile, in the UK, the government has decided to walk back its tax cut for the highest earners, which led to strength in GBP and Gilts, which followed over to US Treasuries, but it is maintaining the rest of its support package amid rising energy costs. Also, Monday's BoE buyback operation only accepted GBP 22.1mln which took Gilts lower from their highs while UBS believe the low acceptance is a message from the Central Bank that it does not look like we are still in the middle of a crisis. Back in the US, data was disappointing with the ISM Manufacturing PMI missing expectations falling to 50.9 from 52.8 while the Employment unit tripped into contractionary territory ahead of Friday's September NFP report while New Orders also fell sub-50. Meanwhile, the Prices Paid component eased slightly, a welcome sign. The signs of declining activity and employment and slowing prices would help support the case for the Fed to slow their aggressive rate hikes and thus sparked a dovish reaction across markets with the Dollar being sold while investors bought bonds, stocks and gold. Construction spending also declined by more than expected. There is still the Services PMI on Wednesday ahead of the NFP report Friday, but there will still be a lot of attention on the inflation metrics (Oct 13th for CPI, Core PCE Oct 28th)for September ahead of the Fed's November rate decision and for a gauge on the Fed's peak FFR which has eased recently to imply a peak in March 2023 between 4.25-4.50%.

GLOBAL

UK: The UK government confirmed reports it will not go ahead with the abolition of the 45p rate of income tax but they are committed to borrowing extra over the winter to help with the ongoing energy crisis. UK PM Truss said that they would be in serious trouble on the economy if they hadn’t acted and that they also needed to act on other areas of taxation to make sure that the economy did not slow down any further. The Chancellor told BBC the proposal was "drowning out a strong package", which includes support for energy bills, cuts to the basic rate of income tax, and the scrapped increase in corporation tax. The reaction to markets on the U-turn saw a bid into both Gilts and GBP helping the Pound hit a high of 1.1334 against the buck while the 10yr Gilt yield fell sub 4.00%. Rabobank however wrote the "pound is far from out of the woods" and maintains a 3-6mth GBP/USD target of 1.04 and in their view, remains a very vulnerable currency. When the chancellor was asked whether there was more to come on taxes, he said there would be no tax cuts ahead of the Spring budget but we look for more details in the full budget later this month. The date of the budget has been bought forward, according to FT, from November 23rd after criticisms the original date was too far away and there were calls for it to be released before the next Bank of England rate decision on November 3rd. Meanwhile, the latest BoE buyback operation only accepted GBP 22.1mln worth of Gilts but reconfirmed the operations are still scheduled to end on October 14th. Analysts at Rabo note this will leave the market exposed to the weight of extra gilt issuance during the coming fiscal year and it comes ahead of the BoE's planned QT operations from the end of October.

GEOPOLITICAL: Footage was seen over the weekend which showed a Russian convoy transporting equipment for Russia's nuclear forces which could be a "signal to the West", according to a military intelligence specialist. Meanwhile, the Times reported that Russia President Putin is set to demonstrate his willingness to use weapons of mass destruction with a nuclear test on Ukraine's borders by sending a nuclear military train, according to The Times citing defence sources. However, the US reiterated they have not yet seen a large-scale reinforcement by Russian forces into Ukraine and it has not yet seen signs of enhanced nuclear activity from Russia.

US

ISM MANUFACTURING: Overall, US ISM manufacturing for September was a poor report highlighted by the fact the headline fell to 50.9, short of the consensus 52.2 and the previous 52.8. Looking at the breakdown, employment and new orders both dropped into contractionary territory printing 48.7 (exp. 53.0, prev. 54.2) and 47.1 (prev. 41.3), respectively, with the latter suggesting climbing interest rates are starting to weigh more heavily on rate-sensitive business investment. However, encouragingly the inflationary gauge of prices paid declined to 51.7 (exp. 51.9, prev. 52.5). Delving into the release, Capital Economics state the headline leaves it consistent with GDP growth of just 0.5% annualised. Meanwhile, there is at least some comfort that the weakness in activity is helping to ease shortages further, with the supplier delivery times index at its lowest since 2019, and the prices paid index fell for the sixth consecutive month. Furthermore, CapEco adds "the slowdown in activity does appear to have contributed to a further easing in shortages." The accompanying comments were still mixed, with some respondents still arguing supply chain constraints are a significant issue, but the backlog of orders, supplier delivery times and prices paid indices all declined close to 50. All three are at their lowest levels since at least the summer of 2020.

CONSTRUCTION SPENDING: US construction spending declined 0.7% in August, more than the expected 0.3% fall and the prior, revised lower, -0.6%. Looking at the report, residential construction spending, which had been driving gains in the headline number for circa two years, is now pulling spending lower, falling 1.0% in August, Oxford Economics says. Meanwhile, non-residential spending declined 0.4%, led by a 0.8% drop in public spending. As such, Oxford Economics note, "a rebound in residential construction spending is unlikely any time soon, given our outlook for housing starts to remain depressed." Additionally, OxEco add, "private non-residential spending is expected to remain subdued given the slowing economy, which should continue to weigh on business investment. The infrastructure legislation passed last year should keep a floor under public construction spending."

FED: There has been some chatter, particularly from FBN's Gasparino, talking about a Fed Pivot due to risks of financial stability and although it is something the Fed is keeping an eye on, commentary has remained focused on inflation and officials have suggested the risk of inflation being too high is greater than the Fed doing too much. **Williams** repeated inflation is too high and the Fed's job is not done - pushing back on some calls for an earlier Fed pivot. Further on inflation, he said persistently high inflation undermines the economy's potential and broad underlying inflation will take time to lower, noting the Fed is cooling inflation but underlying pressures are still strong. On forecasts, he sees inflation likely down to 3% by next year (median view for Core PCE 3.1%), and the US is likely to see unemployment rise to 4.5% by end of 2023 (median view 4.4%). Lastly, the US is likely to see a nearly flat GDP this year (median view 0.2%). **Barkin (2024 voter)** noted the Fed must consider global developments, but the focus is on the US, adding inflation is high, persistent and broad-based. Barkin also warned the post-pandemic era may spell more inflationary headwinds, which suggests tighter monetary policy but it is premature to say this is to happen.

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 1 POINT 4+ TICKS HIGHER AT 113-06+

The Treasury curve bull steepened with the fixed income rally starting with UK Gilts after the government's tax cut reversal, while there were also murmurings of a Fed Pivot given financial stability concerns alongside weak US manufacturing data. 2s -9.1bps at 4.118%, 3s -11.4bps at 4.125%, 5s -14.4bps at 3.897%, 7s -15.8bps at 3.788%, 10s -14.1bps at 3.663%, 20s -7.2bps at 3.999%, 30s -5.4bps at 3.710%. Inflation Breakevens: 5yr BEI +15.7bps at 2.305%, 10yr BEI +9.7bps at 2.249%, 30yr BEI +7.3bps at 2.150%.

THE DAY: The Treasury bid started the day tracking Gilts after the UK abandoned its plan to cut the income tax rates on the highest earners while financial stability woes had also been flagged amid talk of a collapse of Credit Suisse, something that has been pushed back on by management. There were also murmurings of a potential upcoming Fed pivot being sooner than expected, potentially on concerns of financial stability but it is worth highlighting the Fed has acknowledged they are monitoring events abroad. Brainard on Friday said she is committed to avoiding a premature pullback on policy. Williams, on Monday, also stressed inflation is too high and the Fed's job is not done. A bout of weak US economic data added to the Treasury bid to take T-Notes to a high of 113-27+ with a yield of 3.57% - the ISM

Manufacturing PMI implied a slowdown in activity and prices while signalling a contraction in employment. The weak data and financial stability worries saw traders pare bets on an aggressive Fed tightening cycle with the peak FFR now seen at 4.25-4.50% in March 2023 vs a peak of 4.5-4.70%.

STIRS:

- EDZ2 -1.5bps at 95.295, H3 +1.0bps at 95.305, M3 +3.5bps at 95.370, U3 +7.0bps at 95.490, Z3 +9.5bps at 95.605, H4 +11.5bps at 95.785, M4 +12.5bps at 95.955, U4 +12.5bps at 96.075, Z4 +12.5bps at 96.180, Z5 +16.5bps at 96.360.
- NY Fed RRP op. demand USD 2.253tln (prev. 2.426tln - a record), across 102 bidders (prev. 108).
- US sold USD 47bln of 6-month bills at 3.850%, B/C 2.62; Sold USD 61bln in 3-month bills at 3.340%, B/C 2.56.

CRUDE

WTI (X2) SETTLED USD 4.14 HIGHER AT 83.63/BBL; BRENT (Z2) SETTLED USD 3.72 HIGHER AT 88.86/BBL

Oil prices started the week on a firmer footing and saw gains circa USD 4/bbl in line with the risk-on sentiment and reports of OPEC+ production cuts, seeing WTI and Brent saw highs of 84.56/bbl and 89.82/bbl, respectively. The days main update surrounded OPEC+ sources, ahead of the meeting on Wednesday (preview here), where Energy Intel's Bakr said "so far talks among OPEC+ delegates indicate that a cut of 1.5mln or more might be considered. Unclear if this will be in phases", while Reuters sources noted "OPEC+ is discussing a potential oil output cut in excess of 1mln BPD, excluding any voluntary cuts". Elsewhere, Gazprom is to allow Hungary's MVM delayed gas payments for the winter period, according to the MTI news agency.

EU GAS: EU leaders are set to ask the Commission to begin work on negotiating lower prices with gas suppliers, according to a draft EU statement cited by Reuters. EU leaders will ask the Commission to come up with solutions to lower energy prices via gas price caps, as well as requesting to start work on the development of an alternative LNG price benchmark.

NORD STREAM: Russia's Kremlin noted Nord Stream gas pipelines need to be resorted, seabed assessment is needed first. US increased LNG sales and prices following the gas leaks.

BANK COMMENTARY: Goldman Sachs said an OPEC+ supply cut would reinforce its bullish oil price view, helping to limit downside to prices in the scenario that economic growth disappoints. GS expects Russian production to decline into year-end with demand expected to be supported by natgas-to-oil switching in Europe and Asia. Believes OPEC+ supply cut can help remedy large exodus of oil investors that have left prices under-performing both fundamentals and other cyclical asset classes, and the ability for OPEC to conduct such a large cut is rooted in the lack of any supply elasticity, with shale activity showing signs of slowing.

EQUITIES

CLOSES: SPX +2.59% at 3,678, NDX +2.36% at 11,229, DJIA +2.66% at 29,490, RUT +2.45% at 1,708.

SECTORS: Energy +5.77%, Materials +3.4%, Technology +3.15%, Industrials +3.05%, Utilities +2.99%, Communication Services +2.98%, Financials +2.84%, Health +2.14%, Real Estate +1.86%, Consumer Staples +1.74%, Consumer Discretionary +0.24%.

EUROPEAN CLOSES: EURO STOXX 50 +0.72% at 3,342, FTSE 100 +0.79% at 6,908, DAX 40 +0.79% at 12,209, CAC 40 +0.55% at 5,794, FTSE MIB +1.57% at 20,972, IBEX 35 +1.29% at 7,462, SMI +0.21% at 10,288.

STOCK SPECIFICS: **Tesla (TSLA)** delivered roughly 344K vehicles in Q3, beneath expectations of 358K as logistical challenges overshadowed its record deliveries. TSLA exec said, "as production volumes continue to grow, it is becoming increasingly challenging to secure vehicle transportation capacity and at a reasonable cost during these peak logistics weeks." **L3Harris Technologies (LHX)** acquired a military-communications business from **Viasat (VSAT)** for almost USD 2bln. Senior **Credit Suisse (CS)** execs spent the weekend reassuring large clients, counterparties and investors about the bank's liquidity and capital position in response to concerns raised about its financial strength, FT reported. **Stanley Black & Decker (SWK)** cut about 1,000 finance jobs as part of a cost savings drive, according to WSJ. **Myovant Sciences (MYOV)** rejected a USD 2.5bln, or 22.75/shr in cash, takeover offer from Sumitomo Pharma as the bid "significantly undervalues" the co. worth. Barron's reported **Freshpet (FRPT)** hired bankers to explore a possible sale. Morgan Stanley upgraded **Box (BOX)**; pointing to strong execution and a favourable competitive landscape. **DocuSign (DOCU)** was downgraded at Morgan Stanley who said increasing competition, e-signature commoditization and pricing pressures create incremental downside risk for the shares. **Akamai (AKAM)** reportedly receive a takeover approach from a private equity firm, according to Street Insider. **Meta (META)** released an open source AI platform based on Pytorch, according to a blog; which speeds up **Nvidia (NVDA)** A100 chip performance up to 12x and **AMD (AMD)** MI250 chip performance by up to 4x.

FX WRAP

The Dollar was choppy on Monday, but was eventually lower, as the Buck printed a high of 112.540 in contrast a low of 111.460, which was hit in the wake of a poor ISM manufacturing report. On this, the headline missed while employment and new orders both fell back into contractionary territory. On risk apetite, market participants responded to last week's bloodbath with risk on sentiment, as stocks grinded higher throughout the US session, alongside firmness in Treasuries, which weighed on the Buck. Regarding Fed speak, Fed's Williams repeated inflation is too high and the Fed's job is not done - pushing back on some calls for an earlier Fed pivot. Looking ahead, there is ISM services on Wednesday and NFP on Friday, ahead of CPI next Thursday.

Activity currencies, NZD, AUD, CAD, and GBP, surged on Monday to pare some of last week's losses against the Buck, as the antipodeans outperformed while the latter two saw similar gains, up circa 1.5%. On the whole, the aforementioned currencies benefitted from the broader recovery of risk sentiment, as AUD/USD and NZD/USD saw highs of 0.6522 and 0.5730, respectively, ahead of the respective rate decisions later in the week. On this, both RBNZ and RBA (preview here) are expected to hike by 50bps, but the pricing is firmer for the former. The Loonie was supported by the gains in the crude complex, which comes after numerous sources on Monday said OPEC+ is considering cuts in excess of 1mln BPD; ahead of its next meeting on Wednesday (preview here), with USD/CAD trading in a range between 1.3825-1.3629. Lastly, GBP held onto the gains seen in early European doors which emanated from a policy U-turn on the controversial plan to abolish the 45p top tax rate. The boost helped GBP/USD nurse the post-budget slide, with the pair back on a 1.1300 handle and within an impressive 1.1087-1334 daily parameter.

Safe-havens, JPY and CHF, were the G10 underperformers and mixed, as the Yen was flat while the Swissy saw losses vs the Buck, as the increase in risk sentiment did not favour the safer-havens. Currency specific newsflow was light, although overnight the BoJ Summary of Opinions reiterated the Bank should maintain easy policy whilst the Tankan survey overnight showed a further deterioration in corporate sentiment. USD/JPY chopped between 145.20 and 144.16, and even though it was either side of the pivotal 145, there was no mention of policy intervention.

EUR was marginally firmer, but the gains in the single-currency seen in wake of the aforementioned US ISM data could not be sustained, as desk note it is a bearish sign when EUR/USD can't rally with risk markets. Elsewhere, EUR also encountered revisions lower to the EZ manufacturing PMIs, with the commentary in the release suggesting "The downturn [in EZ manufacturing] is being driven primarily by the surging cost of living, which is reducing spending power and hitting demand, but soaring energy prices are also increasingly limiting production at energy-intensive manufacturers.", whilst adding that the "worst looks set to come". Additionally, ECB hike bets pared to under 125bps, for the first time since September meeting. Note, the Euro continues to be weighed on by the Ukrainian war and accompanying energy crisis.

EMFX was mixed. MXN, RUB, ZAR, and BRL saw gains, with the latter the clear outperformer, while TRY saw losses. The Rand piggybacked off firmness in gold, while BRL benefitted from the election results, but the others were beneficiaries of the wider risk tone. For the Lira, Goldman Sachs expects the CBRT to cut rates by 100bps at every meeting until year-end. Back to the Brazilian Elections, in short, neither Lula or Bolsonaro secure 50% of votes for outright victory, sending the election to a run-off (analysis piece here). Following this, the Real strengthened heavily, seeing which saw USD/BRL hitting a low of 5.1537, while the local stock market surged and interest rate future contracts were down sharply. Pantheon Macroeconomics highlights that despite the upcoming election, Brazilian markets have performed relatively well in recent months, suggesting both candidates are considered business and market friendly.