US Market Wrap

5th October 2022: Dollar & Yields clawback recent downside while Services PMI offers glimpse of hope ahead of Friday's NFP

- **SNAPSHOT**: Equities down, Treasuries down, Crude up, Dollar up.
- **REAR VIEW**: ISM services better than manufacturing; OPEC+ agreed oil output reduction of 2mln BPD; TWTR & Musk continue to talk about closing the deal; Fed's Daly pushes back on Fed pivot; ADP above expectations.
- **COMING UP**: **Data**: Australian Trade Balance, EZ/UK Construction PMI, EZ Retail Sales **Event**: ECB Minutes (Sep) **Speakers**: Fed's Waller, Evans, Cook, Mester **Holiday**: China **Supply**: France & Spain.

MARKET WRAP

Stocks initially sold off throughout the morning following their best two day rally since 2020, however there was a turnaround midday in the US with strategists at Wells Fargo putting it down to a chunky derivatives trade. The strategists note someone bought the SPX October 31st and March calls vs selling the January calls, adding the Greeks of the trade are likely what led to the midday rally, which extended throughout the afternoon. The upside saw the SPX rise above 3800, but a chunky sell side imbalance weighed heading into the close, seeing the index fail to close north of 3800 once again and back in the red. Treasuries were sold across the curve on rising oil prices, strong services PMI's, Daly's pushback on a Fed pivot and the BoE staying out of the market again. US data was encouraging, the services PMI beat expectations and saw a decent jump in the employment component ahead of Friday's jobs report. The data saw the terminal rate in the US edge higher to c. 4.52%, implying a FFR of 4.50-4.75% in March, although as trade progressed it dipped back to c. 4.49%, implying a FFR of 4.25-4.50%. Crude prices continued their bid after OPEC+ committed to a 2mln BPD production cut (albeit the "actual" cut is more like 1-1.1mln BPD). Meanwhile, Fed's Daly said the Fed is resolute at increasing rates into restrictive territory and holding rates there for some time, pushing back somewhat on a potential Fed pivot. The pullback in Treasuries supported the buck, as did the morning risk off trade but DXY was off highs as stocks staged its rebound while EUR/USD failed to rise above parity and GBP/USD reversed after testing 1.15 to the upside.

US

ADP NATIONAL EMPLOYMENT: ADP's gauge of national employment reported 208k jobs were added to the US economy in September; the Street was expecting 200k from a revised 185k in August. Within the release, it reported that median wage growth for "job-stayers" rose to +7.8% Y/Y from the previous +7.7%, although wage growth for "job-changers" was +15.7% Y/Y, falling from the previous +16.2%. In terms of the implications for the Friday BLS jobs data, it is worth noting that there was very little market reaction in wake of the release; traders note that the inaugural release of the ADP's new methodology in August failed to capture the trend in the official jobs data. Pantheon Macroeconomics said the ADP's data is hard to take seriously: "We're ignoring ADP for the purposes of forecasting payrolls and strongly suggest you do, too," the consultancy wrote, "it's possible that over time it will become clear that the data have value, but that judgement can't be made now," adding that "occasionally, it probably will be 'right', but consistency is what matters."

ISM SERVICES PMI: Overall, it appears the services sector is in better shape than the manufacturing sector in the US. The headline saw a modest decrease in M/M to 56.7 from 56.9, but was better than the expected 56.0 print. The better than expected print was supported by gains in employment, rising to 53 from 50.2, an impressive gain which keeps the services sector employment out of contractionary territory after the dip in manufacturing employment earlier in the week, offsetting some concerns ahead of Friday's payrolls report. Prices paid also eased, an encouraging sign for the Fed, dipping to 68.7 from 71.5 showing prices are still picking up, just at a slower pace. Business activity slowed to 59.1 from 60.9 while new orders slowed to 60.6 from 61.8. The Supplier Deliveries Index also signalled an improvement in supply chain conditions. Albeit a rosy report, analysts at Oxford Economics continue to believe a mild recession is on the horizon in the US. "We look for the services sector to lose momentum as the weight of high prices, more expensive borrowing costs, soft earnings, and damp sentiment bear down on activity". The desk also notes inflation will not fade quickly and the Fed has signalled it is willing to pay the price of a mild recession to return inflation to target.

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 31 TICKS LOWER AT 112-17

Treasuries were sold across the curve on rising oil prices, strong services PMI's, Daly's pushback on a Fed pivot and the BoE staying out of the market again. At settlement, 2s +5.5bps at 4.152%, 3s +7.8bps at 4.169%, 5s +12.3bps at 3.963%, 7s +14.2bps at 3.875%, 10s +14.4bps at 3.761%, 20s +10.4bps at 4.067%, 30s +8.2bps at 3.769%. Inflation Breakevens: 5yr BEI -1.5bps at 2.325%, 10yr BEI -1.8bps at 2.234%, 30yr BEI -1.8bps at 2.115%.

THE DAY: Treasuries were sold across the curve and pared some of its recent rally with higher oil prices after OPEC+ opted for a 2mln BPD production cut, which sparked fresh inflationary concerns. The losses were led by the belly after commentary from Fed's Daly who noted the Fed is resolute at increasing rates into restrictive territory before holding rates there for a while, pushing back on talk of a Fed pivot. The longer end of the curve then followed suit tracking Gilt's lower after the BoE latest buyback operation also accepted zero offers, but this time only seeing GBP 413.6mln offers, vs Tuesday's 2.226bln. US data on Wednesday was evident of a strong economy, which also supports the Fed going ahead with aggressive tightening, after the ISM Services PMI beat expectations with a strong rise in unemployment, although it was a welcome sign that prices paid showed signs of cooling. The data also painted a more constructive picture of the US economy than the manufacturing report on Monday, which was weak. The Services ISM saw a slight mark higher in market pricing for the Fed terminal rate to 4.52%, taking the terminal FFR to between 4.5-4.75% - more in fitting with the Fed's projections of 4.6%. Meanwhile, the latest ADP private jobs report was a touch better than expected but saw little reaction with attention on Friday's NFP. The housing market continues to slowdown with the weekly mortgage applications showing a 14.2% decline with the 30yr rate at 6.75%, showing further signs of housing demand amid higher rates.

STIRS

- EDZ2 -1.0bps at 95.290, H3 -2.0bps at 95.275, M3 -4.5bps at 95.330, U3 -8.0bps at 95.440, Z3 -10.5bps at 95.565, H4 -11.5bps at 95.760, M4 -12.5bps at 95.930, U4 -14.0bps at 96.040, Z4 -15.0bps at 96.135, Z5 -18.5 bps at 96.300.
- NY Fed RRP op. demand USD 2.231tln (prev. 2.237tln), across 102 bidders (prev. 10);
- US sold USD 30bln in 119-day CMB's at 3.700%, B/C 3.19x; note, US Treasury intends to transition the 4mth cash management bill to benchmark status, with the first benchmark auction on October 19th.

CRUDE

WTI (X2) SETTLED USD 1.24 HIGHER AT 87.76/BBL; WTI (Z2) SETTLED USD 1.34 HIGHER AT 86.84/BBL; BRENT (Z2) SETTLED USD 1.57 HIGHER AT 93.37/BBL

Oil prices were initially choppy on Wednesday, but after source reports the OPEC+ JMMC agreed to a 2mln BPD output reduction it was more-or-less one-way traffic for the crude complex, as WTI and Brent posted highs of USD 88.42/bbl and 93.96/bbl, respectively, settling well in the green. However, given the output production cuts are to be measured from current baselines (more details below), the gains were not as great as they could have been, leaving the actual output cut just north of 1mln BPD. Elsewhere, Russian Deputy PM Novak noted the oil price cap will backfire on those who impose it, Russia will not sell oil to nations who adopt the price cap, via Bloomberg. Lastly, weekly EIA data saw a surprise draw for crude, as was the case with private inventories on Tuesday, while distillates and gasoline both reported larger than expected draws.

OPEC: OPEC+ has agreed an oil output reduction of 2mln BPD and will be measured from current baselines. As reductions are to be measured relative to quotas, it implies a smaller overall production cut than the headline suggests compared to a scenario where existing production levels were used as many producers are failing to meet quota levels. Saudi's Prince Abdulaziz confirmed the 'actual' size of the cut will be around 1-1.1mln BPD. Note, the production cuts will be effective from November, dismissing earlier sources for a phase in over several months. Meanwhile, OPEC+ agreed to extend the cooperation deal until end-2023, and the JMMC will meet bi-monthly with OPEC+ ministers set to meet every six months.

WHITE HOUSE: In wake of the OPEC+ decision, the White House was not impressed. WH representatives noted US President Biden will continue to direct SPR releases as appropriate and Biden is directing the energy secretary to explore further responsible actions to raise domestic production. Additionally, White House said it is clear OPEC+ is aligning with Russia, while the US needs to be less reliant on OPEC+ and foreign producers of oil.

EQUITIES

CLOSES: SPX -0.22% at 3,782, NDX -0.08% at 11,573, DJIA -0.14% at 30,273, RUT -0.58% at 1,762.

SECTORS: Utilities -2.25%, Real Estate -1.9%, Materials -1.09%, Financials -0.86%, Communication Services -0.62%, Consumer Staples -0.6%, Industrials -0.58%, Consumer Discretionary -0.54%, Health +0.33%, Technology +0.36%, Energy +2.06%.

EUROPEAN CLOSES: EURO STOXX 50 -1.05% at 3,447, FTSE 100 -0.48% at 7,052, DAX 40 -1.21% at 12,517, CAC 40 -0.90% at 5,985, FTSE MIB -1.52% at 21,360, IBEX 35 -1.52% at 7,579, SMI -1.07% at 10,477

STOCKS SPECIFICS: **Twitter (TWTR)** and Elon Musk's legal teams are yet to reach an agreement on ending litigation, according to Reuters sources. However, WSJ sources reported Twitter and Musk are continuing talks about closing the deal and hope to have an agreement soon, possibly as soon as later on Wednesday. **Morgan Stanley (MS)** and **Goldman Sachs (GS)** were both downgraded at Atlantic Equities due to the potential of declining investment banking volume. **TSMC (TSM)** has reportedly begun negotiating prices with its suppliers of equipment and materials for 2023, considering price reductions of at least 10%, according to DigiTimes. **Apple (AAPL)** is asking suppliers to move some AirPods and Beats headphone production to India for the first time, Nikkei reported, as part of Apple's gradual diversification from China as it looks to lower risks of supply chain disruptions stemming from the country's strict zero-COVID policy and tensions with the US. **Emerson (EMR)** is in talks with **Blackstone (BX)** to sell part of its commercial and residential solutions business, in a deal that could be valued at between USD 5-10bln. Morgan Stanley upgraded **Ford (F)** citing a potential buying opportunity after the stock's recent decline. Separately, **Ford (F)** said it is adjusting the MSRP on the 2023 F-150 lightning pro due to ongoing supply chain constraints, according to a statement. **Lamb Weston (LW)** beat on EPS and revenue, while looking ahead affirmed FY23 outlook. **Helen of Troy (HELE)** surpassed consensus on top and bottom line but lowered FY23 EPS and revenue view.

FX WRAP

The Dollar was notably firmer on Wednesday, reaching a peak of 111.750, amid the initial downbeat macro sentiment where a return to risk-averse was apparent after the first couple of days, of the week/month. However, stocks staged a strong recovery midday on an apparent chunky derivate position, according to Wells Fargo, which took the Dollar off highs. Meanwhile, Treasury yields had risen across the curve, particularly the belly, helping support the buck as the recent rally in Treasuries faded somewhat. Regarding the day, Fed speak saw Daly (2024 voter) speak on inflation where she expects it to end 2022 closer to 3.0% than 2.0%, adding the Fed have to be prepared for inflation to be more persistent than they expect. Moreover, Daly added the Fed is resolute at increasing rates into restrictive territory and holding there for some time, pushing back on some calls for a Fed pivot. On the data front, ISM services was better than manufacturing, highlighted by the strength in employment, whereas the manufacturing employment fell into contractionary territory. US ADP was slightly above expectations, but in terms of the implications for the Friday BLS jobs data, it is worth noting that there was very little market reaction; traders note that the inaugural release of the ADP's new methodology in August failed to capture the trend in the official jobs data. Looking ahead, the key risk event is NFP on Friday, but before that there is further Fed speak scheduled on Thursday.

GBP was the G10 underperformer and pared some if its recent gains against the Buck, as Cable printed a low of 1.1228, despite reaching a peak of 1.1495 but ran out of momentum into the key round level. For the record, Sterling hardly moved when PM Truss spoke at the Tory Party Conference and reiterated her determination to put growth, growth and growth at the top of the agenda regardless of the financial considerations. Meanwhile, there was no BoE Gilt purchases for the second day in a row.

Activity currencies, CAD, AUD, and NZD were mixed across the board, with the CAD seeing weakness vs the Greenback while the antipodeans were the G10 outperformers. The Aussie and Kiwi were lower for most of the day, but as risk picked up into the close (and stocks went green) the aforementioned currencies managed to pare losses and end up firmer, at pixel time. Overnight the RBNZ hiked its OCR by 50bps to 3.50%, as expected, and stated that the Committee agreed it is appropriate to continue to tighten policy and members agreed monetary conditions needed to continue to tighten until inflation was back in target range, which weighed on AUD/NZD given the dovish surprise from the RBA earlier in the week. The Loonie slumped to highs of 1.3695, despite the rise in oil prices, as it reported mixed Canadian data, illustrated by a notably smaller than expected trade surplus compared to much more pronounced bounce in building permits. Looking to Thursday, BoC Macklem is speaking, while for the Antipodean watchers there is Australian trade balance and AIG construction index.

Safe-havens, CHF and JPY, were weaker amid the broad Dollar bid as USD/CHF even tested 0.9900 to the upside and saw a high of 0.9888. Meanwhile, the USD/JPY saw a high of 144.84, but failed to test the pivotal 145 level and subsequent levels which previously resulted in Japanese intervention, as Yen remained caught between sentiment and rate/policy divergence. Back to the Swissy, SNB's Maechler said we are seeing more signs of second round inflation effects in Switzerland; and it is quite possible the SNB could raise rates again. Maechler repeated monetary policy will be increasingly steered through interest rates, but SNB is ready to buy and sell Francs if currency becomes too weak or strong.

EUR resides in the red vs the Dollar, as the aforementioned strength in the Buck weighed alongside downbeat German data. On the day, the single currency came agonisingly close to climbing another and arguably even more significant rung on the recovery ladder vs its US rival, but narrowly missed par before reversing to 0.9835 with no support from Eurozone PMIs that were revised down from prelim levels of came in below consensus with the sole exception of France’s composite reading. Note also, Germany’s trade surplus shrunk to counter a strong rebound in French IP.

EMFX was predominantly lower, with only the BRL seeing strength vs the Buck. MXN, ZAR, RUB, and TRY all saw weakness to varying degrees with lower gold prices hindering the Rand. Elsewhere, PLN was hit after the NBP unexpectedly decided to maintain rates, against an expected 25bps hike. HUF was hindered in wake of the NBH switching to monetary tightening via liquidity measures, adding that reserve requirements will rise to nearly HUF 2.7tln from HUF 400bln, and it plans to hold another liquidity draining tender next Wednesday.