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US Market Wrap

11th October 2022: The Bailey Ultimatum sees late session dash for cash

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up.
- **REAR VIEW**: Bailey affirms Friday's deadline for BoE purchases; Mester sticks to her hawkish script; Disappointing IBD/TIPP data; NY Fed September Consumer Survey sees 3 and 5yr inflation expectations rise, but 1yr falls; Strong LVMH earnings; Mexico hedge locks in oil prices at around USD 75/bbl; Labor Department proposal could lead to employee status for gig workers.
- **COMING UP**: **Data**: UK GDP, EZ Industrial Production, US PPI Final Demand **Events**: BoK, FOMC Minutes, G20 Finance Ministers' meeting, Astana Summit **Speakers**: BoE's Haskel, Pill, Mann, ECB's Lagarde, Fed's Kashkari, Barr, Bowman **Supply**: Japan, UK, Germany, US.

MARKET WRAP

Indices and bonds saw late-session selling as part of broader Dollar strength/risk-off conditions in wake of BoE Governor Bailey's ultimatum for pension funds that the gilt buybacks will end Friday, "you have three days to get this done", ramping instability fears. Stocks had (pre-Bailey) recovered off their lows from the NY cash open, with no obvious catalyst aside from pre-CPI and earnings positioning. Yields descended through the session, although that failed to help the NDX, with the defensive pockets of the equity market outperforming, perhaps reflective of the big decline in the NY Fed consumer spending expectations component, which coincided with further decline in year-ahead inflation expectations, although rises in the 3yr and 5yr gauges. Note, there there was some more respectable strength (pre-Bailey) in the small-cap Russell 2k index, perhaps finding impetus from the improvement in the September NFIB index, not to mention BofA's strats out bullish on US small caps, particularly small-cap value (over growth). Fed's Mester was the only Fed speaker Tuesday, and she reaffirmed her usual hawkish stance, which is noteworthy given the seeming shift seen in dove Brainard on Monday, showing that the latter's erring to cautiousness does not appear to be a broader consensus for now, but that can be expected to change when/if inflation and labour market tightness data improves.

GLOBAL

FED: **Mester (2022 voter)** stuck to her hawkish script on Tuesday, noting the Fed has yet to make any progress on lowering inflation and policy needs to be moved to restrictive levels and the biggest policy risk is that the Fed does not hike enough. The biggest challenge to the economy is still high and persistent inflation. She does not expect Fed rate cuts in 2023. She did note that high uncertainty is usually associated with being acting inertially. But in the current environment, being cautious does not mean doing less and it means to be very careful to now allow wishful thinking to substitute for compelling evidence, leading one to prematurely declare victory over inflation and pause or reverse rate hikes too soon. Mester did later note the Fed is aware of global markets and it must be very aware of global economic conditions, but the Fed's mandate is a domestic one. The commentary from Mester is more hawkish when compared to some of her colleagues, Brainard on Monday cautioned of the risks of over tightening while Mester notes the largest risk is if the Fed does not hike enough.

BOE: Governor Bailey hit global markets late in the NY afternoon Tuesday after abruptly declaring that pension funds have "three days left to get this done" in reference to gilt buybacks that are expected to conclude on Friday. There had been some expectations that the BoE might extend the purchases to quell financial instability in the UK, but Bailey did not give way on those. The Governor, speaking in public for the first time since the gilt market episode, was vocal about the serious risk to financial stability in the UK, but also was stern in saying there is a window of opportunity for pension funds to rebalance. Bailey also said it's very important to make clear Gilt purchases are financial stability intervention and that the BoE has more to do to distinguish between financial stability and monetary policy operations. He also declared that policy is now operating in opposite directions.

IBD/TIPP: The latest IBD/TIPP Economic Optimism index disappointed, falling to 41.6 in October from 44.7 in September while the six month outlook fell to 35.4 from 39.5. Within the report, it also notes the Financial Related stress index rose 1.9 pts to 69.5, indicative of rising financial stress. Inflation is clearly still an issue with 90% being concerned about the inflationary outlook over the next 12 months while just 22% said wages have kept up with inflation, and 54% say they haven't. Note, the IBD Tipp Economic Optimism index is based on a survey of 1200 adults. Within the survey, it

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found 61% of Americans think the Economy is in a recession, up from 59% in September and just off August's 62%. The concern about job loss also saw a rise, with 38% concerned about job loss in their household, up from 34% in September and 31% in August.

FIXED INCOME

T-NOTE (Z2) FUTURES SETTLED 4 TICKS HIGHER AT 111-04+ (includes Monday trade due to Columbus holiday)

Treasuries bear-steepened in catch-up after the long weekend, but yields came off highs through the session, before the late session Bailey-induced sell-off. 2s -0.4bps at 4.304%, 3s +0.1bps at 4.338%, 5s +1.6bps at 4.153%, 7s +3.3bps at 4.063%, 10s +4.2bps at 3.927%, 20s +6.0bps at 4.198%, 30s +5.5bps at 3.897%. Inflation breakevens: 5yr BEI flat at 2.424%, 10yr BEI +3.4bps at 2.321%, 30yr BEI +5.1bps at 2.204%.

THE DAY: T-Notes hit session lows of 110-21+ at the Tokyo/London handover on Tuesday with Japan playing catch-up to the action on Monday. But from there, it was gradual strength in the contracts, with desks flagging pessimistic IMF commentary. Momentum was maintained after the NY Fed's September consumer survey saw 1yr inflation expectations hit their lowest since Sept. 2021, despite the slight rise in the 3yr and 5yr measures, while the consumer spending expectations component saw its largest M/M drop on record, fuelling growth concerns. T-Notes hit session highs of 111-22 (also the Monday peak) ahead of the USD 40bln 3yr auction, which capped broader upside after tailing 0.8bps. The contracts had been set for a quiet close until BoE Governor Bailey gave remarks at an IIF conference, saying pensions fund have three days left "to get this done", insinuating his lack of appetite for quelling instability through purchases beyond Friday, taking govvies lower into the settlement.

STIRS:

- EDZ2 +1.5bps at 95.145, H3 +4bps at 95.09, M3 +6bps at 95.14, U3 +7.5bps at 95.26, Z3 +7bps at 95.39, H4 +5bps at 95.575, M4 +3.5bps at 95.745, U4 +2bps at 95.86, Z4 +1bps at 95.965, Z5 +2.5bps at 96.155.
- NY Fed RRP op. demand USD 2.222tln (prev. 2.227tln).
- US sold USD 63bln (+3bln since last auction) of 3-month bills at 3.510%, covered 2.39x (lowest since June 13th); sold USD 50bln of 6-month bills at 4.030%, covered 2.86x.
- Treasury announced it is raising 1-month bill auction size to USD 60bn from 50bln, and raising 2-month auction size to USD 50bln from 45bln.

CRUDE

WTI (X2) SETTLED USD 1.78 LOWER AT 89.35/BBL; BRENT (Z2) SETTLED USD 1.90 LOWER AT 94.29/BBL

The crude complex saw losses on Tuesday, which began in the European morning amid the broader risk environment and further bearish COVID-related headlines emanating from China. However, as US players entered the fray oil clambered off lows, but after the US Deputy Energy Secretary reiterated that the US still has the ability to use SPR over the coming weeks and months, oil saw downside and trundled to session lows. Nonetheless, the weakness in crude was capped amid the broader risk sentiment, as the Dollar came off highs and stocks made a recovery. In energy news, Bloomberg reported the annual Mexican hedge has begun and Mexico is locking in oil prices at around USD 75 /bbl.

OPEC: Saudi Arabia defied US warnings ahead of the OPEC+ production cut, according to WSJ citing sources, adding the US called their counterparts in Saudi Arabia with an appeal to delay the decision by a month. That followed the US officials saying President Biden is to "re-evaluate" Saudi/US relations due to the cut. White House Defense Department spokesman Kirby noted the oil output cut was a decision made by OPEC+ but clearly Saudi Arabia is the leader of the organisation.

FRANCE: Amid the ongoing strike problems in France, 31.3% of France's petrol stations have been facing supply problems on Tuesday due to refinery strikes (prev. 29.4% D/D), whilst France's Alpes-Maritime Department has implemented petrol rationing with cars limited to 30 litres and trucks to 120 litres. TotalEnergies (TTE FP) said it is inviting the trade unions that are not participating in the current strike to a consultation and discussion meeting on Wednesday afternoon, but said if CGT union lifts all blockades before noon, it will be welcome also.

EUROPE: EU looks to enforce mandatory co-operation on gas purchases, and Brussels believes requiring member states to make joint purchases would cut prices, but companies are sceptical, according to the FT citing sources. The

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EU wants to force member states to nominate energy companies to join the region-wide platform for gas purchases, where sources believe there is enough support for the legislation. In terms of a timeframe, it is not expected to be effective until 2023.

EQUITIES

CLOSES: SPX -0.63% at 3,589, NDX -1.24% at 10,791, DJIA +0.12% at 29,239, RUT -0.27% at 1,690.

SECTORS: Communication Services -1.63%, Technology -1.52%, Financials -1.31%, Consumer Discretionary -0.81%, Energy -0.76%, Materials -0.74%, Utilities -0.27%, Industrials +0.01%, Health +0.58%, Consumer Staples +0.93%, Real Estate +1.02%.

EUROPEAN CLOSES: EURO STOXX 50 -0.49% at 3,340, FTSE 100 -1.06% at 6,885, DAX 40 -0.43% at 12,220, CAC 40 -0.13% at 5,833, FTSE MIB -0.87% at 20,730, IBEX 35 -0.78% at 7,355, SMI -0.53% at 10,207.

STOCK SPECIFICS: The Labor Department on Tuesday unveiled a proposal that would make it more likely for millions of janitors, home-care and construction workers and gig drivers to be classified as employees rather than independent contractors, according to NY Times, which is of note for he likes of **Uber UBER), Lyft (LYFT), and DoorDash (DASH)**. **KLA Corp (KLAC)** will stop sales and service to China-based customers to comply with US export curbs, according to Reuters sources. China is KLA's largest geographic market, accounting for around 30% of its total revenue last year. **Zscaler (ZS)** President Amit Sinha accepted a CEO position at a privately-held technology company and will resign from the co. effective October 21st. **American Airlines (AAL)** issued Q3 guidance and lifted revenue view to +13% vs Q3 19, (prev. +10-12%), amongst others. **Leggett & Platt (LEG)** lowered its FY22 outlook; CEO said the increasingly challenging global economic environment and consumer backdrop was expected to result in lower than previously anticipated sales and earnings in Q3 and Q4. **ForgeRock (FORG)** is to be acquired by Thoma Bravo for USD 2.3bln or USD 23.25/shr, according to Bloomberg. Note, FORG closed Monday at USD 15.16/shr. US FDA finds new quality-control problems at an **Eli Lilly (LLY)** factory in New Jersey, according to an FDA document. **Roblox (RBLX)** downgraded at Barclays; said the Co. is a prime beneficiary of the pandemic, but that growth may be challenged going forward as its key markets already have high penetration rates. **BlackRock (BLK)** downgraded at UBS; said BlackRock faces some risk from its position on ESG investing, as well as limited expense flexibility. **Meta (META)** was downgraded at Atlantic Equities; said Meta faces an increasingly challenged growth outlook due to macroeconomic headwinds. **DraftKings (DKNG)** exec said he has a relationship with **Disney's (DIS)** ESPN now. **Intel (INTC)** introduced internal foundry model for external customers and Intel product lines; appoints Stu Pann as Chief Business Transformation Officer.

FX WRAP

The Dollar was lower for much of the NY session on Tuesday, but late in the NY afternoon the losses were after BoE Governor Bailey spoke and ruled out any extension to the temporary Gilt purchases beyond Friday. Prior to this, Fed's Mester (2022 voter) said she does not see evidence of market disorder right now, nor see big market risks looming. Earlier, Mester noted the Fed has yet to make any progress on lowering inflation, policy needs to be moved to restrictive levels and the biggest policy risk is that the Fed does not hike enough. Additionally, NY Fed September Consumer saw the 3yr and 5yr inflation expectation gauges rise, although the further decline in 1yr expectations will be seen as a positive for policymakers. Looking ahead, all eyes turn to FOMC Minutes on Wednesday, US CPI on Thursday, and the beginning of earnings season on Friday.

Activity currencies: NZD, GBP, AUD, and CAD were firmer for a large part of the session, but after the aforementioned Bailey remarks there was a broad risk-off move that weighed on all. As such, NZD is still firmer, but well off session highs, while GBP, AUD, and CAD are all lower with Cable hitting session lows of 1.0966 in wake of. Elsewhere in the session, NZD/USD hit a high of 0.5657 but could not sustain momentum above the key 0.5650, even with the added impetus of a rise in NZ electronic card consumption and RBNZ Governor Orr reaffirming that the OCR needs to be higher as the best means of lowering inflation. The Aussie initially piggybacked the broader risk on bid, highlighted by equities turning positive and Dollar weakness, and as such AUD/USD hit a high of 0.6346. Looking ahead, RBA's Ellis speaks Tuesday evening.

The Pound was seemingly a beneficiary of the aforementioned broader revival in risk sentiment, as well as added BoE risk reduction (new inflation linker purchases were made Tuesday) until Governor Bailey spoke at an IIF conference later on. Bailey affirmed Friday being a deadline for buybacks, pushing back on some expectations that the BoE would extend the ops to quell financial instability, as he noted the message to pension funds is, "you have three days left to get this done". Cable traded between a rangy 1.1180-0966.

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The Loonie was the high beta FX underperformer for most of the day, albeit still firmer against the Greenback, and that came amid the weakness seen in the crude complex, but following Bailey's comments the Loonie fell into losses against the Dollar, but off earlier lows as USD/CAD traded between 1.3855-3715. Regarding the week ahead, aside from the key risk events in the form of FOMC Minutes and US CPI, there is UK manufacturing output and GDP on Wednesday, as well as a slew of BoE speak.

The Euro firmed vs the Buck, before paring post-Bailey, despite the ongoing geopolitical concerns regarding Ukraine /Russia which continues to weigh on European energy concerns. For the single-currency, desks note it was aided by the pullback in Treasury yields and the Gilts-led drop in EZ financing costs. However, the EZ faces a difficult economic outlook with nearly 240bps of further ECB rate hikes expected, an energy crisis stemming from the intensifying war in Ukraine and global trade and recession risks. On ECB rhetoric, ECB's Lane stated over the next several meetings, ECB intends to raise key policy rates towards levels that will ensure the timely return of inflation to the 2% medium-term target. Aside from the aforementioned macro risk events, desks await Lagarde's speech on Wednesday.

The Yen was relatively flat vs the buck but remains around intervention levels with Tuesday's range in USD/JPY between 145.51 to 145.89 with perhaps fear of more intervention keeping the cross capped beneath 146, for now. Analysts at Rabobank write the intervention could help keep speculative positions against JPY at bay. Adding, the latest intervention from the MoF has suggested to the market that 145.00 was the line in the sand. However, Rabo says "It is very clear to all participants that FX intervention cannot turn the direction of a currency pair unless the fundamentals are also pulling in the same direction", with the dovishness of the BoJ and hawkishness of the Fed pulling the cross higher. The desk notes, "Another lurch higher in USD/JPY in the coming weeks may trigger some renewed verbal intervention from the MoF, but eventually that would have to be followed by more action – a decision which wouldn't be taken lightly".

The Franc firmed with the Swissy trading on wider macro sentiment, as opposed to anything currency specific. Although, SNB Chairman Jordan said central bank independence is imperative to fight inflation effectively; warning that central banks are more politically vulnerable as inflation rises.

EMFX was lower against the Greenback with the BRL and RUB the underperformers, as the latter continues to be weighed on by geopolitical concerns. PLN appeared to glean some traction at the expense of the HUF hitting another all-time low instead of extremely hawkish from NBP's Tyrowicz, and the ZAR got an unexpected boost from much stronger than forecast SA manufacturing output alongside Gold's recovery from lows under the 200 DMA. But, was weighed on late in the session after Bailey's remarks which pushed spot gold into negative territory, just.

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