US Market Wrap

5th December 2022: Yield surge hits stocks after ISM Services tops expectations

- **SNAPSHOT**: Equities down, Treasuries down, Crude down, Dollar up
- **REAR VIEW**: Strong ISM Services PMI; China cities accelerate reopening efforts; Saudi cut OSPs to Asia; OPEC maintains production; TSLA denies reports it cut December output in Shanghai.
- **CENTRAL BANK WEEKLY**:Previewing RBA, RBI, BoC; reviewing Fed's Powell. To download the report, please click here.
- **WEEK IN FOCUS**: Highlights include: RBA, BoC, China Trade and CPI data, Uni. of Mich. Sentiment. To download the report, please click here.

MARKET WRAP

S&P 500 futures were pinned to its 200dma moving average as North America began arriving for the new week, though tumbled in wake of solid ISM Services PMI data, where the headline was better than the most optimistic analyst forecast. The reaction was risk off, as traders used the familiar Fed normalisation playbook, where better-than-expected data fuels bets for a more aggressive Fed. That said, while Treasury yields widened (yields were up between 7-16bps at settlement, with most of the underperformance in the short-end), money-market implied pricing for the December 14th FOMC was little changed (90% chance of a 50bps rate rise) while expectations of the terminal rate were also little changed (just under 5.00%, or 4.75-5.00%, in May 2023). Nevertheless, the Dollar Index reclaimed the 105.00 handle, supported by higher yields, to the detriment of rate-sensitive FX like the JPY (which was nearly 2% weaker today against the USD). Meanwhile, crude futures began the week on the front foot, initially underpinned by China reopening hopes (some reports suggest we could get an announcement on Wednesday), ignoring the OPEC+ weekend policy decision to stand pat on policy (recall: some had expected a further output cut); however, the complex began the slide along with other risk-sensitive assets after the hawkish ISM, whilst also taking negative cues from the strengthening USD. With the Fed on blackout, traders are contending with a thin US data docket this week ahead of next week's CPI and FOMC; that may leave the focus on technicals and positioning, strategists said, as well as catalysts in other major global macro markets (BoC and RBA are both due this week).

US

ISM SERVICES: Ahead of the November Services ISM data, the S&P Global series of PMI data was glum, noting that the survey data are giving the signal that the health of the US economy is deteriorating at a marked rate, with malaise spreading across the economy to encompass both manufacturing and services in November, and that the data was consistent with the US economy contracting by 1% in Q4, with the decline gathering momentum as we head towards the end of the year. That message, however, was not evident in the ISM data, which surprised to the upside. The headline printed 56.5 (exp. 53.3) from 54.4, and was above the 51.4-55.2 consensus range. Business activity in the services sector improved to 64.7 from 55.7, while employment rose back above the neutral mark, to 51.5 from 49.1. However, new orders pared back a little to 56.0 from 56.5, and while the prices paid sub-index eased to a still elevated 70.0 (from 70.7). Capital Economics said that the rebound on the headline level was consistent with recent consumption data, but says that they still "suspect that resilience will fade next year, as higher interest rates start to take a bigger toll." The consultancy adds, taking a weighted average of the two ISM indices, that is consistent with GDP growth of about 2% in Q4, despite the S&P data pointing to a contraction; "on balance, we suspect the truth will lie somewhere in between the two surveys, with growth dipping slightly below zero over the first half of next year – as recent temporary factors supporting consumption fade, and the lagged impact of higher interest rates feeds through."

FIXED INCOME

T-NOTE (H3) FUTURES SETTLED 25+ TICKS LOWER AT 113-27+

Treasuries bear flattened after hot ISM data confirmed a resilient US economy in wake of NFP Friday. 2s +13.2bps at 4.412%, 3s +15.2bps at 4.143%, 5s +13.9bps at 3.805%, 7s +12.3bps at 3.728%, 10s +10.2bps at 3.605%, 20s +5.8bps at 3.842%, 30s +6.7bps at 3.627%.

Inflation Breakevens: 5yr BEI -4.6bps at 2.512%, 10yr BEI -4.3bps at 2.400%, 30yr BEI -2.6bps at 2.445%.

THE DAY: Treasury futures reopened lower with 10yr yields hovering around 3.53% through to the EU morning as T-notes adjusted to the encouraging China optimism regarding reopening. Nonetheless, the majority of the move was seen in wake of the much stronger than expected ISM Services PMI which saw employment return to expansionary territory while prices paid remained elevated, which eventually saw 10yr yields hit a peak north of 3.60%, albeit it failed to test the 3.64% resistance seen in wake of Friday's NFP report. The strong payrolls report and the Services ISM show how resilient the US economy is in response to Fed's tightening and thus gives them more leeway to continue the hiking cycle, with the main question/concern being how high the Fed ultimately reaches before pausing. Market pricing has the peak at 4.99%, which would imply an FFR of 4.75-5.00%, and is currently lower than what was being priced in pre-Powell last week with terminal seen north of 5.00%.

STIRS

- EDZ2 +0.5bps at 95.173, H3 -7.5bps at 94.830, M3 -11.5bps at 94.775, U3 -15.5bps at 94.895, Z3 -17.5bps at 95.215, H4 -19.0bps at 95.665, M4 -18.5bps at 96.100, U4 -16.5bps at 96.420, Z4 -15.5bps at 96.610, Z5 -14.5 bps at 96.835, Z6 -13.0bps at 96.775, Z7 -10.5bps at 96.640.
- US sells USD 59bln 3-month bills at 4.27%, covered 2.67x; US sells USD 49bln 6-month bills at 4.57, covered 2.57x
- NY Fed RRP op demand at USD 2.094trln (prev. 2.05trln) across 97 bidders (prev. 94).

CRUDE

WTI CRUDE FUTURES (F3) SETTLED USD 3.05 LOWER AT USD 76.93/BBL; BRENT CRUDE FUTURES (G3) SETTLED 2.89 LOWER AT 82.68/BBL

Before the start of the North American day, crude futures were trading on the front foot, underpinned by China reopening hopes, with some reports suggesting that an announcement could come as soon as Wednesday on shifting away from some of the more stringent policies. Additionally, analysts noted that over the weekend, EU policymakers came to an agreement on a Russian oil price cap at USD 60/bbl, which is effective from today. The price cap is already starting to show, with FT reporting an oil tanker jam has formed off the coast of Turkey due to the country demanding new proof of insurance in light of the price cap. Markets were dismissive of the OPEC+ decision to stand pat on policy (recall: there were some expectations that the group could lower output); Citi said the market seemed to be reading the decision as an expression of confidence that OPEC+ has already taken adequate measures to offset demand risks. Elsewhere, Saudi Arabia cut its January Arab light crude prices to Asia while leaving its prices to the US unchanged and cutting the prices of extra light, light and medium grades to Europe. Crude prices turned negative over the course of the US morning, however, with an upside surprise seen in the ISM Services data, which traders rationalised would give the Fed license to continue its brand of hawkish policy in an effort to put a lid on rising consumer prices, with the ISM being cited as further evidence that the economy is taking the Fed's rate hikes in its stride. Accordingly, yields rose along the Treasury curve, supporting the Dollar Index higher and adding a headwind for crude contracts.

EQUITIES

CLOSES: SPX -1.79% at 3,999, NDX -1.73% at 11,787, DJIA -1.40% at 33,947, RUT -2.78% at 1,840

SECTORS: Energy -2.96%, Consumer Discretionary -2.94%, Financials -2.5%, Materials -1.96%, Real Estate -1.72%, Industrials -1.7%, Technology -1.66%, Communication Svs. -1.5%, Consumer Staples -1.2%, Health Care -0.99%, Utilities -0.6%.

EUROPEAN CLOSES: EURO STOXX 50 -0.40% at 3,961.79, FTSE 100 +0.15% at 7,567.54, DAX 40 -0.44% at 14,465.84, CAC 40 -0.47% at 6,710.77, FTSE MIB -0.23% at 24,564.25, IBEX 35 -0.09% at 8,374.80, SMI -0.03% at 11,194.67

STOCK SPECIFICS: **Apple Inc. (AAPL)** supplier **Foxconn (2317 TT)** expects full production at its COVID-hit plant in China to resume from late December to early January. For **Tesla (TSLA)**, it was initially reported the automaker reduced its Shanghai output by up to 20% due to sluggish demand, according to Bloomberg; and output cuts were set to take effect as soon as this week, sources stated. However, Tesla China said the report is "false information". **Microsoft Corp. (MSFT)** is reportedly prepared to fight for its takeover of **Activision Blizzard (ATVI)** if the FTC files a suit to block the deal. Meanwhile, WSJ reported that **Microsoft (MSFT)** President Smith offered **Sony (SONY)** a 10yr contract to make each new "Call of Duty" game available on PlayStation the same day as Xbox. **Amgen (AMGN)** announced its obesity drug demonstrated promising durability trends in an early trial, paving the way for a larger mid-stage study in early 2023. **Verizon Communications (VZ)** Consumer Group Chief is to step down but co. announced it is on track for subscriber growth this quarter, although phone sales could be hampered by supply issues. **Netflix's (NFLX)** launch of an ad-supported subscriber plan has helped the co. gain new users in Q4 to date and is expected to evolve meaningfully over time, according to JPMorgan analysts. **VF Corp (VFC)** announced CEO transition with Benno Dorer appointed as interim President and CEO after the retirement of Steve Rendle. VFC also revised its FY23 outlook to reflect weaker-than-anticipated consumer demand across categories. **Johnson & Johnson (JNJ)** said it does not intend to make an offer for **Horizon Therapeutics (HZNP)**. **NVIDIA's (NVDA)** GeForce RTX 4080 is reportedly getting a price cut by mid-December to make it competitive against **AMD's (AMD)** 7900 XTX. **Pinterest (PINS)** will slow down hiring for the remainder of the year and has laid off part of its recruiting team, according to The Information citing a co. spokesperson. **Salesforce (CRM)** saw its second key executive departure in recent weeks, Slack CEO Stewart Butterfield is leaving **SalesForce (CRM)** in January, according to Business Insider; Lidiane Jones to take over as Slack CEO.

US FX WRAP

The Dollar was bid amid the risk-off conditions that followed hawkish US data. The ISM Services PMI came in above all analyst expectations while employment returned into expansionary territory, prices paid remained elevated and business activity saw a notable increase, while new orders saw a mild move lower. The data didn't have too much impact on implied market pricing for the December FOMC and is still pricing a 90% chance of a 50bps rate hike, while expectations for the terminal rate remain just below 5%. WSJ's Fed whisperer Timiraos warned in a WSJ article that elevated wage pressures could lead the Fed to continue increasing rates to levels higher than investors currently expect. The strong data saw the DXY hit a session high of 105.300 but failed to test the Friday post-NFP high of 105.59.

The Euro was lower due to the rising greenback, which saw EUR/USD fall from highs of 1.0594 pre-ISM to lows of 1.0487 in the US afternoon as risk assets tumbled, with the data allowing the Fed to continue its hawkish trajectory. US yields also surged, adding further pressure on the single currency with yield differentials widening in favour of the USD. Nonetheless, the Final S&P Global PMI data for November was in line with expectations and unrevised from the flash estimate.

The Yen also saw notable weakness, primarily on yield differentials, seeing USD/JPY rise from lows of 134.14 to highs of 137.76, but failed to test 138.00 with USD/JPY now back above its 200dma at 134.61.

The Yuan was an outperformer and firmed against the buck for both onshore and offshore with the currency buoyed by the ongoing China COVID optimism with reports several cities accelerated the loosening of COVID restrictions, including Shanghai and Shenzhen

Cyclical currencies were lower with risk appetite and the dollar strength albeit underperformance was seen in the Antipodean currency despite AUD being supported overnight on the China COVID hopes before swiftly tumbling in the US session on the cautious risk environment. AUD watchers have eyes on the RBA rate decision due overnight, where it is expected to increase its Cash Rate Target by 25bps to 3.10%, with money markets pricing in a 70% chance of such a move; our full preview is available here. AUD gained against its antipodean counterpart to see AUD/NZD reclaim 1.06. GBP and CAD saw similar weakness on the risk play while the downside in crude prices also weighed on CAD ahead of the BoC on Wednesday.

Scandi's were weaker vs the Euro with NOK particularly underperforming after the weakness in Brent crude prices, while SEK saw the latest Riksbank minutes underline their unanimous decision to hike by 75bps at the last meeting, and all members supported the forecast that entails the policy rate probably being raised further at the beginning of next year to just under 3%.

EMFX was mixed: BRL and MXN fell victim to the risk tone and stronger Dollar albeit ZAR managed to gain vs the Dollar as an ANC NEC meeting occurred to decide the fate of President Ramaphosa. The President was not asked to resign, nor did he offer his resignation, while the parliament has postponed the debate on the "farmgate" report by one week to December 13th. Nonetheless, the NEC found Ramaphosa must be held accountable but he will continue with his duties.