US Market Wrap

4th January 2023: Stocks and bonds fight back against hawkish FOMC mins and tight labour market

- **SNAPSHOT**: Equities up, Treasuries up, Crude down, Dollar down.
- **REAR VIEW**: Hawkish FOMC minutes; Kashkari sees 5.4% terminal; job openings remain high; ISM mfg. survey comes in soft; French inflation soft; Ant Group wins China approval for capital plan.
- **COMING UP**: **Data**: German Trade Balance, US ADP, IJC, Canadian Trade. **Supply**: UK.

MARKET WRAP

Stocks closed in the green on Wednesday although index lows and highs were made before midday in NY. US data was disappointing with ISM Manufacturing for December printing beneath expectations, while US JOLTS job openings for November showed little progress in coming down, reflective of a sustained tight labour market, with Friday's Dec. NFP report eyed for a more timely gauge of the labour market. However, across the pond, French CPI figures were the latest in the bloc to come in softer than expected ahead of the EU-wide figures on Friday. Meanwhile, the Dec. FOMC minutes lent on the hawkish side with concerns raised around preemptive loosening in financial conditions whilst warning that much more progress is needed in bringing inflation down despite the promising October and November CPI reports. Treasury curve flatteners were plied on after the minutes although the bulk of the bid for USTs had already occurred by that point, with the earlier French CPI data and continued tumble in oil prices lifting govvies globally. Elsewhere, Fed Speak saw Kashkari (voter) say he pencilled in 5.4% as the Fed terminal rate dot, whilst he warned rates could go "much higher" if monetary lags are not as impactful as expected in bringing inflation down after holding at the target rate for some time - there was little market reaction to his remarks. In FX, the Dollar was sold with cyclical currencies prospering, particularly the AUD as China is being reported to be nearing a partial end to its Australian coal ban. The Yuan was also buoyed alongside Chinese stocks, with optimism after Jack Ma's Ant Group reportedly won Chinese approval for its USD 1.5bln capital plan.

FED

FOMC MINUTES: The minutes were in fitting with Fed commentary, highlighting how no Fed officials see a rate cut in 2023 albeit there was no discussion about the magnitude of the hike in February. The minutes did reveal participants were wary that an unwarranted easing in financial conditions would complicate their effort to restore price stability while several noted the median view on the dot plot, which tracked notably above market expectations, underscores the Fed's commitment to return inflation to target. On inflation, participants generally indicated that upside risks to the inflation outlook remained a key factor shaping the outlook for policy. A couple of participants noted that risks to the inflation outlook were becoming more balanced. Participants welcomed inflation drops in October and November but concurred it would take "substantially more evidence" of progress to be confident of a sustained downward path. Many officials highlighted the need to balance two-sided risks: 1) Insufficiently restrictive monetary policy could cause inflation to remain above target for longer than anticipated, leading to unanchored inflation expectations and eroding purchasing power. 2) The lagged cumulative effect of policy tightening could end up being more restrictive than is necessary and lead to an unnecessary reduction in economic activity. Note, Bloomberg sentiment data suggested the December minutes were modestly more hawkish than November.

FED SPEAK: Fed's Kashkari (voter) said it is appropriate to continue rate hikes "at least at the next few meetings" until the Fed is confident that inflation has peaked, then, in his view, should hold the target rate at 5.4% - above the 5.1% Fed median. Kashkari added there is increasing evidence that inflation may have peaked but they will not know if the target rate is high enough until Fed pauses for a "reasonable" period of time. Once the Fed allows for policy lag effects, it can then assess if rates need to go higher or remain at peak for longer. In this phase, any sign of slow progress on lowering inflation will require taking the policy rate potentially much higher. On rate cuts, Kashkari said the Fed can consider cutting rates only when it's convinced inflation is well on its way back down to 2% and they must avoid cutting rates prematurely and having inflation flare up again, as that would be a costly error

US DATA

JOLTS: The US JOLTS job openings data for November fell to 10.458mln from 10.512mln (revised higher from 10.334 mln) and was above expectations of a cooling to 10mln. The Quits Rate rose to 2.7% from 2.6%, while the Fed-eyed ratio of vacancies to unemployed workers remained steady at 1.7, a metric the Fed would have preferred to see a decline, which Oxford Economics highlights as still well above the post-2001 0.6 average. On the quits rate, the consultancy noted it shows "the continued willingness of laborers to test the market and seek out other opportunities." With JOLTS not cooling as much as hoped and the ratio of vacancies to unemployed workers remaining steady, the Fed will likely view this as a hot labour market report and will continue on their hiking cycle. However, the report was for November and we get the more timely December jobs report on Friday for a more up-to-date gauge of the labour market.

ISM MANUFACTURING: ISM Manufacturing for December was a mixed report, as the headline just missed expectations at 48.4 (exp. 48.5, prev. 49.0), while prices paid fell to 39.4 from 43.0, well beneath the expected 42.6. Employment rose back into expansionary territory and printed 51.4 (exp. 48.3, prev. 48.4), despite hope at the Fed it would show some signs of cooling. New orders and production dipped to 45.2 (prev. 47.2) and 48.5 (prev. 51.5), respectively. Capital Economics note the headline fall to a two-and-a-half-year low is a further sign that the economy was losing momentum at the back end of last year, and as such almost all the survey-based evidence points to a complete stagnation or even contraction in activity. Moreover, CapEco adds, adding to slowing domestic demand, the weak global backdrop also appears to be playing a key role in the headline drop, with the new export orders index falling to 46.2 (prev. 48.4). Supply-chain indicators continue to indicate fading goods price inflation, as supplier delivery times fell as well as the aforementioned prices paid declining. On top of this, backlogs ticked higher which indicates most of the order backlog caused by a lack of supply as the economy emerged from COVID has been cleared. Overall, Capital Economics concludes that the weaker ISM shows activity stalling, but labour market conditions remain tight.

FIXED INCOME

Treasuries were bid Wednesday amid tumbling oil prices and soft European inflation data, although high US job openings and IG supply capped strength. 2s -2.9bps at 4.376%, 3s -5.7bps at 4.136%, 5s -7.7bps at 3.868%, 7s -8.8 bps at 3.801%, 10s -8.7bps at 3.705%, 20s -8.5bps at 3.975%, 30s -7.5bps at 3.817%.

Inflation breakevens: 5yr BEI -5.5bps at 2.251%, 10yr BEI -3.1bps at 2.223%, 30yr BEI -3.2bps at 2.280%.

THE DAY: Treasuries rallied into the APAC Wednesday session with Japan back from holiday although desks noted average activity. T-Notes managed to breach Tuesday's peak of 113-03+ at the Tokyo/London handover, finding spillover strength from EGBs that accelerated after the French CPI data came in on the soft side, similar to the Spanish and German prints. The continued selling in energy prices only added to the bid. T-Notes found resistance at 113-14 in the wake of the European data, before going on to stretch to session highs of 113-15+ in the NY morning. Strength was soon capped in the wake of the 10+ IG Dollar issuers in the primary market and the stubbornly high US JOLTS job openings data for November, despite the soft ISM Manufacturing report, seeing a broad, hawkish reaction that saw T-Notes sold down to interim lows of 113-02+ in an initial bear-flattener. But, heading into the NY afternoon, the long end saw some selling, aided by a 6.9k Ultra 10yr block sale. That brought the curve off of its most inverted levels. Later on, T-Notes printed new, post-JOLTS lows of 113-02 in reaction to the FOMC minutes, which leant hawkish on margin, before paring into settlement as curve flatteners were plied on taking curve spreads back to lows. Attention moves now to Friday's NFP report, with market positioning seemingly balanced amid JPM's latest Treasury survey showing client neutrals at a record high.

STIRS:

- EDH3 -0.5bps at 94.915, M3 -1bps at 94.82, U3 -1bps at 94.93, Z3 flat at 95.23, H4 +2bps at 95.635, M4 +4.5bps at 96.035, U4 +7bps at 96.33, Z4 +8bps at 96.505, H5 +9bps at 96.61, H6 +11.0bps at 96.70, H7 +10.5bps at 96.61.
- NY Fed RRP op demand at USD 2.230tln (prev. 2.188tln) across 108 bidders (prev. 99).
- US sold USD 33bln of 17-week bills at 4.57%, covered 3.10x.

CRUDE

WTI (G3) SETTLED USD 4.09 LOWER AT 72.84/BBL; BRENT (H3) SETTLED USD 4.26 LOWER AT 77.84/BBL

Oil prices extended their decline on Wednesday with desks pointing to ongoing global demand concerns, highlighted by the weak ISM manufacturing data. The selling was gradual and continued all the way into the futures settlement, with the softer Dollar failing to cap the losses. The bearish concerns in the energy market are being reflected in the spot market with Reuters reporting Wednesday that Saudi Aramco looks set to cut its prices for Arab Light even further for February, echoing other Gulf states, "as concerns of oversupply continue to cloud the market." There's also the overhang of Tuesday's reports that China is raising its 2023 export quotas for refined products, indicative of slow domestic demand with question marks on the country's reopening path and the accuracy of COVID statistics. Energy participants now look to the day-delayed US inventory data, with the private release due later Wednesday ahead of official EIA figures on Thursday. Current expectations (stock change in bbls): Crude +1.2mln, Gasoline -0.5mln, Distillate -0.4mln.

EQUITIES

CLOSES: SPX +0.75% at 3,853, NDX +0.48% at 10,915, DJIA +0.40% at 33,269, RUT +1.25% at 1,772

SECTORS: Real Estate +2.28%, Materials +1.74%, Financials +1.59%, Consumer Discretionary +1.41%, Communication Services +1.09%, Utilities +0.94%, Industrials +0.91%, Consumer Staples +0.29%, Technology +0.26%, Health Care +0.25%, Energy +0.06%.

EUROPEAN CLOSES: EURO STOXX 50 +2.36% at 3,973, FTSE 100 +0.41% at 7,585, DAX 40 +2.18% at 14,490, CAC 40 +2.30% at 6,776, FTSE MIB +1.74% at 24,860, IBEX 35 +1.93% at 8,559, SMI +1.57% at 11,151.

STOCK SPECIFICS: **Microsoft (MSFT)** was lower following a downgrade at UBS who cited concern over its Azure and Office businesses following a series of field checks. Separately, MSFT is preparing to launch a version of its Bing search engine that uses AI to answer some search queries rather than just showing a list of links, according to The Information citing sources, in a challenge to **Google (GOOGL)**. **Salesforce (CRM)** firmed after it announced a restructuring plan which includes a reduction of the current workforce by circa. 10%; CRM will incur approx. USD 1.4-2.1bln of charges in connection. **Goldman Sachs (GS)** top dealmakers are bullish on an M&A recovery in H2 2023, adding that it was primed for a recovery when financing markets ease up. **Alphabet (GOOGL)** had an Indian tribunal decline a request by Google to block an antitrust ruling that ordered the co. to change its approach to its Android platform. **Rivian Automotive (RIVN)** 2022 vehicle production was 24,337, missing its annual target of 25k, despite ramping production late in the year. **Alibaba (BABA)** surged, while other Chinese ADRs and the **Golden Dragon ETF (PGJ)** gained after Jack Ma's Ant Group reportedly won Chinese approval for its USD 1.5bln capital plan despite China's tech crackdown in recent years. **Corning (GLW)** closed in the black after an upgrade at Credit Suisse who noted headwinds could change to tailwinds in 2023. **Honeywell (HON)** saw weakness in wake of a double downgrade by UBS; said shares are at a premium and it's anticipating an order slowdown. **Coinbase (COIN)** reached USD 100mln settlement with New York regulators, according to NY Times. **Meta (META)** reportedly faces a EUR 390mln fine and must find a new legal route to targeted ads; the Irish regulator is suing the EU data protection body over claims of overreach. **Disney's (DIS)** 'Avatar' sequel has grossed USD 1.48bln worldwide and is expected to surpass Top Gun on Wednesday. **Credit Acceptance Corporation (CACC)** is being sued by New York AG and CFPB for pushing consumers into unaffordable loans. **Ryanair (RYA ID)** said it expects to report a stronger Q3 with stronger than expected holiday season traffic; raising FY profit guide to EUR 1.325-1.425bln from 1.00-1.20bln but it does expect Q4 to be a loss.

FX WRAP

The Dollar pared back its Tuesday strength with selling observed in Asia hours on the lower US yields driving the price action which saw the DXY cross beneath its 20dma at 104.267 in early trade to lows of 103.80, testing the 50dma at 1.0384 before paring losses in the US session after the hawkish manufacturing employment and job openings data, although the prices and new orders components in the PMI survey did fall beneath expectations. Eventually, the DXY returned to the 20dma in wake of the FOMC minutes, which maintained the Fed's hawkish tone, noting participants are wary of an unwarranted easing in financial conditions.

The Euro was bid after Tuesday's selling pressures with the Dollar paring its strength on Wednesday to support the single currency although there was a knock in the morning on the cooler-than-expected French CPI data ahead of the EZ CPI on Friday, seeing EGBs lead the strength in global govvies. EUR/USD traded either side of 1.06 within a 1.0542 and 1.0635 parameter and hovered around the psychological level heading into the last bit of the US session.

The Yen was notably weaker vs the buck, particularly in wake of the aforementioned US data that keeps the Fed on its hawkish trajectory, widening the Fed/BoJ policy divergence.

The Yuan was bid (both on and offshore) amid the Dollar selling, while there were several updates including China announcing measures to stabilise the price and quality of COVID drugs as well as reports it is considering measures to shore up "too big to fail" developers. Meanwhile, Chinese stocks also performed well, particularly tech, after Jack Ma's Ant Group reportedly won Chinese approval for its USD 1.5bln capital plan. Chinese tourism is also a growing issue with EU members agreeing to recommend that all passengers on flights to and from China wear face masks and will urge pre-departure COVID testing for flights from China.

Cyclicals were bid. AUD saw notable gains and was the cyclical outperformer with the Aussie supported by both the weaker Dollar and upside in US equities, it was also supported by China optimism as well as Bloomberg reports that Chinese authorities are mulling a partial end to the Australian coal ban. Kiwi and Sterling also saw pronounced upside albeit the Loonie was among the Aussie in terms of outperformance in the group despite the continued slump in crude prices while technicians are eyeing support at the 100dma of 1.3465, a level it sits just above at pixel time.

Scandis were mixed with NOK underperforming once again falling victim to the slide in Brent crude prices while SEK was bid vs the Euro and the Dollar.

EMFX was generally supported although RUB also fell victim to the lower crude prices while TRY was flat despite being a net oil importer. ZAR was helped by the bid into gold prices and BRL underpinned by comments from the Chief of Staff Costa that there is no proposal to reverse reforms being considered at the moment. CEE currencies were bid against both the Euro and the Dollar with HUF saw gains after higher-than-expected wages data, as well as the NBH minutes maintaining a hawkish stance. Meanwhile, PLN took hold of another unchanged rate decision from the NBP, very much as expected.