US Market Wrap

31st May 2023: Hawkish bets unwind on dovish Fed Speak and weak mfg. data despite hot JOLTS

- **SNAPSHOT**: Equities down, Treasuries up, Crude down, Dollar up.
- **REAR VIEW**: Woeful Chicago PMI; Hot JOLTS; Cool German and French inflation; Soft China PMI; Harker and Jefferson in the "skip" camp for June; Mester maintains hawkish view; Negotiators confident ahead of debt ceiling vote; Dire AAP earnings.
- **COMING UP**: **Data**: US ISM Manufacturing PMI, Challenger Layoffs, ADP, IJC; EU Flash CPI, Unemployment Rate; Caixin, EU, US & UK Manufacturing PMIs **Events**: ECB Minutes, BoE DMP Speakers: Fed's Harker; ECB's Lagarde, Enria **Supply**: Spain & France.

MARKET WRAP

Stocks were lower Wednesday with particular weakness in real-economy levered names (gauged via Russell 2k) on account of the weak China and Chicago PMI data. The Dollar caught a strong bid on the back of the China data, but also on soft inflation data in Germany and France, which rate differentials move in favour of the global reserve currency. US data was mixed as far as policy/market implications with the weak Chicago PMI offset by a surprise spike in JOLTS job openings. Dollar strength was pared later in the US session after Fed's Jefferson and Harker, both voters on the FOMC, gave the nod to a June 'skip'. That saw US yields make fresh lows on the session with money markets now implying just a 30% implied probability of a 25bps hike, vs 70% implied before their comments. In stocks, note that Nvidia (NVDA) closed lower by 5.7%, its worst day since January 30th in the absence of a particular catalyst, rather just profit taking into month-end, although the Nasdaq still closes the month up nearly 6%, as opposed to the SPX which is flat. On earnings, Advanced Auto Parts (AAP) tumbled after a dismal quarter where it also cut its guidance and dividend. Elsewhere, oil prices tumbled on account of the weak macro data and the stronger Dollar. On the debt limit, the bill goes now to a vote in the House later Wednesday, with Congressional leaders expressing optimism that it can pass.

FED

JEFFERSON (voter and Vice Chair nominee) said in a speech that holding the policy rate constant "at a coming meeting" should not be taken to mean rates have reached a peak for this tightening cycle; noting that skipping a hike would allow time to assess the data. The Board member did not mention anything about his June meeting decision being dependent on data before then either (NFP and CPI), an attempt to take some of the sting out of the approaching releases after recent data has worked in favour of the hawks. The remarks were interpreted by markets and commentators as a strong signal from the Fed hierarchy that an unchanged decision in June is the preferred outcome, with Chair Powell's equally dovish comments on May 19th having been overpowered by the strong data and hawkish Fed Speak since then.

HARKER (voter), speaking at a fireside chat in his first public remarks since April, said he is the camp that we can 'skip' a meeting. The official made the distinction that it would be a skip not a pause, saying that a pause says that you may hold there for a while and he doesn't think that Fed is ready for that. On credit, Harker said we are not seeing so much a credit crunch as a credit squeeze following SVB.

MESTER (non-voter, hawk) gave an interview to the FT, where she said she sees no compelling reason to wait for a fresh rate increase and that the debt-ceiling deal removes "a big piece of uncertainty" over the US economy. Note that Mester had already inferred earlier in May that she was leaning toward another hike. The Cleveland Fed President said in her interview that the only reason for skipping a hike, when it is clear more tightening is necessary, would be when there is extreme market volatility or some other shock such as a debt default. She caveated her view that she could still be swayed by NFP and CPI data. Whilst also warning that rate decisions will become more fraught in the future.

BEIGE BOOK: The latest Beige Book report from the Fed saw overall economic activity little changed in April and early May, with future growth conditions deteriorating a little bit, but contacts still largely expect further expansion. On credit, the report noted financial conditions were stable mainly, although some regions did report further tightening. Employment increased in most Districts, though at a slower pace than in previous reports, with some reporting they were pausing hiring or reducing headcounts due to weaker actual or prospective demand or to greater uncertainty about the economic outlook. Prices rose moderately over the reporting period, though the rate of increase slowed in many Districts. Contacts in most Districts expected a similar pace of price increases in the coming months. Consumer prices continued to move up due to solid demand and rising costs, though several Districts noted greater price sensitivity by consumers than in the prior report.

US

JOLTS: Job openings in April unexpectedly rose to 10.103mln from the upwardly revised 9.745mln, compared to expectations for a fall to 9.35mln. That unwinds some of the progress made in de-tightening the labour market through Q1 and remains at levels far above that of pre-COVID. Oxford Economics writes, "While there are some concerns over the veracity of the JOLTS survey due to historically low response rates, the upshot remains that labour market strength is robust". The silver lining for the Fed is that the Quits Rate fell to 2.4% from 2.5%, the lowest level since February 2021. Oxford Economics adds, "Though this is still above the pre-pandemic average of 1.9%, it signals workers are losing some of the impetus to test the labor market in search of new positions. Workers who land new jobs command larger wage increases, so a slowing in the quits rate should contribute to some easing of wage pressures."

CHICAGO PMI: Chicago PMI plunged to 40.4 in May (prev. 48.6), well beneath the expected 47.0 and lower than the most pessimistic analyst estimate of 45.6. The fall in the headline more than reversed the April spike and remains below 50 for the ninth straight month. As always, it broadly tracks the lagged trend in civilian aircraft orders, due to Boeing's HQ in Chicago, which Pantheon Macroeconomics notes jumped in H2 '22, but adds aircraft orders have dipped more recently as the post-COVID rebound in air travel has petered out. The data set adds to the slew of May regional surveys showing a continued slump in the US manufacturing sector, ahead of ISM Manufacturing on Thursday, although, the regional surveys are way more volatile than the national index due to their small sample sizes. Nonetheless, Pantheon Macroeconomics notes, "The manufacturing sector remains firmly in recession, as the ongoing deterioration in domestic demand, due to higher rates and dwindling capital availability, is offsetting any boost from the re-opening of China's economy."

DEBT LIMIT: The House will vote on the debt limit Wednesday and the final vote is expected at 20:15EDT/01:15 BST. Some of the hardcore lawmakers from both Republicans (House Freedom Caucus) and Democrats (Progressives) are against the bill, but negotiators are confident they still have the votes to pass it. Republican Whip Emmer said the debt limit will pass on Wednesday, and the aim is to get 218 votes, echoing commentary from negotiator McHenry that he has the votes to pass the debt limit bill Wednesday. While some of the Democrats are against the bill, House Minority Leader Jeffries said in a meeting with WH officials he urged the Democratic caucus to back the divided debt ceiling bill. Providing the bill passes the House, it will then be sent to the Senate, where it is also expected to pass with both Senate leaders endorsing the bill, as well as the moderate democratic Senator Manchin. President Biden expects the bill to be on his desk to sign by June 5th, the latest estimate of the X-Date from the government.

FIXED INCOME

T-NOTE (U3) FUTURES SETTLE 14 TICKS LOWER AT 114-15

Treasuries bull-steepened with soft China PMIs and European inflation data accentuated by a dive in Chicago PMI and dovish Fed commentary, despite the spike in JOLTS. 2s -9.7bps at 4.376%, 3s -10.2bps at 4.024%, 5s -9.6 bps at 3.725%, 7s -8.4bps at 3.676%, 10s -7.6bps at 3.620%, 20s -6.8bps at 3.998%, 30s -6.4bps at 3.837%.

INFLATION BREAKEVENS: 5yr BEI -3bps at 2.115%, 10yr BEI -3.7bps at 2.198%, 30yr BEI -6.2bps at 2.231%.

TOKYO/LONDON: Treasuries saw modest strength into the APAC Wednesday session, where above forecast Australian CPI was offset by the beneath-expected China PMI data - Japanese IP data also missed. In the FT, Mester (non-voter, hawk) said the Fed shouldn't skip or pause at the June meeting, especially now that a debt limit deal looks to be agreed on, nothing too incremental from her. New highs were made for govvies in the European morning (T-Notes hit resistance at 114-14+), where soft German regional CPI data front-ran the national figures. The French figures were also soft, although Italian figures fell less than expected, tempering some of the bond strength ahead of the EU-wide figures on Thursday. ECB speakers have been out, with Villeroy saying it's quite likely France has passed its peak in inflation, de Guindos highlighting the positivity from the data, and Visco saying inflation risks have receeded considerably from mid-2022.

NEW YORK: T-Notes re-tested their peaks at 114-14+ at the NY handover right after the German nationwide CPI data, with a chunky 12.9k 2yr/11.5k 5yr block steepener seen leading into that data on arrival of US participants. The continued weakness in commodities also provided tailwinds. Contracts only managed to make a new high (114-15) after the tumble in the Chicago PMI data, adding to the broad slew of disappointing regional surveys. But that bid was swiftly reversed on the release of the surprise jump in JOLTS job openings as T-Notes were sold down to 114-02. It wasn't until Fed's Jefferson and Harker (both voters) both gave the nod to a June 'skip' in the NY afternoon that T-Notes made session peaks at 114-17, with the front-end leading the late rally as hike pricing saw a massive unwind; June 25bp hike currently implied by money markets at 30% probability vs 70% before the Fed speakers. Month-end buying was also a supportive factor.

AHEAD:

- THU: ECB Minutes, Chinese Final Caixin Manufacturing PMI (May), German Retail Sales (Apr), EZ/UK/US Final Manufacturing PMIs (May), EZ Flash CPI (May), US ADP National Employment (May), US Productivity, US ISM Manufacturing PMI (May), Fed's Harker.
- FRI: US Labor Market Report (May).

STIRS:

- SR3M3 +7bps at 94.733, U3 +7bps at 94.845, Z3 +8.5bps at 95.17, H4 +11bps at 95.635, M4 +12.5bps at 96.11, U4 +12.5bps at 96.505, Z4 +11.5bps at 96.775, H5 +10bps at 96.92, M5 +9.5bps at 96.975, M6 +9bps at 96.965.
- SOFR flat at 5.06%, volumes rise to USD 1.530tln (prev. 1.476tln).
- NY Fed RRP op demand at USD 2.255tln (prev. 2.200tln) across 107 counterparties (prev. 103).
- EFFR flat at 5.08%, volumes fall to USD 127bln from 136bln.
- US sold USD 44bln of 17-week bills at 5.325%, covered 2.97x.
- Treasury announced new USD 25bln 3-day CMBs to be sold on June 1st, settling on June 2nd.

CRUDE

WTI (N3) SETTLES USD 1.37 LOWER AT 68.09/BBL; BRENT (Q3) SETTLES 1.11 LOWER AT 72.60/BBL

Oil prices were lower Wednesday after soft China PMI data and a stronger Dollar. However, it's worth noting that the benchmarks closed off their troughs seen at the London/NY handover at USD 67.03/bbl and USD 71.39/bbl for WTI and Brent, respectively. Technicians flagged a rejection for Brent contracts of their 200-WMA, which was at USD 71.25 /bbl, which they haven't been beneath since February 2021. Some loose chatter of month-end buying was also doing the rounds amid the loss paring, or said differently, there was no clear catalyst for the recovery. Later on, Reuters released their May OPEC+ survey: Output falls by 460k BPD from April following the voluntary cuts by members; quota-bound members comply with 137% of all pledged cuts in May (vs 194% in April). That comes ahead of the OPEC+ meeting this coming Sunday. While in Russia, local press reported that Moscow's plan to halve subsidies for oil refiners may be postponed until September; the finance ministry later added that no final decision on subsidies has been taken yet.

EQUITIES

CLOSES: SPX -0.61% at 4,180, NDX -0.7% at 14,254, DJIA -0.41% at 32,908, RUT -1.00% at 1,750

SECTORS: Energy -1.88%, Industrials -1.4%, Financials -1.14%, Materials -1.12%, Technology -1.09%, Consumer Discretionary -0.92%, Communication Services -0.05%, Consumer Staples +0.07%, Real Estate +0.65%, Health Care +0.85%, Utilities +0.96%.

EUROPEAN CLOSES: Euro Stoxx 50 -1.71% at 4,218, FTSE 100 -1.01% at 7,446, DAX 40 -1.54% at 15,664, CAC 40 -1.54% at 7,098, FTSE MIB -1.97% at 26,051, IBEX 35 -1.28% at 9,050, SMI -0.57% at 11,217.

STOCK SPECIFICS: **Advance Auto Parts (AAP)** posted a dismal report; revenue fell short and notably missed on profit alongside cutting the FY23 outlook and its dividend. **American Airlines (AAL)** lifted Q2 adj. EPS and TRASM outlook, while it reaffirmed FY profit guidance. **HP (HPQ)** missed on revenue, while guidance was in line. Profit beat accompanied with some upbeat commentary. **Hewlett Packard Enterprise (HPE)** fell short on revenue with next quarter and FY revenue guide light. Although, profit beat and it raised the FY23 outlook. Activist investor Legion Partners met with the **Twilio (TWLO)** board, pushing for changes including a board shakeup and divestitures. **Ambarella (AMBA)** Q2 revenue view was light. Note, co. posted a shallower loss per share than expected and marginally beat on revenue. **Wells Fargo (WFC)**, speaking at a Bernstein Conference, said credit quality continues to be strong and has taken some steps to reduce origination on some loans on consumer and commercial loans. Has seen no major changes in deposits. **Ford (F)** CEO said more regulatory support needed to hit 50% EV goal and expects EV cost parity with combustion vehicles by 2030-2035. **Amazon (AMZN)** workers plan to walk out over lack of trust in leadership, according to CNBC. **Intel (INTC)** CFO speaking at a conference said he sees Q2 revenue in the upper half of the guided range (USD 11.5-12.5bln), tracking USD 12.0-12.5bln. He added, INTC's data center division is starting to “turn the corner” and China inventory should start to ease after Q3. **Apple's (AAPL)** mixed-reality headset launch next week will be the most complicated hardware product ever made by the Co.; expected to be USD 3k, according to The Information. **Dow (DOW)** cut its Q2 revenue guidance beneath analyst expectations but it was more optimistic on profit. **Boeing (BA)** said it anticipates the 737 MAX certification taking a considerable amount of time, but still sees is in 2023. PE firm Thomas H. Lee Partners is said to have made a USD 17/shr all-cash offer for **Maravai LifeSciences (MRVI)**, according to Street Insider citing sources.

US FX WRAP

The Dollar was bid on Tuesday following a weaker Yuan in APAC trade amid weak PMI data (more below) while it was also propped up by more soft inflation prints in the EZ, this time out of Germany and France. The buck hit highs after the JOLTS job openings saw a surprise spike, which offset the weakness seen just before in the woeful Chicago PMI data. DXY hit a high of 104.70 in wake of the jobs data before paring a lot of the gains down to c. 104.30 after dovish Fed commentary from both Vice-Chair nominee Jefferson and Harker (both voters), who both are in the camp for a 'skip' at the June meeting. Money markets pared hawkish bets in wake of the comments, with the probability for a 25bp hike in June falling from c. 65% post-JOLTS to c. 30% post-Jefferson and Harker.

The Yuan saw weakness in wake of a woeful Chinese NBS Manufacturing PMI print of 48.8, beneath the expected 49.4 and prior 49.2, showing the lowest print since December 2022. The data saw USD/CNH rise above 7.10 to highs later of 7.1120 and had broader implications for other currencies, including the Euro, and Antipodeans.

The Euro was weaker as it traded in sympathy with the Yuan while German and French Inflation data came in cooler than expected, offsetting upside in the Italy release ahead of the overall EZ inflation figures, for more, please see the Newsquawk European Data Wrap. EUR/USD lost hold of the 1.07 handle and hit a low of 1.0636 before paring to 1.0671. Analysts at Rabobank write, "positioning can help explain the move lower, with the market keen to build long dollar positions at a time when investors are likely having second thoughts about the recent build-up of EUR longs". The bank adds that EUR/USD is on course for hitting its H2 target of 1.06.

The Yen saw gains vs the buck with USD/JPY hitting a high of 140.37 in wake of the JOLTS data before paring throughout the session to lows of 139.24 testing the tenkan support at 139.18. The Yen was predominantly supported on the move lower in UST yields with the dovish repricing post-Jefferson and Harker lending a helping hand. During Tokyo trade, however, the Yen was buoyed by commentary from BoJ governor Ueda who observed a new norm has replaced the era of persistently low inflation and interest rates.

Antipodeans were softer on the soft China data as well as the downbeat risk tone, with downside in stocks and upside in the Dollar. AUD/NZD saw initial gains however after hotter than expected Aussie CPI report which saw Goldman Sachs raise their RBA terminal rate forecast to 4.35% from 4.10% and now expects the RBA to hike by 25bps in both June and July. There was also commentary from RBA Governor Lowe who noted policy is in a restrictive environment but service price inflation has remained very high, warning entrenched inflation would lead to higher rates and unemployment. The Governor also noted the RBA will do what is necessary to ensure inflation comes back to target in the next few years.

The Pound was flat vs the buck but saw notable gains vs the Euro after commentary from BoE Hawk Mann and the latest economist poll ahead of the next confab. BoE's Mann noted the gap between headline and core inflation is more persistent vs that seen in the US and eurozone, and the economy is on a path which has an awful lot of volatility. Meanwhile, after recent inflation data, the latest BoE poll has the central bank hiking rates by 25bps to 4.75% on June 22nd, according to 48/50 economists surveyed by Reuters, with the bank rate seen peaking in Q3 at 5%, vs 4.5% in Q2 on May 5th.

The Loonie was stronger vs the buck despite weaker oil prices with the Currency supported by a better-than-expected Q1 and March GDP report.

EMFX was generally weaker. In LatAm, BRL saw general weakness on more bets for rate cuts from the BCB amid constant calls from the fiscal authorities to do so while the latest data saw a weaker than expected jobs report. CLP also saw weakness after a fall in manufacturing activity and copper production, as well as falling copper prices following the soft China data although the red metal pared and finished the session flat. COP fell victim to the lower oil prices. MXN was weaker in fitting with LatAm FX and saw little reaction to Banxico commentary where it lowered its headline inflation forecast for Q3 23 to 5.2% from 5.3%, previously but maintained guidance that it will be necessary to maintain the reference rate at its current level for a prolonged period. Elsewhere, the Lira hit a fresh record low on reports its former Economy Minister Simsek is set to be included in President Erdogan's cabinet as either finance minister or even Vice President.

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