US Market Wrap

18th July 2023: Stocks rally post bank earnings, AI announcements and mixed US data

- **SNAPSHOT**: Equities up, Treasuries mixed, Crude up, Dollar flat.
- **REAR VIEW**: Mixed US retail sales; Financials earnings generally beat with SCHW leading the way; Industrial production missed; US bank regulators set to impose new capital rules next week; ECB's Knot shocks with dovish twang; BoJ Governor Ueda pushes back idea of monetary policy alterations; MSFT lifts AI Copilot cost with upgrade to raise costs for MSFT customers by at least 53% at list prices;
- **COMING UP**: **Data**: UK CPI, EZ HICP (Final), US Building Permits/Housing Starts **Speakers**: BoE's Ramsden **Supply**: Germany, UK & US **Earnings**: ASML; Netflix, Tesla, Goldman Sachs, IBM.

MARKET WRAP

Stocks were bid on Tuesday with outperformance in the Russell 2000 amid strong gains in the regional banking ETF supported by a slew of strong bank earnings from Bank of America (BAC), Morgan Stanley (MS), Bank of New York Mellon (BK), and others. Sectors were predominantly green with outperformance in Technology, namely led by Microsoft (MSFT) and NVIDIA (NVDA) on more AI updates while Energy gains tracked the upside in crude prices, with Financials bid on the aforementioned strong earnings - one woe was PNC (PNC), however, following a guidance cut, but the pre-market weakness completely pared. Defensive sectors were the laggards in risk-on trade, with Real Estate, Utilities and Consumer Staples the only sectors in the red. Aside from earnings, the focus was on the US data with a mixed retail sales report as the headline and core misses were offset by upward revisions and a strong control group while Industrial Production data missed, falling 0.5%. The overall mixed data saw the DXY reclaim 100 although it failed to hold throughout the tail-end of the session while the Yen was weaker after dovish commentary from BoJ Governor Ueda. The Euro pared its post-dovish Knot move lower after the usual hawk questioned the need for rate hikes post-July. Crude prices gained on the risk environment ahead of inventory data after hours. Meanwhile, the risk on move in equities saw the Treasury curve flatten, with any upside seen post data and Knot paring ahead of 20yr supply on Wednesday,

GLOBAL

US RETAIL SALES: The US retail sales report was mixed, although the headline and core metric fell beneath analyst expectations, there were upward revisions to the prior helping offset the downbeat headline. The headline rise of 0.2% was short of the 0.5% expected and down from the prior 0.5% (revised from 0.3%), while the core (ex-autos) rise of 0.2% missed the expected 0.3% and was beneath the prior 0.3% (revised from 0.1%). Meanwhile, the ex-gas and autos metric (supercore) rose 0.3%, cooler than the prior 0.5% (revised from 0.4%). Although the headline and core missed expectations, the control group, that feeds into GDP, saw a notable beat at 0.6%, above the expected 0.3% and prior 0.3%, matching the top end of analyst forecasts. Delving into the report, there was a turnaround for furniture purposes, rising 1.4% from the prior months 0.4% decline, while electronics also gained another 1.1%, adding to the 2.1% in May. Miscellaneous store retailers rose 2.0% from -1.3%, while non-store retailers rose 1.9% from 0.7%. On the flipside, the largest declines were in building materials -1.2% from the prior +1.4% and gasoline stations, -1.4% from the prior -2.1%, coming as gasoline prices continue to fall. Analysts at Pantheon Macroeconomics suggest consumer spending rose 1% annualised in Q2, down from the 4.2% in Q1. Meanwhile, on the control group, the consultancy notes the beat was primarily led by a 1.9% jump in online sales while looking to July they note Amazon's Prime Day will likely boost sales but it is unclear how much of this strength will be offset by reasonable adjustments.

INDUSTRIAL PRODUCTION: US industrial production was much weaker than anticipated in June and fell 0.5% (exp. 0.0%), even greater than the previous decline of -0.2%. Manufacturing output declined -0.3% (exp. 0.0%, prev. +0.1%), while capacity utilisation slipped to 78.9% (prev. 79.6%) short of the forecasted 79.5%. Analysts at Pantheon Macroeconomics note the drop in manufacturing output partly reflects a 3% slump in auto production, but this only partially reverses the 11% surge in April/May. Meanwhile, auto production remains notably above its pre-COVID level, so further declines in the months ahead are a decent bet. Moreover, manufacturing output ex-autos fell for the second consecutive month, resulting in a 0.9% annualised decline over Q2, and as such the ISM manufacturing index points to a much steeper decline in Q3. Overall, the softer data indicates a manufacturing recession and ING further highlights this by not expecting an imminent rebound in output from the manufacturing or mining sectors.

RBA MINUTES: Minutes from the July meeting said that the Board considered holding rates steady or hiking by 25bps, and there was a strong case for both, but the Board judged arguments for holding steady were stronger. The Board agreed some further tightening may be required and would reconsider at the August meeting. The current stance of monetary policy was clearly restrictive, and would become more so. The minutes said that while domestic inflation has eased, service inflation is still high along with rents, energy and food, though it acknowledged that there were risks associated with waiting too long for inflation to return to the target. Analysts at Westpac believe that the RBA meeting minutes suggest the future direction of policy is uncertain. The bank notes that while there is a case for further tightening, the minutes also emphasised downside risks to the outlook. Westpac thinks the decision in August will be balanced, taking into account factors such as inflation, employment, and global trends. "Westpac continues to expect that slow progress in reducing inflation, which is likely to be apparent in the June quarter inflation report, and ongoing tightness in the labour market, particularly as job vacancies remain historically elevated, will make the case for further tightening well justified," though it added that "we cannot be unmoved by the strength of arguments put forward for the July decision to leave rates on hold, particularly new ones around the stance of policy, the shape of the yield curve and downside risks to the outlook."

FIXED INCOME

T-NOTE (U3) FUTURES SETTLED 1 TICK HIGHER AT 112-24

Treasuries flattened with mixed retail sales and dovish ECB comms the impetus. At settlement, 2s +3.4bps at 4.766%, 3s +2.5bps at 4.353%, 5s +1.1bps at 4.014%, 7s +0.8bps at 3.910%, 10s +0.2bps at 3.799%, 20s -1.1bps at 4.085%, 30s -1.5bps at 3.908%.

INFLATION BREAKEVENS: 5yr BEI +7.0bps at 2.250%, 10yr BEI -2.7bps at 2.240%, 30yr BEI -2.5bps at 2.253%.

THE DAY: T-Notes hovered sideways into and through Tuesday's APAC session in a tight 112-23+/112-19+ range with little catalysts to drive price action - RBA minutes were received hawkishly on the margin. As has been a custom lately, Europe came in and lifted the offer, with some weight behind the bid on the back of ECB's Knot, who is typically hawkish, calling into question whether to hike again beyond July. T-Notes hit interim resistance at 113-02+ in the European morning before paring a few ticks, with a weak UK 30yr Gilt auction capping the bid, although the later German Schatz auction was much better received.

The US arrival did not exhibit the kneejerk selling that has been persistent in recent sessions, with futures contracts instead stretching higher ahead of the retail sales data. The softer-than-expected headline figures, in combination with the soft CAD CPI, saw T-Notes spike to peaks of 113-08, levels which swiftly brought in sellers as the stronger-than-expected retail sales control figure (which feeds into GDP, currently tracking at 2.4% for Q2 according to Atlanta Fed tracker) was digested. Contracts swiftly reversed to find a NY morning base of 112-25+, with the soft IP data preventing any range extension to the downside for the rest of the morning, nor could the tape muster a run on the highs.

It wasn't until Europe had departed that weakness crept back in, with contracts paring all their post-Knot bid from the European session, coinciding with the NQ surging as MSFT hit new highs on announcing its latest AI plug-in for "the three people that still use Bing". Attention, at least for rates participants, hones in on Wednesday's 20yr bond auction.

STIRS:

- SR3U3 +0.0bps at 94.600, Z3 -2.0bps at 94.675, H4 -4.0bps at 94.995, M4 -5.0bps at 95.390, U4 -4.5bps at 95.805, Z4 -3.5bps at 96.145, H5 -2.5bps at 96.390, M5 -2.0bps at 96.540, U5 -1.0bps at 96.630, U6 +1.5bps at 96.790, U7 +1.5bps at 96.755
- SOFR rises to 5.06% from 5.05% as of July 17th, volumes rise to USD 1.524tln from 1.448tln.
- NY Fed RRP op demand at USD 1.717tln (prev. 1.728tln) across 94 counterparties (prev. 96).
- EFFR flat at 5.08% as of July 17th, volumes at USD 112bln (prev. 115bln).
- US sold USD 50bln of 42-day CMBs at 5.240%, covered 3.19x.
- Treasury leaves Thursday's 4-, 8-, and Wednesday's 17-week bill auction sizes unchanged at USD 70bln, 60bln, and 46bln, respectively, all to settle on July 25th.

THIS WEEK:

- *WED: **US Housing Starts/Building Permits (Jun), USD 12bln 20yr Bond auction**, UK Inflation (Jun), EZ Final CPI (Jun).*
- *THU: **Philly Fed (Jul), Jobless Claims, Existing Home Sales (Jun), USD 17bln 10yr TIPS auction**, PBoC LPR, CBRT Announcement, Japanese Trade Balance (Jun), Australian Jobs Report (Jun).*
- *FRI: CBR Announcement, Japanese CPI (Jun), UK Retail Sales.*

CRUDE

WTI (U3) SETTLED USD 1.58 HIGHER AT 75.66/BBL; BRENT (U3) SETTLED USD 1.13 HIGHER AT 79.63/BBL

The crude complex was higher, settling around highs, as the risk-on sentiment and initial Dollar weakness aided oil in spite of little catalysts. On the latter, even though the Buck eventually pared the day's losses it did stop WTI and Brent from grinding higher and hitting highs of USD 75.90/bbl and 79.99/bbl, respectively. Moreover, the aforementioned initial Dollar weakness and broader sentiment continued to outweigh the softer-than-expected Chinese economic data. Nonetheless, crude-specific newsflow was very sparse with the highlight arguably being Kazakhstan's KazMunayGas noting all three oil refineries are operating normally, following the power outage at the beginning of July. Elsewhere, according to Reuters calculation, Russian Urals oil price fell below price cap amid weaker Brent. Lastly, Angola is to load 31 crude oil cargoes in September vs. 34 planned for August. The week ahead data docket out of the US is sparse, with the highlight being earnings amid the Fed blackout ahead of FOMC next week. Nonetheless, in the immediacy, there is private inventory data after-hours where expectations are (bbls): Crude -2.3mln, Distillate -0.1mln, Gasoline -2.1mln.

EQUITIES

CLOSES: SPX +0.71% at 4,554, NDX +0.82% at 15,841, DJIA +1.06% at 34,951, RUT +1.27% at 1,976.

SECTORS: Technology +1.26%, Financials +1.12%, Energy +0.98%, Materials +0.78%, Health +0.7%, Industrials +0.57%, Communication Services +0.38%, Consumer Discretionary +0.28%, Consumer Staples -0.13%, Utilities -0.78%, Real Estate -0.82%.

EUROPEAN CLOSES: DAX +0.35% at 16,125, FTSE 100 +0.64% at 7,454, CAC 40 +0.38% at 7,319, Euro Stoxx 50 +0.30% at 4,370, IBEX 35 +0.19% at 9,456, FTSE MIB +0.34% at 28,707, SMI +1.14% at 11,102.

EARNINGS: **Bank of America (BAC)** beat on EPS, revenue, deposits, FICC and Equities revenue; sees FY NII +8%, and to be a little above USD 57bln. CEO continues to see a healthy US economy growing at a slower pace, with a resilient job market and noted it has the flexibility to do a little bit more on share buybacks. **Morgan Stanley (MS)** surpassed consensus on the top and bottom line as well as Wealth Management revenue. But, net interest income and FICC revenue notably missed. CEO said it delivered solid results in a challenging market environment and the quarter started with macroeconomic uncertainties and subdued client activity, but ended with a more constructive tone. **Charles Schwab (SCHW)** topped Wall St. estimates on EPS, revenue and deposits. For FY23, sees 2023 revenue to decline by 7%–8% Y/Y (exp. -7.35%). **Bank of New York Mellon (BK)** beat on the top and bottom line alongside deposits. Although, net interest margin fell short. **PNC (PNC)** missed on revenue and loans with total deposits falling Q/Q and Y/Y. Looking ahead, it cut FY23 revenue outlook. Note, it did beat on profit, NII, and NIM in addition to raising the quarterly dividend 5 cents to 1.55/shr. **Lockheed Martin (LMT)** beat on the top and bottom line alongside raising FY23 guidance. **Prologis (PLD)** posted a strong report, highlighted by earnings beating and raising FY EPS and core FFO outlook. **Masimo (MASI)** reported dismal prelim results on top of slashing its guidance.

STOCK SPECIFICS: **Microsoft (MSFT)** to charge businesses USD 30 per month for 365 AI Copilot; AI upgrade to raise costs for MSFT customers at least 53% at list prices. **Meta (META)** is releasing an updated and commercial version of its AI model Llama, and is to be distributed by 'preferred partner' **Microsoft (MSFT)** via Azure. **Pinterest (PINS)** was upgraded at Evercore; said it sees digital ad spending stabilizing, with indications of a recovery in the second half of the year. **Activision Blizzard (ATVI)/Microsoft (MSFT)** merger is unlikely to close by the Tuesday deadline but as expected the cos. do not intend to abandon the agreement, and will continue seeking regulatory approvals, with progress recently shifting in their favour. **Warner Music Group (WMG)** and TikTok announced a first-of-its-kind expanded agreement where the deal will expand the level of partnership, collaboration, and innovation between the two cos; they have agreed to a licensing deal for TikTok music.

US FX WRAP

The Dollar was flat on Tuesday but losses pared post US data. The headline miss in retail sales saw DXY hit a low of 99.55 before swiftly paring on the decent beat on the control group and the upward revisions to the prior month. DXY grinded higher throughout the rest of the session to reclaim the 100 level. The move was quite marginal when compared to the downside seen since the June NFP report on July 7th, and the following CPI and PPI reports on the 12th and 13th July, respectively.

Similar price action was seen in the **Yen**. USD/JPY hit a low on the retail sales data of 137.70 but overall was choppy around the Retail Sales. Weakness in the Yen ensued once BoJ Governor Ueda spoke, noting there is still some distance to sustainably achieve the 2% inflation target, and unless there is an assumption on the need to sustainably achieve the 2% target changes, the narrative on monetary policy will not change. The commentary disappointed those looking for any potential hawkish twists at upcoming BoJ meetings. USD/JPY returned to a peak just north of 139, albeit it failed to hold above 139.00.

The Euro saw slight weakness but kept its head above 1.12 with a lack of EU data, although some unusually dovish leaning remarks from the outspoken hawk Knot did weigh on the Euro in the early morning. Knot stated a July hike is a necessity, but beyond July, hikes are possible although not a certainty, noting we could have hit an inflation plateau. Knot added that more tightening shifts the balance of risks towards too much - a seeming change of heart from Knot. Meanwhile, Visco noted underlying inflation is stubborn and more complicated.

CAD saw marginal gains vs the Dollar despite noticing pronounced weakness in wake of the cooler-than-expected Canadian inflation data, where USD/CAD hit a peak of 1.3243 on soft inflation, accompanied by the Dollar eventually bought on the aforementioned control group beat and upward revisions. The pair had pared throughout the day, however, with the upside in oil and equity prices supporting the risk-sensitive CAD.

AUD was flat vs the Buck but firmer vs the NZD. The RBA minutes were released overnight noting the board considered standing pat on rates or hiking by 25bps, and adding there was a strong case for both but the board judged arguments for holding steady were stronger. It did note some further tightening may be required and they would reconsider at the August meeting. The **NZD** saw notable weakness when compared to other currencies, which saw AUD/NZD rise above 1.08 to highs of 1.0856 from lows of 1.0767. **GBP** softened vs the Dollar and the Euro despite the upbeat risk tone with Cable losing hold of 1.31 and 1.3050 as market participants await UK CPI due Wednesday morning.

The Yuan was weaker for both offshore and onshore with the fall out of the GDP data still weighing. The latest PBoC fixing saw USD/CNY midpoint at 7.1453 (exp. 7.1704 (prev. 7.1326). There were also reports that China is likely to cut the RRR in Q3 to boost the economy, according to the China Securities Journal citing analysts.

EMFX was mixed. MXN and BRL were flat while TRY saw pronounced weakness and the ZAR gained. In LatAm, BRL traders were attentive to commentary from Finance Minister Haddad, who noted the government would no longer rely on an income tax reform to support the 2024 budget, and said the reform would be submitted to Congress later than planned. The COP meanwhile continued to see gains vs the Dollar hitting a 1yr high as crude prices bounced. The Rand saw further strength and is back to levels seen in April with some suggesting the currency had been undervalued following the recent weakness. Although the gains in gold prices and other metals on Tuesday were enough to keep the Rand rally going ahead of the SARB on Thursday. The Lira hit a fresh record low with all eyes on the CBRT due Thursday with fears of a Central Bank disappointment. Analysts look for a 5% hike to 20% but forecasts range between 17-21.5%.