US Market Wrap

2nd August 2023: US rating downgrade, hot ADP and disappointing AMD earnings weigh on sentiment

- **SNAPSHOT**: Equities down, Treasuries steepen, Crude down, Dollar up.
- **REAR VIEW**: Fitch downgraded the US; Largest ever EIA crude on record; Hot ADP; AMD next quarter revenue guide light; SPR tumble post-earnings; OPEC+ unlikely to tweak current output policy at Friday meeting; Strong CVS report; Ramped US coupon sizes confirmed.
- **COMING UP**: **Data**: Caixin Services PMI, German Trade, EZ & UK Services PMI (Final), Swiss CPI, US IJC, Factory Orders, ISM Services **Events**: BoE Policy Announcement **Speakers**: BoE's Bailey; Fed's Barkin, Bostic & Goolsbee; ECB's Panetta Supply: Spain & France **Earnings**: Adidas, AXA, BMW, Infineon, ING, Lufthansa, Merck, SocGen, Rolls-Royce, ConocoPhillips, Regeneron Pharmaceuticals, Apple, Kellogg, Moderna, Amazon.com, Booking Holdings, Warner Bros Discovery, Airbnb.
- **WEEKLY US EARNINGS ESTIMATES**: [THURS] CI, COP, AMZN, AMGN, GILD, ABNB, SYK, AAPL, BKNG. To download the report, please click here.

MARKET WRAP

Stocks were hit on Wednesday with the Nasdaq leading the downside following strong selling pressure in semiconductors after AMD earnings and guidance disappointed with the AI jawboning not enough to support the stock. Meanwhile, a rise in longer-dated treasury yields (10yr yields still above 4% and the 30yr extending on YTD highs) also weighed on the tech sector. The risk-off tone started overnight in the wake of Fitch downgrading the US credit rating to AA+ from AAA, primarily on future debt concerns. The Dollar and havens outperformed in FX with initial Yen strength pared to see USD/JPY flat in the in the US afternoon. The hot ADP data, ahead of NFP Friday, only emphasised the downside in both stocks and bonds while the quarterly refunding helped push T-notes to lows. However, once Europe left for the day T-notes eased off their lows but stocks meandered around worst levels until just before the market close. Crude prices tumbled on the soured risk environment and rising dollar, despite a record crude stocks draw on the inventory data while attention turns to the OPEC JMMC on Friday, as well as US NFP. Also in focus on Thursday will be the US ISM Services PMI, Jobless Claims, the BoE rate decision and earnings from behemoths Apple (AAPL) and Amazon (AMZN).

GLOBAL

US DOWNGRADED AT FITCH: Fitch downgraded US long-term ratings to 'AA+' from 'AAA', with a stable outlook. Fitch cited increasing debt, weak governance, and anticipated fiscal decline over 3 years, leading to debt standoffs. Goldman Sachs said the downgrade mainly reflects governance and medium-term fiscal challenges, but does not reflect new fiscal information, adding that the move should have little direct impact on financial markets as it is unlikely there are major holders of Treasury securities who would be forced to sell based on the ratings change. Former Treasury Secretary Summers, a Democrat, said Fitch's decision was "bizarre and inept," and the US economy was stronger than expected. Allianz' chief economic adviser Mohamed El-Erian said Fitch's decision was "strange", and was more likely to be dismissed than have a lasting disruptive impact on the US economy and markets. Capital Economics said that the announcement was not a complete surprise given that Fitch hinted at such a move during the recent debt ceiling standoff, and had a long-standing negative outlook on its AAA rating, adding that it echoes the decision by S&P to cut its own US rating from AAA to AA+ in the aftermath of the 2011 debt ceiling standoff; Moody’s still has the US at AAA, but has maintained a negative outlook. For a full Newsquawk analysis piece, please click here.

ADP: ADP’s data surprised to the upside, once again, reporting 324k private payrolls were added in July, blitzing through the consensus view of 189k (the range of forecasts 140-300k); the prior data for June was revised lower to 455k from an initially stated 497k. The wages metrics also cooled sharply again, taking the annual rate for Job Stayers to 6.2% Y/Y (from 6.4%), and for Job Changers to 10.2% from 11.2%. Analysts continue to be critical of the ADP’s ability to forecast the BLS payrolls data. Pantheon Macroeconomics, a very vocal critic, said that "since its relaunch with new methodology last August, ADP has been both unforecastable and deeply unreliable as an indicator of the official first estimate of private payrolls each month," adding that the data "has no implications for our July forecast."

BoE PREVIEW: The MPC is expected to hike rates by 25bps (vs. prev. 50bps increase), bringing the Base Rate to 5.25%, as forecast by 42/62 economists surveyed by Reuters, an outcome that is anticipated by markets with a 75% probability. Expectations of a smaller hike than previous have stemmed from June's CPI report showing a decrease in Y/Y inflation to 7.9% from 8.7%, matching the Bank's May MPR forecast. Elsewhere, focus will be on how the Bank guides future rate expectations with forecasts in the accompanying MPR set to show inflation materially below target over the medium-term. To download the full preview, please click here.

FIXED INCOME

T-NOTE (U3) FUTURES SETTLED 2+ TICKS LOWER AT 110-25+

Treasuries saw further steepening amid ramped coupon sizes confirmed, hot ADP data, and jitters around the Fitch downgrade. At settlement, 2s -2.3bps at 4.889%, 3s -2.3bps at 4.556%, 5s -0.9bps at 4.237%, 7s +1.3bps at 4.169%, 10s +2.7bps at 4.074%, 20s +4.5bps at 4.356%, 30s +5.9bps at 4.162%.

INFLATION BREAKEVENS: 5yr BEI -1.0bps at 2.369%, 10yr BEI +0.8bps at 2.363%, 30yr BEI +2.3bps at 2.318%.

THE DAY: T-Notes hit peaks of 111-07+ on the Wednesday Globex open with some touted counterintuitive haven demand after Fitch downgraded the US' credit rating. At the same time, given the large sell-off on Tuesday, some short-covering was due. However, better selling developed through the APAC session for contracts to find support at 111-00, with JGB yields hitting new peaks - note that BoJ Deputy Governor Uchida said Wednesday that depending on speed of the moves, the bank will step in before the 10yr yield hits 1%. Refinitiv has the 10yr yield hitting c. 0.64% on Wednesday.

Europe lifted the offer on arrival for govvies in the absence of fresh catalysts, although UK gilts lagged ahead of the BoE on Thursday. T-Notes brushed up against their Globex peaks as US traders began to arrive ahead of the cash open, but couldn't break the level. Better selling soon kicked in and accelerated after the hot ADP employment data ahead of Friday's BLS report, and then again as the dust settled from the Treasury's quarterly refunding announcement which confirmed a ramp in coupon auction sizes both for this quarter and likely in the quarters ahead. The bear-steepening extended all the way into the European close, with T-Notes bottoming out at 110-15.

QUARTERLY REFUNDING: The Q3 announcement saw the US announce it is to sell USD 42bln of 3yr notes (prev. 40bln) on Aug 8th, USD 38bln of 10yr notes (prev. 35bln) on Aug 9th, and USD 23bln of 30yr bonds (prev. 21bln) on Aug 10th; all to settle August 15th. Treasury announced increases across all tenors of the coupon curve and said further gradual increases will likely be necessary in future quarters. Treasury also planning increases to the 2yr FRN and 5yr TIPS. For bills, Treasury anticipates further moderate increases in Treasury bill auction sizes in the coming days. And finally, Treasury announced it made significant progress on its plans to implement a regular buyback programme in 2024; will purchase a maximum of USD 240bln a year (USD 120bln in liquidity purchases and USD 120bln in cash management).

STIRS:

- SR3U3 +0.0bps at 94.590, Z3 +2.0bps at 94.640, H4 +4.5bps at 94.875, M4 +7.0bps at 95.210, U4 +7.5bps at 95.575, Z4 +7.5bps at 95.895, H5 +7.5bps at 96.145, M5 +7.5bps at 96.310, U5 +6.5bps at 96.390, U6 +0.5bps at 96.495, U7 -2.0bps at 96.450.
- SOFR flat at 5.31% as of August 1st, volumes fall to USD 1.495tln from 1.551tln.
- NY Fed RRP op demand at USD 1.770tln (prev. 1.740tln) across 101 counterparties (prev. 96).
- EFFR flat at 5.33% as of August 1st, volumes rise to USD 108bln from 103bln.

LATER THIS WEEK (US items bolded):

- THU: **Services and Composite Final PMI (Jul), Durable Goods R (Jun), ISM Services PMI (Jul), Productivity (Q2), Jobless Claims, Fed's Barkin (nv)**, BoE Announcement and MPR, CNB Announcement, Chinese Caixin Final PMI (Jul), Swiss CPI (Jul), EZ/UK Services and Composite Final PMI (Jul).
- FRI: **Jobs Report (Jul)**, RBA SoMP, EZ Retail Sales (Jun), Canadian Jobs Report (Jul).

CRUDE

WTI (U3) SETTLED USD 1.88 LOWER AT 79.49/BBL; BRENT (V3) SETTLED USD 1.71 LOWER AT 83.20/BBL

The crude complex was lower on Wednesday and fell foul to the Dollar strength and broad risk-off sentiment after Fitch downgraded the US credit rating despite a record crude stocks draw. On the day, WTI and Brent tumbled lower throughout the US session to hit lows of USD 79.05/bbl and 82.74/bbl, respectively, despite the record EIA crude draw. Crude stocks drew 17mln against an expected draw of 1.55mln (prev. -0.6mln) following in the footsteps of the private inventory data on Tuesday night. Albeit playing second fiddle to the headline, Distillates unexpectedly drew -0.796mln (exp. 0.262mln, prev. -0.245mln) while Gasoline saw a surprise build of 1.48mln (exp. -1.259mln). Overall, crude production was unchanged at 12.2mln with refining utilisation printing -0.7% from -0.9%. In other news, ahead of the OPEC+ JMMC on Friday, Reuters sources noted OPEC+ is unlikely to tweak its current output policy and the decision to leave policy unchanged stems from the recent increase in oil prices. As a reminder, participants expect the current pact (which does not include the voluntary cuts) to be rolled over, whilst eyes remain on whether Saudi will opt to roll over its 1mln BPD voluntary cuts or unwind offline production by 250-500k BPD. Newsflow has been fairly sparse in August, so far, and attention for the rest of the week will sit on Non-Manufacturing ISMs, Apple and Amazon earnings (Thurs) and US jobs report (Fri).

EARNINGS: **Devon Energy (DVN)** missed on profit and revenue, but noted oil production reached an all-time high of 323k BPD in Q2, supported by strong well productivity in the Delaware Basin, as well as efficiency gains that compressed project cycle times. **Phillips 66 (PSX)** beat on the top and bottom line, and added it is seeing gasoline demand up about 2% over the last year in the US and about 4% globally with jet demand strong on low inventories, rising demand, and international travels. **Pioneer Natural Resources (PXD)** surpassed on profit and saw average production of 710,678 BOE/D (exp. 691,224) and average oil production of 369,070 BPD (exp. 366,576). Post-earnings, PXD noted the recent upward move in oil prices reflects expectations of tightening supply-demand fundamentals in H2 2023 and sees oil prices in the USD 80-100bbl range for the rest of the year and through 2024.

EQUITIES

CLOSES: SPX -1.38% at 4,513, NDX -2.21% at 15,370, DJIA -0.98% at 35,282, RUT -1.37% at 1,966.

SECTORS: Technology -2.59%, Communication Services -2.07%, Consumer Discretionary -1.84%, Energy -1.34%, Materials -1.23%, Industrials -1.08%, Financials -0.89%, Real Estate -0.44%, Utilities -0.01%, Health +0.06%, Consumer Staples +0.25%.

EUROPEAN CLOSES: DAX -1.36% at 16,020, FTSE 100 -1.36% at 7,562, CAC 40 -1.26% at 7,313, Euro Stoxx 50 -1.60% at 4,337, IBEX 35 -1.83% at 9,329, FTSE MIB -1.30% at 28,975, SMI -0.79% at 11,220.

EARNINGS: **AMD (AMD)** data centre and gaming revenue fell short of expectations with the next quarter revenue guidance also missing. Note, EPS was more-or-less in line and revenue beat in addition to offering bullish commentary around AI; said engagements increased by more than seven-fold and is on track to launch and ramp production of MI300 accelerators in Q4. AMD also noted it sees an opportunity to develop AI chip products that comply with export controls to sell in China. **CVS Health (CVS)** beat on EPS, revenue, and comp. sales alongside raising FY23 revenue view and re-affirming EPS view. Note, exec on conference call downgraded its FY24 EPS outlook. **Boeing (BA)** supplier **Spirit AeroSystems (SPR)** reported a deeper loss per share than expected and said work stoppage from the IAM strike will reduce FY Boeing 737 deliveries to the range of 370-390 units. Also, IAM negotiations impacted all programmes at the Wichita, Kansas site, including the 737 programme. Co. added it is starting to ramp up to 42 BA 737 fuselages per month in August but won't recover lost manufacturing days from strike. **Electronic Arts (EA)** beat on EPS and revenue, but next quarter and FY guidance disappointed. **Starbucks (SBUX)** beat on profit but fell short on revenue and comp. sales in most major demographics. **Kraft Heinz (KHC)** posted a mixed report; EPS beat but revenue and organic revenue missed alongside reaffirming FY23 guidance. **SolarEdge Technologies (SEDG)** revenue was marginally short with Q3 revenue guide massively disappointing Wall St. expectations. Exec said that the US residential solar market was seeing headwinds related to higher interest rates. Note, Solar ETF TAN closed down over 5.5%. **Generac Holdings (GNRC)** profit missed and downgraded FY net sales view due to the softer-than-expected consumer environment. **Johnson Controls International (JCI)** fell short on revenue and cut FY23 profit and revenue growth view. **Elf Beauty (ELF)** surpassed Wall St. expectations on the top and bottom line; boosted FY24 EPS and revenue outlook. **Match Group (MTCH)** earnings beat as well as Q3 revenue view coming in better-than-expected. **Humana (HUM)** beat on top and bottom line alongside forecasting its Medicare Advantage business to grow by about 825k members this year. **Emerson Electric (EMR)** topped on the EPS, revenue, and underlying sales. **The Scotts Miracle-Gro Company (SMG)** disappointed the analyst consensus on EPS and revenue with FY sales and adj. EBITDA is expected to decline.

US FX WRAP

The Dollar prospered on Wednesday, with DXY rising from lows of 102.01 to highs of 102.78 before paring to c. 102.50 heading into APAC trade. The gains in the Buck seemingly tracked the move higher in longer-dated Treasury yields in risk-off trade with stocks plummeting all while Fitch downgraded the US rating to 'AA+' from 'AAA', although removed the Negative outlook and replaced it with Stable. Fitch noted the decision "reflects the expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to 'AA' and 'AAA' rated peers over the last two decades that has manifested in repeated debt limit standoffs and last-minute resolutions." A lot of the Dollar upside ensued after the ADP data, although not always correlated with the NFP release (due Friday) it was a notable beat and was higher than all analyst forecasts and shows signs of strength in the labour market. Nonetheless, money market pricing was little changed with a c. 80% probability of rates being left unchanged in September.

The Euro found further pressure on the Buck's ascendance with the single currency trading between 1.0919 and 1.1019, although aside from havens and the Dollar the Euro performed relatively well vs peers with EUR/GBP briefly rising above 0.8600.

Yen was the outperforming currency following its weakness this week, albeit it still only saw very minimal gains vs the Dollar on Tuesday with USD/JPY still sitting above 143.00. The Yen was supported by the aforementioned risk-off tone in markets but gains were capped by the upside in longer-dated UST yields with pressure seen in the Yen in the wake of the latest quarterly refunding. Note, overnight, BoJ Deputy Governor Uchida maintained a dovish stance and suggested Japan is now at a phase where it is important to patiently maintain easy policy. Uchida said last week's decision was a pre-emptive step at continuing monetary easing without disruptions and the BoJ must fine-tune YCC at times and make the policy more flexible. Furthermore, outdated BoJ minutes were released (from two meetings ago) but are ultimately stale given the BoJ’s back-door YCC tweak last week.

The Pound saw further weakness vs both the Euro and the Dollar with the risk off trade weighing on the Pound ahead of the BoE rate decision on Thursday. Market pricing sees a 66% probability of a 25bp hike, but with risk of a 50bp hike being 33% priced while some analysts warn of a three way vote split on the MPC. Elsewhere, the focus will be on how the Bank guides future rate expectations with forecasts in the accompanying MPR set to show inflation materially below target over the medium-term. Note, CAD saw weakness in fitting with the downbeat risk tone and upside in the Dollar while the tumbling crude prices only kept the pressure on the Loonie.

Antipodeans were the underperforming currencies given their sensitivity to risk with AUD and NZD posting notable gains of a similar magnitude with AUD/NZD flat. Losses in the Aussie were emphasised by Yuan weakness as well as base metal prices although investors will be eyeing Aussie retail sales data overnight, as well as the Caixin Services PMI survey in China. Meanwhile, the effect of RBA standing pat earlier in the week still lingers. For the Kiwi, similar aspects were weighing but it also saw a downbeat jobs report overnight with the Q2 unemployment rate rising to 3.6% from 3.4%, above the 3.5% expected, while the labour cost index data was cooler than expected.

EMFX was predominantly weaker vs the Buck due to the downbeat risk environment as well as the fallout from the US downgrade.

The BRL saw marginal losses ahead of the BCB rate decision tonight, where Finance Minister Haddad said he is certain rates will fall today and added there is room for a 50bp cut. Meanwhile, President Lula was critical of the BCB with the nation subject to the highest real interest rate in the world. Analysts look for either a 25 or 50bp cut with market pricing more or less a coin toss. Desks suggest that with significant fiscal reforms passed, a notable decline in inflation, and inflation expectations nearing BCB's target of around 3.50%, the bank appears ready to make a credible rate reduction. The market's main question is whether BCB will commence the cycle with a 25bp or 50bp cut. Interest rates markets already price almost 500bp of easing over the next year. Note, the Brazilian IPC-Fipe Inflation Index for July fell 0.14%, accelerating from the prior -0.03%.

MXN was also softer with some commentary from Banxico's Heath who largely repeated Banxico's guidance, noting interest rates are at the correct level, no matter whether the Fed hikes again. Heath also alluded to future rate cuts, noting in the best case scenario, there will be a "slight adjustment" to the interest rate at the end of the year. On the Peso, Heath added it is important for the exchange rate to be as flexible as possible with no intervention to manipulate it to a rate where it should not be. Although Heath alluded to future rate cuts, he did warn he cannot rule out an alternative scenario where Banxico would have to tighten further.

The Rouble was also softer given lower crude prices but there were also reports in Vedomosti that Russia will not use extra oil and gas revenue to buy FX, adding it will not buy FX to ease pressure on the Rouble either.

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