US Market Wrap

18th December 2023: Oil and yields bounce after Red Sea tanker troubles ahead of BoJ

- **SNAPSHOT**: Equities up, Treasuries down, Crude up, Dollar flat.
- **REAR VIEW**: Heightened Red Sea tensions; Daly notes rate cuts next year could be needed; Mester said markets are a bit ahead of the Fed on rate cuts; Goolsbee notes may need to shift focus to jobs; US NAHB rises; AAPL will shortly halt Apple Watch Series 9 & Watch Ultra 2 within the US; US Steel to be acquired by Nippon Steel; Poor German Ifo.
- **COMING UP**: **Data**: EZ HICP (Final), US Building Permits/Housing Starts, Canadian CPI, Japanese Trade Balance **Event**: BoJ Policy Announcement, NBH; RBA Minutes (Dec) **Speakers**: Fed's Bostic, Goolsbee; BoE's Green; ECB's Elderson **Supply**: UK.
- **WEEK AHEAD PREVIEW**: Highlights include US PCE; BoJ, PBoC, BOC and RBA Minutes; CPI from Japan, UK, Canada. To download the report, please click here.
- **CENTRAL BANK WEEKLY**: Previewing BoJ, PBoC, minutes from the BoC and RBA, CBRT; reviewing FOMC, ECB, BoE, Banxico, BCB, Norges Bank, SNB. To download the report, please click here.

MARKET WRAP

Stocks were firmer Monday with the NDX leading the SPX higher gradually through the session. There was a lack of obvious catalysts, but perhaps legacy equity bear Mike Wilson (at Morgan Stanley) turning bullish on the market had an outsized effect in a quiet newsflow session, or maybe just another Santa rally. The Russell 2k, meanwhile, underperformed, as did the equal-weighted S&P. The Mag7 outperformance was led by strong gains in the likes of META, GOOGL, AMZN, and NVDA, while AAPL was a notable underperformer amid it having to halt sales of its Apple Watch. Energy was an outperforming sector with oil producers benefitting from the jump in oil prices after a slew of shipping companies halted travel via the Red Sea (preventing access to the Suez Canal) amid ongoing attacks by Yemen's Houthis. The jump in energy prices saw Treasuries bear-steepen, although the moves were more acute in EGBs amid a more forceful pushback on market cut pricing from ECB speakers vs the recent Fed speakers. The Dollar Index was little changed with strength against the Yen ahead of the BoJ on Tuesday offset by mild gains in Swissy and Euro.

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GOOLSBEE (2023 voter, dove), in a WSJ interview from Friday, said the Fed may need to begin shifting its focus from inflation to the slowing US labour market, "it's clear we're moving toward a balanced environment". Said it's important to "be aware that historically when the unemployment rate starts going up, it doesn't just gradually drift up. It tends to go up rapidly." The Chicago Fed President did not rule out a rate cut at the March meeting, whilst he also didn't clarify what his 2024 rate projection was beyond that it is lower than current levels but not significantly. He warned that the Fed should be prepared to hike further if the good news stops but caveated that "if we see inflation going down more than we expected, we should be prepared to recognize whether that level of restrictiveness that we're at now, which is clearly restrictive, whether that's appropriate and whether we should loosen". Goolsbee spoke again on Monday in a CNBC interview where he didn't say much new beyond that he was confused a bit with the market's reaction, whilst also saying there has been no contradiction between what Williams and Powell said over the past week.

MESTER (2024 voter, retiring in June, hawkish), in an FT interview Monday, said markets are a "little bit ahead" of the Fed on rate cuts, joining the likes of Williams and Bostic in their light pushback of market pricing. She said the next phase is not when to reduce rates, even though that's where markets are currently at, but it is about how long policy should remain restrictive (one can speculate about just how short this phase will be given some of her proceeding comments). The Cleveland Fed President said markets "jumped to the end part, which is 'We're going to normalise quickly', and I don't see that". At the same time, she said she pencilled in three 25bp cuts in 2024 in the Dec SEPs (eight participants see rates above that), given her view that inflation would continue to moderate as growth cooled further and unemployment ticked up slightly. Her soft landing forecast requires the Fed to begin "normalising policy and bringing it back to a more neutral stance over time". Mester also said officials would be conscious not to wait too long to cut rates to avoid excessive job losses. She said balancing inflation and employment is going to be important from here. When the time comes to discuss more actively the timing and pace of rate cuts, Mester said she would be closely watching one-year forward inflation expectations (without being any more specific on which measures) and how quickly they were moving back to 2%. Said, "If you don't take action as expected inflation comes down, then you're really firming policy. You don't want to inadvertently become more restrictive than you think is appropriate."

DALY (2024 voter, dovish), in a WSJ interview, said rate cuts could be needed in 2024 to prevent over-tightening, via rising real rates, and it is appropriate for the Fed to begin looking ahead to when to cut rates given the improvement in inflation, but refrained from saying when she thought the first cut would be. She said her SEPs were very similar to the Fed's median (three 25bp cuts in 2024), noting that Fed policy would still be "quite restrictive" even if the Fed cuts three times in 2024. Daly echoed Goolsbee in calling on the need to give more importance than before to the employment mandate from here, and echoed Mester in cautioning on waiting for unemployment to rise, "we have to be forward looking and make sure that we don't give people price stability but take away jobs." The San Fran President said further progress on inflation needs to be done with as few disruptions to the labour market as possible. She caveated that if inflation showed greater signs of persistence in the months ahead that could lead the Fed to keep rates higher for longer (notice she doesn't say hike), but on the other hand, she said inflation could decline more rapidly, or the labour market could weaken more meaningfully than it has, justifying easier policy.

MARCH CUT: It's worth noting that all the Fed Speakers post-FOMC have not been willing to rule out a March cut when pressed on the issue, merely saying that it's too early to be discussing that - that probably changes if we get another month or two of improving inflation data, or even softening labour market data, with markets already pricing a March 25bp cut as a 75% likelihood. There's likely much more disagreement on the Fed, and cause for "pushback", on the magnitude of cuts priced for 2024 - currently six 25bp cuts by December vs Fed median of three - rather than the timing of the first cut provided the data continues to soften as it has done.

NAHB: NAHB Housing Market Index for December rose to 37 from 34, above the expected 36, as declining mortgage rates made homebuilders less pessimistic. Although, the headline remains at levels consistent with poor conditions. As such, Oxford Economics says, "Expect housing starts to weaken through the first part of next year, though the recent decline in mortgage rates may lend some upside risk to that forecast". In addition, while the supply of existing homes for sale is scarce, Oxford notes homebuilders continue to use incentives to encourage new home sales, highlighted by an excess of a third of builders offering price cuts this month.

FIXED INCOME

T-NOTE (H4) FUTURES SETTLED 5 TICKS LOWER AT 112-08

Treasuries bear-steepened in light trade after troubles in the Red Sea saw energy prices spike, resurfacing supply shock concerns. 2s +0.4bps at 4.459%, 3s +1.7bps at 4.156%, 5s +2.0bps at 3.950%, 7s +2.4bps at 3.980%, 10s +2.8bps at 3.956%, 20s +3.6bps at 4.242%, 30s +4.1bps at 4.068%.

INFLATION BREAKEVENS: 5yr BEI +1.0bps at 2.215%, 10yr BEI -0.9bps at 2.216%, 30yr BEI -0.0bps at 2.219%.

THE DAY: Treasuries rose modestly through the APAC and European morning in light trade, taking the recent "pushback" from Fed officials with a pinch of salt. T-Notes peaked for the session at 112-21+ before stateside traders arrived. Better selling in govvies globally developed in the NY morning, with Bunds leading USTs, with a couple of factors in play, but primarily the higher energy prices on supply risk in the Red Sea, whilst ECB speakers continued to pushback on market cut pricing more forcefully than their Fed counterparts. T-Notes troughed for the session at 112-06, coming on the heels of a humungous 29.5k block seller in the 5yr future ($1.2mln DV01), with contracts hovering just off lows through into the close. The long-end was weakest on the curve, perhaps a function of set up for this week's 20yr auction on Wednesday.

AHEAD: Attention is now on the BoJ meeting on Tuesday, with Treasury traders also keeping tabs on this week's 5yr TIPS and 20yr bond auctions in thinning trading conditions. Bostic and Goolsbee are the only scheduled Fed speakers remaining this week, with both due to speak again on Tuesday. Also get some economic data in Tuesday's housing starts, Wednesday's consumer confidence and existing home sales, Thursday's final Q3 GDP and Philly Fed survey, and Friday's PCE, Durable Goods, Michigan survey, and new home sales.

THIS WEEK's AUCTIONS: US to sell USD 13bln of 20yr bonds (reopening) on Dec 20th, to settle on Jan 2nd; to sell USD 20bln of 5yr TIPS (reopening) on Dec 21st, to settle on Dec 29th.

STIRS:

- SR3Z3 -0.25bps at 94.625, H4 +0.5bps at 94.925, M4 +0.5bps at 95.335, U4 +1bps at 95.73, Z4 +1bps at 96.10, H5 flat at 96.40, M5 -1bp at 96.61, U5 -2.5bps at 96.715, Z5 -3bps at 96.75, Z6 -3bps at 96.71, Z7 -3.5bps at 96.62.
- SOFR rises to 5.32% as of Dec 15th from 5.31%, volumes rise to USD 1.78tln from 1.70tln.
- NY Fed RRP op demand at USD 0.725tln (prev. 0.683tln) across 86 counterparties (prev. 82)
- EFFR flat at 5.33% as of Dec 15th, volumes fall to USD 101bln from 108bln.
- US sold USD 69bln 6-month bills at 5.130%, covered 3.10x; sold USD 76bln 3-month bills at 5.260%, covered 2.89x.

CRUDE

WTI (G4) SETTLED USD 1.04 HIGHER AT 72.82/BBL; BRENT (G4) SETTLED USD 1.40 HIGHER AT 77.95/BBL

Oil prices bounced on Monday as tanker troubles in the Red Sea baked in a geopolitical risk premium. WTI and Brent futures hit their peaks of USD 74.26/bbl and 79.51/bbl, respectively, late in the NY morning before paring gradually into the settlement. The initial rally came after a slew of companies, including BP (BP/ LN), announced they would be pausing transits through the Red Sea amid an increasing number of tankers coming under attack by Yemen's Houthis, choking supply to Europe through the Suez Canal. Meanwhile, Russian Deputy PM Novak said on Sunday that the country would deepen its oil export cuts in December beyond the 300k BPD already agreed for this year by potentially 50k BPD or more. Some of that deepening may have been forced given weather conditions. Reuters reported Monday that Black Sea's CPC blend oil loadings had resumed on December 16th after the storm.

EQUITIES

CLOSES: SPX +0.45% at 4,740, NDX +0.64% at 16,729, DJIA +0.00% at 37,306, RUT -0.14% at 1,982.

SECTORS: Communication Services +1.89%, Consumer Staples +1.08%, Consumer Discretionary +0.79%, Energy +0.76%, Technology +0.27%, Health +0.19%, Financials +0.14%, Industrials +0.07%, Materials +0.06%, Utilities -0.3%, Real Estate -0.35%.

EUROPEAN CLOSES: DAX -0.60% at 16,650.55, FTSE 100 +0.50% at 7,614.48, CAC 40 -0.37% at 7,568.86, Euro Stoxx 50 -0.65% at 4,519.85, IBEX 35 -0.40% at 10,054.90, FTSE MIB -0.44% at 30,241.02, SMI -0.32% at 11,155.80.

STOCK SPECIFICS:

- **United States Steel (X)** +26%: To be acquired by Nippon Steel (5401 JT) for USD 55/shr, valuing the co. at USD 14.9bln, including debt. Note, X closed Friday at USD 39.33/shr.
- **Nio (NIO)** +4.7%: Entered into a share subscription agreement with Cyvn Holdings who will invest an aggregate of USD 2.2bln.
- **Adobe (ADBE)** +2.5%: Co. and Figma mutually agree to terminate the merger with a USD 1bln termination fee.
- **VF Corp (VFC)** -7.8%: Detected unauthorised occurrences on a portion of its IT systems on Dec. 13th; Reasonably likely to have a material impact on business until recovery efforts are completed.
- **Illumina (ILMN)** +1.5%: Announced that it will divest Grail. The divestiture will be executed through a third-party sale or capital markets transaction with the goal of finalizing the terms by end Q2 '24.
- **Affirm Holdings (AFRM)** -0.6%: Downgraded at Morgan Stanley; said that its valuation is hard to justify downside despite the recent stock surge.
- **Sonoco (SON)** +1.3%: To raise prices for all converted paperboard products by a minimum of 6%, effective Feb. 1st, 2024.
- **PGT Innovations (PGTI)** +9.4%: To be acquired by **Masonite (MASI)** in an USD 3bln transaction or USD 41/shr. Note, closed Friday at USD 36.09/shr.
- **SunPower (SPWR)** -31.3%: Substantial doubt exists about the company's ability to continue as a going concern.
- **Apple (AAPL)** -0.9%: Will shortly halt the sale of Apple Watch Series 9 and Apple Watch Ultra 2 within the US, according to 9to5mac.
- **Netflix (NFLX)** +3%: PT raised to USD 550 (prev. 475) at Morgan Stanley; continues to see shares as offering an attractive risk/reward and sees combined benefits of original programming strength and competitive withdrawal benefiting member growth.
- **Structure Therapeutics (GPCR)** -42.8%: New data suggested its obesity drug can reduce weight and blood sugar, but analysts said investors were hoping it would see weight loss results in the ballpark of **Eli Lilly's (LLY)** orforglipron.

US FX WRAP

The Dollar was flat and traded within very tight parameters (102.370-630) as Fed Speak provided little sway for the index. Briefly recapping, Mester (2024 voter, retiring in June, hawkish) said markets are a "little bit ahead" of the Fed on rate cuts, joining the likes of Williams and Bostic in their light pushback of market pricing, while Goolsbee (2023 voter, dove) said the Fed may need to begin shifting its focus from inflation to the slowing US labour market. Daly gave a late interview in the WSJ, echoing Goolsbee in calling for a more balanced focus on the employment side of the mandate and the need for rate cuts in 2024 to prevent real rates rising, without being specific about when that could begin. As such, with the lead up to the Christmas holiday often subdued, participants will be awaiting BoJ on Tuesday ahead of US PCE on Friday with some tier 2 economic data releases and a 20yr bond auction due between then, and any further Fed Speak.

EUR and **CHF** outperformed on Monday, albeit only seeing marginal gains, with EUR/USD back above 1.09 with little to no reaction seen in wake of the poor German Ifo data given Flash PMIs last week. On the speaker footing, ECB officials continued to push back on market pricing with Vasle noting market pricing for the start of rate cuts, and the totality for 2024, is excessive while Stournaras, one of the more dovish members, stated they need to see inflation sustainably below 3% by mid-year before lowering rates. **JPY** was the G10 laggard and printed a high of 143.15 vs. an earlier low of 142.08 as market participants await the pivotal BoJ (Newsquawk preview available here) as western yields rose. **GBP** and **CAD** also saw slight losses against the Greenback, albeit in a lack of currency-specific newsflow and the Loonie failing to profit off rising crude prices amid heightened Red Sea tensions. Cable hit a low of 1.2629 after eclipsing 1.27 in early European trade before being dragged lower with losses vs. the EUR. Note, BoE Governor Broadbent comments provided little traction. **Antipodeans** were flat despite seeing initial strength in the European morning, and even outperforming, with support coming after further PBoC liquidity and a firmer Yuan fix.

EMFX was mixed. **TRY** and **CLP** were dragged down by the firmer oil prices and lower copper prices, respectively, with the Peso further hindered by voters on Sunday rejecting a new conservative constitution to replace its current text that dates back to the Augusto Pinochet dictatorship. For copper, Codelco reached contract agreements with three unions, putting off the risk of a strike. **BRL** outperformed, while **MXN** also saw gains with Banxico Governor Rodríguez Ceja noting the bank could discuss interest rate cut in Q1, saying any cuts would be gradual. **ZAR** was the laggard, giving up some of last week's gains, with ETM Analytics noting the Rand could strengthen in the coming week as export dollars continue to flow into the market from the mines, while importer demand dries up due to seasonal factors. **HUF** saw weakness, slipping to a one-and-a-half-month low, as traders await a likely interest rate hike when the Hungarian Central Bank meets on Tuesday.