NOVUM
CAPITAL PARTNERS

Weekly Market Flash

Equity investors stand strong against labor report shock

May 9, 2021

Economic data disappointed in the US this week – in particular, a softer nonfarm employment figure and a higher unemployment rate. However, markets shook off the bad news and recovered toward the end of the week, largely due to expectations of lower for longer rates and the reduced risk of tapering by the Federal Reserve (Fed). The pressure on rates is quite evident from reaction in US Treasuries to the weak labor market report: investors sold massively after an initial rally, driven by an increase in inflation expectations.

Highlights

- US nonfarm employment increased by only 266,000 in April, against expectations of around a million jobs being created. The unemployment rate also rose for the first time since the start of the pandemic.
- All Fed members, including Powell, Willams, Mester and Clarida, have repeated the same message this week: we still have a long way to go and it is premature to speak about any kind of normalization.
- Major US equity indexes reported mixed returns. In Europe, the rotation out of momentum and growth stocks and into value stocks was observed, while a positive sentiment regarding the reopenings prevailed.
- Gold broke above 1’800, hitting the highest levels since February, driven by increasing worries about inflation in the coming months.
- Longer-dated high grade corporate bonds regained some luster as US Treasury yields have stabilized; bonds maturing in 10 years or more generated total returns of 1.7% in April.

“The labor market report confirms early signs of some demand/ supply imbalances, underlining issues with the post-pandemic, reopening economies.”

Markets & Macro | Equity investors stand strong against labor report shock

Ongoing Fed support helps markets’ resilience.

US nonfarm employment increased by only 266,000 in April, against expectations of around a million jobs being created, beyond negative revisions (78k) to previous months’ data. The unemployment rate also ticked up for the first time since the onset of COVID.

Our view: The labor market report confirms early signs of some demand/supply imbalances, underlining issues with the post-pandemic, reopening economies. This dynamic is likely fueling a more pronounced upside pressure on wages. The report also highlighted that hourly wages have risen notably (0.7% versus 0.0% estimated). The impression is that companies are also struggling to hire workers in categories where wages are lower. This is because competition from subsidies would be high, or because perhaps some people have qualms about returning for fear of contagion, or other difficulties.

In our opinion, what is certain is that the report is "fitting" with the current ultra-dovish communication from the Fed. All Fed members, including Powell, Willams, Mester and Clarida, have repeated the same message this week: we still have a long way to go and it is premature to speak about any kind of normalization.

In fact, the message from all PMI surveys published during the week, across both the US and Europe, is the same. It confirms that demand is picking up, and manufacturing activity is strong as a consequence of developed markets reopening, which is leading to supply chain disruptions, price pressures on materials, bottlenecks in production, surging backlogs, and distortions/dislocations, as the pandemic caused a shift in consumption away from services.

Herein lies the market paradox: one day before the labor report, a strong warning signal on US valuations emerged from the Financial Stability Report published by the Fed. The publication underlined how the growing appetite for risk would lead to a progressive increase in valuations, creating a certain vulnerability in the US financial system, which, as a consequence, risks being potentially subject to significant downward movements if risk appetite were to fail. But a weak labor market further justifies a lower for longer rates environment, thus supporting stocks.

"Increasing worries about inflation in the coming months prompted the buying of precious metals as a hedge against inflationary pressures."

Elsewhere, equity markets were also resilient against negative news from the geopolitical space. US tensions toward China continue, with the Biden administration deciding to keep intact bans on investments in many Chinese companies, in particular companies more or less directly linked to the Chinese military apparatus. The week also saw the EU suspend investment projects toward China. China's economic planning agency, the National Development and Reform Commission, announced the indefinite suspension of all activities under China-Australia Strategic Economic Dialogue; this came out after the Australian government revoked the 99 year-lease of Darwin Port to a Chinese firm with military background.

Chart of the week

In the aforementioned context, gold finally broke above 1'800, hitting the highest levels since February. Increasing worries about inflation in the coming months prompted the buying of precious metals as a hedge against inflationary pressures. The price action looks constructive and is likely to remain a buy on dips for a move toward 1900/1950, or potentially new highs thanks to real rates being pushed even lower in the coming months.

Figure 1: Gold Breaks 1,800 Level

Source: Bloomberg, as at May 7, 2021.

"The rotation out of momentum and growth stocks and into value stocks was also observed in Europe, where a positive sentiment regarding the reopenings prevailed."

Equities | Positioning and sentiment retreat from elevated levels

A tough week for long duration.

Major US equity indexes reported mixed returns with the Nasdaq ending the week down by 1.5%, while the Dow Jones Industrial Average index, which is more value-oriented, performed the best, rising by 2.7%.

The rotation out of momentum and growth stocks and into value stocks was also observed in Europe, where a positive sentiment regarding the reopenings prevailed. Progress on vaccination programs and the easing of lockdowns were also supportive. A particularly weak US dollar, with the DXY Dollar index falling -1.15%, was helpful for short duration asset prices, especially commodities, miners and carbon energy. Meanwhile, strong earnings from European blue chips like Siemens, Linde, Anheuser-Busch and Adidas were supportive.

Meanwhile, semiconductor shortage concerns seemed to still weigh on European auto stocks, with the STOXX Europe 600 Automobiles & Parts index (SXAP) underperforming the Stoxx Europe 600 (SXXP) by 1.5%. Elsewhere, Chinese and Japanese equities underperformed their major global peers in a holiday-shortened week.

Figure 2: Global Equity Market Performance

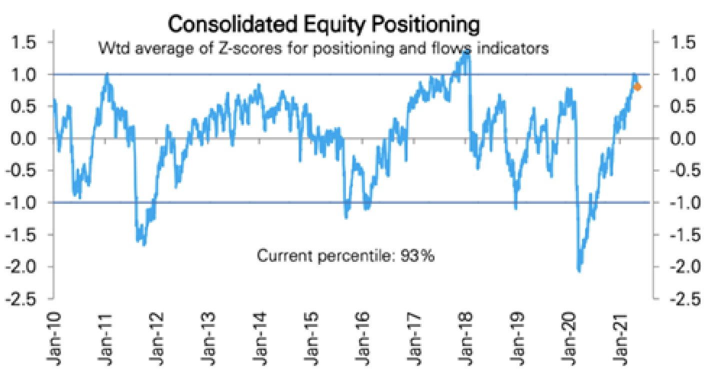
	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	34,777.76	2.72%	2.72%	14.33%
S&P 500	4,232.60	1.26%	1.26%	13.24%
Nasdaq	13,752.24	-1.48%	-1.48%	6.95%
Euro Stoxx 50	4,034.25	1.96%	1.96%	15.13%
Swiss Market	11,173.57	1.49%	1.49%	7.18%
FTSE 100	7,129.71	2.39%	2.39%	11.87%
CAC 40	6,385.51	2.36%	2.36%	16.18%
DAX	15,399.65	1.74%	1.74%	12.25%
FTSE MIB	24,612.04	1.95%	1.95%	11.28%
Nikkei 225	29,357.82	1.89%	1.89%	7.67%
Hang Seng	28,610.65	-0.30%	-0.30%	5.60%
CSI 300	4,996.05	-2.49%	-2.49%	-4.03%

Source: Bloomberg, as at May 7, 2021. Performance figures in indices' local currencies.

> "Data from JP Morgan and Deutsche Bank also highlight the sharp pullback in retail equity trading activity. At the same time, there has been a dramatic boost in retail activity in crypto currencies..."

Our view: Positioning in equity markets is pulling back from extremely elevated levels, and this is coinciding with peak earnings levels and subsiding macro data surprises. Data from JP Morgan and Deutsche Bank also highlight the sharp pullback in retail equity trading activity. At the same time, there has been a dramatic boost in retail activity in crypto currencies, especially Ethereum. And sentiment has also been sharply retreating from elevated levels, according to the Goldman Sachs sentiment indicator.

Figure 3: Equity Positioning Pulls Back



*Weights based on explanatory power in regression of equity performance on indicators

Source: EPFR, CFTC, Bloomberg Finance LP, Haver, Deutsche Bank Asset Allocation, as at May 7, 2021.

> "Until the path for inflation becomes clearer, we prefer to stick with quality stocks that demonstrate high earnings visibility and a strong balance sheet."

Our barbell approach, between growth and value, has served us well until March. Since then, rapid changes in the market leadership's (from value to growth throughout April and back to value since the beginning of May) have put a lid on the performance of the balanced approach. Until the path for inflation becomes clearer, we prefer to stick with quality stocks that demonstrate high earnings visibility and a strong balance sheet.

Fixed Income & Credit | Cash rich companies continue to borrow

Norfolk suggests investors aren't concerned about rising rates.

Longer-dated high grade corporate bonds regained some luster as US Treasury yields have stabilized. Bonds maturing in 10 years or more generated total returns of 1.7% in April, the most of any high grade maturity bucket, according to Bloomberg Barclays index.

Elsewhere, Norfolk Southern, a BBB+ rail transportation services company, suggested that investors are not that afraid of rising yields after all as the company sold USD600 million of 100-year bonds. Norfolk's century bond was offered at 180 basis points (bps) over Treasuries (20 bps less than initial discussions), for a yield of 4.10%.

"On the other hand, cash on the balance sheets of S&P 500 companies is at an all-time high at around USD2.7 trillion – and yet they're still borrowing billions of dollars..."

Our view: On the other hand, cash on the balance sheets of S&P 500 companies is at an all-time high at around USD2.7 trillion – and yet they're still borrowing billions of dollars from debt investors. One could ask why these companies are paying money to park cash on their books when they can't even spend what they already have, and they won't have to pay back for decades.

Since the beginning of the year, investment grade companies have sold USD189.7 billion of US bonds maturing in 20 years or more – and this is in addition to the USD625.2 billion sold in 2020. American banks are prime examples of this. They just reported some of the best quarterly profits ever, yet JP Morgan and Bank of America sold more bonds than they ever have before. Perhaps this is another bet that the much anticipated rise in inflation will effectively make it cheaper to repay in the future.

Week Ahead | Key events to watch for

- **The focus next week will be on the publication of the US inflation** report for April. After last month's benign surprise, the bond market will likely be tested again.
- **Producer prices, retail sales and industrial production** data will also be released. Next week, there are no relevant data releases expected in Europe or Asia.

Vittorio Treichler
Chief Investment Officer

Flavio Testi
Senior Fixed Income Portfolio Manager

Daniele Seca
FX and Derivatives Portfolio Manager

Karim Khalil
Senior Equity Portfolio Manager