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Weekly Market Flash

Does the Fed follow the market?

March 14, 2021

Fiscal and monetary policy action continued to support global markets this week, with the tech sector finally stabilizing despite long rates in the US coming under pressure again. Inflation fears seem to have stalled for now – prices are under control, and do not seem consistent with the Federal Reserve (Fed) starting to raise rates next year. Meanwhile, the European Central Bank (ECB) reaffirmed that it considers the tightening of financial conditions following the latest moves in interest rates to be "undesirable" – and it was reported that the pace of bond purchases would be increased "significantly" next quarter compared to the last few months.

Highlights

▪ Despite a slight miss in the CPI print, inflation appears to be priced for a likely firming in the coming quarters. Core CPI came out marginally below expectations at 0.1%. The 10-year UST yield ended the week toward 1.60%.

▪ The ECB reaffirmed that it considers the tightening of financial conditions following the latest moves in interest rates to be "undesirable". Measures were left unchanged.

▪ Stocks advanced sharply this week – within the S&P 500 index, the consumer discretionary sector led while the communication services and energy sectors lagged. European markets outperformed their US peers as the ECB pledged to buy more bonds.

▪ With the FOMC meeting around the corner, gold has bounced and found support from a long-term trend line.

“Considering that the RBA was among the first to adopt rates curve control during the pandemic, and are now active in rejecting the market assumption of rate hikes, it will be important to see if the Fed follows a similar path.”

Markets & Macro | Does the Fed follow the market?

Prices do not reflect any hike in 2022.

Despite a slight miss in the CPI print this week, inflation appears to be priced for a likely firming in the coming quarters. Core CPI, which is stripped of volatile components (food and energy) came out marginally below expectations (0.1% versus estimates for 0.2%).

The Federal Open Market Committee (FOMC) meeting will take place next week, and the substantial amount of news since the December meeting is likely to be adjusted into the Fed’s forecasts. The price action in rate markets last week created some misalignment between the Fed’s dot plot and investors expectation. An upward revision to the forecast is highly expected, confirming the principle that the central bank tends to follows the market – rather than the reverse.

Our view: For now, inflation fears have stalled, with prices under control. And they do not seem consistent with the possibility of the Fed starting rate hikes next year, given that prior to any such move, the Fed should first end QE – and QE tapering has not begun, and will certainly not be announced with these numbers, in our view.

Elsewhere, the Governor of the Reserve Bank of Australia (RBA) stated that expectations of an increase in rates in Australia do not match the central bank’s view. Considering that the RBA was among the first to adopt rates curve control (on the 3-year maturity) during the pandemic, and are now active in rejecting the market assumption of rate hikes, it will be important to see if the Fed follows a similar path.

The ECB reaffirmed that it considers the tightening of financial conditions following the latest moves in interest rates to be "undesirable", and therefore action is needed to restore the right level of expansion. Measures were left unchanged, both in terms of rates, guidance and the size of the pandemic emergency purchase program (PEPP), but it was reported that the pace of purchases would be increased "significantly" next quarter compared to the last few months, relying on the flexibility of the scheme. Further assessments of the state of financial conditions will be made periodically when the quarterly economic projections are updated, and the size of the PEPP will be adjusted as necessary.

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How will the stimulus impact stock market flows?

After Biden's signature on the latest USD1.9 trillion stimulus bill, the USD1,400 relief cheques will reach Americans between late March and early April.

Our view: The stimulus is having a positive effect on the stock market via two channels: first, the direct economic impact. The stimulus will fuel economic growth and corporate earnings, along with the reopening of the economy.

Second, the flow effect on the stock market. Deutsche Bank has conducted analysis on this topic and reported the potential impact of these subsidies on the stock market, based on a survey of retail investors. The research suggests that 37% of the money could be spent on the stock market. As the amount to be disbursed is around USD400 billion, the money going into the stock market could be between USD25 billion (from only those investors who already have a trading account to invest) to USD150 billion (if just 37% of the whole amount goes in). Considering that fund subscriptions have recently been running at a (record) rate of USD15 billion per month, the additional amounts are significant, especially if invested with leverage, as many retail investors have now learned to do.

Even if the above elements are certainly mostly priced in, sentiment is likely to remain supported by the shift in focus to the infrastructure plan, which is supposed to be different in scope. Expectations on the plan vary widely. For example, there are talks of USD4 trillion over 10 years, but an article by Bloomberg also mentions USD2.5 trillion over four years. In any case, it will be a long process – in part because it will necessarily have to be a bipartisan vote, or may be postponed until next year, given that this year the reconciliation process has already been used for the USD1.9 trillion stimulus bill (and it can only be used once a year). Further, the administration has made clear that the infrastructure plan will be at least partly financed by an increase in corporate and capital gain taxes.

"Market participants continued to focus on bond yields and the impact of rising yields on the valuations of growth stocks."

Equities | Big Tech concentration risk overhang fades

European markets lead as indexes reach record highs.

Stocks advanced sharply this week, lifting major indexes to record highs. Market participants continued to focus on bond yields and the impact of rising yields on the valuations of growth stocks. Within the S&P 500 index, the consumer discretionary sector led while the communication services and energy sectors lagged.

Small-cap stocks continued their ascent seen this year, with the Russell 2000 index ending the week up 7.3% (19.14% year-to-date). European markets outperformed their US peers as the ECB pledged to buy more bonds, and ignored Italy's decision to impose a nationwide lockdown during the Easter holiday.

Chinese stocks were the weakest link, due to Beijing's focus on financial deleveraging as part of the pandemic recovery, and as the government seems determined to use a heavy hand to clamp down on Chinese internet companies' dominance.

Figure 1: Global Equity Market Performance

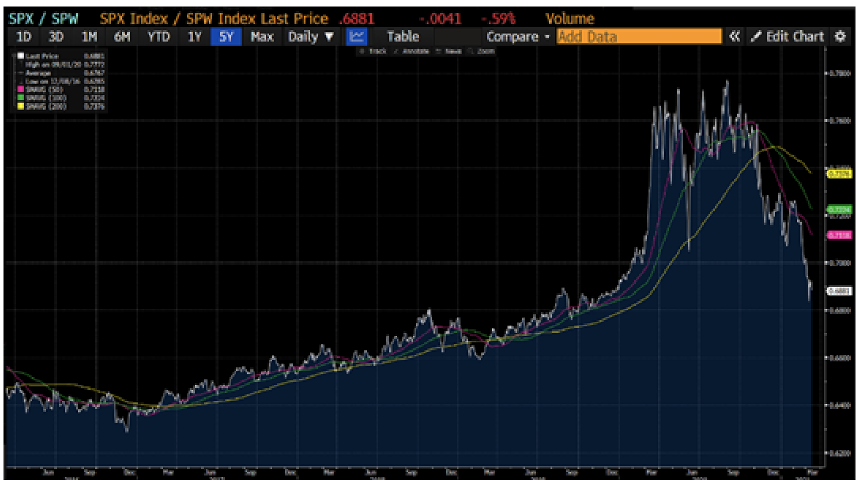
	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	32,778.64	4.17%	6.10%	7.60%
S&P 500	3,943.34	2.69%	3.55%	5.32%
Nasdaq	13,319.86	3.12%	1.00%	3.50%
Euro Stoxx 50	3,833.36	4.46%	5.47%	8.26%
FTSE 100	6,761.47	2.13%	4.69%	5.51%
CAC 40	6,046.55	4.56%	6.02%	9.08%
DAX	14,502.39	4.18%	5.19%	5.71%
FTSE MIB	24,113.22	5.00%	5.53%	8.86%
Nikkei 225	29,717.83	2.96%	2.60%	8.33%
Hang Seng	28,739.72	-0.95%	-0.52%	5.86%
CSI 300	5,146.38	-2.21%	-3.57%	-1.24%

Source: Bloomberg, as at March 12, 2021. Performance figures in indices' local currencies.

"The outperformance of the S&P 500 index over the equal-weighted S&P index in 2000 has been largely reversed. In our opinion, this suggests that the equity market rally has gained solid breadth."

Our view: The outperformance of the S&P 500 index over the equal-weighted S&P index in 2000 has been largely reversed. In our opinion, this suggests that the equity market rally has gained solid breadth. We view this as a strong positive, as it removes the concentration risk overhang of Big Tech.

Figure 2: S&P 500 Index versus S&P Index



Source: Bloomberg, as at March 12, 2021.

"...a low auction demand from foreign investors was not a good sign and it highlights an unstable market, seeking a new equilibrium in the light of a vastly improved US economic outlook."

Fixed Income & Credit | No respite until the 10-year UST reaches 2%

But demand for IG credit remains robust.

US treasuries ended the week on the wrong foot, pushing the 10-year yield toward 1.60%. This sudden spike, which occurred on Friday, has taken the yield back to levels seen after the disastrous 7-year bond auction on February 25th.

Our view: Markets have been looking for a period of calm after the relatively uneventful passage of this week's debt auctions. Still, a low auction demand from foreign investors was not a good sign and it highlights an unstable market, seeking a new equilibrium in the light of a vastly improved US economic outlook. As shown below, the feeling is that there will be no respite until the 10-year yield reaches 2%.

Figure 3: UST 10-year Yield

Source: Bloomberg.

“Undoubtedly, rising Treasury rates have pushed credit investors to be less willing to accept negative concessions on new offerings.”

Our view: In credit markets, for the moment, higher rates are not being reflected in wider spreads. Flows into the investment grade market remain robust as was shown again in the primary market this week. Undoubtedly, rising Treasury rates have pushed credit investors to be less willing to accept negative concessions on new offerings. However, high-grade investors dove into Verizon Communications Inc.’s USD25 billion jumbo bond sale, putting in orders for at least USD109 billion. Such a demand allowed the company to pay zero to seven basis points (bps) in new issue concessions after initially dangling premiums of 33-38 bps.

The robust demand may encourage other issuers to come forward. This is good news for an investment grade market that, after an avalanche of issuance since the start the year, is now showing some fatigue.

FX & Commodities | Gold finds support

RSI reaches oversold levels.

Chart of the week

With the FOMC meeting around the corner, gold has bounced and found support from a long-term trend line. The RSI is at extremely oversold levels, which is something that has happened only three times since 2018 (including the March 2020 crash).

“With the FOMC meeting around the corner, gold has bounced and found support from a long-term trend line.”

Figure 4: Gold Price

Source: Bloomberg, as at March 13, 2021.

Week Ahead | Key events to watch for

- **Central bank meetings**, including the Fed, Bank of England and Bank of Japan, will dominate next week.
- **Key economic data will also be released, including industrial production** and retail sales numbers for the US and China, euro area CPI and March consumer sentiment surveys in Europe.

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