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Weekly Market Flash

Are consensus misses and data volatility the new norm?

May 16, 2021

During the first half of this week, markets went into panic mode following the publication of surprisingly high inflation numbers in the US. However, by Friday's close, equities had almost recovered most of their losses – a reaction which we found very surprising. However, the huge amount of liquidity in investors' pockets evidently prevailed, enabling the buy-the-dip mentality to support prices and erase volatility. The only lasting effect of the new environment is the shifting away from the icons of the slowflationary regime (long duration and long secular growth), and toward the benefit of value and financial sectors (with Europe having become the new "place to hide").

Highlights

▪ US CPI saw the highest headline month-on-month reading since September 2009, and the highest core reading since 1981. Annual inflation rates stand at 4.2% and 3%, respectively.

▪ The week's late rally wasn't sufficient enough to reverse the inflation data-induced losses across major indexes. However, European stocks fared much better than their US peers, ending the week "flattish".

▪ A recent Bloomberg survey of sell-side strategists' 2021 S&P 500 target price showed a 2% increase from the previous month to 4,194. The 2021 average EPS estimate for the S&P 500 index also rose by roughly 3% to 189.78, leaving the implied P/E multiple practically unchanged at 22.1x.

▪ On the primary market, issuance in US junk bonds was high enough to bring the market to a new record for first half supply at about USD220 billion.

"With the economy in its reopening process following the lockdowns, which is clearly having consequences on supply and demand, consensus misses and high data volatility have become and will likely remain the norm for a while."

Markets & Macro | Are consensus misses and data volatility the new norm?

Inflationary spike doesn't derail Fed message, so far.

US CPI saw the highest headline month-on-month reading since September 2009, and the highest core reading since 1981. Annual rates of inflation stand at 4.2% and 3%, respectively. The primary driver of the uptick were higher used car prices, but troublingly, there is evidence of broadening price pressures to other sectors related to the reopening. This "higher inflation" environment was reinforced by the University of Michigan consumer confidence, which declined much worse than expected, mainly due to a surge in inflation fears (4.6% on the year, and 3.1% for the next five to 10 years).

Elsewhere on the data front, there was a reconsideration of Friday's payrolls flop, now seen as inflationary. The reconsideration was prompted by the new record high in the sub-index measuring difficulty in finding labor from the April NFIB small business optimism. This difficulty was certainly among the factors in the resounding miss of the labor market report.

Our view: With the economy in its reopening process following the lockdowns, which is clearly having consequences on supply and demand, consensus misses and high data volatility have become and will likely remain the norm for a while. And with numbers undoubtedly feeding the inflation narrative, this will have consequences on politics and monetary policy.

We believe this is a boon for the Republican camp in order to undermine public support for Biden's infrastructure plan and American Families Plan. The Republicans' communication has shifted toward criticizing the strategy for providing excessive support to an already running hot US economy with rising inflation, as well as criticizing the notion that "unnecessary" unemployment benefits and the prospect of more fiscal stimulus are incentivizing workers to stay at home.

On the Federal Reserve (Fed) side, so far, despite the huge beat and numerous evidence of rising inflationary pressures, this one single month of data is not materially derailing the Fed's "transitory" and "patient" message communication. This is the beauty of the Fed's new mandate: price targeting over a cycle (no longer barely 2%), and a strong job market.

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While the initial reaction to the inflationary spike this week was for markets to challenge the Fed, almost expecting an hawkish reaction to the data surprise, toward the end of the week, markets recovered. On the technical analysis side, for the moment the bearish breakdown attempts seem to have been rejected, but until the S&P 500 index stabilizes above 4,200 points, and the Eurostoxx 50 above 4,000, the picture remains muddy – albeit within a bullish trend. Playing the bearish breakouts has been a rather expensive exercise so far, and it has rewarded only in the tech area.

Chart of the week

The Nasdaq failed to build new highs, showing a clear signal of weakness (confirmed by the RSI), which triggered a fast correction that stopped on a temporary trend line (the red line). After the break, we see the 50-days moving average as a resistance and no longer as a support, confirming our stance to remain cautious and underweight in the tech/growth area despite our neutral positioning.

The next target of the movement sits at 12'500 (200-days moving average). We are ready to take action should the technicals prove to be correct.

Figure 1: Nasdaq Shows Weakness

Source: Bloomberg, as at May 14, 2021.

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Equities | US markets dip on inflation

European stocks outperform.

The late rally on Thursday and Friday this week wasn't sufficient enough to reverse the inflation data-induced losses across major indexes. The Nasdaq Composite finished down 2.3% as long-duration asset prices came under pressure. The Nikkei 225 index also recorded heavy losses (-4.34% week-on-week) in response to accelerating COVID-19 cases and the sharper than expected US CPI data.

European stocks fared much better than their US peers, ending the week "flattish". China A-shares ended the week on a high note, with the CSI 300 index gaining 2.3%. Meanwhile, Hong Kong shares remained under pressure with Alibaba's earnings miss (due to higher expenses from new strategic initiatives) weighing negatively on other internet names.

Figure 2: Global Equity Market Performance

	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	34,382.13	-1.08%	1.61%	13.09%
S&P 500	4,173.85	-1.35%	-0.10%	11.72%
Nasdaq	13,429.98	-2.32%	-3.77%	4.46%
Euro Stoxx 50	4,017.44	-0.19%	1.77%	14.92%
Swiss Market	11,120.77	-0.44%	1.04%	6.70%
FTSE 100	7,043.61	-1.15%	1.21%	10.58%
CAC 40	6,385.14	0.21%	2.57%	16.42%
DAX	15,416.64	0.11%	1.85%	12.38%
FTSE MIB	24,766.09	0.63%	2.59%	11.98%
Nikkei 225	28,084.47	-4.34%	-2.53%	3.04%
Hang Seng	28,027.57	-2.03%	-2.32%	3.46%
CSI 300	5,110.59	2.31%	-0.23%	-1.81%

Source: Bloomberg, as at May 14, 2021. Performance figures in indices' local currencies.

Our view: This week we looked at a recent Bloomberg survey, which revealed sell-side strategists' 2021 S&P 500 target price increasing by 2% from the previous month to 4,194. The 2021 average EPS estimate for the S&P 500 index also rose by roughly 3% to 189.78, leaving the implied P/E multiple practically unchanged at 22.1x.

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Fixed Income & Credit | H1 high yield supply reaches new record

Cash rich Amazon issues USD18.5 billion bond.

Following this week's higher-than-expected US inflation figures, US high grade corporate bond spreads edged wider, and junk bonds weakened on a total return basis. As inflation fears sent government bond yields climbing, buyers of newly issued corporate bonds are already nursing losses.

Based on Bloomberg data, about 80% of high grade non-financial corporate bonds priced in Europe this year are quoted below their issue price. Last Friday, the share of post-issue losers stood at under 50%. This bleak statistic underscores that the reflation trade (bets on a rapid economic recovery and an associated pickup in inflation) has not been painless for credit investors. As everyone knows, investment grade bonds are more sensitive than high yield debt to any threat of higher interest rates because they have longer life spans than lower-quality peers and carry lower risk premiums. The year-to-date total return of euro-denominated investment grade bonds has slumped this week, to -1.03% from -0.55% on Monday, and in the US to -3.94% from -3.10%. By contrast, the less rate-sensitive junk bond market has gained 2.03% in Europe this year and 1.89% in the US.

Our view: On the one hand, spreads on most of this year's new issues are trading tighter than at launch and the average risk premium of high grade euro bonds over safer government debt is indicated at 87 basis points, the lowest in over three years. On the other hand, spreads, with little room to tighten further, seem incapable of compensating duration-driven losses. Therefore, further rate increases and tapering prospects later in the year render long-end risk-reward unattractive.

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On the primary market, issuance in US junk bonds was high enough to bring the market to a new record for first half supply at about USD220 billion. T-Mobile (BB+) was the biggest borrower with a USD3 billion offering for refinancing debt (the 5-year tranche sold for a yield of 2.25%). In Europe, bonds with an ESG label accounted for 40% of the week's issuance, while in Asia, Cathay Pacific Airways' (NR), which has been absent from the market since the 1990s, issued a 5-year bond yielding 4.88%.

Amazon.com also sold USD18.5 billion of notes, the second-largest offering of the year behind Verizon's USD25 billion behemoth. The online retail giant's USD48 billion peak order book allowed the company to pay flat to minimal new issue concessions across tranches. The shortest tranche (2023) was sold at a yield of 0.26%, the 10-year tranche at 2.10%, while the longest (2061) at 3.29%.

“If inflation goes up, negative real yields are only getting negative...”

Amazon has USD34 billion of cash, up 24% from a year earlier, suggesting borrowing was not needed. However, with inflation higher than the rates on newly issued debt, companies are incentivized to borrow. US investment grade companies can now borrow at an average rate of 2.13%, with the spread to Treasury rates near a three-year low. That is well below the 3.16% average in the last decade and lower than the Treasury market’s current 30-year forecast for inflation of 2.36%. If inflation goes up, negative real yields are only getting more negative and as one commentator stated: “you can make money by working or by borrowing, and working isn’t as fun as borrowing and spending.”

Week Ahead | Key events to watch for

- **The highlight next week will be the release of the flash PMIs** for May. The April readings were strong both in the US and in Europe, with all readings well above the “50” threshold.
- **Housing data will also be released in the US**, with housing starts, building permits and existing home sales.
- **With all relevant central bank meetings scheduled in June**, the attention will be on the four Fed speakers scheduled to speak, and their comments on inflation, while the minutes to the April FOMC meeting should constitute old news after the strong figures published last week.

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