NOVUM
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Weekly Market Flash

Will US jobs data rock the Fed's patience?

May 30, 2021

In a pretty uneventful week, equity markets posted marginal gains, challenging trendlines but with no major breakout. The lack of pressure from rates and the absence of any relevant threat pushed volatility lower, reversing moves made in previous weeks. However, it is very likely that volatility will make a comeback next week, given that the week is packed with economic data – in particular, US payrolls – which leads us to central bank meetings in mid-June.

Highlights

▪ Major global indexes recorded solid gains for the week on notably light trading volumes. Despite the lack of directional drivers, risk assets, such as the Nasdaq Composite and the CSI 300 Shanghai Shenzhen index, performed best.

▪ This week saw ECB doves take center stage – the Governor of Banque de France Villeroy stated on Friday that ECB tapering fears that have impacted yields are "unjustified", and any debate on a reduction in the pace of purchases are "purely speculative".

▪ Salesforce reported strong Q1 earnings: cRPO growth was USD17.8 billion, which is a 23% rise year-on-year, and a 17% rise from Q4 2020, and compares to the consensus estimate of USD17.3 billion.

▪ UniCredit's USD2 billion sale pulled in more than USD8 billion of demand from about 200 investors, the majority coming from North America. The strong order book helped the bank to cut the initial spread offered by 25 bps.

"...if it is still difficult to challenge the "temporary" nature of rising inflation, successive strong job data is where the Fed's "long way to go" stance can or will be shaken."

Markets & Macro | Will US jobs data rock the Fed's patience?

US and European policies likely to diverge.
The macro data calendar intensifies again for markets next week, opening an eventful period that will lead to important central bank meetings.

Our view: We believe next week's data publications will be paramount for market developments for a number of reasons. Specifically, inflation is overshooting. The Federal Reserve (Fed) has almost managed to convince the majority of market participants that the visible price pressures are transitory. Essentially, this enables the Fed to kick the can for longer (postponing tapering and rate hikes) and remain highly flexible. Moreover, last month's optically weak NFPs has further cemented the Fed's dovish communication. This means that there is still a long way to go, and more substantial progress on the labor front is needed before taking action.

In other words, if it is still difficult to challenge the "temporary" nature of rising inflation, successive strong job data is where the Fed's "long way to go" stance can or will be shaken. Indeed, investor expectations for the Fed's tapering have been reduced, but pressure will increase on the Fed to start discussing QE tapering over the summer – and the Fed could possibly use the Jackson Hole meeting as an opportunity to announce this. On Fed funds, a repricing of rate hikes could also occur (currently, the first rate hike is expected in December 2022).

Elsewhere, a strong data set in the US will likely contribute to creating a policy divergence between the US and Europe. Many elements point to a reduction in the relevance of the mid-June European Central Bank (ECB) meeting, while September seems a much more likely date for strategic changes in the asset purchase program. We would be very surprised to see the ECB changing the course of monetary policy anticipating any decision by the Fed!

In fact, this week saw the ECB doves take center stage, trying to set the tone for upcoming deadlines.

After Lagarde's comment "we are carefully monitoring yields", other ECB members have intervened to signal that an abrupt tapering of purchases in June is premature. For instance, the Governor of Banque de France Villeroy stated on Friday that ECB tapering fears that have impacted yields are "unjustified", and any debate on a reduction in the pace of purchases are "purely speculative". The ECB will be as patient as the Fed and will tolerate inflation overshooting, while the level of rates should not be considered a floor. ECB member Panetta, who appeared in the Nikkei, also believes the EU recovery is far from sustainable – and only a sustained increase in inflationary pressures can justify a reduction in the pace of purchases.

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The new post-Covid economic environment, with the prospect of higher taxes, a less accommodative Fed and higher-than-expected inflation, was confirmed by some political events this week. In particular, there was a US proposal for a global minimum corporate tax at 15%. The idea, which came from the Biden administration, will most likely be discussed at the G7 finance ministers' meeting next week in London. Additionally, Biden unveiled the proposal for the first budget of his presidency. It's a radical shift in approach to the kind of economic policy the US has followed in past decades: more government intervention in a range of social sectors and education, infrastructure interventions, increased federal debt, and more robust taxes on businesses and higher income earners:

- In the Congress, Democrats are determined to support the plan while Republicans oppose it and have already presented alternative proposals. The affair is destined to profoundly influence the international economy. As has already been known for weeks, the total of spending will be just under USD6 trillion, which means that if the operation is approved by the House of Representatives and the Senate, the budget for the fiscal year that begins next October will put the government on the path to spend USD8.2 trillion by fiscal year 2031.
- The public debt, which is around 100% of GDP today, will rise to 117% at the end of 2031 (higher than that recorded at the end of World War II). Higher taxes, which should take effect immediately, will begin to reduce the debt in the coming years and cancel out the increase in spending decided now in about 15 years, according to the Administration's forecasts.
- Republicans unveiled a USD928 billion infrastructure counter-plan this week. The fact that we are now talking with absolute nonchalance about budgetary stimuli for thousands of billions of dollars signals how profound is the change of climate in economic policies.

"Despite the lack of directional drivers, risk assets, such as the Nasdaq Composite and the CSI 300 Shanghai Shenzhen index, performed best."

Equities | Is Salesforce at a turning point?

Q1 earnings boosts investor confidence.

Major global indexes recorded solid gains for the week on notably light trading volumes. Despite the lack of directional drivers, risk assets, such as the Nasdaq Composite and the CSI 300 Shanghai Shenzhen index, performed best. Also, growth equities outperformed value stocks despite the inflation surprises. Elsewhere, the Nikkei 225 index also registered a strong gain on the back of accelerating vaccinations.

Figure 1: Global Equity Market Performance

	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	34,529.45	1.03%	2.21%	13.76%
S&P 500	4,204.11	1.20%	0.70%	12.61%
Nasdaq	13,748.74	2.08%	-1.44%	6.98%
Euro Stoxx 50	4,070.56	1.24%	3.31%	16.66%
Swiss Market	11,426.15	1.79%	3.87%	9.69%
FTSE 100	7,022.61	0.10%	1.08%	10.44%
CAC 40	6,484.11	1.81%	4.62%	18.74%
DAX	15,519.98	0.53%	2.54%	13.13%
FTSE MIB	25,169.39	1.65%	5.16%	14.78%
Nikkei 225	29,149.41	2.94%	1.17%	6.96%
Hang Seng	29,124.41	2.67%	1.99%	8.03%
CSI 300	5,321.09	3.67%	3.96%	2.31%

Source: Bloomberg, as at May 28, 2021. Performance figures in indices' local currencies.

Our view: For a while, Salesforce.com (ticker: CRM US) has been a sleeping giant in the Novum model portfolio. Up until last Thursday, the stock was up only 1.48% on the year, underperforming the Nasdaq Composite by 5.4%. Investors grew skeptical of the Slack acquisition's synergy potential, compared to the hefty price of USD27.7 billion, which led to a share price underperformance of roughly 18% versus the Nasdaq since the deal announcement on December 2, 2020.

In our opinion, last quarter's earnings results, which were reported on Thursday after market close, were a turning point in regaining investors' confidence. The strong Q1 2021 print was driven by growth coming ahead of expectations. For example, cRPO growth was USD17.8 billion, which is a 23% rise year-on-year, and a 17% rise from Q4 2020, and compares to the consensus estimate of USD17.3 billion. Despite pushing out the closing date for Slack, management raised full-year guidance to USD25.9-26.0 billion. The positive commentary from CEO Marc Benioff regarding the uptick in new business (120% year-on-year increase in seven figure deals) is very supportive for new billings growth.

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We also liked the management's renewed focus on the company's operating margin, something that was lacking in previous quarters. Salesforce.com trades at roughly 7x EV/Sales CY22, compared with a SaaS peer median of 9.4x. Adjusting for growth also shows a discount to peers above 25%. We expect the gap to narrow as the company regains investors' confidence on solid execution.

Fixed Income & Credit | UniCredit draws USD8bn orderbook

Investors look past CASHES confusion.

The saga related to UniCredit's Convertible and Subordinated Hybrid Equity-Linked Securities (CASHES) continued this week. As is well known, the drama began last week when the new CEO surprised bondholders when he decided not to pay a coupon of about EUR30 million on the grounds that the bank made a loss last year. Investors had been assured on earnings calls this year that it would be honored and the news sent bonds plunging about 10.5 cents.

Then, just days later, it emerged that some holders had in fact received notice of payment. It turned out to be a Euroclear error. Euroclear informed clients on May 19 of the news, but due to an internal processing error, nevertheless provisional credits were made and became visible to clients.

Our view: As a result of the above events, the unanimous reaction of the market was that the issuer's reputation would suffer and investors would be very critical at UniCredit's next issue. However, the primary market ignored this.

"With the re-opening of the global economy, leveraged loans, typically a floating-rate asset, are in fierce demand by investors seeking safe returns at a time when rates may rise."

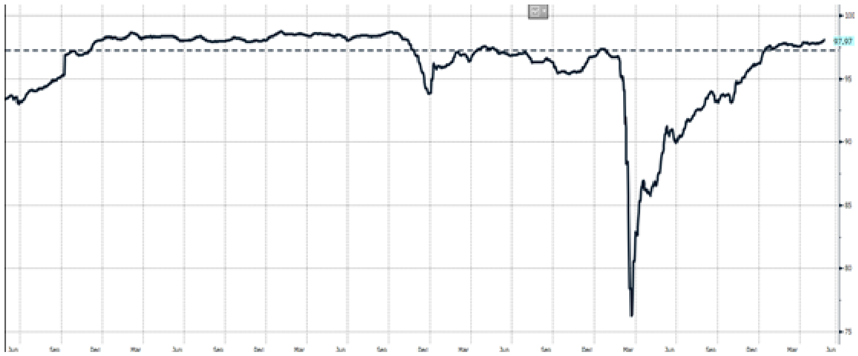
In fact, the bank wasted no time in testing investor appetite, tapping the dollar-bond market with a USD2 billion offering. The sale pulled in more than USD8 billion of demand from about 200 investors, the majority coming from North America. The strong order book helped the bank to cut the initial spread offered by 25 basis points (bps). The bonds sold on Wednesday were in a senior preferred format (Baa1/ BBB with maturity 2027 at 1.98% and 2032 for a yield of 3.187%). Although this is much less risky than the complex, deeply subordinated CASHES bonds, the outcome suggests that many institutional investors are willing to look beyond the confusion of last week.

Moving on to something different, let's look at the loan market. Beyond some mega deals such as the USD41.5 billion loan financing AT&T Inc.'s merger with Discovery Inc, loan new issuance has diminished significantly in the last few weeks. With the re-opening of the global economy, leveraged loans, typically a floating-rate asset, are in fierce demand by investors seeking safe returns at a time when rates may rise. A sudden scarcity of new loans pushed the average leveraged-loan trading price to 98.06.

This rally in secondary debt has helped pave the way for some borrowers to reprice loans to lower their borrowing costs. For example, cruise operator Carnival is working on a cross-border leveraged loan sale that will roughly cut its borrowing costs in half by refinancing a loan it took out in the depths of the pandemic. Carnival is marketing the dollar loan due 2025 at L+375/400 bps, while the existing one costs L +750 bps.

Figure 2: Average Leveraged-Loan Trading Price

“A sudden scarcity of new loans pushed the average leveraged-loan trading price to 98.06.”



Source: Bloomberg, as at May 28, 2021.

Week Ahead | Key events to watch for

- **Business surveys from around the world** will be the released, including the May PMIs, as well as the ISM readings from the US. All indices should sit around all time highs. But inflation components will likely be observed more than the headlines numbers, after the recent spikes.

- **The main highlight will be the latest US jobs report** on Friday, where a strong rebound in job creation is expected after last month’s reading disappointed consensus.

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