



INSPIRING WHAT'S NEXT

CIO OFFICE MORNING MARKET WRAP

21 June 2024

Asian shares fell in the wake of a weak US session. The MSCI Asia Pacific dropped 0.4% in early trading, weighed down by South Korea and China, while Japan rose. US futures were steady before the Friday multiple options expiry, whereas the dollar, gold and Brent crude were little changed. In Japan inflation accelerated, an outcome that would back the case for the BOJ to consider higher policy rates in the next months. Governor Ueda left them unchanged and gave no indications about the pairing of bond purchases in the previous meeting. The yen traded at its weakest levels in almost two months reaching 159 per dollar, raising odds of interventions in support of the currency. Treasuries traded weaker in Asia, despite softer economic data. New home construction showed the slowest pace in four years, the Philadelphia Fed index trailed estimates, while jobless claims were little changed. Fed Governor Kashkari said the central bank will return inflation to 2%, but estimated it would take one or two years to get there. Traders will be keeping an eye on purchasing manager indices in Europe and the US to be released today, for cues on economic activity and cost pressures. The price sub-indices will be particularly important to gauge inflation momentum.

Yesterday, following an IT-led rally where hardly more than tech stocks powered markets higher, IT large caps took the wind out of equities, that closed in negative territory. The S&P 500 lost 0.25% after briefly topping 5,500, while the Nasdaq ended 0.8% lower. Nvidia and Apple led losses in the megacaps. Sector returns were skewed defensively, with energy and utilities topping the outperformer list. Notably, Europe gained 1.3%, and EM stocks rose by 1.2% to almost reach the highs of the year. The Dollar Index gained 0.3% to trade at the top-end of its range. Gold broke out of its holding pattern and ended the session above its 50-day moving average. US Treasuries edged lower, following recent strength that saw the asset class come close to breakeven for the year. But with almost two Fed cuts already priced in for 2024, it is hard to see further gains unless economic data continues to weaken significantly from here. Crude coming back up above \$85 in a straight line poses also a challenge.

Bitcoin has been on a tear till its top in March this year, followed by range-trading that has seen crypto assets in general lose steam. The asset class is sensitive to liquidity patterns and bitcoin in particular has been correlated with the Nasdaq usually leading the equity index. There are other subtle signs that liquidity is shifting less favourably for risk assets. Different gauges of credit risk premia, the difference in spreads between weaker and stronger segments of the credit spectrum, is pointing to larger risk premia. The relative performance of cyclical versus defensive equity sectors is also pointing to a less pro-cyclicals stance amongst investors. And June is a month where there is a seasonal pick-up in the Treasury account with the Fed due to increasing tax receipts that suck bank reserves out of the system, a key gauge of short-term liquidity for markets. In summary, there are fledgling signs across asset classes of a rollover in market liquidity. Anecdotally, it is important to mention that according to Bloomberg insiders at Nvidia are selling the stock "in droves" amidst a "dearth of buyers". It seems we are in for a bout of volatility following an impressive and impressively narrow equity rally.

There is louder chatter that the PBOC is going to implement Quantitative Easing, as it is looking to widen its liquidity tools to the buying and selling of Treasury bonds. Yet, this is not the right perspective. The PBOC is likely to be going to intervene in the Treasury market, but as mentioned for liquidity-management reasons, and not for the further crushing of yields, already depressed by ongoing deflationary pressures. The QE will happen via the financing of the real estate sector in the attempt to lessen its woes. It is planned that the PBOC will finance state purchases of unsold homes to stabilise the sector. This would be in similar fashion to what happened in 2015-16, when the central bank helped finance shanty town renovation, expanding its balance sheet in the process. The balance sheet expansion would constitute Quantitative Easing this time as well. The PBOC involvement is still small, in the order of 300bn yuan, but the expectation is that the program will be ramped up. Sized right, this would be a proper solution for breaking the link between depressed consumer confidence and the home sector.

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