M Mutual Limited

Morning Mutterings: Monday 19 July, 2021

Quote of the day…

*"…trying to forecast the velocity of money is akin to juggling an incontinent squid"…**Russell Napier***

Overview…"The Fed's got this…right?"

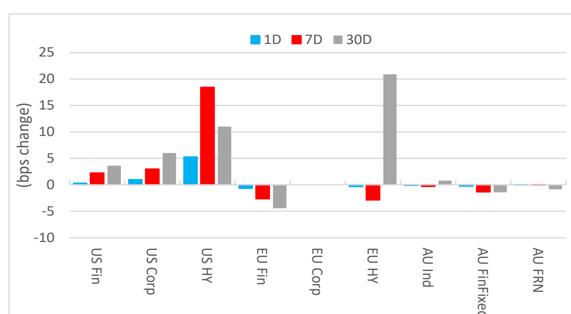
- European markets closed in the red, while US stocks notched up their biggest weekly loss since mid-March following a drop in consumer confidence amid rising inflation concerns. And, stronger US retail sales were largely ignored, especially in the face of elevated valuations. I'd also add the rising number of COVID Delta variant infections across the US as a headwind, starving risk assets of some oxygen. Bond yields continued to fall, reflecting this cautiousness, and a belief, to some degree, that the Fed's "*got this*"…under control that is.
- US markets are rolling into the belly of the Q2 reporting season, hot on the heel of the hottest inflation print seen since the financial crisis, which will likely put a premium on companies best able to handle those price pressures. As noted in a recent GS report, companies with higher pricing power -- the capacity to pass on costs to customers without harming the business -- are on track to outperform those with low pricing power for a second straight month. What they're saying is it's an uneven growth outlook for stocks, so stock-picking will be crucial to performance.
- Talking heads…*"a key to success in investing in the second half of this year is to be long companies who have pricing power, who have more ability to manage their costs…..inflation is front-and-centre in everyone's mind, whether you're a bond investor or an equity investor, as we go into this earnings season."* A comment made in reference to US markets, but a global theme. *"Technology is an example of a sector that can have pricing power -- they have good balance sheets…the adoption we've seen post pandemic, it looks more-sticky versus coming out of the pandemic."*
- Apart from US reporting season, there is a handful of data prints, but nothing market moving (likely). Locally we have the meeting minutes from the July meeting, which will be essential reading. Retail sales also out, for June, with consensus at -0.6% MoM vs +0.4% MoM in May, with Sydney's lockdown impacting here. Payrolls and PMI's also out.

"Rocket man…"

Source: www.theweek.com

	At a glance….	*Last*	*1D*	*7D*	*30D*
EQUITIES	ASX 200	7,348	0.17%	1.03%	-0.15%
	DOW	34,688	-0.86%	-0.52%	2.56%
	S&P 500	4,327	-0.75%	-0.97%	2.49%
	NASDAQ	14,427	-0.80%	-1.87%	1.88%
	STOXX	455	-0.32%	-0.64%	-1.00%
CREDIT	AusBond FRN (bps)	33.7	-0.03	-1.38	-1.38
	AusBond Fixed (bps)	55.4	-0.23	-1.31	-1.75
	US Fin (OAS, bps)	71.8	0.33	3.41	2.07
	EU Fin (OAS, bps)	35.3	-0.67	-2.87	-5.43
BONDS	ACGB (10Y, %)	1.284	0.00	-0.08	-0.36
	ACGB (3Y, %)*	0.295	0.01	-0.05	-0.07
	UST (10Y, %)	1.290	-0.01	-0.07	-0.21
	UST (2Y, %)	0.222	0.00	0.01	0.01
FX & CMDTY	BB Commodities	94.43	0.32%	1.00%	4.80%
	Oil (Brent, $/bbl)	73.59	0.16%	-2.59%	0.70%
	Gold ($/oz)	1,812	-0.95%	0.21%	2.17%
	AUDUSD	0.74	-0.30%	-1.16%	-2.00%
	AUDEUR	0.63	-0.27%	-0.60%	-1.15%

Chart du jour…global spread changes



Source: Bloomberg, Mutual Limited

Details….

- *Offshore Stocks* – a down day for global stocks to end the week, which also resulted in weekly losses for core US and European indices, while Asian indices were able to advance. The S&P 500 saw almost 70% of stocks down, with only four sectors gained on the day. The S&P 500 snapped a three-week winning streak thanks to a retreat by big tech. Utilities (+1.0%), Healthcare (+0.2%) and Staples (+0.2%) lead, while Energy (-2.8%), Materials (-1.5%), and Finance (-1.3%) dragged their feet. It seems investors have abandoned June's safety bid into tech for equity sectors that offer a steady yield like utilities, real estate and consumer staples, while others have pulled out completely and are pursuing bonds – see below.

- *Local stocks* – the first day of the Victorian lockdown on Friday, which had minimal impact on local markets, the ASX 200 positing very modest, but reasonably broad gains (+0.2%). The five-day lockdown is likely a pipe-dream after 19 cases reported on Saturday morning, with 18 of those out and about spreading the love while infectious. And another 16 or 17 on Sunday. And then in Sydney, cases numbers that an opening batsman would be proud of….and unfortunately a third of those were mystery cases. I did my bit, had my first Pfizer jab on Friday, the only side-effect was a bit of a sore arm, like a mild-corky. Nothing debilitating though. The second jab comes in three-weeks. As for markets on Friday, just over half of stocks closed higher, while only two sectors really failed to fire, Energy (-0.4%) and Utilities (-0.4%). The ASX 200 closed up +1.0% on the week, outperforming its US and EU peers.

(Source: Bloomberg)

- *Offshore Credit* – no corporate bond issuers dealt in US IG primary markets on Friday. Volume for the week was expected between US$15bn and US$40bn. Goldman, Morgan Stanley and BofA combined to sell almost US$22bn in new bonds, almost 75% of the week's total. JPMorgan may be next following their results. Syndicate desks are calling for US$15bn to US$20bn of new IG supply this week, with a greater percentage to come from corporate issuers after last week's supply was dominated by banks.

- *Local Credit* – trader talk…"*a quiet end to a long week. Local credit spreads continue to demonstrate impressive resilience with little weakness evident. This weakness may yet manifest itself as and when we see a resumption of* *primary issuance. We acknowledge the slight skew towards better selling but it is not our view that spreads are entering a period of prolonger weakness*". On financials…"*spreads firmly unchanged with no material flows of note. Two weeks since the end of the TFF and we would estimate that senior spreads are in the region of -1 bp tighter. Difficult to foresee any spread widening even with the onset of local senior issuance.*" From my perspective, I tend to agree, but I'm cautious on the risk back-drop and suspect we might see some modest drift wider in spreads – nothing alarming of course, but some drift nonetheless.

- ***Bonds & Rates*** – yields on 10-year Treasuries dropped below 1.30%, which resulted in a flattening of the curve for three straight weeks, yet another signal that the recovery rally of the first half is unlikely to continue for the rest of 2021. Talking heads…"*bond markets are still buying into the transitory inflation narrative, with G-10 nominal yields remaining broadly below year-to-date peaks. But building evidence of significant price overshoots through year-end may prompt earlier tightening guidance, setting up for a further repricing of rate-hike cycles.*" An alternative point to consider, which goes to explain why yields have stubbornly fallen in the face of rising inflation data, is the fact that central banks globally hold some US$22 trillion worth of bonds…so, talking head "*however you slice and dice it, a large proportion of the global bond market is held by entities that are committed to holding on to the securities for the long term and whose decisions are not substantially driven by market metrics*". An important point.

Australia | Browse | 13:31:57 | Treasury & Money Markets

Money Rates		
RBA Cash Target	0.10	+0.00
RBA O/N Cash	0.03	+0.00
SFE IB 30 Day Future		
IB1	99.970	-0.005
IB2	99.970	+0.000
SFE 90 Day Bank Bill		
IR1	99.970	+0.000
IR2	99.930	-0.010
IR3	99.870	-0.020
IR4	99.790	-0.010
SFE Bond Future		
YM1	99.670	+0.010
YM2	99.540	-0.005
XM1	98.740	+0.025
XM2	98.675	+0.005
LTY1	98.140	+0.015
LTY2	98.140	+0.015
3-10S Spread		
ABFS	0.930	-0.010

Tenor	Bank Bills Live		BBSW		BABs EOD		OIS	
1M	0.01	+0.00	0.0100	+0.0000	0.01	+0.00	0.03	+0.00
2M	0.02	+0.00	0.0100	-0.0106	0.01	+0.00	0.03	+0.00
3M	0.02	+0.00	0.0250	+0.0000	0.03	+0.00	0.03	+0.00
4M	0.05	+0.00	0.0450	+0.0050	0.04	+0.00	0.03	+0.00
5M	0.06	+0.00	0.0500	+0.0000	0.06	+0.00	0.03	+0.00
6M	0.06	-0.01	0.0650	+0.0000	0.07	+0.00	0.03	+0.00

Basis vs USD		
1YR	-0.88	+0.25
2YR	3.25	+0.00
3YR	9.13	+0.01
5YR	17.38	-0.01
7YR	23.13	+0.00
10YR	28.25	+0.13

Govt Bonds			Mid Swaps		
1Y	0.039	+0.000	1Y	0.08	+0.01
2Y	0.067	-0.005	2Y	0.26	+0.02
3Y	0.306	+0.007	3Y	0.44	+0.02
4Y	0.530	+0.007	4Y	0.65	+0.02
5Y	0.693	+0.002	5Y	0.82	+0.02
6Y	0.848	+0.000	6Y	0.98	+0.02
7Y	0.987	+0.002	7Y	1.11	+0.02
10Y	1.291	-0.003	10Y	1.40	+0.01
12Y	1.346	-0.005	12Y	1.53	-0.01
15Y	1.671	-0.008	15Y	1.65	-0.02
20Y	1.915	-0.011	20Y	1.76	-0.01
30Y	2.087	-0.011	25Y	1.77	-0.01
			30Y	1.74	+0.01

S&P/ASX Indices		
200	7348.12	+0.17%
SPI FUT	7232.00	-0.51%
ALLORDS	7630.74	+0.19%
SML ORDS	3391.60	+0.42%
200 PROP	1540.10	+0.48%
Gold		
GOLD USD	1812.05	-17.42
GOLD AUD	2449.13	-16.14

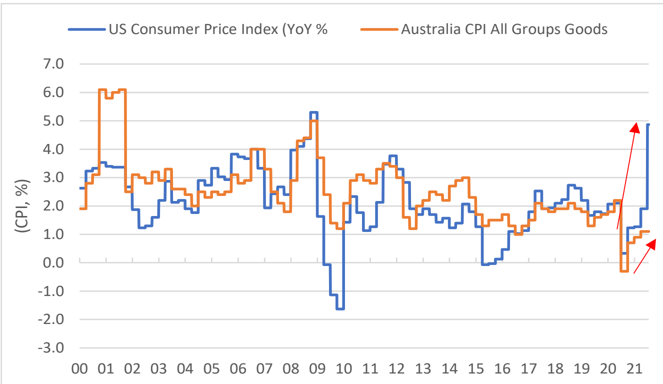
Spot FOREX	
AUD	0.7401
EUR	1.1806
JPY	110.0700
CNY	6.4791
AUDEUR	0.6268
AUDGBP	0.5375
AUDNZD	1.0571
AUDCHF	0.6803

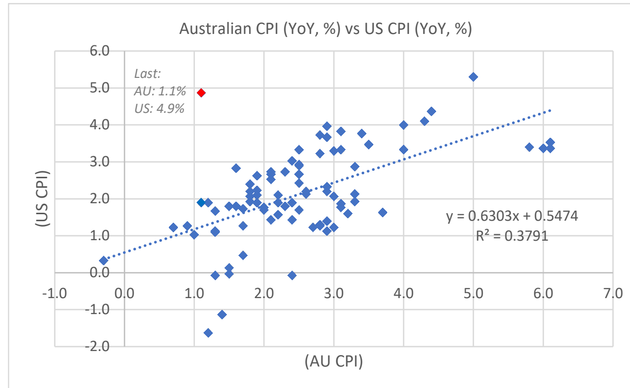
Global Indices			Sov CDS/Markit Indices		
S&P500	4327.16	-32.87	AUST SOV	14.66	+0.02
EU STOXX50	4035.77	-20.62	MARKIT ITRX	59.86	+0.22
NIKKEI	28003.08	-276.01	MARKIT NA IG 5Y	49.99	+0.83
SHANGHAI	3539.30	-25.29	MARKIT ITRX EUR	47.62	+0.35

(Source: Bloomberg)

- ***Offshore Macro*** – June US retail sales rebounded solidly in June despite consensus expectations of a second month of declines. The headline number came in at +0.6% MoM after a revised -1.7% MoM drop in May. Core sales, stripping out autos and gasoline, fared even better, climbing +1.1% MoM following a revised -1.0% MoM decline the previous month. The University of Michigan's preliminary sentiment index decreased to 80.8 in July from 85.5 the prior month.

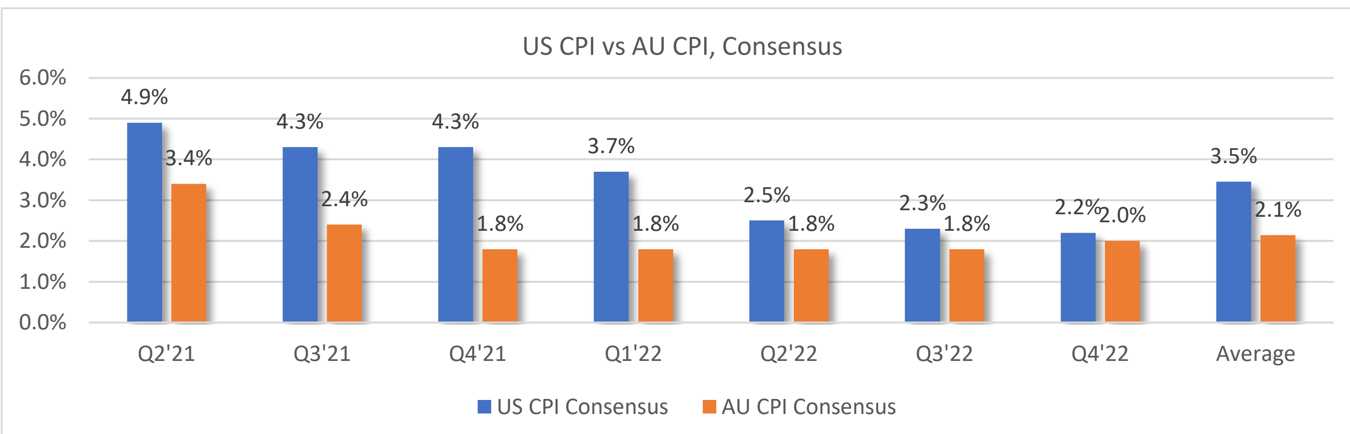
- ***Local Macro*** – there is a big focus on US inflation data, which makes sense, the US economy is the biggest in the world and accounts for about a quarter of global growth (China hot on their heels). But, does US inflation necessarily mean Australian inflation. History suggests no, not necessarily…despite some alarmist clap-trap from a Herald-Sun writer over the weekend…typical irresponsible, half-baked reporting. I won't name names, but as soon as I see an alarmist economics headline, I know it's the same guy, he's been calling a housing collapse for 10 years. Pure click-bait. Any-hoo, Australian and US CPI are correlated around 37% of the time, which is depicted in the following two charts. Why the difference? Basically, as similar as the two economies may appear, there are some key differences. One particular area is manufacturing, where it is a more significant portion of the US economy (~10% - 12%) than the Australian economy (~5% - 6%). US CPI is forecast to average 3.5% YoY between now and the end of 2022 vs +2.1% for Australian CPI, reflected in the bottom chart.





(Source: Bloomberg, Mutual Limited)

US vs Australian CPI forecasts out to Q4’22…



(Source: Bloomberg, Mutual Limited)