Weekly Market Update

29 August 2021

US Data : Positive streak stays in tact

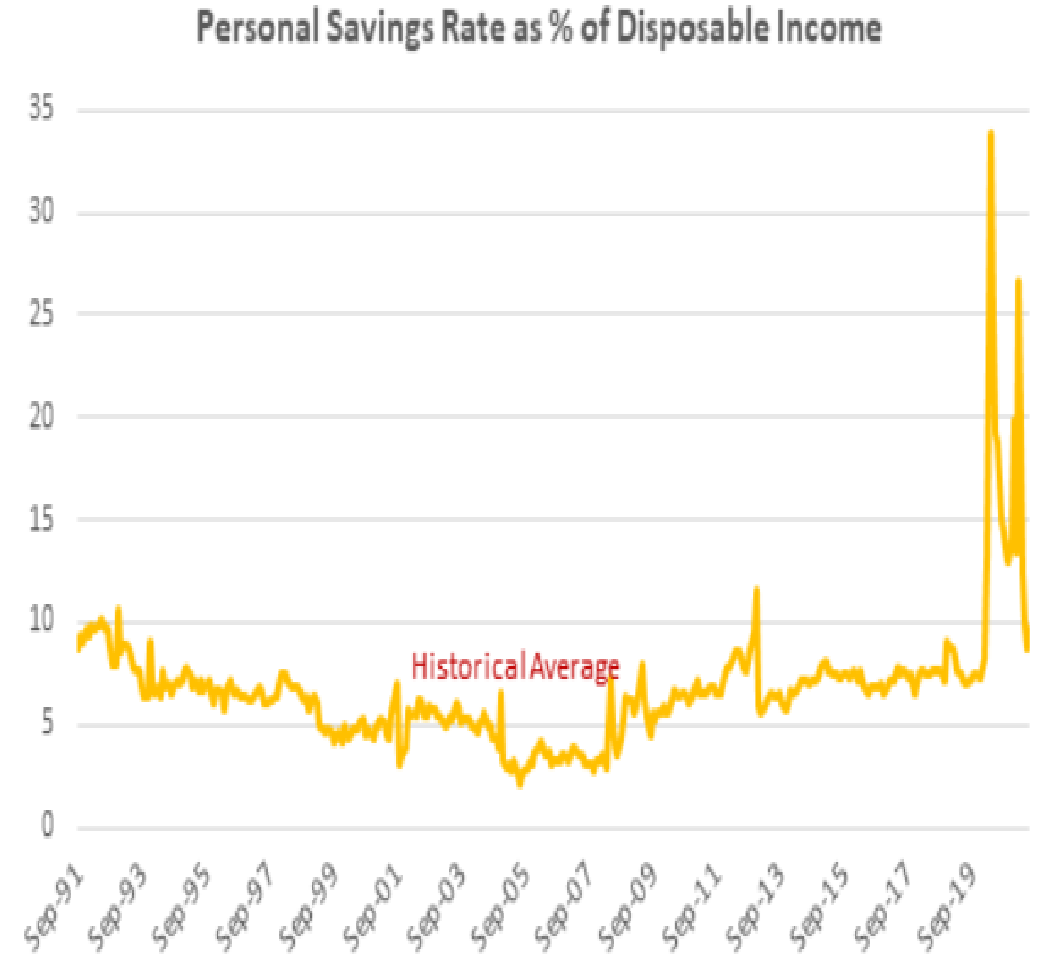
- Last week's economic data releases were generally positive.
- Personal income rose 1.1% month-over-month in July, versus the forecast of a 0.3% increase, following June's upwardly-revised 0.2% gain.
- Personal spending grew 0.3%, below estimates of a 0.4% gain and compared to the prior month's upwardly-adjusted 1.1% increase. The July savings rate as a percentage of disposable income was 9.6%.
- PCE Deflator increased 0.4% m/m, matching expectations and down from June's unadjusted 0.5% increase. Compared to last year, the deflator was 4.2% higher, above estimates of a 4.1% rise and June's unadjusted 4.0% gain. Excluding food and energy, the PCE Core Index rose 0.3% m/m, in line with expectations and versus June's upwardly-adjusted 0.5% rise. The index was 3.6% higher y/y, matching estimates and June's upwardly-adjusted gain.
- August final University of Michigan Consumer Sentiment Index was revised slightly higher to 70.3, but below expectations for it to be revised to 70.8 from the preliminary reading of 70.2. The upward revision came as a modest upward adjustment on the current conditions component of the survey was met with an unexpected downward adjustment to the expectations portion.
- The overall index was solidly lower versus July's 81.2 level, as sentiment regarding both expectations and current conditions fell. The 1-year inflation forecast came in at 4.6%, down slightly from July's 4.7% rate, but the 5-10 year inflation forecast ticked higher to 2.9% from the 2.8% level in the prior month.
- The advance goods trade balance showed that the July deficit shrank more than expected, coming in at $86.4 billion, versus estimates calling for it to decrease to $90.9 billion from June's upwardly-adjusted shortfall of $92.1 billion.
- Preliminary wholesale inventories rose 0.6% m/m for July, compared to expectations of a 1.0% gain, and versus June's upwardly-revised 1.2% rise.

US Equities : Optimism and Caution

- Headlines swung squarely to Fed policy and geopolitical uncertainties last week, while swings in the stock market remained narrow, continuing August's tranquil trend in which S&P 500 has had just one daily move of 1% or more – something that hasn't occurred since December 2019.
- Moreover, the market's move in August is close to half of the average monthly swing during the past 10 years.
- Markets continue to be driven – appropriately so – by the broader outlook for the progressing economic and earnings expansions, which remain intact.
- Does this suggest the market is failing to see the risks –
    - The difficult geopolitical situation, including the tragic loss of life -Just as Nixon was struggling to extricate US from its long, costly, and unwinnable war in Vietnam, Biden has now ended America's long, costly, and unwinnable intervention in Afghanistan.
    - Fed officials last week opened the door to an upcoming wind-down in monetary policy stimulus.
    - Spreading delta variant has disrupted the economic reopening process domestically and around the world.
- However, these expansions won't be immune to shifts in sentiment driven by the above factors.
- While the S&P 500 Index has delivered a steady rally with only two 4% pullbacks this year, the underlying composition has rotated between optimism and caution. Enthusiasm over the reopening saw market gains driven by cyclical areas, including value investments and small-cap equities.
- That has shifted more recently, with defensive and growth investments leading, reflecting a more "risk off" tone that has underpinned the more moderate gains of late

US Consumption : Healthy Clip

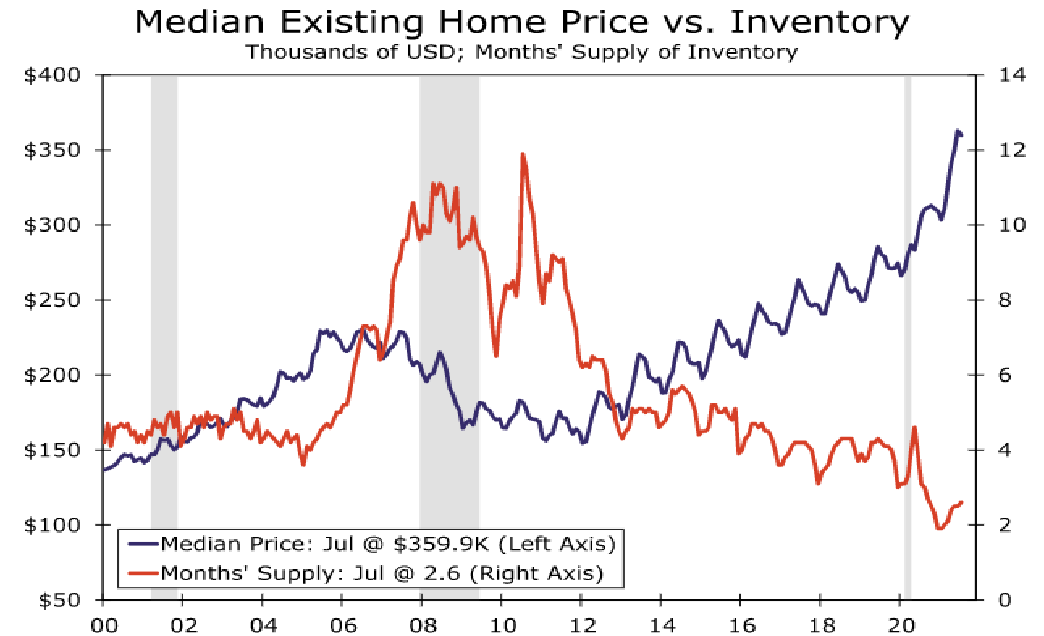
- Personal consumption has surged this year, helped by a healing labour market and govt stimulus checks.
- A return from stratospheric levels should be expected, but household spending is poised to grow at a healthy clip ahead.
- The unemployment rate may continue to fall thanks to solid job growth.
- Wages are rising at the strongest pace in in 2 decades, and the personal savings rate was reported at 9.6% in July, adding to the $2 trillion in estimated accumulated household savings.
- This provides a significant amount of dry powder for consumers to increase consumption, which constitutes 70% of GDP.
- To boot, last week's durable goods report showed that the outlook for business investment remains bright, which would add further gas to the economy's engine.
- Supply-chain disruptions and capacity constraints are limiting investment growth at the moment, but the robust demand to be met with increased production and business investment ahead, <u>a cylinder of the engine that failed to fire in much of the last economic cycle.</u>

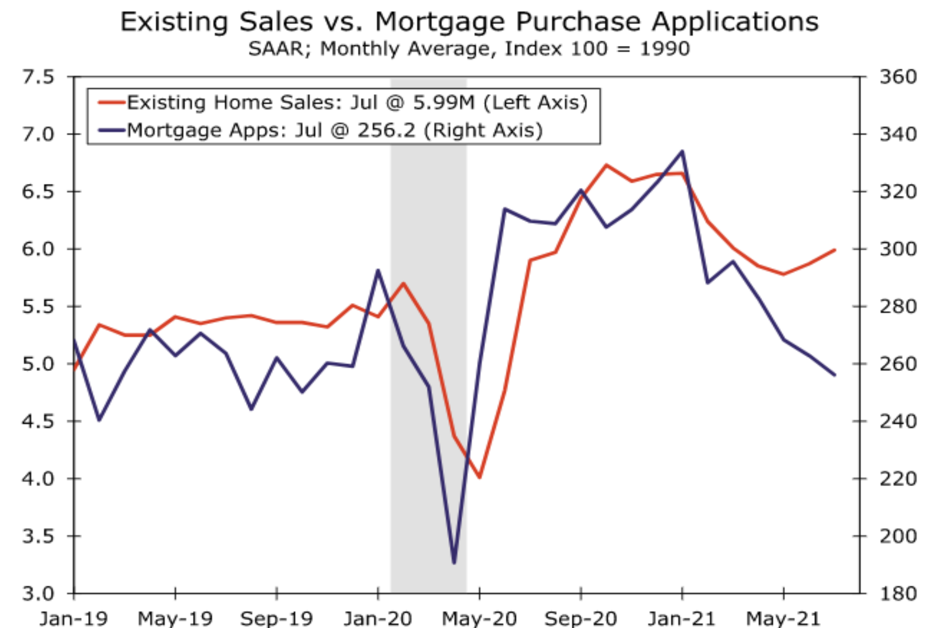


Rapid rise and fall in the personal savings rate as a % of Disposable Income

US Housing : Moving towards Balance

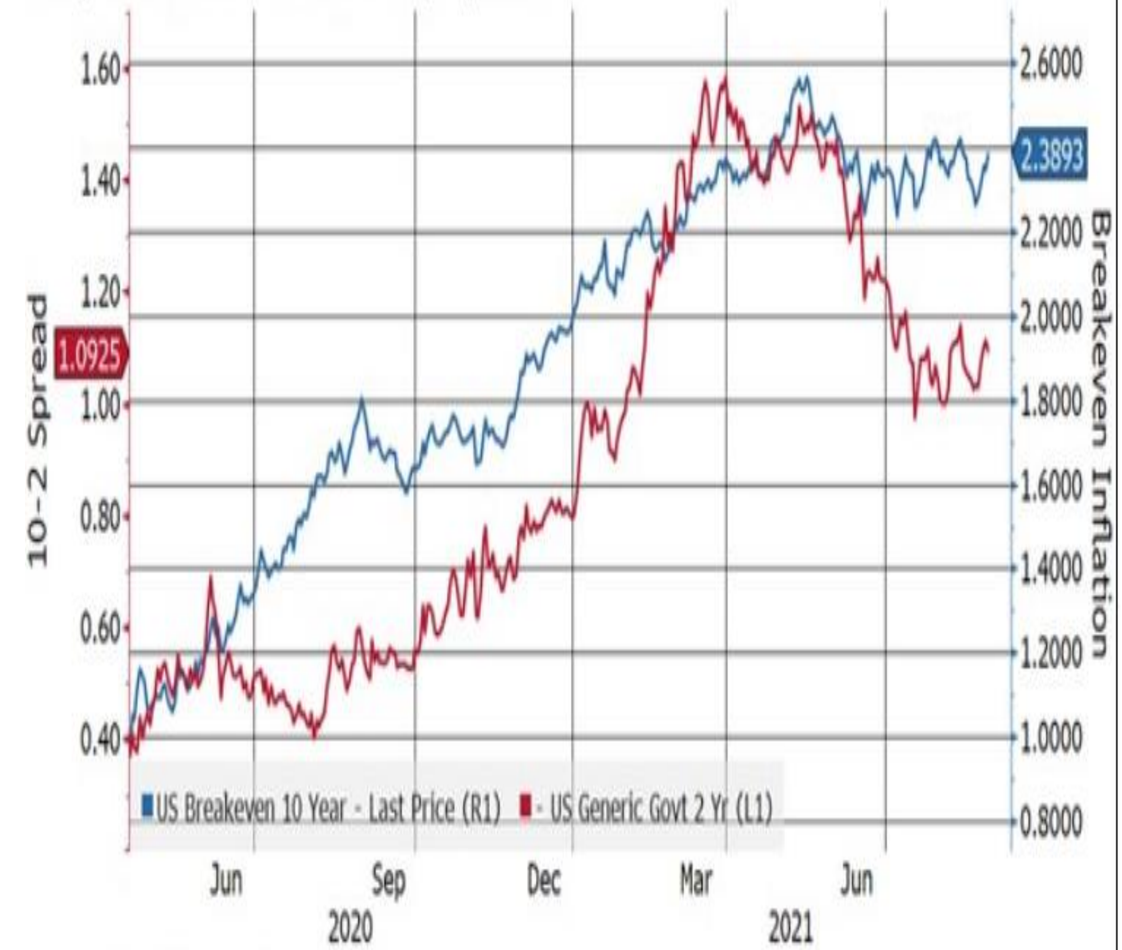
- This past month's housing data suggest the market is beginning to move back into balance. To be certain, inventories of existing homes are still exceptionally low and homes are selling quickly and often above asking price.
- The inventory of existing homes has been gradually trending higher since February and now sits at a 2.6-month supply. A 5.5-month supply has typically been considered the norm, although innovations in mortgage finance and the rise of cash buyers have probably reduced that by a month or two.
- Sales of existing homes slightly topped consensus expectations this past month, rising 2% to a 5.99-million unit pace.
- Sales of single-family homes rose 2.7% and accounted for all the overall gain. The median price of an existing home declined slightly from the prior month, on a non-seasonally adjusted basis, to $359,900.
- That still leaves the median price 17.8% above its year ago level. The pace of price appreciation appears to have peaked in May at 23.6%.
- Low inventories and the rapid run-up in prices have led prospective buyers to put their home-buying plans on hold, which explains a softer pace of sales in recent months.





Fed triggers Non Linear Reflex

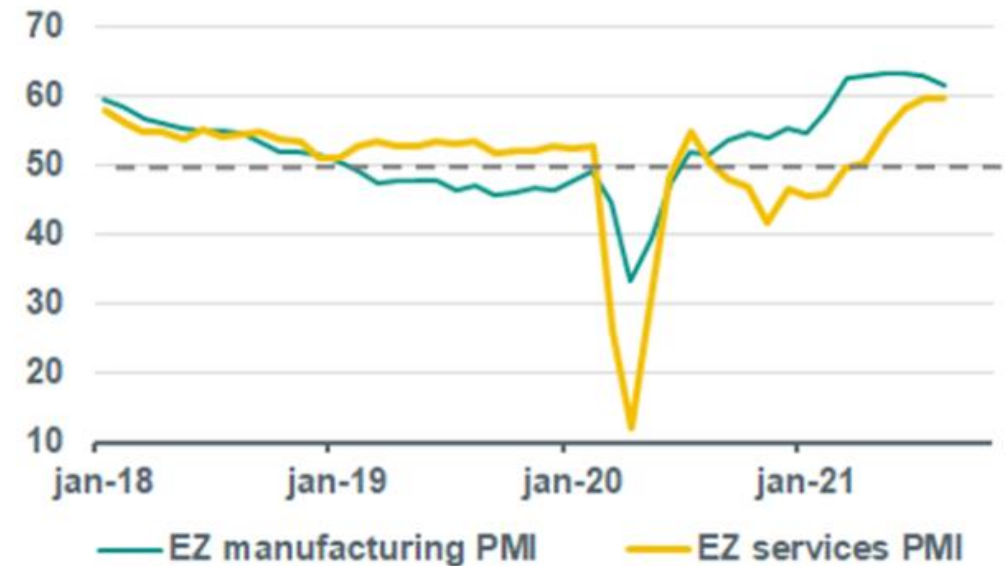
- Powell reiterated that Fed is in no hurry to either taper asset purchases immediately or aggressively. Additionally he made crystal clear that even when Fed does eventually start tapering asset purchases (likely November or December), it should not be taken as signaling interest rate hikes will follow on some preset course.
- Powell continues to lean into the idea that inflation will prove to be transitory and so there is no rush to tighten policy, especially with the employment part of the mandate still far from being achieved.
- The reiteration of the more dovish Fed stance opens the door inflation expectations to turn back up, since Fed is not so eager to front run rises in inflation with more restrictive policy.
- The shape of the yield curve has been highly influential recently in relative performance trends between various areas of the market .
- From last summer through May of this year, the steepening of the yield curve coincided with healthy outperformance of cyclical stocks.
- Since May, the flattening of the curve has coincided with more defensive (or at least high quality) leadership out of the tech and health care sectors. The logic goes, therefore, that a re-steepening of the curve should coincide with a shift back to cyclicals.



- In case inflation expectations turn back up (blue line), we could see a re-steepening of the yield curve (red line).

Europe : Positive momentum

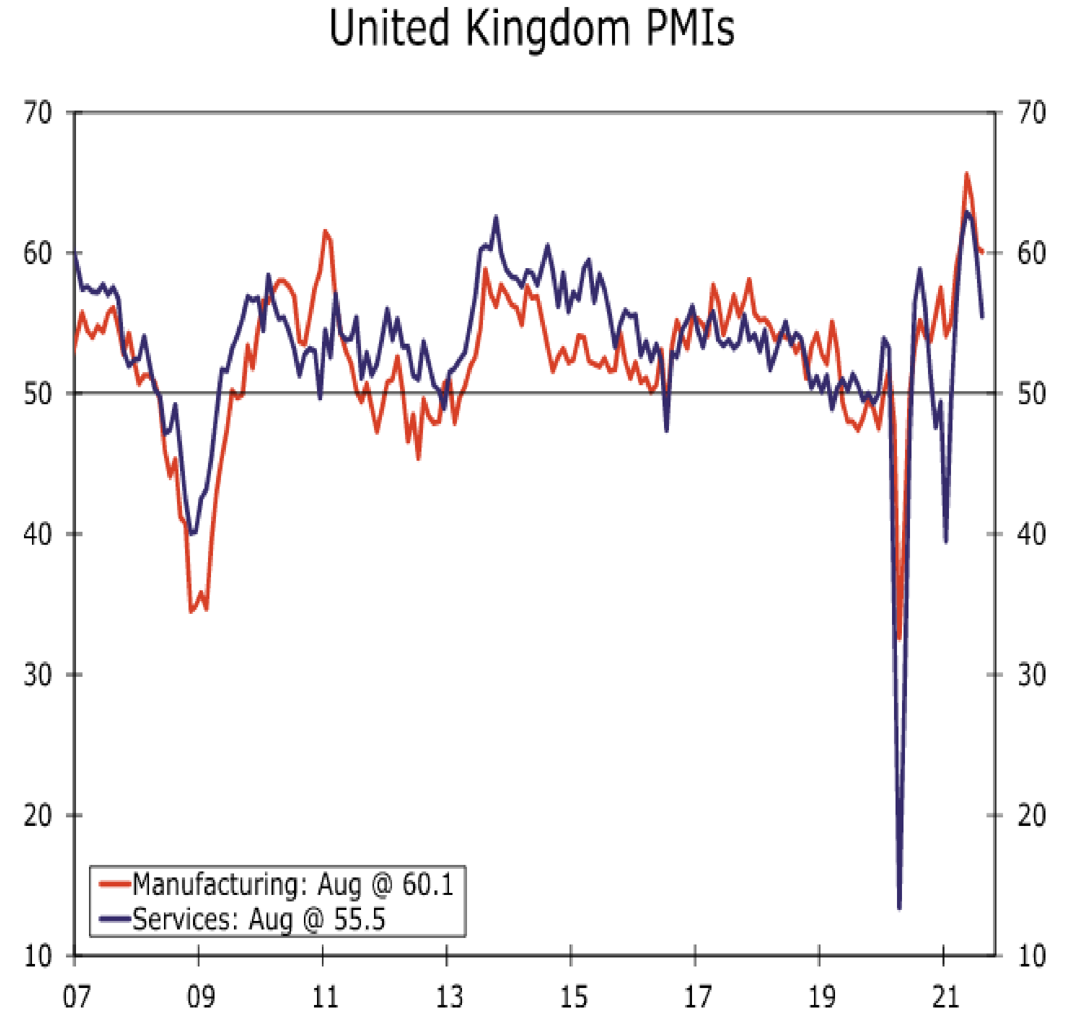
- Eurozone composite PMI (flash estimate) declined to 59.5 in August, down from 60.2 in July. At its current level the index signals that GDP is growing at a rate well above the trend rate.
- Moreover, the August report indicates that economic growth is gradually getting back to normal, after it had earlier bounced back rapidly in May and June, when lockdown measures in the services sector were scaled back.
- The manufacturing PMI has been at levels well above the 50-mark more than a year now, although it has lost some of its earlier gains in recent months. It fell to 61.5 in August, down from 62.8 in July.
- Services PMI was weighed down by restrictions during the second and third wave of the pandemic between September 2020 and May 2021. It returned to levels that are closer in line with to the manufacturing PMI only around the start of the summer, when increased vaccination rates allowed the unwinding of lockdown measures in services.
- In August, the services PMI moved only marginally (to 59.7 from 59.8).



- August flash PMIs is in line with base case scenario for the EZ economy of ongoing robust GDP growth during the rest of this year.
- The high level of vaccination in the vast majority of eurozone countries will prevent new strict and widespread lockdown measures that would push the services sector back into recession.
- This should allow GDP to expand by around 2% qoq in Q3 and another 1% in Q4.

UK : Slowing Pace

- In contrast to the Eurozone, the August PMI surveys for UK showed a more notable slowdown, although that was perhaps always to be expected after U.K. economy enjoyed supercharged growth of 4.8% q/q in Q2.
- August services PMI dropped to 55.5, the lowest level since February, while the manufacturing PMI eased to 60.1.
- The survey comes after a reported decline in July retail sales and suggests that while the service sector will likely continue to grow in Q3, it will probably be at a much slower pace than in Q2.
- As a result, expect slower growth in U.K. Q3 GDP, with forecast 2.5% q/q gain only around half of the increase seen in Q2. U.K. Growth Slowing to a Still Respectable Pace
- Bank of England held monetary policy steady in August, but offered a mildly hawkish policy bias. As a result, we now expect an initial modest rate increase of 15 bps in Q3-2022.



Bond markets : Emerging Conviction

- Liquidity in the banking system, estimated to be more than 7 trln rupees, has kept the appetite for on-the-run gilts, especially the short-term bonds, strong as banks usually prefer parking their surplus cash in shorter-tenure gilts.
- The two most-liquid gilts that the RBI auctioned–the 5.63%, 2026 bond and the 6.64%, 2035 bond–drew strong demand, resulting in higher-than-expected cutoff prices despite the green-shoe auction being exercised,
- Banks were expected to replenish their books with fresh supply of the 2026 bond after they offloaded nearly Rs 45 bln of the 7.59%, 2026 paper, an illiquid 5-year bond, at the bond-purchase auction under the GSAP on Thursday. Banks were also said to have restocked their holdings of the 6.64%, 2035 paper, after offloading a little more than 64 bln rupees of it to the RBI at the bond-purchase auction on Thursday.
- Besides, widening spreads between the 364-day Treasury bill and the five-year gilt have also led banks to step up their purchases of the most-liquid five year paper–the 5.63%, 2026 bond, dealers said. Since July 20, the spread between the 364-day T-bill and the 5.63%, 2026 paper has widened 12 basis points.
- Many mutual fund houses are now offering new schemes which are a mix of equity and debt–like balanced advantage funds, and have started gaining traction. Since Aug 13, till Thursday, mutual funds have net bought government bonds worth Rs .123.74 bln
- After a long time , the markets realise that the liquidity would stay for a long period of time and that there is no risk of any normalization any time soon – The conviction of a cyclical top in the yields emerges strongly .

Indian Equities : Optimism and Caution

- Indian markets experienced a tug of war between bulls and bears this week with benchmark indices largely swaying sideways while investors continued to remain guarded.
- This cautiousness isn't distinctly visible especially in the Nifty50 index which has turned so polarized that only a handful of stocks are participating in a concentrated manner in the rally.
- It is seen that the largest 10 stocks in Nifty 200 outperformed the other 190 stocks by 7-8% this month.
- But while the larger stocks are still in an upward momentum, the broader indices have been experiencing a correction.
- The number of stocks that were trading above their 50 DMA dwindled from close to 100% in June to just about 45% now.
- Range 16300 16800 for the next week ?