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Weekly Market Flash
Buy-the-dip lends support to stocks

July 25, 2021

Concerns about the diffusion of the Delta variant drove sharp losses across Asian and European markets at the Monday open – but dip-buyers almost immediately stepped in and rapidly erased the losses. This prepared the ground for a quick recovery that once again surprised investors. And while the highly infectious variant continues to drive lockdowns across Australia and South Korea, and higher cases in the UK, Europe and the US, investors decided to look through any slowdown induced by such fears. As we said in our commentary last week, we expect a volatile summer, with frequent bouts of volatility erupting from time to time. But we excluded, and continue to exclude, a deeper correction.

Highlights

- US and European equity indices rebounded from the 3-day sell-off that ended on Monday, with most major indices reaching all-time highs. The rebound was largely concentrated in mega cap technology stocks, while Delta variant concerns weighed on recovery and value stocks – in particular, financials, materials and energy.

- This week, the ECB's new framework provided all the excuses to remain dovish for longer. The outcome is pointing toward a delayed and very soft tapering under the best case scenario.

- The July FOMC meeting should help refine the likely timeline for an announcement in the coming months. Investor consensus remains that a tapering announcement will be made either at Jackson Hole (end of August) or at the September 22 meeting, with implementation not before early next year.

- Q2 earnings announcements were solid with 118 S&P 500 companies reporting, on average, sales ahead of estimates by 3.98% and earnings beats of 19.46%.

"...while we expect frequent bouts of volatility erupting from time to time this summer, we exclude a deeper correction that would bring us below key support levels in the S&P 500 index, below the 4'100-4'200 area."

Markets & Macro | Buy-the-dip lends support to stocks

Excluding a deeper correction.
As mentioned, while Asian and European equity markets suffered sharp losses earlier this week, dip-buyers quickly stepped in and rapidly erased the losses. A technical factor has contributed to push equity markets upward, with US stocks leading the way.

Our view: Figure 1 highlights that retail investors spent time during the previous week selling put options on the S&P 500 index. With some negative headlines around the virus and related lockdowns accumulating last weekend, panic short put covering and panic tail risk hedging occurred on Monday – therefore creating unnecessary demand for expensive protection being purchased at the lows of the S&P 500 during the tumultuous day. This dynamic cleared the positioning in the market, with the "weak hands" being caught off guard when indices stabilized, holding key technical levels, and creating conditions for another unexpected rally during the week.

As we mentioned last week, while we expect frequent bouts of volatility erupting from time to time this summer, we exclude a deeper correction that would bring us below key support levels in the S&P 500 index, below the 4'100-4'200 area. The buy-the-dip mentality, and not such extreme market positioning, are the biggest factors lending support to stocks.

"This framework stated nothing very new per se, and the ECB continues to get closer to the dreaded Japanification."

Figure 1: S&P 500 Index

Source: Bloomberg, as at July 23, 2021.

Delta variant concerns support risk assets.

This week, the European Central Bank's (ECB) new framework provided all the excuses to remain dovish for longer. The outcome is pointing toward a delayed and very soft tapering under the best case scenario (some progress on the inflation outlook), but should the inflation and growth picture deteriorate, infinite QE is totally plausible.

Our view: This framework stated nothing very new per se, and the ECB continues to get closer to the dreaded Japanification. In fact, a new forward rate guidance has been introduced, aimed at avoiding "mistakes of the past" (such as avoiding a mistake similar to Trichet's rate hike in 2008).

And why would old tricks suddenly achieve what six years of exuberant unorthodox monetary policy have failed to complete? Inflation has run well below 2% for the past few years despite negative rates and abundant QE programs. Thus, it seems logical to expect that a reiteration of such policies will have the effect of pushing peripheral spreads lower (as a reminder, Italian BTPs still yield 100 bps over Bunds, despite analysts unanimously forecasting a move to 50 bps on Draghi's announcement in February – so, it could still be an opportunity, along with our overweight position in Italian stocks to play the same scenario). Such policies will also put pressure on the Euro to be used as a funding currency. Another structural position that we have not reduced during the past few years, and in which we continue to believe in, is buying gold (and silver) against the Euro. The trade is very stable in its uptrend, with reduced volatility compared to gold against the US dollar, and with a positive carry supporting the cross.

"Another structural position that we have not reduced during the past few years, and in which we continue to believe in, is buying gold (and silver) against the Euro."

Elsewhere with central banks, the Federal Open Market Committee (FOMC) meeting takes place next week. Since the Federal Reserve (Fed) started taper talks at its June meeting, the July FOMC meeting should provide an update on the progress of those discussions that will help refine the likely timeline for an announcement in the coming months. Given the recent guidance from Fed Chair Powell, he should indicate that these discussions will continue at upcoming meetings, but without sending a clear signal that tapering is imminent. Investor consensus remains that a tapering announcement will be made either at Jackson Hole (end of August) or at the September 22 meeting, with implementation not before early next year.
It is possible that the incoming macro data will dictate the exact sequencing. The risk relative to this expectation is that the June CPI inflation surge motivates the Committee to accelerate taper talks and send a clearer signal that tapering could be as early as September. Other key data to monitor include July's labor market report, which is due to be released in the first week of August. Expectations for another sharp 1 million increase in monthly payrolls have been dampened by this week's weekly jobless claims. The reading of 419k (versus 350k expected) represents a 51k increase (and the +11k revision of previous week), marking the biggest weekly increase since March, and a clear interruption of the favorable trend that initiated in the spring.

The possibility of another "jobless recovery" (after that occurred following the 2008 financial crisis) is a clear risk at this point, and at the same time is supporting risky assets since it wards off the risk of policy tightening. In our view, this is also the main explanation why rates remain so low – the 10-year US Treasury yield is stuck at 1.3% despite strong growth and rising inflation. The reduced availability of skilled workers (highlighted in every business survey exhibiting record highs in the "hard to find workers" components) and the ability of corporates to adapt to the crisis, meeting strong demand with a smaller workforce, are becoming a structural phenomenon in the reopening process. Another relevant variable in this picture is the looming expiry (in September) of most US extraordinary unemployment subsidies. Should the labor market start to lose steam, the debate around a prolongation will likely warm up soon.

"The possibility of another "jobless recovery" is a clear risk at this point, and at the same time is supporting risky assets..."

Concerns around the strength of the labor market, and about the impact of the Delta variant on the economic recovery, have dramatically impacted expectations on Fed rate hikes, and indirectly provided support to risky assets and growth stocks in particular. During the past week, implied pricing of Fed Funds in June 2024 onward fell by about 20 bps. Since April, almost 100 bps of expected hikes have been removed, along with the rally in global bonds.

Equities | Value underperformance continues

Delta variant concerns weighs on financials, materials and energy.

US and European equity indices rebounded from the 3-day sell-off that ended on Monday, with most major indices reaching all-time highs. The rebound was largely concentrated in mega cap technology stocks. On the other hand, Delta variant concerns weighed on recovery and value stocks – in particular, financials, materials and energy. Overall, trading volumes remained light.

In China, equities lost ground after news that China is considering asking education and tutoring companies to convert to not-for-profit status, wiping billions from these companies' market capitalization. Internet stocks, in particular, also responded negatively to the news as regulation risk takes a new dimension that puts the profitability of these companies at risk.

"...the value style underperformed growth for the fifth week in a row, erasing almost all of the value outperformance since August 2020."

Figure 2: Global Equity Market Performance

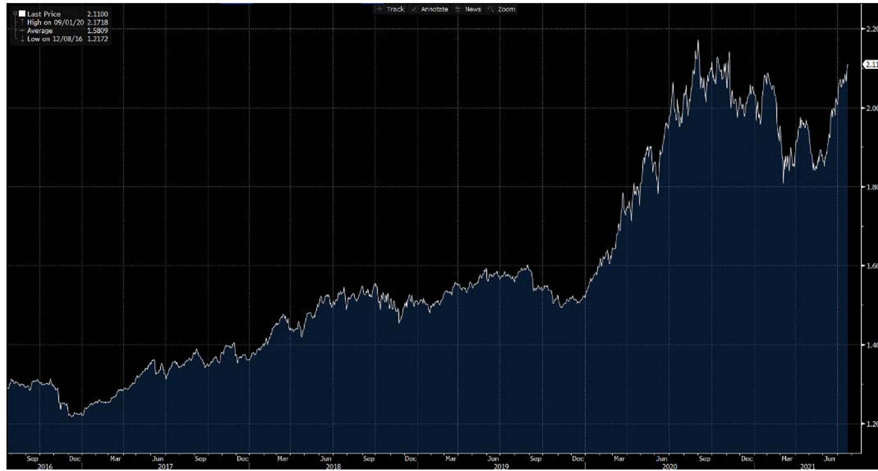
	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	35,061.55	1.12%	1.70%	15.72%
S&P 500	4,411.79	1.97%	2.74%	18.40%
Nasdaq	14,836.99	2.84%	2.32%	15.54%
Euro Stoxx 50	4,109.10	1.90%	1.24%	18.04%
Swiss Market	12,130.83	0.87%	1.58%	16.46%
FTSE 100	7,027.58	0.30%	-0.04%	10.84%
CAC 40	6,568.82	1.68%	0.95%	20.67%
DAX	15,669.29	0.83%	0.89%	14.22%
FTSE MIB	25,124.91	1.71%	0.48%	15.29%
Nikkei 225	27,548.00	-1.63%	-4.32%	1.18%
Hang Seng	27,321.98	-2.44%	-4.84%	2.23%
CSI 300	5,089.23	-0.03%	-2.03%	-1.04%

Source: Bloomberg, s at July 23, 2021. Performance figures in indices' local currencies.

Meanwhile, the value style underperformed growth for the fifth week in a row, erasing almost all of the value outperformance since August 2020 (Figure 3).

“...guidance was largely positive too (for US and European companies), with several companies raising full-year guidance ahead of estimates.”

Figure 3: S&P Growth Index versus S&P Value Index – 5-year



Source: Bloomberg, as at July 23, 2021.

Our view: Q2 earnings announcements were solid with 118 S&P 500 companies reporting, on average, sales ahead of estimates by 3.98% and earnings beats of 19.46%. We noticed that guidance was largely positive too (for US and European companies), with several companies raising full-year guidance ahead of estimates.

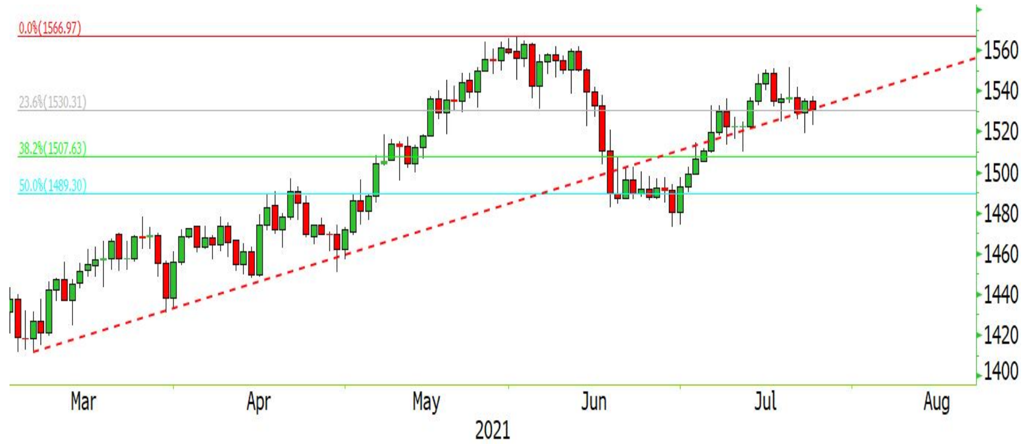
FX & Commodities | Will gold/EUR turn bullish?

Chart of the week

We prefer playing the long gold versus negative yielding currencies. Technically, XAU/EUR prices have found support at 1530 following a technical pullback. This could drive the pair into the previous bullish trend.

“Technically, XAU/EUR prices have found support at 1530 following a technical pullback.”

Figure 4: XAU/EUR



Source: Bloomberg, as at July 23, 2021.

Week Ahead | Key events to watch for

- **The FOMC meeting will take place on Wednesday**, with Fed Chair Powell expected to provide hints toward tapering discussions within the committee.
- **Corporate earnings will gain attention**, as next week is expected to be the busiest of this earnings season. 19 NCP portfolio companies are scheduled to report their numbers including: the FAAMG stocks, LVMH, Tesla, Visa, AMD, Nestle, MasterCard, and P&G.

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