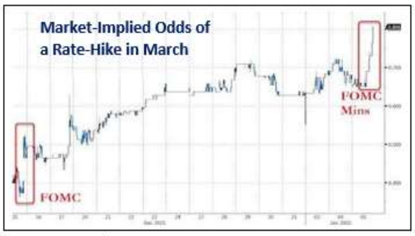
Your eyes and ears on the markets

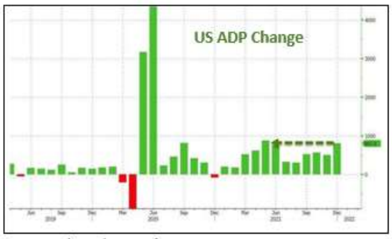
January 6th 2022

HERE WE GO

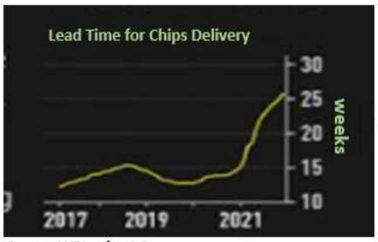
ODDS OF MARCH FED HIKE + US ADP + CHIPS DELIVERY TIME + S&P 500 TOP 10 COMPANIES WEIGHT + US TECH SECTOR vs REST OF THE WORLD + US 10-YEAR YIELD vs SMALL CAPS OUTPERFORMANCE + FED BALANCE SHEET vs S&P 500 + US YIELD CURVE vs CYCLICALS OUTPERFORMANCE



Source WSJ - **chart 1**



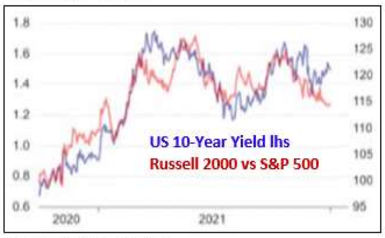
Source Bloomberg - **chart 2**



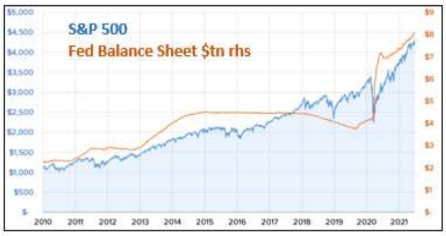
Source WSJ - **chart 3**

Source JP Morgan - **chart 4**

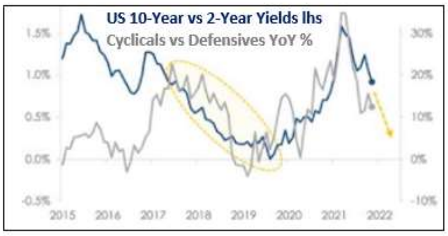
Source MRB Partners - **chart 5**



Source FactSet - **chart 6**



Source Barron's - **chart 7**



Source FactSet - **chart 8**

Investors are suddenly waking up and realizing that the Fed tightening is for real. **The eventual shrinking of the US cenbank's balance sheet, which is obvious and inevitable, will of course remove the main pillar of the US bull market** (chart 7). NAIRU has already been reached months ago (as it has shifted upward), and labour data such as the strong ADP released yesterday (with the NFP tomorrow – chart 2) will become important in a context of rising wages while, as already explained, the supply-chain is still not entirely back to normal (chart 3).

Amazingly, and whatever the risk-off action on the US markets yesterday, this does not prevent many investors from remaining in a state of denial (!), whether because of a possible impact of Omicron on GDP growth (even though the risk of massive quarantines would rather lead to higher inflation + an even tighter labour market), or based on the idea that the dot-plots of the Fed would now be priced in, starting with 80% implied chance of a rate hike in March (chart 1).

Worse, as markets/investors have been spoiled by the Fed put/backstop provided since Greenspan, the conviction that any large pullback of Wall Street would/will force the Fed to reverse its course immediately comes back to the surface!

A whole new generation of investors has no idea of what a bond bear market looks like and, until they understand that this time is different and that the Fed backstop, if any, is placed at a much lower level than expected, the risk of a significant setback for the risk-on assets will loom ahead.

As to the impact on the equity markets, further underperformance of long duration/high growth and expensive stocks will make sense, obviously, with the risk to weigh on large indices due to too high a level of concentration (chart 4), while this may also put an end to Wall Street's supremacy versus the rest of the world, as it was driven by the tech sector (chart 5) + the buybacks.

In the same regard, attention will be paid to the recent underperformance of the US smallcaps when compared to the US yields (chart 6 - although we would prefer to focus on the S&P 600 rather than on the Russell 2000 as the former has fewer frothy stocks). Ditto with the cyclicals which should continue to regain attraction, especially if we are right with our scenario (described yesterday) of a new yield curve steepening cycle (chart 8).

Last but not least, although the "problem" seems to be centered on the US above all, as European indices are more cyclical & less expensive, let's not forget the old adage "when Wall Street sneezes, the rest of the world catches a cold". Let's also keep in mind that the ECB is a mammoth, where the Fed was merely an elephant, in terms of QE/Balance-sheet versus GDP.

STOXX 600 SECTORS SCANNING

Every day, 4 of the 16 main sectors 6 of the Stoxx 600 are reviewed graphically on daily charts. Whether on a relative or standalone basis, attention is particularly attracted when 9-demark signals are flashing and clear opportunities/patterns arise.

NASDAQ 100 FUT – DAILY

The double top pattern is taking shape. Valid as long as the key resistance holds. Confirmation below the double top support as mentioned above.

S&P 500 FUT– DAILY

We like what we see, and the irregular double top scenario since the end of wave VII is definitively taking shape. Valid as long as the key resistance holds.

EUROSTOXX 50 FUT – DAILY

Same comment as above.

US 10-YEAR YIELD – DAILY

The potential on the upside is huge and, clearly, as explained previously, it is absolutely not priced in by investors who considered until now that interest rates would/will never go up and that real interest rates will/would still remain negative for years… TINA is dying and it is a massive game changer!