Key Take-Aways

- The Chinese Communist Party has launched a 6 month "special campaign" to regulate its internet sector and to crackdown on "malicious internet company practices".
- Covid-19 is not behind us. New infections in the U.S have quadrupled in the last 3 weeks. The "Delta variant" is expected to kill 50,000 people in the US and another 500,000 worldwide.
- Reinvigorated lock down initiatives will slow the economy. The Fed knows this, and markets are adjusting to a slower growth trajectory.
- At the June 16th FOMC meeting the Fed forecast Q-2 GDP at +10.3%. It was reported July 29th at 6.5%. Today, the Fed forecasts +4.1% Q-3 GDP growth.
- Peak growth and peak inflation are most likely behind us. There is a risk that reported economic growth in Q-3 may disappoint.
- In the context of a slowing economy, inflation will prove to be a short-term affair. Chairman Powell is correct in his transitory assessment.
- The Fed's main concern going forward is employment. Rightfully so.
- U.S Long term interest rates will continue to trend downwards. They will follow lower inflation just like their G-3 counterparts in Europe and Japan - where bond yields have just made new cycle lows.
- The equity market, the housing market, and the commodity market are rich. Stimulus, and a rapid reopening after a pandemic-induced shut-down are the root causes.
- The dollar, although expected to trend higher against CNY and EM in general, has experienced selling pressure from the top of its recent range against its major trading partners.
- Gold's bullish move is primarily because of recent dollar weakness. For now, we expect price action in both will be preserved with their respective ranges.
- The upcoming debt ceiling discord may become a larger and more combative issue than in recent years due to the aggressive spending ambitions of the new administration.

Review : July 2021

The most stunning development of the month is the collapse of the Chinese stock market. The CSI 300 China Index fell by nearly 8%, taking down the entire Asian and emerging stock market complex with it. The Nikkei 225 index and the MSCI EM indices fell respectively -5.24 and -5.76% in July.

Developed stock markets have been resilient so far with the S&P 500 index leading the walk, printing a new all-time high over the month to end up +2.26%. The Euro Stoxx 600, the SMI and the Nasdaq indices, all had positive returns while the UK FTSE index was flat.

Rotation is still leading the game in various dimensions.

The risk aversion triggered by the Chinese sell-off did not spread to developed markets. However, it amplified the sector rotation. In the US, small & mid cap have been severely hit with the Russel 2000 Index down -3.39% to the profit of Big market capitalizations. Despite stable oil prices, the energy sector fell -8.61% while financials were down by -0.3%. Utilities, Real Estate, Healthcare and Information & Technology led the market, outperforming by large the index.

The sovereign bond market continues to normalize with lower yields and flatter curves.

Inflation expectation are easing, as well as pressure on nominal yields. The US 10 year Treasury fell by 24bps in July, back to February levels. With the exception of US High Yield, widening corporate spreads are limited so far.

The Swiss franc benefits from the risk aversion.

The Swiss franc has been the biggest mover in July, receiving the safe haven flows. The Helvetic currency appreciated against the euro and the US Dollar respectively by 2.04 and 2.09%, leaving EURUSD virtually flat.

The Bloomberg Commodity Index jumped +1.84% in July, supported by a decent +2.92% move in Gold and stable prices in Oil.

Volatility, measured by the Vix spiked somewhat, but remained relatively immune to the Chinese episode.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 395	-0.56	-0.39	2.26	2.26	17.00	20
Nasdaq	14 661	-0.79	-1.18	1.08	1.08	13.76	28
Russell 2000	2 232	-0.35	1.02	-3.39	-3.39	13.03	25
Euro Stoxx 50	4 089	-0.67	-0.48	0.62	0.62	15.11	16
Stoxx 600 EUR	462	-0.45	0.05	1.97	1.97	15.72	16
FTSE 100	7 035	-0.61	0.11	-0.03	-0.03	8.90	12
SMI	12 117	0.25	-0.12	1.46	1.46	13.20	17
NIKKEI 225	27 284	-1.80	-0.96	-5.24	-5.24	-0.59	17
CSI 300 China	4 811	-0.81	-5.46	-7.90	-7.90	-7.68	13
MSCI EM Index	1 295	2.15	-1.21	-5.76	-5.76	0.32	13

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4 395	-0.56	-0.39	2.26	2.26	17.00	20
UTILITIES	338	0.07	1.28	5.20	5.20	6.02	19
ENERGY	372	-1.95	1.39	-8.61	-8.61	30.10	13
TELECOM	274	-0.35	-0.87	3.48	3.48	23.27	20
CONS STAPLES	740	0.34	0.45	2.60	2.60	6.33	20
REAL ESTATE	291	0.74	0.69	4.99	4.99	27.80	49
CONS DISCRET	1 443	-2.47	-2.27	0.79	0.79	10.79	26
MATERIALS	526	0.16	2.54	1.75	1.75	15.44	17
HEALTH CARE	1 540	0.17	0.55	4.84	4.84	16.31	17
INFO TECH	2 682	-0.52	-1.17	3.36	3.36	17.04	25
FINANCIALS	609	-0.39	1.06	-0.27	-0.27	24.17	14
INDUSTRIALS	872	-0.34	-0.41	0.68	0.68	16.36	20

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	92.142	0.30	-0.83	-0.32	-0.32	2.45
EUR-USD	1.1863	-0.20	0.78	0.04	0.04	-2.89
USD-JPY	109.73	0.23	-0.75	-1.26	-1.26	5.91
USD-CHF	0.9061	-0.01	-1.47	-2.09	-2.09	2.31
EUR-CHF	1.0749	-0.21	-0.69	-2.04	-2.04	-0.59
GBP-USD	1.3909	-0.36	1.17	0.56	0.56	1.75
EUR-GBP	0.8529	0.15	-0.35	-0.50	-0.50	-4.79
JP EM FX Index	56.79	-0.13	0.80	-0.81	-0.81	-1.96

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	1.23	-4	-5	-24	-24	32
Germany	-0.46	-1	-4	-25	-25	11
UK	0.57	-1	-2	-15	-15	37
SWITZERLAND	-0.37	-1	-2	-15	-15	18
Japan	0.02	0	0	-4	-4	0
US IG Spread	93	-1	-2	6	6	-9
US High Yield spread	270	5	9	42	42	-57
EUR High Yield spread	325	-3	-0	16	16	-26

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	96.3	-1.25	0.62	1.84	1.84	23.35
Gold Spot $/OZ	1821.8	-0.35	1.09	2.92	2.92	-4.03
Crude Oil WTI	73.7	0.07	1.94	0.27	0.27	51.83

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	18.5	0.80	1.30	2.67	16.87	-4.25

Source: Bloomberg 30.07.2021

Macro, Fixed Income and Rates : Chinese Sell-Off

The most stunning development of the month is the collapse of the Chinese stock and bond markets. The Chinese markets peaked in February after the arrest of Alibaba's Jack Ma. Chinese market asset values face accelerated selling pressure. The Hang Seng Index has fallen 20% since February and 10% in July.

The Chinese Communist Party (CCP) intensified its regulatory onslaught because it is losing control over the internet. The CCP's grip on power requires complete submission to its command. It needs its agenda to be the truth. It's not. The internet, and access to it, represents perhaps the most existential threat to the communist state's absolute control. There are a billion Chinese people living in poverty. There are also 400 million highly educated, strongly motivated, capitalist thinkers who are connected to the largest data base of information in history. They understand and detest the corruption, hypocrisy and the brutal power of a Marxist state which controls all people with all their commands. The CCP makes laws to protect their power. This comes at the expense of personal freedom.

Chinese investments are at substantial risk. Anyone who can sell the yuan will do so. The Renminbi is weakening against G-3 currencies in a safe-haven bid. This trend is just beginning. The Chinese economy will still grow, but Chinese equites are highly likely to see new lows, and credit spreads likely to widen. Most regional Asian markets will be lucky to avoid this fate.

Beyond that we have a continued progression of the status quo.

The Fed is still printing money and buying bonds. This will not change for the foreseeable future. Money market rates will remain at or below 0%. European and Japanese rates will continue their trend and go lower still. Fiscal stimulus has ended. It happened at the same time as rates peaked. The impact of this shift has yet to be fully priced by markets.

The fixed income complex is normalizing. The market concern with inflation will dissipate. Prices pressures will subside as the economy moderates. The bond market knows it. Consider:

-Real yields are at all-time lows, despite the incredible surge in the prices of food, energy and raw materials.

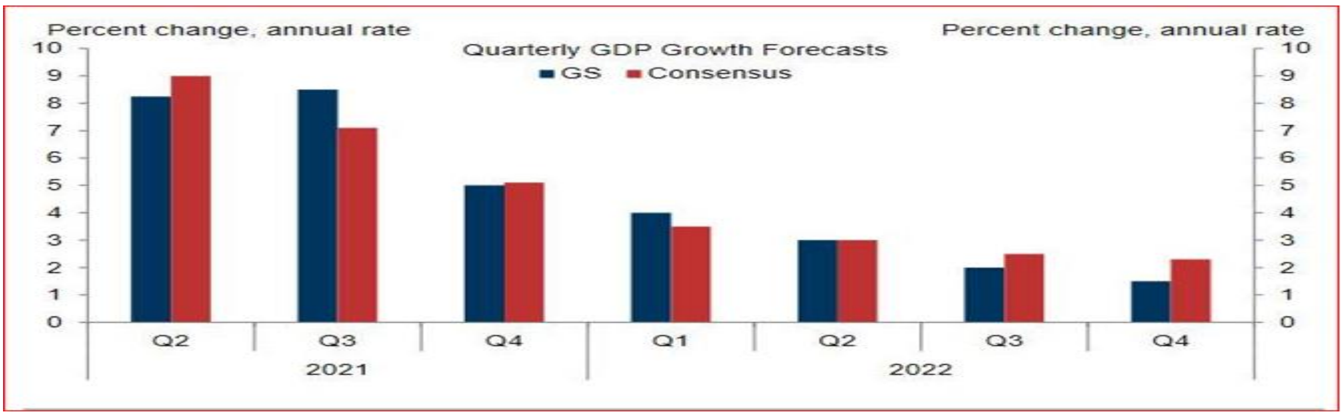
-Nominal yields are now falling faster than Real yields.

-The breakeven rate of Inflation is falling. 10y real yields traded to -1.196% on the last day of July. That is an all-time low, having taken out the March 23, 2020 pandemic lows.

-Nominal yields traded to 1.126%, the lowest since February.

-The breakeven inflation rate therefore is at 2.41% which is very expensive if economic demand disappoints.

-There are forecasts of Q-3 GDP of 0%. If that transpires 10y Treasury yields will be half of what they are today.



Source: Goldman Sachs

Equity : Looking for some convictions

The Equity market appears to be searching for a theme. The Growth vs. Value sector rotation is violently erratic. Conviction is extremely low. Meanwhile the "Internals" of the stock market are wickedly bifurcated and highly concentrated.

Big Cap Tech continues to lead the broad market to more all-time highs. Despite an EPS reporting period where we see that 90% of companies beat their supposed estimates, 70% of S&P 500 stocks are not participating in the rally.

Recovery sectors are lagging significantly. Small Caps and Transports are underperforming in an almost sinister fashion. Mortgage Loan applications have collapsed.

The inflation-centric components are down 4% from the highs. The cyclically sensitive sectors have lagged by 25 in July alone. And the sectors that lead when bond yields fall have jumped 4.5% to an all-time high.

First of all, the Dallas Fed has developed a Mobility and Engagement Index. It measures the deviation from normal mobility behavior based on geolocation data collected from mobile devises.

We're still lower by 30% from pre-pandemic levels. We suspect, that based on international air travel and closed borders throughout the world, international mobility is much lower.

Secondly, The New York Times conducted a survey in New York City. It explored the question of "mobility" at the household level, the results are enlightening. It found that ¼ of household parents plan to home-school their children in the next school year.

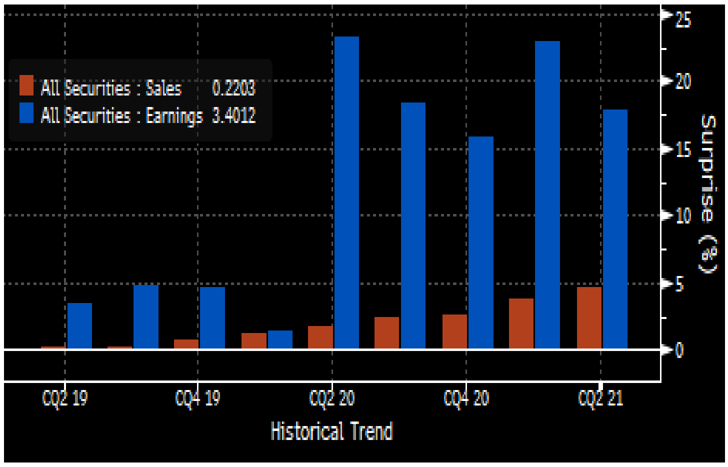
It will come as no surprise that only 4 of the 11 S&P 550 sectors are at fresh highs. They are exactly what you would want to own into an economic slowdown: consumer staples, health care, communication services and technology.

Meanwhile the rebound, reflation sectors are all down between 5%-10% from their March highs. These include homebuilders, transportation, financials, materials, and industrials.

Big Cap Tech leading the S&P 500 Index

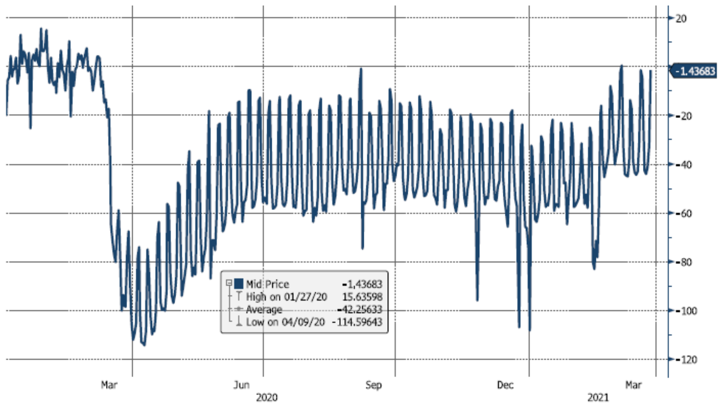
Source: Bloomberg

S&P 500 – Earnings & Sales Surprise



Source: Bloomberg

US Fed Dallas Mobility and Engagement National



Source: Bloomberg

FX and Commodities: Gold: the next mover?

GOLD - The June down trade in Gold (-8.6%) was caused explicitly by the short-lived spike in real yields of 25bps at the June 16th FOMC meeting and the subsequent 3% rally in the dollar.

Gold has reversed higher by 4.8% in July because of dollar weakness and the swoon in real yields to all-time lows. (Which have plunged below the pandemic lows in March 2020)

It is clear: Gold is up on a weaker dollar and investor awareness that the Fed will maintain its support for the U.S economy after growth data severely missed forecasts.

If we are right, real yields will plummet to new depths. As real yields fall, real assets will rise.

Semiconductors are commodities. 80% of semiconductors purchased in 2021 are from four industrial sectors: computing, wireless communications, consumer electronics. Only 9% are purchased in the automotive sector.

That represents 1% of GDP. As acutely problematic as this may appear, within the year, when new domestic supply comes online, we may very well be looking at a supply glut which will drive prices downward, further feeding into the deflationary narrative.

OIL - There are 264 million cars on the road in the U.S. Only 2% of them are EV. The cost of substantial EV market share gain is exorbitantly expensive. Oil dependence will be with us for decades.

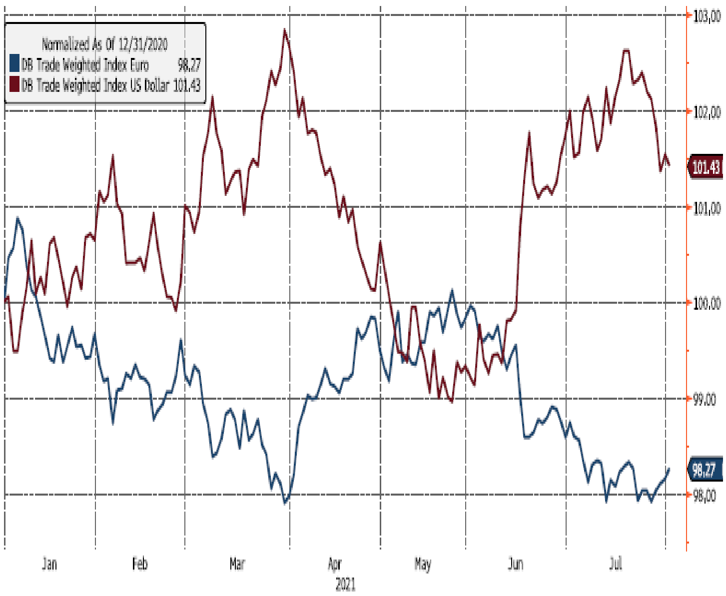
Higher Oil prices act as a tax on anyone who needs a car or truck to do their jobs. As I said last month, OPEC has been given a gift of market share from the U.S. government. They would be wise to exploit it. Any price rise which allows the high priced Frackers to re-enter the market would represent a colossal error in judgement. The rise in Oil, it seems to me, has largely run its course.

The DOLLAR - Excessive indebtedness has a price. It would be advisable for the new administration to begin to recognize that fact, otherwise their rise to power will be just another blundering footnote to history.

The Fed will not taper for years. Furthermore, the free money requirement remains a certainty for the foreseeable future. Market stability is their only real concern.

This is a clear supporting element to the gold rally. We remain comfortable with my theme that the G-3 currencies should remain stable. This recent US Dollar Index weakness could persist until Europe and Japan get uncomfortable.

EUR and US Dollar in a tight range



Source: Bloomberg

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