Weekly Market Update

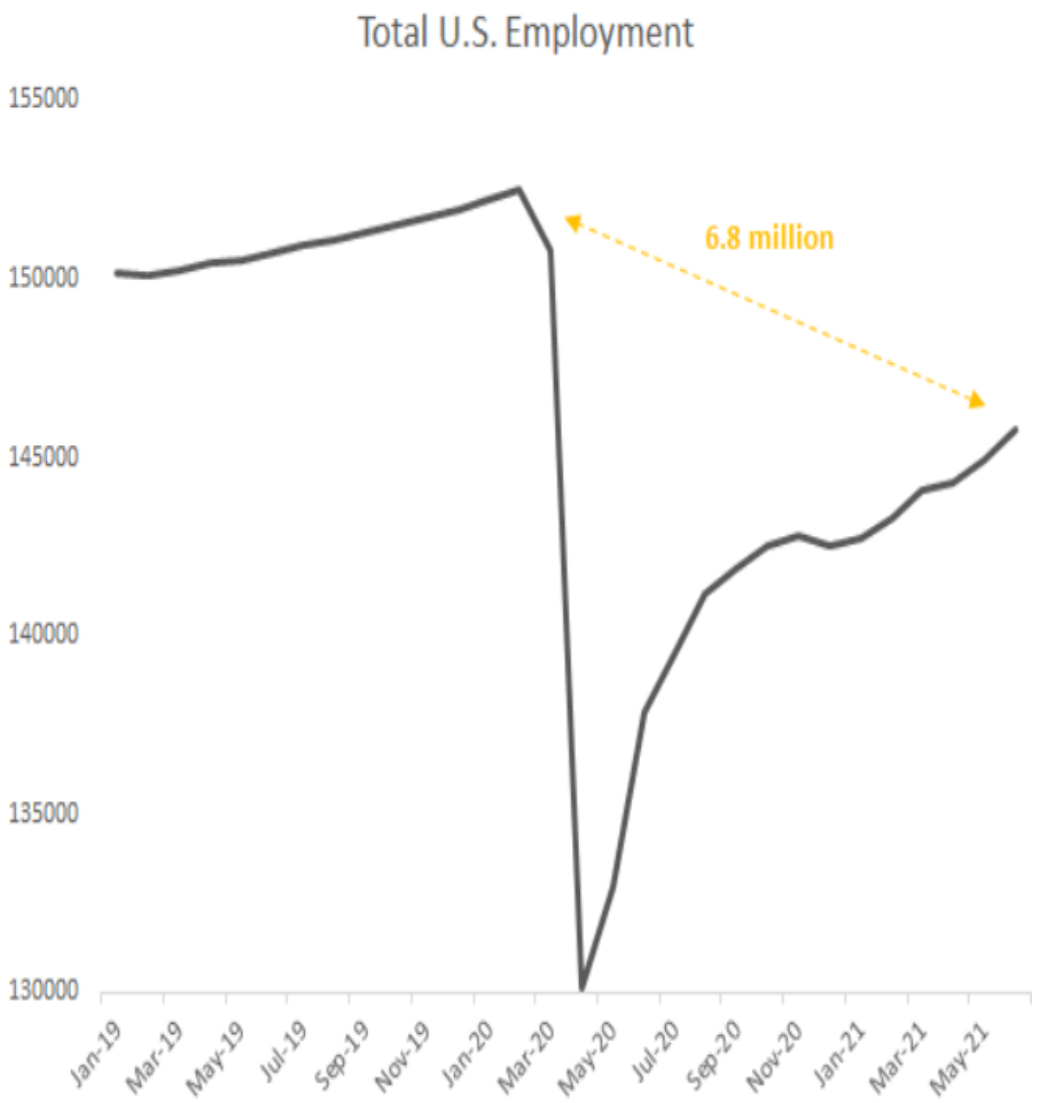
04 July 21

US Data : Strong impulse continues

- After coming in below consensus for two months in a row, nonfarm employment surprised to the upside in June, with employers adding 850,000 jobs. The unemployment rate rose to 5.9%. The unemployment rate rose 0.1 percentage point in June to 5.9%.
- The household employment measure fell by 18,000 in June, while the labor force rose by 151,000. Both the labor force participation rate (61.6%) and the employment-population ratio (58%) were unchanged in June. The lackluster results from the household survey suggest the decision by many states to end their participation in the expanded federal unemployment benefits program has, so far, had little impact in bringing workers back to the labour market. However, the June report, which reflects employment conditions in early to mid-June, likely came too early to pick up the re-entry of these job seekers.
- Job gains were fairly broad based during June, but the reopening of public schools at a time that they would normally be closing for the summer led to an outsized gain in state (74,500) and local education jobs (155,200). Without these gains, which were exaggerated by seasonal adjustment, nonfarm payrolls would have added 620,300 jobs and marked the third disappointment in a row.
- The ISM manufacturing index fell to 60.6 in June. Manufacturers continue to report a litany of supply-chain challenges: lengthening delivery times, persistent component shortages, staffing difficulties and rising prices. The prices paid series rose 4.1 points to 92.1, its highest reading since 1979.
- Consumer confidence and buying plans both rebounded in June, but shortages of automobiles, new and existing homes, household appliances and a whole host of other items continue to weigh on the recovery. Pending home sales surged 8% in May, pointing to an end to the recent slide in existing home sales.

Payroll : Internals

- Much of the growth in jobs has come from the industries hit hardest during the lockdowns at the start of the pandemic.
- The leisure & hospitality sector added back 343,000 jobs, while hiring in retail trade (67,100), administrative services (40,000), social services (32,400) and other services (56,000) all rose vigorously. These five sectors lost 14.5 million jobs at the onset of the pandemic, accounting for roughly 65% of the overall job loss. The five sectors have since recovered 75% of those losses. From a broader perspective, the overall economy lost 22.4 million jobs from February to April 2020 and has since recovered 70% of those job losses.
- Manufacturers added 15,000 jobs in June, with all the gain coming in durable goods. Steel and fabricated metals both rose sharply, while furniture & related products saw industry payrolls add 8,500 jobs.
- Employment in the motor vehicle industry fell sharply, with payrolls declining by 12,300 jobs. The shortfall likely reflects the fallout from the semiconductor shortage, which has limited motor vehicle assemblies. The chip shortage is reportedly easing somewhat, which may lead to outsized gains in July and August, when assembly plants usually shut down for model year changeovers.
- Construction payrolls declined by 7,000 jobs with big losses in nonresidential specialty contractors (-14,800) and heavy & civil engineering (-10,900) more than accounting for the overall drop. By contrast, hiring among residential and specialty trade contractors (12,700) and residential builders (2,500) remains strong.


Total U.S. Employment
155000
150000
145000
140000
135000
130000
6.8 million
Jan-19
Mar-19
May-19
Jul-19
Sep-19
Nov-19
Jan-20
Mar-20
May-20
Jul-20
Sep-20
Nov-20
Jan-21
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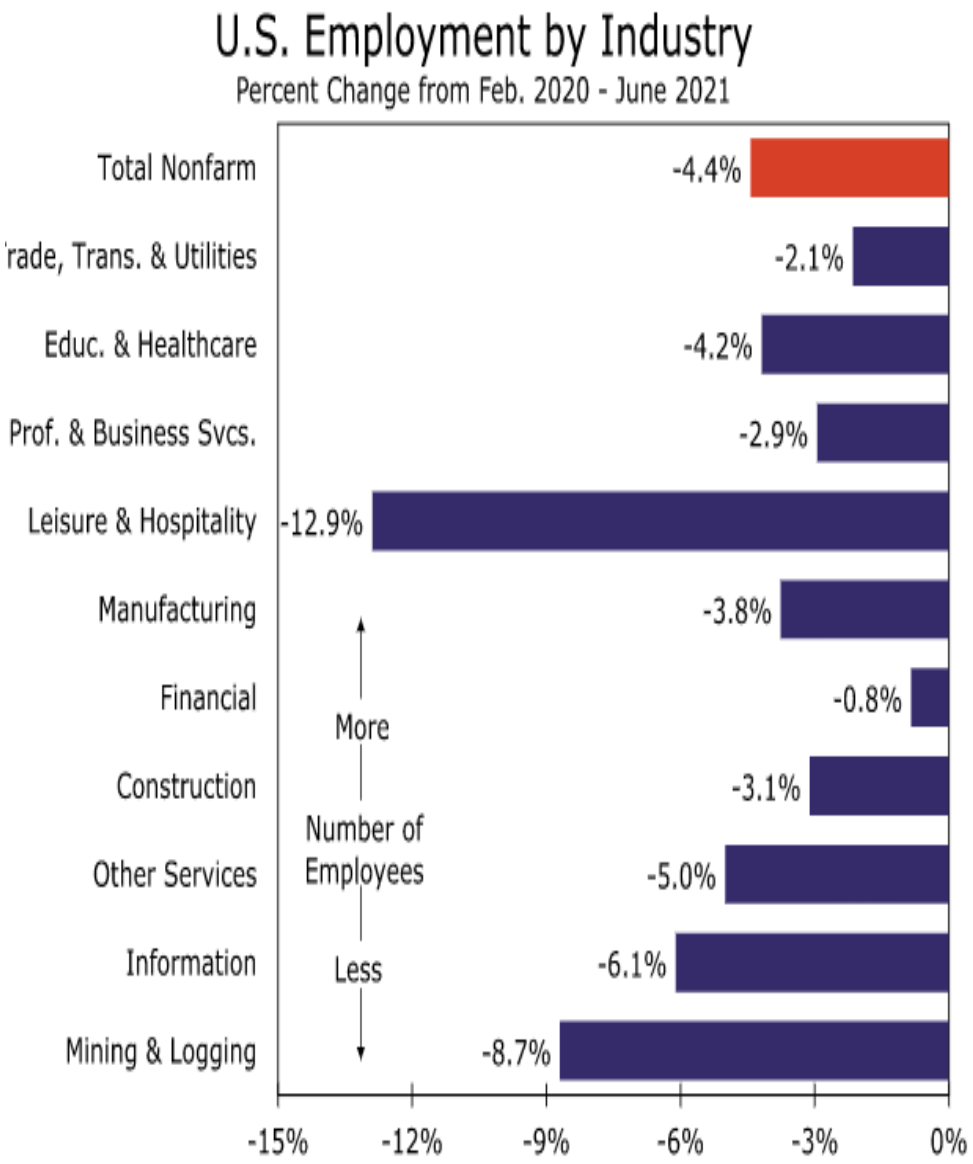
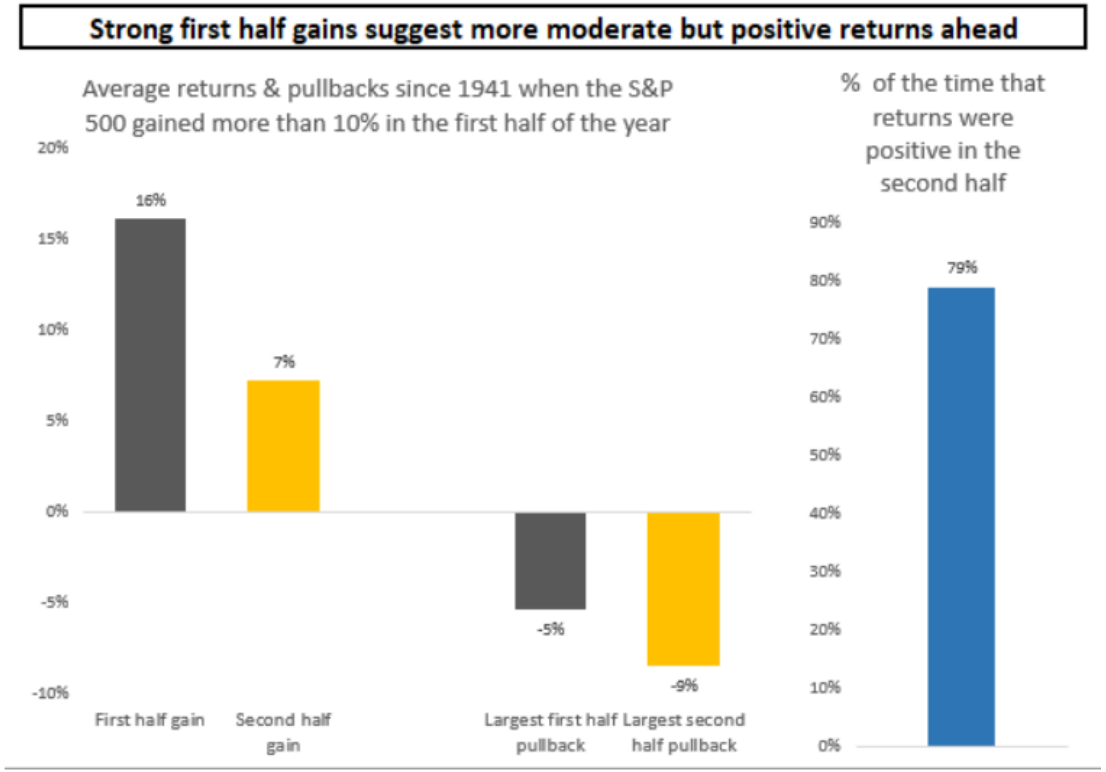

U.S. Employment by Industry
Percent Change from Feb. 2020 - June 2021
Total Nonfarm -4.4%
Trade, Trans. & Utilities -2.1%
Educ. & Healthcare -4.2%
Prof. & Business Svcs. -2.9%
Leisure & Hospitality -12.9%
Manufacturing -3.8%
Financial -0.8%
Construction -3.1%
Other Services -5.0%
Information -6.1%
Mining & Logging -8.7%
More
Number of Employees
Less
-15%
-12%
-9%
-6%
-3%
0%

Equity- Tale of two halves

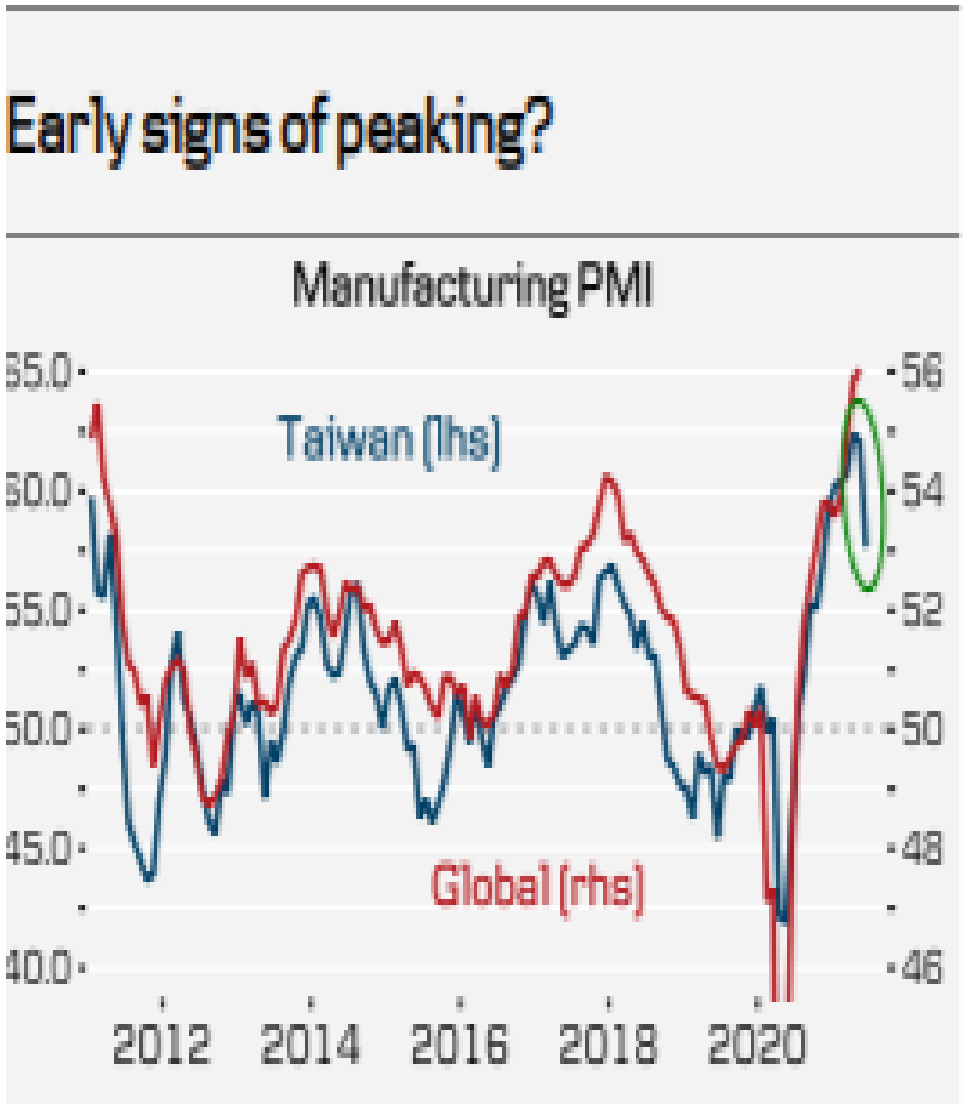
- Following Friday's jobs report, the S&P 500 hit its 36th new high for 2021, adding to the positive momentum from the first half of the year.
- From January through June, the index logged its second-best gain since 1998, with performance driven by the economic reopening, rising corporate earnings and policy support.
- Over the past 80 years, equities rose by 10% or more 24 times in the first six months of the year , S&P 500 went on to gain an average of 7% in the second half, with 19 of those instances having positive returns.
- However, the market's rise was not uninterrupted – the average maximum pullback was 9%, almost twice the average decline experienced in the first half of the year.
- The upshot is that returns are likely to moderate going forward, and pullbacks might become deeper, but history suggests that gains are not exhausted.



- The chart shows average returns and largest pullbacks over the past 80 years when the S&P 500 gained more than 10% in the first-half of the year.
- Returns in the second-half for these years were positive 79% of the time, but more moderate.

Twin peaks

- While much can be learnt from history, no two cycles are the same and there is a lot of variation in asset performance across different peaks. We look at where the current cycle might differ and how it could change the conclusions.
- It is quite possible that we are close to 'twin peaks' in global inflation and global manufacturing, which is likely to have a material effect on financial markets . Possibly US Bond markets are sniffing that peak.
- At these cyclical peaks, there is normally lower return on risk assets but not bear markets, an end to outperformance of cyclical equities over defensives, a stabilisation in metal prices, positive returns on US and German fixed income markets, a decent flattening of the US yield curve and a decline in inflation expectations.
- There is no firm conclusion on the USD around cycle peaks but it typically strengthens when inflation turns lower.
- **<u>Views for H2 across assets are:</u>**
    - Continued outperformance of equities but returns are set to decline as compression of volatility is no longer a driver of equity returns,
    - Slightly higher bond yields - strong US job growth and a more hawkish Fed should outweigh the effect from peak in reflation,
    - A stronger USD and a stabilisation in metal prices.



Why Inflation can be persistent

- The ISM manufacturers index is a diffusion index that is more about the breadth of the strength in the factory sector rather than the magnitude. The latest data show manufacturers are struggling to keep up with demand.
- Manufacturers are still dealing with momentous supply-side challenges. The ISM manufacturing index fell slightly in June, but remains consistent with strong economic growth.
- The production index rose 2.3 points in June to 60.8, while the more leading new orders index fell 1.0 point to a still exceptionally high 66.0. That reading suggests two-thirds of manufacturers saw orders increase in June.
- The proportion of manufacturers with rising order backlogs fell 6.1 points to 64.5. Again, the monthly drop is far less important than the still historically high proportion of manufacturers that report rising order backlogs.
- Manufacturers report shortages of a growing list of components and also noted persistent challenges finding and retaining the workers they need. The prices-paid index rose 4.1 points to 92.1, which marks the highest proportion of manufacturers reporting paying higher prices since July 1979.
- The breadth of price increases and intransigence of supply-chain bottlenecks suggest the recent spike in inflation will likely prove to be sharper and more persistent than the Fed has expected.

C&I Lending declines

- After experiencing double-digit growth in three out of four quarters in 2020, the year-over-year declines seen in commercial & industrial (C&I) lending in April (-12.6%) and May (-16.2%) may look disappointing, but there is no reason to worry yet.
- Due to base effects, these year-over-year measures are somewhat distorted. The summer months last year saw a surge in lending as businesses rushed to receive Payment Protection Program (PPP) loans. These loans were designed to keep businesses afloat by offering government forgiveness as long as the money was used to keep employees on, pay mortgage interest, rent and utilities.
- The first round of loans ran from April to August 8, 2020, but through the end of May, SBA data show around 97% of the total first round funding was already distributed.
- C&I lending data moved in-step with these swings, with the two largest month-over-month gains in its history. Lending in March 2020 jumped 9.2% and surged 14% in April. For reference, the biggest monthly gain before last year was 5.6%, which occurred almost 70 years ago in January 1952.
- The current level of loans remains elevated at almost 8% above that of February 2020

Europe : Good news atlast

- News from the Eurozone last week was generally favorable in terms of the region's economic prospects.
- Of particular note, Eurozone economic confidence rose more than expected to 117.9 in June, the highest level in more than two decades.
- The evidence of economic reopening was apparent in the services confidence component, which jumped to 17.9 in June from 11.3 in May, whereas the increase to 12.7 in industrial confidence in June was more modest.
- Meanwhile, important activity data also offered encouraging evidence of the economic impact of reopening. German May retail sales rose 4.2% month-over-month, reversing a sizable portion of April's sales decline, while French household consumption rose 10.4% month-over-month, more than reversing the April fall. Given these favorable economic indicators, we view the risk to our Eurozone full-year GDP growth forecast of 4.3% as tilted to the upside.
- Separately, while surveys have indicated some supply shortage and bottlenecks, inflation pressure at the consumer price level remain reasonably contained for now. In June, the headline CPI eased to 1.9% year-over-year, while the core CPI also eased to 0.9% year-over-year. Inflation trends will almost certainly quicken in the coming months due to base effects, given the comparison with unusually low price readings in Q3-2020.
- Nonetheless, even with some pickup in prices likely in the months ahead, the extent of inflation pressures across the Eurozone appears likely to be much less than those currently being experienced in the United States, for example.

Europe : What to look for

- Euro Area June Flash Inflation was a disappointment for ECB's inflation hawks. The decline in headline HICP (1.92%; May 1.98%) was driven by both lower contribution from energy prices as well as lower core inflation (0.91%; May 0.95%). The decline in core HICP appears to be related to a drop in German package tours, while rise in NEIG prices compensated for part of the fall.
- ECB's July meeting should not be a game-changer, as the 'significantly higher' PEPP purchase pace has already been confirmed for Q3. Instead, the markets will focus on how optimistic QC members appear in terms of the ongoing recovery and the inflation outlook. Hints about ECB's strategy review are likely to become more frequent towards the end of summer.
- The European Commission is expected to release proposals on a range of legislative measures aimed at achieving its climate target of reducing CO2 emissions by 55% by 2023 in July. Markets look out for the suggested carbon border adjustment mechanism (CBAM) on imports and expanded emissions trading scheme (ETS) for sectors such as cars and heating.

UK : Commonwealth trade ?

- British government is looking for every opportunity to boost trade elsewhere.
- After all, one of the arguments in favor of Brexit was that, being independent of the European Union, Britain would be free to quickly liberalize trade with the rest of the world.
- Most notably, the United Kingdom has commenced negotiations to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the successor to the Trans-Pacific Partnership, which is a free trade area encompassing 11 Pacific Rim countries, including Japan, Canada, Australia, Singapore, Mexico, and others.
- The United Kingdom is also entering into discussions with ASEAN and is seeking to liberalize trade with other countries and regions as well. Of particular importance to Britain is liberalization of trade in services, such as finance, where the United Kingdom is very competitive.
- it almost seems like it is trying to reconstitute the Commonwealth that was largely undermined when Britain joined the European Union in the early 1970s.
- One problem facing Britain is that, traditionally, trade liberalization agreements take a long time to negotiate—often as much as 10 years.
- Thus, it might be awhile before the United Kingdom enjoys the benefits of trade liberalization outside of Europe.

Japan : Challenging phase

- Last week's news from Japan suggests that country's economic recovery remains in a challenging phase.
- The Bank of Japan's Tankan survey—a closely followed barometer of the economy—showed a Q2 increase in the large manufacturers' diffusion index to +14 from +5 in Q1, a bit less than expected.
- Meanwhile, the large non-manufacturers' diffusion index edged only slightly higher to +1 in Q2, from -1 in Q1. Activity data also remained subdued as a state of emergency was in effect in Tokyo, Osaka and surrounding regions during much of the second quarter. May retail sales dipped 0.4% month-over-month, falling further after a 4.6% slump in April.
- Meanwhile, May industrial output fell 5.9%, more than reversing the gain seen in April.
- With the Tokyo Olympics scheduled to proceed with limited spectators, even that is unlikely to provide much of a boost to activity in the months ahead.
- As a result, Japan to be a laggard among the major economies in terms of GDP growth in 2021.

Nifty : Riding the monetary horse

- It was probably the dullest week in last fifteen months that Indian equity markets have experienced.
- There have been many instances where key indices undergo some sort of consolidation and trades in a slender range, but mostly in such times, the action continues in individual themes and there are ample of opportunities available in the market to keep the traders engrossed.
- Barring Friday, stock specific moves were also missing throughout this week which was frustrating for momentum traders.
- Now as far as levels are concerned, NIFTY managed to hold crucial support of 15650. As long as 15650 – 15450 are being held, the bulls have no reason to worry for.
- On the upside, reaching the new milestone beyond 15900 in this macro environment is simply not sustainable even with RBI expanding its balance sheet without batting an eyelid.
- Can this Central bank Monetary expansion alone hide all the macro issues ? If that be the case , there is no upside barrier ..