Damned If You Do, Damned If You Don't!

Well, my "sunny" disposition lasted one week! We were looking for a dip to buy and on Thursday it looked like we'd missed that, but then along came Friday.

It is difficult to figure out what to make of last week's holiday-shortened trading.

- 10-year **Treasury** yields moved higher every day last week, moving 20 bps on the week. Sometimes it seemed like higher yields were hurting stocks, but yields moved slightly higher on Thursday even as stocks soared and they barely rose on Friday after the non-farm payroll report. Despite some serious recession chatter (more on that later) the 2s vs 10s spread steepened slightly, rising from 26 to 27 (2s vs 5s steepened even more, while "naturally" 2s vs 30s flattened significantly from 48 to 43 as 30-year Treasuries outperformed).
- **Credit** performed like a champ! Corporate bond spreads outperformed CDS spreads. The Bloomberg Corporate Bond Spread tightened on the week, dropping from 134 to 131 by Friday (it was 130, 131, 130, 131 from Tuesday to Friday - incredibly stable). Since that is an index, my initial reaction is to take it with a grain of salt (lag effects, estimates, etc.). But LQD (a large IG bond ETF) saw its spread drop from 168 last Friday to 165 on Tuesday. It had a tiny bit more volatility than the index spread, but it still finished the week at 167. Impressive performance on the bond side of things. CDX, which is tied more to the stock market, went from 79 to 82 over the course of the week, with a touch more volatility. Many algos and macro funds trade stocks vs CDX, which explains some of the outperformance on the cash side and positioning likely explains the rest as it seems as though some segment of the market (possibly market makers) got caught short bonds and had "hedged" themselves by selling protection. Since I started harping on **Munis** a couple of weeks ago, it would be remiss of me not to highlight that MUB (Muni ETF) was barely down on the week, despite the weakness in Treasuries. The Muni closed end funds I track were up on average. **Credit sent a strong support signal that equities completely ignored.**
- **Equities.** Maybe it was because a group of us drove 12 hours this weekend on a road trip (mostly with Sirius XM radio channel 33 on), but I can't get the song **Shell Shocked** out of my head. Yes, with a real war going on in Ukraine, I need to be careful applying military terms to something as "trivial" as the stock market, but I'm shell-shocked watching this market. On top of everything else, I've made the "mistake" of focusing even more on the Nasdaq 100 than the S&P 500 where the volatility is being amplified. The Nasdaq 100 swung from 12,548 on Wednesday to a high of 12,898 on Thursday before finishing the week at 12,548 (just under a 3% swing). It was bad enough, from my perspective, that we had these huge back-to-back moves, but the alleged explanations seem underwhelming at best, hence the "shell-shocked" theme running through my head.

It is often that credit is easier to explain than equities or that equities seemed to completely miss the relative strength of credit, but there we have it. I'm still looking to buy a dip (I'm nervous Friday's close was the time), but then again, I was also tempted to buy into Thursday's rally, fitting the damned if you do, damned if you don't mentality of this market.

Damned If You Do, Damned If You Don't - The Fed

It is clear that D.C. is focused on inflation and the midterm elections. Yes, the Fed is independent and prizes its independence from politics. It is crucial to the functioning of the Fed that it is independent of politics as their job is to ensure the smoothest running economy as possible (balancing jobs versus inflation). But there does seem to be intense political pressure to fight inflation and send that message.

We saw some of that this week as speaker after speaker came out, ahead of the blackout period, to largely signal that we have two more rounds of 50 bps hikes coming and that September is on the table.

Friday's job report was strong enough that the Fed has the "ammunition" to be as hawkish as they want on June 15th when we get the next rate decision. This coming Friday's CPI may influence their tone too.

Damned if you don't hike.

With pressure from D.C., daily stories about how inflation is hurting the country and the economy, and with data still "good enough" to justify hikes, it will be difficult for the Fed not to act and sound hawkish.

Damned If You Do, Damned If You Don't - The Economy

Damned if you do hike.

Our base case has been for a serious slowdown in Europe this summer and a noticeable decline in economic activity in the U.S. heading into the fall. Not only are rate hikes going to slow the economy, but quantitative tightening (which in my opinion acts very differently than rate hikes) will function as a headwind for risk assets of all types.

Our concerns were echoed by two famous CEO's this week. One CEO warned that his bank was preparing for an economic "hurricane." That seemed to affect stocks briefly, but didn't last long.

The other CEO warned about his workforce and the economy. That seemed to be a big part of Friday's price action (his stock was down 10% or $70 billion in market cap) and clearly weighed on the market. Over the weekend there seemed to be several tweets walking back some of the messaging on hiring and wages so maybe Sunday futures will open strong and Friday will turn out to be an aberration?

Or maybe it won't be. These are not the only two people or companies that have warned about current levels of staffing.

Will we start seeing this concern about the labor market show up in the data? I think that we will see more signs of rapidly slowing economic activity than I had thought before. Europe is getting hit, the war in Ukraine is dragging on, and housing (or at least mortgage rates) remains an issue for me.

Will it matter? As if things aren't complicated enough, are we at the point **where bad news might be good news** for equities because it will keep yields lower? In last week's "sunny" piece, I highlighted the fact that we had returned to a more "normal" correlation. When stocks can rise (along with yields) on good economic data, we have a real chance for a sustained rally. Hoping bad news will be good news for stocks (at this moment) strains credibility, as the bad news could be very bad, especially if inflation in food and energy doesn't dissipate. So, I think that bad news will matter.

Bottom Line

I'm still in "dip buying mode" on equities (though we haven't hit enough of a dip to pull the trigger or seen a good enough reason to join an already underway bounce). I like rates and continue to like credit, though it is probably a good time to lighten up and take some profits in credit (and Munis).

In the meantime, listen to some 80's new wave music and enjoy what's left of the weekend and if you have a clearer understanding of what is going on out in the markets and the economy, don't hesitate to reach out!

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