# Sunshine In My Pocket

On this Memorial Day, I want to honor all that made the ultimate sacrifice in defense of our country.

I also want to highlight this month's Around the World and the topics covered below:

1. Finland and Sweden Apply to Join NATO
2. China's Investments in Pakistan and Sri Lanka
3. North Korea Prepares for Another Nuclear Test
4. Cyber-Attack on Costa Rica's Government
5. U.S. Sends Special Operations Troops to Somalia

## Sunshine in My Pocket, or even A Pocketful of Sunshine

After last week's almost 7% gain across every major U.S. stock index, I've got nothing but positive songs running through my head. It seems appropriate for this holiday weekend and is a refreshing change from some of the darker songs and themes that have been the focus of many recent T-Reports.

"Can't stop the feeling" seems like the most appropriate song as stock futures are rallying again this morning, along with crypto, though bonds are selling off.

Last week, I had the good sense to at least turn neutral in We Laughed, We Cried, but I let the ongoing malaise (at the time) in the crypto market (among other things) leave me defensive.

The big question is will this rally, which saw a rise of 10% on S&P futures (from a low of 3,807 to as high as 4,202 overnight) stay with us? Heck, one more week like that and we will have erased the 20% drop into bear market territory in presumably record time.

Do those of us who missed this rally pile on or do we fight it? There are so many factors at work with such major possible implications that it is not an easy call (at least not for me).

## This Week's Drivers

Once again, there are several near-term drivers at work. Not the stories that will play out over months and will have the biggest impact on the direction of the economy, but the factors that will drive markets this week. While thinking weekly seems too short, in a market where 3% intraday swings have become the norm, it is also important.

Factors that will "resolve" themselves this week:

- **Month-end buying**. There were supposed to be large "re-balancing" flows as bonds had done much better than stocks, though with the S&P posting a small gain on the month (with bonds down slightly), that flow has already played out. Now we need to see what happens on Tuesday and Wednesday. I suspect that the month-end buying has already occurred and may be so heavily front-run that it acts as a drag on markets this week. Balancing against that is the holiday shortened week, which may just let the higher trend stay in place!
- **The Fed**. Without a doubt the Fed minutes helped markets immensely! Whether it was the realization that the Fed will not crater the economy to save us from inflation or that people now see many inflationary pressures receding, I don't know. I've always been in the camp that the markets are pricing in far too many rate hikes, not because inflation will slow sooner, but because the economy will turn out to be more fragile than expected. Given some of the earnings warnings, chatter about being overstaffed, inventory builds, etc., I think that the Fed will be cautious on hikes (which is bullish**). But (and this is a big but) will the Fed support that dovish view this week as they speak?** We get Waller today, Williams and Bullard Wednesday, and Mester and Brainard speak later this week. Will they confirm this more dovish view, or will they try and dampen the recent enthusiasm? I'm concerned that they could try and undo some of the recent moves in risk assets by hammering home the rate hikes. Also, not wanting to sound

like Debbie Downer, but **we haven't really begun to see balance sheet reduction occur** and that will be starting in earnest now.

- **Crypto is rallying nicely**. Angst over stable coins, the Ethereum conversion, and new regulatory scrutiny are all being overcome right now. I continue to watch crypto closely as I believe that it has become a leading indicator as price movement in crypto is forcing people to trade equities for liquidity and/or risk management. I remain bearish on crypto for now because I think that more people are being vocal about crypto not accomplishing a lot of what has been promised (from a payment system, to an inflation hedge, etc.), but that is for a T-Report later in the week.
- **The Bond Grab!**
  - **Municipal bond closed end funds beat stocks last week!** Let that sink in for a moment. This "weird" part of the market saw funds rise anywhere from 6% to 10% (based on a semi-random sampling). Not only did the underlying Muni market do well, but discounts to NAV declined signaling strong retail interest. The Muni market seemed to do exceptionally poorly throughout the year, but it may finally have turned the corner. There is a lot of upside left in this market if we have in fact turned the corner.
  - **ETF flows.** Not only did Muni's (MUB) see more inflows, but IG (LQD), high yield (HYG, JNK), crossover (ANGL), and even leveraged loans (BKLN, SRLN) all had significant inflows last week. This could be a real turning point as the "chase for yield" comes back. If the fear of higher yields is over or receding, then there could be a rush to lock in these current yields. LQD, for example (longer dated IG) yielded 2.75% for much of last year, and even after the recent rally in IG bonds, still yields almost 4.5%. **Credit and bonds should continue to do well, which should be supportive for risk assets, though I think bonds with credit risk will outperform Treasuries.**
- **Jobs and Economic Data: Is Good News Good or Bad?**
  - **Will the data be good?** I'm most concerned about **the job situation**. When some major companies discuss being overstaffed, it sends a shiver down my spine. We still have not "normalized" from COIVD. Yes, we don't have the same number of jobs that we had pre-COVID (which could be good longer-term). However, we saw hiring in response to the COVID economy and that economy is changing as re-opening has occurred. There are mixed signals on **consumer spending.** The data seems somewhat mixed, but I'm getting concerned here because some of the positive signs seem to be driven by increases in credit purchases, which may not be sustainable. My estimate is that the data will be weak, but not horribly weak (problems take time to show up in the data) and market skepticism on the economy seems high (I've come across the Citi Economic Surprise Index an inordinate number of times this week).
  - **Is Good News Good?** Or vice versa. The bond market seems to be reacting to news "appropriately." Good news pushes yields higher. Bad news pushes bond yields lower. Stocks seem to be trading with a "normal" correlation to bonds, which lets stocks go up even as bond yields go higher. That is the "normal" relationship and is what is going on again today. That is much healthier for markets than when stocks rally on bond yields going lower because of bad data. That tends not to be sustainable. So, the good news is that stocks rising as bond yields rise means we can sustain this rally through good data. The bad news is that data may still be getting worse faster than expectations are coming down.

- **Inflation.** A reprieve for food and energy? Maybe, but that may be very temporary. I remain in the camp that we will have higher inflation (3% to 4%) for longer (2 to 5 years), but that doesn't mean we won't see peaks and valleys within that. So maybe we get some easing on the inflation front, certainly from recent highs, but will we worry about consistently high prices? For now, we probably focus on rate of change (lower inflation than we had), but in the coming weeks, persistently high prices and the outlook for that to continue could weigh on the economy and markets.
- **Insane price moves.** I have absolutely no idea what MSPR does or is supposed to do. None. But I don't think that anything is meant to de-SPAC (if that is the word) at ~$10 and trade down to $1.74 in a week. I'm confused on the market cap of this company and exactly what happened, but it seems sure to attract some attention and seems "odd" if not insane. We continue to see ginormous swings in the market caps of some extremely large companies, that again defy any sort of 'efficient market' hypothesis and point to the gambling, option trading, and algo driven gyrations that have now become the norm.

## Bottom Line

**I'm neutral to slightly bullish on Treasuries.** The 10-year traded in a range of 2.74% to 2.85% last week. I could see us testing the upper end of that range or approaching 3% on strong economic data, but there is plenty of support and it can get to 2.5% in a hurry on bad economic news.

**I like credit products.** The chase for yield seems to have legs and can go on even if equities falter. I'd rather own credit (IG, High Yield, Munis, structured products, etc.) than Treasuries. **I'd still be easing out of floating rate products into fixed income as I want to lock in duration here, especially on the credit side.** While not for the faint of heart, CCC might be the best bang for the buck, as the chase for yield continues, but that is more like next week's trade, as there is still plenty of opportunity in the other markets.

**Crypto**, bearish, though I am not going to fight this current pop.

With respect to stocks, am I being stubborn because I hate to miss a 7% rally? Is that what is holding me back from getting on board with this rally? It shouldn't be. It especially shouldn't be because knowing that it is affecting my judgement should reduce how much it is affecting my judgement, but it is in the back of my mind.

**For stocks**, and this is all crazy when 3% days are the norm, I'm looking for a pullback as we head into next month. While there is a good balance between risk and reward here, I think the preponderance of influences will weigh on stocks, but **I am finally, for the first time in months, looking for buying opportunities rather than selling opportunities**.

**Sectors** that I like include anything travel related, homebuilders, emerging markets (especially Mexico), and even financials, while I'm **leaning bearish on energy** for the first time in almost 2 years!

**Have a great Memorial Day** and if you want to start the work week off right, tune into Bloomberg TV on Tuesday at 8am ET for Academy Securities!

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