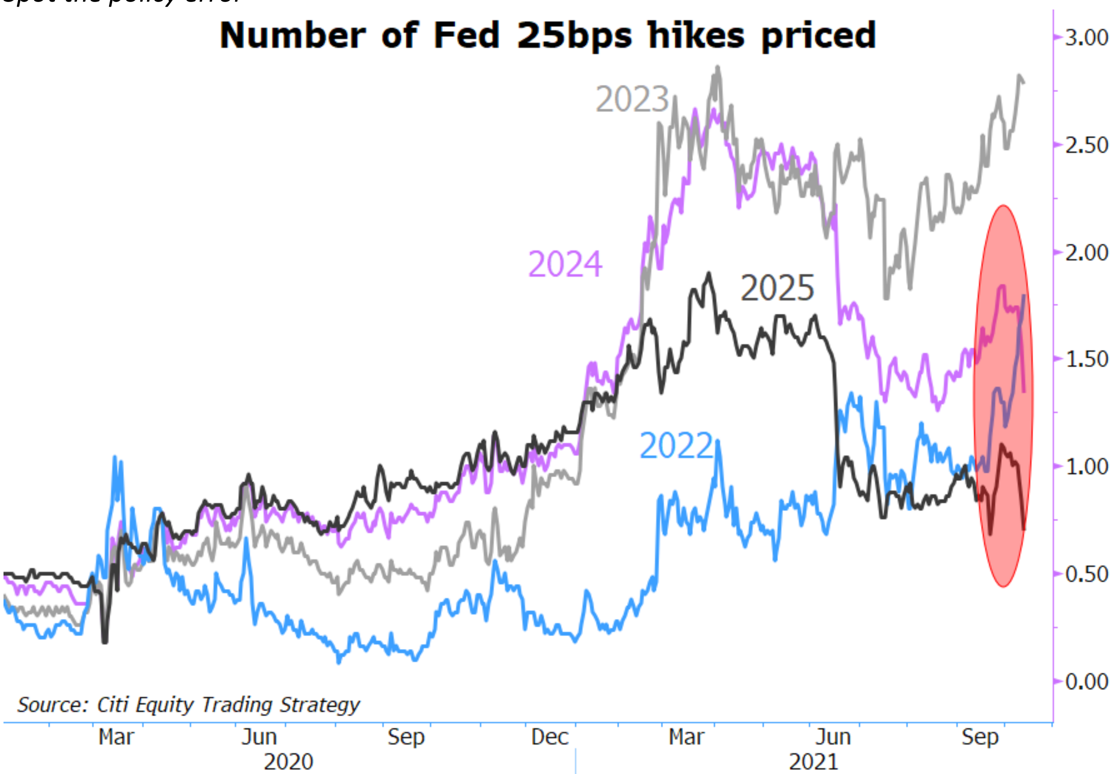
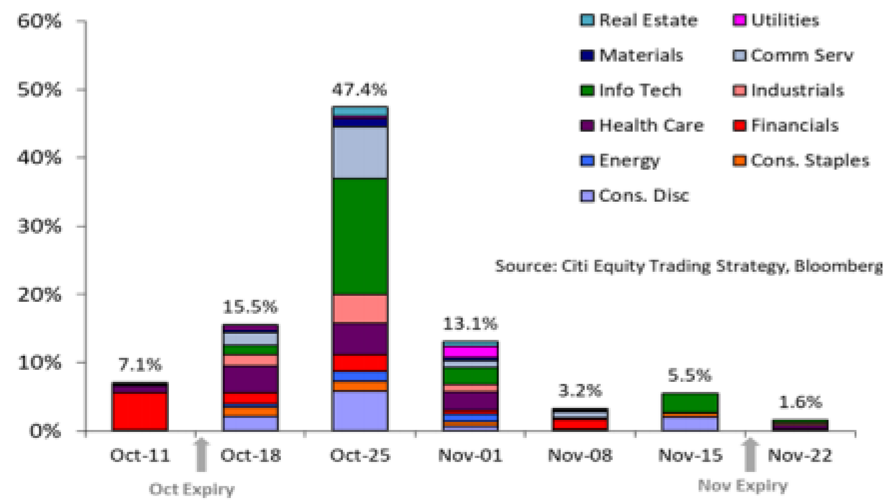
Market Commentary and a not a product of Research. Intended for Institutional use.

Considering we had a much-awaited CPI print today, the 60bps of one day SPX implied move going into the event was in itself sufficiently telling that markets had already voted with their feet, and the (lack of) index movement for the entirety of the session certainly did not disappoint (*…or did disappoint*) – consolidated volumes fell short of 10bn for the fourth day a row after all. There may have been a lot of hand wringing in the fixed income community as to why a broad beat in YoY prices did not manifest in higher long-end yields, and markets were suddenly abuzz with the '*policy error*' whispers, which i found both understandable given how sharply the ED$ moves have been in the ED2s vs ED4s and ED5s, and equally laughable given the Fed haven't even really discussed the notion of hiking at present. Even today's minutes illustrated the prospect of hiking is nothing more than a two-way debate, so how we can conclude failure before even starting is a little presumptuous, in my opinion anyway.

Spot the policy error



That being said, getting through the CPI 'hump' has the Pink Floyd riff running through my head as another 'brick in the wall' (of worry) has been removed. Of course, we also started the thick of earnings season too – arguably one of the larger components of the worry wall that investors are currently considering – and although the JPM results failed to spark a broader rally in Financials today, that was arguably attributed more to the broader rates backdrop than anything specifically untoward in the company results themselves. Equally, AAPL's iPhone unit downgrade on supply issues had been so well telegraphed at the time of product launch that the overnight quantification of the 'warning' really came as little surprise to investors paying attention. It went without saying that the stock ending the session -40bps and near the intraday highs was supportive not just for a more benign setup for Q3 earnings, but also for further tactical strength in equity benchmarks in the near term. Obviously the week of Oct 25th with all that Tech reporting remains front and centre for the wall of worry…

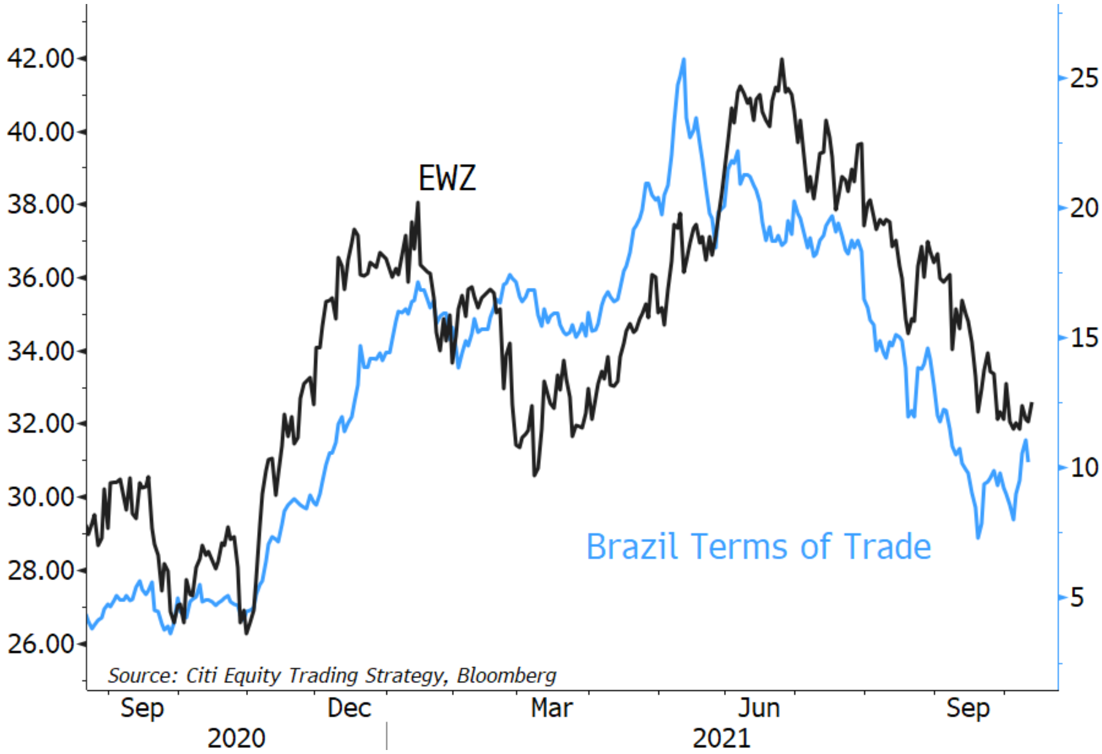


However, it is not going to be peaches and cream for every corner of the equity market during Q3s. Some of you have expressed varying degrees of concern about the state of the American consumer going forward, and although I personally see high home prices and massive excess savings as a powerful buffer to any increase energy/inflation pressures, there are certainly going to be parts of consumer-facing industries that will not get off lightly. DAL provided another warning shot on input cost pressures today, and recall we had a BBBY meltdown not long ago. CETS ran an analysis trying to identify commonalities for businesses that may be under pressure from rising costs and higher wage pressures, and the running theme within this list is that many of the vulnerable names belong to the 'reopening trade' that was red hot during Q1'21. Thus when asked whether this resurgence in cyclical parts of the market means whipping out the Q1 playbook, the answer is a resounding *no* given that many of those economically-sensitive stocks happen to have the least pricing power, the thinnest margins, and are vulnerable to rising wage pressure. Think hotels, QSRs, hardline retailers, and throw in some Industrials and Healthcare to identify vulnerable businesses within the current backdrop: their collective performance clearly illustrates that the reopening trade has turned from a tailwind to a headwind.

Inflationary pressures are hurting a lot of the 'reopening' trade names

Lastly, given the rally in Energy of late I decided to revisit the Brazil narrative given both BRL and EWZ are trading at levels last seen in early Q2. Investors are right to be cautious on Brazil given there is some political risk premium coming back into the investment horizon with a showdown between Bolsonaro and Lula likely occupying the headlines for many months to come, but given the -10% YTD performance in EWZ, the local market now sits on only 8x 2022 EPS (vs Russia on 7x). What's interesting is of course the fact that the rally in oil prices are finally starting to feed through in improving Brazil's terms of trade, which in turn should stabilize the currency and eventually attract equity inflows. Remember, EWZ gives investors exposure to *both* the local market (i.e. commodity exposure) and BRL, so there is scope for a near-term catch up trade here via short-dated optionality. Vols have reset back into the low 30s – the same level they were back in April – so I would consider EWZ Dec 35 calls for 77c (*32.57 ref, 30% delta, indicative only*) as a 'fire and forget' expression.

Brazil – time to revisit at these levels



Alty

Alexander Altmann
Head of US Equity Trading Strategy
Office +1 212 723 1999

Market Commentary and a not a product of Research. Intended for Institutional use.

All charts/data sourced from CETS, Bloomberg and Citi, unless otherwise indicated.