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Citi **Equities** I Equity Trading Strategy

Macro Week Ahead: Dec 6 – Dec 10

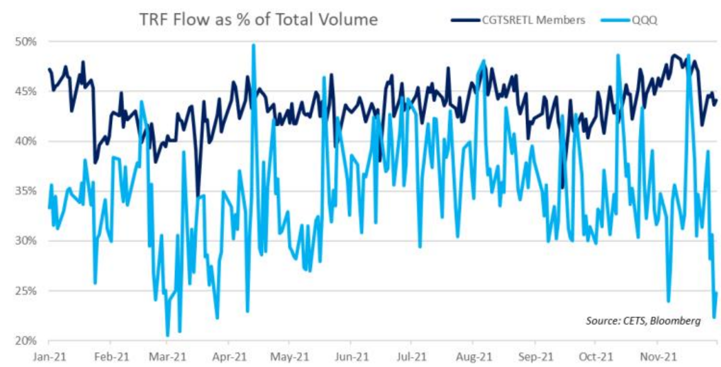
Market Commentary I Dec 4, 2021

Tactical equity views: bracing for more pain. This week's price action was largely a continuation of last Friday's selloff as SPX registered a 3.5% drawdown from all-time highs. Rather concerning however is the fact that there are few upbeat signs to report, with the team's trusted market indicators pointing towards further pain to come. CETS' POLLS indicator (CGTSPOLL Index – see primer here) initially flashed a warning sign back in middle of November, but instead of moderating lower following the -2.4% selloff since then akin to shallow selloffs earlier this year, the indicator has remained in warning (16+) territory and ticked up to close the week at 20, the highest level since September 2018. Low Risk (CIISLRUT Index) was heavily bid to the 87th percentile in the last 6 months, while the Probability of Default basket (CGPRPROB Index) hit the 92nd percentile in the same lookback. Despite the selloff, CTA outflows have yet to hit the market – 4520 remains the key threshold to watch, representing $50+bn levered outflows should that level be broken. Similarly, while the team's Overbought/Oversold indicator (CGUSOVER Index) indicated that a net 113 SPX constituents were oversold on Wednesday, conditions where the dip-buying risk/reward becomes asymmetrically attractive has not yet been reached. The team's preferred positioning at this juncture is Value, which has been the best performing style amid this week's selloff. Recall that Value can perform as a function of cheap outperforming expensive – this week's small dip in financial conditions triggered a disproportionally negative impact on expensive pockets of the market, a trend which should only accelerate as the Fed embarks on the tightening path.

Will equities reach the inflation breaking point? Markets may have more to fear ahead of next Friday's CPI. The team's analysis flagged that equities' tolerance for higher and more sustained price pressures is drawing increasing close to the "breaking" point: plotting 12m average headline CPI against S&P trailing PE reveals that in an environment where average 12m inflation rises above the 4% threshold, equity valuation multiples begin to demonstrate increased negative sensitivity to higher prices. Today, SPX is priced at 25x P/E, with 12 month average CPI at 3.77% - to break above this key threshold, next week's data only has to come in at above 4%, which is considerably tamer compared to the estimated 6.7%. Should higher inflation be realized, it would bring equities into unprecedented territory, with the only other data point to reference back in Dec 1991. As today's inflationary pressures refuse to subside - oil quickly stemmed losses following OPEC's decision to proceed with production increases, while breakevens retreated but only to levels seen during the summer – the team is growing increasingly wary that persistent price pressures will bite into equities valuations.

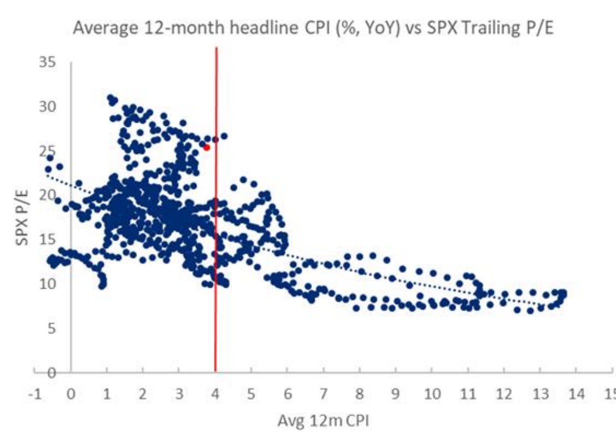
Don't count on the retail bid. One source of market support that has notably been missing in this latest selloff is the retail bid. The lack of participation from retail is evident from the mediocre TRF volumes, as well as the sharp decline in ratio of call/put volume to lowest levels YTD. With retail positioning, as proxied via the TD IMX Index, at unprecedented highs, this latest selloff may represent the line in the sand where the small investor community are sidelined due to lack of remaining dry powder. It is noteworthy that household investors' portfolios are suffering – Citi's basket of crowded retail names (CGTSRETL Index) has underperformed SPX by 11% in the past month, with 60% of the constituents underwater against their YTD VWAP. Taking into account retail's preference for expensive, high growth business against a backdrop of tightening financials conditions, one should not count on a revival in equity sponsorship from the retail community anytime soon.

Retail investors remain a significant portion of retail-exposed volume, but total retail activity has been quite light



Source: Citi Equity Trading Strategy, Bloomberg

Next week's CPI could cross the line on equities' tolerance of inflation



Source: Citi Equity Trading Strategy, Bloomberg

Value can work when 'expensive' underperforms too

Source: Citi Equity Trading Strategy, Bloomberg

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**All prices indicative*

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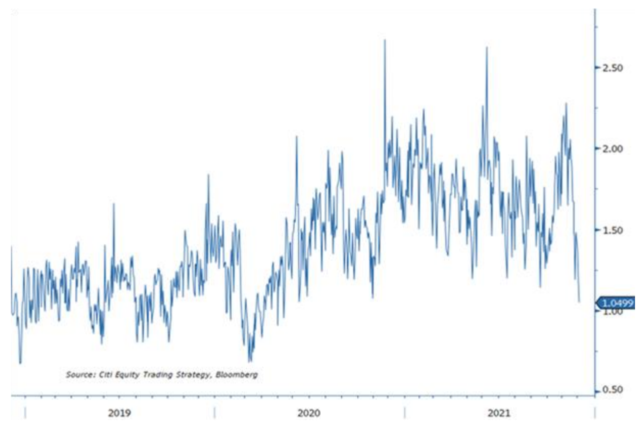
Vol: Balancing Risk and Reward. The bid for Vol-of-Vol remains relentless, driving VVIX to tie the highest levels seen post-Covid and VIX north of 30. Put were near local high volumes in the SPX - 1.6mm - on Wednesday and Friday; when set against a backdrop of rising VIX levels, rising average put delta (-17.2 through January expiries) and steady total put open interest (10.5mm total) offers a view of a market less interested in monetizing hedges and more interested in cleaning up low-delta small strikes left behind by the rapidly rising market over the past several months. The market has retreated slightly over half of the total pullback seen in October (3.4% from local highs vs. 5.1%), yet VIX has been bid nearly half-again higher than it was at the October lows (23.3 vs. 30.6), which again lends weight to the view of more technically-driven short-term put demand and low risk appetite. While a hawkish Fed is a more existential risk to US market valuations than the Evergrande debt crisis, it is also a relatively orderly one – so maintaining the implied-realized vol gap of 13v in both 1m and 3m vol (a 90th and 95th %-ile observation over the past decade) appears difficult and relatively unlikely. As investors seek to protect PnL through end of year, the bid for VoV is may be more technically driven than the result of sustainable demand for crash protection as well. To directly take advantage of this gap without leaving too much tail exposure, CETS sees short 85/115 corridor variance as optimal (Jan 85/115 @ 24.5v, indic only), though this trade does take uncapped risk should the market enter a highly volatile but price rangebound market. For those looking to take advantage of high implieds to hedge out tail risk instead, Put VKOs continue to price excellently in this market, though CETS prefers 30v budgets so that MtM risk over any Powell-driven volatility over the next month is mitigated. **Buy SPX ATM Put VKO 30v – Jan 1%, Mar 1.3%, indicative**

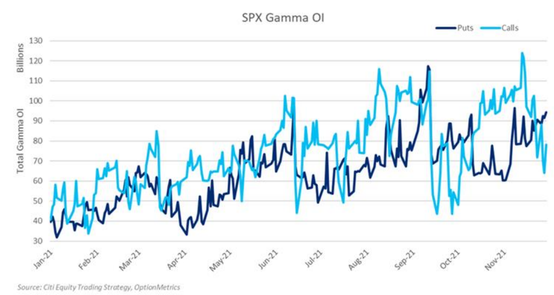
Congress' to-do list remains lengthy. Lawmakers managed to avert shutdown ahead of tonight's deadline by passing a stopgap measure to keep the government funded through Feb 18. Congress now has the opportunity to negotiate new funding legislation ahead of the Feb cutoff, though the parties stand divided on key policy decisions. President Biden's Build Back Better bill also awaits further progress, with risks of delay increasing as Democrats remain at debate over provisions such as the SALT deduction. With more urgent matters on Congress' agenda this month, our Economics team increased their probability that the tax and spending bill will not pass at all from 30% to 40% this week. Citi's tax baskets have also yet to reflect investor concern over taxation risks linked to the bill – the team's tax sensitive basket pair (CGTSTXLW Index/CGTSTXLG Index) sits near YTD lows, and CETS' "Made in America" tax basket (CGTSBTAX), comprised of large cap companies with historically low tax rates, has outperformed over recent weeks. Meanwhile, Treasury Secretary Yellen's caution that the nation will exhaust its use of 'extraordinary measures' around Dec 15 still looms in the background. Democrats are generally expected to raise the debt ceiling along party lines through reconciliation, and given that this process has historically taken ~2 weeks to work through, any absence of progress on the matter next week will likely raise market concern. Though the Bipartisan Policy Center and Citi Economists are projecting a slightly extended horizon for the nation to reach its debt limit, market participants are anticipated to focus on Secretary Yellen's warnings. T-Bill markets priced out some of the risk associated with Yellen's x-date after the government shutdown crisis was dodged today, though officials have advised that possibility of a debt limit breach presents a more dire threat. CETS highlighted in a recent note that equities have also failed to price any event risk premium surrounding this upcoming timeline.

Data next week. Focus will be directed towards the Nov CPI Inflation print on Fri, which could weigh on upcoming FOMC meeting outcomes. Citi's US Economics team is projecting a 0.7% MoM rise in core CPI inflation - slightly higher than consensus at 0.5%MoM. Following Chair Powell's non-transitory inflation comments on Tues, Economics' base case is for the Fed to double its tapering pace at the Dec meeting to $30bln/mth. Other data releases include Oct Trade Balance (Citi -$66.4bn, median -$66.9bn) on Tues, Job Openings on Weds, Initial Jobless Claims (Citi 160k, median 230k) and Wholesale Inventories on Thurs, and U of Mich Sentiment (Citi 66.9, median 68.0) on Fri. There will be no Fedspeak next week, as blackout period commences ahead of this month's FOMC meeting on the 15th.

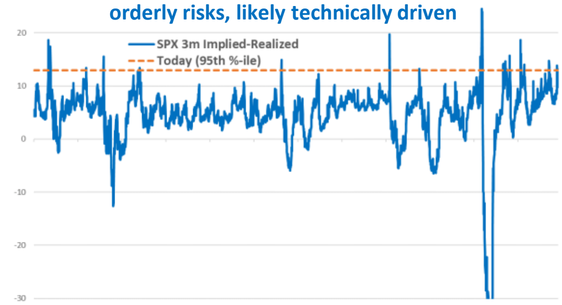
Put vs. Call Ratio has slid dramatically since pre-Thanksgiving



As has outstanding Call gamma, while Puts have held steady



SPX Implied vs. Realized gap looks unsustainably large given orderly risks, likely technically driven



Source: Citi Equity Trading Strategy, Bloomberg

US political to-do list remains packed for December

December

Dec 10:
- Nov CPI release

Dec 15:
- Treasury Secretary Yellen's estimate for when the nation will exhaust its use of 'extraordinary measures' to fund debt obligations
- Dec FOMC meeting

Dec 21-Jan 28:
- The Bipartisan Policy Center's estimate for when the Treasury will reach its debt limit under the Oct 14 increase

January

Jan 3:
- Citi US Economists' estimate for when the Treasury will reach its debt limit under the Oct 14 increase

February

Feb 18:
- Extension date for government funding under the continuing resolution signed into law on Dec 3

Source: Citi Equity Trading Strategy, Bloomberg

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Macro Catalysts Next Week (All times EST)

Monday, December 6

2:00 AM Germany Oct Factory Orders MoM est 0.20%, prior 1.30%
China Nov Trade Balance est $79.40b, prior $84.54b
China Nov Foreign Reserves est $3206.30b, prior $3217.61b

Tuesday, December 7

12:00 AM Japan flash Oct Leading Index CI est 102, prior 100.9
2:00 AM Germany Oct Industrial Production SA MoM est 1.30%, prior -1.10%
5:00 AM Germany Dec ZEW Survey Expectations est 26.1, prior 31.7
5:00 AM Eurozone final 3Q GDP SA QoQ est 2.20%, flash 2.20%
5:00 AM Eurozone Dec ZEW Survey Expectations, prior 25.9
8:30 AM US Oct Trade Balance est -$66.7b, prior -$80.9b
6:50 PM Japan Oct BoP Current Account Balance est ¥1168.4b, prior ¥1033.7b
6:50 PM Japan Oct Trade Balance BoP Basis est ¥127.0b, prior -¥229.9b
6:50 PM Japan final 3Q GDP SA QoQ est -0.80%, flash -0.80%

Wednesday, December 8

7:00 AM US MBA Mortgage Applications, prior -7.20%
10:00 AM US Oct JOLTS Job Openings, prior 10438k
6:50 PM Japan Nov Money Stock M2 YoY, prior 4.20%
8:30 PM China Nov CPI YoY est 2.50%, prior 1.50%
8:30 PM China Nov PPI YoY est 11.70%, prior 13.50%

Thursday, December 9

1:00 AM Japan flash Nov Machine Tool Orders YoY, prior 81.50%
2:00 AM Germany Oct Trade Balance, prior 16.2b, revised 16.0b
8:30 AM US Initial Jobless Claims, prior 222k
10:00 AM US final Oct Wholesale Inventories MoM, flash 2.20%
6:50 PM Japan Nov PPI YoY est 8.50%, prior 8.00%

Friday, December 10

2:00 AM Germany final Nov CPI YoY, flash 5.20%
2:00 AM UK Oct Industrial Production MoM, prior -0.40%
2:00 AM UK Oct Manufacturing Production MoM, prior -0.10%
2:00 AM UK Oct Trade Balance GBP/Mn, prior -£2777m
8:30 AM US Nov CPI MoM est 0.70%, prior 0.90%
10:00 AM US flash Dec U. of Mich. Sentiment est 68.5, prior 67.4
2:00 PM US Nov Monthly Budget Statement, prior -$165.1b

Source: Citi Research, Citi Trading, Bloomberg

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Macro Catalyst & Earnings Calendar

Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Germany Oct Factory Orders MoM ****China Nov Trade Balance** **China Nov Foreign Reserves **Earnings** DG (2.658; 5.6%) KR (0.690; 8.8%) ULTA (2.487; 8.3%) COO (3.367; 5.6%)	Japan flash Oct Leading Index CI Germany Oct Industrial Production SA MoM **Germany Dec ZEW Survey Expectations** **Eurozone final 3Q GDP SA QoQ** Eurozone Dec ZEW Survey Expectations **US Oct Trade Balance** Japan Oct BoP Current Account Balance Japan Oct Trade Balance BoP Basis **Japan final 3Q GDP SA QoQ** **Earnings** AZO (20.921; 6.4%)	US MBA Mortgage Applications US Oct JOLTS Job Openings Japan Nov Money Stock M2 YoY **China Nov CPI YoY** China Nov PPI YoY **Earnings** BF/B (0.525; 7.4%) CPB (0.813; 4.4%)	Japan flash Nov Machine Tool Orders YoY Germany Oct Trade Balance US Initial Jobless Claims US final Oct Wholesale Inventories MoM Japan Nov PPI YoY **Earnings** COST (2.594; 3.5%) AVGO (7.765; 4.3%) HRL (0.503; 4.0%)	**Germany final Nov CPI YoY** UK Oct Industrial Production MoM UK Oct Manufacturing Production MoM UK Oct Trade Balance GBP/Mn **US Nov CPI MoM** **US flash Dec U. of Mich. Sentiment** US Nov Monthly Budget Statement **Earnings** ORCL (E;1.110; -)
Dec-13	**Dec-14**	**Dec-15**	**Dec-16**	**Dec-17**
Japan final Oct Industrial Production MoM **Earnings**	UK Nov Jobless Claims Change UK Oct Average Weekly Earnings 3M/YoY **UK Oct ILO Unemployment Rate 3Mths** Eurozone Oct Industrial Production SA MoM US Nov NFIB Small Business Optimism **US Nov PPI Final Demand MoM** US Nov PPI Final Demand YoY China Nov Retail Sales YoY China Nov Retail Sales YTD YoY China Nov Industrial Production YoY Japan Oct Tertiary Industry Index MoM **Earnings**	**UK Nov CPI YoY** US MBA Mortgage Applications **US Dec Empire Manufacturing** **US Nov Retail Sales Advance MoM** US Nov Retail Sales Ex Auto MoM US Dec NAHB Housing Market Index **US FOMC Rate Decision (Upper Bound)** US Oct Net Long-term TIC Flows Japan Nov Trade Balance Japan flash Dec Jibun Bank PMI Mfg **Earnings**	Eurozone Oct Trade Balance SA **UK Bank of England Bank Rate** **UK Dec BOE Gilt Purchase Target** **Eurozone ECB Main Refinancing Rate** US Nov Building Permits **US Nov Housing Starts** US Initial Jobless Claims US Dec Philadelphia Fed Business Outlook **US Nov Industrial Production MoM** US Dec Kansas City Fed Manf. Activity ****Japan BOJ Policy Balance Rate** **Earnings** ADBE (E;3.198; 4.3%) ACN (2.627; 3.5%) FDX (E;4.213; 6.2%)	Germany Nov PPI MoM UK Nov Retail Sales Ex Auto Fuel MoM **Germany Dec IFO Business Climate** **Eurozone final Nov CPI YoY** **Earnings** DRI (1.457; 5.6%)
Dec-20	**Dec-21**	**Dec-22**	**Dec-23**	**Dec-24**
Eurozone Oct ECB Current Account SA **US Nov Leading Index** **Earnings** NKE (0.630; 5.8%) MU (E;2.116; 5.2%)	Germany Jan GfK Consumer Confidence US 3Q Current Account Balance Eurozone Dec Consumer Confidence **Earnings** GIS (1.045; -)	**UK final 3Q GDP QoQ** US MBA Mortgage Applications US Nov Chicago Fed Nat Activity Index **US 3Q GDP Annualized QoQ** US 3Q Core PCE QoQ **US Dec Conf. Board Consumer Confidence** **US Nov Existing Home Sales** **Earnings** CTAS (E;2.640; -) PAYX (0.799; 2.9%) KMX (1.447; 7.1%)	Japan final Oct Leading Index CI Japan final Nov Machine Tool Orders YoY US Initial Jobless Claims **US Nov Personal Spending** US Nov PCE Core Deflator YoY **US flash Nov Durable Goods Orders** US flash Nov Cap Goods Orders Nondef Ex Air **US final Dec U. of Mich. Sentiment** **US Nov New Home Sales** Japan Nov Natl CPI YoY **Earnings**	**Earnings**

**Earnings Key: Ticker (EPS, Option Implied Move) **Exact release time subject to change*

Source: Citi Research, Citi Trading, Bloomberg

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