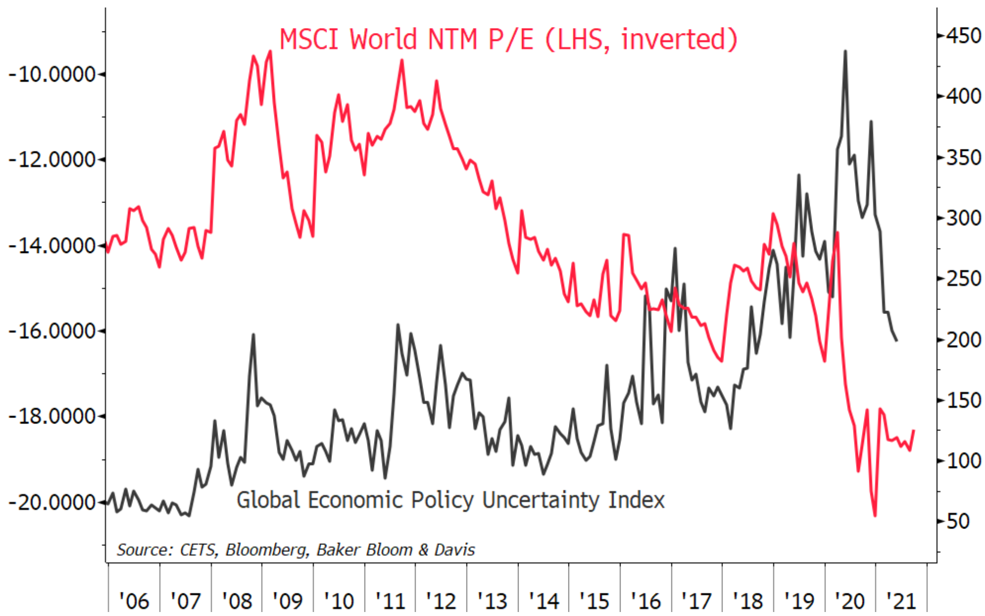
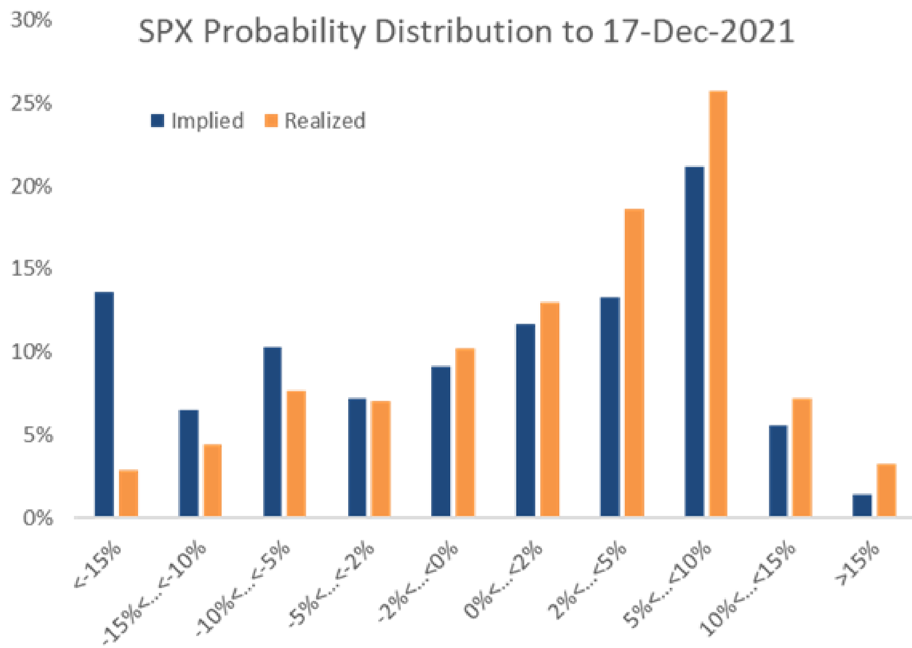
Market Commentary and a not a product of Research. Intended for Institutional use.

Although it was not inevitably going to be a quiet session after yesterday's wake up call, I think most of us breathed a small sigh of relief that markets were able to take a pause and consolidate, even if SPX ultimately ended the day marginally lower on the session and consolidated tape volumes dipped back sub 10bn shares. Factor and sector volatility dipped down to more palatable moves, and that perceived calm before tomorrow's Fed announcement allowed me to uncharacteristically tune into a couple of the UNGA speeches; US, Iran, and China of particular note given their respective roles in shaping global policy at present. Although Xi's pre-recorded speech unsurprisingly made no mention to any domestic issues, there was poorly veiled attack on the recent Aukus announcement, whilst Iran's new leader, Ebrahim Raisi, offered a firm rebuke regarding nuclear negotiations that in turn may provide further support for crude prices in the medium term. This prompted me to unearth and refresh an old 'policy uncertainty index' that has historically shown a loose correlation to global equity multiples over time. And whilst that relationship unsurprisingly broke down during COVID, it is still surprising to see the magnitude of uncertainty declining so sharply at a time where policy at both a geopolitical and monetary level appear to be reversing once again. I would caveat that this data is horrendously lagged (the latest data point appears to be May'21), but I found interesting nonetheless.



On a more tactical basis, the VIX curve pulled itself back into contago (sort of…) and some tentative vol sellers re-emerged from the woodwork, taking advantage of this week's pop in front-end tenors. I was asked by a client if vol was a sell here, but with skew still pretty rich even after today's softening, it's unclear whether outright vol selling is going to perform any better than the current skew curve: I personally still prefer the setup to sell Dec deep OTM puts that remain extremely rich to fund multiple nearer to the money calls. As mentioned in yesterday's EOD, the implied option distribution in SPX at present remains very extreme versus realized.



Source: Citi Equity Trading Strategy, OptionMetrics, Bloomberg

Ultimately, however, most of the market took a hiatus ahead of the Fed tomorrow. You can find the full previews from our economists and FX strategists here and here, and although there is recognition of a likely hawkish meeting, I personally believe the risk of a hawkish *surprise* is now quite low, especially given the SEP forecasts for the dots are anticipated to move higher by at least 30bps in both 2022 and 2023 (see table below). A dovish surprise at the press conference – something along the lines of '*ignore the dots; hikes are not starting until 2023*' – could be enough to kickstart a bit of bear steepening and pull some wind into the sails of a parts of the equity market that have struggled to get any real traction (i.e. cyclicals) since the June SEP update.

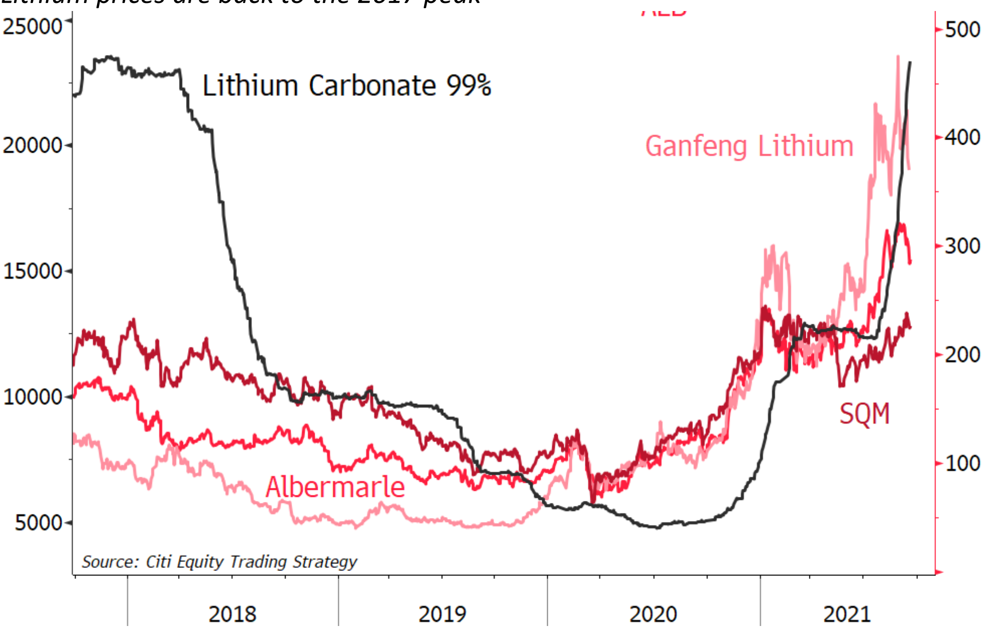
Citi expectations for September Fed SEP

		2021	2022	2023	2024	LR
GDP	September	6.0	4.0	2.4	2.0	1.8
	June	7.0	3.3	2.4		1.8
Unemployment	September	4.6	3.8	3.5	3.5	4.0
	June	4.5	3.8	3.5		4.0
PCE Inflation	September	4.2	2.3	2.2	2.0	2.0
	June	3.4	2.1	2.2		2.0
Core PCE Inflation	September	3.8	2.3	2.1	2.0	
	June	3.0	2.1	2.1		
Fed funds rate	September	0.1	0.4	0.9	1.6	2.5
	June	0.1	0.1	0.6		2.5

Source: Citi Research, Federal Reserve

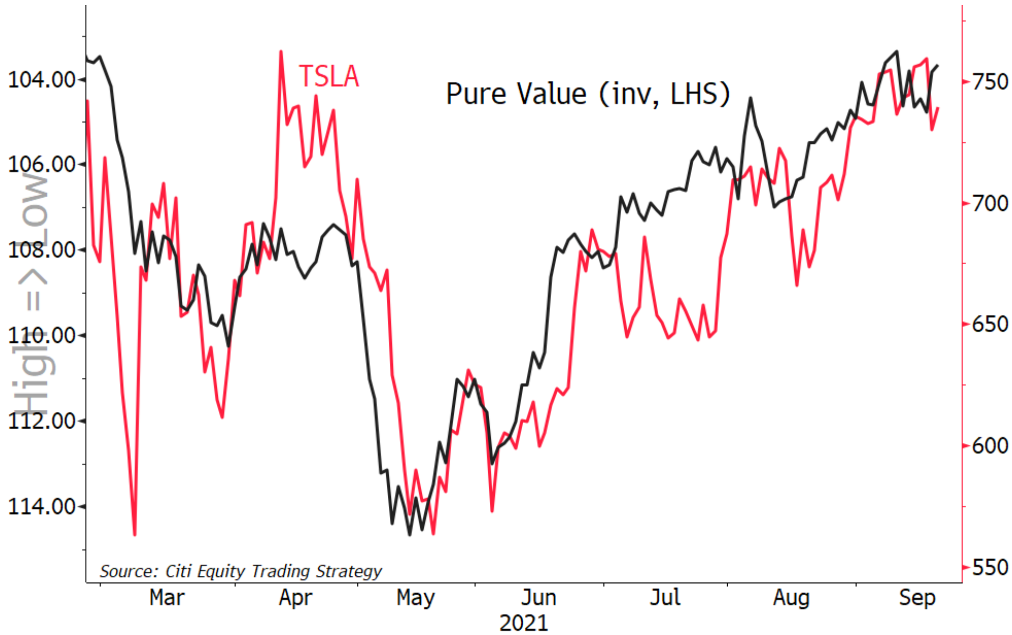
And speaking of cyclicals, it may have gone unnoticed that spot lithium prices are now back to the go-go levels in late 2017 (right before a massive oversupply environment crushed prices by >75%). Arguably the forward on both the prospect for demand, and arguably more constrained supply makes the forwards of lithium companies more attractive today, which is already being reflected in the higher multiples. But at the same time, the 10%-15% pullback in names like ALB may offer long-term investors renewed bites at the cherry on playing the EV supply chain without having to worry about the competitive dimension of downstream (i.e. automotive) players. Incidentally, the same could be argued for the uranium space (*an area that quite a few of you have expressed interest in over the past few months*), where URA has pulled back >15% from the recent highs.

Lithium prices are back to the 2017 peak



Lastly, I could not help but notice a couple of micro data points heading into Q3 reporting: DIS announced a miss on Disney+ subscriber growth due to covid restrictions on production, sending the stock down 5%, whilst FDX not only missed the quarterly numbers but also took their FY guidance lower largely thanks to rising input costs outstripping the company's price hikes. A colleague enquired this morning as to whether Q3 would represent the pivotal quarter where investors get to see the first signs of the tide going out and which companies are left swimming naked in a world of rising inflation and pricing power. However, as DIS guidance today illustrates, even good pricing power may not be enough to insulate corporates that already trade on extremely rich multiples. And that brings me back to TSLA, a name that I keep mentioning in these columns not just because it still represents the talisman for 'terminal growth' businesses, but equally the epicenter of retail investment and the 'anti-Value' trade (see chart below). Any hiccups in businesses like this at the upcoming Q3s may yet represent both a turning point for retail euphoria, and indeed for Value as a stylistic preference.

TSLA is the 'anti-Value' trade



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

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