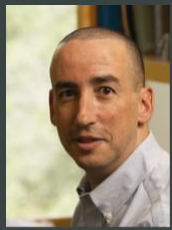


MARKET UPDATE

subscribe at sandyleeds.com

Market Update – May 20, 2024

I. Last Week

A. The Entire Week

1. Nasdaq +2.11%; Russell 2000 (IWM) 1.87%; **S&P +1.54%**; DJIA +1.24%
    a. DJIA closed above 40K for the first time ever on Friday (40,003.59)
2. 10-yr UST **4.42%** (-8 bps)
    a. USD -.64%
3. **Big stories**:
    a. CPI and retail sales consistent with soft landing
        i. FactSet – fewest companies since 2021 discussing inflation
    b. MEME stocks relived glory days at start of week, dropped later in week
    c. Gold and copper hit record highs, silver also doing well
        i. Safe-haven assets, industrial demand, hedge fund speculation
    d. Negatives: inflation sticky, economy slowing, geopolitical tensions

B. Monday – not much movement other than MEME stocks

1. Nasdaq +.29%; Russell 2000 +.11%; S&P 500 - .2%; DJIA -.21%
2. Stocks barely moved, but the MEME stocks jumped (short sellers lost $1B), GME +74%
    a. Traders waiting on the CPI data
3. NY Fed inflation expectation survey – one-year expectation of 3.3% (+.3%) – highest level since July 2022 after being unchanged for seven months
    a. Stifel forecasts S&P will drop 10% due to lack of inflation progress
4. Fed Gov. Jefferson – keep rates high until confident about path to 2%

C. Tuesday – optimism about Wednesday's CPI report

1. Russell 2000 +1.14%; Nasdaq +.75%; S&P 500 +.48%; DJIA +.32%
2. Again, relatively low volume; MEME stocks continued rally
    a. Does MEME stock rally indicate optimism?
3. PPI was a little higher than expected, but ignored by traders
    a. Headline PPI +.5% MoM (expected .3%)
        i. But March revised down to -.1% (from +.2%)
        ii. Majority of increase was services (+.6%); portfolio management fees (based on a % of assets) (+3.9%); goods rose .4% (gas +5.4%)
    b. Core PPI +.55% MoM (expected .2%)
4. Powell said he expects disinflation to continue; a rate hike is unlikely
    a. Acknowledged debate about long-term r* (neutral rate)
5. NFIB small business optimism index rose for first time this year to 89.7 (+1.2), but 28th consecutive month below 50-year average of 98.
    a. Inflation seen as largest problem; election uncertainty and taxes also a worry
6. Biden announced higher tariffs on Chinese goods (especially EVs)

D. Wednesday – seeing the good news in CPI, the market rallied

1. Nasdaq +1.40%; S&P 500 +1.17%; Russell 2000 +1.14%; DJIA +.88%
    a. S&P and Nasdaq both closed at record highs
    b. MEME stocks had sharp decline
2. CPI furthered the disinflation story
    a. Headline CPI +3.4% YoY, +.3% MoM
    b. Core +3.6% YoY, +.3% MoM
        i. OER +.4% MoM and +5.8% YoY
        ii. Core services ex shelter is +5.2% YoY
3. Soft retail sales report – flat MoM (+.4% expected); bad news is good news
    a. Two prior months revised down cumulative .4%
4. Minneapolis Fed Pres. Kashkari – wait and see what happens w/ inflation

E. Thursday – the market pauses after two strong days

1. DJIA -.10%; S&P 500 -.21%; Nasdaq -.26%; Russell 2000 -.63%
    a. Slow day after a two-day rally
2. Traders still believe in soft landing – growth still strong, disinflation continues
    a. Initial jobless claims (222K) dropped after last week's eight-month high (231K)
3. NY Fed Pres. Williams, Richmond Fed Pres. Barkin, and Cleveland Fed Pres. Mester all seemed to indicate rates would need to stay high for longer

F. Friday – another quiet day, but the DJIA closed above 40,000

1. DJIA +.34%; S&P 500 +.12%; Russell 2000 -.03%; Nasdaq -.07%
2. GME dropped 20% after announcing weaker revenue and a larger loss for Q1
    a. For the week, GME +27%, AMC +51%
3. Continued focus on "bad news is good news" because it implies soft landing
    a. Bears ask if bad news will lead to recession
4. Optimism may be extreme. BofA's survey of money managers shows that a net 41% are overweight stocks. This is the highest since Jan. 2022. Cash as a percentage of the average portfolio is the lowest since the first half of 2021. (Barron's)

Source: FactSet Daily Summaries

II. Interesting Stats and Ideas for the Week

A. Stocks

1. **Strategists are frequently wrong**. Bloomberg surveyed 21 Wall Street equity strategists. The average expectation for the S&P 500 at the end of the year is 5,065. The median is 5,170. If they are right, you'd be better off buying Treasury bills.
    a. **Since 2000, there have been six other years when strategists headed into this part of the calendar year expecting negative or negligible stock returns. The market beat the projection every time, and on five occasions delivered returns of 12% or better**.
        i. On nine other occasions, they typical strategist projected significant further upside and the index ended up declining from spring through the end of the year. (Bloomberg)
2. **Shares of companies that have missed earnings expectations have fallen 2.8% (vs. the five-year average of 2.3%) – maybe due to valuation concerns**. Companies that have beaten estimates have gained ~.9% (in line with the five-year average of 1.0%). (WSJ)
3. **Walmart's revenue** of $648B last year (+6% YoY) was more than **$1.2MM per minute**. Amazon reported $575B in total revenue last year, up 12% YoY. (WSJ)

B. Trade

1. **The US will quadruple the tariff on Chinese EVs to 100% this year. Only 2% of US imports of EVs come from China.**
    a. Biden is also tripling the rate on imports of steel and aluminum. The rate on Chinese chips will be doubled from 2025, and the tariff on solar cells will be doubled this year to 50%. (FT)
2. **China accounts for ~33% of Russia's overall trade. Russia makes up only 4% of China's trade.**
    a. The Chinese yuan has overtaken the U.S. dollar in Russia's exports, while Russian companies are increasingly borrowing in yuan and households are stashing savings in it. (WSJ) (FT)
3. **While the US accounts for roughly 15.5% of global GDP (PPP), the dollar is involved in 88% of all international currency transactions.**
    a. Approximately 58% of global reserves are held in US currency.
        i. This supports a US current account deficit that favors US importers and creates markets for the rest of the world. (FT)

C. The Economy

1. **Europe is falling behind (but part of this is due to the US running larger deficits):**
    a. The number of world-class patents issued to US companies since 2000 is ~50K, to China is ~29K, to Japan is ~12K and to the EU is ~10K.
    b. US GDP is 8.7% higher than pre-pandemic levels. The Eurozone is 3.4% higher than pre-pandemic and the UK is 1.7% higher.
    c. Average per-capita income levels in purchasing-power-parity terms in Europe have fallen to one-third lower than the US. (FT)
2. **In 2023, 93,000 new single-family homes-for-rent were completed. That's an increase of 39% YoY and the most in any year ever.**
    a. This is an attempt to capitalize on steep home prices and high mortgage rates. (WSJ)
3. **Of people with credit cards, 18% are using 90% of more of their available credit. These are people who are likely to miss payments (see below).**
    a. While borrowers who were current on all their cards in Q1 had a median utilization rate of 13% in the previous quarter, those who became newly delinquent had a median rate of 90%.
        i. This is why credit utilization is an important part of credit scores – it's indicative of a likely default.
    b. About a third of balances associated with maxed-out borrowers (those using 90%+ of their available credit) have gone delinquent in the last year. (NY Fed)
4. **OPEC continues to forecast oil demand to grow by 2.2MM barrels/day this year and 1.8MM barrels/day in 2025.**
    a. The IEA only expects increases of 1.2MM and 1.1MM. (WSJ)
5. **Virginia is the largest data center market in the world >** 35% of all known hyperscale data centers worldwide are in Virginia. From 2016 to 2023, commercial power consumption rose 37%, while remaining fairly flat in most other states.
    a. GS thinks data center power demand is about equal to the capacity of all US utility-scale solar farms. (FT)
6. **The US fertility rate fell to 1.62%.** (WSJ)
7. **Global life expectancy is now 76 for women and 71 for men**.
    a. China and the US both have approximately the same life expectancy: around 82 for women and around 76 for men. But in the US, the gap in life expectancy between the richest 1% and the poorest 1% is 15 years for men and ten years for women. (FT)
8. **The American Institute of CPAs dropped its opposition to calls to reduce the amount of university education need to qualify as a CPA**. It is currently set at the equivalent of five years.
    a. Three quarters of US accountants are at or near retirement age (and the other 25% wish they were).
    b. The number of people taking the CPA exam fell from a peak of more than 100K in 2016 to a 17-year low of just above 67K in 2022.
        i. There was an uptick in 2023 due to students rushing to take the exam before the introduction of a new curriculum. (FT)

III. Geopolitics and its Impact on Global Trade and the Dollar, IMF First Deputy Managing Director Gita Gopinath (May 7, 2024) (IMF) (**Slides on final two pages**)

A. Introduction

1. After Covid and Russia's invasion, countries are revaluating trading partners based on economic and national security concerns
    a. FDI (foreign direct investment) flows are also being re-directed
    b. Countries are reevaluating their use of the dollar for transactions and reserves
2. It's good to think about economic resilience
    a. But we could reverse the gains we got from economic integration

B. The Global Backdrop

1. Trade restrictions have tripled since 2019; financial sanctions have also expanded
    a. Geopolitical risk has spiked (**Slide 1**)
    b. Private sector concerns about fragmentation have surged (earnings calls)
2. We don't actually see clear signs of deglobalization
    a. Since financial crisis, goods-trade to GDP has been relatively constant
        i. Fluctuating between 41% and 48% (**Slide 2**)
3. But there are increasing signs of fragmentation
    a. Trade and investment flows are being redirected along geopolitical lines
        i. From 2017 – 2023, China's share in US imports declined by 8%
            1. US share in China's exports dropped by 4%
        ii. Direct trade between Russia and the West has collapsed (**Slide 3**)

C. Implications of Geopolitics for Trade Relations More Broadly

1. Consider a world divided into three blocks: US-leaning, China-leaning, nonaligned
2. The average weighted QoQ trade growth between US-leaning countries and China-leaning countries during 2022 Q2 and 2023 Q3 was almost 5% lower than the average quarterly weighted trade growth during 2017Q1 – 2022Q1
    a. At same time, quarterly growth in trade within blocks only saw a 2% drop
3. After Russia's invasion, trade and FDI between blocks dropped by ~12% and 20% more than flows within blocks
    a. Numbers hold up even when you exclude the US and China

D. Why Haven't We Seen an Even Bigger Impact of Decoupling on Global Trade?

1. Some trade and investment are being re-routed through third-party countries
    a. Since 2017, greater Chinese presence in a country (measured either through exports or announced greenfield investment) has been associated with increased exports of that country to the US (**Slide 4**)
2. The emergence of these "connector" countries (most notably Mexico and Vietnam), may have helped cushion the global economic impact of decoupling
    a. Has this helped to diversify exposures and increase resilience? No telling.
    b. Will policymakers accept this or will they continue to raise barriers?

E. How Bad Could It Get?

1. Trade between the rival Western and Eastern blocs was depressed during the Cold War
   a. Currently, the reduction is an order of magnitude smaller (**Slide 5**)
2. But fragmentation is much more costly now – b/c goods-trade to GDP is 45% (vs. 16% then). In addition, back then, countries within a bloc were taking off trade restrictions; today we have growing protectionism even within a bloc.
3. Connector countries are much more important/significant today
   a. They could help reduce some of the costs of fragmentation

F. Have Geopolitical Tensions and Shifting Trade and FDI Patterns Affected the Currency Composition of Cross-Border Payments and FX Reserves?

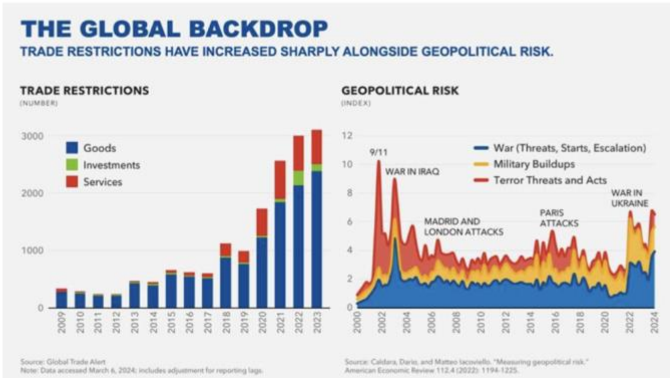
1. Not seeing much impact (**Slide 6**)
   a. Dollar accounts for over 80% of trade finance (commodity trade drives this)
   b. Dollar accounts for nearly 60% of FX reserves
2. There has been change in China-leaning countries (**Slide 7**)
   a. Dollar share of trade finance has declined; RMB share has doubled to 8%
      i. Would still be true even without Russia
3. For Chinese cross-border corporate transactions, RMB share has increased from 0 to 50% in 15 years; dollar has fallen from 80% to 50%
4. China-bloc has been increasing holdings of gold in FX reserves since 2015
   a. Likely driven by sanctions-risk; not seeing it in US bloc
5. In China, share of gold in FX reserves has increased (2% in 2015; 4.3% in 2023)
   a. Holdings of UST and agency bonds relative to FX reserves: 44% to 30%
      i. Reflects both net purchases and valuation effects (**Slide 8**)

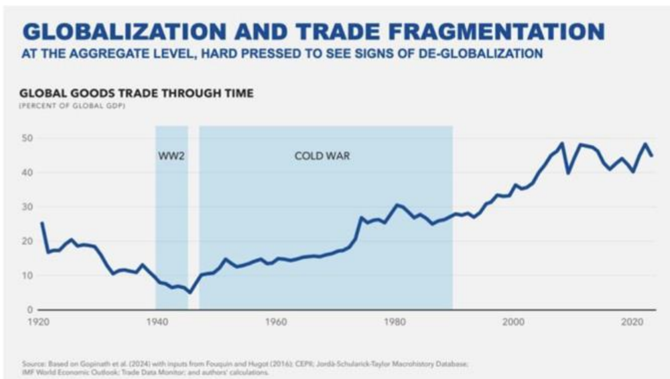
G. Implications

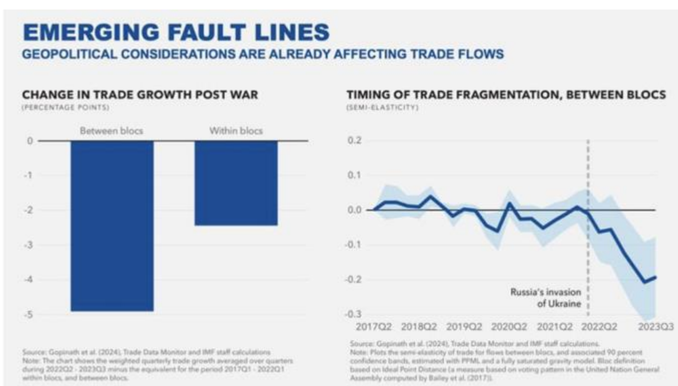
1. Trade fragmentation – could reduce gains from specialization, competition and knowledge diffusion, and limit economies of scale
2. Financial fragmentation – could reduce cross-border capital flows, hinder capital accumulation, weaken international risk-sharing and increase macro-financial volatility; global payment system and FX reserves could become more fragmented
   a. More reserve currencies could help, but you would need swap lines to be available
3. Emerging and developing economies – could be disproportionately harmed due to their dependence on FDI, commodities, and exposure to food security risks
4. Global public goods – efforts to tackle global challenges such as climate change and AI could be impeded
5. Economic losses could range from .2% of GDP to 7%

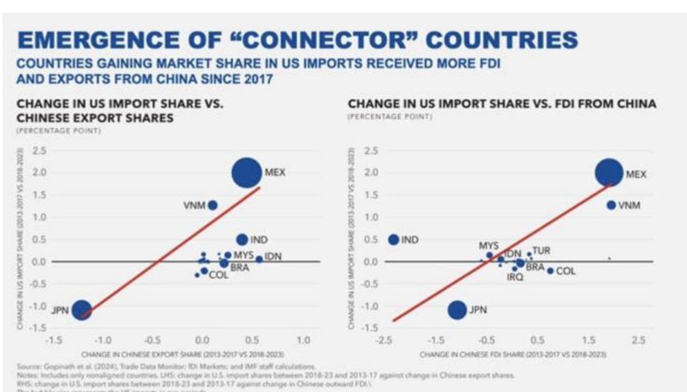
H. Solutions

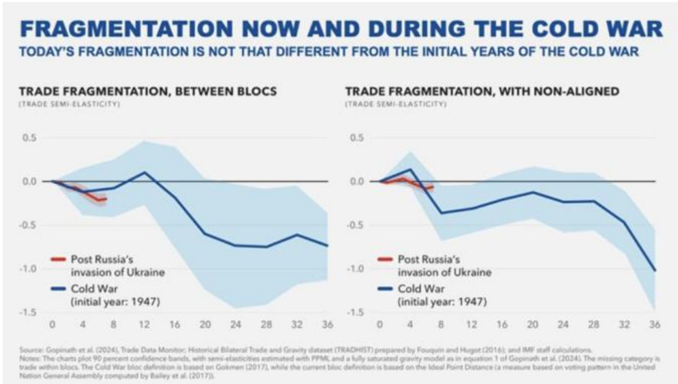
1. Need to have a robust rules-based global trading system and a resilient international monetary system
2. Need a pragmatic approach to rebuild trust: keep lines of communication open, work on areas of common interest, work with groups of interest countries, limit effects from unilateral policy actions (such as industrial policy)

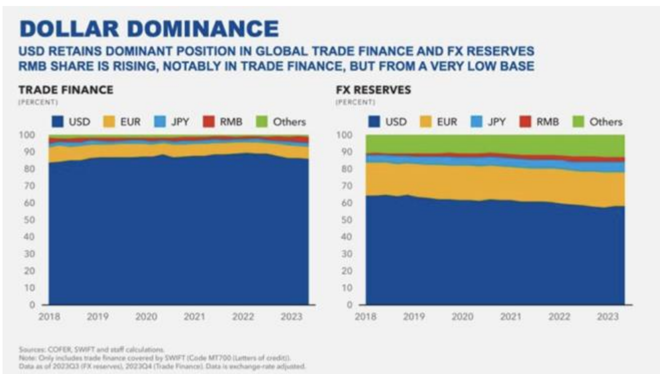
1. 
THE GLOBAL BACKDROP
TRADE RESTRICTIONS HAVE INCREASED SHARPLY ALONGSIDE GEOPOLITICAL RISK.
TRADE RESTRICTIONS
(NUMBER)
Goods
Investments
Services
GEOPOLITICAL RISK
(INDEX)
War (Threats, Starts, Escalation)
Military Buildups
Terror Threats and Acts
9/11
WAR IN IRAQ
MADRID AND LONDON ATTACKS
PARIS ATTACKS
WAR IN UKRAINE
Source: Global Trade Alert
Note: Data accessed March 6, 2024; includes adjustment for reporting lags.
Source: Caldara, Dario, and Matteo Iacoviello. "Measuring geopolitical risk." American Economic Review 112.4 (2022): 1194-1225.

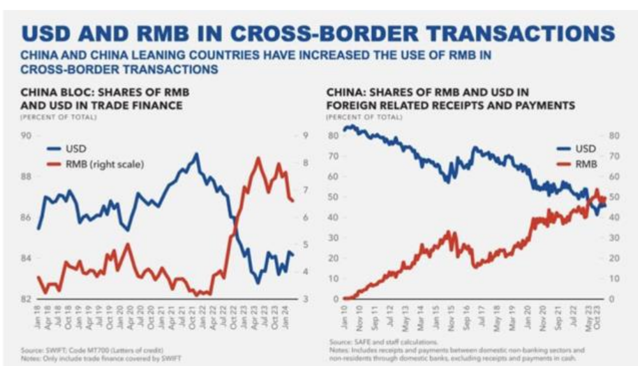
2. 
GLOBALIZATION AND TRADE FRAGMENTATION
AT THE AGGREGATE LEVEL, HARD PRESSED TO SEE SIGNS OF DE-GLOBALIZATION
GLOBAL GOODS TRADE THROUGH TIME
(PERCENT OF GLOBAL GDP)
WW2
COLD WAR
Source: Based on Gopinath et al. (2024) with inputs from Fouquin and Hugot (2016); CEPII; Jordà-Schularick-Taylor Macrohistory Database; IMF World Economic Outlook; Trade Data Monitor; and authors' calculations.

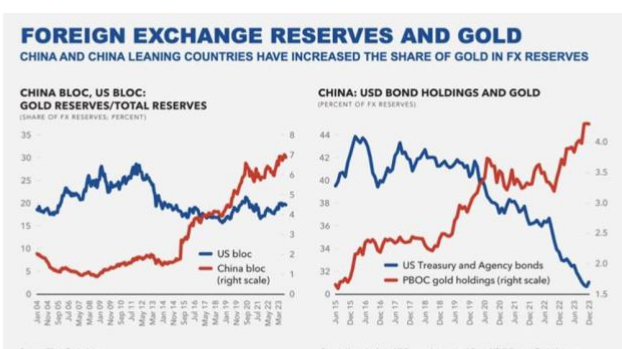
3. 
EMERGING FAULT LINES
GEOPOLITICAL CONSIDERATIONS ARE ALREADY AFFECTING TRADE FLOWS
CHANGE IN TRADE GROWTH POST WAR
(PERCENTAGE POINTS)
Between blocs
Within blocs
TIMING OF TRADE FRAGMENTATION, BETWEEN BLOCS
(SEMI-ELASTICITY)
Russia's invasion of Ukraine
Source: Gopinath et al. (2024); Trade Data Monitor and IMF staff calculations.

4. 
EMERGENCE OF "CONNECTOR" COUNTRIES
COUNTRIES GAINING MARKET SHARE IN US IMPORTS RECEIVED MORE FDI AND EXPORTS FROM CHINA SINCE 2017
CHANGE IN US IMPORT SHARE VS. CHINESE EXPORT SHARES
(PERCENTAGE POINT)
CHANGE IN US IMPORT SHARE VS. FDI FROM CHINA
(PERCENTAGE POINT)
MEX
VNM
IND
MYS
IDN
BRA
COL
JPN
TUR
IRQ
CHANGE IN CHINESE EXPORT SHARE (2013-2017 VS 2018-2023)
CHANGE IN CHINESE FDI SHARE (2013-2017 VS 2018-2023)
Source: Gopinath et al. (2024), Trade Data Monitor; fDi Markets; and IMF staff calculations.
The bubble size represents the US imports in pre-periods.

5. 
FRAGMENTATION NOW AND DURING THE COLD WAR
TODAY'S FRAGMENTATION IS NOT THAT DIFFERENT FROM THE INITIAL YEARS OF THE COLD WAR
TRADE FRAGMENTATION, BETWEEN BLOCS
(TRADE SEMI-ELASTICITY)
TRADE FRAGMENTATION, WITH NON-ALIGNED
(TRADE SEMI-ELASTICITY)
Post Russia's invasion of Ukraine
Cold War (initial year: 1947)

6. 
DOLLAR DOMINANCE
USD RETAINS DOMINANT POSITION IN GLOBAL TRADE FINANCE AND FX RESERVES
RMB SHARE IS RISING, NOTABLY IN TRADE FINANCE, BUT FROM A VERY LOW BASE
TRADE FINANCE
(PERCENT)
FX RESERVES
(PERCENT)
USD
EUR
JPY
RMB
Others

7. 
USD AND RMB IN CROSS-BORDER TRANSACTIONS
CHINA AND CHINA LEANING COUNTRIES HAVE INCREASED THE USE OF RMB IN CROSS-BORDER TRANSACTIONS
CHINA BLOC: SHARES OF RMB AND USD IN TRADE FINANCE
(PERCENT OF TOTAL)
USD
RMB (right scale)
CHINA: SHARES OF RMB AND USD IN FOREIGN RELATED RECEIPTS AND PAYMENTS
(PERCENT OF TOTAL)
USD
RMB

8. 
FOREIGN EXCHANGE RESERVES AND GOLD
CHINA AND CHINA LEANING COUNTRIES HAVE INCREASED THE SHARE OF GOLD IN FX RESERVES
CHINA BLOC, US BLOC: GOLD RESERVES/TOTAL RESERVES
(SHARE OF FX RESERVES; PERCENT)
US bloc
China bloc (right scale)
CHINA: USD BOND HOLDINGS AND GOLD
(PERCENT OF FX RESERVES)
US Treasury and Agency bonds
PBOC gold holdings (right scale)