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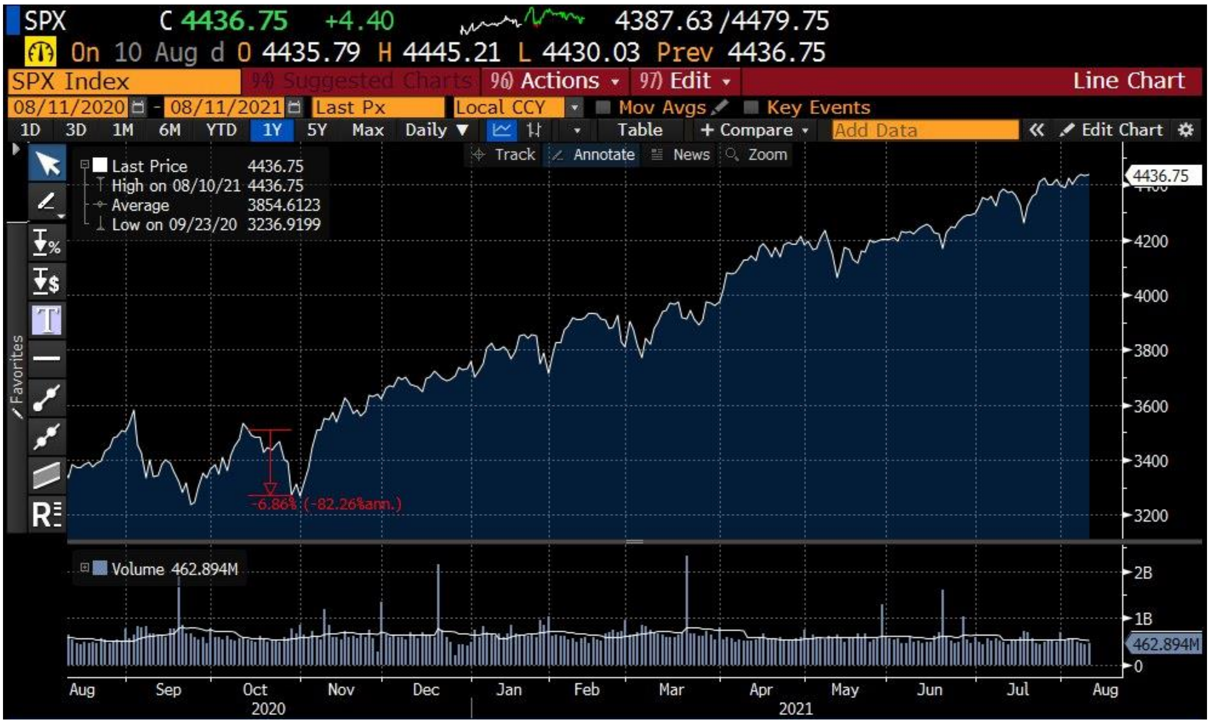
When have we observed a drop of more than 5% in the S&P 500?

The answer is – last year in September and October. Will history repeat this year? As figure 4 shows it would be a normal reaction to see some pullbacks during the 2nd half of August. But we do see a lot of complacency around us. The CNBC fear and greed index is still in the fear area, although we have seen rising markets all over the globe.

US treasury markets have seen a selloff after the stronger than expected US job report. After the weekend, accompanied by a stronger USD gold lost in a mini flash crash more than 6% intraday during the Asian trading hours. The latest US inflation data is a touch lower than expected and especially below the previous month data. Equity and gold have reacted positively, while treasury bond prices have risen due to slightly lower yields.

Fig. 1: Since November 2020 there was no pullback bigger than 5% in the S&P 500



Are European shares finally breaking out of their value trap? Based on the risk premia Europe continues to be cheaper than the US. However, that was the case for most the time since March 2009 , when this equiy bull-in has started. But this earnings season was not only strong in the US but also extremly strong in Europe. For both markets the PE ratio has fallen while equity markets went up. Maybe finaly we do see a continuation of the catch up rally of Europe equities. The fiscal stimulus and money printing will support european markets. We therefore expect Euopean markets to do well in 2022. But only if there is no sharp correction in the US, which we do not expect. Therefore it might continue to be a close race between MSCI Europe and MSCI USA like it has been since the beginning of the year. It is noteworhty that measured in USD Europe has still slightly underperfomed the broad US index. If you compare Europe with the Nasdaq 100 performacne the picture is upside down, i.e. Europe is ahead.

Fig. 2: European and US risk premium

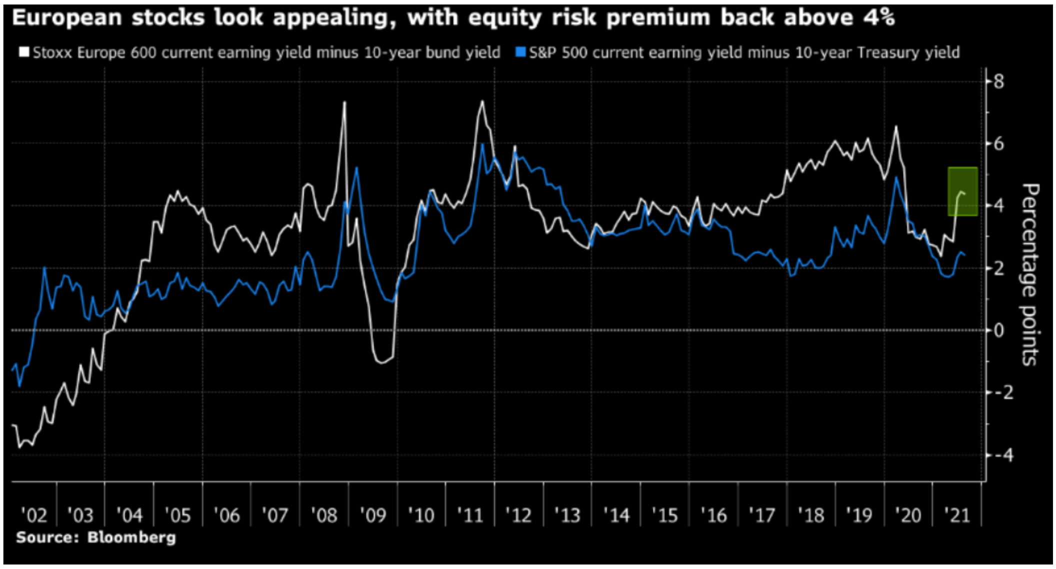
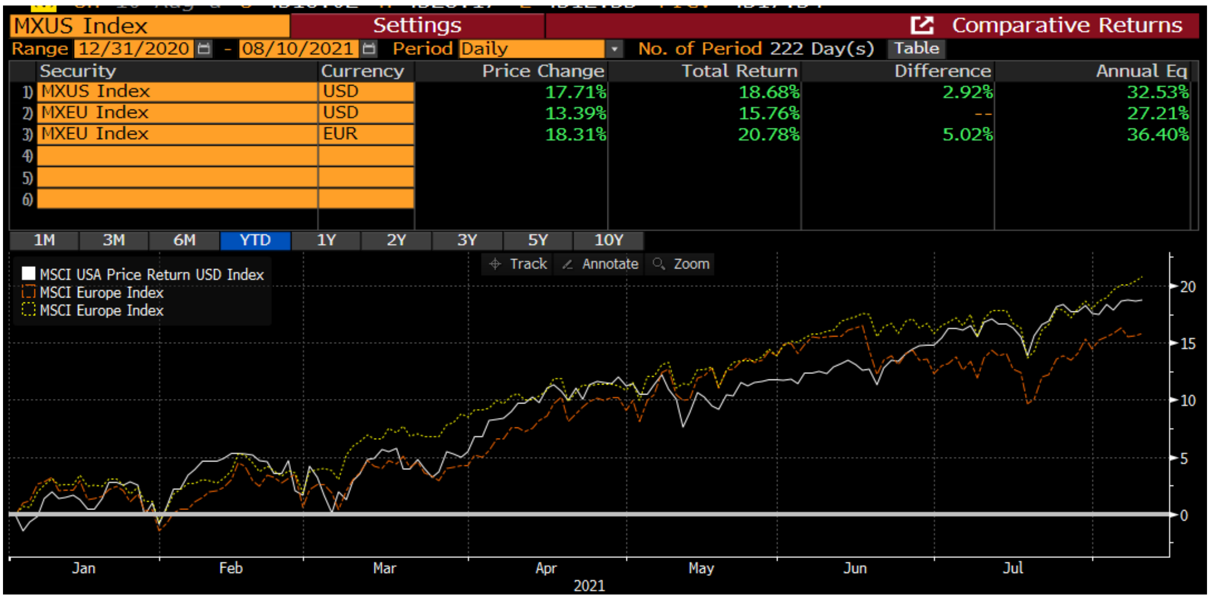


Fig. 3: Strong earnings growth in Europe has pushed markets up while the PE ratio contracted

Fig. 4: S&P 500 seasonality price cluster

Fig. 5: Measured in USD European equites did slightly underperform the MSCI USA



The key for the next weeks will be where are US yields heading for. After the latest US CPI data, which were lower than one month ago we did see some positive reactions in various markets. However, the PPI data comes shortly after CPI and we might be surprised. Intraday treasury 10-year yield dropped by 5 basis points, which helped gold to stay on a slow but steady recovery path. But these moves can be short lived.

Fig. 6: 10-year treasury yields have risen sharply over the last 5 trading days

Fig. 7: Gold reacted to the lower CPI data but still trades far below the 1'800 threshold

Therefore, the new narrative is deceleration of US inflation, and the Fed might be right with its narrative that inflation is transitory (i.e., temporary). This gives more support for equites and especially for long duration stocks like the tech sector.

The elephant in the room is the US treasury bond market and the development of its yield. US 10-year real yield keeps being in the negative which nudges investors into risky assets. Nobody knows when we see a pullback, but due to the parked on the sideline liquidity we do believe that any weakness in coming weeks will be used to buy the dip.

Overall, you should stay invested and be globally diversified. Asian equity and bonds might mean revert as they have significantly underperformed the rest of the world. European equites should continue to perform well, but only if the US is not correcting sharply.

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