

An Unusual Friday

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Friday was a most unusual day in markets for a number of reasons:

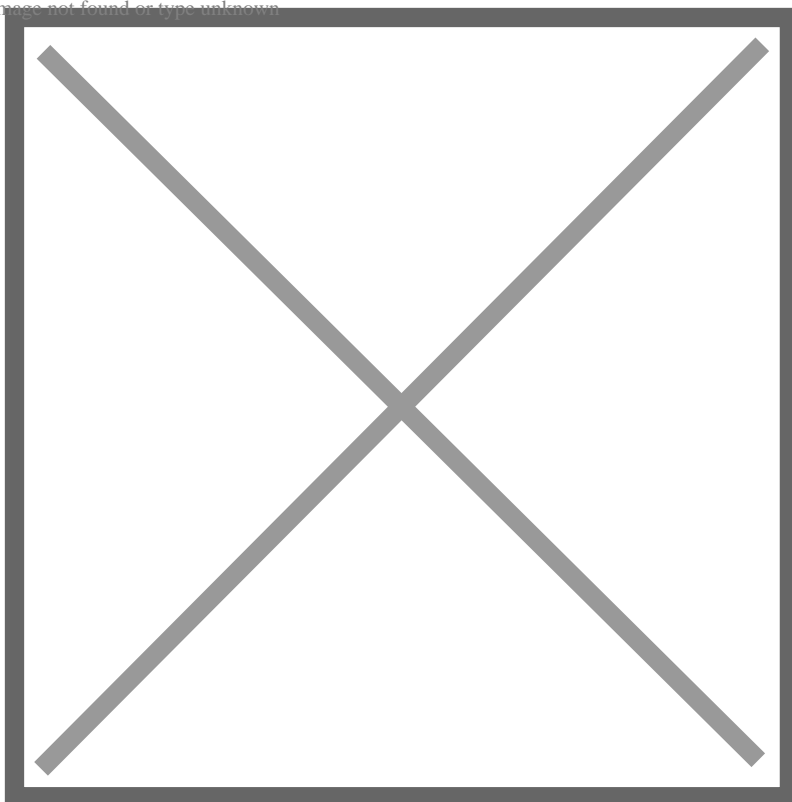
- The US payroll report for January exceeded even the most optimistic forecasts. Without belaboring the point, almost every single category of US employment topped expectations, pointing to a job market that remains very tight, especially for construction workers, blue collar workers and other categories where individuals have a high tendency to spend the money they earn.
- The Atlanta Fed posted a very strong upward revision to its Now GDP forecasts, indicating a US growth rate of 4.2% for the current quarter.
- After posting strong numbers, Amazon and Meta soared higher. A little over a year ago, Meta's share price stood at US\$88 a share but on Friday, it gained some US\$80 a share! The resulting US\$178bn jump in its market capitalization was the fourth biggest absolute increase by a US firm (Amazon had the biggest jump in February 2022, followed by Apple in November 2022 and Nvidia in May 2023). To put things in perspective, on Friday Meta added a Disney's worth of market cap (see chart overleaf).
- Thanks to the gains in Meta and Amazon, the S&P 500 rose 1.1% on Friday. However, the broader market did not fare as well, since two stocks fell for each one that rose. Thus, while the S&P 500 had a very strong day, the Russell 2000 actually fell -0.6%. Aside from the day that followed the 1987 crash, this was the only time that the S&P 500 has registered a gain of more than 1% with more than two thirds of its constituents falling.
- Yields on 10-year US treasuries gained 14bp and moved back above 4%. So along with a bad day for the median stock and smaller-cap indexes, investors also had to contend with a bad day for bonds. It was one more day in which US bonds failed to cushion the equity market pain.

Checking The Boxes

Our short take on the latest news

Fact	Consensus belief	Our reaction
US nonfarm payrolls grew 353K in Jan , from an upwardly revised 333K in Dec	Much stronger than expected 180K payroll growth in Jan; Dec revised up from initial 216K	The US is clearly in the midst of a disinflationary boom scenario, at least for now
US avg weekly hours worked fell to a post-pandemic low of 34.1 in Jan , from 34.3 in Dec	Worse than expected hold at 34.3, but could be due to poor weather in Jan	This boosted avg hourly wages; but too soon to call a change in downtrend (could be weather)
France industrial production rose 1.1% MoM in Dec , from 0.5% in Nov	Above 0.2% exp; IP rose 0.9% YoY from 0.4%	Exaggerated by seasonal issues, but French IP is under less pressure than German IP
Brazil industrial production rose 1.0% YoY in Dec , from 1.3% in Nov	Better than the expected 0.1% growth	Brazil's output is rebounding after a 2015 recession and then Covid knocked it below trend

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So where does all this leave us?

- 1) The US equity market has become hyper-concentrated. On the plus side, it is no longer just about Microsoft and Nvidia, as investors can now also add Meta among a few names making new highs. Moreover, with its new-found momentum, Amazon could join this elite group. However, Tesla continues to head lower, while Alphabet and Apple are struggling to make new highs. I may be mistaken but it feels as if the release of the Apple goggles is the first time for a while that Apple launched a new product amid such indifference? In the past, such releases triggered fanfare in front of Apple stores and much excitement in the market.
- 2) Such concentrated performance is usually not healthy. If the recent breakout is thus to mark the start of a new bull market, it will surely have to broaden from the handful of names listed

above. Such a possibility seemed likely in November and December, but in January, equity markets have returned to their concentrated ways.

3) The strong payroll numbers slashed the odds of a March interest rate cut. Still, the market seemed to take this in its stride in part because—as per Jay Powell’s 60 minutes interview on Sunday—the Federal Reserve is still signaling that cuts should occur by the summer. But also because, fundamentally speaking, job growth and continued economic expansion is broadly good news for many firms (if not for bonds). There is, after all, no better environment for equities than a “disinflationary boom”. This brings me to possibly the greatest risk for US equities in the coming period: **the threat of stronger-than-expected inflation.**

Indeed, while bonds find it hard to brush off strong economic data, equities are happy to do so. But can the same be said for inflation? The poor performance of both bonds and equities in 2022 probably answers this question. This leaves us with a fairly simple decision tree. If US inflation data continue to decelerate in the coming weeks and months, equity investors may cheer the unfolding disinflationary boom. Equity markets can then broaden out and enjoy a best-of-all-worlds scenario that Dr. Pangloss himself would have embraced. However, if US inflation data follow the lead of US growth data and also surprise on the upside, long-dated bonds will likely sell off further and the recent breakout in US equities will probably go down as a “fake” episode only involving a few names. With this in mind, reducing risk into the upcoming consumer price index data release on February 13 may make sense. Any reading that comes in above expectations would likely spook markets that now seem to have become heavily imbalanced.

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