RBC BlueBay Asset Management

Market Commentary

Roaring kitty, purring markets

The 'meme stock' phenomenon was back with a bang this week…

17 May 2024 (London): An in-line US CPI release helped fixed income yields and risk assets to rally during the course of this week. Core prices gained 0.3% in April, raising hopes that inflation may resume its downtrend after several months of data disappointment in Q1.

That said, quite a lot more additional data will be required before the FOMC is likely to feel comfortable to start cutting rates. In that sense, there is some relief not to see another negative data surprise, but there is not much scope to get too complacent on inflation just yet.

Meanwhile, softer retail sales data add weight to recent anecdotal observations, suggesting some slowing of consumer demand. If this plays out, some further moderation in price pressures may follow, and this has also helped to support market moves.

However, if activity does slow more materially, then risks assets may walk a bit of a tightrope, lest fears for a 2025 recession start to bubble up to the surface.

European markets have continued to take their lead from the US over recent weeks. Klaas Knot, speaking at the EBA Forum this week, further underlined the idea that a June cut by the ECB is now a done deal. Thereafter, there is a sense that Lagarde may want to cut rates once per quarter. Yet after lowering rates by 50bps, further policy easing may become contingent on US policy also moving in the same direction at that time.

Meanwhile, much debate around the need for co-ordinated fiscal spending continues to circulate within the EU. This is a topic Mario Draghi that has been pushing recently, in the context of the EU needing to come together to meet needs around its own security, as well as investing to meet increased global competition.

However, it is not clear that the EU populous is ready for more Europe at the moment. On that note, even last weekend's Eurovision song contest was notable in terms of the amount of protest and division.

This theme is also demonstrated in Gert Wilders' 'Party for Freedom' securing its place in the new Dutch coalition government, despite earlier suggestions that other parties would not co-operate with the far-right, populist movement.

At a time when political opinion is quite fiercely divided, it may be more challenging for consensus on broader fiscal initiatives or moves towards a more federal United States of Europe, to be able to flourish.

This week's assassination attempt on the Slovak Prime Minister also speaks to some of these tensions within EU member states and although the notion of Draghi himself taking on a role as EU president could give a more ambitious agenda a bigger push, there remain many obstacles towards progress at a national level.

Meanwhile, prospects for Russia to break line in Ukraine and post significant advances, could be a catalyst for increased solidarity. However, even this could start to quickly fade if it prompts renewed widespread migration flows across borders.

Gilt yields have also moved lower in the past week, following on from increased hopes for a June rate cut from the BoE, in the wake of the MPC's policy meeting last week. However, this week's labour market data, which showed wages continuing to grow at a 6.0% pace, must be an ongoing concern for the BoE, at a time when the UK continues to suffer from very low growth in worker productivity.

Next week's UK CPI print will be important, and we see a risk that this declines by less than many have hoped for. This could place enthusiasm for rate cuts onto more of a back burner, especially with recent growth data having actually managed an upside surprise.

Elsewhere, JGB yields bucked the trend and pushed higher over the week, as the BoJ announced a reduction in the size of its regular bond purchases. We think that much more will be needed from the BoJ in terms of policy normalisation, though this week's move at least suggests that the policy committee is becoming more attentive to yen depreciation and the impact this has been having.

In FX, the dollar has traded softer over the course of the week, as US yields have declined. However, the yen continues to find it difficult to make headway, with the Japanese currency moving close to a new historic low versus the euro in the past week.

Elsewhere, credit spreads continued to grind tighter following the week's data, with equity indices melting upwards. There was renewed interest in meme stocks, with the eponymous GameStop seeing a temporary 300% surge in its stock price, once again, largely thanks to a cryptic pictorial tweet from the legendary 'Roaring Kitty'. However, these trends seem to have more in common with short-term gambling and speculation rather than investing, and other asset prices have not been much affected.

Looking ahead

In the coming week, the data calendar is relatively light. Inflation data in the UK and Japan is likely going to be a focus of attention for us. However, in the US, markets may await their next catalyst for direction. Rates appear fairly priced, though with stocks already sitting at all-time highs, it is not clear that there is enough impetus for the time being for price action to break substantially higher, unless those positioned more defensively are pushed to capitulate.

As risk asset prices continue to rally, we think it will be appropriate to maintain discipline and look to reduce exposure on strength. Strong technicals are helping corporate bond spreads, though this same dynamic does not hold true for CDS, where the lack of relative supply is not a driver in the same way.

That being the case, maintaining CDS hedges and running basis risk on cash corporate bonds remains relatively appealing to us. Yet away from this, there is a sense that not too much is changing and markets are still in wait-and-seemode.

In a way, for market direction to move in a more extreme way would have required either a much higher, or a much lower, monthly CPI read. Instead, data has been pretty much straight down the middle of the fairway, and markets have responded with some genteel applause in the background. Kitty may be roaring again for a while, but for the time being, it is more the sound of markets purring along in contented fashion.

Notes to Editors

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