

Global stocks, PH bonds fall on rising inflation, Delta variant

19 July 2021

- Equities broadly underperform with US, EU and PH uniformly lower on rising delta-variant cases affecting demand and runaway inflation in US.
- UST mounts sharp rebound on risk-off sentiment after high June CPI print. PH bonds diverge vs. UST on Fitch downgrade of outlook to negative.
- US June retail sales growth beat expectations, but consumer sentiment starts to temper on worsening inflation picture. Fed may be out of touch.

US and EU bourses close last week broadly lower on rising delta variant cases and quickening inflation concerns.

- US equities broke a three-week winning streak last week on rising inflation and the spread of the highly transmissible delta-variant (of Covid-19). Particularly hard-hit was the energy sector, owing to expected downturn in demand from renewed hard lockdowns, canceling out promising early retail sales and 2Q/1H earnings growth trends. The Dow Jones, S&P and Nasdaq ended last week uniformly lower, down -0.52%, -0.97% and -1.87% week-on-week, respectively. Volatility rose sharply with the VIX up 14.03% WoW as the 10-Yr UST reflected the shift to risk-off, narrowing 1 basis point to 1.3%.
- In Europe, equity markets were similarly soft on poor 2Q/1H corporate results coloring forward expectations on the fragile economic recovery in the Eurozone. Rising Covid-19 infections, this time of the Delta variety, has forced the re-imposition of lockdowns in some countries, caused commodity-related names to de-rate, as was in the US, while defensive sectors ended the week on firm ground. The FTSE, DAX, STOXX 600 and CAC were uniformly lower, down -1.6%, -0.94%, -0.99% and -1.32%, week-on-week, respectively.

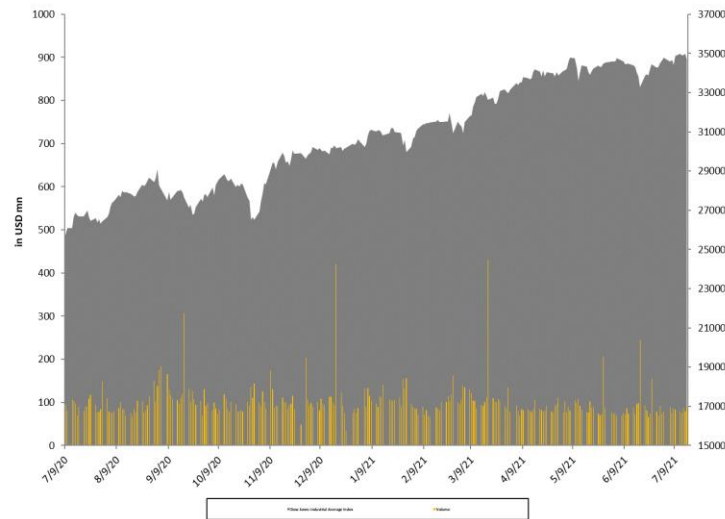
Source: JP Morgan

US retail sales growth in June beat expectations, but sentiment clouded by specter of runaway inflation. CPI a key concern in 2Q.

- US retail sales of discretionary goods, ex-automobiles, rose 1.3% y/y in June, nearly thrice the consensus expectation. Inclusive of durables, retail sales were up 0.6% y/y, still bucking expectations of a 0.4% decline. However, downside risks to this trend became apparent with University of Michigan consumer sentiment index sliding to 80.8 in July vs. 85.5 in June, a possible leading indicator of future softness. The main drag to consumer outlook was runaway inflation.
- The Fed, for its part, has downplayed the risk of inflation, but this is in stark contrast to the far less sanguine view of companies, who've noted inflation was a persistent concern and theme in earnings results investor calls so far in 2Q reporting season. In Europe, results so far have disappointed while inflation remains well in hand with the June print moderating to 1.9% from 2% in May.

Source: JP Morgan

Chart 1 - Dow Jones Industrial Index



Source: Bloomberg

Interest rates				
USD	16-Jul-21	09-Jul-21	29-Dec-20	+/-
UST 2Y	0.22	0.21	0.13	0.01
UST 5Y	0.77	0.79	0.38	(0.01)
UST 10Y	1.29	1.36	0.94	(0.07)
UST 20Y	1.84	1.91	1.47	(0.07)
UST 30Y	1.92	1.99	1.68	(0.07)
ROP 3Y	0.48	0.40	0.44	0.08
ROP 4Y	0.62	0.61	0.48	0.01
ROP 9Y	1.90	1.92	1.52	(0.02)
ROP 10Y	1.94	2.00	1.52	(0.06)
ROP 24Y	2.98	3.00	2.59	(0.02)
PHP	16-Jul-21	09-Jul-21	29-Dec-20	+/-
2Y	1.68	1.70	1.91	(0.02)
3Y	2.29	2.34	1.86	(0.04)
4Y	2.58	2.55	2.33	0.03
5Y	2.57	2.60	2.48	(0.02)
7Y	3.61	3.58	2.92	0.03
10Y	3.72	3.65	2.87	0.07
11Y	3.83	3.70	2.95	0.12
20Y	4.71	4.93	3.93	(0.22)
20Y*	4.75	4.80	3.94	(0.05)
USDPHP	50.235	50.080	52.580	0.155

Source: Bloomberg

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Philippine Equities

- The local equities bourse closed the week markedly lower, sliding -2.1% w/w to 6,693.83, mostly on the back of twin headwinds of the Fitch downgrade and the DoH's announcement of the first set of locally transmitted Delta-variant Covid cases. Investors trimmed risk this week upon credit-watcher Fitch's downgrade of the Philippines outlook from stable to negative, citing further financial stress as the government's battle with the pandemic goes on its second year. The DoH, meanwhile, announced the discovery of at least sixteen, highly contagious, delta-variant cases. Of these, eleven were through community transmission. The total number of known delta-variant cases to have existed domestically is now 35. As a counterweight to the bad news, OFW remittances grew 13.3% y/y in May to \$2.7Bn, the fastest since November 2016. Also, another 1 million (out of 2.5Mn due this week) Sinovac vaccines arrived last July 14th.
- For this week, investors will continue to monitor the rate of change in new daily COVID-19 cases as well as the progress of the vaccine rollout and track further news on the worrisome delta variant. As of last Friday, 13.8Mn people were at least partially vaccinated and 184.4Mn doses have been ordered, of which 21.8Mn have already been delivered. The primary risk at this point is a possible return to hard lockdown due to the highly infectious delta variant. On the macro front, the June Budget Balance and Money Supply figures are due out this week.

USD fixed income

- 10Y Treasury yields hit a high of 1.42% on a higher-than-expected June CPI print, before posting a strong rally to end the week at 1.29% on the back of dovish Fed statements and rising COVID concerns globally. ROPs ended the week wider by 5-10 bps after Fitch downgraded the country's outlook to negative.

PHP fixed income

- Local bonds took a hit with the Fitch announcement, but losses were kept to 2-5 bps WoW in 3-10Y tenors. The new 20Y bond rallied from 5.125% to 4.8%, leading to a bull steepening of the curve at the end of the week.

Outlook for the week

Stock market

- We expect the PSEi to sustain its weakness in the week ahead as investors turn risk-off amid fears of a Delta variant breakout in the Philippines and globally. A re-test of the 6,500 is likely as foreign flows remain in the outflow especially in the face of a weakening PHP. On the other hand, we still expect stocks with strong expected 2Q21 earnings results to be resilient in the coming sessions.

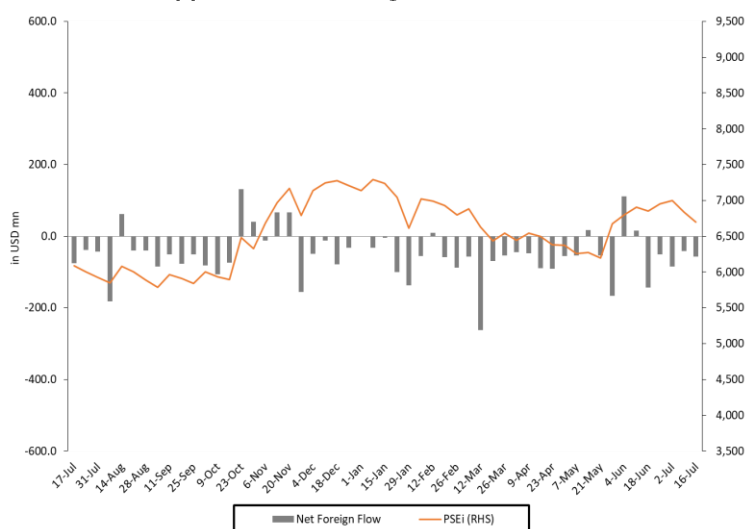
USD fixed income

- 10Y Treasury yields may challenge 1.20% support on the lack of firm direction from Fed with regards to tapering and increase in risk-off sentiment on growth concerns and COVID-related headlines.

PHP fixed income

- Weak PHP and supply concerns to cap rallies in the long-end despite rally in Treasuries. Market is looking at 10Y auction scheduled on Wednesday for further guidance.

Chart 2 - Philippine Stock Exchange Index



Source: Sun Life Financial Philippines

Sectors: Mining and Oil -0.47%, Services -0.63%, Financials -1.63%, Industrial -2.08%, Holding Firms -2.77%, Property -2.85%

Leaders: JFC +3.4%, ICT +2.4%, FGEN +1.5%, JGS +1%, MPI +0.8%

Laggards: LTG -10.3%, RLC -8%, MEG -5.4%, BLOOM -5.1%, SM -4.4%

Source: Bloomberg, The Philippine Stock Exchange