Strategy

# JefMacro Weekly—1H Contraction; Beginning of the End, or Pause That Refreshes?

July 31, 2022

## Key Takeaway

**Zervos thinks Powell has taken a risk with dovish tone after meeting. However, summer squeeze higher for equities has room to run. GREED & fear thinks ECB meeting was historic, marked commencement of direct involvement in domestic politics & fiscal policy of individual economies. Aneta is not in recession camp, judging from rate cuts priced into curve, consensus expects 1H contraction in output will lead to cycle of layoffs and recession. Not the likely path.**

**David Zervos**—Jay just took a fairly aggressive calculated risk with his credibility. And if inflation breakevens or the inflation expectation surveys data start to jump, we will quickly see a change in Jay's tone. For now, though, with two consecutive quarters of negative growth in place and a dovish dumping of forward guidance, **the summer squeeze looks like it has some more room to run.**

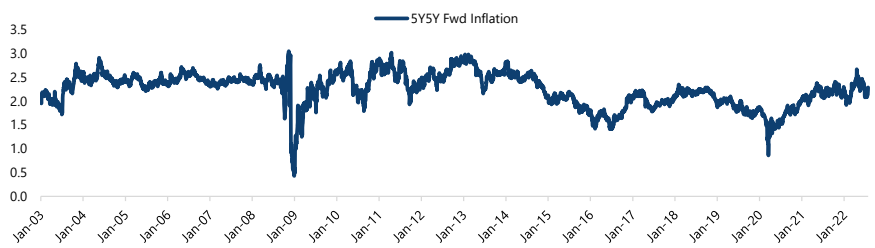
**GREED & fear**—The ECB meeting was historic, as it marked the commencement of an ever more direct involvement into domestic politics and the fiscal policy of individual economies. The ECB unveiled the Transmission Protection Instrument (TPI), and much-anticipated anti-fragmentation tool. This is the latest instrument for ECB bond buying even though it was announced at the same time as the ECB ended negative rates, while also abandoning the practice of "forward guidance".

**Aneta Markowska**—GDP may have contracted for two quarters, but the US economy is not in a recession. The output contraction did not result in job losses, spending cuts, or earnings declines. Judging from the rate cuts priced into curve in '23, consensus expects that the 1H contraction in output will lead to a full-blown cycle of layoffs and snowball into a real recession fairly quickly. **In our view, that's not the most likely path.**

**Sherif Hamid**—The supply/demand picture is supportive into August, particularly for US HY. We would continue to harken back to the idea that the middle of the trade is tricky, with valuations no longer quite as cheap nor sentiment quite as negative.

**Desh Peramunetilleke**—We believe value will take a backseat amid slowing earnings and a challenging macro environment. We prefer quality stocks and continue to favour DM over EM, stick to our Asian country call of OW Australia, India and Asean. We would focus on QARP, dividend growers and FCF-backed unlevered high dividend yield stocks.

**The key metric to watch to confirm the pivot, the 5Yr/5Yr inflation breakevens**




Source: FRED Data; Jefferies

# JefMacro

**The JefMacro Weekly is the accumulation of this week's best Macro research.**

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^Prior trading day closing price unless otherwise noted.

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