Strategy

JefMacro Weekly—What Do Profits Tell Us About Business Cycle; The CPI We Wanted

August 13, 2022

Key Takeaway

GREED & fear remains cautious and would fade rally in reversion trade. Inflation will remain more persistent than expected, prompting more Fed action. GREED & fear remains Bullish Energy. As for credit, we think selling BBs and buying both BBBs and lower quality HY makes a lot of sense. We would be reducing overall spread risk into strength. On back of CPI report, Global Strategy made sector shifts including Bullish Fin'ls, Discretionary, Bearish Health Care.

GREED & fear—If the US labor market seems on the face of it surprisingly healthy, look under the bonnet and there is growing evidence of weakness. *GREED & fear*'s base case is growing evidence of US economic weakness in coming quarters, signaled by yield curve inversions. *GREED & fear* wants to maintain exposure to Energy. There is no doubt that the oil price would be higher were it not for China's Covid suppression policy.

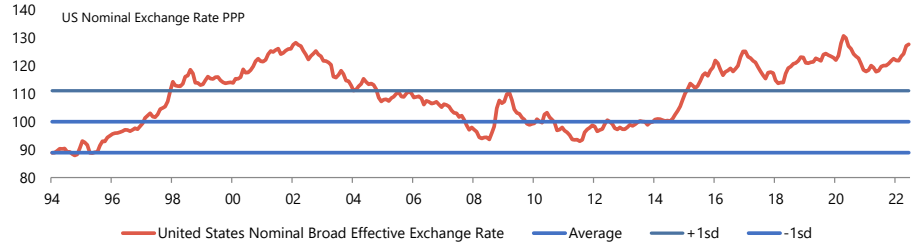
Aneta Markowska—The bear case for economy has been built on the assumption that the 1H output and productivity contraction will lead to a layoff cycle, which sets off recession. There is a hole in this argument: pricing power offsets productivity weakness, leaving profits & margins intact. Margins will compress modestly in 2H, and intensifies in '23 once Fed pushes rates deeply into restrictive territory, and labor market slack is exhausted. This sets off a recessionary dynamic around Q3'23.

Sherif Hamid—We continue to think selling BBs and buying both BBBs and lower quality HY makes a lot of sense. We would be reducing overall spread risk into strength. We think we could continue to squeeze during the latter half of this month, and would use strength from here to there to move to a small short going into the Fed's Jackson Hole conference.

Global Strategy—We move to Bullish for Fin'ls. We lower our weighting of Health Care to Bearish. We believe dollar has peaked, and this has been reflected in our Japan basket recommendations. We continue to like Gold Mining stocks on the basis that the Fed will find it hard to get back to 2% inflation. The drop in gasoline prices, long-term rates, and CPI is excellent news for the Consumer. We lift Consumer Discretionary to Bullish.

Steven DeSanctis—Small caps have pushed past large in the YTD race. The rally has come despite flows into the size remaining non-existent, so the next leg of the rally could be driven by interest from non-traditional owners of small caps. Secular growth had their day in sun; now its time for the Cyclicals to lead the way.

On most measures, the US Dollar is over-valued—20% on PPP



Source: Bloomberg, 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.

Please refer to Jefferies important disclosure here.

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