

Good MornING Asia - 5 February 2018

The sell-off in bond and equity markets shows few signs of abating just now, with last Friday's high wages shock in the US labour report pushing at an open door with respect to market sentiment



Wages pushing at an open (bond) door - but not that unusual

Admittedly, wages growth in the US has not been this strong (2.9%YoY) since mid-2009, though shortly after this point, it fell off a cliff and by the end of that same year, was running below 2%. Also, we have been fairly close to this growth rate a number of times, hitting 2.8% twice in the last 12 months, and 2.7% also. From memory, we might also have hit 2.9% - though these wages figures have a nasty habit of being revised (always) down, so this is clearly a risk in the months ahead. That said, after warnings that the survey timing might bias the reading down, it certainly was a positive surprise and may limit downwards revisions.

The wages data also tee-up new Fed Chair, Jerome Powell nicely for a March rate hike - and make it look more likely that our house forecasts of three rate hikes this year from the Fed has some upside risk - we should now probably say "three to four hikes". Futures markets are still not quite there yet, and as this slowly gets priced in, that should keep the front end of the yield curve marching relentlessly higher.

The week after payrolls is usually a quiet one for macro releases, especially in the US. But that doesn't mean that it will necessarily be a quiet one for markets, with the lack of data adding to, not necessarily reducing any volatility.

First - momentum to dominate

What happens now is going to depend on market sentiment, not hard data. In the short term, we imagine, markets having become rather stretched (Yellen makes this point too in her parting comments), momentum likely favours a further unwinding of bonds and equities. Speculative positioning, for example in the EUR had become extreme, no doubt the same could be said for other correlated assets. So bond yields could go a bit higher, though this could be tempered by very aggressive declines on the equity market. In the backdrop of higher yields, and a steepening US curve relative to the Eurozone, the dollar could also make some further gains, and Asian currencies will likely remain on the back foot - a number, SGD, KRW, IDR to name a few, have already seen notable slides already against the USD.

Then, value to become the new driver

But there will come a point, and this is probably not too far away, when investors start to look at markets again with a view to picking up bargains. Valuation is a relative, not an absolute strategy, and there is still a lot of money in the wings waiting to be invested. It may require some further declines first before this starts to dominate trade flows, but as prices decline, the value investors should start to push back and we don't think it will be too long before we see equities, the EUR, and Asian FX moving higher again.

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