

Daiwa's View

Will price movements start to factor in US economic slowdown?

- Financial Conditions Index implies substantial slowdown in 2H

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp



Daiwa Securities Co. Ltd.

Financial Conditions Index implies substantial slowdown in 2H

Will price movements start to factor in US economic slowdown?

◆ Significant drop in US long-term yield

Last night, the US long-term yield declined substantially to 4.85%. After the yield declined to 4.91% led by short covering at the end of last week, it rose temporarily above 5% once again due to selling. However, the yield posted a substantial drop again during New York trading hours on Monday led by short covering. These price movements could be interpreted simply as fluctuations in the term premium. However, we may need to be aware of the possibility that another story has started. This is because the US Financial Conditions Index has deteriorated to 100.7 due to the recent rise in yields, wider corporate bond spreads, the stronger dollar, and lower stock prices. The US GDP growth rate tends to follow this index with a 3-month time lag.

◆ US economic indicators are likely to worsen

Yesterday, the media reported that well-known US investor Bill Ackman covered US Treasury short positions, saying, "the economy is slowing faster than recent data suggests." His opinion is supported by the recent deterioration in the US Financial Conditions Index—the index suggests a decline in the growth rate to 1% or lower. In any case, if there were to be a revision to the still widely held view that the US economy is solid, it is not hard to imagine that that would have an influence on the Fed's stance. Particularly in the current situation in which the US long-term yield is at the stretched level of around 5% (inversion of 2yr/10yr yields is almost back to normal), the optimal investment behavior could turn out to be one of two opposite approaches depending on whether investors heed strong lagging indicators (such as the GDP growth rate and inflation) or the deterioration in the Financial Conditions Index, which is a leading indicator. We must be careful to note that price movements may have started to factor in the fundamentals indicating a slowdown in the US economy, hidden behind fluctuations in the term premium.

Goldman Sachs Financial Conditions Index (US)



Source: Bloomberg; compiled by Daiwa Securities.

Financial Conditions Index, US Real GDP Growth Rate



Source: US Department of Commerce, Bloomberg; compiled by Daiwa Securities.

IMPORTANT

This report is provided as a reference for making investment decisions and is not intended to be a solicitation for investment. Investment decisions should be made at your own discretion and risk. Content herein is based on information available at the time the report was prepared and may be amended or otherwise changed in the future without notice. We make no representations as to the accuracy or completeness. Daiwa Securities Co. Ltd. retains all rights related to the content of this report, which may not be redistributed or otherwise transmitted without prior consent.

Ratings

Issues are rated 1, 2, 3, 4, or 5 as follows:

- 1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
- 2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
- 4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
- 5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices

Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities

Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings

This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at:

<https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf>. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association