MAPM: Markets Weekly

25th November 2022

Summary

- Risk assets post a strong week against a backdrop of falling government bond yields and low trading volumes
- Preliminary November PMIs paint a picture of continued contraction in economic growth, with the UK and Eurozone modestly outperforming expectations;
- Minutes from the Fed underline a gradual shift towards a slower pace of rate rises, as economic data begin to show a deceleration in US economic data;
- Goldman Sachs agree to pay a $4m penalty for misleading customers about the ESG credibility of its funds.

Market and Economic review

Developed and Emerging market equities finished the week in positive territory amid thin volumes during the Thanksgiving period and the first week of the Qatar World Cup. While the results for Argentina and Germany in the group stages may have left supporters agog, developments in financial markets were broadly in line with market expectations. Government bond yields declined across the board, and corporate bond spreads tightened amid improved risk sentiment. The US dollar continued its decline from recent highs, largely based on a reduction in the market's expectations of future interest rate increases.

This week saw preliminary November PMI indices released across a number of major markets. In the UK and Eurozone, both the Services and Manufacturing parts of the economy continued to contract, but at a slower rate than forecast and an improvement on October. In Japan there was a deceleration in economic activity, with Services neither growing nor shrinking (with a reading of 50.0) and Manufacturing slipping into contraction (49.4 vs. 50.7 last month). Meanwhile in the US, there was a broad-based deterioration in conditions, which pointed to an unexpected contraction in the Manufacturing sector. Modest optimism could be drawn from the University of Michigan's 1-year inflation expectations index which fell from 5.1% to 4.9%, as well as October Durable Goods Orders which rose by +1.0%, ahead of the +0.4% forecast.

Minutes from last month's Federal Open Markets Committee were published on Wednesday, in line with recent comments from Federal Reserve members that it may soon be time to reduce the pace of interest rate hikes, with markets now expecting 50bps increments rather than 75bps, on the basis that the Fed wants to give the economy time to respond to the recent sharp pace of rate hikes before piling on additional monetary tightening. This is the central bank tightrope writ large: tighten too much and drive the economy into recession. Tighten too little and inflation may remain untamed for longer. Perhaps in a nod to this conundrum, the minutes noted a fairly even split between the chances of a recession and a soft landing.

The ECB also published their last batch of meeting minutes, which contained no surprises. Committee members believe inflation remains too high and will likely remain above target for an extended time, but noted that there were no immediate signs of second-round effects, and longer-term inflation expectations remained anchored to around 2.0%. In another note of optimism, the German Ifo Business Climate index rose to 86.3 in November, which was ahead of expectations and may indicate that the German recession could be less severe than currently forecast.

In a bid to reignite its property sector, China's largest lenders are expected to pump over $162bn of credit into the country's property developers, seemingly pausing the ongoing deleveraging exercise efforts which have been in force for over a year and seen a number of notable defaults. This week also saw the country report its highest ever daily number of COVID cases, complicating efforts to selectively reopen the economy. Officials in the city of Zhengzhou - which boasts the country's largest iPhone factory – were forced to restrict mobility and imposed compulsory daily testing after a spike in infections.

Goldman Sachs has agreed to pay the SEC a $4m penalty over accusations that the bank's asset management division misled customers about ESG investments. It is understood that Goldman's employees completed ESG questionnaires for investments in the fund, but only after the securities had already been selected for inclusion. According to the SEC, Goldman also failed to adopt written policies and procedures governing how it evaluated ESG factors as part of its investment process until "some time after" the strategy was introduced. The fine comes not long after the SEC's first $1.5m penalty for ESG indiscretion, and shows the increased scrutiny the regulator is applying to the area.

Economic data next week includes UK house prices, consumer credit, and retail sales, Eurozone confidence indices, Canadian GDP, and industrial production in Japan.

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	626	1.61%	-17.07%	-16.46%
MSCI EM	946	0.27%	-23.25%	-24.54%
S&P500	4,027	1.56%	-15.50%	-14.34%
FTSE 100	7,476	1.22%	1.23%	2.60%
Eurostox	3,958	0.83%	-7.93%	-7.45%
US Value vs Growth	--	0.52%	11.97%	13.90%
Government bond				
US 10 year Yield	3.69%	-13.8	218.0	205.6
US 2 / 10 Spread	-0.77%	-6.0	-154.4	-175.9
Germany 10 Year Yield	1.90%	-11.1	208.0	213.1
UK 10 Year Yield	3.07%	-17.4	209.4	206.9
Italy / Germany 10 Year Yield	1.83%	-5.3	48.2	52.9
Credit Spreads				
Barclays £ Corp TR Index	2.01%	-8.0	88.1	89.3
Eur High Yield Spread (XOVER)	4.42%	-29.8	200.4	178.9
US High Yield Spread (CDX HY)	4.56%	-24.1	163.2	149.9
EM $ Spread (CDX EM)	2.41%	-14.7	53.4	38.4
Currency				
USD Index	105.83	-1.03%	10.62%	9.24%
GBPUSD	1.2105	1.81%	-10.55%	-9.18%
GBPEUR	1.16	0.88%	-2.32%	-2.38%
EM FX Spot (JPM Index)	49.84	0.58%	-5.19%	-5.82%
Other				
Crude (1st Future)	86.07	-1.77%	10.66%	4.64%
Vix index	20.69	-2.4	3.5	2.1
Treasury Vol index (SMOVE)	132.13	4.4	53.6	49.8

Source: Bloomberg as at 9:20am on 25/11/2022

Outlook

The core theme for investors remains central banks' attitudes towards the task of bringing down inflation using monetary policy tools, without excessively tightening conditions and driving economies into recession. Markets currently price in a mild contraction in economic activity but remain very sensitive to each month's inflation print as well as the trajectory of corporate earnings growth. The ongoing economic side effects of the war in Ukraine, and the supply chains scars caused by COVID-19, provide additional complexity and uncertainty in the calibration of monetary policy.

Following a small increase in tactical equity positioning in early November, which acknowledged promising inflation data in the US and light investor positioning, we made no further changes this week. The overweight to US equities is complemented by a smaller overweight to Chinese equities. In addition to the equity overweight, which is at the low end of our total risk budget, we retain a small overweight in Alternatives, which can act as a good diversifier and offer inflation protection characteristics over the longer term. The overweight positions are funded through a Fixed Income underweight and, where possible, this is implemented using a mix of UK and European Fixed Income.