MAPM: Markets Weekly

27th May 2022

Summary

- Equity markets bounce with the US delivering its first positive weekly return in 8 weeks
- Central banks continue on their path of policy tightening, with the Fed showing unity in decision making and the ECB signalling an end to negative interest rates by Q4 2022
- Global macro-economic data prints below expectations, with signs of housing weakness in the US. However, consumers and the labour market still look strong
- The US Securities and Exchange Commission shows a new focus in strengthening ESG regulations

Market and Economic review

After hitting a low of 3,810 last Friday (-20% from January's peak) the S&P 500 has bounced back sharply, ending its seven-week losing streak this week (its longest since 2001). At the time of writing the US index is up 4% week-to-date, however, we continue to see large intra-day price swings driven by light volumes and low conviction amongst investors, so it remains to be seen if recent gains will hold for long. Fears around growth in China and negative pre-earnings comments from Snapchat drove poor performance early in the week but the minutes from the May Federal Open Market Committee (FOMC) meeting, which were less hawkish than some had feared, appeared to spur the revival on Wednesday. UK and European equities registered gains of 2% and, in a reversal of fortunes from last week, Emerging Markets was the weakest region - flat for the week.

The FOMC minutes confirmed a broad consensus for 50bp rate increases at the next two meetings, and that all members supported the balance sheet normalisation process. The Committee agreed that inflation risks were skewed to the upside, while growth risks were skewed to the downside, emphasising that data-dependence was crucial in this "highly uncertain" environment. Many participants expressed a view that "expediting the removal of policy accommodation will leave the Committee well positioned" to "assess the effect of policy firming" later this year. Short end US yields reduced a little, but the 10-year US treasury yield remained largely unchanged around 2.8%. The announcement of a £15bn fiscal package in the UK, aimed to address the surge in energy prices, pushed 10- year gilt yield a few basis points higher, leaving them close to 2%.

The European Central Bank President, Christine Lagarde, confirmed that the bank's Asset Purchase Programme would end in June, in line with market expectations, and signalled that the ECB is likely to raise interest rates for the first time in 11 years in July, reaching 0% by the end of September. When asked about 50bps increments, Lagarde stressed that growth must not be risked: "We need to make sure that this is going gradually enough so that we don't put the brake on this car that is moving. We have to lift the accelerator for sure, to slow inflation, but we cannot be breaking any speed". The Euro strengthened versus the dollar, but European yields did not change much.

Global macro-economic surprise indices deteriorated sharply this month, with the US and China moving into negative territory. US Q1 GDP came in a little worse (-1.5%) than the initial estimate (-1.4%), with the biggest drag coming from trade. This is the worst quarter since Q2 2020. US business activity slowed in May, with the composite PMI dropping to 53.8 from 56.0 in April, notably below expectations of 55.7. The services component disappointed the most, with businesses stating that demand was coming under pressure due to concerns over the cost of living, broader economic slowdown, and higher interest rates. Housing indicators suggest that the recent jump in mortgage rates may be weighing on the housing market. New Home Sales fell 16.6%, the largest decline in 9 years, much sharper than the forecasted 2% drop. Pending home sales also fell by more than expected. Employment and consumer spending continues to look robust, as seen in recent personal consumption and jobless data.

The flash UK Manufacturing PMI fell to 54.6 in May from 55.8 in April, due to rising inflation, supply chain disruption, and the war in Ukraine. The UK services PMI dropped from 58.9 in April to 51.8, the fourth largest decline on record and well short of expectations (57.0). Survey respondents noted that geopolitical and economic uncertainty led to a slowdown in demand. Eurozone flash PMIs came in slightly below expectations but still well in expansionary territory. A decline in demand for manufactured goods is linked to strong price pressures and raw material shortages. The report suggests that there has been an increase in demand for consumer facing service sector businesses as the economy reopens and COVID restrictions are lifted, particularly in tourism and recreation activities.

The US Securities and Exchange Commission strengthened its stance on regulating ESG funds, releasing a proposal to standardise ESG disclosures for registered funds and advisers, and increase visibility on ESG credential investment products to investors. This proposal came out shortly after the regulator announced a legal settlement of $1.5m with BNY Mellon Investment Adviser for allegedly misstating and omitting information about ESG considerations when making investment decisions in certain mutual funds.

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	639	2.80%	-15.31%	-9.77%
MSCI EM	1,023	-1.19%	-16.97%	-24.33%
S&P500	4,058	4.01%	-14.86%	-3.29%
FTSE 100	7,560	2.30%	2.38%	7.59%
Eurostox	3,757	2.74%	-12.59%	-6.80%
US Value vs Growth	--	0.82%	12.45%	11.25%
Government bond				
US 10 year Yield	2.75%	-3.6	123.5	116.9
US 2 / 10 Spread	0.27%	7.9	-50.1	-115.2
Germany 10 Year Yield	0.98%	3.9	116.0	118.9
UK 10 Year Yield	1.95%	5.6	97.8	119.7
Italy / Germany 10 Year Yield	1.94%	-11.7	59.0	81.3
Credit Spreads				
Barclays £ Corp TR Index	1.76%	0.1	62.7	66.3
Eur High Yield Spread (XOVER)	4.29%	-58.7	187.7	177.9
US High Yield Spread (CDX HY)	4.65%	-57.8	172.0	174.3
EM $ Spread (CDX EM)	2.70%	-34.1	83.2	109.7
Currency				
USD Index	101.68	-1.42%	6.28%	12.93%
GBPUSD	1.2620	1.12%	-6.74%	-10.62%
GBPEUR	1.18	-0.59%	-1.16%	1.51%
EM FX Spot (JPM Index)	52.37	-0.33%	-0.37%	-9.19%
Other				
Crude (1st Future)	117.72	4.59%	51.35%	70.93%
Vix index	27.37	-2.1	10.2	10.0
Treasury Vol index (SMOVE)	107.47	-7.0	29.0	49.4

Source: Bloomberg as at 09:11am on 27/05/2022

Outlook

Central banks continue to cement their hawkish stance, but have a difficult balancing act in the wake of a potential slowdown in growth and a less optimistic economic outlook, with macroeconomic data disappointing. Market pricing of inflation suggests an expectation that inflation will fall back eventually, but the key question that remains is whether the swift withdrawal of stimulus will dent economic growth prospects, triggering a “hard landing”. However, this is complicated by the economic side effects of the continuing Russia-Ukraine conflict, with it having a material impact on inflation and supply chains that had already been hit by the COVID crisis.

We are currently running a small overweight position in UK and US equities (providing diverse sector exposures). We also have a moderate overweight in Alternatives and Property, which we think can act as good diversifiers, less directional in nature, and also to benefit from potential inflation protection characteristics. Where funds do not hold either Alternatives or Property, we maintained a beta-adjusted exposure to equities in its place. The overweight positions are funded by a Fixed Income underweight (rather than partly through cash). Where possible, this is a diversified underweight of UK/US/European Fixed Income (noting that some funds have more limited regional exposures). We will continue to monitor the market for both opportunities and threats from here.