MAPM: Markets Weekly

20th May 2022

Summary

- In a volatile week for equity markets, focussed on macroeconomic data, DM equities close the week lower
- Poor data from China casts further shadows over global growth prospects and ongoing supply chain bottlenecks
- Inflation continues to hit global retailers, but with employment at record levels, DM retail sales hold firm

Market and Economic review

Volatile markets have been a theme of the Weekly for some while, and this week the trend continued. It was a bumper week of macroeconomic data releases and central bank comments, alongside some notable earnings releases. S&P 500 underperformed other regional indices and had its largest daily fall in 2 years (-4.04%) on Wednesday, with weak housing data and major retailer profit warnings painting a gloomy consumer picture. The US index has fallen 3.06% since last Friday while FTSE 100 index (-1.82%) and STOXX 600 (-1.27%) followed suit, despite a strong start to the week on positive retail sales reports from Apple, Tesla and other mega-cap growth stocks.

Macroeconomic data from China published at the start of the week significantly missed expectations, with zero-COVID policies still being implemented in major cities. Industrial production fell 2.9% YoY (vs +0.5% forecast) – the lowest reading since March 2020, with autos manufacturing a particular standout: dropping by 31.8%. Retail sales figures were equally poor, printing at -11.1% vs an expectation of -6.6%, while property investment (-2.7% vs 1.5% expected) also missed. A sharp slowdown in China's economy from its strict zero-COVID rules and Beijing's shift away from a traditional reliance on external demand, have cast doubts over how much the country will contribute to future global trade and investment. While China staged a remarkably quick recovery from its initial pandemic slump, thanks to bumper exports and factory production, fundamental issues such as rising unemployment will be under the spotlight from the authorities, who may look to implement further accommodative policies as social restrictions are unwound, following the PBoC's decision to cut 5 year mortgage rates this week. Against this backdrop, Chinese equities outperformed, in a sign that equity markets may have already priced in much of the negative sentiment

In the US, the Federal Reserve will "keep pushing" to tighten US monetary policy until it is clear that inflation is declining, confirmed Chair Jerome Powell, emphasising that policy change would continue to be data-dependent. Investors continue to search for evidence of a Fed put, following a poor run for risk assets. So far this month, the base rate priced in to the end of the year has fallen rather than risen; the first time that has occurred this year. This has been echoed throughout the Treasury yield curve, even though inflation has proven much stickier than markets expected over the recent months. This may be a result of concerns of a slowdown in economic growth and a normalisation in rates over the medium and long term. Better than expected retail sales in the US (+0.9% MoM vs +0.6% exp), driven by increased spending on motor vehicles, alongside beats in industrial production (+1.1% vs 0.4% exp) and persistently low levels of unemployment provide indicators of an accommodative macro backdrop.

Retail was the major focus in the middle of the week and despite the macro retail sales print beating expectations, poor earnings reports from Target and Walmart sent equity markets tumbling. Target Group (whose share price fell 26% after their earnings report), one of the largest general retail companies in the US, halved its quarterly profit due to margin pressures, with narrative discussing inflation pressures from rising fuel and freight costs and consumer spending shifts. The company said costs will rise by an additional $1 billion, more than it had anticipated for the year. Costs have remained elevated for companies due to pandemic disruptions to shipping channels and the crisis in Ukraine, with executives expecting supply issues to continue through 2023.

The UK's unemployment rate hit a 48-year low in the first 3 months of 2022, as employers paid higher salaries and bonuses (+7.0%) to keep or attract staff. In the same week, UK CPI hit 9.0% (vs 9.1% exp), rising from 7.4% in April. This surge came as millions of UK residents saw an average £700 a year increase in energy costs – with increasing calls for government support for households struggling to pay their energy bills. Bank of England Governor Andrew Bailey stated this week that the current surge in inflation was the central bank's biggest challenge since it gained independence in 1997, but that the BoE could not have done anything to stop it; highlighting that the MPC could not have foreseen the war in Ukraine or a further leg of COVID affecting China. Bailey also cautioned that rising food prices were a major concern – not just for the UK, but for developing economies as well.

The European Commission published REPowerEU plan this week, which outlined how it will accelerate its green energy transition in Europe. However, the EU highlighted that it would need to burn 5% more coal over the next decade in order to replace Russian energy supplies. In order to achieve their target, the plan focused on three key areas improving "energy savings, diversification of energy supplies and accelerated roll-out of renewable energy".

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	620	-1.53%	-17.92%	-10.81%
MSCI EM	1,015	1.03%	-17.62%	-23.55%
S&P500	3,901	-3.06%	-18.16%	-5.22%
FTSE 100	7,432	0.18%	0.64%	6.93%
Eurostox	3,692	-0.30%	-14.10%	-6.21%
US Value vs Growth	--	0.40%	11.83%	9.15%
Government bond				
US 10 year Yield	2.87%	-5.3	135.6	119.5
US 2 / 10 Spread	0.23%	-9.9	-54.1	-127.7
Germany 10 Year Yield	0.99%	3.8	116.3	109.6
UK 10 Year Yield	1.91%	16.7	94.0	106.3
Italy / Germany 10 Year Yield	1.98%	7.4	63.0	75.1
Credit Spreads				
Barclays £ Corp TR Index	1.77%	0.6	64.0	67.5
Eur High Yield Spread (XOVER)	4.64%	18.0	222.0	202.4
US High Yield Spread (CDX HY)	5.16%	31.8	223.0	216.9
EM $ Spread (CDX EM)	3.00%	5.7	113.0	134.8
Currency				
USD Index	102.93	-1.57%	7.58%	14.12%
GBPUSD	1.2488	1.84%	-7.72%	-11.53%
GBPEUR	1.18	0.20%	-0.77%	1.79%
EM FX Spot (JPM Index)	52.69	2.04%	0.24%	-8.40%
Other				
Crude (1st Future)	111.88	0.30%	43.84%	67.84%
Vix index	28.57	-0.3	11.4	6.4
Treasury Vol index (SMOVE)	117.38	-1.0	38.9	54.7

Source: Bloomberg as at 10:00am on 20/05/2022

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.