The economy starts from a strong position, with a very robust jobs market, and household wealth and corporate balance sheets in good shape.

Central banks get serious

by Robert White, CFA

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After the first 50bps interest rate rise by the Fed in over 20 years (with more to come) and the announcement of quantitative tightening starting in June, there is no doubt that the Fed is getting serious about containing inflation. Inflation data in April continued the pattern of the past year, generally exceeding expectations, with price rises becoming more broadly based and accelerating to multi-decade highs in the US and Europe. Strong demand, supply chain shortages, and war in Ukraine have combined to push producer price inflation (PPI) in the US up by 11.2% in the year to March. The figures are even more dramatic in Europe, with German PPI up by 30.9%, the highest since immediately after WWII, and this pricing pressure is feeding through to consumers.

Both these central banks are now on a much more aggressive tightening path than anticipated only a few months ago. The European Central Bank (ECB) signalled an end to its huge asset purchase programme in July, followed shortly thereafter by its first-rate rise. The market is now expecting the ECB's policy rate, currently -0.5%, to move into positive territory by Q4 2022, although the extent to which the ECB can tighten is limited by Europe's much greater exposure to the knock-on effects of the war in Ukraine.

It is the US, however, which is key in this monetary cycle. The Fed is now expected to push the Fed Funds rate close to or above the rate which it estimates to be the neutral rate by year end, being neither expansionary nor contractionary. This would imply a rate of close to 3%.

The result has been one of the worst periods of performance for US Treasuries in history, -3.2% in April and -8.2% year-to-date (YTD). Bond markets around the world have followed the US with big falls, the only notable exception being Japan, where inflation has remained remarkably subdued, and the Bank of Japan has reaffirmed its policy of yield curve control and committed to buy unlimited amounts of 10-year government bonds to cap the yield at 0.25%. Inevitably the currency has taken the strain, with the yen down 6.2% in April and 11.3% YTD against a resurgent US dollar. All major currencies have fallen significantly this year, and the USD trade-weighted index has risen by 7.6%, including a rise of 4.7% in April, taking it to a 20-year high. With the Fed's much more aggressive monetary tightening than other central banks and rapidly rising interest rate differentials in favour of the dollar, further rises cannot be ruled out, in effect imparting a significant tightening of financial conditions globally through the dollar's status as the world's reserve currency and the widespread use of dollar borrowings, especially across developing countries.

We undoubtedly face a much more challenging environment than for some time, but, importantly, there are no significant systemic risks arising from the deterioration in the outlook, and unlike in the Global Financial Crisis, banks are in strong financial shape and well placed to handle the difficult period we are entering. The economy starts from a strong position, with a very robust jobs market, and household wealth and corporate balance sheets in good shape.

The next few months are likely to be volatile and uncertain in markets, but as we move through the second half of the year inflation is likely to have peaked, the Fed's tightening well underway and the risks from war diminished. Equity markets have already corrected, in some cases materially, from peak levels and are offering some valuation opportunities on a longer-term perspective. With careful diversification, now more important than ever, we believe it is important to ride out the short-term volatility and stay invested for those longer-term opportunities now emerging.

Source: Momentum Global Investment Management, Bloomberg Finance L.P.

Market Focus

- **Global equities fell 1.1% last week.**
- **Most indices saw declines after a volatile week with interest rates and inflation fears weighing on sentiment.**
- **Brent crude rose 2.8% to $112.4 a barrel following an EU proposal to ban Russian imports.**
- **Gold fell 0.7% to $1883.8 per ounce.**

US

- Benchmark US equities fell 0.2% last week with the major benchmark falling for a fifth consecutive week.
- The 10-year US Treasury yield breached +3% for the first time since late 2018, climbing as high as 3.13% last Friday.
- Freddie Mac reported that the average rate for a 30-year mortgage had risen to 5.27% - the highest level since 2009.
- US weekly initial jobless claims came in at 200k in the week ending April 30 (vs. 180k expected). The unemployment rate remained stable at 3.6%.
- Nonfarm payrolls added 428k jobs in April, slightly ahead of forecasts.
- Federal Reserve policymakers announced a 0.5% increase in the federal funds target rate, the largest in over 20 years, to a range of 0.75% to 1.00%.

Rest of the World/Asia

- The benchmark Global Emerging Markets index fell 4.1% last week
- Japanese equities increased 0.9% last week.
- Chinese equities fell 6.9% as the government showed no sign of relaxing its zero-tolerance approach to the coronavirus outbreak.
- Japanese real wages shrank 0.2% year-on-year in March, its first decline since December though less than the market estimate of a 0.6% drop
- In Japan, the Tokyo core consumer price index (CPI) rose 1.9% year on year in April compared with 0.8% in March.

UK

- UK equities fell 1.9% last week.
- The Bank of England (BoE) warned that the UK could slip into a recession by the end of the year, along with inflation breaching 10% later this year.
- The BoE hiked interest rates by 25bps as expected taking the Bank Rate up to 1%.
- The UK has set out sweeping new plans to regulate tech companies and impose massive fines, though it remains unclear how it will enforce the laws.

Europe

- European equities fell 4.3% last week.
- German factory orders fell by a larger-than-expected 4.7% in March (vs. 1.1% expected).
- EU retail sales fell 0.4% in April, with mail order and online sales recording the biggest falls.
- Austria's top energy official says it will take years to wean off Russian natural gas, and that an upcoming tender to accumulate a strategic fuel reserve may well have to rely on Russian supply.
- Several European Central Bank policy makers are hinting at an early increase in interest rates, potentially as early as July.

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

Market Summary

		Cumulative returns			
Asset Class / Region	Currency	Week ending 06 May	Month to date	YTD 2022	12 months
Developed Markets Equities					
United States	USD	-0.2%	-0.2%	-13.2%	-0.9%
United Kingdom	GBP	-1.9%	-1.9%	3.8%	11.5%
Continental Europe	EUR	-4.3%	-4.3%	-13.0%	-2.4%
Japan	JPY	0.9%	0.9%	-2.7%	1.8%
Asia Pacific (ex Japan)	USD	-4.0%	-4.0%	-14.3%	-20.6%
Australia	AUD	-3.1%	-3.1%	-1.8%	6.2%
Global	USD	-1.1%	-1.1%	-14.0%	-5.1%
Emerging Markets Equities					
Emerging Europe	USD	-4.2%	-4.2%	-75.0%	-73.1%
Emerging Asia	USD	-4.5%	-4.5%	-17.2%	-24.0%
Emerging Latin America	USD	-3.1%	-3.1%	7.3%	-3.1%
BRICs	USD	-6.0%	-6.0%	-22.2%	-31.7%
China	USD	-6.9%	-6.9%	-23.4%	-39.7%
MENA countries	USD	0.0%	0.0%	17.0%	31.1%
South Africa	USD	-7.2%	-7.2%	-2.6%	-12.2%
India	USD	-4.6%	-4.6%	-8.2%	7.8%
Global emerging markets	USD	-4.1%	-4.1%	-15.8%	-21.3%
Bonds					
US Treasuries	USD	-1.2%	-1.2%	-9.3%	-8.5%
US Treasuries (inflation protected)	USD	-2.6%	-2.6%	-7.1%	-2.0%
US Corporate (investment grade)	USD	-1.3%	-1.3%	-13.9%	-12.1%
US High Yield	USD	-1.2%	-1.2%	-9.3%	-6.5%
UK Gilts	GBP	-1.3%	-1.3%	-11.3%	-10.1%
UK Corporate (investment grade)	GBP	-1.0%	-1.0%	-10.7%	-10.4%
Euro Government Bonds	EUR	-1.6%	-1.6%	-10.3%	-10.6%
Euro Corporate (investment grade)	EUR	-1.3%	-1.3%	-8.7%	-9.2%
Euro High Yield	EUR	-1.8%	-1.8%	-8.6%	-7.6%
Japanese Government	JPY	-0.3%	-0.3%	-2.2%	-2.2%
Australian Government	AUD	-2.1%	-2.1%	-9.8%	-9.9%
Global Government Bonds	USD	-1.3%	-1.3%	-12.5%	-14.6%
Global Bonds	USD	-1.2%	-1.2%	-12.9%	-14.9%
Global Convertible Bonds	USD	-1.3%	-1.3%	-14.0%	-16.8%
Emerging Market Bonds	USD	-1.4%	-1.4%	-23.3%	-23.0%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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Market Summary

Asset Class / Region	Currency	Cumulative returns: Week ending 06 May	Month to date	YTD 2022	12 months
Property					
US Property Securities	USD	-4.5%	-4.5%	-12.7%	7.4%
Australian Property Securities	AUD	-8.2%	-8.2%	-14.8%	1.4%
Asia Property Securities	USD	-1.3%	-1.3%	-4.6%	-14.3%
Global Property Securities	USD	-4.2%	-4.2%	-12.2%	-2.4%
Currencies					
Euro	USD	0.2%	0.2%	-7.2%	-12.3%
UK Pound Sterling	USD	-1.8%	-1.8%	-8.7%	-11.0%
Japanese Yen	USD	-0.6%	-0.6%	-11.8%	-16.4%
Australian Dollar	USD	0.3%	0.3%	-2.4%	-8.6%
South African Rand	USD	-1.3%	-1.3%	-0.2%	-10.9%
Swiss Franc	USD	-1.4%	-1.4%	-7.6%	-7.8%
Chinese Yuan	USD	-0.9%	-0.9%	-4.7%	-3.0%
Commodities & Alternatives					
Commodities	USD	1.2%	1.2%	34.3%	51.8%
Agricultural Commodities	USD	-1.0%	-1.0%	22.6%	31.3%
Oil	USD	2.8%	2.8%	44.5%	65.1%
Gold	USD	-0.7%	-0.7%	3.0%	3.7%
Hedge funds	USD	-0.2%	-0.2%	-2.5%	-1.5%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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