



CIO OFFICE MORNING MARKET WRAP – 7th April, 2022.

It is a bad start to April for financial markets. If policy badly inflated equities post covid, the undoing of that support should not see them sitting close to their all-time highs, especially if the removal of stimulus must happen fast. And stocks slumped yesterday as more Fed officials expressed hawkish views, confirmed by the minutes of the March FOMC meeting. Technology continued to lead declines and the sell-off in bonds deepened, with investors positioning for a steeper monetary campaign. The Nasdaq 100 lost more than 2%, the S&P 500 1%, the yield on the 10-year note climbed briefly above 2.6%, the US dollar edged higher and Brent crude weakened. Bitcoin tumbled 4% to close below the 45,000-support level, and we should expect it to follow the direction of the broader market as risk aversion rises. This morning Asian stocks are falling under the prospect that the Fed's bond holdings are planned to be reduced by \$1tn a year even as rates will be hiked aggressively.

The release of the March FOMC minutes did not reveal many new details about the Fed's future monetary stance. Investors had already suspected that the conflict in Ukraine had delayed a 50 basis-point hike in March, now more likely both at the May and June meeting, as "many" officials viewed more half-point increases as appropriate. The maximum monthly rate for the shrinking of the balance sheet is at \$95bn, in line with expectations, but almost double the peak rate of 2017-2019, when the Fed last reduced its bond portfolio. And herein lies the rub. Starting from higher multiples and with a very brisk tightening ahead both in terms of rates and portfolio holdings, markets could feel the heat sooner rather than later. It is not a

coincidence that Bill Dudley, ex New York Fed president, has just authored a Bloomberg column titled “If Stocks Don’t Fall, the Fed Needs to Force Them”. Will investors wait to be forced, or will they rather promptly discount what is being spelt out very, very loud? The tightening is necessarily going to occur via financial assets simply because the healthy private sector’s balance-sheet requires no deleveraging this time. We are in an asset cycle, rather than a credit cycle, hence markets remain the transmission channel. The yield curve steepened after the publication of the minutes, and more should follow, as the Fed not reinvesting the matured bonds equates to less incremental liquidity available for longer-dated treasuries.

The US and China remain on diverging monetary paths. The State Council said that monetary policy will be used at an appropriate time to boost consumption. And Beijing most likely will have to loosen sooner, rather than later, in order to cushion the negative impact both of the covid lockdowns and the crisis in the property sector. As much as one central bank is spelling out a hawkish stance, the other is projecting dovish intentions. And actually a leading analyst said that the government is going to coordinate fiscal and monetary policy for the recovery to be sustained. If investors have learnt that central banks must not be fought, they should also take notice that US equities are historically expensive, while Chinese stocks cheap.

Each new day sees additional sanctions on Russia. It is the turn of the two largest banks and of President Putin’s daughters to be hit soon. The recovery of the ruble to pre-invasion levels may be casting some doubt on the full efficacy of additional measures, although US officials dismiss it entirely as an artefact of capital controls enacted within the country. Maybe. What should be of major concern is the growing risks of unintended consequences, the major one being a food crisis, at a global level. Crucial supplies of wheat, corn and barley are trapped in Russia and Ukraine due to the war. Last month the United Nations said that the impact on the food market could see an additional 7.6 million to 13.1 million people go hungry. Whoever lives on the brink of food insecurity could be pushed over the edge, and rising food prices have been a cause for social unrest in poor African and Arab countries. Yet, there is little hope that Washington and Brussels will also take these calculations into account when gauging sanction-versus-negotiation efforts. Joe Biden stood to his script that sanctions will cripple Russia’s economy for years and said that the war could continue for a long time.

Joe Biden’s remarks could have implications for gold and underpin its war premium. The yellow metal has not been perturbed by US real rates spiking higher, holding above the \$1,900 support level. This could point to rising odds of a worsening conflict in the shorter term as investors discount further stagflationary pressures. In that case we could witness a renewed attempt to clear the all-time highs and a spike towards \$2,200. We would deem that pricing as not sustainable, though, with the shrinking of the Fed’s balance-sheet in the meantime inflating gold’s war premium to new record levels as well.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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