



CIO OFFICE MORNING MARKET WRAP – 10th June, 2022.

Developed-market stocks fell yesterday following the ECB's pivot to tighter policy to fight inflation. US equities underperformed ending sharply lower with a sell-off late in the session, treasuries fell on both sides of the pond and the US dollar gained across the board. The tech-heavy Nasdaq led on the way down, as Apple, Meta Platforms and Amazon lost at least 3.6%. In Asia markets are again weak, within the major exchanges Korea and Japan are leading losses, while India and China are rebounding. Stagflation and central banks front-loading rate hikes are at the forefront of investor concerns as today's US CPI report looms larger.

China has reported overall weak inflation readings today, highlighting still sluggish demand and the need for further stimulus. The headline CPI rose 2.1%, in line with April's reading, while MoM it dropped for the first time this year, most likely due to covid restrictions. Gains in factory gate inflation slowed to 6.4% YoY. On a more positive note yesterday it was reported that exports jumped 16% YoY in May, a spurt that may not be set to last, though. Consensus sees a slow recovery ahead and investors will be looking forward to the release of the key industrial production, investments and retail sales figures next week. But parts of Shanghai were locked down again yesterday, as virus fears returned. President Xi called on his government to adhere

‘unwaveringly’ to the Covid Zero policy, while striking a balance with the needs of the economy.

Europe’s decisive moment to end years of easy monetary policy came yesterday, as the ECB communicated the decision to end asset purchases on 1 July and increase the policy rate by 25 basis points at the next meeting to be followed by bigger hikes in the fall. This will mark the first hike in a decade and set the path towards positive rates, after 8 years in negative territory. Fresh forecasts showing much higher inflation ahead, though lower growth as well, underlie the policy pivot. If the medium-term outlook for inflation persists, a “larger increment” in September will follow. Many of us would have plentiful questions, if not primarily doubts about the sustainability of the ECB stance. Markets are betting the Fed will be forced to ease already in 2024, so how long could the ECB hold out putting on a tougher stance? This could be Lagarde’s ‘Japanese moment’. The BOJ never managed to tighten sustainably without unleashing deflationary forces following the bursting of the real estate bubble in the late 80s and given adverse demographics. Europe’s population is ageing fast, Germany will no longer be such a speedy locomotive of Europe given more subdued growth rates in China, and the bill to be paid for the presumably long-lasting sanctions on Russia will be huge. Last and absolutely not least, the end of QE even as inflation rises and the economy slows will eventually put elevated pressure on both Italy’s and Spain’s costs of servicing debt. European equities fell alongside the euro following the policy decision, in spite of Lagarde’s claim that the ECB has the tools and the determination to avoid that the cost of debt rises too far in the weaker countries. The rate on the 10-year German bond jumped by 7 basis points.

Investors are nervously awaiting today’s CPI report in the US. Mohammed El Erian, who about a year ago forecast that inflation will be persistent, said that it hasn’t peaked yet. Should figures show that a convincing turn has yet to happen, markets would promptly reshape views for a more aggressive Fed.

Famed investor Stanley Druckenmiller in a dire warning for Wall Street said that ‘the bear market has a ways to run’. The catalyst for further losses is the Federal Reserve’s restrictive stance, that in his view will lead to a recession at some point in 2023

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