



CIO OFFICE MORNING MARKET WRAP – 16th June, 2022.

Wednesday ended well for all asset classes, after the US Federal Reserve held their monthly policy meeting. Following the recent shocking inflation data and signals from officials, the decision was unambiguous: a mega hike. The Fed raised rates by 75 basis points, the largest increase since 1994. Importantly, chair Powell didn't exclude the possibility of a similar move next month, but clearly said that he was not expecting this size to become common. The committee also updated their rates projections, the "dot plot", as well as their economic forecast. The former now suggests another 175 basis points of cumulative increase in 2022 – which is a lot in four FOMC meetings. According to the internal poll among decision makers, 2023 should see only 33 basis points of additional hike while cuts should start in 2024. Of course, it all depends on inflation: failure on that front is "not an option", and the language used for the communique evolved in a radical way: Fed officials were previously "expecting" to get price pressures back to target, now they are "strongly committed" to do so. There is only one priority, and economic forecast were consistently adjusted to reflect its cost: less growth and less jobs. The 2024 estimate for the unemployment rate is now at 4.1% which is roughly half a point higher than the current level, but the economy is not seen as going into recession – this looks challenging. The monthly retail sales report for the US released yesterday was already disappointing with a net decrease, mostly due to the auto sector.

Another central bank held a surprise meeting yesterday. The ECB, inventor of the martial "whatever it takes" formula, appears to be this time much less radical. Nuances are needed for two reasons. First, Eurozone's inflation issue is somewhat different, as the proportion of energy, the cost of political solidarity with Ukraine, is much more predominant, which limits the ECB's potential impact. Second, and crucially, the zone is highly indebted, with very different economies sharing a currency and its

curve, and the recent surge in peripheral bond yields and spreads is a sinister reminder of the extreme risks of so called “fragmentation”. Bottom-line, yesterday’s ad hoc meeting set the stage to offer some flexibility in the usage of the balance sheet even if the current program is linked to the pandemic. In addition, in the purest ECB tradition, a new tool will be created to avoid “fragmentation”. As always, billions of magic money will be dedicated to buy government bonds, with a weird acronym on top, while policy rates will be raised in parallel. To stay in Europe, economic data continue to show resilience but a huge energy bill, which is about to translate into pay slips: the current wage negotiations in Germany look set to agree around a +6% increase in 2 years for industrial sectors. It’s serious: Germany’s industry will suffer from all kind of cost increases, and so is the planet as the country is now mostly relying on coal-generated electricity. It’s not going to change soon. On the energy front, natural gas prices jumped after Gazprom halted a turbine used for its biggest pipeline to Europe. No rate hike can do anything against this.

When central banks speak, markets listen and often all react in the same direction. After the recent terrible sessions, yesterday ended very positively everywhere. It may look surprising given the undoubtedly hawkish outcome from the FOMC, but what matters to market participants is clarity, trust in the process, and some kind of visibility about the level of pain lying ahead. To that extent: the message is clear, so are the objectives, and the fact that the maximum hikes are now is also a positive. The worse case is to believe that the Fed is panicking behind the curve – and we could see that concern in earlier sessions. After the meeting, implicit bets for another 75 bps hike in July have been cut massively – there is more confidence. As a result, global stocks ended +1.2% higher, led by the US adding +1.5% with tech outperforming. Bonds obviously benefitted from lower yields: the US 10-year closed almost -20 basis points lower than Tuesday at 3.28%. This remains a level at which we seriously consider closing our underweight on govies to go neutral. Our base line for positioning is unchanged: we keep on expecting extreme volatility until there is visibility of an inflexion in the Fed’s policy. This volatility brings opportunities: our latest move to cut EM debt and add to EM stocks earlier this month is so far delivering well. We remain confident over the medium term but again, on the short term, we strongly recommend against leverage and speculation – visibility is brutally low which remains our theme for the year.

As we write this morning, Asian markets are well oriented. This is not euphoria, but it’s important to reminder that they weathered quite well last days’ storm on developed markets, as the acceleration of inflation in the West coincides with the improvement of the covid situation in China. Economic improvement is set to follow quickly, as already illustrated by China’s May data released yesterday: retail sales, industrial production and even fixed asset investments all came above expectations. Today as we write, stocks are up +1.4% in Japan and Korea, +0.3% in China onshore and flat in Hong-Kong. US interest rates in Tokyo trading are modestly up again, with the 10-year at 3.33%. Major cryptocurrencies are in the green with bitcoin around 22k and ether at 1,200.

Today we will have more central bank action with the Bank of England the Swiss National Bank. We will also look at Italy’s monthly CPI and keen an eye on US May housing starts and weekly jobless claims.

Stay safe.

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