



## CIO OFFICE MORNING MARKET WRAP – 23rd March, 2022. ALSO AVAILABLE ON ALEXA.

The bond sell-off continued on Tuesday, while equities were broadly supported as market participants adjust to the Fed scenario combining resilient growth with inflation. The rise in yields affected the entire curve. The 2-year added +5 basis points to 2.16% and the 5-year +8 basis points to 2.40%. The 10-year and 30-year both added +9 basis points, closing respectively at 2.38% and 2.60%. Global bonds are thus heading for their worst quarterly performance since the eighties. By contrast, global stocks gained +0.9% on Tuesday in developed markets, led by a +1.2% close of US indices, while emerging equities added +0.5% on average. The price of Brent crude oil consolidated -1% to \$114.5. The trade-weighted dollar continued to benefit from an increasing rates differential, gaining +0.2%, especially against the yen.

Fed officials are now unanimously voicing their focus on the fight against inflation, which means that a +50 basis points hike in one of the coming meetings is being seriously considered – almost telegraphed now. This is more aggressive than the already hawkish FOMC press conference of last week. There is little doubt that the institution finds comfort in the fact that stock markets are so far reacting positively. Indeed, inflation is at the heart of the mandate of any central bank, and it also happens that inflation is highly unpopular, and mid-term elections are coming later this year in the US. However, one can legitimately question

the ability of the Fed to actually curb this very inflation episode. The situation is an imbalance between global aggregate supply, disrupted by the pandemic and by the war in Ukraine, and global aggregate demand, which remained strong during the pandemic due to fiscal support, and has only increased since with the reopening and gains in the job market. In such a context, hiking rates should not restart a semiconductor factory in Asia, stop the war, generate cheap energy, and will probably not have a strong moderating impact on demand, especially as US consumers are in a healthy financial situation on both wages and balance-sheet. The short-term impact of the Fed on the economy is indeed debatable, but its power on financial markets is not. The Fed may be too aggressive for them at some point. Yes, to some extent, stocks are a hedge against inflation: they are nominal assets, price increases are part of their top-line growth and as long as they can defend their margins, it's definitely not bad. However, there is a level on risk-free rates which will command materially lower valuations for equities. Scenario wise, we keep on believing that inflation should normalize organically, i.e. not because of the Fed action, but in case we are wrong, the Fed could become even more aggressive, with consequences on markets and ultimately on the economy. This is a risk rather than a scenario, for the time being we are still underweight bonds and overweight equities. But treasury yields are increasingly tempting, while potential risks for some cyclical assets are mounting. We will adjust our scenario and year-end fair values in our next tactical asset allocation committee in mid-April accordingly.

There was neither critical economic data nor major development in the Ukraine crisis yesterday. Joe Biden is in Europe for a special NATO summit which will see Zelensky also take part, and the US President keeps on pushing for more sanctions against Russia – especially as they have virtually no impact on the US economy. It's a different story for Europe, which could not avoid a recession without Russian energy. The US and UK also agreed to ease mutual tariffs from the Trump era.

As we write this morning, Asian markets follow yesterday's script. Equity indices are all in the green, led by Japan up +2.7%, literally flying due to a weaker yen. The Nikkei is down only -2% year to date in yen, but -7% in dollar. Stocks are up +1.4% in Hong-Kong and +0.5% in Korea, and unchanged in China's onshore markets. Staying in China, new lockdowns have been announced and China Evergrande Group assured investors it should provide them with a preliminary restructuring plan by the end of July. US Treasury yields keep on climbing in Tokyo trading. The 10-year adds 2 basis points and just crossed the 2.40% mark while the 5-year is at 2.42%. Oil prices are well oriented with the Brent crude oil trading just above \$117.

Today we will have a look at the UK CPI for February, expected to accelerate to 6% from 5.5% in January. The Chancellor will deliver a speech in which he's expected to announce some measures to help British consumers – it could be a moderation in taxes on gasoline. There will also be speeches from BOE and ECB officials, as well a consumer confidence index for the Euro area.

Stay safe.

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