



## CIO OFFICE MORNING MARKET WRAP – 23rd May, 2022.

A seventh week of decline for global equities which fell a percent last week, taking year to date performance to -17% with mounting concerns around the growth outlook and recession risk and Central Bank hawkishness to combat inflation. Developed market equities continued a downward trend with US equities dropping 3% last week and briefly entering bear market territory. Key retail sector earnings exacerbated inflation concerns. Other developed markets fared better with Europe and Japan both ending the week on an up note as did the major emerging markets: the UAE, China, India and LATAM. A risk off mood prevails as the 10 year yield fell to 2.8% and with gold trading up at \$1853. Oil steady with both Brent and WTI trading at above \$110/ barrel. Major cryptocurrencies closed above their respective round levels of \$30,000 for bitcoin and \$2,000 for ether.

This morning Asia markets are mixed with Hong Kong and China down but less than a percent (lockdowns continue to weigh on sentiment) and Japan trading up. Japan has been an outlier on tightening with inflation at 2.5% helping it to keep policy on hold.

Recession is defined as 2 consecutive quarters of negative GDP growth or a slowdown in the economy as a whole, that lasts more than a few months or a decline in real income, depending whether it's the IMF or economists defining it. It's not around the corner with the possibility of 2023 at the earliest and as many economic indicators such as PMI's and GDP growth remain expansionary in most economies. However, a deterioration in real income and living conditions

can be felt in almost every region, with inflation and supply chain issues plaguing the world. The Goldman Sachs Financial Conditions Index has been tightening. China retail sales fell 11% y/y in April. Sri Lanka has defaulted on a foreign debt payment as it conserves its FX reserves for essential imports. Turkey has seen consumer prices rise 70%, with the fall of the Lira adding to the impact of inflation. The US is facing a massive shortage of baby formula. Whilst rising energy costs with energy seen to be 50% of the 7.4% y/y inflation growth in Europe compared to one third of the US 8.3% y/y April number, food is an important component for many lower income economies. Countries have begun measures to combat inflation and India has a large fiscal package out this morning to subsidize fuel costs.

Central banks creating liquidity and the equity markets rise has been highly correlated and the last 2 years markets rose, with surplus liquidity boosting savings. And now the opposite is happening. Market performance is seen as a leading indicator of where the economy is trending. What could move markets up as fundamentals i.e. earnings and growth are taken off the headboard by investors? We still see earnings growth as an important catalyst, which though lower is still at trend. A benign resolution to Russia/Ukraine and China resumption of activity would dampen inflationary pressures. China has been working on domestic stimulus and last week lowered a key mortgage lending rate. Reopening will drive consumption and productivity. Finally, the Fed and central banks turning less hawkish would boost investor sentiment.

Pulling US performance down last week was surprisingly not technology but the consumer sector. as companies disappointed on profit and guidance. Big cap consumer companies Walmart and Target shares had selloffs of over 20% last week. Rising transportation, warehousing and wage costs along with higher prices of products with supply chains in disarray are hurting retail companies. Not all the costs or higher prices can be passed onto the consumer and with inflation tracking over 8% in the US and the end of federal stimulus, consumers have been lowering discretionary purchases. The credit-rating outlook for investment-grade retailers could start to shift negatively. The above-average Ebitda margins due to strong consumer demand paired with lower inventories, led to higher pricing and lower discounting during the last 2 years. This scenario is changing with higher inflation, labor and transportation costs.

Today we get data on Germany May IFO Business climate, tomorrow plenty of PMI data and Friday PCE (the Fed's preferred measure of inflation) numbers from the US. World leaders will be meeting in Davos at an in-person World Economic Forum gathering with deglobalization a key topic.

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