



## **CIO OFFICE MORNING MARKET WRAP – 24th January, 2022. ALSO AVAILABLE ON ALEXA.**

Asian markets are mixed this morning, while US futures are rebounding as traders look forward to Wednesday's FOMC meeting statement to gain clues about the timing of the Fed's planned tightening.

Last week represented one of the worst stretches in over a year for global stocks, which lost 4%, with the US tech-laden Nasdaq entering correction territory and down more than 7%, the S&P 500 more than 5%, and EM equities only 1% in the red, and still marginally up year to date. The expectation of shrinking central bank liquidity is causing a repricing out of more expensive assets, which explains the underperformance of the US market within the developed benchmarks. Fast rising real rates have also forced investors out of speculative assets which had been all the rage as of just a few months ago. Bitcoin has lost 17% so far in 2022, definitely challenging the commonplace notion that it could be a safe-haven, and both a Goldman Sachs basket of loss-making tech companies and the Solactive Meme Stock Index, tracking the darlings of social-media investors, have shed at least one fifth of their value over the same period. Long-dated US yields touched a 2-year high, to reverse and end lower for the week, while the yield curve flattened to reach close to its lows in 2021. The flight to quality capped yields at the longer end of the curve, which is starting to discount that the Fed will curb growth while tackling inflation. Amidst growing turmoil the US dollar rebounded, gold edged higher, while Brent crude traded above \$87 for the first time since 2014 as market conditions remain tight.

Investors are looking forward to next week's FOMC meeting, where the Fed is expected to signal that it intends to raise policy rates in March, and soon after begin the process of shrinking its balance sheet, by failing to replace the maturing bonds in its portfolio. The focus will be on policy normalization, as most economists predict at least 25 basis points of tightening, while markets already discount four hikes in 2022. Irrespective of what Powell will say, as the tapering of asset purchases proceeds and less incremental liquidity flows into financial assets, markets will start to feel the bite and continue to wobble. What is relevant is that this process has not even started, at least judging from system liquidity as gauged by financial conditions indices. Once the shrinking of liquidity begins to impact markets, and the economy, the Fed will judge whether it can continue at the same pace, or rather will have to adjust, or worst case even stop. Crunch time should be when the Fed will be raising rates even as it shrinks its balance sheet. So, focusing now on the number of hikes is highly premature, when not even Fed officials have full visibility on the whole process. We know that they are willing to sacrifice markets in order to avoid a self-feeding wage-price spiral, given a red-hot labor market, but we are in the dark as to what extent they are ready to push. Also, we should not forget that the tightening is not at all on autopilot, since the Fed is removing liquidity as the economy is slowing. The spread between the yields on the 10- and the 2-year treasury notes is at 76 basis points, which as a coincidence happens also more or less to be in line with the average degree of tightening in a Fed cycle. In other words, just by raising rates as per plan the yield curve could get inverted, pointing then to a recession about one year down the road.

The earnings season, in full swing next week, failed to cheer investors. Actually, financials were amongst the worst performers, following mixed results from some sector heavyweights. Investment banking results were strong, whereas trading revenue and loan growth offered a more clouded picture, and higher expenses on rising compensations acted in general as a drag. Of the three major banks that reported, Bank of America smashed expectations, Morgan Stanley exceeded and Goldman Sachs disappointed. Bank of America comes out as one of the best managed banks and poised to benefit the most from rising interest rates. Morgan Stanley, which pivoted to wealth management after the financial crisis, profited from surging trading activity and deal-making. As for other sectors, Netflix was heavily punished for reporting underwhelming subscriber growth rates, falling more than 20% in one day. And last week the old economy definitely beat the new economy, with Procter & Gamble standing out in terms of revenue growth and Schlumberger providing a set of solid results and a bullish outlook.

Investors did not miss out on a good share of rising geopolitical tensions either. Warnings that Russia was ready to invade Ukraine only increased and attempts at solving the crisis via diplomacy failed. Although this is one of the many issues to be tackled on Biden's agenda, it is becoming more than just a headache. Washington and his Western allies seem reluctant to intervene directly, and would rather opt for sanctions, which anyway would end up hitting the European countries, big importers of Russian natural gas, disproportionately. The United States remains the primary superpower, but one gradually losing diplomatic clout as the regional power of other nations increases.

Week ahead: This week will see the release of the January readings of consumer confidence and consumer sentiment, as well as the readings on Markit's manufacturing and services surveys. Reports on December pending and new home sales, as well as the December report on personal consumption expenditure are also expected. A two-day Federal Open Market Committee will be concluded with a statement Wednesday afternoon.

Stay safe.

**MAURICE GRAVIER**  
Chief Investment Officer  
Wealth Management  
Emirates NBD

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