



## CIO OFFICE MORNING MARKET WRAP – 27<sup>th</sup> June, 2022.

The past week gave indications that US inflation may be moderating and growth cooling, which helped stocks and bonds rally. The S&P 500 outperformed, with above-mid-single-digit returns, the 10-year yield came off by almost 10 basis points and commodities fell hard, with losses above 5% for the second consecutive week. All equity sectors recorded broad gains, energy being a notable exception. Recession worries dominated the narrative, first stoked by chair Powell who said that avoiding a downturn is ultimately going to be “challenging”, then allayed by Fed Governor Bullard, observing that talking about recession probabilities is now a “little early”.

A recession seems to be more of a matter of when than if, and therein lies the rub. Ex NY Fed Governor Bill Dudley did away with all of the previous “softish-landing” rhetoric and in his Bloomberg column provided many insights as to why the economy is headed for a hard landing, even as he mentioned that “it’ll take time and a considerable ... tightening to reduce demand”. So, investors may be focusing on the short-term risks only to be caught unaware sometime further down the road. Historically, activity has taken a plunge at the end of the monetary cycle, and we are far from it, confirming Dudley’s point. Yet, quite a slowdown may be in the offing, as commodities are on track for their first month in the red since November last year and long-dated yields pulled back fast globally. Indeed, economic data pointed to softer activity and moderating inflation. The Chicago Fed National Activity Index reached an

eight-month low, the euro area flash PMIs underwhelmed, and the US business confidence measure undershot estimates by a wide margin as well.

Notably, the University of Michigan's final June reading of consumer inflation expectations printed lower than the initially reported 14-year high. Less Fed's need for steep hikes? Not really, as Powell said at the Senate testimony that commitment to lowering inflation is "unconditional". Peaking inflation? Possibly, as activity is slowing, copper entered bear market and calls from relevant investment houses to lengthen duration in portfolios are multiplying. This would have relevant consequences, as historically equities have fallen into rising inflation and rallied after its peak, provided a recession was avoided. Also, as per past patterns commodities have settled down with softer price pressures, explaining the recent sharp pullback without onboarding the recession narrative.

Is it then the all-clear to add significantly to risk? Maybe not so fast. A meaningful slowdown is yet to be reflected in hard data. JPMorgan's Kolanovic called a 7% equity rally in this coming week based both on calculations of quarter-end rebalancing flows - a well-known seasonal feature of market functioning - and low positioning. But another known unknown is the probable downward revisions to earnings as the economy softens further. Waiting to buy also on that weakness would go in the direction of mitigating potential downside risks. Overall, going long high-quality bonds seems to make much sense in this murky environment.

On a different note, the splitting of the world in two blocks, one US- and the other China-centric, is becoming more evident by the day. At the BRICS virtual summit hosted by Beijing, President Xi criticised the levying of sanctions by the West and blamed NATO for antagonising Russia. In May the five member countries reached consensus to start an expansion process to include others. And last week Putin said that Russia is ready to develop a reserve currency alongside China and other BRICS nations. History will tell whether this proves to be a significant challenge to US dominance.

Russia defaulted on its foreign-currency debt for the first time in a century, due to ever tougher sanctions that shut down payment routes to overseas creditors, as the grace period on \$100ml worth of interests expired on Sunday.

Week ahead. Monday: durable goods orders, China industrial profits; Tuesday: Case-Shiller home-price index, consumer confidence; Wednesday: Germany CPI inflation; Thursday: personal income and spending, China manufacturing and non-manufacturing PMI; Friday: ISM manufacturing, euro area CPI inflation, China Caixin PMI manufacturing.

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