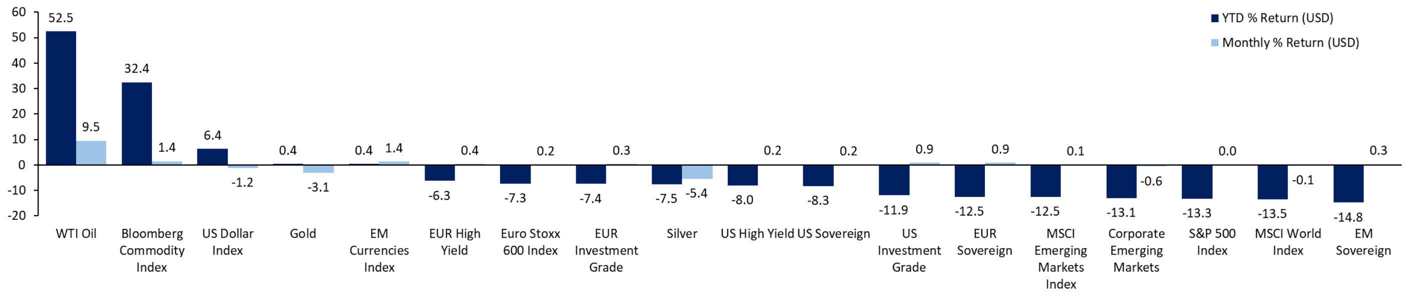
June 1, 2022

Monthly Market Wrap, May 2022

The high inflation data prints led to a stagflationary-flavoured 2022 macro environment with an increasing likelihood for prices to remain elevated across the board (i.e., metal, energy, livestock, agriculture). With real growth continuing to slow (at a faster pace) bond yields fell while credit spreads widened. On a QoQ basis, Q1 2022 GDP came in at -1.5%, down significantly from the previous quarter's +6.9% **(Chart 2)**. The contractionary print was well below consensus (and it was just Q1), the next print will be just as interesting. With Powell now officially appointed chairman of the Fed, markets are weighting if he will go full-Volcker. Time will tell.

Chart 1. Asset Class Return YTD (USD Base)



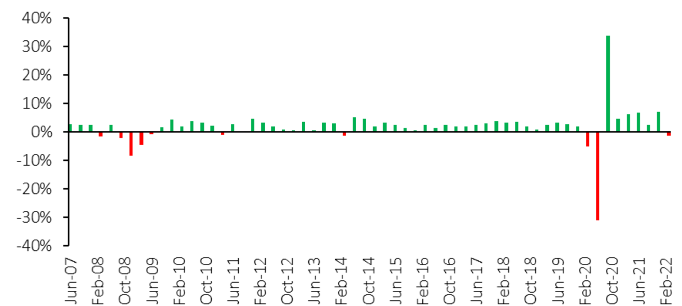
Equities

Global equities were two-toned this month. First, a weak start of the month saw major indices dropping more than 7% before pairing some of the losses in yet another standard bear market bounce in the closing weeks on the back of some Fed members turning slightly "less-hawkish" and a progressive relieving of the pandemic restrictions in China. Post-market bounce, the MSCI World Index closed the month up 8bps, but still down 13% YTD.

Up until two weeks ago, bright red was the colour on the screen for US equities with the S&P 500 recording seven consecutive weeks of negative weekly return. Inflation and growth concerns were to blame for the price action. At the lows, the index was down more than 7% MoM **(Chart 3)**. While it managed to close the month up 18bps, the S&P 500 remains down 12.8% YTD. The Nasdaq 100 continued to underperform, down 1.5% in May and 22.3% YTD. Smaller caps turned slightly positive with the Russell 2000 up 0.2%, but remain down 16.6% YTD. Sector-wise, energy led the gains (+15.5% MoM, +57.6% YTD) as real estate suffered the most (-4.9% MoM, -5.1% YTD). Consumer facing sectors were not spared with discretionary and staples taking a hit, down a respective 4.9% and 4.6%. The former was impacted by a decelerating growth outlook and demand shift from goods to services. The latter suffered margins risks amid decelerating revenue growth as consumers begin to adjust their spending.

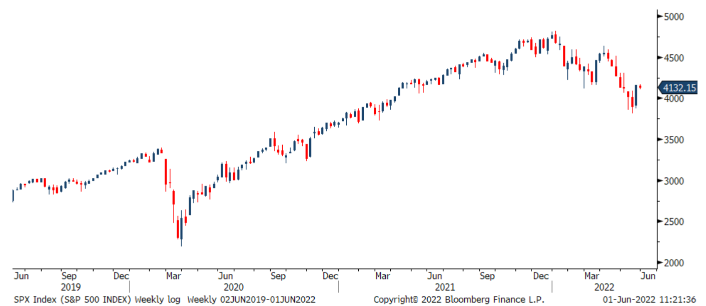
European equities faced similar headwinds as inflation ramped up further. Eurozone CPI accelerated to 8.1% in May from 7.5% last month, forcing the hand of the ECB to turn incrementally more hawkish in its policy. Then, the European Commission cut its growth forecast for the continent down to 2.7% from the 4% predicted back in February, citing the impact of soaring inflation and war in Ukraine. The EuroStoxx 600 was down 0.9% this month, and now down 7.6% YTD **(Chart 4)**. Geographically, Spain was the best performing region (+3.2% MoM) followed by Germany (+2.1% MoM).

Chart 2. US GDP Growth QoQ



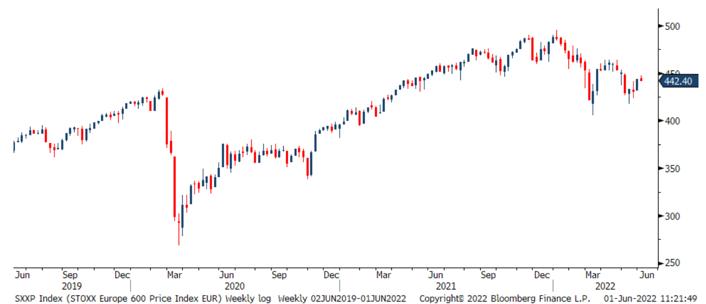
Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)



Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)



Source. Bloomberg, MAM Research

Fixed Income

The US 10-Year Treasury Yield **(Chart 5)** hit a 3-Year high and cycle peak of 3.14% before pulling back towards 2.8% in May on the back of a decelerating growth outlook. The 10-2 Year spread continues to sit above zero (sub-zero = high risk of recession). However, 1-Year forward rates continue to trade well below the zero bound. With real growth continuing to slow, fixed income is turning more attractive and notably longer duration sovereign credit. As such, it came to little surprise to see a strong 7-Year auction earlier this month which had the best bid-to-cover in over two years at 2.7x vs. the six month average of 2.4x. Foreign bidders made up nearly 80% of the interest, showing a strong international demand for US treasuries, supporting the dollar.

On the credit front however, we are seeing several financial conditions measures turning a bit more negative. For instance, Credit Suisse 5Y CDS (Senior) rose to 130bps from 60bps back in January **(Chart 6)**. The National Financial Condition Index (NFCI) confirmed this idea with the latest reading slowly approaching neutrality at -0.20, up from -0.60 at the beginning of the year.

In Europe, the 10-Year German Bund Yields rose to 1.1% in May. Global high yield bond issuance fell off a cliff in 2022 by totalling only USD 90 billion between January 1st and May 23rd, which is the lowest amount raised over that period since 2009.

Currencies

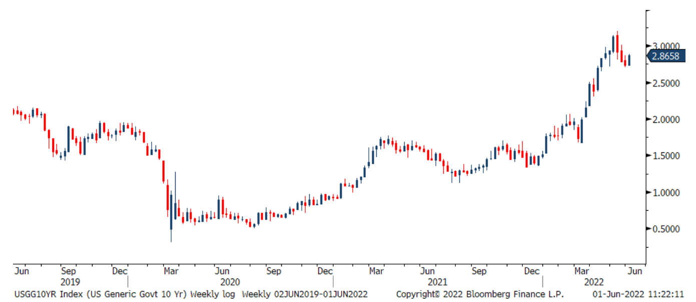
The rate hike expectations continue to show extremely hawkish sentiment in the Fed Funds futures market with another 1.75% baked in for the remainder of 2022. Despite the shift in tone at the ECB and other central banks, rates and growth differential continue to support a strong dollar. However, the move is not a straight line. After rising to a high of 104 **(Chart 7)**, the US Dollar pulled back towards 102 in the later stages. Hawkish ECB rates comments provided some of the short-term headwinds.

The Euro suffered for most of this year and continued to do so in early May given the then ECB's unwillingness to raise rates immediately in an effort to curb inflation. The EUR/USD touched 1.035 **(Chart 8)**, a 5-Year low. Yet, things quickly pivoted when several ECB officials made hawkish comments. The central bank is now looking to potentially start hiking rate in July and commit to raising them (by 25bps increments) another three times this year. On the back of these headlines, the Euro paired some of its losses to end the month in positive territory at +1.79% MoM.

On the back of a broadly strong dollar, double-digit inflation, slowing growth, and political uncertainty as the Conservative party suffered losses in the local elections, the GBP started the month poorly yet managed to recover some of the losses in the end as the dollar weakened to close up 22bps MoM **(Chart 9)**.

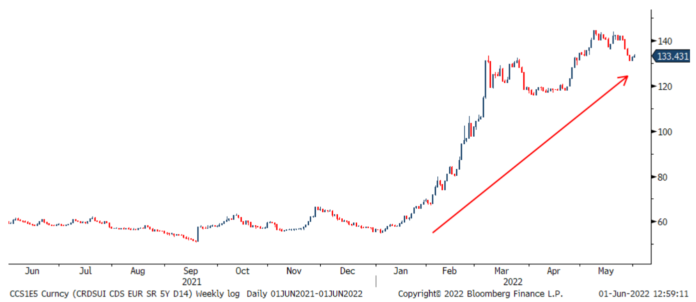
The Japanese Yen's correlation to US Treasury yields remained strong this month given the current BoJ monetary policy. With US Treasury yields falling in the second half of May, the Yen was able to catch a bid and pair back some of the most recent losses to close the month up 79bps.

Chart 5. US 10-Yr Treasury Bonds (Weekly)



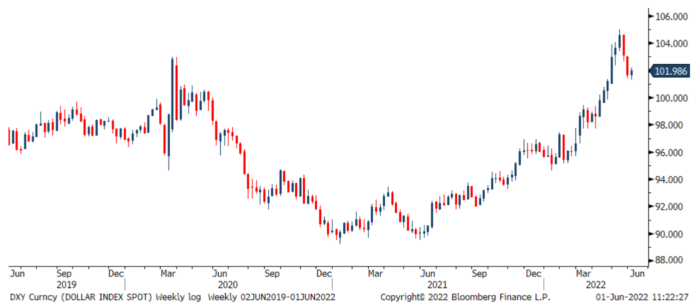
Source. Bloomberg, MAM Research

Chart 6. Credit Suisse 5Y Senior CDS (Daily)



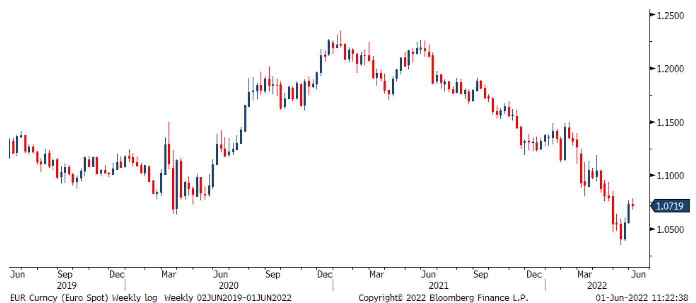
Source. Bloomberg, MAM Research

Chart 7. US Dollar Index (Weekly)



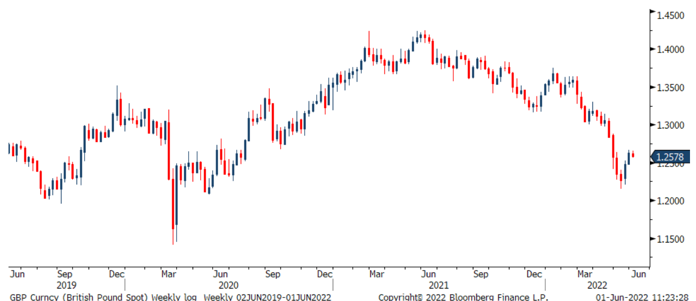
Source. Bloomberg, MAM Research

Chart 8. USD/Euro Spot Exchange Rate (Weekly)



Source. Bloomberg, MAM Research

Chart 9. USD/GBP Spot Exchange Rate (Weekly)



Source. Bloomberg, MAM Research

Commodities

May was yet another positive month for the broad commodity complex with the index up 1.3% MoM and up 32.7% YTD.

WTI Crude Oil **(Chart 10)** was up 9.5% MoM and +52.5% YTD. Recurring questions over the demand side (i.e. China lockdown) was a source of headwinds for the commodity in the first few weeks of May. However, the trend reversed quickly when the country decided to lift some of the restrictions meanwhile the Europeans continue to put pressure on Russian energy exports. Then, seasonal factors such as the start of the US driving season amid a limited supply given OPEC's current supply schedule were further supportive. Natural gas continued its unwavering bull trend, up 12.4% MoM and 118.4% YTD. Energy prices need to stabilize for inflation to come down as these feed into other key resources such as fertilizers and thereafter food prices.

Industrial metals were down 6.5% last month, still up 7.6% YTD. The deteriorating macro economic outlook has been weighting on future expectations for industrial (cyclical) commodity needs which was reflected in the now down trending copper prices. Copper was down 2.3% MoM, now at -3.8% YTD **(Chart 11)**.

Precious metals failed to catch a bid in May with Gold **(Chart 12)** down 3.1% MoM, up 0.5% YTD. Positive real yields still remain a source of headwind for gold, even if growth expectations drop.

Emerging Markets

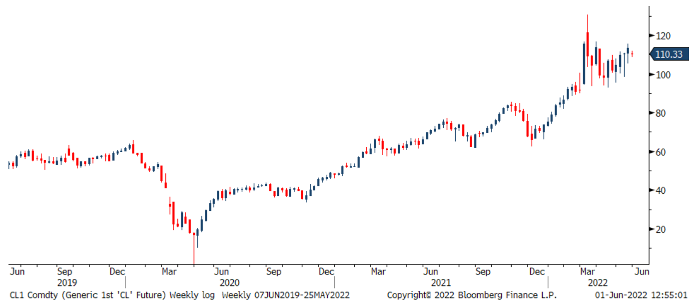
Emerging markets were up 0.4% MoM, now down 11.8% YTD **(Chart 13)**, outperforming global equities albeit by some margin.

Chinese equities started off on the backfoot following a series of lockdowns in major urban regions, fuelling worries around a decelerating global economic growth outlook. Regional equities paired the early losses and then some in the second half of May to close up 1.2% MoM yet still down 16.7% YTD. Indications of Chinese authorities looking to lift pandemic-related restrictions contributed to the relief rally which was then further supported by improving economic data at a time when the PBOC is materially more accommodative. Albeit still contractionary, manufacturing PMI improved to 49.6 from 47.4. Non-manufacturing PMI also improved significantly from 41.9 to 47.8. Along with pandemic restrictions being lifted, the picture in China is improving.

After a peak at 6.84, CNH depreciated 0.6% MoM and 5.1% YoY. Several catalysts contributed to the strengthening last month. (1) Consensus was long USD/CNH after adding in early April. The shorts unwinding and profit takings contributed to the market move. (2) Covid in Shanghai and Beijing is under control, easing concerns about further lockdowns. (3) Biden commented he would discuss tariff reduction with Secretary of Treasury Yellen, which raised optimism about tariff reduction.

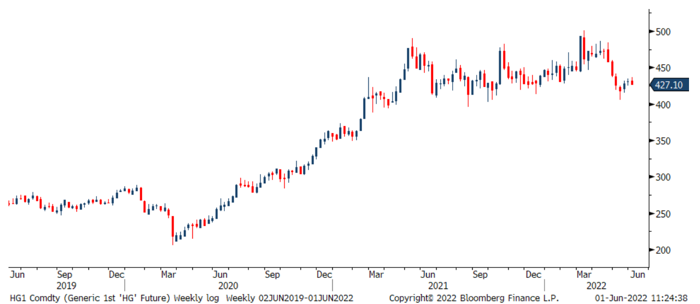
Elsewhere, Brazilian equities were up 8.4% in May thus building up to +27.1% YTD. The continued surge in commodity prices has continued to benefit the region, a global commodity exporter.

Chart 10. WTI Crude Oil Continuous Futures (Weekly)



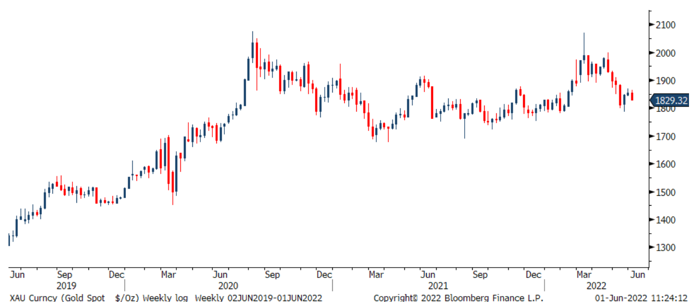
Source. Bloomberg, MAM Research

Chart 11. Copper Continuous Futures (Weekly)



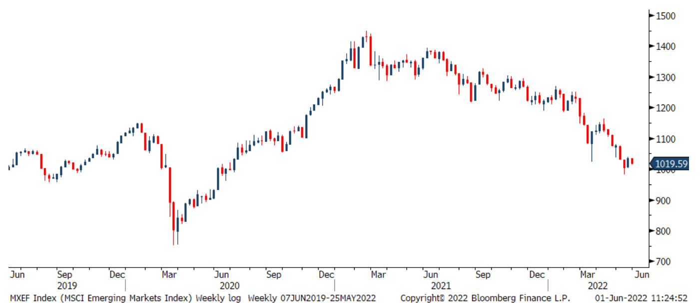
Source. Bloomberg, MAM Research

Chart 12. Gold Spot Prices (Weekly)



Source. Bloomberg, MAM Research

Chart 13. MSCI EM Index (Weekly)



Source. Bloomberg, MAM Research

Chart 14. MSCI EM FX Index (Weekly)

Source. Bloomberg, MAM Research