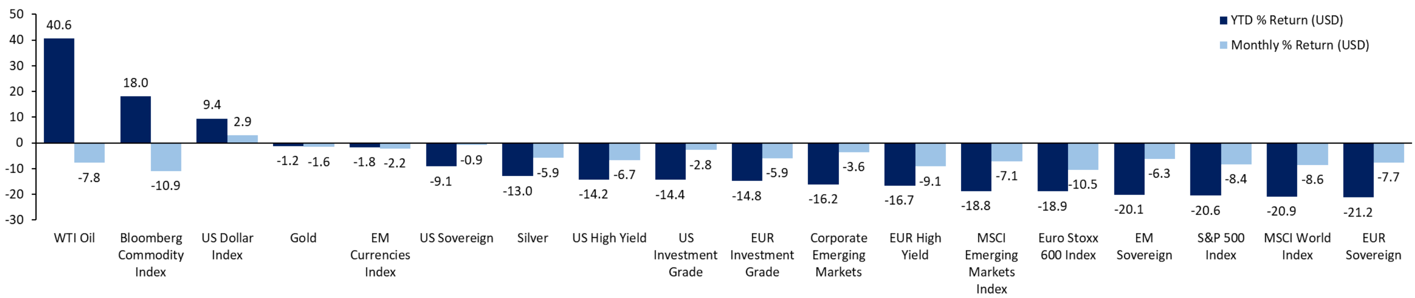
July 7, 2022

Monthly Market Wrap, June 2022

Consumer confidence is down to all-time lows, revolving credit jumped to all-time highs, real earnings growth is negative and falling, and credit card interest rates reached all-time highs. Nominal spending held up but real consumption turned negative. Consumers are not in good shape. A reverse wealth effect is materializing. Bourgeoning disinflation and recession concerns are pushing break-even rates lower. Markets are challenging the Fed's terminal rate assumption and pulling forward rate cut expectations to 2023. Global central banks (excl. PBOC) are hiking into an economic slowdown, pushing markets ever lower.

Chart 1. Asset Class Return YTD (USD Base)



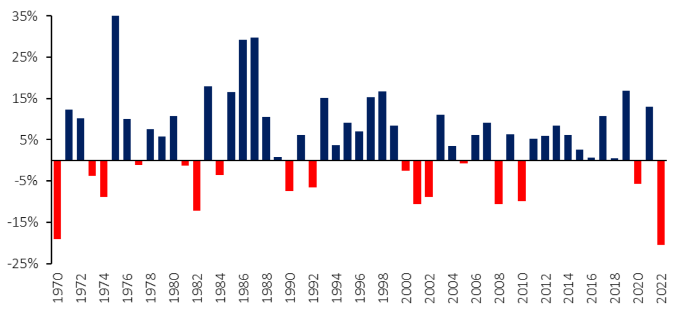
Equities

Another difficult quarter for risk assets. It is the worst first half for developed market equities in over 50 years **(Chart 2)**. Global equities entered bear market territory in June as the MSCI World index declined more than 20% from its cycle peak. Similar to May, a weak start to the month brough equities down by more than 10% before pairing back some of the early losses in yet another bear market bounce in the second half of June. The index closed down 8.7%, and now down 20.5% YTD.

The S&P 500 suffered a similar set up with an 11% drawdown in the first half of the month. Rising inflation, peak hawkishness at the Fed with a 75bps rate hike (a first since 1994), and growing fears of economic recession have kept markets under pressure. The S&P 500 closed down 8.3% in June, and -20% YTD **(Chart 3)**. The Nasdaq 100 and Russell 2000 were respectively down 8.9% and 8.2%, -29.2% and -23.4% YTD. The consumer discretionary and tech sectors continued their route down 10.8% and 9.3%, respectively, in June, and now down -32.9% and -27% YTD. As lower growth and recessionary narratives caught up, the energy and materials sectors struggled. Energy was down 16.9% but remains the sole sector with positive returns this year (+31.1%) while materials dropped 13.9%. Defensives were the relative outperformers, healthcare and staples down 2.7% and 2.6%.

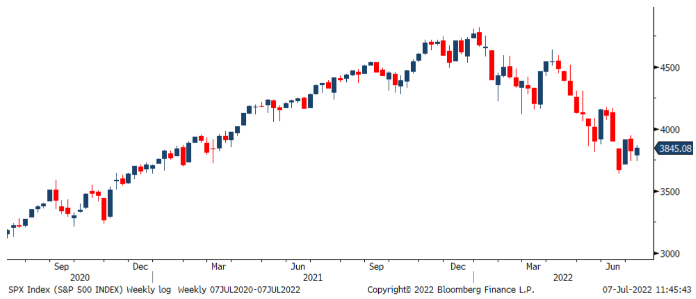
In Europe, consumer confidence has also fallen dramatically. The key risk to the local economy is gas supplies out of Russia. Not only has it driven prices materially higher, it raises fears of rationing should the situation deteriorates. Yet, even without a gas rationing, the economy weakened. European equities have been discounting tighter monetary policies but are adjusting to prospects of lower growth. The EuroStoxx 600 was down 8.0% in June, down 15.0% YTD **(Chart 4)**. Germany was amongst the worst performing region, down 11.1% in June. Basic resources, real estate, and travel have been the worst performing sectors, down a respective 19.0%, 16.5%, and 14.8%.

Chart 2. MSCI World 1H Total Returns (1970-Present)



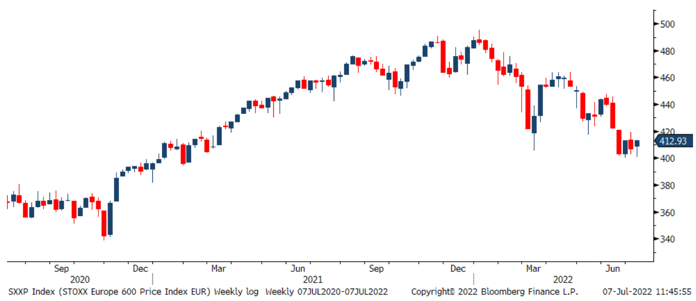
Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)



Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)



Source. Bloomberg, MAM Research

Fixed Income

Government bonds have been hit as markets moved to price in significant further increases in interest rates on top of what had already been announced. US 10-Year Treasury topped at 3.5%, an 11-Year high, before pulling back towards 3.0% as markets began to discount higher risks of a recession. The yield curve on the 10-2 spread was flirting with an inversion at +5bps **(Chart 5)**.

In Europe, German-Italian spreads widened as much as 250bps, echoing to the sovereign debt crisis from a decade ago. After Lagarde mentioned fragmentation within the Eurozone, Italian 10-Year yields hit 4.3%. German bunds rose as high as 1.75%. Spreads narrowed later in the month after an ECB crisis meeting announcing the design of a new anti-fragmentation instrument but without revealing any detailed just yet.

In Japan, the BoJ continues with a highly accommodative policy in an effort to keep the cap on its 10-Year yield at +25bps. JGB volumes saw outflows in excess of $40bn from foreigners in the final week of June - not helping the BoJ's YCC policy.

On the credit front, the picture continued to deteriorate with Credit Suisse 5Y Senior CDS closing just under 200bps **(Chart 6)**. The National Financial Condition Index (NFCI) keeps trending up with the latest reading at -0.14, up from -0.22 in May and -0.60 at the start of the year, or levels unseen since March 2020.

Currencies

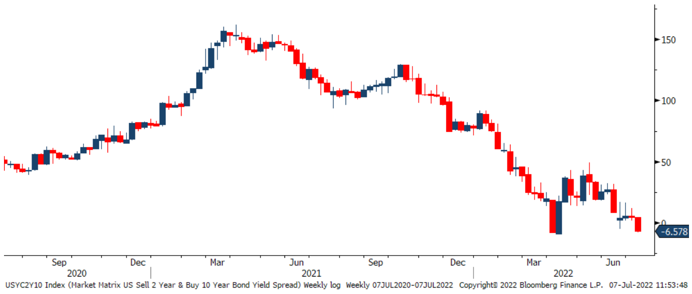
The Fed's hawkish rhetoric has been a key support to the dollar. Rates and growth differentials were strong factors contributing to the broad dollar appreciation outside of its safe haven status. A rolling over of inflation (meaning past peak Fed hawkishness) would be one of the first dominos to drop for a weaker dollar. The dollar closed up 2.9% in June, up 9.4% YTD **(Chart 7)**.

The Euro dropped ever lower, rapidly approaching parity levels. To a great extent, the weakness reflects the broad-based dollar strength. A trade-weighted index of Asia's most actively traded currencies with regards to the dollar collapsed. Elevated policy uncertainty, widespread recession fears, and a hawkish Fed are keeping the dollar bid. Lingering concerns of energy security are execrating these dynamics. Even though the ECB is expected to provide more details on its anti-fragmentation plan, investors rising borrowing costs will hurt the region's weakest economies. The Euro dropped by 2.3% in June, down 7.8% YTD **(Chart 8)**.

In the UK, the amount of uncertainty is weighting on the GBP. While Boris Johnson survived the motion of no confidence, he collected more votes against him than any Tory leader since Margaret Thatcher. The weak economic data and BoE cornered into fighting inflation with fears of stagflation did little to ease uncertainties. GBP was down 3.4% in June, down to -10.0% YTD.

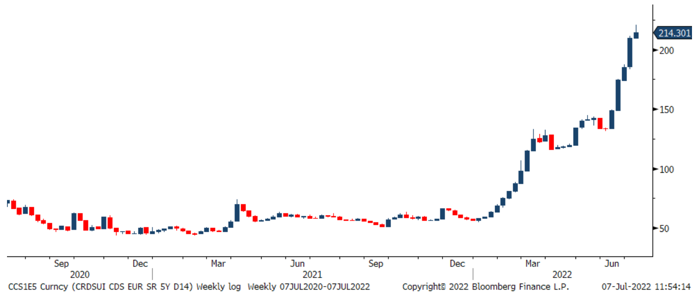
The BoJ is maintaining highly accommodative monetary policies, extending unlimited bonds buying in the spot markets and thus further contributing to the weakening of its currency, reaching its weakest level in the past two decades at 138. The Yen was down another 5.5% in June to 135.4, down 17.9% YTD **(Chart 9)**.

Chart 5. US 10-2 Treasury Spread (Weekly)



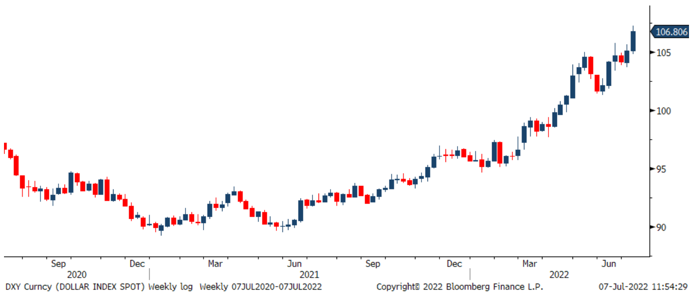
Source. Bloomberg, MAM Research

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



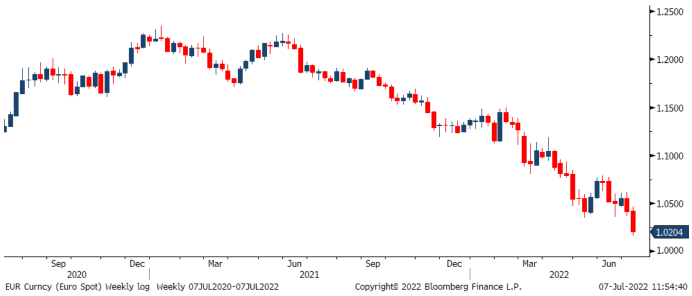
Source. Bloomberg, MAM Research

Chart 7. US Dollar Index (Weekly)



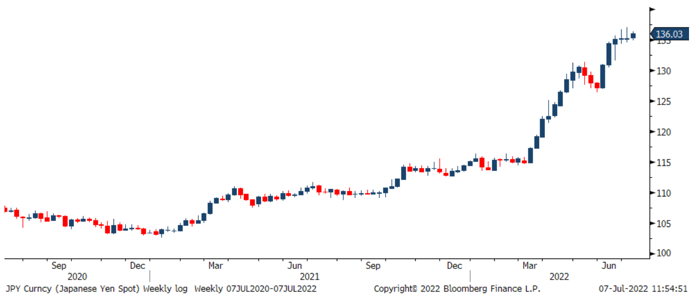
Source. Bloomberg, MAM Research

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



Source. Bloomberg, MAM Research

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



Source. Bloomberg, MAM Research

Commodities

Commodities were down (-10.8%) for the month time this year, pulling back from their highs as inflation peaked, recession fears grew, and the dollar got stronger. They remain up 18.4% YTD.

Base metals topped the ranks as worst performing commodities as investors weighted supply-demand balances in a decelerating growth environment. Chinese lockdowns and European energy rationing risks in the fall added to the worries. Aluminum was down 12.0%, copper dropped 13.5% **(Chart 10)**, and zinc 19.0%.

Energy was the second worst performing sector, down 14.6%. Seasonal factors and recession fears have been contributing to the decline in commodities. Natural gas dropped 33.4% in June after reaching its highest since 2008. Oil **(Chart 11)** started off well until the recession rhetoric arose. Despite the 7.8% drop in prices, impacts of a recession on oil prices is exaggerated. While slowing economic growth (and high prices) reduce demand, supply-side problems remain unresolved. Going forward, US shale oil producers and national oil companies will maintain capital discipline and production management strategies. Thus, output increases from KSA and UAE may not be sufficient to compensate losses from other.

Gold, though down 1.6% **(Chart 12)**, generated alpha, protected capital, and de-correlated from other asset classes.

Emerging Markets

Although outperforming developed markets, emerging market equities were down 6.7% in June, down 17.6% YTD **(Chart 13)**.

China was the best performing region in June, up 6.6%, pairing back some of its year-to-date losses. The PBOC has a divergent monetary policy path, easing as the rest of the world tightens. China is expanding its money supply, PMI numbers are showing an acceleration with comps getting easier in 2H22 and 1H23, and its PPI continues to decelerate on a monthly basis. Then, credit spreads continue to contract. The macro dynamics in the region are highly supportive to risk assets. The easing of its zero Covid policy is an additional tailwind. Exports rebounded in May to grow 16.9% in dollar terms. The housing sector remains a key unknown in the equation nevertheless.

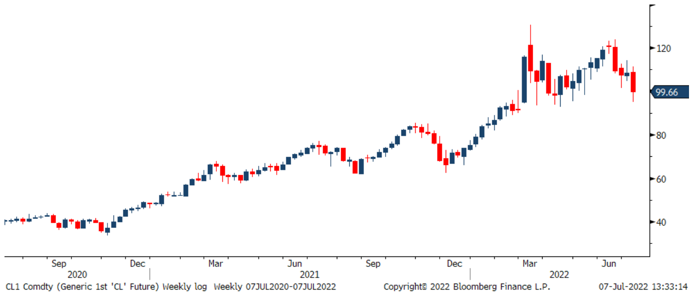
Brazil was one of the worst performing region, down 19.2% but still up 2.8% YTD. The broad commodity weakness, notably in energy and materials, has been one of the key contributor to index underperformance (c.45%) given the over-representation of these sectors in the Brazilian equity index. Furthermore, BRL weakened by more than 11% in June against the dollar.

The broad dollar strength has been a key headwind to emerging market currencies. As mentioned, the BRL depreciated by 11%. However, it was not a one-off. The Mexican Peso declined 2.4% while the South African Rand dropped 4.1%. In turn, it meant the MSCI EM FX Index was down 2.2% in June, now negative for the year at -1.8% **(Chart 14)**. Despite the accommodative policy, CNH was relatively flat last month, down 5.3% YTD.

Chart 10. Copper Continuous Futures (Weekly)

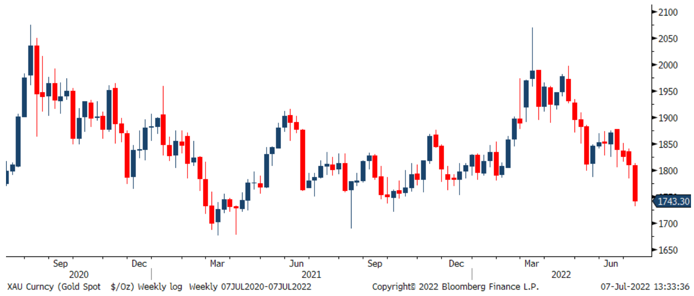
Source. Bloomberg, MAM Research

Chart 11. WTI Crude Oil Continuous Futures (Weekly)



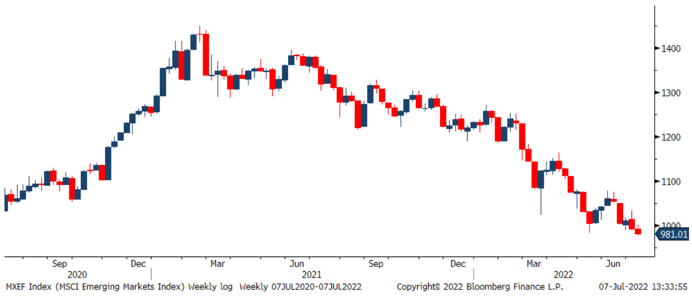
Source. Bloomberg, MAM Research

Chart 12. Gold Spot Prices (Weekly)



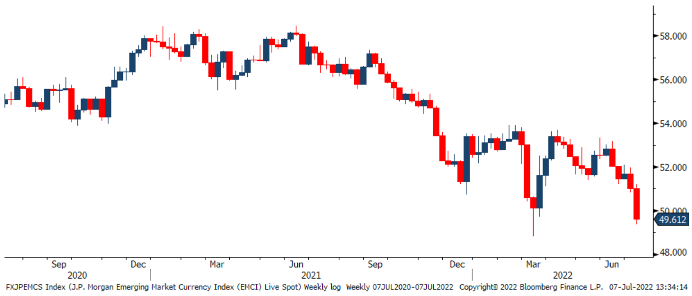
Source. Bloomberg, MAM Research

Chart 13. MSCI EM Index (Weekly)



Source. Bloomberg, MAM Research

Chart 14. MSCI EM FX Index (Weekly)



Source. Bloomberg, MAM Research

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