



A Month



in the Markets

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In this latest edition our Head of Systematic Research for TAA and Alpha, Stefano Amato, looks at how key themes impacted markets in January: inflation woes and central bank challenges alongside geopolitical tensions.

Market Overview

Despite markets ending 2021 with a strong performance, the rally ended abruptly in the new year as investors once again became concerned about high inflation and rising interest rates. Global stock markets struggled throughout January and on average produced negative returns, with only a few pockets of positivity.¹

Although it has been the primary influence on stock markets over the last two years, COVID-19 is now being largely overlooked in favour of inflation, at least for now. This makes sense, given that the Bank of England (BoE) increased its benchmark interest rate to 0.25% from 0.10% in December.² This initial raise paves the way for a further 0.25 percentage point-hike in February.³ The US Federal



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Reserve (Fed) also signalled its intention to raise rates in 2022.⁴

Against this backdrop, most major markets finished January with negative returns for the month in sterling terms. The US, Japan and Europe were among the worst performers of the major global markets, followed by China, the broad Asia Pacific region, and the emerging markets. The UK stood out as the lone major developed market to deliver a positive return for the month.

¹FE Fund Info 2022, 31/01/2022

²Bloomberg, UK Inflation: BOE's first back-to-back hikes in 17 years may just be the start, 31/01/2022

³CNBC, Bank of England expected to impose back-to-back rate hikes for the first time since 2004, 31/01/2022

⁴Reuters, Fed signals intent to join the great central bank stimulus exit, 27/01/2022

UK and Europe

There was a mix of good and bad news for both the UK and Europe in January. Positives included data showing manufacturing activity and industrial output remained in good health over the month.^{5/6} Furthermore, the latest figures for economic growth showed that gross domestic product in both the UK and Europe returned to pre-pandemic levels in the closing months of 2021.^{7/8} On the opposite side, the services sector struggled yet again in the UK and Europe. This was largely due to the Omicron variant that caused more pandemic restrictions, staff absences due to illness and subdued demand from consumers.⁹

Inflation was the biggest concern over the month. It reached 5.4% in the UK¹⁰ in December and 5% in the euro area¹¹.

US

The US economy has been showing strength lately. Unemployment has fallen to 3.9% nationally¹², wage growth has been brisk and the labour market strong¹³. While the numbers have been promising from an employment perspective, there are still lingering concerns about the pandemic and rising inflation. Recent survey data show that businesses experienced a slowdown in growth at the beginning of 2022¹⁴ as a surge in COVID-19

infections led to reduced demand and exacerbated supply chain disruptions.

In addition, the Fed was still faced with the challenge of heightened inflation. At 7%¹⁵, consumer price inflation is at its highest for decades and prompted the Fed to signal that interest rate hikes would be necessary. It has held off so far but is widely expected to make its first move in March.¹⁶

Asia and emerging markets

Yet again, China's economy struggled. Along with an overall slowdown in its rate of economic growth, the country continued to grapple with a slowdown in its property market.¹⁷ In addition, the government's pursuit of zero COVID-19 policies also took its toll on manufacturing and services sectors over the past month with a key survey showing that business activity edged closer to contraction.¹⁸

While demand for China's exports was a bright spot in recent months, there is evidence that many of its smaller manufacturers have been hit by weakening demand.¹⁹ The People's Bank of China, the country's central bank, has taken notice and cut its benchmark interest rate in January.²⁰ This is in addition to reducing lending rates for corporate and household loans in the country.²¹

Outlook

There has been a distinct shift in financial markets to start 2022. For much of the past two years, COVID-19 has been the key driver of stock markets, pushing share prices up to elevated levels. However, the tide seems to have turned and investors are now more concerned about inflation and rising interest rates. Following a pullback in many markets in January, we have a broad expectation that there will be more volatility in the coming months as central banks seek to reel in inflation. With that in mind, all eyes are on the Fed and the speed at which it raises rates.

Also front of mind is the worsening geopolitical situation regarding Russia and Ukraine and the potential for an invasion. While Western powers may avoid a military conflict, there is the possibility they may impose punishing sanctions that will affect the Russian economy. Should this happen, the impact could affect global stock markets, particularly given that Russia is a major oil and gas exporter.

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- ⁵ Markit Economics, IHS Markit/CIPS Flash UK Composite PMI: Two speed recovery in January as Omicron variant continues to weigh on customer-facing parts of the economy, 24/01/2022
- ⁶ Markit Economics, IHS Markit Flash Eurozone PMI: Eurozone growth slows as Omicron hits services, but manufacturers benefit from easing supply constraints, 24/01/2022
- ⁷ The Guardian, UK economy back to pre-pandemic levels in November, 14/01/2022
- ⁷ Yahoo Finance, 4th Quarter GDP numbers for the Eurozone provides little EUR comfort, 31/01/2022
- ⁸ Reuters, Eurozone recovery stumbled in Jan as Omicron hit services - PMI, 24/01/2022
- ⁹ Office for National Statistics, Consumer price inflation, UK: December 2021, 19/01/2022
- ¹⁰ Eurostat, Inflation in the euro area, 2/02/2022
- ¹¹ U.S. Bureau of Labor Statistics, State employment and unemployment summary – December 2021, 25/01/2022
- ¹² CNBC, Wage growth may be slowing from 'breakneck' pace, 31/01/2022
- ¹³ Markit Economics, IHS Markit Flash US Composite PMI: US output growth slows to 18-month low as Omicron wave exacerbates supply delays and labour shortages, 24/01/2022
- ¹⁴ The Guardian, US inflation reached 7% as prices rise at rates unseen in decades, 12/01/2022
- ¹⁵ Reuters, Fed signals intent to join the great central bank stimulus exit, 27/01/2022
- ¹⁶ Bloomberg, China manufacturing slips in latest sign of slowing economy, 30/01/2022
- ¹⁷ Reuters, China's Jan factory activity contracts as COVID lockdowns bite – Caixin PMI, 30/01/2022
- ¹⁸ CNBC, Exports could be key driver for China's growth as Covid drags down spending, say analysts, 19/01/2022
- ²⁰ Reuters, China cuts key rates, steps up monetary stimulus to boost economy, 20/01/2022
- ²¹ Reuters, China cuts key rates, steps up monetary stimulus to boost economy, 20/01/2022

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