



A Month



in the Markets

JUNE 2022

In this latest edition our Head of Systematic Research for TAA and Alpha, Stefano Amato, looks at how investors continued to adapt to the investment environment in May: higher inflation, rising interest rates and the ongoing war in Ukraine.

Market Overview

Global stock markets were fairly turbulent in May as investors continued to grapple with higher inflation, rising interest rates and the ongoing war in Ukraine. The Bank of England (BoE) and the US Federal Reserve (Fed) raised interest rates¹ early in the month in an effort to cool economic activity and reel in inflation. On average, the world's stock markets produced a small positive return for the month, but there was significant variation in performance among geographies and individual markets.² After following a downward trend for much of the month, global stock markets rebounded in the closing week.³

Yields on benchmark government bonds went up over the month as prices fell.⁴ This is because bond yields move in the opposite direction to prices.

UK and Europe

Once again, a main concern for investors over the month was persistently high inflation. The UK inflation



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rate reached its highest level for 40 years, at 9%.⁵ Strong demand, supply chain bottlenecks and the fallout from the war in Ukraine pushed up the cost of goods.⁶ Electricity, gas, automotive fuel and rising household costs were the biggest contributors to higher inflation.⁷ In response, the BoE implemented the fourth consecutive interest rate rise since December 2021, increasing the rate by 0.25% to 1%.⁸ With prices rising

¹ The Guardian, 4 May 2022

² Refinitiv Datastream, 31 May 2022

³ Reuters, 20 May 2022

⁴ Refinitiv Datastream, 31 May 2022

⁵ Office for National Statistics, 18 May 2022

⁶ The Guardian, 1 June 2022

⁷ The Guardian, 18 May 2022

⁸ The Guardian, 5 May 2022

across the board, it was perhaps not surprising that consumer confidence fell to its lowest level since records began in 1974.⁹ Moreover, there was evidence that economic activity in the UK was beginning to wane. The Office for National Statistics reported that economic growth fell by 0.1% in March.¹⁰

For Europe, there were mixed fortunes. Much like other parts of the world, inflation continued to be high, reaching 8.1% in May.¹¹ Despite the onset of war on its borders and ongoing uncertainty about the COVID-19 pandemic, the economy in the eurozone appeared to be holding up better than expected. Economic growth for the first three months of the year increased by 0.3% when compared with the final three months of 2021.¹² This suggests that the war in Ukraine did not have as much of a negative impact as initially feared. Meanwhile, business activity appeared to be holding up in May, as the services sector saw solid growth and continued job creation.¹³

US

Over the month, economic challenges related to supply chains and the ongoing pandemic¹⁴ persisted. Major ports in the US continued to experience shipping bottlenecks, as California, New York and New Jersey dealt with a surge of goods and queueing container ships.¹⁵ There was some respite for US consumers in May as inflation fell to 8.3% from its level of 8.5%¹⁶

Outlook

Many of the conditions that existed last month remain in place. We continue to see rising inflation, interest rate hikes from central banks, an ongoing war in Ukraine and supply chain disruptions stemming from COVID-19. This environment has been negative for both shares and bonds, and our view is that we will likely see more volatility in the months ahead.

There will be certain areas of the economy that should perform well, such as financial companies, certain industrial sectors and energy. However, parts of the economy that are more sensitive to consumer spending will likely struggle. In particular, consumer retail and other areas of discretionary spending, such as luxury goods, may be challenged.

in April. While there was some optimism that this might point to inflation reaching its peak, the reality for consumers remained that prices were still rising at the fastest pace since the 1980s.¹⁶ The Fed increased interest rates by half a percentage point, its largest single increase since 2000¹⁷, in an effort to tame inflation. Further interest rate rises are expected in the second half of the year.¹⁸

Asia Pacific

China's economy continued to be challenged in May as the pandemic, strict lockdowns and lower industrial output all took their toll. China's manufacturing sector contracted yet again¹⁹, but at a slower pace than in April as the government began to lift strict lockdowns in factory hubs like Shanghai²⁰.

In Japan, the lingering effects of the pandemic, as well as rising commodity prices which have pushed up the cost of goods²¹, hurt the economy. While inflation remains relatively low, when compared with other countries, the most recent reading for April 2022 came in at 2.1%, which was above the Bank of Japan's target of 2%.²² With Japan's economy having contracted in the first quarter of the year²³, there are concerns that the combination of COVID-19 and rising prices for goods, services and energy could cause a prolonged downturn in the country.

With interest rates rising in response to higher levels of inflation, stock markets are likely to continue following a downward trend for a short period. We expect central banks to begin easing off on further interest rate hikes as inflation peaks. While recent market moves can be distressing for some investors, it is important to mention that this is a natural response to major changes in monetary policy and global market conditions. Unlike 2008, when markets fell significantly due to serious systemic problems in the financial sector²⁴, we do not see any evidence of similar issues this time around.

All data as at 31 May 2022.

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- ⁹The Guardian, 20 May 2022
¹⁰Office for National Statistics, 12 May 2022
¹¹Eurostat, 31 May 2022
¹²Reuters, 17 May 2022
¹³PMI by S&P Global, 24 May 2022
¹⁴Bloomberg, 2 June 2022
¹⁵The Wall Street Journal, 18 May 2022
¹⁶The Guardian, 11 May 2022
¹⁷The Guardian, 4 May 2022
¹⁸Reuters, 24 May 2022
¹⁹Bloomberg, 31 May 2022
²⁰Reuters, 31 May 2022
²¹Reuters, 18 May 2022
²²Reuters, 20 May 2022
²³U.S. News and World Report, 7 June 2022
²⁴McKinsey Global Institute, 29 August 2018

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