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A Month in the Markets

MAY 2022

In this latest edition our Head of Systematic Research for TAA and Alpha, Stefano Amato, looks at the difficult investment environment in April: high inflation, rising interest rates, the ongoing COVID-19 pandemic and Russian invasion of Ukraine.

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Market Overview

It was a difficult time for investors in April as concerns about high inflation, rising interest rates, the ongoing COVID-19 pandemic and the Russian invasion of Ukraine weighed heavily on global stock markets.[1] Despite staging a recovery throughout March following a volatile first two months of the year, most of the world's major stock markets were negative for April, with China, the US and emerging markets leading the way.[1] The broad Asia Pacific region excluding Japan region was also negative, as was Japan and Europe.[1] The UK, with a very small gain, was one of the only major global markets to end the month in positive territory.[1]

While investors often flock to bonds when shares are volatile, the general trend in government bond markets was for rising yields (yields move in the opposite direction to bond prices) over the month.[1]

UK and Europe

In April, high inflation remained one of the biggest concerns in the UK. The latest reading of consumer price inflation came in at 7.0% in the 12 months to March 2022 up from 6.2% the previous month.[2] The main drivers of this were higher costs for housing and household services – which includes energy and gas - as well as higher prices for automotive fuels.[3] With prices for goods and services on the increase, consumer confidence fell substantially in April, with one survey suggesting it was near a historic low.[4] While business

[1] FE Fund Info, 1 May 2022
[2] ONS, 13 April 2022
[3] The Guardian, 3 May 2022
[4] GfK, 22 April 2022

activity was still expanding, it did so at a slower rate than previous months[5] as the higher cost of living and economic uncertainty caused by the Russia invasion of Ukraine took some wind out of the service sector's sails.

In Europe, many of the same issues were front of mind: spiking inflation, the ongoing Ukraine conflict, economic uncertainty and the continuation of the COVID-19 pandemic. Despite inflation increasing to 7.5% in April, up from 7.4% in March[6], the European Central Bank signalled that it was unlikely to raise interest rates until later in the year[7]. Economic activity appeared to be in good health in April with the services sector growing at the fastest pace since August 2021.[8] This was in contrast to the manufacturing sector, where output practically stalled in April[8] due to a major loss of production among auto manufacturers.

US

The US appeared to be one of the hardest-hit economies in April following a series of data releases that showed soaring consumer prices and retreating growth.[9] While corporate earnings for the first three months of the year were generally good[10], most investors were paying attention to inflation as the cost of goods and energy continued to rise[11]. Inflation was reported at 8.5% in the 12 months to March 2022, with some of the biggest price increases coming from gasoline and electricity, as well as food.[12] In addition, economic growth for the first three months of the year came in at an unexpected -1.4%, due to a rise in imports, lower exports and a drop in government spending.[13]

Asia Pacific

All eyes were on China during the month as its zero COVID-19 policy led to lockdowns that gained widespread media attention.[14] The epicentre of this was Shanghai, China's largest city, where residents were held in a strict lockdown for more than a month. The measures were so strict that it took its toll on the economy, causing manufacturing activity in the city to slow down and its industrial output to fall.[15] Nevertheless, the wider Chinese economy appeared to be in better shape than first expected, as the economy grew more than predicted in the first three months, measuring 4.8%.[16]

Outlook

The economic and market environment is being shaped by a wide range of risks that include rising inflation, interest rate hikes from central banks, supply chain disruptions and severe geopolitical tensions. With the Bank of England, US Federal Reserve and other major central banks seeking to tame inflation by raising interest rates for the first time since before the 2008 financial crisis, there will likely be further bouts of volatility in financial markets in the months ahead. We expect that interest rates will rise to around 2% by the end of the year, which may cause yet more turbulence in markets. In addition, we remain cognisant of the potential for the ongoing COVID-19 pandemic and the Russia invasion of Ukraine to send further shockwaves through stock markets.

While the present state of markets may be a cause of concern for investors, it is important to remember that downturns are natural. Stock markets have moved a long way since the beginning of the COVID-19 pandemic in early 2020 and the current setbacks we have observed account for only a small part of the growth we have seen in global markets during that time.

All data as at 30 April 2022.

[5] Markit Economics, 22 April 2022
[6] Eurostat, 29 April 2022
[7] Independent, 14 April 2022
[8] Markit Economics, 22 April 2022
[9] Bureau of Economic Analysis, 28 April 2022
[10] Bloomberg, 26 April 2022
[11] CNBC, 3 May 2022
[12] U.S. Bureau of Labor Statistics, 18 April 2022
[13] The Guardian, 28 April 2022
[14] The Guardian, 22 April 2022
[15] Reuters, 22 April 2022
[16] Reuters, 18 April 2022

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