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Market Review

Global Market Strategy @ Natixis Investment Managers Solutions

Economic & Political News

While economic data has continued to come in strong, there have also been some signals suggesting that it might be peaking in some regions. The May US CPI surprised on the upside for its second consecutive month, with the headline number at 5% YoY (vs. 4.7% expected) and core inflation at 3.8% (vs. 3.2% expected). But, although these are levels not seen since the beginning of the 1980s, specific factors such as car rentals and sales as well as airline fares exacerbated the rise. In addition, 559’000 jobs were created in the US in May and the unemployment rate fell to 5.8% from 6.1% in April. However, leading indicators such as the Composite PMI came in below expectations at 63.9 from a record high of 68.7 hit in May, personal spending was flat in May, defying expectations for a 0.4% gain and, new home sales fell 5.9%. On the other hand, these indicators continued to advance in Europe after lagging the US due to longer covid restriction measures. The Euro Area’s Composite PMI rose to 59.2 in June, its highest level since 2006.

At its last policy meeting, the Federal Reserve’s (FED) members shifted the dot plot to a medium projection of two interest rate hikes in 2023 compared to none in March. However, although the Fed is clearly watching inflation, no changes were made to its policy and the message of transitory inflation was reiterated. Moreover, the European Central Bank (ECB) remained dovish, announcing that the higher pace of bond purchases under the Pandemic Emergency Programme for Q2 will continue throughout the summer.

A bipartisan USD 579 billion deal on US infrastructure was reached. The deal provides funds for clean water, transportation, and power infrastructure. Importantly, it does not contain higher taxes on wealthy individuals nor corporations. For its part, the European Commission proposed that the Stability and Growth Pact should remain suspended until the end of 2023, which will avoid having to abruptly adjust public budgets like in 2009-2010. In the European Union, 24 out of 27 member countries are running a public deficit above 3% of GDP and 13 have a public debt above 60% of GDP. Finally, the G7 countries agreed to back a new global minimum tax of at least 15% that companies would have to pay regardless of where their headquarters are located. However, since the agreement is not binding and the US corporate tax rate is already above 15%, the impact could be limited.

Equities

Despite the highest inflation figures in decades, equity markets have headed higher supported by the continued consolidation in long-term rates. With this trend, growth stocks outperformed cyclical stocks in June, which had been leading during the first half of the month, especially the Financial and Energy sector. However, the latter continues to benefit from oil prices tailwind — oil prices have reached their highest level since 2018. Developed markets posted a +1.5% return, outperforming emerging ones (+0.2%), which were penalised by a strengthening US dollar. Within developed markets, the technology-heavy NASDAQ (+5.5%) outperformed, while more cyclical indices such as the S&P500 and STOXX600 lagged (returning +2.3% and +1.5%, respectively). Within European markets, the Swiss market increased 5.1%, followed by the OMEX Copenhagen and the AEX Netherlands, which increased 4.9% and 2.9%, respectively. Moreover, the CAC 40 increased 1.2%, the FTSE 0.4% and the DAX 0.7%. The best performing developed market sectors were Information Technology (+5.3%), Energy (+3.1%) and Healthcare (+3%). The worst performing sectors were Material (-4.1%), Finance (-3.4%) and Utilities (-2.6%).

Fixed Income

Although volatility increased following last Fed meeting, long term government bond yields retreated in June. The US 10-year yield has declined around 30bp from its March’s peak (currently ~1.47%) largely driven by a drop in inflation expectations and a rise in real rates. In addition, as expectations regarding monetary tightening have increased (from almost zero), the 2-year yield surged from 0.14% to 0.25%, which led to a notable flattening of the yield curve (the 2y10y spread declined 23bp). European yields also fell and curves flattened, to a lesser extent, especially after the ECB maintained its very accommodative stance. The yield on the 10-year German Bund declined 2bp to -0.21% and its 2s10s spread tightened 2bp. In addition, OATs fell 4bp to 0.13%, BTPs fell 9bp to 0.82% and Gilts fell 8bp to 0.71%.

Moreover, while developed corporate debt stayed well behaved (US IG and HY tightened 3bp and 28bp, respectively, and EU IG and HY tightened 3bp and 7bp), both EM corporate rates widened (2bp for IG and 17bp for HY) as a stronger US dollar weighed on the region.

Emerging Markets

The MSCI Emerging Markets (EM) returned 0.2% during the month, underperforming the MSCI World (+1.5%), weighed by a strengthening US dollar and topping commodity prices. Since spring, the Chinese market (which accounts for 38% of the MSCI EM) has been penalised by the slowdown in growth, what has led Chinese EPS to deteriorate for several months. Moreover, although the vaccination campaign in EM remains slow, the progress achieved so far has helped to tackle the spread, particularly in India, where 330 million people (20% of the population) have received at least one dose.

At the index level, the best performing emerging market (in local currency) was Saudi Arabia (+4.2%), followed by Philippines (4.2%) and Russia (+3.6%). From a regional perspective, emerging Latam led, increasing 2.7%, followed by emerging Europe and Asia, which were up 1.7% and 0.1% respectively. The worst performing emerging markets were Turkey (-4.5%) and Malaysia (-3%).

FX & Commodities

The DXY index, which measures the US dollar against a currency basket, increased 2.9%, driven by the rise in real rates that followed last Fed meeting. The US dollar strengthened against every major currency. It gained 3% to 1.18 against EUR, 2.7% to 1.38 against GBP, 2.9% to 0.92 against CHF, 1.4% to 111 against the JPY, 1.4% to 6.54 against CNY, 3% to 0.75 against AUD, 4.8% to 4.9 against BRL and 1.7% to 734 against CLP.

The gold price declined 7.7% to USD 1,770 per ounce in June, also driven by the rise in real rates and the strengthening of the US dollar. Oil prices posted another strong month and rallied to levels not seen since October 2018 as they continue to benefit from increased economic growth forecast. In addition, during its last meeting at the beginning of June, OPEC+ announced that the increase in production of 2mb/day, initially planned for last January, will be delivered in July, and no further increases were announced. The WTI increased 8.5% to USD 73.5 per barrel and Brent increased 8.4% to USD 75.1 per barrel. Lumber prices continued to selloff, they declined 45.3% in June and are 60% off their highs in May. Copper fell 8.5% while aluminium rose 2.2%.