September 2022

Market Review

Global Market Strategy @ Natixis Investment Managers Solutions   Marketing Communication

Macroeconomic developments

Major central banks escalated their fight against inflation in September, signalling much higher policy rates for longer. This approach was supported by the continued broadening of prices pressures into core items across economies. As such, policy rates are now expected to be raised up to a level where demand is induced to contract, i.e., restrictive territory. This means that the Fed funds rate and ECB's deposit rate will most likely be hiked above 4% and 2%, respectively. We should highlight the increasing opposite direction that the PBoC is undertaking in terms of its monetary policy, which continues to maintain the status quo.

In the meantime, economic data released throughout the month kept pointing towards a slowing but still fairly strong US economy while the activity in Europe and UK keeps plunging. The US ISM Non-manufacturing PMI surged to 56.9 in August and the Manufacturing one remained flat at 52.8, reflecting the continued shift in consumer spending away from goods into services. Nonfarm payrolls increased by 315,000, which is almost double the pre-pandemic average and average hourly earnings advanced at 5.2% yoy, which keeps being below the 8.2% advance on headline prices. This might have probably been behind the increase in the labour participation rate as more people are feeling the purchasing power squeeze. Furthermore, in Europe the energy crisis continued to dominate the headlines as Russia completely stopped gas flows through the Nord Stream 1 pipeline. However, thanks to the good job that Europe has done at filling up gas storages the impact of a potential worst-case scenario has been minimized. This was reflected by fact that European gas prices did not reach new highs and actually fell by the second half of the month. On the economic front, the Euro Area composite PMI, which combines gauge for both the services and manufacturing sectors, slumped further into contractionary territory in August at reached 48.1 versus 48.9 the month before. Moreover, the Euro Area's industrial production dropped sharply in July, falling 2.2% yoy, and consumer confidence dropped to a new all-time low as the region's inflation reached 9.1% yoy (with Germany at 10%). UK's economic momentum also continued to slow, and prices kept soaring at a near record pace (9.9% yoy for the headline print). Noteworthy was the annualised 5.5% advanced of private sector wages which are being driven by the extreme tightness of the country's job market. In addition, UK's new government announced a new budget, which investors deemed as fiscally unsound, and forced the BoE to launch a temporary bond purchase program after soaring yields led to a struggle for collateral by UK pension plans to meet margin calls.

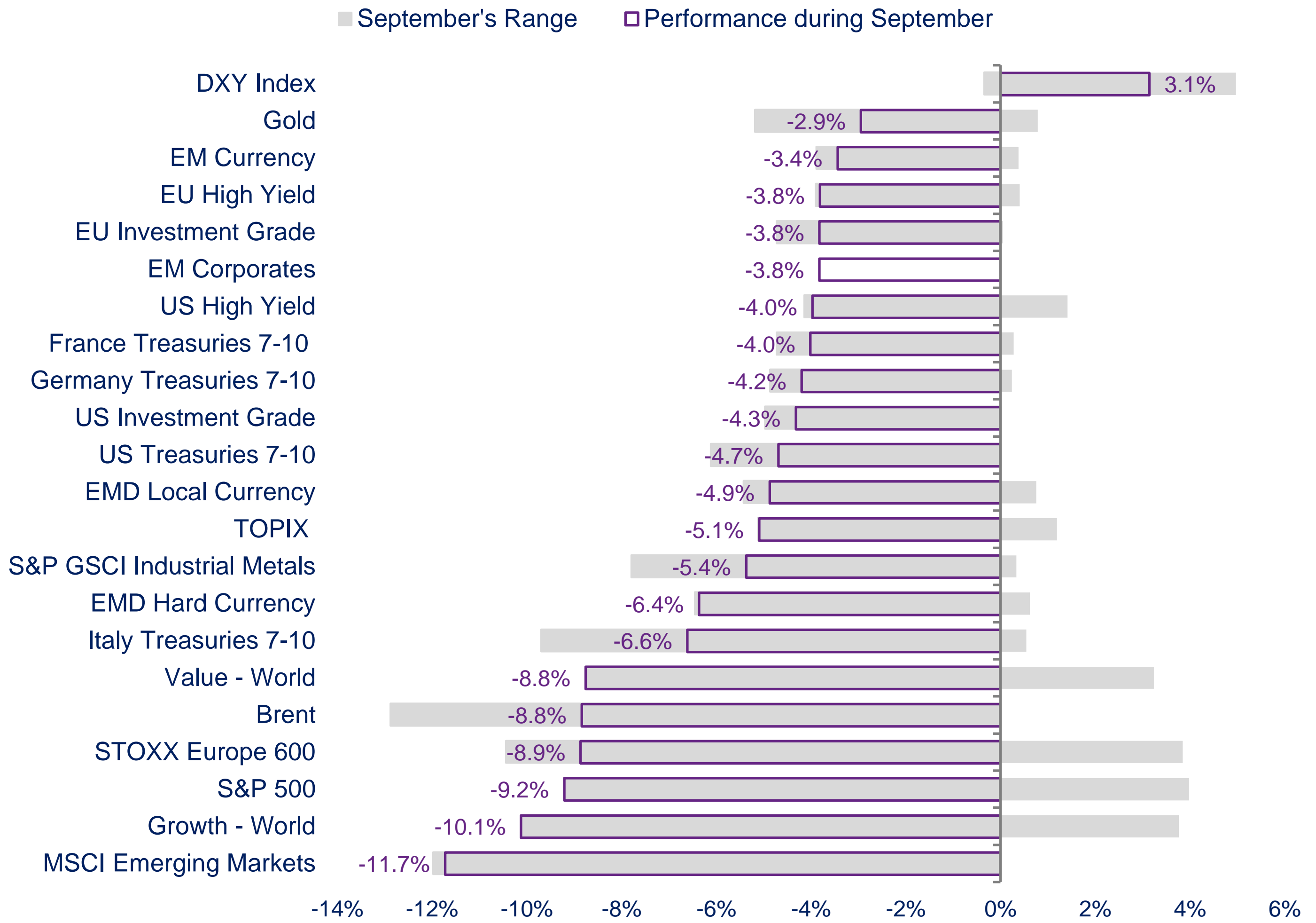
Last but not least, although China's domestic demand remained weak, they were some encouraging signs of rebound in fixed asset investment and industrial production. Such a poor internal demand continued to prevent an increase inflationary pressure, in fact, headline inflation headed down from 2.7% to 2.5% in August. This benign inflation environment allowed the PBoC to ease its policy and China's State Council to announced new measures worth CNY 1 trillion to support the economy.

Markets' reaction

The downward move that initiated after Jackson Hole meeting, when monetary policymakers shattered down investors' hopes for a moderation in policy hikes, extended throughout September as remarks kept on being very hawkish. The Fed, ECB and BoE all raised interest rates and arguably were the main driver behind the sharp rise in bond yields and sell-off in stocks.

The US dollar was the only place to hide (DXY +3.1%) as equities and bonds sold off across the board. The MSCI World lost 9.3% as the S&P 500 and the EuroStoxx 600 fell 9.2% and 6.4%, respectively. On a sectoral and global basis, real estate (-12.7%), information technology (-11.9%) and communication services (-11.8%) were the largest losers while healthcare (-3.9%), consumer staples (-7.7%) and material (-8.1%) were the least negative. On a factor basis, again value (-8.5%) slightly outperformed growth (-10.1%) in September as global yields jumped. The MSCI EM fared particularly poor, declining 11.7% driven by EM Asia, with a 18.3% decline in South Korea, a 15.8% fall in Taiwan and a 14.6% fall in China. Latam outperformed the region, but still posted negative returns, driven by strengthening currencies and improving growth and inflation prospects.

Global bonds took another large beat in September as discouraging inflation readings prompted central banks to signal "tighter for longer" monetary conditions. The US 2-year and 10-year yields rose by 75bp to 4.19% and 68bp to 3.79%, respectively. The impact of monetary tightening in the real economy was reflected by the 100bp monthly increase in the 30-year fixed mortgage rate, which rose above 6.5%. Similarly, European core yields also increased sharply as hawkish remarks from the ECB continued to come through. Bunds' yield rallied 67bp to 2.18%, OATs' 67bp to 2.8%, BTPs' 82bp to 4.65% and Gilts' 144bp to 4.14%. Credit again saw negative returns across the board with EU HY and IG performing the best but still both declining by 3.8%. US HY lost 4% while US IG lost 4.3%.



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