August 2022

Market Review

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Macroeconomic developments

Economic data released in August continued to show areas of resilience while central banks cleared up any doubts about a potential policy pivot anytime soon during their yearly meeting at Jackson Hole Symposium. After all, price pressures are still holding inflation significantly above central banks' targets. As such, risk assets came again under pressure in August as policymakers redirected rate expectations, which had started to price rate cuts by early 2023, to signal their determination to push inflation down, even if this causes a recession.

The US headline CPI slowed more than expected to 8.5% yoy in July from an over 40-year high of 9.1% hit in June, hinting that the peak might be already behind. However, core inflation, which excludes volatile components such as energy and food, remained steady at a six-month low of 5.9% yoy, suggesting persistent and widening price pressures. In addition, the US labour report was surprisingly strong, with 528,000 new jobs been created in July compared to expectations of only 250,000. Although this data should be indistinctly positive, the labour market remained very tight as suggested by the new 0.1 percentage point decline in the labour participation rate, which reached 62.1% in July. These developments were largely behind the Federal Reserve Chair Powell hawkish statement: “historical record cautions strongly against prematurely loosening policy”.

Eurozone's economic outlook continued to send mixed signals. Despite advancing 0.6% qoq in the second quarter, significant growth divergences are present amongst member states: southern countries, such as Spain (+1.1% qoq) and Italy (+1.1% qoq), benefited from services' rebound as activity reopened while Germany (+0.1% qoq) and France (+0.5% qoq) lagged. Headline inflation surprised on the upside in the Eurozone and reached 9.1% yoy in August, up from 8.9%, and core inflation rose 4.3% yoy, up from 4.0%. Additional liquified natural gas (LNG) imports and a successful reactivation of coal-fired power plants, European natural gas inventories in August remain in line with historical levels. However, the energy crisis aggravated after Russia completely halted gas flows through the Nord Stream 1 pipeline arguing an unscheduled maintenance procedure and sending European energy prices to new highs.

Economic data released in China throughout the month reflected that the country's accommodative policy has so far failed to support the country's sluggish domestic demand, which continues to suffer from soaring Covid-19 cases and lockdowns triggered by the government's zero-Covid policy. Retail sales dropped 0.3% mom in July while industrial production growth more than halved from 0.84% mom to 0.38% in July. Against this weakening backdrop, the People's Bank of China (PBoC) further cut its key policy rates and the country's State Cabinet announced an additional USD 146 billion stimulus largely focused on infrastructure spending.

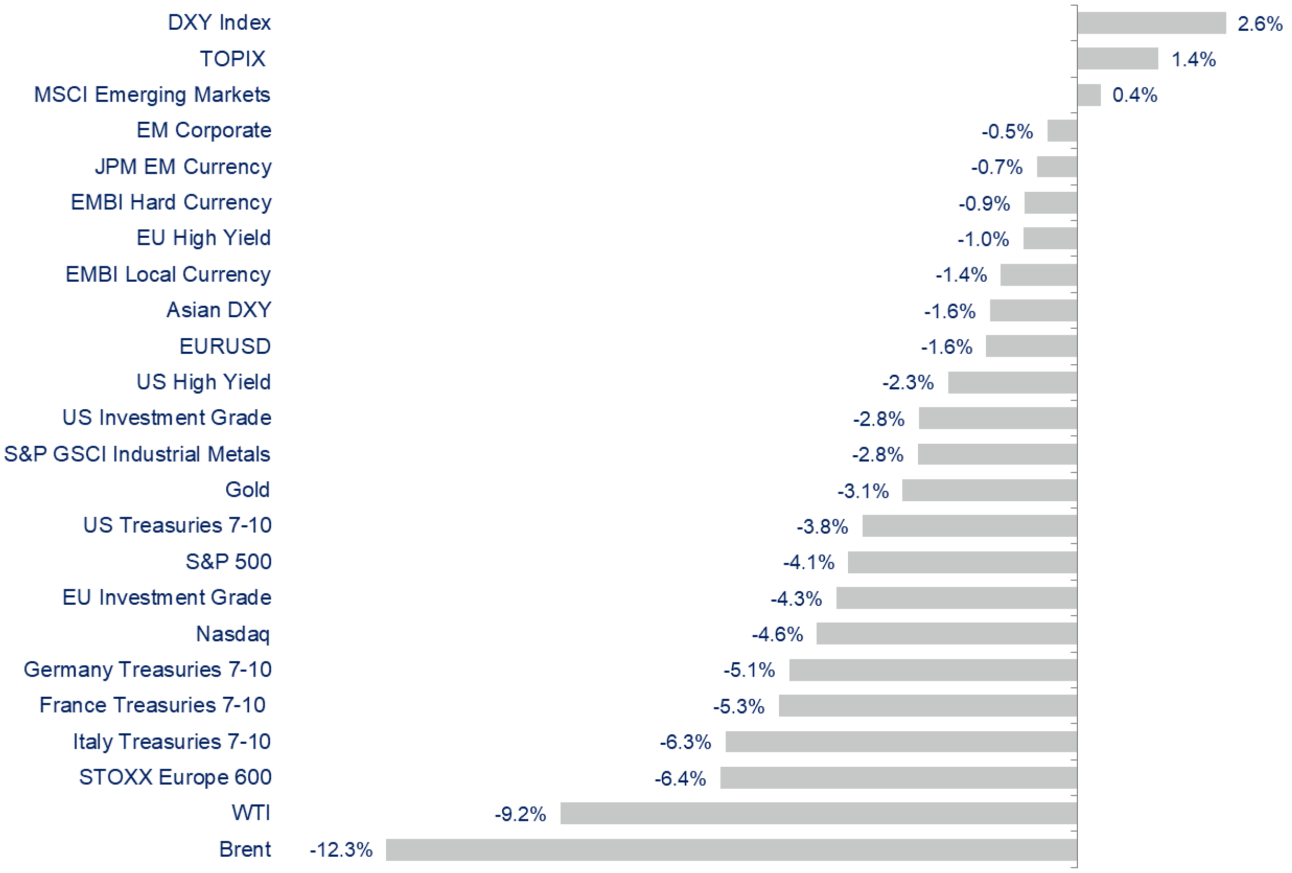
Markets' reaction

Ongoing worries over inflation and central banks' hawkish remarks during their annual Jackson Hole meeting, shattered investors' hopes that further interest rates would moderate, sending both equity and bond prices lower and maintaining volatility elevated throughout August. Developed equity markets lost 4.2% as the STOXX Europe 600 and the S&P 500 fell 6.4% and 4.1% respectively. On sectoral basis, healthcare (-6%), real estate (-5.9%) and information technology (-5.9%) were the largest losers while energy was the only one to post positive returns (1.9%). And, on a factor basis, value (-3.1%) outperformed again growth (-5.3%) in August as global sovereign yields rose. Moreover, despite the negative news coming from China and the stronger US dollar, emerging equity markets significantly outperformed developed markets (+0.4% vs -4.1%). Turkey led the index after the country's central bank delivered a surprise rate cut despite facing an inflation that nears 80% yoy.

Global bonds took a beat in August as central banks restressed their determination to fight inflation and keep policy tight for an extended period of time. The US 10-year yield jumped 53bp to 3.1% and the 2-year yield increased 57bp to 3.44%. European core sovereign yields increased even more sharply as markets priced that the ECB would hike its deposit rate by 75bp at its next meeting in early September. The Bunds' yield rallied 73bp to 1.51%, OATs' 78bp to 2.13%, BTPs' 94bp to 3.83% and Gilts 90bp to 2.7%. Credit also saw negative returns but performed better than sovereign bonds. High yield led the space, especially in Europe as it lost just 1%, while European investment grade lagged the most, losing 4.3%.

The DXY index reached a new 20-year high for the second consecutive month as both interest rate and growth differentials between the US and Europe kept favouring the greenback. On a positive side, Brent and WTI prices declined 12.3% and 9.2%, respectively, slowing economic growth weighed on the expected demand for oil.

Cross Asset Performance in August – in USD



Cross Asset Performance YTD – in USD