Investec

OUT OF THE ORDINARY

09 May 2022

Market reflection

John Wyn-Evans
Head of investment strategy

Overview

The market trends of the first quarter of the year continued into April, with both equity and bond markets delivering capital losses to investors.

Continued overleaf

We continue to be faced with an adverse combination of market drivers, namely a tightening of liquidity conditions by central banks and a deceleration of earnings growth, with the geopolitical background exacerbating the situation. Indeed, Russia's invasion of Ukraine has only served to put further upward pressure on consumer prices which, owing to the effects of the pandemic, were already rising faster than we had become used to.

Central banks are trying to lean against this, especially before a more inflationary mindset becomes embedded in consumers' expectations. This could lead to demands for higher wages, setting off a damaging wage/price spiral.

Although the US Federal Reserve, the world's most important central bank, has only raised its base rate by 0.25% so far, market expectations are for cumulative increases of around 2.5% in 2022. It will also begin to shrink its balance sheet in May, reversing the policy of Quantitative Easing that has provided a strong tailwind for financial assets.

Previous attempts at balance sheet reduction have been unhelpful to investors. The Bank of England has already effected three rate rises, with the base rate now standing at 0.75%. Futures markets are discounting a move to more than 2% by December. It is one thing for market participants to be expecting these increases, but quite another to see how they will affect activity in the real economy.

The concern is that central banks will keep raising rates until something breaks, and more pessimistic economists are forecasting imminent recessions. While we are not as gloomy as that, there is enough current uncertainty to warrant adopting a more defensive stance across portfolios.

- There has been a further deterioration in global economic growth projections, with the International Monetary Fund adding its voice to the chorus of concern. It reduced its 2022 global GDP growth forecast from 4.4% to 3.6%, and 2023's from 3.8% to 3.6%. The negative effects of the war in Ukraine are exacerbating already high inflation and the pain is spread widely across both developing and emerging nations.

- The latest inflation prints in the UK, US and the Eurozone were 7%, 8.5% and 7.5% respectively, numbers that have not been seen for decades. It is possible that the peak is in for the US, but the lagged effect of energy price rises means that the worst might yet be to come for the UK and Europe. We believe that 2022 will be the peak inflation year, but a return to the pre-pandemic trend of low inflation appears improbable in the face of retreating globalisation and the massive investment required to limit carbon emissions.

- Global aggregate forecasts for corporate earnings growth in 2022 remain around 9%, but all the heavy lifting is being done by Resource sectors buoyed by rising commodity prices. While the first quarter earnings season has produced a few shocks (notably including the performance of streaming pioneer Netflix), investors are also getting a clearer view of which businesses have greater pricing power and cost flexibility.

- Markets remain in a tricky transitional period, whether it be related to the exit from the pandemic, energy supplies, monetary policy or global geopolitical shifts. This suggests that market volatility will remain elevated.

 Continued overleaf

Investec

The information in this document is for private circulation and is believed to be correct but cannot be guaranteed. Opinions, interpretations and conclusions represent our judgement as of this date and are subject to change. The Company and its related Companies, directors, employees and clients may have position or engage in transactions in any of the securities mentioned. Past performance is not necessarily a guide to future performance. The value of shares, and the income derived from them, may fall as well as rise. The information contained in this publication does not constitute a personal recommendation and the investment or investment services referred to may not be suitable for all investors; therefore we strongly recommend you consult your Professional Adviser before taking any action. All references to taxation are based on current levels and practices which may be subject to change. The value of any tax benefits will be dependent on individual circumstances.

investecwin.co.uk

Member firm of the London Stock Exchange.
Authorised and regulated by the Financial Conduct Authority.
Investec Wealth & Investment Limited is registered in England.
Registered No. 2122340. Registered Office: 30 Gresham Street, London, EC2V 7QN.