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OUT OF THE ORDINARY

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Market reflection

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Overview

Global bond and equity markets have both sustained capital losses during the first three months of 2022, but the picture is much improved at the end of the quarter compared to how it looked at the beginning of March.

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Although bond yields have continued to rise, delivering the worst performance since the early 1980s, equities have rallied from the lows that they reached in reaction to Russia's invasion of Ukraine and the associated disruption to commodity supplies. Markets now appear to be relatively sanguine about the situation in Ukraine, but an escalation or widening of the conflict could still knock confidence.

The first quarter results season will provide the next big test, as companies disclose the effects of rapidly rising producer input price inflation. The winners will be those that can pass through higher costs or at least mitigate them through productivity enhancements. Headline consumer price inflation is set to move even higher, especially in the UK when the household energy price cap is lifted again in April.
The response of central banks will be crucial in determining the next phase of the investment cycle. The Bank of England announced its third base rate rise in March, and the Federal Reserve initiated its own policy tightening with a rise of 0.25%. Markets will also have to contend with the end of Quantitative Easing and, potentially, the beginning of Quantitative Tightening, whereby central banks allow the bonds held on their balance sheets to mature without being reinvested or even start to sell them down.

The risk of weaker economic activity, lower corporate earnings growth and more restrictive monetary policy is an unhealthy combination and we remain cautious on the outlook for markets in the short term. But despite the potential for increased volatility, equities may remain the most attractive asset class for generating long-term returns.

• Global economic growth (GDP) expectations continue to deteriorate, from +4.5% at the turn of the year to a current 4%, and there remains a risk of more downgrades to come. Economists still expect global growth in 2023 to be around 3.5%, an estimate that has been much more stable. But this will depend upon policymakers' ability to execute the desired 'soft landing'.

• Global inflation forecasts for 2022 have risen sharply this year, from 3.9% to 5.1%. A year ago, the consensus forecast was 2.8%. Concerns have grown that central banks might lose control of inflation, with the forecast for 2023 having also risen this year, from 2.9% to 3.3%. More reassuringly, the 2024 forecast is still at 3%, very much in line with the levels that prevailed pre-Covid.

• We are beginning to see more downgrades to corporate earnings forecasts than upgrades. Citigroup's Global Earnings Revisions Index has fallen to a negative balance of minus 20%. However, earnings in aggregate have been more resilient owing to sizeable upgrades for Energy and Mining companies. This has led to a wide dispersion of returns within markets.

• With bond yields rising rapidly, $2.3 trillion of global debt now has a negative yield to maturity. This figure was close to $17 trillion as recently as last August. Even so, persistently high inflation readings mean that positive nominal yields are still negative in real terms, and so bonds remain relatively unattractive in their potential to generate returns that might keep pace with higher prices.

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