Economic & Market review – June 2022

All around inflation

This month, Inflation is the main topic in financial markets.

Global equities and bonds have suffered year-to-date losses not seen in decades as inflation is hitting 40-year highs with headline CPI increasing by 8,6% in May. This showed that US inflation is surely more entrenched in the economy than what previously thought.

The Federal Reserve had no choice than fighting inflation with higher borrowing cost. Therefore, the Fed hiked rates by 75 basis points at his June's meeting and is expected to hike rates by 75 basis points at his June's meeting and is expected to hike rates by 75 basis points for its next meeting in July 2022. ECB finally also tightens its policy by guiding for a 25 basis points hike in July and opening the door for a 50 basis points increment in September.

For the Fed and ECB, to find a balance to slow the economy without destroying demand is becoming increasingly difficult. As rates rise, growth slows and consumer confidence declines, the margin for a policy error narrows.

Market sentiment remains in the grip of a hawkish monetary policy outlook, tightening financial conditions and geopolitical risks.

Global equities finished sharply lower in June with indexes closing it worst half of the year since 1970 for the S&P500 as example. Therefore, the MSCI World finished the end of the month with a performance of -8,8%, S&P 500 – 8,4%, Nasdaq 100: -9.0% and EuroStoxx 50: -8,8% bringing a Year-To-Date performance for the MSCI World: -21.2%, S&P500: -20,6%, Nasdaq 100 : - 29,5% and EuroStoxx 50: – 19,6% respectively.

It seems that equities are not yet pricing-in a significant economic slowdown which will be triggered by rising interest rates. Valuations are not cheap enough at this stage of the cycle as earning's expectations have not yet been revised lower for the second semester of 2022 and for the year 2023.

A cocktail of higher rates, widening spreads and the withdrawal of central bank liquidity resulted in fixed income posting the worst YTD loss since 1976. The moves in fixed income have been unprecedented in size and speed. There were no places to hide as all sub-segments of the Fixed Income were hit.

The dollar index strengthened to 104,68 but the big new came from the EUR/CHF at 1,0010 as the Swiss National Bank increased interest rates by 50 basis points. This decision was unexpected.

The market selloff has questioning whether the strategies of the last decade will still work going forward. The traditional 60/40 portfolio for Anglo-Saxon investors (60% allocation to equities for capital appreciation; and 40% allocation to fixed income for income and risk mitigation), may need to be rebuilt as we enter a new investment paradigm characterized by high inflation and increasing interest rates.