INFORMATION FOR INVESTMENT PROFESSIONALS

Your success. Our priority.

Market updates

Investment team updates | 4 February 2022

Fixed income

News

- An unhappy end to the week for markets, with rising/normalising rates and discount rates to blame. It would seem the era of super stimulative policy has ended – and markets, unsurprisingly, don't like it!
- In the UK the Bank of England raised rates, as expected, to 0.5% from 0.25%. However, four of the nine monetary policy committee voters wanted a 50bps rise – so the tone is more hawkish. Five further hikes are priced in for this year. The Bank will begin to dismantle its balance sheet by letting assets redeem and not investing further, and said it sees inflation peaking at 7.25% in April.
- In the euro zone there was also a more hawkish tone than expected, with risks in inflation to the upside – CPI was 5.1% year-on-year in January – while core prices rose 2.3% year-on-year
- Also in the euro zone, the unemployment rate fell to 7% in December, the lowest since the single currency began. In Germany the unemployment rate fell to 5.1%, which was lower than expected as well as being a post-pandemic low. The euro area saw a 0.3% expansion in GDP in Q4 2021, which was around a tenth lower than expected.
- In the US, ISM Services came in at an encouraging 59.9 in January. The ISM Manufacturing report was a robust 57.6 for January, recording a large increase in prices paid which feeds into the inflation theme. There was also a weak ADP jobs report, which showed a loss of 301,000 jobs in January as Omicron hit.

Markets

- Can February be any worse than January for markets? It was a month of more hawkish rhetoric by central banks in the face of stubbornly high inflation, while the pricing of higher interest rates dented returns in government and credit markets.
- It was a weak end to the week in core bond yields as well, especially in Europe. The US 10-year started the week (31 January) at 1.78% and ended it (3 February) at 1.825%. Germany started the week at 0.02%, finally in positive territory, and ended it at 0.16%, while the UK started at 1.3% and ended it at 1.36%. January as a whole saw UK yields up 34bps, the US up 27bps and Germany up 20bps, so a poor month.

- Credit markets, based on BofA Merrill Lynch Bond Indices, Global IG started the week (31 January) at 110bps and ended it (3 February) at 109bps. Global HY tightened a little over the week from 418bps to 402bps. In January as a whole, Global IG spreads were 10% wider while HY were 12% wider.
- Oil was up around 17% in January, while natural gas rose 30%. This week, oil started (31 January) at $88.2 a barrel and ended it at $91.1. It is now up 21% year-to-date. Commodities as a whole are now up nearly 10% year-to-date,
- In FX the US dollar was generally stronger over January against the euro and ended the month at 1.126. But it weakened over the past week to 1.145.

Multi-asset

- Our economic forecasts continue to point to growth having already peaked around the globe, and for inflation to peak in the first half of 2022. While our longer-term inflation outlook still suggests that the current pick-up is transitory due to ongoing structural disinflationary trends such as technology and demographics etc, the sharp price increases in areas where bottlenecks and supply chain disruptions continue to persist warrant careful monitoring. A key indicator here will come over the first half of the year, when base effects reflecting lockdown easings move out of inflation prints and the extent will become more clear to which increased inflation has become self-sustaining through labour markets without government support. In accordance with our transitory inflation view, we don’t expect market pricing for key developed market central bank rate rises to increase meaningfully from here.
- Over 2022 we expect growth and inflation to slow towards trend levels. A continuation of historically relatively easy policy levels and our continued solid earnings growth forecasts should continue to deliver decent, positive returns from risk assets like equities and credit over the next 12-18 months. Indeed, despite the materialisation of previously anticipated loss of earnings growth momentum from the reopening peak, Q3 21’s set of corporate results demonstrated broad ongoing strength across regions while early signs of Q4 21 remain firm.
- Over the last month, fears around long-term disruptions to global economic activity due to the emergence of the Omicron Covid-19 variant have receded due to evidence of its lower severity. However, volatility has remained elevated on the back of the more hawkish stance from the US Federal Reserve. This has shifted the focus of concern from the corporate fundamentals outlook to the expected path of policy rates and implications for discount rates applied to future cashflows. While more persistent inflation remains a key risk to our current rates forecast of two to five hikes from the Fed in 2022, strength in experienced inflation continues to be concentrated in areas where demand rose quickly as economies re-opened, and supply has struggled to keep up. We maintain our expectation that these will fade over the coming quarters as supply chains adjust.
- While the pace of the global economic recovery continues to ease off and valuations continue to feel the impact of changes in central bank policy expectations, we believe there is still value to be found in select cyclically sensitive areas and low-duration credit..

European equities

- In Europe, all eyes are on the situation in Ukraine where Russian intervention poses risks. These heightened tensions have pushed energy prices higher, further boosting inflation. Longer term, all but the worst outcome should lead to more benign macroeconomic effects – inflation may peak fairly quickly if energy prices subside.

- While there are risks of higher US interest rates, and the Bank of England has once again risen rates by 0.25 percentage points, we believe the European situation is less of a concern.
- Domestic politics remain important, with French president Emmanuel Macron jockeying for position in the election race, and in the UK Boris Johnson beset by "party gate" fallout.
- High-quality stocks have taken a back seat to cyclicals, prompting a sharp rotation in January. But high inflation benefits stocks with pricing power, so quality is likely to return in importance.

Note: all data as at 3 February 2022, unless otherwise specified. Source: Bloomberg.