Market Review

as at June 30, 2022

Markets have shifted from concern about stubbornly high inflation to inflation coupled with a recession. The recognition of this possibility along with already nervous investors caused an acute pull-back in nearly all asset classes. With the exception of certain commodities, there was no place to hide.

Global stocks saw severe selling with the US entering bear market territory. The MSCI World Index and the S&P 500 Index both ended the six months down by around 20 percent, and the Bloomberg European 500 Index was down by about 14 percent. The FTSE 100 Index of UK stocks fared somewhat better – it fell by about 1 percent – thanks to its oil stocks performing well.

A Looming US Recession?

Fretting over the possibility of a US recession is reasonable given the declining US consumer sentiment, consumer confidence and retail sales. Business confidence has also shown that the pace of growth in US manufacturing has declined sharply in June compared to May. These factors cast doubt over the ability of the private sector to help the US economy through the uncertainties caused by soaring inflation (US consumer prices were 8.6 percent higher in May than they were a year earlier, a 40-year high). The bright spot is employment, which continues to be very strong. If there is a recession, it will be the first one where employment did not weaken.

US companies exporting their goods and services are selling into a weakening global economy and through a very strong dollar, making their products more expensive to sell overseas.

The Atlanta Fed's *GDPNow* model forecasts that the US economy will contract by 2.1 percent (in real terms) in the second quarter. That would be a second consecutive quarter of decline, the technical definition of a recession.

Fed Watching

In May, the US Federal Reserve (the Fed) signalled that it was serious about combatting inflation by raising its benchmark interest rate by an extra-large 0.75 percentage points to a range of 1.5 to 1.75 percent. The futures market is expecting this policy trend to continue.

There is concern whether the Fed will be able to bring the economy into a so-called 'soft landing'. Many fear that the Fed will err on the hawkish side, exacerbating the decline in economic activity. This environment is an extremely challenging and treacherous one in which to navigate US monetary policy and bodes for continued volatility over the coming months.

Challenges in Europe

European monetary policy is embroiled in its own difficulties. Eurozone inflation hit a record high of 8.6 percent in the year to June, up from 8.1 percent in May. Energy and food prices surged in many countries due to supply disruptions caused by Russia's invasion of the Ukraine.

A sustained rise in gas prices would likely push the European Union into a recession. Europe is dependent on Russian gas, and Russia has already responded by cutting off gas supplies to certain sectors.

ECB Marshals Its Forces

European Central Bank (the ECB) president Christine Lagarde said that the bank would stick to its plan to begin raising interest rates with an increase of 25 basis points on July 21st. She added that a larger move was likely in September, unless there is a marked slowdown in inflation.

To put this into perspective, the ECB expects its deposit rate to rise above zero in September. Most western central banks have already started raising rates, whereas the ECB rate remains at minus 0.5 percent. It needs to reverse almost a decade of this very loose monetary policy, while trying to avoid pushing the region into a deep recession.

It seeks to avoid another 2009-style sovereign debt crisis, and to this end recently called an emergency meeting to announce it was fast-tracking work on a new instrument to tackle the divergence in Europe's disparate bond markets, as it tries to prevent borrowing costs – typically in southern European countries – from escalating so sharply that they trigger a financial crisis.

Outlook

Historically, for a downward lurch of this severity, there are usually major triggers such as the public defaulting on their mortgages *en masse* and a subsequent collapse in real estate values. Or, for example, sudden emerging market currency devaluations. But the current collapse has been caused by an overstimulated economy due to the unprecedented impact of the pandemic, which is now settling back towards "normal" growth.

Since 1946, the tendency is for markets to rally hard after a fall such as we have experienced. The exception was 2008, which showed that another downward spiral is possible, even after the crash we've seen so far. Note that Lehman Brothers was *not* bailed out in 2008, which greatly extended the market's decline.

Rather than falling in order to discount a potential crisis trigger, today's market may be attempting to reflect the lack of an implicit bailout. The current inflation problem may prevent the profligate money printing strategies of the post-2008 period. In other words, if there is a recession, there is a danger we may find ourselves 'out of ammo'. We continue to be cautious over the coming months.

Macro Indices Report as at June 30, 2022 (%)

	JUN	MAY	APR	Q2 2022	YTD	2021	Annualized 3 Years	Annualized 5 Years
GLOBAL EQUITY								
MSCI AC World Total Return	-8.4	0.1	-8.0	-15.7	-20.2	18.5	5.8	7.1
MSCI EAFE	-9.3	0.9	-6.4	-14.3	-19.2	11.9	0.7	2.3
NORTH AMERICA EQUITY								
S&P 500 Total Return	-8.3	0.2	-8.7	-16.1	-20.0	28.7	10.4	11.7
DOW JONES INDUSTRIAL AVG	-6.6	0.3	-4.8	-10.8	-14.4	20.9	7.1	10.2
S&P 400 Net TR	-9.7	0.7	-7.1	-15.5	-19.7	24.3	6.4	6.9
NASDAQ COMPOSITE	-8.7	-1.9	-13.2	-22.3	-29.2	22.2	12.6	14.4
RUSSELL 2000 INDEX	-8.2	0.1	-9.9	-17.2	-23.4	14.8	4.6	5.8
S&P/TSX COMPOSITE INDEX	-8.7	0.1	-5.0	-13.2	-9.8	25.2	7.6	7.7
EUROPE EQUITY								
BLOOMBERG EUROPEAN 500	-7.8	-0.5	-0.5	-8.8	-13.7	23.1	3.7	4.1
FTSE 100 INDEX	-5.5	1.1	0.7	-3.8	-1.0	18.4	1.7	3.3
CAC 40 INDEX	-8.2	0.5	-1.3	-8.9	-15.0	31.9	4.4	5.7
DAX INDEX	-11.2	2.1	-2.2	-11.3	-19.5	15.8	0.0	0.3
ASIA EQUITY								
MSCI AC Far East Ex Japan	-4.8	1.3	-5.8	-9.1	-17.5	-10.1	-1.3	0.2
NIKKEI 225	-3.1	1.6	-3.5	-5.0	-7.3	6.7	8.3	7.5
HANG SENG INDEX	3.0	2.2	-4.1	0.9	-4.8	-11.8	-6.4	0.0
S&P/ASX 200 INDEX	-8.8	-2.5	-0.9	-11.8	-9.3	18.7	3.9	8.1
SHANGHAI SE COMPOSITE	7.5	4.8	-6.3	5.6	-5.7	7.0	5.9	3.2
SOUTH AMERICA & EM EQUITY								
MSCI EM Net Total Return USD Index	-6.6	0.4	-5.6	-11.5	-17.6	-2.5	0.1	2.1
S&P LATIN AMERICA 40	-17.1	8.7	-13.8	-22.3	0.6	-12.8	-9.0	-1.7
BRAZIL IBOVESPA INDEX	-11.5	3.2	-10.1	-17.9	-6.0	-11.9	-1.8	9.5
S&P BSE SENSEX INDEX	-4.5	-2.2	-2.5	-8.9	-8.3	23.2	12.1	12.7
FIXED INCOME								
ICE BoA 1-3 Year US Treasury Index	-0.6	0.6	-0.5	-0.5	-2.8	-0.6	0.2	0.9
Barclays US Agg	-1.6	0.6	-3.8	-4.7	-10.3	-1.5	-0.6	1.1
Barclays Multiverse (Unhedged)	-1.5	0.3	-5.4	-8.4	-10.1	-4.5	-3.0	-0.4
Citi World BIG US Hedged	-1.7	-0.2	-3.2	-5.0	-8.3	-1.8	-1.2	1.2
ICE BoA US High Yield Index	-6.8	0.2	-3.6	-10.0	-14.0	5.4	0.5	2.3
JPM EMBI Global Core – US$	-6.6	0.3	-6.1	-12.1	-20.8	-2.1	-5.2	-0.9
JPM EM Global Cove – Local	-4.3	1.3	-5.5	-8.3	-13.0	-9.2	-6.4	-2.7
COMMODITIES								
BLOOMBERG Commodity Index	-10.9	1.4	4.1	-5.9	18.0	27.1	12.3	6.3
GOLD	-1.2	-3.8	-1.6	-6.4	0.6	-7.1	8.5	7.7
OIL (WTI)	-5.7	11.2	5.0	10.0	54.9	62.2	0.2	5.3

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