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2022 - END OF SUMMER MACRO OUTLOOK

20/09/2022

SUMMER REVIEW

Equity markets experienced a largely upward movement with the MSCI World up +14% from mid-June to mid-August. As from the second half of August, persistence in inflation and central bankers recalled to the market that they were still focus on tightening their policy whatever it takes, putting an end to this upward movement.

Why so ?

- A bear market rally? Market positioning was pessimistic. In such a context the pain trade was clearly with markets moving higher and the tolerance for losses being uneven among investors some have been quick to unwind hedges. A sequence which is typically seen in bear market rallies (this year alone there has been already 5 rebounds where equity markets recorded +5% returns or more).
- It's either that or, some form of complacency on fixed income markets. Indeed, market narrative has shifted from hopes of seeing the inflation being under control at the beginning towards a longer (albeit potentially slower) tightening cycle.

Indeed market narratives have somewhat evolved in the light of a stronger US dollar, the US 10 year close to the important technical level of 3.1%, and credit spreads wider and commodities holding relatively well.

ECONOMIC OUTLOOK

In the US

Economic growth has been weaker (the country having recorded 2 consecutive quarters of negative growth, the so-called technical recession) during the first half of the year, but going forward, the US economy should enjoy a consumption rebound during the second half of the year in a context of still tight labor market and a rebound in real wages (indeed wages are trending on 6% growth year on year and inflation is expected to come down towards 3.5% by year end). Which portends for a resilient consumer and hence a longer hiking cycle than generally accepted (albeit potentially at a slower pace than what we have seen so far).

In Europe

Most recent PMI (below 50 for the Eurozone composite) aren't of good omen for the continent's growth trajectory. But the prospects of restrictions on energy (whether imposed by authorities or by the impact of electricity prices which have been multiplied by 5 over the past 6 months) will weigh on economic prospects (as per the German energy regulator to avoid the implementation of rationing this winter, demand must be curbed by 20% across those coldest months). Indeed, the corollary to a drop in demand - whether self-imposed or prescribed – is a drop in production and hence a drop-in economic activity. Likewise with the increase in fixed costs, corporates will decrease capital expenditure, further weighing on growth. Germany is the main driver of economic growth on the continent and the most exposed which doesn't bode well for the other 26 member states. Recession is expected to hit the country by the 4th quarter of the year, the magnitude of which will largely be dependent on offsetting fiscal measures and which economic agent and sectors will be most subject to energy restrictions. On that respect, upcoming Industrial production publications will be key to watch so as to assess the overall and specific impact of the drop in energy demand.

In China

Most recent economic publications have been disappointing and both youth unemployment and mortgage boycott are likely additional sources of concern to authorities. While more can be expected on the policy front, so far, the response has been mainly focusing on infrastructure and subdued elsewhere to say the least with a merely 10 bps cut from the PBOC and merely CNY200bn of subsidized loans to address a 1 to 2 trillion problem). Not necessarily calling for an outright exit from Chinese equities given the low correlation between China macroeconomic environment and the evolution of Chinese equity markets, but still some form of cautiousness in exposure and individual stock selection.

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