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Market updates

Investment team updates | 21 January 2022

Fixed income

News

- In the eurozone, the European Central Bank has sought to distance the path of eurozone policy from that of the US Federal Reserve, sighting change in rates in the immediate term. Minutes for the ECB's December meeting are more hawkish, however, as it noted inflation higher for longer than initially expected, and a long-term forecast of around 2% for 2022/23. This is even as eurozone inflation this week reached the highest level since the formation of the single currency zone at 5% year-on-year.
- Also in Europe, in Germany specifically CPI was up 0.1% in December to 5.3%, in line with the first estimate and consensus. Latest figures also showed that GDP in 2021 in Germany grew at 2.7%, led by government spending, net exports and investment. Conversely, consumption was weak.
- In the UK, consumer confidence in January fell to -19 from -15, against a long-run average of -9. This was mostly down to the Omicron situation. However, inflation also jumped to a 30-year high of 5.4%, and retail sales for December were much weaker than October and November, down -3.7% and the worst since early 2020.
- There was encouraging UK news on Covid-19, with cases down more than 40% in the past week – with other countries watching this outcome with anticipation. The prime minister announced that from January 26 there would be no further need to work from home or wear face masks.
- In the US, there was employment weakness with jobless claims their highest in three months to 286,000 with the economy cooling as a result of Omicron. Elsewhere in the US news was quiet with the Fed entering blackout ahead of the FOMC meeting.
- In Japan, the Bank of Japan estimates inflation will be 1.1% in 2022, revised up from 0.9%, with GDP growth of 3.8%.
- In China, 2021 GDP grew by 4% – more than expected – though it slowed into year-end with Omicron and property sector problems. The country also reported stronger industrial production in December, but retail sales were weaker than expected.

Markets

- The end of the week saw core bond yields rally for a second day – driven lower by the ongoing correction in equities. The US 10-year started the week (17 January) at 1.88% before recovering to 1.79% on Thursday 20 January. Germany started the week at -0.02% and ended it at -0.06%, while the UK started and finished at 1.18% after hitting 1.26% on Wednesday 19 January.

- The shape of moves remains interesting as inflation expectations are now 26bps lower year-to-date, which is consistent with the idea that inflation is topping out. However, real yields are higher by 55bps – consistent with the more hawkish approach from the Fed which has four rises priced in this year.
- Credit markets, based on BofA Merrill Lynch Bond Indices, were mostly unchanged across the week, even as equities fell, with Global IG at 101bps and Global HY at 377bps.
- In FX, the US dollar ended the week a little better with the euro at 1.133. Bitcoin fell below 40,000 and is down 17% year-to-date.
- Oil has been marching higher recently, up 13%-15% year-to-date, but shifted lower for the first time in a while on 20 January to $84.1. Commodities as a whole are up 6% year-to-date.

US equities

- US equities continued their theme of weakness over the past two weeks, as the rotation away from highly valued growth stocks continued. The S&P 500 has fallen 4.1% over this period and down by 5.9% year-to-date, while the Nasdaq has lost 4.8% in the past two weeks and 9% in January so far, reflecting the sell-off in growth names. Unsurprisingly, growth has lost ground to value with the difference between the S&P 500 growth and value indices standing just shy of 8% this year. Adding to the risk-off tone, small caps (as per the Russell 2000) have declined by 9.8% in January.
- The rising rate environment, and the prospect of several increases this year, has been detrimental for the growth category with the 10-year treasury yield hitting two-year highs at close to 1.9% in the past week.
- On the economic data front, US CPI came in at 7% year-over-year in December, the highest reading since 1982, while jobless claims rose last week to the highest level since October, suggesting some short-term disruption in the jobs market caused by the Omicron variant and as temporary seasonal workers fell out of the labour market. While the overall labour market remains very tight with an unemployment rate of 3.9%, total labour force participation remains below pre-pandemic levels.
- Despite record gains of 6.4 million workers in 2021, the economy still has 3.6 million fewer workers than before the pandemic. A run-off in savings levels and the end of federal support packages could see more people going back to work, although some jobs may be permanently lost due to early retirements, for example. If the economy is indeed closing in on full employment, then the upward pressure on wages will likely strengthen the Fed’s case to move ahead with a rate hiking cycle.
- The Q4 earnings season got underway in the past few weeks. Going into this reporting period, expectations were for 21% earnings growth which would take us to around 45% growth for the whole of 2021. So far, around 12% (by market cap) of the S&P 500 has reported. Earnings are currently beating estimates by 5.4%, with 74% of companies ahead of expectations. Cyclicals are projected to record higher rates of earnings growth.
- Banks have been the first to report and the key messages have been an improving outlook for loan growth and net interest margins, offset by higher expenses caused by upward wage pressure and technology investment. JPMorgan and Citi both reported overall declining profits. Headline Q4 profits went down by 14%, or $10.4 billion, at JPMorgan and 26% ($3.2 billion) at Citi on a year-on-year basis. Although these figures were ahead of expectations, shares have since sold off. Big banks have become accustomed to subdued expense growth over the past year or two, but this is turning into a more significant headwind. There is more competition for banking talent and a need to invest in technology, which are pushing expense ratios higher. Also, during 2021 banks’ bottom lines benefited enormously from the release of loan-loss reserves, but that boost is coming to an end. Despite the outlook for banks remaining healthy, with rising rates on the horizon, these results show there are a number of headwinds, particularly on the cost side, that they will need to grapple with over coming quarters.

European equities

- European equities have been dull since the start of the year, and growth stocks – especially technology – have de-rated.
- There are three short-term headwinds for the market: the spread of the Omicron variant, likely to peak soon; higher energy prices, which may subside after the winter but depend to some extent on the Ukrainian situation; and a slower Chinese economy, although we expect it to rebound as Omicron recedes, inflation subsides and stimulatory measures take effect. So all three headwinds may reverse later in 2022, meaning the market will anticipate better overall conditions.
- Inflation will remain a short-term issue, but this should increase the attractions of companies with pricing power, and is unlikely to prompt much higher interest rates in Europe.

Note: all data as at 20 January 2022, unless otherwise specified. Source: Bloomberg.