



## Market review: August 2022

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- US and European equities weaker; Emerging Markets flat
- Federal Reserve's Jay Powell delivers most hawkish statement on inflation to date
- Political uncertainties will add to market volatility for the rest of 2022

**US and European equity markets weakened in the second half of August following the strong gains initiated in July. Worries about the economic outlook grew as inflation gathered pace and the messages emerging from central banks became increasingly hawkish. There were also worries in Europe about the growing energy crisis.**

The most significant market event in August was Federal Reserve Chairman Jay Powell's address to the Jackson Hole symposium of central bankers. In his most hawkish message on fighting inflation so far, he said the Fed 'must keep at it until the job is done' and that this would probably result in a 'sustained period of below-trend growth'. While this would lead to some pain for businesses and households, he said, a failure to restore price stability would mean far greater pain. Having delivered two successive 75bp hikes, Fed officials were now debating whether to impose a similar or 50bp increase in September.

The second estimate of Q2 GDP showed the US economy shrank less than previously reported, a 0.6% decline as opposed to the previous estimate of -0.9%. Although this still represented a second quarter of negative growth, and technically a recession, the unemployment rate remained at a multi-decade low of 3.5% and jobs figures surprised on the upside, with 528,000 jobs having been added in July, easing concerns of a recession. It meant that the US had recovered all the jobs lost since the start of the pandemic in February 2020, but it did raise concerns that the Fed would continue to raise interest rates aggressively rather than pivot to a more dovish stance. The inflation data was marginally encouraging for markets, however, with a reading of 8.5% in July, which was below the 8.7% economists had expected and the June figure of 9.1%.

In Europe, investor sentiment continued to be dampened by fears of tighter monetary policy and a European energy crisis. The euro fell to a two-decade low versus the dollar and Eurozone bonds were also volatile as the European Central Bank's (ECB) withdrawal from the market removed one of the most important buyers and recession fears grew. Rate setters were also signalling another half percentage point increase at the ECB 8 September meeting. At the Jackson Hole symposium, Isabel Schnabel, an ECB Board member, and Francois Villeroy de Galhau, Governor of the Banque de France, had warned that European monetary policy would have to remain tight for an extended period. This would need to be more severe than previous spells of tightening if inflation is to be controlled, they said. Schnabel warned that inflation would be harder to control the longer they waited.

Sterling suffered its worst monthly fall against the dollar (-4.5%) since the 2016 Brexit referendum as political and economic uncertainty mounted in the UK. The UK economy contracted by 0.1% in Q2, after having risen by 0.7% in Q1. Notable factors were households cutting spending because of the cost of living crisis and a decline in the health sector output as Covid cases and testing levels fell. The UK's Q2 economic performance was better than that of the US but worse than other G7 nations, including Germany, France, Italy and Canada, which have seen stronger recoveries from Covid. New data showed UK inflation jumped to 10.1% in July, which was the first double-digit figure in four decades. Higher food prices were a key factor in driving inflation up from 9.4% in June. It was the highest rate of any G7 country and added to the pressure on the Bank of England (BoE) for another 50bp rate hike.

Fears of recession also grew as the energy crisis loomed. The BoE had acted 'forcefully' earlier in August with a 50bp hike in the base interest rate to 1.75%. It forecast inflation to rise to 13% and that the UK would slip into a

15-month recession later this year. The extent of the rate rise was expected by markets, but the BoE's gloomy outlook caused some dismay. It predicted the UK economy would shrink from Q4 and the downturn would last for five success quarters. There were concerns that a new government led by Tory party leader frontrunner Liz Truss would implement fiscal policies that would only make the monetary objectives of the BoE harder to achieve.

Emerging market equities were mostly flat over August despite some challenges. A major flood crisis exacerbated the woes of Pakistan, which was already seeing its sovereign bonds shunned by investors on fears it would follow Sri Lanka into default. The country was struggling with soaring prices of imported commodities and tighter credit conditions, but it did find some support from expectations that an International Monetary Fund (IMF) bailout would help it to avoid a default.

Across the border, the People's Bank of China cut its medium-term lending rate by 10-basis points to 2.75%. This was the first cut since January and a surprise to the consensus view, which was for the rate to remain unchanged. China cut the lending rate to support economic growth, which had been adversely impacted by repeated Covid lockdowns and the deteriorating mortgage crisis. A slew of data for July highlighted China's economic malaise, with youth unemployment at 19.9% and worse than expected retail sales and industrial production. China's economy only narrowly avoided a contraction in Q2.

Financial markets look set to see more volatility throughout the remainder of 2022. Change of leadership in the UK, a general election in Italy, China's 20th National Party Congress in October and the US' mid-term elections in November will generate political uncertainty while the growing hawkishness of central banks is causing jitters. Markets dislike uncertainty, but this can also create opportunities.

We are adjusting our funds and portfolios to take account of current conditions but we believe a protracted slowdown is less likely than the consensus fears and there are assets that are attractively priced now following indiscriminate selling this year. We are already some way through the current market decline, which usually last around nine to 12 months, and we have positioned our funds and portfolios for the opportunities we envisage coming through over the next five to 10 years, which will inevitably be markedly different from those seen over the last decade.

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