

Market Commentary – August 2022

August's highlights

- While backward looking economic data releases were generally a little better than expected, forward-looking indicators, such as the 26-month low in global manufacturing Purchasing Managers' Index ("PMI"), highlight the ongoing slowdown in global economic activity.
- The pace of inflation eased in the US but continued to accelerate in the UK and Europe as gas prices remained on an upwards trend.
- Growth forecasts were revised lower and inflation forecasts rose as consumer's real incomes decline sharply and businesses face ongoing cost pressures.
- As the major central banks re-iterated their commitment to stamping out unacceptably high inflation, interest-rate expectations, and sovereign bond yields, surged higher, weighing on both equity and bond prices.
- The dollar continued to strengthen against global peers and commodity prices slid for the third consecutive month, as oil prices led the energy sub-sector lower and industrial metals prices weakened on slowdown fears.

Market Performance

UK	August	QTD	Year to date	GLOBAL	August	QTD	Year to date
UK	-1.7	2.6	-2.1	UK			
GLOBAL	0.8	7.6	-3.7	Conventional gilts	-7.6	-5.2	-18.6
North America	0.5	9.5	-3.5	Index-linked gilts	-7.3	-2.4	-23.9
Dev. Europe ex UK	-2.3	2.7	-13.2	Corporate	-6.1	-3.3	-15.4
Japan	2.0	7.3	-3.4	GLOBAL			
Dev. Asia ex Japan	2.7	7.0	0.4	Government Bonds	-2.5	-0.4	-8.2
Emerging Markets	5.8	4.7	-0.7	High Yield	-2.5	3.1	-11.2
Sterling v US dollar	-4.4	-4.2	-14.1	Emerging market	3.2	5.2	-6.9

Source: Morningstar. Percentage returns in sterling terms. All data as at 31/08/2022. Emerging market bond returns are a composite of 50% hard currency and 50% local currency bonds.

Economic background

Q2 GDP data released in August generally surprised to the upside, however, forward looking business and consumer indicators added to growing evidence of a global growth slowdown. While lower commodity prices pointed to an easing of global inflation pressures, higher regional gas prices are seeing European inflation and forecasts continue their ascent. Central banks re-asserted their commitment to bringing down inflation, even if this is delivered via economic recession, sending interest rates, and sovereign bond yields higher, weighing on both equity and bond prices.

While labour market strength, and resilient consumer spending, will prevent the National Bureau of Economic Research from declaring the US is in "recession", a second successive quarter of negative growth in Q2 suggests the economy is carrying little forward momentum. Global Growth forecasts have fallen further, and recession risks are high, as falling real incomes and higher costs weigh heavily on consumer and business sentiment.

With regards to price pressures, US inflation surprised to the downside in July, falling by more than expected to 8.5% year-on-year. Meanwhile UK inflation continued to rise in July hitting 10.1%. US and UK inflation pressures continue to look more broad-based, owing in part to very tight labour markets, which are driving wage and services price inflation. In contrast, more than half of eurozone headline inflation still relates to more volatile energy and food prices.

Interest rate expectations surged higher in August as central banks re-iterated their commitment to stamping out unacceptably high inflation. Whilst there have been some nascent signs of global inflation pressures easing, central bankers stressed there should be no easing at the first signs of a dip in inflation. The Bank of England delivered a 6th consecutive rate rise at their August meeting, lifting the base rate by a larger-than-usual 0.5% p.a. to 1.75% p.a. Market pricing at the end of August implies the BoE will raise rates to a peak of around 4.4% p.a. in September 2023, before embarking on a series of rate cuts, presumably as reduced demand sees inflation fall.

Equity markets

Despite falling sharply at the end of the month on account of interest rate expectations rising once more, global equities rose 0.8% in August. The US outperformed, although this mostly reflects a strengthening of the US dollar compared to the pound, which fell over 4% in the month. Emerging markets performed well, once more predominantly down to pound weakness. Conversely, European and UK markets underperformed, as the regional economic outlook dimmed.

Developed market government and investment-grade corporate bonds

Central bankers' strengthened resolve in keeping rates high led to government bond prices falling. UK gilts recorded their worst performing month since the 1990s while global bonds also sold off. A more significant rise in near-term yields saw the spread between US 2-year and 10-year yields widen further into negative territory (a yield curve inversion) – a sustained inversion being a typical indicator of an upcoming recession in the next year or so.

UK long term implied inflation expectations, as measured by the difference between conventional and inflation-linked bond yields, rose 0.4% p.a., meaning index-linked gilts outperformed conventional gilts. Widening credit spreads as well as a rise in underlying sovereign bond yields drove negative total returns in sterling credit markets of -6.1%.

Alternative bonds

Global high-yield spreads widened slightly but the lower duration of the asset class, compared to investment grade bonds, meant the impact of rising yields was more dampened - losses were limited to 2.5%. Moody's lifted their one-year baseline global speculative default rate to 3.7%, from 3.3% last month. Emerging market debt generated a positive return as yields fell and the pound broadly weakened against other currencies.



Jack Richards
Investment Manager

Risk warning

This communication is issued and approved by Hymans Robertson Investment Services LLP. It is based on its understanding of events at the time of the relevant preparation and analysis. The information and opinions contained in this document are provided by HRIS and are subject to change without notice and should not be relied upon when making investment decisions. The value of your investments and the income from them may go down as well as up and neither is guaranteed. Investors could get back less than they invested. Past performance is not a reliable indicator of future results. Changes in exchange rates may have an adverse effect on the value of an investment. Changes in interest rates may also impact the value of fixed income investments. The value of your investment may be impacted if the issuers of underlying fixed income holdings default, or market perceptions of their credit risk change. There are additional risks associated with investments in emerging or developing markets. The information in this document does not constitute advice, nor a recommendation, and investment decisions should not be made on the basis of it. The material provided should not be released or otherwise disclosed to any third party without prior consent from HRIS.