INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 1 April 2022

Fixed income

Markets

- It was a mixed week for core government bond yields, following a bit of a meltdown last week (ending 25 March). The US 10-year started the week (28 March) at 2.5% and ended it (31 March) at 2.38% having travelled in both directions across the week. Germany started and ended the week at 0.59% and 0.58% respectively, but again saw movement in both directions, while the UK started at 1.71% and ended at 1.61%. On Tuesday 29 March the US yield curve briefly inverted between two and 10 years.
- Credit markets, based on the BofA Merrill Lynch Bond Indices, saw Global IG start the week at 134bps, and end it tighter at 129bps. They 153 bps at the wides of 15 March. Global HY started the week at 434bps and ended the week rallying to 412bps. They were 499bps on 15 March.
- The Emerging Markets Bond Index Global was little moved through most of the week in the low 380bps, but saw a huge movement on 31 March to 347bps as Russia dropped out of the JP Morgan fixed income indices at the end of the month. The EMBIG was as wide as 451bps in first week of March.
- Oil fell from $109.4 at the back end of last week (25 March) to $103 as of 1 April. This is likely as a result of the US strategic petroleum reserve (SPR) release announcement.

News

- Vladimir Putin's decree that Russian gas must be paid for in rubles for "unfriendly countries" has come into effect. However, there is a loophole in that the measure won't apply to European gas customers, who can pay via designated accounts in Russia that convert their USD or EUR payments into rubles.
- Russia claimed earlier in the week that it would be "dramatically reducing" military operations around Kyiv, which was well received in markets. Later, however, it poured cold water on talk of negotiation progress – although they are expected to resume.
- Germany and Austria triggered their emergency plans for gas disruption. Germany urged households and companies to reduce consumption in anticipation of shortages, while both countries are in the "early warning stage". The final stage is bringing in gas rationing – gas storage facilities in Germany are currently 25% full.
- US president Joe Biden announced he will release up to 180 million barrels of oil over the next six months from the US's SPR. This amounts to around a million barrels a day, which is approximately 1% of daily global demand.

- In the UK, GDP expanded at 1.3% quarter-on-quarter in Q421. This was above market expectations of 1%. However, the data is lagged so doesn't factor in the Russia/Ukraine impact. Meanwhile, Nationwide house prices, which were very strong in Q1, are expected to slow as mortgage rates rise and real incomes fall. The UK has also seen a massive £1.5 billion leap in credit card spending. This is three times the average monthly increase and the highest on record, suggesting consumers are struggling with reduced disposable income and using debt to fund spending.
- In France, CPI rose higher than expected to 4.5% year-on-year in March, compared to 3.6% for April. This follows unexpectedly high CPI prints from Germany (7.3%) and Spain (9.8%). Also in France the INSEE consumer confidence index dropped to 91 in March, against an expected 94. In Germany, meanwhile, the unemployment rate held steady at 5%, as expected. Retail sales in the country rose 0.3% month-on-month in February and 7% year-on-year, which was better than expected.
- In the US, consumer confidence edged higher in March from a year-long low in February. As in other countries, inflation is outpacing wage gains – though labour conditions remain strong.

US equities

- US equities rounded off the quarter in the red, but well off the lows after a rally in the past two weeks. The S&P 500 finished the quarter down by 4.6%. Small caps have fared worse, down by 7.5%, while the Nasdaq 100 declined by 8.9%. This was the first quarterly decline for the S&P 500 since Covid-19 took hold in Q1 2020. In the past two weeks, though, the S&P 500 was up by 1.5%, helping to reduce those losses.
- With a lack of stock-specific news, equities have continued to move around on geopolitical headlines with some signs of progress being made towards an end to hostilities in Ukraine. The US Federal Reserve has also started out on its rate-hiking path, something which has long been anticipated by markets and signalled. The inflation outlook continues be heavily tilted to the upside, although the market seems to be embedding higher expectations with recent inflation readings coming in at or below market expectations rather than exceeding them. A flattening of the yield curve has come to the forefront of conversation, given the ominous omens for recession were it to invert. Two-year Treasury yields are currently sitting at around 2.35%, almost identical to the 10-year yield. Back in November, when the Fed started to talk about raising rates more aggressively to combat inflation, the two-year yield was around 0.5%. The strength of the move at the front end of the curve demonstrates how the market is pricing in more Fed action to tame inflation which is running at 40-year highs: CPI was 7.9% in February. Given these ominous levels it makes it much more likely that the Fed will decide to move in 50bps increments, at least for some of its rate hikes.
- Since the beginning of the year, large cap value has outperformed large cap growth by more than 8%, with growth stocks in general underperforming on account of the higher rate outlook and the associated increase in the discount rate. Over the past few weeks, as markets have recovered slightly, growth factors have regained some ground against value. From a sector perspective, the main winners and losers this year come as no surprise with energy at the top of the sector table and communications services, consumer discretionary and technology at the bottom.
- Despite the negative headwinds in the form of higher prices and supply chain challenges exacerbated by the situation in Ukraine, we remain confident in the consumer outlook. We are continuing to see a significant transition from goods spending to services spending in the US, evident in the personal consumption expenditures data and in recent airline, restaurant and lodging figures. Overall, financial stress in the economy appears to be low and absent a big weakening in the jobs market, consumers are set up well. The shift from

goods to services spending should also benefit the inflation outlook. Added to this mix, growth still remains above pre-Covid levels, unemployment is low and, as mentioned in previous weeks, the US has a high level of energy security given its ability to tilt towards domestic shale production.

- In corporate news, Nike and Adobe have reported in recent weeks. Nike's earnings were taken positively, especially comments about demand significantly exceeding available inventory supply and production levels in Vietnam returning to pre-Covid levels, along with expectations for improvement in China. Adobe, on the other hand, disappointed: despite reporting higher profit and better-than-expected revenue growth, guidance was weaker, especially given its decision to cease all sales in Belarus and Russia. It also pencilled in slowing growth rates before recovering in the second half of the year.

European equities

- Sanctions aimed at Russia and its oligarchs continue. The latest potential economic danger from the war is Russia's apparent insistence that energy bills be paid in roubles. Resistance to this prompts more rapid disengagement from Russia's energy supplies, but short-term constraints and threats of rationing pose greater risks of recession.
- European equities have recovered since the invasion and now stand little more than 5% down year-to-date.
- Higher energy prices remain a concern, boosting overall inflation, but the US reserve release may temper this.
- Companies have proved operationally resilient, albeit higher inflation and geopolitics may impact consumer expenditure.
- The Omicron variant of coronavirus may be peaking and appears less dangerous than its Covid forerunners, and markets appear to have consigned the virus to history.

Multi-asset

- Our economic forecasts continue to point to growth having already peaked around the globe, and for inflation to peak this year. While our longer-term inflation outlook still suggests the pick-up to current levels is transitory, the sharp price increases in areas where bottlenecks and supply chain disruptions persist warrant careful monitoring.

- Russia's invasion of Ukraine adds further uncertainty here given disruptions to a meaningful combined portion of the world's energy and grains markets in terms of both production and transportation hubs, as does China's continued enforcement of its zero-Covid policy and the associated supply chain disruptions.

- The broader themes of onshoring of supply chains and energy production have the potential to lead to structurally higher inflation from here, but our central expectation isn't for this to lead to current levels of inflation persisting. A key indicator will become apparent over the first half of this year when base effects reflecting lockdown easings move out of inflation prints, and the extent to which increased core inflation has become self-sustaining through labour markets, without government support, will become clearer.

- In accordance with our transitory inflation view, we don't currently expect market pricing for key developed market central bank rate hikes to increase meaningfully from here. Over 2022 and 2023 our base case remains for growth and inflation to slow towards trend levels and remove pressure on policymakers to raise rates into next year. What we view as relatively full central bank pricing in terms of anticipated hikes, combined with continued solid earnings growth forecasts, should continue to deliver attractive returns from risk assets like equities and credit over the next 12-18 months.

- Indeed, despite a materialisation of the previously anticipated loss of earnings growth momentum from the reopening peak, corporate results from Q421 beat expectations across the majority of ACWI. The conflict in Ukraine is anticipated to impact broader non-directly-linked markets mainly through disruptions to commodity prices, likely increased defence spending, and domestic shoring up of energy and food production across regions.

- Another notable contributor to market volatility over the past month has been uncertainty regarding Chinese regulatory risks, but within the emerging market universe effects have been broadly limited to immediate Chinese assets with broader spill-over effects remaining relatively muted.

- While the pace of the global economic recovery continues to ease off and valuations continue to feel the impact of changes in central bank policy expectations, we believe there is still value to be found in select cyclically sensitive areas and low-duration credit.

Note: all data as at 31 March 2022, unless otherwise specified. Source: Bloomberg.

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