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Global Market Strategy – September 2022

More pain to come for equity investors – at least in the short term

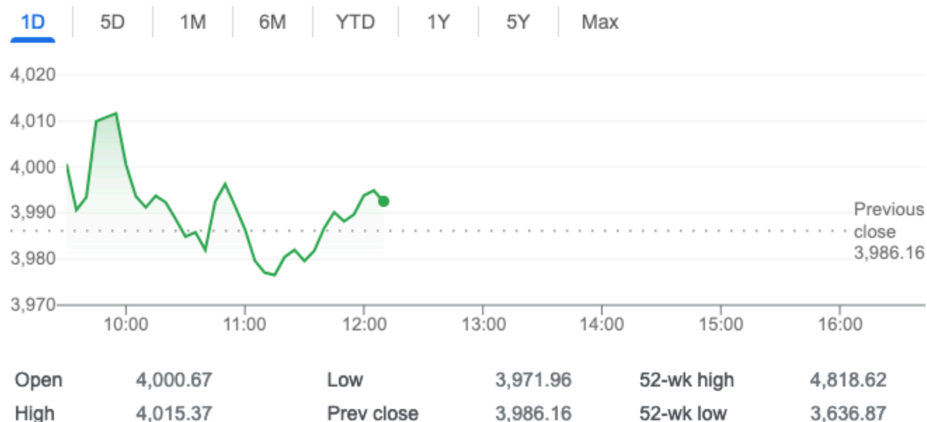
While the UK's FTSE100 headline index bumbled along in August, volatility returned to the S&P500 in the US.

The benchmark index between mid-June and mid-August managed to recover 50% of the stockmarket fall which began on January 5th and sent stocks tumbling 22% on the S&P500 and 28% on the tech-heavy Nasdaq. The fall in stock values brought the average price-earnings multiple down from 22 to the long term average of 15. Doubtless the sell-off was overdone, hence the June-August rebound, sending the average valuation multiple back above 17, but now the bear market bounce is over.

The S&P500 fell 3.4% last Friday in reaction to Federal Reserve chairman Jerome Powell's 'pain' statement, when he warned of near-term pain to be felt by both business and consumer in the face of a new-found determination to combat inflation through higher interest rates.

Finally, the Fed is trying to put behind it policy complacency of the last 18 months when it continued to seek inflationary tendencies which it felt would be only temporary. On the one hand it wanted easy money to keep the US economy growing despite the pandemic, and on the other it felt inflation would be contained and momentary. The Fed perhaps in fairness has found itself caught out by the left-field event of the war in Ukraine which will likely cause some form of recession, shallow or otherwise, throughout Europe.

The word pain was mentioned twice in Jerome Powell's 8 minute statement on Friday August 26th, and further equity market falls were felt the day after the weekend market close. From a technical perspective, there has never been a retracement to bear market lows following a 50% rebound from them, so for the S&P500 to move back to the June 16th closing lows of 3666 it would be extraordinary and is not expected; rather, a retreat to 3800-3850 is more likely. This gives those with cash an opportunity to invest in stocks at discounted levels during a period of equity bearishness which is not expected to outlast the year. As was seen during the eight weeks since June 16th, markets can rebound quickly and investing is always about time in the market rather than timing it.



S&P500 year to date to noon on August 31st (Source: Google)

Unsurprisingly, gold backed off in the wake of Powell's remarks. Priced in US dollars, the precious metal fell as short term US interest rates rose and the 2s-10s US treasury yield inverted. Yield inversion historically has meant recession follows.

2 yr US treasury yield (Source: marketwatch.com)

10 yr US treasury yield (Source: marketwatch.com)

Again, unsurprisingly the dollar's strength is maintained as short term interest rates rise and are expected in the short term to keep rising until the Fed sees true signs of a slowing economy, ie unemployment rising. Unfortunately, while rising unemployment may be good as an inflation buster, needless to say it's not so good for those becoming unemployed and unable to afford to spend, ergo corporate earnings suffer.

Higher rates mean a stronger dollar (the dollar is up more than 17% year to date against a basket of currencies) which is especially bad for emerging markets, making more expensive (inflationary) servicing of their dollar loans. Historically, a dollar index above 95 has been a warning sign for equities.

US dollar index DXY (Source: marketwatch.com)

In China the People's Bank of China lowered two key lending rates in mid-August and injected more cash into the system to try to stimulate the economy in the wake of covid shutdowns throughout the year to date. China is the only country seeking to lower rates in the current environment. The central bank cut its one-year lending rate by 10 basis points to 2.75% and, according to the Financial Times, cut the seven-day lending rate by the same amount to 2%. Economists had expected the seven-year rate to stay steady but policymakers are still clearly worried that risks are to the downside. Retail sales increased 2.7% in July compared with the same period in 2021, below the 5% forecast. In addition, China's jobless rate for 16-to-24-year-olds hit 19.9%, the highest ever recorded.

Against the backdrop of all the doom and gloom, there is Fundstrat's managing director Tom Lee who believes there are a number of factors which point to a healthy year-end rally for stocks, namely falling prices across many sectors, including oil (Brent is down 23% since mid June), clothing, second hand cars, airfares, and chicken (prices are down 62% from their peak). House prices are also falling. Tom Lee sees a recovery of the stockmarket to at least 4800 by end year, a full 1000 points higher than the predicted level the current reversal is expected to retrace to.

Perhaps inflation will prove temporary after all?

Brent crude oil, continuous contract, 1 year (Source: bigcharts.com)

Gold, 1 year (Source: https://goldprice.org/spot-gold.html)

<u>Favoured investment plays</u>

Cautious risk: **Cash**
Balanced risk: **Managed / Multi-asset funds**
Market risk: **Multi-asset funds,** UK equity
Adventurous risk: **Asia,** Europe, Japan, US equity
Speculative risk: **Technology, Energy,** Agriculture, Emerging Markets, **China**

<u>Disclosure:</u>
Nicholas Chappell has the following personal investment exposure: Technology (all US, including fintech & green energy) 35%, (Other) Energy 4%, Pharmaceuticals (US) 2%, China 11%, Asia (ex China) 7%, Global Multi-Asset 10%, UK smaller companies 12%, (Other) UK equity 4%, US smaller companies 1%, (Other) US Equity 3%, Food & Agriculture 2%, Cash 9%

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