Alan Boswell Financial Planners

Market Update - July 2022

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There was no safe harbour from choppy market cross currents during the second quarter. Equities and fixed-interest asset classes alike capsized around the globe, and even commodity prices ran aground. Emerging-market equities fell by double digits during the quarter, although they still fared better than their developed-market counterparts, buoyed by a rebound in China. UK shares posted significant losses, but they were not as steep as those of Japanese or European equities. US shares, meanwhile, had the sharpest drop among major markets as the US dolla appreciated by 6.49% versus a trade-weighted basket of foreign currencies. While the departure of Boris Johnson as Prime Minister is newsworthy from a political perspective, it is unlikely to have much of an effect on financial markets.

Value-oriented equities tended to fall by less than growth-oriented equities across both large and small-cap markets, although the performance spread was much wider within larger companies. No sectors were spared from losses, but energy and consumer staples had the mildest declines, while information technology and consumer discretionary had the steepest.

Government-bond rates climbed throughout the second quarter as prices fell. UK gilt and eurozone government-bonds rates rose across the yield curve, with longer-term rates increasing by more than shorter-term rates. US Treasury yields also increased across the curve, but shorter-term rates outpaced longer-term rates for the full quarter.

Labour shortages in the UK have been exacerbated by Brexit, which cut off the easy flow of workers from the EU. Canada and Europe usually have unemployment rates that are considerably higher than the US and UK. That remains the case, but both report jobless totals that are below previous cyclical lows. All of this suggests that workers are in a strong position to seek bigger wage gains in an effort to keep up with inflation. The possibility of a global wage-price spiral still cannot be dismissed out of hand - another reason why cental banks may be forced to raise interest rates more than they would prefer.

The EU imposed a partial ban on Russian crude oil and petroleum products in early June, blocking seaborne oil shipments but allowing Hungary, Slovakia and the Czech Republic to continue pipeline imports for domestic consumption. In a farther-reaching move, EU companies were banned from providing shipping insurance to transporters of Russian petroleum products, regardless of the destination country, depriving shippers of a critical market for insurers.

Russia began reducing natural gas pipeline supply to Europe in mid-June, limiting its ability to stockpile for winter, and driving prices in the region much higher.

The 27 members of the European Council agreed in late June to formally accept Ukrain and Moldova's candidacies to join the EU, taking the first steps to expand the union since Croatia's entrance in 2013.

Economic Data

- UK manufacturing activity settled lower throughout the second quarter. Manufacturing growth in June was positive, but soft.
- Growth in the UK services sector cooled during the second quarter from a dizzying peak in March, ending in June at a moderately healthy pace of expansion.
- Inflation climbed to 9.1% in the UK for the 12-month period through May, the highest in 40 years.
- The UK claimant count (which calculates the number of people claiming Jobseeker's Allowance) continued to improve in recent months - declining by roughly 85,000 from March through May, with total claimants representing 4.0% of the population in May compared to 4.2% in March.
- The expansion in eurozone manufacturing continued to slow throughout the second quarter, ending in June with an anaemic pace of growth.
- Activity in the eurozone services sector accelerated in April to strong growth territory, before softening to end the quarter with a modest but healthy expansion.
- The year-over-year rate of consumer price inflation in the eurozone climbed to 8.6% in June, hitting an all-time high.
- The eurozone unemployment rate held at 6.8% from February through April, before cracking through to 6.6% in May to set a new record low (since Eurostat began tracking the dataset in 1998).
- US manufacturing growth peaked in April after accelerating through early 2022, then cooled (slowly in May, and then sharply in June), leaving a soft expansion at the end of the second quarter.
- US services-sector growth declined throughout the second quarter, moving from notably high levels in March to a weak expansion in June.
- The US labour market remained quite healthy during the second quarter. New claims for unemployment benefits trended higher - from roughly 180,000 per week in April to about 230,000 per week in June - but remained low relative to history.
- The US Consumer Price Index climbed to 8.6% year over year in May - the highest since December 1981 - while the Personal Consumption Expenditures (PCE) Price Index (the Federal Reserve's preferred inflation gauge) edged down to 6.3%.

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Summary

There are signs of economic trouble ahead. The surge in US mortgage rates is delivering a big blow to the housing market. Rising interest rates will slow econmic growth, but changes in monetary policy affect the economy with a long a variable lag. While the financial strength of US businesses and households is likely to ebb, the starting point is a very high one. The labour market, for instance, remains exceptionally tight. Until a better balance between the demand and supply of labour is achieved, one should expect further large wage gains at the lower end of the age-income spectrum, where the job market is tightest.

The UK has unemployment rate below 4%. Canada and Europe usually have unemployment rates that are considerably higher than the US and the UK. That remains the case, but both report jobless totals that are below previous cyclical lows.

In Europe, the need to hike interest rates has once again raised the spectre of another periphery debt crisis. Italian 10-year bonds are trading some 70 basis points higher against German bonds than they were at the start of the year. This is on top of the two percentage-point jump in German rates that has been logged over the same six-month stretch.

China's economy appears to be in recovery mode. COVID-19 lockdowns in Beijing, Shanghai and other parts of the country have eased. The zero-COVID policy pursued by the Chinese government has hurt the economy to an extent seldom seen in the past three decades.

The froth certainly appears to have been taken out of the markets by this year's pullback. However, a corresponding decline in earningsmight not yet be fully reflected in stock prices. Multiples tend to slide as projected earnings estimates fall. Even if price-to-earnings ratios remain at current levels, there could be a decline in projected earnings and a comparable drop in stock prices.

Please note the following:

All investments involve different degrees of risk. Please remember that past performance is not a guide to future performance. The value of units and shares and the income from them can go down as well as up and investors might not get back the amount originally invested. Exchange rates may cause the value of overseas investments to rise or fall.

Where we have expressed views and opinions, these may change over time. None of the information mentioned in this document represents a specific portfolio or holding nor constitutes a recommendation to buy or sell.

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