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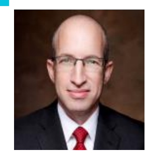
WEEKLY MARKET RECAP

10 January 2022

Summary for the week ending on Friday, 7 January

MULTI-ASSET SOLUTIONS EMEA & LATAM



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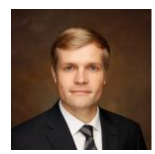

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ECONOMIC AND POLITICAL BACKDROP

The US

Sentiment took a notable turn for the worse on Wednesday afternoon following the release of minutes from the Federal Reserve's mid-December policy meeting. The minutes revealed that policymakers had discussed faster and more aggressive rate hikes, with the first 0.25% hike in the official short-term rate coming as soon as March. Officials also discussed taking steps to reduce the Fed's balance sheet soon after lift-off. Selling a portion of the Fed's USD 8.8 trillion in Treasuries and agency mortgage-backed securities would put upward pressure on long-term rates as well.

The week's omicron news seemed to have a mixed impact on markets. New lockdowns in Hong Kong appeared to contribute to Wednesday's sharp declines in stocks, and US case numbers set new records. Investors seemed reassured that hospitalisations, though rising, were apparently decoupling from reported cases and the number of deaths remained roughly stable.

Economic data released during the week were also mixed. The gauges of the Institute for Supply Management (ISM) of both manufacturing and service sector activity missed consensus expectations but still indicated healthy expansion. The ISM survey also indicated that supply challenges might be easing for manufacturers.

Friday's closely watched jobs data offered decidedly mixed signals. The monthly payrolls report showed that employers added only 199,000 jobs in December, roughly half of consensus expectations. Average weekly hours worked also fell slightly. The household survey, on the other hand, showed that the unemployment rate fell to 3.9%, lower than the 4.2% expected and near levels seen just before the pandemic. Average hourly earnings rose 0.6% in December, beating expectations for a 0.4% gain. The conflicting data suggested that many Americans were choosing self-employment, especially considering the record 4.5 million people quitting their jobs in November.

Europe

Europe posted record levels of coronavirus infections. In France, daily cases soared above 330,000, prompting hospitals to brace for a crisis. The government reduced the self-isolation period for infected people to mitigate staffing shortages. Italy ruled that all university staff and people above age 50 must be vaccinated. Spain moved to make mask-wearing mandatory again, and the army was deployed to help regions increase vaccination. However, most countries stopped short of imposing lockdowns. The Netherlands faced large-scale protests against the lockdown measures that the government had implemented.

Inflation in the eurozone accelerated to a record level in December, driven by a surge in energy and food costs. Consumer prices rose 5% year over year – an acceleration from the 4.9% inflation rate registered in November – according to the EU's harmonised index. German inflation came in near a 30-year high, prompting Finance Minister Christian Lindner to announce that the government was considering financial aid for lower-income households to pay for rising heating bills.

German factory orders rebounded more than expected in November, rising 3.7% sequentially in seasonally adjusted terms, on increased international demand for capital and intermediate goods.

The resurgent coronavirus hit the eurozone service sector and dampened business activity in December, a survey showed. IHS Markit's Composite Purchasing Managers' Index (PMI) fell to 53.3 from 55.4 in November – a downward revision from the initial reading of 53.4 and the lowest level since March (PMI readings greater than 50 indicate an expansion in activity). Inflation remained elevated at the end of 2021, with input and output cost increases coming in just below November's record levels.

The UK

Prime Minister Boris Johnson said the UK could "ride out" the omicron-driven wave of infections without further restrictions and kept "Plan B" restrictions in place.

Japan

Citing surging COVID-19 cases, Prime Minister Fumio Kishida brought back quasi-states of emergency to the prefectures of Okinawa, Yamaguchi and Hiroshima, lasting until 31 January and entailing measures such as limits on the operating hours of restaurants and bars. There have been some suggestions that the surge in cases is linked to US military bases located within the prefectures. While Kishida has stressed the need for the US to take stricter antivirus measures at its bases in Japan, he has also emphasised the difficulty in identifying the cause and roots of spreading infections.

Japan's manufacturing and services sectors were buoyed by signs of a gradual recovery from the coronavirus pandemic in December. However, the improvement in operating conditions for manufacturers was slightly softer compared with the previous month, with the au Jibun Bank Japan Manufacturing PMI falling to 54.3, from November's 54.5. Rates of growth in production and incoming business were stronger than the average seen over 2021. However, rising raw materials prices continued to add to manufacturers' cost burdens. Services sector PMI data showed a slight easing in business activity growth, with the headline index falling to 52.1 from 53.0. Moderate expansion in activity was, in part, attributable to the easing of pandemic restrictions, which supported demand growth and allowed customer-facing businesses to operate more freely.

China

The Caixin Manufacturing PMI, a private survey of nationwide manufacturing conditions, rose to a higher-than-expected 50.9 in December, up from 49.9 in November. Central bank data showed that China's foreign exchange reserves rose by USD 28 billion in December to USD 3.25 trillion, boosted by stronger capital inflows.

China's cash-strapped property developers, which are grappling with an unprecedented liquidity squeeze due to a housing slump and high debt levels, continued to make headlines. China Evergrande, the world's most indebted developer with over USD 300 billion in borrowings, said it would seek approval for a payment delay on one of its yuan-denominated bonds at a meeting with creditors over the weekend. Evergrande has not yet missed any payments on its onshore bonds, which are more senior than the offshore debt, after missing USD 82.5 million in offshore interest payments last month.

Meanwhile, Shimao Property failed to pay off part of a local loan after its creditor demanded early repayment, causing a sell-off in its bonds and shares. Guangzhou R&F Properties said it did not have enough funds to buy back a USD 725 million bond as the developer's asset sales failed to come through as planned. Kaisa Group, which became the first Chinese developer to default on its dollar bonds in 2015, is under pressure from local authorities to repay investors in its wealth management products, Reuters reported. Kaisa, which defaulted on a USD 400 million bond in December, has started restructuring USD 12 billion in offshore debt out of liabilities totalling nearly USD 20 billion.

In pandemic news, China continued to lock down the city of Xi'an and re-imposed travel restrictions in Shenzhen after two infections were detected in the southern tech hub. Hong Kong also announced additional restrictions, including a two-week ban on incoming flights from eight countries, including the US and UK. In response to the resurgent virus, China's Premier

Li Keqiang said the government would increase tax and fee cuts for businesses and provide targeted support for COVID-affected sectors.

Australia

The Markit Composite PMI remained unchanged at 54.9, indicating a solid pace of activity with manufacturing outpacing services. Job ads fell in December from elevated levels the prior month. Hiring intentions are still strong especially in the hospitality sector.

EQUITY MARKETS

Last week, MSCI All Country World Index (MSCI ACWI) returned -1.5% (4.0% in December, 19.0% in 2021).

In the US, the S&P 500 returned -1.8% (4.5% in December, 28.7% in 2021). Stocks backed away from record highs at the start of the week as longer-term bond yields increased. Expectations for higher interest rates took a particular toll on growth stocks and the technology-heavy Nasdaq Composite – which suffered its biggest weekly decline in nearly a year – by increasing the implied discount on future earnings. Technology and healthcare shares were particularly weak within the S&P 500, while energy shares outperformed as the price of Brent crude oil moved above USD 80 per barrel. Financials were also strong. Growth strongly underperformed value and small capitalisation stocks lagged large ones. Russell 1000 Growth returned -4.8% (2.1% in December, 27.6% in 2021), Russell 1000 Value 0.8% (6.3% in December, 25.1% in 2021) and Russell 2000 -2.9% (2.2% in December, 14.8% in 2021).

The S&P 500 reached a new high on Monday, although only five of the index's 11 sectors recorded a gain. Tesla was a big driver of the gains after the electric vehicle maker reported more fourth-quarter deliveries than expected. Indeed, reflecting the dominance of the most heavily weighted stocks, stripping out gains in Tesla and mega-caps Apple and Amazon.com would have left the S&P 500 nearly flat for the day.

In Europe, the Euro Stoxx 50 returned 0.2% (5.8% in December, 24.1% in 2021). Shares pulled back amid worries that central banks may reduce asset purchases and raise interest rates at a faster pace to contain persistent inflation. Germany's DAX advanced 0.4% (5.2% in December, 15.8% in 2021), France's CAC 40 rose 1.0% (6.5% in December, 31.9% in 2021) and Italy's FTSE MIB gained 1.0% (5.9% in December, 26.8% in 2021). Switzerland's SMI returned -0.6% (5.9% in December, 23.7% in 2021). The euro was little changed against the US dollar, ending the week at 1.14 USD per EUR (over 2021, the euro fell from 1.22 to 1.14).

In the UK, the FTSE 100 firmed 1.4% (4.8% in December, 18.4% in 2021), as banks and energy – industries that include some of the index's largest stocks – rallied, but the FTSE 250 lost 0.5% (4.4% in December, 16.9% in 2021). The British pound was stronger against the US dollar, ending the week at 1.36 USD per GBP, up from 1.35 (over 2021 the pound weakened from 1.37 to 1.35).

Japan's stock markets generated mixed returns for the week. The Nikkei 225 returned -1.1% (3.6% in December, 6.6% in 2021), the broader TOPIX 0.2% (3.4% in December, 12.7% in 2021) and the TOPIX Small Index -2.0% (3.8% in December, 11.1% in 2021). In coronavirus developments, the government announced that three prefectures would be placed under quasi-states of emergency due to surging COVID-19 cases, bringing back restrictions for the first time since September 2021. Concerns about more aggressive monetary policy tightening by the US Fed weighed on technology and other growth stocks.

Against this backdrop, the yield on the Japanese 10-year government bond rose to 0.14% (from 0.07% at the end of the previous week), tracking the general rise in bond yields and hovering around highs last reached in April 2021. The yen weakened to JPY 115.6 against the US dollar, from the prior week's JPY 115.1 (over 2021 the yen depreciated from 103.3 to 115.1). Persistent yen weakness, stemming primarily from the Bank of Japan's divergent monetary policy stance, prompted Japan's Finance Minister Shun'ichi Suzuki to stress the need for currency stability and the careful monitoring of market moves and their impact on the economy.

In Australia, the S&P ASX 200 returned 0.1% (2.8% in December, 18.7% in 2021). After a volatile start of the year with some large daily moves (three days out of four with changes higher than 1.3%), the local stock market managed to finish the week largely unchanged. The value rotation driven by the US markets spilled over to Australia, with Energy and Bank sectors doing well. The Australian dollar lost value against the US dollar, which benefited from a more hawkish than expected tone in the US Fed's December meeting minutes. The yield curve moved higher by 10 to 20 basis points following the global sell off in bonds.

Emerging markets and other markets

MSCI Emerging Markets Index returned -0.5% last week (1.8% in December, -2.5% in 2021), with negative contributions to performance from the stock markets of China, Taiwan, South Korea and Brazil and positive contribution from that of India.

Chinese stocks fell for the week. The CSI 300 Index of large-cap stocks slid 2.4% (2.2% in December, -3.5% in 2021) and the Shanghai Composite Index shed 1.7% (2.1% in December, 7.0% in 2021) amid ongoing turmoil in the property sector and the US Fed's hawkish tilt. Yields on China's 10-year government bonds rose to 2.837% from the previous week's 2.793% as investors adjusted for a reduced yield premium between China and the US. The yuan posted its biggest weekly drop since mid-September, reflecting expectations of US monetary tightening. The currency struck a three-week low of 6.3832 against the US dollar before recovering to 6.376.

Elsewhere, in Russia the Russian Trading System (RTS) Index returned -3.1% (21.7% in 2021) through the close of business on Thursday; the market was closed on Friday. The ruble – which held up relatively well versus the US dollar in 2021, thanks in part to Russian central bank interest rate increases – has been weakening recently, due in part to continued geopolitical tensions with the US regarding Ukraine.

While Russian military forces are still massing near the Russian-Ukrainian border – prompting US threats of harsh sanctions if Russia invades Ukraine – T. Rowe Price sovereign analyst Peter Botoucharov believes there is a low probability of an invasion or an escalation of violence in the Donbas region of Eastern Ukraine. He believes the situation is likely to remain unresolved in the near term, but with various diplomatic and regional security meetings to be held in the days ahead – involving the US, Russia, Ukraine and various European nations – there are hopes for at least a reduction in tensions.

A new development potentially complicating the geopolitical situation with Russia is the eruption of violent protests in Russia's southern neighbour Kazakhstan stemming from a substantial increase in liquified petroleum gas prices. The violence spread despite the government's reversal of the price increases, prompting President Kassym-Jomart Tokayev to declare a state of emergency. The Kazakh president also called upon the Russia-led Collective Security Treaty Organisation – a group of several former Soviet nations – to dispatch troops to help restore order to the resource-rich nation.

In Turkey, the BIST-100 Index rallied 9.5% (30.7% in 2021). Stocks continued to rebound from a sharp drop that took place in the days prior to Christmas. However, other Turkish assets remained under pressure this week following news that both core and headline inflation jumped sharply in December on the back of extended lira weakness, as well as broad-based price pressures, particularly in the cost of energy and consumer goods.

According to the Turkish Statistical Institute, the core consumer price index increased to 31.9% year over year from 17.6% year over year in November, while headline inflation surged to 36% year over year from 21.3% year over year in November. These are the highest inflation readings since the 2003–2004 time frame.

Botoucharov believes that upside inflation risk is likely to prevail throughout the first quarter of 2022. He also believes that year-over-year inflation could stabilise in the 40% to 45% range in the second quarter – assuming that the lira stabilises and that the government's recent policy changes, which are intended to shift foreign exchange risks from consumers to the government, have at least a partial positive impact.

FIXED INCOME MARKETS

Last week, Bloomberg Global Aggregate Index (hedged to USD) returned -1.0% (-0.4% in December, -1.4% in 2021), Bloomberg Global High Yield Index hedged to USD -0.8% (1.6% in December, 2.5% in 2021) and Bloomberg Emerging Markets Hard Currency Index -1.5% (1.0% in December, -1.7% in 2021).

US stock prices fluctuated on the conflicting data, but US Treasury yields moved decisively higher. The 10-year Treasury yield touched 1.80%, its highest level since the onset of the pandemic. It ended the week at 1.76%, up 25 basis points from 1.51% (six basis points higher in December, 60 basis points higher in 2021).

Core eurozone bond yields rose with US Treasury yields. Minutes from the Fed's mid-December meeting justified the need for a faster pace of rate hikes, contributing to a broad sell-off in developed market government bonds. Core yields also jumped on Friday in anticipation of eurozone inflation data. Over the week, German 10-year bund yield increased 13 basis points, ending the week at -0.05%, up from -0.18% (17 basis points higher in December, 39 basis points higher in 2021). Peripheral eurozone bond yields also rose as part of the global sell-off but faced additional upward pressure from reports of new supply in Italy.

UK gilt yields broadly tracked core markets. The 10-year gilt yield ended the week 21 basis points higher, up from 0.97% to 1.18% (16 basis points higher in December, 78 basis points higher in 2021).

US investment-grade corporate bond credit spreads tightened at the start of the week despite an active primary calendar. However, sentiment appeared to soften as investors digested the hawkish tone of the Fed's meeting notes, and spreads drifted wider in response. From a technical perspective, secondary trading volumes rebounded, and new issuance exceeded weekly expectations.

High yield bonds traded lower due to rates increasing and general risk-off sentiment. Investors also appeared to focus on the reopening of the primary market, which contributed to some weakness in the secondary. Broader risk markets seemed to be assessing the hawkish tone of the Fed's meeting minutes and the prospect of earlier rate hikes.

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