Market Synopsis – April 2022

Market expectations

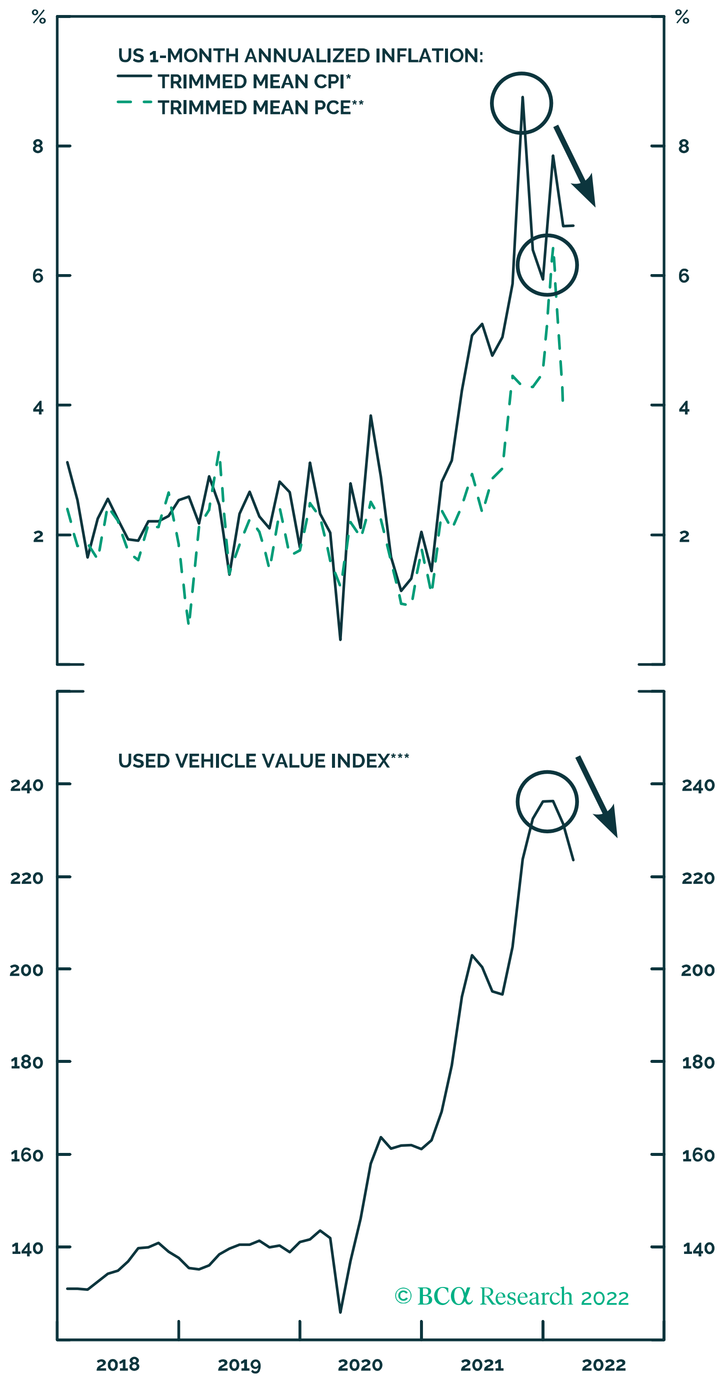
2020 and 2021 were exceptionally volatile years, making any tactical investment decisions incredibly challenging. 2022 has already experienced its fair share of drama, most notably the ongoing conflict in Ukraine and its impact on global commodity prices. Instead of focusing on single issues, let us dive into what we think the rest of 2022 has in store for markets.

The good news is…

Inflation should fall

Consumer price inflation ("CPI") is currently exceedingly high in the United States, reaching levels not seen since the early 1980s. Thankfully, it does appear that inflation has potentially peaked, or will soon, in the US. The annualised level of CPI and the price of used cars appeared to have peaked in October, and has since trended downwards – see Figure 1.

We expect a continued shift away from consumer spending to services, further assisting the downward trend of core ex-COVID-related consumer prices. Additionally, crude oil prices are anticipated to pull back somewhat to USD90/barrel for the remainder of the year, which will lower both headline inflation and the passthrough effect on core prices – see Figure 2 on the following page. A deceleration of inflation should assist in alleviating the recent decrease in real wage growth, and should lower the equity risk premium, providing a boost to consumer spending and equities respectively.



* SOURCE: FEDERAL RESERVE BANK OF CLEVELAND.
** SOURCE: FEDERAL RESERVE BANK OF DALLAS.
*** SOURCE: MANHEIM AUCTIONS.

Figure 1 – US CPI and used vehicle value index

Long-term bond yields will remain stable

Based on recent data, we predict core personal consumption expenditure inflation of ~4.3%, which is only slightly above the US Federal Reserve's ("Fed") current forecast. This suggests that the Fed will likely raise rates in line with, or slightly above, their projected levels in March – 1.9% by the end of 2022, and 2.8% by the end of 2023. Conversely, the overnight index swaps curve is pricing in a Fed's fund rate 80 bps above what the Fed projected in March. This implies that market expectations make a hawkish surprise, which in turn, informs the expectation that bond yields have entered a holding pattern for now.

The pandemic will continue to recede and service spending will increase

While China is currently experiencing a resurgence in cases, the pandemic is likely to continue to decrease in importance in the US and other highly vaccinated countries. Even though case numbers increased through March and April across the world, ICU visits and deaths have plateaued or trended downwards – see Figure 3.

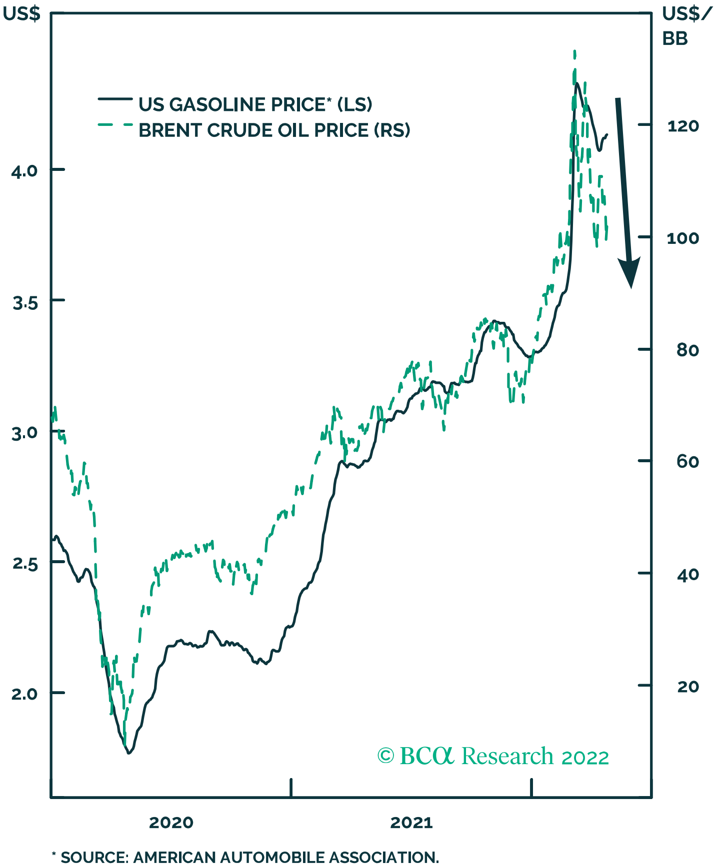


Figure 2 – US gasoline and crude oil prices

Roughly 60% of the adult population in the US has contracted Covid and 70% have been vaccinated, meaning there is an extremely high national immunity to severe illness or death. Deliveries of Paxlovid, a drug from Pfizer that has been shown to be extremely effective in reducing Covid related hospitalisations, has also expanded rapidly in the US, further bolstering the populace's resistance.

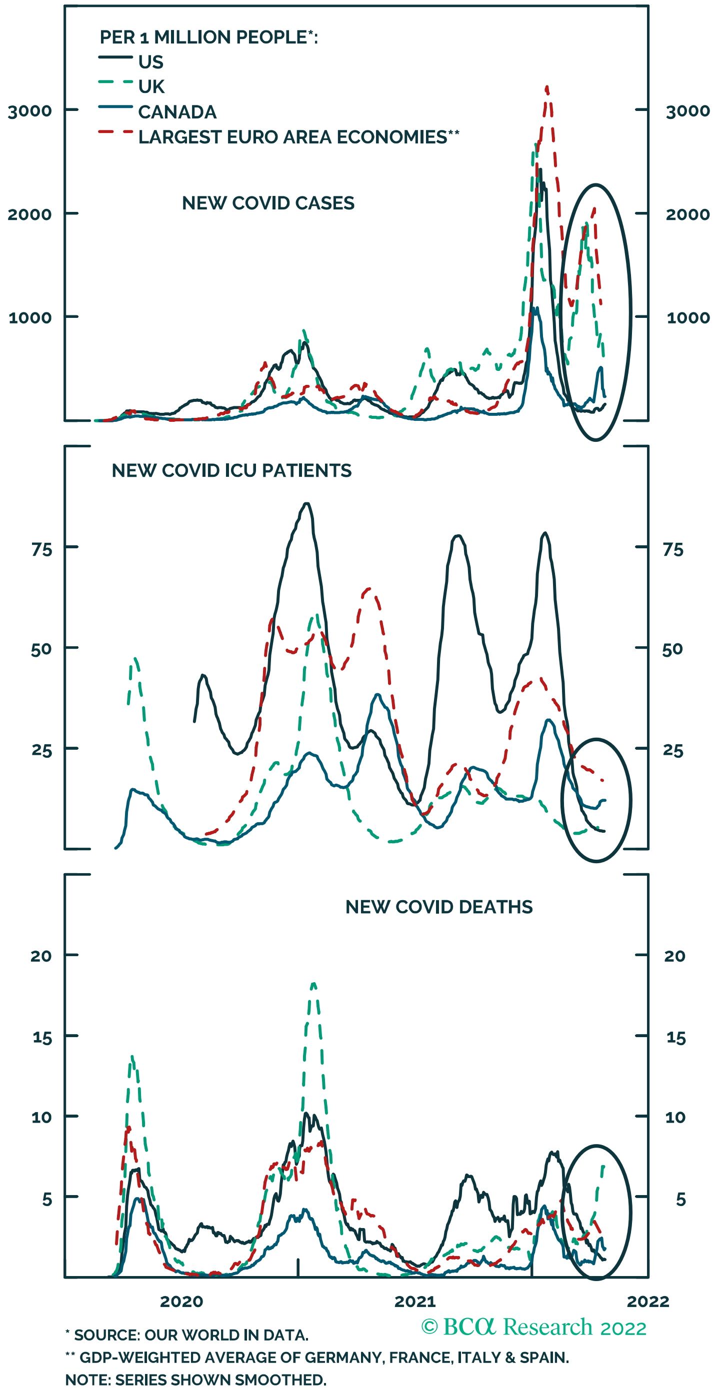


Figure 3 – Global Covid rates

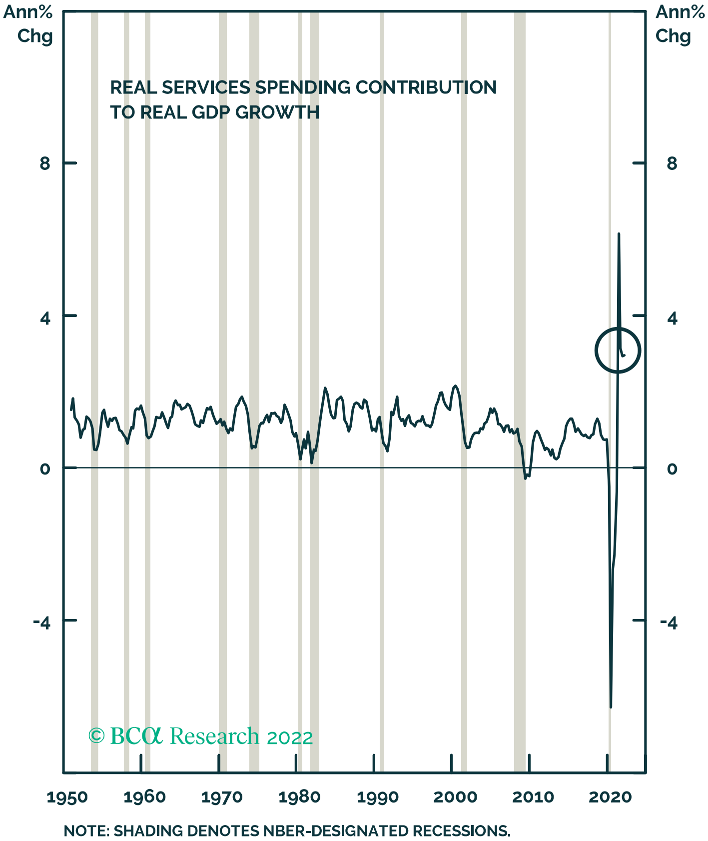


Figure 4 – Service spending contribution to GDP

Given the fact that the pandemic caused a global slowdown in service spending, the diminishing of the pandemic's effects should continue to improve spending in impacted services related industries. While spending on goods is generally a larger driver of economic activity compared to service spending, the magnitude of contributions to growth from service spending is unprecedented in the post WW2 global environment – see Figure 4. The continued recovery trend in service spending will act as ballast to overall consumer spending as goods spending continues to return to normalised levels.

<u>The bad news is…</u>

The United States could experience a recession scare

While we believe that the US will ultimately avoid an actual recession, it is likely that markets will experience a recession scare over the coming 12 months. While it has subsequently returned to positive levels, the inversion of the 2-10 year yield curves has planted the seed of doubt in investor's minds, making any visible weakness in the US economy appear much more threatening. As mentioned previously, US manufacturing and goods-producing sectors are likely to decline over the coming months as more spending shifts to services.

More impactfully, the sharp increase in mortgage rates will likely cause a slowdown in the US housing market, even if the slowdown does not prove to be contractionary. The increase in mortgage rates has caused US housing affordability to deteriorate to levels below the 2008 housing crisis – see Figure 5 on the following page. High current prices in the housing market is likely to spur additional construction, further supporting growth. However, over the short term the deterioration in affordability implies that the housing price appreciation will fall below income growth. This may result in a correction in house price gains, providing recessionary signals to watchful investors.

The European economy will contract

The conflict in Ukraine has put extreme pressure on many European nations, and the threat of cutting energy exports looms over many nations' heads. The complete stoppage of all exports remains unlikely, but the odds have increased significantly following the halt of gas supplies to Poland and Bulgaria, as well as Germany's acceptance of an oil embargo on Russia. If sanctions ramp up, both sides can expect decreased economic activity as well as increased prices across the board.

Omicron will continue to spread in China

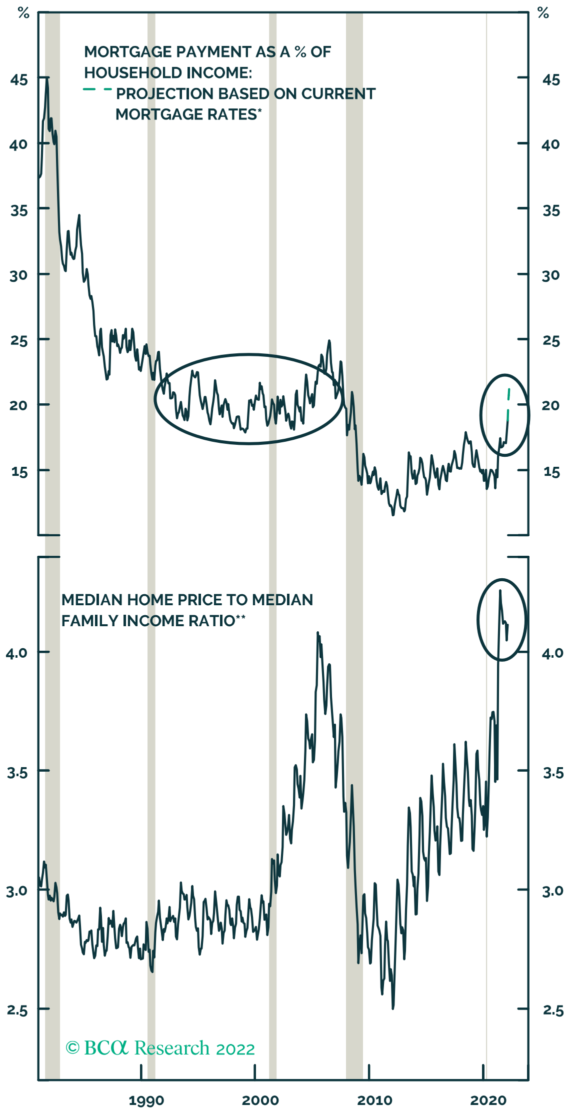
Cases of Omicron has spiked in China recently, and it is clear that the country's zero tolerance policy has failed to stop the spread. While clearly negative for the Chinese economy, the recent lockdowns have had distinct impacts on the global economy. The surge in key cities has led to increased port congestion and shipping delays, which threatens to further increase global shipping costs. As seen last year, temporary slowdowns in shipping can have long lasting impact on struggling supply chains. The surges are also likely to significantly decrease Chinese contribution to global growth. If the outbreaks continue, Chinese policy makers are likely to announce stimulus packages similar to what was experienced in the West, in order to support struggling households. Decreased Chinese activity may have positive impacts in some ways, as the reduction in commodity imports should alleviate some inflationary pressure in other developed nations. However, this reduction in spending is likely to further decrease imports from the Euro area, further pushing the region into a recessionary zone.

Investment conclusions

In terms of risk assets, investors should be cognisant of whether they believe the US will experience a recession this year. Based on the information above and other considerations, we believe that this is unlikely to occur. Once any recession scare passes and inflation decelerates, risk assets could enter a period of upward momentum. Once the current bout of volatility recedes, an increase in risk asset exposure could hence be warranted. While Europe is more likely to experience a recession than the US which would suggest underweighting the region, European equities have already underperformed significantly since the conflict in Ukraine began. No clear regional preferences are thus prevalent at present.

Value still seems more attractive than Growth, both in terms of more attractive current prices as well as a hedge toward potentially higher long term yields. However, a large portion of the outperformance in growth equities during the recession has already reversed.

During these volatile times, various investment opportunities will be offered to nimble investors… A steady hand at the wheel and a constant finger on the pulse are required.



* SOURCE: BCA CALCULATIONS.
** SOURCE: US NATIONAL ASSOCIATION OF REALTORS.
NOTE: SHADING DENOTES NBER-DESIGNATED RECESSIONS.

Figure 5 – Mortgage rate and house price

For more information on this Market Synopsis or to discuss solutions provided by Integrity Asset Management, please contact us at:

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Indicator	Spot	MTD	YTD	Y-o-Y
Gold	1 937,44	-2,1%	3,7%	7,2%
Brent Crude	107,91	1,3%	40,6%	62,6%
USDZAR	14,6115	8,1%	-0,9%	8,9%
EURZAR	16,1685	3,1%	-8,0%	-4,2%
GBPZAR	19,2001	3,5%	-7,9%	-0,8%
JSE All Share TRI	12 435,43	-3,7%	0,0%	13,2%
JSE Resources TRI	6 391,91	-5,4%	11,8%	21,1%
JSE Industrials TRI	16 870,89	-1,8%	-15,4%	-5,1%
JSE Financials TRI	11 558,50	-6,4%	12,5%	37,8%
JSE Listed Property TRI	1 662,37	-1,4%	-2,7%	12,2%
S&P 500	4 530,41	-8,8%	-13,3%	-1,2%
Euro STOXX 50	8 641,45	-2,1%	-10,8%	-2,4%
FTSE 100	7 524,08	0,8%	3,7%	12,3%
Nikkei 225	47 173,86	-3,5%	-5,9%	-5,0%
Hang Seng	67 727,53	-4,1%	-9,5%	-24,7%

Source: Bloomberg, as at 29 April 2022