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Global Economic & Market Review
Second Quarter 2022

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Summary

During the second quarter, the global economy remained challenged by record high inflation and global supply chain issues which were exacerbated by the continuing conflict between Russia and Ukraine. As well, COVID-19 lingered and resulted in lockdowns in China, however, investor worries about the virus mostly faded into the background as other threats to the global economy took center stage. Investors also remained uneasy about potential policy missteps by central banks in response to these issues and the impact on global economic growth. As a result, major global equity markets saw negative returns with trillions of dollars in stock market value being lost in the first half of the year. Global bond markets also saw a rout as inflation and interest rates increased. In its April forecast, the International Monetary Fund (IMF) noted that the conflict between Russia and Ukraine would contribute to a significant slowdown in global growth this year and predicted that the global economy would expand by 3.6% in 2022, down from its previous forecast of 4.4%. The IMF indicated that rising food and fuel prices would affect vulnerable and low-income nations the most. These sentiments were echoed by the World Bank who predicted that many nations would find it difficult to avoid a recession amidst rising food and energy prices.

CFAL Global Economic & Market Review Q2-2022

United States

It was a brutal second quarter for US equity markets with the major indices posting double digit losses. The Dow Jones Industrial Average and S&P 500 indices fell by -11.25% and -16.45% respectively while the Nasdaq shed -22.44%. Amidst rising bond yields, US bond markets also performed poorly with US Treasuries 1-10 years losing -1.59% while riskier US corporate (-6.71%) and high yield (-9.97%) issues saw larger losses. In an effort to control inflation the US Federal Reserve increased rates by 50 basis points in May and then by another 75 basis points in June; the largest rate hike since 1994. More rate hikes are expected. Fed chairman Jerome Powell noted that inflation was too high and stated that the Central Bank was expeditiously trying to bring it down. However, the Fed admitted that it would be challenging to bring down inflation without causing a recession. Year over year, inflation rose to a 40-year high of 8.6% in May as food and energy prices were higher than expected. In the first quarter, US real GDP declined by an annual rate of -1.6% primarily due to decreases in exports, government spending and private inventory investment. While growth is projected to be positive in Q2-22, a slowdown is expected during the second half of the year with the potential for a slight recession as inflation persists and the Fed maintains its hawkish stance.

> *"In an effort to tame inflation, the US Federal Reserve increased rates by 50 basis points in May and then by another 75 basis points in June; the largest rate hike since 1994."*

Europe

Eurozone equities also suffered in the second quarter as war in the region led to concerns about gas supplies and drove inflation higher. The DJ Euro Stoxx 50 lost -11.47% in Q2-22 and inflation remained elevated, jumping to a record of 8.1% in May. In June, the ECB confirmed that it would increase interest rates by 25 basis points in July and September to tame inflation. Despite the war in Ukraine, the Eurozone economy grew by 0.6% in Q1-22 from the previous quarter or 5.4% year over year. GDP growth was mixed across the bloc, Ireland (+10.8%), Romania (+5.2%) and Latvia (+3.6%) recorded the largest increases while Sweden (-0.8%), France (-0.2%) and Denmark (-0.1%) saw the biggest contractions. Germany's economy, the largest in the bloc, expanded by only 0.2%. Many European countries rely heavily on gas imports from Russia who reduced gas supplies to the region in retaliation for sanctions related to the invasion of Ukraine. This resulted in record high prices and could force the affected countries to begin rationing gas which will continue to have negative implications for economic growth. Meanwhile, the UK economy grew by 0.8% in Q1-22 from the previous quarter. However, a -0.3% contraction in April confirmed that rising prices took a toll on economic growth. The economy, which grew by 7.5% in 2021, is expected to grow by half that rate this year with growth falling sharply in 2023 as high inflation, tax increases and mediocre investment stagnates the economy. The Bank of England raised interest rates by 25 basis points in both May and June. UK equities performed relatively well compared other developed equities, the FTSE 100 lost -4.51% in the second quarter and -2.92% year to date.

> *"After its June policy meeting, the ECB confirmed that it would increase interest rates by 25 basis points in July and September to tame inflation."*

Asia Pacific

Chinese markets ended Q2-22 in positive territory as the Shanghai SE Composite index gained +4.50% contrary to the global market selloff. Year to date, the Index remains negative with losses of -6.63%. China's Q1-22 GDP growth surpassed forecasts, increasing 4.8% compared to the same period last year, and 4.0% quarter over quarter. China's zero-tolerance approach to COVID-19 threatened growth as many businesses were forced to close due to the resumption of lockdowns. These lockdowns had a trickle-down effect on employment, consumption, and global supply chains. In May, China's youth unemployment rate hit a record of 18.4% while the overall unemployment rate stood at 5.9%. The IMF forecasts that the Chinese economy will grow by 4.4% in 2022 and 5.1% in 2023. Elsewhere in Asia, Japan experienced negative growth in Q1-22 due to external disruptions related to the Russia-Ukraine conflict and the COVID-19 lockdowns in China. This led to a large trade imbalance as imports outpaced exports. In addition, household spending declined as a sharp decline in the yen and a rise in commodity prices increased retail costs. The world's third largest economy shrank by -0.1% over the period or an annualized rate of -0.5%. The IMF projects that Japan will grow 2.4% for 2022 and 2.3% for 2023. Japanese equities fell over the quarter with the Nikkei 225 losing -5.13% for a year to date decline of -8.33%.

"China's zero-tolerance approach to COVID-19 threatened growth as many businesses were forced to close due to the resumption of lockdowns."

Emerging Markets

The MSCI Emerging Markets Index fell -12.36% in Q2-22, outperforming the MSCI World Index which lost -16.60%. Year to date, the index is down -18.78% while the MSCI World is down -21.21%. The outlook for Emerging Markets (EM) has deteriorated due to the Russia-Ukraine conflict with the IMF projecting a deep contraction in GDP for both countries. The IMF forecasts that the Ukrainian economy will contract by -35.0% in 2022. It is expected that the economy will not recover for several years due to the loss of life, destruction of physical capital and flight of citizens. The Russian economy has been significantly impacted by the trade and financial sanctions imposed by western countries, the European Union, and the United Kingdom. As a result, Russia's GDP is expected to decline by -8.5% in 2022 and -2.3% in 2023. In Latin America, high inflation has hampered growth and central banks have aggressively increased interest rates to combat the rise in prices. In June, Brazil's central bank announced its eleventh consecutive rate increase and raised its benchmark interest rate by 50 basis points to 13.25%. The Central Bank of Mexico also increased its reference interest rate by a record 75 basis points to 7.75% in June. The country's inflation rate stood at 7.88% in mid-June. Additional rate hikes are expected for both Brazil and Mexico. In India, economic growth slowed to 4.1% in Q1-22 representing the slowest pace in one year. This followed growth of 5.4% in Q4-21 and 8.4% in Q3-21. Like other emerging market countries, inflation has led to weak consumer demand as citizens, especially those with low incomes, struggle to pay for daily necessities. The IMF estimates that overall growth for emerging markets in 2022 including China will stand at 3.8% while 2023 growth is forecast at 4.4%.

"The IMF projects that the Ukrainian economy will contract by 35.0% in 2022. It is expected that the economy will not recover for several years due to the loss of life, destruction of physical capital and flight of citizens."

Commodities

In the commodities market, losses were seen across most assets, backtracking on strong first quarter gains as interest rates continued to increase. Gold (-6.72%) and silver (-18.21%) futures declined, particularly driven by the metals' inverse relationship with the US Dollar which strengthened significantly as investors moved into the safe haven currency. WTI crude oil was the only bright spot for investors, posting a return of +11.23% for its ninth consecutive quarter of gains as the ongoing war in Ukraine and the resulting sanctions against Russian oil continued to result in elevated prices. Concerns of shortages and disruptions in oil supply remain a major concern, particularly for European economies largely dependent on Russian gas. For the foreseeable future, oil prices are expected to remain elevated and volatile as any supply increases by OPEC+ remain insufficient to offset Russian oil. However, it is noteworthy that recession concerns have led to a slight retreat in oil prices. Copper fell -21.94% to its lowest point in 11 years as interest rates are expected to continue to increase and economic uncertainty grows. Additionally, lumber decreased -28.05% as mortgage rates rose and the demand for lumber fell, contributing to lumber's historic volatility. The commodities market is expected to remain volatile in the third quarter as looming economic uncertainty, fears of recession, and rising interest rates weigh on investor sentiment.

"Concerns of shortages and disruptions in oil supply remain a major concern, particularly for European economies largely dependent on Russian gas."

Conclusion

The strength of the global economic recovery has deteriorated as Russia's invasion of Ukraine brought about higher inflation and supply chain disruptions which resulted in a slowdown in global economic growth. The consequences of the war have led to a rapid increase in food and energy prices around the world as well as greater geopolitical unease. COVID-19, while less dominant in the headlines, still persists and remains a threat to global productivity. As these issues continue, it becomes more likely that some countries around the world will face a recession and put a strain on global growth. As well, the environment of slowing growth and high inflation has increased stagflation fears and puts pressure on policymakers who are trying to pullback from accommodative pandemic era policies. The global economy once again finds itself in a difficult position and the outlook remains uncertain.

Market Returns Q2-2022

	As at 30 June 2022			
	MTD	**QTD**	**YTD**	**1 year**
Equity Indices *(% local currency)*				
S & P 500	-8.39	-16.45	-20.58	-11.92
Dow Jones Industrial Average	-6.71	-11.25	-15.31	-10.80
NASDAQ	-8.71	-22.44	-29.51	-23.96
FTSE 100	-5.76	-4.61	-2.92	1.87
DJ Euro Stoxx 50	-8.82	-11.47	-19.62	-14.99
Shanghai SE Composite	6.66	4.50	-6.63	-5.36
Nikkei 225	-3.25	-5.13	-8.33	-8.33
MSCI Emerging Markets	-7.15	-12.36	-18.78	-27.20
MSCI World	-8.77	-16.60	-21.21	-15.61
ICE BofA Bond Indices *(% local currency)*				
US Treasuries 1-10 years	-0.64	-1.59	-5.55	-6.10
US Corporates	-2.35	-6.71	-13.93	-13.83
US High Yield	-6.81	-9.97	-14.04	-12.66
UK Gilts 1-10 yrs	-0.73	-1.97	-4.64	-5.76
Euro Government	-1.82	-7.30	-12.25	-12.64
Global High Yield & Emerging Markets	-7.57	-11.91	-17.24	-18.40
Global Broad Market Index	-3.08	-8.16	-14.21	-15.74
Currencies vs. USD				
British Pound	-3.36	-7.31	-10.01	-11.95
Euro	-2.33	-5.27	-7.79	-11.59
Japanese Yen	5.48	11.52	17.94	22.15
Swiss Franc	-0.46	3.53	4.62	3.25
Commodities *(% USD)*				
Gold	-1.64	-6.72	-1.20	2.10
Silver	-5.90	-18.21	-13.00	-22.38
Copper	-13.81	-21.94	-16.26	-13.08
WTI Crude Oil	-5.50	11.23	46.54	61.47