The Weekly Market View

February 21 2022

بنك أبوظبي التجاري ADCB

ASSET MANAGEMENT LIMITED

What's driving?

In one of our recent weeklies, we argued that a mixture of macro-micro (MoMo) risk-on risk-off (RoRo) is causing volatility in financial markets. Add to that, a geopolitical whipsaw of war-on war-off (WoWo) relating to the situation with Russia-Ukraine, financial markets turned more volatile. Last week saw conflicting headlines relating to a potential escalation/de-escalation of the situation. UST 10Y yields fell marginally as markets digested geopolitical risks, Fed talk, and economic data releases. VIX index remained volatile through the week on the news flow relating to geopolitical risks. Global equities (as measured by MSCI ACWI) lost another 1.7% last week as geopolitical tensions added to the recent rise in volatility. EM indices posted losses but outperformed DM indices. Within EM, commodity-dependent markets including GCC, LatAm, and EMEA outperformed. Elsewhere, China-A shares and EM ASEAN markets outperformed. Within DM, Japan and US outperformed in USD terms. Gold prices rose strongly last week on increased geopolitical tensions. Oil prices fell last week after rising for eight straight weeks as the prospects of an Iran nuclear deal outweighed persistent geopolitical risks.

Taking a step back and thinking about drivers of financial markets in recent months, we think there are three. First, the development of the global growth-inflation mix; second, monetary policy normalization in developed markets; and third, the recent rise in geo-political risks. Changes in perceptions about the evolution of these three factors and the interplay between them has caused volatility in financial markets in recent months.

What's priced in?

It might be prudent at this stage to see what markets are pricing in regarding each of these three drivers. We think various assets have priced in the movements in these three factors to varying degrees. In some cases, the pricing has gone to an extreme in our view. For instance, the Fed funds futures are pricing in 6 to 7 rate hikes this year and the start of the balance sheet unwind. This has caused the yield curve to flatten substantially and move closer to inversion which in the past indicated an imminent recession. We believe that this Fed policy pricing by the markets has now moved to a hawkish extreme. Turning to equities, they appear to be pricing in an average Fed hiking cycle (as reflected in the valuation compression in recent months), and partly the recent rise in geopolitical tensions. The outperformance of value relative to growth seems to be largely pricing in the valuation reset driven by interest rate changes. The sharp rise in VIX index is reflecting the uncertainty around the evolution of the growth-inflation mix. Also, the higher inflation has kept a lid on earnings growth revisions. In our view, prices of various commodities are reflecting various drivers. For instance, higher energy prices are reflecting a geo-political risk premium quite significantly. While aluminium prices have been helped by potential supply disruptions, copper prices seem to be reflecting the strong economic momentum. USD has benefitted in recent weeks from its safe haven status. EUR has not yet benefitted from the possible ECB rate hikes this year, but instead has been driven by rise of the geopolitical tensions in Eastern Europe.

Whilst there are strong reasons to expect a normalization in the situation and an accompanying reversal in the pricing, we admit the timing of that will be difficult. Especially risks associated with growth-inflation mix and monetary policy might take longer to abate. This means headline volatility will remain high over the next couple of months possibly paving a way for a better second half of the year. But in absence of concrete evidence of a recession, we think it is prudent to stay invested with a diversified and disciplined approach. As a reminder, our asset allocation strategy is to overweight cash, underweight bonds, and neutral on both equities and alternatives (see Quarterly Investment View, January 2022).

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Global markets' performance snapshot*

Index Snapshot (World Indices)*

Index	Latest	Weekly %	YTD %
S&P 500	4,349	-1.6	-8.8
Dow Jones	34,079	-1.9	-6.2
Nasdaq	13,548	-1.8	-13.4
DAX	15,043	-2.5	-5.3
Nikkei 225	27,122	-2.1	-5.8
FTSE 100	7,514	-1.9	1.8
Sensex	57,833	-0.6	-0.7
Hang Seng	24,328	-2.3	4.0
Regional Markets			
ADX	9,155	1.7	7.9
DFM	3,327	2.1	4.1
Tadawul**	12,477	3.7	10.1
DSM**	12,735	0.8	9.6
MSM30**	4,093	0.1	-1.3
BHSE**	1,926	2.9	7.1
KWSE**	7,629	2.8	8.3
MSCI			
MSCI World	2,984	-1.8	-7.7
MSCI EM	1,232	-0.7	0.0

Global Commodities, Currencies and Rates*

Commodity	Latest	Weekly %	YTD %
Brent USD/bbl	93.5	-1.0	20.3
WTI USD/bbl	91.1	-2.2	21.1
Gold USD/t oz	1,895.4	3.4	4.0
Silver USD/t oz	24.0	2.9	2.9
Platinum USD/t oz	1,091.0	6.7	13.8
Copper USD/MT	10,010.0	1.2	2.8
Alluminium	3,299.0	4.9	17.6
Currencies			
EUR USD	1.13	-0.2	-0.4
GBP USD	1.36	0.2	0.5
USD JPY	115.03	-0.3	-0.1
USD CHF	0.92	-0.4	1.0
Rates	**Latest**	**Weekly (bp)**	**YTD (bp)**
USD Libor 3m	0.48	-2.7	27.0
USD Libor 12m	1.29	-10.6	70.3
UAE Eibor 3m	0.61	5.5	25.0
UAE Eibor 12m	1.32	14.1	58.0
US 3m Bills	0.32	-2.0	29.0
US 10yr Treasury	1.94	-1.5	44.3

Notes: *Data as of February 18 2022 unless stated otherwise; **Data as of February 17 2022

Summary market outlook

Global Yields	UST 10Y yields fell marginally as markets digested geopolitical risks, Fed talk, and data releases. US investment grade and high yield credit saw their spreads widen. Core Eurozone bond yields fluctuated but ended lower overall on rising geopolitical tensions in Eastern Europe. Peripheral Eurozone and UK government bond yields broadly tracked core markets. Yields on 10Y JGBs remained unchanged. Overall, we recommend a lower duration stance (5Y USTs) in anticipation of interest rate volatility in the near term.
Stress and Risk Indicators	VIX index remained volatile through the week as markets digested the news flow relating to geopolitical risks. We think the VIX index is unlikely to fall back to the pre-pandemic levels until the virus comes fully under control.
Equity Markets	
Local Equity Markets	GCC equity markets posted gains despite the fall in oil prices last week, and outperformed the global equity benchmarks. Gains were led by Saudi Arabia where the equity benchmarks hit a 16-year high. Abu Dhabi equities hit another all-time high last week. Equities in Kuwait and Dubai performed strongly too on upbeat earnings. We stay neutral GCC equities within our global equity framework. Stable to higher oil prices, potential for revival in growth prospects, and scope for reversing the underperformance of the past years are all balanced by lack of structural growth plays in the equity markets.
Global Equity Markets	Global equities (as measured by MSCI ACWI) lost another 1.7% last week as geopolitical tensions added to the recent rise in volatility. EM indices posted losses but outperformed DM indices. Within EM, commodity-dependent markets including GCC, LatAm and EMEA outperformed. Elsewhere, China-A shares and EM ASEAN markets outperformed. Within DM, Japan and US outperformed in USD terms. Canada and Europe-ex-UK underperformed the most. Amongst global sectors, with the exception of consumer staples, all global sectors posted losses. Energy, communication services, and financials underperformed the most while consumer staples along with materials and utilities outperformed. We are moderately overweight US, UK, and Asia Pacific; underweight Eurozone and EMs outside Asia. By sector we prefer industrials, IT, and communication services. Our strategic preference is for large cap non-cyclical growth with focus on quality. 'Build back better' themes including green recovery, digitalization and health care innovation are likely to do well. Yet, in the very near-term, as the new wave of COVID-19 fear subsides, we see opportunities in cyclicals, value, small caps, and re-opening sectors.
Technology Segments	Both HK tech and Nasdaq-100 indices posted losses of c2% each. Over the past month, HK Tech index lost c4% while the Nasdaq-100 index posted losses of c8%.
Commodities	
Precious Metals	Gold prices rose strongly last week on increased geopolitical tensions. Silver and platinum prices rose too. We keep our overweight in gold as a hedge against potential inflation and geopolitical risks on the horizon.
Energy	Oil prices fell last week after rising for eight straight weeks as the prospects of an Iran nuclear deal outweighed persistent geopolitical risks. Overall, over the medium-term we believe that oil prices will remain sustained as the market balances into the new normal.
Industrial Metals	Copper and aluminium prices rose. Iron ore prices fell sharply on Chinese regulatory concerns. Another commodity super-cycle is difficult, yet demand for commodities linked to "green infrastructure" is likely to sustain.
Currencies	
EURUSD	Geopolitical risks in Eastern Europe caused weakness in EUR/USD but the potential for the ECB to hike rates in 2022 set a floor. We expect ECB policy divergence to play a major role in the performance of the euro.
Critical levels	R2 1.1449 · R1 1.1385 · S1 1.1269 · S2 1.1217
GBPUSD	Cable strengthened for the third straight week despite the risk-off as expectations for BoE rate hikes rose. We expect the GBP to be driven by how the BoE policy evolves over the near-term and to decouple from the EUR.
Critical levels	R2 1.3729 · R1 1.3659 · S1 1.3503 · S2 1.3417
USDJPY	JPY appreciated against the green back in a risk-off move triggered by rising geopolitical tensions. Over the medium-term, BoJ's yield curve targeting should put downward pressure on JPY.
Critical levels	R2 116.30 · R1 115.65 · S1 114.57 · S2 114.14

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

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Forthcoming important economic data/events

United States

	Indicator	Period	Expected	Prior
02/22/22	FHFA House Price Index MoM	Dec	--	1.10%
02/22/22	**Markit US Manufacturing PMI**	**Feb P**	**56.0**	**55.5**
02/22/22	**Markit US Services PMI**	**Feb P**	**53.0**	**51.2**
02/22/22	**Conf. Board Consumer Confidence**	**Feb**	**110.0**	**113.8**
02/22/22	Richmond Fed Manufact. Index	Feb	--	8
02/23/22	MBA Mortgage Applications	18-Feb	--	-5.40%
02/24/22	Chicago Fed Nat Activity Index	Jan	--	-0.15
02/24/22	**Initial Jobless Claims**	**19-Feb**	**235K**	**248K**
02/24/22	**Continuing Claims**	**12-Feb**	**1,580K**	**1,593K**
02/24/22	**GDP Annualized QoQ**	**4Q S**	**6.90%**	**6.90%**
02/24/22	New Home Sales	Jan	813k	811k
02/24/22	Kansas City Fed Manf. Activity	Feb	--	24
02/25/22	**Personal Income**	**Jan**	**-0.30%**	**0.30%**
02/25/22	**Durable Goods Orders**	**Jan P**	**0.60%**	**-0.70%**
02/25/22	**Personal Spending**	**Jan**	**0.80%**	**-0.60%**
02/25/22	**PCE Deflator YoY**	**Jan**	**6.00%**	**5.80%**
02/25/22	**PCE Core Deflator YoY**	**Jan**	**5.20%**	**4.90%**
02/25/22	Pending Home Sales MoM	Jan	--	-3.80%
02/25/22	U. of Mich. Sentiment	Feb F	61.7	61.7

Japan

	Indicator	Period	Expected	Prior
02/21/22	**Jibun Bank Japan PMI Services**	**Feb P**	**--**	**47.6**
02/21/22	**Jibun Bank Japan PMI Mfg**	**Feb P**	**--**	**55.4**
02/21/22	Machine Tool Orders YoY	Jan F	--	61.40%
02/22/22	PPI Services YoY	Jan	--	1.10%
02/24/22	Nationwide Dept Sales YoY	Jan	--	8.80%
02/25/22	Tokyo CPI YoY	Feb	0.60%	0.50%
02/25/22	Tokyo CPI Ex-Fresh Food YoY	Feb	0.30%	0.20%

Eurozone

	Indicator	Period	Expected	Prior
02/21/22	**Markit Eurozone Manufacturing PMI**	**Feb P**	**58.6**	**58.7**
02/21/22	**Markit Eurozone Services PMI**	**Feb P**	**51.7**	**51.1**
02/22/22	**Germany IFO Business Climate**	**Feb**	**97.5**	**95.7**
02/23/22	**Germany GfK Consumer Confidence**	**Mar**	**-6.3**	**-6.7**
02/23/22	Eurozone CPI YoY	Jan F	5.10%	5.00%
02/23/22	Eurozone CPI Core YoY	Jan F	2.30%	2.30%
02/24/22	France Consumer Confidence	Feb	--	99
02/25/22	France CPI YoY	Feb P	--	--
02/25/22	Eurozone M3 Money Supply YoY	Jan	--	6.90%
02/27/22-03/02/22	Germany Retail Sales MoM	Jan	--	-5.50%

United Kingdom

	Indicator	Period	Expected	Prior
02/21/22	Rightmove House Prices YoY	Feb	--	7.60%
02/21/22	**Markit/CIPS UK Services PMI**	**Feb P**	**55.0**	**54.1**
02/21/22	**Markit UK PMI Manufacturing SA**	**Feb P**	**57.0**	**57.3**
02/25/22	GfK Consumer Confidence	Feb	-17	-19

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Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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