The Weekly Market View

September 19 2022

ADCB ASSET MANAGEMENT LIMITED

Inflation roars!

The latest US inflation reading proved to be a major disappointment for those who were expecting a possible peak in inflation arriving in August. US headline inflation rose by 8.3% yoy in August, beating market expectations and the core inflation accelerated to 6.3% yoy, also exceeding expectations. Higher shelter costs-which tend to be sticky in nature- were the main driver. Reacting to the inflation data, rate hike expectations jumped with the markets now pricing in a higher peak-rate of 4.5% by March 2023. Markets' pricing of the possibility of 100bp rate hike increased with a 75bp rate hike now fully priced in at the upcoming Fed meeting on 20th-21st September. Elsewhere, US core producer prices recorded their second monthly decline, but failed to derail rate hike expectations. The preliminary University of Michigan Consumer Sentiment survey showed that consumer sentiment slightly weakened while the 1yr consumer-based inflation expectations fell to 4.6% in August from 5% in July and the 5-10yr inflation expectations eased to 2.8% from 3%. However, upward surprise in US retail sales and drop in weekly jobless claims to the lowest level in three months pointed to relative economic resilience. Meanwhile, the World Bank warned of rising recession risks in 2023 due to synchronised global central bank tightening.

Global equity markets sold-off with the MSCI ACWI Index declining by c4.2%. In DM, US equities were the worst performers with the S&P 500 Index registering its largest weekly drop since mid-June. On the other hand, UK equities outperformed peers. With jump in peak-rate expectations, UST yields rose across the yield curve but short-term yields rose the most. The 2yr UST yield rose to 3.86%, the highest level since 2007. As a result, inversion in the 10-2yr UST yield curve further deepened. The US dollar advanced, hovering near the 20-year high while gold prices dropped to a two-year low. Oil prices also posted their third consecutive week of loss with stronger dollar and global demand concerns weighing on the sentiment.

Higher for longer

With inflation turning out to be more persistent in nature, there is a shift in narrative from "lower for longer" to "higher for longer" rates. Market expectation of the peak Fed fund rate has jumped to c4.5% from c3.2% as of beginning of August, with markets now more aggressive than the Fed. Unless the Fed signals a more aggressive stance compared to market pricing, we do not expect the sell-off in the bond market to aggravate further. In addition, a more hawkish Fed completely ignoring downside risks to growth will further raise the risks of policy error. Given the high degree of policy-related uncertainty, we maintain our long duration stance versus the benchmark (UST 7-10yr segment). As interest rate risk and policy uncertainty are likely to be the key driver for the fixed income markets, inflation-linked bonds are not a good hedge in such a scenario. Similar to nominal bonds, inflation –linked bonds are susceptible to the shifts in the central bank monetary policy and interest rates. The performance of inflation-linked bonds is dependent on inflation expectations, which have eased this year with the Fed turning hawkish. Bloomberg Global inflation-linked bond Index has a high duration - thus also making them highly sensitive to interest rates. As a result, global inflation-linked bonds have been the worst performers in fixed income space this year. On the other hand, fixed income assets (Leveraged loans: short-duration strategy during Fed tightening) like floating rate notes (FRNs) whose performance is positively linked to the Fed's hiking cycle are likely to benefit the most. Bloomberg US FRN Index has been the best performer, recording marginal positive gains on a YTD basis. FRNs tend to perform well during a concentrated Fed-rate hike cycle (aggressive Fed) compared to a more-spread out Fed rate hike cycle (patient Fed). We believe that FRNs could be a good tactical bet to consider in the short-term. However, FRNs only act as an interest-rate risk hedge. Like any other bond- FRNs are susceptible to credit risk and could come under pressure in the event of a sudden Fed dovish shift.

Global markets' performance snapshot*

Index Snapshot (World Indices)*

Index	Latest	Weekly %	YTD %
S&P 500	3,873	-4.77	-18.73
Dow Jones	30,822	-4.13	-15.18
Nasdaq	11,448	-5.48	-26.82
DAX	12,741	-2.65	-19.79
Nikkei 225	27,568	-2.29	-4.25
FTSE 100	7,237	-1.56	-2.00
Sensex	58,841	-1.59	1.01
Hang Seng	24,209	-3.10	-20.48
Regional Markets			
ADX	10,202	4.14	20.18
DFM	3,489	3.82	9.18
Tadawul**	11,830	-0.04	2.57
DSM**	13,244	2.28	12.50
MSM30**	4,479	-0.76	8.14
BHSE**	1,939	0.56	7.83
KWSE**	7,606	0.68	7.71
MSCI			
MSCI World	2,569	-4.23	-20.50
MSCI EM	944	-2.70	-23.37

Global Commodities, Currencies and Rates*

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	91.4	-1.60	18.26
Nymex WTI USD/bbl	85.1	-1.94	13.81
Gold USD/t oz	1,675.1	-2.43	-8.72
Silver USD/t oz	19.6	3.88	-16.83
Platinum USD/t oz	909.7	2.88	-6.52
Copper USD/MT	7,792.0	-2.42	-19.60
Alluminium	2,268.8	-0.37	-19.06
Currencies			
EUR USD	1.00	-0.26	-12.08
GBP USD	1.14	-1.46	-15.75
USD JPY	142.92	0.32	19.62
USD CHF	0.97	0.37	5.48
Rates	**Latest**	**Weekly (bp)**	**YTD(bp)**
USD Libor 3m	3.57	31.99	335.62
USD Libor 12m	4.67	48.31	408.90
UAE Eibor 3m	3.29	43.46	292.45
UAE Eibor 12m	3.89	12.00	314.54
US 3m Bills	3.09	8.49	306.18
US 10yr Treasury	3.45	13.97	193.93

Notes: *Data as of September 16 2022 unless stated otherwise; **Data as of September 15 2022

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Summary market outlook

Global Yields	With the jump in peak-rate expectations, the UST yields rose across the yield curve but the move-up was led by short-term bond yields. The 10yr UST yields jumped to 3.45%, testing the 11-year high of 3.5% reached mid-June. The 2yr UST yield rose to 3.86%, the highest level since 2007. As a result, the 10-2yr yield curve inversion deepened further. Corporate bonds sold-off with the Global HY bond index declining by c1.6%. In Europe, bond yields jumped on hawkish ECB comments. Bond yields and prices are inversely correlated. i.e. when bond yields fall, prices rise and vice versa. Overall, we recommend adding duration on USTs (7-10Y segment) as growth slowdown/recession fears rise.
Stress and Risk Indicators	VIX index, a measure of implied volatility in equities jumped last week on the back of equity market sell-off. VVIX, a measure of volatility in VIX rose over the week. SKEW index, a measure of tail risks, dropped to the lowest level since July 2022. MOVE index, which measures implied volatility in bonds, rose and stayed at elevated levels. We expect financial market volatility to stay elevated as the monetary policy normalizes.
Equity Markets	
Local Equity Markets	GCC stock markets posted gains, outperforming global equities. Within the region, Abu Dhabi was the best performer while Oman recorded losses and underperformed the most. 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 several years are all balanced by lack of structural growth plays in the equity markets.
Global Equity Markets	Global equities sold-off with the MSCI ACWI Index declining by c4.2%. EM equities fell by c2.7%, thus outperforming DM peers. In DM, UK equities outperformed the most while US equities were the worst performers. Sector wise, IT, communication services, and consumer discretionary underperformed significantly. We are moderately overweight US, UK, and Asia Pacific; underweight Eurozone and EMs outside Asia. By sector we prefer healthcare, industrials, and communication services. Our strategic preference is for large cap non-cyclical growth with focus on quality. Our other high conviction ideas include clean energy themes (for medium to long-term); aerospace & defence, food security, energy security, and cybersecurity as plays on rising geopolitical tensions and deglobalization; and consumer services, airlines, and hotels, restaurants & leisure as plays on re-opening.
Technology Segments	HK tech fell by 5.37% over the week while Nasdaq-100 index declined by 5.77%. Within the technology sector, we prefer non-cyclical growth over cyclical growth (tech hardware, semiconductors etc.) over a 12-month horizon.
Commodities	
Precious Metals	Gold prices declined on strong dollar bias and increased Fed rate hike expectations. Silver and platinum prices rose strongly. We are overweight gold as a hedge against potential inflation, growth, and geopolitical risks.
Energy	Oil prices fell for the third consecutive week on concerns slowing economic growth will impact fuel demand. Overall, over the medium-term we believe that oil prices will remain sustained as the market balances into the new normal.
Industrial Metals	Copper prices fell sharply over the week while Alluminium prices ended the week flat. Another commodity super-cycle is difficult, yet demand for commodities linked to “green infrastructure” is likely to sustain.
Currencies	
EURUSD	The euro ended the week flat against the US dollar. We expect ECB policy divergence to play a major role in the performance of the euro.
Critical levels	R2 1.0306 · R1 1.0161 · S1 0.9908 · S2 0.9800
GBPUSD	GBP weakened versus the USD on account of disappointing retail sales data. We expect GBP to weaken against USD and stay flat versus the EUR.
Critical levels	R2 1.1890 · R1 1.1655 · S1 1.1268 · S2 1.1116
USDJPY	JPY ended the week flat versus the dollar. BoJ policy remains odd-one out and is likely to cause JPY weakness.
Critical levels	R2 146.48 · R1 144.70 · S1 141.40 · S2 139.88

Forthcoming important economic data/events

United States

Date & Time (GST)	Indicator	Period	Expected	Prior
09/19/22 18:00	NAHB Housing Market Index	Sep	47	49
09/20/22 16:30	Building Permits	Aug	1609K	1685K
09/20/22 16:30	Housing Starts	Aug	1450K	1446K
09/21/22 15:00	MBA Mortgage Applications	16- Sep	--	-1.20%
09/21/22 18:00	Existing Home Sales	Aug	4.70m	4.81m
09/21/22 22:00	**FOMC Rate Decision (Lower Bound)**	**21- Sep**	**3.00%**	**2.25%**
09/21/22 22:00	**FOMC Rate Decision (Upper Bound)**	**21- Sep**	**3.25%**	**2.50%**
09/22/22 16:30	**Initial Jobless Claims**	**17- Sep**	**216K**	**213K**
09/22/22 16:30	Continuing Claims	10- Sep	1408K	1403K
09/22/22 19:00	Kansas City Fed Manf. Activity	Sep	5	3
09/23/22 17:15	**S&P Global US Manufacturing PMI**	**Sep P**	**51.2**	**51.5**
09/23/22 17:15	**S&P Global US Services PMI**	**Sep P**	**45.5**	**43.7**

Japan

Date & Time (GST)	Indicator	Period	Expected	Prior
09/20/22 03:30	**Natl CPI YoY**	**Aug**	**2.90%**	**2.60%**
09/20/22 03:30	**Natl CPI Ex Fresh Food YoY**	**Aug**	**2.70%**	**2.40%**
09/22/22 09:30	Nationwide Dept Sales YoY	Aug	--	9.60%
09/22/22	**BOJ Policy Balance Rate**	**22- Sep**	**-0.10%**	**-0.10%**
09/22/22	**BOJ 10-Yr Yield Target**	**22- Sep**	**0.00%**	**0.00%**

Eurozone

Date & Time (GST)	Indicator	Period	Expected	Prior
09/20/22 10:00	**Germany PPI YoY**	**Aug**	**36.80%**	**37.20%**
09/20/22 12:00	Eurozone ECB Current Account SA	Jul	--	4.2b
09/22/22 10:45	**France Manufacturing Confidence**	**Sep**	**102**	**104**
09/22/22 12:00	**Eurozone ECB Publishes Economic Bulletin**			
09/22/22 18:00	Eurozone Consumer Confidence	Sep P	-25.5	-24.9
09/23/22 11:30	**Germany S&P Global/BME Manufacturing PMI**	**Sep P**	**48.2**	**49.1**
09/23/22 12:00	**Eurozone S&P Global Manufacturing PMI**	**Sep P**	**48.7**	**49.6**

United Kingdom

Date & Time (GST)	Indicator	Period	Expected	Prior
09/22/22 15:00	**Bank of England Bank Rate**	**22- Sep**	**2.25%**	**1.75%**
09/23/22 03:01	GfK Consumer Confidence	Sep	-42	-44
09/23/22 12:30	**S&P Global/CIPS UK Manufacturing PMI**	**Sep P**	**47.3**	**47.3**
09/23/22 12:30	**S&P Global/CIPS UK Services PMI**	**Sep P**	**50**	**50.9**

China and India

Date & Time (GST)	Indicator	Period	Expected	Prior
09/20/22 05:15	**China 1-Year Loan Prime Rate**	**Sep 20**	**3.65%**	**3.65%**
09/20/22 05:15	**China 5-Year Loan Prime Rate**	**Sep 20**	**4.30%**	**4.30%**
09/15- 09/30	**India BoP Current Account Balance**	**2Q**	**-$30.50b**	**-$13.40b**

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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