

The week in seven charts

Monday, 07/04/2022

Commodities roll over and bond yields move lower as global demand softens

Last week saw the main equity indexes giving up a portion of the previous week's gains, as the market now anticipates that the Fed's fight against inflation would push the economy into recession. US inflation and rate hikes anticipation are moving lower. Bond yields and commodity prices as well. Each week, the Syz investment team takes you through the last seven days in seven charts.



Charles-Henry Monchau
Chief Investment Officer

Chart #1 - Worst-ever first half for a 60/40 portfolio

Last week the S&P 500 index posted its worst first half of a year since 1970. It also happened to be the worst-ever first half for multi-asset portfolios. A US 60/40 (equities/fixed income) portfolio fell 20% through June. The last eight times the S&P 500 fell during a calendar year, bonds finished the year higher, cushioning the blow. So far in 2022, it has been very different, with stocks and bonds both declining more than 10%, something we've never seen.

This double bear market also implies massive wealth destruction. Global equity and debt capital markets lost \$31 trillion in the first six months of the year, the largest destruction of wealth ever recorded.

Chart #2 - US Economic data continue to surprise on the downside

Since the end of April, US macro data have continued to disappoint. Atlanta Fed Nowcast has revised second-quarter real GDP growth lower at a very fast pace. With a -2% contraction now expected, the US economy may already meet the technical definition of a recession: two successive quarters of negative growth, following an already-negative first quarter.

Chart #3 - Commodities are showing early signs of rolling over

While commodities were by far the best performing asset class in the first half, more recently we have seen commodity markets weaken again as global demand may soften. Weakness in commodities includes metals, food and agriculture, and even energy markets.

Chart #4 - Yields are moving lower, not higher, for now

One of the key macro numbers published last week was the US Core PCE (Price Consumption Expenditures). The index fell to 4.7% in May, its third straight monthly decline. Note that the PCE is the Fed's "preferred measure of inflation," and may have an impact on rate hike expectations. With both growth expectations declining and inflation surprising on the downside, government bond yields are moving lower. The yield on US 10-year Treasuries crashed below 3% on recession fears after the ISM June purchasing managers index, a measure of US manufacturing activity, fell to a two-year low as new orders contracted.

Chart #5 - Inflation expectations and rate hike expectations are moving lower

One consequence is that inflation expectations are starting to tumble. US inflation break-evens are at their lowest levels since September 2021. Fed rate hike expectations are also drifting lower.

Chart #6 - Germany and most EU countries face a major energy crisis

Electricity rates in Germany are about six times higher than in early 2021. This rise is weighing heavily on inflation and denting both consumer and business confidence. Another risk from rising energy input prices became visible last week: German utility company Uniper has applied for state aid because it is getting less cheap Russian gas. Gas prices have increased ten-fold since 2020 and German consumers face a significant price shock.

Chart #7 - Euro plunges against dollar; Swiss franc rises to parity with euro

Rising energy costs threaten to push the eurozone into recession. As a consequence, traders are paring back their European Central Bank rate hike bets, leading to renewed euro weakness. Meanwhile, the Swiss franc rose to parity with euro for the first time since March. A stronger franc seems to be what the Swiss National Bank asked for... Note that the Swiss franc was the only gainer among G-10 currencies against the US dollar in June.

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