FEBRUARY 2022

Flash —

A brutal awakening

After a strong 2021, it has been a rough start to 2022 for risk assets. For many years, stock and bond returns have consistently moved in opposite directions. But in January expectations of more rapid monetary policy tightening and inflation concerns pushed equities and bonds to sell-off simultaneously. Here are 10 stories to remember from an eventful month.

PRIVATE BANKING

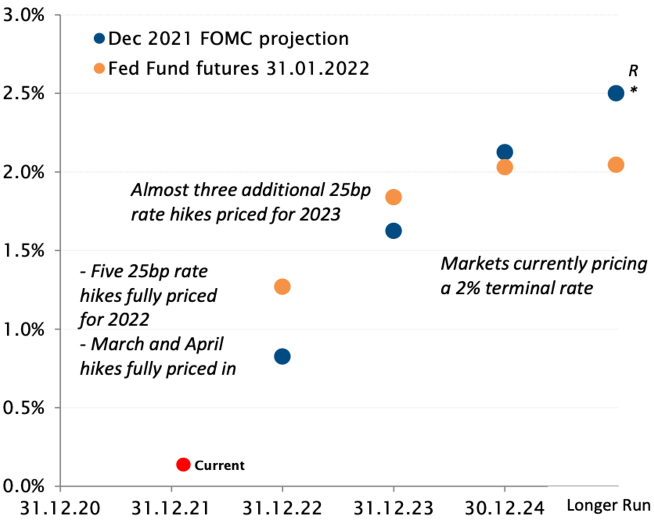
A brutal awakening

After a strong 2021, it has been a rough start to 2022 for risk assets.

Story #1: Central banks hawkish pivot

The biggest market story in January was undoubtedly the US Federal Reserve's hawkish pivot in response to persistent inflation. Throughout the month, investors moved to price-in a much more aggressive pace of rate hikes relative to their expectations around the start of the year. Fed funds futures have moved since the end of December from pricing fewer than three rate hikes in 2022, to anticipating almost five hikes. Furthermore, markets are now having to factor-in the prospect of quantitative tightening through a shrinking Fed balance sheet. With full employment, strong economic growth and rising inflation, the Fed has every reason to normalize monetary policy, and fast.

Latest Fed Dot Plot (December 21) and market expectations as of 31.01.2022



Source: Federal Reserve, Bloomberg

Story #2: Geopolitical tensions

The second main theme was the rising friction between Russia and the West over Ukraine. In addition to falling US oil stockpiles, these tensions drove energy prices higher with Brent crude surpassing USD90 a barrel for the first time since October 2014. After strong gains in 2021, crude oil remained the best-performing major asset in January, with Brent and West Texas Intermediate both gaining more than 17%, their strongest increases in 11 months. The perceived risk of conflict between Russia and Ukraine also sent European natural gas futures 20.4% higher over the month, although still below their December 2021 peak. Long-duration sovereign bonds, historically a haven during geopolitical tensions, didn't benefit from the crisis this time (see story #6 for more on this).

Story #3: Omicron variant led to more cases but is proving less virulent

The pandemic continued to make headlines as weekly Covid cases worldwide rose from 9.2 million at the end of December 2021 to 23.1 million in January. However, global weekly fatalities increased from 44,100 to 66,600, indicating there may be a major decline in the mortality rate. In addition, the fact that the Omicron variant is proving less virulent and not leading to significant lockdowns has raised hopes that we can avoid further mobility restrictions. This led investors to divest from 'stay-at-home' stocks that are mostly growth style names (see story #9).

Story #4: IMF lowers 2022 growth outlook as inflation jumps

The International Monetary Fund lowered its forecast for global economic growth this year, citing uncertainty about the pandemic, inflation, supply disruptions, and US monetary policy tightening. The IMF now projects global gross domestic product growth of 4.4%, 50 basis points lower than its earlier forecast, mainly due to downgrades for the US and China. After a very strong fourth quarter year-on-year expansion of 6.9%, US macro data has seriously disappointed in January with both 'hard' real data and 'soft' survey data falling on the month. Meanwhile, inflation data around the world continued to hit its highest levels in decades. US consumer inflation climbed to 7% in December compared with 12 months earlier, its fastest pace in nearly four decades. In Europe, December headline inflation rose to 5.0% year-on-year, mainly driven by rising food and goods prices.

Story #5: Global risk assets sold off

With the prospect of monetary policy tightening much earlier than anticipated, risk assets struggled in January. In total return terms, the S&P 500 fell 5.2%, its worst monthly performance since the start of the pandemic in March 2020. The main US equity benchmark briefly entered correction territory (-10%) before the end of the month but a subsequent recovery during the last days of January lifted the S&P 500 above correction territory. Volatility surged during the month as the VIX nearly doubled intra-month at one point. Still, in the US, the Nasdaq led the selloff with a 9.0% fall and Europe's Stoxx 600 fell 3.8%. Emerging markets, recording a 1.9% decline, outperformed developed markets. Credit also struggled on both sides of the Atlantic, as did traditional haven assets such as sovereign bonds and precious metals. US high yield dropped 3.0% and US investment grade, non-financial credit closed with a loss of 3.4%. January's best performing asset class was commodities, which gained 8.8% on strong energy gains.

A brutal awakening

After a strong 2021, it has been a rough start to 2022 for risk assets.

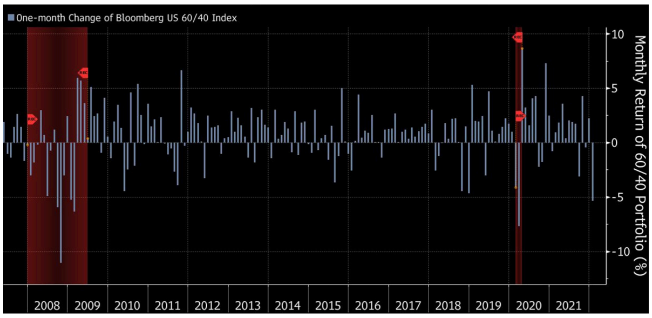
Story #6: The worst month for US Treasuries since November 2016

Developed markets' sovereign bonds lost ground with US Treasuries down 1.9% and underperforming European counterparts such as the German bunds 1.1% fall, and French OATs' 1.2% decline. Italian BTPs -0.6% loss was a relative outperformer, thanks to easing concerns over political risk with the re-appointment of President Sergio Mattarella. This enabled Prime Minister Mario Draghi's government to continue in office. In the US, the short-end of the curve yielded more than 40 basis points higher and the long-end rose by around 20 bps. The US two-year note now offers its highest yield since February 2020, while five-year and 10-year papers are at their highest since January 2010, flattening the yield curve for a fourth consecutive month.

Story #7: No place to hide

With equities and bonds both pulling back, January saw a 'balanced' bond-stock portfolio suffering its worst monthly performance since March 2020, and before that February 2009. Even with the benefit of hindsight, finding portfolio diversifiers was not easy as precious metals also closed in negative territory. Indeed, central banks' hawkish pivots helped to undermine precious metals' role as a hedge against inflation; both gold (-1.8%) and silver (-3.6%) declined over the month.

60/40 portfolio posted one of biggest monthly losses in recent years



Source: Bloomberg

Story #8: 'Bubble assets' suffered even more

While the main equity indices recorded meaningful drawdowns in January, the setback was greater the market's more speculative segments. So-called 'bubble assets' recorded double-digit losses: the Russell 2000 growth index lost 13%, the SPAK ETF fell 15%, the Nasdaq momentum index dropped 17% while the Ark Invest Innovation ETF – a proxy for non-profitable technology stocks – declined more than 20%. It was also a very bad month for cryptocurrencies as the selloff from late-2021 continued. Bitcoin ended the month down 17.0%, its third consecutive monthly decline, while XRP dropped 26.5%, Ethereum fell 27.3% and Litecoin lost 25.3%.

Story #9: Value outperformed growth

In the US, energy was the only sector to close the month higher with consumer discretionary and technology the worst performers. Bank stocks outperformed, supported by higher yields. Value stocks, which lost 1.2%, outperformed growth names' 9.3% decline, as rates rose and long duration stocks reversed some of their accumulated relative gains. This was growth stocks' worst month since September 2008 and value stocks' largest monthly outperformance versus growth in more than 20 years. Small cap stocks, which fell 7.5%, underperformed large capitalizations, but this was mainly due to the strong underperformance of small cap growth stocks.

Story #10: King dollar

The US dollar was the strongest performer among the Group of 10 currencies in January, with the dollar index hitting an 18-month high thanks to a further 0.9% rise. The currency's strength came as investors priced-in a more aggressive series of rate hikes from the Fed this year and follows its gain of 6.4% in 2021.

For further information

Banque Syz SA
Quai des Bergues 1
CH-1201 Geneva
Tel +41 58 799 10 00
Fax +41 58 799 20 00
syzgroup.com

Charles-Henry Monchau, Chief Investment Officer
charles-henry.monchau@syzgroup.com