THE GLOBAL CIO OFFICE

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Questionable Positives

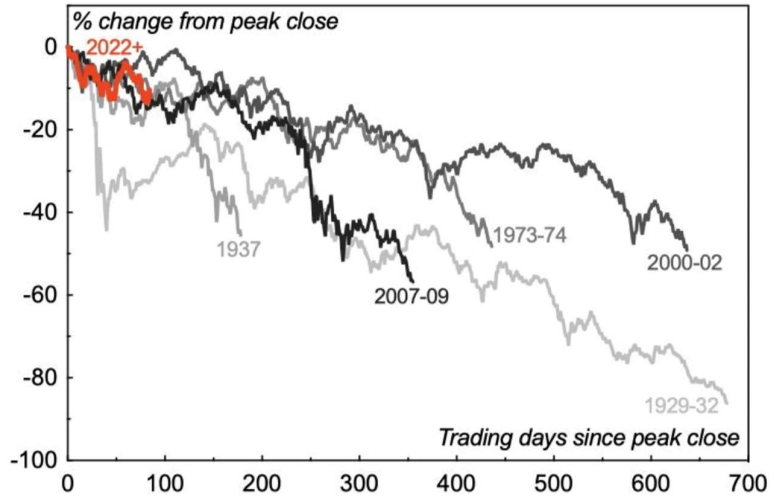
- **Equities rebound as bond yields dip**
- **Ordinarily, historical precedents suggest, the setback in equities would be followed by a positive year but…**
- **Inflation is still a major concern, and central banks have much to do**
- **Higher oil prices clearly helping GCC equity markets – Aramco becomes the world's most valuable company**
- **Elon Musk's Twitter twister – an ill-timed bid?**

Let us start with a positive—and some statistics. Based on data dating back to the 1950s, when the S&P500 fell 15%, in the subsequent year, on all occasions bar two, the index gave a positive return.

Unfortunately, this time, the balance appears tilted towards risks that the minority scenario will most likely play out. We, therefore, still see downside risks.

We would characterise the current challenges facing the equity markets as a combination of events that unfolded during 1973-74 and 2000 to 2002. Today we have an inflation problem, as we did in the 1970s. Then, similar to 2000 to 2002, we also see a sharp correction in what has been a significant overvaluation of equities (Chart 1). On both occasions, the market eventually fell 50% before rebounding.

Chart 1: This might just be the start to the end of the market correction



Note: The series show the percentage change in the S&P500 share price index from the peak close before each bear market began; the final trading day is the bear market's trough, except for 2022+, which is updated to May 4th.

Source: @joefrancis505

What – or who – could save us from a more catastrophic fall this time? The easy answer is policymakers. In recent years, both governments and central bankers have worked overtime to prop up financial assets. However, it is difficult to see a repeat of the massive stimulus programmes that governments instituted in the wake of the COVID-19 pandemic, considering the extreme challenge that inflation currently poses. Also, governments have, in the process, run up debts that are at multi-year highs and are ever more challenging to finance when long-term interest rates are on the rise.

There is some ongoing good news from the tight labour market conditions in Europe and the United States where labour shortages have pushed up wages. Higher wages have encouraged consumers to maintain their spending even if it has meant a drop in savings rates. The US household savings rate is estimated to have fallen by two percentage points in the first few months of 2022 as consumers have absorbed the impact of inflation. However, there is a sting on the tail of such trends as the consumers' willingness to pay up and run down their savings only encourages companies to push up prices, adding to the persistence of inflation.

Last week's US consumer price and producer price inflation were firm in the service sector but slightly easier on prices of goods. However, we need to remind ourselves that the previous month's data was a blowout relative to expectations; hence, there was always some room for a levelling out of inflation.

The market expects US retail sales data for April, due this week, to remain strong. However, other recent data sets point to future consumer spending weakness. Jobless claims, for instance, are starting to pick up from a run rate of 170,000 to 200,000 and last week's Michigan Consumer Sentiment Index for May showed a new post-pandemic low. There are 1.9 vacancies for each unemployed person, which shows an unwillingness to take the jobs available (salaries too low?) or a residual workforce that doesn't have the skill set to do the job.

The US inflation data and ongoing concerns about growth led to a significant drop in government bond yields both in the United States and Europe. The US 10 year was 10bps lower on the week, and the average across Europe was 20bps lower. These events though do not deflect us from our view that yields will move higher in time.

The pricing of credit is deteriorating. Despite government bond yields edging lower, the global high yield index lost a further 0.33% last week, reflecting the market's greater concern about potential credit problems. According to Bloomberg estimates, in just the past week, there was a 70% increase in distressed debt and loans in the United States. The last US loan officers survey also added to credit concerns, showing a noticeable increase in loan officers tightening credit conditions.

Saudi Aramco quietly slipped past Apple last week to become the world's most valuable company. It is also a sign that large movements in commodity prices wrest spending power from some parts of the world and enable others. The company announced first-quarter results that showed a net income of $40bn. With the Saudi government still owning more than 94% of the company, the Kingdom will remain in an expansive mood, with the World Bank projecting 7.2% real GDP growth this year against global growth of around 2%. The economy grew at a decade high 9.4% in the first quarter.

Clearly, investors could do worse than consider an investment in the GCC region in anticipation of a high oil price for longer and a commitment from GCC countries to plough back into their economies the benefits accruing from high oil prices.

Elon Musk – What a Twit(ter)!

You know we are in the evening of the bull market when you see corporate activity lacking any sense. Elon Musk's unpredictable diversion into bidding for Twitter, then seemingly trying to talk himself out of the move some days later, ranks up there for corporate arrogance. He is undoubtedly an extraordinary entrepreneur in the EV space; however, he may have stretched himself a bit too far by trying to campaign

for freedom of speech via a bid for a publicly quoted equity. Sadly, thousands of other equity investors suffer the share price volatility from a paper billionaire's vanity.

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