# Views from the desk

Global Market Overview and Outlook
Habib Investment Limited
*(Regulated by the Dubai Financial Services Authority)*

Issue # 220902
September 2022

Quote of the month: **"An investor without investment objectives is like a traveler without a destination."**

- **Sandeep.S.Jadwani-ASCI,CIB**
  Head Of Investment Advisory

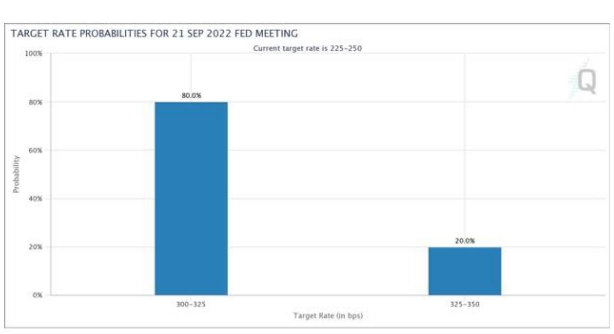
## Market Overview

The uncertainties, bring out two possibilities of a slowdown or mild recession in the near term but a full-blown recessionary impact in H2,2023 and a deep recession could trigger a large equity BEAR market. The later seems to be taking shape earlier than expected.

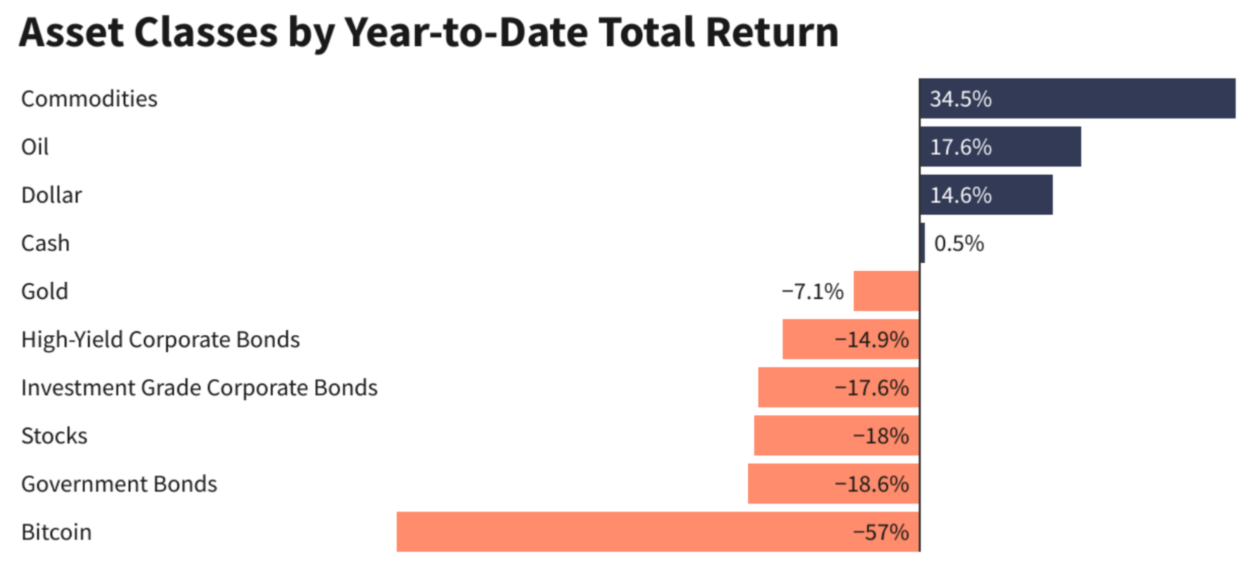
Three of the largest five economies will hold their central bank meetings week 3 of September, including the US, Japan and the UK. Attention very much focuses on the Fed after September higher than anticipated inflation figure as falling energy costs failed to offset surging prices in other categories, meaning inflation held higher than expected at 8.3%. These sticky and core numbers are likely to be significant concerns for the Fed. On top of that, job growth has remained hot. Subsequently, the Fed's aggressive stance is expected continue with markets pricing in a **third consecutive 75 bp hike**, though a 100-point rise is also on the table. Interest rates are expected to reach 4.25% by the end of 2022.

**The risk-off mood** in markets has left some investors seeking refuge in cash. Fund managers increased average cash balances to 6.1% in September, according to a survey by BofA Global Research. With both the stock and bond markets hitting a big air pocket thanks to a hotter-than-expected inflation report, all eyes are on the next Federal Reserve meeting on how aggressive the Fed will need to be to tame inflation.

A backdrop of **uncertainty** marked by lower economic growth and recessionary headwinds may warrant investors to have extra cash on hand. Higher interest rates finally make some **shorter-duration strategie**s more appealing right now




***Jumbo Rate Hike** : With expectations centered on another big rate increase in September, the question facing the markets is how high the Fed will take interest rates before they pause, or even start to lower them.*




Source : Bank Of America Research (as on 18th September 2022)

# Inflation: The Hue & Cry

Our long-term outlook on mature equities continues to remain positive with intermittent volatility.

**US Treasury yields** rose to their highest levels since mid-June, with the yield on the 10-year note closing at 3.45%. The two-year yield soared to 3.87%, its highest level in 15 years, with the yield curve inversion between the two-year and ten-year notes widening, often considered a leading indicator of a recession. Crude oil prices remained under pressure amid concerns a global recession could impact demand, with the price of **WTI** crude trading near $85 per barrel. It makes the Fed projections very important, as it will lay out a potential policy path for the remainder of 2022 and 2023. If the Fed gives forecasts that are too low, they run the risk of financial conditions easing, which is not what they want. The market may have made the Fed's job easier because the Fed Funds futures now see the overnight rate climbing to a terminal rate of 4.45% by April. The problem lies with what comes next, because currently the market is pricing in rates to fall back to 4.0% by December 2023. That may prove too low for the Fed's liking, given the hotter-than-expected CPI report and calls to hold rates steady for some time.

**China's recovery** is constrained by Covid-19 pandemic restrictions and a prolonged property slump. We now expect growth to slow to 2.8% this year and recover to only 4.5% next year, prudent to build positions from a SAA perspective.

**The eurozone and UK** are now expected to enter recession later this year and the US is expected to suffer a mild recession in mid-2023. We forecast that US and eurozone growth in annual terms will be quite close to 0% next year, roughly in line with the possibility of a downside stagflation scenario. Deep and Wide Cuts to Growth Forecasts, **The European** gas crisis, high inflation and a sharp acceleration in the pace of global monetary policy tightening are taking a heavy toll on economic prospects. Deep and Wide Cuts to Growth Forecasts, **The European** gas crisis, high inflation and a sharp acceleration in the pace of global monetary policy tightening are taking a heavy toll on economic prospects.

As major developed economies grapple with multiple problems like rising inflation and rates, slowing growth and contracting economic activity, **India** is relatively doing better on these parameters Moreover, India's economic activity is back to pre-pandemic levels, structural growth drivers like reforms, demographics, FDI flows are in place. This further gives confidence in the long term prospects of the economy. We believe Valuations are in Neutral Zone, Business Cycle has begun picking up, possible market Triggers in near terms can be macro headwinds and market Sentiments too appear in a Neutral zone.

## Economic Definitions 101

### Inflation

Inflation is the broad rise in the price of goods and services across the economy. The Federal Reserve deems annual inflation averaging 2% over the long run Typically, inflation goes hand-in-hand with economic growth, and an overheated economy is one possible cause of higher inflation

### Stagflation

Stagflation is a term that describes the simultaneous occurrence of stagnation and inflation in an economy. Conditions typically present in an economy experiencing stagflation include rising prices for goods and services, rising interest rates, relatively high unemployment, and slow-no economic growth.

### Recession

A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. Recessions may last as little as a few months, but the economic recovery to the former peak can take years.



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# Asset Class Views

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| Asset Class | Sub-Class | View (Aug) | View (Sept) | Rationale |
|---|---|---|---|---|
| **Main Asset Class** | Equities | = | = | Potential slowdown in global economic growth remains a major risk for equities; Powel's hawkish tone at Jackson Hole meeting, the headline CPI reading above market consensus, European energy crisis, UK cost of living crisis, continuing Russia-Ukraine unrest etc firms up to dent equity sentiments. |
| | Fixed Income | = | = | With inflation readings, though lower, but remaining elevated, firms the global central banks stance of aggressive interest rate hikes and probably higher each time. eventually pace down the IR hike in Q2,2023 that will benefit Sovereigns and IG long duration to lock in the higher yields. Lack of liquidity, dispersion, funding scarcity and a likely rise in the default rate are all factors that lead us to confirm and retain our underweight stance on US and euro high yield. |
| | Commodities | =▲ | ▼ | The crude oil price appears unreasonably low in view of the tight supply. The EU ban on Russian oil imports starting in December will reduce supply by about 2 million barrels per day. US inventories are very low, the US government used up about 17% of its strategic reserve last year, and OPEC reserve capacity has shrunk significantly. Weaker energy demand will have some negative impact, but we expect Brent crude oil to rise above $100 by year-end (from $92 currently). While the long-term outlook for metals needed for the energy transition (especially copper) remains attractive, prices could fall further due to slumping Chinese demand. |
| | Currencies | = | =▲ | With the USD looking very overvalued, there is a risk that the ECB and other developed country central banks could limit dollar strength with their tighter measures. However, we still expect another window in which the dollar will appreciate but remain cautiously overweight. |
| **Equities** | USA | = | = | We continue to prefer US stocks which have outperformed global ex-US equities by 2% year-to-date, despite a challenging environment for Tech, where the US market is very overweight. Our sector preferences remain tilted towards defensive sectors, for example Consumer Staples and Healthcare – with an overweight in Energy as a hedge against further upside for oil prices. Quantitative Tightening and diminishing earnings growth to put pressure on equities |
| | EU (Ex UK) | ▼ | ▼ | Leading economic indicators suggest sharp downturns in Germany and Italy, and a European Commission reading of economic sentiment hit a 17-month low amid fears of energy shortages and concerns that a recession is nearing. European energy price spikes should continue crimping consumer spending and globally, some key measures of output imply contraction. Should growth slow further in Q4, markets may focus on the risk of global recession |
| | UK | = | = | Inflation increasing at a fast pace, cost of living crisis, political disarray and trade battle with the EU point to a poor outlook to take fresh exposure |
| | EM (Ex MENA) | = | = | EM under pressure from rising inflation, rising oil prices, supply chain (export) disruption, structural reforms. For China, the combination of zero-Covid strategy and the deteriorating property sector continues to drag down the economy, even as export growth remains elevated. With PBOC cutting short term rates, contrary to global CB's , indicates situation is far worse than reported. Valuations are attractive but further outbreaks remain a risk. India's economic activity is back to pre-pandemic levels, structural growth drivers like reforms, demographics, FDI flows are in place. This further gives confidence in the long term prospects of the economy. |
| | MENA | =▲ | =▲ | Scaling of capital markets by divesting PSU, Range bound Oil prices, Rising USD IR and key structural reforms make GCC a key low beta, attractive return allocation. |
| **Fixed Income** | US Treasuries | =▲ | =▲ | FED Hawkishness fully priced into the treasuries. Demand for duration will grow from these levels as portfolios flow back to rebalance and safe havens |
| | Euro (Bunds) | ▼ | ▼ | Bund yields at highest levels but gradually pricing in rake hikes. Yields still not peaked out and uncertainty remains |
| | UK Gilts | ▼ | ▼ | Lack of policy clarity, red hot inflation and weak economic outlook poses challenges to BOE's further guidance on pace and magnitude of interest rate hikes. |
| | US IG | ▲ | =▲ | Sluggish corporate earnings and likely jumbo FED rate hikes; prefer companies with high interest coverage ratio, and tilt towards cautious stance. |
| | US HY | = | = | Based on majority analyst consensus, neutral high yield. We prefer up-in-quality credit exposures amid a worsening macro backdrop. |
| | Europe IG | ▼ | ▼ | Economic and political struggles to weigh on EU credits whilst ECB remaining hawkish. |
| | EM (ex Japan) | = | = | We are neutral EM fixed income amid a worsening macro-outlook. Valuations are not compelling enough yet to turn more positive on the asset class, EM local ccy could prove a good play based on tactical risk allocation |
| **Commodities** | Oil | =▲ | =▲ | Global supply disruption to support Oil whilst a sluggish demand and slowing economic activities put pressure on Oil. Supply reductions to provide some support |
| | Precious Metals | =▲ | = | Heightened geopolitical risks amidst recessionary fears, US-China tension, Russia-Ukraine and market volatility to drive safe haven demand, however, strengthening USD could pull the metal down. |
| **Currencies** | USD | =▲ | =▲ | Bad news on inflation has resulted in good news on USD and any reversal will have an impact on the USD. USD remain the safe haven global currency |
| | EUR | ▼ | ▼ | Weak economic outlook but technically overvalued USD and valuations can give an upside lift in the mid-term |
| | GBP | = | = | Weak economic outlook, and anticipation of aggressive BOE rate hike until end of 2022; |
| | EM | = | = | Benign USD, compelling currency valuations, consolidating energy/commodity prices may support EM currencies. |


# US Mortgage Rates Climb Above 6% for First Time Since 2008

**Fast-rising borrowing costs have slammed the housing market - Tight inventory will limit home-price declines**

Mortgage rates in the US topped 6% for the first time in nearly 14 years & has doubled from 3% from start of 2022. This is dampening their ability on discretionary spending with monthly payments going up by almost double considering an average home is priced at USD 550,000/- Mortgage rates continued to rise alongside hotter-than-expected inflation numbers in September.

The average for a 30-year loan jumped to 6.02% in September, Freddie Mac said in a statement. The last time rates were above 6% was in November 2008, the company's data show. This year's rapid rise in borrowing costs has slammed the brakes on the US housing market, sidelining potential buyers, crimping sales and slowing price growth. Weakening demand has forced lenders including Citi Group to cut jobs and spurred warnings from bank executives about falling revenue from the mortgage business. The Federal Reserve has been seeking to cool certain parts of the economy including housing. Inflation in August ran hotter than expected, boosting expectations of bigger interest rate hike from the central bank.

*"A 6% mortgage rate isn't just a psychological threshold, it is a major threshold of affordability, particularly for first-time homebuyers," said Greg McBride, chief financial analyst at Bankrate.com. "The increase in mortgage rates since the beginning of the year has had the same impact on affordability as a 28% increase in home prices -- and that's on top of the already heady appreciation seen the past couple of years."*

Although the increase in rates will continue to dampen demand and put downward pressure on home prices, inventory remains inadequate. This indicates that while home price declines will likely continue, they should not be large.





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