

MFS

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Equities Bounce on Lower Inflation

A review of the week's top global economic and capital markets news.

Investment Solutions Group

For the week ending 12 August 2022

As of midday Friday, global equities were up on the week, supported by a report that inflation eased to 8.5% in July, down from 9.1% in June. The yield on the US 10-year Treasury note rose to 2.85% from 2.83% a week ago, and the price of a barrel of West Texas Intermediate crude oil rose to \$92, up from \$88 last Friday. Volatility, as measured by the Cboe Volatility Index (VIX), fell to 19.2.

MACRO NEWS

Stocks rise even as recession signs flash

Global equities have staged a comeback in recent weeks despite signs of slowing global growth and the fear of recession in Europe and the United States. The MSCI All Country World Index is up nearly 10% since midyear, with US technology stocks leading the charge. At the same time, the OECD index of leading economic indicators predicts slowing growth across member countries, and the US yield curve inversion has deepened. Yield curve inversion occurs when shorter-term rates rise above longer-term ones. It has often preceded recessions, although not always.

Inflation slowed in July, but remains dangerously high

The US Consumer Price Index increased by 8.5% in July on a year-over-year basis, lower than expectations of 8.7%. Lower energy prices contributed to the decline while food and shelter prices remained high. Lower inflation eased investor concerns that the US Federal Reserve would need to hike rates more aggressively to mitigate runaway inflation. While risk assets rose on the news, an 8.5% inflation rate remains considerably higher than the Fed's target of 2% and tightening through the end of the year is widely expected.

Consumer sentiment rises on improved outlook

US consumer sentiment, which had been on the decline, rose to a three-month high as energy prices eased. The University of Michigan sentiment index rose to 55.1 from 51.5, exceeding most economists' forecasts. Consumer inflation expectations fell for the year ahead, and the

overall outlook improved. The importance of a strong consumer is difficult to overstate given that consumer spending comprises nearly 70% of US nominal GDP.

Biden to sign Inflation Reduction Act

US President Joe Biden is expected to sign the \$700 billion Inflation Reduction Act on Friday, a victory for Democrats as the midterm elections draw closer. The spending program invests in green energy, lowers some health care costs and increases the size of the IRS. During late negotiations, policymakers added a 1% excise tax on buybacks as well as a 15% minimum tax on large corporations. Republicans criticized the bill as unnecessary during a period of high inflation, saying it would do little to help middle- and lower-income Americans.

Crypto regulations closing in

After a dramatic meltdown across cryptocurrencies in the first two quarters that more than halved the value of the cryptocurrency market, the SEC is considering new reporting rules for hedge funds that would require greater disclosure on their exposure to cryptocurrencies. Momentum for more robust cryptocurrency regulations increased after hedge fund Three Arrows Capital crashed this summer. The shuttering of the fund created a chain reaction across the crypto industry, resulting in frozen customer funds and platform closures. The US Department of the Treasury imposed sanctions on Tornado Cash, a so called “mixer” platform designed to hide cryptocurrency transactions and owners.

QUICK HITS

FBI agents served a search warrant at former US President Donald Trump’s Mar-a-Lago home in Florida, reportedly as part of an investigation into Trump’s handling of classified material. Republicans called the search a political move while Attorney General Merrick Garland defended it, noting that he had approved it personally.

China’s property market continues to cool as construction slows in both residential and commercial properties. Stocks of Chinese builders remain under pressure losing \$55 billion in value in 2022, according to Bloomberg.

On Tuesday, the Taiwanese military conducted exercises to simulate a defense against an invasion by China. While the drills were part of an annual exercise, they come at a time of increased tension between Taiwan and China after US congressional leader Nancy Pelosi’s visit to the island last week.

The US Producer Price Index increased 9.8% in July year over year, although the index was down 11.3% in June.

The UK economy contracted for the first time since the pandemic as household spending softened. Raging inflation and slowing growth is an unfortunate economic mix for a country that has struggled to recover from the effects of the coronavirus.

Venture capital firms are flush with cash, with \$539 billion in dry powder, according to Preqin.

The semiconductor industry remains under pressure, with the Philadelphia Semiconductor Index down around 22% year to date.

Video game companies, big beneficiaries of lockdowns, posted disappointing quarterly earnings as pandemic restrictions faded.

EARNINGS NEWS

With about 90% of the constituents of the S&P 500 Index having reported for Q2 2022, blended earnings per share (which combines reported data with estimates for those that have yet to report) shows that earnings growth is running at 6.7%, with the energy sector reporting the highest growth rate at 299%, according to data from FactSet Research. Ex energy, earnings are on track to contract 3.7%.

Stay focused and diversified

In any market environment, we strongly believe that investors should stay diversified across a variety of asset classes. By working closely with your investment professional, you can help ensure that your portfolio is properly diversified and that your financial plan supports your long-term goals, time horizon and tolerance for risk. Diversification does not guarantee a profit or protect against loss.

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Sources: MFS research, Wall Street Journal, Financial Times, Reuters, Bloomberg News, FactSet Research, CNBC.com.

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