



October 2022 Market Pulse

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CENTRAL BANK GUIDANCE REIGNS



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Despite global equity and bond markets reaching new year-to-date lows during October, both rallied to finish the month higher, with equities in particular generating strong gains over the month. Continued upward surprises in inflation readings and hawkish rhetoric from central banks contributed to the initial falls. Equity markets established a floor before bonds, with early third-quarter earnings results ahead of expectations, while key technical levels also provided support. A slight change in tone from global central banks and the resultant renewed speculation about a possible policy pivot was a key catalyst behind the late month rally.

The Fed

At the start of the month, US Federal Reserve (Fed) commentary remained relatively hawkish. The minutes for the previous Fed meeting stated that inflation remained unacceptably high and there were clear concerns over an upward wage spiral developing. Statements from Fed members highlighted that the central bank remained resolute in terms of bringing inflation back to target, that policy was not yet seen as restrictive and that interest rate cuts in 2023 were unlikely.

However, a shift in rhetoric became evident from mid-month as central banks became concerned over financial stability risks, as highlighted by the recent turmoil in UK bond markets. An article in the Wall Street Journal, which suggested the pace of rate rises could be slowed in December, gave rise to renewed speculation over a policy pivot and led to a strong recovery in bonds and equities over the last seven trading days of the month.

Inflation surprised to the upside. US headline inflation rose 0.4% month-on-month (m/m), with the year-on-year (y/y) reading at 8.2%. US core inflation was surprisingly strong at 0.6% m/m and 6.6% y/y.

The ECB

The European Central Bank (ECB) also reflected this 'step down' from the more hawkish commentary of recent months, even as it raised interest rates by 75 basis points (bps) for the second consecutive meeting. It indicated further rate rises are likely but omitted previous references to rises being required at the next several meetings, suggesting a pause in rate rises could be near. As a result, expectations for the peak in the ECB deposit rate fell by approximately 50 basis points (bps) to 2.50%.

Subsequently, however, Eurozone inflation came in at 10.7% year-on-year, and there was some row-back by ECB council members. They emphasised a rapid pace of rate rises was still warranted, which caused expectations for the peak in the deposit rate to reset higher again to 2.8%. The ECB also indicated that the broad principles for the start of quantitative tightening (QT) through limiting the automatic rollover of maturing debt will be agreed in December, thereby suggesting QT could begin in the first quarter of 2023.

The BoE

The Bank of England (BoE) succeeded in stabilising the UK gilt market and supporting UK pension funds by buying gilts over the first two weeks of October. Having initially delayed the plan to sell gilts from its balance sheet due to this unplanned intervention, the BoE confirmed it would go ahead and begin selling gilts from 1 November.

Macroeconomic backdrop

Consistent with a contraction in growth, global flash PMIs for developed markets in October fell again with the composite PMI down to 48.1.

While the US economy showed resilience through most of the month, data releases began to soften in the last week of October. The labour market remained strong with unemployment falling back to a 50 year low at 3.5%, while unemployment claims remained at the lower end of historic ranges. The housing market, however, is under pressure given its sensitivity to higher interest rates, with activity and prices falling. Consumer confidence slipped again in October, as consumers are being forced to dip into savings to offset the squeeze in real incomes from higher inflation.

MARKET ROUND-UP

Equities

Over the month, the MSCI AC World equity index rose 6.1% (5.1% in euros). US equities rose 7.9% (7.0% in euros) on suggestions the Fed could begin to slow the pace of interest rate rises from December. European equities also outperformed, rising 7.2% (6.6% in euros) as the ECB suggested the scale of interest rate rises could be lower than previously indicated. Pacific Basin equities underperformed, rising only 0.6% (-0.4% in euros) as Hong Kong was sharply lower due to a disappointing interpretation of the future policy path after the 20th Chinese Party Congress. Emerging market equities also lagged, falling -2.6% (-3.9% in euros), for similar reasons.

Currencies and commodities

The euro rose slightly by 0.8% against the dollar to 0.9887. The euro initially weakened against the dollar amid the ongoing 'risk off' environment and hawkish stance at the Fed. The dollar then began to weaken against the euro in the second half of the month on reports that the Fed could slow the pace of interest rate rises in December.

Commodities rose 6.7% (5.8% in euros). Brent oil rose 8.9% as OPEC+ announced plans to cut production by 2 million barrels per day to support the oil price.

Gold was down -1.5%, with the initial strength in the US dollar acting as a drag.

Bonds

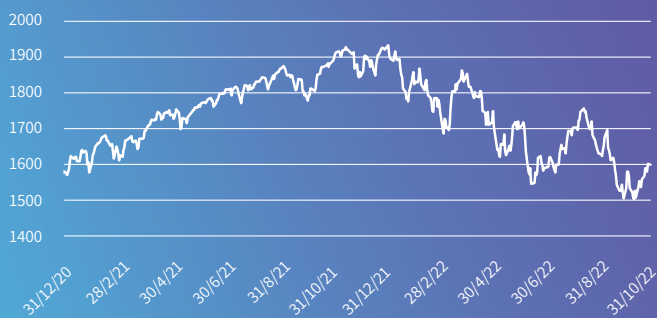
The Eurozone >5-year bond index rose slightly, by 0.3%. German 10-year yields initially rose to 2.53%, the highest since 2011, as investors feared ongoing tightening of monetary policy in a persistently high inflation environment. Yields, however, fell into month end as global central bank rhetoric became less hawkish. Suggestions by the ECB that fewer interest rate rises might be implemented compared to previous guidance contributed to the fall in yields with the German 10-year yield eventually ending the month only 3bps higher at 2.14%. Peripheral spreads narrowed over the month as expectations for the scale of ECB policy tightening eased, with the anticipated peak in the deposit rate falling to 2.80%. Italian 10-year spreads against Germany fell to 215bps while Spanish 10-year spreads declined to 109bps.

European investment grade corporate bonds rose 0.2%, even as yields rose 8bps to 4.21%, with the yield carry helping to offset the rise in yields. Spreads eased 6bps to 214bps. High yield corporate bonds rose 2.7% as yields fell 46bps to 8.09% while spreads declined 68bps to 417bps.

Emerging market (EM) local debt fell -1.5% as yields rose 16bps to 7.55%, impacted by the volatility in global bond yields and fears over the long-term growth outlook in China. EM currencies were also slightly weaker against the euro. EM hard currency debt fell -0.3% as yields rose 10bps to 8.82%, pulled higher by the same factors impacting EM local debt during the month.

CHARTS OF THE MONTH

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 1 November 2022.

Bonds - German 10-year yield



Source: ILIM, Bloomberg. Data is accurate as at 1 November 2022.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	QTD Return (%)	YTD Return (%)	2021 Return (%)
MSCI Ireland	10.1	-22.0	17.1
MSCI United Kingdom	5.1	-0.7	27.5
MSCI Europe ex UK	6.6	-14.8	25.4
MSCI North America	6.9	-6.3	36.6
MSCI Japan	2.1	-12.5	9.8
MSCI EM (Emerging Markets)	-3.9	-18.5	5.2
MSCI AC World	5.1	-8.9	28.1
10-Year Yields	Yield Last Month (%)	2021 Yield (%)	2020 Yield (%)
US	4.05	1.51	0.91
Germany	2.14	-0.18	-0.57
UK	3.52	0.97	0.20
Japan	0.25	0.07	0.02
Ireland	2.62	0.24	-0.30
Italy	4.29	1.17	0.54
Greece	4.62	1.34	0.63
Portugal	3.15	0.47	0.03
Spain	3.23	0.57	0.05
FX Rates	End last month	2021 Rates	2020 Rates
U.S. Dollar per Euro	0.99	1.14	1.22
British Pounds per Euro	0.86	0.84	0.90
U.S. Dollar per British Pounds	1.15	1.35	1.37
Commodities (USD)	QTD Return (%)	YTD Return (%)	2021 Return (%)
Oil (Brent)	7.8	15.1	55.0
Gold (Oz)	-1.5	-10.6	-3.4
S&P Goldman Sachs Commodity Index	6.7	30.0	40.4

Source: ILIM, Bloomberg. Data is accurate as at 1 November 2022.

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THE ILM VIEW – LOOKING AHEAD

The outlook for equity markets over the next twelve months is dependent on several factors including central bank policy, growth, inflation (both expected and realised) and the evolution of the Russia/Ukraine crisis.

Equities have declined year-to-date as central banks have tightened policy, bond yields have risen and growth forecasts have fallen.

Post the falls, equities now look attractive on an absolute valuation basis, trading on a 12-month forward price-to-earnings (P/E) multiple of 14.2x against a long-term average of 16.0x.

If consensus economic and earnings forecasts prove to be correct and we are just in a mid-cycle slowdown, there is double-digit upside in equity markets on a one-year view. A moderation in inflation with no additional policy tightening beyond what is currently discounted in markets would also be supportive.

However, equities continue to face several headwinds. Due to the persistence of high inflation, central banks continue to tighten policy and withdraw policy accommodation, which has been supportive of equity markets in recent years. Given the significant rise in bond yields, equities are no longer cheap on a relative valuation

basis and are now expensive versus bonds. Earnings are at risk of being downgraded due to margin pressures from higher input and labour costs with risks also to top line growth in a slowing growth environment.

For equities to trough, investors need to believe we are at the peak of policy tightening and growth risks are fading. Given the risks around inflation and central banks' policy responses, the potential downside in growth and earnings forecasts, the failure to find resolutions to geopolitical issues and the removal of the undervaluation of equities versus bonds in the higher yield environment, we see risks in equities as still being skewed to the downside.

Navigating equity markets is difficult even in a benign environment, but it has become more arduous against the current backdrop, with heightened uncertainty on many issues. As a result, the increased volatility evident this year is likely to continue.

While our outlook for equity markets suggests limited upside in the short term, the prospects remain positive over the medium to long term with upside of approximately 6% per annum expected on a 5-10 year view.

THE MONTH AHEAD

NOVEMBER

			10	11		
			US Inflation Rate YoY (October)	GB GDP MoM (September)		
	15	16				
	US PPI MoM (October)	GB Inflation Rate YoY (October)				
		23		25		
		US New Home Sales (October)		GB Consumer Confidence (November)		
	29		30			
	DE Inflation Rate YoY (November)		US GDP Growth Rate QoQ			
			EU Inflation Rate YoY (Flash November)			

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