



M&G Investments
September 2022

Market overview: August 2022

Global equity markets were broadly negative in August, as concerns over higher interest rates and a concomitant slowdown in economic growth weighed on investor sentiment. In the US, the Federal Reserve signalled its intention to keep borrowing costs “higher for longer” in a bid to curb inflationary pressure, while economic data confirmed that the economy had entered a technical recession. Elsewhere, preliminary figures out of the UK signalled a contraction in GDP growth for Q2, while the BoE continued its path of raising interest rates to combat runaway inflation. Turning to China, investors were left downbeat following the reintroduction of lockdowns across key cities following fresh Covid-19 outbreaks, which were further compounded by severe power outages across the country. Meanwhile, in South Africa, global risk-off sentiment and contractions in China’s manufacturing sector lowered demand for base metals, placing downward pressure on the local bourse.

Looking at global equity market returns (all in US\$), the MSCI All Country World Index returned -3.6% for the month. Emerging markets outperformed developed markets, with the MSCI Emerging Markets Index delivering 0.4% and the MSCI World Index returning -4.1%. The Bloomberg Global Aggregate Bond Index (US\$) returned -3.9%, while the EPRA/NAREIT Global REIT Index (US\$) produced -6.2%.

The spot price of Brent crude oil closed the month 12.3% lower at around US\$95 per barrel, as concerns over more restrictive monetary policies from central banks and a slowdown in demand from China lowered the energy demand outlook. The price of metals followed suit, with nickel returning -3.6%, copper -1.0%, gold -2.6%, aluminium -3.4%, palladium -0.7 and platinum -5.2% (all in US\$).

US

Market sentiment waned after US Federal Reserve Chair Jerome Powell reiterated his hawkish message of “higher interest rates for longer” at the Jackson Hole Economic Symposium. Powell noted that another large increase could be appropriate at the Fed’s next meeting; however, the decision would largely depend on the totality of the incoming data and the evolving outlook. Last month the Fed raised the fed funds rate by 75bps to 2.25%-2.5%, marking its fourth consecutive rate hike in a bid to curb inflationary pressure. Meanwhile, the yield on the 10-year US Treasury Bill closed the month at around 3.1% on the back of the Fed’s hawkish rhetoric. Markets are now pricing in a further 75bps hike in September, which saw the 2-year Treasury yield close at around 3.4% at month-end, its highest level since November of 2007.

In other news, annual inflation in the US slowed to 8.5% in July, well off the 40-year high of 9.1% posted a month earlier, and marginally below market forecasts of an 8.7% rise. This was helped by falling food prices, even as energy costs remained elevated and were the largest driver behind the increase in prices, with Energy CPI rising 32.9%. New economic data showed that the US economy contracted by an annualised 0.6% q/q in Q2, below advanced estimates of a 0.9% fall. However, the economy still remains in a technical recession, following a 1.6% contraction in Q1, prompting concerns over the impact that higher interest rates would have on GDP growth going forward. The unemployment rate, meanwhile, showed signs of improving, decreasing to 3.5% in July from 3.6% in the previous period, the lowest reading since February 2020.

Equities closed the month lower, with the S&P 500 returning -4.1%, the Dow Jones Industrial Average -3.7%, and the technology-heavy Nasdaq Composite -4.5% (all in US\$).

South Africa

The annual inflation rate in South Africa accelerated to a 13-year high of 7.8% in July, marginally above market expectations of a 7.7% rise. This marked the third consecutive month where inflation increased above the upper limit of the SARB's 3%-6% target range. This comes after the SARB raised the repo rate above market expectations to 5.5% in July, while signalling further aggressive monetary tightening over the medium term. Meanwhile, annual core inflation, which excludes prices of food, non-alcoholic beverages, fuel and energy, rose to 4.6% in July from 4.4% in June, the highest reading since October of 2017. The market is expecting a significant interest rate hike of 50-75bps from the SARB at its September MPC meeting to keep up with the US Fed, and more in the months to come.

In other news, PMI data showed manufacturing activity contracted to 47.6 in July from 52.2 in June, largely due to electricity supply disruptions following last month's nationwide load shedding. South Africa's 10-year government bond yield rose to around 10.4% at the end of August, largely due to the prospect of further interest rate hikes across major central banks, particularly in the US. Turning to performance, the FTSE/JSE All Share Index returned -1.8% in August, dragged lower by Resources stocks (-3.8%), which largely tracked the downturn of base metals amid expectations of lower demand after Chinese manufacturing PMI contracted for the second consecutive month. All major sectors were in the red for the month: Industrials returned -0.4%, Financials -1.9% and Property (as measured by the FTSE/JSE All Property Index) -5.9%. The FTSE/JSE Capped SWIX All Share Index, which we use as the equity benchmark for most of our client mandates, returned -1.3%. SA bonds (as measured by the FTSE/JSE All Bond Index) delivered 0.3%, SA inflation-linked bonds returned 2.5%, and cash (as measured by the STeFI Composite) delivered 0.45%.

Finally, the rand depreciated against most major currencies, falling 2.5% against the US dollar and 1.0% against the euro, while gaining 2.0% relative to the pound sterling.

UK and Europe

The Bank of England raised its main rate by 50bps to 1.75% in August 2022, marking the sixth consecutive rate hike and pushing borrowing costs to its highest level since 2009. According to the BoE, inflation is expected to rise to 13.3% in October and remain at elevated levels throughout much of 2023. Annual inflation reached its highest reading since February 1982, increasing to 10.1% in July, above the 9.4% recorded in the previous month and slightly above market forecasts of a 9.8% rise. Meanwhile, preliminary estimates showed that the British economy contracted by 0.1% q/q in Q2.

In Europe, preliminary estimates showed annual inflation in the Euro Area accelerating to a new all-time high of 9.1% in August from 8.9% in July. Energy costs remained elevated, with the benchmark European gas price having already increased by 550% in the past 12 months, placing significant pressure on already-embattled consumers in the run-up to what is expected to be an even harder winter period. ECB policymakers noted that the 50bp rate hike in July should be regarded as frontloading the exit from negative rates, and a necessary move to normalise monetary policy. In other news, Eurozone GDP was revised lower to 0.6% q/q for Q2 from a preliminary estimate of 0.7%, further dampening investor sentiment.

For the month, the UK's FTSE 100 returned -5.4%, Germany's DAX -6.1% and France's CAC 40 -6.3% (in US\$).

China and Japan

China's path toward economic recovery was dealt a blow in August, after data showed factory activity having slowed for a second consecutive month, with China's Purchasing Managers Index contracting to 49.4 in August. The decline came largely on the back of widespread Covid-19 lockdowns following fresh outbreaks of the virus, and electricity shortages due to disruptions to the country's hydroelectricity supply. In slightly more positive news, the People's

Bank of China lowered its key loan prime rates in August, the second reduction this year, as the board ramped up its efforts to revive demand for borrowing to spur economic activity. Policymakers added a further 1 trillion yuan worth of measures to help the economy recover and lift the depressed property sector. Meanwhile, China's annual inflation rose to 2.7% in July from 2.5% in June, below market forecasts of a 2.9% increase but still the highest reading in two years.

In Japan, the economy grew by 0.5% q/q in Q2 according to preliminary estimates, marginally below market estimates of a 0.6% increase. Market sentiment was dampened somewhat after data showed annual inflation increasing to 2.6% in July from 2.4% in June, signalling the 11th straight rise in consumer prices and the fastest pace in nearly eight years. In other news, Japan's Services PMI was down to 49.2 in August, while annual retail sales increased by 2.4% in July 2022, well above the market consensus of 1.9%. The latest reading pointed to the fifth consecutive month of increased retail activity and improved consumption following the lifting of Covid-19 restrictions.

For the month, Japan's Nikkei 225 delivered -2.5% and Hong Kong's Hang Seng -0.7% (in US\$).