May Monthly Newsletter

A summary of key events and market trends during the month of May

Global Markets Update

- Most equity markets closed May relatively flat while the year-to-date performance continues to be deeply negative with the technology heavy Nasdaq faring the worst with negative -22.78% after another monthly decline of -1.65%

- We have seen some initial signs of slowing inflation and more importantly the interest rate markets paused its upward trajectory with the 2-year US Treasury currently trading at 2.57% compared to the recent highs of 2.78%. The same applies to 10-year rates which declined from 2.98% to 2.86%

- Energy prices stubbornly remain at the upper end of the recent price ranges, however as we have not seen new highs since March the higher base effects will kick in to ease the year-on-year price comparisons with the passage of time

- The conflict between Ukraine and Russia continues on a smaller battle ground in the east, however with renewed intensity as both sides are determined to prevail. We closely monitor developments here as any escalation could have important knock-on effects for markets

- The bulk of the corporate results are out and the numbers have, barring some outliers, been relatively positive.

- Volatility has, in May, started to taper off and we have seen key levels on multiple volatility indices ease over the same period. Given the various negatives the market has had deal with this action is noteworthy and suggests risk assets could find a base sooner rather than later.

- While short term equity market movements will remain volatile and bumpy, the technical factors outlined above could highlight a market rebound might be imminent

- With the simultaneous widening of credit spreads and raise in interest rates, fixed income investments are now an interesting asset class again both from a relative and absolute point of view, and we will look to gradually add to them accordingly

Are we over the hump?

Financial markets have priced in a good deal of negatives since the start of the year … is it now time for markets to bottom out?

Key markets

Index	Month to Date (%)	Year to Date (%)
Topix	0.69	-4.00
Hang Seng China Enterprises	1.62	-9.95
Dax	2.06	-9.42
Euro Stoxx 50	-0.36	-11.85
S&P 500	0.01	-13.30
Dow Jones	0.04	-9.21
Nasdaq 100	-1.65	-22.54
US 10 Year Treasury	-0.09	0.51
Bloomberg Barclays Global Corporate Bond Index	0.27	-11.06
EUR USD	1.79	-5.59
USD JPY	-0.79	11.81
Gold	-3.14	0.45

Recap of the month …

After a negative April a fair amount of the price action in May continued to the downside. The last full week of May (23rd – 27th) did however see a strong bounce from the lows which culminated with key volatility indices also heading lower simultaneously. The 2 year US Treasury currently trades at roughly the same level that we had in early April and this suggests to us that barring a fresh impetus to inflation we could now see some stability in rate expectations.

The longer end of the curve also suggests similarly. The 10 year US Treasury is now at around 2.86% compared to 3.13% at the recent highs. Along the way the move higher in rates has had the necessary impact on the housing markets with prices stalling and reversing as well with financing activity coming off the boil. This would be good news for the US Federal Reserve which has various pockets of price appreciation in its sights.

We continue to watch energy prices, both as a result of the war on Ukraine as well as pent up demand given relatively healthy consumer balance sheets that are being reported especially by the larger US Banks. A factor which cannot be ignored as well is the speculative element in chasing energy higher which might be the case in the short term but which could see large players offload inventory.

China has started easing restrictions in the large cities as the number of positive covid cases has dropped significantly. At the same time various provinces are cranking up the economic support machinery and these actions have started to feed into a more optimistic outlook on the economy and markets. The 20th National Congress meeting of the Chinese Communist Party is a big event for the country and we would expect support for the economy to continue into year end.

The US heads into elections early November and while we are some distance away from that event the intervening weeks and months will heavily influence voter preferences and electoral outcomes. While the Democrats currently are in control of the House and Senate they have not been able to go full steam ahead with all their proposals as some Senators have been pushing back heavily against the broad Democratic agenda.

President Biden will be under pressure for his record on inflation and will do his best to ensure that is brought under control to the extent he can. Of note are two non-partisan issues which have resurfaced in the last month; the stance on abortion and the stance on gun control. While we are not sure of the extent to which these issues drive the final outcome, they are certainly likely to draw a lot of debate and attention in the run up to the election.

While the US Dollar has had a strong run this year, the month of May brought it to a bit of a pause and reversal too. This coincided with the stall on the move in rates. We now expect the Dollar to continue its path upwards and would position long positions versus the Swiss Franc and Japanese Yen to take advantage of the potential move. While rates have now stalled at the current level, that would still dictate a further 2 percentage points of tightening to come. Also, the rolling-off of the balance sheet will also likely tighten conditions leading to support for the Dollar.

The Volatility Index (VIX) has now cooled off and we have not seen moves to the highs of late 2021 or earlier this year. This has been relatively surprising given the heavy price action in the cash markets which have taken various indices and individual stocks to the lowest levels seen in a long time before the more recent bounce back. We expect the worst of short term volatility to be behind us; having said that we keep a close eye on this space at all times.

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