Wealth Management
Weekly Market Update

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Market Update

Equities rose across the board last week ahead of the Federal Reserve's upcoming policy decision. Risk assets appeared to react positively to slowing economic data and hints that inflation could be beginning to ease. In the US, stocks rose by 1.1% on weaker manufacturing and housing data. Similarly, European stocks rose by 3.2% in spite of the European central bank raising interest rates for the first time in 11 years, and data showing that manufacturing activity in the Eurozone fell into contraction. Bond yields also fell in response to the weaker economic data, with US 10 year yields dropping by 16.5 bps, German yields falling by 10.2 bps and UK yields falling by 15.2 bps. Japan was another market which showed strength, albeit for different reasons; stocks rose by 3.8% as the Bank of Japan kept its ultra-loose monetary policy stance at its meeting last week. Chinese markets posted mixed returns after Premier Li Keqiang ruled out the possibility of excessive stimulus being used to hit growth targets – Li noted that if household income grows, and prices remain stable, lower growth rates may still be acceptable. All said, emerging markets stocks rose by 1.6% in GBP terms over the last week. Oil fell once again last week by 1% to a price of 93.4 dollars per barrel.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +1.6%	▲ +1.1%	▲ +3.2%	▲ +1.8%	▲ +1.6%	▲ +3.8%	▲ +1.7%	▼ +1.2%

all returns in GBP to Friday close

Macro News

- The annual inflation rate in the UK increased to 9.4% in June, which is the highest rate since 1982 and slightly above market forecasts of 9.3%. The biggest price pressure came from the cost of motor fuels which increased at a record 42.3%, as average petrol prices rose by 18.1 pence per litre in June 2022, the largest monthly rise on record since at least 1990. Food prices made the second biggest upward contribution and prices of housing and utilities also increased.
- The ECB raised its key interest rate by 50bps, the first increase since 2011, ending eight years of negative rates, in an attempt to release the inflationary pressures. The central bank had initially committed to a 25bps rate hike in the June meeting, but inflationary risks continue on the upside and policymakers considered appropriate to take a larger first step. Inflation in the Euro Area continues to march higher and break record rates, showing no signs of peaking, and approaching double-digits.

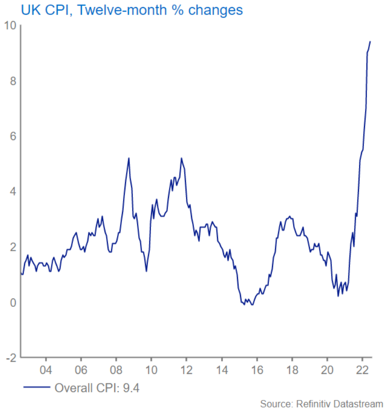
The Week Ahead

- On Wednesday, the US Fed rate decision will be released. The FOMC is widely expected to raise its benchmark policy rate by 0.75% for the second consecutive month. That will hoist the federal funds rate to a target range of 2.25% to 2.50%, in line with officials' long-term estimates of a "neutral" policy setting.

Week in Charts

UK inflation hits 40-year high of 9.4%

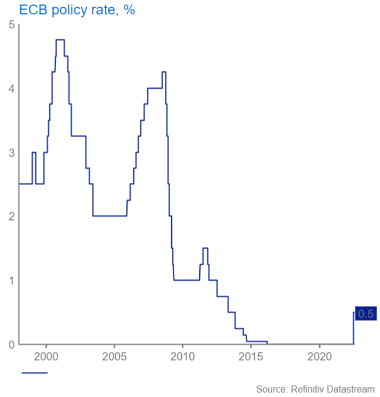
UK CPI, Twelve-month % changes



UK inflation hit a new 40-year high in June, intensifying the cost of living crisis and heaping pressure on the Bank of England to deliver an aggressive interest-rate increase next month.

ECB hikes rates for the first time in 11 years

ECB policy rate, %



The European Central Bank raised its key interest rate by half a percentage point, a bigger-than-expected move.

View From the Desk

In 2012, Mario Draghi, then Chair of the ECB, was staring down the barrel of the the total collapse of the Euro. At the height of the crisis, he stood up and boldly pronounced:

'We will save the Euro, whatever it takes'.

Then paused for effect, looked around the room and added:

'And trust me, it will be enough'.

Pretty bold, considering that when he said it, the Euro had almost collapsed, there was no plan and the ECB had no mandate to print money. No one had approved the comment. Germans were shocked to hear of a hint of QE, a step towards European debt mutualisation. It was the mother of all 'Hail Marys'. Bond investors, who had already lost betting against American QE, were afraid of what another 'Bazooka' might mean for their returns. Angela Merkel, of course, had remained silent. She was happy to let markets believe what they want to believe, until she had time to put a plan together.

A gamble that worked, but a gamble nonetheless.

Now when Draghi said that, with absolutely no plan, markets took him at his word. Afraid of challenging another central bank, investors ate it, rod, line and sinker. This gave enough space to the Eurozone to come up with the right tools to save the monetary union. And still, the whole thing almost came apart in 2015 again, when Greece was almost ejected from the Union.

A decade later it's Ms Lagarde who leads the ECB. Her pronouncements were much more careful. On the one hand, she ended years of negative rates (a questionable practice to begin with). A 50bps hike was very bold.

Then, she introduced the Transmission Protection Instrument (TPI). This tool will allow the ECB to purchase bonds of countries where spreads have risen significantly. It solves the 'how do you raise rates without endangering Italy' conundrum. But she was careful on how she phrased it. She mentioned the four conditions for potential recipients:

- They must be in line with the Eurozone's fiscal rules
- They mustn't have severe macroeconomic imbalances
- Their debt trajectory must be sustainable
- Their macro policies also need to be sustainable

This means that the ECB would still decide whether a country 'deserves' to be saved. This is important. No matter how big Italy is, if election was held today, polls suggest that Eurosceptic parties would get 52% of the vote. Italy itself would have to decide whether it wants to play by the rules.

Markets were sceptical. This was not a big grandiose statement, despite Ms Lagarde's pledge that there's no upper limit to those instruments. There were caveats. The Euro remained weak. Italian spreads remained high.

As investors, we think there are two conclusions after the ECB's heavily caveated rate hike yesterday:

1. The ECB is serious about throwing money around to save the Euro. We will see political wrangling, but then again when is that not a feature of Eurozone politics?

2. Gambles may sometimes work. But they are hardly an investment strategy. Investors need to look past bold policy statements, understand that different people express themselves differently, and focus on actual policies, as well as the ability and dependability of those in charge to implement them.

David Baker, CIO

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