Philequity Corner (March 28, 2022)
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First hike

Last Wednesday, the Federal Reserve (Fed) implemented its first interest rate hike since 2018. This marks a major shift from an ultra-easy and accommodative stance during the pandemic towards policy normalization. The Fed hiked its policy rate by 25bps, bringing the federal funds rate to 0.25%-0.50%. The latest dot-plot showed the Fed consensus calling for six more rate hikes this year, one for each scheduled policy meeting.

US market surges after Fed rate hike

In a stunning move that surprised many investors, the US market surged after the Fed rate hike announcement. This occurred despite the bad news concerning the Russia-Ukraine war, elevated inflation, more rate hike concerns, and stagflation fears. On the other hand, the Fed's move was highly anticipated by investors who had priced-in a faster policy normalization. What happened was typical "sell on rumor, buy on news" as the first rate hike drove the best weekly performance of the US stock market since November 2020. The S&P 500 posted a strong return of 6.2% last week.

Powell sees low probability of US recession

The Fed's hawkish tilt was triggered by elevated US inflation which climbed to 7.9% in February, the highest since 1982. Despite this, the Fed does not expect rising interest rates to stifle economic growth. In his speech, Fed Chair Jerome Powell calmed the market by emphasizing that the odds of a US recession in the coming years is low. Moreover, Powell confidently stated that the strong US economy can flourish even with less accommodative monetary policy.

Fed to be nimble

Aside from elevated inflation, the Fed is also concerned that sustained and excessive volatility in financial markets may tighten credit conditions. Powell assured that the Fed will remain attentive to inflation risks and use the appropriate policy tools to promote financial and macroeconomic stability. He stressed that the Fed would have to be nimble in responding to incoming data and the evolving economic outlook.

Biggest stock market rout in China

While US stocks corrected in 2022 due to inflation and rate hike fears, Chinese stocks experienced a bloody free fall in the past year or so. This was caused by a fierce regulatory crackdown on major sectors such as education, ride-hailing, food delivery, property, and technology. We have written extensively about the China crackdown in the past. To understand how this started, readers can refer to our previous articles (see *China Crackdown*, August 2, 2021, and *Common Prosperity*, August 30, 2021).

The market rout turned from bad to worse when major investment houses like JP Morgan labeled China as "uninvestable." There were fears of potential sanctions due to its close ties with Russia. There was also news that Russia asked military aid from China. The crippling sanctions on Russia served as a stern forewarning that China can be lumped with Russia and become an economic pariah if it supports the invasion of Ukraine.

From crackdown to support

As a result of the painful free fall in Chinese stocks, Xi Jinping announced a dramatic policy reversal and pledged all-out support for the stock market. China promised to relax the regulatory crackdown on specific sectors while promising support for battered property and technology stocks. Top economic officials of China stated that the government should "actively introduce policies that benefit markets" while making regulations more transparent and predictable. Regulators would also delay the implementation of a property tax and prevent a disorderly collapse of the property market. The People's Bank of China (PBOC) assured that it would use its policy tools to ensure market stability.

Historic surge in Chinese stocks

After declining precipitously for the past year, Chinese stocks staged a roaring comeback following the reassuring pronouncements made by the Chinese government last week. The Hang Seng Tech Index was up 22.2% in one day. The Nasdaq China Golden Dragon Index, a gauge of US-listed Chinese companies, jumped 32.9% last Wednesday, the most since 2001. Chinese mega-tech companies which were the main targets of the regulatory crackdown posted staggering rebounds. In a single day, Tencent bounced 33.4%, Alibaba rose 37% while Didi surged 41.7%. It is a rare occurrence to see one-day gains exceeding 30% in major Chinese tech stocks and indices. This historic one-day surge is probably a once-in-a-lifetime event. It signifies a remarkable reversal in sentiment which was triggered by the turnaround in China's policy direction.

Rare opportunities amid unprecedented market turbulence

Global markets had a turbulent start this year due to the emergence of numerous risks. We are facing an extremely volatile environment as the whole world confronts several once-in-a-generation developments all happening at once. These include the COVID-19 pandemic, the Russia-Ukraine war, the rise of authoritarian regimes, the turnaround in monetary policy from accommodation to normalization, inflation at multi-decade highs, and record-high prices for fuel, food, and metals. There are also fears of a possible global resurgence of COVID-19 and further supply disruptions as cases rise anew in China and Europe. Despite these, the recent statements and actions of policy-makers have triggered an improvement in market sentiment. As seen in the impressive rallies in US stocks and the historic surge in the Chinese stock market, the heightened turbulence may present rare opportunities in a market that is affected by the COVID-19 pandemic and an ongoing military and economic war. Indeed, we are witnessing the occurrence of numerous unprecedented and disruptive historic events that are all happening simultaneously. Nonetheless, the recent market move is encouraging, and the wisdom of policy-makers to address major risks bodes well for the stock market and economic outlook.

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