

All asset classes under-perform in wake of massive Fed hike

20 June 2022

- Global and local equities were down last week even after 75bps Fed hike cleared market over-hang as more hikes (and a recession) on the way.
- USTs and USD/local bonds declined last week given aggressive Fed rate hike and persistence of hawkish stance amid worsening inflation outlook
- Fed signals more hikes on the way (up to 125bps) to combat inflation. Signs of US housing sales slowing and business sentiment souring.

US and EU markets crater on massive Fed hike, recession chances

- The S&P slid to a fresh 2022 low last Monday as bearish sentiment took hold and reflected recessionary fears ahead of this week's Fed meeting in which a massive hike was expected. US bourses continued to weaken into mid-week as a sizable Fed rate hike seemed imminent. US markets enjoyed a brief relief rally last Wednesday as the Fed delivered on hawkish guidance and expectations, hiking by 75bps, leading to a short-lived clearing event as they promptly signaled further substantial rate hikes at its next meeting in July. Still, it was encouraging that the Fed took inflation very seriously. That expectation, though, raised the prospect of a US recession given the fast pace of rate hikes may abruptly result in a downturn and caused US markets to slide further as the weekend approached. By Friday, most US bourses were down for the week despite sideways movement on that last trading session. The Dow, S&P and Nasdaq indices were down -4.79%, -5.79% and -4.78% week-on-week, respectively, while volatility (VIX) shot up 12.18%.
- EU equity market performance mirrored that of the US with ECB and BOE action largely expected to track the Fed's hawkish trajectory. Higher-than-expected US inflation along with slowing UK economic growth in April led to fears of a broad downturn in the UK in 2Q and continued to suppress EU bourses last Tuesday. German inflation rose to a five-decade high of 7.9% in May, supporting the case for aggressive ECB hikes as well. After a brief mid-week respite, EU markets continued trending lower Thursday on hawkish actions and rhetoric from European central banks and lingering recession fears. The BOE hiked rates by 25bps for a fifth consecutive time and the Swiss National Bank surprised markets with a 50bps rate hike. These proved to be market clearing events as most bourses posted modest daily gains on Friday but were still down for the week. The FTSE, DAX, CAC and STOXX were down 4.12%, 4.62%, 4.03% and 3.57% week-on-week, respectively.

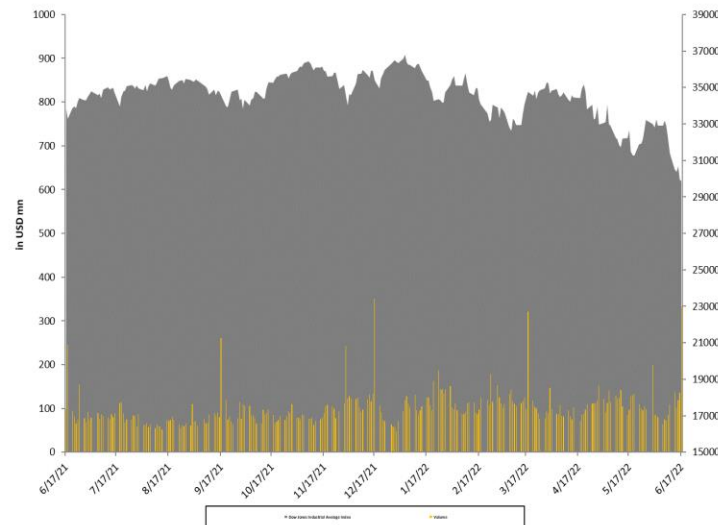
Source: JP Morgan

Fed delivers on hawkish rhetoric with aggressive 75bps rate hike

- US macro indicators pointed to deterioration last week with the BLS pegging May inflation at 8.6% the fastest rise since late 1981. Inflation forecasts for the next year also trended higher given no end let up in inflation. This led to CEO confidence survey souring in 2Q for a 4th consecutive quarter. The Fed delivered on expectations of at least 75bps rate hike last week with more needed to fight inflation. Some prominent investors said it needs to hike by a further 100bps in July to get things under control. Others have said the US economic cycle is overdue for a recession and most see this happening in 2023, triggered by sky-high oil prices or Fed tightening. Co-incident with the hike was Fed language suggesting up to 175bps more in additional hikes and a downgrade for 2022 GDP from 2.8% to just 1.7%. By the weekend, more unwelcome macro data was released and tied to Fed tightening and inflation. May housing starts fell 14% in May (vs. 2.6% consensus expectations).

Source: JP Morgan

Chart 1 - Dow Jones Industrial Index



Source: Bloomberg

| Interest rates | | | | |
|----------------|-----------|-----------|-----------|--------|
| USD | 17-Jun-22 | 10-Jun-22 | 31-Dec-21 | +/- |
| UST 2Y | 3.18 | 3.06 | 0.73 | 0.12 |
| UST 5Y | 3.34 | 3.26 | 1.26 | 0.08 |
| UST 10Y | 3.23 | 3.16 | 1.51 | 0.07 |
| UST 20Y | 3.53 | 3.44 | 1.93 | 0.09 |
| UST 30Y | 3.28 | 3.19 | 1.90 | 0.09 |
| ROP 3Y | 3.54 | 3.25 | 0.91 | 0.29 |
| ROP 4Y | 3.71 | 3.56 | 0.98 | 0.15 |
| ROP 9Y | 4.33 | 4.05 | 2.02 | 0.29 |
| ROP 10Y | 4.33 | 4.01 | 2.00 | 0.33 |
| ROP 24Y | 4.86 | 4.68 | 2.94 | 0.18 |
| PHP | 17-Jun-22 | 10-Jun-22 | 31-Dec-21 | +/- |
| 2Y | 3.45 | 3.68 | 2.59 | (0.23) |
| 3Y | 3.45 | 3.68 | 2.59 | (0.23) |
| 4Y | 5.67 | 5.28 | 3.82 | 0.39 |
| 5Y | 6.99 | 6.73 | 4.71 | 0.26 |
| 7Y | 6.62 | 6.38 | 4.49 | 0.24 |
| 10Y | 6.94 | 6.73 | 4.69 | 0.20 |
| 11Y | 6.99 | 6.73 | 4.71 | 0.26 |
| 20Y | 6.50 | 6.72 | 5.07 | (0.22) |
| 20Y* | 6.50 | 6.72 | 5.07 | (0.22) |
| USDPHP | 53.750 | 53.000 | 52.580 | 0.75 |

Source: Bloomberg

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Philippine Equities

- The local equity bourse closed last week markedly lower, losing 198.48 points (-3.04%) Week-on-Week to close at 6,331.56 as a modest increase in daily Covid cases locally and aggressive Fed monetary tightening amid runaway global inflation triggered the rapid deterioration in sentiment. Also, voices warning of an imminent recession in the US grew louder. Given the robust Fed move, the Peso immediately weakened in reaction, depreciating to a 3-year record level of 53.75. On the bright side, April OFW remittances rebounded strongly, rising 3.9% YoY to bring YTD growth to 2.7%.
- For this week, all eyes are on the BSP's Monetary Board meeting on June 23rd in which a rate hike of at least 25bps is expected. The BOP and budget balance figures are also due for release this week. Investors are watching the crucial 6,300 support level, a break below which may mean further downside to 6,000.

USD fixed income

- US Treasury curve bear flattened last week as the Fed delivered a 75 bp rate hike, raising the Fed Funds Rate to 1.50%-1.75%. More rate hikes can be expected in the upcoming meetings as the Fed remains firm in their resolve to tame inflation.

PHP fixed income

- Local GS curve bear flattened as yields rose amid weak market activity. Market players are speculating on the possibility of more aggressive policy adjustments from the BSP after the Fed hiked rates by 75 bps. Incoming BSP Gov. Medalla gave a statement that they will hike 25 bps for June.

Outlook for the week

Stock market

- After hitting YTD 2022 low of 6,319 earlier this week, the PSEi managed to stay above this crucial support level as of EOD Friday. A relief rally may occur as the PSEi stands at oversold levels. Equity futures for overseas markets also looking up as of COB Friday Manila time.

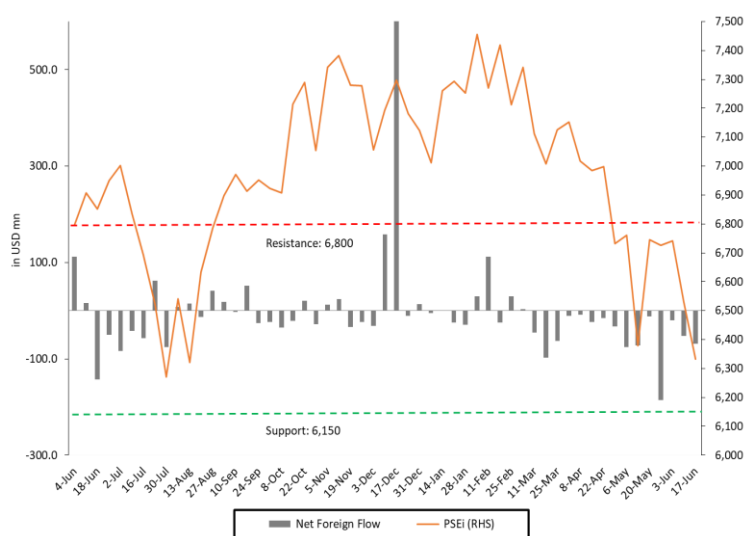
USD fixed income

- US Treasuries will likely continue to trade in a wide range as market players weigh Fed's hawkish stance alongside looming recession risks. Range for 10Y US Treasury yield is 3.20%-3.50%.

PHP fixed income

- Local bond yields will remain under pressure on ongoing supply and inflation risks. The possibility of a more hawkish BSP is also encouraging market players to stay defensive.

Chart 2 - Philippine Stock Exchange Index



Source: Sun Life Financial Philippines

Sectors: Financials (-1.24%), Mining (-2.29%), Property (-2.55%), Industrials (-3.22%), Conglomerates (-3.98%), Services (-4.34%)

Leaders: EMP (+5.29%), BPI (+2.38%), SMPH (+2.03%), TEL (+1.53%), MER (+1.28%)

Laggards: FGEN (-8.22%), AGI (-9.26%), MEG (-13.08%), CNVRG (-13.52%), WLCON (-15.27%)

Source: Bloomberg, The Philippine Stock Exchange