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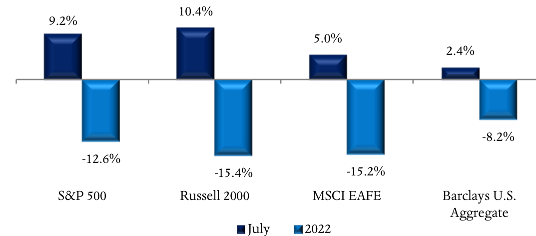
Markets

Amidst a slowing economy, financial markets began pricing the potential for future interest rate cuts from the Federal Reserve. The anticipation of a monetary policy pivot supported risk assets in July. Growth stocks benefited most, with the tech-heavy Nasadq composite soaring +12.4%, recouping some of the prior heavy losses (-20.5% ytd). Similarly, the bellwether S&P 500 delivered a +9.2% total return during the month (-12.6% ytd), while the smaller capitalization Russell 2000 index rose +10.4% (-15.4% ytd). Overseas equities also rebounded, as seen by the MSCI EAFE index's +5.0% monthly return (-15.2% ytd). The Euro Stoxx 600 ascended +7.8% (-7.8% ytd), while Tokyo's Nikkei 225 index's +5.3% monthly return resulted in the most resilient major market performance in 2022 (-2.3% ytd), with the caveat that the Yen has depreciated to a 25 year low. In the developing markets, strong performance from Indian and South Korean markets was counteracted by Chinese weakness (-3.1% in July; -8.6% ytd) on the back of malaise in the real estate sector. As a result, the MSCI emerging market equity index ended July lower by -0.2% (-17.7% ytd).

Fixed income markets featured falling sovereign yields, coupled with tighter credit spreads, elevating US high yield bonds by +6.0% in July (-8.9% ytd). Since mid-June, investors have bid two-year US Treasury yields lower by about 50 basis points (2.88%) and 10-year yields by 75 bps (2.70%). In this context, the US Aggregate bond index produced its best monthly performance of the year, rising +2.4% (-8.2% ytd).

Commodities advanced +4.3% on average in July, driven by European gas prices which spiked on fears that Russia might shut off their supply. Associated equities rose +3.5% during the month (+2.1% ytd). WTI Crude oil fell by -6.8% to $98.62 per barrel, near levels last seen



just prior to the Russian invasion of Ukraine, as supply lines normalized and demand softened.

Geopolitics

In the UK, Prime Minister Boris Johnson resigned after he lost the support of his parliamentary party. Shortly after, the Conservative leadership race narrowed the field down to two candidates: Rishi Sunak, the former chancellor, and Liz Truss, the current foreign secretary. Ahead of the final vote by the roughly 200,000 Conservative party members, Truss is leading in the polls. The winner, and next prime minister, will be announced on September 5. While there are key differences on fiscal spending between the candidates, thus far investors appear to be fairly agnostic.

Italy's unelected head of a unity government, and former ECB president, Mario Draghi resigned as prime minister after 18 months on the job. Mr. Draghi stood down after three parties in his government refused to back him in a confidence vote. President Mattarella asked him to remain as caretaker leader until early elections take place on September 25. Far-right, Brothers of Italy (FdI), party-leader Giorgia Meloni is now tipped to become the country's first female prime minister.

The war between Russia and Ukraine entered its sixth month with the two sides mounting offensives and counter-offensives trying to retake ground, respectively. Meanwhile, the effort to move an estimated 18 million tons of Ukrainian grain out of besieged ports, to avert a

global food crisis, made progress. In a deal brokered by Turkey, the first shipment transited the Black Sea.

United States

During July, a variety of data points emerged, pointing towards a softening of the US economy. Concurrently, inflation continued to climb, reaching 9.1% year-over-year, driven by shelter and services, which are considered the stickiest. Seeking to reign in prices, the Federal Reserve raised short-term interest rates by 75 basis points (to a range of 2.25-2.50%) for the second consecutive meeting. Central bank Chair Jerome Powell noted in his commentary that the Fed Funds rate is now close to neutral, indicating an official end of the post-pandemic easy money policy. Powell further referenced that the rate would likely reach a range of 3.0%-3.5% by the end of the year, implying 50-100 basis points more tightening over their next three meetings. Looking beyond, financial markets expect the Fed Funds rate to peak in February of 2023 and gradually decline after that.

The release of second quarter GDP, which came in at -0.9% quarter-over-quarter annualized, which was well below consensus of +0.8%, added to economic concerns. The report indicated a widespread slowdown stemming from construction, investment and government spending, only partly offset by modest increases in trade and consumption. Residential investment fell sharply, down -14% compared with +0.4% growth last quarter, on the back of higher interest rates. This second consecutive quarter of negative economic growth, is considered by many to be the technical definition of a recession. However, the resilient labor market led Fed Chair Powell to comment: "I do not think the US is currently in a recession and the reason is there are too many areas of the economy that are performing too well. This is a very strong labor market. It doesn't make sense that the economy would be in a recession with this kind of thing happening."

Europe

High EU inflation –an all-time record of 8.9%– pushed

July 2022 Economic Statistics

	Jul-22	Dec-21	Dec-20
Federal Funds Target Rate	***2.25 - 2.50%***	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	***95.7***	115.8	88.6
Manufacturing PMI Index	***52.8%***	58.7%	*60.7%*
Unemployment Rate	***3.6% (est.)***	3.9%	*6.7%*
JPY/USD	***133.19***	115.08	*103.24*
USD/EUR	***1.0218***	1.1368	*1.2213*
Gold/oz.	***$1,755.49***	$1,828.39	*$1,896.49*
Oil (WTI)/bbl	***$98.62***	$75.21	*$48.52*

the European Central Bank to deliver its first interest rate hike in over a decade, taking the eurozone out of negative rates. To help ensure a smooth transmission of monetary policy the ECB also announced the Transmission Protection Instrument, enabling the central bank to purchase specific securities to counter "unwarranted market dynamics" (read: widening of peripheral yield spreads). The tool is flexible by design, but the ECB is still debating the criteria for activation, and any bond purchases will be sterilized. The collapse of the Italian government and the fragility of its bond market could be the first test of the new framework.

European natural gas supplies continued to flow, despite fears that the Nordstream 1 pipeline (which delivers nearly 40% of the region's pipeline imports, from the Russian coast near St. Petersburg to north-eastern Germany) would remain closed after its scheduled maintenance. However, tangible energy supply risks remain as the Russian government continues using natural gas as a political weapon. After initially restarting flows at 35% of baseline levels, Russia announced a reduction to 20%, citing necessary turbine repairs. Germany rejected this explanation as gamesmanship and gas prices rose sharply. As a contingency, the European Commission requested that member countries aim to reduce their consumption by 15%.

European economic concerns driven by interruptions in supply chains and the war in Ukraine, were showcased in currency markets where the euro briefly slipped below parity versus the US dollar before rallying slightly in response to the ECB's rate increase.

While currency depreciation is positive for European exporters, it is on balance a negative, especially for those exposed to imported goods, which are now significantly more expensive. Nevertheless, second quarter Eurozone GDP grew 0.7%, comfortably beating out expectations of 0.2%, proving relatively resilient to the geopolitical headwinds.

Asia

China continued to grapple with Omicron outbreaks and a series of rolling lockdown measures were enacted in various cities. There are still few signs of softening the zero-Covid policy, likely to last until after the Party Congress in the autumn. In this context, economic data was surprisingly buoyant, with Q2 GDP growing 1.0% year-over-year and, most importantly for its trading partners, exports far exceeded expectations with 17.9% growth over the same period last year. The increased flow of goods contributed to an easing of supply chain pressures, which was apparent in the latest global PMI readings.

Chinese credit growth also improved thanks to the ability of central planners to increase stimulus measures to support the economy, especially the property market which is suffering from a liquidity crunch. This was possible given the lack of local inflationary pressures that have dogged western economies.

Outlook

The global economy is now starting to feel the impact of high inflation, central banks' attempts to curb it, and likely to experience below-trend growth levels for the foreseeable future. It is notable that second-quarter GDP data did not account for the impact of most of the Fed (and other central bank) rate hikes to-date, nor its delayed quantitative-tightening program. Greater effects will likely be felt in the coming quarters, particularly for the most interest-rate sensitive parts of economies, such as housing. Labor markets remain a bright spot, with tightness driving nominal wage growth. Heightened inflation, however, means that real wage growth is negative, resulting in an ongoing slow pinch to the consumer's spending ability. While there is the potential for a double-dip recession in 2023, we don't envisage it as being deep or prolonged, given the strong starting position which will provide some cushion against the cyclical downturn. The upshot is that inflation will undoubtedly decline over time as supply chains normalize, inventories build, pent up demand is satisfied, and economies soften.

US equity markets had highly anticipated a stalling of the economy amid much tighter monetary conditions, pricing in a dire scenario which has not yet come to pass. More recently, expectations of a Federal Reserve pivot have buoyed indexes. Valuation de-ratings have driven stock prices thus far in 2022. Looking ahead, earnings downgrades pose a further risk, but are likely to be modest in magnitude. S&P 500 company earnings forecasts remain resilient (profit margins have been steady despite cost increases) with the current year calling for 8.9% growth, while 2023 has seen a modest reduction to 8.5%. The index's forward price/earnings multiple of 17 seems reasonable but also offers limited upside. As such, we think the best return prospects will come from value added stock picking and special situations investing.

Sovereign bond and credit markets have witnessed massive volatility, greater relatively than that of equities, having entered the central bank tightening cycle at record low yields and spreads. A recently more dovish Fed, and the specter of recessionary times, may have marked a near-term high in yields. Investors in short duration bonds still appear to be only modestly compensated.

We remain conservative with regard to portfolio construction, with a portion of non-market correlated alternative assets used to mitigate volatility and boost returns. The agriculture sector is set to benefit from input cost inflation and food security concerns, offering solid investment prospects. For long-term investors, seeking to capitalize on disruptive technology trends, we are focusing on attractive growth and venture opportunities in the fields of edu-tech and cybersecurity. We also believe that the market is offering an attractive entry point for our Nordic Technology and Innovation Fund.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.

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