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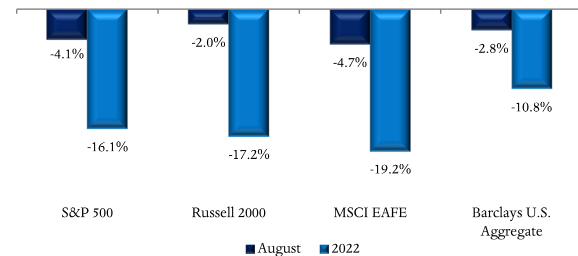
Markets

Central banks' commitment to bring inflation under control, despite the inherent risks to economic growth, shook both equity and bond markets in August. Indeed, most of the economic data published of late has illustrated a continuing slowdown of the global economy and an easing of inflationary pressures.

The S&P 500 index rebounded strongly (+17.5%) off its mid-June lows, peaked in the middle of August, and corrected -8.1% into month-end. Overall the benchmark declined -4.1% last month (-16.1% ytd). Small capitalization stocks, measured by the Russell 2000 index, followed a similar trajectory (-2.0% in August; -17.2% ytd). Overseas, the MSCI EAFE index declined -4.7% in August (-19.2% ytd), led by European stocks (Stoxx 600 -5.0% in August; -12.4% ytd). Japan continued to outperform most equity markets in August, with the Nikkei 225 gaining +1.1% (-1.3% ytd), helped by the weakness in the yen. Emerging market stocks were up +0.5% last month as the relatively better economic momentum was balanced by economic difficulties in China.

Within bond markets, higher yields led to negative returns last month. The 10-year US treasury yield rose sharply to 3.2%, driving the Barclays US Aggregate index down -2.8% in August (-10.8% ytd), while US high yield bonds pulled back -2.4% (-11.0% ytd). Overseas, Emerging Market debt and European high yield bonds outperformed.

Commodities produced a mixed performance in August, with the S&P GSCI falling -2.7% (+32.0% ytd). In the energy complex coal (+14.1%) and European natural gas (+36.5%) rose, rattled by the precarious position of the European power markets, while US crude oil retreated -9.2%. Metal prices rose +3.7% on average, with copper rebounding +5.8%, but iron ore and nickel both fell by sizeable amounts (-12.2% and -9.4%, respectively)



primarily due to Chinese manufacturing weakness. Conversely, agricultural grains rose +3.5%, with corn leading the way higher (+9.3%) as US and European crop prospects appear weak on account of drought. Also affecting commodities is the US dollar which reached another 20-year high in August.

Geopolitics

During August, Ukraine marked the bittersweet celebration of its Independence Day as well as the six-month anniversary of Russia's invasion. The war continues to drag on with little progress on either side, leading Russia to play its trump card: natural gas exports to Europe will reportedly come to a halt until all sanctions against the country are lifted, further exacerbating the growing EU energy crisis. On a more positive note, the resumption of Ukraine's grain exports through the port of Odessa has eased global food price pressures.

Tensions between the US and China mounted as a fallout of Nancy Pelosi's provocative Taiwan visit. The technology war between the two sides also escalated as the US Congress approved a $280 billion plan – The Chips and Science Act – to boost US semiconductor manufacturing. Importantly, any company availing of its $52.7 billion subsidies for locating computer chip manufacturing in the US is prohibited from expanding or upgrading their advanced chipmaking facilities in China. Currently, 75% of microprocessor manufacturing in the world takes place in East Asia, centered around Taiwan, South Korea and China. Meanwhile,

China has made major advances in manufacturing with SMIC, a local champion manufacturing 7nm chips. Currently, only Taiwan's TSMC and South Korea's Samsung have succeeded in producing chips at such a small nanometer scale. One could argue these protectionist efforts may negatively affect US semiconductor R&D investments, previously financed from Chinese sales. The US strategy also leaves open the possibility of asymmetric responses from China.

United States

In the US, with the economy having recorded two consecutive quarters of negative GDP growth, recent data points have held up quite well. Labor markets remain robust with healthy job additions (+315,000 in August) across sectors, and continuing wage growth (+5.2% year-over-year). The unemployment rate edged up in August, to 3.7% from a five-decade low of 3.5% in July, partly the result of more people re-entering the labor market, but also a modest rise in the number of people losing jobs. US manufacturing was steady in August, with new orders rebounding, aided by gradually improving supply chains.

At the same time, inflation may have peaked as annualized CPI increased 8.5% in July, down from 9.1% in June. However, even an optimistic downward path over the coming year would likely leave inflation well above the Federal Reserve's 2% target. Moreover, the central bank appears committed to curbing inflation, as evidenced by the rather hawkish speech that Jerome Powell gave at Jackson Hole at the end of August. As such, the Fed has committed to continue raising interest rates this month and beyond.

So far, tighter monetary policy has been mainly reflected in lower housing market activity, with existing and new homes sales falling 5.9% and 12.6%, respectively, as the 30-year fixed mortgage rate reached nearly 6%.

Europe

Eurozone second-quarter GDP proved resilient, growing 4.0% year-over-year. Those countries benefiting

August 2022 Economic Statistics

	Aug-22	Dec-21	Dec-20
Federal Funds Target Rate	***2.25 - 2.50%***	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	***103.2***	115.8	88.6
Manufacturing PMI Index	***52.8%***	58.7%	*60.7%*
Unemployment Rate	***3.7%***	3.9%	*6.7%*
JPY/USD	***138.96***	115.08	*103.24*
USD/EUR	***1.0057***	1.1368	*1.2213*
Gold/oz.	***$1,710.71***	$1,828.39	*$1,896.49*
Oil (WTI)/bbl	***$89.55***	$75.21	*$48.52*

from the post-Covid services rebound, such as Spain, Italy and, to a lesser extent, France, generally performed well while the German economy, which is the most dependent on Russian gas imports, came to a standstill. The relative strength of the eurozone economy in the first half of the year is also due to the fiscal measures deployed in the European Union since the start of the war in Ukraine. According to the European Central Bank, these measures should add 0.4% to the EU's GDP this year and reduce inflation by as much.

Looking ahead, the second half of the year looks more challenging. Even though EU natural gas inventories reported in August were in line with the 10-year average, thanks to more liquefied natural gas imports and the reactivation of coal-fired power stations, the recent cessation in gas flows through the Nord Stream 1 pipeline continues to squeeze prices higher. In this context, German producer prices increased by 37.2% in July, their biggest increase on record. As a result, the European Commission indicated it is working on an emergency intervention and longer-term structural reform.

The risk of a European recession is further exacerbated by the weakness of the euro currency, which dropped to parity with the US dollar, forcing the ECB into an interest rate raising program. The Eurozone composite PMI, which dropped into contraction territory at 49.9% in August, is also indicative of future prospects.

In the UK, Liz Truss is set to become prime minister after winning the Tory leadership race. On the monetary policy front, the Bank of England raised its policy rate by 0.50% to 1.75%, and indicated its expectation

that the economy will enter a recession in the fourth quarter. With inflation estimated to rise to 13% (from the latest reading of 10.1%, a 40-year high), the central bank warned of further monetary tightening.

Asia

China's economy continued to struggle over the summer, amid Covid-19 lockdowns and weather-related disruptions. Recent economic data highlighted the softness of domestic demand, with consumer sentiment affected by weakness in the housing market. Retail sales also disappointed, contracting 0.3% sequentially last month. Similarly, activity in the service sector appears to have stalled, with the index up only 0.6% year-over-year.

Growth in China's total social financing and fixed investment came in below expectations. This is in spite of the recent policy boost which was supposed to support credit growth and infrastructure investment spending in the third quarter. As a result, the People's Bank of China eased monetary policy further by lowering its policy rate (the one-year medium-term lending facility rate) by 0.10% to 2.75%, and the one-year and five-year loan prime rates by 0.05% and 0.15% respectively. In addition, China's State Council, chaired by Premier Li Keqiang, announced new economic support measures worth 1 trillion yuan ($146 billion), largely focused on infrastructure spending.

Outlook

In the wake of Federal Reserve Chair Jay Powell's Jackson Hole "tough-love" speech, investors have once again turned cautious on the outlook for economic growth. Central banks worldwide are expected to continue raising rates, with the aim of slowing economies, to tame the rampant inflation. The Fed's goal is to reduce inflation to 2%, from levels currently multiples higher. As a result, several central bank policy makers have telegraphed the need to raise interest rates into 2023 and hold them at that high level throughout the year, or until such time as conditions normalize. In the meantime, leading indicators suggests global economic growth is decelerating rapidly, with the US no exception. Mortgage applications are down 25% from a year ago. Wage growth has slowed. The unemployment rate has begun to rise concurrent with the lowest monthly jobs growth since April 2021. As a result, investors finally appear to be paying heed to the seriousness of the Fed's commitment, which is dampening their sentiment across asset classes.

The energy crisis in Europe, driven by sanctions associated with the seemingly unending Russo-Ukrainian war, are set to take center stage as colder weather approaches. Last year, Gazprom provided about 40% of the EU's natural gas. Today, amid unimaginably high natural gas prices, due to lack of Russian supply, a European recession appears unavoidable.

Stocks are no longer as cheap as they were in mid-June when the earnings multiple had fallen to 15. Now that ratio is back to 17, which appears fair for today's interest rates; unfortunately, yields are more likely to rise than not. Therefore, investors should be prepared to hold through more turbulence while the market works its way to the other side of this uncertain period. The same holds true for fixed-income investors. Interest rates have rocketed higher this year, in short order, with more set to come. Incredibly, not long ago there were trillions of dollars worth of negatively yielding bonds globally. Yet the US 10-year Treasury Note and 10-year German Bund still yield a relatively low 3.2% and 1.6%, respectively, insufficient to maintain purchasing power.

We remain conservative with regard to portfolio construction, suggesting a portion of non-market correlated alternative assets as a substitute for fixed income. The agriculture sector is set to benefit from inflationary trends 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 edutech and cybersecurity. We also wish to highlight the compelling growth prospects of the companies in 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.