



MORE VOLATILITY AS MARKETS FLIP BETWEEN FEAR OF INFLATION AND FEAR OF RECESSION

This week we got a preview of the dynamic that will probably come to dominate markets through 2022, violent swings as investors flip from worrying about inflation to worrying about recession and back again. Inflation was the focus at the start of the week with the US, Europe and the UK all posting rapid price rises; the UK headline rate jumping to 9%, caught a lot of attention although rising energy prices based on the revised price cap explain most of the move. This was promptly followed by central bankers warning that tackling inflation was likely to lead to a recession.

Markets did not respond well to the ambiguity, a strong rebound rally in stocks was followed by one of the largest single day drops in US shares. Perversely the prospect of a recession is bringing optimism, largely because it will reduce inflation and speed up the time when central banks might start cutting rates and printing money again. Tough talk on inflation is considered negative as it pushes expectations of future monetary easing further out. These two competing outlooks are going to continue to roil markets as there is no obvious sign yet which one we're headed for.

THE MARKETS THIS WEEK

FTSE 100	S&P 500	Nikkei 225	MSCI Europe	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Iron Ore	GBP USD
-1.56%	-3.06%	-0.09%	-1.57%	+4.11%	-0.08%	+0.09%	+1.53%	-0.74%	-0.44%	+2.21%



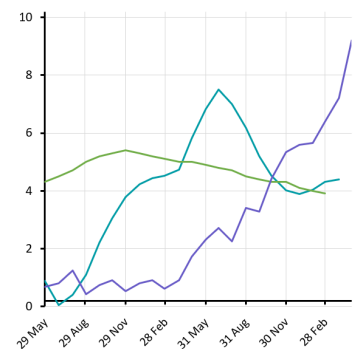
UK: BoE SAYS UNEMPLOYMENT MAY HAVE TO RISE TO CURB INFLATION

Inflation hit its highest level in 40 years as it touched 9% for the 12 months to April.

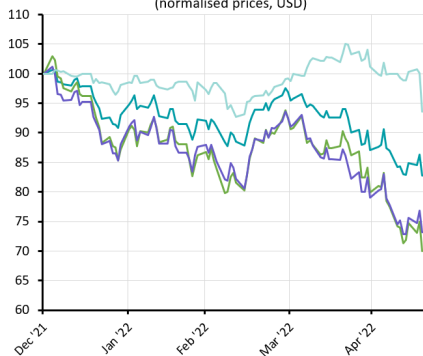
This was a big increase from the 7% seen in March and is mainly driven by recent energy price rises. Speaking this week, Bank of England Governor Andrew Bailey said he expects inflation to peak at 10% in the autumn and that interest rate rises are largely ineffective against rising energy costs caused by Covid and Russia's invasion of Ukraine.

The unemployment rate has fallen to its lowest level on record as it hit 3.7% in April. Average wages remain below inflation as many UK businesses are looking to retrain existing staff in response to ongoing difficulties in recruiting qualified staff. However, Bailey said unemployment may increase as he acknowledged that raising interest rates high enough to curb inflation would hit economic growth. Inflation also increased in Europe and the European Central Bank moved closer to raising interest rates as minutes from its last meeting show members favouring a rate hike in July and an early end to asset purchases.

UK Average Earnings excl. Bonuses, UK CPI, and UK Unemployment Rate (%)



NASDAQ, S&P Consumer Discretionary, S&P Consumer Staples, and S&P 500 (normalised prices, USD)

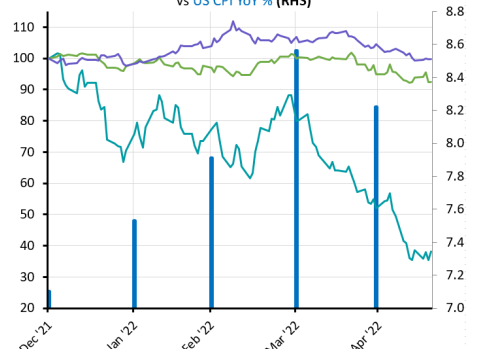


US: STOCKS FALL AS FED SAYS IT WILL TRADE GROWTH FOR INFLATION

A drop in US equities triggered a wider sell-off in global markets after the US Federal Reserve indicated that it is willing to sacrifice economic growth in its efforts to tame inflation. US Fed chairman Jerome Powell told a conference on Tuesday that the Fed will keep increasing interest rates until there is convincing evidence that inflation is falling and the central bank would be willing to raise rates past a neutral level (the level when higher rates begin to act as a drag on the economy) if needed.

Powell's comments came only a day after Bank of England Governor Andrew Bailey said it would be prepared to see the UK enter recession to tame inflation if necessary and this helped establish a pessimistic outlook for markets. This view was reinforced by slowing US consumer spending and several stock market updates which blamed rising inflation for falling company profits. The result was another sharp fall in US equities with tech stocks once more leading the way and many global equity markets also sold off.

S&P GSCI Gold, S&P 500 Value, and Global X Blockchain ETF (LHS, normalised, USD) vs US CPI YoY % (RHS)



INFLATION: HEDGING ASSETS ARE FAILING THEIR BIG TEST

Inflation has risen rapidly over the last 18 months but assets that are often presented as a hedge against rising prices have performed poorly over this period. Gold has traditionally been seen as a good way of preserving value during periods of high inflation. However, the price of gold is flat this year and it is down around 4% since the start of 2021.

Cryptocurrencies have also been promoted as a hedge against inflation and this is the first real test during an inflationary environment. Although many cryptocurrencies soared in value in 2021, since the beginning of this year, when inflation really began to bite, the performance of cryptocurrencies has been very poor and plunging values in recent weeks mean that most major cryptocurrencies are down between 25% and 50% over the last 12 months. The best performance this year has been from value equities which have managed to protect value as most other markets have fallen.

Data Sourced from FE Analytics, and FactSet

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