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## EUROPE IS NOW TALKING SERIOUSLY ABOUT HIKING RATES TOO

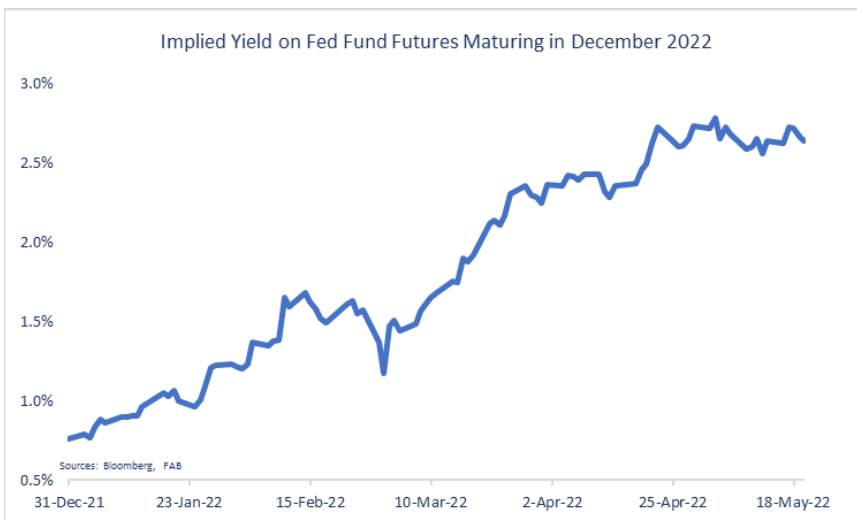
May 23<sup>rd</sup> 2022

- The ECB minutes last week indicated the central bank could lift off later this year
- The Fed continues to signal an accelerated pace of rate hikes
- The US dollar has started to retreat as investors consider higher euro rates
- Rising Covid cases in Beijing increase concerns about Chinese growth

Global economic data has been downbeat lately. March manufacturing orders in Germany fell 4.7% year-on-year, one of the biggest drops in the history of the euro. Chinese industrial output fell 2.9% year-on-year in April, nearly a record. US data remains relatively healthy, but with mortgage rates seeing their biggest spike in decades, home sales have begun to falter.

Despite the clear economic slowdown, the biggest central banks in the world are focused on hiking rates to stem inflation, even if that means a recession. Investment-grade markets have mostly priced this outlook in, but stock markets are still working on it. Hence, the downside for high quality bonds is relatively small, especially if compared to stocks and junk bonds.

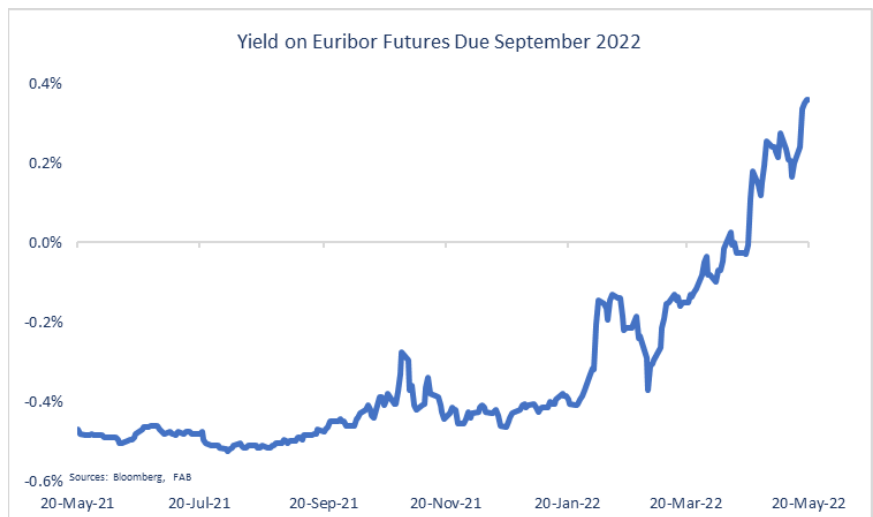
## MARKETS ARE CONVINCED US RATES WILL BE AT, OR HIGHER THAN, 2.5% BY YEAR-END



- There are five more Fed meetings this year, so the current 2.63% implied yield on Fed fund futures maturing in December implies at least two more 50 basis points hikes ahead.
- Futures are showing the benchmark rate peaking in September, 2023, at 3%. This is lower than the 3.25% peak futures indicated just two weeks ago.
- The Fed's preferred inflation gauge, Core PCE, for April will be released this week and the median forecast is for a 4.9% year-on-year increase, far above the Fed's 2% target.

## THE ECB IS NOW INDICATING TWO 25BP RATE HIKES OVER THE NEXT FOUR MONTHS

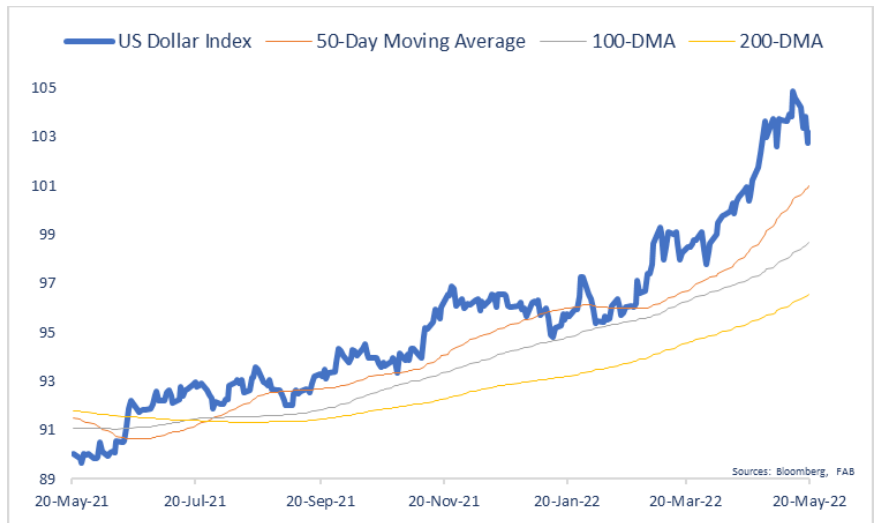
- ECB Chairwoman Christine Lagarde said today she expects the benchmark rate to be positive by September, compared to the -0.5% currently offered in the deposit facility.
- The stance had already become clear in the minutes of the ECB's last meeting released last week.
- The move comes as several economic indicators show Europe could face a recession later this year.
- The shift in rate expectations has boosted the euro and helped to weaken the dollar in the past week.





## THE DOLLAR INDEX HAS FALLEN 2.26% SINCE MAY 13<sup>TH</sup> AS THE EURO HAS RISEN 2.54%

- The Dollar index peaked at 104.56 on May 13<sup>th</sup>, its highest level since 2003.
- The euro accounts for nearly a third of the dollar index.
- A weaker dollar supports higher commodity prices, which may translate into higher inflation across most of the world.
- Rising deficits and a slowing economy in the US suggest the dollar could suffer further throughout the year.
- China's health and the yuan may drive the direction of the euro and the dollar in the weeks ahead.



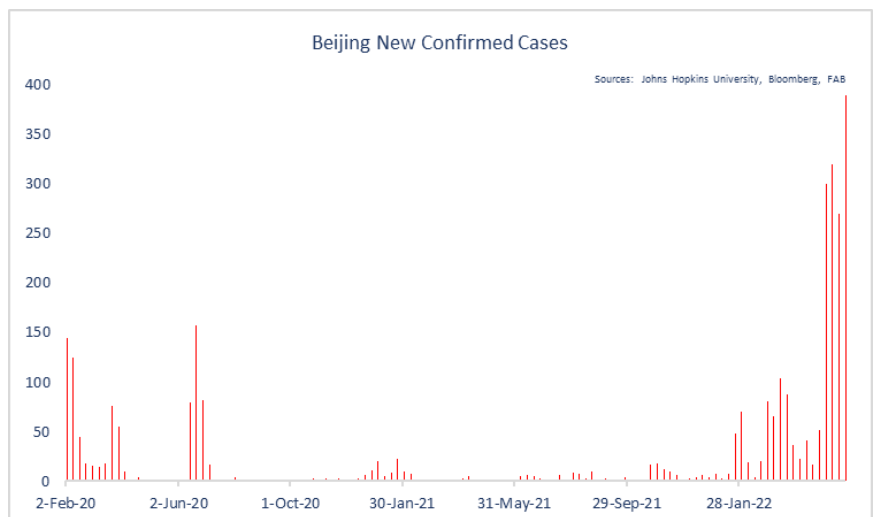
## US MORTGAGE RATES HAD THEIR STEEPEST RISE IN RECENT HISTORY SINCE DECEMBER



- The average 30-year fixed-rate home loan hit 5.4% in May, the highest level in more than 12 years.
- The rate has increased by 215 basis points since the end of 2021, the fastest rise since Bankrate.com started to follow mortgage costs.
- The rise has already started to impact existing home sales, which have fallen 13.6% over the past three months.
- Rising home loan costs could fuel higher yields on 10-year Treasuries as mortgage investors hedge their portfolios using US government debt.

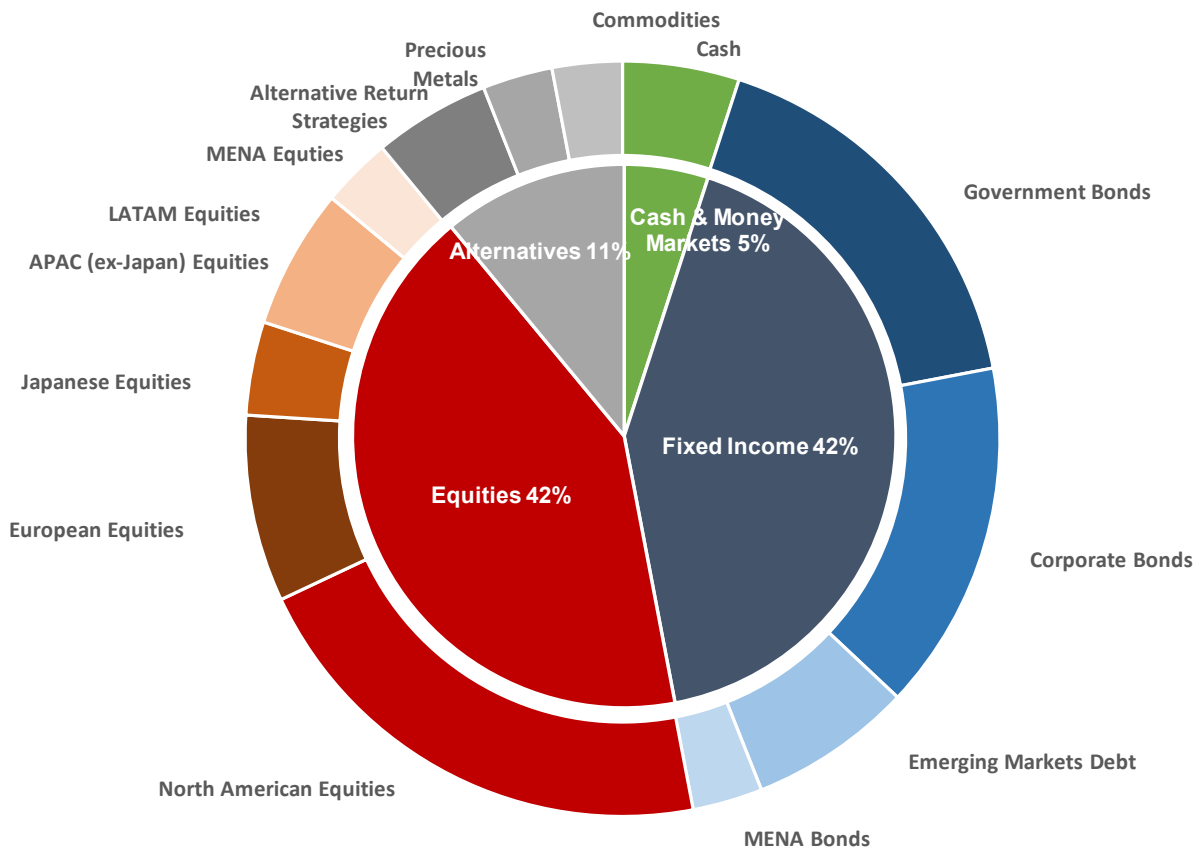
## RECORD NEW CASES IN BEIJING FUEL CONCERNS OF FURTHER LOCKDOWNS IN CHINA

- The spike in cases last week happened as Shanghai has started to ease some restrictions after seeing a notable drop in new cases last week.
- China's CSI 300 index fell 0.58% today amid fears that Beijing will expand movement restrictions.
- Markets also reacted negatively to the PBOC's decision to keep the one-year loan prime rate steady on Friday.
- The PBOC, however, cut its five-year prime rate, which is used as a benchmark for mortgages, in a sign of support for the housing market.





Asset Class	Positioning	Detail
Cash	Underweight	Putting cash to work in risk assets.
Fixed Income	Overweight	Keeping a slight overweight focused on EM dollar debt.
Equities	Overweight	Slightly overweight in Asia ex-Japan and US markets.
Alternatives	Underweight	However, reducing the underweight in hedge funds.





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