May 16, 2022

REGIONS
ASSET MANAGEMENT

WEEKLY MARKET COMMENTARY

What We're Watching

MARKET UPDATES

May 13, 2022: Recorded Leadership Discussion Featuring: Chief Investment Officer, Chief Market Strategist and Director of Investment Strategy.

May 20, 2022: Join the upcoming live Regions Market Update.

KEY OBSERVATIONS

Stocks: Another Week Of Wild Swings As Inflation Data, 'Fed Speak' Drives A 'Sell Anything You Can' Market. It was another volatile week for global equities with few places to hide as investors grappled with whether the U.S. economy is experiencing a 'growth scare' or is on a crash course with a recession amid inflationary pressures and monetary policy uncertainty. The S&P 500 fell 2.35% on the week after rallying into the close on Thursday and churning out a 2.4% gain on Friday. All in all, the week could have been much worse, and despite a selling reprieve on Thursday and Friday that allowed investors to catch their breath, we remain skeptical of the staying power of rallies, so long as credit spreads on corporate bonds continue to widen as they did last week. The Russell 2000 small-cap index fell 2.5% on the week as market participants waiting on a bounce to take down exposure did so early last week, taking the opportunity to jettison the least liquid securities in their portfolio, i.e., small-caps, after a rally in the Russell 2000 during the first week of May. Abroad, developed markets outperformed the S&P 500 as the MSCI ACWI ex U.S. index dropped 0.53% on the week, with exposure to Canada, the U.K. and Spain only partially offset by relative strength out of France, Italy, Japan, and Germany. Within the MSCI Emerging Markets index, India and Taiwan were notable detractors during the week, contributing to the MSCI EM index's 2.1% weekly decline, while Brazil and China exhibited relative strength.

Bonds: 'Hotter' Than Expected April CPI, PPI Prints Point Toward Inflation 'Stickiness', Credit Spreads Widen Further As 'Risk-Off' Dominates. The Federal Open Market Committee (FOMC) remains stuck between a rock (elevated, sticky inflation) and a hard place (a slowing economy). On the heels of the Committee's meeting in early May, the yield curve steepened as market participants grew concerned that the pace of monetary policy normalization wouldn't be aggressive enough to stem the tide of rising prices. Fast forward to last week, and now market participants have been flocking to 'safety,' buying long-term Treasury bonds due to concerns that the FOMC would respond too aggressively to incoming 'hot' inflation data and hike the fed funds rate until something in the economy breaks, ultimately leading to a recession. The 2-year/10-year (2's/10's) yield spread narrowed to 34-basis points last week after beginning the week at 40-basis points. The narrowing of spreads highlights how swiftly markets pivoted toward pricing in a higher probability of a U.S. recession and away from fears of stagflation due to the FOMC failing to normalize monetary policy aggressively enough, thus leading to entrenched or 'sticky' inflation.

WHAT WE'RE WATCHING

- April Industrial Production is released Tuesday and is expected to show a 0.05% month over month pick-up in manufacturing activity after rising 0.9% in March relative to February.
- April Leading Economic Indicators (LEI) is released Thursday and is expected to remain static month over month after a 0.3% rise in March.
- The Philadelphia Fed Index for May is released on Thursday and is expected to rise slightly month over month to 17.8 from 17.6 in April. The Philly Fed Index is a measure of overall manufacturing conditions as participants indicate the direction of change in overall business activity and in the various measures of activity at their plants: employment, working hours, new and unfilled orders, shipments inventories, delivery times, prices paid, and prices received.

	Price/Yield	Total Return (%)					
	5/13/2022	1 Week	1 Month	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	32196.66	-2.08	-6.74	-10.81	-3.58	10.65	11.44
S&P 500	4023.89	-2.35	-9.40	-15.12	-0.76	14.60	12.98
NASDAQ	11805.00	-2.77	-13.42	-24.35	-9.45	16.53	15.09
Russell 2000 Index	1792.67	-2.50	-11.40	-19.83	-16.52	6.91	6.68
MSCI World ex US	1983.08	-0.53	-7.76	-14.52	-9.91	5.40	4.49
MSCI EM	1004.52	-2.08	-10.08	-17.90	-20.29	2.28	2.74
Bloomberg US Aggregate	3.48	0.89	-1.91	-9.71	-8.45	0.14	1.16
Bloomberg Global Aggregate	2.58	0.30	-3.81	-12.16	-13.35	-1.62	0.20
Bloomberg US Corporate	4.38	0.60	-3.23	-13.37	-10.76	0.63	1.79
Bloomberg 10-Year Muni	3.33	-0.56	-2.63	-9.84	-9.16	-0.25	1.50
Bloomberg High Yield	7.61	-1.21	-4.14	-10.41	-7.43	2.30	3.15

	Price/Yield						
	5/13/2022	1 Week Ago	1 Month Ago	12/31/2021	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	0.79	0.78	0.29	0.05	0.01	2.38	N/A
30 Year Mortgage (average rate)	5.39	5.54	5.07	2.88	3.05	3.99	4.01
2 Year Treasury (yield)	2.59	2.67	2.34	0.73	0.16	2.18	1.29
10 Year Treasury (yield)	2.93	3.13	2.69	1.51	1.66	2.40	2.33
30 Year Treasury (yield)	3.09	3.22	2.79	1.90	2.40	2.84	2.99
WTI Crude (closing price)	110.49	109.72	104.26	75.33	63.82	60.97	47.83
Brent Crude (closing price)	111.32	113.86	108.49	77.24	67.36	72.35	49.08
Gold (NYM $/oz)	1807.40	1881.20	1981.00	1827.50	1823.80	1300.10	1226.20

Source: FactSet

WHAT HAPPENED LAST WEEK?

Stocks: Another Week Of Wild Swings As Inflation Data, 'Fed Speak' Drives A 'Sell Anything You Can' Market.

It was another volatile week for global equities with few places to hide as investors grappled with whether the U.S. economy is experiencing a 'growth scare' or is on a crash course with a recession amid inflationary pressures and monetary policy uncertainty. The S&P 500 fell 2.35% on the week after rallying into the close on Thursday and churning out a 2.4% gain on Friday. All in all, the week could have been much worse, and despite a selling reprieve on Thursday and Friday that allowed investors to catch their breath, we remain skeptical of the staying power of rallies, so long as credit spreads on corporate bonds continue to widen as they did last week. The Russell 2000 small-cap index fell 2.5% on the week as market participants waiting on a bounce to take down exposure did so early last week, taking the opportunity to jettison the least liquid securities in their portfolio, i.e., small-caps, after a rally in the Russell 2000 during the first week of May. Abroad, developed markets outperformed the S&P 500 as the MSCI ACWI ex U.S. index dropped 0.53% on the week, with exposure to Canada, the U.K. and Spain only partially offset by relative strength out of France, Italy, Japan, and Germany. Within the MSCI Emerging Markets index, India and Taiwan were notable detractors during the week, contributing to the MSCI EM index's 2.1% weekly decline, while Brazil and China exhibited relative strength.

• There was a decidedly defensive tone to sector leadership as the health care, utilities, and consumer staples sectors each outperformed the broader index's decline although each of the three sectors ended the week lower. The consumer discretionary, financial services, information technology and real estate sectors were notable laggards last week as each sector fell at least 3%.

• The MSCI China index held up well last week, climbing 1.6% as chatter made the rounds that the country was planning to ease COVID lockdowns over the back-half of May. The reopening of the Chinese economy would provide a much-needed shot in the arm for global supply chains, which have been hindered by the country's ports effectively being shut down for the past month, pushing prices of various goods higher in the U.S. and in Europe. However, the reopening of China's economy will also likely serve to push commodity prices higher as fears of supply shortfalls for agricultural, industrial, and energy-related commodities returns. Optimism as to when China could ease lockdown restrictions generated an 12.5% per barrel rise in West Texas Intermediate (WTI) crude and a 9.9% bump in the price per barrel of Brent crude from their lows last Tuesday into the weekend. WTI ended the week at $110.5 per barrel, while Brent closed at $111.3.

Bonds: 'Hotter' Than Expected April CPI, PPI Prints Point Toward Inflation 'Stickiness', Credit Spreads Widen Further As 'Risk-Off' Dominates.

The Federal Open Market Committee (FOMC) remains stuck between a rock (elevated, sticky inflation) and a hard place (a slowing economy). On the heels of the Committee's meeting in early May, the yield curve steepened as market participants grew concerned that the pace of monetary policy normalization wouldn't be aggressive enough to stem the tide of rising prices. Fast forward to last week, and now market participants have been flocking to 'safety,' buying long-term Treasury bonds due to concerns that the FOMC would respond too aggressively to incoming 'hot' inflation data and hike the fed funds rate until something in the economy breaks, ultimately leading to a recession. The 2-year/10-year (2's/10's) yield spread narrowed to 34-basis points last week after beginning the week at 40-basis points. The narrowing of spreads highlights how swiftly markets pivoted toward pricing in a higher probability of a U.S. recession and away from fears of stagflation due to the FOMC failing to normalize monetary policy aggressively enough, thus leading to entrenched or 'sticky' inflation.

• The 10-year U.S. Treasury yield peaked at 3.20% last Monday and yields on the long end of the Treasury fell over the balance of last week as market participants priced in a more aggressive path forward for monetary policy in the U.S. and a higher probability of recession over the near-term. We expect monetary policy uncertainty to remain for months to come, consequently, we expect volatility in long-term U.S. Treasury yields to remain as well, presenting trading opportunities for active managers with flexibility along the way.

• The April Consumer Price Index (CPI) was released Wednesday and came in 'hotter' than expected, rising 8.3% year over year vs. the 8.1% consensus estimate. While surpassing the consensus estimate, year over year CPI at 8.3% is a slight improvement from the 8.5% year over year reading in March, a minor victory for those lauding the potential for March to be an inflation 'peak.' However, while year over year inflation may have indeed reached a 'peak' in March, underlying components, specifically rents, as well as a 'hot' Producer Price Index (PPI) reading on Thursday, point toward inflation 'stickiness,' which will cause the FOMC significant heartburn between now and its mid-June meeting. Perhaps most concerning, while headline CPI rose less month over month than it did in March, the same can't be said for core CPI as, excluding volatile food and energy, core CPI rose 0.6% month over month, double the 0.3% reading from March, a data point that will undoubtedly have the FOMC's attention.

• Credit spreads widened further last week as risk aversion continued to dominate market action. The option adjusted spread (OAS), or credit spread over the Treasury curve for the Bloomberg High Yield index reached 458-basis points on Thursday, its highest-level dating back to November of 2020. Notably, the High Yield index's OAS remains 65 bps below its 20-year average of 517-basis points, implying that additional weakness in riskier bonds may be in the cards as price discovery returns to the corporate bond market. One positive implication of the back-up in credit spreads is that the yield-to-worst (YTW) on the Bloomberg High Yield index is now back above 7.5% for the first time since May of 2020, so at least investors are being more adequately compensated for taking credit risk than they have been in some time. Price discovery is swiftly returning to credit markets and yields/credit spreads are likely to move higher still over coming quarters as the fed funds rate moves higher and balance sheet runoffs gets into full swing.

Source: AAII, FactSet

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