October 3, 2022

REGIONS ASSET MANAGEMENT

WEEKLY MARKET COMMENTARY

What We're Watching

MARKET UPDATES

September 30, 2022: Recorded Leadership Discussion Featuring: Regions Chief Economist, Chief Investment Officer, and Chief Market Strategist.

October 14, 2022: Join the upcoming live Regions Market Update.

KEY OBSERVATIONS

Stocks: Weaker U.S. Dollar, Falling Treasury Yields Spur Mid-Week Rally, But Bounce Proves Short-Lived. As has been the case throughout September, global equity indices remained beholden to the fixed income market last week, rallying as yields fell and falling as yields rose. Stocks staged a comeback in the middle of last week as yields on U.S. Treasury and euro area sovereign bonds fell sharply and the U.S. dollar weakened, but even after a mid-week bounce, the S&P 500 still closed out the week with a 2.8% loss and September with an 9.3% monthly drop as the month lived up to its historical billing as a challenging one for equity investors. International equity indices fared even more poorly during the month, the MSCI ACWi ex. U.S. and MSCI Emerging Markets (EM) indices losing 9.6% and 11.5%, respectively, as U.S. dollar strength and a sharp rise in sovereign bond yields in the U.S. and euro area weighed on investor sentiment and risk appetite. Despite a weaker U.S. dollar, emerging markets still couldn't catch a bid last week, the MSCI EM index falling 2.7% as Brazil, South Korea, and Taiwan weighed while China and India closed the week lower and narrowly outperformed the broader MSCI EM index. Investor sentiment remained near rock-bottom levels as last week wrapped up, potentially setting stocks up for an oversold bounce leading up to earnings season in mid-October, but this could be short-lived as corporate earnings are revised lower and guidance pulled, forcing volatility higher as well.

Bonds: Bank Of England 'Blinks,' Buys Gilts To Stabilize Markets; Stress Shows In Credit. The U.K. was at the epicenter of volatility in the rates market last week as the yield on the 10-year U.K. gilt eclipsed the 4.50% level before the Bank of England (BoE) intervened to ensure normal market functioning last Wednesday. The BoE was forced to step in as buyer of last resort for gilts as levered U.K. pension plans were rumored to face solvency issues as gilts held as collateral plummeted in value. If the BoE failed to act a wave of margin calls could have occurred, pushing gilt yields higher and further destabilizing markets. The BoE committed to buy £65 billion, or £5 billion per day, of gilts maturing in 20+ years through October 14 and delayed outright gilt sales until October 30. U.S. Treasury yields initially fell on news of the BoE's intervention as market participants began to place bets that the FOMC would follow the BoE's lead and make a dovish pivot. However, it is notable that even after the mid-week drop in yields, the 2-year yield ended the week 2 basis points higher at 4.22% while the 10-year ended the week 14 basis points higher at 3.83%. The sell-off in U.S. Treasuries and corporate bonds has been much more orderly than what was occurring in the U.K. gilts market before the BoE stepped in, and with fixed income markets stateside functioning normally and unemployment still sub-4%, the FOMC will likely remain focused on the price stability component of its dual mandate as it attempts to regain lost credibility. In short, we do not expect the BoE's decision to impact the path forward for the FOMC.

WHAT WE'RE WATCHING

- Wednesday brings with it the release of the September Purchasing Managers Index (PMI) with the Institute for Supply Management (ISM) Services PMI expected to fall to 55.6 from 56.9 in August. A reading above 50 is indicative of expansion in business activity while a reading below 50 indicates contraction.
- The September Nonfarm Payrolls report is released Friday and is expected to show 250,000 jobs were created during the month, down from 315,000 created in August. The unemployment rate is expected to remain static month over month at 3.7%.
- Average hourly earnings for September are also released Friday and are expected to show a 5.1% year over year rise during the month, down from a 5.2% increase in August. Month over month, average hourly earnings are expected to rise 0.35%, in-line with the August reading.

	Price/Yield	Total Return (%)					
	10/3/2022	1 Week	1 Month	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	28725.51	-2.92	-9.46	-19.72	-13.40	4.35	7.27
S&P 500	3585.62	-2.89	-9.91	-23.88	-15.50	8.13	9.13
NASDAQ	10575.62	-2.68	-10.94	-31.99	-26.23	10.68	11.22
Russell 2000 Index	1664.72	-0.82	-10.12	-25.11	-23.53	4.25	3.27
MSCI World ex US	247.05	-1.90	-10.20	-26.17	-24.77	-1.02	-0.29
MSCI EM	875.79	-3.29	-11.58	-26.99	-27.86	-1.76	-1.50
Bloomberg US Aggregate	4.75	-0.99	-4.69	-14.61	-14.60	-3.25	-0.27
Bloomberg Global Aggregate	3.70	-0.72	-5.20	-19.89	-20.43	-5.73	-2.26
Bloomberg US Corporate	5.69	-1.89	-5.80	-18.72	-18.53	-3.65	-0.04
Bloomberg 10-Year Muni	4.04	-0.96	-3.88	-12.13	-11.50	-1.85	0.59
Bloomberg High Yield	9.68	-1.36	-4.39	-14.74	-14.14	-0.45	1.57

	Price/Yield						
	10/3/2022	1 Week Ago	1 Month Ago	12/31/2021	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	2.98	2.99	2.29	0.05	0.05	2.35	N/A
30 Year Mortgage (average rate)	7.06	6.59	5.98	3.27	3.18	3.72	3.80
2 Year Treasury (yield)	4.13	4.20	3.44	0.73	0.28	1.62	1.48
10 Year Treasury (yield)	3.70	3.68	3.10	1.51	1.49	1.66	2.33
30 Year Treasury (yield)	3.69	3.61	3.22	1.90	2.04	2.11	2.86
WTI Crude (closing price)	83.78	78.74	91.64	75.21	75.03	54.07	51.67
Brent Crude (closing price)	89.19	86.15	99.31	77.78	78.52	60.78	57.54
Gold (NYM $/oz)	1664.80	1645.30	1726.90	1828.60	1755.30	1465.70	1281.50

Source: Bloomberg (3- and 5-Year Returns Annualized)

WHAT HAPPENED LAST WEEK?

Stocks: Weaker U.S. Dollar, Falling Treasury Yields Spur Mid-Week Rally, But Bounce Proves Short-Lived.

As has been the case throughout September, global equity indices remained beholden to the fixed income market last week, rallying as yields fell and falling as yields rose. Stocks staged a comeback in the middle of last week as yields on U.S. Treasury and euro area sovereign bonds fell sharply and the U.S. dollar weakened, but even after a mid-week bounce, the S&P 500 still closed out the week with a 2.8% loss and September with an 9.3% monthly drop as the month lived up to its historical billing as a challenging one for equity investors. International equity indices fared even more poorly during the month, the MSCI ACWi ex. U.S. and MSCI Emerging Markets (EM) indices losing 9.6% and 11.5%, respectively, as U.S. dollar strength and a sharp rise in sovereign bond yields in the U.S. and euro area weighed on investor sentiment and risk appetite. Despite a weaker U.S. dollar, emerging markets still couldn't catch a bid last week, the MSCI EM index falling 2.7% as Brazil, South Korea, and Taiwan weighed while China and India closed the week lower and narrowly outperformed the broader MSCI EM index. Investor sentiment remained near rock-bottom levels as last week wrapped up, potentially setting stocks up for an oversold bounce leading up to earnings season in mid-October, but this could be short-lived as corporate earnings are revised lower and guidance pulled, forcing volatility higher as well.

• West Texas Intermediate (WTI) crude closed the week higher by half of 1%, but the S&P 500 energy sector fared better, rallying 2.2% and outperforming the S&P 500 as the only sector to end the week in positive territory. Crude oil traded sideways despite inventories falling more than expected and OPEC publicly preparing markets for a large supply cut coming out of this week's meeting, with media reports pointing toward Russia pushing for a 1 million barrel per day reduction. A strong U.S. dollar and a deteriorating global economic backdrop pose headwinds for energy producers and prices, but with Strategic Petroleum Reserve (SPR) releases set to end in coming months, crude oil supplies will likely remain tight for quarters to come. With this backdrop in place, energy price 'shocks' are likely to be to the upside, leaving us constructive on companies in the energy sector growing their dividend alongside free cash flow.

• The MSCI ACWi ex. U.S. index outperformed the S&P 500 on the week after it closed lower by 1.4% as the euro area was mixed and the MSCI Japan index fell 2.4%. Within the euro area, France and the U.K. posted weekly losses of less than 1% while Germany and Italy experienced declines of 1.6% and 1.9%, respectively. The MSCI U.K. index closed the week 0.1% lower after the Bank of England (BoE) stepped in to buy long-dated gilts to stem the tide of rising yields. The bounce attempt out of U.K. equities was short-lived as reality quickly set in that the Bank of England buying gilts would do little to bring down elevated inflation and that inflationary pressures would persist, forcing the BoE to tighten monetary policy to more restrictive levels.

Bonds: Bank Of England 'Blinks,' Buys Gilts To Stabilize Markets; Stress Shows In Credit.

The U.K. was at the epicenter of volatility in the rates market last week as the yield on the 10-year U.K. gilt eclipsed the 4.50% level before the Bank of England (BoE) intervened to ensure normal market functioning last Wednesday. The BoE was forced to step in as buyer of last resort for gilts as levered U.K. pension plans were rumored to face solvency issues as gilts held as collateral plummeted in value. If the BoE failed to act a wave of margin calls could have occurred, pushing gilt yields higher and further destabilizing markets. The BoE committed to buy £65 billion, or £5 billion per day, of gilts maturing in 20+ years through October 14 and delayed outright gilt sales until October 30. U.S. Treasury yields initially fell on news of the BoE's intervention as market participants began to place bets that the FOMC would follow the BoE's lead and make a dovish pivot. However, it is notable that even after the mid-week drop in yields, the 2-year yield ended the week 2 basis points higher at 4.22% while the 10-year ended the week 14 basis points higher at 3.83%. The sell-off in U.S. Treasuries and corporate bonds has been much more orderly than what was occurring in the U.K. gilts market before the BoE stepped in, and with fixed income markets stateside functioning normally and unemployment still sub-4%, the FOMC will likely remain focused on the price stability component of its dual mandate as it attempts to regain lost credibility. In short, we do not expect the BoE's decision to impact the path forward for the FOMC.

• The Bank of England stepping in to buy 20+ year U.K. government bonds forced yields on 10-year gilts lower by a whopping 50 basis points on Wednesday alone, which pulled yields on U.S. Treasuries and euro area sovereign bonds lower as well. Market participants appeared all too eager to believe that the BoE's decision would allow the Federal Open Market Committee (FOMC) and other global central banks to take a less aggressive path toward policy normalization as well, but we do not see it playing out that way. The FOMC has worked hard to regain lost credibility on the inflation fighting front, and we expect the Committee to do anything in its power to ensure markets function as intended, while staying focused on bringing down inflation expectations. By acknowledging that it was, in essence, the only buyer of long dated U.K. government bonds, once the BoE is done buying in mid-October, market forces may challenge the BoE yet again by pushing yields back toward recent highs.

• As of the the time of this writing, the U.K. government is rumored to have scrapped plans of a tax cut on high income earners after facing immense pressure at home and abroad. While a positive for the British pound, economic and political issues will continue to plague the U.K., weighing on equities and pushing gilt yields higher over coming quarters. Coinciding with its decision to buy gilts, the BoE reinforced that more rate hikes were coming, and that it still expects to sell down some £80 billion of bonds over the next twelve months. Taken together, we question the durability of last week's rally in gilts as sellers will likely take the opportunity to unload exposures to the BoE while they still can over coming weeks.

• Credit spreads widened over the balance of last week as investors continued to demand greater compensation for taking credit risk. The yield-to-worst (YTW) on the Bloomberg U.S. High Yield index ended last week at 9.68% after closing Thursday at 9.71% - a post-COVID high. On the week, the option adjusted spread (OAS), or credit spread over the Treasury curve for the High Yield index widened by 40 basis points to 552 over the U.S. Treasury curve and ended September wider by 68 basis points, indicative of investors requiring a greater margin for safety to properly compensate them for taking on what they deem to be elevated credit risk.

Source: Bloomberg, Factset

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