Date: August 5, 2022
Topic: Macroeconomic

Authored by:
Investment Forum

Jon Maier
Chief Investment Officer

Michelle Cluver
Portfolio Strategist

Morgane Delledonne
Head of Investment Strategy, Europe

Pedro Palandrani
Director of Research

Rohan Reddy
Director of Research

Global X House Views

Elevated inflation, slowing global economic growth expectations, and reduced central bank liquidity remain the key economic considerations. Together, they create a typical late cycle environment, but with a few extra complications from the war in Ukraine.

	House View
Global Macro	Federal Reserve (Fed) language softened at their July FOMC meeting, potentially opening the door for a slower rate rising trajectory in the second half of 2022. Policy interest rates increased 75 basis points (bps) to 2.25% - 2.50% and another likely hike in September, though the Fed indicated futures moves would be more data dependent. The July meeting potentially reflected a slightly dovish pivot that may be supportive to markets.[1] Policy yields are likely to continuing rising during 2022, with the market currently expecting policy rates to peak around 3.3%. This implies potentially only a handful more interest rate hikes. The Fed's interest rate hiking trajectory is expected to peak in early 2023, with the market already pricing in interest rate cuts from early next year.[2] Historically, monetary policy induced market corrections tend to bottom when the Fed pivots to become more accommodative.[3] As such the market is highly sensitive to any indication that the Fed may slow their rate rising trajectory. The balance between interest rate sensitivity and economic growth sensitivity has potentially shifted to favor economic growth sensitivity. U.S. and global economic growth are slowing, and key countries are at risk of moving into recession. We expect a mild but protracted recession within the U.S., with a European recession occurring amid energy shortages expected in the second half of the year. U.S. preliminary Q2 GDP reading reflected a decline of -0.9%.[4] This is the second quarter of negative GDP growth, a widely regarded signal of the start of a recession. Markets will be watching the National Bureau of Economic Research (NBER) to determine if the U.S. economy is in a recession or not. Inventories and business investment were the main drags on Q2 GDP while the first quarter decline was more technical. While the labor market remains tight and consumer balance sheets are solid, economic growth concerns are rising. U.S. consumer sentiment deteriorated as inflation pressures weighed on real disposable income. Reduced economic growth has followed almost all periods with a sharp reduction in consumer sentiment and consumer confidence. Slowing demand is starting to impact U.S. manufacturing, with new orders declined at their fastest rate in two years as companies right size their inventory levels.[5]
Regional Macro	The policy interest rate divergence between the U.S. and Europe is likely to increase amid heightened recession risk in Europe. The ECB ended net asset purchases from July and is set to increase interest rates by 159bps by year end according to OIS pricing as of 18 July. The faster Fed hiking cycle is likely to

	keep the euro lower, possibly below parity versus the dollar throughout the second half. Currently, the market may be pricing in more European Central Bank (ECB) interest rate hikes than Europe's economy can withstand. Should underlying economic data deteriorate significantly, interest rate expectations could be pared back. Europe is likely to accelerate its energy transition as cutting off energy imports from Russia continues. The European Commission recently announced a ban on most Russian oil but stands ready for retaliatory actions likely impacting gas supply. In Asia, China's GDP growth slowed significantly to 0.4% yoy in the second quarter, down from 4.8% growth in Q1.[6] The weaker growth reflects the impact of China's lockdowns. However, with China reopening, June's industrial production improved from around 0.7% to 3.9%, and retail sales rebounded strongly posting 3.1% yoy growth after a 6.7% decline in May.[7] July's data is likely to reflect headwinds, with the official manufacturing PMI index unexpectedly moving into contractionary territory amid lockdowns and some electricity shortages.[8] The People's Bank of China (PBOC) is expected to remain accommodative amid China's economic slowdown. The Bank of Japan (BoJ) has not signaled intentions to tighten its monetary policy amid supply-led inflation and stagnant wages.
Asset Class Views	Current conditions are typical of a late cycle environment. We expect market volatility to remain elevated through the interest rate hiking cycle, although aggressive tightening by the Fed and the ECB seems mostly priced into the market. At this stage, we prefer equities over fixed income because real yields are still in negative territory. In fixed income, we prefer lower duration assets due to the rising rate environment. However, long duration Treasuries can provide some protection as recession risk rises. The inflationary environment creates a favorable backdrop for commodities. The trajectory for recovering demand out of China is supportive for commodities. However, a strong dollar and tightening financing conditions could make commodities slightly less attractive at this stage. We prefer commodities over other assets, but with a somewhat more muted outlook.
Sub Asset Class & Industry Views	Increased focus on defensive segments of the market as recession risks rise. Preferred sectors include Health Care, Consumer Staples, and Utilities while discretionary consumption remains an area of concern. For more detail, please refer to our sector views blog post. Raw materials and commodities including lithium and copper are well-positioned if inflationary pressures and supply chain disruptions continue. Demand for commodities will likely rise as Chinese lockdowns ease. Within the commodity complex, oil prices are unlikely to decline much further from here with limited supply growth. Energy could be a good place for investors to park money as inflation remains elevated and the oil and gas price outlook is constructive. Inflation protection should be balanced with quality, defensive equity position. We also view assets tied to derivatives like covered call strategies and those targeting rising interest rates as potentially attractive with volatility remaining elevated.
Product Opportunities	Food and energy remain key inflation concerns. A few key products stand to benefit from disruption in these areas:

	• Global food security is a growing risk, thus increasing the need for Agtech & Food Innovation solutions to counter future challenges. • Renewable Energy Producers provides more defensive, utility focused exposure to the energy transition. • The world moving away from Russian uranium is creating opportunities for alternative uranium suppliers, and uranium miners may be well positioned. Cybersecurity is an area of growing importance in the public and private sectors. Secure digital connectivity is essential to and benefits from the digitization trend. We expect the sticky nature of the cybersecurity business model to increase, helped by growing awareness of cyber threats, including those related to the Russia-Ukraine crisis. Cloud Computing has become a business essential. Cloud companies benefit from recurring revenue streams and are currently trading at attractive valuations relative to historic levels. Currently, cloud companies in (CLOU/CLO) are trading at an average price/sales (P/S) ratio of 4.4x, below its long-term average of 8.7x.[9] Lithium is a vertical that might hold up better than other commodity-related equities since it presents inelastic supply (it takes between 3 to 5 years to bring lithium to market) and strong demand tailwinds from the continuous adoption of EVs. Healthcare-related areas such as Genomics and Aging Population themes can potentially outperform as the companies within the themes are expected to continue to see constant demand for their services and products during different economic cycles. Genomics companies, often considered “high-growth” stocks, could potentially rebound faster than other themes once macro-economic conditions improve.

Footnotes

1. Bloomberg data as of July 28, 2022.
2. Bloomberg data as of July 15, 2022.
3. Bloomberg, *Goldman Strategist Says Stocks Will Bottom Once Fed Signals Shift*, 24 May 2022
4. BEA, *Gross Domestic Product, Second Quarter 2022 (Advanced Estimate)*, 28 July 2022
5. Trading economics data as of 1 August 2022
6. Cheng, E. (2022, July 15). China’s GDP growth misses expectations in the second quarter. *CNBC.*
7. Yao, K., & Zhang, E. (2022, July 14). China June industrial output rises 3.9%, retail sales up 3.1%. *U.S. News.*
8. Trading Economic data as of August 2, 2022
9. FactSet data as of June 30, 2022 (latest available)