Monthly Review and Outlook

July 2022

Review

Developed market equities (shares) rose overall as investors began to focus on the prospect of interest rate cuts next year, given signs of a slowing global economy.

Emerging market equities lagged global equity markets as a whole, amid weakness in China.

Bond prices rose overall, meaning bond yields fell.

Company shares

UK equities bounced back during July. This was largely driven by the performance of companies in the non-essential consumer goods (consumer discretionary) and the industrial sectors, areas that had performed poorly since the start of 2022. These sectors had been weighed down by the cost-of-living crisis, which had a negative impact on the outlook for the UK consumer and the broad economy. In contrast, areas such as healthcare and telecommunications, which can potentially hold up relatively well in periods of economic weakness, performed poorly in the month. US equities also rebounded in July. As anticipated, the US Federal Reserve (Fed) raised interest rates by 0.75%, although Chair Jerome Powell subsequently said the pace of rate rises is likely to slow from here. All sectors advanced, with consumer discretionary and technology companies making some of the strongest gains. Eurozone shares also rose in July. The Japanese stock market rose steadily, ending the month 3.7% higher. Asian equities (excluding Japan) had negative returns in July, with declines in China and Hong Kong offsetting gains in India, South Korea and Singapore. Emerging market (EM) equities also had negative returns in July. This was largely attributable to weakness in China, as most of the other emerging markets ended the month positively. China was hit by slowing economic growth, ongoing Covid-19 lockdown measures and government regulations in areas such as education, technology, property and gaming.

Bonds

Bond prices rose in July, making up for some of the declines in the year-to-date. In the US, this appeared to reflect evidence of a potential economic slowdown, with housing activity particularly weak, leading to the expectation of potentially more moderate interest rate rises to come. The yield on US government bonds with 10 years to maturity fell from 2.97% to 2.64% (bond yields fall when bond prices rise). The European Central Bank (ECB) raised interest rates by 0.5% to 0.0%, its first rate rise in 11 years. This ended the era of negative European interest rates, which began in 2014. European government bond prices also appeared to be affected by economic growth concerns and rose in the month. The yield on Germany's 10-year government bonds fell from 1.37% to 0.82% and Italy's from 3.39% to 3.15%. Bonds from companies rebounded robustly and performed more strongly than government bonds.

Commodities

The S&P GSCI Index of commodity markets rose moderately in July as declines in agriculture and precious metals offset higher natural gas and livestock prices. There were sharp falls in the price of wheat due to an improvement in production prospects and good weather conditions. Gold and silver prices declined but natural gas prices spiked upwards amid heightened worries over Russian gas supply to Europe.

Outlook

Investors continue to face the impact of rising interest rates (used by central banks in an effort to limit inflation) and recessionary risks. We continue to be cautious on equities for two main reasons. First, we do not expect imminent interest rate reductions from central banks, given the need to quell inflation, and higher interest rates can hinder economic growth. Second, we believe corporate earnings expectations, which have helped support equity prices, still do not adequately reflect the risks to economic growth. We are particularly cautious regarding equities with high sensitivity to the performance of the underlying economy. We maintained a neutral outlook on government bonds and see value in high-quality European corporate bonds compared with government bonds. All in all, we remain cautious on equities and neutral on bonds and commodities.

Asset overview

Our general view of assets over the coming months can be summarised as follows:

Equities	🔴	We maintain our negative view, noting that downgrades in expectations for corporate earnings have only just begun.
Government bonds	🟡	We believe valuations generally look fair. But we are concerned about the potential for inflation to rise higher than markets currently seem to expect.
Corporate bonds	🟡	We maintain our neutral stance, despite our concerns for high inflation combined with poor economic growth (stagflation). We have a preference for high-quality (investment grade) bonds rather than more speculative (high yield) bonds.
Commodities	🟡	We remain neutral. The supply of commodities is generally still restricted, but weakening global growth is constraining demand, particularly in the energy sector.

	Legend
🟢	Positive outlook
🔴	Negative outlook
🟡	Neutral outlook

Source: Schroders, 12 August 2022

Important information

Forecasts of future performance are not a reliable guide to actual results, neither is past performance a reliable indicator of future results. The value of investments and the income from them can fall as well as rise and are not guaranteed, and the investor might not get back their initial investment.

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