Handelsbanken
Asset Management

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Weekly bulletin: Fed accelerates its balance sheet reduction

Key takeaways

A more aggressive tone from the US Federal Reserve (Fed), ongoing geopolitical tensions, and persistent concerns about inflation, produce a jittery week for markets.

- Markets last week were somewhat unnerved by minutes from the Fed's last meeting in March, which outlined a faster plan for policy tightening than had been anticipated. The emergency measures employed during the pandemic are now no longer required and the Fed looks likely to begin reducing the amount of assets it holds on its balance sheet after its May meeting. The Fed plans to reduce its bond holdings, starting with $40 billion per month, rising to $95 billion from September.

- When the Fed last tightened policy in 2018, stock markets fell sharply in response, however, the circumstances this time are quite different with the growth and inflation backdrop requiring a reduction in the balance sheet. Despite last week's wobble, stock markets should quickly align with the Fed particularly since a combination of balance sheet reduction alongside planned interest rate increases, could well mean less rate rises are needed during this economic cycle. Ultimately the Fed want to slow the economy to bring down inflation and that means tightening financial conditions.

- Meanwhile, in the bond market, attention remained focused on yield curve inversion - when this happens, the yields offered on longer-duration bonds become lower than the yields on shorter-duration bonds. A signal like this typically points to bond market concerns that recession is imminent. While yield curve inversions are not perfect predictors of recessions, they are worth keeping in mind, and we are monitoring the economic situation closely. For more of our analysis on this topic, please see our recent Insight article: 'Are bond markets predicting a recession'.

- Elsewhere, in a quiet week for economic data releases, data that was published confirmed that inflationary pressures remain strong, and that UK and European economies are still expanding, although manufacturing data in Germany indicated that the war in Ukraine is affecting Germany's economic growth. In the US, the employment market continues to strengthen with the most recent weekly figure of 166,000 jobless claims, the lowest since 1968. China though is continuing to have problems managing the COVID-19 Omicron wave, which is threatening economic growth and further disrupting supply, with the region's most recent data on the services sector showing a contraction.

- Finally in France, the first round of the presidential election took place on Sunday with the result that President Macron is set to go up against right-wing candidate Marine Le Pen in the second round on April 24. Attention will be focused on who the supporters of the defeated first round candidates decide to vote for.

Weekly market moves

Global stock markets had a mixed week (in sterling terms) with the UK once again outperforming other major markets.

Bonds had a tough time, though where the recent sell-off continued apace after minutes from the March Fed and ECB meetings confirmed that both central banks want to tighten policy to deal with inflation running at multi-decade highs. Inflation-linked bonds in particular struggled, as real yields rose.

In commodities, oil continued to fall, but other commodities were more resilient with gold up 1.4% over the week.

What to look out for this week

Thursday's meeting of the European Central Bank is set to be one of the main highlights with the central bank expected to confirm a faster reduction in their asset purchases given the deteriorating inflation outlook.

In the US, Consumer Price Index data is released on Tuesday and the Q1 earnings season will get underway with reports from a number of US financials, among others.

Market moves (as at 8 April 2022)

	Index Levels	Last Week	Month to Date	Year to Date
Equity				
MSCI United Kingdom	2,204.5	2.1%	2.5%	7.3%
MSCI United Kingdom Mid Cap	1,282.9	-0.1%	-0.2%	-11.7%
MSCI United Kingdom Small Cap	421.2	0.2%	0.5%	-11.4%
MSCI World (GBP)	2,320.2	-0.7%	-0.1%	-2.4%
S&P 500 (GBP)	4,488.3	-0.5%	0.3%	-1.6%
MSCI Japan (GBP)	1,167.6	-3.0%	-3.9%	-7.5%
MSCI Europe ex-UK (GBP)	1,594.3	-0.6%	-0.4%	-7.6%
MSCI Pacific ex-Japan (GBP)	1,698.8	0.0%	0.3%	7.1%
MSCI Emerging Markets (GBP)	65,022.7	-0.8%	0.0%	-4.2%
Bonds				
BoA Merrill Lynch Conventional Gilts	1,230.3	-1.6%	-1.4%	-8.8%
BoA Merrill Lynch Index-Linked Gilts	591.8	-4.6%	-4.0%	-9.5%
BoA Merrill Lynch £ Corporate	432.0	-1.0%	-0.9%	-7.7%
Commodities				
Oil (West Texas Intermediate, GBP)	$98.3	-0.3%	-1.1%	35.8%
Gold (GBP)	$1941.4	1.4%	1.2%	11.9%
S&P / GSCI (GBP)	3,683.4	0.9%	0.9%	38.2%

Past performance is not a reliable indicator of future results. The value of investments may fall as well as rise. All performance returns are in GBP, while all index levels are in local currency.

Important Information

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