CITY OF LONDON
Investment Management Company Limited

Developed Markets Quarterly Outlook

August 2022*

Overview

Countering Inflation, Bracing for Recession

The rise in inflation continues to dominate the policy setting, and with that, the cyclical outlook in all DM countries. Yet, there is considerable dispersion in the current position in the cycle as well as the inflation outlook across countries. The possible outcomes range from a 'soft landing' to stagflation, to inflationary recessions.

Markets have turned on a dime several times in the past few years. From the depression of the Covid-induced lockdowns, to the euphoria surrounding the reopening of economies and the unleashing of consumer demand, to worries about the sharp rise in inflation, followed by the risk of recession in response to monetary tightening. Investors have now become sufficiently worried about a (US) recession that they anticipate the Fed to 'pivot' as soon as early 2023 and begin easing interest rates again. The latest Fed statements were interpreted as indeed supporting the idea that the recent 'jumbo' rate hikes would end soon. As the turn of the monetary policy cycle has thus come into sight, Treasury yields declined again, US stocks rebounded and the US dollar eased off.

The depth and the duration of any recession will likely hinge on the prospects for inflation and the appropriate policy reaction. Given the multitude of factors that have impacted price growth over the past 12-18 months (some outside the purview of central bank policy), the future trajectory of inflation remains shrouded in uncertainty. While the shocks from food and energy prices will likely begin to fade, the impact of services price growth is taking over as the principal driver. Consumption-driven price growth may well soften as the economy (employment) weakens in response to tighter monetary policy. But with solid wage growth and a decent buffer from elevated household savings, this can take time. In the meantime, the supply side remains vulnerable to geopolitical and pandemic-related risks.

The features of slowing growth and rising inflation are now in place across all DM economies. However, there is considerable dispersion in outcomes. Inflation is still moderate in Switzerland and Japan but at a multiple of target-level in the UK and the eurozone. Policy action thus has farthest to run in the latter. The key counter-examples are Japan and China where central banks are either on hold or in easing mode. Growth remains still robust in commodity exporters such as Canada and Australia and is weakest in the UK and Switzerland. The US is in recession technically, but a debate rages when and if the economy will officially enter a recession.

Market Strategy: The MSCI ACWI reported another loss during the May-July period, with a return of -1.9% (-4,8% ex-US). The US and Japan were the only outperformers (though still incurring negative returns), while all other countries underperformed, with EMs and Australia reporting the weakest outcomes. Yet, despite the gloomy economic outlook across the majority of economies, markets have barely altered their expectations for corporate earnings over the next year when the downswing will likely be most pronounced. There thus remains considerable downside for the market as a whole.

In our country allocation we favour exposure to countries with the best cyclical prospects and the most attractive valuations. Thus, we upgrade **Japan** to *overweight* as its economy does not face the headwind of domestic monetary tightening, even if its exports will encounter slowing global demand. However, equities will be helped by a weak yen and attractive valuations. In the face of the global slowdown, we are sceptical of significant support for commodities from the demand side, even though energy prices may continue to be supported by tight supply given the sanctions on Russian exports. As a result, we downgrade **Australia** to *neutral*, but retain an *overweight* to **Canada**, which also offers more attractive valuations. On the other hand, we believe that **UK** valuations are not sufficiently attractive to compensate for the highest inflation record in the asset class combined with the darkest cyclical outlook. We also retain our *underweight* to the **Eurozone** as monetary tightening, energy disruptions and the resulting rationing will weigh on activity. In addition, the ECB remains constrained in its fight against inflation by the union's fragmentation risks. We remain *overweight* **US** equities as labor market strength points to a resilient economy. We also think that the Fed has become more nimble in its policy conduct and will try to mitigate too sharp a slowdown. Valuations have become more attractive.

Global Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
US	–				■	
Canada	–				■	
Eurozone	–		■			
Switzerland	–	■				
UK	–			■		
Japan	↑				■	
Australia	↓			■		
EM	–			■		

International Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
Canada	–				■	
Eurozone	–		■			
Switzerland	–		■			
UK	–			■		
Japan	↑				■	
Australia	↓			■		
EM	–			■		

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

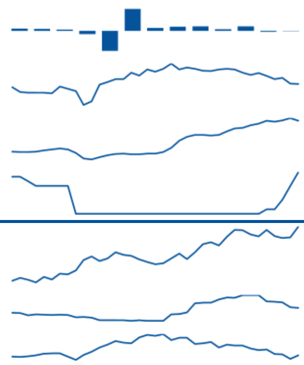
Source: CLIM

**This publication reflects asset performance up to 30 July, 2022, and macro events and data releases up to 10 August, 2022, unless indicated otherwise.*

United States

OW (Global Index)

The recession debate in the US remains unresolved, but markets expect the Fed to lean against it when it arrives.



	3Y history	Latest	
GDP, % qoq saar		-0.9	Q2
PMI, index		52.8	Jul
CPI, % yoy		8.5	Jul
Policy rate, %		2.38	Jul
MSCI USA*		1.9%	Jul
EPS, % yoy		18.8	Jul
Trailing P/E		20.7	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

The operating environment in the US economy has changed dramatically over the past quarter. Defying investor expectations, inflation rose to new heights throughout the quarter, the Federal Reserve delivered a series of 'jumbo' interest rate hikes and the economy slid into technical recession. In the face of these developments, markets have begun to price in a 'pivot' towards monetary easing by the Fed as early as March 2023 and a peak in Fed Funds rates below 3.3%.

Several activity indicators have deteriorated significantly since our last review. The housing sector (both housing starts and sales) slowed sharply as interest rates rose. Consumer confidence deteriorated to near all-time lows, while PMIs fell sharply. The services PMI dropped 5.7 points in July alone and, while manufacturing PMI held up better as a whole, the new orders component dropped below 49, a development mirrored by a sharp decline in the Philadelphia Fed manufacturing survey. Industrial production began to contract outright in June after weakening for several months.

Not all the data paint a negative picture though. House price appreciation remains strong and unsold inventory is still low. Durable goods orders in industry are robust. The news from retail sales has been mixed despite the sharp deterioration in consumer sentiment. Most importantly, labor markets remain solid. While it is true that (new) jobless claims have gradually trended higher as the economy softened, the unemployment rate has remained unchanged at a low 3.6% over the past quarter.

Indeed, the labor market is where opinions on the outlook for the economy divide. Some Fed officials believe that the current tightness of the labor market will enable the central bank to raise interest rates and reduce the vacancy rate (Beveridge ratio), without at the same time significantly pushing up the unemployment rate. Indeed, the vacancy rate has already fallen from a peak of 7.3% in March to 6.6% in June, while the unemployment rate has not budged. Some Fed officials believe that vacancies can even be brought to their pre-pandemic level of 4.6%, while triggering no more than a 1% point rise in the unemployment rate. Others contend that there is no historical precedent for such a scenario and that the desired reduction in inflation will inevitably drive the economy into recession. In addition, the rule devised by economist Claudia Sahm suggests that any rise of 0.5% or more in the three-month unemployment rate relative to its low during the previous 12 months signals the start of a recession.

Indeed, from a technical perspective, the US economy entered a recession in Q2 when GDP declined by 0.9% qoq saar, following a 1.6% qoq saar contraction in Q1. A large extent of the decline was attributable to a decline in inventories (subtracting 2.0% points from the headline figure), but the detail of the report also revealed weakness in several interest-sensitive sectors of the economy such as business equipment spending, spending on consumer durables and housing. Still, the inventory drawdown leaves some room for upside in the next quarter. The NBER definition of recession is not tied to these figures, but looks at a broader set of measures, not least employment growth, which remains far from signalling a downturn yet.

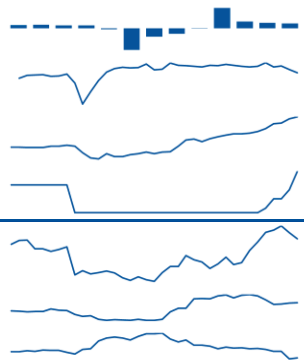
The Fed has now increased its Fund rate by a total of 225 bps this year, raising the pace of hikes first to 50bps and following up with two 75bps hikes. This makes for the fastest tightening cycle on record. The 2.50% Funds rate now corresponds to the FOMC's estimate of the neutral rate and the market interpreted Chair Powell's remarks that "at some point it will be appropriate to slow down" as signalling a 'pivot' in the Fed's stance. However, subsequent official comments have pushed back against this notion and the Fed 'dots' suggest another 100bps of hikes by year-end. Meanwhile, after surprising to the upside for much of the year, July inflation undershot expectations with a reading of 8.5% yoy (0% mom). Core CPI also slowed to 0.3% mom, leaving the annual rate unchanged at 5.9% yoy. The headline drop was driven by a decline in energy prices, which will likely repeat. But core inflation remains stickier as services price growth continues to gather pace. Although headline inflation may have passed its peak, underlying price pressure will require the Fed to remain vigilant.

Market Strategy: Inflation has risen for longer and to higher levels than markets anticipated originally. Nevertheless, recent data releases have supported the idea that the Fed would soon need to 'pivot' and cut rates to support the economy. These expectations are likely somewhat overdone given the inertia in core prices. Indeed, equity markets have not sufficiently adjusted as earnings expectations have only eased 1.5% from their peak in early July and remain some 5% higher than at the start of the year. Yet, even though the US equity market outperformed the MSCI ACWI ex-US by 470bps during the past three months, its P/E premium has declined to 20%, compared to a long-term average of 15%. Given that the Fed is now more pro-active than other central banks, the US may witness a shorter and shallower recession than its peers. We thus retain our *overweight* allocation.

Canada

OW (Global and Global ex-US index)

Strong growth momentum and a commodity-driven export sector support a robust economic outlook



	3Y history	Latest	
GDP, % yoy		2.9	Q1
PMI, index		52.5	Jul
CPI, % yoy		8.1	Jun
Policy rate, %		2.50	Jul
MSCI Canada*		-2.7%	Jul
EPS, % yoy		41.0	Jul
Trailing P/E		12.5	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

Like other DM economies, Canada has had to grapple with the highest inflation readings in 40 years. However, the Bank of Canada has wasted little time in reacting and, having begun to tighten rates in March, raised the pace of rate hikes to 50bps in April and June, accelerating to a full 100bps in July. This has brought the overnight lending rate to 2.50%, the midpoint of the range the BoC considers neutral. According to the BoC, this aggressive frontloading will obviate the need for rates to rise significantly above neutral. However, with inflation expectations rising fast and year-end CPI still projected at 7.5% (it recorded 8.1% yoy in June), the BoC will likely raise rates further.

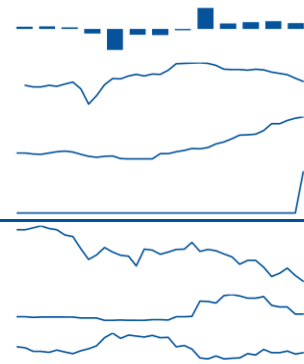
As a result, home sales have fallen in four straight months through June and have returned to the pre-pandemic trend. While sales have declined sharply, the rate of house price gains has remained strong on an annual basis, although the pace has moderated from earlier months. Yet, overall growth in Canada has remained solid in the first half of the year, in contrast to the US, rising 4.6% annualized in Q2 according to an advance release. Yet, both consumer confidence and business sentiment have slipped for several months. PMIs have also softened over the past three months but, at 52.5, remain solid. Importantly, the unemployment rate remains at an all-time low of 4.9%, even as employment softened a bit (due to a drop in the participation rate). Indeed, tight labor markets have contributed to a sharp rise in wages, with average hourly earnings rising at a pace of over 5%.

Market Strategy: Despite the strong growth outturn and support for activity in the form of elevated energy prices, Canadian equities remain attractively priced. The forward P/E ratio of the MSCI Canada stands at a 23% discount to MSCI ACWI, significantly cheaper than its five-year average of 10%. This reflects a sharp rise in earnings expectations, which have increased by 11% over the past six months. We thus retain our *overweight* allocation.

Eurozone

UW (Global and Global ex-US index)

Rate increases and energy supply disruptions will likely tip the economy into recession before year-end.



	3Y history	Latest	
GDP, % yoy		4.0	Q2
PMI, index		49.8	Jul
CPI, % yoy		8.9	Jul
Policy rate, %		0.50	Jul
MSCI Eurozone*		-3.4%	Jul
EPS, % yoy		18.0	Jul
Trailing P/E		17.1	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

Europe continues to face the greatest risk of a deep recession as the possibility of energy supply disruption rises and has gradually begun to materialize. In that, the region is different from other economies such as the US, where the possibility of a recession is primarily the policy-induced consequence of the fight against inflation. This stands in stark contrast to the outlook at the start of the year: strong momentum in a post-pandemic recovery, easing supply bottlenecks, robust private sector fundamentals, strong labour market conditions and the financial support of the EU recovery fund. However, the resurgence of Covid variants, the recurrence of supply bottlenecks and shortages and eventually the geopolitical shock of the Ukraine invasion altered the Eurozone's trajectory dramatically. Gas supply disruptions, a US recession and the Italian political upheaval (PM Draghi's resignation) all weigh on the outlook. Central bank tightening in response to the inflation shock represents yet another headwind.

Inflation has continued its relentless ascent, reaching ever new highs. In July, a 0.7% monthly gain resulted in a headline advance of 8.9% yoy in CPI. The increase reflected both strong gains in core prices (up 0.3% mom, 4.0% yoy), split almost evenly between goods and services prices, as well as a strong rise in food prices (energy prices declined during the month). While inflation is expected to peak before year-end (barring further unforeseen shocks), it will likely not have slowed down significantly. A sharper deceleration will have to await 2023.

The ECB rightly concluded that it could no longer delay the onset of the monetary tightening cycle, even if it carried cyclical and macro risks. At its July meeting, the ECB raised its main refinancing rate by a larger-than-signalled 50bps to 0.5% and its deposit rate from -0.5% to 0%. However, President Lagarde was at pains to point out that the larger hike did not signal a higher end-point for the cycle, but that the ECB was instead frontloading the hikes. In addition, net asset purchases under the PEPP ended in March and as of July 1 the ECB also terminated net purchases under the APP. This leaves the ECB balance sheet at Eur8.8 trn, including Eur2.1 trn in liquidity measures and Eur5.0 trn in assets purchased. Most importantly though, the ECB announced the creation of a new Transmission Protection Instrument (TPI), designed to ward off the widening of peripheral country yield spreads. Indeed, the Italy-Germany 10yr BTP-Bund spread had risen as high as 242bps in June, equivalent to 87% of its 2020 peak or 74% of its 2018 peak. While the TPI has not yet been activated, it did provide the ECB with the room to proceed with the larger 50bps hike. The TPI is of unlimited size, allows the purchase of bonds with maturities between one and 10 years, imposes conditionality on participating countries and requires sterilization. To be eligible, a country needs to 1) comply with the EU fiscal framework (i.e. not be subject to an excessive deficit procedure), 2) exhibit an absence of severe macroeconomic imbalances (i.e. not be subject to an excessive-imbalance procedure), and 3) demonstrate fiscal sustainability, based on debt-sustainability analyses by the European Commission, the ESM and the IMF. These are important requirements, but they are less stringent than those of the OMT program initiated in 2012, which was never used. As a result, the TPI may be more likely to see action, but its criteria are also more likely to be fudged.

Meanwhile, the Eurozone experienced a strong recovery as it ended mobility restrictions, with GDP growth accelerating to 0.7% qoq in Q2, equivalent to 4.0% yoy. At the same time, the unemployment rate fell to a historical low of 6.6%. However, consumer sentiment has dropped sharply since the invasion of Ukraine and now stands at a historical low. As a result, retail sales also slipped into outright contraction. Business sentiment witnessed a more modest decline so far and remains above its long-term average. But the euro area composite PMI dropped to 49.8 in July, continuing its deceleration and signalling slowing, though still robust, growth in Q3.

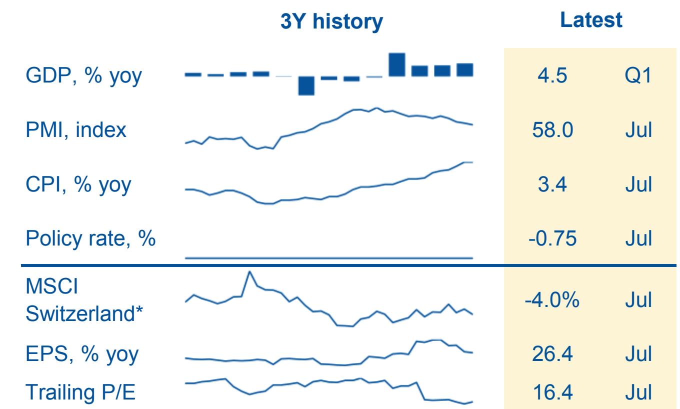
In the face of recurrent disruptions to the gas supply, allegedly due to maintenance work carried out by Russia, the EU Council has agreed on a gas savings plan ahead of the winter. It proposes a voluntary gas demand reduction target of 15% from August 2022 to March 2023, focused on industry. It also aims to refill 80% of gas storage facilities by November 2022. Shortfalls in savings by individual member countries can be offset by excess savings by others, in the spirit of European solidarity.

Market Strategy: While the Eurozone has stood out with particularly attractive valuations for some time, it is also subject to unique downsides. With gas supply through NordStream 1 already at a mere 20% of capacity, Eurozone economies will likely face energy rationing before long. Additional supply disruptions during the winter appear likely, further denting activity and, through the impact on disposable income, private consumption. In addition, the ECB faces fragmentation risks if its acts too aggressively in fighting against inflation. We maintain our *underweight* recommendation as a result.

Switzerland

UW (Global and Global ex-US index)

A weak growth outlook and expensive valuations bode ill for Swiss equities.



**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

Switzerland experiences many of the same developments its peers do, a slowing growth momentum and a rise in inflation. Following a short-lived rebound in April in the wake of the post-pandemic reopening, the KOF leading economic indicator has been in near-uniform decline since its May 2021 peak, dropping to a post-pandemic low in July. The composite PMI has witnessed a similar decline but, at 58, remains solidly in expansionary territory. Yet, as elsewhere, labor markets remain tight as the unemployment rate dropped to an all-time low just below 2.0% in July.

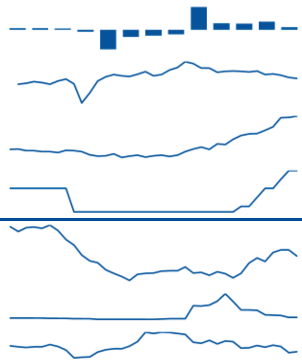
In the face of supply bottlenecks, rising food and energy prices, inflation has accelerated successively since it touched a low in June 2020. Since the beginning of the year, it has risen more rapidly, from 1.5% to 3.4% yoy in July. While the Swiss National Bank (SNB) may have been helped by the 5% appreciation of the franc against the euro since end-April, it nevertheless felt the need to tighten monetary policy in response to the rise in inflation: as a result, it lifted the rate by 50bps in June, from -0.75% to -0.25%. The SNB is likely to move at a slower pace than the ECB, but is nevertheless expected to reach positive territory by year-end and keep raising rates over the next two years.

Market Strategy: Economic growth is expected to decline from an estimated 2.5% in 2022 to 1.5% in 2023, according to Consensus. While positive, this is the second-worst growth outlook in DM after the UK. As forward earnings have tumbled over the past three months, Swiss equities have become the most highly valued ones in DM space with a 11% P/E premium over the MSCI ACWI. As a result, we remain *underweight* Switzerland.

United Kingdom

NW (Global and Global ex-US index)

Soaring inflation calls for a strong monetary response, which in turn is likely to cause a sharp recession.



	3Y history	Latest	
GDP, % yoy		8.7	Q1
PMI, index		52.1	Jul
CPI, % yoy		9.4	Jun
Policy rate, %		1.25	Jul
MSCI UK*		-1.8%	Jul
EPS, % yoy		27.0	Jul
Trailing P/E		14.8	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

In the face of rapidly rising inflation, the Bank of England (BoE) was one of the first central banks to kick off the tightening cycle, with an early hike in December 2021 (the RBNZ was the first in the G10 in October). However, despite a series of rate increases since, including a 50bps hike in August, the base rate stands at only 1.75%, below the current rates in the US, Canada, New Zealand and Australia.

Yet, what made the BoE's most recent MPC meeting in August noteworthy was not the large scale of the rate hike, but the accompanying economic forecasts. Indeed, the BoE forecast the economy to enter a recession by Q4 of this year and to keep contracting throughout 2023. It expects inflation at over 13% yoy by year-end 2022 and at 5.9% yoy at end-2023, at constant interest rates. If interest rates were to follow the path set by markets, the base rate would peak at 3.1% in May 2023 and inflation would end the year at a slightly lower 5.5% yoy. The BoE's gloomy forecast of a 1.4% contraction in 2023 contrasts with the Bloomberg consensus view of a 0.6% expansion, which perhaps incorporates the prospect of fiscal easing under a new Conservative leadership (which the BoE, by default, does not). Unemployment would rise only by 100bps to 4.7% under the BoE scenario, but reach 6% by 2025.

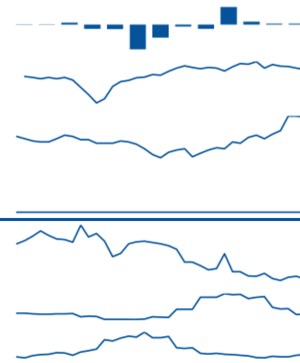
So far, composite PMI has held up at a robust 52.1, whereas retail sales have softened since spring. House prices also weakened, but labor markets remain tight, with unemployment at 3.6% and earnings growth accelerating.

Market Strategy: UK equities underperformed the MSCI ACWI by 180bps during the May-July period, despite elevated commodity prices, a weak exchange rate and attractive valuations. While the BoE may be too pessimistic in its cyclical outlook given the likelihood of fiscal support from a new government, the slowdown is nevertheless likely to be significant as the UK's high inflation rates require a sharper monetary tightening than elsewhere. Earnings expectations appear at a stretch, putting valuations at increased downside risk. We thus keep our *neutral* allocation.

Japan

OW (Global and Global ex-US index) ↑

Muted inflation, the absence of rate hikes and a weakening yen support the economic expansion.



	3Y history	Latest	
GDP, % yoy		0.4	Q1
PMI, index		52.1	Jul
CPI, % yoy		2.4	Jun
Policy rate, %		-0.10	Jul
MSCI Japan*		0.9%	Jul
EPS, % yoy		-13.0	Jul
Trailing P/E		15.2	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

Unlike many other countries, Japan is experiencing its worst wave of COVID-19 infections in July/August as the sub-variant BA.5 has affected it more than any other country (over 200,000 known cases per day). Cases are mostly affecting the young (children and under 30 year olds) and are believed to be due to the fading effectiveness of the vaccination, which took place several months ago, widespread mask-wearing notwithstanding. While Japan has never imposed a generalized national lockdown, local curfews have been imposed and disruptions have already occurred to train operations due to staff shortages and some manufacturers had to suspend shifts.

While Japanese growth has generally languished in comparison to its peers, it has been less impacted during the recent slowdown across DMs. Instead, Japanese manufacturing, vehicle production in particular, has benefited from the gradual reopening of suppliers in China, leading to a bounce in industrial production. Consumption also recovered in the course of the reopening in Q2, but dropped slightly in June. The unemployment rate remains above its pre-pandemic lows, but remains very moderate at 2.6%. Yet, a rising offers-to applicants ratio suggests that the labor market is tight and employment will likely rise further.

Inflation has risen sharply by Japanese standards, but at 2.4% yoy in June, it remains relatively low by international standards. The yen eased some 20% against the US dollar from the start of the year until mid-July, but has given back ca. 5% since. Against this background, the BoJ is likely to leave its monetary stance unchanged for an extended period of time.

Market Strategy: Although it experiences a low run-rate of growth, unlike its peers, the Japanese economy is not facing rising domestic interest rates, given that inflation remains relatively low. This will likely allow Japan to evade a recession. Given the significantly weaker exchange rate and moderately attractive valuations, we upgrade Japan to *overweight*.

Australia

NW (Global and Global ex-US index) ↓

Demand for Australia's commodity exports is likely to weaken as both DM and Chinese growth moderate.

	3Y history	Latest	
GDP, % yoy		3.3	Q1
PMI, index		55.7	Jul
CPI, % yoy		6.1	Jun
Policy rate, %		1.85	Jul
MSCI Australia*		-5.4%	Jul
EPS, % yoy		37.4	Jul
Trailing P/E		15.5	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

The commodity price boom has allowed Australia to weather the recent global slowdown better than other DM economies so far, even if it is now beginning to ease. Nevertheless, the overall picture is similar: Growth is slowing and inflation rising.

Headline inflation reached 6.1% yoy in June, with core CPI (trimmed mean) also rising rapidly, to 4.9% yoy in the same month. Australia's PMI remains in expansionary territory (51.1 for the composite measure), but has been softening over the past three months. The unemployment rate has declined to a multi-decade low of 3.5% in July, mirroring developments in other DM economies. Retail sales have begun to soften as the RBA began to tighten interest rates.

Indeed, the RBA started to raise rates only in May, but then moved swiftly in 50 bps steps in June, July and August. This has brought the cash rate to 1.85% by August, still deeply in negative territory in real terms and far from the 2.50% level the RBA considers as neutral. Yet, the RBA's actions have already affected the red-hot housing sector as new housing loan commitments have fallen and new building approvals have declined. While the economy is still expected to grow 3-4% this year, consensus expectations for next year have declined to 2.5% as lower demand for resources is expected to weigh on Australian exports.

Market Strategy: A 13% rise in forward earnings estimates over the past six months, together with a 5.4% point underperformance of the MSCI ACWI leaves valuations for Australian equities at attractive levels. However, as both DM and Chinese demand for Australia's commodity exports are likely to slow over the next six months, we downgrade our allocation to Australia to *neutral*.

Emerging Markets

NW (Global and Global ex-US index)

Slowing global growth represents yet another headwind to EM, despite elevated commodity prices.

	3Y history	Latest	
GDP, % yoy		4.3	Q1
PMI, index		50.8	Jul
CPI, % yoy		5.2	Jun
Policy rate, %		5.41	Jul
MSCI EM*		-4.5%	Jul
EPS, % yoy		9.8	Jul
Trailing P/E		11.0	Jul

**US$ total return relative to MSCI ACWI. Latest is three-month return. Economic indicators are GDP-weighted with the exception of PMI, which is value-added-weighted.*

Source: Bloomberg

Many emerging markets (China being a notable exception) entered the monetary tightening cycle to counter rising inflation long before the US and most DM countries. As the impact of external shocks begins to fade and the effect of sharply higher domestic interest rates is making itself felt, EMs will also be able to exit from their tightening stance earlier, supporting the resumption of growth. Indeed, the IMF expects the growth differential between EM and DM to expand to 2.5% points in 2023, compared to a mere 1.1% points in 2022.

A crucial headwind countering this domestic support is the likely weakening of demand in export destinations. This will negatively affect exporters of both manufactured goods (such as in North Asia) as well as exporters of raw materials (such as Brazil or South Africa) eventually. Chronic geopolitical shocks could help those economies that also export oil and gas (Brazil, Mexico, Gulf countries), without necessarily hurting those which import energy, such as India and Turkey, which have secured discounted prices from Russia while it is under sanctions. However, while there is some visibility surrounding the economic impact of the war in Ukraine, a looming conflict over Taiwan carries potentially much higher risks for the global economy, given the weight and importance of both China and Taiwan in global industry (not to speak of their combined weight of almost 45% in the MSCI EM index). The recent visit by US Speaker Nancy Pelosi, Chinese military drills, trade sanctions and the new Taiwan Policy Act passed by Congress in August point to a sharp deterioration in Sino-US relations.

Market Strategy: Despite a decline in earnings expectations, emerging markets have cheapened relative to the MSCI ACWI as they underperformed the index by 450bps during the May-July period. However, in light of tighter financial conditions (higher yields, stronger US dollar) and sharply slowing US, European and Chinese economies, downside risks still outweigh the upside. We thus retain our *neutral* allocation. ◆

INTERNATIONAL EQUITY - KEY ECONOMIC AND FINANCIAL INDICATORS

		Macroeconomic Data													Market Performance				Forecast†	
		% change on year ago				Latest 12 months														
	Developed Market	Annual GDP Growth	Quarterly GDP Growth QoQ*	Industrial Production Growth	Consumer Price Index	Budget Balance % of GDP 2022F**	Trade Balance	Current Account Balance	Foreign Reserves 2022 Latest	Foreign Reserves 2021 Year Ago	Currency vs $ 2022 Latest	Currency vs $ 2021 Year ago	Short-Term Interest Rates	Sovereign Rating S&P	% MSCI ACWI Net***	Stock Market Index (MSCI ACWI Net) US$	Change since 12/31/21 US$	Change since 12/31/21 Local	2022 P/E Forecast	3 month Currency vs $ +/-
		%	%	%	%		$ Bns	$ Bns	$ Bns	$ Bns			%		Jul. 29, 2022	Jul. 29, 2022	%	%		
Overweight	CANADA	5.6	3.1	19.0	8.1	-2.2	18.9	4.6	79.46	77.01	1.28	1.25	3.13	AAA	8.19	7166.08	-7.58	-6.25	11.8	+
	JAPAN	0.4	-0.5	-3.1	2.4	-6.5	-85.9	82.5	1192.91	1294.26	133.55	110.40	-0.12	A+	14.16	6687.05	-15.72	-2.19	12.8	+
Neutral	AUSTRALIA	3.3	3.2	-1.0	6.1	-2.8	99.0	46.7	34.45	37.30	0.71	0.73	0.30	AAA	5.03	4690.30	-6.42	-2.51	13.8	-
	DENMARK	6.3	-2.0	26.3	8.7	0.7	2.7	39.0	66.00	68.62	7.24	6.34	-0.10	AAA	1.79	43503.90	-10.98	-0.61	16.3	+
	EM****	4.3	n.a.	3.8	5.2	-4.0	749.3	457.9	7539.74	7846.33	1666.64	1725.18	5.41	n.a.	28.61	499.82	-17.83	-13.59	11.3	n.a.
	ISRAEL	9.0	-1.8	19.4	4.4	-1.7	-40.8	56.1	193.38	199.71	3.24	3.22	1.74	AA-	0.49	144.66	-20.90	-16.22	7.9	-
	NEW ZEALAND	1.2	-0.8	14.7	7.3	-5.2	-7.2	-16.0	9.13	12.25	0.64	0.70	2.87	AA+	0.12	534.36	-19.01	-11.57	38.7	+
	NORWAY	3.7	-2.4	-2.3	6.8	5.0	109.7	97.8	69.60	77.55	9.56	8.84	2.28	AAA	0.53	10315.01	-0.45	9.13	7.7	-
	SINGAPORE	4.4	-0.2	2.2	6.7	-0.5	130.5	79.7	304.96	393.93	1.37	1.36	2.44	AAA	0.93	1062.19	-13.31	-11.34	17.5	-
	SWEDEN	3.0	-3.2	1.7	8.5	-0.4	-0.3	30.5	42.53	44.92	10.17	8.68	1.49	AAA	2.26	26892.81	-26.01	-16.69	17.1	+
	UK	2.9	-0.4	2.4	9.4	-4.4	-113.0	-132.3	108.20	130.95	1.21	1.38	2.15	AA	9.94	6888.20	-5.43	5.25	10.0	-
Underweight	SWITZERLAND	4.5	2.0	6.8	3.4	-0.5	57.0	79.2	887.45	1018.81	0.94	0.92	-0.75	AAA	6.60	16047.19	-16.23	-12.44	17.5	-
	FRANCE	4.2	2.0	1.4	6.1	-5.5	-135.7	-9.5	52.23	54.11	1.03	1.17	2.00	AA	7.17	7223.80	-17.17	-7.62	12.1	+
	GERMANY	1.4	0.0	-0.4	7.5	-3.5	126.0	230.2	37.31	37.06	1.03	1.17	0.08	AAA	4.79	5223.48	-27.00	-18.59	10.4	+
	HONG KONG	-1.3	4.1	-1.2	1.8	-2.2	-49.0	94.0	447.11	491.50	7.84	7.78	2.28	AA+	1.94	65020.36	-6.44	-5.82	14.9	-
	NETHERLANDS	6.7	1.6	6.2	10.3	-2.7	65.2	75.1	4.79	5.86	1.03	1.17	0.04	AAA	2.73	20787.89	-26.12	-17.83	21.6	+
	ITALY	4.6	4.2	-1.2	7.9	-5.8	4.0	18.7	46.41	48.53	1.03	1.17	1.47	BBB	1.40	766.61	-24.08	-15.32	7.5	+
	SPAIN	6.3	4.5	6.4	10.8	-5.4	-19.9	0.7	52.60	55.92	1.03	1.17	0.04	A	1.47	2708.01	-13.57	-3.60	10.5	+
	BELGIUM	3.3	0.8	11.7	9.6	-4.8	-17.5	-4.0	10.72	10.60	1.03	1.17	0.04	AA	0.60	7574.33	-17.72	-8.23	17.8	+
	FINLAND	3.7	0.8	6.9	7.8	-2.5	-9.4	-4.6	7.59	8.11	1.03	1.17	0.00	AA+	0.62	1128.92	-18.73	-9.36	15.9	+
	IRELAND	11.0	50.7	6.5	9.1	-0.5	78.6	-28.5	1.12	0.97	1.03	1.17	0.39	AA-	0.36	349.94	-31.16	-23.22	15.3	+
	AUSTRIA	9.5	2.0	4.6	9.2	-3.0	-26.1	-0.1	8.55	8.53	1.03	1.17	0.04	AA+	0.11	3082.49	-32.83	-25.08	5.6	+
	PORTUGAL	6.9	-0.8	3.7	9.1	-2.2	-29.1	-5.0	3.78	7.03	1.03	1.17	0.04	BBB	0.15	195.36	0.60	12.20	18.9	+
	EUROZONE	4.0	2.8	2.4	8.9	-4.5	1.7	4.1	306.94	324.22	1.03	1.17	0.08	n.a.	19.49	333.45	-21.75	-12.76	11.6	+

*Note: All data shown are as at August 12, 2022 unless otherwise stated. S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. **Bloomberg consensus forecast.*
****MSCI All Country World ex USA Index Daily Total Return Net. ****IP data from CPB; Currency level from MSCI EM Currency Index; GDP, CPI, budget and interest rate data from Bloomberg.*
†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.

Source: Bloomberg, CLIM

GLOBAL EQUITY - KEY ECONOMIC AND FINANCIAL INDICATORS

	Developed Market	Annual GDP Growth	Quarterly GDP Growth QoQ*	Industrial Production Growth	Consumer Price Index	Budget Balance % of GDP 2022F**	Trade Balance	Current Account Balance	Foreign Reserves 2022 Latest	Foreign Reserves 2021 Year Ago	Currency vs $ 2022 Latest	Currency vs $ 2021 Year ago	Short-Term Interest Rates	Sovereign Rating S&P	% MSCI ACWI Net***	Stock Market Index (MSCI ACWI Net) US$	Change since 12/31/21 US$	Change since 12/31/21 Local	2022 P/E Forecast	3 month Currency vs $ +/-
		Macroeconomic Data													Market Performance				Forecast†	
		% change on year ago				Latest 12 months														
		%	%	%	%		$ Bns	$ Bns	$ Bns	$ Bns			%		Jul. 29, 2022	Jul. 29, 2022	%	%		
Overweight	UNITED STATES	1.6	-0.9	4.2	8.5	-4.5	-979.1	-940.9	36.27	42.39	1.00	1.00	3.47	AA+	61.97	11445.40	-13.97	-13.97	18.5	uc
	CANADA	5.6	3.1	19.0	8.1	-2.2	18.9	4.6	79.46	77.01	1.28	1.25	3.13	AAA	3.11	7166.08	-7.58	-6.25	11.8	+
	JAPAN	0.4	-0.5	-3.1	2.4	-6.5	-85.9	82.5	1192.91	1294.26	133.55	110.40	-0.12	A+	5.39	6687.05	-15.72	-2.19	12.8	+
Neutral	AUSTRALIA	3.3	3.2	-1.0	6.1	-2.8	99.0	46.7	34.45	37.30	0.71	0.73	0.30	AAA	1.91	4690.30	-6.42	-2.51	13.8	-
	DENMARK	6.3	-2.0	26.3	8.7	0.7	2.7	39.0	66.00	68.62	7.24	6.34	-0.10	AAA	0.68	43503.90	-10.98	-0.61	16.3	+
	EM****	4.3	n.a.	3.8	5.2	-4.0	749.3	457.9	7539.74	7846.33	1666.64	1725.18	5.41	n.a.	10.88	499.82	-17.83	-13.59	11.3	n.a.
	ISRAEL	9.0	-1.8	19.4	4.4	-1.7	-40.8	56.1	193.38	199.71	3.24	3.22	1.74	AA-	0.18	144.66	-20.90	-16.22	7.9	-
	NEW ZEALAND	1.2	-0.8	14.7	7.3	-5.2	-7.2	-16.0	9.13	12.25	0.64	0.70	2.87	AA+	0.04	534.36	-19.01	-11.57	38.7	+
	NORWAY	3.7	-2.4	-2.3	6.8	5.0	109.7	97.8	69.60	77.55	9.56	8.84	2.28	AAA	0.20	10315.01	-0.45	9.13	7.7	-
	SINGAPORE	4.4	-0.2	2.2	6.7	-0.5	130.5	79.7	304.96	393.93	1.37	1.36	2.44	AAA	0.35	1062.19	-13.31	-11.34	17.5	-
	SWEDEN	3.0	-3.2	1.7	8.5	-0.4	-0.3	30.5	42.53	44.92	10.17	8.68	1.49	AAA	0.86	26892.81	-26.01	-16.69	17.1	+
	UK	2.9	-0.4	2.4	9.4	-4.4	-113.0	-132.3	108.20	130.95	1.21	1.38	2.15	AA	3.78	6888.20	-5.43	5.25	10.0	-
Underweight	SWITZERLAND	4.5	2.0	6.8	3.4	-0.5	57.0	79.2	887.45	1018.81	0.94	0.92	-0.75	AAA	2.51	16047.19	-16.23	-12.44	17.5	-
	FRANCE	4.2	2.0	1.4	6.1	-5.5	-135.7	-9.5	52.23	54.11	1.03	1.17	2.00	AA	2.73	7223.80	-17.17	-7.62	12.1	+
	GERMANY	1.4	0.0	-0.4	7.5	-3.5	126.0	230.2	37.31	37.06	1.03	1.17	0.08	AAA	1.82	5223.48	-27.00	-18.59	10.4	+
	NETHERLANDS	6.7	1.6	6.2	10.3	-2.7	65.2	75.1	4.79	5.86	1.03	1.17	0.04	AAA	1.04	20787.89	-26.12	-17.83	21.6	+
	ITALY	4.6	4.2	-1.2	7.9	-5.8	4.0	18.7	46.41	48.53	1.03	1.17	1.47	BBB	0.53	766.61	-24.08	-15.32	7.5	+
	SPAIN	6.3	4.5	6.4	10.8	-5.4	-19.9	0.7	52.60	55.92	1.03	1.17	0.04	A	0.56	2708.01	-13.57	-3.60	10.5	+
	HONG KONG	-1.3	4.1	-1.2	1.8	-2.2	-49.0	94.0	447.11	491.50	7.84	7.78	2.28	AA+	0.74	65020.36	-6.44	-5.82	14.9	-
	FINLAND	3.7	0.8	6.9	7.8	-2.5	-9.4	-4.6	7.59	8.11	1.03	1.17	0.00	AA+	0.24	1128.92	-18.73	-9.36	15.9	+
	BELGIUM	3.3	0.8	11.7	9.6	-4.8	-17.5	-4.0	10.72	10.60	1.03	1.17	0.04	AA	0.23	7574.33	-17.72	-8.23	17.8	+
	IRELAND	11.0	50.7	6.5	9.1	-0.5	78.6	-28.5	1.12	0.97	1.03	1.17	0.39	AA-	0.14	349.94	-31.16	-23.22	15.3	+
	PORTUGAL	6.9	-0.8	3.7	9.1	-2.2	-29.1	-5.0	3.78	7.03	1.03	1.17	0.04	BBB	0.06	195.36	0.60	12.20	18.9	+
	AUSTRIA	9.5	2.0	4.6	9.2	-3.0	-26.1	-0.1	8.55	8.53	1.03	1.17	0.04	AA+	0.04	3082.49	-32.83	-25.08	5.6	+
	EUROZONE	4.0	2.8	2.4	8.9	-4.5	1.7	4.1	306.94	324.22	1.03	1.17	0.08	n.a.	7.41	333.45	-21.75	-12.76	11.6	+

*Note: All data shown are as at August 12, 2022 unless otherwise stated. S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. **Bloomberg consensus forecast. ***MSCI All Country World Index Daily Total Return Net. ****IP data from CPB; Currency level from MSCI EM Currency Index; GDP, CPI, budget and interest rate data from Bloomberg.*
†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.

Source: Bloomberg, CLIM

CITY OF LONDON
Investment Management Company Limited

Contacts

Macroeconomic Analysis

Michael Hart, London Office
Phone: 011 44 207 711 1558
E-Mail: michael.hart@citlon.co.uk

Yasemin Engin, London Office
Phone: 011 44 207 711 1551
E-Mail: yasemin.engin@citlon.co.uk

London Office
77 Gracechurch Street
London EC3V 0AS
United Kingdom
Phone: 011 44 20 7711 0771
Fax: 011 44 20 7711 0774
E-Mail: info@citlon.co.uk

Philadelphia Office
The Barn, 1125 Airport Road
Coatesville, PA 19320
United States
Phone: 610 380 2110
Fax: 610 380 2116
E-Mail: info@citlon.com

Singapore Office
20 Collyer Quay
10-04
Singapore 049319
Phone: 011 65 6236 9136
Fax: 011 65 6532 3997

Website

www.citlon.com