ARGUS
Wealth Management

Macro & Market Outlook

as at March 31, 2022

Central Banks

(decrease by 2*)

- The US Federal Reserve has become significantly more hawkish and clearly erred in its initial estimate of inflation. It is now behind the curve and looking to aggressively catch up. The outlook for rate increases has shifted from three increases of 0.25% to at least three of 0.50%. Economist are projecting a neutral Fed Funds rate of 2.5% by year end.
- At the same time as the Fed is increasing rates, it is also reducing its quantitative easing program, further restricting monetary policy. Inflation has worked its way into way into wage expectations, and the risk is that inflation becomes structural and stickier. Engineering a soft landing is possible – where growth and inflation revert to long-term trends without a recession – but has rarely occurred. The potential to tighten too much or too little is high.
- As the 10-year bond yield increases (now around 3%), bonds become more attractive as an investment while simultaneously increasing the discount rate used to value future earnings.
- The US dollar is at its highest level in two decades (+7% since the beginning of the year). The greenback is likely to continue strengthening as the rest of the world has not kept up in matching interest rate hikes, in addition to concerns over global economic growth and a possible recession.

Liquidity & Credit

(decrease by 1*)

- Increased market volatility and a widening of credit spreads have caused financial conditions to deteriorate, however, financial conditions are only modestly negative.
- The US yield curve is flat, with negative real interest rates, indicating an anticipated slowdown in growth.
- While the cost of credit and the cost of capital has moved higher, on a historical basis, it is still inexpensive for corporations to borrow and access capital.
- Mortgage rates have moved above 5%, the highest since 2009.

Economics

(decrease by 1*)

- The war in Ukraine is a regional war with global consequences. Supply chain disruptions for commodities and the impact of sanctions are far reaching and have inflationary consequences in a world already trying to contain price pressures.
- Europe and Japan are likely to be more heavily impacted from higher commodity prices and weakening growth in China.
- US GDP decreased by 1.4% in the first quarter, the first decline since the very beginning of the pandemic. The decline was caused by an unusually large portion of consumption being filled by inventories or imports rather than American output.
- On the positive side, the US consumer's balance sheet is still healthy. Along with the removal of Covid restrictions, consumers are spending on homes, automobiles, major appliances, and vacations.
- Private demand growth of 3.7% is faster than the economy's potential growth of 2%. The result is inflationary when the economy is at operating at capacity and unemployment is at 3.6%.
- The western world is learning to live with Covid, with each successive variant having less of a psychological impact on behaviour. However, China has implemented stricter lockdowns in many parts of the country, which might have a greater, negative impact to the global economy than during the initial stages of the pandemic. China will step up its efforts to stimulate its own economy as strict lockdown measures are impacting growth. President Xi Jinping wants to be appointed for a third term in the Fall. Until that time, China's Communist Party does not want any (financial or social) unrest.

Legend:

NEG. NEUTRAL POS.

* Change from the previous 12-month outlook.

** The weights to calculate the Overall rating are determined by Argus Wealth at its discretion based on market conditions.

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Valuations (increase by 1*)	• YTD markets have adjusted to the increasing cost of capital by reducing multiples from their earlier extremes. • While US valuations are still at elevated levels, on a global basis, P/E levels have declined to their long-term averages. Some regions are particularly attractive (e.g. China, the UK and Japan). • Earnings growth is likely to be challenged, but initial results for the first quarter of 2022 show a high number of companies exceeding expectations.
Sentiment (unchanged*)	• Consumer confidence in Europe has noticeably soured with the impact of the invasion of Ukraine being felt as natural gas prices have surged (briefly touching the equivalent of $600 per barrel). • The US consumer is still spending. While overall confidence has come down, it is still positive. • Institutional investor sentiment is neutral to slightly negative.
Technical (US Large Cap) (decrease by 2*)	• Short-term, the S&P 500 is trading along support but has downward pressure. If the market breaches support, it could decline to 3800, about 9% below current levels. • Volatility as measured by the VIX remains at elevated levels of 30.
Overall (decrease by 4**)	Conclusion: A lot has changed in the last three months. Our decline to an overall rating of minus one reflects these changes. The world is bifurcated with investors in the US believing that the Fed will regain control of inflation without inducing a recession, while the rest of the world trying to maneuverer among rampant inflation, an unprovoked regional conflict, soaring commodity prices and new strains of Covid. In the short term, this is likely to keep volatility high and put pressure on equities, interest rates and credit spreads. Corporations have adapted rapidly to the changes, and the outlook for earnings growth is just under 11% in the US for 2022. If this is achieved, market dips are attractive entry points. If earnings falter, investors will seek a new intrinsic value that will likely be at lower levels.

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