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March 2022
Quarter in review

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RUSSIA SHOCKS THE WORLD

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After a strong 2021, the first quarter of 2022 has shocked markets. Equities and bonds both fell early in the quarter on inflation-combative guidance from the US Federal Reserve (Fed). Concerns around the economic implications of Russia's invasion of Ukraine added further volatility through February and early March due to Russia's vital role in global commodity markets. Brent crude oil spiked to $139 per barrel (/bbl), while European gas prices also saw new highs. Through March, bonds fell as yields rose to their highest levels in several years on persistently high inflation and increased interest rate expectations.

Russia-Ukraine crisis

Since Russia launched its invasion of Ukraine in the latter days of February, we have seen significant volatility in financial markets on top of a global economy already struggling with inflationary pressures. Higher commodity prices and supply disruption have impacted global growth, with consensus forecasts for the year revised down by almost 1% to expected growth in 2022 of 3.4%. The overall impact of the crisis on broader equity markets has been limited by the fact that Russia and Ukraine account for less than 2% of global GDP, while exposures to Russian assets within the global financial system are modest.

Energy shock

The implications of the war have been felt globally and the clearest economic impact can be seen in commodity markets, especially in oil and gas. Brent crude oil and natural gas prices were extremely volatile over the period, spiking early in March before falling back, with brent crude ending the month at $103/bbl and European gas prices at €121 per megawatt hour. The US announced a release of 180 million barrels of oil from strategic reserves over a six-month period. The gas situation in Europe is yet more precarious, as Russian supplies account for almost 25% of European gas usage, which is not easily replaced from other sources. Europe has announced plans to reduce its dependence on Russian gas and diversify to other producers with deals announced to increase supplies of LNG (liquefied natural gas) from the US and Qatar.

Monetary meanderings

The notion that inflation was transitory finally fell out of favour at the beginning of the year; economic data began to portray a much broader set of underlying inflation drivers. The energy shock stemming from the war in Ukraine then compounded these pressure. US, Eurozone, and UK inflation rose to 7.9%, 5.9% and 6.2% respectively. These readings led many central banks to reassess their accommodative monetary policy which had been in place since the Covid-19 pandemic began. In the US, the Fed guided towards a faster pace of interest rates rises and balance sheet reduction. The European Central Bank (ECB) maintained its sanguine view on inflation early in the quarter, with many policymakers still describing inflation as transitory in nature. This view began to shift when inflation numbers for January surprised to the upside and, at its March meeting, the ECB announced a more rapid reduction of asset purchases.

CHART OF THE QUARTER

Global Equities

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2022

MARKET ROUND-UP

Equities

Over the quarter, the MSCI AC World equity benchmark fell -4.6% (-3.2% in euro terms) as centrals banks became increasingly concerned with combating inflation, while Russia's invasion of Ukraine hit global growth. The US fell -5.2% (-3.1% in euros). Europe underperformed, falling -8.1% (-7.8% in euros), as its proximity to the war in Ukraine and its exposure to Russian energy exports led to growth downgrades and higher inflation. Japan fell -1.4% (-4.4% in €) as the Bank of Japan maintained an accommodative policy stance and the yen weakened, which was supportive of exporters. The Pacific Basin outperformed, rising 1.7% (6.1% in €), and benefited from a positive commodity price backdrop. Emerging markets were down -6.1% (-4.9% in €), negatively impacted by their exposure to Russian assets amid the war in Ukraine

Bonds

Global bonds fell over the quarter as yields rose considerably due to policy pivots from major global central banks and the transitory inflation narrative was finally retired. US 10-year yields rose 83 basis points (bps) from 1.51% to 2.34% as the Fed delivered the first rate hike of the cycle in March, while guiding to 10 to 11 rate hikes by the end of 2023. UK 10-year yields rose 64bps to 1.61%, with the Bank of England announcing the third rate rise of the cycle in March, raising the base rate to 0.75%. Japanese 10-year yields were 15bps higher at 0.22%.

The ICE BofA Merrill Lynch Eurozone > 5-year sovereign bond benchmark fell -7.2% over the quarter, the selloff following rising inflation readings and more inflation-focused central bank policy guidance. 10-year German yields rose to a new recent high of over 0.70% in late March, before settling at 0.55% at quarter end as markets priced multiple ECB rate hikes in 2022. Purchases via the Pandemic Emergency Purchase Programme (PEPP) ended in March, while other asset purchases look set to cease in the third quarter. At the end of March, Italian 10-year spreads against Germany were 149bps, while Spanish spreads were 89bps.

European investment grade (IG) corporate bonds fell -5.3%, with global high yield (HY) credit down -4.5%. Higher sovereign bond yields pulled yields in IG bonds up to 1.54%. In HY, yields rose over 150bps through the quarter to 5.2%. Despite the war in Ukraine, spreads in IG bonds only widened 30bps to 128bps, while high yield spreads were close to 38bps higher at 318bps.

Currencies and commodities

The euro fell to 1.1082 against the US dollar; the dollar benefited from a faster pace of Fed rate rises being discounted by investors, while the euro continued to suffer from uncertainty related to the Ukraine crisis.

Commodities rose 33.1% (36.1% in €) as prices across many key commodities rose sharply amid the war in Ukraine. Russia and Ukraine are key commodity producers and account for 25% of wheat exports globally, while Russia alone accounts for 17% of global gas production and 12% of global oil production. Oil prices are up 33.3% year to date, having peaked close to $140/bbl as the US and UK placed an embargo on Russian oil imports. European gas prices rose significantly through the quarter, given Europe's heavy reliance on Russia for gas imports, which many feared could be cut off because of the ongoing conflict. In the commodity space, the Russia-Ukraine conflict is also impacting fertilisers, industrial metals, precious metals, and grains prices. Russia is a major producer of aluminium, nickel, and palladium, all of which rose sharply on supply concerns and uncertainty around the impact of western sanctions.

Gold rose 5.9% and was supported by safe-haven demand.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	QTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	-18.2	-18.2	17.1
MSCI United Kingdom	4.1	4.1	27.5
MSCI Europe ex UK	-7.8	-7.8	25.4
MSCI North America	-2.7	-2.7	36.6
MSCI Japan	-4.4	-4.4	9.8
MSCI EM (Emerging Markets)	-4.9	-4.9	5.2
MSCI AC World	-3.2	-3.2	28.1
10-Year Yields	**Yield Last Month (%)**	**2020 Yield (%)**	**2019 Yield (%)**
US	2.34	1.51	0.91
Germany	0.55	-0.18	-0.57
UK	1.61	0.97	0.20
Japan	0.22	0.07	0.02
Ireland	1.07	0.24	-0.30
Italy	2.04	1.17	0.54
Greece	2.67	1.34	0.63
Portugal	1.35	0.47	0.03
Spain	1.44	0.57	0.05
FX Rates	**Current**	**2020 Rates**	**2019 Rates**
U.S. Dollar per Euro	1.11	1.14	1.22
British Pounds per Euro	0.84	0.84	0.90
U.S. Dollar per British Pounds	1.31	1.35	1.37
Commodities (USD)	**QTD Return (%)**	**YTD Return (%)**	**2020 Return (%)**
Oil (WTI)	33.3	33.3	55.0
Gold (Oz)	6.3	6.3	-3.4
S&P Goldman Sachs Commodity Index	33.1	33.1	40.4

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2022

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THE ILIM VIEW – LOOKING AHEAD

The outlook for equity markets over the next twelve months is dependent on several factors, including central bank policy, growth, inflation (both expected and realised) and the evolution of the Russia/Ukraine crisis.

Global growth forecasts for 2022 have been revised down to 3.4% but remain well above trend growth of 2.7%. Looking into 2023, some further slowdown is expected, particularly when taking account of the recent flattening of the yield curve and the expected pace of central bank policy tightening in response to rising inflation threats.

While equity markets have fallen over the year to date – and, as a result, absolute valuation levels have declined – price-to-earnings multiples remain above the long-term average. In recent years, equities have consistently remained attractive on a relative valuation basis against bonds given the historically low level of bond yields. With the recent sharp rise in bond yields, this relative valuation support for equities has been removed and equities now appear close to fair value against bonds. Equities, however, are still supported by the persistence of negative real yields.

Given the removal of the undervaluation of equities against bonds, the potential for higher bond yields and possible risks to economic growth, equities appear fair value at current levels with limited upside. If anything, the balance of risks is probably skewed to the downside in an environment of heightened uncertainty and volatility.

While our outlook for equity markets suggests limited upside in the short term, the outlook remains positive over the medium to long term, with upside of approximately 5% annualised expected on a five to 10-year view.

THE MONTH AHEAD

Economic data releases

11 April	GB GDP MoM (March)
12 April	GB balance of trade (November) GB Unemployment Rate (February)
13 April	GB Inflation Rate YoY (March)
14 April	ECB Interest Rate Decision US Retail Sales MoM (March)

Source: Trading Economics. Data is accurate as at 31 March 2022.

Events to watch

10 & 24 April	France – Presidential election
April 14	Euro area – ECB meeting
April 27	Japan – BOJ meeting

Source: BlackRock geopolitical calendar. Data is accurate as at 31 March 2022.

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