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Bulltick Research and Strategy

Kathryn Rooney Vera
Head of Research & Strategy
krooney@bulltick.com
+1 786.871.3758

Gregan Anderson, CFA
Macroeconomic Strategist
ganderson@bulltick.com
+1 786.871.374

Global Cross Asset Strategy:

Stagflation is Now. Recession is Next.

Fed: Hard Landing Is Preferable To Unanchored Inflation

Fed Chair Jerome Powell stressed, both in person and through the FOMC statement, the Federal Reserve's re-discovered commitment to price stability. Now well behind the curve, the Fed has the choice between a 'hard landing' and a 'very hard landing', and is opting, in its own words, to 'front-load' the rate hikes now, in a bid to stave off further un-anchoring of inflation and runaway price pressures. It is also clear that the Fed is concerned about its own institutional credibility and sought to present a more united and unambiguous front against the highest CPI and PCE prints seen in four decades.

We expect that inflation will remain well above target due not only to the domestic dynamics that got us here – high deficit spending, demand stimulation coupled with supply restriction during COVID lockdowns, restrictions on fossil fuel production, etc – but also external dynamics outside of the Fed's control. This most notably includes Chinese supply chain disruptions and energy dynamics due to the war in Ukraine.

The Fed drastically reduced its 2022 GDP forecasts and increased its 2022 inflation forecasts, making stagflation (Bulltick's long held view for this year) its own base case scenario. See table on page 2. Stagflation is now. Recession is next.

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Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2022

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.3–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

Fixed Income Strategy:

- ***The Federal Reserve exceeded expectations, and market pricing up until very recently, hiking by 75bps*** in its benchmark Fed funds interest rate. The statement released in conjunction with the move was altered, now saying that the Fed is 'strongly committed to returning inflation to its 2% objective', rather than the more optimistic line previously in place, which said that it 'expects inflation to return to its 2% objective and the labor market to remain strong'.

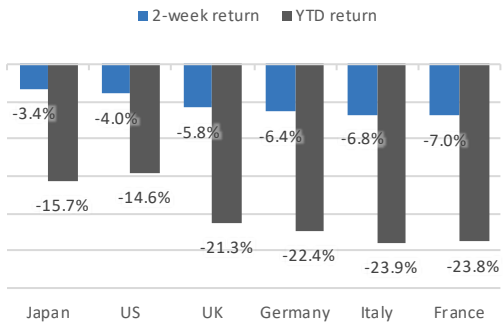
- ***The DOTS plot submitted by the Fed shows that officials expect a much faster cycle,*** with the Fed funds rate reaching 3.375% by end-2022, compared to the previous projection of 1.875%, a difference of 150bps, following a 100bps increase at the last DOTS plot revision.

- ***Reading between the lines, it is clear that within the Fed's dual mandate, price stability is paramount,*** even if it comes as the cost of their other mandate, to maximize employment.

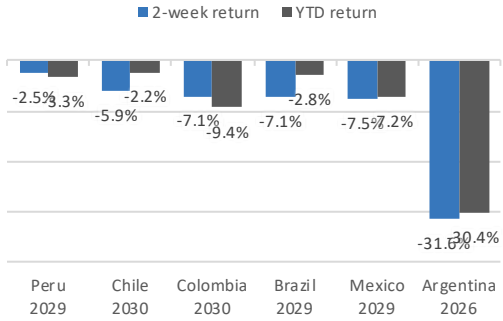
- ***Despite the unquestionably more hawkish stance, in the press conference Chair Jerome Powell sought to calm fears*** about an overly aggressive future. He stressed that the Fed was seeking to 'front-load' rate hikes, and that he doesn't expect moves of this size to become common.

- ***Although Powell had to renege on promises to take 75bps off the table, we view the plan to front-load rates as positive*** from a market's perspective, and we expect greater attention to be made to fundamental data, including CPI, PCE, and NFP moving forward, which is a healthy shift away from parsing Fed commentary.

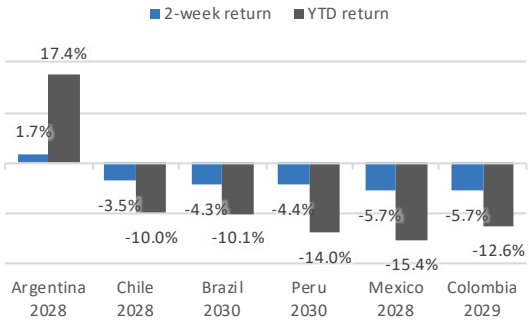
Developed Markets 10Y Total Returns



EM Local Currency Bond Total Returns



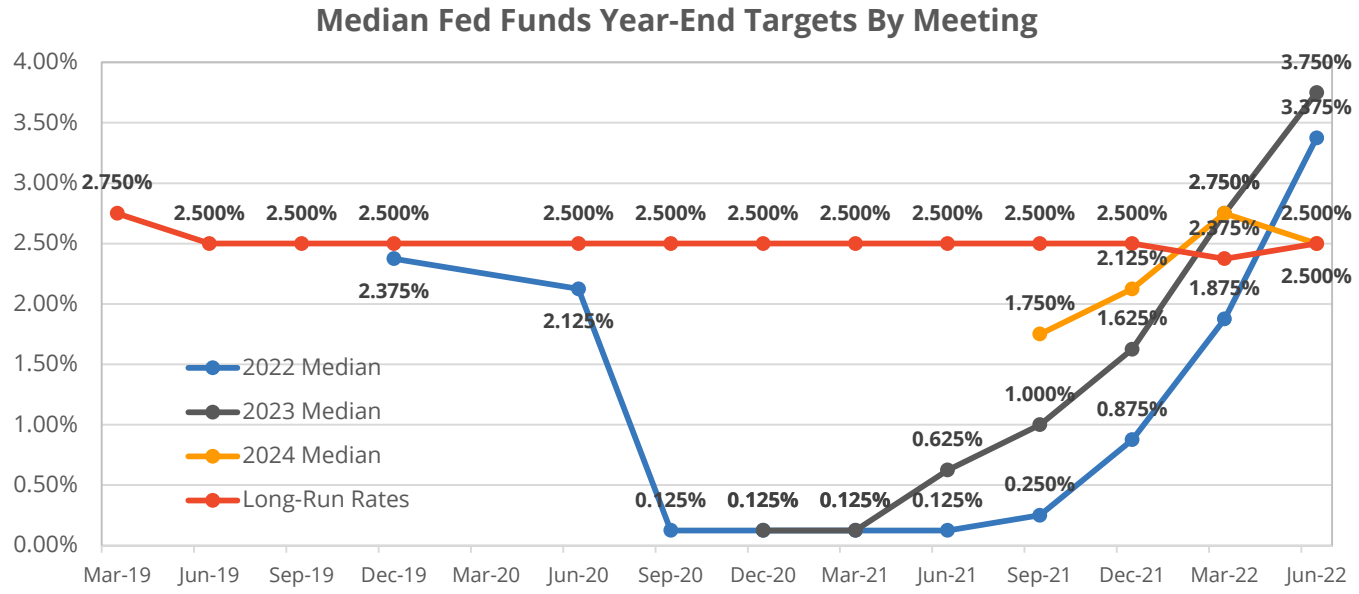
EM USD-Denominated Bond Total Returns



Benchmark Asset	Begin-2022 YTM	Current YTM	YTD Interest Gains, %	YTD Capital Gains, %	YTD Forex Gains, %	Total YTD Return, %	2022 Target YTM	2022 Return, %
UST 10Y	1.51	3.41	0.64%	-15.26%	-	-14.62%	3.00	-11.33%
German 10Y	-0.18	1.60	0.00%	-15.06%	-8.64%	-22.40%	-0.20	4.02%
Japan 10Y	0.07	0.24	0.05%	-1.56%	-14.40%	-15.70%	0.10	-0.14%
Mexico MBONO 2031	7.56	9.20	3.53%	-9.98%	-0.78%	-7.18%	8.50	1.72%
Mexico USD, 2031	2.95	5.31	1.26%	-16.69%	-	-15.44%	3.10	1.48%
Brazil BRL 2031	10.84	13.10	4.82%	-6.33%	8.86%	7.21%	11.75	17.14%
Colombia TES 2031	6.34	11.58	3.23%	-27.51%	5.59%	-20.06%	8.00	1.37%
Chile CLP 2032	5.65	6.57	2.68%	-3.68%	-1.25%	-2.24%	6.00	9.33%
Argentina ARS, 2026	49.55	59.97	16.76%	-15.45%	-15.46%	-14.36%	50.00	-6.05%
Peru Soberano 2031	5.90	8.01	2.98%	-13.12%	7.62%	-3.30%	6.00	8.54%

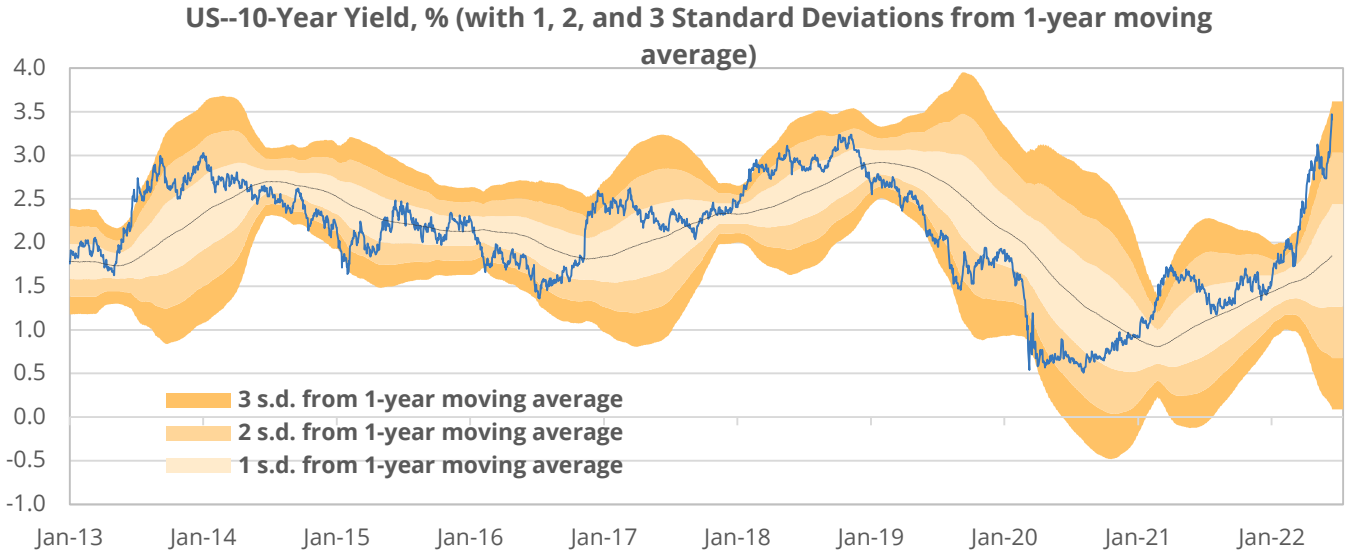
Source: Bloomberg, Bulltick. All returns are in USD *As of 06/15/2022*

The Fed's 'DOT plot', which tracks the expectations of Fed officials over time, shows a very drastic change in the forward guidance for the coming quarters. Most immediately, the 2022 expected Fed funds rate has climbed 250bps since the beginning of the year, as Fed officials react to far-higher and far-stickier price pressures. While this change has been historic, much has been priced in.



Source: Bloomberg, Bulltick

Yields have spiked 50bps in the UST 10Y just since the beginning of the month, and the 30-2Y turned negative. Both dynamics reversed somewhat on Wednesday as the Fed eased concerns about continuing hikes at this accererated pace, but we believe that growth concerns will be of increasing importance to bond markets in the US, and abroad, as the prospect of a 'hard landing' seems more likely than ever, and with Fed growth forecasts likely to prove overly optimistic.



Source: Bloomberg, Bulltick

FX Strategy:

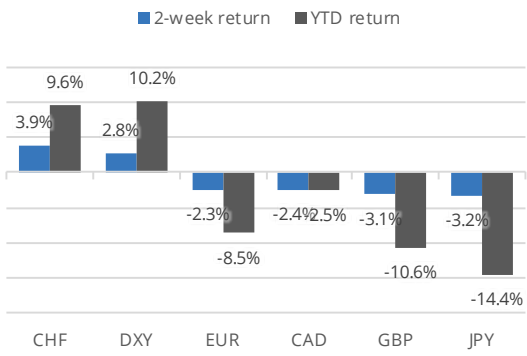
- ***The dollar saw further strength amid traders pricing in a more hawkish Federal Reserve,*** a bet which appeared to be validated following the announcement that the benchmark Fed funds rate increased by 75bps at the latest meeting, despite earlier assurances that the increments would not exceed 50bps.

- ***The biggest losers ytd amid the USD rally have been JPY, the GBP, and the EUR.*** The yen has slipped amid lackluster growth prospects and a decline in the value of safe haven assets generally amid a surge in US treasury yields. EUR and GBP have both been impacted by the divergence that investors have observed and continue to expect between the European central banks' response to rising price pressures on one hand, and the Federal Reserve on the other.

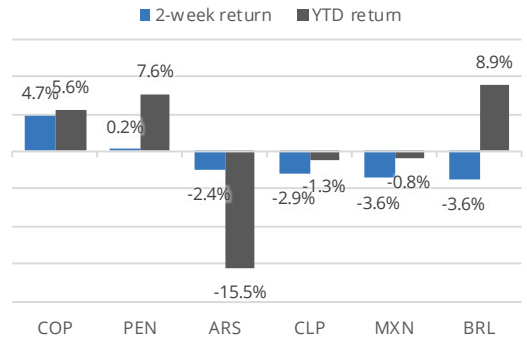
- ***We expect that dollar strength will persist, but that much has been priced in,*** and that the great bulk of the rally is behind us. Indeed, from current levels, we expect a modest decline in the value of the dollar as measured by the DXY, to our end-year target of 102.

- ***EMFX in contrast has been remarkably resilient,*** particularly in Latin America which has historically had strong correlations with commodity markets, which continue to post gains. While our preferred pick, the BRL, has outperformed its peers consistently throughout the year, we believe it has yet further to go, and we remain constructive. We also like the COP given improving fiscal dynamics and our expectation for investor appetite to improve following this year's election.

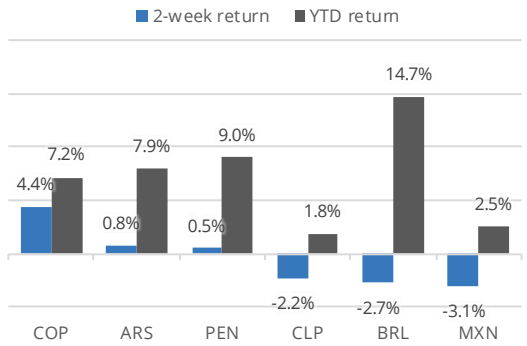
Developed Markets, FX Spot Returns



Emerging Markets, FX Spot Returns



Emerging Markets, FX Carry Returns

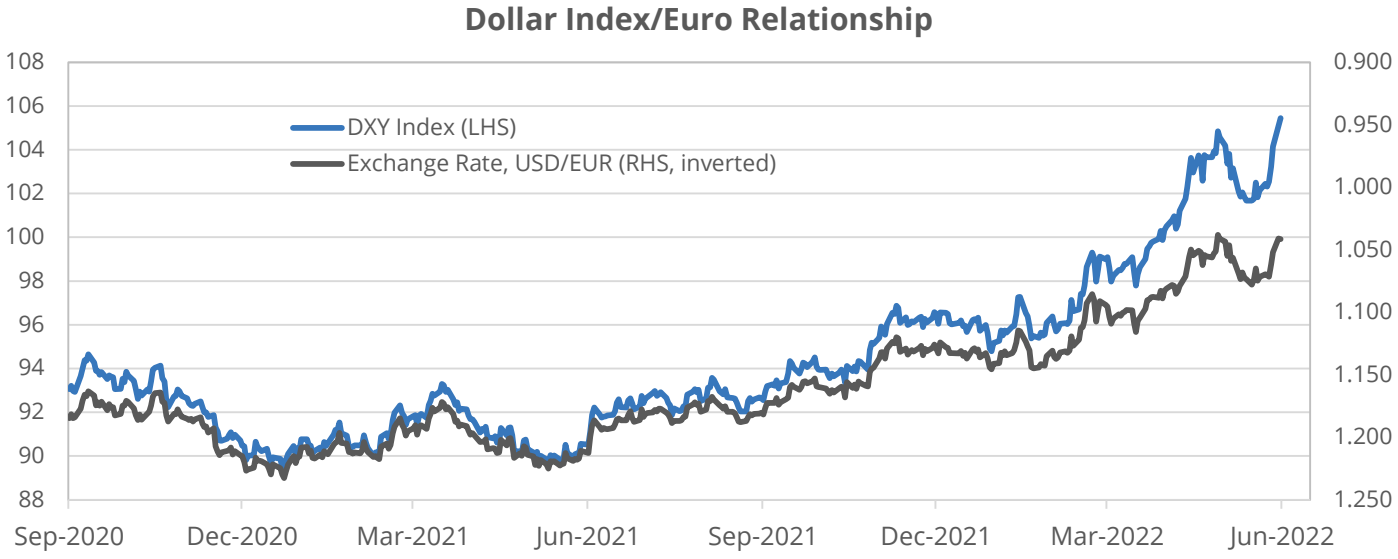


Asset	Begin 2022	Current	YTD Spot Return	YTD Interest Gains	End-2022 Target	2022 Expected Spot Return	2022 Expected Total Return
DXY	95.7	105.4	10.2%	-	102.0	6.6%	-
USD/EUR	1.14	1.04	-8.6%	-0.21%	1.18	3.8%	3.3%
JPY/USD	115.1	134.5	-14.4%	-0.04%	115.0	0.1%	0.0%
CNY/USD	6.36	6.72	-5.3%	-	6.50	-2.2%	-
MXN/USD	20.52	20.68	-0.8%	3.52%	20.50	0.1%	8.3%
BRL/USD	5.57	5.12	8.9%	5.50%	5.20	7.1%	23.5%
COP/USD	4,122	3,904	5.6%	2.85%	3900	5.7%	13.8%
CLP/USD	852.0	862.8	-1.3%	3.28%	800.0	6.5%	15.5%
PEN/USD	4.00	3.72	7.6%	1.95%	3.90	2.6%	8.8%
ARS/USD	103.09	121.95	-15.5%	29.41%	140.00	-26.4%	12.1%

Source: Bloomberg, Bulltick. Note: Total returns include 3m deposit (or comparable) interest gains. Carry gains incorporate interest rate differential with US rates. All FX returns are against USD

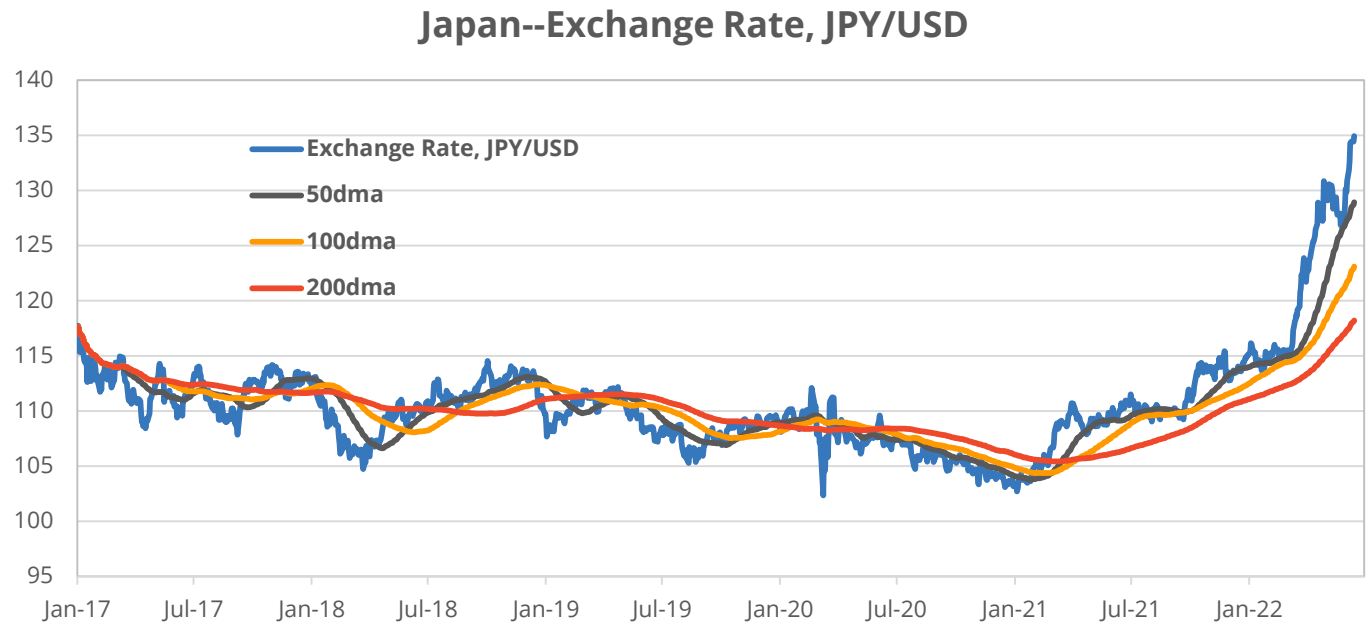
As of 06/15/2022

The DXY Index reached new multiyear highs in recent trading, and stood at 105 at the time of writing, levels not seen since 2003. As usual, the principal dynamic at play was the EUR, which has slipped sharply amid rising inflation (reducing purchasing power) coupled with the (accurate, in our view) perception that the ECB will lag the Fed in its response.



Source: Bloomberg

Nevertheless, a further story in the above chart is that the gap between the DXY and EUR performance has widened in recent months. This is due in part to the collapse in the value of the JPY, which while much smaller in terms of weight in the DXY, has seen much greater moves. The yen, which as a safe haven asset often moves in sympathy with USTs, has lost 14.4% of its value ytd against the greenback.



Equities Strategy:

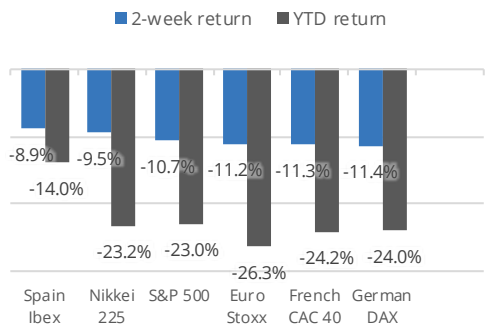
- ***After tremendous volatility induced by high inflation rates*** and Federal Reserve uncertainty, SPX valuations have come down to below long-term historical averages. We highlighted this in the last publication, where we noted that these multiples <17x/earnings, are more comparable to eras in which the index had a substantially lower weighting of tech stocks (which should have higher PE ratios given their dependence on future growth and innovation). This said, we think equities could well get cheaper if in fact the US is moving towards recession while the Fed hikes rates and rolls over its tremendous balance sheet.

- ***In our view, the US economy will not be unable to withstand full execution of this double-barreled approach without sliding into recession. I***n fact, the Fed may have to pull back on the reins. This means a slower pace of asset rolloff and or fewer rate hikes.

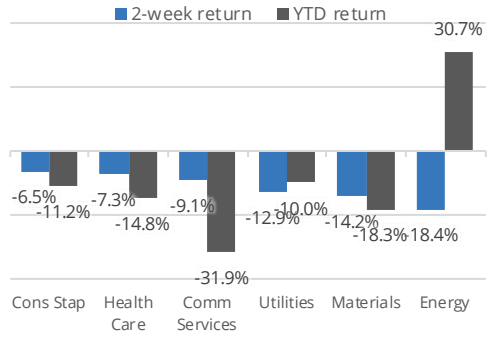
- ***Markets could move higher by year-end led by a recovery in technology stocks IF:*** 1) inflation does in fact come down (we expect core PCE at 4.7% by 2022 year-end based on both base effects and economic slowdown from tightening financial conditions 2) real wages move positive IF labor market stays strong and wage growth begins to top inflation and 3) the Fed doesn't crash the economy with $95 billion monthly roll offs combined with an additional 175bps in tightening.

- ***Our top picks in LatAm have surged (Brazil, Colombia),*** due to commodity tailwinds and favorable political developments. In Colombia it appears Gustavo Petro may indeed lose to right wing Rodolfo Hernandez.

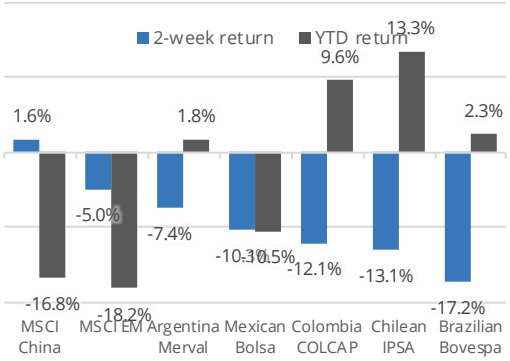
Developed Market Equity Returns



Select S&P 500 Sectors Returns



Emerging Market Equity Returns

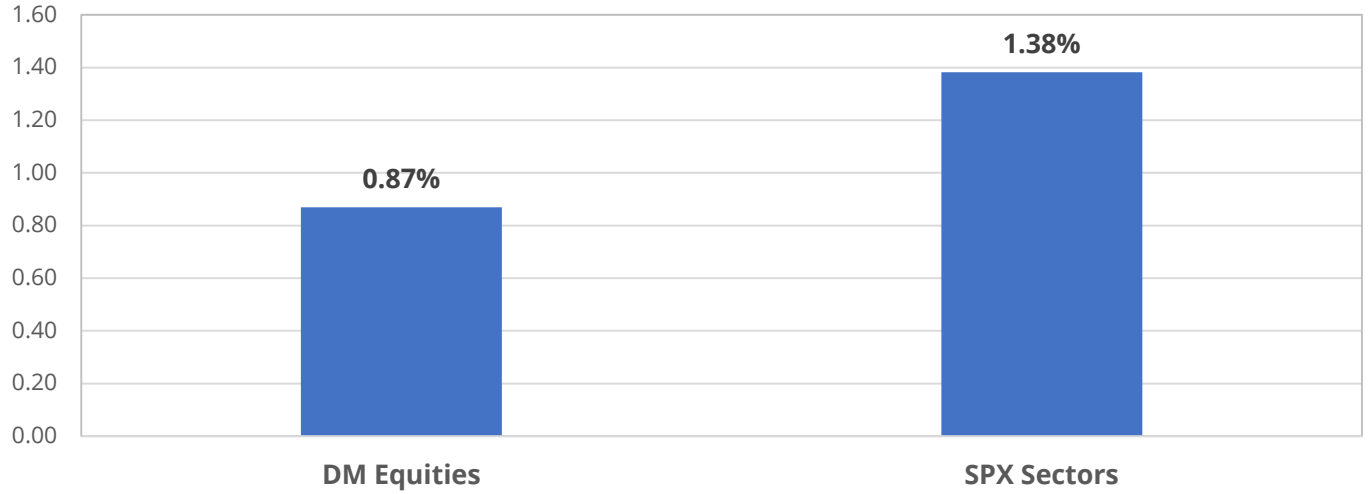


Asset	Div Yld	Begin 2022 Price	Current Price	Cap Gains (LCY, YTD)	Cap Gains (USD, YTD)	Target 2022	2022 Expected Total Returns LCY	w/Div	USD	w/Div
S&P 500	1.8%	4,766	3,668	-23.0%	-23.0%	4,700	-1.4%	-0.1%	-1.4%	-0.1%
Euro Stoxx	3.8%	4,298	3,442	-19.9%	-26.3%	4,200	-2.3%	0.5%	1.4%	4.3%
German DAX	3.8%	15,885	13,125	-17.4%	-24.0%	15,500	-2.4%	0.2%	1.3%	4.0%
Nikkei 225	2.3%	28,792	25,963	-9.8%	-23.2%	29,500	2.5%	4.3%	2.6%	4.4%
Shanghai Comp	2.8%	3,640	3,317	-8.9%	-13.8%	4,100	12.6%	15.0%	10.1%	12.4%
MSCI India	1.6%	2,037	1,785	-12.4%	-16.3%	2,250	10.5%	11.7%	6.2%	7.4%
MSCI EM	3.3%	1,232	1,008	-18.2%	-18.2%	1,450	17.7%	20.5%	17.7%	20.5%
MSCI World	2.5%	755	586	-22.4%	-22.4%	775	2.7%	4.5%	2.7%	4.5%
Mexican Bolsa	4.0%	53,272	47,566	-10.7%	-10.5%	56,000	5.1%	7.9%	5.2%	8.0%
Brazilian Bovespa	9.4%	104,822	99,088	-5.5%	2.3%	120,000	14.5%	22.1%	22.6%	30.8%
Colombia COLCAP	6.0%	1,411	1,463	3.7%	9.6%	1,400	-0.8%	2.6%	4.9%	8.5%

Source: Bloomberg, Bulltick. Chart returns are in USD, excluding dividends *As of 06/17/2022*

We re-iterate an analysis we presented one month ago: Over the past ten years, the intra-index, sector dispersion of monthly returns has been nearly 60% higher than the dispersion seen across the principal DM equity markets in the US, Europe, the UK, and Japan. As a result, beating the market is much more a factor of getting sector calls right than of investing with geographic preferences.

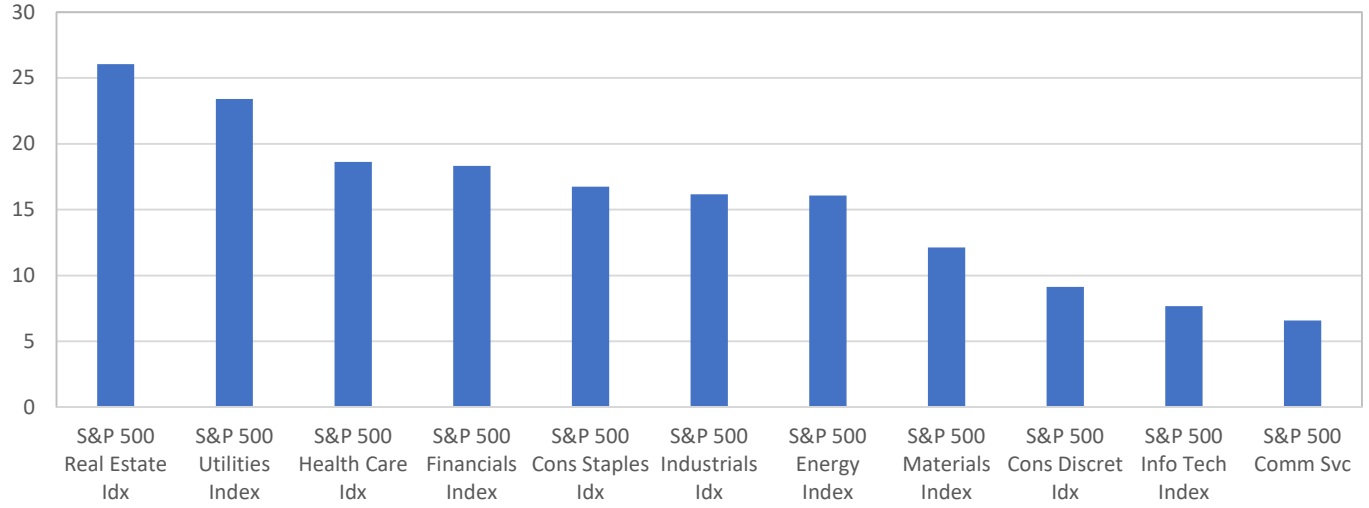
Average Cross-Asset Standard Deviation of Monthly Returns Over Past 10 Years, %



We expect the growth rates of forward-EPS estimates to continue to fall, and substantially. In past instances where this has been the case, Utilities and Health Care, two of our preferred sectors presently, have tended to outperform the broad index.

Average Sector Returns, 12m following past EPS peaks

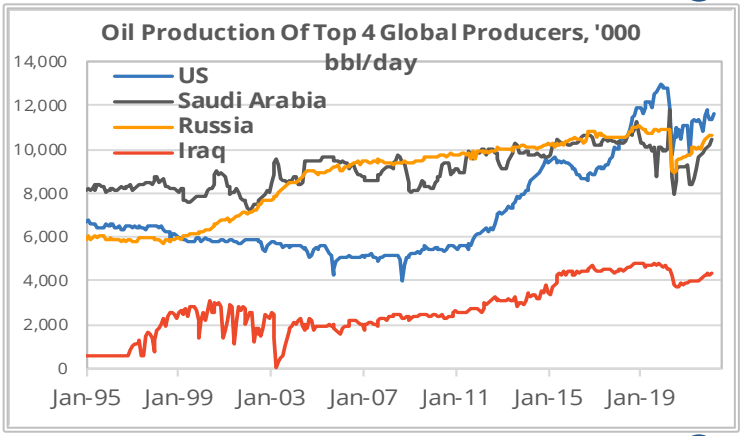
(since 1996, looking only at peaks which were followed by >10% decline in EPS estimates)



Alternative Investments

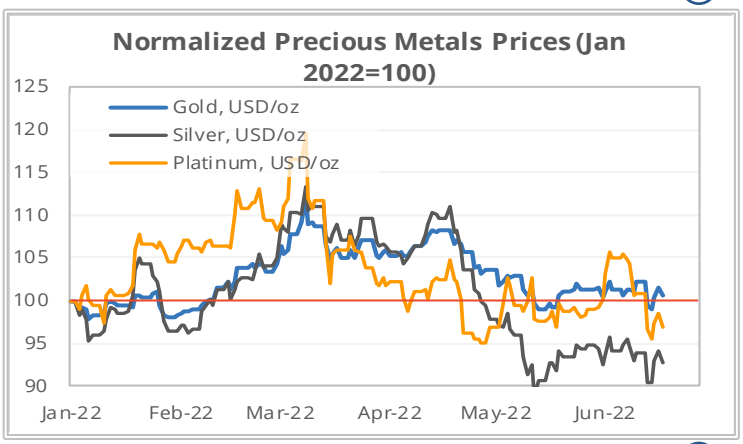
① Oil production continues to rebound following its steep drop in 2020, but has yet to return to pre-pandemic levels, and has also failed to keep pace with rising global demand. As the US heads into the driving summer season, when it typically consumes a higher amount of gasoline, the price of oil will continue to trade at historically high levels.

#1



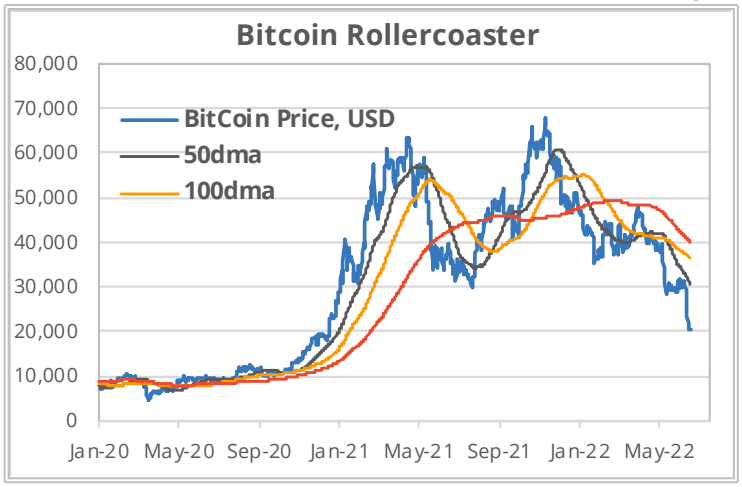
② We like gold and believe precious metals in general are an important part of a portfolio. As an inflation hedge and store of value we like gold: 1) inflation will continue to linger at high levels, while 2) the rise in UST yields will start to level off, as most of the Fed's hiking cycle has already been priced in. As a result, the attractiveness of USTs will wane as real yields continue to be negative across all maturities, and non-yielding assets will be seen more favorably.

#2



③ Bitcoin has failed thus far in its role as an inflation hedge, dropping more than 50% even as inflation accelerated. Nevertheless, cryptocurrencies have entered the mainstream and we think at $20,000 BTC looks cheap and could be an attractive means to protect against the MT to LT threat to confidence in fiat money,. At present prices, we believe that risks are weighted to the upside.

#3



Source: Bloomberg, Bulltick

As of 06/17/2022

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