Economic outlook.

Second Quarter 2022

The “value restoration” project is underway.

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SEI recently released its second-quarter Economic Outlook. A summary of the conclusions is provided below:

- The second quarter of 2022 was a tough slog for investors with relatively few places to hide. Stocks and bonds simultaneously faced steep price declines amidst extreme volatility, while commodities recorded a broad and robust gain.
- Stocks experienced peak-to-trough declines of more than 30%, including the Russell 2000 Index, the NASDAQ Composite Index, and the S&P 500 Index information technology sector. Energy, which was up nearly 30%, was the sole sector to post a gain for the six-month period.
- Bonds did not provide much of a diversification benefit. Long-duration bonds, as measured by the Bloomberg US Government/Credit Index, have suffered a year-to-date decline of nearly 20%.
- The poor performance of the equity and bond markets suggests that considerable bad news has already been priced into financial markets. We view price declines in the equity market as value restoration, returning stock valuations (particularly for high-flying growth and technology names) to something more reflective of economic fundamentals.
- US Federal Reserve Chairman Jerome Powell still hopes that the central bank can achieve a soft landing for the US economy, where inflation gradually decelerates back to the 2% target without a recession. At present, the central bank still appears woefully behind the inflation curve.
- The rest of the world faces similar challenges to the US, and then some. Inflation in the UK and major euro-area countries has accelerated almost in tandem with the US. We could see inflation in Europe surpass that of the US in the months ahead given the region’s greater vulnerability to energy blackmail by Russia.
- Leading indicators of economic activity are already pointing to below-average economic growth for many countries. Declining financial-asset prices, worsening consumer and business sentiment, and weaker demand are among the reasons for the economic slowing. The extent of the deterioration is still not on par with an outright recession, but the trend is concerning. The UK is seeing the sharpest deterioration among major industrial countries. On top of all the other problems facing Europe, the need to hike interest has once again raised the specter of another periphery debt crisis.
- Labour shortages in the UK have been exacerbated by Brexit, which cut off the easy flow of workers from the EU. Canada and Europe usually have unemployment rates that are considerably higher than the US and UK. That remains the case, but both report jobless totals that are below previous cyclical lows. All this suggests that workers are in a strong position to seek bigger wage gains in an effort to keep up with inflation. The possibility of a global wage-price spiral still cannot be dismissed out of hand—another reason why central banks may be forced to raise interest rates more than they would prefer.
- A mild recession along the lines of the 2001 experience appears to be a more likely economic scenario than a rerun of the global financial crisis. The timing of its onset is still unclear; however, we think much of the damage has been done. Yet, predicting the future is a hazardous venture most of the time. Accordingly, SEI believes that focusing on diversification, fundamentals, and sound planning matter more now than ever.

A full-length paper is available if you wish to learn more about these timely topics.

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