Unsere Emerging Markets und Global Income Inhalte sind auf Deutsch verfügbar.

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Inflation May Be Peaking in the U.S. What about the Rest of the World?

By: Jim Caron | September 14, 2022

New York - Inflation is inching downward at the headline level, but remains stubbornly high at the core level (excluding food and energy). In fact, inflation data released on September 13 revealed that prices rose slightly in August. Still, inflation in the U.S. may be peaking, but it's more of a "rounding top" than a sharp decline from the highs, putting added pressure on the Fed to continue tightening.

The picture is cloudier in Europe and the UK, where inflation is still on the rise primarily due to severe energy shortages throughout the region, in part because of the war in Ukraine. But since the pandemic, the UK and European economic cycles have lagged the U.S. by about 3 months, meaning that if U.S. inflation is in fact peaking in 3Q — albeit slowly — then inflation may peak for the UK and Europe in 4Q. Following the Fed's lead, both the European Central Bank and the Bank of England have been aggressive with rate hikes to combat inflation.

In the Asian-Pacific (APAC) region, economic weakness in China is a drag, especially for Emerging Markets (EM). Central banks in Australia and New Zealand are still tightening but seem to be softening their pace. EM is more idiosyncratic and country specific, but the rate of change for increasing inflation is starting to slow and central bank policy across the region is likely to follow suit.

To date, 2022 has been mostly about rising inflation. Looking ahead, however, we should perhaps incorporate a view of peaking, then falling, inflation in 2023. That said, inflation risks remain: Inflation may in fact peak, then fall, but the question is will it fall enough — to target levels — **and will it then stay there?** Inflation could reverse a downward course based on changes in supply chains or labor shortages, keeping it higher than target levels, and for longer than expected.

In this scenario, central banks may need to restart a tightening cycle sometime late in 2023 — and this is a risk scenario that is not currently priced in the markets. Alternatively, if the economy slows more than expected, then inflation will likely be controlled, but for all the wrong reasons.

Given this backdrop, I am often asked "is it time to buy bonds?" Well, the short answer is yes *and* no, depending on my four Ws: **Where** geographically, **Which** bonds, **What** maturity and **When** to buy.

Where
U.S. as inflation has likely peaked and Fed may reach the terminal federal funds rate of 4% by end of the year. **UK & Europe** as inflation and policy lags the U.S. by three months. **Emerging Markets** may be a little early but idiosyncratic to country risk.

What
According to the "Three Bears," **long duration is "too hot"** — an attractive play for a recession but also riskier. **Short rates are "too cold"** as central banks become aggressive. So **3-4 years of duration looks "just right."**

Which
Investment Grade/High Quality offers yield, duration sensitivity and lower default risks but if we have a mild recession, then **High Yield** can offer more potential upside.

When
Timing is everything. U.S. policy rates are likely to peak and hold first. This plus a strong U.S. dollar gives **U.S. assets an edge over other markets**.

RISK CONSIDERATIONS

Diversification does not eliminate risk of loss. There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict *the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks.* ***Fixed income securities*** *are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. Longer-term securities may be more sensitive to interest rate changes.* ***Mortgage- and asset-backed securities*** *are sensitive to early prepayment risk and a higher risk of default, and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks.* ***Certain U.S. government securities*** *purchased by the Strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future.* ***High-yield securities ("junk bonds")*** *are lower-rated securities that may have a higher degree of credit and liquidity risk. Public bank loans are subject to liquidity risk and the credit risks of lower-rated securities.* ***Foreign securities*** *are subject to currency, political, economic and market risks. The risks of investing* ***emerging market countries*** *are greater than risks associated with investments in foreign developed countries. Sovereign debt securities are subject to default risk. Derivative instruments may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks.* ***Restricted and illiquid securities*** *may be more difficult to sell and value than publicly traded securities (liquidity risk). The initial interest rate on a* ***floating-rate security*** *may be lower than that of a fixed-rate security of the same maturity because investors expect to receive additional income due to future increases in the floating security's underlying reference rate. The reference rate could be an index or an interest rate. However, there can be no assurance that the reference rate will increase. Some floating-rate securities may be subject to call risk.*

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