



# Market Watch

## Margin pressures intensify

### Summary

**US equity markets fell sharply amid renewed growth concerns.** The weakness was concentrated in the US; the S&P500 fell 4.0% while the Nasdaq fell 4.7%.

**Poor earnings across major US retailers appear to have been a key trigger,** raising questions both about the health of the US consumer as well as the impact of rising input costs.

**US corporate earnings, inflation, Chinese policy efforts, technicals** are key signposts to watch in the days ahead.

### Background

**US equity markets took a sharp tumble lower, with much of the selling focused on US markets.** The S&P500 fell 4.0% while the Nasdaq fell 4.7%, the biggest 1-day fall since June 2020, with all sectors recording a loss. European equities were also lower, though to a lesser extent.

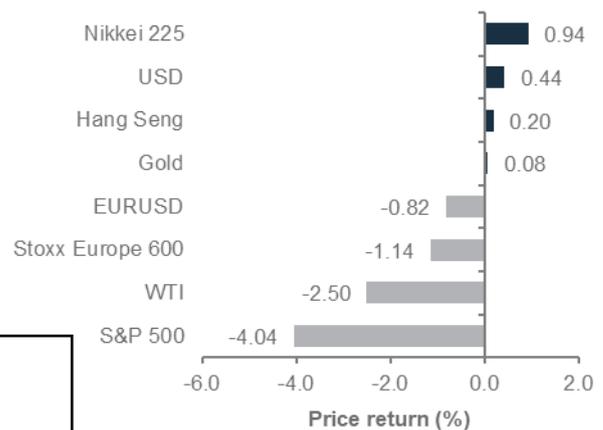
The US consumer discretionary and staples sectors led declines, falling more than 6%, while the Tech sector was the third worst hit sector. Gold was largely flat, while the USD Index (DXY) was down as US government bond yields fell. Spreads on global high yield bonds spiked while yields rose above 8%, the highest level since May 2020.

**Consumer health and margin pressures were key focus areas after several major retailers highlighted a significant hit** to profits due to higher supply chain and inventory costs. This week, several other retailers are expected to report results, which would be key to the broader macro question of whether there is a risk of consumers starting to pull back on discretionary spending. We view Staples as a less preferred sector, while we see Discretionary as a core holding in the US and Europe.

**Impact of policy tightening remains a concern.** Concerns about how much Fed tightening is likely in the pipeline, and what impact it may have in terms of slowing growth, remains an ongoing narrative. Federal Reserve officials reaffirmed that tighter monetary policy lies ahead to get inflation under control. Chicago Fed Charles Evans said raising policy rates to above estimates of the 'neutral' level should enable the Fed to bring inflation down from its current elevated level.

### Much of the market weakness was concentrated in US equities

1-day price return (%) on 18 May

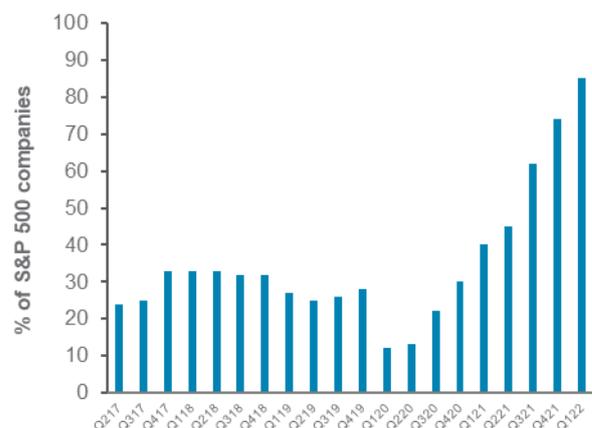


Source: Bloomberg, Standard Chartered

Margin pressures intensify

### Inflation a rising factor of corporate earnings reports

% of US companies citing 'inflation' on their earnings call



Source: Factset, Standard Chartered

## What does this mean for investors?

**Corporate earnings still resilience though margin and growth pressures have surfaced more prominently.** More than 90% of US companies have reported results, with 77% reporting positive earnings surprise.. However, more than 80% of US companies cited inflation pressure in their earnings call, driving analysts to revise down margin expectations. Current net profits estimates have been lowered compared to 31 March 2022, though consensus are still projecting record high EPS for 2022 and 2023.

**S&P correction still within pullback territory, with equity-bond correlation now negative, which means US government bonds did offset the drop in risky assets.** The S&P500 is now around 18% from its most recent peak. On its own, this remains within the 10-19% pullbacks witnessed six times within the broader 2009-2020 equity bull market, though sentiment felt worse than that due to the elevated volatility and the correlated fall across asset classes for much of 2022. The good news is that the equity-bond correlation has turned negative once again, with equity losses now being offset to some degree by bond gains.

**Government bonds starting to act as safe havens as growth concerns intensify.** It is possible that we are approaching the point where the markets limits how much further it expects policy rates to rise, given the impact on growth and economic activity. This means bonds could once again offer diversification benefits, helping offset downside volatility in equities. Having said that, inflation remains a risk to this view. Nevertheless, now may be a good opportunity to rebalance investment allocations to ensure they are in line with one's risk profile.

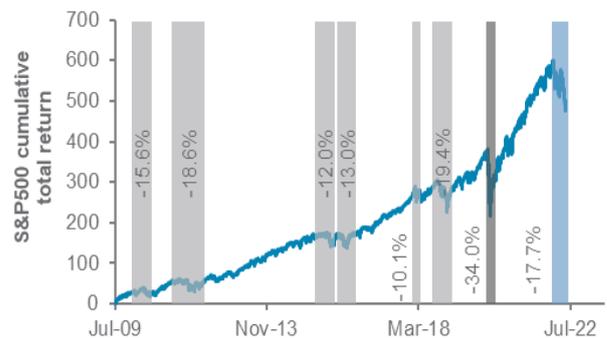
**Consumer health, inflation data and Fed policy key from here.** The near term outlook continues to hinge on how consumers are coping with higher prices and the impact of tighter Fed policy on growth. US retail sales as well as US CPI data will be key economic data points to watch over the coming weeks. While US inflation remains high, it has started to moderate from the prior month, which suggests that the worst of inflation pressures may be behind us.

**Technical:** Short-term technical outlook remains weak. The S&P 500 has broken below its key support at 4063, and the short-term bias remains to the downside. We see supports every 100 points down from 4000, all the way to the important support at the 3600 level. Yesterday's move in the US 10-year government bond yield is also consistent with our view that 3.26% likely marks a cap in the near term.

— Audrey Goh, Head Asset Allocation

## 10%+ equity market sell-offs are not uncommon; there were six in the last bull market, each presenting a buying opportunity

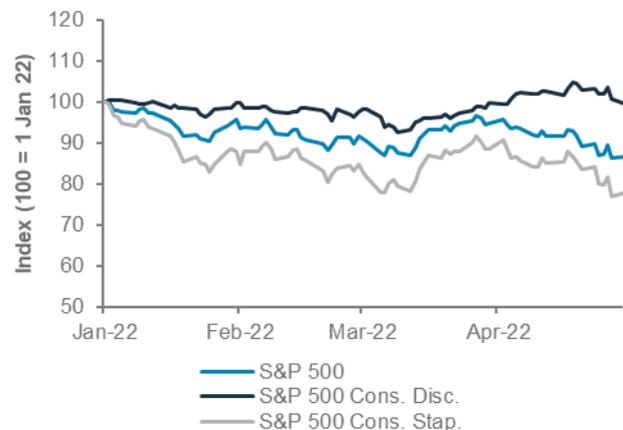
S&P500 marked with prior 10% pullbacks



Source: Bloomberg, Standard Chartered

## Consumer sectors led yesterday's market drop

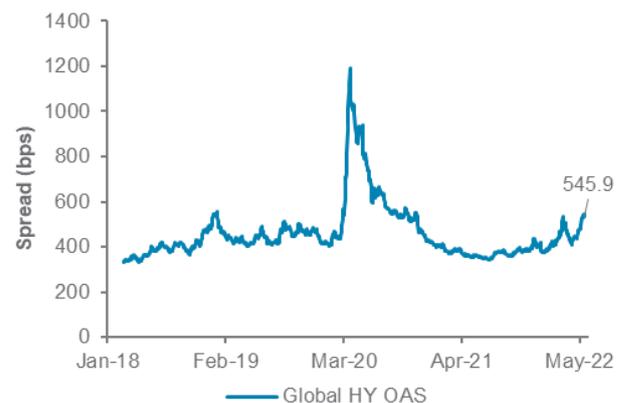
Performance of consumer sectors versus S&P500



Source: Bloomberg, Standard Chartered

## US high yield premiums over Treasuries widened

Global HY bond credit spread



Source: Bloomberg, Standard Chartered

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