Quarterly Market Commentary
First Quarter 2023

Banking on volatile markets.

- Global equity markets garnered positive returns in the first quarter of 2023, amid numerous periods of volatility. Although Canadian equities lagged, developed markets generally outperformed emerging markets.
- Fixed-income asset classes gained ground during the period as bond yields fell (prices increased) for nearly all sectors of the Canadian bond market.
- We believe that recent events in the financial markets have raised the odds of recession in the U.S. beginning later this year or in early 2024, with a similar view for Canada.

SEI's Domestic View

We observed at the start of 2023 that "the challenges facing Canada's economy are significant but not insurmountable," and that still seems to hold true at the start of the second quarter. While there are certainly challenges, there's been some good news as well, and economic data on balance has been surprising to the upside since November 2022. In fact, some of the challenges facing the Bank of Canada (BoC) and the domestic economy arise from what is essentially good news. The prime example remains the challenge of still-high inflation associated with a historically low unemployment rate.

Another key challenge is productivity growth, a critically important tool in the fight to lower inflation. Unfortunately, productivity has actually been *falling* since the second half of 2020 and is flat relative to where it was at the end of 2018. While lagging productivity can be a normal feature of tightening labour markets, it's not clear from the latest gross domestic product (GDP) report that business investment is going to be sufficient to meet the challenge. Perhaps this isn't surprising given that capacity utilization is still several percentage points below the level that prevailed before the global financial crisis of 2008 and 2009.

Finally, we also noted in January that "If the BoC is able to get inflation under some semblance of control, and if economists' projections of a shallow, two-quarter recession prove accurate, we may hear plenty of talk about a 'technical' or 'rolling' recession in 2023 or early 2024 without much in the way of serious or lasting economic damage. That's the hope anyways." That remains the hope as we enter the second quarter, and we have yet to see clear-cut indications of a recession taking hold (first-quarter GDP will not be reported until the end of May).

While inflation is still uncomfortably high on a year-over-year basis, month-over-month readings are a bit more encouraging, and producer price pressures, though volatile, have been easing. Of course, how recently announced production cuts from the Organization of the Petroleum Exporting Countries plus Russia (OPEC+) impact this remains to be seen.

Business and consumer sentiment reports have been quite mixed. Household sentiment is still largely depressed, although this isn't squared easily with healthy consumer activity of recent months and quarters. There's no denying that 2022 was a very difficult year for the housing market, but recent trends in sales and permits have shown improvement while construction starts are still above pre-COVID-19 levels despite worries about high mortgage balances adjusting to higher interest rates. At least one bank CEO believes that mortgage support measures should prove sustainable and effective.[1] Of course, we don't yet know how the recent banking system paroxysms in the U.S. will impact Canadian banks, but it's something economic and market observers will be keeping a close eye on. As for business sentiment, it has seemed weakest among manufacturers of late, although full-year views of sales activity and hiring plans are still relatively optimistic, according to S&P Global.[2]

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[1] CIBC CEO Says Mortgage Aid Sustainable for 'Foreseeable Future', https://www.bloomberg.com/news/articles/2023-04-04/cibc-ceo-says-mortgage-aid-sustainable-for-foreseeable-future, last accessed 4 April 2023.
[2] "PMI slips back into contraction territory in March," https://www.pmi.spglobal.com/Public/Home/PressRelease, last accessed 4 April 2023.

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Facing all of these cross-currents and uncertainties, the BoC remained on hold in March after raising 0.25% at its January meeting. Like many advanced-economy central banks, the BoC has promised to maintain higher rate for as long as needed to get inflation to more acceptable levels. However—and this is the case for many developed market central banks—markets aren't completely buying it. Rate markets are currently pricing in a BoC interest rate-cutting cycle from the middle of 2023 through the end of 2024. Given that U.S. Federal Reserve (Fed) finds itself in a similar situation, the loonie has been largely range-bound against the U.S. dollar since late 2022.

Of course, Canada's outlook will also be influenced by the global economic environment, where additional cross currents and uncertainties are very much at play. To echo Bette Davis as Margo Channing in "All About Eve," investors should keep their seatbelts fastened.

SEI's Global View

Economists have been struggling for the past several months to find the right analogy to describe the future trajectory of growth and inflation in the U.S. The optimists favour the term "soft landing," whereby growth in business activity slows just enough to reduce inflation pressures without causing a recession. Pessimists see a "hard landing" ahead as the global economy stumbles into recession due to overly tight central-bank monetary policies. Still others see "no landing" whatsoever—economic growth actually accelerates, along with inflation. SEI suggests a fourth possibility: a "holding pattern" in which the economy moves in circles with no estimated time of arrival. Economic growth slows, but not enough to push inflation back to the 2% target rate that the Fed and other major central banks have set as their goal. Eventually, the plane runs out of gas and a recession develops.

The federal-funds futures curve has swung dramatically in just three months, with traders beginning 2023 expecting the central bank to cut interest rates in the second half of the year. When the nonfarm payrolls report for January was released in early February, however, sentiment began to change and those anticipated rate cuts were completely priced out of the futures curve. Before the failure of SVB and the other banks, the entire futures curve had shifted upward in dramatic fashion, with the peak funds rate rising into the 5.50%-to-5.75% area, and the December 2023 contract yielding 5.58%. The federal-funds futures curve now has been reset well below where it was at the start of this year.

We understand the market's willingness to "fight the Fed" at this juncture. The tumult in the banking system isn't over yet; even after this panic stage passes, smaller banks will face ongoing pressure to raise deposit rates to more competitive levels, while borrowing from the Fed and U.S. government agencies to improve their liquidity. A recession becomes likelier due to the important role that community and regional banks play in the U.S. financial system. According to the Fed, smaller banks (below the 25 largest banking institutions ranked by domestic assets) account for roughly two-thirds of commercial bank loans. They also comprise a very large proportion of credit extended to small businesses.

SEI is assuming that the current banking panic will be quelled by the government's "whatever-it-takes" attitude. If that belief proves wrong, the Fed could indeed blink and cut rates as the futures curve applies; however, the surge of liquidity being injected into the banking system may well make the job of reducing inflation that much more difficult. The Federal Open Market Committee (FOMC) has underestimated the extent and persistence of core personal consumption expenditures (PCE) inflation for nine consecutive quarters. And, in every quarter since March 2021, the FOMC members have forecast a return to a 2.0% to 2.5% within the next two years. The latest forecast follows the same trajectory, with core PCE inflation falling to 3.6% by December 2023, 2.6% by December 2024, and 2.1% by December 2025. By contrast, PCE core inflation ended 2021 at 4.8% and 2022 at 4.7%.

The current panic in the banking sector doesn't seem to be dissuading other central banks from pursuing their inflation-fighting goals. In particular, the European Central Bank (ECB) surprised the markets by raising its three key policy rates by 0.5% in March, as members of the Governing Council strongly hinted they would prior to onset of the recent market turbulence. The ECB's rationale was clear—the mandate is to bring inflation back to its 2% target rate, and the central bank will use its monetary toolset (interest rates and security sales from its balance sheet) in an effort to achieve this goal.

The ECB is not ignoring the financial stability and the underlying health of the banking system, however. Rather, ECB President Christine Lagarde insists there is another set of tools that can be used for that purpose, including liquidity support via its various asset purchase and lending programs, such as the Transmission Protection Instrument (TPI). The TPI was introduced in July 2022, and can be used to counter disorderly market conditions that pose a serious threat to the transmission of monetary policy across the euro area. It gives the central bank the ability to buy the public-sector securities of sovereign and regional governments and agencies with remaining maturities between one and 10 years. There is no preordained limit to the purchases that can be made, and the ECB will have wide discretion regarding which securities to purchase from which member countries.

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We believe that recent events in the financial markets have raised the odds of recession in the U.S. beginning later this year or in early 2024. As has been the case following previous recessions, wage pressures most likely will ease and inflation should fall as well. However, global financial markets are probably getting ahead of themselves, pricing in near-term cuts in policy rates and a rapid decline in inflation back below 2% within a year. Both cyclical factors (tight labour markets and consumer resiliency especially) and secular factors (a persistently tight labour market, an emphasis on supply chain resiliency over efficiency, higher capital costs, and higher future tax burdens) suggest to us that inflation will remain higher than what central banks and market participants expect. The Fed and other central banks are facing a severe challenge in their attempt to fight inflation while simultaneously ensuring financial stability. If push comes to shove, we expect the central banks to choose financial stability, leaving the inflation fight for another day.

Economic Backdrop

Global equity markets finished in positive territory for the first quarter of 2023, amid numerous periods of volatility in reaction to the latest monetary policy actions and public comments from central banks. Additionally, late in the period, turbulence in the banking sectors in the U.S. and Europe led to a selloff in equity markets globally before stocks rallied towards the end of the quarter.

In early March, California-based Silvergate Capital, a major lender to the highly speculative cryptocurrency industry, announced that it was entering a voluntary liquidation due to significant losses following massive withdrawals of funds by depositors. Soon thereafter, two U.S.-based regional banks–Silicon Valley Bank (SVB) and Signature Bank–failed after depositors withdrew funds on fears regarding the valuation of the institutions' bond portfolios. The Federal Deposit Insurance Corporation (FDIC) was appointed as receiver to SVB on March 12 after the California Department of Financial Protection and Innovation closed the bank. Occurring on the heels of the collapse of Silvergate Capital, SVB's failure prompted investors to reconsider the safety of their positions across the banking industry. Signature Bank, which was shut down by New York state regulators on March 12, also was closely aligned with the cryptocurrency industry. In a separate matter, 11 of the largest U.S. banks deposited US$30 billion (C$40.5 billion) with First Republic Bank, another troubled lender.

The bank troubles were not limited to the U.S. Swiss lender Credit Suisse also came under pressure after suffering significant investment losses in 2021 and 2022. Credit Suisse reported that clients had withdrawn 110 billion francs (US$119 billion) of funds in the fourth quarter of 2022. The Swiss National Bank, Switzerland's central bank, announced that it would provide the embattled bank with 50 billion francs (C$74.5 billion) in financial support. Soon thereafter, Swiss bank UBS took control of rival lender Credit Suisse in an emergency 3 billion franc (C$4.8 billion) deal negotiated by Swiss government regulators. While this development was not directly related to the failures of the U.S. regional banks, the timing resulted in significant declines in the share prices of other banks worldwide.

Although Canadian equities lagged, developed markets garnered positive returns over the quarter and generally outperformed emerging markets. Europe was the top-performing region among developed markets for the quarter due primarily to strength in Ireland and the Netherlands. North America also performed well. The Far East region generated the largest gains in emerging markets, buoyed by robust performance in Taiwan and Korea.

U.S. fixed-income assets ended the quarter in positive territory as Treasury yields declined for all maturities of one year or greater (yields and prices have an inverse relationship). High-yield bonds were the top performers for the period, followed by corporate bonds and U.S. Treasurys. Mortgage-backed securities (MBS) saw relatively more modest gains and were the primary fixed-income market laggards. The yields on two-, three-, five-, and ten-year Treasury notes decreased 0.35%, 0.41%, 0.39%, and 0.40%, respectively, over the quarter. The spread between ten- and two-year notes widened 0.05% to -0.58% during the period, further inverting the yield curve. Canadian bond markets showed similar strength with all sectors but real-return bonds generating strong gains for the quarter.

Global commodities markets generally lost ground over the quarter. The West Texas Intermediate (WTI) crude-oil spot price decreased 5.9%, while Brent crude oil fell 7.1% amid concerns that additional interest-rate hikes from central banks may weigh on global economic growth and reduce demand. However, the prices for both commodities rallied sharply over the last two weeks of the quarter amid easing worries about the banking crisis and supply concerns after Turkey stopped pumping oil from a pipeline in Kurdistan following an arbitration decision that the oil could not be shipped without the consent of Iraq's government. The New York Mercantile Exchange (NYMEX) natural gas price tumbled nearly 47% during the quarter as an unusually mild winter in the U.S. continued to weigh on demand during the home-heating season. The gold spot price was volatile, but ended the quarter with an 8.1% gain. The gold price rallied sharply in January due to weakness in the U.S. dollar and declining U.S. Treasury yields before falling in February on investors' worries that the Fed's rate hikes may lead to a recession in the U.S., which would hamper demand for precious metals. The spot price then rose during the banking crisis in March, as investors generally view gold as a "safe-haven" asset during times of uncertainty. Wheat prices fell 12.6% during the quarter as Egypt made a large purchase tender for Russian wheat at a relatively low price. Additionally, in March, Russia renewed a deal with Ukraine that allows the shipment of Ukrainian grain through the Black Sea.

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In the U.S., all eyes (and ears) were on the Fed over the quarter. During a discussion at the Economic Club of Washington, D.C., in early February, soon after the FOMC had implemented a 25-basis-point (0.25%) increase in the federal-funds rate, Fed Chair Jerome Powell commented that the central bank's efforts to cool inflation are "likely to take quite a bit of time. It's not going to be smooth. So we think we're going to have to do further [rate] increases, and we think we'll have to hold policy at a restrictive level for some time." The subsequent banking crisis in March may have tempered the Fed's aggressive rate-hiking policy. At a news conference following the announcement of a 25-basis-point (0.25%) increase in the federal-funds rate to a range of 4.75%-5.00%, a reporter inquired about the possibility of interest-rate cuts later this year. Powell responded, "That's not our baseline expectation." He acknowledged that the FOMC members had considered a pause in the rate-hiking cycle, given the recent turmoil in the banking sector. He also noted that prior to the onset of the banking crisis, the Fed had discussed the possibility of a more hawkish 0.50% rate increase as U.S. economic data remained relatively strong.

On March 15, U.K. Chancellor Jeremy Hunt unveiled the government's new budget, which directly addresses the nation's tight employment situation. Among some of the proposals: increasing vocational training; providing tax incentives, enhancing access to capital and easing certain regulations to encourage the creation of new enterprises. Elsewhere, the labour tensions between U.K. public employees and the government appeared to be easing. The administration of Prime Minister Rishi Sunak had been plagued by public-sector employee strikes and other job actions since late 2022, as pay increases have not kept up with the U.K.'s inflation rate, which was up 10.4% year-over-year in February, according to the Office for National Statistics (ONS). Several National Health Service (NHS) unions–including the Royal College of Nursing, GMB and Unison–supported the government's offer of a pay raise of 2% in 2022-2023, followed by a 5% increase in 2023-24, with larger raises for the lowest-paid employees. While labour issues in the health care industry appeared to be resolved, a problem arose in another area. Leaders of the National Education Union, the U.K.'s largest teachers' union, urged their members to reject the government's offer of a 4.5% wage increase over the next academic year "in the strongest possible way," commenting that the proposal was an "insulting offer from a government which simply does not value teachers."

Within the eurozone, the proposal of President Emmanuel Macron of France to raise the minimum retirement age for the country's public pension program from 62 to 64 led to civil unrest in that country. There were many violent demonstrations and several large labour unions staged widespread job actions in opposition to the plan. The tensions were exacerbated as Macron did not put the measure up for a vote in the National Assembly, France's lower house, in which his political party does not have a majority. Fears of recession in Germany arose as the nation's economy contracted by a greater-than-expected annual rate of 0.4% in the fourth quarter of 2022. High inflation weighed on consumer spending and investments in buildings and machinery during the period.

The Russia-Ukraine conflict raged on. In March, President Xi Jinping of China met with Russian President Vladimir Putin in Moscow to discuss China's proposal to end the conflict with Ukraine. The Biden administration criticized the plan as "the ratification of Russian conquest," as it proposed a ceasefire that would recognize Russia's right to occupy territory in Ukraine and provide Putin with time to bolster the nation's military forces.

Central Banks

- The Bank of Canada (BoC) paused its interest rate-hiking cycle following its meeting on March 8. The overnight rate was held steady at 4.50%, while the Bank continued reducing the amount of bonds it holds on its balance sheet—a policy known as quantitative tightening. This broke a string of eight consecutive rate hikes totaling 4.25% over the course of 2022 and early 2023. The BoC indicated that expectations are for continued moderation of consumer price inflation to about 3% by mid-2023. It also noted that a 3% level of inflation was still too high and would need to continue receding—further rate hikes may be justified based on economic conditions. The next scheduled meeting is on April 12.

- The Fed raised the federal-funds rate to a range of 4.75%-5.00% in two increments of 0.25% on February 1 and March 22. In a statement announcing the rate increase in March, the FOMC noted that, despite the current financial difficulties, "The banking system is sound and resilient. Recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation. The extent of these effects is uncertain." The FOMC also commented that it "anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." The statement omitted the Fed's longstanding reference to "ongoing increases in the (federal-funds) target range," suggesting that the central bank may be nearing the end of its rate-hiking cycle.

- The Bank of England (BOE) increased its benchmark rate by an aggregate of 0.75% to 4.25% over the quarter. The central bank noted its ongoing concerns about inflation, as the government's consumer-price index rose 10.4% year-over-year in February (the most recent available data). Even in the midst of a banking maelstrom, BOE Governor Andrew Bailey warned that further policy-rate hikes may be needed.

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- The ECB boosted its benchmark interest rate from 2.0% to 3.0% in two increments of 0.50% in February and March. In its rate-hike announcement in March, the ECB commented that “Inflation is projected to remain too high for too long” that the increase was “in line with [the ECB’s] determination to ensure the timely return of inflation to the 2% medium-term target.”

- The Bank of Japan (BOJ) left its benchmark interest rate unchanged at -0.1% following its meetings in January and March. At a news conference after the announcement of the interest-rate decision in March, outgoing BOJ Governor Haruhiko Kuroda said that the central bank “has been taking various steps to mitigate the side effects of its monetary easing. I can say that the benefits of our monetary easing have far exceeded the demerits.” Kazuo Ueda will succeed Kuroda as BOJ governor in April.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, the rate of inflation continued to moderate (as measured by the change in the Consumer Price Index (CPI)) to 5.2% for the year ending February, and increased by 0.4% for the month. Base-year effects—the rolling off of exceptionally robust price increases from February 2022 in the annual data—played a significant role in the moderation of price increases. Energy prices generally eased from the prior report, while food prices were generally strong. Producer prices declined in February, but were mixed from year-ago levels. The Industrial Product Price Index (IPPI) fell 0.8% in February, while the Raw Materials Price Index (RMPI) was down 0.4%. On a year-over-year basis, the IPPI rose a modest 1.4% and the RMPI slid 5.2%. Prices for many commodities, especially for energy and metals, were generally weaker. The Labour Force Survey remained mostly positive—the unemployment rate held steady at 5.0%, as the economy added a modest 35,000 jobs in March.

- The U.S. consumer-price index (CPI) rose 0.4% in February, down 0.1% from January, according to the Department of Labor, and was up 6.0% year-over-year. Higher housing and services costs contributed significantly to the rise in inflation in February. The government attributed the year-over-year upturn in the CPI to sharp increases in prices for energy services and food. Core inflation, as measured by the CPI for all items less food and energy, was up 0.5% in February and 5.5% over the previous 12 months. The Department of Labor reported that U.S. payrolls expanded by 311,000 in February, down sharply from 517,000 for the previous month. The unemployment rate, which had dipped to a 54-year low in January, rose 0.2% to 3.6%. The leisure and hospitality, retail trade, and government sectors saw the largest employment gains for the month. Average hourly earnings rose 0.2% in February and 4.4% year-over-year. The slowdown in wage growth over the past several months suggests that employers may be having less difficulty finding new workers. According to the Census Bureau, U.S. retail sales–a gauge of consumer spending that comprises more than two-thirds of GDP dipped 0.2% in February but rose 5.4% year over year. Non-store retailers and general merchandise stores posted the largest gains in February and over the previous 12-month period, respectively. Conversely, sales for furniture and home furnishings stores saw the most significant downturn for the month, while electronics and appliance stores recorded the greatest year-over-year decline in sales. The Department of Commerce reported that U.S. GDP grew at an annual rate of 2.6% in the fourth quarter of 2022, marking a slowdown from the third quarter's increase of 3.2%. The U.S. economy expanded by 2.1% for the 2022 calendar year. The reading was also modestly lower than the government's initial fourth-quarter estimate of 2.9%. The revised estimate resulted from downward revisions to exports and consumer spending. This was partially offset by a downward revision to imports (which are subtracted from the calculation of GDP). The upturn in GDP for the quarter was attributable to increases in private inventory investment (a measure of the changes in values of inventories from one time period to the next), consumer spending, nonresidential fixed investment (purchases of both nonresidential structures and equipment and software), federal government spending, and state and local government spending.

- According to the Office for National Statistics (ONS), consumer prices in the U.K. rose 1.1% month-over-month in February—a notable reversal of the 0.4% decrease in January. The year-over-year inflation rate increased 10.4% over the previous 12-month period, up from the 10.1% annual rise in the previous month. Housing and household services (mainly from electricity, gas, and other fuels), as well as food and non-alcoholic beverages, were the primary contributors to the year-over-year increase in prices. Core inflation, which excludes volatile food and energy prices, came in at an annual rate of 6.2% in February, up from a 12-month increase of 5.8% in January. The ONS also reported that U.K. GDP increased 0.3% in January 2023, following a decline of 0.5% in December 2022, and was flat for the three-month period ending in January. The services sector grew 0.5% in January, led by education, transportation and storage, and arts, entertainment and recreation. Conversely, production output fell 0.3% for the month due mainly to downturns in manufacturing of basic pharmaceutical products and pharmaceutical preparations, and machinery and equipment. The S&P Global/CIPS Flash UK Manufacturing Output Index declined 1.9 to a two-month low of 49.0 in March due to a decrease in demand. A reading below 50 indicates contraction in the manufacturing sector. The S&P Global/CIPS Flash UK Services PMI Business Activity Index was down 0.7 to 52.8 in March, but indicated expansion for the second consecutive month. There was particular strength in the services sector.

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- Inflation in the eurozone slowed by 1.6% to 6.9% in the 12-month period ending in March. Natural gas prices decreased 0.9% year-over-year, while food, alcohol and tobacco costs climbed 15.4% for the same period. Eurozone manufacturing activity declined in March, with the S&P Global Flash Eurozone Manufacturing Output Index falling 1.2 points to 49.9. Services activity in the eurozone reached a 10-month high in March, with the S&P Global Flash Eurozone Services PMI Activity Index increasing 2.9 points to 55.6. According to Eurostat's third estimate issued in March, eurozone GDP was stable in the fourth quarter of 2022. The eurozone economy grew 1.8% year over year in the fourth quarter and expanded 3.5% for the 2022 calendar year.

Index Data (Q1 2023)

- The S&P/TSX Composite Index gained 4.55%.
- The FTSE Canada Universe Bond Index returned 3.22%.
- The S&P 500 Index, which measures U.S. equities, gained 7.37%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was up 7.18%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 3.56% (currency hedged) and 3.59% (unhedged).
- The Chicago Board Options Exchange Volatility Index, a measure of implied volatility in the S&P 500 Index that is also known as the "fear index," fell from 21.67 to 18.70—this was despite a bout of volatility in mid-March related to issues in the banking sector.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, moved from US$80.26 to US$75.67 a barrel to end the quarter.
- The Canadian dollar was unchanged at C$1.35 per U.S. dollar. The U.S. dollar was weaker versus the euro and sterling, but slightly stronger versus the yen. It ended March at US$1.09 versus the euro, US$1.24 against sterling and at 133.09 yen.

Glossary of financial terms

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value.

A **recession** is a significant and prolonged downturn in economic activity.

Monetary policy refers to decisions by central banks to influence the amount of money and credit in the economy by managing the level of benchmark interest rates and the purchase or sale of securities. Central banks typically make policy decisions based on their mandates to target specific levels or ranges for inflation and employment.

Mortgage-backed securities (MBS) are pools of mortgage loans packaged together and sold to the public. They are usually structured in tranches (a slice or portion of a structured security) that vary by risk and expected return.

Yield curve represents differences in yields across a range of maturities of bonds of the same issuer or credit rating (are (which is used to assess the risk of default of companies or countries). A steeper yield curve represents a greater difference between the yields. A flatter curve indicates the short- and long-term yields are closer together.

An **inverted yield curve** occurs when short-term yields exceed long-term yields. While an inverted yield curve historically has predicted economic recessions, it is an indicator—not a forecast.

The **federal-funds rate** is the interest rate charged to lending institutions on unsecured overnight loans. It is set by the U.S. Federal Reserve's Federal Open Market Committee. The rate is increased when the Federal Reserve wants to discourage borrowing and slow the economy and decreased when the Federal Reserve wants to spur economic growth.

Inflation is the rate of increase in prices over a given period of time.

Gross domestic product (GDP) is the total monetary or market value of all the goods and services produced in a country during a certain period.

A **soft landing** refers to a moderate economic slowdown following a period of growth.

A **hard landing** refers to a notable economic slowdown or downturn following a period of rapid growth, usually resulting from a government's attempts to slow inflation.

Quantitative tightening refers to efforts by central banks to decrease the supply of money in the economy.

Federal-funds futures provide a gauge of market expectations about the future course of the Federal Reserve's monetary policy.

Index definitions

The **MSCI All Country World Index (ACWI)** is a market capitalization-weighted index that tracks the performance of over 2,000 companies, and is representative of the market structure of 48 developed and emerging-market countries in North

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and South America, Europe, Africa, and the Pacific Rim. The index is calculated with net dividends reinvested in U.S. dollars.

The **ICE BofA U.S. High Yield Constrained Index** is a market capitalization-weighted index which tracks the performance of U.S. dollar-denominated below-investment-grade (rated BB+ or lower by S&P Global Ratings and Fitch Ratings or Ba1 or lower by Moody's Investors Service) corporate debt publicly issued in the U.S. domestic market.

Consumer-price indexes measure changes in the price level of a weighted-average market basket of consumer goods and services purchased by households. A consumer price index is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically.

A **purchasing managers' index (PMI)** tracks the prevailing direction of economic trends in the manufacturing and service sectors.

The **S&P Global/CIPS Flash UK Manufacturing Output Index** measures the activity level of purchasing managers in the manufacturing sector of the U.K. A reading above 50 indicates expansion in the sector; below 50 indicates contraction.

The **S&P Global Flash UK Services PMI Business Activity Index** measures the activity level of purchasing managers in the services sector. A reading above 50 indicates expansion in the sector; a reading below 50 indicates contraction.

The **S&P Global Flash Eurozone Manufacturing Output Index** measures the activity level of purchasing managers in the manufacturing sector of the eurozone. A reading above 50 indicates expansion in the sector; below 50 indicates contraction.

The **S&P Global Flash Eurozone Services PMI Activity Index** measures the activity level of purchasing managers in the services sector of the eurozone. A reading above 50 indicates expansion in the sector; below 50 indicates contraction.

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