

A Rebound Has Never Felt So Good

July 2022

Market vitals

- Global markets rebounded in July (up 7%), after falling more than -20% in the 1H 2022.
- In several major markets, the technology sector led the charge in July.
- The rebound comes despite the European Central Bank raising interest rates and two consecutive quarters of negative GDP growth in the US.

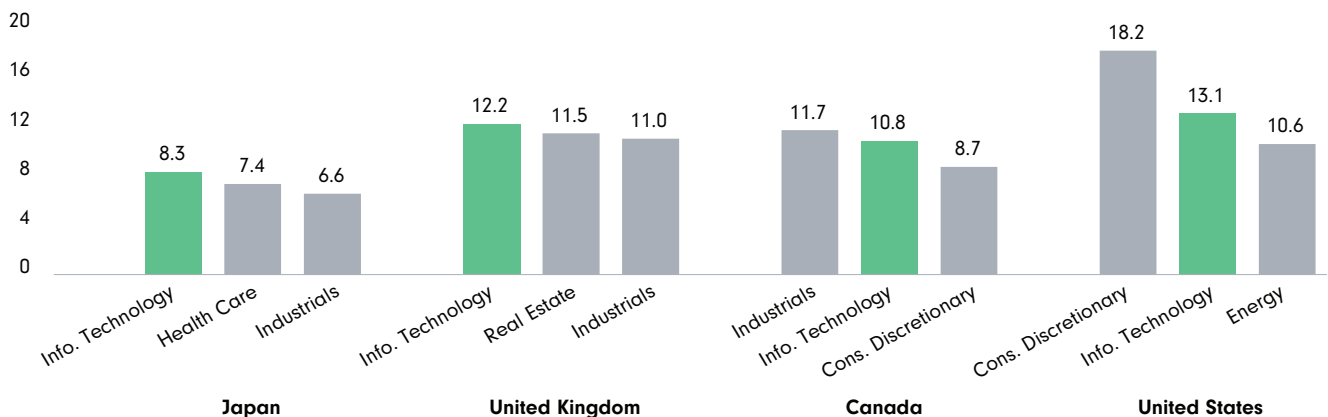
Market summary

After one of the worst starts to a year, global stocks advanced in July, providing a welcome reprieve for investors who have been dealing with a challenging macro environment highlighted by rising inflation, Russia’s war in Ukraine and slowing economic growth. Year to date, July is the second month of positive returns (March being the other one) for global markets this year.

Stocks in Europe, the Middle East and Africa, and Latin America posted gains north of 4% in July. Asia Pacific was an outlier (up 2%), dragged down by a -10% decline in Chinese stocks. In Europe, the Netherlands and Sweden saw the biggest gains with stocks up 10%–11%, while stocks in France, Switzerland and the UK were up 6.5%, 4.7% and 3.8%, respectively. In Asia, Japanese equities were up 5.7% and stocks in India advanced 9.4%.

In several major developed markets, technology stocks were among the biggest winners, having been oversold in the first half of 2022. Other more cyclical sectors also performed well.

Exhibit 1 – Top Three Performing Sectors in Major Markets (July) (%)



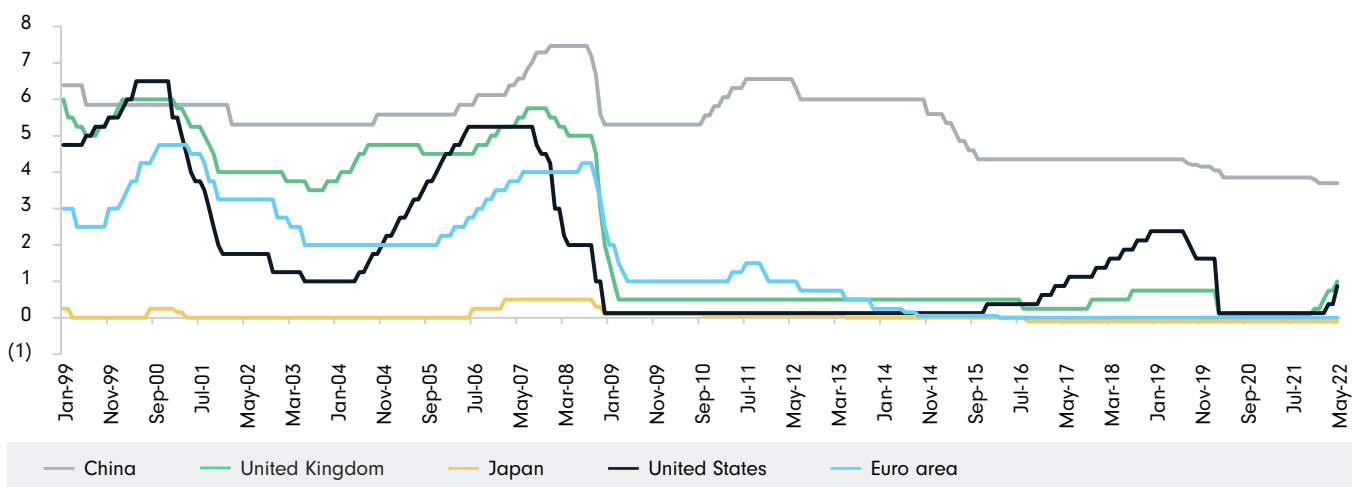
Source: FactSet. Non-US sector returns based on MSCI ACWI ex USA Index; US sector returns based on Russell 3000 Index.

Europe – currency and political headwinds

In July, the euro fell below parity with the US dollar for the first time in 20 years reflecting the region’s economic woes, driven by the pandemic, inflationary headwinds and Russia’s war in Ukraine, which is pushing up gas prices and threatening Europe’s gas supply. Not to mention political instability in Italy after prime minister Mario Draghi resigned, prompting the dissolution of parliament and an unexpected election in September.

The euro has depreciated more than 10% since the start of the year when one euro bought \$1.14 (one euro bought \$1.02 as of the final trading day in July). The European Central Bank (ECB) has been less aggressive than the US Federal Reserve in terms of monetary policy. It stopped asset purchases in June (the US Fed stopped in March) and doesn’t have plans to start reducing its balance sheet until 2024 (US Fed has already started). The ECB’s short-term interest rate sat at -0.5% prior to the higher-than-expected 50 bps increase in late-July, taking its key interest rate to zero. The ECB indicated it would continue increasing rates at a normal level, determining the size of future increases at each meeting based on the latest economic data.

Exhibit 2 – Central Bank Policy Rates (%)



Source: Bank for International Settlements (BIS) policy rate statistics.

Other news from Europe

- Spanish unemployment fell 12.5% in Q2, its lowest level since 2008.
- German inflation accelerated to 8.5% in July driven by a large jump in food and energy prices.
- With inflation at 9.4% in the UK, consumer borrowing doubled in June as the cost of living rose.
- In the UK, car production remains below pre-COVID levels due to shortages in the supply chain for parts and semiconductors. Output is not expected to resume until at least 2025.
- Boris Johnson, the UK’s prime minister, resigned from his position in July amid fallout from a string of scandals. He will remain prime minister until a successor is determined.

China

Chinese stocks were down over -10% in July with technology and real estate shares leading the broad selloff. Regulatory uncertainty continues to cloud the tech space while the battered real estate property market continues facing a liquidity crunch. As a reminder, the large Chinese property developer Evergrande reported in the 2H 2021 that it was at risk of default following new Chinese regulations on company debt limits. Evergrande went on to officially default in December 2021, as have other property developers. Though the People's Bank of China recently committed \$148 billion in loans to help shore up the property market, it remains to be seen how much and how fast the bailout will help. Moreover, GDP grew at an annual rate of 0.4% in Q2, the weakest growth China has seen since Q1 2020.

United States

The S&P 500 advanced 9% in July, its best month since November 2020. The tech-heavy NASDAQ added just over 12% as investors gobbled up tech stocks that had gotten beaten up earlier this year. All sectors (based on the Russell 3000 Index) posted gains in July. Technology heavy-weights Microsoft, Apple and Alphabet issued more positive outlooks than investors expected, while oil companies ExxonMobil and Chevron reported record quarterly profits due to rising oil and gas prices.

US inflation hit 9.1% in June, its highest level in nearly 41 years. Food and energy were the biggest contributors. US Q2 GDP fell -0.9% for the second quarter in a row (fell -1.6% in Q1) – a common definition of recession (read our [fixed income update](#) for more detail on recession definitions) – driven by high inflation, softer consumer sentiment and supply chain headwinds.

MSCI ACWI Index measures the performance of large- and mid-cap stocks across 23 developed and 25 emerging markets. **MSCI ACWI ex USA Index** measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. **Russell 3000 Index** measures the performance of roughly 3,000 of the largest US companies. **S&P 500 Index** measures the performance of 500 large companies in the US. The indexes are unmanaged, market capitalization weighted, include net reinvested dividends, do not reflect fees or expenses and are not available for direct investment. See diamond-hill.com/disclosures a full copy of the disclaimer.

As of 30 June 2022, Diamond Hill owned shares in Microsoft Corp., Alphabet, Inc. and Chevron Corp.

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