Investment Strategy Insights

Monthly Views From Our Diverse Global Investment Teams

PineBridge® INVESTMENTS

What a Hot and Hungry Summer Could Mean for Inflation

Michael J. Kelly, CFA, Global Head of Multi-Asset

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Crop failures and food shortages may seem like vestiges of the past, at least in developed countries. But this summer and fall may come to show that the past is still very much with us. Worldwide disruptions in food supplies are likely to continue fueling inflation in the developed world and could pose even greater problems for developing markets.

While much of the food-shortage issue stems from the effects of the Russia-Ukraine war, weather is also a major factor. Climate change is steering conditions to be either too wet or too dry. In the US, roughly half the nation, mostly in the West, has been suffering from years of chronic drought. Much of the other half has been subject to violent rainstorms, flooding, and tornados. All have taken a toll on agriculture.[1]

In its much-watched June acreage report released on the last day of the month, the Department of Agriculture estimated that 89.9 million acres of corn have been planted in the US for 2022, down 4% from last year.[2] It also noted that the 47.1 million acres being devoted to wheat represents the fifth-lowest wheat-planted area since records began in 1919. Globally, the outlook for 2022-2023 wheat production has deteriorated sharply in recent months, according to reports from a recent meeting of the International Grains Council in London.[3]

Since Ukraine and Russia together account for about one-quarter of the world's trade in wheat and other similar grains, the war has disrupted Ukrainian agriculture. Whether from Putin's explicit attempts to stir a global hunger crisis, or trade restrictions imposed on Russia by the European Union and the US, Russian fertilizer exports are also down substantially this year.[4] Russian troops have also reportedly made Ukrainian livestock military targets.

Widespread hunger in the developing world not only would spawn a humanitarian crisis, it also could spark political unrest. Fortunately, there are a few partial cross-currents.

Several nations, including Egypt and Jordan, have stored grain, which will help them ride out the current difficulties. Fortuitously, record Australian wheat and Brazilian corn crops combined with strong sales of wheat by Russia to the Middle East and North Africa are also serving as partial offsets.[5]

Markets would normally look through the impacts of food and energy, focusing instead on core inflation, which is finally showing signs of cresting. But Chair Powell has reminded all that consumer inflation expectations are a key focus for the Fed, to ensure that inflation expectations do not seep into wage and price expectations. He also reminded us that these rising expectations are highly influenced by food and energy.

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

[1] World-Grain.com as of 29 June 2022. https://www.world-grain.com/articles/17105-worries-about-wheat

[2] United States Department of Agriculture, National Agricultural Statistics Service as of 30 June 2022. https://www.nass.usda.gov/Newsroom/2022/06-30-2022.php

[3] International Grains Council as of 30 June 2022. https://www.igc.int/en/

[4] Bloomberg as of 13 June 2022. https://www.bloomberg.com/news/articles/2022-06-13/us-quietly-urges-russia-fertilizer-deals-to-unlock-grain-trade

[5] Bloomberg as of 6 June 2022. https://www.bloomberg.com/news/articles/2022-06-06/bumper-wheat-crop-looming-in-australia-set-to-ease-tight-market?srnd=markets-vp&sref=fyhEsXfZ#xj4y7vzkg

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Economy

Markus Schomer, CFA
Chief Economist,
Global Economic Strategy

CS 3.25 (unchanged)

Stance: Our score remains unchanged and moderately bearish, more due to downside risk for the growth outlook than to fundamentals. We are close to peak bear sentiment, and while inflation is still rising in most economies, it is likely to slow in the US. China's macro data has been extremely bearish, which should prompt more policy easing, and economic data in the US keeps surprising on the upside. We are starting to look for a trigger to upgrade the CS back to neutral but want to wait and see the initial impact of the Fed's quantitative tightening on markets and the economy.

Backdrop: We are still on the bearish side of the current mini-cycle. Inflation hasn't convincingly rolled over, and growth continues to slow. But PMIs are still holding above 50, real consumer spending is still positive, and central bank policy rates are still below neutral, meaning monetary policy is not outright restrictive. We still see this as a slowdown but not an automatic path to recession. Central banks must talk a hawkish game as long as inflation is still accelerating. Once that trend turns, banks will change their rhetoric and re-focus on growth and unemployment.

Outlook: Our base case is still 'Slowdown, no Recession.' That assumes a rebound in real-income growth later this year. The US led major developed markets (DMs) in the upcycle of the great 2022 inflation surge and we expect it also will lead on the way down. The US economy is slowing more noticeably, and the second and especially third quarters could well see below-trend quarterly growth rates, but no recession — which is much more likely in Europe, especially if Russia continues to reduce energy deliveries. China's outlook has improved somewhat after the lifting of many Covid restrictions and more signs of policy easing. We will likely upgrade our score in the next few months once more convincing evidence emerges of inflation having peaked.

Risks: 1) Geopolitical events that push energy prices even higher, 2) Central bank policy errors, particularly in Europe, and 3) A sudden change in corporate demand for workers.

Rates

Gunter Seeger, CFA
Portfolio Manager, Developed Markets Investment Grade

CS 2.00 (unchanged)

As the war in Europe and Covid lockdowns continue, the path to a soft landing becomes less likely. Consumer sentiment numbers are disastrous, and retail sales are falling. We anticipate that a slowing economy will be a poor environment for equities and credit, but a robust rally in the long end of the Treasury curve ultimately will happen, even amid higher inflation. The lesson: Don't fight the Fed or the European Central Bank (ECB). When the latter was in full quantitative easing (QE) last August, the Greek 10-year was at 55 basis points. The ECB then decided to end QE and the Greek 10-year moved to 4.74%. In June, mere hours before the Fed's 75-basis-point hike, the ECB had an "emergency meeting" saying it will continue to purchase periphery credits if necessary, driving the Greek 10-year to 3.86% (at 21 June 2022). Without meaningful progress on the war and Covid, our score could change to 1.0 based on a forecast of strong economic headwinds in the US.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

CS 3.25 (unchanged)

Since valuations are not yet reflecting recession or stagflation and near-term trends indicate greater chances for risk assets to cheapen further, we are maintaining our current slightly defensive posture. Credit spreads, particularly in leveraged finance, have widened sufficiently to offer attractive total return prospects over the intermediate term. In high yield (HY), spreads have crossed +500 levels, and total yields exceeding 8.5% offer enticing return potential. Loan prices also have cheapened meaningfully, and a path toward a flatter yield curve as SOFR rises should close the total yield gap. Investment grade (IG) spreads have been more resilient as investors become more defensive, and the BB-BBB differential has increased to +170-180 levels, making BBs much more appealing. While European spreads and foreign exchange (FX) adjusted yields provide a premium over the US, we prefer to maintain a geographically defensive posture of being overweight US credit versus Europe and emerging markets (EM) as we believe the differential is not yet sufficient for the risks. Overall, as probabilities tilt more toward near-term widening than tightening, we are maintaining an incrementally defensive posture.

Currency (USD Perspective)

Joey Cuthbertson, CFA
EM Sovereign Analyst,
EM Fixed Income

CS 2.75 (unchanged)

The strong US dollar remains supported by rising yield differentials, the persistent terms-of-trade shock, and broad risk aversion. While valuation models suggest it is now expensive, notwithstanding that other major currencies are fading due to their home-grown issues, we continue to project a stronger trend for the US dollar short-term and cannot rule out parity against the euro over the summer. The euro's higher beta to China and the second-order effects of the Ukraine crisis leave the currency vulnerable to further shocks. Furthermore, widening spreads between Italian and German government bonds raise memories of the eurozone financial crisis, which may limit the ECB's ability to hike rates much above zero. The longer-term fate of the US dollar rests largely on the Fed's ability to tread a fine line between reining in stimulus while containing pessimism over a possible US recession. The Bank of Japan continues to be the lone dove among hawks, and we see no signs of it reversing its yield-curve control policies. That, and higher oil prices and increasing yield differentials, have prompted us to move our US dollar/Japan yen forecast higher to 147, but a quicker-than-expected deterioration in global growth leading to an unwinding of global hawkishness could trigger a 2016-style period of yen appreciation.

Emerging Markets Fixed Income

Chris Perryman
Senior Vice President, Corporate Portfolio Manager and Head of Trading, Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.50 (+0.50)

Local Markets (Sovereign)
CS 3.00 (+0.50)

Despite a challenging global macro backdrop, EM companies remain optimistic. Above all, they are in a strong position, with stable net margins and leverage at its lowest point in 10 years; they can ride out the downcycle. First-quarter results and conversations with companies in Asia, Latin America, Central and Eastern Europe, the Middle East, and Africa support our neutral to slightly positive credit outlook. Identifying winners and losers within sectors remains key. Near-term, EM credits are unattractive on an index spread basis in comparison with US high yield. Ultimately, the threat of a global recession next year and an overly aggressive Fed justify a defensive approach as part of our quality and creditworthiness theme. Our current strategy is defensive and selective, with a low-beta, short-duration focus. Corporate IG stands out as most attractive on a risk-adjusted basis, yet the risk of Fed overtightening and a further US Treasury yield overshoot make higher cash levels and investment flexibility more desirable.

Multi-Asset

Sunny Ng
Managing Director, Portfolio Manager, Global Multi-Asset

CS 3.50 (unchanged)

China continues to be out of sync with other economies. Its shift to a "dynamic zero-Covid" policy, coupled with a stimulus plan, have initiated a reopening of its economy. This is good news for Main Street but a return to bad news for Wall Street. By "slowing the slowdown," China's economic revival will put to rest fleeting hopes for a Fed pause or a peak of inflation. We maintain a cautious score of 3.5. Stagflationary pressures are likely to persist in the near-term, although our base case calls for inflationary pressures to moderate and for the economy – which is on a solid footing – to withstand moderately higher rates and higher unemployment over the medium term. The potential for a policy mistake, however, cannot be ignored, as demand-driven tools are likely to fail in fighting supply-driven inflation in the months ahead, and overtightening won't be visible until after the fact. Remember, too, that Fed tightening affects the economy and markets differently. Massive, long-lasting QE had virtually no effect on the economy yet was highly favorable for markets. Now the film is running in reverse.

Global Equity

Chris Pettine, CFA
Senior Vice President, Senior Research Analyst, Global Focus Equities

CS 2.50 (unchanged)

Company management teams are expressing continued confidence in strong demand and healthy order books, while labor and supply chains remain manageable. The outlook is now a little more challenged, as persistent inflation has pushed central banks to act more forcefully. The impact of higher interest rates and FX volatility adds to the pressures that companies have so far handled successfully. Markets are reacting adversely to the macro picture, pricing in a hiking cycle and a recession, which 60% of CEOs are seeing in the next 12 to 18 months, according to the latest Conference Board survey. As valuations have come down considerably across sectors and life cycle categories, we are finding more opportunities and are revisiting strong companies where we have confidence in the earnings outlook.

Global Emerging Markets Equity

Taras Shumelda
Senior Vice President,
Portfolio Manager,
Global Equities

CS 2.25 (unchanged)

We retain our high-conviction long-term outlook and score. Near-term, geopolitics and macro conditions are a headwind, but any reduction in sector- or style-driven dominance plays well to our investment strengths. In China, auto purchase tax cuts surprised positively in terms of scale and model range; property sales have recovered slightly; supply chain disruptions are lessening; and the worst in e-commerce seems over, but recovery will be slow. Shanghai and other cities saw gradual relaxation of Covid measures. Regulatory, monetary, and fiscal policy support is more visible. In India, government interventions to address inflation are creating winners and losers. For example, a new 15% export duty on steel triggered a steep correction in steel prices and lower producer profitability, but user industries are likely to benefit. Latin America recently saw a drawdown similarly to other parts of the world amid broader market volatility, inflation concerns, and domestic uncertainties. Still, the region's appeal based on the relative growth and valuation of its equities remains. Central and Eastern European economies are absorbing the shock of war and inflation, with regional stocks somewhat stabilizing after a large sell-off. Middle East and North Africa equities have been weak due to recent commodity price softness. We added to our exposure in China internet due to the improving regulatory environment. Overall, we consider long-term opportunities to be some of the best we have seen in years.

Quantitative Research

Haibo Chen, PhD
Managing Director,
Portfolio Manager,
Head of Fixed Income
Quantitative Strategies

Our US Market Cycle Indicator (MCI) improved to 3.47, a small reversal in its downward trajectory, but the first since September 2021. The move came as a result of a steeper curve (up 13 bps) outweighing BBB spread-widening (up 2 bps). Our Global Corporate Model remains positive on EM and negative on developed markets. In industry selection, it favors energy, natural gas, electric, basic industry, and insurance, and dislikes brokerage, financial, consumer cyclicals, and technology. Our Global Rates Model continues to forecast lower yields and flatter curves. The rates view expressed in our G10 Model portfolio is overweight global duration. It is slightly underweight North America (underweight the US and overweight Canada), slightly overweight Europe (overweight peripheral and underweight core countries), and slightly overweight Australia/New Zealand in Asia while slightly underweight Japan. Along the curve, we still position on flattening and are overweight the long end.

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