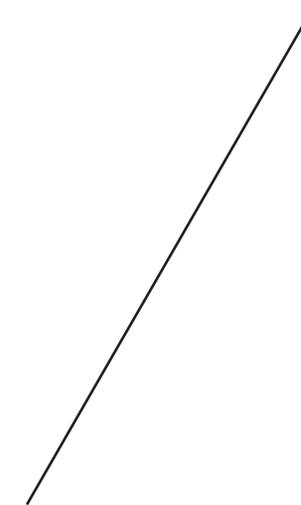


# Q3 2022

## GLOBAL MARKET OUTLOOK



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# SYNOPSIS

Recession fears and central-bank tightening are driving market volatility. We think equity markets are oversold, and believe U.S. core inflation has likely peaked. In our view, this should help markets stabilize and possibly recover over the second half of 2022.

## KEY MARKET THEMES

Markets have faced a laundry list of concerns this year, including new COVID-19 lockdowns and an economic slowdown in China, the Russia-Ukraine war, surging inflation and central-bank tightening. This has led to a tough first half of the year, with global equities down around 20% and the Bloomberg Global Treasury benchmark off 9%, as of mid-June.

Our composite sentiment index, which measures investor sentiment for the S&P 500® Index via a range of technical, positioning and survey indicators, reads as deeply oversold. This provides some reassurance that markets have accounted for the bad news so far and could recover if inflation and growth turn out better than currently feared. Of course, it's possible that investors will panic and reach a *sell-everything* capitulation point. The lesson from previous market corrections, however, is that periods of panic can provide the best opportunities for longer-term investors.

The main uncertainty is the outlook for the U.S. economy. We believe the pace and magnitude of U.S. Federal Reserve (Fed) tightening creates the risk of a recession by the second half of 2023. While a deep recession could trigger a larger equity bear market, we think a slowdown or mild recession are the two most likely outcomes. The upside risk for the U.S. economy and markets comes from the possibility that U.S. core inflation has peaked. This, combined with some softening in the labor market, could allow the Fed to become less hawkish in the second half of the year.

In Europe, the European Central Bank (ECB) has recently turned hawkish, signaling that a 25-basis-point rate rise is likely in July and that it's winding down its quantitative easing programs. Futures markets expect the ECB's policy rate to rise from -0.5% currently to 2.0% by the middle of 2023. Meanwhile, headline inflation in the eurozone reached 8.1% in May, in line with the U.S. and the UK. Core inflation, however, is more subdued at 3.8%—compared to around 6% in the U.S. and the UK. This should

allow the ECB to tighten policy by less than the Fed or Bank of England (BoE).

The UK economy is likely to continue slowing, as households cope with rising mortgage rates, high energy prices and the 1.25% increase in the national insurance levy that took effect in April. The BoE has recently softened its hawkish rhetoric and faces a difficult balancing act between reining in inflation expectations and preventing a sharp economic downturn. Despite these concerns, the UK continues to be the best performing major equity market this year as measured by the FTSE 100 Index. With high exposure to commodity prices and financial stocks that benefit from higher interest rates and almost no exposure to under-pressure technology stocks, the index reflects the cheapest of the major equity markets, and offers a dividend yield of 3.9% as of mid-June 2022.

In China, recent lockdowns triggered a significant slowing in economic activity, but early signs of a tentative reopening have emerged. However, the low level of vaccination among the nation's elderly means the risk of further lockdowns will continue until either vaccination rates increase or COVID-19 treatment production reaches critical mass.

In Japan, the economy continues to face the challenge of higher energy and food prices, which have been exacerbated by the significant depreciation in the Japanese yen. We think this decline in the yen should improve the export-oriented parts of the economy through the second half of the year.

In Australia, interest-rate increases and higher fuel costs have caused consumer confidence to fall. The Reserve Bank of Australia has raised rates from 0.1% to 0.85%, and the market expects the cash rate to reach 4% by early next year. We think this is too aggressive, given the country's heavy use of variable rate mortgages and the impact this will have on household disposable incomes.

The Bank of Canada (BoC)'s unmistakably hawkish tone has been surprising, especially since signs are emerging that housing-market fundamentals are unwinding. We believe the developing instability of Canadian housing will eventually limit the BoC, but more conclusive signs of a correction may need to emerge before the bank can pivot. This raises the risk that rates will rise above neutral before a policy shift occurs.



## ECONOMIC VIEWS



### INFLATION

We think headline inflation may rise further if international sanctions on Russian oil exports cause an additional increase in energy prices. Core inflation, however, may have already peaked in the U.S.



### U.S. RECESSION RISKS

We judge that recession risks at around 30% through mid-2023 are already higher than normal—and are likely to increase further in the months ahead.



### CHINA STIMULUS

We expect more fiscal stimulus in China, most likely in the form of consumption vouchers. Further easing measures should help the under-stress property market stabilize in the second half of the year.



### EUROPEAN RECESSION RISKS

We believe the most significant risk for Europe is if Russia responds to the European Union's embargo of its oil exports by cutting off gas supplies to the region. Europe's heavy dependence on Russian gas means that retaliation and a large rise in gas prices would almost certainly send the region into a recession.



### U.S. LABOR MARKET

In our view, some cooling in the U.S. labor market is likely. High wages should encourage workers back to the labor force—particularly lower-wage workers who have been the most reluctant to return and have had the largest wage gains. The Fed's shift to higher interest rates should also slow aggregate demand.

## ASSET CLASS VIEWS

### Equities: Preference for non-U.S. developed equities

We prefer non-U.S. developed equities to U.S. equities. They're relatively cheaper and we think they'll benefit from weakness in the U.S. dollar, should the Fed become less hawkish.

### Fixed income: Improved valuations for government bonds

We think government bond valuations have improved after the rise in yields, with U.S. bonds now offering good value, although we still see Japanese, German and UK bonds as moderately expensive. A positive for government bonds is that markets have fully priced hawkish outlooks for most central banks. In our view, this should limit the extent of any further selloff.

### Currencies: Strong U.S. dollar could weaken if hostilities subside

The U.S. dollar has made gains this year on Fed hawkishness and safe-haven appeal during the Russia-Ukraine conflict. We think it should weaken if hostilities subside, and if lower inflation outcomes later in the year lead to less Fed tightening than markets currently expect. The main beneficiaries are likely to be the euro—which has become more undervalued—and the Japanese yen, which has weakened on commodity price inflation and China growth concerns.



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## IMPORTANT INFORMATION

The views in this Global Market Outlook report are subject to change at any time based upon market or other conditions and are current as of June 27, 2022. While all material is deemed to be reliable, accuracy and completeness cannot be guaranteed.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Keep in mind that, like all investing, multi-asset investing does not assure a profit or protect against loss.

No model or group of models can offer a precise estimate of future returns available from capital markets. We remain cautious that rational analytical techniques cannot predict extremes in financial behavior, such as periods of financial euphoria or investor panic. Our models rest on the assumptions of normal and rational financial behavior. Forecasting models are inherently uncertain, subject to change at any time based on a variety of factors and can be inaccurate. Russell believes that the utility of this information is highest in evaluating the relative relationships of various components of a globally diversified portfolio. As such, the models may offer insights into the prudence of over or under weighting those components from time to time or under periods of extreme dislocation. The models are explicitly not intended as market timing signals.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Investment in global, international or emerging markets may be significantly affected by political or economic conditions and regulatory requirements in a particular country. Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation. Such securities may be less liquid and more volatile. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and political systems with less stability than in more developed countries.

Currency investing involves risks including fluctuations in currency values, whether the home currency or the foreign currency. They can either enhance or reduce the returns associated with foreign investments.

Investments in non-U.S. markets can involve risks of currency fluctuation, political and economic instability, different accounting standards and foreign taxation.

Bond investors should carefully consider risks such as interest rate, credit, default and duration risks. Greater risk, such as increased volatility, limited liquidity, prepayment, non-payment and increased default risk, is inherent in portfolios that invest in high yield

("junk") bonds or mortgage-backed securities, especially mortgage-backed securities with exposure to sub-prime mortgages. Generally, when interest rates rise, prices of fixed income securities fall. Interest rates in the United States are at, or near, historic lows, which may increase a Fund's exposure to risks associated with rising rates. Investment in non-U.S. and emerging market securities is subject to the risk of currency fluctuations and to economic and political risks associated with such foreign countries.

Performance quoted represents past performance and should not be viewed as a guarantee of future results.

The S&P 500® Index, or the Standard & Poor's 500, is a stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ.

The FTSE 100 Index is a market-capitalization weighted index of UK-listed blue chip companies.

The Bloomberg Global Treasury Index tracks fixed-rate, local currency government debt of investment grade countries, including both developed and emerging markets. The index represents the treasury sector of the Global Aggregate Index. The index was created in 1992, with history available from January 1, 1987.

Indexes are unmanaged and cannot be invested in directly.

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