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In this week's recap: Stocks rally, despite recession concerns.

Weekly Economic Update

Presented by Ed Papier, June 27, 2022

THE WEEK ON WALL STREET

Prospects of cooling inflation powered a rally in stock prices last week despite growing recession concerns.

The Dow Jones Industrial Average gained 5.39%, while the Standard & Poor's 500 climbed 6.45%. The Nasdaq Composite index rose 7.49% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, edged 0.78% higher. [1,2,3]

STOCKS BOUNCE

Declining energy and food prices and falling bond yields signaled a potentially improving inflation outlook, buoying investor sentiment. The rally in stocks was most powerful on the first and final trading days of a holiday-shortened week. Stocks turned a bit choppy mid-week as investors digested Fed Chair Jerome Powell's Senate appearance but resumed their momentum on Thursday and rallied Friday as rate-hike expectations eased.

Though the weekly gain was a welcome respite from the market's downward trend, declining bond yields and falling food and energy prices can also be interpreted as signs of slowing economic growth, which may represent a headwind for corporate earnings in the months ahead.

POWELL TESTIFIES

Fed Chair Jerome Powell told members of the Senate Finance Committee that the Fed is committed to lowering inflation and moving quickly to do so. He conceded that a recession could result from the Fed's inflation-fighting efforts and acknowledged that some of the forces driving inflation (e.g., supply chain, war) are out of the Fed's control. [4]

Perhaps the most exciting part of his testimony was what he didn't say, which was a definitive statement on future hikes. Instead, Powell told lawmakers that he "anticipate[s] that ongoing rate increases will be appropriate." Before his testimony, the Fed published a new research paper that found a greater than 50% chance of recession in the next four quarters. [5]

THE WEEK AHEAD: KEY ECONOMIC DATA

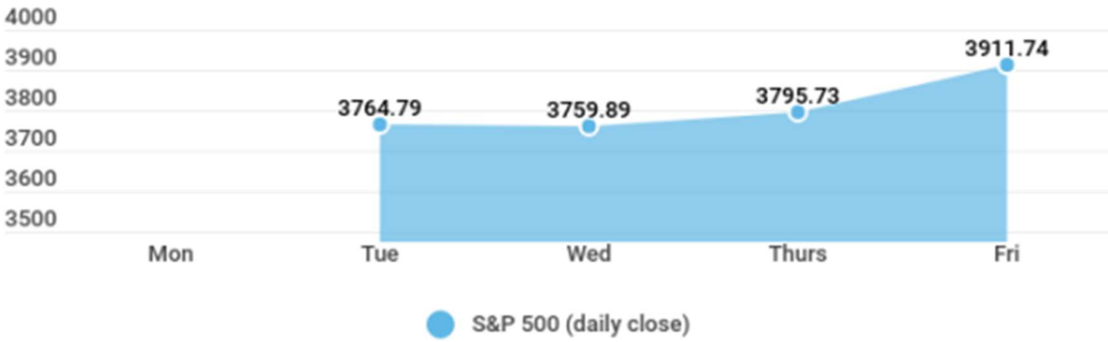
Monday: Durable Goods Orders.
Tuesday: Consumer Confidence.
Wednesday: Gross Domestic Product (Third Estimate for Q1).
Thursday: Jobless Claims.
Friday: Institute for Supply Management (ISM) Manufacturing Index.

QUOTE OF THE WEEK

"Loneliness does not come from having no people about one, but from being unable to communicate the things that seem important to oneself, or from holding certain views which others find inadmissible."

CARL JUNG

Market Index	Close	Week	Y-T-D
DJIA	31,500.68	+5.39%	-13.31%
NASDAQ	11,607.62	+7.49%	-25.81%
MSCI-EAFE	1,837.39	+0.78%	-21.35%
S&P 500	3,911.74	+6.45%	-17.93%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.13%	-0.12%	+1.61%

Sources: The Wall Street Journal, June 24, 2022; Treasury.gov, June 24, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, June 17, to Friday, June 24, close. Weekly performance for the MSCI-EAFE is measured from Friday, June 17, open to Thursday, June 23, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Since the start of 2019, investors have plowed more than $300 billion into environmental, social and governance (ESG)-themed exchange traded funds. Monthly investment has ebbed and flowed, but the annual trend has been on a consistent upward trajectory: $30 billion in 2019, $94 billion in 2020, and $159 billion in 2021.

Something happened this May, however. The biggest class of ESG ETFs had outflows for the first time in almost six years. Bloomberg tracks three types of ESG exchange-traded funds: equities, which hold stock in companies; fixed income, which hold bonds; and commodities and alternatives, which hold … commodities as well as hedge funds, real estate and infrastructure funds. Total ESG inflows last month were barely positive, relatively speaking — about $400 million, whereas flows in 2021 averaged $11 billion and twice topped $20 billion. More importantly, equity flows were negative, with a bit more than $200 million leaving the universe of ESG ETFs.

Last month's negative flow is also striking in the context of just how much money was going *into* ESG ETFs only a year and a half ago. In January 2021, more than $20 billion poured into ESG equity ETFs, a high-water mark that no other month of fund flows even approaches. The trend has been steadily downward for six months.

The resulting decline in equity ETF net flows — and the plateau in cumulative flows to the asset class — means that 2022 is now running behind 2020, and investment is at less than one-third the pace of 2021.

If May 2022 was a nadir in one way, it was an ESG peak in another. Using Google Trends to track ESG interest over time shows that last month was the high point for web searches for the term in the past five years. Looking at the data, we see a dramatic spike in the week of May 15.

It isn't hard to find reasons why. On May 18, none other than Elon Musk described ESG as a "scam" that "has been weaponized by phony social justice warriors." A day later, an HSBC executive said that "climate change isn't a financial risk that we need to worry about", adding a series of colorful attacks on sustainable investing approaches in general (the bank swiftly suspended him as a result).

Correlation (negative, in this case) isn't causality, of course. But it is worth considering that a peak in ESG interest, coinciding with two highly public and decidedly negative statements on the very nature of environmental, social and governance, might lead institutional fund managers to question their recent allocations. Elon Musk has legions of fans, many of whom might invest based on his stated position on ESG, and retail investors are "slowly starting to look under the hood" of the industry and not always liking what they see, as Bloomberg's Natasha White and Frances Schwartzkopff recently reported. But the fund flows that Bloomberg tracks are almost entirely those of institutional investors, not retail investors acting on their own behalf.

It's also worth considering that some institutional fund managers may be seeking returns elsewhere. The S&P Oil & Gas Exploration and Production ETF was up 68% year to date through June 7, with a significant portion of that run-up happening in May.

And there is a final factor to take into account: a regulatory crackdown. It emerged last weekend that the US Securities and Exchange Commission is investigating the ESG claims of the asset-management unit of Goldman Sachs Group Inc., after the agency announced "a slate of new restrictions Wednesday aimed at ensuring ESG funds accurately describe their investments." At the end of May, German police raided the offices of Deutsche Bank AG and DWS Group over allegations of greenwashing.

The ESG reality lies somewhere between a politically weaponized scam and an investing nirvana with perfect clarity and transparency. As that reality resolves itself — through investors' decisions, regulatory scrutiny and perhaps still a tweet or two — ESG fund flows may find their new normal. [6]

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Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:
1. The Wall Street Journal, June 24, 2022
2. The Wall Street Journal, June 24, 2022
3. The Wall Street Journal, June 24, 2022
4. The Wall Street Journal, June 22, 2022
5. The Wall Street Journal, June 22, 2022
6. advisorperspectives.com/articles/2022/06/17/esg-investment-cools-as-the-sectors-notoriety-grows?topic=alternative-investments