MAPM: Markets Weekly

15th October 2021

Summary

- Equity markets rebound (+1-2%) as government bond yields take a breather (down 5-10bps)
- US QE tapering set to begin in mid-November or mid-December, provided that the economic recovery remains broadly on track
- European Union launches its first ever Green Bond

Market and Economic review

Equity markets rebounded this week as lower government bond yields, decent economic data, and a strong start to quarterly earnings encouraged investors to buy the dip. Investors have begun taking money out of fixed income funds whilst equity inflows have remained unabated, the US remaining the favourite region. Government bond yields in US were down 7bps and in the UK down 9bps; corporate bond spreads also narrowing on the week.

Minutes from the Federal Reserve's September meeting signposted that tapering, a reduction in the emergency pandemic support QE package, will begin in mid-November or mid-December. The general consensus appears to be for a mid-November announcement. The illustrative guidance was for a $10bn reduction in Treasury securities and $5bn of mortgage backed securities from the monthly purchases, concluding by mid-2022. US CPI continued to inch higher with September figures revealing a 0.1% increase to 5.4% year on year whilst Core CPI remained at 4.0% year on year. The number of Americans filing for unemployment benefits dropped below 300,000 last week for the first time in 19 months. Further evidence the labour market is in good health and the recent slowdown in jobs growth, as indicated in last week's Non-Farm Payrolls numbers (+194k, exp. +500k), is a supply restriction as opposed to demand driven.

The IMF reduced its forecast for 2021 economic growth by 0.1% to 5.9%, citing supply-chain bottlenecks in developed countries and slow vaccination programs in developing countries. 2022 predictions remain unaltered. Goldman Sachs are aligned, lowering US growth forecasts for both 2021 and 2022 to reflect a slower recovery in consumer spending and lasting disruptions to semiconductor supply.

China trade numbers for September were a pleasant surprise, Exports up 28.1% year-on-year, from 25.6% and a beat of over 7% compared to expectations. Imports sagged (17.6% from 33.1%) as steel production curbs began to bite.

UK GDP estimates for August indicated growth of 0.4%; with the economy still 0.8% small than pre-pandemic levels. Services sector output grew as consumer facing services continued to rebound but remained 4.7% below pre-pandemic levels. The number of workers on payrolls rose by the most on record, up 207,000 in August, and job vacancies hit an all-time high of 1.1 million (roughly equal to the number of people coming out of the UK furlough scheme). Unemployment nudged downwards to 4.5% from 4.6%

The quarterly earnings season began in earnest this week. Luxury goods conglomerate LVMH, owner of brands like Louis Vuitton and Tiffany & Co, reported revenue growth of 11% and an increase in margins to 33% (from 26% pre-COVID-19), demonstrating the resilience of quality growth names in Europe. JPMorgan grew third quarter earnings by 25% year-on-year, ahead of expectations. Half the increase came from the corporate and investment bank which benefitted from the increase in IPOs and mergers. Cautious customers may be spending more but remain disciplined and haven't materially increased borrowings. With a market cap that is twice its book value (a 20-year high), investors evidently believe interest rates are going up and borrowing will return. Bank of America and Morgan Stanley also topped quarterly earnings estimates.

A few weeks ago the UK Debt Management Office (DMO) sold £10bn of green Gilts to the market. It was a remarkable success, with over £115bn of client interest (which is called an order book). It was a record oversubscription for the DMO. This week it was the turn of the European Union to launch its first green bond with a €12bn issuance. The EU accumulated the largest ever green order book to date with demand totalling €135bn. Non-brown government bond markets are growing with China leading the way at $54bn with Germany and the US both at around $45bn. The UK has attempted to create accountability by opening a separate General Account ledger at the HM Treasury so investors can track the investments that are being made with green money.

The Nobel prize for physics was shared by Syukuro Manabe of Princeton University, Klaus Hasselmann of the Max Planck Institute for Meteorology and Giorgio Parisi from Sapienza University of Rome. It is the first physics prize to be awarded for the understanding of climate and is timely given the gathering of world leaders at COP26 at the end of the month. Their foundations relate to "quantifying variability and reliably predicting global warming"; weather can be chaotic and unpredictable in the short term but reliably understood over longer time periods. Who said weather and financial markets had nothing in common! The upcoming United Nations Climate Change Conference (COP26) in Glasgow runs from the 31st October to the 12th November 2021.

Next week China releases Q3 GDP figures with the expectation of a slowdown from 7.9% to 5.2%. UK and European inflation figures for September will be keenly watched to see the impacts of supply side bottlenecks and rising energy prices. Towards the end of the week we get the latest PMI prints in the US, UK and Europe which will provide an update on growth expectations as we close in on year end.

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	727	1.27%	12.43%	23.86%
MSCI EM	1,267	0.77%	-1.94%	11.55%
S&P500	4,438	1.07%	18.16%	27.22%
FTSE 100	7,221	1.76%	11.77%	21.66%
Eurostox	4,162	2.17%	17.14%	27.14%
FTSE MIB	26,437	1.48%	18.91%	34.83%
US Value vs Growth	--	-0.91%	8.13%	9.10%
Government bond				
US 10 year Yield	1.54%	-7.1	62.7	81.5
US 2 / 10 Spread	1.18%	-11.0	39.0	59.7
Germany 10 Year Yield	-0.17%	-2.3	39.5	40.7
UK 10 Year Yield	1.07%	-8.9	87.2	84.9
Italy / Germany 10 Year Yield	1.04%	1.1	-7.3	-19.9
Credit Spreads				
Barclays £ Corp TR Index	1.08%	0.1	-4.3	-38.0
Eur High Yield Spread (XOVER)	2.56%	-8.1	13.7	-72.9
US High Yield Spread (CDX HY)	3.00%	-8.1	7.2	-68.2
EM $ Spread (CDX EM)	1.81%	-0.7	29.9	-27.9
Currency				
USD Index	93.90	-0.18%	4.41%	0.56%
GBPUSD	1.3734	0.87%	0.45%	5.55%
GBPEUR	1.18	0.48%	5.70%	6.73%
EM FX Spot (JPM Index)	55.19	0.17%	-4.38%	1.04%
Other				
Crude (1st Future)	84.99	3.16%	64.07%	96.19%
Vix index	16.77	-2.0	-6.0	-9.6
Treasury Vol index (SMOVE)	73.55	1.2	0.3	3.8

Source: Bloomberg as at 09:07 on 15/10/2021

Outlook

Tactically, we remain neutral in equities and fixed income, while we maintain a diversifying overweight to Alternatives. We continue to weigh the prospects for risk assets, which face conflicting factors including a softening of global growth rates, and the reaction of central banks' to their assessment of stickiness of elevated inflation rates. A key question that remains is whether in the face of softer growth, central banks will have the desire and the inflation leeway to continue with stimulus rather than to take steps to unwind it. The recent rise in government bond yields suggests that markets expect monetary policy to tighten sooner rather than later, but after a number of false dawns in recent history, investors will continue to pay attention to the volatile macro landscape for insights into the state of the global economy and to determine the actions that central banks are likely to take.