MAPM: Markets Weekly

12th November 2021

Summary

- US CPI Inflation data registers 6.2% annualised for October, the highest since 1990. Initial reactions for yields were to rise, but lack of follow through allowed equity sentiment to rebound.
- UK GDP prints slightly below consensus at 6.6% annualised for Q3, leaving wiggle room for the Bank of England on path to rate normalisation
- Real yields and by implication financial conditions, remain at multi decade lows. We are considering the implications for risk assets following the new data releases this week.
- The US and China have pledged to take 'enhanced' action to curb global warming and the People's Bank of China has started offering preferential lending rates to 'Green' companies.

Market and Economic review

Global government bond yields moved between 5bps and 10bps higher, and global equity markets sold off, following US inflation data coming in well above estimates on Wednesday. Headline CPI registered at 6.2% year-over-year to October (vs 5.9% forecast), while Core CPI printed at 4.6% (vs 4.3% expected). Although we had Veteran's Day in the US on Thursday, global government bond yields remained subdued later in the week, although (forward looking) implied volatility levels in options markets remained elevated. Equity markets also bounced on Thursday and in the main are registering positive territory at the time of writing. It should be noted that US yields stand today at 1.58%, which even after the significant rise on Wednesday, is still a low absolute level compared to history. The ongoing 'temporary vs persistent' inflation debate gained further urgency given the numbers were in excess of already high estimates. Interestingly-and not stated policy- with inflation above 6% and rates at zero, the US real rate moved to a multi decade low and negative real yields may allow governments to reduce the current high debt stock using inflation as their tool.

Global equity performance was marginally negative for the week, with the recent winning streak of the S&P 500 ending on Tuesday. The US equity index had registered eight consecutive all-time-highs, the longest streak since 1997. Retail investor favourites played their part in the turning the tide; Tesla dropped over 12% after its chief executive, Elon Musk, used a Twitter poll to seemingly inform his decision to sell 10% ($20bn) of his stake in the company. Also of note, in a reversal of recent fortunes, UK and Emerging market equities are the top regional performers this week (both up around 1%). Although UK GDP growth slowed in the summer from 5.5% to 1.3% for the quarter, due to rising Covid infection rates and continued supply shortages, the Bank of England's lack of follow through in rising rates at the MPC meeting last week, led to markets repricing rate rises across the globe, even after adjusting for the rise in yields that occurred on Wednesday. This combined with lower oil prices helped outperformance of regions such as emerging markets.

Initial jobless claims in the US hit yet another post-pandemic low, adding further pressure on the central bank to hike interest rates, given its dual mandate on both inflation and employment. For now, policy makers in the major developed nations appear to remain patient, reinforcing the narrative that accommodation will be reduced slowly and cautiously. Emerging Markets are experiencing the same issues with price rises - Factory gate inflation in China hit a 26 year high, +13.5% YoY, as makers of components and finished goods are passing on high energy and raw materials costs. Consumer prices also came in above consensus (at +1.5%), driven primarily by food (vegetables). However, with the fall-out from the Evergrande property crisis being watched closely by authorities in China, they will be even more cautious about tightening policy to temper inflation, with more targeted macro-prudential tools being the preferred policy of choice.

Last Friday the US House of Representatives passed a $1.2trn infrastructure bill (including ~$550B of new spending) focused, on roads, bridges, and waterways. A vote on an additional $1.75trn social spending package could happen next week and markets are also waiting to hear more on whether Jerome Powell will be reappointed as Chair of the Federal Reserve. There have been rumours that President Biden has been considering other candidates, such as Lael Brainard, to take the helm at the US Central Bank, but odds makers and economists think a change is unlikely.

The US and China put aside diplomatic differences at the United Nations Climate Change Conference (COP26) this week and pledged to take 'enhanced' action in the next decade to curb global warming. The declaration was short on firm deadlines and specifics, but the general aim is to boost clean energy, combat deforestation and curb emissions of the potent greenhouse gas, methane. In another positive step, the People's Bank of China launched a long-awaited lending program to support the reduction of carbon emissions. The facility offers cheaper funding for banks (1.75% vs 2.95%) if they increase lending to companies in clean energy, environmental protection, and carbon reduction industries.

Data releases next week include Japanese GDP and inflation numbers from Japan, the EU and UK. Retail sales from the US, China and UK will give an indication on the impact of higher prices on consumer demand. Finally, it is important to note that Covid 19 cases have been rising in some regions (for example Europe), however there has been encouraging news about a new Merck and Pfizer pill, which will aid distribution and speed of delivery.

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	752	-0.67%	16.36%	24.28%
MSCI EM	1,281	1.37%	-0.80%	8.70%
S&P500	4,649	-1.03%	23.78%	30.13%
FTSE 100	7,346	0.57%	13.70%	15.10%
Eurostox	4,361	-0.04%	22.77%	25.79%
FTSE MIB	27,639	-0.56%	24.32%	31.66%
US Value vs Growth	--	0.39%	7.60%	8.02%
Government bond				
US 10 year Yield	1.58%	12.7	66.5	60.3
US 2 / 10 Spread	1.03%	-1.4	24.1	24.0
Germany 10 Year Yield	-0.24%	4.5	33.4	27.2
UK 10 Year Yield	0.93%	8.4	73.2	51.6
Italy / Germany 10 Year Yield	1.24%	8.7	13.1	-0.2
Credit Spreads				
Barclays £ Corp TR Index	1.08%	-0.9	-4.3	-25.7
Eur High Yield Spread (XOVER)	2.49%	4.6	6.4	-44.9
US High Yield Spread (CDX HY)	2.97%	9.3	3.9	-35.4
EM $ Spread (CDX EM)	1.79%	4.1	27.9	7.3
Currency				
USD Index	95.15	0.88%	5.79%	2.26%
GBPUSD	1.3394	-0.77%	-2.03%	1.30%
GBPEUR	1.17	0.31%	4.62%	4.22%
EM FX Spot (JPM Index)	54.83	-0.43%	-5.01%	-2.01%
Other				
Crude (1st Future)	81.95	-0.95%	58.20%	87.10%
Vix index	17.58	1.1	-5.2	-5.9
Treasury Vol index (SMOVE)	76.37	1.0	3.2	10.7

Source: Bloomberg as at 10:45 on 12/11/2021

Outlook

Tactically, we remain neutral in equities and fixed income, while we maintain a diversifying overweight to Alternatives. We continue to look for signs of monetary policy divergence amongst the developed markets following the central bank meetings last week. As noted above, while there is incentive to keep real yields in significant negative territory, but there is also a need to not let inflation "run away" from central bank control. Although bond yields moved significantly on Wednesday following the higher US inflation data, realised volatility has remained contained since then, and this has allowed equity market sentiment to recover. Yields remain at low absolute levels, meaning that financial conditions remain loose. We are considering that absent a significant and fast upward move in bond yields, risk may continue to do well in such an environment, despite already high valuation levels.