Wealth Management
Weekly Market Update

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Market Update

Global economies are reopening, and moving into the recovery phase, this pickup in activity has lead investors to question the potential impact on inflation. Investors are cautious of whether inflationary effects will be transitory or long-lasting. The US inflation reading unnerved markets and all major equity markets fell last week. US equities fell -2.2% in Sterling terms, partly driven by currency effects, markets had sold off sharply at the start of the week before recovering in the latter half. UK equities, which typically move inversely to Sterling, due to high levels of overseas earnings, fell -1.2%. Japanese equities fared worst last week, caught in global equity volatility and increased lockdowns, falling -4.0% last week. Despite strong Chinese equity performance, emerging market equities fell -3.8% in Sterling terms. The US 10Y yield rose 5.1bps to 1.6%, while the UK 10Y rose 8.2bps to 0.9%. Both gold and oil were nearly unchanged, falling -0.2% and -0.1% on the week respectively.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼ -1.2%	▼ -2.2%	▼ -1.4%	▼ -2.1%	▼ -3.8%	▼ -4.0%	▼ -1.2%	▲ +0.8%

all returns in GBP to Friday close

Macro News

- Britain's GDP shrank by -6.1% YoY in the first quarter of 2021, a fifth consecutive period of contraction and in line with market expectations. On a QoQ basis, GDP shrank by -1.5%, ending a two-quarter period of growth although beating market expectations of -1.6% contraction. Household consumption and business investment declined as a result of the reintroduction of coronavirus restrictions.
- The annual inflation rate in the US soared to 4.2% in April from 2.6% in March and well above market forecasts of 3.6%. It is the highest reading since September of 2008, amid a surge in demand as the economy reopens, soaring commodity prices and supply constraints. There is also a base effect weighing as Covid-19 dented economic activity bringing the inflation rate to 0.3% in April 2020. US core consumer prices, which exclude volatile items such as food and energy, rose 3.0% in April 2021, its largest annual increase since January 1996 and well above market consensus of a 2.3% advance.

The Week Ahead

- The annual inflation rate for UK will be released this week. Annual inflation edged up to 0.7% in March from 0.4% in February. British inflation is forecast to rise sharply in the coming months largely due to higher global oil prices and a low comparison base due to disruption in the demand for oil this time last year due to the pandemic.

Week in Charts

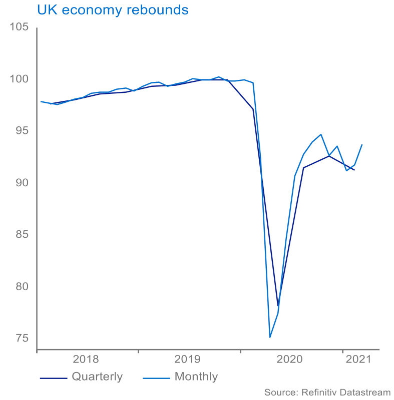
US consumer prices

US inflation jumps to highest rate since 2008

As recovery continues in the US economy, inflationary pressures have started to manifest, resulting from stimulus associated with Covid-19 as well as from base effects. Headline CPI rose faster than expected in April, up 4.2% YoY in the largest increase since 2008.

UK GDP

UK economy rebounds



UK GDP fell 6.1% in 2021 Q1 compared to the same period last year, as the country remained in lockdown. March data suggest the economy bounced back stronger than many expected, with output 1.4% higher than in March of last year, the country's first month of lockdown. However, output remains notably lower than pre-crisis levels.

View From the Desk

Last week saw inflation figures in the US jump while retail sales numbers came in as a second big disappointment after weak jobs figures. Coupled with the usual fears about technology's overvaluation, stocks corrected intra-week only to rise back up. Equity markets continue to defy a very good earnings season to focus on macroeconomic data. In a regime where risk asset prices have become so completely dependent on monetary policy, it is natural for investors to look for clues that would challenge that policy. However, despite the jump in inflation figures, one must be mindful of three things:

One: Macroeconomic data is and will continue to be volatile over the next few months. We often use year-on-year figures (e.g. April 2020 vs April 2021) to remove seasonal variation. But when comparing the worst economic year in modern history versus a period of sharp rebound, the image is distorted and the conclusions are limited. The traditional methods of gauging economic activity will be less useful until a modicum of economic normality is restored.

Two: Monthly inflation figures are influenced by both the re-openings and supply side issues. As the economy reopens, there's pent-up demand. We saw this phenomenon exactly a year ago. With developed market demand picking up and supply chains unbalanced, as a large part of the emerging world, especially India, is experiencing an exacerbation in Covid-19 conditions, it is natural for short term inflation to pick up.

Three: The Federal Reserve is not worried. Market fears that the Fed will be influenced by these inflation figures imply a bet that the Fed along with other major central banks are wrong about the temporary nature of inflation and will be forced to hike rates. However, it is rare that markets, whose job is to focus on corporate profitability, are better judges of macroeconomic conditions than policy makers, whose job is exactly to peer into the minutiae of economic data releases.

Macroeconomic volatility will continue in the next few months, not just because of 'counting' issues but because the global economy is completely unbalanced. Markets look at macroeconomic figures to determine the stance of the Fed. This might be the wrong place to look, because the Fed itself is probably laser-focused on the implications of adding an extra $4tn to the real economy, on top of the $1.9tn already added, if Mr. Biden's stimulus plan passes as is. The total amount added to the US economy in six months will almost equal the amount that the Fed added to markets in twelve years of quantitative easing. If the stimulus, directed at the real and not the financial economy, proves enough to break the 'secular stagnation' mindset, only then does long-term inflation become a possibility. But that inflation would be a consequence of real demand, real earnings growth and real investment and would bring asset pricing in a more normalised mode that markets haven't seen probably since before the turn of the millennium.

To survive, liberal capitalism needs to work for more people. As the market's 'invisible hand' hasn't been particularly effective in addressing rising imbalances, the state needs to step in to restore some balance after a decade of stagnating incomes and political resentment. This may lead to a temporary re-rating of risk assets, but more market resilience over the long-term. The devil will be in the detail however. Over the next few months, market participants will have to become fiscal policy experts to determine whether the extra stimulus is aimed at activities that will release dormant economic powers, or whether it will just be a debt-widening exercise.

David Baker, CIO

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