Wealth Management
Weekly Market Update

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Published 24 May 2021

Market Update

In a relatively volatile week of equity market trading, ultimately most major equity markets ended nearly unchanged. Following on from US inflation last week, there was increased focus on the UK and EU readings this week, with investors looking for any evidence of a potential shift in monetary policy. US equities fell most of major equity markets for British investors, down -0.7% in Sterling terms, although more modestly in local currency terms. UK equities ended a mixed week down -0.2% as the effects of stronger than anticipated labour market data and inflation played out. Emerging markets and Japanese equities saw a role reversal last week as they moved from laggards to leading markets, with emerging market equities providing the best returns to Sterling investors up +1.4% on the week. European equities rose +0.6% in Sterling terms. The US 10Y yield fell -0.7bps to 1.6%, while the UK 10Y fell -2.7bps to 0.8%. In commodity markets, gold rose +1.7%, while oil fell -2.9% to $64.1 a barrel.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼-0.2%	▼-0.7%	▲+0.6%	▼-0.2%	▲+1.4%	▲+1.2%	▲+0.3%	▲+0.4%

all returns in GBP to Friday close

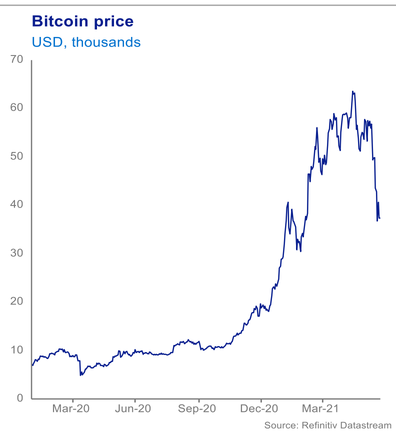
Macro News

- UK inflation accelerated to 1.5% in April on an annualised basis, up from 0.7% in March driven primarily by higher energy prices. The headline inflation figure would have been higher but for the temporary reduction in VAT on the hospitality sector. The Bank of England are currently forecasting inflation to reach 2.5% towards the end of the year.
- The UK labour market showed signs of tightening as employment rose, unemployment fell, and an acceleration in hiring all point towards a healthier economy. Labour markets are still being distorted by the affects of the government furlough scheme, although as the scheme unwinds it is possible these losses will be offset by employment gains. A noticeable challenge is in the youth labour market where both the number of unemployed and employed has falling, indicating more young people are not looking for work either due to staying in education or being dissuaded from searching in the current environment.

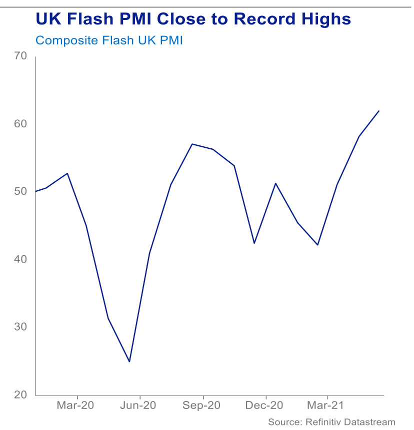
The Week Ahead

- German consumer confidence data will be released Thursday morning, whilst expected to remain in negative territory an improvement is expected, especially given the acceleration of the vaccination campaign across Europe. With elections later this year, and its role as the largest European economy, marginal changes in German confidence can have material impact on the outlook for the region

Week in Charts



Bitcoin has fallen by almost half from it's all time high, although remains significantly up over the last year. The cryptocurrency's price was hurt by further crackdowns from China, this time targeting miners of cryptocurrencies. Cryptocurrencies have been attracting increased institutional focus in recent years with some investment banks opening trading arms focusing on 'cryptos' such as Bitcoin.



Flash PMI data indicated the UK private sector expanded at an accelerated pace in May, the highest since the series has been tracked. A combination of fewer restrictions and pent-up demand have contributed to the rise. Demand has been so strong that in spite of a wave of new hiring, backlogs have been rising for companies, providing plenty opportunity for growth in the coming months.

View From the Desk

Last week, minutes from the Federal Open Markets Committee (FOMC), the Fed's rate setting body, suggested that the US central bank was 'beginning to think' about tapering its asset purchases, which stand at $120bn per month. With May flash PMIs suggesting that the global economy might be overheating and inflation pushing higher all traditional gauges would support a significantly tighter monetary regime. But the times we live in are truly different from the past.

For one, a once-in-a-hundred-years pandemic, which is still gripping the world despite the more positive narrative of late, makes the situation unique. Never in the history of modern central banking did independent policy makers have to deal with such an economic disruption.

Second, the phase we are experiencing is called the 'recovery', by definition both short and sharp. Not just a recovery from the pandemic, but an economic recovery following a sluggish twelve-year consumer period known as Secular Stagnation. Apart from the usual arguments, that this is pent-up demand, it is difficult for economists to gauge what the developed market consumer reaction will be after more than a year of quasi-internment on top of a decade of lacklustre growth. Any economist worth his salt knows that in such circumstances previous models are rendered useless as the usual demand/supply assumptions don't stand. Such profound lack of visibility means that monetary policy makers will necessarily remain behind the inflation and growth curve, acknowledging the primacy of Treasury departments in influencing consumer psychology and driving prices.

Third, there is a guiding precedent. In 1937, a few years after FDR enacted the 'New Deal', the US Federal Reserve tightened interest rates prematurely, crippling the recovery and leading to a sharp recession. Post-mortem studies, suggest that "small changes in the public's beliefs about the future inflation target of the government can lead to large swings in both inflation and output. This effect is much larger at low interest rates than under regular circumstances". There's a clear case to be made about mis-communicating inflation expectations.

So what is the Fed doing? Is it talking about tapering prematurely? Far from it. In normal circumstances, and up until last month, the Fed reiterated in all possible tones that recovery inflation was transitory. It continues to do so, accepting that prices might rise above 2% per annum due to "transitory supply chain bottlenecks" and pent-up demand. They assume that the deflationary forces of globalisation are still with us and that supply chains will soon repair themselves. But what they can't control, is stimulus from the central government, especially at the enormous size Joe Biden is thinking of, c. $4tn on top of a previous $1.9tn package. The central bank has accustomed markets to six-month warnings before any major move. But a package like that clearing Congress in a matter of weeks would fundamentally change inflation expectations and may force the Fed to move in a much shorter window than it usually has to warn markets. So what the FOMC is trying to do is simply lay the groundwork to warn markets as much as it can in advance, in case it is forced to taper asset purchases faster than anticipated or even raise rates, and avoid a market panic. For the last twelve years, the Fed's approach worked well, because it didn't control just policy, but also the narrative and communication around that policy. As the narrative now moves towards the Treasury, the US central bank is trying to adjust to new modes of communication it doesn't entirely control. Whether this shift will lead to a volatility hike, remains to be seen.

David Baker, CIO

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