Wealth Management
Weekly Market Update

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Market Update

It was a steadily positive week for equity markets last week, with all major regions gaining in Sterling terms. Emerging markets equities were the strongest performing, up +1.8%, while Yen strength saw Japanese equities returning +1.2%. Energy was the strongest performing sector globally, as oil prices reached their highest level in two years. European autos performed well, with the Volvo board proposing that the proceeds from the sale of UD Trucks be distributed to shareholders. Sterling fell versus both the US Dollar and the Japanese Yen, however was marginally up against the Euro. Yields were down globally, particularly in the US, where 10Y yields fell 4bps to 1.553%. In the commodities space, gold fell -0.6% while oil gained +5.0% in US Dollar terms.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +0.7%	▲ +0.9%	▲ +0.8%	▲ +0.9%	▲ +1.8%	▲ +1.2%	▼ -0.3%	▼ -0.2%

all returns in GBP to Friday close

Macro News

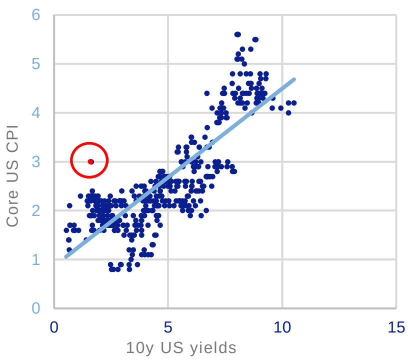
- This weekend G7 leaders agreed that a minimum tax rate of 15% should apply to corporate profits and that countries should be entitled to tax multinationals in the locations where profits are generated. The next stage is for agreement to be reached at a G20 level.
- On Sunday Germany's CDU party won a key victory in elections in the state of Saxony-Anhalt, which is seen as an indication of the outcome of the national elections due in September. Both the far-right AfD party and the Green party fared worse than expected in a result which is supportive of the status quo in German politics.
- Supply chain constraints look set to continue as one of the world's largest electronics manufacturers has warned that the current computer chip shortage is set to last until the middle of 2022. Supply chain disruption is considered a near term cause of price inflation.

The Week Ahead

- The ZEW survey data will be released on 8 June giving a reading on Euro Zone and German economic sentiment and an indication of future GDP growth.
- Christine Lagarde is expected to shed light on the plans for the ECB's ongoing liquidity provisions at a press conference on 10 June, which impact corporate financing costs.
- The US inflation number for May will be released on 10 June.

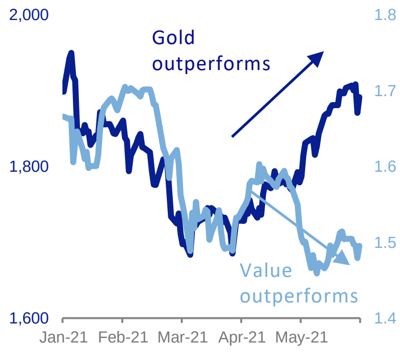
Week in Charts

Bond markets say inflation is transitory
Yields low given level of inflation



When looked at on a historical basis, US yields are remarkably low given the current level of inflation (CPI). This implies that bond markets don't forecast inflation remaining at elevated levels, since persistently high inflation corrodes the real value of future coupon payments.

….other markets don't
Inflation hedge assets performing well



Value equities, which generally have higher economic sensitivity and lower duration, outperforming growth equities implies markets expect persistently higher inflation. Gold is also an asset class which traditionally fares well in periods of high inflation, as its value tends to remain stable in real terms.

View From the Desk

As we head into the summer, and with the US earnings season solidly behind us, equity trading volumes traditionally thin out and risk asset movements become less pronounced. Investors are now turning their attention to the most important question of our times: Will the inflation figures we are seeing across the world persist and force rates up?

Markets are giving mixed signals. On the one hand, gold near the $1,900 level and value stocks rallying are consistent with higher inflation. On the other, the bond market, the most powerful inflation gauge known to man, has barely budged.

The quick and simple answer to the question is likely 'no', at least according to the Fed. The market's present obsession with inflation stems mostly from what is probably a short-term reading of current figures and their projection into the future. To be sure, upward price pressures are very real. For one, the pandemic has rolled back globalisation, the key driver of lower prices across the globe for decades. Supply chains are not only more localised, but also unable to cope with the spike in demand from the developed world as G7 nations simultaneously wake up from the pandemic-induced coma with an appetite to spend. Looking around these days there's literally a 'shortage of everything'. Also, with frictional unemployment rising, companies are being forced to pay higher wages to lure workers back, especially in hospitality services. Higher demand for goods and services and lower supply of both plus labour shortages are an explosive cocktail for higher prices, which may look bigger under the magnifying glass of the current news cycle.

For investors used to the Fed running the 'only game in town' however, what matters is not so much the expected impact on corporate margins or the price of goods on the shelves, but what the Federal Open Markets Committee (FOMC) thinks. For the time being, the American, and arguably the world's, rate setting body considers all these factors transitory. Supply chain disruptions and frictional unemployment are textbook examples of slack in the economy, which Mr. Powell and co expect will be resolved in the next few months. The Fed has lived with higher inflation before.

At any rate, investors would be well served to remember that rates are not a panacea against every type of inflation. Even if the Fed miscalculates the extent of the current inflation bout, how would withdrawing accommodation cool prices? Would higher rates make time go faster and expunge year-on-year effects on the Consumer Price Index basket? Or would they rebalance global economies and supply chains? Would they convince people to get back to working at the pub for the same amount of money, or would it take an economic slump to achieve that? Higher rates could potentially dampen consumer spirits after more than 14 months of internment, but discouraging a sorely needed rebound in demand and a reduction in savings after the worst economic year in modern times would probably count as a policy error.

As for long term inflation? Mr. Biden's early promises of a historic stimulus lost some of their lustre last week as parliamentary procedures seem to bog some of his spending plans down in political reality and at the very least deferring them until after the summer. Our best guess right now is that demand-driven, wage-pushing long-term inflation without fiscal expansion of epic proportions and/or banks creating credit at a much faster pace than in the past decade, might prove to be a very difficult proposition. On the other hand, if we forego the gifts of globalisation, then the wrong kind of inflation, 'stagflation', could become a more realistic and worrisome scenario.

David Baker, CIO

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