Wealth Management
Weekly Market Update

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Market Update

In a week where global equities fell -0.1%, European stocks were flat and UK stocks rose +0.1%, we shouldn't be deceived by the apparent calm. Global equities were shaken on Thursday due to concerns about slowing global growth and this caused a sharp sell off across developed markets. However, on Friday the realisation that central bank liquidity is unlikely to be withdrawn reassured market participants causing a rebound in risk assets. The US 10Y yield fell as low as 1.25%, expressing the bond market's doubt in the Federal Reserve's ability to raise rates and the UK 10Y Gilt similarly fell to recent lows of 0.65%. Emerging market equities fell -3% as some central banks are having to tighten policy to curb inflation in the face of concerns about slowing growth. Japan equities fell -1.7% as tightening Covid restrictions mean the Olympic Games will not have any spectators. GBP strengthened against the USD with central bank tightening not expected to happen significantly sooner in the US than the UK.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +0.1%	▶ +0.0%	▶ -0.0%	▼ -0.1%	▼ -3.0%	▼ -1.7%	▲ +0.6%	▲ +0.6%

all returns in GBP to Friday close

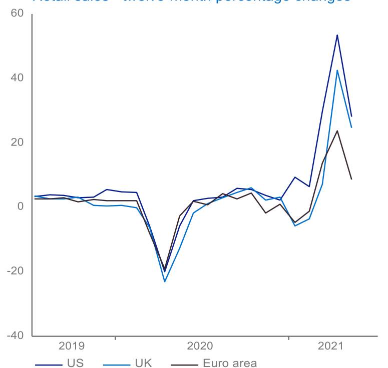
Macro News

- China's producer prices rose by 8.8% year-on-year in June, after a 9.0% gain in the prior month and in line with market expectations. This was the sixth straight month of increase in factory gate prices, amid a further recovery in domestic production and rising commodity prices. China's consumer price inflation rate unexpectedly fell to 1.1% in June from May's eight-month high 1.3%, amid a sharp decline in the cost of food as pork prices fell.
- The highly anticipated US FOMC minutes were released last week but did little to clarify when the Fed will begin to change the monthly bond purchases and near-zero interest rates it put in place in the spring of 2020 to support the economy through the coronavirus pandemic and associated recession. The FOMC shifted towards a post-pandemic view of the world, dropping a longstanding reference to the coronavirus as a constraint on the economy and, in the words of Fed Chair Jerome Powell, "talking about talking about" when to shift monetary policy as well.

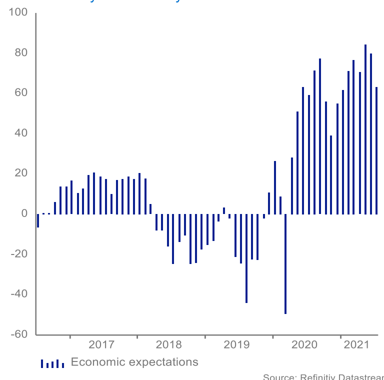
The Week Ahead

- US consumer price inflation for June will be released this Wednesday. Investors will be watching closely as inflation is worrying the world's leading economists as stimulus measures kick in and developed countries emerge from coronavirus lockdowns.

Week in Charts



Consumers have already begun to spend some of those built-up savings, including at retail stores. However, policymakers expect that this positive shock to demand will fade over the coming quarters.



The ZEW Indicator of Economic Sentiment for Germany dropped to 63.3 in July, the lowest level since January and below market expectations of 75.2. It was the second monthly decline in investor confidence, after reaching its highest level in two decades in May, but still suggesting that the overall economic situation will be extraordinarily positive in the coming six months.

View From the Desk

With inflation dominating the financial news cycle, investors were slightly dumbfounded last week when yields for US 10-year bonds collapsed to 1.268% before bouncing slightly higher to 1.356% by the end of Friday, way below the 1.7% levels seen last March. UK Gilts followed a similar path, ending the week at 0.659%. Inflation is a phenomenon that mostly affects the longer end of the curve. It is also the only factor which may force a more hawkish stance by central banks, curbing demand for global fixed income. Ostensibly, this market action is inexplicable. Bond yields should go up predicting higher rates to keep up with inflation, not down, which is why investors assigned it to 'technical factors'. However, this may not necessarily be the case.

Certainly, part of the move can be attributed to a low-volume summer environment, where some volatility might be traditionally expected. Looking past this and into the broader trend it is a fact that the bond market has remained stubbornly deaf to higher inflation forecasts throughout the year.

In 2009 central banks warned bond vigilantes not to go against their monetary 'bazooka'. Now the bond market is taking the opposite stance, ignoring warnings from central bankers that the punch bowl might eventually be taken away. This is probably not mindless conditioning. It is more likely that bond traders and fund managers have reached a logical conclusion: that even if supply-side inflation persists, sluggish long-term demand and a mountain pile of global debt leave central bankers with no real exit strategy other than to keep printing money and increasing their liabilities to keep supporting global growth and suppressing risk. Even if Mr. Powell & Co decided to reverse course, how would hiking rates or reversing QE bring prices for global containers or oil down? Conversely, rate hikes or quantitative tightening could endanger a weak economic recovery. Since 2008, assets of the world's largest central banks (Fed, BoJ, ECB and the Chinese central bank) have risen more than sixfold. The market knows that any attempt at 'quantitative tightening' or even rate normalisation has failed miserably during that time. The Fed even completely ignored a bout of inflation early in the 2010s, keeping rates floored which turned out to be right. So, despite the slightly more hawkish tone recently struck by the Fed's rate setting body, the bond market is calling the central bank's bluff: 'Can you really stop printing money in this volatile economic environment'?

Make no mistake. An 'infinite' quantitative easing policy comes with strings attached. The most important issue is not the obvious, i.e. debt itself or even the moot point of 'moral hazard'. As long as central banks hold national debt, a large part can be restructured to reduce interest payment and refinance the government when and where needed. The real problem is that the EU, China and Japan, very different economies to America, are forced to mimic the Fed's policies even if they don't want to. Failure to follow the moves of the bank that issues the global reserve currency could see their own currencies appreciate sharply, which would further disrupt hopes of a swift economic recovery. However, in a world increasingly fragmented due to the pandemic and trade wars, monetary policy needs may be more targeted and more local. Erecting a wall of money to be bluntly directed once again at financial markets is great for those who hold investment portfolios, but it does very little to solve the very real economic strains wrought by the pandemic, the end of which could find the world even more uneven, unbalanced and unequal. The Fed knows this. Unfortunately, its' alternative, tightening money supply, would just add strain to long-suffering middle-class consumers. So, all it can do is print and hope that supply pressures will peter out fast.

David Baker, CIO

Important information

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