Wealth Management
Weekly Market Update

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Market Update

Equities in major markets retreated last week as tightening central banks and the prospect of further coronavirus restrictions due to the Omicron variant gave rise to renewed volatility. US, UK and EU stocks slipped following the decisions of the Federal Reserve to taper at a faster rate than expected, the Bank of England to raise interest rates, and the ECB to phase out its Pandemic Emergency Purchase Programme. Concurrently, reimpositions of restrictions on social activity in European countries served to weigh down on sentiment. Global stocks fell by -1.5%, emerging market stocks fell by -1.7%, while Japanese stocks posted modest gains of +0.2%. The US 10Y Treasury yield fell 8.2bps, finishing the week at 1.402%, while the UK 10Y yield rose 1.8bps to 0.759%. In US Dollar terms gold rose by +0.9%, and oil fell by -1.1% to $68.5 per barrel.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼ -0.3%	▼ -1.9%	▼ -0.9%	▼ -1.5%	▼ -1.7%	▲ +0.2%	▼ -1.3%	▼ -0.2%

all returns in GBP to Friday close

Macro News

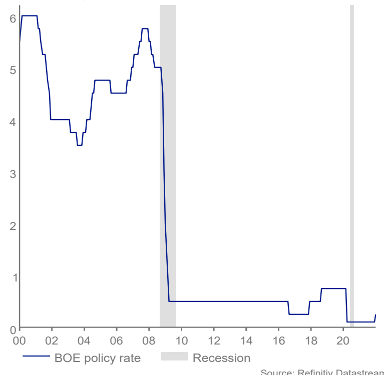
- The consumer price inflation rate in the UK rose to 5.1% year-on-year in November, from 4.2% in the previous month and above market expectations of 4.7%. It was the highest rate since September 2011, due to rising energy prices, supply chain disruptions and a low base effect from last year. Main upward pressures came from cost of transport, principally from motor fuels and second-hand cars, and housing and household services.
- The Bank of England voted by a majority of 8-1 to increase interest rates by 15bps to 0.25% during its December meeting, the first rise since the onset of the pandemic, as inflation pressures mount in the UK, surprising markets that expected no changes due to the threat of Omicron. The Committee continues to judge that there are two-sided risks around the inflation outlook in the medium term, but that some modest tightening of monetary policy over the forecast period is likely to be necessary to meet sustainably the 2% inflation target.

The Week Ahead

- Finalised Q3 GDP data for the US will be released this week. In November, the US economy grew 2.1% YoY, higher than the 2% increase estimated a month earlier. The third and final reading is expected to confirm the 2.1% figure.

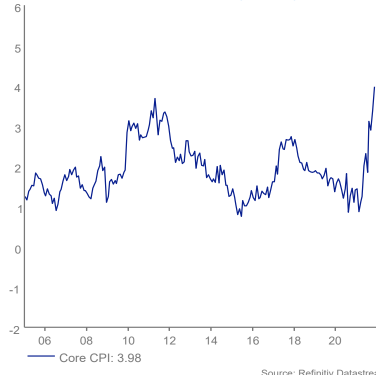
Week in Charts

The BoE unexpectedly raises rates
BoE policy rate, per cent



The BoE raised interest rates for the first time in more than three years in response to calls to tackle surging inflation. The increase to 0.25% from 0.1% followed data this week that showed prices climbing at the fastest pace for 10 years.

UK inflation hit the highest level in a decade
UK CPI , twelve-month percentage changes



UK CPI surged by 5.1% in the 12 months to November. This was the steepest increase for a decade and more than double the central bank's target. The BoE expect inflation to remain around 5% through the majority of the winter period, and to peak at around 6% in April 2022, before falling back in H2 of next year.

View From the Desk

2022 could be volatile

In a very different modus operandi from the last pandemic resurgence, central banks are now on a firm tightening road. Last week the Fed toned up its hawkishness and stepped up the pace of asset tapering. Likewise, the Bank of England proceeded with a not entirely well communicated minor rate hike. In both cases, monetary tightening in the real economy is nominal and certainly not commensurate to 5%-plus inflation. It is a calculated bid to prevent supply-side inflation, which they can't really control, from becoming demand-driven.

Hawkishness, even in the face of worsening economic conditions due to the Omicron variant, is more about signalling that substance. The plain fact is that with so much debt, governments simply can't afford much higher rates on refinancing costs. However, even marginally higher rates should, in theory, dampen inflation expectations and stave off a wave of wage increases that could lead to an inflationary vicious circle. It is no surprise that the ECB, which has seen little evidence of wage inflation, is more dovish than its Anglo-Saxon counterparts. Futures markets now estimate three rate hikes for the US and the UK in the next twelve months, up from nearly one they expected in September.

Markets oscillated near the end of the week without reacting significantly. However, investors should not mistake the mild initial market reaction for a sign that we are back to 'business as usual'. A twelve-year investment paradigm, where the slightest market volatility is met with the full force of the Fed's printing machine, is clearly shifting. From 'QE-on-demand', financial markets are transitioning into a different regime, driven by a mountain of 'residual liquidity', which should take a long time to be absorbed into the system, coupled with the assumption that the 'Fed Put' will still hold in times of stress.

No matter how well communicated, it's difficult to imagine a regime change without any sort of volatility. Investors still believe that the Fed is fundamentally dovish, which means they expect QE if equity indices drop below certain levels. The more the Fed stays its hand, the more nervous they will get trying to discover the 'Put's floor'.

We would not be too surprised if, in the near future, markets wish to test what the new limits are for the Fed to exercise its 'Put'. We believe that, for 2022, investors should at the very least be prepared for more volatility. Gauging how the Fed responds to that will tell us a lot more about the terms and conditions surrounding the new investment regime.

David Baker, CIO

Important information

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