Wealth Management
Weekly Market Update

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Market Update

It was a volatile week for global equities as investors were presented with a mixed array of economic data. US and EU stocks fell -0.8% and -1.5% respectively, while heavy exposure to the energy sector continued to favour UK equity markets which gained +0.8%. Emerging market stocks posted a rebound after a prolonged period of underperformance, up +2.0%. Globally, energy stocks saw widespread gains, whilst industrial & consumer discretionary stocks lagged behind. The US 10Y Treasury yield paused its dramatic climb last week; up 2.2bps, finishing the week at 1.784%, while the UK 10Y yield fell slightly; down 2.8bps to 1.150%. In US Dollar terms gold rose by +1.2%, while oil continued its ascent to reach $84.30 per barrel; up 6.2%.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +0.8%	▼ -0.8%	▼ -1.5%	▼ -0.7%	▲ +2.0%	▼ -0.2%	▲ +0.5%	▲ +0.6%

all returns in GBP to Friday close

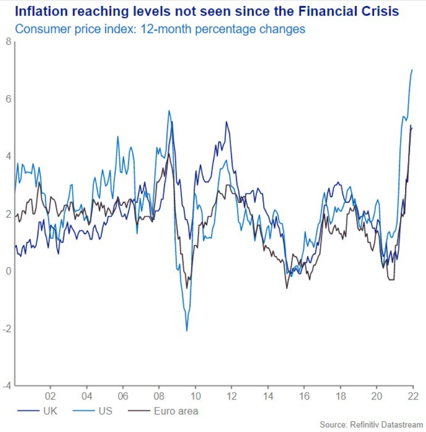
Macro News

- US consumer prices rose by 7% year-on-year in December, a rate of increase unseen in decades. The largest contributors to the price increases were used cars and trucks, rising 0.4% and 3.5% respectively. Food prices also rose by 0.5%, less than in previous months.
- US retail sales fell by 1.9% in December, the largest drop in 10 months and far more than economists had been expecting. Both online and in-person stores were affected, as economic disruptions caused by the Omicron variant put further strain on supply chains and surging prices discouraged customers.
- According to data from its National Bureau of Statistics, China's economy grew by 8.1% in 2021, helped by robust exports over the year. Although this expansion was the highest on record since 2011, growth in the final quarter of 2021 was the slowest since the second quarter of 2020, at only 4% year-on-year, indicating that the rate of growth is slowing.

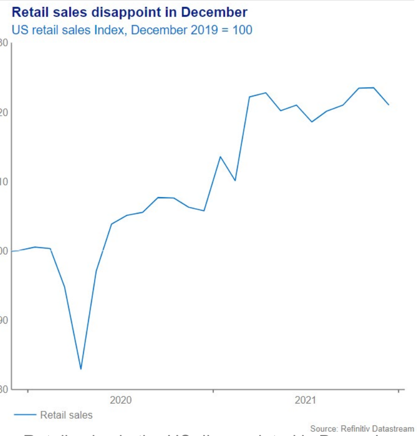
The Week Ahead

- Investors will be paying close attention to US earnings this week as many major financial, transport and technology companies are set to release their Q4 results. Analysts are expecting overall earnings to grow by 22.1%.

Week in Charts



Inflation in the UK, US and euro area is reaching levels unseen since the great financial crisis.



Retail sales in the US disappointed in December, dropping by 1.9%, but may also be viewed as a slow end to an otherwise strong year for sales. Sales at the end of the year were particularly affected by the Omicron variant as well as surging prices for consumers.

View From the Desk

In 1897, Ivan Petrovic Pavlov made a dog salivate without the presence of food. The Nobel Laureate (1904) arguably changed the twentieth century when he introduced behaviourism and the idea that human behaviour is, by and large, programmable.

In the past twelve years, the Fed certainly paid homage to the idea. When Quantitative Easing was introduced to western markets in 2008-9 it was a novelty. Even though traders and investors realised the potency of the Fed's bazooka, they remained sceptical. The period from 2009 to 2015 was a long realisation for active fund managers that flows and communication can be more important than perceived fundamentals. They underperformed indices and saw the rise of passive investing before yielding to the Fed's awesome power. The Fed just had to remind investors on occasion that it can print money at will, to keep everyone in line.

The more pressing the conditioning, the less accepting is the subject to change, however. Inflation at 7% simply precludes the Fed from printing more money and rushes the timetable for ending Quantitative Easing. Talks of Quantitative Tightening immediately after only exacerbate the situation.

But what about those conditioned investors? We are not just talking about humans, but more importantly, about algos. Humans, unlike dogs, are rational. They might adapt, reduce risk, wait for a stock and bond re-rating, look for opportunities and missed sectors etc. But algorithms, which account for over 80% of all trading, have never worked outside a QE regime.

Most of the time, in fact, they search for correlations without much regard to causation. Algorithms don't like to wait much. In March 2020 they did not just give us one of the steepest drops in history, but also one of the quickest recoveries. Algorithms are the children of the current paradigm. Currently, much like Pavlov's dogs, they continue to wait for food (QE) to arrive. But what happens when they realise there's no more of their favourite treat?

Oddly enough, to find an answer, we may have to look back to 1996, when the world chess champion played Deep Blue, a very advanced computer. By the last two games, Kasparov understood that Deep Blue knew all the games ever played, so he changed the paradigm. He made a series of unprecedented moves. The computer had no historical analogy and it was thrown off-balance. Deep Blue surrendered easily.

So how will a paradigm shift affect algos? 'Smart' algos may look for opportunity. Whether they will discover real value or not, time will tell. 'Lazy' algos, will probably not know how to react. At the very least, volatility will ensue. 2022 has seen one of the most volatile starts to the year across risk assets, and this could very well be the trend, at least until inflation settles. That is not necessarily bad news. Volatility can be an enemy of passive investing, but it can be the bread and butter for good active, well-rounded investors who have stayed in the side-lines for years. In other words, at the very least, a paradigm shift could mean a change in the types of managers that outperform.

David Baker, CIO

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