Wealth Management
Weekly Market Update

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Market Update

Equity markets were rocked last week, as inflation in the US surged past estimates to a record 7.5%, causing yet more problems for the Federal Reserve in their attempt to combatting inflation without triggering a catastrophic market shock. To further add to economic uncertainty, the White House also signalled that an imminent invasion of Ukraine by Russia was becoming increasingly likely, triggering a sell-off in US equities on Friday afternoon. The build-up of Russian troops on the Ukrainian border has caused many NATO member countries great concern, with UK nationals now being advised to evacuate Ukraine immediately. US equities finished the week down -2.3% in sterling terms, whilst Europe did not have the chance to catch up with Friday's price action; up +0.3% for the week. The UK concluded last week in positive territory, up +1.9%, whilst emerging markets and Japan also posted gains of +1.1% and +0.4% respectively. Yields continued to climb across the globe on the expectation of higher interest rates, with the UK 10Y rising by 13.4 bps, finishing the week at 1.55%. Oil continued to rally to $94.4 per barrel on further tensions in Europe, whilst gold also benefited from increased economic uncertainty, up 2.8% for the week in US dollar terms.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +1.9%	▼ -2.3%	▲ +0.3%	▼ -1.2%	▲ +1.1%	▲ +0.4%	▼ -1.5%	▲ +0.2%

all returns in GBP to Friday close

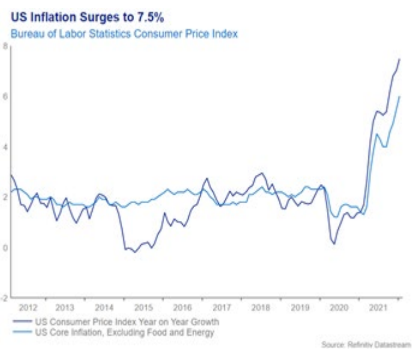
Macro News

- US Inflation surged to a level of 7.5% last month, the highest level seen in 40 years, beating economist forecasts of 7.2%. Price rises were broad based, with increases seen in higher food, energy and housing costs. The news has caused traders to escalate their bets on faster rate rises by the Federal Reserve, and saw US stocks fall more than 3% and the US 10 year treasury yield rise above 2% in the second half of the week. Core inflation, the measure of inflation which excludes volatile elements such as food and energy rose by 6.0%, beating analyst expectations of 5.9%.
- The UK economy expanded by 7.5% in 2021, the fastest pace of growth seen in an advanced economy since World War II. The figures show that the UK is experiencing a strong recovery after suffering a deeper pandemic contraction than its peers, falling 9.4% in 2020. GDP in December still fell by 0.2% as the Omicron variant kept consumers at home.

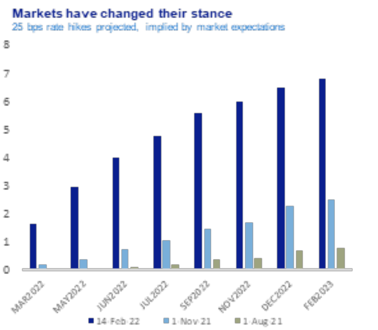
The Week Ahead

- This week is critical for geopolitics in Europe as the situation over Ukraine becomes increasingly uncertain. Markets will also be watching Federal Reserve officials for further indications of more aggressive interest rate hikes.

Week in Charts



Headline inflation in the US rose to a level of 7.5% last month, while core inflation reached a level of 6.0%, beating economist expectations in each case. Such price increases have been unseen in over 40 years and were driven by rises in energy, food and shelter costs.



Markets have continued to raise their expectations of interest rate hikes, following this week's inflation data. While markets anticipated only two interest rate hikes three months ago, they are now pricing in more than six, and putting the probability of a half point hike in March at higher than 50%. Despite this, James Bullard, of the St. Louis Federal Reserve is the only official to have officially come out in support of a half point hike.

View From the Desk

For a generation that has only experienced the benefits of globalisation, inflation is a riddle, wrapped in a mystery, inside an enigma. Twenty-two years of falling prices, twelve of which saw muted consumer demand and preference for saving overspending had ostensibly consigned inflation to history.

The great Milton Friedman, the first major economist of the Monetary Era suggested that "inflation always and everywhere is a monetary phenomenon". This would imply that interest rates would be the most appropriate tool to fight it. However, and with respect to the Nobel Laureate, this aphorism, which seems to be anchored in many an investor's and central banker's thinking, is probably wrong.

At the risk of angering the ghost of the great economist, our observations about this current bout of inflation are not monetarist in nature. We believe that:

1. When inflation is concerned, everyone is a novice. Especially since such a fast build-up of prices hasn't happened in fifty years. This means that central banks and policymakers are likely to get it wrong before they get it right.
2. Inflation is everywhere and always… different. Each major episode has significant differences from the past. It is really the first time that this event did not involve some sort of general conflict, in over one century of data.
3. Supply disruptions historically cause much more inflation than demand surges. This sort of inflation is caused mainly by disruptions, a major departure from the status quo. When western governments closed borders and shut off production, they were responding to a crisis, but they never thought they would have to deal with such a disruption.

There's a strong possibility we may see the end of the episode soon. We are already ten months into this event. Historically, all of the events described lasted about 11-14 months. This time, this should be more the case as no all-out or post-war rebuilding is required. The underlying infrastructure has not been destroyed, just hobbled from erratic demand and supply. We have evidence that supply chains are mending and adapting.

The larger question is whether there can be a global policy approach to repair damaged supply chains quickly. This would entail lifting travel banks, tariffs, taxes, barriers to facilitate a speedy recovery of goods and services in their pre-pandemic condition. We feel that, given the current geopolitical environment, this is a very low probability event. Thus, on the one hand, the rate by which prices rise could start to decline by the next quarter, if history is any guide. On the other, however, supply chains could take long to mend, and overall price levels could remain elevated versus pre-pandemic numbers

David Baker, CIO

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