# Wealth Management
# Weekly Market Update

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## Market Update

Last week, markets were whipsawed by further escalation and uncertainty surrounding the invasion of Ukraine, as well as US inflation figures, now comfortably situated at levels not seen since the early 1980s. US stocks fell -1.5%, whilst European markets posted significant gains of +4.0%, recouping some of the considerable losses over the last month. UK equities continued the trend of relative outperformance last week, posting gains of +2.8%. However, both emerging market and Japanese stocks fell -3.7% and -3.1% respectively. While risk-off sentiment in markets is often accompanied by a flock to safety into government bonds, this was not observed last week as yields rose. The US 10Y rose 26.1 bps, finishing the week at 1.992%. The German 10Y Bund also recorded similar outflows, with yields rising 31.8 bps to 0.249%. In the commodities space, news that the London Metals Exchange (LME) cancelled trades as a short squeeze forced the price of nickel to skyrocket unsettled traders and investors alike. Metals returned +0.9% in GBP terms whilst gold continued to perform well, up +2.3% on the week.

| UK Stocks | US Stocks | EU Stocks | Global Stocks | EM Stocks | Japan Stocks | Gilts | GBP/USD |
|---|---|---|---|---|---|---|---|
| ▲ +2.8% | ▼ -1.5% | ▲ +4.0% | ▼ -0.5% | ▼ -3.7% | ▼ -3.1% | ▼ -3.2% | ▼ -1.5% |

*all returns in GBP to Friday close*

## Macro News

- Nickel prices surged by +66% on Monday of last week and further rose by +107% in an 18 minute window on Tuesday, reaching more than $100,000 per ton at the highest point. The incredible rise was triggered by a short squeeze, in large part driven by a massive short position held by Chinese tycoon Xiang Guangda, who had bet that nickel prices would fall. These movements led the London Metals Exchange to take the unprecedented move of halting all trading and cancelling all trades which took place on Tuesday.
- US inflation rose at 7.9% year-on-year in February, a 40-year high. Increases in gasoline, shelter and food were the greatest contributors to the final figure: the gasoline index accounted for almost a third of the all items increase, while food and shelter costs rose by 1% and 0.5% respectively. Excluding food and energy, core prices rose by 6.4% year-on-year. As oil prices remain high following the Russian invasion of Ukraine, many expect inflation to surge past 8%.

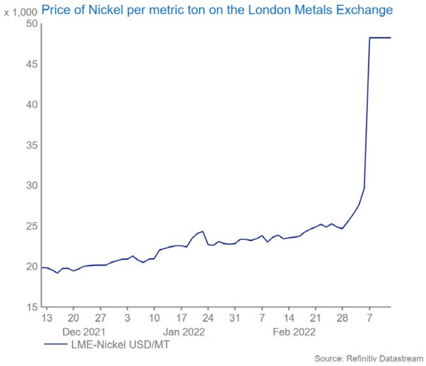
## The Week Ahead

- The shutdown of nickel trading on the London Metals Exchange is a story that has garnered little attention outside of the investing world, but perhaps it should. This event disrupted to an entire subsection of the market and investors should follow this story closely this week due to the systemic risk it poses to portfolios.

## Week in Charts

**Nickel Prices Go Through the Roof**

Price of Nickel per metric ton on the London Metals Exchange




The price of nickel jumped by +66% to reach an all-time high on Monday. However, this move was paltry compared to what happened on Tuesday: in the 18 minutes between 5:42 and 6:00 AM GMT, the price of nickel soared by +107%, from $48,078 to above $100,000, eventually compelling the London Metals Exchange to halt all trades, and cancel all transactions that took place on Tuesday. As of Monday 14 March, the London Metals Exchange remains closed for trading.

**US Inflation Surges to 7.9%**

US Consumer Price Index, 12 month percentage growth


The US consumer price index rose by 7.9% year-on-year in February, while core CPI, the index excluding the effects of food and energy, rose by 6.4%. Price increases were broad based with gasoline, shelter and food being major contributors. The figures fell within economist expectations, however many warn that headline inflation could surge past 8% in the coming months as the effect of rising energy prices following the Russian invasion become apparent.

## View From the Desk

One of the great myths of capitalism is that financial markets are predictive mechanisms. The idea is that 'there's wisdom in the crowds' and therefore wherever markets choose to go, this is the highest probability event. Reality is, of course, far removed from ideological fantasies. Markets are not a singular homogeneous organism. They are, for lack of a better word, chaotic. Which is why no one has ever found a way to predict them. Prices are usually led by a narrow cohort of 'fast' money with short term profit targets, whose unpredictable average sets the market trend. 'Slow' money is usually reactive only to long term events.

Markets brushed off the possibility of an actual Russian invasion of Ukraine, until the time it actually happened. Just like they failed to predict sharp inflation a year ago. In the same way, markets were caught off guard in March 2020, when they collapsed after the first Covid-19 victim in Europe, two months after the outbreak in Wuhan. Markets failed to predict the 2016 Presidential Election, Brexit, the possibility of Lehman Brothers collapsing and a host of other very important events.

Failures to predict lower probability events, which occur far too often, result in high market volatility, the enemy of portfolios and trades with low liquidity thresholds. Many clients have reduced the size of their portfolios on high volatility, never to return until the rebound was completed. And many more traders who got the market right but lost money anyway because they could not sustain a position due to high volatility.

Developed governments and markets believed that Russia would not pull the trigger as sanctions would be crippling. Russia did not believe that the western world, barely standing after the pandemic, would impose such heavy sanctions on a global commodity producer. The result, predictably, is mutually assured economic pain.

Why markets are so bad at predicting is a big conversation. Humans have seldomly shown any capability of correctly assigning probabilities for an event, especially when they have a stake in it. Call it 'Optimism Bias', a staple of capitalism, short-termism, or simply inability to adjust a portfolio for fringe events, markets consistently get big events wrong. Three Economic Nobel prizes have been given to behaviourists and I find myself ill-equipped to fully explain the intricate workings of human logic. The result of failing to predict Russia's invasion has been further upheaval in the equities market, where volatility (if extrapolated to year end) would reach that of the Euro Crisis.

Why? Because at the heart of this crisis is not the financial system like 2008. Instead, it's the global commodities markets. Errant commodity prices exacerbate inflation pressures and, as usual, the first victim is low yielding fixed income.

But things are taking a turn for the worse very quickly. Just last week, global Nickel trading froze and remains thus, after Tsingshan Holding Group, the world's biggest producer of nickel and stainless steel found itself on the wrong side of the market and is now subject to billions of Dollars of losses. It's owner, Xiang Guangda, has been hailed as the industry's Steve Jobs. While we are talking about a Chinese company, its near (?) collapse is already impacting western economies. As of Monday morning, some hedge funds were reported leaving the London Metal Exchange. A thinner market is going to make it difficult for big companies to hedge their positions. Global economies and markets are as interconnected as they were in 2008, the derivatives market is as big and a large enough dislocation may reverberate across the world.

It's not just nickel of course. Global commodity prices are rising at a very fast pace, and the dislocations only grow. It's only a matter of time before a western "Tsingshan" finds itself against the ropes.

Sanctions on Russia are taking an enormous toll on western markets. Volatility for stocks and bonds is one thing. But commodities markets are experiencing serious dislocations. The result of commodity volatility has a very direct impact on economies. Maybe ATMs won't freeze within a week and the crisis won't be as fast as in 2008. But it may well be equally potent. Price rises and shortages of everything for the second time in two years will prove challenging even for the most robust economies.

***David Baker, CIO***



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