

Are you sitting comfortably?

Global Matters Weekly

1 March 2021

– Richard Parfect

As I write this there is a good news story of a B777 executing a successful diversion and emergency landing following the dramatic loss of one of its two engines. Somewhat unnervingly for passengers the remnants of the burning engine were clear to see. More seriously there was fuselage damage too, however the pilots' frequent rehearsed emergency procedures and risk controls prevented a catastrophic outcome.

Passenger unease is understandably common on aircraft, particularly if the aircraft enters clear air turbulence. Whilst even significant buffeting is normally well within design limits of the aircraft, passengers can become alarmed that something catastrophic will befall them. However, the best thing passengers can do is sit back, try and relax and trust in the professionalism of the pilots and engineers; the turbulence will pass.

As we near the anniversary of the UK economy entering lockdown and the associated collapse of markets around the world, it is almost unbelievable that markets have staged the swift recovery that they have. The market volatility (or turbulence) passed and recovery ensued. For markets such as the UK (which had already endured prolonged weakness post the Brexit referendum), some investors saw the logic of looking past the near term costs of lockdown and appraised the opportunity presented to them to purchase many years' worth of future profits for the bargain basement prices of 2020.

While markets do not follow any known laws of physics (not least because of human participation), investors who seek to remove emotion from their process or, better still, exploit the over-reaction of others, can profit from the principle of "mean-reversion". This is the basic premise that once the temporary effects of a transient event are removed (a war, a pandemic, the initial shock of leaving a trade-bloc); naturally adjusting and compensatory forces take hold and restore the system to something approximating to what went before.

Extrapolation of past and current observations is a natural human trait. However, unfortunately memories are short and many market participants place heavy emphasis on recent experience and much less weight on events several years (or decades) past. This is why people find it hard to sell when markets have been recently strong or buy when the markets are similarly weak.

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various "quantitative easing" means, which in simple terms collectively amounted to printing money. The recovery certainly materialised, but instead of it being felt in the real economy, it was centred around asset prices such as capital markets. The reaction of authorities to the COVID19 pandemic has seen a degree of money printing that has dwarfed that of the GFC response.

Most market participants have not seen a prolonged bear market in fixed income (credit) markets. Their natural horizon has been of central banks buying government debt to maintain low interest rates whilst a low level of inflation has afforded such largesse. Extrapolating indefinite low yields, of even sub 4% for so called "high yield corporate debt" and now negative yields for increasing amounts of sovereign debt, requires the continuation of many things, not least the persistent absence of inflation.

Doom-mongers have warned about the return of inflation for almost as long as quantitative easing commenced; and to date they have been wrong. However, such risks cannot be so easily dismissed now. There is a collective incentive for authorities to allow inflation to rise above target for a prolonged period, if for no other reason than to deflate the huge amounts of debt that has built up. Pent up demand and substantial accumulations of household savings from the last 12 months, as well as the loss of spare capacity in some quarters, could see a material over-shoot of inflation, which may prove to be less temporary than people expect.

The multi-decade rise in bond prices (and associated fall in interest rates) could finally be severely tested in a way that proves to be significantly longer lasting than the market effects of COVID19. We will then see whether the central banks are certain of their position on their economic flight plan and whether they have planned for an emergency diversion airport. Otherwise the resulting economic turbulence may find investors reaching for their parachutes.

The Marketplace

- Global equities fell -2.8% last week
- 10-year US Treasury yields rose 14.4bps on Thursday in their biggest daily move since March 2020, before falling -11.5bps on Friday. The substantial moves were driven by real rates increasing, rather than higher inflation expectations
- Brent crude rose 5.1% last week to \$66.1 a barrel
- Gold fell -2.8% to \$1734.0 per ounce.

Market Focus

US

- US equities fell -2.4% last week
- The estimate of GDP growth in Q4 was revised up to an annualised 4.1%, slightly below the 4.2% reading expected
- The fiscal stimulus bill was passed by the House, though the proposed minimum wage hike is likely to be taken out by the Senate
- Weekly initial jobless claims for the week ending 20th February fell to 730k against 825k expected. The number of continuing claims also fell to a post-pandemic low of 4.42m against 4.46m expected
- The Conference Board's consumer confidence index rose to 91.3 in February, outperforming expectations of 90.0
- New home sales rose to an annualised rate of 923k in January, against 856k expected
- Durable goods orders rose by 3.4% in January against 1.1% expected.

UK

- UK equities fell -1.7% last week
- Prime Minister Johnson outlined the roadmap out of the English lockdown, beginning on 8th March with schools reopening. All social restrictions will be ended no earlier than 21st June
- The unemployment rate in the three months to December was 5.1%, as expected.

Asia/Rest of The World

- The benchmark Global Emerging Markets index returned -6.3% last week
- Japanese equities fell -3.3% in the week
- The Bank of Korea left their main interest rate unchanged at 0.5% as expected, though they raised their 2021 CPI forecast to 1.3%
- Ghana received the first delivery from the Covax vaccine-sharing initiative, with 600k doses of the AstraZeneca vaccine
- Japan's manufacturing PMI for February was 51.4, while India's was 57.5
- China's official manufacturing PMI was 50.6 against 51.0 expected, with the composite index dropping to 51.6.

Europe

- European equities fell -2.4% last week
- Germany's Ifo business climate indicator rose to 92.4 in February against 90.5 expected, a four-month high
- The GDP reading for Q4 in Germany was revised up to 0.3% quarter-on-quarter growth, versus the initial 0.1% estimate
- ECB chief economist said the bank would purchase assets flexibly "with a view to preventing a tightening of financing conditions"
- The European Commission's economic sentiment indicator for the Euro Area rose to 93.4 in February, its highest level since March and beating expectations of 92.1.

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Asset Class/Region	Currency	Currency returns			
		Week ending 26 Feb. 2021	Month to date	YTD 2021	12 months
Developed Market Equities					
United States	USD	-2.4%	2.7%	1.6%	23.8%
United Kingdom	GBP	-1.7%	1.8%	1.0%	-6.3%
Continental Europe	EUR	-2.4%	2.2%	1.1%	4.7%
Japan	JPY	-3.3%	3.1%	3.4%	18.9%
Asia Pacific (ex Japan)	USD	-5.7%	1.4%	4.9%	35.1%
Australia	AUD	-1.6%	1.5%	1.8%	2.3%
Global	USD	-2.8%	2.6%	1.5%	22.7%
Emerging markets equities					
Emerging Europe	USD	-4.3%	1.3%	-1.1%	-5.2%
Emerging Asia	USD	-6.7%	0.9%	5.3%	41.9%
Emerging Latin America	USD	-7.8%	-3.0%	-9.5%	-10.4%
BRICs	USD	-8.5%	-0.3%	3.5%	27.3%
China	USD	-9.6%	-1.0%	6.3%	40.1%
MENA countries	USD	1.2%	3.0%	5.1%	10.4%
South Africa	USD	-6.8%	2.9%	5.7%	12.6%
India	USD	-4.6%	5.3%	2.9%	22.1%
Global emerging markets	USD	-6.3%	0.8%	3.9%	31.1%
Bonds					
US Treasuries	USD	-0.8%	-2.3%	-3.4%	0.4%
US Treasuries (inflation protected)	USD	0.0%	-1.8%	-1.6%	6.5%
US Corporate (investment grade)	USD	-0.5%	-1.7%	-3.0%	3.0%
US High Yield	USD	-0.6%	0.4%	0.7%	7.7%
UK Gilts	GBP	-1.3%	-5.6%	-7.2%	-3.5%
UK Corporate (investment grade)	GBP	-1.2%	-3.4%	-4.5%	1.2%
Euro Government Bonds	EUR	-0.4%	-2.0%	-2.5%	-0.5%
Euro Corporate (investment grade)	EUR	-0.4%	-0.8%	-0.9%	0.7%
Euro High Yield	EUR	-0.4%	0.6%	1.1%	3.4%
Japanese Government	JPY	-0.6%	-1.0%	-1.3%	-3.0%
Australian Government	AUD	-2.9%	-4.5%	-5.1%	-4.1%
Global Government Bonds	USD	-0.9%	-2.4%	-3.7%	4.0%
Global Bonds	USD	-0.7%	-1.9%	-2.9%	5.1%
Global Convertible Bonds	USD	-2.3%	2.9%	2.9%	28.2%
Emerging Market Bonds	USD	-2.5%	-3.7%	-5.4%	-1.9%

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Property					
US Property Securities	USD	-0.4%	3.9%	4.1%	-5.8%
Australian Property Securities	AUD	0.0%	-3.2%	-7.1%	-18.0%
Asia Property Securities	USD	1.5%	6.9%	6.8%	0.3%
Global Property Securities	USD	0.1%	3.5%	2.5%	-3.2%
Currencies					
Euro	USD	-0.4%	-0.4%	-1.2%	11.0%
UK Pound Sterling	USD	-0.6%	1.7%	2.2%	8.0%
Japanese Yen	USD	-1.1%	-1.8%	-3.1%	3.6%
Australian Dollar	USD	-1.9%	1.0%	0.4%	17.8%
South African Rand	USD	-3.3%	0.2%	-3.3%	0.6%
Swiss Franc	USD	-1.5%	-2.1%	-2.7%	7.4%
Chinese Yuan	USD	-0.2%	-0.7%	0.8%	8.5%
Commodities & Alternatives					
Commodities	USD	0.6%	9.2%	13.8%	16.9%
Agricultural Commodities	USD	1.1%	4.6%	9.6%	34.7%
Oil	USD	5.1%	18.3%	27.7%	23.8%
Gold	USD	-2.8%	-6.1%	-8.5%	5.7%
Hedge funds	USD	-0.6%	1.9%	1.9%	8.4%

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