INFORMATION FOR INVESTMENT PROFESSIONALS

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Market updates

Investment team updates | 5 November 2021

US equities

- Following September's decline, US equities came back strongly in October following a better than expected Q3 results season. The month saw the S&P 500 up by 6.9% with a 3% gain in the last two weeks. Small caps fared better over this period, with the Russell 2000 returning 4.9% over the two weeks. This week the S&P 500 has reached a series of new highs, ending Thursday 4 November's session with its sixth consecutive record close.
- Coming into earnings season there were a number of risks which were concerning investors – supply chain disruptions, rising inflation and the durability of growth. In the event, the market has managed to climb the "wall of worry" and looked through some of those concerns, at least for now. Instead, it has been buoyed by a strong set of corporate earnings. So far, more than 80% of companies have reported results by market cap and earnings are beating estimates by 10.5%, with 79% of companies beating projections. Financials as a group have so far delivered the biggest beat. Based on a blend of actual results and estimates, year-on-year earnings growth for Q3 currently stands at 37%, well ahead of the expected 27%. While supply chain and inflation pressures have been noted, companies have still delivered good results and guidance for 2022 has surprised to the upside, which the market has taken particularly positively. The ability of companies to flex their operating leverage to the benefit of the bottom line has been a recurring theme.
- The past few weeks have seen a majority of the big index heavyweights reporting, especially in tech. The results have been mixed with Microsoft and Alphabet performing best, and Apple and Amazon disappointing slightly. The latter pair cited supply chain issues as a headwind, which was particularly an issue for Amazon which posted lower than expected sales and warned that such issues, as well as labour shortages, would persist and weigh on Q4 earnings. Amazon Web Services, however, continued to be a bright spot. Meanwhile, revenues were a miss for Apple, although earnings per share was in-line, with a $6 billion headwind from supply constraints likely to mean growth will be tepid next year.
- By contrast, Microsoft shares accelerated as it overtook Apple to become the world's most valuable company once again. It was particularly helped by growth in its Azure cloud computing unit. Alphabet's Google nearly doubled its profit in Q3 and recorded its highest sales growth in nearly a decade given surging ad revenues.
- The industrials sector was helped by news over the weekend that the US and EU are close to an agreement to relax steel and aluminium import tariffs. It should be beneficial for some materials companies and industrials companies. Motorbike manufacturer Harley-Davidson rallied on the news.

- As expected, the US Federal Reserve announced its intention to start scaling back its $120 billion-a-month bond-buying programme. It will reduce the pace by $15 billion a month in November, consisting of $10 billion of treasuries and $5 billion of mortgage backed securities. At this rate it should have phased out purchases completely by June 2022 – although the question remains as to what it will do with its vast accumulated balance sheet. Despite other central banks beginning to pivot towards raising interest rates, Fed chair Jay Powell downplayed the rates issue and focussed on tapering.
- In Washington, two substantial stimulus packages are still on the table and facing a tricky path through Congress. West Virginia Democrat senator Joe Manchin has once again broken rank with his party over the size and funding of the healthcare, education and climate package. While it has already been reduced to $1.85 trillion from $3.5 trillion, Democrats hope to pass it using the budget reconciliation method which would require all 50 of their senators to be onside.

Fixed income

News

- This week (3 November) the US Federal Reserve kept rates unchanged at 0.25%, but as expected cut its purchases of assets by $15 billion ($10 billion government bonds and $5 billion mortgage backed securities). The market is pricing two rate rises in 2022 starting in Q3.
- Also in the US, the ISM Services PMI rose to a record high of 66.7 in October, which was well ahead of expectations, while the ISM Manufacturing figure for October moved higher to 60.8, with prices paid rising strongly and supplier delivery times extended.
- In the UK, the Bank of England held interest rates at 0.1% on 4 November, with the MPC voting 7-2 in favour of this. Markets were 50:50 on a rate hike but we were confident they would wait. However, every meeting from now is up for grabs. Also in the UK, the Nationwide house prices index rose 0.7% month-on-month in October. The annual rate of growth fell to 9.9% but still exceeded expectations.
- In Europe, the European Central Bank's president, Christine Lagarde, said a rate hike next year is very unlikely. Also in the eurozone, GDP for Q3 came in +2.2% quarter-on-quarter against expectations of 2.1%. On an annual basis GDP grew at 3.7% year-on-year, while CPI inflation rose by 4.1% year-on-year in October, against expectations of 3.7%. The core rate came in at 2.1% year-on-year.
- At the COP26 conference in Glasgow, Modi committed India to be net zero, but not until 2070.

Markets

- In government bonds the US 10-year treasury yield started the week (1 November) at 1.56%, and were up (to 1.59% on 3 November) and down over the week, ending 4 November at 1.52%. German bunds followed this direction of travel and ended the week (4 November) at -0.24% having started (1 November) at -0.12%, as did the UK (1.06%-0.91%).
- Credit markets, based on BofA Merrill Lynch Bond Indices, were effectively unmoved over the week, with Global IG starting and ending the week at 93bps, and Global HY moving from 390bps to 398bps
- Oil prices moved slightly lower over the week, from $84.3 a barrel on Monday 1 November to $79.7 a barrel on Thursday 4 November.
- Wheat prices reached their highest since 2012 this week (1 November) as food price increases continue.

Multi-asset

- Our economic forecasts continue to point to peak growth and inflation this year. While our longer-term inflation outlook still suggests the current pick-up is transitory due to ongoing structural disinflationary trends such as technology and demographics etc, the sharp price increases in areas where bottlenecks and supply chain disruptions are prevalent warrant careful monitoring. In accordance with this view we don't expect any US Federal Reserve rate rises this year or next, although we do expect a tapering announcement in the November Federal Open Market Committee meeting. A continuation of historically relatively easy policy and our optimistic earnings growth forecasts should continue to deliver decent, positive returns from risk assets like equities and credit over the next 12-18 months.
- Over the past month the Bank of England has emerged as the core central bank where the most is expected in terms of rate rises. We continue to lean against this, driven by a view that the underlying UK economy is less robust than inflation figures would suggest. While more persistent inflation remains a key risk to our dovish rates forecasts, strength in experienced inflation continues to be concentrated in areas where demand is rising quickly as economies reopen. We maintain our expectation that these will fade over time and supply chains adjust.
- Concerns regarding Evergrande potentially becoming the "Lehman of China" have faded over the past month. However, as China continues to attempt to alter the composition of its growth away from property and manufacturing, our assessment of risks around China have moved away from a market-crisis towards a potential growth crisis. Risks will remain until policy makers show their ability to sufficiently "turn on" the new desired drivers of growth while "turning off" old growth drivers. Despite this, the current strength in global trade volumes should provide some respite whilst this rejigging is attempted. If successful, this could leave the Chinese economy in a stronger and more sustainable position.
- While the pace of the global economic recovery is showing some signs of easing off, we believe there is still value to be found in select cyclically sensitive areas where vaccination programs were rolled out later and recovery profiles are, therefore, less advanced. No asset allocation changes were made over the past month.

Responsible investment

- The 26th United Nations Climate Change conference, COP26, got underway in Glasgow on 31 October, with the opening of the world leaders' summit culminating in an enormous amount of announcements
- We found former Bank of England governor Mark Carney's comments particularly striking, that 450 banks, insurance companies and asset managers – representing $130 trillion, or 40% of global assets – are committing to targets to get to net zero by 2050.
- This will mean there will be huge pressure on companies, as investors will simply sell if they don't commit to – or achieve – net-zero targets in line with portfolio decarbonisation plans. This shows us how important the investment industry could be in the race to net-zero emissions.
- Elsewhere, the US released detail on its own targets, adding credibility and paving the way for other nations to follow suit. They also led more than 100 countries in announcing a headline 30% reduction in methane emissions by 2030, covering 50% of global methane emissions. However, the International Energy Agency (IEA) estimate that methane emissions need to fall by 75% to meet net zero – the oil and gas and agricultural sectors are responsible for the lion's share of global methane emissions, so we can expect implications for these sectors.

- While there was some scepticism around India's commitment to net zero only by 2070, it is a big step in the right direction and its interim targets are promising. Kenya's 2050 commitment is comparatively punchy compared to this, and to China's 2060 deadline. This could lead the way for more African nations to follow suit and support the trend whereby new energy demand is met by renewable generation.
- For more of our views on COP26, please look out for our new series of articles from the Responsible Investment team: The bumpy road to net zero.

Note: all data as at 4 November 2021, unless otherwise specified. Source: Bloomberg.