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Market updates

Investment team updates | 19 March 2021

US equities

Markets

- Last week (ending 12 March) US equities made significant gains, recovering most of the losses from previous weeks, particularly in the S&P 500 which finished last week up by 2.6%. The small cap Russell 2000 index did even better, rising 7.3%. In the recent market sell-off and subsequent recovery, both the S&P 500 and Dow Jones have fared better than the tech-heavy Nasdaq given their higher relative weighting of cyclical stocks. Both have recovered to make all-time highs in recent days while the Nasdaq remains down more than 7% from its peak.
- This week the US market trended higher before a pullback on Thursday 18 on account of the surging 10-year bond yield, which touched 1.75% for the first time since before the pandemic began. Once again, the more highly valued growth end of the market sold off the most, with the Nasdaq down by 3% yesterday. Despite positive assurances from the US Federal Reserve this week, bonds have continued to sell-off given the market is pricing in a stronger-than-expected economic recovery, higher inflation in the short term and increased supply of bonds given the amount of government stimulus hitting the system.
- At a sector level it was all positive last week, with particular strength in real estate, consumer discretionary and utilities. This week, however, energy has been a poor performer with WTI Crude falling for five consecutive days given concerns over faltering demand in Europe amid the possibility of renewed lockdowns.
- The Fed released minutes from its latest policy meeting this week which the markets generally took positively. They issued upgrades to GDP forecasts while remaining dovish on the prospect of rate rises. Chairman Jerome Powell reiterated that the Fed would continue to provide support for the economy for “as long as it takes”. The median expectation for the first rate hike is currently slated for 2024 based on the opinions of the Federal Open Market Committee members.
- Now that the $1.9 trillion stimulus package has been signed off by President Biden, attention will turn to the next source of stimulus and especially his infrastructure-oriented “Build Back Better” programme. Estimates for this are in the $2 trillion-$4 trillion range but could be staggered over several years. The broad idea seems to have bipartisan support, but there will be some resistance from policymakers who are concerned about the growing debt burden.

European equities

- Cyclical stocks continue to attract interest across Europe, although the UK, with a quick vaccine roll out, will see the economic bounce-back earlier.
- IPOs continue to be a big feature of equity market, with dovish monetary and fiscal policy continuing to support – but given inflation concerns this has not helped bond markets.
- The vaccine roll out is causing political issues in Europe, but with the European Medicines Agency (EMA) saying the AstraZeneca vaccine is “safe and effective” it appears that the pause may be short-lived.
- The Dutch election returned the incumbent government, but in Germany Merkel’s CDU lost ground in local elections.

Fixed income

News

- On Thursday 18 March the first high-level talks between the US and China since President Biden’s inauguration got underway – rather acrimoniously.
- In the week ending 12 March there was a rise in US Initial Jobless Claims to 770,000 versus an expected 700,000.
- On Wednesday 17 the US Federal Open Market Committee (FOMC) met and discussed the following results:
    - The US Federal Reserve upgraded growth estimates to 6.5% in 2021 (it was estimated at 4.2% in December 2020)
    - US unemployment is set to fall to 4.5% this year, and to 3.5% by 2023, from its current 6.2%.
    - Inflation is expected to spike to 2.4% this year before falling back to 2% next year.
    - Interest rates expected to remain on hold through 2023 – with now not the time to talk about tapering either. Markets on the other hand have three rate hikes priced in 2023 – so more hawkish.
- Also in the US there was a sharp fall in housing starts in February reported, likely as a result of the recent bad weather. This also affected retail sales which were weaker -3% month-on-month in February against an expected -0.5%. However, January’s figure was revised much higher. US industrial production was also weaker in February falling 2.2% month-on-month.
- In the UK, meanwhile, 10-year inflation expectations rose to their highest since 2008 at 3.5% RPI (not CPI). UK industrial production in January came in weaker than expected at -1.5%, while GDP was -2.9%, which was less bad than expected. On Thursday 18 March the Bank of England left rates unchanged, noting a better economic outlook and the Biden stimulus in the US.
- In the eurozone industrial production for January was up 0.8%, again better than hoped for. New car registrations for the area fell by 19.3% year-on-year in February, with BMW doing best (-13%), then VW (-19%) and Renault (-29%). BMW also said it expects 50% of its sales to be EV by 2030, lower than VW at 60%.
- Turning to Covid-19, the Oxford/AstraZeneca vaccine was under review in parts of Europe this week over fears of blood clotting, before the EMA reaffirmed its safety on 18 March. Meanwhile, both France and Germany are seeing rising case numbers, with former facing new lockdown restrictions.

Markets

- Core government yields were mixed this week. The US 10-year started the week (Monday 15 March) at 1.6 but were led higher to 1.75% before finishing Wednesday 17 at 1.71% as a sell-off recommenced. They fell back slightly on Thursday 18 to 1.68%. Germany, meanwhile, started the week at -0.34% before rising to finish Wednesday 17 at -0.28%. These moves higher were led by rising real yields not inflation expectations, which is still at 2.3% for 10 years).
- In credit spreads, based on BofA Merrill Lynch Bond Indices, Global IG barely moved all week from the 100bps mark, while high yield weakened slightly from 383bps on Monday 15 March to 387bps on Thursday.
- Oil moved sharply lower to $60.10 per barrel towards the end of the week (Thursday 18) from $64.7 per barrel on Monday.
- FX was fairly quiet over the week. The euro versus the dollar moved from 1.193 at the end of last week (12 March) to 1.197 on 17 March, mainly down to a dovish Federal Reserve.

Multi-asset

- Last week's asset allocation meeting was focussed on the outlook for emerging market (EM) debt. Since late 2013 our asset allocation group has been favourably inclined towards EM local bonds (on a hedged basis) despite broader caution on core government bonds, and neutral on US$ EM debt, within a more constructive view on credit overall. After an update with the EM team, no changes were made to these views.
- Although EM real rates are at historically low levels, the cushion versus developed markets rates remains decent. With inflation in most places comfortably below target, favourable developments in local fundamentals and lower reliance on foreign capital, EM sovereign assets appear to be reasonably supported.
- Higher oil prices are a risk, but on balance there are judged to be more EM winners than losers from richer oil prices.
- The group also reflected on a more constructive medium-term dollar view driven by a combination of mounting evidence of US exceptionalism, or US-led growth; more neutral valuations; and favourable rate differentials, particularly in real terms against the euro and sterling.

Note: all data as at 18 March 2021, unless otherwise specified. Source: Bloomberg.