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Market updates

Investment team updates | 3 December 2021

Fixed income

News

- The week saw an increase of cases of the newly identified Omicron variant of Covid-19 observed in South Africa and elsewhere. Though the week cases have been seen across Europe, Asia and in the US, causing fears of more lockdowns and economic disruption. On Thursday 2 December New York City reported its highest level of new cases since January 2021, while the UK reported its highest daily cases since July with 53,945. The Moderna CEO postulated that vaccines will be less efficacious against the variant, while the Pfizer CEO says we will likely know how well vaccines work in two to three weeks.
- The US employment report for November is due, and is expected to show the unemployment rate falling to 4.4%. In the eurozone, meanwhile, the unemployment rate fell to 7.3% for October, a post-pandemic low.
- The US Federal Reserve chair, Jay Powell, struck a hawkish tone this week, which upset risk markets. He called for a faster taper, noting inflation is likely to remain higher for longer, noting that the taper would be a removal of “unnecessary” stimulus. Also in the US, consumer confidence in November fell to its lowest level since February.
- In Australia, GDP for Q3 declined 1.9% quarter-on-quarter, which was slightly better than expected. In India, meanwhile, Q3 GDP was up 8.4% year-on-year – also slightly stronger than expected.
- In the euro area inflation rose to 4.9% headline and 2.6% core, both higher than expected. In Germany specifically inflation rose to its highest level since 1992 at 5.2% year-on-year.

Markets

- It’s been a turbulent November. We saw most markets lower in the month, led by commodities (especially oil), although government bonds were a bit better led by Gilts (with no rate rise from the Bank of England). Credit spreads continued to widen led by the European market/European swap spreads, and a premium put on (scarce) German government debt. Markets had to contend with higher inflation – for example, 6.2% in the US and 4.9% in the euro area; the Omicron Covid-19 variant; a stronger US dollar; and a collapse in the Turkish currency. There was also sabre rattling on Ukraine and Polish borders. We ended November with a more hawkish US Fed Reserve and a suggestion that the word “transitory” as it relates to inflation is redundant.

- This week, in government bonds the US 10-year treasury yield started the week (29 November) at 1.47% and ended it (2 December) slightly weakened at 1.45%. Germany started the week at -0.34% and ended it at -0.36%, while the UK started at 0.86% and finished at 0.8%.
- Credit markets, based on BofA Merrill Lynch Bond Indices, saw Global IG start and finish the week at 106bps, while Global High Yield started at 429bps and tightened slightly to 426bps on 2 December.
- Oil spent the week at $68 a barrel before moving a little higher after weakness to $68.4. It remains about 20% lower than in November.

US equities

- The main issue over the past couple of weeks in the US market has been the emergence of the Omicron variant of Covid-19. Equity indices have swung around, mostly to the downside, as information emerges. Also contributing to this volatility was the slightly more hawkish tone from the Fed, that they could speed up the pace of the asset taper.
- Over the past fortnight the S&P 500 has returned -2.5%, while small caps have sold off more with the Russell 2000 falling by 5.8%. Value has slightly outperformed growth but both factors have roughly traded in line and are negative for the period.
- While the early part of last week was quiet and volumes were low heading into the Thanksgiving holiday, the news from southern Africa about the Omicron variant by the end of last week upended the calm. However, we note it will still take a couple of weeks for hard data and a fuller picture of the new variant to emerge, especially around the efficacy of existing vaccines. The data from southern Africa on case rates and hospitalisations will also have a bearing. A lot of the initial selling pressure on Friday 26 November and Monday 29 November was driven by non-fundamental quant and algo-driven market participants as they sold on the basis of negative headlines. 30% of total US volume on those days came from index ETFs alone.
- Speaking at a Senate hearing earlier this week, Fed chairman Powell suggested the central bank was prepared to quicken the pace of its tapering programme in the face of stubbornly higher inflation and the Omicron variant which could worsen existing supply chain disruptions. They will discuss such a move at their upcoming December policy meeting. A quicker end to asset purchases could also bring forward the timeline for the first rate hike. All of which suggests inflation might now be viewed as remaining above target for longer, hence the need to take action sooner by turning off stimulus and tightening monetary conditions. Ending the period of accommodative monetary policy would give the Fed greater flexibility and more firepower to fight higher inflation. Core PCE – the Fed’s preferred gauge of inflation – was up 4.1% in October, more than double the 2% target, while private sector wages have increased at their fastest pace since the 1980s over the past year.
- On the back of the Omicron news, a lot of vaccine companies have been in focus. The Pfizer and Moderna booster shots have recently been authorised by the FDA for all adults, while positive assertions that the vaccine makers could tweak their covid shots to account for the new variant within a few months has been a big boost. Moderna is up 14% over the past two weeks, having given back some of its games, which takes its year-to-date gain to 189%. Pfizer has also traded above the market, while Novavax has fallen back, despite initially rising, and is down 15.8% as investors weigh up how effective each vaccine will be against the new strain, although there is so far very limited evidence on this front.
- The Federal Trade Commission announced it is moving to block Nvidia’s proposed $40 billion acquisition of British chip designer Arm Holdings on the grounds it was anticompetitive. Similar deals in the sector have fallen apart due to regulatory hurdles so there is no guarantee this will be approved.

- While earnings season is mostly behind us, tech company Salesforce issued results this week – a 27% increase in Q3 sales. However, its revenue forecasts for Q4 and Q1 2022 came in below expectations, sending the stock down. The firm also announced a new co-CEO structure with Bret Taylor taking up the role alongside Marc Benioff. Recently, the company has signalled a shifting approach. Whereas previously it had grown rapidly through acquisition – such as the recent purchase of messaging service Slack for $28 billion – it has now signalled it will slow acquisitions in order to improve profitability with a target-adjusted operating margin of 20% by early 2023. Since this announcement in September, shares have run far ahead of cloud computing peers.
- Looking ahead to next year, earnings will most likely come down from 2021's elevated levels, but the market is still forecasting a healthy 10%-15% EPS growth rate in 2022.

European equities

- The Omicron coronavirus variant caused a scare for markets, which were marked down sharply on the day that the news broke. However, there is so far little certainty around how infectious it is, and how serious. It is possible that it is highly infectious but less serious than earlier variants.
- Markets have been volatile since this, reflecting the uncertainty. Travel lockdowns have returned, not only for southern Africa but also more generally, and this has had varying impacts on individual countries, but has yet again hurt the travel and hospitality sectors.
- Q3 results have generally been ahead of expectations, meaning a bumper year for corporate profits overall. Momentum will slow in due course, if only because the bar for comparison has been set high, but benign interest rate and fiscal policy will help.
- This environment continues to bode well for stock pickers, particularly those with a focus on the quality of business models and the sustainability of returns.
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Note: all data as at 2 December 2021, unless otherwise specified. Source: Bloomberg.

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