07/2021

Market Snapshot

Equity Snapshot

United States US equities made gains for a sixth consecutive month, with both the S&P 500 Index and technology-focused Nasdaq Index reaching fresh highs against well-received financial results and still ultra-low interest rates.

Following its two-day meeting, the Federal Open Market Committee said US monetary policy would remain unchanged for the time being, taking the view that it was not yet the right time to begin tapering the huge quantitative easing programme. While Jay Powell said the economic impact of COVID-19 had continued to decline, the Federal Reserve (Fed) chair noted that the pace of vaccinations had slowed, with the Delta variant causing a rapid rise in case levels in certain areas.

Europe European equities advanced over July (in EUR terms). The EuroStoxx 600 Index traded at record highs amid generally buoyant corporate earnings and falling bond yields. New daily coronavirus infections were on the increase across major European countries such as France and Germany with the spread of the Delta variant. While most sectors made gains, travel and leisure, autos and parts and banks were among the laggards, impacted by COVID-19 worries. Technology stocks found support from lower interest rate expectations.

The European Central Bank (ECB) tweaked its official strategy to target euro-zone inflation of 2%, compared to its previously stated aim for inflation "at below but close to 2%." The change was viewed as giving the ECB more scope to leave interest rates lower for longer, with the new strategy also explicitly allowing the ECB to tolerate limited overshoots of the 2% objective. Early official estimates showed euro-zone inflation rose to 2.2% in July, from 1.9% in June, driven by higher energy prices. However, Eurostat's preliminary estimates also showed core euro-zone inflation dipped to 0.7% in July, versus 0.9% in June. Following its July policy meeting, the ECB said it would leave monetary policy on hold and maintain bond buying at current levels.

Asia Equity markets in Asia declined in July, largely impacted by a crackdown on the education sector in China and rising coronavirus cases across many Asian countries. Private education reforms caused China and Hong Kong equities, to plunge, while increased scrutiny of technology companies and measures to stabilize the housing market further dampened sentiment. The steep sell-off of Chinese equities also weighed on stocks in Korea, Taiwan, and Hong Kong. In Taiwan, old economy stocks came under pressure by retail investors, as regulators prepared to tighten their monitoring of day trading practices. Economic data showed South Korean exports moved to a record high in July as overseas demand for chips and biohealth products extended export growth. Weakness across Chinese stocks also lowered sentiment in ASEAN, with the Philippines underperforming sharply after seeing elevated coronavirus cases. Thailand and Malaysia equities declined as their respective new daily COVID-19 case levels surged to fresh highs. Singapore outperformed the region, participating in the wider rally across global equity markets despite regional worries.

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Bond

US bonds rose over July as rising coronavirus cases due to the Delta variant weighed on the economic outlook. The yield on the 10-year Treasury bond fell more than 20 basis points during the month to end at 1.22%. Federal Reserve (Fed) chair Jay Powell claimed the economic impact of Covid-19 on the US economy had continued to subside. However, he noted that the pace of vaccinations had slowed, with the Delta variant causing a rapid rise in case levels in some areas of the US.

Euro-zone bonds rose over July, with core European markets outperforming peripheral markets. The spread of the Delta variant and rising coronavirus cases across major European countries led investors to assume a more protracted economic recovery. The European Central Bank also tweaked its strategy, a change that was interpreted as making euro-zone interest rates more likely to stay lower for longer. UK gilts also gained over the month.

Outlook

When COVID-19 first brought about global lockdowns, people quickly began looking forward to "the day" things returned to normal. It is increasingly apparent that – in the medium-term at least – there will be no one single day that returns us to life as it was in 2019. Instead, societies are vaccinating and learning to mitigate the impact of any outbreaks or new variants. Economies and companies are following suit.

As a result, the fastest phase of economic recovery is likely to have passed. A combination of historically low bases, rapid vaccination programmes and fiscal stimulus all boosted GDP and cyclical company earnings growth dramatically. Forward earnings expectations for Q3 are thus noticeably less ebullient and, in a recent update to its World Economic Outlook, the International Monetary Fund highlighted its 4.9% growth forecast for 2022 was materially lower than the 6.0% expected in 2021.

The spread of the COVID Delta variant places an additional barrier to full normality. While it is more contagious, the strain is mercifully not (yet) vaccine resistant, and despite rising infection numbers in the likes of the UK and the US, vaccinations appear to be keeping hospitalisations and deaths manageable. However, its impact in emerging markets, which have both lower vaccination rates and a lower capacity to operate socially distanced economies, will be greater.

At a company level, these factors have the potential to sustain a higher level of operating volatility. Labour shortages, supply chain disruptions and cost inflation will remain significant factors in certain company statements. In the short-term, we are also likely to see seasonally lower liquidity drive up volatility. Ensuring portfolio holdings have the management, product offering and pricing power to offset these concerns longer term remains a priority in all our investment cases.

"Life after COVID" may therefore be a case of learning to live alongside it. In any case, sufficient normality is already causing share prices to be driven more by underlying fundamentals than shorter-term cyclical considerations. Here, more expansionary fiscal policy and a less favourable environment for global trade still contend with long-term structural forces such as digitalisation, automation and rising debt burdens. Owning quality companies on sensible valuations that are harnessing these trends provides the best defence against a volatile and unpredictable inflationary environment.

Sources: 1 Eurostat 2 Bloomberg 3 Office for National Statistics

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