INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 26 February 2021

US equities

Markets

- US equities finished modestly lower last week (ending 19 February) with the S&P 500 down by 0.7%. That weakness has accelerated into this week with the S&P 500 down by 2% by the end of Thursday 25 February. The tech-dominated Nasdaq index has borne the brunt of the sell-off, dropping 5.5% in four trading days this week.
- The recent weakness in equities has gone alongside a sell-off in bonds, with the yield on the 10-year Treasury going past 1.5% for the first time since before the pandemic took hold. While the increase in rates suggests confidence in the economy and the prospect of higher inflation and company earnings, certain portions of the stock market have become vulnerable to a sell-off given valuations. Stocks which particularly benefited from the lockdowns last year, such as the big tech names, have fared worst in recent days while the more cyclical stocks leveraged to a reopening of the economy have done better. This has been a feature of the market on and off since the positive vaccine news in November gave a boost to cyclicals.
- An update from Jerome Powell at the US Federal Reserve this week reiterated its easy monetary policy stance. Following an update to guidance in 2020 which will allow for periods of above-target inflation to compensate for prior undershoots, the Fed remains prepared to look through temporary bouts of inflation before raising rates. Powell stated that the economy is still “a long way” from employment and inflation goals and will continue with near-zero rates and asset purchases.
- Coronavirus trends have continued to improve in the US, giving a boost to the economic outlook. US cases are down more than 80% over the past six weeks with 10-15 million doses of vaccine being administered a week. It is hoped that this figure will gradually improve as the rollout accelerates, up to a level of 30 million a week by June. Recent reports have also demonstrated the high efficacy of just one shot of the vaccine.
- Q4 earnings are mostly complete with 83% of companies having reported results. They continue to confirm a trend we have seen throughout this earnings season of results coming in significantly better than expectations. While estimates initially predicted a decline in earnings for Q4, this picture has improved significantly. Current estimates are for Q4 earnings growth of 3.2% with 79% of companies beating EPS expectations by an average of nearly 15%. Considering that the next two or three quarters will face much easier comparisons versus the equivalent quarters last year, there are expectations for double-digit earnings growth in all four quarters of 2021.

European equities

- VW rejoining the UN Global Compact is a significant move and opens the shares up for investment to many funds again, though governance remains under the spotlight. European carmakers are all redoubling their efforts to develop electric vehicles, and Daimler's proposed demerger is an interesting development, potentially releasing shareholder value.
- Elsewhere in Europe, some countries are seeing dissatisfaction with slow vaccine distribution, and take-up is worryingly slow in some places. But overall the trend is positive, albeit slower than in the UK.
- M&A continues to be a key theme in Europe: recent rumours or announcements include the battle to takeover Birkenstock, and Diasorin pursuing Luminex, a US-based Covid-19 test maker.
- Markets remain in positive territory year to date, and our focus on quality continues to bear fruit, albeit we are mindful that cyclicals have some attractions in a recovering backdrop and valuations in some areas are at heady heights.

Fixed income

News

- Covid vaccinations continue to be administered across the world. In the UK 28% of people have had a first dose, and 1% have received both doses, while in the US the figure is 20%, and in Germany and France it's at around 6% of the population.
- In the US on Tuesday 23 February Federal Reserve Chairman Jerome Powell , in comments to the Senate Banking Committee, played down inflation risks, pointing to uneven and incomplete economic recovery and high joblessness. Meanwhile, US Consumer Confidence rose to its highest level in three months in February, while jobless claims for the week ending 19 February moved lower to 730,000.
- Also in the US, the Composite PMI, which tracks business trends across both manufacturing and service sectors, was at 58.8 in February, its best since 2015, and durable goods orders for January were much stronger at +3.5%. In Europe the Composite PMI also rose but is still below 50 – 48.1 – which indicates business is generally declining.
- In Germany, the IFO business climate index, which measures sentiment among German managers, rose to 92.4 in February. Also, Q4 GDP in Germany rose only 0.3%, driven lower from Q3 by consumption and a rise in savings.
- In the UK, meanwhile, the government announced its plans this week to reopen the economy, starting with schools on 8 March. UK unemployment, meanwhile, ticked higher to 5.1% in December, latest figures show.

Markets

- The loss of support of ultra-low/ negative bond yields is affecting risk markets (at last). Core government bond yields have risen across the week. The US 10-year started the week (Monday 22 February) at 1.36% but ended Thursday 25 having climbed through 1.5%. This is being driven by rising real yields now, not increasing inflation expectations! In total, US yields are up more than 50bps this year and nearly 100bps since summer 2020.
- Credit spreads, based on BofA Merrill Lynch Bond Indices, have seen Global IG at around 95bps for most of the week, with High Yield at around 370-375bps.

- In FX, the US dollar started the week at 1.211 against the euro, before ending the week exactly the same. Earlier in the week, the GBP was at its strongest against the dollar since early 2018, at $1.418.
- Oil rallied across the week. Having ending last week at $59.7 per barrel, it rose to $63.7 by Wednesday 24 February, before slipping slightly to $63 on Thursday.

Multi-asset

- Nominal yields moved higher again over the week with 10-year yields in the US, for instance, breaking through 1.5%. In contrast to earlier in the month, however, it has been real yields driving this move rather than increases in inflation expectations (the latter tends to be broadly risk-friendly).
- The scenario that would be most damaging for risk is one where real yields rise because of perceived policy uncertainty/errors – a redux of the taper tantrum of 2013; but there has been no real change in the US Federal Reserve's tone, which continues to stress that it is far too early to talk about tapering.
- On balance, particularly given the Fed's move to average inflation targeting and allowing things to "run hot", it would seem unlikely to us that real yields would rise as they did in the disruptive 2013 period. Ultimately, it boils down to the Fed's ability to look through higher prices, rising activity and, indeed, more fiscal stimulus as the year progresses.
- So, thus far we have not reversed our positive view on risk assets (equities and corporate credit). Our largest risk positions are in areas which serve to benefit from reflation, levered as they are to the global economic and trade cycle, such as Emerging Asian and Japanese equities.

Note: all data as at 25 February 2021, unless otherwise specified. Source: Bloomberg.

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