INFORMATION FOR INVESTMENT PROFESSIONALS

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Market updates

Investment team updates | 21 May 2021

US equities

- Over the past two weeks (the nine trading days to Thursday 20 May), US equities have drifted slightly lower, with large caps slightly ahead of small caps. Over the period the S&P 500 has returned -1.7% and the Russell 2000 -2.8%.
- The value factor performed better than growth and momentum, but all factors declined overall. Some of the big tech names sold off before recovering some ground yesterday (20 May). Apple is off by -2.2% and Alphabet by -1.9% over the past two weeks.
- Inflation continues to be one of the key themes dominating the narrative, especially after the April CPI report came in well above expectations with a 4.2% year-on-year increase – the highest increase in prices for a 12-month period since 2008. This has helped to confirm the notion that the economic recovery is beginning to be felt in the form of higher prices. The 10% increase in used-car prices was one of the most noteworthy data points, with rental firms scouring the used-car market due to supply constraints of new cars related to the semiconductor shortage. This, combined with a tightening labour market, have increased suggestions that the US Federal Reserve may be forced to act to prevent inflation running out of control. The Fed's first move before increasing rates will likely be a tapering of the asset purchase programme, but for now it remains firmly on hold, willing to look through this period of higher prices. Anecdotally, many more companies have been mentioning inflation on earnings calls, showing it is becoming an increasing concern for supply chains and labour markets.
- Talks are ongoing regarding a bipartisan infrastructure package, with Republicans unwilling to commit to the full extent of President Biden's $4 trillion plans across physical and social infrastructure spending. So far, Republicans have been willing to agree to $800 million, up from an initial $568 million offer, which still means a wide disparity in expectations.
- With 91% of S&P 500 companies having reported Q1 earnings, the key conclusions are that we have witnessed very strong earnings and revenue results, well ahead of expectations. However, this seems to have been largely priced in by the market as, unless companies exceeded expectations by a very wide margin, the price reaction was fairly muted or even negative – the big tech stocks being a good example. In aggregate, 86% of S&P 500 companies have beaten their earnings estimates with year-on-year earnings growth of 50.3%. If sustained to the end of earnings season, such a growth rate would be the highest since Q1 2010 (55.4%). Unsurprisingly, the consumer discretionary sector is reporting the highest year-on-year growth rate of any sector given its leverage to reopening and easier comparisons with one year ago. The S&P 500 is now expected to report earnings growth of 33% for the whole of 2021, with 59% year-on-year currently pencilled in for Q2.

European equities

- The Q121 results season was positive for banks: investment banking and wealth management have proved the best areas. Consumer discretionary businesses have also done well.
- However, share prices have not reacted positively in many cases, as recent performance has meant valuations now reflect much of this good trading experience.
- Bond markets continue to be under pressure, with yields on the rise. Inflation expectations have ticked up, and the belated vaccine roll-out in Europe is likely to support economic growth, despite concerns over the Indian variant of the virus. Some of these themes are reflected in the corporate sector, with cost pressures becoming evident.
- M&A, especially in the media sector, and IPOs continue at a rapid pace in Europe, albeit the quality of some of the new issues has been a cause of some concern.

Fixed income

News

- In the US, jobless claims last week (ending 14 May) fell again to a new "post-pandemic" low of 444,000. Housing starts in the country weakened a little in April, with a suggestion that supply-chain constraints and rising materials costs are constraining builders.
- At the back end of last week (ending 14 May) in the US, 10-year inflation expectations came in around its highest level since 2005, at 2.45%. Retail sales, meanwhile, were at 0% month-on-month, which was weaker than expected, as was industrial production at 0.7%.
- In China, a series of data releases generally missed expectations: retail sales in April came in at 17.7% year-on-year against an expectation of 25%; industrial production was at 9.8% against an expected 10%; and fixed investment came in at 19.9% year-on-year against an expected 20%. In Japan, Q121 GDP fell 5.1% quarter-on-quarter annualised, which was also weaker than expected, while the country also recorded a weak composite PMI reading of 48.1, down from 50.
- In Europe, headline inflation was up to 1.6% in April, from 1.3% in March. The core rate fell to 0.7%. In the UK, CPI inflation came in at 1.5% in April, up from 0.7% the previous month. Core inflation was 1.3%, up from 1.1%. Both these numbers were as expected.
- In commodities, the broad index in May is at highest since 2015 – adding to inflation concerns.
- In the UK, the jobless rate fell to 4.8% with significant strength reported in April, while retail sales bounced by more than 9% – stronger than expected. In Europe, meanwhile, new car registrations are up around 250% year-on-year in April.

Markets

- Core yields drifted around a narrow range this week, with the US 10-year Treasure starting the week (Monday 17 May) at 1.65% and ending it (Thursday 20 May) at 1.63%, and Germany starting the week at -0.12 and ending it at -0.10.
- In credit markets, based on BofA Merrill Lynch Bond Indices, Global IG started the week (17 May) at 93bps and ended it (20 May) at 94bps. It has been in a 10bps range for the whole of 2021. Global High Yield, meanwhile, widened slightly from 363bps on 17 May to 367bps on 20 May.
- In FX, the US dollar heads ever lower. The Euro is now at 1.224 – the highest level since early January. Bitcoin rallied somewhat on 20 May having plummeted more than 35% midweek, mostly on the back of Elon Musk's proclamation about its carbon footprint.
- Oil started the week (17 May) at $66.5 a barrel and tracked lower over the week to $62, following talk of an end to Iranian oil sanctions and higher US inventories.

Multi-asset

- We have spent some time reviewing our regional equity preferences over the past weeks, where asset allocation portfolios retain their favourable tilts towards the US and Japan, with the strongest preference for EM Asia.
- Asian equities, including Japan, have underperformed global indices since mid-March, surprising in the context of broadening global cyclical strength which tends to benefit the region. A review of the position led us to make no changes, where, for example, fresh lockdowns in Japan appear to have knocked sentiment more than the economic impact might justify, and where consensus earnings forecasts appear overly cautious.
- In the US meanwhile, the strength of Q1 earnings season has been fairly astonishing with, most notably, beats in cyclical sectors like consumer discretionary, energy and financials. Commensurately modest total return gains may be down to crowded investor positioning in some names.
- Broadly, we remain comfortable with our equity positions, as the world continues to recover and while earnings come in ahead of lofty consensus forecasts.
- While inflation remains a risk to these views, we remain firmly in the “transitory inflation” camp, and don’t expect the US Federal Reserve to panic after one startling CPI report. Indeed, while April CPI was well above consensus, it was pushed up by the reopening of the services sector and used-car prices, with people reluctant to use public transport.

Note: all data as at 20 May 2021, unless otherwise specified. Source: Bloomberg.

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