INFORMATION FOR INVESTMENT PROFESSIONALS

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Market updates

Investment team updates | 25 June 2021

US equities

- Over the past two weeks – the nine trading days to 24 June – the S&P 500 has continued to trend sideways close to all-time highs, while the Nasdaq has made fresh all-time highs. The S&P 500 has returned 0.5% over this period while the Nasdaq 100 is ahead by 2.7%. The big news event was the US Federal Reserve meeting which, while the headline rate and asset purchase programme remained unchanged, was taken to be hawkish in terms of forward guidance. The taper of the asset purchase programme was discussed and Fed officials, on average, are now looking at two rate rises in 2023, which is ahead of where the market was positioned before the meeting.
- Equity markets sold off in the days following the meeting, culminating in a steep fall on Friday 18 June before recovering the lost ground this week with the market looking through the rate headlines to the underlying economic backdrop which remains a picture of very strong growth. In fact, the Fed raised its own GDP forecast for 2021 to 7%. The reflation trade also faded away, which helped boost the growth end of the market. Over the past two weeks, the growth factor has outperformed the value factor by 4.4%.
- Thursday 24 June saw substantial progress towards agreement on an infrastructure bill. A group of bipartisan senators reached agreement on a $973 billion package over five years and $1.2 trillion if continued over eight years. This is somewhat less than President Biden had originally proposed, but it still contains an important package of improvements to roads, bridges and airports, as well as a boost to the realm of "digital infrastructure" such as funding for broadband and electric vehicles. It will now need to make its way through Congress, which is not a foregone conclusion.
- General Motors announced last week that it will boost its spending on electric and autonomous vehicles to $35 billion through to 2025, a jump of 30% over its most recent forecast. As part of this investment it will build two new battery plants in the US. This follows on from Ford recently saying it would be upping its expenditure on EVs to more than $30 billion by 2030. This theme should also see a tailwind from President Biden's infrastructure package, as it contains provision for rebates and direct investment in EVs and charging for the sector. However, it's not all plain sailing for the sector, as the recent funding issues at Lordstown Motors have shown.
- On the M&A front, Elanco Animal Health paid $440 billion to acquire Kindred Biosciences, which is a leader in pet and animal health and has drugs involved in the treatment of certain viruses and diseases in dogs. For Elanco, which is a much larger $16 billion market cap company, paying a 52% premium for Kindred will give them access to a good pipeline of canine drugs with more in development. Elanco's share price also reacted positively.

Fixed income

News

- In the UK, the Bank of England met yesterday (Thursday 24 June) and rates remained unchanged at 0.1%, with sentiment remaining quite dovish. It noted a temporary rise in inflation, but expectations remain anchored and it was an 8:1 vote to maintain government bond buying. This helped gilts but weighed on GBP.
- UK retail sales for May, meanwhile, were weaker than expected, down 1.4% month-on-month, but up 28.3% year-on-year.
- Covid-19 cases continue to rise in the UK, and are now at their highest level since February.
- In the US, the Composite PMI (Purchasing Manager's Index – an indicator of business activity) fell from May's record high to 63.9 in June. Durable goods rose in May by 2.3%, which was less than expected. Meanwhile, US initial jobless claims fell in the week ending 18 June, down 7,000 to 411,000.
- At the Federal Reserve, speakers including chair Jerome Powell are trying to calm markets. They said the inflation rise was due to one-off elements (used cars/trucks etc) but it was a higher than expected rise. They also said interest rate rises were a long way off.
- Also in the US, new home sales fell to a lower level than expected in May, the second month in a row they have showed a decline. Existing home sales also fell again, to 5.8 million.
- In the euro area, the flash composite PMI reached its highest level in 15 years. Consumer sentiment in Europe, meanwhile, is at its highest since January 2018. In Germany the IFO Business Climate Survey, an indicator of German economic activity, rose to its highest level since 2018.

Markets

- It was a flat week for government bonds, with the US 10-year starting and ending the week (Monday 21-Thursday 24 June) at 1.49%. In Germany the 10-year started the week (21 June) at -0.17% and ended it (24 June) at -0.18%. The UK 10-year was at 0.74%.
- In credit markets, based on BofA Merrill Lynch Bond Indices, Global IG started the week (21 June) at 90bps and remained at that level all week, while high yield tightened from slightly from 348bps on 21 June to 346bps on 24 June.
- Oil prices started the week (21 June) at $73.7, up slightly from Friday 18 June's $71.9. It barely moved across the rest of the week, finishing Thursday 24 June at $73.3.
- In FX the US dollar gave up some ground over the week with the euro, starting (21 June) at 1.190 and finishing (24 June) at 1.195.

Multi-asset

- While our broad asset class tilts remain unchanged, our preferences within corporate credit markets have evolved, leaving us more optimistic on the outlook for European high yield relative to investment grade, albeit within broad credit positivity. Lighter duration, attractive carry, fair valuations (particularly given lower defaults) and a very constructive bottom up view continue to favour HY credit, particularly in context of the ongoing global cyclical recovery.

- The debate continues around the evolving macro picture, where inflation expectations are rising, with firm growth and continued corporate deleveraging. Insofar as this fine balance is maintained, spread risk should be reasonably supported. The environment could get more challenging as the US Federal Reserve tightens, but we are with the consensus in expecting inflation pressures to prove transitory – and our rates forecasts are commensurately dovish.
- Our preference for cyclical exposure has also left us more positive on commodities, although we remain at neutral on the asset allocation grid. Commodity markets have rebounded powerfully and are supported by factors such as pent-up demand, restricted supply from pandemic-induced production disruption and relatively contained investor positioning.
- No other changes were made to asset allocation, where we favour equities (alongside credit) over core fixed income, with neutrality on cash, property and commodities.

Note: all data as at 24 June 2021, unless otherwise specified. Source: Bloomberg.