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Market updates

Investment team updates | 6 August 2021

US equities

- Over the past two weeks, US large cap equities have hovered close to all-time highs without decisively breaking through to new levels. While earnings have generally been strong, fears over the spread of the delta variant and its potential impact on economic growth have tempered expectations and the upward progress of risk assets. Over the past two weeks, the S&P 500 is up by 0.4%, having nudged into positive territory for the period yesterday. Small caps by contrast are still short of recent highs having traded largely sideways since February, following their stellar run from November-February after the vaccine announcements. However, they slightly outperformed large caps in the last two weeks; the Russell 2000 returning 1.2%. Generally, valuations of large-cap tech stocks have been supported by the falling 10-year yield (now around 1.25%, down from a high of 1.7% in April) though recently the Nasdaq 100 has traded in line with the S&P 500, returning 0.5% in the last fortnight.
- With well over half of S&P 500 companies having reported Q2 earnings, the overall picture has again been very positive. So far, 88% of companies have beaten revenue estimates and the same percentage have beaten earnings expectations. The estimated earnings growth rate for the quarter, based on those companies which have already reported and estimates for the rest, stands at 85.1%. If maintained through to the end of the reporting window, this would be the highest year-on-year quarterly growth rate since Q4 2009. Going into the quarter, the market was expecting a growth rate of 63.1% which has had to be substantially revised upwards given the magnitude and quantity of the earnings surprises.
- All 11 sectors are showing positive year-over-year earnings growth, with the highest rates coming from the energy, industrials and consumer discretionary sectors. Given that these sectors were among the most impacted during the height of the pandemic, they are facing a very low comparison with 12 months ago. In fact, the easier comparisons with Q2 2020 is one of the main reasons for such a strong earnings season, together with the strong rebound in economic activity as the US economy has reopened.
- Company commentary has also been very positive, expressing a strong demand environment and higher operating margins. However, there continue to be notable headwinds from supply chain constraints and input price inflation; which will likely persist into the back half of the year. This has led to heightened caution among management teams on forward guidance.

- Last week many of the big tech names reported results. Amazon announced Q2 sales of $113 billion which was a touch below expectations, but earnings came in ahead of estimates at $7.8 billion. It expects revenues to grow 10-16% year-over-year in Q3[1], which is well below expectations of 24% growth and online sales only grew by 16% which is weak by Amazon's high standards. Given the revenue miss and underwhelming forecast, shares sold off more than 7% in after-hours trading and have remained low, down by nearly 9% over the last two weeks. Amazon's results highlight the difficulty that it will have to maintain the record numbers it posted during the pandemic amid global lockdowns.
- Other tech names got a generally weak reception to results as well; only Alphabet is up over the last two weeks. Facebook, Apple and Microsoft all declined, though not to the same extent as Amazon. Apple recorded $21 billion in profits – it's best-ever spring quarter – while Microsoft's Azure cloud business, a big driver of growth, posted 51% revenue growth on the same quarter last year. The fact that the market was generally unmoved by these results shows the high expectations built into share prices, especially given their gains last year. Having said that many of the structural trends which were amplified by Covid and of which tech companies were the beneficiaries should remain in place.
- In industrials, GM's results were given a poor reception after the stock missed earnings expectations. The production environment remains challenging with material costs forming a substantial headwind. On the positive side, GM raised 2021 guidance.
- In other areas of news, the $1 trillion bipartisan infrastructure bill continues to make its way through Congress and is looking closer to becoming reality, however the larger $3.5 trillion bill focusing on "social infrastructure" which the Democrats hope to pass through reconciliation measures faces a more rocky path.
- President Biden also made further moves with his green agenda, signing an executive order yesterday which sets a target for electric vehicles, hydrogen-fuel cell and plug-in hybrid vehicles to comprise 50% of US sales by 2030[2]. Energy major Exxon Mobil also came out to say that it is considering a net zero target by 2050. All of these moves further emphasise the decarbonisation trends shaping the US and global economy.
- In M&A, aerospace and defence company Parker Hannifin announced that it was taking out London-listed Meggitt for £7.1 billion. This increases Parker's exposure in aerospace and away from its lower-quality machinery business.

Fixed income

News

- There were 385,000 initial claims for unemployment benefits in the US during the week ending July 31. We expect guidance from the Fed to be forthcoming at the Jackson Hole symposium at the end of August.
- Meanwhile in the UK, the Bank of England is worried about inflation and might need to tighten to policy to reflect this
- In manufacturing: Germany posted strong factory orders of +4.4% month on month but Eurozone manufacturing PMI fell to 62.8 in July (63.4 in June); meanwhile in the US, ISM Manufacturing PMI is still robust but at its lowest level since January 2021; and in China the Caixin Services PMI (54.9) strongly beat estimates and reached its highest level since December 2020.

[1] https://www.cnbc.com/2021/07/29/amazon-amzn-earnings-q2-2021.html
[2] https://www.caranddriver.com/news/a37232112/biden-target-50-percent-evs-2030/

Markets

- Core government bonds ended July lower in yield. The US 10-year started the week on 2 August at 1.23%, dropping to 1.18% on Tuesday 4 August, again on Wednesday 5 August (to 1.17%), before edging higher on Thursday 5 August (1.18%) and once again on Friday 6 August (1.21%). On Friday 6 August Germany reached -0.49% and the UK 0.52%.
- In credit markets, based on BofA Merrill Lynch Bond Indices, Global IG started the week (2 August) at 93 basis points and ended it (6 August) at 94bps. High Yield tightened over the week from 382bps (2 August) to 380bps (6 August).
- Oil started the week (2 August) at $73.1 a barrel, closing at $69.5 (6 August).
- In FX, USD began the week (2 August) weaker with Euro at 1.187. Ending week (6 August) at 1.183.

European equities

- Volumes are low owing to it being the holiday season and there is a large focus across the region on the Olympics.
- The market rose slightly, extending year-to-date gains on the back of rising hopes of economic recovery.
- The vaccine rollouts continue, but there are still some regional restrictions in place.
- The UK is at the forefront of relaxations.
- Company results have generally been encouraging.

Note: all data as at 6 August 2021, unless otherwise specified. Source: Bloomberg.