INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 8 October 2021

US equities

- US equities sold off over the past two weeks, with the S&P 500 down by 1.2% as of 7 October. The worst of the decline was confined to last week (ending 1 October) when the S&P 500 fell by 2.2% before recovering some ground this week. A lot of the large cap tech names bore the brunt of the selling. This saw the Nasdaq 100 down by 2.8% while value outperformed growth. There have been a number of factors contributing to this recent sell-off. The sharp rise in the 10-year treasury yield to touch 1.6% has been a headwind for tech stocks, while the lack of progress in Washington towards averting a debt default and on stimulus packages also proved a negative for risk assets, though in the past few days the Senate has voted to raise the borrowing limit into December and temporarily avert a messy default. There also remain ongoing concerns about inflation and supply chain issues, which are putting pressure on company margins, so we may start to see this coming through in the upcoming Q3 results. A number of company pre-announcements have already cited these factors as negative for the outlook.
- While higher rates are a catalyst for ongoing market rotation, they are not restrictively high for growth to persist and the 10-year yield is only just reaching pre-pandemic levels. The first rate hike is still some way out, so borrowing rates will remain constructive, especially as the expectation of policymakers at the US Federal Reserve is for the neutral Fed funds rate, and the ultimate peak of the next hiking cycle, to be lower than previously.
- The S&P 500 rounded off September with a 4.8% fall, which was the largest monthly decline since the height of the pandemic in March 2020. Despite this dip the market is still markedly higher over the past 18 months and in each instance of recent pull-backs, market participants have been quick to “buy the dip”, especially given the amount of cash which still sits on the side lines. The market action this week has shown there is still plenty of demand for equities at these levels.
- On a sector basis, energy has been the standout performer in recent weeks as crude prices have soared, with WTI crude now trading close to $80 a barrel. Financials have also performed well alongside the uptick in rates. As mentioned previously, technology has been a laggard, as well as healthcare.
- The upcoming September jobs report will be closely watched to see if there is evidence of sustained recovery in the labour market, which would allow the Fed to continue toward tapering its asset purchase programme. While it is still likely to kick off the process at its November or December meeting, a very weak jobs report may push back those plans.
- Looking ahead to Q3 earnings, there is likely to be much greater dispersion in results, and we are unlikely to see beats and raises across the board, as has been the case for the last year or so, as analysts have had to dramatically scale up expectations. Demand remains robust, but given the inflation and supply chain issues, earnings could come in a little lower than expected and companies will be marked out by pricing power and their ability to pass on price increases to customers.

Fixed income

News

- Progress was made in the US this week on the debt ceiling, with the Republicans offering an olive branch. This helped raise sentiment. It was also announced that President Biden will meet with China's Xi Jinping before the end of the year
- Also in the US the ADP Payroll data was strong, with private jobs rising by 568,000, better than the 425,000 estimate and ahead of August's downwardly revised 340,000. The US jobs report is due today and is expected to show a stronger 400,000 jobs were created in September, up from August's weaker number, and with an unemployment rate of 5.1%
- US business activity in September, as measured by the composite PMI, was the lowest in a year at 55 – so still above 50 which indicates expansion.
- Last week (ending 1 October) the US Core PCE inflation for August was published, rising to 3.6% from a year previously – the biggest jump in 30 years. Inflation expectations continue to rise in the US, on higher gas prices, with the 10-year figure at 2.46%, which is the highest in four months. It was as low as 0.55% in March 2020.
- In the UK and Europe, gas prices continued to surge earlier in the week, which saw Russia's President Putin offer on 6 October to supply more gas to Europe to help stabilise markets.
- Also in the UK, wage growth is rising at its fastest pace in more than 20 years, according to REC/KPMG. UK car sales, meanwhile, have collapsed due to chip shortages, although electric vehicle sales very strong.
- In Germany, factory goods orders in August were very weak, with supply issues to blame, and industrial production was also much weaker in August, down 4% against an expectation of -0.5%.
- The Reserve Bank of New Zealand raised interest rates by 0.25% to 0.5% this month, the first increase in seven years.
- In China, Fantasia Holdings, a developer of high-end apartments and urban renewal projects, had its rating cut to CCC by S&P and failed to pay a US bond that was due on Monday.

Markets

- In government bonds the US 10-year started the week (4 October) at 1.49% before moving higher across the week to finish it (8 October) at 1.59%. German bunds started the same period at -0.22% and finished at -0.18%, while UK government bonds started at 1.01% and finished the week at 1.08%.
- In credit markets, based on BofA Merrill Lynch Bond Indices, Global IG ignored this weakness, starting the week at 91bps and ending it 92bps. High yield, meanwhile, moved a little more, starting the week at 380bps and ending it at 389bps.
- Tuesday 5 October was a poor day for asset markets, with a risk off, but surprisingly this did not help core bond prices. The fear is that higher energy/commodity prices and supply chain shocks will lead to higher inflation, which in turn will lead to tighter monetary policy – which has of course been so supportive for all markets. The other way of looking at this, however, is that higher prices leads to a destruction of demand, which should support ongoing loose/supportive monetary policy.
- Oil moved higher over the week from $77.7 (4 October) to $79.4 (7 October), but European natural gas prices are now more than 35% weaker since Wednesday's peak with Russia president Vladimir Putin indicating Russia would increase its natural gas exports to Europe over the course of the autumn.

European equities

- Europe has been beset by concerns over oil and gas prices, made worse in the UK by a shortage of deliveries to fuel stations. Interest in oil stocks has subsequently spiked.
- Inflation remains a concern, and companies with pricing power may (in relative terms) benefit companies who can pass on costs.
- The AUKUS defence deal, fishing licences and the Northern Ireland protocol have heightened tensions between the UK and the EU, and with France in particular. This poses some geopolitical risks, thought so far there has been little discernible short-term impact for us.
- In Germany, the end of the Angela Merkel era will probably bring a centrist coalition to power, most likely with a left-wing slant. Pro-European policies and an economically supportive approach is likely to continue. The French election looms for next year.

Multi-asset

- Our economic forecasts continue to point to peak growth and inflation this year, although over the past month expectations for near-term growth and inflation have been drifting lower and higher respectively. While our longer-term inflation outlook still suggests the current pick-up is transitory due to structural trends such as technology and demographics etc, the sharp price increases in areas where bottlenecks and supply chain disruptions are prevalent warrant careful monitoring.
- In accordance with our transitory inflation view, we don't expect any Fed rate hikes this year or next. A continuation of historically relatively easy policy and our optimistic earnings growth forecasts should continue to deliver decent, positive returns from risk assets like equities and credit over the next 12-18 months.
- More persistent inflation remains a key risk to our dovish rates forecasts, with strength in experienced inflation concentrated in areas where demand is rising quickly as economies re-open. We continue to expect these to fade as more time passes from the initial re-opening of economies and supply chain adjust.
- While the pace of the global economic recovery is showing some signs of easing off, we believe there is still value to be found in select cyclically sensitive areas where vaccination programs were rolled out later and recovery profiles are, therefore, less advanced.

Note: all data as at 7 October 2021, unless otherwise specified. Source: Bloomberg.

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