Stanhope Capital Fortnightly Bulletin

Period ending 30th September 2021

Tactical Positioning

As we discuss below, market volatility has increased over the last two weeks with central bank policy taking centre stage. Inflation data has become a market obsession with every utterance from bankers being picked over for evidence of monetary policy tightening and investors are concerned that a move to start tapering bond purchases may lead to a 'taper tantrum'. *The concept of 'taper tantrums' derives from the 2013 reaction to the news that the US Federal Reserve ("Fed") was reducing its bond buying programme and fears that interest rate increases would follow. As a result, US Treasury yields rose and equities fell sharply (only to recover and deliver a strong performance overall in the year)*. Whilst equity markets rarely rise in a straight line, current volatility should not be seen as a warning that central bank stimulus is about to come to an abrupt and sorrowful end. As we saw back in 2013, monetary tightening will be contingent upon continued positive economic data.

Market Moves

	Equities *(incl. Dividends)*						
30-Sep-21	**World ($)**	**US ($)**	**Europe[1] (€)**	**UK (£)**	**Japan (¥)**	**EM ($)**	**Asia ($)**
Last 2 Weeks	-3.7%	-3.8%	-1.9%	1.1%	-2.9%	-2.6%	-2.6%
September	-4.1%	-4.7%	-3.3%	-0.2%	5.5%	-4.0%	-4.0%
Year to Date	11.1%	15.9%	16.1%	13.1%	8.9%	-1.2%	-2.1%

	Commodities			Currencies (vs. USD)			Gov't
	COM[2] ($)	**Gold ($)**	**WTI Oil ($)**	**EUR**	**GBP**	**JPY**	**UST 10Y[3]**
Last 2 Weeks	1.2%	-2.1%	3.3%	-2.0%	-2.6%	-1.7%	19bps
September	5.0%	-3.1%	9.5%	-1.9%	-2.0%	-1.1%	18bps
Year to Date	29.1%	-7.4%	54.6%	-5.2%	-1.4%	-7.1%	57bps

Note: [1]Europe excluding UK; [2]Bloomberg Commodity Index; [3]US Treasury 10 Year Yield shows absolute, not percentage, change in yield; Source: Bloomberg

Although the current fall in global daily reported Covid related deaths is supportive of growth, the virus has fallen down the list of investor concerns in recent months. Talk of tapering quantitative easing programs is now the major driver of investor sentiment as inflation expectations increase; since September 2020, US, UK, and German 10-year inflation expectations have risen by 0.35%, 0.76%, and 0.99% respectively, to 2.38%, 3.82%, and 1.65%. The recent upward move in government bond yields was caused by concerns that central banks will start to tighten policy and Norway just became the first G10 country to actually make a move, raising rates from nothing to 0.25%. Following last week's Fed meeting, Jerome Powell, said that they could begin tapering bond purchases as soon as the next Federal Open Market Committee meeting, in November. The Bank of England statement was also more hawkish with some members voting for an earlier end to quantitative easing.

Equity markets are generally up over the last three months and year, but the fall in markets in the last couple of weeks of September, partly prompted by inflation concerns and higher bond yields, ended a seven-month positive streak to new 'all time highs' for many indices.

In recent months, news from China has damaged investor sentiment and the Chinese market is one of the year's worst performers with the MSCI China index down 16.7% this year. We have previously mentioned the crackdown on the education and gaming sectors, all part of President Xi's plan to control some of the perceived excesses seen in the private sector. He has previously spoken-out against speculation and high debt levels in the property sector and last week's missed debt payment by the country's largest property company, Evergrande, highlights the potential consequences. To put some perspective on the matter, the entire population of any one of five G7 countries (including the UK or Germany) could inhabit all China's vacant property and there would still be excess supply (J. Kynge, FT, Sep-21). Despite the scale of Evergande's over $300bn of debt, the impact of the default has so far been limited, given the combination of the collateral available to creditors and the likelihood that any default will be carefully managed. Analysts at J.P. Morgan mentioned that Evergrande "does not pose a systemic risk for the Chinese or the global economy". That said, it is still likely to have some impact on Chinese economic growth.

In the last two weeks, the dollar has benefitted from risk-off sentiment, with most European currencies falling against the rising dollar. Commodity markets have also been resilient with the Bloomberg Commodity Index rising 6.2% in the third quarter of the year, although, precious metals have struggled a little as the prospect of higher bond yields dulls demand for assets with no yield.

We regularly hear examples of supply chain disruption. In the UK, estimates suggest that over 60% of the 5,500 Petrol Retailers Association's independent retail outlets were out of fuel on Monday 27th, owing to a lack of delivery drivers. (The petrol shortage has enabled environmentally smug electric vehicle drivers to become even smugger!)

Linked to supply chain issues, talk of stagflation (high inflation with low growth and rising unemployment) is filtering through into news headlines. Inflation is proving less transitory than some first thought, with oil at around $80/barrel, food prices still on the rise and economic data displaying slowing growth. However, the gradual return to work currently underway in many economies should help resolve supply chain issues and should reduce the risk of stagflation.

Betting odds indicate that the recent German election is likely to lead to a left-of-centre coalition led by Olaf Scholz, but the major parties are engaged in negotiations that may take months to reach agreement and the makeup of the next government remains uncertain. Although Germany and Europe have lost a leader in the form of Angela Merkel, it is likely that we will not see a significant change in direction overall and consequently the result of the ballot has had little impact on markets so far.

Economic Updates

In the US, employment data has been slightly worse than expected recently, with initial jobless claims at around 350k per-week versus 330k expected. US housing, however, is showing real resilience with new and pending home sales exceeding expectations and housing starts are also ahead of expectations. Q2 GDP rose 0.1% more than expected at 6.7%.

German unemployment came in at 5.5%, which was slightly disappointing, though there were not any other major concerns from Eurozone data. UK Q2 GDP came out higher than forecasts at 5.5% although growth seems to have slowed and retail sales data unexpectedly fell in August. The Bank of England forecast that with the furlough scheme now ended, the unemployment rate will be 'near 5%' compared to 4.6% in August, but with nearly 1,000,000 citizens still using the scheme, this could materially increase the next unemployment reading.

Global Purchasing Manager Index's (PMIs) are mostly comfortably above 50 (expansionary), though these have all started to ease off as growth begins to slow with US, German, UK, and Eurozone PMIs undershooting market forecasts from services and manufacturing sectors.

JONATHAN BELL
IVO COULSON
GEORGE MARTIN

30th September 2021

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