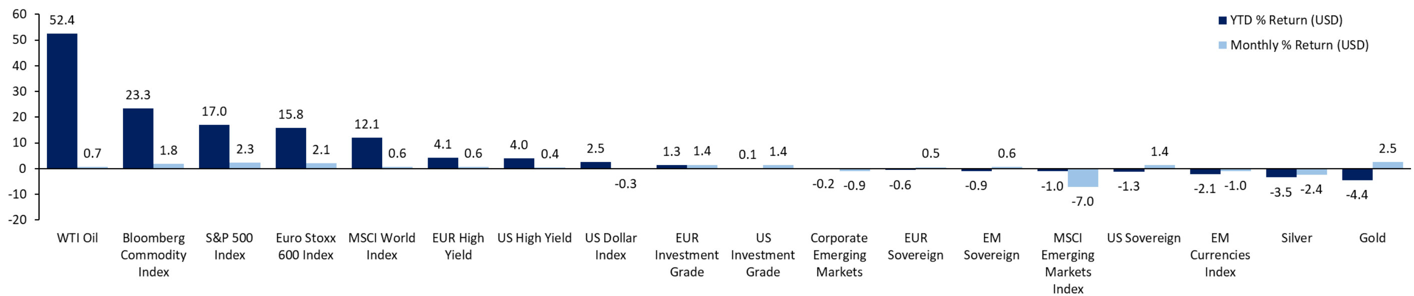
August 2, 2021

Monthly Market Wrap, July 2021

The global economic recovery pursued its course last month with the vaccine rollout making steady progress and social restrictions were eased further in several major developed markets. While we are seeing a two speed vaccination (developed vs. rest of world), more than 28.3% of the global population had already received at least its first dose at the end of July, up from 23.7% in June. Nonetheless, the spread of a more contagious Delta variant dented sentiment, raising concerns for a bumpier the path to normality.

Chart 1. Asset Class Return YTD (USD Base)



Equities

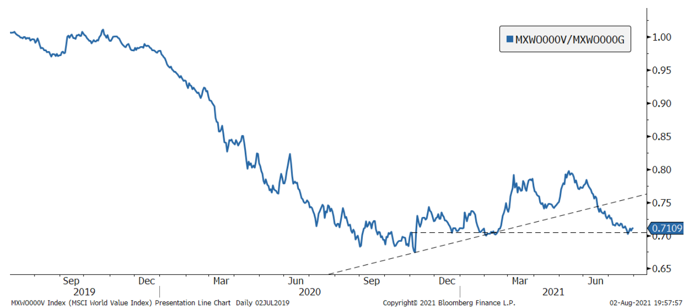
Global equities were up 1.8% this month, up 15.1% YTD. Despite the spread of the new variant coming in the picture, another change in tone at the Fed (more dovish this time), and no clear sight to the end of the monetary policy easing cycle at the ECB, yield curves flattened further. Value equities underperformed growth equities **(Chart 2)** as a result.

US equity and bond markets painted contrasting pictures as the S&P 500 hit new all-time highs while US Treasury yields slumped to lows last seen in February. "Easy to say", the quality-growth (FAANG) now counting for more than c.25% of the S&P 500 had something to do with it. We can argue that equity markets took their cues from the bond market with growth stocks benefiting from the decline in yields. Nasdaq 100 led the gains up 2.8%, followed by the S&P 500 **(Chart 3)**, up 2.4%. In the meantime, the Russell 2000 closed down 3.6%.

In Europe, the Stoxx 600 extended on its longest monthly gains streak since 2013, ending the month up by 2.1% and bringing its year-to-date performance to 18.2% **(Chart 4)**, beating both the global and US indices by 3.1% and 0.2% respectively.

On a sector basis, the mid-cycle transition playbook worked well with falling earnings revision breadth this fall likely to complete the process. The barbell of defensives, quality, and tech worked quite nicely last month with the spread Delta variant weighting in. Healthcare was the best performing sector, up 4.7%, while tech performed well, up 3.8%. With the possibility of new travel restrictions, energy stocks suffered with the sector down 8.4% in the US and 4.6% in Europe. However, we note that materials continued to perform on the back of supply-demand imbalances still supporting prices for a broad set of commodities.

Chart 2. Global Value vs. Growth Equities



Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)

Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)

Source. Bloomberg, MAM Research

Fixed Income

The moves in the bonds market were the most eye catching last month with US 10-Year Treasury Yields continuing their decline, falling below 1.2% **(Chart 5)**. While such a stark decline in yields would normally imply a significant downgrade to the growth outlook, there appears to be several factors at play. (1) The rapid spread of the Delta variant amplified talks about the economy moving past peak rate of growth, and (2) demand has been usually high with Fed purchases, institutional investors looking to rebalance following strong equity gains, and elevated cash balances across the private sector. However, the move in bond markets is not sending a negative signal about the health of the US economy. In fact, current level of yields look to us inconsistent with the strength of the economy. Yields are likely to move higher driven by President Biden's infrastructure plan (more fiscal support) and the Fed's plan to normalize monetary policy. Inflation continued to surprise to the upside, pushing inflation expectations to continue to move higher **(Chart 6)** as the transitory vs. persistent inflation debate carried on.

Elsewhere, in Europe, yields followed a similar path lower with the German 10-Year Bunds falling further into negative territory to -0.50%, down 8.2bps from last month. On the other side of the English Channel, UK 10-Year Yields dropped to 0.52%.

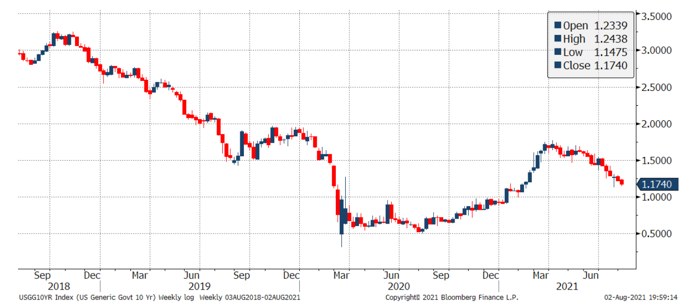
Currencies

The US dollar is fighting a tug of war between two diverging forces: an economic slowdown around the world but plunging real interest rates. The litmus test for determining which force will gain the upper hand is if the Dollar Index **(Chart 7)** fails to break above the 93-94 level that marked the March highs. So far, that appears to be the case.

The main event in the eurozone last month was the outcome of the European Central Bank (ECB) strategic review. The inflation aim was adjusted to a more symmetric 2% target (versus the previous target of "below, but close to 2%") while housing costs will also be incorporated into the calculation of inflation over time. The goals might have changed, but so far, the tools to achieve the new target remain the same. With little scope to cut interest rates deeper into negative territory and multiple asset purchase programmes already in place, it appears fiscal policy will rather than monetary policy will need to be doing the bulk of the work if the eurozone is to break out of the low-growth, low-inflation environment it has been stuck in in recent years. The union's currency was relative unchanged against the dollar last month with the Euro closing at 1.19 **(Chart 8)**.

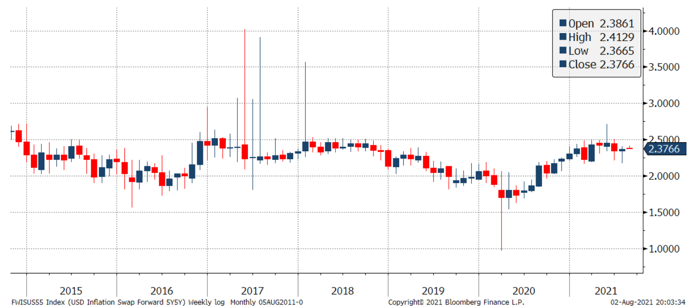
As the UK saw most virus-restrictions lifted, the British Pound was up slightly to 1.39 **(Chart 9)**. Supply bottlenecks are putting a lid on economic activity and likely financial assets for now.

Chart 5. US 10-Yr Treasury Bonds (Weekly)



Source. Bloomberg, MAM Research

Chart 6. US 5Yr5Yr Forward Breakeven Rate (Monthly)



Source. Bloomberg, MAM Research

Chart 7. US Dollar Index (Weekly)

Source. Bloomberg, MAM Research

Chart 8. USD/Euro Spot Exchange Rate (Weekly)

Source. Bloomberg, MAM Research

Chart 9. USD/GBP Spot Exchange Rate (Weekly)

Source. Bloomberg, MAM Research

Commodities

With the dollar relatively unchanged, commodities were slightly up last month with the broad commodity index expanding its gains to 22.8% YTD, up 1.8% in July.

At a sector level, the sole negative contributor to the asset class was agriculture commodities, down 0.85%, The move has been driven by weaker corn and soybean meal prices, respectively down 24.0% and 6.1% in July. The easing of weather worries in the US has taken corn price back down, abetted by what was a very crowded long positioning. In South America, high-than-expected yields added pressures on prices, even as the crops suffered from bad weather earlier this year.

Precious metals were up 1.2% with higher gold prices **(Chart 10)** compensating for a decline in silver **(Chart 11)**. The metals were respectively up 2.5% and down 2.4%.

Energy and industrial metal commodities remain strong, up 3.8% and 4.0% respectively. As GDP recovery remains on track, inventory data continues to be encouraging, and sizeable deficit remains for H2 2021 stable oil prices should continue to prevail despite the OPEC+ overhang. Copper **(Chart 12)** was up 4.3% supported by a trio of copper mines in Chile facing strike actions (c.7% global mine supply) countering any demand lull.

Emerging Markets

Emerging market equities continued to lag developed markets last month with weakness in Chinese stock markets particularly notable. In the later stages of the month, reforms to the private tutoring sector triggered volatility with the changes coming hot on the back of higher scrutiny being applied to the technology sector as well as actions taken to stabilize the housing market. The changes appear to reflect the renewed focus from policy makers on their long-term structural goals, with particular efforts to curb inequality and ensure healthy competitions across all sectors. While the broader and longer-term outlook for Chinese and Asian equities may remain positive, sentiment appears quite fragile in the near-term or at least until the length and breadth of regulatory clampdown becomes clearer.

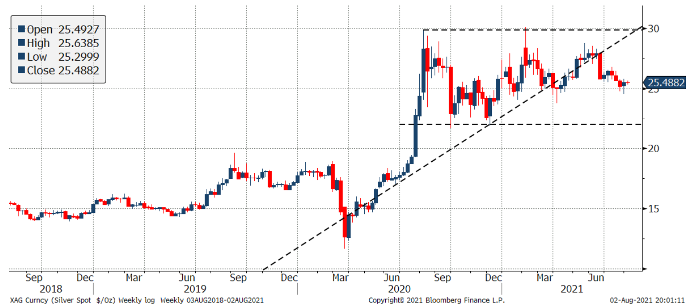
The MSCI Emerging Market was down 6.7% in July, +0.2% YTD **(Chart 13)**. *Note: Chinese equities account for c.32.5% of the region's index*. The MSCI China Index was down 13.8% last month. Another key contributor to the region's poor performance outside of Asia was Brazil, down 6.1%.

On the FX front, EM currencies were down by 1.0% **(Chart 14)**, down 1.7% YTD. The lion share of the decline was driven by the Brazilian real, down 4.9% against the dollar, as the country faces inflation well above the target celling for 2021 and lingering commodity prices pressures.

Chart 10. Gold Spot Prices (Weekly)

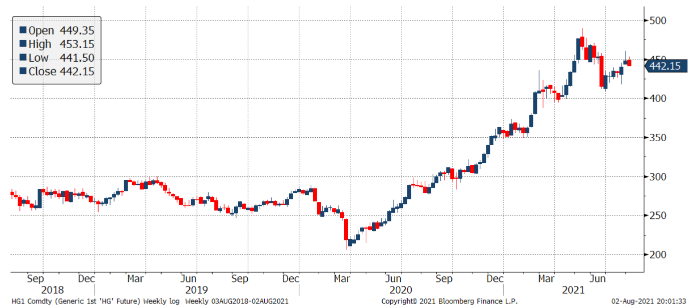
Source. Bloomberg, MAM Research

Chart 11. Silver Spot Prices (Weekly)



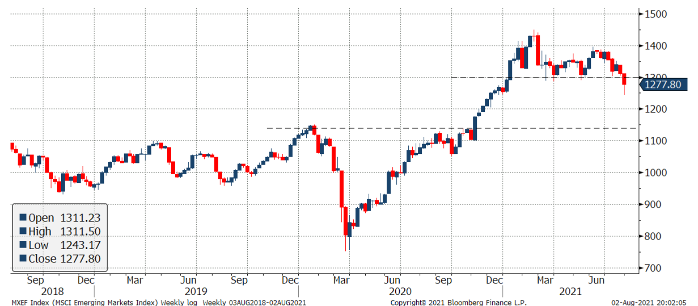
Source. Bloomberg, MAM Research

Chart 12. Copper Continuous Futures (Weekly)



Source. Bloomberg, MAM Research

Chart 13. MSCI EM Index (Weekly)



Source. Bloomberg, MAM Research

Chart 14. MSCI EM FX Index (Weekly)

Source. Bloomberg, MAM Research