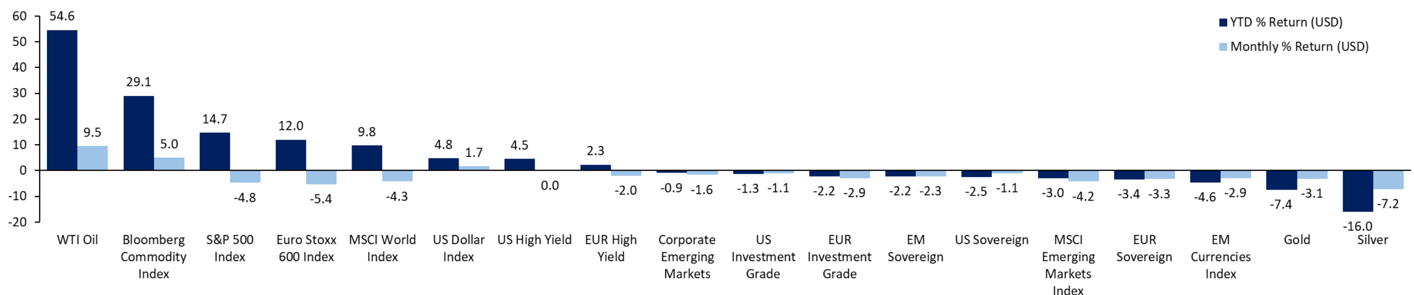
October 4, 2021

Monthly Market Wrap, September 2021

The "September Effect" was in full force this year with nearly all major financial assets generating above-average losses last month. Market moves were dominated by a breakdown in the stock-bond relationship. Slight hawkish surprises from several major central banks triggered a sharp selloff in sovereign bonds. Meanwhile, near-term uncertainty about the evolution of risks stemming from China's slowing economy, Evergrande debacle, US domestic policy, and stagflation fears led to an equity pullback. The durability of the shift in stocks-bonds correlation in fine depends on whether inflationary pressures are a transitory or a persistent phenomenon.

Chart 1. Asset Class Return YTD (USD Base)



Equities

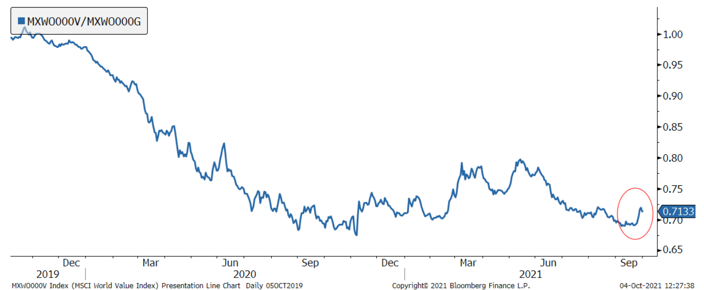
Global equities were down 4.2% last month. Value, down 3.5%, outperformed growth, down 5.6%, by 2.1% **(Chart 2)**. The vast majority of value's outperformance occurred in the last week, following the September FOMC meeting which coincided with long rates spiking higher.

On a total return basis, the S&P 500 **(Chart 3)** ended a streak of seven consecutive months in the green with a 4.7% decline. The relative outperformer was small-caps with the Russell 2000 down 2.9% in comparison. The technology heavy Nasdaq 100 underperformed with a 5.7% decline in September.

Ten out of eleven sectors finished lower in September, including seven sectors with declines of more than 5.0%. Energy was the lone sector in the green registering a total return of 9.4%, and now up 46.4% YTD. A month ago, all 21 S&P 500 Energy Index members were trading below their respective 50 DMA, but last week, that figure rebounded to 100% trading above. Financials declined a relatively modest 1.8%. However, green shoots were visible amongst regional banks. Another sub-industry standout was Airlines, gaining 2.8%, when the broader DJ transportation index declined 4.4%.

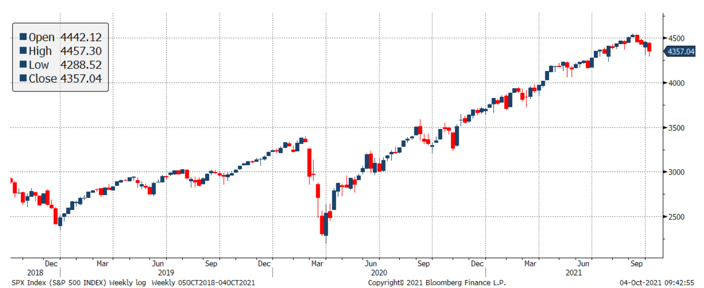
European equities **(Chart 4)**, down 3.3%, outperformed both Global and North American equities last month. At the sector level, we depict a relatively similar picture to the rest of the world where energy was clearly the best performing sector with European Oil and Gas equities up 10.4%. Banks were another green sector in region, up 3.4%. Travel was up 2.7% as the UK planned to reopen the corridor with the US, prompting a hint of optimism for a restart in long-haul flights. Another standout was the positive performance of autos, up 0.4%.

Chart 2. MSCI World Value vs. Growth (Daily)



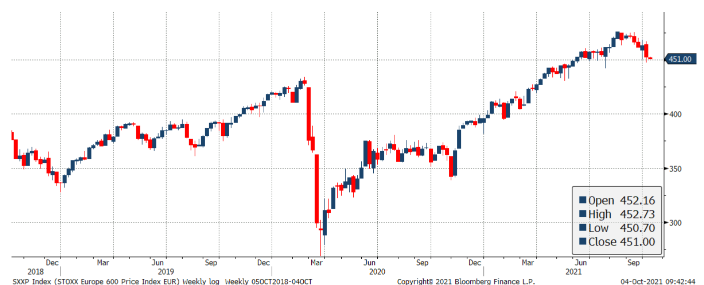
Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)



Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)



Source. Bloomberg, MAM Research

Fixed Income

The Fed announced at the September FOMC meeting that it will begin to slow the pace of its assets purchases, with purchases set to come to an end by around the middle of next year. The Fed also released its projections for interest rates to increase to 1.75% by the end of 2024. While the dot plot does not have the strongest track record when it comes to predicting future paths for rate hikes, it was enough to trigger a reaction in the market. As the pace of rate increases was faster than the market had been pricing in, it resulted in a rise in US Treasury yields in the following days. US 10-Year bond yields **(Chart 5)** erased some of the earlier quarterly gains. The sharp rally in oil prices fed fears that inflation will remain elevated. As a result, US 5-Year 5-Year forward breakeven rates failed to retrace substantially despite lower economic growth projections globally **(Chart 6)**.

The BoE delivered a similarly hawkish shift, suggesting it could put interest rates up at before the end of the year. In Europe, the ECB announced a reduction in the pace of its asset purchases. However, in contrast to the Fed, the ECB has been keen to say it was not the beginning of a process of tapering purchases down to zero.

As the Fed and BoE set out on a path towards higher interest rates, the ECB looks likely to stay accommodative for longer.

Currencies

The US Dollar Index **(Chart 7)** rose for four straight weeks last month to build up a monthly gain of 1.7%. Over half of the gains were concentrated in the last week, which registered a bullish breakout from a common "double bottom" price pattern built over the first three quarter of this year. The width of the pattern projects a minimum measured move to 97.35, up 3% from here. This projection is purely based on technical charting, but would align with our view of a dollar strength into the year-end.

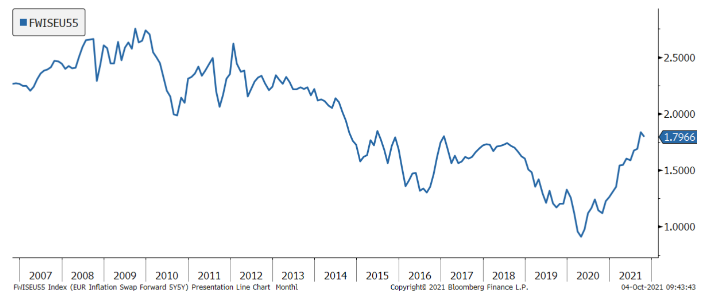
The relatively dovish tone at the ECB continues to weigh on the union's currency in the near-term. The Euro **(Chart 8)** was down 4.9% against the US Dollar. Pressures are likely to persist for the time being. A rate hike requires (1) inflation to be forecasted at or above target 15-18 month out, (2) this period of above target to continue to the end of the forecast horizon (3-years), and (3) evidence that underlying inflation will be at or above target over the medium-term (out to about 5 years) beyond the forecast horizon. In other words, rates hikes are unlikely anytime soon.

GBP (**Chart 9**) caught the market's attention with a 2% weakness earlier last week, breaking through key levels. A combination of risk-off sentiment, concerns over slowing economic growth, high inflation, and month-end USD demand likely contributed to the weakness. Stagflation concerns are emerging given the rise in energy price and the time it will take for shortages to ease.

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

Source. Bloomberg, MAM Research

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



Source. Bloomberg, MAM Research

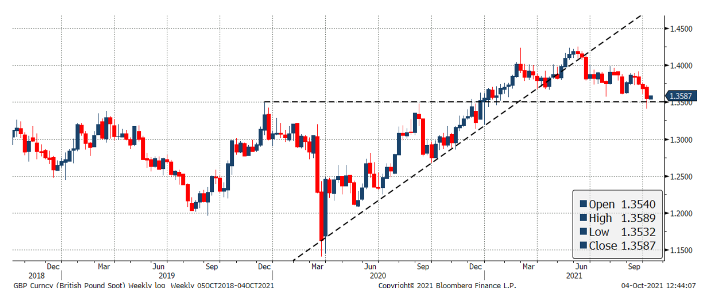
Chart 7. US Dollar Index (Weekly)

Source. Bloomberg, MAM Research

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

Source. Bloomberg, MAM Research

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



Source. Bloomberg, MAM Research

Commodities

Broad commodities gained 5.0% in September, up 30% YTD. It is the largest annual gain since 1979 (42 years).

Precious metals continued to underperform other commodities as a result of rising real yields and stronger USD. Gold **(Chart 10)** and Silver **(Chart 11)**, were respectively down 3.1% and 7.2%.

Natural gas prices have gone parabolic with a monthly gain of 34% and 135% YTD. WTI Crude Oil **(Chart 12)** gained 14.1%, up 55% YTD, its highest monthly close since 2014. A consortium of factors on both the supply and demand side are driving energy prices higher with seemingly little end in sight. The summer season saw record-high gasoline demand in the US when supplies were negatively impacted by hurricanes. China demand is strong and recovering from August fears surrounding the delta variant. A cooler winter is being priced in at a time when inventories failed to build up over the summer.

Inflation forces are spreading with the generic cotton contract rising 14.8% in September, its largest monthly gain in more than five years, and now up 38% YTD. Furthermore, the September price action made a "bullish breakout" above a near 10-year, clearly defined, resistance line. From a technical perspective, breakouts above major multi-year price levels bring with it an expectation for powerful, long-lasting momentum.

Emerging Markets

The negative news flow out of China seemed relentless in Q3: China moved to turn private tutoring companies into non-profit organizations, more regulations on the technology sector and *de facto* monopolies were announced, and one of the largest property developers in the region faces default risks prompting fears of slipover to the broader financial system. Emerging market equities **(Chart 13)** were down 4.0% last month, turning negative 1.8% for the year.

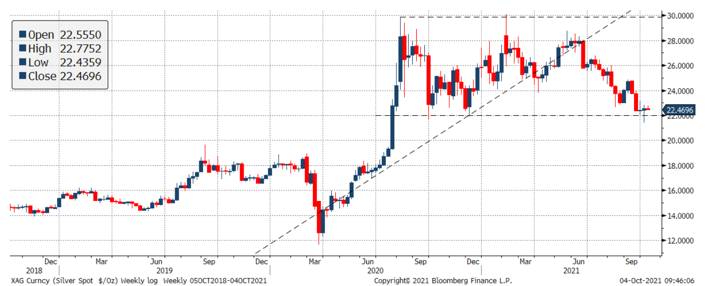
Brazilian equities, down 13.0% last month, were the strongest negative contributors to emerging market equities with the pain exacerbated by a substantially weaker currency. The BRL closed down 5.4% last month. The perception of fiscal risk and the rise in commodity prices has weakened the currency, the inverse of the correlation observed in commodity exporting countries.

Emerging market FX **(Chart 14)** rolled over in early-June and are depreciating sharply against the US dollar. Odds are the trend is likely to continue. Regulatory changes, lower credit growth, and slowing economic growth in China continue to create near-term headwinds for emerging market currencies, which are closely correlated with USD/CNY developments. With China's economy slowing down until policy easing measures are introduced, the dynamics for commodity exporting countries remains poor.

Chart 10. Gold Spot Prices (Weekly)

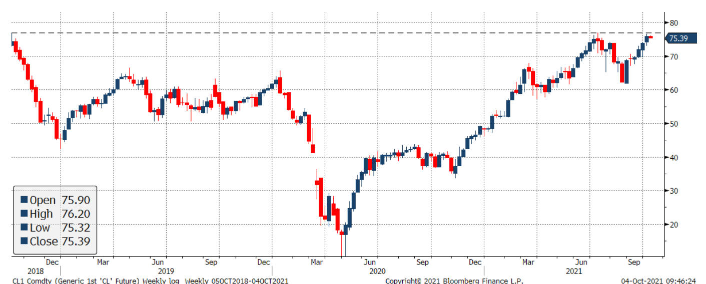
Source. Bloomberg, MAM Research

Chart 11. Silver Spot Prices (Weekly)



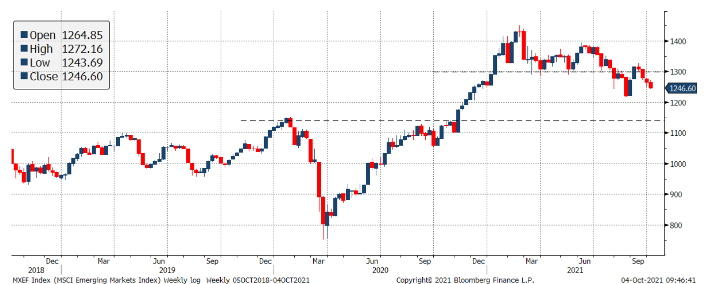
Source. Bloomberg, MAM Research

Chart 12. WTI Crude Oil 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

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