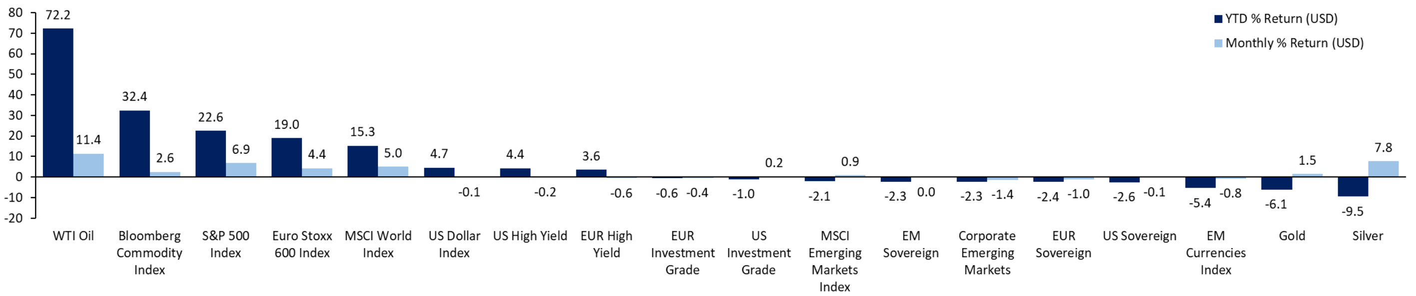
Global Research & Investment Strategy

November 3, 2021

Monthly Market Wrap, October 2021

With vaccine coverage improving in many countries, investors' attention is moving away from the virus towards the post-pandemic process of normalization. Persistent supply chain constraints are weighing on the path of recovery and feeding fears of longer lasting inflationary pressures. Concerns around the Chinese property sector eased slightly after a large property developer made an interest payment that had previously been missed in September. In the US, Congress managed to avert a debt ceiling crisis, kicking the can down the road to a new deadline in December. President Biden made further adjustments on his infrastructure spending proposals.

Chart 1. Asset Class Return YTD (USD Base)



Equities

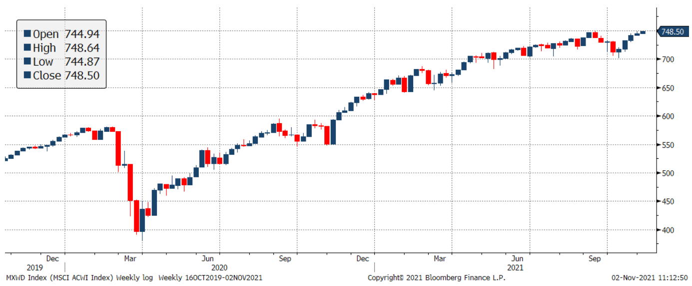
After a weak start, equities regained some momentum through October with many indices making new highs during the course of the month. Global equities were up 5.7%, 20% YTD **(Chart 2)**.

US equities were supported by a strong start to the Q3 earnings season with more than 80% of companies beating expectations. The S&P 500 **(Chart 3)** ended the month up 7.0%, up 24.3% YTD. Nasdaq was up 7.9%, up 24.1% YTD. Small caps underperformed with the Russell 2000 lagging by 2.7%, up 20.3% YTD. At the sector level, consumer discretionary and energy led the advances with the sectors respectively up 10.9% and 10.3%, bringing YTD performance up to 23.9% and 58.9%. With yields rising in October, telecommunication and utilities were among the worst performers but up 2.8% and 4.7%, respectively.

Europe kicked of the distribution of the Recovery Fund. Italy and Spain announced their intensions to pursue expansionary fiscal policies and to postpone fiscal consolidation until much later in the recovery. On the macro side, economic growth in Europe is still suffering from a loss in momentum. However, this is mostly attributable to Germany where the automotive sector weakness weighing on industrial production is driven by semiconductor shortages. European equities were up 4.7% last month, and are up 22.4% YTD **(Chart 4)**. At the country level, France was among the best performing markets with the CAC 40 Index up 4.8%. On a sector basis, financials and tech led the gains, respectively up 7.7% and 7.3%. As in the US, telecommunication was the worst performing sector last month, down 3.6%.

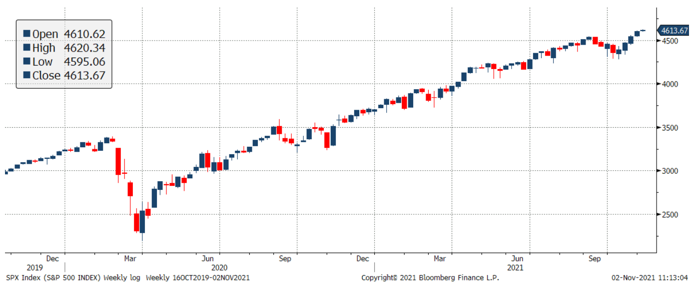
The UK market remained out of favour, but attractive valuations and dividend yields could encourage global investors to return. The FTSE 100 and 250 Index were up 2.2% and 0.5% last month.

Chart 2. MSCI World Index (Weekly)



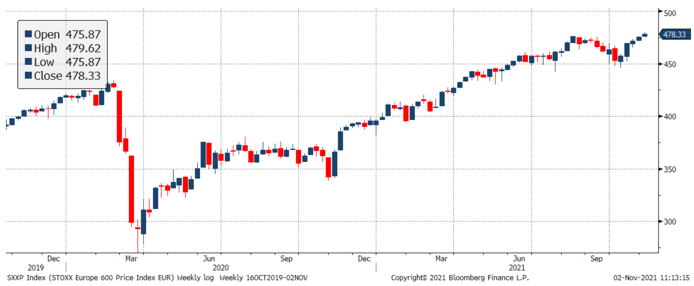
Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)



Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)



Source. Bloomberg, MAM Research

Fixed Income

Q3 GDP growth (2%) disappointed. Persistent bottlenecks in the supply chain and booming energy prices drove concerns over the non-transitory nature of inflation. However, more timely data published in October showed momentum was picking up again. The recovery is solid with the economy fast approaching full employment despite the inflationary pressure build up. As a result, markets have been pricing a faster pace towards policy normalization. The Fed is now anticipated to announce the start of the tapering cycle at the November FOMC meeting this week with a view of ending bond purchases gradually by mid-2022. A gradual hiking cycle could then start as early as the end of next year. US 10-Year Treasury yields hit a high of 1.7% in October. Larger increases were observed at the short end of the curve. The US 2-10 Year and 5-30 Year spreads were respectively lower by 15.6 and 33.0bps. A similar bear steepening scenario was observed in several other regions.

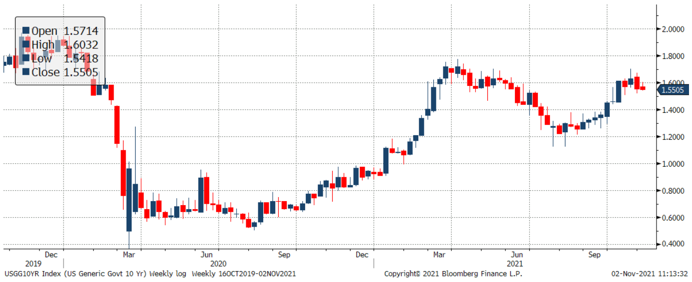
The ECB reiterated its view on the transitory nature of inflation. The decision on how to conduct asset purchases after the end of the PEPP was postponed to December. The resignation of Bundesbank President triggered speculation that his successor may be less hawkish, which, in turn, could boost the prospects for cheap funding conditions to persist for longer. Short Bund rates rose last month with 5-Year yields 16.6bps higher.

Currencies

The US Dollar was fairly unchanged (-11bps) and remains up 4.5% YTD **(Chart 7)**. We remain long USD into the November FOMC with our constructive view remaining concentrated vs. low-yielding funding currencies (e.g., EUR, JPY, CHF). Higher real yields in the US (diverging from those in Europe) are likely to support the USD over time versus low yielders. Near-term USD long positioning has been rising ahead of the FOMC, but is far from extreme **(Chart 8)**. The ample liquidity, rising commodity prices, and positive growth momentum keeps the risk appetite supported. If the FOMC was to show increased concern about persistent inflation or indicate that inflation expectations were rising too high, then it could put pressure on break-evens, dragging real yields higher, and leading to a more broad-based US Dollar rally. Indications of "maximum employment" likely to be reached sooner than anticipated might have a similar effect.

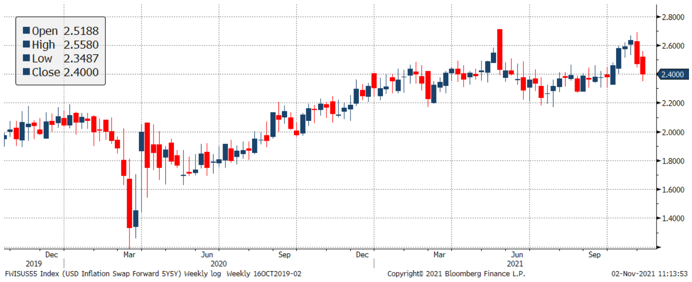
Despite the small broad US Dollar weakness, the Euro was down 19bps last month with the pair oscillating between 1.15-1.17. The ECB remains one of the most dovish G10 CBs. Growth momentum in the eurozone and US should also diverge for the rest of the year in favour of the US, which, coupled with the difference in reaction functions between the Fed and ECB, will continue to put downward pressures on the union's currency.

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. Broad USD Net Poisoning Not Excessively Bullish

Source. DTCC, Bloomberg, MS Research

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

Source. Bloomberg, MAM Research

Commodities

Global commodities were up 2.6% last month, up 33.0% YTD.

The combination of strong demand and supply chain constraints moved energy prices to record highs in October. In Europe, natural gas prices jumped by 60% in a week **(Chart 10)** before moderating after comments from President Vladimir Putin and his intention to increase gas supply to the region. The extent to which it will resolve supply shortages remains unclear given that pipelines are already close to capacity. In Asia, coal shortages induced the government to take steps to increase production as energy blackouts weighed on manufacturing activity.

Industrial metals were the best performing sector, up 4.5% with Zinc leading the gains, up 15.5%. Copper prices recovered, up 6.8%, meanwhile aluminium prices retraced lower, down 4.8%.

Precious metals caught a bid with the sector up 3.0%. Gold prices continued to be bugged around by diverging rates and inflation/stagflation concerns, but was up 1.5% nonetheless. Silver prices, supported by the broader strength in industrial metals, was up 7.8% last month **(Chart 11)**.

Energy continues to be the best performing commodity sector this year, up 2.0% last month and up 78.7% YTD. Crude oil prices were 11.4% higher **(Chart 12)**.

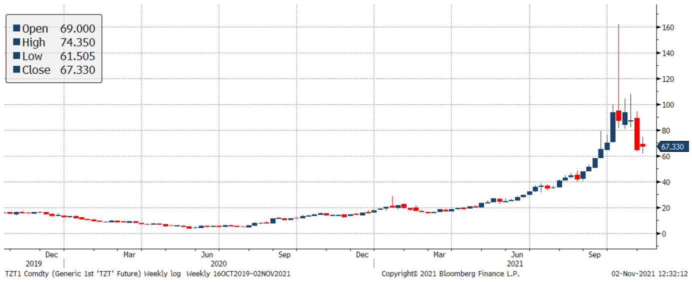
Emerging Markets

EM equities underperformed with the index up 1% **(Chart 13)**. After several months of substantial underperformance, Chinese equities rebounded after Beijing made more positive comments on big tech and took further action to mitigate the power crunch and property crisis spillover. Policy is fast approaching an inflection point with cyclical policy easing and a relatively more institutionalized phase of the regulatory reset on big tech and decarbonization setting up. The MSCI China was up 3.2%.

Brazilian equities were the worst performer in the region, down by more than 9.0% hit by a combination of sluggish growth, higher BCB rates, and fears President Bolsonaro may be about to blow up the country's finances. The administration's proposal to change the correction of the spending cap rule has been perceived by the markets as a serious breach of the fiscal rule, leading to a fall in prices, and a deterioration of expectations.

EM FX continued to edge lower last month with the index down 77bps in October, bringing YTD tally down to 5.7% **(Chart 14)**. Positioning in EM currencies is light and history would suggest the market could bounce. Notwithstanding our constructive view on the US dollar in the near-term, an important factor for remaining optimistic about EM currencies is historically low real money positioning. Each time the FX positioning beta dropped below 1.0 (like today), 2-month returns were positive.

Chart 10. EU Natural Gas Continuous Futures (Weekly)

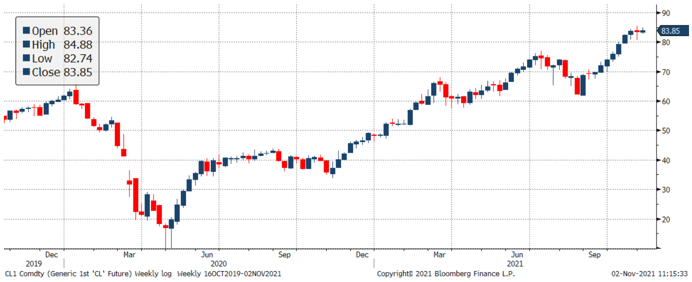


Source. Bloomberg, MAM Research

Chart 11. Silver Spot Prices (Weekly)

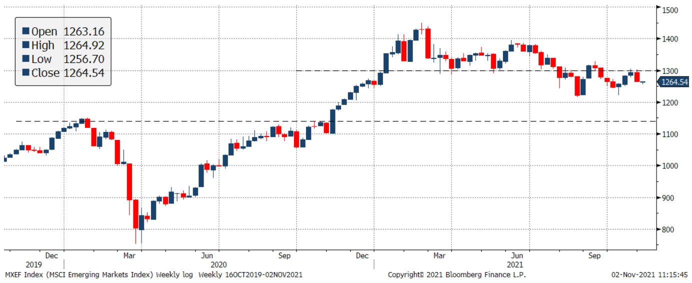
Source. Bloomberg, MAM Research

Chart 12. 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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