July Market Reflection

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Although the first month of the second half of the year has seen the trend of rising equity markets maintained, progress has been somewhat laboured and more volatile. The increasing threat of disruption from the COVID Delta variant triggered the sharpest one-day falls in indices witnessed for several months. However, the damage was limited and short-lived, with investors remaining confident in the supportive powers of fiscal and monetary policy. Indeed, having hinted at an acceleration of their policy-tightening intentions at June's meeting, US Federal Reserve Board members spent much of July rowing back on that suggestion. Even so, almost all market participants expect that the next move in interest rates globally will be upwards and managing this transition will remain a challenge for central bankers and investors alike. The rate of change will be influenced not only by the pace of economic recovery, which appears likely to remain sprightly well into 2022, but also by the path of inflation. Current readings remain substantially higher than a year ago, with a low base effect being exacerbated by supply constraints in a number of sectors, notably second-hand vehicles. This, in turn, is being driven by a shortage of new vehicles, with insufficient supplies of semiconductor chips largely to blame. The big question is whether or not these higher inflation readings are transitory. Optimists can cite the 64% fall in the price of US Lumber futures contract prices from their peak as an example of supply and demand returning to some balance. For now, at least, market-derived indicators of future inflation levels are below their recent peaks, which has favoured the "Growth" style of investing once more. But it is likely to be several months before the broader picture becomes clear.

- The global economy is set to recover strongly in 2021, although upgrades to growth expectations have not pushed beyond 6% (Bloomberg median estimate and IMF forecast). Expectations for 2022 are still rising, with the IMF the latest body to upgrade its forecast (to 4.9% from 4.4% in April). However, vaccine distribution and developments with the Delta variant are favouring Developed Markets over Emerging Markets currently.

- Consumer price measures advanced again in June, and once more exceeded consensus forecasts. The headline rate in the UK rose to 2.4%, while in the US it came in at 5.4%. The majority of investors and central bankers still believe this spike to be transitory owing to COVID-related supply chain disruptions and patterns of demand.

- Government bond yields have continued to trend lower, with real yields in the US reaching new lows. These moves have

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benefitted longer-duration equities, with, for example, Growth stocks clawing back their underperformance against Value stocks earlier in the year.

- The Chinese government continues to spring nasty surprises on investors by tightening its regulatory grip. Having intervened already in parts of the technology sector, in July it cracked down on profits in the private education industry. While it has since claimed not to be discouraging innovation and entrepreneurialism as a route to greater wealth, investors are likely to demand a higher risk premium until the dust settles.

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