August Market Reflection

| 2 September 2021 |

After an exceptionally strong first half of the year, equity markets have continued to find conditions less friendly in the third quarter, although further advances have still been made. Investors are facing two major challenges. The first is the COVID Delta variant which has spread more widely in recent months, leading to further disruption in labour markets and supply chains. This has, in turn, led to some downgrading of immediate growth prospects, although a full recovery is generally deemed to be delayed rather than cancelled. At the same time, central banks are openly discussing the imminent tightening of monetary policy, with an end to asset purchases, interest rate increases and a shrinking of balance sheets all on the horizon. COVID developments will play an important part in their deliberations, as will levels of consumer price inflation. Delta's influence suggests that policymakers will continue to be cautious in their approach. As for inflation, the central view is that the current spike is transitory, although higher readings seem set to persist for somewhat longer than originally expected. The UK has very specific challenges related to a tight labour market, with, for example, heavy goods vehicle drivers currently in short supply. Even so, the corporate sector in aggregate continues to enjoy a strong rebound in profitability and dividend growth, which lends good support. Merger and acquisition activity provides a further fillip, with private equity buyers keen to deploy high levels of liquidity. Although the developments in Afghanistan have dominated the news headlines most recently, they have had little bearing on financial markets, although we will carefully monitor how they might influence the political situation, especially here in the UK and in the United States.

- The global economy is set to recover strongly in 2021, although growth expectations have stalled at the 6% level for several months. Most recently we have witnessed some downgrading of growth forecasts in both the US and the UK owing to a combination of Delta variant influences and supply chain issues.

- Consumer prices rose more slowly in July, with the headline rate in the UK actually falling back to 2%, while the US rate was unchanged at 5.4%. Encouragingly, inflation breakeven rates, which chart the market's expectations for future levels of inflation, have also remained stable.

- Government bond yields, which dropped sharply during the second quarter and July, have been less volatile of late. This means that the relative performance between different market sectors has also been less volatile.

- Bond yields remain low relative to any historical context, and the lack of safe income continues to force investors towards higher risk asset classes in the hunt for adequate returns.

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- The Chinese government's imposition of tighter regulations on a number of sectors ranging from technology to private education and gaming has led many to question their faith regarding investment in China-based equities. While it is probable that such uncertainty will provide interesting longer-term value opportunities, there would appear to be no need to rush in immediately. We await clearer policy signals from the Communist Party leadership.

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