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OUT OF THE ORDINARY

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Market reflection

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Equity markets continued to rise in October despite growing concerns about the threat of persistently higher inflation and the narrowing horizon for monetary policy tightening. The fact that conventional bond yields did not rise as fast as inflation expectations meant that real bond yields moved deeper into negative territory, underpinning equity valuations, especially those of Growth stocks.

COVID developments were mixed, although encouragement continues to be taken from the fact that hospitalisations and fatalities remain much lower relative to overall case numbers than during previous waves, thanks to vaccinations.

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However, especially in Asia, there have been more stringent social restrictions put in place to combat the Delta variant, and these have contributed to further supply chain disruptions. Broad commodity indices have continued to rise, with energy prices especially influential to the moves. A confluence of negative factors has contributed to a big spike in the price of natural gas, which has, in turn, flowed through to the oil price, with domino effects felt through the supply chain. More positively against this background, companies have, in aggregate, started the third quarter reporting season strongly, with a large proportion of earnings coming in ahead of forecasts. For now, it seems as though input cost pressures are being largely offset through a combination of price rises and productivity enhancements. A standout feature of the results season so far has been the profitability of the banking sector, with unutilised pandemic-related loan loss provisions being written back into profits. We believe that the banking sector is in much better health this cycle and that it constitutes a limited risk to financial stability despite unpleasant memories of the financial crisis.

• The upward momentum of global growth forecasts has stalled owing to a combination of supply and demand constraints, most of which are the result of COVID-related disruption still. Even so, consensus forecasts for World GDP growth in 2021 still stand close to 6%, with around 4.5% pencilled in for 2022. Both of these figures remain well above the pre-COVID trend of around 3.5%.

• One market disrupted more by non-COVID influences is energy, leading to a big squeeze in natural gas prices. This has led to price volatility in other fuel and metals markets, as well as to shortages of certain goods and services. This situation should not remain acute for an extended period, but the risk of further price squeezes will be with us over the winter owing to low gas inventories for power generation. The whole episode has also served to remind us of the challenges of the transition to a low/no carbon world.

• Company earnings remain buoyant. Consensus analyst forecasts ect close to 50% global earnings growth in 2021 as activity rebounds from the COVID recession. The aggregate level of earnings is around 30% above the previous peak in 2018, providing some justification for world equity indices being around all-time highs.

• The UK Budget revealed a pleasant surprise in terms of the government's projected fiscal deficit, although there were no big giveaways from the Chancellor. The Budget adhered to the themes of "levelling up" with a touch of "green", which epitomises the current sweet spot for the majority of incumbent and aspiring political parties.

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