Weekly Digest

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Back To Reality

I returned to the UK this morning after spending several weeks in rural Canada. The transatlantic overnight flight was so empty that four seats in the centre aisle were available for a fully extended sleep. Yes, there are some silver linings to Covid. We nipped through passport control in record time, another benefit of the paucity of travellers. The road in from Heathrow was noticeably quieter than it might have been previously. We used to take the Tube, but weren't going to risk that this time. The biggest changes, though, were the implementation of various new cycle lanes, and, the closer to home we got, more draconian road closures to facilitate the commutes of more cyclists. Not sure how that's going to go in February. Meanwhile the biggest shock was saved until last. The local primary school is just around the corner, and today was the first day of term. We passed the gates just on opening time to witness a vast milling crowd of parents adhering to nothing that could be called social distancing, all involved in animated conversation with not a mask in sight. Everyone's been worried about the virus spreading via pupils and teachers. Looks as though they forgot the parents. Luckily we face two weeks of housebound quarantine, as I feel that the locals now represent more of a risk to us than we do to them!

The global Covid rollercoaster continues its ride. India is currently at the top of cycle, and along with Brazil it accounts for almost 60% of new cases. France, notably, is seeing rising case numbers too, with the UK also on the up. Meanwhile, Germany and South Korea, after recent spikes, are back on the downswing. We never thought that Covid would run in a linear fashion, and that seems to be the case.
Higher case numbers trigger both official and voluntary action in terms of increased avoidance measures, and so there is a natural ebb and flow. Yet we continue to believe that, in the absence of unforeseen circumstances – a nasty mutation, perhaps? – the extreme lockdown measures imposed in March and April will not be revisited. For now they are not viewed as socially, economically or politically acceptable. More positively, mortality rates are not rising to anything like the same extent thanks to improved treatment and the fact that a younger, less vulnerable, cohort of the population is currently at the sharp end of increased infections.

We pay particular attention to investors' expectations around the development of a vaccine, because news on this front is generally expected to set off the next big market sentiment shift. To this end, we have been tracking Deutsche Bank's monthly client surveys. The latest, conducted last week, showed that thirty-eight percent of respondents expect a vaccine "to be available" within six months, and a further forty-four percent within six-to-twelve months. That's a total of eighty-two percent who expect the means for

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some return to normality to be with us within a year - a pretty large majority. Of course, it's not unreasonable. Three of the four leading candidates (outside Russia and China, whence reliable data is a bit less forthcoming) suggest that important trial data will be released within the next few weeks. The US authorities have suggested that fast-track approval is a possibility as long as the candidate is only marginally more than fifty percent effective. But that eight-two percent figure does make one think that quite a lot of optimism is already built in.

As an aside, I might mention here that one of the books I read over the summer was Why We Sleep, by Matthew Walker. It's one of the most fascinating books I have ever read, and really opened my eyes to the benefits of good sleep and the dangers of not getting enough of it – additionally relevant when I have jet lag. One interesting observation is that vaccines do not seem to produce as many antibodies in people who have not had optimal sleep in the run up receiving them. Given that Dr Walker believes the world is generally suffering from a chronic lack of sleep, on average, that might represent something of a hurdle to expected efficacy. Anyway, get some good kip before the jab, when it comes. And read the book!

Talking of reality checks, rollercoasters and unforeseen circumstances, a combination of those factors hit equity markets at the end of last week. In our latest Monthly Commentary, which was circulated on Thursday, I set out to explain some of the reasons for the apparent dislocation between economic data (business closures, job losses, huge fiscal deficits, etc) and the booming global equity markets. With some (purely fortuitous) prescience, I kicked off with the following: "It always feels a bit dangerous to be explaining on an ex post facto basis why markets have behaved as they have done. Often when such justifications are brought to bear it can signal that a trend is about to reverse." Call it the "Commentator's Curse", if you like ("Here's Root, looking well set for that elusive century… oooh, and there goes his middle stump!"). The Technology-led US NASDAQ Index proceeded to fall around 10% at one point during the next couple of trading sessions before staging a rally on Friday afternoon.

Much of the blame has been laid at the door of Softbank, a Japanese company led by the mercurial Masayoshi Son, which defies a neat description. A conglomerate with a focus on technology that is not averse to taking some big risks, perhaps. Its latest move has been to buy as much as $4 billion worth of (predominantly) call options on leading US Technology companies, helping to drive up the share prices in the process, which might help to account for the 11% rise in the NASDAQ Index in August alone. There had been rumblings of something odd going on in the options market for a while, with talk of a large buyer of out-of-the-money call options. As the underlying share prices rose, this required those who had sold the options to hedge their positions, creating an upward squeeze. Another peculiarity was that market volatility was rising at the same time as the market, a phenomenon last noted for any lengthy period in the latter part of the 1990s, an era associated with rampant speculation.

There's no saying when these things are going crack, and everyone's still looking for the catalyst for last week's unwinding. At the margin there must have been a small surfeit of sellers, and, running into a long weekend in North America, liquidity was limited. It's not the first time markets have hit an air pocket, and it certainly won't be the last, but it serves as a reminder that equity markets tend to fall a lot faster than they rise, and that liquidity is "pro-cyclical", meaning that there is less of it when prices are falling. This is a natural function of risk tolerance, but it has almost definitely been exacerbated by the structure of markets today and the prevalence of passive index funds and Exchange Traded Funds, as well as those who attune their positions to the level of volatility. Unless some new evidence is uncovered, for now it all looks like no more than a welcome blowing off of froth.

In the last Weekly Digest before the Bank Holiday, I trailed the Jackson Hole symposium of central

bankers, and the expected shift of US central bank policy. This was duly unveiled by Federal Reserve Bank chairman Jay Powell, although we still await finer details. The key point remains, though, that the ceiling has been removed as far as US inflation is concerned. No longer is 2% the level beyond which the Fed will start to rein it in; rather, it is now the level that should prevail, on average, across the cycle (as yet undefined). I can only identify thirteen months since the financial crisis in which the Fed's preferred measure of inflation, the Core Personal Consumer Expenditure rate, has had a print that begins with a two, with peaks of 2.12% in 2012 and 2018. This suggests an awful lot of catching up needs to happen, meaning that inflation could "run hot" for a while. Some might say, with justification, that there is an element of wishful thinking in this, given central banks' track record so far. Japan has struggled to keep inflation much above zero for the last thirty years, and Europe saw its headline annual rate of Consumer Price Inflation fall into negative territory in August. But the latest combination of both monetary and fiscal loosening has raised the probability of success. We remain on high alert for confirmatory signals.

Finally, for the benefit of those who do not receive the Monthly Commentary, I will repeat the words of legendary Yorkshireman, cricketer and commentator, "Fiery" Fred Trueman; words which should probably be the conclusion to any investment strategy piece: "Unless something happens that we can't predict, I don't think a lot will happen"!

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Last week's Economic Highlights

FTSE 100 Weekly Winners

Melrose Industries PLC	9.5%
Hikma Pharmaceuticals Plc	4.3%
Fresnillo PLC	3.3%
Compass Group PLC	3.0%
Whitbread PLC	2.8%
Evraz PLC	2.8%
ITV PLC	2.3%

FTSE 100 Weekly Losers

Rolls-Royce Holdings plc	-13.0%
Scottish Mortgage Investment Trust Plc	-12.0%
Flutter Entertainment Plc	-10.5%
M&G Plc	-9.9%
Ocado Group PLC	-9.0%
Pearson PLC	-8.8%
Intermediate Capital Group plc	-8.6%

FTSE 100 Index, Past 12 Months

Source:FactSet

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