Weekly Digest

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The Secret Six

My early reading skills were honed on a diet of Enid Blyton, from Noddy through to the Famous Five. However, the Secret Seven might have found themselves in some difficulty as the government's latest social distancing rules come into force, especially as they often convened in a garden shed. At least by jettisoning one of the boys they will become gender balanced. As for The Magnificent Seven, even if one of the characters played by Horst Buchholz and Brad Dexter is digitally removed, non-expert quizzers will still fail to name the complete set.

The use of humour is a time-honoured method of helping to cope with stressful periods, although it must not trivialise the seriousness of the situation. And there is no doubt that things are getting more serious again, notably: on the Covid front; with regard to Brexit; and the forest fires on the US west coast which are turning into a political football – climate change vs forest mismanagement being the latest example of identity politics.

We often emphasise that it is developments outside the market's range of expectations that are the ones that cause the most volatility. With regards to a second wave of Covid, the last time that Deutsche Bank tested investors' views about a potential second wave was in the middle of June, when around two-thirds of respondents believed there would be one in either the autumn or the winter. I acknowledge that three months ago is a long time, and also that the second wave is materialising somewhat earlier than anticipated, but, even so, I would not have expected opinions to have shifted materially on this subject, especially as the projected timing for the availability of a vaccine has remained fairly constant.

If anything, markets still seem to be reacting asymmetrically positively to vaccine updates. Last week's news that Astra Zeneca and Oxford University were suspending their trial owing to an adverse medical development in one of the participants barely registered. News over the weekend from Pfizer that its vaccine might be available to the public before the end of the year is being touted as one reason for a firmer equity market tone today. However, without wishing to put too much of a dampener on things, I also note fresh comments from the Serum Institute of India, the world's largest volume manufacturer of vaccines, suggesting that sufficient doses to inoculate the world's population (fifteen billion, assuming requirement for a booster) will not be available until 2024. There are also logistical problems to overcome, such as the fact that vaccines have to be stored at low temperatures - as low as -80 degrees centigrade in the case of those developed using the mRNA (messenger RNA) route. Even if more developed countries can reach some acceptable level of immunity, many less developed countries will remain excluded from full participation in any recovery.

The main backstop for markets remains the stimulus being provided by governments and central banks. One cause for slight concern is that the fiscal element in both the UK and US is potentially at risk. Here, Chancellor Sunak has vowed to unwind a large part of the furlough scheme in the next few weeks, just as more companies, mainly in the retail, hospitality and transport sectors, are talking about greater numbers of permanent redundancies. Interestingly, his views were endorsed by the Bank of England's Chief Economist. Is this some sort of "jaw-boning", an attempt to convince people that we are on a path to normality? I'm really not sure. However, I do believe that the Chancellor knows which side his bread is buttered on, and there will be some sort of climb-down (dare I say "U-turn"?). I note that UK government bond yields are tracking lower again, suggesting no signs of revolt from fixed income investors.

In the United States, matters are different, in that both parties want another round of stimulus: it's just that they cannot reach an agreement about the size and finer details. Obviously as we get closer to the election (3rd November), this situation becomes even more political. However, recent experience suggests that neither side will be willing to countenance another sharp economic downturn, and so if one starts to develop they will be forced into agreement.

As for the central banks, we will hear the latest updates from both the Bank of England and the US Federal Reserve this week. Neither is expected to change current policies in terms of the level of interest rates or quantum of asset purchases, but outlook statements will be parsed to within an inch of their lives for clues as to future policy.

This is the first Fed meeting since Chairman Jay Powell's Jackson Hole speech, in which he outlined the plans for maintaining an average inflation rate over the cycle and a focus on full employment. Some commentators have noted that this shift of emphasis is an implicit admission of the fact that the Fed made some major mistakes in the past, notably with regard to the point at which low unemployment levels become inflationary. Thus they tightened policy prematurely. So be it. As John Maynard Keynes is famously believed to have observed: "When the facts change, I change my mind. What do you do, sir?" But when orthodoxies shift, there is inevitably a lot of complaint. The consensus view is that major details will be parked until after the election, but there remains capacity for a surprise, possibly in terms of "forward guidance", in which the Fed would commit to keeping interest rates no higher than at their current level for several years.

The Bank of England is similarly expected to sit on its hands, although some are forecasting an increase in its total planned asset purchases. The new Governor, Andrew Bailey, has been pretty vocal in his comments. At the same Jackson Hole symposium he reiterated his support for the "go Big" and "go Fast" intervention strategy, and so we should not be too surprised by more asset purchases in future. But the nature of these purchases is changing (everywhere). It is one thing to intervene to provide liquidity to financial markets and the financial system, and quite another to provide liquidity (on a de facto basis, even if not specifically) for the purchase of government debt. The debate about government debt monetisation, the advent of Modern Monetary Theory and their implications for inflation has only just begun. Let's wait and see what happens later in the week before passing judgement.

Moving on from Covid, but providing no light relief… Brexit is doing its best to recapture the headlines. Like Jaws 2, Alien 2, etc, the sequel is not quite as shocking as the original, but the government's Internal Market Bill has ruffled more than a few feathers. Add to that reports that Prime Minister Johnson is preparing to opt out of much of the European Convention on Human Rights, and everything that appeared once to be resolved is up in the air again.

I am not going to offer an opinion either way on these matters today, but I will observe the market's reaction. This was to mark the pound around 4% lower against the dollar and 3% lower against the euro, a movement consistent with the experience since 2016 – markets view a "No Deal" or even a "skinny" deal as bad for the UK's economic prospects. The upside, as much as there can be one, is that the pound's weakness masked a relatively mixed week for global equities (with the US market losing some more ground) as overseas assets became more valuable in sterling terms. It feels as though negotiating brinkmanship (which I am still inclined to believe it is) promises more currency volatility in the weeks ahead.

Last week's Economic Highlights

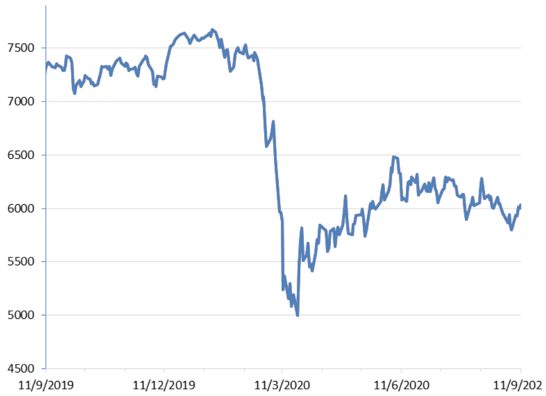
FTSE 100 Weekly Winners

Aviva PLC	10.8%
Experian PLC	10.3%
Scottish Mortgage Investment Trust	10.2%
Ashtead Group PLC	10.2%
JD Sports Fashion PLC 10.1%	10.1%
Unilever PLC	9.2%
Rio Tinto PLC	9.1%

FTSE 100 Weekly Losers

International Consolidated Airlines	-11.5%
Whitbread PLC	-8.4%
Wm Morrison Supermarkets PLC	-5.5%
Natwest Group PLC	-5.25
Associated British Foods PLC	-4.4%
British Land Company PLC	-4.0%
Barclays PLC	-4.0%

FTSE 100 Index, Past 12 Months



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