6 Key Trends from September 2021

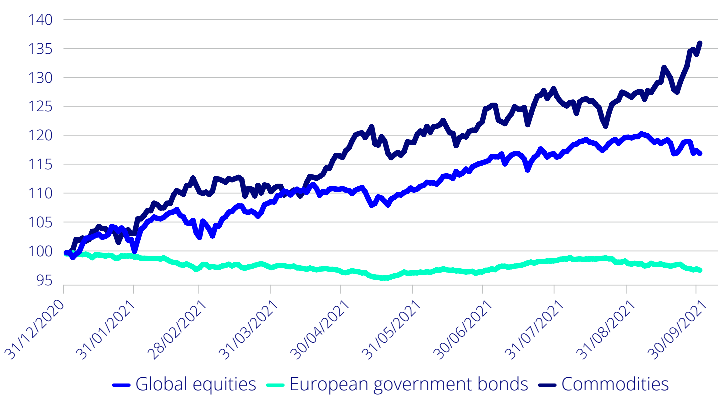
Choppy waters...has "TINA" turned?

"TINA", the acronym for "there is no alternative', has become a watchword for equity markets this year. With such meagre and negative returns on offer from cash and bonds, equities, it is argued, continue to be the asset class of choice for investors. September 2021 has challenged this however, with a series of events that have made the waters choppier. While most equity markets are down on the month for the first time this year, it must also be said they are withstanding some very significant changes. (See Figure 1 below)

Looming largest amongst these changes was the US Federal Reserve (the Fed's) announcement that it would begin to reduce its bond purchasing programme (taper), most likely, in November 2021 and would be done by the middle of next year. This was accompanied by news that the first interest rate increase may be sooner also. To date, markets have seen this, along with announcements from other global Central Banks, broadly, as a vote of confidence that economies are normalising and that economic growth continues. However in the final days of the month we saw significant negative reactions from the bond and equity markets.

The month's most eye-catching headlines were the events surrounding Evergrande **(see trend 2)**, the mammoth Chinese property developer that has been on the brink of debt default[1]. While this has been known for some time, concerns that this could be contagious shook markets in September as the company failed to make payments on some of its bonds.

Figure 1: Returns from major asset classes to end September 2021



2021 Year to Date performances (to 30/09/2021)

- Global equities +17.3%
- European government bonds -3.0%
- Commodities +36.0%

Source: Bloomberg 30/09/2021

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Markets also continued to adjust to what the post pandemic environment might be like. In Q3 overall, we continued to see a transition to more normal returns from peaks in a number of the factors that have been driving markets:

1) Economic growth expectations
2) Corporate earnings
3) Inflation
4) Central Bank support
5) Covid-19

The coming months will tell a lot, especially whether inflation is indeed transitory (we believe it is but that it will take longer to resolve) and whether we are seeing the last chapter in the pandemic (signs are encouraging that the Delta variant has peaked[2]). Towards the end of the month, equities did drop as bond prices fell (and yields rising) and technology stocks in particular sold off **(see trend 6)**. We can expect this type of market volatility to persist for some time yet.

[1] Source: Bloomberg 30/09/2021

[2] Source: www.ourworldindata.org

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6 Key Trends from September 2021

1 The Fed's tantrum-less taper & other Central Bank news

The Fed signalled that it would gradually reduce its $120 billion monthly bond buying programme "soon" if the economy continues to improve. Fed Chairman Powell, indicated that the programme could be wrapped up by mid-2022 and a number of prominent Fed members have weighed in to suggest that a moderation of the support programmes is now warranted. That said, U.S. Senate hearings at the end of the month were less than supportive of Chairman Powell and there remains doubts about the support for the scale of infrastructure spending being planned. Elsewhere, the Bank of England, Norges Bank, and the Swiss National Bank all made similar announcements during the month with Norway the first developed economy to begin raising rates[3]. The good news is that markets have digested this significant news reasonably well and it appears that it is viewed as a vote of confidence in the strength of the global economy and positive for investors.

2 The Evergrande crisis rolls on

Evergrande, the largest Chinese property developer, has been on the brink of debt default during September 2021. While the problem has been known for months, it came into sharp focus as the company missed interest payments with its banks over the month. A fear of contagion spread into the Hong Kong market and beyond. At this point, it looks like the Chinese government will allow some form of managed default by Evergrande, but it will support the wider financial system. As a result, it looks unlikely to us that the impact will spread globally. Western Central Banks have been quick to assure markets that the exposure in the West is limited.

The risk that remains is an overheated Chinese property market and that could be a more worrisome event. As two thirds of Chinese wealth is in property[4], if they are to avert this crisis turning into a catastrophe, the Chinese authorities must maintain confidence in China's property market and avoid a big drop off in construction activity, which would slow the Chinese (and global) economy materially.

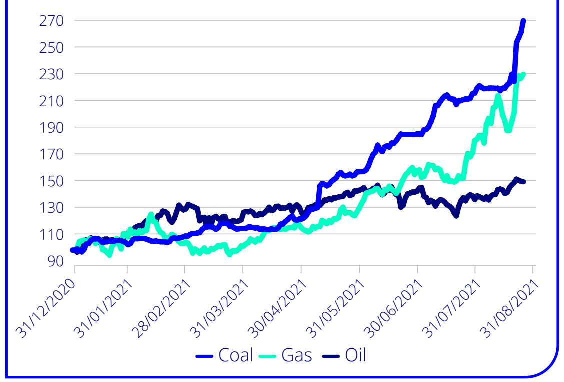
3 An energy crisis?

The price of natural gas has jumped in response to a shortage of supply and Europe in particular looks likely to face a significant shortage. As the world tries to quit coal and increase use of cleaner energy, a greater reliance has been placed on natural gas to heat homes and power industries. But there isn't enough gas to fuel the post-pandemic recovery and refill depleted stocks before the colder months.

Countries are trying to outbid one another for supplies as exporters such as Russia move to keep more natural gas at home. The crunch will get a lot worse when temperatures drop and the crisis in Europe may spreader further as the continent's energy shortage has governments warning of blackouts and factories closures.

To add to the challenges, oil surged past $80 a barrel towards the end of the month with electricity prices also surging. Coal has also seen dramatic price increases and a shortage of inventory in China alongside the already difficult supply chain blockages, will add to the stickiness of inflation for the near term. (See Figure 2)

Figure 2: Energy prices Jan-Sep 2021 (rebased to 100)



Source: Bloomberg 01/10/2021

4 German elections

The Social Democrats won the 2021 German election by 1.6% based on preliminary results. They have increased their share to 5.2% compared to 2017, whereas the CDU/CSU (unofficial Union parties in Germany) dropped 8.8% to 24.1% - the party's worst ever showing in elections. The Greens also gained up to 14.8% from 8.9% in 2017, its best ever showing. It seems likely that a three party coalition will be the outcome and for investors it looks likely that whatever combination wins, there will be a more expansionary government spending policy and 'greener' agenda. The combination of the Social Democrats, Greens and the FDP is probably the most market positive option and will mark out a change from austerity led politics of the past several decades, greater fiscal expansion and a focus on the green agenda.

[3] Source: Bloomberg 27/09/2021

[4] Source: Survey Report on China's Household Wealth, 2017, edited by China Economic Trend Research Institute of the Economic Daily.

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6 Key Trends from September 2021 (Cont'd)

5 Covid

The Delta variant has been the culprit behind a slowdown in economic growth expectations for Q4 2021. The most recent data on infection levels suggests that we have seen it peak and it is now declining in most major economies (the US, Canada, France, Germany and India all appear to be seeing a decline, with the UK bucking that trend). A substantial drop in Delta variant infection levels would be a very positive stimulant for economic growth.

6 Inflation and the US 10 year bond

Inflation in Europe finished the month on a 13 month high at 3.4% and the measure of inflation that the Federal Reserve focuses on in the US (the "Personal Consumption expenditure" gauge) reached an annual rate of 4.3%, its highest in 30 years.[5]

Bond markets have been responding to this. The US 10 year bond is probably the single most influential asset in the world, with so many other assets being influenced by it. In the last days of September, the 10 year yield moved over 1.5% for the first time since June 2021 in response both to the stickiness of inflation, and the direction that the Fed is taking over what looks like a shorter time frame.

Summary outlook

The end of Q3 marked a break in the month-on-month gains in equity markets as markets had to digest the firmest signal yet that the US Taper will be starting. The Evergrande crisis added to the mounting challenges faced by markets leading to a drop of 2.4% in equities for the month of September. Yet considering the scale of changes that markets are digesting, this suggests that the 'TINA' effect is weathering a difficult month quite well. We have been saying for some time that Q4 is likely to be bumpier than we have seen for some time and that is looking likely to be the case. However, this is also a necessary part of the process of restoring a normalised economy.

For investors, being well diversified across asset classes during this period and having the benefit of active risk management continue to be critically important as we manage back to normality.

For more information:

Fund Centre

boi.com/marketwatchupdates

[5] Source: Bloomberg 01/10/2021

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Appendix

	2016	2017	2018	2019	2020
Global equities	11.09%	8.89%	-4.85%	28.93%	6.65%
European government bonds	3.21%	0.24%	0.85%	6.75%	4.98%
Commodities	15.16%	3.25%	-6.81%	9.70%	-11.11%
Evergrande	-27.1%	385.9%	4.5%	-5.5%	-36.3%
Oil	57.0%	3.2%	-15.5%	25.1%	-27.9%
Coal	109.8%	15.1%	-18.3%	-16.4%	-9.4%
Natural gas	64.2%	-30.4%	4.5%	-24.1%	6.5%
US 10 year bond yield	7.71%	-1.59%	11.59%	-28.56%	-52.38%

Source: Bloomberg 30/09/2021

Please note US 10 year bond returns are expressed in US Dollars. All other returns in Euro

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Warning: The value of your investment may go down as well as up.

Warning: If you invest in these funds you may lose some or all of your investment.

Warning: These funds may be affected by changes in currency exchange rates.

October 2021

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