Market2Market

A forward view of the global economy and financial markets

November 2021

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GHC Capital Markets

Happy Christmas

"It's not how much we give but how much we put into giving".
Mother Teresa

Source: Wikipedia

Christmas 2021 looks as though it is going to be more like the season of goodwill than the Christmas of 2020 which was blighted by lockdown restrictions caused by the awful COVID-19 pandemic without a vaccination programme. This year has already felt more like normal as the Christmas special advertisements have been assaulting us since the end of October. It's a bit like a war in that one company launches their Christmas ad and every other company feels obliged to retaliate.

Christmas is actually a mixture of pagan and Christian customs and symbolism. In the distant past the climax of Yule, or Midwinter Day on the 21st December, became the Christian feast day of St. Thomas. This was the time when Christmas activities such as carolling, putting up decorations and wrapping presents began. However my local garden centre had an ice rink and full winter land experience set up by the end of October and on a visit to Chatsworth House in early November I was able to do most of my Christmas shopping if I had felt so minded.

Originally on the 21st December the old Norse festival of Yule was celebrated with evergreens such as holly and ivy being used to symbolise renewal and the eternity of life. Fires were lit in honour of Thor which were kept alight until the shortest day was passed. The Yule log is a continuation of this tradition and was kept burning in the hearth throughout the twelve days of Christmas. This symbolised the need to keep the stable warm for the infant Christ. Today this tradition is remembered by the Chocolate Yule Log which has now become standard fare of the season.

Saturnalia was the Roman celebration of the winter solstice when the sun was welcomed back after the shortest day. The Romans didn't eat cake to celebrate but rather had a week of gift giving, feasting and orgies. Elements of both the Yule and Saturnalia customs have been combined to bring us to what we do nowadays.

The Christmas Tree is a relatively modern introduction to out festive traditions as it was made popular by Prince Albert in 1841, although German immigrants in Manchester were putting them up in the 1820s. Mistletoe is much older and was venerated by the druids. The old custom was that any woman passing under the mistletoe may be kissed and to refuse a kiss meant certain spinsterhood. In our modern world any woman or man is able to refuse a kiss without consequence.

Christmas is now a time when families come together and presents are given. The tradition of feasting is still carried on by our having a huge meal and lots of drinks which is reflected in most of the pre-December advertising. Boxing Day is a bank holiday and after recovering from the excesses of Christmas Day many people will go to one of the many sporting fixtures that take place. Although customs and beliefs may have changed somewhat over the last few millennia, at its core, it is still a time to come together with family and friends to support each other at what is the darkest time of the year.

I sincerely hope that you are all able to have a happy and healthy Christmas however you chose to celebrate it and that the season of goodwill prevails.

Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

GHC Capital Markets

Asset Allocation

In which **Tim Harris**, the Chair of our Asset Allocation Committee, describes the factors influencing our latest Asset Allocation decisions

Global inflation is not transitory

After two decades of falling inflation, it is quite understandable that central bankers are reluctant to acknowledge that we might have an inflation problem at hand. They negotiated the previous inflation challenge so well that they had to spend the last 15 years trying to re-create it. Now it appears to have all the hallmarks of a monster they may not be able to control easily. Current US data serves as a wake-up call to those who believe inflation to be transitory. Earlier this year, economists forecast that US inflation would peak somewhere below 4.0% and then slip back to under 2.0%. That was not to happen. Latest inflation was reported at 6.2% in the US and 4.2% in the UK. Inflation pressures were seen across a broad set of products and services. Rents, which account for around 30% of the inflation basket, could add one percentage point more than their normal average contribution to inflation in the coming months. The longer the central bankers stay in denial that inflation could persist well through their targets, the greater the probability that they will then have to implement policies that will pop the myriad of bubbles in financial markets.

In an interview with Bloomberg, Mohamed El-Erian, PIMCO's former CIO, called the Fed out for its hesitancy, terming it "a material risk to economic and social wellbeing". He believes the Fed is making things far worse by maintaining its record easy monetary conditions. "The more the Fed falls behind (*in tightening monetary policy),* the greater the threat of it being a driver of three or four simultaneous contractionary forces in the middle of next year if not earlier; higher interest rates, financial market instability, a reduction in the real value of household savings and the erosion of fiscal stimulus."

Monetary conditions are very easy

The financial markets have enjoyed a positive backdrop of some of the easiest monetary conditions on record. A world of zero interest rates and 6.2% inflation is inconceivable unless the Fed expects inflation to fall sharply in the coming months with a high degree of confidence. We don't see it. On the contrary, pipeline product and service sector inflation combined with signs of wage inflation do not presage lower inflation in the coming quarters. We worry that the Fed is taking an unacceptable and uncalculated risk with financial stability. Nevertheless, they do have a few measures at their disposal in the coming few months. This includes an imminent acceleration in quantitative easing tapering and messaging that they will likely raise rates soon. We believe that it would be inconceivable for the Fed to leave the first increase in interest rates until 2023.

What might save the day for the Fed?

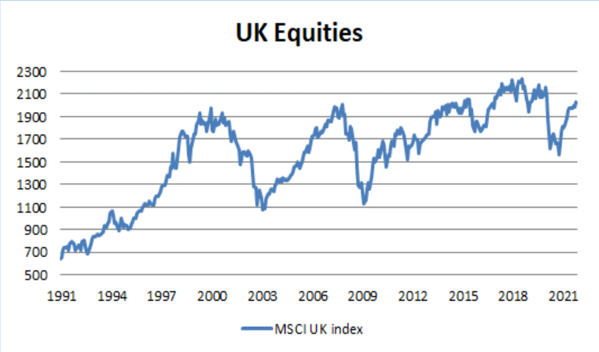
Firstly, we would need global supply constraints to start to melt away; secondly, a buyers' strike amongst consumers as they baulk at the higher prices, forcing companies to cut prices again and absorbing the cost pressures in their profit margins. The market is already pricing 2.5 Fed rate increases by the end of 2022. There is a noticeable gap in credibility opening up for the Fed, with the market seeing the need for a number of rate increases next year and the risk that the US will see the persistence of the highest inflation in decades.

Valuations by themselves are rarely a good guide to the future performance of equity markets.

However, if an investor buys into the US equity market this week, they will be investing at a Shiller P/E multiple of 40 – a high level last seen in 1999. A Bear Market Probability model used by Goldman Sachs has risen to one of the highest levels in 50 years with a probability of 90%. *The great bull market in bonds and equities can only continue while the Fed maintains very loose monetary policy.* Inflation news puts the days of plentiful liquidity at risk. Unless the Fed is more aggressive in its tightening intentions, it risks leaving it too late and having to act more aggressively later in 2022, which threatens a sell-off in risk assets, such as equities, credit and real estate.

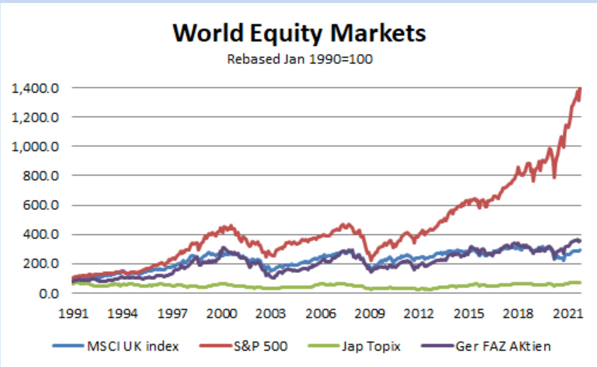
We have become more cautious investors, rebalancing to better value equities (commodity plays and markets that have been left behind, such as the UK and Japan). In bond markets, we maintain short duration in portfolios and look to take profits in high yield.

Markets at a glance



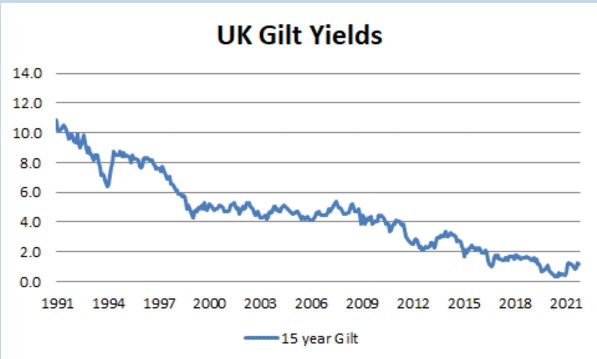
Source: Lipper for Investment Management

The UK equity market has become more popular with international investors after a post Brexit sell-off. Its relatively modest valuation and the resilience of leading international companies has alerted fund managers to its attractions. However, despite a strong earnings and cashflow recovery from the lows of the COVID crisis, signs of softening economic growth and rising inflation pressure with a risk that monetary policy may become less accommodative are concerns. Eyes will focus on the Bank of England's next monetary policy meeting in December, as committee members admit to unease over the levels of prevailing inflation.



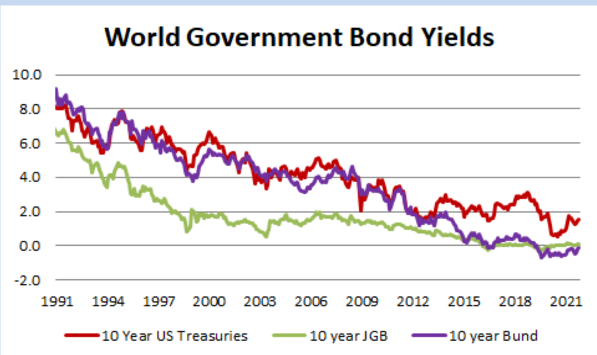
Source: Lipper for Investment Management

Global equity prices have continued to attract net inflows in an environment of easy monetary conditions, as corporate earnings are recovering strongly in many countries. Europe and the US are leading the way in the year-to-date, as Japanese and Asian equities tread water. Global trade is addressing supply and shipping availability issues, which are leading to a moderation of growth expectations. The major global challenge across the world is inflation risk, which might sponsor monetary policy action, even as key economies continue to manage coronavirus pandemic risks. This might put the brake on further upside in coming weeks.



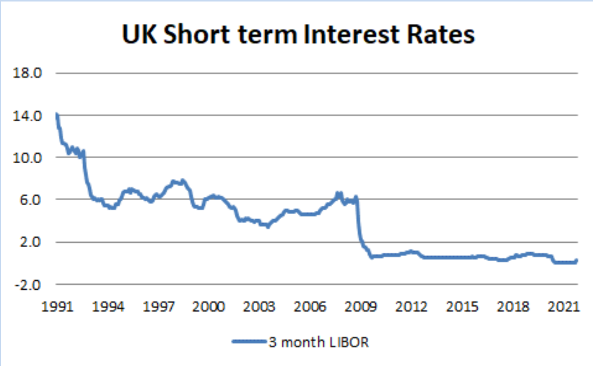
Source: Lipper for Investment Management

Gilt yields have continued to rise at both the short and long end of the curve – the 10-year gilt currently yields 0.92% to redemption, some 30 basis points higher than in July. Inflation concerns reflect shortages of materials and wage pressures, given labour shortages in sectors, such as retail and hospitality. While low absolute yields reflect extremely low official interest rates, policymakers are now voicing their concern about inflation risks and real yields are negative. It is quite possible that we shall see changes in interest rate policy by the end of this year.



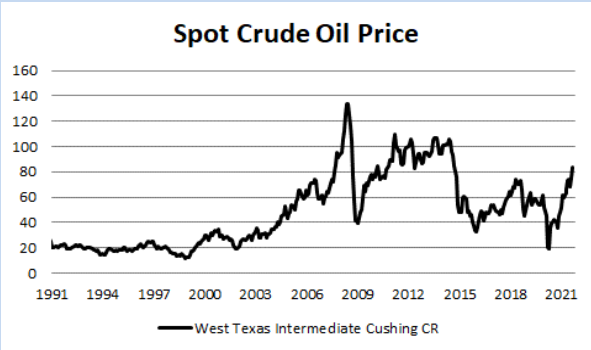
Source: Infront

Government bond yields are rising across the US, Germany, and Japan. Higher inflation risks and possible resultant policymaker action remain concerns for investors, although policymakers are still discouraging markets from expecting actions too soon. We expect the levels of quantitative easing to fall through the remainder of this year and no changes in interest rates across the overseas developed economies. However, we also expect tapering of the quantitative easing programmes that have turbo charged liquidity across developed markets through the recent crises. A number of emerging market central banks are raising their domestic rates to counter inflation and support currencies. While monetary policy will remain loose in developed markets for now, longer dated yields may rise.



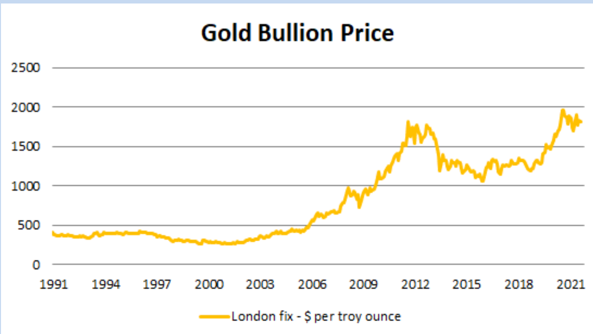
Source: Lipper for Investment Management

The Bank of England is warning of a pronounced period of above-target inflation in the near term. The Bank's main lending rate remains at a historic low of 0.1%, where it has been since March 2020. The central bank has raised its inflation forecast to 4% into 2022 Q1. The rise in the consumer price index is primarily due to rising energy and other goods prices. The key debate is whether these are temporary and will moderate in the medium term, bringing inflation back toward its 2% target, or more embedded. We expect short-term rates to rise in the short- to medium-term, although the Bank will be mindful of being too heavy on the tiller.



Source: Lipper for Investment Management

Brent crude oil spot prices have continued to rise to $82/ barrel in August, up $36/barrel from August 2020. Rises over the past year have resulted from steady draws on global oil inventories, which averaged 1.8 million barrels per day through 2021. At the same time, there is limited sign that OPEC+ is likely to increase supplies by any margin. We expect Brent prices to remain near current levels for the remainder of 2021. In 2022, we expect that growth in production from OPEC+, US light oil and other non-OPEC countries will outpace slowing growth in global oil consumption and contribute to Brent prices declining to an annual average of $66/barrel.



Source: Lipper for Investment Management

Amidst uncertainties about economic growth and the next interest rate hike, gold prices are a little below their all-time highs, set last summer. The physical market for gold remains weak. Despite a rebound in India's gold imports, China's gold imports are very weak. In the short to medium term, gold demand will continue to be driven by central bank policy and investor fears of inflation risks. Gold is a real asset – real assets are the optimum hedge against inflation. This asset presents a store of value in inflationary times, as witnessed by a modest rally from early year price lows.

Note that where an MSCI Index has been used for illustration. This has been sourced with permission from MSCI Inc.

Quick facts

ISA Allowance 2021/2022	Stocks & Shares ISA Cash ISA Junior ISA	£20,000 £20,000 £9,000
Pension Allowance 2021/2022	The limit is the greater of £3,600 and 100% of salary, subject to the annual allowance of £40,000 (unless money has been accessed through flexi drawdown in which case the annual allowance is limited to £4,000).	

Tax facts

Income Tax	Personal Allowance 2021/2022	Up to £12,570
	Basic Rate @ 20%	£12,571 to £50,270
	Higher Rate @ 40%	£50,271 to £150,000
	Additional Rate @ 45%	Over £150,000
	Married couple's allowance:	Minimum £3,530
	Older spouse born before 6 April 1935	Maximum £9,125
		Up to 10% of the appropiate Min/Max
Capital Gains Tax	Annual Exemption - Individuals	£12,300
	Basic Rate tax band (residential property)	18%
	Basic Rate tax band (other assets)	10%
	Higher Rate tax band (residential property)	28%
	Higher Rate tax band (other assets)	20%
	Business Asset Disposal Relief	10%
	Business Asset Disposal Relief limit of gains	£1,000,000
Inheritance Tax	Threshold up to £325,000	Nil
	Over £325,000	40%
Corporation Tax	Full Rate	19%
	Small Companies Rate (SCR)	19%

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