Summer
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market outlook.

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FINANCIAL AWARENESS

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contents.

The UK Economy

Over the quarter (May-July) the FTSE 100 gained 0.90%, the FTSE 250 (UK Mid-cap) returned 2.01%, whilst sterling also gained vs most major currencies. Relative to other global equity markets, the UK continues to trade at a discount and therefore remains attractive in relative terms.

As a service led economy, consumer confidence (and therefore spending) has a large influence on UK economic growth. The pace of vaccine deployment has enabled many restrictions to be relaxed and consumption to pick up, however, covid related isolation continues to weigh on the ability for the economy to fully reopen.

UK headline CPI inflation came in at 2.5% for year to June, the highest reading since 2018. This headline figure is largely influenced by categories mostly impacted by the reopening of the economy and so it is unlikely that current inflationary forces will remain elevated or influence policy maker decisions.

Over the coming months, as restrictions continue to be relaxed, many support measures will also be removed. Furlough will end, however, that will provide a much-needed boost to supply of labour, as with the economy reopening, there has been evidence of labour supply falling short of demand.

The Japanese Economy

One year delayed, rightly or wrongly the Japanese pressed ahead with the Olympics in July this year. This came in the face of public protests against the hosting of the event with over 70% of the population believing it should not go ahead. Whilst much of the decision was made by the International Olympic Committee, and whilst by enlarge spectators are banned from the events, this has weighed heavily on Prime Minister Yoshihide Suga's approval ratings, which have already come under pressure.

Even though Japan has seen a surge in the Delta variant of Coronavirus in recent months, seeing Tokyo declare a state of emergency, the vaccination programme has picked up seeing the majority of the elderly vaccinated and over a quarter of the population. With that in mind, as with other regions, it seems sensible to focus more on the mortality rate which has been slowly decreasing by enlarge.

Inflation continues to be elusive, with much of last quarter posting negative CPI data. With the current unprecedented stimulus levels designed to stimulate inflation, the lack of fiscal level polices remain, meaning wage inflation remains scarce. Whilst it is evident that Prime Minister Suga is less committed to the 'three arrows' stimulus programme than his predecessor, the threat of deflation prevents any talk of policy tapering.

Compressed market valuations driven largely by the resurgence in the virus and the countries liberal approach to lockdowns, in addition to a short term bounce in large-cap stocks earlier this year, has made the small and mid-cap end of the market arguably more attractive. With this end of the market largely under-researched and mispriced, opportunities are rife as the domestic economy slowly comes back on line as the pandemic subsides and consumption picks up.

The Emerging Markets & Asia Economy

When considering the current clarity of economic data, many of the Emerging Market and Asian regions are appearing attractive heading into 2022. With the majority of countries within these asset classes not having their data sets impeded by wage support schemes, the impact to unemployment, wage growth and inflation has already been factored into markets.

China continues to make headlines, which often causes fluctuations to markets in the asset class… but fluctuations are all that they appear to be, often presenting opportune entry points. For example, regulatory changes to the technology space that will see acquisitions of competitors constrained, in addition to restrictions on a company's ability to list and raise capital abroad, whilst initially appearing to limit the growth of the mega-cap names such as Alibaba and Tencent, over the long term are effective growth policies. As, a quasi-monopolies commission will breed grass roots growth, which in turn will breed idea generation, competition and consumption. China are looking to stimulate growth, with the mega cap names spearheading the charge, but regulation is arguably key to allow for this.

In terms of policy implementation, China has been flexing its muscles in recent months. We have seen a cut in the Reserve Rate Requirement, allowing banks to inject capital into the market to stimulate consumption. Whilst they kept their headline interest rates unchanged, the People's Bank of China made it clear that they had flexibility to adjust to prevailing market conditions. This focus on consumption within the Chinese domestic economy was echoed when they injected more metal supply from their reserves into the economy in order to reduce price pressures… however, they are set to impose a 20-25% export tariff on these commodities to ensure a Chinese competitive advantage.

The opportunity set in the Emerging Market and Asia regions remains strong, but we again emphasise that vigilance on a country to country basis is key. Whilst we see countries such as India as a strong investment opportunity due to domestic level policy stimulus driving growth following the pandemic, in addition to the ongoing success of their vaccination programme and tactical local lockdown programmes allowing business to continue to trade, there are countries to be weary of. Latin America remains a harbour for the pandemic with Mexico and Brazil remaining severely impacted, with little by way of mass immunity measures imposed. In addition, political turmoil remain prevalent in the South American region, with Brazil and Mexico both seeing a severe drop in their leaders approval ratings, introducing excess political instability for markets.

The US Economy

Despite volatility, largely surrounding the pandemic, the broader US market has been robust year to date. Whilst valuations are considered high when compared to historical averages, it must be remembered that it is also historically correct to say that breaking through 'all time highs' has been the modus operandi of US markets! To that end, the short term value stock reversion at the beginning of the year presented a buying opportunity at the growth end of the market. June and July have since seen a rapid and strong bounce in growth stocks, in sectors such as technology.

Like many other regions, there has been and is some uncertainty surrounding inflation. With inflation (consumer price index – CPI) coming in at 5.4% year on year in July, all eyes were on July's Federal Reserve (Fed) meeting. Fed Chairman, Jerome Powell, announced no change to policy leaving its bond purchases unchanged and interest rates at 0.25% at the upper bound. This was arguably positive for markets with Powell stating that any form of rate rise was not even discussed, and that significant progress was needed before it is even considered.

The accommodative stance of the Fed will likely be positive for markets as we head into September, with the US job support package for furloughed individuals being wound up. As, with inflation running higher than its 2% target, the Fed made it clear that they believe the levels of inflation are transitory, with spending likely driven by the temporary support packages. Come September, we will likely begin to see what true unemployment, wage growth, demand and inflation truly is… and with the runway for the take-off of policy tapering looking much longer than what the market is pricing in, there appears plenty of room for opportunity and market buoyancy! However, it is again the growth end of the market that stands to benefit, as the current long term monetary stimulus is appearing to again hold back a meaningful cyclical shift.

Economic and political frictions with China remain, but whilst a resolution does not seem likely anytime soon, and with China flexing their monetary policy muscles in addition to posturing their control over a number of commodity prices, amongst other things, the consistency of both parties approach to the economic fray introduces stability which is beneficial for businesses.

The European Economy

Valuations within continental Europe remain some of the most attractive globally, however the covid recovery plan remains arguably vaguer than that of its western world peers in that public support packages differ between member countries. Consequently, it could be thought that the Market is beginning to bake in some of this uncertainty, as it looks to the European Central Bank (ECB) for some stability and reassurance, with the majority of its 1.85 trillion support package yet to be allocated.

In July's ECB policy meeting, its president, Christine Lagarde, announced no significant changes to current monetary policy support, leaving headline interest rates at -0.5% and asset purchases unchanged. With the tone from Largarde being one of accommodative policy, and little to support the consideration of policy tapering anytime soon, this can be seen as a boon for markets.

Despite policy remaining unchanged, with inflation currently sat at 1.9% driven largely by "furlough" fuelled domestic demand, there remains uncertainty within the block of what true unemployment, wage growth and demand looks like. As job support schemes wind up and 'zombie employee' roles are extinguished, that is when we will likely see what the true demand is in the economy. The ECB echoed this when introducing an updated forward guidance policy in addition to announcing that they will allow inflation to overshoot its 2% target (within reason) given its transitory nature. Whilst uncertainty remains, the forward guidance stance appears enough to reassure markets as to the ECB's accommodative stance.

With negative rates likely to persist, and certainly be lower for much longer, a full rotation away from growth seems an age away, certainly with profitability in the banking sector drained by the low rate environment. Despite a short term value reversion in early 2021, growth has since come back strongly, something that looks likely to persist this year.

Fixed Interest

After an aggressive sell-off to start the year, government debt has largely recovered. However, at current levels, government bonds remain expensive and yields remain low.

Corporate bonds are also expensive, a large part of their pricing is based off government bonds, so while they have provided positive returns for the quarter, it does mean future returns are likely to be moderate.

Fixed income markets remain well supported by government and central bank policy, and companies are emerging from the pandemic with strong, and in many cases improving company finances. However, all of these positives are already widely acknowledged, and therefore unlikely to provide a catalyst for further gains.

Some areas of the market, that were not as directly targeted by central banks, do still offer relatively better value, however, we believe equities are likely to offer better returns in the medium term.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on **0800 049 2011,** Monday to Friday 9am-5pm or you can email us at **affinity.advise@wealthatwork.co.uk**

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