



**Singer**  
Capital Markets

# Global Equity Markets Report

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# AN INTRODUCTION

It started with a bang, at least in the UK, but then equity markets fell – Lockdown 3.0 – before they went on a strong run from the beginning of February all the way to the middle of June. The buzz words for global markets during the period were 'recovery', 'reflation', 'rotation' and 'value'. But then the Covid-19 wobbles returned as the more easily transmittable 'Delta' variant became the dominant strain. Markets are now worrying variously about the third (or is it the fourth?) wave of infections and whether we have seen the best of the recovery in growth. To be fair, many Asian countries are only now seeing what is effectively their 'first wave' due to previously successful containment policies.

Lockdowns were then, still, very much to the fore in the period with the UK entering 'Lockdown 3.0' on 6th January, but markets have been doing their job of looking through them and the focus has now turned, I would say, to three key factors:

- (1). Firstly, how well a country is managing its vaccination programme and the speed of that programme.
- (2). Secondly, Covid-19 variants with Delta, the current dominant strain.





(3). Thirdly, whilst the first half of 2021 can be categorised as the 'Half of the Upgrade', attention has now turned to "is that it?" **Have we seen the best of the bounce back in growth?**

A factor readers will have heard me talk on before that is the other delta that generally drives markets rather than the absolute. By that, I mean the 'rate of change', which will be a prevailing theme throughout this report.

In the 2020 Equity Market Report I wrote how economic recovery was likely to be H2 weighted. The UK has recovered a little earlier, as unlocking of the economy essentially kicked in from early March as children returned to school. The US locked down for a much shorter period than other nations, so recovery is more advanced there, with Europe out of the developed nations bringing up the rear. China and Asia, of course, led the recovery, but are now being challenged.

Sovereign bond yields behaved much as I expected for most of the period – i.e. yields rose – but then, starting in June, we saw the beginning of a rapid pull back in yields that has left, not just me, but many others scratching their heads for an explanation! By early July US 10 year yields were back to 1.2% having neared 1.8% in March. In the UK, the 10 year hit 0.9% in May before falling back to below 0.6%. That trend has been repeated globally.



Are the falls in yield because the rate of recovery in growth is seen to have peaked? The initial bounce back from restarting the global economy must, of course, slow to a more sustainable rate. Okay, the delta is a key driver of markets – here a declining rate of growth being the potential negative factor – but we are looking at an unprecedented period in global economic history. The global economy was essentially turned off and then turned back on again, just like the archetypal advice you may get from your IT department. "A perfect storm for the global economy" you may say. Restarting economies has led to some once in a generation, maybe once in a century, economic growth data points being reported! Of course, those rates cannot be maintained and growth must slow, but to what rate? The consensus forecast for 2021 global GDP growth has been upgraded from 4.9% in the last annual report to 6% now. The 2022 forecast has moved up from 3.7% to 4.5%. Growth prospects look solid and well above, for example, the UK long-term secular growth rate, which is put at around 2%.

The perfect storm of restarting the global economy has created a supply-demand storm, too. Freight rates have been catapulted higher with a global shortage of containers aggravated by them being stuck in the wrong place and a certain ship getting stuck in the Suez Canal –



all being factors that have contributed to this.

Ports have been impacted by Covid-19 restrictions, too. 'Just-in-time' supply chains are just that. Stop them and then start them all again at the same time and we are now seeing the resultant impact on the global economy. Chip shortages, concrete shortages, timber shortages and food ingredients are just a few areas where supplies are being constrained. If that was not occurring, you could argue the economic recovery would be stronger still. Commodity prices, both hard and soft, are well up year-to-date with only iron ore showing signs of any weakness on the back of China's actions to constrain steel production.

If supply is less than demand, then what does basic economics say? Prices will rise. That brings us on to the global inflation outlook.

As I had expected through the majority of H1, the global sovereign debt yield curves steepened on those concerns over inflation and the strength of the economic recovery. The fall back in yields, particularly at the long end, has meant that they have flattened again. So, you ask what of the inflation outlook? The Q4 2021 CPI forecast for the UK has moved up from 1.5% in December to 4% today and it is expected to be over 2.5% in 2022. In the US, the Q4 2021 forecast is for 4.3% and then for it to fall back to 2.2% in 2022.







Remember, the Fed and the Bank of England's targets are for 2%, although the US – and now Europe too – are post policy changes, happy for it to be above target for a period. Most recent readings for the US are June headline CPI at 5.4% and in the UK 2.5%, and continue to move higher, so markets are taking a lot on trust – particularly bond markets. They are buying into the Fed and other central bankers premise that inflation is 'transitory'. Wages will be the key driver of whether that is true. Job vacancy rates are elevated both in the UK and in the US and we are seeing many instances of wages being raised, some significantly so.

Time will tell if inflation is transitory or not, but it is likely, at the least, to remain elevated longer than markets expect. So we can't explain the fall back in yields on falling inflation expectations. In that case, it must be the delta on growth and the impact of the Delta variant.

Let us now turn to our usual journey around the world.

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# Asia-Pacific







China was first out of the pandemic and the first to start tightening policy back in March. It was the usual worries that drove that, namely property lending with Evergrande at the centre of market concerns and property prices. Despite that, GDP growth in Q2 accelerated on Q1. By the beginning of July they were taking 50 basis points off the bank's required Reserve Ratio, so perhaps back to easing. Of late they are attacking growth in their own particular anti-capitalist ways, but that may be something to discuss further in the full year report! Geopolitical rumbles continue between China and the West and even intra-AsiaPac with Australia and Taiwan, for example.

Much of Asia still remains isolated with borders locked. To date they have not really had a 'Covid wave' (excluding India) but are now seeing one more like those previously seen in the West, courtesy of the Delta variant. Their vaccination rates are well below those in Europe and North America and the race is now to get jabs in arms as quickly as possible so economies can open up again. Vaccination is key, it appears, to protect against serious illness and hospitalisation with the Delta variant, so this is a race they need to win.

Remember that Asia is in the 21st century, the industrial and production engine of the world, and so any hits to their production





(both of goods for consumer and industrial markets) could have a knock-on effect on growth in the West. The squeeze point is likely to be this Autumn and Christmas. Better buy those Christmas presents early, then! Time to mention inflation again. If goods are in short supply and demand is higher then, yes, prices are likely to rise. Further inflation pressures here.

New Zealand, as so often happens, looks to be at the forefront of measures to roll back QE with RBNZ tapering having started and the futures market forecasting interest rate rises in 2022, with the date of the first rise gradually being brought forward in the year. A similar picture is developing in Australia.



# Europe







H1 has not been an exemplary period for the major power block in Europe, namely the EU. A number of countries saw a double dip recession as the second wave of Covid-19 hit. Arguments over the supply of the vaccine and the safety of the AstraZeneca vaccine itself meant that vaccination programmes were held up both by lack of supply (with hindsight, the centralisation of purchasing was perhaps not the best idea) and distrust of vaccines themselves. Europe was catching up fast though on vaccination rates, as the half ended.

Equity markets took no notice of those vaccination rates and have been among the best performing in the world. Asset allocators look to have made the decision to buy the European block for its broad sector exposure with the Stoxx 600 ex-UK +13.4% in H1 against the FTSE 100 +8.9% although the UK Small Cap was +18.1%.

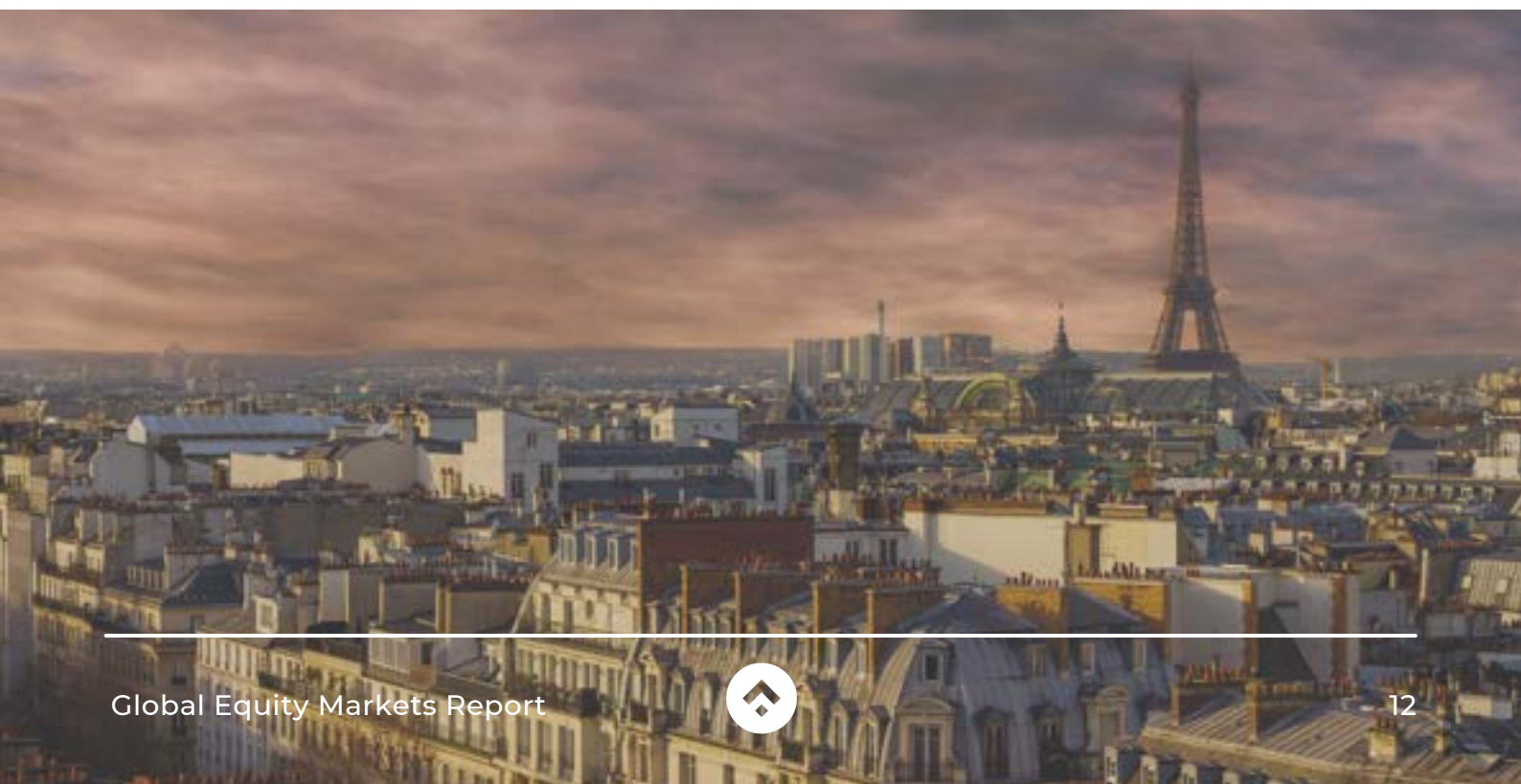
Of note was the European Central Bank's ('ECB') decision to ape the US Fed and move their inflation target from under 2% to 2% and also allowing it to remain above 2% for a period – so called 'symmetry targeting'.

The huge ECB Pandemic Recovery Fund is gradually being put to work, although it is fair to say that recovery will be pretty firmly



established by the time any of those monies 'go into the ground' as it were. That should help create an enduring recovery, so long as the monies are spent efficiently. There are absolutely no signs of the ECB reining back on stimulus measures in contrast to some other areas of the world.

The strains with the more Easterly countries in the EU, namely Poland and Hungary, continue to rumble and this needs to be watched. Germany without Merkel will soon be a reality and that will likely change the political dynamics within the EU. As you would think, France will make a big play for leadership.







# USA





Biden kicked off 2021 at a pace as most Presidents do at the start of their term, as they seek to take advantage of the 'honeymoon period' to enact policies. The wins in the post election Senate votes in Georgia gave the Democrats a precarious majority in the Senate – the Vice President has the casting vote – giving them the mechanisms to enact policy. First the enormous \$1.9 trillion fiscal Covid-19 relief Bill – equal to c.8% of 2021 GDP – was voted through in March, which included the extension of unemployment benefits. The \$15 minimum wage didn't make the cut, but a sizeable number of particularly larger companies have moved that way anyway. Like in the UK, the labour market in the US seems to have seen a change in its behaviour. There are large numbers of unfilled vacancies but a lack of candidates willing to fill them, even though unemployment rates remain relatively high.

Biden's \$2 trillion Infrastructure Plan, however, is struggling to get BiPartisan support and looks likely to see a significant cut in its size.

In the 2020 Year End edition we surmised that the Democrats, combined with Yellen as Treasury Secretary and Powell at the Fed, would mean that the economy would be 'run hot'.



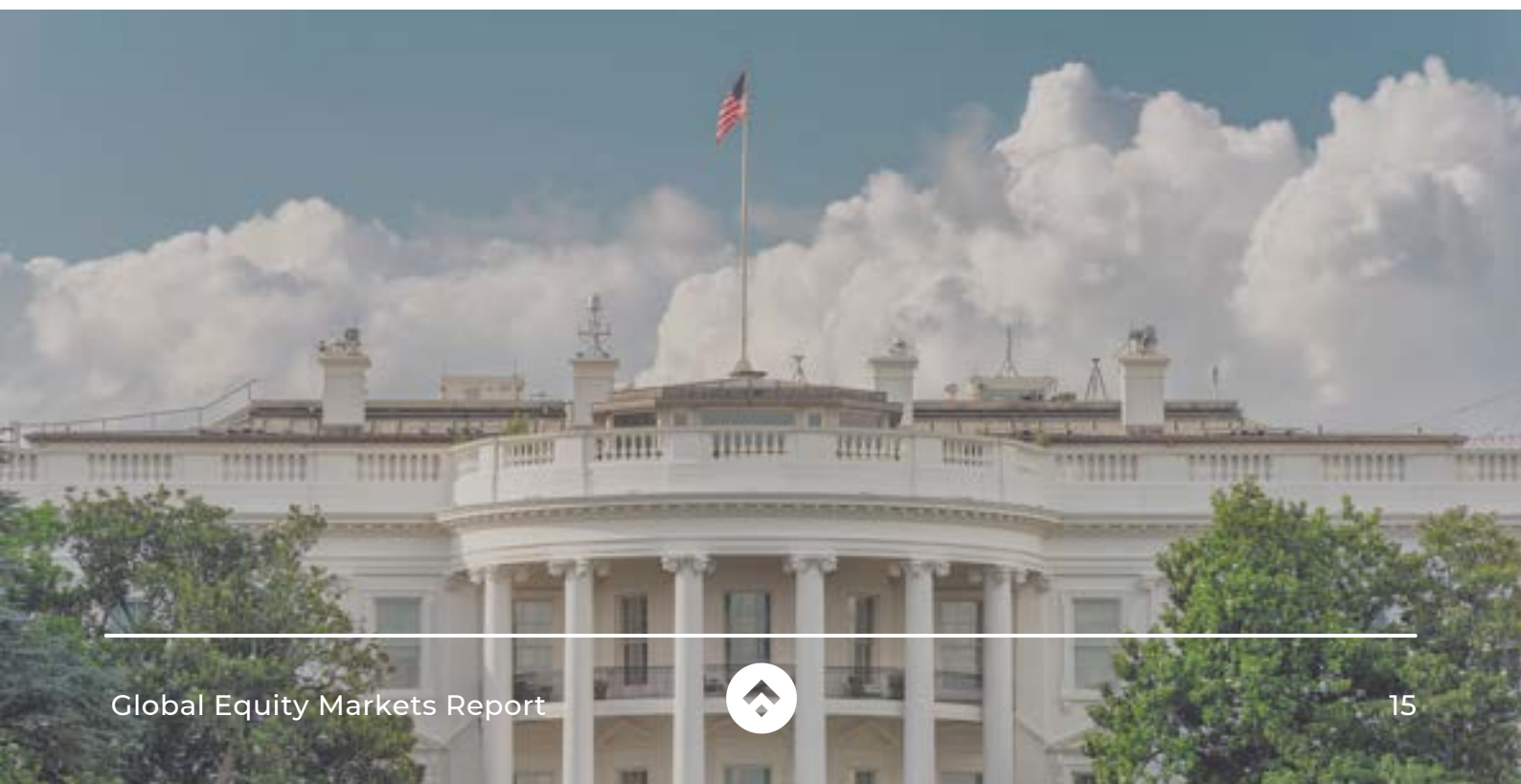


The growth bounce back has been strong, but maybe not quite so hot as I thought.

Q1 GDP growth in the US was 6.3% annualised and for Q2 6.5%, although it had been forecast to accelerate to 8.4%. Full year 2021 growth is forecast to be 6.5% followed by 4.2% for 2022. Only a small downgrade for 2021 at the moment then, and as we move through H2 the question is: "will the US growth outlook be impacted by the Delta variant?" I feel that would only be growth deferred, not lost.

Biden has been pretty successful with his vaccination plan, particularly in Democrat states. It is true to say, though, that the success of the vaccination programmes has split on bipartisan grounds. The Delta variant will provide a test of this. Watch the Southern states for any problems with hospitalisations.

What about Fed policy, then? Here, the focus has been for how long they will keep QE stimulus measures running and the often asked question "when will they start tapering QE?" No sign yet, despite inflation being way above their now 'symmetrical' 2% target. Looking to the North – Canada, which started to taper in October, is continuing to wind down QE. Maybe the Fed thinks if it keeps saying transient in relation to inflation, then it will come true.





The annual Jackson Hole Symposium in August is likely to drive much talk on for how long the 'free money' experiment can continue.

Looking at US equities, it doesn't matter what measure you use, they remain expensive globally and against their own historic valuation levels. If the US catches a cold then the rest of the world will likely, at least, sneeze! Company earnings upgrades though are all the rage and, as we entered the second half of the year, economic momentum remained strong.

But the dip remains the prevailing trend for the US equity market and the renaissance of the private investor has driven some wild market anomalies. "Only in the US", you may say!







UK





If the UK got one aspect of the pandemic right it was devolving the power to manage the vaccination strategy to what was, effectively, a body led by private sector management combining with the NHS to implement it. The result has been a world-leading rate of vaccination. This has, it appears, protected the country against the worst of the Delta-led third wave. As a result, the economy has gradually unlocked, starting in March with children going back to school – and hence freeing up parents – and then in April, with non-essential retail opening, and then in May with indoor hospitality allowed.

UK GDP thus fell by 1.5% in Q1 after the strong bounce in the second half of 2020. It is forecast to grow by 4.8% QoQ in Q2 and 7% for the full year 2021, followed by 5.5% in 2022. Growth like that brings pressures, though, and inflation measured by CPI is forecast to be 4% in Q4 2021 and still 2.54% in Q4 2022. As for the US, no sign yet of the Bank of England Monetary Policy Committee tapering QE bond borrowing. The Bank of England are following the Fed's mantra of transitory. If growth and inflation follow the forecast path, then I have to feel that tapering has to be imminent.

One side effect of the rapid rise in inflation is the rising cost to government of servicing their debt, which is (give or take) equivalent





to 100% of GDP. The coupon on inflation linked gilts rises with inflation and they make up about 25% of all gilts. No wonder the government are looking to change the reference inflation index from RPI to CPI. It is not just index-linked gilts that are pressuring government finances, it is pensions, too, and the 'triple-lock' promise to protect pensioners. The Autumn Budget is likely to see Sunak looking to rein back on the pandemic spending.

In H1 2021 the UK equity market has seen performance accelerate as you move down the size bands. The FTSE 100 rose by 8.9%, the FTSE 250 by 9.2% and Small Cap by 18.1%. As I outlined earlier, rotation and value were key drivers of stock performance as investors rotated out of the pandemic winners and into those stocks most likely to benefit from reopening and economic recovery. Many of those stocks could be classified as value stocks, given their valuations against the rest of the market.

M&A was a major feature in the UK in 2020 and that has continued in spades into 2021, with many of the aggressors being Private Equity firms. Q1 inward M&A into the UK was c.£58.7 billion, which is three times higher than Q1 2020 (i.e. pre-pandemic) and c.£87 billion for the whole of H1. Premiums being paid seem to be compounding higher with the latest, a potential 70% premium for Meggitt if that deal proves to be successful. The old 30% takeover premium adage now



appears to be a new 40-50%!

No wonder, though, with the UK equity market continuing to trade at a substantial discount to other global markets. Yes, I did say the same at the end of 2020! It is on a c.30% discount to Continental Europe, for example, and of course even more to the US. After that initial burst of buying of the UK, as asset allocators closed their UK underweight positions on Brexit finally completing – my that seems a lifetime ago – interest in the UK seems to have waned. Is that because bond yields have fallen and yield curves flattened decreasing the attractiveness of financials that make up a large part of the FTSE 100? Further, back to the delta (change not variant) and could the slowing rate of growth reduce the attractiveness of resources stocks? Cost inflation is squeezing those international staples like Unilever. Better stick with those mid and small caps, then.

IPO's and secondary market fundraises have been a major feature of 2021 to date. The money from takeovers has thus been reinjected back into markets. Activity has picked up to a level not seen for a few years. Activity became almost a frenzy in early summer as monies were also raised by existing listed companies, many for acquisitions. It appears that company executives have used the lockdown to build their M&A

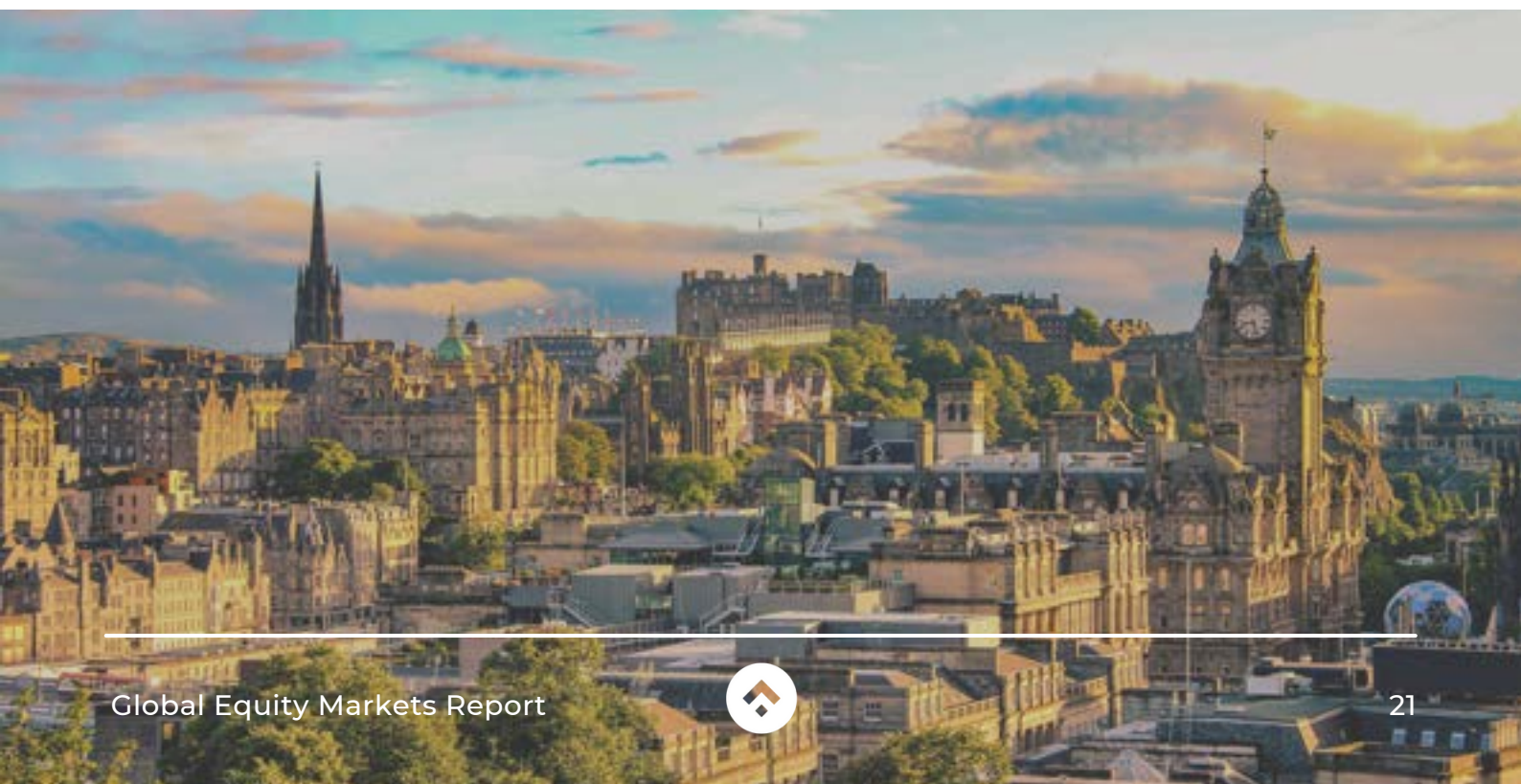


target pipelines and now confidence has returned, buttons on deals are being pushed.

What then for the second half of 2021 in the UK? More of the same, I feel. Expect economic activity to continue to hit levels not seen in the UK for a long time. Inflation will remain elevated and the key question remains "will that translate into wages?" There are initial signs it is. The UK labour market has seen the perfect storm of Brexit and the pandemic and, like the US, there appears to have been, at least a temporary, shrinkage in the labour pool. Any potential issues on the horizon? Well, there is the level of government debt as discussed above. The furlough scheme shortly comes to an end and what will that mean for unemployment? That seems to be the only potential blot on the horizon with respect to the recovery of the UK economy. The large number of unfilled job vacancies appears to mitigate against this being an issue, though.

Consumer 'lockdown' savings remain huge with the total revised up a number of times since the 2020 report. The total now appears to be close to £200 billion! Mortgage rates are at generational lows again with widespread availability, too – but to what effect?

The potential challenge for the UK – and for the rest of the world – could well be when, if ever, the 'free money' heroin is withdrawn.







To finish on some “P’s”. Not the 5 of Marketing text books but some key ones as we move through the rest of 2021.

## **PRICING POWER**

Prices of inputs are rising across the board in most industries, whether it is goods or services, with wages starting to show signs of rising, too. The companies who will be the winners are those with the pricing power to be able to pass those costs on. For many, this may be a brave new world with many of their employees not ever having to have had those types of conversations with their customers before. The equity market is likely to become increasingly discriminatory between the winners who can protect their margins and those who see them being squeezed.

## **PROPERTY**

The reopening of economies has driven some exceptional growth in domestic property prices. From China, to New Zealand, to Australia, to Canada, to the US and of course the UK; the picture is remarkably consistent. Year-on-year increases are well into double digits. A result of the huge stimuli applied to economies globally and the support for



workforces and their 'enforced' savings during lockdowns now being released into property markets. There has also been a work from home ('WFH') effect. Add those factors to the continuation of interest rates at generational lows, and we have a potent combination. Housing costs are not typically included in countries' inflation measures, although the ECB is looking at how they may do it. The increases do have the potential to be a destabilising impact on economies, though, and on social mobility and inequality.

## **PURCHASING MANAGERS' INDICES (PMI'S)**

They may be off the highs they reached as economies reopened – some of those readings were not surprisingly all time highs – but they are still signalling a robust level of growth in most of the developed world. Remember, too, they are designed to be assessing the growth rate and prospects for the next 6 months or so. Asia is, not surprisingly, seeing a bit more pressure as the Delta variant spreads, so (given the importance of these economies to the global economy) a close eye needs to be kept on their readings.

As I said earlier, the stopping and starting of the global economy will drive some exceptional economic data readings that it is mathematically impossible to maintain. The key is the rate that growth settles back down to. Markets are currently questioning valuations whilst there is this uncertainty.





## PARALYSIS

Finally, the usual mechanism seen in a financial crisis – 2008-2009 – and now the pandemic is that events such as these lead to a shake out of the corporate world and insolvencies, but this mechanism remains paralysed. Governments seem to not want to see companies going bust anymore, with insolvencies remaining at record lows despite the pandemic! They did not rise after the financial crisis either. Why do I mention this, you say? Surely it is good to keep people in jobs?

Of course it is, but not to the detriment of the overall economy. Businesses being run for cash in hock to the banks are no good for anyone. They drive down the rates of return for everyone and, more importantly, drive down the potential return on any investment (i.e. capital investment). If we are to see productivity rise, then I am afraid we need to have some 'casualties' of capitalism.







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