6-Month Market Review

(as at June 30, 2021)

Overview

Stock markets extended their gains over the quarter as global policymakers continued to support economic growth. The easing of lockdown restrictions, the vaccine rollout and a plethora of stimulus programs have all buoyed hopes for a sustained global economic recovery.

In response, the US Federal Reserve recently raised its forecast for the rate at which the US economy will grow this year from 6.5 percent to 7 percent.

Business volumes in the US and across Europe have bounced back strongly, creating supply shortages and price increases. A recent IHS Markit (purchasing managers) report showed that Eurozone business activity expanded at its fastest rate in 15 years in June and that UK business activity was also very strong.

EQUITIES

The MSCI All Country World Index rose 7.4 percent over the quarter, bringing its gains to 12.3 percent over the first half of the year. Both, the US and the European equity markets, gained around 15 percent since the start of the year, with the S&P 500 Index and the Bloomberg European 500 Index rising by 8.5 and 6.4 percent respectively during the second quarter alone.

Data provider FactSet reports that analysts are forecasting double-digit earnings growth over the remaining three quarters of 2021 for companies in the S&P 500. The positive sentiment has been supported so far this year by higher-than-expected reported earnings.

The extent of this profit growth is due in part to being measured against a low base that is, compared to the low earnings of last year amid lockdowns. Thus, earnings growth, in percentage terms at least, may peak in the current quarter.

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BONDS

The downside of the surge in economic growth is that it has been accompanied by a rise in inflation. The US Consumer Price Index (CPI) reported a year-on-year growth rate of 5 percent for May, easily surpassing the 3.3 percent average for the OECD countries.

The world's major central banks quelled investor concerns by reassuring them that the recent rise in consumer prices is temporary. Stocks responded positively to this.

For fixed income instruments however, inflation represents a far more serious issue. Income from a bond typically does not vary. It pays a stream of fixed cash amounts over its life, the value of which diminishes in real terms (i.e. after inflation is taken into account) over time.

A recent survey by Bank of America found that the outlook for inflation was the reason bond investors were most worried about. The survey commented that "the 40 percent (year-on-year) rise in global food prices" risked "ushering in higher policy uncertainty".

The Bloomberg Barclays US Aggregate Bond Index fell by nearly 2 percent since the start of the year. The decline illustrates that inflation has a negative impact on bonds, but the fact that the decline was so minor shows that the bond market agrees that higher inflation is indeed likely to be temporary.

OUTLOOK

This sentiment seems reasonable. Higher inflation has been caused by issues such as supply bottlenecks and strong levels of demand driven by temporary factors.

Current inflation dynamics are unlikely to prevent global policymakers from coming to the rescue if need be. Lockdowns can release all manner of carnage into the economy but governments and central bankers are both willing to, and, for the moment at least, capable of preventing this from causing a market crash.

Nevertheless, uncertainty remains. For example, the basis of much of the optimism lies in the success of the vaccines. But we've recently seen some nations with very high vaccination rates – such as the UK and Israel – experience rising COVID rates due to the Delta variant. If data were to show that the vaccines are relatively ineffective against the Delta, or indeed any future variant, and if it were to call the vaccines into question, then this could have the potential to cause another panic.