James Ryan Thornhill

Fairstone

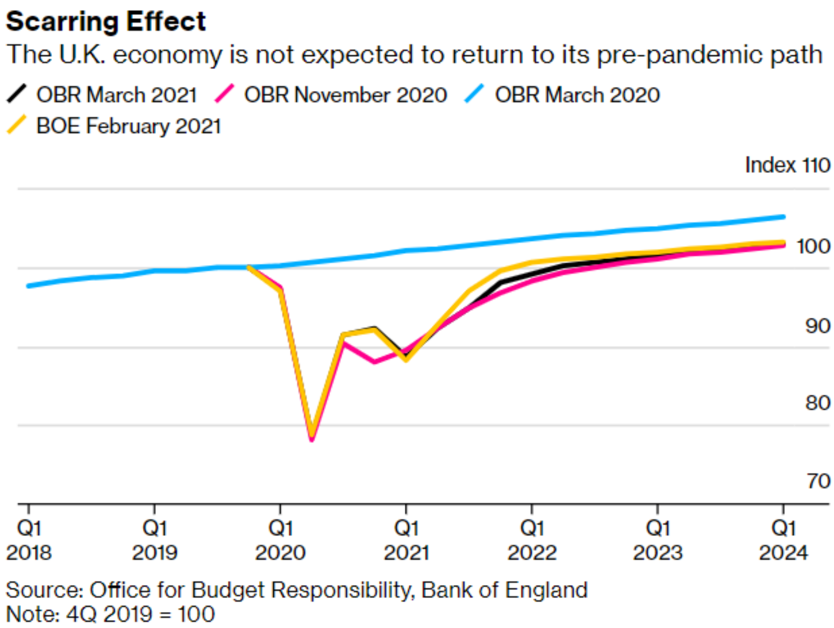
Market Update

15 March 2021

The UK's monthly GDP outturn for January was released last week which showed a better than expected drop of 2.9%, versus a consensus expectation of -4.9%. This was driven by a surprise gain in construction and stronger activity in the health sector.

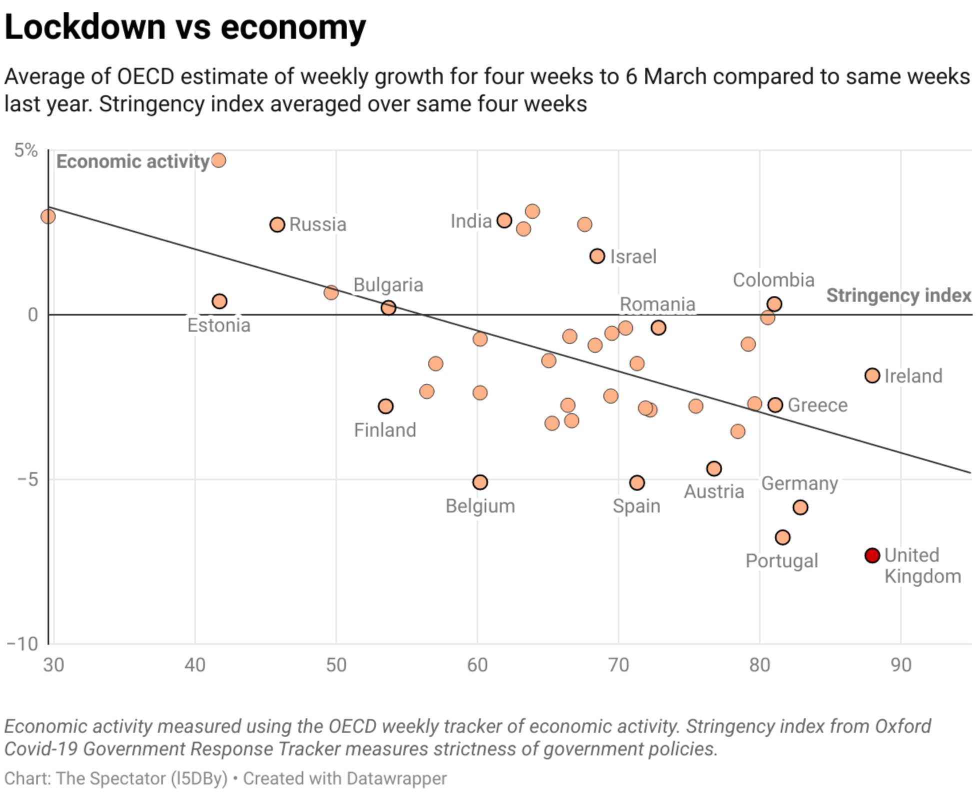
The data indicate that the UK's successful vaccination roll-out is helping somewhat to bolster the economy, in addition to providing optimism that restrictions will be lifted by the middle of the year. Trade proved a significant drag on the economy in a disrupted first month of post-Brexit commerce. Exports to the EU fell by more than 40% from December 2020 to January, while imports fell by nearly 29%, though timelier surveys and indicators suggest that normality was returning by the end of the month.

January may well mark the low point in this most recent negative cycle, with the economy likely to now pick up as restrictions are removed, albeit very slowly. The Office for Budget Responsibility forecasts a 3.8% drop in output this quarter, then followed by a rapid recovery to pre-Covid levels in the second quarter of 2022, though the Bank of England (BoE) is more upbeat in predicting a return to end-2019 levels by the start of 2022 as the first chart below shows:



This will all feed into the BoE's monthly Monetary Policy Committee meeting this week as to whether additional stimulus is required; counterparts at the European Central Bank last week were non-committal on the need for increased, explicit rescue packages.

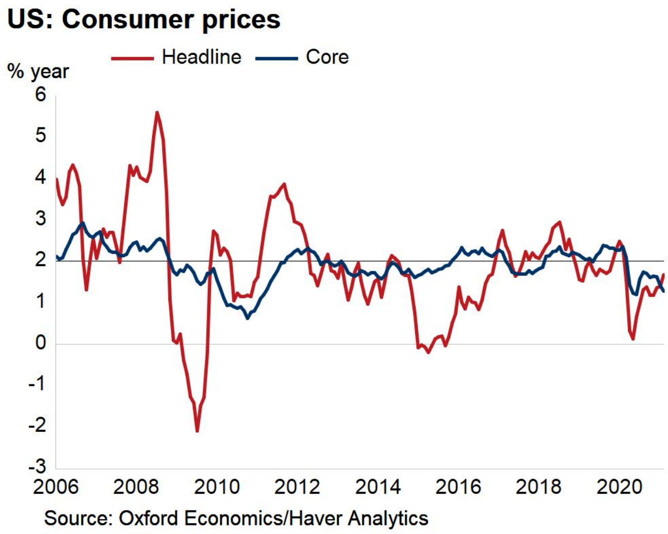
For now, the UK remains in an extremely harsh lockdown relative to other countries, and experiences commensurately poor economic growth, as the second chart below shows in plotting the Oxford University lockdown stringency index versus the OECD's estimate of year-on-year GDP growth. As of last week, the UK has the second-lowest level of Covid infections in Europe, and an already-high level of inoculation, making the political decision to continue along such a slow path to normalisation difficult to explain:



Economic activity measured using the OECD weekly tracker of economic activity. Stringency index from Oxford Covid-19 Government Response Tracker measures strictness of government policies.

Chart: The Spectator (I5DBy) • Created with Datawrapper

As flagged in last week's note, US inflation data were released last week that showed a modest year-on-year increase in the headline rate of CPI, rising from 1.4% in January to 1.7% in February, with energy prices particularly contributing:



From March, year-on-year inflation data should start to concertedly rise as the 'base effect' starts to kick in due to last year's Covid crash. While this much is known, what is less certain is how persistent higher inflation will prove to be; an important consideration given its impact on financial markets. With economies reopening, a progressive acceleration in job creation and the prospective deployment of accumulated excess household savings, inflation could remain above 2% for an extended period.

With this in mind, US government bond yields pushed higher again over the week, with the 10-year benchmark reaching 1.64% on Friday, while inflation expectations over the same time horizon rose to 2.30%; a level not reached since early 2014.

These moves weighed on some of the most expensive technology stocks but in aggregate we saw strong positive moves for equities over the week, with European (3.20%), UK and US (2.13%) indices leading the way, ahead of Asian and broader Emerging Market indices which saw low or negative returns. Asian equities proved worst with a 0.4% return, suffering as Tencent became the latest company to be targeted by the Chinese authorities on antitrust grounds, following in Alibaba's footsteps.

Bond indices unsurprisingly were largely negative for the week, with UK Gilts falling by 0.26% and inflation-linked Gilts by 0.33%, driven by the same negative forces as in the US. Gold and silver prices gained 0.70% and 1.92% respectively, though both remain in a consolidatory trend.

For now, inflationary signs are showing up in a diverse range of areas such as food and industrial metal prices, semiconductor chips and shipping costs, driven by combinations of supply and demand dynamics and supply chain bottlenecks. Though it already seems like the consensus, these shifts are still yet to play out in the coming months and will have yet-unforeseen impacts on prices, meaning diversification will remain crucial.

Oliver Stone

Head of Portfolio Management

The value of investments may fluctuate in price or value and you may get back less than the amount originally invested. Past performance is not a guide to the future. The views expressed in this publication represent those of the author and do not constitute financial advice.