James Ryan Thornhill

Fairstone

Market Update

22 February 2021

With markets closed for Presidents' Day on Monday 15th February, the US had a shortened trading week, which ended in negative territory. The technology heavy Nasdaq index closed down -1.20%, in local currency terms, as rising long-term interest rates weighed on future earnings expectations of the large growth stocks. In contrast, the positive effect that rising rates would have on the balance sheets of financials led to relative outperformance of value shares. Higher than expected initial jobless claims in the region dampened sentiment, with the broader S&P 500 index closing at -0.69%. European markets fared little better, with the Euro STOXX 50 and Germany's DAX index ending the week at -0.38% and -1.16%, respectively. In the UK, the FTSE 100 posted gains.

Despite Chinese markets being closed Monday through Wednesday for the tail end of the Lunar New Year holiday, indices in the region generally ended Friday on positive ground. Usually, this time of year would see migrant workers return to their villages to celebrate the festival, but with the Government urging people not to travel, consumer spending patterns have been very different – with retail spending vastly increased, and travel expenditure reduced.

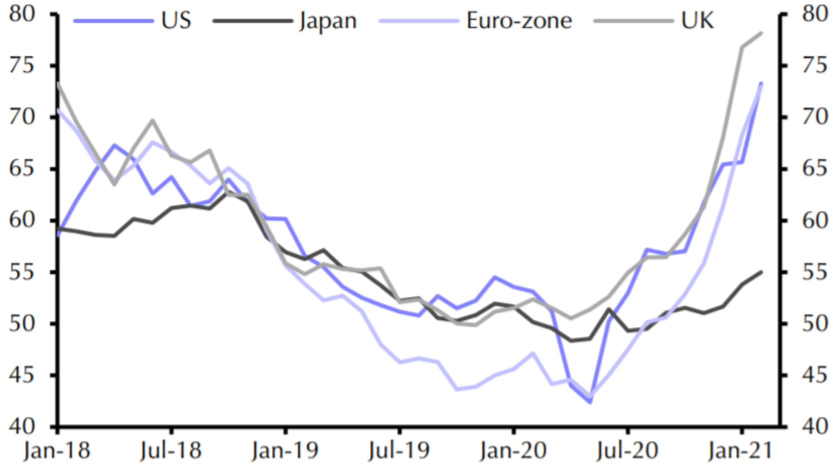
In Japan, fourth quarter GDP figures beat expectations with 3% quarter on quarter growth, boosting equity markets and leading the Nikkei 225 to end the week up 1.69%.

UK CPI data show inflation rose at a rate of 0.7% in the 12 months to January, up 0.1% from the December figure, and above consensus expectations. At the same time, the US saw the largest increase in producer prices since 2009, an indication of mounting inflation at the wholesale level.

Signs of nascent rising inflation are pushing up bond yields across the board, with that of the US ten-year Treasury note hitting its highest level in almost a year. Prices of the ten-year gilt, ten-year German bund and ten-year Japanese government bond all saw week on week falls (bond prices and yields move in opposite directions), with the latter reaching its lowest level since late 2018.

Rising prices are also being seen through 'flash' Purchasing Managers' Index (PMI) data, which reflects broad business sentiment. While the aggregate developed market data for February show a small increase in outlook, figures remain below the threshold for expansion in the euro-zone, Japan and UK, indicating output is still relatively weak. Further, survey data collected suggest that input prices caused by shipping constraints and supply issues are continuing to push up manufacturing costs.

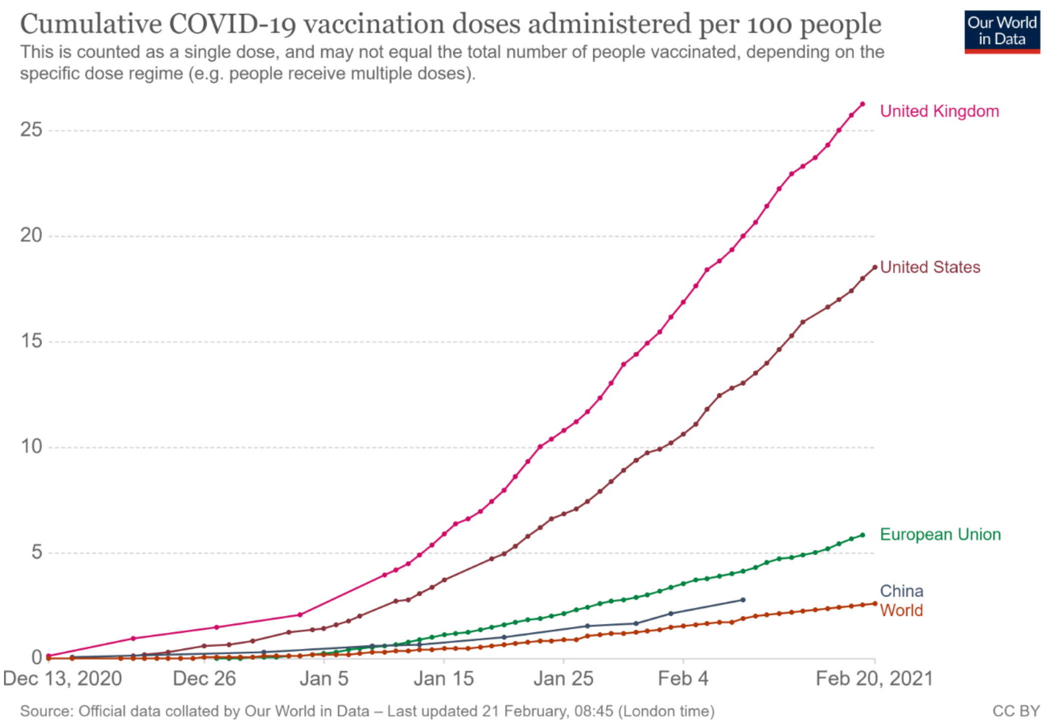
Chart 4: Manufacturing PMI: Input Price Indices



Sources: IHS Markit, Capital Economics

In currency markets we are seeing some positive moves in Sterling. Rising real yields in the UK, relative to the US, as well as growing clarity around Brexit are providing tailwinds for the pound, which on Friday, hit its highest level versus the dollar in nearly three years.

On the whole, economic data continues to be driven by Coronavirus and policy level reaction to it. The latest UK lockdown has led retail sales in the region to fall 8.2% from December to January, a figure that is 5.7% lower than expectations, while UK government debt has risen to 98% of national income.



Thankfully, there are still reasons to be optimistic. Vaccine news coming out of the UK is increasingly positive, with Matt Hancock confirming that one in three adults in the UK have now had a vaccine and Boris Johnson announcing that every adult in the nation will have been offered a vaccination by the end of July. These factors are no doubt going to be key inputs to the timeline out of lockdown that is due to be presented by the Prime Minister on Monday 22nd February. Early reports continue to indicate a "cautious but irreversible" easing of current restrictions, with school re-openings; care home visits; and one-on-one socialising outdoors, expected to mark the first of a four-stage plan back to normality.

Turning to efficacy, data being reported from Israel indicates that two doses of the Pfizer/BioNTech vaccine are 98.7% effective in preventing severe cases of the virus, and 89.4% effective at stopping transmission. There remain questions from a number of European nations around side effects associated with the Oxford/AstraZeneca inoculation and its efficacy in the older age groups, albeit these appear to be driven primarily by insufficient data volumes. The UK retains full confidence in the vaccine.

On the global stage, a G-7 meeting on Friday saw nations begin to increase their commitments to COVAX, the global scheme designed to ensure low-income nations have sufficient access to Covid-19 vaccinations. The UK has pledged to donate surplus vaccinations to the scheme, while French President, Emmanuel Macron proposed sending 5% of the European stock. Joe Biden has provided an immediate donation of $2bn to the effort, with a further $2bn available over the next few years. The global vaccine effort is going to be key when it comes to re-opening borders, so is something we need to keep a close eye on as the year progresses.

Imogen Hambly

Portfolio Manager

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