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Market Update

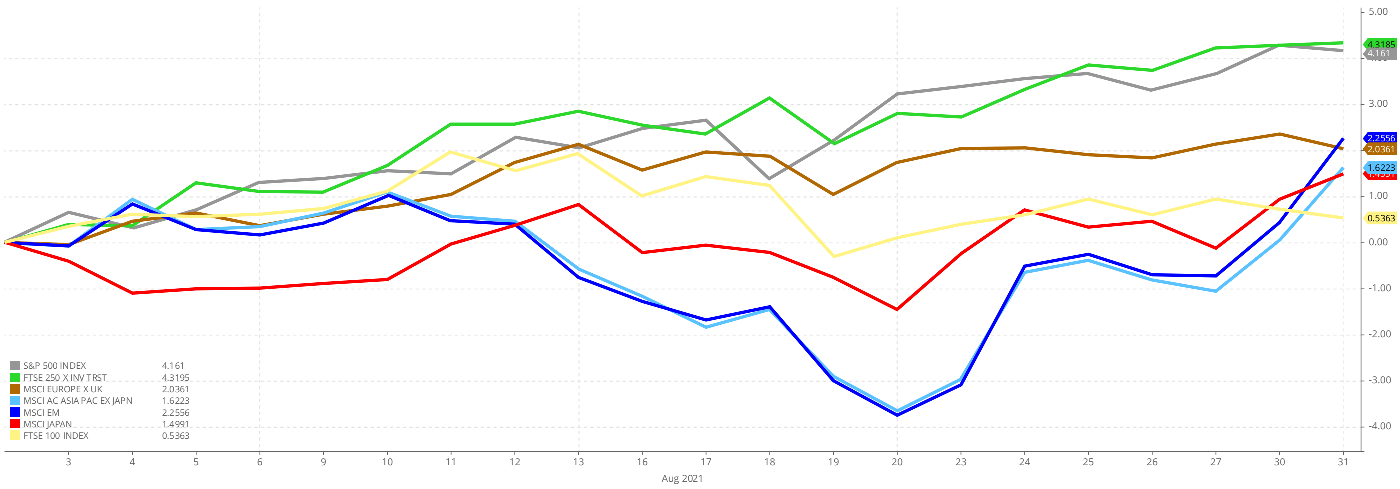
Monthly Round up August 2021

Summary

- Developed markets outperform Emerging, though the latter have started to catch up.
- Chinese regulatory action continues to drive Asian equity narrative.
- With sharp falls seen however, the region now looks more attractive.
- US jobs numbers disappointed, complicating the picture for monetary policy.
- Growth still positive, but more uncertainty now exists.

Developed market equity indices rose the most again through August, led in Pound terms by the UK's mid-cap FTSE 250 index and the US S&P 500, with relative gains versus Japanese, Asian and broader Emerging Market equities made in the first half of the month.

As the chart below shows, those latter indices rallied strongly into the end of August to register positive overall returns; a trend that has continued into the first week of September, breaking a series of lacklustre months:



The recent gains in Asia come despite a sharply more hawkish regulatory landscape in China, covered previously in last month's note. Crackdowns have been seen across a wide swathe of sectors, from for-profit education to music streaming, with Chinese President Xi Jinping continuing to make headlines over the last couple of weeks:

Tech Trauma
A crackdown from regulators has hammered China's tech stocks

Source: NASDAQ Golden Dragon China Index via Bloomberg

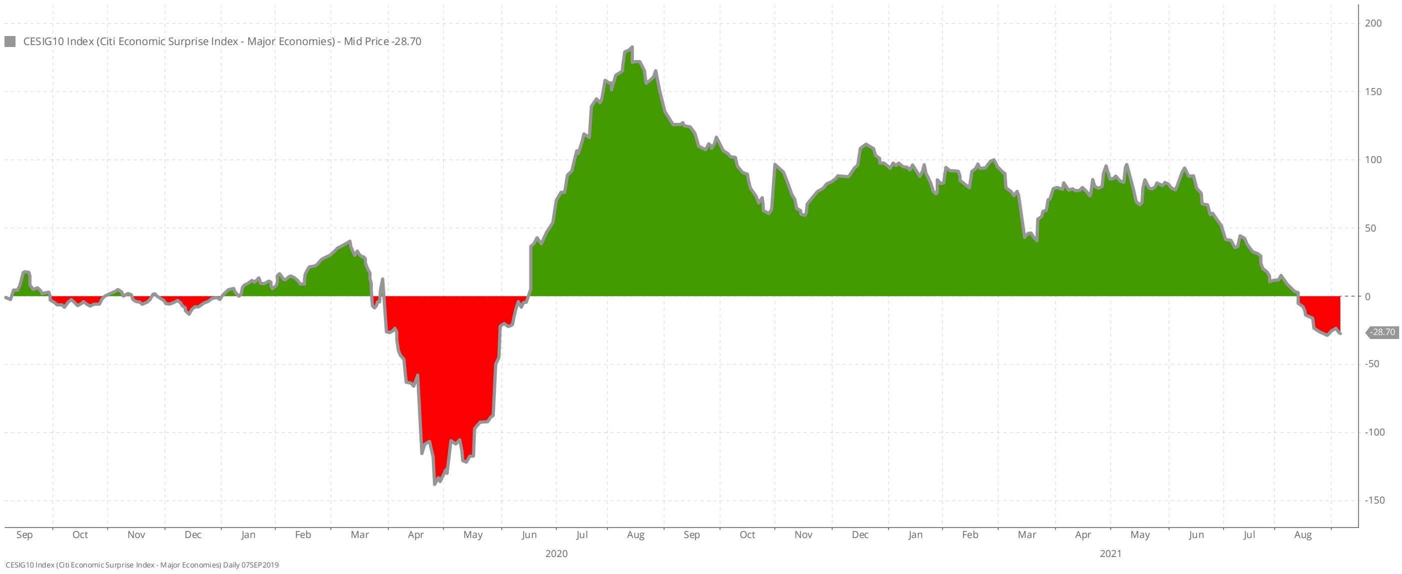
Further pronouncements were made against ride hailing services run by tech giants Didi Global, Meituan and Alibaba, criticising them for disrupting fair competition and hurting the interests of drivers and passengers. Regulators highlighted violations including recruiting unlicensed drivers and the need to strengthen user data protections and ordered these companies to rectify instances of misconduct by December 2021.

While moves like these can be seen in a somewhat positive light of trying to improve the welfare of millions of low-wage workers under a banner of 'common prosperity', other interferences into media and entertainment have a more insidious feel to them, with President Xi also ordering sweeping action to ban film stars with 'incorrect' politics, cap salaries and rein in celebrity fan culture. Children under the age of 18 will also be limited to three hours of video games per week.

Commentators see the last few months as being part of a geostrategic move from President Xi aiming to ensure that the younger generation turns into motivated, patriotic and productive workers, and encouraging them to seek jobs outside of white-collar roles. This has the ultimate aim of upgrading China's advanced manufacturing base to achieve core technological breakthroughs that will allow them to end any remaining dependencies on the US and other nations for crucial industrial components.

The market impact has been overwhelmingly negative, but as the last month shows, relative fortunes may now be turning, with some of the biggest Chinese tech stocks having seen near-50% drawdowns from their peaks. While there may be more adverse news flow to come, equities have shown a greater resilience to government announcements in recent weeks, with valuations across the space now much more attractive than earlier in the year. After such sharp falls, prominent government ministers have also been at pains to reassure investors that private businesses will remain well supported, and that property and intellectual property rights will be protected, while fiscal and monetary policy seems to be easing again.

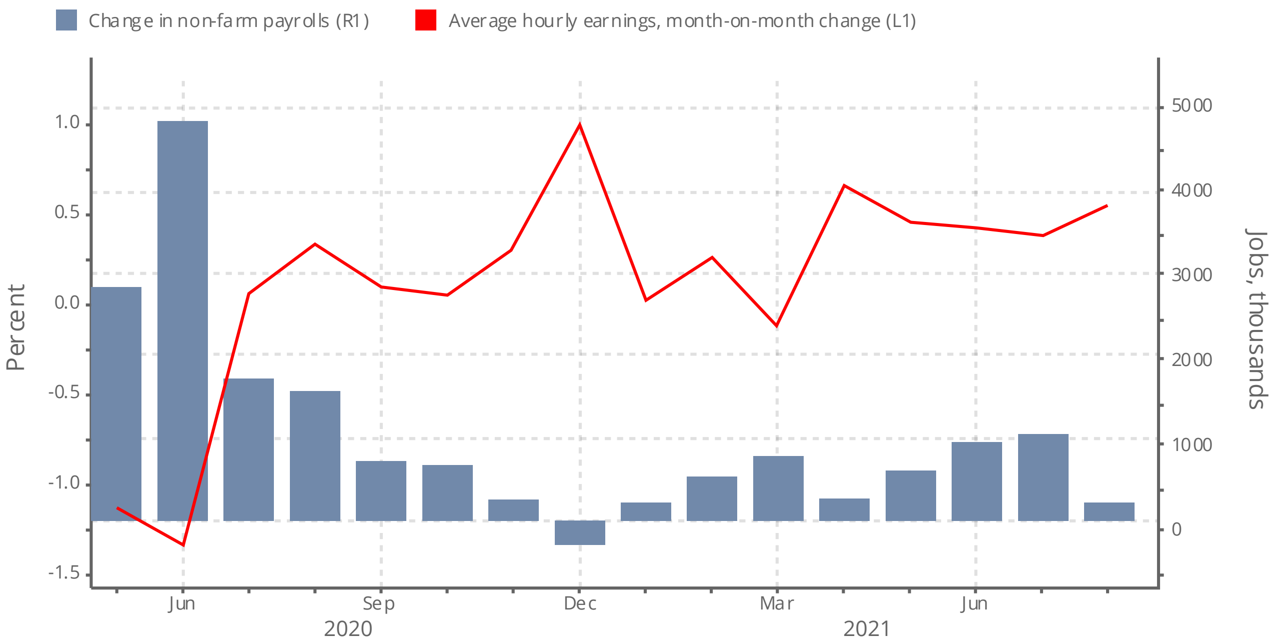
This leaves us with a relatively positive outlook on the region as growth remains solid, particularly as macroeconomic data points in developed market economies are now starting to disappoint relative to lofty expectations, as the chart below shows in looking at Citi's Macroeconomic Surprise Index for major economies:



On this note, the US added fewer jobs than expected in August at c.235,000 per the chart below – the smallest jobs gain in seven months and further complicating a potential decision by the US Federal Reserve to begin tapering monetary support by the end of 2021. Leisure and hospitality employment was notably flat, reportedly affected by Covid and a continuation of hiring challenges. Some analysts have now downgraded their Q3 2021 GDP growth estimates for the US on the back of these and other weaker data, with the likes of Oxford Economics forecasting just 2.7% annualised, down from 6.5% last month:

Few Jobs Added, High Wages

The U.S. added fewer workers in August, yet wages rise quickly



Source: Bloomberg, Bureau of Labor Statistics

US payrolls are still 5.3m below their pre-pandemic level despite many employers both large and small offering significant incentives to lure workers back to jobs. Wage growth remains robust as the chart above also shows, but the attraction and retention of employees remains a challenge. Most recently, Amazon has raised wages and offered one-time bonuses to prospective candidates, while Kohl's Corp announced bonuses of up to $400 for workers who stay with the department store operator for the whole holiday season.

On balance this points to a higher probability of current stimulus measures continuing, which has to date been positive for risk assets. But if the taps are open for too long, with rising wage costs and unabated supply chain disruption, we could see more persistent inflation, along with higher government bond yields and a resumption of more cyclical equity market leadership.

As before, though we see global growth remaining solid through 2021, there are risks to the downside, with those now becoming apparent in the US. In this uncertain environment we seek to ensure that our portfolios are well diversified by geography and strategy, with exposures to multiple themes, including hedges should the status-quo in markets shift in a different direction.

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