Market News 04-10-2021

Two weeks ago today global markets were rocked by the news that Evergrande, the Chinese mega-property developer, was close to going bust and unable to pay its bondholders. The company's stock, listed on the HK stock exchange was suspended today pending an announcement. Another rival to Evergrande, Hopson development, is rumoured to be buying a 51% stake in Evergrande Real Estate – one of Evergrande's subsidiaries. The deal may just be enough to see it out of this mess in the short term.

The Hang Seng index however was over 2% lower before the announcement and ended the day 2.25% lower by the close.

US markets endured their worst week since late February and their worst month since the start of the pandemic in March 2020.

The reasons are two-fold albeit closely related. Persistent inflation, as opposed to the forecast transient inflation and slowing economic growth are the two main concerns, which is not just a US issue; last week's Chinese manufacturing PMI data came in at 49.6, the lowest level since the height of the pandemic in February 2020, suggesting a more marked slowdown.

The same angst is being felt in the US treasury market (US sovereign bonds) where the yield on the bell-weather 10-year bond climbed to 1.46% from 1.3% the previous week.

The FT reports that fund managers are the most short they have been of the 10-year treasury market since September 2016. i.e., they are expecting the market to fall as the FED looks ready to start the tightening cycle by commencing the tapering of QE in at November's FOMC meeting.

Normally when stock markets come off, bond markets perform well but, in this case, shares are coming off because the Fed is about to embark on this tapering which is also negative for bonds. So, shares and bonds were hit last week which is not great for investors and does not bode will for markets in general if inflations does turn out to be more than transitory.

Explainer: Why do bonds fall when interest rates rise.

When interest rates are on the rise, bonds tend to fall as they carry a **fixed coupon** or **annual interest**.

So, when competing interest rates rise (i.e. when savings rates for example rise), bonds that offer a lower interest rate fall in price so that the actual price of the bond plus the annual coupon equates to a **higher return** or higher **yield**. That's why bonds fall when interest rates go up and vice versa.

Review

FTSE -24 -0.35% DOW -471 -3.2% S&P -98 -2.2% NASDQ -481 -3.2%
DAX -375 -2.42% NIKKEI -1477 -4.89% Hang Seng +383 +1.59%

Despite US market jumping last Friday US indices struggled last week. Consumer confidence numbers painted a less rosy picture last week which sums up the market's mood. The FTSE was slightly insulated from the global falls as weakness in Sterling softened some of the falls.

The Nikkei fell again last week as the buy on rumour rally was replaced by sell on fact as the new prime minister was announced.

EURUSD -1.28 -1.09% GBPUSD -1.76 -1.28% USDJPY +0.32 +0.28%

The Dollar continues to rally as the market speculated about the end of the QE era and the start of the tightening cycle. We refer to the start of the tightening cycle because when / if the FED do start to taper the emergency QE at their November meeting, then interest rates will start to rise, and the amount of new money starts to slow up and stop.

Sterling fell sharply at one-point last week as investors worried about the effects of Brexit, supply bottle necks such as fuel shortages and a potential interest rate rise. Odd reaction in some respects as you would expect Sterling to do well if interest were to rise in the UK before the year end as the BoE warned. That would put the cat amongst the pigeons!

Gold +10 +0.57%   UK OIL +1.1 +1.4%   US OIL +1.76 +2.38%

As discussed last week, the natural gas shortage has started to spill over into the crude market. The supply side remains tight which will limit pull backs…. unless the Biden administration can pressure the Saudis enough to increase production at this week's OPEC+ meeting in Vienna.

Gold is torn between the inflation outlook and the stronger US Dollar. Last week's key reversal needs more follow through. Perhaps this week's NFP might provide that catalyst.

Data / Events this week

Important week for the markets with inflation very much in investors minds. The key employment release this Friday will be pivotal in confirming whether the FED start tapering in the next FOMC meeting on 3rd November.

Monday

China "National Day" celebrations. Referred to as national Day Golden week as the markets remain closed nearly all week for a weeklong public holiday.

OPEC Major OPEC+ meeting in Vienna as the cartel meet to discuss possible production increases to alleviate the tight supplies. The Biden administration has heaped pressure on Saudi Arabia to increase production. Last week Goldman Sachs increased its year end target to $90 from $80.

Tuesday

Australia RBA policy meeting. No change expected despite record house price growth but pandemic uncertain make any change unlikely.

Wednesday

New Zealand Expectations a week ago was that the RBNZ would raise rates, but those expectations have eased slightly so it is not a definite.

US ADP non-farm employment change. Volatile and not a reliable indicator to the official data from the bureau of Labor statistics numbers on Friday.

Thursday

Nothing to report

Friday

US Non-farm employment change. -or NFP for short. A key release for investors.

NFP – 490k expected – employment rate of 5.1%

These numbers would be enough for the FED to start tapering. But obviously we will to wait and see what the actual numbers are.

The Federal reserve have said repeatedly that they will continue with their QE to buy $120bn of Treasuries and agency mortgage-backed securities each month **until the economy had made substantial further progress on the two goals** of **inflation averaging 2%** AND **employment reaching a maximum** (not necessarily zero of course as there has to be a number unemployed at any one time as people move and take up new jobs).

Clearly the Fed have met the inflation goal…….. and some. As we all know the other worry now is that inflation **stays persistently high above the 2% average** –central bankers now believe this jump in inflation will not be as transitory as hope for and that it could **last well into spring next year**.

Nerves will start to fray at the Fed and with investors in general. The markets will have reacted well before then should inflation persist in this way.