EQUITIES SHAKE OFF DELTA FEARS

Lenny McLoughlin
Chief Investment Strategist, Irish Life Investment Managers Limited (ILIM)

Despite a mid-month fall of 2.5%, global equities edged higher in July, thanks to a strong second-quarter earnings season and ongoing support from the European Central Bank and Federal Reserve. Although global growth may be close to peaking, it remains strong in absolute terms and well above trend, which also helped boost equities. Bonds gained and yields (which move inversely to prices) fell back to February levels due to worries that the US economy was petering out. Cautious statements from the European Central Bank also pushed yields lower too.

Delta variant blunted by vaccinations

Lockdown fears resurfaced as Covid-19 case numbers rose again, mainly due to the highly infectious Delta variant. The UK was the epicentre of the surge in infections, with new daily cases rising from 2,000 in late May to over 50,000 by the middle of July. But though case numbers were rising, the impact on health systems has been significantly lower than in earlier waves. Combined with daily UK cases falling to less than 25,000 by month end, earlier fears around new restrictions and negative implications for growth began to fade.

Companies report strong results

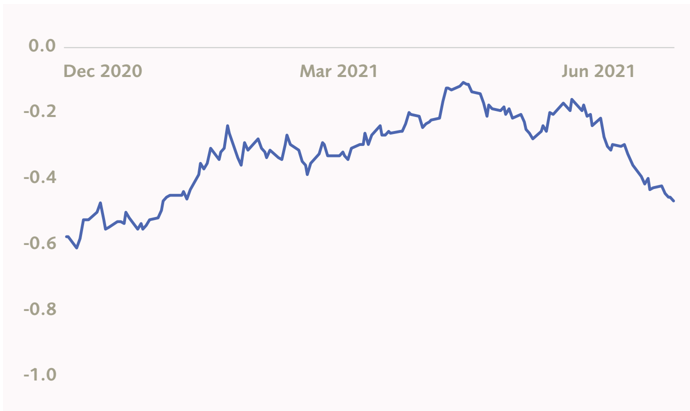
The second-quarter earnings season has been strong and well ahead of expectations, which has supported equities. In the US, results to date are 18% ahead of forecasts, while earnings are up 83% year on year. The corresponding figures for Europe are 8% and 29%, while in Japan, earnings are 13% ahead of forecasts and are up 46% year on year. Global earnings forecasts for 2021 have continued to be revised higher – growth of 43.6% is now expected for this year, with 8.6% pencilled in for 2022.

Fed not yet ready to 'taper' asset purchases

Federal Reserve policymakers acknowledged recent progress in the US economy and admitted that in-depth discussions about tapering (scaling back) asset purchases had begun. That said, they did not indicate any urgency to begin reducing current monthly purchases of $120bn. Chair Powell implied that the labour market has not recovered sufficiently to justify tapering. He said the Fed will review the tapering decision over upcoming meetings, implying that it will probably be the first quarter of 2022 before tapering begins. Meanwhile, despite another higher-than-expected US inflation release (CPI rose to 5.4% year on year), investors increasingly believed that the recent rise in inflation will prove to be temporary.

CHART OF THE MONTH

German 10-year yield



Source: ILIM, Bloomberg. Data is accurate as at 1 August 2021

Brexit issues resurface

Tensions rose between the UK and EU over the Northern Ireland Protocol, as the UK sought to rewrite some terms of the agreement. The EU has paused the threat of legal action against the UK, which has averted the immediate risk of escalation. An extension of the transition period (which provides exemptions on customs requirements in certain product areas) is possible and an eventual compromise is likely, as neither party wants to see the introduction of new tariffs.

MARKET ROUND-UP

Equities

The MSCI AC World equity index rose 0.7% (0.7% in euro terms). The US rose 2.4% (2.4% in euro terms) due to a strong second-quarter earnings reporting season and suggestions from the Federal Reserve that asset purchases might not be scaled back until the first quarter of 2022. European equities rose 1.8% (2.1% in euro terms), due to dovish interest rate guidance from the European Central Bank. Emerging markets fell -6.0% (-6.7% in euro terms), impacted by more stringent regulations in the Chinese technology sector. Japan fell -2.4% (-1.3% in euro terms) as Covid-19 case numbers rose and new restrictions were implemented.

Bonds

Eurozone >5-year bonds rose 2.7% in July. The German 10-year yield fell to -0.46% as the ECB indicated that interest rates will not be raised for several years and that asset purchases will continue. Peripheral spreads drifted higher, with Italian and Spanish 10-year spreads rising to 108 basis points (bps) and 73bps, respectively. The euro rose slightly to 1.1870 against the US dollar.

Currencies and commodities

Commodities rose 1.6% (1.6% in euro terms) with West Texas Intermediate (WTI) oil rising 0.7%. Commodities were supported by positive demand as global growth continued to recover from last year's recession. Meanwhile, oil was supported by the OPEC+ announcement that supplies will continue to be managed until September 2022. Gold rose 2.4%, as US real yields fell to new lows.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	1.77	13.53	5.97
MSCI United Kingdom	0.92	17.18	-17.83
MSCI Europe ex UK	2.15	18.24	2.43
MSCI North America	2.26	21.49	10.64
MSCI Japan	-1.26	3.36	5.42
MSCI EM (Emerging Markets)	-6.66	3.60	8.89
MSCI AC World	0.73	16.98	7.18
10-Year Yields	**Yield Last Month (%)**	**2020 Yield (%)**	**2019 Yield (%)**
US	1.22	0.91	1.92
Germany	-0.46	-0.57	-0.19
UK	0.57	0.20	0.82
Japan	0.02	0.02	-0.02
Ireland	-0.06	-0.30	0.11
Italy	0.62	0.54	1.41
Greece	0.61	0.63	1.43
Portugal	0.17	0.03	0.43
Spain	0.27	0.05	0.46
FX Rates	**Current**	**2020 Rates**	**2019 Rates**
US Dollar per Euro	1.19	1.22	1.12
British Pounds per Euro	0.85	0.90	0.85
US Dollar per British Pounds	1.39	1.37	1.33
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2020 Return (%)**
Oil (WTI)	0.65	52.41	-20.54
Gold (Oz)	2.36	-4.23	24.40
S&P Goldman Sachs Commodity Index	1.57	33.47	-23.72

Source: ILIM, Bloomberg. Data is accurate as at 1 August 2021

THE ILIM VIEW – LOOKING AHEAD

The outlook for equity markets over the next 12 months depends on several factors, including central bank policy, inflation (both expected and realised) and the evolution of the Covid-19 pandemic.

While equity markets are expensive in absolute terms, they are still attractive in relative terms, given the low yields available on bonds and cash. The current low level of bond yields, even allowing for recent rises, justifies higher-than-average valuations in equities. We believe global equities can trade on a 12-month forward price-to-earnings (PE) multiple of 18.5–19 times at the end of 2021. With the global economy in the initial stages of a new cycle and strong economic and earnings growth forecast over the next two years, upside of around double digits in global equities is expected over the next 12 months.

Potential risks to the positive outlook include unexpected central bank policy tightening, further significant rises in bond yields (which would diminish the relative valuation case for equities) or a resurgence in Covid-19 cases with vaccines proving to be ineffective in treating new variants. We see the probability of these occurring as low. Given elevated valuations, volatility will be a feature of markets if any of these issues become a cause for concern over the next 12 months.

THE MONTH AHEAD

Economic data releases

2 July	US non-farm payrolls
8 July	Germany's balance of trade (May)
13 July	US core inflation rate, year on year (June)
16 July	Bank of Japan's interest rate decision US retail sales, month on month (June)
23 July	Gfk consumer confidence (UK, July)
29 July	US GDP growth rate (quarter on quarter)

Events to watch

Tokyo Olympic Games

Source: ILIM, Trading Economics. Data is accurate as at 1 August 2021

Irish Life

CONTACT US

PHONE: (01) 704 1200
FAX: (01) 704 1918
WEBSITE: www.ilim.com
WRITE TO: Irish Life Investment Managers, Beresford Court, Beresford Place, Dublin 1