ILIM

Life \ Pensions \ **Investments**

October 2021
Market Pulse

Helping people build
better futures

EQUITY MARKETS AT FRESH HIGHS AMID MORE PERSISTENT INFLATION

Conor Kearney

Fund Manager
Irish Life Investment Managers Limited (ILIM)

Following the first 5% pullback in almost a year in September, equity markets are again at fresh highs. A number of headwinds eased through the month of October and strong earnings reports provided a boost to markets. The meaningful gap between Covid-19 cases and hospitalisations, and the development of viral treatments for the infection, remain encouraging; significant new restrictions are unlikely in the US and Western Europe. Supply constraints, which have acted as a drag on the global economy, are potentially peaking as Asia begins to reap the benefits of increased vaccination uptake, just as energy prices look to be coming off recent highs. Bond markets, however, have seen 2–5 year yields rising as investors bet that inflation will prove more persistent than central banks expect.

Strong start to Q3 earnings season

A strong start to the Q3 earnings season buoyed equity markets through October and left Wall Street stocks with their best monthly performance for the year. Up to end October, over 50% of US companies had reported Q3 earnings, with over 80% beating analyst earnings estimates by over 10%. In Europe, earnings have also been strong, with over 65% of companies surprising positively. This strong performance allayed fears of margin compression due to recent price inflation, as many companies maintained pricing power and were able to pass input price rises to end customers.

Evergrande concerns ease

In Asia, concerns surrounding the embattled Chinese property developer Evergrande receded as authorities confirmed that any fallout from a default on the developer's debts would be within the scope of what authorities could handle and would not pose any spill over risks to the Chinese economy. The company has so far avoided default by making payments on outstanding debts just as grace periods were about to expire.

Energy crunch fuels further inflation

Inflation continues to be a key concern for investors as a recent spike in energy prices has put further upward pressure on inflation readings. This comes as we continue to see the price pressures from recent supply chain bottlenecks driven by supply and demand imbalances as economies open up from pandemic induced lockdowns. US headline inflation hovered at a 13-year high of 5.4% y/y while core inflation, which strips out volatile items such as food and energy, stood at 4.0% y/y. Food prices jumped a significant 0.9% for the month, and shelter costs were also higher. Together those two categories accounted for more than half of the monthly increase in the headline figure. In Europe, headline inflation surprised positively at 4.1% y/y, largely driven by a 23% year-on-year increase in the energy component. Core inflation remains more stable at 2.1% y/y.

Rate rises on the horizon?

With higher levels of inflation persisting globally, central banks have started to signal a willingness to raise interest rates earlier than expected to curb rising prices. The Bank of England is expected to be at the vanguard of tighter monetary policy when it meets in November with the prospects of a rate hike very real. ECB President Christine Lagarde admitted that higher inflation might be more persistent, while reaffirming the ECB's commitment to ultra-loose monetary policy and pushing back against market expectations of rate hikes in 2022. However, this was not enough to dissuade investors who kept bets alive for interest rate hikes as soon as next year. The US Fed will meet the first week of November where it is expected to announce a tapering of its $120bn per month pandemic-era bond purchases.

CHART OF THE MONTH

Global Equities

Source: ILIM, Bloomberg. Data is accurate as at 31 October 2021

MARKET ROUND-UP

Equities

Over the month the MSCI AC World equity index rose 5.0% (5.3% in €). The US rose 7.0% (7.1% in €) on the back of a strong start to the Q3 earnings reporting season. European equities rose 4.2% (4.8% in €) as economic data remains strong and earnings surprised positively. Emerging markets rose 0.9% (1.1% in €), underperforming the broader market, as some disappointing earnings reports fed fears about supply chain woes hitting global growth momentum. Japan fell -1.2% (-3.2% in €) ahead of the country's first election under newly elected Prime Minister Fumio Kishida.

Bonds

The Eurozone >5-year bond index returned -0.6% in October as bond markets continued their sell-off for the year. This brought the total return in 2021 to -4.8%, which leaves the index in line for its worst performance since 1999. Ten-year German bond yields rose to -0.10% from -0.20% during the month. Peripheral spreads widened with Italian and Spanish 10-year spreads at 128bps and 72bps respectively as the ECB provided no guidance on asset purchases post-PEPP at its October meeting. Investment grade corporate bonds fell -0.7% while high yield bonds were down -0.3%. Spreads widened with investment grade credit spreads at +87bp and high yield at +282bp.

Currencies and commodities

The euro fell slightly to 1.1558 against the US dollar having reached 1.1687 intra month on the back of perceived hawkish ECB commentary.

Commodities rose 5.8% (6.0% in €) driven by sharply higher energy prices as the world continues to grapple with an energy crunch. The prices of gas, coal, and oil all rose over the month. WTI oil rose 11.4%, to above $80 a barrel, amid strong demand, and shortages in natural gas and coal have led to substitution to oil. OPEC+ announced only a gradual increase in production levels in September, which boosted oil prices.

Gold was up 1.5% over the month as market-based inflation expectations pushed higher.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	1.57	15.98	5.97
MSCI United Kingdom	4.16	23.41	-17.83
MSCI Europe ex UK	4.85	21.96	2.43
MSCI North America	7.16	30.64	10.64
MSCI Japan	-3.22	8.53	5.42
MSCI EM (Emerging Markets)	1.15	5.73	8.89
MSCI AC World	5.28	23.92	7.18

10-Year Yields	Yield Last Month (%)	2020 Yield (%)	2019 Yield (%)
US	1.55	0.91	1.92
Germany	-0.11	-0.57	-0.19
UK	1.03	0.20	0.82
Japan	0.10	0.02	-0.02
Ireland	0.33	-0.30	0.11
Italy	1.17	0.54	1.41
Greece	1.33	0.63	1.43
Portugal	0.52	0.03	0.43
Spain	0.61	0.05	0.46

FX Rates	End last month	2020 Rates	2019 Rates
U.S. Dollar per Euro	1.16	1.22	1.12
British Pounds per Euro	0.84	0.90	0.85
U.S. Dollar per British Pounds	1.37	1.37	1.33

Commodities (USD)	MTD Return (%)	YTD Return (%)	2020 Return (%)
Oil (WTI)	11.38	72.24	-20.54
Gold (Oz)	1.43	-5.86	24.40
S&P Goldman Sachs Commodity Index	5.80	46.28	-23.72

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

THE ILIM VIEW – LOOKING AHEAD

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

While equity markets are expensive in absolute terms, they still remain attractive in relative terms, given the low yields available on assets such as bonds and cash. The current low level of bond yields, even allowing for the rise since the end of last year, justifies higher than average valuations in equities. We believe global equities can trade on a 12-month forward P/E multiple of 18.0/19.0x one year from now. With strong economic forecasts and earnings growth forecast over the next two years, upside of around mid to high single digits in global equities is expected over the next twelve months.

As the global economy moves from the early to mid-cycle stage, we expect equity returns to remain positive even as the pace of gains slows. The growth/policy mix should remain supportive, even as the level of stimulus is reduced in 2022, with authorities determined to ensure the recovery is complete and self-sustaining, meaning growth will remain above trend even as momentum in growth appears to have peaked.

Longer term potential risks to the equity outlook include unexpected central bank policy tightening, 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. The probability of these occurring is viewed as being low. Given elevated absolute valuations and the array of short-term risks, volatility is expected to remain a feature in markets.

THE MONTH AHEAD

Economic data releases

3 November	US Fed interest rate decision
4 November	Bank of England interest rate decision US balance of trade (September)
5 November	US Non Farm Payrolls (October)
9 November	Germany balance of trade (September)
10 November	US inflation rate YoY
11 November	GB balance of trade (September)
16 November	US retail sales MoM (October)
17 November	GB Inflation rate YoY (October)

Source: ILIM, Trading Economics. Data is accurate as at 31 October 2021

Events to watch

1-12 November	COP26 UN Climate Change Conference, Glasgow

This is intended as a general review of investment market conditions. It does not constitute investment advice and has not been prepared based on the financial needs or objectives of any particular person, and does not take account of the specific needs or circumstances of any person.

The author cannot make a personal recommendation for any person and you should seek personal investment advice as to the suitability of any investment decision or strategy to your own needs and circumstances. Any comments on specific stocks are intended as an objective, independent view in relation to that stock generally, and not in relation to its suitability to any specific person.

ILIM may manage investment funds which may have holdings in stocks commented on in this document. Past performance may not be a reliable guide to future performance. Investments may go down as well as up. Funds may be affected by changes in currency exchange rates. Irish Life Investment Managers Limited is regulated by the Central Bank of Ireland.

Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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