



CIO OFFICE MORNING MARKET WRAP – 12th October, 2021. ALSO AVAILABLE ON ALEXA.

Monday was a mixed session for global markets. Stocks were down -0.4% in developed markets and up 0.7% in emerging regions, the latter being helped by a rebound in Chinese technology stocks. The fixed income asset class remained under pressure from steady interest rates, while gold was marginally up. The action is in energy markets: the price of oil kept on rising, close to \$84 for the Brent and above \$80 for the US WTI, a level not seen since 2014. It's a perfect storm: the revived economic recovery and the start of the winter in the northern hemisphere are driving demand, while on the supply side, the OPEC+ didn't boost output above what was initially planned, and generally speaking, the world is facing the consequences of under investment for years in hydrocarbon upstream and infrastructure. Electricity prices have risen by double digit in Italy last week, thermal coal futures surged at a record level in China, and even if European natural gas prices, at EUR 84 per MWh, are off their last week peak of 120, the absolute level remains very high, This obviously adds to broader inflation concerns, and market participants are weighing the consequences on both the economic outlook and on the ability of companies to pass through rising costs.

With regards to the economic outlook, our scenario remains constructive. To put it short, we see upside risks to inflation and downside risk to growth, but the combination remains a net positive: control over the virus is improving every day, which unlocks the potential of many sectors of the economy which haven't fully recovered yet. Growth is firmly above trend. Better virus situation also means a gradual normalization of supply chain bottlenecks which should overtime moderate the current price issues. Markets will however be sensitive to inflation numbers, and the latest one, the production price index in

Japan for September, shows a +6.3% year on year increase, above forecast. We will get the US consumer price index tomorrow, as well as the minutes of the latest Fed meeting to have an idea of how the institution sees the problem. The second concern is the ability of companies to preserve their profitability in such an environment. The Q3 earnings season is about to start this week. We have no doubt that numbers will be strong, potentially spectacularly, but the focus will be on management guidance especially on margins and pricing power. Again, we are reasonably constructive: input costs are one element, but in a context of booming top line growth, operational gearing should be at play, especially as many other components of the cost base had been managed during the pandemic. Fundamentally, strong Q3 numbers should deflate further valuation multiples, but short-term emotional reactions to guidance are also probable.

Two countries are making headlines today. In Turkey, President Erdogan warned of potential military action against targeted elements in Syria, which was another element, after the recent surprise move from the central bank, to pressure the currency. One dollar is currently buying 9 lira, an absolute record in recent history. This compares to 7 earlier this year and to 3 on average in the last decade. The other headline comes as often from China: after technology, education, gaming, gambling and real estate, financial institutions are the next in line to see increased regulatory scrutiny. The inspection should include banks, insurers but also asset managers and even financial regulators. Inspectors will look for corruption, collusion, and check political compliance, with as always in China extremely severe punishments for breaches. With the Evergrande meltdown as a backdrop, this means more volatility ahead for Chinese assets, from stocks to bonds. We remain believers in the long-term investment case but we have to admit that the regulation crackdown inspired by the “common prosperity” objective is relentless.

Staying in Asia, the mood is unsurprisingly not brilliant on markets today. As we write, stocks are down everywhere, around -1% on average, with technology heavy segments such as Hong-Kong and South Korea leading the losses. Future contracts on Western stock indices are also down while interest rates are stable. Energy prices are steady, and gold is slightly rising, together with the trade weighted US dollar. Bitcoin is close to \$57,000.

On the economic agenda this week, we would highlight the US CPI on Wednesday and retail sales on Thursday. Q3 earnings releases have started, and the season will really kick off with US financials from tomorrow onwards.

Stay safe.

MAURICE GRAVIER
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