

Six minute strategy

So will rising bond yields ruin the party?

19 February 2021

If you are a private investor, you should not act or rely on this document but should contact your professional advisor.



Record investor optimism on a recovery as metal & energy prices surge

 Fund managers have never been more optimistic on recovery

 Surge in metal and energy prices driven by recovery hopes

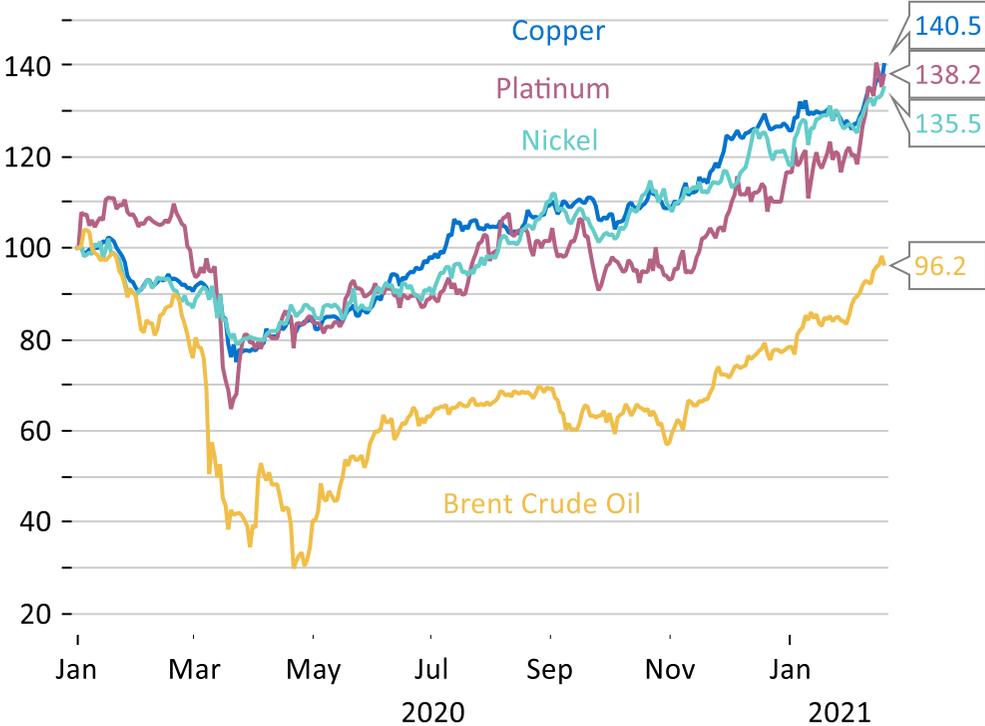
Exhibit 2: Record amount of FMS investors expect a stronger economy

Net % Expecting Stronger Economy



Source: BofA Jan 2020 Fund Manager Survey

Metals & Energy returns 2020 to date (rebased to 100)



Source: Macrobond, 19.02.21

Global uncertainty falling as the new US Administration finds it's feet



Vaccines, Biden and a Brexit deal lower uncertainty...

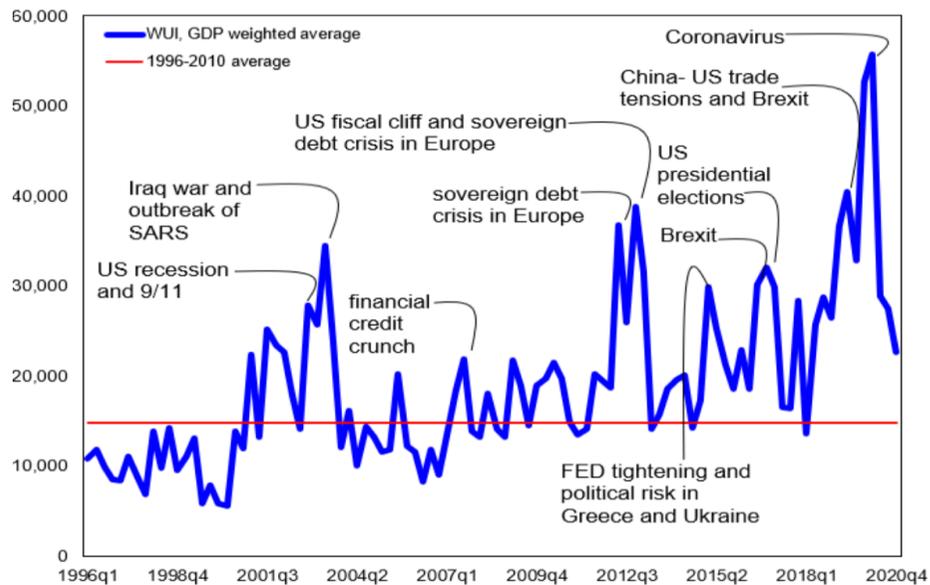


Driving manufacturing surveys close to 20 year highs

Uncertainty in the world

Global uncertainty as measured by the World Uncertainty Index remains high.

World Uncertainty Index (GDP weighted average)



Source: Ahir, H, N Bloom, and D Furceri (2018), "World Uncertainty Index", Stanford mimeo.
 Note: The World Uncertainty Index (WUI) is computed by counting the percent of word "uncertain" (or its variant) in the Economist Intelligence Unit country reports. The WUI is then rescaled by multiplying by 1,000,000. For example, an index of 200 corresponds to the word uncertainty accounting for 0.02 percent of all words, which—given the EIU reports are on average about 10,000 words long—means about 2 words per report. A higher number means higher uncertainty and vice versa.

US - ISM Manufacturing Index



Source: Macrobond, 19.02.21

INTERNATIONAL MONETARY FUND

So will rising bond yields spoil the equity party?



Bond yields rise and the yield gap widens

US 10 & 2 year T-bond yields

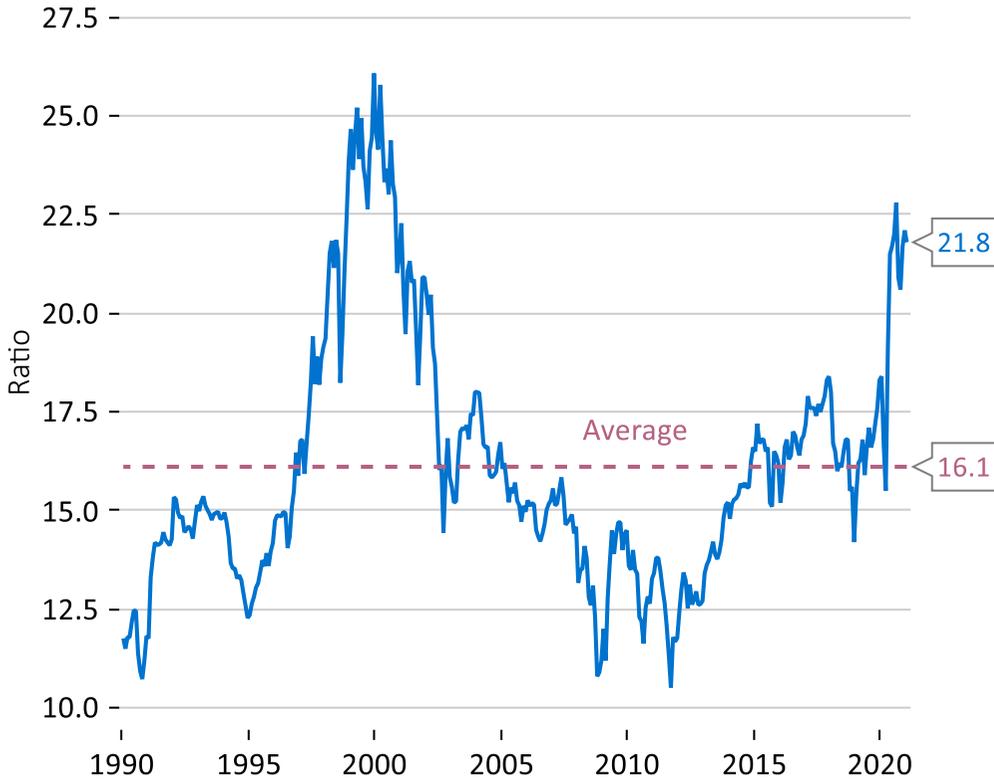


Source: Macrobond, 19.02.21



2020 market performance driven by multiple expansion

S&P 500 12 Month Forward P/E



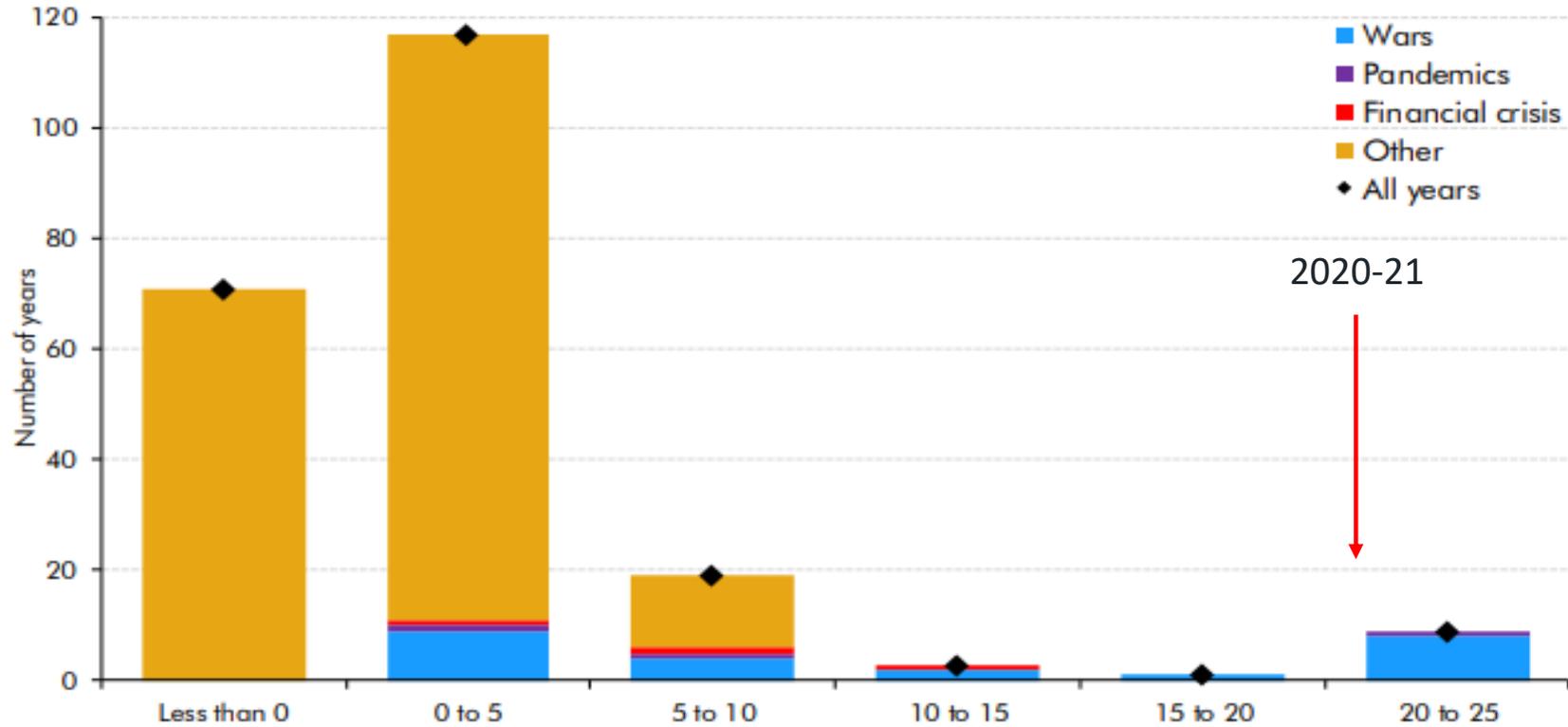
Source: Macrobond, 19.02.21

1. The impact of the virus on public finances is like a war – this makes negative real interest rates a necessity



2020-21 UK Budget Deficit forecast to reach 19% of GDP – levels only previously seen in times of war

Chart 1.1: Historical distribution of public sector net borrowing as share of GDP since 1800

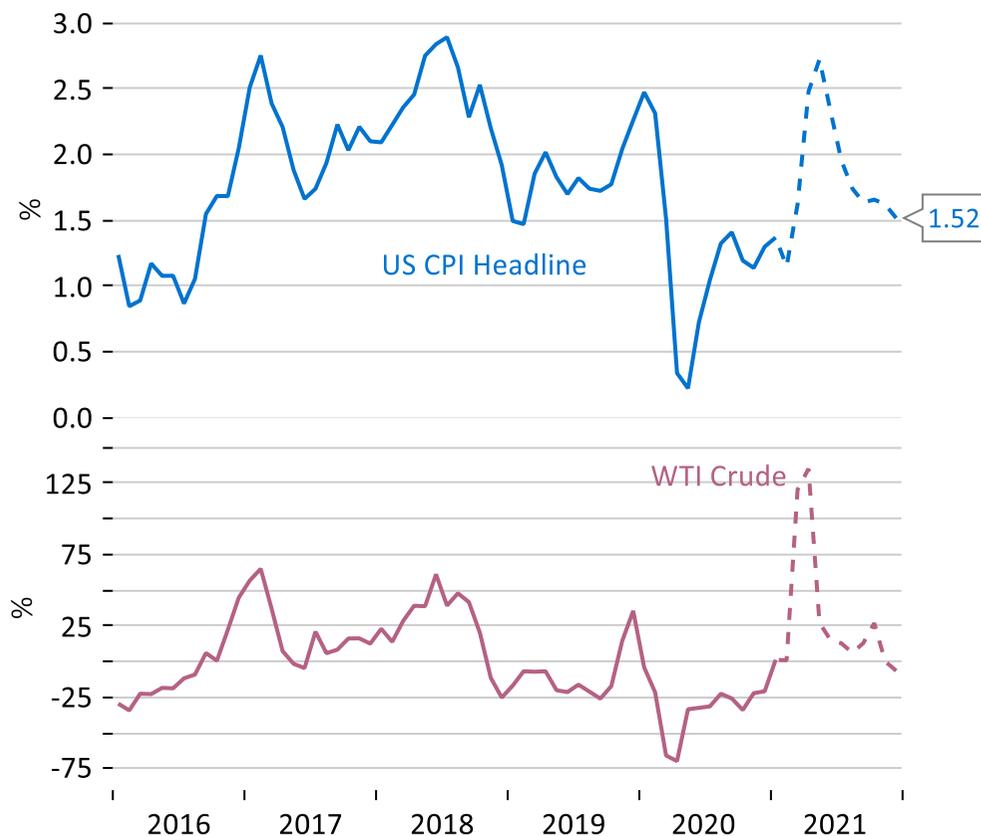


Source: Bank of England, OBR Jan 2021

2. Policy makers have committed to allow economies to run hot



US inflation will climb temporarily as oil prices rise



Source: Macrobond, 19.02.21

“The Committee seeks to achieve inflation that averages 2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time”

US Federal Reserve

Jan 26 2021

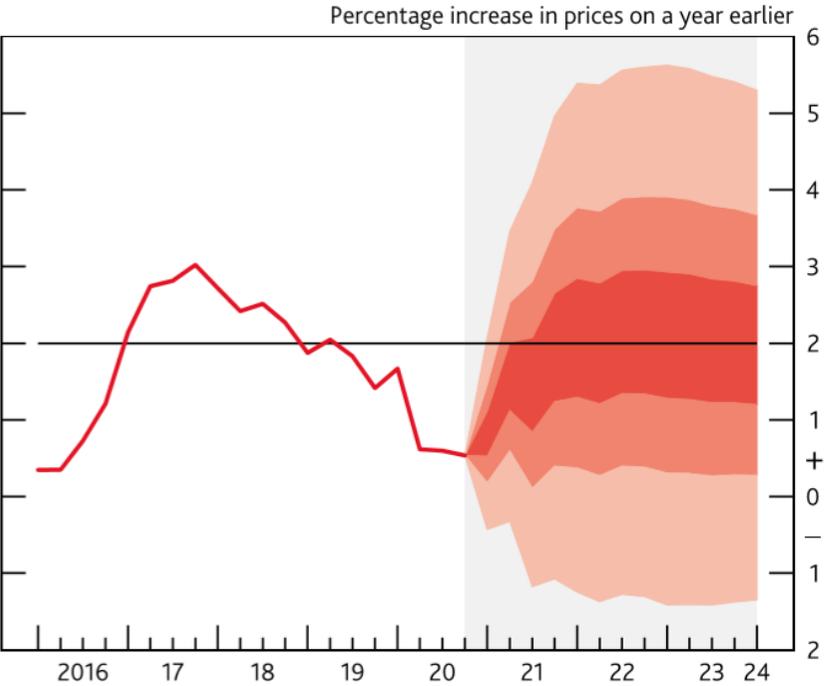


3. In the UK the inflation risks are broadly balanced

 The recent rise in energy prices will push UK inflation to 2%

 Severe damage to UK Services will cap price pressures

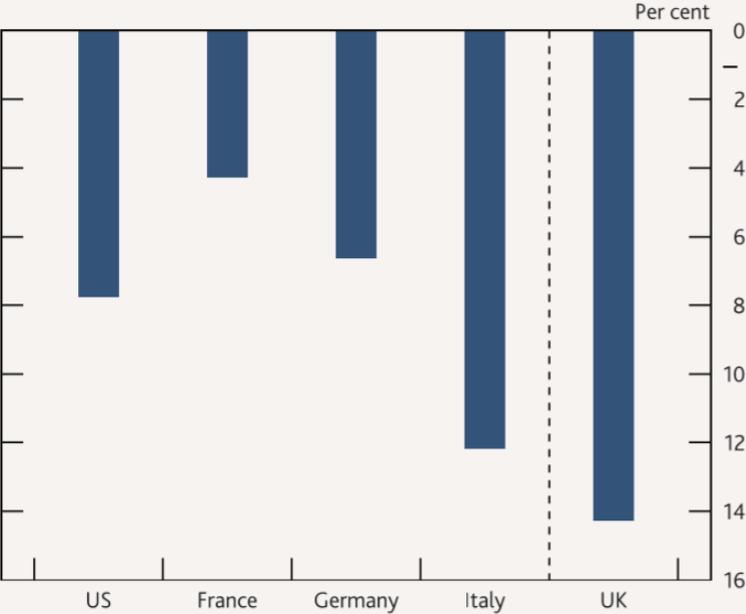
Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



The fan chart depicts the probability of various outcomes for CPI inflation in the future.

Chart C: Spending on services has been relatively weak in the UK

Percentage changes in real services consumption between 2019 Q4 and 2020 Q3^(a)



Sources: US Bureau of Economic Analysis, Eikon from Refinitiv, Eurostat, ONS and Bank calculations.

(a) Data are not available for Spain.

4. There is a powerful need for policy makers to ‘level up’ & help those in society most impacted by the pandemic

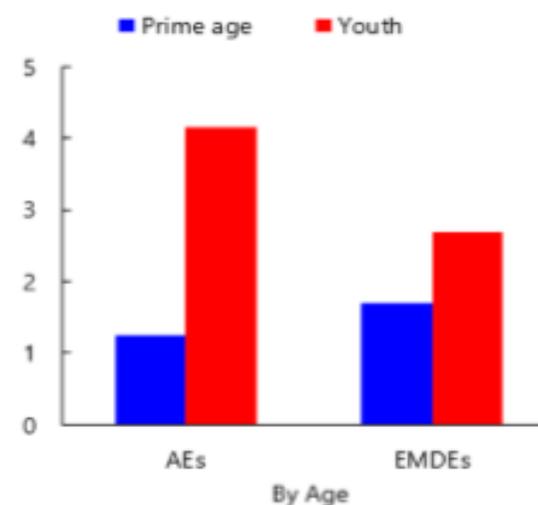
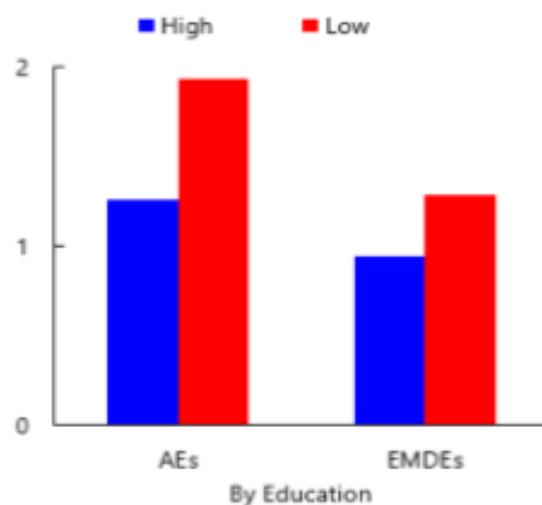


Workers with less education, youth, women and those informally employed have suffered disproportionate loss

Impact on workers uneven

Workers with less education and youth have been disproportionately affected.

(unemployment rate change from latest quarterly data relative to average level during 2018-2019; percentage points)



Source: IMF Jan 2021 – Youth are 15-24 years old & prime age are 25-54 years

Markets 2020 to date

Emerging Markets lead a global equity surge - bonds fade - UK equity recovery begins

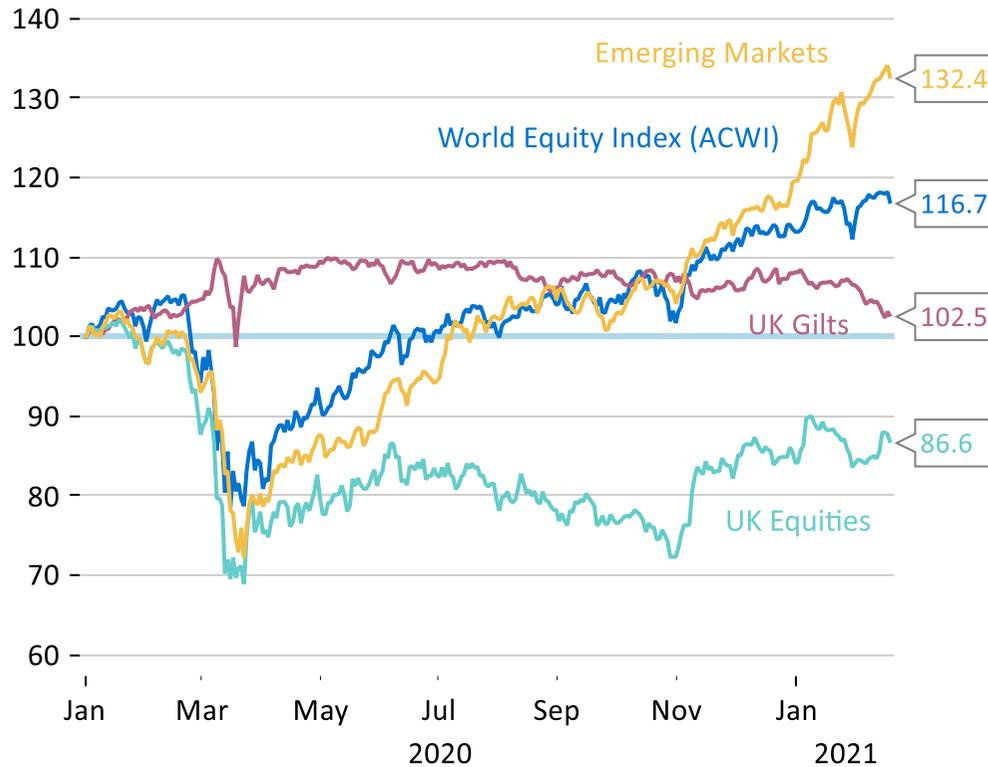


Equity rally continues on election, Brexit and vaccine news



Volatility still stubbornly high

Global Asset Class Returns 2020 (GBP) to date



Source: Macrobond, 19.02.21

US Equity Volatility Index (VIX) 2020 to date



Source: Macrobond, 19.02.21

Important information

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