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Gradually and then Suddenly

Global Matters Weekly

22 November 2021

– **Richard Parfect**

Spotting dangers and threats can be a difficult skill; not least because they often hide in plain sight. The physical act of literally seeing a danger can require a deliberate act of searching it out. For example an object such as a car or aircraft you are on a collision course with is often masked by the fact that the relative angle between you is constant, thereby it appears stationary. If the eye does not detect an angular change then it can be literally blind to it until the final moments before impact when its relative size in your field of view blooms to a large size, at which point evasive action can be too late. It is due to this optical phenomenon that to spot the danger we need to move our head around in our scan to create an angular change for the eye to spot.

Just like in Ernest Hemingway's novel "The Sun Also Rises", the character Mike Campbell was asked how he went bankrupt; "Two Ways" Campbell replies, "Gradually and then suddenly". Essentially the factors had been in place for a long time but their insidious effects only showed themselves in the final moments of his financial demise.

We are now witnessing a similar situation with this current "inflation shock". While Central Banks are hoping (with diminishing credibility) that it is short term and transient, we can point to a number of factors that have been present for many years but are only now revealing themselves. Whether, we are talking about an insufficient (in size and skills) workforce, the supply of which was artificially (and unsustainably) boosted by low cost immigration in the service economy, a demographic retirement bulge in lorry drivers, commodities that have been mis-priced against their hidden costs (e.g. carbon embedded within fossil fuels), a supply chain that was so stretched to maximise "efficiency" that it lacked any level of resilience to cope with shocks (blockages in the Suez canal, chip shortages for car manufacturers, insufficient warehouse space to accommodate "onshoring" of production and storage). All these factors have been present

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for many years, and while it may have taken COVID amongst other things to trigger the inflation shock but the foundations had already been laid.

Having been mindful of this risk through the years of Quantitative Easing and the build up of structural risks, we became increasingly concerned about inflation early this year. It is for this reason we had already built up a high level of knowledge and understanding within our Specialist Assets or, "real assets" as some commentators call them. This portion of our portfolio generates income streams, much of which is implicitly or even explicitly linked to inflation, but without having to pay the very high prices of government index-linked bonds. Diversifying across real estate (REITs), infrastructure, specialist financial and asset backed lending trusts and even private equity, has resulted in a portfolio of assets that are not intrinsically linked to headline short term GDP expansion or significant counterparty risks of default.

Our inflation defences are further bolstered by an allocation to physical gold and gold mining companies. The yellow metal has been valued for its wealth preserving qualities for millennia. While gold suffers the flaw of failing to pay an income; this is of little concern for the moment as governments and central banks grapple with how to combat inflation that will not necessarily respond to any future increase in interest rates. Financial Repression; the act of allowing inflation to run without hiking interest rates above it and thereby deflating the real value of government debt, could prove to be that stationary dot on the horizon.

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The **Marketplace**

- Global equities fell by -0.1% last week
- A mixed week for global markets reflecting some strong economic data, ongoing inflation fears and regional Covid-19 surges
- Brent crude oil fell by -4.0% last week to $78.8 a barrel
- Gold fell by -1.0% to $1845.7 per ounce.

Market **Focus**

US

- US equities rose by +0.4% last week with growth stocks outperforming value
- the Commerce Department reported that retail sales jumped 1.7% in October, the biggest gain since March
- Industrial production in October rose more than expected at 1.6% versus 0.7%
- The ISM manufacturing print for August rose to 59.5 vs 58.5 expected. New orders were up to 66.7 vs 61.0 expected
- The U.S. House of Representatives passed President Biden's climate and social spending bill. The bill will now proceed to the Senate. This follows President Biden signing a physical infrastructure bill into law on Monday
- US housing starts fell in October to an annualised rate of 1.52 million (vs. 1.57m expected), whilst the previous months' reading was also revised lower despite building permits rising to an annualised rate of 1.65m vs an expected 1.63m.

UK

- UK Equities fell by -1.7% last week
- CPI came in at +4.2% year-on-year in October. That was above +3.9% consensus expectation that was also the BoE's staff projection in their November Monetary Policy Report. Inflation now stands at its highest level in almost a decade
- The inflation situation was also seen as strengthening the case for a December rate hike by the Bank of England.

Europe

- European equities returned -0.1% last week
- Core eurozone bond yields fell last week on dovish comments from ECB President Christine Lagarde. She indicated that interest rate rises are unlikely as she thinks recent inflation surges will fade
- Countries across Europe implemented new lockdown measures and vaccine requirements to combat the latest rise in Covid cases. Austria began a nationwide lockdown at the end of last week and Belgium, Germany and the Netherlands have imposed partial lockdowns
- The European Automobile Manufacturers' Association said that new car registrations in the EU dropped by 30.3% month over month in October to a record low of 665,001 units.

Asia/Rest of The World

- The benchmark Global Emerging Markets index fell by -1.3% last week
- Japanese equities returned 0.2% last week, a muted reaction given the approval of a larger-than-expected and wide-reaching stimulus package of 55.7 trillion Yen
- Chinese equities fell by -2.1% last week as Alibaba slumped by as much as 10% after missing sales estimates for a second quarter
- Canada's CPI inflation reading rose to +4.7% in October as expected, marking the largest annual rise since February 2003

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Asset Class/Region	Currency	Currency returns			
		Week ending 19 Nov. 2021	Month to date	YTD 2021	12 months
Developed Market Equities					
United States	USD	0.4%	2.1%	26.2%	32.5%
United Kingdom	GBP	-1.7%	0.1%	16.5%	18.7%
Continental Europe	EUR	-0.1%	2.8%	24.5%	28.4%
Japan	JPY	0.2%	2.2%	15.5%	20.9%
Asia Pacific (ex Japan)	USD	-0.8%	0.3%	-0.2%	6.8%
Australia	AUD	-0.5%	1.4%	16.3%	17.2%
Global	USD	-0.1%	1.5%	21.2%	28.2%
Emerging markets equities					
Emerging Europe	USD	-3.8%	-6.8%	19.1%	33.2%
Emerging Asia	USD	-0.7%	1.0%	-2.0%	5.2%
Emerging Latin America	USD	-4.7%	-0.6%	-11.1%	0.1%
BRICs	USD	-2.3%	-0.5%	-5.8%	-0.7%
China	USD	-2.1%	-0.9%	-14.8%	-12.6%
MENA countries	USD	-1.0%	1.6%	32.8%	36.0%
South Africa	USD	-2.6%	-1.2%	2.7%	11.7%
India	USD	-1.6%	1.6%	26.5%	40.6%
Global emerging markets	USD	-1.3%	0.4%	0.1%	7.9%
Bonds					
US Treasuries	USD	0.3%	0.2%	-2.6%	-2.7%
US Treasuries (inflation protected)	USD	-0.1%	1.5%	6.2%	8.2%
US Corporate (investment grade)	USD	0.0%	-0.1%	-1.2%	-0.1%
US High Yield	USD	-0.4%	0.0%	4.3%	7.1%
UK Gilts	GBP	0.6%	1.4%	-4.2%	-2.0%
UK Corporate (investment grade)	GBP	0.2%	1.0%	-2.3%	0.5%
Euro Government Bonds	EUR	0.6%	1.9%	-1.8%	-1.7%
Euro Corporate (investment grade)	EUR	0.0%	0.8%	-0.3%	0.1%
Euro High Yield	EUR	0.0%	0.4%	3.5%	5.2%
Japanese Government	JPY	0.0%	0.1%	-0.1%	-0.2%
Australian Government	AUD	0.0%	1.2%	-4.2%	-4.6%
Global Government Bonds	USD	0.1%	-0.1%	-6.0%	-4.5%
Global Bonds	USD	-0.1%	-0.3%	-5.1%	-3.4%
Global Convertible Bonds	USD	-1.3%	-0.7%	-0.5%	5.7%
Emerging Market Bonds	USD	-0.3%	-0.1%	-4.4%	-2.7%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 19 Nov. 2021	Month to date	YTD 2021	12 months
Property					
US Property Securities	USD	0.2%	1.9%	34.1%	36.2%
Australian Property Securities	AUD	1.8%	4.3%	16.9%	15.8%
Asia Property Securities	USD	-1.2%	-0.7%	1.2%	-0.7%
Global Property Securities	USD	0.0%	1.3%	19.8%	23.2%
Currencies					
Euro	USD	-1.3%	-2.1%	-7.6%	-4.6%
UK Pound Sterling	USD	0.3%	-1.6%	-1.4%	1.7%
Japanese Yen	USD	-0.1%	0.1%	-9.4%	-8.9%
Australian Dollar	USD	-1.2%	-3.6%	-5.9%	-0.4%
South African Rand	USD	-2.7%	-2.9%	-6.9%	-1.8%
Swiss Franc	USD	-0.8%	-1.2%	-4.7%	-1.7%
Chinese Yuan	USD	-0.1%	0.3%	2.2%	3.1%
Commodities & Alternatives					
Commodities	USD	-1.3%	-1.3%	41.8%	54.7%
Agricultural Commodities	USD	0.8%	3.0%	33.0%	43.1%
Oil	USD	-4.0%	-6.5%	52.3%	78.5%
Gold	USD	-1.0%	3.5%	-2.6%	-0.9%
Hedge funds	USD	-0.2%	0.2%	4.9%	7.9%

Source: Bloomberg. Past performance is not indicative of future returns

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The Rex Building, 62 Queen Street, EC4R 1EB

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