Cave's Quarterly

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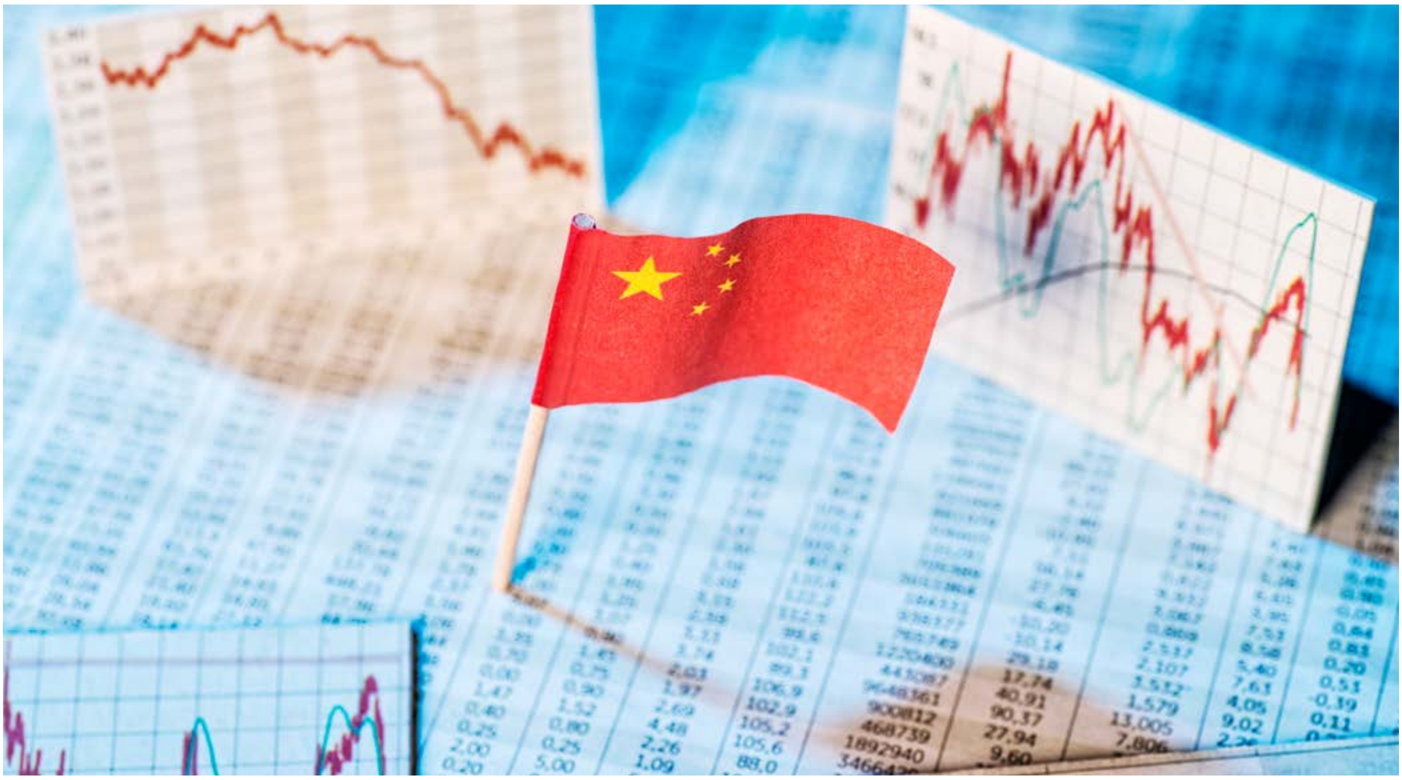
Delta Danger

The post-lockdown recovery continued through the summer months, with a number of developed markets further lifting mobility restrictions, despite a rise in global cases of the highly contagious "Delta" variant. Vaccination rates accelerated worldwide with several countries announcing booster programmes in an attempt to combat rising hospitalisations, after UK data indicated that antibody protection fades after six months.

The economic reopening has been robust, propped up by global Central Bank support which has seen unprecedented levels of monetary and fiscal stimulus made available during the pandemic. As anticipated, however, the pace of economic growth has started to moderate in recent months and the phased withdrawal of stimulus programmes has been well signposted through recent Central Bank policy meetings; the U.S. Federal Reserve (the Fed), the Bank of England and the Bank of Japan left key interest rates unchanged in September, but the Fed raised its inflation forecasts and announced that it will soon reduce its asset-purchasing programme ($120 billion a month of bond purchases) which has helped to stimulate economic activity since March 2020.

Hawkish comments made by Fed chairman, Jerome Powell, were added to the growing list of concerns unnerving investors through the third quarter, as an earlier-than-anticipated conclusion to the Fed's quantitative-easing could bring forward interest rate hikes in the US. In contrast to the sanguine economic backdrop, it was a volatile end for financial markets in September, with equities suffering from a lack of risk appetite as inflation spiked and Chinese real estate debt issues came to the fore.



Global Equities

With the majority of the country now "double jabbed", the UK government lifted the last of our domestic Covid-19 restrictions in August, as hospitalisations and deaths data trended downwards. In currency markets, the British pound fell to its lowest level of 2021 against the US Dollar, as supply bottlenecks and labour shortages (notably a lack of HGV drivers) linked to Brexit, saw a UK fuel crisis in September prompting fears of an economic slowdown.

UK equities, as represented by the FTSE All-Share Index, registered a positive return of 1% over the 3 month period, with cyclical stock sectors (energy, financials, materials) buoyed by healthy corporate results and the big overseas earners benefitting from the weakness in sterling. Despite a flurry of takeover offers witnessed across small and mid-cap equities, the domestic FTSE100 remains the cheapest of the major developed equity markets with overseas asset allocators seemingly indifferent towards the UK in general.

Having clocked up a fresh all-time high in August, the US stockmarket fell sharply as concerns over rising interest rates, persistent inflation and China's industrial and property sectors intensified. September represented the worst monthly performance for the S&P500 since the nadir of the coronavirus-induced crisis last year, pushing the equity index close to negative territory for the third quarter. The S&P500 was flat, and the NASDAQ index eked out a 1% gain in the three months to the end of September

The European Union's pandemic recovery fund started to distribute stimulus during the period and economic data in the region remained broadly positive as the vaccine rollout accelerated across Spain, Italy, and Germany. The Euro Stoxx 50 index traded sideways since June, with the information technology sector among the strongest performers, as semiconductor manufacturers continue to benefit from a boom in global demand after last year's factory shutdowns.

Japanese corporate results were bright as the economy benefitted from hosting the Olympic and Paralympic games. Prime Minister Suga announced his intention to resign, but investors reacted positively, seeing a political leadership change as a chance for more fiscal stimulus. The Nikkei 225 added 3% over the period. Emerging markets were largely dragged lower by events in China, after a regulatory crackdown by Chinese authorities on education and technology companies prompted a sharp decline in July. Later in the period, negative headlines surrounding China's 2nd largest property developer, Evergrande, also commanded the attention of investors, as fears over the heavily indebted company's ability to service its bond payments roiled markets. The Hang Seng (China) index registered a negative return of -15% over 3 months.

Commercial Property

Most remaining Covid-related restrictions were relaxed in England on so-called "Freedom Day" and the government guidance to work from home where possible was removed during the period. Whilst remote working policies look set to extend beyond the pandemic, the subsequent return to offices has been encouraging, with increased business activity witnessed across the major cities. The industrial sector remains a bright spot within the UK commercial property market, as the acceleration of growth in e-commerce and the increased importance of 'just in case' supply chains accentuate the ongoing demand-supply imbalance. Hotels, retail, and leisure sectors remain under pressure, hampered by the ongoing international travel restrictions and the recent tapering of business rates relief.

Alternatives

Brent Crude oil traded at $78 a barrel towards the end of September, with prices well supported by falling inventory levels and OPEC (Organisation of the Petroleum Exporting Countries) and its allies struggling to meet global demand. US oil production continues to recover from the fallout of Hurricane Ida and a shortage of natural gas across Europe and Asia has prompted a switch to oil for heating and manufacturing, boosting overall consumption by approximately half a million barrels a day.

The price of gold was stuck in a range near $1,750 an ounce through the period, hindered by a stronger US dollar and Fed taper talk. Traditionally a safe have asset, investor anxieties over China's Evergrande debt crisis offered some support for the precious metal in the final weeks of September.

Fixed Interest

September policy meetings saw hawkish shifts from the US Federal Reserve and Bank of England spark a wave of selling that pushed yields sharply higher across global bond markets. The significant jump in yields was further reinforced by the improving outlook for the US economy now that the spread of the Delta variant appears to be under control, and the recent surge in energy prices due to supply and demand imbalances across Europe and China.

At the end of September, the yield on the US 10-Year Treasury Note had climbed to 1.49%, and the UK 10-Year Gilt had nudged above 1% for the first time since March last year, to close out the month at 1.04%.

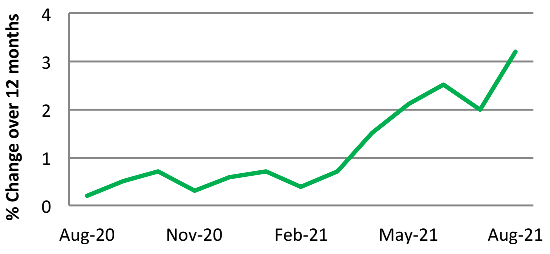
Outlook

Looking ahead, we anticipate a challenging fourth quarter for investors with key risks to sentiment including a prolonged slowdown of the Chinese economy, the potential for Central Bank policy error in response to 'transitory' inflation data and the forthcoming winter flu season.

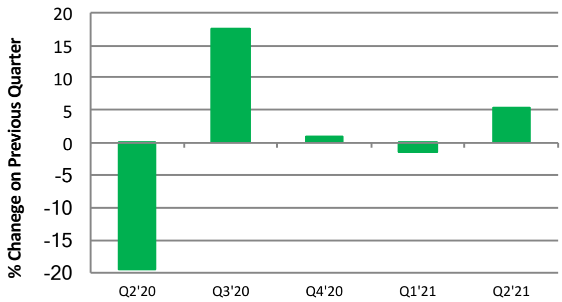
Encouragingly, vaccination programmes in developed countries have (so far) significantly weakened the link between infections and hospitalisations. As temperatures drop across the Northern Hemisphere, waning vaccine efficacy, or indeed a new variant that proves resilient to vaccinations, cannot be entirely ruled out. Should governments feel the need to reimpose mobility restrictions, we may witness a global economic freeze worthy of the winter weather.

A year in numbers

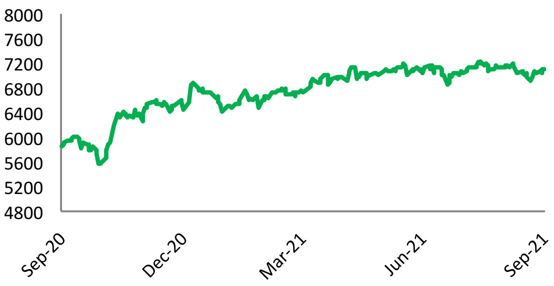
UK Consumer Prices Index (CPI)



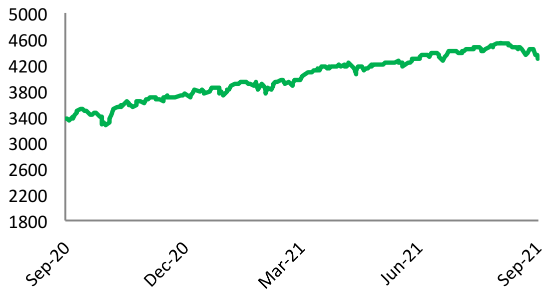
UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index



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