THE **CAMBRIDGE** WEEKLY

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Source: A dull president with interesting new policies, Andy Davey, 28 April 2021

Doubling of earnings leaves markets cold

After the previous week's lull in global equity markets, most regions recovered their previous highs last week, albeit in somewhat lacklustre trading patterns. Just as there were several reasons why markets were in a bad mood the previous week, there are many reasons for the more positive outlook last week. Those who were most fearful of geopolitical risks will have sounded a sigh of relief when Russia backed down from its threatening build-up of army forces on the Ukraine border, and the relationship between China and the US, appeared more agreeable than contentious at the (digital) climate change summit.

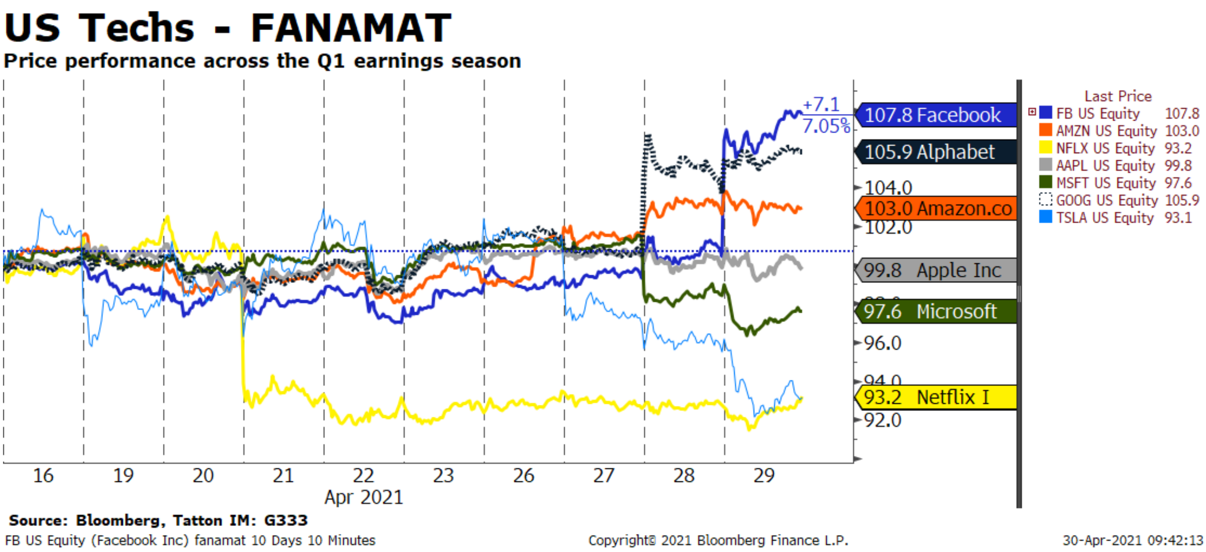
Investors concerned about runaway share price valuations of late have also been relieved by the massively positive corporate earnings growth figures coming out of the US and (to a lesser degree) Europe. In the US, of the S&P500 companies reporting so far (51%), corporate profits grew by an astonishing 57% over the year. In Europe, where 45% of STOXX600 companies have reported, the respective figure is +41%. Given this is even higher than already-optimistic expectations we reported last month – which cannot be explained away by a base effect given Q1 2020 was still largely COVID-free – it was perhaps surprising stock markets did not react much more positively. However, given how elevated stock markets are, the calm response should be welcomed.

For the US mega-cap tech stocks listed below, the first quarter has been nothing short of a blowout, underlining the almost global dependence on digital services during the winter lockdown. On the other hand, if the very largest companies can grow faster than the average, there might be a competition problem.

Name	Market Cap ($bn)	20d price move	Yday price move	GICS Sector	Revenue q/q	Revenue 5yrs ann.	EPS q/q	EPS 5yr ann.	Announced
NETFLIX	226	-5.6%	0.5%	Communication Services	24.2%	29.6%	139.1%	128.7%	20-Apr
FACEBOOK	934	10.3%	7.3%	Communication Services	47.6%	37.2%	94.2%	40.6%	28-Apr
ALPHABET	1616	13.7%	2.1%	Communication Services	34.4%	22.3%	167.4%	34.3%	27-Apr
AMAZON	1750	9.8%	0.4%	Consumer Discretionary	43.8%	30.1%	216.1%	71.3%	29-Apr
TESLA	652	13.67%	-2.50%	Consumer Discretionary	73.6%	55.38%	2460%	-	26-Apr
MICROSOFT	1902	4.2%	-0.8%	Information Technology	19.1%	14.2%	45.4%	30.3%	27-Apr
APPLE	2227	8.5%	-0.1%	Information Technology	53.6%	12.1%	118.6%	24.1%	28-Apr
TAIWAN SEMI	559	2.1%	-0.1%	Information Technology	25.1%	12.2%	28.1%	16.6%	15-Apr
GENERAL ELECTRIC	116	-0.5%	0.1%	Industrials	-12.2%	-9.3%	-	-	27-Apr

Source: Bloomberg, Tatton IM, Companies listed

That may well be why share price performance generally did not match the growth surprise. The perception is that the more they are seen to be winning, the more vulnerable they are to sustaining such rates of growth. Below are the FANAMATs (Facebook, Amazon, Netflix, Apple, Microsoft, Alphabet [aka Google] and Tesla) share prices over the past two weeks:



Against the outstanding levels of their results (bar Netflix) the share price development will have disappointed. There are some strategies they can use to overcome the size effect headwinds they face. It may be that Apple's announcement of a massive long-term capital expenditure programme is such a strategy, though Apple may also try a share buyback later this year – rumoured to amount to as much as $90 billion – but which may not go down as well as investment for future growth.

Apple's push on privacy is also interesting. As a strategy for offsetting political pressure, giving consumers the ability to stop apps tracking their activity sounds virtuous. Google is also doing something similar. However, this means third-party providers do not get something of value to them – only Google and Apple do – which sounds a bit like "abuse of platform". This brings us swiftly back to tech market concerns that interventions from competition watchdogs look increasing likely to becoming a headwind to further growth. The Chinese are punishing tech giants Tencent and Alibaba for such moves, which reminds us that global political sentiment is definitely working against the big tech names now.

In the bigger picture, US President Biden's address to Congress marking his first 100 days in office had the hallmarks of an epoch-changing event. While announcing his third trillion-dollar programme – this one to turn around educational standards and opportunities – Biden broke with the iron principle of US policy of the past 35 years, that the better state is the smaller state. Judging from the positive reception he received, it would appear that recent events have led many US citizens who used to rail against federal government intervention to change their view.

Some journalists even went as far as suggesting the US was adopting the Scandinavian welfare state model. We believe that is quite unlikely given this speech was Biden's opening gambit - negotiations to get his programmes through Congress will see them watered down. When a government embarks on materially improving the very base of economic growth and prosperity –namely through physical infrastructure and upskilling its broader population – it can only be welcomed by markets. After all, investors want to see the return of sustainably higher growth levels – as long as that does not come at the price of a systematic crowding out of the public sector. Biden's speech gave no mention of a vision of an overwhelming role of the state, but rather one of re-establishing means and measures that have served the US very well in past – paid for by a tax system where the most wealthy pay the same (but no higher) tax rate as the upper middle class.

We will be following this distinct turnaround in US economic policy with great interest, but we are already pleasantly surprised that Biden – who only last year was considered the dull compromise candidate with his best years behind him – has within just 100 days presented himself as one of the most effective change managers the US has ever voted into office. His predecessor must be furious.

'Sleepy Joe' wakes up the US economy

Things are looking good for President Biden as his hundredth day in office passes. The US economy grew by a very healthy annualised 6.4% during the first quarter. While overall growth was a little less than expected, personal consumption accelerated more than 10%. The reason this is not proportionally reflected in GDP growth is because inventories had to be drawn down to satisfy demand amid the problems in supply chains which knocked growth back. As inventories are replenished this should translate into stronger growth for the rest of this year.

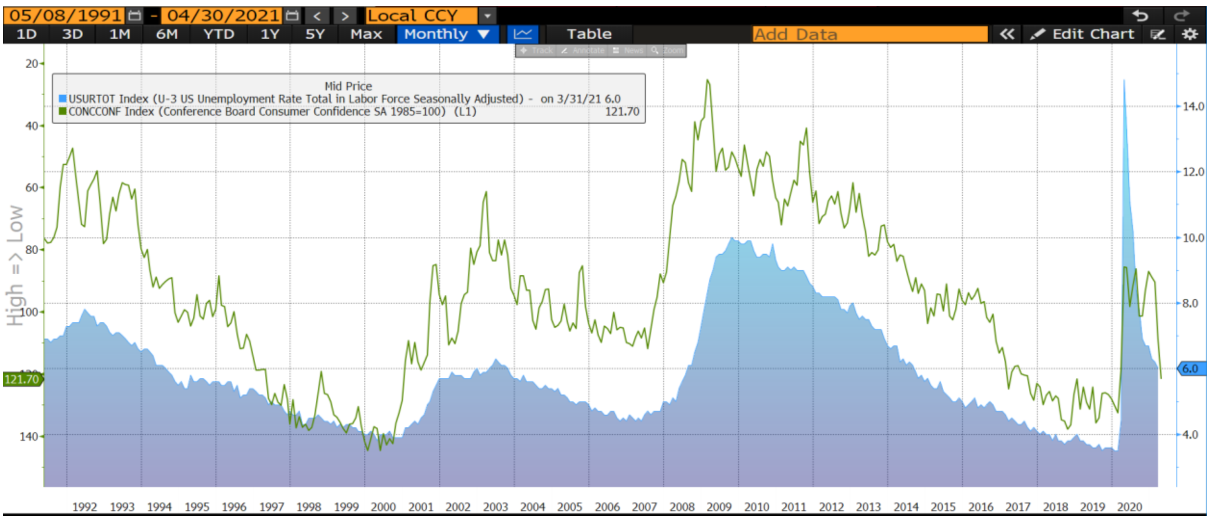
In a sea-change from the tumultuous Trump years, the Biden administration has exuded an air of activism and effectiveness as America recovers from the pandemic – and capital markets are fully behind it. The 200 million vaccine doses injected into citizens has given hope that the economy can reopen swiftly, and several huge packages of fiscal stimulus have supercharged growth expectations. Investors, businesses and consumers all appear confident the recovery will continue in force – the latter buoyed by the $1,400 stimulus cheques handed out in recent weeks.

Fiscal policy has played a huge part in the good mood, and will continue to do so as the White House's spending plans move from emergency support to long-term public investment. But just as important has been the incredible support provided by the US Federal Reserve (Fed). Throughout the pandemic, it has kept interest rates at historic lows and flooded the financial system with liquidity through its asset purchase programme.

Fiscal and monetary stimulus has been so effective at boosting US growth expectations that markets have recently suspected the Fed may have to tighten its policy sooner than it is letting on. Policymakers are showing no sign of backing down, however. After its most recent meeting, Fed Chair Jay Powell dismissed talk of winding down support, even after upgrading the bank's own forecasts for the economy. "We are a long way from our goals," claimed Powell, adding that the Fed would respond only to hard data rather than forecasts.

For capital markets, the difficulty is that the hard data is already coming through. Last quarter's growth figures mean the US economy is slightly larger than it was one year ago, when the pandemic reached American shores, and consumers are in very good shape. Last month, the labour market added nearly one million jobs, bringing the official unemployment rate down to 6%. And judging from consumer confidence levels, the labour market remains buoyant.

The chart below shows consumer confidence stretching back over a few decades, which is closely and inversely correlated with employment figures. Before the pandemic, confidence steadily rose just as unemployment fell to its lowest level in decades – only for the shock of lockdown to send expectations the other way. Now though, consumers are almost as confident as they were before the COVID crisis began. That is understandable, given the artificial nature of many lockdown-related job losses (as travel and leisure industries are expected to hire back workers almost as fast as they laid them off) and the substantial income support provided by the government. But it means the labour market may well be tighter than it looks from the employment figures alone. This is backed up by anecdotal reports that businesses are struggling to find employees – particularly smaller businesses affected by lockdowns.



Source: Bloomberg, Tatton IM, 30 April 2021; Note that the consumer confidence graph tracks against an inverted scale to illustrate the positive correlation.

A tight labour market and booming consumer spending is a recipe for inflation, which is why markets are expecting price increases to ramp up and put pressure on central bankers as we move through the year. But again, the Fed has made it clear it wants to be reactive to inflation rather than proactive, and will allow substantial overshoots of its 2% target to account for past periods of low inflation. This decision is the result of the Fed's recent policy overhaul, which prompted a re-evaluation of its 'dual mandate' (stable prices and full employment) in favour of better promoting jobs and wage growth.

As we have written before, the framework shift makes it difficult to assess how the Fed will react to incoming data. But what we do know is that the central bank wants to give greater consideration to the 'participation rate', a measure of how much of the working age population is pursuing employment. Participation rates are certainly still low historically, suggesting workers lack the incentive to join the labour market.

Usually, this disincentive is because of a lack of well-paid or favourable jobs, but this time there could be a different explanation. Household savings have held up extremely well in aggregate through the pandemic, supported by substantial fiscal support, a fall in consumer spending and – crucially – a decent housing market. In short, consumers are in good shape financially, having paid down debts and put money away over the past year. And when savings are high, consumers are much less willing to take whatever job they can get their hands on. If that is true, it would suggest wages will need to rise as the recovery gets underway, to tempt people back into the labour market, or for households to have run down their savings enough as they resume consuming more with the re-opening of the economy.

Let's take stock of all these factors. We have a central bank committed to keeping things loose, and liquidity abundant for the foreseeable future, a government supporting incomes in the short-term and investing heavily in the future, a population with plenty of savings and high confidence, and an economy finally starting to reopen. Together, these point to a booming 2021 US economy and an uptick in inflation – perhaps even more than is currently expected. How broad-based and long-lasting inflationary tendencies become will depend more on next year's than this year's growth. How will the economy react once the sugar rush of reopening has washed through, and the temporary bottlenecks in supply chains have subsided? Much will depend on fiscal and monetary policymakers to carefully manage the transition back to a 'normal' economy.

In past episodes, when the US economy recovered from a recession, the natural response was for the Fed to signal monetary tightening down the line – which has tended to result in pre-emptive tightening through markets before the tightening actually happens (the last significant such episode was the 2013 'Taper Tantrum', for those who remember). That is why bond yields rose over recent months – as markets tried to anticipate the Fed's movement. But this misses the crucial point – the Fed wants to change its 'natural' response. The point of its recent policy review was to get rid of a structural bias for low price inflation, and instead promote the share of wages in the overall contributions to GDP – by broadening the workforce through inclusion of all social groups in the labour market. The objective is to shift the emphasis of the US economy from capital to labour, after decades of the reverse. In this sense, the Fed is fully in line with the White House agenda for changing the structure of the US economy. As such, coming out of the pandemic, we can expect not just growth but a different kind of growth than we saw before. Capital owners may perceive this as a threat, but judging by the relative stability in US stock markets, investors seem more concerned with stronger growth lifting all boats, than a fraction of investors at the very top end having left a little less, once the taxman has had their share.

CAMBRIDGE
INVESTMENTS LIMITED

4th May 2021

Global Equity Markets

Market	Fri 15:46	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6991	+0.8	+53	⬀	↗
FTSE 250	22509	+0.6	+137	↗	↗
FTSE AS	3994	+0.7	+29	⬀	↗
FTSE Small	7138	+0.7	+48	↗	↗
CAC	6292	+0.5	+34	↗	↗
DAX	15199	-0.5	-81	↗	↗
Dow	33841	-0.6	-202	⬀	↗
S&P 500	4189	+0.2	+9	↗	↗
Nasdaq	14029	+0.1	+12	↗	↗
Nikkei	28813	-1.3	-376	⬂	↗
MSCI World	2963	+0.6	+17	↗	↗
CSI 300	5123	-0.2	-12	→	↗
MSCI EM	1365	+0.9	+12	→	↗

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
Stan Chartered	+8.5	AVEVA	-10.8
HSBC	+8.2	Fresnillo	-7.1
Intermediate Capital	+6.7	Polymetal International	-7.0
Lloyds Bank	+6.6	Ocado	-5.1
BT	+6.3	Bunzl	-4.8

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.385	-0.2	Oil	67.25	+1.7
GBP/EUR	0.869	+0.3	Gold	1771.2	-0.3
USD/EUR	1.20	-0.5	Silver	26.09	+0.3
JPY/USD	109.27	-1.3	Copper	449.9	+3.7
CNY/USD	6.47	+0.4	Aluminium	2417.0	+2.3
Bitcoin/$	56,069	+10.9	Soft Cmdties	439.8	-0.9

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.5	20.0	14.2	14.0
FTSE 250	1.8	19.1	23.2	15.4
FTSE AS	3.1	20.2	15.2	14.2
FTSE Small x Inv_Tsts	1.4	20.4	-	15.1
CAC	1.8	25.3	18.4	14.6
DAX	2.3	20.3	15.9	13.3
Dow	1.8	20.7	20.4	16.1
S&P 500	1.4	27.0	23.1	17.2
Nasdaq	0.7	33.1	33.5	22.3
Nikkei	1.4	25.9	20.7	17.5
MSCI World	1.7	25.2	21.0	16.3
CSI 300	1.7	17.2	14.3	12.4
MSCI EM	1.9	18.6	15.1	12.4

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.83	+0.09
UK 15-Yr	1.18	+0.08
US 10-Yr	1.63	+0.08
French 10-Yr	0.16	+0.08
German 10-Yr	-0.21	+0.05
Japanese 10-Yr	0.10	+0.03

UK Mortgage Rates

Mortgage Rates	Apr	Mar
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.56	1.60
3-yr Fixed Rate	1.68	1.70
5-yr Fixed Rate	1.75	1.78
10-yr Fixed Rate	2.55	2.54
Standard Variable	3.62	3.62

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

If anybody wants to be added or removed from the distribution list, please email enquiries@cambridgeinvestments.co.uk

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Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

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