THE **CAMBRIDGE** WEEKLY

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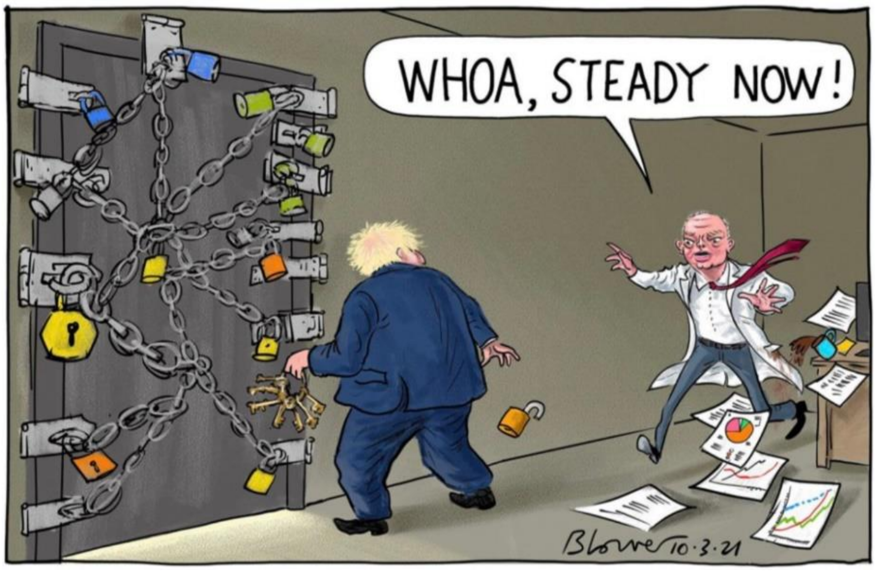


Source: Patrick Blower, 9 March 2021

Recalibrations

Stock markets around the world have had another choppy week, but this time there was more up than down across the board and bonds yields stopped their upwards trend – at least for a while. The general upward trend notwithstanding, there was a lot of rotation and counter rotation between different market segments. With the tech heavy US Nasdaq index going through the wildest of the week's roller coaster rides – first down a lot then up a lot only to then sell off again – it does look as though markets are still undergoing a recalibration phase.

This makes sense, given rising yields (on the back of a vastly improved near-term economic outlook) mean that stock markets have to learn to stand on their own feet again, rather than relying on being the only (investment return) show in town, while governments take care that risk of corporate failures are mostly contained compared to traditional recessionary periods. Valuations metrics are beginning to matter again and, just as the stay-at-home-economy of lockdowns had its winners and losers, so will 'the catching up' recovery that lies ahead.

The same applies to different global regions, be it because of their relative success in suppressing the impact of COVID, (i.e. China) their cyclical industrial structure (i.e. Europe and wider Emerging Markets) or because of vast and effective fiscal stimulus measures to re-accelerate their economies out of deep recessions (i.e. the US).

As a result, we are this week looking in our two focus articles at the $1.9trn US fiscal stimulus package that President Biden signed into law last Thursday night after it successfully passed through Congress and contrast it with China's likely fiscal and monetary stimulus position following the National People's Congress.

Both are decisively important for other economies and for global markets. The political leaders of both areas have stated that employment is at the heart of their efforts. However, the timescales for their policies differ – in part, perhaps, because of the different political systems. The US is embarking on another splurge to ensure the nation is positioned strongly for the post-pandemic restart, while China has long term stability of its capital markets as a main goal. That is leading to quite different near-term paths for growth. The US, rather than China, will once more be imparting its largesse to the rest of the world and become the economic motor after China had taken over that role for the past decade. That probably means a more general benefit for world growth, whereas Chinese growth tends to specifically benefit commodity, machine and luxury good producers.

Meanwhile, last Friday morning, China's push for stability impacted markets more immediately. The Chinese Renminbi weakened after authorities imposed fines on Chinese mega-tech companies on behalf of monopolistic deals in the past. China's consumer tech giant Tencent was among the companies hit, which also means that Tencent potentially faces the prospect of having to create a separate holding company for its fintech arm. Tencent's share price is down about 5% from Thursday's level, sparking renewed tech sell-off pressures, just as the sector seemed to have stabilised after the pronounced sell off earlier last week.

Increased oversight of "fintech"-related companies hit hard before, when at the end of last year, the stock market floatation (IPO) of Ant Group (Alibaba's fintech offshoot) was stopped a day before being sold. By comparison, it may be that over in the US, Biden's administration will set about dealing with some of the US tech giants' negative impacts at some point over his four-year presidency, but it does not appear to be top of their agenda for now.

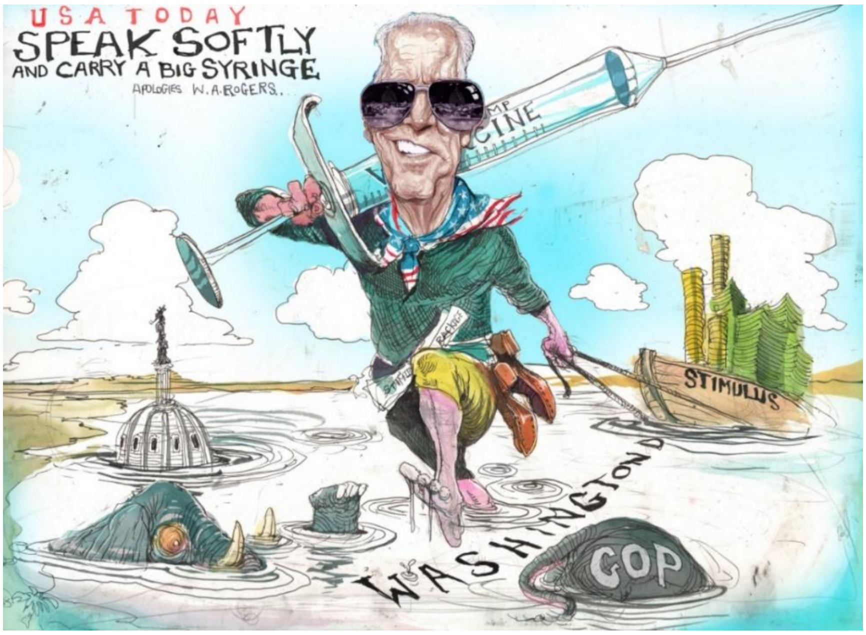
Over to Europe it is worth noting that Europe's economy is about the same size as North America's (In January the IMF reckoned Europe will produce about $23 trillion of output this year, North America $24 trillion). However, following the slow roll-out of mass vaccinations, fewer think that Europe is likely to overtake the US in term of growth this year, even if stock market valuations still present more upside potential on a comparative basis after the US' outsized recovery rally last year.

In 2020, the market was happy to slap the backs of Europe's leaders after they worked together to raise vast amounts of fiscal stimulus money jointly. Markets rewarded the Euro particularly, taking it up to $1.23/€ at the start of the year, amid the certainty of vaccination. But it turns out that wishing to work together is not the same as actually getting things done at speed and so it waits to be seen whether the EU's recovery fund will beat Biden's infrastructure rebuilding plan timings. However, Europe's advantage is that its social net already constitutes the private demand stabilisers that Biden's $1.9trn support program has to create for US employees and produces many of the goods a rebounding 'physical' global economy needs.

It was nevertheless a positive last week that Europe's central bank, the ECB, signalled markets that they would not allow financial conditions to tighten from rising bond yields and step up their countermeasures.

Much of investors' focus was on the US last week because of its raucous market action and the mind-boggling size of the fiscal support program. We should, however, keep in mind that various European nations are approaching elections and so it is reasonable to expect that they will not want to continue to lag behind for much longer. We hope that this urge by politicians to get things moving will manifest itself on constructive industrial and infrastructure policy action instead of the current painful 'he said, she said' finger pointing.

US stimulus bazooka?



Source: David Rowe, 12 March 2021

Despite the harsh economic realities of the pandemic, capital markets have had a staggering amount of confidence over the last year, all things considered. Vaccine hopes have undoubtedly played a big part in this – as can be seen in the fact that investors have rewarded those nations with advanced vaccination programs and punishing those falling behind. But perhaps even more important for the medium-term outlook is fiscal stimulus. Governments around the world have spent more since the beginning of 2020 than most would have thought possible. Much of this has been aimed at emergency support – bridging the funding gap between now and normal – but, more recently, fiscal outlays are being aimed at investing in the post-pandemic world.

Fiscal stimulus always excites investors, and nowhere has been more exciting on the fiscal front this year than the US. The Biden administration is currently pushing through a touted $1.9tn recovery plan, bringing hope that it will kickstart the American recovery in earnest. Given the size and importance of the US economy, markets are also hopeful that US activity will have a significant effect globally, generating demand to power the world economy forward this year and beyond.

Over the first few months of Biden's presidency, those expectations were tempered somewhat. The usual political logjam in Washington means that any bill of this size and importance is going to come with compromises – with fiscally hawkish Republicans threatening to block or diminish the top-line spending figures. But hopes around Biden's fiscal plans and the "Green New Deal" spending got an extra boost in January after Biden's Democratic party gained (slim) control of the Senate, allowing them to push through the budget without breaking partisan ranks. This meant they could push through the COVID relief bill last week with the reconciliation approach, where effectively the Democrats did not need the Republicans' votes.

But of course, as time goes by, more spending projects will come up, especially the significant infrastructure bill which President Biden outlined during his election campaign. It is unclear whether the incumbent government will be able to – or indeed would want to – use the rather narrow reconciliation process again. Hence, it is worth keeping an eye on the political relationship Democrats and Republicans are in the process of establishing.

Recent political news has been even more encouraging on this front. Reports suggest that Republican lawmakers are considering re-introducing "earmarks" in budget negotiations – a tactic where legislators give their support to a bill on the condition that their local pet projects are greenlit. This suggests that Republicans are ultimately willing to negotiate around spending – a far cry from the Obama era when blocking tactics impeded almost all legislation. This sign of compromise is significant: Even with the Democrats controlling both houses of congress, Republican lawmakers have the ability to slow or diminish any legislation that comes their way. The fact they are willing to negotiate with the Biden administration therefore increases the chances that the budget will get through.

Coming back to the Covid bill that just passed, there are a few signs that it may not quite match the $1.9tn headline in the end. Biden's American Rescue Plan Act actually 'only' adds $1.6tn to the government's ability to spend this year. And the Congressional Budget Office (CBO) estimates that only $1.1tn will be spent in 2021 (thereafter, there will be a few spillovers into 2022). This is because clauses in the bill mean that actual spending may turn out lower than the huge numbers making headlines. Proposed spending comes with the same 'automatic stabilisers' that we see in much of Europe's permanent social security set-up , meaning that outlays will automatically decline if the economy fares well. What is more, much of the proposed spending comes from emergency support that distressed individuals and businesses can access if needed, rather than direct payments. Ultimately, if growth and employment accelerate faster than anticipated, net spending figures will be lower.

The media has focused on the $1,400 stimulus cheques being sent to the public, but a few things should be added here. These are, first and foremost, emergency measures designed to support the hardest hit by the pandemic. This support will certainly have a knock-on effect for the wider economy, but suggestions that this amounts to "helicopter money" should be tempered. The eligible income band is actually lower than for Trump's CARES Act last year, and the total spend on the cheques amounts to just a fraction of overall wages. The primary purpose is to lessen the impact lower income groups are suffering on the back of Covid restrictions.

Markets have become excited and concerned in equal measure about the inflationary impacts that America's fiscal drive could have, but ultimately, stop-gap support is unlikely to send price levels skyward. The real excitement on the fiscal front comes from the long-term changes to spending, with promises of productive public investment in vital infrastructure.

There is not much mention of long-term measures in Biden's relief bill of last week. The plans do increase short-term government borrowing, but there is no structural widening of the budget deficit, with fiscal expenditure expected to fall dramatically next year and beyond.

None of this is to say that the rescue plan is insignificant. Support is undoubtedly vital for millions of Americans, and the knock-on effect it could have on confidence and spending habits should not be underestimated. Biden's plans are bridging the COVID gap, but legislators have a fairly generous interpretation of what that means. That is important for inflation expectations, since stimulus is likely to be amplified once activity returns to normal levels.

Ultimately, however, the plan will not provide the supercharge for long-term growth that some might be expecting. Fortunately, the President does have a plan for that too. Biden's plans on infrastructure and tax reform are likely to have a much longer-lasting impact than his short-term support. This seems to be the Democrats' hope: Support those who need it and build back confidence with emergency spending, then invest in a productive post-pandemic future afterwards. The political will to make structural fiscal changes is there; it just has not quite been delivered on with this plan.

Capital markets still have much to get excited about when it comes to US fiscal policy. The rapid rollout of vaccines, combined with generous enough support, should mean that growth is ready to return in force – to the benefit of the global economy. We just still need to look out for structural changes.

China stimulus dud

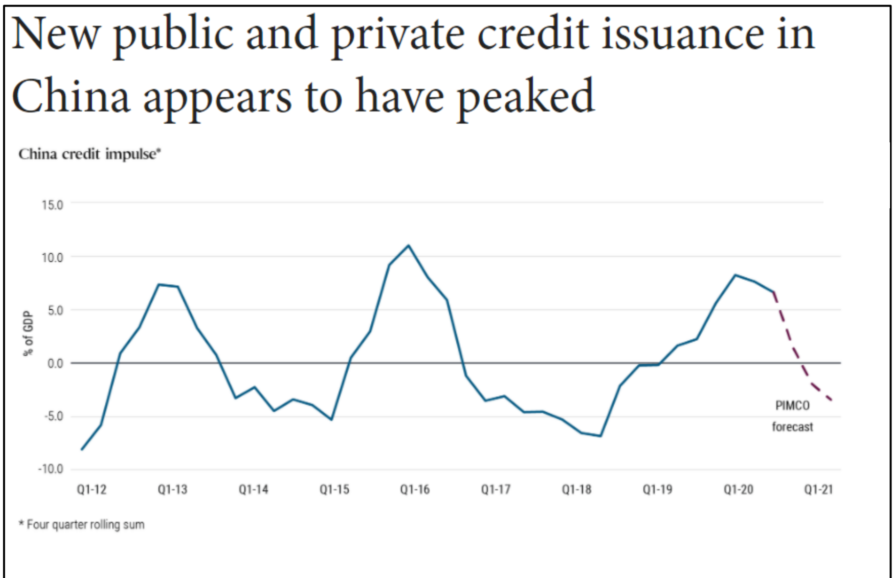
Economic growth, particularly over the long-term, is notoriously hard to predict. So, it makes the job a little easier when someone tells us outright what is going to happen. The Chinese Communist party fortunately revels in such tasks. Last week, the party released the People's Republic's 14th Five Year Plan, setting out growth and development targets until the middle of the decade. With China now the world's largest economy in terms of purchasing power parity, these economic plans are hotly anticipated affairs. Past five year plans have included explicit pledges to reach designated GDP growth numbers – such as the "above 6.5%" level set from 2016-2020.

For the most part, those targets have been dutifully met (assuming one believes the official Chinese growth statistics) but like all else, the unprecedented 2020 spoilt that party at the last minute. After the COVID outbreak and harsh lockdown measures across China, the government abandoned its longstanding annual growth target for the first time in 30 years. Considering the historic falls in economic activity elsewhere, the +2.3% growth figure China recorded last year is nothing to be sniffed at – though well below the stellar numbers we are used to seeing.

The government wants to see growth of "above 6%" this year, but unlike previous five year plans, officials declined to set an average target the 2021-25 period. Growth will instead be kept "within an appropriate range" and new targets set each year depending on economic conditions. A tailing off of China's intense growth should not be surprising, but this move is nonetheless significant for what it says about the government's priorities.

It is hard to overstate the importance of China to the global economy. Over the last 20 years, growth spurts in China have increasingly been the motor of worldwide activity - much like the US used to provide. Many of these have come from government directed stimulus, in the form of injections of credit to stimulate domestic demand. In 2009, while the world was in the throes of the great recession that followed the Global Financial Crisis (GFC), China dramatically increased its lending activity, stimulating domestic activity and providing a vital source of demand globally. This happened again in periods of global decline in 2012, 2015-16 and last year – the deepest global recession on record. Even as China had shown itself less willing to overstimulate its economy post the 2009 experience, it managed to more than double its share of global GDP since.

The chart below shows China's bouts of 'credit impulse' over the last decade. These are times when the government has tried to pump up activity through financing. As the chart also shows, each of these peaks has been followed by a significant drop in credit activity, after the government has applied the brakes to the nation's runaway credit growth.



Source: CEIC, PIMCO as of 31 December 2020.

These troughs have also had a big impact on the global economy, and are very much deliberate domestic policy. Over the last few years, the government has been engaged in a well-publicised deleveraging process, where financial conditions have been tightened and harsh restrictions placed on the notorious shadow banking sector. This is well justified: Authorities are worried about a credit bubble in China and the damaging effect it could have if it bursts, in large part because of the pumping up they pursued in the past. But the end result has been a slowing Chinese economy, and less demand filtering through to the rest of the world. This was most acutely felt in 2018-19, when tightening financial conditions led to distinct weakness in the domestic economy. The Chinese liquidity withdrawal strengthened the effect of tighter Fed policy, and a pronounced sell off in US stock markets followed.

The pandemic forced the government to prime the pump yet again, unleashing significant fiscal stimulus and encouraging lending once more. But unlike other major economies, this time authorities in China did so through gritted teeth. Even last year we saw this: Monetary stimulus around the world increased to historic levels, but in China the response was much more muted. And as we have seen both in the credit impulse data and recent announcements from the People's Bank of China, the government are already keen to tighten conditions.

Chinese authorities have begun to reduce their stimulus measures, something the world's other central banks and governments would not entertain. This is somewhat understandable; the country got a quicker handle on managing the virus, so extensive fiscal bridging was less necessary. But the reduction of stimulus is a clear statement of the government's priorities. Despite being in the deepest global recession on record, the party is focused on controlling future risks rather than stimulating the economy. Again, this is understandable. On the back of China's exceptional 2020 positive growth and being on course for another strong year overall, the high societal debt-to-GDP ratio and its rapidly developing capital markets have made financial stability a key concern.

The ‘controlling risks’ approach is also apparent in other areas: Chinese authorities rather inelegantly cut short the Ant IPO last year to make sure the company had a financial holdings framework for its banking and insurance business. Tech giant Tencent has now come under similar regulatory scrutiny over its fintech activities, which is perhaps also confirmation that Chinese authorities have much less qualm to take on the tech mega caps than the West.

Containing risks now is likely to be a long-term benefit, both for the Chinese economy and international investors. Ultimately, the country’s financial infrastructure is too weak to support an economy of its size in the long run, and improving it will clearly bring benefits. But for now, this tightening means that we should not expect extraordinary economic strength domestically, or for Chinese demand to reinvigorate the global economy as it has in the recent past. Latest fiscal stimulus announcements have generated some media coverage in the West, but when we see these in the context of tightening financial conditions, the government support is somewhat underwhelming. While China has been a driver of global growth over the last decade, now it is happy to be a passenger.

We should point out a couple of things here. First, China’s underwhelming stimulus is certainly an overall negative for global growth – and one that is not fully appreciated by Western commentators – but that does not mean we should be pessimistic about the world economy. Fortunately, where Chinese authorities have to urge caution, the US government can practice largesse. A sizable fiscal package and rapid vaccination program in the US mean we are almost certain to see strength in the world’s largest economy – which should filter out to the rest of the world, just as it used to, when the US economy was the world’s economic motor.

Second, government stimulus is far from the only thing China has going for it. There is still a significant potential for growth – with estimates of 8-9% this year – and international investors are becoming increasingly keen to buy Chinese assets. Fortunately, the latter is the kind of financial growth the government is more than happy to encourage. Focusing on stability will actually help here, meaning there are still plenty of reasons to be positive.

We suspect a ‘soft landing’ is on the cards, but we should nevertheless be prepared for relative disappointment with China, when for once it will not outgrow the rest of the world – at least in 2021. Stability is a key facet of the party’s five year plan, but it may only see the benefits after that.

Global Equity Markets

Market	Fri 15:35	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6746	+1.7	+115	→	⇗
FTSE 250	21472	+2.4	+511	↗	↗
FTSE AS	3843	+1.9	+71	→	↗
FTSE Small	6717	+2.4	+160	↗	↗
CAC	6033	+4.3	+251	↗	↗
DAX	14489	+4.1	+568	↗	↗
Dow	32644	+3.6	+1147	↗	↗
S&P 500	3919	+2.0	+77	⇗	↗
Nasdaq	13212	+2.3	+292	⇘	↗
Nikkei	29718	+3.0	+854	⇗	↗
MSCI World	2806	+2.8	+78	→	↗
CSI 300	5146	-2.2	-116	⇘	↗
MSCI EM	1358	+1.4	+18	⇘	↗

Top 5 Gainers

Company	%
Burberry	+13.0
Kingfisher	+13.0
Scot Mtge Inv Trust	+10.7
Carnival	+9.7
Ashtead	+8.7

Top 5 Decliners

Company	%
StanLife-Aberdeen	-7.2
Hiscox	-4.6
BT	-2.9
Rentokil Initial	-2.8
Evraz	-2.6

Currencies

Pair	last	%1W
USD/GBP	1.388	+0.3
GBP/EUR	0.859	+0.2
USD/EUR	1.19	+0.1
JPY/USD	109.05	-0.7
CNY/USD	6.51	-0.2
Bitcoin/$	56,659	+15.5

Commodities

Cmdty	last	%1W
Oil	69.28	-0.1
Gold	1707.1	+0.4
Silver	25.59	+1.4
Copper	411.7	+0.7
Aluminium	2178.0	+1.1
Soft Cmdties	441.6	+0.3

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.4	20.2	14.9	14.0
FTSE 250	1.7	18.2	22.6	15.3
FTSE AS	3.1	19.7	16.8	14.1
FTSE Small x Inv_Tsts	1.4	19.6	-	14.6
CAC	1.8	23.3	18.8	14.5
DAX	2.4	22.6	16.1	13.2
Dow	1.9	22.7	21.3	16.0
S&P 500	1.5	27.7	22.7	17.1
Nasdaq	0.7	0.0	32.7	22.1
Nikkei	1.4	27.6	22.7	17.4
MSCI World	1.7	25.7	21.3	16.2
CSI 300	1.7	18.8	14.1	12.4
MSCI EM	1.9	21.3	16.2	12.3

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.82	+0.06
UK 15-Yr	1.18	+0.07
US 10-Yr	1.62	+0.06
French 10-Yr	-0.06	-0.01
German 10-Yr	-0.30	+0.00
Japanese 10-Yr	0.12	+0.03

UK Mortgage Rates

Mortgage Rates	Mar	Feb
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.62	1.73
3-yr Fixed Rate	1.72	1.90
5-yr Fixed Rate	1.80	1.89
10-yr Fixed Rate	2.53	2.53
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

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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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