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SIGNIA TALKING POINTS

December 2021

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Do US yields make sense?

Market consensus in terms of direction for 2021 has played out as expected. Economists and strategists were broadly constructive equities and negative bonds. When one looks at headline levels, global equity has rallied almost 19% and the Vanguard Global Bond Index Fund has sold off more than 2%.

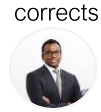
The area where the forecasters have been less prescient is inflation. The Federal Reserve, "the Fed" has up until mid November been maintaining its stance that inflation is "transitory". Year on year CPI inflation rose steadily throughout 2021 from 1.4% in January to 6.8% in November, at which point the Fed threw in the towel, saying it is a "good time to retire that word". The Fed's inflation target is 2%; however it is likely to end the year much nearer to 7%, a hugely material overshoot. So given CPI inflation is the highest it has been since 1982, one would expect US bond yields (bond yields move inversely to bond price) to have also shot up, correct? Wrong, whilst US 10 year yields have increased over the course of 2021, they ended the year at 1.5%, almost exactly where they were in January 2020, days before the pandemic started severely impacting markets.

The aforementioned economists and strategists are experts at rationalising market behaviour after the event, but I suspect few would have predicted US yields being where they are given inflation levels and the strong equity rally. In this context, yields are an anomaly. Conventional economics suggests sovereign bonds, and certain equity sectors, should perform poorly in periods of high inflation.

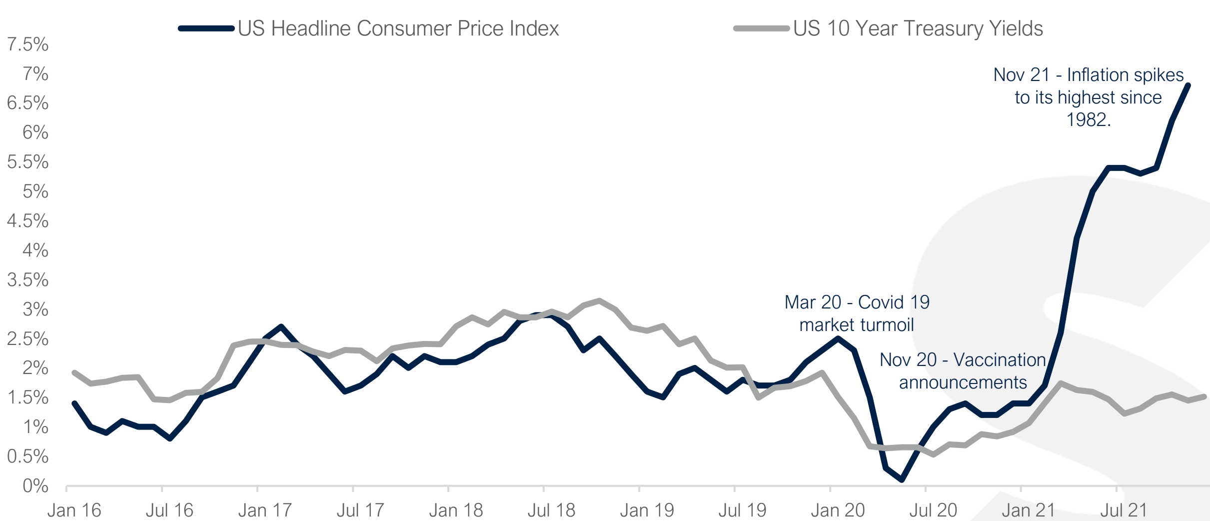
Amongst the various theories as to why US yields are so suppressed, three sound the most plausible:

- once economies recover from the shock of Covid, growth will settle back down to structurally low levels. In such a low growth world, bonds do not have to produce high returns in order to attract investors.
- financial repression, whereby large private investors such as pension funds and insurance companies have to buy bonds in order to comply with regulation.
- the Fed's quantitative easing programme which has been buying $120 billion of bonds a month. This is going to start reducing but the US government is also forecast to issue less debt so this may not impact yields materially.

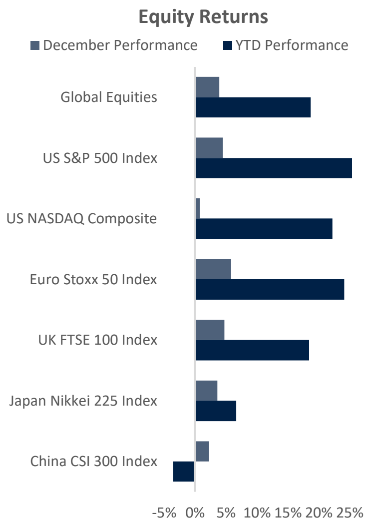
Whatever the real reasons, the path and level of US yields is hugely important to financial markets as it is a crucial determinant in equity valuations and is the anchor in the relative pricing of various assets and investment projects. In the inflation versus yields tug of war, it will be fascinating to see whether the disconnect continues and if not, which side corrects.

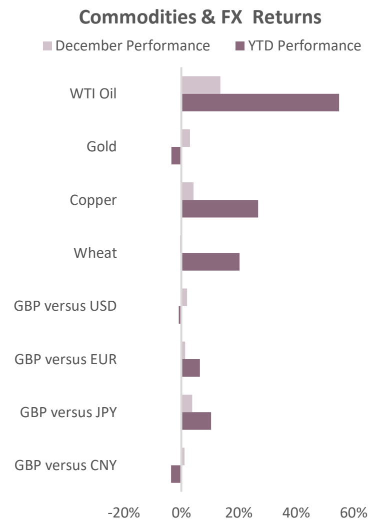


Ammalan Annalingam
Co-Head of Multi-Asset Investments



Source: Bloomberg, Data as at 31/12/2021.





Source: Signia Wealth, Bloomberg. Data as at 31/12/2021.

Global Equities: iShares MSCI ACWI ETF; Global Aggregate: Vanguard Global Bond Index GBP Hedged Fund; Global Sovereign: Xtrackers Global Government Bond GBP Hedged ETF; Global IG Corporate: Vanguard Global Corporate Bond Index GBP Hedged Fund; Global HY Corporate: iShares Global High Yield Corporate Bond GBP Hedged ETF; EM$ Sovereign: iShares J.P. Morgan USD EM Bond ETF; EM$ Corporate: iShares J.P. Morgan USD EM Corporate Bond ETF; EM Local Sovereign: iShares J.P. Morgan EM Local Government Bond ETF.

Equities

Jack Rawcliffe
Senior Equity Fund Analyst

- In what was a strongly positive month for equities Continental European and UK markets rose the most, driven by their greater exposure to cheaper, cyclically-orientated industries which outperformed more expensive parts of the market
- US and Japanese bourses lagged comparatively but still recorded decent positive returns, with the former somewhat constrained by the anticipated impact of tighter monetary policy on higher valued companies
- Chinese equities achieved positive absolute returns during December but lagged the aforementioned markets, as investors strongly favoured exposure to developed rather than emerging markets

Fixed Income

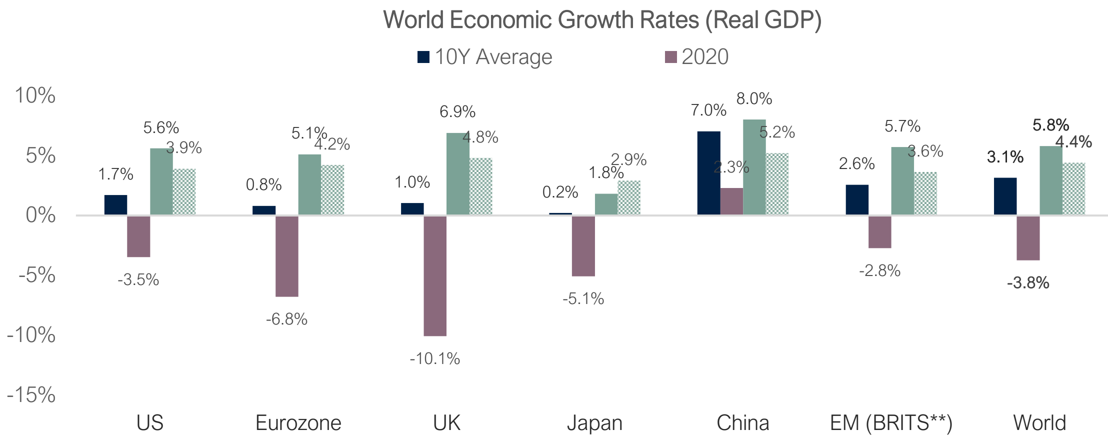
Grégoire Sharma
Fixed Income Fund Analyst

- Global sovereign bonds were down slightly in December, driven by the rise in the US 10year treasury yield as investors priced-in the month's significant inflation readings along with the potential effects of the Omicron variant on the global economy.
- Global corporate credit indices were mixed as the global investment grade credit index ended December flat whilst the riskier global high yield index rose strongly in keeping with equity gains, reflecting the month's risk-on sentiment.
- Emerging market debt indices were broadly positive on the back of strong risk-on sentiment which buoyed dollar-denominated sovereign and corporate debt.

Commodities & FX

Harry Elliman
Investment Analyst

- US 10 Year Treasury yields rose to 1.51% (+0.066%) in December on expectations of the Federal Reserve tightening policy quicker than expected to combat the highest headline inflation since 1982. Despite this, the US Dollar still dropped 0.34% against its peers, although, the Dollar posted a 6.37% gain for 2021.
- Gold appreciated 3.1% on concerns that the spike in Omicron cases could derail the global economic recovery as central banks begin to pullback support. Despite this, Gold posted its first loss since 2018, falling 3.4%.



*Bloomberg Contributor Composite Forecasts, except IMF WEO for India. **Brazil, Russia, India, Taiwan, South Korea.
Source: Signia Wealth, Bloomberg, IMF. Data as at 31/12/2021.

United States of America

The economy is expected to grow in 2021 at its fastest pace since the 1980s as pent-up consumer demand from record high levels of savings boost consumption, trillion-dollar fiscal stimulus packages work their way through congress and the economy, and as the Fed maintains its accommodative stance, albeit it has now started tapering its emergency QE program. Inflation risk remains a primary concern, there are upward pressures from rising wage costs, a record quits rate, and labour supply shortages.

Eurozone

Europe has enjoyed a period of strong recovery; there are still positive aspects, but headwinds are building. The latest PMI data was unexpectedly strong, households appear in good shape, and federal stimulus from the Next Generation Recovery Plan is yet to be drawn down. However, global pressure on supply chains is hurting Europe more than most, especially Germany. Inflationary pressures are likely to constrain the outlook going into 2022 but fears of an Omicron induced shut down are fading.

United Kingdom

The UK is displaying similar inflation trends to Europe but a more pronounced energy crisis and HGV driver shortfall on supply chains are hitting consumer prices harder after Brexit. The BOE has hiked its Bank rate from an all-time low of 0.1% to combat these growing inflation concerns, however, declining real household incomes may slow its hiking cycle. High inflation, supply side shortages, Omicron cases still at high absolute levels and impending tax hikes mean UK sentiment is poor.

Japan

Japan’s economic recovery still lags behind other major economies but is catching up and helped by a recently announced large fiscal stimulus package from newly elected Prime Minister Kishida. Headline consumer inflation is accelerating from low levels, but core inflation has fallen back deeper into deflationary territory.

China

Consumer price inflation has diverged lower relative to other major economies, and whilst producer price inflation is surging, rising input costs have not passed-through to consumers. Exports have remained robust, whilst retail sales have been relatively positive, although declining commodity consumption is reflective of moderating economic conditions. The People’s Bank of China is expected to continue easing liquidity conditions after cutting the bank reserve requirement ratio by a modest 0.5%. Credit impulse levels are near a cyclical trough and could prompt policymakers to further boost economic and credit stimulus.

Emerging Markets

Most emerging economies have found themselves lagging global vaccine rollout programmes with the poorest EM populations left largely unvaccinated. Despite a buoyant global economic recovery in 2021 as broad economic momentum gathers pace, the BRITS economies are still expected to grow at an even pace relative to their developed market counterparts in the US and Europe where policy support has been greater.

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We enjoy working with successful people, creating and managing global investment portfolios.
Our clients are entrepreneurs who value independence.

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By meeting your needs, by being serious about your money, we establish good relationships. We think you'll enjoy working with us.

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Whatever your needs we will work with you to find a solution, call us on +44 (0)20 7298 6060.

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