The Weekly Market View

May 16 2021

ADCB ASSET MANAGEMENT LIMITED

Deflated by inflation

Equity markets have been hovering around their record highs over the past few weeks. As we highlighted in our recently weekly (The Weekly Market View, May 02 2021), behaviour of the markets over these past few weeks was hinting that they are perhaps nearing their 'local maximum'. Last week, financial markets turned a lot more volatile and equity markets ended the week with losses as inflation concerns took a strong hold. This along with the 'peak re-opening' narrative, has brought into focus, the possibility of a 'stagflationary' environment. On inflation, in China, while the April CPI came largely in line with expectations, PPI was slightly higher than expected. In the US, both CPI and core-CPI were more than expected. Countries like Brazil and India also reported higher than expected inflation during April. On the growth side, moderating monetary conditions in China, weaker than expected industrial production in Eurozone, and negative surprises in both retail sales and industrial production in the US created some jitters around growth prospects. Increasing COVID-19 cases in Asia added further to the concerns.

Global equities came under pressure as volatility increased on inflation concerns. MSCI ACWI lost 1.5% over the week. DM outperformed EM. Within DM, Canada and UK outperformed while Japan underperformed the most in USD terms. 10Y UST yields rose during the week but remained well below the end-March highs of 1.74%. In Eurozone, bond yields of both the core and peripheral markets rose too. UK gilts also experienced a rise in the yields. In the commodities space, crude oil and gold prices rose, while silver and industrial metal prices fell. USD appreciated against the Euro and the Japanese yen, but fell against the GBP. For summary on performance and outlook, see page 2.

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Inflation: point and countperpoint

We held the view that inflation is the major risk facing financial markets this year (Global Equity Outlook 2021: The unabnormal, January 19 2021) but persistent inflation is not a given (Q2 2021 Outlook Chart book: A balancing act, April 2021). We have also positioned accordingly (Q2 2021 Outlook: A balancing act, April 2021). On the outlook for sustainable inflation, we think it is rather highly uncertain. In our view, the consumer behaviour in the near-future will likely determine how durable the inflation could be for the next few years. For the US households, the savings which are currently very high can quickly turn into stickier 'wealth' thereby reducing the scope for large consumer splash once the restrictions are fully eased. As for the fiscal support packages and their impact on the economic outlook, multipliers are difficult to estimate. Further, the weak link between unemployment rate and inflation makes it even harder for someone to say with conviction what the inflation rate will likely be. Wage growth statistics continue to be distorted and weak levels of union-coverage (unlike in the 1970s) of the labour force makes a sustainable wage inflation hard to achieve. Productivity growth (derived from strong investments in technology) can be durable over the next years trumping the rise in costs. So, to that extent, we consider inflation to be the 'wildcard'. The base-effects from last year might mean higher price rises this year. Rise in commodity prices and supply bottlenecks are resulting in a 'cost-push' inflation trend, which tends to be temporary in nature compared to 'demand-driven' inflation which can be more longer-lasting. Overall, we are in Fed's camp and believe that rise in price pressures will be temporary in nature. However the risk is that, just like last week, the upcoming inflation data could be higher than expected, putting this key risk in the spotlight.

Global markets' performance snapshot

Index Snapshot (World Indices)

Index	Latest	Weekly %	YTD %
S&P 500	4,174	-1.4	11.1
Dow Jones	34,382	-1.1	12.3
Nasdaq	13,430	-2.3	4.2
DAX	15,417	0.1	12.4
Nikkei 225	28,084	-4.3	2.3
FTSE 100	7,044	-1.2	9.0
Sensex	48,733	-1.0	2.1
Hang Seng	28,028	-2.0	2.9
Regional Markets (data as of May 10 2021)			
ADX	6,209	0.9	23.1
DFM	2,696	1.2	8.2
Tadawul	10,323	0.9	18.8
DSM	10,951	0.5	4.7
MSM30	3,817	0.2	4.8
BHSE	1,527	0.4	2.6
KWSE	6,260	0.1	13.2
MSCI			
MSCI World	2,939	-1.4	9.2
MSCI EM	1,308	-3.0	1.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly %	YTD %
Brent USD/bbl	68.7	0.6	32.6
WTI USD/bbl	65.4	0.7	34.7
Gold USD/t oz	1,843.4	0.7	-2.9
Silver USD/t oz	27.4	-0.1	3.9
Platinum USD/t oz	1,229.5	-2.1	14.7
Copper USD/MT	10,212.0	-1.4	31.9
Alluminium	2,438.8	-3.4	23.2
Currencies			
EUR USD	1.21	-0.2	-0.6
GBP USD	1.41	0.8	3.1
USD JPY	109.35	0.7	-5.6
CHF USD	0.90	0.1	-1.8
Rates			
USD Libor 3m	0.16	-2.5	-34.6
USD Libor 12m	0.26	-2.4	-22.6
UAE Eibor 3m	0.39	-14.9	-24.7
UAE Eibor 12m	0.57	-6.7	-12.6
US 3m Bills	0.00	-150.0	-104.3
US 10yr Treasury	1.63	3.3	78.3

Summary market outlook

Global Yields	10Y UST yields rose during the week but remained well below the end-March highs of 1.74%. Whilst the US April CPI was higher than expected, Fed continued to highlight that the inflation is likely to be transitory. In Eurozone, bond yields of both the core and peripheral markets rose too. UK gilts also experienced a rise in the yields. Overall, we recommend a lower duration stance (5Y US Treasuries) in anticipation of interest rate volatility in the near term.
Stress and Risk Indicators	VIX index rose through the first half of the week to the highest level in two months and moderated subsequently. VVIX, a measure of volatility in VIX hit the highest level since late January. We think the VIX index is unlikely to fall back to the pre-pandemic levels until the virus comes fully under control.
Equity Markets	
Local Equity Markets	GCC equity markets remained closed for most part of last week due to Eid holidays. For the first two days of the week, all regional markets posted positive returns – led by Dubai, Abu Dhabi and Saudi Arabia. Trading volumes were notably thin, however. We remain neutral GCC equities within our global equity framework. Stable to higher oil prices, potential for revival in growth and scope for reversing the underperformance of 2020 are all balanced by lack of structural growth plays in the equity market.
Global Equity Markets	Global equities came under pressure as volatility increased on inflation concerns. MSCI ACWI lost 1.5% over the week. DM outperformed EM. Within DM, Canada and UK outperformed while Japan underperformed the most in USD terms. Amongst EMs, whilst all three regions (LatAm, EMEA and Asia) posted losses, EM Asia underperformed the most. Across sectors, consumer staples, financials and energy outperformed while consumer discretionary, IT and communication services underperformed the most. Our equity strategy is to overweight US and UK, and underweight Eurozone and EM outside Asia. We are neutral Asia and prefer structural growth opportunities there. By sector we prefer IT and communication services as long-term plays and energy as a cyclical play. We have also identified industry level opportunities to play the vaccine availability in the medium-term. Our strategic preference is for large cap non-cyclical growth with focus on quality. 'Build back better' themes including green recovery, digitalization and health care innovation are likely to do well.
Technology Segments	Technology segments underperformed for yet another week. Both Nasdaq and HK Tech indices fell as concerns of inflation fed into higher rate expectations which in turn are likely to be negative for high-duration equities (including technology and other new economy segments).
Commodities	
Precious Metals	Gold prices rose for the second consecutive week. Higher inflation in the US, and a risk-off tone in markets were partly offset by stronger USD. We keep our overweight in gold as a hedge against potential risks on the horizon.
Energy	Oil prices rose for the third consecutive week. However, they been volatile over the past week as the Colonial pipeline disruption and India's COVID-19 situation weighed. Overall, we believe that oil prices are likely to remain sustained as the market approaches a balance.
Industrial Metals	Industrial metal prices fell as Chinese officials introduced measures to bring down prices. Also easing supply and softening demand started emerging in physical markets. While another commodity super-cycle appears difficult, demand for commodities linked to environmental friendly green infrastructure is likely to sustain.
Currencies	
EURUSD	Expectations for higher interest rates in the US kept EUR weak against the USD. Movements in major currencies are likely to be influenced by how re-opening of the economies, and the policy support unfold.
Critical levels	R2 1.2464 · R1 1.2303 · S1 1.1859 · S2 1.1576
GBPUSD	Gradual reopening of the economy and the hawkish BoE helped cable strength for the second week. We expect the cable to be driven by how the re-opening plays out over the near-term and to decouple from the EUR.
Critical levels	R2 1.4474 · R1 1.4286 · S1 1.3789 · S2 1.3480
USDJPY	Weakness in Japanese equities and the extension of emergency in the country resulted in depreciation of the JPY. Over the medium-term, we believe that BoJ yield curve targeting should put downward pressure on JPY.
Critical levels	R2 112.46 · R1 110.91 · S1 107.64 · S2 105.92

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

Forthcoming important economic data/events

United States

	Indicator	Period	Expected	Prior	Comments
05/17/21	Empire Manufacturing	May	24.0	26.3	Preliminary/flash PMI for May will be the key data release this week. In line with the narrative of the 'peak reopening', market consensus expects both manufacturing and services sectors to expand at slightly slower pace than in April. FOMC meeting minutes will be read to see if there was any discussion about tapering the pace of asset purchases (currently at USD120bn per month).
05/17/21	NAHB Housing Market Index	May	83	83	
05/18/21	Building Permits	Apr	1,770k	1,766k	
05/18/21	Housing Starts	Apr	1,705k	1,739k	
05/19/21	MBA Mortgage Applications	14-May	--	2.10%	
05/19/21	**FOMC Meeting Minutes**	**28-Apr**	**--**	**--**	
05/20/21	Philadelphia Fed Business Outlook	May	41.5	50.2	
05/20/21	**Initial Jobless Claims**	**15-May**	**455k**	**473k**	
05/20/21	Continuing Claims	8-May	3,640k	3,655k	
05/21/21	**Markit US Manufacturing PMI**	**May P**	**60.2**	**60.5**	
05/21/21	**Markit US Services PMI**	**May P**	**64.5**	**64.7**	
05/21/21	Existing Home Sales	Apr	6.08m	6.01m	

Japan

	Indicator	Period	Expected	Prior	Comments
05/17/21	PPI YoY	Apr	3.10%	1.00%	Consensus estimates the Q1 GDP to have contracted q-o-q, after two consecutive quarters of gains. Second state of emergency during Q1 is likely to have impacted domestic consumption negatively while net exports are likely to have moved less favourably.
05/17/21	Machine Tool Orders YoY	Apr P	--	65.10%	
05/18/21	**GDP SA QoQ**	**1Q P**	**-1.10%**	**2.80%**	
05/20/21	Exports YoY	Apr	31.00%	16.10%	
05/20/21	Imports YoY	Apr	9.00%	5.70%	
05/20/21	Core Machine Orders MoM	Mar	5.00%	-8.50%	
05/21/21	**Natl CPI YoY**	**Apr**	**-0.50%**	**-0.20%**	
05/21/21	**Natl CPI Ex Food, Energy YoY**	**Apr**	**-0.10%**	**0.30%**	
05/21/21	**Jibun Bank Japan PMI Mfg**	**May P**	**--**	**53.6**	
05/21/21	**Jibun Bank Japan PMI Services**	**May P**	**--**	**49.5**	

Eurozone

	Indicator	Period	Expected	Prior	Comments
05/18/21	**Eurozone GDP SA QoQ**	**1Q P**	**-0.60%**	**-0.60%**	Second print of the Eurozone GDP will be watched for any potential revisions – although markets do expect the print to confirm the region to have entered a double-dip recession. Flash PMIs will be closely watched – especially for the services sector.
05/19/21	EU27 New Car Registrations	Apr	--	87.30%	
05/19/21	**Eurozone CPI YoY**	**Apr F**	**1.60%**	**1.30%**	
05/19/21	**Eurozone CPI Core YoY**	**Apr F**	**0.80%**	**0.80%**	
05/20/21	Germany PPI YoY	Apr	5.10%	3.70%	
05/21/21	**Markit Eurozone Manuf. PMI**	**May P**	**62.6**	**62.9**	
05/21/21	**Markit Eurozone Services PMI**	**May P**	**52.4**	**50.5**	
05/21/21	Eurozone Consumer Confidence	May A	-6.7	-8.1	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
05/17/21	Rightmove House Prices MoM	May	--	2.10%	Market consensus expects stable employment data for March, higher inflation in April, and improvement in consumer confidence in May. Elsewhere, PMIs are expected to paint a divergent picture of moderating manufacturing and improving services sectors.
05/18/21	Average Weekly Earnings 3M/YoY	Mar	4.50%	4.50%	
05/18/21	**ILO Unemployment Rate 3Mths**	**Mar**	**4.90%**	**4.90%**	
05/19/21	**CPI YoY**	**Apr**	**1.50%**	**0.70%**	
05/19/21	**CPI Core YoY**	**Apr**	**1.30%**	**1.10%**	
05/21/21	GfK Consumer Confidence	May	-12	-15	
05/21/21	Retail Sales Inc Auto Fuel YoY	Apr	36.80%	7.20%	
05/21/21	**Markit UK PMI Manufacturing SA**	**May P**	**60.7**	**60.9**	
05/21/21	**Markit/CIPS UK Services PMI**	**May P**	**62.1**	**61.0**	

China and India

	Indicator	Period	Expected	Prior	Comments
05/14/-05/17/21	China 1-Yr MLF Rate	15-May	--	2.95%	Industrial production, fixed asset investments and retail sales in China are expected to have moderated in April. PBoC is expected to keep rates unchanged and interbank liquidity conditions stable.
05/17/21	**China Industrial Production YTD YoY**	**Apr**	**21.10%**	**24.50%**	
05/17/21	**China Fixed Assets Ex Rural YTD YoY**	**Apr**	**20.00%**	**25.60%**	
05/17/21	**China Retail Sales YTD YoY**	**Apr**	**31.90%**	**33.90%**	
05/17/21	India Wholesale Prices YoY	Apr	9.20%	7.39%	
05/20/21	**China 1-Year Loan Prime Rate**	**20-May**	**3.85%**	**3.85%**	
05/20/21	China 5-Year Loan Prime Rate	20-May	4.65%	4.65%	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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