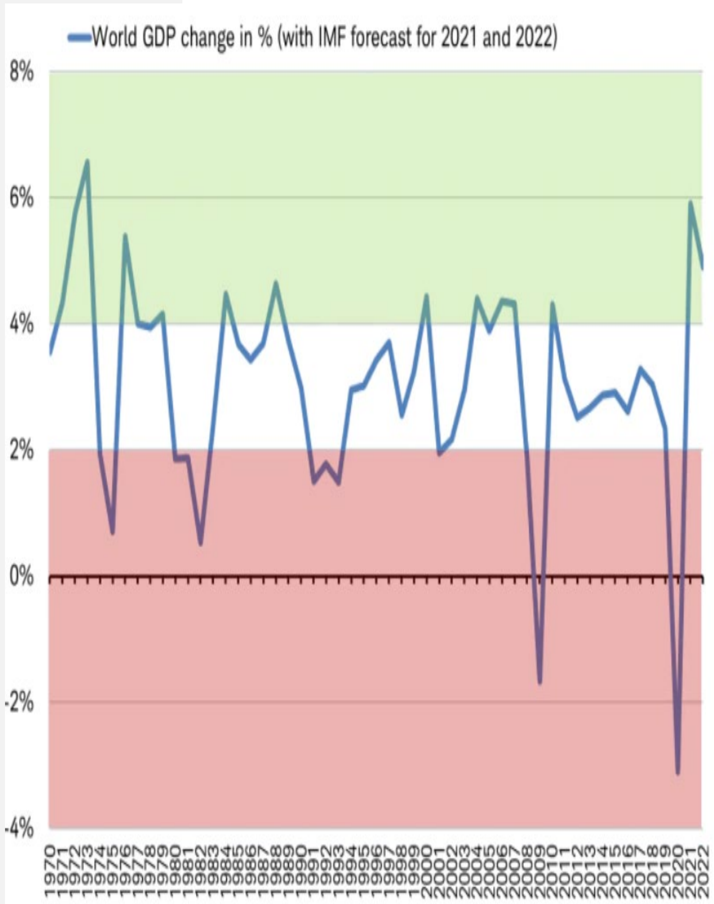
Weekly Market Update

28 NOV 2021

Global Growth Outlook 2022

- A high tide of growth, aided by a sea change in fiscal policy, is likely to help float the global economy safely over the rocks of risks in 2022, despite waves of worries emanating from COVID, inflation, shortages, and rate hikes.
- Global GDP has surpassed its pre-pandemic level in 2021 and completed the transition from recovery to expansion, aided by strong policy support, the deployment of effective vaccines and the resumption of economic activities. In 2022, global GDP is anticipated to grow around 5%, forming the strongest back-to-back years for the world economy since the early 1970s.
- As COVID becomes endemic rather than pandemic, a seasonal surge in cases could lead to some new restrictions. Yet, each successive wave is likely to have diminished economic impact with hospitalization trends, rather than new case counts, becoming the hurdle for restriction
- Historically, when central banks were lifting rates from a low level (below average) as they are now, stocks in the MSCI World Index performed best (+10.3%). Conversely, it was when they were being cut from a high level (above average), global stocks performed the worst (-17.8%).

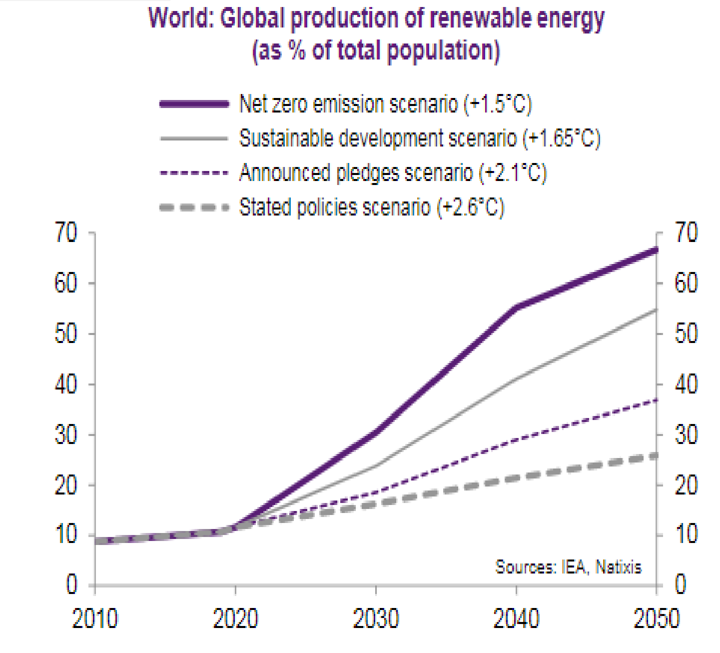


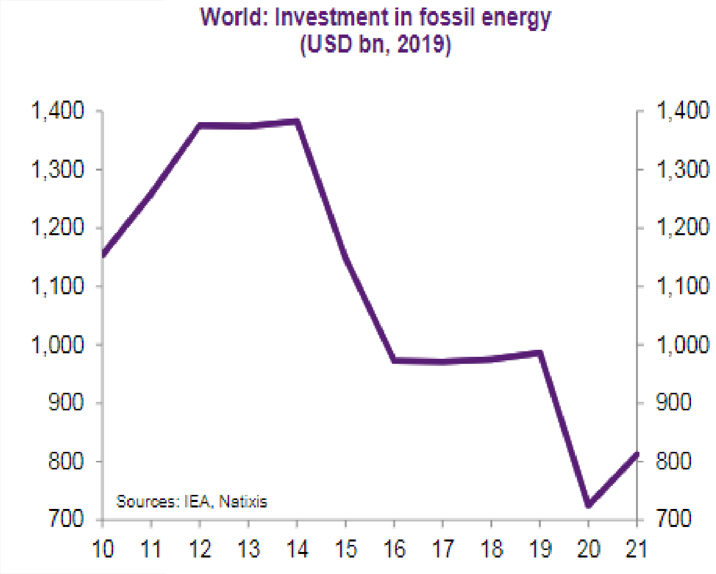
Annual performance of global stocks under different policy rate environments

G20 Central Bank Rates	Above Average	Below Average
Rising	5.9%	10.3%
Falling	-17.8%	5.5%

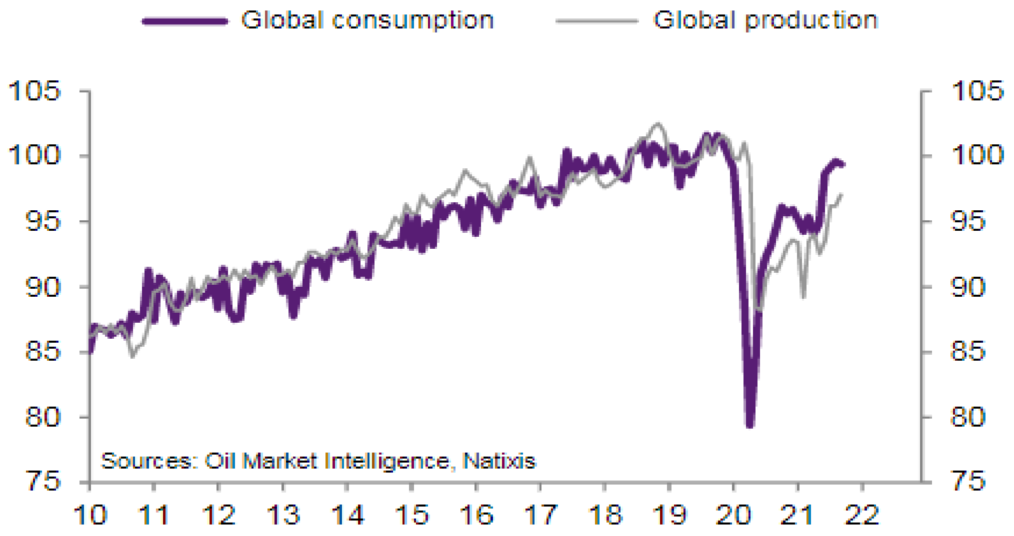
Inflation is on account of Transition (… not transitory)

- The environmental emphasis and in particular the drive towards net-zero is the single biggest factor pushing inflation higher.
- The risk then is that during the transition, fossil fuel production will decline faster than fossil fuel demand which would give rise to price peaks for these energies like the one we have been seeing now. The energy transition will probably lead to higher inflation on average.
- An electric vehicle requires five times as much copper wiring as an internal combustion engine, and a 3-megawatt wind turbine (enough to Power around 800 homes) uses up to 4.7 tonnes of the metal.
- Electrification of everything is central to the energy transition, which has pushed copper prices to the highest in a decade. Oddly, this isn't yet stimulating increased investment in new production, which on current trends will drop by half over the next five years.
- Climate policies, pressure from public opinion, governments and savers discourage investment in fossil fuel production by cutting the financing of these investments. The rebound from Covid is colliding with reticence among the large publicly owned energy companies to invest in new production
- The increases in copper and oil are both inflationary, even though they're the result of opposing energy transition effects. Although the media breathlessly forecasts imminent peak oil, demand continues to grow while supply shrinks and the price does not decline because of that.

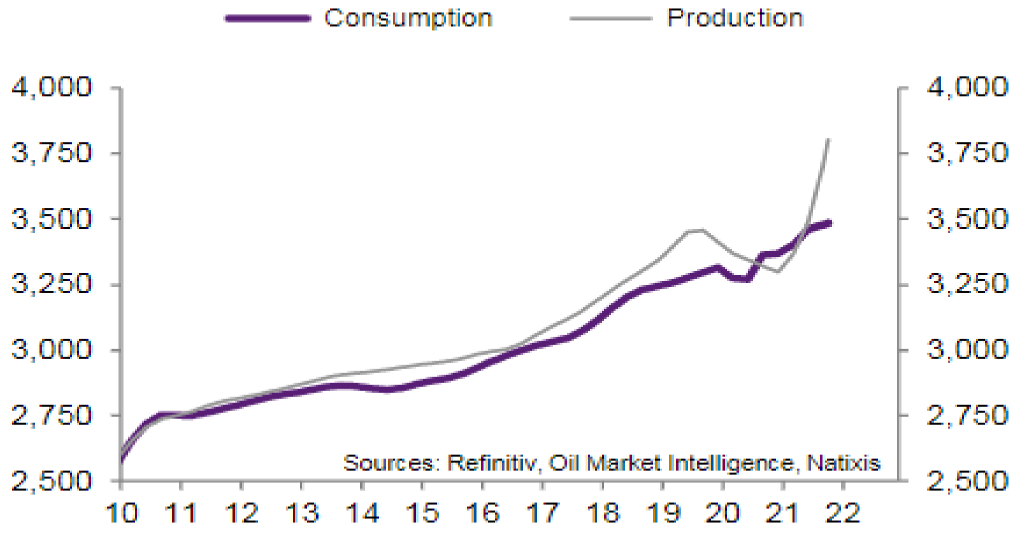




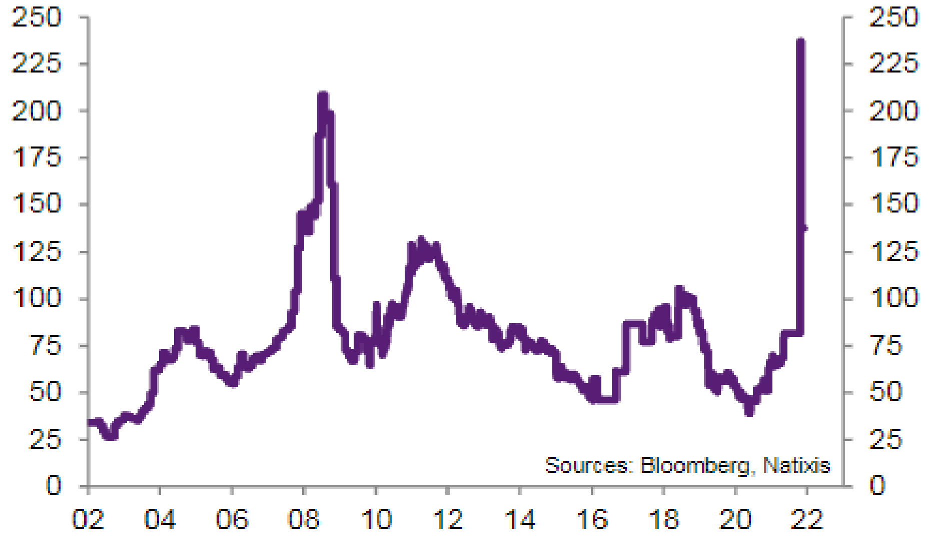
World: Oil consumption and production (million bbl/day)



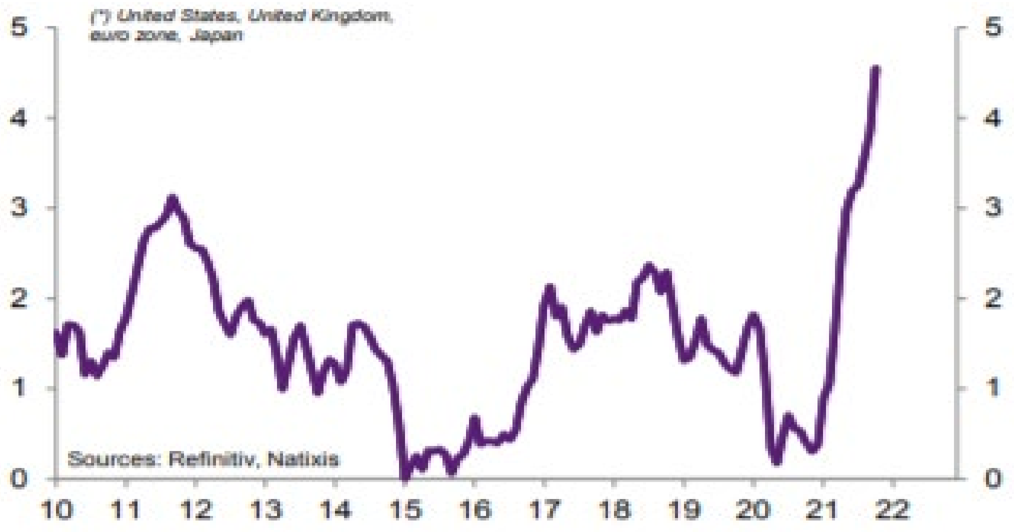
World: Natural gas consumption and production (MTEP)



Price of coal (USD/tonne)



OECD*: Inflation (CPI, Y/Y as %)



Thanks Giving says Inflation is Persistent

- American consumers hunting for Black Friday bargains did not find much in 2021 as supply remained tight and inventory was low and prices high .
- They had paid between +5-17% more for toys, apparel, appliances, furniture, computers, sporting goods and TV sets compared to 2020.
- Adobe Digital Economy Index has shown consumers spent $14 billion online during Thanksgiving and Black Friday combined. This marks the first time where both days did not see an increase in online spending over last year.
- Offline Sales surged 29.8% through mid-afternoon, according to Mastercard Spending Pulse, which tracks all types of payments, including cash and credit cards.
- Out-of-stock messages have increased by 124% compared to just before the beginning of the pandemic in January 2020. The Adobe Index showed appliances, electronics, housekeeping supplies and home & garden having the highest out-of-stock levels.
- Looking at the inventory-to-sales ratio of the main segments of discretionary retail, inventories are significantly below their 10-year average.
- Measuring the gap in current inventory levels vs their long-term average against current sales levels, the estimate is that USD 41bn in goods are missing from the inventories of US discretionary retailers.
- Low inventory levels are the glass-half-empty way to look at the current retail environment.
- The glass-half-full view is that, in dollars terms, inventories have never been so elevated, and that lower ratios reflect the difficulty for retailers to keep pace with all-time high spending on discretionary goods.
- Durable goods consumption looks set to remain well above trend, **maintaining demand-side pressure (alongside ongoing supply-side pressure) on inflation.**

Risk of the New Variant

- A new variant is causing concerns among scientists (and investors with Friday's sharp risk sell-off) due to the variant's high number of mutations.
- Concern is that the new variant is able to evade immunity, as some of the mutations are known for reducing neutralisation, and is more infectious.
- Omnicron now accounts for nearly all cases in South Africa which happened much faster than for delta although number of new cases is very low.
- There is an opinion arguing that new treatments should still work and expects protection from the existing vaccines will remain high, at least against severe illness
- It is still early days. We know, for instance, that the beta variant is a bigger concern than the delta variant from a vaccine perspective, but the more contagious delta variant dominates beta.
- The worst-case scenario from an economic perspective is still a variant, which means that the world may have to start all over again.
- The most important questions remain : 1) is transmissibility higher?, 2) is it more dangerous? and 3) is the variant better able to evade immunity?
- A new variant, which means lower protection from being vaccinated or previously infected, is a risk near-term, but vaccine producers should be able to quickly update their vaccines if needed.

US Economy – Strength Continues

- The big things to know from the latest batch of data is that consumer spending remains strong despite the highest inflation since 1990, the housing market remains strong if not quite as hot as sky-high expectations and a pop in exports might mean that trade could actually add to GDP growth in Q4 rather than detract from it as it has for the past five consecutive quarters.
- To the extent that this week brought surprises, the biggest was the drop in initial jobless claims, which fell to 199K. That is the lowest since 1969.
- While that was a bigger improvement than most expected (Bloomberg consensus was 260K), a single week's numbers may hardly make a story.
- The seasonality may have been a factor and could reverse next week.
- Still the trend decline in claims has been a steady driver of the Leading Economic Index for several months.
- Employers are struggling to find good help, so it makes sense that they would be reluctant to hand out pink slips in such an environment.
- USD continued to strengthen amid strong US data and re-nomination of Powell as Fed chair.
- Inflation is no doubt a headwind, but in October at least, it was not enough to stop consumers from spending, with a real personal spending pickup of 0.7%. With a five-handle on the PCE deflator, inflation is higher now than at any point since 1990.
- The headline PCE deflator came in at 5.0% year-over-year in October and core PCE was 4.1%.

US Equity Markets : Seasonal strength in store

- The holiday-shortened week ended with a bang, as news of a new COVID-19 strain overseas sparked worries over potential renewed lockdowns, with equity markets enduring the steepest daily decline in two months.
- Thin holiday trading volume likely exacerbated the reaction, but this is a reminder that despite the recent rally and still-favorable fundamental outlook, pandemic and policy uncertainties still pose credible risks to the market's tranquility in the near term.
- Going back to 1950, the market has come into Thanksgiving with a year-to-date gain of 20% or more 19 times, including this year.
- The average return in the following year was more than 18%.
- We don't expect 2022's gains to be quite that high, but this demonstrates that strong years don't have to be followed by disappointing ones.

What to expect next week

- Manufacturing and Services PMIs from the ISM and Markit, but will likely be headlined by Friday's November nonfarm payroll report.
- Other releases slated for next week that could garner attention include, Consumer Confidence, jobless claims for the week ended November 27, and the Fed's Beige Book.
- Also, amid the Fed accelerated tightening uncertainty, next week's host of Fedspeak could be a potential market mover, headlined by three days of commentary from Fed Chairman Jerome Powell.
- Rest of the world data includes China's Manufacturing and Services PMIs for this month, which will be accompanied by Japan's preliminary industrial production and retail sales for October, as well as preliminary Eurozone consumer price inflation statistics, and German retail sales.

Changing Face of FOMC

- Biden announced his intention to reappoint Powell as Fed Chair. There are two takeaways from his renomination.
  - The Administration is more confident in the probability the Build Back Better plan (BBB) will be passed. House passed its version of BBB late last Thursday. The Powell renomination was a bargaining chip in the case BBB faltered.
  - The probability of more aggressive Fed policy next year—i.e., accelerated tapering and more tightening than the two and half 25 bp rate hikes currently in the curve—is much higher now than if Brainard were to have been nominated .
- There will soon be three open governorships on the FOMC—one that was carried over from Trump and two others (Quarles and Clarida). In addition, there are two bank president openings in Boston and Dallas, but only the former has a vote on next year's FOMC.
- Powell may be less dovish next year now that he is reappointed.
- Next year the FOMC loses one super dove (Evans), a regular dove (Daly) as well as two moderates (Barkin and Bostic). They will be replaced by two super hawks (Bullard and George)
- If the Administration does not fill the governor openings, the FOMC will become much more hawkish next year.
- This argues for these positions to be filled before next summer when the bond market expects Fed liftoff to begin
- The upshot is that the Administration may be incentivized to fill the governorships with super doves to minimize the chance the Fed aggressively hikes rates next year.

US Oil Dynamics

- While US oil production at the beginning of 2020 was still over 13 mb/d, it stabilised for a long time at 11 mb/d.
- A slight increase is now noticeable, but at 11.4 mb/d, production is still nowhere near the level of two years ago.
- All the more striking is Biden's call for more oil production while his local policy is more focused on meeting climate targets by 2050.
- In that context, he has, among other things, called off the construction of the Keystone XL Pipeline from Canada, announced stricter environmental measures and revoked permits for oil/gas production on federal land.
- Lower oil production has made the US a net importer again.
- At the same time, we see that access to financial markets for many oil products has become significantly more difficult in recent years. Furthermore, there is more discipline among these companies in terms of capital management.
- The larger producers, in particular, are looking more at a healthy business model and less at growth with borrowed money.
- Also, regulations and legislation (e.g. on waste water and methane emissions) have become stricter and importantly labour costs have risen

Europe : Risks aplenty

- European economy appears to be performing better than expected with November Euro area PMIs surprising on the upside.
- The EZ PMIs came in stronger than expected in November. The composite PMI increased to 55.8, up from 54.2 in October.
- Particularly the service sector picked up pushing composite PMI higher for the first time since the reopening fumes dozed off in July.
- The jump in the services PMI was totally due to higher ‘current business activity’, whereas the forward looking part of the services PMI (‘business expectations’) dropped by 2.4 points to its lowest levels since February.
- This drop in the business expectations in services probably is related to the rapid spreading of the Delta variant - Potential new restrictions in Europe ahead. The Netherlands and Austria are already in lockdown and further countries could follow.
- German Ifo figures indicated slowdown in the coming months particularly in the service sector as further restrictions are lurking ahead and consumer confidence are heading lower in Germany, and in the Euro area, as high inflation erodes purchasing power
- Manufacturing PMI showed that production continues to rise, but that growth in the sector is still hindered by supply bottlenecks and shortages of material and/or equipment. Supplier’s delivery times continued to lengthen at a steep rate in November, easing only slightly compared to October. Meanwhile, the sub-index for backlogs of work stayed at a high level, although it fell somewhat compared to October.
- Overall, the PMI report is in line with the view that economic growth will slow down markedly in Q4 (0.7% qoq) after GDP expanded by 2.2% qoq in Q3.

China : Peak Stress Behind us

- The overall picture is still one of weakness, but with signs of a peak in stress in the property sector and leading indicators (such as credit growth) pointing to a bottom in early 2022. Base case is that there is Likely to be more weakness in the short term, as headwind from the property sector will continue to linger.Consumption is tempered by more frequent lockdowns and momentum in exports is coming down.
- PMIs continue to trend lower. Credit growth remains very weak but with signs of turning.
- Copper prices move sideways still in line with weaker manufacturing momentum.
- Govt has stepped in, though, to stabilize the developer crisis and also initiated moderate stimulus measures.
- It will pave the way for a gradual recovery of PMI's and growth during 2022 with growth getting back to trend by the end of 2022.
- PPI inflation jumped to a new high in October at 13.5% driven by high coal prices.
- CPI inflation is also grinding higher but at 1.5% is still far below the 3% target.
- PBoC cut the RRR rate by 50bp on 9 July but has refrained from more easing since. Markets look for a further cut soon, though.
- M1 growth remains weak and rising credit yields add new headwind.
- The effective yuan is at the strongest levels in six years spurred by strong trade flows.

India Bonds : Range bound

- Markets now expect global central banks to continue with accommodative stance, till there is clarity with respect to the impact of the new COVID strain, instead of tightening monetary policy to curb rising inflation as had been expected in the past few weeks.
- 10-year benchmark 6.10%, 2031 bond ended at 98.35 rupees or 6.33% yield.
- Markets are however wary of the RBI's moves in the secondary market after the they sold Rs.11.80 bln outside of open market operations in the week ended Nov 19.
- Rates are likely to stay range bound ahead of the outcome of the RBI ‘s monetary policy review meet from Dec 6-8.
- Currently, liquidity in the banking system is estimated to be in a surplus of over Rs.7.30 trln.
- GDP is expected to have grown 8.1% in the September quarter, thanks to a combination of factors, including improved economic activity levels and a favourable base effect.
    - Nomura's India Business Resumption Index had risen to 105.0 by the end of September, well above the pre-pandemic baseline of 100.0.
    - Merchandise exports performed robustly, hitting an all-time high of $35.43 bln in July. This has since been exceeded in October, when it came in at $35.65 bln.

Nifty : Not out of woods yet

- At a time when companies are grappling with high costs, the spread of a new variant has worsened the situation, raising concerns over the negative impact on demand and the nascent economic recovery. This has led to a sharp rise in bearish bets. The over 6% rise in the open interest of the Nifty 50's December futures contract suggested the build-up of short positions as investors feared a further correction in the index
- Investor sentiment had turned tepid at the fag end of the second quarter results, post the fanfare in topline growth of companies due to rising demand as economies continue to open up. The relentless selling by foreign institutional investors, who feel that current valuations do not reflect inflation-related risks, has led to a pause in the strong upswing in Indian equities.
- This week's sharp correction has clearly validated our recent cautious stance on the market. Considering the 'Shooting Star' on the monthly chart and formation of bearish 'Head and Shoulder' pattern on daily chart.
- One should not be in a hurry to do any kind of bottom fishing immediately.
- The likely range 16850-17350 is likely to prevail