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weekly

Macro Matters

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07 June 2021

We don't believe in investing on the basis of macro, but nor do we ignore it

When I raise the issue of the importance of macro, I tend to get the same responses, which fall into two categories: 1. It can't be done; no one has a good record predicting macroeconomic variables like GDP growth. 2. Why bother? Even if you had perfect foresight of what these variables were going to be, you wouldn't be able to predict the market's reaction.

Addressing the second point first, the reason predicting macroeconomic variables is desirable is that they have a bearing on your future payouts from any investment: if GDP growth is weak or negative, company sales are likely to be lower; if inflation is high, the squeeze on real incomes is likely to have a similar effect by reducing consumer discretionary spending; if interest rates go down, holders of government bonds stand to profit, other things being equal.

The biggest factor affecting the performance of most companies is not the size of the wider economy, but whether anyone actually wants to spend money on their product. Hence while every company has a sensitivity to macroeconomic variables as described above, that is not to say that idiosyncratic risk is not key. At times, the macro is dwarfed by these company specific factors, at which point macro doesn't matter, but this will not be true at all times and for all companies. Ignoring cyclical businesses and companies with less than perfect finances in order to avoid having to think about the outlook for growth and interest rates, curtails one's investment universe.

Predicting key variables like growth, interest rates and inflation is extremely difficult, even for professional forecasters[1]. However, establishing reasonable bounds for key variables is more achievable. For example, are central bank rates of 10% in the US likely next year? We are realistic about our forecasting abilities but we do not assume that anything between plus and minus 10% carries an equal probability. We pay close attention to historical norms. The hurdle to moving away from these norms is high, given that this time is rarely different. In many instances history reveals the natural level of key variables, to which they revert over time by virtue of the natural stabilisers that exist within economies.

As with all big problems, the key is to reduce it into something manageable, which for us means a set of four scenarios. Currently we believe the most likely outcome for the global economy is a strong rebound in growth, with higher attendant inflation than during the pre-pandemic period. In each of these scenarios we don't immediately assume asset class x will go up and asset class y will go down. Instead we think about what is likely to happen to the key variables that influence investment returns. For example, by trying to understand what is likely to happen to company sales in a range of scenarios, we can then interrogate the price we're being asked to pay for equities today. This means we can tolerate a recession without running into cash, if we think the price we're paying for equities and credit adequately compensates us for this scenario.

The key distinction is between a top down investment approach akin to an investment clock, and using macro as an input to a bottom-up, valuation driven approach. We don't believe in investing on the basis of macro, but nor do we ignore it. Macro variables don't tell you what investment returns are going to be: they contribute to the payouts you are going to receive in future, at which point you need to decide what you are going to pay for those payouts today.

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[1] *T Stark, 'Realistic Evaluation of Real-Time Forecasts in the Survey of Professional Forecasters', Federal Reserve Bank of Philadelphia Research, philadelphiafed.org, 2010*

Market Focus

- Global equities rose 0.6% last week
- Brent crude rose 3.2% last week to $71.9 a barrel
- Gold fell -0.6% to $1891.6 per ounce
- G7 nations agree in principle for a minimum global corporation tax of at least 15% on overseas earnings

US

- US equities rose 0.6% last week
- Final services and composite PMIs for May generally showed upgrades from the flash readings, with the composite PMI revised up to 68.7 from the flash reading of 68.1, its highest reading since the series began in 2009
- ADP's report of private payrolls came in at +978k in May beating expectations of +650k, marking the biggest rise since last June
- The ISM services index rose to a record 64.0, beating expectations of 63.2
- Weekly initial jobless claims for the week ending 29th May fell to a post-pandemic low of 385k, against expectations of 387k
- The US job report showed +559k new jobs in May, missing expectations of +675k
- The ISM prices paid figure of 80.6 reached the second highest level on record
- The Federal Reserve's Beige Book showed the US economy growing at a "moderate pace" during the observation period of early-April to late-May

UK

- UK equities rose 0.8% last week
- May's final manufacturing PMI rose to a record high of 65.6
- 75% of the adult population in the UK have now received a first vaccine dose and more than half have now received both doses of the vaccine

Rest of the World/Asia

- The benchmark Global Emerging Markets index returned 1.6% last week
- Japanese equities rose 0.7% over the week
- Chinese equities rose 0.8% last week
- Japan's services PMI reading came in at 46.5 and the composite reading at 48.8, revised up from the flash readings of 45.7 and 48.1 respectively
- China's Caixin services PMI came in at 55.1, down from 56.3 in April, bringing the composite to 53.8, from 54.7 in April
- China's May exports grew 27.9% year-on-year, against expectations of 32.1%, while imports came in at 51.1% year-on-year, against expectations of 53.5%

Europe

- European equities rose 0.9% last week
- The flash CPI reading in the Euro Area rose to +2.0% in May, against expectations of +1.9%, the highest reading since November 2018
- The Euro Area manufacturing PMI was revised up from the flash reading to 63.1 vs 62.8
- The Euro Area composite PMI was revised up to 57.1 from the flash reading of 56.9, its strongest reading since February 2018
- Producer price inflation for April rose to +7.6% as expected, its highest level since 2008
- Germany's retail sales for April fell by -5.5%, weaker than the -2.5% expected
- Unemployment in Germany fell by -15k in May, worse than the -9k expected, while the wider Euro Area saw employment fall to 8.0% in April, against expectations of 8.1%, marking its lowest level since last June
- In Italy, growth in Q1 was revised up to +0.1%, from a -0.4% contraction previously estimated

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

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Market Summary

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Asset Class / Region	Currency	Cumulative returns: Week ending 04 June	Month to date	YTD 2021	12 months
Developed Markets Equities					
United States	USD	0.6%	0.6%	13.1%	37.4%
United Kingdom	GBP	0.8%	0.8%	11.7%	14.7%
Continental Europe	EUR	0.9%	1.5%	14.5%	27.4%
Japan	JPY	0.7%	1.9%	9.6%	24.8%
Asia Pacific (ex Japan)	USD	1.0%	0.1%	7.3%	41.7%
Australia	AUD	1.6%	1.9%	12.5%	25.5%
Global	USD	0.6%	0.8%	12.2%	37.1%
Emerging Markets Equities					
Emerging Europe	USD	2.8%	2.7%	15.5%	28.2%
Emerging Asia	USD	1.2%	-0.1%	5.8%	43.8%
Emerging Latin America	USD	4.9%	4.1%	10.4%	38.3%
BRICs	USD	1.7%	0.5%	5.2%	36.3%
China	USD	0.8%	-0.6%	1.1%	30.8%
MENA countries	USD	1.2%	1.1%	19.2%	39.1%
South Africa	USD	2.7%	1.2%	21.4%	53.2%
India	USD	1.1%	0.1%	12.9%	63.5%
Global emerging markets	USD	1.6%	0.4%	7.7%	42.6%
Bonds					
US Treasuries	USD	0.2%	0.2%	-3.4%	-2.8%
US Treasuries (inflation protected)	USD	0.2%	0.2%	1.1%	8.0%
US Corporate (investment grade)	USD	0.2%	0.2%	-2.6%	3.8%
US High Yield	USD	0.3%	0.3%	2.5%	12.9%
UK Gilts	GBP	-0.3%	-0.3%	-6.7%	-6.0%
UK Corporate (investment grade)	GBP	0.0%	0.0%	-3.7%	3.5%
Euro Government Bonds	EUR	0.2%	0.2%	-3.3%	1.6%
Euro Corporate (investment grade)	EUR	0.2%	0.2%	-0.6%	4.1%
Euro High Yield	EUR	0.3%	0.3%	2.8%	10.9%
Japanese Government	JPY	-0.1%	-0.1%	-0.4%	-0.4%
Australian Government	AUD	0.0%	0.1%	-3.1%	-2.0%
Global Government Bonds	USD	0.2%	-0.1%	-3.9%	1.6%
Global Bonds	USD	0.1%	-0.1%	-2.9%	3.4%
Global Convertible Bonds	USD	0.2%	0.0%	1.1%	21.9%
Emerging Market Bonds	USD	0.2%	0.2%	-3.8%	3.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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Asset Class / Region	Currency	Cumulative returns			
		Week ending 04 June	Month to date	YTD 2021	12 months
Property					
US Property Securities	USD	2.9%	2.9%	21.6%	32.1%
Australian Property Securities	AUD	2.6%	2.6%	6.1%	18.3%
Asia Property Securities	USD	0.0%	0.9%	8.4%	14.7%
Global Property Securities	USD	1.9%	1.9%	15.1%	28.3%
Currencies					
Euro	USD	-0.3%	-0.5%	-0.5%	7.3%
UK Pound Sterling	USD	-0.2%	-0.3%	3.8%	12.4%
Japanese Yen	USD	0.3%	0.0%	-5.7%	-0.5%
Australian Dollar	USD	0.3%	0.0%	0.6%	11.7%
South African Rand	USD	2.4%	2.3%	9.1%	25.9%
Swiss Franc	USD	0.0%	-0.1%	-1.6%	6.3%
Chinese Yuan	USD	-0.4%	-0.4%	2.1%	11.2%
Commodities & Alternatives					
Commodities	USD	2.5%	2.5%	26.9%	59.5%
Agricultural Commodities	USD	3.1%	3.1%	22.7%	59.5%
Oil	USD	3.2%	3.7%	38.8%	79.8%
Gold	USD	-0.6%	-0.8%	-0.1%	10.2%
Hedge funds	USD	0.2%	0.1%	3.6%	12.8%

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