Global markets have fully achieved economic recovery?

2Q 2021

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Five Key themes over the 2nd Quarter, 2021

The US Federal Reserve - FOMC meeting

There was a flurry of market activity after the June FOMC meeting although arguably no significant policy announcements were made. The jitters that the markets experienced are indicative of the positive sentiment seen in recent months relying partly on continuing supportive monetary policy stance from the Fed. Hence the concerns when Mr Powell and subsequently Mr Bullard, head of the St Louis Fed, signaled tightening "somewhat sooner than previously anticipated".

As the dust settles from the FOMC meeting, market participants are grappling with deciphering what, if anything, has really changed with the Fed's announcement. Economies around the globe, as in the US, are still relatively early on in their reopening and hence point to the reflation trade continuing for the rest of the year. On balance the Fed still seems to be guarded about tightening policy too quickly and we are likely to see rates volatility for 30 year rates declining as the markets will tend to anchor their focus on when the Fed will eventually hike.

Inflation – Transitory discussion

Inflation spikes have again been hitting the headlines and there is a case to be made that these are still transitory in nature. In the US, one component of a key inflation indicator is used car prices, which seems to have driven the recent inflation hike, but is showing signs of deceleration. The pandemic has created a significant amount of supply bottlenecks in many areas as pent up consumer demand remains at elevated levels. In light of this, while some market commentators are pointing to US CPI continuing to print figures above the 3% mark, with the Eurozone and UK likely to present similar rising inflation trends, the view that this is not indicative of a structural change where inflation is headed over the longer term continues to resonate.

Where inflation does eventually head in the US (and other geographies) could be the result of how the labour market shapes up. There is a belief that excess capacity in the labour market will not lead to any significant inflationary effects but there is some uncertainty around this. Stimulus payouts and unemployment benefits in the US are leading employers to face difficulty in recruiting and some States are looking to pare back benefits before there are originally slated to run out.

Amongst all the chatter it is appealing to look back in history to try and draw parallels. Although one has to tread with caution, an interesting point worth noting was highlighted in an article published in the Financial Times, referencing a Federal Reserve Bank of Atlanta's paper. It details the situation post World War 2 where pent up consumer demand and supply constraints that rapidly presented themselves led to a short-lived inflation spike, before dissipating. The discussion around the path of inflation in the current environment is unlikely to ease anytime soon.

Covid-19 Vaccination Rates – Divergence between DM and EM countries

The biggest vaccination campaign in history is underway. More than 3.05 billion doses have been administered across 180 countries, according to data collected by Bloomberg, with the latest vaccination rate at roughly 42.9 million doses a day.

Enough doses have now been administered to fully vaccinate 19.9% of the global population but the distribution has been lopsided.

Countries and regions with the highest incomes are getting vaccinated more than 30 times faster than those with the lowest.

Source: Eastspring Investments.

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The Asia-Pacific region's Covid-19-containment response was a relative global outperformer in 2020, but in 2021 its vaccine rollout has in aggregate lagged that of other regions, apart from Africa. The number of doses delivered in the Asia-Pacific region remains low relative to the US and to that necessary to achieve "herd immunity". Reasons vary from slow vaccine approvals & rollouts to difficulty procuring vaccine supplies.

The low rates of vaccination and outbreaks of new infections pose near-term downside risks to our economic growth forecasts and could delay recoveries from the pandemic shock of 2020. However, relatively narrow applications of lockdowns, coupled with adjustments in societal and business behavior, should help to cushion the economic impact.

Cryptocurrencies

Bitcoin became legal tender in El Salvador, the first country to recognize it as such. Business will now have to keep bitcoin on par with the US Dollar, which is the official currency, in accepting it as a mode of payment. Reports cited that the government is hoping this will be attractive to the large proportion of the population without access to bank accounts.

El Salvador is an outlier in providing this status to Bitcoin as China's ban on cryptocurrency mining has paralysed an industry that accounts for over half of global bitcoin production, as miners dump machines in despair or seek refuge in places such as Texas or Kazakhstan.

Soon after the government warning, several cryptocurrency miners including HashCow and BTC.TOP halted all or part of their China operations last month. This had huge ramifications since Chinese miners reportedly account for as much as 70% of crypto mining worldwide.

Authorities in China say cryptocurrencies disrupt economic order and facilitate illegal asset transfers & money laundering. Analysts say Beijing is also worried about potential competition for the digital yuan and that the power-hungry business of bitcoin mining could damage the environment.

If all the miners do leave China, it will mean less fossil fuel-powered mining, but it will also mean that the crypto network's share of renewable energy-powered mining will drop. Since miners at scale compete in a low-margin industry, where their only variable cost is typically energy, they are incentivized to migrate to the world's cheapest sources of power. Therefore, the question of where these migrant miners end up could prove critical to bitcoin's carbon footprint.

The 2020 energy cost breakdown report by Lazard shows that many of the most common renewable energy sources are either equal to or less expensive than conventional energy sources like coal and gas. However, wind and solar power supplies face limitations at scale, so there is concern over the viability of miners turning exclusively to wind or solar energy

Shipping Woes

Shipping has made headlines over the recent months, notably the vessel blocking the Suez Canal in March and more recently Yantian Port, which is one of China's busiest ports, announced it would not accept new export containers due to Covid-19 affecting its operations.

Yantian's partial temporary closure added to a backlog creating supply chain chaos that could take months to clear, as ship schedules and container availability revert to normality, with ramifications across the globe in the interim. Yantian's partial temporary closure added to a backlog creating supply chain chaos that could take months to clear, as ship schedules and container availability revert to normality, with ramifications across the globe in the interim.

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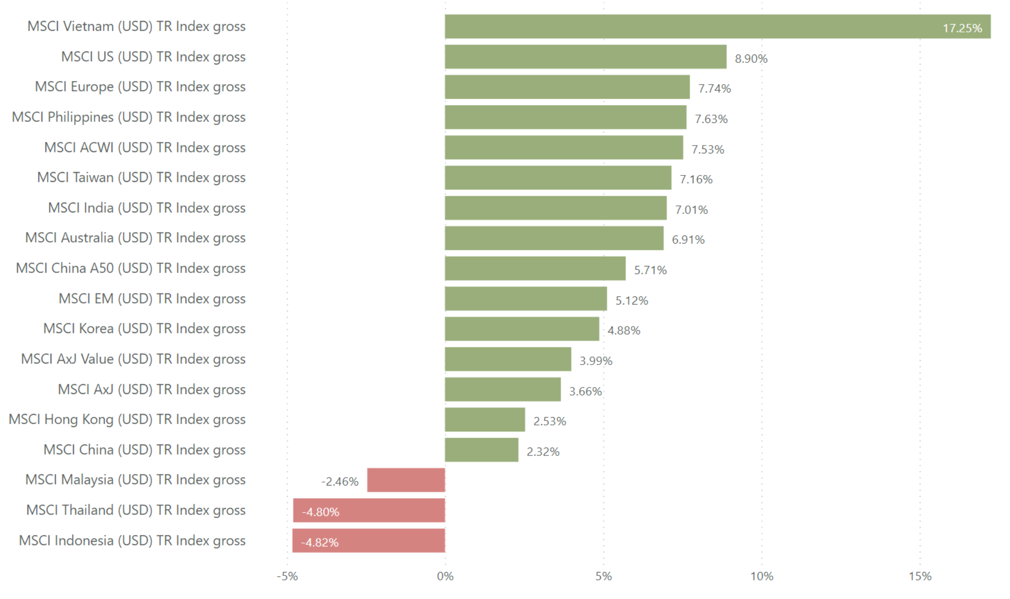
Equities

- The majority of equity markets ended the second quarter in positive territory. Vietnam led the pack with MSCI Vietnam (17.3%) followed by MSCI US (8.9%). The broader markets represented by MSCI Europe (7.7%), MSCI ACWI (7.5%) and MSCI EM (5.1%) also posted gains over Q2.
- While still rising, MSCI Asia ex Japan (3.7%) was behind the other broad indices, dragged down by comparatively lower returns of several Asian equity markets, including MSCI China (2.3%) and MSCI Hong Kong (2.5%).
- Elsewhere, delivering negative returns over the quarter we saw MSCI Malaysia (-2.4%), MSCI Thailand (-4.8%) and MSCI Indonesia (-4.8%).

Asset Performance Custom (31 Mar 21 till 30 Jun 21)



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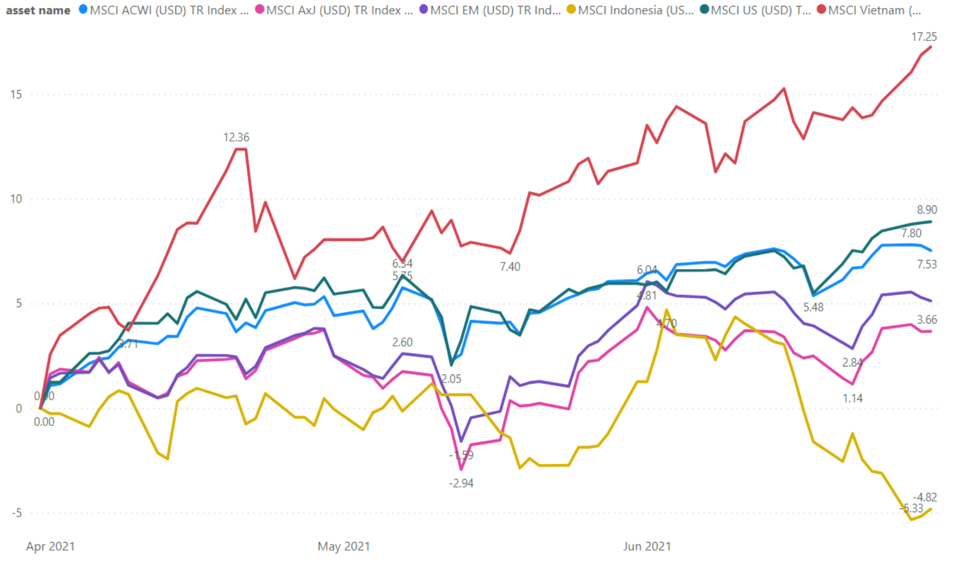

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 June 2021.

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Fixed Income

- In Fixed Income markets, Bloomberg Barclays Global Aggregate index ended the quarter month in positive territory returning 1.3%. With sovereign bond yields not being very high and inflation rising, investors were focused on yield and inflation hedges in recent weeks.
- The JACI Index returned 1.1% for the quarter with investment grade names (1.14%) outperforming their high yield counterparts (0.81%). From a country perspective, Sri Lanka was the strongest performer, adding 7.8% over the quarter, keeping up with the momentum from its returns in 1Q2021, with a year to date return of 18.5%. China as well as Cambodia were at the other end of the spectrum in 2Q2021, both returning 0.1%.

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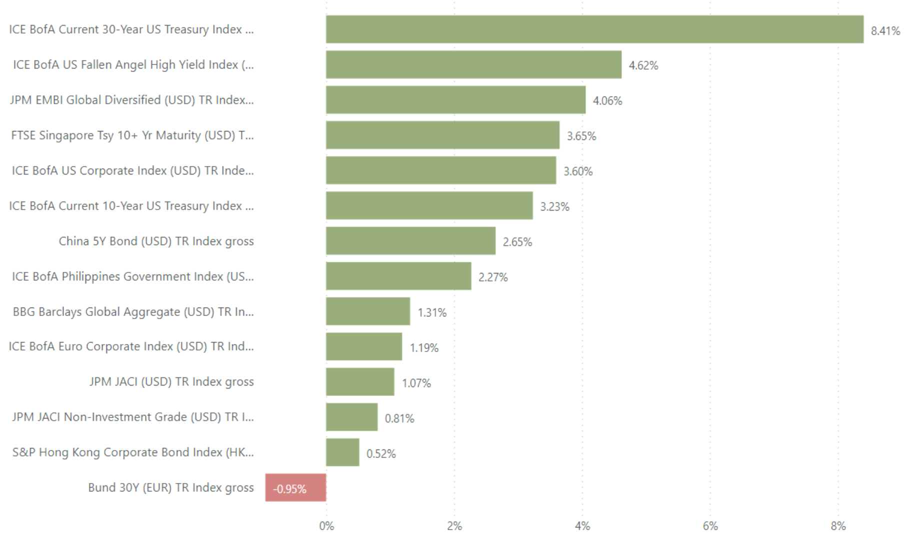

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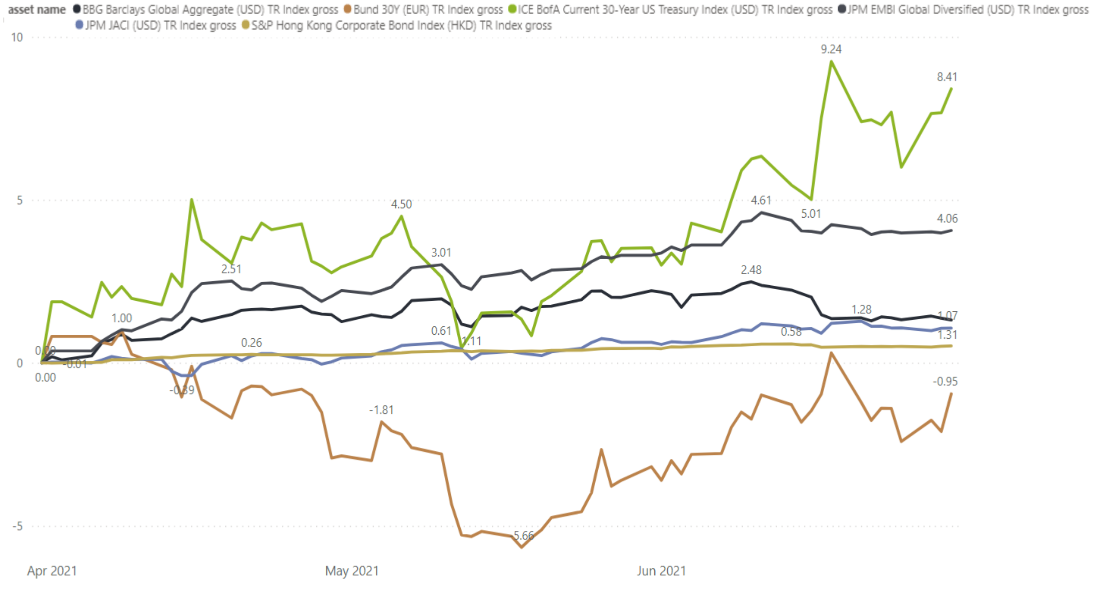

Source: Eastspring Investments. Chart data from Refinitiv Datastream as of 30 June 2021.

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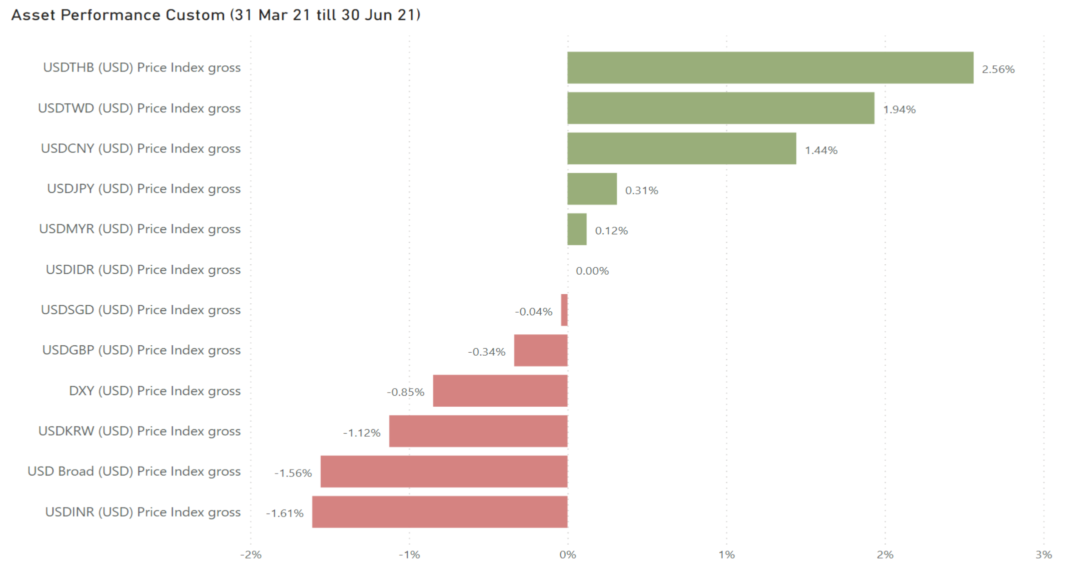
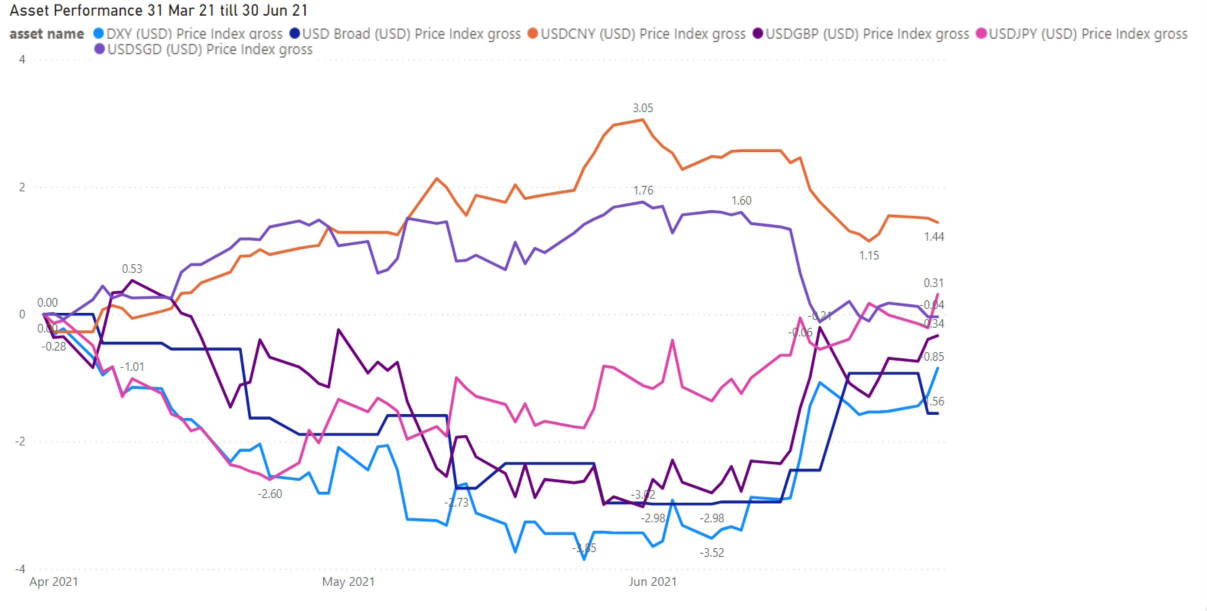
Currencies

- The USD Dollar Index fell -0.9% over the second quarter. Broad-based declines were seen in the US dollar, with the Fed behind some of the drivers behind this. In April lower US treasury yields and in May the messaging around supportive monetary policy pushed the currency lower. The British Pound also finished the quarter lower, easing -0.3% against the USD and the Indian Rupee also fell -1.6%, with the Covid situation weighing on the economy.
- On the flip side in terms of the gainers, the Thai Bhat, Chinese onshore Reminbi and the Japanese Yen were up over the quarter. The Bhat rose 2.6%, the Reminbi was up 1.4% and the Yen 0.3%





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Economics

- The OECD forecast that the world economy is likely to grow by 5.8% in its latest outlook. This a sharp revision upwards from its previous estimate of 4.2%in December 2020. However, some sectors such as tourism will not be beneficiaries of this growth, as expected. The UN estimated that the ongoing COVID-19 pandemic' s impact on the tourism industry will cost global GDP around 1.9-2.7% of the total with countries that have lowest vaccination rates, to be hit the hardest.
- Australia and Britain signed a free trade deal, which is the first since Britain left the European Union. This raised concerns from British farmers about cheaper Australian goods impacting them, although there is a cap for 15 years on tariff-free imports.
- MSCI dropped Argentina from its EM index in response to the capital controls which were introduced in the country in September 2019. This led to share prices tumbling in the country as a result.

Source: Eastspring Investments.

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