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APRIL REVIEW

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Financial markets have started April strongly and the rotations that characterised much of the first quarter have eased. The move higher in US Treasury yields that had triggered market and asset class shifts peaked at the end of March, briefly touching 1.75% in the US 10-year Treasury yields, before falling back to 1.55% by mid-April. In sympathy, the opening weeks of April have seen global equities rise c. 5%, the Dollar index fall -2.3% and Gold rise nearly 5%. For now, investors continue to look through the risk of COVID-19 virus mutations, vaccine concerns and infection surges in countries such as Brazil and India. Headline grabbing stories covering the blockage of the Suez Canal and collapse of US family office Archegos, also had little lasting influence on market sentiment.

Somewhat surprisingly, the reversal in US Treasury yields has taken place against a run of strong US data releases, however, there seems to be a series of reasons behind the move, not least a loss of momentum following the worst quarter for US government bonds since the 1980's. Fundamentally government bond yields have already adjusted a great deal for stronger growth and inflation expectations, but they had also moved well ahead of the Federal Reserve's path of future interest rate forecasts. Successful treasury auctions together with the Federal Reserve's consistent message of no change in policy until significant progress is made towards their average inflation and full employment objectives, unsettled market positioning that was looking increasingly stretched.

At March's Federal Reserve Open Market Committee (FOMC) meeting Chairman Jerome Powell did nothing to talk down long-term bond yields, but the combination of sharp upward revisions to 2021 growth and inflation forecasts, 6.5% and 2.2% respectively, without any change to the expectation of rates remaining near zero until at least 2024, gave a firm impression of the Fed's reaction function as the economy rebounds strongly this year. More recently, in remarks to the Economic Club of Washington, Powell confirmed asset purchases would not be tapered before substantial progress was made towards the Fed's goals and a reduction of asset purchases would take place "well before" a rise in interest rates.

In the US, President Biden rolled out plans for another round of fiscal stimulus, this time focusing on creating jobs. The American Jobs Plan of c. $2.5tr aims to renew US infrastructure, upgrade schools and hospitals and invest in both digital and climate control programmes. Unlike the American Rescue Plan, it is intended this package will be paid for through tax increases. The Biden administration has proposed spending the funds over 8 years and paying for it over 15 years, through an increase in corporate taxes from 21% to 28%. Passing the plan will not be straight forward and will likely rely on compromises within the Democratic party and the reconciliation process in the Senate.

Although the size of the fiscal policy response in Europe and the speed of deployment has lagged the US, Italian Prime Minster Mario Draghi is pushing hard to provide further support. In recent days Draghi has launched further spending measures that will stretch the Italian fiscal deficit to 11.8% of GDP this year, taking advantage of a temporary suspension in European fiscal rules.

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In its April update of economic forecasts, the International Monetary Fund (IMF) lifted its 2021 global GDP projection to 6% from 4.4%, led by positive revisions in the US. However, the IMF also recognised the growing divergence in recovery between developed and emerging countries as a result of differing fiscal capacity. As a result, developed economies are now expected to experience very little lasting impact from the COVID-19 crisis, whilst much of the emerging world will suffer significant medium term loses.

On balance, data releases in the major economies have met or beaten expectations over the past month. In the US, data has been particularly strong with the latest round of household stimulus cheques driving a 9.8% month-on-month surge in retail sales in March. Labour market data has continued its trend of improvement with 916,000 non-firm jobs added in March, positive revisions to January and February prints and a fall in the headline unemployment rate to 6%. The US services sector business survey index jumped to an all-time high of 63.7 in March, well ahead of expectations and the February level of 55.3. As expected, US inflation year-on-year picked up to 2.6% in March due largely to the base effects from a year ago when the economy suffered a disinflationary shock as the COVID-19 crisis escalated.

Despite renewed restrictions in several European countries, economic and survey has remained robust and not deteriorated, with particular strength seen in the manufacturing sector. Recent data from China confirms a loss of momentum in Q1 as policy makers start to cool credit growth in the economy.

Changes to asset allocation over recent months, increasing equity risk and reducing low yielding fixed income have positioned client portfolios to benefit from the global growth upswing, but also help to navigate the transition in government bond yields.

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