MERRION
INVESTMENT MANAGERS

CANTOR Fitzgerald

Strategy & Outlook MARKET UPDATE

August 2021

Global equities ended the month higher, rising by +0.6% over the month to stand +16.6% year-to-date, with a continued outperformance of growth over value, a +1.4% gain for the MSCI Growth Index vs -0.3% for MSCI Value Index (all figures in euro terms).

Mid-month saw the worst daily sell-off for global equities since February and the worst two-day return since last October, and followed three months of declining market breadth, falling bond yields, and rising concerns about the Delta variant, US-China relations and the US infrastructure bill. It is difficult to point to any one trigger for the move, but the market quickly recouped its losses to return to the highs led by growth and momentum stocks with a significant improvement in market breadth and back-to-back 80% upside days in US equities. These are quite rare except for reversals off major market lows. The last similar readings were last November post the US election which preceded a multi-month rally in global equities.

The main news of the month came from China, where the theme of regulatory tightening continued, sparking the worst selloff in Chinese equities since 2018. The initial focus was on Didi, China's dominant ride-hailer, the cybersecurity regulator announcing an investigation into the company, and, less than a week after Didi went public on the NYSE, asking app stores in China to remove Didi's app. The regulatory crackdown expanded, the focus turning to the After School Tutoring sector, a theme several well-known international investors were very bullish on. The regulations could effectively turn industry players into non-profit companies and stop them from accessing capital markets. Policymakers have since come out and said that the actions where not meant to harm companies in other industries, however it is unclear that the sharp selloff will halt the regulatory tightening as the CCPs broader social goals take precedent over investor returns. The international capital leaving China is a potential tailwind for equites elsewhere - US Tech an obvious candidate.

On monetary policy, the ECB gave some clarity on how their strategy review will affect the conduct of monetary policy, making it more outcome based, the Governing Council expecting that interest rates will "remain at their present or lower levels until it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon". President Lagarde even said that the ECB will not react if inflation exceeds their target for a……transitory period.

While the Fed has started to discuss how and when to begin tapering, it emphasized that Covid-related risks still linger and that more progress is needed to achieve full employment. The major development from the Fed, seemingly overlooked by many, was the announced establishment of a domestic standing repo facility (SRF) and a repo facility for foreign and international monetary authorities (FIMA repo facility). Initially this will be open only to primary dealers but will be expanded over time. This means that in a crisis, cash can be accessed from the Fed rather than by having to sell USTs – the introduction of such a market stabiliser reducing future risk of disorder in the treasury market arguably warrants a higher market multiple over time.
Elsewhere, China cut its reserve requirement ratio, suggesting the country's slowdown is really beginning to bite.

As we end the month, passing the peak of Q2 earnings season, results have generally been strong, with a 'beat and raise' trend and a notable step up in buybacks. Misses however have been harshly punished. With nearly a third of European companies having reported results, 63% have beaten on EPS and 67% on sales. The large US Tech names took centre towards the end of the month, the results mostly good to outstanding, justifying their recent outperformance, which explains the somewhat muted reaction in certain cases. Amazon stands out as the disappointment, as slowing retail growth post the pandemic boom surprised the market, albeit its higher margin businesses are performing well. Commodity players also stood out, announcing a major step up in shareholder returns.

Positioning and Outlook
Over the month we removed the short positions we had in commodities, which have fallen a long way and appear to be stabilising and added a basket of names in the mining and energy space. The economic cycle in China could be once again improving as both monetary and fiscal policy has shifted. Although it is too early yet to confirm this the compelling valuations of commodity stocks, allied to the long-term bull case of demand for metals in particular and supply constraints for oil meant it was worth investing now. We also closed our short position in European banks and reduced our bond exposure.

The funds are positioned slightly above the mid-point in growth assets, but the mix is what is key. A slowing western economic cycle and a supportive rates backdrop, along with recent results, supports our quality and growth holdings. The very early signs of a policy-induced turn in China's economic cycle, combined with outstanding free cash-flow generating ability supports owning commodity names. We also continue to own equity index put options to offer protection against a summer selloff.

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