SEASPRAY PRIVATE
Wealth Management Solutions

Q3 21

QUARTERLY INVESTMENT UPDATE: Q3 2021

Introduction

The third quarter was a much more volatile quarter as we had expected in our half-year forecast. Over the course of Q3 we saw risk assets initially move higher, with many equity indices trading through their all-time highs in mid-summer. This was then followed by a period of choppy trade and elevated volatility during September, which resulted in the MSCI World index pulling back by roughly 6% from its record high. In recent weeks, we have seen market participants express a number of concerns, which we will look to address throughout this investment update:

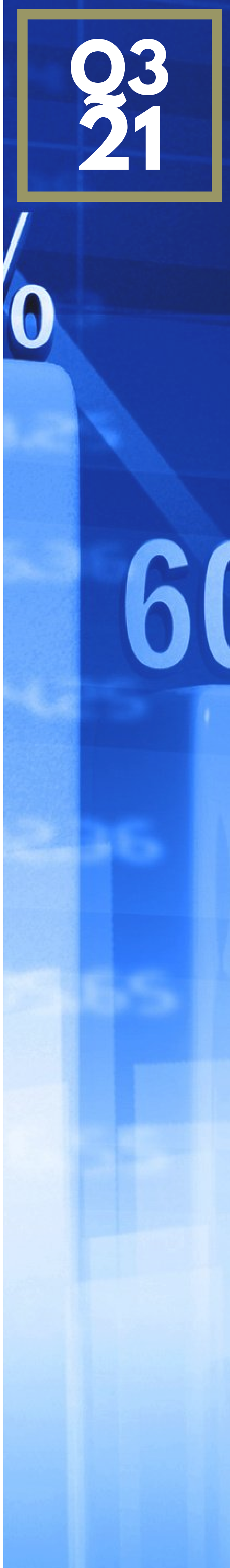
- China's largest property company, Evergrande Group's missed debt payments, and the possible contagion event that could take place throughout China's property sector and beyond. Notably, China's property sector makes up 28% of the nation's gross domestic product.

- A looming unwind of the Federal Reserve's easy money policies, which will come in the form of a tapering of its asset purchases – due to begin before the end of the year, and could lead to one or more rate hikes in 2022. This move will be matched by other central banks, with the ECB for example planning to begin their own QE tapering sometime during Q4.

- Ongoing political disagreements in the United States with regard to Biden's proposed $1.2 trillion infrastructure bill and $3.5 trillion national social safety net and climate change bill. Importantly, and in addition to these issues, concerns remain over the US' debt ceiling – an issue that could see the United States begin to default on its debt as soon as December, should an agreement not be reached.

- Bond yields, most notably US Treasury yields, have risen relatively sharply in recent weeks, which has caused investors to call into question equities and their seemingly lofty valuations, especially high-growth names in the tech sector. This increase in yields comes as investors begin to price in higher-for-longer inflation on the back of soaring energy prices around the world, along with a Federal Reserve tapering which is just around the corner and the possibility for rate hikes sooner than was previously expected.

In our last monthly Investment Update at the beginning of September, we acknowledged that it would be normal to see some pullbacks at this stage of the bull market, and that is exactly what we have witnessed in recent weeks. We pointed out that the early phase of this recovery was likely now behind us, both for the stock market and many parts of the global economy, but ultimately, we still saw scope for risk assets to move higher on both medium and longer-term timeframes, albeit with higher volatility than we have seen over the last 6 to 12 months.



We would like to take this opportunity to reiterate these views– while slightly smaller gains are to be expected over the next 12 months when compared with the strong rally of the last year, we are of the belief that in the medium-term stocks can and should still move higher. Markets will likely be driven by a combination of robust earnings results, still-attractive valuations relative to bonds despite recent moves, an ongoing return to more normalized economic activity as a higher percentage of the global population are vaccinated, and by central banks who despite their tapering – have learnt their lessons from the past and will be very reluctant to tighten policy too quickly and stifle economic growth in the process of doing so.

Amid our optimistic bias for the medium to long term, we believe that opportunities will continue to present themselves within specific asset classes as we move through the final quarter of the year and into 2022.
At Seaspray we carry out our own thorough, team-based research to help us find what we believe to be the best investment opportunities. Our main aim is to meet the needs of our clients. Whatever their priorities – from income and growth to sustainable investing - our experience in these areas allow us to target a wide range of outcomes in this regard.

	1 Month	3 Month	YTD	1 Year
Equity Indices				
S&P 500	-1.6%	0.7%	16.8%	24.1%
DAX	-3.0%	-3.4%	10.4%	15.2%
EuroStoxx 50	-2.6%	0.0%	14.3%	23.1%
ISEQ	-3.6%	1.2%	13.1%	24.7%
FTSE	1.3%	0.2%	10.2%	18.7%
Nikkei 225	-6.2%	2.0%	3.8%	21.0%
Multi-Asset Funds				
Aviva Cautious (Risk 3)	-0.9%	-0.1%	3.8%	8.2%
Irish Life MAPS 3	-1.3%	0.2%	7.2%	11.5%
New Ireland iFunds 3	-0.7%	-0.2%	2.1%	4.9%
New Ireland PRIME 3	-0.7%	0.8%	6.2%	8.3%
Zurich Prisma 3	-1.1%	0.2%	5.5%	8.2%
Aviva Strategic (Risk 4)	-1.1%	0.5%	9.1%	16.4%
Irish Life MAPS 4	-1.7%	0.4%	10.4%	16.0%
New Ireland iFunds 4	-1.0%	0.1%	6.2%	10.8%
New Ireland PRIME 4	-1.0%	1.3%	11.9%	16.1%
Zurich Prisma 4	-2.0%	0.5%	11.5%	17.1%
Aviva Dynamic (Risk 5)	-1.2%	1.0%	13.5%	23.5%
Irish Life MAPS 5	-2.1%	0.2%	12.3%	19.8%
New Ireland iFunds 5	-1.1%	0.8%	11.9%	19.6%
New Ireland PRIME 5	-1.1%	1.8%	16.5%	22.3%
Zurich Prisma 5	-2.8%	0.7%	15.9%	24.1%
Currencies				
EUR/USD	-2.0%	-2.5%	-5.2%	-2.0%
EUR/GBP	-0.6%	-0.7%	-5.0%	-6.2%
GBP/USD	-1.4%	-1.8%	-0.2%	4.4%
USD/JPY	2.9%	2.7%	9.6%	7.5%
Fixed Income				
US 10yr	0.27	0.25	0.69	0.85
Bund 10yr	0.21	0.18	0.45	0.42
Irish 10yr	0.22	0.14	0.55	0.45
Gilt 10yr	0.44	0.53	0.99	0.92
Commodities				
Gold	-2.0%	-2.9%	-7.8%	-9.8%
WTI Crude Oil	16.9%	9.4%	68.0%	100.8%

Source: Seaspray Financial Services, October 2021

Equities

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The economic recovery in areas that emerged early from Covid restrictions such as the US, UK, and China, is increasingly mature and has already started the mid-cycle stage, as expected by market participants. Equity volatility and drawdowns should increase from here, as we have alluded to for some months now. Following an impressive policy and vaccine-fueled recovery phase, we believe the global equity cycle is beginning to transition back to fundamentals. While full valuations and a moderating forward-return environment may ease our optimism slightly, equities remain our preferred asset class.

As we enter the longest phase of the equity cycle – this mid-cycle 'growth phase' - corporate earnings, positive investor sentiment, and increased confidence around the sustainability of the recovery should continue to drive returns. The mid-cycle phase tends to be the longest of the economic cycle, with the economy in a strong position, and a moderating growth rate. This is what we are currently seeing when we look at the data. Corporate earnings are usually at their strongest of the cycle during this current phase, and interest rates are still low albeit with the possibility for higher rates as central banks try to fight off rising inflation.

While above-target inflation is not usually a major problem for equities, the challenge for investors is that rising inflation will most likely be accompanied by higher bond yields. We would not be surprised to see higher bond yields put pressure on some areas of the market that are trading on loftier valuations, having benefited from the recent low yield environment. Large US tech names come to mind. Therefore, focusing on cheaper parts of the market that tend to do well in rising yield environments may make sense at this point in time.

On the topic of large tech in the US, we would like to point out that at present, the weight of the five largest companies (all tech firms) in the S&P 500 index is above 22% and during the height of the pandemic came close to 25%, as can be seen on the chart below. The big five's weight in the S&P 500 is almost double the next-largest industry, health care. Importantly, this is an issue that European equity indices do not face to the same extent, with the whole technology sector at a weighting of 21.5% in the EuroStoxx50 but importantly as the second largest sector, and at 12.7% in the EuroStoxx600 as the index's fourth largest sector.

Source: Goldman Sachs, Bloomberg

Equities contd...

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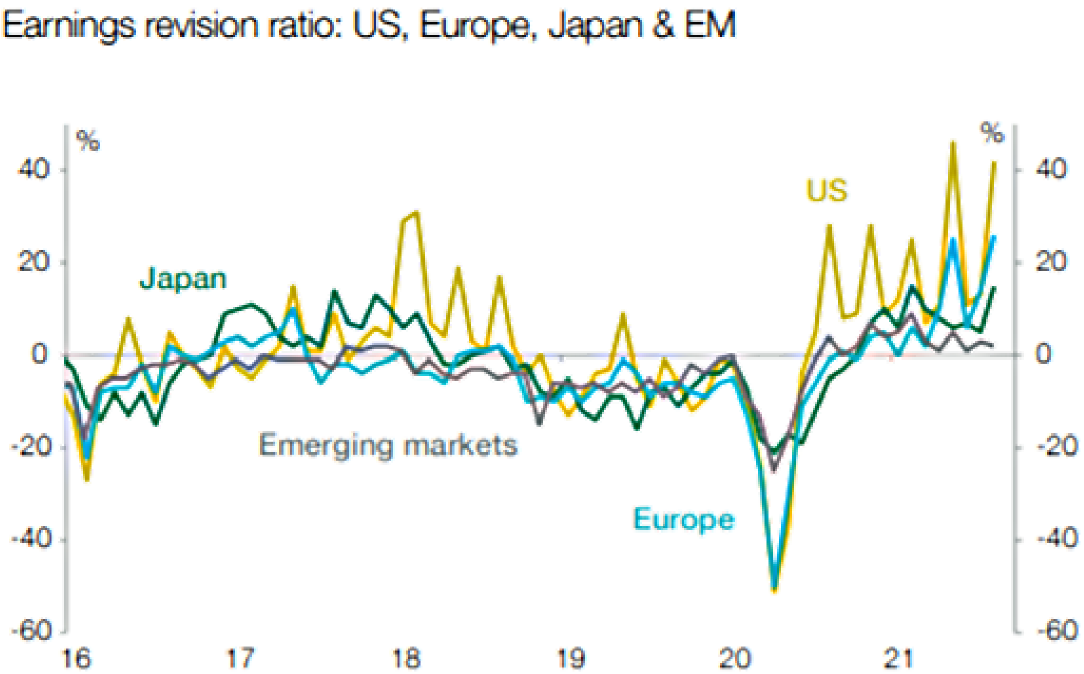
We see greater opportunities in more affordable pockets of the global equity market. As such, we believe that an eye for selectivity when it comes to corporate profitability, balance sheet strength, and secular growth opportunities may benefit investors' bottom lines. Additionally, diversifying assets, or those that can secure returns through dividend income rather than capital appreciation, may benefit portfolios in a lower return environment.

To summarize, the move to the mid-cycle stage does not signal the end of the economic cycle nor the end to the equity market rally. We remain invested in equities, but we now look more actively for quality as well as opportunities in alternative assets to create resilient portfolios. We maintain our positive outlook for markets into year-end predicated on that fact that the global economies continue to recover from the pandemic related economic shock, overall demand remains strong, and monetary policy, despite any forthcoming adjustments by central banks, will continue to remain supportive.

The upcoming third quarter earnings season will be an interesting one. While this time last quarter the market was buoyed by companies across a range of sectors providing trading statements as they were exceeding expectations, they may be less forthcoming this time given the potential impact of supply chain delays and increasing input, labour and transport costs on quarterly numbers. In addition, year-on-year numbers for Q3 are unlikely to be as impressive as during Q2, when in 2020 firms were grappling with the first round of lockdowns.



Source: Refinitiv, UBP

Company earnings have been stellar, especially among cyclical names. While we see peaks as inevitable, they don't necessarily suggest a cycle's end. We continue to expect above-trend growth through the end of 2022 and see further upside for equity earnings as economies around the globe reopen fully and pent-up demand materializes. But without doubt, the momentum of growth is diminishing, and over recent months we have seen economic surprise indices drop from elevated levels.

Higher rates, without a doubt, have the potential to pressure stocks' price-to-earnings ratios, which currently sit above historic norms. As we move through Q4, we believe the anticipation of both higher rates and slightly less rapid earnings growth may fuel more volatility than we have witnessed for some time now. With our view on equities for medium to longer term growth, we will likely look to any periods of volatility over the next few months as opportunities to add to positions and to find value within specific areas of the market. Such pullbacks could also help restore risk premiums in general and preserve potential returns for the selective stock and sector pickers.

Modesty lower valuation thanks to very strong earnings

S&P 500: 12-month forward PER

Source: Refinitiv, UBP

While we stay overweight equities, on the back of our outlook for still-robust earnings amid moderate valuations, we gradually shifted our attention towards quality over the second and third quarters of the year. Companies with high-quality earnings streams and greater visibility have outperformed over recent months as we emerged from the early-phase of the post-pandemic recovery and entered a more mid-cycle type investment environment. With rising but transitory inflation expectations, we begin to tilt toward cyclicality but importantly maintaining a quality bias.

We are remaining overweight European equities considering a strong growth backdrop for the region and see a sizeable pickup in activity helped by accelerating vaccinations. We would also like to reiterate our slight underweight positioning with regard to the US. Stronger economic growth and steeper yield curves after the slight third-quarter slowdown should favour both quality stocks and undervalued cyclical value stocks when compared to expensive technology and growth stocks. Relative to the US, the rest of the world is generally overweight cyclicals.

Our optimism on Europe, both in absolute terms but also relative to global peers, is built on three main criteria. Firstly, Europe’s growth fundamentals continue to look favorable in our view, with the region likely to be a GDP outperformer next year, given it is earlier in its recovery than most other developed regions and hence offers a greater rebound potential. We also see upside risk to consensus earnings forecasts for European firms next year, as the current estimate of just 7% growth seems disproportionately low for the region.

By taking an objective view, we can see that over the last 30 years during the months of September and October, earnings forecasts for the following year have never been this low. For us, such low expectations are seen as a positive factor, as they provide greater potential for profit upgrades in the months that lie ahead.

A second significant factor in favor of European stocks is their valuation, which is close to a record low versus North American equities or even European bonds. We see the comparison with bonds in the region as particularly relevant - if you are looking to allocate capital in Europe you are faced with a choice between a real positive dividend yield on domestic stocks versus a negative real yield on 10-year German bunds. While you may face higher volatility with stock holdings than with bonds, the real yield advantage for stocks is undeniable and is also approaching a record high. We also see European equities representing value when we look at their current valuations relative to history.

Thirdly, we believe global investors of all sizes remain significantly underweight Europe in their portfolios. Over the summer we saw a period of general risk reduction from hedge funds in particular, which interestingly has left futures positioning in European indices at its lowest level in five years. With this in mind, we are of the view that even modest inflows into the region could drive outsized price gains going forward.

Investors may also look towards real assets, such as property or core infrastructure, to hedge against a rise in inflation, as income from these types of real assets is typically linked to inflation. While sustained above-target inflation isn't a certainty, seeking some protection in the form of real assets, while reducing exposure to fixed income and cash, makes sense in our opinion given the balance of risks has probably shifted towards more inflation, rather than less.

Bonds

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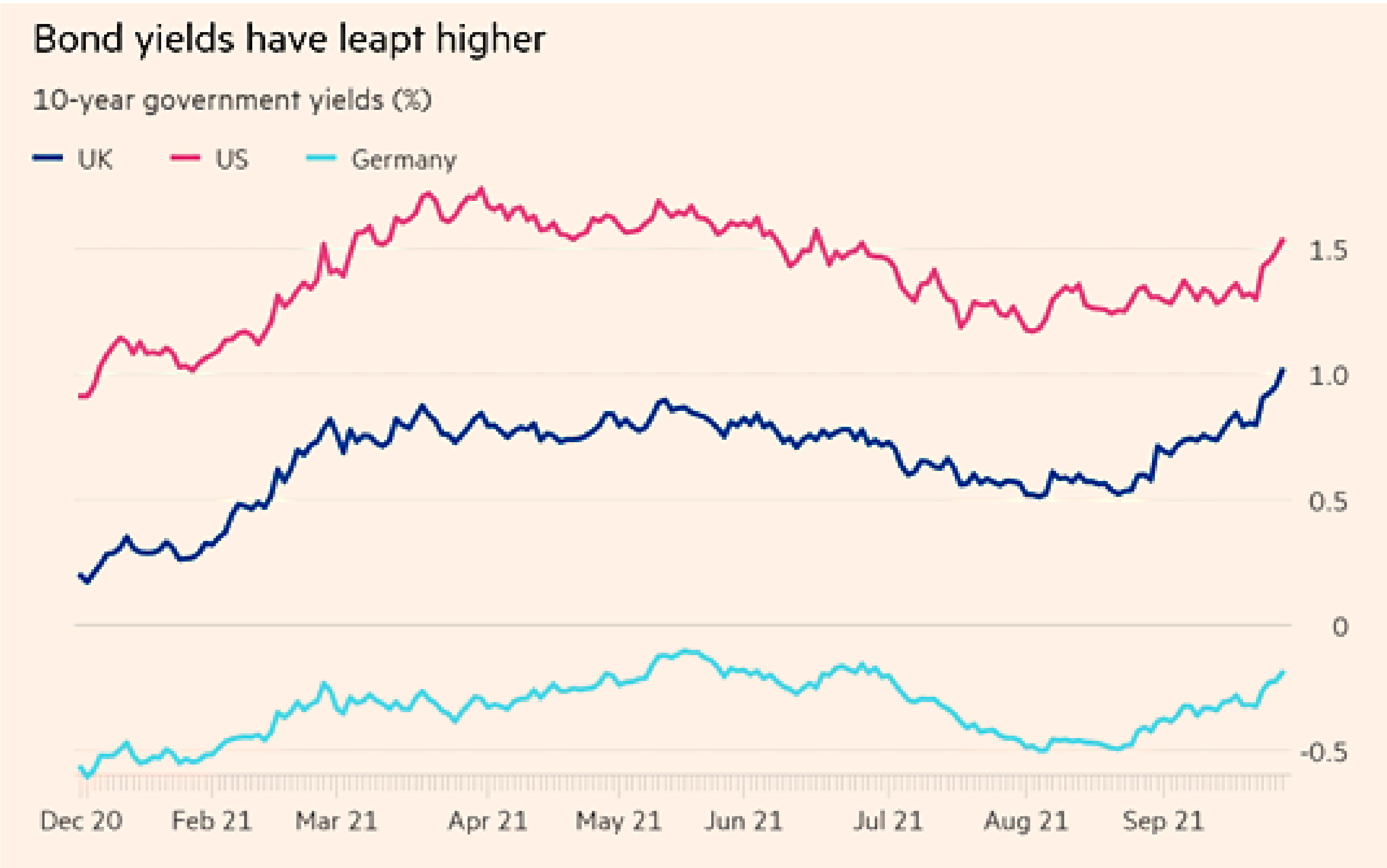
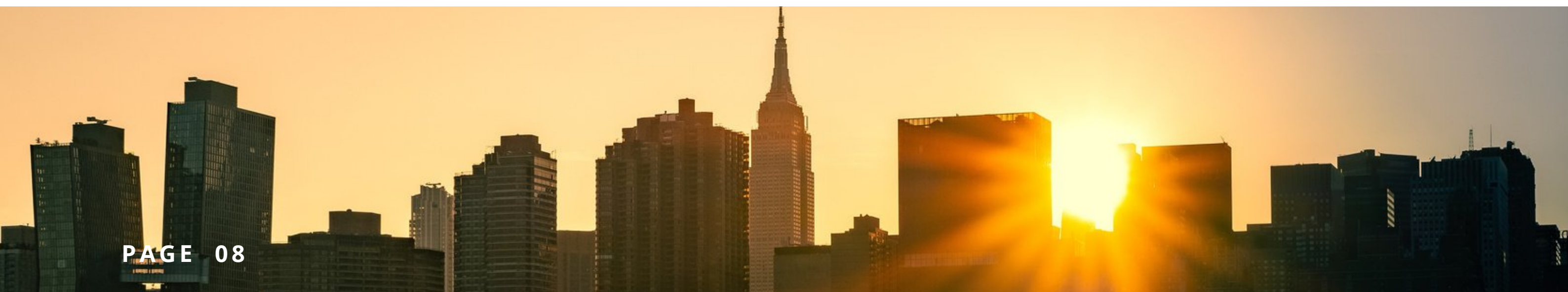
In our Half-Year Investment Update back in July, we expressed our opinion that the often-used benchmark US 10-year Treasury bond would move lower, pushing its then c.1.25% yield up into the 1.5% - 2.0% region over the course of H2.

This week we have seen the yield reach 1.63% on the back of higher-for-longer inflation expectations in the US and overseas, driven by surging energy prices after OPEC+ nations opted not to increase their production significantly at their recent meeting. We would expect the yield to continue to edge upwards toward 1.75% and possibly higher before the end of the year. Eurozone bonds still offer little or no long-term value, with many of the main nominal yields still in negative territory. We continue to favour corporate bonds over sovereign debt. Our bond positions are well below the middle of their ranges whilst the duration of these bonds is below the industry benchmark.



Sources: Bloomberg, Financial Times



Bonds contd...

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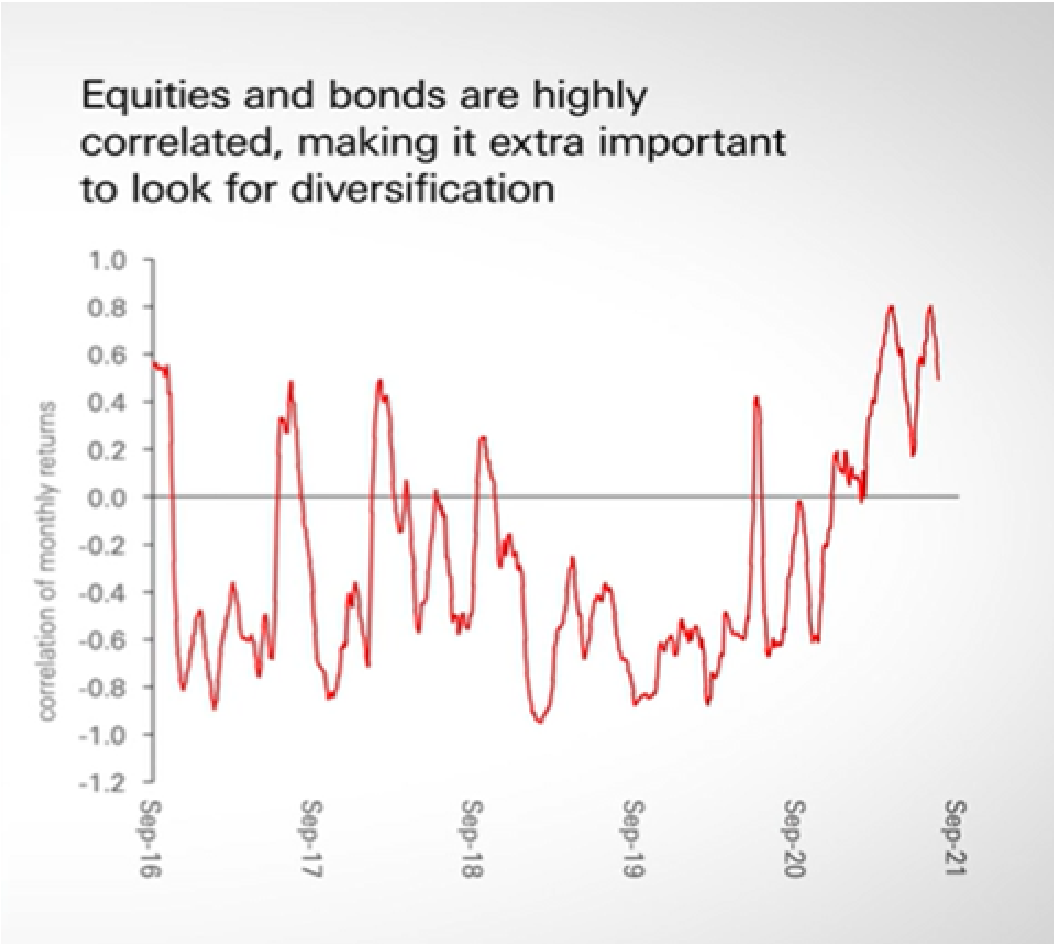
We see real US rates rising in the fourth quarter, not only as the Fed is expected to start reducing its bond purchases but also as global economies recover, which could encourage foreign investors who have flocked to Treasuries as a 'safe haven' to move their money elsewhere. Another core reason for our underweight positions in government bonds are due to their diminished ability to act as portfolio ballasts within the current investment environment. With so much now hinging on the Fed's outlook and their pace of normalizing policy, bond markets are currently seeing a high correlation with equities, as can be seen on the below chart. It is for this reason that we believe investors need to look at opportunities across asset classes, regions and within alternative assets to appropriately diversify. That will be the best way, in our view, to create portfolio performance that is as steady as possible.



Source: HSBC Global Private Banking

Historically, inflation has been the enemy for bond investors. It eats away at nominal fixed coupon payments. While inflation-linked bonds, such as TIPS (Treasury inflation protected securities), will outperform nominal bonds in the event of an unexpected pickup in inflation, inflation expectations priced into these bonds have already risen significantly over the last 6 – 12 months. Despite TIPS currently offering a negative yield, they may make sense as an inflation hedge if you think inflation will average more than it is currently expected to over the next decade. However, inflation linked bonds are still vulnerable to potential rises in real yields. This is similar to gold, in that the metal tends to do well when real yields decrease but faces challenges when real yields rise.

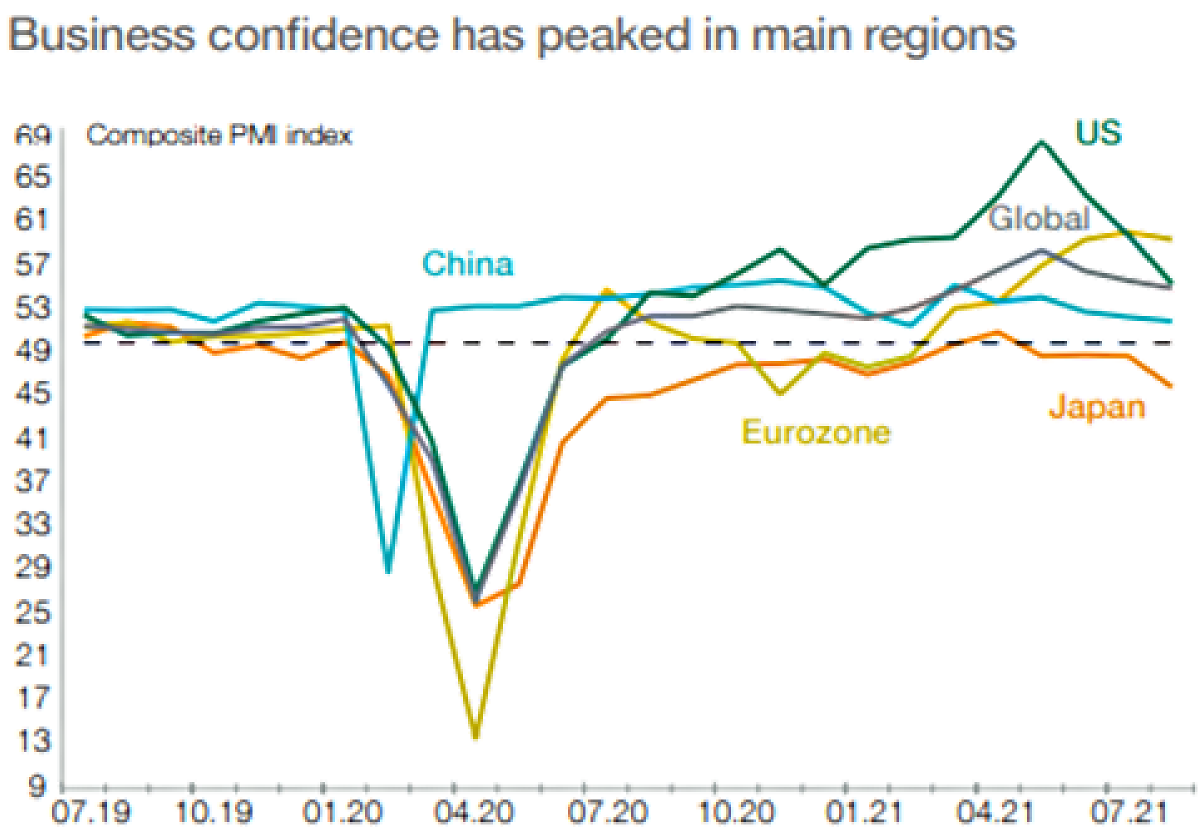
Economy & Inflation

Q3 21

Economy

Having started its reopening later, Europe is slightly behind the US and the UK on the road to normalisation. Momentum has softened slightly and Europe is now probably reaching its peak rate of growth, a few months behind the US and UK. From recent PMI (Purchasing Managers' Index) results:
While business activity did continue to grow last month, with the Eurozone, the UK, and the US each registering scores above 50.0 and therefore in expansionary territory, we must point out that global growth is indeed beginning to slow. On this side of the Atlantic, activity grew at its slowest pace in five months during September, as certain regions saw consumer demand get affected by Delta variant concerns and mini-shutdowns. The Eurozone as a whole saw a Manufacturing result of 58.7, coming in below the forecast for 60.4 and the previous 61.4. Likewise, the Services figure was 56.3 for the month, well below the estimates for 58.4 and the prior 59.0. The United Kingdom registered a Manufacturing PMI of 56.3 versus 59.0 forecasts, while Services were 54.6 versus 55.0.

With much of Europe and the United States largely reopened for business now, the initial pent-up driven bounce in demand has eased, something reflected in the PMIs over the last couple of months. They still indicate that growth is continuing, just not at the breakneck pace of a few months ago. The US composite PMI reading of 54.5 was the lowest the region has seen this year.



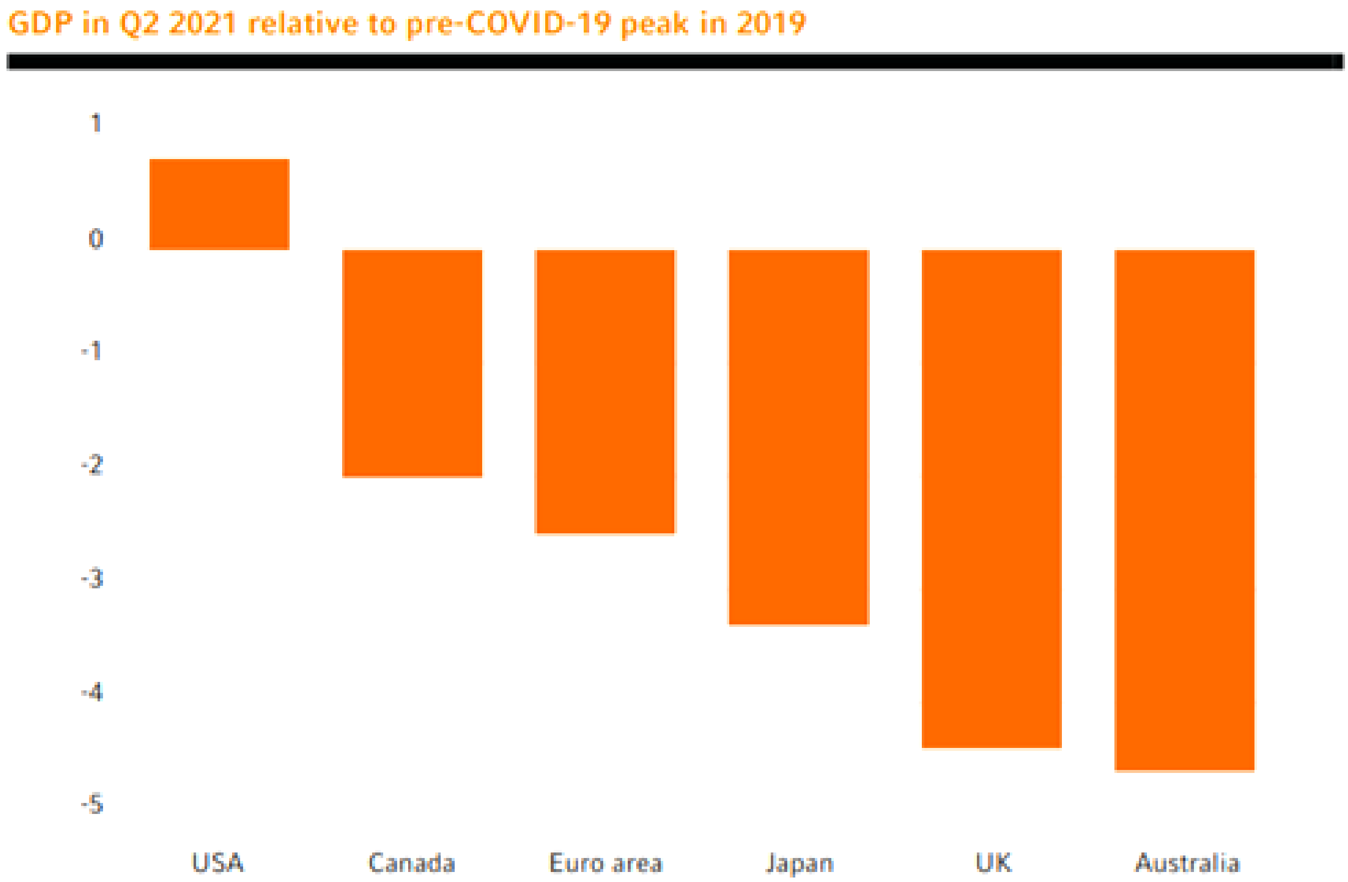
Source: Markit, UBP

Economy & Inflation contd...

Q3 21

Economy

We acknowledge that the US recovery is more advanced than that of other developed economies. The following chart shows how far GDP has recovered, relative to the pre-pandemic peak almost two years ago. GDP is 0.8% higher in the US after the second quarter, although this level is still short relative to the pre-Covid trend. GDP is still 2.5% below 2019 levels in the euro area and 4.5% below in the UK. We expect more cyclical upside for economic growth outside the US in the coming quarters, and this should allow market leadership to rotate toward the rest of the world. We note that we will be due to get the first estimates for Q3 GDP readings towards the end of October.



Source: Refinitiv Datastream, Russell Investments

Economy & Inflation contd...

Q3 21

Economy

While it looks like Eurozone growth slowed through the third quarter, we expect it to get back on track for a return to above-trend growth over Q4 and into 2022. Vaccination rates are high across Europe, and the area has more catch-up potential than other major economies, particularly the United States. The euro area is also set to receive more fiscal support than other regions, with the European Union's pandemic recovery fund only just starting to disburse stimulus, which is set to provide significant support in particular for southern Europe.

In addition, the Organisation for Economic Co-operation and Development (OECD) highlight that "The recovery remains very uneven, with strikingly different outcomes across countries", as it also lowered its 2021 growth forecasts for the world and the United States, while upgrading its outlook for Europe. Global output is now estimated to grow by 5.7% this year, 0.1% lower than the organisation's May forecasts, with the 2022 outlook having improved somewhat (4.5% growth now forecast, 0.1% higher than previous estimate).

Looking at specific regions: the OECD now expects the US to grow by 6% this year, down from its May forecasts for 6.9%. We note that the US Congressional Budget Office expects 6.7% growth for the country this year. The OECD's forecast for the Eurozone this year was increased to 5.3%, though the outlook varied within the bloc, with stronger growth estimated for France, Italy, and Spain. Interestingly, the growth outlook for China, the second-largest economy in the world, remained unchanged at 8.5%. Taking a look at inflation, the OECD now expects the average inflation rate across the G20 leading economies to reach 4.5% during Q4 of this year, with 1.5% of this directly caused by the effects of higher commodity prices and shipping costs.

When speaking about the economy in general and reflecting on the developments of the last quarter, we must shed some light on the ongoing Evergrande situation in China. Evergrande, China's largest property developer and the world's most leveraged property developer, is now on the brink of default. With the equivalent of over $300 billion's worth of obligations to creditors, the most recent update is that Evergrande has made good on some of its domestic payments in recent weeks but has missed some overseas Dollar denominated pay-outs and has now entered its 30-day grace-period.

Economy & Inflation contd...

Q3 21

Economy

The contagion from these events has already spread to the Hong Kong market and indeed the impact of a full default could have ramifications around the world. Developers, financials' stocks and high yield dollar-denominated bonds have fallen in recent weeks as a direct result of Evergrande. While this situation is ongoing with new developments emerging every other day, it is beginning to look like the Chinese authorities will allow some form of a managed default by Evergrande but will support the wider financial system. In addition, we have recently seen the People's Bank of China (the region's central bank) come out and state that it will protect individuals from any potential Evergrande-related fallout, and as a result we see it as unlikely to us that the impact will spread globally.

Last week we saw Democrats and Republicans in Congress open the door to a temporary solution to the United States' debt ceiling dilemma, stating that they would look at a stop-gap measure which would extend the nation's borrowing limit until December. This development came after the Senate's top Republican, Mitch McConnell, offered to support a temporary extension to the country's debt limit. This of course will bring a short-term solution to a stand-off that has certainly brought some discomfort for investors in US markets as of late.

The Debt ceiling has been lifted on more than 100 occasions to allow the government to borrow more. Congress often acts on it in a bipartisan manner and it is rarely the subject of a political standoff. As the country has become more bitterly partisan, however, lawmakers have used the debt ceiling vote as leverage against other issues.

We note that lawmakers in the US remain at odds with one another over Joe Biden's proposed $1.2 trillion bipartisan infrastructure bill and $3.5 trillion bill that aims to expand the nation's social safety net and also combat climate change. We have seen postponements with regard to Congressional votes on these new bills, which have of course been a temporary blow to the White House as divisions within the president's own party threaten to block his legislative agenda.

Economy & Inflation contd...

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Inflation

Over the past few weeks we have seen leading central bankers acknowledge the fact that the ongoing disruptions to global supply chains seem likely to last longer than had been expected earlier in the year. This could keep inflation elevated for a more extended period than has been priced in to markets up until now. Indeed, Fed Chair Powell said it is frustrating to see that bottlenecks and supply chain problems are not getting better and, in fact, “at the margin apparently getting a little bit worse”. If high inflation lasts long enough, it could start to push up inflation expectations and spill over into higher wage demands, and other second round inflationary effects. Central bankers have indicated that they will be keeping a very close look out for any such developments.

While inflation now seems likely to remain elevated for a longer than expected period, most central bankers still seem to expect price pressures to moderate over the course of next year, allowing annual inflation rates to start easing. Indeed, Powell has alluded to the dilemma that high inflation now poses to the central bank, considering the still noticeable slack in the US labour market. Managing these competing forces, Powell indicated, “is going to be very challenging” over the next couple of years. We cannot deny that the Fed’s expectations of US inflation have been rising. In the statement following last month’s meeting, Fed officials saw core inflation at 3.7% in 2021, up from their June estimate of 3.0%. Next year the Fed expects inflation to reach 2.3%, against its previous forecast for 2.1%.

When thinking about inflation expectations for Europe, the UK and the US, investors will continue to pay close attention to energy prices in the months ahead, as many measures of inflationary pressures around the world take into account year-on-year price changes in energy and fuel. We must point out that earlier this week we saw Brent crude oil rise above $84 a barrel for the first time in more than three years, while the American WTI Crude traded above $82 for the first time since 2014. Other commodities including coal, carbon and European gas prices have all hit record highs recently.

Economy & Inflation contd...

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Inflation

The Personal Consumption Expenditures (PCE) price index in the United States climbed 0.4% m/m during August, matching the median forecast from analysts. It also echoed the 0.4% jump seen in July. The index gained 4.3% when compared with the same month in 2020, slightly exceeding the median estimate of 4.2% growth. Core PCE, which measures the same items as the regular PCE except minus food and energy, came in at 0.3% m/m versus 0.2% expectations and 3.6% y/y – in line with July's score and 0.1% below the Fed's 3.7% inflation projection for this year. We must note that core PCE is the inflation metric of choice for the Federal Reserve, and therefore usually has the heaviest weight in the minds of market participants.
German inflation notably rose to a 29-year high of 4.1% in September, while in the 19-nation Eurozone it accelerated to a 13-year high of 3.4%, ahead of the 3.3% expected and boosted by surging energy prices (17.4% higher y/y). The Core figure for the Eurozone, importantly excluding energy and other volatile items, came in in-line with forecasts at 1.9% y/y and versus August's 1.6%. Most economists believe euro area inflation will reach 4% by the end of this year, twice the European Central Bank's target, but then fade next year. That also remains the main message to date of ECB president Christine Lagarde.

Source: Refinitiv Datastream, Russell Investments

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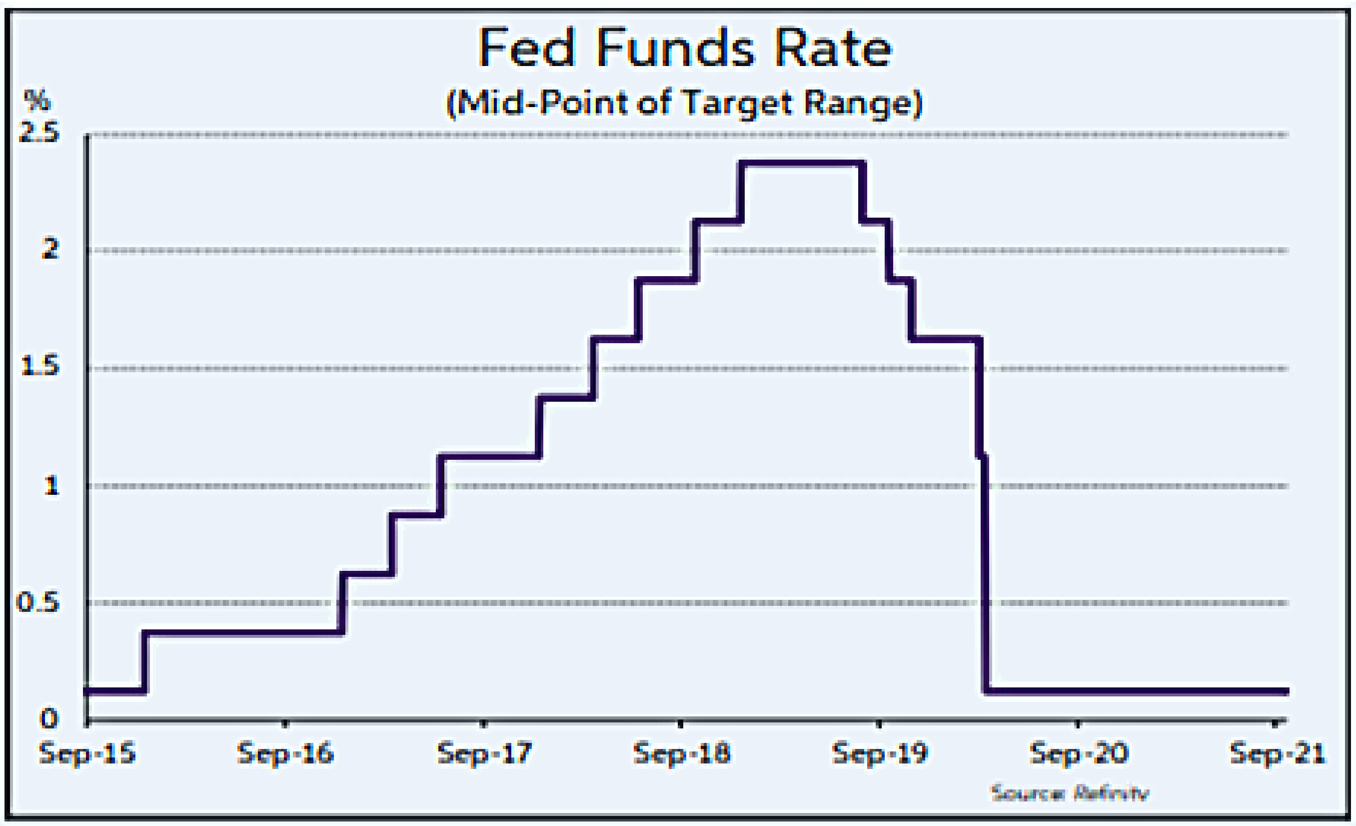
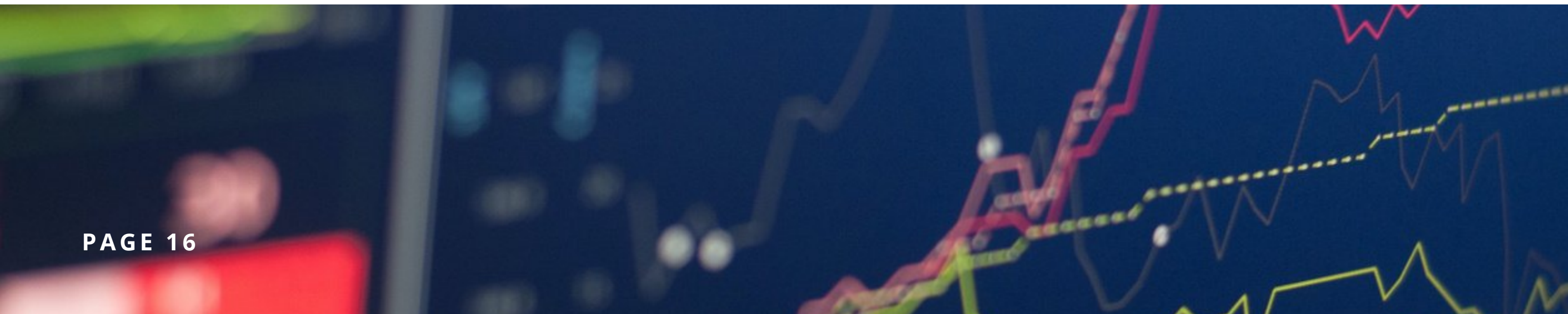
Monetary Policy

Federal Reserve:

The US central bank decided to leave policy settings unchanged at their September 22nd meeting, as was widely expected by the market, while also opting not to officially announce when the beginning of their asset-purchase tapering will be. The Federal funds rate was maintained within its target range of 0.00-0.25%, we note that there was unanimity within the Federal Open Market Committee (FOMC) to leave interest rates unchanged this time around. However, on the topic of tapering, the Fed did state that "a moderation in the pace of asset purchases may soon be warranted", with Chairman Jerome Powell adding that board members believed tapering could conclude around the middle of next year, potentially opening the way for interest rate hikes after that. Bond purchases under the Fed's QE programme are currently running at $120bn per month, suggesting that they could be scaled back by $15bn per month over an eight-month period, starting in either November or December.



Source: Refinitiv, AIB



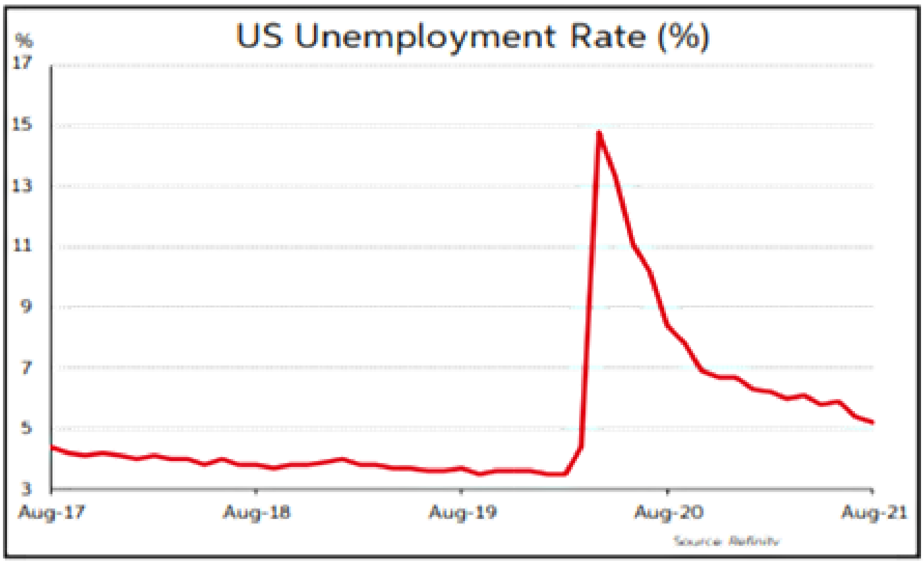
Q3 21 Monetary Policy contd...

Federal Reserve:

Lessons from 2013 highlight that a premature withdrawal of liquidity could surprise markets and result in deteriorating financial conditions and unintentionally slow the economy too dramatically. We are reassured with our (and many other market commentators') belief that the Federal Reserve has learnt from the past. This time, they have prepared markets for a more gradual end to their bond purchases, communicating well in advance their ideas and plans for reducing the highly-accommodative, pandemic-era policies that we have seen for a year and a half now.

It is important to note that nine of eighteen Federal Reserve officials are now expecting an interest rate increase in the States next year, with the remaining nine forecasting a later increase. This compares to the central bank's June meeting when seven officials were expecting a hike in 2022. Meanwhile, for 2023, all bar one FOMC member now expects that rate hikes will be warranted. In June, five FOMC members anticipated rates remaining unchanged through to the end of 2023.

We saw Powell stating: "My own view is that the 'substantial further progress' test is all but met" during his post-release press conference last month, referring to the central bank's employment goal (chart below). The Chairman went on to add that the bank could "easily move ahead" with an announcement of the taper at its next meeting on November 3rd. The Federal Reserve has a dual mandate of low unemployment and a 2% average inflation rate, and as we know the inflation target has already been met this year, as consumer demand increases as we emerge from the pandemic with supply chain bottlenecks also coming into the equation.



Source: Refinitiv, AIB

The Fed's September meeting also saw the group of central bankers update their view on the economic outlook. This saw a downgrade to the 2021 growth projection, with the Delta variant slowing the pace of recovery since mid-year. The Fed reduced its 2021 GDP growth forecast noticeably to 5.9%, versus its June projection for 7%. However, it did increase its growth forecast for 2022 to 3.8%, versus the previous 3.3%. 2023 estimates came in at 2.5%, up marginally from the prior 2.4%.

Meanwhile, the bank readjusted its inflation expectations upwards. It now expects 'Core PCE' to increase to 3.8% by the end of this year, compared to its June view that the figure would reach just 3.3%. Importantly, Inflation is then expected to fall back to 2.3% (vs the previous 2.1% forecast) by the end of next year, and 2.2% (was 2.1%) by the end of 2023. We saw 2024 forecasts provided for the first time, with end-year growth and inflation projected at 2.0% and 2.1%, respectively. Interestingly, the Fed sees inflation in the US still remaining slightly above its target in three years' time.

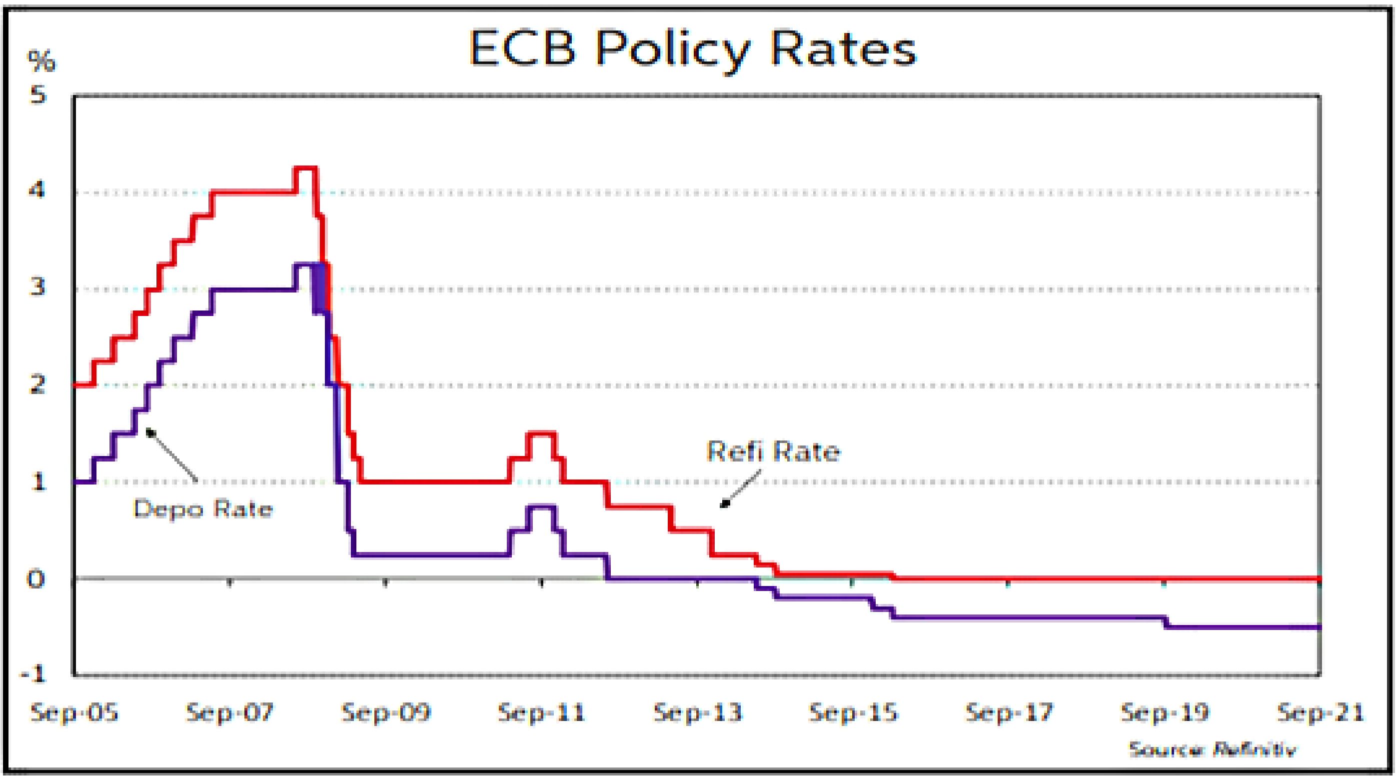
Monetary Policy contd...

Q3 21

European Central bank

On September 9th we saw the latest monetary policy release from the European Central Bank, with markets reacting positively at the time, and the release bringing no surprises. The ECB announced plans to reduce its Pandemic Emergency Purchase Programme (PEPP) during Q4, while not actually providing any concrete figures or dates for the public as of yet. The programme includes €80 billion worth of asset purchases per month at present, we expect this first tapering step to bring monthly buys down to between €60b and €70b. "The Governing Council judges that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the PEPP than in the previous two quarters" the bank's statement reads.

The ECB deposit rate, currently at an all-time low of -0.50%, is set to remain at this level until the ECB sees inflation hitting its 2% target well before the end of its projection horizon. In our opinion, the dovish messaging from the ECB on its gradual reduction of PEPP purchases, highlights that it is mindful of the fact that a significant degree of monetary policy accommodation will still be warranted for some time to come in the region.



Source: Refinitiv, AIB

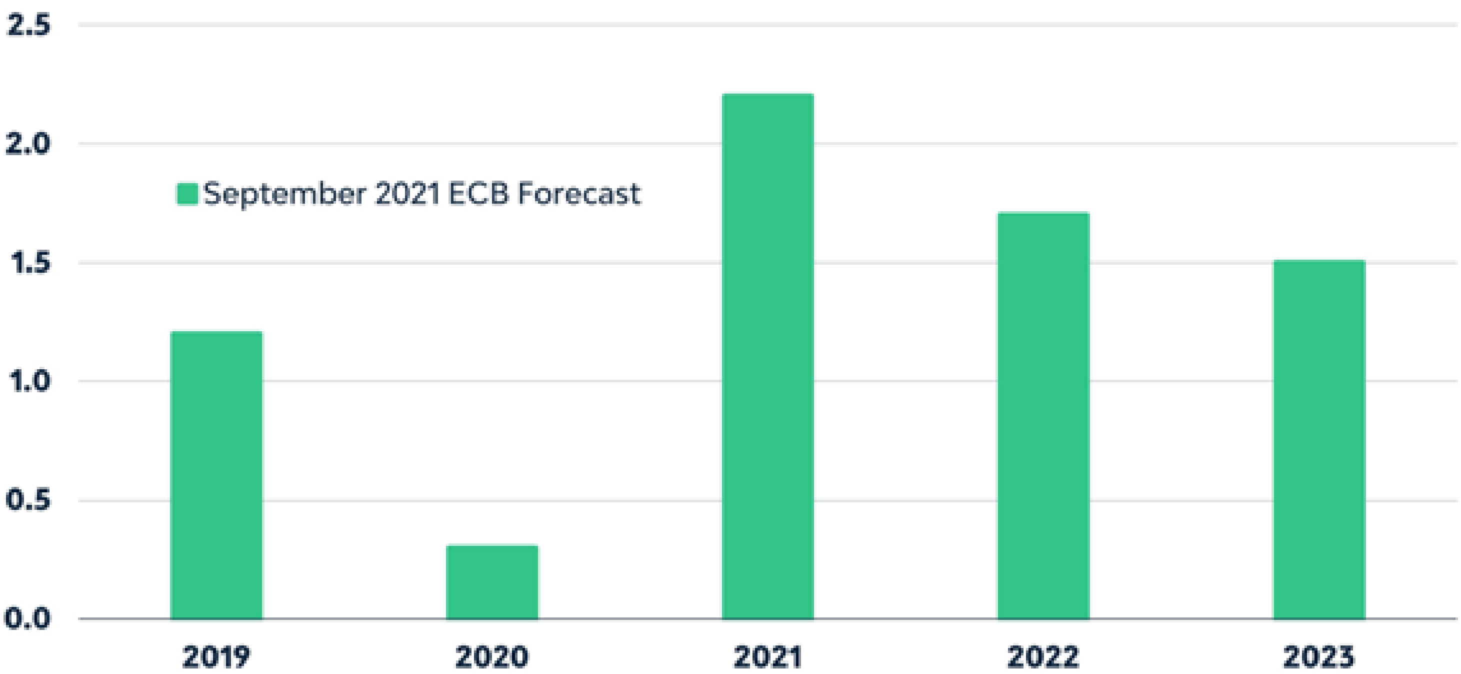
Monetary Policy contd...

Q3 21

European Central bank

In terms of the ECB's updated economic projections for the Eurozone, which similar to the Fed only come at every second meeting and will be updated once more this year in December, the economy is now expected to grow by 5% this year (vs previous forecasts for 4.6%). Next year, the ECB is now expecting growth of 4.6% versus previous forecasts for 4.7%, with its view for 2023 unchanged at 2.1%. The central bank's assessment is that the risks to the economic outlook for the Eurozone remain broadly balanced.

The ECB also revised higher its inflation outlook. However, while it expects inflation to rise further this autumn and winter, it continues to be of the view that the current upswing will prove temporary and inflation will start to fall back next year. The latest estimates are for a 2.2% rise for 2021, with a drop to 1.7% next year and then 1.5% the year after, as can be seen on the below graph. ECB President Lagarde noting that "In the medium term, inflation is foreseen to remain well below our 2% target".



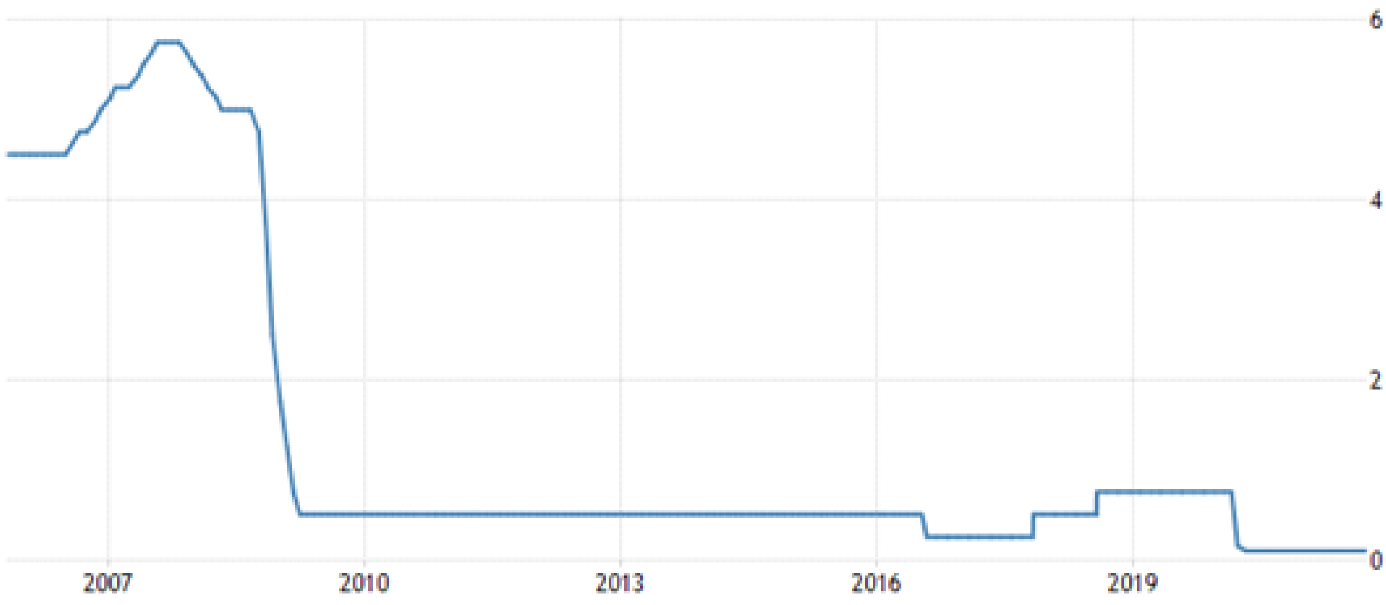
Source: True Insights, ECB

Q3 21

Monetary Policy contd...

Bank of England:

As was priced in, the September meeting of the Bank of England's Monetary Policy Committee (MPC) saw no changes to the central bank's policy. The Bank Rate was maintained at its record low of 0.10% (chart below), while the MPC also decided to leave the size of its QE programme unchanged at £895 billion, which is broken down into £875bn in UK Gilts and £20bn in corporate bonds. Interestingly, the central bank suggested that it could hike its interest rate before the end of this year, which would of course make it the first of the main global central banks to do so in this cycle. While we are still of the opinion that rates in the UK will likely not rise before quantitative easing is wound up at the end of this year, the BOE's latest guidance suggests that a rate rise could certainly come early in 2022.



Source: tradingeconomics.com, Bank of England

Q3 21

Monetary Policy contd...

Bank of England:

Meanwhile, as was also the case at the bank's June and August meetings, there was disagreement regarding leaving the QE unchanged. Of the MPC's nine members, we saw seven vote to leave the Gilt purchases at their current size, with two members voting to reduce the target stock of these purchases by £35bn to £840bn. It is worth noting that there was just one vote to reduce purchases at the BOE's previous two meetings.

We acknowledge that the Bank of England faces a difficult balancing act with the region's recovery slowing, but inflationary pressures still on the rise. In this regard, last month's release, containing the bank's latest macroeconomic forecasts, showed significant upward revisions to its shorter-term inflation expectations compared to its previous economic projection release in May. The CPI rate was seen rising to 4% in Q4 2021 compared to the previous forecast for 2.5%. However, the BOE repeated that it still believes the sharp rise in inflationary pressures will prove transitory. The BOE inflation forecast from its August release is for it to fall to 2% by the fourth quarter of 2023. However, the bank acknowledges that upside risks to inflation have increased, and it may take longer to fall back than initially expected.

The BOE expects the UK economy to grow strongly in 2021 and 2022, although in September it did acknowledge that growth will be weaker than expected for Q3 at circa 2%. The pace of growth is likely to slow sharply in 2023, to 1.5%, as the boost from factors such as the very stimulatory stance of both fiscal and monetary policy and the rundown of household savings, dies down.

SEASPRAY PRIVATE
Wealth Management Solutions

Q3 21

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