newnormal **Insight**

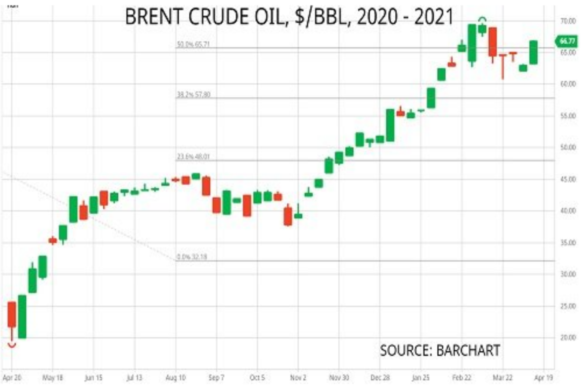
Markets' hopes rise for a major "blow-off" rally

19 April 2021

Excitement continues to build in most financial markets, with commentators highlighting the potential for a second 'Roaring Twenties'

Oil

Brent moved up $3/bbl to close at $66.72/bbl, amid the general market euphoria. Traders are clearly hoping they can retest the technically important area around $70/bbl.



✦ HIGHLIGHTS

- Today's euphoria takes no account of supply/demand reality. This means the market's key role of price discovery is undermined
- Higher oil prices give the illusion that the economy is doing well, encouraging OPEC to relax volume cuts
- US production is also being encouraged, with the rig count up another 7 this week, as producers can lock in higher prices on the futures curve
- The International Energy Agency now forecasts 610kbd non-OPEC output growth in 2021, impacting OPEC's market share
- Unnecessary investment in refining capacity is also being encouraged, especially in China, and will lead to a surge in product exports

WATCH FOR

Real world consequences from the price gains, leading to a sharp turn-around – possibly at the key $70/bbl level

S&P 500

The S&P ended at an another record at 4185, with the VIX volatility index unchanged at 16.

✦ HIGHLIGHTS

- As expected last week, a solid start from the finanical sector to the Q1 earnings season supported equity bulls
- China's Q1 GDP data was also taken as a positive indicator for global recovery
- Positive news on vaccination progress and reopening the economy added to the atmosphere of optimism
- Weakness in interest rates has been a further positive factor, although we expect this to prove temporary
- Interestingly, the S&P's rally has seen it outperform Nasdaq again, suggesting the Tech area is falling out of favour

WATCH FOR

Equity euphoria at risk if corporate outlook statements disappoint

Interest rates

The yield on the 10-year rate ended down at 1.58% whilst the MOVE volatility index rose slightly to 63.

✦ HIGHLIGHTS

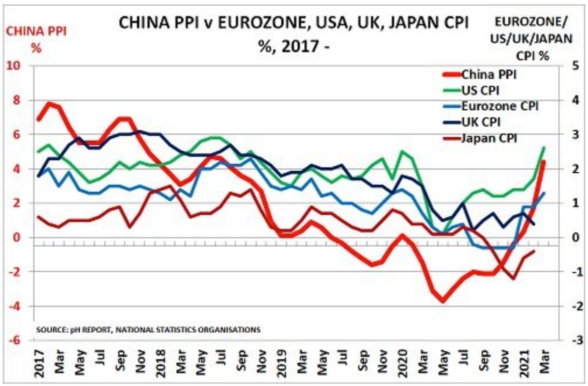
- ✦ Fed Chair Jay Powell's continued expectation for 'rates to remain low' led to downward pressure on bond yields
- ✦ Blackrock reported strong client appetite for high-yield during Q1
- ✦ Junk bond pricing was boosted by news on default rates falling to ten-month lows, taking average yields to within 10bp of February's low
- ✦ Bank of America estimates that junk bond yields imply a default rate of only 1.9% over the next 12 months
- ✦ Consumer and producer price inflation are both rising, as discussed below, with many companies taking the opportunity to raise prices

WATCH FOR

Risks are rising in junk bond markets, which are becoming priced for perfection

Inflation

The rise in China's Producer Price Index is now starting to roll through into western Consumer Price Indices



✦ HIGHLIGHTS

- ✦ As we noted in February, "supply chain bottlenecks are having their usual short-term impact on inflation, as buyers over-order to try and ensure they receive at least some product"
- ✦ China's PPI hit 4.4% in March, its highest level since June 2018
- ✦ Beijing is clearly worried about the potential impact on consumer prices, and is already taking steps to cool the bubbles, particularly in housing
- ✦ But in the meantime,the hike in the PPI is now feeding through into the US CPI (2.6% in March), and the eurozone (1.3%). The UK will no doubt follow
- ✦ Even Japan has seen its CPI start to rise: it may well see the CPI make a rare move into positive territory in Q2

WATCH FOR

Higher headline rates in Q2, due to the easy comparisons with 2020 – when prices collapsed along with demand due to the first lockdowns

Summary

The market's short-term mentality is highlighted by the fact that it has only taken a few days of positive news to turn many investors into raging bulls.

	Oil	S&P 500	Interest rates
Market view today	Some concerns	All news is good news	Expecting modest inflation
Our current view	Negative	Reversion to mean inevitable	Expect long-term deflation
Positioning began	March 2021	March 2021	December 2020
Confidence level			
Initial	◐	◐	◐
Today	◕	◐	◕
Relevant positioning	Reality starting to dawn	Waiting for reality to dawn	Expecting higher rates for the 10-year and longer-dated Treasuries

Confidence level: ● = 100%, ◕ = 75%, ◐ = 50%, ◔ = 25%

Disclaimer