

THE BIG PICTURE OF GLOBAL ECONOMICS

WITH



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Testing Times

- **India's challenges still present a risk to markets**
- **The rally in conventional government bonds has fixed income managers thinking**
- **Equity managers commitment to growth stocks to be tested**
- **ESG in the headlines with Earth day delivering new targets for cuts in emissions**
- **President Biden's tax raising plans show that some-day soon someone will have to pay**
- **Bank of Canada tapering unlikely to influence the Fed**

You might also like our [The US 10-Year Bond Yield – A Tale Of Two Countries](#) and [Time For Value As Growth And Inflation Arrives](#). Click [here](#) to read them for free.

A tale of two countries continued...

The tragic sight of the COVID challenges in India brings into sharp contrast the difference between the haves and the have nots. The roll-out of vaccinations remains pitiful in most emerging markets, while developed countries often surpass their targets. This human tragedy has so far not affected the general performance of emerging markets.

India's battle with mutations of the virus worry has many in Asia fearing the COVID variations may spread more widely, slowing the economic recovery. To date, conventional wisdom is that emerging markets will benefit from the economic recovery evident in the US and Europe. For example, the European emerging markets have seen upgrades to GDP forecasts in recent weeks. In Latin America, Mexico is expected to report 4.5% quarter-on-quarter annualised GDP growth for the first quarter.

We would advise investors to watch for further developments in India; firstly, we need to see a peaking of daily COVID cases. Secondly, we hope the strains in India do not start to impact other countries in a significant way. Don't also forget that India's challenges could affect the rest of the world more immediately. In 2018 India accounted for 67% of the global outsourcing market.

Portfolio manager's dilemma in the fixed income markets

For fixed-income managers, the market bet is still mainly that the recovery in the global economy will be largely uninterrupted. Spreads for high yield bonds and emerging market debt are still largely very narrow. The biggest loser over the past year has been long-dated treasuries, where the 20year+ government bond index is down 16.5%. Over the same period, the US high yield index has returned over 20%.

However, the recent rally in government bonds is a warning for bond managers not to run with too little exposure to plain old government bonds. The US long bond index has returned 3.6% over the past month, going from last to first in the ranking of bond index returns over the month. If investors believe in the reflation trade, the rally in the long bond will be seen as a good selling opportunity. However, if virus related trouble leads to a setback in global growth, the pain trade for most investors will be a rally in bonds that will cause underperformance.

Payback time

President Biden's outline plan for higher capital gains tax only shows that someone will have to pay for the spending plans of the new administration at some stage. The proposal is called the American families plan, which would reverse some of the former president Trump's tax cuts from 2017.

The proposed capital gains tax for Americans making over \$1,000,000 per year would nearly double to close to 40%. The new package also includes an increase in the top income tax rate. The new federal tax rates would compound state taxes such that the effective capital gains tax rate could hit 60% in some states. For context, data from the Federal Reserve shows that the top 10% of households by net worth owned over 87% of American equities in 2020.

Earth day sees moving targets

President Biden led a virtual climate summit to 41 world leaders this past week. At the meeting, he pledged to cut US greenhouse gas emissions by at least half by 2030. The pledge near doubles the previous commitment made at the 2015 Paris climate. Other countries followed; Japan raised their target for cutting emissions by 46% by 2030, up from 26%. Canada's Prime Minister Justin Trudeau raise that country's goal to a cut of 40% to 45% by 2013, up from 30%. Among emerging countries, Brazil stood out with a commitment to reach emissions neutrality by 2050, 10 years earlier than previously targeted. Some commentators, however, are still deeply sceptical about the possible action. As Reuters reported Greenpeace UK's head of climate, Kate Blagojevic, said that the summit had more targets than an archery competition, emphasising the need for countries to offer financial support for such targets.

Big week for tech

Heavy reporting season this coming week, with 35-50% of US and European companies scheduled to report this week. But there will be a focus on tech with upcoming earnings reports from Tesla, Apple, Facebook, Microsoft and Amazon.

Of more concern for tech investors are whether we will see more of the slowdown in activity for those companies that benefited most from the lockdowns of last year. Netflix was a casualty last week, down 10% as the lack of new subscriptions and the lack of content growth due to the lockdown's affecting studio output. **For Tesla**, the key metric will be the annual delivery trajectory for 2021. **For Apple**, the market expects good news on demand for iPads and Macs together with an increased dividend payout and share buybacks. We sense that depending on how well or otherwise the week goes for the tech sector may determine whether investors continue to back the growth sector or whether they are persuaded to shift into the value sector more aggressively.

Will the Fed concede that things are getting materially better? – probably not

Despite signs of improvement, the Federal Reserve's commentary to date has focused mainly on the downside risks rather than conceding that things have improved materially in the United States. Over the past few months, economic data has been upbeat. The labour markets have shown good improvement, even if more people prefer to stay at home rather than work, and the pace of vaccinations has improved materially.

We do not expect the Fed to change their statement, selecting to indicate that they still see risks to the downside. In all probability, they will not comment on the inflation outlook, choosing not to disturb the Treasury market that has 10-year yields still marked below 1.60%.

Taper time

The Bank of Canada hit the headlines by becoming the first major central bank and to cut back its accommodative monetary policy. They announced a scaling back in its quantitative easing. Weekly debt purchases will drop from 4 billion Canadian dollars to \$3 billion. The question for the markets is whether the change of perspective from the Bank of Canada marks the beginning of the end for QE across the world..... probably not.

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