Sanctum Wealth Management

THE BIG PICTURE OF GLOBAL ECONOMICS

WITH

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Not Out of the Woods

- **COVID challenges still abound – a smooth pick up in global growth not assured**
- **The gold price may be a bellwether of investor concern's about the spread of virus variants**
- **Growth has pushed inflation pressures not seen in decades**
- **Some inflation particularly in metals may stick for structural reasons**
- **Japanese equity underperformance may start to reverse in coming months**

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We would caution investors not to go gung-ho on the recovery/reflation trade. There are reasons to be optimistic, but to be sure, we are not out of the woods. If Singapore is a bellwether of the world's fight with COVID-19, the past few days decision by the authorities to walk back some of the relaxation of measures to control COVID is a wake-up call.

What a contrasting world. While the US and UK continue to open after their COVID lockdowns, many other parts of the world continue to struggle. India remains the epicentre of challenges with COVID-19 so far, with no abatement in the growth of cases. Countries bordering India, such as Sri Lanka and Nepal, are now facing mounting cases. Medical opinion is still up in the air as to whether the Indian COVID strains that appear to spread far quicker than others represent a danger to the western world. **We would note that the US government will only close its borders to travellers from India from Tuesday this week.** One only hopes that the authorities are not making the same mistakes of delaying the closing of borders to keep the virus at bay.

At present, the financial markets continue to discount that the recovery is on track. The US remains the centre of a recovery that has some pace. First-quarter global GDP growth appears to have been stronger than expected. Economists now forecast growth as much as 3.2% quarter-on-quarter at an annualised rate.

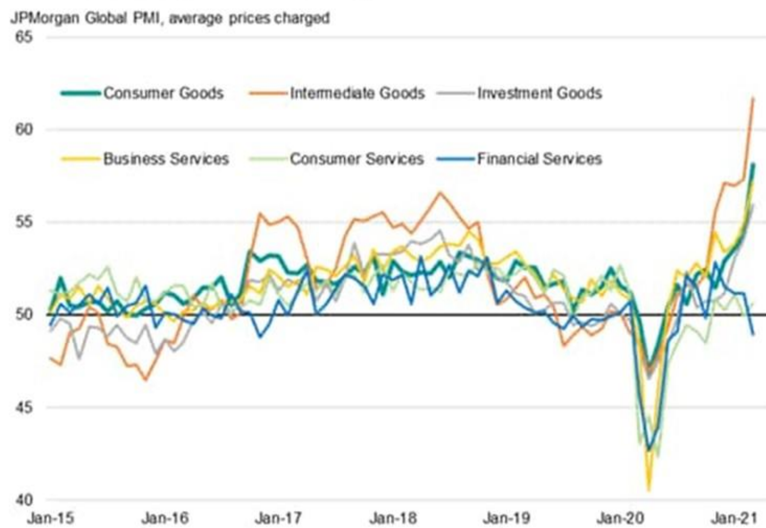
Keep an eye on gold

How will we know whether the world faces another significant stutter in its recovery? Waiting for confirmation from economic data as a confirmation signal will be too late. It is worth watching the gold price. Gold has recovered its poise in recent weeks. From a low of $1684, it has recovered to $1791. A break in the gold price through the $1800/oz level would have chartists targeting a move to at least $1900.

Inflation wings higher

The surge in growth continues to bring signs of inflation. We were surprised to find a dearth of chicken wings at the weekend in Singapore supermarkets. A quick internet search showed that the shortage of chicken wings is a global phenomenon; in the United States, restaurant owners complain of prices rising 20% in one week and significant shortages even at the higher prices. Part of the problem is that power outages in Texas caused a huge problem for chicken production, and the ongoing restrictions on people's mobility led to increased demand for stay-at-home menu items such as 'buffalo' wings.

But more seriously, IHS Markit Research, in a note published last week, commented that "near-record supply chain disruption has led to the fastest rise in global input prices since August 2008". And "inflation is now pushing through to end prices as higher costs have been passed through to end clients as the sharpest pace for over a decade in March".



Source: IHS Markit, JPMorgan.

Inflation is Green

Too often, analysts try to characterise the current inflation as just a 'monetary phenomenon' or just 'supply disruptions', and that demand growth is 'just transitory'. But it is not that simple. In truth, the first two factors are very much in evidence, but we would take issue with the idea that demand growth is just transitory.

Demand for some metals could have multi-year strong growth based on the world's pivot to a 'greener world'. The metals intensity of technology such as solar and electric vehicles will provide ongoing strong demand for metals that had previously lacked sufficient investment to drive capacity growth. According to the International Copper Association (ICA), a battery-powered electric vehicle uses 83kg of copper, a hybrid electric vehicle 40kg and an internal combustion engine with only 23kg of copper. Renewable energy sources are also heavily dependent on the use of copper in their construction. According to Breakthrough institute, "wind energy requires on average 2,000 tons of copper per gigawatt, while solar needs on average 5,000 tons per gigawatt – several times higher than fossil fuels and nuclear energy" (Source Christopher Yates- Seeking Alpha.com).

Hence, we are more confident to invest in the inflation of some metal prices than to chase too hard the broader inflation theme necessarily. We still see upside for the global miners, particularly those with exposure to copper and uranium.

Global equities have ended April with around 5% return, near doubling the year-to-date returns. US equities have continued to lead the way while emerging markets have continued to lag. As we go through the balance of the year, there is an opportunity for Japanese equities to recover from their recent lows. However, we suspect that investors will have to be patient through the coming few months.

Japanese equities attractive after sell off

April was a bad month for Japanese equities, with the lockdowns most notably in Tokyo and

Osaka hitting sentiment. While infection rates are not as high as in other major countries, hospitalisations are high due to higher numbers of older people. Things should improve. Economists, for example, expect Japan's growth to hit 9% quarterly annualised in the third quarter. **Such an outlook bodes well for a sharp recovery in Japanese equities in coming months.**

Chinese assets weaving through structural hiccups

Adding to the underperformance of the Asian equities in April was the generally poor showing of the Chinese market. The Shanghai composite was down 3.1%, and the Shenzen Composite dropped 5.6%. China was certainly not the victim of a serious lockdown. There is a general perception growing in the market that while the early stage of the pandemic was handled better by China, the vaccination phase is causing it some difficulties.

Furthermore, the government has been very clear that it is looking to rein in some of the tech giants, not stopping at the suspended listing of the Ant group but extending the clampdown to various other entities in the form of fines and other sanctions. It was recently reported that the major institutional investor, Fidelity, reduced the valuation it put on Ant from $295 billion in August to $144 billion as at the end of February (source: Bloomberg). With the Chinese government in the mood to bring the major players to heal, the market has struggled to make headway.

To add to a sense of discomfort, Huarong Asset Management, a major player in the distressed debt market in China, has run into credit difficulties. A solution to its problems is yet to be finalised. The firm has an aggregate of around $22 billion of debt outstanding, including subordinated and preferred debt instruments that carry more risk than conventional senior bonds. Our take: the Chinese government will look to tread a careful path between inflicting too much damage to senior bondholders, but still make it clear to the market that it favours transparent credit pricing for all entities.

For reference:
https://ihsmarkit.com/research-analysis/supply-delays-and-commodity-price-hikes-stoke-inflation-concerns-Apr21.html

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