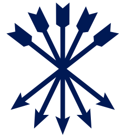
Market Perspective



Running hot – or overheating?

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Rothschild & Co
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Foreword

This last *Market Perspective* of 2021 does not contain dramatically new advice, even with COVID-19 risk rising again – a visible threat, but perhaps a more familiar one now. A New Year is no time to break our resolve.

We think the primary macro risk remains one of too much demand, not too little, and that even as monthly inflation (eventually) subsides, trend rates will settle at higher levels than in the pre-pandemic period.

With the Federal Reserve overachieving on its inflation mandate, and close to doing so on its employment mandate too, the question increasingly is not whether it should raise rates, but rather: why wouldn't it?

Higher rates are bad for most assets, and stocks are volatile at the best of times. After another strong run, they are expensive, and could be hit as money markets and yield curves adjust. But corporate earnings may stay ahead in their race with interest rates; meanwhile, bonds remain more expensive than stocks, with some measures of real yields lower even than in the 1970s. From our top-down perspective, we continue to favour business-related assets over the nominal safety of lending to governments.

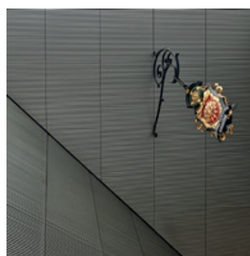
Our inflation views are not new, and do not make us any more receptive to crypto assets. Blockchain technology is not gaining wider traction. Attempts to find a legal question to which it might be the unwieldy answer will doubtless continue, squandering ever more energy in the process, but that doesn't make it an attractive investment.

Energy efficiency is a central component of ESG investing. It is a safe bet that the momentum there will continue. We review COP26 below, and identify a couple of possible bumps in the road ahead.

Another safe bet is that geopolitical strains will continue. China will not relinquish its claim to Taiwan, nor Russia its influence on Ukraine; meanwhile, France faces a resumed old-style populist challenge in April, and another familiar populist will be watching the US midterms keenly. But dramatic denouements are far from certain.

Market Perspective will be published next in February. We wish readers a healthy, peaceful and prosperous New Year.

Kevin Gardiner/Victor Balfour
Global Investment Strategists



Cover:
A very public symbol of the heritage and values of the family business is the Rothschild shield positioned on the exterior wall of our New Court office in St Swithin's Lane, London. The five arrows combined with the family motto is the only advertisement for the business within.

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Values: all data as at 30 November 2021.
Sources of charts and tables: Rothschild & Co or Bloomberg unless otherwise stated.

Running hot – or overheating?

Inflation risk is likely to persist

Just 18 months or so ago the economic headlines proclaimed mass unemployment. Today the talk is of labour shortages and inflation.

It is not a big surprise. The dramatic slump in activity in 2020 did not reflect underlying economic weakness, but was a collective and considered response to the public health emergency.

We thought economies would be able to reopen quickly when it was deemed safe. When they did so, there would be pent-up demand, and monetary and fiscal policy would likely err on the side of generosity. Inflation, not deflation, was always a likely eventual outcome. Omicron permitting, this remains our view.

The spike in inflation to date has been bigger than we thought. In the US and Germany, headline rates have breached 6% and 4% respectively, remarkable levels (three-decade highs) by local standards.

The inflation has so far been accompanied by ongoing growth: talk of “stagflation” is premature. The global economy is bigger than it was pre-pandemic, and business surveys remain upbeat. The main exceptions are where output is being held back not by weak demand, but by shortages of key inputs – including labour: wages have risen alongside prices.

Some of these shortages may be with us for some time. The lead times on new semiconductor capacity, for example, are long, and semis are ubiquitous – the big carmakers are the most visible casualty.

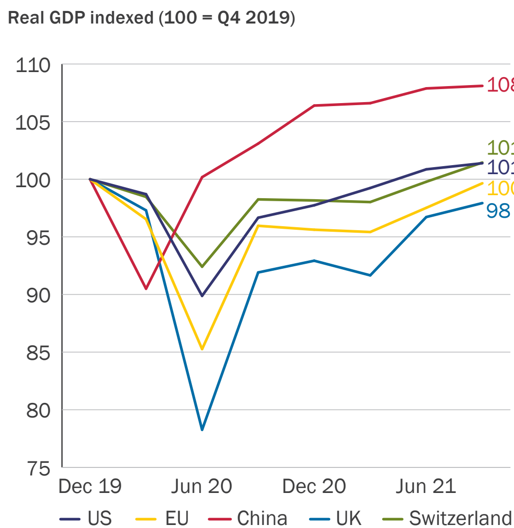
But many shortages reflect pandemic disruption, and may prove short-lived. We are not yet back at levels that we might think of as “full” employment, total industrial capacity is not yet fully utilised, and there is ongoing new investment.

And all the time, at any given level of labour and capital input, economic potential is expanding as productivity grows. New technology, and the learning curve, will together continue to give us more from less.

As bottlenecks fade, and commodity prices stabilise or go into reverse, the immediate inflation surge should subside.

Figure 1: The recovery to date

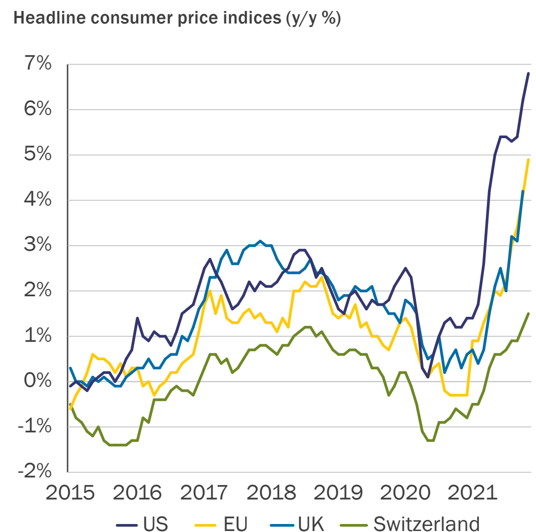
Real GDP indexed (100 = Q4 2019)



Source: Bloomberg

Figure 2: Headline inflation

Headline consumer price indices (y/y %)



Source: Bloomberg

We doubt this will be the end of the matter, however. Some underlying inflation risk is likely to persist, even as overall capacity grows, as long as demand remains robust.

Consumer balance sheets are strong and liquid, and politicians will be slow to push taxes up or cut public spending. Environmental mitigation and adaptation – signalled again in the Glasgow Climate Pact – may also add (understandably, and unavoidably) to the inflationary mix.

The big central banks have clearly signalled their willingness to let economies "run hot" for a while. We get it: as noted, some of today's inflation is indeed likely to be temporary, and is perhaps being overstated by the news industry (like the deflation of spring 2020). We also recognise that economies may be less inflation prone than they used to be. Labour markets are more flexible, economies are more digital, and monetary policy is more credible.

The risks are not symmetrical, however, and inflation may not be susceptible to fine tuning. It can get out of control and do serious societal damage: there are countless historical examples. There have been no hyperdeflations. And a careful analysis of the seemingly more benign inflation process requires taking all relevant variables into account, not just a handful.

We think, then, that there is a significant risk that today's "running hot" becomes tomorrow's "overheating". In which case, monetary policy may yet end up tightening faster, and further, than central bankers and money markets expect.

Central banks in several smaller economies (and not just the usual suspects) have already begun to raise interest rates – they are getting their retaliation in first, perhaps.

We continue to think inflation will settle at a trend rate of perhaps 2–4% across the big developed economies. This is above the 1–2% pre-pandemic norm, but moderate rather than alarming. Higher inflation on this scale, and some interest rate risk, poses an obvious headwind for bonds. Prices have fallen modestly in 2021, but most high-quality yields remain below central bank inflation targets, never mind today's above-target CPI rates.

It would be nice to think that such low real yields reflect our collective wish to value the welfare of future generations more highly. In reality, they likely reflect market technicalities, including liability-driven investing and central bank purchases. We doubt they will stay this low permanently.

If this makes us sound like rather stale bond bears, that's because we are. The future remains profoundly uncertain; diminishing marginal utility still applies to wealth as to most things; and corporate assets remain firmly profitable. Each of these argues for a positive long-term real discount rate.

Moderately higher inflation need not be a bad environment for equities. To date, corporate profits have been ahead in their tactical race with interest rates, and stocks have done well, even as inflation has revived. But if monetary credibility were at risk, and interest rate expectations were to change more dramatically, equities would be vulnerable too.

Stocks are the more volatile asset, even in normal times, and are currently expensive (albeit less so than bonds). And when investors need to liquidate assets in a hurry, they sell what they can, not what they should: blue chip equities can act as the cash-dispenser of choice in a crisis.

Our preference for stocks has served client portfolios well in 2021, and can do so into 2022. When inflation is active, however, there is no iron law of wealth conservation, and we take nothing for granted.

A less friendly policy backdrop?

Inflationary pressures have intensified in 2021, and central banks are starting to take notice. More than a dozen emerging market central banks (not all shown below), alongside New Zealand and Norway, have nudged policy rates higher this year – and those rates are now back above pre-crisis levels (on a GDP-weighted basis).

The bigger central banks have done little so far, but an increasingly hawkish (or at least, a less doveish) narrative is slowly beginning to emerge. Unorthodox policy tools are being curtailed: Canada has stopped its asset purchases altogether; Australia has abandoned its yield-curve control; and the US has started *slowing* the pace of its bond purchases – and is perhaps about to do so on an accelerated timescale, given recent remarks from the re-nominated (and perhaps emboldened) US Federal Reserve Chair, Jay Powell.

Specifically, none of the big three western banks has delivered an interest rate increase. Inaction at the Bank of England – which declined to deliver a widely anticipated November interest rate hike – attracted some sceptical remarks ("is the unreliable boyfriend back?").

It's possible the arrival of the Omicron variant may complicate the inflationary narrative. Indeed, the consensus disinflationary view has reduced the number of expected US rate hikes priced into the money markets from three to two in 2022 (still more than the median FOMC member expects) and pushed back the hike priced into the UK's money market until the early New Year.

We still think policy normalisation lies ahead, and perhaps on a timescale faster than the big central banks are indicating. Turkey's current predicament – a currency crisis and annual inflation above 20% – serves as a potential reminder of what can happen when monetary credibility is tested.

Figure 3: Central bank policy rates

Country / region	Current rate	Previous rate	Latest change	YTD change	Date of change
United States	0.25%	1.25%	-1.00%	–	Sunday, 15 March 2020
United Kingdom	0.10%	0.25%	-0.15%	–	Wednesday, 18 March 2020
Eurozone	0.00%	0.05%	-0.05%	–	Tuesday, 15 March 2016
China	3.85%	4.05%	-0.20%	–	Sunday, 19 April 2020
Japan	-0.10%	0.10%	-0.20%	–	Thursday, 28 January 2016
Australia	0.10%	0.25%	-0.15%	–	Monday, 2 November 2020
Canada	0.25%	0.75%	-0.50%	–	Thursday, 26 March 2020
Chile	2.75%	1.50%	1.25%	2.25%	Tuesday, 12 October 2021
Brazil	9.25%	7.75%	1.50%	7.25%	Tuesday, 7 December 2021
Czech Republic	2.75%	1.50%	1.25%	2.50%	Wednesday, 3 November 2021
Denmark	7.75%	-0.35%	-0.10%	-0.50%	Thursday, 30 September 2021
Hungary	3.30%	2.10%	1.20%	2.70%	Thursday, 9 December 2021
India	1.50%	4.40%	-0.40%	–	Thursday, 21 May 2020
Indonesia	3.50%	3.75%	-0.25%	-0.25%	Wednesday, 17 February 2021
Israel	7.25%	0.12%	-0.02%	–	Wednesday, 27 May 2020
Malaysia	1.75%	2.00%	-0.25%	–	Monday, 6 July 2020
Mexico	5.00%	4.75%	0.25%	0.75%	Wednesday, 10 November 2021
New Zealand	0.75%	0.50%	0.25%	0.50%	Wednesday, 24 November 2021
Norway	0.25%	0.00%	0.25%	0.25%	Thursday, 23 September 2021
Poland	1.75%	1.25%	0.50%	1.65%	Wednesday, 8 December 2021
Russia	7.50%	6.75%	0.75%	3.25%	Thursday, 21 October 2021
South Africa	3.75%	3.50%	0.25%	0.25%	Thursday, 18 November 2021
South Korea	1.00%	0.75%	0.25%	0.50%	Wednesday, 24 November 2021
Singapore	5.25%	5.33%	-0.08%	–	Wednesday, 30 January 2019
Sweden	0.00%	-0.25%	0.25%	–	Wednesday, 18 December 2019
Switzerland	-0.75%	-0.25%	-0.50%	–	Wednesday, 14 January 2015
Thailand	0.50%	0.75%	-0.25%	–	Tuesday, 19 May 2020
Turkey	15.00%	16.00%	-1.00%	-2.00%	Wednesday, 17 November 2021

Change in 2021

Source: Bloomberg
Correct to 9 December.

In other news...

Investing after COP26

We may not make many forecasts, but it is a safe bet that environmental, social and governance (ESG) issues will continue to move up the investment agenda in 2022, and will do so in that order.

Environmentally sustainable growth has arguably become the most important non-financial objective for investors, and the wealth and asset management industries will continue to modify their thinking, and their clients' portfolios, accordingly.

Rothschild & Co Wealth Management's investment philosophy in this respect has been detailed elsewhere by our investment colleagues in London and Zurich: two of them kindly provide a review of COP26 below (but are not liable for these comments!).

Not everyone cares: crypto assets continue blithely to waste colossal amounts of energy. Meanwhile, "E" and "S" can conflict: carbon taxes can be unfair. But the ESG movement currently is on a (welcome) roll.

We see two possible bumps in the road. Firstly, we are keen observers of public opinion, and can confidently predict that it will at some stage lose the plot. Elected politicians are unlikely to stop this happening: they appear happy (or content) to follow public opinion.

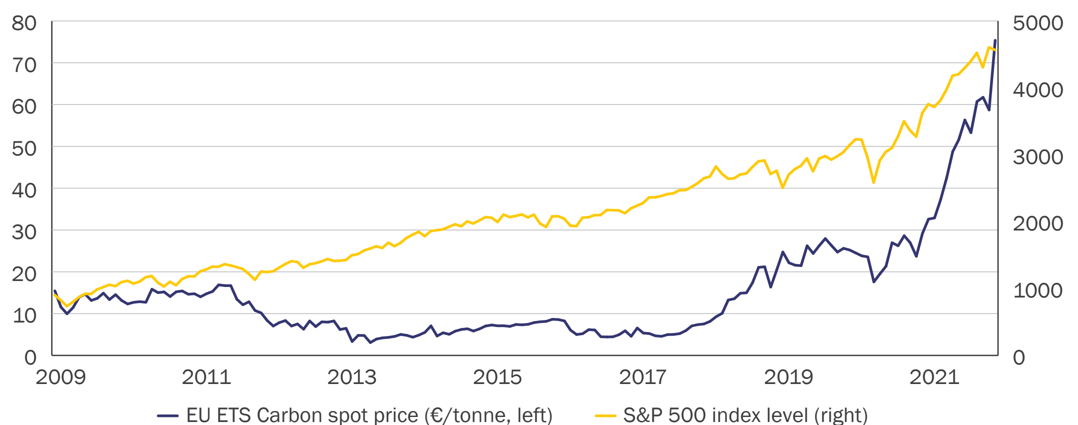
When it does, we should remember – as we noted back in August – that scientists are not proclaiming an extinction level event. A combination of mitigation and (especially) adaptation can plausibly keep the show on the road: the world does not need to go ex-growth (as urged by the "Degrowth Movement", nor to look again for a non-existent alternative to the current economic "system".

Much, if not most, economic growth comes from higher productivity, not the use of extra inputs: this is why Malthus got it so wrong. And while a healthy environment is a public good – no one can be excluded from benefiting from it – and so needs some government intervention to secure it, many problems can be dealt with in a decentralised way. Mitigating and adapting to climate change likely requires more markets, not fewer: for example, by extending markets' reach to internalise the currently unpriced "externalities" of carbon emissions and pollution. The debate is perhaps becoming more balanced: see for example Matthew E. Kahn's *Adapting to Climate Change* (2021).

The second potential bump in the road is more prosaic, and partially visible in 2021. To date, ESG-informed investing has been associated with portfolios that have done better, not worse, than market averages. This may not always be the case, and investors and their advisers should be braced for the possibility that doing the right thing is not always rewarded.

Figure 4: Carbon versus US stock prices

EU's ETS carbon spot price (€/tonne) and S&P 500 index level



Source: Bloomberg

We do not invest in an ESG-aware way in order to boost investment performance, but because such investing is (we think) a valid non-financial objective to consider alongside the traditional objective of wealth preservation.

It *could* boost investment performance. Companies with the best corporate governance are likely to be better run; and if they follow best social and environmental practices – or produce products that satisfy "green" and impact-oriented investor demand – then that might also result in their prices being bid higher.

But equally, it might not. Once their virtues are priced in, there is no guarantee that such companies will continue to outperform in their day-to-day business. And "greenwashing" is a risk.

Much of the last few years' outperformance of ESG-focused indices reflects the poor performance of energy and mining sectors, which are less present in such indices, and this unwound a little in 2021. You don't have to believe that big oil will change its ways to imagine that this revival might continue, though we think their business models probably will improve (much of the world's research into alternative energy is done by them).

At some stage, higher carbon prices and taxes may be fully priced in ("internalised"), and big oil's stock prices might rebound further. The world will continue to need fossil fuels, at least until nuclear fusion becomes viable (that is, for another decade or three).

More prosaically, there is also the narrowed portfolio choice to consider. The bigger the range of investments from which we can choose, the better our portfolio diversification is likely to be. Unless ESG considerations now become the overriding, dominant driver of investment selection this must count for something.

A look back at COP26, the UN climate summit

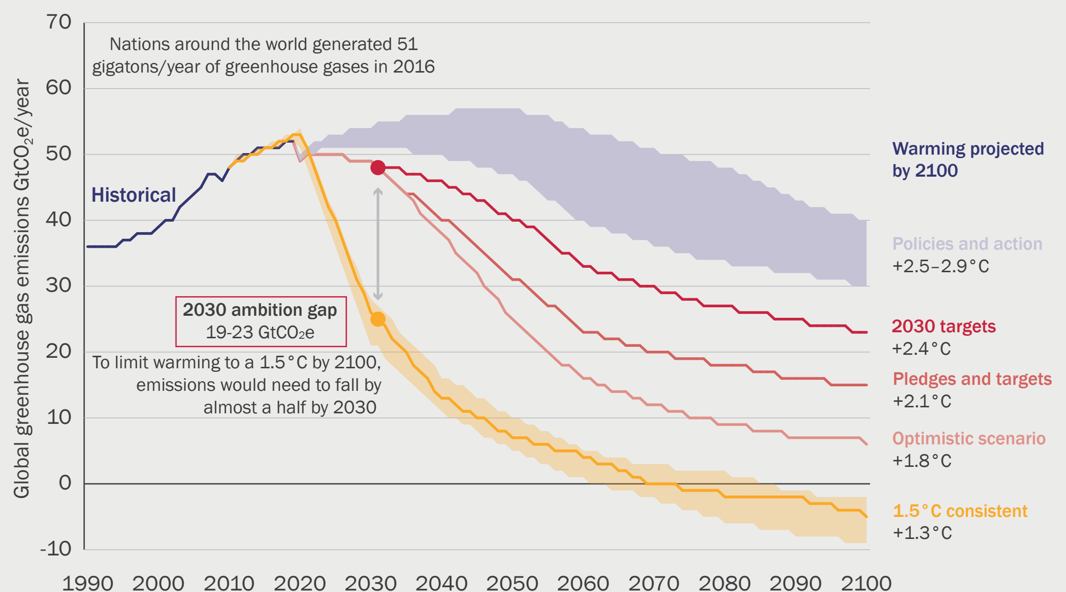
Tracy Collins/Nana Baffour

The 26th "Conference of the Parties", COP26, took place in Glasgow in the first two weeks of November and brought together diplomats from nearly 200 countries to revisit climate pledges they had made six years ago in Paris. The objective was to agree far-reaching action on climate change in order to keep the goal of the 2015 "Paris Agreement"[1] (a zero carbon economy by 2050) alive.

The Glasgow Climate Pact adopted by all 197 participating countries was inevitably a compromise, but is unambiguous in its urgency and acknowledgement that not enough is being done. Although countries representing 90% of global GDP have now pledged to be net zero by 2050, current national climate plans – NDCs, or Nationally Determined Contributions – fall far short of what is needed to limit warming to 1.5°C, the ultimate ambition of the Paris Agreement.

Figure 5: Keep 1.5°C alive?

Median estimate of the Global Mean Temperature based on different climate pledges



Source: Climate Action Tracker

[1] *The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015 and entered into force on 4 November 2016. Its goal is to limit global warming to well below 2°C, preferably to 1.5°above pre-industrial levels.*

Ahead of COP26, a report released by the IPCC (Intergovernmental Panel for Climate Change[2]), the leading authority on climate change, had delivered a stark assessment: delivering the Paris Agreement's commitment "will be beyond reach" in the next two decades "without immediate, rapid and large-scale reductions in greenhouse gas emissions".

The six years since the Paris Agreement have been the warmest on record, and according to the World Meteorological Organization in 2020 global temperatures were already 1.2°C above pre-industrial levels. If human-induced global warming continues at its current pace, we will surpass 1.5°C warming by 2040 and 2.0°C by 2050 – tipping points beyond which extreme effects of climate change are considered irreversible.

COP26 – the highs and lows

Getting 197 countries to agree on every issue was always a nigh-on impossible task. The summit nonetheless saw a stream of new pledges, including notable commitments on coal, deforestation, methane, the phase-out of fossil fuel-powered cars, carbon trading and transition finance:

- **Deforestation:** more than 140 countries, accounting for approximately 85% of the world's forests, pledged to end deforestation. Trees absorb CO_2, so this is a significant step.
- **The global methane pledge:** more than 100 countries pledged to cut methane emissions (which account for one third of human-caused warming) by 30% by 2030, from 2020 levels.
- **Zero emission cars and vans:** at least six major car manufacturers and 30 national governments pledged to phase out petrol and diesel-powered cars and vans by 2040.
- **Carbon Trading:** a global framework for trading carbon credits was agreed.
- **GFANZ:** Glasgow Financial Alliance for Net Zero, a group of more than 450 banks, asset managers and insurers, pledged $130 trillion to fund transition to net zero by 2050.

There are obvious caveats. Pledges are not legally binding; important protagonists did not sign up to some pledges; much more detail is needed for implementation.

Noticeable disappointments include the stance on coal – which accounts for nearly 40% of global CO_2 emissions. An agreed phase-out of coal had been cited as one of the most significant ambitions of COP26. However, at the 11th hour India and China insisted that the reference to coal and fossil fuel subsidies be changed from 'phasing *out*' to 'phasing *down*'.

Agreements on climate finance for developing countries also remained elusive. G20 economies account for around 80% of cumulative global greenhouse gas emissions, but emerging nations are often the most severely impacted by the physical effects of climate change.

Back in 2009 developed countries pledged $100bn a year of finance to help poorer countries move away from fossil fuels and to cope with climate change. Yet this funding – which leaders of developing countries have made clear is inadequate in any event – has never fully materialised. 12 years after the original commitment, developed countries have grudgingly agreed to make the funds available – but only by 2023. Distrust on the part of developing countries is understandable.

But an unexpected highlight of COP26 perhaps was the agreement between the world's two largest CO_2 emitters – the US and China – to boost climate co-operation over the next decade. Maybe this accord, although light on details, warrants some cautious optimism.

Beyond COP26

Some progress was made. Global leaders reiterated their commitment to tackling climate change and reaffirmed the goals of the Paris Agreement. The Glasgow Pact requires countries to 'revisit and strengthen' their climate plans by the next COP in Egypt next year, not in five years as previously required. Despite the watered-down language, this was the first COP whose final text directly addresses reducing the use of fossil fuels.

According to analysis by The Climate Action Tracker (CAT)[3], if all the new commitments made at COP26, together with existing national targets, are fully implemented, the world would be on track for 1.8°C warming – which would just about 'keep 1.5°C alive'. CAT describes this as a 'best case scenario', however. It remains to be seen whether this will happen. There have been 25 COPs before Glasgow which didn't deliver.

No one is arguing that this is easy or that there is a quick fix. Tackling climate change is hugely complex and collective global action will be vital.

[2] The IPCC, or Intergovernmental Panel for Climate Change, is a body of scientists that advise governments and policymakers on the state of climate change, with regular scientific assessments, and released the first of three papers of their 6th annual review of the global climate (IPCC AR6).

[3] The Climate Action Tracker (CAT) is a collaboration between Climate Analytics and NewClimate Institute which provides independent scientific analysis tracking government climate action against the globally agreed Paris Agreement. CAT has been providing independent analysis to policymakers since 2009.

Crypto crackers

"There's a simple inescapable truth at the heart of technical crypto scepticism that almost all software engineers intuit at some level: ***any application that could be done on a blockchain could be better done on a centralized database. Except crime.****"*
– Stephen Diehl

"The Bitcoin system consumes, at minimum, 10 gigawatts of power... (or as much as New York City!) ... 10 gigawatts of power to support three transactions per second worldwide..."
– Nicolas Weaver

Crypto assets are finishing 2021 in typically noisy fashion (see below). Bitcoin, still the market leader by a long way, has mostly had a very strong year, punctuated by two dramatic sell offs. During 2021 it has more than doubled; more than halved; more than doubled again; and most recently, fallen by a third.

Its gains have coincided with higher inflation, which has further encouraged the bitcoin bulls: "*We told you so, bitcoin is an inflation hedge*!". We remain deeply sceptical: its correlation with the inflation news was not that close, and an annualised daily volatility of three-fifths cannot "hedge" anything.

Crypto's late-year flurry has occurred even as it has become steadily more obvious that whatever else these things might be, they cannot be currencies. Blockchain is a complicated and wasteful answer in search of a question. After more than a decade of enthusiasm, it has yet to find a wider commercial application.

We have admittedly had to change our thinking a little. A colleague recommended Nicole Perlroth's book *This is how they tell me the world ends*, which gave us a glimpse of just how extensive cybercrime might be, and we can now imagine that demand for decentralised, private ledgers will stay stronger for longer than we'd thought. But blockchain as a viable building block for a currency, while more efficient and credible central bank digital currencies loom on the horizon? Not likely.

The good news perhaps is that the systemic risk posed by these speculative pyramids seems small, almost by definition. They are outside the banking system, and even the biggest banks – rarely slow at finding new ways to lose money – seem to have avoided accepting them as collateral. So far.

Figure 6: Bitcoin

Source: Bloomberg

Geopolitical stress: business as usual?

Two obvious potential geopolitical flashpoints are in Eastern Europe and South East Asia. As we write, Russia's intimidation of Ukraine has escalated, while China's claim on Taiwan is being pressed more firmly.

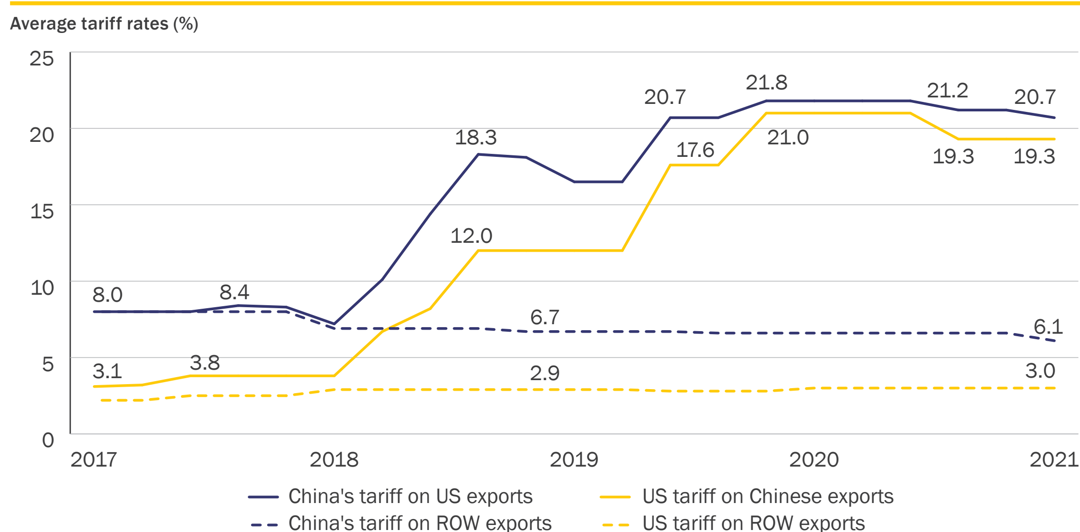
Afghanistan may have robbed an inward-looking (decadent?) west of some residual self-confidence. That said, neither Russia nor (even) China can easily afford an economic rupture with the rest of the world, and dramatic outcomes are far from guaranteed.

In the case of China-US tension in particular, pundits' talk of a "Thucydidean Trap" is exactly that – talk. A classical allegory is not an infallible predictor.

Our view since the previous US administration took office has been that economic self-interest may restrain China's response to (initially) higher tariffs (Figure 7). Maybe it will have a similar moderating influence as China ponders President Biden's promised support for Taiwan. China will never relinquish its claim there, but as long as the prosperity of its people relies on economic engagement with the wider world it may hold back from demonstrating that claim militarily.

The global balance of power feels precarious, but the stresses feel acute partly because since the end of "Mutual Assured Destruction" and the fall of the Wall we have become used to stability, a sort of political echo to the Great Moderation in the global economy. Talk now of these stresses leading to "deglobalisation", and a "Great Decoupling" of the two largest economies, is premature.

Figure 7: Trade tariffs



Note: Trade-weighted average tariffs computed from product-level tariff and trade data, weighted by exporting country's exports to the world in 2017.
Source: Peterson Institute for International Economics

France's presidential election… and US midterms

Political jostling ahead of the French election next April is underway.

The incumbent, Emmanuel Macron of *La Republique En Marche!* (LREM), is a member of the pro- European liberal party. Macron won the 2017 election by a decisive margin, despite having no major party backing, and over the past few years support for him in opinion polls has been relatively stable. His likely main opponent Marine Le Pen – a member of the right wing populist party, *Rassemblement National*, known as the *Front National* before June 2018 – has seen her support fall since regional elections in the summer.

Macron has not announced his candidacy yet, but is widely expected to run again. Le Pen (whom he beat in the second round of voting in 2017) has already begun her campaign. This is now her third bid for presidency.

Further to the right is Eric Zemmour, a polemicist who has been convicted twice for incitement to racial hatred, and has recently confirmed his candidacy. Zemmour is a TV pundit, an 'ultranationalist' dubbed as the 'French Trump' and known for his polarising views on immigration.

His manifesto pledges to stop immigration and limit asylum rights. He has no party alliance, entering as an independent, but announced in a recent rally – met with violent protests – that he will launch a new party called *Reconquête*, French for 'reconquest'.

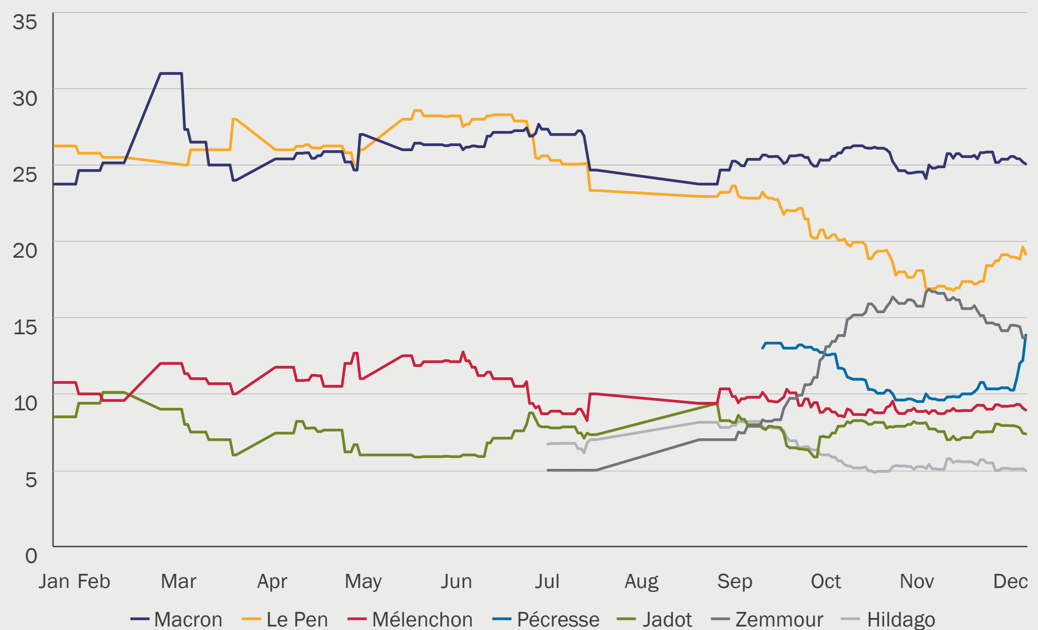
Another contender, recently confirmed as party leader for *Les Républicains*, is conservative Valérie Pécresse, a former minister under Sarkozy, and currently fourth in the polls, behind Macron, Zemmour and Le Pen. She is a pro-business centre-right moderate, and has described herself as "two-thirds Merkel, and one-third Thatcher".

Other confirmed candidates include the left's Jean-Luc Mélenchon, leader of *La France Insoumise*, running at roughly 9% in the polls. Other socialists include Yannick Jadot, leader of the Green party running at 8% in the polls, and Anne Hildago, another socialist candidate and the Mayor of Paris, currently at 5% in the polls. Generally, the left seems more fragmented than the right (as has usually been the case since 1789).

A first round of voting will take place in early April. If no candidate wins a majority, a second round takes places two weeks later between the top two candidates. Every election since 1965 – when the current voting system was implemented – has gone to a second round. Parliamentary elections will follow in June.

Figure 8: French presidential election opinion polls

Smoothed, 15-day moving average



Source: Elabe, Ifop-Fiducial, Harris-Interactive, Odoxa, OpinionWay, BVA, IPSOS
Note: Correct to 6 December 2021

At present, opinion polls suggest a Macron/Pen second round election, with Macron winning by a small margin. At this stage, however, candidates are still being confirmed, and campaigns are only just beginning. One thing seems certain: cultural issues – those of national identity and immigration – will continue to play a big role in shaping candidates' discourse and the outcome.

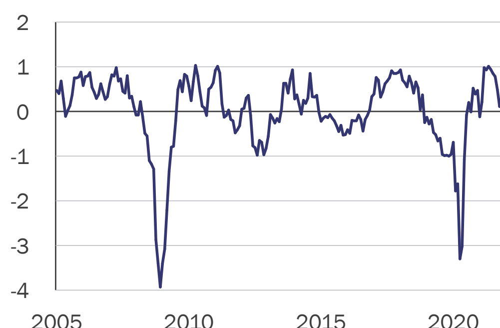
There are also important elections in the US next year: early November sees the midterm elections, with all 435 seats in the House, and a third of seats of the Senate, being contested.

Democrats won control of both the House and Senate in the 2020 presidential elections, but by a thin margin. Midterms don't often favour the incumbent administration, and more often than not the president's party will lose either one or both houses of Congress. Biden's approval ratings – currently at 43% – are low. At this very early stage, the most likely outcome perhaps is a US political process that is even more hamstrung than it is today.

Economy and markets: background

Growth: major economies

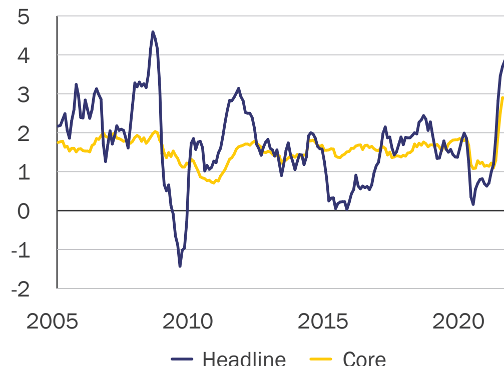
Business optimism: standard deviations from trend



Source: Bloomberg, Rothschild & Co
Composite of the forward-looking components of manufacturing surveys from China, Germany, Japan, UK and US loosely weighted by GDP

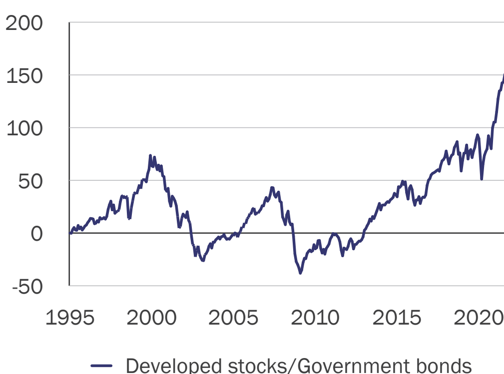
G7 inflation

%, year-on-year



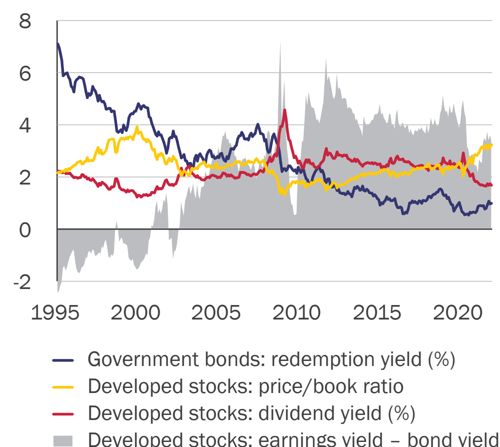
Source: OECD, Bloomberg, Rothschild & Co

Stocks/bonds — relative return index (%)



Source: MSCI, Bank of America Merrill Lynch, Bloomberg, Rothschild & Co

Stocks/bonds — relative valuations



Source: MSCI, Bank of America Merrill Lynch, Bloomberg, Rothschild & Co

Selected bonds

Current yields, recent local currency returns

	Yield (%)	1yr (%)	3yr (%)
10-yr US Treasury	1.5	-2.8	17.3
10-yr UK Gilt	0.7	-2.4	7.0
10-yr German bund	-0.4	-1.4	4.8
10-yr Swiss Govt. bond	-0.3	-1.5	1.1
10-yr Japanese Govt. bond	0.1	0.3	0.9
Global credit: investment grade (USD)	1.3	-0.5	14.1
Global credit: high yield (USD)	5.1	3.3	21.4
Emerging (USD)	4.5	-0.6	19.2

Source: Bloomberg, Rothschild & Co

Selected stock markets

Dividend yields, recent local currency returns (MSCI indices)

	Yield (%)	1yr (%)	3yr (%)
World: all countries	1.8	21.8	65.7
Developed	1.7	24.6	69.7
Emerging	2.5	3.2	39.0
US	1.3	27.0	87.5
Eurozone	2.2	22.6	47.2
UK	4.0	16.9	19.0
Switzerland	2.4	23.5	52.2
Japan	2.1	16.0	34.6

Source: Bloomberg, Rothschild & Co

Selected exchange rates

Trade-weighted indices, nominal (2000 = 100)

	Level	1yr (%)	3yr (%)
US Dollar (USD)	109.2	3.6	-0.2
Euro (EUR)	127.4	-3.2	1.4
Yen (JPY)	88.1	-6.5	-2.3
Pound Sterling (GBP)	81.8	5.5	6.5
Swiss Franc (CHF)	170.9	1.3	8.7
Chinese Yuan (CNY)	144.7	8.2	10.4

Source: Bloomberg, Rothschild & Co

Commodities and volatility

	Level	1yr (%)	3yr (%)
CRB spot index (1994 = 100)	225.7	42.0	22.6
Brent crude oil ($/b)	75.4	54.6	22.3
Gold ($/oz.)	1,784.1	-4.2	42.8
Industrial metals (1991 = 100)	350.3	23.0	47.0
Implied stock volatility: VIX (%)	21.9	2.8	-5.8
Implied bond volatility: MOVE (bps)	88.1	77.5	45.1

Source: Thomson Reuters, Bloomberg, Rothschild & Co

Data correct as of 30 November 2021.

Past performance should not be taken as a guide to future performance.

Notes

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