Rathbones
Look forward

Review of the week

13 December 2021

Christmas at risk

Déjà vu in the UK. With COVID cases mounting once again and restrictions piling up, everyone is wondering whether Christmas will be cancelled once again.

A torrent of demand for a booster jab made the NHS website crash at the weekend. Faced with the possibility of "a tidal wave" of Omicron cases, the government raised the alert level from three to four and opened up the booster jab to all adults immediately. With Christmas once again on the line, people are doing all they can to stay well enough to see family this year. Hopefully it will be enough to keep a lid on the latest infections spike and prevent the NHS from getting overwhelmed.

And so, the potential for yet more lockdowns, for shuttered shops, for closed borders is creeping back onto the table. This is disheartening at the best of times, let alone when we're all on the downward slope to Christmas. Yet the recent stock market reaction had a sort of resigned weariness about it. There's certainly not yet enough information to determine whether Omicron will definitely supplant Delta or whether that would be a good thing or a bad thing. Lest we forget, Omicron beating out Delta might actually be helpful! If it's more infectious but less harmful, that should shunt us all much further down the track toward herd immunity and COVID-19 receding, like past plagues, into a mild form of cold and flu.

In recent weeks, people have forgotten just how horrendous and pervasive the Delta strain of COVID is. It's Delta that forced many European nations back into an autumn lockdown, not Omicron. Delta, first discovered in India back in October 2020, makes up about 90% of worldwide COVID infections and remains the strain of most concern to scientists and doctors, despite several other mutations arising since. The newcomer Omicron accounts for just 5%, albeit that share has grown rapidly from less than 1% at October's end. Facts on the new mutation are still in short supply, yet early tests show increased infectiousness relative even to Delta. It is believed to be more resistant to vaccines as well. However, several doctors and scientists say that Omicron seems to be less harmful than Delta.

Only time will tell. All we can do is stay as safe as possible and hope that we can save this Christmas from going the way of last year's.

Yielding insights

All this flux has thrown markets into confusion. Bond yields have been whipsawed this quarter. UK 10-year government bond yields have slumped to near 0.70%. As recently as October they had been hitting post-outbreak highs of 1.20%. Yields run in tandem to economic expectations, so when investors expect stronger GDP and higher inflation, yields rise; and when they believe growth will be low, yields fall. (Usually, slower GDP expansion means lower inflation, so bondholders are ignoring the current spike in inflation.) UK inflation, at 4.20%, is the highest it has been in a decade and is expected to go higher still when it's updated this week. Meanwhile, the unemployment rate is forecast to fall slightly to 4.2%

The scene is set for a difficult Bank of England (BoE) monetary policy meeting this Thursday. At last month's meeting the BoE committee voted 7-2 to keep rates unchanged at 0.10%. Whether to raise rates at the December meeting is "a finely balanced decision," according to the bank's chief economist. Since that cryptic hedging comment, the UK has posted disappointing October GDP growth (just 0.10%), and so remains 0.50% below its pre-pandemic level.

A rule of thumb is that longer-term bond yields illuminate investors' expectations of GDP growth, while short-term government bond yields tell you what interest rate moves they think are coming from the central bank. Short-term gilt markets show investors think the BoE will stay pat once again. At the absolute fever pitch of expectations of BoE interest rate rises, back in October, the one-year UK government bond yield flew from below 0.15% to near 0.65%. It's now trading below 0.20%.

Bond yields have been volatile in the US as well, with the 10-year Treasury yield trading near 1.70% as recently as three weeks ago, before slumping as low as 1.36% in early December. Today the yield is around 1.50%. For whatever reason, the US seems to be more resilient to the latest wave of COVID-19, with economic measures remaining strong. Either that, or the nation is simply bulldozing on regardless.

Figures on Friday showed that US inflation hit an almost 40-year high of 6.8% last month, but with energy prices falling sharply in recent weeks this could well mark the peak. The jury is still out on whether the US Federal Reserve will accelerate its 'tapering', or winding down, of its quantitative easing bond purchases. Political pressures are also mounting, with some Democrats worrying that high prices might prove toxic in next year's midterm elections.

Thank you for investing with us through this bumpy year and for reading our weekly thoughts. We are taking a festive break and will be picking up the pen once more on 10 January. Happy holidays! As always, if you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by review@rathbones.com. We'd love to hear from you.

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