



# Monthly Market Report

## May 2021



*With commentary from David Stevenson*

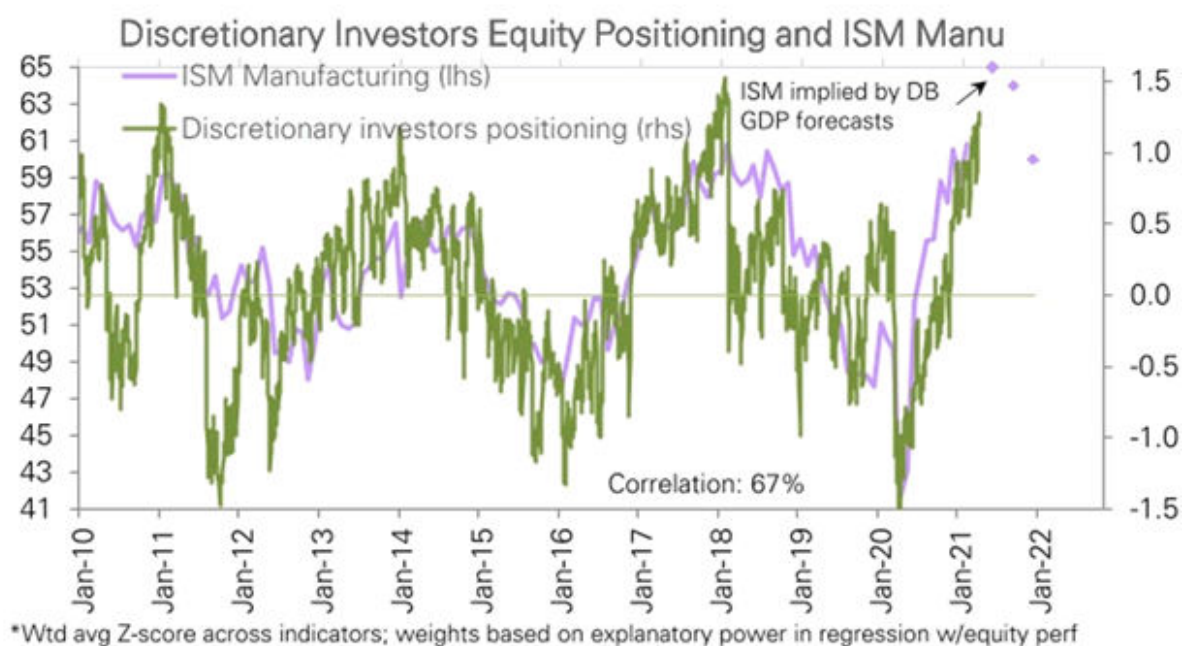
I am going to stick my neck out and suggest that we may be fast approaching a key turning point in the stock market. I would now offer a bet with a 50% probability that we'll have a proper market tantrum around May or June, with a 10% S&P 500 fall. My logic is best summed up by this note today from analysts at Deutsche Bank in the US. *"Discretionary positioning is now near the all-time highs seen back in early 2018... However, growth should peak sometime in Q2, potentially coinciding with a broader re-opening, warmer weather and an increased return to work at the office, arguably shifting retail investor attention away from markets as they find something else to do, and we are likely to see a pullback in equities."*

That seems to sum it up nicely for me.

People are back at work with many alternative uses of their spare time.

The stimulus cheques have been banked and spent. Investors will start worrying about other things - inflation, Taiwan, alien sightings (I jest not, a US DoD unit is focused on this threat).

The one risk I would identify in my very cloudy crystal ball at this point in time is that oil prices might spike in the second half of this year.



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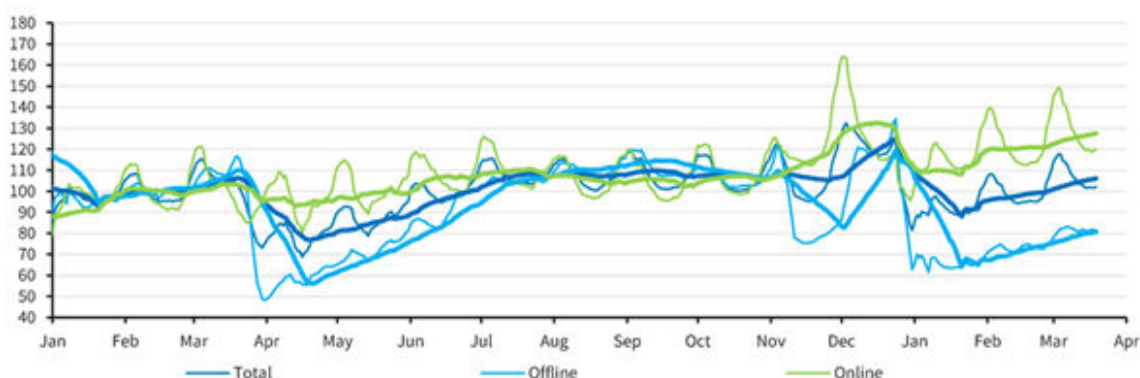
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## Headline Numbers

If I had to guess, I would suggest that the consumer bounce back this spring in the UK will be a great deal more aggressive than many analysts expect. My sense is that a) many people are desperate to go out and spend and b) are less worried than before that any resurgence in activity will result in another full lockdown. The bargain is I suspect set. We don't go on many foreign holidays, the borders stay tight (though not closed), some vaccine passports come in but otherwise we'll be 80% free. Whether that will push back into another lockdown late summer is anyone's guess, but I suspect that this time - it would be the fourth - the government will have a heck of a time forcing a full lockdown on people.

Anyway, back in the near present, it is worth keeping an eye on spend data coming in thick and fast from the big investment banks. Quick off the mark is the equities team at Barclays. I'd highlight the following observations on spending trends... "total spending levels continue to accelerate through March (see below), driven by home improvement/furnishing, food, transport, and hospitality, while both online and offline spending levels have increased. Cards data from the BoE/ONS (CHAPS) has also been on an upward trend since the start of the third lockdown, albeit improvement has slowed in March. Spending and mobility continued to improve at the end of March, as activity increased even before more meaningful reopenings. While cases could increase, with just under 60% of adults now having had a first dose of a vaccine, we see low risks of a surge in hospitalisations following today's loosening of restrictions."

Figure 2. Spend Trends levels: total, offline and online (28D and 7D averages), Feb 20 = 100



That should be good news for UK unemployment numbers, which actually haven't been as horrid as we all probably expected. There's been some discussion that these recent numbers were freak outliers or that the true situation is much worse than the data suggests but SocGens chief UK economist Brian Hilliard is buoyed by the most recent monthly numbers, especially as it's the third

consecutive monthly increase in employment. He observes that while "there are some issues with data quality in some respects, we think the broad picture is correct. That is, the palpable improvement in business confidence caused by the successful roll-out of the vaccination programme is leading companies to start hiring again. Nevertheless, we don't think that is the end of the story. When, eventually, the government winds down its support programmes, we still expect a fresh wave of redundancies, albeit a far less severe one than we feared in the dark days of last year. So, we predict an increase in the unemployment rate from the current level of 5% to a peak of 7% in early-2022 but with an increasing hope of a lower peak."

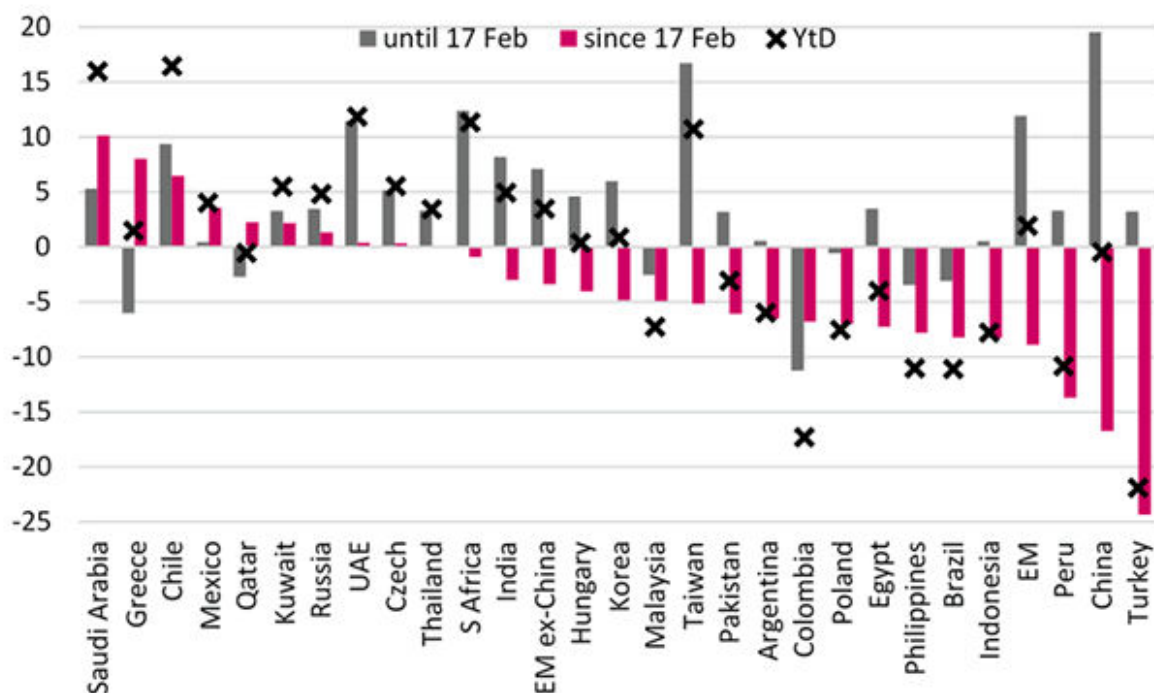


#### Value in the UK - "trade of the decade"

If I had to take a guess at which national stockmarkets most institutional investors thought had outperformed in the last year, I'd probably put the US and its growth/tech stocks near the top of the list. Except that if you actually look at numbers to the end of March of this year from index firm S&P Dow Jones you discover that emerging markets have actually been the stars. Taking 12 month returns from the first week of April (Tuesday 6th April 2021), the biggest gains have in fact been from investing in India (up 83%), Taiwan (also 83%) and South Africa (up 79%). The US is by far and away the best developed world market with a return of 60% but it's only just a smidgeon ahead of Mexico, its neighbour to the south (up 58%).

But these numbers from emerging markets are now changing before our eyes. According to equity analysts from Renaissance Capital until mid-February, tech-heavy China and Taiwan (as well as - Naspers heavy - South Africa) were outperforming. Since then, a combination of oil/commodity exporters and those with either pegged currencies or relatively low macro risk (Saudi Arabia, Chile, Kuwait, Russia, UAE) or strong trade links to the US (Mexico) has been outperforming. Of these, Russia has outperformed in the EM sell off (and YtD) despite sanctions fears.

Figure 4: MSCI EM country performance (\$)



Measure	Values as of 4th March, 2021	Values as of 7th April, 2021
UK Government 10 year bond rate	0.73%	0.79%
GDP Growth rate YoY	-7.80%	-7.30%
CPI Core rate	0.70%	0.40%
RPI Inflation rate	1.40%	1.40%
Interest rate	0.10%	0.10%
Interbank rate 3 month	0.07%	0.09%
Government debt to GDP ratio	100%	100%
Manufacturing PMI	55.1	58.9

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## Bank CDS options

Rates for credit default swaps pretty much across the board have increased over the last month with declining rates for only a couple of banks (Santander and HSBC). Interestingly, two banks experienced fairly meaningful increases - Credit Suisse (with its own problems involving its asset management business and Greenshill) and Nomura.

Bank	One Year	Five Year	Credit Rating (S&P)	Credit Rating (Moody's)	Credit Rating (Fitch)
Banco Santander	8.62	314.6	A	A2	A -
Barclays	15.02	44.34	BBB	Baa2	A
BNP Parabis	10	30.52	A+	Aa3	A+
Citigroup	27.05	55.43	BBB+	A3	A

Credit Suisse	34.23	62.29	BBB+	Baa1	A-
Deutsche Bank	39.54	93.52	BBB+	A3	BBB
Goldman Sachs	28.94	61.41	BBB+	A2	A
HSBC	9.21	29.65	A+	A1	AA-
Investec	n/a	n/a	n/a	A1	BBB+
JP Morgan	26.28	48.45	A-	A2	AA-
Lloyds Banking Group	9.66	30.66	BBB+	A3	A+
Morgan Stanley	31.1	60.4	BBB+	A1	A
Natixis	34.08	46.43	A+	A1	A+
Nomura	17.52	54	BBB+	Baa1	A-
RBC	19.44	57.51	AA-	A2	AA
Soc Gen	10.91	30.98	A	A1	A-
UBS	9.77	29.09	A-	Aa3	A+

Source: Tempo Issuer & Counterparty Scorecards ('TICS') 1st April 2021 [www.tempo-sp.com](http://www.tempo-sp.com)

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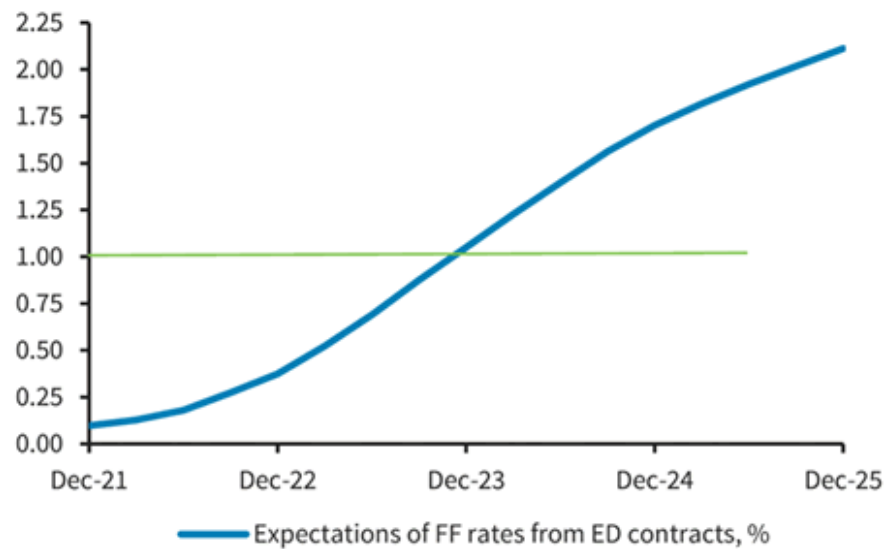
## Government Bonds

### Bonds

Bonds are suffering their worst (monthly) run since the 1950s in length, if not yet in scale. According to analysts at macro research house Cross Border Capital worse is yet to come "because of the strength of the upcoming economic rebound from COVID. We target 2½% for US 10-year Treasuries, but the key movement from here will likely involve rising real yields. Break-evens have already jumped higher. The coming market regime will see equities and bonds begin to more positively correlate (on the downside)."

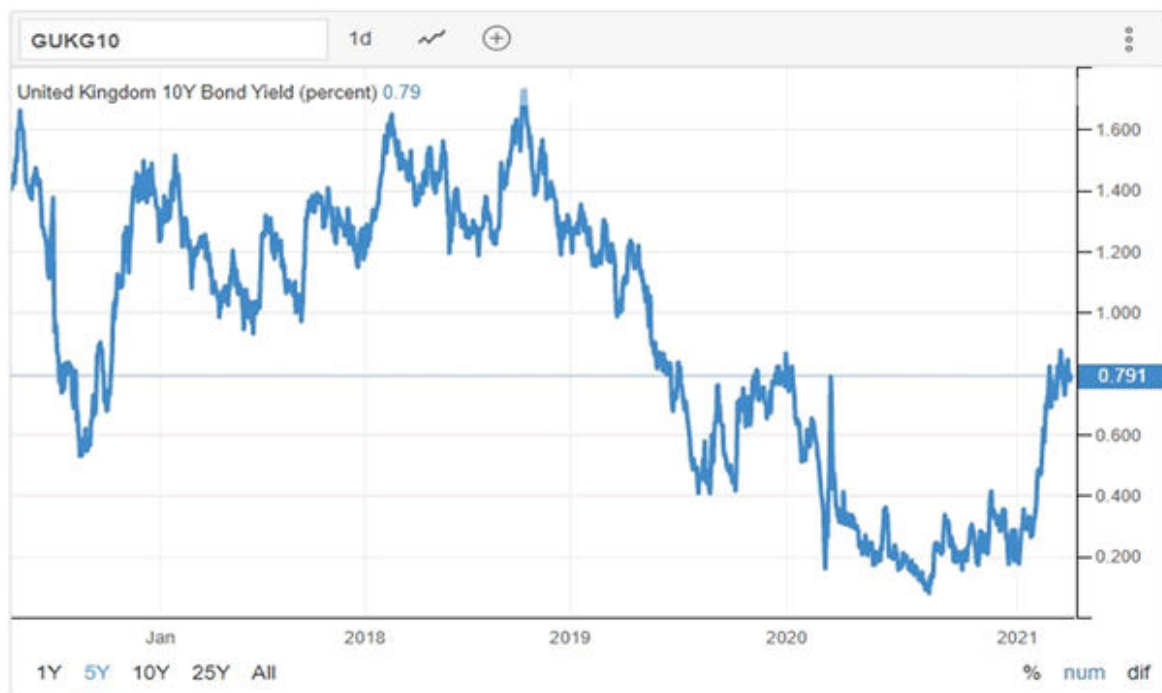
One early hint of increasingly cautious tone comes from Barclays Plc's Anshul Pradhan. In the chart below he shows that US Federal Reserve's funds futures now price in four rate rises by the end of 2023. According to Bloomberg's John Authers, "this is far more hawkish than the Fed's "dot plot" of forecasts from its governors, so the market is betting that the central bank will be forced to tighten before it wants to".

Figure 1. Markets are now pricing in almost four hikes by YE-23



Source: Bloomberg, Barclays Research

UK Government Bonds 10-year Rate 0.79%



Source: <http://www.tradingeconomics.com/united-kingdom/government-bond-yield>

## CDS Rates for Sovereign Debt

Country	Five Year
France	18.17
Germany	10.37
Japan	16.64
United Kingdom	12.51
Ireland	13.97



Italy	77.16
Portugal	29.81
Spain	33

## Eurozone peripheral bond yields

Country	March 2021	April 2021	Spread over 10 year
Spain 10 year	0.37%	0.33%	68
Italy 10 year	0.74%	0.66%	99
Greece 10 year	0.96%	0.85%	118

	S&P Rating		Moody's Rating		Fitch Rating
Germany	AAA	Stable	AAA	Negative	AAA
United Kingdom	AAA	Negative	AA1	Stable	AA+
United States	AA+	Stable	AAA	Stable	AAA

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## Equity Markets and Dividend Futures

Earlier this month saw the launch of the regular *Bank of America Global Fund Manager survey*. As usual lots of interesting takeaways, starting with the bottom line: "investor sentiment unambiguously bullish: COVID-19 no longer #1 "tail risk", 1st time since Feb'20 (inflation and taper tantrums now bigger risks); V-shaped recovery inducing jump in rate expectations, capitulation into cyclicals, biggest drop in tech exposure in 15 years; BofA Bull & Bear Indicator unchanged @ bullish 7.2."

Other highlights included the following observations:

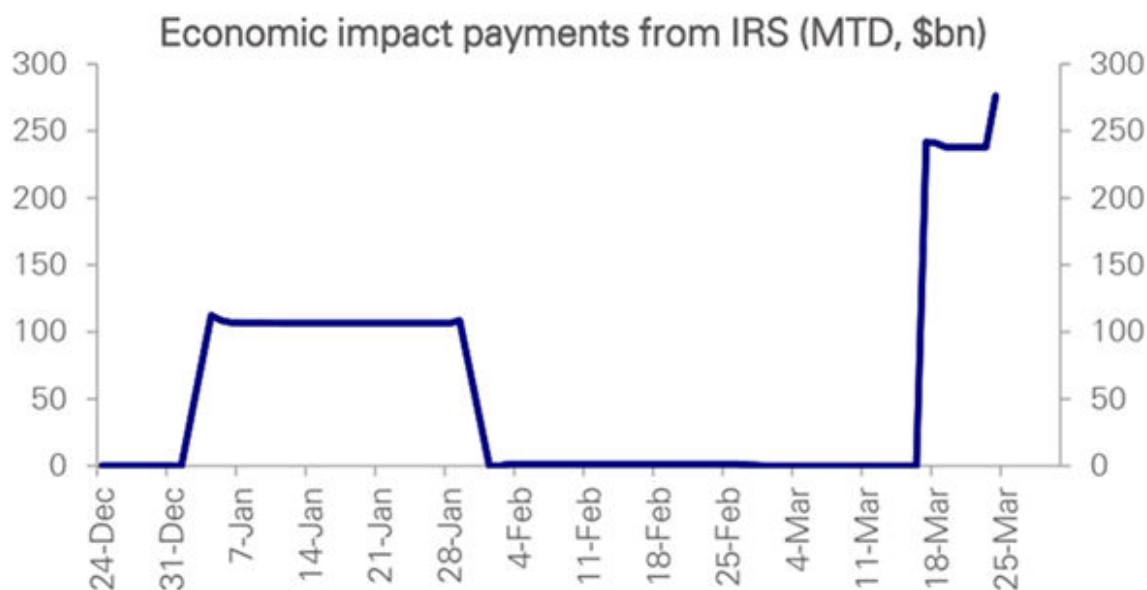
- "long tech" still deemed most crowded trade (then long Bitcoin and long ESG); but allocators cut tech to lowest OW since Jan'09; in contrast OW in banks largest since Mar'18, energy largest since Nov'18. FMS contrarian trades: long cash-short commodities, long utilities-short industrials if GT10 heading to 2%; long tech-short banks, long EM-short Europe if Fed YCC coming.
- conviction in UK equities continues to be on the rise... while optimism for EM equities has pulled back.
- A record 52% of investors now think value will outperform growth in the next 12 months.
- Higher-than-expected inflation overtakes COVID-19 vaccine roll out for top "tail risk" at 37% of FMS investors; #2 A "tantrum" in bond market, #3 COVID-19 vaccine roll out, #4 A bubble on Wall St. Record net 93% of FMS investors expecting higher global CPI in the next 12 months, up 7ppt this month.

But this survey data seems to miss one very obvious, predictable headwind.

Those stimulus cheques from Uncle Sam.

Most analysts reckon that something between 5 to 15% of the value of this free cash will be spent on equities, probably via brokerage accounts at Robin Hood. Analysts at Deutsche Bank stateside reckon that two-thirds of stimulus payments has already been distributed: "\$276bn or more than two-thirds of the anticipated payments of \$410bn have already been distributed as per US Treasury data. This means the incremental impact of stimulus payments should start to fade. This week also saw the first outflow from US equity funds (-\$10bn) in 7 weeks, after averaging \$23bn a week since early February."

**Figure 12: Two-thirds of the anticipated \$410bn in stimulus payments have already been distributed**



Source : U.S. Treasury, Haver, Deutsche Bank Asset Allocation

Index	March 2021	April 2021	Reference Index Value	Level 6 Months Ago
Eurostoxx 50 (Dec 19)	93.9	95.9	3969	83.5
FTSE 100 (Dec 19)	226	226.5	6916	208.5

Note changed to Dec 2021 contracts in January 2021

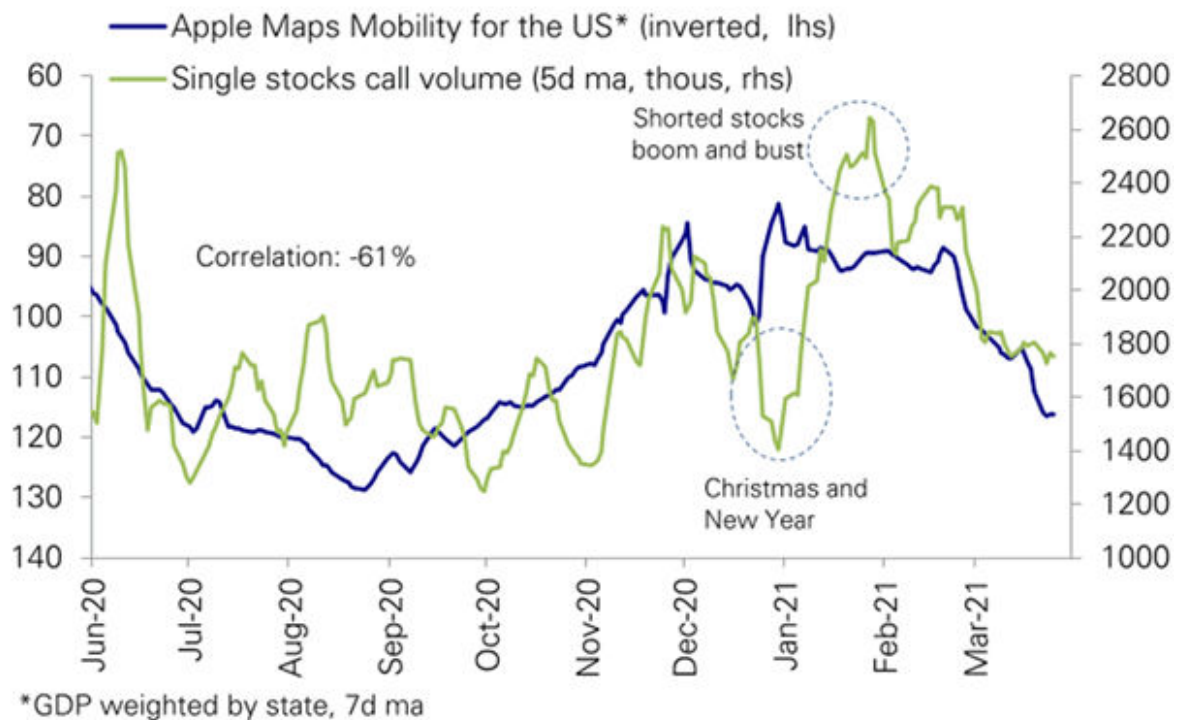
Name	Price % change						Close
	1 mth	3 mths	6 mths	1 yr	5 yr	6 yr	
FTSE 100	2.88	0.569	15.6	21.7	11.4	-0.361	6912.37
S&P 500	6.77	6.67	18.4	48.4	99.3	96	4079.95
iShares FTSE UK All Stocks Gilt	0.0995	-5.07	-5.18	-6.39	7.88	9.35	1385.5
VIX New Methodology	-32.6	-20.4	-34.9	-60.4	11.7	22.7	17.16

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## Volatility

Two follow ons in this section from the previous equities round up. The first is the chart below, from Deutsche again. It shows a fascinating 2020/21 relationship between real time measures of personal mobility in the US and single stock call option activity. According to Deutsche call volumes have been inversely correlated with measures of reopening over the last few months. The recent decline in call volumes has coincided with a rising pace of reopening. So as vaccination rates constantly tick up, the economy starts to recover and bullish call option activity might decline. That could be bad news for all those tech stocks so beloved of day traders. As bullish call option trading falls away sharply.



The Bank of America Investor survey also contains a useful nugget of information that might help us understand volatility. Their survey reports that cash levels are slowly starting to rise - see the chart below.

## Exhibit 10: FMS cash levels up to 4.0 in March

FMS average cash balance, %



Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

Measure	April Level	March Level	February Level	January Level
Vstox Volatility	16.15	22.1	21.21	21.41
VFTSE Volatility	16.95	26.16	21	23.33



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# Summary of Pricing Impact on Structured Products

Pricing Parameter	Change	Impact on Structured Product Price
Interest Rates	Up	Down
Underlying Level	Up	Up (unless product offers inverse exposure to the underlying)
Underlying Volatility	Up	Down for capped return/fixed return/capital at risk products. Up for uncapped return/capital protected products.
Investment Term	Up	Down
Issuer Funding Spread	Up	Down
Dividend Yield of Underlying	Up	Down
Correlation (if multiple underlyings)	Up	Up (unless product offers exposure to the best performing underlyings only)

*Source: UK Structured Products Association, January 2014*

*This information is provided for information purposes only, and the impact on a structured product price assumes all other pricing parameters remain constant.*

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## Explanation of Terms

### CDS Spreads and Credit Ratings

A CDS effectively acts like an option insuring at a cost in basis points a bank or government bond in case of default. The higher the basis points, the riskier the market perceives that security. Crucially CDS options are dynamic and change in price all the time. A credit rating is issued by a credit rating firm and tells us how risky the issuer is viewed based on the concept that AAA (triple A) is the least risky and ratings at C and below are regarded as much riskier. CDS and ratings are useful for structured product buyers because they give us an indication of how financial risk is viewed by the market. Crucially a high CDS rate indicates that an issuer of a bond will probably have to pay a higher yield or coupon, which could be good for structured product buyers as bonds are usually a prime source of funding for a structured product. G8 government bonds issued by the likes of the UK and US Treasury are also sometimes used as collateral in some form of investments largely because they are viewed as being low risk. One last small note on credit ratings and CDS rates. A is clearly a good rating for a bond (and much better than B) but AA will be viewed as even safer with triple AAA the least risky. Terms of CDS rates anything much above 100 basis points (1%) would warrant some attention (implying the market has some, small, concern about the possibility of default) while anything above 250 would indicate that the market has major concerns on that day about default.

### Why does the yield matter on a bond?

As we have already explained bonds are usually used as part of a structured product. The bonds yield or coupon helps fund the payout. All things being equal a higher bond yield means more

funding for the payout. But rising bond yields, especially for benchmark US and UK Treasury 10 year bonds also indicate that the markets expect interest rates to rise in the future. Rising interest rates are not usually a good sign for risky financial assets such as equities.

## Volatility measures

Share prices move up and down, as do the indices (the 500 and FTSE100) that track them. This movement up and down in price is both regular and measurable and is called volatility. It is measured by stand alone indices such as the Vix (tracking the volatility of the 500), VStoxx (the Eurozone Dow Jones Eurostoxx 50 index) and VFtse (our own FTSE index). These indices in turn allow the wider market to price options such as puts and calls that pay out as markets become more volatile. In simple terms more volatility implies higher premiums for issuers of options. That can be useful to structured product issuers as these options are usually built into an investment, especially around the barrier level which is usually only ever broken after a spike in volatility. Again all things being equal an increase in volatility (implying something like the Vix moving above 20 in index terms) usually implies higher funding levels for issuers of structured products.

## Dividend Futures

These options based contracts measure the likely total dividend payout from a major index such as the FTSE 100 or the Eurozone DJ Eurostoxx 50 index. In simple terms the contract looks at a specific year (say 2015) then examines the total dividend payout from all the companies in the index, adds up the likely payout, and then fixes it as a futures price usually in basis points. Structured product issuers make extensive use of dividend futures largely because they've based payouts on a benchmark index. That means the bank that is hedging the payout will want to be 'long' the index (in order to balance its own book of risks) but will not want the dividends that come from investing in that benchmark index. They'll look to sell those future possible dividends via these options and then use the premium income generated to help fund their hedging position. In general terms the longer dated a dividend future (say more than a few years out) the lower the likely payout on the dividend future as the market cannot know dividends will keep on increasing in an uncertain future and must fix its price in some level of uncertainty.

## Equity benchmarks

Most structured products use a mainstream well known index such as the FTSE 100 or 500 as a reference for the payout. For investors the key returns periods are 1 year (for most auto calls) and 5 and six years for most 'growth' products. During most though not all five and six year periods it is reasonable to expect an index to increase in value although there have been many periods where this hasn't been the case especially as we lurch into a recession. Risk measures such as the Sharpe ratio effectively measure how much risk was taken for a return over a certain period (in our case the last five years using annualised returns). The higher the number the better the risk adjusted return with any value over 1 seen as very good.

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To find out more about UKSPA, please visit [www.ukspassociation.co.uk](http://www.ukspassociation.co.uk).

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