



Monthly Market Report

October 2021



With commentary from David Stevenson

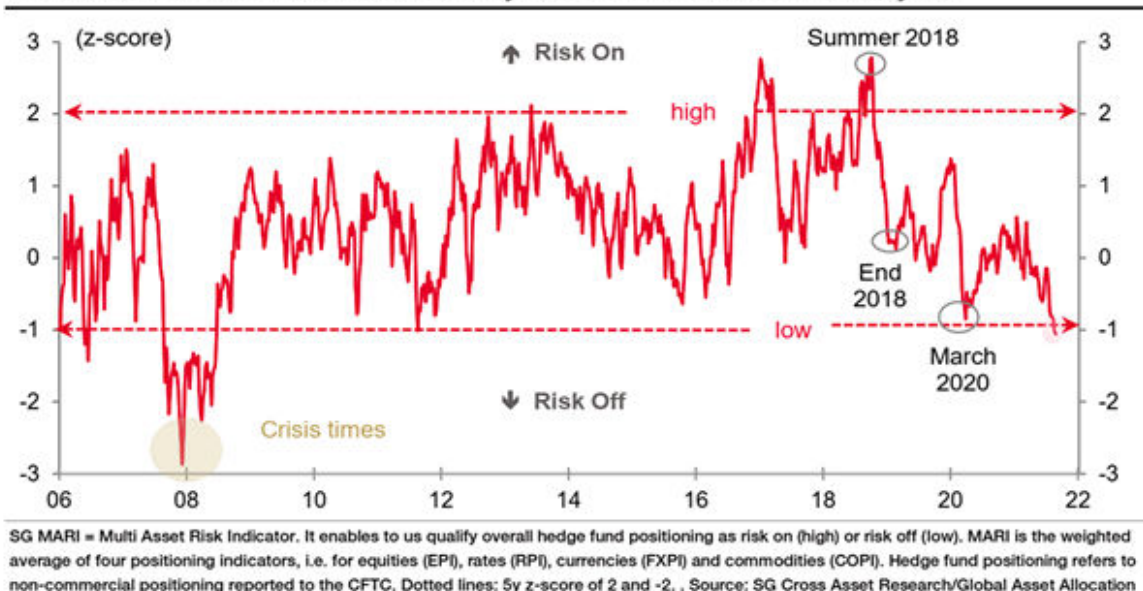
Well, so far the old adage about selling in May and coming back on St Ledgers day isn't panning out again. After a few wobbles, the markets have taken the summer and Jackson Hole in their stride. According to Fidelity since May global markets have enjoyed a rewarding summer, with the FTSE All Share rising by 4.52% between 1 May and 31 August while the Nasdaq rose by 21.58%. Of the six markets included in Fidelity's analysis, just the Nikkei 225 fell during the period by 2.30%. Investors appear to be bristling with confidence.

There are potentially lots and lots of reason for this confidence but one factor might be that share buybacks in the all important US market which have been steadily increasing. Ironically though, according to Andy Laphorne at SocGen, the rate of growth in buybacks hasn't kept up with the rate of growth in share prices. Laphorne reports that buybacks for the S&P 1500 non-financials have fallen by around 20% from pre-crisis levels but are once again growing year-on-year and in terms of cash flow represent the same payout as dividends at around 20%.

"However, given that US equity prices are also up 40% from end-2019, this 40% total distribution payout ratio still only equates to a total payout of 2.4%, near its all-time low, and to get back to pre-pandemic levels of distribution relative to price looks challenging. In these times of low yields, maybe 2.4% is acceptable, but given the importance of compounding in driving long-term equity returns, the difference between 2.4% and 4.8% is huge."

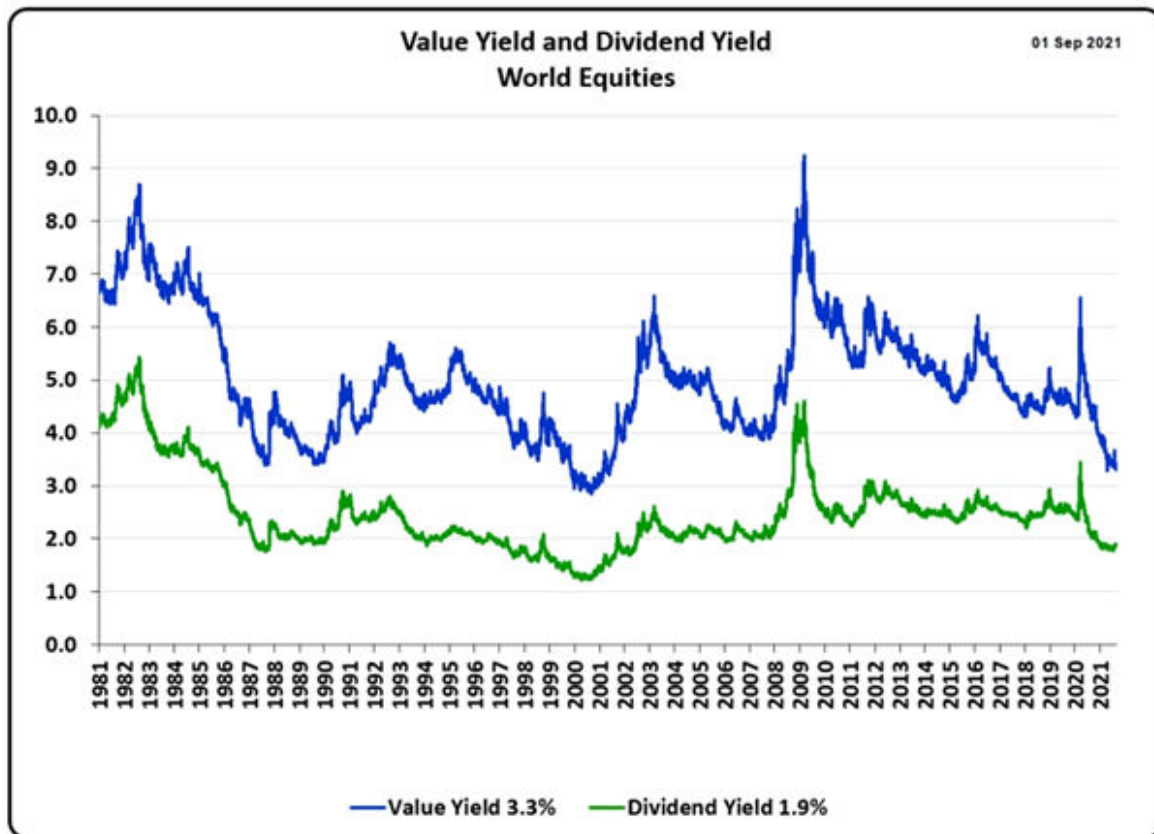
Buybacks are of course only one piece of the valuation puzzle – the big question is whether the market confidence is bordering on bubble-ish behaviour. Laphorne's colleagues at SocGen, Arthur Van Slooten and Alain Bokobza run an in house proprietary risk model called the SG Multi Asset Risk Indicator (SG MARI) which attempts to give investors a quick snapshot of market confidence. Curiously their model currently suggests that "investors are remarkably risk off (see chart below). Just three days before Jay Powell's 'tapering' speech at Jackson Hole, SG MARI touched the lower bound of its normal trading range at -1.06, almost one standard deviation below its long-term average. " The key point here is that this reading is very unusual – " We have only seen such a low reading in just 9% of all observations since 2000. In the past, any drop below the current SG MARI level has been typically triggered by a major crisis such as the TMT bubble, the subprime crisis and the 'taper tantrum'. The current level is below even the Covid-19 blighted March 2020 reading. Conversely, whenever SG MARI has bounced back from current levels, it has typically heralded the start of a more positive tone, which is good for risky assets such as equity and commodities but not for rates". So, time to panic ? Not quite the SG analysts conclude.

Trouble ahead or are investors excessively cautious? – SG MARI is unusually low



"We do not find the current low reading from our risk indicator SG MARI particularly worrying. Rather, we take it is a sign of restraint on the part of investors on risky assets (equities, FX and commodities) which is appropriate whenever market conditions are about to change. That said, whatever the cause of potential future shocks, the fallout should be relatively mild – so no pressing need for overly optimistic investors to square positions, at least for now. Without readily identified major immediate threats, SG MARI's low reading could still call for a more balanced approach to risk."

Charles Ekins is a well respected technical and fundamentals analyst who runs his own multi asset ETF for EkinsGuinness. Like everyone else he keeps tabs on the aggregate market valuations, using his own value/technical measures. His conclusion? "World Equity absolute valuations are stretched historically but are not yet extreme. But Equities are still very cheap against artificially-expensive Bonds". The chart below nicely sums up this cautious stance – his World Equity Value Yield measure (blue line) is at 3.3% which is lower than in 2007 before Global Financial Crisis, similar to pre-1987crash , but not as low at Tech Bubble in 2000. The second measure, the World Equity Dividend Yield (green line) is currently running at 1.9%. This is also low but is not extreme.



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Headline Numbers

China has been grabbing all the headlines at the moment, probably rightly so given the big tectonic shifts. Overall I've been more cautious than most although one can't help but note that China Tech stocks are cheap and getting cheaper.

An alternative take on this huge debate comes from fund manager Mark Sheppard who runs the Manchester and London investment trust. As a tech investor he's bet big on China and perhaps unsurprisingly has a different take on how events might unfold. As he says the "core fear some are sensationalising is that China may be moving away from the New Era of Socialism towards Xi Jinping Thought which is shifting ever more Mao-ist in nature."

I'm not sure that this is a sensationalizing read of events but Sheppard's bigger point is that if the

cynics are right, why hasn't there been a wider impact on key developed market stocks. Names such as Burberry, HSBC, LVMH, Renishaw, SSAB, Kone are all businesses that should be impacted given their profits from China but don't appear to have been so far. As Sheppard observes there are "numerous global growth favourites in the tables below that earn material parts of their earnings from China. Beware!"

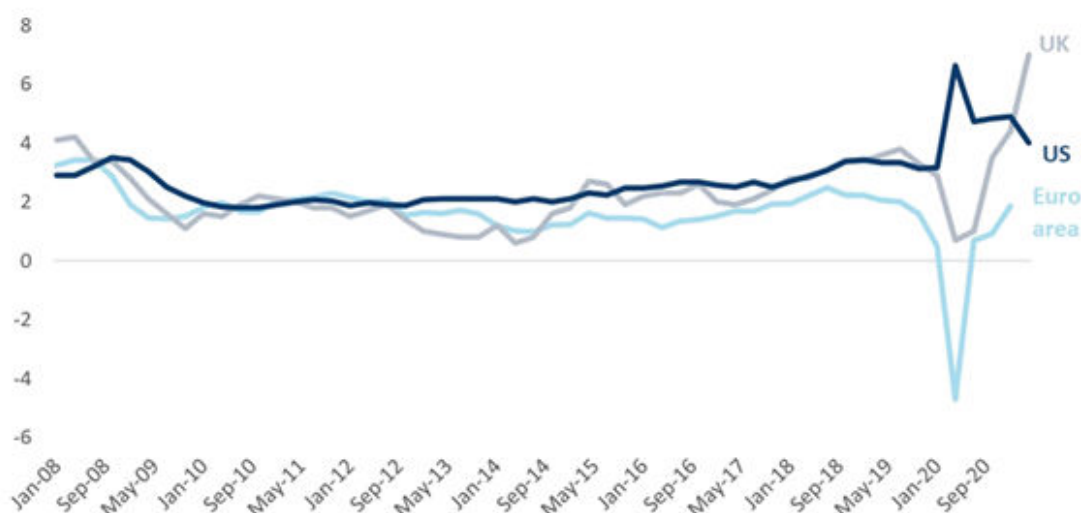
Exhibit 80: China Exposure Basket (MSRERECH) - Top 50 European stocks with the highest revenue exposure to China

Company Name	GICS Industry Group	Market Cap \$bn	Price (07-Jun-2021)	MS Rating	% of 2021e revenues from China
BHP Group Plc	Materials	65.0	£ 21.76	EW / I	62
Rio Tinto Plc	Materials	109.3	£ 61.92	EW / I	58
Swatch Group Ltd. Bearer	Consumer Durables & Apparel	19.1	CHF 332.20	EW / I	55
ams AG	Semiconductors & Semiconductor Equipment	5.8	CHF 18.97	EW / I	54
Compagnie Financière Richemont SA	Consumer Durables & Apparel	67.2	CHF 115.30	OW / I	44
Glencore plc	Materials	61.0	£ 3.24	OW / I	42
Burberry Group plc	Consumer Durables & Apparel	12.7	£ 22.22	EW / I	42
Salvatore Ferragamo S.p.A.	Consumer Durables & Apparel	4.0	£ 19.51	EW / I	40
TOD'S S.p.A.	Consumer Durables & Apparel	1.9	£ 47.92	EW / I	40
Anglo American plc	Materials	61.4	£ 31.83	OW / I	39
Hermès International SCA	Consumer Durables & Apparel	152.1	€ 1182.00	EW / I	37
Kering SA	Consumer Durables & Apparel	113.0	€ 742.00	EW / I	35
NXP Semiconductors NV	Semiconductors & Semiconductor Equipment	54.7	\$ 198.25	EW / I	35
Moncler SpA	Consumer Durables & Apparel	19.7	€ 58.92	EW / I	35
Prada S.p.A.	Consumer Durables & Apparel	17.1	HK\$ 51.75	EW / I	35
LVMH Moët Hennessy Louis Vuitton SE	Consumer Durables & Apparel	405.8	€ 659.70	OW / I	32
Kone Oyj Class B	Capital Goods	36.7	€ 66.52	EW / C	31
Elkem ASA	Materials	2.3	NOK 29.44	EW / I	30
STMicroelectronics NV	Semiconductors & Semiconductor Equipment	33.5	€ 30.19	OW / I	28
Infineon Technologies AG	Semiconductors & Semiconductor Equipment	52.5	€ 32.97	OW / I	27
Remy Cointreau SA	Food Beverage & Tobacco	10.0	€ 162.40	UW / A	26
Soitec SA	Semiconductors & Semiconductor Equipment	7.0	€ 172.10	EW / I	25
adidas AG	Consumer Durables & Apparel	72.1	€ 295.10	EW / I	23
Knorr-Bremse AG	Capital Goods	19.9	€ 101.10	OW / C	22
Renishaw plc	Technology Hardware & Equipment	5.7	£ 55.50	EW / C	22
Covestro AG	Materials	13.3	€ 56.54	OW / I	21
Durr AG	Capital Goods	2.9	€ 34.10	OW / C	21
Atlas Copco AB Class A	Capital Goods	72.5	KR 511.00	EW / C	21
SKF AB Class B	Capital Goods	12.4	KR 225.70	UW / C	20
JCDecaux SA	Media & Entertainment	6.5	€ 24.96	EW / I	20
ageas SA/NV	Insurance	11.5	€ 49.59	OW / I	20
Airbus SE	Capital Goods	105.8	€ 110.50	OW / I	19
Intertek Group plc	Commercial & Professional Services	12.1	£ 53.04	OW / I	19
L'Oréal SA	Household & Personal Products	260.2	€ 380.80	OW / I	18
Bayerische Motoren Werke AG	Automobiles & Components	75.8	€ 95.52	UW / I	18
Autoliv Inc.	Automobiles & Components	9.2	\$ 105.49	UW / I	18
LANXESS AG	Materials	6.6	€ 62.28	EW / I	18
Veoneer, Inc.	Automobiles & Components	2.8	\$ 25.36	EW / I	18
Carlsberg A/S Class B	Food Beverage & Tobacco	28.0	DKK 1112.50	OW / A	17
PUMA SE	Consumer Durables & Apparel	17.1	€ 93.20	OW / I	16
Schneider Electric SE	Capital Goods	91.2	€ 131.96	EW / C	16
ABB Ltd.	Capital Goods	75.7	CHF 31.30	UW / C	16
Schindler Holding AG Pref	Capital Goods	31.7	CHF 268.90	EW / C	16
SGS SA	Commercial & Professional Services	23.6	CHF 2800.00	EW / I	16
Bureau Veritas SA	Commercial & Professional Services	14.4	€ 26.19	OW / I	16
Schaeffler AG	Automobiles & Components	1.6	€ 8.03	UW / I	16
Aurubis AG	Materials	4.4	€ 80.86	UW / I	16
SIG Combibloc Group Ltd	Materials	9.2	CHF 24.38	EW / I	15
Kuehne & Nagel International AG	Transportation	42.4	CHF 314.50	EW / I	15
Hapag-Lloyd AG	Transportation	36.5	€ 170.50	EW / I	15

The inflation debate continues to rumble on with the data supporting both sides of the discussion. My own view is probably closer to the central banks one, which is that much of the current price action is more transitory rather than permanent. But we always need to keep a beady eye on wages and the papers are certainly full of stories at the moment about labour shortages – oh to be a HGV driver – and increasing wages. As with all inflation measures, in reality the hard data is trumped by a softer measure which is 'expectations' data for the future i.e how will these price or wage rises be baked into future expectations. With wages, the warning signal is when wage bargainers try and push rates up even higher to allow for either increasing retail prices or playing catch up with other sectors. The chart below is from a recent report by economists at Jefferies. Wage rates in the UK are now rising faster than in the US and the Euro zone. Given the UK's long history of above average wage rises (and RPI increases), this is a potentially worrying development.

Global rates of wage growth

% YoY



Source: Jefferies

The Jefferies report also contains a fascinating sting in the tail. Their economists go through a number of sectors and look for those that might be most vulnerable to a wage spiral – and alight on the asset management and wealth space ! In this space they reckon that the cost bases of asset and wealth managers are typically dominated by compensation costs, accounting for c.35-50% of total revenues (around two-thirds of total costs).

Measure	Values as of 11th August, 2021	Values as of 7th September, 2021
UK Government 10 year bond rate	0.61%	0.73%
GDP Growth rate YoY	-6.10%	22%
CPI Core rate	2.50%	2%
RPI Inflation rate	3.90%	3.80%
Interest rate	0.10%	0.10%
Interbank rate 3 month	0.07%	0.06%
Government debt to GDP ratio	97.4%	97.4%
Manufacturing PMI	60.4	60.3

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Bank CDS options

It's been another quiet month for the market in credit default swaps, with no big moves. Some of the US banks saw their pricing marginally decline, especially for Citi and JPMorgan whereas some of the European banks saw their pricing for 1 year swaps increase – notably for SG whose 1 year swaps increased from 5.57 basis points to 9.11 basis points. That said these rates are still very low historically.

Bank	One Year	Five Year	Credit Rating (S&P)	Credit Rating (Moody's)	Credit Rating (Fitch)
Banco Santander	8.07	28.98	A	A2	A -
Barclays	11.55	38.69	BBB	Baa2	A
BNP Parabis	5.77	26	A+	Aa3	A+
Citigroup	24.42	47.44	BBB+	A3	A
Credit Suisse	20.01	52.61	BBB+	Baa1	A-
Deutsche Bank	29.36	76.19	BBB+	A2	BBB
Goldman Sachs	26.06	52.43	BBB+	A2	A
HSBC	8.85	29.3	A+	A1	AA-
Investec	n/a	n/a	n/a	A1	BBB+
JP Morgan	23.05	42.43	A-	A2	AA-
Lloyds Banking Group	6.47	26.35	BBB+	A2	A
Morgan Stanley	26.05	50.43	BBB+	A1	A
Natixis	34.08	46.43	A	A1	A+
Nomura	17.52	54.61	BBB+	Baa1	A-
RBC	17.35	51.51	AA-	A2	AA-
Soc Gen	9.11	27.65	A	A1	A-
UBS	7.74	26.27	A-	Aa3	A+

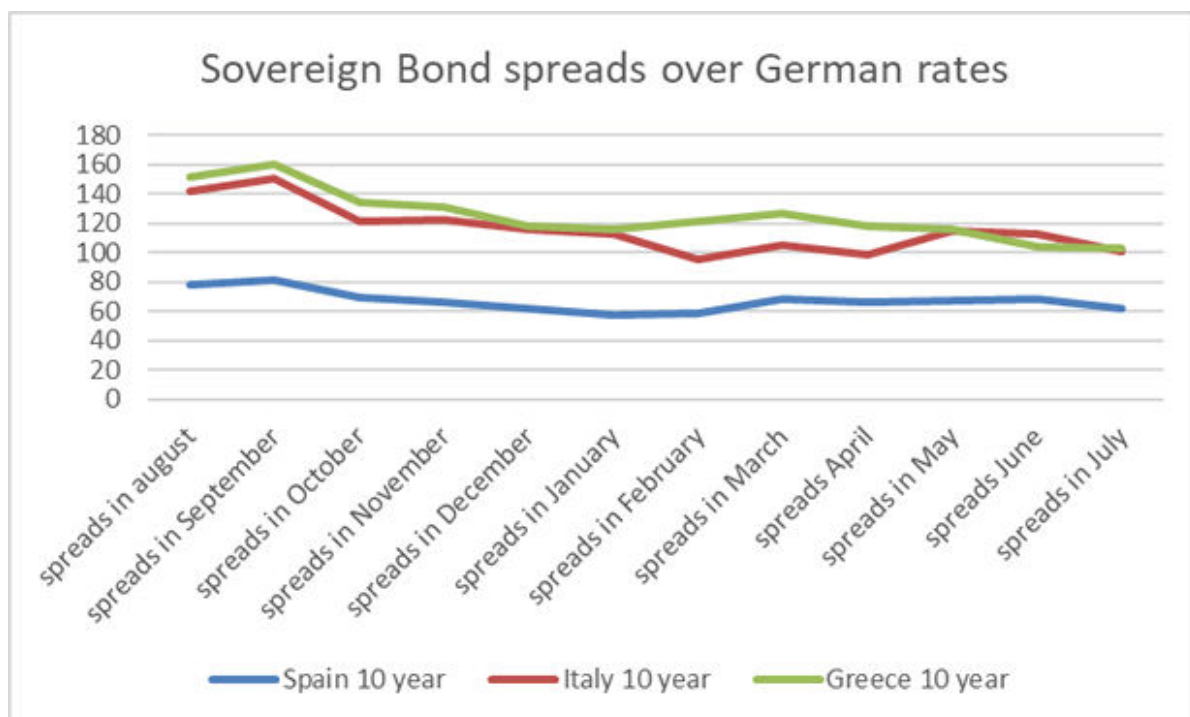
Source: Tempo Issuer & Counterparty Scorecards ('TICS') 1st September 2021 www.tempo-sp.com

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Government Bonds

Fixed Income

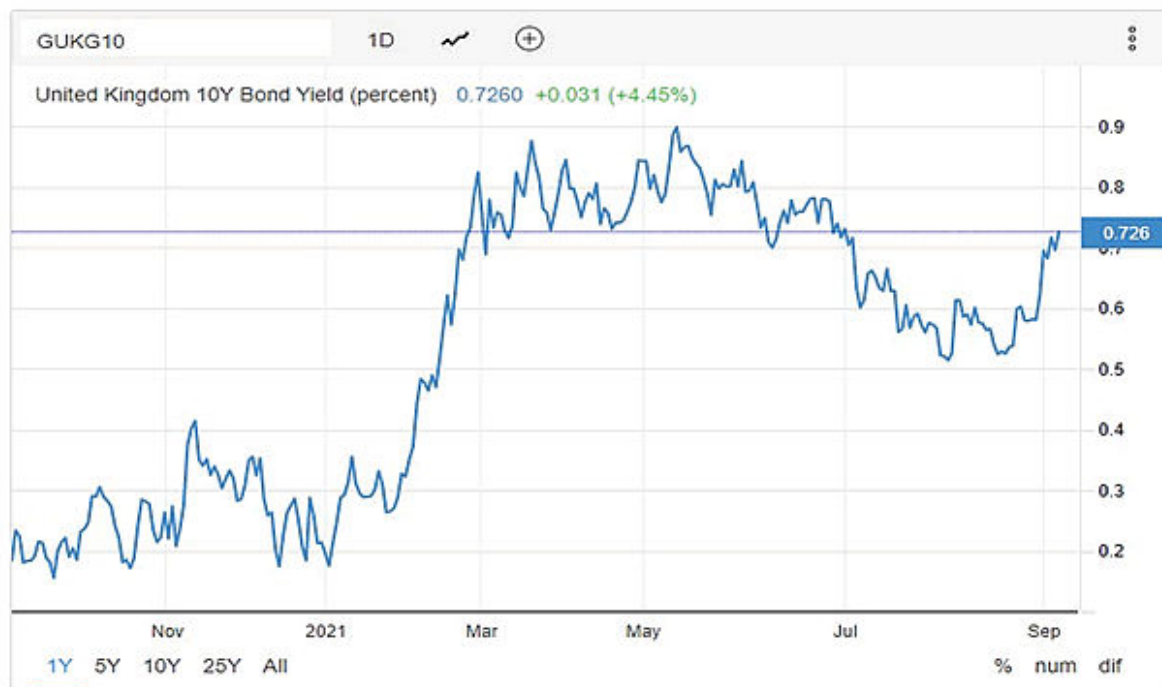
I'm sure the avid reader of these monthly reports spends an inordinate amount of time poring over the tables and charts, reserving most of their attention for the data on fixed income securities. If they haven't I'd highlight two charts below which I think deserve extra mention. The first is the spread of yields for various key Euro zone sovereign 10 year bonds over German rates. For me the fascinating insight – observed previously – is how these spreads have steadily headed south with Greece's spread now on a par with that of Italy. Oh how the fallen have become mighty again!



Spreads	Spain 10 year	Italy 10 year	Greece 10 year
August	78	142	152
September	81	151	161
October	69	122	134
November	66	123	131
December	62	116	118
January	58	113	116
February	59	95	122
March	68	105	127
April	66	99	118
May	67	115	116
June	68	113	104
July	62	101	103

The second chart above highlights another fascinating transformation, arguably of even more importance. This shows the CDS rates for sovereign debt from key developed world nations. The stunning line for me is the blue line which shows how the 1 year CDS rates for UK gilts is now BELOW that of Germany's. Brexit was supposed to be the great destabiliser that would result in markets running scared of the UK but the swaps markets have taken on the opposite message – the UK looks the safer jurisdiction!

UK Government Bonds 10-year Rate 0.73%



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

CDS Rates for Sovereign Debt

Country	Five Year
France	19.25
Germany	9.32
Japan	17.16
United Kingdom	9.16
Ireland	14.97
Italy	72
Portugal	28.18
Spain	29.18

Eurozone peripheral bond yields

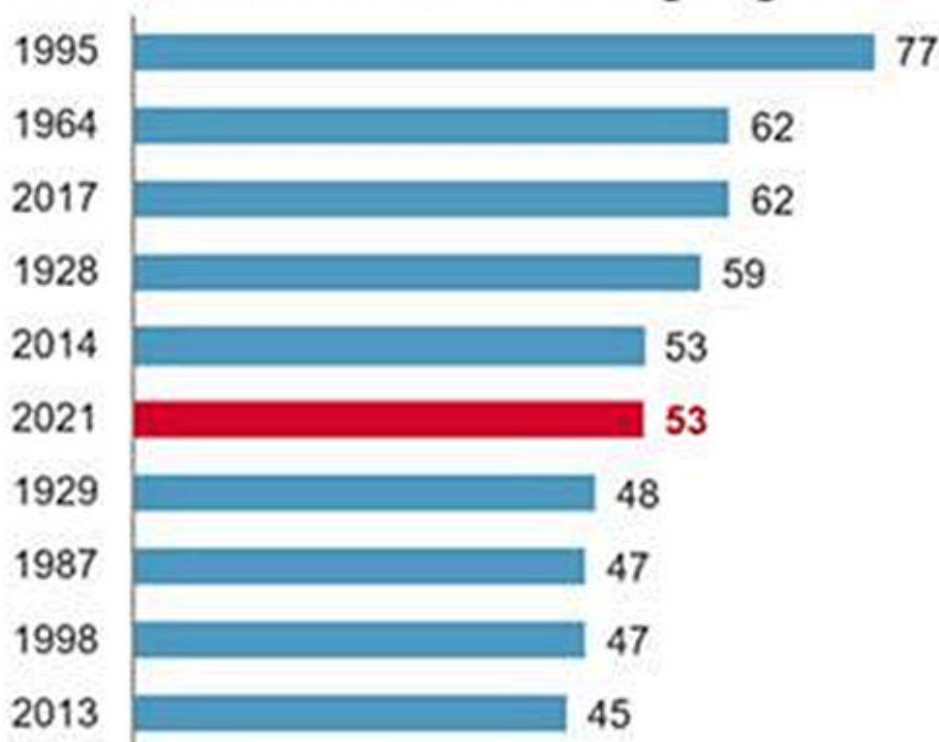
Country	August 2021	September 2021	Spread over 10 year
Spain 10 year	0.26%	0.329%	66
Italy 10 year	0.60%	0.69%	102
Greece 10 year	0.55%	0.767%	109.7

	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

Equity Markets and Dividend Futures

Repeating my introductory observation, equity markets seem to be in fine form – with no sign (yet) of any taper tantrums. According to Howard Silverblatt, Senior Index Analyst at S&P Dow Jones Indices, Monday August 30th marked the 12th new closing high for the S&P 500 in August and the 53rd new closing high for the year. 2021 is currently tied in fourth with 2014 on the leader board for most closing highs in any year; only ten more highs before the year ends are required for a spot in the top three, while 1995's total of 77 new highs provides the number to beat for the all-time record.

S&P 500: Number of Closing Highs



Source: S&P Dow Jones Indices. Data courtesy of Howard Silverblatt and as of Aug. 30, 2021. Past performance is no guarantee of future results.

Index	August 2021	September 2021	Reference Index Value	Level 6 Months Ago
Stoxx 50 Dec 21 contract#	100.5	101.2	4236	93.9
FTSE 100 (Dec 19)	243.9	243.5	7162	226

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	0.526	1.18	7.99	20.6	4.58	17.9	7160.44

S&P 500	2.23	7.31	18.1	32.3	107	136	4535.43
iShares FTSE UK All Stocks Gilt	-0.588	2.99	2.03	-3.73	0.955	13.3	1415.13
VIX New Methodology	1.61	-0.0609	-33.5	-46.6	37.4	-41	16.41

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Volatility

The chart below tells a remarkable tale. It shows the index levels for the Vix starting at the end of January last year. As you'd expect the Vix peaked in late March but notice the consistent downwards trend since then with the vix trending below 20 and sometimes dipping below 15 which indicates relative market calm.

Measure	September Level	August Level	July Level	June Level
Vstox Volatility	18.13	17.4	18.04	17.59
VFTSE Volatility	16.41	16.72	16.7	16.7



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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.

Kind Regards,



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