Flash boursier N° 619
16 August 2021

Hazy world outlook and slower growth in China

Overview

Main indices continued gaining last week in spite of pandemic-related angst and pricey share valuations, as inflation clocked in on expectations and the US Senate waved through the USD 1 trillion infrastructure drive. If the bill then passes through the House of Representatives, it will unleash an unprecedented amount of investment expenditure on roads, bridges and airports. Talking of roads, the road will probably be long before the 3.5 trillion welfare plan championed by the Democrats can make it over the finish line, given the plethora of amendments.

Much of the good news is already reflected in share prices. Yet the proportion of buy recommendations is hovering at its highest level in a decade, while solid earnings growth is powering a patchy short-term uptrend. The main markets have started this week in the red, pinned back by disappointing economic data out of China pointing to a slower economic growth. Meanwhile, the increasing chaos in Afghanistan, with the capital Kabul falling into the hands of the Taliban, is stoking geopolitical uncertainty. The flight to safety has been lowering government bond yields and sending the US dollar and the yen higher.

Disappointing economic data out of China and chaos in Afghanistan

In the US, the consumer price index advanced by 5.4% year on year in July, in line with estimates. The core component, which strips out food and energy prices, was ahead by 4.3% year on year. However, the price growth in some hot segments such as second-hand cars has started to ease, rising by just 0.2% in the latest figures compared with upwards of 7% in previous months. This suggests that the inflation peak could be near, which if so would leave the Fed more time to extricate itself from its ultra-loose monetary policy.

Inflation peak could be nearing in the US

Chinese retail sales – the bellwether for domestic spending – were up 8.5% in July, which was far less than expected. The slower growth number can be pinned on the rapidly spreading delta variant and the hit sustained by some local economies from natural disasters. Industrial production growth also cooled off, clocking in at +6.4%. In Japan, GDP rose by 0.3% in the second quarter but left the stock market impassive as the latter headed down on news of the spreading pandemic. A record number of coronavirus cases (20,000) was recorded for Friday and Saturday.

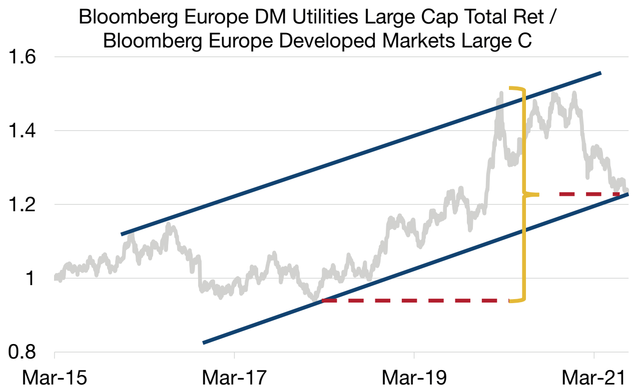
The SMI is set to behave as in the previous week: gaining ground, but this time with a higher risk of a correction. Support is situated at 12090.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.92	1.08	12'464.44	4'229.70	15'977.44	6'896.04	7'218.71	4'468.00	14'822.90	27'977.15	1'280.86
Trend	→	→	↑	↑	↑	↑	↑	↑	→	→	↓
YTD	3.39%	-0.16%	16.45%	19.06%	16.46%	24.22%	11.74%	18.95%	15.01%	1.94%	-0.81%

(values from the Friday preceding publication)

Seeing the world in relative terms



With most indices poised closed to all-time highs, it may be worth looking at sectors through a relative lens, in relation to their benchmarks. On a chart, this can show where there is out- or under-performance as well as highlighting opportunities for gaining exposure.

If we look at where the utilities sector is trading relative to the broad market, we can see that it is lagging both in the US and in Europe. In Europe, utilities has chalked up under-performance of 18% since mid-January. Globally, utilities are ahead by only 2% year to date whereas the broad metric is riding high upwards of 20%.

The utilities sector is made up of companies delivering public services such as power, water and gas supply. In Europe, it is currently trading on 16x estimated 2021 earnings whereas the broad market measure stands at over 20x. Because of its business, the sector is slightly more defensive than average. Its dividend yield is usually attractive, ranging from 3% to 6% for most companies.

The chart opposite indicates the performance of the sector relative to the broad European index. Looking at technicals, we can see that the utilities/market ratio has ebbed to the lower end of the channel, coinciding with 50% retracement of the major uptrend lasting from 2018 to 2020. Hence the current level should act as support. Our view is that utilities could well outperform the European broad index in the short/medium term.

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