Weekly Market Flash

What We Learned in Q1, and What May Await Us in Q2

March 26, 2021

So here we are with a quarter of the year gone by already. One thing we think is safe to say: the world we are observing today is not radically different what we might have imagined at the beginning of the year. When we go back and look at the main themes of our annual outlook from January, there is much that still rings true. Interest rates are higher amid renewed inflationary expectations, the stock market rotation from growth to value has shown itself to be durable, and the path to a post-pandemic world is more or less following the script of the increasing availability of vaccines. As summer approaches we should be feeling our way back to some semblance of normality in the activities we used to take for granted.

That is certainly a marked contrast from the first quarter of 2020, the final weeks of which looked nothing like the world we observed as we got back to work in the early days of that year. Here's to the joys of no momentous change – and to getting those vaccines into all the arms still waiting for their turn.

Economic Fragility

That being said, a couple things happened this week to remind us that it is never a good idea to sit back and assume that all is well. Every time we look at one of those headline macroeconomic data releases – GDP, inflation, the jobs report or what have you – we have to remind ourselves of the incredibly complex pieces of machinery that make up the global economy.

These intricate connections are highly susceptible to disruption – say, when a container ship runs aground and spins sideways in the middle of one of the most important pieces of maritime real estate. A container ship called Ever Given did just that this past Wednesday. According to a press release from the ship's operating company, it met with an unexpected gust of wind while proceeding through the canal's narrow fairway, turning it in such a way as to hit the sand banks on both sides of the passage.

The blockage, which will last at least until the middle of next week, will have a major impact on shipping costs, which are already high for a variety of other reasons. Freight costs have been putting pressure on corporate margins across a range of industry sectors, and those will likely go higher still. Companies will have to figure out how much margin compression they are willing to live with and how much they could potentially pass on to their end markets in the form of price inflation. Inflation, of course, has been a constant news story throughout the first quarter and is not likely to become less important any time soon.

Geopolitics Don't Matter, Until They Do

Another handful of stories this week focuses on the growing tensions between China and its major trading partners. Now, geopolitical events normally have a fairly muted impact on investment markets. Most investment strategies are predicated on the assumption that the backdrop political picture stays the same – that the world's nations will continue to trade with each other and their citizens will continue to purchase goods and services with little regard paid to any political considerations.

The sharpening edge of relations with China matters more than many others, though, because it is the world's second-largest economy, the largest consumer of most major industrial commodities, a big value-added part of the global supply chains of the world's leading enterprises and, of course, home to more domestic consumers than anywhere else on the planet. Uncomfortably for its trading partners in North America, Europe and elsewhere in the Asia Pacific region, China is also an authoritarian state with a conspicuously poor track record in human rights. Recent examples of its ill will focus on the rapidly disappearing freedom accorded to the citizens of Hong Kong, and the abusive treatment of the Uighur minority population in the far western province of Xinjiang. This week, a series of tit-for-tat sanctions on high-ranking individuals went back and forth between a coalition of the US, UK, EU and Canada on one side and China on the other. Among other things, the sanctions put in jeopardy a major trade deal between the EU and China that was put in place at the end of last year but has yet to be ratified. China is an incredibly important market for many export-dependent companies in the EU.

Geopolitics Meet Markets

The hostilities are being felt directly in the corporate world as well. Two major retailers – Nike and H&M – are the targets of a potential boycott in China due to positions both companies have taken in opposition to the abuses in Xinjiang. Nike and H&M have sizable operations in China – as does almost every other prominent mass market retailer you could think of.

On the other side of this coin, the US SEC raised this week the possibility that Chinese companies with US stock exchange listings could risk de-listing if they are not more transparent in providing US regulators with access to their domestic financial records (this is something nominally required of any foreign company listing in the US but has not been strictly enforced in the past). This would be a huge deal for global institutional investors with sizable holdings of names like Alibaba and Tencent in their portfolios.

All of this is just from a single week's worth of news. So as we head into the second quarter it is safe to say that there will be no absence of things keeping us focused on our day-to-day analysis. We believe that our portfolio models are allocated in a way well-suited to the current environment – but there is always the potential for that to change.

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