THE **CAMBRIDGE** WEEKLY

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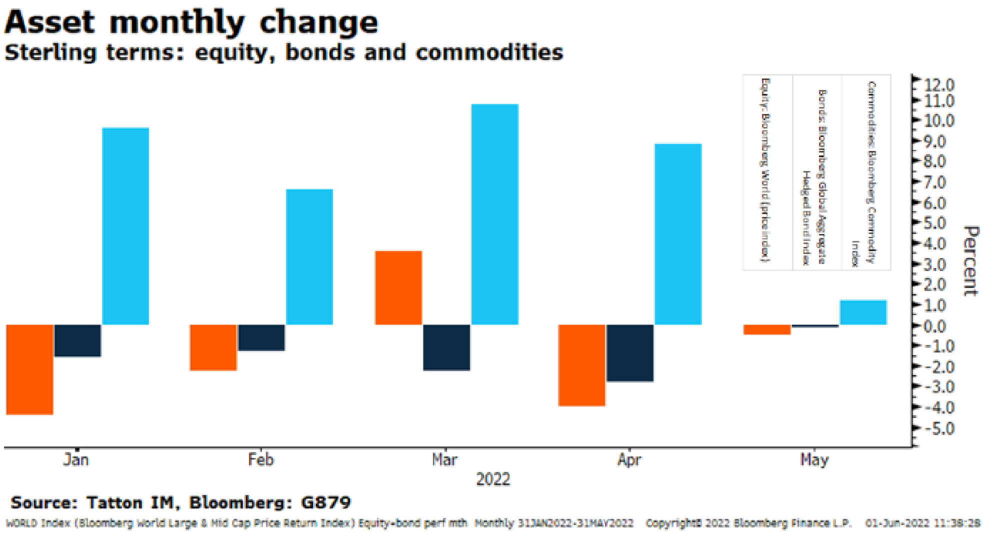
Rollercoaster for the Jubilee funfair

Party stalls went up and libations flowed for the Platinum Jubilee. But no fairground is complete without some thrilling rides. Over the last month, capital markets chipped in with a rollercoaster of their own: equity indices jumped in the first few days of May, only to sink frighteningly low mid-month. At times it felt like markets were in meltdown, with investors buffeted by fierce global economic headwinds.

The thing about rollercoasters, though, is that they eventually end up right where they began. A late rally eventually saw global equity prices climb back up to where they started. Bond returns were virtually flat as well and even commodity prices could only gain a net 1% in May. In the end, markets recorded their lowest monthly change this year. As you were then; keep calm and carry on.

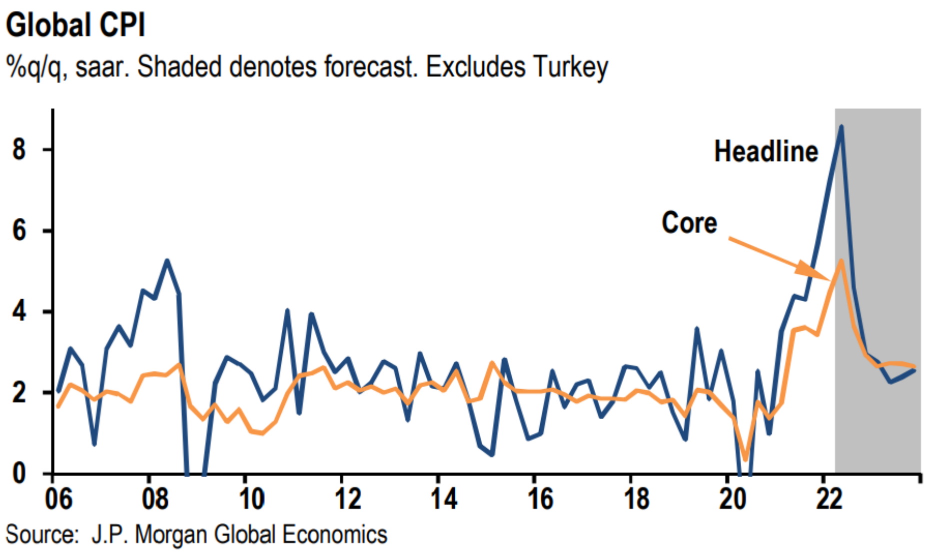


The fears that set off this wild ride were threefold. Central banks are tightening policy around the globe and sapping liquidity from the financial system, rapid inflation has bitten a chunk out of people's disposable incomes, and another round of lockdowns in China has plunged the world's second-largest economy into a sharp downturn. Too strong a combined headwind for post Covid demob happy consumer spending to neutralise.

There is some debate about which of these factors has the most impact. Consumer demand has fallen on the back of sharply higher prices – but labour markets are still tight, providing plenty of income-earning opportunity, and US retailers revealed decent profits just recently. Central banks are unequivocally in tightening mode – but there is still ample liquidity and interest rates are low by historical standards. COVID restrictions have weakened the Chinese economy – but production has held up better than other components, and this acts as a counterbalance to global inflation.

What no one can dispute, though, is the end result. Growth indicators have significantly slowed in the western world, and in China they have all but collapsed. In the earlier part of May, the recession questions being asked were 'when, and how bad' rather than 'if'. In the UK, this was apparent from the Bank of England's (BoE) latest growth forecasts, which predicted inflation of more than 10% by the end of the year, and a shrinking economy in 2023.

A month is a long time, though, and by the end of May things looked distinctly less gloomy. The US Federal Reserve (Fed) has been itching to tighten financial conditions all year, but the very fact that markets have slumped seems to have done a lot of that work already. Having raised rates once, it looks like the Fed has found the economy's 'biting point' already. So, judging by the latest market reaction, it may not have to step on the brakes any harder.



Markets now believe we are past the peak in global inflation pressures (though the year-on-year rate of change may not peak for a few months). US mortgage applications are falling while lumber prices (a sign of housebuilding activity) are declining. The Fed will take this as clear signals that the economy is cooling down – and may well judge that its policy has worked.

As mentioned, the weakness in China has helped cool global inflation. COVID outbreaks and the government's zero-COVID policy have forced lockdowns across the world's most populous nation, dramatically reducing consumer demand. This gives temporary respite as we battle with sharply higher prices, but ultimately the world economy will suffer if China continues to flag.

Fortunately, extreme lockdown measures appear to be easing. Even better, the Chinese government has signalled that future outbreaks will not be dealt with as harshly. Recently, Premier Li Keqiang told officials they must balance virus containment against the nation's economic growth. This is a positive for China over the medium-term, and so too for global growth. Chinese equity markets have started climbing from their lows, and the Renminbi has gained against the US dollar. A sense that China will be stable once more now pervades markets.

Elsewhere, oil and gas supply remains a major concern. The European Union (EU) recently announced an embargo on Russian oil, pushing prices higher again to nearly $124 per barrel. But this is expected to be more of a restructuring of global energy flows than a dismantling, and so the sense of dislocation is no longer as strong.

The 15 member countries that make up OPEC+ met on Thursday, and Russia's production 'quota' was removed. Russia's amount was allocated elsewhere though, allowing those nations with more flexible capacity to pump out more crude – which could easily reverse the supply reduction that global oil markets have suffered because of sanctions placed on Russia. In particular, Saudi Arabia are stepping in. On that front, frosty US-Saudi relations seem to be thawing, with President Biden rumoured to be heading to the Kingdom for talks. This would have been impossible in the immediate aftermath of the murder of Saudi dissident journalist Jamal Khashoggi in 2018, and highlights how Russia's war has warped geopolitical priorities around the world.

With an improved outlook for China, and a possible peak in energy prices, the global economy looks to be on a firmer footing. The recession fears that swept up investors a few weeks ago have subsided, and markets now appear to only expect a slowdown – rather than a full-blown contraction – in the short to medium-term. That is important, since recession takes a major toll on credit markets and equity earnings, which can be hard to recover from in the short term.

We should not get ahead of ourselves, though. Global input inflation may have passed its peak, but there is still plenty of feed-through and second round effects to come. For Britons, this is clearest in household energy bills, which are expected to jump once again in October, and could cause serious pain for many of the worse off.

Even with fewer problems in the supply of goods, labour markets are still tight across the developed world, and the gap between jobs and workers will not drop away anytime soon. Consumers are still spending and borrowing, as credit card data suggests. Savings ratios – which built dramatically through lockdowns – have plummeted pretty much everywhere, and are only slowly building back up.

Central banks are still intent on preventing a wage-price spiral – and that tightening bias will continue to be a headwind for equity valuations. As we enter June, fears of short-term catastrophe have subsided. But this is far from the all-clear, and we are still waiting to see what the post-COVID 'normal' really looks like.

In the spirit of the Jubilee, we would do well to remind ourselves of thinking for the long-term. Queen Elizabeth II's 70 years on the throne have seen more governments – and prime ministers – than one could wave a stick at. Many of them no doubt caused a lot of noise during their respective terms in office. Like the Queen might be inclined to do, we prefer to look over the long-term – and chart the best path to future growth and prosperity.

Insight: Economics 'the scarce science'

If you took an introductory Economics class today, the tutor would probably start by discussing some key terms. These would most likely include 'utility', 'budget set' or 'indifference curves'. After giving their technical definitions, you might even be shown how to draw supply and demand curves and asked to find their 'equilibrium' point. There would still be a long way to go in your economics training, but this style of analysis would be repeated throughout most of it – growing ever-more sophisticated as extra terms or features are included. Curiously though, one word almost never gets a firm definition: "economics".

You can ask the tutor what it means, but you might be told any number of things (if you have a dismissive tutor, "stop asking and just calculate" could well be one of them). Textbooks are not much help either. Some call it the science of exchange, others the science of general human behaviour, and some the trivialising 'study of economies'. Now you start to worry. What is it we are actually doing here? Economists have huge influence in every corner of modern life, from government and central banking to insurance and personal loans. If they cannot tell us what their work is about, how can we trust that they are not just charlatans?

Luckily, the lack of agreement on the definition of economics is not so much because there is no single good definition – but rather that economists spend little time thinking about these issues. One definition that certainly smells right (and is probably the most widely accepted) comes from British economist Lionel Robbins. Some 90 years ago, Robbins wrote one of the most influential economic methodology texts in the history of the subject, where he defined it as "the science which studies human behaviour as a relationship between ends and scarce means that have alternative uses".

The best way to explain this mouthful is by example. Let's say you want two things: chocolate and cheese. An ideal world has an endless supply of both, and there are no downsides to consuming them. In that world, you could eat both without any limit. But to constant dismay, the real world is different. There are various 'costs' to eating chocolate and cheese: you must pay money for them, they may make you less healthy, you might feel sick after gorging too much, or perhaps you feel bad about the environmental impact of eating dairy.

Take the simplest cost: the money. With a limited budget, you have to decide how much chocolate you eat *relative* to how much cheese. Any chocolate you buy is money that could have been spent on cheese, and so eating more chocolate creates an 'opportunity cost' in terms of lost cheese. As such, you can decide the relative trade-off of how much chocolate to consume relative to the amount of cheese. The fact that chocolate and cheese are scarce – relative to an unlimited desire for them – is what allows us to approach consumption as an economic problem.

Economics is not about chocolate or cheese. But the fact we want them (they are ends) and only have limited money to spend on them (scarce means) makes the problem ripe for economic analysis. Crucially, it is not about money either. In the real world, you must use limited funds to buy chocolate and cheese, but even if they were free, they would still come with costs, in the economist's sense. If you only have so much time in the day, you will inevitably have to divvy it up between chocolate and cheese consumption – making time the scarce means in that context.

At an abstract level, we can think of economics as the science of scarcity – the study of how our wants and limited resources shape our behaviour. In this sense, the global economy is one big machine for allocating scarce resources. But what if resources were not scarce? Would that leave no room for economics?

That exact question is the premise of Manu Saadia's book *Trekonomics: The Economics of Star Trek*. In the *Star Trek* universe, humans have invented replicator machines that endlessly reproduce all goods. In that world, consuming one item has no opportunity cost in terms of consuming anything else – so there is no need to trade, and hence no need to attach monetary value to anything. In *Star Trek*, there is no currency because there is no 'market' for goods at all. The so-called 'basic economic problem' – that we want things but only have limited means to get them – is gone.

Economics is not completely inapplicable to *Star Trek,* though. As mentioned, even if all goods were free, we still have limited time and brain power to do all the things we want to. *Trekonomics* describes how, in a world without scarce goods, people strive for reputation, respect, and to boldly go where no one has before. Our ways of achieving these abstract goals are inherently scarce, meaning that we can still think about the time Captain Kirk spends on his various tasks as an economic problem. Therefore, despite having no need to ever work, the crew of the USS Enterprise are always surprisingly busy.

This abstract way of thinking about economics even impacts how we might think about more down-to-earth problems, like public finance or consumer behaviour. A famous way of teaching the subject's basic principles is via Daniel Defoe's *Robinson Crusoe*, the fictional 18th century traveller who is shipwrecked on a Caribbean Island. Crusoe lives off the island's resources, which must be procured or refined for his consumption or leisure activities. He has two choices of how to spend his time: produce goods or consume them.

On the island economy, Crusoe is the only producer and only consumer. In his role as producer, he maximises 'profits' (by making consumable goods), and in his role as consumer, he maximises his own utility. With some simple assumptions, we can derive the equilibrium point for this one agent economy. That will dictate how much time Crusoe spends on his production and consumption activities.

Details will change depending on the scenario, but this basic framework is applied to households, governments, firms or developing nations. And it is only because of scarcity – because we want more than we have – that the framework has any use. That is why, with any luck, economists might still be useful in *Star Trek* times – even if investment managers are not.

CAMBRIDGE
INVESTMENTS LIMITED

6th June 2022

Global Equity Markets

Market	Wed 14:59	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	7602	+1.1	+79	→	⬀
FTSE 250	20513	+2.9	+579	⬂	➘
FTSE AS	4203	+1.3	+56	→	→
FTSE Small	6717	+1.7	+112	⬂	➘
CAC	6493	+3.1	+195	→	→
DAX	14469	+3.3	+461	⬀	➘
Dow	32929	+3.1	+1001	➘	⬂
S&P 500	4153	+5.4	+211	➘	⬂
Nasdaq	12134	+7.7	+870	➘	➘
Nikkei	27458	+2.9	+780	→	→
MSCI World	2791	+3.4	+91	➘	➘
CSI 300	4083	+2.5	+100	⬂	➘
MSCI EM	1078	+5.7	+58	⬂	➘

Top 5 Gainers

Company	%
Ocado	+21.6
Scot Mtge Inv Trust	+16.2
Melrose	+12.8
Just Eat Takeaway.com	+12.7
JD Sports Fashion	+12.0

Top 5 Decliners

Company	%
Johnson Matthey	-9.5
National Grid	-8.3
B&M European Value Ret	-7.4
Severn Trent	-7.2
United Utilities	-5.8

Currencies

Pair	last	%1W
USD/GBP	1.251	-0.5
GBP/EUR	0.853	-0.5
USD/EUR	1.07	-0.0
JPY/USD	129.69	-1.8
CNY/USD	6.68	+0.2
Bitcoin/$	31,572	+9.9

Commodities

Cmdty	last	%1W
Oil	118.02	+3.5
Gold	1842.6	-0.6
Silver	21.75	-1.1
Copper	433.9	+0.3
Aluminium	2787.0	-3.9
Soft Cmdties	238.9	+1.0

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	2.13	+0.22
UK 15-Yr	2.42	+0.24
US 10-Yr	2.89	+0.15
French 10-Yr	1.67	+0.19
German 10-Yr	1.15	+0.20
Japanese 10-Yr	0.24	+0.03

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.9	12.5	10.5	14.3
FTSE 250	3.2	11.0	14.6	16.3
FTSE AS	3.8	12.2	11.0	14.5
FTSE Small x Inv_Tsts	3.3	8.0	9.8	15.4
CAC	2.9	14.2	11.5	15.3
DAX	3.2	12.8	12.0	13.8
Dow	2.0	17.0	17.2	16.9
S&P 500	1.5	20.1	18.2	18.2
Nasdaq	0.8	22.6	25.5	24.1
Nikkei	2.0	15.8	15.5	17.8
MSCI World	2.1	16.9	16.3	17.1
CSI 300	1.9	14.1	13.0	12.7
MSCI EM	2.8	11.0	11.9	12.7

UK Mortgage Rates

Mortgage Rates	May	Apr
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	2.35	2.24
3-yr Fixed Rate	2.26	2.15
5-yr Fixed Rate	2.36	2.25
10-yr Fixed Rate	2.68	2.58
Standard Variable	4.10	4.07

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values

** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

If anybody wants to be added or removed from the distribution list, please email
enquiries@cambridgeinvestments.co.uk

6th June 2022

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

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