Global stocks regain traction in October as solid earnings offset inflation and Fed tapering concerns

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Highlights

- Global equity markets lost steam in 3Q21 on higher uncertainty, but regained traction in October helped by solid earnings.
- The MSCI AC World fell by a marginal 0.8% q/q versus +6.6% in 2Q21, and is up a solid 16.5% YTD (as of 22 October).
- The MSCI GCC outperformed global peers (7.8% q/q), helped by higher oil prices, vaccine progress, and a better fiscal outlook.
- Downside risks to a sustained rally stem largely from persistently high inflation, slowing growth and pandemic and policy-related uncertainty.

Equities take bearish turn in 3Q21 on dented sentiment

The third quarter saw the weakest performance for global equities since 1Q20, breaking the bullish streak that lasted over a year. A range of adverse developments led to weaker sentiment and performance over the quarter, including Fed tapering talk, slower growth prospects, higher inflation, the risk of financial contagion from China (Evergrande), and US debt ceiling concerns. Rising US treasury yields may also have hindered stock market momentum over the quarter. However, markets regained traction in the first two weeks of October, as investors bought the dip, helped by solid corporate earnings and easing virus concerns. GCC equity markets bucked the trend, with strong gains in 3Q and so far in October, as confidence remained solid with support from higher oil prices and recovery optimism.

While global equities have performed relatively well so far this year, downside risks are becoming more apparent, especially in light of the elevated inflation and tighter central bank policy on the horizon. The prospect of slower growth due to ongoing pandemic risks and supply chain constraints in addition to steep stock valuations and rising bond yields have prompted investors to adopt a more cautious and less risk-on attitude.

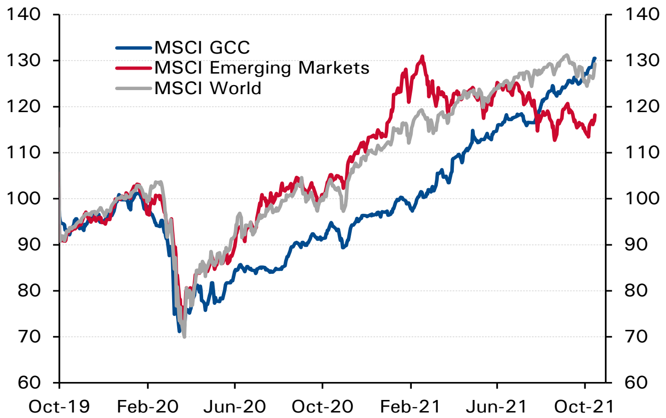
Global equities lose steam on weaker sentiment

The weaker sentiment in 3Q21 is reflected in the MSCI AC World index, which fell by 0.8% q/q versus a 6.6% increase in the previous quarter, paring the YTD gain to 16.5% as of October 22. Emerging markets led the quarterly decline, with the MSCI Emerging Market index down a steep 7.5% q/q, with sentiment hit by softer global growth expectations, ongoing global supply chain bottlenecks, and China's Evergrande-related financial turmoil. US and European markets also lost momentum (DJIA -1.9% q/q, Euro Stoxx 50 -0.4%) weighed down, in addition to the aforementioned factors, by renewed inflation concerns, and as Fed asset purchase tapering draws nearer. Higher treasury yields may have slightly hindered demand for stocks, given that this leads to lower expected excess returns although that impact is, at best, very minor given the limited increase in yields. However, a solid start to the earnings season so far in October revived stock momentum, offsetting investor concerns about inflation and tighter Fed policy. In the month-to-date (as of October 22), the S&P500 is up a solid 5.5% and the MSCI AC World 4.4%.

Looking forward, the direction of global stocks will continue to depend largely on Fed policy, inflation, pandemic uncertainty, and the pace of the economic recovery. Prolonged supply chain issues could continue to cause inflationary pressures, prompting an earlier-than-expected tightening of monetary policy, and in turn softer economic growth and weaker investor confidence. On the other hand, should supply bottlenecks and higher inflation subside, the timeline for the beginning of policy tightening could be longer, which will likely be supportive of a rally in equities.

Chart 1: Global equity markets

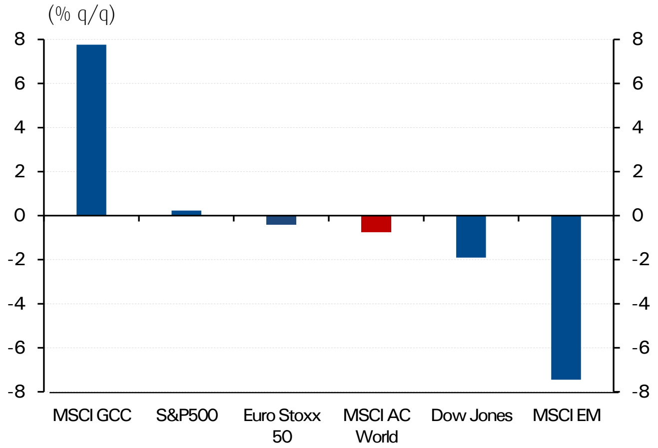
(rebased, 31 December 2019=100)



Source: Refinitiv DataStream

Chart 2: Global equity markets in 3Q21

(% q/q)



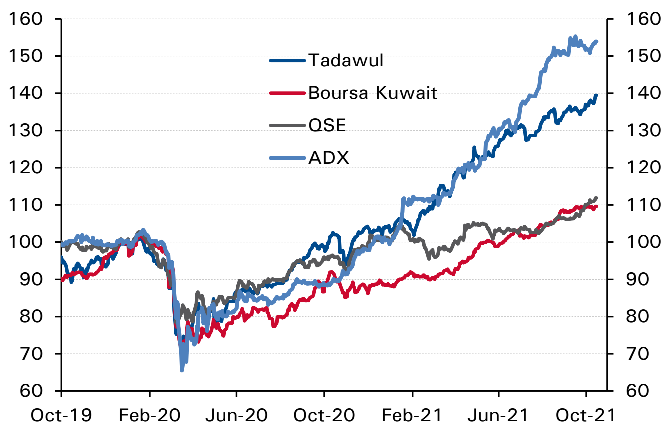
Source: Refinitiv DataStream

GCC equities outperform global peers in 3Q21

While 3Q21 saw a downturn in global markets due to increasing headwinds, GCC markets outperformed their global peers by a wide margin (MSCI GCC +7.8% q/q), helped by higher oil prices, vaccine progress, and a better fiscal outlook. In the lead were Abu Dhabi, Kuwait, and Bahrain, which were up 12.6%, 7.5% and 7.4%, respectively. Solid gains were also seen in Qatar and Saudi Arabia (7.0% and 4.7%), while Oman bucked the trend, down 3%. The bullish momentum extended into October, tracking global markets, with the MSCI GCC up 4.8% in the month-to-date. It is noteworthy that the top two year-to-date performers, Abu Dhabi and Saudi Arabia, with exceptional gains of 56% and 37% YTD, witnessed increased IPO activity, including Adnoc Drilling's $1.1 billion and Arabian Internet and Communications Services Co's $966 million IPOs in September, with both offerings receiving overwhelming demand.

Chart 3: GCC equity markets

(rebased 31 December 2019 = 100)



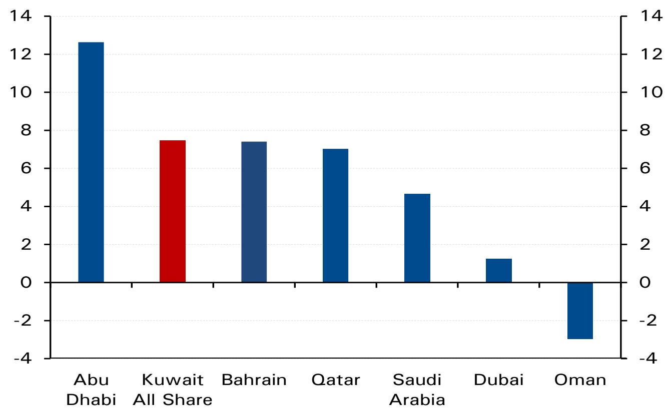
Source: Refinitiv DataStream

The strong IPO activity is set to continue, with the potential near-term listing of several large cap Saudi and UAE firms including the Saudi Stock Exchange (Tadawul), a chemicals subsidiary of SABIC, Emirates Global Aluminum, and Adnoc's fertilizer joint venture Fertiglobe.

Kuwait's strong performance (All-Share up 7.5% q/q) was led by the premier market (+8.1% q/q), with the strongest gains coming from the consumer and financial services sectors, pushing market capitalization to a near 12-year high of over KD 40 billion, while turnover continued to be healthy, at KD 50 million/day in October. Kuwait's All-Share index was up a solid 26% in the year to date (as of October 22), making it among the best emerging market performers so far this year.

Chart 4: GCC equity markets in 3Q21

(% q/q)



Source: Refinitiv DataStream

A cautious outlook for equities as uncertainty builds

Although markets have generally performed well this year on recovery optimism, vaccine progress and stimulus support, near-to-medium term market prospects are subject to notable downside risks stemming from the pandemic, inflation, and policy-related uncertainty (upcoming Fed tapering and sooner-than-expected rate hikes). Continued supply chain constraints and softer growth prospects are further sources of concern in addition to high US stock valuations. The possibility of rising bond yields, higher inflation, and the expected US policy rate hikes in 2022-2023, may also prove to be a drag on equity market sentiment. On the other hand, November and December have historically been among the best months in terms of stock market performance, especially in the US. Finally, GCC markets will continue to be influenced by oil prices, the pace of structural reforms, geopolitics, and pandemic-related developments.

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