INVESTMENT STRATEGY WEEKLY VIEW

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US CONSUMERS SEEM TO BE FEELING THE PINCH OF INFLATION

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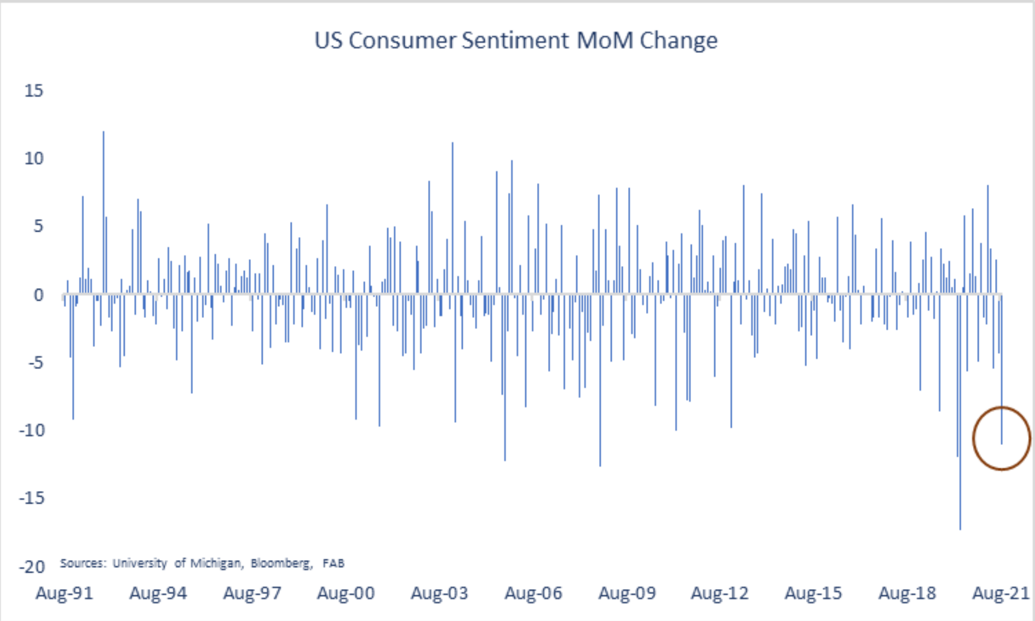
- The consumer sentiment survey number of the University of Michigan fell 11 points in August.
- The shift happened as gasoline prices and overall inflation becomes more of a concern for Americans.
- The rising Covid-19 case-count in the US may also be weighing on sentiment.
- The FAB AAC is overweight in equities, IG and EM bonds. It is underweight cash and neutral in gold.



Federal Reserve Chairman Jerome Powell is expected to speak this week in a conference and, if asked about it, he is likely to say, yet again, that inflation is transitory and, effectively, not something to be too concerned about. He may be talking calmly about it, but the US consumer seems to be increasingly less comfortable with rising prices.

The University of Michigan's consumer sentiment survey fell to 70.2 in August from 81.2 in July, missing analyst estimates of an unchanged number by more than 10 points and staging one of the biggest monthly drops in the past 30 years. Expectations of inflation one-year ahead retreated to 4.6%, from 4.72% in July, the highest since 2008, but remains very high.

The perception of quickly rising prices is starting to become more tangible for US consumers as stimulus programs come to an end, with very few extraordinary welfare payments expected to continue beyond next month.

A similar dynamic is also becoming evident in the labour market, where continuing jobless claims have started to drop faster since the beginning of July and are now at 2.86 million, still roughly 1.1 million higher than before the pandemic but already below where the figure was as recently as 2013.

The US unemployment rate remains at 5.4%, a lot higher than the 3.5% at which it was before the pandemic struck, but with 943,000 jobs having been created in July and another 938,000 in June, it looks like the US could be back in full employment mode within a year or so, at least if the six-months average job creation of 681,000 remains the norm. This should also support higher consumer confidence, but it has not.

Consumer sentiment had one of its worst monthly falls in the past 30 years in August

Instead, US consumers are not only probably feeling the pinch of rising prices, but they are also likely getting increasingly concerned about the spread of the Delta variant. Last week, the US recorded 868,108 new Covid-19 cases, the biggest weekly number since mid-January. The difference, however, is that the country is in the middle of summer and flu season, when Covid has been shown to become more prevalent, has not even started.

The rising number of cases has come amid difficulties to move the vaccination numbers higher. Brazil, which has a population of a similar size to the American, surpassed the US in terms of percentage of population vaccinated last week, as more Americans resist the idea of getting inoculated amid headlines about more people who had been vaccinated being included in the lists of those infected with Covid-19.

The hesitation, however, is clearly misguided. While the vaccines are not able to fully stop the Delta variant, as numbers seem to show, they have a clear impact on how sick infected people get. Even as the number of deaths are rising together with the number of new cases in the US, the death rate from Covid-19 is now around 0.7%, compared to around 2% throughout most of last year. This bodes well and is probably the result of the fact that the US has managed to get nearly three quarters of its population fully vaccinated, despite the hesitation of some groups.

While these numbers would suggest that even when flu season begins the US (and other countries for that matter) should be able to avoid any new lockdowns, the psychological and political aspects of the rising numbers cannot be ignored, and the consumer sentiment drop may be a reflection of this.

The threat of deflated activity is real, though. Around this time last year, the US was registering about 350,000 new Covid-19 cases a week. By early January, the number had increased 5-fold to about 1.5 million new cases. If the nearly 870,000 new cases of last week were extrapolated, they would entail an unprecedented number of Covid cases by January.

Naturally, it is not only mathematical, and vaccines as well as herd immunity would probably mean the relationship is a bit different this time around. It is still clear that once flu season begins, the number of new cases should increase significantly.

The question then becomes how governments will react. If there is a focus on the death rate and the hospital situation, there is a chance that no major disruption to economic activity will ensue the higher case counts likely to come.

China, unfortunately, is reacting in the same manner as it did early in the pandemic. Last week, the country closed a terminal in the Port of Ningbo, the world's third busiest container port, after one of the workers tested positive.

This is the second recent shutdown of a Chinese port due to the coronavirus, after the closure of Yantian port in Shenzhen from late May for about a month. That event led goods to back up in factories and storage yards and also was partly blamed for rising freight rates, which are near record levels.

Such freight costs for Chinese products are partly to blame for higher inflation across the world. Another reason also harks back to China: supply shortages of key components that are causing reduced factory output of several products just as demand rises rapidly.

News of reduced activity in China could, therefore, impact the rest of the world. That has started to be reflected in the price of some commodities, such as oil. The price of a barrel of Brent crude has fallen for five of the past seven weeks and closed at US$70.59 on Friday, 8.51% below the US$77.16/barrel where its price ended on July 5th, its most recent high. The drop has coincided with rising numbers of new Covid cases in China and in most advanced economies. Prices for other raw materials have also fallen in the same period.

Some metals, however, got a boost last week after the US Congress passed a US$550 billion infrastructure bill and moved ahead on another US$3.5 trillion spending package. Copper, which is a key material for construction and an important input in the renewable industry energy, saw its prices rise 1.02% last week following the passage of the so-called 'bridges and roads' bipartisan bill.

The passage of yet another stimulus bill in the US, however, is increasing calls for a check on inflation and the rise in prices is likely to start featuring in the political agenda as well. After all, while the Fed may continue to believe that inflation is transitory, the common people are feeling the pinch.

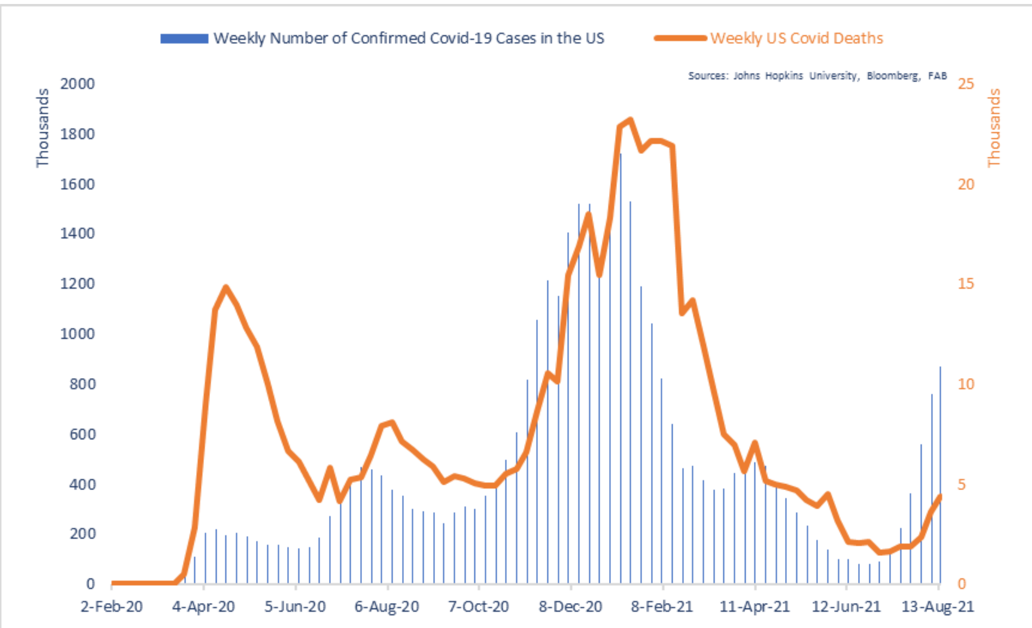
In fact, it could be argued that inflation has already entered the political agenda, as US President Joe Biden suggested last week that he would ask OPEC+ members to increase oil output as gasoline prices are beginning to hurt US consumers.

Inflation is not necessarily bad for stocks. If companies can pass some of their higher costs on (and there are indications that they have been able to some extent), profits rise in tandem with prices. The issue is how the Fed will react.

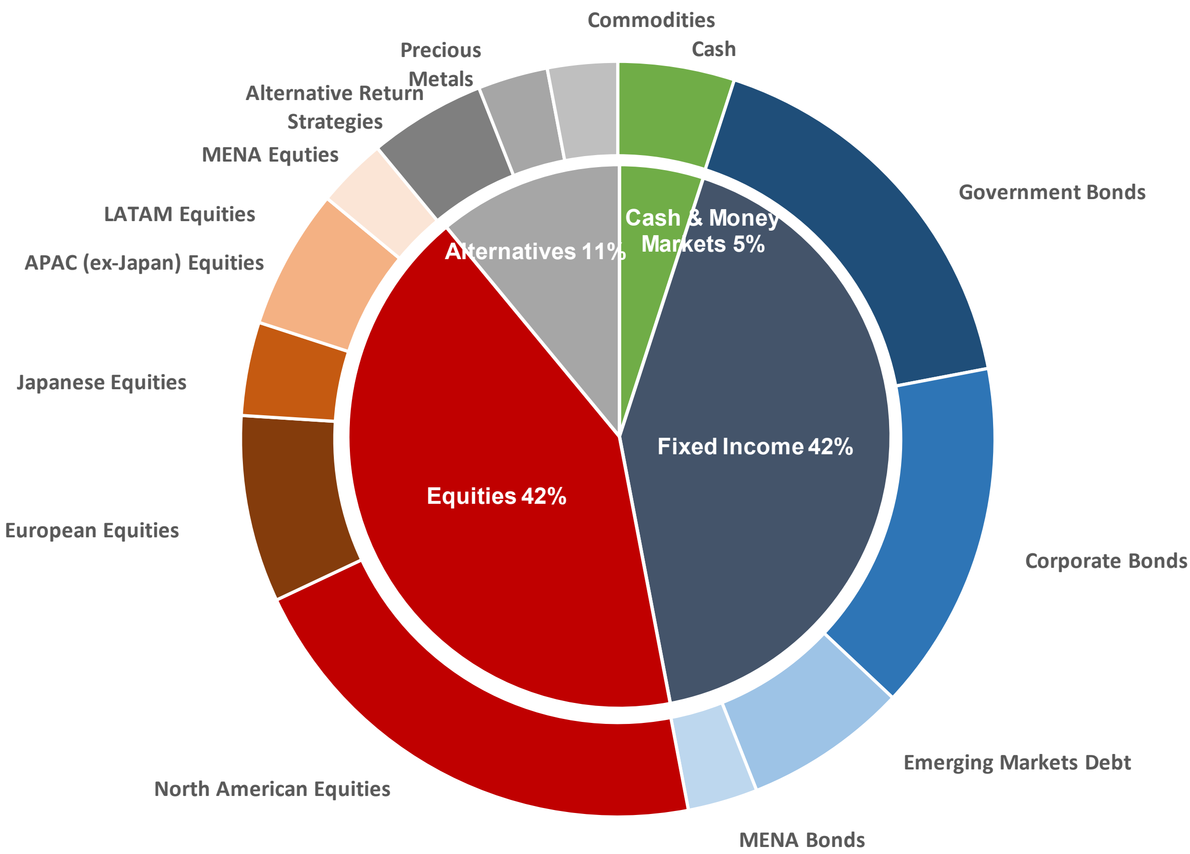
And while Chairman Jerome Powell is likely to repeat again in his remarks that he thinks the current inflation is a transitory phenomenon, the subject is getting more attention among Fed economists. Investors will have a better sense of how concerned they are with the minutes of the July FOMC meeting, which will be released this week.

Even if Fed economists sound more alarmed, though, the central bank is likely to be very careful about tightening monetary policy. And this is supportive for markets to continue to rally into the end of the year.

While the death rate has been low, rising US cases may spur some movement curbs



Asset Class	Positioning	Detail
Cash	Underweight	Putting cash to work in risk assets.
Fixed Income	Overweight	Keeping a slight overweight focused on EM dollar debt and on corporate investment grade bonds
Equities	Overweight	Slightly overweight in Asia ex-Japan and US markets.
Alternatives	Underweight	However, reducing the underweight in hedge funds



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