

# Equity Headwinds Continue to Build

- Energy spike yet another headwind for equities
- Positive for Energy earnings, negative for many others
- Increasing probability of Federal Reserve tightening

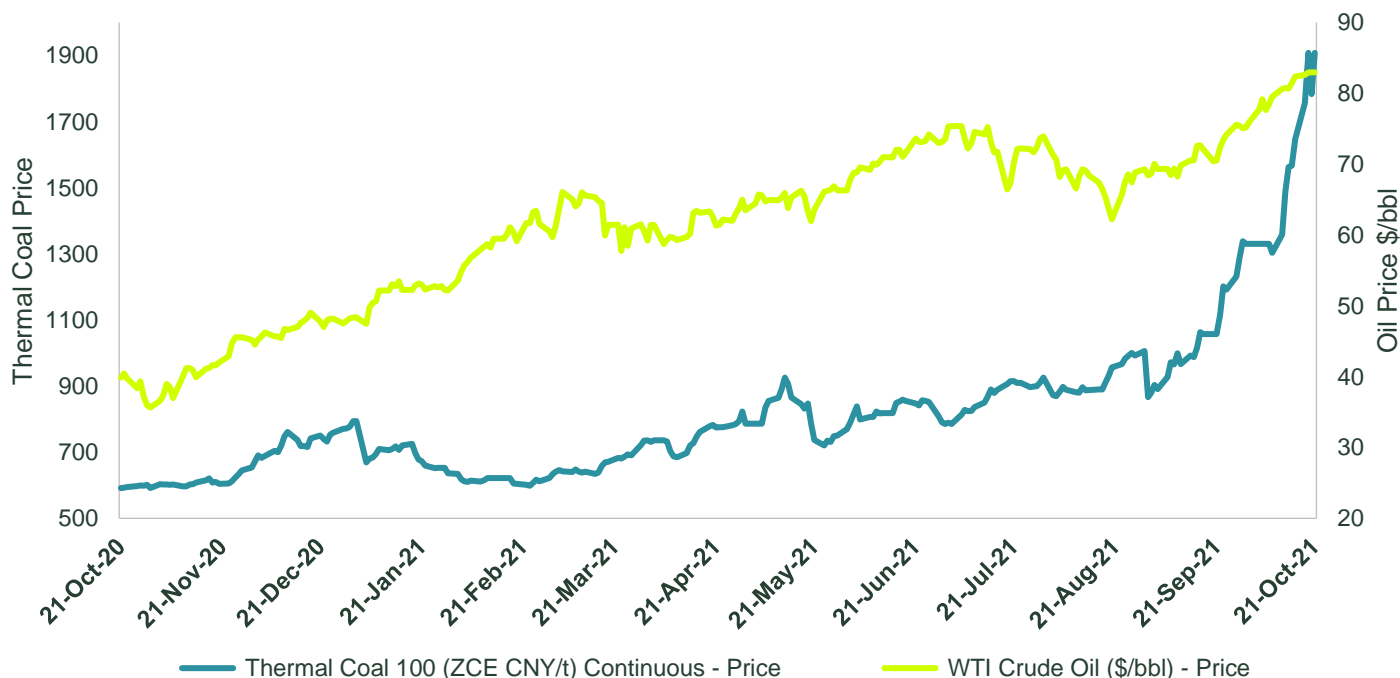


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## Energy Spike Yet Another Headwind for Equities

The recent spike in energy prices is another headwind for the equity market. Oil is one of the biggest commodity inputs for production directly feeding into higher input costs. The majority of companies will see rising cost pressures and margin compression. Industries such as Transportation, Capital Goods, Utilities and Autos are likely to be the most negatively impacted.

**Figure 1: Recent Spike in Oil and Thermal Coal Prices**

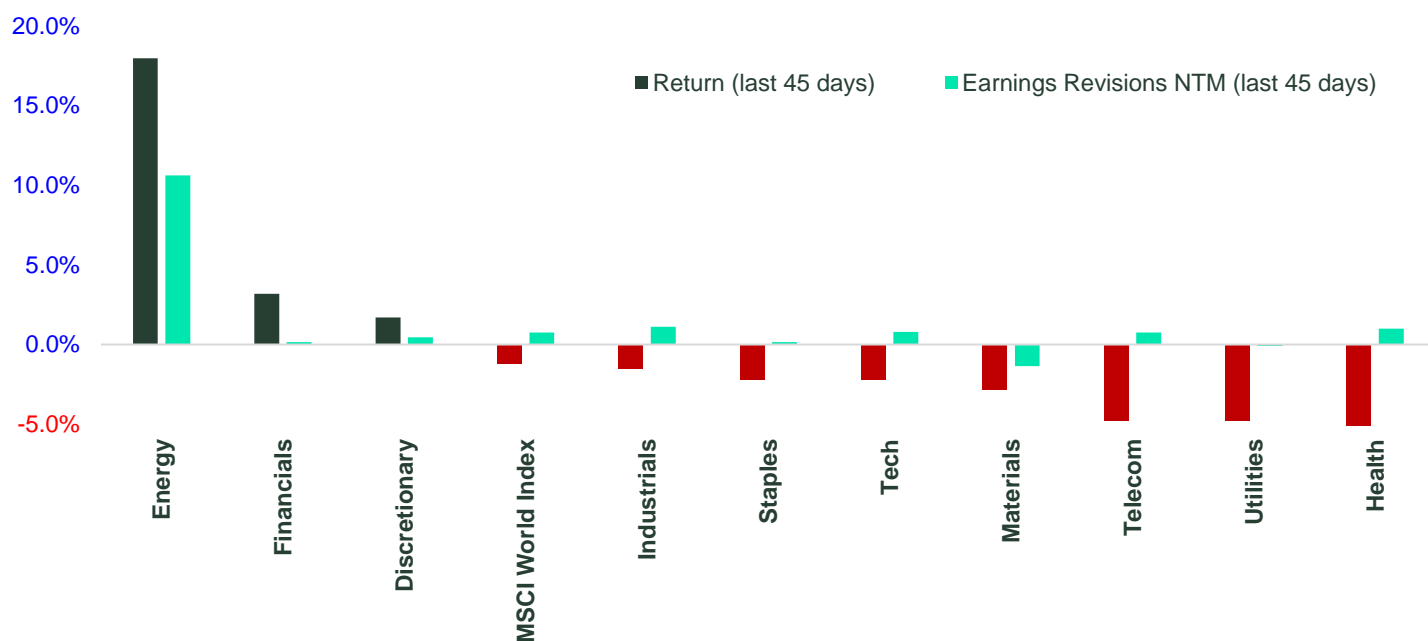


Source: State Street Global Advisors, Factset as of 20 October 2021. This information should not be considered a recommendation to buy or sell any security or sector shown. It is not known whether the securities or sectors shown will be profitable in the future. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

## Positive for Energy Earnings, Negative for Many Others

Figure 2 highlights the sector performance over the period in which the energy price has spiked. The obvious winners are the energy producers and energy service companies. The Energy sector has massively outperformed up 18% in the last 45 days. Earnings expectations have improved by 10.6% over the same period. Financials and Discretionary sectors have managed to generate positive returns but the rest have seen negative returns over this period. The MSCI World Index is also down 1.2% over this period. With reporting season just beginning in the United States it will be interesting to see if inflation continues to remain a key concern for corporate earnings and margins.

**Figure 2: Sector Returns and Earnings Revisions During the Recent Spike in Energy Prices**



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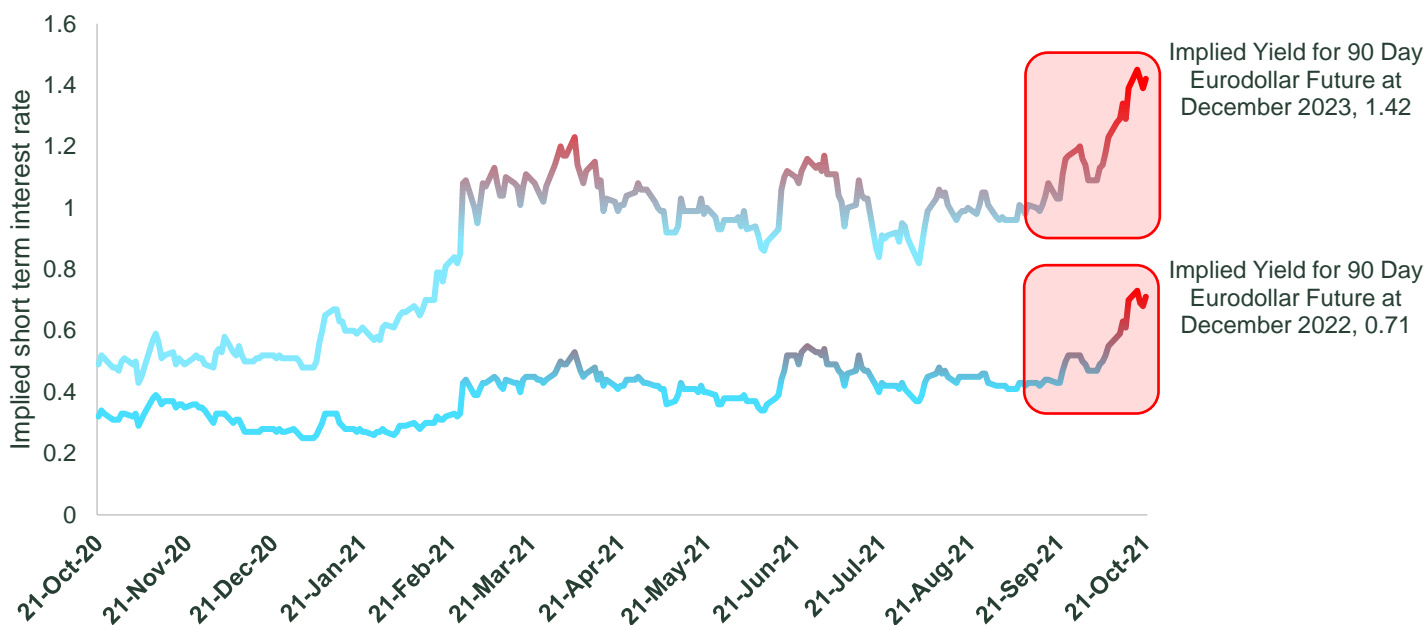
Other than Energy all other sectors have seen muted changes to the expected earnings for the next 12 months. The Materials and Utilities sectors have both seen downgrades during this energy price spike. The materials sector is generally more related to expectations for a slowing Chinese economy more to do with concerns over the Evergrande Group crisis and potential spill over effects into the broader economy. Within China the constrained energy supply has also impacted expectations for growth within some industries. Generally speaking we would expect to see a negative impact on the consumer spending as higher transportation costs and higher cost of goods and services impacts weekly budgets.

## Rising Energy Prices Increases Chance of Tightening

The increase in inflation in 2021 has been an increasing concern for investors and now the spike in energy prices adds to this concern. Not surprisingly investors are now pricing a greater chance of tightening in the United States.

Figure 3 below provides an insight into the market’s changing expectations for short term interest rates in the United States. Since the start of September 2021 to 20th of October investors are pricing an extra 30 basis points of tightening by the end of 2022, and extra 46 basis points of tightening by the end of 2023. Whilst these may be modest increases in expectations for higher short term interest rates they do represent another headwind to the equity market and a change from the current pandemic regime policy settings.

**Figure 3: Implied US Short Term Interest Rates for the End of 2022 and the End of 2023**



Source: State Street Global Advisors, Factset as of 15 October 2021. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses

## The Bottom Line

Equity markets are continuing to show remarkable resilience in the face of increasing headwinds. The recent spike in Energy is yet another concern for equities both in terms of earnings and margins but equally in terms of the ever increasing likelihood of tighter monetary policy down the road.

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