Market Review September 2021

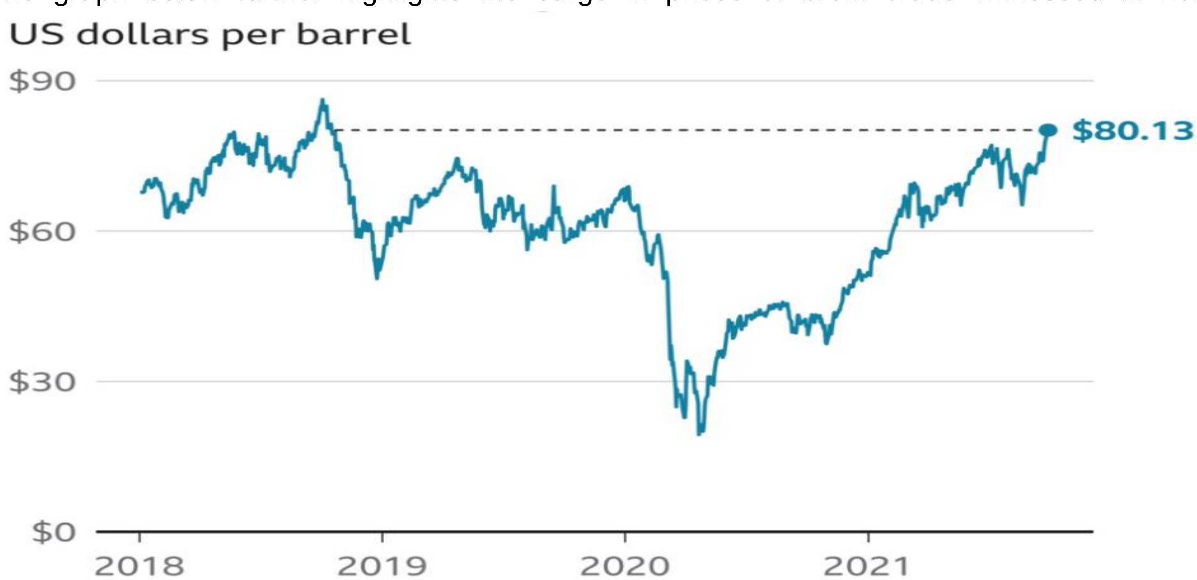
September proved to be a challenging month for financial markets with inflationary trends witnessed in key energy commodities including oil and natural gas. The evolving real estate situation in China has further increased the uncertainties in financial markets and have badly impacted growth stock valuations.

Oil Price Rises Above US$ 80 per barrel

Oil prices climbed above US$80 per barrel, reaching their highest level in three years as Brent crude, the international oil benchmark, rose to as much as US$80.69; its highest level since October 2018. Brent crude benchmark has so far gained around 55% during YTD 2021. Another oil benchmark, West Texas Intermediate (WTI) also rose to around US$75 per barrel. Analysts have noted that oil prices are likely to continue to rise amidst surging demand and relatively tight supplies. Investment Bank Goldman Sachs has estimated that oil prices could reach US$ 90 per barrel by the end of the year.

It is pertinent to note that oil prices slumped at the start of the pandemic when they fell below zero for the first time in history during April 2020 as covid-induced economic lockdowns wiped out demand while producers continued to pump crude from their wells. However, demand has been rising in recent months as economies around the world have started to reopen. Global oil supplies have also taken a hit from hurricanes Ida and Nicholas passing through the Gulf of Mexico damaging US oil infrastructure. Additionally, a dramatic surge in natural gas prices has also made oil a relatively cheaper alternative for power generation, which in turn has further supported demand. Oil exporters group Opec expects there to be a further surge in global demand for crude at about 370,000 extra barrels a day.

The graph below further highlights the surge in prices of brent crude witnessed in 2021.



Extraordinary Surge in Natural Gas Prices

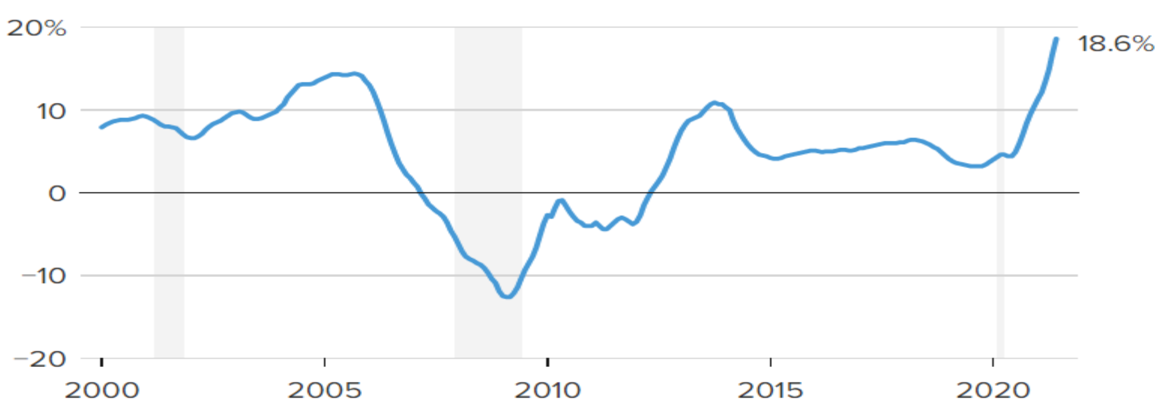
Natural Gas remains a key source of energy for global economies as it is an efficient alternative to oil from a climate change perspective. It remains one of the most common ways for providing heating inside homes and is a leading fuel source for generating electricity. Prices of natural gas have surged more than 80% over the past 12 months across the globe to US$ 5.90 per million British thermal units; its highest level since February 2014. The underlying story remains similar to what we have seen in other industries post covid-19 whereby demand has increased more quickly then supply lines resulting in supply bottle-necks. The US has an abundance of natural gas (a benefit of the shale boom that unlocked an abundance of cheap gas) and has also experienced a dramatic spike in natural gas prices as more and more gas has been exported overseas to meet demand in Europe and Asia (a YoY increase of 48% in gas exports). The natural gas situation is far worse overseas whereby Europe and Asia are grappling with crippling increases in natural gas prices and shortages that have forced blackouts, shutdowns of factories and cast a shadow over the economic recoveries there.

The central problem for natural gas prices remains that while economic activity has bounced back, natural gas production didn't as after years of losing money, natural gas producers have been cautious about ramping up production again which means that demand is coming back faster than supply, forcing prices to go higher.

However, wall street firms are predicting that the natural gas spike may be getting out of hand. Bank of America wrote last week that winter risk premium built into natural gas prices has "reached excessive levels" and the bank expects natural gas prices to drop during the final three months of 2021.

S&P Case-Shiller national home price index

Percent change from prior year



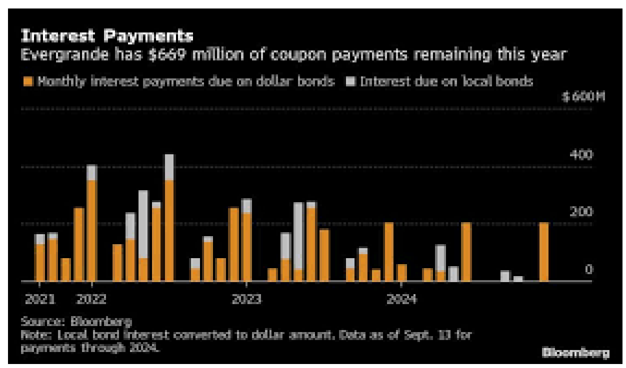
Note: Shaded areas indicate U.S. recessions.

Inflation Indicators Continue to Rage

According to the U.S. Commerce Department, inflation ran at a fresh 30-year high in August 2021 as supply chain disruptions and extraordinarily high demand supported ongoing inflationary pressures. The core personal consumption expenditures price index, which excludes food and energy costs and is the Federal Reserve's preferred measure of inflation, increased 0.3% for the month and was up 3.6% from a year ago. That's the highest increase since May 1991 and reflective of inflationary pressures that Fed Chairman described earlier this week as "frustrating."

It is also pertinent to note that prices that producers get for final demand goods and services also surged in August 2021 to their highest annual rates since at least 2010. The producer price index rose 8.3% on YoY basis which is the biggest annual increase since records have been kept going back to November 2010. That came following a 7.8% move higher in July 2021, which also set a record. The data comes amidst heightened inflation fears led by supply chain issues, a shortage of various consumer and producer goods and heightened demand related to the Covid-19 pandemic.

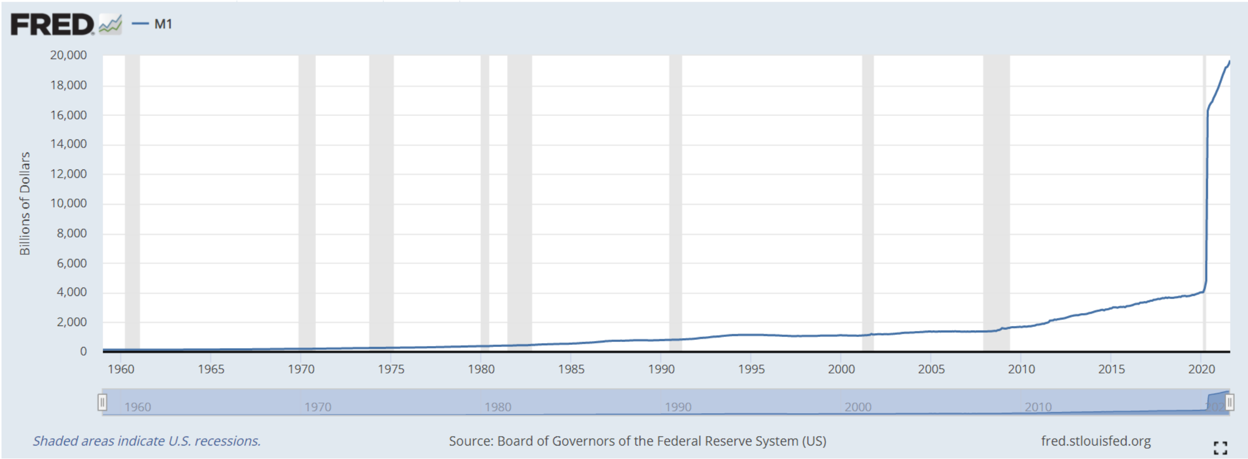
Evergrande Saga Rages During September 2021



During last month, we heard disturbing news about Evergrande, China's largest private property development company with an estimated 2 trillion Yuan of Assets (equating to 2% of China's GDP). Evergrande is China's most indebted property developer with circa US$ 300 Billion in debt. The company is faced with a liquidity crisis, underscored by US$ 669 Million of interest payments due in 2021 and a whopping bond maturity of US$ 7.4 Billion in 2022. The prospects of a looming default of Evergrande are sending shockwaves across financial markets. The Chinese Govt. has moved in to provide liquidity to the banking sector and have also vowed to protect the property sector and consumers. The adjacent graph shows the interest payments for Evergrande in 2021 of which the company has already missed the first two obligations.

The Federal Reserve in the Spotlight

In the US, concerns regarding Fed policy is having an impact on the markets. About 35% of all US dollars in existence have been created in the 2 years. M1, the value all the currency in peoples' wallets plus all accounts they can write checks against, has grown exponentially as the following chart shows. Much of this can be attributed to the Fed bond buying program.



The Federal Reserve is currently buying $120 billion of bonds monthly and indicated that it could begin tapering those purchases as soon as their next meeting in November 2021. Reducing purchases would reduce liquidity in the financial system. The lift-off for rate hikes would likely not commence until after the taper process is complete, which could happen by the middle of 2022. As the markets are forward looking these actions could create volatility in the ensuing months.