# FACETOLOGY

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## Bank of England – The only game in town

You would think with all the doom and gloom around that at least some of the negativity would be showing up in the UK stock market. Not a bit of it. On the last day of October, the market closed near the high of the year, up over 12% - a decent showing for any normal year.

Of course, this year has been anything but normal and one could argue that given the economic bounce back, it should be higher still. Perhaps it should be, the index is only now within spitting distance of where it was before the pandemic. Contrast this with US stocks where the main benchmark is a third higher than before the pandemic.

However, this isn't too surprising because, at the sector level, this has a lot to do with the composition of the UK stock market which has a far heavier weighting in banks, for example. In addition, the UK stock market is not graced with the USA superstars of Apple or Tesla among its number.

On the other hand, perhaps we should be more grateful. October can be a tricky month for global stock markets. The "October effect" – the perception that it is a vulnerable month for market corrections, has been around for decades. In part, there is the lingering memory that the crashes of 1929 and 1987 both took place in October. Even allowing for these two momentous events, the reality is the annual statistics don't support the theory even in 2021 when there is a growing list of concerns.

By no means least of these concerns is the rise in inflation. The current rate is running at 3.1% which, whilst not running as hot as the USA, has drawn the eye of the Bank of England's Monetary Policy Committee (MPC). Just a few weeks ago, Governor Andrew Baily launched the sternest warning yet that inflation is now the primary concern for the Bank and that interest rates will have to rise to counter the threat. This is a big deal for bond markets and, ultimately, stocks.

At the recent summit of central bankers at Jackson Hole in Wyoming, US Federal Reserve Chairman, Jerome Powell, appeared supremely relaxed about inflation running at double the target rate. It is, in their view, only temporary and not requiring anything as drastic as an interest rate hike policy response.

So, it came as some surprise when The Bank of England suddenly announced the opposite. The UK bond market immediately priced for an immediate hike from 0.1% to 0.25% at the meeting on 4th November and a full 1% by May next year.

The problem was that on the 4th November, the Bank of England appeared to bottle it by announcing no change in interest rates. Andrew Bailey, tried to justify the apparent U-turn by citing a need to take a long-term view on employment and wages. It's hard to question his sincerity. After all, the Bank of England has a well-established reputation for taking it's time to assess the right time for a major change in policy.

The problem here is one of communication. The Bank of England may not see its job as one of giving daily guidance to the markets. Unfortunately, that really is their job. It may be uncomfortable to have the world hanging on their every word but then why compound the problem by painting a picture of runaway inflation and then doing nothing about it. Fundamentally, this sort of behaviour can undermine confidence which, in turn can undermine Sterling itself, leading to other problems – not least of which more inflation by raising the cost of imports.

Away from the policy makers, companies are displaying a level of adaptation, innovation and confidence through the recovery as witnessed by a US third-quarter earnings season that was better than many expected. This partly explains why the stock market is still creeping higher to record highs.

There is ample evidence that UK companies are similarly blessed with good managements doing what they can to adapt not just to the post-pandemic recovery, but the new challenges of rising labour costs and supply bottlenecks.

The widely predicted October stock market correction never came because despite the political dramas, there is still plenty to be positive about in the real world. But times like this, a bit of clarity of policy from governments and central banks is essential. If it is not forthcoming, the stock market is in danger of following the bond market into taking a more negative view of its own. For UK investors, watching the Bank of England has become the only game in town.