

Global Investment Strategy

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Investment Summary

Covid vaccines have arrived and 2021 growth expectations look much better.

However new lockdowns are being enacted around the globe as the virus's casualties are rising sharply. It will also take some time before sufficient vaccinations are in place to allow a return to "normal". So perhaps 2022 will be the year we can say that the virus has been conquered? Fortunately markets are forward looking and can see blue sky rather than the current murky depths.

Inflationary expectations are not an issue, for now.

Inflation expectations have remained well anchored, and remain below target for most central banks. However some central banks are loosening their inflation targets. Growth is the main target for the Authorities, debt levels are rising, it could all look very different down the line.

An end to loose money is not in sight, yield curves steepen.

The short end of the interest rate curve remains at low levels and negative for several major countries. Ten year yields remain below inflation targets for the next ten years, hardly suggesting a boom. This is a damning view of the future, no growth, as well as concern that central banks are now powerless.

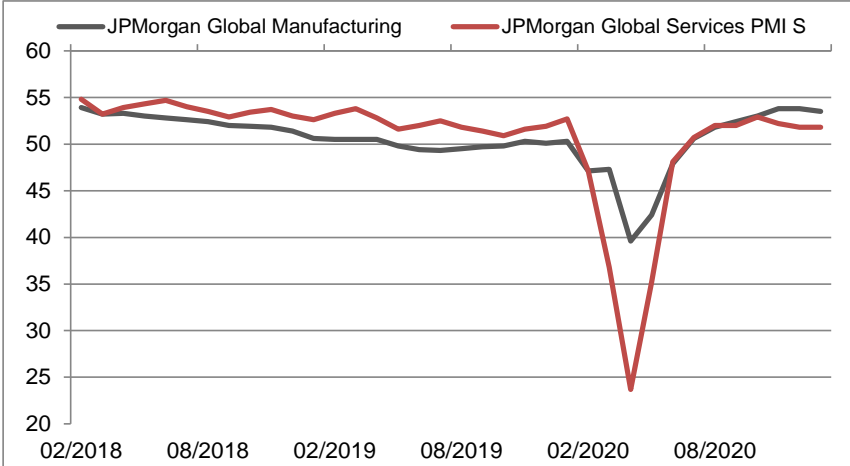
Equity markets are at highs, assuming earnings will recover strongly.

Equities already discount a return to normal economic activity, so pressure is on corporate earnings. Is this the time to bite the bullet and buy cyclicals and value? And sell growth like technology? What is clear is that if growth becomes more prevalent, then there are cheaper ways to buy into it.

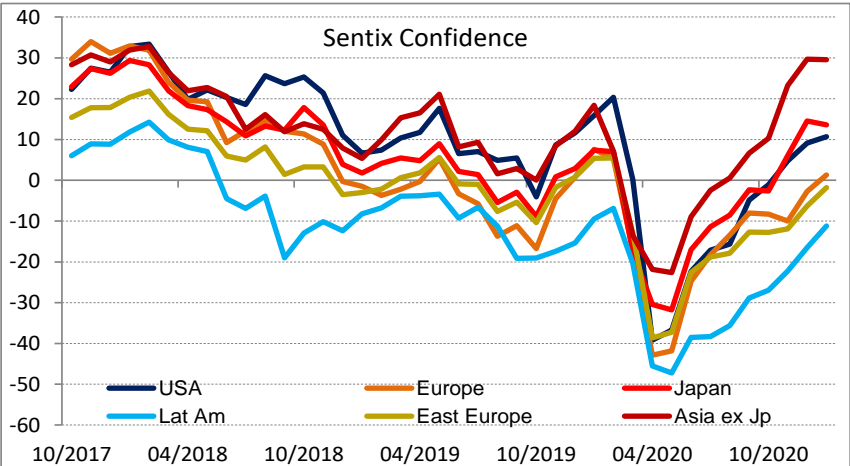
Growth and Inflation

Source: JP Morgan, Sentix, OECD, Bloomberg,

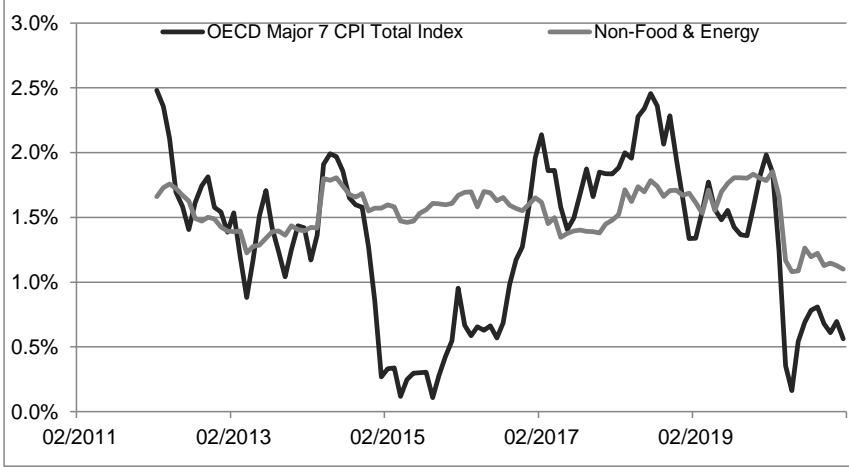
JP Morgan Global PMIs



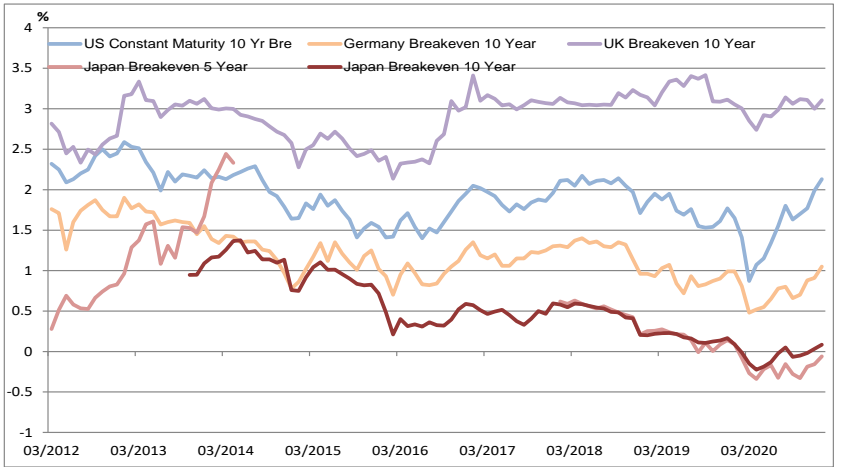
SENTIX Business Expectations Survey



OECD G7 Inflation



Implied Inflation from Index Linked Bonds



What are markets telling us?

Bond markets have had a limited reaction to the news of a vaccine, a slight steepening of curves but little else.

Investors expect inflation to remain at low levels for some time to come.

Central Banks are expected to keep monetary policy loose, until there are clear signs that growth is strong.

Real yields are low, bond issuance is high: this will not change soon.

Some equities have moved up to new highs, discounting a return to normal economic activity.

It will take time to understand all of the impact from the pandemic.

When will the jobs market pick up? Which businesses are fatally wounded?

You have to laugh: retail investors have driven some hedge funds to bankruptcy over “short” positions.

Where is the sophisticated risk management we are always told about?

What are we thinking?

Any hope that 2021 would be a year of rising growth has been damaged by the new lockdowns.

This provides an opportunity to buy into the blue sky of vaccinations and better times ahead.

The problem is that equities already discount a new high in profits, and real interest rates are negative.

Central Banks have no ammunition left and negative rates are impacting the financial system.

Climate change and ESG will drive investment trends near term for Europe.

The UK will find out the true cost of Brexit.

It is not the time to be short of Value.

Fixed Income

Fixed Income Strategy (1)

DURATION

We are slightly short duration.

Vaccine rollout, loose fiscal policy, loose monetary policy, higher inflation targets: what is to like about bonds?

Well: large output gaps, pre-Covid struggle to increase inflation, in some markets yields haven't changed from Covid (DEM) and in others yields have already risen (CNY, JPY, USD), fiscal austerity ahead.

All in all we think growth will rise, inflation targets approached and yields rise.

But it will be a slow process.

SPREAD PRODUCT

Spread product is attractive, but choose carefully.

The economic outlook, positive growth and supportive policies, favours spread product.

Despite this we have reduced our overweight for reasons given below:

Spreads have come in from 330 over to 100, basically back to the Pre-Covid level;

Corporate leverage and cash balances have risen, so far for precautionary reasons;

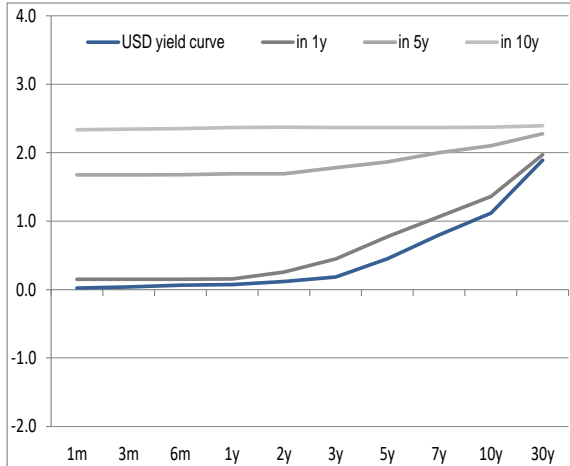
Governments are in weaker positions: debt levels are higher, monetary policy limited in efficacy.

We don't see another economic shock, but if there is one there is less ability to withstand it.

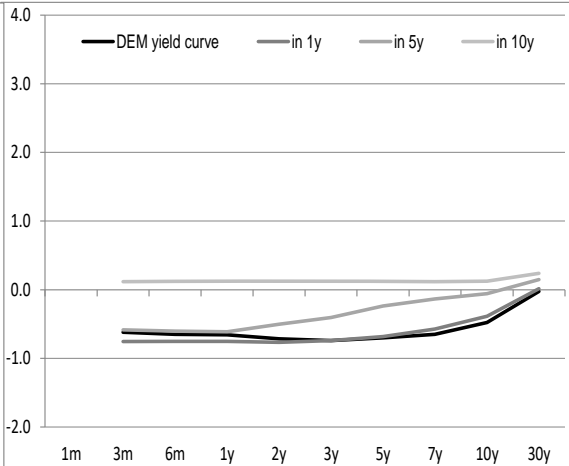
Forward Yield Curves

Source: Bloomberg,

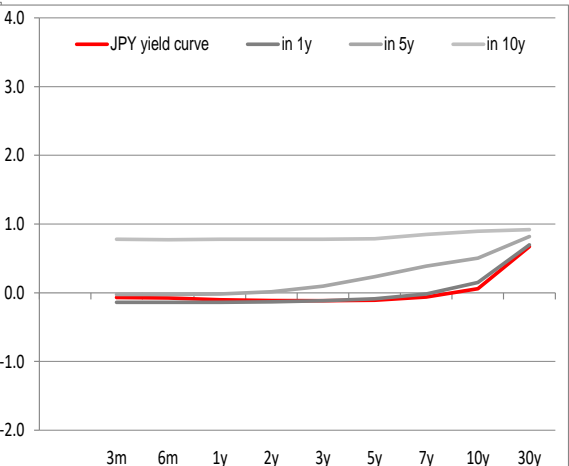
USA



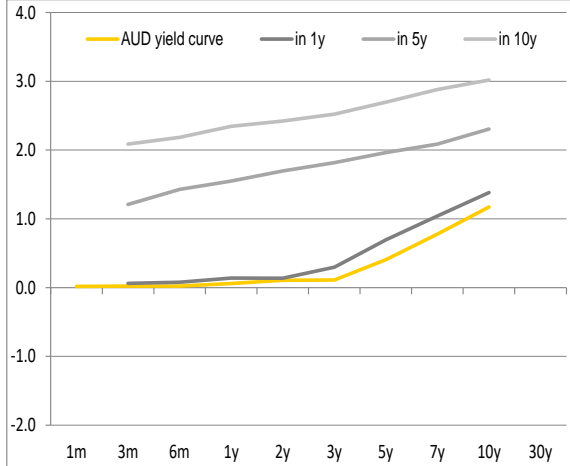
GERMANY



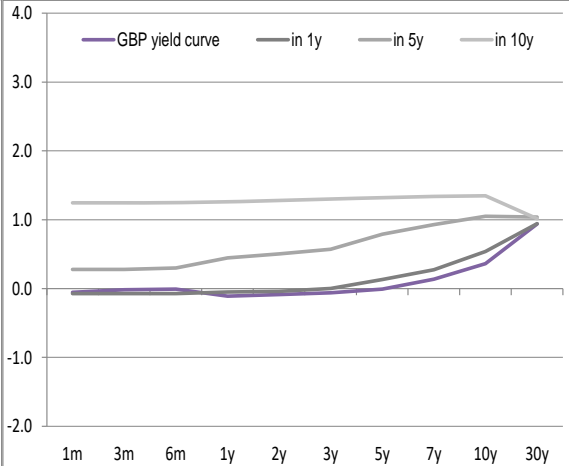
JAPAN



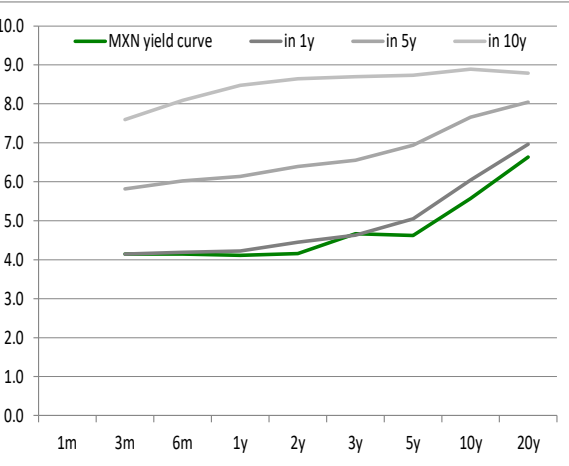
AUSTRALIA



UK



MEXICO



Fixed Income Strategy (2)

COUNTRY ALLOCATION

We have little preference.

US forward curves put US rates in the distant future way higher than EU rates - in the long run that is wrong.

For now the more dynamic US economy will win the argument. We will keep our powder dry.

Central banks will not anticipate and will keep rates low until targets are reached.

The world before Covid suggests that will be a long time coming.

Changes to inflation targets make nominal yield convergence less obvious.

The fiscal and monetary actions are raising some concerns longer term, worry about those later.

Negative yields are no longer rare.

Banking sectors are struggling with the negative yield environment creating a vicious circle.

Japan oddly now looks normal rather than an outlier.

German yields are poor value. If yield downside is negligible why risk suffering the upside?

CURRENCY

We have limited currency positions.

The USD weakened because of rate cuts, but the US is still expected to return to normal more quickly.

The Euro is cheap on fundamentals, but rates are not rising and risks around the EU persist.

Equity

Equity Strategy (1)

GLOBAL

The global profit cycle should be important to investors.

Current earnings rose for the first time in a year, 20% below the levels of early 2020.

Expected earnings revisions are rising, a key support for share prices.

But we must caution that the 1 year forward EPS is already 5% above the previous earnings peak level.

We do not know the damage that COVID has done to the economy or businesses.

With little room for disappointment we would not be rushing to buy equities.

Valuations are extended and still not the focus.

P/Es are related to future earnings growth in which confidence has improved.

The current historic P/E of 33x is expensive, and the forward P/E remains at 21x.

Corporates have taken on debt while at the same time boosted cash balances to all time high levels.

Dividends are unlikely to grow until the future is better understood, and yields remain at low levels.

Profit forecasts are not too excessive at present.

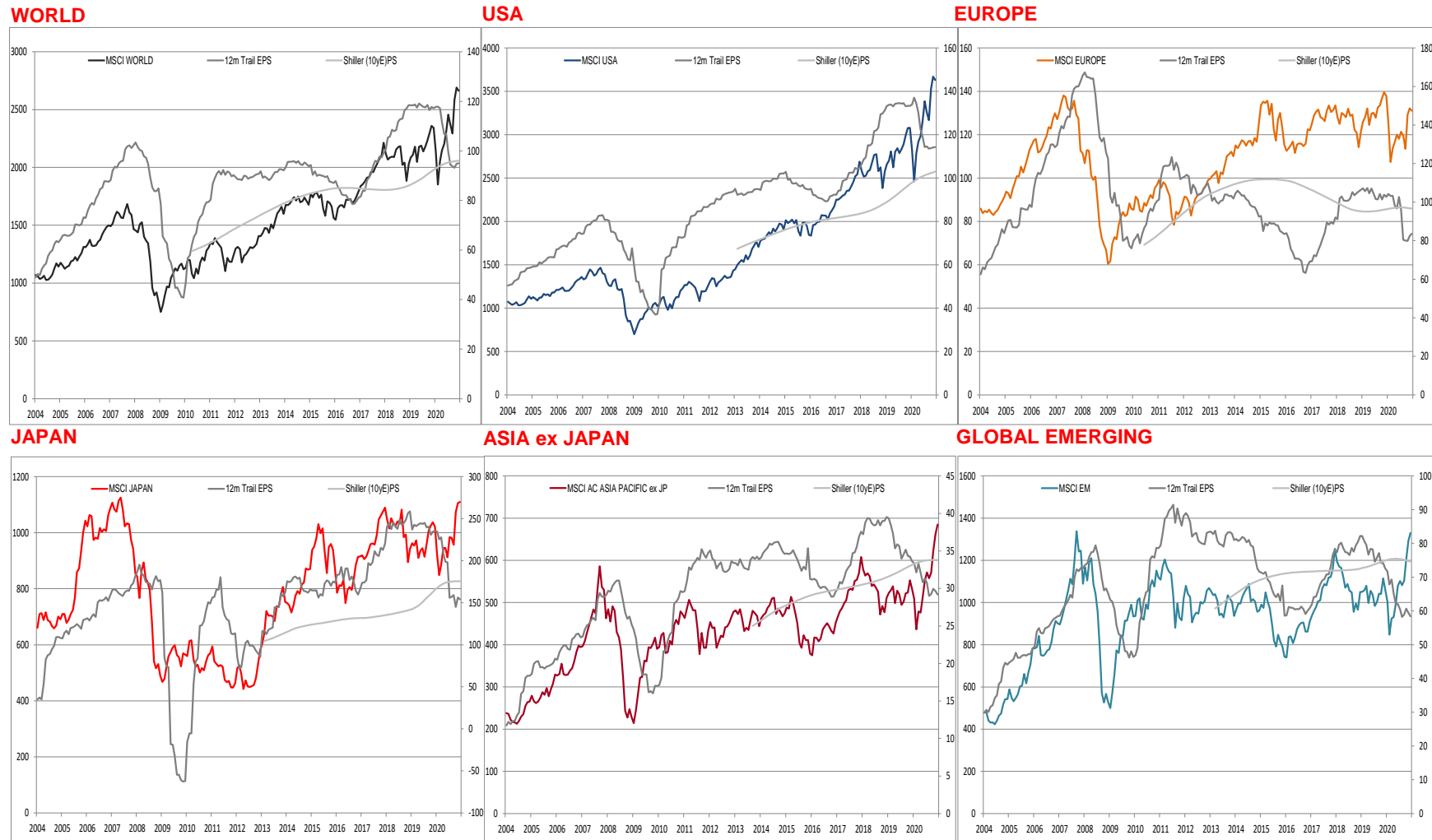
The next twelve months are forecast to see 35% profit growth, which is not ridiculous.

In 2018 before COVID appeared, MSCI World earnings were forecast to reach 140 on a P/E of 16x.

Currently forward earnings are at 130 on a P/E of 21x, if forecasts rise to 140 then the P/E would be 18.5x.

MSCI Equity Indices and Earnings (right hand axis)

Source: MSCI, Bloomberg,



Equity Strategy (2)

SECTORS

Improved confidence in growth expectations has caused trends to reappraise.

Cyclical sectors saw a rise while previous leader Technology had a set back.

Energy and Bank stocks though remain friendless hitting new lows relative to the market.

Defensive Growth – Staples and Health Care are slipping down.

What is clear is that “Covid beneficiaries” took a step back, while “Covid losers” were picked up.

FACTORS

Factor trends are becoming market dependent?

Rising earnings revisions and rising bond yields are meant to support Value, but it is never that easy.

Investors are unwilling to give up on Growth and Quality, and why should they.

In Japan Value was a positive influence, but not in the USA or Europe.

Size was equally mixed large caps doing better in Japan, but not USA or Europe.

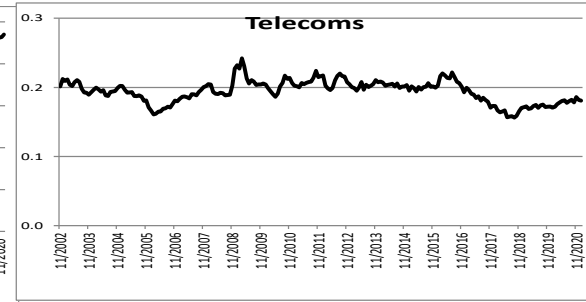
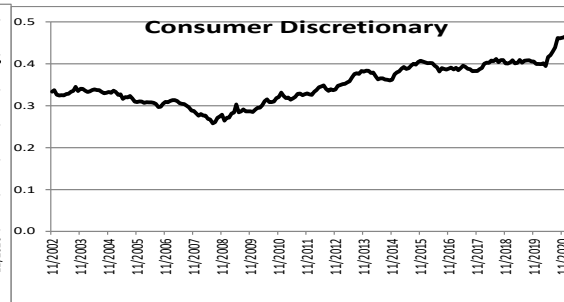
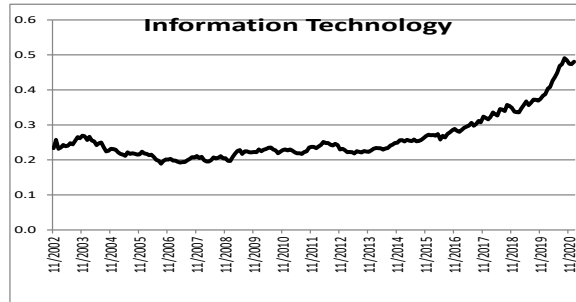
If growth is to be more prevalent as economic activity returns then expensive growth will be unattractive.

It is a time for investors to reappraise portfolios and probably avoid being underweight to Value.

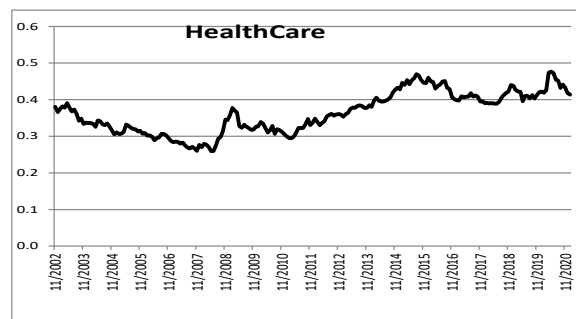
MSCI Equity Sectors Relative Performance (in USD)

Source: MSCI, Bloomberg,

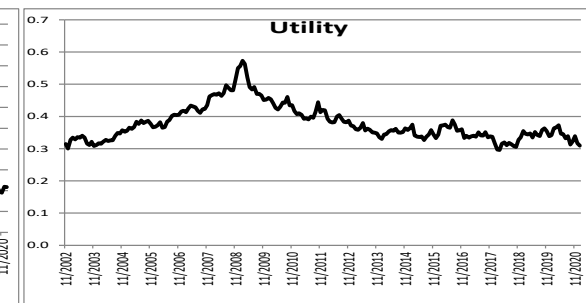
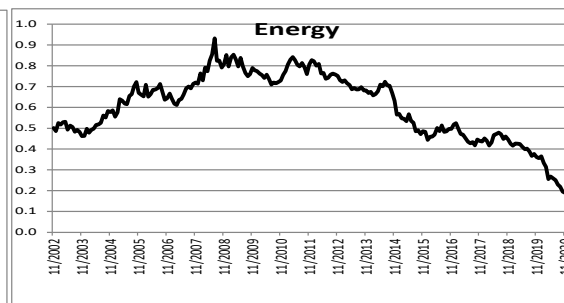
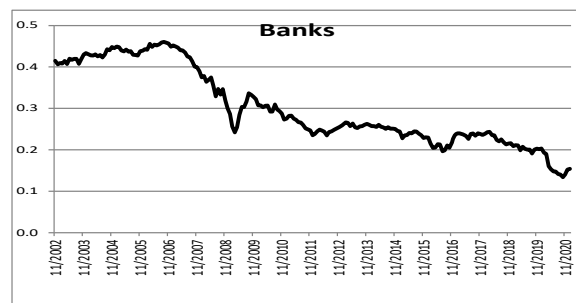
WINNERS



MAKING THEIR MINDS UP



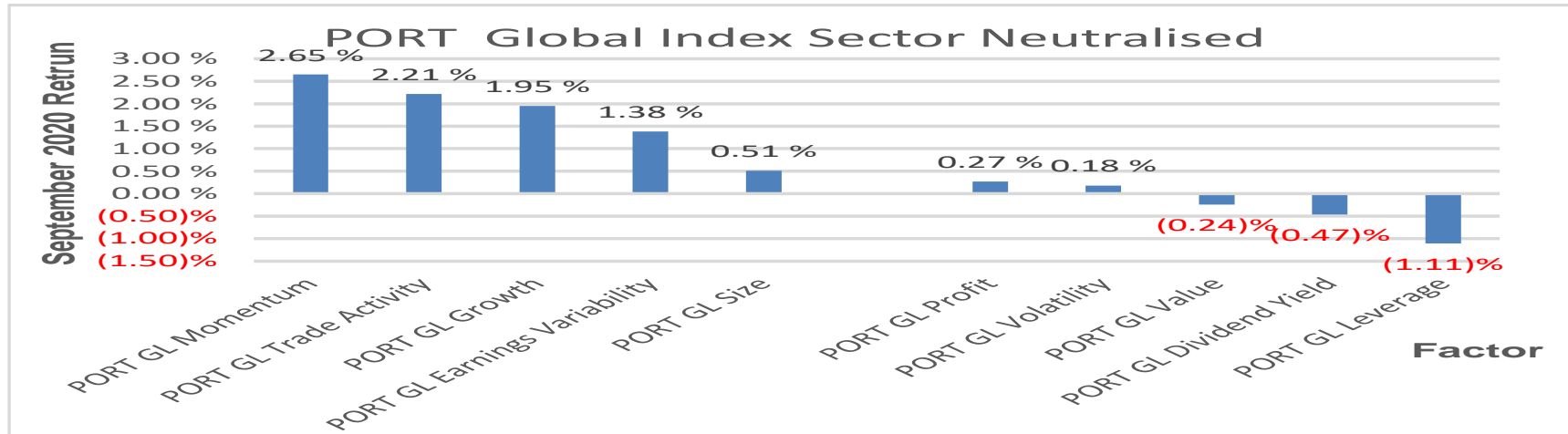
LOSERS



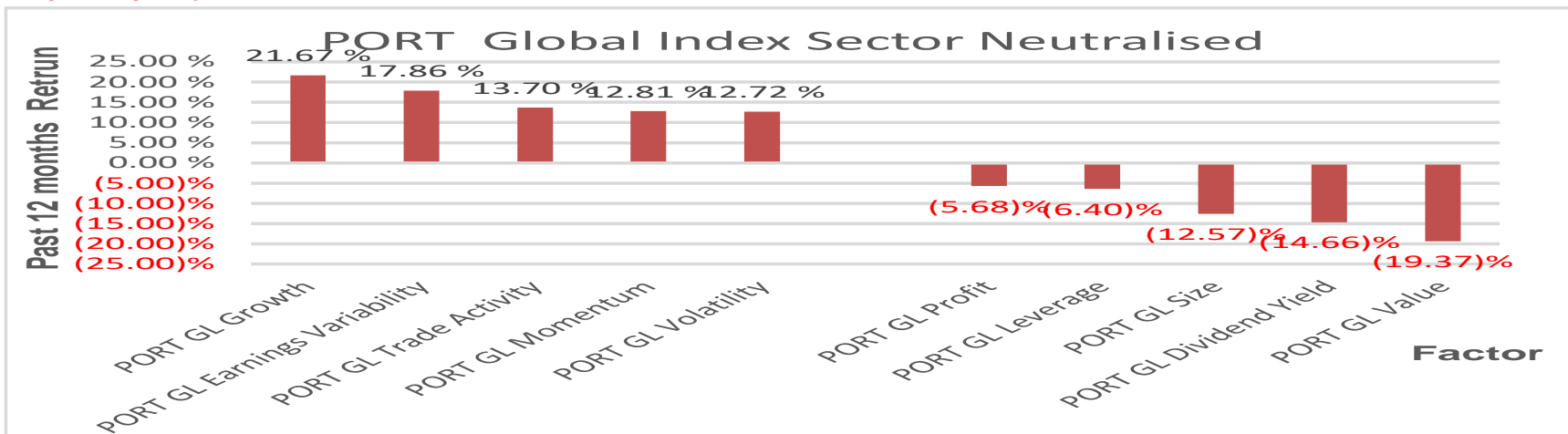
PORT Factor Analysis

Source: Bloomberg,

1 MONTH



PAST 12 MONTHS



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