Global Investment Strategy

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MUFG ASSET MANAGEMENT

Mitsubishi UFJ Asset Management (UK) Ltd. (Registered in England No 1842259)
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Investment Summary

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

Vaccinations are providing justified optimism pushing business confidence and interest rates higher.

It is likely that major economies can be back to a "new normal" by the end of this year.

So 2022 is increasingly likely to see renewed socialising, travel and rising consumer confidence.

Inflationary expectations remain well anchored, but have risen.

Inflation expectations have risen closer to targets, but for how long can commodity prices rise?

The US is aggressively pursuing maximum growth and higher than 2 per cent inflation.

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.

Five years out, five year forwards are at or above inflation targets in the North American linked markets;

but remain below in the EU and Japan; this does not suggest a boom.

The view remains therefore of soft productivity growth in the future and lack of bold action in some quarters.

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.

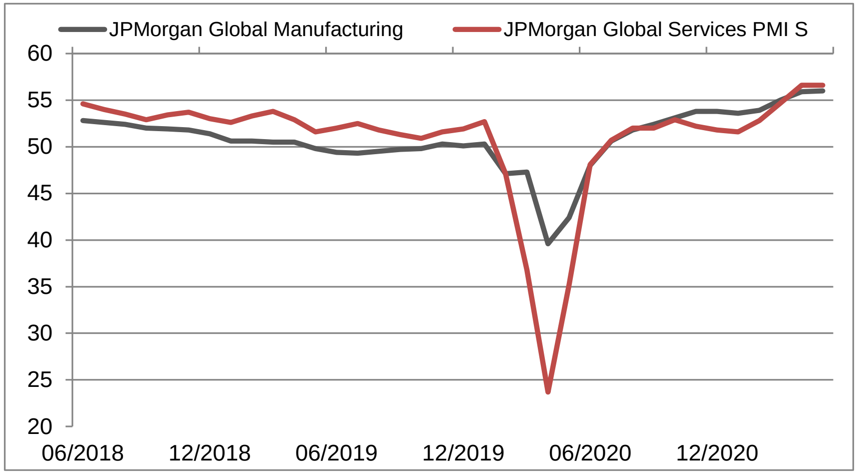
Is this the time to bite the bullet and buy cyclicals and value? And sell growth like technology?

What is clear is that if growth becomes more prevalent, then there are cheaper ways to buy into it.

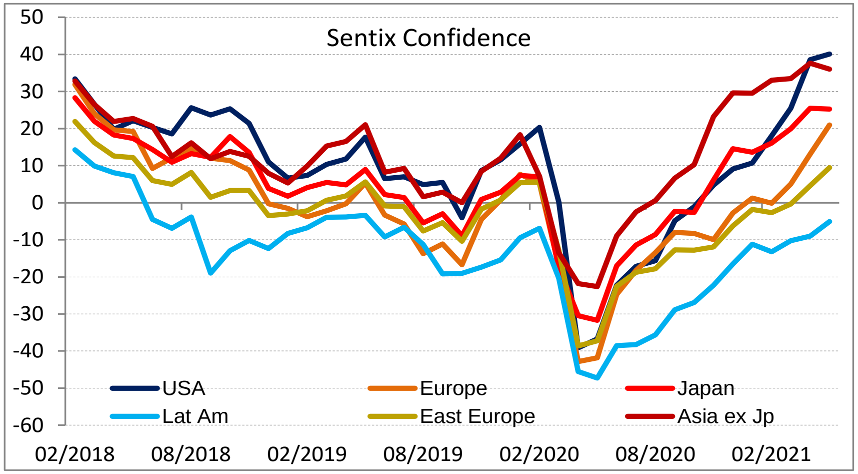
Growth and Inflation

Source: JP Morgan, Sentix, OECD, Bloomberg,

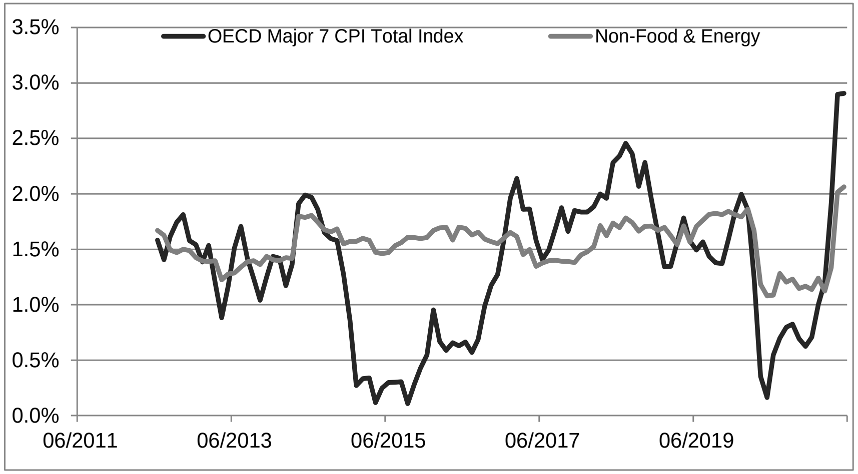
JP Morgan Global PMIs



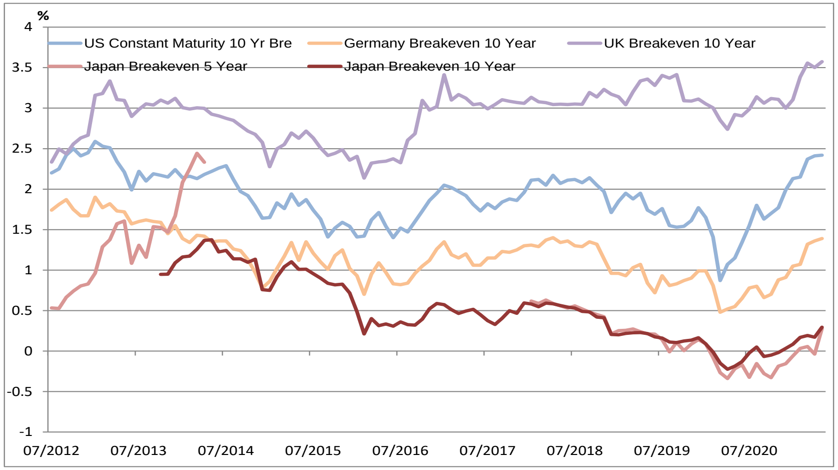
SENTIX Business Expectations Survey



OECD G7 Inflation



Implied Inflation from Index Linked Bonds



Commentary

What are markets telling us?

Bond markets stabilised in April, it seems investors need to better evaluate what the future will look like.

Cyclical equities are in favour, while the initial revaluation of growth has run its course.

A strong rebound in economic activity is understood, but what will be the trend pace of growth for 2022.

The US government is pushing ahead with a strong Fiscal boost.

Implied inflation from indexed linked bonds has risen to highs, so markets are aware of the inflation risks.

For now markets are behaving as normal in an economic upturn;

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

What are we thinking?

US action on monetary and fiscal policy is a game changer, can / will other jurisdictions follow?

Only tardily, is our view. However it will be an influence.

Central Banks have little ammunition, but if inflation moves upwards they will embrace it.

It is now clear that 2021 will be a year of rising growth; vaccinations are providing real hope.

For now we can journey in hope, but markets will spend much time picking trends from volatile numbers.

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

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 short duration.

- The US fiscal package is a game changer since it eliminates the output gap.
- High savings and wealth provide extra spending.
- Fed have stated they will not hike rates until both inflation is above target and employment is maximized.
- Here is the best chance for a shift in inflation expectations and higher market rates.
- What about everywhere else? Australia and Canada should largely follow.
- UK should too, since it is largely a service economy. Fiscal austerity has been delayed and likely will again.
- EU has a fiscal boost, but will be a laggard. That should not stop yields drifting upwards though.

SPREAD PRODUCT

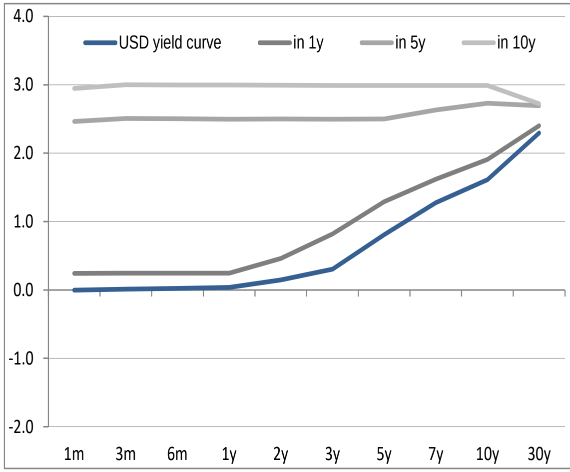
Stronger growth is positive, but rich valuations and risks further out prompt caution.

- 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 historically low 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.
- US fiscal action accelerates the upturn, but raises the risk of volatility later as overheating becomes debated.

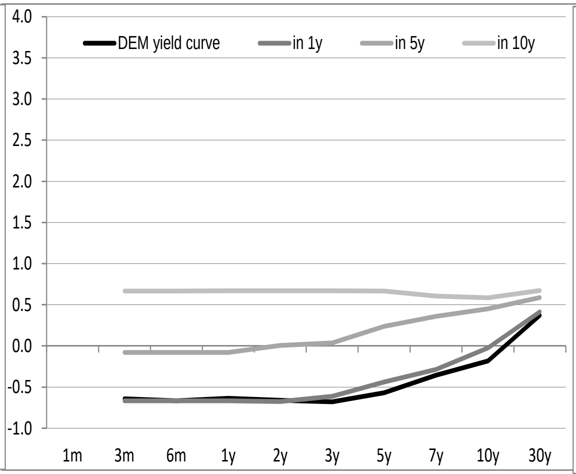
Forward Yield Curves

Source: Bloomberg,

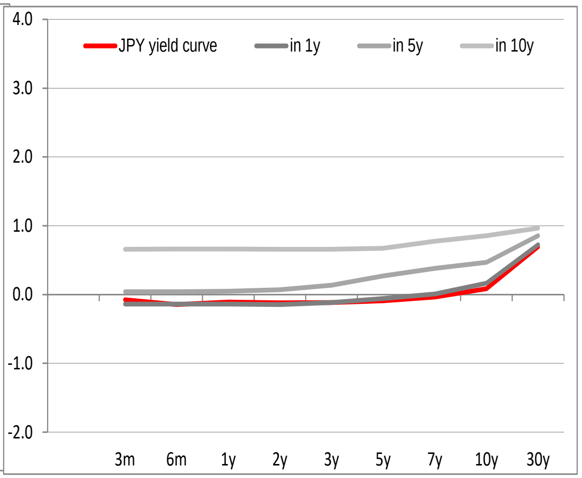
USA



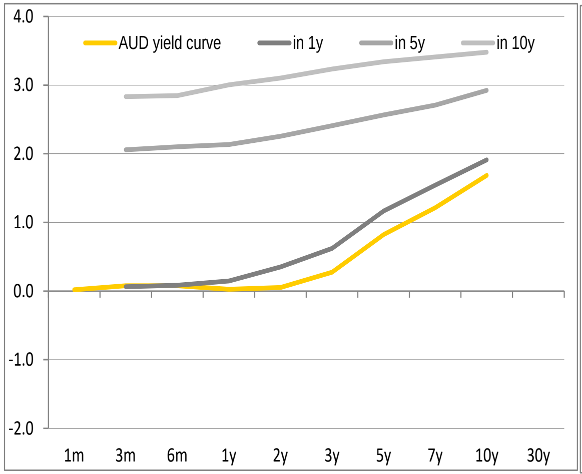
GERMANY



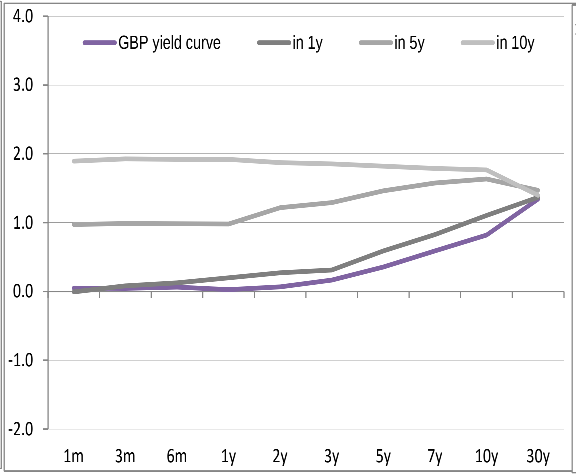
JAPAN



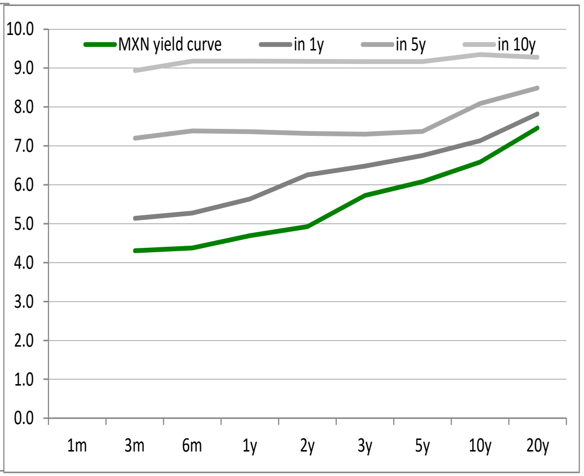
AUSTRALIA



UK



MEXICO



Fixed Income Strategy (2)

COUNTRY ALLOCATION

We have a slight preference for US over EU.

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

US long rates see inflation at target and a small real yield. If Fed policy works rates should sell off a bit more.

Euro rates don’t see the inflation target being met, on balance we think that is too pessimistic.

Central banks will not anticipate and will keep rates low until targets are reached. Yield curves will be steep.

Changes to inflation targets make nominal yield convergence less obvious, but the differences are stark.

CURRENCY

We have limited currency positions.

USD positives: stronger economy, higher long rates, will hike rates earlier.

USD negatives: current account deficit, overvalued, low rates and higher inflation not a good combination.

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

If growth gains traction and inflation starts to rise the EU will not be eager to raise rates.

A strong Euro being dependent on a weak economy is not obvious.

Equity

Equity Strategy (1)

GLOBAL

The global profit cycle is turning up again, supporting equities.

Earnings expectations continue to rise at a fast pace boosted by economic optimism.

Cyclical growth is the main driver lifting previous laggards and reducing the attraction of secular growth.

Positive news flow will stay with us for the near future, so equities will have support from news flow.

But it remains that the real damage that COVID has done to the economy or businesses is unknown.

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 29.7x is expensive, and the forward P/E has fallen to 19.8x.

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

Dividends need to grow as the cash is put to use.

Profit forecasts are not too excessive at present.

The next twelve months are forecast to see 50% profit growth, which is not ridiculous.

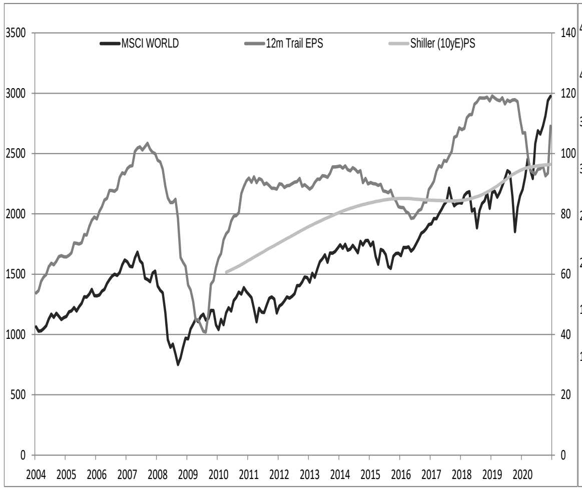
In 2018, before COVID appeared, MSCI World earnings were forecast to reach 140 on a P/E of 16x.

Currently forward earnings are at 150 on a P/E of 19.8x, is it too soon to see a new high in profits?

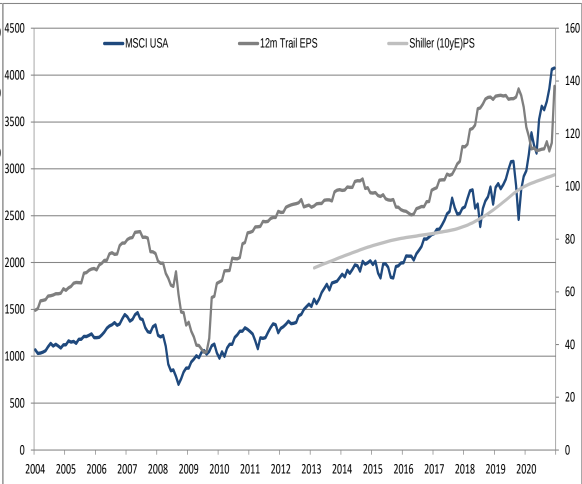
MSCI Equity Indices and Earnings (right hand axis)

Source: MSCI, Bloomberg,

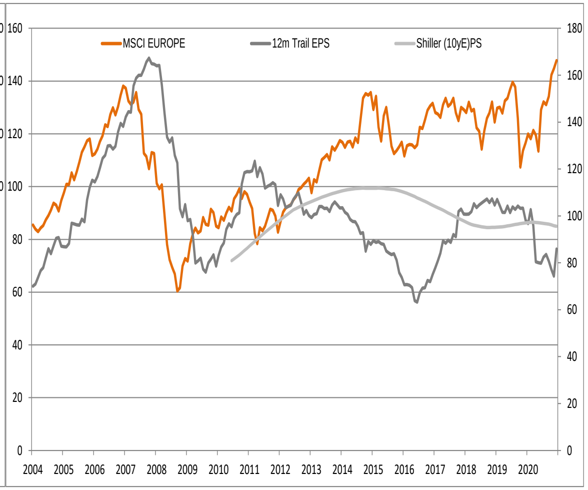
WORLD



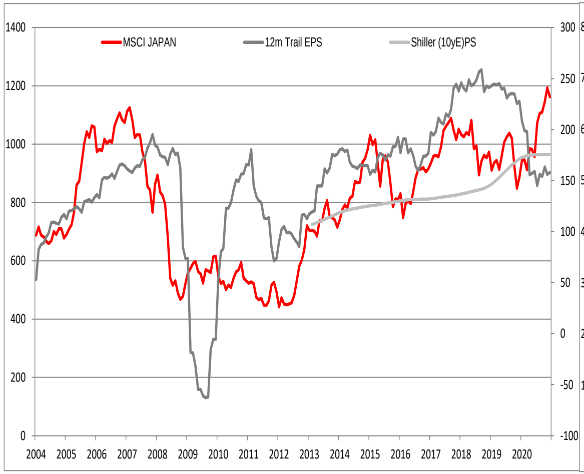
USA



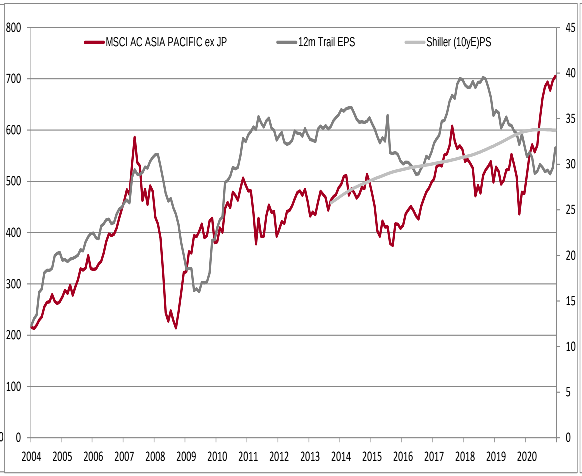
EUROPE



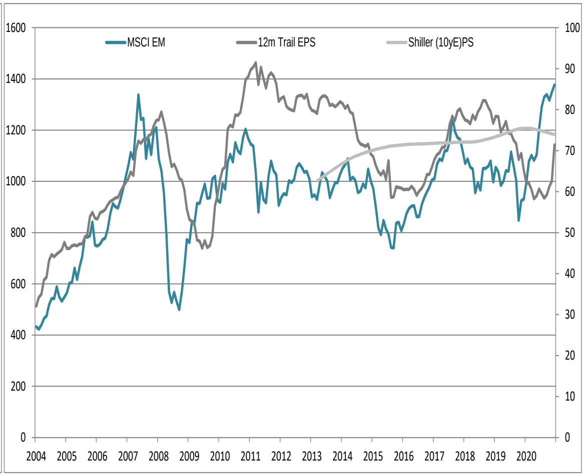
JAPAN



ASIA ex JAPAN



GLOBAL EMERGING



Equity Strategy (2)

SECTORS

Improved confidence in growth expectations has caused trends to reappraise.

Cyclical sectors are moving up, helped by rising earnings forecasts and expectations of higher interest rates.

Energy, Materials and Bank stocks are in demand, as relative earnings rise from lows.

Defensive Growth – Staples and Health Care are struggling as high valuations are de-rated.

Technology and other secular growth sectors are seeing weaker relative earnings trends, pulling down prices.

What is clear is that “Covid losers” are being picked up.

FACTORS

Trends are starting to reverse, cyclicality is winning the argument.

Value and Earnings Momentum are in favour through the cyclical bounce.

Value remains in demand – helped by rising interest rates and cyclical strength.

The revaluing of growth has just begun, what is an appropriate valuation for secular growth?

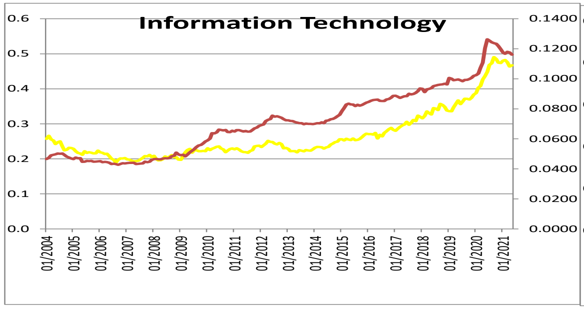
If growth is to be more prevalent as economic activity returns then expensive growth will be unattractive.

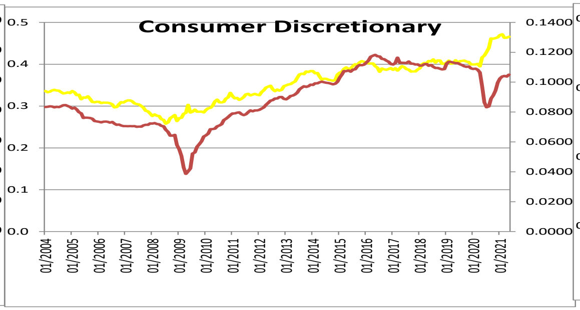
It is a time for investors to reappraise portfolios and probably avoid being underweight to Value.

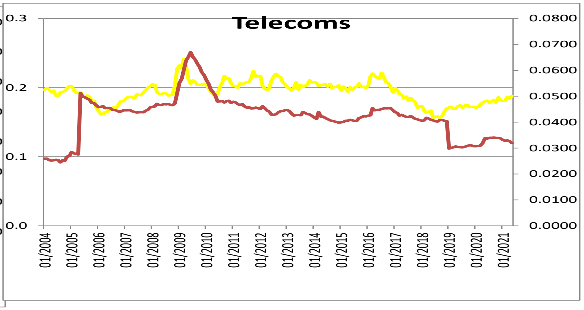
MSCI Equity Sectors Relative Performance and [E] Earnings(in USD)

Source: MSCI, Bloomberg,

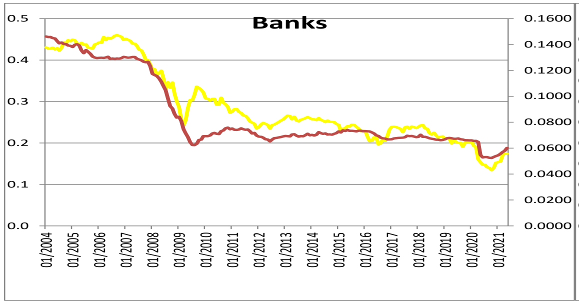
LEADERSHIP OVER?

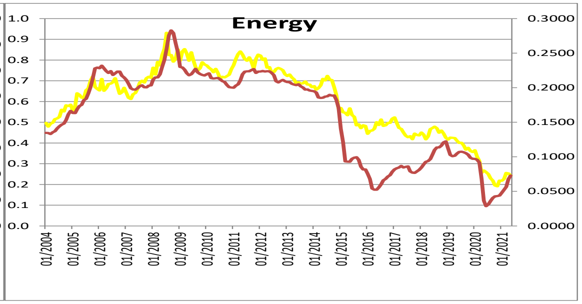


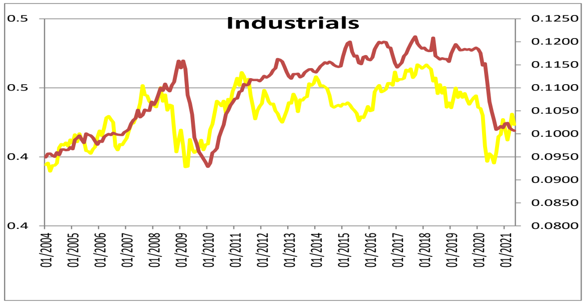




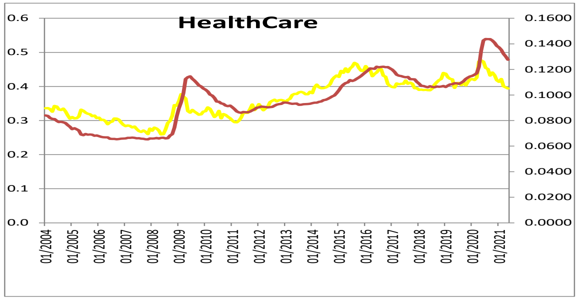
ON THE TURN?

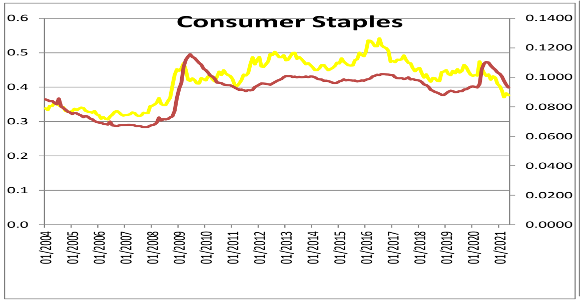


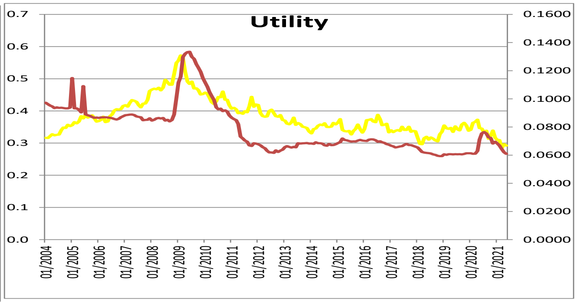




OUT OF FAVOUR



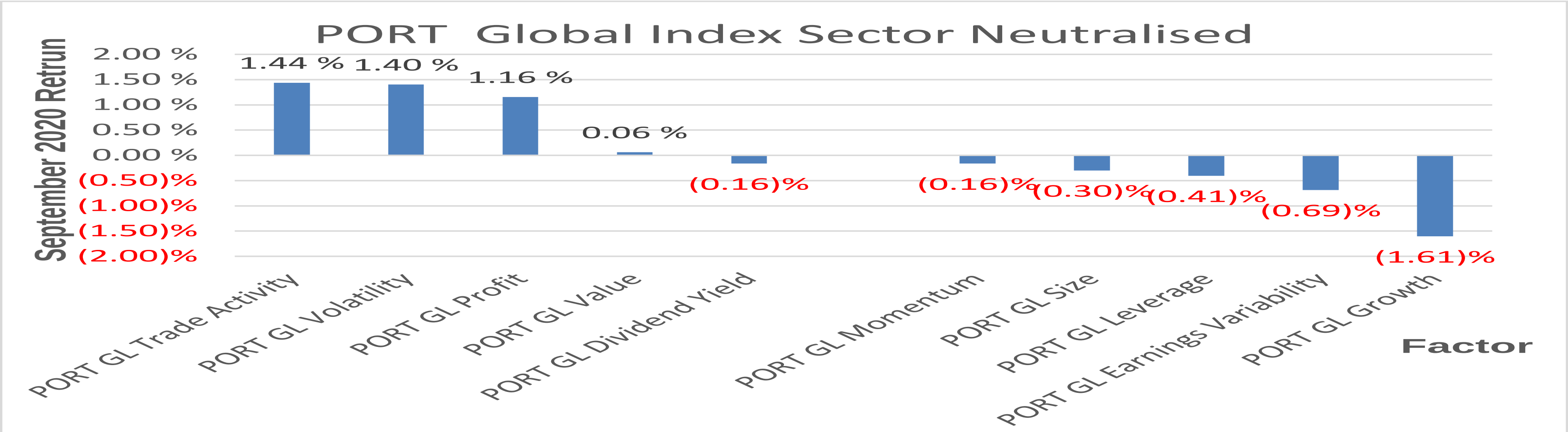




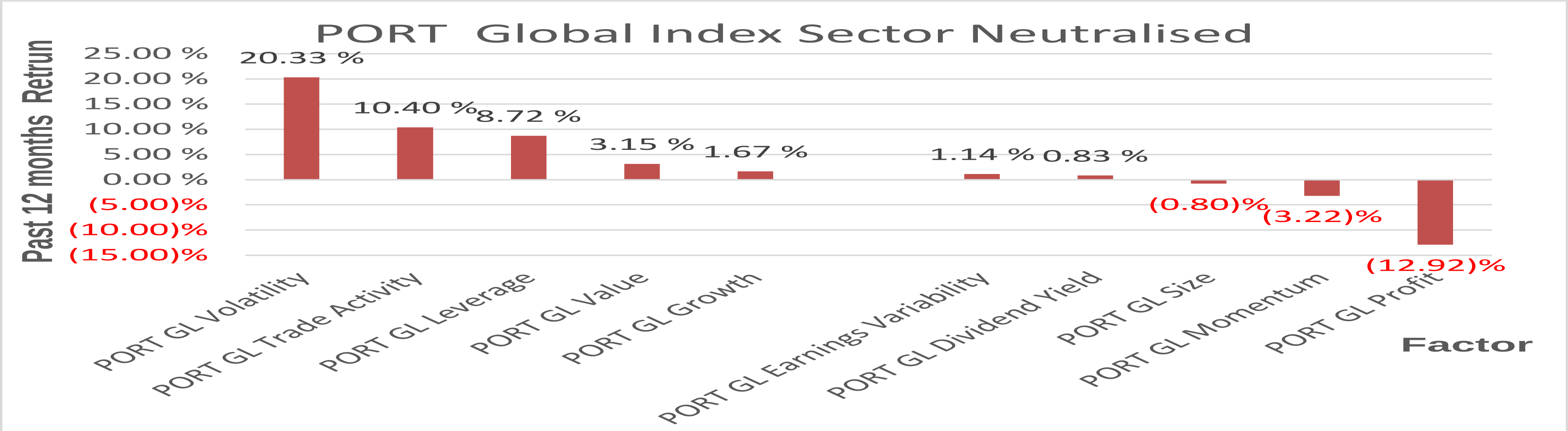
PORT Factor Analysis

Source: Bloomberg,

1 MONTH



PAST 12 MONTHs



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