# Market Review

as at March 31, 2021

Global stocks gained on expectations of a strong rebound in economic activity after lockdown restrictions are lifted across the globe. An unprecedented level of support from fiscal and monetary policy and the ongoing rollout of vaccine supply and distribution led the International Monetary Fund (the IMF) to forecast a 5.5 percent surge in global growth for 2021, the highest in five decades.

The MSCI AC World Total Return Index gained 4.6 percent over the quarter, and the S&P 500 and the Bloomberg European 500 Index rose by 6.2 and 8.1 percent respectively since the start of the year.

## Trouble in Bonds

Fixed income markets were less impressed with prospects of resurgent global growth however, with investors fearing that this time the growth dynamic may be different and inflation may surface. Longer-maturity US Treasury bonds took the brunt of the pain, slumping by around 15 percent since the start of the year.

Since long-dated US Treasury rates are the single most important metric in global finance, this requires some attention. Indeed, the US long bond encapsulates the two biggest fears of investors in the current climate; firstly, an uncontrolled surge in inflation, and secondly, a sharp escalation of the current bond market fallout, squeezing the cost of finance higher for the entire economy.

The market is concerned that the US Federal Reserve (the Fed) will make a policy error, let the inflation genie out of the bottle, which will have the knock-on effect of bringing forward its first rise in interest rates.

## Stimulus Remains Intact

The Fed expects surging economic growth of 6.5 percent this year, and inflation to break the 2 percent target. This is against a backdrop of unprecedented fiscal stimulus. The Biden administration passed the controversial $1.9 trillion stimulus bill, and is thinking of an additional $3 trillion on longer-term projects, such as the green economy.

These programs total to almost a quarter of US GDP. Yet the Fed stimulus package remains intact.

They're reticent to risk withdrawing policy support too soon, and indeed will have learned from the last crisis that inflation is not sensitive enough to demand pressure, to merit policy tightening at so soon a stage in a recovery.

In a bond market, which has normalized negative yields, the majority response to the uptrend in Treasury yields may well be for investors to buy into the longer end of the US yield curve. Indeed, the Financial Times report that a 1.7 percent yield on the 10-year US Treasury note is now higher than that of nearly 70 percent of all bonds in the Bloomberg Barclays Global Aggregate Index.

## Inflation Under Control, For Now

This recent rise in the US long bond yield should not give great cause for worry – as far as inflation is concerned, at least. In the face of expectations of such a buoyant economic rebound it would have been strange for there to have been little or no reaction.

Whilst the bond markets do seem overvalued – and may well decline further – these returns of the last quarter do not necessarily imply inflation is about to run rampant. For the bond market itself however, it presents an extremely challenging environment.

The most important leading indicator of broad-based inflation is wage growth. And the consensus amongst central bankers is that, in the current climate, the response of wages to unemployment is fairly tepid. The Fed, and other central banks, will be hoping that a strong upturn in growth and inflation is sustainable and will hopefully present them with the opportunity to raise rates without the stock market melting down. And if rates were to be well above their present levels, this would give them scope for greater manoeuvre in the future in response to unpleasant macro shocks.

## Stock Rotations

This resurgent economic growth in the US economy has also changed the dynamic of returns within its stock market. Investors have shifted their focus to so-called value stocks, that benefit from a cyclical economic rebound. The Russell 2000 Index – representing these stocks – surged 12.7 percent over the last quarter.

Meanwhile, the NASDAQ, having surged by a stunning 45 percent over the course of 2020, has lagged behind since the start of the year, returning 3 percent. Economic prospects in Europe also lag, with sentiment towards the euro, viewed through the pricing of derivative instruments, at its most bearish since July.

The yield on the German 10-year bond is now around 2 percentage points lower than that of the US Treasury note, illustrating a strong demand for Europe's safest debt. Relative to the US and the UK, continental Europe is perceived as failing to deal effectively with the pandemic.

Interestingly, the rotation in stocks in the European markets has started moving in the reverse of how they're moving in the US. Money has moved out of cyclical and into defensive stocks. For example, after an initial surge in the prices of European travel shares, on expectations of summer travel returning, they've now stalled as European countries extend restrictions, amid an ongoing and ugly squabble with the UK for limited vaccine supplies.

## A Changed Landscape

We've written in previous notes how this pandemic has hastened trends that were already well under way.

Any semblance of prudency over fiscal policy, for example, has now been completely abandoned. And the Fed has a very different philosophy from the days when warnings over the stock market's "irrational exuberance" was in concert with their traditional role. Nowadays the Fed's priority is to nurture an economic bounce and it is prepared to leave the stimulus "in place until the job is fully and truly done".

While this may lack nuance, and be a harbinger of difficulties further down the road, at least it's transparent, and certainly makes clear where the wind's blowing over the shorter term. Earnings momentum should gather and economically sensitive stocks and sectors should have the most potential to surprise on the upside as the economic and earnings cycles progress throughout the year.

# Macro Indices Report as at March 31, 2021 (%)

| | MAR | FEB | JAN | Q1 2021 | YTD | 2020 | Annualized 3 Years | Annualized 5 Years |
|---|---|---|---|---|---|---|---|---|
| **GLOBAL EQUITY** | | | | | | | | |
| MSCI AC World Total Return | 2.7 | 2.3 | -0.5 | 4.6 | 4.6 | 16.3 | 13.2 | 14.0 |
| MSCI EAFE | 2.4 | 2.3 | -1.0 | 3.6 | 3.6 | 8.4 | 7.1 | 10.2 |
| **NORTH AMERICA EQUITY** | | | | | | | | |
| S&P 500 Total Return | 4.4 | 2.8 | -1.0 | 6.2 | 6.2 | 18.4 | 18.3 | 17.0 |
| S&P 400 Net TR | 4.6 | 6.8 | 1.5 | 13.4 | 13.4 | 13.1 | 13.9 | 14.4 |
| RUSSELL 2000 INDEX | 1.0 | 6.2 | 5.0 | 12.7 | 12.7 | 19.9 | 15.5 | 16.9 |
| **EUROPE EQUITY** | | | | | | | | |
| BLOOMBERG EUROPEAN 500 | 6.2 | 2.7 | -0.9 | 8.1 | 8.1 | -1.7 | 7.9 | 8.7 |
| FTSE 100 INDEX | 4.2 | 1.6 | -0.8 | 5.0 | 5.0 | -11.4 | 2.8 | 6.4 |
| **ASIA EQUITY** | | | | | | | | |
| NIKKEI 225 | 1.3 | 4.8 | 0.8 | 6.9 | 6.9 | 18.3 | 13.2 | 15.6 |
| HANG SENG INDEX | -1.8 | 2.5 | 3.9 | 4.6 | 4.6 | -0.2 | 2.0 | 11.2 |
| SHANGHAI SE COMPOSITE | -1.9 | 0.7 | 0.3 | -0.9 | -0.9 | 16.5 | 6.0 | 5.5 |
| **SOUTH AMERICA & EM EQUITY** | | | | | | | | |
| MSCI EM Net Total Return USD Index | -1.5 | 0.8 | 3.1 | 2.3 | 2.3 | 18.3 | 7.3 | 13.0 |
| **FIXED INCOME** | | | | | | | | |
| ICE BoA 1-3 Year US Treasury Index | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 3.1 | 2.8 | 1.7 |
| Barclays US Agg | -1.2 | -1.4 | -0.7 | -3.4 | -3.4 | 7.5 | 4.8 | 3.1 |
| Barclays Multiverse (Unhedged) | -1.9 | -1.6 | -0.9 | -4.3 | -4.3 | 9.0 | 3.2 | 2.9 |
| Citi World BIG US Hedged | -0.4 | -1.7 | -0.6 | -2.7 | -2.7 | 6.2 | 4.6 | 3.3 |
| ICE BoA US High Yield Index | 0.2 | 0.3 | 0.4 | 0.9 | 0.9 | 6.2 | 6.6 | 8.0 |
| **COMMODITIES** | | | | | | | | |
| BLOOMBERG Commodity Index | -2.1 | 6.5 | 2.6 | 6.9 | 6.9 | -3.5 | -1.0 | 1.3 |
| GOLD | -3.0 | -6.5 | -1.3 | -10.4 | -10.4 | 24.6 | 9.3 | 7.0 |
| OIL (WTI) | -3.7 | 18.1 | 7.5 | 22.3 | 22.3 | -60.3 | -20.4 | -8.7 |

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