

# THE SECOND COMING



2021 Global Market Outlook – Q2 update



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# Synopsis

Vaccines and U.S. stimulus have the global economy on track for a strong rebound in the second half of the year. We expect the reopening trade to favour equities over bonds, the value factor over the growth factor and non-U.S. stocks over U.S. stocks.

## Key market themes

After last year's false start, the prospects for a sustained reopening of economies through the second half of 2021 are promising. The vaccination rollout, plus the latest U.S. fiscal stimulus package—to the tune of \$1.8 trillion—has sparked fears that economic growth will accelerate too fast, placing more upward pressure on interest rates. We agree that economies are poised to rebound sharply as restrictions are gradually lifted, but disagree that inflation pressures and interest rates are likely to increase significantly over the next 12 months. We believe it will take until at least the middle of 2022 for the U.S. economy to recover the lost output from the coronavirus-induced lockdowns—and even longer in other economies. Amid this backdrop, we believe that broad-based inflation pressures are unlikely to emerge until 2023—with late 2023 or early 2024 a more likely timing for the first U.S. Federal Reserve (the Fed) rate hike.

The vaccine rollout and large fiscal stimulus have upgraded our conviction in the cycle component of our cycle, value and sentiment (CVS) investment decision-making process. In our view, global equities remain expensive, though the very expensive U.S. market is offset by better value elsewhere. We see sentiment as close to overbought, but not near dangerous levels of euphoria. The strong business cycle gives us a preference for equities over bonds for the remainder of 2021, despite expensive valuations. It also reinforces our preference for the value equity factor over the growth factor and for non-U.S. equities over U.S. equities.

In the U.S., we think long-term interest rates are close to peaking for now, which means the catalyst for value outperformance is unlikely to be as powerful going forward. Even so, we still expect value to perform better than growth, as the value factor is still very cheap compared to the growth factor. In addition, we believe that the latest round of U.S. stimulus, plus the broader reopening from lockdowns, should boost the earnings growth of cyclical sectors such as materials and industrials, which comprise a high weight in the value index.



Europe's relatively slow vaccine rollout and smaller fiscal stimulus means it continues to lag the U.S. in terms of economic performance. However, its pace of vaccinations is increasing, putting the region on track for an economic reopening by the third quarter. We expect that the MSCI EMU Index, which reflects the European Economic and Monetary Union, should outperform the S&P 500® Index in 2021. Europe's exposure to financials and cyclically sensitive sectors such as industrials, materials and energy—in addition to its small exposure to technology—gives it the potential to outperform in the post-vaccine phase of the recovery, when economic activity picks up and yield curves in the region steepen.

In the UK, the FTSE 100 Index has reflected the worst performing regional equity market in recent years, but the outlook is improving in line with the economy. The FTSE 100 is the cheapest of the major markets in late March, and we expect UK corporate earnings are set for a substantial rebound after declining by 35% in 2020. The UK market is also overweight cyclical value sectors, such as materials and financials, that should benefit from a post-pandemic reopening.

We expect Chinese economic growth to be strong in 2021, boosted by the recovery in the global economy. While China-U.S. tensions continue to linger in the background, our base-case expectation is that there will not be any further escalation from the new U.S. administration during these early stages of the economic recovery.

We continue to think Japan's growth will significantly lag other major economies, although 2021 growth should still be above-trend. The slower vaccine approval process and subsequent rollout likely will push back the potential for some form of herd immunity.

GDP (gross domestic product) growth in Australia is likely to be lower than most other developed nations this year, but this is largely reflective of the country's smaller economic drawdown in 2020, due to lower COVID-19 infection rates.

In Canada, the improving business cycle supports cyclical sectors and the value factor. When combined with better relative value than U.S. equities, we believe Canadian equities likely will outperform their U.S. counterparts this year.

## Economic views



### STRONG GROWTH

We believe that U.S. real GDP growth of 7% is possible for 2021, which would be the best calendar-year outcome for the U.S. since 1984.



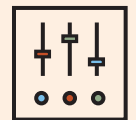
### INFLATION

We think the Fed's *average inflation targeting* approach means the central bank will wait until the consumer price index (CPI) measure of inflation has sustainably reached 2.5% before starting to tighten policy. In our view, this seems doubtful before late 2023.



### EUROPEAN RECOVERY

Europe's post-lockdown recovery is likely to be extremely strong. We forecast GDP to bounce back by around 5% this year, following 2020's decline of nearly 7%.



### CHINESE POLICY TIGHTENING

We expect China to be the first country to embark on policy tightening this year. Importantly, we think this will be a gradual process, and we anticipate that authorities will be sensitive to economic volatility and quickly ease back on tightening if there are signs of labor-market weakness.



### U.S. STIMULUS

U.S. stimulus is likely to boost growth in Japan, Europe and China by 0.5 percentage points over the next 12 months, and lift global GDP growth by just over 1 percentage point, according to the Organisation for Economic Co-operation and Development (OECD).

## Asset class views

### Equities: Preference for non-U.S. equities

We prefer non-U.S. equities to U.S. equities. The post-vaccine economic recovery should favour undervalued cyclical value stocks over expensive technology and growth stocks. Relative to the U.S., the rest of the world is overweight cyclical value stocks.

### Fixed income: Government bonds still expensive

Government bonds continue to look expensive, even after the recent selloff. Low inflation and dovish central banks should limit the rise in bond yields during the recovery.

### Currencies: U.S. dollar likely to weaken during recovery

The U.S. dollar should weaken later in the year as investors unwind Fed tightening expectations and as the global economic recovery picks up speed, given that it typically gains during global downturns and declines in the recovery phase. The main beneficiary of this is likely to be the euro, which is still undervalued. We also believe British sterling and the economically sensitive *commodity* currencies—the Australian dollar, the New Zealand dollar and the Canadian dollar—can still make further gains, although these currencies are no longer undervalued from a longer-term perspective.



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## IMPORTANT INFORMATION

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