

# THE SONG REMAINS THE SAME

## 2021 Global Market Outlook – Q3 update



# Synopsis

The global economic reopening remains on track as COVID-19 vaccination rates climb. While rising inflation has become a concern, the spike in prices looks transitory so far. Ultimately, we still like the pandemic recovery trade that favours equities over bonds, the value factor over the growth factor and non-U.S. stocks over U.S. stocks.

## Key market themes

With mid-June vaccination rates close to 50% in the United States and Europe, over 60% in the United Kingdom and beginning to finally accelerate in Japan, we believe the economic reopening should continue across the major developed economies through the second half of 2021. Amid this backdrop, the focus for markets has shifted to the strength of the growth rebound, the implications for inflation and the timing of central-bank moves to taper asset purchases and eventually raise interest rates.

Our view is that the inflation spike is mostly transitory, a combination of *base effects* - from when the U.S. consumer price index fell during the initial lockdown last year - and temporary supply bottlenecks. We believe that market expectations for the U.S. Federal Reserve (the Fed) to begin hiking rates in 2022 are premature. We expect the Fed to commence tapering in 2022, with the second half of 2023 the likely timing for the first interest-rate hike.

Our cycle, value and sentiment (CVS) investment decision-making process leads us to conclude that global equities remain expensive, with the very expensive U.S. market offsetting better value elsewhere. We see sentiment as close to overbought, but not near dangerous levels of euphoria. The business cycle is still in the early recovery stages following the lockdown-induced recession, with the strong cycle giving us a preference for equities over bonds for at least the next 12 months - despite expensive valuations. This also reinforces our preference for the value equity factor over the growth factor and for non-U.S. equities to outperform the U.S. market.

In the U.S., S&P 500® earnings growth shattered industry consensus expectations in the first-quarter (52% actual vs. 24% expected), and we expect the results for the second quarter to be considerably stronger as the reopening progresses. Strong earnings delivery will be particularly important for the U.S. market, given current valuations based on a range of standard valuation measures.



In Europe, the vaccine rollout has gathered pace and a more sustained reopening of economies is on track for the second half of the year. We expect the MSCI EMU Index, which reflects the European Economic and Monetary Union, to outperform the S&P 500 in 2021. The region's exposure to financials and cyclically sensitive sectors such as industrials, materials and energy - as well as its relatively 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 Europe steepen.

We believe the UK is set for a strong rebound in both gross domestic product (GDP) and corporate profits as it recovers from the dual headwinds of Brexit and the pandemic. The UK market is overweight the cyclical value sectors, such as materials and financials, that are benefiting from the post-pandemic reopening. We believe that financials should also be boosted by the improvement in interest margins from yield-curve steepening as the Bank of England moves closer to lifting interest rates (although we don't expect it to move before the Fed). The UK, as reflected by the FTSE 100 Index, is the cheapest of the major developed equity markets, and we think this should help it deliver higher returns than other markets over the next decade.

Chinese equities have struggled over the last couple of months, in part due to increasing regulation on Chinese technology companies - and in particular, their foray into financial services. Forecasting regulation measures is a difficult task, but our base assumption is that most of the regulation changes are behind us for now.

Regarding Japan, we expect a solid economic recovery through the back half of the year, boosted by strong global capital-expenditure spending and a return to services activity domestically.

The Australian economy continues to exhibit solid growth, and at mid-year has more people employed than before the COVID-19 outbreak. We expect that the Reserve Bank of Australia will continue its quantitative easing programme until the Fed begins to taper, and that a rise in the cash rate is still some way away.

In Canada, the revival of the domestic economy and the continuation of the global recovery are favourable conditions for cyclically oriented Canadian equities, particularly relative to U.S. equities.

## Economic views



### STRONG U.S. GROWTH

We expect strong economic growth in the U.S. through the second half of this year. Real GDP growth of around 7% for 2021 would mark the best outturn for the nation's economy since 1984.



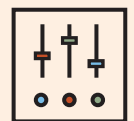
### INFLATION

We believe that the surge in inflation is mostly transitory, and that the major central banks, led by the Fed, are still two years from raising interest rates.



### 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 last year's decline of nearly 7%.



### CHINESE GROWTH

Our base-case outlook is for Chinese growth to remain solid through this year. There is still some catch-up potential from domestic consumption, and the production side of its economy should benefit from the global economic recovery.



### LONG-TERM RATES

We expect that long-term interest rates have modest upside over the next few months as global growth continues to improve. Our models suggest a range of 1.5% to 2.0% for the U.S. 10-year Treasury note over the remainder of the year.

## Asset class views

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

The post-vaccine economic recovery should favor 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

We view government bonds as expensive, and think that yields will be under upward pressure as output gaps close and central banks look to taper back asset purchases.

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

The U.S. dollar should weaken once investors have fully priced in Fed tightening expectations and as the global economic recovery becomes more entrenched. The dollar typically gains during global downturns and declines in the recovery phase. The main beneficiary is likely to be the euro, which is still undervalued. We also believe British sterling and the economically sensitive *commodity currencies*—the Australian dollar, New Zealand dollar and the Canadian dollar—can make further gains, although these currencies are no longer undervalued from a longer-term perspective.



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