# 2021 mid-year check-in

How we are managing our clients' portfolios

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In our last communication, we anticipated that 2021 would be a year of global economic recovery. Now, with vaccination rates close to 50% in the United States and Europe, over 60% in the United Kingdom, and finally set to accelerate in Japan, we have a positive outlook for economic growth across the major developed economies in the second half of 2021. While the reopening of the global economy faces uneven bumps in the road as regional efforts to tame the virus and lift restrictions vary, so has rising inflation reared its head; there are mounting concerns over whether central banks will prematurely curtail the economic growth rebound, via tapering asset purchases and raising interest rates. However, our view is that the inflation spike is mostly transitory, a combination of a data quirk known as "base effects"—which makes this year's gains look artificially high compared to the Consumer Price Index's fall during the initial lockdown last year—and temporary supply bottlenecks.

What's more, since the start of the global vaccine rollout, the markets have shifted with a rotation towards more cyclical areas. Value stocks, driven by vaccine tailwinds, have been a standout performer across all regions, whereas growth and momentum stocks—last year's strong performers—were the clear laggards as the market rotation picked up steam. Overall, we believe the pandemic-recovery trade should favor equities over bonds, value stocks over growth stocks, and non-U.S. stocks over U.S. stocks.

Here is how we are managing these shifts in our clients' multi-asset portfolios, using our cycle, valuation, and sentiment (CVS) investment decision-making process.

## Equities

### Preference for non-U.S. equities and shift to value stocks

We maintain our moderately risk-on positioning in our clients' portfolios relative to strategic levels, which is driven by our overweight to equities and, notably, our value managers. As the cyclical rotation trade continues, value managers have outperformed broad and style indices in our clients' portfolios, whereas growth managers have struggled to keep pace. Global equities remain expensive, with the very expensive U.S. market offsetting better value elsewhere. Because of this, we continue to prefer non-U.S. equities over U.S. equities as, overall, much of the rest of the world is overweight cyclical value stocks relative to the United States, which has a higher weight to technology and growth stocks. This has nuances regionally. For instance, we expect that the vaccine rollout in Europe, plus the fiscal boost from the European Union's recovery fund to support member states hit by the pandemic, will provide further support for value stocks and non-U.S. stock outperformance. By contrast, emerging market equities have lagged since the vaccine announcement, held back by the high weighting towards technology stocks in the emerging markets benchmark, concerns about slowing credit growth in China, and the slow regional vaccine rollout. Generally, we favor undervalued cyclical value stocks over expensive technology and growth stocks, as we believe there is strong potential upside.

## Fixed income

### Government bonds still expensive

We maintain our underweight to high yield credit in favor of equity risk as spreads are historically tight—back to pre-COVID levels—and have poor skew relative to equity risk, continuing the trend from late last year as equities outpaced high yield credit. We continue to view government bonds as expensive, and we think that yields will be under upward pressure as growth remains on track and investors refocus on how the Federal Reserve and other major central banks are deliberately putting themselves behind the curve to run high-pressure economies. High yield and investment grade credit are expensive on a spread basis but benefit from a positive cycle view that supports corporate profit growth and keeps default rates low. U.S. dollar-denominated emerging markets debt presents an attractive opportunity, as it is close to fair value in spread terms and should gain support on U.S. dollar weakness.

## Currencies

### Weakening U.S. dollar

We continue to hold our underweight to the U.S. dollar due to historically stretched valuations, in favor of funding overweights to the yen, the euro, and emerging-market currencies. We anticipate 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. We think the main beneficiaries of the global economic recovery are likely to be the Norwegian krone and the euro, which are still undervalued. We also believe the British sterling and the economically sensitive commodity currencies—including the Australian dollar, New Zealand dollar, and Canadian dollar—can make further gains, although these currencies are no longer undervalued from a longer-term perspective.

While efforts to loosen restrictions and tame the spread of new COVID variants vary across the globe, we believe the global economic recovery remains on track. We are optimistic this should lead to a staggered reopening of economies, creating volatility and opportunity.

Our seasoned team of investment strategists and portfolio managers will continue to monitor the markets and adjust portfolios to help ensure we are capitalizing on opportunities and managing risk below long-term strategic levels for our clients. At the end of the day, our focus is on empowering our clients, and making sure we're putting your money in the right place.

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First used: July 2021 AI-28921-07-24