MONTHLY HOUSE VIEWS

May 2021

Up?

Macro

Many recent business confidence surveys have reached multi-year highs – the US Institute of Supply Management's manufacturing index reached the highest level since 1983 in March – as rapid progress in vaccinations has bolstered confidence in cyclical recovery. Moreover, year-on-year growth figures in the second quarter will show an extremely strong rebound from 2020's recession low. Liquidity is abundant and fiscal spending is being ramped up – President Biden recently launched a $1.8 trillion (tn) programme to invest in education and families, taking total plans since December for new spending over the next few years to 36.5% of GDP. Despite the recent spike in coronavirus infections to new highs driven by India, we continue to expect a synchronised global recovery by year end.

Central Banks

Abundant liquidity, lavish fiscal spending and skyrocketing commodity prices have sparked a turn upwards in inflation expectations, leading many investors to fret about imminent tightening in monetary policy. Although the Bank of Canada recently started to reduce the pace of asset purchases ("taper"), we do not expect the Federal Reserve (Fed) or the European Central Bank (ECB) to follow suit for now. Indeed, the ECB recently announced a "significantly higher" pace in asset purchases over Q2 and the Fed still does not plan to raise rates before end 2023. Moreover, neither expects this year's spike in inflation to last. All in all, monetary policy is likely to remain extremely supportive for many quarters to come.

Markets

The macro environment should continue to foster risk appetite among investors. Cyclical recoveries tend to favour stock markets and inflows to equity funds worldwide have been robust – Bank of America calculates that subscriptions over the past five months have been higher than the aggregate over the preceding twelve years. Even if the spike in inflation does prove transitory, ultra-low bond yields do not look sustainable and we expect them to resume their rise, pushing bond prices lower. The difference in yield between corporate bonds and sovereigns (known as the "spread") remains narrow, offering little value for investors. We remain bullish on the euro against the US dollar – growth differentials should favour the single currency in the second half.

Bottom line

We have made no changes to our asset allocation this month. The environment continues to favour equities and we remain Overweight, with a focus on those markets – such as Europe and Japan – which should benefit most from cyclical recovery. We also continue to recommend a blend of "Value" – stocks which rank as cheap on ratios such as price-to-book-value, dividend yield and price-to-earnings – and fast-expanding "Growth" sectors in portfolios. We remain Underweight on bond markets – especially advanced economy sovereign bonds – while highlighting the attraction of some emerging market issuers, for example China. Among diversification tools, we are Neutral on both gold and hedge funds.

Unless otherwise specified, all statistics and figures in this report were taken from the following sources on 29/04/2021: Bloomberg and Datastream.

OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee

Summary house views

			Strong U/W	U/W	N	O/W	Strong O/W
EQUITY		**GLOBAL EQUITY**				X	
EQUITY		**United States**			X		
EQUITY		**Eurozone**				X	
EQUITY		**United Kingdom**				X	
EQUITY		**Japan**				X	
EQUITY		**Emerging**				X	
FIXED INCOME		**GLOBAL RATES**		X			
FIXED INCOME	SOVEREIGN	**U.S. Treasuries**	X				
FIXED INCOME	SOVEREIGN	U.S. Breakeven			X		
FIXED INCOME	SOVEREIGN	**Bunds**	X				
FIXED INCOME	SOVEREIGN	EMU Breakeven			X		
FIXED INCOME	SOVEREIGN	**Gilts**	X				
FIXED INCOME	SOVEREIGN	Gilts Breakeven			X		
FIXED INCOME	SOVEREIGN	**EM Govies ($)**			X		
FIXED INCOME	CORPORATE	**U.S. IG**		X			
FIXED INCOME	CORPORATE	**U.S. HY**		X			
FIXED INCOME	CORPORATE	**EMU IG**		X			
FIXED INCOME	CORPORATE	**EMU HY**		X			
FIXED INCOME	CORPORATE	**UK IG**		X			
FIXED INCOME	CORPORATE	**UK HY**		X			
FIXED INCOME		**Duration USD***		X			
FIXED INCOME		**Duration EUR***		X			
FIXED INCOME		**Duration GBP***		X			
FOREX		**EURUSD**				X	
FOREX		**USDJPY**			X		
FOREX		**GBPUSD**			X		
FOREX		**EURCHF**				X	
FOREX		**EM FX (vs. USD)**			X		
CMDTY		**Brent**			X		
CMDTY		**Gold**			X		
ALTERNATIVE		**ALT. STRATEGIES**			X		
ALTERNATIVE		**L/S Equity**			X		
ALTERNATIVE		**Event-Driven**				X	
ALTERNATIVE		**FI Arbitrage**			X		
ALTERNATIVE		**Global Macro / CTAs**			X		

	Positioning	*Duration
O/W	Overweight	Long – 7-10 years
N	Neutral	Intermediate – 5-7 years
U/W	Underweight	Short – 3-5 years

EQUITIES	
United States	We remain Neutral on US equities, which reached new all-time highs in mid-February and stress the importance of diversifying into more cyclically-sensitive, undervalued sectors.
Eurozone	Eurozone equities resumed the outperformance begun in November as markets reacted to excellent vaccine trial results. We continue to be Overweight the region with a preference for more cyclically-sensitive sectors.
UK	We remain Neutral given stringent lockdown restrictions and Brexit disruptions, which will have a strong impact on the UK economy.
Switzerland	The market is dominated by high-quality, defensive stocks, which should help cushion any downside.
Japan	We remain Overweight on Japanese equities, which recently reached levels not seen since early 1991 but this time without any exaggeration in valuations.
Emerging (EM)	We expect a stronger recovery in growth in Emerging countries than in advanced economies. We continue to hold a strong Overweight position.

FIXED INCOME	
Sovereigns	Government bonds remain unattractive, offering negligible or negative yields to investors. We are Strong Underweight.
Duration*	We still prefer shorter-dated bonds across markets, which are less sensitive to any rises in rates.
Inflation-linked	Inflation is likely to return to lower levels after this spring's spike higher. We are Neutral.
Investment Grade	Spreads have tightened further towards historic lows. We remain Underweight.
High Yield	High Yield remain close to historic lows and we've stuck to an Underweight stance.
Emerging debt (in € and $)	We continue to recommend a Neutral position, with a particular focus on Asian issuers given better macro fundamentals.

CURRENCIES	
EUR/USD	We expect range-bound trading, but the second half of the year should favour the euro zone as it begins to catch up with the US in vaccinations and economic growth.
GBP/USD	Sterling has gained 1% over April thanks to signs of strong recovery from the coronavirus crisis.
EUR/GBP	Post-Brexit disruptions may weigh on sterling against the euro in coming months.
USD/JPY	We forecast that USD/JPY will consolidate just below current levels but expect increased volatility as risk sentiment waxes and wanes.
EUR/CHF	We expect a sharp economic recovery in the euro zone in H2 which should further alleviate any lingering upward pressure on the franc.
Emerging	With US rates set to grind gradually higher, we expect EM currencies to trade sideways for now.

ALTERNATIVES	
Hedge funds	Our preferred strategies are Special Situations, directional L/S Equity, discretionary Global Macro and CTAs.
Gold	We expect a decline in real rates, which should help gold prices consolidate their recovery from March's lows.
Oil	Rising oil demand as economies reopen will be met by increased output, leaving prices in a range.

Source: SGPB, 30/04/2021
* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years
HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)

ECONOMIC OUTLOOK

Spring in the Air

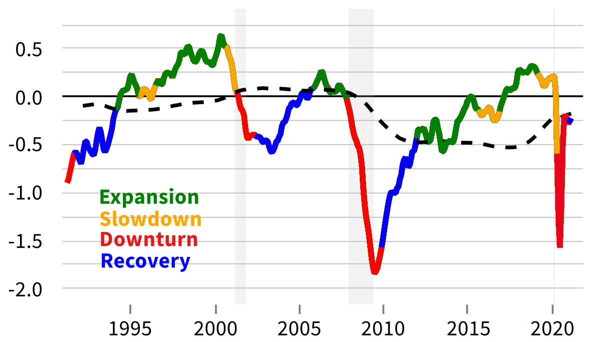
A robust macroeconomic backdrop continues to anchor the dazzling momentum in risk assets as a renaissance in global demand for goods is met by accelerating appetite for services whilst lockdowns ease and vaccinations proliferate.

The momentum from a buoyant first quarter has carried through into the spring with April witnessing another strong month for both global economic indicators and risk assets. While manufacturing has been in a renaissance of sorts since last year with global demand for physical goods soaring following the pandemic, demand for services – the bulk of economic activity in advanced economies – also appears to be accelerating now as lockdowns ease and vaccinations proliferate.

In the euro zone, the Purchasing Managers Index (PMI) for services rose to 50.3 last month – with 50 marking the dividing line between growth and contraction, this is the first expansionary signal since last August. In China, consumer sentiment strengthened to the highest on record in February amid hopes of post-pandemic recovery, pushing the services PMI up to 54.3. The recovery in services confidence in the UK and US is even more extraordinary, with each registering PMI figures above 60 in April. It is no coincidence that both lead the world's large countries in terms of vaccinations, with the UK and the US having administered at least one dose of a coronavirus vaccine to huge swathes of their respective populations (50% and 42%).

The resurgence in services is a critical factor behind what is a spectacular macroeconomic surge. In April, the International Monetary Fund upgraded it global growth projections to 6% for 2021 and 4.4% in 2022. This growth is also translating into strong corporate earnings. For US equities, the earnings growth rate for this year is expected to be about 27%, followed by 13% next year; the 52-week forward expectations for revenues, profit margins and earnings have all risen to record highs. The euro zone and the UK should also have banner years for earnings growth, 38% and 55%, respectively, albeit from deeper troughs.

Our macro cycle indicator shows we are back in recovery territory



Source: SGPB, Macrobond, 30/04/2021

For now, this robust macroeconomic backdrop continues to anchor the dazzling momentum in risk assets. Admittedly, valuations for these assets are elevated by any historical measure, which is a cause of concern. However, we have been tolerant of higher valuations given what remains a historically low interest rate environment – future cash flows are worth more when discounted by lower rates, leaving low-yielding fixed income assets looking relatively unattractive.

We are also cognisant of the dangers. With such a strong economic backdrop, further rises in rates are possible, which is one of the chief risks for the ongoing bull market and its extended valuations. Nonetheless, we remain sanguine and believe it unlikely that rates will skyrocket for many months to come, if not years. This is primarily guided by our view that inflation expectations should remain anchored at low levels. This year should see higher prices as economies reopen and pent-up consumer demand is unleashed, but this should prove transitory – gaps between actual and potential output still gape wide, there is enormous slack in the labour market and huge underutilised capacity in commercial real estate.

Bottom line. Historic highs in business sentiment mean that there is little room for higher euphoria levels and we would expect PMI surveys to ease lower by year end. Nonetheless, our macro cycle indicator shows we are still in recovery territory (see chart), typically a supportive environment for risk assets. Despite the concerns raised by extended valuations and investor complacency, we continue to call for a "risk-on" stance in asset allocation.

FIXED INCOME

Little Appeal

Today's environment of reflating economies and spiralling debt issuance to finance fiscal largesse presents a challenging backdrop for bonds. Our convictions are unchanged – Strong Underweight in sovereigns and Underweight in "credit" (i.e., IG and HY corporate bonds).

Sovereigns

US. After a rapid rise from 0.51% last August to 1.74% at end March, 10-year Treasury yields have paused for breath as bond prices have recovered (yields move inversely to prices). These moves have been driven by rising inflation expectations – fiscal spending is massive and raw material prices are rising sharply – and the dissipation of pandemic worries as investors look forward to steady reduction in lockdown restrictions. Although we expect this year's rise in inflation to be transitory (see Economic Outlook on page 5), we see Treasury yields trending higher towards 2.0% over the next year.

Eurozone. Yields on 10-year German Bunds have followed a similar upward trajectory to US Treasuries, recently matching end-2019 levels at -0.20%. The size of the move has been more modest than in the US, given that deflationary factors are more firmly entrenched in the euro zone which remains mired in recession. Moreover, the ECB has stepped up the pace of its €1.85 tn asset purchase programme to €24.9 bn per week since Easter versus a €18.3 bn average in February, helping keep yields low. Nonetheless, with cyclical recovery looming in the second half (H2), we expect Bund yields to follow Treasuries higher.

UK. The yields on 10-year sovereign bonds ("gilts") have also risen sharply from last August's all-time lows of 0.08% to 0.85%. Investor confidence has been bolstered by the UK's world-leading progress in vaccinations but inflation expectations are also a factor – 10-year breakevens (calculated by subtracting yields on inflation-linked bonds from those on fixed-coupon gilts) has risen to 3.49%, close to the highest level since 2008.

After a rapid rise, 10-year Treasury yields have paused

Source: SGPB, Macrobond, U.S. Department of Treasury, 29/04/2021

Credit

US. We moved Underweight in IG bonds in early January, judging that tight yield spreads offered little protection against any rise in Treasury yields and so it has proved – the sector has registered negative performance year-to-date. Looking ahead, spreads have tightened further to 96 bp, close to 2018's historical lows, and we see little reason to change stance. HY spreads at 294 bp are close to 2007's pre-crash lows and also offer little appeal.

Eurozone. Yields on euro IG bonds have risen modestly from -0.02% in mid-December to 0.16% and remain deeply unattractive with headline inflation set to rise further from March's 1.3%. Downside in prices will be cushioned by faster ECB purchases but we remain Underweight. HY bonds in EUR have registered steady performance in recent months on the coattails of the rally in euro zone equities. However, yields remain close to historic lows and we've stuck to an Underweight stance.

UK. IG spreads over gilts are back at historical lows as are those on speculative-grade bonds, offering little value for income-seeking investors. The macro backdrop remains supportive but such narrow spreads will provide little protection if conditions deteriorate, for example if inflation were to break decisively higher. We remain Underweight.

Emerging Market (EM) debt

Despite rising US rates, EM sovereign bonds in USD still look attractive, offering yields of around 4.5%. Our preferred region is Asia where credit quality is generally higher and where the macro backdrop remains supportive. Among local currency bonds, we highlight the attractions of Chinese government bonds, where yields have held steady this year around 3.2% and which offer potential currency gains.

EQUITIES

Uptrend Intact

Inflows to global equity markets have been extremely strong since November's vaccine announcements, pushing many indices to all-time highs. Year-on-year (YoY) comparisons in GDP and earnings growth will reach their highs in Q2. Investors should rotate portfolios towards a balanced mix between Growth and Value.

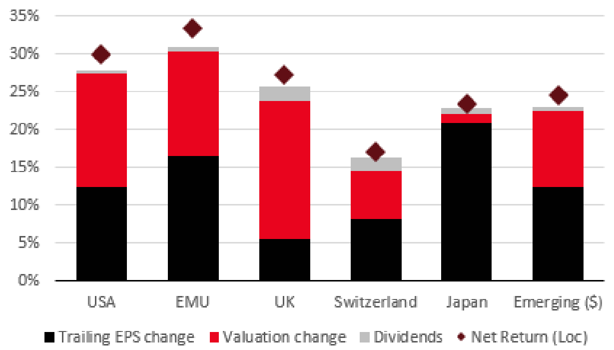
US. With US Treasury yields easing lower in April, stocks rallied hard to reach new all-time highs. Rising yields are a key risk for equity valuations – a higher discount rate reduces the net present value of future cash flows. Optimism was also bolstered by robust corporate profits for Q1 – with over half of S&P 500 members having reported, earnings are up 52% YoY, 24% higher than consensus forecasts.

Valuations, however, are demanding – the price-to-cash flow ratio is currently 49% above its average over the past decade – and signs of exuberant optimism abound with speculation rife in large and small companies alike. We continue to encourage investors to balance portfolios between Growth – where we find much of the overvaluation – and Value in more cyclically-sensitive sectors like Consumer Discretionary, Materials or Energy. Looking ahead, we believe that investors will rotate portfolios away from the US to diversify in laggard markets like Europe and Japan and, as a result, we remain Neutral.

Eurozone. In late April, euro zone equities reached their highest level since early 2008 on the back of rising optimism about post-pandemic recovery. Vaccination programmes accelerated last month helping bring new COVID-19 infection rates down and governments have begun to announce roadmaps for easing lockdown restrictions. We expect a synchronised global recovery in H2 with economies which suffered deep recessions (such as the euro zone) outperforming those where the downturn was milder (for example, the US).

Moreover, the sector breakdown across euro zone markets is skewed towards more cyclically-sensitive Value stocks. As a result, the analyst consensus expects a sharp acceleration in euro zone earnings growth this year to 38.4%, outstripping the 26.9% growth they forecast for US equities. Valuations no longer look cheap but the index pays an estimated dividend yield of 2.7%, an attractive source of income compared to high-quality corporate bonds paying only 0.16%. We remain Overweight.

Performance breakdown (in local currencies) since November 2020



Source: SGPB, Macrobond, MSCI, 29/04/2021

UK. We keep our Overweight in UK equities. Earnings growth this year will outstrip most other developed markets – the consensus expects +54.5% YoY – and the UK is the cheapest market we follow. It trades on a 6% discount in price-to-cash flow compared to the last decade's average and pays a 4% dividend yield. With over half of the population having received at least one vaccine jab, the country is gradually easing lockdown restrictions which should boost cyclical recovery and bolster investor sentiment.

Switzerland. Swiss equities proved their resilience during the COVID-19 crisis as investors sought exposure to high-quality defensive stocks. Since the announcement of successful vaccine trials in early November however, Swiss stocks have lagged more cyclically-sensitive markets elsewhere in Europe. Fundamentals remain solid – net profit margins recently reached new highs – which should provide downside protection.

Japan. After tracking global stock markets closely since end 2019, Japanese equities underperformed in April, with no real catalysts other than some modest JPY strength against the dollar and the reintroduction of pandemic restrictions. Analysts have continued to revise earnings forecasts higher – +5.7% over the past three months – while valuations remain relatively attractive. Japan is well-positioned to thrive on strong Asia-Pacific trade and growth and we remain Overweight.

Emerging Markets. After peaking in mid-February, EM equities have given up part of their outperformance over the past twelve months. Nonetheless, we remain constructive. The International Monetary Fund recently upgraded its 2021 GDP growth estimate to 6.7%. Analysts continue to revise earnings expectations higher, particularly in Latin America and Eastern Europe (+13.9% and +13.4% respectively over the past 3 months). And valuations remain reasonable at 14.7 times 12-month forward earnings. EM look set for long-term outperformance and we remain Overweight.

CURRENCIES

FX to Follow Growth Differentials

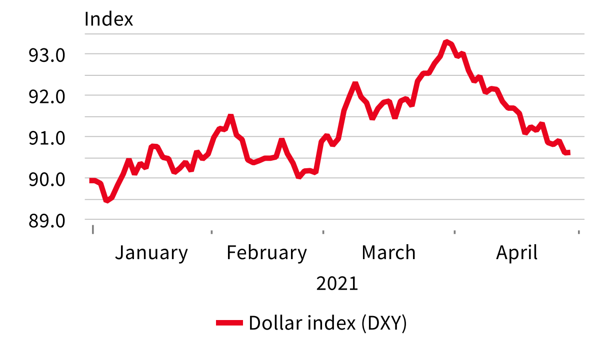
With US Treasury yields easing lower, the dollar has followed suit, enabling both developed and emerging market currencies to regain some ground. We expect a synchronised cyclical recovery in H2 which should trigger another bout of weakness in the dollar.

Dollar Index. Following a precipitous fall last year, the trade-weighted US dollar has regained its composure, up about 1% year-to-date. However, April once again witnessed a sell off as fears of dollar debasement in the face of enormous US stimulus were raised. Collectively, President Biden's spending plans equate to about 27% of GDP, pushing up inflation expectations which, in turn, are pushing real yields on 10-year US Treasuries back down to about -0.80%.

EUR/USD. April saw a strong surge in the euro, with the single currency rising by over 3% from $1.17 to $1.21, crossing the psychological $1.20 hurdle and reversing much of its year-to-date losses. However, the euro zone is not out of the woods – GDP contracted by 0.6% over the first quarter, lagging well behind the US which grew 1.6%. For now, we expect range-bound trading, but the second half of the year should favour the euro zone as it begins to catch up with the US in vaccinations and economic growth.

GBP/USD. The UK shows signs of strong recovery from the coronavirus crisis. The composite purchasing managers index (PMI) rose to 60 in April, from 56.4 the previous month and the highest level since November 2013. Moreover, with restrictions on mobility and social interaction coming down, retail sales in Great Britain rose 5.4% in March compared with the previous month, far above the 1.5% expected. Sterling has gained 1% over April, but GBP/USD is still struggling to break above 1.40 for now.

The US dollar has fallen back against major currencies



Source: SGPB, Macrobond, ICE, 29/04/2021

USD/JPY. USD/JPY has retreated from overbought levels in late-March around 111 after a rapid Q1 rally from 103 in early January to settle just under 109 in April. However, expectations of US fiscal spending and reflation have widened Treasury yield differentials versus Japanese Government Bonds, and that should keep the US dollar well bid. Looking ahead, we forecast USD/JPY to consolidate just below current levels but expect increased volatility as risk sentiment waxes and wanes.

EUR/CHF. As we expected, the EUR/CHF exchange rate has continued to consolidate in a very narrow band between 1.10 and 1.11 after shooting up from 1.08 to 1.11 in February. With the euro resurgent against the greenback in recent months, the Swiss National Bank has been able to wind down its currency interventions for now. We expect a sharp economic recovery in the euro zone in H2 which should further alleviate any lingering upward pressure on the franc.

EM currencies. With US Treasury yields easing lower over April, JP Morgan's index of emerging currencies has regained much of the ground lost in March – as many emerging nations borrow in greenbacks, traders fear periods of rising rates and dollar strength. Fundamentals remain mixed – Turkey's President recently fired its central bank governor, who had attempted to raise rates to buttress the currency and cap inflation, whereas Brazil, Mexico, Indonesia and India have all seen dramatic improvement in their current account balance during the pandemic. With US rates set to grind gradually higher, we expect EM currencies to trade sideways for now.

USD/CNY. Economic activity in China has snapped back from 2020's draconian lockdown – YoY growth hit 18.3% in Q1 while the trade surplus continues to grow – and the authorities have begun to roll back some of last year's policy easing measures. This stands in stark contrast with Washington's fiscal profligacy and chronic trade and current account deficits. Chinese government bonds still yield a healthy premium to US Treasuries and it is no surprise that the CNY looks like resuming its upward march against the dollar.

ALTERNATIVES

Rising Jewellery Demand for Gold

Rising oil demand as economies reopen will be met by increased output, leaving prices in a range. Gold prices should stabilise once real rates fall back. In hedge funds, our preferred strategies are Special Situations, directional L/S Equity, discretionary Global Macro and CTAs.

Commodities

Oil

At their meeting in late March, OPEC and its allies (OPEC+) decided to commence gradual increases in output, by 350,000 barrels per day (b/d) in May, another 350,000 in June and over 440,000 for July. The cartel and Russia believe that demand should continue to recover steadily – the US and UK have made rapid progress in vaccinating their populations and have eased travel restrictions, helping improve mobility measures and thirst for oil.

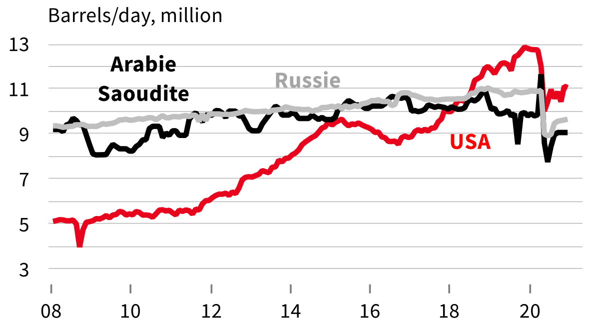
Despite the recovery in oil prices – up 32% year-to-date – the increase in US oil rigs has been sluggish since last summer's lows. It takes time and capital to add new rigs and numbers remain around 50% below pre-pandemic levels. As a result, US output remains around 2 mb/d below pre-crisis levels, which has probably emboldened OPEC+ in its increases – major players like Saudi Arabia are reluctant to let prices rise too high for fear of encouraging a new US shale boom.

Nonetheless, we expect US production to rise steadily from here along with additional OPEC+ increases, which will help meet post-pandemic demand. All in all, Brent prices should continue to trade between $60 and $70 /b in coming months.

Gold

Central bank gold purchases continued their recovery in Q1, up 20% to 95 tonnes (t). However, buying remained well below the 250t record highs in Q3 2018. The -10% fall in gold prices in Q1 sparked heavy outflows of -178t from gold-backed ETFs – bullion came under pressure as real rates (i.e., after inflation) rose steadily over the quarter.

Oil production has started to increase



Source: SGPB, Macrobond, EIA, 03/2021

On the other hand, demand for gold bars and coins was stimulated by lower prices and investors accumulated an aggregate 340t over the quarter, well above the 5-year quarterly average of 249t. Jewellery demand also continued its recovery from last year's slump, up 52% YoY to 477t. The improvement was particularly noteworthy in China – where demand reached 191t, the highest quarterly total since 2015 – and India, thanks to a cut in import duties.

Looking ahead, we expect a decline in real rates – 10-year yields should continue to rise but inflation is likely to rise faster over spring and summer – which should help gold prices consolidate their recovery from March's lows.

Hedge funds

Long/Short (L/S) Equity

Our Neutral allocation is split between an Overweight view on more Directional managers and an Underweight in Market Neutral funds, which hedge out most exposures to swings in the market. The former should benefit from the bull market in global stocks while the latter face rapid switches between sectors and style factors, although their bias to Value may help.

Event Driven

The environment remains supportive. 2021 has been a record year so far for M&A, while Merger Arbitrage managers have also traded successfully in SPACs (Special Purpose Acquisition Companies, newly-listed stocks which seek mergers with promising private companies). Special Situations funds also remain attractive – their idiosyncratic positions are often difficult to hedge, leaving sensitivity to rising stock markets.

Fixed Income Arbitrage

The opportunity set for L/S Credit is constrained by a backdrop of rising Treasury yields and fundamental support for historically tight credit spreads. There is little room for spreads to narrow further in USD or EUR but abundant liquidity and cyclical recovery should prevent much widening in coming months.

Global Macro / CTAs

Trend-followers (known as Commodity Trading Advisors, or CTAs) have built positions in solid momentum in commodities and equities, which should continue to drive returns, but have little exposure to rates or currencies. Among Global Macro managers, we continue to prefer discretionary traders to systematic funds, given their greater ability to take tactical advantage of new opportunities.

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