STONEHAGE FLEMING

5 April 2021

Dear Equity Client

GLOBAL EQUITIES – 1st Quarter 2021

World equity markets continue their recovery on an improving economic outlook. The MSCI World Index (including Emerging Markets and dividends) increased +4.6% (US$ terms, +3.4% UK£ terms) over the quarter.

This optimism is based on the successful rollout of vaccination programmes and high expectations of rapid economic recovery, especially in the US economy with strong stimulatory support from the new administration. Consensus twelve month forward earnings expectations for the S&P 500 Index already exceed pre-pandemic expectations while the consensus bottom-up valuations for the MSCI AC World Index exceed the pre-pandemic peak level by a fifth. The World index's price level currently is +17% against its pre-pandemic peak level. There is clearly material optimism in the equity markets.

This optimism about the economic outlook also reflects well in the US bond market, the world's most liquid and effective market. The ten-year Treasury yield has almost doubled from 0.91% to 1.74% over the quarter alone. This has brought the bond market the closest to a bear market (-20% from its peak price level) environment in forty years.

Inflation fears are becoming more widespread. Analogies with the seventies following the strong fiscal and monetary support and social welfare spending during President Nixon's reign are being drawn. Current inflation expectations (as reflected in breakeven rates) have increased in excess of pre-pandemic levels. The current big question in the equity markets therefore is whether bond vigilantes have enough ammunition to take the US bond market into a prolonged bear market and, if so, the potential negative implications on equity valuations.

We would caution against a direct seventies' analogy. The Dollar was materially overvalued then and the breaking of its last link to Gold triggered a collapse in the currency, with inflationary effects. The oil price increased from $1.8 to $11.6 in a matter of only three years. The Dollar is currently lower valued, and the oil price has been relatively stable for five years. Further to this, very importantly, Technology has become the world economy's 'new oil' with its cost effectiveness increasing rapidly.

The US bond market is currently mirroring its reactions following the Credit Crisis. Inflation then marginally exceeded the Federal Reserve's target for a short period, and subsequently receded. Seeing inflation's very low recent readings during the recession, upcoming data may well spike beyond the Federal Reserve's target rate and continue to unsettle some investors' nerves in the process. It is, though, our perception that the bond market is currently more reflective of a normal economic recovery process, and we are not yet convinced that excessive structural inflation is an imminent threat. A debate around the level of sustainable US economic growth may also become a factor and we remain comfortable investing for sustainable growth, rather than simply for a cyclical recovery.

We remain grateful for all your support.

With best wishes.

Gerrit Smit
Partner – Head of Equity Management

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