KEY FAMILY PARTNERS

Global Market View

August 2020

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GUIDE TO RATINGS

Positive View

🟢 Market expected to provide better than normal returns for that market

Neutral View

🟡 Market expected to provide normal returns for that market

Negative View

🔴 Market expected to provide below normal returns, or negative returns

Ratings are not bound by a specific timeframe; they will change when fundamental conditions change

GLOBAL ECONOMY

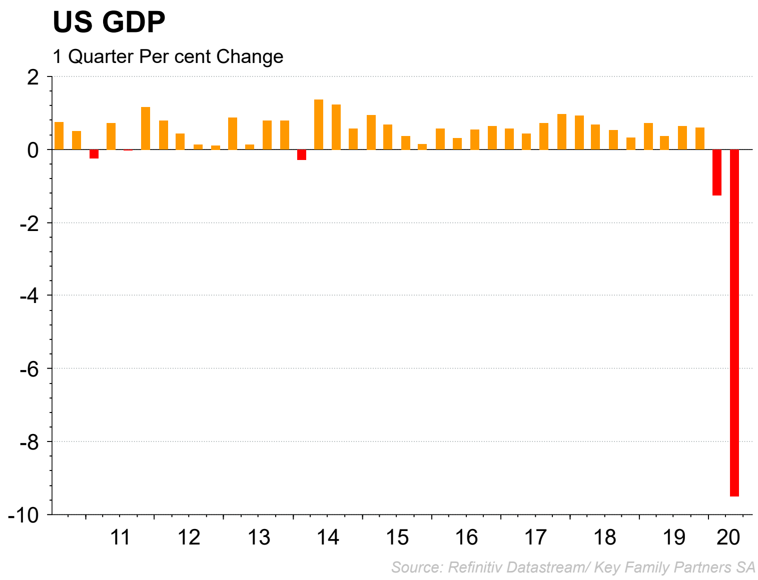
Pandemic records

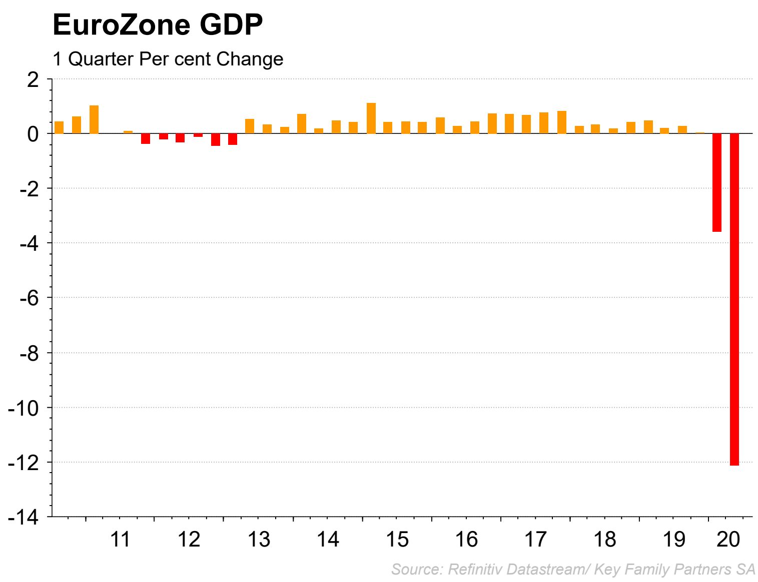
As economic data for Q2 comes in, mainly negative records on growth, corporate earnings and other measures are being set daily – as expected perhaps given the severity of the economic impact of lock down measures in many countries.

In the US, Q2 GDP growth fell at an ANNUALISED rate of -32.9%, leaving the economy -9.5% smaller than in the same quarter in 2019 and back to 2014 real GDP levels. This rate of contraction is the fastest ever seen and confirms the severity of the recession seen in the US. Q2 corporate earnings are down -39.1% on prior year, based on S&P 500 earnings releases to date.

In the EZ, a similar story has been written where the economy contracted -12.1% in Q2 over Q1, which was also negative by -3.6%. Again, this was record territory for the EZ economy.

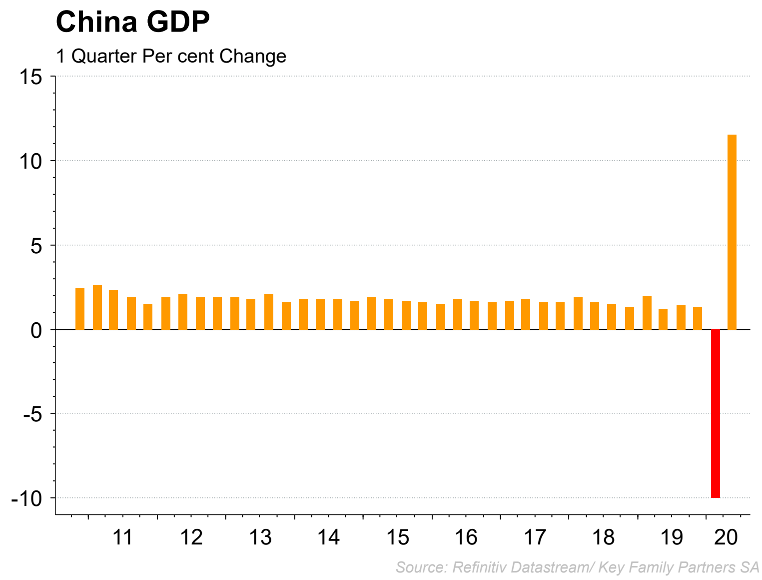
By contrast, China set a record for quarterly GROWTH in Q2 at +11.5% while maintaining an annual growth rate of +3.2%. (We can only wonder at how this has been achieved while the rest of the world remains in the grip of economic contraction over the past 6 months.)





In spite of the above, economic activity has started to pick up from the lows of Q2 in the US, EU and UK - all delivering composite PMI figures of greater than 50 for July, with Japan a shade below.

This seems to confirm that the recession has technically come to an end, in spite of the awful Q2 GDP numbers. Whether this recovery continues to gather pace will largely depend on the progression of the pandemic and lock down measures and there is some evidence that the pace of recovery has actually SLOWED in the last two weeks, particularly in the US as confirmed by the recent Fed meeting comments. The pandemic continues to expand globally and is re-appearing in countries which thought they were clear and have re-imposed lock down measures.

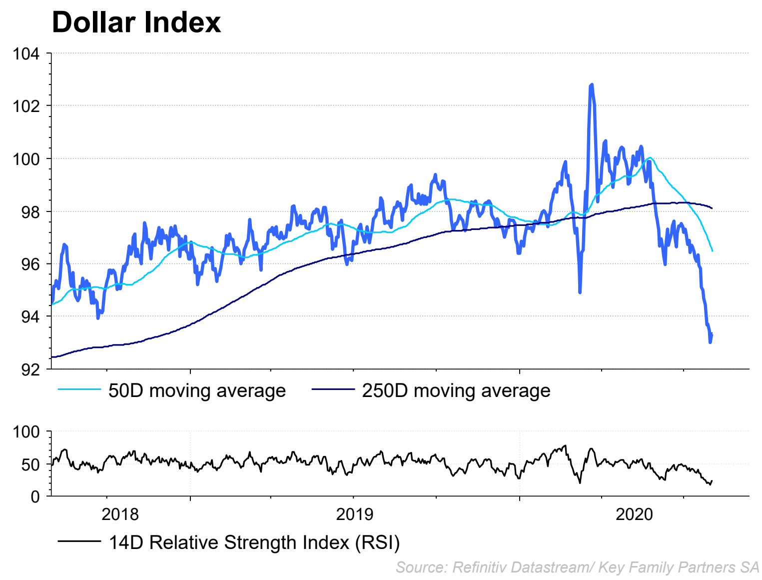


I believe these factors support the view of a slow, uneven economic recovery (the Swoosh), rather than the more optimistic “V” recovery some have suggested. We may only be at the end of the beginning of the crisis.

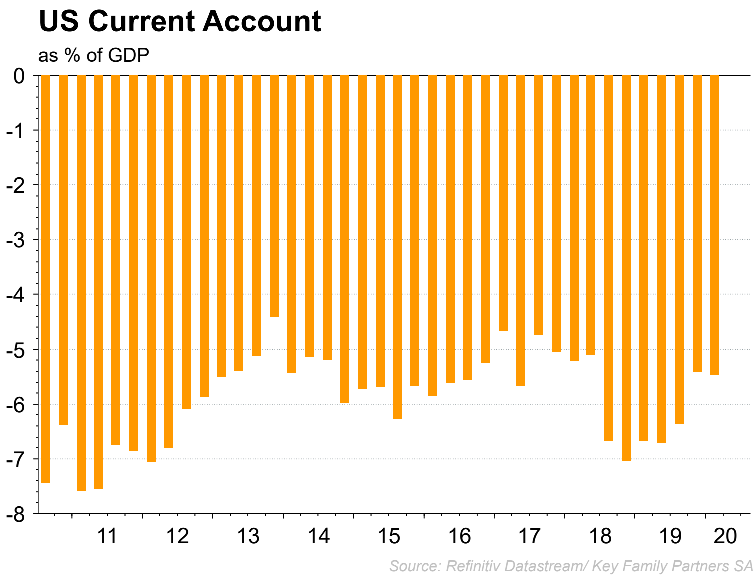
Currency upheavals

Amongst the many substantial economic developments, currency markets are delivering their own shock to the global system – a weaker USD against DM and EM currencies.

After 5 years of a strong(er) USD vs major currencies, a significant change to the outlook for the currency has developed. From a purely technical perspective, an important trend change has taken place with the currency level against the DXY Index of leading currencies. Both the currency and 50 and 200 moving averages are now in steep decline, a strong negative signal for the longer term. After a period of resilience and strength against other majors, and in particular the Euro, why should the USD see a longer term correction?

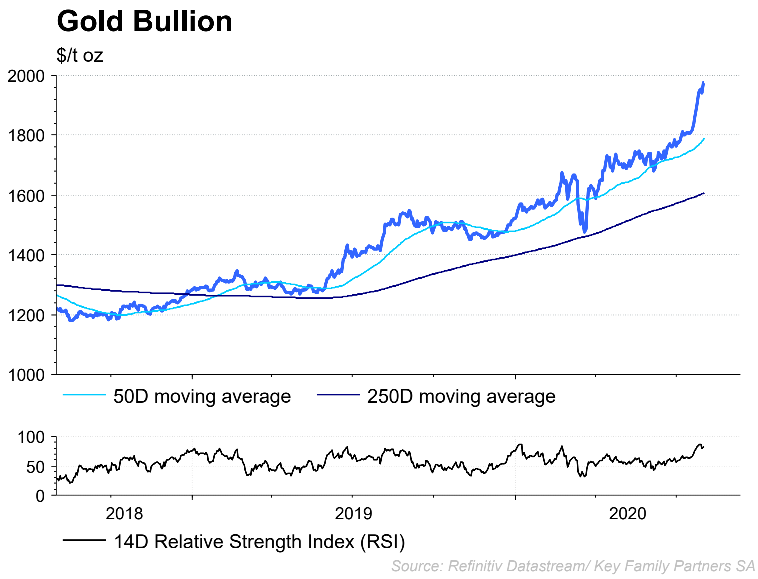


Numerous factors have come together to create something of a perfect storm for the USD. These include:



- **Record monetary and fiscal easing** in the US, which has seen interest rates pushed to almost zero, giving the USD yield little advantage over other currency yields. The attraction of the USD as a global savings vehicle has fallen.
- **The US current account deficit** is on the rise again after a long period of modest deficits in the last decade. As the deficit expands, so increased volumes of USD enter the global economy providing the necessary USD to meet financial obligations (ie debt) outside the US. In addition, currency swap arrangements between the Fed and other Central Banks have ensured a ready availability of USD around the world.
- **The EZ** has made a major stride in confirming the durability of the Euro with the recently announced EU issued Covid support bond. While the size (€750billion) is modest compared with US stimulus, it is the first major step towards socialising the economic risks of some EZ countries (Italy and Spain in particular) amongst all EU members.
- **China** and most large EM's have maintained positive nominal and real interest rates during the crisis, thereby improving the attractiveness of these currencies, assuming no default risk.
- **Political upheavals** in the US. This year's election outcome remains uncertain and under various scenarios could destabilise the country for a considerable period. This is not an environment for a strong currency.

And what about gold?



As gold smashes through its previous high seen in 2011, the question is how far can it go?

Short term the market is very over stretched but longer term, fundamental forces are at play which should continue to drive demand for gold, and hence prices, upwards. These include:

- As a currency, gold looks attractive vs the Euro, Yen and USD, which today offer negative REAL yields, and negative NOMINAL rates (except the USD). Thus the yield penalty of holding gold as a currency is no longer a factor.
- China has been seen to be buying aggressively (although hard to quantify the precise amounts) to support its global master plan to have a currency with substance (even a parallel reserve currency) for trading outside the USD sphere. Gold is the ideal (and only) credible backing.
- Gold is an excellent diversifier for investment portfolios, and institutional investors typically have very small or zero gold holdings. This view is changing as more institutional investors start to diversify into gold from a low level.
- Retail investors once again see gold as a safe haven against currency debasement from money printing. ETF demand, with only half a year gone, is already at a record annual high. Year to date, western institutions have bought 880 tonnes of gold (worth $230 bn) in ETFs – about half of global mine production.
- Finally, longer term momentum remains very strong, even allowing for a necessary cooling off after the recent powerful move.

Gold can therefore move higher, even a lot higher, from here while these factors remain in play.

For investors...

The uncertain pace of the economic recovery continues to provide a challenge for portfolio investors. Further **diversification into non-USD assets and gold** provides some protection in this unstable environment.

EQUITIES

GLOBAL EQUITIES

	1 month	YTD	12 month
Global Equity	+3.6%	-2.4%	+7.3%
Global Eq. Ex US	-1.0%	-8.4%	+0.4%

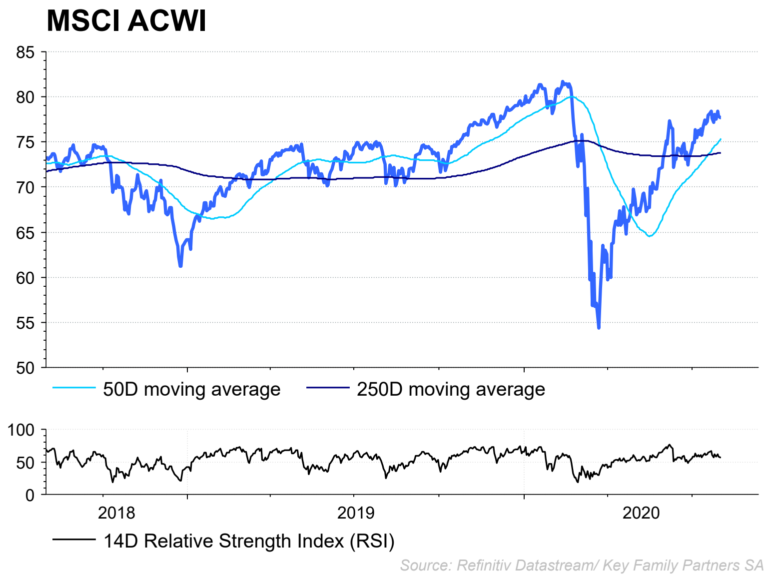
Equity markets gained in the US and EM, with valuation of tech stocks reaching extreme levels. Other markets were flat to negative.

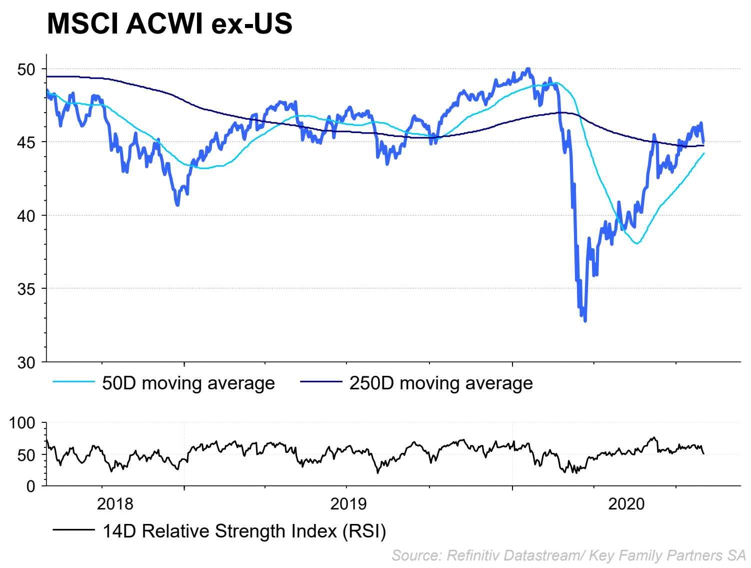
Global equities rose in July, driven by tech stocks globally. Global equities remain 5.2% below the peak level seen in February this year.

Sentiment overall has improved, driven mainly by the global tech sector.

Valuations on adjusted 2020 expected earnings have risen slightly to 22.6x from 21.8x as earnings expectations are scaled back and markets recover. These levels are the highest seen over the past 10 years.

The outlook remains NEUTRAL with downside risk due to extreme valuations in tech stocks.

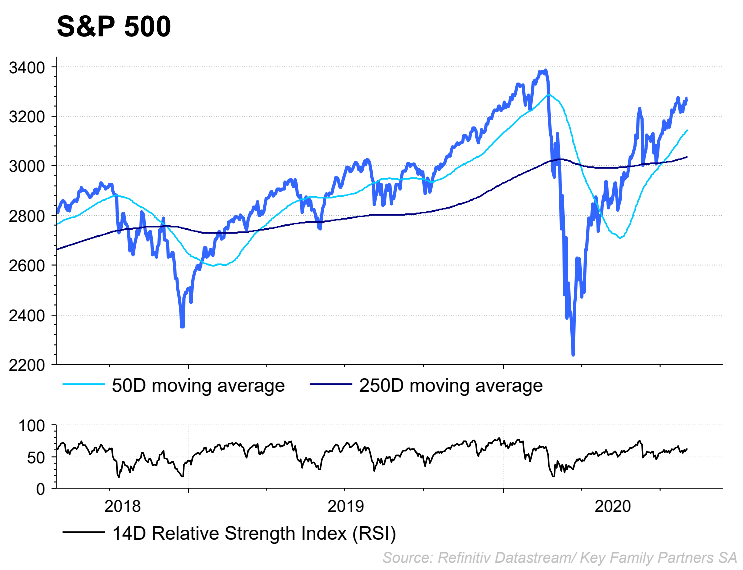




USA

	1 month	YTD	12 month
US Equity	+4.5%	+1.3%	+11.6%

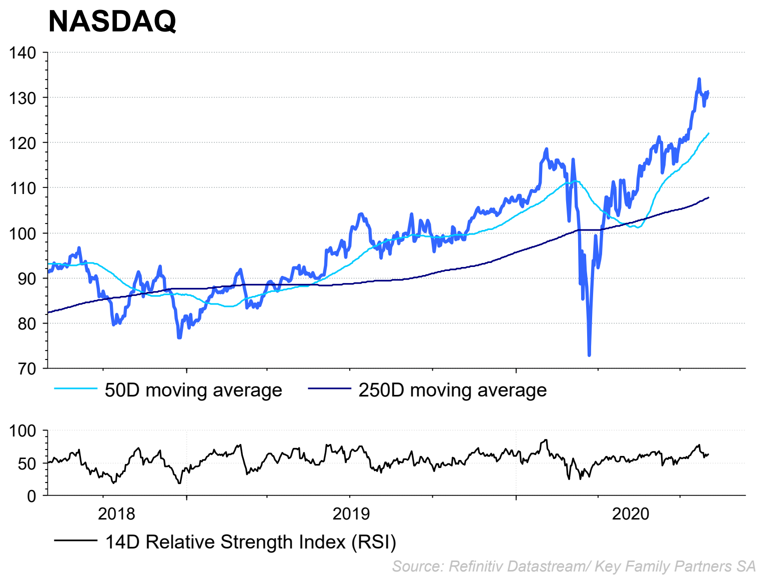
The S&P500 saw a further appreciation in July, reaching a new higher valuation on expected 2020 earnings, which has moved to 25.5x 2020 forward earnings (from 24.8x).



Q2 earnings are as dismal as was expected, down -39.1% on prior year, but with analysts still expecting a strong recovery in the second half of the year, and 2021.

NASDAQ Comp

	1 month	YTD	12 month
NASDAQ	+5.3%	+19.8%	+34.3%
FANG+ Index	+9.5%	+50.6%	+83.0%



Longer term sentiment has moved to positive.

Political risks are seen increasing in the US with the upcoming Presidential election in November.

The outlook remains NEUTRAL with risk to the downside due to valuation, economic recovery uncertainty and political risks.

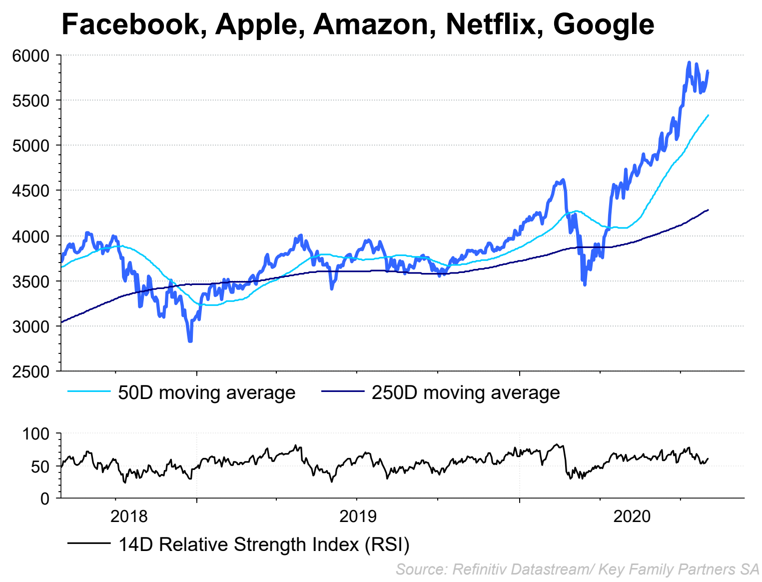
The NASDAQ and FANG+ indices both reached new peak levels in July, driven by better than expected tech results – eg Apple, where earnings in Q2 were +26% better than forecast.

Valuation has now moved to an even more extreme level at 38.0x (from 37.5x) prospective 2020 earnings for NASDAQ and 44.9x (from 38.4x) for the FANG+ index. The Bubble continues to inflate.

Both markets are in very overbought territory short term, but long-term sentiment remains positive.

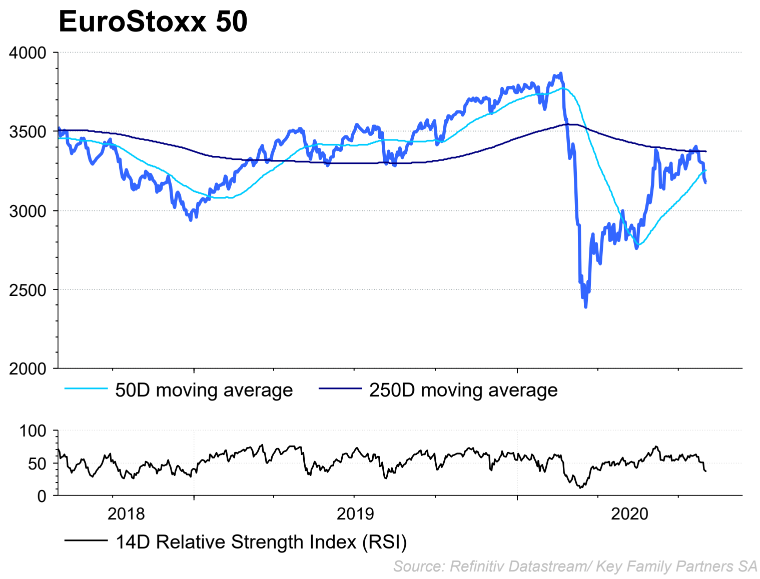
The power of the large tech companies is coming under increasing political scrutiny globally, a dangerous development.

The outlook is moved to NEUTRAL with downside risk due to valuation levels and growing political risks.



EUROZONE

	1 month	YTD	12 month
EU Equity €	-3.6%	-15.2%	-5.9%
$	+1.0%	-11.0%	-0.1%



Euro equities were negative for the month (but positive in USD) as the scale of the recession in the EU in Q1&2 became apparent.

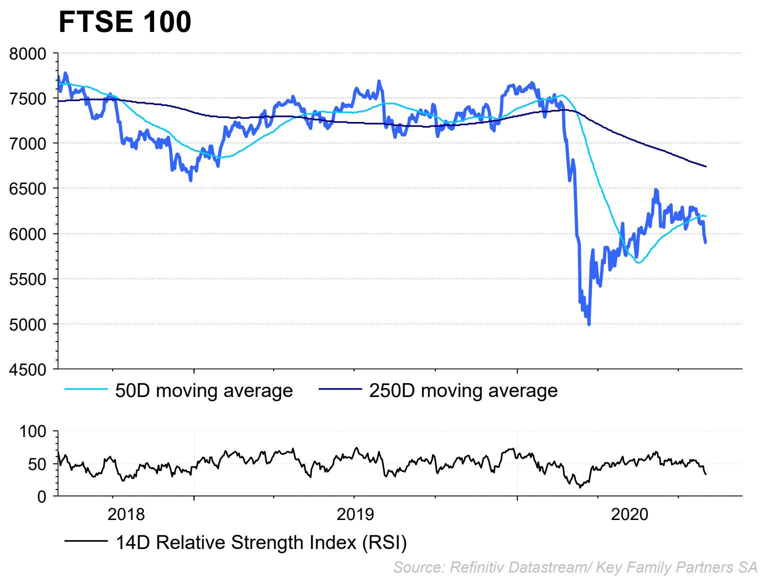
Valuations rose to 20.2x (from 19.7x) adjusted prospective 2020 earnings as expected earnings were adjusted downwards.

Longer term sentiment remains neutral. Short term the market is approaching oversold.

The outlook remains NEUTRAL.

UK

	1 month	YTD	12 month
UK Equity £	-4.2%	-21.8%	-20.4%
$	+1.1%	-22.8%	-14.3%



The FTSE100 fell for the month, and for year to date and the past 12 months it is one of the worst performing major global markets (in USD).

In spite of some domestic economic recovery, concerns remain of renewed lock down measures as the spread of the virus picks up once again.

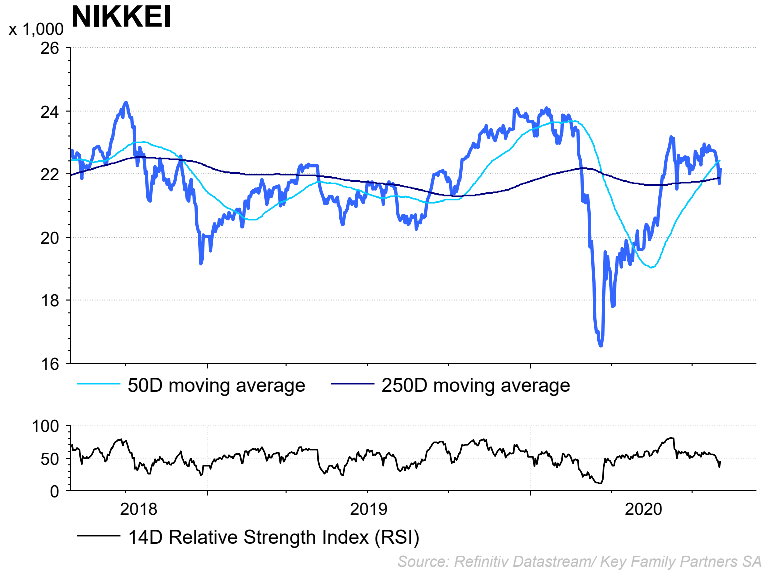
Market sentiment has turned more negative.

Valuation remained flat at 18.4x adjusted prospective 2020 earnings, at the top of the 10 year range.

The outlook moves to NEUTRAL with downside risk.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	-2.7%	-8.2%	+2.9%
$	-0.7%	-5.8%	+5.8%



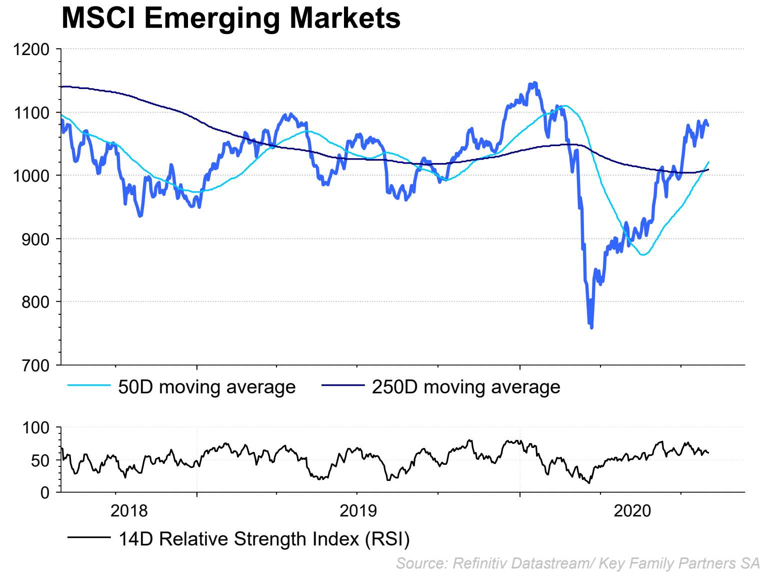
The Nikkei fell in July as the recession continued to bite in Japan, and export markets remained weak.

Sentiment turned more neutral with the month end sell off.

Valuation remained flat at 21.6x adjusted 2020 earnings, making the market expensive. Overall the outlook remains NEUTRAL with downside risk on the continuing recession.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity £	+4.4%	-3.2%	+7.5%



EM equities had a strong month in July, led by China, and tech stocks in particular. Brazil also recorded a strong month (+11.3% in USD) on the back of recovering resource prices.

Lower USD levels and USD interest rates should be positive for EM equities for the foreseeable future, but rising C-19 levels in many countries remain a brake on renewed growth for the time being.

Valuations have risen to 17.7x (from 15.8x) prospective earnings bringing EM equities into the top range of valuations over the past 10 years.

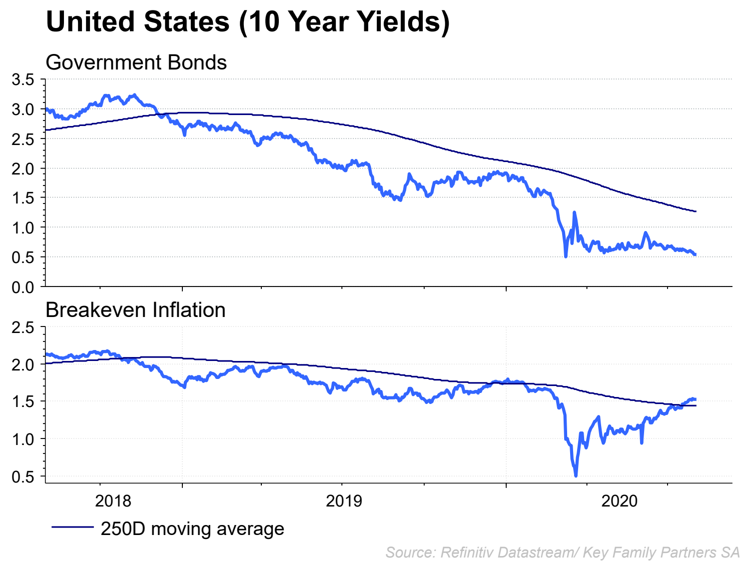
Sentiment has turned more positive.

The outlook moved to NEUTRAL with a positive bias.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	+1.25%	+9.96%	+10.71%



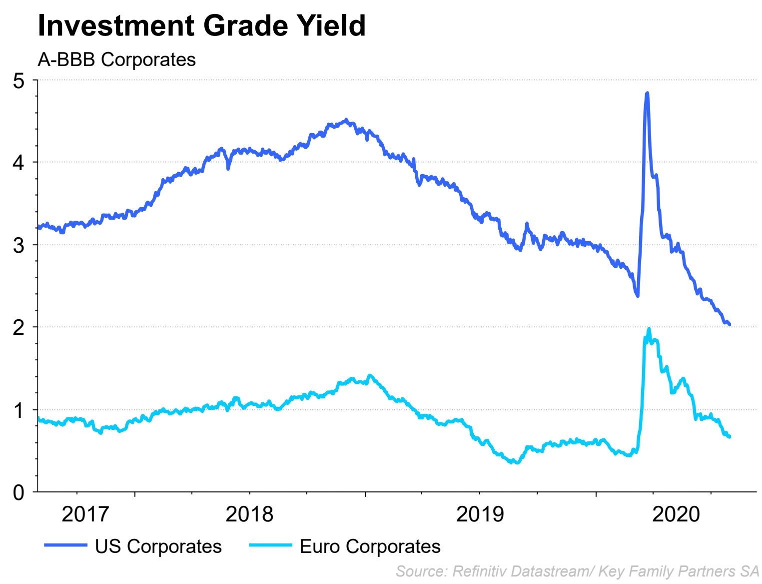
Yields on 10 year Treasuries fell in July to another record low of 0.53% from 0.65%, while 10 year inflation expectations rose to 1.55% from 1.34% - continuing the trend over the past 4 months.

Yields should remain flat with the Fed's yield control actions in place regardless of the direction of inflation expectations. The Fed has indicated that QE will remain active until the economy and inflation recover to the target levels – with no time restriction.

The outlook remains NEUTRAL.

Investment Grade

	1 month	YTD	12 month
US Inv Grade Total return	+2.66%	+8.44%	+11.55%



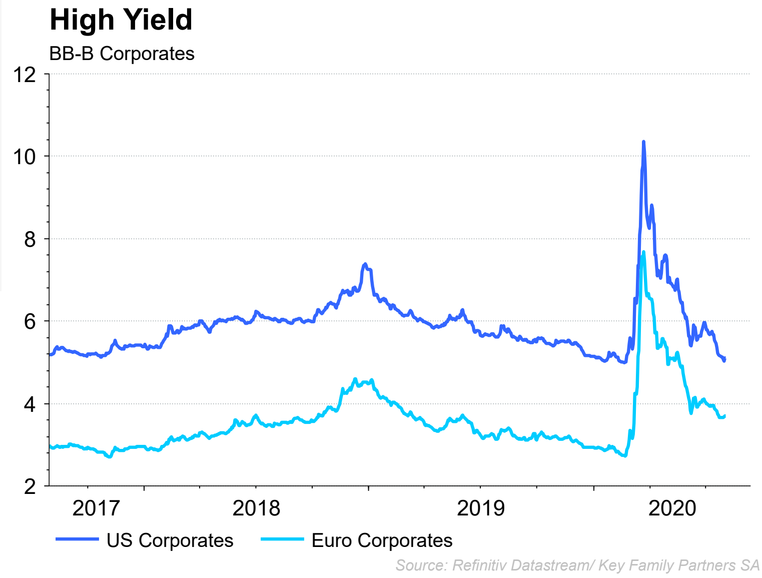
Yields on investment grade corporates fell sharply again to 1.86% from 2.16% on the back of falling spreads to 133bps from 153bps as the Fed's support effort continued. Spreads can go lower still with the Fed programme in place.

The yield pick up over Treasuries remains attractive even at these low spread levels, while defaults levels remain low. This could change if the default level rises on a renewed slow down outlook.

The outlook remains NEUTRAL given the Fed support measures for the sector and the still attractive spread over Treasuries.

High Yield

	1 month	YTD	12 month
US High Yield Total return	+3.93%	+0.71%	+4.48%



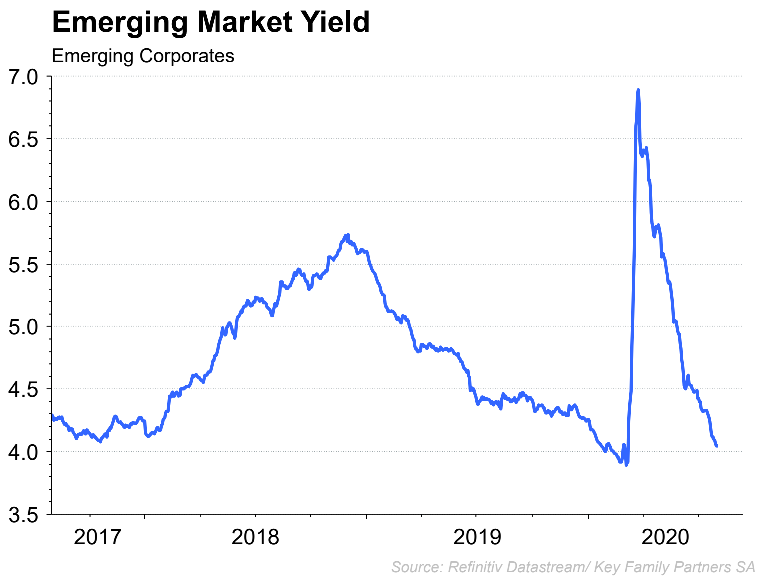
US HY bond yields and spreads were largely flat for the month, but this masked a rise in both measures in the second half of the month as more defaults began to be seen in this market.

On the one hand we are likely to see further default activity, but the Fed support package remains in full swing to support the overall market.

The outlook is moved to NEUTRAL but with continuing downside risk of default.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	+2.58%	+2.68%	+5.03%



Yields on EM USD debt fell sharply again in July to 4.23% from 4.66% and spreads narrowed further to 376bps from 408bps – approaching the lowest levels seen over the past decade.

Demand is likely to remain for the attractive yield pick up assuming no deterioration in the pandemic in EM.

The outlook remains NEUTRAL

CURRENCY – USD vs DM, EM

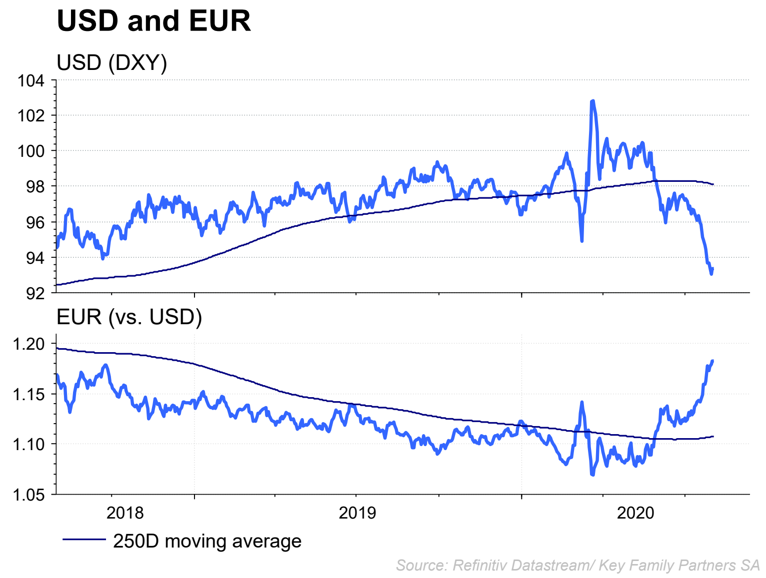
USD vs DM currencies

The USD fell at its fastest rate since 2017 against major currencies, and in particular against the Euro, which recovered to levels last seen in 2018.

As described above, the USD looks set for a longer term decline against other DM currencies. Short term however it looks oversold and will likely pull back before resuming its decline.

Longer term sentiment is now strongly negative.

The outlook remains NEUTRAL short term, but with downside risk longer term.



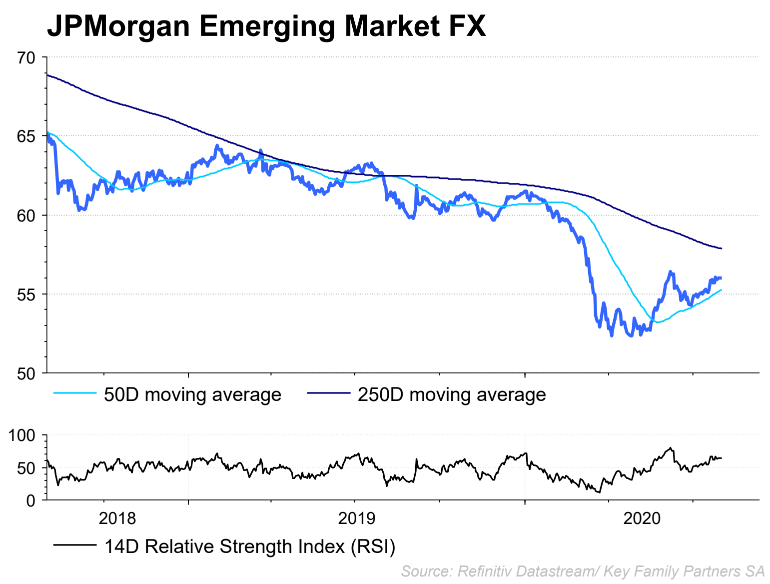
EM currencies vs USD

EM currencies recovered in July, led by the Chinese CNY, which has shown a steady appreciation over the past 2 months.

The major EM currencies are all running positive real interest rates, a fundamentally different economic picture from the DM currencies, including the USD. Longer term we can expect the currencies to appreciate as the yield spread of EM assets over US assets remains attractive to investors.

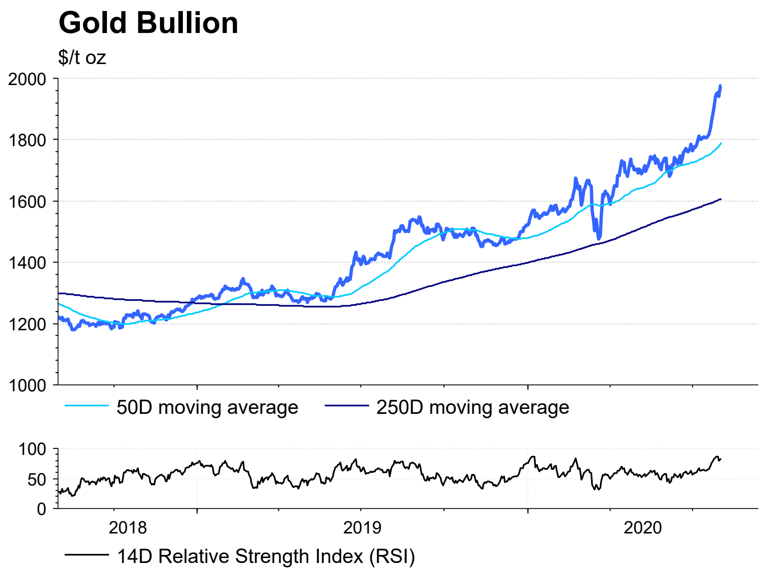
Short term sentiment remains neutral.

EM currencies outlook changes to NEUTRAL with a positive longer term outlook.



GOLD

	1 month	YTD	12 month
Gold	+10.9%	+30.4%	+38.1%



Source: Refinitiv Datastream/ Key Family Partners SA

Gold continued its strong performance, breaking through its previous high seen in 2011.

Sentiment towards gold remains very positive, as more investors seek to use gold to diversify portfolios and central banks (particularly China) accumulate the metal.

One reason for gold's "store of value" property is its permanence. All the gold ever mined is still in circulation – something that cannot be said of countries, business or most investment assets.

Short term the market is seriously over bought and could pull back, but the longer term outlook remains POSITIVE.

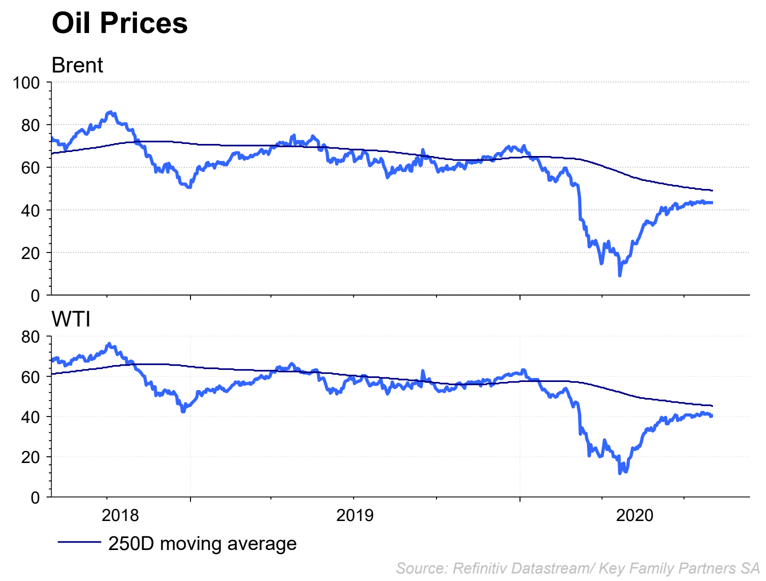
COMMODITIES

OIL

Oil prices levelled out in July as demand and supply came further into balance with the Opec+ production quotas remaining in place.

Further price moves will likely be driven by demand considerations – and new lockdown actions are likely to cut demand once again.

With the speed of economic recovery still unclear, the outlook for oil remains NEUTRAL.



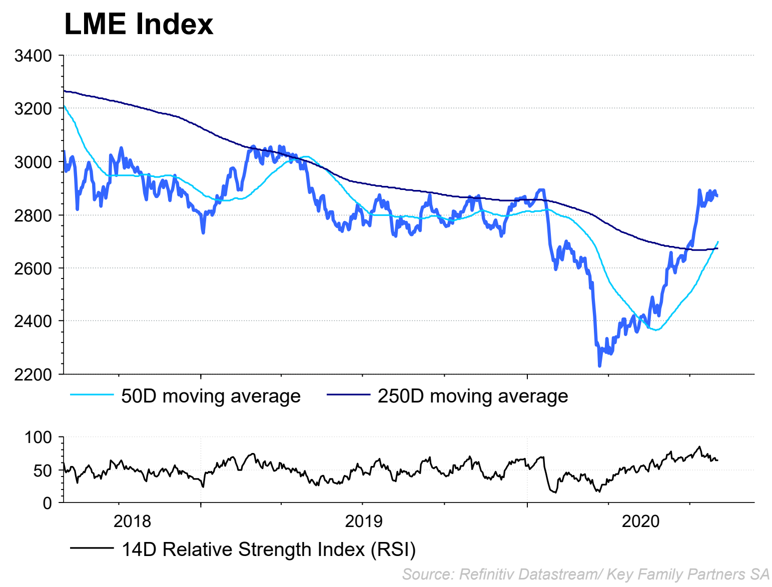
METALS

Metal prices recovered to pre pandemic levels, led by copper on the rebound of demand from China.

Metal prices remain well below peak levels seen in 2011, while supply remains subdued from low prices (and therefore investment) for the past 10 years.

Metal prices remain in overbought territory but longer term the trend has turned positive – the previous occasion in 2016 saw a 50% appreciation in copper prices.

The outlook is moved to POSITIVE.



ILLIQUID ASSETS

Real Estate	No change from previous month
Hedge Funds	No change from previous month
Private Equity	New opportunities for PE investors are likely as the economy slows and credit becomes scarcer. New investments going forward should attract better pricing than seen in the past 2 years.

Disclaimer

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