KFP
KEY FAMILY PARTNERS

Global Market View

October 2020

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🟢 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

Time to take stock

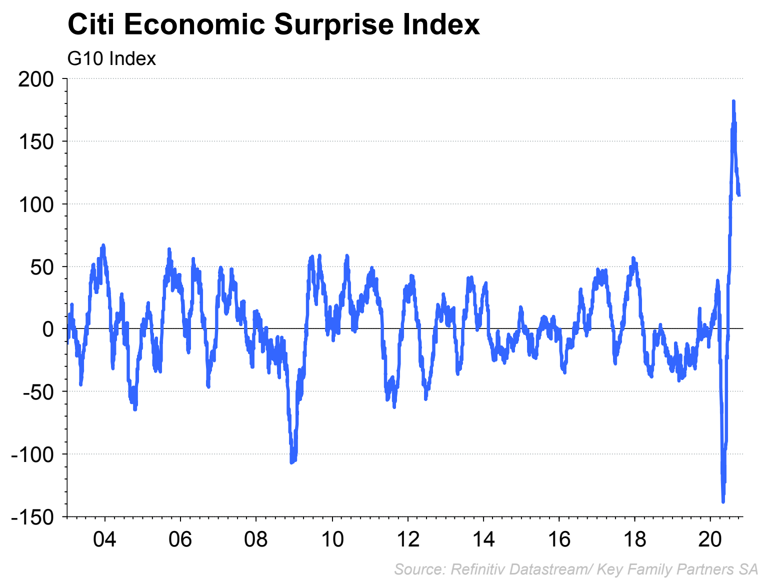
Nine months into 2020 and six/seven months into the pandemic (and lockdowns) it is perhaps worth reviewing the state of the world economy and what we might expect in the coming 6-12 months. So much news, views and data are available that sometimes it is hard to see the facts from the fiction. I will try and stick to hard data to compile a current picture and glean some views for the near future of economic activity.

In market economies, the key economic drivers we need to understand are the future direction of growth and inflation. Both drive economic policy and ultimately the price of money and investment returns. Politics adds another layer of complexity and needs to be added to the pot to derive an appropriate investment outlook.

Growth

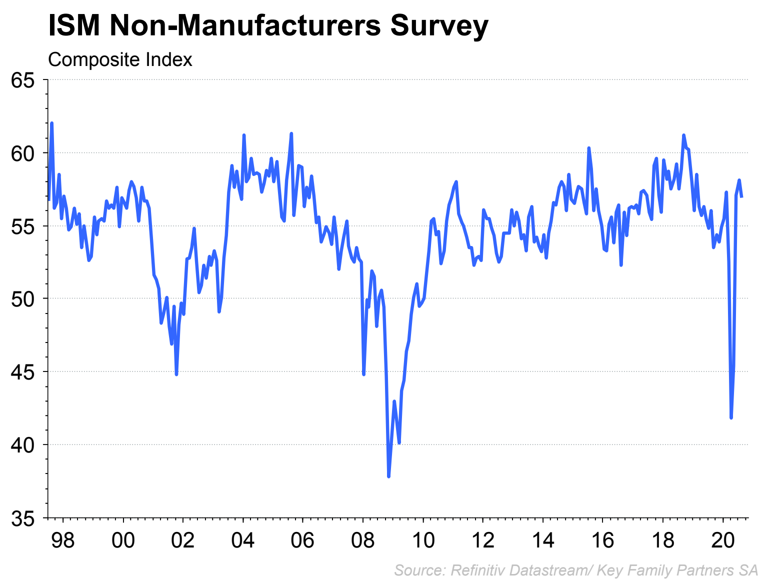
Q2 2020 saw the sharpest global economic contraction in economic activity in a generation or more, followed by a sharp recovery in Q3. Q3 GDP data is not yet available so we must rely on sub data that is available in more real time (nowcasts) to get an up to date picture.

The Citi Economic Surprise Index (CESI) for the G10 nations shows clearly, since inception of the index, the depth of the economic contraction and subsequent recovery against market expectations. (NB this is a relative, not an absolute, measure of GDP activity).

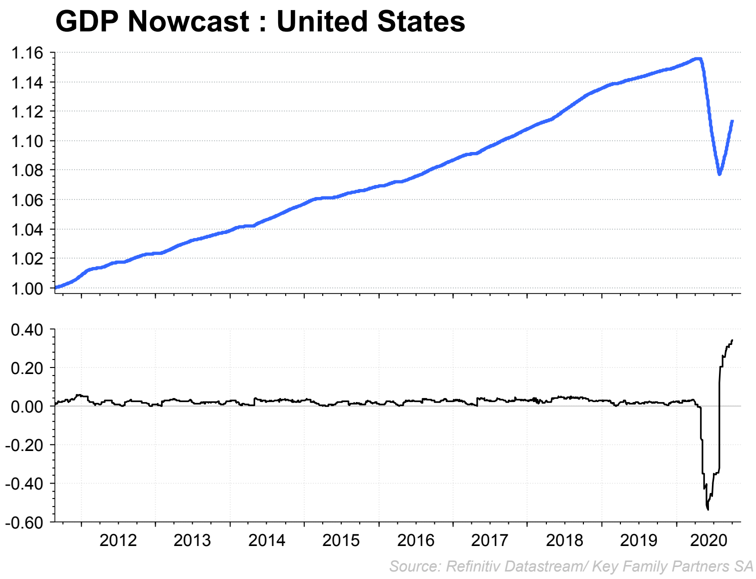


Clearly the contraction and recovery were larger than initial expectations.

PMI numbers also provide a reasonable real time measure of economic activity change – that is, less than 50 represents contraction, and greater than 50 expansion, from the previous monthly reading. The chart for the US Composite PMIs clearly shows the growth recovery from June onwards. Other major economic blocks followed a broadly similar profile, with China's recovery proving the most rapid and Japan's the slowest. Note however the slight slowing in September, which was also consistent across major blocks, and principally in the services sector as new lockdown restrictions came into force.



A measure of the current **absolute** level of global economic activity is provided by the nowcast from ECRI as part of their Leading Indexes service.



The important point here is that although economic recovery is in place worldwide, the absolute level of economic activity remains well below the peak seen in January 2020, and close to the levels seen in 2017. The economy will continue to feel recessionary for some time ahead with growing unemployment and corporate bankruptcies – always lagging effects of recession. Most forecasters do not expect economic activity to recover to previous levels until 2022 at the earliest.

The **conclusions** to be gleaned from this data are that:

1. A growth recovery is well established in the global economy, albeit at different rates in different sectors and economic blocks, and
2. Given the well publicised monetary and fiscal support from all major economies, this cyclical recovery is expected to continue for the foreseeable future as interest rates are kept at or near zero (or below) and fiscal support continues to expand, but
3. Due to the extreme economic contraction already experienced it will take some years to get back to where we were before the pandemic struck.

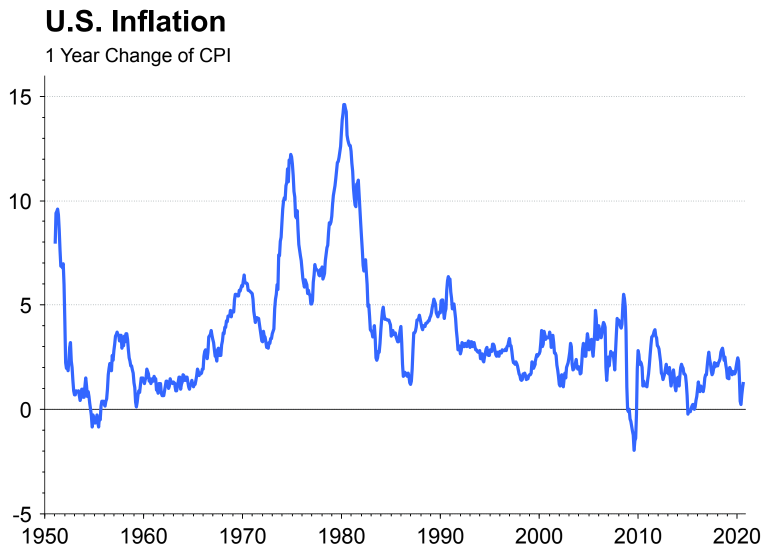
The principal short term risk to this outlook is likely to be the political reaction to the continuing spread of Covid-19, and the extent of future economic lockdowns imposed by the politicians. The damage to business and consumer confidence and the "animal spirits" of investors is likely to be substantial. Longer term, the volume of debt being created by Governments to pay for the impact of the recession is also likely to weigh on growth prospects.

Inflation

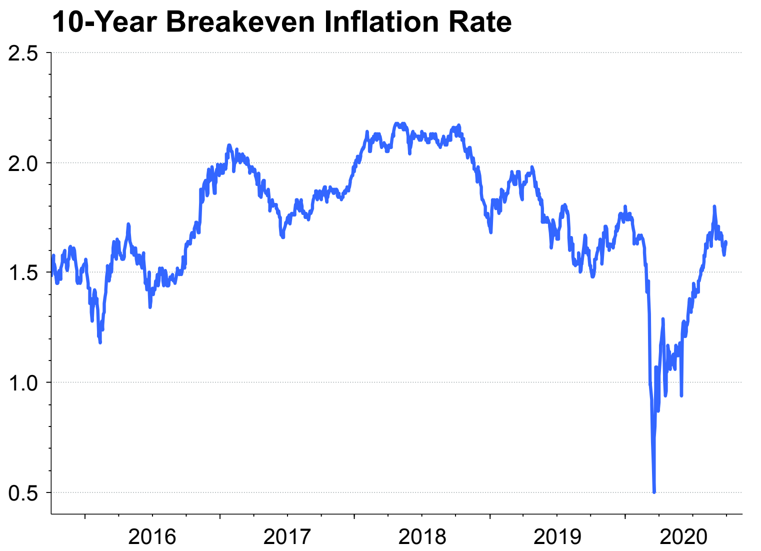
Consistent with historical experience, global inflation collapsed during the recession with numerous countries including the Eurozone and Japan recording negative rates.

However, with the recovery in progress actual inflation and expected inflation rates are picking up in most economic areas

US CPI year-on–year to August showed a recovery in prices as consumer spending picks up. Core inflation excluding food and energy costs rose to 1.7%. Nevertheless food prices which are a key component especially for the poorer people, were up 4.1% over the year, a trend which is being seen globally.



Source: Refinitiv Datastream/ Key Family Partners SA



Source: Refinitiv Datastream/ Key Family Partners SA

10 year break even inflation rates in the US have risen rapidly and have now recovered to levels last seen in 2019. The trend in inflation break even rates is now up and we can expect to see inflation pick up further for all the reasons discussed in previous papers.

Furthermore, leading indicators of inflation are now in cyclical upswings for most major economies, including the Eurozone which has been a recent laggard. The ECB continues to believe that deflation is a greater danger, as per their statements on Wednesday of last week, and will continue to provide greater monetary stimulus as required.

The **conclusions** from this data are:

1. Inflation pressures have returned, and risks are to the upside as economic growth recovers
2. Further monetary stimulus is likely from Central Banks including the ECB, adding fuel to the fire
3. Negative real interest rates will persist for some time

Impact of politics

A myriad of major political risks exist today on a global scale with which readers will undoubtedly be familiar. Suffice to say here is that any of these major political risks, if they materialised in a negative manner, could have a significant impact on the economic recovery envisaged above. The most pressing of these is perhaps the November election in the US which today has no clear outcome. A contested result could be the worst scenario for investment markets.

In conclusion

- A global economic recovery has been established, but with a long way to go to reach levels of economic activity seen before the pandemic
- Inflation pressures are to the upside, while monetary and fiscal policies will keep base interest rates at near zero levels for the foreseeable future
- Political uncertainties have the real potential to derail the economic recovery

...and for investors

- Take advantage of the economic recovery by investing in those sectors and business that will prosper in the recovery and avoiding the zombies
- Beware rising inflation and market interest rates and the negative impact on investment grade fixed income returns
- Hold decent allocations of safe haven assets (gold, swiss francs, etc) to protect against inflation and political risks

EQUITIES

GLOBAL EQUITIES

	1 month	YTD	12 month
Global Equity	-4.0%	-0.1%	+9.5%
Global Eq. Ex US	-3.0%	-7.3%	+1.1%

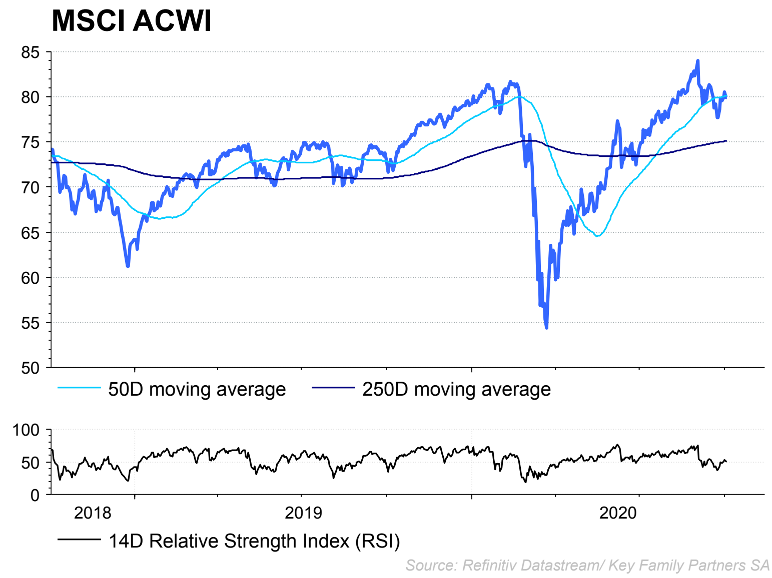
Equity markets sold off, again driven by tech stocks. Evidence of market distortion in FANG stocks unsettled the market. Political risks are mounting around the November election.

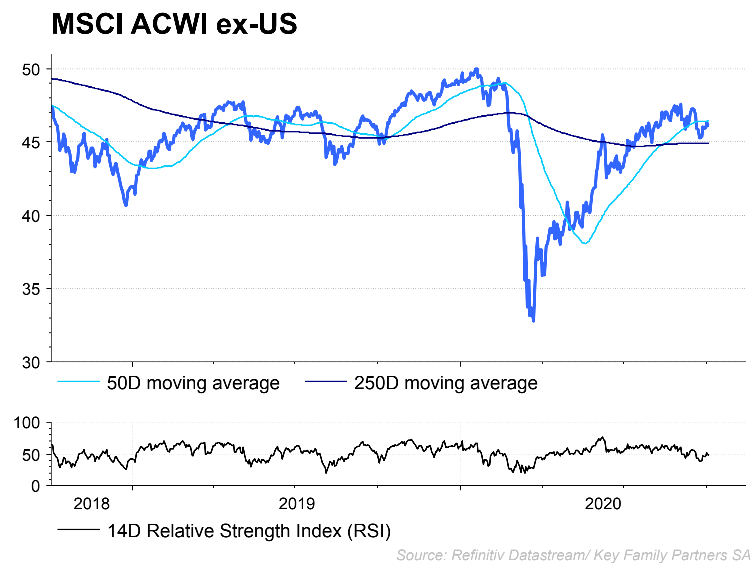
Global equities fell in September, led by tech stocks around the world.

Sentiment has turned neutral, while the short term overbought position seen last month has corrected.

Valuations on adjusted 2020 expected earnings have fallen slightly to 22.9x from 23.7x as markets sold off. These levels remain very elevated on a 10 year view.

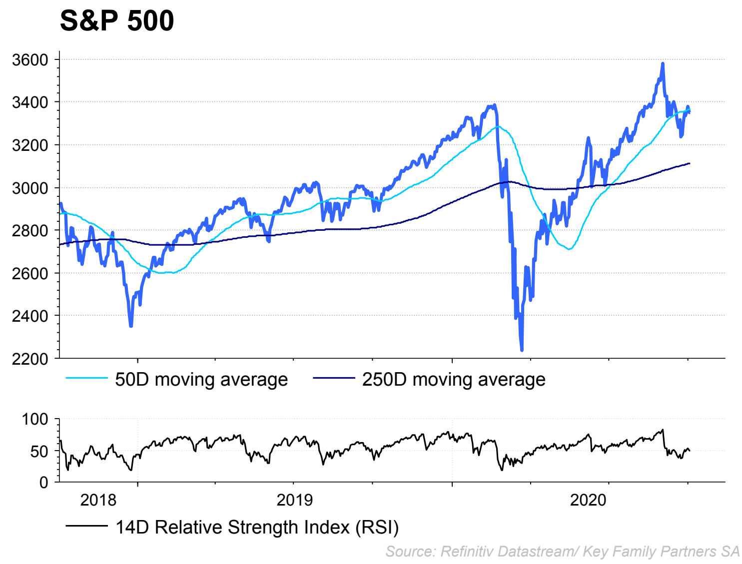
The outlook remains NEUTRAL with downside risk due to continuing extreme valuations in tech stocks and mounting political risks.





USA

	1 month	YTD	12 month
US Equity	-3.9%	+4.1%	+12.9%



The S&P500 pulled back in September on the back of the tech correction.

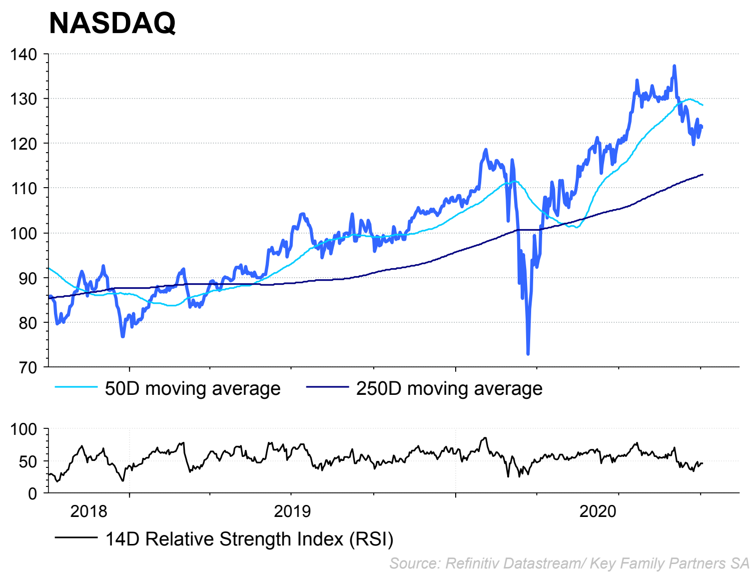
Valuation moved to 25.5x from 26.8x 2020 forward earnings and remains extremely elevated.

Evidence of massive call option buying by retail buyers and Softbank distorted the market, pushing it to an extreme overbought level, which has now been corrected in the sell off.

The outlook remains NEUTRAL but with risk to the downside due to extreme valuations and growing political risks.

NASDAQ Comp

	1 month	YTD	12 month
NASDAQ	-5.2%	+24.5%	+39.6%
FANG+ Index	-4.9%	+73.6%	+112.1%

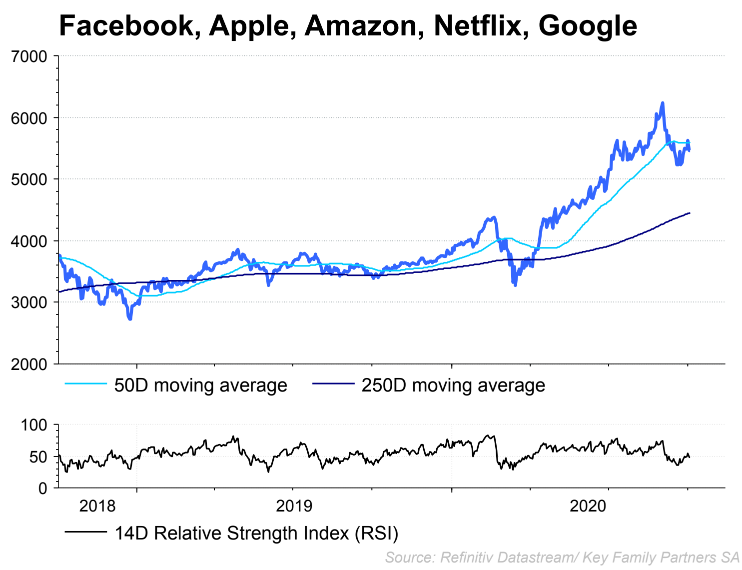


The NASDAQ and FANG+ indices both sold off in September

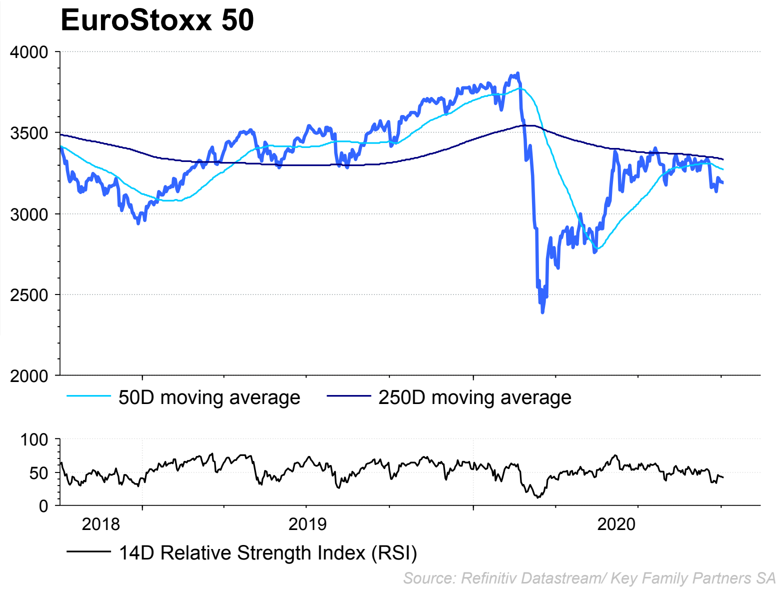
Valuation of both indices fell, to 37.5x from 40.4x prospective 2020 earnings for NASDAQ and 43.3x from 51.7x for the FANG+ index. The bubble in tech stocks continues in spite of the selloff.

Sentiment has turned more neutral, and the overbought condition of last month has been corrected.

The outlook remains NEUTRAL with downside risk due to extreme valuation levels and growing political risks.



EUROZONE			
	1 month	YTD	12 month
EU Equity €	-2.4%	-14.7%	-10.5%
$	-4.2%	-10.9%	-3.8%



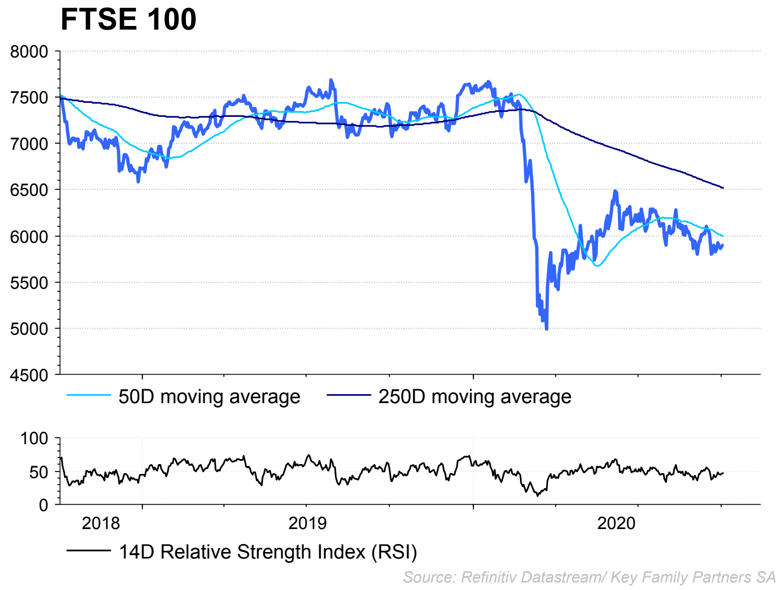
Euro equities sold off again in September on evidence of further covid19 lockdowns in some EZ countries.

Valuations rose to 21.3x from 20.7x adjusted prospective 2020 earnings as expected earnings were adjusted further downwards.

Longer term sentiment has turned more negative while the speed of economic recovery shows signs of slowing.

The outlook remains NEUTRAL.

UK			
	1 month	YTD	12 month
UK Equity £	-1.6%	-22.2%	-20.8%
$	-5.1%	-24.3%	-16.9%



The FTSE100 fell again on the month, and remains by far the worst performing global market year to date in sterling and USD – accurately reflecting the weakness of the underlying economy.

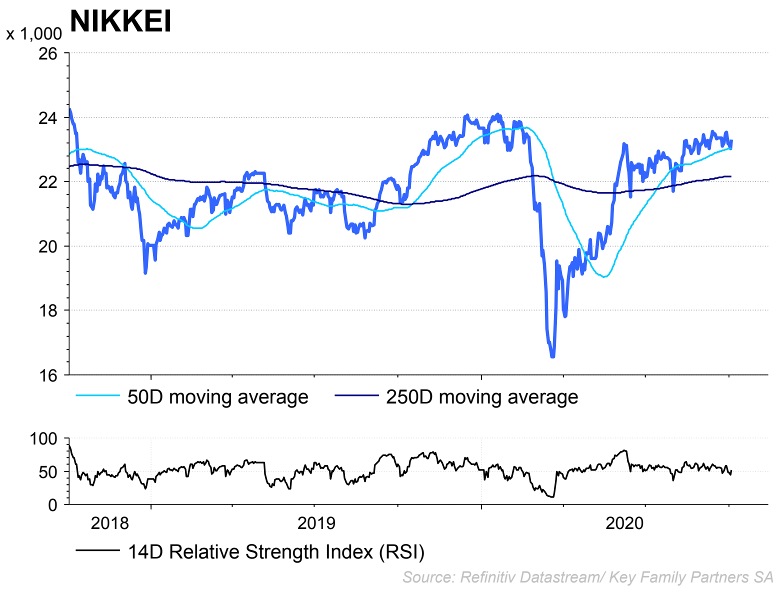
Political uncertainty over the final Brexit deal,
and the mis-handling of the Covid affair are weighing on the market. Sentiment remains negative in the short and longer term and has become more pronounced over the month.

Valuation fell to 19.4x adjusted prospective 2020 earnings, at the top of the 10 year range, as prospective earnings for 2020 were moved down.

The outlook remains NEGATIVE.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	+0.2%	-2.0%	+5.9%
$	+0.6%	+0.9%	+8.5%



The Nikkei rose for the month, the only major global market to do so.
Export led recovery, mainly to China, sustained the market.

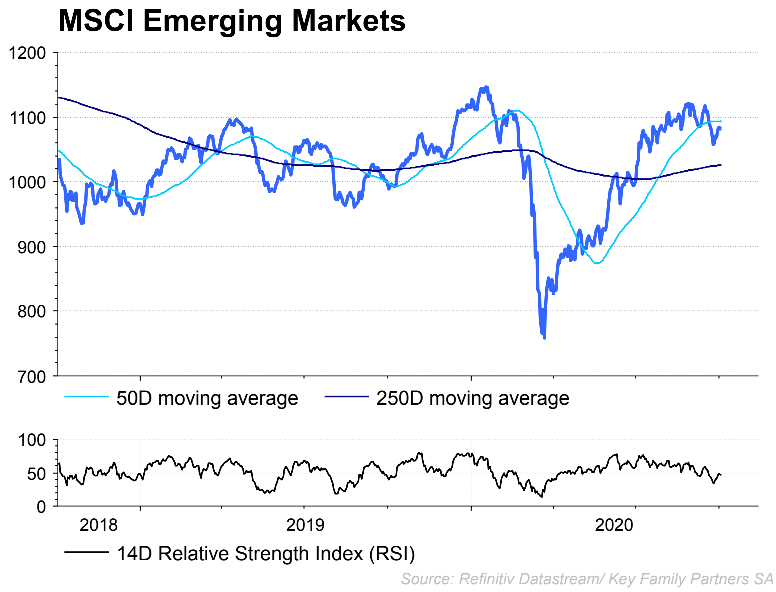
Sentiment remains neutral/positive in the short and longer term.

Valuation remains at 23.2x adjusted 2020 earnings, making the market expensive on a historical basis.

Overall the outlook remains NEUTRAL.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity £	-3.4%	-2.9%	+8.4%



EM equities fell in August, led by China once again (down 6.0% in Shanghai), and tech stocks in particular.

Valuations have fallen to 17.8x from 17.7x prospective earnings keeping EM equities in the top range of valuations over the past 10 years.

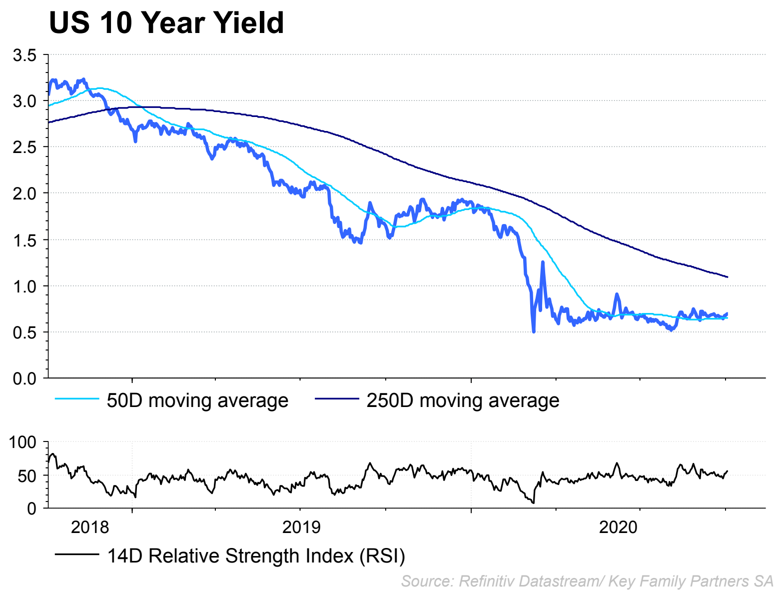
Sentiment remains positive.

The outlook remains NEUTRAL with a positive bias.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	-0.01%	+8.90%	+7.81%



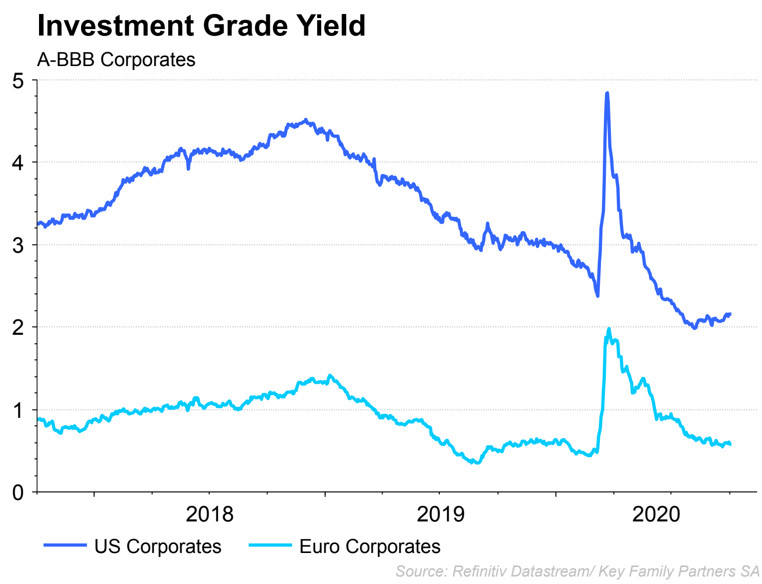
Yields on 10 year Treasuries fell in September to 0.68% from 0.71% while 10 year inflation break even fell slightly to 1.64%.

Treasuries have remained in a sideways trading range as Fed actions to keep interest rates low have continued to impact the market, as well as a residual safe haven buying in a rising political risk environment. However longer term inflation pressures are likely eventually to push yields up and returns down.

The outlook remains NEGATIVE on a deteriorating inflation outlook.

Investment Grade

	1 month	YTD	12 month
US Inv Grade Total return	-0.63%	+6.64%	+7.70%



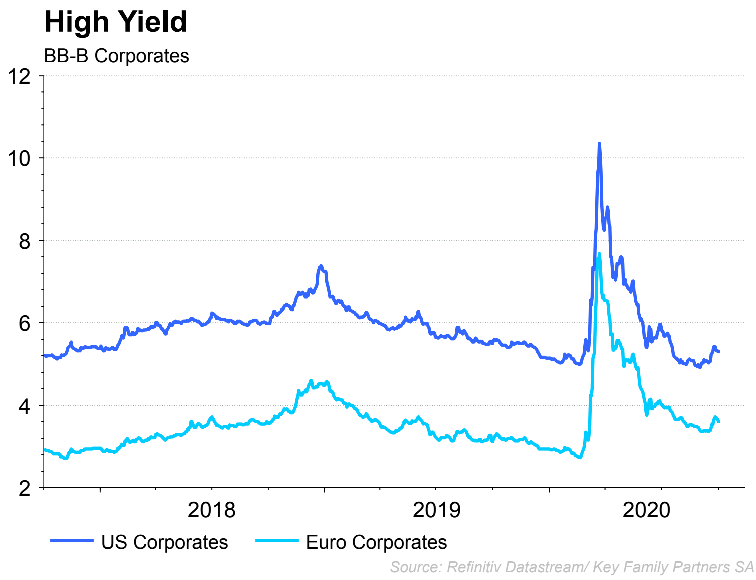
Yields on investment grade corporates increased to 2.01% from 1.99% and spreads rose to 135bps from 130bps.

Risk of default rose marginally for investment grade as the rate of economic recovery was seen to slow slightly, and new fiscal measures were not implemented to support consumers.

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	-1.11%	+0.62%	+3.34%



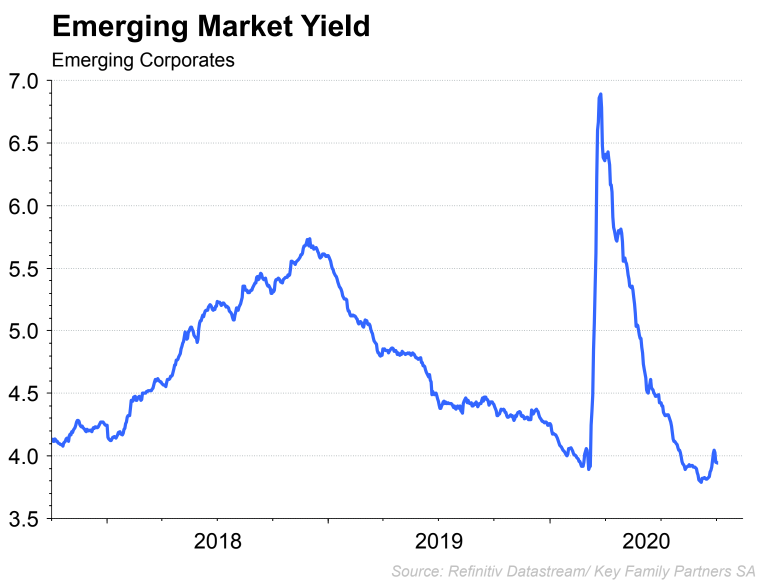
US HY bond yields rose to 5.77% from 5.35% on concern over the pace of economic recovery. Spreads also rose to 537bps on increased default risks.

Fed actions continue to support the market so spreads are likely to remain tight for the time being.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	-1.57%	+1.93%	+4.05%



Yields on EM USD debt fell again to 4.07% from 4.17% and spreads narrowed further to 348 from 357bps.

As economic growth recovers in EM, led by China, and US domestic rates stay lower for longer, EM USD debt should remain attractive to investors.

The outlook remains NEUTRAL with a positive outlook.

CURRENCY – USD vs DM, EM

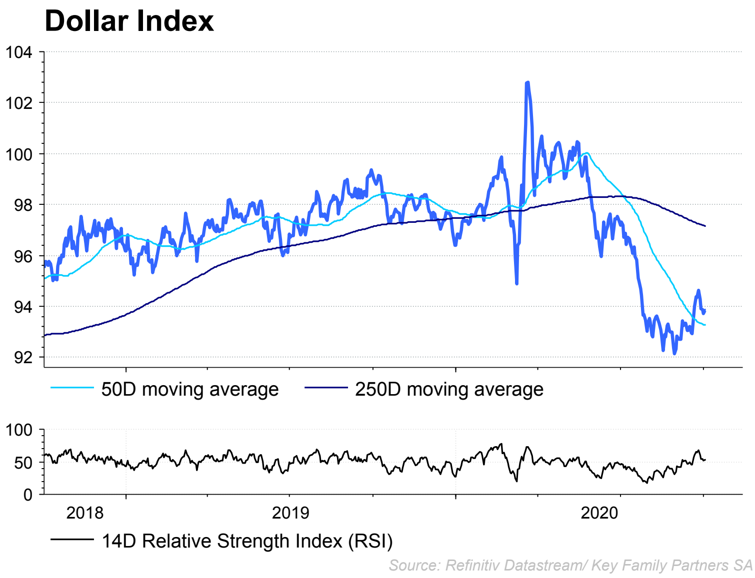
USD vs DM currencies

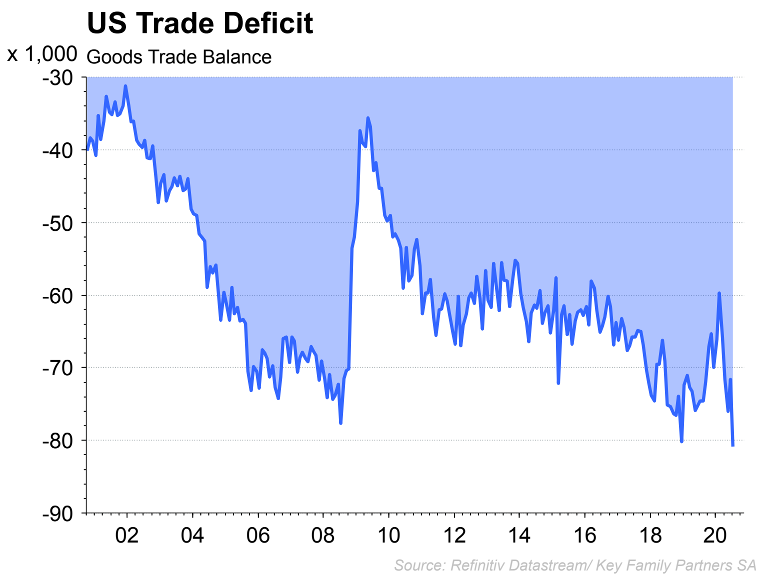
The USD recovered from an oversold position during the month against all major DM currencies.

The US trade deficit has ballooned to record levels last seen in 2008, thereby increasing the supply of USD in the global economy, which is negative for the dollar.

Longer term sentiment remains strongly negative in spite of the uptick this month.

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





CURRENCY – USD vs DM, EM

EM currencies vs USD

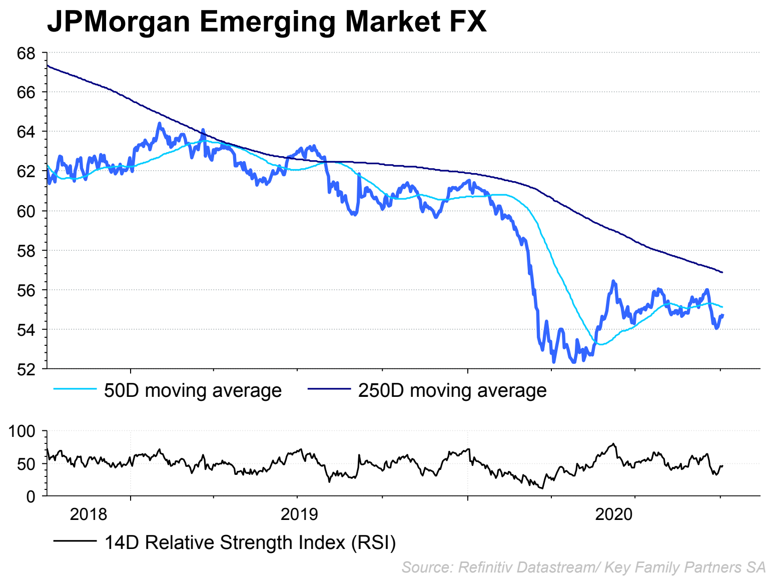
NB The EM currency index is changed to the MSCI EM Currency Index from the JPMorgan index used previously. The MSCI Index better reflects the bigger weighting of China in EM.

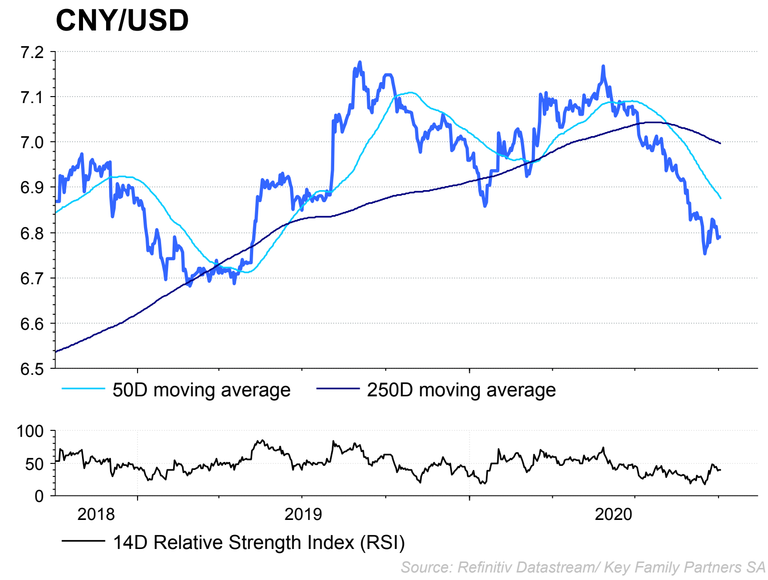
EM currencies gave up some of their gains but short and long term sentiment remains positive overall, principally driven by the RMB (CNY).

With China leading the global recovery and offering a positive carry over inflation on Government bonds, currency investors are likely to switch in increasing volumes from USD to RMB.

The Brazilian Real and Russian Rouble however remain in decline.

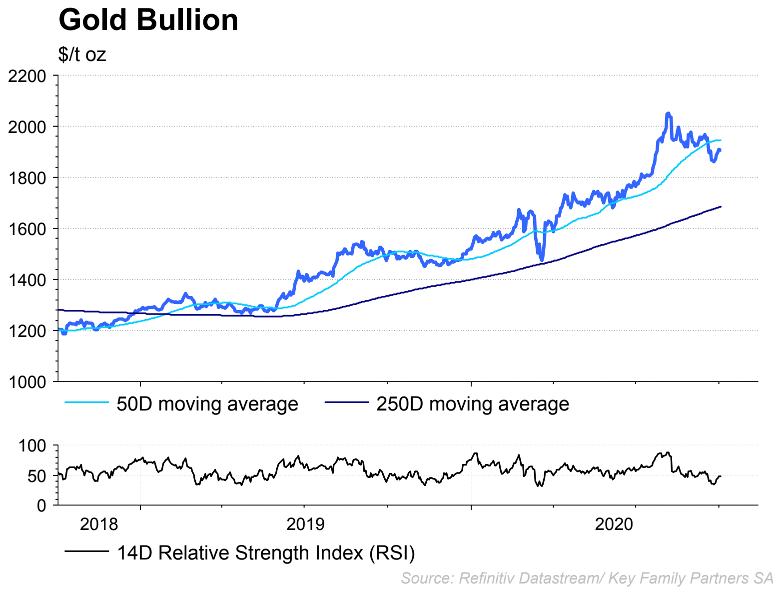
EM currencies outlook overall remains NEUTRAL with a positive longer term outlook.





GOLD

	1 month	YTD	12 month
Gold	-3.9%	+24.7%	+28.5%



Gold paused in September and retreated to levels seen in late July.

Nevertheless momentum remains very positive, as do the fundamentals supporting gold. Negative real interest rates are the key driver and these look set to expand as inflation picks up.

Furthermore gold will play its safe haven role in any political upheavals we may experience down the road, starting with the November election in the US.

The outlook remains POSITIVE.

COMMODITIES

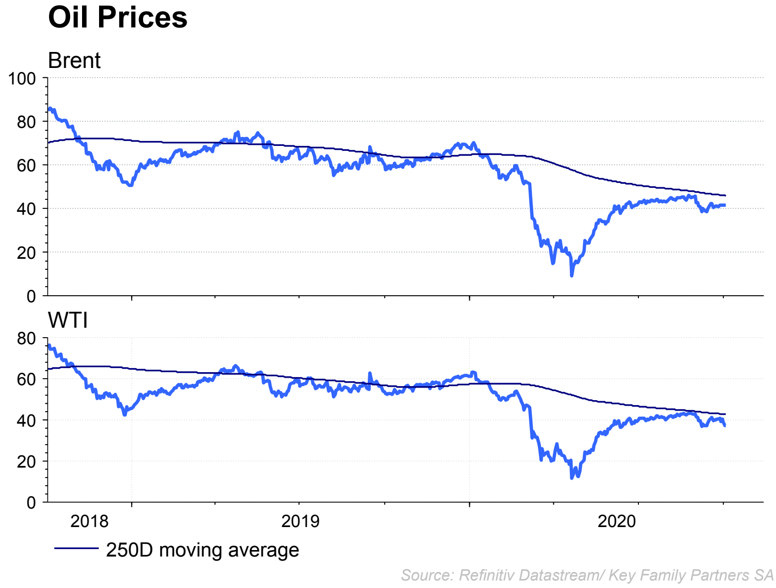
OIL

Oil prices have turned down once again, with both short and longer term trends turning negative.

Assuming the world economy continues to recover, albeit more slowly than expected a few weeks ago, demand for oil should increase once again.

Oil is in oversold territory and could see a short term recovery from here.

The outlook for oil remains NEUTRAL.

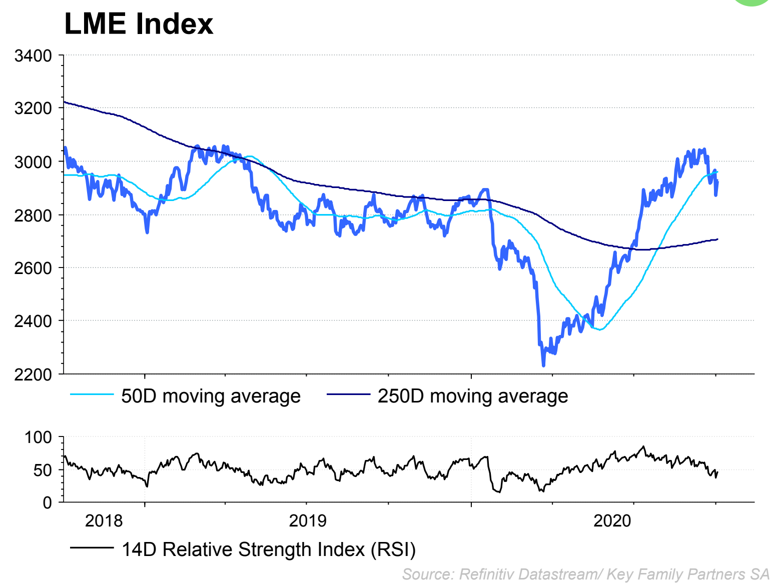


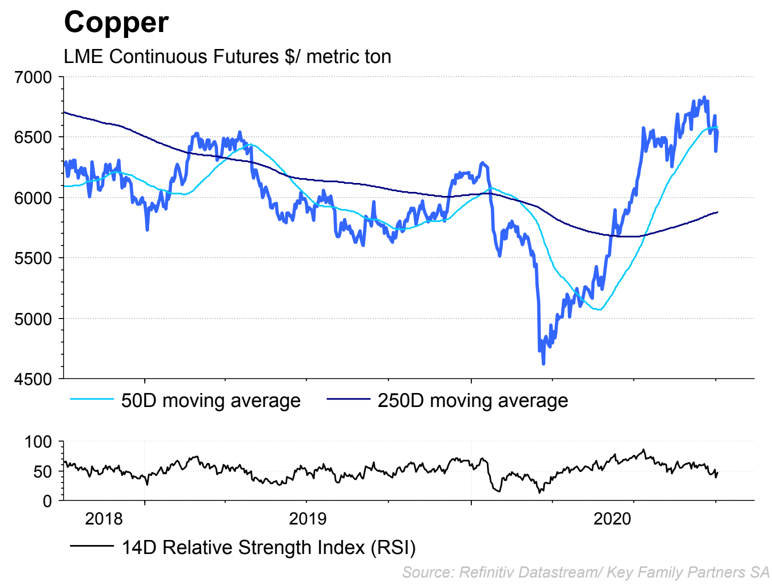
METALS

Metal prices paused during the month but short and long term trends remain positive for the main metals group.

Copper remains the bell weather for global economic growth, and prices were lower over the month. However at this level the metal is heavily oversold and a rebound is likely in the near future.

The outlook remains 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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