KEY FAMILY PARTNERS

Global Market View

October 2021

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Market expected to provide better than normal returns for that market

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

GLOBAL ECONOMY

New Monetary tightening cycle at hand

The Federal Reserve finally got off the fence and announced plans for a new monetary tightening cycle to start later this year with a phased reduction in its bond buying programme (tapering of QE) to be completed by mid 2022. Thereafter, rate rises could start in the second half of the year, with a further 3 pencilled in for 2023.

The importance of the announcement is that the tapering and rate rises are being brought forward by 12 months or more in the face of higher and more persistent than expected inflation levels i.e. inflation may not be as transitory as first thought?

For the technically minded, a recent Fed paper examining the assumption that inflationary expectations are the main driver of actual future inflation concluded that the assumption "rests on very shaky ground" (https://www.federalreserve.gov/econres/feds/files/2021062pap.pdf).

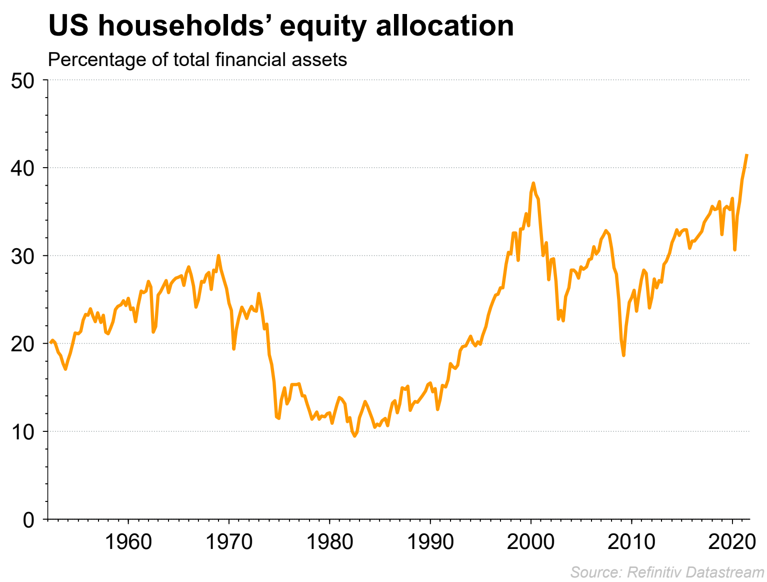
This belief has been at the core of Fed policy decisions for some decades. But the paper suggests the belief is not supported by empirical evidence, throwing a spanner into Fed assumptions for the future direction of inflation. In particular, it may explain the change to the Fed's "transitory inflation" position and the acceleration of monetary tightening.

It is not only the Fed that has embarked on a new tightening cycle. The ECB and the BoE are also looking at early tightening in the face of higher and more persistent than expected inflation rates, while some EMs (notably Brazil, Russia and Mexico) have seen multiple rate rises already this year. The one outlier remains China, which is on a modest loosening cycle given developments in their domestic economy (see below).

These tightening cycles usually last for multiple years, but given the fragility of the current economic recovery, any further economic slowdown (or even a new recession) may reverse the cycle. **For the moment, investors should work on the assumption that monetary conditions will be tightening, and interest rates are likely to rise in 2022 if not before.**

Growth recovery in 2022?

Economic commentators (e.g. J P Morgan) are beginning to discuss their outlooks for 2022, and a developing theme (although by no means consensus) is that we are likely to see a growth rebound after the 2021 slowdown. This assumes that the supply chain disruptions will be largely resolved (semiconductors included) and consumers will be eager to spend their substantial accumulated savings from the past few years.



Based on Fed data, ING has calculated that household wealth in the US has grown by $26 trillion since the end of 2019 (and $32 trillion since the low point in 2020) to $159.3 trillion – an astonishing 21% increase in 18 months. With household liabilities at "only" $17.7 trillion, this leaves household net worth at $141.7 trillion – and at an all-time high against disposable incomes. The driver of this increase has been a combination of stimulus payments, wage increases and asset price appreciation.

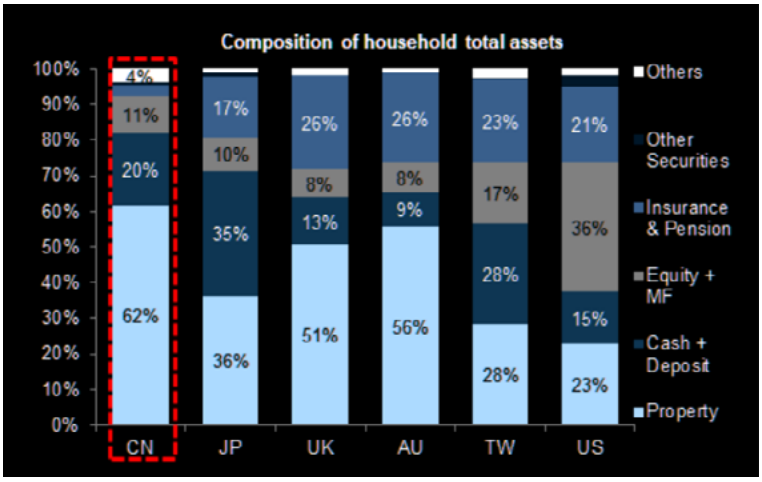
Given the Fed goal of supporting the recovery and inflation with consumer spending, the asset price inflation driven by ultra-loose monetary policy appears to have worked, putting US households in a stronger financial position than ever. **A consumer led boom next year in the US is therefore a real possibility if supply chain disruptions are resolved, and particularly if consumers buy early in anticipation of future price rises.**

Stock Market Breadth

Despite a recent correction in US equity markets (see Equities below), market breadth remains very narrow. The chart attached (from GS) reinforces the point that valuations of the top 5 stocks by market cap now make up 23% of the total market capitalisation of the S&P500. In addition, the market cap proportion has substantially exceeded the share of earnings (16%) contributed by those 5 stocks.

This suggests that the market performance is even more narrowly supported than was seen in 1999/2000. Given the recent moves in the Fed stance on monetary tightening, and the rise in market interest rates, these stretched valuations remain a significant risk to these stocks and the overall market level.

China update



Chinese equity and corporate debt markets have been rocked by the apparent imminent insolvency of Evergrande (or, maybe more appropriately, "Nevergrande") one of China's largest residential real estate developers. Total debts are believed to exceed $300 billion, of which $20 billion are USD denominated borrowings and the balance, domestic RMB debt. The overarching causes of the property crisis in China are overbuilding, excessive borrowings and government initiatives to control speculation in the property market – the usual causes of property busts.

The overriding goal of the CCP is to maintain social stability in China and it is exactly this sort of event which could snowball into wider disorder, hence the protection of retail investors.

Loosening monetary policy is consistent with this view and policy is likely to become looser over the following months as the property market in China adjusts to current events.

Whether the insolvency of Evergrande (and other similarly indebted developers) becomes a systemic risk in China and abroad remains to be seen. A credit crunch, coupled with an apparent and growing electric power shortages impacting manufacturing and service business, could put China's economy at risk of a near-term recession.

In summary...

- The world economy, except for China, has entered a monetary tightening cycle, which could extend for some years as inflation appears more persistent and stuck at a higher level than expected.
- Interest rates are likely to rise across most G10 countries in 2022 and beyond
- Growth continues to slow, but with some upside potential in 2022 in the US
- Some risk to this scenario comes from China, should a full-scale domestic credit crisis develop

For investors...

- Fixed income investments are likely to deliver very low to negative returns for the foreseeable future as inflation runs and interest rates rise
- Equity markets could also see lower returns as interest rates rise, and P/E ratios fall, particularly on higher priced stocks
- Commodity assets and commodity related stocks are likely to continue to perform as supply disruptions continue.

GLOBAL EQUITIES

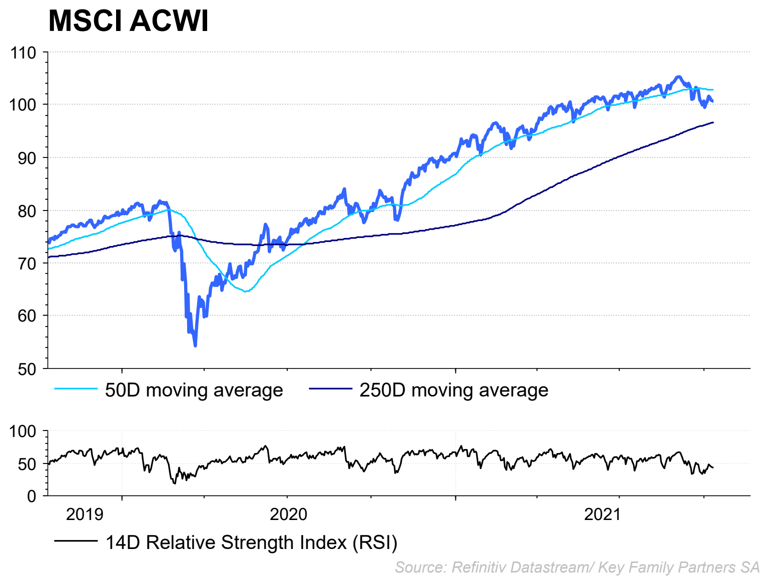
GLOBAL EQUITIES	1 month	YTD	12 month
Global Equity	-3.8%	+10.4%	+21.1%
Global Eq. Ex US	-3.4%	+6.8%	+19.9%

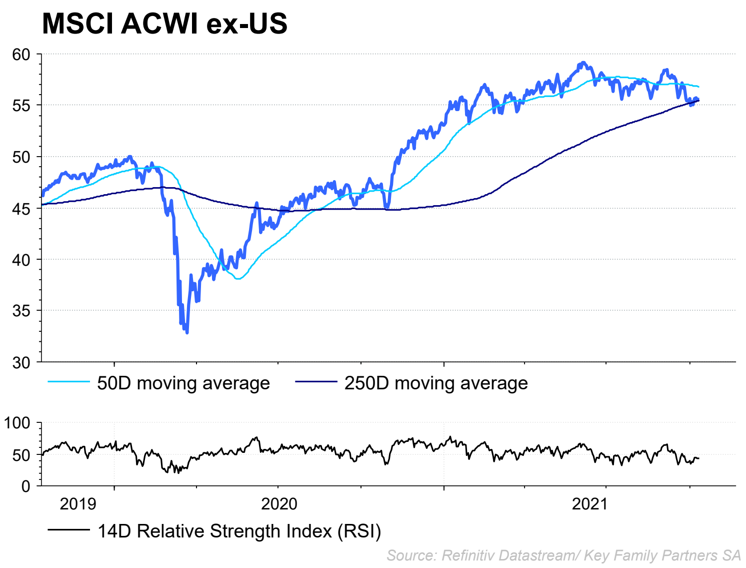
Global equities fell from all-time highs early in the month based on the MSCI All Country World Index.

Market sentiment has turned decidedly more bearish across the board as market interest rates have started to rise (see Fixed Income below). Short term, the market is approaching oversold so a pullback could be expected.

Valuations on adjusted **2021** expected earnings were steady at 19.1X, but this remains elevated on a 10-year average and vulnerable to higher rates. Ex US, the forward P/E is 15.2x.

The outlook is moved to NEUTRAL with a negative outlook and risk to the downside.



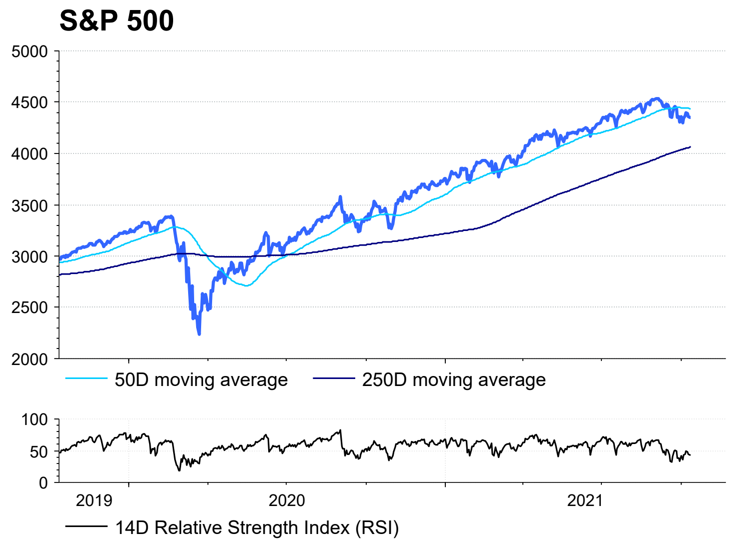


USA			
	1 month	YTD	12 month
US Equity	-3.8%	+15.8%	+23.9%

The S&P500 had a negative month after reaching a new all-time high early in September.

Economic recovery remains positive but at a slowing rate for the time being. 2022 may see a renewed growth acceleration.

Market sentiment has turned neutral but with further risk to the downside.



Source: Refinitiv Datastream/ Key Family Partners SA

Valuations remain elevated at 21.5x prospective 2021 earnings, and at risk if earnings start to disappoint in Q3 results.

The outlook is moved to NEUTRAL with a negative outlook given rising interest rates and risks to Q3 earning given continued supply disruptions.

NASDAQ Comp

	1 month	YTD	12 month
NASDAQ	-5.2%	+12.2%	+21.9%
FAANG+ Index	-6.9%	+16.0%	+20.6%

The NASDAQ and FAANG both saw significant correction in the month after reaching new all-time highs early on.

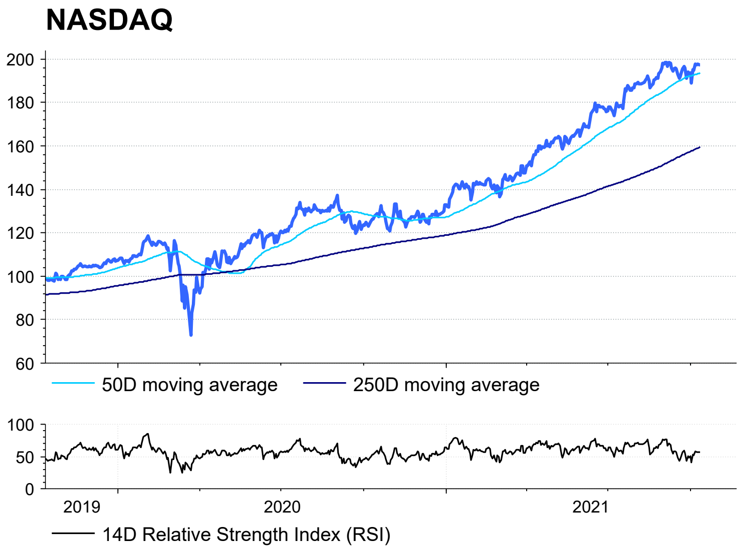
Sentiment has turned neutral but with a negative outlook based on declining tends.

Valuations of both indices fell to 31.9x prospective.

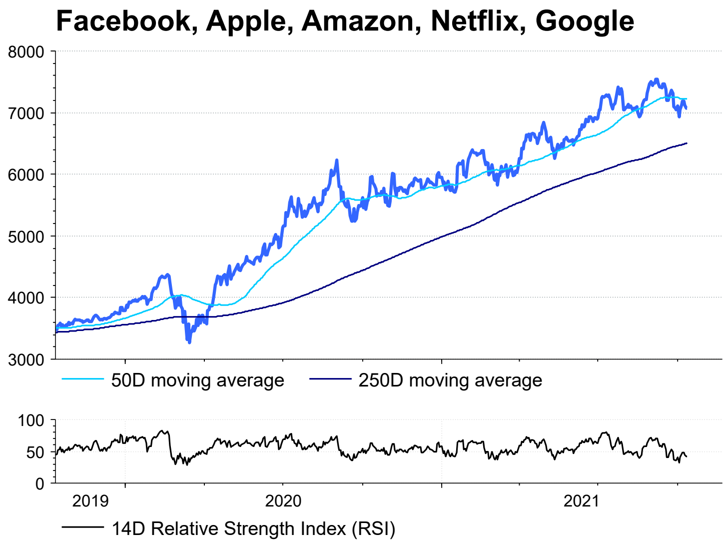
2021 earnings for NASDAQ and 30.6x for the FAANG index, with both remaining at elevated levels.

Market breadth is worsening, raising the risk to the future performance of the market.

The outlook remains NEUTRAL with further downside risk due to rising interest rates and slowing economic growth.

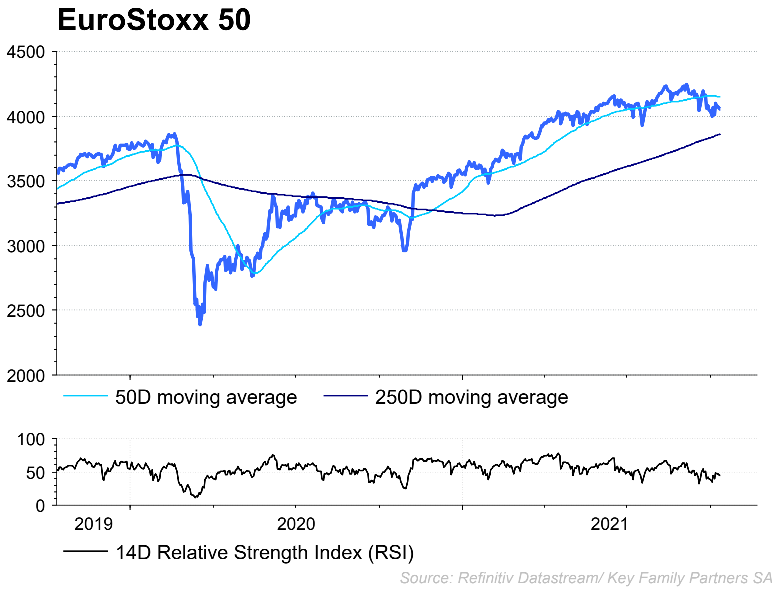


Source: Refinitiv Datastream/ Key Family Partners SA



Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE			
	1 month	YTD	12 month
EZ Equity €	-3.4%	+14.1%	+23.7%

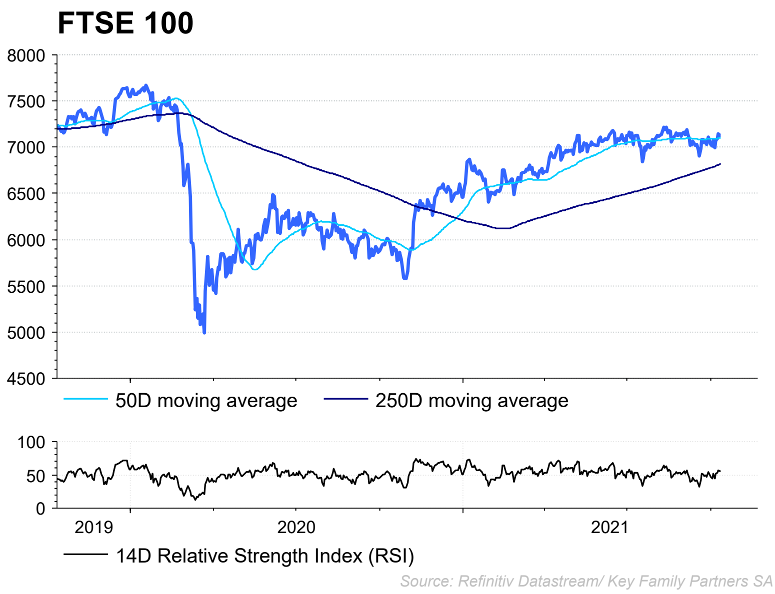


Euro equities fell sharply as Eurozone market interest rates rose. Economic activity slowed further while remaining positive – the September composite PMI fell to 56 from 59 in August. Further slowing is expected as the energy shortage continues to impact.

Sentiment remains neutral but with a negative outlook.

Valuation fell to 16.4x prospective 2021 earnings
The outlook is moved to NEUTRAL but with a negative outlook.

UK			
	1 month	YTD	12 month
UK Equity £	+0.1%	+10.4%	+19.4%



The FTSE100 fell for the month on rising interest rates, but at a slower pace than other major markets, reflecting the more value orientation of the market components (eg energy and materials stocks).

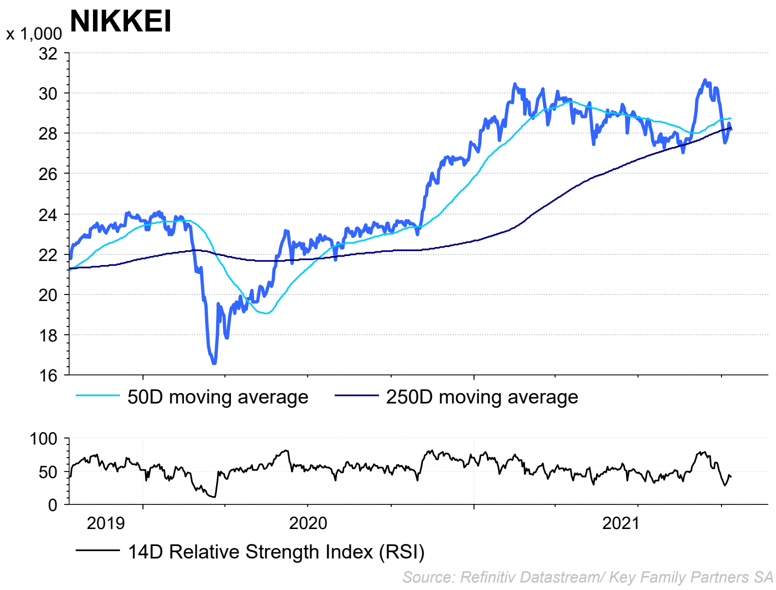
Economic activity has slowed (September Composite PMI 54) and is likely to fall further on supply disruptions.

Sentiment remains neutral and valuation remains very attractive at 12.1x prospective 2021 earnings. Prospective dividend yield is 4.1%.

The outlook is moved to NEUTRAL, but with some further downside risk on interest rate concerns.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	+0.5%	+2.9%	+19.6%



The Nikkei had a strong month on continued recovery hopes, while monetary policy remains very loose.

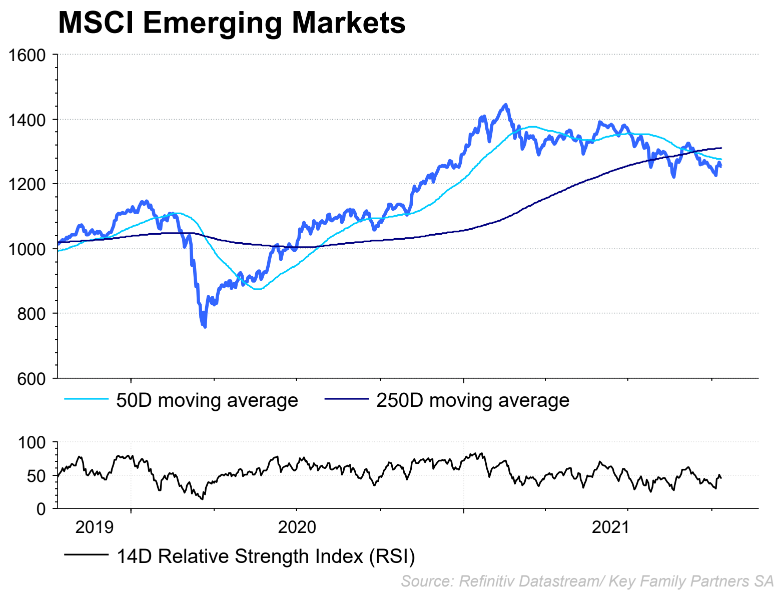
Japan is likely to be materially impacted by events in China and could therefore see a renewed slowdown if those events escalate further.

Market sentiment moved to a more positive outlook, while valuation moved up to 17.9x prospective 2021 earnings.

The outlook remains NEUTRAL.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	-4.2%	-2.9%	+10.3%
China CSI 300$	+1.6%	-6.3%	+0.9%



EM equities overall had a negative month on rising USD interest rates and developing events in China.

Latam markets in particular were hit, with the Brazilian market down -12.1% in USD.

China on the other hand managed to buck the trend, surprisingly, given developing events there while India put in a solid performance of +2.0% in USD.

Overall valuation is 13.2x prospective 2021 earnings.

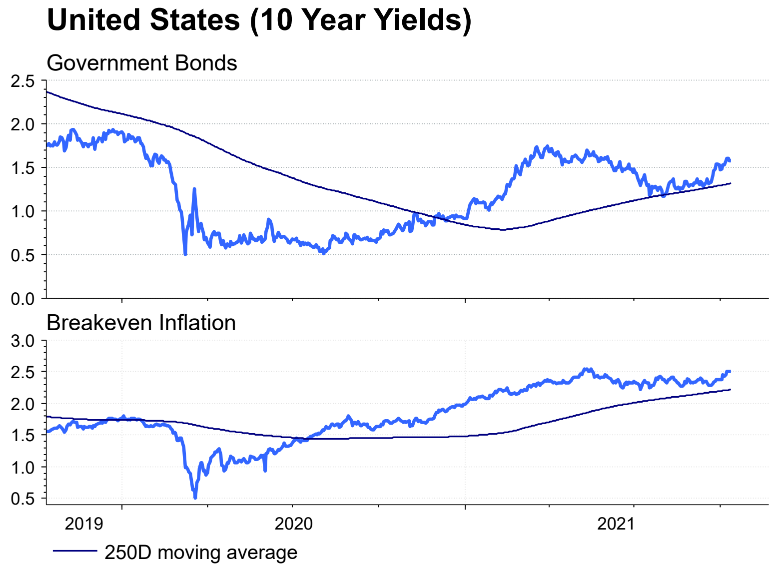
Rising USD interest rates are negative for EM overall and sentiment has turned negative.

The overall outlook is moved to NEGATIVE.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	-2.1%	-3.9%	-4.8%



Source: Refinitiv Datastream/ Key Family Partners SA

Yields on 10-year Treasuries jumped to 1.54% (from 1.31%) in the month as the market started to take note of the inflation risks and the Fed tightening cycle.

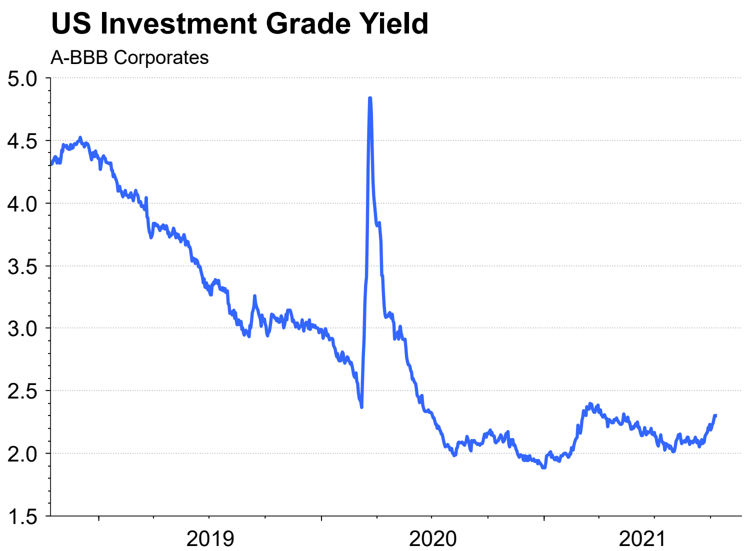
The Fed's more definitive statements on tapering and the prospects of interest rate rises next year, and continuing inflationary pressures, finally spurred the markets to recognise the reality.

Sentiment towards Treasuries and most G10 Government bonds has turned firmly negative.

The outlook remains NEGATIVE long term on continuing inflation risks and rising interest rate expectations.

Investment Grade

	1 month	YTD	12 month
US Inv Grade	-2.2%	-2.8%	-0.3%



Source: Refinitiv Datastream/ Key Family Partners SA

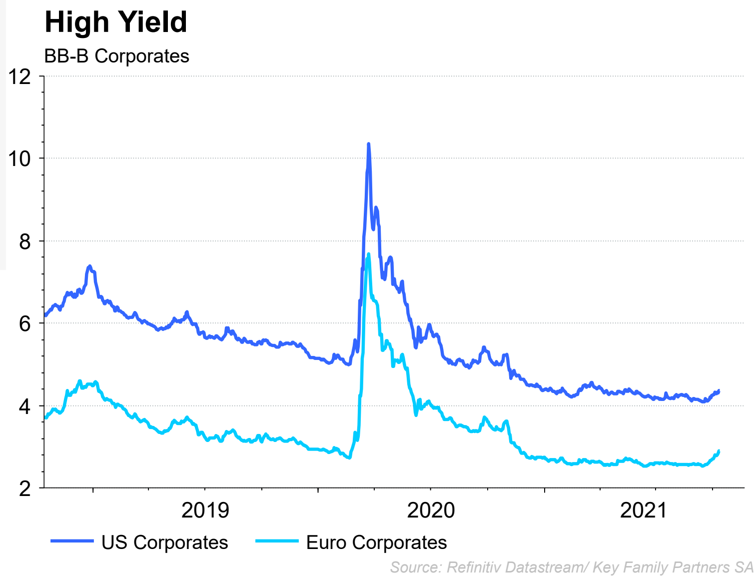
Yields on investment grade corporates rose again on the back of rising Treasury yields, while spreads fell to new record lows.

Clearly investors are taking the view that credit risk on investment grade is minimal, which could be costly if the economy slows further.

The outlook is changed to NEGATIVE.

High Yield

	1 month	YTD	12 month
US High Yield Total return	-0.8%	+2.8%	+6.8%



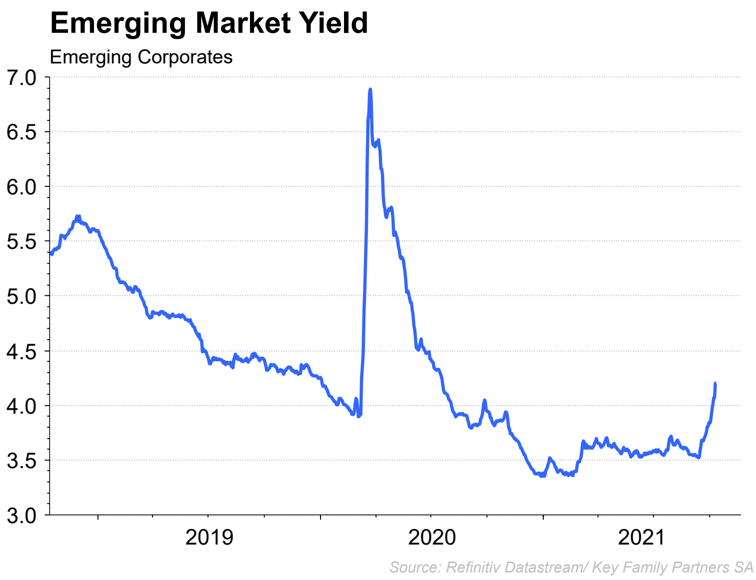
US HY bond yields rose slightly while spreads fell again, leaving a small positive total return.

Spreads remain at historic low levels, representing a belief that credit risks on high yield are historically low. Whether this is a reasonable assumption given the new tightening cycle is debatable. For the moment yield hungry investors are ignoring it.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	-1.9%	-0.9%	+2.7%



Yields and spreads rose on EM USD debt, in line with rising risk to EMs from the Fed's new tightening cycle.

Evergrande events in China have also impacted sentiment on Asian USD bonds, as interest payments have now been missed by the company on outstanding bonds. The situation seems to be getting worse by the day.

Sentiment has turned negative on EM debt as a whole, and the outlook is moved to NEGATIVE.

CURRENCY – USD vs DM, EM

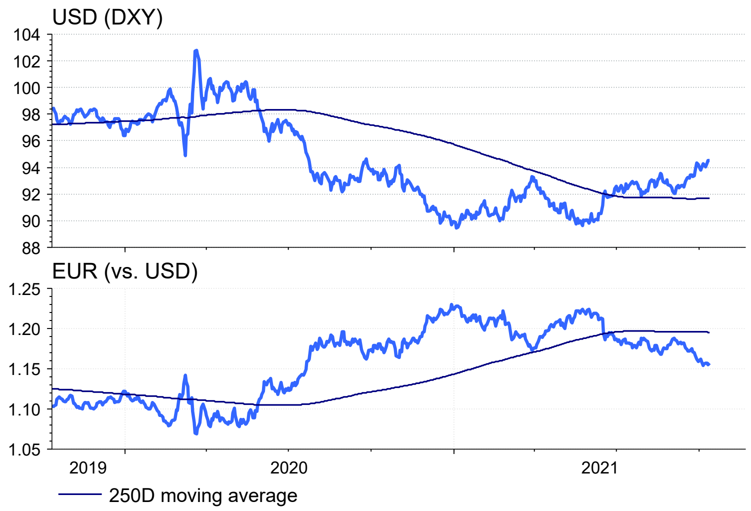
USD vs DM currencies

The USD rose against most DM currencies in September as yields on USTs picked up.

For now, the sentiment is positive USD as investors move back into the higher yielding currency, and the twin deficits are ignored. Prospects of a recovery in growth next year in the US is encouraging that view.

The outlook is moved to NEUTRAL with a positive bias.

USD and EUR



Source: Refinitiv Datastream/ Key Family Partners SA

CURRENCY – USD vs DM, EM

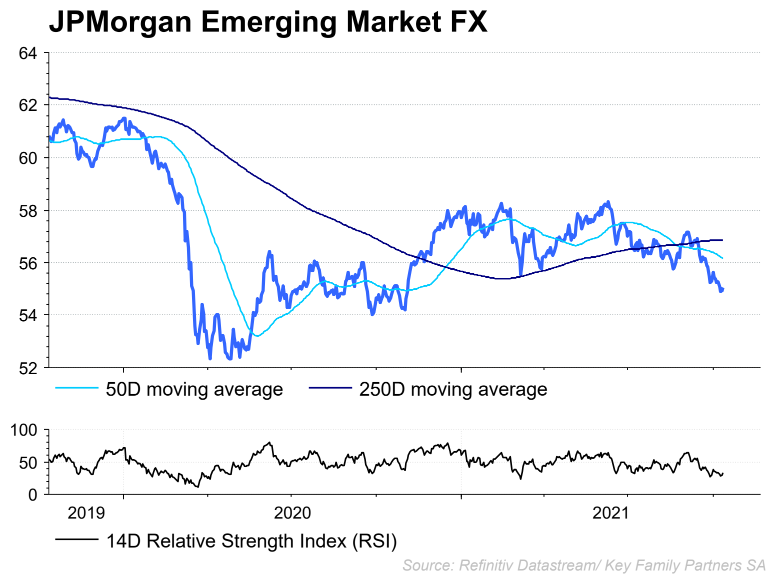
USD vs EM Currencies

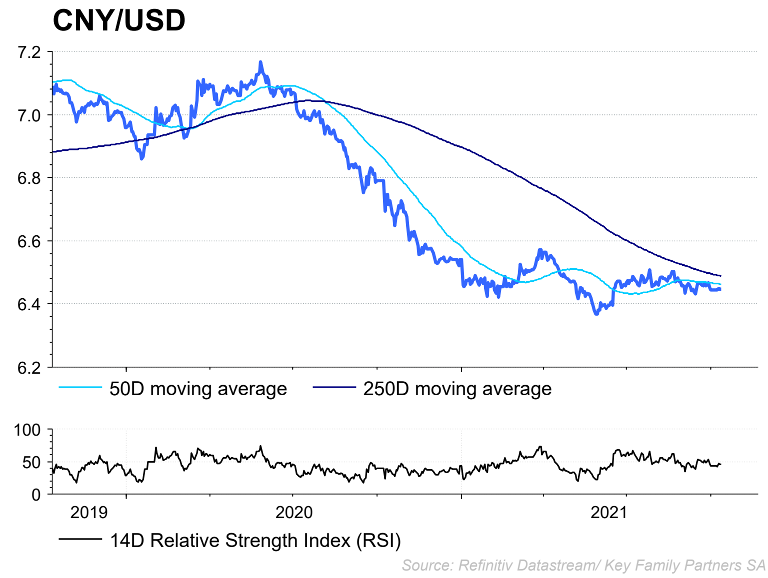
EM currencies, led by CNY, were generally flat for the month against the USD.

Overall sentiment has turned more neutral towards EM currencies vs USD. The yield uptick from investing in EM assets has narrowed as the yield on US assets has risen.

Having said that, the CNY continues to hold its level as the Government seeks to maintain stability in the currency market. Given the stated aims of the CCP, it is likely this stability will be maintained despite other developments in the country.

The USD outlook vs EM currencies is moved to NEUTRAL.





GOLD

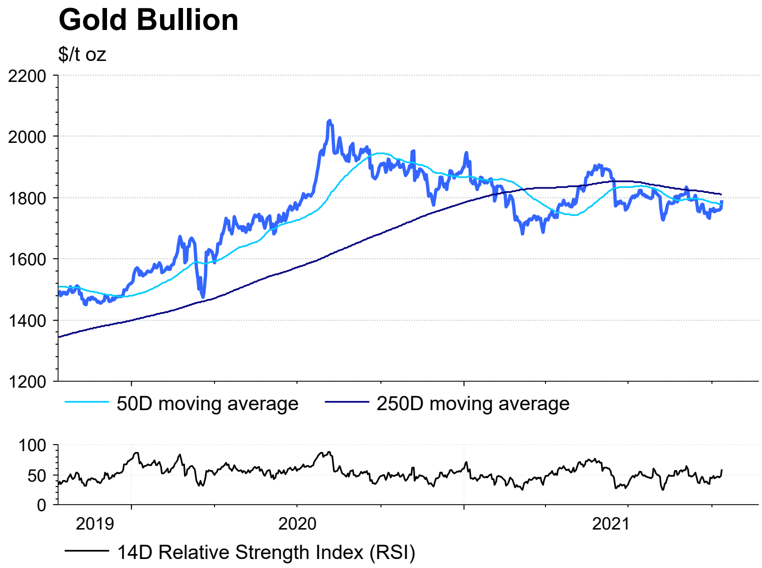
	1 month	YTD	12 month
Gold	-1.9%	-7.2%	-6.9%

Gold reacted negatively to the rising market interest rates.

Sentiment has turned more negative but short term gold is oversold and likely to see a recovery.

Given the continued uncertainties in financial markets worldwide, gold remains a key diversification asset longer term.

The outlook for gold is moved to NEUTRAL.



Source: Refinitiv Datastream/ Key Family Partners SA

COMMODITIES

OIL

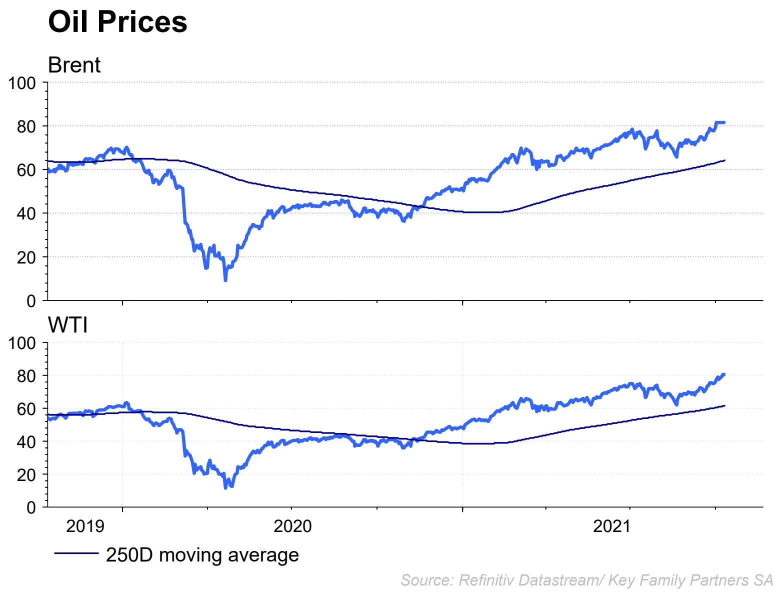
Oil resumed its upward move as energy shortages became widespread.

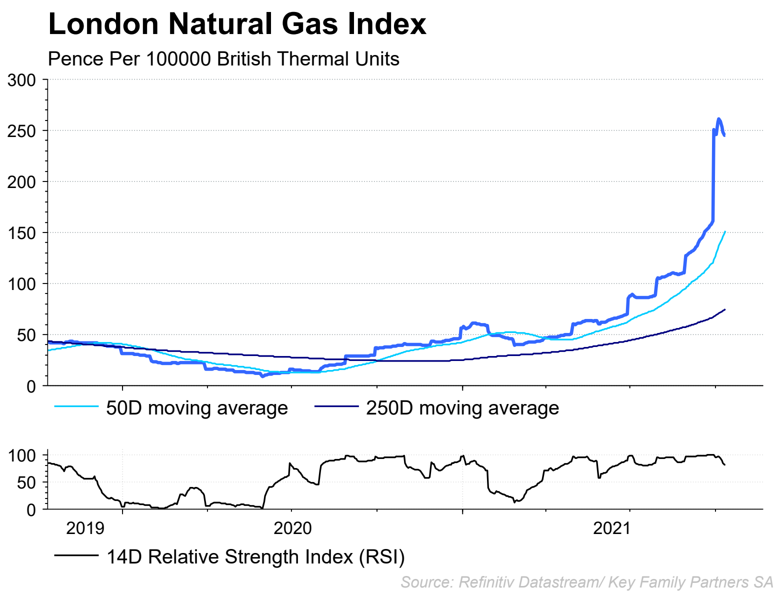
Not only oil, but natural gas and coal (not shown) have seen large upward price movements since the lows of the recession.

This is clearly the impact of supply shortages, whether caused by reduced investment in production capacity, or political motivation, including the consequence of the green lobby on carbon energy production. The world cannot yet do without carbon-based energy and demand is likely to continue to grow – even with growing alternative energy supplies.

Market sentiment towards oil (and other carbon based energy sources) remains positive.

The outlook for oil is moved to POSITIVE.



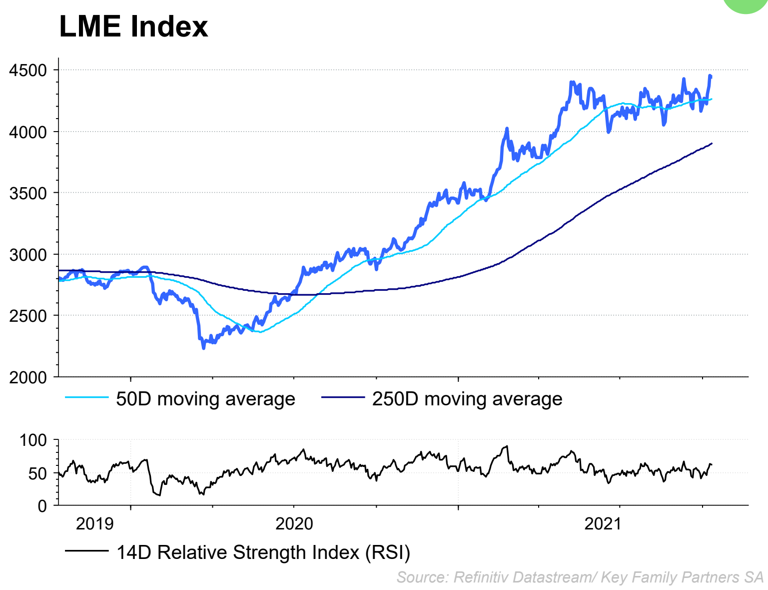


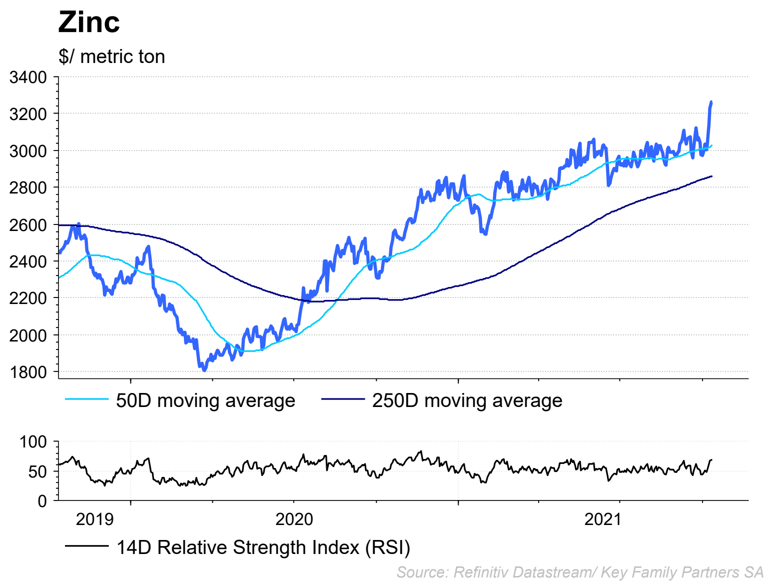
COMMODITIES

METALS

Metals prices continued their downward trend on weak demand, especially from China. However the falling long term trend is flattening and the shorter term looks more positive. Any recovery in growth could see metal prices recover from these very low levels.

The outlook remains NEUTRAL for the time being for the main metal prices assuming a soft landing.





ILLIQUID ASSETS

We have decided to remove the section on illiquid assets for several reasons:

- This report is more focused on real time economic and liquid market events
- Within each illiquid asset class there are so many sub classes that trying to generalise is not necessarily helpful
- Investment returns tend to be much more specific investment or manager dependent than for liquid asset classes

Illiquid assets are essential investment strategies, but they should be considered on a case by case basis for suitability and return potential. Please don't hesitate to request input on these asset classes when considering them.

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