KEY FAMILY PARTNERS

Global Market View

April 2021

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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

Early Warning Signals?

While real time economic data continues to follow the recent growth and inflation script from previous Global Market View reports, a number of recent events in financial markets might serve as early warning signs of trouble ahead – rather as singing canaries signalled forthcoming danger in coal mines before the advent of electronics.

Firstly, the bankruptcy of Greensill Capital in early March. The supply chain (trade finance) financing company, which was valued at $3.5billion less than two years ago when Softbank invested $1.5billion, collapsed after insurers withdrew $4.6 billion of insurance cover on the trade finance loans it had extended. Without the insurance Greensill could no longer raise further funds to make new loans to its clients, forcing some of those to the brink of default – and Greensill to default on its own funding.

Secondly, an investment firm (Archegos Capital Management) defaulted on margin calls for its highly leveraged, estimated $50billion portfolio (FT) of mainly tech stocks in the US and China, leading to the forced liquidation of the portfolio and 100% loss of the firm's capital – and large losses for the banking institutions that had provided the leverage. The stocks were not held directly but through total return swaps and other derivatives with financial counterparties, and thus evaded disclosure rules on the stocks held. The proximate cause was a decline in tech stock prices over the previous days before the margin call - and especially in Viacom, one of the largest holdings in the portfolio, although the full details are not yet public.

Why is this important, and what is the connection between the two events? Both can be linked directly to the impact of rising USD interest rates, bringing memories of 2008 and earlier financial crises.

Financing was provided by Greensill to companies such as Abengoa of Spain (filed for insolvency in February) and GPG of the UK (at risk of bankruptcy, seeking Government support), both highly leveraged firms which relied on Greensill financing– classic "zombie" companies which have been impacted by rising USD interest rates. Greensill used securitised funds to raise money from HNW and institutional investors on the basis that the underlying assets (loans to Greensill clients) were insured. Those investors, and the equity providers, are likely to see $billions in losses.

In the case of Archegos, the lack of transparency in its operations raises the question of how many other significant investment vehicles exist with similar levels of leverage, which could destabilise financial markets as longer term interest rates continue to rise?

Back in 2007, similar early warnings were provided by the failure of two leveraged Bear Sterns funds, which were invested in sub-prime mortgages (via securitised CDOs), and which eventually led to the failure of Bear Sterns itself. The rest is the history of the 2008/9 financial crash.

In 1998, the failure of the fund Long Term Capital Management (it was not long term and managed to lose all its capital) was driven by high leverage on EM bonds during the 1997 Asian financial crisis. The Fed arranged an orderly liquidation of the fund to avert a financial market meltdown.

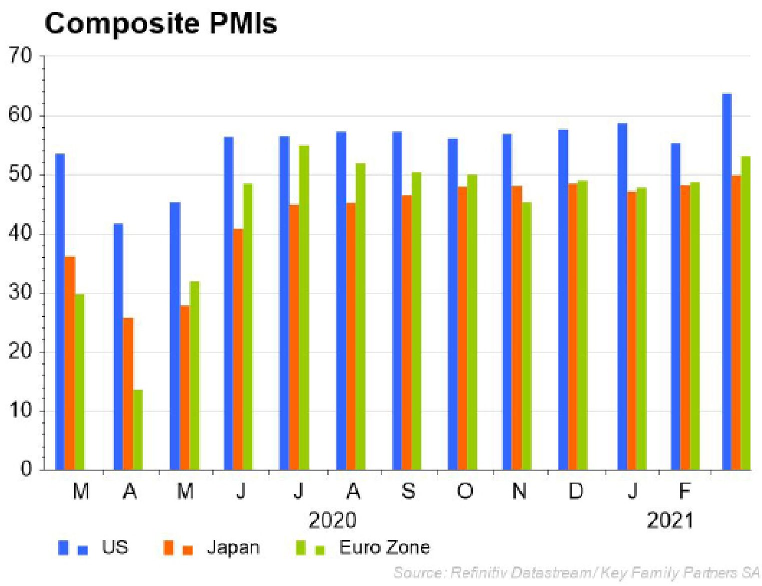
Today we have some similar characteristics: rising longer-term USD interest rates in a highly leveraged environment, negatively impacting bond prices and equity market valuation multiples (especially in the tech sector) and the financial viability of 'zombie' companies.

Are these warning signs a prelude to another economic and financial crisis, or are they one off company specific events? The answer probably lies in the future course of USD interest rates – and the Fed's reaction. The pressure on the Fed to implement some Yield Curve Control is growing.

Growth and inflation on course

As described in prior reports the world economy is on course for a strong economic recovery and rising inflation. The latest figures confirm this outlook:

Growth: Composite PMI data continues to show expansion across the world suggesting the expected recovery remains on track.

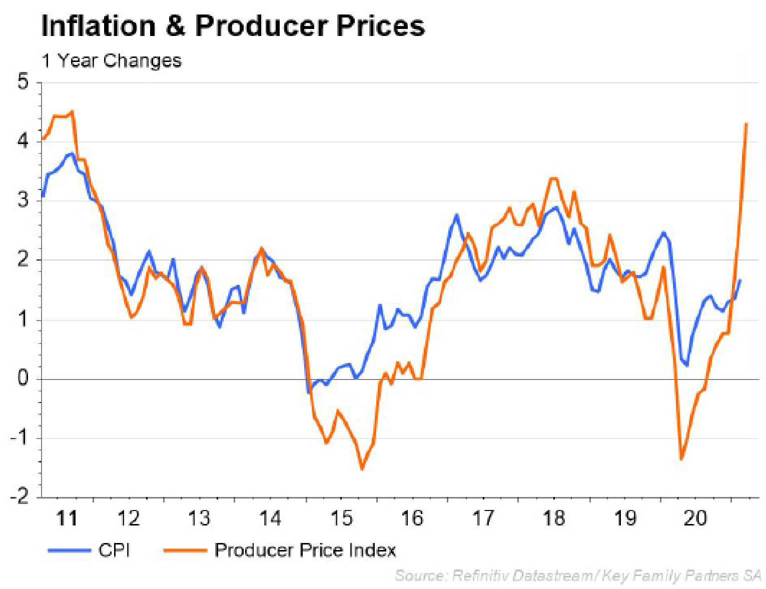


Note that China's PMI remains stable and slightly positive up to end February, March data not yet being available. Renewed lock down restrictions in the EU may delay the anticipated recovery, but is not expected to tip it back into recession. The UK continues to recover strongly as lockdown restrictions continue to be lifted, even though Q1 GDP is expected to show a contraction of approximately 2.0%

Recovery stimulus continues to flow from US Government's coffers. The Administration announced $2 trillion of new fiscal spending on infrastructure and manufacturing subsidies (with a green and technology bias), adding to the already substantial stimulus to the economy over the past year. However, the difference this time is that corporate taxes will be raised to pay for the spending, raising strong protests from the opposition party, but perhaps avoiding another large expansion of the deficit. **The price of higher taxes will be a reduction in after tax earnings for US companies, estimate to reduce earnings yield from 2.1% to 1.9% - approximately 10%, and with implications for equity market valuations.**

Inflation

Evidence of rising inflationary pressures are coming in daily, from commodity price impact on CPI (left hand chart) to housing price rises in the US (right hand chart) driven by a shortage of new housing supply.

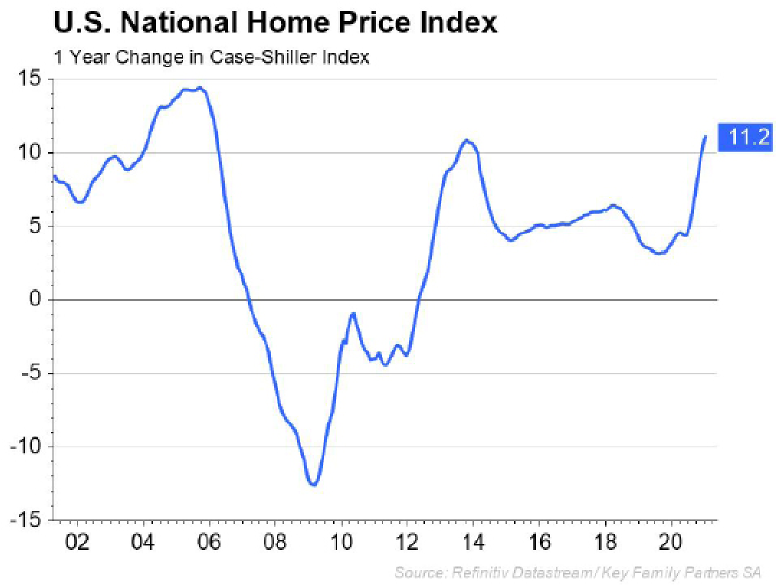


Most importantly, inflation expectations continue to rise strongly. 2-year expectations have now risen to 2.7%, substantially exceeding the Fed target at 2.0%. 2-year Treasury yields remain anchored at 0.16% providing strong negative real yields over that period, while 10-year yields have risen to 1.71% (from 1.42% at the beginning of March)

The impact on inflation of cost push (raw materials and labour) and demand pull from a strong recovery is being augmented by supply disruptions and bottlenecks – the most recent being the blockage of the Suez Canal – meaning that inflationary expectations may be under-estimated over the next 12 months.

The impact of rising price inflation on asset market performance has been the subject of much debate and study, but the conclusion seems to be (from Bridgewater):

- In the first two years of rising inflation, equity markets, gold and commodities provide positive nominal and real returns, while bonds and cash are flat to negative.
- Thereafter if inflation keeps rising, equity and bond real returns turn negative while commodities and gold continue to deliver positive returns.



These are important conclusions for investors given where we are in the inflation cycle.

In summary...

- Some early warning signals on the economy may have been seen, driven by higher market interest rates
- Meanwhile, the economic recovery is on track albeit at differing rates across economic blocks
- Inflation is pushing higher and may exceed expectations over the coming months

For investors...

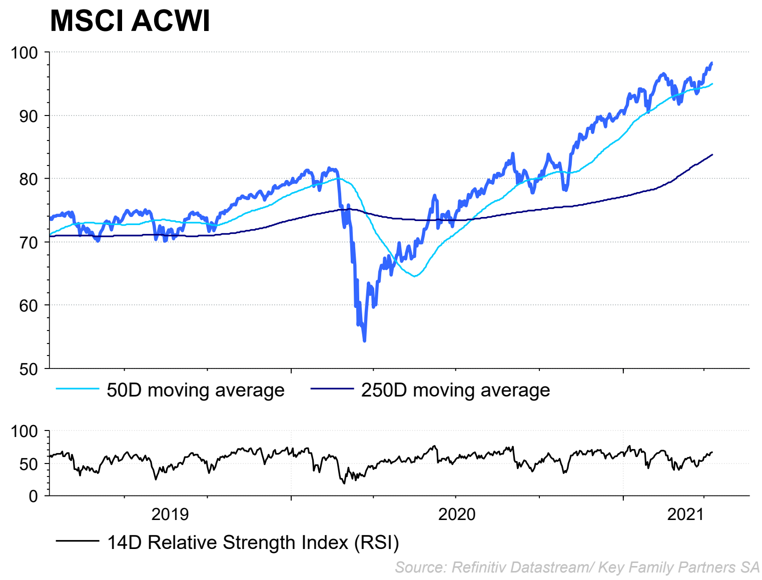
- Continue to hold equities for the recovery/growth outlook, but beware early warning signs of trouble ahead from rising interest rates
- Continue to be cautious on any fixed income investments.

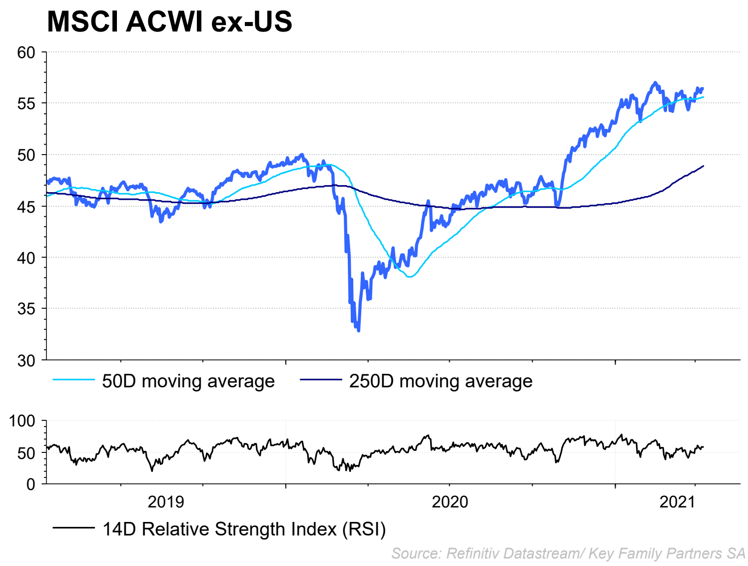
EQUITIES

Equity markets advanced for the month, but with tech and EM markets being laggards.

NB The very strong 12-month performance number reflects recovery from the lows seen in March 2020.

GLOBAL EQUITIES	1 month	YTD	12 month
Global Equity	+2.4%	+4.2%	+58.1%
Global Eq. Ex US	+0.9%	+2.9%	+50.4%





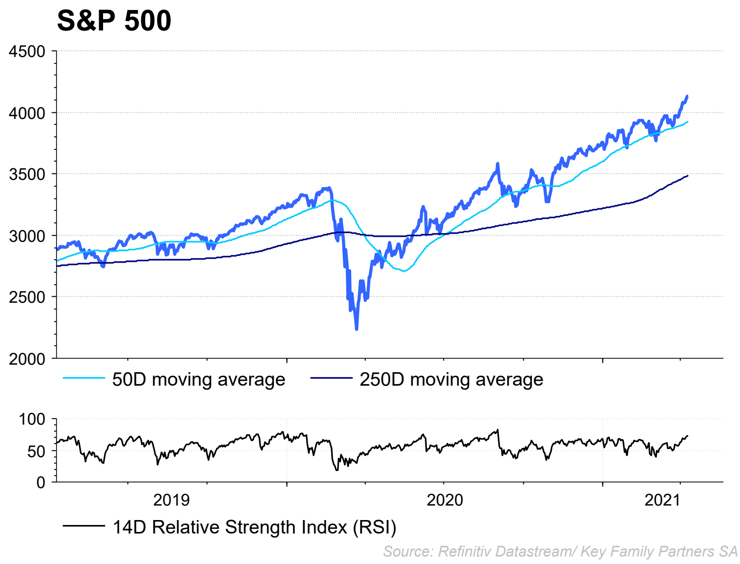
Global equities rose on the month, based on the MSCI All Country World Index, in spite of rising USD market interest rates.

Global growth remains positive with valuations on adjusted **2021** expected earnings steady at 20.3x on earnings recovery expectations, but this remains elevated on a 10-year average and vulnerable to higher rates.

Longer-term and short-term sentiment has become more neutral.The outlook remains POSITIVE with some downside risk due to rising market interest rates and elevated valuations.

USA

	1 month	YTD	12 month
US Equity	+4.2%	+5.8%	+53.7%



The S&P500 had a strong month in March, and broke the 4,000 level for the first time on April 1st.

Economic recovery remains strong while inflation expectations are also rising, which is overall positive for equities in the short term. However, tax rises will reduce corporate after tax earnings.

Market sentiment has turned more neutral, both longer and shorter term. However rapidly rising US market interest rates and higher corporate taxes have the potential to derail this bull market as earnings fail to make expectations.

Valuations remain elevated at 23.0x prospective 2021 earnings, and at risk if market rates continue to rise from here. The outlook remains NEUTRAL but with growing downside risk.

NASDAQ Comp

	1 month	YTD	12 month
NASDAQ	+0.4%	+2.8%	+72.0%
FAANG+ Index	-4.5%	+2.6%	+116.4%

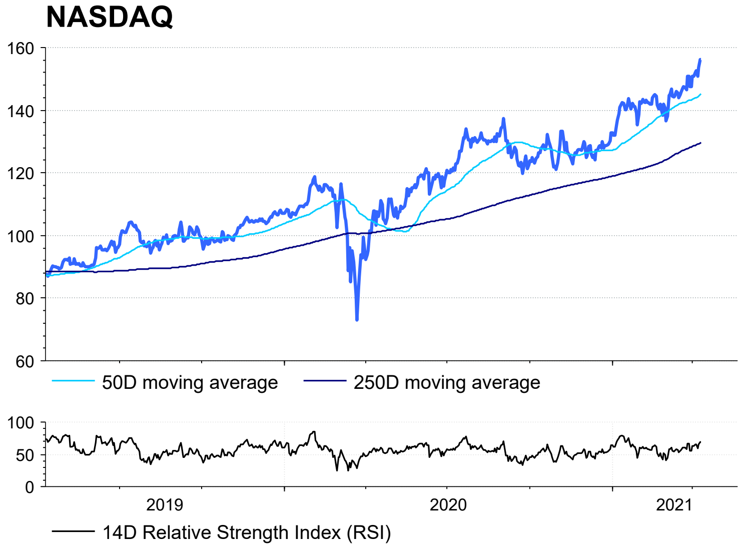
The NASDAQ had a flat month, while tech stocks (FANG+) sold off for the worst monthly performance since a year ago as rising interest rates ate into multiples

Valuations of both indices were flat at 33.1x

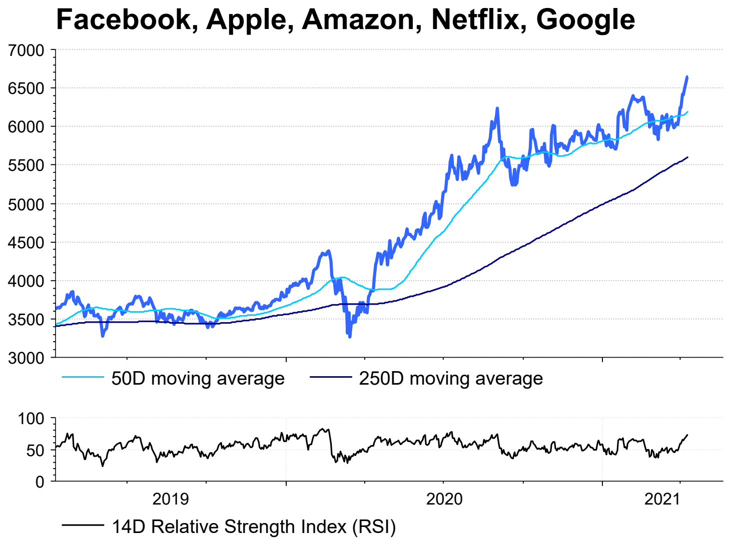
prospective 2021 earnings for NASDAQ and 34.6x for the FANG+ index, with both remaining at elevated levels and **at further risk of rising market interest rates**.

Meanwhile sentiment remains positive for both markets longer term, and the economy is recovering.

The outlook remains NEUTRAL with downside risk due to rising market interest rate.



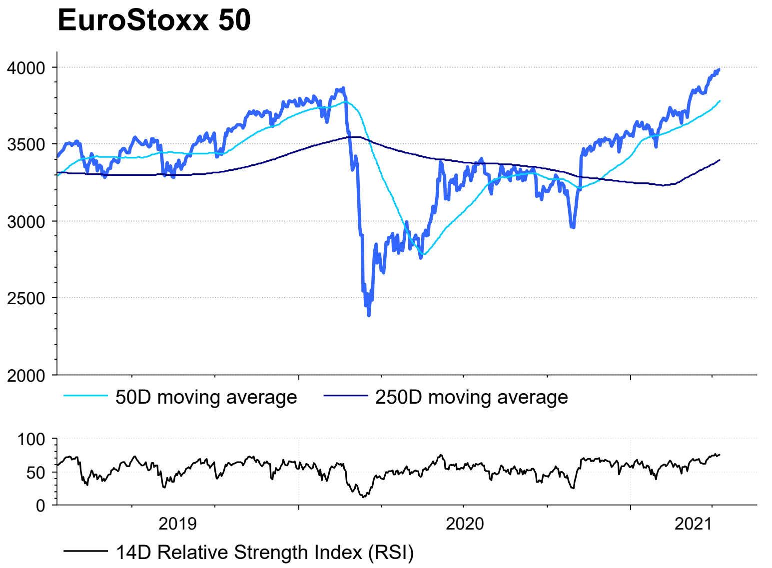
Source: Refinitiv Datastream/ Key Family Partners SA



Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE

	1 month	YTD	12 month
EU Equity €	+7.8%	+10.3%	+40.6%
$	+5.1%	+6.1%	+49.8%



Source: Refinitiv Datastream/ Key Family Partners SA

Euro equities performed strongly again in March on evidence of a recovery in manufacturing across the EZ, although there may be a pause in the recovery now due to new virus control restrictions.

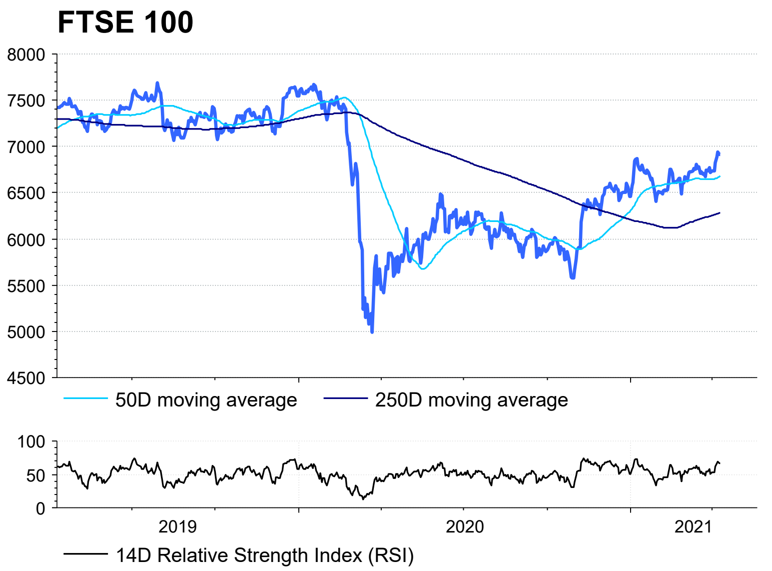
Valuation rose to 19.0x 2021 prospective earnings which now moves to the higher levels of the past 10 years.

Sentiment has turned more positive in spite of the month end correction.

The outlook remains NEUTRAL.

UK

	1 month	YTD	12 month
UK Equity £	+3.6%	+3.9%	+18.4%
$	+2.7%	+5.0%	+31.7%



Source: Refinitiv Datastream/ Key Family Partners SA

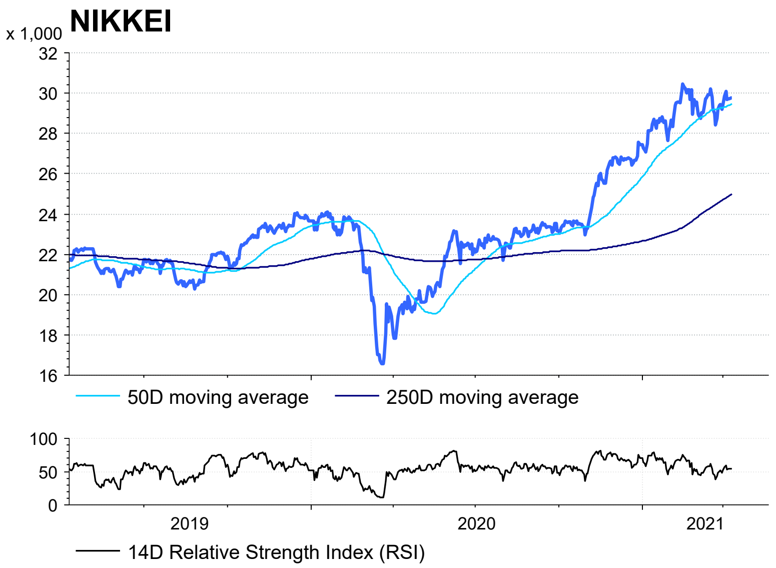
The FTSE100 had a strong month on growing confidence of economic recovery and the vaccination success.

Valuation remains attractive with a P/E on expected 2021 earnings of 14.3x, while sentiment has turned more positive. The FTSE100 is essentially a basket of value type stocks, which will benefit from the current rotation from growth.

The outlook is moved to POSITIVE given the UK's recovery potential and valuation.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	-1.6%	+6.3%	+61.5%
$	-5.2%	-0.9%	+56.8%



Source: Refinitiv Datastream/ Key Family Partners SA

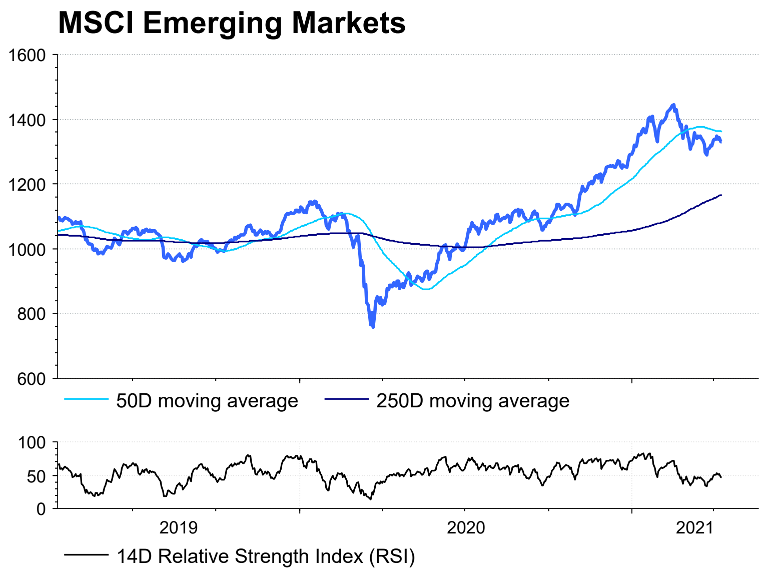
The Nikkei sold off further in March while sentiment weakened. Economic data was not seen to be improving as rapidly as other countries, with the composite PMI remaining flat at 48.3 for March.

Longer term sentiment remains positive, while valuation remains elevated at 21.6x prospective 2021 earnings.

The outlook remains NEUTRAL with a positive bias.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	-1.7%	+1.9%	+59.1%
China CSI 300$	-5.4%	-3.1%	+36.9%



Source: Refinitiv Datastream/ Key Family Partners SA

EM had a weak month, dragged down again by the China market, and their tech stocks in particular.

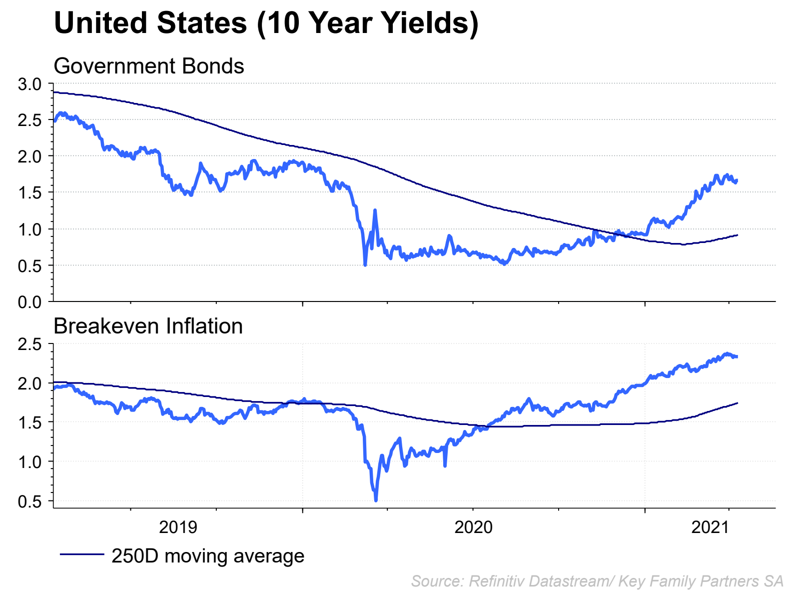
EM will benefit from the strong recovery expected in the G7 markets, while domestic inflation remains subdued.

Sentiment longer term remains positive and valuations attractive at 15.6x prospective 2021 earnings.

The outlook remains POSITIVE on EM equities given the global growth outlook.

FIXED INCOME

Developed Government Bonds	1 month	YTD	12 month
US Treasuries Total return	-1.28%	-4.25%	-4.80%



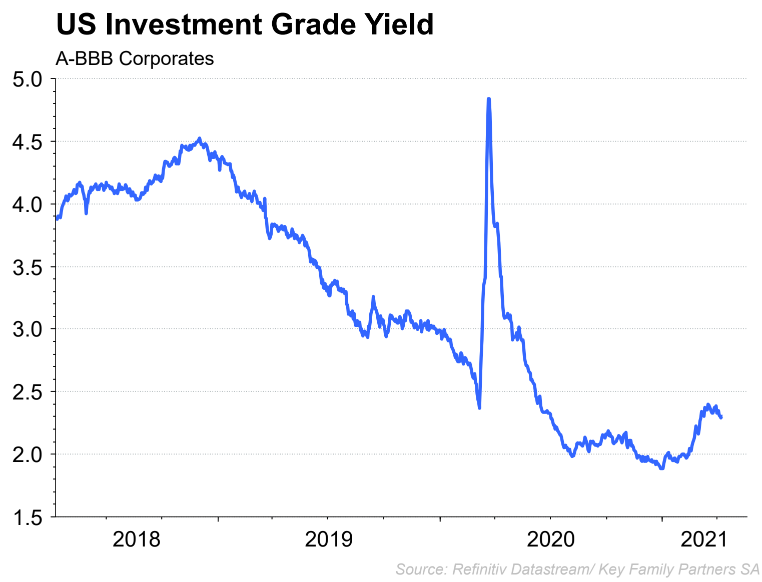
Yields on 10-year Treasuries rose strongly once again during the month reaching 1.69% after briefly breaking the 1.70% level, **delivering the worst quarterly performance in 40 years for US Treasuries** (and a negative 1-year performance). 10-year break even inflation expectations rose further to 2.36%, leaving real rates over 10 years in negative territory.

Longer term, yields are likely to rise further to match inflation expectations. **Short-term however, the rise in yields is seriously over extended and a pull back is likely** as some investors take advantage of the higher yields on offer.

Longer term leading indicators for future inflation continue to rise (not shown).

The outlook remains NEGATIVE long term on a deteriorating inflation outlook, but with a short term pull back to lower yields.

Investment Grade	1 month	YTD	12 month
US Inv Grade Total return	-1.42%	-4.65%	+8.94%



Yields on investment grade corporates continued to rise to 2.28%, in spite of spreads staying flat at 90bps.

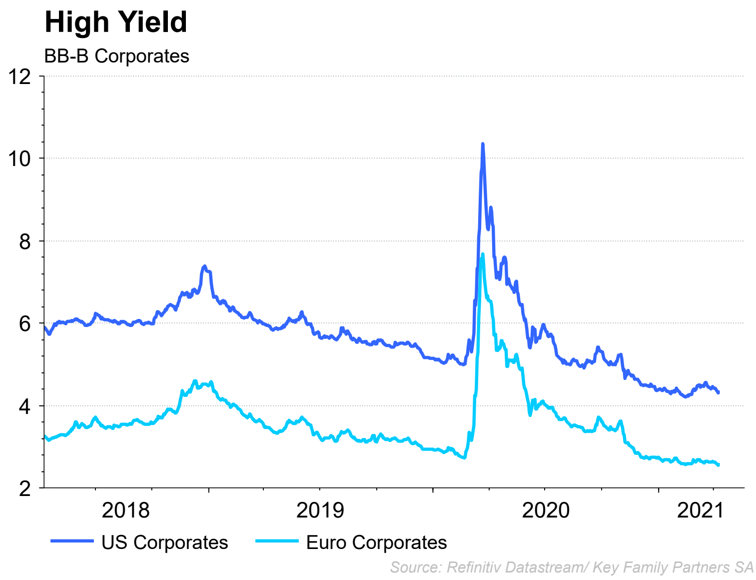
Given the record narrow spreads, IG performed in line with Treasuries and also delivered one of the worst performance quarters on record.

At these levels, the market is seriously oversold, and IG are once again attracting investors.

The outlook remains NEGATIVE long term with a neutral bias in the short term.

High Yield

	1 month	YTD	12 month
US High Yield Total return	+0.10%	+0.85%	+25.97%



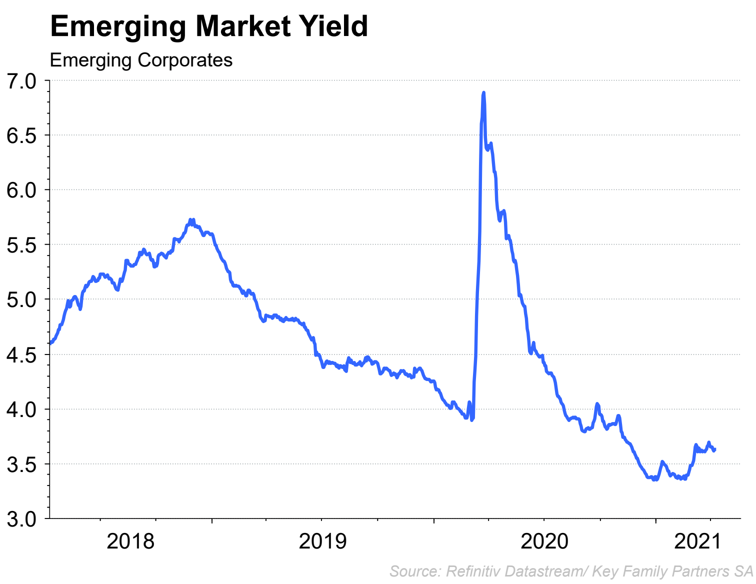
US HY bond yields were flat over for the month while spreads narrowed marginally.

HY remains attractive to investors providing a real yield over inflation expectations. However record narrow spreads over Treasuries remain a risk factor in the event that the economic outlook, and therefore credit risk, worsens in the future.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	-1.36%	-3.48%	+14.24%



Yields on EM USD debt rose above 4.0%, while spreads remained at record low levels.

Investors will still find this yield level attractive given the premium over inflation and the sounder macro-economic policies of many EM countries, particularly China.
The outlook remains NEUTRAL with a positive bias.

CURRENCY – USD vs DM, EM

USD vs DM currencies

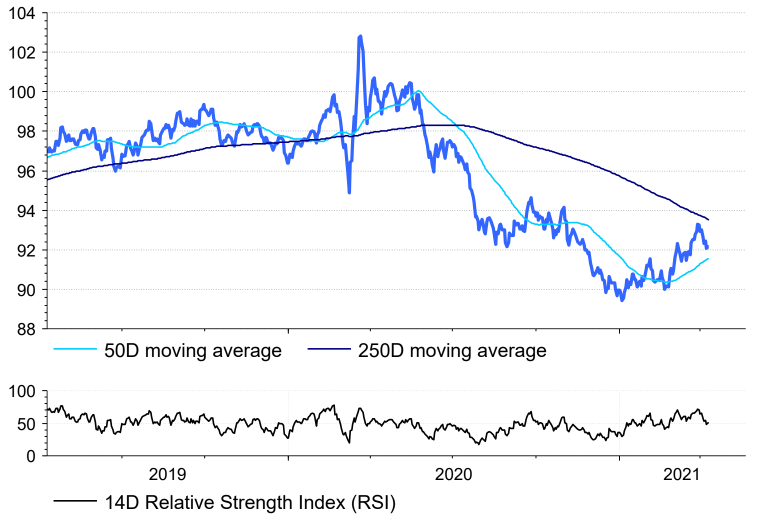
The USD continued to rally as longer-term yields rose attracting investors looking for yield in G7 currencies. Sentiment has turned more positive short term, while remining negative longer term.

However, the current account remains deeply negative, supplying large quantities of USD into the global economy. As the recovery in the US gathers pace, the current account deficit is likely to expand along with the budget deficit.

The main support for the USD is the rising longer- term yields. The Fed decision on any Yield Curve Control will weigh heavily on the prospects for the USD, and in the event that they implement YCC the USD will likely weaken further as yields stay low and real yields negative.

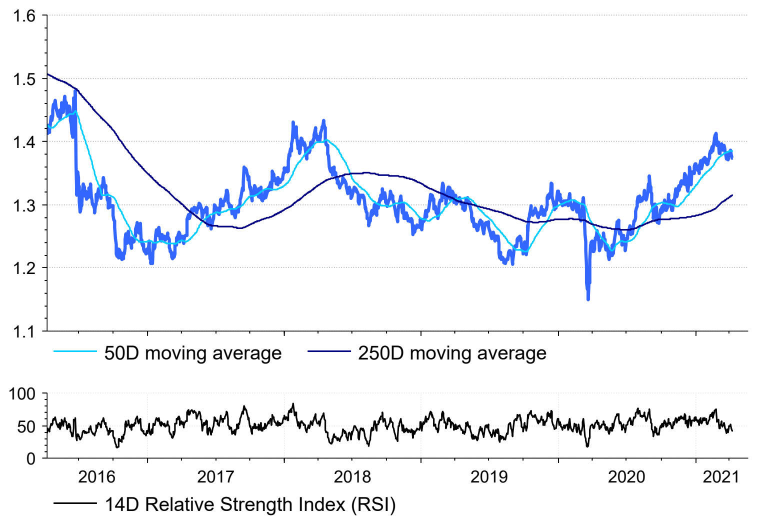
The outlook is moved to NEUTRAL given the attractive yields now on offer in the USD.

Dollar Index



Source: Refinitiv Datastream/ Key Family Partners SA

GBP/USD



Source: Refinitiv Datastream/ Key Family Partners SA

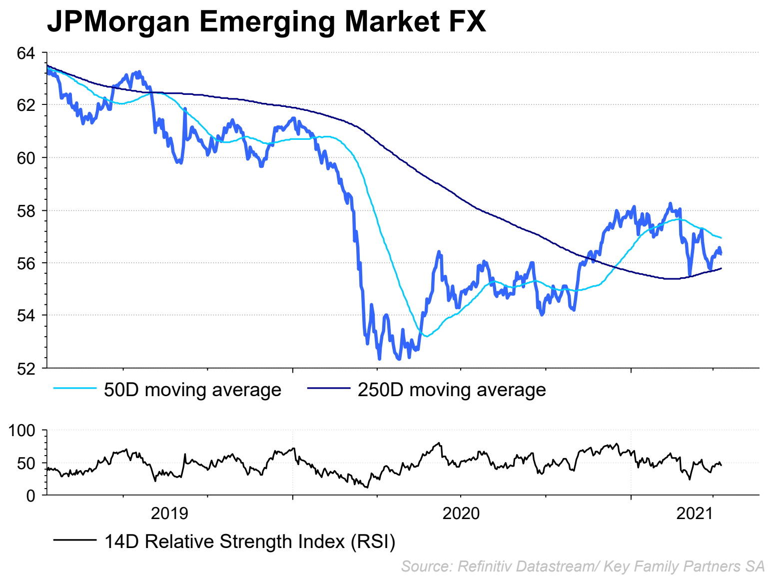
CURRENCY – USD vs DM, EM

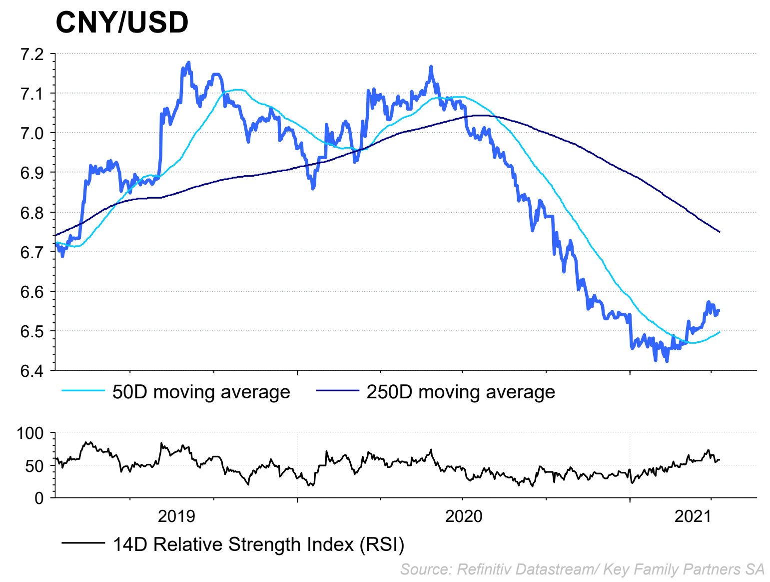
USD vs EM Currencies

EM currencies were largely flat over the month with the exception of the CNY which weakened against the USD. Given that a strong CNY acts like a monetary tightening on the Chinese economy, it is likely that the authorities are trying to avoid too much of an economic slowdown in the growth rate – recent PMI numbers have been flat in China.

All major EM currencies maintain positive yields differentials over the USD, keeping them attractive to currency investors.

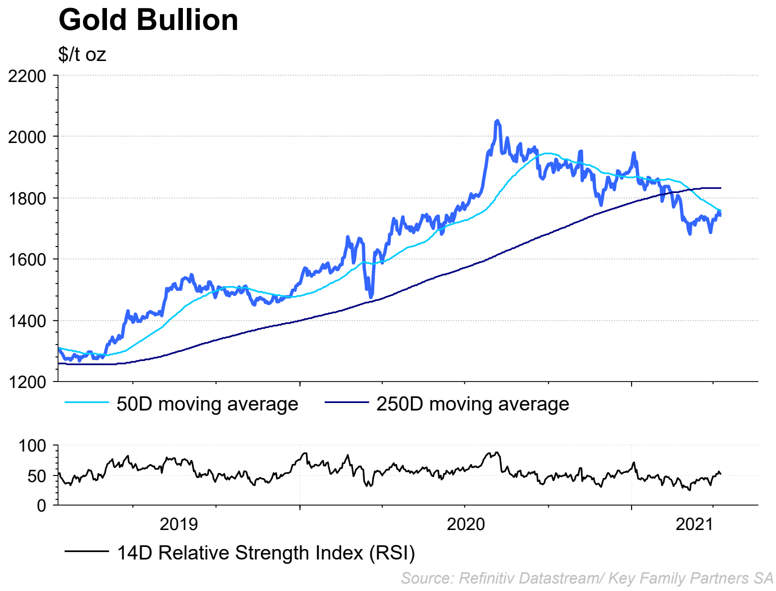
The USD outlook vs EM currencies remains NEGATIVE with a neutral bias.





GOLD

	1 month	YTD	12 month
Gold	-1.6%	-10.0%	+8.2%



Gold continued to sell off as yields rose and has now reached a new major resistance level at $1,700. Any breach of this level could see gold move lower still.

However, as the higher inflation numbers come through gold should rally as a traditional inflation hedge, as confirmed by the Bridgewater research mentioned above. Short term gold is oversold and likely to see a rebound, but longer-term trends need to turn positive to support a new rally.

The outlook remains NEUTRAL.

COMMODITIES

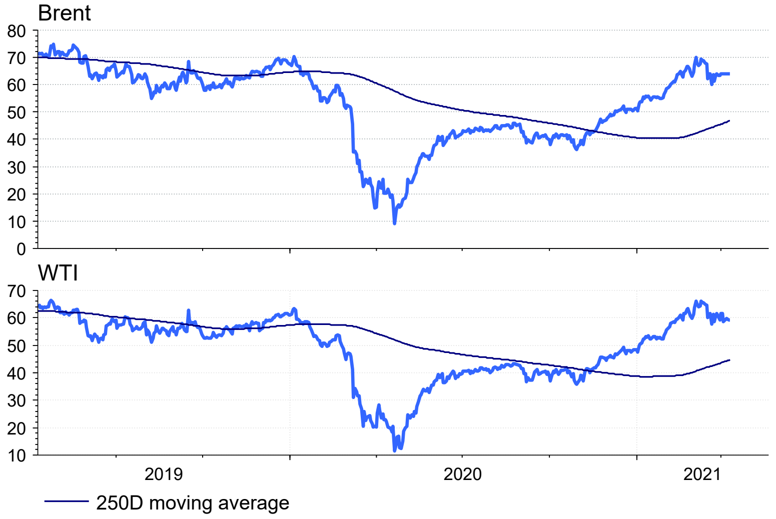
OIL

Oil prices stabilised in March ahead of the Opec+ meeting which took place at the start of April. Agreement was reached to add up to 2 million Bbls/day to production in anticipation of greater demand as the global economy continues to recover.

Sentiment remains strongly positive for oil and demand likely to continue to grow, keeping the price at these levels for the time being.

The outlook for oil remains NEUTRAL with upside potential.

Oil Prices



Source: Refinitiv Datastream/ Key Family Partners SA

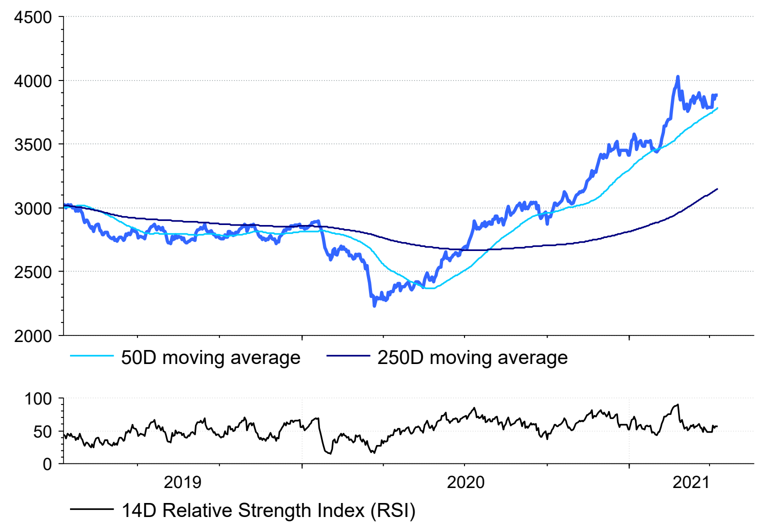
METALS

Metal prices moved sideways in March after becoming seriously overbought in February.

Copper remains a key focus as the world moves to greater electrification, especially in transportation. A recent study by CRU Group (commodity market consultants) suggested the world might face an annual shortage of up to 5million metric tons by 2030, given the slow pace of new mine development in the pipeline. If the demand assumptions are correct, the price has to move higher.

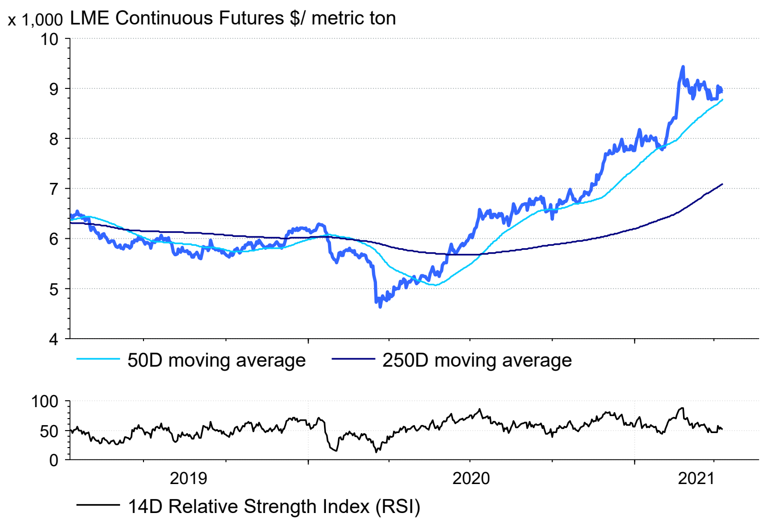
The outlook remains POSITIVE.

LME Index



Source: Refinitiv Datastream/ Key Family Partners SA

Copper



Source: Refinitiv Datastream/ Key Family Partners SA

ILLIQUID ASSETS

Real Estate	● (red)	No change from previous month
Hedge Funds	● (amber)	No change from previous month
Private Equity	● (amber)	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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