KFP
KEY FAMILY PARTNERS

Global Market View

December 2020

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🟡 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

A Record Month

In spite of a sense of suspended animation in economic direction caused by a resurgent C-19 virus, November proved to be a month of records - all of which should, one way or another, impact future economic growth and inflation. Notably,

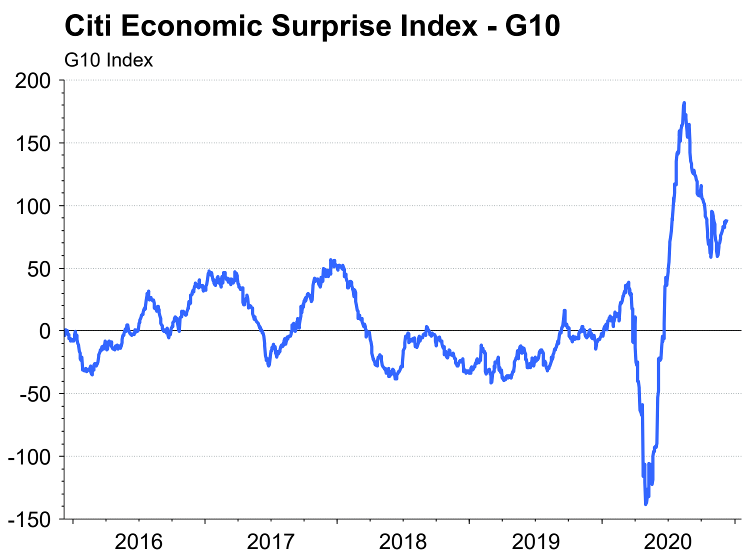
- C-19 hit new records of infection and deaths globally, with acceleration of the spread of the virus in many countries
- the fastest vaccination developments on record were announced as effective
- a record level of votes was cast in the US election
- the largest trade deal ever was signed in East Asia (RCEP)
- Government deficits hit record levels in many Western countries and Japan – by contrast with China and the other developing economies in Asia, which have pursued a more conservative strategy
- stock markets hit record levels in the US, and had the sharpest rotation from growth to value stocks in history
- the USD declined at the fastest pace in 10 year over the past 6 months, while RMB had the fastest appreciation

Any one of these events could be deemed very important for future economic and market development; coming all together in one month they look like a veritable tsunami of impacts.

Continuing recovery

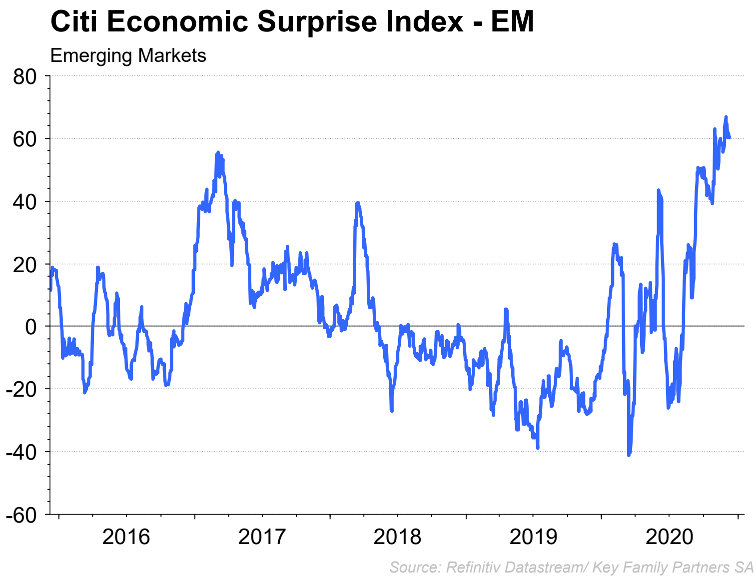
In spite of the new lockdown arrangements being imposed to fight the spread of C-19 by governments around the world, economic activity has largely continued to expand, based on the most up to date data available.

The Citi Economic Surprise Index (CESI) continues to show better than expected economic data on a global basis (chart level above zero). CESI measures actual data vs expected data globally and gives a clear "direction of travel" message for the global economy.

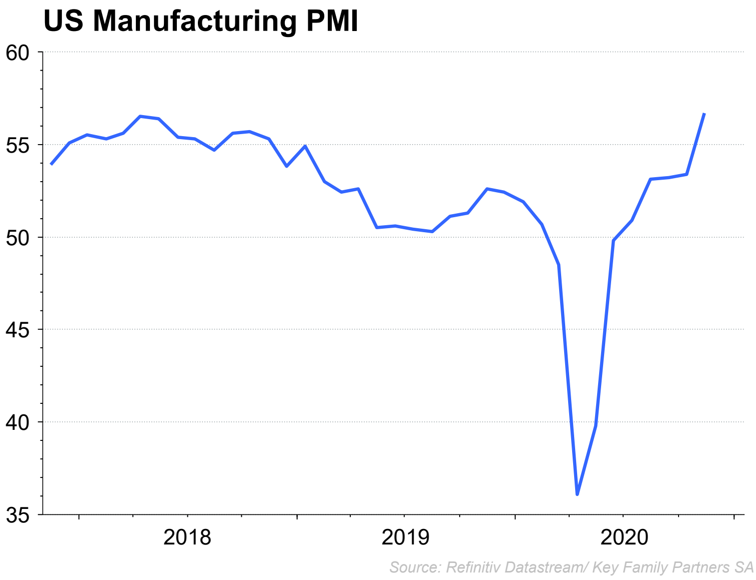


Source: Refinitiv Datastream/ Key Family Partners SA

The subset measure for EM shows EM economies continuing to recover faster than expected compared to the global economy as a whole. This is perhaps not surprising given that China's economy appears to have returned to normal levels of growth with few apparent lockdown restrictions on economic activity.



Manufacturing PMI numbers for November continued to show growth in the US and EU, while the Services PMIs for the EU and the UK slipped back into contraction in November on the back of new lockdown impacts and poorer business sentiment (not shown).



As a reminder that the world economy is not yet anywhere near back to pre- C-19 levels of activity, the IMF released the following forecast to show the impact of C-19 on the G7 GDPs in 2020. Note the poor performance of the UK, despite massive levels of stimulus in 2020 (see below)

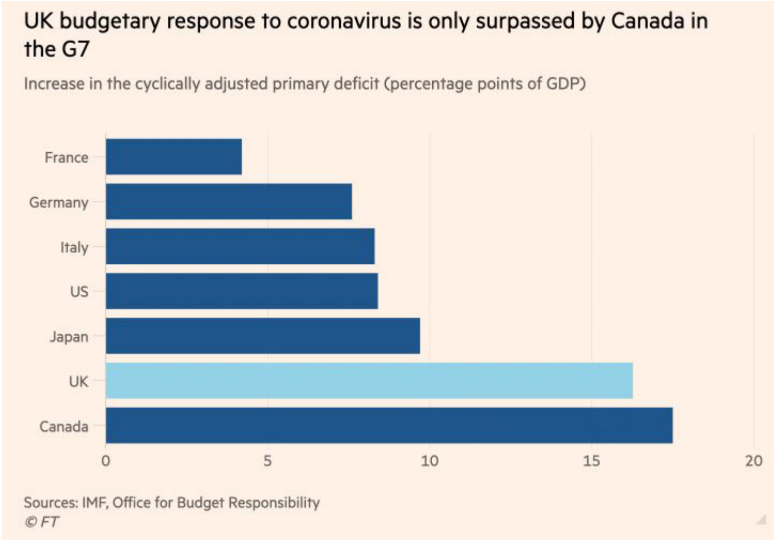
The assumptions increasingly being made by economic commentators is that with the advent of the new vaccines and planned mass vaccinations, economic recovery will continue from the record contractions we witnessed in 2020.

Indeed, there is some expectation of a upside surprise to economic growth in 2021 resulting from corporate re-stocking and pent-up consumer demand after lockdown restrictions are lifted and consumer confidence returns.

Government budget deficits grow dramatically

G7 deficits have grown dramatically in Government efforts to support their economies during 2020.

This chart shows the ADDITIONAL spending required to tackle C-19, as a percentage of GPD. While the UK expected a pre-C19 deficit in the order of 3.0% for 2020, the new forecast is 19% of GDP – an absolute peace time record by some margin. The story is similar in all developed market countries, while EM have on the whole not resorted to this level of Government borrowing.



According to the IMF, total expected Government additional borrowing in 2020 is expected to be $2.6trillion, taking global government debt to GDP to 96%, primarily in Developed economies. Japan provides a model for the future for this economic condition.

These levels of Government debt are likely to keep interest rates low for the foreseeable future, while Governments continue to finance their deficits at ultra-low interest rates – regardless of the direction of inflation. Janet Yellen as Treasury Secretary in the new Administration in the US is expected to support this view.

The Regional Comprehensive Economic Partnership (RCEP)

With little fanfare from a C-19 obsessed press, the RCEP was signed earlier this month. By some measures it is the world's largest multilateral trade agreement and constitutes a major development in China's trade empire ambitions.

10 years in the making, the RCEP is a free trade agreement covering most Asia Pacific nations led by China – but excluding India, Taiwan and the US for the time being. The 15 nations make up 30% of the world population (2.2billion) and 30% of world GDP ($26 trillion), making it the largest trade bloc in history, and larger than the North American block and the EU. It is the first trade agreement to include China, Japan and South Korea, the latter two allies of the US, along with Australia and New Zealand.

RCEP is expected to eliminate 90% of tariffs on imports between members over the next 20 years, and establish important rules on trade, e-commerce and IP in the area.

The impact of this agreement in a region of growing demography and economic power is difficult to estimate – other than to say it will be significant and likely to further concentrate economic control in the hands of China, just as China's entry to the WTO did in 2001

In summary...

- C-19 has dramatically worsened the financial conditions of the developed economies of the world, with long term consequences for growth rates (lower) and interest rates (low for longer)
- The developing economies in east Asia, and some developed economies, are taking control of their own destinies through a free trade agreement which is likely to deliver superior growth relative to other major trade blocks
- China further cements it's economic and political influence over the world's largest trading block
- Short term, the advent of a vaccine against the virus is likely to generate an economic growth spurt in 2021, and a profit recovery for those industries most negatively impacted by the pandemic

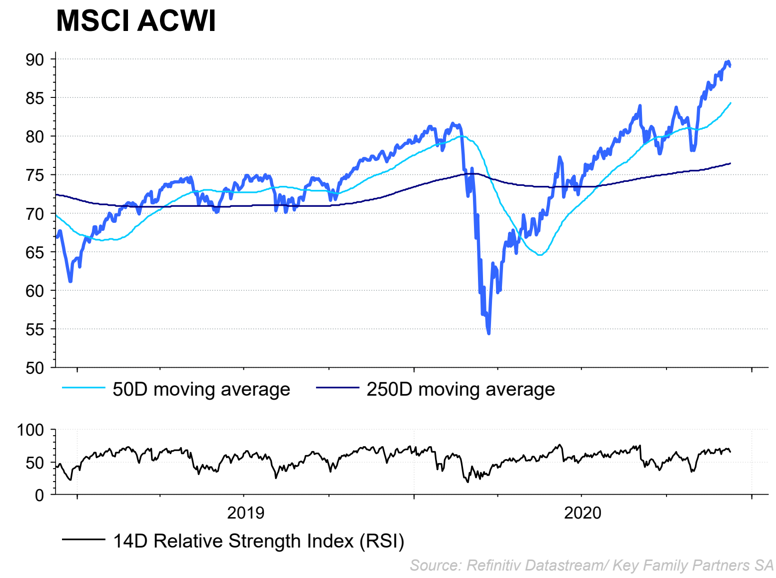
For investors...

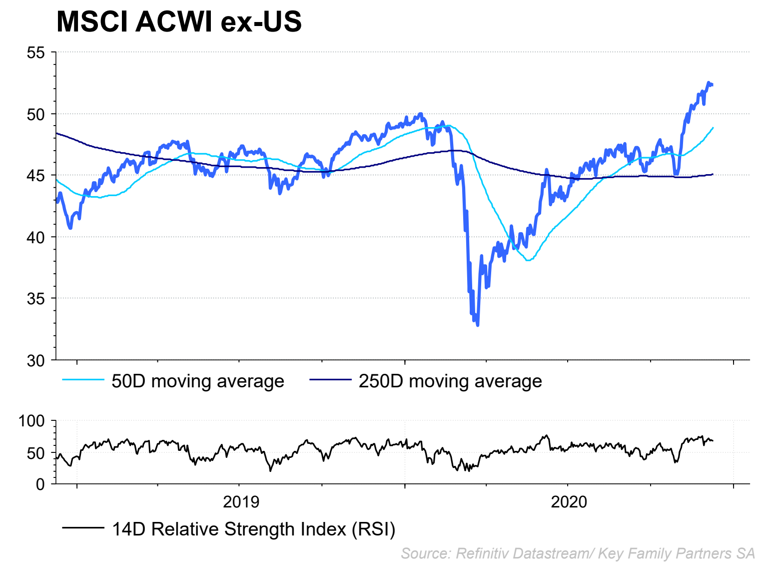
- A focus on risk assets in sectors and geographies most impacted by the pandemic should pay a good "recovery" dividend
- Beware highly priced assets which no longer have a growth advantage over recovering assets
- Take a long-term view of the risk assets in Asia-Pacific

EQUITIES

Vaccine announcements had an electrifying impact on equity markets world-wide, sending most into short term overbought levels. Strong sector rotation from Growth to Recovery/Value.

GLOBAL EQUITIES	🟡 / 🔴	→	🟡 / 🟢
	1 month	YTD	12 month
Global Equity	+12.1%	+9.4%	+13.1%
Global Eq. Ex US	+15.1%	+4.4%	+8.7%





A huge jump in world equity prices on the back of vaccine announcements. Equity markets now betting that the pandemic will be controlled in 2021. Global growth rates should then rise strongly and GDP levels should recover from the 2020 recession.

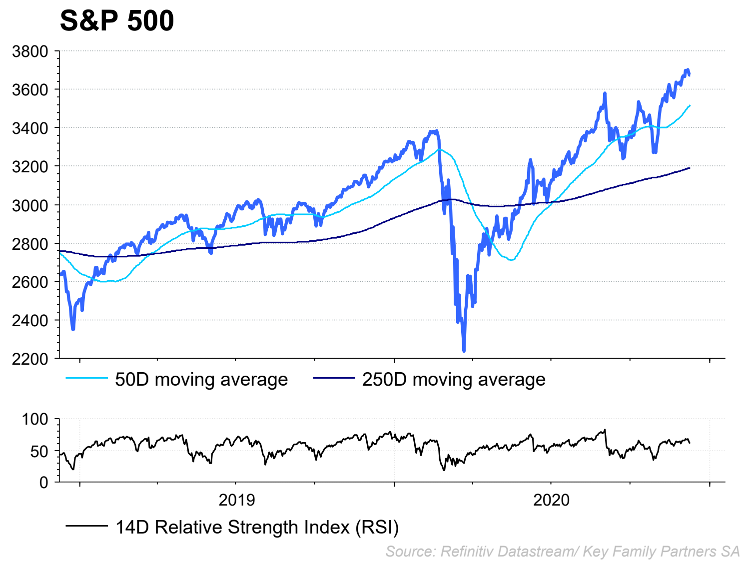
November PMI numbers support this view, but some pockets of weakness exist – Services PMIs in the EU are negative and consumer confidence back to levels seen in April.

Market sentiment short and long term has turned positive, but very short term the entire equity sector is overbought and at risk of a pull back.

Valuations on adjusted **2021** expected earnings have fallen to 18.8x from 21.8x on earnings recovery expectations next year.

The outlook is moved to NEUTRAL with a positive bias.

USA	1 month	YTD	12 month
US Equity	+11.8%	+12.1%	+15.3%



The S&P500 participated in the global rally in November providing, but with a significant rotation into recovery/value stocks from growth.

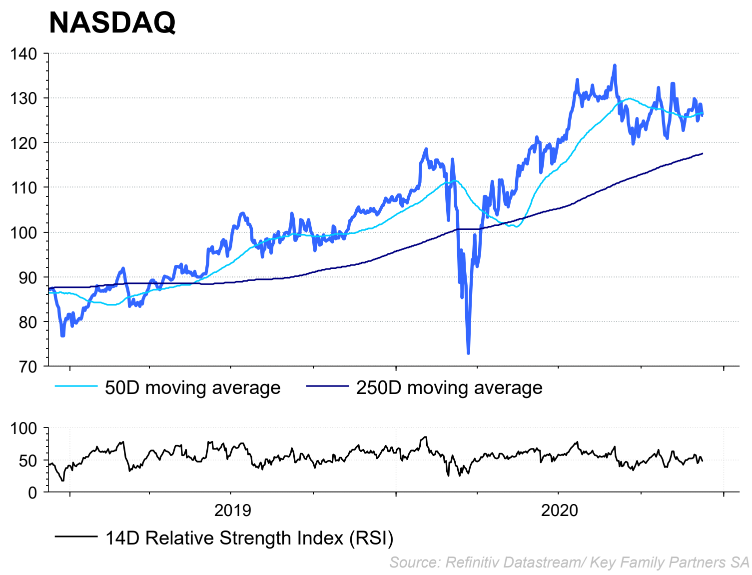
US PMIs for November remain robust in spite of the accelerating virus spread and presidential elections.

Market sentiment now turned to positive longer term, but short term remains overbought and at risk of a pull back.

Valuation falls to 21.2x prospective 2021 earnings from23.8x.

The outlook is moved to NEUTRAL.

NASDAQ Comp	1 month	YTD	12 month
NASDAQ	+11.8%	+36.0%	+40.8%
FANG+ Index	+8.0%	+83.7%	+98.0%



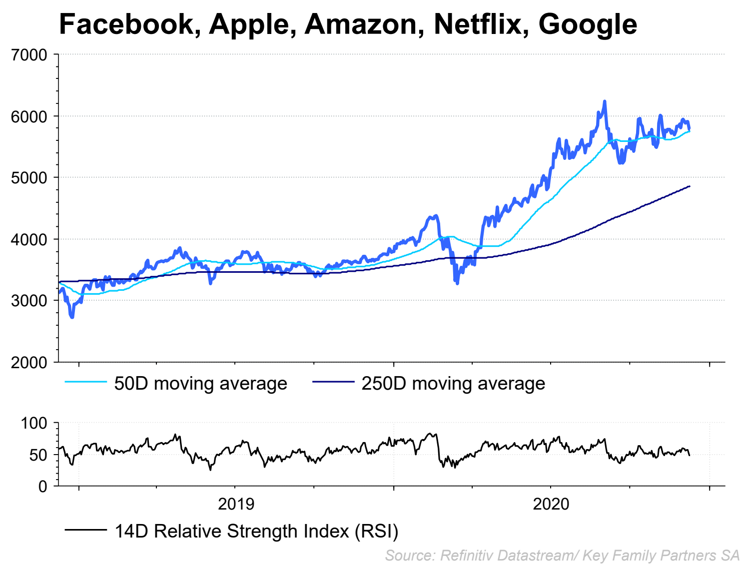
The NASDAQ and FANG+ indices both participated in the global rally, but with the FANGs slightly underperforming the broad market during the market rotation.

The economy remains robust, but with some increased anti- trust political risk for larger tech stocks from the new Administration.

Sentiment has turned more positive for both markets, longer term, but with a risk of a short-term pullback from the overbought levels seen at month end.

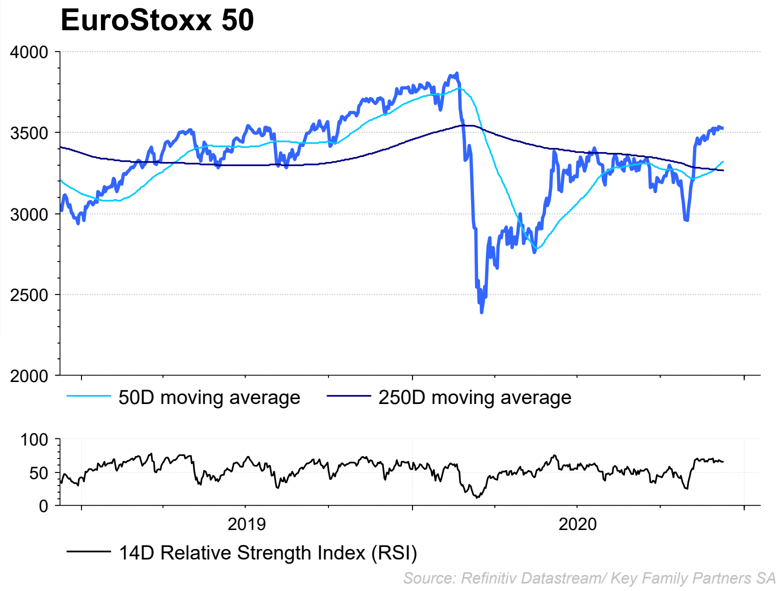
Valuation of both indices fell, to 30.3x prospective 2021 earnings from 35.7x for NASDAQ and 32.0x for the FANG+ index, while both remaining at elevated levels.

The outlook moves to NEUTRAL.



EUROZONE

	1 month	YTD	12 month
EU Equity €	+18.1%	-6.7%	-5.7%
$	+21.1%	-0.6%	+1.7%



Euro equities had a strong month in spite of the accelerating pandemic in many EU countries. The markets benefited particularly from the growth/value rotation given the lower tech exposure in EU markets.

The EU economy is the hardest hit by the recent spike in pandemic numbers, with November PMI's showing renewed weakness.

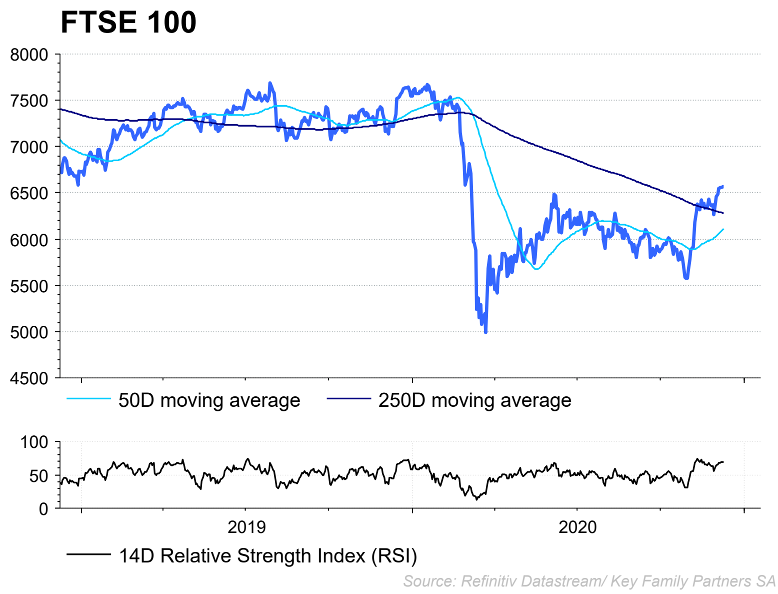
Sentiment has improved to neutral longer term but remains at risk of renewed sell off form the short-term overbought position.

Valuation on 2021 prospective earnings falls to 17.8x.

The outlook remains NEUTRAL with but with downside risk if the lockdowns are extended into 2021.

UK

	1 month	YTD	12 month
UK Equity £	+12.4%	-16.9%	-14.7%
$	+15.8%	-16.4%	-12.1%



The FTSE100 had a strong month but remains well behind global markets on a year-to-date basis and 12-month basis.

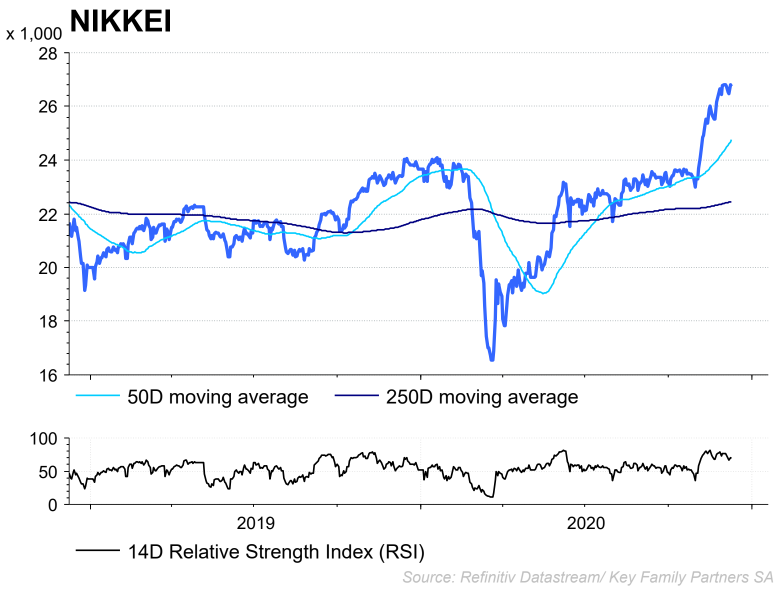
The recent increased lockdown will have slowed economic recovery but PMI numbers for November remained neutral.

Prospective P/E on expected 2021 earnings now at a global low of 14.6x. Sentiment has improved to neutral, but short term the market remains overbought.

The outlook is moved to NEUTRAL with a downside risk if lockdown is further extended and/or from a messy Brexit.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	+15.0%	+11.7%	+13.5%
$	+15.4%	+16.3%	+18.5%



The Nikkei followed the global rally and has now outperformed the S&P500 over 12 months in USD.

While November PMIs remain soft in Japan, the country is deemed to be one of the major beneficiaries of the RCEP, boosting economic confidence.

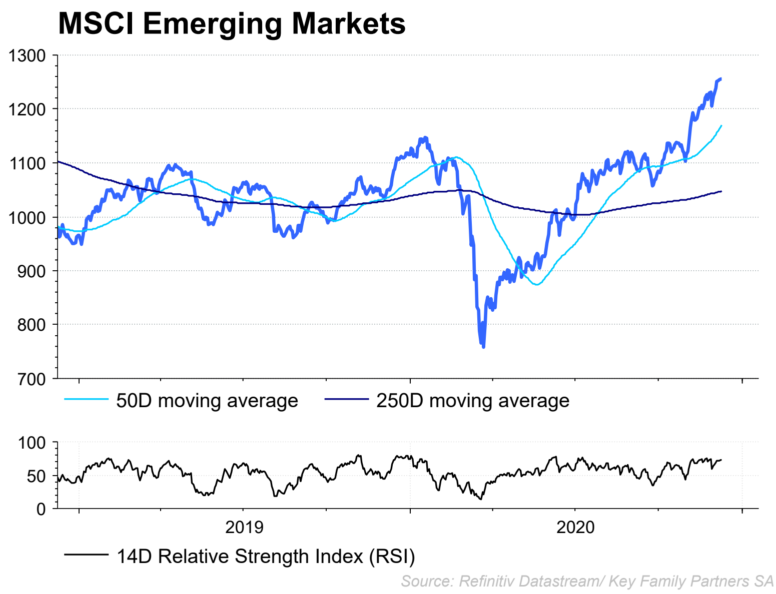
Market sentiment has turned positive longer term, but the market is seriously overbought short term.

Prospective earnings multiple for 2021 falls to 20.2x, which remains elevated.

Overall, the outlook is moved to NEUTRAL with a positive bias.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity £	+9.2%	+8.1%	+15.9%



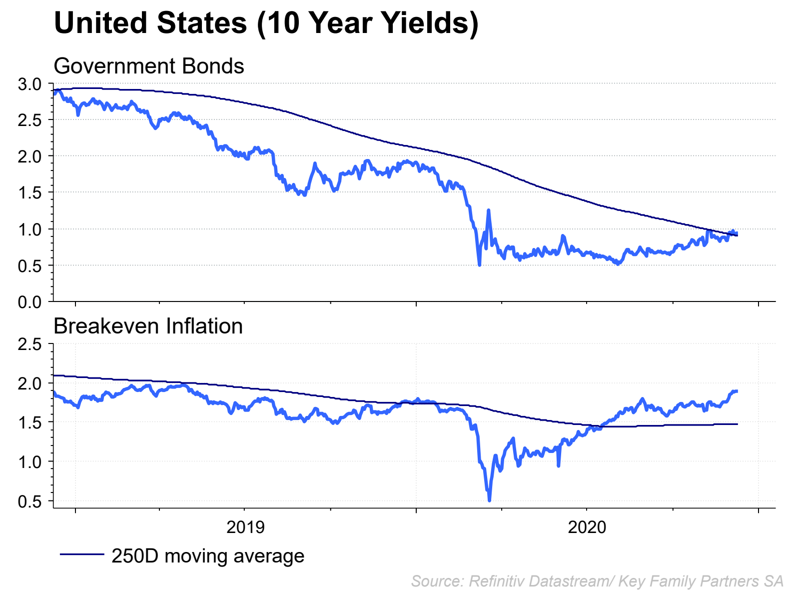
EM had a strong month across the board with all markets participating in the rally. Brazil was the strongest performer with a 24.5% gain in USD.

The weaker USD, low interest rates and relative success on the pandemic in Asia has moved sentiment to positive. Valuation for 2021 on prospective earnings is positive at 14.1x The outlook is moved to POSITIVE.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	+0.31%	+8.21%	+7.61%



Yields on 10 year Treasuries were largely flat for the month, while 10-year inflation break even rose to 1.80% from 1.70%.

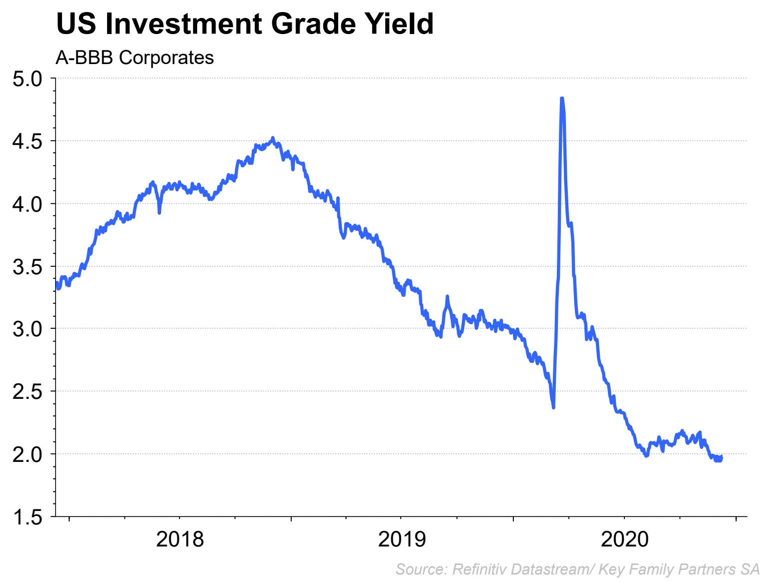
Yields on longer dated Treasuries and inflation expectations are on a clear rising trend. Pent up consumer demand once the pandemic is controlled is expected to push up prices.

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

The outlook remains NEGATIVE on a deteriorating inflation outlook.

Investment Grade

	1 month	YTD	12 month
US Inv Grade Total return	+2.57%	+9.18%	+9.53%



Yields on investment grade corporates fell to 1.80% from 2.03% while spreads fell to 104bps from 125bps.

Investment grade spreads over Treasuries are now approaching the lows for the last decade, as investors believe default risk has declined as the economy recovers. Spreads are unlikely to fall much lower than here. However, as inflation risks pick up and treasury yields rise, IG yields will rise as well.

Given the pickup in the economy and inflation risks, IG yields are likely to rise from here.

The outlook is moved to NEUTRAL with downside risk.

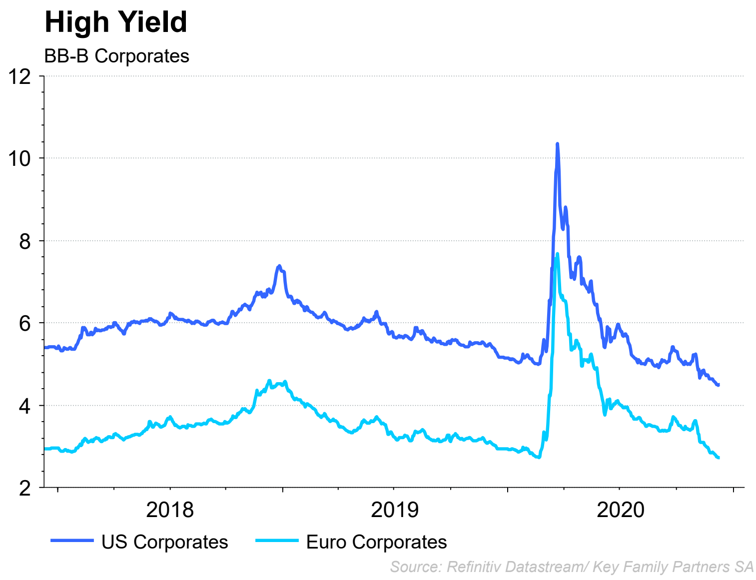
High Yield

	1 month	YTD	12 month
US High Yield Total return	+3.88%	+5.06%	+7.16%

US HY bond yields fell to the lowest levels in a decade, 4.91%, while spreads also reached near decade lows of 453bps on reduced default risk.

Yields have not got much further to fall even in a recovering economy but could remain at these levels given the lack of yield in Inv. Grade and Treasuries.

The outlook remains NEUTRAL.



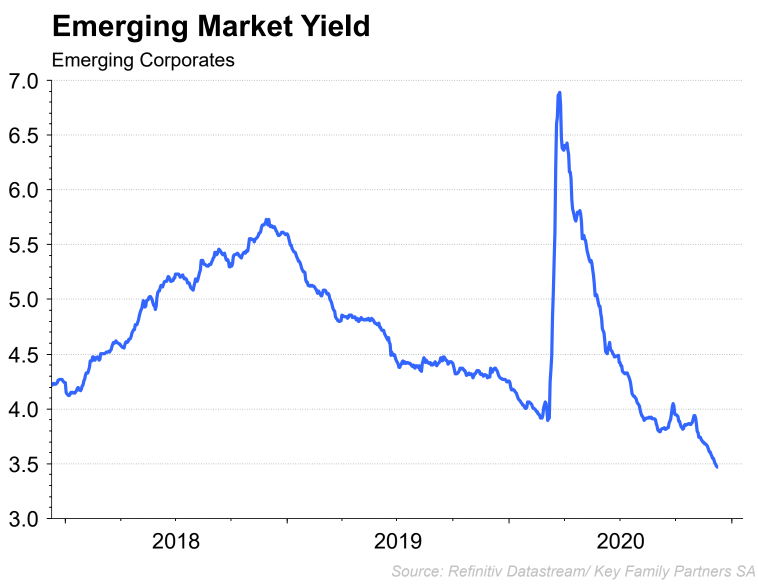
EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	+3.08%	+4.94%	+6.63%

Yields on EM USD debt also fell to decade lows, 3.69%, and similarly spreads fell to all-time lows of 303bps.

With attractive recovery opportunities in EM and a weaker USD reducing default risk, yields and spreads are likely to remain at these levels for the time being.

The outlook remains NEUTRAL with a positive outlook.



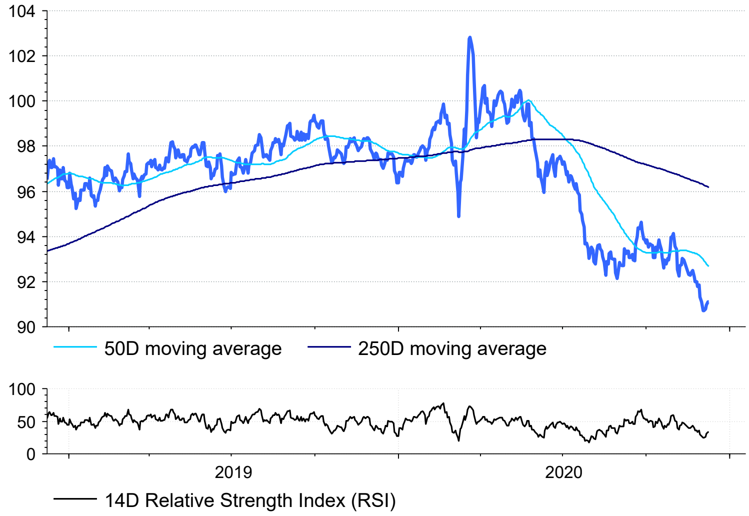
CURRENCY – USD vs DM, EM

USD vs DM currencies

The USD continued its dramatic correction against major DM currencies in November. It has now lost 10% against a basket of DM currencies since late March, as measured by the DXY.

In addition to the twin deficits of the US (Government and Trade) US assets have lost their competitive appeal to international investors. Yields on fixed income give little advantage, while equities are the most expensive of the major markets. Further, earnings from growth stocks may underperform earnings from value stocks during the early phase of the recovery.

Dollar Index



Source: Refinitiv Datastream/ Key Family Partners SA

Sentiment remains firmly Negative, with no bottom in sight.

The outlook is moved to NEGATIVE.

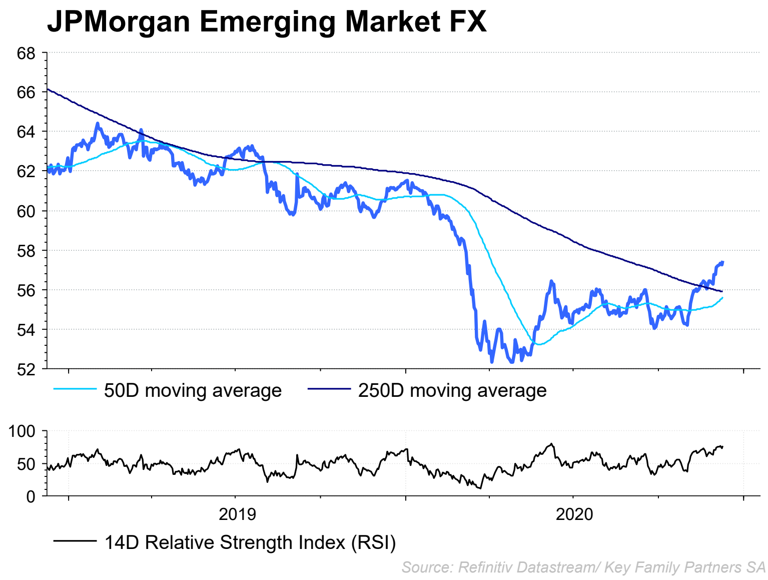
CURRENCY – USD vs DM, EM

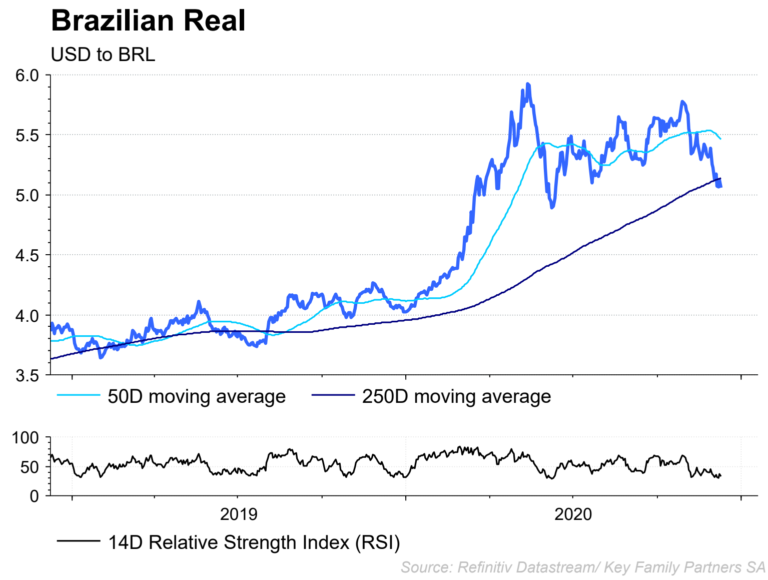
EM currencies vs USD

All EM currencies rose against the USD in the month, this time led by the Brazilian Real with a near 10% appreciation in the month.

Stronger commodity prices (including oil) benefit the Brazilian economy, while the second wave of the pandemic appears less severe in Brazil than elsewhere. PMI numbers for Brazil have been particularly positive recently.

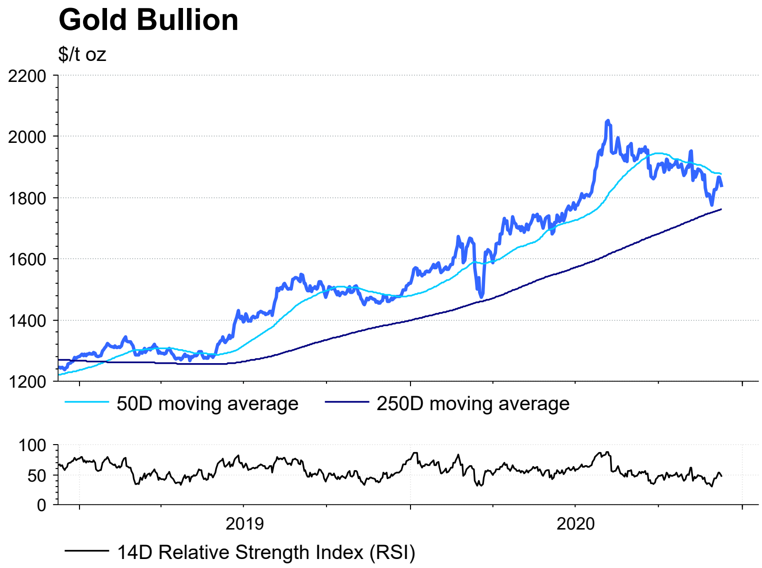
EM currencies outlook is moved to POSITIVE.





GOLD

	1 month	YTD	12 month
Gold	-6.4%	+17.2%	+21.5%



Source: Refinitiv Datastream/ Key Family Partners SA

Gold sold off during the month as speculators appeared to switch their attention to BitCoin, and longer dated Treasury yields rose.

The market has reached a deeply oversold level, at which point there has always been something of a recovery in the past. The long-term sentiment remains positive and gold should do well in a period of rising inflationary pressures in the future – as forecast by Goldman Sachs. Fundamental buying by central banks continues.

The outlook remains POSITIVE long term.

COMMODITIES

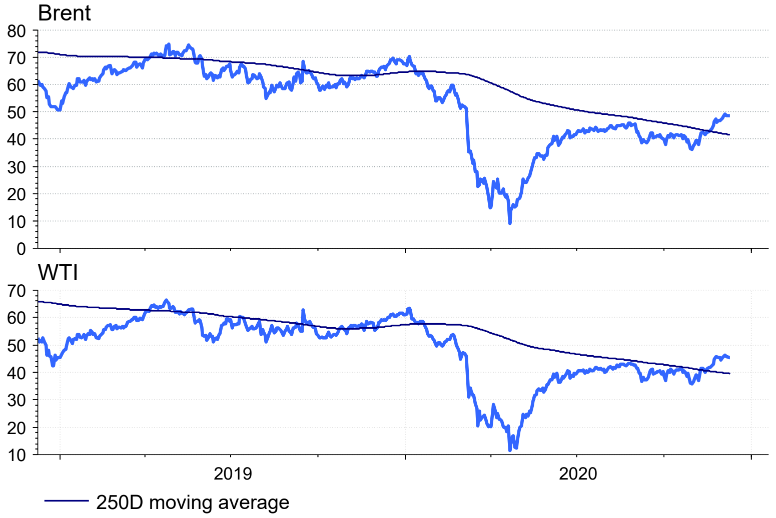
OIL

Oil prices regained their upward move in the month on expectation of demand increases from economic recovery. At the same time OPEC+ appears determined to keep the lid on any supply increase until mid-next year.

Should vaccination start to increase travel demand and general economic activity, there could be a spike in prices as supplies remain limited for the time being.

Short term trends have turned more positive, while longer term as becoming less negative.

Oil Prices



Source: Refinitiv Datastream/ Key Family Partners SA

The outlook for oil is moved to NEUTRAL with upside potential.

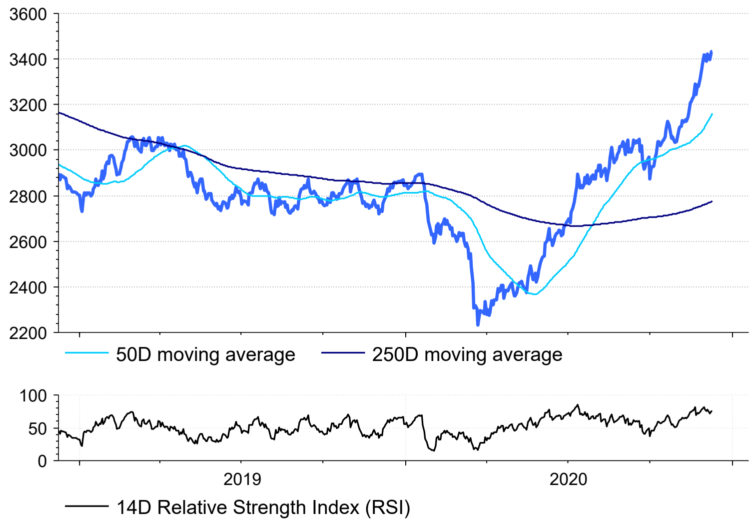
METALS

Metal prices as a whole rose again on evidence of demand from China – the world's largest consumer of metals of all types – and growth of electric car production worldwide.

Zinc made the largest gains in the base metal group. This metal is an integral part of the electrification of cars and supplies are relatively inelastic. Demand will rise as the electrification process grows.

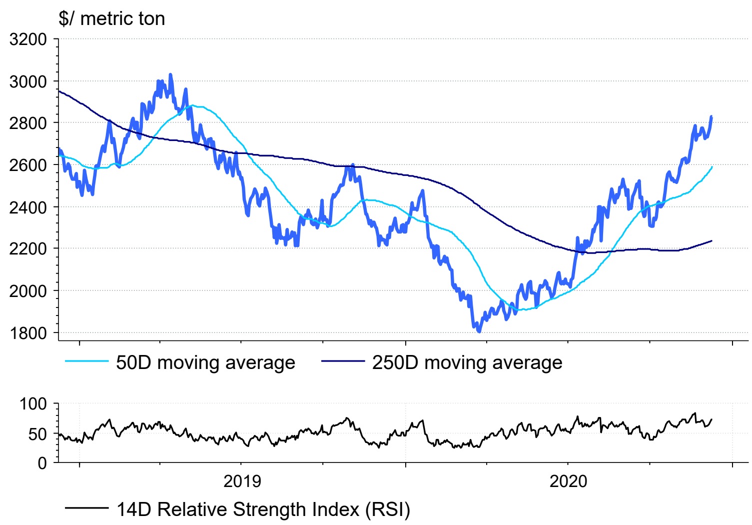
The outlook remains POSITIVE.

LME Index



Source: Refinitiv Datastream/ Key Family Partners SA

Zinc



Source: Refinitiv Datastream/ Key Family Partners SA

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.

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