KEY FAMILY PARTNERS

Global Market View

June 2021

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TABLE OF CONTENTS

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

Talking about....talking about tightening monetary policy

The super-accommodative monetary policy seen in the leading developed economies over the past 15 months may have seen its low point as talk and some actual moves towards tightening start to take shape.

While no major Central Bank has so far raised rates, Canada has led the way to less accommodation by reducing bond purchases (QE), while the Bank of Japan has scrapped fixed targets for buying equities in the future. The Reserve Bank of New Zealand, often a leader in monetary policy, has been handed a new mandate to consider asset prices (mainly property) in setting monetary policy – perhaps the first time such a policy has been imposed on an "independent" Central Bank.

Most importantly, senior Fed officials have started to publicly call for a debate on tapering the asset purchase programme in the face of a strong economic recovery and falling unemployment numbers.

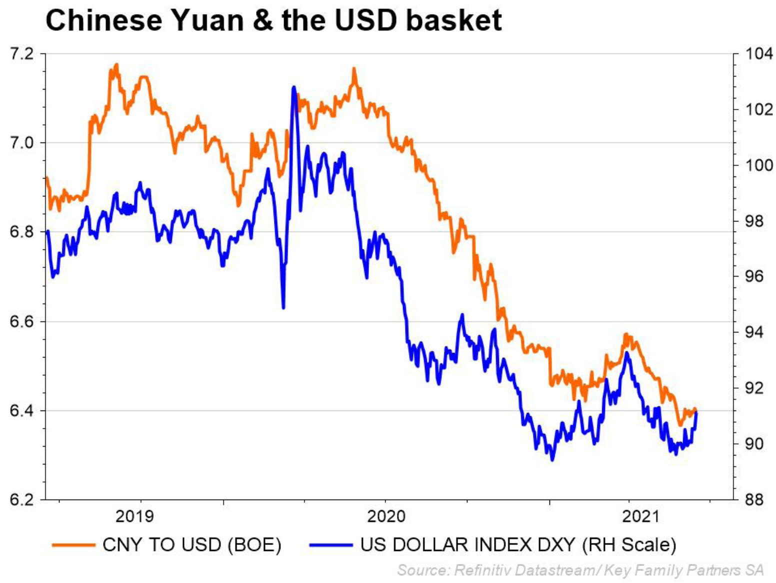
The driver for these developments has been the stronger than expected pickup in inflation in major economies and particularly the US. In April core prices had risen over the past 12 months +3.0% vs 2.3% expected and, most importantly, inflation expectation for the next 12 months are 4%, based on a New York Fed consumer survey. Inflation expectations are key as they drive wage demands.

Most CBs continue to state that this inflationary spike is transitory, caused by the base effect of the Covid recession of last year, but clearly CB actions are beginning to recognise the inflationary impact of the ultraloose monetary policy of the past 15 months.

If actual inflation proves to be stronger and more persistent than the current transitory expectations, we can expect more than talk on monetary tightening from the major CBs. Tightening through tapering and eventually actual rate rises would come through sooner than currently expected.

China's monetary tightening by stealth

Over the past year China has pursued a policy of RMB appreciation which has seen the USD depreciate 10.6% against the RMB (orange line). Against the basket of DM currencies (DXY) the USD has depreciated 7.9% over the same period (blue line).



This is partly a USD effect (the twin deficits of the US) but also clear policy from China. There are numerous possible explanations for this, both political and economic, other than simply a large trade surplus with the US. These include:

- Fear of domestic inflation. Periods of high inflation in China have given rise to periods of political instability (eg Tianamen Square) and the current global inflationary pressures can be mitigated domestically by a stronger currency.
- China is pursuing an e-currency strategy to ultimately provide trading partners with an alternative to trading in USD and want the RMB to be perceived as a strong currency, probably backed by some form of gold support.
- China wants to present its government bond market as a credible (and safer) alternative to the Western model. Over the past 12 months the China 10-year bond has substantially outperformed the US 10-year Treasury, by over 20% (in USD).

At the same time, China has not undertaken a significant monetary or fiscal reflation exercise, as it did after the GFC, and thus on a relative basis appears more prudent than the Western approach this time around.

By default, China's actions will be inflationary for the rest of the world, and particularly in the US, as the strengthening RMB pushes up the price of exports to other countries.

Oil on a slippery slope....maybe

The oil industry took some heavy blows in May, even though prices rose 3.7% to $69.3 for Brent Crude in the month, back to levels seen before the Covid recession.

1. The first "hit" was the report from the International Energy Agency (IEA) entitled "Net Zero by 2050" in which the Agency did a full U-turn from its previous position and called on energy companies to stop ALL new oil and gas exploration projects from this year if global warming is to be kept in check. Given that the IEA is in effect the industry body for the oil and gas business worldwide, this was an extraordinary event.
2. Royal Dutch Shell lost a landmark legal battle in a Dutch court requiring it to cut emissions significantly by 2030, which in turn would require less production by the company.
3. Exxon Mobile and Chevron were both obliged by activist shareholders to accelerate their pollution reduction plans.

US Oil production is struggling to recover post the recession in 2020. The number of drilling rigs operating in the US is 57% lower than the peak in December 2018. US production capacity is not being replaced at this rate.

The impact of all these initiatives is likely to mean that oil production globally by the established majors will decline over the forthcoming years. Demand however is likely to continue to grow, at least until 2025, leaving a deficit to demand (in red).

OPEC+ will be in a position to take up some of the slack from the US, and exert increased power over pricing.

All things being equal, oil prices are likely to rise in this scenario over the next few years – despite the move to alternative energy sources.

In summary...

The era of ultra-loose monetary policy appears to be coming to an end, with the next cycle likely to see reduced bond buying by Central Banks and eventually raising of interest rates.

Already rising energy prices and a stronger RMB are acting as an indirect monetary tightening as well as pressure on global inflation. For the reasons given, these pressures are unlikely to reverse anytime soon.

For investors...

- Remain cautious of fixed income markets, except in the China sphere of influence.
- Equity markets remain attractive in this early stage of the inflation cycle, except for the overpriced growth sector.
- Gold and commodities remain a powerful diversifier from fixed income for diversified portfolios.

EQUITIES

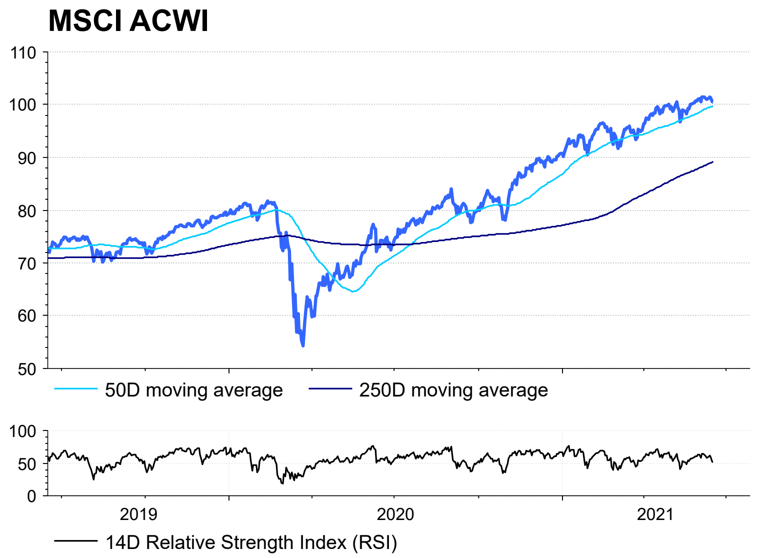
Equity markets generally rose with a strong performance in China and Europe.

GLOBAL EQUITIES	1 month	YTD	12 month
Global Equity	2.6%	11.1%	35.9%
Global Eq. Ex US	4.6%	11.9%	32.8%

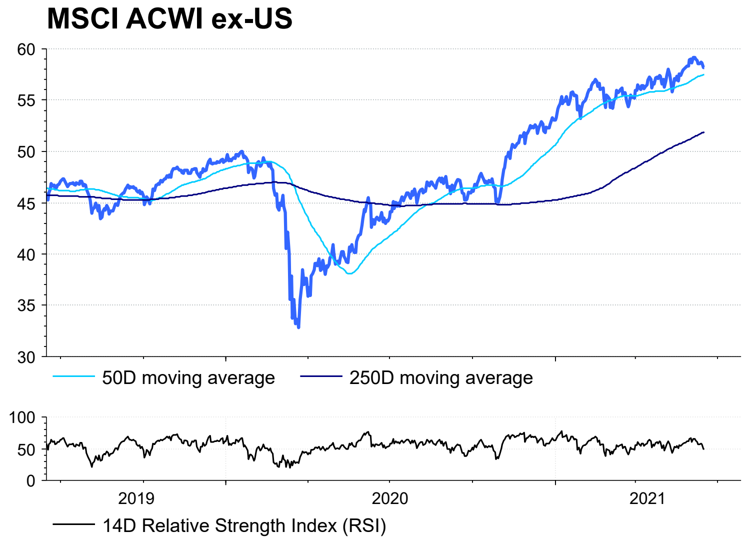
Global equities rose on the month, based on the MSCI All Country World Index, reaching another new high as the world economy continued its growth recovery.

Valuations on adjusted **2021** expected earnings was steady at 19.5x on earnings recovery expectations, but this remains elevated on a 10-year average and vulnerable to higher rates. Overall sentiment remains positive but decelerating on monetary risks.

The outlook remains POSITIVE with downside risk.



Source: Refinitiv Datastream/ Key Family Partners SA



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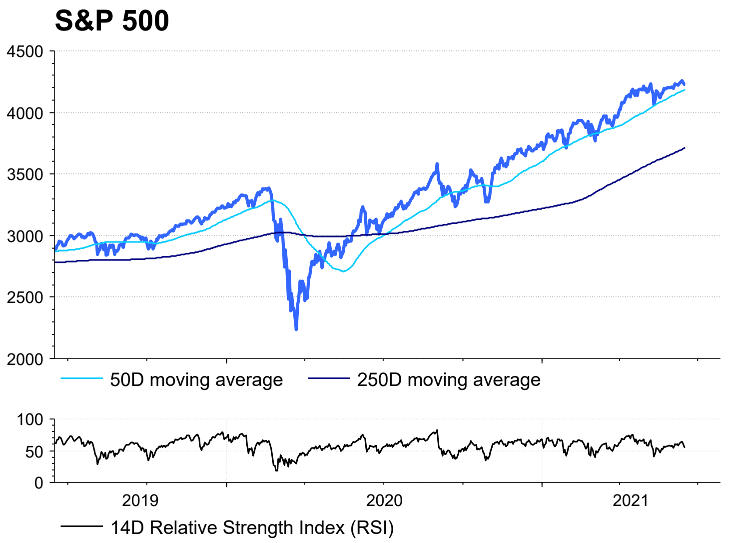
USA

	1 month	YTD	12 month
US Equity	1.3%	12.4%	35.7%



Source: Refinitiv Datastream/ Key Family Partners SA

The S&P500 had another positive month. After a sharp sell off at the start of the May, the market recovered but remains below its previous high. Year to date the US market has underperformed European markets (in USD) for the first time in many years.

Economic recovery remains strong while inflation continues to rise at an annualised rate of 4.2% in April (CPI).Market sentiment remains positive while the overbought position seen last month has been corrected for the time being.

Valuations remain elevated at 22.5x prospective 2021 earnings, and at risk if market interest rates continue to rise from here. The outlook remains NEUTRAL but with some downside risk due to valuation and sentiment.

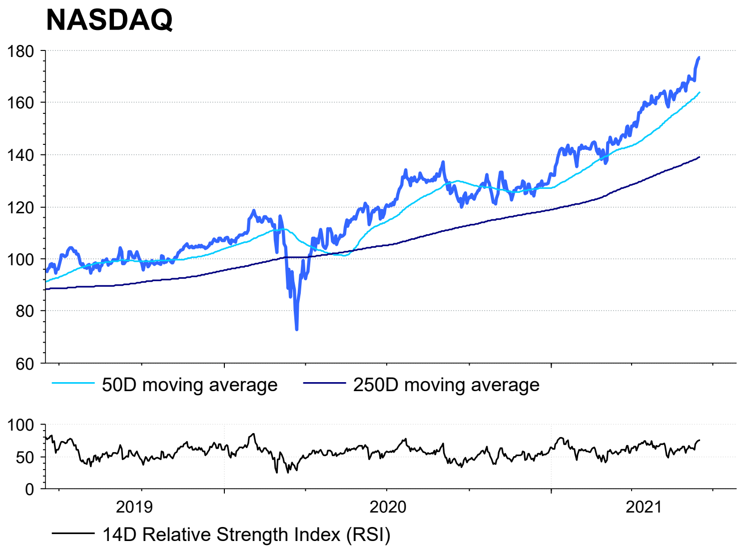
NASDAQ Comp

	1 month	YTD	12 month
NASDAQ	3.4%	8.9%	41.7%
FAANG+ Index	3.6%	10.2%	45.2%

The NASDAQ and Fang index both sold off during May as value stocks continue to outperform the more highly priced growth socks. Sentiment remains neutral with neither market making news highs during the month.

Valuations of both indices were down slightly at 31.9x prospective 2021 earnings for NASDAQ and 32.1x for the FANG+ index, with both remaining at elevated levels and **at further risk of rising market interest rates**.

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



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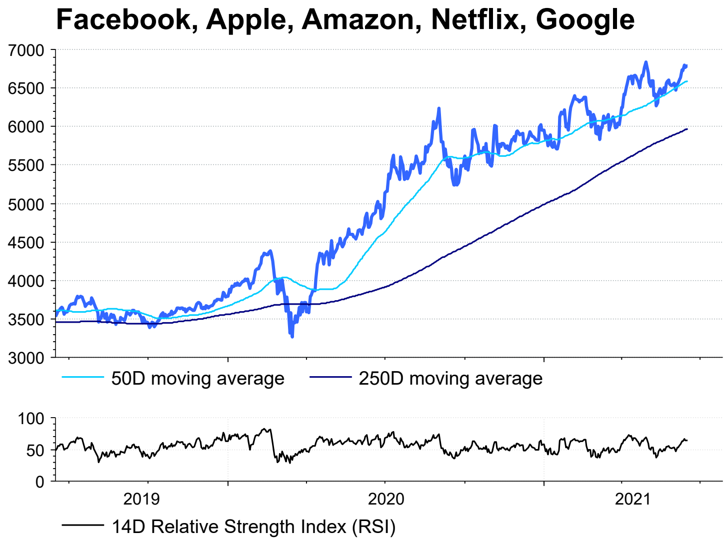
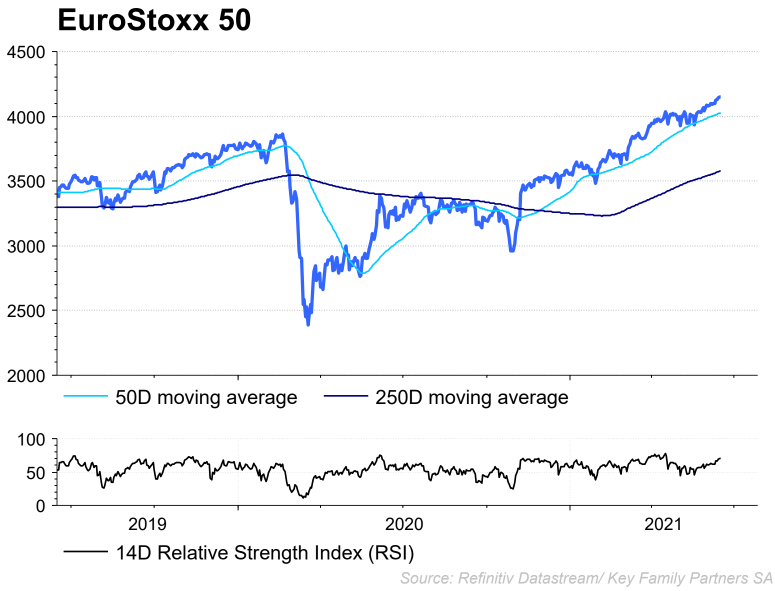


Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE

	1 month	YTD	12 month
EuroStoxx 50 €	3.7%	16.9%	27.1%



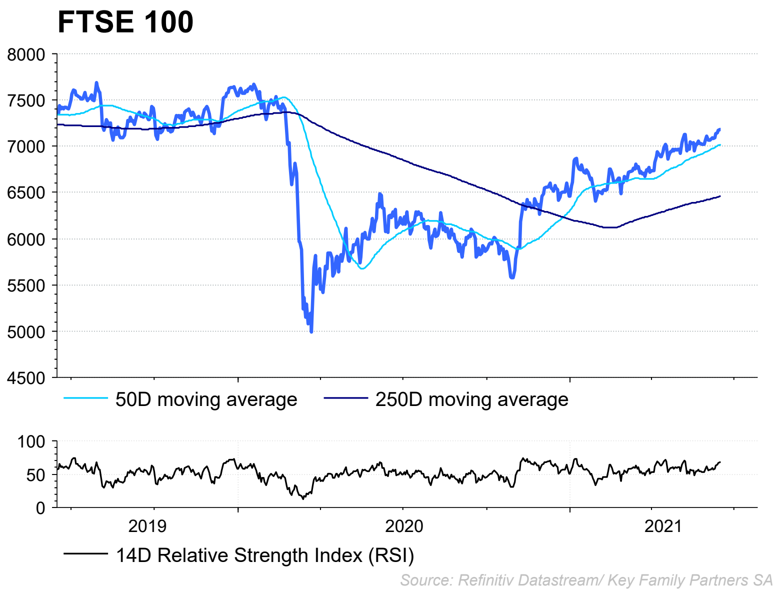
Euro equities have had a good year as the vaccination rate in the EU picked up and some lock down restrictions start to be lifted. The market has reached the highest level since early 2008. Valuation fell slightly to 18.5x 2021 prospective earnings which remains elevated compared to the past 10 years.

Sentiment remains positive.

The outlook remains NEUTRAL with a positive outlook on recovery expectations.

UK

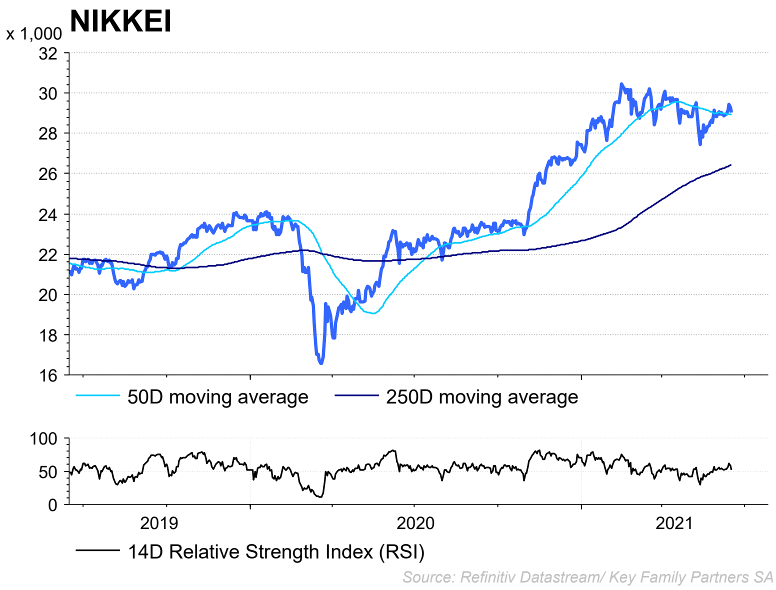
	1 month	YTD	12 month
UK Equity £	2.1%	11.2%	14.9%



The FTSE100 had a positive May and June as PMI numbers came at the highest level (62.0) since 1998. Valuation remains attractive with a P/E on expected 2021 earnings of 14.0x, while sentiment remains positive. The FTSE100 is essentially a basket of value type stocks, which will benefit from the current rotation from growth. The outlook remains POSITIVE given the UK's recovery potential and valuation.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	1.7%	6.7%	30.4%

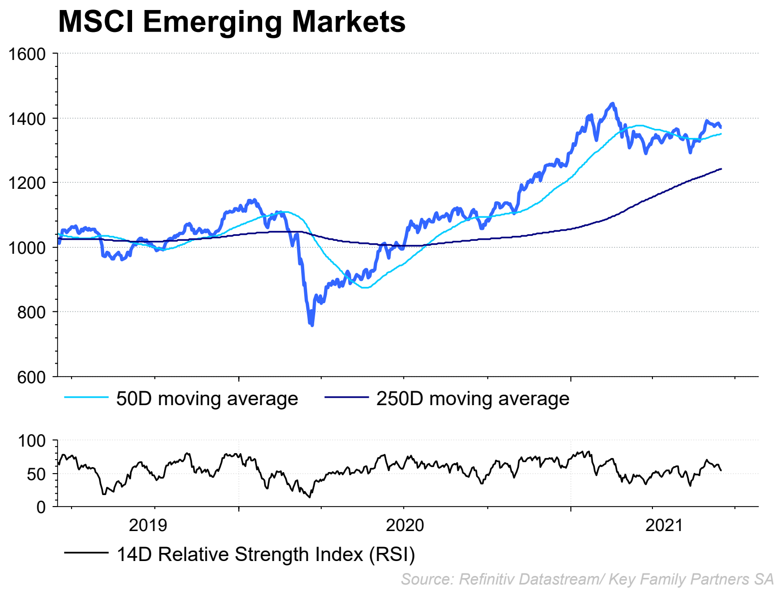


The Nikkei is having a muted year, having seen a sharp sell off early in May. Economic data was strong for manufacturing and exports, but domestic services suffered from renewed lockdowns. Valuation remains elevated at 20.0x prospective 2021 earnings. Market sentiment remains neutral.

The outlook remains NEUTRAL with a positive bias.

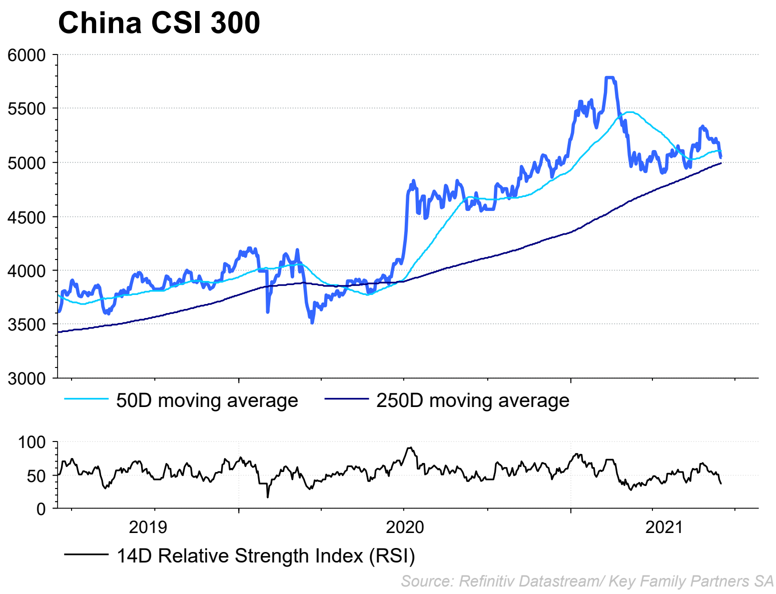
EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	2.8%	6.1%	37.7%
China CSI 300$	-0.8%	-2.5%	26.5%



EM equities were up for May with strong performances across the board. Equities in resource rich economies continued to outperform, with Brazil, Russia and Mexico leading. India also rebounded after the covid scare started to subside. Sentiment longer term remains positive and valuations attractive at 14.8x prospective 2021 earnings.

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

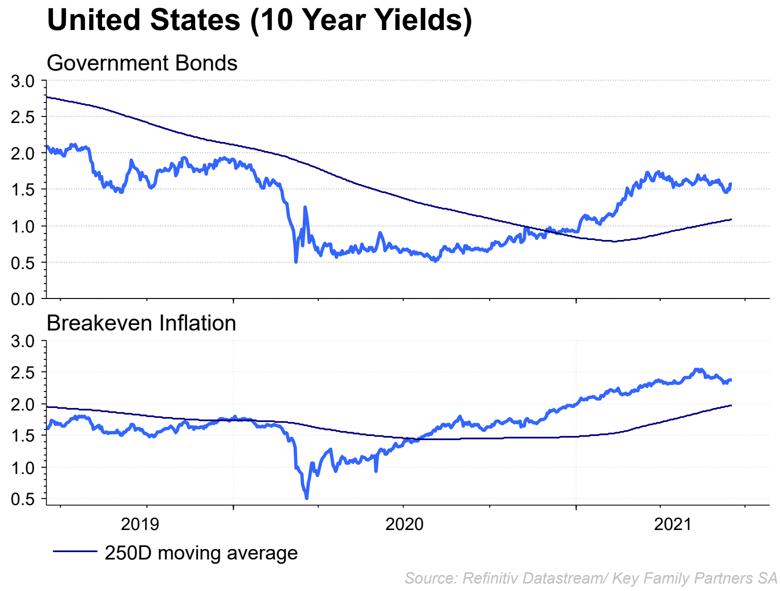


FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries	0.3%	-4.2%	-4.6%

Yields on 10-year Treasuries moved sideways despite the rising inflation numbers in the US. 10-year inflation expectations also traded sideways. With input prices in almost all areas continuing to rise, rising inflation numbers are likely over the next few months until the base effect starts to pass through - as proposed by the Fed.



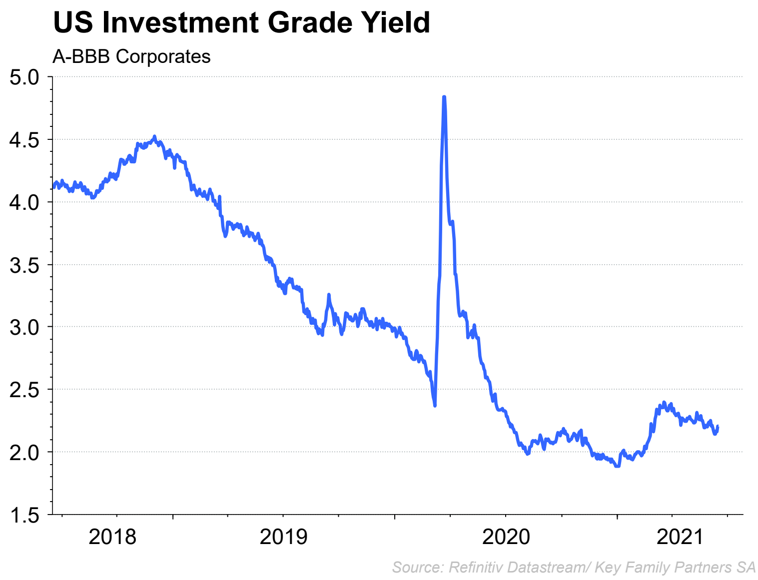
The outlook remains NEGATIVE long term on a deteriorating inflation outlook.

Investment Grade

	1 month	YTD	12 month
US Inv Grade	2.0%	-2.4%	2.5%

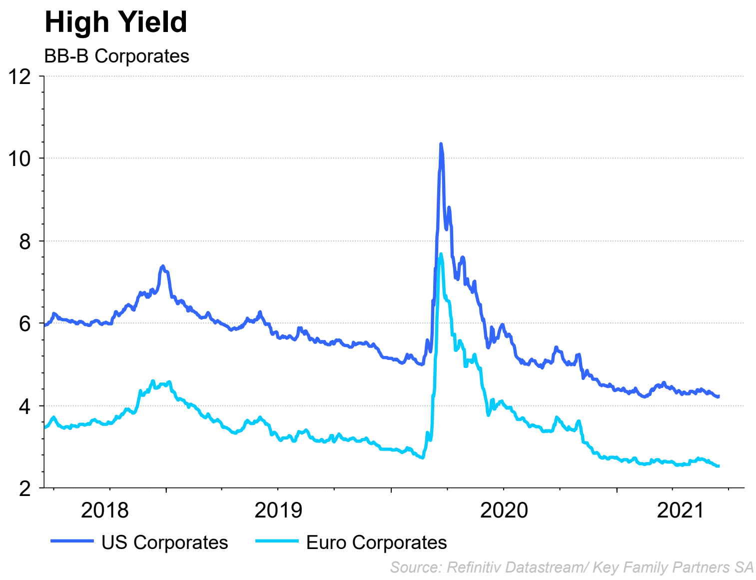
Given the record narrow spreads, IG will perform largely in line with Treasuries for the time being. Any rise in Treasury yields will see Inv Grade yields rise as well.

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



High Yield

	1 month	YTD	12 month
US High Yield	0.9%	2.3%	10.3%

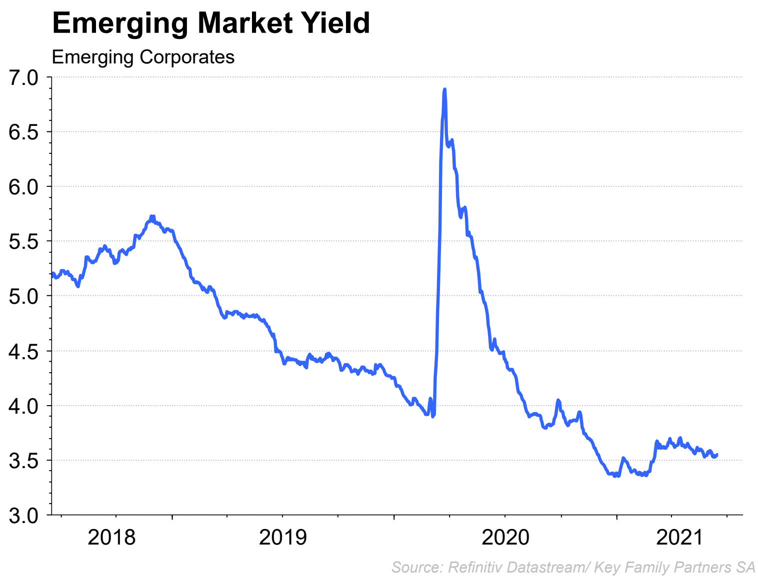


US HY bonds are historically very expensive, however HY remains attractive to investors providing a real yield over inflation expectations. Record narrow spreads over Treasuries remain a risk factor if the economic outlook, and therefore credit risk, worsens in the future.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Corp	1.1%	0.1%	7.9%



Given the relatively more prudent economic policies pursued by many EM countries during the pandemic, and especially China, investors continue to find these assets attractive.

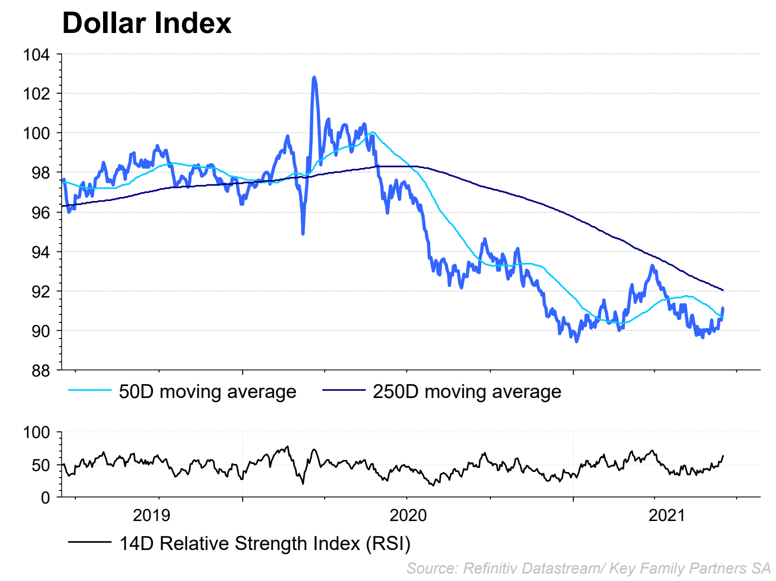
The risk remains of a more systemic debt crisis in the future, but for the moment these risks look small.

The outlook remains NEUTRAL with a positive bias.

CURRENCY – USD vs DM, EM

USD vs DM currencies

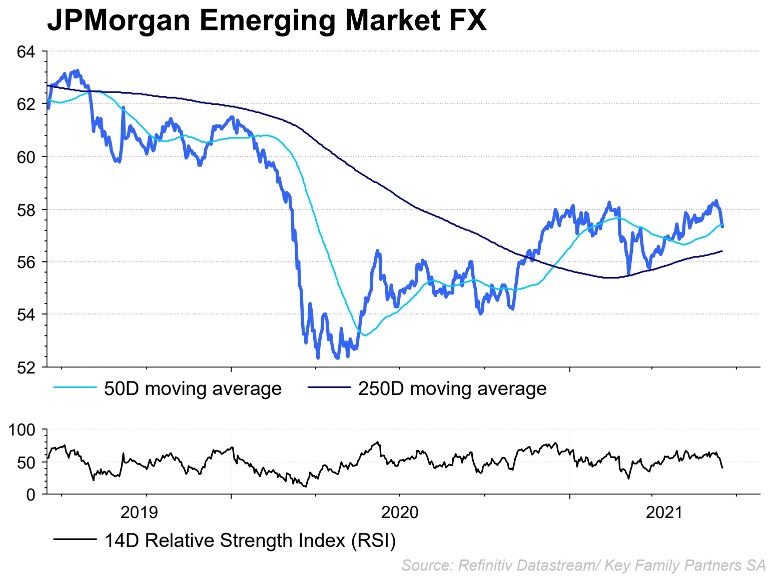
The USD lost ground against all DM currencies in May, as the USD fell to its lowest level against the DXY (89) since December 2014. However we are seeing a sharp reversal the last two sessions. Any rise in USD yields would likely support the currency at this level. The outlook is moved to NEGATIVE but with a neutral bias in the short term.



USD vs EM Currencies

EM currencies continued their strong recovery against the USD. Commodity currencies were strong in May, while the Indian Rupee also ticked up 2.7% as the covid scare began to subside.

All major EM currencies maintain positive yield differentials over the USD, keeping them attractive to currency investors. The USD outlook vs EM currencies remains NEGATIVE with a neutral bias if USD yields rise.

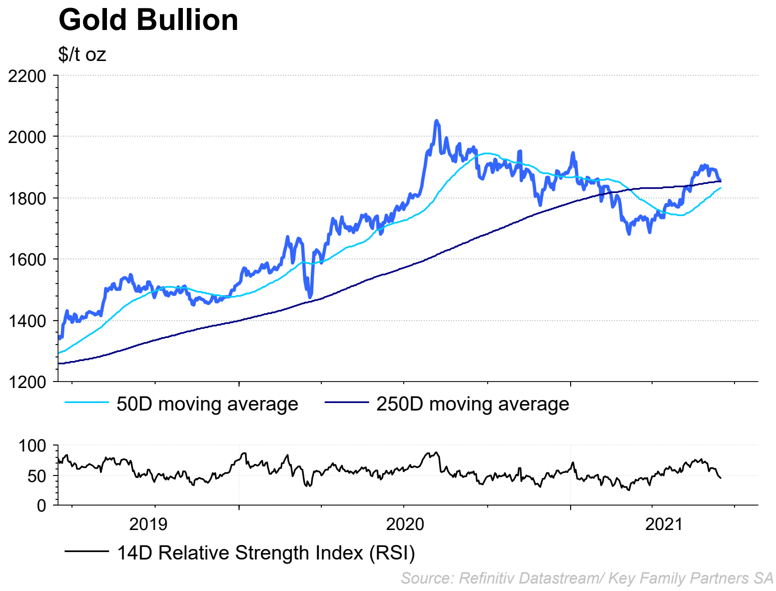


GOLD

	1 month	YTD	12 month
Gold	+7.7%	+0.0%	+10.1%

Gold rallied strongly the past month as inflation fears continue to mount and gold returns to being an inflation hedge. The price has moved back above the 200DMA, an important longer-term milestone, but in the short term it is overbought. There is some risk of a short term pull back from here. However, longer-term sentiment has improved towards for gold.

The outlook is moved to NEUTRAL with a positive bias.

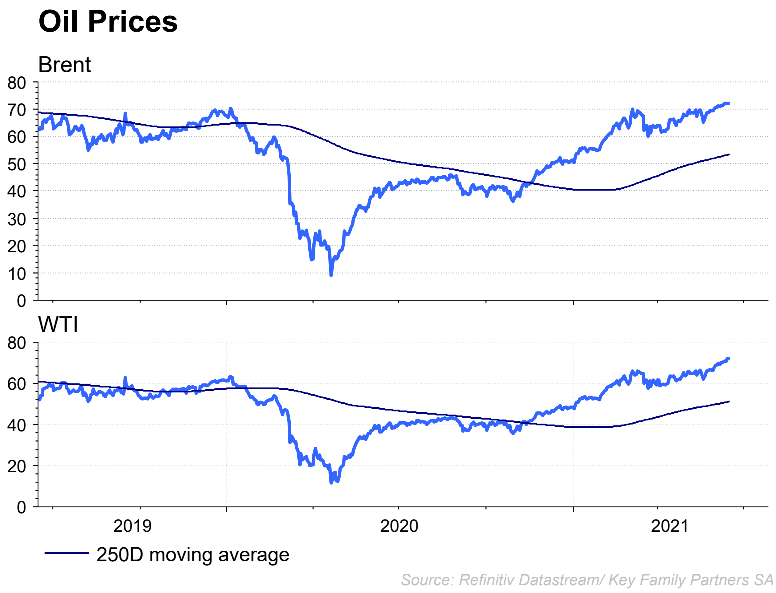


COMMODITIES

OIL

Oil prices had a volatile May but finished on a high with Brent breaking the $70 level for the first time since early 2020. The Opec meeting in progress at this time may lift some of the production cuts imposed last year, thus tempering price rises in the short term. However, as described earlier, oil is likely to see a production deficit over expected demand as oil majors cut back on investment, leading to higher prices in the medium term.

Sentiment remains strongly positive for oil and demand likely to continue to grow, keeping the potential for further upside.

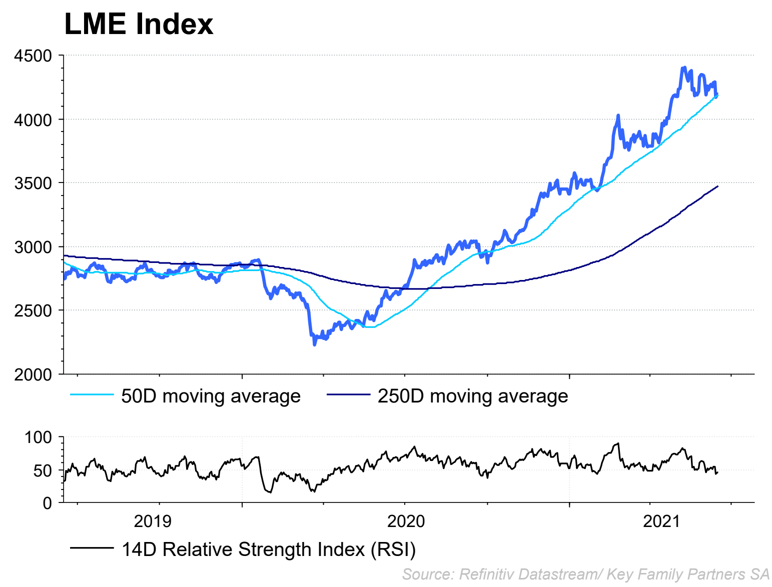


The outlook for oil remains NEUTRAL with upside potential.

METALS

Metal prices maintained their upward momentum, with copper leading the way once again.

Lithium prices have also made a strong recovery since the start of the year, as demand for the metal for heavy duty batteries increases. This can be expected to continue as motor manufacturers grow their electric fleets. (NB Lithium is not included in the LME Index). Sentiment towards industrial metals remains very positive, while the overbought position at the end of last month has been corrected.



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.

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