KFP
KEY FAMILY PARTNERS

Global Market View

July 2021

Key Family Partners SA
Rue Francois-Bonivard 6
1201 Geneva
Tel: +41 22 339 00 00
kfp@keyfamilypartners.com
keyfamilypartners.com

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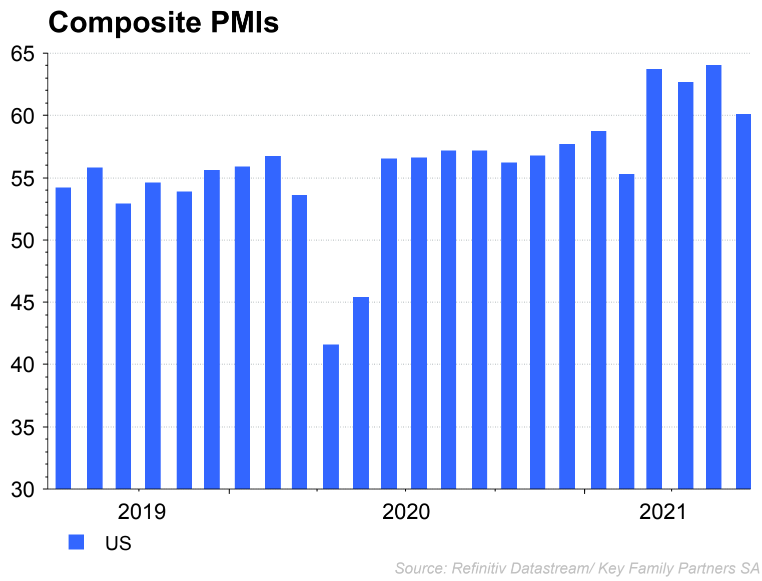
Ratings are not bound by a specific timeframe; they will change when fundamental conditions change

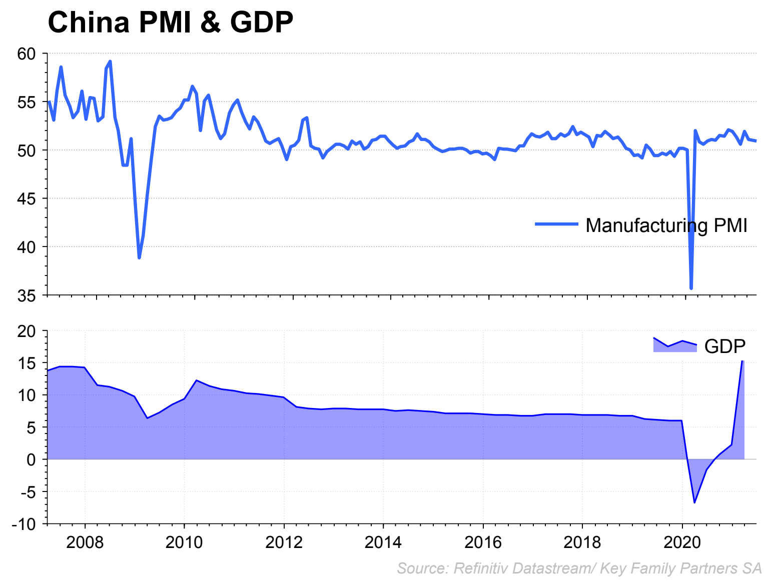
GLOBAL ECONOMY

Growth RATE slowdown ahead

GDP growth numbers for the quarter just ended (Q2, 2021) are likely, once the data is released, to shoot the proverbial lights out across developed markets. **Annualised** growth for the US is expected to exceed 10%p.a.



In the meantime, we can see real time "nowcast" PMI numbers reaching record levels for manufacturing in the US, EZ, UK and to a lesser extent Japan, during Q2. Service sector PMIs have followed a similar track, but at a slightly lower level. The Composite PMI chart for the US shows the overall impact.



The one large outlier from this picture is China, where a growth rate slowdown has already set in according to the latest manufacturing PMI numbers. This makes sense, as China was the earliest economy to emerge from the 2020 recession, and has not provided the same level of fiscal and monetary support as the developed economies.

Looking ahead, however, **economic growth at the rate seen in the first half of this year is unlikely to be repeated in the second half**.

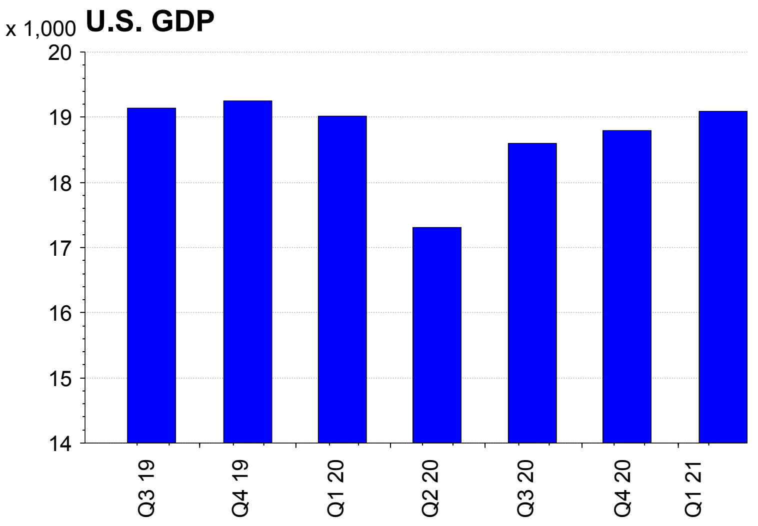
NB: There is no suggestion of renewed recession (at this stage), rather a moderation of the exceptional growth we have seen as the world economy recovers from the recession of 2020.

There are numerous reasons to expect the coming slowdown:

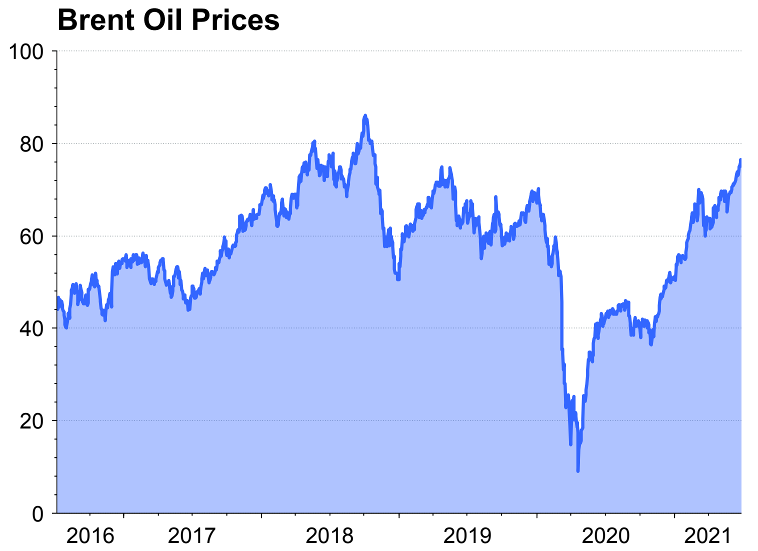
- As most economies reach GDP levels seen before the pandemic, the rate of recovery will slow and growth rates will move back towards longer term trends, which in the case of the US is 2.0%-3.0% annualised
- The **Federal Reserve** started talking in June about the need to tighten monetary policy as the recovery continues and inflationary pressures rise. This caused a mini market tantrum in June (see later), but as set out last month, **the direction of travel of the Fed has now changed from a loosening bias to a tightening bias**. The forthcoming annual Jackson Hole annual jamboree of central bankers should provide better guidance on the Fed's thinking.

- **The Oil price**. We have often said that rising oil prices are a significant brake on economic growth. Today we are seeing oil prices rising once again for reasons that have been well covered – growing demand from the recovery but sluggish output growth and low investment. Petrol prices in the UK have risen to an 8 year high, for example.
- Continuing supply disruptions, at a time when consumer spending is rising in the recovery. This can be seen in the level of inventories held by retailers relative to sales; this ratio has fallen to a 30-year low in the US.
- Delayed economic re-opening due to the continuing spread of Covid through new variants. In some countries new lock down restrictions have been brought in which will slow the expected recovery, including in China which is seeing new sporadic outbreaks
- Finally, leading economic indicators from numerous sources are now flashing warning signals of a growth rate slowdown on a global scale.

In summary, after seeing a strong recovery from the recession of 2020, economic growth is likely to slow from these elevated levels, towards a more normal, trend growth path.



Source: Refinitiv Datastream/ Key Family Partners SA



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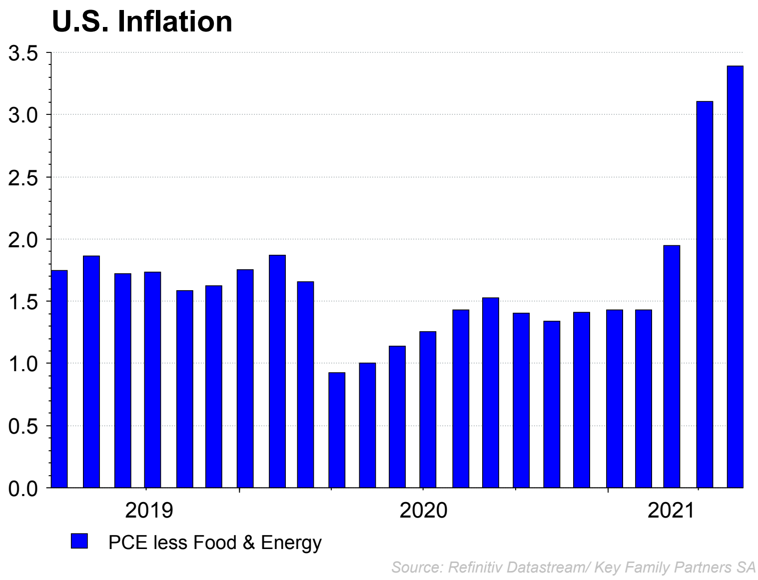
Retail inventories to sales (months) show strains are spreading throughout the economy

Meanwhile on the inflation front...



The rise in inflation marches on across the global economy, with no sign yet of a pull back. Markit, the economic statistics provider (eg PMI data), for the first time specifically noted wage inflation in their data releases for June in both the US and Eurozone Core inflation in the US continues to surprise on the upside, with the May number coming in at 3.8% year on year vs 3.4% consensus. This number is one of the likely causes of the Fed's decision to start talking about monetary tightening last month, somewhat earlier than the market had expected. As a result, market expectations of a first interest rate rise have moved in from 2024 to 2023 – and with a risk of even earlier action if growth and inflation continue to exceed expectations (the IMF base case).

While the US has seen the strongest acceleration in inflation amongst DM countries, core inflation rates are increasing across DM and EM economies. Producer prices are growing at alarming rates, with Germany's PPI seen rising at 7.2% year on year in May, the highest level since the GFC in 2008/9.

The debate on the transitory nature of this global inflation surge continues, with Central Banks generally dovish (i.e. believing it will be transitory and keeping real interest rates negative), while independent commentators are becoming more hawkish.

In summary...

- We can expect to see some slowing in the breakneck growth seen in the first half of the year as economies recover to pre-pandemic levels and trend growth rates.
- Inflation continues to exceed most expectations as energy prices and supply constraints continue to push up consumer prices
- However the rise in longer-dated US government bonds since mid-May may reflect investors doubts over longer-term growth and inflation.

For investors...

- Equity markets are likely to see more downside risk as slowing growth would impact corporate earnings
- Portfolio hedging of equity risk through allocation to alternatives remains important

EQUITIES

Equity markets were flat with the exception, once again, of technology sectors. Overall the outlook for equities is NEUTRAL.

GLOBAL EQUITIES

	1 month	YTD	12 month
Global Equity	+1.2%	+11.4%	+37.4%
Global Eq. Ex US	-0.5%	+7.9%	+32.8%

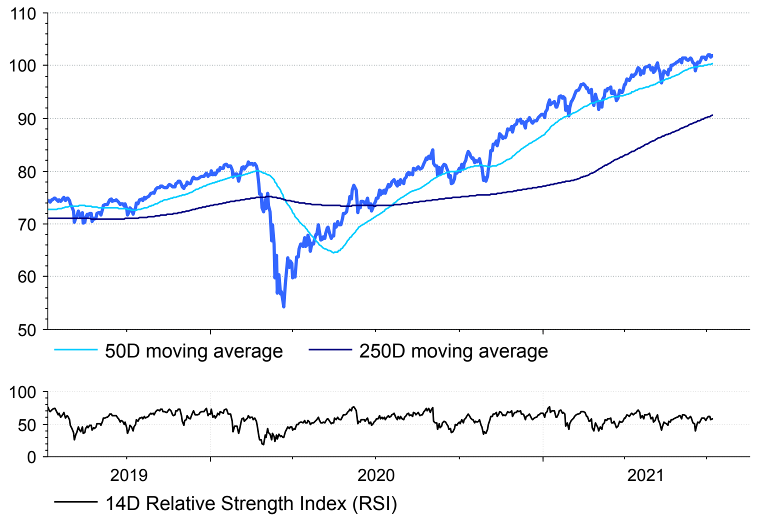
Global equities rose on the month, based on the MSCI All Country World Index. After an early month pull back, equities reached another new high as the world economy continued its growth recovery.

Valuations on adjusted **2021** expected earnings was steady at 19.6x on earnings recovery expectations, but this remains elevated on a 10-year average and vulnerable to higher rates.

Overall sentiment remains positive but continues to soften on monetary risks.

The outlook is moved to NEUTRAL.

MSCI ACWI



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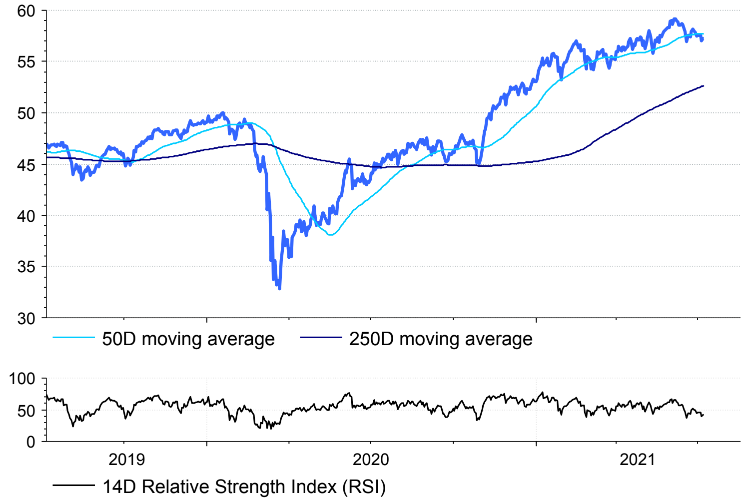
MSCI ACWI ex-US



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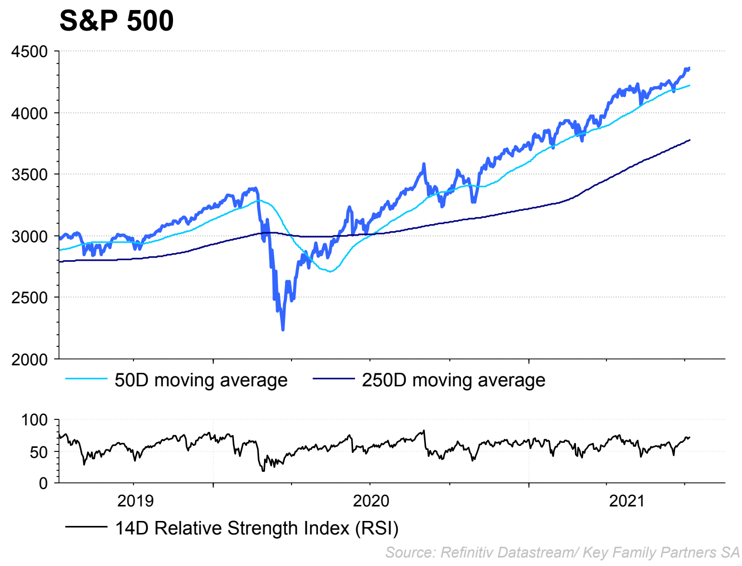
USA

	1 month	YTD	12 month
US Equity	+2.2%	+14.4%	+38.1%



The S&P500 had another positive month. After a sharp sell off at the start of the month after the Fed's comments on monetary policy, the market recovered and has made new highs.

Economic recovery remains strong but with an increasing risk of cooling growth – earnings growth RATES are likely to slow.

Market sentiment remains positive but the market is approaching an overbought level.

Valuations remain elevated at 22.8x 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

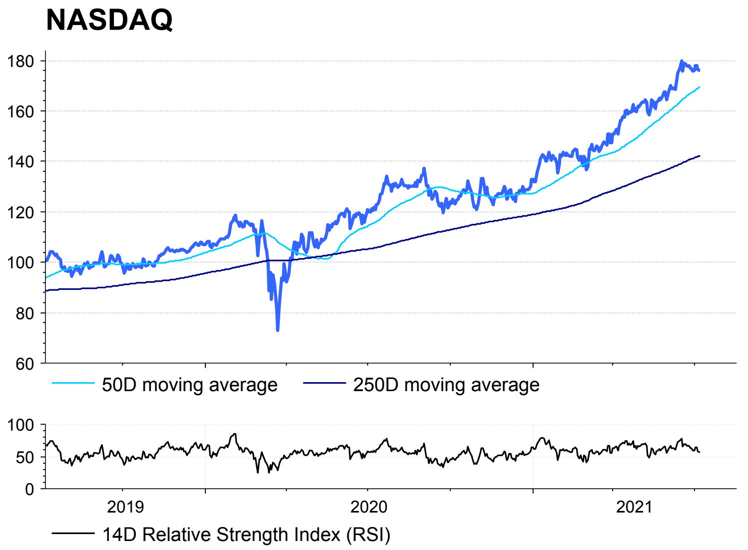
	1 month	YTD	12 month
NASDAQ	+5.4%	+12.5%	+44.2%
FAANG+ Index	+9.7%	+15.2%	+76.7%

The NASDAQ and Fang indices both had a strong positive month as sentiment for "growth" stocks revived at the expense of "value".

Despite the strong month, sentiment remained soft and both markets reached overbought levels once again.

Valuations of both indices rose to 33.5x prospective 2021 earnings for NASDAQ and 35.2x for the FANG+ index, with both remaining at elevated levels but temporarily supported by recent interest rate declines.

The outlook remains NEUTRAL with downside risk.



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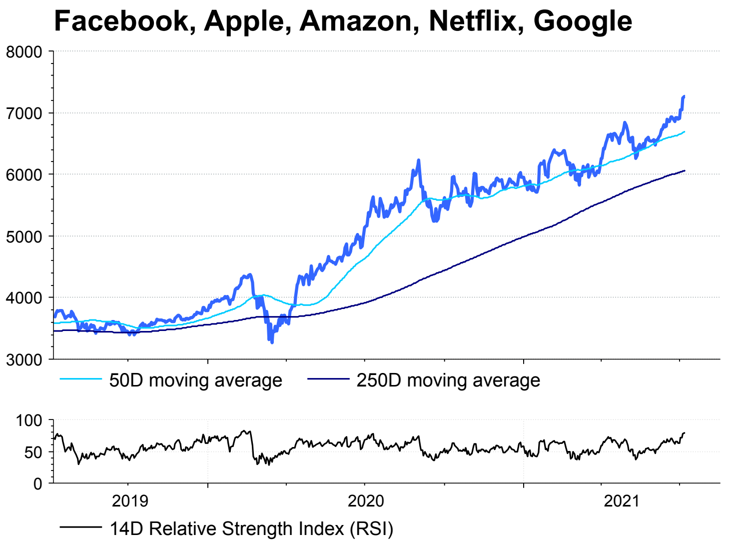
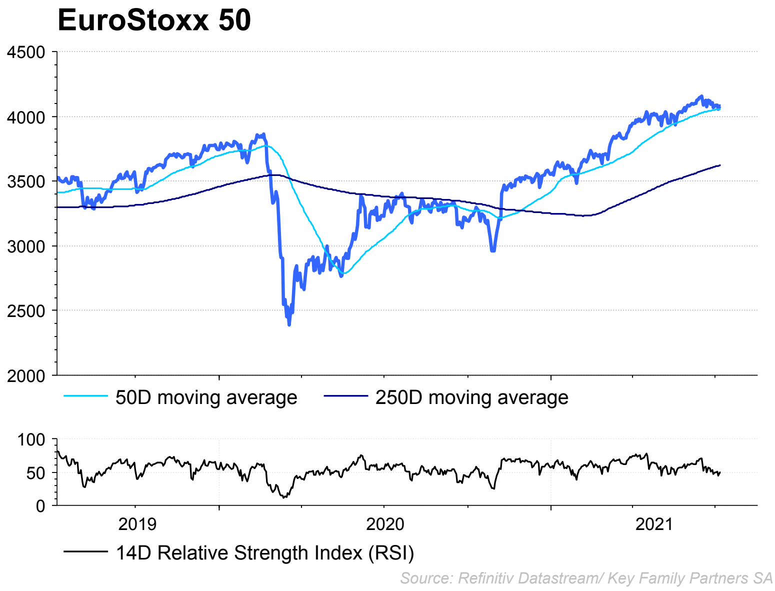


Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE			
	1 month	YTD	12 month
EZ Equity €	-0.1%	+13.8%	+25.7%
$	-2.9%	+10.8%	+31.1%



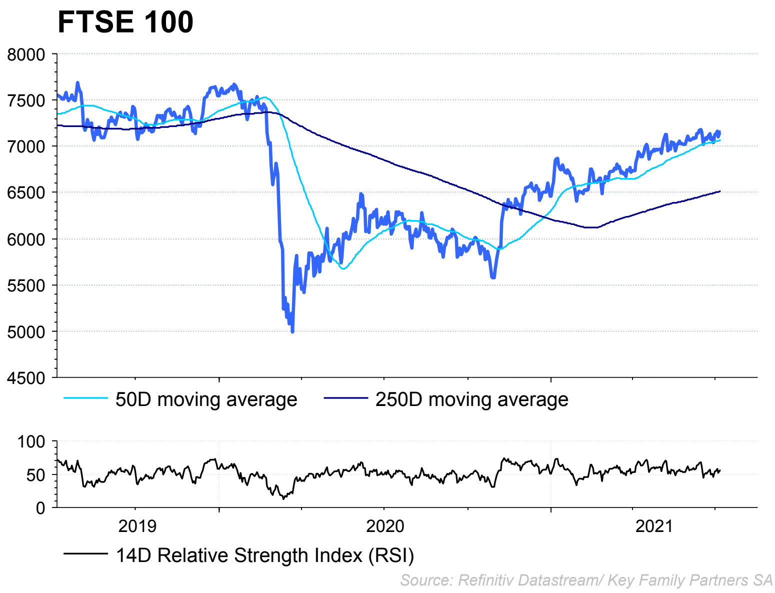
Euro equities had a flat month measured in Euros, but suffered from a weakening Euro compared to US indices.

After the strong run since the start of the year the market sentiment has started to soften from very positive levels.

The EZ economy is also likely to slow from its current rapid recovery pace given its high export reliance on China and the US. Valuation remains elevated at 18.3x prospective 2021 earnings.

The outlook is moved to NEUTRAL.

UK			
	1 month	YTD	12 month
UK Equity £	+0.2%	+8.9%	+14.1%
$	-2.3%	+10.1%	+25.6%

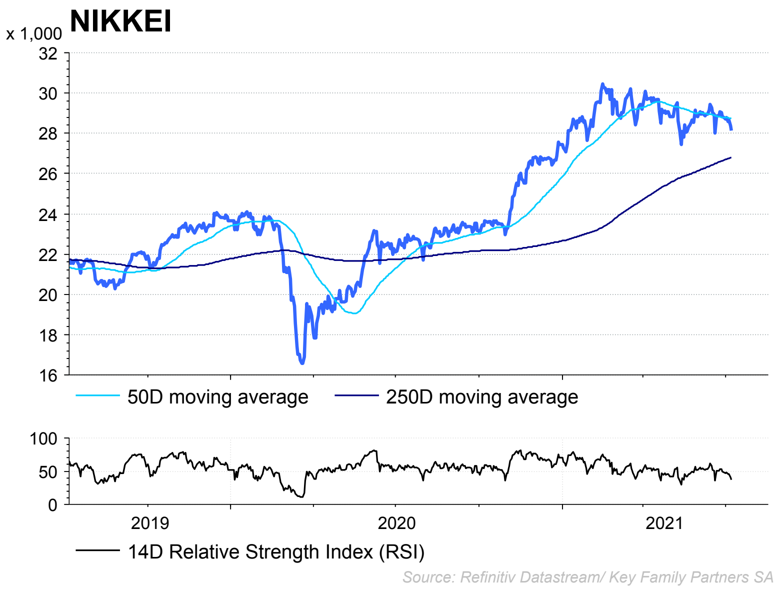


The FTSE100 had a flat month as release from lockdown regulations was delayed. Market sentiment softened somewhat on continuing political scandals but remains positive, while valuation remains very attractive at 13.5x prospective 2021 earnings. Prospective dividend yield is 3.9%.

Economic recovery continues but concerns continue to be raised about the growing number of covid cases despite the vaccination success. The outlook is moved to POSITIVE with some downside risk.

JAPAN

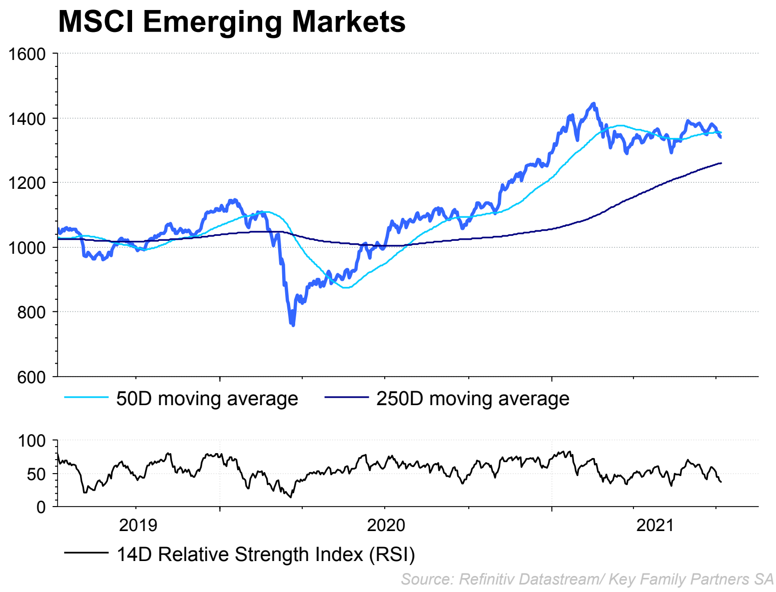
	1 month	YTD	12 month
Japan Equity ¥	-0.2%	+4.9%	+30.9%
Japan Equity ¥	-1.6%	-2.7%	+27.9%



The Nikkei had a flat month overall having seen a sharp sell off early in the month. Economic data was strong for manufacturing and exports, but domestic services suffered from renewed lockdowns. Valuation remains elevated at 19.3x prospective 2021 earnings. Market sentiment remains neutral. The outlook remains NEUTRAL with a positive bias.

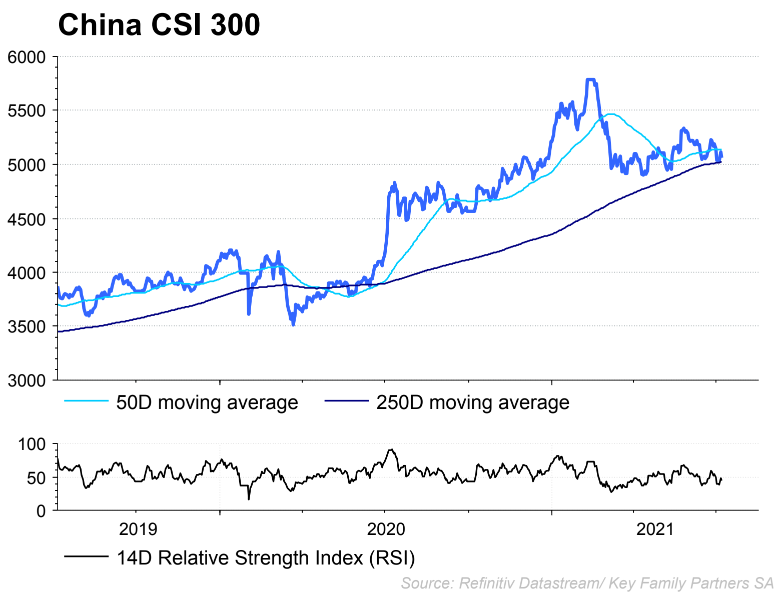
EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	-0.1%	+6.5%	+38.1%
China CSI 300$	-3.3%	+1.4%	+34.4%



EM equities overall were flat for the month while markets in oil rich economies continued to outperform.

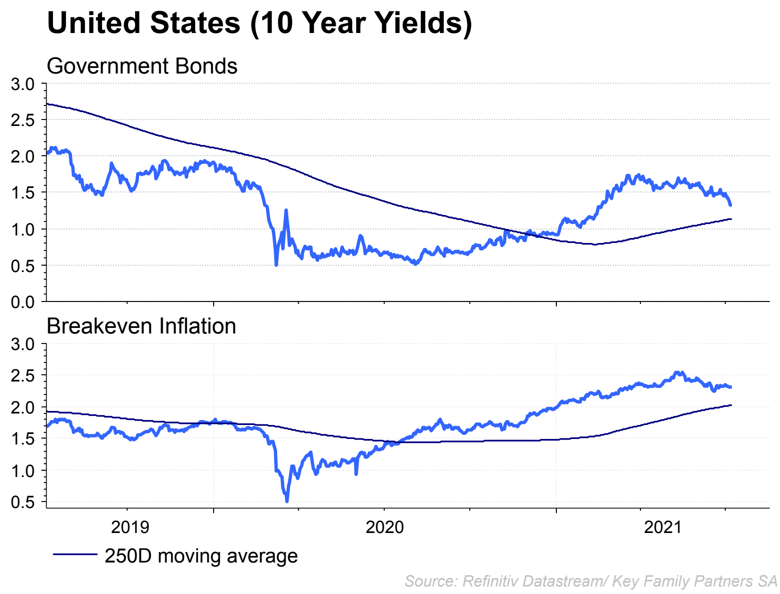
China's economy continues to be resilient albeit at a slower growth rate, which is being reflected in its market performance. Sentiment longer term remains positive and valuations attractive at 14.4x prospective 2021 earnings. The outlook remains POSITIVE on EM equities given the global growth outlook.



FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	+0.68%	-2.42%	-2.95%



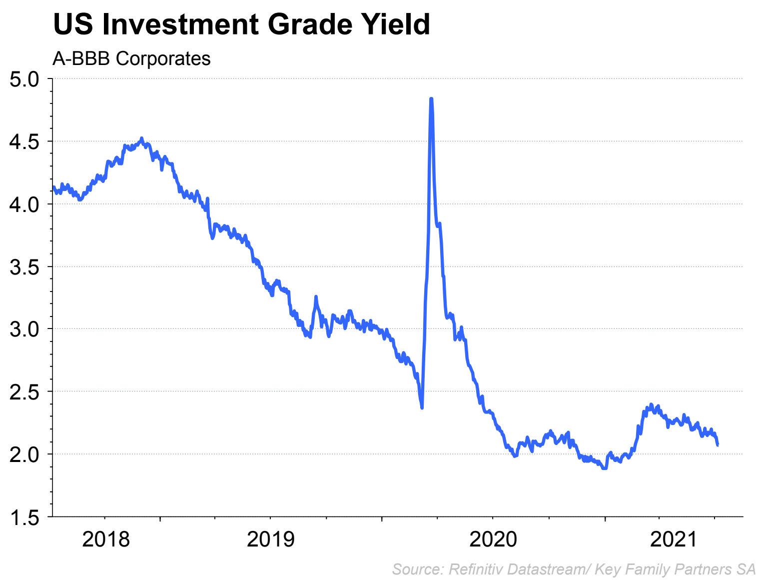
Yields on 10-year Treasuries ended the month down after Fed discussions about monetary policy tightening.

This may seem counter-intuitive, but the market appears to be discounting the short-term inflation risk and looking through to lower inflation in the longer term, based on expected Fed actions. The 10-year break even inflation expectation chart shows this effect.

Whether inflation continues at an elevated level after the base effect of 2020 washes through is the key issue for Central Banks and fixed income markets. The outlook remains NEGATIVE long term.

Investment Grade /

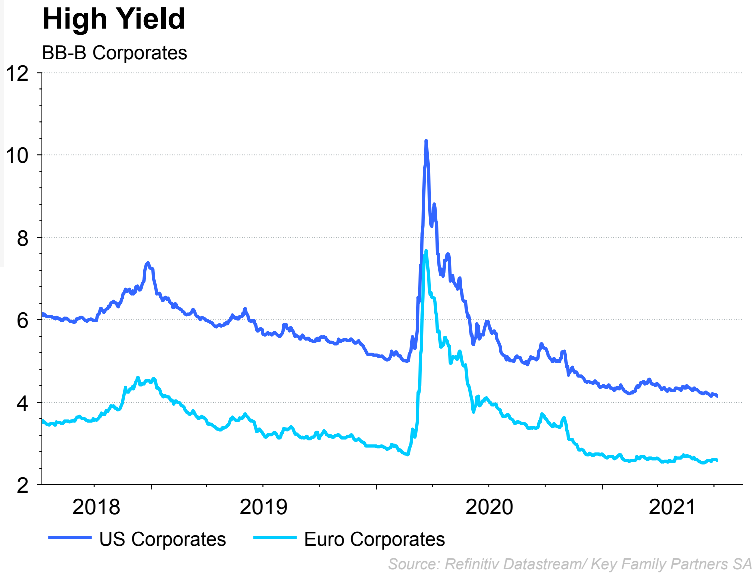
	1 month	YTD	12 month
US Inv Grade	+1.56%	-1.11%	+2.87%



Yields on investment grade corporates fell slightly, while spreads narrowed further to the lowest level since March 1998. Given the record narrow spreads, Investment Grade has become expensive – in the sense that spreads could widen rapidly should credit risks rise on an economic slowdown, as they have in the past. The outlook remains NEGATIVE long term with a neutral bias in the short term.

High Yield

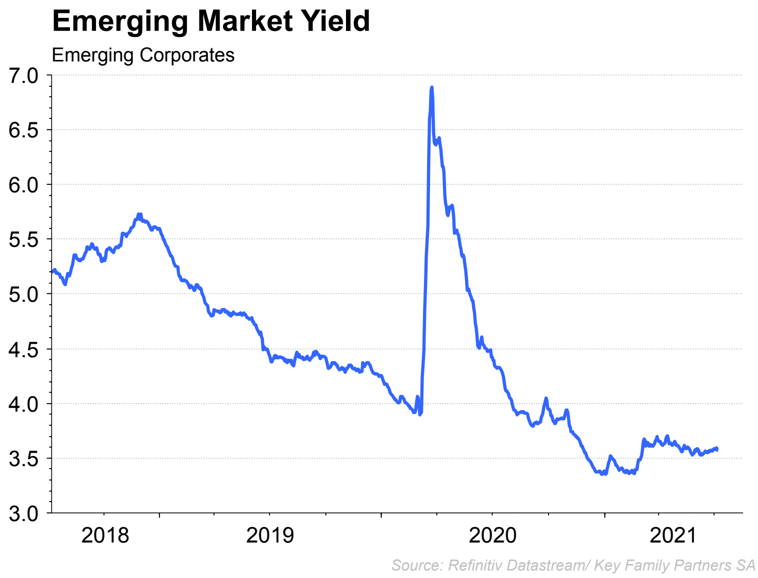
	1 month	YTD	12 month
US High Yield Total return	+0.55%	+2.15%	+14.76%



US HY bond yields fell over the month to 3.70% while spreads fell further to 267bps, the lowest level since September 1997. Any change to economic expectations will likely see spreads widen as credit risk rises. High yield is now at risk of such an event, which would be a consequence of a slowing economic growth rate. In the short term however, high yield remains in demand. The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	+0.92%	-0.58%	+5.80%

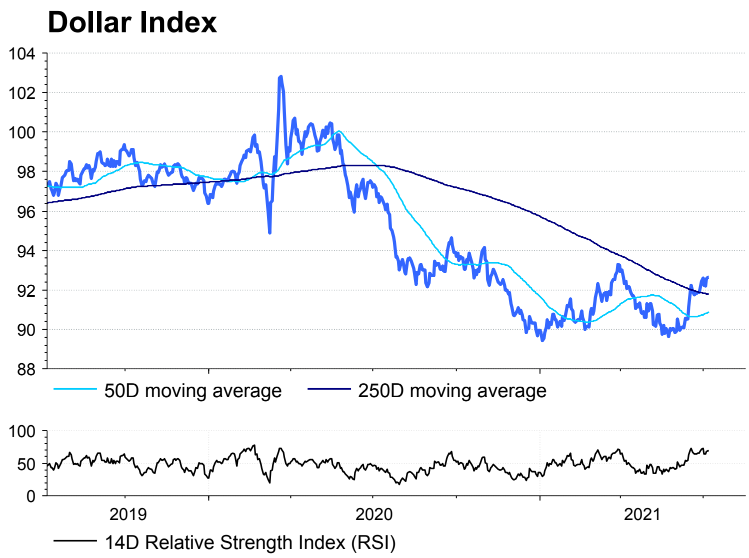


Yields and spreads on EM USD were largely flat for the month. Economic policies in EM countries are generally more prudent than developed economies and investors continue to like the yield pick up available. The outlook remains NEUTRAL.

CURRENCY – USD vs DM, EM

USD vs DM currencies

The USD staged a strong Fed-induced rebound in June against DM currencies, and particularly the Euro. Earlier than expected Fed tightening, including rate rises in 2023 rather that 2024, encouraged currency investors to move back to USD to pick up the future higher yield. But the US remains saddled with the growing twin deficits and from a technical perspective the USD is not yet out of the woods. The outlook remains NEGATIVE but with a neutral bias in the short term.



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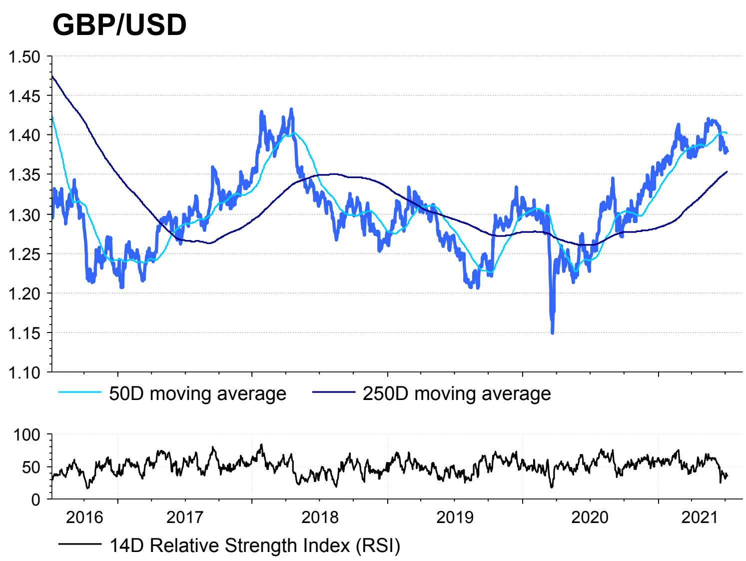


Source: Refinitiv Datastream/ Key Family Partners SA

CURRENCY – USD vs DM, EM

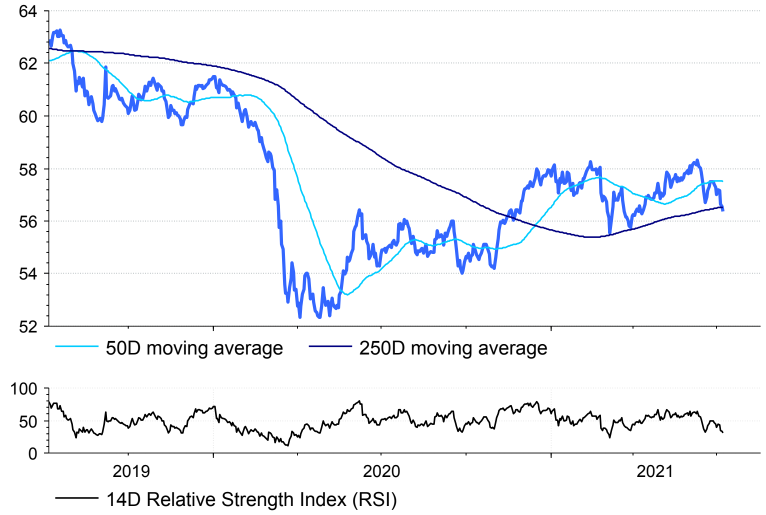
USD vs EM Currencies

EM currencies continued their recovery against the USD.

Some Fed induced volatility during the month was largely extinguished by month end, as seen in the Mexican Peso. Sentiment towards EM currencies remains positive despite the Fed action. In particular the resource based currencies (Peso, BRL, Rouble, Rand) continue to make progress.

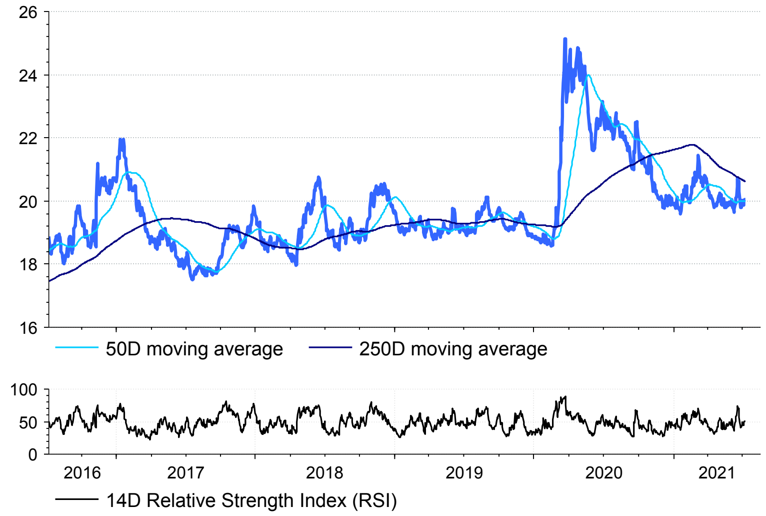
The USD outlook vs EM currencies remains NEGATIVE with a neutral bias if USD yields continue to rise.

JPMorgan Emerging Market FX



Source: Refinitiv Datastream/ Key Family Partners SA

Mexican Peso /USD

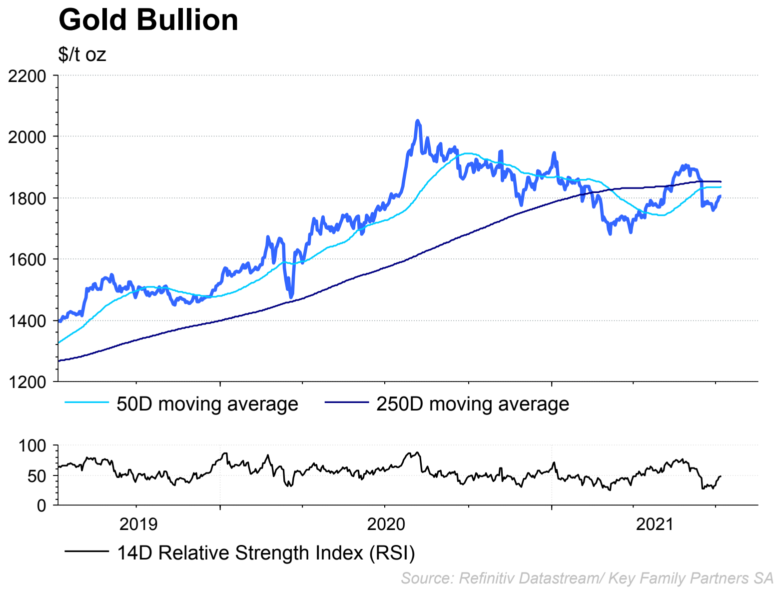


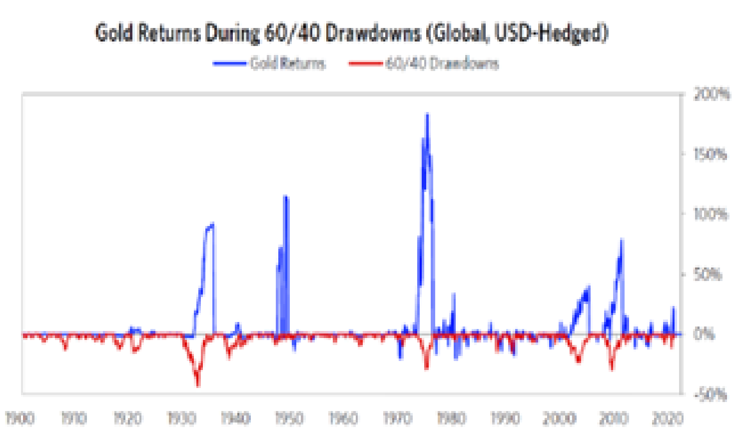
Source: Refinitiv Datastream/ Key Family Partners SA

GOLD

	1 month	YTD	12 month
Gold	-7.1%	-6.7%	-0.6%

Gold had a substantial correction following the Fed's announcement mid-month, giving up all the previous month's gains. Gold has moved from overbought to oversold in one month. The lower chart shows an important recent piece of research by Bridgewater. This shows the performance of gold vs a traditional balanced (60/40) portfolio and clearly shows the diversification benefit of gold, which performs well when other assets are negative. The conclusion of the piece, to paraphrase, is "*In summary, adding a gold overlay (15-20 per cent) would improve the portfolio's return and only slightly increase the risk*". The outlook for gold remains NEUTRAL with a positive bias.





COMMODITIES

OIL

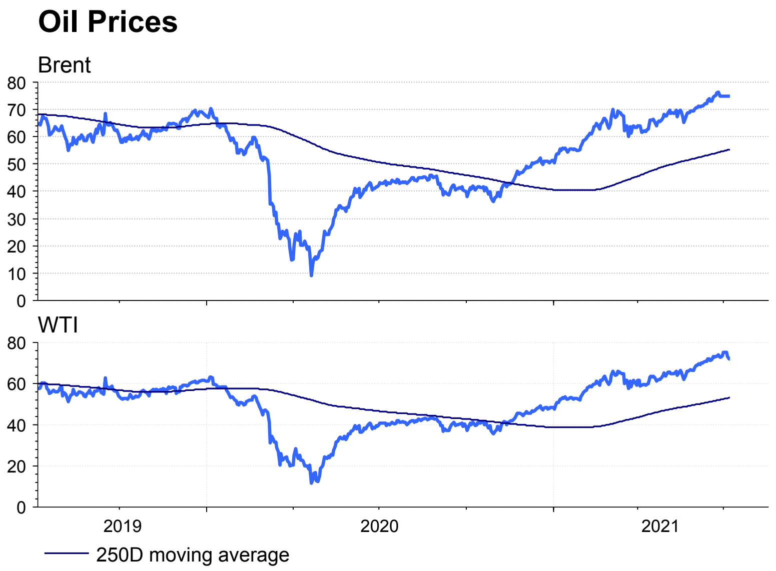
Oil prices continued to rise over the month, breaking the $75/bbrl level.

Momentum remains strong as demand grows but supply side growth remains limited. Short-term the market is overbought.

The OPEC+ meeting currently in progress has not come to a conclusion on increased supply levels but indications are it wants to keep supply tight and prices high.

Longer term, supply constraints due to underinvestment by oil majors (the ESG impact) will likely push oil prices higher and hand more control to Opec+, keeping prices higher for longer.

The outlook for oil remains NEUTRAL with upside potential.



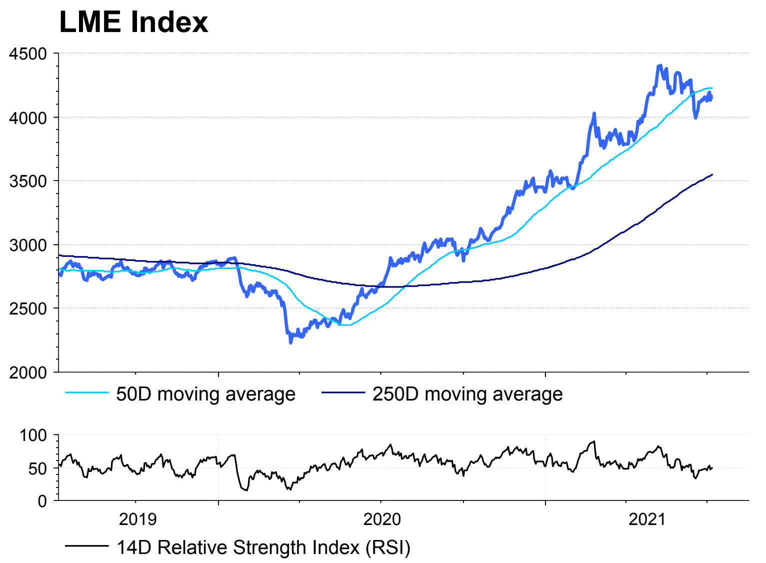
Source: Refinitiv Datastream/ Key Family Partners SA

METALS

Metal prices took a pause in June, driven mainly by Chinese Government efforts to slow forward buying (“speculation”) of copper.

Nevertheless, sentiment towards industrial metals remains very positive, and a pause before the next leg up is always healthy. The fundamental demand supply imbalance, particularly in copper, will be with us for some years ahead.

The outlook remains POSITIVE.



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ILLIQUID ASSETS

Real Estate	🔴	To be updated
Hedge Funds	🟡	To be updated
Private Equity	🟡	To be updated

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KEY FAMILY PARTNERS

Key Family Partners SA
Rue Francois-Bonivard 6
1201 Geneva
Tel: +41 22 339 00 00
www.keyfamilypartners.com