KEY FAMILY PARTNERS

Global Market View

August 2021

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

The China Investment Conundrum

As will be apparent to all readers, China has started to flex its political and economic muscles in a significant way over the past few years based on its perceived and real economic strength.

As of December 2020, China's GDP was calculated by the World Bank at $14.7trillion (13.0% of global GDP), vs $20.9trillion (18.6%) for the USA. Equity market capitalisation in the US stands at approx. $50trillion, vs $11trillion for China (ex Hong Kong). China's economic growth continues to impress, with the latest year on year growth to June 30th set at 7.9%. Based on these metrics, China cannot be ignored from a global investment perspective and increasing investment flows have been seen into both equity and fixed income markets over the past few years.

Nevertheless, over the past year starting with the last-minute failure of Ant Financial's IPO in November 2020 due to regulatory issues, Chinese market regulators have been disrupting the market for Chinese stocks with a variety of controlling measures. This has seen the listed China Tech equity market sector lose $1.2trillion in value (per Goldman Sachs) since the start of this year. The latest swipe has been at the private education business (tutoring), with proposals that they should be run as not-for-profit enterprises, as opposed to profit driven enterprises. $16bn has been wiped off the market capitalisation of the largest three businesses listed in the US, with TAL Education (the largest tutoring business in China with 45,000 employees) losing 93% on the price of its ADR. Overall, the China CSI 300 index lost -6.3% in the week the new measures were announced and is down -7.7% year to date. Other market sectors are believed to be in the aim of regulators – in particular, pharmaceuticals and essential consumer goods.

Much of the capital raised for these companies has been in the US market through ADR's on instruments known as Variable Interest Entities (VIE) which provide economic exposure but not legal ownership of equity in Chinese companies, and therefore with limited investor protection compared to western expectations. The recent events are likely to preclude further capital raising by Chinese companies in the US markets for the foreseeable future, essentially forcing Chinese companies to raise capital domestically, or through Hong Kong for international investors. This may indeed be part of China's game plan.

Clearly these events have unsettled markets and foreign investors in China, who will be looking for stability and certainty for their investments. China however has other priorities, summarised again by GS as "*the Chinese authorities are prioritizing social welfare and wealth redistribution over capital markets (...) consistent with their repeated emphasis of promoting fair growth and "broad prosperity" since late last year.*"

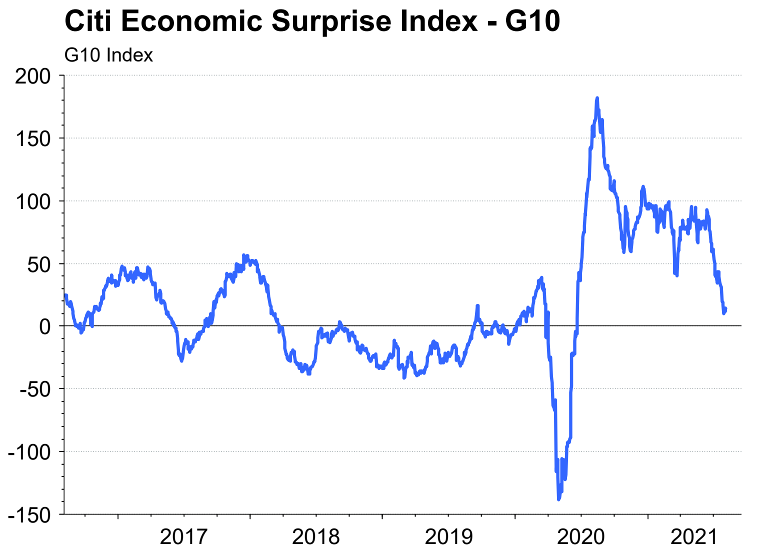
For international investors, the message is clear: **"It's hard to know what you're getting into with Chinese assets. And between the current Chinese regime's laser-sharp focus on political control and its intention to control financial risks, more shocks are likely to come." (Bloomberg).** The China political risk is now clearer than ever for investors.

The conundrum for investors is (and always has been) how to take advantage of the growth opportunities in China, while understanding (and minimising) the economic and political risks associated with the investing in China – whether in public or private markets.

Portfolio allocation limits and proper diversification are essential to controlling some of these risks, with thorough due diligence on company specific risks.

Growth Rate Slowdown in evidence

As previewed in last month's report, global economic activity has started to slow from the breakneck levels seen in Q2. The global Citi Economic Surprise Index, which measures actual results against market expectations, is on a declining trend while remaining above the zero level for the time being. However, both the US and China are both somewhat below the zero level already (not shown). Essentially this means that in both countries, growth levels are already disappointing relative to expectations, with the US posting a 6.5% annualised Q2 growth rate, versus market expectations of 8.5%. Composite PMI numbers for July (where available) confirm this trend, with the US number falling to 59.7 in July from 63.7.



Source: Refinitiv Datastream/ Key Family Partners SA

While remaining generally positive, a declining economic growth rate can lead to market disappointments versus elevated consensus expectations for corporate earnings and other growth measures. This is especially true at this time, after Q2 earnings in the US have massively exceeded expectations, with 91% of the 255 companies in the S&P500 that have reported so far exceeding analyst expectations by an average of 17.8%. This has led analysts to raise year end earnings growth forecasts to 21.0% from 17.3% for the year as a whole; normally mid-year revisions for end year earnings are down, not up. Substantial scope for disappointment versus expectations has now been built into the market in the US. (NB A good example of this effect is Amazon's Q2 results which disappointed vs forecasts, even though on-line store sales rose ONLY 16%, well below forecasts. Amazon's share price fell -7.6% on the day).

Inflation update

Core inflation rates continue to rise driven principally by input prices of materials, including energy, food and transportation. The US reached 4.5% in June while all other major economies are on rising trends. In addition, market based inflationary expectations have risen slightly on the month (see Fixed Income section below).

An important part of the debate on whether this inflation is transitory or not centres on the impact on real wages of economic growth and recovery from the pandemic, and whether they will be pushed higher and risk keeping the inflation rate elevated. An interesting study by the Federal Reserve of San Francisco titled "Longer-Run Economic Consequences of Pandemics" focused on 15 major pandemics over history, starting with the Black Death in the 14th century. This found that the economic effects generally persisted for 40 years after major pandemics and real wages were pushed higher because of a shortage of labour. Some evidence of this effect is being seen in the US today, with retirement numbers surging beyond normal levels and employers having to offer higher wages and better conditions to attract and retain staff (eg Walmart's offer to pay 100% of employees' college fees, and the lowest paid in the hospitality industry achieving 10% increases in wages). Whether this translates into the current pandemic experience is still open to debate – future data will settle it.

Monetary policy stays loose

The ECB, at its July meeting, has followed the Fed in being more flexible on future inflation levels – and confirming that it would keep buying bonds and maintaining its negative interest rate policy even if "transitory" inflation were to exceed its new target of 2%. Where the Fed goes, others are sure to follow….and the Fed's Central Bank offsite in late August bears watching for signals on future Fed actions.

Also of note is that China has made a "pre-emptive" easing move by cutting the Reserve Ratio Requirement by banks by 50bps (to 8.9%). The impact is to expand banks' capacity to lend and therefore head off any serious slowdown in the economy, some evidence of which has already been seen over the past few months. In this respect China is out of step with other central banks on monetary policy – as it has been throughout the pandemic. Nevertheless, this move is a positive move for Chinese (and global) growth.

In summary…

- Global growth is on a slowing trajectory, with the risk of disappointment in equity markets in particular.
- China's regulatory tightening is highlighting the political risks of investment in the country and EM more broadly.
- Inflation continues to rise, with increasing risks that it may not be as transitory as the Fed believes, while monetary policy remains loose.

For investors…

- As market risks rise, maintaining broad diversification is more important than ever.
- Volatility in all markets is likely to rise as economic progress becomes less certain.
- Careful stock selection, especially in EM, is essential.

GLOBAL EQUITIES

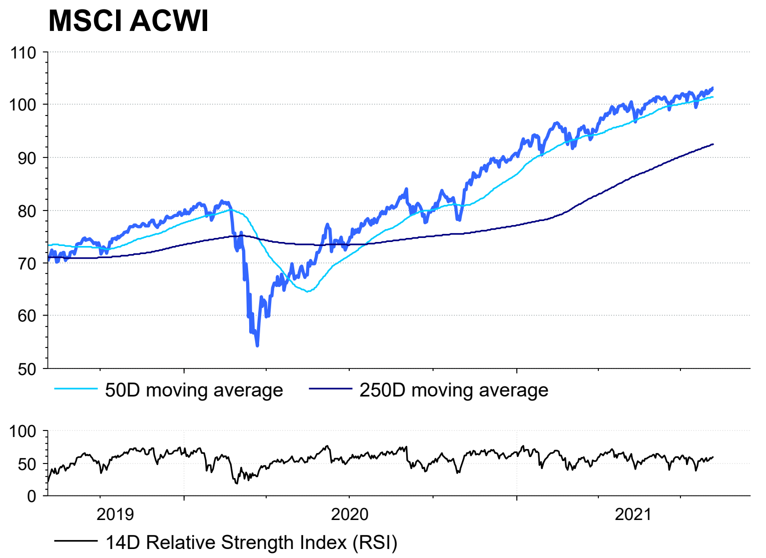
GLOBAL EQUITIES	1 month	YTD	12 month
Global Equity	+0.6%	+12.1%	+31.2%
Global Eq. Ex US	-1.8%	+5.9%	+25.2%

Global equities rose on the month, based on the MSCI All Country World Index, the gain principally coming from the US. After an mid month pull back, equities reached another new high in spite of signs of an economic slowing growth rate.

Valuations on adjusted **2021** expected earnings was steady at 19.2x on earnings recovery expectations, but this remains elevated on a 10-year average and vulnerable to higher rates. Ex US, the forward P/E is 15.5x.

Overall sentiment remains positive but continues to soften.

The outlook remains NEUTRAL.



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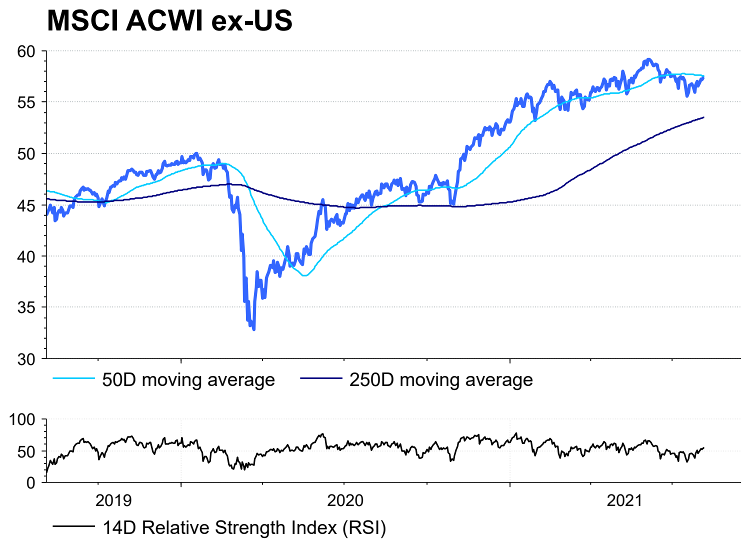

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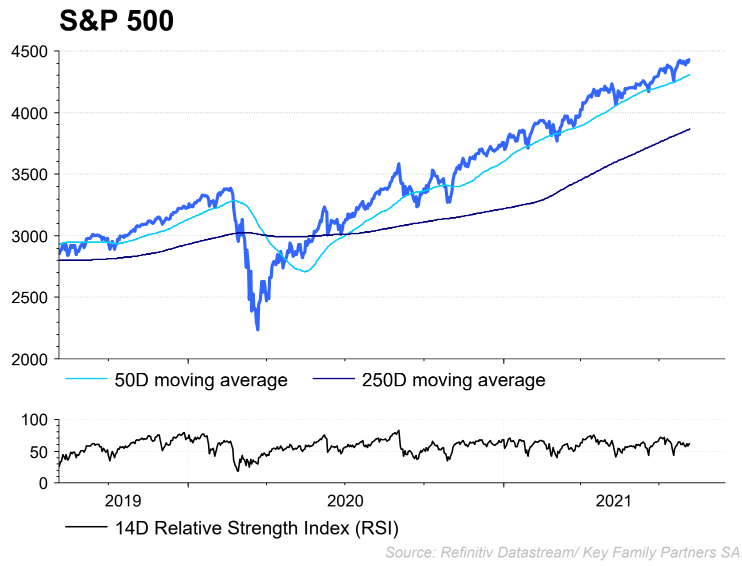
USA

	1 month	YTD	12 month
US Equity	+2.3%	+17.0%	+34.4%



The S&P500 had another positive month. After a sharp sell-off mid-month on pandemic and growth fears, the market recovered and has made new highs.

Economic recovery remains positive but at a slowing rate.

Market sentiment remains positive, but the market is once again approaching an overbought level after correcting mid-month.

Valuations remain elevated at 22.2x prospective 2021 earnings, and at risk if earnings start to disappoint.

The outlook remains NEUTRAL but with some downside risk due to valuation and sentiment.

NASDAQ Comp

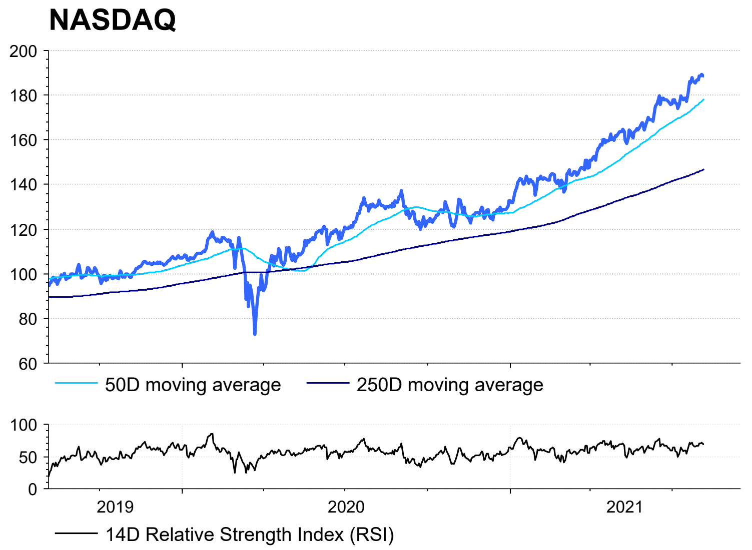
	1 month	YTD	12 month
NASDAQ	+1.2%	+13.9%	+36.6%
FAANG+ Index	-2.0%	+12.8%	+51.9%

The NASDAQ and Fang+ indices diverged for the month, with the Fang+ underperforming Nasdaq and the S&P500 year to date.

Sentiment remained positive but both markets reached overbought levels once again.

Valuations of both indices fell, to 32.6x prospective 2021 earnings for NASDAQ and 32.8x for the FANG+ index, with both remaining at elevated levels. As seen in the Amazon Q2 results, any earnings disappointments at these elevated valuation levels will be punished by the market.

The outlook remains NEUTRAL with downside risk due to the continued overbought level of the market and rising risk of earnings disappointments.



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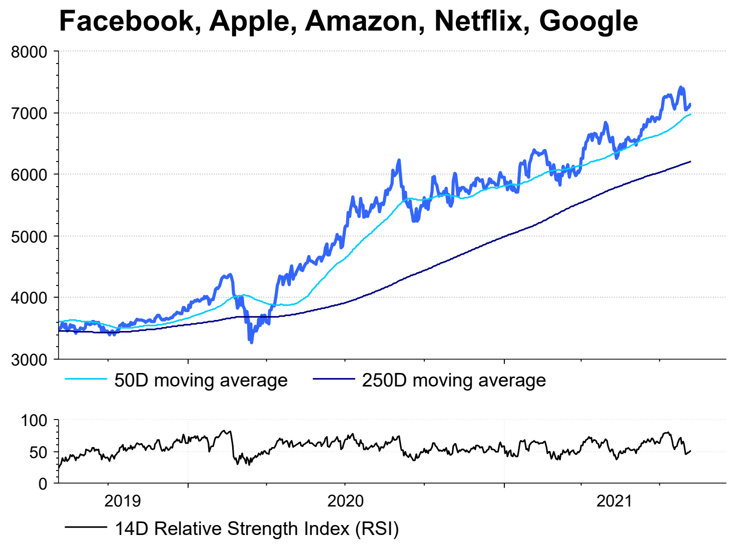
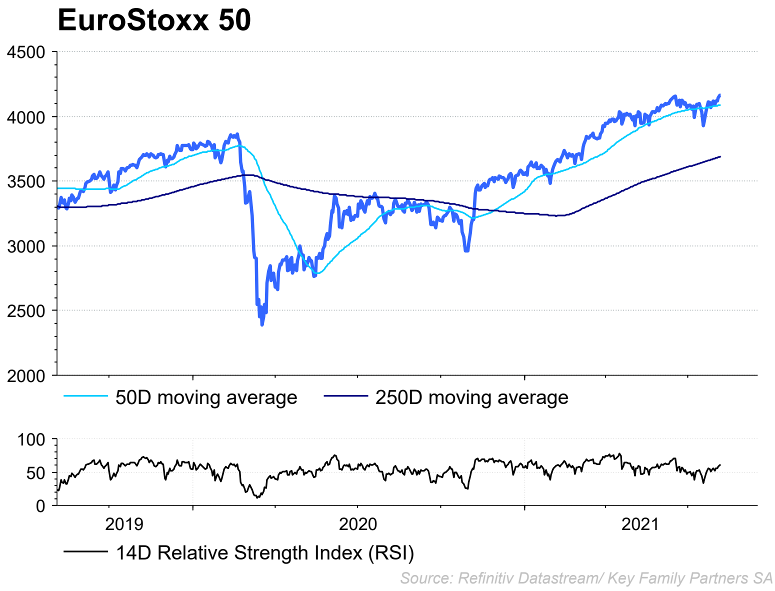


Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE

	1 month	YTD	12 month
EZ Equity €	+0.6%	+15.1%	+28.8%
$	+0.7%	+11.8%	+29.0%



Euro equities had a flat month after a sharp correction mid-month.

The EZ economy is also likely to slow from its current rapid recovery pace given the global growth rate slowdown likely to be seen in H2.

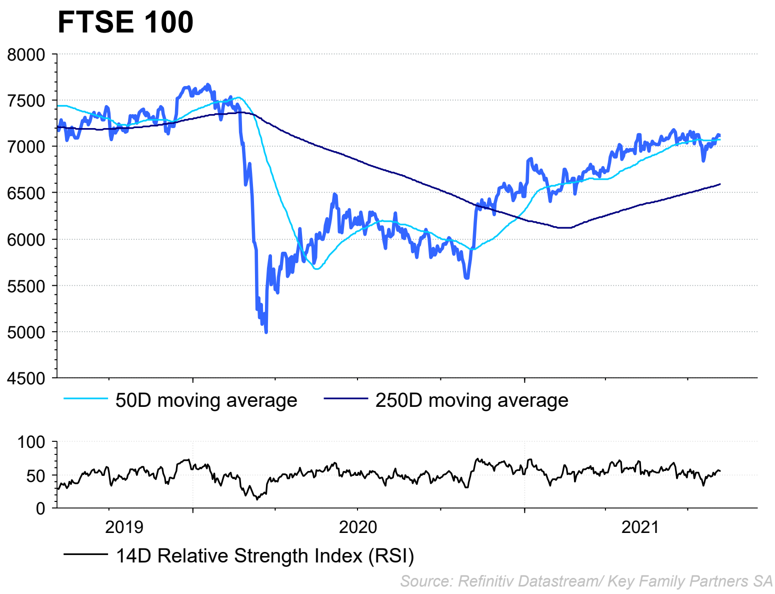
Sentiment has weakened further and now stands at neutral.

Valuation remains elevated at 17.8x prospective 2021 earnings.

The outlook remains NEUTRAL.

UK

	1 month	YTD	12 month
UK Equity £	-0.1%	+8.9%	+19.2%
$	+0.4%	+10.7%	+26.6%



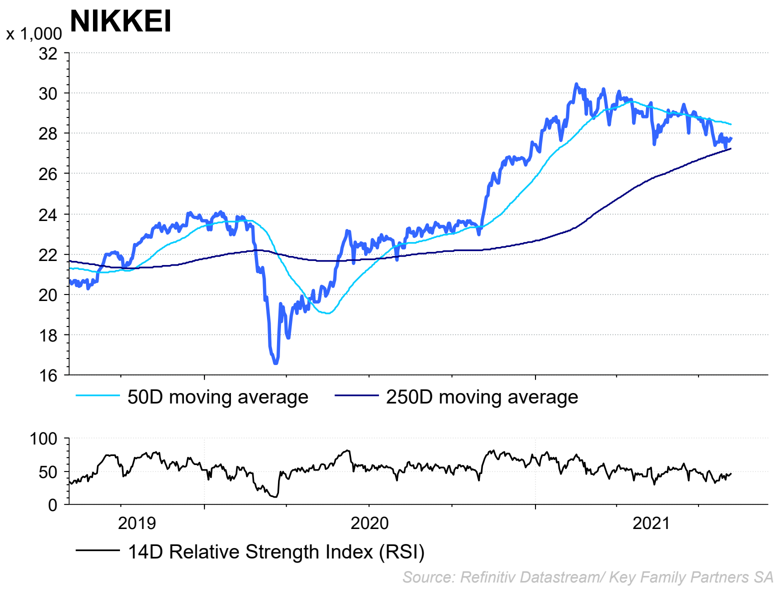
The FTSE100 had a flat month on continued pandemic recovery concerns with the Delta variant. Market sentiment continued to softened somewhat and is now in neutral territory, while valuation remains very attractive at 12.9x prospective 2021 earnings. Prospective dividend yield is 4.1%.

Economic recovery continues but a H2 slowdown in growth rate is likely.

The outlook remains POSITIVE on valuation, but with some downside risk.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	-5.2%	-0.6%	+25.7%
Japan Equity ¥	-4.0%	-6.5%	+19.9%



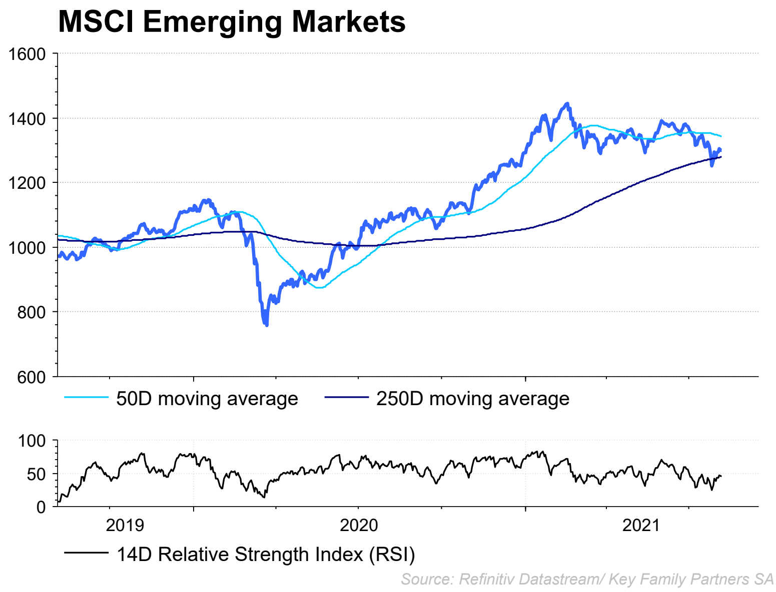
The Nikkei had a sharp correction in the month as composite PMI numbers fell back into negative territory, and pandemic numbers continued to rise. The Olympic Games provided little boost without tourism.

Valuation fell to 17.9x prospective 2021 earnings while Market sentiment turned somewhat negative.

The outlook is moved to NEUTRAL.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	-7.0%	-1.0%	+18.4%
China CSI 300$	-7.9%	-7.7%	+2.5%

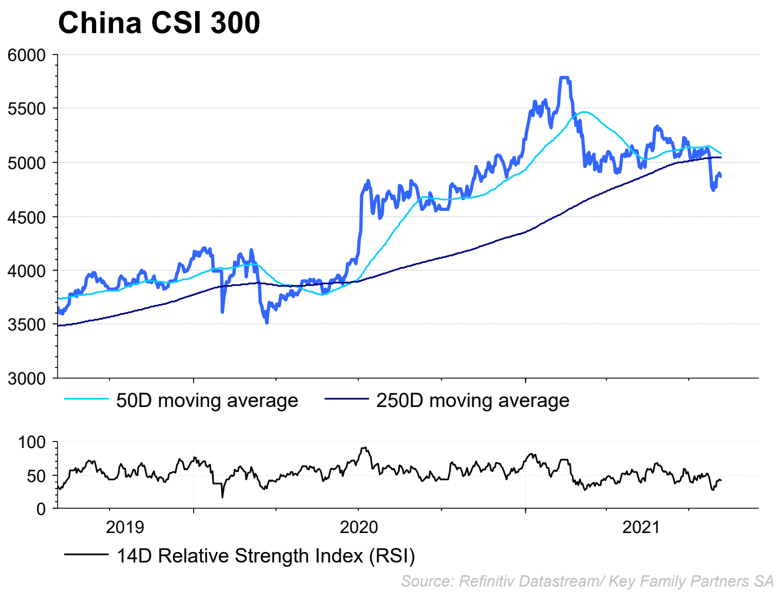


EM equities fell sharply on the back of developments in China, and Brazil following the China market down. Energy producers however were largely flat for the month.

With China highlighting the continuing political risk element of investment in EM, market sentiment has turned neutral/ negative, and particularly on the Chinese market.

Valuations remain attractive at 13.7x prospective 2021 earnings.

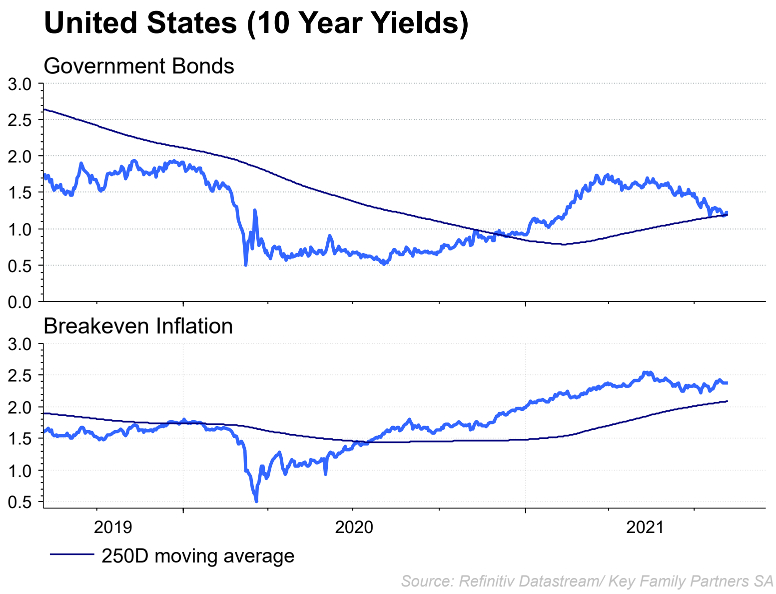
The outlook is moved to NEUTRAL.



FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	+1.19%	-1.25%	-3.01%



Yields on 10-year Treasuries ended the month down again despite rising long term inflation expectations.

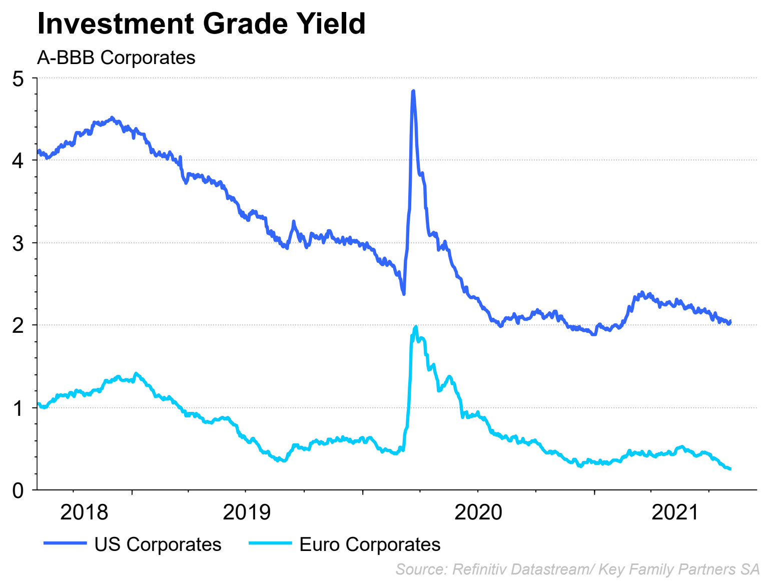
The Fed Chairman, J Powell, admitted that even the Fed was unsure why longer-term yields were coming down ("no consensus on what explains the moves"). He suggested an explanation was "technical factors – where you put things you can't quite explain". So that explains it.

Meanwhile expectations of the start on a new tapering cycle in Q3 are now high, but much will depend on the progress of rising inflation rates in the US, and the impact on growth expectations. Technical factors again.

The outlook remains NEGATIVE long term on renewed rising inflation expectations.

Investment Grade /

	1 month	YTD	12 month
US Inv Grade	+1.21%	+0.08%	+1.42%



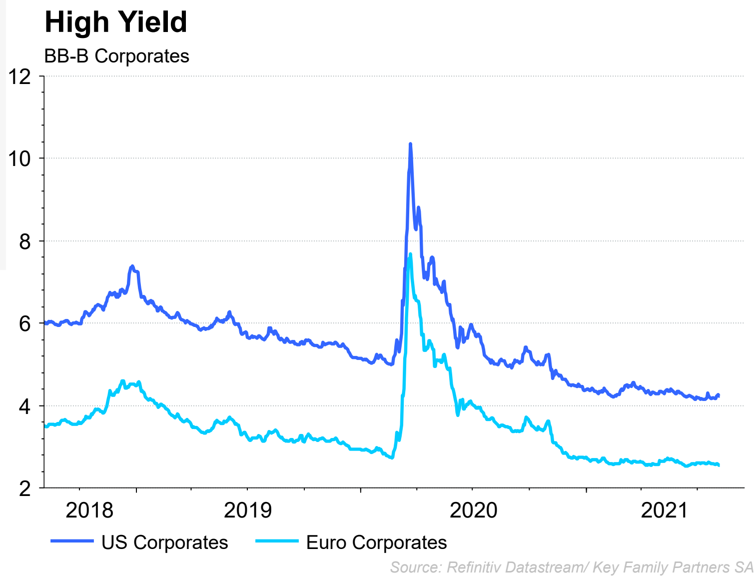
Yields on investment grade corporates fell slightly on the back of falling Treasury yields, while spreads ROSE slightly for the first time in some months.

With a slowing economic growth rate, credit risk will rise and we could see spreads rise further in the months ahead. Short term the yield pickup vs Treasuries remains attractive to 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	+0.18%	+4.01%	+10.6%



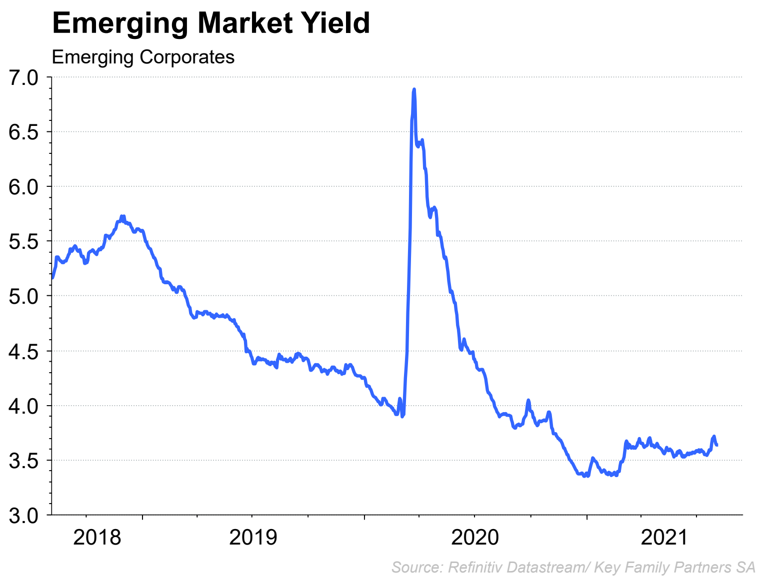
US HY bond yields were flat for the month, as spreads widened slightly on the back of rising credit risks.

If the expected slowdown does materialise, then spreads are likely to widen from these ultra-tight levels. In the short term however the yield pickup of 294bps will remain attractive to investors.

The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	+0.14%	-0.44%	+3.29%



Yields on EM USD rose slightly on the month, driven primarily by widening spreads. Total return however remained marginally positive.

Political risks are seen to be rising with the actions in China, and some commercial debt (eg Evergrande property business) is seen as rising credit risk.

The outlook is moved to NEUTRAL.

USD vs DM currencies

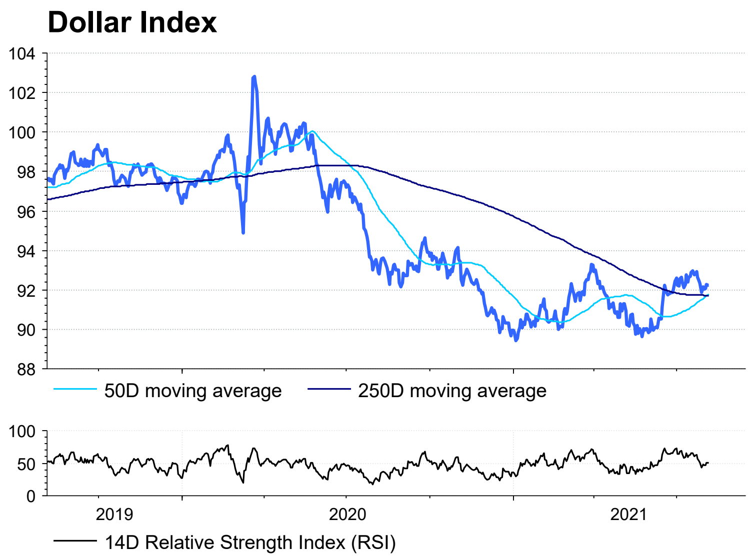
The USD moved down in the month, principally against the Yen and Sterling.

After a brief pull back, the US trade deficit continued to expand in May and is expected to continue that trend as the economy continues to grow.

The Government deficit remains huge at $2.4trillion for the first 9 months of the fiscal year (vs $2.7trn in the prior year) and unlikely to shrink further from here. The longer-term trend of the twin deficits is likely to push the USD to lower levels, except in a global economic crisis in which case the Treasury market remains a safe haven.

Lower yields on Treasuries also makes the USD less attractive for foreign holders.

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



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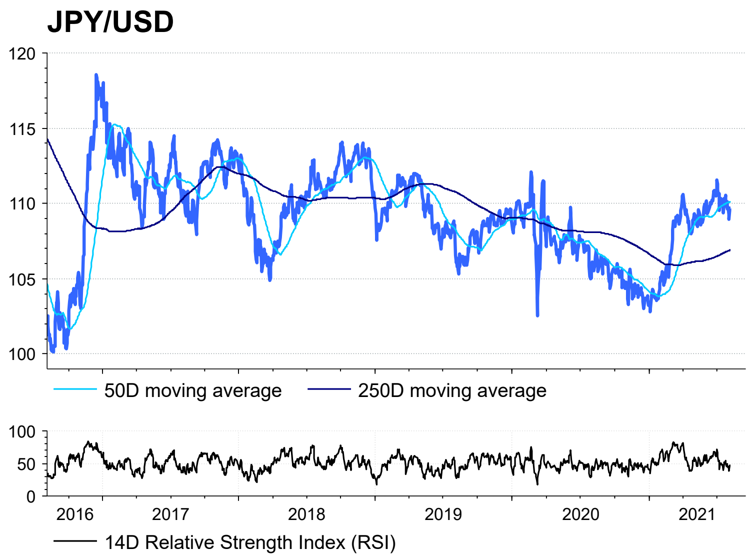


Source: Refinitiv Datastream/ Key Family Partners SA

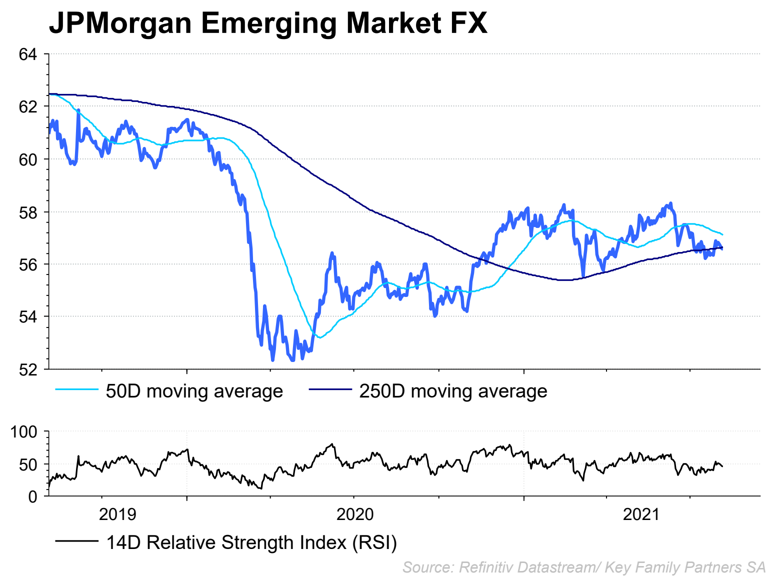
CURRENCY – USD vs DM, EM

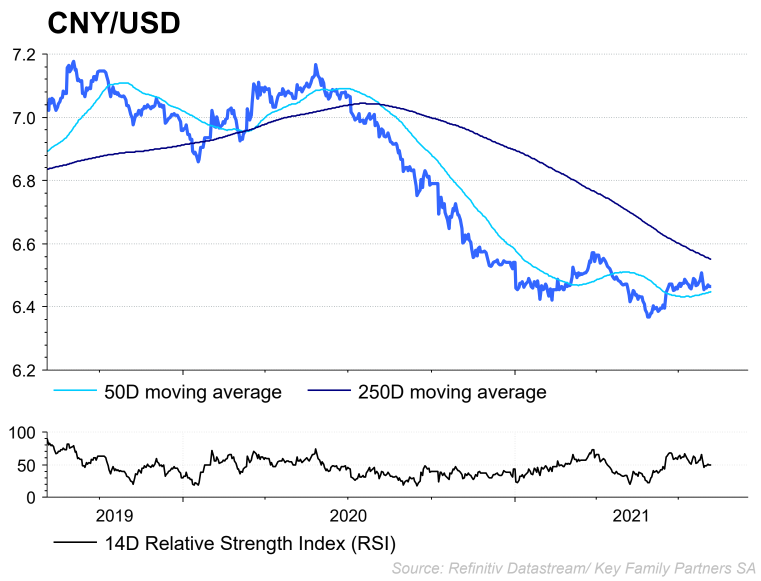
USD vs EM Currencies

EM currencies were generally flat for the month against the USD despite the developments in China.

The BRL however gave up 5% on domestic economic concerns and the slowdown in China's demand for resources, while the South African rand was also down after the politically driven rioting in that country.

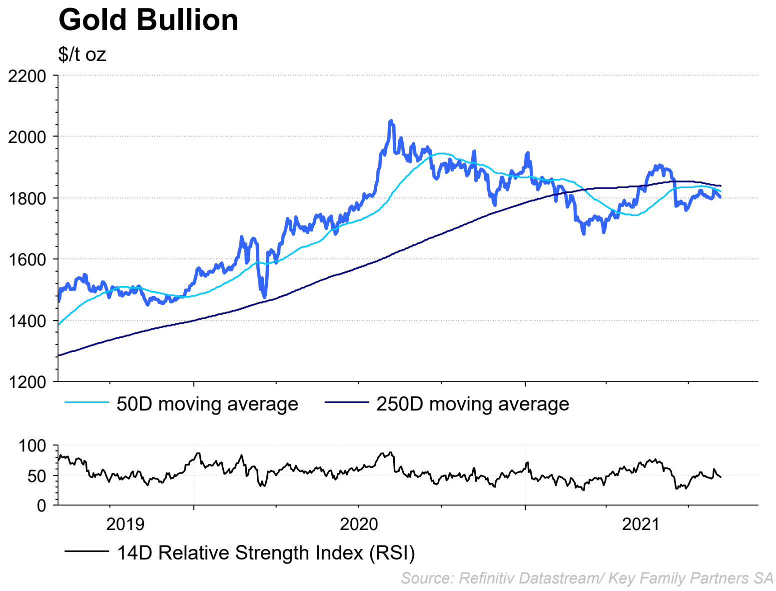
The USD outlook vs EM currencies remains NEGATIVE with a neutral bias.





GOLD

	1 month	YTD	12 month
Gold	+2.5%%	-4.4%	-8.2%



Gold recovered some of its lost ground from the previous month, as real yields on the USD turned more negative once again.

Political risks in EM also add to the attraction of gold as a haven, as seen during the China events at month end.

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

The outlook for gold remains NEUTRAL with a positive bias.

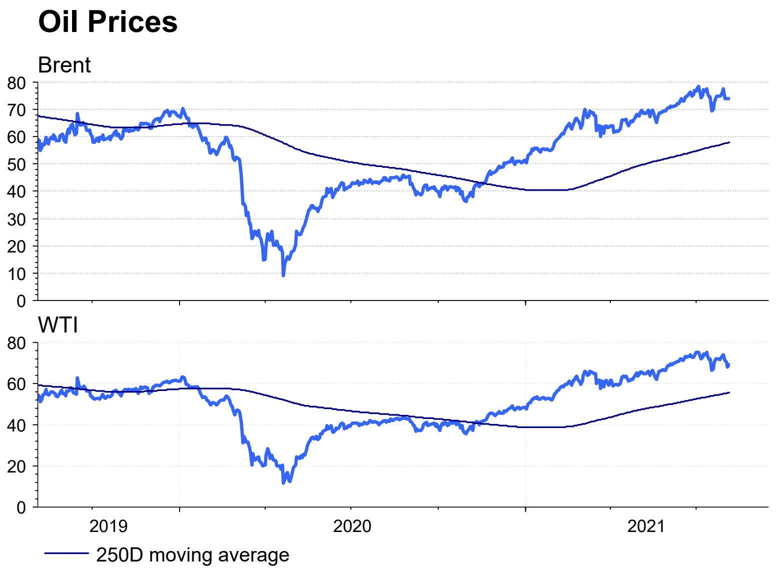
COMMODITIES

OIL

Oil regained its peak levels after briefly dipping during the month.

Opec+ (ie including Russia) finally reached an agreement to increase output starting in August with 400K b/d extra each month, reaching 2million b/d by year end.

Prices fell on the announcement, coupled with concerns over China's growth outlook. However, with the announcement of some monetary easing in China, that concern has been allayed and the view is that the proposed increases in output will only bring the supply/demand balance back to equilibrium.



Source: Refinitiv Datastream/ Key Family Partners SA

Market sentiment towards oil remains positive.

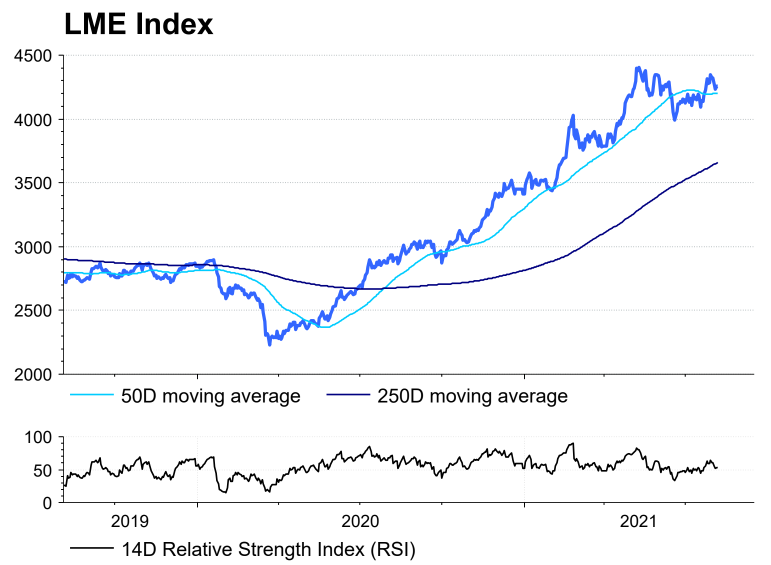
The outlook for oil remains NEUTRAL with upside potential.

METALS

Metal prices resumed their climb in July after China's monetary easing, led by copper once again.

Sentiment towards industrial metals remains very positive. The fundamental demand supply imbalance, particularly in copper, remains.

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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