KEY FAMILY PARTNERS

Global Market View

March 2021

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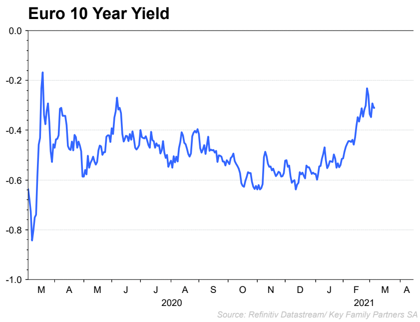
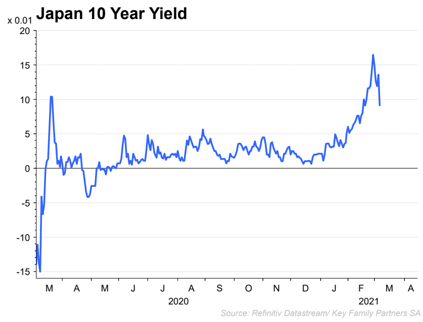
Ratings are not bound by a specific timeframe; they will change when fundamental conditions change

Warning – Inflation Returns

The past month has seen a rapid rise in longer dated Government bond yields in all G7 countries as inflation fears finally began to impact financial markets. Investors sold Government and Investment Grade fixed income instruments, pushing up yields and leading to losses of up to 10% on longer dated Treasuries in the month.

This development has been well signalled in our past few reports, but perhaps the surprise has been the speed with which the market has moved over the past month across all G7 markets in the face of rapidly rising inflation expectations.



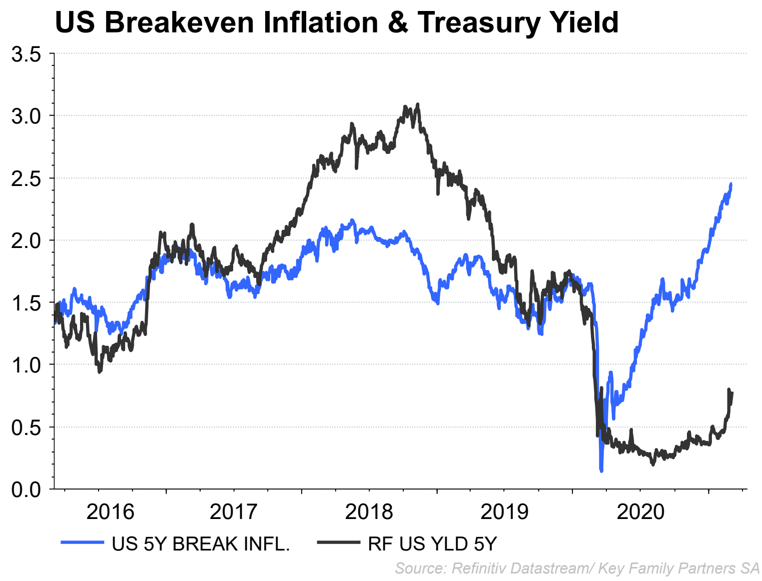


Inflation numbers are starting to show up in the most recent data with CPI in all major economies rising in January, most notably the Eurozone moving to 0.9% from -0.3% in December. The US posted 1.4% in January, the highest level since March 2020 – and rising.

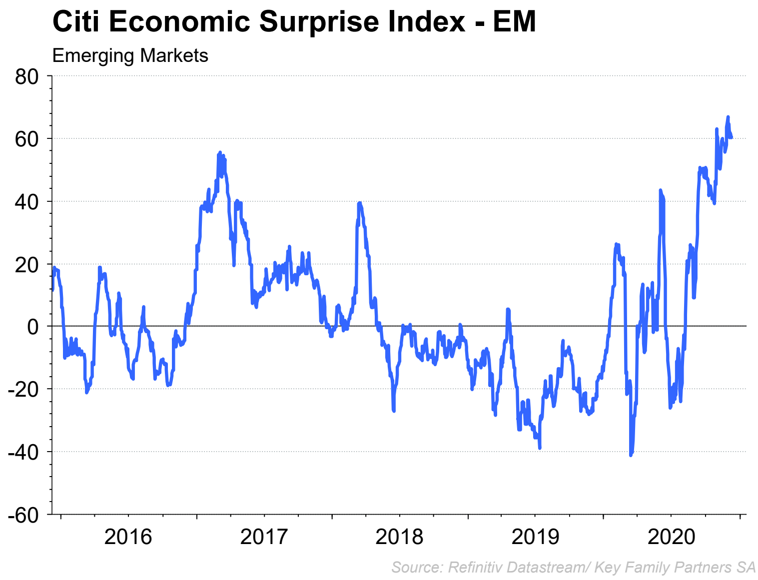
While these numbers are not yet of concern per se, the inflationary **EXPECTATIONS** are. The 5-year break even US inflation expectations (black line) have risen to the highest level in 8 years and remain on a strongly rising trend. Yet yields on 5-year Treasuries (blue line), which normally would trade at a premium to inflation expectations, have fallen to a substantial discount – a direct measure of the impact of the 'super Keynesian' monetary and fiscal policies being conducted by the US and other developed economies, and covered in our previous reports.

The bond 'vigilantes' have recently moved to close this gap, but REAL rates remain strongly negative across the yield curve, except for the ultra-long 30-year Treasury yield.

The issue for markets, and investors, is what happens next? Do the market rates continue to rise to catch up with inflation expectations, or do inflation expectations fall to meet market interest rates – or some of both?



Interest rates – Quo Vadis?



Central Banks (CB) actions will be critical in the near term in determining the direction and level of market interest rates. Currently, all G7 CBs remain dove-ish on growth and inflation, and have reduced SHORT term rates to near zero, or below, using QE bond buying programmes to artificially reduce market rates to these levels. What we are now seeing is market driven yields rising at the longer end of the yield curve, where the CBs have not been particularly active, if at all, in holding down rates.

The dilemma for CBs is whether to let the yields rise at the longer end and hence increase the cost of borrowing for longer term borrowers (e.g. mortgages) – which would contradict their objectives of reflating their economies with cheap money and letting inflation run higher. Or should the CBs introduce active **YIELD CURVE CONTROL** by buying bonds at the longer end thus keeping interest rates down and real interest rates negative?

CB action on Yield Curve Control is the big unknown in bond markets today in the face of rising inflation expectations. The Fed has not yet given any such indications, while the ECB has flagged concern at the rise in longer term rates and given a strong indication that they will not let these rates rise. The BoJ has been doing this for years while the BoE has “discussed” using these measures.

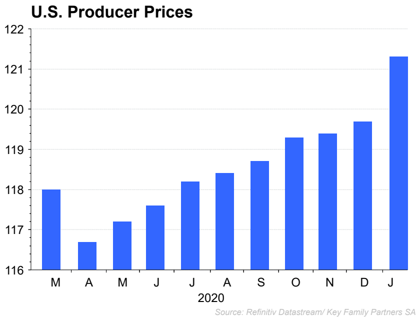
These decisions matter hugely for investors, as without intervention by CBs yields can be expected to continue to rise towards the higher inflation expectations (and bond prices to fall), and economic recovery would slow. **This would be negative not only for Fixed Income assets, but also highly priced growth equities, commodities and real estate** as borrowing costs would rise and discount rates increase on future corporate earnings.

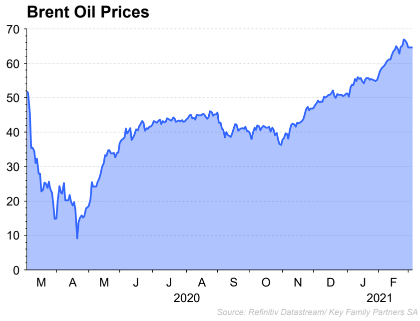
On the other hand, **if CBs intervene to keep yields low (and real yields negative) the bull market in real assets could be expected to continue as the economy continues** to recover from the recession in 2020 – and the CBs meet their economic goals.

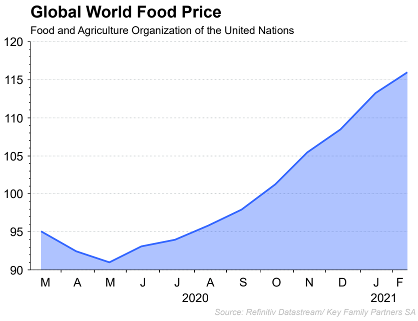
Inflation - continuing to rise

“Super Keynesian” monetary and fiscal measures remain in place. Boosted by the US Administration’s recent $1.9trillion fiscal stimulus, they will continue to fuel inflationary pressures.

While inflation year-on-year remains below the average 2.0% target of the Fed, rising medium-term inflation pressures are visible in many areas:







Over the next quarter, headline inflation numbers will also be boosted by the “base effect” – essentially the impact of comparing today’s prices with the unusually low prices seen in the recession last year. Beyond that, the course of inflation will depend on the rate of economic growth (demand growth) and the ability to meet that demand (supply). Demand continues to be boosted by monetary and fiscal measures, while established manufacturing supply chains have been disrupted by the pandemic and political factors. Service industries have contracted due to insolvencies, reducing supply of both manufactured goods and services. Meanwhile labour costs continue to rise in spite of high levels of unemployment (+2.6% year on year in the US in Q4 2020).

Growth - Continuing recovery

Economic recovery continues with the Citi Economic Surprise Index remaining well into positive territory for G7 countries, suggesting that economic data continues to be better than expected in G7 countries. Composite PMI numbers for February (where available) continue to show improving trends, with strong positive numbers in the US (58.8). Manufacturing PMIs for February were strongly positive, particularly in the US (58.5) and Eurozone (57.7).

These numbers reflect the continuing recovery in the G7 countries from the recession of 2020. China on the other hand had not (apparently) seen such an extreme economic contraction and has already recovered to pre-pandemic levels of GDP. While economic growth remains strong (+6.5%) for Q4 2020 over the previous year, positive economic surprises remain low (CESI +2.5).

In summary…

- Economic growth and recovery remain broadly on track
- Inflation has picked up and will continue to rise through Q2 putting pressure on G7 Central Banks to implement further YIELD CURVE CONTROLS.

For investors…

- CB action to control market driven interest rates will be important for markets in the near term.
- With **rising inflationary pressures and market interest rates**, circling out of highly priced growth equities to lower priced recovery (value) equities makes sense
- Government and investment grade **bonds will remain under pressure** UNLESS G7 Central banks deploy yield curve control (YCC) in serious quantities.
- **Real assets** continue to be attractive over G7 fixed income assets assuming YCC action.

EQUITIES

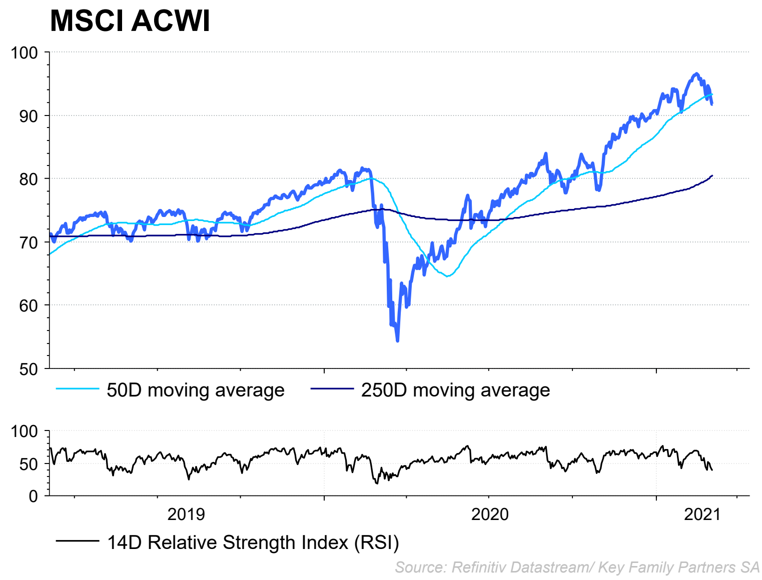
Equity markets started the month positively before rising market interest rates forced a correction, particularly amongst the highly priced growth equities in the US and Asia.

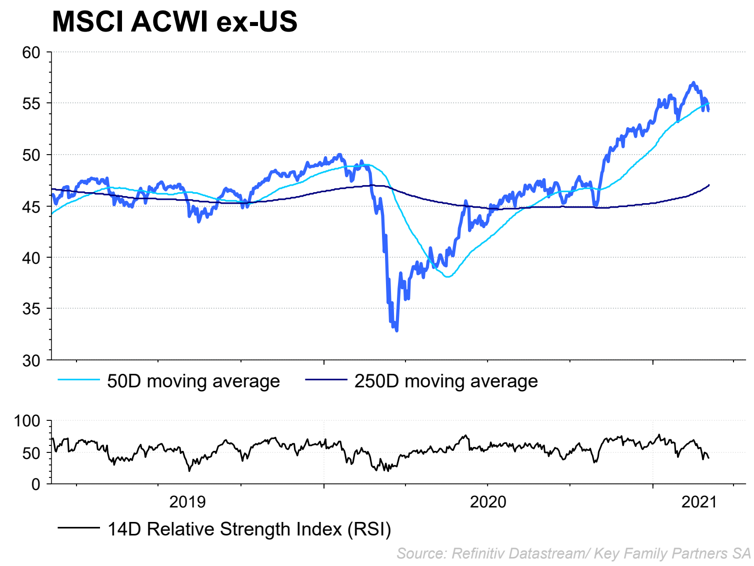
GLOBAL EQUITIES	1 month	YTD	12 month
Global Equity	+2.2%	+1.7%	+28.2%
Global Eq. Ex US	+1.9%	+2.0%	+23.5%

Global equities rose to record levels by mid-month, based on the MSCI All Country World Index. Markets corrected in the second half of the month on rising market interest rates.

Global growth remains positive with valuations on adjusted **2021** expected earnings steady at 19.8x on earnings recovery expectations, but this remains elevated on a 10-year average.

Longer-term sentiment has become more neutral, while short-term is approaching oversold once again.





The outlook remains POSITIVE with some downside risk due to rising market interest rates and elevated valuations.

USA

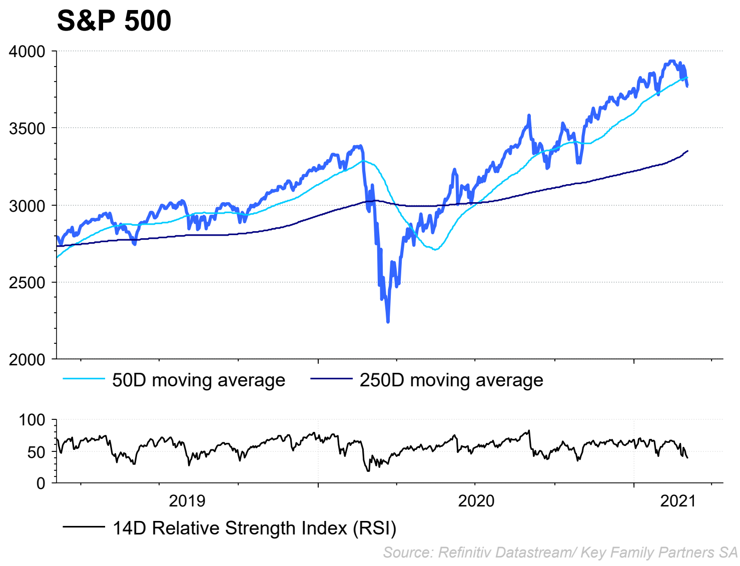
	1 month	YTD	12 month
US Equity	+2.6%	+1.5%	+29.0%

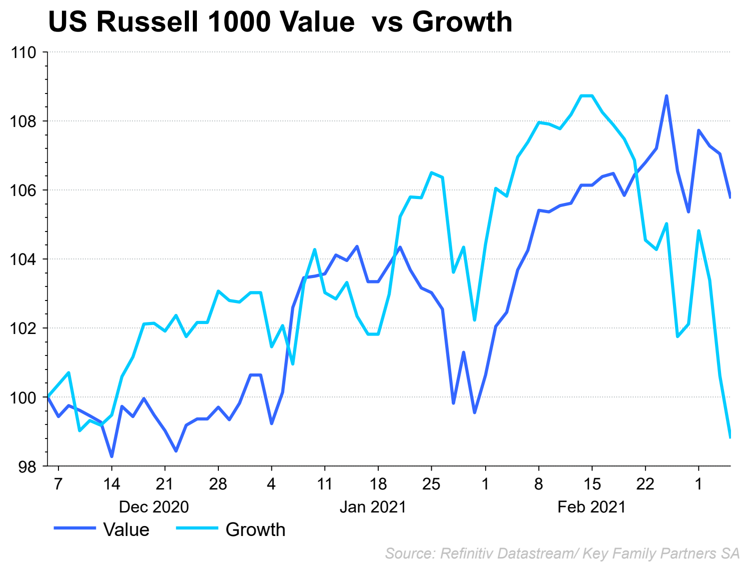
The S&P500 recovered in early February before seeing a correction at month end, but leaving the market ahead.

Economic recovery remains strong while inflation expectations are also rising, which is overall positive for equities in the short term.

Market sentiment has turned more neutral, both longer and shorter term. However, value (orange line) strongly outperformed growth stocks (black line) during the month as market interest rates rose, favouring value stocks.

Valuations remain elevated at 22.2x prospective 2021 earnings, and at risk if market rates continue to rise from here. The outlook remains NEUTRAL.





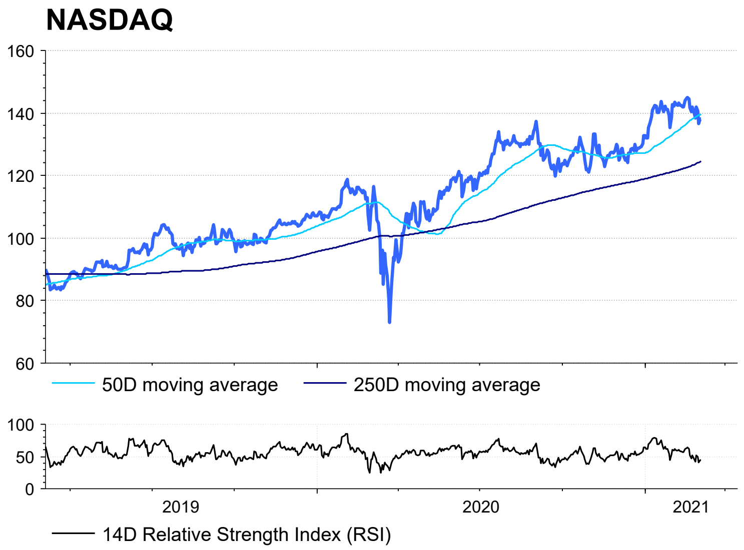
NASDAQ Comp			
	1 month	YTD	12 month
NASDAQ	+0.9%	+2.4%	+54.0%
FAANG+ Index	+5.4%	+7.3%	+102.7%

The NASDAQ and FAANG+ indices both delivered positive returns in spite of the sell off at month end – the Faang index was down -7.5% from its mid-month high.

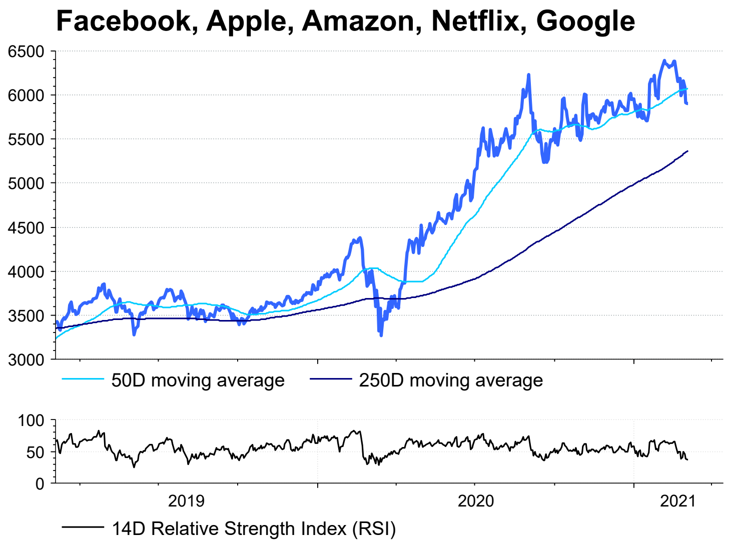
Valuations of both indices were flat at 32.5x prospective 2021 earnings for NASDAQ and 35.9x for the FAANG+ index, with both remaining at elevated levels and at **further risk of rising market interest rates**.

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 rates.



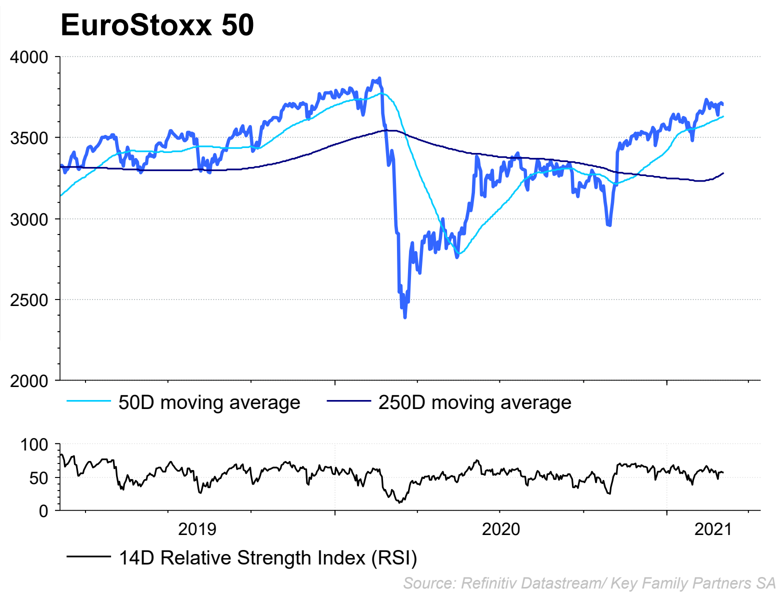
Source: Refinitiv Datastream/ Key Family Partners SA



Source: Refinitiv Datastream/ Key Family Partners SA

EUROZONE

	1 month	YTD	12 month
EU Equity €	+4.5%	+2.4%	+9.2%
$	+3.9%	+1.2%	+21.2%



Euro equities performed strongly in February on evidence of a recovery in manufacturing across the EZ, and expectations of a reducing lock down impact on the economies of the EZ.

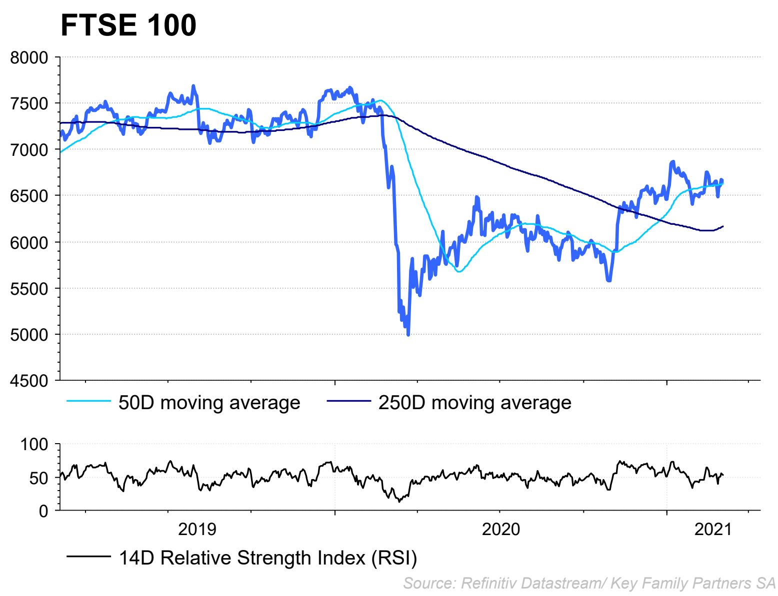
Valuation rose to 17.9x of 2021 prospective earnings which remains in the mid-range over the past 10 years.

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

The outlook moves to NEUTRAL given the prospect for a stronger economic recovery.

UK

	1 month	YTD	12 month
UK Equity £	+1.2%	+0.4%	-1.5%
$	+2.8%	+2.3%	+6.4%



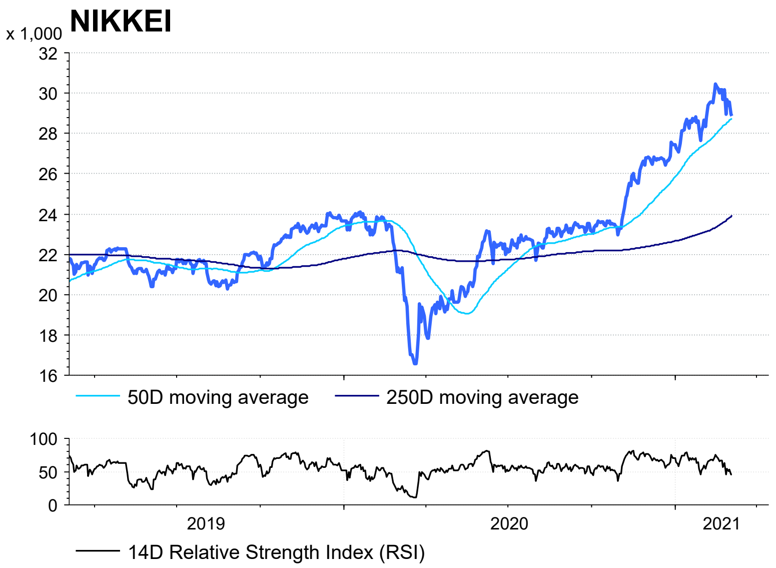
The FTSE100 recovered on better economic data but then retreated as the Government delivered a very cautious road map for the lifting of lock down restrictions, and rising market interest rates.

Valuation remains attractive with a P/E on expected 2021 earnings of 14.5x, while sentiment remains neutral to positive. The market is now approaching oversold territory once again.

The outlook is remains NEUTRAL with a positive outlook given the potential for earnings recovery and low valuation of the market.

JAPAN

	1 month	YTD	12 month
Japan Equity ¥	+4.7%	+5.5%	+37.0%
$	+2.9%	+2.3%	+42.0%



Source: Refinitiv Datastream/ Key Family Partners SA

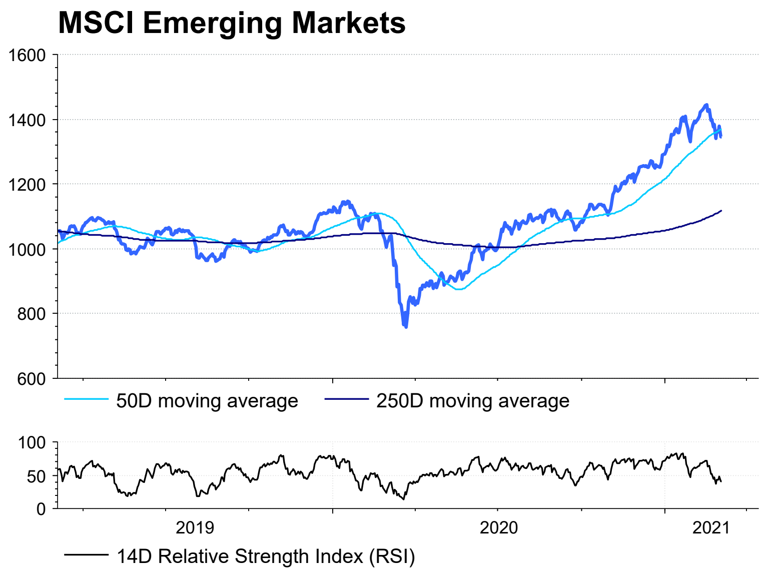
The Nikkei delivered a strong performance in February with the Nikkei breaking the 30,000 level for the first time since the bull market in 1990, before selling off at month end. The economy delivered stronger PMI numbers in February, and even inflation expectations rose.

Longer term sentiment remains positive, while valuation remains elevated at 23.1x prospective 2021 earnings.

The outlook remains NEUTRAL with a positive bias.

EMERGING MARKETS

	1 month	YTD	12 month
EM Equity $	+0.7%	+3.7%	+33.2%
China CSI 300$	-1.0%	+3.3%	+46.9%



Source: Refinitiv Datastream/ Key Family Partners SA

EM had a modest month, dragged down somewhat by the China market. However, EM equities remain the best performers y-t-d in USD other than the FAANG stocks.

China sold off at month end in line with the global event but sentiment longer term remains positive and valuations attractive at 14.7x prospective 2021 earnings overall.

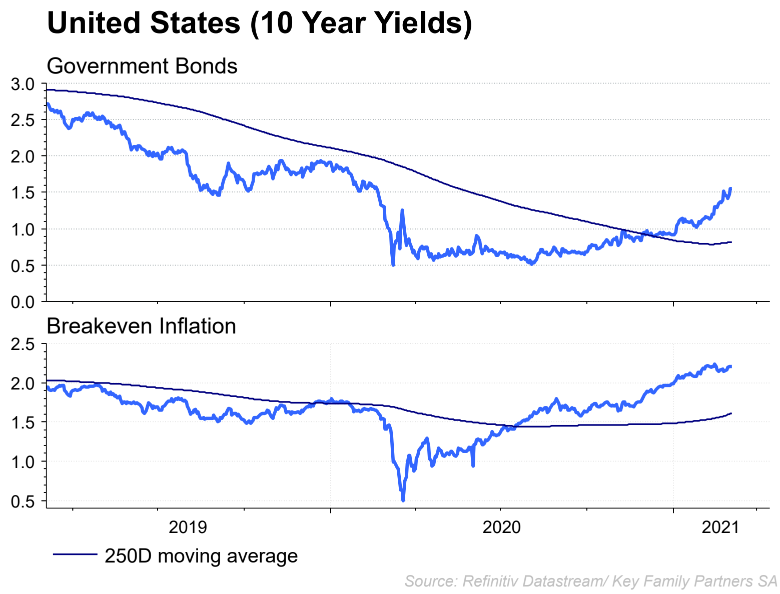
The outlook remains POSITIVE on EM equities given the global growth outlook.

FIXED INCOME

Developed Government Bonds

	1 month	YTD	12 month
US Treasuries Total return	-1.87%	-2.75%	0.13%

Yields on 10-year Treasuries yields rose strongly during the month, breaking the 1.50% level for the first time in a year, before pulling back during the last day of the month. 10-year break even inflation expectations rose further to 2.15%, leaving real rates over 10 years in negative territory.



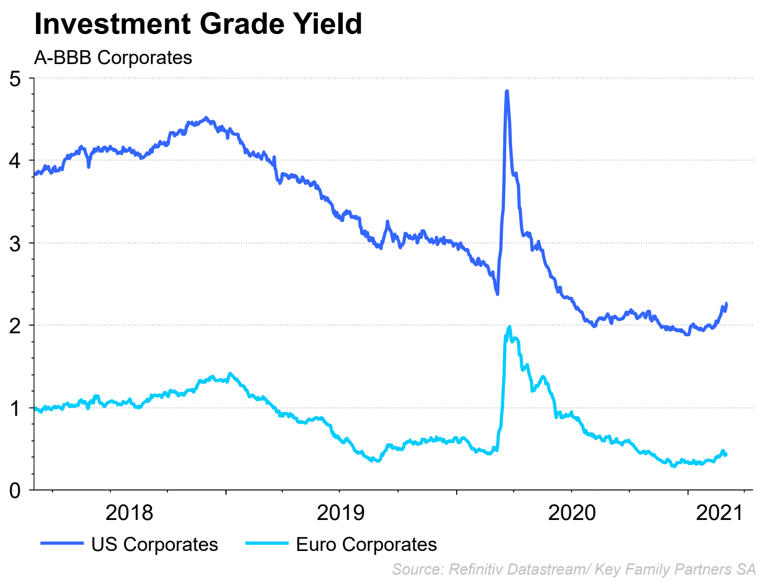
Longer dated yields are likely to rise further to match inflation expectations UNLESS the Fed implements YIELD CURVE CONTROL in some form, which to date it has not suggested is likely.

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	-1.77%	-2.98%	+2.79%



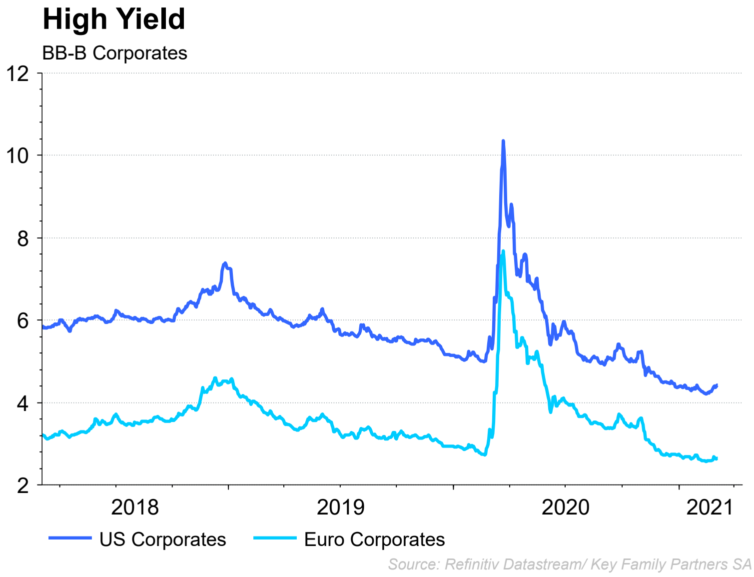
Yields on investment grade corporates continued to rise to 2.05%, in spite of spreads narrowing further to 89bps – which now represents a record low.

Yields are now likely to follow Treasury yields closely as very little “cushion” remains to absorb any rise in treasury yields. With rising inflation expectations, a further rise in yields in the short term remains likely.

The outlook remains NEGATIVE.

High Yield

	1 month	YTD	12 month
US High Yield Total return	+0.30%	+0.70%	+9.38%

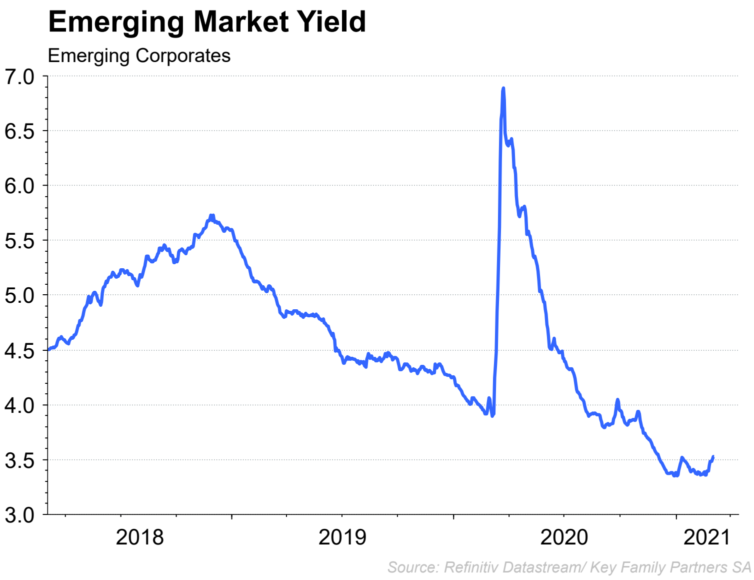


US HY bond yields fell sharply to below 4.00% during the month, the lowest yield ever seen in this market, before pulling back to finish slightly lower on the month. Spreads also fell to the lowest on record. The market is "priced close to perfection".

Yields remain attractive and provide a real return after inflation. However, with such narrow spreads the risk to high yield is rising and any unexpected economic shocks could derail this market. The outlook remains NEUTRAL.

EM Fixed Income

	1 month	YTD	12 month
EM USD Agg Total return	-1.50%	-2.26%	+2.73%



Yields on EM USD debt rose to 3.73%, but spreads fell further to record lows of 272bps.

Investors will still find this 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

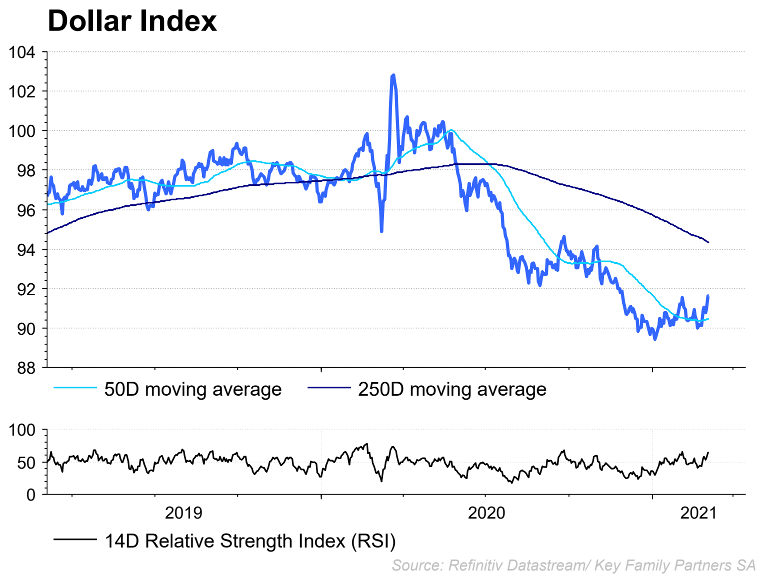
The USD had a volatile month but ended slightly higher against most major currencies – except GBP.

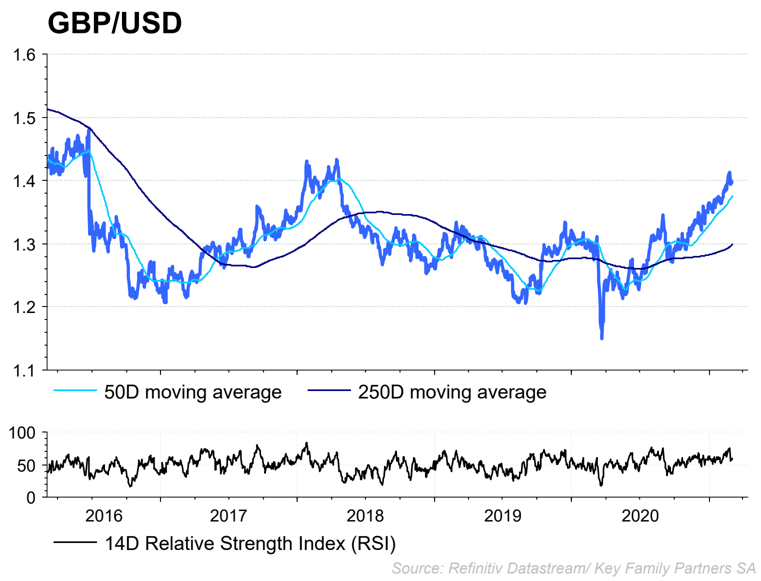
Rising market yields in the US attracted fresh inflows into the USD towards the end of the month.

With rising interest rates, short term sentiment to the USD has become more neutral, while longer term sentiment remains strongly negative.

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 negative.

The outlook remains NEGATIVE longer term but could see a further short term rebound on the higher rates.



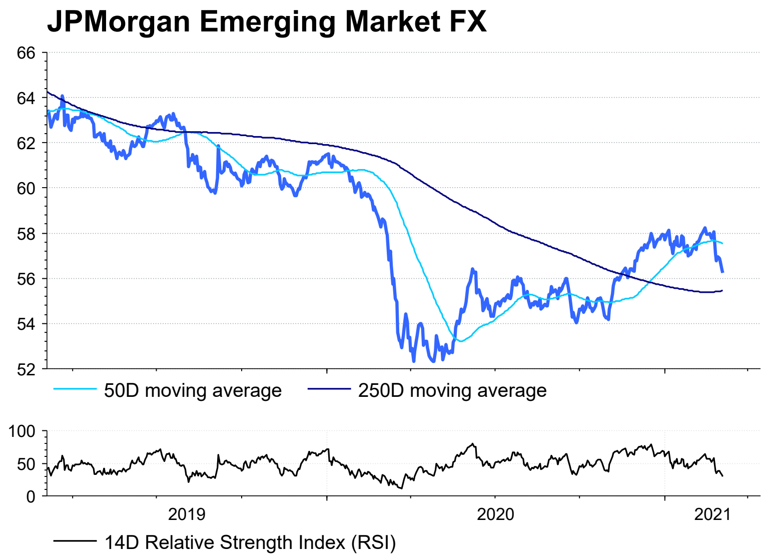


EM currencies vs USD

EM currencies were volatile over the month, with wide variations in performance. Mexican Peso, Indian Rupee and the Brazilian Real all saw a sell off at month end, while the CNY and Rouble were flat for the month.

With many EM interest rates now significantly lower than a year ago (eg Mexico 4.0% vs 8.0%), investors are becoming more discerning and favouring those countries with stronger fundamentals – and China in particular.

The USD outlook vs EM currencies is moved to NEGATIVE but with a neutral bias.



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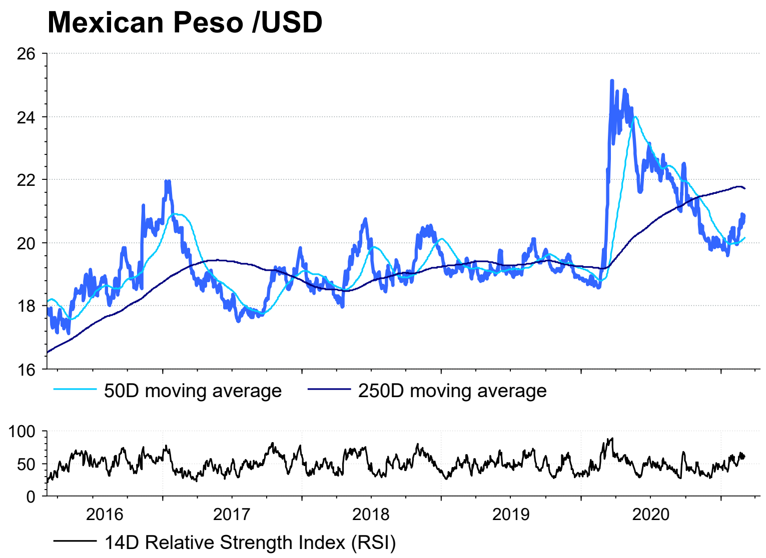
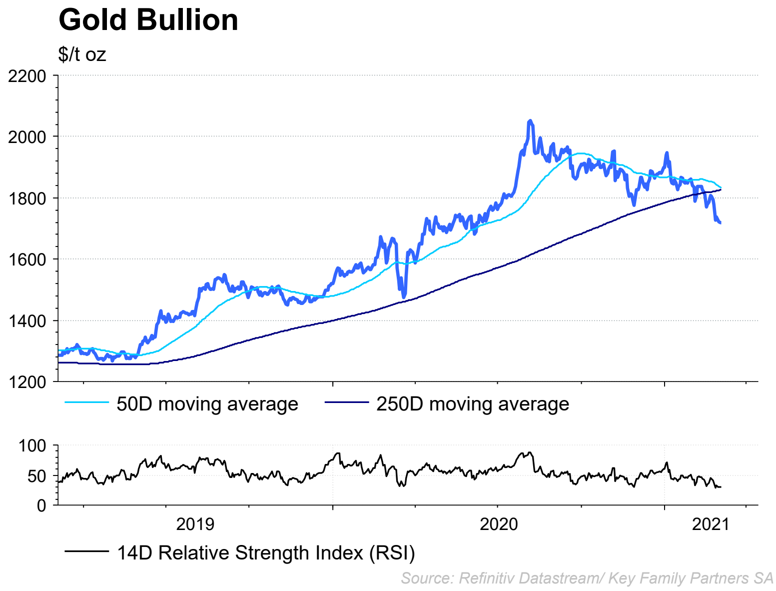


Source: Refinitiv Datastream/ Key Family Partners SA

GOLD

	1 month	YTD	12 month
Gold	-6.1%	-8.6%	+9.2%



Gold has struggled with rising USD market interest rates and has returned to levels last seen in mid 2020.

The prospects for gold short term are likely to be driven by Fed actions. If YCC is activated and negative real yields persist for longer than now expected, gold should benefit.

If however market yields rise to match inflation expectations, gold is likely to continue to trade in this sideways move or lower.

Longer term, clear evidence that gold provides better investor protection in a super Keynesian environment should continue to provide support. Short term the price has reached extreme oversold levels and could have a near term up tick. The outlook is moved to NEUTRAL.

COMMODITIES

OIL

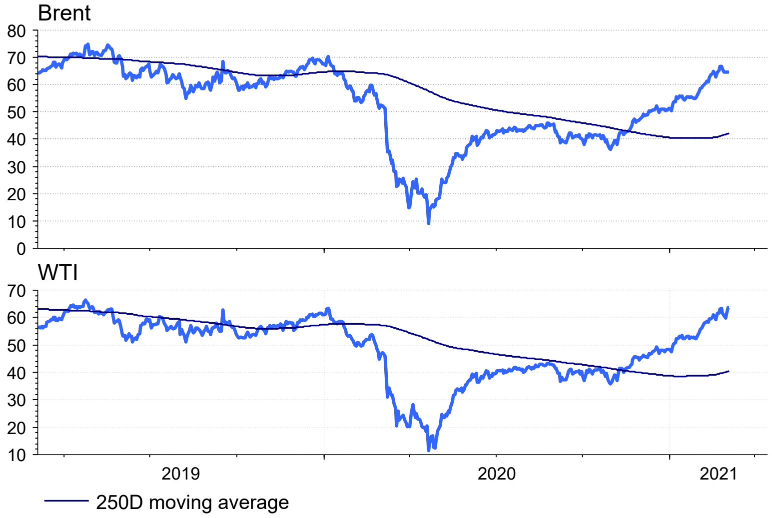
Oil prices shot up in February, as the demand supply imbalance worsened with the big freeze in the US. Oil prices have now risen 29% this year, and 230% since the lows seen in March last year.

OPEC+ seems likely to loosen the output limits in March, but supply growth is not expected to match demand growth in the near term.

However, oil prices are now at an extreme overbought level which gives room for a short- term correction.

The outlook for oil remains NEUTRAL with upside potential.

Oil Prices



Source: Refinitiv Datastream/ Key Family Partners SA

METALS

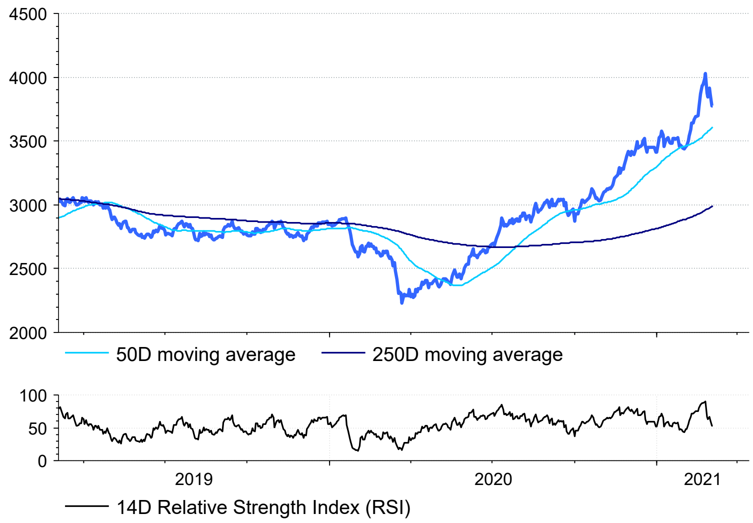
Metal prices had a strong month in February and copper prices are now up 14.2% this year, and 91.1% since the lows last year.

Demand has grown rapidly on the expected economic recovery, particularly in China. In addition, the electrification of transport is now beginning to impact copper prices longer term while global supplies have not increased in the past decade. Copper prices remain 10% below peak levels seen in 2011.

Rising market interest rates could cool the price appreciation in the short term as these markets are now overstretched, but the long-term trend remains positive.

The outlook remains POSITIVE.

LME Index



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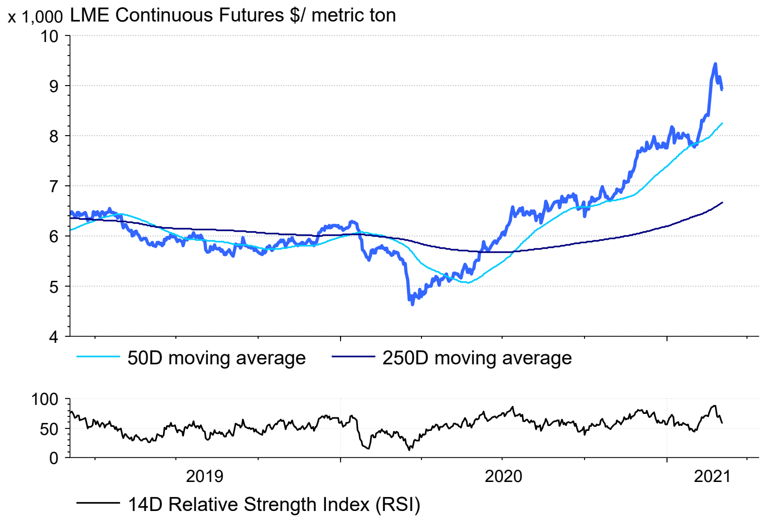
Copper



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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