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GLOBAL INVESTMENT COMMITTEE OUTLOOK: CONTINUE RISK-POSITIVE

The global economic recovery should surge, even above consensus

A large majority of our members agreed on a positive scenario in which the global economy mildly outperforms market consensus, while equities continue to rally. Even though we forecasted in December that GDP growth would rise well above consensus, the aggressive fiscal and monetary stances globally have pushed CY21 consensus above those forecasts, especially for the US. Our new scenario continues to predict that vaccines will heighten optimism among a much wider number of investors and that geopolitical risks will not hamper economic activity. Meanwhile, we continue to expect the US Senate to avoid stalemate via various compromises (although the rhetoric will remain virulent), leading to a mollified version of the Democratic agenda, and thus, that the economic recovery will have a disinflationary tenor globally.

For the US, GDP should increase 8.7% Half on Half Seasonally Adjusted Annualised Rate (HoH SAAR, as used in all references below) in the 2Q–3Q and 4.8% in the 4Q21–1Q22, vs the 8.2% and 4.5% consensus estimates for each. Personal consumption should surge, especially in the re-opening services sectors (while auto sales will be dented by supply shortages), and private capex should continue to improve in most sectors, especially tech spending. Construction spending outside of the infrastructure sector will likely be constrained, but government spending should contribute to grow due to the Democratic agenda, while net foreign trade will likely subtract from GDP growth.

After a virus-constrained 1Q, Eurozone GDP growth should be 7.1% in the 2Q–3Q and 7.5% in the 4Q21–1Q22, vs the 6.7% and 6.9% consensus estimates for each. Meanwhile, Japan's 1Q was also hurt by virus issues and supply shortages but should grow 4.4% in the 2Q–3Q and 4.2% in the 4Q21–1Q22, vs the 4.0% and 3.3% consensus estimates for each. Deep consumer fears shifting toward optimism should be particularly pronounced in these two regions, with business confidence also boosting capex to a surprising degree. Japan should benefit greatly from continued global tech demand, but auto production will be hampered due to industrial accidents at auto-related semiconductor plants, which worsened since we made our forecasts. Europe, China and the US will also have automotive production disruptions, with smartphones and some other electronic products also somewhat disrupted, which will be somewhat of an economic headwind.

For CY21, growth for the US, Eurozone and Japan should hit 6.7%, 4.8% and 4.3%, respectively, vs market consensus of 6.2%, 4.5% and 4.2%. Meanwhile, China's official CY21 GDP growth should be 10.1% vs consensus of 9.5%. In sum, these positive GDP results should please risk markets, but present a challenge to fixed income markets.

Non-economic factors less of a concern

There continue to be valid reasons for concern about many geopolitical issues, especially regarding North Korea, China and the Middle East. Fortunately, we were correct in December that BREXIT would not have a traumatic outcome, but implementation may hit a few snags in 2021. Relations between the West and China remain very tense, but neither side seems willing to cross any red lines, although the blacklisting of a major European retailing firm certainly ratchets up the potential for major economic disruptions. Increased fears about Taiwan certainly should not be ignored either. The G-7 coalition addressing concerns in China may trigger continued retaliation and the recent EU-China investment pact could well be in jeopardy. Meanwhile, the Middle East is even more a powder keg than usual, with Iran (and its regional proxies, including the Houthis' continual bombing of Saudi Arabia) becoming increasingly desperate, while Turkey is involved in several intense conflicts. However, we continue to expect wiser heads to prevail in these situations and, thus, not expand into crises. The foreign perception is likely correct that the Biden administration is more concerned with domestic policy and economic prosperity than it is on international affairs, although they may increase the rhetoric and minor sanctions on top of those by the Trump administration.

In December, we expected the Senate to remain Republican-controlled, but the surprising double victory in Georgia led to semi-Democratic Senate control. We also had expected a few moderate GOP Senators to vote for moderate tax increases to help pay

for increased federal stimulus, but this now looks unlikely and any bill passed would need the "reconciliation" method, which will likely constrain the size of the stimulus and require significant tax hikes. If the Democrats try to force through major reform of the filibuster rules, a stalemate has promised by the Republican Senate leader via the "unanimous consent" rules, so the Democrats will not likely attempt such reform fully. For non-budgetary items, Biden will be less constrained; indeed, he will need to satisfy his left-wing by extensively issuing executive decrees and regulatory mandates to achieve the Democratic agenda (although some of these will be blocked by federal judges). The net result of this political change, especially if it includes tax hikes, should make risk markets and business leaders wary in some US sectors, but such will likely boost the economy in some sectors, particularly in the new energy and technology fields.

Central banks: mostly plateauing, shifting further to semi-formal YCC

We continue to think that central banks will maintain QE purchases and policy interest rates at current levels in 2021. We were incorrect, partly due to the Democratic Senate victory, that global bond markets would be calm. Instead, yields have risen, especially in the US. There is a significant chance if the bond market becomes unruly that the Fed will adopt Yield Curve Control (YCC), pegging 3-year maturities to about 0.3%-0.5%, hoping, like Japan's case, for a gradually increasing yield curve in the longer part of the curve. This may not be a formal policy, as the impression of free markets is sacrosanct in the US, but it is already implicitly accepted to a large degree by markets, while zero interest rates, coupled with forward guidance are also anchoring bond yields in a similar way. The ECB is also shifting to an informal YCC regime, with flexible QE purchases conducted to informally maintain the yield curve to its liking, and hopefully avoiding a forced massive injection of new funds to prevent surges in bond yields.

Moderate yen depreciation and a flat euro; mildly increasing G-3 bond yields

Although strong economic growth will be a challenge, inflation data will likely remain (except the 2Q21 YoY figures compared to their low bases levels) tolerable for bond investors, as we expect that they will assume that inflation will not be persistent. Helping in this regard, we expect commodity prices to stop rising thanks to increased supplies and constraints in global auto production. Thus, we expect 10-year yields will likely rise moderately in 2021. As mentioned above, they are somewhat pinned down by low central bank policy rates and continued QE, if not by increasingly explicit YCC. For US 10-year Treasuries, our target for end-September is 1.80%, while those for 10-year Bunds and 10-year JGBs are -0.25% and 0.15%, respectively, with December 2021 at 1.85%, -0.20% and 0.15%. Regarding forex, we expect the yen to weaken a bit and the euro to flatten, at 112 and 1.17 , respectively, at end-September and 113 and 1.16 at end-December. This aligns to the general trend of the euro appreciating vs the yen when global risk is favourable, but also reflects increased market confidence in European cohesion and its massive trade surplus in goods and services.

This all implies that the FTSE WGBI (index of global bonds) should produce a -2.4% unannualised return from our base date of March 24th through September in USD terms, and -3.3% through 2021. Thus, we continue our unenthusiastic stance on global bonds for USD-based investors. For yen-based investors, this index in yen terms should return 0.6% for both those periods, entirely due to helpful forex movements, with JGBs returning -0.6% for both periods, so the case for preferring offshore bonds continues to look very strong in 2021.

Oil prices have risen much more than we forecasted, likely due to increased US fiscal stimulus, the winter disaster in the heart of the US oil patch, and continued OPEC discipline. However, we believe the prospects of a large increase in "OPEC+" oil supply (including illicit Iranian exports), coupled with the acceleration away from oil toward alternative energy sources should calm oil prices. Our Brent forecasts are $64 at end-September and end-December, which contribute to our forecast of the US CPI of 3.3% YoY in September (high due to the low base-effect) and 2.6% next March, with Core CPI at 2.4% at both points. Notably, inflation in home prices outside of certain US city centres will likely continue, but the housing rent components in CPI indices are skewed to troubled major city-centres, and when coupled with some rent default effects, will likely remain low, thus keeping headline and core CPI measures under control. Medical CPI inflation seems to be structurally decelerating as well. Similar moderate increases in CPIs in Europe and Japan should also occur, in our view; thus, at least regarding the CPI, the global recovery will be dis-inflationary, while showing progress toward central banks' targets.

Global equities should be very strong, especially Asia Pac

Our positive stance on global markets in our December meeting was correct, as they performed nearly exactly in line with such, at least through March, although the regional variation was much less than we expected. While the *circum* 5% total returns in USD terms (and much higher in yen terms) do not appear large, when annualised they are very high. We continue to expect strong equity performance in 2021 globally. Moderately higher taxes ahead for the wealthy, and perhaps for all equity investors too, in

the US will hurt investment sentiment, but increased US fiscal spending and the global vaccine-driven economic recovery should more than offset such. The lack of geopolitical events that hurt market sentiment should also support prices. Moreover, a major positive factor should be 1Q earnings and their impact on 2021 expectations. The last three quarters' US earnings seasons were astonishing, with many companies beating consensus "by a mile". The CY21 SPX EPS estimate has already risen about 6% since our December meeting and if, as we expect, 1Q EPS forecasts sharply exceed consensus, analysts will have little choice but to be much more enthusiastic in their 2021 forecasts. Thus, although PE ratios look high, the upside to CY21 earnings estimates will likely make valuations much less expensive. We continue to cite the mantra: "the ability of US corporations to beat profit expectations, especially on an adjusted basis, is very impressive and should not be doubted going forward, even under difficult circumstances".

Japan and Europe also greatly exceeded earnings expectations in the 4Q after a strong showing in the 3Q. Japanese analysts tend to be quite conservative and corporate managements, upon which sell-side analysts highly rely, can get in legal trouble if they guide earnings too optimistically. However, as we thought, Japan, more than any major country, saw CY21 earnings expectations rise the most after 4Q earnings, with TOPIX rising by nearly 16% since our December meeting. Furthermore, as the March quarter completes most companies' fiscal year, analysts will likely be even more confident in raising CY21 EPS estimates except in a few supply-chain-burdened sectors. Widespread analyst scepticism was also greatly alleviated in Europe despite the region's troubles (although its exports have been booming), with CY21 EPS revised up by 7% since our December meeting, and the strong vaccine-led economic recovery should continue to boost confidence among analysts and managements about future profits.

In sum, we retain an enthusiastic view on global equities. Aggregating our national forecasts from our base date, we forecast that the MSCI World Total Return Index in USD terms will rise 8.3% through September and 11.7% through the rest of 2021 (11.6% and 16.2% in yen terms). **We expect quite similarly positive returns** (in both USD and yen terms) **in each region, but with Developed Asia Pacific Ex Japan having the highest.**

In the US, the SPX's PER on its CY21 EPS estimate is now about 22, which remains, by historical standards, very high. However, there are clear reasons for such. Even if they rise moderately, fixed income yields are low (and long bonds total returns will likely be negative), buybacks are rebounding sharply (with banks now allowed to accelerate such) and earnings growth looks to exceed the already strong consensus view. Although there are valid concerns about valuations about "stay-at home" plays once vaccines are widespread, at least regarding work from home, the need for tech equipment and software for such should be long-lasting. The wild valuations among some small speculative stocks is mostly a sideshow, but there are a few major growth stocks whose valuations and earnings outlooks require scrutiny. Indeed, it has been "the wild west" in some parts of the market and financial regulators are increasingly intervening against such; not harshly yet, but such could become much more so. Also, government intervention, especially on anti-trust concerns, among major tech stocks is likely to be a moderate headwind. In sum, we expect the SPX to rise to 4,194 (8.0% total unannualised return from our base date) at end-September and 4,331 at end-2021 (11.9% return), with yen-based returns being 11.3% and 16.3%, respectively.

Like we expected, European equities reversed their long-term trend of underperforming the US, but only performed approximately in line with such in USD terms. Europeans' confidence in their intermediate-term economic future should improve strongly, while the global economy surpassing consensus should also improve investor, business and consumer sentiment. The PER at 15.5 times CY21 EPS is not low compared to its history, but as mentioned above, we expect EPS to be revised upward. The high market dividend yield, especially now that most dividend cuts seem finished and hikes will likely be allowed for banks, should also continue to attract domestic and global investors. Thus, we expect the Euro Stoxx index will rise to 460 at end-September and FTSE to 7,300, which translates to returns of 8.2% (unannualised from our base date) for MSCI Europe through then in USD terms (11.5% in yen terms). We project even better returns through December, at 12.0% (16.5% in yen terms). As for a "known unknown," it will be interesting to see how the markets react to the developing outlook for German political leadership this autumn, which could shift significantly to the Left.

Japanese equities have performed very well, basically in line with USD-based global returns, in a firm upward trend since our mid December meeting date. Their yen-based returns have been very good, though year to date in USD terms, as the yen weakened, they have underperformed MSCI World ex-Japan a bit. Japan is benefitting from the global tech cycle, in which Japan holds many leadership positions, especially in the booming sector of semiconductor producing machinery. Japan has low political risk and structural reform is continuing with digitalization and other structural reforms. Valuations now are a bit high compared with history, with TOPIX high at 16.8 times CY21 EPS consensus earnings, but earnings estimates will likely be marked up. One item that will likely constrain the market in the short term is component shortages affect auto and some tech production.

Notably, the market's dividend yield is highly attractive, even by global standards. **We expect domestic investors, once the virus fear is overcome, to return to the equity market in large fashion, based upon dividend income. Indeed, the accentuation of the equity culture here should be driven by the realization that the 1987–2012 period does not provide**

the proper example for Japan's intermediate-term future, now the country has greatly reformed. As for sectors, continued improvements in the global semiconductor and smartphone cycles and rapidly improving global demand for capex goods should boost earnings and, thus, incentivise investors, to return to Japanese equities, as it did for Warren Buffett. The auto sector's fortunes are more worrisome in the short run, as shortages have been reported to be even worse than what we knew at the time of our forecasts, but the sector outlook remains positive in the intermediate term given its technological proficiency. Meanwhile, the Olympics and Paralympics will likely proceed well and hopefully Japan will be globally lauded for hosting it during troubled times, both of which would aid Japan's political stability leading into the autumn elections. Overall, we expect TOPIX to rise substantially to 2,180 at end-September and 2,140 at year-end, for **total unannualised returns of 9.1% in USD terms (12.4% in yen terms) and 6.7% (10.9% in yen terms)**, respectively, from our base date through those periods. Meanwhile, the Nikkei should hit 32,000 and 31,500, respectively. Our Japan experts are much more cautious on 4Q returns than our other regional experts, partly due to investor fear of global tax increases (including on Japanese multinationals), but the **returns are still obviously attractive for domestic and global investors.**

Developed Pacific-ex Japan MSCI: the improvement in the global economy, and in particular, China's economy, which should grow over 10% off its low 2020 base, should clearly help this region. Although the Biden Administration is maintaining Trump's tough actions on China, it will likely retain current trade relations and accept the multipolar global construct. However, China's recent party-led boycott of Western firms that have expressed human rights concerns ratchets up the trade pressure, as do other tensions with global democracies, including relations with Taiwan. Australia's relations with China are not worsening now from their very poor level, but the country is benefitting from strong global demand for commodities. Hong Kong is managing to stay fairly stable despite all the challenges and residential property prices are rising. Clearly, vaccines and increased global tourism (and in the case of Australia, educational enrolment) will help these two economies tremendously. In sum, we are positive on both the Hong Kong and Australian markets, with the Hang Seng at 32,085 and 33,480 at end-September and year-end, respectively, and the ASX at 7083 and 7,366. Thus, we expect the region's MSCI index in USD terms to rise 11.2% through September and 17.4% through year-end (14.6% and 22.0% in yen terms), so this region should clearly still be overweighted.

Investment strategy concluding view

Global economic growth will mildly surpass consensus, in our view, thanks to vaccinations, continued monetary and fiscal stimulus, improving global geopolitical conditions, low interest rates, and moderate inflation. This, via increased corporate profits, should allow equity markets to perform very well through 2021, with impressive returns in each region, while we expect continued losses for global fixed income in USD terms. There remains, of course, a significant chance of alternate scenarios, for which we have mapped out and provided investment and economic targets, and institutional investors are welcome to contact us for such.

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