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GLOBAL INVESTMENT COMMITTEE OUTLOOK: ESPECIALLY BUOYANT NON-US EQUITIES

The global economy's recovery should continue, above consensus

Although some on the committee agreed with the market consensus for a moderate continuation of economic growth and equity markets, and a few were even more cautious, especially regarding increased fears of inflation later in 2021, the majority agreed with a more positive scenario in which the global economy outperforms market consensus, while equities, especially those outside of the US, rally sharply. The scenario also predicts that vaccines will turn pessimism into optimism among a much wider number of investors and that geopolitical risks will not hamper economic activity. This latter point is especially important in Europe, where BREXIT fears have constrained equity performance. Meanwhile, we continue to expect Republican control of the Senate, 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 4.2% Half on Half Seasonally Adjusted Annualized Rate (HoH SAAR, as used in all references below) in both the 1H21 and 2H21 periods, vs the 3.4% consensus estimates for each. Personal consumption should continue to recover, especially as vaccines improve consumer sentiment, while private capex will improve in most sectors, especially tech spending. Notably, Boeing's aircraft production will likely be an important positive factor for economic growth after the 1Q21. However, construction spending outside of the infrastructure sector will likely be constrained. Government spending should contribute to growth due to the Democratic agenda, while net foreign trade will likely become more neutral.

Eurozone GDP plunged the most in the 2020, so its rebound should be the strongest among the G-3 at 2.7% HoH SAAR and 5.2% in the 1H and 2H, respectively, vs the 1.3% and 4.5% consensus. Meanwhile, Japan's will likely be 3.3% and 3.5%, vs consensus estimates of 2.5% and 2.8% for those periods. Deep consumer fears shifting toward optimism should be particularly pronounced in these two regions, with business confidence also boosting capex to a surprising degree.

For CY21, growth for the US, Eurozone and Japan should hit, or even slightly exceed, 4.2%, 5.0% and 3.5%, respectively, vs market consensus of 3.8%, 4.6% and 2.5%. China's official GDP growth should be 6.5% HoH SAAR in the 1H21 and 6.6% in 2H21, with CY21 around 9% vs consensus of 8.2%. These GDP results should please risk markets but present a challenge to fixed income markets.

Non-economic factors less of a concern

There remain valid reasons for concern about many geopolitical issues, especially regarding BREXIT, China and the Middle East. As for BREXIT, a challenging but not traumatic outcome is likely, in our view; however, such is already mostly anticipated by the market, so there should be relief in investor and economic sentiment as implementation progresses acceptably in 2021. Relations between the West and China remain very tense, but neither side seems willing to cross any red lines. Meanwhile, the Middle East is even more a powder keg than usual, with Iran (and its regional proxies) becoming increasingly desperate, while Turkey is involved in several intense conflicts. However, we continue to expect wiser heads to prevail in these situations under a Biden Administration and, thus, not expand into crises.

We continue to believe the Senate will remain Republican, although only narrowly so. We expect a few moderate GOP Senators will vote for moderate tax increases to help pay for increased federal stimulus after a small package is passed in the weeks ahead. For non-budgetary items, Biden will be less constrained; indeed, he will need to satisfy his left-wing by extensively issuing executive actions and regulatory mandates to achieve the Democratic agenda. The net result of this political change should make risk markets and business leaders wary in some US sectors, but increased fiscal stimulus should boost the economy, particularly in the new energy and technology fields.

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

After their recent massive, multi-pronged stimulus, central banks will likely maintain QE purchases and interest rates at current levels in 2021. This will likely be enough to fund fiscal deficits and maintain calm in global bond markets. There is significant chance (especially if the bond market becomes temporarily unruly) that the Fed will adopt Yield Curve Control (YCC), pegging 3-year maturities to about 0.3% in 2021, 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 rates, coupled with forward guidance are also anchoring bond yields in a similar way. The ECB is also shifting to a YCC regime, with flexible QE purchases conducted to informally maintain the yield curve to its liking, hopefully avoiding a forced massive injection of new funds.

Mild yen depreciation and euro appreciation; mildly increasing G-3 bond yields

Although strong economic growth will be a challenge, inflation data will likely remain, except the 2Q21 YoY figures due to the low base levels, tolerable for bond investors. However, there will likely be increased progress towards meeting central banks' inflation goals, so 10-year yields will likely rise moderately in 2021. As mentioned above, they are 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-June is 1.00%, while those for 10-year Bunds and 10-year JGBs are -0.45% and 0.05%, respectively, with December 2021 at 1.1%, -0.35% and 0.1%. Regarding forex, we expect the yen to weaken a bit and the euro to rise mildly, at 106.0 and 1.23, respectively, at end-June and 108.0 and 1.25 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 0.1% unannualized return from our base date of 4 December through June in USD terms, and 0.4% through 2021. Thus, at this stage, we maintain a relatively unenthusiastic stance on global bonds for USD-based investors. For yen-based investors, this index in yen terms should return 1.8%, and 4.0% for those periods, entirely due to helpful forex movements, with JGBs returning -0.2% and -0.7%, respectively, so the case for offshore bond investing looks very strong in 2021.

We believe the prospects of a large increase in Iranian oil supply, coupled with the acceleration away from oil toward alternative energy sources should calm oil prices after their recent upturn. Our Brent forecasts are $47 at end-June and end-December, which contribute to our forecast of the US CPI of 3.0% YoY in June (high due to the low base-effect) and 2.2% in December, with Core CPI at 2.7% and 2.2%, respectively. Notably, inflation in home prices outside of certain US city centres will likely continue, but the housing rent components in CPI indices, which are skewed to major cities, coupled with some rent default effects, will likely decelerate mildly further, thus keeping headline CPI measures under control. Medical 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 and Europe

Although in our September meeting we were positive on Asia Pacific markets for the 4Q, we, along with most others, were far too cautious on the US market, not expecting stronger returns until after the 1Q's digestion of political changes. We did, however, expect a good 2021 globally and we do so now even more so. Moderately higher taxes ahead for the wealthy, and perhaps for all equity investors too, in the US will hurt investment sentiment, but the vaccine-driven economic recovery should more than offset such in the US as well as being a clear boon for global equities. The lack of geopolitical events that hurt market sentiment, including avoidance of a no-deal BREXIT, should also support prices, especially for Europe. Moreover, a major positive factor should be 4Q earnings and their impact on 2021 expectations. Both the 2Q and 3Q US earnings seasons were astonishing, with many companies beating consensus "by a mile". CY20 guidance obviously rose, but analysts only increased CY21 estimates by a similar amount. If, as we expect, 4Q 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. As mentioned last quarter, although not heeded enough by us, "to reiterate, 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 3Q, but forecasts for 2021 did not improve much. 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, so Japan, more than any country, is likely to see CY21 earnings expectations rise the most after 4Q and 1Q (the final quarter for most companies' fiscal year) results when there is an obvious case that optimism is justified. Scepticism also remains relatively widespread in Europe currently, so coupled with a reasonably decent BREXIT progression, confidence among analysts and managements about future profits should increase.

In sum, we have 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 6.9% through June and 13.4% through 2021 (8.7% and 17.5% in yen terms). **We expect positive returns** (in both USD and yen terms) **in each region, but the US should finally underperform.**

In the US, the SPX's PER on its CY20 EPS estimate is now about 26, and 22 on CY21 EPS, which is, by historical standards, very expensive even given extended low interest rates. However, there are clear reasons for such. Buybacks are rebounding overall and will provide support to major parts of the market. Clearly, the tech sector is booming. 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. Government intervention among major tech stocks is likely to be a moderate headwind, however. In sum, along with the better than consensus improvement in the global economy, our expectations of major upgrades to 2021 EPS should more than offset economic worries about the Democratic agenda. However, combining the headwinds of this agenda and the recent surge in equity prices, we expect the SPX to rise only to 3,816 (4.1% total unannualized return from our base date) at end-June and 4,009 at end-2021 (10.1% return), with yen-based returns being 5.9% and 14.1%, respectively.

European equities should reverse their long-term trend of underperforming the US and Japan in constant currency terms. Europeans' confidence in their intermediate-term economic future should reverse from low levels to reasonably bright ones, while the global economy surpassing consensus should also improve investor, business and consumer sentiment. The avoidance of no-deal BREXIT, in our view, will be a particularly positive factor in the year ahead, as well. The PER on CY20 EPS is high, at 23.1, and far from low at 16.1 times CY21 EPS, but as mentioned above, we expect EPS to be greatly revised upward. The high market dividend yield, especially now that most dividend cuts seem finished and hikes will likely be allowed for banks, is also attractive to domestic and global investors. Thus, we expect the Euro Stoxx index will rise to 438 at end-June and FTSE to 7,500, which translates to returns of 15.1% (unannualized from our base date) for MSCI Europe through then in USD terms (17.1% in yen terms). We project even more remarkable returns through December, at 25.7% (30.3% in yen terms).

Japanese equities have performed very well, with TOPIX on a firm upward trend even as the yen got a bit stronger vs the USD. Year to date, they have underperformed MSCI World ex-Japan by only about 3% (underperforming the US but massively outperforming Europe), as Japan's lockdowns were less severe, the tech cycle, in which Japan holds many leadership positions, improved and as leverage/credit excesses are minor. Importantly, the smooth and propitious transition of political leadership also continued Japan's reputation for low political risk, coupled with increased concentration on digitalization, financial sector and other structural reforms. Valuations now are seemingly high, with TOPIX high at 23.0 times CY20 EPS, and 16.4 times CY21 EPS consensus earnings, but CY21 earnings should be greatly marked up. Meanwhile, dividends have not been cut much overall, so 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, incentivize investors, to return to Japanese equities, as it did for Warren Buffett. The auto sector's fortunes are improving with strong global demand, although a Biden Administration will likely push for more US production and higher emission standards, thus increasing costs for this sector. Thus, we expect TOPIX to rise substantially to 2,050 at end-June and 2,100 at year-end, for **total unannualized returns of 14.6% in USD terms (16.6% in yen terms) and 16.3% (20.5% in yen terms)**, respectively, from our base date through those periods. Meanwhile, the Nikkei should hit 31,000 and 31,800, respectively. **These are higher returns than the US, so Japan should still be overweighted by global investors, and are obviously attractive for domestic investors.**

Developed Pacific-ex Japan MSCI: the improvement in the global economy, and in particular, China's economy, should clearly help this region. Although a Biden Administration will be far from easy on China, it will likely return to more normal trade relations and accept the multipolar global construct. Given this, it is highly likely that Australia will improve its relations with China to some degree too and, thus, heighten its economic and corporate profit prospects. Clearly, vaccines and increased global tourism (and in the case of Australia, educational enrolment) will help these two economies tremendously. In sum, we are very positive on both the Hong Kong and Australian markets, with the Hang Seng at 29,520 and 30,861 at end-June and year-end, respectively, and the ASX at 7,243 and 7,681. Thus, **we expect the region's MSCI index in USD terms to rise 12.0% through June and 21.4% through year-end (13.9% and 25.9% in yen terms), so this region should clearly still be overweighted too.**

Investment strategy concluding view

Global economic growth will surpass consensus, in our view, and while a Biden Administration will cause a bit of market and economic concern in the US, the help of vaccines, continued monetary stimulus, improving global geopolitical conditions, low interest rates and moderate inflation should allow equity markets to perform very well through 2021. We continue to expect particularly impressive returns in Asia Pacific including Japan, but now we add Europe for such too, while the US should experience lower but still healthy returns. 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.

Important Information