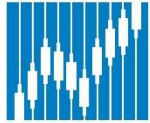


# Multi-Asset Strategy



iInvest Securities

## Quarterly #17...

3 May 2021

**Overarching view:** When you peel it all back, the risk & reward equation appears unbalanced thus projecting a dimmed outlook for investment returns. Equity markets are already delivering solid returns YTD CY21, commodities are booming, and credit spreads are tight. We are not seeing the synchronized global growth investors had hoped for at the start of the year, but a more mixed recovery picture has developed around the world – the U.S. economy is roaring, India is facing a catastrophic second Covid-19 wave, Europe is coming out of its Covid-19 restrictions but their vaccine rollout program has been disappointing, Japan is stop / start (also battled a second Covid-19 wave) and China appears to be slowing its stimulus measures (which is not a good sign for commodities). While in Australia, we have managed to sterilize ourselves from Covid-19 within the national borders. This has allowed the economy to surge on pent-up domestic demand aided by very favourable economic policies. Despite this mixed outlook, given the significant monetary and fiscal stimulus measures, economic growth is expected to continue to improve over the course of this year. In this environment, equities will outperform bonds. Cyclical and value stocks should resume their leadership on growth stocks over CY21 and into CY22, but beyond that, the sustainability of this lead is debatable. We expect sovereign bond yields to rise from current levels driven by the U.S. (where we expect the 10-Yr to cap out at 2.5%). Credit on a relative basis offers good yields and with broader economic conditions improving, we would still favour high yield.

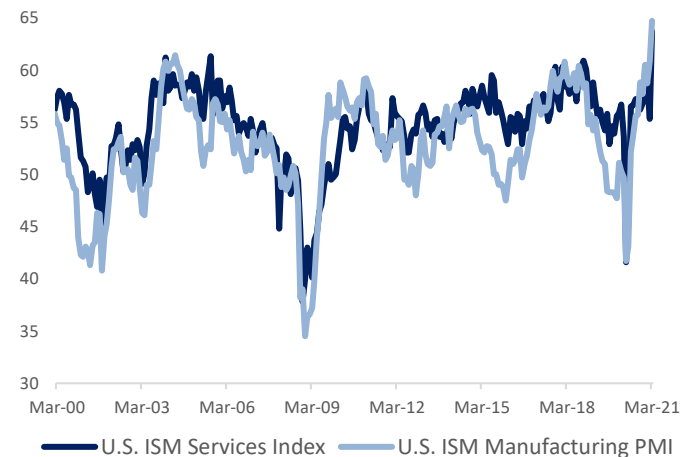
- **Market update - risk-off sentiment.** Since Feb-21, equity markets appear to have adopted a risk-off sentiment. The U.S. small caps index Russell 2000 Index has been in a tight trading range and MSCI Emerging Markets Index is slightly negative. Global value/U.S. small caps significantly outperformed global growth during the first quarter CY21. However, at the turn of the second quarter 'growth' stocks have clawed back somewhat. As at Apr-21 month-to-date, MSCI Global Growth Index (+8.2%) is significantly ahead of MSCI Global Value Index (+2.5%), Russell 2000 Index (+3.5%) and MSCI Emerging Markets Index (+2.7%). Similar trend can be found in the tech sector, with mature tech stocks such as Apple Inc (up +10.8%) outperforming high risk tech growth stories such as Tesla Inc (down -17.4%) over a 1-mth period.
- **Commodities supercycle – what could go wrong?** The narrative around a new commodities supercycle receives a lot of airplay these days. Investors seeking an inflation hedge adds to the strength of this narrative. It is a worthwhile exercise considering the opposing argument to this narrative. What could go wrong with this positive narrative? Could the recent rally in commodity prices start to fizzle out? We nominate a few reasons: China, a major driver of commodities, may pull some liquidity in order to balance out the recovery and not overheat its economy; Multi-decade demand outlook for oil is tapering down; Bitcoin could possibly displace gold in portfolios (or at least attract more dollars which would have otherwise been invested in gold); and "Greening" of economies is a positive long-term thematic but it's not positive for all commodities. Conclusion – blanket approach to commodities may not deliver. Instead investors should take a more targeted approach.
- **Equities – growth may struggle to regain leadership in the near-term.** Growth (led by Information technology) stocks saw a period of stellar returns during the previous decade. However, since the Covid-19 market lows of Mar-20, the leadership has shifted to cyclical / value stocks from growth. The sustainability of this shift probably needs to be broken down into two stages – near-term and medium-term. The CY21 consensus earnings estimates show Information Technology sector profits are expected to grow well below the broader market. Instead the key drivers of market earnings growth will come from the value/cyclical sectors in Financials, Energy, Consumer Discretionary, Industrials and Materials. This would suggest, over the near-term, given the strong earnings recovery expected in the cyclical sectors, growth is likely to lag value. In 2022, Information Technology is expected to deliver earnings growth more in line with the broader market. As economic conditions and earnings profile normalise across cyclical parts of the market post 2023, we suspect the attractive growth profile of technology stocks may again warrant a premium.

### Macro: U.S. vs Eurozone...

The synchronized global growth investors were starting to factor in has now become multi-speed: U.S. economy remains on a strong recovery path, India is facing a catastrophic second Covid-19, parts of Europe (Germany, France) had to go back into lockdown, Japan battling its own Covid-19 cases and China is appearing to normalise the stimulus measures.

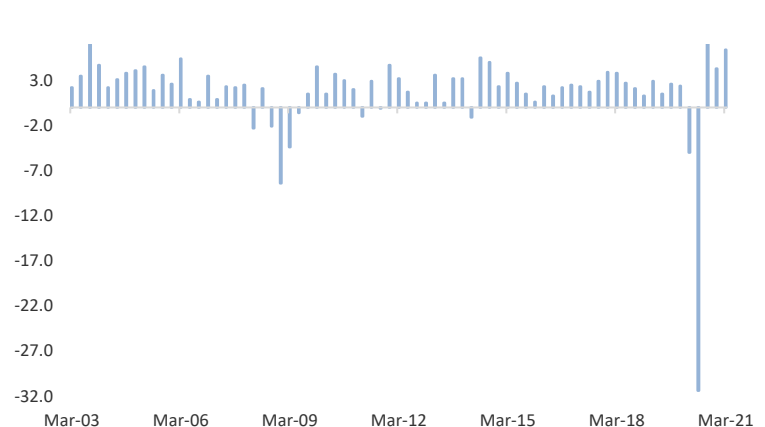
**U.S.** The success of the U.S. recovery comes down to ongoing stimulus measures (fiscal & monetary) and the strong vaccine rollout program. The U.S., along with the U.K., has led the rest of world with its vaccine rollout program. The Mar-21 quarter GDP accelerated to 6.4% (annualised) versus 4.3% in the Dec-20 quarter, driven by a strong pick up in consumption (+10.7%). The latest ISM Services Index also jumped in Mar-21 to 63.7 vs 55.3 in the prior month, with easing lockdowns driving the recovery in the sector (which makes up two thirds of consumer spending). What is worth highlighting is that the forward looking indicators within the ISM numbers – New Orders (67.2) and Business Activity (69.4) – saw the largest gains during the month.

Figure 1: U.S. Services and Manufacturing PMI



Source: Bloomberg, Banyantree

Figure 2: U.S. GDP Growth (%)



Source: Bloomberg, Banyantree

**Europe.** Disappointing vaccine rollout campaign and increased Covid-19 restrictions have impacted the region's recovery efforts. On a positive note, the Services PMI (critical component of the economy) is trending up and is now in expansionary territory. Further, the manufacturing sector should continue to see momentum.

Figure 3: Eurozone Services PMI



Source: Bloomberg, Banyantree

Figure 4: Eurozone Manufacturing PMI



Source: Bloomberg, Banyantree

## Two charts...

Anyone who has been following the financial markets for an extended period will understand the importance the following two data points play in global investment decisions: U.S. 10-Yr Treasury Yield and U.S. dollar (USD). If you take a global approach to asset allocation, it is worth running a quick check on exactly what your current positions are saying about where these two data points will be in the future.

Figure 5: U.S. dollar (DXY Index)

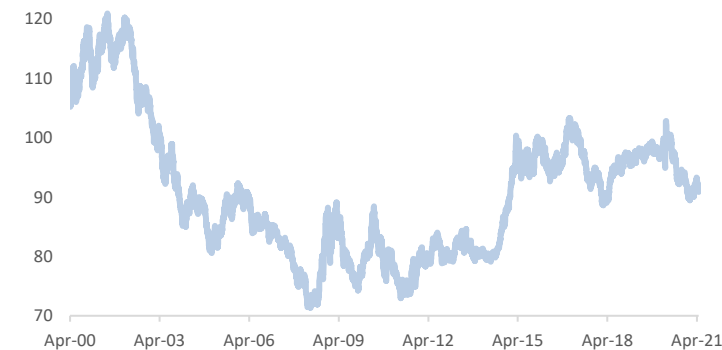
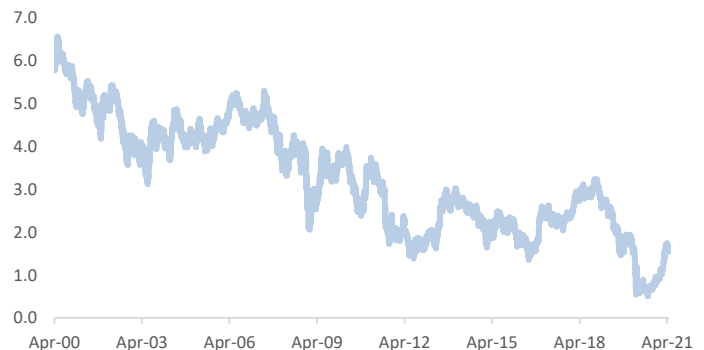


Figure 6: U.S. 10-Yr Treasury Yield (%)



It is worth reminding investors the importance of getting these data points right directionally when considering an investment strategy and portfolio positioning.

- **10-Yr Treasury Yield = value vs growth.** Rising bond yields have significant impact on the value of financial assets, but it is also a key driver of who wins out in the value vs growth trade. Rising bond yields favour cyclical / value oriented stocks while growth stocks are penalized (via higher discount rate) for their longer dated cash flows. The move in treasury yields will indiscriminately (remember there are now many quant and algorithm driven funds!) see investors shift allocation. It is worth just pausing and explaining why we use the term indiscriminately – that is, the business models and earnings growth prospects of the two styles don't necessarily change because of the shift in long-term yields. Therein lies the next debate – should you start shifting your portfolio to “old economy” business models aka value stocks just because of a change in the discount rate driven by rising yields that place a higher value to shorter term cashflows? (old economy business models are normally characterised by lower margins, high fixed costs, large capex cycles to maintain infrastructure and potentially threats from disruption). Or are the “new economy” business models still better long-term prospects?
- **USD impact on equities.** The U.S. dollar (USD) is a countercyclical currency. In a lower USD environment, cyclical and value stocks are likely to outperform. Cyclical / value stocks include materials, oil & gas, financials and some industrials. The weighting of these sectors is much higher in non-U.S. equity indices – Japan, Euro Area, UK, EM, Australia – which means non-U.S. equities are likely to outperform U.S. stocks. The USD and U.S. equity markets are also considered safe havens, hence in times of market and economic uncertainty, investors tend to gravitate to the safety of the USD and U.S. equity markets. This in turn puts selling pressure on non-U.S. assets. This is particularly true for Emerging Markets. Emerging markets are also negatively impacted from a rising USD given most commodities are priced in USD and EM nations are exporters of commodities. Further, given the USD denominated debt in EM markets, a higher USD also increases the borrowing costs for companies.

### Inflation – we'll believe it when we see it...

Essentially, the above is also the stance of key global central banks, in our view. The U.S. Federal Reserve has shifted its policy from raising interest rates in anticipation of inflation to an approach where it will react to actual reported inflation (not expected), which has sustainably exceeded their targets before considering raising rates. Justified, given they haven't been able to achieve their inflation targets over decades. We expect to see inflation to exceed in the short term (which shouldn't come as a surprise to anyone!), however medium term we still inflation as largely contained. Our reasons:

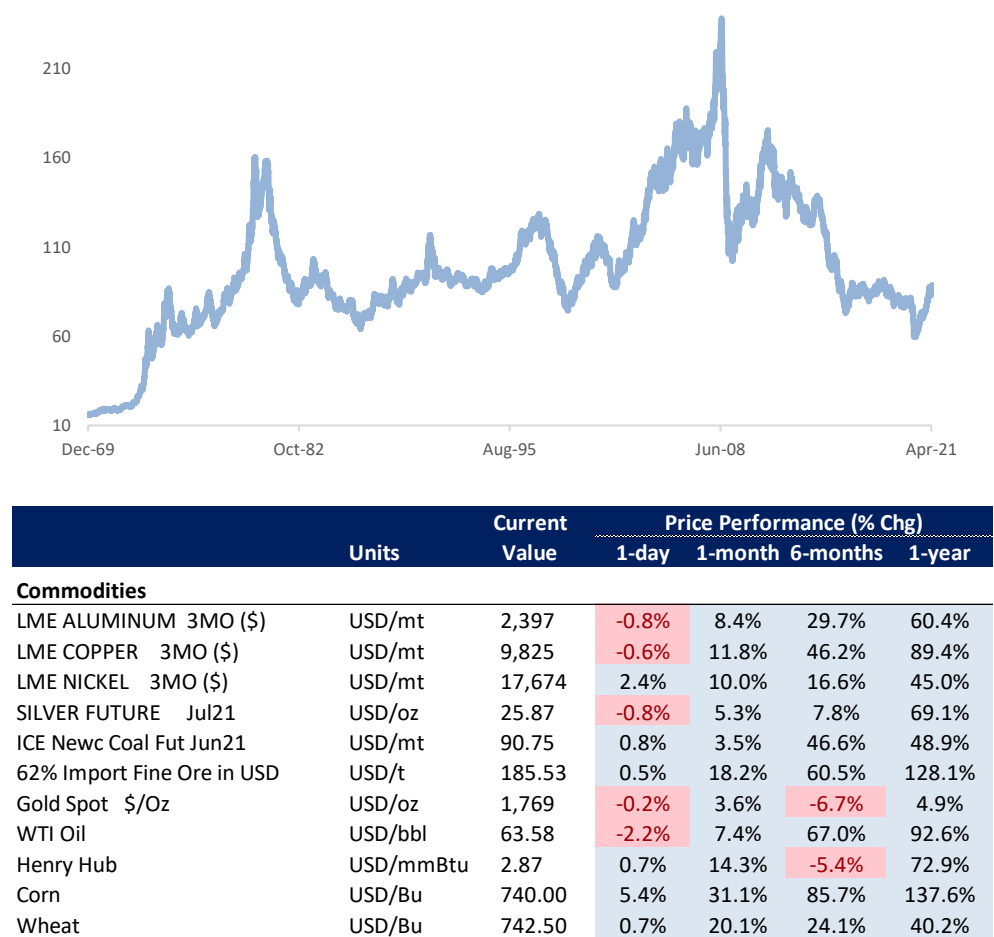
- **Technological disruption and innovation will keep prices low.** It is very difficult to envisage a future where technological innovation does not continue at a rapid pace. Technology is rapidly changing the way we do just about everything – you don't need charts to prove this, just have a look at the change in your/family's day-to-day behaviour over the past decade. Covid-19 has accelerated several changes to consumer behaviour – work from home (people are now opting to work more days from home even after companies encourage workers back to the office) and e-commerce (consumers are even questioning the need to travel to do groceries). In our view, automation and adoption of technology will continue and this theme will either replace jobs or limit the opportunity for wage growth in some sectors. A great example we came across recently is a company called Sustenir Agriculture in Singapore, which has created vertical urban farms and selling its produce in grocery stores at 30% the cost of imported products. Innovation such as this is deflationary in the long-term.
- **Wage growth remain constraint over the long-term.** In many ways, the point above means wages growth will need to contend with the constant threat of a job's mandate being replaced by technology or there is downward pressure from jobs being outsourced to foreign workers. In the past, companies have also been able to push through prices increases to consumers because there has been a lack of price discovery and accessibility. However, this has changed in recent history, with consumers now about to easily compare the best price for products and services online and, further, can order the product & delivered to their doorstep in matter of hours and days from domestic and global e-commerce companies. What this has meant is that competition has increased, and cost pressures are more likely to be absorbed by companies (impacting margins) than pass through to consumers. With the constant threat of disruption and increases cost pressures, management teams will continue to look at technology as a source to become more efficient. This is deflationary in the long-term.
- **Significant stimulus measures (inflationary) are being paid by higher taxes (deflationary).** How this all plays out is still uncertain, but we believe the economic benefits of the stimulus measures could be dampened by the proposed tax increases.
- **Policymakers will move as inflation starts to emerge.** We are of the view, central bankers will pull back liquidity quickly (that is, buying long-term bonds and mortgage-backed securities) which will start to increase the cost of borrowing for companies and consumers. This will at the very least start to feedback into the economy from a sentiment perspective instantly. If we assume the U.S. Fed was to take such a move, mortgage rates would increase (which will likely impact consumer sentiment and potentially spending habits), company borrowing costs will increase, impacting business sentiment (credit spreads will increase and, given the leverage in the system, this may raise concerns of corporate defaults) and the U.S. dollar will increase (higher dollar is bad for global growth). In short, the U.S. Fed alone can put the brakes on global growth and therefore impacting inflation.

## What if we are *NOT* in a new commodities supercycle?

The narrative around a new commodities supercycle receives a lot of airplay these days. It is a worthwhile exercise considering the opposing argument in this narrative – what is the market missing?

There have been 4 widely noted commodities supercycles in the past: **(1)** peaking in early 1900s, driven by the second industrial revolution (electricity, petroleum and steel); **(2)** peaking in late 1940s, driven by the second world war rearmament and subsequent rebuild; **(3)** peaking in late 1970s, driven by the reindustrialization of Europe and Japan; **(4)** peaking in 2011, the last boom was largely thanks to emerging markets BRIC – Brazil, Russia, India, China – but in particular it was the industrialization of China that was the driving force behind this cycle. Since March 2020, commodities have awakened from their slumber and have seen a broad-based rally in prices. Commodities supercycles last multiple decades, so investors want to be on the right side of this trade!

**Figure 7: Bloomberg Commodity Index & some commodities' price movement**



Source: Banyantree, Bloomberg

**The question is what can go wrong with this positive narrative and what if the recent rally in prices starts to fizzle out?** We nominate a few reasons.

- **China stimulus fades away.** The recent jump in commodities' prices has been supported by Chinese stimulus and growth in Chinese money supply. As we have

previously highlighted, there is a strong relationship between higher commodities (iron ore, copper) and credit growth in China (government pumping stimulus to drive economic growth). The credit growth cycle in China also appears to have turned, which has implications for equities and commodities. That is, should the regulators continue to pull back on credit growth, commodities' prices could be looking at their peaks in the coming quarter. A similar story played out post the GFC, when commodities demand increased due to global stimulus in 2009 and 2010. But commodities' prices fell away from 2011 (see chart above). Clearly, should China re-engage in extensive stimulus measures (including infrastructure build) then this will clearly be a positive for commodities.

- **Multi-decade demand outlook for oil is lower.** We are bullish on oil near-term due to the supply / demand equation. However, over a multi-decade timeframe, it is likely oil is on a declining trajectory due to the acceleration of electrification and digitalization of global economies. Further, the near-term cuts to OPEC supply to support oil prices means there is supply waiting to come back online once prices are sustainably higher (i.e. when demand fully recovers from Covid-19 related impacts). The Bloomberg Commodity Index has a meaningful weighting towards oil and will be negatively impacted from a long-term decline in oil prices.
- **Could Bitcoin displace gold in portfolios.** Gold is another key commodity which makes up a large component of the Bloomberg Commodity Index. Gold appears to be fighting a battle with Bitcoin for a position in investors' portfolios as a hedge against potential depreciation in value of fiat currencies. Gold being the tried and tested whilst Bitcoin still has several questions outstanding in investors' minds. But what cannot be denied is the fact Bitcoin continues to gain wider acceptance (more companies accepting bitcoin as method of payment, increasing ETFs dedicated to the space). The price of bitcoin may continue to rise on increasing acceptance and technological change. The gold price will likely come under pressure with higher real yields and economic recovery.
- **“Greening” of economies is a positive but it's not positive for all commodities.** Decarbonisation thematic is definitely a positive for commodities from the perspective of the globally synchronized build-out of the green infrastructure but the process is long-dated and not all commodities benefit. Copper will be among the biggest beneficiaries from the green trend. However, other commodities such as agriculture and oil (as noted above) are not expected to benefit with the same magnitude. We are of the view that innovation in the food sector (e.g. plant based meat) may lead to demand changes in soft commodities space as well.

What the above drivers suggest is that there is a danger of the commodities supercycle narrative losing steam in the near-term. The most important near-term factor worth watching is the Chinese credit growth. If history is a guide and China continues to reduce money supply, then we are likely to see commodities come under pressure second half of the year. This will obviously have implications for markets, sectors and currencies.

**How to play the commodities complex?** We would be selective and nimble in our approach. That is, play specific commodities where the supply/demand equation is attractive in the near-term (oil as economies reopen and demand normalises e.g. international air travel) or there are long-term structural drivers (copper's exposure to a greener future).



## Global Equities...

**Risk-off sentiment.** Since Feb-21, equity markets appear to have adopted a more risk-off sentiment. The U.S. small caps index Russell 2000 Index has been in a tight trading range and MSCI Emerging Markets Index is slightly negative. Global value and U.S. small caps significantly outperformed global growth during first quarter CY21. However, Apr-21 month-to-date MSCI Global Growth Index (+8.2%) is significantly head of MSCI Global Value Index (+2.5%), Russell 2000 Index (+3.5%) and MSCI Emerging Markets Index (+2.7%). Similar trend can be found in the tech sector, with mature tech stocks such as Apple Inc (up +10.8%) outperforming high risk tech growth stocks such as Tesla Inc (down -17.4%) over a 1-mth period.

We may enter a short period during which risk-off sentiment continues to consolidate markets and defensive / low volatility stocks outperform their higher volatility counterparts, which saw a massive run from March 2020 lows when markets saw a significant risk-on period.

**Figure 8: Valuations by key regions and price performance**

	Current Level	PE-Multiple			Dividend Yield			Price Performance			Total Return (TR) CY20	YTD TR CY21
		1-Yr	2-Yr	3-Yr	1-Yr	2-Yr	3-Yr	3-mth	6-mth	1-year		
S&P/ASX 200 (Australia)	7,026	19.6x	18.3x	17.7x	3.6%	3.6%	3.8%	2.9%	15.8%	33.9%	2.3%	8.3%
S&P 500 Index (U.S.)	4,181	23.0x	20.3x	18.4x	1.4%	1.5%	1.6%	9.2%	24.1%	47.7%	18.4%	11.8%
FTSE 100 (UK)	6,970	14.1x	12.9x	11.9x	3.8%	4.0%	4.1%	7.1%	20.4%	20.9%	-11.4%	9.3%
Stoxx Europe 600 (Europe)	437	17.8x	15.8x	14.3x	2.9%	3.1%	3.4%	7.4%	22.9%	29.6%	-1.4%	11.0%
Topix (Japan)	1,898	16.2x	14.2x	12.7x	2.1%	2.2%	2.4%	1.5%	18.1%	32.6%	7.4%	6.1%
Shanghai Composite (China)	3,447	12.5x	11.5x	10.1x	2.4%	2.7%	3.1%	-2.0%	5.4%	20.5%	16.5%	-0.7%
MSCI India Index	1,686	20.8x	18.1x	17.2x	1.4%	1.6%	1.7%	0.8%	23.4%	47.0%	18.6%	5.7%
MSCI Emerging Markets Asia	744	16.4x	14.3x	12.7x	1.9%	2.1%	2.3%	-5.0%	18.4%	48.5%	28.9%	4.6%
NASDAQ	13,861	28.8x	25.6x	22.8x	0.7%	0.8%	0.8%	4.0%	22.9%	59.0%	48.9%	7.8%
Nikkei 225	28,813	20.7x	18.3x	15.2x	1.7%	1.8%	2.0%	-3.5%	23.7%	46.9%	18.3%	5.7%
MSCI World Index	2,939	20.8x	18.6x	16.9x	1.9%	2.0%	2.1%	3.4%	24.0%	46.6%	16.5%	10.0%
MSCI World Index excl. Australia	3,004	20.9x	18.7x	16.9x	1.8%	1.9%	2.0%	3.4%	24.0%	46.3%	16.7%	10.0%
MSCI World Index excl. US	2,277	17.0x	15.3x	14.0x	2.8%	3.0%	3.2%	2.1%	23.2%	39.6%	8.2%	7.5%
MSCI Europe Index	145	17.1x	15.4x	14.0x	3.0%	3.2%	3.4%	1.1%	22.6%	28.5%	-2.8%	10.9%
MSCI Europe Index excl. UK	174	18.6x	16.5x	14.9x	2.7%	2.9%	3.2%	1.0%	22.1%	30.9%	2.5%	10.4%

Source: Banyantree, Bloomberg, FactSet

**Figure 9: Valuations by key markets and sectors with YTD performance**

	12-mth Forward Blended PE-Multiple (x)				Current Year-to-date (YTD) Returns			
	USA	Australia	Europe	Japan	USA	Australia	Europe	Japan
<b>Market</b>	<b>21.8x</b>	<b>18.7x</b>	<b>17.0x</b>	<b>15.9x</b>	<b>11.8%</b>	<b>8.3%</b>	<b>11.0%</b>	<b>6.1%</b>
Financials	14.4x	16.6x	10.6x	11.2x	23.5%	16.0%	24.6%	16.1%
Materials	19.5x	12.1x	9.3x	15.0x	14.9%	11.0%	20.8%	6.9%
Real Estate	53.1x	17.2x	20.4x	14.0x	18.1%	2.2%	3.2%	10.0%
Consumer Staples	20.8x	22.2x	23.9x	20.9x	3.4%	-1.5%	7.5%	-1.6%
Healthcare	16.6x	36.9x	18.4x	15.6x	7.3%	0.8%	4.8%	-9.7%
Industrials	25.2x	33.2x	23.5x	17.5x	15.4%	3.3%	13.1%	8.4%
Consumer Discretionary	33.8x	27.1x	17.6x	12.4x	10.4%	12.4%	14.8%	4.5%
Energy	18.7x	14.8x	12.8x	7.2x	31.6%	-1.1%	7.9%	31.5%
Telecom	21.7x	29.3x	15.1x	11.3x	16.6%	11.8%	12.9%	10.5%
Utilities	18.8x	26.3x	16.9x	16.2x	7.2%	-3.0%	0.7%	3.4%
Information Technology	25.8x	76.7x	30.4x	28.2x	7.3%	-2.6%	15.4%	9.4%

Source: Banyantree, Bloomberg

USA = S&P500, Australia = ASX200, Europe = Stoxx Europe 600, Japan = TOPIX

## Research – Strategy

**Growth may struggle to regain leadership in the near-term.** Growth (led by Information technology) stocks saw a period of stellar returns during the previous decade. However, since the Covid-19 market lows of Mar-20, cyclical / value stocks have outperformed their growth counterparts. The sustainability of this shift probably needs to be broken down into two stages – near-term and medium-term. The CY21 consensus earnings estimates show Information Technology is expected to grow well below the broader market. Instead the key drivers of market earnings growth will come from the value/cyclical sectors in Financials, Energy, Consumer Discretionary, Industrials and Materials. This would suggest over the near-term, given the strong earnings recovery expected in the cyclical sectors, growth is likely to lag value. In 2022, Information Technology is expected to deliver earnings growth more in line with the broader market. As economic conditions and earnings profile normalise across cyclical parts of the market post 2023, we suspect the attractive growth profile of technology stocks may again warrant premium.

Figure 10: S&P 500 EPS growth estimates (% Year-on-Year)

EPS Growth Estimates (% YoY)	1Q20	2Q20	3Q20	4Q20	2020	1Q21	2Q21	3Q21	4Q21	2021	1Q22	2Q22	3Q22	4Q22	2022
<b>S&amp;P 500 Index</b>	<b>-14.7%</b>	<b>-33.0%</b>	<b>-7.1%</b>	<b>2.3%</b>	<b>-13.0%</b>	<b>28.3%</b>	<b>51.2%</b>	<b>17.3%</b>	<b>13.3%</b>	<b>25.2%</b>	<b>9.4%</b>	<b>15.3%</b>	<b>13.6%</b>	<b>12.6%</b>	<b>12.7%</b>
Communication Services	-9.6%	-21.4%	3.7%	10.0%	-4.3%	18.2%	27.8%	12.8%	7.2%	14.6%	13.7%	16.3%	14.5%	15.9%	15.7%
Consumer Discretionary	-55.4%	-65.5%	-1.0%	-12.8%	-44.5%	56.8%	131.8%	-6.1%	24.8%	58.7%	51.5%	47.0%	30.5%	23.3%	36.2%
Consumer Staples	6.9%	-5.9%	7.7%	5.9%	-1.0%	4.1%	8.1%	4.4%	4.3%	9.9%	8.1%	9.5%	8.1%	8.2%	8.4%
Energy	-20.5%	--	--	--	-92.2%	-16.5%	--	--	--	1006.0%	82.6%	31.0%	17.4%	14.6%	30.5%
Financials	-39.7%	-49.4%	-8.3%	18.1%	-18.3%	116.7%	106.4%	13.3%	-4.9%	38.3%	-16.5%	7.0%	10.4%	12.2%	2.1%
Health Care	4.0%	2.5%	10.1%	8.4%	7.8%	22.4%	13.2%	8.7%	12.6%	12.3%	1.3%	3.8%	7.0%	4.8%	4.3%
Industrials	-27.9%	-83.8%	-50.2%	-34.7%	-50.7%	-24.5%	307.9%	74.5%	65.7%	59.6%	84.5%	51.3%	28.2%	21.8%	40.4%
Information Technology	5.3%	3.2%	8.9%	19.5%	12.2%	25.3%	19.1%	15.4%	5.9%	12.9%	9.7%	15.3%	14.6%	12.5%	12.9%
Materials	-29.6%	-28.9%	-1.5%	25.2%	-5.2%	59.0%	99.2%	48.1%	19.5%	43.7%	7.6%	-3.4%	-0.6%	5.2%	1.9%
Real Estate	-1.1%	-12.3%	-7.2%	-1.7%	-6.1%	0.7%	8.4%	1.5%	-1.1%	2.8%	1.4%	6.6%	8.4%	9.9%	6.4%
Utilities	3.9%	5.2%	1.3%	-6.8%	-5.0%	-0.9%	3.0%	2.5%	6.3%	9.2%	10.0%	3.0%	3.3%	5.6%	5.4%

Source: Banyantree, Bloomberg, FactSet

**Revenue growth of Big tech is still attractive.** It is worth highlighting that the top line growth outlook for the big tech stocks remain attractive. The structural tailwinds in their respective end markets hasn't disappeared or reversed. Those positive themes remain. The FANG (Facebook, Amazon, Netflix, Alphabet) stocks are expected to deliver revenue growth of +15.7% in 2021 and +17.1% on 2022 vs ex-FANG revenue growth of +8.3% in 2021 and +5.4% in 2022.

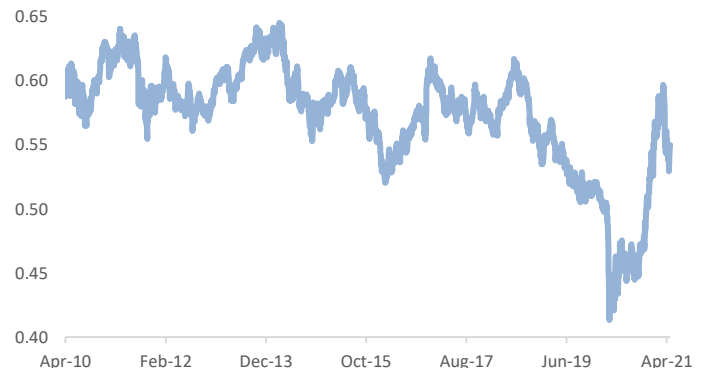
**Large Cap vs Small Cap.** Small caps outperformance relative to large cap peers appear to be overbought. Low quality, easy rally from Mar-20 lows is likely banked now. Earnings and business quality will drive the next leg up for small caps from here.

Figure 11: Australia - ASX Small Ords / ASX 200



Source: Banyantree, Bloomberg

Figure 12: U.S. - Russell 2000 Index / S&P 500 Index



Source: Banyantree, Bloomberg



### Global Fixed Interest...

**Bonds take a breather.** In late March we wrote to clients highlighting that U.S. Treasuries appear to be oversold and that a potential reversal (even if temporary) was likely. At the time of writing, month to date Apr-21, the U.S. 10-Yr Treasury yield is down ~17bps from its high at the end of Mar-21.

Figure 13: U.S. 10-Yr Bond Yield (%)



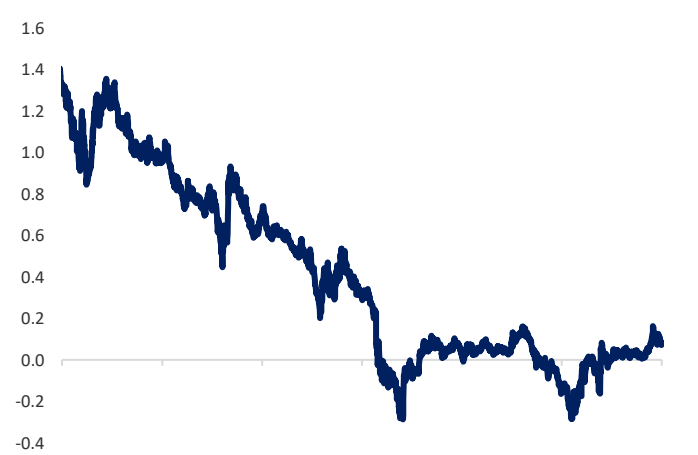
Figure 14: German 10-Yr Bond Yield (%)



Figure 15: Australian 10-Yr Bond Yield (%)



Figure 16: Japanese 10-Yr Bond Yield (%)



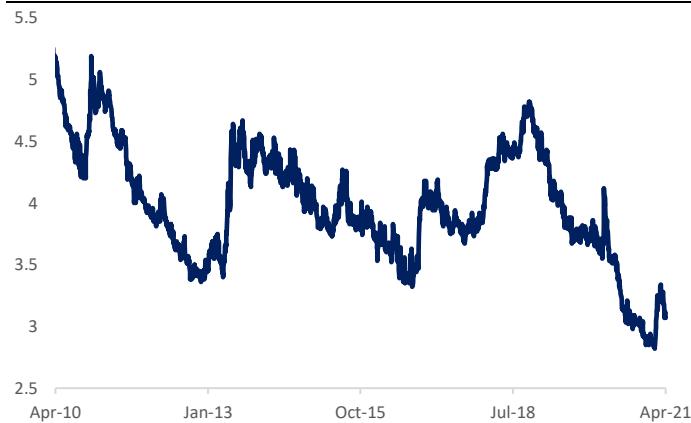
**How far will long-term bond yields rise? Another way to put it is how far will the U.S. Federal Reserve let bond yields rise? 2%? 3%?** The recent pause in rising bond yields in the U.S. is expected to resume – this means directionally, other developed markets will follow, although the magnitude of change will vary. In our view, the U.S. Fed is more likely to be open to global stocks' rally stalling rather than push back on yields rising just yet. However, what the U.S. Fed will not want to see is financial conditions tightened in the real economy, which could stall the economic recovery and reaching its targets. We believe the U.S. Fed wouldn't want to see mortgage rates rise too quickly in the U.S. We note mortgage rates in the U.S. have started to increase again and this is having some impact on mortgage applications and housing permits. In our view, long-term bond yields at >3% could be a risky proposition for the housing sector and therefore

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markets are likely to respond adversely to this well before the bond yields get to 3.0%. We note the latest U.S. Fed dot plot highlights the consensus Board view of long-term Fed rate was at 2.5%.

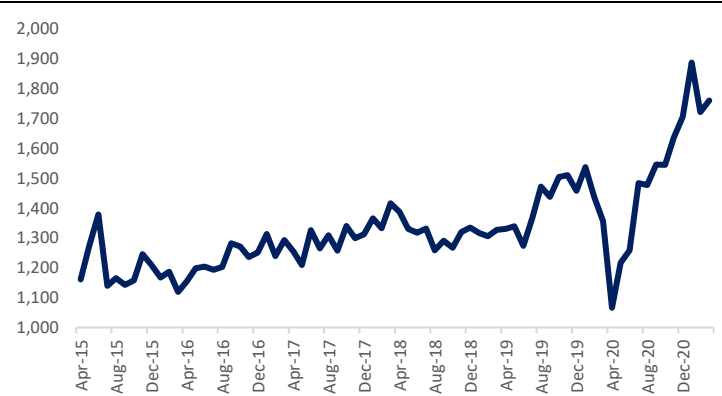
**Some signs of financial conditions tightening in the U.S.** Below we have provided 2 charts which are worth keeping an eye on to gauge the state of real economy financial conditions: **(1) U.S. 30-Yr fixed rate mortgage (%)** – this index tracks the overnight national average in the U.S. **(2) U.S. Private Housing Building Permits ('000)** – this tracks the number of permits issued for new construction, additions to existing structures and major renovations.

Figure 17: U.S. 30-year fixed rate mortgage (%)



Source: Banyantree, Bloomberg

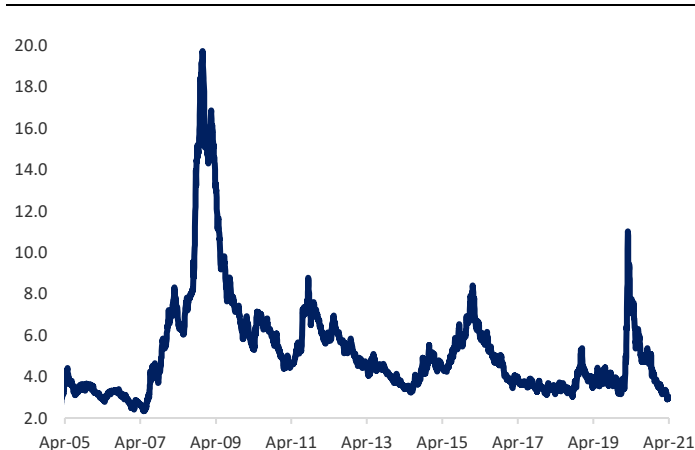
Figure 18: U.S. Private Housing Building Permits ('000)



Source: Banyantree, Bloomberg

**Corporate credit markets.** Given sovereign bond yields are delivering little yield, investors continue to push into investment grade, EM debt and high yield. In absolute terms, U.S. & Pan-European high yield and EM investment grade still offer attractive yields. U.S. investment grade is well bid now and is trading at a ~42% premium to its long-term average. In this regard, EM investment grade is offering relatively good value, trading at a ~27% premium to its long-term average. Having said that, we see limited room for significant credit spread tightening from current levels. In terms of risk, with an improving macro (U.S. economic growth solid, Europe to improve in 2H21) and easy financial conditions, it is hard to see an environment in the short-term where default rates could spike out of control.

Figure 19: US High Yield spreads (%)



Source: Banyantree, Bloomberg

Figure 20: US Investment Grade spreads (%)



Source: Banyantree, Bloomberg

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Figure 21: EM Investment Grade spreads (%)



Source: Banyantree, Bloomberg

Figure 22: Pan-European High Yield spreads (%)



Source: Banyantree, Bloomberg

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