3-Month Market Review

(as at March 31, 2021)

Overview

Two themes currently dominate global investment markets. Firstly, global growth is expected to surge as government policies remain in stimulus mode and because the vaccine supply and distribution has been extremely successful in major economies such as the US and the UK. Indeed, the International Monetary Fund (IMF) forecasts global economic growth of 5.5 percent for 2021.

Secondly, investors are concerned about the US economy having too much of a good thing, fearing that this time the growth dynamic of a rollback of COVID restrictions and too much stimulus may create an inflationary spiral (uncontrolled price increases), which would be extremely destructive to economic stability.

Geopolitically, the most significant development is that we're seeing an ever more assertive China. Beijing is hoping to persuade Biden policymakers to lift the tariffs imposed by the Trump administration. These tariffs currently make Chinese goods more expensive in the US and have led US companies to shift their purchases away from Chinese suppliers and onto countries such as Vietnam.

China has also hit Australia with unprecedented sanctions, amounting to more than 10 percent of Australia's exports, after Canberra called for an independent inquiry into the virus outbreak in Wuhan.

EQUITIES

The MSCI All Country World Total Return Index continued unabashed however and gained 4.6 percent over the last quarter, and the S&P 500 and the Bloomberg European 500 Index rose by 6.2 and 8.1 percent respectively since the start of the year.

The prospect of strong economic growth in the US economy shifted investor focus away from the tech sector and on to those stocks that benefit from a cyclical economic rebound.

Earnings momentum remains strong and these economically sensitive stocks and sectors should continue to have the most potential to surprise on the upside as the earnings cycle progresses throughout the year.

The Russell 2000 Index, an index of these so-called value stocks, surged 13 percent over the last quarter. The NASDAQ, on the other hand – having surged by a stunning 45 percent over the course of 2020 – has lagged behind since the start of this year, returning 3 percent.

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BONDS

Fixed income markets were less impressed with prospects of resurgent global growth however. Long-dated US Treasury bonds – the price which moves opposite to inflation – took the brunt of the pain, slumping by around 15 percent since the start of the year. This may not be on the scale of significant stock market falls, but it is the sector's worst quarterly performance since the early 1970s.

The US Federal Reserve (the Fed) sets short-dated interest rates, but the market ultimately determines the rates paid by long-dated bonds.

The Barclays US Aggregate Bond Index – which is often used as a stand-in for measuring the performance of the US bond market – fell by 3 percent since the start of the year.

OUTLOOK

The Biden administration passed the controversial $1.9 trillion stimulus bill and is thinking of an additional $3 trillion on longer-term projects such as the green economy. It's little wonder that investors are concerned that the economy may be overstimulated.

They are worried that the Fed will make a policy error, and let the inflation genie out of the bottle, which will have the knock-on effect of bringing forward its first rise in interest rates.

The issue is less about whether 10-year interest rates are rising and more about how orderly future rises will be. If we see a natural trend upwards due to stronger growth as the economy recovers, in the wake of lockdown restrictions being lifted, that's one thing. Rising sharply in a disorderly manner however, due to concern that the economy is overheating, would be much more of a concern.

But even the first scenario, whilst a natural development in a recovering economy, will nevertheless present an extremely challenging environment for fixed income markets.