PACIFIC MULTI-ASSET SOLUTIONS

INVESTMENT OUTLOOK

2021: 2nd Quarter Insights

OUTLOOK SNAPSHOT: (Estimated reading time 60 seconds)

1. What's happened over Q1 21?

Global Rebound led by the US: Huge government stimulus packages further bolstered by infrastructure spending set to boost growth to record levels.

Significant Market Rotation: Strong quarter for Equity markets and the most challenging quarter for Global Bonds since 1980. 'Growth' companies lose their shine whilst 'Value' companies thrive.

Portfolio characteristics: Dynamic Overlay Portfolios leading portfolio performance this year across the board. Strong performance from Value Equities, and low exposure to 'duration' in fixed income, along with diversifying assets exposure, helped to dampen a challenging fixed income environment?

2. Looking Ahead

Where to find Value? Value investing has a stellar long term track record. Q1 has shown only the beginnings of how powerful this investment strategy can really be.

OUTLOOK: (Estimated reading time 6 minutes)

After the sharpest fall in GDP in 300 years in the UK in 2020, this year looks set to see a record bounce back in growth. Global forecasts for growth have been revised up furiously as the vaccine rollout has gathered pace and as governments around the globe push for greater fiscal spending, leading the IMF to forecast that global growth in 2021 will be the strongest since at least 1980.

A global rebound led by the US

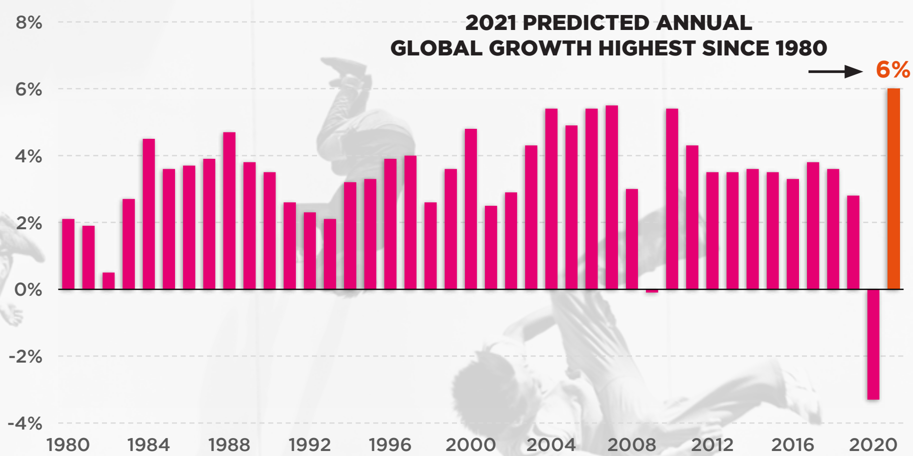
In the US, the government enacted a $900bn plan in December under former president Trump and a $1.9 trillion stimulus plan in March under President Biden. Now the Democrats are pushing for a further $2.25 trillion dollar infrastructure spending plan over the next ten years. This spending plan covers a range of areas from electric vehicles and transportation to broadband infrastructure, partially funded by tax increases, thereby rolling back some of the tax cuts gifted to corporates by Trump.

GDP forecasts for the US in 2021 have increased from just under 4% to nearly 6% over the last three months as economists race to keep up with stronger growth prospects. To put this into context, this year the US looks set to grow faster than China for the first time since 1976. The infrastructure programme alone, which the Biden administration hopes to pass over the summer, would push up US GDP by an estimated 1% next year.

Annual global growth rate from 1980 to 2021 (YoY %)

GLOBAL REBOUND

The IMF predicts that the global growth rate in 2021 will be the most since at least 1980.



Source: International Monetary Fund

SIGNIFICANT MARKET ROTATION

The impact of the pickup in economic growth has seen a significant rotation within markets. Equity markets have risen on the expectation that stronger economic growth will boost corporate earnings whilst significant monetary stimulus remains in place from central banks. The most visible casualty has been the bond market where US treasuries recorded their biggest losses since 1980 as bond yields rose sharply from the depressed levels they reached last year. Central banks have continued to guide investors that they will maintain interest rates close to zero for at least another two years and will not remove monetary stimulus until the recovery is fully entrenched. For the time being they are allowing bond yields to rise to reflect an improvement in the economic outlook. However, if bond yields move too far, too fast, they are likely to adjust their bond buying programme to hold down longer dated bond yields.

The shift in growth is also having a profound effect on the leadership of equity markets, under the surface of the broad indices. For the last 15 years as global growth has slowed, investors have focused on fast growing companies and as growth has been scarce, so the valuations of these companies have been pushed higher. The combination of faster earnings and higher valuations has been a powerful cocktail for growth investors.

Investing in companies that grow faster than the broader markets has many appealing qualities: those companies normally operate in a sector that's enjoying outsized sales and profit growth and often operate in the cutting edge technologies of the time; today that would include cloud computing, video gaming and ecommerce stocks to name but a few.

> **There's only one potential downside to growth investing and that's when the benefits of growth expectations are outweighed by the price you have to pay to invest in those companies. Today many of these companies trade on eye watering valuations.**

VALUE INVESTING: THE OTHER SIDE OF THE INVESTMENT COIN

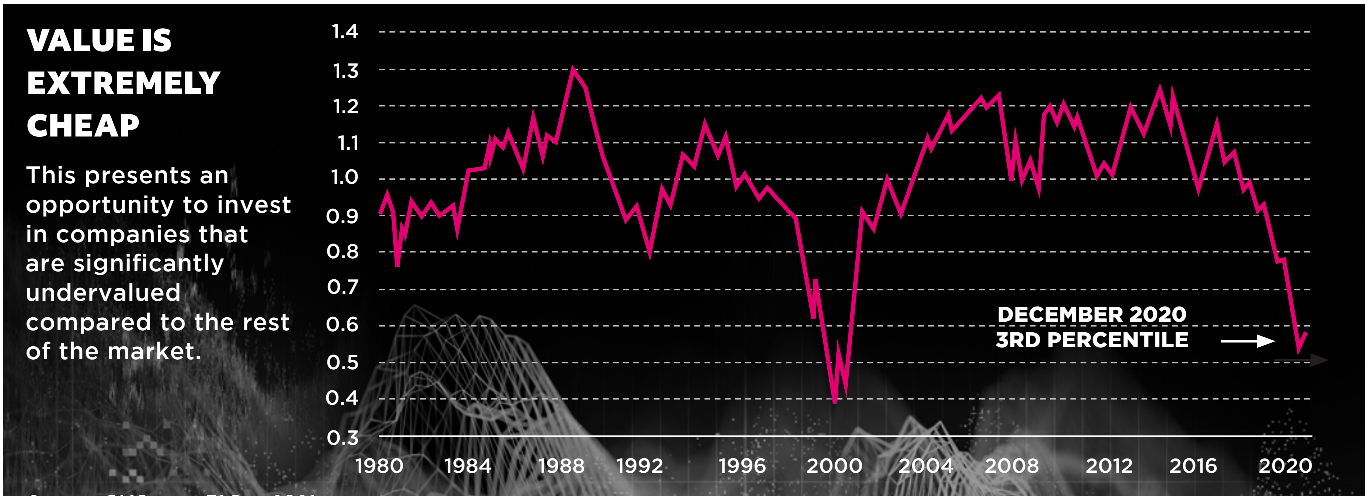
Value investing is the other side of the investment coin, focusing on businesses that trade at a discount to the market. This style of investing has something of a PR problem: the companies tend not to be focused on glamourous sectors, but here's the thing: value investing works. Since 1926, investing $1 in growth stocks returned around $5,500 – not bad – but investing $1 in value stocks returned over $67,000, more than ten times as much. This is because investors tend to overestimate the growth potential of growth stocks and so overpay for them. On the other hand, investors tend to underestimate the potential rebound of both earnings and valuations of value stocks and so they get marked down to valuations that are lower than is warranted by their prospects.

Critical to the success of value investing is that there are stocks to buy that are materially cheaper than their faster growing cousins. Fifteen years ago, the valuation gap between the cheapest and most expensive companies was narrow compared to history so paying a slight premium for faster growing companies made sense.

> **Today, the opposite is the case: value stocks have only been this cheap against growth stocks on a handful of occasions over the last fifty years.**

We think that this presents an opportunity to invest in companies that are significantly undervalued compared to the rest of the market, many of which are the beneficiaries of the reopening of the global economy. Furthermore, we believe that buying companies whose valuations are depressed is particularly appealing when parts of the stock market are trading close to record high multiples.

Relative valuation of cheapest 50% of US Stock Market vs. Expensive Less Average: 1980 to 2020



Source: GMO as at 31 Dec 2021
Composite Valuation Measure is composed of price/sales, prices/gross profit, price/book, and price/economic book.

CONCLUSION

The fiscal and monetary stimulus that global governments are injecting into the economy combined with the success of the vaccine rollout in the UK and US has seen a sharp increase in economic growth. This stands in stark contrast to ten years ago when austerity was a drag on the recovery from the last recession.

There are of course risks of an uneven recovery as other parts of the developed and emerging world lag behind in their vaccination programmes and whilst the vast majority of the world has yet to be vaccinated, risks of virus mutation are clear. This environment presents significant opportunities as well as some risks – an ideal environment for multi-asset investing.

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