Spring
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market outlook.

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contents.

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The UK Economy

The FTSE 100 breached the 7,000 level during the quarter (a level not seen since 26 February 2020 and a far cry from the sub-5,000 level it fell to in March 2020). While this is undoubtedly great news as it reflects the economic recovery, the index still remains well below its all-time high of 7,877.

Relative to its global peers, the FTSE 100 index trades at a discount on most valuation metrics yet thanks to the UK's aggressive and successful vaccination programme, the UK economy is set to be one of the fastest growing over the next couple of years.

Recent data has been encouraging, retail sales bounced significantly in March beating analyst estimates and house price growth has remained strong. Forward looking PMI readings for services and manufacturing also surged in April, and given lockdown restrictions weren't eased until 12 April 2021, these data readings probably underestimate the UK's actual economic recovery.

From a policy perspective, the annual UK Budget statement in March set out further support measures for households and businesses to help offset the economic damage caused by the coronavirus lockdowns. However, with the economy emerging from the lockdowns, rising bond yields and inflation expectations have been gaining a lot of investor attention.

Technically, inflation will pick up, as we already know that energy prices have risen significantly over the past year, however, as this is likely to be transitory (and not sustained inflation), policymakers are unlikely to react and therefore, allow inflation to run above target. In time, economic support measures will need to be unwound, however, until there is clear evidence the recovery can sustain, support will remain in place.

The Japanese Economy

With Prime Minister Yoshihide Suga's approval ratings dropping, there remain concerns over the stability of leadership once again in Japan. Following former Prime Minister Abe's 8 year term (the longest serving Japanese Prime Minister), there is concern that Japan could once again be thrown into a period of long-term leadership turmoil.

Demographic issues and lack of immigration are both beginning to raise problems for the Japanese economy. With the population of under 14's now at a record low (since records began 40 years ago), the average age of the population is increasing. With the Job-to-Applicant ratio still at 1.1 jobs per person, this only stands to increase over the longer term. And, with wage growth under this scenario still not present, inflation appears to be lacking if it was not for the current record breaking stimulus package.

Haruhiko Kuroda, the current head of the Bank of Japan (BoJ) dropped the bank's ETF buying targets, choosing to allow more flexibility for the BoJ to control the quantitative easing (debt/ETF buying) policy. The market interpreted this as the BoJ winding up policy, and whilst we do not believe this to be the case, as the economy is far from self-sustaining, it has injected a further element of uncertainty.

With global investment exposure to Japan typically done via large-cap ETF's, and with the Japanese Government Pension Scheme also owning large amounts of the large-cap ETF space, valuations look uncertain, and the space looks over-researched. Mid and small cap names do however remain attractive. As, the majority of the space is hugely under-researched allowing for large valuation disparities.

The Emerging Markets & Asia Economy

The Asia and Emerging Asset classes remain some of the most attractive from an investment standpoint, arguably from both a political and valuation perspective. As, with countries such as China and Russia able to rollout policy quickly and effectively, this has aided in the path to economic recovery from Covid, and prevented further severe breakouts of the virus.

Whilst India has been in the headlines following a second wave of Covid, due to the population being approximately 1.4 billion, in absolute terms the infection rates and death rates have appeared worse that they statistically are. As, due to the average age in India being much lower, the mortality rate from the virus has been significantly better than that of the West. In addition, on a relative basis, the infection rate has also been lower than much of the West. When compared to last year's lockdown, regional lockdowns are anticipated to have impacted growth by approximately 1/5 of that of last year's lockdown, and with over 140 million people vaccinated (increasing rapidly due to global aid), the Indian market did not shift. This stability represents a buying opportunity following a strong domestically focussed budget.

Whilst there remains some political frictions between China and much of the Western World, primarily surrounding some questionable humanitarian actions taken by the government... economic trade relations have been strengthening. In addition, China's recent regulatory clampdown on some of the Chinese Mega Cap names (such as Alibaba and Tencent), whilst not hindering their growth that much, it has allowed small cap names in the space to thrive bolstered by support packages (particularly in the technology sector). China has pushed out small and micro-cap support packages to 2023.

There remains much clearer data sets out of Asia and Emerging Market countries following Covid when compared to the West, due to the lack of furlough type policies. This allows for clearer research at the macroeconomic level. With that in mind, valuations remain attractive in the asset classes, and other than some political/Covid/policy concerns surrounding the Latin American block, the long term outlook appears attractive so long as investors remain region and sector specific.

The US Economy

At the beginning of March the US House of Representatives passed the \$1.9 trillion Covid relief package. This was a significant victory for newly elected president, Joe Biden. This support has settled markets, giving a stronger outlook for US corporates and the economy following Donald Trump's failed attempts to ratify a support package. Both fiscal and monetary stimulus will likely remain in place for some time to come.

The US Covid roadmap has been a lot clearer under the Joe Biden regime, with over a third of the US population now vaccinated, and a target date of the 4th July to have at least the first vaccine administered to over 70% of the population. The 4th of July is also the date that has been floated for the full economic reopening of the US economy.

US economic data is looking robust, with unemployment and inflation rates strengthening. Whilst we are cognisant of these data sets being distorted by the current Covid support measures (unemployment data in the US includes individuals on 'furlough', and inflation is distorted by the US furlough scheme often paying more than an individual's salary), the Federal Reserve Bank is keeping policy adaptive and flexible in order to keep the economy on a path to recovery.

Whilst valuations in the large cap space, particularly in the technology sector, do look toppy, and whilst the S&P500 is at all-time highs, this is not abnormal for the US market. With many large technology companies sitting over multiple sectors worldwide, in addition to opportunities for revenue and profit margin growth remaining strong, valuations do not concern us (this can be seen from some strong Q1 earnings data). In addition, the S&P500 has historically broken through all-time highs continually. The support packages also strengthen the opportunity set in the small cap space, particularly with valuations looking attractive following 2020 lockdowns.

The European Economy

Following a period of uncertainty in Europe surrounding Covid and resurgences in the virus, the vaccine programme has now gained traction. Despite European Union orders for the AstraZeneca vaccine to be cancelled from June onwards, the supply of the alternatives has enabled the region to set a path to recovery, injecting an air of confidence for investors.

The European Central Bank, whilst not making any major alterations to policy this year, has remained vocally accommodative towards the path to economic recovery from the Covid lockdowns. This flexibility, coupled with the 1.85 trillion recovery package and an improving vaccine programme has given some stability to a region that was looking arguably in disarray heading into 2021.

Valuations in Europe remain some of the most attractive globally, and with more growth-oriented names/sectors compressed following a value reversion earlier in the year, the opportunity set appears strong at a stock and sector specific level.

Data is beginning to incrementally improve, with unemployment and inflation slowly gaining traction. However, it remains prudent to be aware of some of the hurdles on the path to recovery as and when domestic level support packages (which differ for each member country) are removed.

Fixed Interest

Development market government debt has sold off considerably since the start of the year, however, by any meaningful measure, yields in this area remain low. The sharp rise in yields in this space highlights how low they were, rather than representing an attractive entry point.

Corporate debt should, in the short term at least continue to be supported by central banks, improving economic conditions, and strong liquidity positions on company balance sheets, however all of this support is likely to already be accounted for in the price.

Corporate bonds remain expensive. Relative to government debt, corporate debt has performed better over the quarter, and still offers better value, but looking forward, returns are likely to remain subdued.

Whilst there are areas of corporate debt that remain attractive, equities are likely to offer better returns in the medium term.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on **0800 028 3200**, Monday to Friday 9am-5pm or you can email us at **mywealth@wealthatwork.co.uk**

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