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GLOBAL INVESTMENT COMMITTEE'S 12-MONTH OUTLOOK: CONTINUE RISK-POSITIVE, ESPECIALLY FOR JAPAN

The global economic recovery should surge as per consensus

Out of the six scenarios presented, a solid majority of our committee agreed again on a positive scenario, in which the global economy matches the market consensus for very strong growth, while equities continue to rally. Although we realise that variants present some risk, we estimate that vaccine distribution will, overall, continue to heighten optimism among investors, as will geopolitical risks not hampering economic activity. Meanwhile, we continue to expect the US Congress to pass fiscal stimulus via various compromises, leading to a mollified version of the Democratic agenda, thus allowing the economic recovery to have a disinflationary tenor globally unless monetary policy becomes much more dovish.

In our March meeting, we expected GDP growth for 2021 to be higher than expected, which so far has only been partially accurate, as Japan and Europe struggled longer than expected with the virus and global supply chain problems worsened. We also expected inflation to remain under control, and while prices surged in certain sectors, many (but far from all) due to accident-related supply problems, estimates of inflation beyond this year remain disinflationary. That said, although "transient" is an applicable term, there has been a large, mostly permanent step-up in overall consumer prices, which is particularly burdensome for low- to middle-income households, and there certainly is some risk that inflationary psychology takes hold. Fortunately, long-term interest rates and other bond market indicators also currently imply that inflation will subside.

For the US, GDP should increase 7.4% at a Half on Half Seasonally Adjusted Annualised Rate (HoH SAAR, as used in all references below) in the 2H21 and 3.3% in the 1H22, matching consensus estimates. Personal consumption should remain strong, especially in the re-opening services sectors (while autos and durables consumption should flatten HoH), and private capex should continue to improve in most sectors. Construction spending outside of the infrastructure sector will likely be constrained, but government spending should contribute to grow due to the Democratic agenda, while net foreign trade will likely subtract from GDP growth.

After a virus-constrained 1H, Eurozone GDP should grow 10.1% in the 2H21 and 4.0% in the 1H22, matching consensus estimates. Meanwhile, Japan's 1H was also hurt by virus/vaccine issues (heightened by the burden of hosting a safe Olympics) and supply shortages, but should grow 5.9% in the 2H21 and 3.9% in the 1H22, matching consensus estimates. Deep consumer fears shifting toward optimism should be particularly pronounced in these two regions, with business confidence also boosting capex to a large degree, especially to solve supply chain issues and improve climate-related mandates. Japan's economy should, in particular, benefit greatly from continued global tech demand and a rebound from hampered auto production.

For CY21, growth for the US, Eurozone, Japan and China should match the 6.7%, 5.4%, 3.1% and 8.8% consensus estimates that we used for comparison (although Japan and Europe moderately exceed some other consensus estimates). Obviously, these rebounds are highly positive, but at the same time, are currently nearly completely embedded in the markets (although some people never believe good news until it is concrete).

Non-economic factors always concerning but not significantly impactful

There continue to be, as always, valid reasons for concern about many geopolitical issues, especially regarding North Korea, China and the Middle East. Relations between the West and China remain very tense, but neither side seems willing to cross any red lines, although the blacklistings of certain foreign businesses certainly ratchets up the potential for major economic disruptions. Increased fears about Taiwan certainly should not be ignored either. The G-7 addressing concerns in China, including the investigation of the origins of the virus, may trigger continued retaliation and the recent EU–China investment pact is likely in jeopardy, while the increased chance of many countries boycotting official attendance of Beijing's Olympics would increase tensions even further. Meanwhile, the Middle East remains risky, especially whether the Iran deal will be completed.

We still expect that any additional stimulus bill will require the "reconciliation" method, which, due to the influence of moderate Democrats, will likely constrain the size of the stimulus and require significant tax hikes. For non-budgetary items, Biden will be less constrained; indeed, he will need to satisfy his left-wing by extensively issuing executive decrees and regulatory mandates to achieve the Democratic agenda (although some of these have already been at least partially blocked by federal judges and more are likely to be so). The net result of this political change, especially if it includes tax hikes, should make risk markets and business leaders wary in some US sectors, but such will likely boost the economy in some sectors, particularly in the new energy and technology fields.

Central banks: shifting slowly less dovish

We continue to forecast that central banks will maintain QE purchases and policy interest rates at current levels in 2021 except that the Fed will likely start tapering in December. It may also shift the composition away from MBS in the summer. We expect that in the autumn it will also guide the market for mid-2023 tax hikes . As for the ECB, we expect it to end its PEPP program as scheduled, which would be considered moderately hawkish, but it should remain extremely accommodative. The BOJ is likely to remain on hold, but with a few minor tweaks.

One of the biggest monetary questions regards the potential replacement of all top three Fed positions. There is a major chance that Powell will decide he has worked hard enough and can retire with honour, in which case current Fed board member Lael Brainard, a seven-year veteran at the Fed (who worked at high level Treasury jobs under President Obama and was once an MIT professor in economics), and who is on 7 of the 8 board committees (and chairs 4 of them), **would likely be nominated** for the job. She is firmly in the Democratic Party and tilts moderately toward the dovish side, while being much more strict on bank regulation. Meanwhile, the Vice Chair position normally regarding monetary affairs is held by Richard Clarida, who is a staunch Republican and will likely be replaced when his term expires early next year. The Vice Chair for Supervision (for the financial sector), Randy Quarles, is also a staunch Republican who will likely be replaced when his position expires in October, although he has mentioned he may stay on as a regular board member (which would be highly unusual). There is also one open general board position, so if Powell, in leaving as Chair, also retires as a board member (which is almost always the case), two seats would be open. So, the Democrats likely need to nominate four board members, two of which require substantial expertise. These nominations should start in the summer. There is a strong predilection to nominate minorities, and there are likely several candidates who are likely suitable, especially if the Democrats are willing to accept a candidate for the monetary affairs job from Wall Street, although it is highly unlikely that they would accept such for the Supervision job. **The Democrats, especially from the moderate wing, wish to be very careful about pushing the Fed into an even more bold progressive mode lest the bond market, especially its foreign investors, lose confidence in the USD; however, at least a moderate increase in that direction is extremely likely, so it will be interesting to see how markets react. The top positions all have four-year terms, and can hardly ever be fired, so it will be a long-lasting shift. The effect of much stricter banking regulation, coupled with progressive, including green-oriented, lending mandates, would also have wide ranging implications.**

USD quite flat; mildly increasing G-3 bond yields after December

The US Treasury market was very volatile in 2Q. After exceeding our forecast of a moderate rise in such, the 10-year yield fell below it. Meanwhile, our European and Japanese forecasts were approximately correct. Although strong economic growth will be a challenge, the inflation outlook after 2021's conniptions will likely remain tolerable for bond investors, as they will likely assume that inflation will not be persistent. Helping in this regard, we expect most commodity prices to stop rising thanks to increased supplies and constraints in global auto production. Thus, we expect 10-year yields will remain stable for the rest of 2021. As mentioned above, they are somewhat pinned down by low central bank policy rates, continued QE, and official or unofficial Yield Curve Control. For US 10-year Treasuries, our target for end-September is 1.50%, while those for 10-year Bunds and 10-year JGBs are -0.15% and 0.05%, respectively, mildly rising by next June to 1.70%, -0.05% and 0.10%. Regarding forex, we expect the USD to fall a bit to 110 vs the yen through December but revert to 111:USD next June, while it should also mildly weaken vs the euro to 1.21 at end-December and remain there through June.

This all implies that the FTSE WGBI (index of global bonds) should produce a 0.4% unannualised return from our base date of 23 June through September in USD terms, 1.2% through 2021 and 0.6% through next June. Thus, we continue our unenthusiastic stance on global bonds for USD-based investors. For yen-based investors, this index in yen terms should return -0.4%, +0.4% and +0.7%, for those respective periods, with JGBs returning 0.1%, 0.1% and -0.4%, respectively, so the case for preferring offshore bonds looks acceptable for the next year.

Oil prices have risen much more than we forecasted, likely due to global growth, continued low US production and OPEC discipline. However, we believe the prospects of a large increase in "OPEC+" oil supply (including Iranian exports), coupled with the acceleration away from oil toward alternative energy sources should calm oil prices. Our Brent forecasts are USD 77 at end-

September and USD 79 at year-end, which contribute to our forecast of the US CPI of 4.0% YoY in December and 2.2% next June, with Core CPI at 3.4% and 2.4%, respectively (these forecasts imply 6M SAAR results in December to be only moderately above the Fed's 2% mandate). Notably, inflation in home prices outside of certain US city centres has been massive, but the housing rent components in CPI indices are skewed to troubled major city-centres, and when coupled with some rent default effects (with eviction moratoriums ending after July), so they will likely remain low, thus keeping headline and core CPI measures under control. Medical CPI inflation seems to be structurally decelerating as well and used auto prices will likely decline enough to offset the increases in certain "re-opening" service sector prices. Similar moderate increases in CPIs in Europe and Japan should also occur, in our view; thus, at least regarding the CPI indices, the global recovery will be dis-inflationary, while showing progress toward central banks' targets.

Global equities should continue upward, especially Japan

Our positive, near-Goldilocks scenario, stance on overall global equity markets in our March meeting was successful, with the US and Europe surpassing our targets, Japan undershooting such, and Developed Asia Pacific approximating such. Our circum 5% total return for MSCI World in USD terms, however, was exceeded by nearly 5%, partly due to surging CY21 EPS estimates after strong 1Q earnings seasons globally. Our new scenario forecasts a solid return for global equities in the 3Q, especially on an annualised basis, and further gains in the 4Q too. Moderately higher taxes ahead for the wealthy, and perhaps for all equity investors too, in the US will hamper investment sentiment, but increased US fiscal spending and the global vaccine-driven economic and corporate earnings recovery should more than offset such. The lack of geopolitical events that hurt market sentiment should also support prices, although we admit to "crossing our fingers" on the Iran deal. Moreover, a major positive factor should be 2Q earnings and their impact on 2021 expectations. The last four quarters' US earnings seasons were astonishing, with many companies beating consensus "by a mile". The CY21 SPX EPS estimate rose about 8% during the 2Q and if, as we expect, 2Q EPS forecasts sharply exceed consensus, analysts will have little choice but to be even more enthusiastic in their CY21 forecasts. Thus, although PE ratios look high, the upside to CY21 earnings estimates will likely make valuations much less expensive. We continue to cite the mantra: "the ability of U.S. 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 1Q after a strong showing in the previous two quarters. Japanese analysts tend to be quite conservative and corporate managements, upon which sell-side analysts highly rely, often guide earnings too cautiously. However, analysts' CY21 earnings expectations continued to surge, with TOPIX's rising by nearly 6% during the 2Q. Thus, after the 2Q earnings season, analysts will likely be even more confident in raising CY21 EPS estimates except in a few supply-chain-burdened sectors. Widespread analyst scepticism was also greatly alleviated in Europe despite the region's troubles (although its exports have been booming), with CY21 EPS revised up by 5% during the 2Q, and the strong vaccine-led economic recovery should continue to boost confidence among analysts and managements about CY21 profits. Notably, Developed Pacific ex Japan's CY21 EPS only increased 2% during the 2Q.

I**n sum, we retain our usual 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 4.1% through September, 7.2% through year-end and 9.7% through next June (3.2%, 6.3% and 9.8% in yen terms). **We expect positive returns in each region, with Japan's the highest.**

In the US, the SPX's PER on its CY21 EPS estimate is now about 22, which remains, by historical standards, very high. However, there are clear reasons for such: fixed income yields are low (and long bonds total returns should be low), buybacks are rebounding sharply (with banks now allowed to accelerate such) and earnings growth should exceed the already strong consensus view. The wild valuations among some small speculative stocks is mostly a sideshow and indeed, it has been "the wild west" in some parts of the market, so financial regulators are increasingly intervening against such; not harshly yet, but such could become more so. However, interestingly, Democrats seem unwilling to disturb Wall Street and also hope for asset revaluation, just like Republicans. Government intervention, especially on merger and anti-trust concerns, especially among major tech stocks, is also likely to be a moderate headwind. In sum, we expect the SPX to rise to 4,397 (3.4% total unannualised return from our base date) at end-September, 4,508 at year-end (6.4% return) and 4,573 next June (8.6% return), with yen-based returns being similar.

As we expected for the second quarter in a row, European equities reversed their long-term trend of underperforming the US, but again only performed approximately in line with such in USD terms. Europeans' confidence in their intermediate-term economic future should improve strongly, while the global economy surpassing consensus should also improve investor, business and consumer sentiment. The PER at 17.8 times CY21 EPS is not low compared to its history, but as mentioned above, we expect EPS to be revised upward. The high market dividend yield, especially now that most dividend cuts seem finished and hikes will likely be allowed for banks, should also continue to attract domestic and global investors. Thus, we expect the Euro Stoxx index to rise to 475 at end-September and FTSE to 7,350, which translates to returns of 4.6% (unannualised from our base date) for MSCI Europe through then in USD terms. We project even better MSCI Europe returns through December, at 6.9%, and at 10.3% through next June. As for a "known unknown," it will be interesting to see how the markets react to the developing outlook for German political leadership this autumn, which could shift to the left.

Japanese equities were disappointingly quite flat in USD terms in the 2Q, after a very strong 1Q. Optimism has suffered from the initially slow (but now rapid) vaccine distribution and related shutdowns (heightened by the Olympics consideration). However, as mentioned earlier, its CY21 EPS estimates continued to rise, partly due to Japan benefitting from the global tech cycle, in which Japan holds many leadership positions, especially in the booming sector of semiconductor producing machinery. Meanwhile, Japan has low political risk and structural reform is continuing with digitalisation and other structural reforms. TOPIX's PER fell to 15.8 times its CY21 EPS consensus estimate, which is much lower than other regions, and here too, earnings estimates will likely be marked up. Items that will boost the market in the 2H should be Japan's sharp GDP increases in the 3Q and 4Q, driven by reductions in the shutdowns, increased share buybacks, strong global GDP growth and the alleviation of component shortages in auto and some tech production.

Notably, 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 that the country has greatly reformed.** In particular, 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 were troubled in the short-run, as shortages have been even worse than expected, but the sector outlook remains positive in the intermediate term given its technological proficiency. Meanwhile, the Olympics and Paralympics will likely proceed well and Japan will be globally lauded for hosting it during troubled times, both of which would aid Japan's political stability leading into the autumn elections. Overall, we expect TOPIX to rise substantially to 2,100 at end-September, 2,170 at year-end and 2,210 by next June for **total unannualised returns of 9.3% in USD terms (8.4% in yen terms), 13.4% at year-end (12.5% in yen terms) and 15.4% by next June (16.5% in yen terms),** respectively, from our base date through those periods. Meanwhile, the Nikkei should hit 31,000, 32,000 and 32,600, respectively. **These returns are obviously attractive for both domestic and global investors.**

Developed Pacific-ex Japan MSCI: the improvement in the global economy, and in particular, China's economy, which should grow over 8% off its low 2020 base, should clearly help this region. Although the Biden Administration is maintaining Trump's tough actions on China, it will likely retain current trade relations and accept the multipolar global construct. However, China's recent party-led boycott of Western firms that have expressed human rights concerns ratchets up the trade pressure, as do other tensions with global democracies, including relations with Taiwan. Australia's relations with China are not worsening now from their very poor level, but the country is benefitting from strong global demand for commodities. Hong Kong is managing to stay fairly stable despite all the challenges and residential property prices continue to rise. Clearly, vaccines and increased global tourism will eventually help these two economies tremendously. In sum, we are positive on both the Hong Kong and Australian markets, with the Hang Seng at 30,326, 31,770 and 33,214 at end-September, year-end, and end-June respectively, and the ASX at 7,335, 7,445 and 7,745. Thus, we expect the region's MSCI index in USD terms to rise (total annualised return) 3.0% through September, 7.3% through year-end and 13.1% through next June.

Investment strategy concluding view

The global economy should match the consensus for strong growth, thanks to vaccinations, continued monetary and fiscal stimulus, decent global geopolitical conditions, low interest rates, and the prospect for moderate future inflation. This, via increased corporate profits, should allow equity markets to perform very well through 2021 and the first half of next year, with impressive returns in each region, particularly in Japan. Meanwhile we expect continued low returns for global fixed income. There remains, of course, a significant chance of alternate scenarios, for which we have different market and economic targets, and institutional investors are welcome to contact us for such.

Important Information