SECOND QUARTER 2021 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

July 12, 2021

PORTFOLIO THEMES

- We continue to favor larger, high-quality companies as our assessment is that we remain in a late bull market cycle despite the technical bear in 2020.
- As growth resumed leadership late in Q2, we believe the relative strength in value-oriented companies was likely a countertrend in a longer growth-led cycle.
- Economic growth and inflation expectations likely continue to moderate as global economies reopen supporting our preference for growth equities.

MARKET OUTLOOK

- **Expect an Above-Average Year for Global Equities:** After a solid first half of 2021, global markets are on track for a strong year tied to equities' resilience, political clarity and continued vaccine development and distribution.
- **We Believe We are Late in the Market Cycle:** The 2020 downturn behaved more like an outsized correction than a traditional bear so the market cycle did not reset. The vast majority of our sentiment and market indicators point to this being a late cycle bull market, yet many forecasters expect early-cycle leadership.
- **Investor Sentiment is Elevated but not Euphoric and can Remain High for a Long Time:** Positive sentiment can reign for a while before equities reach a euphoric peak, with strong returns along the way. Monitoring sentiment will be key for investors in 2021.

Global equities enjoyed another good quarter rising 7.4% and seem on course for robust full-year returns.[i] Much in line with our expectations, growth outperformed value in Q2, displaying characteristics typical of a late stage bull market.[ii]

While market leadership will inevitably change, we believe growth will maintain leadership in the near future. While last year's downturn was a bear market by magnitude and cause, it behaved like a correction. The downturn didn't last long enough to reset the market cycle and usher in long-running value leadership. Accordingly, equities are behaving as if we are in the late stages of the bull market that began in 2009.

Growth has led overall since March 2020's recovery started and continues to do so despite several value countertrends along the way. We are choosing to maintain our growth emphasis with select value exposure for diversification. This positioning helped mitigate the impact of the year's early countertrend.

Consistent with our outlook earlier in the year, we maintain the view that recent jumps in economic growth and inflation will likely be temporary. As opposed to previously, the consensus view now seems more in line with ours, which is normally concerning. But the facts and logic supporting our view still hold.

i Source: FactSet, as of 07/01/2021. MSCI ACWI returns with net dividends, 03/31/2021 – 06/30/2021.

ii Source: FactSet, as of 07/01/2021. Statement based on the MSCI ACWI Growth and Value Index returns with net dividends, 03/31/2021 – 06/30/2021.

Specifically, pundits now cite the declines in lumber prices and long-term interest rates as signs inflation pressures are temporary. They also note the base effect from last year's pandemic-induced deflation in April and May. These are correct observations, if incomplete. Spiking resource prices due to supply shortages don't represent lasting inflation. We see this more as a false fear resolving and people realizing what the market already knew. While broad measures of money supply soared, most of the components aren't actually mediums of exchange. Note, we aren't arguing there is no inflation. Just that there is a big difference between the 1970s-style inflation many fear and the slow, pre-pandemic inflation rates we expect.

Pundits are also moderating on infrastructure spending as stimulus, noting the slow rollout. Instead of overheating and a new Roaring Twenties, many now anticipate slow growth. We largely agree. After a temporary surge tied to reopening, we have long said pre-pandemic slow growth was likely to return. "Stimulus" was never likely to have the anticipated effect, considering shovel-ready infrastructure projects are largely a myth and households spent only a portion of their Covid-19 relief money. Regardless, government spending can aid growth when the conditions are right, but that isn't now. Most economic data are near or even above pre-pandemic levels. The notion the economy needs support from here strains credulity.

While some US legislation has passed under President Biden and other proposals could come to fruition, overall, we expect the Democratic Party's narrow edge in the House and Senate, alongside internal division, to make passing legislation difficult. Gridlock is blocking some ideas and diluting others. Tax hikes have already fizzled. The G7's vaunted global minimum corporate tax rate agreement will likely do the same. Further, we are three months away from the traditional start of US midterm campaigning. Politicians are already shifting gears. The rhetoric around a bipartisan infrastructure deal looks more like campaign talk than serious progress on legislation. Moreover, markets are familiar with all this. If major legislative disruption were likely, equities would show it.

Political risk remains benign in global developed markets, but several meaningful elections will draw attention in the second half of 2021. Germany will go to the polls in September and will replace Prime Minister Angela Merkel. We don't envision a successor with her political influence and believe it is unlikely for any single party to win a majority resulting in an inactive coalition government—positive for equities.

In Japan, Prime Minister Yoshihide Suga survived a no-confidence vote—an unsurprising outcome as his Liberal Democratic Party (LDP) and its coalition partner, Komeito, wield a huge majority in the lower house. Some speculate Prime Minister Suga may call a snap general election—a vote is due by October 22—following the Tokyo Olympics' conclusion in early August. A fresh mandate from voters may help Prime Minister Suga shore up support within his own party.

Additionally, rumors speculate that Canadian Prime Minister Justin Trudeau may also call an early election attempting to capitalize on his vaccination campaign success and fiscal response. If he moves forward, it is too early to predict whether this will result in a majority government led by Prime Minister Trudeau.

Emerging Markets (EM) also rose in Q2, adding to a positive first half of 2021. Unlike global developed markets, growth narrowly trailed value over the quarter.[iii] However, that trend reversed in June as growth in EM led alongside developed markets, a sign of things to come in our view.

Brazil was EM's best performer in Q2. The likely reason why, in our view, is simple: The country is beating exceedingly low expectations. Between political uncertainty, slow vaccine progress and the reduction of direct aid payments in April, most observers expected Brazil to struggle for the foreseeable future. However, reality has proven better than feared.

iii Source: FactSet, as of 07/01/2021. Statement based on the MSCI EM Growth and Value Index returns with net dividends, 03/31/2021 – 06/30/2021.

China got a respite from its deep February – March correction as the MSCI China rose during the quarter. On the economic front, not much has changed. Data, while still showing recovery from last year's lockdowns, remain skewed by the base effect, making year-over-year measures of little use for investors right now. Most major economic indicators have been slowing in Q1, part of the broader slowdown likely attributable to the base effect, as China's recovery was accelerating last spring.

Further, markets have been reacting to recent news that Chinese government agencies are considering revising rules on overseas listings as part of broader capital markets reform. With this news, investor sentiment turned negative overlooking strong fundamentals, in our view. Potential regulatory changes appear aimed at strengthening domestic capital markets rather than a draconian move against foreign listed companies.

Halfway into 2021, global markets are well familiar with the pandemic's issues and setbacks—and are looking beyond them. We think they are pricing in the return to pre-pandemic growth trends. This still leaves further room for the bull market to rise this year, but rising optimism makes monitoring for euphoria and areas of excess paramount, in our view.

Should you have any questions about any of the information in the Second Quarter 2021 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.