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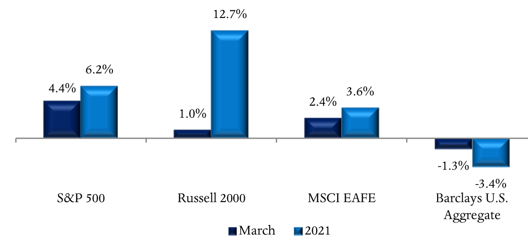
Markets

The first quarter of 2021 was dominated by a value-oriented US equity market rally, amid rising bond yields. The two key drivers of this performance were the Democratic party sweep of Congress, which paved the way for further US fiscal stimulus, and the ongoing vaccine rollout, enabling economies to recover from the pandemic. In turn, there has been rising optimism toward the outlook for global economic growth.

During the month of March, the S&P 500 index advanced +4.4% (+6.2% ytd), achieving a record high above the 4,000 mark. Small capitalization stocks, which tend to be more domestically focused, are off to a strong start in 2021, with the Russell 2000 index advancing +1.0% in March (+12.7% ytd). The outperformance of small cap stocks versus large cap ones, evident over the past several quarters, appears to be a reversal of a multi-year trend. Similarly, value stocks (+9.8% ytd) outpaced their growth oriented counterparts (+0.3% ytd), a two quarter trend thus far.

Overseas stocks, as measured by the MSCI EAFE index rose +2.4% in March (+3.6% ytd). Notwithstanding the EU's challenging vaccine roll-out process, which may delay re-openings, local equities rallied +6.5% in March (+8.5% ytd). Japanese equities also rose +1.4% last month (+7.0% ytd), despite the country having vaccinated only about 1% of its population. The takeaway is that investors are focused on a positive outcome, rather than the timing. In addition, export oriented economies have solid prospects thanks to a strong rebound in global goods demand.

The first quarter was a negative one for government bonds, and fixed income in general, due to rising interest rates amid increasing inflation expectations. The 10-year US Treasury yield ended the quarter at 1.75%, vs. a low of 0.50% last August and 0.90% at the start of the



year. As such, the Barclay's US Aggregate index declined -1.3% in March (-3.4% ytd).

Higher inflation expectations, driven by pent-up demand and low inventory levels, boosted commodity prices, with oil +22% and copper +13% so far in 2021. Rising real-yields were, however, a negative for gold, which has declined -10% year-to-date.

Geopolitics

Covid-19 vaccinations continue to be administered globally. As we go to press, the share of people who have received at least one dose has reached 61.0% in Israel (plateauing), 46.5% in the UK, 36.7% in Chile, 32.4% in the US, and 12.6% in Germany (a proxy for the Eurozone), with availability of the vaccine being the bottleneck. In turn, the number of people being hospitalized due to the virus is much lower than at the start of the year. In an encouraging sign, President Biden doubled the US's vaccination goal from 100 million to 200 million doses during his first 100 days in office. Conversely, the increasing Covid infections in some emerging markets, such as Brazil and India, are concerning.

United States

US business surveys improved in March, with manufacturing expanding strongly to 64.7% (the highest reading since December of 1983). The service sector also continued to perform well, with companies noting improving consumer confidence and signs of pent-up demand. This was confirmed by the latest reading of Consumer

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Confidence which surged to its highest level in a year, reaching 109.7, up from 90.4 in February. March's employment report delivered two positive surprises. The US economy generated 916,000 jobs, far above expectations, and initial jobs gain estimates for January and February were revised upward by a total of 156,000. The unemployment rate declined to 6.0%.

US factory inventories are currently at an all-time low due to a shortage of workers and supply chain interruptions. According to IHS Markit, average delivery times have lengthened and are at a record high leading to the second highest input cost increase ever. Meanwhile, the Atlanta Fed's inflation survey showed the highest proportion of companies reporting unit cost growth of 5%+ since the survey began in 2012. The New York Fed surveyed consumers and found that they expected 3.1% inflation (including rents rising by 9.0%), the highest forecast in almost seven years. With regard to housing, the National Association of Realtors indicates that there are only 1.03 million homes for sale in the US, a record low figure that led the median existing home price to soar by 15.8%, year-over-year, last month. Yet the most recent Bureau of Labor Statistics (BLS) inflation figure of 1.7% (year-over-year) remains suppressed on account of various hedonic adjustments. Note: the BLS's latest inflation figure for the "shelter" category was 1.5% (representing 42.4% of CPI).

March also saw the passage of President Biden's $1.9 trillion pandemic stimulus package, worth 9% of GDP. This has led to an upgrade of the consensus forecast for US economic growth in 2021, to over 6%, the most in four decades.

Europe

Business activity in the euro area expanded in March, but economies are bracing for a third wave of Covid-19 infections which are likely to delay the eventual recovery. The composite PMI, accounting for both manufacturing and services, hit 52.5% in March, up from 48.1%, breaching the expansionary 50.0% level. Of note, German manufacturing hit record levels.

March 2021 Economic Statistics

	Mar-21	Dec-19	Dec-18
Federal Funds Target Rate	***0 - 0.25%***	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	***109.7***	126.5	128.1
Manufacturing PMI Index	***64.7%***	*47.2%*	*54.1%*
Unemployment Rate	***6.0%***	*3.5%*	*3.9%*
JPY / USD	***110.70***	*108.61*	*109.56*
USD / EUR	***1.1728***	*1.1210*	*1.1469*
Gold / oz.	***$1,707.00***	*$1,517.01*	*$1,282.73*
Oil (WTI) / bbl	***$59.16***	*$61.06*	*$45.41*

The European Central Bank is now calling for a GDP (gross domestic product) rate of 4.0% for the euro area this year (back-end loaded in the second half) and 4.1% for 2022. These figures are based on circa 50% of adults being vaccinated by the end of July. This would allow most restrictions to be lifted during the summer, paving the way for a sustainable economic rebound.

Asia

In China, where the coronavirus outbreak has been largely contained since the middle of last year, the domestic vaccine rollout has been slow, with only about 4% of the population vaccinated, according to health officials. Ahead of the politically important 100th anniversary of the Chinese Communist Party in July, leadership is aiming to vaccinate 40% of the population by the end of June and more than 64% by the end of the year, in an effort to reach herd immunity.

Chinese Premier Li Keqiang announced last month the world's second-largest economy would target growth of over 6% for 2021. China reported growth of 2.3% last year, the only major economy to expand amid the coronavirus pandemic, leading to a 16% share of global GDP. On international trade, Li sounded an optimistic note, saying the country would "promote the growth of mutually beneficial China-US business relations on the basis of equality and mutual respect." However, of some concern, the Chinese Premier said the country would "resolutely deter" any separatist activity that sought the independence of Taiwan, which Beijing considers a breakaway province, while remaining committed to peaceful reunification with the region.

Outlook

Covid-19 vaccinations are well underway and, with better weather on the horizon, economies are poised to rise. Consumers have spent less than normal during the pandemic which, combined with government relief packages, has resulted in excess savings ($2.5 trillion dollars in the US). As restrictions are lifted, consumers should feel safer and more confident, leading to a boom in demand for goods and services. A celebration of sorts.

But at what cost? Last year the US Federal Government commenced a much needed fiscal stimulus program to combat the economic downturn related to the coronavirus pandemic. Further rounds of stimulus have ensued, with the Treasury Department reporting that the federal budget deficit soared to $3.5 trillion (16.5% of GDP) over the past year. On the horizon is President Biden's $2.2 trillion infrastructure program, which includes a bailout for money-losing rail company Amtrak, the creation of a $50 billion Technology Directorate at the National Science Foundation, a $50 billion office at the Commerce Department to monitor "domestic industrial capacity and funding investments to support production of critical goods" and a new Deployment Authority at the Department of Energy. The infrastructure program will likely be followed by a $1 trillion bill to expand child and health care (plus a proposal to lower Medicare eligibility to as low as age 50). As if all this was not enough, in late-March, 21 Senate Democrats wrote to President Biden urging him to include recurring direct payments and further extensions of jobless benefits in his recovery plans. Most recently, President Biden reportedly asked Education Secretary Miguel Cardona to prepare a memo on the president's legal authority to cancel up to $50,000 in student debt, per borrower. The cost would be covered by $2 trillion in corporate tax increases, over 15 years, with rates rising to 28% (potentially 25%) from the current 21%.

Despite upgraded economic growth forecasts (aided by ongoing monetary and fiscal stimulus the US is already back to near-peak GDP) and rebounding employment data (US unemployment is expected to decline to 4.5% by the end of this year and 3.5% by the end of 2023), the Federal Reserve does not believe inflation will remain sustainably above their target and does not expect to raise rates before 2024. Further, the central bank continues to purchase at least $120 billion of securities per month which has thus far resulted in a balance sheet size of $7.7 trillion, nine times higher than when their quantitative easing program started in late-2008. Note: The Fed is not the only guilty party, the European Central Bank's balance sheet is even larger at €7.5 trillion ($8.9 trillion), up almost 60% over the past year and equal to 75% of Eurozone GDP. Yet Chairman Powell recently telegraphed that any change in monetary policy would happen "very, very gradually over time and with great transparency, when the economy has all but recovered." San Francisco Fed President Mary Daly added "we are not going to take this punch bowl away."

Combined, all of these events, plus disruptions in supply chains leading to imbalances, hint at an extremely inflationary economy in the latter half of 2021 and 2022. This does not bode well for fixed income markets, which we continue to believe will be challenged.

Against this backdrop, we remain positive on the outlook for equities relative to bonds. While it has been a challenging period for the smaller, poorly-capitalized, or less well-technologically-enabled companies. It should be a prosperous time for our favored globally dominant businesses which score highly in the above mentioned areas, and posses strong pricing power. In addition, we see the current rotation from growth to value, as well as large capitalization to small, favoring active management, which is advantageous to many of our strategies.

As we look forward to the economic recovery of 2021, and beyond, we have identified several opportunities in merger arbitrage, distressed real estate, hedged credit, European equities, and water infrastructure. In addition, we are preparing for the launch or our proprietary Nordic Technology and Innovation Fund.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.

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