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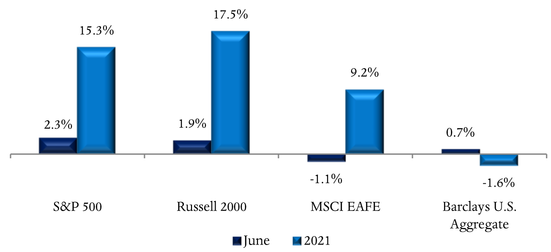
Markets

During the second quarter, equities rose as vaccination campaigns continued to accelerate, spurring economic growth in most developed economies. The S&P 500 delivered one of its best ever first-half performances, rising +8.5% during the quarter (+15.3% ytd), thanks to strong earnings growth, and the prospect of more fiscal stimulus via infrastructure spending. European stocks followed closely (+6.8% in Q2; +15.8% ytd), supported by the reopening of regional economies and strong global goods demand. Market trends saw the outperformance of growth stocks over value oriented ones, ending a two quarter streak. In contrast, the slow vaccination campaign weighed on the relative performance of the Japanese equity market (-1.2% in Q2; +5.8% ytd). Meanwhile, policy tightening and regulatory concerns were headwinds for Chinese stocks (+5.4% in Q2; +4.4% ytd), and on Asian indices in general.

In fixed income markets, 10-year US Treasury yields dropped by 30 bps in Q2, ending the period at 1.45%, reversing the first quarter's rising trend. Given the pervasiveness of negative real-interest rates, amid higher inflation, investors searched for yield, placed hedges against rising prices, and bid up the US Dollar. The supply-demand driven environment led to buying of spread products such as emerging market debt, US and European credit, as well as inflation-linked bonds. In this context, the Barclays US Aggregate index advanced +0.7% in the second quarter (-1.6% ytd).

Energy markets rallied to multi-year highs on the back of surging demand, constrained supply and low storage levels. While some drivers may prove transitory, market participants drove WTI crude oil higher to end the quarter at $73.47 per barrel (+24.2% in Q2; +51.4% ytd). However, Federal Reserve comments regarding tapering of monetary stimulus buffeted precious metals prices, with gold declining to $1,769.80 per ounce (+3.7% in Q2; -6.7% ytd)



Geopolitics

Governments in most of the developed world continued to ease Covid-19 related mobility restrictions and activity levels remain on the rise, thanks to improving vaccination trends, coupled with societies that have adapted to living with the virus. The increasing prevalence of a more contagious Delta variant has led to some concern. However, the increasing number of related cases has thus far not led to significantly higher hospital admissions, suggesting that the vaccines work well against the new strain. Emerging economies continued to lag in terms of inoculation but cases remain very low in China and seem to have peaked in India.

United States

Second quarter US economic data has generally been very strong, following-up on annualized GDP growth of 6.4% in the first quarter. Consumer confidence increased in June, following gains in each of the previous four months, and is currently at its highest level since the onset of the pandemic's first surge in March 2020. The June Manufacturing PMI registered 60.6%, indicating expansion in the overall economy for the 13th month in a row since the initial contraction of April 2020 (of note regarding inflation, the prices paid component rose to 92.1%, its highest level since January 1979). Additionally, the Case-Shiller home price index soared once again, rising +14.9% over the past year, higher than last month's +13.3% figure.

On the labor front, employers added a robust 850,000 workers in June, the most in 10 months. The unemployment rate rose to 5.9%, in part because the number of job seekers grew, a healthy development. Leisure & hospitality hirings increased by 343,000, half of which came from restaurants, with the rest split between hotels and arts/entertainment. Perhaps most importantly, wages rose briskly as the labor market heated up. The average hourly pay of private-sector employees rose 3.6% in June, from a year earlier, and 6.6% compared with February 2020, the month before the pandemic plunged the US into a recession. The takeaway is that the labor market trends remain strong, the market is tightening (as seen by the labor market differential, measuring jobs plentiful, minus jobs hard to get, jumping from 36.9, to 43.5, a high since 2000), and the tightening is accelerating.

The lifting of pandemic restrictions and the ensuing rebound in activity and employment has fueled pricing pressures. The most recent US consumer price index increased by 5.0% year-over-year. Though some of the underlying data points suggest that there are temporary factors at play, for example the rise in used car prices (a knock-on effect from the shortage of semiconductor chips that has significantly curtailed output of new vehicles). The Federal Reserve continues to see this inflationary impulse as transitory, yet it has become slightly more hawkish, acknowledging that tapering of monetary stimulus is being discussed. The median Federal Open Market Committee participant now expects two rate hikes sometime in 2023, up from zero just three months ago.

With regard to coming fiscal stimulus, a group of moderate Republican and Democratic senators agreed on a curtailed infrastructure spending package amounting to $1.2 trillion, of which $579 billion would be new spending. The bipartisan deal, embraced by President Joe Biden, would not necessitate raising corporate taxes, but rather be paid for through a variety of measures that include stricter tax enforcement, repurposing unused pandemic relief funds, reducing fraud and overpayments in unemployment benefits and through a variety of public-private partnerships that typically rely on user fees such as tolls. If enacted, the plan would be a slight positive for US economic growth, employment and productivity, according to economists at the University of Pennsylvania's Wharton School.

June 2021 Economic Statistics

	Jun-21	Dec-19	Dec-18
Federal Funds Target Rate	***0 - 0.25%***	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	***127.3***	126.5	128.1
Manufacturing PMI Index	***60.6%***	*47.2%*	*54.1%*
Unemployment Rate	***5.9%***	*3.5%*	*3.9%*
JPY/USD	***111.10***	*108.61*	*109.56*
USD/EUR	***1.1855***	*1.1210*	*1.1469*
Gold/oz.	***$1,769.80***	*$1,517.01*	*$1,282.73*
Oil (WTI)/bbl	***$73.47***	*$61.06*	*$45.41*

Europe

Although the eurozone economy contracted by 0.6% in the first quarter, leading economic indicators, such as purchasing managers' index (PMI) business surveys, have subsequently reached multi-year highs in many member countries. As such, we expect a strong European GDP expansion in the second quarter. Moreover, we believe the region's economic growth will persist throughout the second half of the year, backed by ongoing monetary and fiscal policy support.

After six months of parliamentary debates, internal discussions and judicial procedures, all 27 EU countries finally ratified the legal instrument that underpins the European Union's €750-billion NextGenerationEU recovery fund, paving the way for money to reach national governments in July. In actuality, funds to be disbursed will total €672.5 billion (€312.5 billion will be handed out as grants and €360 billion as loans) because many countries have chosen not to request loans.

Asia

The Chinese economy appears to have lost its near-term momentum, as seen by the Non-Manufacturing

PMI decline to a four-month low of 53.5%. Similarly, new orders shrank to 49.6% vs 52.2% in May, and export orders declined for the third month running, plus at a steeper rate (45.4% vs 47.6%), while employment contracted further (48.0% vs 48.9%). China's counter-cyclical trends can be attributed to lower-level covid-related pent-up demand, but also to global supply bottlenecks and higher commodity prices.

In a sign of further reform, Beijing is planning to loosen capital controls on household savings (which are sizeable as a % of GDP, specifically double that of advanced economies), increasing the amounts and flexibility. Further, in June, the government approved record amounts of money to flow out of the country through an official investment quota. It is also on the verge of launching a program with Hong Kong, called Wealth Connect, that will allow households in southern China to invest overseas.

Outlook

The outlook for global economic growth remains strong, with room to run. After the bounce from pent-up consumer spending inevitably fades, we expect government and business spending to pick up the baton. Inflation worries are likely to contribute to financial market jitters, but it will require significant persistence to shift central banks towards withdrawal of monetary stimulus.

In the short-term, corporations are executing and capitalizing on the robust demand environment with much of the re-opening still ahead. Excess cash levels, held by US consumers remain near $2 trillion, boosted by unemployment benefits, job growth, and child tax credits. Additionally, from a monetary stimulus perspective, there is still circa $720 billion of liquidity to come from the Fed through year-end, plus a similar amount stemming from the ECB, with much of it likely to gravitate towards equities. Thereafter, a healthy consumption outlook and fiscal stimulus should continue to boost demand.

Equities can likely maintain their momentum in such a scenario. Expectations for full year S&P 500 index earnings growth have risen to +36.7% (vs 24.4% at the start of the last earning season), with second quarter forecasts depicting +68.5%, albeit off the pandemic lows. The last time the index delivered year-over-year earnings growth of similar magnitude was in 2010 (+38.0%). With the S&P 500 index ending the period trading at roughly 20x 2022 consensus earnings, seasoned investors may argue that the market has discounted a fair amount of positive news. We would counter that the environment has become more interesting for stock pickers and less so for indexers, especially considering the level of investor complacency and the propensity for future bouts of volatility. It is interesting to note that outside of Energy, Airlines, Travel and Leisure, most sectors were already growing earnings off the 2019 base in the second half of 2020. Value stocks have outperformed growth equities so far this year and we believe this rotation is still in its infancy, especially if inflation leads to higher bond yields. We also believe that overseas equity markets are attractive. European stocks have the potential to begin closing their multi-year valuation gap versus the US. Similarly, Asian economic growth and the attractiveness of local shares remains intact.

With regard to fixed income markets, we forecast a fair amount of relative volatility given the uncertainty surrounding inflation and the discounting of eventual central bank reactions. As such, we reiterate our conservative posture, urging investors to avoid long duration bonds in favor of inflation adjusted securities, and consider that an allocation to alternatives could help increase portfolio resilience.

Given strong economies, rebounding corporate profits and the potential for higher corporate taxation in the US, merger activity is poised to achieve record volumes in 2021. With trillions of cash and cheap debt financing available, the environment bodes well for buyouts of smaller capitalization value equites and, in turn, the strategy of merger arbitrage. We also maintain a positive view of hedged credit, as well as inflation protected investments such as real estate, and water infrastructure. As long-term investors, with the belief that technology will advance secularly, we continue to highlight our proprietary Nordic Technology and Innovation Fund.

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.