Irish Life

STOCKS RALLY, BUT BONDS SAG

Despite a sell-off late in the month, global equities enjoyed a strong month in February, boosted by improved growth expectations and a strong fourth-quarter earnings season. Accommodative central banks and President Biden's efforts to pass his $1.9trillion fiscal stimulus package were also a factor in the positive returns. The reflation theme (a view that inflation would increase, weighing on bonds and helping 'value' stocks) captured markets late in the month and forced a sell-off in fixed income assets. US and European government bonds sold off, with German yields (which move inversely to price) pulled higher by rising US Treasury yields. The announcement that Mario Draghi would form a new government in Italy supported spreads in peripheral European bonds.

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Are better times coming?

The global economy should grow more than expected in 2021, aided by substantial US fiscal stimulus, and increasing optimism on containment of Covid-19. Fourth-quarter GDP numbers have been better than expected, providing a strong base for recovery.

Fourth-quarter earnings are encouraging

The fourth-quarter earnings season has also been much stronger than expected, with earnings per share (EPS) surprises running at +18% in the US and +10% across the Europe. At a sector level, energy and industrials have done poorly, while technology stocks fared better. In total, 93% of S&P 500 companies have reported fourth-quarter earnings, with 78% beating EPS estimates.

Political relief in Italy, but US divisions remain

On the political front, there continued to be discord between the Democrats and Republicans, with the House of Representatives passing President Biden's Covid-19 stimulus package without Republican support. The bill will now go to the Senate, where it is expected to be fine-tuned before facing a vote. In Europe, Mario Draghi was sworn in as the new Italian Prime Minister following the formation of a new unity government. The move to install the former ECB chief to lead Italy's recovery from the pandemic was viewed favourably by the market.

Vaccine rollout gathers pace

The rollout of vaccines had been slower than expected, due to production and logistical difficulties, but it has ramped up over the past month. There has been a rapid and well-publicised rollout of vaccines in Israel and the UK, which has yielded positive results, but the United Nations warned that more than one hundred countries have yet to administer a single dose. A widespread vaccination programme is viewed as key to a global recovery from the pandemic, and emerging markets are particularly vulnerable. From a political perspective, the European Commission came under scrutiny due to the slow rollout of Covid-19 vaccines across the bloc. Many blamed this on bureaucracy in Brussels.

CHART OF THE MONTH

US 10-year yield

Source: ILIM, Bloomberg. Data is accurate as at 1 March 2021

Central banks' round-up

The US Federal Reserve (Fed) continued its recent dovish tone, with members indicating that asset purchases would continue at their current pace until a lot more progress was made towards employment and inflation goals. Fed members saw an improvement in the medium-term economic outlook, due to the expected stimulus package. In Europe, the European Central Bank reiterated its stance of supportive monetary policy and stepped up its rhetoric around monitoring higher nominal yields. The Bank of England held rates at 0.1%, but announced preparations for negative interest rates (though stressed it was unlikely to need them). The Bank also gave a positive outlook for the UK economy. However, the market viewed the Bank of England's inflation forecasts as slightly hawkish, which prompted underperformance in long-dated gilts. Several emerging-market central banks have moved in a more hawkish direction recently, due to rising inflation and concerns around financial stability.

MARKET ROUND-UP

Equities

The MSCI AC World equity index rose +2.5% (+2.4% in euro terms). Emerging markets rose +1.0% (+0.9% in euro terms), underperforming due to their sensitivity to rising US yields. Pacific Basin equities rose +2.3% (+3.0% in euro terms), as the prospects for growth looked brighter and commodity prices rose. European equities rose +2.6% (+2.2% in euro terms) as growth expectations improved and investors positioned themselves in value-focused markets in the hopes of outperformance in cyclicals. The US rose +2.6% (+2.7% in euro terms) as Democrats pushed ahead with plans for $1.9bn in additional US fiscal stimulus.

Bonds

Eurozone >5-year bonds fell -2.7%, with the German 10-year yield rising 26 basis points (bps) to -0.26%, pulled higher by US Treasuries. The announcement that Mario Draghi would form a new government in Italy supported spreads in peripheral European bonds; Italian 10-year spreads narrowed by 14bps to 102bps.

Currencies and commodities

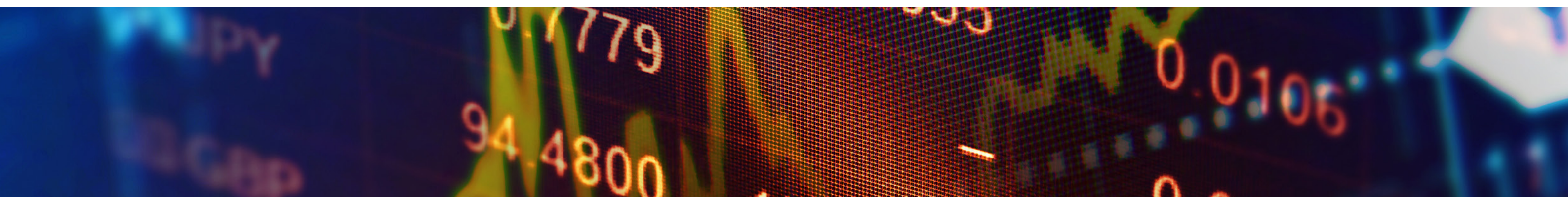
The euro fell against the US dollar to 1.2043, driven by higher US yields. The dollar also benefited from the more 'risk off' environment at month-end. Commodities rose 10.6% (10.7% in euro terms), as strong manufacturing demand and supply-side constraints pushed prices higher. West Texas Intermediate (WTI) oil rose 17.8% as global growth expectations continued to be revised upwards. Gold fell -6.1%, negatively affected by rising real interest rates and a stronger US dollar.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	0.74	-2.26	5.97
MSCI United Kingdom	3.69	4.18	-17.83
MSCI Europe ex UK	2.22	1.11	2.43
MSCI North America	2.84	2.61	10.64
MSCI Japan	1.61	1.31	5.42
MSCI EM (Emerging Markets)	0.86	4.72	8.89
MSCI AC World	2.44	2.72	7.18
10-Year Yields	**Yield Last Month (%)**	**2020 Yield (%)**	**2019 Yield (%)**
US	1.40	0.91	1.92
Germany	-0.26	-0.57	-0.19
UK	0.82	0.20	0.82
Japan	0.16	0.02	-0.02
Ireland	0.10	-0.30	0.11
Italy	0.76	0.54	1.41
Greece	1.11	0.63	1.43
Portugal	0.32	0.03	0.43
Spain	0.42	0.05	0.46
FX Rates	**Current**	**2020 Rates**	**2019 Rates**
US Dollar per Euro	1.21	1.22	1.12
British Pounds per Euro	0.87	0.90	0.85
US Dollar per British Pounds	1.39	1.37	1.33
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2020 Return (%)**
Oil (WTI)	17.82	26.75	-20.54
Gold (Oz)	-6.15	-8.46	24.40
S&P Goldman Sachs Commodity Index	10.58	16.05	-23.72

Source: ILIM, Bloomberg. Data is accurate as at 1 March 2021



THE ILIM VIEW – LOOKING AHEAD

The outlook for equity markets over the next 12 months depends on several factors, including the evolution of Covid 19, the scale of recovery from the 2020 recession and the level of stimulus provided by global authorities.

While equity markets are expensive in absolute terms, they remain very attractive in relative terms, given the low yields available on assets such as bonds and cash. The current low level of bond yields justifies higher-than-average valuations in equities. We believe global equities can trade on a 12-month forward price-to-earnings (PE) multiple of 18.5–19 times at the end of 2021. With the global economy in the initial stages of a new cycle and strong economic and earnings growth forecast over the next two years, upside of at least mid-to-high single digits in global equities is expected over the next 12 months.

Potential risks to the positive outlook include a resurgence in Covid-19 cases and a failure to contain the virus; vaccines proving to be ineffective in treating new variants, which would threaten the improving growth backdrop; fiscal and monetary support being reduced; or a significant rise in bond yields, which would diminish the relative valuation case for equities. The probability of these occurring is viewed as being low. But volatility could remain a feature in markets if any of these issues become a cause for concern over the course of 2021.

THE MONTH AHEAD

Economic data releases

1 March	China Caixin Manufacturing PMI (February) Italy Government Budget
4 March	Australia balance of trade (January) Japan consumer confidence (February)
5 March	Canada balance of trade (January) US non-farm payrolls (February) US balance of trade (January)
9 March	Australian business confidence (February) Germany balance of trade (January)
10 March	China inflation rate (year on year, February) US inflation rate (year on year, February) US core inflation rate (year on year, February)
12 March	UK balance of trade (January)
16 March	US retail sales (month on month, February) Japan balance of trade (February)
17 March	Canada's inflation rate (year on year, February) US Fed interest rate decision
18 March	Japan's inflation rate (year on year, February)
19 March	UK consumer confidence (March)
22 March	China one-year loan prime rate
24 March	UK inflation rate (year on year, February)
25 March	German consumer confidence (April)
26 March	US personal spending (month on month, February)

Political events to watch

China's National People's Congress, Dutch general election, and the UK budget.

Source: ILIM, Trading Economics. Data is accurate as at 1 March 2021

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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