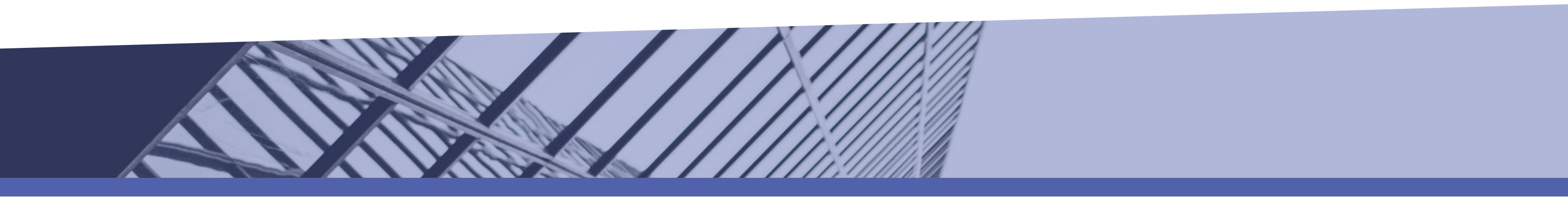

EQUITIES RISE, WHILE INFLATION FEARS WEIGH ON BONDS

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Equity markets started the year on the front foot, given optimism around vaccines, more US fiscal stimulus measures and hopes that economies reopening and pent-up demand would propel global growth higher. Upward revisions to growth and earnings forecasts boosted markets, as did confirmation by the Federal Reserve that accommodative monetary policy would be maintained through 2021. As the quarter progressed, inflation became a key topic of debate following the revisions to global growth and higher inflation expectations. Global bond markets were volatile because of the perceived risk of inflation, after the significant fiscal stimulus passed by the Biden administration. This forced a sell-off in government bonds and a correction in equities as bond yields rose across the US and other regions. Despite some hiccups, equity markets generally took the rates sell-off in their stride, as yields were seen to be rising for the right reasons, due to the market expecting a solid recovery in the global economy through 2021 and in 2022.

Biden takes office and goes big on stimulus

In January, the Democrats won both Senate seats in the run-off elections in Georgia, boosting expectations of economic growth in the US. With control of the Senate, President Biden announced plans for another stimulus programme, totalling $1.9 trillion. President Biden had hoped to pass the bill on a bi-partisan basis, but Republican support was not forthcoming, with Senate Republican leader Mitch McConnell opposing the plan. Congress eventually passed a $1.9 trillion fiscal programme without Republican support in March. It included a payment of $1,400 to those earning less than $75,000 per annum and a supplementary unemployment benefit of $300 per week, to be paid until September. President Biden also announced plans for an additional $2.2 trillion infrastructure programme, ideally to be passed by the autumn and implemented over 10 years. This too would boost growth and the productive capacity of the US economy in future. The US government plans to partly fund it by higher corporate taxes, although the US equity market appeared to give more weight to the positive growth implications of the package than the increased tax burden for US corporations.

Covid-19 vaccines rolled out at pace

The vaccine rollout across the UK, Israel and the US gathered pace early in the new year, although the European rollout lagged due to supply issues. As the quarter progressed, global Covid-19 cases numbers declined as the situation improved in many of the worst-affected countries. But in late March, some areas – particularly in Europe – saw cases on the rise once again, as authorities faced more transmissible variants of the infection. Lockdowns were enforced in Germany, large parts of Italy and regionally in France.

Despite this, investors remained optimistic, focusing on news flow relating to vaccination progress, which has generally been positive. The manufacture and supply of vaccines is expected to significantly increase through the second quarter, enabling a sharp acceleration in vaccine rollout, particularly in Europe, which has lagged other regions to date. The ongoing decline in case numbers and substantial reduction in hospitalisations in regions which have achieved high vaccination levels provides confidence that economic reopening will be possible as inoculation rates rise.

CHART OF THE QUARTER

US 10-year yield

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2021.

Central banks' round-up

The Fed kept interest rates unchanged, confirming that accommodative monetary policy would be maintained through 2021. The minutes for the January meeting noted that the economy is still far from the Fed's employment and inflation goals. Substantial further progress is required in both before policymakers will find it appropriate to raise rates. While a temporary rise in inflation is expected in the coming months, the Fed has indicated that it is willing to look through this – it will not consider tightening policy in response to this temporary rise in inflation. Elsewhere, the European Central Bank indicated that it would significantly increase its pace of bond buying over the next three months, in response to the recent rise in sovereign bond yields. It also highlighted that it could increase the overall size of its Pandemic Emergency Purchase Programme, if required. These moves were received well by the market and are expected to cap further upside in yields, at least in the near term. Meanwhile, the Bank of England left rates unchanged but noted positive recent developments in global growth expectations. On the economic outlook, the meeting minutes struck an upbeat note, echoing Governor Bailey's hint that the bank could upgrade its forecasts in May. Overall, the bank's comments were seen as setting the stage for a shift towards tighter policy guidance in coming months.

MARKET ROUND-UP

Equities

Over the quarter, the MSCI AC World equity benchmark rose 6.0% (9.0% in euro terms). Emerging markets rose 4.0% (6.5% in euro terms), as the stronger US dollar, fears around a Covid-19 resurgence in some emerging markets and rising yields caused concern in some regions. Pacific Basin equities rose 5.8% (8.9% in euro terms), supported by strong commodity prices. Europe outperformed, rising 8.4% (7.9% in euro terms) as it benefited from reassuring language from the ECB, a weaker euro (which is positive for exporters) and Europe's tilt to 'value' stocks, which fared well over the quarter. The UK performed well too, rising 5.2% (10.6% in euro terms), reflecting the success of the vaccine rollout and the removal of the Brexit uncertainty that hung over markets since 2016.

Bonds

The ICE BofA Merrill Lynch Eurozone > 5-year sovereign bond benchmark fell -3.3%. German 10-year yields (which move inversely to prices) rose to -0.29% in sympathy with US Treasuries. Eurozone yield increases were capped in March, as the ECB indicated that it would increase the pace of asset purchases through the second quarter to ensure financial conditions remained favourable across the bloc. Peripheral spreads narrowed across Italy and Portugal, with spreads widening marginally in Spain. Italian spreads narrowed as political tensions abated following the formation of a new government led by former ECB chief Mario Draghi. By quarter-end, Italian 10-year spreads against Germany were down to 96 basis points (bps) from 111bps at year-end; Spanish spreads were 63bps, having been 62bps at year-end; while Portuguese spreads were 52bps, down from 59bps at year-end.

European investment-grade corporate bonds fell -0.7% with high-yield credit performing better; it fell by -0.3%. Volatility in credit spreads has been low recently, despite large moves in government markets. Ongoing monetary policy support and the reach for yield has supported credit markets in recent months.

Currencies and commodities

The euro fell against the US dollar to 1.1750, due to the ongoing rise in US yields and an indication by the ECB that it will increase bond purchases over the next three months in an effort to limit the tightening of financial conditions evident through higher yields.

Commodities rose 13.5% due to their sensitivity to global growth expectations. Oil performed well in the first quarter, but gains were pared in March. Brent crude started the year just above USD50/bbl and rallied through January and February to a high of around USD71/bbl. This move higher was supported by signs of cohesion in OPEC+ and optimism around demand, given the successful rollout of many Covid-19 vaccination programmes. However, the second half of March was more challenging, as concerns around demand meant that oil pulled back from its highs. Gold fell -10.0%, negatively impacted by the ongoing rise in US real interest rates and the stronger US dollar.

MARKET SNAPSHOT

Market returns

Equity indices (€)	QTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	9.82	9.82	5.97
MSCI United Kingdom	10.56	10.56	-17.83
MSCI Europe ex UK	7.89	7.89	2.43
MSCI North America	10.02	10.02	10.64
MSCI Japan	5.88	5.88	5.42
MSCI EM (Emerging Markets)	6.54	6.54	8.89
MSCI AC World	8.98	8.98	7.18
10-year sovereign bond yields (€)	**Yield last month**	**2020 Yield (%)**	**2019 Yield(%)**
US	1.74	0.91	1.92
Germany	-0.29	-0.57	-0.19
UK	0.85	0.20	0.82
Japan	0.10	0.02	-0.02
Ireland	0.06	-0.30	0.11
Italy	0.67	0.54	1.41
Greece	0.87	0.63	1.43
Portugal	0.23	0.03	0.43
Spain	0.34	0.05	0.46
Commodities ($)	**QTD Return (%)**	**YTD Return (%)**	**2020 Return (%)**
Oil (WTI)	21.93	21.93	-20.54
Gold (Oz)	-9.63	-9.63	24.40
S&P Goldman Sachs Commodity Index	13.55	13.55	-23.72
FX rates	**Current**	**2020**	**2019**
U.S. dollar per euro	1.18	1.22	1.12
British pounds per euro	0.85	0.90	0.85
U.S. dollar per British pounds	1.38	1.37	1.33

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2021.

ECONOMIC OUTLOOK

Global growth expectations have accelerated since the turn of the new year, due to new US stimulus measures, accommodative central banks and the ongoing vaccine rollout. Equity markets have been positive, but volatility has remained a feature. Markets came into the year on the back of all-time highs and continued in this vein through the opening quarter, boosted by further US fiscal stimulus, strong fourth-quarter earnings and upgrades to global growth forecasts, supported by the vaccine rollout. However, equities experienced several modest pull-backs as government bonds sold off.

The outlook for equity markets over the next 12 months depends on several factors, including the evolution of Covid-19, the scale of the global vaccine rollout 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 (P/E) ratio of 18.5–19.0 times at the end of 2021. With the global economy in the initial stages of a new cycle and with strong economic and earnings growth forecast over the next two years, upside of 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 supports being reduced or further significant rises in bond yields, which would diminish the relative valuation case for equities. The probability of these occurring is viewed as being low. Volatility, however, will likely remain a feature in markets if any of these issues become a cause for concern over the course of 2021.

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2021.

THE MONTH AHEAD

Economic data and events to watch

1 April	China Caixin Manufacturing PMI (March) Australia balance of trade (February)
2 April	US non-farm payrolls (March)
6 April	Australia interest rate decision
7 April	Canada balance of trade (February) US balance of trade (February) US federal open mark committee decision
8 April	Japan consumer confidence (March)
9 April	China inflation rate (year on year, March) Germany balance of trade (February)
13 April	Australian business confidence (March) UK balance of trade (February) US inflation rate (year on year, March) US core inflation rate (year on year, March)
14 April	Australia Westpac consumer confidence (April)
15 April	US retail sales (month on month, March)
19 April	Japan balance of trade (March)
20 April	China one-year loan prime rate German consumer confidence (May) UK claimant count change (March)
21 April	UK inflation rate (year on year, March) Canada's inflation rate (year on year, March)
23 April	UK Gfk consumer confidence (April)
24 April	Japan's inflation rate (year on year, March)
26 April	US durable goods orders (month on month, March)
27 April	BoJ interest rate decision
28 April	US Fed interest rate decision US Fed press conference
29 April	US GDP growth rate (year on year, quarter one)
30 April	China NBS manufacturing PMI (April) Japan consumer confidence (April) US personal spending (month on month, March)

Political events to watch

India's various state elections, Peru general election and IMF Spring meeting

Source: ILIM, Bloomberg. Data is accurate as at 31 March 2021.

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