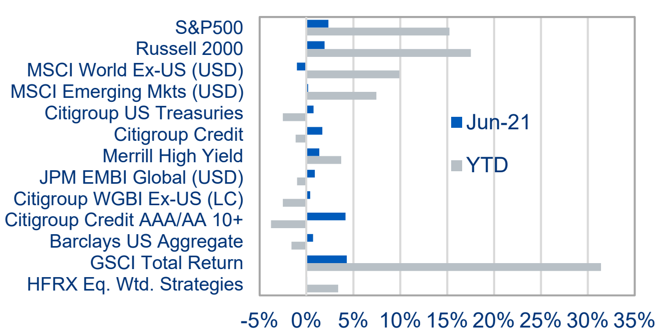
Global Market Review

Macro Summary

U.S. equities rose in June adding to already substantial gains. Non-U.S. equity markets fared less well, however, as advanced economy markets declined and emerging market equities were little changed. Signs that the record-breaking pace of the post-pandemic rebound in U.S. economic activity would continue contributed to the sustained rise in U.S. equity markets. Demand surges and supply bottlenecks have contributed to isolated price spikes and incipient inflationary pressures. However, the unexpectedly hawkish tone struck by the June FOMC meeting reassured markets that these pressures would likely be temporary, contributing to declining long-term yields. U.S. Treasury securities enjoyed strong price gains, but the prices of non-U.S. sovereigns fell as real yields rose. Commodity prices are up over 30% so far this year, spurred by the high demand for oil and industrial metals from a recovering global economy.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



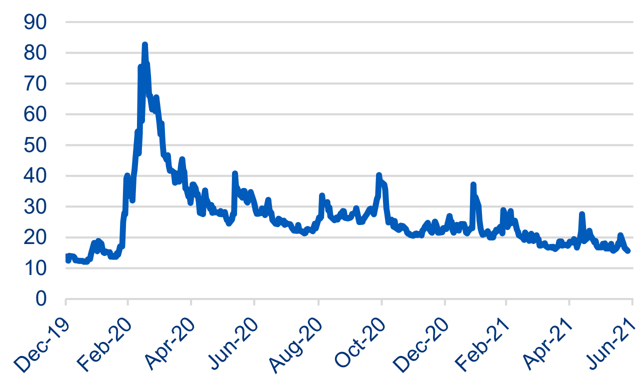
U.S. equity markets post further strong gains.

Steady Ascent of U.S. Equities Continues

U.S. equity markets rose in five of the first six months of 2021, bringing the cumulative gain on the S&P 500 index to 15.3%. This steady ascent has contributed to stretched equity valuations coupled with a decline in the VIX. This key measure of near term expected equity market volatility calculated using options prices has fallen to its lowest level since the pandemic began (Exhibit 1). The low level of volatility implied by options markets despite rich valuations does not appear to connote investor complacency, however. The skew index, a measure of the cost differential between options used to protect against equity market falls and those used to benefit from price rises, hit a record high in June, suggesting that at least some investors are seeking protection from a possible equity market correction notwithstanding relentless equity market gains.

Exhibit 1. Implied Volatility Falls amid Steady Equity Rise

Source: Bloomberg. VIX volatility index.



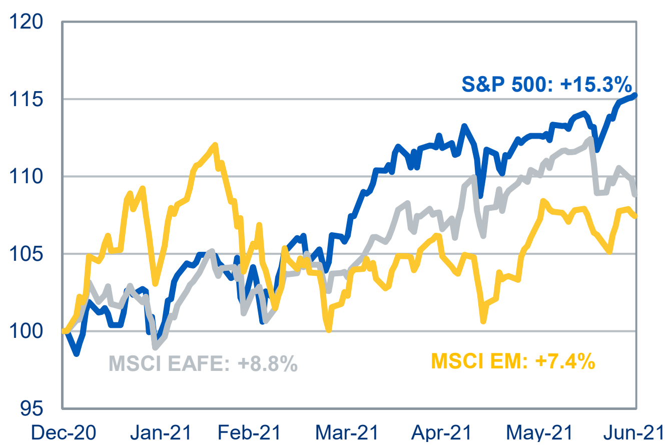
Within the U.S. equity market, value stocks, which have handily outperformed growth so far this year, declined 1.1% in June while growth stocks, including in particular large cap growth stocks in the tech sector, rebounded 6.2%. Despite this reversal of fortune in June, value stocks are up 17.7% in the first six months of the year, compared with the 12.7% increase in growth. Tech stocks led all other sectors in June, rising 7.4% followed by stocks in the energy sector, which gained 4.3% in June. In the first six months of the year, energy sector stocks are up 41.6% propelled by a surge in demand for oil and other petroleum products to fuel the strong economic rebound.

Non-U.S. Equity Markets Lag the U.S.

Non-U.S. equity markets declined in June, with the MSCI World ex-U.S. index falling about 1%. Both advanced and emerging equity markets fell, notwithstanding the outlook for a continued strong global economic rebound. Concern over the spread of the virulent delta variant of COVID-19 contributed to the retrenchment. For the first half of the year, advanced economy equity markets, as measured by the MSCI EAFE index, are up 8.8%, compared with the 7.4% gain of their emerging market counterparts (Exhibit 2). Among advanced economy regions, European equity markets (+11.8%) have enjoyed the strongest gains so far this year. Emerging equity markets have been led by bourses in the EMEA region (Europe, the Middle East and Africa), while China and other emerging Asian markets have lagged.

Exhibit 2. Non-U.S. Equity Markets Lag U.S. so far in 2021

Source: Bloomberg. Index December 31, 2020 = 100.



Fed's Hawkish Tone Soothes Inflation Fears

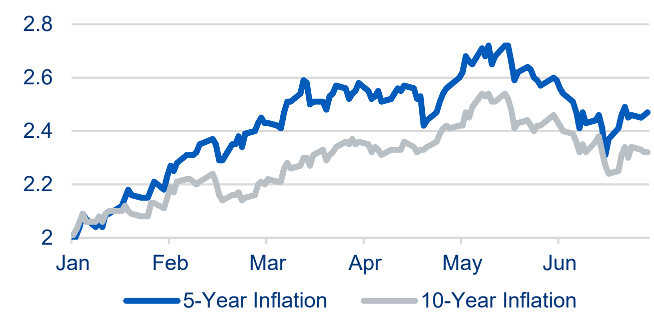
Concern over the risk of inflation has been mounting in recent months. Capacity constraints, supply bottlenecks, stubbornly high job vacancy rates, and rising wage and input prices all paint a picture of an economy running hot as it speeds out of a deep recession. Against this backdrop, markets were relieved by the more hawkish than expected tone adopted by the June FOMC. The FOMC's median forecast for the Fed Funds rate now projects two rate hikes in 2023, up from zero hikes in the projections of the March meeting. Immediately following the meeting, inflation expectations fell and ended the month well below the peak levels of May when inflation fears were most acute. Market derived inflation expectations over 5- and 10-year horizons continue to point to relative price stability. Average inflation expectations over a 10-year horizon have been consistently below the 5-year average, suggesting market expectations that price pressures are likely to be transitory (Exhibit 3).

Reflecting this dynamic, U.S. Treasuries with maturities of 10 years or more gained 3.9% in June, while the index of Treasuries with maturities between 1-10 years was little changed. U.S. credit markets also rose in June as spreads on investment grade and high yield bonds narrowed further, approaching all-time lows. As was the case with the U.S. equity market, the implied volatility of U.S. credit markets declined to low levels in June, while the volatility skew hit an all-time high, indicating that the price of protection against a credit market decline was at a premium.

In contrast to the U.S., advanced economy sovereign bonds fell 2.1% in June, to bring their decline in the first half of the year to 6%, with the bulk of the decline reflecting rising real yields. Emerging market sovereign bonds rose modestly in June, but remain down 1% so far in 2021.

Exhibit 3. Inflation Expectations Remain Well Anchored

Source: U.S. Treasury Department. Inflation expectations measured by the difference between the yield on U.S. Treasuries and TIPS.



Hedge Funds Tread Water

Hedge funds rose 0.1% in June, bringing their gains for the year to 3.3%. Equity Hedge continued to lead other strategies gaining 1.2% in June, bringing the sub-strategy's gain to 7.9% so far in 2021. Return dispersion among sub-strategies persists with Fixed Income and Global Macro strategies continuing to lag the aggregate benchmark through June.

Commodity Prices Soar

The heavy demand for raw materials fueled by the rapid global economic recovery has driven commodity prices up over 30% so far in 2021. Oil prices rose 10.8% in June, bringing the gain for the year to over 50%. Industrial metals and food prices have also soared this year as commodity producers have struggled to meet surging demand. Although higher commodity prices have bolstered commodity-exporting countries, other emerging market economies have experienced rising inflationary pressure, a development that limits their latitude to pursue expansionary policies.

Performance of Major Market Indices through 06-30-2021

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	2.3%	8.5%	15.3%	40.8%	18.7%	17.6%
Russell 2000	1.9%	4.3%	17.5%	62.0%	13.5%	16.5%
MSCI World Ex-US (USD)	-1.0%	5.6%	9.9%	33.6%	8.6%	10.4%
MSCI Emerging Mkts (USD)	0.2%	5.0%	7.4%	40.9%	11.3%	13.0%
Citigroup US Treasuries	0.8%	1.9%	-2.5%	-3.2%	4.6%	2.2%
Citigroup Credit	1.7%	3.5%	-1.2%	3.4%	7.7%	4.8%
Merrill High Yield	1.4%	2.8%	3.7%	15.6%	7.2%	7.3%
JPM EMBI Global (USD)	0.9%	3.9%	-1.0%	6.8%	6.5%	4.4%
Citigroup WGBI Ex-US (LC)	0.4%	0.0%	-2.5%	-1.0%	2.3%	1.1%
Citigroup Credit AAA/AA 10+	4.2%	7.1%	-3.8%	0.5%	10.9%	6.2%
Barclays US Aggregate	0.7%	1.8%	-1.6%	-0.3%	5.3%	3.0%
GSCI Total Return	4.3%	15.7%	31.4%	57.4%	-2.7%	1.7%
HFRX Eq. Wtd. Strategies	0.1%	1.7%	3.4%	10.6%	3.3%	3.4%