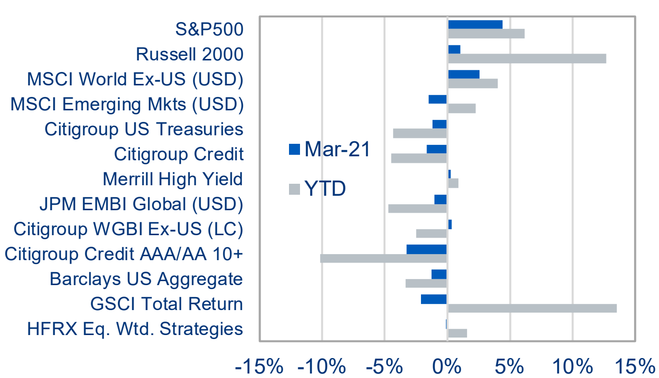
Global Market Review

Macro Summary

Rising interest rates, increased inflation expectations, and a steepening yield curve have been the main manifestations of market expectations for resurgent economic growth fueled by fiscal stimulus, continued monetary ease, and the unleashing of pent up demand as more and more people are vaccinated. Against this backdrop, sovereign and investment grade corporate bonds lost ground in the first quarter, while high yield bonds and global equity markets rose. Supported by widening yield differentials, the U.S. dollar has appreciated against most currencies so far this year. Commodities, especially oil and industrial metals, led other asset classes in the first quarter fueled by the prospect of reflation. One year after the pandemic trough, global equities are up 55%, while 10-year U.S. Treasury yields are 107 basis points higher.

Performance of Major Market Indices

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



Reflation hopes buoy equities but sink bonds.

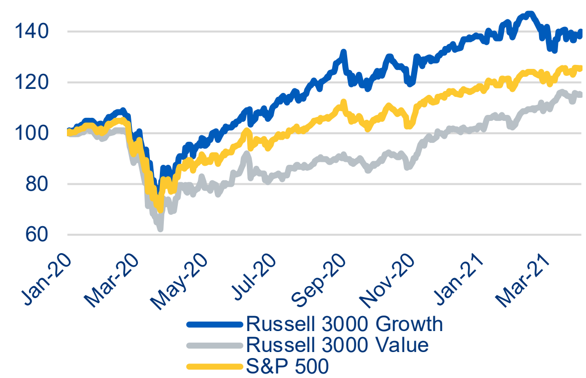
One-Year on from the Pandemic Trough

U.S. equity markets continued their strong rally in March, bringing the gain of the S&P500 index to 6.2% in the first quarter. Since the pandemic trough in March 2020, U.S. equities, as measured by the S&P500, are up 56.4%, driven by a heady mix of mounting optimism and massive stimulus.

So far in 2021, there has been a notable rotation from large-cap growth stocks to their smaller cap, value counterparts. The Russell 3000 Value Index rose 11.9% in Q1, compared with a 1.2% gain for growth stocks. The Russell 2000 index of small cap stocks has outpaced large caps by a wide margin (up 12.2% vs. 5.9%). From the pandemic trough of one year ago, growth and value shares are up 64.3% and 58.4%, respectively, while small cap stocks have gained 94.8% versus the 60.6% increase of large cap shares (Exhibit 1). Across sectors, energy has generated particularly strong returns over the past 3 and 12 months reflecting the spike in oil prices.

Exhibit 1. Strong Equity Rebound from Pandemic Trough

Source: Bloomberg. Index December 31, 2019 = 100.



Although prospects generally appear bright for the U.S. economy and equity market, there are signs of froth and potential vulnerability. These include lofty equity market valuations, hyperactivity by retail investors, hidden pockets of leverage, a boom in mergers and acquisitions, rising debt levels, as well as supply bottlenecks and mounting input price pressures. Global M&A volumes in Q1 rose to their highest level in four decades. The abundance of capital fueling the buying binge has reduced investor caution and inflated the prices of deals. IPO volumes, fueled by the SPAC boom, were also extraordinarily high, following a record year in 2020.[1]

1. Jay Ritter, University of Florida

1001 Nineteenth Street North
16th Floor
Arlington, VA 22209 USA

+1 703.243.4433 TEL
+1 703.243.2266 FAX

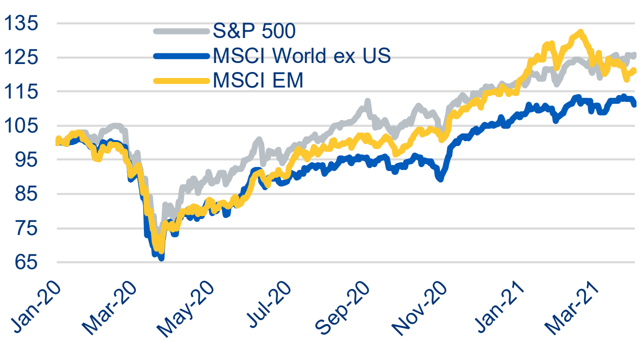
strategicgroup.com

Non-U.S. Equity Markets Face Mixed Prospects

Non-U.S. equity markets have rebounded strongly from the pandemic lows of a year ago, although the outlook across economies is mixed with increasing signs of a divergence in the pace of recovery across economies. The rebound in Europe has been considerably more modest than in the U.S., and Japan and is now threatened by renewed lockdowns in the face of another wave of contagion. Nevertheless, advanced economy equity markets are up modestly so far this year, with the MSCI World Ex-U.S. index of non-U.S. developed equity markets gaining 4% in Q1, bringing its 12-month gain to 45.9% from pandemic lows (Exhibit 2).

Exhibit 2. Non-U.S. Equities Rebound from COVID Lows

Source: Bloomberg. Index December 31, 2019 = 100.

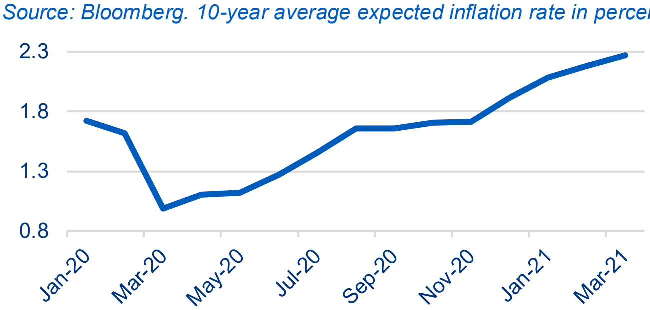


Emerging equity markets lagged their developed counterparts, with the MSCI emerging markets index gaining 2.3% in Q1. Emerging markets in the EMEA region led others, rising by 7.3%, compared with the 1.9% advance of Asian emerging equities and the decline of 6.1% of Latin American bourses. Rising U.S. bond yields increased investor anxiety over the stability of emerging economies burdened by heavy debt loads. Brazil, Mexico, Turkey, Russia, and South Africa appear particularly susceptible to destabilizing debt dynamics. Brazil's central bank is raising interest rates to dampen inflationary pressure. In Turkey, the lira fell to near its all-time low following the firing of the central bank governor and deputy governor in favor of more malleable replacements who share President Erdogan's eccentric views on monetary policy.

Growth, Stimulus, Inflation, and Yields

Exhibit 3. Inflation Expectations Rise

Source: Bloomberg. 10-year average expected inflation rate in percent.



The prospect of a rapid acceleration of growth and signs of incipient inflationary pressure caused the U.S. yield curve to steepen, nominal and real yields to rise, and market-implied inflation expectations to increase (Exhibit 3). Reflecting these dynamics, U.S. Treasuries declined across the maturity spectrum. The index of U.S. Treasuries having maturities of 10-years or more fell 13.8% in Q1, the largest quarterly plunge since 1980. Investment grade corporate bonds also lost ground (-3.5%), with longer-term bonds falling most (-10.2%). High yield bonds, in contrast, eked out a small gain reflecting their shorter duration and the cushion of wider credit spreads.

Bond markets outside of the U.S. also suffered losses, with the WGBI ex-U.S. index of investment grade sovereign bonds falling 6.4% so far this year. Nevertheless, the real yield on a wide swathe of European sovereign bonds remained negative, reflecting continued ECB intervention and the concerns about the resilience of the economic recovery.

Hedge Funds Tread Water

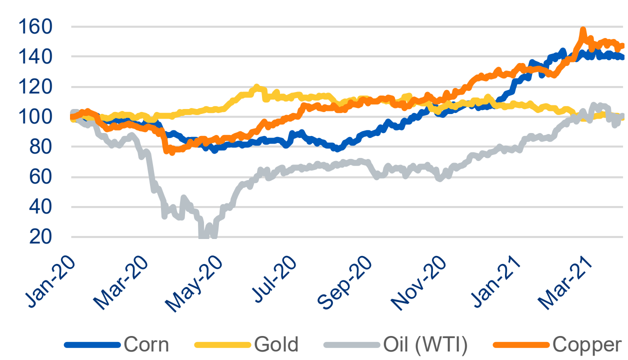
Hedge funds were little changed in March, bringing gains so far this year to 1.6%. Equity long short and equity market neutral strategies have been the best performing, rising 2.7% and 2.5%, respectively.

Oil and Industrial Metals Soar

Resurgent demand and supply bottlenecks have pushed industrial metals and agricultural prices higher. This performance suggests that the recovery will be bumpy until production and transport rustiness wears off. Oil, which suffered the largest losses in the wake of the pandemic, is up 188.9% in the 12 months through March. Gold prices, in contrast, have fallen from record highs last year (Exhibit 4).

Exhibit 4. Global Recovery Buoys Commodity Prices

Source: Bloomberg. Index December 31, 2019 = 100.



Performance of Major Market Indices through 03-31-2021

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	4.4%	6.2%	6.2%	56.4%	16.8%	16.3%
Russell 2000	1.0%	12.7%	12.7%	94.8%	14.8%	16.4%
MSCI World Ex-US (USD)	2.6%	4.0%	4.0%	45.9%	6.3%	8.9%
MSCI Emerging Mkts (USD)	-1.5%	2.3%	2.3%	58.4%	6.5%	12.1%
Citigroup US Treasuries	-1.2%	-4.3%	-4.3%	-4.4%	4.0%	2.2%
Citigroup Credit	-1.7%	-4.5%	-4.5%	8.6%	6.1%	4.8%
Merrill High Yield	0.2%	0.9%	0.9%	24.1%	6.5%	7.9%
JPM EMBI Global (USD)	-1.0%	-4.7%	-4.7%	14.3%	3.9%	4.7%
Citigroup WGBI Ex-US (LC)	0.3%	-2.5%	-2.5%	0.2%	2.2%	1.7%
Citigroup Credit AAA/AA 10+	-3.2%	-10.2%	-10.2%	0.2%	7.7%	5.9%
Barclays US Aggregate	-1.2%	-3.4%	-3.4%	0.7%	4.7%	3.1%
GSCI Total Return	-2.2%	13.5%	13.5%	50.2%	-4.9%	1.2%
HFRX Eq. Wtd. Strategies	0.0%	1.6%	1.6%	15.6%	2.8%	3.4%