Strategic Investment Group®

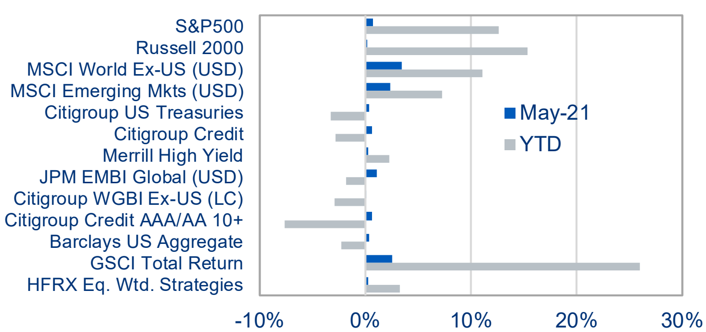
Global Market Review

Macro Summary

Widespread optimism for a strong global economic rebound was dampened somewhat by concerns that incipient price pressures might presage more sustained inflation and the need for central bank tightening ahead. The vacillating market response to rising input prices, mounting job vacancies, and supply bottlenecks reflected uncertainty over whether these were isolated glitches to be expected in an economy rapidly emerging from a deep slump or harbingers of a sustained burst of generalized inflation. Despite this uncertainty, global equity markets made modest gains in May, following April's blockbuster returns. Bond markets also rose and market-based indicators of inflation expectations suggested that price pressures were likely to be short-lived. Rising global demand and recovering manufacturing production sent commodity prices sharply higher. The dollar fell against most major currencies.

Performance of Major Market Indices

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



Markets made modest gains in May.

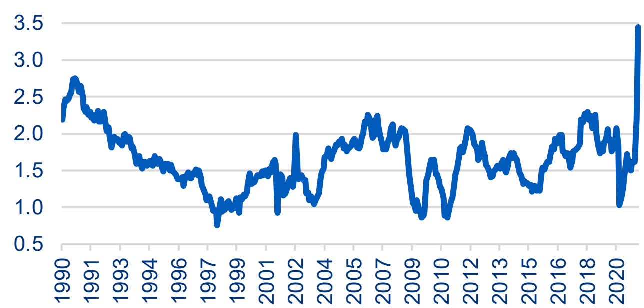
Value Outperforms Growth as Economy Rebounds

The economic backdrop presented a mixed picture. Leading indicators of economic growth suggested a continued strong rebound. The ISM Manufacturing Index rose further in May, with the new orders component of the index rising particularly sharply, pointing to a sustained growth trajectory for the sector. New housing starts, in contrast, fell 9.5% in April as builders delayed new construction in the face of the soaring cost of lumber and other inputs and supply bottlenecks.

There were other signs of an economy rousing itself in fits and starts from its medically induced coma. Job openings surged and layoffs fell to record lows as restaurants and other high-contact services were in high demand following the pandemic's lockdown. Inflation spiked, with headline and core CPI increasing by 4.2% y/y and 3.0% y/y, respectively. The Fed's preferred inflation indicator rose to a 30-year high, exceeding its 2% target by a wide margin (Exhibit 1). Fears that rising inflation might lead the Fed to tighten policy sooner than anticipated clouded otherwise bright prospects for a strong recovery.

Exhibit 1. Inflation Spurt Dampens Optimism

Source: FRED. Core PCE. Percentage change from one year prior.



Despite these concerns, the S&P 500 gained 0.7% in May, following its 5.3% jump in April, to bring the gain so far in 2021 to 12.6%. Concern that rising inflation would lead to higher yields and thus undermine an important pillar of current equity valuations contributed to the muted gain. Within U.S. equities, value stocks continued to outperform growth, gaining 2.5% in May versus a 1.4% decline in growth. So far in 2021, value is up 19% versus growth's 6.2% gain (Exhibit 2). Stocks in the energy and financial sectors led all others in May and are the best performers so far this year.

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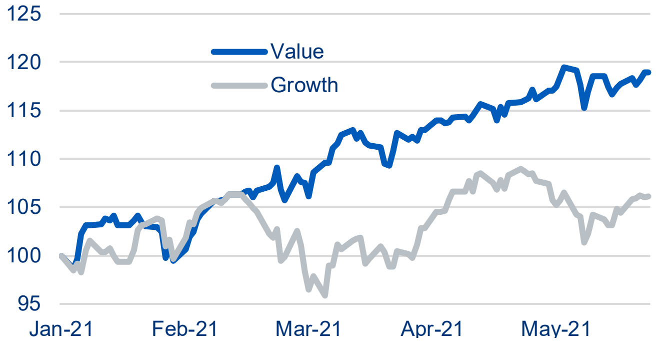
Exhibit 2. Value Continues to Outpace Growth

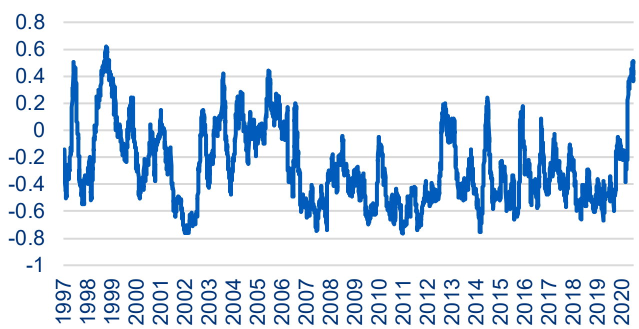
Source: Bloomberg. Index December 31, 2020 = 100.



Rising inflation concerns have contributed to a sharp reversal in the correlation between U.S. stock and bond returns (Exhibit 3). The negative correlation between stocks and bonds that prevailed over most of the past two decades has turned sharply positive and is now at its highest positive level since 1999. If this relationship were to persist, the value of bonds as ballast to a diversified portfolio would be diminished, especially given their current low yields and high valuations.

Exhibit 3. Stock / Bond Correlation at Two Decade High

Source: Bloomberg. Rolling 65-day correlation of stocks and bonds.



Developed Non-U.S. Equities Enjoy Strong Gains

The strong post-pandemic economic recovery is not limited to the U.S. The latest OECD projections point to global output expanding by 6% this year following a 3.5% contraction in 2020. Buoyed by expectations for a strong economic rebound, advanced economy equity markets generated strong gains in May. The MSCI World ex-U.S. index rose 3.8% to bring its gain so far in 2021 to 11.4%. European bourses enjoyed particularly strong gains.

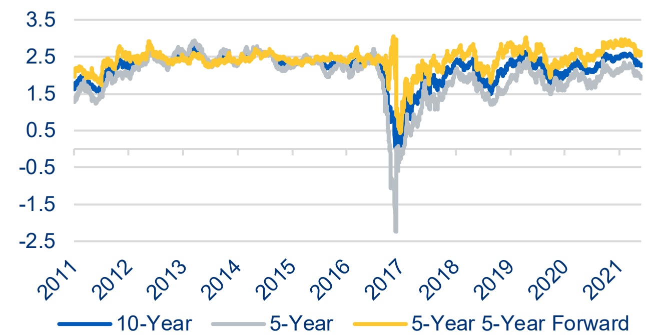
Facing mixed economic prospects and an uneven recovery from the pandemic, emerging economy equity markets posted smaller gains, with the MSCI EM index up 1.2% in May and 6% so far this year. Weighed down by China, Asian emerging equity markets declined in May while bourses in Latin America and EMEA generated gains. So far this year, emerging equities have lagged their advanced counterparts, gaining 6%.

Inflation Expectations Stay Anchored Despite Spurt

Despite the reported inflation spurt, signs of tightening labor markets, rising input, commodity and transport prices, and supply bottlenecks, the yield on the 10-year U.S. Treasury note declined in May and inflation expectations remained unchanged (Exhibit 4). Futures markets continue to price in a near certainty (89%) that the Fed will hold interest rates constant in 2021 and point to mid-2023 for the first hike. Some FOMC members, however, are beginning to consider tapering the Fed's asset purchases. U.S. Treasuries gained 0.3% in May but remain down 3.3% so far this year. 10-year TIPS real yields fell deeper into negative territory in May. U.S. credit markets were up modestly across the credit spectrum, but, like Treasuries, remain down for the year. Bond markets outside of the U.S. also rose in May. The WGBI ex-U.S. index of investment grade sovereign bonds gained 0.8%, but remained down so far in 2021.

Exhibit 4. Inflation Expectations Remain Well Anchored

Source: Fred. Expected average inflation rate.



Hedge Funds Post Muted Gains

Hedge funds rose 0.3% in May, bringing their gains for the year to 3.3%. Equity Hedge continued to lead other strategies gaining 0.8% in May. Return dispersion among sub-strategies persists with Fixed Income and Global Macro strategies lagging the aggregate benchmark.

Strong, Broad-Based Commodity Rally

Commodity prices, led by oil, continue to surge higher. The GSCI is up 26% so far this year, led by a 36.7% increase in oil. Although increased demand from a rapidly recovering global economy is contributing to the sharp price increase, research by Bloomberg suggests that a significant share of the price increase reflects speculative activity in anticipation of even higher commodity prices as the global growth gathers steam.

Performance of Major Market Indices through 05-31-2021

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	0.7%	6.1%	12.6%	40.3%	18.0%	17.2%
Russell 2000	0.2%	2.3%	15.3%	64.6%	13.1%	16.0%
MSCI World Ex-US (USD)	3.5%	6.7%	11.0%	39.6%	8.5%	9.9%
MSCI Emerging Mkts (USD)	2.3%	4.9%	7.3%	51.0%	9.6%	13.9%
Citigroup US Treasuries	0.3%	1.1%	-3.3%	-3.8%	4.4%	2.4%
Citigroup Credit	0.6%	1.8%	-2.8%	3.7%	6.9%	4.9%
Merrill High Yield	0.3%	1.4%	2.3%	15.2%	6.8%	7.2%
JPM EMBI Global (USD)	1.1%	3.0%	-1.9%	9.0%	5.8%	5.0%
Citigroup WGBI Ex-US (LC)	0.1%	-0.4%	-2.9%	-1.0%	2.3%	1.5%
Citigroup Credit AAA/AA 10+	0.6%	2.8%	-7.6%	-1.8%	9.0%	6.2%
Barclays US Aggregate	0.3%	1.1%	-2.3%	-0.4%	5.1%	3.2%
GSCI Total Return	2.5%	11.0%	26.0%	58.6%	-3.6%	0.9%
HFRX Eq. Wtd. Strategies	0.3%	1.7%	3.3%	12.2%	3.2%	3.5%