SEASPRAY PRIVATE
Wealth Management Solutions

Q1
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QUARTERLY INVESTMENT UPDATE: Q1 2021

Executive Summary

Risk assets have seen a broadly positive start to 2021, and while we acknowledge that it has not been a simple and straight forward ride higher for markets, we do note that the S&P500's 'VIX volatility index' at the beginning of April has traded through its lowest price since before the initial pandemic-led equity sell-off. We believe market participants are fully looking through the pandemic at this point and towards a brighter future.

The middle of March marked the one-year anniversary of the transition to the world with Covid-19, a theme that has dominated our investment updates and indeed markets as a whole. This time last year, having just entered our first lockdown in Ireland, very few of us could have predicted the extent of the social, emotional, and economic impact the virus would bring. Fast forward to April 2021, we are in a world with significantly less uncertainty on the virus front, and have essentially witnessed a whole market cycle within a very short and surreal period of time over the past 12+ months. Importantly, there is a definite end in sight, and we are undoubtedly finally starting to see evidence that the economic needle is moving in the right direction.

Executive Summary contd...

The news on the vaccine front has been both positive and well documented by ourselves and by other market commentators. Just in the past couple of weeks we have seen US President Joe Biden state that his administration is now aiming to distribute 200 million vaccine doses in its first 100 days of the rollout, doubling their original goal. Key health metrics are moving in the right direction in both the US and UK, and we are seeing their respective economies begin to slowly reopen – a truly encouraging sign of what is to come for Europe over the next few months and into the summer.

	1 Month	3 Month	YTD	1 Year
Equity Indices				
S&P 500	6.14%	9.42%	8.57%	53.34%
DAX	9.85%	12.08%	11.47%	47.65%
EuroStoxx 50	8.44%	12.23%	12.01%	39.25%
ISEQ	6.47%	10.01%	10.12%	69.77%
FTSE	2.79%	3.16%	5.49%	19.47%
Nikkei 225	2.88%	9.35%	8.21%	56.71%
Multi-Asset Funds				
Aviva Cautious (Risk 3)	0.56%	0.51%	0.45%	12.17%
Irish Life MAPS 3	2.28%	2.98%	2.83%	15.94%
New Ireland iFunds 3	0.64%	0.56%	0.72%	10.99%
New Ireland PRIME 3	1.73%	2.34%	2.17%	9.67%
Zurich Prisma 3	1.63%	2.03%	1.79%	15.11%
Aviva Strategic (Risk 4)	1.88%	3.84%	3.69%	23.88%
Irish Life MAPS 4	3.41%	4.55%	4.19%	20.41%
New Ireland iFunds 4	2.06%	3.19%	3.19%	20.84%
New Ireland PRIME 4	3.29%	5.06%	4.66%	17.51%
Zurich Prisma 4	3.21%	4.27%	3.77%	31.54%
Aviva Dynamic (Risk 5)	2.88%	6.58%	6.37%	34.00%
Irish Life MAPS 5	3.73%	5.67%	5.34%	26.17%
New Ireland iFunds 5	3.53%	6.37%	6.25%	32.75%
New Ireland PRIME 5	4.91%	7.86%	7.32%	25.19%
Zurich Prisma 5	4.66%	6.15%	5.35%	44.77%
Currencies				
EUR/USD	-0.91%	-3.96%	-3.32%	8.42%
EUR/GBP	-0.82%	-5.40%	-4.40%	-3.35%
GBP/USD	-0.06%	1.52%	1.17%	12.13%
USD/JPY	1.97%	7.54%	7.04%	1.61%
Fixed Income				
US 10yr	0.093	0.653	0.776	1.014
Bund 10yr	-0.003	0.277	0.268	0.117
Irish 10yr	-0.021	0.344	0.350	0.321
Gilt 10yr	0.054	0.593	0.610	0.473
Commodities				
Gold	2.19%	-11.19%	-8.41%	3.09%
WTI Crude Oil	-9.62%	19.21%	23.10%	152.77%

Source: Seaspray Private, April 2021

What to watch in Q2.

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1.Interest rates

Recent spikes in bond yields have incited mini 'taper tantrums' in stocks during the first quarter of 2021, mild versions of the 2013 market retreat when yields soared after the Fed hinted at a pullback in easy policy. Stocks may continue to react to rate moves, as low yields on bonds are a key contributing factor to the relative attractiveness of equities. Any sharp bond yield rises could undermine support for equity valuations on a short-term basis.

Importantly, however, today's Fed is not contemplating near-term tightening, as it was in 2013, and interest rates are still very low on a historical basis. While future rate-related equity pullbacks are likely, we expect rates to remain low for some time as central banks globally look to maintain support and see economies to full recovery. Ultimately, rates may only return to the average seen following the 2008 financial crisis, as we see no real structural changes in the economy that would suggest a growth trajectory far different from the pre-pandemic times. This is still a level that we would view as supportive of stocks.

2. Vaccine progress

Markets are priced for positive vaccine news and progress, and while positivity has been and continues to be our base case, any disappointments in vaccine supply, distribution or adoption - or increased risk from virus variants - could stoke some short-term volatility during Q2, in our view.

The Biden administration has indicated that the U.S. will have enough vaccines for all adults by the end of May. Our analysis of data from the major vaccine makers approved so far suggests this is entirely feasible. The UK are on a similar trajectory with the aim to fully reopen their economy by the end of June. The European Union, as we well know, are lagging somewhat, with a slightly less definitive and speedy reopening schedule announced by its member states so far. Efficacy data shows the current vaccines are extremely effective in preventing severe disease and hospitalizations, which is precisely what is needed for economic reopening. The new variants are likely the biggest risk to the restart from a Covid point of view, yet clinical data has shown that current vaccines demonstrate sufficient efficacy against the known mutations – enough to provide immunity and alleviate hospitalizations.

What to watch in Q2.

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3. Company Earnings

Over the last couple of months, we saw Q4 2020 earnings results strongly beat consensus expectations as well as what was mostly conservative company guidance. We generally see this pattern continuing throughout 2021, and while that should be good for the stock market broadly, we don't expect real clarity on the earnings picture until the third or fourth quarter earnings seasons come around.

Economically sensitive sectors and stocks have the most potential to surprise to the upside in our opinion, with the potential to easily beat dismal prior year earnings as these industries struggled through the pandemic. We plan on paying particularly close attention to names within the energy, materials, financials, and industrials sectors. Growth companies that excelled in 2020 will likely find it much harder to exceed prior year levels in this year's earnings results.

Many of the so-called stable sectors that did well in 2020 have poorer earnings momentum. Mega-cap technology stocks, long bastions of stability, also bore the brunt of the recent rates-related pain. Because these large tech stocks are long duration in their cash flow and growth prospects, they reap the greatest benefits from low rates and, in turn, have gotten hurt most as rates normalize upward. We give cyclical stocks and reopening plays in general the advantage for the moment, while remaining watchful for signs of a cycle transition as the recovery moves forward - potentially returning the upper hand to growers. We believe that fundamental active management in this regard continues to offer an edge to our clients in this current environment.

While central bank officials continue to believe that any short-term move higher in inflation will be transitory as a direct result of the year-over-year comparisons in the likes of energy prices, we cannot deny that equity markets have priced in a lot of good news in their rally of recent months, and therefore may be susceptible to some short bouts of volatility over the remainder of the year. We do however maintain our constructive medium to longer term view for risk assets given the continued backdrop of fiscal spending, economic reopening, and ongoing upward earnings revisions. In light of these expectations, we plan to take advantage of equity market pullbacks and to exploit any volatility over the coming months, either at a market or single stock level, as we have done for some time now.

We believe that the continued benefit of our active approach, driven by a strong, coherent, and well-tested investment process should be evident over the course of this year through our clients' returns. We maintain our focus on the medium-term recovery and secular transformation themes. We will continue to seek opportunities to add additional cyclical exposure which should benefit from the next leg of earnings recoveries through 2021.

Global Overview

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We accept that so far, 2021 isn't looking too different from where we ended 2020. But we must reiterate to clients that we do see the second quarter bringing greater global economic re-awakening, underpinning our constructive outlook for risk assets in general. While small rate-related panics are likely, we expect rates to remain low for some time as central banks globally look to maintain support and see economies to full recovery. What do we envisage for the next few months?

- **Economically sensitive stocks continue to lead.**
- **An opportunity to boost value positions.**
- **Bouts of volatility sparked by rate movement.**

Looking beyond Q2 2021, we firmly believe there is a strong basis for a rebound in global economic activity throughout the rest of the year and into next. This week the IMF upgraded its global growth forecast for 2021 in a very significant way, and is now anticipating global growth of 6%, which is 0.5% higher than its December forecast. The upward revision is due to a combination of the vaccine rollout, the US fiscal stimulus package, and considerable pent-up demand in the global economy.

Looking at the US: the $1.9 trillion Biden fiscal stimulus package from the start of the year, combined with the rapid roll out of vaccines, should see the US economy print exceptionally strong economic data from next month on. The $1.9 trillion bill greatly exceeded investors' expectations in both size and scope. To put the package into perspective, it represents roughly 8.8% of annual GDP in the United States. However, we also must keep in mind that this round is only a small portion of the overall stimulus. Total fiscal and monetary support throughout the pandemic has been roughly 57% of annual GDP for the United States, which is simply massive.

Global Overview

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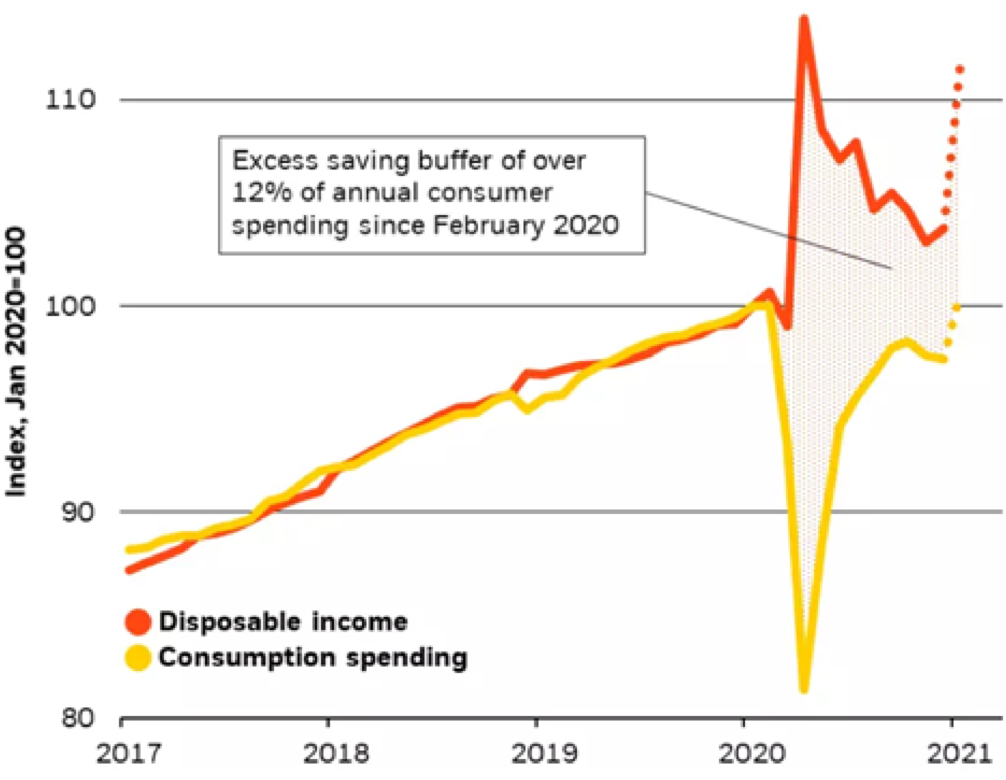
The Fed has boosted its end-year GDP growth forecast to 6.5% from the previous 4.2%. Inflation is now projected to rise to near 2.5% this year, with the unemployment rate forecast to fall to below 4% by the end of 2022. American consumers have built up a savings buffer equivalent to more than 12% of annual consumer spending over the past year, as the chart below indicates. The orange line shows the US nominal household disposable income, while the yellow line shows the US' nominal personal consumer spending – the two showing extremely high correlation in pre-pandemic times.

U.S. disposable income vs consumer spending



Sources: BlackRock Investment Institute, Bureau of Economic Analysis, US Treasury Dept, Opportunity Insights, Bureau of Labor Statistics, Eurostat, Haver Analytics.

Global Overview contd...

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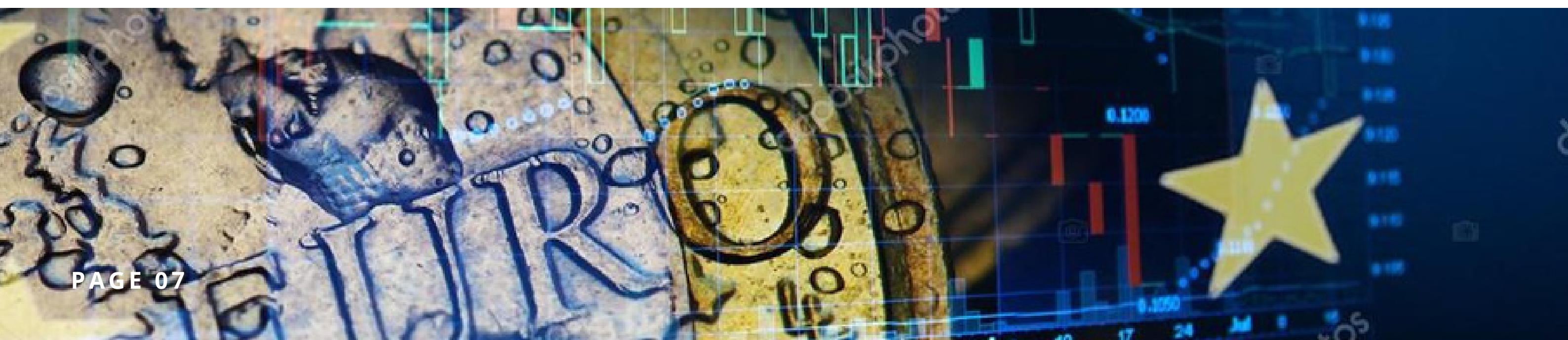
With regard to Europe, we currently see a slightly different picture than in the United States. As our clients will have noticed, the recent upward move in Eurozone yields has been much less pronounced than that of Treasury yields in the States, as the roll out of vaccines here has been relatively slow to date, there has been much less fiscal stimulus, the recovery will likely be more gradual than elsewhere, and Eurozone inflation is expected to be well below target in 2022 and 2023. As a result of these factors, the market believes that rate hikes in Europe are still a long way off, while the ECB has also stepped up the pace of asset purchases in the near-term to curtail the rise in long-term yields.

Unfortunately, the Eurozone economy is set to remain weak in early 2021, as the extension of restrictive measures designed to keep a lid on new Covid-19 cases, hold down economic activity also. The slower pace of vaccine rollouts risk pushing the economic recovery back to the later part of Q2. Yet, there are grounds for optimism. Highly effective vaccines have begun to be rolled out, with supply set to ramp up from April onwards. Monetary policy will almost certainly remain accommodative also, and governments will continue to provide fiscal support. Grants and loans from the EU recovery fund will also come on stream this year, with the worst affected countries set to benefit the most from the fund. In its latest update, the OECD has revised its growth forecasts for the Euro-area upwards to 3.9% in 2021 and 3.8% in 2022. Similarly, the ECB expects GDP to grow by circa 4% this year and in 2022.

Notwithstanding the issues mentioned above, European equity markets continue to perform well as a result of the fact that the ECB remains committed to maintaining and possibly increasing its level of monetary policy support for the region. Also supporting the performance of European equities is the recent weakness in the euro which is supportive of export-focused economies such as Germany. In our '2021 Investment Outlook' back in January we highlighted our overweight position and bullish view on Europe, given our view that the region would "disproportionately benefit from the global cyclical recovery via a sharp recovery in domestic economic activity as lockdowns ease, but also thanks to its sector composition".



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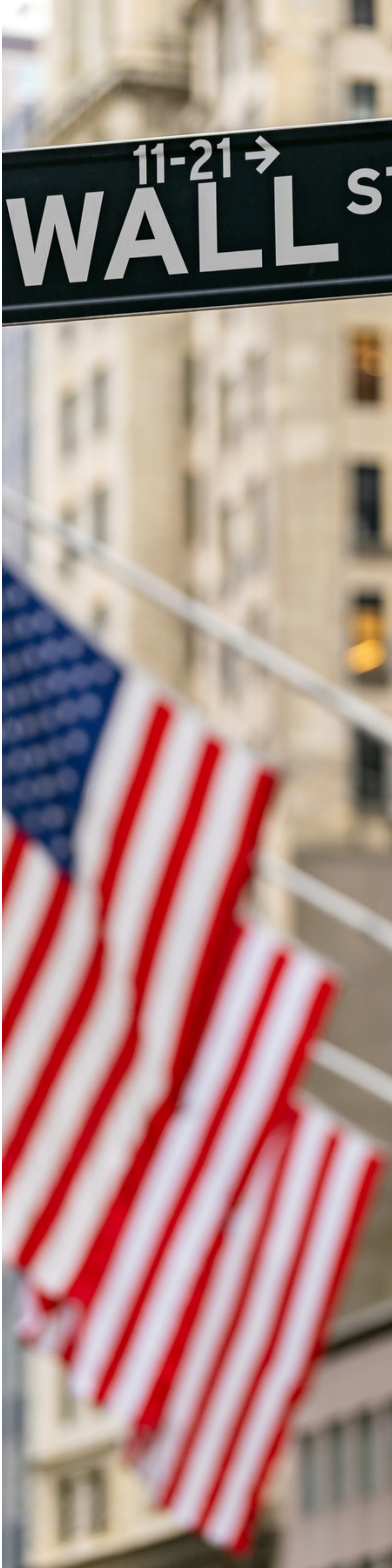
Global Overview contd...

When commenting on and studying the overall global macroeconomic picture, one must always keep one eye on the US Dollar. Over the past two weeks we saw the Dollar Index (DXY) trade through 5-month highs above 93.40, bringing the Euro almost as low as $1.17 for the first time since the week of the US Presidential election back in November.

A few factors have led to this move in our opinion, the world's reserve currency has been in demand over the last few weeks as a slightly more cautious market mood pushed investors to safety, while US economic strength and a rapid vaccine rollout in the States has also added to the greenback's shine. In addition to this, the Dollar has seen support recently as Treasury yields have moved higher and proved to be a more attractive safe-haven alternative with a positive yield vs the likes of Germany's 10yr Bund which is still amazingly yielding a negative 33 basis points. Even more recently, the announcement of Biden's new plans for a $2 trillion fiscal spending package for infrastructure in the States has added to the Dollar bull argument, at least in the short to medium term.

While we still believe in the Dollar weakening story on a longer-term horizon, we would like to point to the likelihood that the tightening of restrictions in the Eurozone, combined with the slower pace of the vaccine rollouts means this divergence in performance between the Eurozone and US economy will remain a feature over the coming months. Such a backdrop should continue to pose a more challenging trading environment for the Euro.



Global Overview contd...

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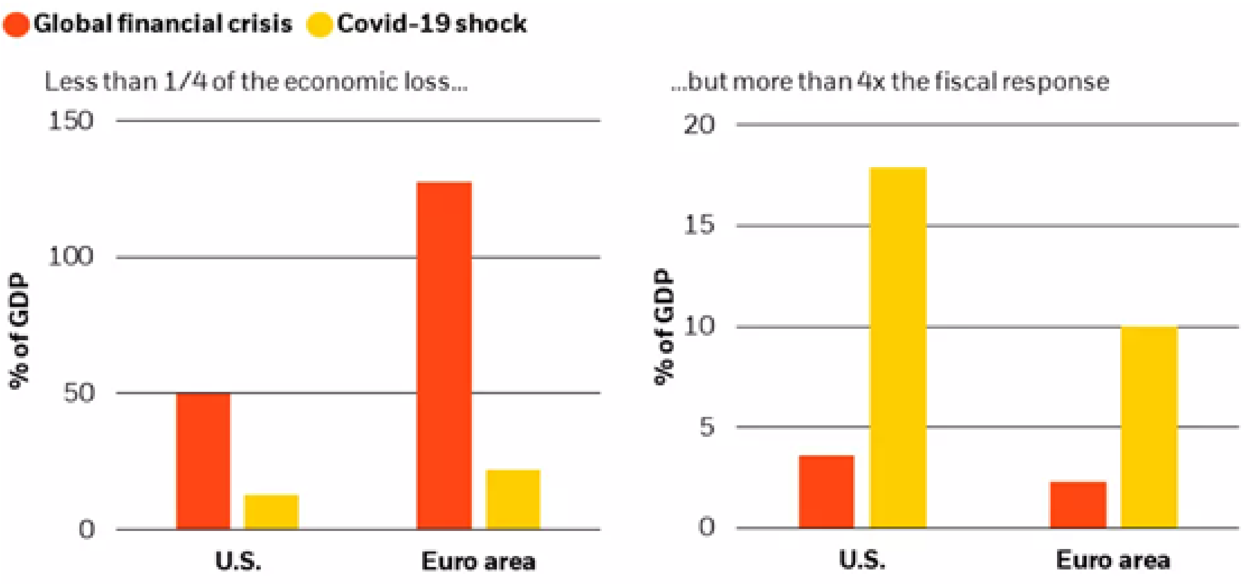
We would also like to point to the fact that the fiscal response to the Covid-19 shock is now a multiple of the response after the global financial crisis (GFC). The chart below shows BlackRock Investment Institute's estimate of the cumulative GDP loss from the GFC in 2008-2009 and their expectations for 2020-2021 Covid (left-hand side), along with the fiscal support witnessed in both the US and Europe over the same two periods (right-hand side). Our hypothesis from previous investment updates still holds: the ultimate cumulative impact of the current crisis on global growth is likely to be a fraction of the 2008 crisis. We believe this matters most for financial markets. We also note that policymakers, academics, taxpayers, and markets have been surprisingly relaxed about the large increase in debt this time around – also a stark contrast to the aftermath of the GFC, when the focus shifted to austerity.



Sources: BlackRock Investment Institute, Haver Analytics.

Not only is the policy response this time far more overwhelming, but a large part of economic activity will restart on its own once the pandemic is under control, in our view. This is a key difference with the GFC. The objective of the current policy response has been different, it has not been to stimulate growth, but rather to provide a bridge to the post-Covid world.

Finally, we would like to repeat a narrative that we have visited from time to time over the past year in our updates: from our point of view as advisors we believe that the pandemic has added fuel to certain pre-existing structural trends such as an increased focus on sustainability, rising inequality within and across nations, and the dominance of e-commerce at the expense of traditional retail. We see developed market ESG-focused equities as best positioned to take advantage of such a climate transition. Whether driven by regulation, consumer demand, technological innovation, or some combination of all three, the world is also undoubtedly moving toward a lower-carbon economy, and we think this will create a foundational, structural shift in our economic landscape. We believe capturing the implications of these changes is important to the return-generating potential of our portfolios.

Equities

We maintain our positive outlook for risk assets and see justification for maintaining our overweight positioning in equities as we head through 2021, with a focus on value stocks over growth, given the supportive monetary policy backdrop, the increasing roll-out of vaccines which supports further economic re-opening, as well as rising earnings growth forecasts within certain key sectors.

This positive medium to long term outlook remains unchanged from our past two investment updates released so far this year. We will look to take advantage of any weakness over the coming months in our preferred sectors and regions, adding to positions either at a market or single stock level as opportunities present themselves. Equity markets will look to the combination of zero rates and fiscal expansion which will continue to drive investment into the industries that will dominate the next decade in our view.

The likely rise in risk-free rates, or US Treasury yields, could prompt further pullbacks in technology and health care as the rest of the year plays out, these sectors historically have not reacted well to rising rates. In contrast, financials and banks, energy, materials, and industrials are more resilient in this environment.

This coincides with our belief in the style rotation that is more generally known as value outperformance. This also fits in with the macroeconomic outlook, as these sectors were hard hit by the pandemic and have a stronger potential to bounce back as global recovery becomes more comprehensive.

Equities contd...

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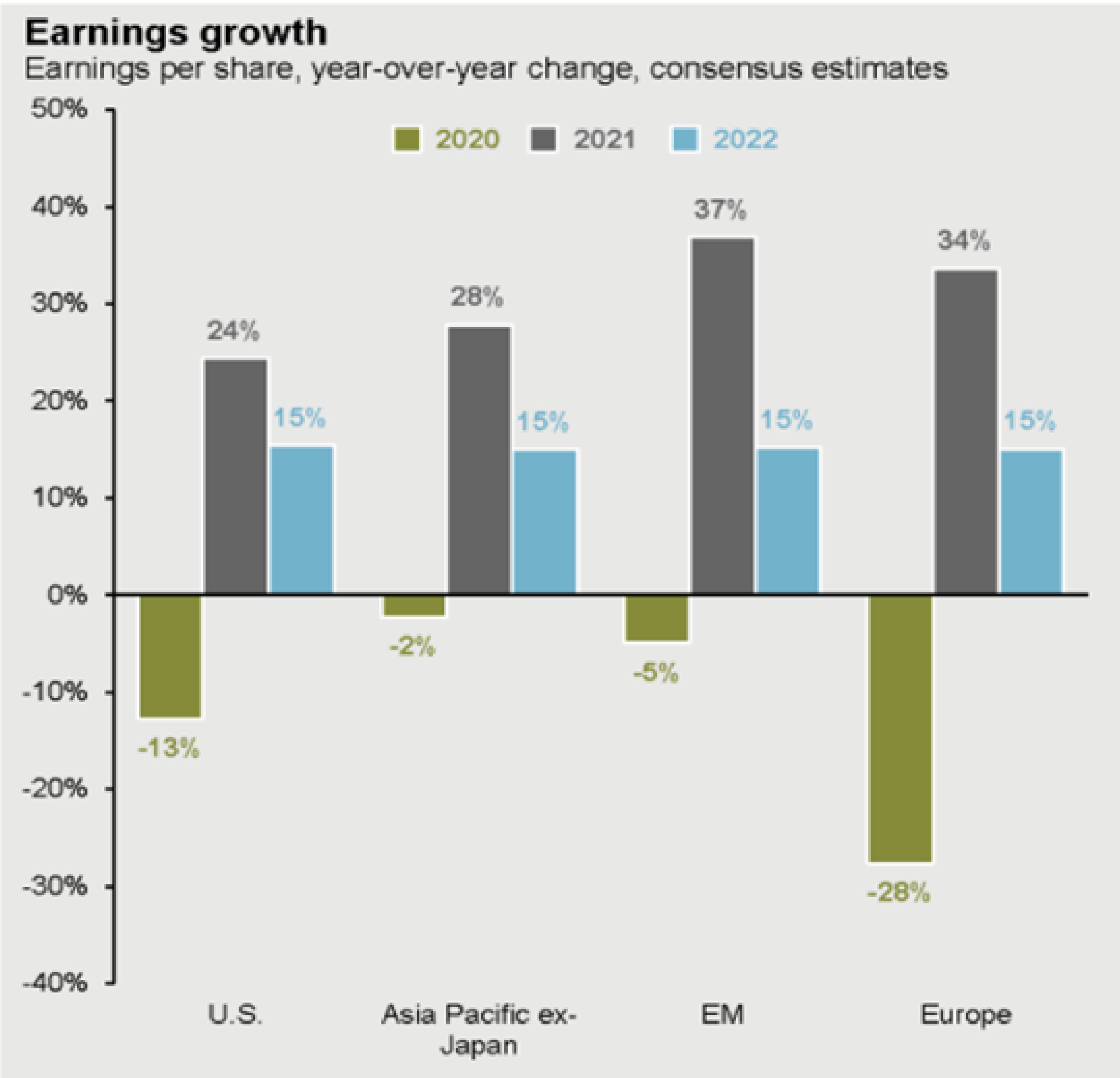
We acknowledge that traditional valuation metrics such as Price to Earnings ratios have been inflated by an expansion in central bank balance sheets and money supply. While there can be little doubt that such valuation metrics are at historically elevated levels for equity markets, notably in the US, it is important to consider this in the context of historically low and unattractive bond yields.

Valuation metrics are also often poor market timing tools; they can become more stretched over long periods leading overly cautious investors to miss out. Considering that the consensus of analysts forecast strong global Earnings Per Share growth of between 24% and 37% for 2021 depending on the region, and a further 15% in 2022 (graph below), valuation multiples can continue to expand to even higher levels to capture the positive company earnings backdrop and supportive money supply growth.



Sources: IBES, MSCI, Standard & Poor's, Thomson Reuters Datastream, JP Morgan Asset Management

Equities contd...

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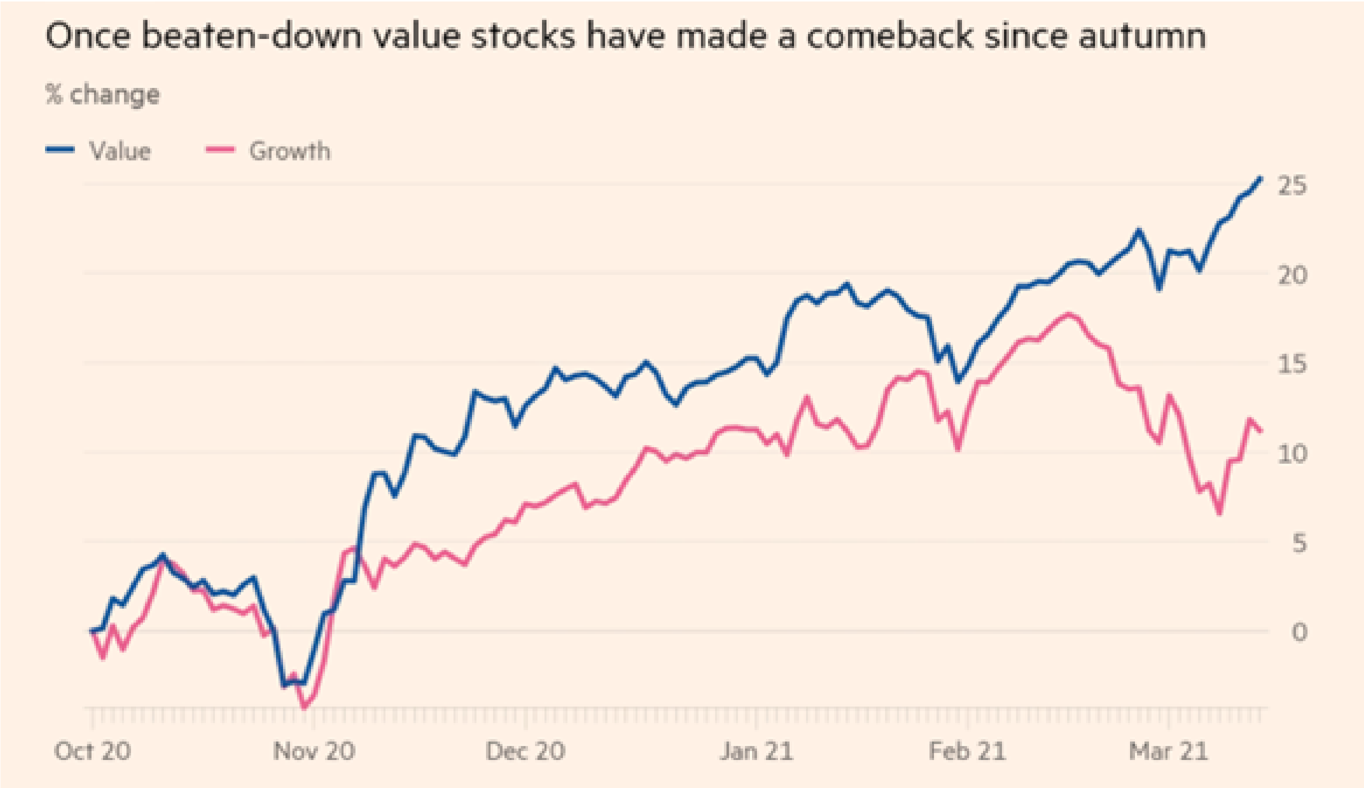
Cyclical stocks, those sensitive to economic momentum, continued to lead during the first quarter, building on outperformance that began with Pfizer's initial vaccine-trial news in November of last year. We see their strength continuing in the second quarter as economic signals point positive.

The key propellants: the recent $1.9 trillion fiscal package in the United States, continued monetary policy support by central banks around the globe, an uptick in vaccine supply and distribution during Q2 especially in Europe, and ample corporate and consumer cash waiting to be deployed almost immediately when restrictions are fully lifted.



Sources: Bloomberg, Financial Times

We give cyclical stocks and reopening plays in general the advantage for the moment, while remaining watchful for signs of a cycle transition as the recovery moves forward - potentially returning the upper hand to growers at some stage in the future. We are overweight equities on a strategic horizon and see a stronger outlook for earnings amid moderate valuations. Tactically, we are choosing to stay overweight equities as we expect the restart to re-accelerate and interest rates to stay low for the remainder of this year and well into next.

We tilt toward cyclicality and maintain a bias for high quality large cap names. We believe that markets are just beginning this shift into more value-oriented sectors and reiterate to our clients that it is not too late to get involved, trends like these can and have taken place across multiple years in the past, under certain circumstances and fundamental backdrops.

Equities contd...

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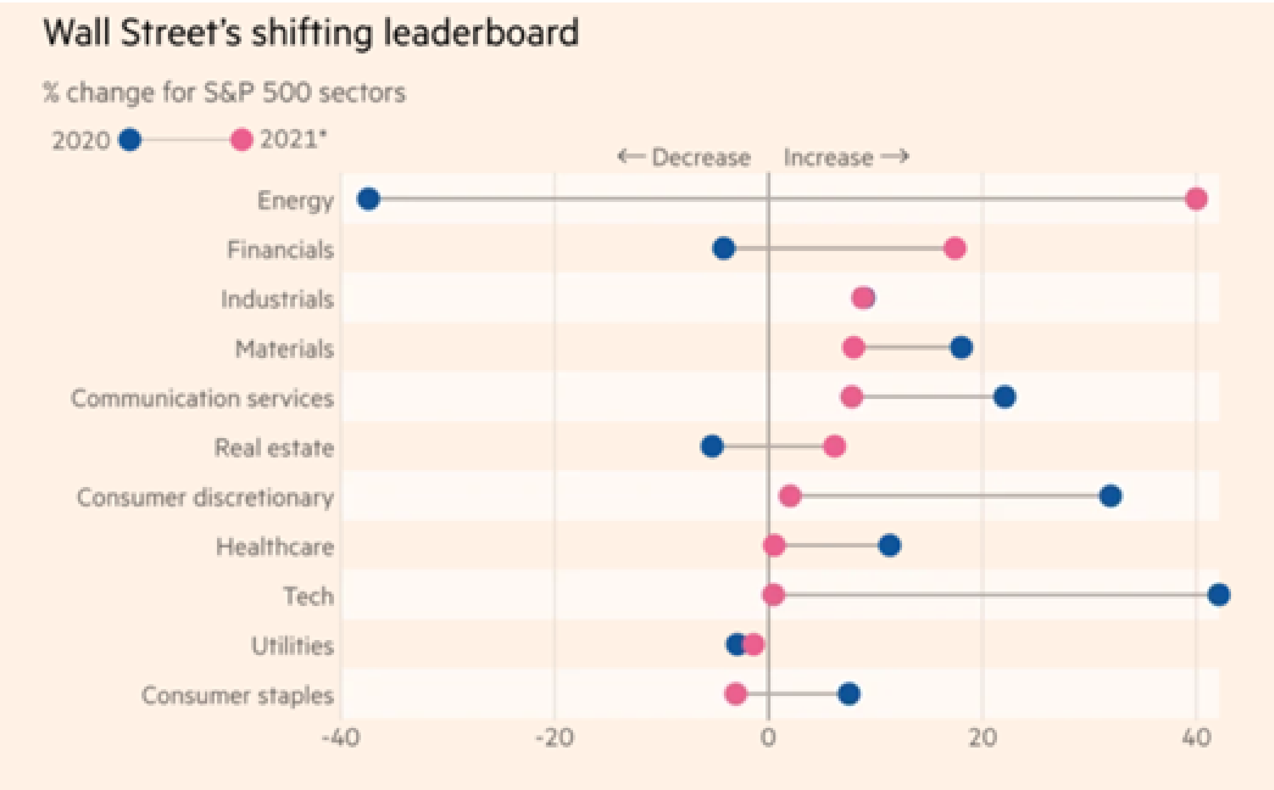
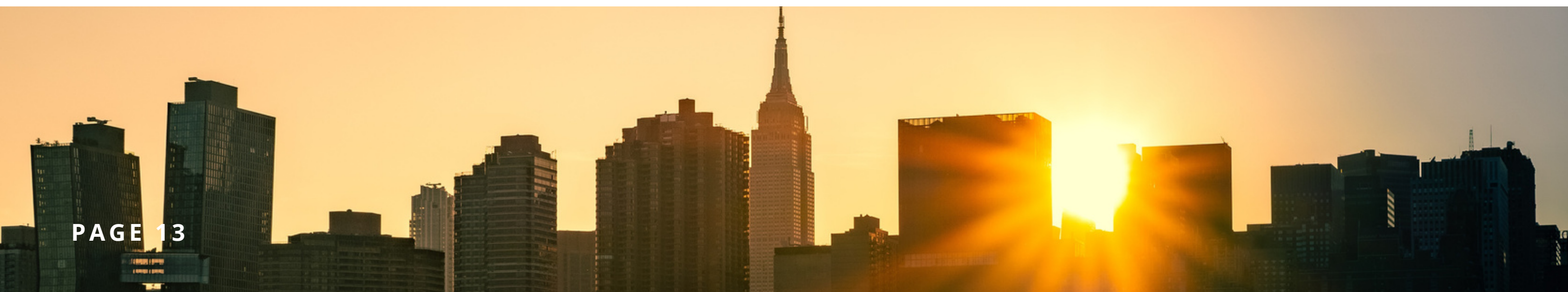
The way in which equities have responded to aggressive monetary and fiscal measures is a familiar one. With growth picking up, policy starts to lag, nominal yields increase and “expensive” growth stocks tend to underperform their cheaper cyclical peers. As we have witnessed in recent months with rising Treasury yields, the higher the equity valuations are, the greater their sensitivity to interest rate movements. In our view, this will be an ongoing theme for the remainder of 2021 as we see yields looking to move higher amid surging global growth and higher inflation readings through the summer and well into H2.



Sources: Bloomberg, Financial Times

In terms of geographic positions, our focus for 2021 remains on Europe, Japan, Emerging Markets (EM) in general, and the UK. We are slightly underweight US equities with no change from our 2021 Outlook in January in this regard.

As we have mentioned, slow vaccination rollouts in the eurozone mean lockdowns are remaining in place for now. Growth entered a double dip recession and stayed depressed in Q1 for the region, but manufacturing was resilient; a strong Q2 rebound is expected. Even apart from these negative factors for Europe, market participants are looking through the current virus-related struggles and are seemingly looking to the US and UK re-openings as somewhat of a prototype for what Europe will experience a few months later. Many of the large European stock indices are likely to continue to outperform this year due to their sectoral make-up and lower exposure to growth and tech names with stretched valuations.



Equities contd...

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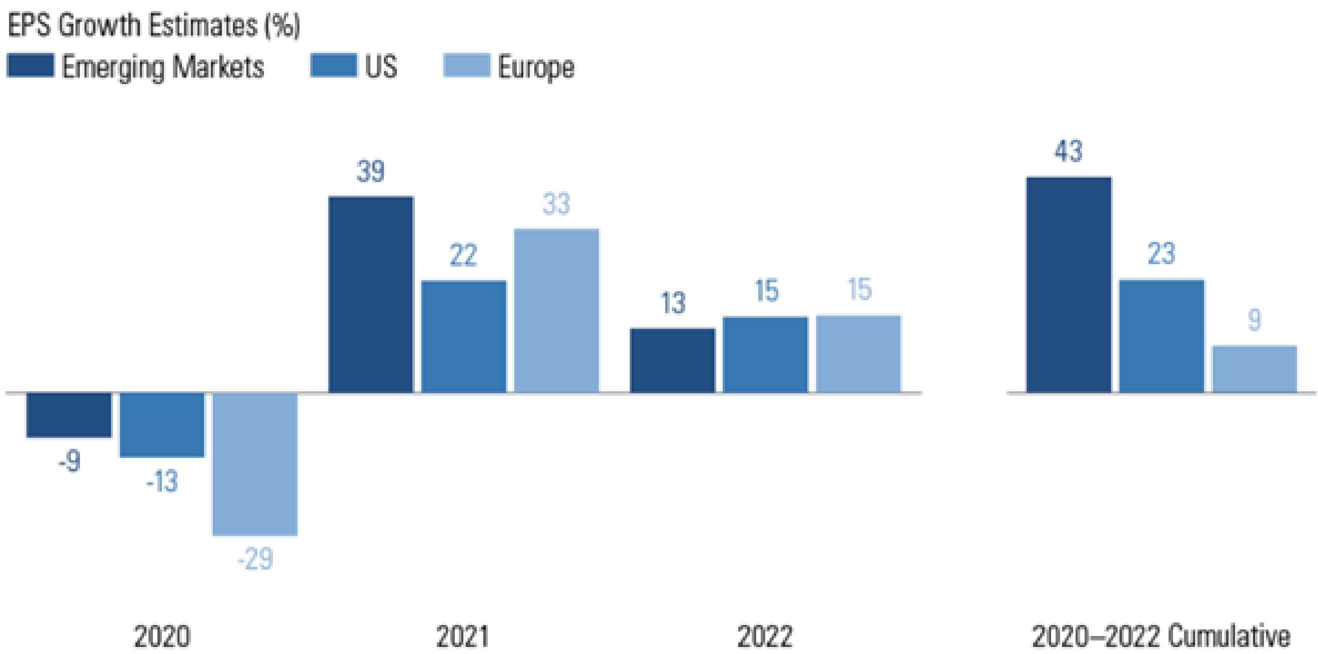
As we have alluded to in our recent investment updates, we see EM equities as principal beneficiaries of a vaccine-led global economic upswing throughout 2021. In addition, our medium-long term expectation for a weaker US Dollar and more stable trade policy under a Biden administration will only serve as catalysts for these risk assets to move higher again. Earnings growth has also been resilient, as the graph below shows, EM earnings are expected to outperform their developed market peers with shallower declines in 2020 and strong recoveries in 2021 and 2022. The result is cumulative earnings growth of 43% over this period, with the strength broad-based across countries.



Sources: Goldman Sachs Global Investment Research and GSAM

With regard to the United Kingdom, we believe the removal of uncertainty over a potential 'hard Brexit' should see the risk premium on UK assets attached to that outcome erode. We also see UK large-caps as a relatively attractive play on the global cyclical recovery as they have significantly lagged their global peers. We believe the UK should benefit from its rapid and widespread vaccination campaign.

Bond yields & Inflation

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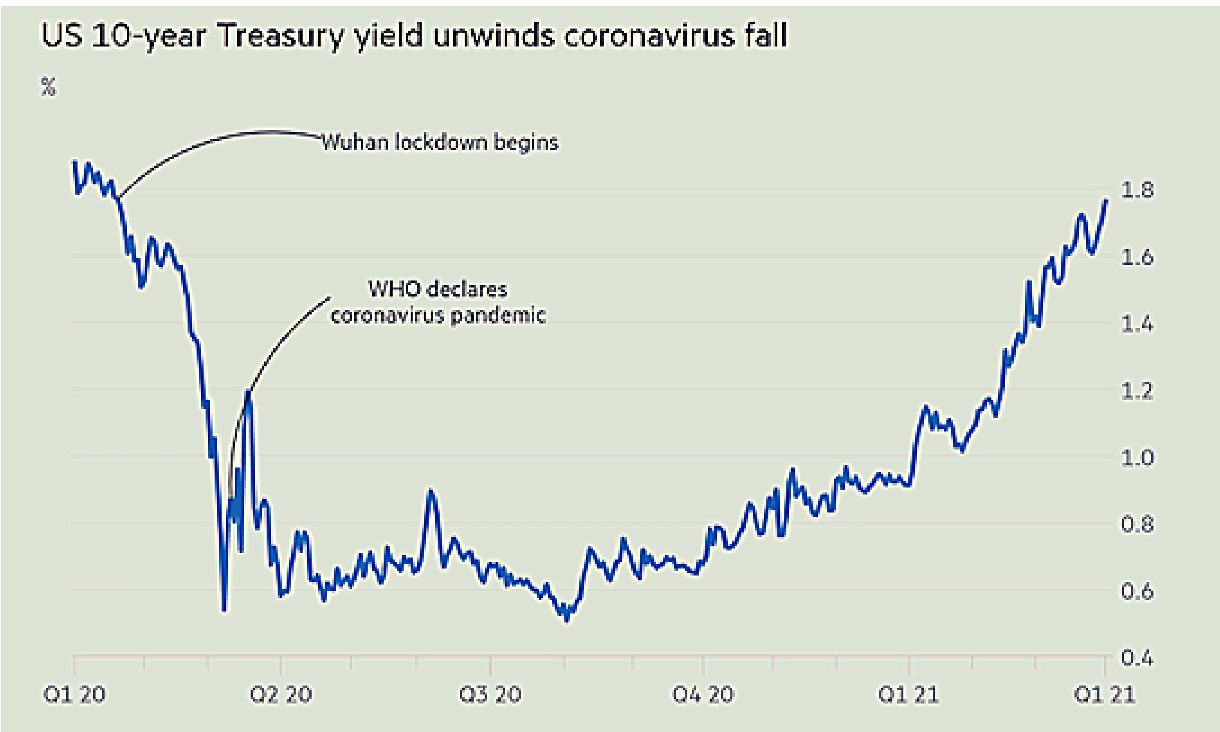
Market participants have become increasingly concerned about the potential for inflation in the US in particular as of late, and the prospect that the Federal Reserve might be forced to increase interest rates at some stage to rein in spiralling prices. The head of the Federal Reserve, Jerome Powell, has sought to dampen nerves by arguing that the uptick in inflation will be “neither large, nor sustained”. Meanwhile, the new Secretary of the Treasury, Janet Yellen, has always sought to downplay such concerns and we expect her to continue in this fashion throughout 2021.
We would like to take this opportunity to remind clients that we are underweight nominal government bonds as their ability to act as portfolio ballasts are diminished with yields near lower bounds and rising debt levels may eventually pose risks to the low-rate regime. We prefer structured products and inflation-linked bonds as we see risks of higher inflation in the medium term.
Bond yields have been rising in recent months, driven by investors’ expectations that inflation is set to return, spurred by rising economic activity later this year as the vaccine rollouts take effect. The US 10-year Treasury yield has risen from around 0.5% in the summer of 2020 to about 1.7% today (see chart below). We believe central banks have strong incentives to lean against any rapid rise in nominal yields, yet we still envisage further gradual increases in yields as markets price in a rapid economic restart supported by fiscal stimulus. We underweight US Treasuries as a result. Bond investors typically start to demand a higher yield to compensate for rising economic growth during the early phases of an economic expansion, and we believe that is exactly what we are witnessing at present.



Sources: Bloomberg, Financial Times.

Bond yields & Inflation contd...

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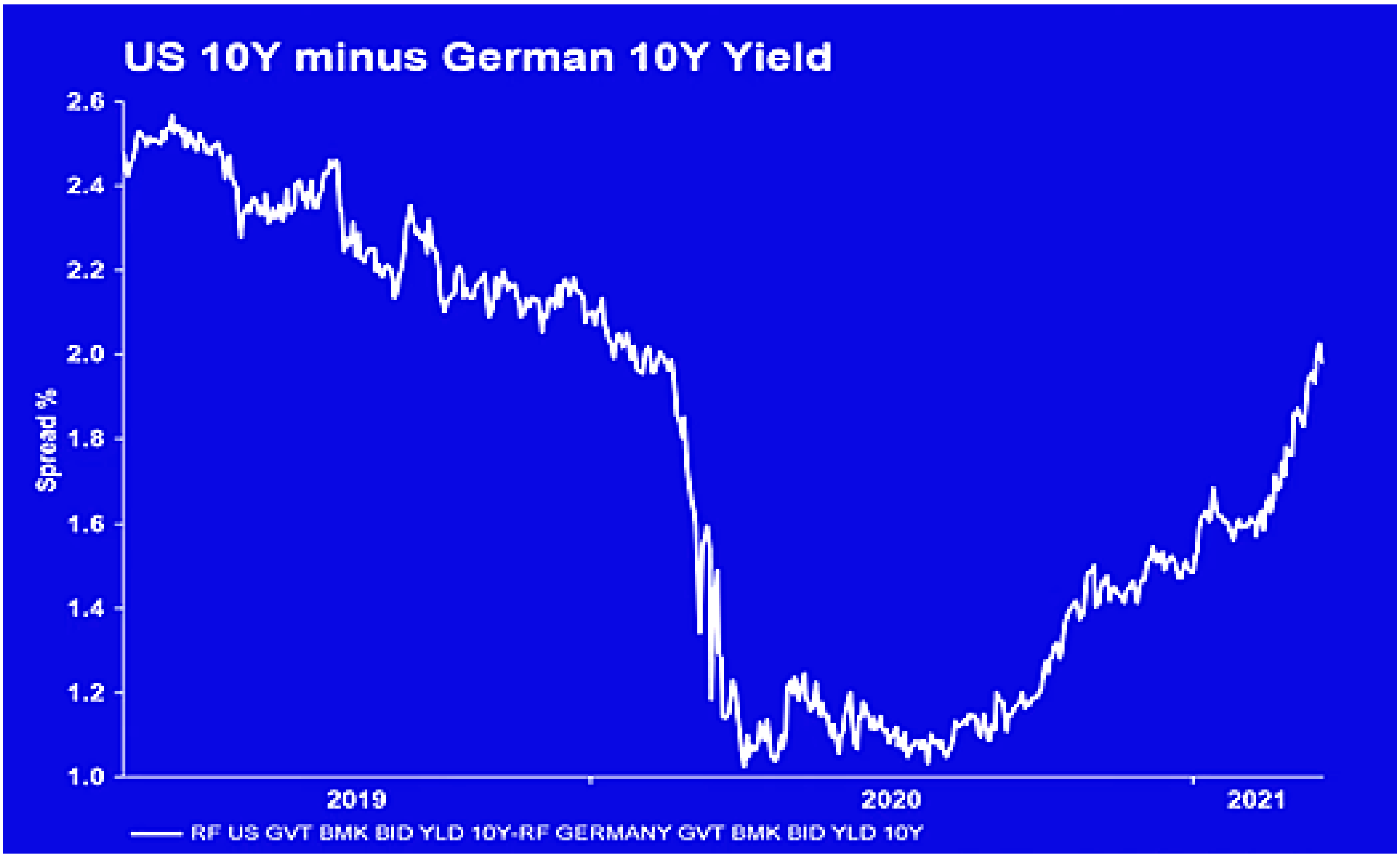
The move in yields was initially driven entirely by rising inflation expectations, real yields remaining anchored, but real yields have now also started to rise. This is good news – yields this time are rising for good reasons (stronger growth) not bad (policy mistake of early taper). In fact, central bank speakers have been at pains to clarify and re-clarify their dovishness – interest rates will not be raised, and bond purchases will not be tapered until unemployment falls meaningfully and the pandemic is truly behind us.

The upward move in Eurozone yields has been slower so far in 2021 when compared with the likes of US Treasuries, as investors are beginning to expect a much more muted rise in inflation this side of the Atlantic over the coming years. In addition, and as we have already alluded to, there has been much less fiscal stimulus in Europe than in the United States, which will likely lead to a slower and more drawn out recovery here. The growth differential between Europe and the US continues to widen out with the spread between the US and German yields at its widest level in over a year (chart below).



Sources: Refinitiv Datastream.

Bond yields & Inflation contd...

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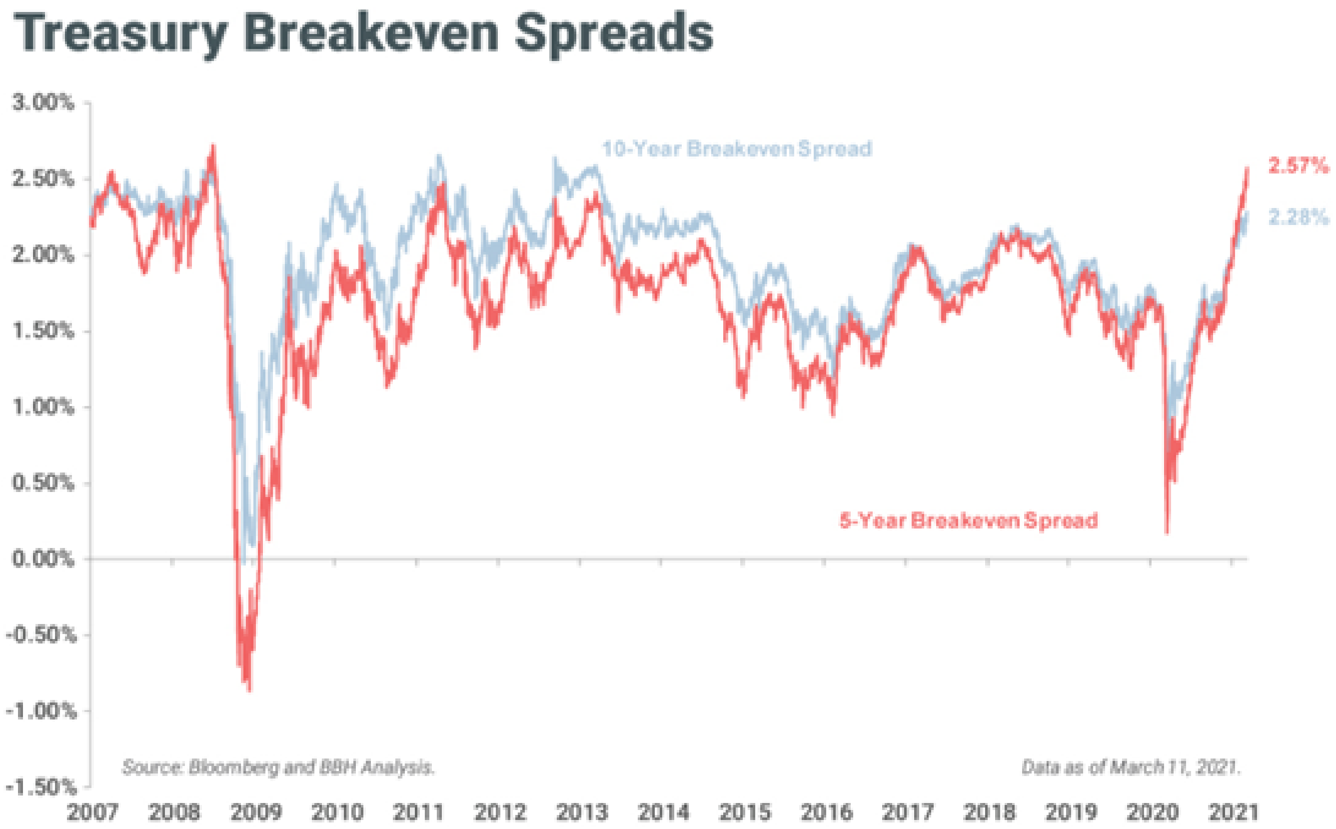
We see rising inflation expectations clearly when we look at breakeven spreads. A breakeven spread is the difference in yield between a nominal US Treasury bond and the Treasury Inflation-Protected Security (TIPS) with an equivalent maturity. The only difference between these two securities is who bears the risk of inflation: An investor in a nominal Treasury bond runs the risk of being repaid in dollars whose value has been reduced by inflation, whereas the principal of a TIPS is adjusted to reflect inflation, so the US Treasury bears the inflation risk. The gap between these two yields – the "breakeven" at which they provide a comparable return to each other – is the aggregate market expectation of inflation over the life of the bond.



Sources: Bloomberg, BBH Analysis.

The chart above shows the 5yr (red line) and 10yr (blue line) breakeven spreads for the United States. At present, breakeven spreads are signalling that bond investors expect inflation to average 2.57% over the next five years and 2.28% over the next 10 years.

Bond yields & Inflation contd...

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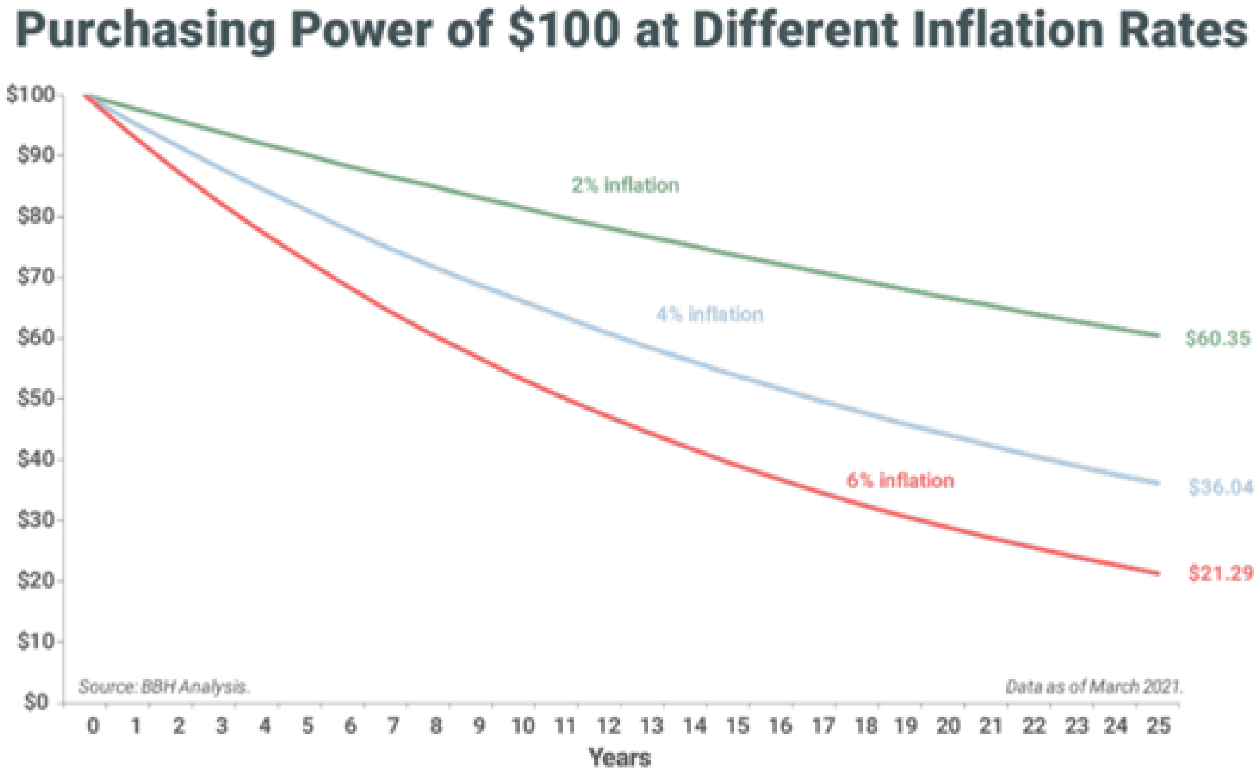
At Seaspray we are of the strong belief that even a modest increase in inflation poses a risk to the objective of preserving our clients' wealth. After all, at the end of the day it's not how much money you have that counts, but what you can buy with the money you have. Wealth is, in other words, an absolute concept.

Money is simply a way of measuring wealth on any given day. While our clients are well aware of compound interest and our constant search for cash alternatives as a way to avoid inflation, we would like to remind everyone how a small amount of money, at even a modest interest rate, can compound into a large figure over time. Inflation is the equal and opposite of compounding: It can cause great wealth, at even a modest rate of inflation, to diminish over time. The below chart demonstrates how $100 would fare over a 25-year period at three different average inflation rates, even just at 2% inflation this $100 would be reduced to just $60.35 if left in cash throughout the period.



Sources: BBH Analysis.

We believe this is the single biggest threat confronting longer-term investors, almost regardless of the level of their wealth. Market and economic cycles will come and go, the political power of parties will ebb and wane, interest rates will rise and fall, and taxes will be raised, and then cut, and then raised again. Inflation is the often-unheard background noise amidst all these outside factors we have mentioned. Like the proverbial frog in the pot of warm water that slowly heats to a boil, investors should recognize that inflation is heating up before it cooks their portfolio.

Bond yields & Inflation contd...

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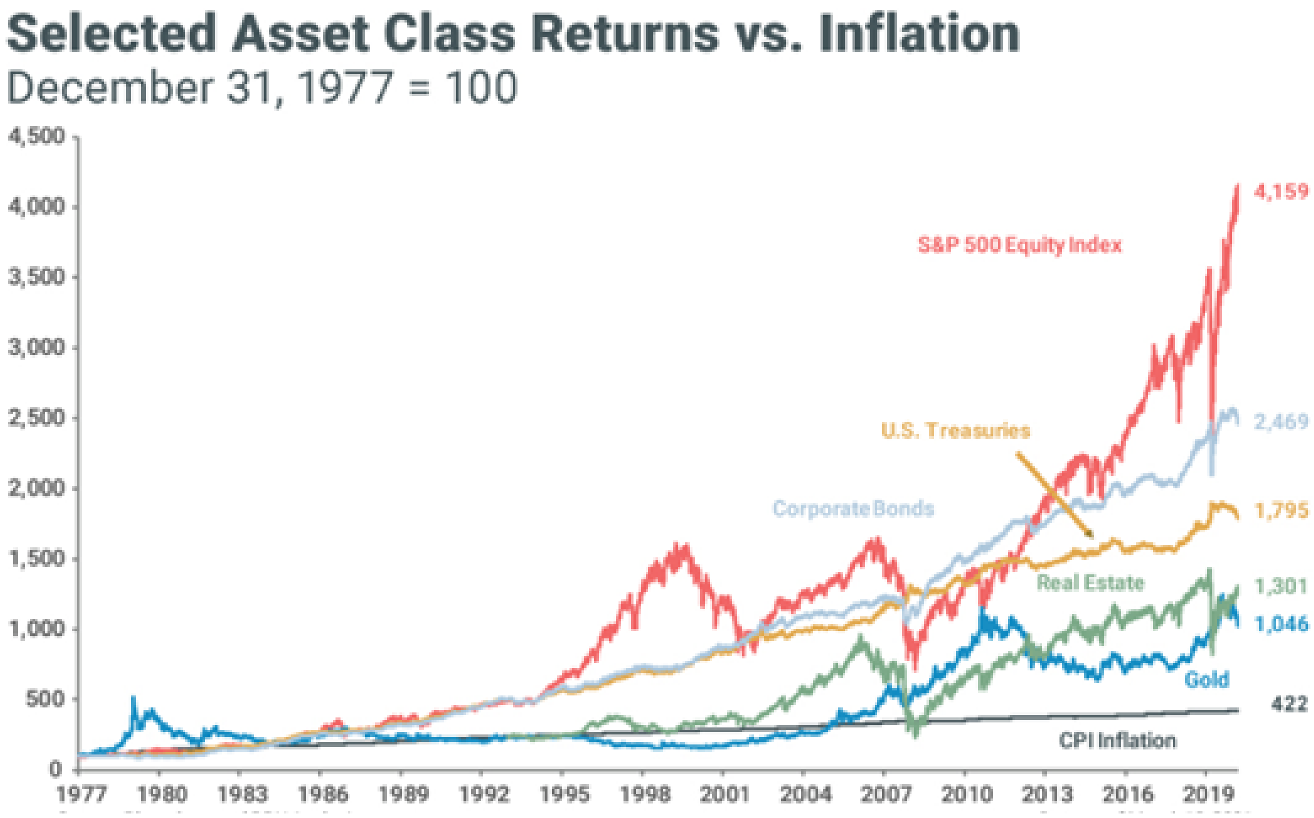
So, how should investors hedge their portfolios against inflation? First, through appropriate asset allocation. Each and every asset class plays a role in a portfolio, and we find that equities play the primary role of both preserving and growing value – in a real, inflation-adjusted sense – over time. On the below chart we highlight how each major asset class has performed against inflation since the 1970s, with equities of course coming out on top by a long stretch.



Sources: Bloomberg, BBH Analysis

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Monetary & Fiscal Policy

The latest round of central bank monetary meetings saw policymakers attempt to soothe market fears that rate tightening could commence as early as next year in some major economies. Central bankers are strongly of the view that the rise in CPI rates that is expected over the course of 2021 is not the start of an inflationary spiral. Rather the pick-up is coming from very low levels and in general they expect it will see inflation return to around their 2% target level. Much of the rise in inflation will likely be due to base effects, such as an unwinding of the sharp fall in energy prices and cuts in VAT rates seen in 2020, with central bankers viewing the rise as "transitory" as a result. Indeed, in the Eurozone, the ECB sees inflation dropping back again to well below its target level in 2022 and 2023. Central bankers also point to the considerable slack in labour markets as keeping inflation in check over the next few years.

Federal Reserve:

At the Federal Reserve's March meeting, Chairman Jerome Powell gave the clearest sign yet that the bank is willing to let things run hot by holding down interest rates until the economy has fully recovered. One of Powell's intentions was almost certainly to keep a green light for the risk-on environment that he and other central bank leaders have nurtured since the lows that were hit in March of last year. There were no changes to policy as expected although there were sizable upwards revisions to GDP and inflation forecasts for 2021. GDP is now expected to rise 6.5% for the full year according to the Fed, versus their previous view for 4.2%. The US central bank still signalled a desire to keep interest rates close to zero until at least 2024.

Monetary & Fiscal Policy contd...

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FOMC March 2021 Forecasts*

Percent**

	2021	2022	2023	Long run
Change in real GDP, Q4 to Q4	6.5	3.3	2.2	1.8
December Forecast	4.2	3.2	2.4	1.8
Unemployment Rate, Q4	4.5	3.9	3.5	4.0
December Forecast	5.0	4.2	3.7	4.1
PCE Inflation, Q4 to Q4	2.4	2.0	2.1	2.0
December Forecast	1.8	1.9	2.0	2.0
Federal Funds Rate, end of year	0.1	0.1	0.1	2.5
December Forecast	0.1	0.1	0.1	2.5

*Forecasts of 18 FOMC participants, median estimate

** Green denotes an adjustment higher, red denotes an adjustment lower

Sources: Federal Reserve, JP Morgan Asset Management.

Federal Reserve policymakers now expect inflation to rise to 2.4% (vs their previous 1.8%) by the end of 2021, declining back to 2% by the end of 2022 and edging back above 2% by end-2023. However, Fed Chair Powell did comment that the rise above its 2% target this year would be "transitory" and would "not meet" the condition of its desired inflation outcome. He also stated that the economy is a "long way" from its employment and inflation goals, and it is "likely to take some time" for "substantial further progress to be made". The update to the Fed's view on the likely path of future interest rates (i.e. the dot plot) was similar to December, in that the median projection was for no change to the fed funds rate through to the end of 2023. All 18 FOMC members anticipate that the current level of interest rates will be warranted until the end of 2021. There were some additional members though, projecting rate hikes in subsequent years compared to December. Four FOMC members (from one) now believe a rate hike will be required next year. Meanwhile, seven members (from five) expect rate hikes by the end of 2023.

In his press conference, Chair Powell emphasised to not read too much into the changes in the dot plot. He also stated in response to numerous questions on whether it was time for the Fed to think about tapering its QE programme, that now is not the time, and that the Fed would give ample advance notice for tapering to allow markets to gradually adjust. Despite Powell stressing the dovish credentials of the Fed, futures contracts continue to show that the market is expecting the first rate hike in the second half of 2022, with the fed funds rate ending the year at 0.25%. Indeed, the market anticipates rates rising to 0.5% by end 2023. This represents a significant shift in market expectations compared to the time of the Fed's last meeting in January, when futures contracts were indicating the first rate hike around mid-2023 and rates not getting to 0.5% until the first half of 2024.

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Monetary & Fiscal Policy contd...

European Central Bank:

The ECB kept its monetary policy stance unchanged at its March meeting as expected, maintaining its deposit rate and refi rate at –0.5% and 0%, respectively. The central bank did announce an increase to the pace of monthly asset purchases under its Pandemic Emergency Purchase Programme (PEPP). The meeting statement noted PEPP purchases in the second quarter would be "conducted at a significantly higher pace than during the first months of the year". This alteration to monthly QE comes amid a backdrop of rising bond yields and interest rates over recent weeks, as markets react to the prospects for a stronger global economic rebound and likely rising inflation.

We note that while the pace of asset purchases was sped up in the near-term, the total envelop of PEPP was left unchanged at €1.85 trillion. ECB President Christine Lagarde did emphasise that the central bank retains flexibility and that the envelop can be "recalibrated" if required to maintain favourable financing conditions. At the same time, she stated that the bank does not need to use the full envelop if it is not required. The Governing Council once again guided that they expect rates to remain at their present or lower levels until the inflation outlook robustly converges close to, but below 2%.

The ECB also released its updated macroeconomic projections, in which it expects the ongoing vaccination programmes combined with the gradual easing of restrictions to underpin a rebound in activity over the course of this year. It is forecasting GDP growth of 4% this year, followed by an increase of 4.1% in 2022 and 2.1% in 2023. These forecasts are broadly similar to its December projections. The ECB's assessment is that the risks to the medium-term economic outlook have become more balanced, but downside risks remain in the near-term. Meanwhile, the central bank revised higher its inflation outlook for 2021-22. It is now forecasting inflation to average 1.5% (from 1.0%) this year and is projecting it at 1.2% (from 1.1%) for 2022. However, it stressed that these upward revisions were largely due to temporary factors and higher energy price inflation. Its 2023 inflation forecast was left unchanged at 1.4%.

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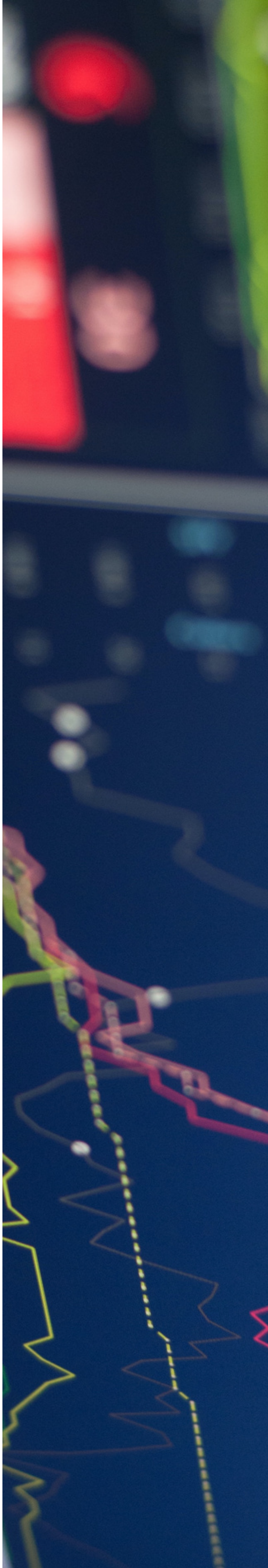
Monetary & Fiscal Policy contd...



Bank of England:

On March 17th the Bank of England maintained its main interest rate at 0.1% at its Monetary Policy Committee meeting and left its UK government bond purchase programme target unchanged at £875 billion. The BOE alluded to the fact that global GDP growth had been stronger than anticipated since its last meeting, and that the US fiscal package “should provide significant additional support to the outlook”. We expect the bank’s asset purchases to continue to the end of 2021, with an increase in the bank rate likely only a year later.

Bank of Japan:

Last month we saw the Bank of Japan keep its policy rates unchanged, while it also widened its long-term yield target range from ± 20 bps to ±25 bps and removed explicit stock buying guidance (average per year of 6Tr Yen / $55b). The BOJ maintained its accommodative stance to buy ETFs when necessary with a ceiling of 12Tr Yen per year.

Monetary & Fiscal Policy contd...

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Fiscal Stimulus:

From a fiscal point of view, we are of the opinion that the stimulus response from the EU has been relatively modest, and is estimated at about half that of the US in GDP terms. The latest instalment from Europe is the €750 billion recovery fund agreed in December, which will consist of a mixture of grants and loans. The overall EU response to the crisis has been disappointing in this regard, with the US responding in a far more dramatic fashion. Once the current $1.9 trillion Biden package is implemented, the total fiscal stimulus will total around $5.1 trillion (circa 24% of GDP), with President Biden is planning a further $2+ trillion capital spending plan to invest in infrastructure over the coming months.

Government debt has experienced unprecedented growth in the past year, as fiscal expansion has backstopped entire sectors of major economies that have undergone permanent change and long-term scarring through the pandemic. Central banks have provided the indispensable channel for this via purchases of government debt with newly printed money, at zero and negative interest rates. Covid-19 has in effect forced major economies into the domain of modern monetary theory, where central bank balance sheets have expanded in lockstep with the surge in government deficits to fund income transfers to large sectors of economies.

As markets begin to anticipate the end of the pandemic, questions arise about the “new post-pandemic normal” that will emerge from the historic symbiosis of fiscal and monetary policy. One thing is certain: while vaccines may help us to return to some degree of normal life, they will not turn the clock back on much higher public debt ratios and much higher bond market valuations due to the combined effects of fiscal and monetary action. A key assurance for both government borrowers and market creditors is that central banks will be reluctant to challenge financial stability and economic recovery by selling their holdings of government debt back into markets or raising policy rates too soon, thus pushing borrowing costs higher.

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E: info@seasprayprivate.ie **Ph: 065 6710507**

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