

A close-up photograph of a fountain pen's nib resting on a document. The document features a line graph with a dashed horizontal line and a solid line that trends upwards. The background is a soft, blue-tinted light.

MONTHLY INVESTMENT UPDATE

May 2021

PREPARED BY

Introduction

The last month has been relatively quiet for financial markets, as volatility rests near 15-month lows, as the western world prepares for the highly anticipated re-openings this summer. The United States, who are still averaging about 2 million inoculations per day, have over the past week surpassed 45% of their population in terms of first doses, with over 34% fully vaccinated at this stage. Closer to home, 28% of the EU's population and 52% of the UK have now received their first dose, with 11% and 26% fully vaccinated, respectively.

Despite a fairly steady and slow grind higher for risk assets over the past month, we have still seen some external developments play out. These developments included President Biden's proposed new minimum global corporation tax and higher rate of CGT in the US, Central Bank reiterations that rates will remain at or near zero while policy will have an easing bias despite some near-term temporary inflation surges, a so-far robust quarterly earnings season, and Q1 GDP results indicating a technical double-dip recession for Europe during Q1 due to widespread lockdowns. More recently, we even saw the US Treasury Secretary, Janet Yellen, test the proverbial waters with her comments that interest rates in the United States may have to rise somewhat "to make sure our economy doesn't overheat".

	1 Month	3 Month	YTD	1 Year
Equity Indices				
S&P 500	1.46%	5.83%	11.51%	45.93%
DAX	-1.32%	8.12%	9.45%	38.78%
EuroStoxx 50	-1.05%	7.80%	10.35%	35.93%
ISEQ	-0.12%	11.69%	9.91%	47.18%
FTSE	0.37%	6.35%	7.03%	15.35%
Nikkei 225	-3.15%	-3.23%	4.24%	40.47%
Multi-Asset Funds				
Aviva Cautious (Risk 3)	0.44%	0.82%	1.85%	10.47%
Irish Life MAPS 3	0.59%	2.47%	4.69%	13.17%
New Ireland iFunds 3	0.40%	0.72%	1.69%	8.22%
New Ireland PRIME 3	0.42%	1.71%	3.29%	8.17%
Zurich Prisma 3	0.18%	1.86%	3.17%	10.67%
Aviva Strategic (Risk 4)	0.55%	2.61%	5.49%	19.28%
Irish Life MAPS 4	0.86%	3.70%	6.80%	17.35%
New Ireland iFunds 4	0.53%	2.30%	4.71%	15.24%
New Ireland PRIME 4	0.44%	3.00%	6.44%	14.81%
Zurich Prisma 4	0.43%	3.77%	6.43%	21.37%
Aviva Dynamic (Risk 5)	0.66%	4.17%	8.51%	26.81%
Irish Life MAPS 5	0.66%	3.50%	8.04%	22.35%
New Ireland iFunds 5	0.98%	4.32%	8.52%	24.10%
New Ireland PRIME 5	0.40%	4.31%	9.33%	20.38%
Zurich Prisma 5	0.50%	5.17%	8.88%	29.39%
Currencies				
EUR/USD	2.04%	0.32%	-0.50%	12.04%
EUR/GBP	-0.72%	-1.78%	-3.65%	-2.73%
GBP/USD	2.80%	2.23%	3.31%	15.22%
USD/JPY	-0.77%	3.84%	5.12%	1.31%
Fixed Income				
US 10yr	-0.049	0.460	0.695	0.918
Bund 10yr	0.128	0.293	0.407	0.348
Irish 10yr	0.158	0.374	0.561	0.053
Gilt 10yr	0.041	0.359	0.639	0.560
Commodities				
Gold	5.40%	-1.02%	-3.94%	5.25%
WTI Crude Oil	8.14%	10.31%	33.06%	150.43%



Introduction, contd..

While vaccine supplies have picked up significantly over the past couple of months, we have still seen some mixed news on the virus front with concerns growing over the possibility of new variants. Over the last week or two we have seen investors turn their attention to India's alarming infection rates. The world's second most populated country is now seeing over 400,000 new cases per day along with the reported emergence of a new variant which highlights the fact, that despite the availability of multiple vaccines, their efficacy against new strains is still somewhat unknown.

Despite the relatively strong possibility of short-term bouts of volatility over the coming months and quarters, we remain positive on equity markets for the remainder of the year on the basis that the overall tone of outlook statements from CEO's have been positive, monetary policy support remains in place (as evidenced by the ECB and Fed recently), and critically, fiscal policies continue to be rolled out in a manner never seen before. Whilst Markets have moved to new highs, the outlook for earnings growth supports further price appreciation. Equally, with bond yields trading in a more stable manner than that seen in the first two months of the year, this too is supportive for risk assets.

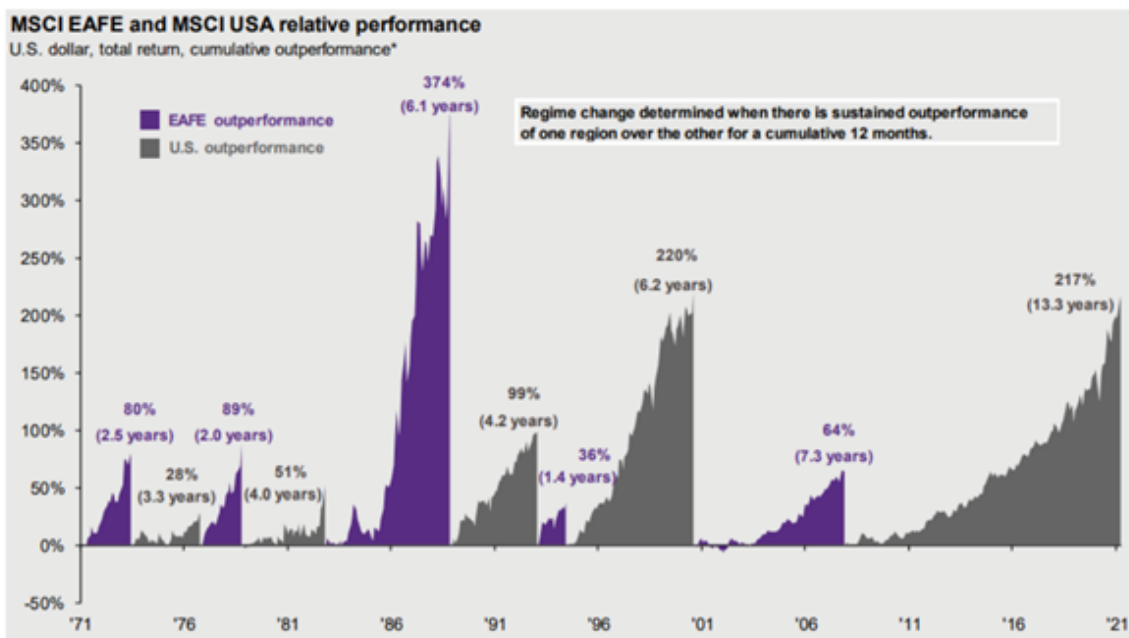
As part of our ongoing macroeconomic research, we are constantly keeping an eye on risks that we believe could cause pullbacks for risk assets. At present, potential risks to the positive outlook include a resurgence in Covid-19 cases and a failure to contain the virus, vaccines proving to be ineffective in treating new variants (which would threaten the improving growth backdrop), fiscal and monetary supports being reduced or further significant rises in bond yields due to inflation concerns, which would diminish the relative valuation case for equities. We see the probability of these occurring as being low. Volatility, however, will likely remain a feature in markets if any of these issues become a cause for concern over the rest of 2021.

Equities

April and indeed the beginning of May have seen equities trade higher, with many of the major indices reaching new all-time highs as the CBOE VIX index in the States traded over 1-year lows on the back of lower volatility across markets in general. This recent robust equity performance has been against the backdrop of the ongoing earnings season which has been one of the strongest in recent quarters and also against the backdrop of a still dovish Federal Reserve which remains committed to maintaining its accommodative monetary policies of zero-bound interest rates and substantial asset purchases. So far in May, investors renewed a rotation away from technology and growth stocks into cyclical stocks, due to valuations being viewed as stretched especially as market participants remain mindful of the potential for higher rates and bond yields towards the second half of the year, which would disproportionately weigh on growth stocks. With regards to geographic positioning, our main focus remains on Europe over the US, with Asia, Japan, and the UK also each set to outperform this year due to their sectoral weightings, more attractive valuations in many cases, and their faster emergence from restrictions than many other regions around the world.

With global growth (ex-US) more synchronized than a potentially peaking United States, global-facing cyclical stocks are well-positioned relative to US-centric equities in our view, especially if European growth accelerates. We continue to find opportunities for bottom-up selectivity in European equities given their greater leverage to global growth. As such, we also see more potential for re-rating than in other major markets as a stronger growth environment materializes. As can be seen in the below chart, equities in the United States have outperformed their European peers for over 13 years now. We believe, from a long-term investment point of view, we could be at somewhat of a turning point in this relationship, and see value in many areas and sectors within the European equity space at present.

European Equities time to Shine?



Equities, contd

Our positive medium to long term outlook remains unchanged this month, we will likely use any weakness over the summer on both a single stock and sectoral level to add to positions. We will continue to actively manage our risk and our exposures using all available instruments, asset classes and structured products available to us on behalf of our clients. We see the ongoing policy support from the Fed and other major central banks along with ongoing fiscal policy support and the current strong earnings season as significant backstops to any pullbacks that equities may face during the remainder of Q2. Notwithstanding full valuations, we believe stock markets in our preferred regions remain attractive, supported in 2021 by low real yields, easy financial conditions, peak earnings, and a substantial equity risk premium.

Regarding the current Q1 earnings season, over half of S&P 500 companies have now reported results, with over 80% exceeding analysts' expectations while the rate of earnings growth for the quarter is set to be circa 34% (or more than double the growth rate expected at the start of the year). In Europe, over 40% of companies have reported with c.65% exceeding forecasts while the rate of earnings growth is currently running at an impressive 57%.

While equity markets are expensive in absolute terms, they remain very attractive in relative terms, given the low and in some cases negative yields available on other traditional 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 ratio of 18.5 - 19 times at the end of the year. With the global economy in the initial stages of a new cycle and with strong economic and earnings growth expectations for the next two years, we forecast upside of mid-to-high single digits in global equities over the next 12 months from this point.





Economy/Inflation

Market commentators recently have been increasingly pointing to the likelihood of higher inflation readings in the near-term as year-on-year comparisons lead to price surges in the coming months. We note that according to Bank of America this month, the year-on-year change in S&P 500 companies mentioning inflation in their earnings calls has risen 800% this reporting season, roughly (and somewhat alarmingly) eight times higher than the previous peak. US Treasury Secretary Janet Yellen even suggested that small rate rises may be needed sometime soon to stop the US economy and inflation from “overheating”. The following day however Yellen did row back on these comments saying that she was not suggesting that rates needed to increase immediately, but rather that the Fed had the policy of higher rates in its tool box if needed. She also stressed the importance of the independence of the Fed and as an ex-Fed Chair she would never seek to influence its decision making process. With regard to inflation, we acknowledge that over the next few months we will likely witness spikes in year-on-year inflation data as we factor in the base effects from last year's unprecedented pandemic shock. This will be an ongoing situation which we will no doubt revisit in our future investment updates.

Last month we also saw the announcement by US President Joe Biden that he is proposing tax increases for citizens earning in excess of \$1 million per annum in order to fund his various stimulus plans. Included in this proposal was an increase in US Capital Gains Tax from the current 20% to 39.6% which did raise some concerns among investors that this could trigger a bout of profit-taking ahead of any implementation of the new rate should it be approved. If we look at it objectively, history has shown that in previous instances where there have been significant increase in taxes, markets do tend to see some level of selling pressure towards the end of the tax year, but then rebound strongly in the following year as the gains crystallised are reinvested. So, while there is unlikely to be any immediate impact on the markets as a result of this proposal, when taken in conjunction with the President's plans for higher corporate taxes, the increased focus on taxes by the Biden administration is something that markets will have to contemplate in H2.



Economy/Inflation contd.

The Eurozone's recovery from the economic downturn of the past 12+ months was stronger than expected during April, with the region's Services and Manufacturing PMI results remaining resilient in general despite a fresh wave of infections and some reimposed lockdowns in key nations during March and April. The data showed a record reading for the manufacturing component, of 63.3 versus 62.0 estimates, with the services side moving back into expansionary territory with a result of 50.3 (vs 49.1 expectations). This helped to push the composite figure to a 9-month high. However, Eurozone services data continues to lag the likes of the US and UK, with continued restrictions as a result of a slower vaccine rollout being identified as the main cause.

Looking at the United States, these Services and Manufacturing PMIs moved higher through Quarter 1 with the April Services reading coming in at 63.1 vs 61.6, driven by stronger customer demand and the reopening of businesses. The US' Manufacturing result was 60.6 (its highest level since the series began in 2007) vs 60.9 forecasts and led by a sharp rise in output. PMI readings are a leading indicator and always reflect data from the current month. From our experience, market participants tend to pay close attention to any trends in PMI figures or any large beats or misses of expectations when allocating capital. Any PMI result above the 50.0 mark indicates economic expansion for that particular sector, while below 50 represents contraction.

We acknowledge that inflation remains more muted in the eurozone when compared to that of the United States. Estimates for April showed that headline inflation rose to 1.6% year-on-year, but the core figure, which excludes items such as food, energy, alcohol and tobacco remained subdued at 0.8% y/y. ECB President Christine Lagarde also acknowledged that the eurozone and the US are on different pages when it comes to the economic and inflationary outlook and, as such, the ECB would not be acting in tandem with the Fed – a nod that the tapering of its bond purchases will likely be slower.

Economy/Inflation contd.

Historically in periods when inflation has been between 1% and 3% and is rising, which tend to coincide with strong economic growth, risk assets have done well. In particular, cyclical and real asset returns with high sensitivity to the macro backdrop have been positive. Inflation higher than 3% may pose a headwind to core equities, though commodities and emerging market equities have still outperformed as tail risks emerge, as seen in the below graph.

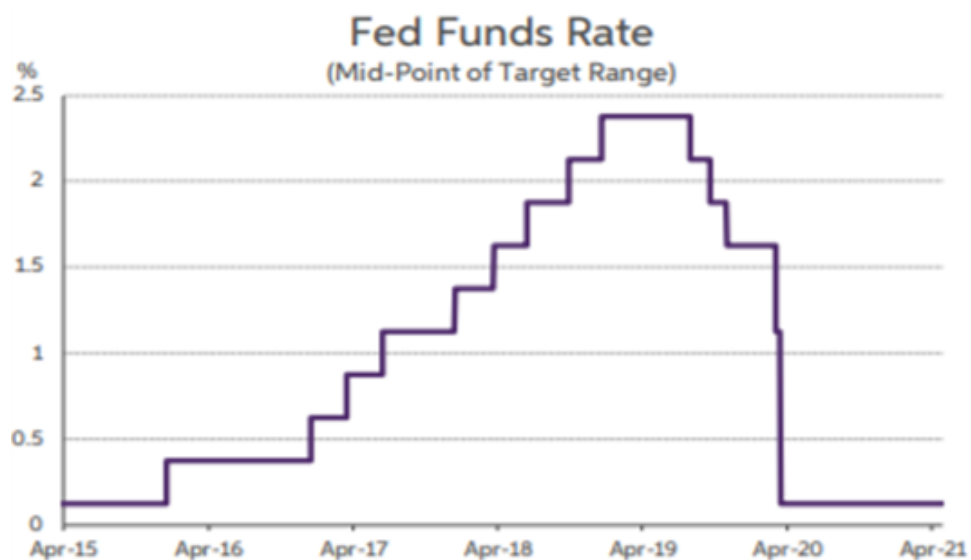
Asset Performance in Inflation Environments		
	INFLATION IN-LINE AND RISING	INFLATION HIGH AND RISING
Asset classes that tend to do well	Oil EM & DM Equities Gold TIPS	Oil Gold EM Equities TIPS
Asset classes that tend to be challenged	Cash	DM Equities US Treasuries Cash

Source: Goldman Sachs Asset Management, Goldman Sachs Global Investment Research

Central Banks

In our view, the focus for central banks, at least for now, will remain on ensuring that monetary policy helps the broader economy emerge from the deep 2020 recession, and is restored to a sound footing. Markets, though, may well be right to be wary of assurances that monetary policy can remain very accommodative for years to come. One can't help feeling that when economies return to a more even keel, central banks may have to change their tune somewhat and start taking their foot off the pedal rather quickly. In this regard, given the very favourable US economic outlook in particular, it is hard to see the Fed waiting until 2024 to hike rates, as indicated by their latest 'dot-plot' forecasting metric.

As expected, Federal Reserve policymakers voted to keep interest rates and monetary policy unchanged in the US during their April meeting, with the current asset purchase programme to be kept at \$120 billion per month. We believe that a key point of focus and speculation for markets over the coming months will be if and how soon the Fed will start to announce a tapering to its QE programme. In Jerome Powell's press conference last month, the Fed Chair faced numerous questions on this topic, with the same dovish responses ensuing as we expected. Powell stated very clearly that "it is not time yet", while reiterating the Fed's assertion that it will want to see "substantial further progress" in the economy's recovery before contemplating any tapering let alone any rate hikes.



Source: Refinitiv, AIB

Central Banks contd.

In April we saw more of the same language from the American central bank, when they alluded to the oncoming higher inflation readings as likely being a temporary factor. In light of the progress in the ramping up of the vaccination programmes, the Fed downgraded its assessment of the risks posed by Covid by removing the word “considerable” in its characterization of the difficulties that the pandemic still poses to the economic outlook. The central bank has indicated, though, that it will give the market plenty of notice about when it will start to taper. If, as we expect, the US economy booms in the coming months, then we would anticipate that such guidance may come as early as this summer, allowing the Fed to begin tapering around the end of the year or in early 2022.

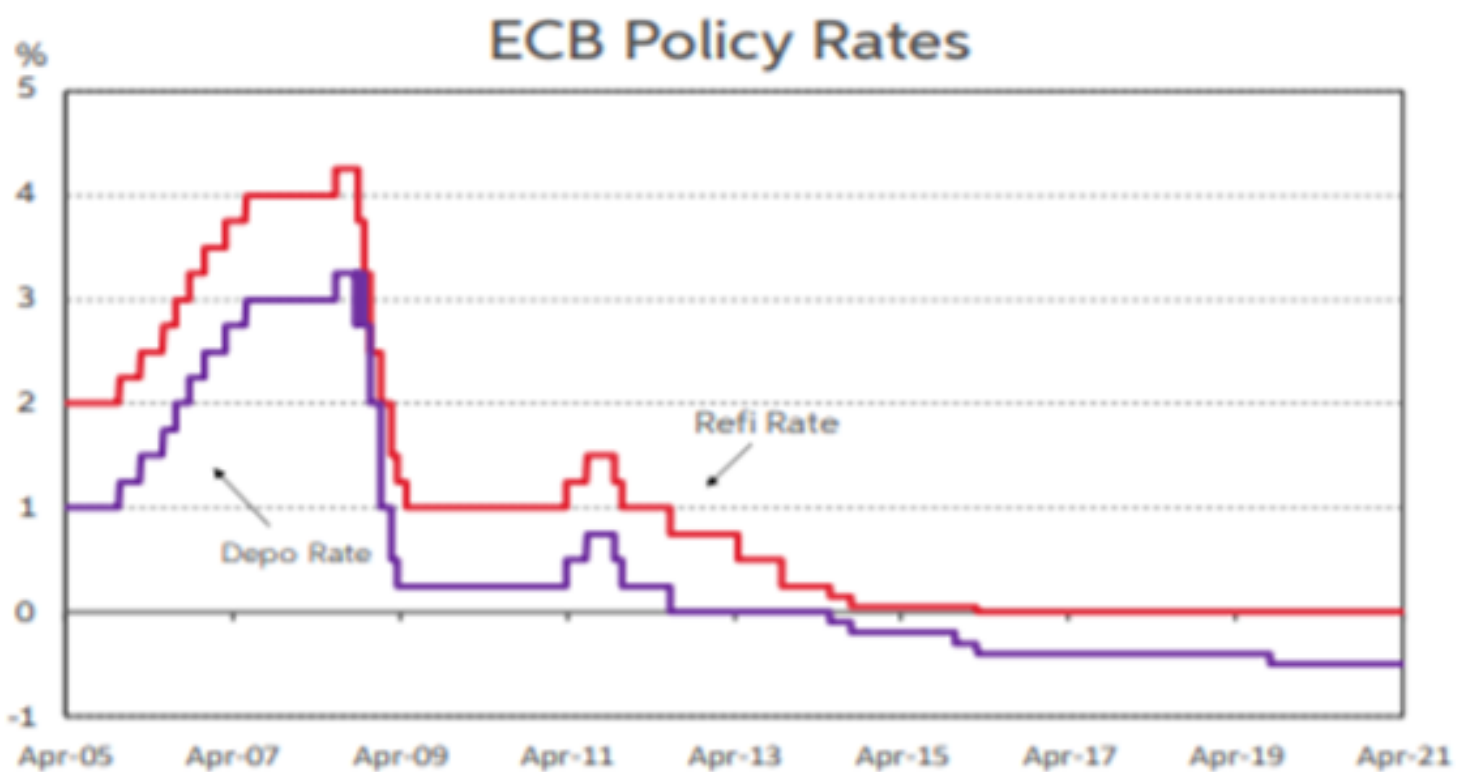
Market participants will now begin to look to the Federal Reserve’s next release in June, during which the bank is set to release their quarterly economic projections for the first time since their significant upgrades back in March.

In its statement last month, the Federal Reserve acknowledged the US’ recent higher moves in inflation, but reiterated this “largely” reflected “transitory factors”. Powell also highlighted so-called base effects, which reflect that prices crashed this time last year as the pandemic intensified, and supply chain constraints, which have emerged as demand has surged alongside the easing of lockdown measures, that will lead to a temporary burst in inflation readings over the coming months due to y/y results for many of these data points.



Central Banks contd.

Looking at Europe, the ECB's April meeting was much the same as we saw from the other major central banks, with no changes to policy for the time being. As expected, the ECB left its deposit rate and refinancing rate unchanged at -0.5% and 0% , respectively. Meanwhile, the Pandemic Emergency Purchase Programme was left unaltered at $\text{€}1,850$ billion.



Source: Refinitiv, AIB

The ECB is anticipating that inflation will remain well below its 2% target until at least 2023, the central bank is likely to maintain an ultra-loose monetary policy for quite some time. Market expectations are consistent with this outlook, with futures contracts suggesting that investors do not envisage rates rising from their current levels until 2024.



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