# INVESTMENT OUTLOOK

## OCTOBER 2021

WE BELIEVE THE GLOBAL EXPANSION IS BROADLY UNDERWAY, THOUGH THE COVID-19 DELTA VARIANT HAS TAKEN SOME STEAM OUT OF THE GLOBAL GROWTH ENGINE. WE ANTICIPATE SOLID BUT LESS SYNCHRONIZED GLOBAL GROWTH AHEAD.

It appears most central banks plan to remove accommodation slowly, which is the silver lining to our less-robust growth and labor market outlook. Markets tend to get a little bumpier at this stage of the cycle, but we believe risk assets should still perform well.

## MACRO DRIVERS

We expect inflation pressure to fade as supply chain bottlenecks likely correct.

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## CREDIT

Top-down conditions and strong bottom-up fundamentals support low downgrade and default expectations.

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## GOVERNMENT DEBT & POLICY

Monetary and fiscal policymakers remain dedicated to fostering growth and employment.

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## CURRENCIES

The broad US dollar tends to trend lower when global growth expectations begin to accelerate relative to the US.

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## EQUITIES

Global equity markets have the potential to deliver positive returns across growth and value styles.

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## POTENTIAL RISKS

Corporates have preserved margins by passing through higher input costs, but it is unclear how long that can last.

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# MACRO DRIVERS

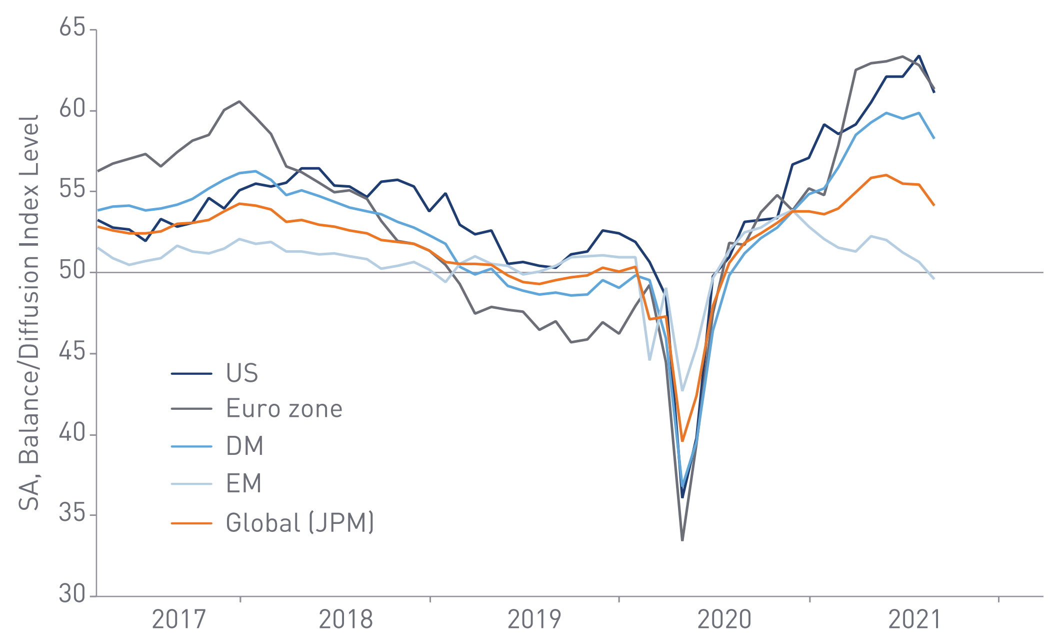
## Financial conditions likely to remain easy as the Fed tapers asset purchases.

- The delta-variant-fueled surge in COVID-19 cases is showing signs of peaking but may linger into early 2022. FDA approval of COVID-19 vaccines for children under 12 years old could be an important catalyst that helps stop the spread.
- We have lowered our growth expectations for the second half of 2021 as the uptick in COVID-19 cases has weighed on services, in-person business and consumer sentiment.
- In our view, the strong consumption and demand for goods and services we had anticipated in the second half of 2021 should resume in 2022.
- Higher inflation data has been stickier than we previously expected. However, we believe some current inflationary drivers, such as supply chain bottlenecks, will correct over time.
- As inflation moderates, central bankers will likely focus on labor market health. We believe the United States and euro zone are several quarters away from rate hikes.

**MARKIT MANUFACTURING PMI INDICATORS**

*Source: Refinitiv Datastream, datastream as of 30 September 2021. SA= Seasonally adjusted.*

IN OUR VIEW, US AND EURO ZONE MANUFACTURING PMIs SHOULD CONTINUE TO LEAD WHILE EM LIKELY FACES HEADWINDS



# CREDIT

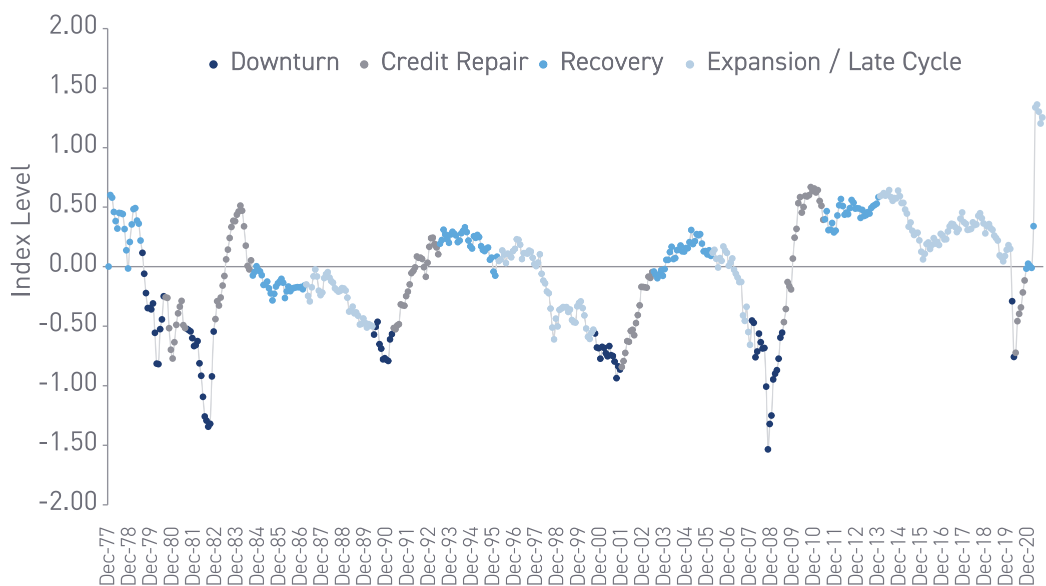
## We believe global and US credit have the potential to deliver positive excess returns in the months ahead.

- Government bonds appear unlikely to deliver positive returns amid rising rates, particularly after adjusting for inflation.
- Higher coupon income and modest spread compression may help US and European high yield credit outperform investment grade credit. The high yield sector's low-duration profile relative to investment grade could also bolster performance when government rates begin to rise.
- We believe solid fundamentals could lead to credit rating upgrades.
- The US levered loan market is generally a high-yielding sector of the credit market. In our view, strong fundamentals and a supportive macroeconomic backdrop could provide potentially attractive opportunities to earn carry in the loan market.
- Emerging market investment grade and high yield corporate credit can be another source of excess return potential versus government bonds. However, we believe security selection will be critical as global growth becomes less synchronized. We will be looking for opportunities to invest when securities trade at a discount to perceived fair value.

**CORPORATE HEALTH APPEARS STRONG RELATIVE TO HISTORY. THIS SUPPORTS OUR VIEW THAT THE CREDIT CYCLE IS FIRMLY IN EXPANSION.**

**LOOMIS SAYLES' CORPORATE HEALTH INDEX**

*Source: Loomis Sayles, Bloomberg, as of 31 August 2021. Loomis Sayles' Corporate Health Index "CHIN Index" is a proprietary framework that utilizes a combination of macro, financial market and policy variables to project US corporate health relative to history. A higher reading indicates stronger corporate health.*



# GOVERNMENT DEBT & POLICY

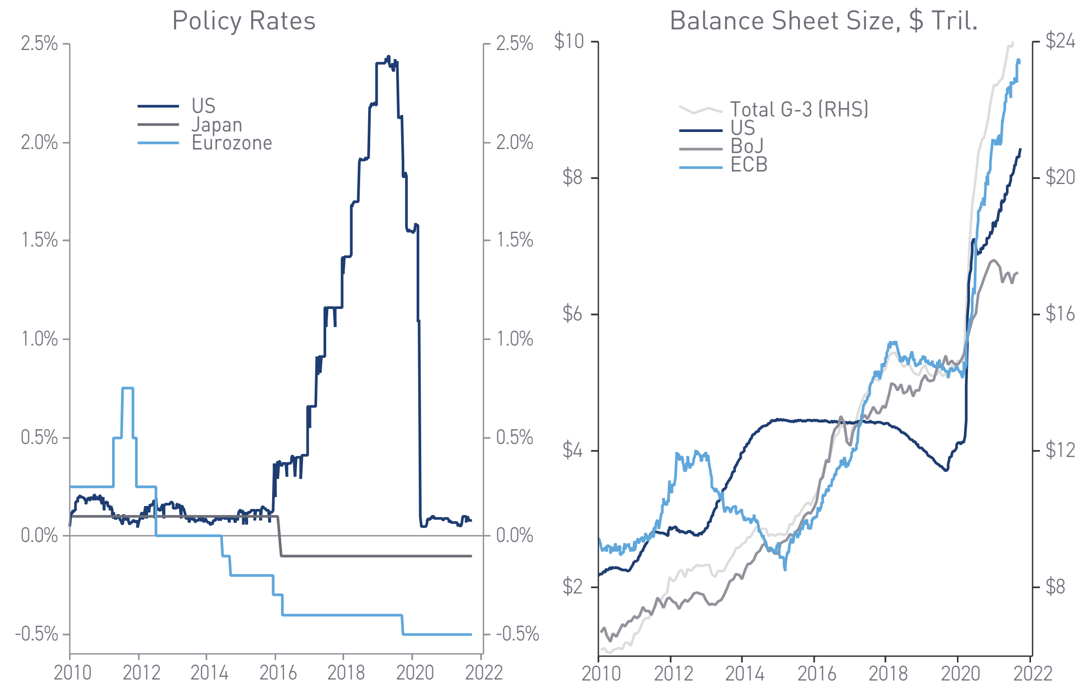
## We expect developed market interest rates to gradually drift higher.

- The Fed has signaled that it will begin tapering asset purchases around year-end. The tapering period is likely to last six to eight months. We believe quantitative easing will conclude in the middle of 2022.
- Fed communications have thus far been effective in avoiding a "taper tantrum." Any deviations from the anticipated time frame could surprise financial markets and spark volatility.
- A Fed rate hike in 2022 would surprise us. We think the Fed is unlikely to start hiking rates until mid-2023 or later.
- We believe the European Central Bank and Bank of Japan will wait for the Fed to embark on a hiking cycle before initiating their own.
- We do not currently see any catalysts that would drive developed market interest rates significantly higher, but we do expect rates to generally trend upward during the global expansion.
- In our view, idiosyncratic country developments will likely help drive performance among emerging market US-dollar-denominated sovereign bonds. We believe some frontier markets can offer attractive valuations.

### G-3 CENTRAL BANK MONETARY POLICY

*Source: Source: Refinitiv Datastream, data as of 30 Septmber 2021.*

**WE BELIEVE THE FED WILL END ITS EXTRAORDINARY ASSET PURCHASE PROGRAM LONG BEFORE RAISING THE TARGET POLICY RATE.**



# CURRENCIES

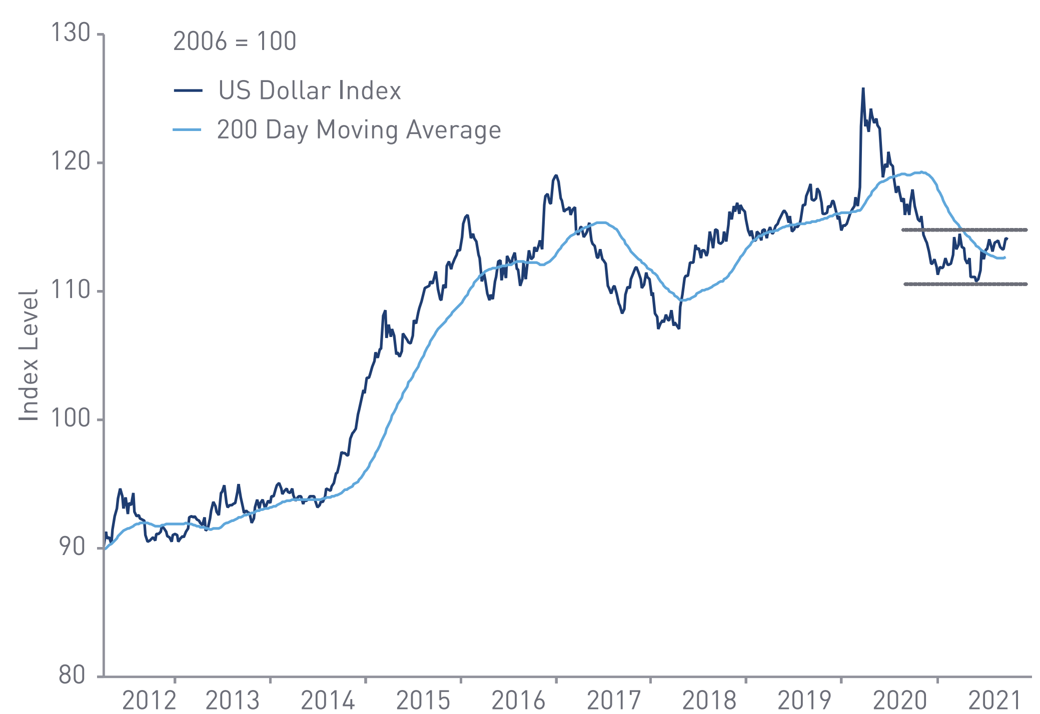
## We are looking to selectively add non-US-dollar exposure in developed and emerging markets.

- The global economic expansion has been uneven, but we anticipate positive growth in most countries. We expect the broad dollar indices to trade in a tight range near term.
- We believe strong risk appetite and cyclical improvement in the global economy will eventually lead to a broadly weaker dollar, but for now we prefer a selective approach.
- We currently see opportunities to add non-dollar exposure in developed Europe and some emerging markets within Latin America and Asia.
- We believe country selection within emerging markets is critical. The fundamental backdrop for each country has been progressing at a different rate. Political risk remains a key consideration for some emerging markets, notably in China.
- Global growth forecasts may soften a bit further in the months ahead. We expect capital flow into non-dollar assets will pick up once expectations begin to firm.

**US TRADE-WEIGHTED NOMINAL BROAD DOLLAR INDEX**

*Source: Bloomberg, Federal Reserve, JP Morgan, data as of 17 September 2021. Indices are unmanaged and do not incur fees. You cannot invest directly in an index.*

**THE TRADE-WEIGHTED US DOLLAR HAS TRADED IN A TIGHT RANGE FOR MOST OF 2021; WE DO NOT BELIEVE A BREAKOUT OR BREAKDOWN IS IMMINENT**



## EQUITIES

### From a relative value standpoint, we currently prefer equities over government bonds.

- The expansion phase of the credit cycle is typically favorable for equity performance. Early expansion could be a good buying point for equity investors looking for multi-year upside potential.
- We believe the pace of earnings growth has peaked for this cycle. We believe equity returns will remain positive, but below the levels achieved during the post-pandemic recovery.
- In our view, equities are likely to outperform credit and government bond markets. We think earnings growth and dividend income will help drive equity performance rather than multiple expansion.
- Large-cap US equity valuations appear elevated relative to history. However, most major large-cap US equity indices are now heavily weighted in high-profitability sectors that typically command a valuation premium, such as information technology.
- We expect US equities to outperform global equities over the long term, likely driven by strong fundamentals and economic prospects that typically lead to a more solid and consistent operating environment.
- In our view, market corrections and bouts of risk-off trade are bound to happen. However, we would view such events as potential buying opportunities unless the expansion itself is at risk.

**CORPORATE EARNINGS HAVE BEEN STRONG AND FORWARD ESTIMATES HAVE BEEN REVISED HIGHER.**

**CONSENSUS ESTIMATES FOR MSCI ALL COUNTRY WORLD EARNINGS PER SHARE BY CALENDAR YEAR**

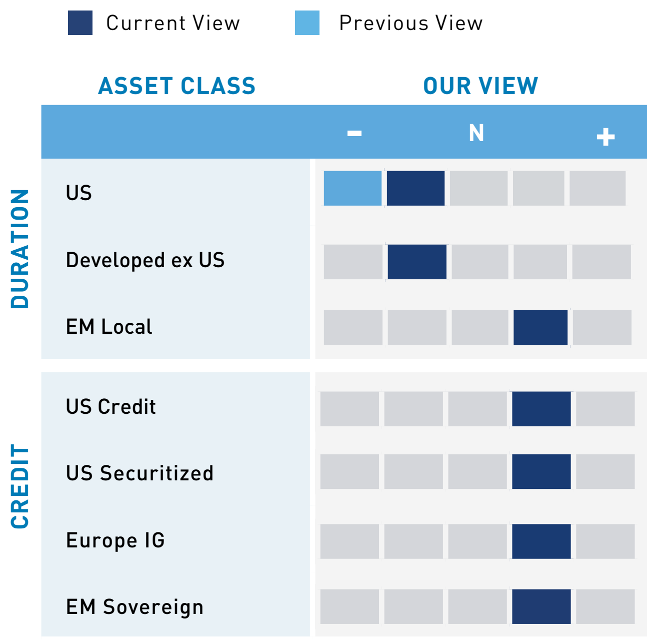
*Source: Refinitiv Datastream, IBES, data as of 29 September 2021.*

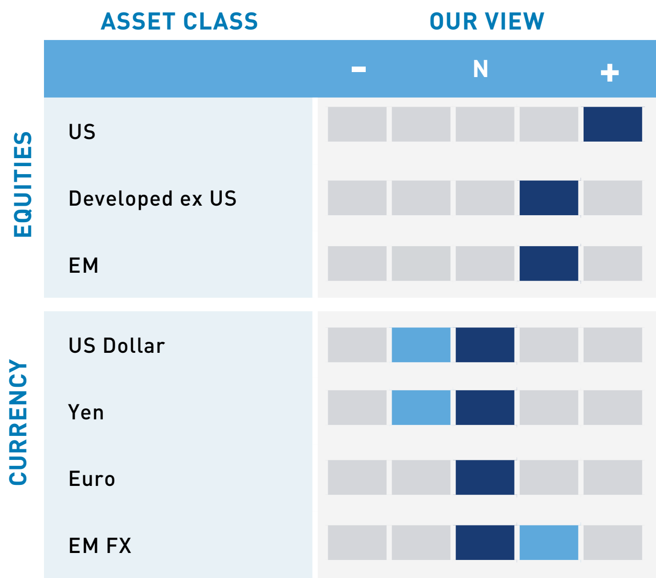
## POTENTIAL RISKS

### Supply chain bottlenecks could last longer than anticipated and may result in higher inflation.

- Inflation may stay higher than anticipated if supply chain bottlenecks become a long-term growth constraint. Remaining patient and accommodative may be the only tool policymakers have to effectively fight that battle.
- Disruptions from COVID-19 are likely to fade as worldwide vaccination continues. However, a return to synchronized global growth could still fail to materialize within the next year.
- A shift toward more severe policy crackdowns and ongoing deleveraging in China could negatively impact the growth outlook for emerging markets tied to China's growth.
- Developed market government bond yields have been shifting higher in line with expectations. If the move becomes a significant repricing of higher yields, risk asset valuations would likely take a hit.
- Negative shocks could spark downward revisions to our broadly positive outlook for corporate profits and risk asset performance.

## ASSET CLASS OUTLOOK



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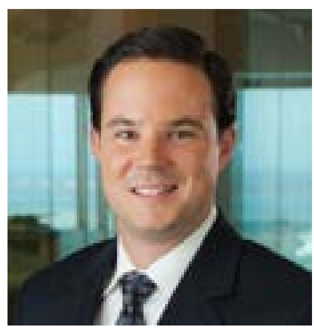

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