Prescient
INVESTMENT MANAGEMENT

MULTI-ASSET MONTHLY COMMENTARY

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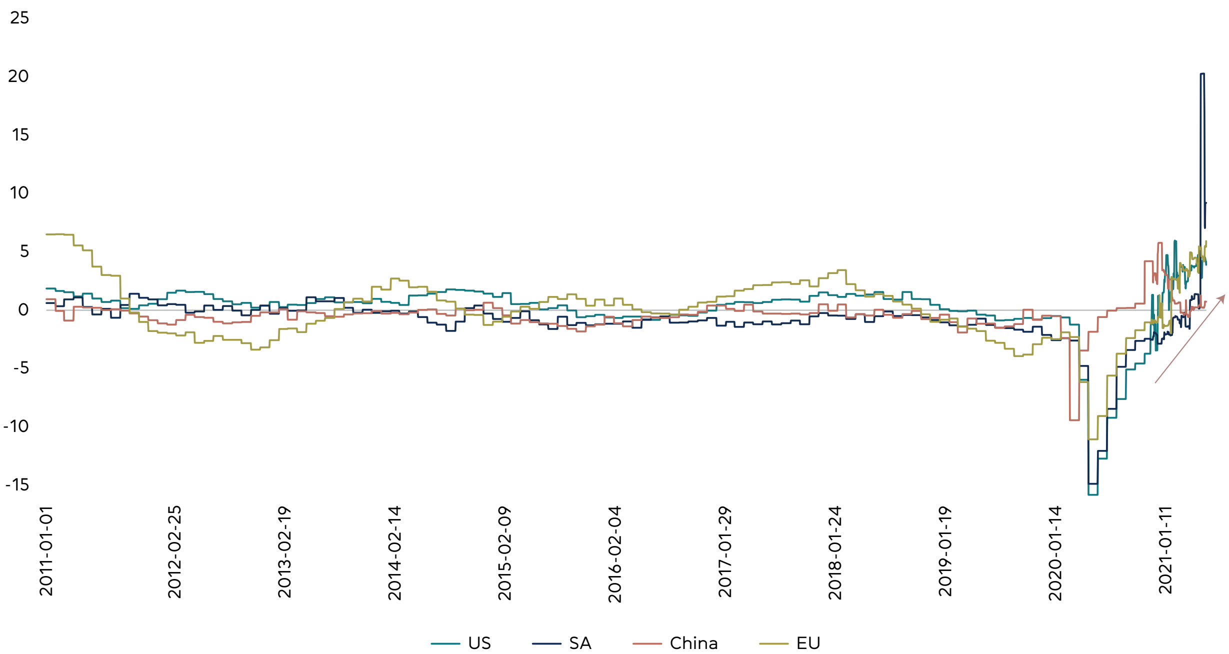
1. QUICK VIEW

- While 2021 started on an upbeat note based on expectations of a synchronised global upswing post the pandemic shock, the emphasis on the 'reflation' narrative shifted very quickly to inflation rather than growth.
- Risk assets have continued to rise in recent weeks, although at a much slower pace than in the first quarter.
- We remain negative on safe-haven assets, such as developed market bonds and the US dollar. On the other hand, we still favour growth assets such as SA equities, SA bonds and US equities.
- We maintained a neutral to moderate overweight position in US equities for most of the previous six months. Our indicators have now started to generate a high-conviction positive signal on the asset class.
- US CPI will likely decelerate as the lockdown-induced low-base effects start to wane at a time when commodity prices hit a soft patch.
- Fed Chair Jerome Powell continues to explain in his press conferences that the policymakers have commenced a discussion about the potential mechanics of tapering asset purchases.

2. GLOBAL MACROECONOMICS

While 2021 started on an upbeat note based on expectations of a synchronised global upswing post the pandemic shock, the emphasis on the 'reflation' narrative shifted very quickly to inflation rather than growth. While the focus on the global reflation narrative might have shifted rapidly towards inflation, this does not change the fact that global economic activity is recovering strongly following last year's COVID-19 induced slump. We have already seen strong activity numbers among some major emerging and developed economies in Q1 2021. The recovery will likely gather pace in the coming quarters, led by a pickup in aggregate demand on the back of vaccination progress. Our proprietary economic indicator suggests that this recovery may continue synchronously (see below chart) in the near term.

Prescient Economic Indicator



Sources: Prescient Investment Management, Bloomberg (as at 06 June 2021)

Risk assets have continued to rise in recent weeks, although at a much slower pace than in Q1. Credit spreads also continued to tighten in Q2 across Investment Grade and High Yield. Activity data has been mixed of late, and the big inflation debate is raging on. The strong rebound in economic activity seems to be the core driver of returns, particularly in the equity markets, which are more sensitive to growth cycles. As such, global equities have already posted double-digit returns, with some indices posting record highs. That said, developed markets primarily led this, particularly the US, and emerging markets equities have lagged their developed peers, mainly reflecting the disappointing vaccination performance and the limited room for further policy support.

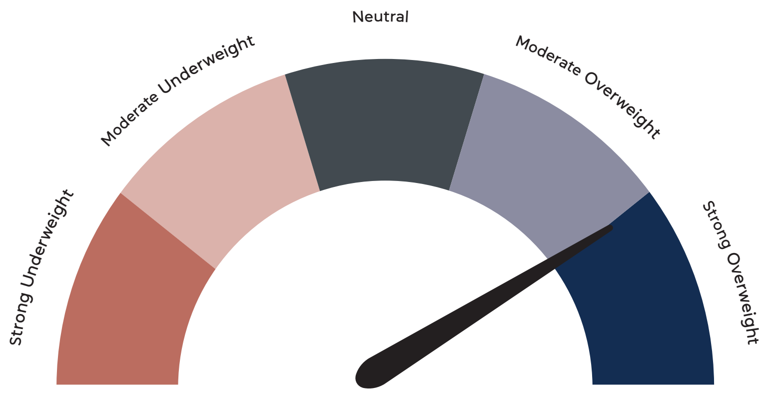
OUR SYSTEMATIC VIEW ON GLOBAL MARKETS

Our stance remains relatively unchanged from our last update. We remain negative on safe-havens such as developed market bonds and the US dollar. On the other hand, we still favour growth assets such as SA equities, SA bonds and US equities. The big central banks' liquidity creation, rebounding economies around the globe, and healthy sentiment are critical drivers of our risk-on stance. In the absence of any significant bout of risk aversion, equity market valuations will remain expensive as company fundamentals will likely take some time to catch up to rampant post-lockdown asset price advances.

	Strong Underweight	Moderate Underweight	Neutral	Moderate Overweight	Strong Overweight
Equities					
South Africa					Overweight
United States					Overweight
European Union				Overweight	
Emerging Markets				Overweight	
DM Small Caps					Overweight
EM Small Caps			Neutral		
Bonds					
South Africa					Overweight
United States	Underweight				
European Union	Underweight				
EM (USD)		Underweight			
EM (Local)			Neutral		
Credit					
South Africa					Overweight
DM Investment Grade				Overweight	
DM High Yield				Overweight	
EM (USD)		Underweight			
Real Assets					
SA Property				Overweight	
SA Preference Shares					Overweight
SA ILBs					Overweight
DM Property					Overweight
FX					
Euro					Overweight
British Pound					Overweight
Japanese Yen				Overweight	
SA Rand					Overweight

UNPACKING OUR VIEW ON US EQUITIES

WHERE WE CURRENTLY STAND



We have maintained a neutral to moderate overweight position in US equities for most of the past six to nine months. Our indicators have now started to generate a tentatively high-conviction positive signal on the asset class. This is mainly driven by the compression of the LIBOR-OIS spread to extremely tight levels, which led to further improvement in our financial conditions indicator. With that said, US equity valuations remain rich while the economy continues to recover on the back of improving sentiment. Furthermore, going forward, US CPI will likely decelerate as the lockdown-induced low-base effects start to wane at a time when commodity prices hit a soft patch. This should release much of the upward pressure on bond yields, which, in turn, would be supportive of the long-duration large-cap tech names that constitute a large part of the S&P500 index. Indeed, decelerating consumer price advances coupled with recovering economic activity represents a "Goldilocks" scenario, favouring risk-on positioning.

Valuations	Economics	Financial Conditions	Sentiment
Price to Earnings	Monetary Policy	Prescient Economic Indicator	Business Sentiment
Price to Book	Economic Surprise Index	Credit Spreads	Consumer Sentiment
Price to Sales	Profit Margin	Funding Pressure	Investor Sentiment
Relative Earnings Yield	Yield Curve	Cross-Currency Basis	
	Labour Market		

LOOKING AHEAD: RISKS TO OUR VIEWS

TAPER TALKS

There are a few key elements to watch post the 15-16 June FOMC meeting. Policymakers updated their economic forecasts for the first time since March. Of particular note are the projections for inflation and policy rates. Given the inflation, growth, and labour market data over recent months, the median projection for the Federal Fund's rate shifted higher to show that a slight majority of the 18 policymakers now project at least one 25bps increase in the federal funds rate by the end of 2023. In addition, Fed Chair Jerome Powell explained in his press conference that the policymakers had commenced a discussion about the potential mechanics of tapering asset purchases. The goal would be to provide more information to financial markets about how tapering would be structured, even as any decision to begin slowing asset purchases would remain dependent on "substantial further progress" toward the Committee's economic objectives. No immediate changes to policy settings are expected post this June meeting: we expect the FOMC to keep the Federal Fund's target range steady at 0-0.25% and to maintain a combined USD120bn per month pace for asset purchases – USD80bn per month for Treasury securities and USD40bn per month for agency mortgage-backed securities for the foreseeable future. By December, the "substantial further progress" criteria may have been met, and the FOMC may begin reducing its asset purchases.

The tapering process may continue throughout much of 2022, and we do not expect any increase in the Federal Fund's target range until at least 2023. Even if the Federal Fund's target range is kept unchanged, it is possible that two administered rates could be lifted post the June meeting. In April, the interest rate on reserve balances (IORB) was kept at 10bp, and the rate on the Fed's overnight reverse repo facility (ON RRP) was held at 0bp. Since then, the Effective Federal Fund's Rate (EFFR) has drifted lower from 7bp to 6bp, even closer to the bottom end of the intended target range. It is possible that the IORB and ON RRP rates could each be raised by 3bp over the next couple of months. In his future press conferences, Fed Chair Powell will likely highlight that these technical adjustments do not have broader monetary policy implications. While this may represent unchanged monetary policy configuration, financial markets are forward-looking in nature. They may start to discount gradual withdrawal of liquidity, which would present significant headwinds for risk-on positions.

BRINGING IT ALL TOGETHER

Admittedly, the easy part of the recovery trade is firmly behind us. However, we continue to see pro-risk positioning as appropriate in the current environment - where inflation is likely to have peaked and the rate of change in economic activity remains buoyant. Our tactical models have kept us in risk assets over the past nine months. We will continue to lean on our robust data-driven process for guidance going into the second half of the year - which may prove to be a relatively more challenging environment for generating satisfactory returns.