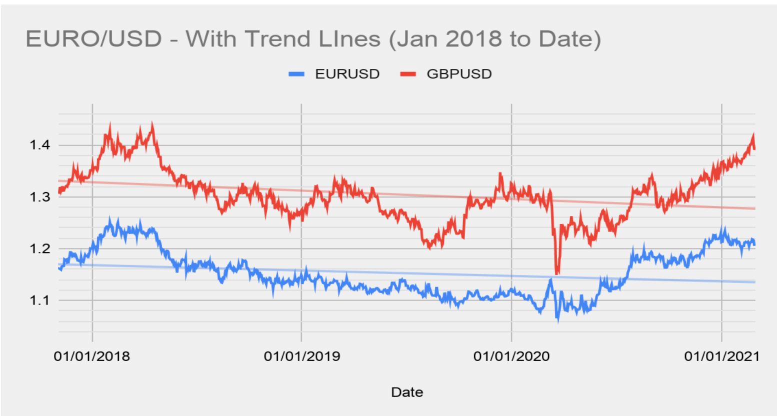
The Market Wrap

February 2021

Introduction - Welcome to our February issue of our monthly summary of the market. We shall give you the price action across asset classes and offer our insights and opinions. We hope these will aid your understanding of markets and the complex system that is the global economy. We shall generally use ETFs in our market appraisals as these are easily accessible and liquid entities that are now in very common use and reflect most facets of the markets. We hope you enjoy and if you have any questions please visit our website: www.toiip.com or contact us at: info@toiip.com - Thank You and enjoy !

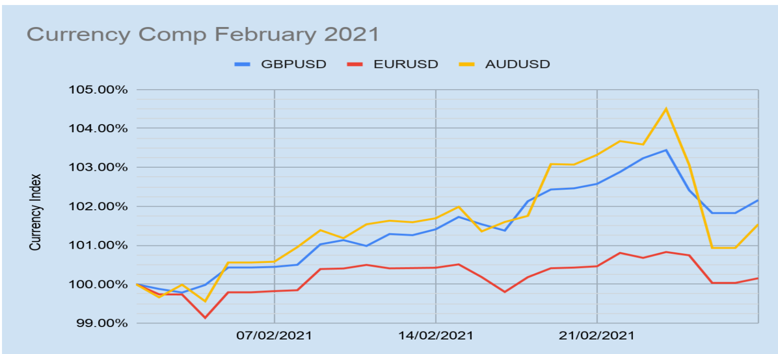
Currency

This month saw the DXY stabilize a bounce a little from its lowest levels so far, we would see it being in a near term range of 89 to 92 and would want to see a breakout above the 93.5 level to see it switching to a bullish trend. The GBP os showing strength and emerging market currencies have been fairly muted this month with the USD showing a small recovery. The USD is still very important to shining light on this market especially as yields in the US are on the rise and this could add to the strength of the USD. We still see the general dilution of fiat currencies and the winners will those diluting less and current account surplus economies

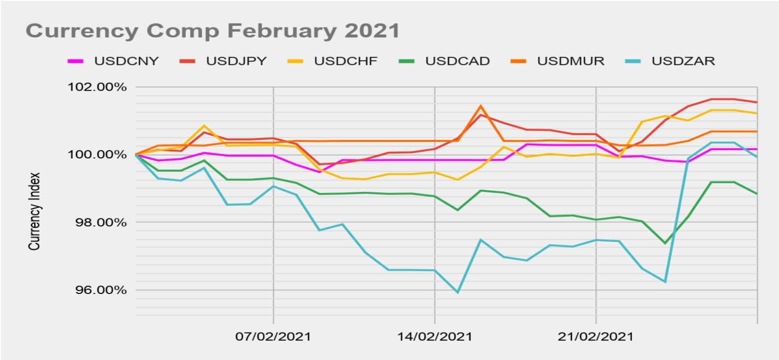


The Euro seems to have hit a plateau for now as the USD appears to have found a bottom and has been consolidating to now slightly strengthening, which can have large implications for both inflation and the global economy. GBP has seen continued strength as the vaccine rollout has been very successful in the UK especially when compared to Europe. It does remain to be seen whether this strength can be sustained going into the future. We do see headwinds coming later in the year and further USD strengthening may undermine this as well.

The Euro lagged the other currencies this month for varying reasons least not the rollout of the vaccine in Europe has been much slower than anticipated and therefore the recovery in Europe will probably be a lot slower than other parts of the developed world and resistance to the vaccine there seems to be more pronounced than other places around the world. GBP and AUD fell as the USD strengthened.

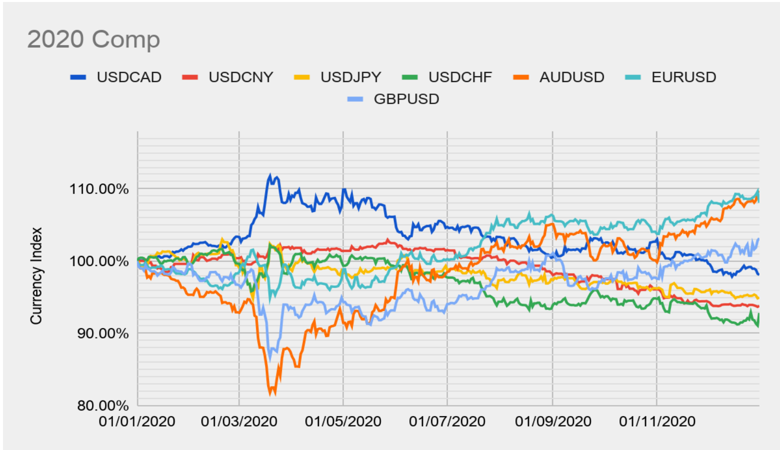


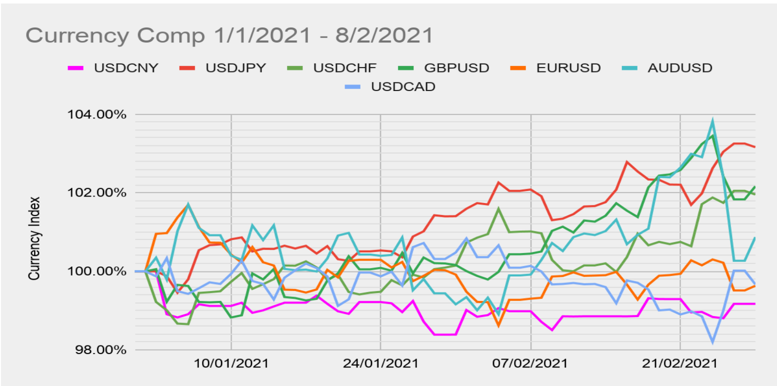
The USD has consolidated over the start of this year and now seems to be moving up towards the higher end of the 89 -92 range we stated before. To be bullish we would like to see USD breakthrough 93.5.



Generally against other currencies we saw a flattish month with perhaps a bottoming out process in the USD as support level in DXY held. The exception was the South African Rand which may be a virus story as we saw a new more transmissible variant emerge out of South Africa. This will present more challenges for the economy which has already been hot hard by this pandemic. CNY was the strongest of these currencies.

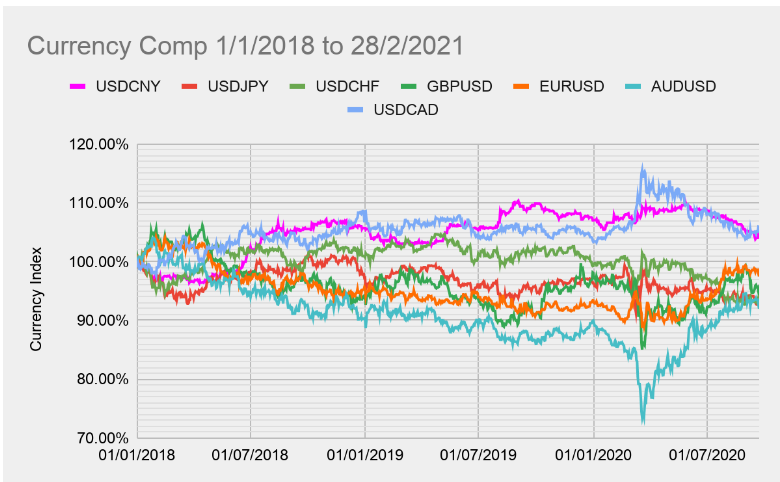
Over the course of 2020 we have generally seen USD weakness, which has been in line with the general hope of recovery and initially a V shaped recovery. This has not come to fruition and as we come to the realisation that this is going to be a long hard slog, we see the USD downtrend faltering and we could see some reversals in the past trends. The story of the USD will be important this year and we need to watch it carefully. The AUD has had the strongest recovery from its initial fall which was also very pronounced.





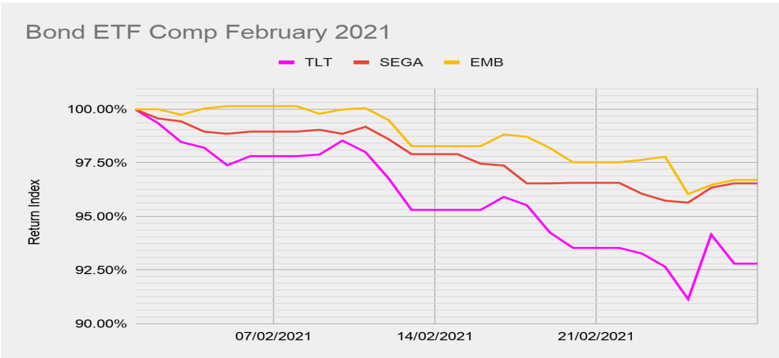
Over the second half of last year to date we can clearly see the weakening of the USD by around 10% across the board. This was the expression of the reflation trade and this has now become a very crowded trade. Any upsets to this narrative can see a reversal in this trend and we would see that happening to some extent throughout the course of this year. Hope is a great thing but must be tempered with reality, the comparables are good for now but be careful moving forward.

Over a longer time frame we can see that the USD has held strength over time and especially in times of stress as it still represents the safe haven trade. As the hope fades and reality sets in we would still see general strength for the USD the other currencies are printing with comparable speed and will be more willing to devalue their currencies to achieve the growth they all need. Growth after the initial spurt is going to be elusive and markets will come to this realisation with time. Boosting aggregate demand will prove a struggle.



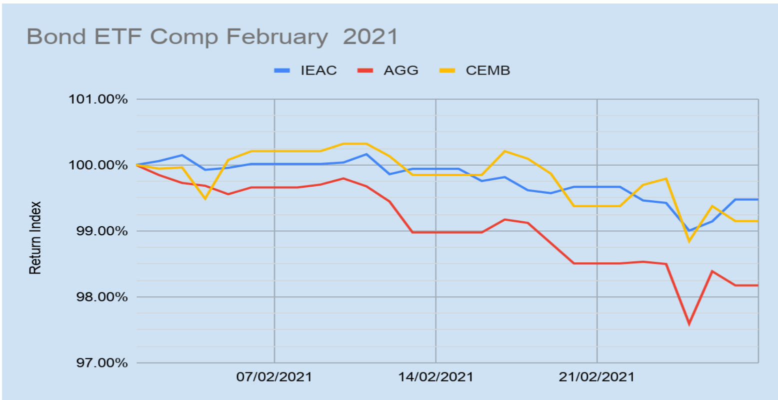
Fixed Income / Bonds

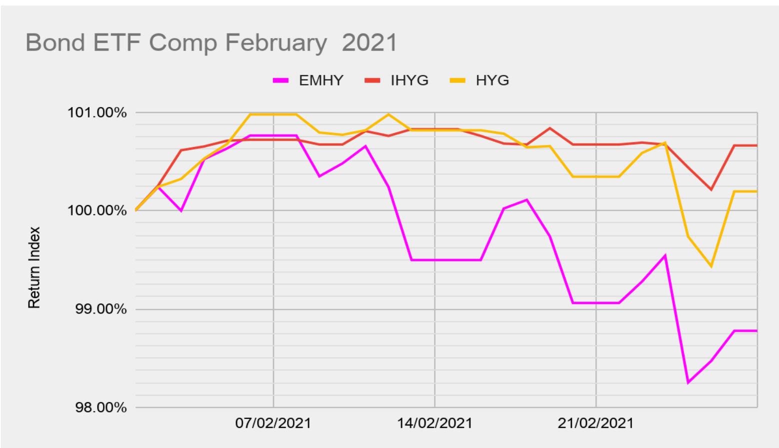
We saw this month the continuing rise in yields across the globe as the markets started to price in inflation and growth expectations as these grew. This trade is very consensus and is becoming very crowded. At some point, but not for a few months we would see this reversing and quite sharply due to the crowding of the trade. For now we would look for this to continue until central banks have to step in, in some way to curtail this rise. We see Europe as being most susceptible to higher rates.



TLT representing the US long term government rates saw quite a large drawdown this month as the rates continued to rise. As yet the FED has not stepped in to stop or even slow this rise so we would see this continuing at a slower pace until there is some reaction from the central bank. Europe and emerging markets also followed lower but to a lesser extent. Again we see this continuing in the short term.

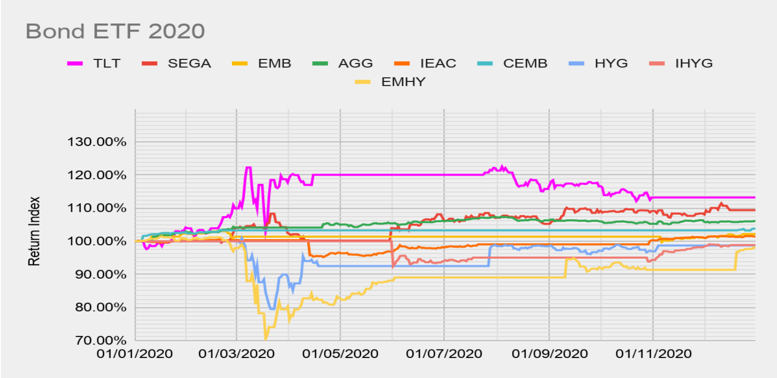
Investment grade bonds around the globe also saw a drawdown this month with the AGG lead the way as we saw rates generally pick up. There is still a huge issuance of debt in this sector and the up take is still generally good as investors continue to search for yield. The rise in yield is caused by both rising inflation expectations and the hope of future growth. GDP will pick up this year however we still have reservations about the sustainability.





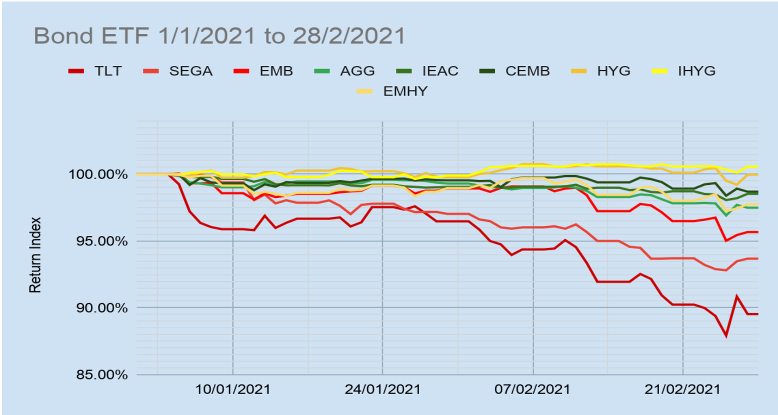
The high yield sectors fared a little better as investors were forced further out the risk curve in their hunt for yield. One does need to question whether investors are getting rewarded suitably for the risk they are taking. We would tend to think that at this point they are not really getting that ratio falling in their favour and although this asset class could see further appreciation we do feel that the upside is limited and the downside although deemed to be limited may not be as limited as people may perceive

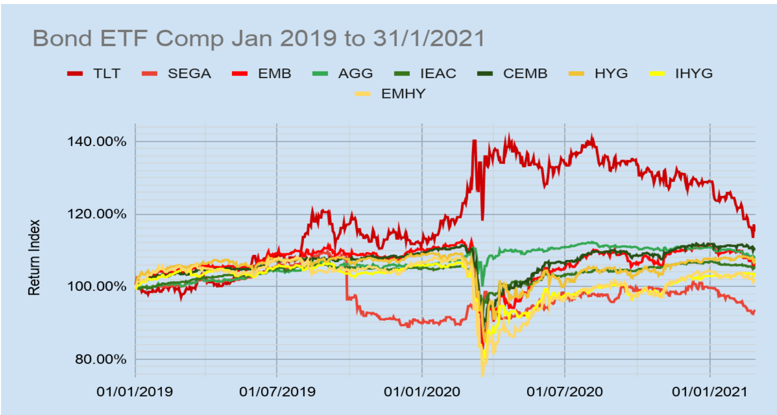
As favourable data and base effects continue over the next few months we would look to see a continuing but slower rise in rates over the next few months. After that it becomes a little less clear.



Over the course of 2020 the best bond performance was from US government bonds, the safe haven tarde not unsurprisingly in this time of uncertainty. As we got more clarity and visibility on the likely path and outcome of the pandemic its performance did start to falter in the second half of the year. Emerging market high yield suffered the largest drawdown in the initial panic but has since staged a recovery as risk appetite has built.

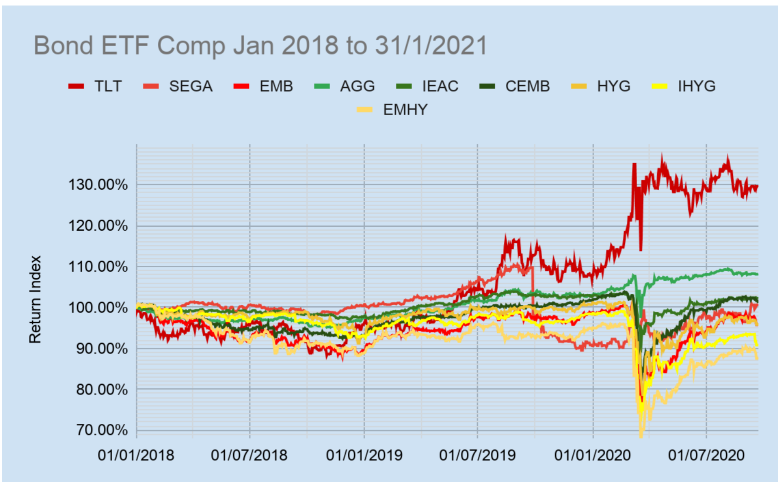
Since the start of the year we can see here how government bond yields around the world have started to rise, being led by the US rates. This is due to both rising inflation expectations and also hopes of growth coming from the re opening. At some point the FED will want to arrest the rise of longterm US yields as this will slow the housing market, influence growth stock prices and could dampen growth. We think this point has not come yet but it is not that far away.





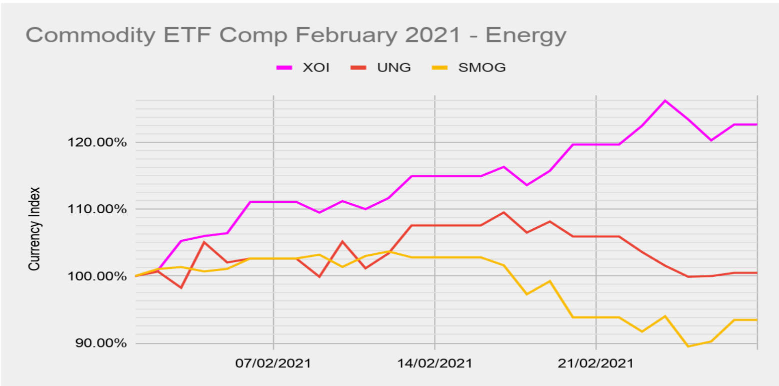
Over this 2 and a bit year time period we can clearly see how the safe harbour of the US Government long bond has been the best performer over this timeframe. The performance of this has started to roll over as the market starts to price in both inflation and growth. The numbers will support this narrative in the short term but may later in the year struggle to continue to support this belief. We would see further falls in the short term but would look to start getting long again in the middle to the end of the year.

The out performance of the US government long bond is more pronounced over this longer time frame of 3 years plus. This does certainly illustrate the importance of having some allocation to this asset class in any portfolio. As stated above we are experiencing a drawdown at present but need to keep a close eye on the economy to know when to start increasing our allocation to this area. The amount of debt build up around the world is quite staggering and will have an effect on the future growth of this economy.



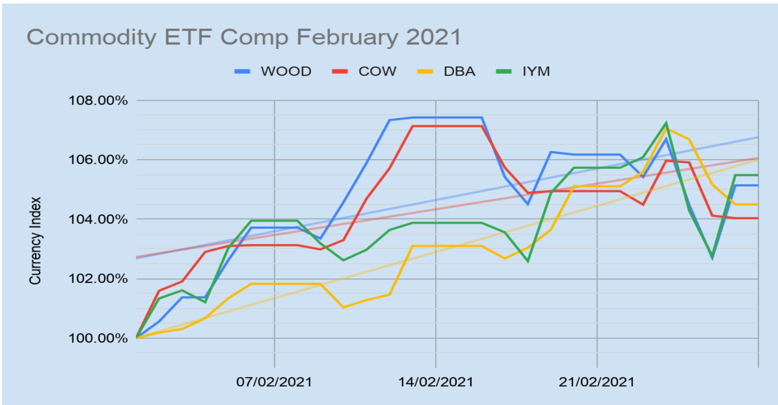
Commodities

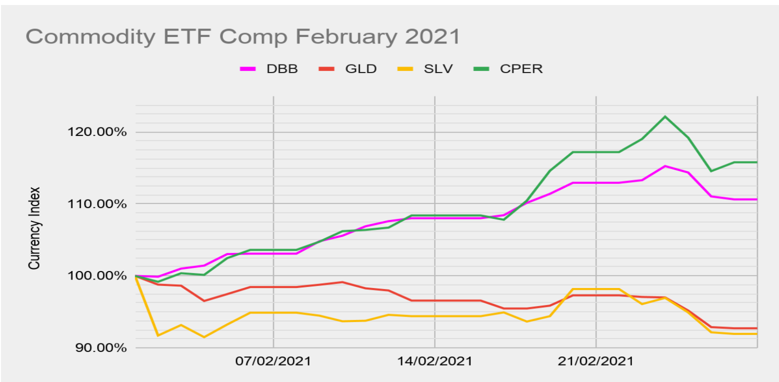
Commodities continued their general upwards trend this month. Gold and silver had small drawdowns over the month as nominal interest rates rose and this had a detrimental effect on their performance. Oil continued its advance and we still see this continuing into the future but not in a straight line. As the USD has seemingly found a bottom we think this could become a headwind to the commodity story



Energy prices have remained muted over the past month but as mentioned above there could be some upward pressure to come as we see colder weather in the northern hemisphere and the global roll out of the vaccine continues. Although the pace of the roll out is not as rapid as most have expected and is certainly not uniform, the production and logistical problems may extend the timeframe to the unwind of lockdowns and therefore recovery.

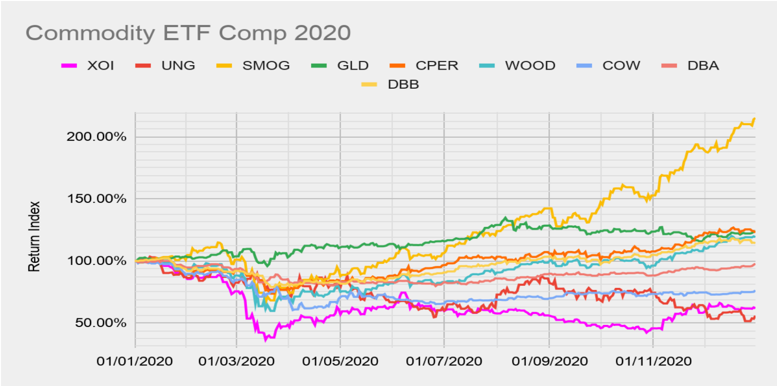
This group of commodity ETFs saw a general uptrend this month initially but again levelled out towards the end of the month as the USD showed some strength. The USD will play a big role on further price movements here as the market is still very short of the USD this year and sees the currency continuing to depreciate. An unwind in this could cause a pullback in the commodity sector. We believe that the USD will be fairly constant this year and commodities will slowly move up.





Copper and base metals saw a continuation of the uptrend although they also levelled off toward the end of the month.Gold and silver saw a small drawdown as the US yields rose during the course of the month and we would see this continuing for a while. We are still not convinced that inflation will be sustained after the initial burst , would still look to increase our gold holding at lower levels. We still are undecided about these levels and the allocation.

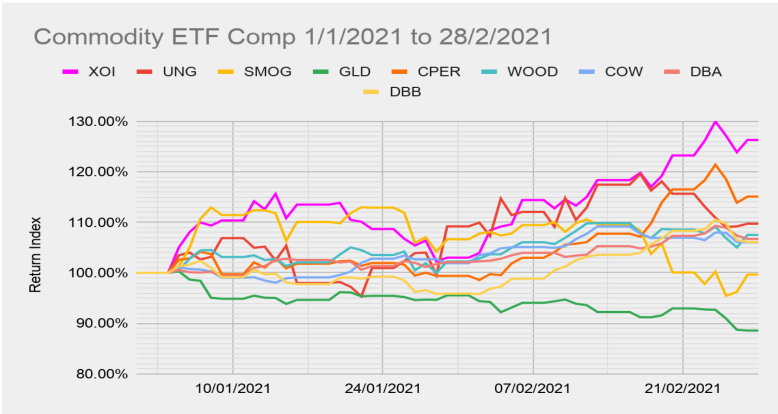
The reversal we saw in the gap between ESG and traditional energy plays has started to reverse in a small way and we would see this continuing in the short term.



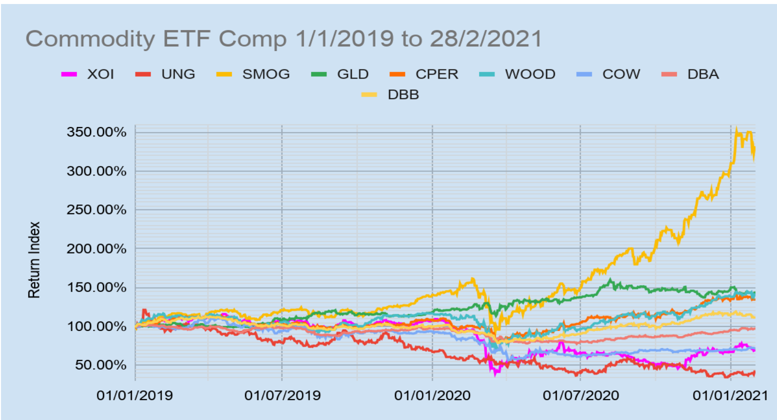
Commodity ETF Comp 2020

2020 saw the massive outperform of the low carbon sector as the general green narrative took hold and the market ploughed money into the section of the economy. This has very much been a momentum play and we feel that as reality raises its head we shall see the tailing off of this trade as people reassess their allocations. Traditional energy plays will come back as they are probably best placed to evolve into the new green economic players.

Oil has started to appreciate so far this year as the predicted recovery in traditional energy takes place. Low carbon sector has levelled off so far this year. Gold has seen a continued decline this year as real yields have slowly risen as nominal rates have risen. Copper still shows signs of appreciating as the markets look to the electrification of the world. The path of the USD will be important for the rest of the year and will have a bearing on the commodity sector.



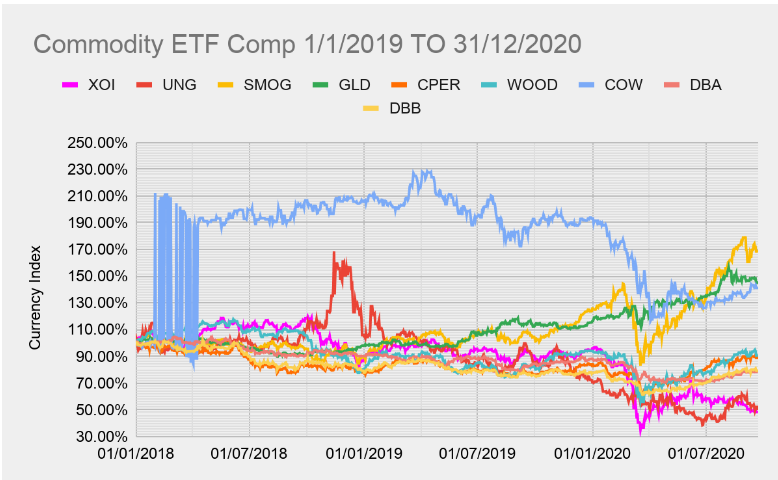
Commodity ETF Comp 1/1/2021 to 28/2/2021



Commodity ETF Comp 1/1/2019 to 28/2/2021

In a look back over the last 2 years or so we can clearly see how the low carbon sector has been a massive outperformer, but has just seemed to top out in the last month and has started to slightly reverse. Natural gas has been the under performer over this period and may have some upside moving into the future as the market rethinks how the future will look in reality. Gold has seen steady appreciation , but has fallen back with rising real rates, we feel that at some point this will change.

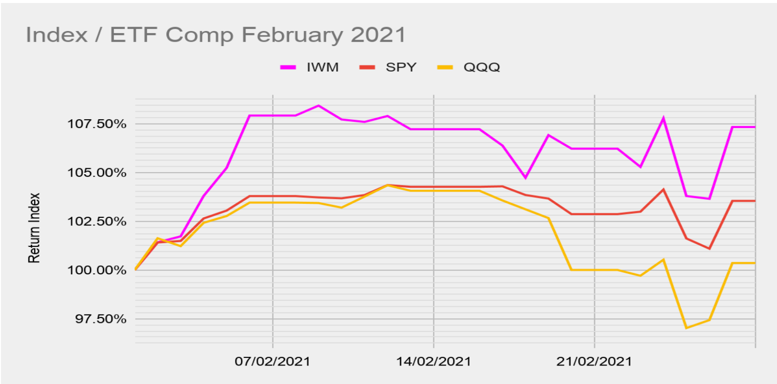
Looking back further around 3 years we can see that Gold has been right up the top in performance over this timeframe and as mentioned above would look to reenter this trade probably somewhere around the middle of this year as we see growth and inflation starting to slow towards the end of the year. We could also see some USD strength towards the latter part of the year and this would present headwinds for the commodity sector in general. Oil will be subject to demand and we do not see that supply will be an issue moving forward for the immediate future.



Commodity ETF Comp 1/1/2019 TO 31/12/2020

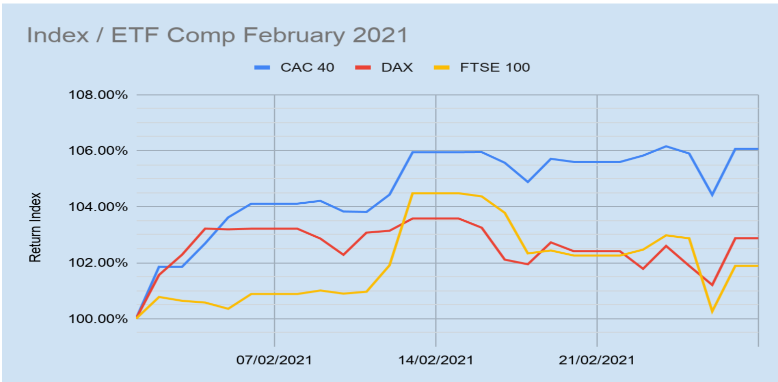
Stock Indexes

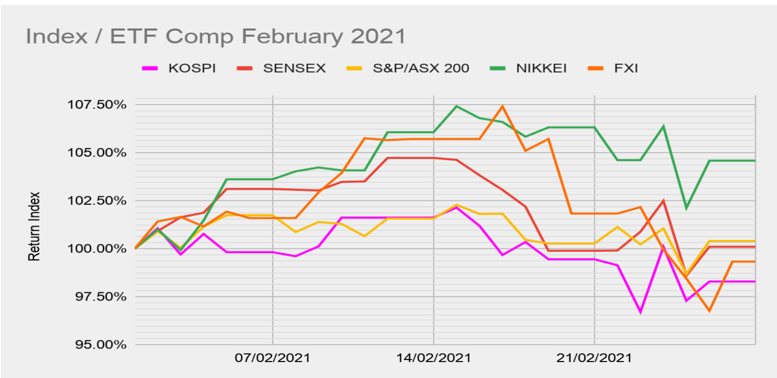
These are the local indexes of varying countries reflecting the value of the companies quoted on them, importantly in their local currency. We must always bear in mind the Index performance and the currency performance against other localities. Investing is a relative game and we like to show comparative charts to identify this and point out the opportunity cost of choosing one investment above another. For risk aspects we prefer developed markets, and prefer to enter smaller markets via investment vehicles that are located in developed markets. Liquidity can be an issue.



In February it was the US small caps that led the way as the market was in risk on mode even as US rates were rising, on the belief that growth was going to pick up in the economy. The base effects for the next few months will certainly show that for both growth and inflation but once these have gone away the story will become harder. We are not as confident as the markets are that growth will continue to accelerate and think there will be a slowing.

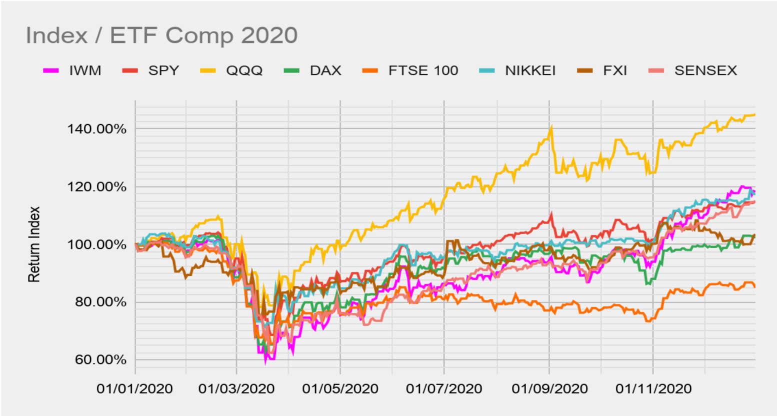
Europe as a whole saw a small appreciation over the course of the month of February. The UK was the slowest of these shown markets, which is somewhat surprising as their vaccination rollout seems to be going very well, especially with the disaster that is the European vaccine program. There is also a worry that a third wave may hit Europe as the different variants are present there and could definitely cause problems there.





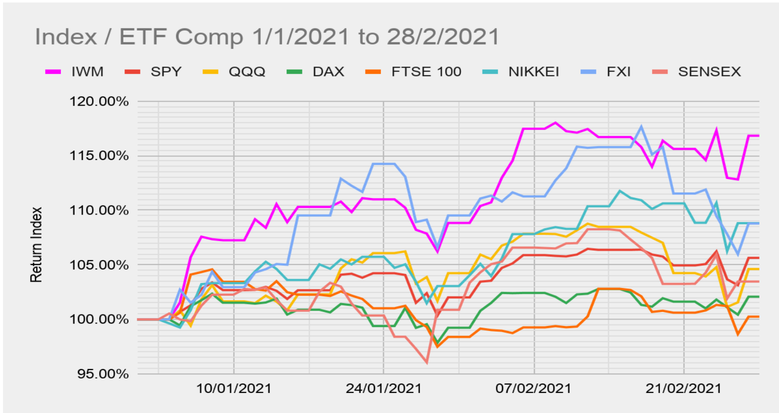
For February it was Japan that showed the greatest strength. It also seems that China may be slowing which does cause concerns for the global economy as it was the first into this pandemic and also the first economy to come out of it performing remarkably well in 2020. If they are having issues this may be an indication of what lies ahead for the rest of the world. The Kospi was also flat on the month.

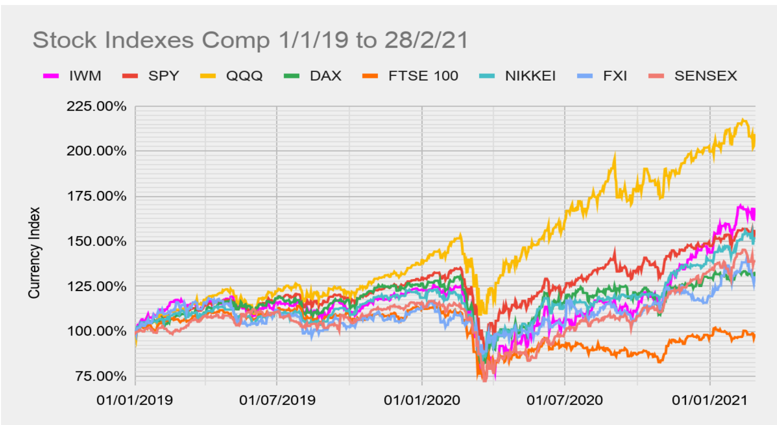
Let us now take a bigger picture look at what has transpired over recent history and also the last few years to gain some perspective.



Over the year of 2020 it was by far the technology sector that led the way as we all looked to how we could continue to work from home and technology was the answer and the markets poured money into this sector. The UK was the worst performer as their economy suffered badly under various lockdowns and restrictions, along with overhanging issues about Brexit.Other parts of the world generally recovered their starting levels by the end of the year, even though economies did not.

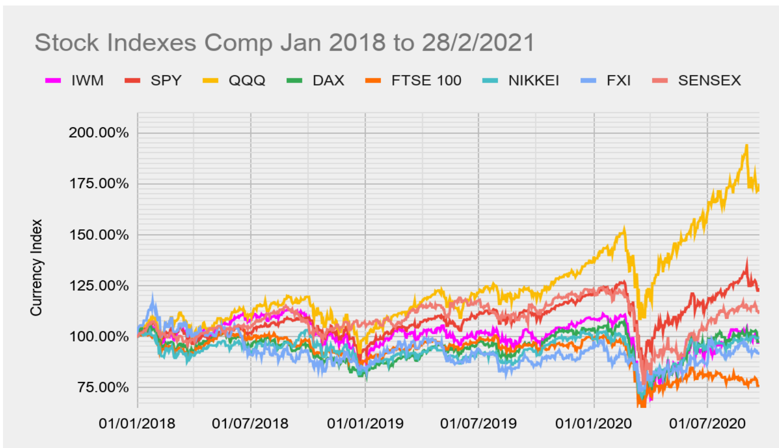
So far in 2021 it has been the US small caps that are leading the way in markets as there is a general reflation and growth narrative in play at present. Internationally it is Japan and China that have performed well so far but in the case of China they are rolling over a bit which should be of concern to the global economy. The UK market is still very much the laggard and Europe is not fairing that much better with their poor performance in the vaccination rollout.



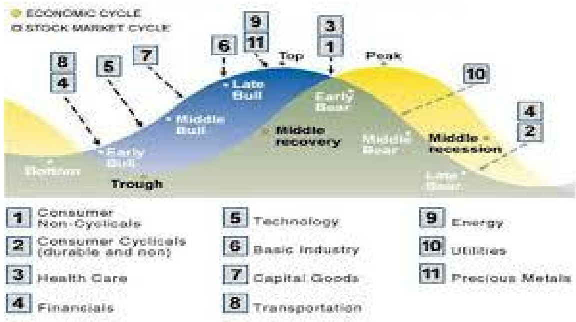


Looking back over the last 2 years or so we clearly see how US technology sector is leading the world into the future and realistically we can see no real reason for this to change, but with the proviso that the valuations of some of these companies are quite steep at present and they may take some time to grow into these valuations. Again the UK is the visible laggard here with the various issues that it has had over the recent years. Hopefully they can recovery strongly from the pandemic.

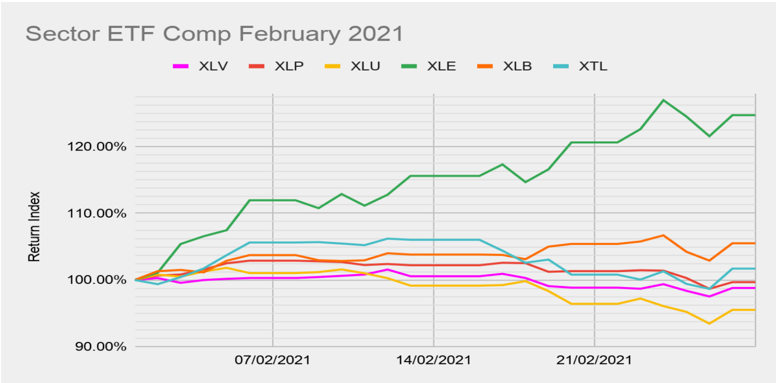
Looking further back we can basically see the same picture with the US tech sector leading the way and the UK struggling to just maintain its value. Europe and other markets around the world have basically remained stable perhaps with small declines and we feel that this will challenge the global growth story moving forward. At present there are so many headwinds to global growth that it will take something quite extraordinary to spur growth at the pace that some investors are expecting.



Sectors

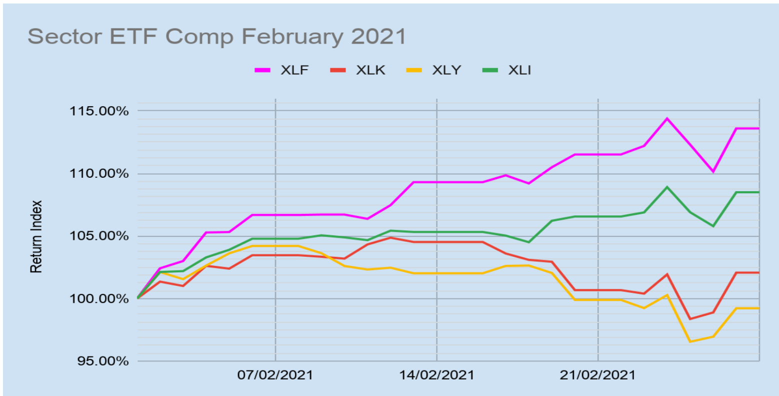


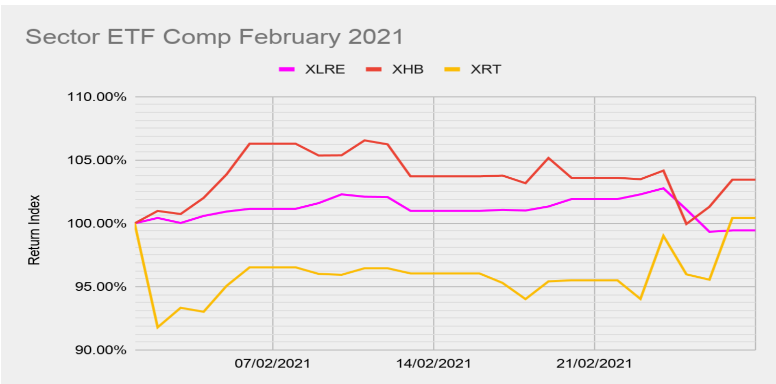
We use sectors to place stocks and other investments into categories such as technology, healthcare, energy, utilities and telecommunications. The different sectors have diverse risk profiles and perform at varying degrees throughout the business cycle. Here we shall contrast and compare the performance of the different sectors over time to help our understanding of their relative virtues with the target of augmenting our investment returns over time. We generally use US markets as these are the largest and most liquid.



In February we saw the Energy sector lead the way this month as the rotation trade continued. The other sectors shown, mainly the defensive sectors were basically flat on the month with the energy sector creating a large amount of alpha this month. We think that even though the energy play does have further room to run it may slow in its ascent from here.The bond proxies XLU and XLP should be avoided for now as they will continue to underperform.

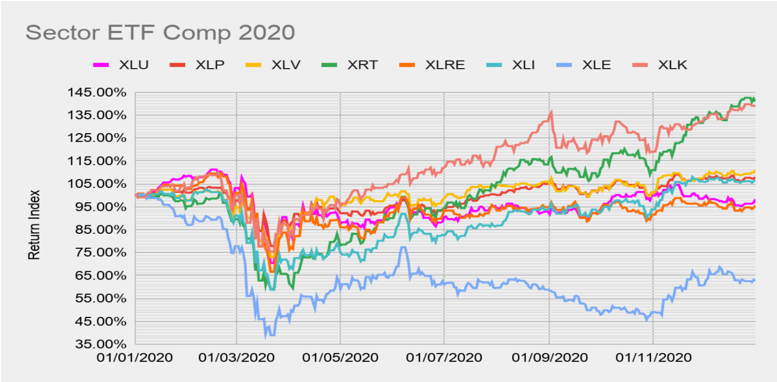
The financials and industrials had good months also. Financials as the yield curve in the US continued to steepen and again we feel that this will slow as we come closer to 1.75 - 2.0% and we believe that it may roll over in the latter part of this year as the initial burst of growth and inflation in the economy dwindles as the economy come to terms with the new reality of the economy. Aggregate demand will need to be watched carefully along with credit growth.





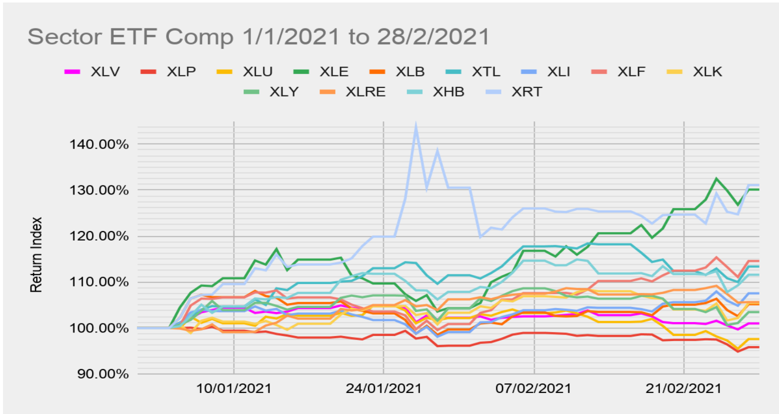
Retail had a very quiet month in February after its stunning performance in recent months and although there may be some good months ahead, the latter part of the year we feel will be a struggle for this sector moving forward. Real estate and home builders had fairly flat months, and although there is a structural housing shortage in the US there is a mismatch between units needed and the type the homebuilders want to build.

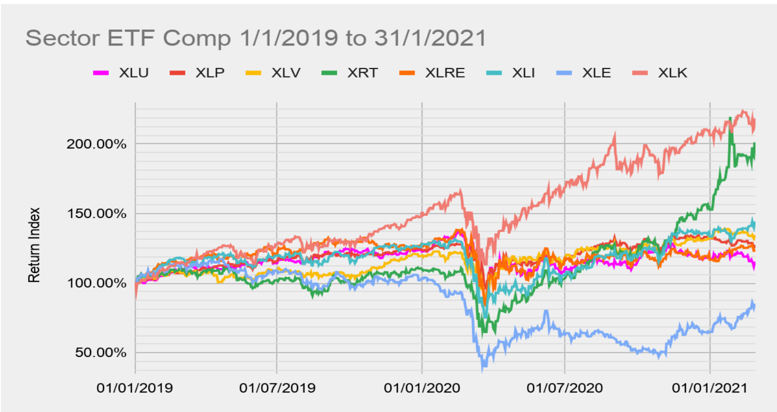
As we move into a new year with fresh hope let’s take a look back over the recent years to see where it is that the markets can potentially go and the trends that have been in place in recent history.



It was Tech and Retail that were the best performers of 2020 by quite some measure despite the pandemic in the case of retail and because of the pandemic in the case of Tech. Energy was the worse performer as the global economy was shut down for extended periods during the course of this year. The other sectors struggled to recover their starting points from the beginning of the year.

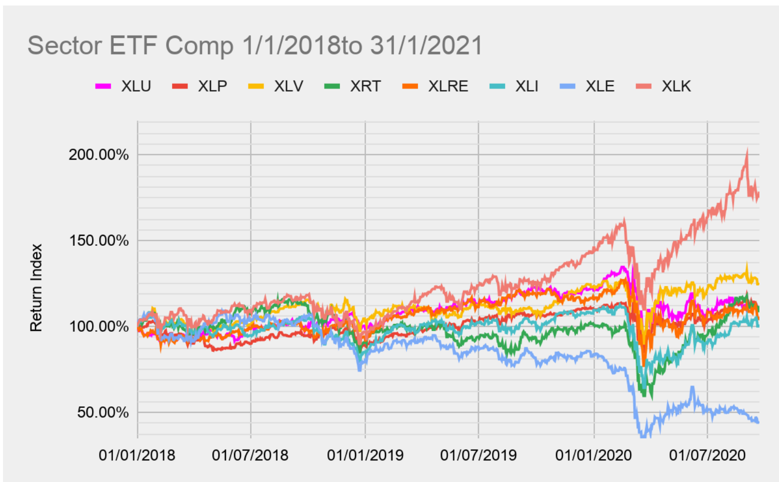
So far this year we can see that energy has made a very strong comeback as we suspected and retail is still performing well even though it has rolled over a bit in the last month or so. Financials have also done well so far this year as the yield curve in the US has started to steepen. Although retail and the financials may have further room to run in the coming months as economic data will be good, we would look to start being cautious on these sectors and we think that they will have some downside.





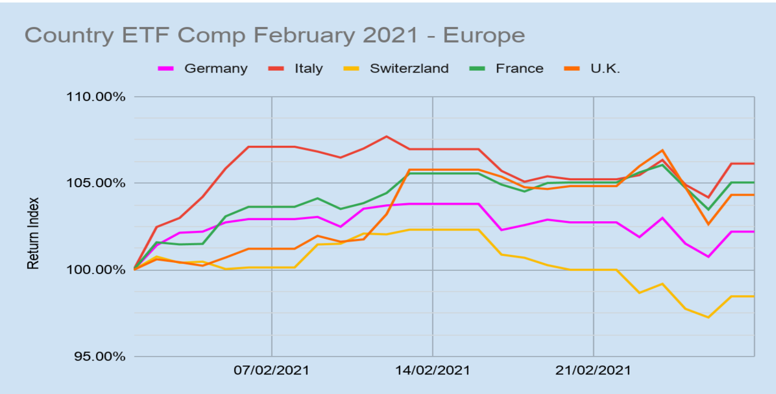
Over the last 2 years we can see that the same trends remain in place with tech and retail being the best performers, with energy being the stand out worse performer. The remaining sectors have not really had any great movement over this period, perhaps a small appreciation in general. So we can clearly identify the sectors that it is important to be invested in in order to have generated alpha. Energy still has room to run we believe and should be accumulated on pull backs.

Over the last 3 odd years we can see that retail as a sector has not had any outperformance over this period and this demonstrates that since the start of the pandemic its performance has been quite remarkable and we do think that there will be challenges ahead for this sector as it has come very far very quickly. The same can be said of the tech sector. Energy is by far the worst detector and demonstrates that there remains possibilities for alpha generation in this space, but with the green revolution you will need to be very selective.



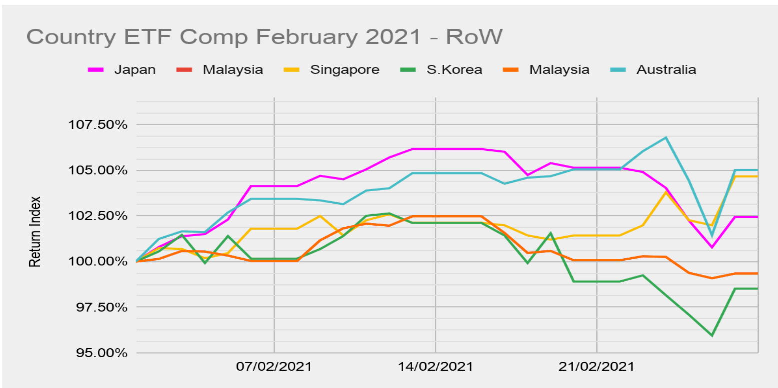
Geographic

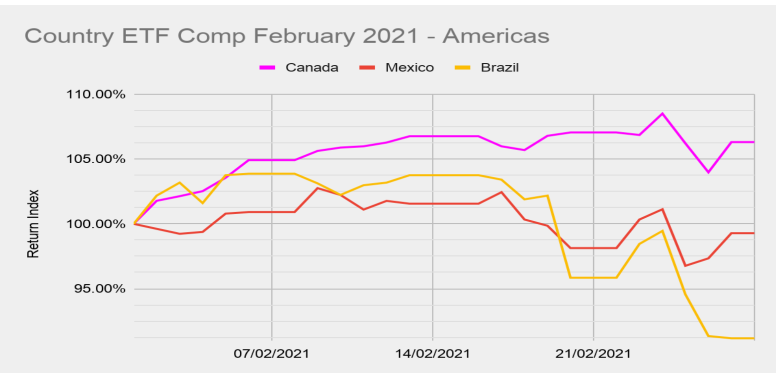
Certain countries or regions around the world will be experiencing different economic circumstances at any given time, usually. Therefore it is important to access these differences and utilise them in order to create greater returns on your capital. In this section we shall look at a range of ETFs, all quoted in USD covering varying countries around the world and look to analyse their differing performances and where they are in the economic cycle so that we may look to add value to our investment decisions



Europe with the exception of Switzerland saw growth in general despite their appalling vaccination performance to date. This will hinder their recovery but it could be very rapid over the summer period if they manage to get their act together and the vaccine production ramps up. We do like these markets in the short term and it is worthwhile to have some exposure here. Germany would be our preferred place to put some money to work.

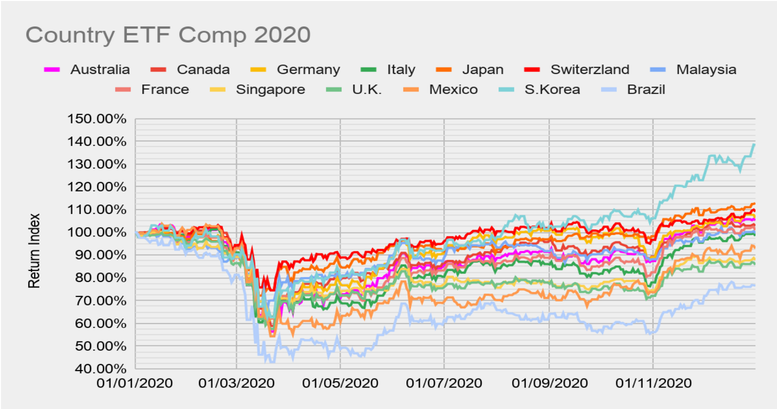
In february the doctor S.Korea was flat to down as we saw a pause in the global reflation trade, We need to watch this closely for any changes we think we are seeing consolidation and it will start to move higher but need to watch the DXY as well for any strength. Singapore has performed well and may warrant some capital allocation. We are still basically watching a risk on the environment and this should continue through the first half of the year.





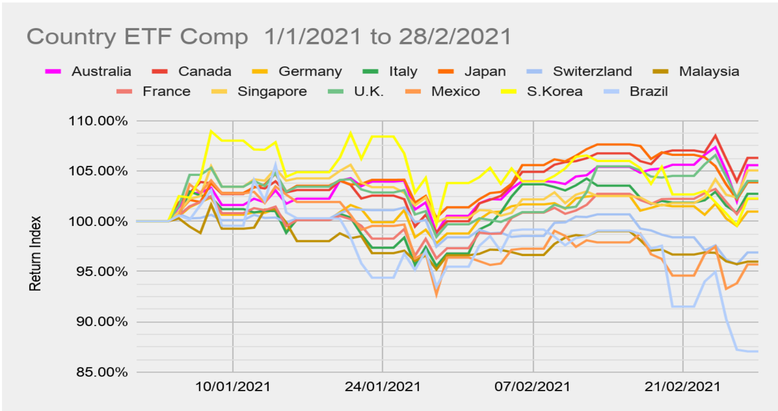
Here we can see that Brazil is suffering from their very poor performance in handling the pandemic. While Mexico is not really going anywhere at the moment, Canada seems to be picking up momentum. In general at present we think that there are better regions to put money to work than any of these at the moment. Mexico may be worth keeping an eye on for later in the year and also at some point in the future Brazil will present opportunities.

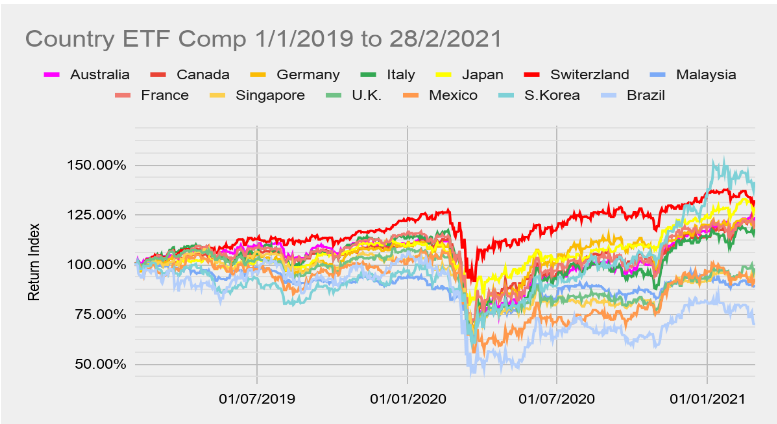
Let's step back and take a bigger picture look at the performance of the various regions leading up to and after the start of the pandemic, to see if we can gain some insight as to the possible trends moving forward.



.The doctor: S.Korea was the best reformer by some way over the course of 2020, as they are a tech heavy economy and dealt very well with the pandemic.Most other countries have really struggled to recover their starting levels of 2020 and their economies have not yet caught up and how the economies perform from here on will be imperative to their future performance. Vaccination programs will decide how quickly their economies can reintegrate back ito the global economy.

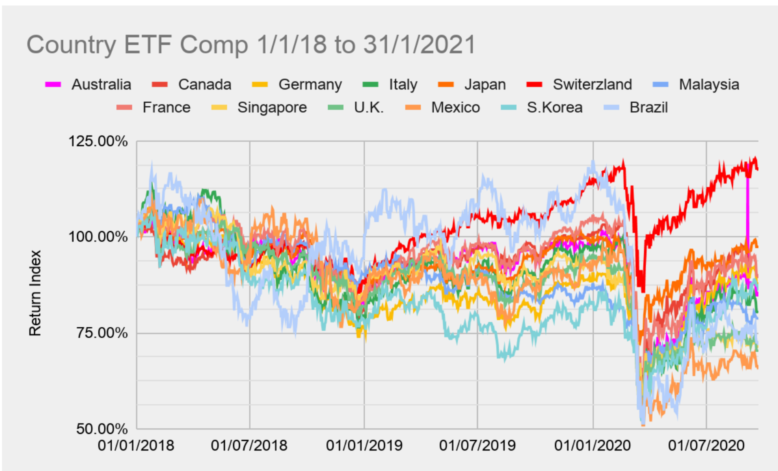
Over the beginning of this year we can see that the commodities countries: Australia and Canada have performed well so far this year, this may change as we start to see a possible bottom having been put in the DXY and USD strength from here would have a detrimental effect on these economies. Brazil has been the worst performer and this is down to the pandemic situation in their country. This will persist for some time until they can get a handle on the situation.





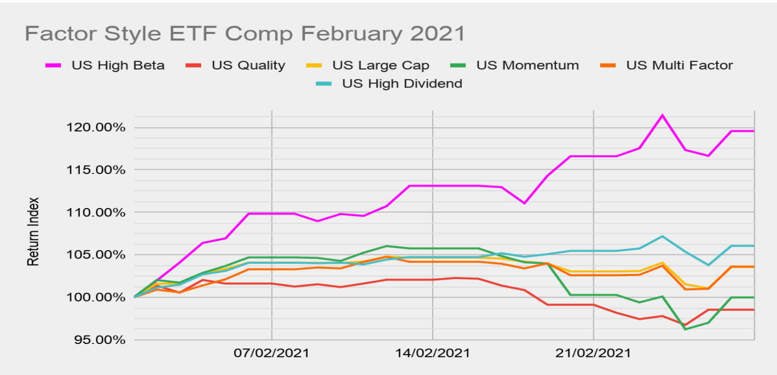
Over a longer time frame of roughly two years we can see that the safe haven of Switzerland and the dynamic economy of South Korea have been the best performers. As we start to see this global recovery we would favour Germany and Singapore from here over the next few months. The UK may also be a reasonable place to put some capital to work as they have a good vaccination roll out and should be fully open by the middle of the year, therefore see improving numbers.

Here we take a look back over a slightly longer time frame of 3 odd years, and here we see that Switzerland is still the best performer. The rest have really struggled to regain the levels that they were at 3 years ago. This really demonstrates how the US economy has been the main place to have had capital at work. The question remains that is this going to be the case moving forward and with the amount of fiscal spending that seems to be coming over the next couple of years we would tend to think that this would remain true in general .



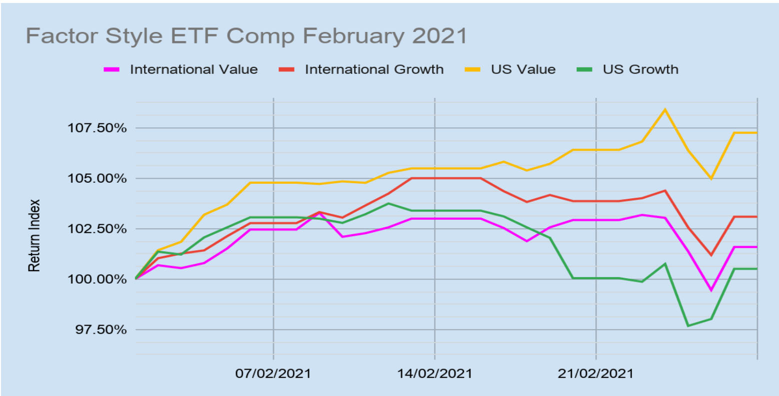
Factor Styles

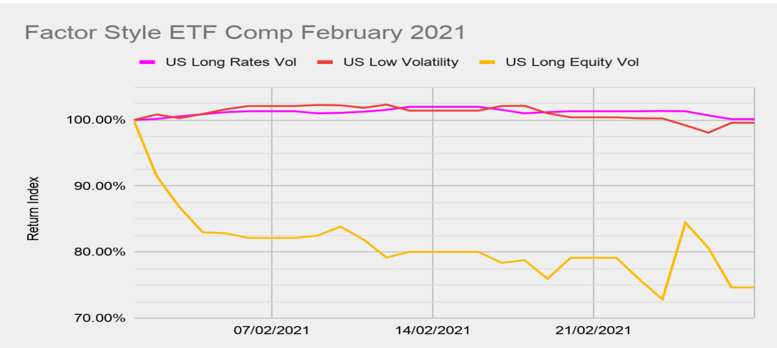
Factor investing is a strategy that chooses securities on attributes that are associated with higher returns. There are two main types of factors that have driven returns of stocks, bonds, and other factors: macroeconomic factors and style factors. The former captures broad risks across asset classes while the latter aims to explain returns and risks within asset classes. Macroeconomic factors include: the rate of inflation; GDP growth; and the unemployment rate. Microeconomic factors include: a company's credit; its share liquidity; and stock price volatility. Style factors encompass growth versus value stocks; market capitalization; and industry sector.



During February there was still a general risk on narrative, and again the High beta factor style led the way in returns. Momentum and quality were the laggards here as there was a move to the more value orientated shares. Again the multifactor was very run of the mill and we feel does not really provide much opportunity for alpha generation. For Q2 we still favour high beta and momentum to look to generate the best returns.

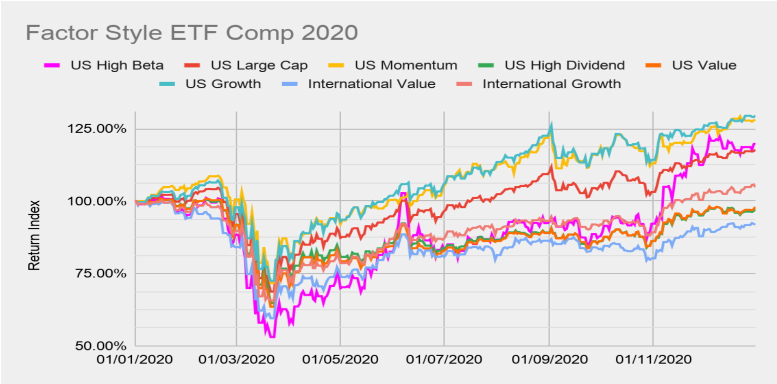
In February when comparing US and international we see that US value led the way, with US growth being the laggard this month. International growth and value were similar and in between the 2 US factors. We would look to US value to continue to perform well and we also see US growth picking up slightly next month from its performance this month. International value should do well over the coming quarter and we would look to allocate some capital here.





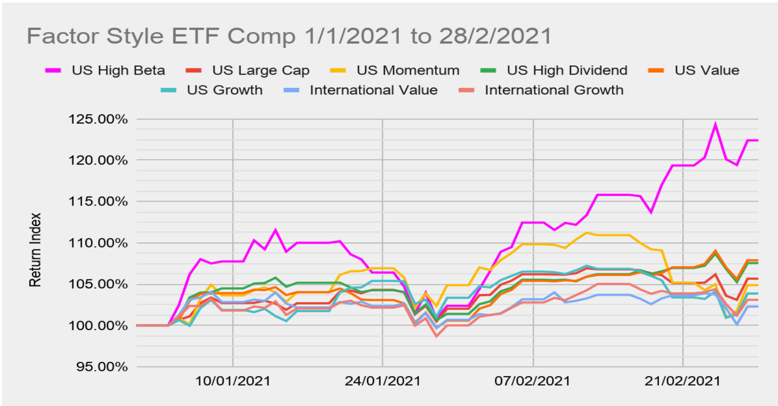
In February US equity volatility is being crushed in this risk on environment. We see this continuing for some time but would look at some point to go long of this as a hedge but probably not until later into the second quarter. Rates and inflation volatility and low volatility had quite steady months and we would anticipate that this will continue over the coming few months heading into summertime.

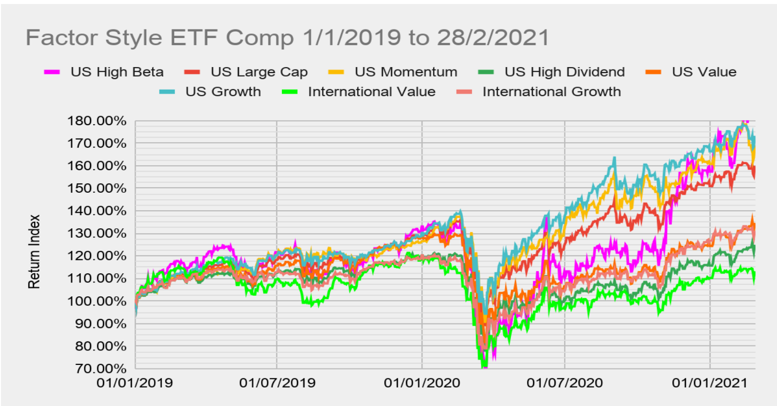
Let us now take a look over the longer time frames and see how we can look to utilise volatility as a hedge. Fundamentally there are just 2 asset classes, short volatility and long volatility.



Over the course of 2020 we can see that US markets were again the best performers, with US growth and momentum leading the way closely followed by high beta and large cap styles. International value was the trailing performer across the duration of 2020, As the recovery starts to take hold this year we would still see US markets leading the way due to the size of monetary and fiscal policy but International value could have possibilities.

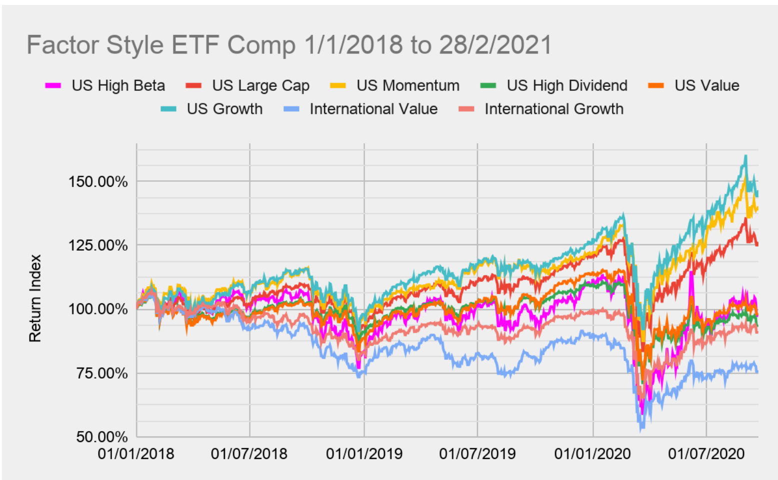
So far in 2021 to the end of February we have seen the US high beta be the best performer by some distance as there is a general risk on sentiment in the markets. The outperformance is quite marked at the moment with the rest of the shown factors being fairly tightly grouped. Momentum was performing well until we saw a reversal around the middle of February. We still see US markets performing well until Q3 until it mat be beneficial to reassess.

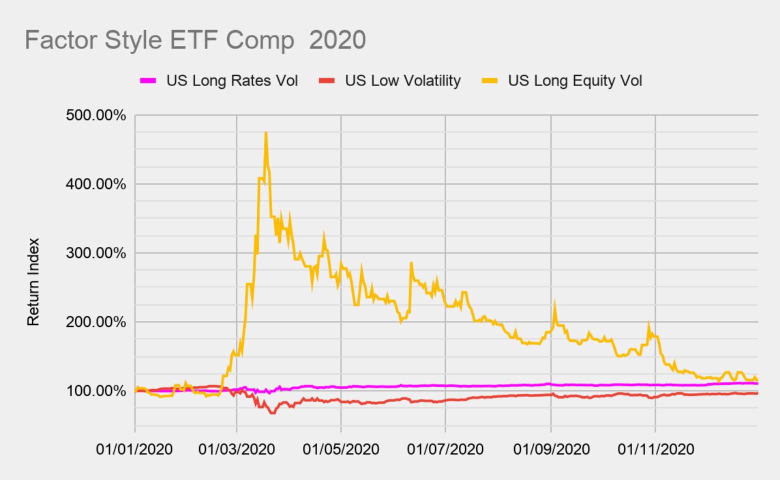




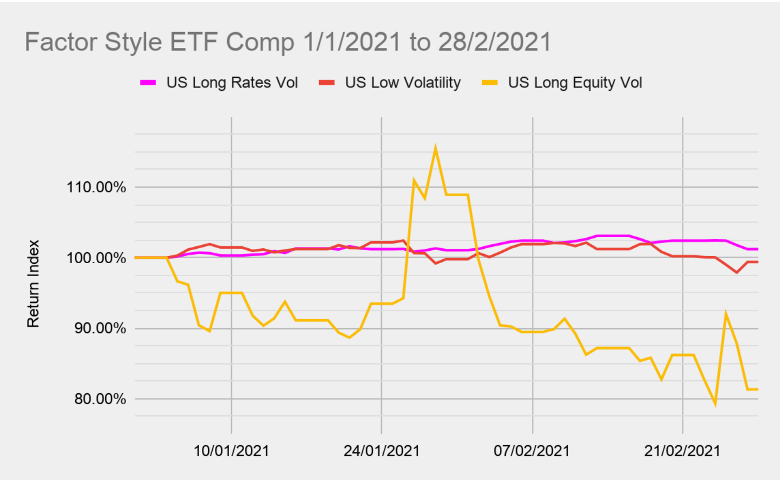
Over the last 2 years or so we can clearly see that the US markets have in general been the out performers when compared to the international factor exposures. With the size of the monetary and fiscal stimulus that has been implemented in the US we would see this trend continuing in the near term. China is not stimulating strongly and they have lowered their growth targets which may present issues for the global growth expectations that the markets have.

With a look back over a longer time frame of around 3 years here we see that the trends above are still in place with US growth and momentum leading the way across this time frame. There are certain regions of the world that are well placed to outperform in the future as the US markets now by most metrics are richly valued and their future returns can be limited. For the immediate future we still like them but believe that this should be reassessed in the summertime as we will then have more clarity on the recovery and if it has real legs.





Across the duration of 2020 we saw the massive spike in equity volatility as the pandemic shock struck markets, with several smaller shocks throughout the course of the year as volatility generally subsided as the markets came to terms with the pandemic and its implications for the markets. Us rates vol and US low volatility were generally very subdued throughout the year with the longrates vol offering a steady but fairly muted return across the course of the year, offering about an 11% return but with very low volatility.



This year up until the end of February The US long rates Volatility ETF has been the best performer and we do consider this to be a core holding in a portfolio for this year. Long equity volatility had a spike in early January but since has been on a downward trend. We do see volatility being crushed further and remaining low until the latter part of this year. There will be spikes along the way but the general trend will remain downward until there is the next big event in the market which we feel will inevitably happen.

Summary : February saw the continuation of US rates rising and the general belief in the reflation trade. There were some switches between growth and value as the market tried to guess where the alpha would be going forward. Vaccine roll outs started in the US and Europe and the speed and effectiveness of these will have a bearing on how the relative economies recover as confidence will be a very important factor in the economic recovery.

China has dialled back its stimulus and credit creation process which we believe will put a dampener on the global recovery. It also seems that Europe is struggling with their vaccination roll out and this will certainly set back their recovery timeframe.More fiscal stimulus was agreed in the US and they appear to be the most aggressive in terms of monetary and fiscal policy and they should be at the forefront of the global recovery. Also their vaccination program is off to a very good start and this should accelerate over the coming months and put them in a good place to have confidence return to their consumer led economy.

Global interest rates have continued their rise and the reflation narrative continues to drive the markets, and the coming economic data will be positive for both growth and inflation until we reach the summertime. Thereafter it is hoped that the recovery will have gained its own momentum through the reopening process and that the growth can continue. Central banks are stating that inflation will be transitory and we would tend at this stage to agree with them. The economy will certainly rebound but to what extent we are still concerned. The virus will still be with us for years to come probably and may still pose threats to the global economy as the world needs to vaccinate as many people globally as possible to negate the threat of mutations that could set us back. Without a global effort we fear that this could be a very real threat that will be with us for a longtime.

Market Insights

The markets are still in melt up mode and will probably continue to be for some while. The base effects of inflation will start to kick in soon. And this should lead to rates rising further. How far is the big question, but a bigger question maybe what will happen to growth ?

Everyone is believing that we shall continue on this growth path, even though it will slow. The global supply lines are still disrupted and will take time to recover but whether growth will continue at the pace people think into the future is a question that we are concerned with at the moment.

Governments have become a large part of demand over the last year supporting the economy and when they step back will the real economy be strong enough to fill that gap. We have our doubts about that and the governments may be forced to stay very active for a long time yet.

For the next few months we see equity markets continuing their march higher but the latter half of the year could be a different story.

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Once again thank you for your time and see you again next month.

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