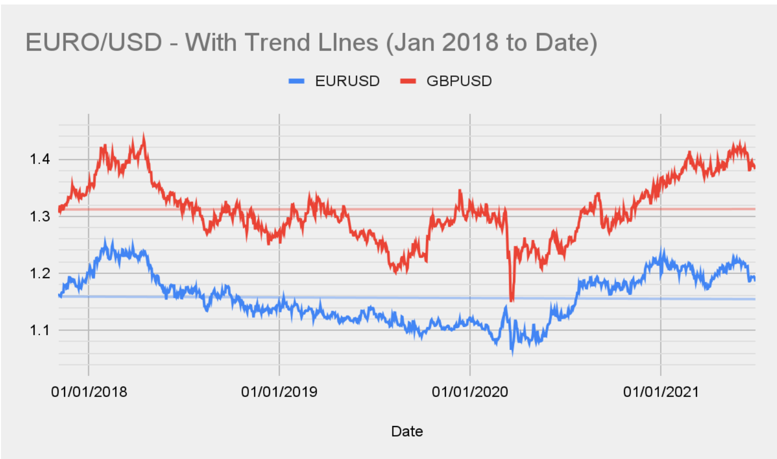
The Market Wrap

June 2021

Introduction - Welcome to our Q2 2021 issue of our quarterly 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 !

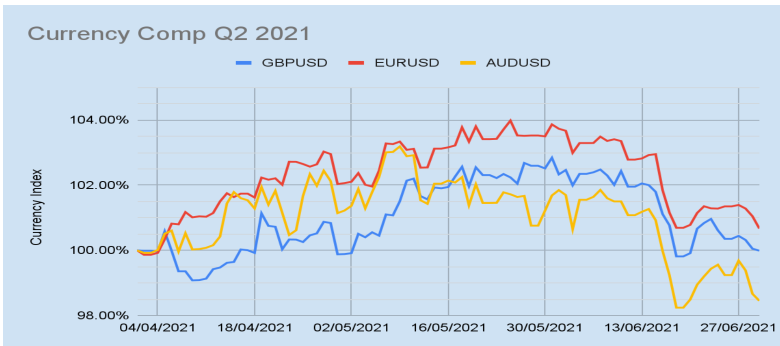
Currency

Generally this Quarter we have seen the USD strengthen against most currencies as some concerns have come into the markets. The safe haven trade seems to be gaining some traction as these concerns start to build and the market starts to reflect whether this pace of recovery can continue. The general supply chain issues continue to hinder markets and cause some supply side price issues as the world still struggles to get back to some semblance of normality. The virus is still with us and endemic in society for now, how we learn to live with this will be very important to people regaining their confidence to live their lives in the manner that they used to.

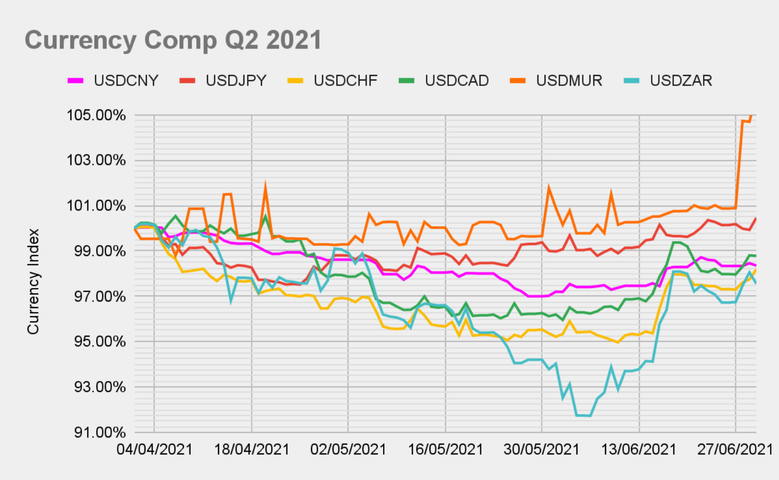


Both the gbp and the Euro seem to have found a top for the moment as we see the USD bouncing off the bottom of its range and showing strength. This coincides with some doubts creeping into markets about the global reflation trade and if we have already seen peak inflation and also peak growth. We have seen the Delta variant become the predominant variant globally and the ease of transmissibility is concerning market participants that this shall slow the global recovery.

As the USD strengthened this quarter we saw the AUD, GBP and EUR all weaken against it as we seem to be experiencing some risk off sentiment coming into markets. The virus is the main contributing factor to this we feel and we shall need to see this play out before we can get a truer sense of the actual strength of the economy moving forward.

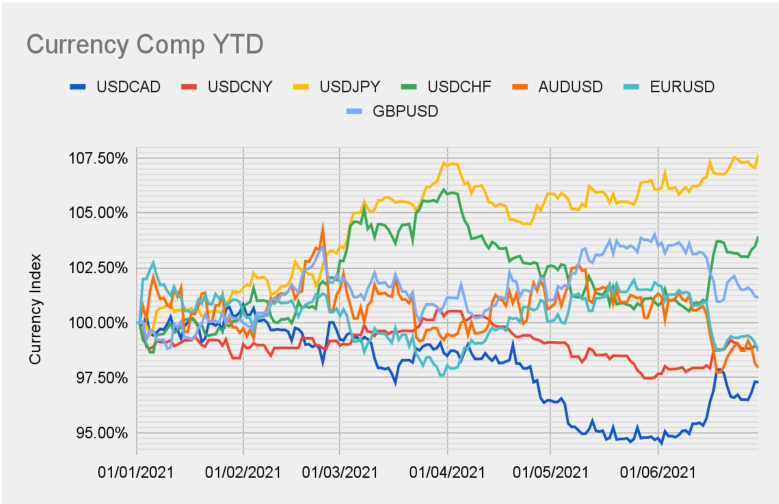


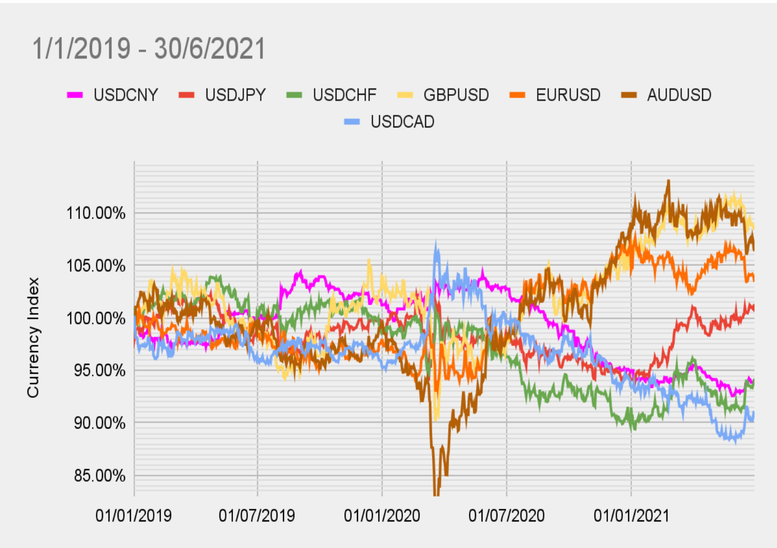
The USD has firmed up as we have mentioned but still would like to see it breakthrough the 93.5 level on the DXY to say that it is now in a bullish trend. This needs to be watched closely.



The month of June is when we really started to see strength in the USD, against most currencies. We could see this continue as the doubts about the global reflation grow in strength. The Delta virus has brought in a fair degree of doubt as to the strength and duration of this recovery and is making investors start to question the current narrative. We can quite easily see the USD bouncing back up to the 98 Level on the DXY and this would be detrimental to stocks at their current levels. The DXY needs to be carefully watched in the coming months.

So far in the first half of this year we have seen the USD remain strong against the traditional safe havens , The CHF and the JPY and commodity currencies have been relatively strong against the USD (AUD & CAD). Further USD strength will start to affect the commodity prices and thus we could see weakness in the AUD and CAD if this transpires. We would also see potential weakness in the Euro and GBP if this USD maintains itself as they both are struggling with the virus at the moment.

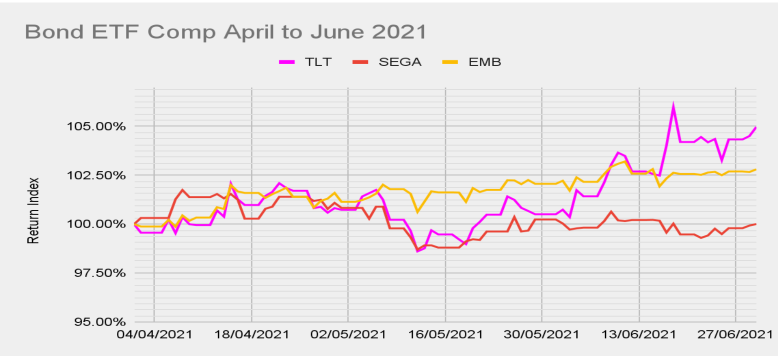




On a longer look back we can see that the USD has weakened slightly over this period of time, but that it has appeared to have found a bottom around the DXY level of 89 and has since strengthened somewhat up to the 91 to 92 level. However when there is a risk off mode in global markets we see the USD strengthen and all the calls for a much weaker dollar have so far not come to fruition and we see continued strength in the USD which does not indicate that there is a great deal of strength in the global economy. The AUD it seems had topped out and is starting to roll over as the Chinese economy shows signs of slowing.

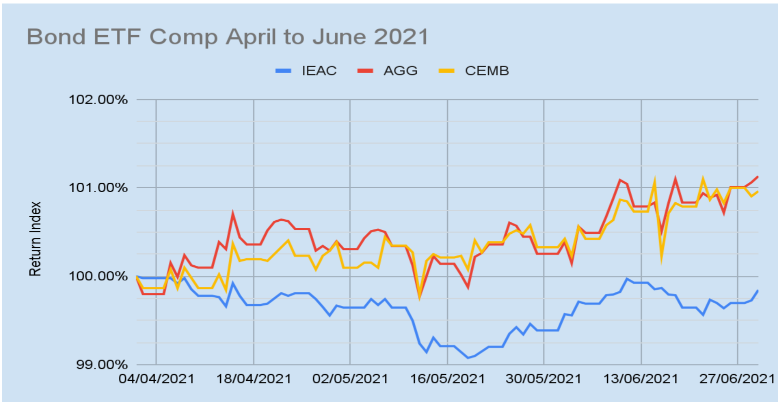
Fixed Income / Bonds

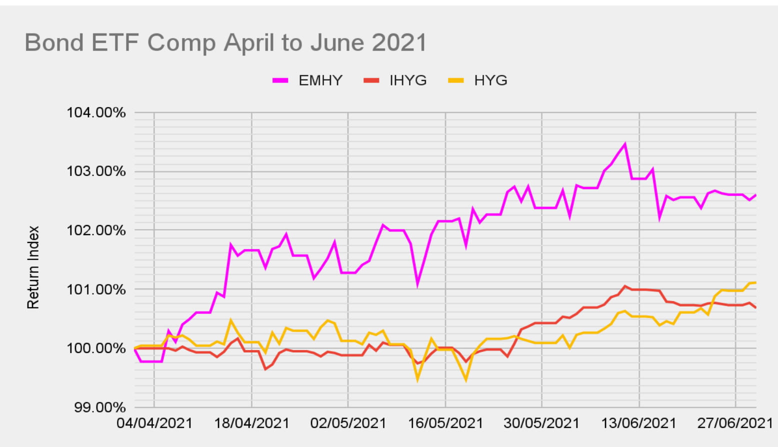
After the first quarter of the year where we saw US yields rise on inflation concerns as we got to the tough year on year comparisons that were due to happen in the second quarter and the markets anticipated the rise of rates. The second quarter we saw this rise slowly start to reverse itself as there were worries from investors about the durability of the reflation trade in the light of the ongoing virus issues. Again the delta variant is causing concerns that are bringing doubt into markets.



TLT representing the US long term government rates Saw a slow and fairly constant appreciation over the second quarter especially in the latter part. This was more pronounced in the US in comparison to the Euro area and emerging markets. In actuality the Euro area government bond prices actually fell slightly over this quarter. However as the concerns about the virus grow we see this could reverse itself.

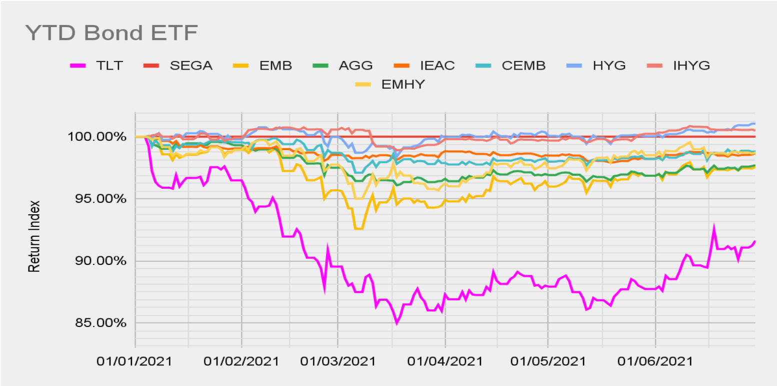
Investment grade bonds around the globe also saw a very similar pattern as in the treasury markets with both the US and emerging markets seeing price appreciation and the Euro area seeing a small drop in prices over this period. Again we see this starting to reverse itself towards the end of the quarter as concerns start to rise. We think this may continue in the near term, however if inflation proves to be more resilient then perhaps this could halt this.





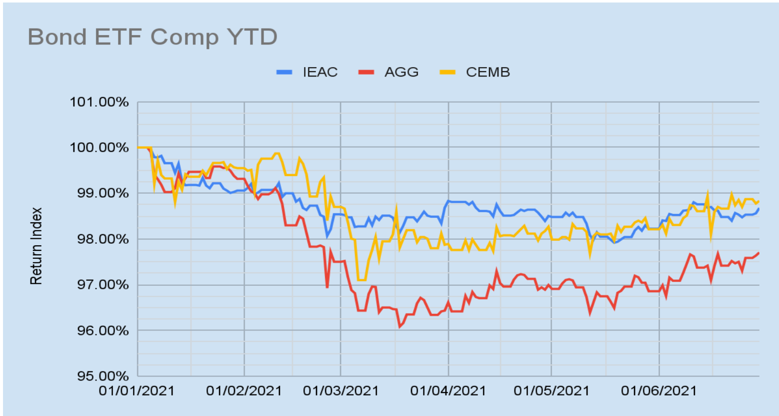
The high yield sectors saw rates come down slightly over the quarter as spreads continued to tighten as the search for yield carried on. The return investors now receive for the risk they take seems to be small however with the liquidity floating around and rates so low default risks seem to be very low for the time being. As we come out of this and the economy finds its new balance we might see financial conditions tighten and at this point high yield would be a very risky place to be overexposed.

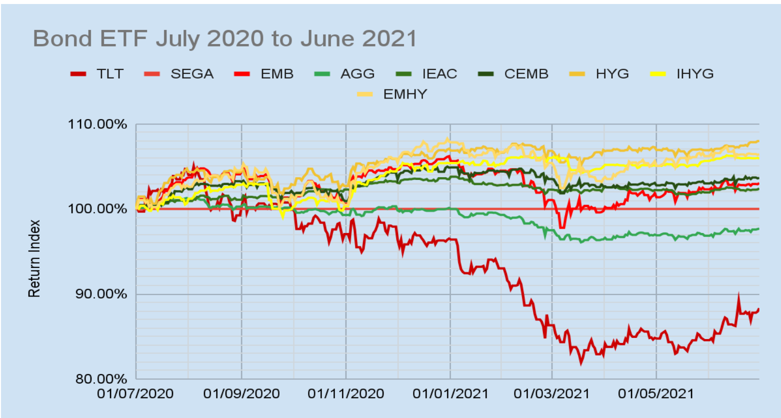
The growth of the economy moving forward shall be very important and it seems that bond markets are seeing that the real economy is struggling more than financial markets, so this bears careful monitoring.



Over the first half of this year it was only really TLT longer end Government bonds that saw large price movements as through the first quarter rates rose on the reflation narrative and then markets calmed and started to reassess the narrative in the second quarter. We still feel that the longer end of the curve can offer some protection against any pullback in the equity markets, as the general melt up continues for now.

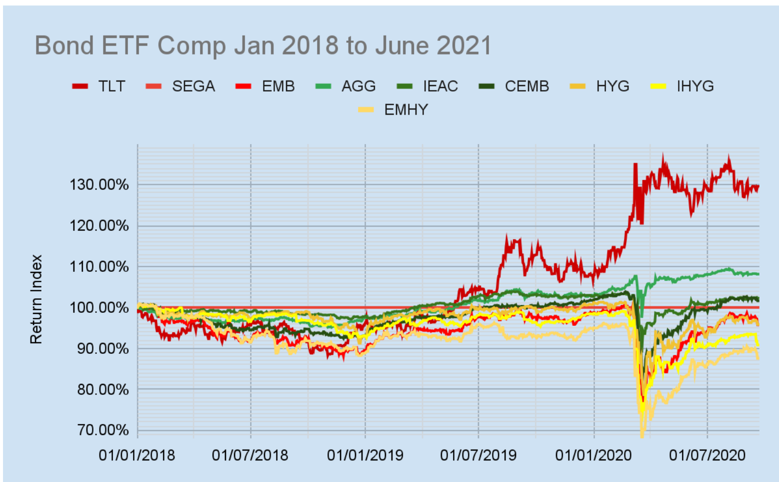
Since the start of the year we can see here how corporate bond yields around the world have started to rise, being led by the US rates. This is due to both rising inflation expectations and also hopes of growth coming from the re-opening. In the second quarter this slowed and started to reverse itself. The virus story still needs to play out with further variants possible and the vaccine story still developing, for us to get a better idea of growth moving forward.





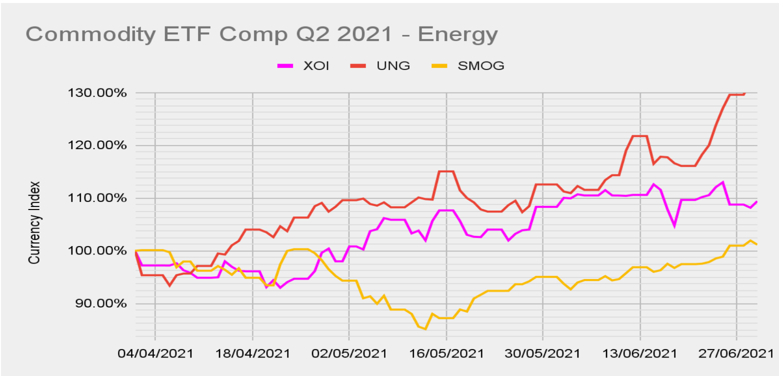
Over the last year we can also still see that it is really only the TLT ETF that has seen drastic price moves with most others remaining fairly range bound and the high yield space showing slow but gradual appreciation. The negative correlation between stocks and bonds seems only to have any real showing with the TLT and we feel that clients should look to the longer end of the yield curve to look for protection against any pullback in stocks.

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.



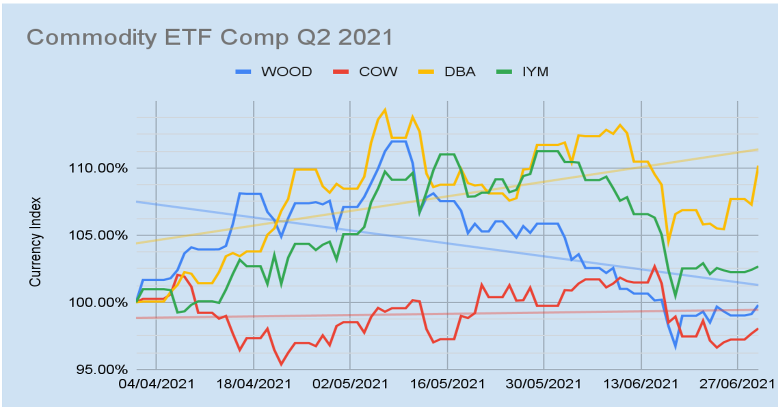
Commodities

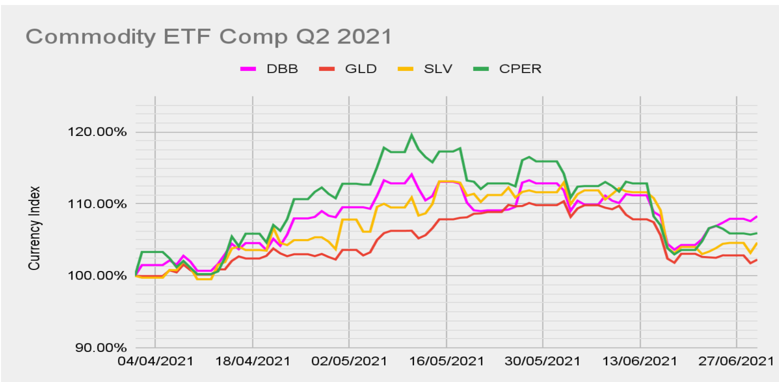
Commodities are the hard assets of the economy, the physical substances that we need to live, build and grow the economy. They are an alternative asset class that have a place in most portfolios and can be a great source of outperformance. With the advent of the new greener economy and the need to preserve our environment we see that there will be fluctuations in this asset class and we can use that to our advantage.



While oil has had a fairly small continued price recovery over this period Natural gas has risen almost 3 times as much as oil over the quarter. The green low carbon ETF SMOG was fairly flat over the spread of the quarter. As then doubts grow about the pace of growth moving forward we may see a slowing in the rise of both oil and gas. Also USD strength may be a head wind for further rises in these commodities.

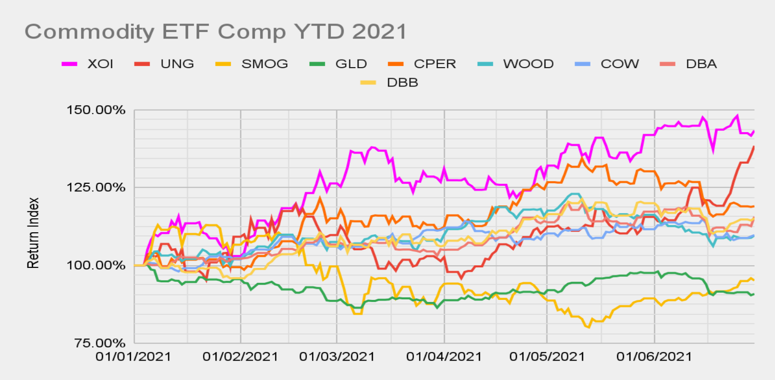
This group of commodity ETFs saw a general uptrend Although the pace has slowed and in some cases has started to reverse. The path of the USD will play a role going forward in the commodity complex. We still see inflation persisting for some time to come especially as supply side issues continue to persist and we think that they will for some time to come at least until the supply chains can return to some form of normality, thus could take quite a few months.





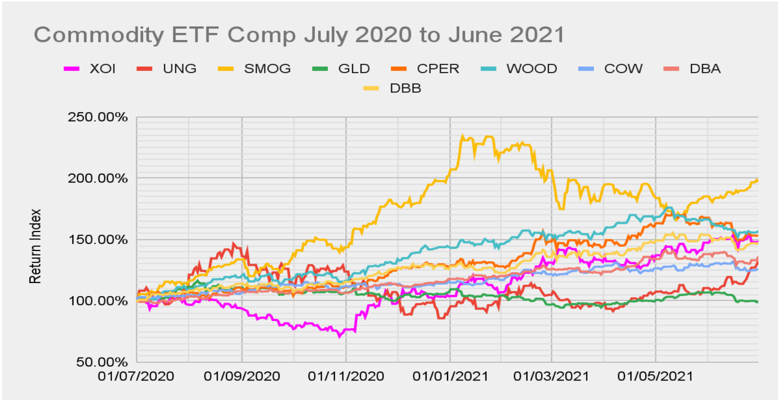
In the metals complex we saw a topping process happen around the middle of the period and most generally finished a little bit higher than they started the quarter. We still like Gold and Silver in the long term but they may be better levels to increase positions in the future and would hold off on adding any further allocation at this stage. The virus may put a hold on the uptrend in base metals as we come to terms with the virus and learn to live with it.

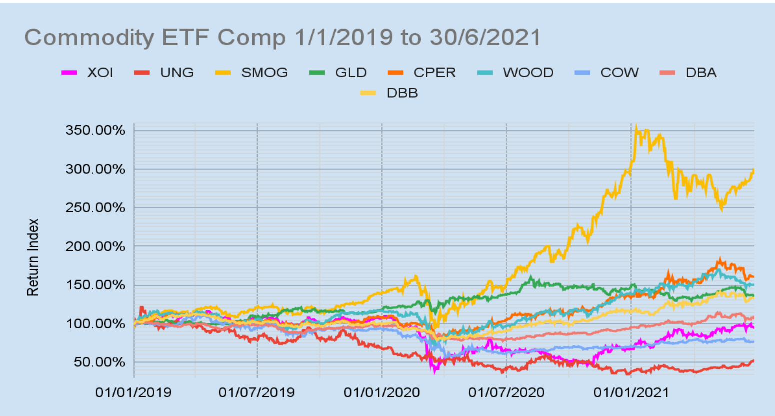
We are seeing lots of strange weather events occurring and this will keep the ESG theme to the forefront of the future investment story, although the transition to green energy will be long and difficult.



So far this year we have seen a rebound of traditional energy sources as markets see demand building as we slowly come back to normality. The low carbon trade calmed somewhat but still has seen a rise over the period but not the huge outperformance of prior periods. This will continue to prolong the inflation issue and although this may be transitory it is not going to reverse those price rises, and this may put pressure on aggregate demand.

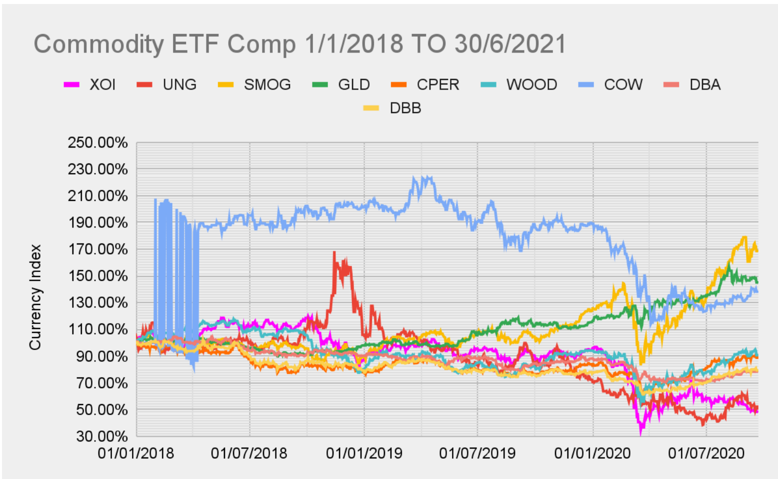
Over the last year it has been the low carbon trade that has massively outperformed although this outperformance has been reigned in somewhat during the course of this year. Gold has been flat to slightly down over the last year, which is somewhat surprising as it is associated with being an inflation hedge and we are certainly seeing inflation at the moment. We still like gold and will look to add on any further pullbacks.





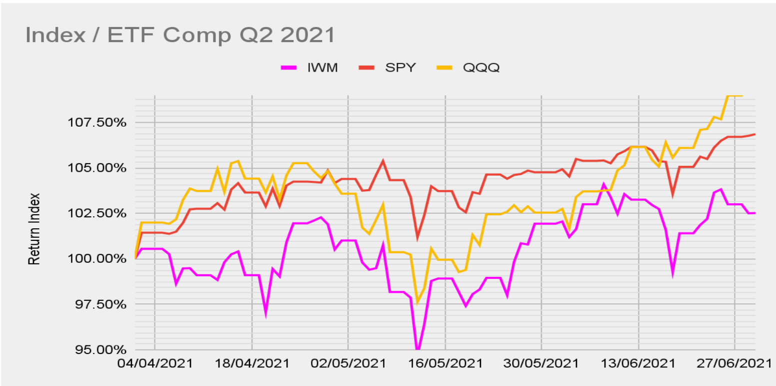
Looking back to the beginning of 2019 we can see that the trend in outperformance of low carbon was already in place before the virus struck. This continued after the virus hit and has to date remained in place. So it seems that the bigger picture trends are intact and although we have suffered a global pandemic the pre existing trends have not been disrupted by this and perhaps they have even been more reinforced as the divergence in performance has been more extreme.

Ignoring the noise for the COW ETF at the beginning of this graph, we can see that commodities in general have fallen over this period and even if there is inflation it will only get prices back to where we were a few few years ago, so if we assume that the deflationary forces are still in place such as demographics and technology perhaps this bout of inflation although worrying could be reversed over the next few years once we get back to normalcy. With the continuing QE we shall still see the asset markets increase and thus increase the wealth gap.



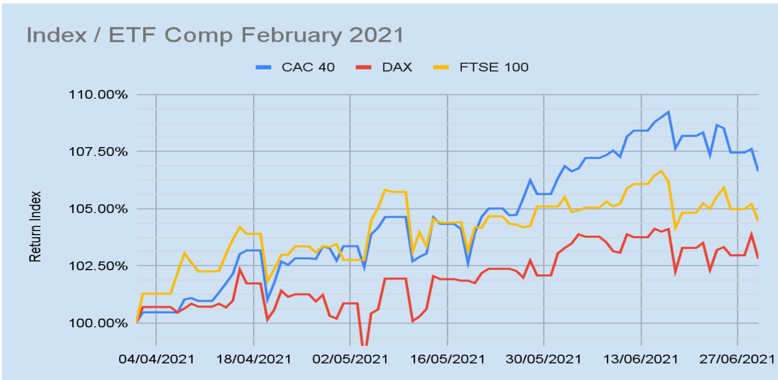
Stock Indexes

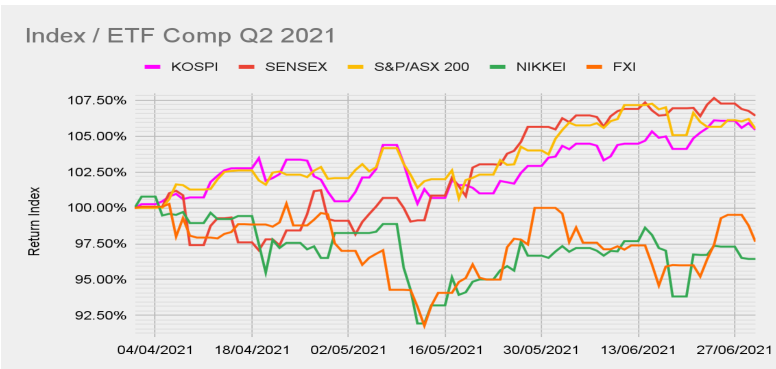
These are the local indexes of varying countries reflecting the value of the companies quoted on them, importantly in their local currency. We must always bear in mind the Index performance and the currency performance against other localities. Investing is a relative game and we like to show comparative 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.



This quarter saw appreciation in US markets with the Tech sector, i.e. growth leading the way, closely followed by the SPY and the small cap IWM bringing up the rear with only a small rise. We would envisage some more inflows from international markets as concerns about global growth surface, and investment managers look to the safety of the USD. The melt up can continue into the end of the year, if there is no tapering from the FED.

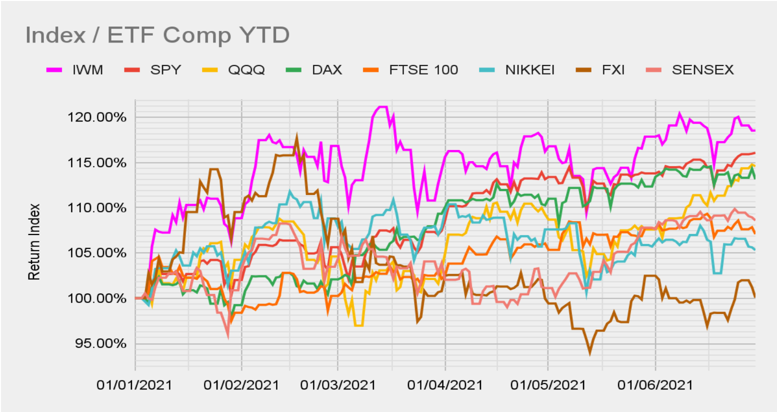
European markets have been strong in the second quarter of the year, but have started to level off somewhat in the last few weeks. As mentioned we can see that there may be some booking of profits from investors in this part of the market and a shifting of assets over to the US. Currencies could also see a slight fall off as the USD strengthens as people look to the safe havens for protection. However we do not see the FED tapering until early next year.





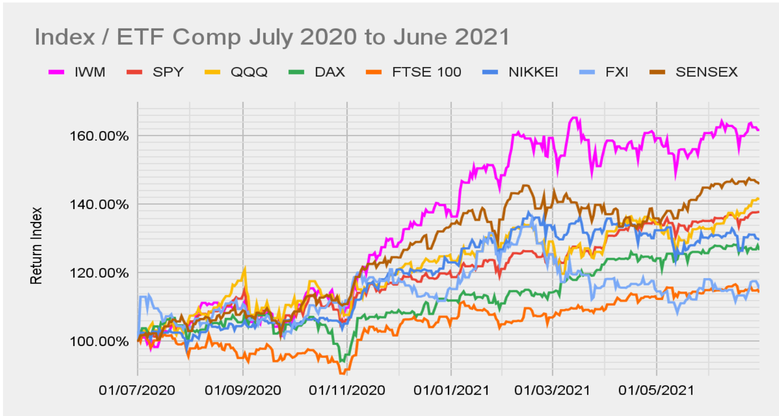
Across global markets we saw that Japan and China were flat to slightly down over the quarter as China growth slowed quicker than most anticipated and the virus started to hit the country of Japan. The others shown here had steady and gradual rises over the quarter, but may be topping out here. Again as profits are booked and the investors may look to move to safer areas as questions are being asked about continued growth.

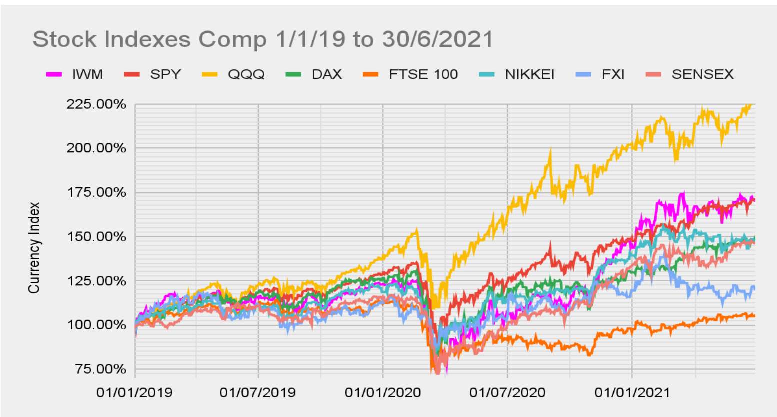
Let us now take a bigger picture look at what has transpired over recent history and also the last few years to gain some perspective.



So far this year we have seen the US small caps leading the way as the reflation trade was in full swing favouring value over growth. In recent weeks we have seen that this story is starting to change a little as the QQQ has risen quite strongly in the last few weeks as we see a switch back to investors favouring growth stocks. China has been the laggard in the first half of this year as their economy slows more abruptly than most anticipated and this could be a warning sign for the rest of the world.

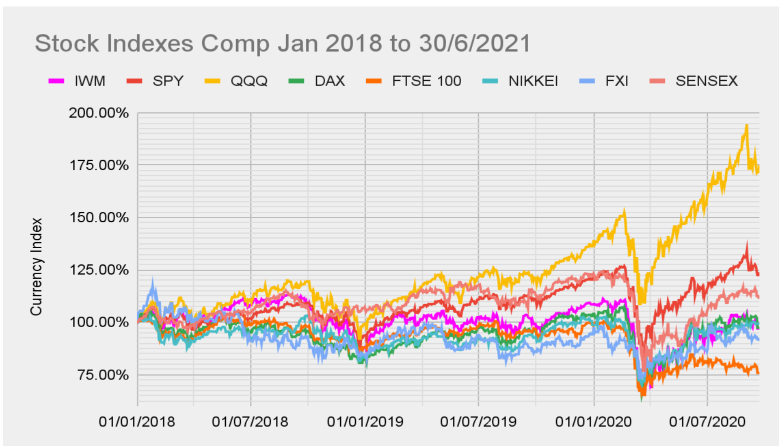
Looking back over the last year we can still clearly see that it was the US small cap market that was the leading performer, with the UK and China being the laggards over this timeframe. India has also had a strong market recovery despite all their issues with the virus. Europe has been strong at the start of this calendar year but may be faltering now as we see the Chinese economy slow in growth terms and this will have an effect on Europe.



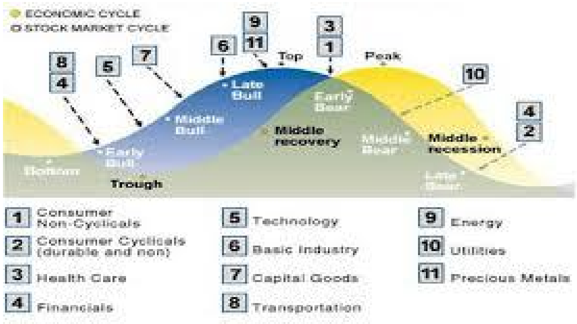


Over the last 2 and a half years it is clear to see the best performing Index and the pre pandemic trends still seem to be intact and investors seem happy to continue with this allocation. The UK market has been the underperformer here, and one would think at some point there will be some outperformance from this market, but there are still many structural hurdles that the economy needs to overcome. However the important question as always is when ?

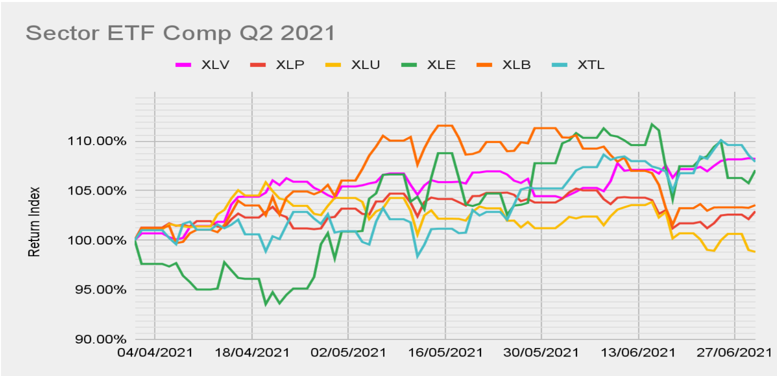
Looking further back we can basically see the same picture with the US tech sector leading the way and the UK struggling to just maintain its value. Europe and other markets around the world have basically remained stable perhaps with small declines and we feel that this will challenge the global growth story moving forward. The big trends seem to be fairly constant and do not really change with external events. The impulse central banks and governments have given the economy may soon diminish and how markets react will be interesting.



Sectors

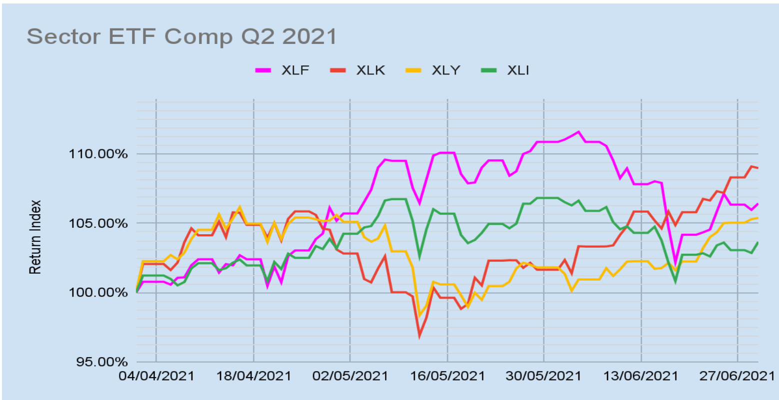


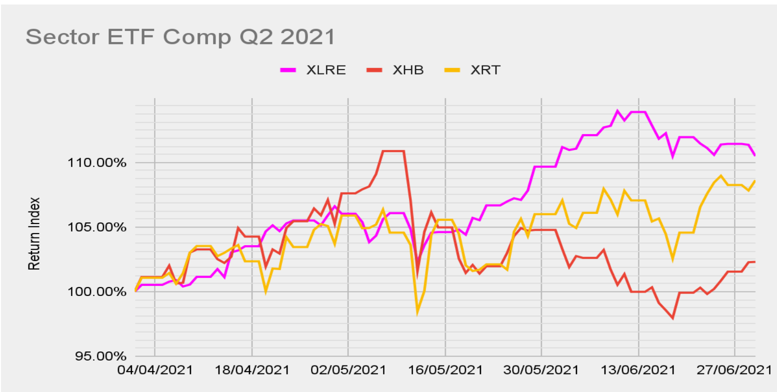
We use sectors to place stocks and other investments into categories such as technology, healthcare, energy, utilities and telecommunications. The different sectors have diverse risk profiles and perform at varying degrees throughout the business cycle. Here we shall contrast and compare the performance 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.



Healthcare and Telecoms lead this group this quarter, with energy close behind and utilities were the laggard, falling slightly over the duration of this quarter. We may have seen peak inflation and growth during this quarter, and we need to step back and take a big picture look at where the economy is likely to go from here. Inflation is definitely here but for how long will it stay with us. We feel that it may go higher and be more durable than the FED would like.

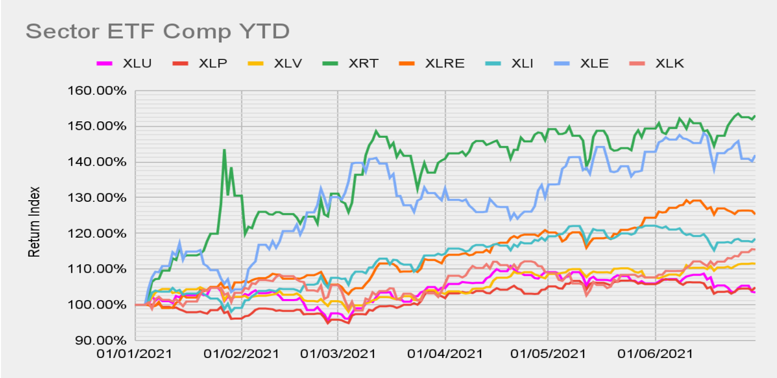
The financials and technology were the best performers in this quarter from this selection,with technology making a strong turnaround from midway through the quarter. The financials pulled back towards the end of the quarter as markets started to flatten the yield curve slightly. Market doubts about the outlook for the economy are creeping into the market, however while QE is in operation we still see the market melt up continuing into the end of the year.





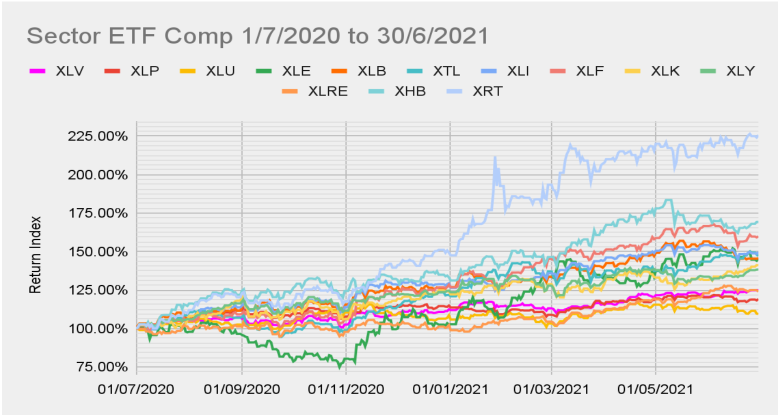
Real estate had a strong quarter with retail also performing well. Homebuilders struggled a bit this quarter as supply side issues caused delays and also cost increases. Demand for housing is still generally good but as always at what price and the prices have risen steeply so far and at some point this will affect demand. Delta variant we feel shall cause some slowdown in the second half of the year and this could slow the rise of markets.

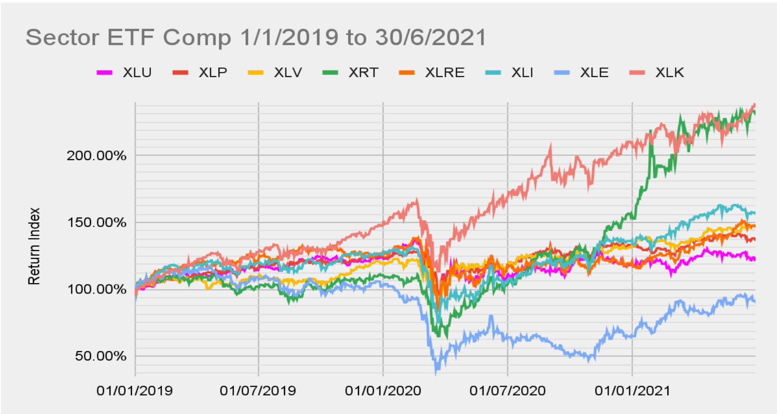
Lt’s now take a look back over the pandemic period and before to get further perspective on the markets and where we may go from here.



Over the course of the year to date Retail has been the top performer and been a real alpha generator for a portfolio. Energy has also had a strong comeback from the depths that it plunged to. The more defensive sectors of utilities and consumer staples have been the laggards over the course of the year, but may now become important to hold as we have now had the initial bump and things going forward can be a bit more uncertain.

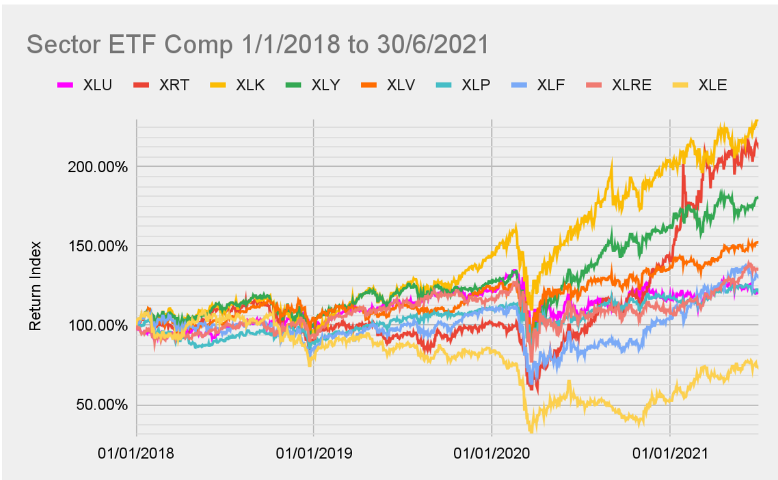
Over the last year we can clearly see the out performance of the retail sub sector. Also notable is the drawdown in the energy sector and its subsequent recovery. Utilities have been underperforming over this period of time as the recovery trade was in full swing through this period. Going forward with the uncertainty creeping into the markets this under performing sector is worth considering for the near term as we negotiate this uncertain time. Consumer staples are also worth looking at.





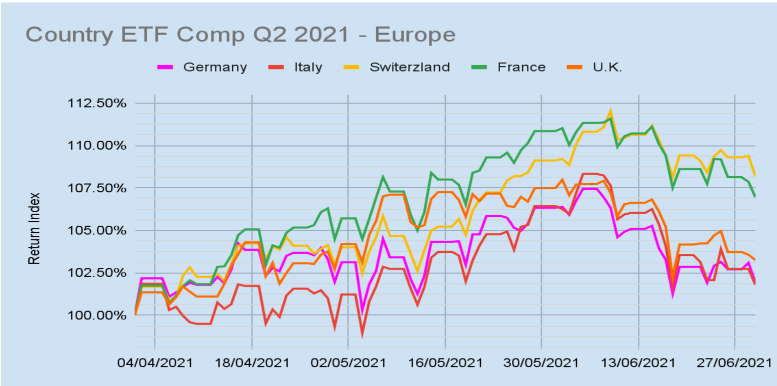
Over the last 2 years we can see that the same trends remain in place with tech and retail being the best performers, with energy being the stand out worse performer. Retail has certainly been the best performer since the initial pandemic drawdown, however was nothing special performance wise beforehand. Healthcare has been a consistent performer over the whole time frame, Technology has been the outperformer and we see no reason for this to change in the future.

Over the last 3 odd years We can see much more clearly the divergence between technology and energy sectors and the various others in between. Retail and consumer discretionary are chasing technology closely with the others forming the middle range. These trends seem to be well established and we do not see any great change going forward as the world shifts to a new digital format of value creation. Technology will lead the way in this brave new world and exposure to it will be very important to gian alpha.



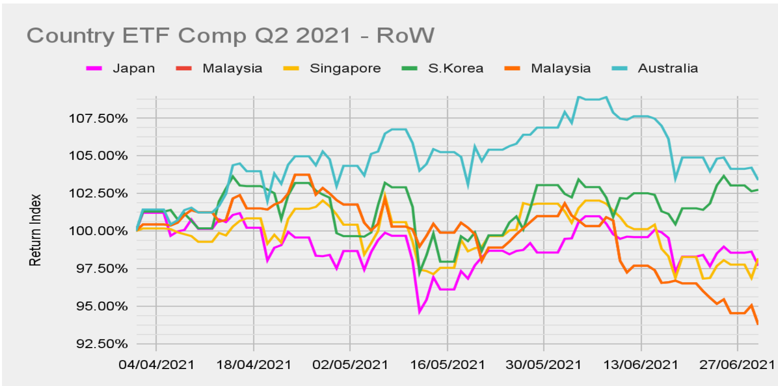
Geographic

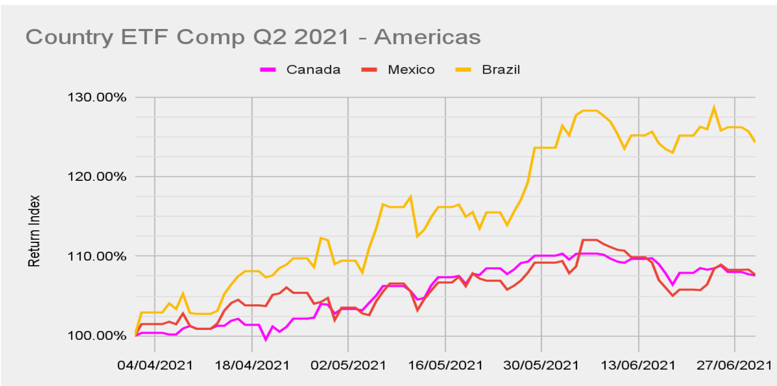
Certain countries or regions around the world will be experiencing different economic circumstances at any given time, usually. Therefore it is important to access these differences and utilise them in order to create greater returns on your capital. In this section we shall look at a range of ETFs, 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 saw all round growth in the second quarter with Switzerland and France leading the way. The others only saw a small amount of growth and all of them tailed off towards the end of the quarter. This was mainly due to concerns starting to rise from the Delta variant of the virus and how this would affect global growth moving forward. China has also started to slow which is a concern to all as they were first in and first out of this pandemic.

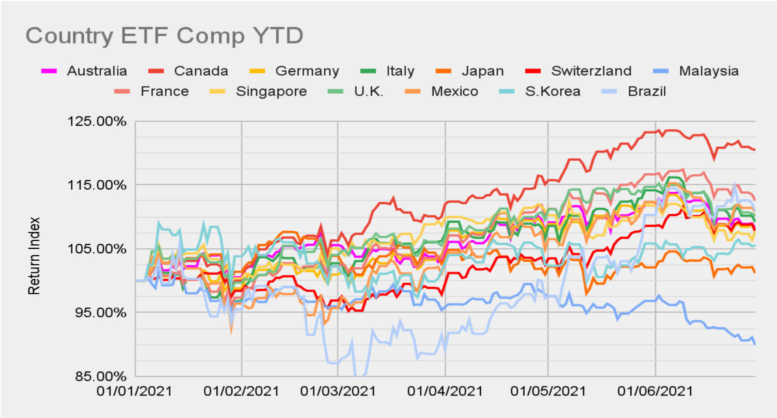
With respect to this group we saw only 2 countries have appreciation in this quarter and they were Australia and S.Korea. S Korea was the only one that finished the quarter on an uptrend, while all the others followed the trend established above. None though showed any particular strength throughout this quarter. It seems that investors are reassessing the path forward from here and realising that there may be a more risk off tone in the near future.





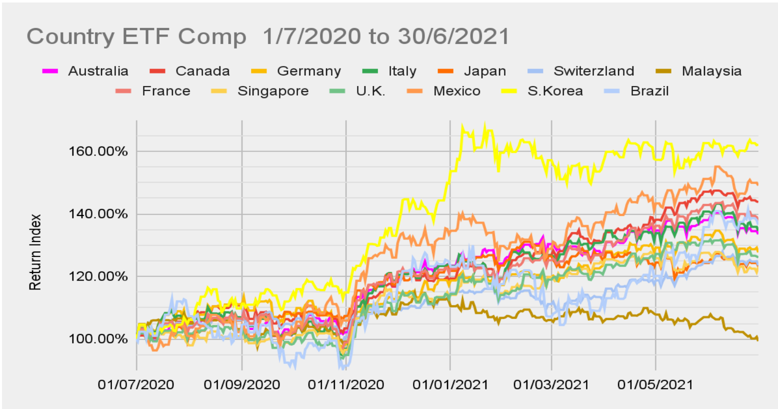
Brazil showed marked improvement this quarter but has fallen further than most so any recovery must be looked at in the bigger picture. Again this group topped out at the end of the quarter and started to look to roll over a little bit. With the delta variant now being the foremost variant globally there are many uncertainties ahead, and this will surely put a pause on markets as investors need to reassess the risks and the likely road ahead.

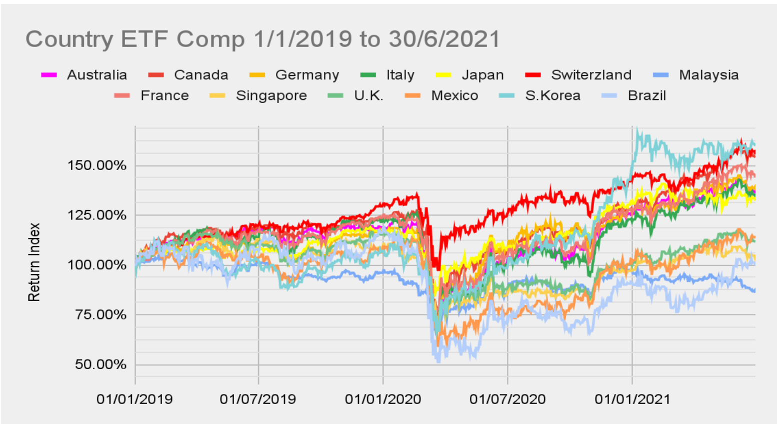
Let's step back and take a bigger picture look at the performance of the various regions leading up to and after the start of the pandemic, to see if we can gain some insight as to the possible trends moving forward.



The year so far has seen all returns conforming fairly closely with the outliers being Canada to the upside and Malaysia to the downside. All have levelled off at best heading into the end of the quarter as these global concerns have risen. Smaller countries have been less able to stimulate their economies and will be reliant on others to boost them going forward and a country's ability to deal with the virus in the future may have a large impact on investors' sentiment regarding their economies.

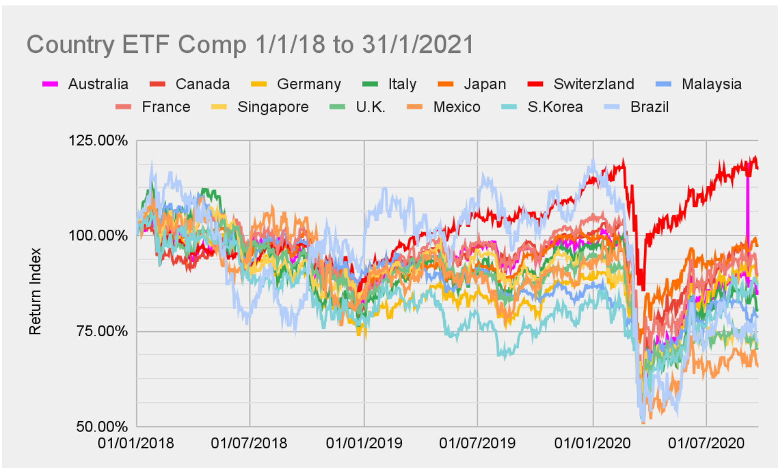
Over the course of the last year we have seen that S.Korea were rewarded by investors for their initial ability to cope with the pandemic, however their performance has levelled off in this calendar year. Germany was also favoured by investors during this period but they have continued to rise this year, but like all now there is a pause as investors start to re appraise the outlook from here. Malaysia is still the worst performer and there could be some value there.





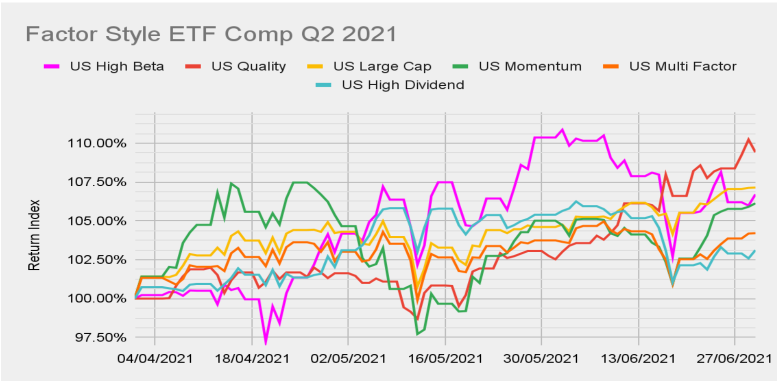
Over a longer time frame of roughly two years we can see that the safe haven of Switzerland and the dynamic economy of South Korea have been the best performers. So we can see that quality and technology are consistent factors that reward investors over longer time frames and that we do not see changing as we move forward from here. Brazil and Malaysia have been the worst performers over this period and we shall let you draw your own conclusions on that.

Over the last 3 and a half years we see that it is Switzerland that has been the most favoured and best performing investment this is for a variety of reasons, but all amount to quality and solidity. When looking at long term investments these things should be valued highly by investors and will be rewarded over the course of time, come what may. However if you are more active in your investment style, we must look to data to provide us with more imminent moves that can inform our asset allocations. Most countries have not seen a rise at all !



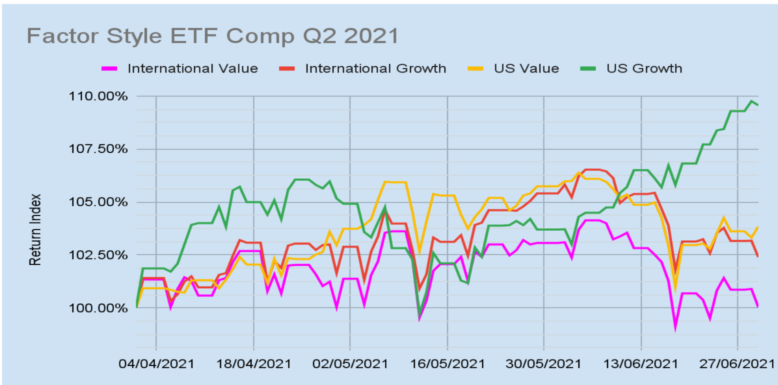
Factor Styles

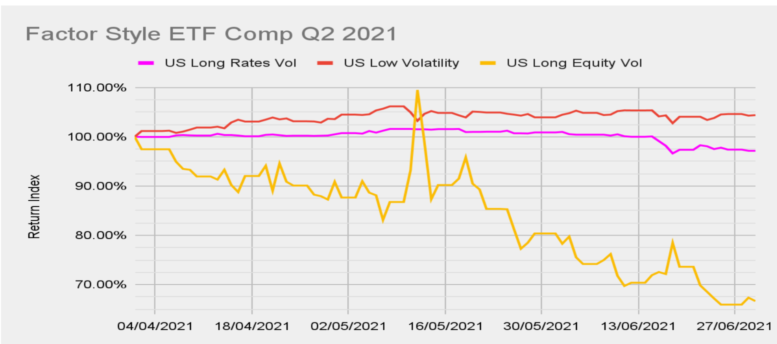
Factor investing is a strategy that chooses securities on attributes that are associated with higher returns. There are two main types of factors that have driven returns of stocks, bonds, and other factors: macroeconomic factors and style factors. The former captures broad risks across asset classes 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.



Here in the second quarter we see a similar pattern emerging where the reflation trade was to the forefront in the first half of the quarter and then some doubts started to creep into markets towards the latter part of the quarter. Quality finished up being the best performer of the quarter with its late surge while high beta tailed off towards the end of the quarter. Large cap also had a late surge to beat high beta over the course of the period.

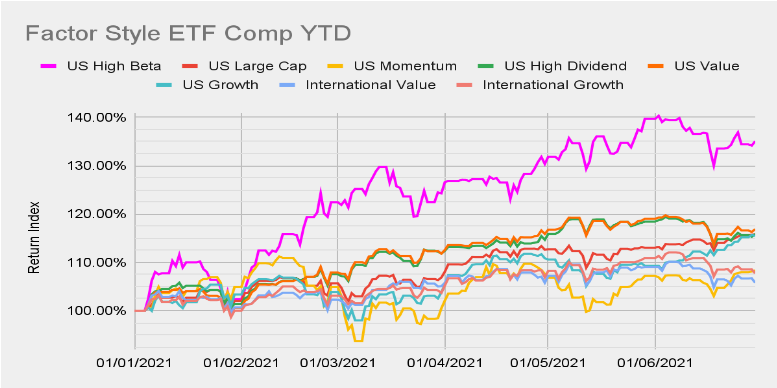
In the second quarter when comparing US and international we see that US growth was by far the leader in terms of returns with international value staying flat over the course of the quarter. These are trends that seem to be fairly consistent with international shares persistently underperforming their US counterparts. This is primarily due to the QE programs that the FED has implemented over the last 12 years. What happens when it stops ?





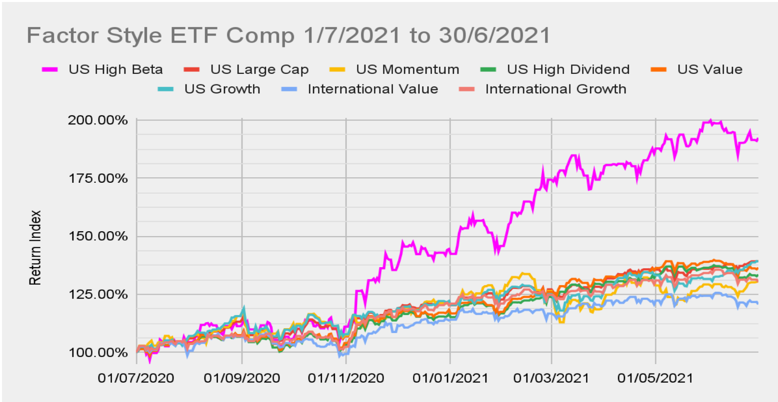
In the second quarter US equity volatility is being generally crushed in this risk on environment,with the exception of the spike in May. We see this continuing for some time but would look at some point to go long of this as a hedge but probably not until later in the year when the taper may potentially start, or at least there is the announcement that they are about to start.

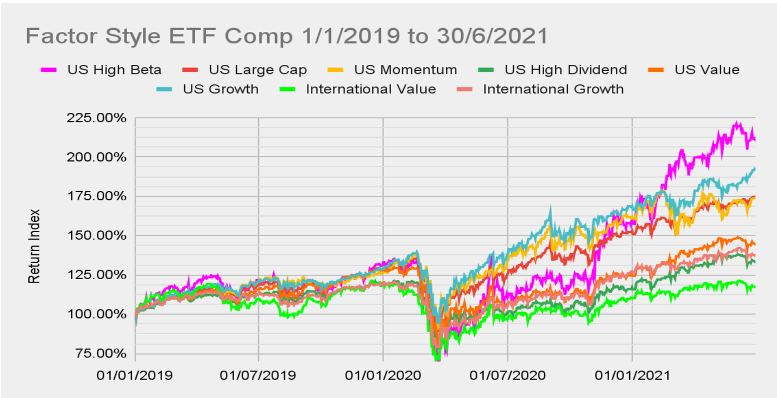
Let us now take a look over the longer time frames and see how we can look to utilise volatility as a hedge. Fundamentally there are just 2 asset classes, short volatility and long volatility.



So far this year US High beta has been the stand out performer, with many of the other US factors clumped together. Momentum has not had a great performance so far this year as there has been many switches in market sentiment over this time swinging from growth to value as investors seem to be uncertain of the economic trends with the virus still inducing much uncertainty in markets.

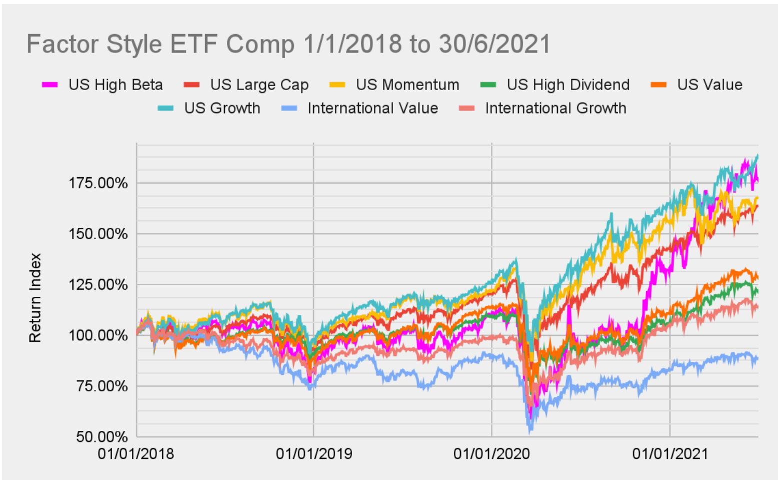
Over the last year we can clearly see that US High beta has been the best performer by a very large distance. All other factor styles have risen but have drastically underperformed high beta. Lately we have seen a pause in the rise of high beta as investors re assess markets as year over year comparisons have peaked and the path forward from here is less clear. International value has been the worst performer over the course of the last year.

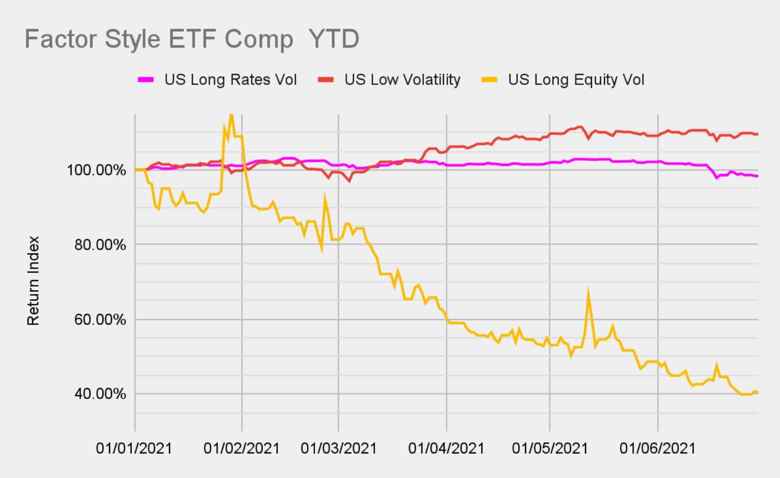




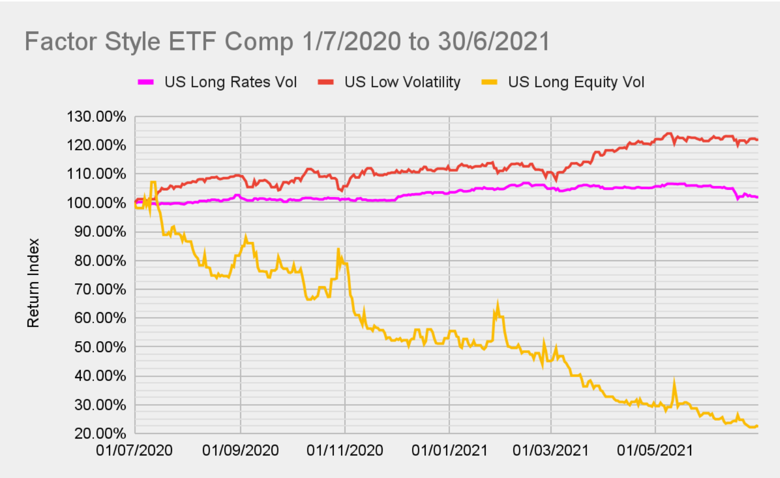
Over the last 2 and a half years the trends are clearer to see and going into the pandemic we saw that the US factors were outperforming their international counterparts and this was only more exaggerated after the pandemic hit. A contributing factor to this is that in Europe there is a higher propensity to own bonds as regulations are strict on duration mismatches and the US is a more equity favoured marketplace.

With a look back over a longer time frame of 3 and a half years the trends are more pronounced and show to be fairly consistent. Investors no matter what their geographic location and locality biases should carefully consider these trends and make asset allocation accordingly. With a large amount of daily transactions being executed by algorithms and passive investment strategies investors and asset allocators need to be fully aware of how and why these operate and adjust their investment process accordingly in order to maximise returns for clients.





In the year to date we have seen equity volatility generally fall as confidence has returned to markets and earnings have rebounded. There have been a couple of spikes which have caused small pullbacks which have immediately been bought by the markets. While the FED is in markets and supporting them through QE programs the markets see this as a safe and stable environment for risk assets. However once this safety blanket has been removed the likelihood of more volatility increases although at the moment markets seem to be well hedged.



Over the last year we have seen volatility generally edge lower, the nature of the VIX product means that holding it over a long period of time will generally result in losses = Explanation
Markets have recovered from the initial shock and now have reduced volatility levels down to very low levels. For the moment this is not an issue as conditions for risk assets are favourable for the coming months though a few more worries are slowly creeping into markets as uncertainty mounts with the delta variant causing problems around the world.

Summary : At the being of this quarter we saw markets believing in the reflation trade and earnings were good as companies reported, however as we came into the last part of the quarter we saw some more concerns creep into markets as the Delta variant took hold around the world and we also saw soe rather disappointing data start to emerge from China.
It appears that vaccines may not be as efficacious as they were thought to be initially as the virus mutates and this problem could be with us for longer than most thought. Inflation has, it seemed peaked, but the question is how long will it take to come down. The narrative that inflation is transitory from the FED seems to us to be complete rubbish as it is here and it is real and the prices to consumers will not go down in most cases. The MBS purchases are forcing housing prices higher along with supply and demand issues and this will have a knock on effect into rentals in the coming months and this will affect the CPI numbers as this occurs.
Bond yields peaked in March it seems and they have slowly come down hinting that the bond market (the smart money) is not convinced by this reflation narrativeIf inflation is more sticky than the FED believes at present this could force their hand with respect to tapering and most importantly rate rises. The recovery has certainly been led by monetary and fiscal policy and as we progress through the Biden presidency the ability to continue expansive fiscal policy will become more difficult. Whether the economy can stand on its own feet without the support of the government remains to be seen.
As the Delta variant spreads round the globe markets and investors are reassessing the future path of the economy and markets. As long as governments and central banks can supply monetary and fiscal support to the economy we would see markets continue to drift up. However there could be issues if this support is pulled as we still see many signs that the economy may not be as strong as we are led to believe.

Market Insights

The markets are still in melt up mode and will probably continue to be for some while. The base effects of inflation have now subsided but it appears that inflation may be more sticky than people have expected. This could present the FED with issues in the future if the inflation persists longer.

Employment on the surface of it, appears to be recovering nicely however with very generous unemployment benefits available until September in most states it may not happen as quickly as people would hope.

Whether higher prices are accepted or not by the consumer will be important to see over the next few months especially into the end of the year. We think that you could see a rejection of these higher prices causing a fall in demand.

There is excess liquidity in markets but there is no real loan growth from banks and there appears to be a collateral shortage manifesting. The Fed does not want foreign entities to start selling their US holdings as this would cause rates to rise faster than they would like so they may need to do something to address this issue.

The bond market is telling us there may not be the strength in the economy that everyone is telling us there is and data coming from China is leading to this conclusion as well.

We see they melt up continuing into the end of the year, however the taper will be an interesting time as the real economy will need to pick up the slack and at present we do not see that there is the inherent strength in the economy to be able to do this.

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

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