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Global strategy update – November 2021
The journey back to normality

Guy Monson

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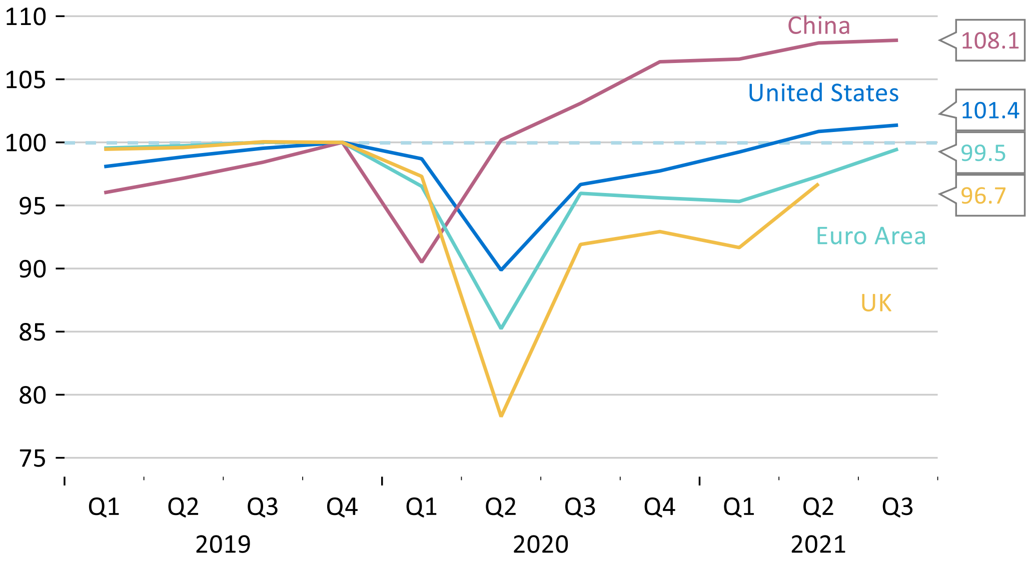
01 Global economy

Global GDP expected to be above pre-COVID levels by end of 2021 - economic surprises now moderating

The US & Chinese economies already larger than pre-COVID

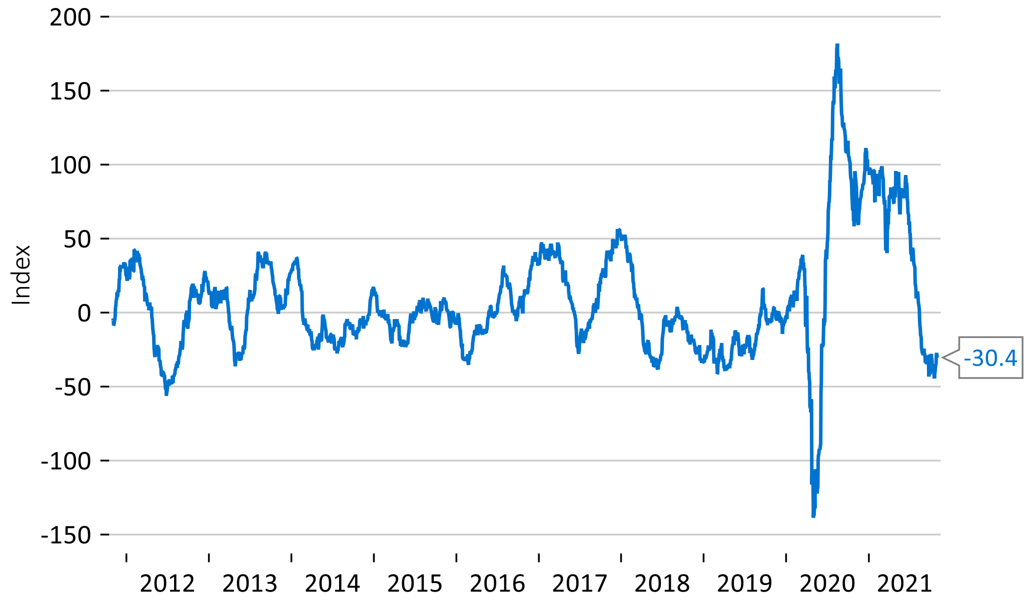
Economic momentum now modestly below expectations

GDP in selected countries
Indices: 2019 Q4=100 (the start of COVID)



Source: Macrobond, 02.11.21

G10 Economic Surprise index (Citi)

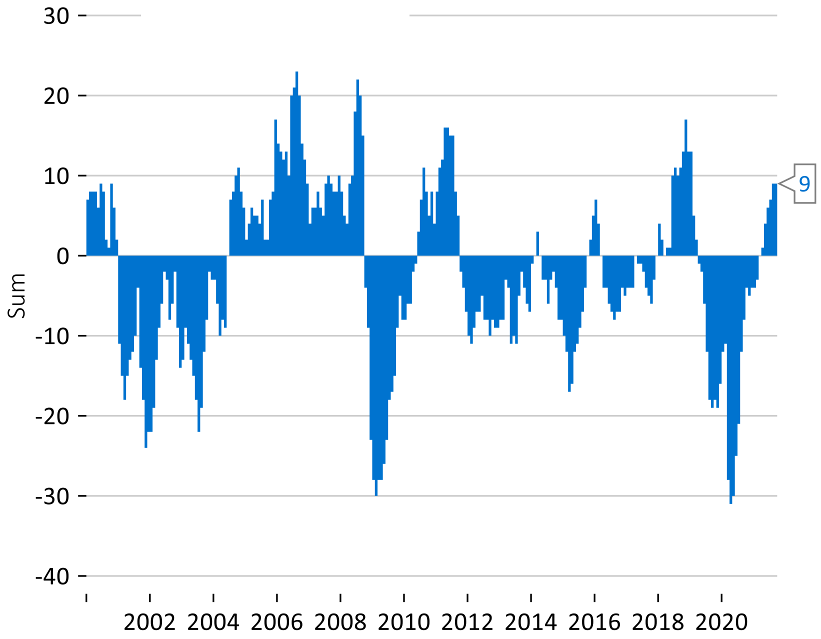


Source: Macrobond, 02.11.21

Rising global inflation risks are already prompting central banks to lift rates

Global monetary policy now starting to tighten

Number of Central Banks raising rates less those lowering

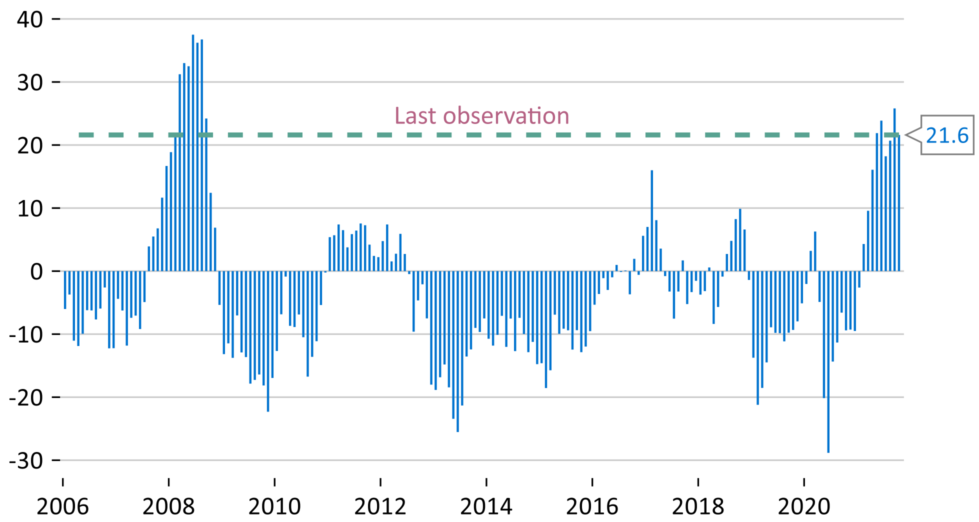


Source: Macrobond, 02.11.21

Global inflation risks are rising

Inflation surprises hit highest level since 2008

Source: Citigroup



Source: Macrobond, 02.11.21

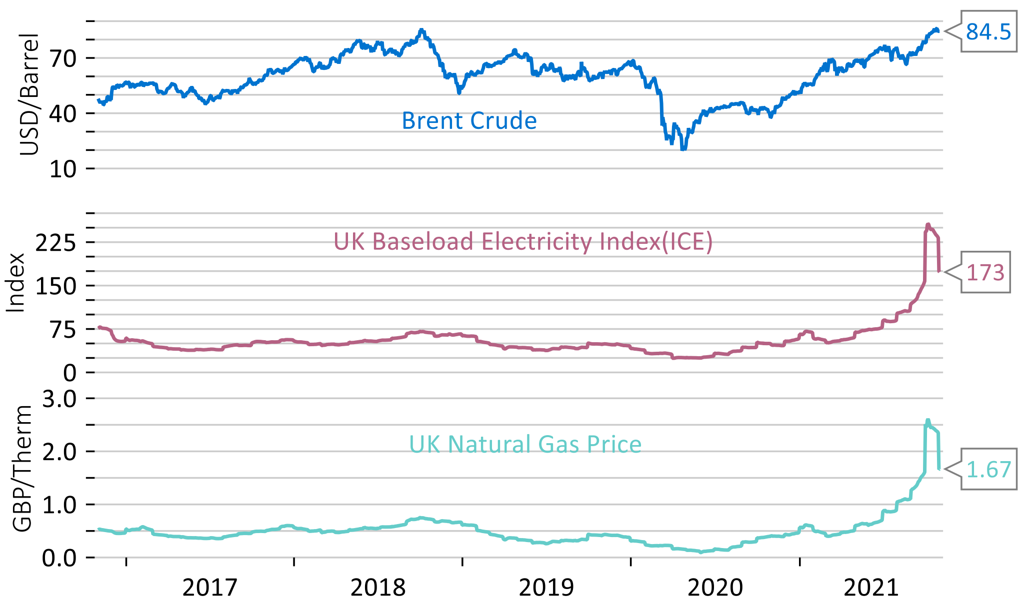
Rate rises already seen in 2021 include Norway, Brazil, Mexico, South Korea and New Zealand

Why is inflation rising?

1. Energy costs 2. Supply chain disruptions 3. Base effects

Prices rising across all energy sources

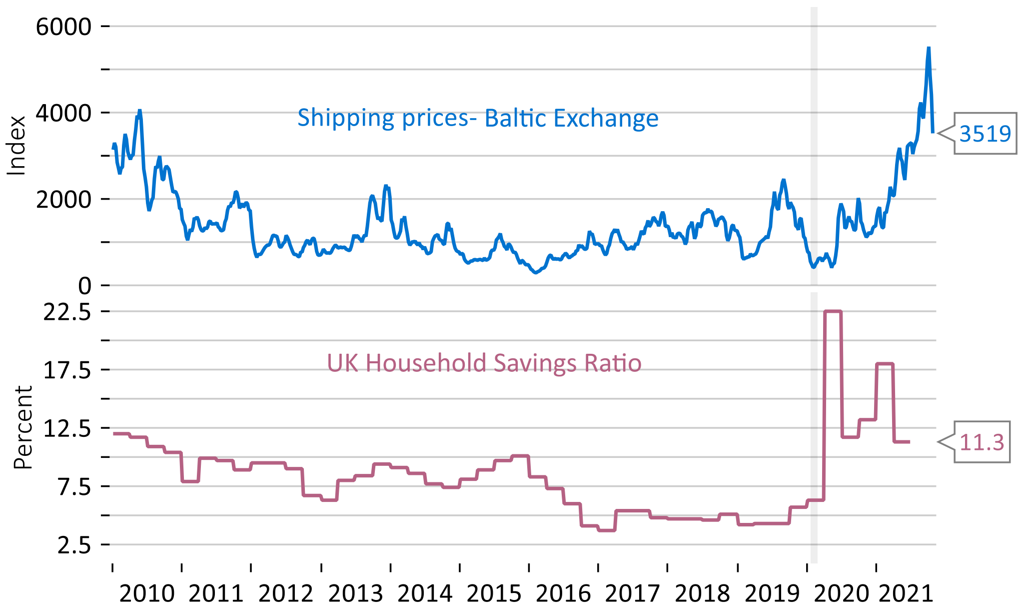
Energy Costs



Source: Macrobond, 02.11.21

Supply chain challenges meets savings rich consumers

Supply Chain Disruptions & Excess Savings

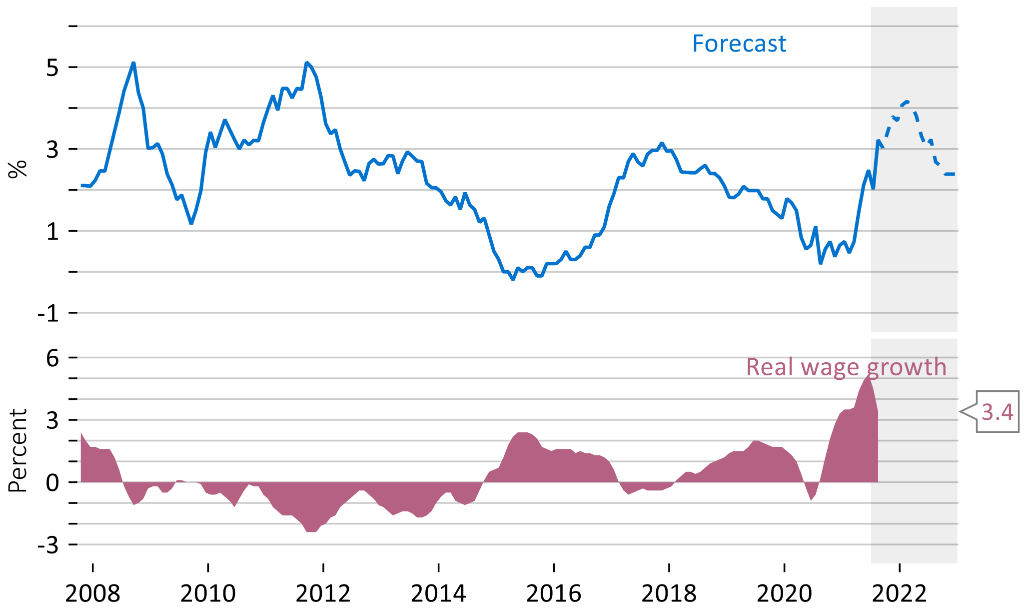


Source: Macrobond, 02.11.21

Could the UK be the first G7 Central Bank to lift rates?

Expect inflation to reach 4% by end of 2021

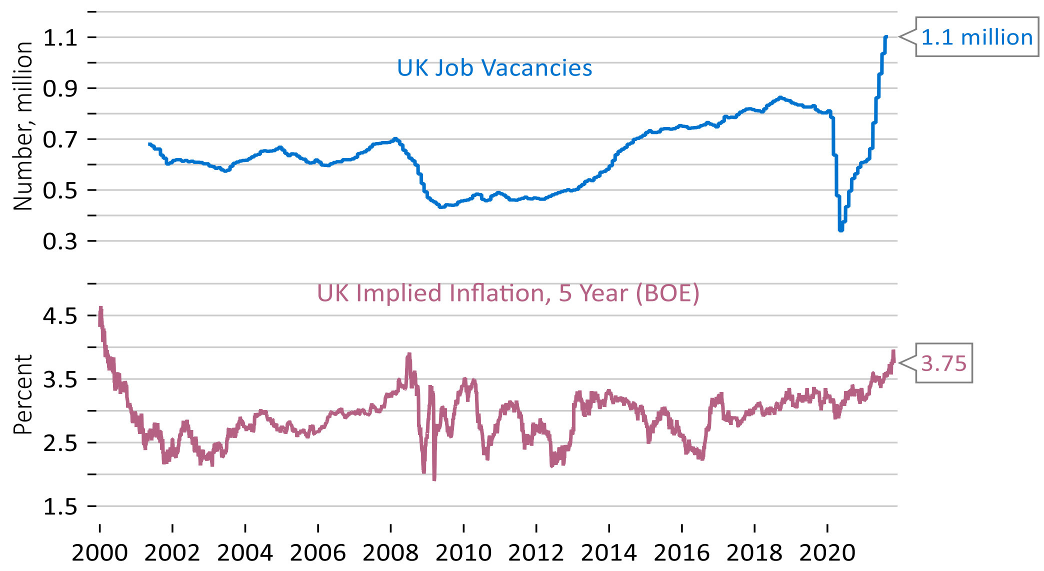
UK CPI growth



Source: Macrobond, 02.11.21

Tight UK labour market – implied inflation rising

UK Job Vacancies and Implied Inflation



Source: Macrobond, 02.11.21

"We have got some very big and unwanted price changes"

Andrew Bailey Governor BoE 9/10/21

"Increases in the bank rate do not need to wait for the end of the current asset purchase programme" (end 2021)

Andrew Bailey 27.9.2021

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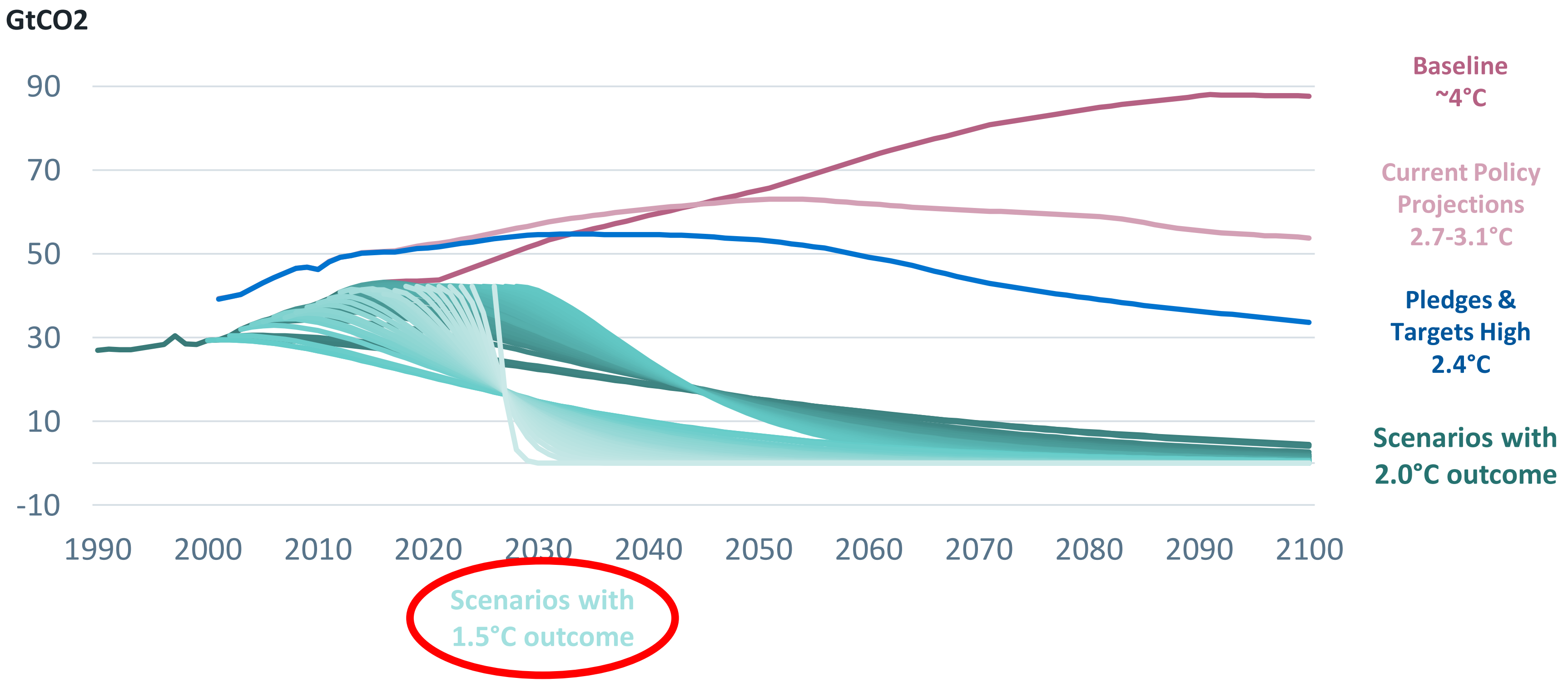
02 Key risks

Key Risk 1: Climate - Action now required is on a dramatic scale

We need to bend emissions curves very fast

2100 warming projections & emissions reduction scenarios necessary to limit global average warming to 1.5°C & 2.0°C



Source: Climate Action Tracker & Global Change Data Lab, 2019

Risk 2: China slowdown meets rising political risk

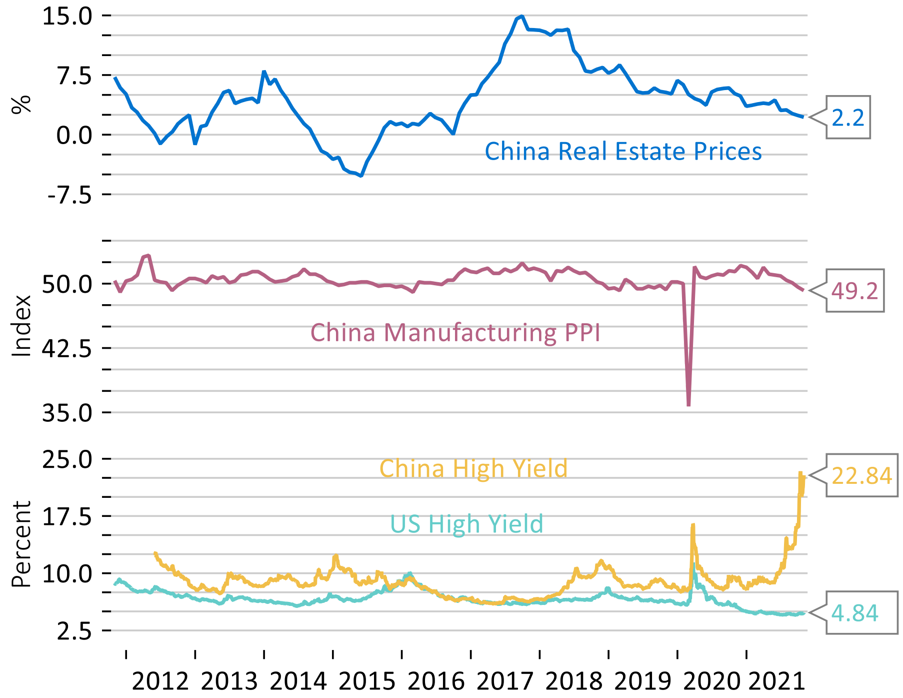
Domestic activity weaker-than-expected, driven by COVID restrictions, floods & regulation

Chinese data weakens & regulatory uncertainty rises

1. **Economic weakness appears broad-based across** sectors such as property and infrastructure-related industries, amid policy tightening.
2. **Retail sales, industrial production and manufacturing sentiment** softened.
3. **'Common Prosperity Agenda'** risks slowing economic activity across internet & gaming while '**Three Red Lines'** restrictions on leverage in real estate means bankruptcies are possible (Evergrande and others).
4. **China-Taiwan** tensions rising worryingly.

Strains in the highly leveraged property sector

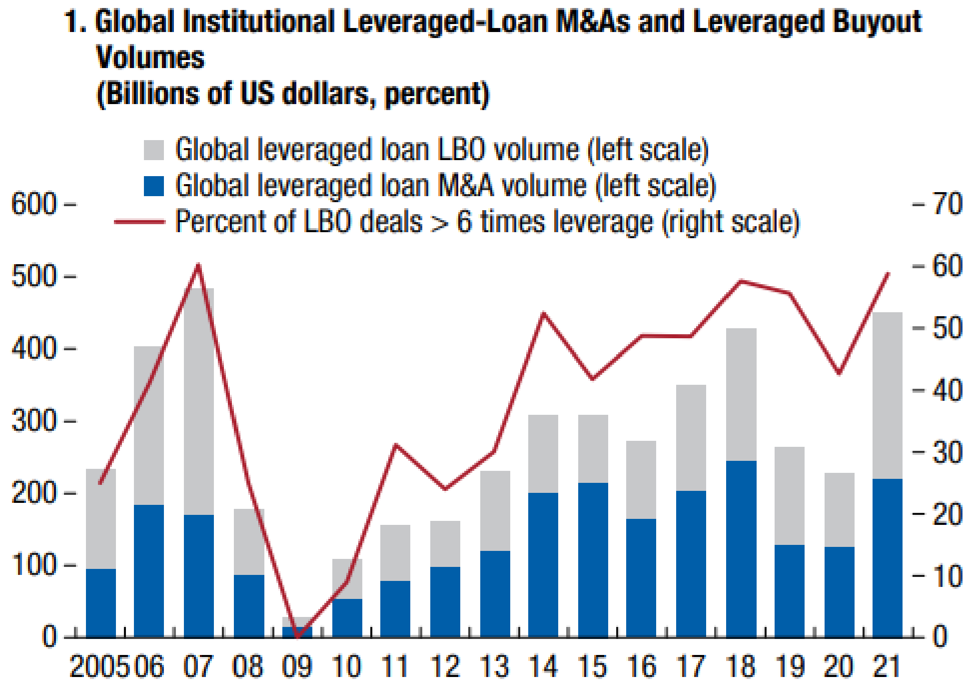
China slowing while high yield bond spreads climb



Source: Macrobond, 02.11.21

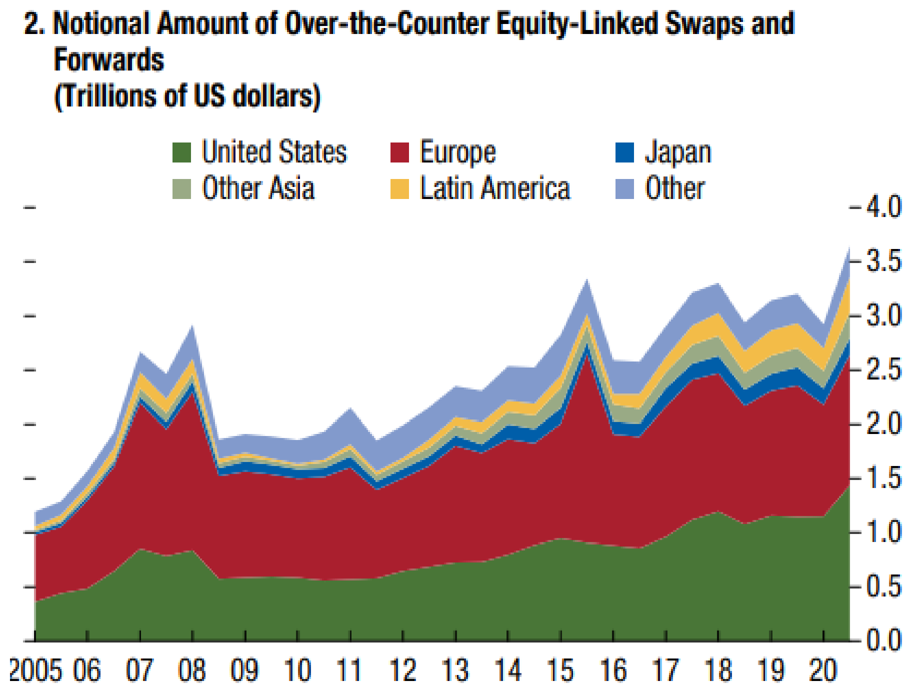
Risk 3: The IMF sees signs of financial excess emerging once again

Leveraged buy-outs back at 2007 peak levels



Source: BIS and IMF October 2021

Unlisted derivatives volumes are at new highs



Source: BIS and IMF October 2021

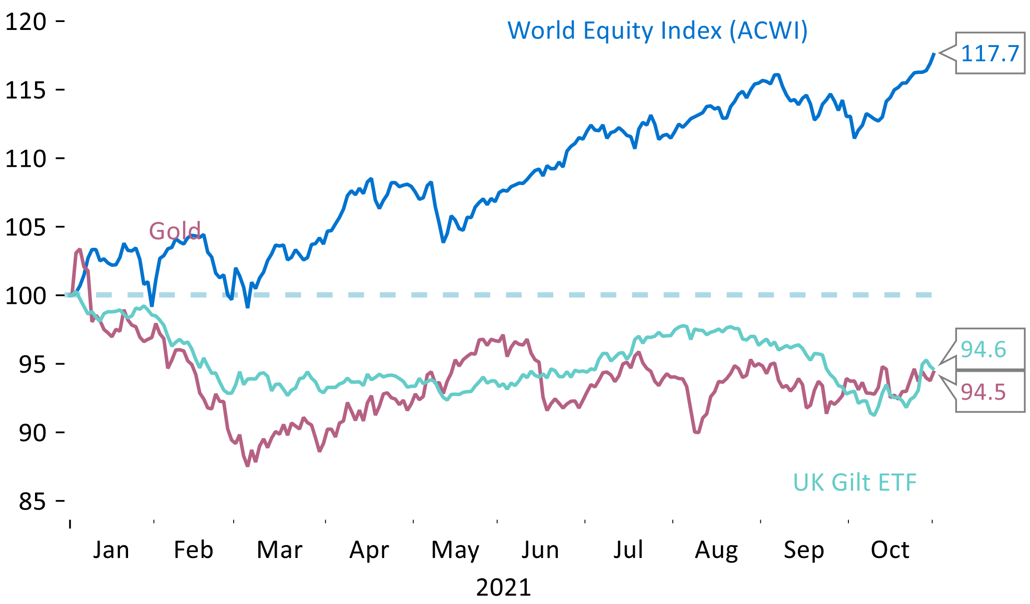
03 Policy implications

Asset class performance 2021 to date

Equities lead – Value modestly outperforms – Volatility steadily declines

Equities rally, bonds & gold decline

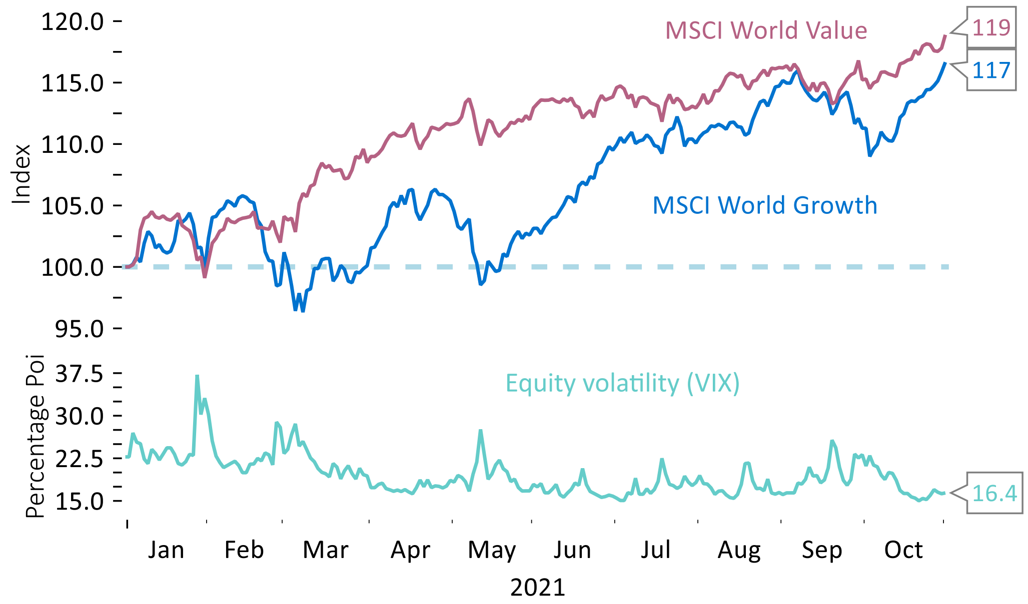
Global Asset Class Returns 2020 (GBP) to date



Source: Macrobond, 02.11.21

Growth catches up to value as volatility falls

World Equity Style 2021



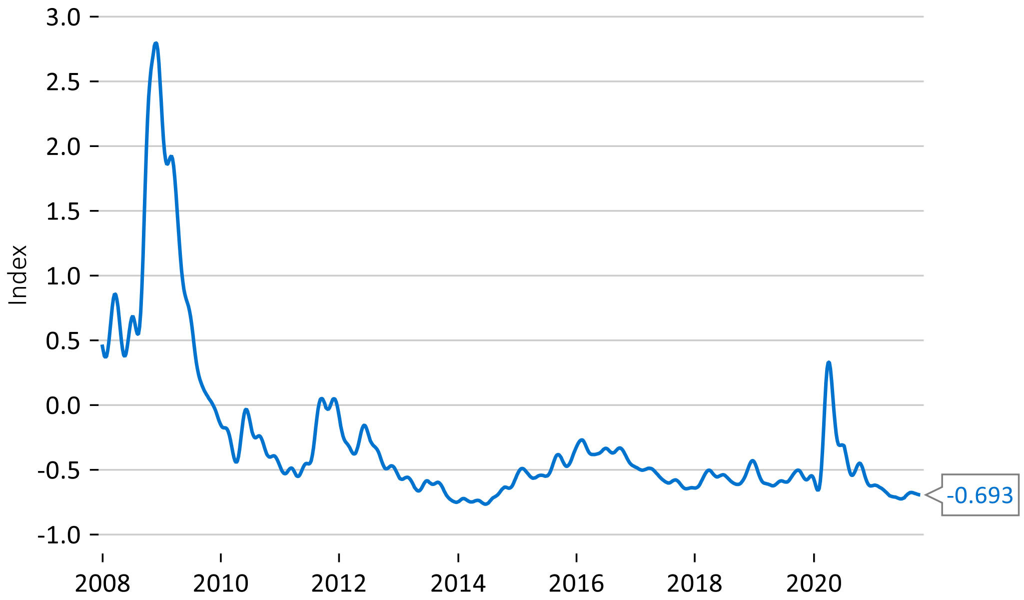
Source: Macrobond, 02.11.21

Why do we remain cautiously overweight risk assets?

1. Record monetary support will only be withdrawn slowly

Financial conditions still extremely generous

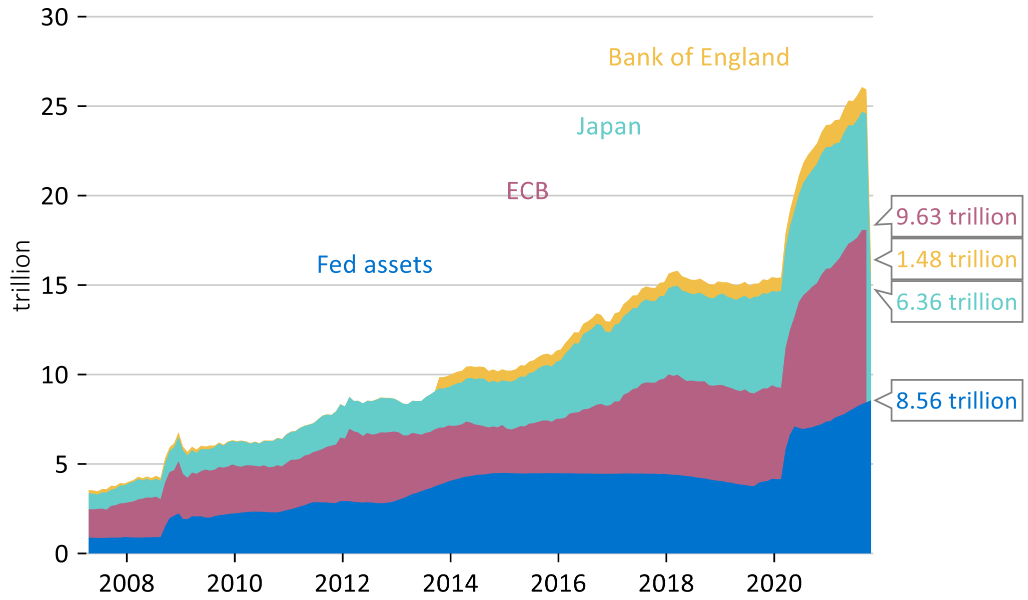
US Financial Conditions Index



Source: Macrobond, 02.11.21

Fed & ECB will still purchase $2trn of assets even with taper

Central bank balance sheet (USD, monthly)



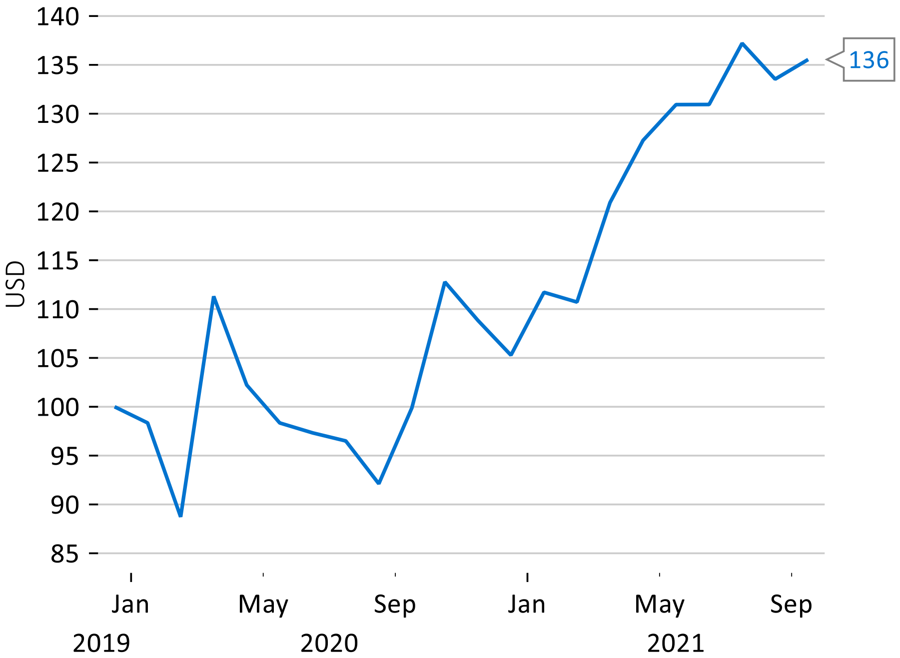
Source: Macrobond, 02.11.21

Why do we remain cautiously overweight risk assets?

2. Corporate earnings have recovered rapidly while generous liquidity has allowed PE multiples to expand

Global earnings (ex China) now surpass pre-COVID levels

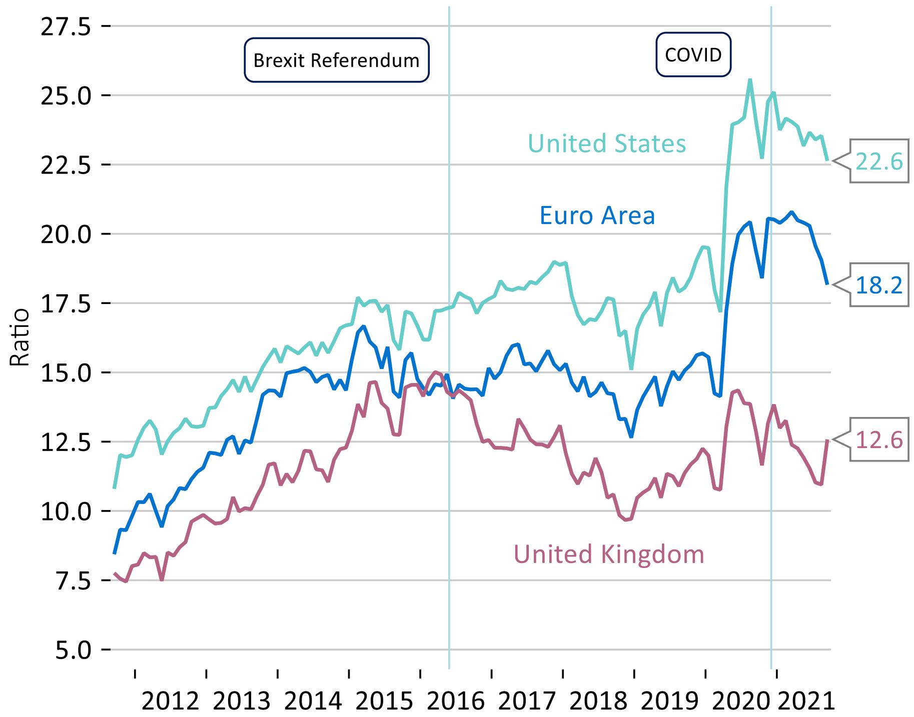
Global Earning Per Share (EPS) 12M forward (Factset 31/12/2019 = 100)



Source: Macrobond, 02.11.21

Valuations differences across markets are high

Forward PE Multiple Global Large-Cap (Factset)

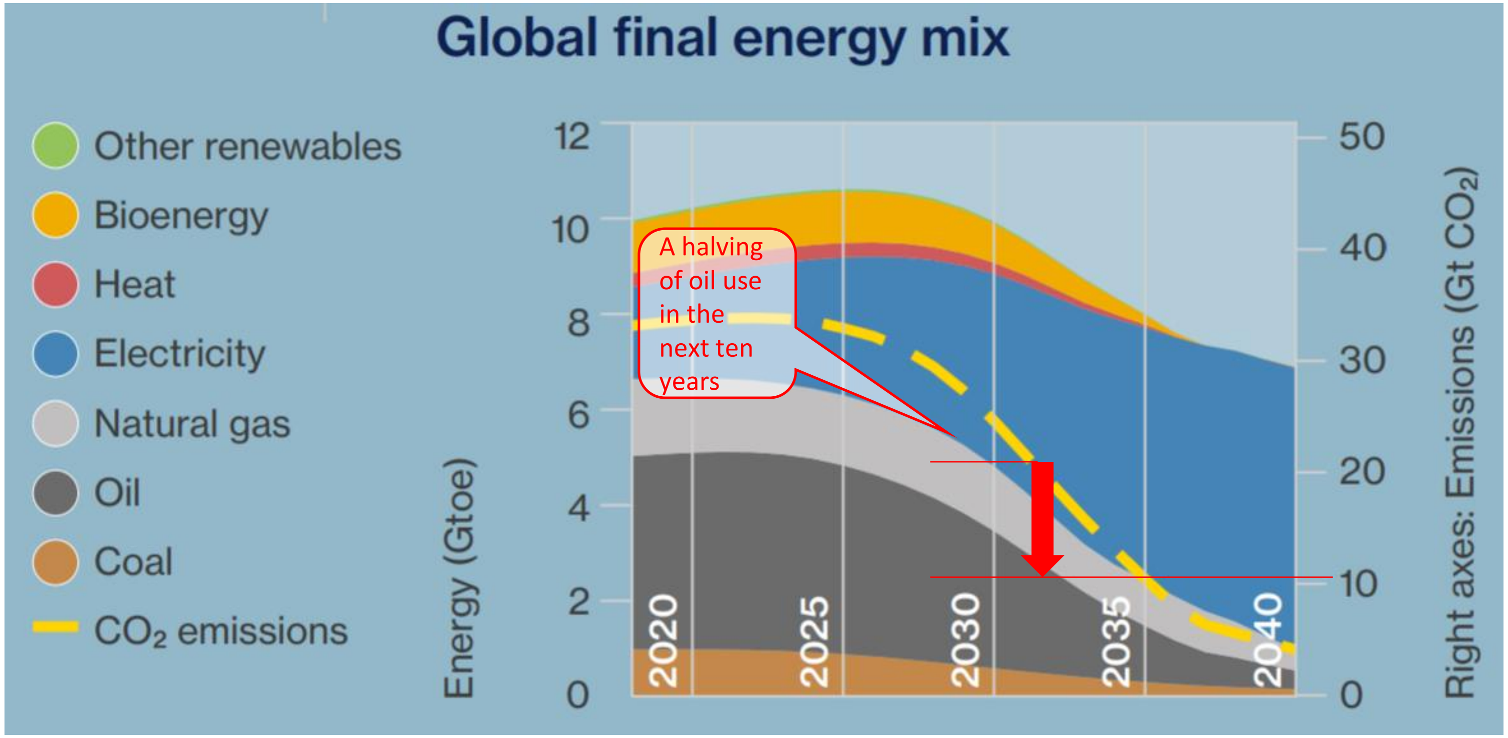


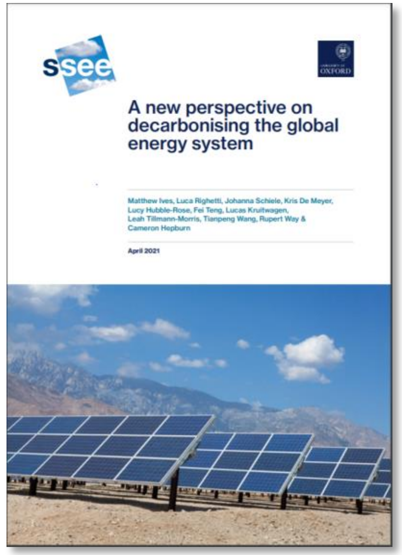
Source: Macrobond, 02.11.21

Why do we remain cautiously overweight risk assets?

Change in energy mix as the price of renewables falls under a ‘Decisive Transition’ scenario

3. Falling prices and continued exponential growth rates in clean energy technologies rapidly displace fossil fuels





Source: Smith School of Enterprise and the Environment, University of Oxford. Report No. 21-04.
[A new perspective on decarbonising the global energy system](#) / Sarasin annotations

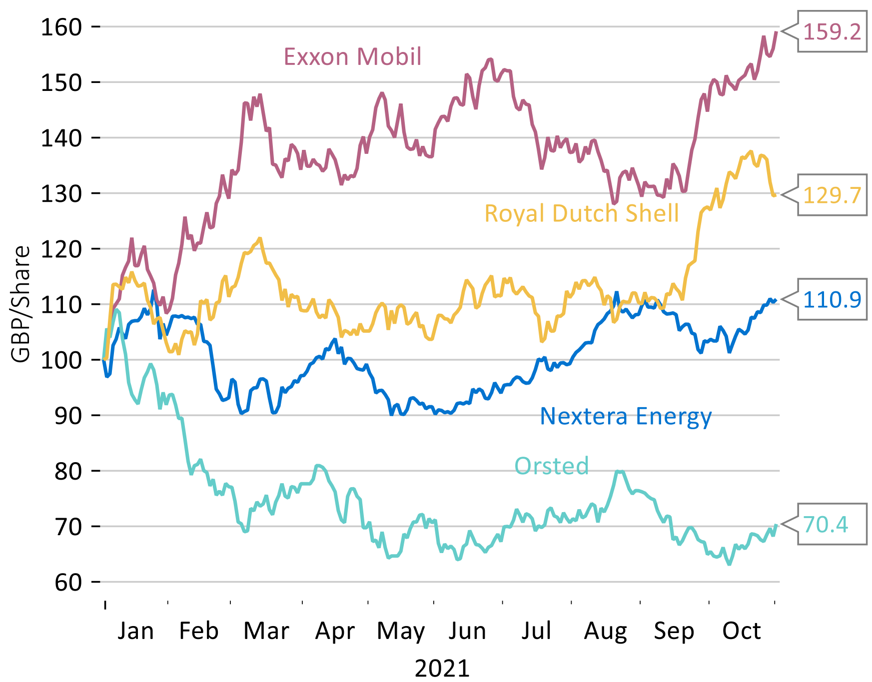
Essential liquid fuel use replaced by “green” hydrogen-based fuels. Solar and wind provide most of the energy; transport and heat are mostly electrified; and reliable electricity is maintained using batteries and chemical-based energy storage technologies.

The economic recovery and a supply squeeze have generated a bounce in fossil fuel companies – and an opportunity to buy renewables

2021 – fossil fuel energy rebound

Last three years – renewable energy outperforms

Share prices (rebased, GBP)



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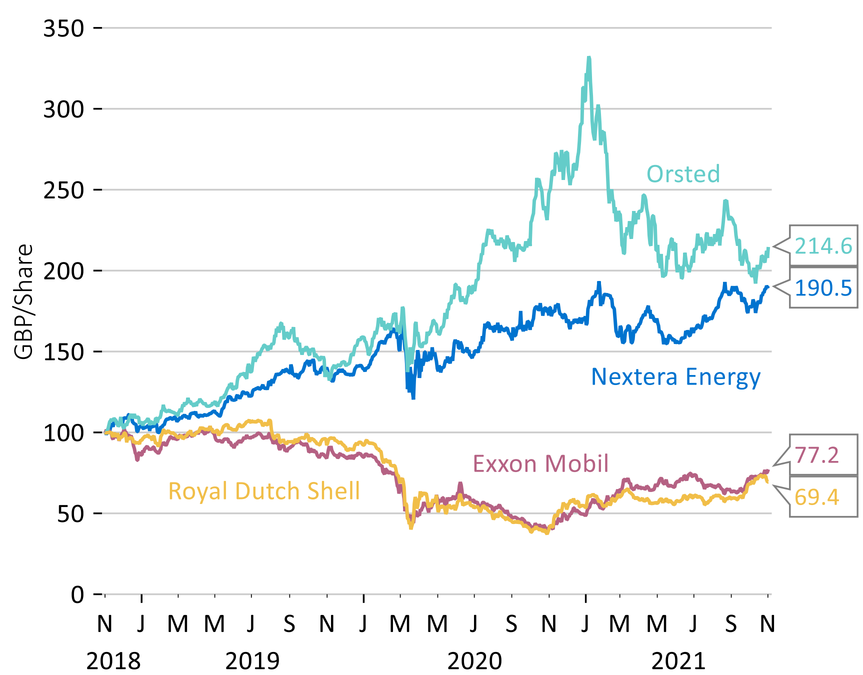
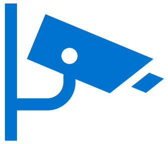
Share prices (rebased, GBP)



Source: Macrobond, 02.11.21

Sarasin's current climate activities

Accounting
Net-zero accounting is essential for net-zero emissions
Our letter to COP26 President, Alok Sharma, & Mark Carney
signed by other investors with assets of c.$2.5 trillion



Audit
Letters sent to Big Four Audit firms calling for net zero accounting disclosures
Supported by other investors with assets of c.$4 trillion

KPMG	PWC
EY	DELOITTE

Net Zero Plan
Publishing our NZAM Action plan early November – sets out how we are aligning our investment process with a +1.5ºC pathway

COP26 in Glasgow

- City of London Corporation Green Horizons Summit opening debate on harmonised global standards, litigation risk, mandatory net zero accounting disclosures
- Carbon Tracker Accounting for Climate Panel with CalPERS, IFRS Board, KPMG
- Sarasin LinkedIn debates with Heidi Hellmann (member of Sarasin Climate Active Advisory Panel & Centrica Group Head of Strategy & Environment)

Strong earnings momentum & still generous financial conditions continue to favour risk assets

Global strategy update – November 2021

Bonds	Strong underweight • Strong UW Government Bonds – global inflationary pressures remain elevated • UW Investment Grade Credit – yield spreads narrow – UK charity & infrastructure issues offer social impact benefits
Equities	Overweight • OW Global – earnings remain robust with central bank support still generous despite taper • UK – dividend support attractive – fund flows return as Brexit deal settles • EM – recent underperformance offers opportunities as vaccine roll-out accelerates
Alternatives	Overweight • OW Other Alternatives – infrastructure and renewables beneficiaries of fiscal spend – liquidity issues remain • OW Uncorrelated Alternatives – gold positions as hedge against policy error
Cash	Overweight • Risk of policy error high in US & China • No currency preference given still similar macroeconomic policies/rates worldwide • Consider portfolio insurance
Risks	Current: Climate transition risks, valuations stretched, inflationary pressures not transitory Longer-term: Inflation pressures become entrenched, central bank policy error, China tensions with US/Taiwan

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