

INVESTMENT STRATEGY QUARTERLY

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Letter from the Chief Investment Officer

Resilience is in our DNA – And in the Markets

Sixty years ago, Marshall Nirenberg and Henrich Matthaei began the process of cracking the genetic code. Thanks to their persistence and resilience, today's scientists developed effective mRNA-based vaccines in record time – saving millions of lives from COVID-19. With the darkest days of the pandemic behind us, investors can also appreciate the resilience of the economy and financial markets and the hopeful prospect of brighter days ahead.

As a backdrop, we'll bring a bit of scientific language to our analysis this quarter as we celebrate the amazing feats of our scientific brothers and sisters. After all, as Carl Sagan said, "Science is more than a body of knowledge. It is a way of thinking." We'll look at the *physics* of the economic momentum created by government stimulus; *dissect the anatomy* of our outlook for major asset classes; examine the *quantum leap* in the equity markets; and peer through our *telescope* at a higher S&P 500 earnings forecast.

We begin with Isaac Newton's *Law of Motion, Force = Mass x Acceleration*. Over the last year, we witnessed policymakers *experiment* with ways to force the economy out of its steepest dive since the Great Depression, applying massive fiscal and monetary stimulus at *light speed*.

In the United States, The Fed used the power of its record-setting \$7.6 trillion (and growing) balance sheet while Congress voted \$5.5 trillion of fiscal stimulus to fill the *black hole* COVID-19-induced lockdowns created. And the experiment's not over yet. Chair Powell has said the Fed is "not even thinking of thinking about raising interest rates" as it downplays the risk of sustained, elevated inflation. Meanwhile, Congress is in the midst of early negotiations for a multi-year 'social' and 'physical' infrastructure recovery package for later this year. With at least \$2 trillion in excess disposable income and confidence growing, pent-up consumer demand should lead to a summer surge in economic activity. Given that consumer spending accounts for 70% of GDP, the demand for goods and services is the *electromagnetic force* that drives our economy.

Of course, the biggest catalyst comes directly from medical science: enhanced COVID-19 vaccine availability and the related drop in cases, hospitalisations, and deaths are paving the way to a rapid, sustainable reopening of the economy. The stronger-than-expected force of these dynamics leads our economist to lift his expected 2021 GDP growth forecast to well over 5% from 4%.

Dissecting our growth forecast into major asset classes, we

expect the *supercharged* economy (the best growth since 1984) to push both inflation and Treasury yields modestly higher. We're forecasting the 10-year Treasury yield at 2% by year end, up from our original 1.5% estimate. We *hypothesise* continued Fed purchases, healthy demand from foreign investors, and the economy's interest-rate sensitivity to keep the rate *beaker* from boiling over beyond the 2% level and ruining the *experiment*. Since the return profile of fixed income will be challenged in a rising rate environment, we continue to prefer investment-grade bonds over high-yield bonds. Dollar-denominated emerging market bonds may also be attractive, boosted by our expectation of a weakening dollar.

The *astronomical* amount of fiscal and monetary stimulus has propelled the Dow, S&P 500, Nasdaq and Russell 2000 to *out of this world* record levels. Despite the *quantum leap*, we expect earnings will still be *under the microscope*. The good news is that the *kinetic energy* of the economy requires aiming the forecasting *telescope* ever higher in this strong earnings environment. As a result, we have lifted our 2021 S&P 500 earnings forecast to \$190 (from \$175), which correlates to a year-end target of 4,180 (up from 4,025). As long as earnings growth remains robust, we expect the bull market to remain healthy.

Investors should appreciate the *higher mathematics* of fundamental analysis. Our favoured sectors include Information Technology, Communication Services, Financials, Industrials, and Consumer Discretionary because of hefty visible earnings growth and attractive valuations. Not only are these sectors leveraged to the economy in the short run, but they also have had long-term secular growth trends accelerated by the pandemic (e.g., e-commerce, streaming, advertising, broadband expansion, and fintech). Don't be distracted by the *chaos* of hot momentum trades, day traders, or all-or-nothing thematic calls (i.e., reopening trade vs. stay-at-home).

To elaborate, we're cautious about some of the reopening beneficiaries (i.e., hotels, airlines, leisure facilities, etc.) as their strong rallies appear to be *defying gravity* given

the lack of robust, if any, earnings over the next 12 to 18 months. Our *observation* is that selectivity will become more important at the sector, industry, and individual stock level as we begin the bull market's second year.

Our *Theory of Relativity* isn't as sophisticated as Einstein's original one. We just believe that the relatively higher growth trajectory of the US equity market makes it more attractive than other developed markets. Given its superior vaccination progress, state of reopening and aggressive policy stimulus, the US economy has generated the highest upward revisions to GDP forecasts among the world's ten largest economies so far this year. Since Asian emerging markets are relatively less expensive, a substantial rebound in economic growth (both China and India are growing over 8%) should drive those markets as well.

As global economies emerge from lockdown and economic growth accelerates, commodities have benefitted. In particular, rebounding demand drove global oil from its *state of inertia* as crude prices have returned to pre-pandemic levels. However, now that oil prices are higher, watch for producers in the US, OPEC, and Russia to increase production. With supply and demand on the same *wavelength*, the recent price momentum is likely to be tempered by rising supply. As a result, we have only modestly raised our year-end West Texas Intermediate oil target to \$70 from \$65.

The start of 2021 has been far more enjoyable for investors than the start of 2020, and while market volatility is likely to be more palatable in the year ahead, it does not lessen the importance of adhering to your asset allocation. Pullbacks

are an *organic* occurrence in the market and there is no shortage of possible *toxic* risks. In particular, investors must watch for *boiling points* in the economy, inflation, investor exuberance, partisan politics, geopolitical tensions, and vaccine-evasive variant COVID-19 strains. However, *chemistry* with an adviser who understands the *elements* of risk tolerance, diversification, liquidity needs, and long-term investment goals should help in designing your *formula* for success.

The last year has been a challenge for most of us. As we approach a sustainable reopening this quarter, the old saying "With spring comes new life and hope" may be truer than ever this year!



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Hope For Growth In The U.K.

Chris Bailey, *European Strategist*, Raymond James Investment Services Ltd.

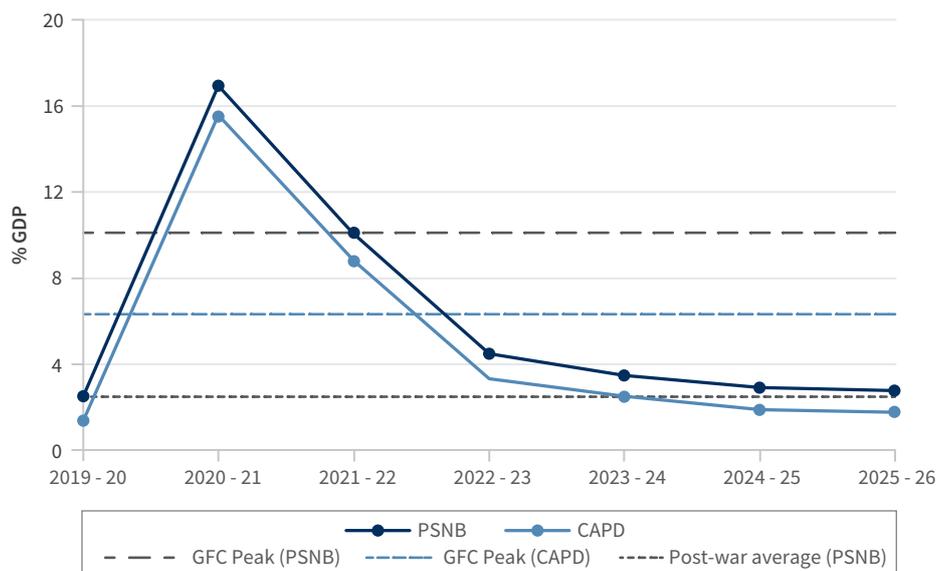
“To live without hope is to
cease to live” – Fyodor Dostoevsky

Whilst U.K. economic data in 2020 saw its biggest contraction in over three centuries (back in 1709 the agricultural centred U.K. economy suffered an even worse economic decline due to that year's great frost), the positive prospects for 2021 have continued to improve. The most recent data from the International Monetary Fund (IMF) has predicted that the U.K.'s near ten percent economic contraction last year will be regained by the end of next year, a view shared by the recent budget announcement from the U.K. government. So are economic growth prospects - boosted by the recent significant COVID-19 vaccine progress - inexorably strongly recovering?

Classically, economic growth is determined by a combination of consumer spending, investment levels, overall net government initiatives and global trade opportunities. Despite the introduction by the U.K. government of significantly widespread furlough schemes, consumer spending, corporate investment levels and global trade levels all fell significantly. Unsurprisingly a U.K. economy which is progressively moving significantly away from a period of lockdown will naturally progress. However - sadly - no period of significant economic support can be achieved without major cost. And this starts with U.K. debt levels.

Whilst we continue to experience extremely low interest rates combined with significant amounts of Bank of England stimulus, a significant heightening of national debt levels is a short, medium and longer-term problem. Current government borrowing levels are anticipated to reach nearly seventeen percent of GDP in the financial year at the end of March 2021, the highest level of peacetime borrowing on record. Unsurprisingly whilst there have been some indications of higher mainstream business tax rates later on this decade, these levels still remain relatively light compared to many other countries around the world. Additionally a new policy initiative to try to encourage business investment expenditure is a positive effort, as this should encourage both corporate growth as well as new job employment. And whilst the freezing of personal taxation levels will mean anyone with a gain in their wages will pay more tax,

Fiscal stance - The net injection by the government into the non-government sector, or the extent to which fiscal policy is contributing directly to the level of GDP.



Source: Office for National Statistics, Offer for Budget Responsibility and HM Treasury Calculations.

the change is currently anticipated to be relatively moderate. In short, whilst the raised debt levels do mean that higher tax levels will occur over upcoming years the increase is not yet too dramatic and is unlikely alone to significantly hold back U.K. growth recovery.

“ Whilst the raised debt levels do mean that higher tax levels will occur over upcoming years the increase is not yet too dramatic and is unlikely alone to significantly hold back U.K. growth recovery.”

But how about global trade opportunities? Undoubtedly impacts from differing levels of COVID-19 vaccination progress will have some impacts on both export and important trends, but still the most important issue for upcoming years remains centred on Brexit. The forging of a deal just before Christmas last year was a positive move with the part of the world which will continue to generate the most trade opportunities for the U.K. for the foreseeable future. Whilst there are still some practical uncertainties, economy-wide impacts are unlikely to be extremely negative for the 2020s assuming trade wars can be avoided (a likely scenario even with China).

And finally we are back to the consumer. With unemployment levels now expected to peak more rapidly than anticipated last year, hopes for significant progress in consumer spending levels - assuming continued opening up of the U.K. economy - will also positively impact the U.K. financial markets.

Globally there is always the potential for uncertainties centred on excessive optimism, too much debt, diplomatic challenges, and unanticipated weather or earthquake effects. For the markets over time the most challenges later this decade will come from the rapid increase in global debt levels. But this - in all likelihood - is something for 2022 and beyond and not for this year, which will give governments and central banks around the world further time to find more solutions for the rest of the 2020s. Meanwhile for this year, the outlook for 2021 - on balance - still suggests further improvement. And the U.K. - after its economic difficulties last year - is set to bounce back well over the rest of this year and into 2022. ■

KEY TAKEAWAYS:

- The U.K. economy in 2020 saw its biggest contraction in over three centuries.
- Whilst corporation and personal taxation rates are rising, other benefits are helping.
- Brexit issues can still impact the economy but the threat of any global trade wars are low.
- U.K. reopening is likely to help boost economic profiles - and the stock market - this year.

(INFLATION)

THE DOG THAT BARKED IN THE NIGHT?

Jeremy Batstone-Carr, *Raymond James European Strategy Team*

Financial markets have spent much of 2021 to date obsessing about building inflationary pressures, the consequence of a slow emergence from lockdown across developed Western economies. A “perceived” inflationary threat has driven sovereign bond market break-even rates higher and nominal bond yields, especially longer-dated government bond yields, have risen from 2020 lows. All fine, except that there is no inflation! Critical to the debate is the difference between, on the one hand, one-off price adjustments and the impact of supply chain disruption and on the other hand, a steady and persistent increase in wages and costs (that which economic textbooks describe as true inflation).

Yet for all the talk, what do our own eyes reveal to us? The crude oil price is falling back from recent high levels. Barring a temporary blip higher caused by a crashed tanker in the Suez Canal, forcing oil-related traffic to make the more circuitous journey around the African Cape, Brent crude has dropped well below \$70 per barrel and the lighter grade, West Texas Intermediate, below \$60 per barrel. The International Energy Agency is reporting a steady supply build-up as production exceeds demand. Meanwhile, across developed economies, longer dated government bond yields have dropped back too. The repatriation by Japanese pension and life assurance companies of substantial funds parked in US Treasuries, to “window dress” domestic performance ahead of that country’s fiscal year-end on 31 March, thus driving US Treasury prices lower

and yields higher, is now over and “normal service” is resuming.

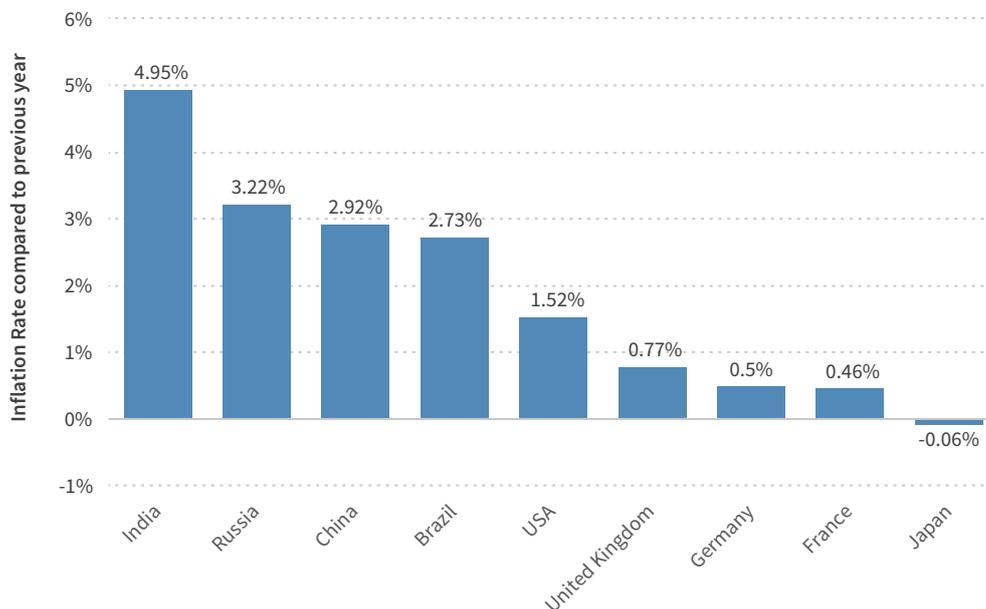
So, what is going on? On a global level, away from purely the US and the UK, the war against COVID-19 is nowhere near over.

“On a global level, away from purely the US and the UK, the war against COVID-19 is nowhere near over.”

On Wednesday 24 March the message from Germany really drove that message home. The daily count of new COVID-19 cases in that country is rising rapidly again and, if the current rate is sustained, will double over the next three weeks. The under-pressure Chancellor, Mrs Angela Merkel, has been forced into an abrupt “U-turn” having earlier emerged from a highly fractious 11-hour meeting with regional leaders to announce an ultra-hard five-day lockdown of the entire country over the Easter weekend. With national elections scheduled for the end of September, what the electorate think counts for a lot. Public pressure dissuaded the Chancellor from following through with implementation, although all plans to reopen the German economy remain on hold, at least until the next high-level meeting on 12 April. Add to that the fact that Italy is now locked down completely again and that restrictions have been reimposed in France and the clear conclusion is that Europe’s economic recovery has been postponed again.

Away from Europe the picture is no better. It is worth noting

Estimated inflation rate of the main industrialised and emerging countries in 2020 (compared to the previous year)



Source: Statista, <https://www.statista.com/statistics/256630/inflation-rate-in-selected-global-regions/>

that global daily COVID-19 infection rates are now ahead by 65% from February's low and higher by the same margin over last spring's peak. Until COVID-19 is finally vanquished, the world over, there cannot be a lasting economic recovery. Until COVID-19 is completely beaten, international commerce will continue to be impaired.

“ Until COVID-19 is completely beaten, international commerce will continue to be impaired.”

It's a point often made, but well worth reiterating. The activities most severely impacted by containment policies aimed at curbing the virus' spread are mainly those in the service sector and amongst lower income earners. This cohort have seen incomes hit hard by the enforced closure of businesses and are effectively living on government hand-outs. In contrast, wealthier people are actually saving money by not commuting to work, not taking overseas holidays and not dining out. People locked down cannot go to the gym, or the spa, to the theatre or to visit a museum. Neither can they take a business trip, stay in a hotel, attend a conference or otherwise run-up the

expense account. Demand for many of the services that comprise a big proportion of both household and business budgets is down, sharply down!

This, for the most well-off, leaves savings higher and cash yearning to be spent. So, demand for electronic equipment, household durables and any other consumer items that Amazon can deliver is soaring. Also soaring is demand for bigger houses outside congested urban areas, where isolation and work-from-home is more convivial. ■

KEY TAKEAWAYS:

- As a result of a slow emergence from lockdown, financial markets have spent much of 2021 obsessing about building inflationary pressures.
- Europe's economic recovery has been postponed again.
- Until COVID-19 is completely beaten, international commerce will continue to be impaired.



Global Energy Transition: What It Is, Why It Matters, and How to Invest in this Theme

Pavel Molchanov, *Director, Energy Analyst*, Equity Research

Energy transition, also commonly referred to as decarbonisation, is one of the global megatrends of our time. As it underpins the paradigm of environmental sustainability, energy transition is a megatrend not just for the next few years, but toward the middle of the century. Here is the big picture: the global economy's traditional reliance on fossil fuels (coal, petroleum, natural gas) is diminishing, as both technological/economic and political/regulatory factors drive the adoption of renewable energy sources and other low-carbon technologies. For investors, it is essential to at least conceptually recognise the impact that this megatrend will have for the entire energy value chain, along with many non-energy areas (e.g., transportation, manufacturing, and agriculture). There will be winners and losers, but not always the ones you'd expect, and with a wide range of impacts in different geographies.

RENEWABLE ENERGY IS GOOD BUSINESS

Technological change is creating economic incentives for self-motivated decarbonisation. Case in point: more than 280 large companies around the world, encompassing nearly every industry,

For investors, it is essential to at least conceptually recognise the impact that this megatrend will have for the entire energy value chain, along with many non-energy sectors.

have committed to source 100% of their electricity from renewable sources — and many have already achieved this target. Even more impactful, a dozen of the top-tier oil and gas producers have committed to reorient their operations toward low-carbon energy over the next 20 to 30 years. To clarify, these companies are doing it not because they are forced to by governments, but rather because they see it as good business. For example, the past decade's massive reductions in wind turbine and solar hardware costs mean that in-house wind and solar farms routinely provide lower-cost electricity for data centers as compared to buying power from the grid — and, amid frequent headlines about weather-related power outages, integrating such assets with batteries can also provide 24/7 reliability. Bus and truck fleets converting to electric or fuel cell vehicles stand to achieve savings on fuel as well as maintenance, which offsets the higher upfront cost of these vehicles. Similarly, upgrading buildings with energy-efficient windows, LED lighting, and energy management software also pays for itself over time.

“ More than 280 large companies around the world, encompassing nearly every industry, have committed to source 100% of their electricity from renewable sources. ”

POLICY MILESTONES

On the policy front, there are some specific milestones that we are tracking in 2021. In December 2020, the European Union approved the European Climate Law, thereby becoming the world’s largest carbon emitter to impose a legally binding mandate for net zero CO2 emissions by 2050. As the details of the implementation roadmap are unveiled over time, the entire European economy will need to be transformed — not solely the ‘usual suspects’ (power plants and transport). The UK is no longer an EU member, but it has had equivalent legislation since 2019. In the run-up to the United Nations climate conference this November, more countries will set net zero targets — China, Japan, and South Africa have already signaled plans to do so — though the details are more important than the headlines. President Biden has proposed the same policy for the US, as well as a 100% carbon-free electricity mandate by 2035 and \$2 trillion of federal spending on energy transition over four years. We are not confident that any of this can get through the narrowly divided House, and the 50/50 Senate looms as an especially tough hurdle. Thus, we will be watching

how the Biden administration uses executive action (e.g., fuel economy standards, oil and gas permitting rules, and tariff policy) to incrementally boost decarbonisation, as well as what happens at the state level. Much like in the US, many other jurisdictions around the world are not yet ready to enact sweeping climate reforms but still have some targeted policies, such as a coal phase-out, a carbon tax, a renewable electricity or fuel mandate, or an energy audit requirement for buildings. Contrary to conventional wisdom that only high-income countries have the ‘luxury’ to approve such policies, in reality there are plenty of emerging markets that are active in energy transition — most notably China, which in January 2021 launched what will eventually become the world’s largest carbon trading program.

SUSTAINABLE INVESTING

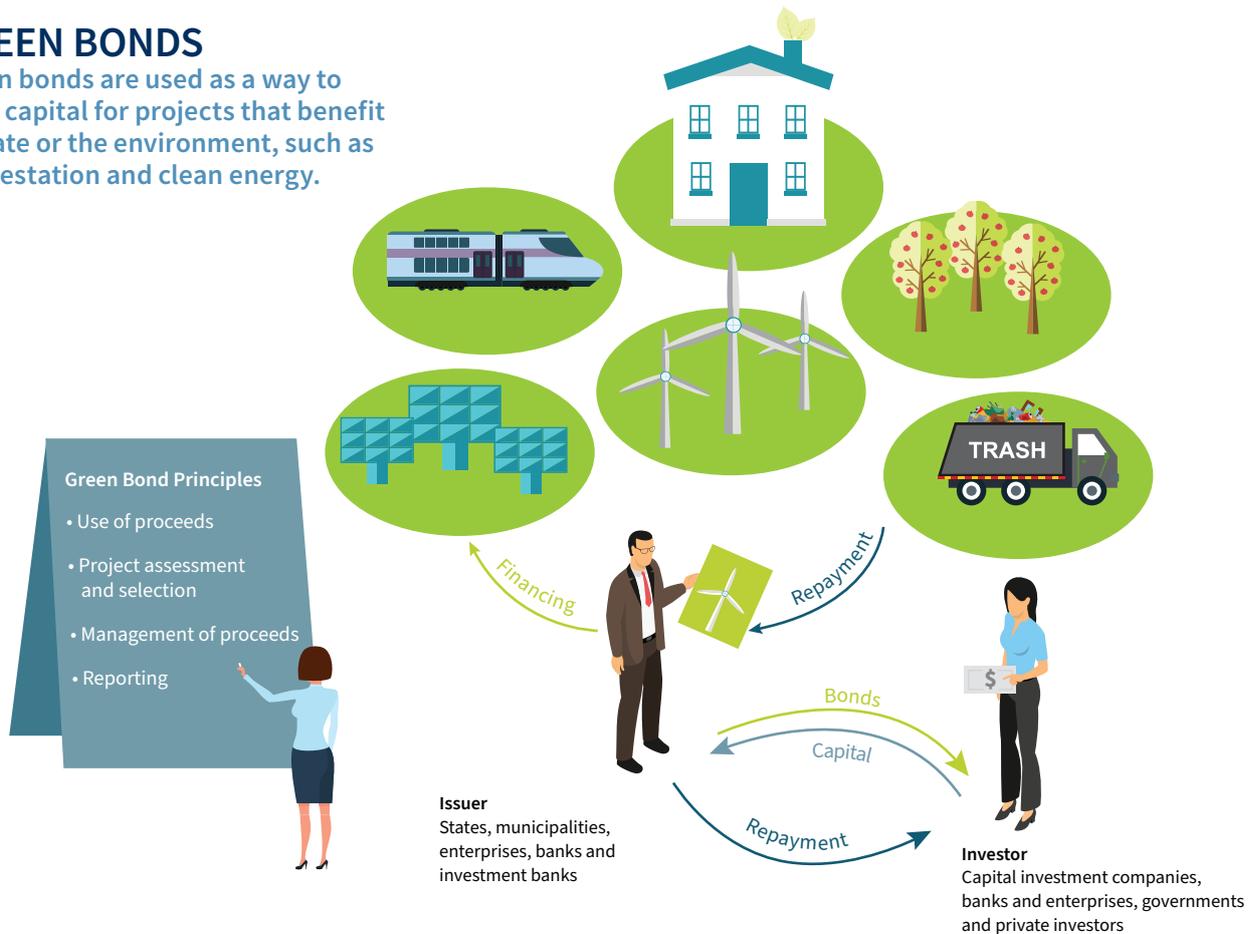
Alongside the fundamental drivers mentioned above, sustainable (ESG) investing — and, more specifically, climate investing — is raising the importance of energy transition for management teams, particularly at publicly-traded companies. Broadly speaking, there are two approaches to climate investing, and these are not mutually exclusive. First, investors can exclude those companies that are having a disproportionately negative effect on the climate. Second, they can favour those companies that are creating beneficial climate-oriented solutions. Here are the key statistics vis-à-vis ESG: as of 2020, \$16.6 trillion of professionally-managed assets (equity and debt combined) in the US are covered by one or more ESG criteria, up 56% from 2018. Remarkably, this represents fully one-third of all managed assets. Within the \$16.6 trillion pie, the largest single slice — climate funds — accounts for \$4.2 trillion. Meanwhile, the worldwide total of funds with a fossil fuel divestment policy is approaching \$20 trillion, though the vast majority of the divestments pertain solely to coal, at least for now. Divestments are more common in Europe than elsewhere, and more common

Milestones in Sustainable Policy

1984	1990	2006	2020	2020	2021	2030	2050
Social Investment Forum founded	Launch of the Domini Social Index, the first socially responsible investment index	Launch of the Principles for Responsible Investment (PRI)	European Climate Law approved	John Kerry appointed special presidential envoy for climate	China launched what will become the world's largest carbon trading program	UN sustainable development goals target date	EU target date for net zero CO2 emissions

GREEN BONDS

Green bonds are used as a way to raise capital for projects that benefit climate or the environment, such as reforestation and clean energy.



among universities and foundations than traditional asset management firms. Looking at debt specifically, green bonds are a popular way to raise capital for projects with a positive climate impact, including below-the-radar projects such as reforestation, public transit, or making the electric grid more resilient.

ENERGY TRANSITION HAS UNLIMITED SCOPE

Investing in energy transition does not need to be limited to high-beta, high-multiple stocks of solar, electric vehicle, or hydrogen companies (which is what tends to come to mind first). Certainly there are plenty of options in the clean tech sector – the aggregate market cap is approximately \$1.5 trillion, the highest ever – but businesses in many other sectors are also playing a role. For example, some banks and insurers are more active than others in boosting lending to renewable energy initiatives and/or cutting back on lending to fossil fuels. Alongside the well-known electric vehicle (EV) pure-plays, just about every major automaker has EV models available, and some have committed to becoming exclusively electric over the long

run. Food, beverage, and other consumer goods companies are taking steps to reduce single-use plastics, which sometimes involves partnering with startups developing bio-based chemicals. REITs and homebuilders are deploying energy-efficient technologies across their asset base. The bottom line is that investors ought to be creative, rather than only looking at the well-known high-flyers. ■

KEY TAKEAWAYS:

- Energy transition is a megatrend not just for the next few years but toward the middle of the century.
- A dozen of the top-tier oil and gas producers have committed to reorient their operations toward low-carbon energy over the next 20 to 30 years. They are doing it because they view it as good business.
- Sustainable (ESG) investing – and, more specifically, climate investing – is raising the importance of energy transition for management teams, particularly at publicly-traded companies.

Sustainable (ESG) Investing considers qualitative environmental, social and corporate governance criteria, which may be subjective in nature. There are additional risks involved, including limited diversification and the potential for increased volatility. There is no guarantee that these products or strategies will produce returns similar to traditional investments. Because criteria exclude certain securities/products for non-financial reasons, investors may forego some market opportunities available to those who do not use these criteria.



Still Correct To Be This Excited Towards The Emerging Markets?

Chris Bailey, *European Strategist*, Raymond James Investment Services Ltd.

“An emerging market is a country where politics matters at least as much as economics to the market.” – Ian Bremmer

Based on average allocations over the few years, emerging markets have been a popular investment for global fund managers in recent months. Are such thoughts based on good analysis or not?

Typically an emerging market only has some characteristics of a developed market, but does not fully meet its standards. Current MSCI Emerging Markets index allocations are led by China, followed by South Korea, Taiwan, India, Brazil, South Africa and Russia, with the first four names focusing overall exposure to Asia. Meanwhile the latest earnings expectations data from the International Monetary Fund (IMF) estimate emerging market countries - on average - to again outperform 'advanced economies' alternatives.

Whilst still including the economies of South Korea and Taiwan within the emerging markets is now more controversial because of their respective economic gains over the last forty years, today's most significant individual country is China. Unsurprisingly the world's largest individual population at just over 1.4 billion, also has the world's higher total GDP (at least on a purchasing power parity specific basis).

However, there are currently a lot of potentially controversial issues with China. During March, the United States, Canada, Britain, and the European Union announced business and economic sanctions on China, regarding the latest alleged treatment of the Uyghur Muslims, which has been an issue of complaint for quite a long time. Certainly the timing of this is

GDP (PPP) sector composition, 2017 (in percentage and in millions of dollars)

Country/Economy	Total GDP (PPP)(US\$MM)	Agricultural	Industrial	Service
World	127,800,000	6.4%	30%	63%
China	23,210,000	7.9%	40.5%	51.6%
European Union	20,850,000	1.6%	25.1%	90.9%
United States	19,490,000	0.9%	19.1%	80.0%
India	9,474,000	15.4%	23.0%	61.5%
Japan	5,443,000	1.1%	30.1%	68.7%

Source: https://en.wikipedia.org/wiki/List_of_countries_by_GDP_sector_composition

auspicious coming less than a week after a slightly grumpy first meeting - held in Alaska - between representatives of the recently inaugurated U.S. government and their Chinese counterparts.

Unsurprisingly after a brief wait, the Chinese responded with some of their own specific trade actions too, raising fears of a reversal to any freer trade efforts. This seems highly unlikely given there are too many exports and imports ongoing between these countries. In any case, the underperformance of the Chinese stock market over recent months reflects a slightly different evolution. Whilst the Chinese government did undertake a significant range of stimulus policies during their COVID-19 challenges over the first few months of last year, levels of stimulus (including central bank lending efforts) for 2021 appear extremely light compared to the United States or in Europe. Some worry that the influence of timing efforts between China and the United States specifically could mean the latter - for the first time in around forty years - could generate a higher growth level this year. However with China not only likely to beat 6% annual growth in a year which will mark the one-hundredth anniversary of the Communist Party of China, there is little likelihood of significant economic growth disappointment. Meanwhile over this decade, the combination of relatively low levels of Chinese debt plus the ongoing increasing of Chinese service and technical sectors will provide a lot of natural stimulus.

And such a focus naturally does not also assist other aforementioned important emerging market countries such as South Korea and Taiwan but also India. Whilst the Chinese service sector GDP split at just over fifty percent is modest compared to the near eighty percent levels in the U.K. or the United States, in India the equivalent figure is also modest. Additionally India - unlike China - has a youthful and fast growing population and is

likely to be just a few years from overtaking the Chinese on this measure. Economically India is a generation behind China, but progress in the 2020s is likely to be striking with the world's fastest-growing tech hub helping to complement an economy which should lead the IMF's country growth statistics in 2021.

However elsewhere individual countries - admittedly with far lighter MSCI Emerging Market index allocations, are having their own troubles. For example Brazil - despite some significant exposure to the important minerals sector - has struggled with its COVID-19 challenges and even rising interest rates. Certainly economic growth levels too in Russia and South Africa - among others - are also expected to be relatively dull compared to many other nations, including the aforementioned emerging markets in Asia. Potential for later in the decade naturally however remains for any emerging market name as all medium-term investors should be aware of.

As is often the case with investment choices, picking and choosing is likely to matter and thoughts just forged on a single quarter are rarely too insightful. Global emerging market investment opportunities still appear set to offer considerable interest for many investors with a timescale of a few years into this decade. ■

KEY TAKEAWAYS:

- Emerging markets only have some characteristics of a developed market
- Index allocations are centred in Asia led by China, South Korea, Taiwan and India.
- Dull recent performance in the Chinese stock market is unlikely to impact medium-term positives.
- India is likely to lead the IMF's country growth statistics in 2021.



The Longer-Term Market Impact of the Biden Agenda: A Preview of a New Economy?

Ed Mills, *Managing Director, Washington Policy Analyst, Equity Research*

The early theme of the Biden presidency is domestic policy, working with Congressional Democratic majorities in the House and Senate to ‘act fast’ and ‘go big’ on COVID-19 relief efforts with the first legislative priority being the \$1.9 trillion fiscal relief package. The American Rescue Plan Act of 2021 (American Rescue Plan) includes \$400 billion in direct response to COVID-19 (vaccine distribution, testing, personal protective equipment (PPE), and school reopening); \$1 trillion in relief to families and individuals (another round of stimulus checks, enhanced child tax credits, and unemployment benefits); and \$440 billion for communities and businesses (state and local aid, small business grants and loans). This package is in addition to the approximately \$3.5 trillion in fiscal support provided in 2020.

UNIVERSAL BASIC INCOME

While the next round of individual support checks (up to \$1,400 per individual) has received most of the press attention of this legislation, we think it is more important to focus on the \$14,000 that an average family of four, with a household income under \$150,000, could receive as result of these efforts, \$11,000 of

which will be directly deposited into bank accounts this year. This comes from adding the individual check received in January with the \$1,400 per individual check in the latest round, for a total of \$8,000 per household (subject to the income limitations of the bill). The expanded child tax credit would provide \$3,000 per child aged 0-6 and \$3,600 per child aged 6-17 (up from a \$2,000 tax credit currently). The big change with this program is monthly deposits of either \$250 or \$300 per child from July through December. For a family of four, this adds \$6,000-\$7,200 to the \$8,000 received via stimulus checks. Beyond the stimulus checks and child tax credit, overall economic support is higher for households with an unemployed worker (\$300 weekly), individuals with federal student loans (automatic forbearance through September), and households accessing mortgage or rental relief. These efforts are aimed at directing assistance to the lower portion of the ‘K-recovery’ and the expansion of the child tax credit is targeted at reducing childhood poverty in the US. From an economic, political, and market impact, these actions will be far reaching.

In the near term, we expect the market to debate the potential inflationary impact of this increased spending, with a positive impact on reflation-related equities and consumer discretionary spending.

Longer term, we believe it opens a debate on which, if any, of

\$14,000 Windfall

Under the American Rescue Plan, a family of four with household income under \$150,000 could receive as much as \$14,000 via individual stimulus checks and the child tax credit.

these programs become more permanent and whether these efforts are establishing new economic tools that government will consistently access. The size of the overall household aid, especially with monthly payments of the child tax credit and unemployment support, has similarities to calls for the establishment of a universal basic income.

The key question is whether this is a temporary phenomenon, or if this is the beginning stage of a new normal for the US economy. Once a benefit has been created through legislation, it is very difficult to reverse. Crisis response programs, including direct payments and the more recently formulated monthly advances of the child tax credit, see some level of bipartisan support among lawmakers. This raises the likelihood that they could become more permanent fixtures of the economy. They could also be reversed depending on future Congressional majorities – adding volatility tied to election results.

THE RECOVERY PACKAGE: A BROADER DEFINITION OF INFRASTRUCTURE SPENDING

Following the \$1.9 trillion American Rescue Plan, we anticipate the focus to pivot toward a recovery package, which has largely been referred to as an infrastructure package, for which we currently see appetites among Democrats in the \$3 trillion range (bond market reaction/inflation metrics will be watched closely and will influence the final price tag). Importantly, while it will be referred to as an ‘infrastructure bill,’ it is likely to be much more than a traditional ‘roads and bridges’ package. Democrats view ‘infrastructure’ in much broader terms, including: modernisation of the economy, tackling climate change, addressing racial (first time homebuyer tax credits/down payment assistance) and economic inequalities (e.g., universal broadband), and investments in the workforce (e.g., paid sick leave). Democrats are united in advancing a recovery bill addressing infrastructure priorities, and believe that unless they deliver, they will suffer in the midterm elections. These dynamics set up a ‘generational opportunity’ to enact major planks of their agenda.

As typical with DC conversations about infrastructure spending, look for revenue raising measures to be floated as funding mechanisms. We expect the majority of any potential tax changes to be targeted at the corporate tax rate and at the highest income earners. Other conversations may involve a financial transactions or wealth tax, but we view these as less likely to advance. On the corporate rate, we may see a smaller

initial increase followed by a multi-year phase-in to a higher rate in the 28% range, depending on the course of the economic recovery. During the debate, we are likely to see an effort to reform the current cap on the state and local tax (SALT) deduction, focused on reducing the financial incentive to move from a high-tax to low-tax state. However, this would likely go hand in hand with a return to the top individual rate of 39.6% for the highest income earners – reducing the benefit of any state/local tax deduction adjustments for higher income filers. In DC, we typically advise that major policy changes take longer than expected. Given the current uncertain economic situation, we view next year as the most likely implementation of these changes (with passage later this year), but will be watching to see if anything is implemented for 2021.

Current political dynamics have placed domestic policy at the forefront of the Biden administration’s first term agenda.

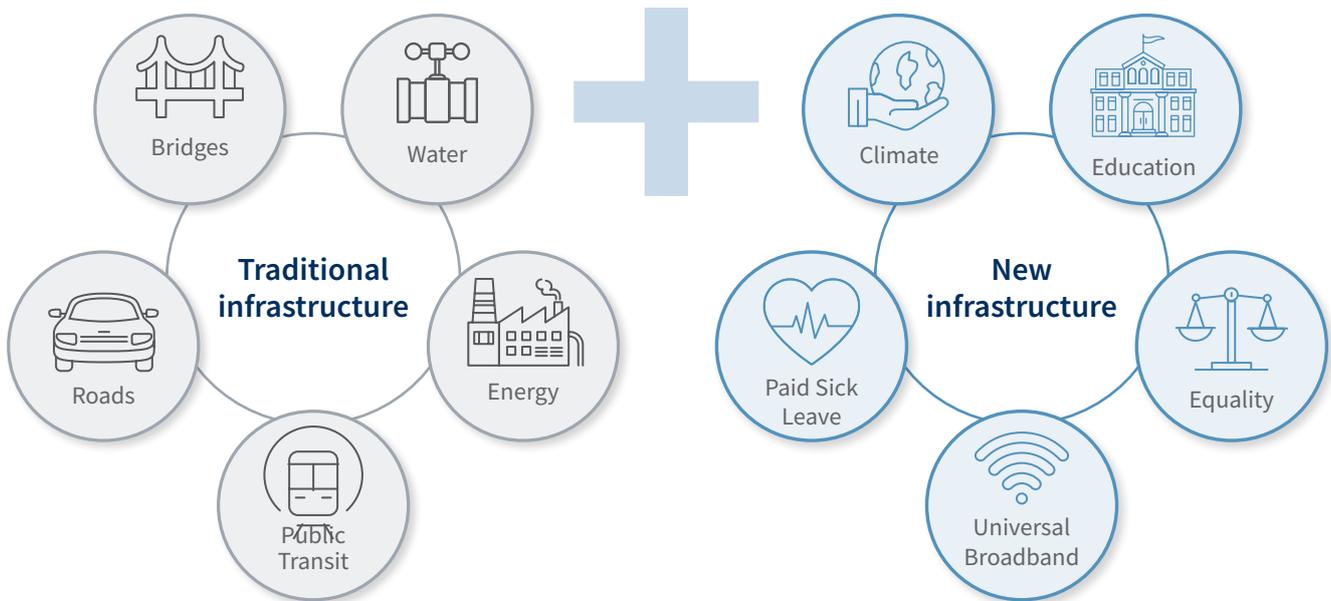
DOMESTIC POLICY AS FOREIGN POLICY

Finally, the Biden administration’s focus on domestic investment is also underscored by the approach to foreign policy and trade relations. The administration’s recently outlined national security strategy emphasises that “distinctions between domestic and foreign policy have simply fallen away.” Keeping with this theme, we expect the Biden administration to pursue an agenda of enhanced domestic manufacturing as a strategy closely tied to overall economic and national security, which elevates the issue in a bipartisan manner for this year.

We have already seen the first steps taken in this direction, with an early push by the Biden administration to enhance ‘Buy American’ procurement provisions in federal spending to invest in domestic producers and suppliers. We expect this to be a longer-term theme of economic policy, as it is closely tied in the eyes of policymakers to the ability of the US to remain competitive with China. Domestic manufacturing capability in next-generation technologies such as 5G, artificial intelligence, quantum computing, and semiconductors will also be a key area of focus with federal investment and incentives directed toward technology supply chain reshoring. We expect this shift in economic policy to be a primary driver in Biden’s foreign policy, guiding relations with traditional allies, competitors, and adversaries.

A New Meaning Of Infrastructure

The modern definition of ‘infrastructure’ will go beyond just roads and bridges to include improvements in climate change, social justice issues and developing technologies.



To conclude, current political dynamics have placed domestic policy at the forefront of the Biden administration’s first term agenda. Although the next election is just around the corner in DC terms, the Democratic sweep solidified in January carries with it the potential for the Biden administration to make significant economic reforms – from consumer support programs to domestic manufacturing incentives – a more permanent fixture of the US economy. ■

KEY TAKEAWAYS:

- The early theme of the Biden presidency is domestic policy, working with Congressional Democratic majorities in the House and Senate to ‘act fast’ and ‘go big’ on COVID-19 relief efforts.
- The size of the overall household aid, especially with monthly payments of the child tax credit and unemployment support, has similarities to calls for the establishment of a universal basic income.
- The ‘recovery’ package takes a broader, non-traditional view of infrastructure, including: modernisation of the economy, tackling climate change, addressing racial and economic inequalities, and investments in the workforce.
- Current political dynamics have placed domestic policy at the forefront of the Biden administration’s first term agenda.

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