Q1 2021
Capital Markets Outlook

May 2021

Essex Pension Fund

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HYMANS ROBERTSON

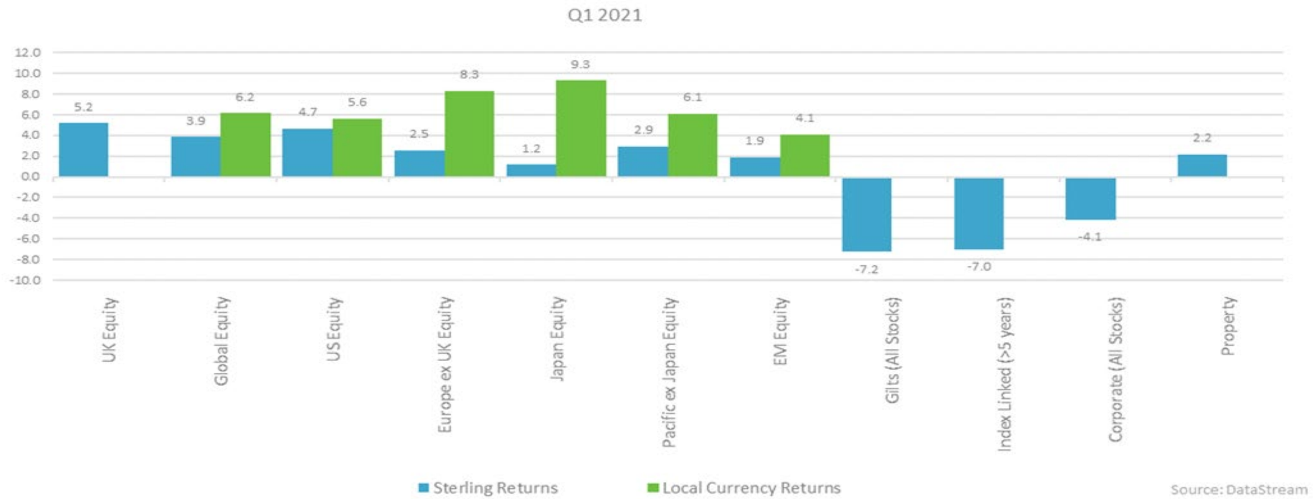
Economic background

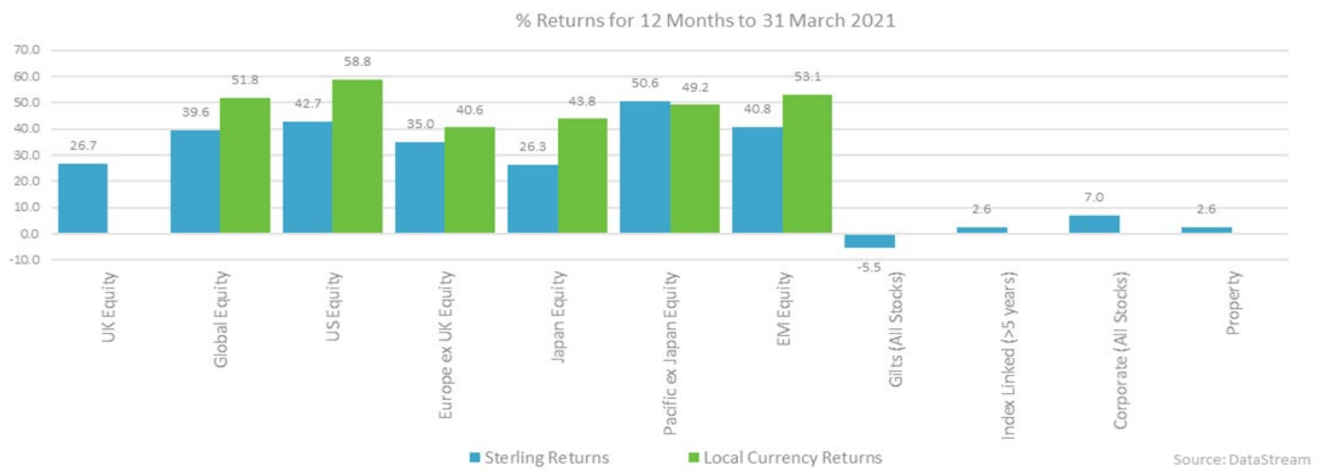
Rises in sovereign bond yields accelerated in February as the medium-term growth and inflation outlook was boosted by vaccine rollouts.

Global investment-grade spreads fell 0.1% p.a. to 1.0% p.a. and sub investment-grade spreads fell 0.4% p.a. to 3.7% p.a.

Global equities rose 6.2% in the first quarter, led by outperformance in the old-economy cyclical value sectors that were the major laggards in 2020.

Market Returns





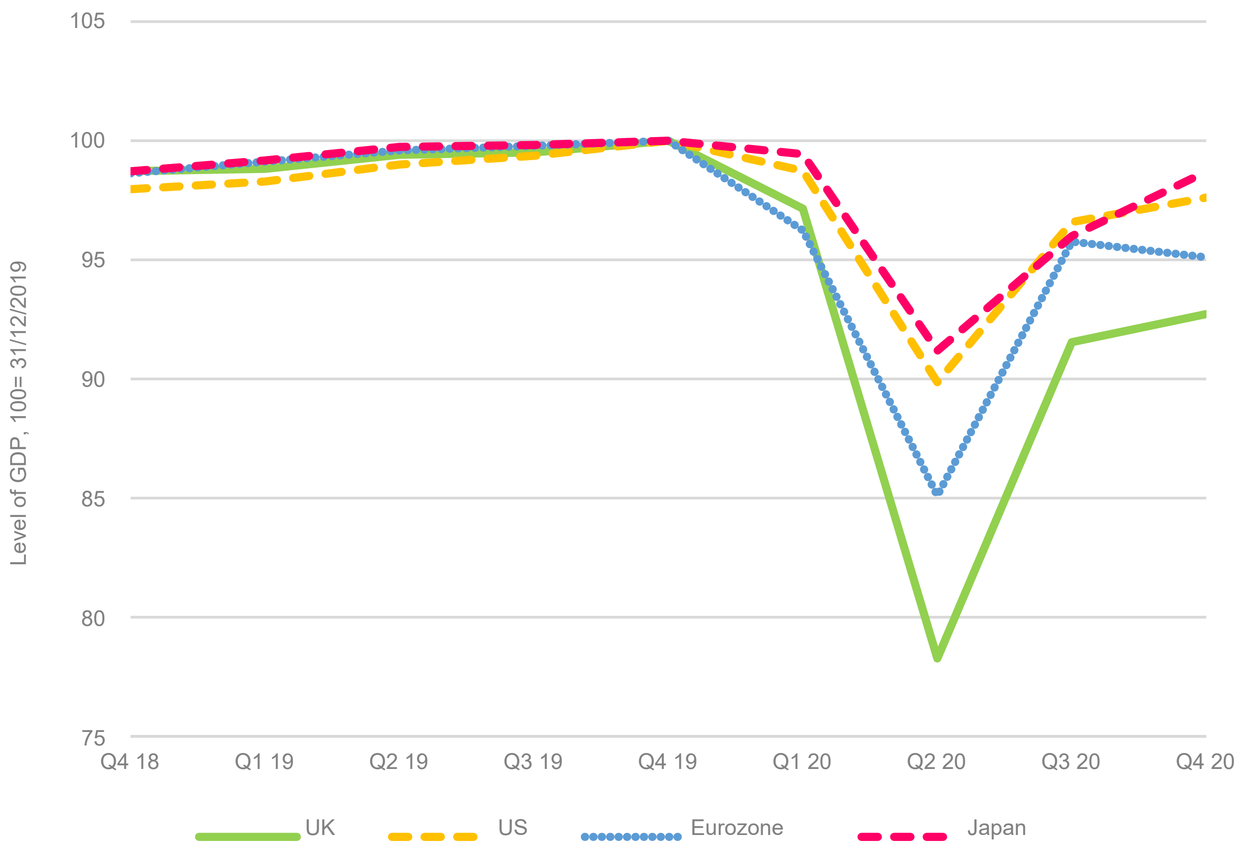
Q4 GDP releases confirm the economic recovery slowed in Q4 - US and UK growth slowed to 1.1% and 1.3% quarter-on-quarter, respectively.

Slower than hoped vaccine roll out and high COVID-19 cases in many parts of the world suggest global GDP growth in Q1 2021 will be even weaker than Q4 2020.

Accumulating evidence of the effectiveness of vaccines provides some optimism. Therefore, a marked acceleration in global GDP growth is expected from Q2.

As a result, consensus forecasts for global growth in 2021 have risen to 5.6%.

GDP Growth



Source: DataStream

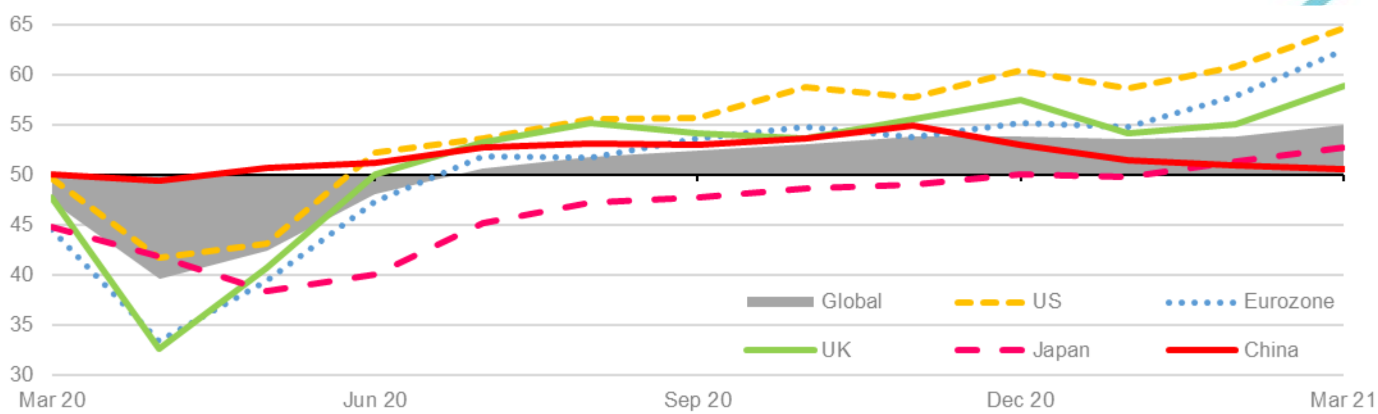
Composite PMI data for March were strong across the US, UK and Eurozone. The services-led jump in the UK was particularly notable.

Service sector surveys generally remain weaker than manufacturing surveys given ongoing lockdown restrictions in some regions.

The manufacturing surveys continue to show solid momentum as current output and new orders ticked higher. In addition, business confidence about the outlook also improved.

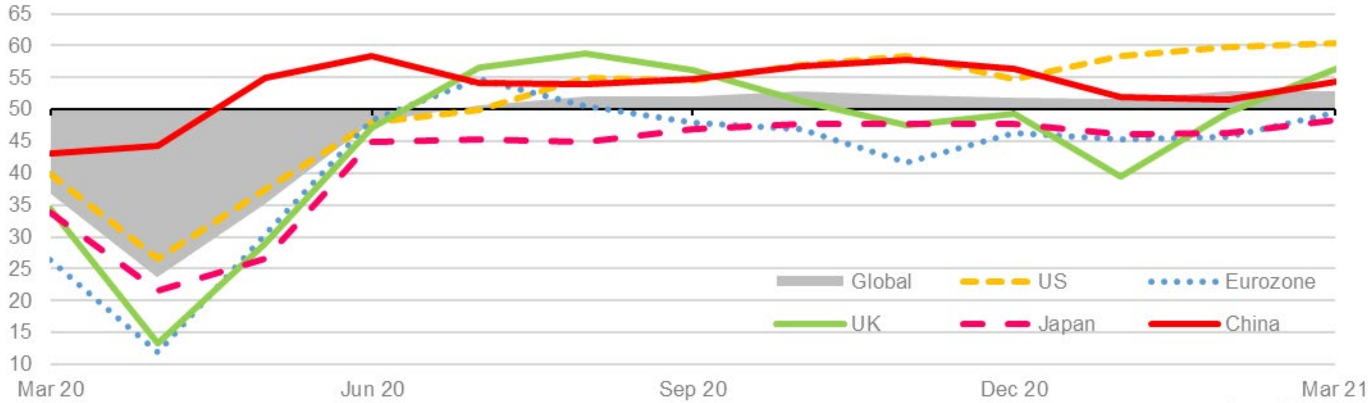
Employment at a global level remains well below pre-pandemic levels but gains have accelerated recently, particularly in the US and UK.

Manufacturing PMI



Source: Bloomberg

Services PMI



Source Bloomberg

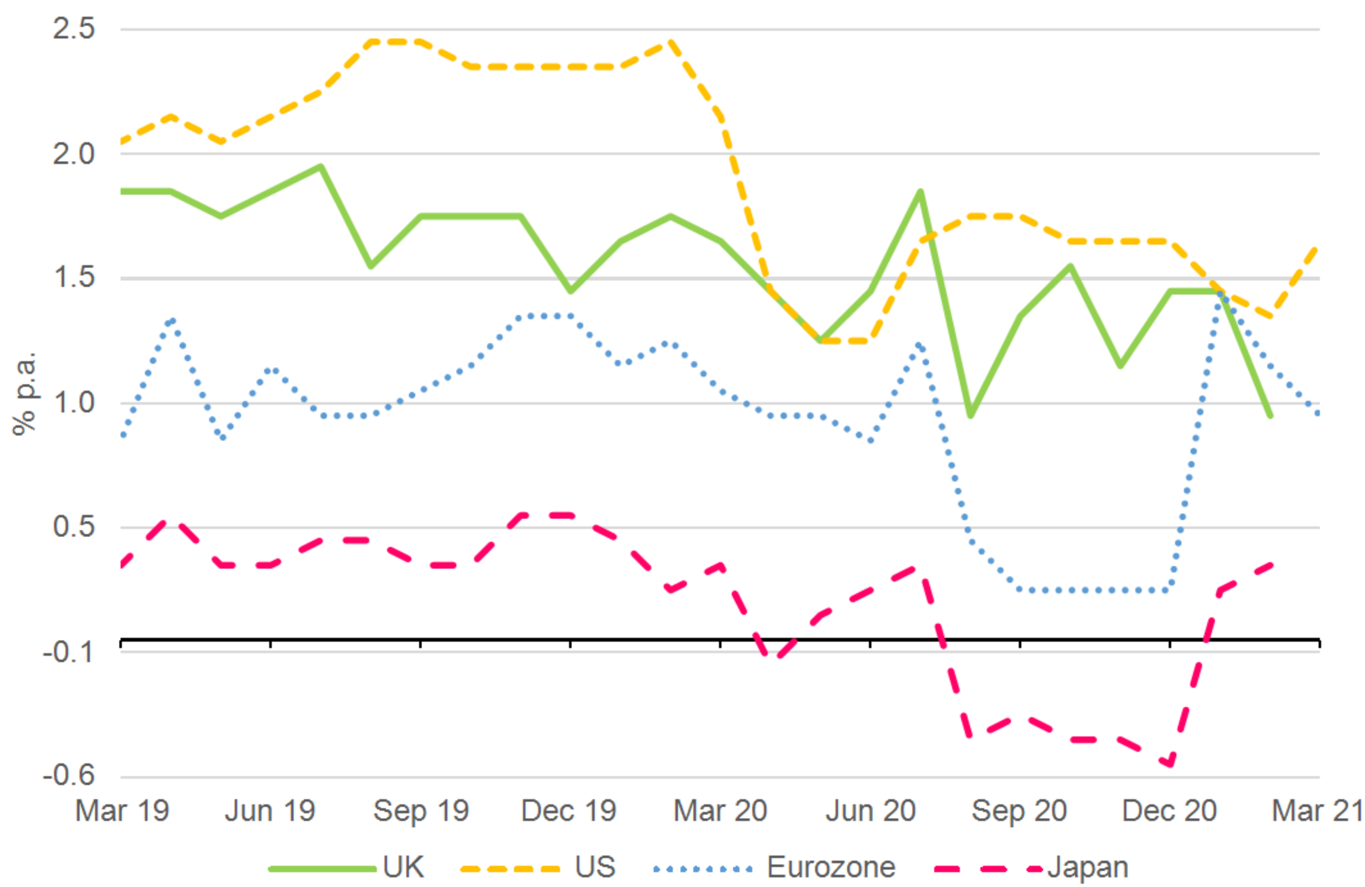
UK headline CPI inflation rose to 0.7% year-on-year in March due to increases in the price of clothing and transport.

The outlook for inflation has attracted growing attention as government stimulus programmes, higher energy costs and supply chain stresses look poised to trigger a surge in price pressures over the course of this year

However, as most forecasters expect the rise to be temporary, central banks will likely look past the increase.

Consensus forecasts are for a recovery in inflation in the UK in 2021 to be followed by a modest increase in 2022.

Core CPI Inflation



Source: DataStream

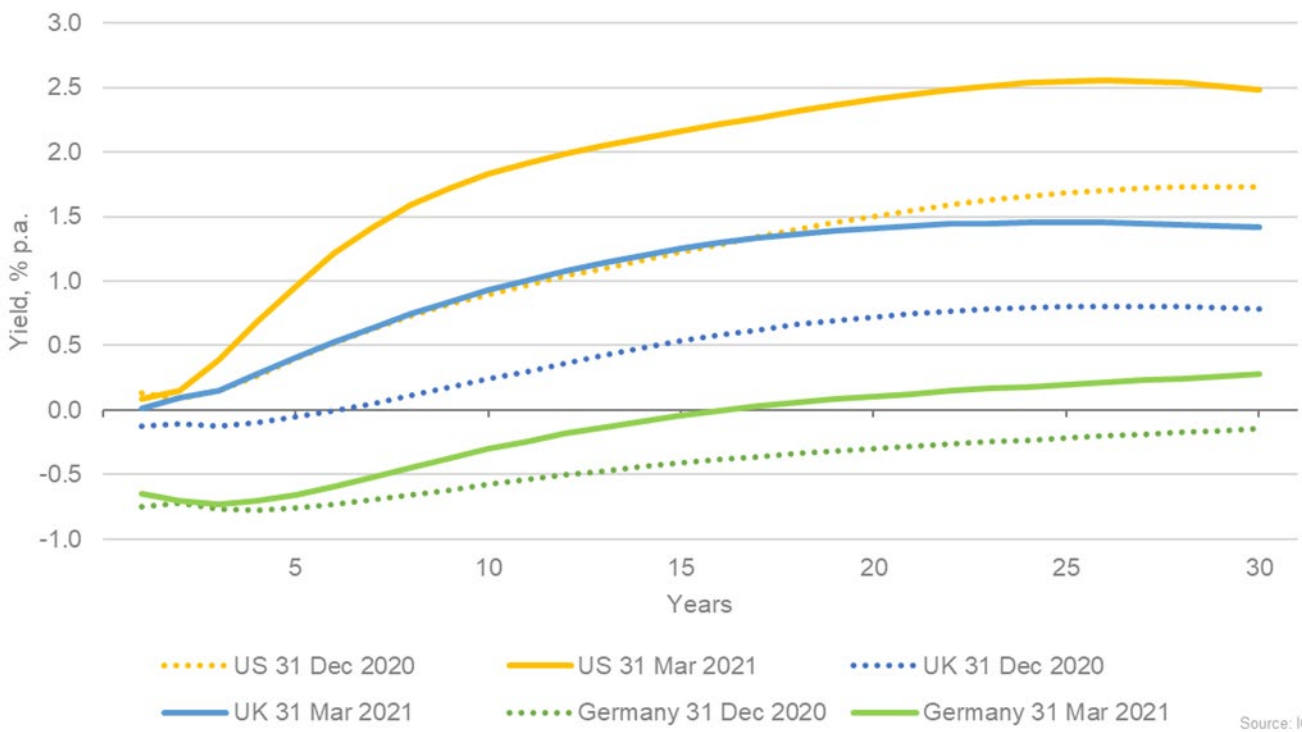
Asset class views

Sovereign bond yields have risen significantly in the first quarter of 2021 as the growth and inflation outlook is boosted by vaccine rollouts and the passage of huge fiscal stimulus in the US.

The UK yield curve steepened as the vaccine rollout progressed. Moves in the German yield curve were more muted.

Mainland Europe is seeing a rise in new COVID-19 cases and progress with vaccination has been slower than in the UK and US, potentially leading to a delay in economic recovery.

Conventional government bonds



Source: ICE

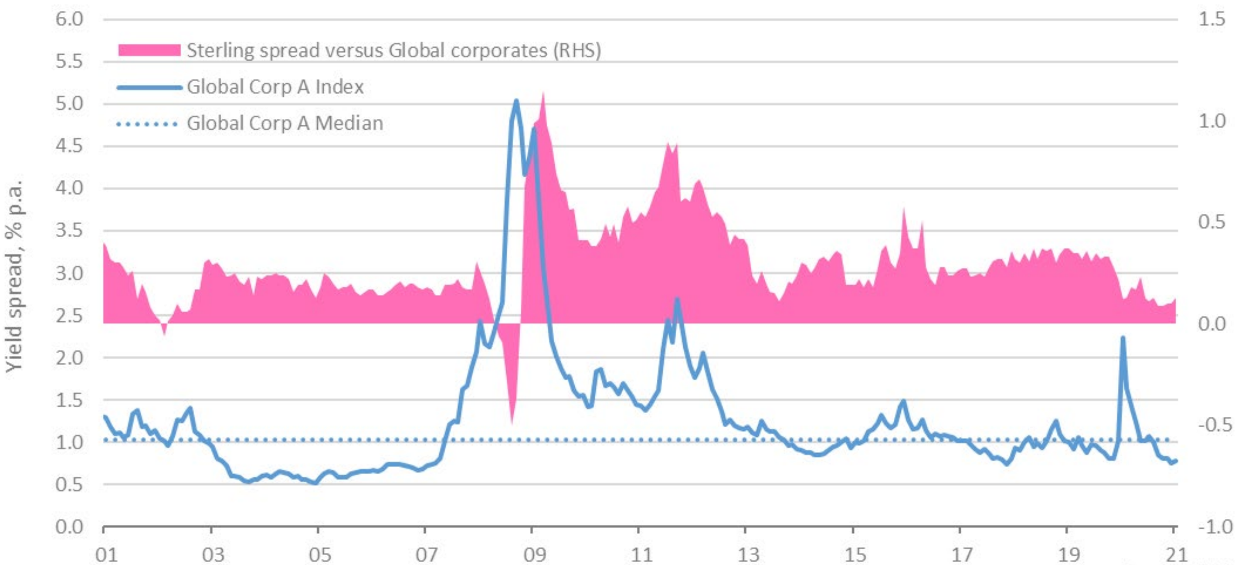
Rising sovereign bond yields have weighed on total returns in fixed interest markets, which are negative year to date for investment-grade markets given their longer duration. Global investment-grade spreads fell 0.1% p.a. to 1.0% p.a.

Corporate fundamentals remain weak: leverage levels are close to record highs. However, the earnings recovery forecast should be supportive of debt fundamentals going forward.

Sterling investment grade spreads, on a ratings-consistent basis, remain well below long-term median levels and the premium relative to equivalent global credit is low relative to history.

Investment-grade corporate credit

Spreads (bps)	31 March	-3 Mth	-12 Mth	10-yr Median
US IG	**97**	103	305	**138**
Sterling IG	**113**	113	265	**151**
Euro IG	**91**	93	238	**122**



Source: ICE

	Fundamentals	Valuations	Technicals	Overall
Global IG credit	Neutral to Unattractive	Unattractive	Neutral	**Cautious**
Sterling IG credit	Neutral to Unattractive	Unattractive	Neutral	**Cautious**

Global sub-investment grade spreads fell 0.4% p.a. to 3.7% p.a.

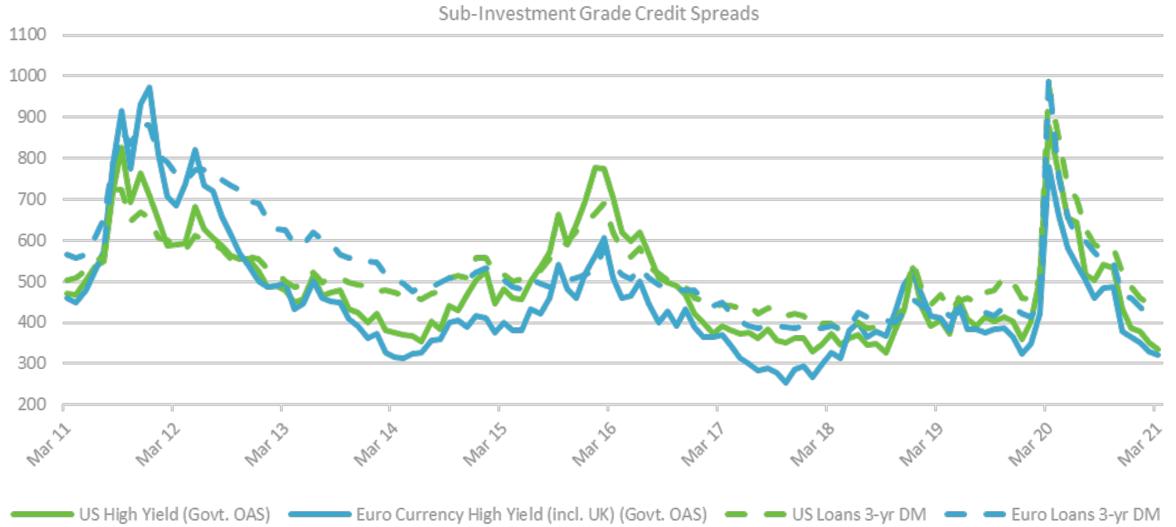
Corporate finances look stretched as leverage remains elevated. However, the earnings recovery forecast should ease the strain. Recent data suggest defaults have already passed their peak and are on a declining trend.

However, a robust recovery is already reflected in very thin credit spreads which remain well below longer-term median levels and provide little upside exposure to the economic recovery.

More affected outstanding debt in public and private markets may create opportunities.

Sub-investment grade credit yield

Spreads (bps)	31 March	-3 Mth	-12 Mth	10-yr Median
US HY	**336**	386	877	**466**
Euro Currency HY	**321**	365	779	**422**
US Loans 3-yr DM	**449**	486	974	**506**
Euro Loans 3-yr DM	**425**	459	998	**505**



Source: Bloomberg/BoA ML

	Fundamentals	Valuations	Technicals	Overall
Liquid	Neutral to Unattractive	Unattractive	Neutral	**Cautious**
Private	Neutral to Unattractive	Neutral	Neutral	**Neutral to Cautious**

Global markets gained 6.2% over the quarter. Sterling strength softened these returns to 3.8% for an unhedged sterling-based investor.

Last year's laggards stand to gain the most from a recovery in economic activity. Outperformance from the more cyclical sectors partially explains the pattern of regional equity performance.

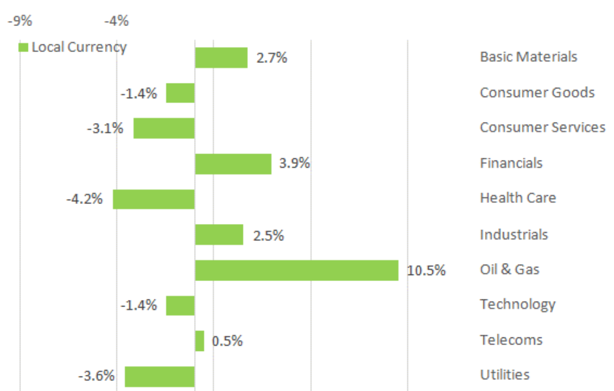
Japan, with their above average exposures to industrials, lead regional performance rankings year-to-date.

Despite its above-average exposure to the oil & gas sector, the UK market was in the middle of the pack. Sterling strength continued to weigh on the revenues of many UK companies.

Global equity returns

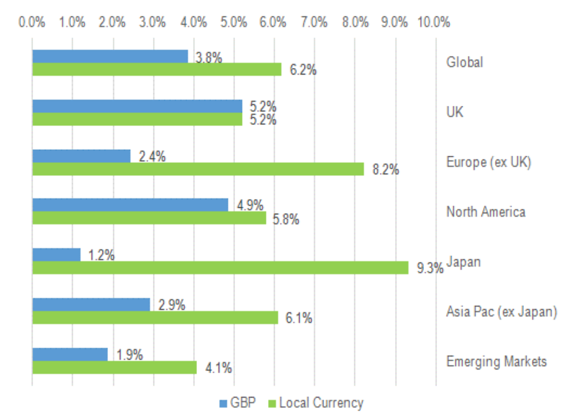
Total returns 31 Mar 2020 to 31 Mar 2021. Source: DataStream

Relative Q1 equity sector performance



Global Sector returns relative to FTSE All World Index 31 Dec 2020 to 31 Mar 2021. Source: Datastream

Q1 Regional Equity performance



Total returns 31 Dec 20 to 31 Mar 21. Source: DataStream

The improved outlook for the global economy supported global equities in the first quarter.

The consensus forecast is for global earnings per share growth of 28% in 2021.

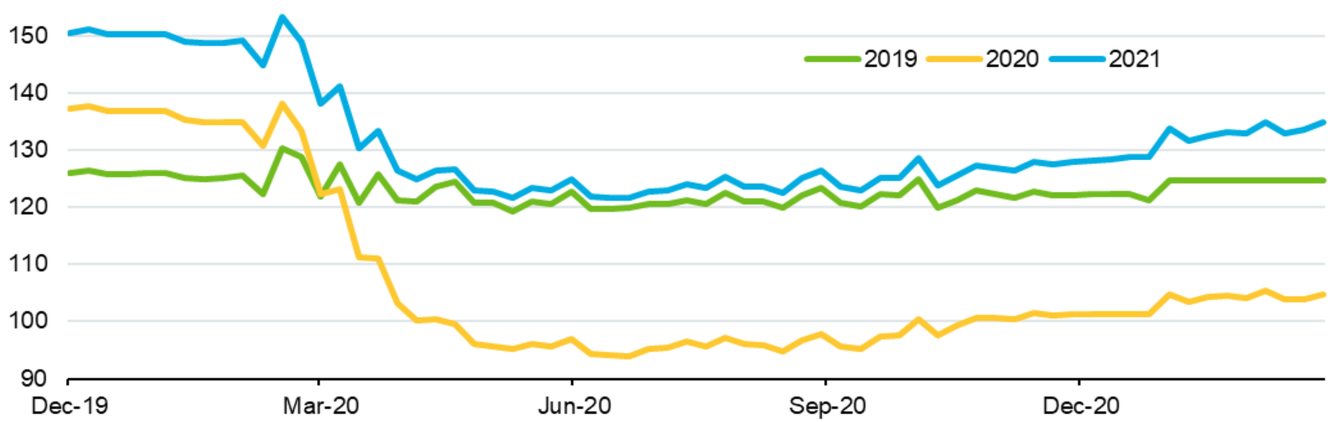
While global equity valuations remain elevated in absolute terms versus history, they look less demanding in the context of very low real yields.

Price/Earnings multiples for MSCI World are at highs although the picture is different across regions. The US equity market appears unattractive while Emerging Markets, Japan and UK appear attractive across several valuation metrics.

Global equities

Region (MSCI index)	P/E (Trailing)		P/E (Shiller)		Price/Book		Price/Sales		EV/EBITDA		Dividend Yield (%)
	Current	Historic Median	Current	Historic Median	Current	Historic Median	Current	Historic Median	Current	Historic Median	
World	30.4	18.6	26.1	21.5	3.1	2.2	2.0	1.3	14.2	10.0	1.7
US	34.0	18.3	33.2	20.6	4.6	2.6	2.6	1.6	16.3	10.8	1.4
EM	21.5	14.4	16.5	15.3	2.1	1.7	1.1	0.9	11.0	8.2	1.8
UK	19.8	14.1	13.2	14.9	1.7	1.9	1.2	1.2	8.9	7.7	3.3

MSCI World full-year earnings per share



	Fundamentals	Valuations	Technicals	Overall
Global equity	Neutral to Attractive	Unattractive	Neutral	**Neutral**

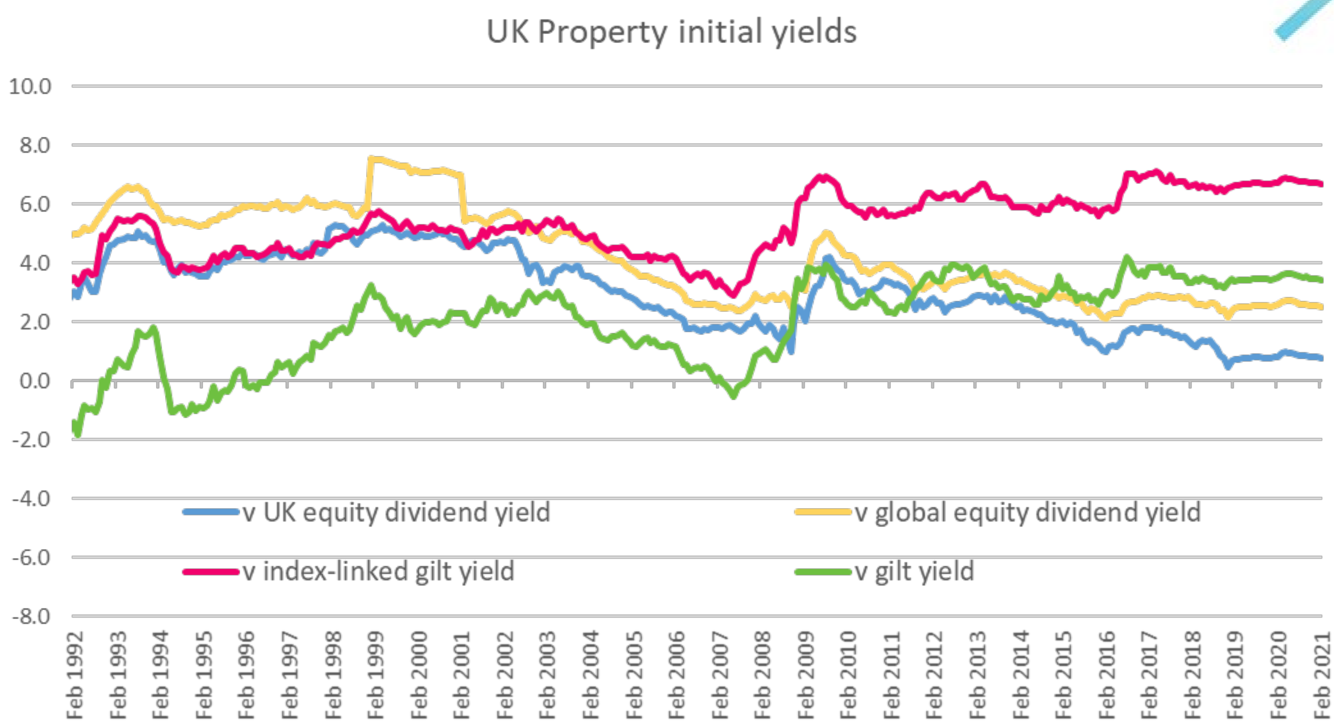
The rolling 12-month total return on the MSCI UK Monthly Property index was -0.5% to end February, as income was offset by declining capital values.

Real rental growth has steadied over recent months, although vacancy rates are rising.

Monthly rental growth has improved across all sectors over recent months, while both rent expectations and occupier demand have also improved over the last quarter, albeit from very low levels.

Overall, the outlook for UK property market fundamentals has improved slightly, as the pace of rental declines has eased.

UK property



	Fundamentals	Valuations	Technicals	Overall
Core	Neutral to Unattractive	Unattractive	Neutral	**Cautious**
Long Lease	Neutral	Unattractive	Neutral	**Neutral to Cautious**

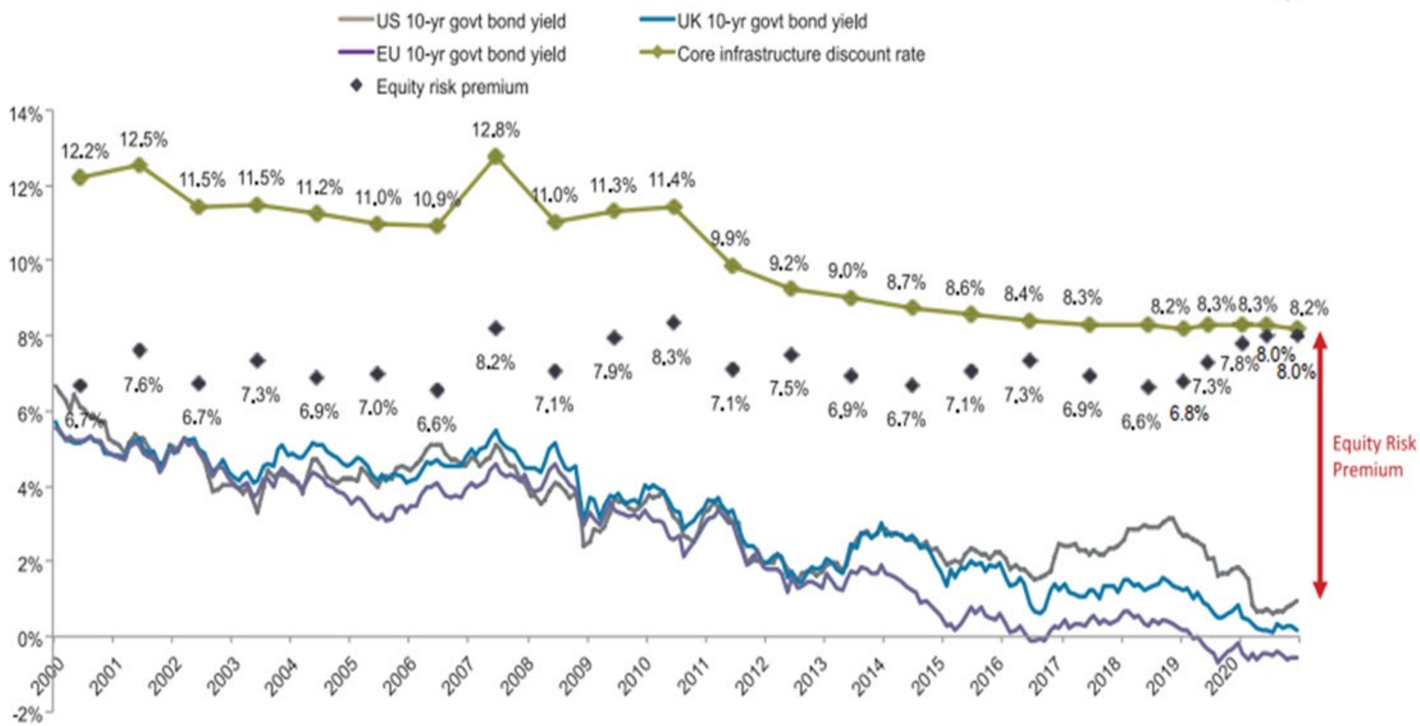
The economic impact of the pandemic is having a greater effect on the more GDP-sensitive sectors (airports, toll roads) of the infrastructure market.

Less economically sensitive sectors such as utilities remain in high demand as they provide essential services.

The pandemic has led to significant write-downs of some GDP-sensitive assets which has created some value opportunities, although overall transaction levels are suppressed so far this year.

Overall, valuations remain high but technical drivers remain strong and could underpin revaluation.

Infrastructure



	Fundamentals	Valuations	Technicals	Overall
Infrastructure	Neutral	Unattractive	Attractive	**Neutral**

Appendix

Consensus forecasts

GDP Growth (%)	2020 Actual	Forecasts for 2021		Forecast for 2022	
		As at Mar 21	*As at Jan 21*	As at Mar 21	*As at Jan 21*
World	-3.7	5.3	*4.9*	4.1	*3.9*
US	-3.5	5.7	*4.4*	4.0	*3.4*
UK	-9.9	4.6	*4.3*	5.8	*5.8*
Eurozone	-6.8	4.3	*4.4*	4.2	*4.0*

Consumer Prices (%)	2020 Actual	Forecasts for 2021		Forecast for 2022	
		As at Mar 21	*As at Jan 21*	As at Mar 21	*As at Jan 21*
World	2.1	2.6	*2.4*	2.7	*2.6*
US	1.2	2.4	*2.1*	2.2	*2.2*
UK	0.8	1.6	*1.5*	2.0	*2.0*
Eurozone	0.3	1.5	*0.9*	1.3	*1.3*

Asset class views framework

The views are intended to give a guide to our views on markets over the medium term; although they are updated quarterly, they are not intended as tactical calls.

The views reflect our expectations of absolute returns and assume no constraints on the investment decisions. In practice, they need to be interpreted in the context of the strategic framework within which individual funds are managed.

Fundamentals

These are the underlying economic drivers of an asset class which impact returns. Examples of fundamental factors include earnings, rents, inflation, interest rates, defaults, and leverage levels.

Valuation

Valuation is concerned with the price the market places on the relevant fundamentals and how that compares with history and/or our view of fair value.

Technicals

These are shorter-term factors that may tend to move markets back towards or further away from fair value. These are often factors which impact the supply/demand balance and include asset flows, issuance, investor confidence, central bank intervention, and geopolitical risk.

Risk warnings

General risk warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance. Private equity investments, whether held directly or in pooled fund arrangements carry a higher risk than publicly quoted securities. The nature of private equity pooling vehicles makes them particularly illiquid and investment in private equity should be considered to have a long time horizon.

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